WEEKLY VIEW

Goldilocks challenged?

19 February 2024

Bumpy ride towards 2% inflation

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SUMMARY

US equites stumble on inflation figures

Emblematic chipmaker to report results

China returns from holiday

THE WEEK IN REVIEW

The release of consumer and producer inflation figures for January that showed US prices rises slowing less than expected briefly jolted markets, as the figures suggested the Fed will remain uncomfortable about cutting rates in the near term. Yet the damage was limited (the S&P 500 was down 0.35%[i] over the week in USD) as good corporate results continued to roll in and there were stirrings in M&A activity. Outside the US, **Japan's Nikkei 225 rose to its highest level since the start of 1990.**

By further clouding the outlook for the timing of Fed rate cuts, the January inflation numbers caused a sell-off in US Treasuries, with the 10-year US Treasury rising to 4.29%, its highest level since end-November—while the inching up of one-year inflation expectations put more pressure on short-term yields. Short-term German yields also rose, although investors seem to have solidified their bets for June rate cuts. In currencies, **the yen weakened more** as disappointing Q4 GDP numbers were seen as complicating the Bank of Japan's plans for normalising its monetary policy.

QUOTE OF THE WEEK

Paolo Gentiloni, European Commissioner for Economy, on the Commission's updated forecasts for the European economy: "The rebound expected in 2024 is set to be more modest than projected three months ago, but to gradually pick up pace on the back of slower price rises, growing real wages and a remarkably strong labour market. Investment is expected to hold up."

KEY DATA

The US consumer price index (CPI) came in at an annual 3.1% in January, slowing less than expected from 3.4% in December. Annual core CPI was unchanged at 3.9%. The US producer price index declined only slightly to an annual 0.9% in January from 1.0% in December. January retail sales dipped by 0.8% from December and industrial production by 0.2%.

According to preliminary estimates, **Japan's GDP contracted by an annualised 0.4% in Q4.** This was the second consecutive quarter of contraction, with GDP declining an annual 3.3% in Q3.

The UK economy also fell into a technical recession, with GDP slipping 0.3% in Q4 from the previous quarter, following 0.1% in Q3. But there was some good news in the euro area, with industrial production up an annual 1.2% in December, the first annual rise in 10 months.

MARKETS VIEW

The Q4 earnings season in the US has peaked, with three-quarters of companies reporting earnings above estimates. But the most emblematic AI-related chipmaker, whose stocks have soared this year, will report results on Wednesday, with all eyes on guidance. **Our view remains that the concentration of gains in just a few stocks makes US indexes vulnerable.**

Earnings announcements pick up steam this week in Europe, but so far have been somewhat more lacklustre. We will watch purchasing manager indexes for hints that flaccid business sentiment is at least steadying.

We will also see whether the Chinese economy and markets can gain some momentum after the end of Lunar New Year holidays. **Early signs are good, with a surge in consumer spending and travel over the holiday.**

Tech-dominated concentration

Concentration of the S&P 500 has reached levels unparalleled since the 1970s, with a handful of stocks accounting for a third of the S&P 500 index. This is due to the rise of the so-called 'Magnificent Seven', which have played a pivotal role in propelling index gains in recent years.

Source: Pictet Wealth Management, FactSet, 16.02.2024

Asset class performance

Stock Markets	Last close	1 week change %	YTD%
Dow Jones*	38,627.99	-0.1%	2.5%
S&P500*	5,005.57	-0.4%	4.9%
NASDAQ Comp*	15,775.65	-1.3%	5.1%
MSCI World Small Cap $*	524.71	1.1%	-0.7%
MSCI Europe*	165.00	1.4%	2.7%
MSCI EMU*	158.34	1.1%	3.7%
SMI*	11,310.61	2.0%	1.6%
MSCI China $*	52.97	3.7%	-4.5%
Nikkei*	38,487.24	4.3%	15.0%
CBOE Volatility (VIX)*	14.24	10.1%	14.4%

