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First quarter 2024
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INDEX

2 Macroeconomic View
3 Fixed Income
4 Equities
5 Commodities and Currencies
6 Latin America

Quarterly Report

Our view on the markets

Anchoring and inflation

Fixed income should be a core component of portfolios, but we must not forget that the enemy to beat, for any saver, is inflation.

Some years ago, an experiment was carried out with two groups of judges. They were all given the same case separately. Half were recommended a very short sentence and the other half a much longer one, but the judges were given absolute discretion to decide for themselves. The result was that the first group, on average, gave a sentence that was much shorter than the second group.

This problem is not exclusive to judges. Our brains take the most recent data as the starting point or anchor for making approximations when information is lacking. This happens unconsciously, without even evaluating whether the starting point makes sense or not. (The above experiment was repeated with the judges rolling dice before making the decision, and the number rolled also influenced the final sentencing).

Now we are seeing something similar with interest rates. Since 2008 and up until very recently, they have mostly been at zero (or negative). Now that positive rates are possible on a variety of instruments, we are very tempted to settle for them. The problem is that our brain is comparing them with zero, that is to say, nothing. Of course, no matter how trivial, earning something is better than earning nothing, but that leads us to make bad decisions. Rates have not normally been zero (this last decade has been an anomaly from a historical point of view).

Saving is nothing more than postponing consumption for the future. Unfortunately, inflation in the years to come, on average, is almost certain to be much higher than it has been since the turn of the century. Several factors that were keeping inflation in check have flipped and are acting in the opposite direction. A full explanation is beyond the scope of this article, but perhaps one of the most powerful elements is the reversal of globalisation which, among other things, puts pressure on the labour market in many countries, with shortages in many positions. Prices will also be pressured by the enormous amounts of investment, both public and private, that will have to be undertaken in the coming years. A lot of money needs to be invested into the energy transition and energy independence (often the same thing), automation, artificial intelligence and defence (unfortunately), to give a few examples. Thus, inflation will (almost certainly) be higher on average than the rates we can obtain on products that pay us a fixed coupon without too much risk.

So, what do we do? By taking very long time series, rather than recent data that fools the brain, we can make better decisions. Since 1800, equities have returned on average almost 7% annually, net of inflation (more than twice as much as the next alternative). It therefore appears to be an indispensable asset. Always, of course, with the percentage that corresponds to our risk profile. Otherwise, when there are stock market downturns (as there are bound to be from time to time), we will inevitably get nervous and want to sell at the worst time.

Ultimately, however much we are tempted by fixed rate solutions, remember that the anchor effect may be playing a trick on you. Inflation is the enemy to beat for any saver.

David Macià, CFA
Chief Investment Officer, Creand Asset Management

Strategy

Asset allocation (2024 Q1)

Monetary	↑
Fixed Income	→
Equities	↓

Fixed Income

GOVERNMENT	
USA	→
Eurozone	→
INVESTMENT GRADE	
USA	↑
Eurozone	↑
HIGH YIELD	
USA	↓
Eurozone	↓
EMERGING MARKETS	→

Equities

USA	→
Eurozone	→
Japan	↑
Emerging Markets	→

Commodities

Oil	→
Gold	→

Currencies

EUR/USD	→
JPY/USD	↑

Macroeconomic View

Too early to cry victory!

2023 will probably go down as the year when most economists got it wrong. At the start of the year, many expected a recession due to high inflation, central banks' aggressive tightening cycle and geopolitical tensions. Yet growth was remarkably resilient. Looking to 2024, most are predicting a soft-landing. Time will tell!

At the December meeting, the Federal Reserve recognised the encouraging decline in inflationary pressures and not only signalled an end to their hiking campaign but also indicated cuts for 2024, underpinning the soft-landing narrative. A dovish pivot that surprised the markets and likely had economists rushing to brighten up their 2024 outlooks.

