Marketing Material

MONTHLY HOUSE VIEW

February 2024

The year of the Wood Dragon

Architects of Wealth

• Table of contents

THE YEAR OF THE WOOD DRAGON

Alexandre
DRABOWICZ
Chief Investment Officer

Dear Reader,

As we firmly walk into 2024, all global outlooks for the financial industry have now been published, deliberated on, and rigorously debated. This New Year also coincides with the start of a new lunar year, marking the beginning of the year of the Wood Dragon, an auspice of growth and transformation that appears only once every 60 years. It will also mark the beginning of a new cycle in Feng Shui, the 9th cycle, which will last until 2044. In a recent client event in Hong Kong, a Feng Shui master shared his own outlook: 2024 would be a year full of energy and changes with the following recommendations: i) keep an open and crystal clear mind to weather any unexpected changes; ii) stay calm and focused without losing sight of what is of utmost importance; iii) stay vigilant to get rid of unwanted "items".

Take time to reflect on these wise words. They resonate well with what lies ahead of us in the financial markets. We now look towards a year of full energy as growth stabilises and the US moves on from the recession fears that plagued in 2023. A year of changes as central banks start to normalise monetary policy in developed economies, another sharp contrast to last year.

USD 8 TRILLION SITS IN MONEY MARKET FUNDS

2023 was a record year in terms of inflows into money market funds in the US, with USD 1.3 trillion of new money being parked into short-term cash solutions. In Europe, it was a record year for fixed income funds, as investors took advantage of attractive yields they had not seen in a decade. But the pivotal question for the coming year will be where this newfound liquidity will end up.

The value proposition of 5% in US dollars seemed compelling for 2023, but after a +25% rally in the MSCI World last year, many investors may be looking back wishing they had put more cash to work. An open mind can serve us well at this pivot point: once central banks start to unwind their restrictive policy, the key question will be to see how this liquidity (USD 8 trillion!) might move into riskier assets again.

With only USD 170 billion of inflows in equities last year, the reallocation away from money markets could provide a significant floor to any drawdown in equities.

THE FED AND THE ECB TO BE SYNCHRONISED IN EASING RATES

We do recognise that sentiment has improved significantly, as shown by various metrics like the Bull & Bear ratio, which illustrate that investors positioning (especially speculative positioning) seems to be stretched. But institutional investors have barely moved: as the economic outlook improves and central banks ease, they might return gradually to the market. On central banks expectations, we are revising our projections and now expect both the US Federal Reserve (Fed) and the European Central Bank (ECB) to cut rates by 100 bps in a synchronised fashion starting from Q2. The main rationale being the fall of inflation in both regions but also a weakening economy in Europe. Market expectations, six cuts for a total of 150 bps as early as Q1 for both central banks, appear too aggressive for now.

As written above, equity inflows have been rather timid last year. In Europe, companies buying back their own shares has made up the bulk of equities purchases. International investors have left Europe already after a good run in the first half. In the US, both corporates and retail have been buying equities. This is likely to continue, and if liquidity shifts away even partially from money market funds and institutional investors gradually reallocate to equities, there will be competition to buy any market dip. So stay calm and focused, without getting side tracked on the markets.

In this edition of our monthly house view, Nicolas Mougeot is taking a deep dive into the theme of electric vehicles. His analysis goes beyond the debate of the environmental question and looks at the profound implications from a geopolitical, technological, economic and social point of views.

Enjoy reading.

ELECTRIC VEHICLES AT A CROSSROAD

Nicolas MOUGEOT
Head of Investment Strategy
& Sustainability

The adoption of electric vehicles (EV) is leading to far-reaching transformations in the automotive sector and beyond, from a geopolitical, technological, economic and environmental as well as social perspective.