Currency, Commodity, Rates	Last close	1 week change %	YTD%
EURUS**	1.0772	-0.1%	-2.5%
GBPUS**	1.2586	-0.4%	-1.3%
USDCHF**	0.8807	0.7%	4.6%
USDJPY**	150.23	0.6%	6.6%
USDCNY**	7.1937	0.0%	1.4%
EURCHF**	0.9487	0.5%	2.0%
Gold**	2,013.59	-0.5%	-2.4%
Silver**	23.4207	3.6%	-1.6%
Crude Oil**	78.4700	1.6%	9.2%
US Investment Grade	3,189.15	-0.4%	-1.5%
US High Yield	1,587.15	-0.4%	-0.2%
EU Investment Grade	274.85	0.1%	-0.9%
EU High Yield	355.93	0.3%	1.0%

Source: Pictet as of 16.02.2024. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. This table may contain information about financial instruments or issuers but does not set out any direct or implied recommendation whatsoever (either general or personalized). YTD stands for year to date. *measured on a non Total Return basis.
** showing mid price numbers.

WHAT TO WATCH THIS WEEK?

MONDAY
Japan: core machinery orders (December)
UK: Rightmove House Price index (February)

TUESDAY
US: Conference Board Leading Economic Index (January)

WEDNESDAY
Euro area: European Commission consumer confidence survey
Japan: Trade balance data (January)
US: Release of minutes from 31 January FOMC meeting

THURSDAY
S&P Global/HCOB purchasing managers' indexes for the euro area, Japan, UK, US and Canada (February)

FRIDAY
Germany: Ifo business climate survey (February), final Q4 GDP numbers.

SATURDAY
US: Republican party presidential primary in South Carolina.

Glossary of Risks

Commodity risk: The value of commodity-linked instruments can fluctuate substantially due to changes in supply and demand as well as due to political, economic and market events.

Concentration risk: Refers to identifying the risk in a portfolio arising from a concentration in a single asset, counterparty, sector or country.

Counterparty/issuer risk: The risk of losing part or all of an investment due to the insolvency of the issuer of the financial instrument.

Country risk: Country risk should be considered when investing in a foreign country and in particular in emerging markets, e.g. the risk of investing in shares of a foreign company that is exposed to the risk of nationalisation or the inability to repatriate proceeds of an investment due to capital controls.

Credit and default risk: This risk arises when the financial health of an issuer of a fixed-income security deteriorates, leading to the issuer's inability or unwillingness to repay the bond or meet contractual obligations (interest or principal repayments). This can result in a decline in the value of the bonds or render them worthless.

Currency/exchange rate risk: This risk arises when the reference currency differs from the investment currency. Fluctuations in foreign exchange rates directly impact (positively or negatively) the value/price or income of the holdings. Funds that attempt to hedge against currency risk can mitigate the direct impact of currency movements but cannot completely isolate the indirect effect of foreign exchange fluctuations. When investing in structured products, investors may benefit from an embedded hedge of the underlying currency risk that is referred to as a quanto.

Economic risk: The economic cycle and macroeconomic situation of a country, a region or the global economy can have a significant influence on prices of financial instruments.

Emerging market risk: Investing in emerging markets carries a heightened risk profile; liquidity may be less reliable and price volatility can be higher than that experienced in more developed economies, potentially resulting in sudden and significant declines in value. Emerging markets have less sophisticated rules governing the clearing and settlement of transactions and investor protection.

Inflation risk: Inflation risk should be considered in particular when investing in emerging markets or fixed-rate investments. Inflation is defined as the rate at which prices increase in an economy. Inflation can lead to currency depreciation and reduce the real returns of investments and financial instruments.

Interest rate risk: Changes in interest rates usually result in an opposite movement in the value of bonds and other debt instruments (e.g. a rise in interest rates is generally reflected by a fall in bond prices). The longer the maturity of the bond (the time when the principal is due to be repaid), the higher the interest rate risk. This is the commonly referred to as duration risk.