Inflation continues to be the focal point of the macroeconomic story. In an economy of near full employment, the thinking was that only much weaker growth could bring down inflationary pressures. However, throughout 2023, growth surprised to the upside while price indices dropped more than expected. Several factors explain the economic strength: prolonged fiscal impulse; the positive performance of financial markets, offsetting the impact of monetary tightening; and the pandemic's lagged effects—a desynchronised performance amongst sectors and a tight labour market. Even the ripple effects of the collapse of some US regional banks during the first quarter were contained. Despite this resilience, core US Personal Consumption Expenditure (the Fed's preferred gauge of underlying inflation) dropped to 3.2% in November, down from 4.9% at the beginning of the year. The fall has been relatively rapid as disruptions in supply chains were fixed, unwinding some of the swift price increases in goods. However, to reach target, we will need to see further progress in both shelter and core services, which have been somewhat sticky. The latter depends heavily on the outcome in labour markets. Although we are seeing some signs of slackening, with job openings having fallen significantly to 8.7 million down from a peak of 12 million last year, the labour market is still tight. Looking at history, the last leg down from high levels of inflation is somewhat longer, so getting to target might still be a bumpy ride.

The picture has not been so rosy in the eurozone, as growth stalled in the third quarter and the region entered a technical recession (i.e., negative growth during two consecutive quarters). On the positive side, this weakness has allowed inflation to drop even quicker than in the US. Inflation fell to 2.4% in November from 9.2% at the beginning of the year, while core inflation, excluding energy and food, fell to 3.6% from 5.2%—both below consensus expectations. Even so, headline inflation is due to pick up in the next few months, driven by base effects in energy and the removal of some fiscal support, and the ECB will want to see wage increases slow before considering any cut in interest rates.

A dovish pivot that surprised the markets and likely had economists rushing to brighten up their 2024 outlooks

Many of the drivers that have supported growth over the past year will lose their impulse as we enter 2024, and several risks could challenge economists' goldilocks predictions for 2024. With no end in sight to wars in Ukraine or the Middle East, a wave of elections around the world contributing to geopolitical uncertainties and the lag in monetary policy transmission, the moderation in inflationary pressures could stall or even pick up, and the growth slowdown could result in a mild recession. While we do not forecast a deep recession since firms are still expected to try and hold on to their workers amid the lack of skilled labour (reducing the shock to employment), we still think it is early days to cry victory.

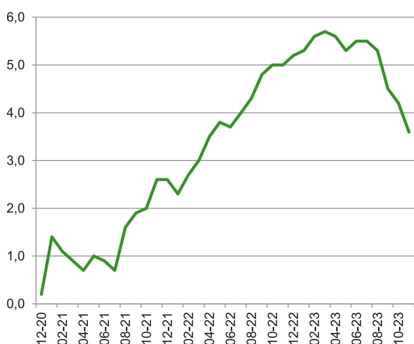
Jadwiga Kitovitz, CFA
Head of Multi-Asset Management and Institutional Accounts

US Job Openings By Industry Total

Source: Bloomberg

Job openings have fallen significantly to 8.7 million down from a peak of 12 million last year.

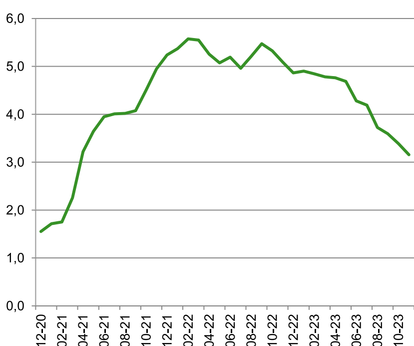
Eurozone Core Inflation



Source: Bloomberg

Core inflation which excludes energy and food, fell to 3.6% from 5.2% in the eurozone.

US Personal Annual Consumption Expenditure Core Price Index



Source: Bloomberg

Core US Personal Consumption Expenditure dropped to 3.2% in November, down from 4.9% at the beginning of the year.

Fixed Income

The central banks' shift

Following the central banks' December meetings, there was a paradigm shift. They announced that they are prepared to begin easing monetary policy, after the most aggressive tightening in decades, and rate cuts in 2024 are even being predicted. Inflation and economic developments will determine the extent of these cuts.

The market expects 2024 to be the year of interest rate cuts by the central banks. The US Fed in December said that it was ready to cut rates after containing rising inflation without causing a recession or significant cost to employment. In the eurozone, the new projections showed that a weak economy tempered the inflation outlook, and the ECB will continue to reduce its balance sheet and, in turn, the liquidity in the system. No rate cuts were discussed, but they will be keeping a close eye on the data for the next move.

The baseline scenario now is clearly that there is no intention to raise rates further. Of course, it will all depend on whether the disinflationary trend continues, and economic data do not come out too strong, as this would make the case for the rate cuts that the market is already discounting in a synchronised fashion. Bloomberg has an aggregate indicator of global rates showing a 128 bp fall in 2024, led by the emerging economies (Brazil, Chile, Czech Republic, Hungary and China, among others, have already started the process).

