N° 177

4th quarter 2023

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- If history is any guide, monetary tightening will eventually trigger a recession, despite the current resilience of economic activity.
- A more significant deterioration in the labour markets will be necessary for inflation to return to 2%.
- Rather than leaning towards further interest rate hikes, the central banks are contemplating a permanently tighter monetary policy.

Financial markets
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- The indicators that traditionally characterise the start of a new bull market are absent from the rise in indices in 2023.
- Defensive quality stocks have suffered from the rise in long-term interest rates and are now attractive.
- The traditional link between the gold price and real interest rates seems broken.

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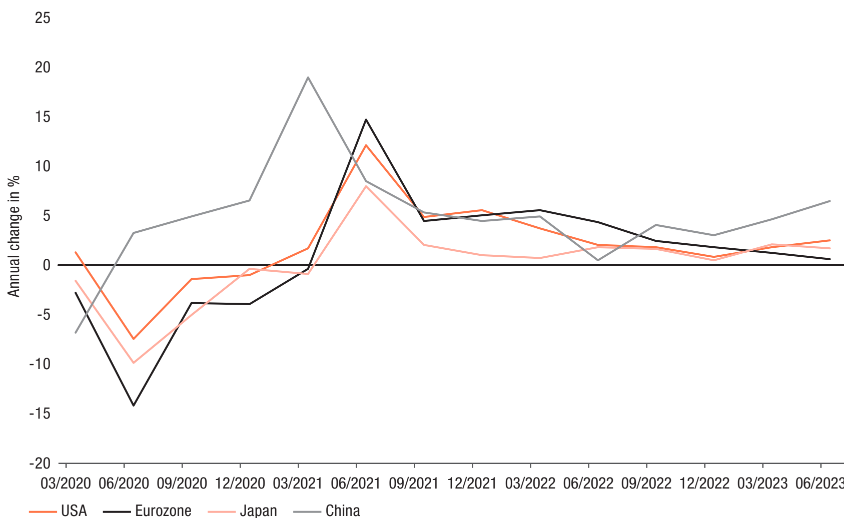
Macroeconomic environment

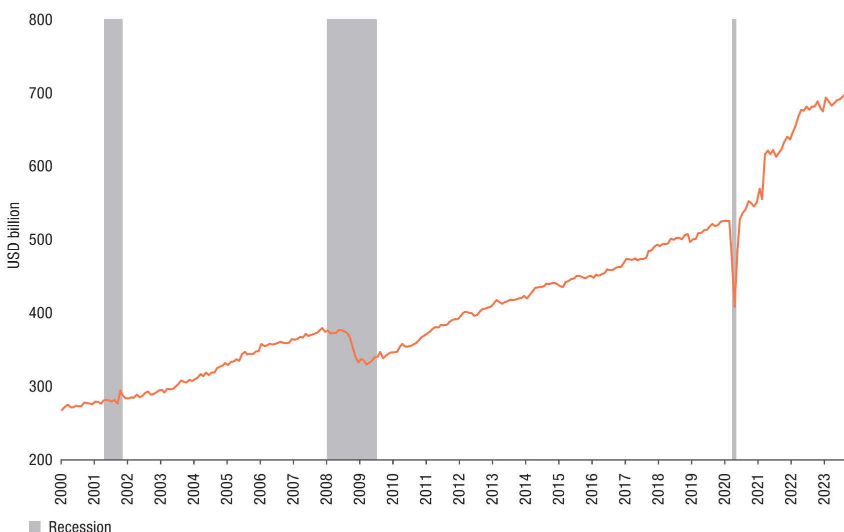
REAL GDP GROWTH



Source: Bureau of Economic Analysis, Eurostat, National Bureau of Statistics of China, Economic and Social Research Institute Japan, Bloomberg

Although the global economic slowdown is continuing, there remain pockets of resilience that are preventing a recession. Overall, services are still holding up well as the catch-up effect following the extended period of leisure deprivation continued during the summer. Geographically, the United States continues to be the most robust region, with household consumption remaining firm despite the rising cost of living and a hefty increase in interest rates. In the eurozone, greater exposure to the manufacturing sector and a higher energy bill are weighing more heavily on activity, taking it to the verge of recession at the end of the third quarter. In China, the GDP growth rate of over 6% in the second quarter is the result of a very favourable annual comparison base given that activity had virtually stagnated during the lockdown period a year ago. A general climate of uncertainty as a result of geopolitical tensions and the moderate nature of public support measures seems to be preventing a more significant rebound in the Chinese economy. In Japan, the economy is doing rather well, buoyed by the highest wage increases for three decades and the weakness of the yen.

US RETAIL SALES



Source: U.S. Census Bureau, Bloomberg

In the United States, domestic consumption remains the main driver of economic growth. Strong household spending in July means that positive GDP growth for the third quarter is virtually assured. This is not the first time that the Americans have surprised us with their relentless desire to keep consuming, despite the significant increase in the cost of living and tighter financing conditions. An ever-increasing range of new consumer services – often with little correlation between them and accessible even to tighter budgets – also reinforces the robustness of the main component of US GDP. In addition to private consumption, public spending has become an ongoing factor of support, although the high level of the budget deficit, at 8% of GDP, is more the result of a reduction in revenue than an expansion in spending. On the other hand, business investments have started to stagnate under the impact of rising interest rates and slower profit growth. Exports have been weakened by the strong dollar and slowdown in global demand, which hardly makes them a supportive factor in the current economic environment.

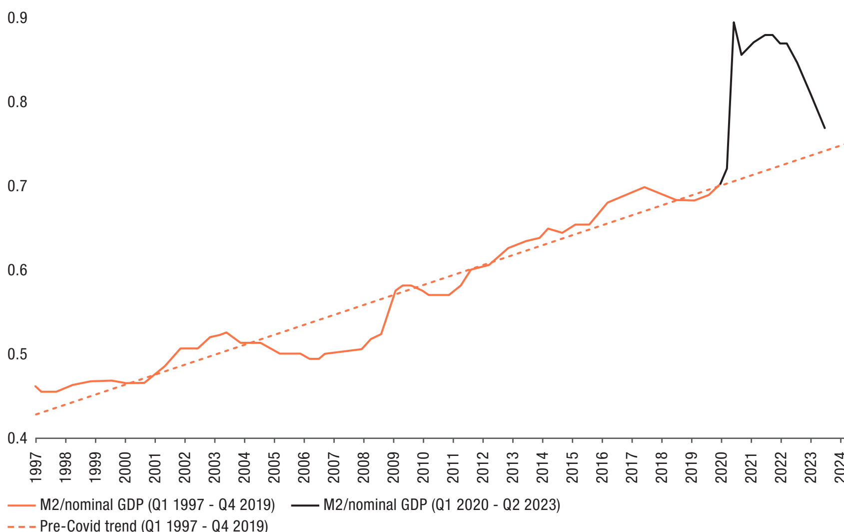
INTERVAL BETWEEN THE START OF INVERSION OF THE YIELD CURVE AND THE ONSET OF RECESSION IN THE US

Recession	Start of inversion of the yield curve	Onset of recession	Interval (number of months)	
January 1970 – November 1970	Dec-68	Jan-70	13	
December 1973 – March 1975	Jun-73	Dec-73	6	
February 1980 – July 1980	Nov-78	Feb-80	15	
August 1981 – November 1982	Oct-80	Aug-81	10	
August 1990 – March 1991	Jun-89	Aug-90	14	
April 2001 – November 2001	Jul-00	Apr-01	9	
January 2008 – June 2009	Aug-06	Jan-08	17	
March 2020 – April 2020	Jun-19	Mar-20	9	
Average of 8 recessions			**11.6**	**(354 days)**
Recession 2023-2024 (average interval)	**Nov-22**	***Oct-23***	***11.6***	
Recession 2023-2024 (maximum interval)	**Nov-22**	***Apr-24***	***17***	

Source: Federal Reserve Bank of St. Louis, US Treasury, NBER, Jefferies

The favourable behaviour of household consumption and absence of deterioration in the labour market are persuading an increasing number of observers to revise their estimate of the onset of a recession in the United States, despite the warning signal from the two leading indicators that have been the most reliable in the past. Previously, an inversion of the yield curve lasting at least three months and a year-on-year decline of at least 1% in the Conference Board's composite index of leading indicators have correctly predicted each of the eight recessions in the post-war period. Even so, the interval between the start of the inversion of the yield curve and the onset of recession can vary significantly, from 6 months at the time of the first oil crisis in 1973 to 17 months during the 2008 financial crisis. If the average interval of 11.6 months were to apply to the current cycle, the contraction in activity would start in October this year. If the interval were to be closer to the maximum level of 17 months recorded during the sub-prime crisis, GDP would post two more quarters of positive growth before entering a phase of decline from April 2024.