Liquidity risk: When market conditions are unusual or characterised by particularly low volumes, a portfolio can encounter difficulties in valuing and/or trading some of its assets.

Market risk: Financial instruments are subject to price fluctuation/volatility and to political and economic risks which can significantly impact the performance of the financial instrument/portfolio.

Political risk: Countries with unstable political leadership or where politics strongly influence markets and business practices may be subject to greater volatility. Political risk may include potential for currency controls that would disrupt the financial markets in that country.

Sustainability risk: The risk arising from any environmental, social or governance events or conditions that, were they to occur, could have a material negative impact on the value of the investment. Specific ESG/sustainability risks vary for each compartment and asset class and include, but are not limited to, the following:

***Climate transition risk:** This refers to the risk associated with the exposure to issuers that may be negatively affected by the transition to a low-carbon economy due to their involvement in fossil fuel exploration, production, processing, trading and sale, or their dependency on carbon-intensive materials, processes, products and services. Transition risk may result from several factors, including rising costs and/or the limitation of greenhouse gas emissions, energy-efficiency requirements, the reduction in fossil fuel demand or the shift to alternative energy sources due to policy, regulatory, technological and market demand changes. Transition risks can negatively affect the value of investments by impairing assets or revenues, or by increasing liabilities, capital expenditures, operating and financing costs.

***Climate physical risk:** This refers to the risk associated with the exposure to issuers that may be negatively affected by the physical impact of climate change. Physical risk includes acute risks arising from extreme weather events such as storms, floods, droughts, fires or heatwaves, and chronic risks from gradual climate changes, such as changing rainfall patterns, rising sea levels, ocean acidification, and biodiversity loss. Physical risks may negatively affect the value of investments by impairing assets, productivity or revenues, or by increasing liabilities, capital expenditures, operating and financing costs.

***Environmental risk:** This refers to the risk associated with the exposure to issuers that may be affected by environmental degradation and/or the depletion of natural resources. Environmental risk can result from air pollution, water pollution, waste generation, the depletion of freshwater and marine resources, the loss of biodiversity or damages to ecosystems. Environmental risks can negatively affect the value of investments by impairing assets, productivity or revenues, or by increasing liabilities, capital expenditures, operating and financing costs.

***Social risk:** This refers to the risk associated with the exposure to issuers that may be negatively affected by social factors such as poor labour standards, human rights violations, damages to public health, data privacy breaches or increased inequalities. Social risks can negatively affect the value of investments by impairing assets, productivity or revenues, or by increasing liabilities, capital expenditures, operating and financing costs.

***Governance risk:** This refers to the risk associated with issuers that may be negatively affected by weak governance structures. For companies, governance risk can result from malfunctioning boards, inadequate remuneration structures, abuses of minority shareholders or bondholders' rights, deficient controls, aggressive tax planning and accounting practices or lack of business ethics. For countries, governance risk can stem from governmental instability, bribery and corruption, privacy breaches and lack of judicial independence. Governance risk may negatively affect the value of investments due to poor strategic decisions, conflicts of interest, reputational damages, increased liabilities or loss of investor confidence.

Our investments take into account Sustainability Risks, by integrating in the investment process Environmental Social and Corporate Governance (ESG) factors, based on proprietary and third-party research, to evaluate both investment risks and opportunities. Consequent impacts to the occurrence of Sustainability Risks can be many and varied according to a specific risk, region or asset class. Generally, when a Sustainability Risk occurs for an asset, there will be a negative impact and potentially a partial or total loss of its value. However, the integration of Sustainability Risks analysis should mitigate the impact of such risks on the value of the investments and could help enhance long-term risk adjusted returns for investor.

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i) Source: Pictet WM AA&MR, Thomson Reuters. Past performance, S&P 500 Composite (net 12-month return in USD): 2019, 31.5%; 2020, 18.4%; 2021, 28.7%; 2022, -18.1%; 2023, 26.3%.