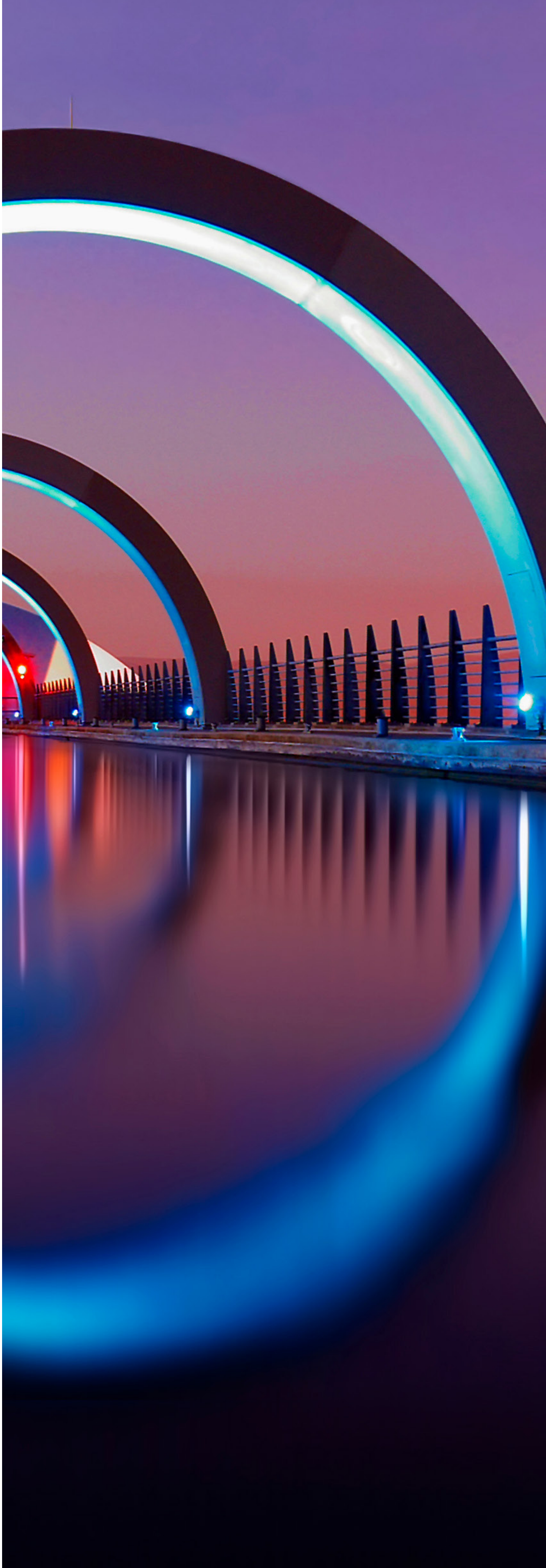
December 2023

OUTLOOK 2024 – CHALLENGES AND OPPORTUNITIES

INTRODUCTION

GAM's purpose is to protect and enhance our clients' financial future. By attracting and empowering the brightest minds to think beyond the obvious, we strive to provide investment leadership, innovation and a positive impact on society and the environment.

By living our purpose every day, we believe that we can realise our vision of building the most respected specialist active investment manager and trusted solutions and services platform in the world.



Online Edition

FOREWORD

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Welcome from Group CEO, Elmar Zumbühl

In the ever-evolving landscape of global finance, standing still is not an option. As we turn the page to 2024, we at GAM stand ready to embrace the challenges and opportunities this new year holds. Our heritage, deeply rooted in Swiss precision and complemented by our expansive global presence, has afforded us a platform of extraordinary reach and capability. For four decades, we've offered our clients not just services and solutions, but gateways to some of the world's most impressive investment acumen. GAM's global platform provides access to great investment talent.

This current volatile, uncertain, complex and ambiguous world is changing fast. As a globally active investment manager we are well positioned internationally to understand local risks and mitigate the impacts of macroeconomic events on our portfolios. Our investment teams' expertise and specialisms are overlayed by robust investment processes and risk control frameworks which we believe contribute to positive investment outcomes for our clients. Investment performance at GAM continues to be strong, with 82% of Assets under Management (AuM) in GAM funds outperforming their benchmarks over three years as of 30 September 2023.

Our partnerships and investment teams are the heartbeat of our organisation, and we have cultivated an environment that empowers them to excel. With a sharp focus on aligning our solutions and innovative capabilities with the dynamic demands of our clients, we're not just preparing for their future; we're helping them shape it. As the global finance landscape changes fast, we invite you to delve into our Investment Outlook for 2024, where our experts share their views.

We are proud to invest for you, working hard to target the best outcomes and we thank you for your business.

A message from Global Head of Client Solutions, Rossen Djounov

Welcome to the gateway of opportunity that is 2024. In a world where certainty is a luxury and change is the only constant, GAM's international reach and local knowledge offer a range of distinctive investments and excellent client service. Our global team is well-versed in the art of turning macroeconomic challenges, combined with rigorous company research, into tailored investment opportunities that resonate with the unique profiles of our clients wishing to diversify their portfolios with something beyond the obvious and different.

As an independent active asset manager with specialist and distinctive investment capabilities, our global sales team is poised to guide you through GAM's diversified investment landscape, showcasing strategies designed to thrive amid market fluctuations and deliver solutions which fit with our clients' needs. Whether it be the resilience of our High Conviction Equities, the innovative edge of our Specialist Fixed Income, the creative solutions within our Alternatives, the balanced approach of our Multi-Asset offerings, or the forward-thinking of our Sustainable Investing, our 2024 Investment Outlook is your compass to navigating the future.

Let's embrace the year ahead with confidence, always mindful that with the right partner, even the most challenging conditions can be navigated successfully.

Join us as we explore the potential that awaits in 2024, and please do follow us on LinkedIn or contact us to find out more.

Elmar Zumbühl
Group CEO

Rossen Djounov
Global Head of Client Solutions

GAM LinkedIn

SUSTAINABILITY

SUSTAINABILITY

Stephanie Maier, Chief Sustainability Officer

Sustainability – Stakes are increasing as sustainability-related risks and opportunities face greater scrutiny

To misquote Mark Twain, 'Reports of ESG's death have been greatly exaggerated'. While 2023 saw the term ESG challenged, the environmental, social and governance challenges that this acronym represents will continue to shape the investment and regulatory landscape; in many cases exacerbated by geopolitics and physical impacts of climate change.

The disorderly transition

The stakes are increasing as both climate-related physical and transition risks are becoming more impactful. On the physical side, we are already seeing extreme weather events on a more regular basis, and these are expected to increase in frequency. Coupled with the El Niño, this could extend the already record-high temperatures we have seen towards the end of 2023 into 2024 – impacting agriculture and food supply, manufacturing, and human health – and increasing the focus on resilience and adaptation.

On the policy front, just 12 months on from the introduction of the US Inflation Reduction Act, it has reportedly created more than 170,000 clean energy jobs and led companies to announce over USD 110 billion in clean energy investment. The European Green Deal, with ambitious targets and measures such as the Carbon Border Adjustment Mechanism, regulating carbon-intensive products imported to the EU, such as cement, iron and steel, fertiliser and electricity, could have a significant impact on supply chains, pricing and where companies chose to locate.

The investment opportunities for the transition are evident in the acceleration of clean energy innovation. So too are the challenges, dependencies and potential trade-offs associated with, for example, the growing demand for critical minerals, grid infrastructure and connectivity. And the potential impact of transformative technologies, such as generative artificial intelligence (AI) and automation are all still to be fully understood.

The question is how these complex dynamics will play out – delayed or accelerated action, competition and innovation or friction in global trade? National policies, incentives and responses will need to be much more closely watched and, as we have seen from recent UK policy announcements, liable to change.

Our nature (inter)dependency

With over half the world's GDP reliant on nature and with the huge potential of nature-based responses to provide cost-effective solutions on both climate mitigation and adaptation, our dependency on nature and the interdependency with addressing the climate challenge is increasingly understood.

Building on the Taskforce on Nature-related Financial Disclosures issued in September 2023, and the publication by the Network for Greening the Financial System, comprising over 100 central banks and supervisors globally, of a framework to assess the interactions between nature, the macroeconomy and the financial system, we expect to see a continued focus on nature from investors and regulators.

Stephanie Maier
Chief Sustainability Officer

Progress in 2024 at COP16 on the Kunming-Montreal Global Biodiversity Framework and National Biodiversity Strategy and Actions Plans will be critical to determine the speed with which policy and finance will mobilise behind the target to halt and reverse nature loss by 2030 and plug the estimated annual USD 700 billion biodiversity finance gap.

Sustainability disclosure no longer optional

Up to 50,000 companies in the EU and non-EU companies with EU subsidiaries or regulated entities will be subject to mandatory sustainability reporting under the EU Corporate Sustainability Reporting Directive (CSRD), being introduced from 2024. This will include a requirement to disclose a climate transition plan. Set to work alongside this disclosure regulation, the proposed EU Corporate Sustainability Due Diligence Directive (CSDDD), once introduced, will also require companies to monitor their supply chains for the risk of violations of human rights and negative environmental impacts. We also expect developments in the US with proposals for the Securities and Exchange Commission (SEC) Climate Disclosures under consideration, and the SEC Human Capital Disclosures that require companies to disclose human capital measures.

This mandatory reporting will be supplemented with industry standards such as the IFRS sustainability and climate standards issued by the International Sustainability Standards Board (ISSB) and the UK Transition Plan Taskforce guidance.