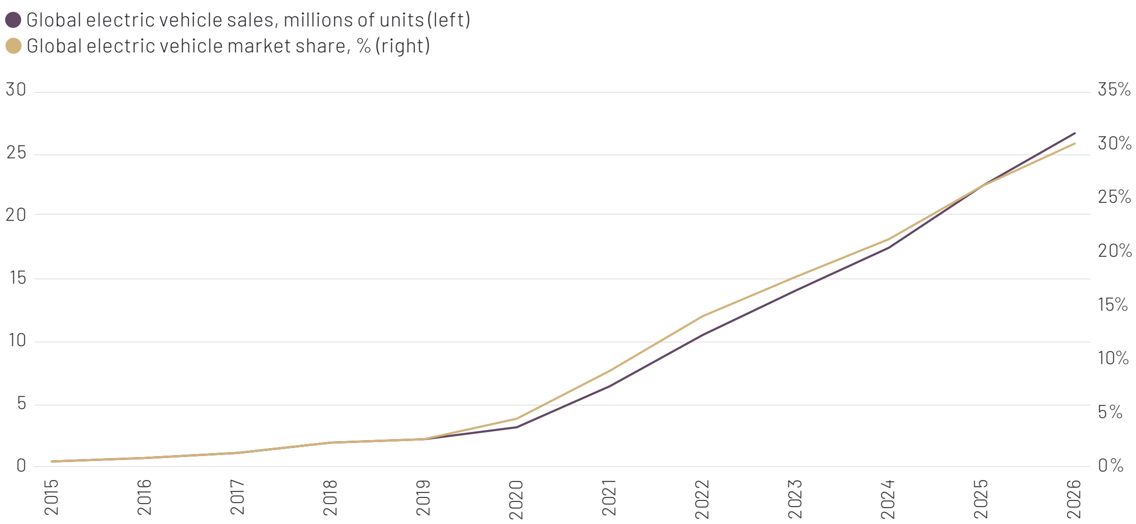
50%:
the share of EVs in China in 2026

The automotive world is experiencing a real revolution. While the number of electric vehicles sold each year stood at no more than 500'000 in 2015 worldwide, sales are expected to reach more than 17 million in 2024, i.e. annual growth of 50%. The next 10 years look just as promising as annual sales could reach more than 57 million in 2034, i.e. more than the current fleet of electric vehicles, which should increase from about 20% of sales today, all types of engines combined, to 30% in two years (Chart 1). This transformation of the car fleet has far-reaching geopolitical, technological, economic, environmental and social impacts.

GEOPOLITICAL

While the sector has long been dominated by US, European, and Japanese carmakers, new electric vehicle champions are emerging. The top two players on the market are currently US-based Tesla and China-based BYD. The former is very familiar to the general public but was overtaken by the latter, in number of vehicles sold, in the fourth quarter of 2023. Five Chinese carmakers rank among the top 10 global carmakers in terms of electric vehicles sold in 2023. Large groups such as Ford, General Motors, Toyota and Nissan are noticeably absent from this top 10. As further proof of China's progress in this area, we note that more than half of the vehicles sold in China in 2026 are expected to be electric versus 40% in Europe and just over 25% in the United States. This is a time of geopolitical upheaval and the automotive sector is likely to create new tensions between the United States and Europe, on the one hand, and China, on the other. Will it be possible to withstand the flood of Chinese electric vehicles, often priced 20% lower, without protectionist measures?

CHART 1: CHANGE IN THE GLOBAL ELECTRIC VEHICLE MARKET



Source: Bloomberg, Indosuez Wealth Management.

TECHNOLOGICAL

The United States' lag can be attributed to a combination of factors: lobbying by oil companies; the small number of electric trucks, given the US consumer's fondness for pickup trucks; and the vastness of the country, which requires vehicles with a long range. Some carmakers like Toyota have nevertheless announced that they are working on "super batteries" that could cover a range of more than 1'200 km. Battery range should therefore no longer be an obstacle in the coming years and carmakers are expected to continue to invest massively to remain relevant and competitive. The phaseout of petrol engines in favour of electric engines is also expected to expand the use of artificial intelligence (AI) for autonomous driving, engine optimisation and safety. This will therefore also increase demand for semiconductors, as an electric vehicle requires more (and more sophisticated) semiconductors than a traditional vehicle.

ECONOMIC

2028:
peak oil demand?

In addition to the automotive sector, the advent of the electric vehicle will fundamentally change other sectors as well. Remarkably, road transport oil demand is expected to fall starting in 2027, according to the International Energy Agency (IEA), and peak oil demand could be reached in 2028. The mining sector is one of the major beneficiaries of electric vehicle adoption. Demand for lithium, a key component of electric batteries, could of course increase twenty-fold by 2050. But building the electric networks and charging stations needed for electric vehicles will also lead to increased demand for copper, for example. Demand for the electricity needed for the electric car fleet is expected to increase from 20 million GWh in 2020 to 132 million GWh this year and nearly 600 million GWh in 2030. A bet on the future of the electric vehicle is also a bet on the need for new infrastructure to generate and supply the necessary electricity.

ENVIRONMENTAL

The good news for the environment is that we could soon be approaching peak oil demand thanks to electric vehicle adoption. However, the overall environmental impact of an electric vehicle is still up for debate. Demand for rare and less rare metals has a negative environmental impact and we will need to make sure that the phaseout of the motor vehicle does not merely move the CO_2 emissions problem further up the chain. The overall environmental impact of electric vehicles will therefore depend not only on the mining sector's sustainability efforts and the development of battery recycling but also on the massive use of low-carbon electricity (nuclear and renewables) despite the turmoil seen in this sector in the last two years.