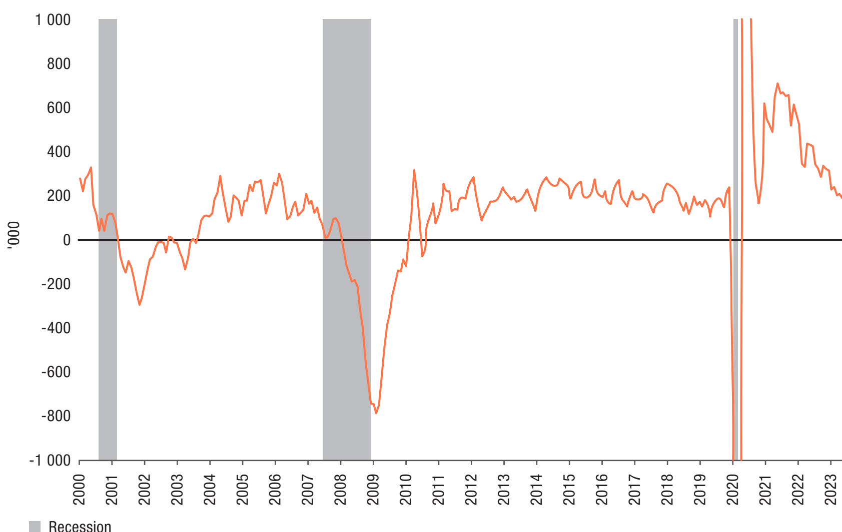
MONEY SUPPLY AND NOMINAL GDP IN THE US



Source: Federal Reserve, Bureau of Economic Analysis, Jefferies

Several factors argue in favour of a longer interval than in the past between the start of the inversion of the yield curve and the onset of recession. The overabundance of liquidity in the financial system following the record monetary and fiscal stimulus during the pandemic is the first factor likely to extend the duration of the current cycle. That said, the increase in interest rates and the Federal Reserve's balance sheet contraction have led to the biggest decline in the money supply since the 1920s, largely correcting the excess built up hitherto. Secondly, compared with previous cycles, interest rates (despite the hikes) are fairly moderate in real terms, which reduces their restrictive impact on economic activity. Thirdly, both households and businesses took advantage of the period of extremely low interest rates during the Covid era to extend the duration of their debts, thereby reducing their sensitivity to tighter monetary conditions. Lastly, budget deficits in most Western countries, although now off the peak reached during the pandemic, are still at high levels, especially as the economies are not as yet in recession.

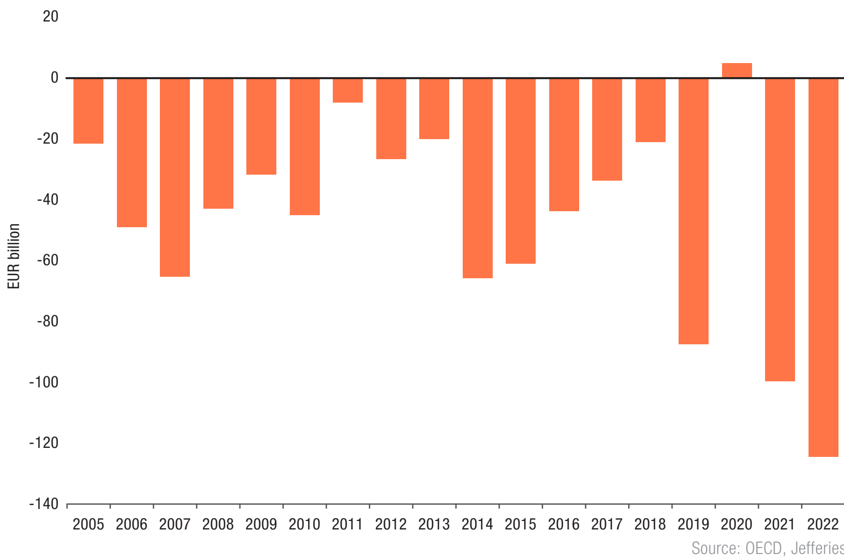
JOB CREATION IN THE US



Source: Bureau of Labor Statistics, Bloomberg

Developments in the labour market will be the key factor determining the eventual outcome of the current economic slowdown. So far, signs of deterioration have remained fairly moderate, which explains why the soft-landing thesis has gradually prevailed. The main signs of weakness stem from the slowdown in both job creation and the number of temporary jobs, the latter often being a good leading indicator. However, the recent slowdown is to some extent mitigated by the fact that the comparison bases are all very high and it is also called into question by the soaring payroll data published for September. Jobless claims also remain at very low levels, suggesting that companies, which were desperate to find workers during the pandemic boom, are reluctant to make redundancies despite the deterioration in their profitability. That said, it should not be forgotten that the labour market has traditionally acted as a lagging indicator, reflecting past economic performance and giving little insight into future developments. If the recent timid signs of weakening household consumption were to be confirmed, the labour market would not be able to stay as firm as it has to date.

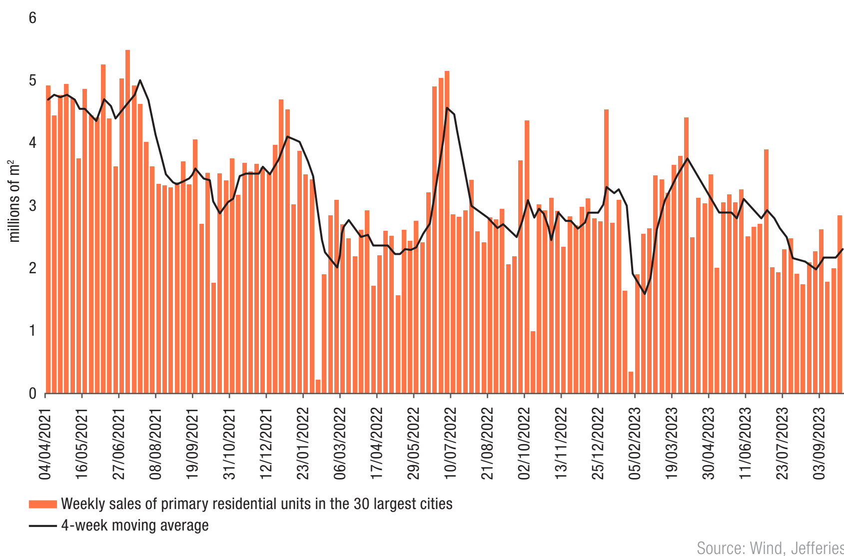
NET FOREIGN DIRECT INVESTMENT IN GERMANY



Source: OECD, Jefferies

The economic slowdown is much more pronounced in the eurozone than in the United States. Higher energy costs since Russia's invasion of Ukraine and a slightly less excessive budget deficit are penalising Europe's growth rate and the eurozone appeared to be on the verge of recession at the end of the third quarter. Germany has become the main problem child, with its role as the economic engine of the eurozone stalling. In addition to the cyclical slowdown that Europe's leading economic power has naturally been unable to avoid, given the importance of its industrial sector, the country is also affected by deeper problems that are making it less and less attractive for new investment, the main source of long-term growth. For years, investment by foreign companies in Germany has been lower than investment by German companies abroad, and this trend is worsening. A dilapidated public infrastructure, a chronic shortage of skilled personnel, an increasingly cumbersome bureaucracy and the rise of the far right are all factors signalling the need to question an economic model that is overly reliant on the success of exports and has lost sight of the ongoing need to improve working conditions within the country itself.