Bond yields are attractive and now have upside potential if rates fall

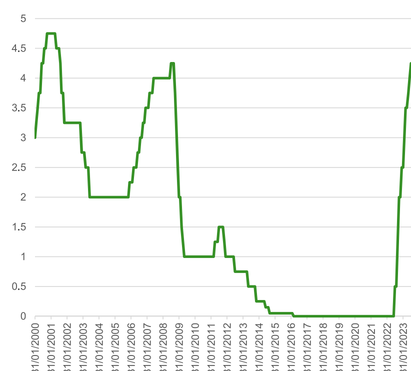
In the closing months of the year, there was a strong rally in fixed income that reflected the expectation of lower rates and advance economic data that showed economic weakness in both services and manufacturing. Perhaps the market is too bearish, and we can expect more erratic bond yields in the first part of the year. We must consider how inflation may be impacted by the increase in corporate margins and the result of wage increases from salary negotiations. How fiscal policy evolves is also relevant, as the fiscal deficit has increased and the reactivation of the Stability and Growth Pact from 2024 onwards may generate friction. Increasing duration is gaining popularity if you position yourself for slower growth and lower yields or an increase in slope where longer stretches would become more attractive.

Regarding corporate and financial bonds, the current environment remains favourable, especially for high credit quality bonds. There are high yields and decent credit fundamentals (high cash, low leverage...) and supported by technical factors such as high investor demand with significant money flows into fixed income. Idiosyncratic stories will now be more frequent and visible (we have already seen some in 2023, such as Alstom, Siemens, Bayer, SBB, Credit Suisse...). We overweight the financial sector versus corporate and issuers with a more defensive bias, especially those with recurring cash flow such as utilities, infrastructure, etc. The more cyclical sectors may have their moment if disinflation continues in the second half of the year and the rate cuts are confirmed, which would favour growth prospects.

In 2024, there will be more volatility and we must be prepared to actively manage portfolios depending on the scenario that unfolds. There will be a trade-off between preferring to pick names with good fundamentals in the face of higher idiosyncratic risk and considering higher beta bonds if the cost of financing is reduced.

Josep Maria Pon, CIIA
Head of Fixed Income and Monetary Assets

Evolution of ECB refinancing rate



Source: Bloomberg

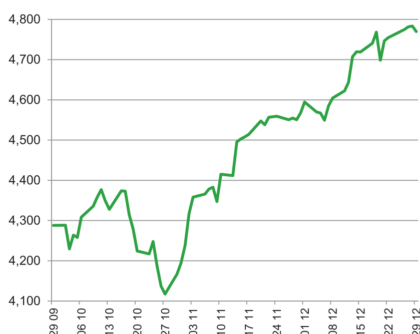
After the fastest and most aggressive rate hike, the rate cut is expected to begin.

Evolution of US inflation

Source: Bloomberg

There is a global disinflationary trend, which would allow central banks to start lowering interest rates.

S&P 500



Source: Bloomberg

The market was driven higher by a steep drop in interest rates.

Yield of US 10 year Treasury

Source: Bloomberg

The market decline was driven by a sharp rise in interest rates.

Rate cuts coming in 2024

Many Wall Street strategists are forecasting a moderately good year for the S&P 500 in 2024. They see a soft landing for the US economy, continued improvement in inflation, a Fed that will cut rates in 2024, a double-digit increase in S&P 500 earnings, and another good year for the stock market.

The rally at the end of 2023 has been predicated in large part on the thinking that the Fed will be cutting rates in 2024. Not so much because it has to respond to a rapidly deteriorating economic environment, but it brings rates back down due to inflation steadily retreating towards the Fed's two percent target. Rate cuts are typically thought to be good for the stock market, but you want rate cuts happening for the right reasons. In this case, that would be inflation getting back to the Fed's target without a concomitant recession. Recessions are bad for corporate earnings and hence equity valuations.

Prior to the better than expected November employment report, the fed funds futures market had been pricing in five rate cuts before the end of 2024. This view has been priced in even though at the time, most Fed officials were still suggesting they were not thinking about rate cuts. Fed Governor Waller came the closest in saying that the policy rate could be lowered if inflation continues to fall for several more months.