Sustainability disclosure and labelling will also step up in 2024 with proposals from the European Securities and Markets Authority, Financial Conduct Authority and SEC all setting more detailed parameters for sustainability-related funds.

As regulators, supervisory authorities and investors seek greater transparency and accountability, we expect data and disclosures to face greater scrutiny as they are integrated into the investment process.

About Stephanie Maier

ACTIVE EQUITIES

ACTIVE EQUITIES

Jian Shi Cortesi, Investment Director, Asia/China Growth Equities

Asia & China Growth Equities – An exciting market with mispriced opportunities

Asia: A growth story with low valuation
Asia offers a compelling combination of strong secular growth and low valuation, while China and other Asian countries remain the key drivers for global growth. According to International Monetary Fund (IMF) data, Asia will have contributed approximately 70% of global growth in 2023, and we expect this share to remain high in 2024. China is likely to achieve 4-5% GDP growth, with the support of all the policies rolled out in 2023. Taiwan and Korea should benefit from the recovery in the demand for semiconductors and some technology hardware. Meanwhile India should sustain its robust growth momentum, thanks to the expansion of its manufacturing sector.

Technology: A key growth area in Asia
One of the sectors that is driving the growth in Asia is technology. First, semiconductor-related industries are booming in China, as it aims to achieve self-reliance on semiconductors after the US-imposed restrictions on semiconductor sales to China. All related areas, from electronic design automation (EDA) software to foundry, are growing fast in China. Second, India and Southeast Asia are benefitting from technology supply chain relocations, particularly related to assembly. Third, Chinese internet players are increasingly targeting overseas markets in their pursuit of further growth beyond domestic markets. Examples of this are Temu (launched by PDD), Shopee (a Singapore-founded company backed by Tencent), Lazada (a subsidiary of Alibaba), TikTok (a subsidiary of ByteDance), and SHEIN (a private Chinese company). Southeast Asia has been an attractive market compared with the US, Europe or Latin America because of its greater growth potential and high consumer acceptance. The e-commerce retail sales volume in Southeast Asia witnessed fivefold growth from 2016 to 2021, according to McKinsey. We expect industry consolidation and strategy shifts towards profitable growth in the coming years.

China: A shift to high-value-added industries
Another factor that is shaping the growth in Asia is the transition of China from a real estate-driven economy to a more diversified and high-value-added one. Asia equities are undervalued, as they have suffered from excessive selling pressure. The MSCI Asia ex Japan Index is currently at the bottom of its historical range. Over the past three years, China has been the main drag on Asia equity performance, while other Asian markets have fared relatively better. The MSCI China Index has plunged almost 60% from the previous peak in 2021 (as of 31 October 2023). The Chinese economy is undergoing a major transition to reduce its dependence on real estate construction and to pivot towards high-value-added industries.

In 2024, we expect lacklustre property construction and the relocation of low-end manufacturing to cheaper countries will continue to weigh on economic growth. However, we believe speeding up the bankruptcy and asset liquidation process of the troubled developers will help the real estate market return to a healthy state. On the other hand, we believe the key drivers of economic growth in China in 2024 will include advanced manufacturing (such as aircraft and robotics), new energy equipment (such as solar), electric vehicles, consumption focusing on experience (such as travel), technology self-reliance (such as AI and semiconductors), as well as healthcare and biotech.

Given the counter-cyclical nature of Chinese policy, we believe the Chinese government will maintain the supportive policies next year to stabilise property sales and to support economic growth. Low inflation offers room to keep the expansionary monetary policies. We believe that economic growth will also be supported by fiscal spending on social housing and the domestic spill-over effect from the One Belt One Road initiatives.

Jian Shi Cortesi
Investment Director

A market with mispriced opportunities

Despite the challenges and uncertainties, we find the current market environment exciting with ample stock investing opportunities, especially in China. The MSCI China Index has lagged behind the economy and corporate earnings growth for 10 years. We believe the areas with the highest level of investor misconception offer the most interesting opportunities.

Many companies have delivered good earnings results, but some have so far been ignored by the market. We have seen some stocks react positively to earnings improvements, such as education companies. Many Asian companies have a large amount of cash and have announced share buyback plans. Large cash levels also enable dividend payout increases. Both could boost the stock prices.

We see opportunities in these areas:

- The technology cycle is recovering in Asia, benefitting semiconductor and hardware manufacturers in Korea, China and Taiwan.
- AI is emerging as a timely catalyst. AI-related names, such as Chinese internet companies with AI capabilities, are well-positioned for growth.
- Secular growth in travel and education, including overseas test preparation and online travel platforms, is driven by the rising middle class and demand for quality experiences.
- Electric vehicles and battery makers, where industry leaders have a competitive edge in the fast-growing market.
- Secular growth in healthcare and the rise of biotech in Asia, including some of the leading pharmaceutical companies and contract development and manufacturing organisation (CDMO) names in India, Korea and China, is supported by the aging population, health awareness and biotechnology innovation.

About Jian Shi Cortesi

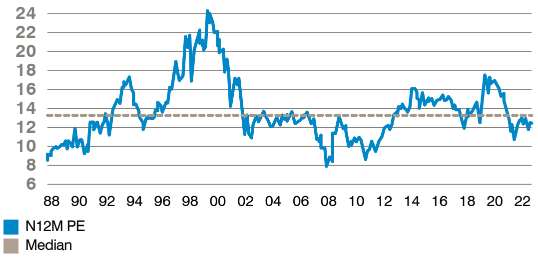
ACTIVE EQUITIES

Niall Gallagher, Investment Director, European Equities

European Equities – We remain positive on the prospects for the European banking sector; market pricing of the stocks has failed to appreciate the sustainable nature of the increase in earnings and return on equity from a return to positive interest rates

We think the prospects for further accretion in the value of European equities into 2024 are positive. The European equity market (as represented by the MSCI Europe Index) remains attractively valued on 12.5x forward earnings, which is below long-term median values and the expected earnings growth for the next two years is 6% for 2024 and 9% for 2025[1], respectively. The prospective dividend yield is also very attractive at 3.7%[2] (and well above median values) while share buybacks are becoming an increasingly important component of the European market, driven by banks and energy sectors and add about 2% to the dividend yield leading to an overall distribution yield of 5.7%. Despite the negative sentiment around the European economy, it is important to remember that only 42% of the revenues of the MSCI Europe index are derived from western Europe, with most revenues now derived from faster growing parts of the world; this changing exposure ultimately serves to increase the structural growth rate of the asset class. The forward price/earnings multiple of our strategy (a weighted average forward price earnings multiple of the strategy's holdings) is in line with the MSCI Index illustrating a lack of style bias at the present time, consistent with our style agnostic/ style flexible investment process.

European forward valuation multiples I



Source: Morgan Stanley, as at 6 December 2023. Past performance is not an indicator of future performance and current or future trends.

European forward valuation multiples II

Source: Morgan Stanley, as at 6 December 2023. Past performance is not an indicator of future performance and current or future trends.

Niall Gallagher
Investment Director

[1]Source: Bloomberg, as at 6 December 2023

[2]Source: Bloomberg, as at 6 December 2023

1992 Berkshire Hathaway Annual Report

Our equity-investing strategy remains little changed from what it was fifteen years ago, when we said in the 1977 annual report: "We select our marketable equity securities in much the way we would evaluate a business for acquisition in its entirety. We want the business to be one (a) that we can understand; (b) with favorable long-term prospects; (c) operated by honest and competent people; and (d) available at a very attractive price." We have seen cause to make only one change in this creed: Because of both market conditions and our size, we now substitute "an attractive price" for "a very attractive price."

But how, you will ask, does one decide what's "attractive"? **In answering this question, most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth." Indeed, many investment professionals see any mixing of the two terms as a form of intellectual cross-dressing.**

We view that as fuzzy thinking (in which, it must be confessed, I myself engaged some years ago). In our opinion, the two approaches are joined at the hip: Growth is always a component in the calculation of value, constituting a variable whose importance can range from negligible to enormous and whose impact can be negative as well as positive. **In addition, we think the very term "value investing" is redundant.** What is "investing" if it is not the act of seeking value at least sufficient to justify the amount paid? Consciously paying more for a stock than its calculated value - in the hope that it can soon be sold for a still-higher price - should be labeled speculation (which is neither illegal, immoral nor - in our view - financially fattening).

Whether appropriate or not, the term "value investing" is widely used. Typically, it connotes the purchase of stocks having attributes such as a low ratio of price to book value, a low price-earnings ratio, or a high dividend yield. Unfortunately, such characteristics, even if they appear in combination, are far from determinative as to whether an investor is indeed buying something for what it is worth and is therefore truly operating on the principle of obtaining value in his investments. Correspondingly, opposite characteristics - a high ratio of price to book value, a high price-earnings ratio, and a low dividend yield - are in no way inconsistent with a "value" purchase.

Similarly, business growth, per se, tells us little about value. It's true that growth often has a positive impact on value, sometimes one of spectacular proportions. But such an effect is far from certain. For example, investors have regularly poured money into the domestic airline business to finance profitless (or worse) growth. For these investors, it would have been far better if Orville had failed to get off the ground at Kitty Hawk: The more the industry has grown, the worse the disaster for owners.

The investment shown by the discounted-flows-of-cash calculation to be the cheapest is the one that the investor should purchase - irrespective of whether the business grows or doesn't, displays volatility or smoothness in its earnings, or carries a high price or low in relation to its current earnings and book value. Moreover, though the value equation has usually shown equities to be cheaper than bonds, that result is not inevitable: When bonds are calculated to be the more attractive investment, they should be bought.