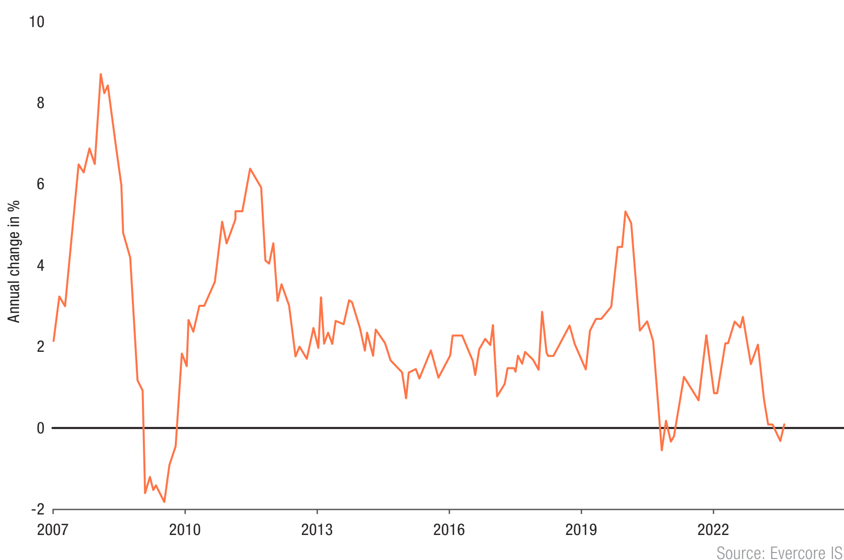
HOUSE SALES IN CHINA



Source: Wind, Jefferies

The economic situation in China is complicated. After the post-Covid economic bounce rapidly faded at the start of the year, the public authorities ramped up their support measures to kick-start activity. But instead of implementing vast programmes requiring a sharp increase in debt, the authorities preferred to proceed in a series of stages, adjusting the levers here and there, with mixed effects on the economy overall. This does not mean that economic growth is completely sluggish – domestic tourism has returned to pre-pandemic levels, for example. However, there is little chance of a real growth dynamic taking hold given the widespread undercurrent of uncertainty among the population as a result of persistent geopolitical tensions and difficulties in stabilising the still distressed property market. At the start of the fourth quarter, the government in Beijing even hinted that it was preparing additional support measures to ensure that the target of 5% GDP growth in 2023 was achieved.

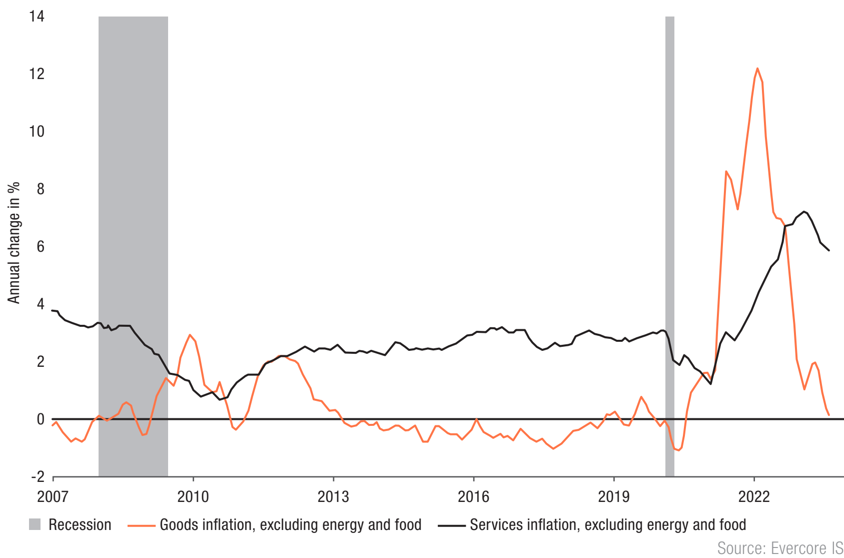
INFLATION IN CHINA



Source: Evercore ISI

Stagnating inflation in China since April has prompted many observers to wonder whether the country could be entering a prolonged period of deflation similar to that experienced by Japan for around thirty years after the financial and property bubble burst in 1990. There certainly seem to be several similarities between the China of today and the Japan of yesteryear: a massive property bubble that is difficult to deflate, an abundance of bad debts on the banks' balance sheets, the challenge of moving from an economy driven by investment and exports to one driven by domestic consumption, the determination to avoid financial crises, which generally tends to slow down the recovery process, a booming automotive sector attacking overseas markets, demographic trends reducing the potential for economic growth, and an inflation rate close to 0%. For all that, Xi Jinping's autocratic regime bears no comparison to Japan's firmly entrenched democracy, meaning that the government in Beijing will use different levers from those the Japanese authorities resorted to, with a result that could be hugely different from that seen in Japan.

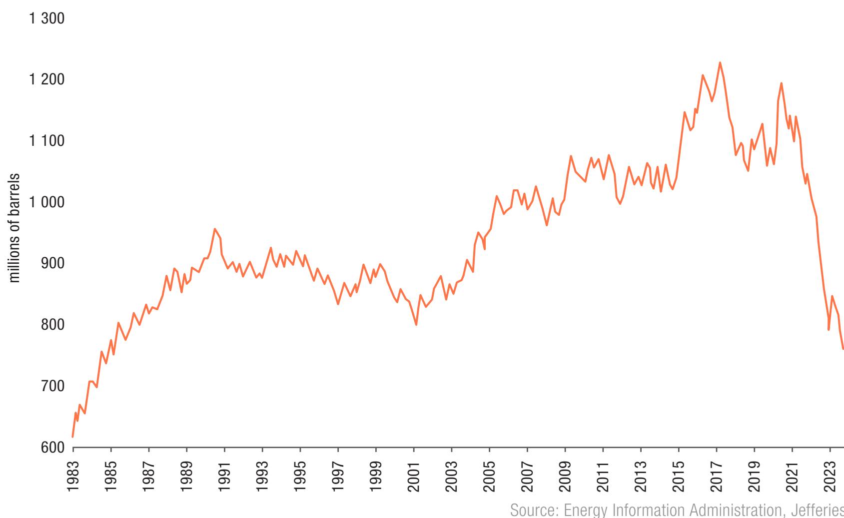
US INFLATION



Source: Evercore ISI

As expected, inflation has slowed considerably over the course of this year. In the United States, price inflation fell from a peak of 9.1% in June 2022 to 3.7% in September 2023. In the eurozone, inflation peaked at 10.6% in October 2022 and has since fallen to 4.3%. Price rises have eased on consumer goods in particular, while services inflation, closely linked to wage trends, has proved more tenacious, reducing the moderation in inflation excluding energy and food. Forecasting future inflation trends based on current levels has become more complicated. In the case of the United States, inflation in the housing cost component, which accounts for around 30% of the overall inflation rate and generally reacts with a slight lag to the trend in the latest asking rents, should ease considerably in the coming months and could even turn negative from the second half of 2024. If, on the other hand, the job market holds firm, the tenacity of services inflation excluding housing, a target explicitly mentioned by Federal Reserve chair Jerome Powell, could considerably slow the current disinflationary trend. Then there is the energy component, which is also subject to a host of uncertainties.

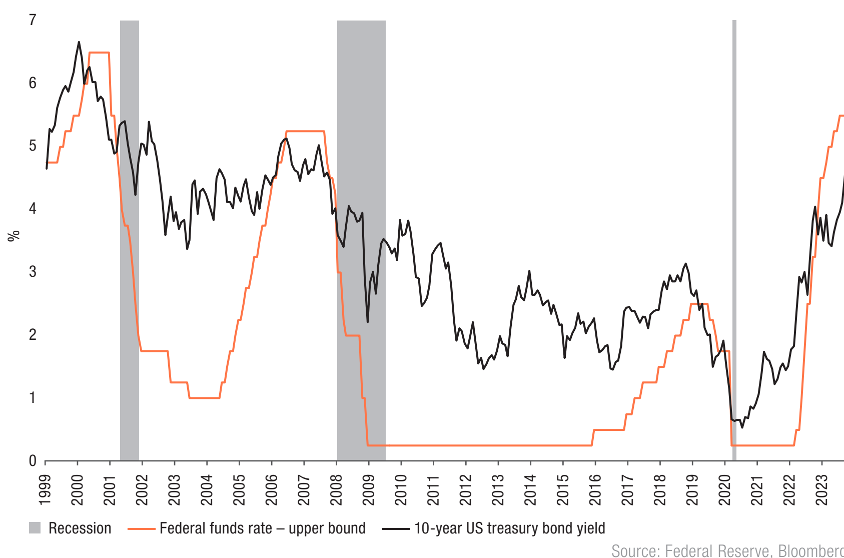
TOTAL US CRUDE OIL STOCKS (INCLUDING THE STRATEGIC RESERVE)



Source: Energy Information Administration, Jefferies

Crude oil prices rebounded by almost 30% in the third quarter, reversing the downward trend that had been running since June 2022. Since Russia's invasion of Ukraine, uncertainties surrounding energy prices have increased considerably. While there is still no end in sight to the Russian-Ukrainian conflict, a second major arena has just opened up in the Middle East following the attacks on Israel by the Palestinian Islamist organisation Hamas. It is too early at present to assess whether the confrontation will remain confined to the two protagonists in question, or whether it might extend to other countries, such as Iran, one of Hamas's main sponsors. In the event of the conflict spreading, a further rise in oil prices would be more than likely. On top of this is the fact that total crude oil stocks in the United States (including the strategic reserve) are at their lowest level since the mid-1980s, accentuating the precarious balance between supply and demand. In a global economy where fossil fuels still account for 82% of total primary energy consumption, the fact that Russia and Saudi Arabia are increasingly on their guard and would not hesitate to cut production at the slightest sign of weakening demand is also contributing to keeping prices under pressure.