> "Opportunity comes to the prepared mind."
> -Charlie Munger

Those expectations retreated a bit in the following weeks, but then shifted towards even further cuts after the December FOMC meeting which left the market expecting six rate cuts. In that fateful meeting, Fed Chairman Jerome Powell said that the Fed had begun discussions on when it would be appropriate to start cutting interest rates. Treasury yields plummeted lower and stock prices took another parabolic step higher that sent the Dow Jones Industrial Average to a record closing high and the S&P 500 within striking distance of its own record.

Additionally, lest not forget that 2024 is a Presidential election year in the US. Market performance during Presidential election years tends to be very positive with the average return since 1928 being over 11%. Furthermore, in every single election since 1944 that involved an incumbent running for reelection, the market returns were positive. Apparently, the market appreciates political stability with a President who is a known quantity. The current front runners for the 2024 election are the current incumbent (Joe Biden) and the previous incumbent (Donald Trump).

Of course, not every strategist is bullish on 2024. A couple are downright bearish, thinking that the effects of the Fed's aggressive tightening cycle will show in 2024 and drive the economy into a recession. This in turn means the labor market will deteriorate, corporate earnings will disappoint, and the stock market will fall. However, these opinions comprise a very small minority. Another risk for the market is that the Fed, which waited far too long to raise rates and watched inflation run amok, now waits too long to lower rates out of fear of cutting rates too soon and inflaming inflation again. The market would likely be agitated by this thinking, particularly if inflation keeps coming down, sensing that there would be a heightened risk of recession with real rates staying too high for too long.

The good news that at least partially counteracts the bearish thesis is that the Fed has room to cut rates to support economic growth, if need be, which is some ammunition it lacked for the better part of the last 15 years.

Charles Castillo
Senior Portfolio Manager

Commodities and Currencies

COMMODITIES

Geopolitics

Nowadays it is difficult to imagine more international conflicts fuelled by disputes over oil. Yet, it is nothing new. Past examples that have gone down in the history books include the first Gulf War in 1991, the invasion of Iraq in 2003, the Iranian coup d'etat in 1953 and the 1973 Yom Kippur War, which many compare to the current situation.

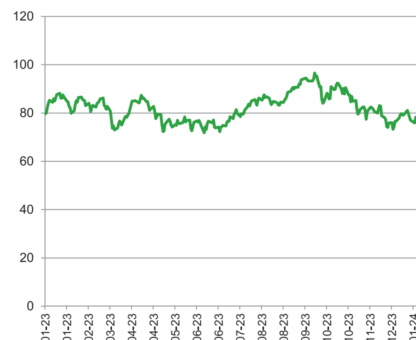
These are just a few examples, but the list of conflicts in key areas for oil-producing countries is extensive. Thus, a pattern can be drawn of what usually happens to the price of oil at times like this. It tends to rally when the conflict breaks out, and then it falls back to pre-conflict levels as the situation becomes clearer.

The International Energy Agency tempered the mood in its October report by drawing a distinction between the current situation and that of 1973. In the words of the Agency, "fifty years on from the first oil shock, the world has lasting solutions to address energy insecurity that can also help tackle the climate crisis". In the IEA's opinion, and in the context of new geopolitical tensions, countries have "a much broader range of highly competitive clean technologies at their disposal, and an accumulated wealth of policy experience on how to accelerate their deployment". In any case, alternatives to fossil fuels are neither easy nor immediate, as already shown by the drastic rebound in natural gas in the wake of the war in Ukraine, but it is true that countries today are capable of obtaining alternatives.

Thus, the almost $100 per barrel seen recently after the attacks in Israel would be a medium-term ceiling for the Brent and it makes sense that it would gradually fall back.

Miguel Ángel Rico, CAIA
Chief Investment Officer at Creand Asset Management in Spain

Brent Crude Oil



Source: Bloomberg

Brent crude oil prices picked in October.

CURRENCIES

It all depends on who cuts first!

The euro-dollar exchange rate has moved in a trading range of 1.05–1.12 for most of 2023. The relative strength of the dollar can largely be explained by the differential in real interest rates and the resilience of US economic growth, which has surprised more than one. The exchange rate ended the year at the upper end of the range, as positive inflation data and the surprise Fed pivot in December put pressure on the dollar, with the market discounting a soft-landing for the economy, continued moderation in inflationary pressures and rate cuts by March. A goldilocks scenario to say the least!