Leaving the question of price aside, the best business to own is one that over an extended period can employ large amounts of incremental capital at very high rates of return. The worst business to own is one that must, or will, do the opposite - that is, consistently employ ever-greater amounts of capital at very low rates of return. Unfortunately, the first type of business is very hard to find: Most high-return businesses need relatively little capital. Shareholders of such a business usually will benefit if it pays out most of its earnings in dividends or makes significant stock repurchases. Source: Berkshire Hathaway, as at 31 December 1992.

A broad mix of performance drivers over the course of 2023 – despite running a concentrated/focused investment process – is testament to our mantra of driving both stock selection and portfolio construction through taking idiosyncratic risks and avoiding being dragged into the tedious growth versus value box sorting; we think this is the most appropriate way of managing money and generating long-term alpha, and hopefully helps us avoid being stuck in cognitive traps where we have to justify owning expensive stocks, or value traps because of adhesion to a proclaimed style bias. We remind readers of one of our favourite Warren Buffet quotes from the 1992 Berkshire Hathaway Annual Report.

Looking into 2024 we remain positive on the prospects for the European banking sector; market pricing of the stocks has failed to appreciate the sustainable nature of the increase in earnings/return on equity (ROE) from a return to positive interest rates. We think a return to the extreme interest rates of 2008-2021, which represented a multi-century low in rates, according to the Bank of England, is highly unlikely yet this is what is priced into share prices. As long as interest rates remain above 2% banks can continue to earn attractive ROE, which are well above any conservative estimate of the cost of capital, yet most of the sector still trades at a discount to book value despite returns on tangible equity between 12 and 20% for most stocks; this makes no sense.

The energy sector shares some of the same ‘market characteristics’ as the banks sector with very low valuations relative to history and high cash returns, through dividends and buybacks. We think this may in part be due to many investors refusing to invest in this sector – either because their mandate precludes it or because they have forgotten, or do not know how to analyse the sector as with banks (all very poor excuses). We have articulated the view many times over the past three years that we expect the oil price to remain in a higher price range over the next decade given a significant reduction in global capital investment in hydrocarbon extraction into a (still) rising demand picture, driven by developing/non-Organisation for Economic Co-operation and Development -(OECD) countries desiring the same middle-class living standards we enjoy in the OECD. We would add to this that shortages and price inefficiencies are likely to occur across the energy spectrum due to insufficient capital investment and this will offer profit opportunities in a whole range of areas across refining, trading, liquefied natural gas (LNG), marketing and retail operations – indeed one could not invent a better set of badly thought through and woefully implemented public energy policies than those we have at present across Europe, that provide for attractive profit making opportunities for energy companies and attractive returns on capital employed. It is also critical to remind readers that we see a very large role for European integrated energy companies in the energy transition and indeed believe that the energy transition will not be possible with the engineering expertise and financial clout of European energy companies; European companies are active across activities such as solar and wind power deployment (onshore and offshore), green and blue hydrogen, electric vehicle (EV) charging roll-out, biofuels, sustainable aviation fuel, carbon capture and storage, and we will continue to support them in their efforts to decarbonise our societies.

Outside of banks and energy we retain significant exposure to parts of the market benefiting from strong structural growth drivers, where we strive for our holdings to be best in class globally and where the equity is attractively/appropriately valued. We believe the most interesting such area is semiconductor and semiconductor capex-exposed technology companies encompassing our holdings in Infineon, STM, ASM International, BE Semiconductor and Atlas Copco. The single biggest drivers of Infineon and STM is the automotive sector where the transition to EV and the growth of safety and autonomous driving will dramatically increase the semiconductor content per car (by a multiple) such that increased penetration of these technologies power secular growth. What we particularly like about automotive semiconductors (across the range of automotive applications) is that once designed into a vehicle there is typically strong persistence of demand as automakers tend not to change semiconductor components absent a major redesign of the vehicle; over and beyond this, we see very strong growth from broader electrification trends such as renewables and the explosive growth in data centre power requirements. It seems hard to believe that Infineon and STM trade at close to decade low valuations given the strong position they enjoy in their respective segments, and the much higher levels of valuations US peers trade on in addition to the strong structural growth. Our semiconductor capex stocks, ASM International and BE Semiconductor have both experienced extraordinary share price appreciation in 2023 and are trading at multiples closer to the top of their historic ranges, which has encouraged some profit taking on our part, but we remain attracted by the very powerful structural growth drivers requiring semiconductor 'shrink' beyond lithography.

Other areas where we see an attractive combination of valuation, structural growth and decent returns are in industries that we expect to see strong impetus from decarbonisation and the transition to net zero. Stocks exposed to electrification where a 2-3x increase in electricity generation transmission and distribution is required by 2050 include Prysmian, Schneider (and of course Infineon and STM); stocks exposed to the building envelope with a need for stricter new build standards on thermal efficiency and new build include Kingspan and Saint Gobain; while stocks exposed to green and blue hydrogen include Linde, Atlas Copco as well, of course, as our energy holdings. The transition to net zero is going to require a monumental pick up in physical capital expenditure – far higher than politicians have explained to their electorates – and this will be a strong demand driver for many of our portfolio companies with the right exposure.

Beyond the above exposures, driven by identifiable structural growth drivers, we have several large exposures with strong idiosyncratic drivers. Such stocks include Ryanair, Volvo Trucks, Novo Nordisk and Inditex. The key driver of Ryanair is the juxtaposition of a very strong market position in short- haul intra-European aviation, combined with well controlled and established costs and a strong delivery schedule of new planes at a time when the industry is supply constrained and customer demand is normalising post-Covid; the stock trades on an exceptionally low valuation and is about to become very cash generative driven by rising fares and falling capital intensiveness. The company also leads the aviation sector in 'greening', having very low carbon emissions per passenger KM and a clear strategy to deploy sustainable aviation fuel. Novo Nordisk continues to power forward on the back of explosive demand for its transformative weight loss drugs and excellent results from clinical trials focused on cardiovascular and kidney disease risks. We are big bulls on the long-term potential of these drugs to improve human health but the path will not be a linear one and valuations are elevated versus history.

About Niall Gallagher

ACTIVE EQUITIES

Mark Hawtin, Investment Director, Disruptive Growth Equities

Disruptive Growth – We see a base case scenario that is very compelling for growth equities

Risk assets did better in 2023 than many had expected at the start of the year as economic activity remained strong, driven by strength in the cash-rich consumer and the apparent taming of the inflation dragon. 2024 will not have the benefit of these two factors - in fact they may well prove to be headwinds as stubborn core inflation remains persistent and consumer cash levels run low. This latter factor is starting to show up in more depressed outlooks for discretionary spending – on a micro level visible in retail spending, payments volumes and basic services like food delivery.

The 2023 equity market picture was not all as robust as the headline numbers might suggest. While the S&P 500 index has tacked on close to 20% returns, the S&P equal-weighted index has hardly risen at all. Further down the risk curve, the Russell 2000 is also broadly flat for the year. Returns have been highly dependent on the 'Magnificent 7' (M7) (Apple, Alphabet, Amazon, Meta, Microsoft, Nvidia, and Tesla). The Goldman Sachs mega-cap basket of stocks is up 70% year-to-date (at the time of writing)! Not owning these names has been a significant drag on performance. We believe there were three factors at play in the strength of these names. First, investors sought big, liquid, safe and relatively cheap equities. Second, heading into 2023, there was concern over economic growth and a good proportion of these names rely on economically sensitive revenues like advertising (Alphabet and Meta) or retail (Amazon). This led to some of the M7 being sold off at the end of 2022. Third, May 2023 saw the real results of ChatGPT's launch late last year, with one of the biggest blowout earnings reports from any large company ever coming from Nvidia.

When we put all the 2023 drivers together we see a base case scenario that is very compelling for growth equities. It is likely that inflation will remain stubborn but in a more palatable range below 4-5%. This would allow interest rates to remain 'peaked'. The mere sniff of softer economic growth in November and the more than 50 basis points decline in US 10-year yields led to a sharper move up in equities. Growth fundamentals have not blinked, with over 90% of S&P technology company earnings beating expectations in Q3 2023. We do not expect the next few quarters to be any different. Growth remains strong. However, the valuation of the M7 now appears stretched relative to the market. On the broadest measure, the S&P 500 trades on 18x 2024 expected earnings (Goldman Sachs); this is above the average levels of the last 30 years. However, the equal-weighted S&P trades at 14x 2024 earnings, at the lower end of the average 30-year range. The forward PE of the M7 names is 29x and this, we believe, is the key factor in our base case that growth equities will remain robust but that the winners will come from below the M7 names. The artificial intelligence (AI), healthcare, storage, and Software as a Service (SaaS) themes will drive the best returns, in our view – it is a bottom-up stock pickers' market for 2024.

The wild card for disruptive growth will be China, where valuations have sunk to ridiculously low levels. Efforts to stimulate growth in the Chinese economy against a backdrop of ultra-low inflation should be rewarded with outsized returns in equities and for this reason, we believe the macro and geopolitical risks are more than priced in.

In summary, we believe growth equities will continue to perform well in 2024, led by names outside the M7, with China as a good risk/reward wildcard.