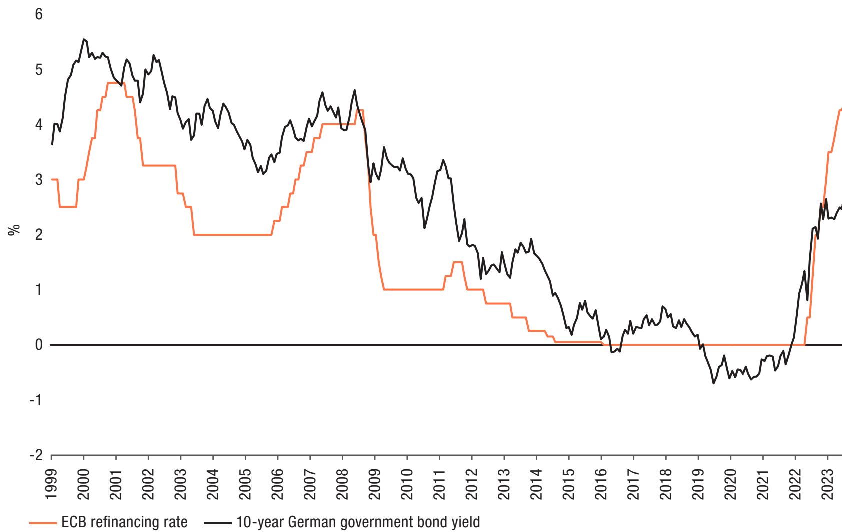
US MONETARY POLICY



Source: Federal Reserve, Bloomberg

The US Federal Reserve raised its key interest rates again in the third quarter, increasing the target range for the federal funds rate to 5.25%–5.50%. Although Fed chair Jerome Powell did not rule out a further interest rate hike at the last monetary policy committee meeting in September, his main message was more about the longer-term outlook, suggesting permanently higher interest rates. By dampening hopes of significant monetary easing in 2024, and possibly beyond, the top US monetary official triggered a further rise in long-term interest rates to the highest levels since August 2007. Long rates nearing 5% and a 30-year fixed mortgage rate of almost 8% could constitute sufficiently restrictive monetary conditions to prevent the Federal Reserve from raising short-term rates further. A possible final rise in key interest rates in the remaining months of this year will depend mainly on how inflation and the job market perform in the fourth quarter.

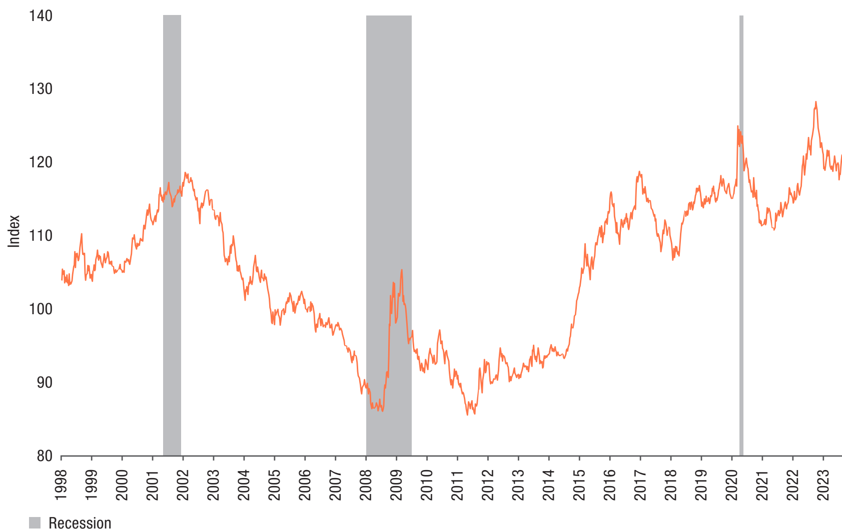
EUROZONE MONETARY POLICY



Source: ECB, Bloomberg

The European Central Bank raised its interest rates twice in the third quarter, taking the deposit rate to 4% and the refinancing rate to 4.5%. At its September meeting, ECB president Christine Lagarde stated for the first time that interest rates have now reached a sufficiently high level which, if maintained for long enough, should help inflation to return to the 2% target. Although the level of interest rates is still lower in the eurozone than in the United States, these comments suggest that the ECB's monetary tightening cycle is coming to an end. Compared to the US, signs of recession are more marked in Europe, with Germany presenting the most obvious indicators. On top of this, the weakness of the housing market is more pronounced in Europe, with most indicators suggesting a collapse in construction sector activity in 2024. As a result, European monetary policymakers seem keen to avoid further tightening of monetary conditions, even though wage growth remains high in most eurozone countries. Whether inflation returns to the 2% target will therefore depend on the scale of the recession that appears to be looming.

TRADE-WEIGHTED US DOLLAR INDEX

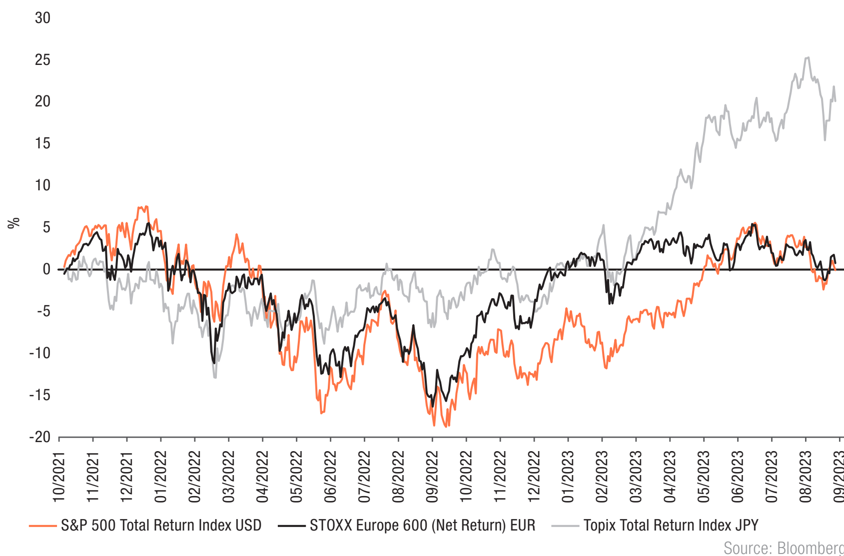


Source: Cornerstone Macro

The current state of the global economy bears a strong resemblance to that of the late 1990s and early 2000s. At that time, the monetary policies of the major central banks were equally restrictive, short- and long-term interest rates were rising, oil prices were appreciating, and the dollar was strengthening against most other world currencies. Another similarity was the thesis that rising interest rates would not trigger a recession as the technological revolution was generating sustainably high productivity gains that would prevent activity from contracting. Today, it is the low-cyclical services activities, these being increasingly dominant in our modern economies, that it is hoped will prevent a recession. Back then, however, even though US domestic consumption was similarly highly resilient, ultimately it could not prevent a contraction in GDP, which despite being moderate was sufficient to trigger a second wave of bearishness on the stock markets, generating significant falls in share prices and affecting even those previously spared. This time round, there is a strong chance that monetary tightening will eventually prevail and trigger a recession, at the end of which a new growth cycle will be able to emerge.

