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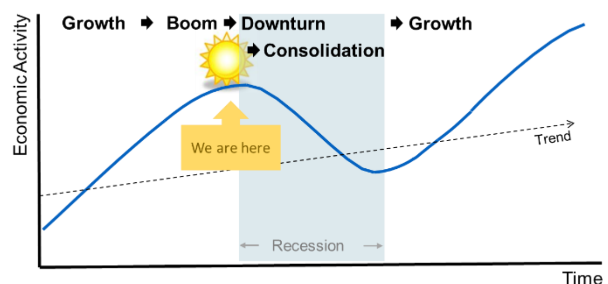
Briefing from the ARVEST Investment Committee

Global financial markets had an amazing year in 2023. U.S. equity markets closed at near-record highs despite persistent fears of inflation, which prompted the Federal Reserve to raise interest rates on an unprecedented scale. Bond markets also rebounded from earlier slumps, particularly in the final quarter. This was all the more remarkable given that the recovery of the Chinese economy was much slower than expected after the lifting of the pandemic restrictions, that global trade and industrial production were stagnant, and that most financial analysts had predicted a recession in the US at the beginning of the year. The only beneficiaries of the global uncertainty were, as usual, the Swiss franc and gold.

To the delight of many investors, everything went wrong in the financial markets, but in a good way! The strong performance of the equity markets was driven by the seven leading US technology companies, known as "The Magnificent Seven"[1]. These seven companies were heavily weighted[2] in the equity indices and alone contributed almost 16% to the S&P 500's 28% total return for the year in US dollar terms. They attracted investors with strong financial results and inflation- and interest-rate-resistant business models. However, their share prices reflect the huge expectations for their future innovations in artificial intelligence.

As the ARVEST Investment Committee, we joined the canon of financial analysts last year and did not prove to be infallible as we too saw the risk of a US recession as the greatest immediate threat to the equity markets. As early as January, however, we pointed out that we believed that the US economy was more resilient than our preferred models suggested and that the onset of a recession was likely to be delayed. It was not until last summer that we realized that the crucial question of whether the risk of a US recession had finally been averted could still not be off the table in early 2024.



[1] Microsoft, Apple, Nvidia, Amazon, Meta (Facebook), Tesla, Alphabet (Google)

[2] 28% of S&P 500, 19% of global equities

Future Prospects

Market participants expect 2024 to be a year of interest rate cuts. Money markets have already priced in six significant Fed rate cuts of -0.25% each by the end of the year. Rate cuts tend to make financial markets more risk-taking and optimistic. As a result, equity and credit markets are currently pricing in a soft landing, in which economic growth will slow but not spiral into recession and inflation will remain under control. But it also means that buying into that optimism is an expensive proposition.

According to our preferred models, the risk of a recession in the US economy remains high. Although these indicators improved somewhat between November 2022 and July 2023, their forecasts have deteriorated again since then. It could therefore be that only this renewed weakness is a real sign of a recession, that will eventually have a negative impact on the labor market. In this case, the models would have raised a false alarm last year because they were not sufficiently calibrated to account for the monetary and economic consequences of the previous battle against the pandemic.

Geopolitically, 2024 is also unlikely to be quiet and boring. Nearly half of humanity lives in a country where elections will be held in 2024. Investors and the ARVEST Investment Committee will certainly focus on the US election campaign. The more so as there is a choice between two extremes, neither of which is likely to satisfy the silent majority. Beyond the US, there is also a great danger that power-hungry politicians will try to mask domestic tensions with foreign conflicts.

US equity markets remain overvalued. Longer-dated bonds have also become less attractive after the strong rally in the last quarter. They will only be attractive if inflation expectations continue to fall. In our view, this is particularly likely in the event of a US recession.

We are therefore keeping the equity allocation in the portfolios stable. In our opinion, it is still too early for a "full" re-entry into the equity market. We prefer relatively attractively valued quality stocks with secure dividends. True global diversification remains essential for us, as the economic cycle and exchange rates in China and Japan are more favorable than in the US or Europe. In complete humility before the vagaries of the financial markets, we consider short and medium-term bonds with low default risk and money market investments to be attractive. A high US dollar exposure should remain hedged in portfolios with other reference currencies, as the US continues to rely on foreign dollar purchases to finance its trade deficit. However, the attractiveness of the US dollar is likely to decline further due to the expected interest rate cuts.

8 January 2024
On behalf of the Investment Committee
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