Mark Hawtin
Investment Director

About Mark Hawtin

ACTIVE EQUITIES

Flavio Cereda, Investment Manager, Luxury Equities

Luxury Brands – Stock picking in 2024 will be more important than at any time since 2016

Q3 results validate process of growth 'normalisation', albeit at different speeds

Once the post-Covid China reopening trade started to fade, and US comparable metrics started to look very tough, the trend towards a more sustainable rate of growth became evident, and as you can probably date this to the start of the holiday season, it was in the Q3 or June-September prints that this became obvious. While relative underperformance started earlier (channel checks, credit card data, post-H1 conversations with management) – effectively in mid-summer – results season unequivocally highlighted this. 2023 was a year of two halves: H1 starting very buoyant and maintaining momentum in Q2, with H2 more challenged on a year-on-year basis and a return to normal growth dynamics which we think will also be evident in H1-24. What we are likely to witness once more is a flight to quality, with the stronger brands appearing to prove their resilience yet again with the upper end of the 'Luxury Pyramid' benefiting from more affluent and loyal customers, a less volatile demand pattern and significant pricing power as demand/supply imbalance remains skewed in its favour.

Flavio Cereda
Investment Manager

Luxury Pyramid – Life's better at the top

Source: GAM as at October 2023. The views are those of the manager and are subject to change The mentioned financial instruments are provided for illustrative purposes only and shall not be considered as a direct offering, investment recommendation or investment advice. Logos are trademarks of their respective owners and are used for illustrative purposes and should not be construed as an endorsement or sponsorship of GAM. Past performance is not an indicator of future performance and current or future trends.

Why the deceleration and is it a good thing?

We have to put current trends in context. If we track performance over the longest possible credible period, ie back to 1995, we see the sector growing at a Compound Annual Growth Rate (CAGR) of 6.5% which is a remarkable number in that it implies growth from EUR 66 billion to EUR 343 billion last year. The CAGR since the Global Financial Crisis or from 2010 is 6.4%, delivering further evidence that a mid-single digit metric is not only sustainable but very credible. The sector plunged 22% in 2020 as is known, but fully recovered and more in 2021 when the total value exceeded 2019. And herein lies the challenge: post-Covid recovery, set at different times for different geographies, was abnormally strong, delivering +29% in 2021 and +21% in 2022.

These metrics are neither sustainable nor healthy in our view, although they do underline the never-ending appetite for the space amongst consumers globally. What is commonly referred to 'normalisation', or a 6-7% yearly growth, is inevitable and significantly more resilient than elsewhere. So yes, it is a good thing as 20%+ growth had blinded the market to the most important of considerations: sustainability. We currently forecast 9-10% growth for the sector in 2023, dropping to 5% in 2024 and 6-8% in 2025.

Is the sector in good shape?

Absolutely. Let us look at it from the point of view of both the consumer and the brands.

The consumer of luxury has been increasingly Asian for a number of years, with the US cohort holding its own whereas the European buyer is increasingly less relevant. We believe Asians now account for well over 50% of total spend or similar to 2019 again, only in the context of a sector that is a third bigger. The well-known drivers here, especially in China, such as demographics, growth of the middle class and the importance of social status, continue to deliver an insatiable appetite for luxury further lifted by post-Covid's travel preference of the Chinese to stay within Asia. The US buyer historically always under indexed in luxury but has recently increased from low- to mid-20s as there has been more interest in the sector after 2020, driven not only by a return to travel and the quest for experiences, but also by the success of the better brands to significantly broaden their reach across categories and trigger a much greater response from younger consumers through involvement in the likes of sports, music and entertainment. The US buyer travelled extensively to Europe in 2022-23 alongside Asians (less so Chinese) and Middle East consumers, hence why Europe is much more relevant for luxury than the Europeans, and will stay this way. The better brands are significantly bigger, much more profitable and better capitalised than perhaps they ever were, leaving them in a strong position to manage any possible short-term volatility. They have better distribution, more pricing power and have become very effective on social media; all of this matters.

Is China a risk or an opportunity?

China is an incredible opportunity with an element of risk. The propensity of the Chinese consumer to spend in luxury remains very high, the perceived 'status' element is just as important as ever, the brands are much better positioned to engage with the ongoing growth (more and improved stores, better digital, more effective on local social media), the price gap versus Europe has shrunk, the household savings rate is very high at over 40% (twice that of Germany), international travel is recovering but at a slower pace, the expansion of the middle class proceeds as expected and there is no evidence that the Communist Party has any concerns (the common prosperity narrative was never anti-luxury but rather anti-the excessive display of wealth and opulence: not the same thing at all). We think China will increase its spend in luxury by almost EUR 80 billion between 2025 and 2029.

The risk here would come from a change of policy but we see no evidence that this is the case. A deceleration in spend versus the abnormal peaks is not a risk; we already factor it in.

A sector or stock-led recovery?

As outlined, we think 2024 will see growth below the average but the better brands will continue to outperform. Indeed, we think that while momentum will stay positive in all geographies bar the US (2024 is also a notoriously volatile election year) it is becoming increasingly important to distinguish between the names that have simply benefitted from the general uplift in recent years (ie 'carried' by the current as opposed to self-propelled) and those that generally are well-positioned to grow market share further and deliver superior returns even, or rather especially, during more volatile times. Stock picking in 2024 will be more important than at any time since 2016.

Are shares attractively valued?

The recent derating across the board appears to have largely absorbed the expected slower rate of growth, as outlined above, having broadly returned to 2019 valuation levels. We think there is room for further adjustments, but it is particularly the weaker names that are more at risk here. Quality is, and always will be, more defensive and resilient, and yet leave these names in excellent stead for the gradual acceleration we expect to see in H2 2024. The sector remains a solid hedge versus inflation, supported by good cash generation, stronger balance sheets and the capability to support high margins driven by brand clout and underlying demand. Short-term wobbles are exactly that, which is why we are reassured by its time tested track record and very reliable foundations. The luxury consumer ''is last in, first out of volatile moments which we are in right now'' said the CEO of Saks in early November…in other words the last to restrain spending and the first to return…the best type of consumer.

How do we engage to succeed?

The broader definition of luxury brands encompasses both the actual set of brands themselves but also relevant names in adjacent sectors which overlap due to strong appetite from consumers with a very similar profile (ie affluent). We will focus on the more resilient quality names that we think are in a better position to weather current volatility and seek relevant related stories across categories that offer opportunity to secure greater upside.

About Flavio Cereda

ACTIVE EQUITIES

Tim Love, Investment Director, Emerging Markets Equities

Emerging Market Equities – Perceptions are way behind reality; the opportunity cost of missing a rally could be high

Emerging market (EM) equities are still under-loved, under-owned and undervalued, in our view – more so than at any time in the past decade. We believe that all they lack is a 'risk on' catalyst to release their inherently attractive upside returns and for investors to appreciate the more limited downside characteristics of the asset class. In short, to take the view that EM offer an enviable risk/return quadrant.

As international markets oscillate between 'Goldilocks' and 'higher-for-longer' sentiment, local domestic flows are growing meaningfully in India, China and Taiwan. This adds to the heady risk of a decade-long break out to the upside and a material risk of not being in EM equities when they finally turn.

What could the missing catalyst be?

There are a number of potential catalysts, including the US dollar and US Treasury yields peaking, post the US Dollar Index reaching 26-year highs. Both these would be very supportive for EM equities, especially EM value stocks. We believe EM equities are at a rare point in a multi-decade perspective, exhibiting highly attractive cyclical entry points, as well as considerable secular support – in our view, a confluence of events that is as powerful as it is rare. Cheap cross-asset EM equity valuations with large demographic dividends and GDP per capita gains (especially India) is a powerful tailwind. Even if global economic growth underwhelms, then EM equities are unlikely to meaningfully underperform the developed world, in our view. We believe that they are, however, likely to exhibit good relative upside performance in USD.

Drivers of EM equities include a multitude of factors. Cyclical and valuation supports include higher GDP and corporate top-line growth compared to developed markets (DM), as well as lower 'growth at a reasonable price' valuations with an accompanying EM yield attraction. EM equities should appeal to value, growth and yield investors, in our view.

EM equities have evolved

The asset class bears little resemblance to the old EM Index from a decade or more ago. In 2004 the index had only four investment grade (IG)-ranked countries in the top 11 country constituents – now that has risen to nine of the 11 top markets. Furthermore, EM debt and debt service dynamics, at both sovereign and corporate levels, are materially lower than DM economies. EM countries mainly avoided the quantitative easing decade of negative real rates and, instead, still have high 'positive carry trades', despite their central banks noting lower consumer and producer price inflation falls than that of nominal rates. And the two non-IG countries, South Africa and Brazil, have been relatively stable currencies, despite this choppy change in world GDP expectations.

The inclusion of centres of excellence in robotics/artificial intelligence (Korea/China), electric vehicles (EV) (China), global consulting (India), EV materials (South African platinum, Latin American (LatAm) lithium/copper, Malaysian rare earth minerals) and on-shoring high end industrialisation parks in Poland/Mexico and Vietnam/Romania, are all major foreign direct investment and earnings per share (EPS) sources for EM nations. These are not the same as agricultural and low value add end export economies of the 90s. This higher resiliency and quality facilitate a greater stability of EPS and a higher target for multiple expansion as and when it occurs.

The domestic demand in India is massive – see the number of new bank accounts in the past decade (greater than EU in total). Add on the China economy's scope to benefit from fiscal stimulus, and it leads to a long list of positive structural challenges. Note, in the short term, a 'command economy' like China can address economic challenges more directly from a coordinated state level.

