Markets
& Convictions

September 2024

RJ Management

We present here a different perspective on the impact of rising sovereign debt since 2008/09 and the response of our central banks to the inflation shock of 2021. With sovereign debt exceeding 100% of GDP, the increase in interest rates to combat inflation poses significant budgetary challenges. While this situation supports consumption, it also exacerbates deficits. In the shorter term, we expect our economies to slow down. This phase of heightened volatility will offer us the opportunity to increase our equity allocation when recession fears are significantly higher.

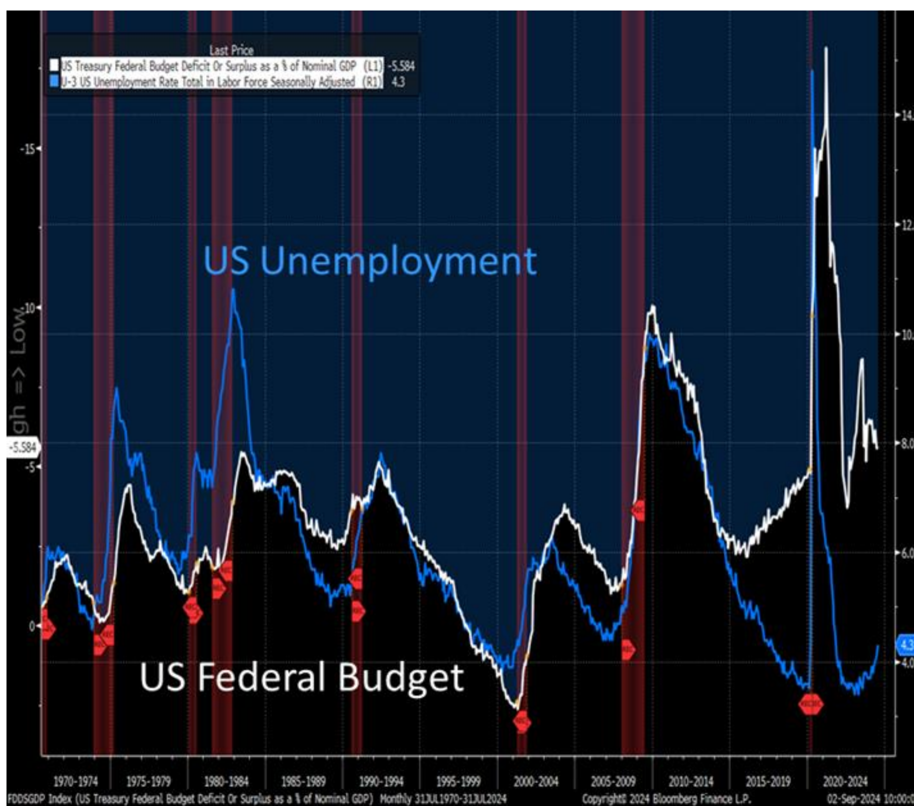
Medium / Long Term Vision

- It's interesting to analyse the inflation paradigm from a different angle in the current economic situation, which is quite specific, such as in the US or Europe, where sovereign debt has literally "exploded" (US > 120% of GDP!!!).
- Since the 2008/09 crisis, our governments have responded to various challenges (the 2009 financial crisis, the 2011 European crisis, etc.) by providing more aid and subsidies to their citizens/voters, which ultimately **means more debt for our countries**.
- Since COVID, this phenomenon has accelerated even further, with states stepping in to assist businesses unable to service their debts. As a result, they transferred massive amounts of private debt onto their own balance sheets while also initiating huge stimulus and economic support plans by taking on new debt.
- **As long as the cost of debt decreases, everything runs smoothly.**
- But when the inflation shock hit in 2021, our central banks had only one tool to combat it: raising their key interest rates (US from 0.25% to 5.50% / ECB from 0% to 4.50% ...).
- The problem: when you have a total debt exceeding 100% of your GDP and rates jumping from 0% to 5%, you can no longer maintain your annual budget.
- Consequently, **the cost of this debt becomes a major issue**, as it surpasses other expenditures like healthcare or defense (various charts on US debt). The result: the budget deficit skyrockets (US at -5.6%).
- The cost of this debt comes from the interest payments made by the state on sovereign bonds held by savers. In the US, $1,100 billion was distributed in the past 12 months alone!
- Therefore, a significant wealth effect is created, which fuels consumption, even though the goal of raising key interest rates is to reduce inflationary pressure (more on this in the podcast).
- What's astonishing today is to see **our states heavily indebted, even while the economic situation is very good.** How will they support the private sector when it faces a real recession? (See image below).