For the dollar to break out and depreciate further, we will need to have confirmation of the Fed's pivot and see the US cut rates more than in other regions—if the US were to fall into a recession quicker than expected, for example. However, the risks versus market pricing are that the Fed easing cycle is delayed. There is also now very little safe-haven risk premium priced into the USD despite geopolitical risks. And after the extremely positive performance of markets during 2024, potential corrections would also play in favour of the greenback. It is not just about the US, however. The timing and speed of change in monetary policy for individual central banks will play a major role for each currency in 2024. Parity or below levels are achievable if the ECB is first to cut rates.

It is always a daunting task to predict where currencies are heading and probably a futile exercise, as there are always unknown risks. Yet, the most probable outcome is that the dollar stays range-bound while awaiting more clarity on inflation's progress and central banks' next actions.

Jadwiga Kitovitz, CFA
Head of Multi-Asset Management and Institutional Accounts

Euro dollar exchange rate

Source: Bloomberg

The euro-dollar exchange rate has moved in a trading range of 1.05–1.12 for most of 2023.

Latin America

YPF S.A - ADR

Source: Bloomberg

YPF stocks bounced back strongly after Javier Milei's election win, with the privatisation plans promised during his campaign.

Sovereign bonds that expire in 2030

Source: Bloomberg

Argentine sovereign bonds, valued in USD, which still find themselves in a state of distress, rebounded following the election of the new government.

All or nothing

The market is reacting favorably to the first shock measures of the new president of Argentina, Javier Milei.

On 20 November, shares of Argentinian state-owned oil firm YPR soared 40% on the New York Stock exchange. Argentina's most heavily traded dollar ETF was up more than 10%, and dollar-denominated sovereign bonds also rose strongly. The reason: expectations among investors that the recent president elect, Javier Milei, would be able to reverse the country's dire economic and financial situation.

The erstwhile economic leader of the region has today become one of the countries with the lowest growth, after decades of bad governance, with the poverty rate exceeding 40% and moving inevitably towards hyperinflation. And all this in a country with extraordinary natural resources and a high level of human capital, and which remains a regional leader in terms of education.

Milei was very clear and convincing in his intentions during the election campaign, but it remained to be seen whether he would be able to make decisions that were as important as they were unpopular when he took office. In just two months in government, he has already taken far-reaching measures. The major ones concern the unprecedented fiscal adjustments to clean up the public accounts, and a significant exchange rate adjustment.

> The new government announced a sharp devaluation of the peso, from 400 pesos to the dollar to 800

The new finance minister, Luis Caputo, presented an ambitious fiscal adjustment plan to reduce the deficit by 5% of GDP. To achieve this, 3 points correspond to a direct reduction in public spending, while 2 points relate to temporary tax hikes. On the spending side, the most important items are the cut to transport and energy subsidies (1.3-point reduction); the suspension of tenders for new public works and the cancellation of those already tendered but not started (1.1); and the reduction to discretionary transfers from the national government to the provinces (0.3).

In terms of the exchange rate adjustment, the new government announced a sharp devaluation of the peso, from 400 pesos to the dollar to 800. This does little more than bring the official rate towards the market rate, which is currently closer to 1,000 to the dollar. This measure aims to reduce the heavy subsidy to importers, who manage to buy dollars at the official rate, and also to stop penalising exporters, who receive fewer pesos for each dollar sold abroad.

In addition, Milei's government are working on drastically reducing the central bank's interest-bearing financial liabilities, i.e., the Leliqs (28-day term) and Pases (1 or 7 days). To this end, Milei has decided not to sell assets, but rather to issue Treasury Bills and above all to "liquefy" this debt, paying below inflation interest rates, and thus progressively reducing the real value of these debts. This measure is not free from risk, as lower rates may lead to further depreciation of the peso.

For now, the market is giving Milei some confidence. The Treasury has recently placed 28-day Treasury Bills at an annualised interest rate of 104%, below the 130% that it paid for the Leliqs. This is in the context of even greater inflation due to the impact of lower subsidies to importers, who pass on their higher costs in the form of higher prices for the consumer.

We do not yet know the outcome, but we cannot say that the new executive is not being brave. Few, if any, presidents have been met with cheers after shouting "there is no money"

Juan Gestoso Ruiz
Investment analyst

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