Financial markets

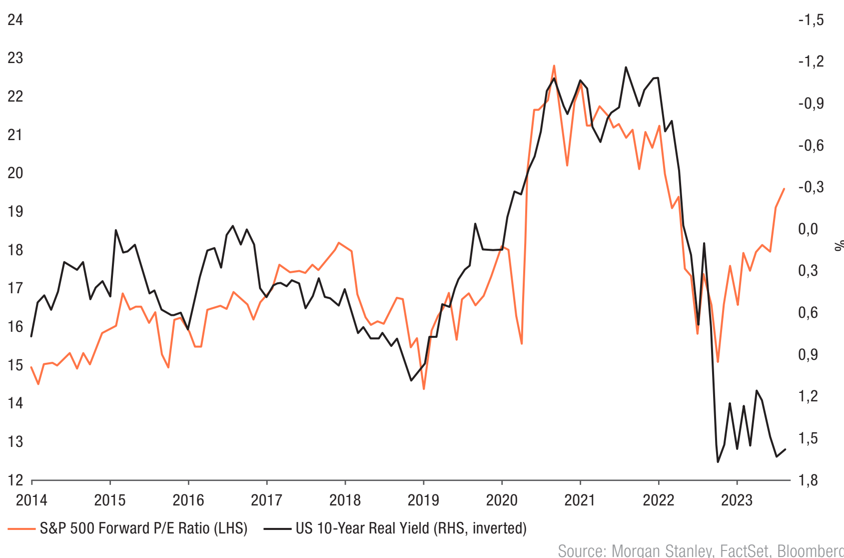
US, EUROPEAN AND JAPANESE MARKETS OVER 2 YEARS



Source: Bloomberg

Stock markets took a breather during the third quarter, with the global equity index declining by some 0.5% in euro terms and 3.5% in USD terms. In local currency terms, the Japanese market was the best performer, up by almost 2.5%, while the US and European markets were down by 3.3% and 2.1% respectively. Within the markets, the artificial intelligence craze calmed down somewhat, leading to a decline in the technology sector. The energy sector, on the other hand, benefited from the rebound in oil prices. Also of note was the poor performance of consumer staples, affected by rising long-term interest rates and fears of a possible negative impact on their sales from the new class of weight-loss drugs.

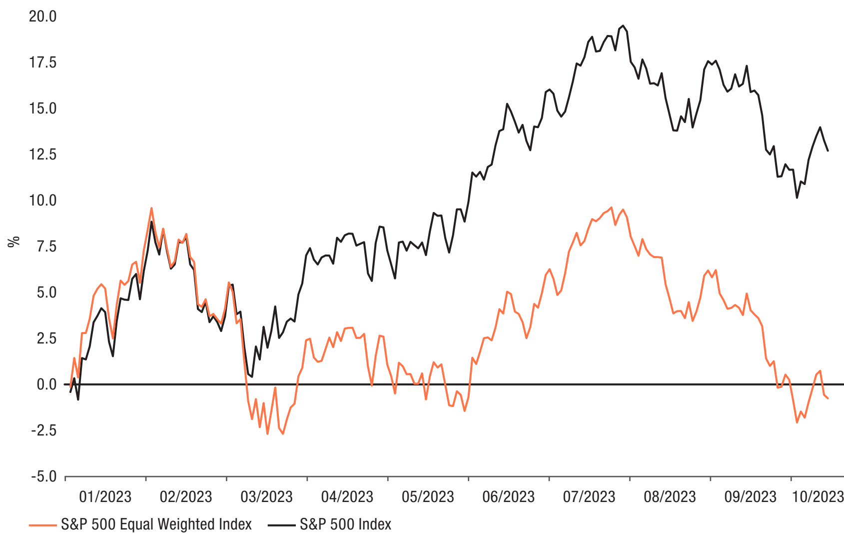
REAL RATES AND PRICE/EARNINGS RATIO FOR THE US MARKET



Source: Morgan Stanley, FactSet, Bloomberg

Most indices have corrected by between 5% and 10% from their highs, but continue to post positive performances for the year. The rise in stock market indices since the beginning of the year is essentially due to higher valuation multiples, and not to an increase in corporate earnings. The latter are now some 10% below analysts' forecasts of a year ago. Moreover, rising wage and financial costs are not pointing to an improvement in profit margins. In contrast, analysts are forecasting a 14% increase in S&P 500 company profits in 2024 and 2025. Such earnings growth is rare in normal times. It seems particularly unrealistic in view of the global economic slowdown.

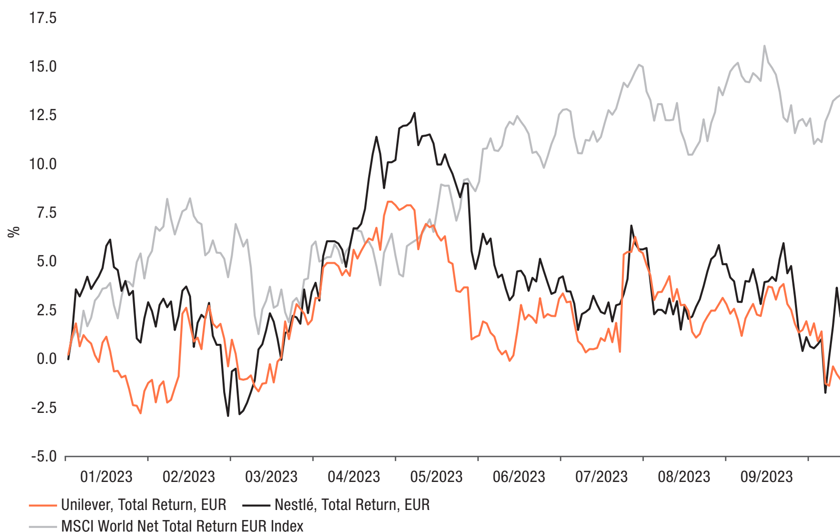
S&P 500 AND S&P 500 EQUAL WEIGHTED



Source: Bloomberg

A rise in multiples is very rare in an environment of rising short- and long-term interest rates. It was largely due to the fact that market participants have gradually moved away from the scenario of a US economic recession to one of a soft landing. Moreover, the rise in the indices is very narrow and limited to a relatively small number of stocks, starting with technology stocks, which have taken full advantage of the artificial intelligence craze. In the United States in particular, the ratio between the S&P 500 Equal Weight Index and the S&P 500 fell to its lowest level since the pandemic. The indicators that traditionally characterize the start of a new bull market - an outperformance by small-cap stocks and a large number of stocks participating in the rally - are thus absent from the 2023 rise in the indices. This suggests that the rebound in stock prices seen since October last year is only a temporary rally within a bear market.

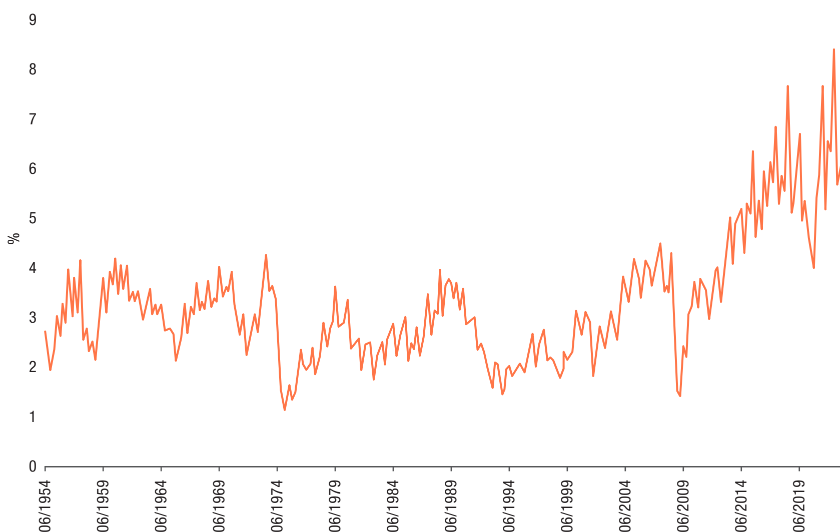
UNDERPERFORMANCE OF NESTLÉ AND UNILEVER SINCE APRIL



Source: Bloomberg

Weakness in defensive sectors such as healthcare and consumer staples offer buying opportunities. Since companies in these sectors generally offer good earnings visibility, their shares are generally considered high-duration assets. As such, they are often passed over in periods of rising long-term interest rates, the argument being that such a rise increases the discount rate on their future earnings and therefore reduces their present value. It should be noted, however, that such a rise in long-term interest rates has no effect on them as companies, since they generally have low levels of debt and are little affected by any economic slowdown that the rise in interest rates might induce. As defensive stocks, they have also been neglected in an environment where the consensus has shifted towards a soft-landing scenario for the economy. Their defensive qualities would regain the favour of investors should such a scenario be called into question. It's not for nothing that many of these companies are among the "dividend aristocrats", a group made up of companies with a track record of paying increasing dividends over several decades, irrespective of the economic context.