SOCIAL

By setting 2035 as the end-date for petrol vehicle production, the European Union (EU) has forced the automotive sector's hand. How relevant will a petrol engine specialist be in five to ten years? The automotive sector currently employs more than 12 million Europeans, and they will have to adapt to the change in technology. Governments cannot ignore the social impact of electric vehicles. They will have to support this transformation of the labour market by offering new training programmes as well as retraining for the sector's current employees.

The advent of the electric vehicle, with all its attendant risks and opportunities, will therefore disrupt the electricity sector and beyond.

AN (ALMOST) PERFECT SCENARIO?

Lucas MERIC
Investment Strategist

The markets head into 2024 with a nearly perfect scenario as a backdrop: a combination of resilient growth, smooth disinflation and imminent rate cuts by the Federal Reserve (Fed) and European Central Bank (ECB). Although we agree on the soft landing theory, especially for the US economy, we believe the disinflation and rate cut expectations are optimistic and come with significant risks, in particular with respect to inflation.

We expect
1.4% GROWTH
in the United States
in 2024 and 2025

THE MARKETS SAY YES...

The recession that was widely anticipated a year ago and kept getting postponed quarter after quarter has since given way to the idea of a soft landing for the US economy. Although resilient growth is projected (1.3% in 2024 and 1.7% in 2025), economist consensus also expects the disinflation trend to continue (2.6% in 2024 and 2.3% in 2025), enabling the Fed (and the same goes for the ECB) to start its first rate cuts in 2024.

The story is the same from the markets' perspective: inflation expectations have fallen sharply (one-year inflation swaps in the United States are at 2.1% versus 2.6% in October 2023) and the markets now expect nearly 160 basis points (bps) of rate cuts in 2024 (versus 80 bps at end-October). Moreover, while the yield on the US 10-year government bond has fallen below 4%, a far cry from the 5% reached in mid-October. At the same time, in the last three months of 2023 cyclical stocks outperformed defensive stocks by more than 7%, high-yield credit spreads compressed by 70 bps and the S&P 500 rose by nearly 11%.

The market seems to have incorporated this almost ideal scenario, which combines solid growth dynamics, the return of inflation to the central banks' targets, and the start of a rapid monetary normalisation cycle in early 2024.

... BUT SEEM SOMEWHAT OPTIMISTIC TO US

These market dynamics reflect our macroeconomic scenario to some degree. Although we expect the US economy to slow in the fourth quarter of 2023 and first quarter of 2024, our scenario remains that of resilience, with the economy projected to gradually move towards its potential growth levels at end-2025, ultimately justifying growth of 1.4% in 2024 and 2025. This soft-landing scenario is based largely on the robustness of the US consumer, supported by healthy balance sheets (and benefiting from significant wealth effects); gains in purchasing power (with inflation decelerating faster than wages); a healthy labour market, with the unemployment rate hovering at 3.7%; record-low job destructions; and continued job creations despite the gradual slowdown in recent months. At the same time, households and businesses were able to secure attractive rates before the first rate hikes, which is now reflected in relatively low effective rates and a delayed impact of monetary tightening.

This last point could hamper growth in the medium-term, as households and businesses refinancing at higher rates over time could mean the risk of the delayed impact of rate hikes weighing on the economy.

However, we expect the disinflation trend to continue in the coming quarters (with headline inflation falling on an annual average basis from 4.1% in 2023 to 2.5% in 2024 and 2.4% in 2025) which would allow the Fed to start adjusting the restrictiveness of its monetary policy by making its first rate cuts in the second quarter of 2024 (100 bps of cuts in 2024).

We nevertheless believe that inflation could prove stickier than the markets expect, due in particular to resilient services inflation as wages remain high at this time (the Atlanta Fed's wage tracker is currently still at 5.2% year-on-year). At the same time, the labour market remains robust, supported by a supply/demand imbalance that is still above historical levels (with 1.4 jobs available for each unemployed worker). In our view, this justifies smaller rate cuts than those currently factored into market valuations.

PARTICULARLY AS INFLATION RISKS REMAIN

This soft landing also comes with its share of risks, meaning that the last step towards the 2% inflation target could prove more difficult than expected, particularly as recent developments in wage dynamics and the geopolitical sphere show us that upside risks remain.

US December inflation surprised expectations to the upside, but also highlighted the stickiness of services inflation excluding housing, which remained unchanged at 4.1% (year-on-year) and which could pose a significant risk to continued disinflation as nearly one-third of US small businesses still plan to raise wages (National Federation of Independent Business, NFIB). In the Euro Area, wages accelerated by 5.3% (year-on-year) in the third quarter of 2023 and remain a particular focus of attention for the ECB, as there will be a number of wage negotiations in the first quarter of 2024 and wage data for the fourth quarter of 2023 will not be available before March 2024.