Tim Love
Investment Director

The risk of being out versus in

EM equities are not far from their all-time low valuations and stock price levels, while the opposite applies in DM equities. 2010-2023 compares to a lost decade in EM equities in the Asian Crises and SARS years in 1994-2004, prior to its subsequent massive re-rating.

A possible taster of a catalyst was the impact of the evidence of lower cost of capital in late October/early November 2023. Equities rallied, bond yields fell, and the US dollar depreciated after the release of data showing cooler US headline and core inflation in October. The weaker-than-expected data bolstered hopes that the Federal Reserve's rate hiking cycle is over and that rates could be cut in 2024. In this environment, we expect EM equities to meaningfully keep outperforming cross-asset alternatives, as well as other DM equities.

The risk is clearly to being 'out' versus being 'in', but, in our view, EM equities are still being wrongly perceived as still supported by the EM EPS stream of the past. We believe perceptions are way behind reality. Nothing increases awareness quite as much as the fear of missing a rally when the opportunity costs of doing so could be high. Then we think awareness of the real merits of the asset class will shine though.

In our view, it seems EM equities are wrongly named, wrongly priced and fully misunderstood. We believe that a decent PER multiple re-rating will soon bring animal spirits back to the fore, as in 2004-08. We think this time could be equally breathtaking.

About Tim Love

ACTIVE EQUITIES

Lukas Knüppel, Investment Director, Japan Equities

Japanese equities – Unique investment opportunities are emerging in Japan in quality companies at reasonable prices

As we approach the beginning of 2024, we find ourselves at a pivotal juncture in various aspects of the investment landscape. On one hand, key industry indicators, such as machinery and robotic orders or the US Institute for Supply Management (ISM) Manufacturing Purchasing Managers Index (PMI), which strongly correlates with the industrial sectors in Japan, are bottoming out and showing signs of recovery. Global semiconductor sales are already rebounding. In addition, many industrial companies are successfully reducing the excess inventories that accumulated when consumer demand worldwide shifted abruptly from goods to services after the pandemic. These positive developments collectively suggest that the industrial sector in Japan is poised for a stronger performance in 2024.

On the other hand, companies that focus on domestic consumption and the service sector are poised for a return to more normal growth rates. This projection is based on a comparison of the expected performance in 2024 with the exceptional recovery witnessed in Japan after the post-Covid consumption boom and the resurgence of tourism that boosted domestic spending.

Earnings growth: Modest but with potential for upward revisions

Our 2024 outlook for listed Japanese companies is a mid-single-digit earnings growth in yen terms, followed by a further acceleration of 10% in 2025. While this may seem modest compared to the 10-year average growth rate of 8%, there is potential for upward revisions if our bullish scenario of a more pronounced recovery in manufacturing materialises in 2024.

Interest rates: Diverging from other central banks

There is a growing expectation that the Bank of Japan (BoJ) may end its long-standing negative interest rate policy in 2024, but any such move is expected to be relatively modest. Consequently, Japanese bank stocks have experienced a substantial re-rating in 2023, reaching their 10-year average valuations.

If the BoJ raises interest rates in 2024, it will be diverging from other central banks. The global economic landscape is characterised by a noticeable slowdown in inflation and a gradual easing of labour markets, which may contribute to the stabilisation of interest rates and the possibility of rate cuts, in the US and other countries.

Investment opportunities

Considering these factors, we believe unique investment opportunities are emerging for Japan equities, enabling us to invest in quality companies that have long been on our radar at reasonable prices. Despite the significant outperformance of value stocks, especially in the banking sector, in 2023, our commitment remains unwavering in adhering to our strategic, long-term perspective. We remain focused on participating in the value creation of growing companies in attractive sectors and leveraging structural trends. Our core objective continues to be investing in quality companies with robust margins and sound fundamentals.

Lukas Knüppel
Investment Director

About Lukas Knüppel

ACTIVE EQUITIES

Daniel Häuselmann, Investment Director, Switzerland Equities

Swiss equities – Pricing power will become even more important

The Swiss equity market faced another challenging year in 2023, after a difficult 2022. Share prices recovered massively from Oct 2022 to May 2023, but then underwent a major consolidation. The market was largely driven by macroeconomic factors and at the beginning of this year there was optimism that global economic growth would recover. However, the pandemic-induced recovery and the resulting strain on supply chains led to higher inventory levels. Initially, it was expected that the inventory adjustment would be over in the first or second quarter, but it took longer than anticipated. We expect this process to have been completed by the end of 2023.

The impact of interest rates and currency movements on Swiss equities

The Swiss equity market is highly sensitive to the current economic data and the resulting fluctuations in interest rates, especially after the interest rate hike in 2023. Swiss equities have faced downward pressure on their valuations due to the global increase in interest rates; as interest rates rise above negative or near-zero levels, investors have found alternatives to equities.

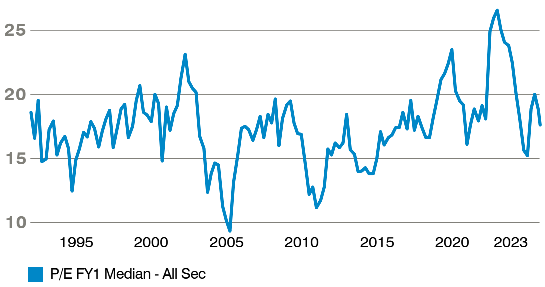
Another challenge for Swiss companies is the appreciation of the Swiss franc against all major currencies in 2023. This reduces their earnings in Swiss franc terms, as most of their revenues are generated abroad. However, Swiss companies have adapted to the strong currency and have not lost their competitive edge in the recent past. The strong Swiss franc motivates them to enhance their cost efficiency and productivity. Moreover, the inflation rate in Switzerland is significantly lower than in other countries at around 2.2% for 2023, which implies lower wage pressure.

Company performance and prospects

Most Swiss companies coped well with the inflation shock in 2022. They passed on the higher costs to customers, and leveraged their pricing power to maintain or even slightly improve their margins. Switzerland has a large number of companies with high market shares and business models with high barriers to entry, which enable them to enforce higher prices. During the pandemic, companies were generally able to raise their prices, but today it is only possible if a company has a strong competitive position. As the reopening of supply chains is creating price competition, we believe pricing power will become even more important in the current environment.

Daniel Häuselmann
Investment Director

P/E median for Swiss companies near long-term average range



Source: GAM Equity Analytics, Bloomberg. Past performance is not an indicator of future performance and current or future trends.

Our investment strategy

We are strongly focused on companies with high earnings growth and high return on capital, which are able to successfully reinvest capital in the business. We favour profitable, high-quality and well-managed growth companies with healthy balance sheets that can gain market share over time and achieve sustainable value creation. These companies have the ability to invest in research and innovation, develop new markets and expand sales despite crises, and emerge stronger from the downturns. The Global Purchasing Managers' Index (PMI) has been declining for more than a year. We anticipate a recovery over the course of 2024. This should provide a tailwind for small and mid caps, which we favour. However, if the economic slowdown persists, our companies should be resilient thanks to their healthy balance sheets and margins. We believe market leaders can grow disproportionately faster in the next upturn. Valuations are reasonable – most stocks are trading near their historical average Price to Earnings (P/E) ratios, and therefore the Swiss equity market has become more attractive for medium and long-term investors.

About D. Häuselmann

ACTIVE EQUITIES

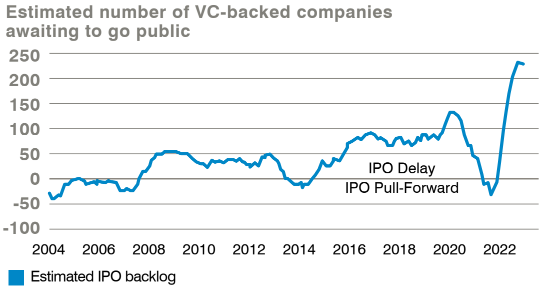
Christian Munafo, Chief Investment Officer, Liberty Street Advisors

Private Shares – An opportunity to participate in the accelerating growth of companies staying private for longer

By investing in later-stage, highly differentiated private companies in areas like artificial intelligence and machine learning, cyber security, robotics, big data and analytics, and fintech, that have typically generated robust operational metrics and often have very strong balance sheets, we believe investors can potentially generate attractive risk-adjusted returns and with far less volatility during their holding period compared to public equities. We continue to see the most significant innovation and disruption happening in the private market which we think, once again, underscores the importance for all investors to have access to the private innovation economy.

Unprecedented Backlog of VC-Backed Pre-IPO Companies

A strenghtening macro environment could lead to a flurry of IPO activity in the near-term



Source: iCapital as of 12 June 2023. Past performance is not an indicator of future performance and current or future trends.

The above chart shows the estimated number of VC-backed companies waiting to go public. It used to be a relatively short journey from founding to listing innovative tech companies. Take Apple (NASDAQ: AAPL) or Adobe (NYSE: ADBE) which both only took four years to list. It is a different story today with companies staying private for longer. Atlassian (NASDAQ: TEAM), for example, took 15 years to list, while Airbnb (NASDAQ: ABNB) took 17 years. Unsurprisingly, this longer lead time to initial public offering (IPO) has seen the number of unicorns [private companies valued at over USD 1 billion] in the private market increase dramatically as they mature into larger operating businesses. As a result, when such companies launch on the public market (or are bought out), it is now typically at a significantly higher value than in the past which means investors unable to access them privately may be missing some of the opportunity to participate in the accelerating growth of these companies in later stages of development.