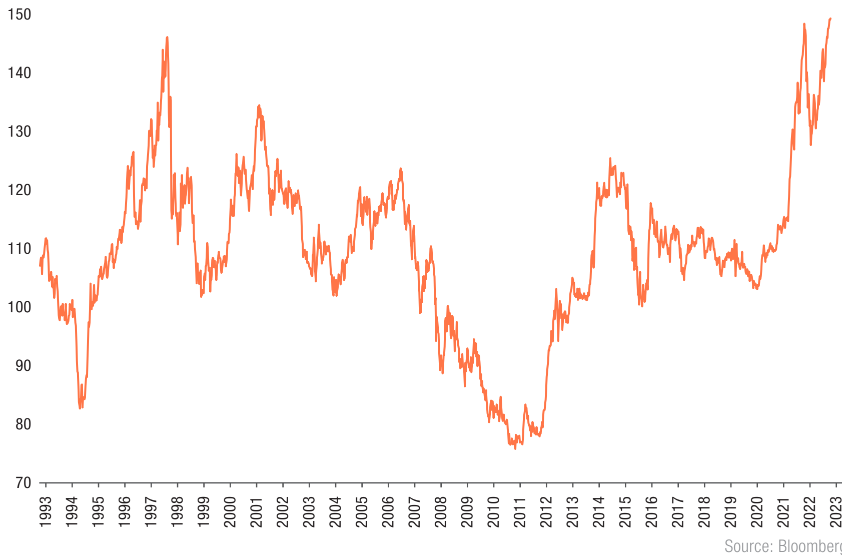
PROFIT MARGINS OF JAPANESE COMPANIES



Source: CLSA, MoF

The Japanese market continues to outperform most of its peers. The main argument in favour of the Japanese market relates to improved corporate governance. In the past, Japanese companies were more concerned with increasing market share than maximizing profits. This resulted in high levels of investment, poor capital allocation and low profitability. Things have changed, and companies are now highly disciplined in their capital allocation. This has resulted in an increase in their return on capital employed and higher earnings per share growth than in the rest of the world. Japanese companies are now recording profit margins close to their historical highs, while their net capital expenditure is low. This leaves them plenty of money to return to shareholders. At the same time, shareholder pressure is increasing, with the emergence of activist investors.

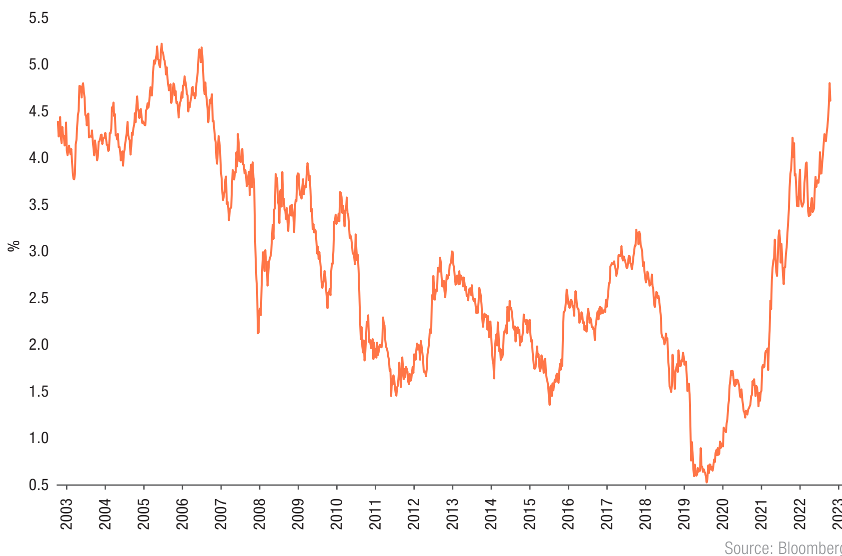
YEN/DOLLAR EXCHANGE RATE



Source: Bloomberg

The good performance of the Japanese market in local currency was partly offset by the depreciation of the yen. Since the beginning of last year, the yen has lost over 20% of its value against the euro and the dollar. The reason for the yen's fall is the widening interest rate differential with other currencies, as the Bank of Japan has so far refused to tighten its monetary policy. Things are likely to change in the coming months, however, with the end of monetary tightening in the West and the possibility of the Bank of Japan changing its monetary policy under its new governor. In particular, the policy of yield curve control looks less and less tenable. Such a change in monetary policy would lead to a rise in bond yields and an appreciation of the yen. Contrary to what one might think, these developments would be favourable for the stock market. The former would encourage local institutional investors to redirect their portfolios towards equities, the latter to repatriate capital from abroad.

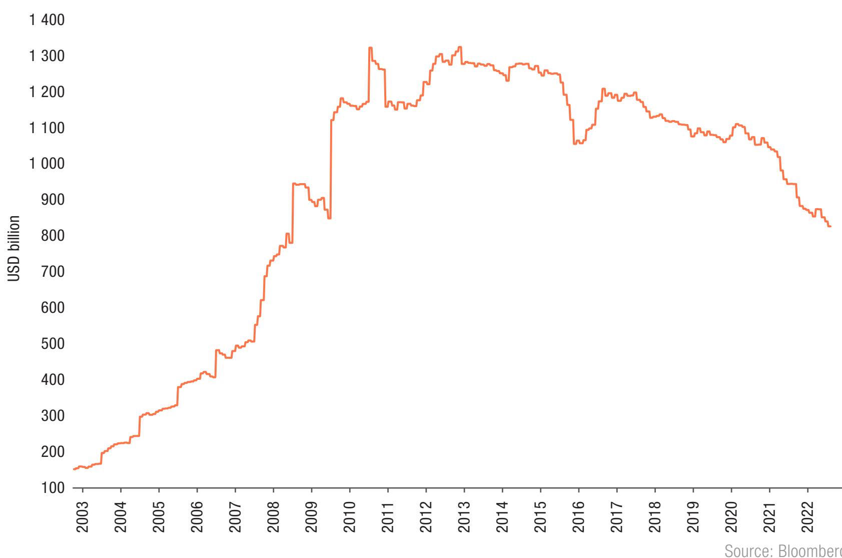
US 10-YEAR GOVERNMENT BOND YIELD



Source: Bloomberg

The highlight of the third quarter was the continued rise in long-term interest rates, which had begun in April. The resilience of economic activity in the United States and central bank pronouncements that they would keep their key rates higher for longer led to a clear upturn in long-term rates. The benchmark 10-year rate rose from 3.84% to 4.57% in the USA, its highest level since 2007, and from 2.39% to 2.84% in Germany. In the US, the yield curve has thus become less inverted. As expectations of a rapid easing of the Federal Reserve's monetary policy cooled, there was less reason for long rates to settle at levels well below short rates. Since its peak in 2020, the US long-dated government bond index has fallen by half. Such a fall has never been recorded before. However, this also illustrates the excesses of the bond markets in 2020/2021, with yields largely negative in real terms.