RJ Management SA
5 Cours de Rive
1204 Genève — Suisse

+41 22 888 00 50
info@rjmanagement.ch
www.rjmanagement.ch

Since 1970, unemployment rate in blue and budget deficit (inverted left scale): what will happen when unemployment rises ???



Shorter-term convictions

- In the shorter term, we believe the economy is slowing down, as reflected by recent reports on the labor market and the latest news regarding banking activity in the US.
- Companies that borrowed heavily during periods of exceptionally low interest rates (2020–2021) will need to refinance these debts starting in 2025 ➔ challenging given current rate levels.
- We've observed in recent quarterly reports that CEOs are also adopting a more cautious approach.
- Meanwhile, stock markets are at historically high valuation levels (S&P500 at 23x), as is the proportion of equities held in US household portfolios (57%).
- From a political perspective, it's worth noting that the upcoming US elections are fraught with tension and discord surrounding both candidates, **yet both parties are likely to result in increased debt**.
- Indeed, it's unthinkable today in the West that voters would support a program of massive debt cuts and tax increases to restore budgetary balance (can you imagine voting for M. Thatcher or R. Reagan toda

- The same applies in Europe, where, for example, in France, the extreme left and extreme right "strangely" share many common points in their economic programs: more state aid, more subsidies, and ultimately, more debt!
- Therefore, in this phase, it will be crucial for states to continue financing their growing deficits. We are convinced that this will happen through the ingenuity of our central bankers (creating new tools like the famous Quantitative Easing) but at the expense of their currency.
- **This partly explains the recent broad decline in the USD**.
- Since this game is relative, it will be important to carefully understand the monetary policies of the various major blocs to identify significant currency movements that we will face.
- In any case, we believe this will continue **to benefit the CHF in the medium to long term**.
- Similarly, gold remains one of our strong convictions, reflected in portfolios **through the theme of gold mining companies** (the IXIOS Gold Miners fund is up +29.4% YTD).
- We also note that current monetary policies seem to be curbing the speculative bubbles we had seen emerging without conviction.
- Some examples of trendy themes with their performance since their peak:

Category	Name	Drop from peak (%)
Electric vehicles	Tesla	-49 %
	Rivian	-92 %
	Nio	-91.50 %
	Lucid	-93 %
NFTs	Bored Ape Yacht Club	-92 %
	CryptoPunks	-81 %

- We also note that within a few days, we saw the founder of Facebook admit to being pressured by the US government not to release certain information, Brazil banned the X platform, France detained the owner-founder of the Telegram platform, and the UK arrested people for reposting content on their page.
- The aggregate of these short-term factors strengthens our belief that the equity market will not attract many new buyers; quite the opposite.
- We believe that equity markets are therefore in a correction/consolidation phase with an unfavorable seasonal effect over the past two months and a US election coming up in November.
- Equity indices have experienced an over-concentration of stocks and performance in the AI theme, and we believe this trend will reverse in the coming weeks.
- Nevertheless**, we do not align with those expecting a severe recession**, as nominal growth will remain relatively strong and the inflation cycle continues upward (we do not foresee a sustained return below 2%).

RJ Management SA
5 Cours de Rive
1204 Genève — Suisse
+41 22 888 00 50
info@rjmanagement.ch
www.rjmanagement.ch

- In this context, it is possible to see our central banks providing support by lowering their key rates, but these decisions would mainly serve **to "steepen" the yield curve** (10y rate - 2y rate) — a theme present in several of our structured products and short-duration certificates.
- In the short term, we are struggling with our energy equities theme, where the "big caps" are showing relatively weak YTD performances:

Titles	Performance YTD
TotalEnergies	- 1.77 %
Shell	+ 2.27 %
ENI	- 8.20 %

- However, the quality of their balance sheets and valuation levels keeps us confident in these companies, which are also strong dividend payers (>5% per year).
- Despite the significant movements and corrections in oil, the Westbeck hedge fund manager has posted a performance of over +12% YTD.
- **Volatility is therefore expected to continue evolving in a higher regime.**
- This will provide us with the opportunity to increase our equity allocation during challenging times when investors are more pessimistic about the future growth trajectory.
- Our bond allocation is fully benefiting from the current credit and interest rate environment:

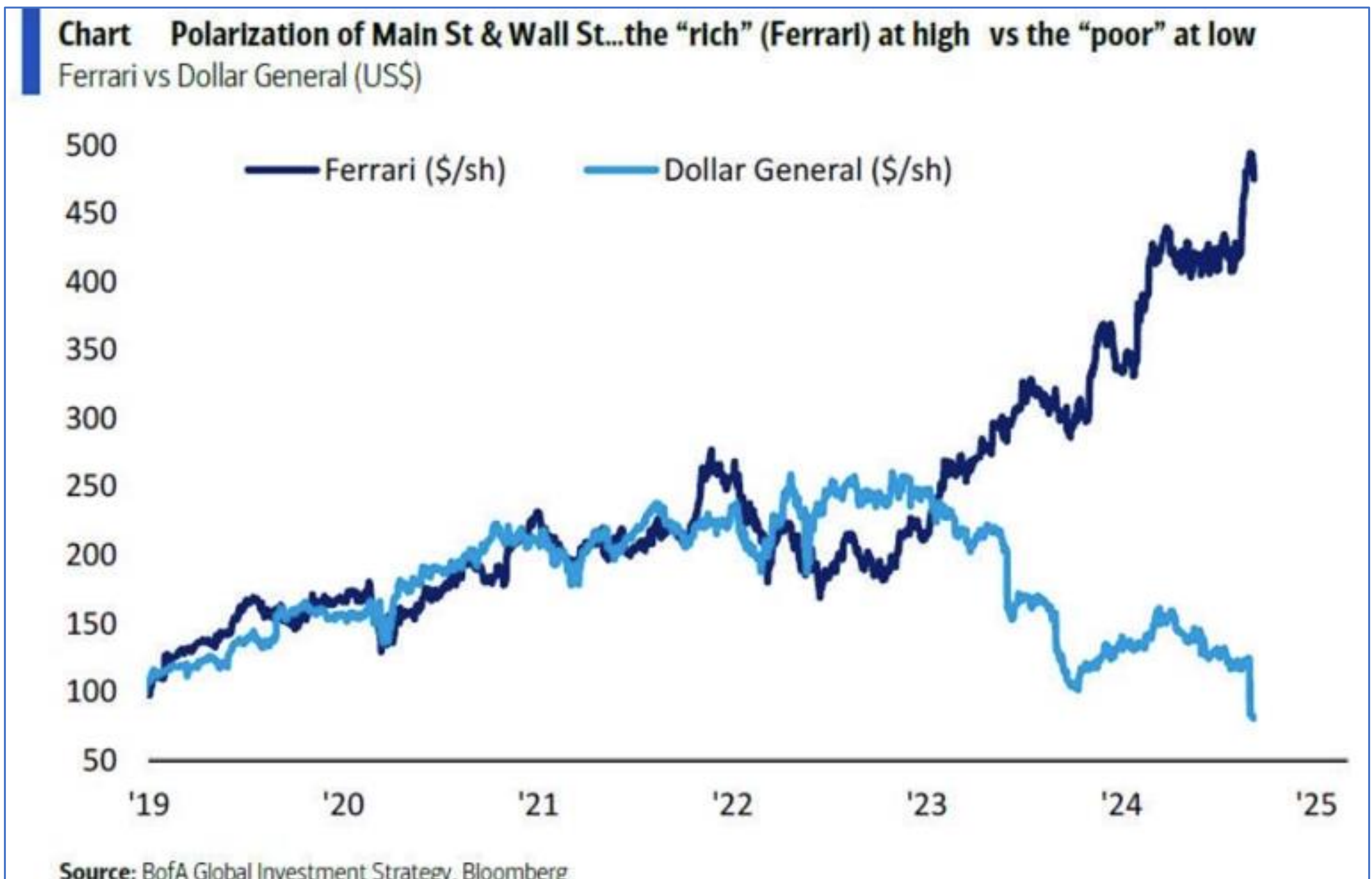
Funds	Performance YTD
Vontobel EM	+ 8.05 %
Carmignac Credit	+ 6.74 %
Axiom	+ 5.81 %
Certificat short Duration	+ 3.90 %

- Our alternatives segment is struggling with Volta (+0.2%) and Invenomic (-8.5%), but their "value" approach should allow them to rebound during sector rotation.
- The other vehicles are performing:

Funds	Performance YTD
Westbeck	+ 12.08 %
Nova	+ 3.90 %
Advent	+ 4.90 %
Eleva Absolute	+ 6.22 %

- **Therefore, we are confident that our diversified allocation will be able to navigate through more challenging times in equities and, most importantly, will allow us to deploy more capital into these equities during a downturn.**

Which segment of the population has benefited from the interest rate increase: Dollar General is a massive discount chain in the US, and Ferrari...



RJ Management SA
5 Cours de Rive
1204 Genève — Suisse

+41 22 888 00 50
info@rjmanagement.ch
www.rjmanagement.ch