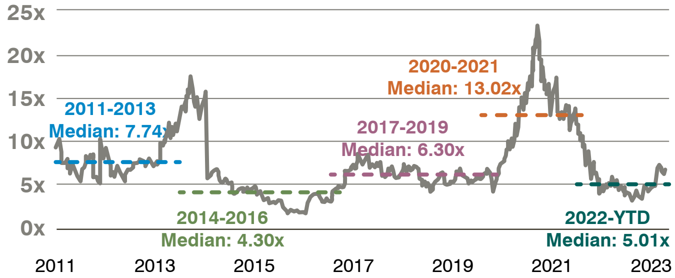
Venture capital is not traditionally accessible to most investors, bar the biggest institutions and wealthiest investors. It can also come with different risk-return profiles depending on which point of the development cycle you invest in. Usually the accelerated growth phase, which many refer to as late-stage venture and growth equity, offers a more attractive risk-return profile compared to earlier stages.

Christian Munafo
Chief Investment Officer,
Liberty Street Advisors

VC-Backed IPO Valuation Multiples at Historic Lows

Anticipate historical cycle to repeat, signaling rebound is likely imminent

Price to sales multiples of VC-backed IPO index (excluding Pharma & Biotech)



Source: Pitchbook NVCA Monitor as of 30 September 2023. Past performance is not an indicator of future performance and current or future trends.

Although we never recommend that any investor try to time entry into any asset class, particularly ones that require a longer-term perspective like ours, we cannot think of a better time to be allocating to the late-stage venture and growth space given both the opportunity set and amount of price dislocations in the market. The VC-backed IPO valuation multiples are at historic lows, with the median Price-to-Sales (P/S) ratios of the VC-backed IPO index (excluding pharma and biotech) at decade lows of 5 times. We anticipate that this historical cycle will repeat, and there are signals that a rebound is likely imminent.

While we are seeing multiple signs of sentiment shifting to the positive and expect this trend to continue in 2024, we remain keenly aware that the current macro environment and geopolitical landscape present multiple challenges, which can further impact both valuations and exit activities. However, it is important to understand that historically, investments made during periods of dislocation have generated strong performance in subsequent years largely due to discounted entry points and the ability for investors to negotiate more favourable terms, but investors must be patient, disciplined and share our longer-term perspective in order to benefit.

About Christian Munafo

SPECIALIST FIXED INCOME

SPECIALIST FIXED INCOME

Nelson Seo, Co-Founder and Managing Director, Fermat Capital

Catastrophe bonds and insurance-linked securities – Issuance should keep spreads buoyant

2023 has been one of the best performing years in the history of the catastrophe (cat) bonds and insurance-linked securities (ILS) markets. In our view, the stage is set for similar conditions in 2024.

The reinsurance market was marked by significant supply and demand imbalances in 2022 and 2023. The performance was impacted by spread widening in 2022, which was further exacerbated by Hurricane Ian. However, the fundamentals of high and persistent inflation drove the demand for reinsurance coverage, while the supply of reinsurance/ILS capital decreased. This resulted in the dramatic returns seen in 2023. As those dynamics persist, we think the outlook for next year remains favourable for investors.

Cat bond spreads had reached historical highs in December 2022 and somewhat abated throughout 2023 due to speculative capital inflows and increased coupon yields. While inflation is slowing down, pent-up demand and the impacts of the 'new normal' in replacement costs to be borne by primary insurers will support the demand for risk transfer in the foreseeable future. This means that cat bond issuance could be even larger in 2024, which should keep spreads buoyant.

Beyond 2024, barring any major catastrophes, spreads are likely to revert to normal levels. With a moderate exposure to spread duration in the portfolios, when spreads inevitably compress, investors could enjoy a positive outcome.

Nelson Seo
Co-Founder and
Managing Director,
Fermat Capital

About Nelson Seo

SPECIALIST FIXED INCOME

Romain Miginiac, Fund Manager and Head of Research, Atlanticomnium

Subordinated debt – A clear dislocation between fundamentals and valuations

After a choppy 2023, marked by chaos in the US banking sector and the acquisition of Credit Suisse by UBS, global bond markets have suffered a big drop, as investors adjust to the reality of prolonged high interest rates. Bondholders can benefit from high levels of carry - 10.9% yield to call on European banks' Additional Tier 1 (AT1) Contingent Convertibles (CoCos) and convexity given potential for spread tightening and as bonds get called at par. Despite short-term turmoil, we believe the current market dislocation is indeed presenting an attractive entry point in subordinated debt markets, especially for high yielding assets with solid fundamentals.

Strong fundamentals

Fundamentals have never been as supportive for bondholders – big banks had strong Q3 earnings, signified by 'ugly', 'bad' and 'good' features. The 'ugly' feature is that earnings may have already peaked at decade high double-digit return on equity (ROE). The 'bad' is capital stagnation around all-time highs – more than EUR 500 billion excess capital. The 'good' is the stubbornly benign loan loss provisions and non-performing loans (NPLs) – the credit quality of the sector is undoubtedly strong.

Attractive valuations

The strength of the European banking sector is not adequately reflected in the current valuations, in our view. With around 530 bps of spread between option-adjusted spread (OAS) and treasury (circa 11% yield to call), it is hard to find a lens through which AT1s do not screen well. AT1s currently offer circa 100 bps (1%) spread pick-up to high yield and to US bank preferred stock – around the highest differential seen over the past decade. On top of high income, this is a first leg of potential price upside, as there is high potential for spread tightening.

Convexity and call advantages

Investors can potentially benefit from significant convexity, which is how bond prices and yields change in a non-linear way when interest rates fluctuate, as market fears of extension risk lower prices further. Around two-thirds of AT1s are still priced to perpetuity, reflecting fears around issuers' ability to refinance bonds. Non-calls remained the exception in 2023, with over 90% of AT1s redeemed at their first call date (circa USD 111 billion out of USD 118 billion). We believe bond redemption will remain a supportive feature of the market in 2024, with at least 80% of AT1s expected to be called even at our most conservative expectation. In our view, many upcoming calls in 2024 are already safe because some AT1s had been pre-financed and could be replaced at a similar or lower cost. On top of this, adding the willingness from most European banks to pay some incremental cost, and banks' ability to call without refinancing by using excess capital, leaves limited call uncertainty.

The case for financial subordinated debt remains intact in our view, with a clear dislocation between fundamentals and valuations. The 'status quo' catalyst – ongoing strong earnings from the sector in upcoming quarters and bonds called at par – supports a normalisation of spreads. While investors in AT1s tend to benefit from high carry, potential for spread tightening and bonds re-pricing to call leaves the door open for price appreciation and solid overall total returns looking at the next 12 to 24 months.

Source: Bloomberg, Atlanti. All data as of 31/10/2023.

Romain Miginiac
Fund Manager and
Head of Research,
Atlanticomnium

About Romain Miginiac

SPECIALIST FIXED INCOME

Paul McNamara, Investment Director,
Emerging Markets Fixed Income

Emerging Market Debt – Looking at yields, and the biggest driver – inflation and policy rates – gives us grounds for optimism

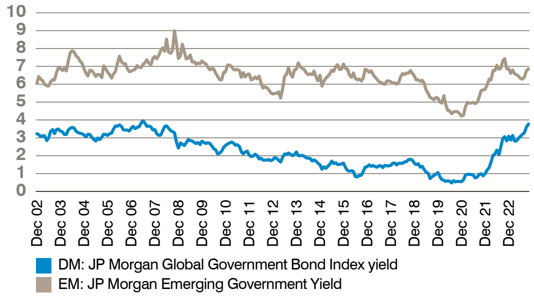
After a dire year amid rising interest rates in 2022, emerging market (EM) bonds in both local and hard currency did well in 2023. At the time of writing, both asset classes had outperformed US developed market (DM) government bonds, US Treasuries (which admittedly had a poor year) and investment-grade corporate credit; local currency debt also outperformed US high yield, despite an indifferent year for the dollar.

Grounds for optimism

Across the two calendar years of global rate hikes, EM has performed solidly. A rally late in 2022 (when DM rates continued to rise) meant that EM rates rose less than DM rates over the course of 2022. Outperformance was even more notable in 2023 – by November, EM rates were over 1% lower than their peak a year earlier. DM yields did not peak until October 2023 and are only 25 bps off this peak as we write.

Looking at yields, and the biggest driver – inflation and policy rates – gives us grounds for optimism. Most of our optimistic views for 2023 were vindicated – lower food and energy prices had a bigger impact in EM, where commodities play a larger role in consumption and services play a smaller part in economic activity. Inflation fell quickly and central banks responded – generally more cautiously than their DM counterparts but through 2023, even hawkish institutions like the central banks of Chile and Brazil had embarked on cutting cycles. Looking across the EM world we continue to see plenty of value. Several EM countries are showing forward-looking real yields much higher than longer-term averages, even allowing for further disinflation. We find Mexico especially attractive here.

EM vs DM Yields



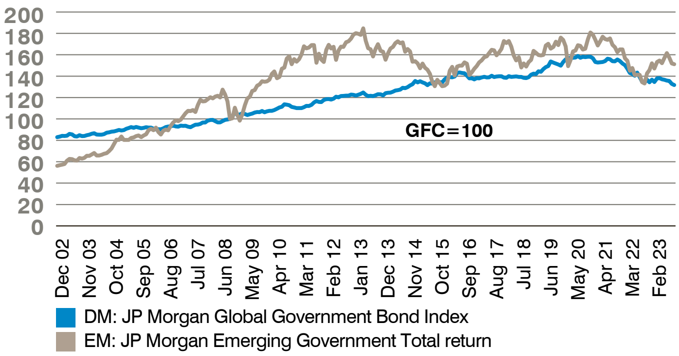
Source: JP Morgan. Past performance is not an indicator of future performance and current or future trends.