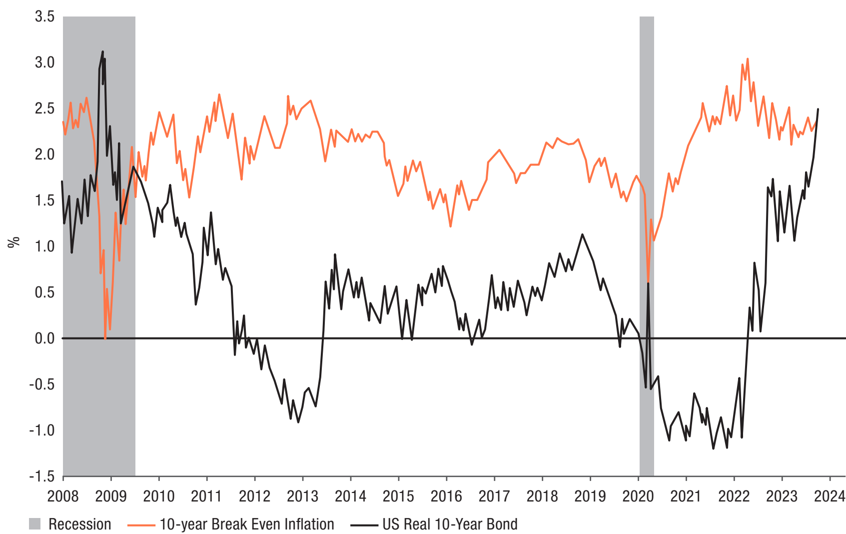
CHINA'S HOLDINGS OF US TREASURIES



Source: Bloomberg

It's hard to know for sure whether the recent rise in bond yields is due to a lack of demand or an oversupply of bonds. A growing number of observers are concerned about the ever-increasing financing needs of governments, reflected in high levels of public debt and large budget deficits. In the USA, for example, the budget deficit stands at some 8% of GDP, despite historically low unemployment - a situation never seen before. This raises the question of who is going to buy all the bonds needed to finance these deficits, especially at a time when central banks have stopped buying bonds and are declaring their intention to reduce the size of their balance sheets. As for emerging countries, their purchases of US government bonds are in sharp decline. Despite a historically high trade surplus, China has not increased its purchases of US bonds, preferring to recycle its surplus into oil and gold. It will therefore be interesting to see how the US bond market reacts to worse economic figures. A fall in long-term yields would confirm that US government bonds remain a safe haven in the event of a recession.

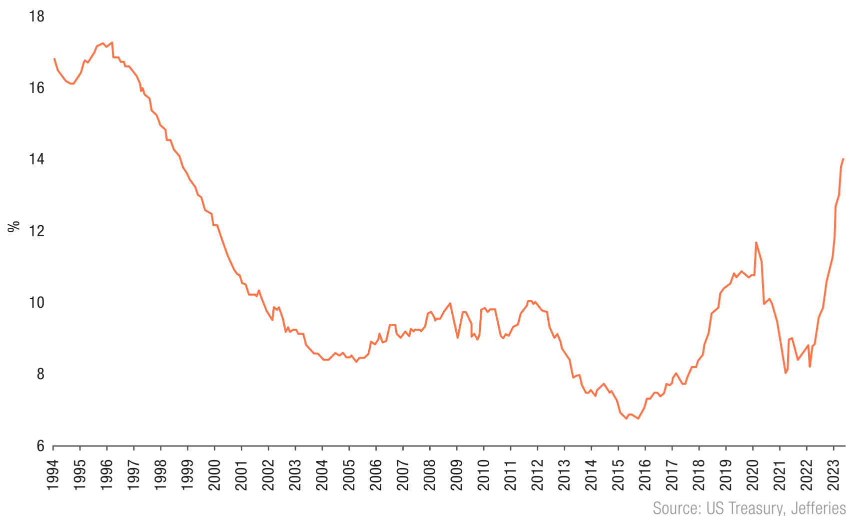
US INFLATION EXPECTATIONS AND REAL RATES



Source: Minack Advisors, Federal Reserve, Bloomberg, NBER

The rise in long-term interest rates does not seem sustainable. The US economy is often considered a long-rate economy, the idea being that changes in long rates are far more important for economic activity than changes in short rates. Between rising rates, slowing growth and falling inflation, long- and short-term interest rates are now higher than nominal growth. This creates a dangerous economic and fiscal dynamic. On the financial front, rising long-term rates are beginning to have an impact on private-sector borrowing and the cost of credit for small businesses. At the same time, signs of growing problems in the private equity sector are mounting. In this respect, it is important to note that the private equity industry has only developed over the last few decades, i.e., in an environment where interest rates have either fallen or remained low. More generally, many loans have emerged in the shadow banking system in recent years, despite the fact that this system is far less regulated. The longer interest rates remain at current levels, the greater the risk of a financial accident.

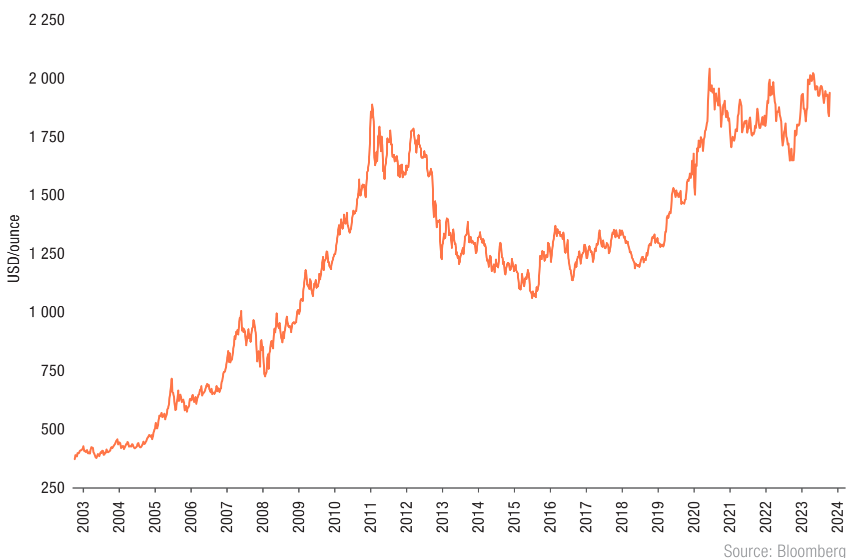
NET INTEREST PAYMENTS ON US PUBLIC DEBT AS % OF TAX REVENUES



Source: US Treasury, Jefferies

Given the trajectory of fiscal deficits in industrialized countries, a return to a more expansive monetary policy and renewed quantitative easing seems pre-programmed for the longer term. Recent months have shown that the market seems to be struggling to absorb US Treasury bond issues without the help of the Federal Reserve. Between expansive fiscal policies, financing the energy transition, rising military spending and spending linked to an ageing population, the financing needs of governments will only continue to grow, leading to a continuous flow of bond issues onto the market. Under normal circumstances, this would lead to a sharp rise in real interest rates. However, such a rise in real interest rates would mean that an ever-increasing proportion of tax revenues would have to be devoted to paying interest on public debt, a situation that would be difficult to sustain. In order to reduce the pressure on interest rates, central banks would have to start buying bonds again. In such a scenario, the bond markets of emerging countries would increasingly emerge as an alternative to those of industrialized countries. The strong outperformance of these markets since 2020, against a backdrop of rising interest rates and a stronger dollar, may come as a surprise, but is explained by much more orthodox monetary and fiscal policies.

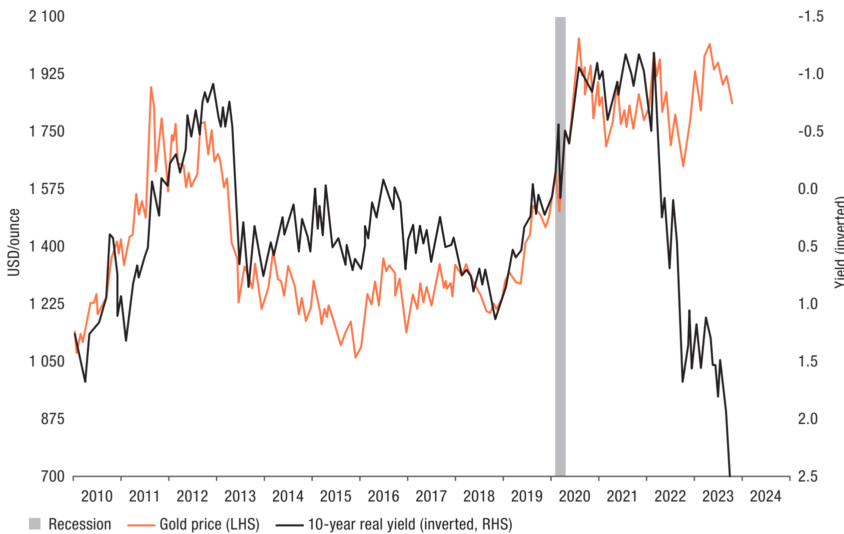
GOLD PRICE



Source: Bloomberg

The rise in interest rates and the strength of the dollar weighed on the gold price, which fell from $2,050/ounce to $1,820/ounce between early May and early October, before the deterioration in the geopolitical context brought it back above $1,900 Given the historically close correlation between the price of the yellow metal and the level of interest rates in real terms (adjusted for inflation) and the dollar, the damage done by the rise in real rates (higher nominal rates and lower inflation) and the greenback remains limited. The average price of gold should reach a record high in 2023. This suggests that other factors are driving the price of gold. A first explanation could lie in the fact that investors do not believe that real rates can remain at their current level for long, and that either nominal rates will fall, or inflation will rise, causing real rates to fall again. The latter scenario would correspond, in particular, to an environment where the need to finance growing deficits outweighs the Federal Reserve's desire to keep inflation low. As mentioned above, the window of opportunity currently open to central banks to be restrictive will gradually close.