This rosy rate picture leaves us with two concerns: first, while EM currencies have done enough to leave EM returns very comfortable compared with non-US DM, dollar returns have been at the mercy of dollar strength; second, bond markets in DM are clearly straining at the prospect of unprecedented net supply, as quantitative tightening coincides with the prospect of dramatically looser fiscal policy globally.

The issue for local currency EM continues to be the extent to which global growth is US centric. In this environment, the dollar is almost inevitably strong, especially now that the US is once again not a significant oil importer (due to fracking). Since the Global Financial Crisis (GFC), the dollar has risen in 10 out of 14 years, and the pre-crisis outperformance of local currency EM debt vs USD EM debt has reversed.

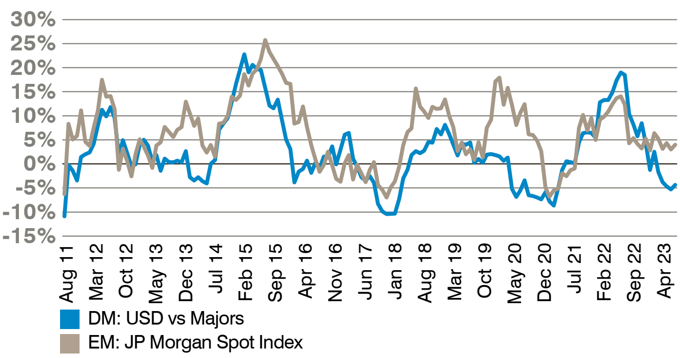
Paul McNamara
Investment Director

EM vs DM Returns



Source: Bloomberg, JP Morgan. Past performance is not an indicator of future performance and current or future trends.

EM Currencies follow DM currencies vs US$ (%yoy)



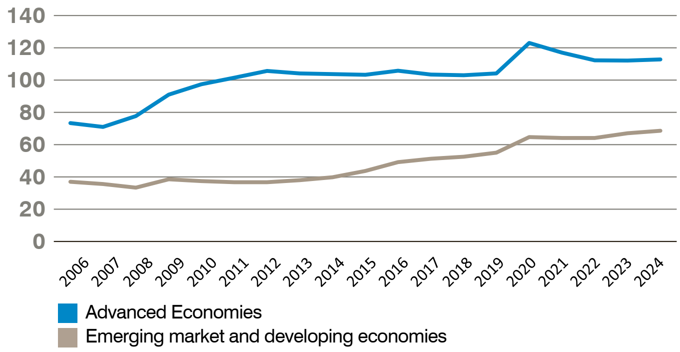
Source: Bloomberg, JP Morgan. Past performance is not an indicator of future performance and current or future trends.

One positive: we see scope for stronger Chinese growth – which traditionally lifts especially the currencies of commodity exporters, but it is harder to be sanguine about Europe. Tight fiscal policy and institutional rigidities continue to weigh on growth in the region. There is also the ongoing threat of the cut-off of Russian gas sales. While last winter demonstrated that Europe can cope as long as the winter is mild, the large increase of gas usage if winter is less benign leaves the continent at risk.

Rising global government debt

The rising global government debt story should, on the face of it, be a positive for EM. Government debt – net or gross – in EM is generally much lower than in DM and has risen less since the GFC (including during the Covid pandemic). We are uncomfortable with this glib narrative for a number of reasons: a rising term premium seems unlikely to restrict itself to DM; real yields remain higher in EM and institutions weaker, so financeable levels of government debt will be lower; and the countries with the lowest debt are inevitably not the large issuers where market exposure is. We see scope for some outperformance but see material risks to a fundamentally benign outlook for EM rates.

Gross Government Debt: GDP



Source: IMF. Past performance is not an indicator of future performance and current or future trends.

The story for hard currency bonds – sovereign debt from EMs issued in DM currencies – was, as usual, very similar to that for corporate credits of similar ratings issued in the same currencies. As befits a strong year for risk assets, the lowest-rated credits performed best in 2023, with distressed countries like Ukraine, Sri Lanka, Pakistan and Venezuela returning over 40% (159% in the last case). Here the outlook for 2024 is simpler – absent a recession, or a slowdown sufficient to have recession-like impact, the very high yields should produce strong returns, with the weakest part of the credit stack performing best, although unlikely to be quite as outstanding as in 2023.

About Paul McNamara

SPECIALIST FIXED INCOME

Tom Mansley, Investment Director, Asset Backed Fixed Income

Mortgage-Backed Securities – The senior bonds we focus on are backed by robust mortgages that have substantial home equity and low default risk

The US housing market has been mixed; house prices are rising, but the increase in mortgage rates has posed a challenge to the housing market. Affordability of single-family housing has deteriorated substantially for first time buyers. We saw prices of single-family homes drop modestly, but then quickly followed by seven months of increases this year, largely due to the supply shortage of housing available for sale and rent, plus the pent-up demand for housing among millennials, who are forming new households.

Vacancy rates are at historical lows, and with the strong growth in household formation, a sustained increase in new housing construction is needed. The current increases in construction of single-family housing is not adequate to meet the strong demand. For this reason, we expect a strong support for house prices even if we experience a substantial economic downturn. Our base case for 2024 is a moderate drop in mortgage rates and a stabilisation of prices, as the housing market remains constrained by tight inventory.

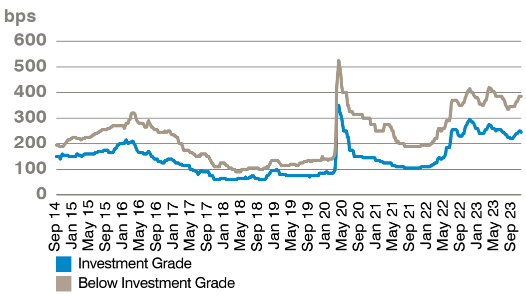
We are in favour of securities that are senior in the capital structure and collateralised by seasoned mortgages issued prior to the Global Financial Crisis (GFC) of 2007-2008, while homeowners have a substantial amount of equity in their homes. This provides a strong incentive for homeowners to continue making mortgage payments even in periods of financial stress, to avoid foreclosure. These securities provide significantly more protection against defaults than more recent mortgages in the event of house price declines or recession.

We believe the outlook for these securities is positive for several reasons:

- **Legacy Residential Mortgage-Backed Securities (RMBS) spreads are near the wider end of the historical range**
  The current wide spreads enable the possibility of capital gains on top of the carry. In addition to the strong underlying credit, we believe that one of the major catalysts for spread tightening will be the dwindling supply of new issue RMBS in the current high interest rate environment.

Tom Mansley
Investment Director

Legacy RMBS Spreads

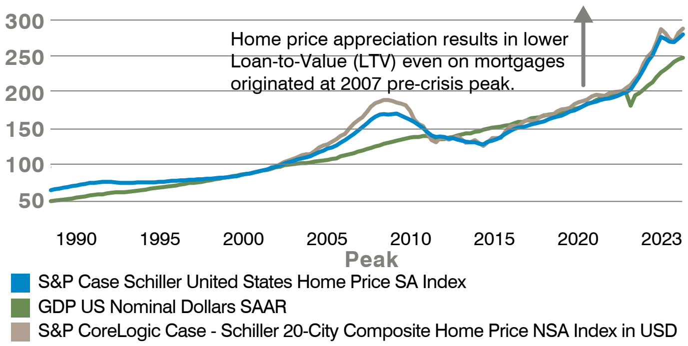


Source: Bloomberg. Past performance is not an indicator of future performance and current or future trends.

- **Strong underlying mortgage loans in Legacy RMBS**
  Mortgages originated before 2009 have experienced strong home price appreciation (HPA) over the past 15+ years. On average, a mortgage loan originated at the pre-crisis peak in 2007 will have experienced over 50% HPA. The increase in the underlying home asset value improves the performance of the mortgages through lower delinquency levels and higher recovery levels in the case of a default.

S&P Case Schiller United States Home Price SA Index

From Feb 28, 1987 to Aug 31, 2023



Source: Bloomberg. Past performance is not an indicator of future performance and current or future trends.

- **Defensive positioning even in a recession**
  The senior bonds we focus on are backed by robust mortgages that have substantial home equity and low default risk, as discussed above. The current economic conditions of low unemployment, low household debt and high savings also support the creditworthiness of the securities, even in the event of a recession. Moreover, the average mortgage we invest in has a sufficient value cushion to withstand a potential decline in home prices that exceeds the magnitude of the GFC.

About Tom Mansley

ALTERNATIVES

ALTERNATIVES

Dr Chris Longworth, Head of GAM Systematic & Guglielmo Mazzola, Head of Systematic Investments Specialists

Systematic Core Macro – Reacting incrementally to changes in market conditions while dynamically managing risk

Systematic investing has seen renewed interest in recent years, against a backdrop of lacklustre performance from traditional 60/40 portfolios. Notably, systematic trend-following styles performed extremely well in 2022, boosted by strong trends across grain and energy markets in the wake of the invasion of Ukraine, and also from the ability to benefit from sustained declines across equities and fixed income. Many trend- following managers struggled in 2023, with the sharp market reversals in March following the collapse of Silicon Valley Bank proving difficult to navigate. However, other systematic approaches, such as those incorporating value or carry strategies, have fared much better this past year.