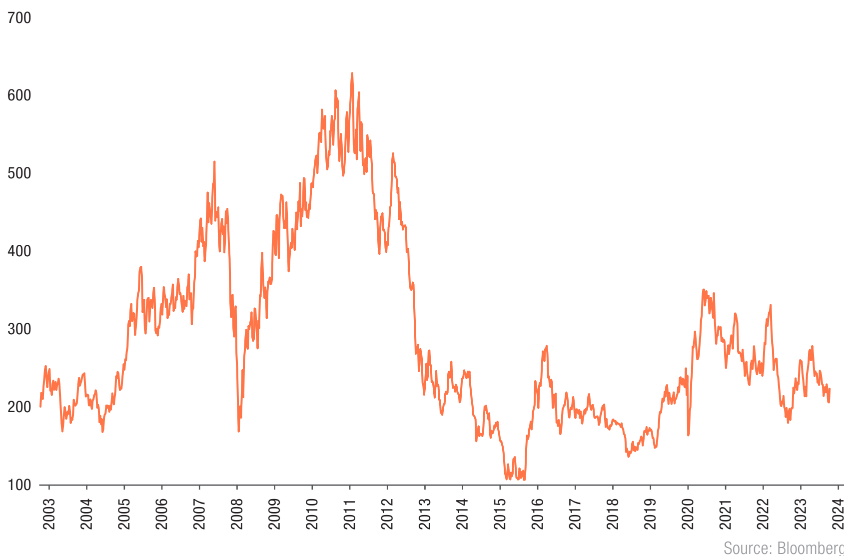
GOLD PRICE AND REAL INTEREST RATES



Source: Minack Advisors, Bloomberg, NBER

A second explanation could lie in the fact that new factors are now supporting the gold price, starting with central bank purchases. In a multipolar world, where geopolitical links are less stable, the freezing of Russia's foreign exchange reserves has convinced many countries that it may be important to hold a growing proportion of their foreign exchange reserves in a neutral asset, with no counterparty risk. This seems to be one of the reasons behind central bank gold purchases reaching their highest level in over 50 years in 2022. While investment demand is indeed affected by the level of real interest rates, its weakness is more than offset by physical demand (particularly from emerging countries) and central bank purchases. Purchases were particularly high in the case of Eastern central banks. In addition to diversifying their foreign exchange reserves, their purchases could also be motivated by the possible reintroduction of gold into the global monetary architecture, under the impetus of China, which aims to establish an alternative to the dollar-based financial system. Gold is thus moving further and further east.

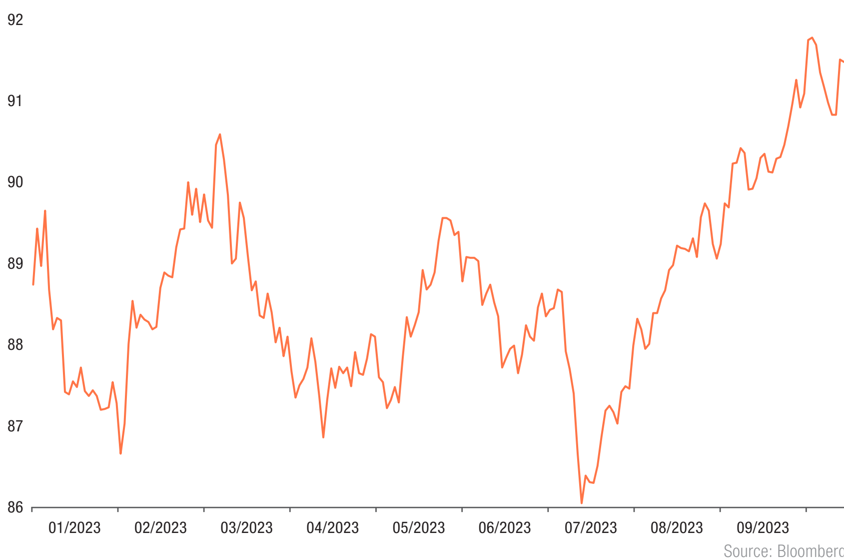
GOLD MINING INDEX OVER 20 YEARS



Source: Bloomberg

Gold companies have underperformed the gold price. The gold mining index is now some 50% below its August 2011 high, notwithstanding a higher gold price. Gold companies thus continue to pay for their past mistakes, despite the fact that they are now demonstrating greater discipline in capital allocation. However, their recent underperformance can also be explained by declining profit margins. Since the first quarter of 2020, the price of gold has risen by some 20%, while production costs have risen by over 30%, driven by higher wage and energy costs. Royalty companies offer a way of investing in the gold industry with less operational risk. They provide financing to a producer for the construction of a mine, in exchange for a percentage of the mine's revenues or production. However, they are not exposed to any increase in the mine's operating costs. They also offer greater diversification, since they generally hold royalties on a large number of mines.

EVOLUTION OF THE TRADE-WEIGHTED DOLLAR INDEX



Source: Bloomberg

As long rates have risen more in the US than in other countries, the dollar has benefited from a widening interest rate differential. It is interesting to note that the dollar appreciated more against the currencies of industrialized countries than against those of emerging countries. The dollar's weak appreciation against these currencies and the sharp fall in US government bond prices could confirm that a significant part of the world is moving away from the dollar-based financial system with US government bonds at its centre. While the dollar has benefited from a wider interest rate differential, the yen has suffered the opposite fate, falling to its lowest level against the dollar in over 30 years. Its sharp fall led to higher import prices and reduced household's purchasing power. As a result, pressure on the Bank of Japan to change its monetary policy increased. Today, the Japanese currency is heavily undervalued, and recent interventions on its behalf by the Japanese authorities seem to show that they are not prepared to tolerate any further depreciation.

Summary

In short, the risk of a pronounced slowdown in the global economy remains very real, with the possibility of a recession in the fourth quarter of this year, or in early 2024. Defensive positioning therefore remains appropriate. Such a defensive stance is all the more justified given that the alternative scenario of a soft landing for the US economy has become the consensus and now seems to be priced in.

Monetary tightening by central banks is coming to an end, but a rapid easing does not appear to be on the agenda, unless global economic conditions deteriorate rapidly. If the US economy manages a soft landing despite an increase of more than 5% in the Federal Reserve's key interest rate, investors will have to revise their estimates of the neutral rate upwards and get used to an environment of permanently higher interest rates. None of these scenarios looks particularly favourable for equity markets, at a time when valuation multiples have risen again. Also, unlike a few years ago, investors can now find attractive returns in the money and bond markets.

Within the equity markets, high-quality defensive stocks should regain favour with investors, especially as their relative valuations have become attractive again after their underperformance of recent months. On a regional level, Asian markets should benefit from a decline in long-term interest rates, more favourable medium- to long-term economic dynamics and lower valuation levels. The evolution of corporate governance towards greater consideration for shareholders will continue to make the Japanese market one of the most attractive for years to come. A sharp contraction in the global economy could, however, temporarily halt its upward trend, as the earnings of many Japanese companies are highly exposed to the global cycle.

In the short term, the price of gold could remain volatile, given the upward pressure on long-term US interest rates and the strength of the dollar. Nevertheless, the upward trend in the price of the yellow metal seems well established. In any case, an investment in the yellow metal should never be seen as a short-term investment.

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