Making direct predictions or speculating about future markets behaviour is somewhat antithetical to the systematic investment approach, as a robust systematic framework will attempt to position itself in line with market developments to take advantage of likely investment opportunities as and when they occur. However, with this in mind, looking forward to 2024 we think many of the key themes driving markets in 2023 will stay relevant. The ongoing Russia-Ukraine conflict and the continued tensions in the Middle East are likely to result in persistent volatility in energy prices. Similarly, the macroeconomic outlook remains uncertain and central bank monetary policy will continue to have a significant impact on the outlook for fixed income and equity markets, especially as we move to the end of the year with a common theme of ‘higher for longer’ across most major economies. These uncertainties and the resulting volatility in underlying markets generally favour the strengths of a systematic approach, which can react incrementally to changes in market conditions, while dynamically managing the risk profile of the portfolio.

As systematic investors, one feature that we monitor closely is the degree of concentration prevalent across the markets in which we invest.

A more diversified universe will provide more independent trading opportunities for the portfolio, which should generally lead to higher expected returns. One way in which this can be visualised is to look at the number of independent factors present in the returns of a set of markets. This is shown in the chart below for the 10 most liquid commodity markets, which encompass energy, metals and agricultural markets. During periods of macro stress, for example during the onset of the Covid epidemic or the invasion of Ukraine, the number of independent factors can reduce as they diminish, and markets behave more alike. Going into 2024, we believe this asset class will present a much more diversified opportunity set.

Number of independent factors driving the returns of the 10 most liquid commodity markets

Source: GAM Systematic. Past performance is not an indicator of future performance and current or future trends.

Another important factor in the outlook for systematic strategies is the elevated cost of funding. The current interest rate environment poses funding challenges for traditional investments, which are typically highly cash intensive, causing a drag on the excess returns. Conversely, this often will not be the case for strategies, such as systematic macro, that primarily invest in derivatives. These are typically paid on margin, with the majority of assets in the portfolio held in cash or other liquid instruments that will benefit from the increased risk-free rate.

Dr Chris Longworth
Head of GAM Systematic

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About Chris Longworth

MULTI ASSET

MULTI ASSET

Julian Howard, Lead Investment Director, Multi Asset Class Solutions (MACS), London

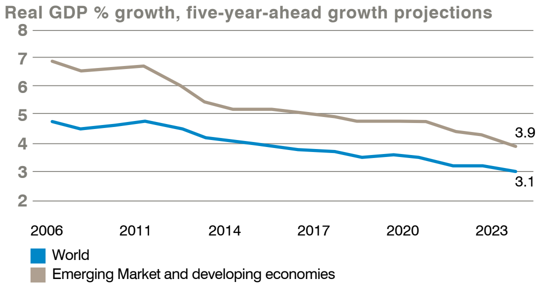
Multi-Asset – A focus on super-secular trends has arguably never been more necessary

As 2023 draws to a close, it would be safe to conclude that it has been the second year in a row in which the investment landscape was dominated by the future trajectory of inflation and interest rates. 2024 seems hardly likely to be spared from the same focus. Yes, US inflation has been coming down but it has been relatively slow to do so and core inflation remains stubborn at 4%. As such, the US Federal Reserve (Fed) will remain on alert amid the feeling that its job is not quite done yet. Furthermore, the apparent impotency of the Fed's primary weapon, the discount rate, may make the US central bank more hawkish than investors expect. Even as interest rates have ratcheted up (5.5% at the time of writing), the US labour market remains tight, with unemployment standing at just 3.7% and nominal wages still growing at over 4% per year. Recession in such conditions is therefore far from obvious, even though the housing market has stalled and credit card delinquencies are on the rise.

Beyond the US, China's economy is posting slightly less disappointing figures which could be sustained if the monetary authorities can continue to pull off the balancing act of cooling the real estate market without crashing the wider economy. Encouraging as this may be, none of it really changes the longer-term calculus for the world economy, namely secular stagnation. As the International Monetary Fund (IMF) noted at its recent World Economic Outlook, global GDP growth in the five years before the pandemic averaged nearly 4% but over the next five years now looks set to average just 3% (see chart). Persistent inequality, shrinking workforces, demographic challenges, trade protectionism and climate change all look set to weigh heavily on growth even if the US somehow escapes recession and China manages to muddle through.

Secular stagnation remains the world's long-term growth fate

From 31 Oct 2008 to 31 Oct 2023



Source: IMF World Economic Outlook (WEO). Horizontal axis refers to year in which projection is made. 2008-2022 = April WEO, 2023 = October WEO. Past performance is not an indicator of future performance and current or future trends.

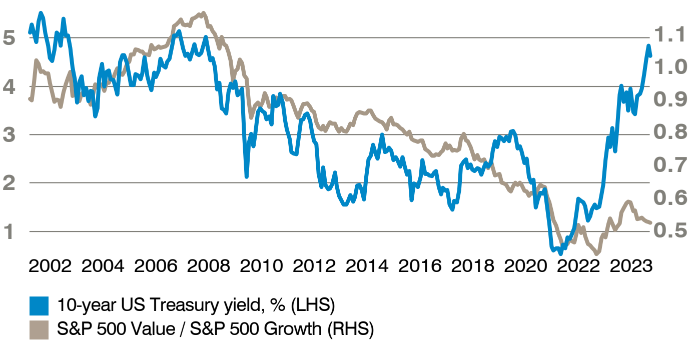
Julian Howard
Lead Investment Director

Amid such a bleak growth context, the good news is that inflation, and subsequently interest rates, should eventually settle down from current levels. Which bring us to markets. In the US – which dominates global equity indices – stocks currently pay very little more in terms of (earnings) yield than government bonds. For this to change, there has to be one or more of an equity price correction, a jump in corporate earnings, or a meaningful decline in bond yields. None of these are impossible in themselves, but a market correction and/or bond yields slowly falling as inflation and growth prospects ease seem more likely than a boost in corporate earnings. At that point, US equities at least should start to become relatively more attractive than bonds and emerging market equities would also benefit from the associated weaker US dollar given how global trade is mostly invoiced in dollars. But these pathways are by no means certain.

Markets could simply stay stretched as speculation around artificial intelligence (AI) continues to support technology stocks. Indeed, one of the more striking features of 2023 has been the sector's continued strong performance in the face of higher rates, which accounting logic dictates should induce a sell-off in such high revenue flow stocks (see chart).

US Growth stocks (read Tech), driven by AI, have outperformed even as yields have risen

From 29 Dec 2000 to 10 Nov 2023



Source: Bloomberg. Past performance is not an indicator of future performance and current or future trends.

Similarly, bond yields could take some time to fall. It is important to note that the rise in yields seen in the second half of 2023 was in significant part attributable to the so-called 'term premium' which measures the riskiness investors see in government bonds. Amid rising geopolitical tensions, extended budget deficits and hopelessly divided US politics, a lower inflation and growth trajectory may take a little longer to make itself felt in the bond markets in 2024. Given this uncertain picture, professional investment management focused on super-secular trends has arguably never been more necessary. Well-established narratives such as the ability of stocks to outperform bonds, real estate and cash over time, as well as the additional opportunity they afford to capture the gains from US technological innovation and the ascendancy of China and emerging markets remain undimmed given a long enough horizon. But near-term volatility in the coming months may well unnerve investors, inducing unforced errors which divert them from the optimal pathway to their financial goals. This is where carefully structured equity strategies, with complementary capital preservation assets that can smooth out episodes of volatility, come in. By happy coincidence one of the main headwinds to equities in the near term – high risk-free short-term yields – also offer superb risk-reward characteristics ideally suited to offsetting volatility in stocks. Such pragmatism, along with an active focus on transparency and simplicity in portfolios, will be essential as the challenges outlined play out in the coming months.

About Julian Howard

MULTI ASSET

Andrea Quapp, Lead Investment Director,
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Multi Asset – Challenges and opportunities

We have passed through the valley of tears in 2023, with the hope that it can become a place of springs. This does not mean that the coming year will be less challenging in terms of events, but we are optimistic that we can overcome any obstacles. We will keep calm and carry on.

Bonds: Balancing duration

The bond markets have experienced more volatility than the equity markets. This is certainly due to the repositioning and shift in investors' preferences after decades of favouring stocks over bonds. The central banks were slow to respond to the rising inflation rates, and they will probably act similarly in the countermovement. For this reason, we favour a strategy that balances the duration of bonds with a tilt towards corporate bonds.

Equities: A boost for the earnings outlook

We believe that the US dollar will lose its appeal as the interest rate gap with the European and Swiss currencies narrows and the US government debt skyrockets. This will benefit all economies that depend on imported energy. As a result, inflation rates will ease and wage pressures will subside, which we think will definitely boost the earnings outlook for companies. With strong demand for goods and services, we foresee higher profits.

The traditional asset classes of equities and bonds have regained their attractiveness, after a long period of underperformance. This, we think, will discourage investors from seeking other asset classes unless they have a comparable risk/return profile. However, in our view diversification by spreading your investments across a variety of asset classes is always an advantage.

Our model indicators suggest three main strategies:

- Reducing the exposure to government bonds
- Increasing the exposure to equities
- Avoiding real estate investments from a global perspective.

Andrea Quapp
Lead Investment Director

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OUTLOOK 2024

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