Lastly, the current international trade disruptions in the Red Sea (with freight prices from Asia to Europe having tripled as of mid-January 2024) could pose a risk to goods inflation, particularly for the Euro Area (even though larger ship capacity, smooth port operations and lower demand for goods should limit the increase in freight prices compared with the 2020-2022 period) while the conflict in the Middle East remains more generally a key focus for energy prices.

TABLE 1: MACROECONOMIC FORECAST 2023 - 2025, %

● Revised down since last month ● Revised up

	GDP			INFLATION		
	2023	2024	2025	2023	2024	2025
United States	2.4%	1.4%	1.4%	4.1%	2.6%	2.4%
Euro Area	0.5%	0.6%	1.2%	5.4%	2.6%	2.4%
China	5.2%	4.5%	4.2%	0.5%	1.3%	1.6%
Japan	1.9%	1.1%	1.5%	3.2%	2.0%	1.3%
India	6.5%	6.0%	6.0%	5.7%	5.9%	6.0%
Brazil	3.0%	1.3%	2.0%	4.8%	4.0%	3.5%
World	3.0%	2.7%	2.7%	-	-	-

Source: Indosuez Wealth Management.

04 • Fixed Income
THE MARKETS HAVE BROKEN THE ICE

Thomas GIQUEL
Head of Fixed Income

With the contribution
of the Fixed Income Team

Rates are gradually rising as we start the year. The extent and the speed of their decline at the end of 2023 had come as a surprise. The readjustment is expected and beneficial.

MACRO FRAMING VERSUS MARKET EXPECTATIONS

In our January issue, we highlighted the inconsistency between the markets' expectations for Fed and ECB rate cuts and those of strategists and managers. As we start the year, the markets – which had become increasingly optimistic in their (irrational?) expectations – are quickly adjusting to the macroeconomic framework described in the first section: a slowdown without a recession in the United States, with inflation following a rocky path to converge towards the central banks' targets.

EURO AREA:
a worsening growth outlook

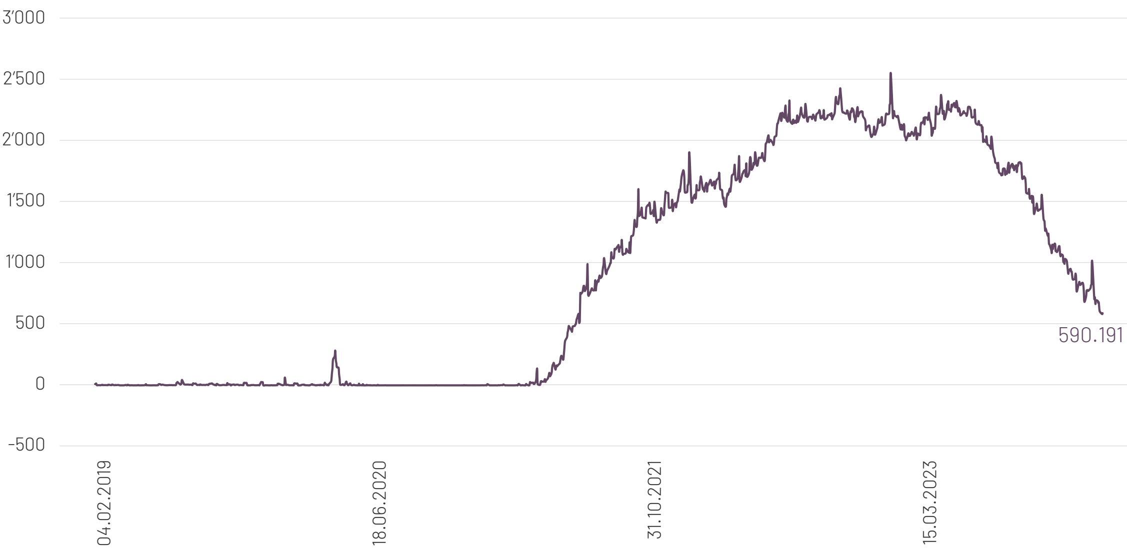
In the Euro Area, the growth outlook has worsened compared with the United States, with goods inflation potentially rising again due to higher ocean-freight costs. The Olympic Games will sustain growth and employment in France in the first half of the year (mainly in the building, infrastructure and tourism sectors) and in other European tourist destinations. If domestic or external demand does not take up the baton, growth will be weak in the second half of the year.

CENTRAL BANKS

Key rates are not likely to fall as sharply as the markets expect. A plateau in the medium-term remains our core scenario. This plateau could wind up being 100 bps below current levels in the United States, but this would still pose an upward correction risk for the entire rate curve and lead to signs of steepening on the longer segments of the curve, i.e. 10 years and above.

In the United Kingdom, the unexpected rebound in inflation in December (published in January) postpones the prospect of monetary easing. The knock-on effect was immediate in the Euro Area, where (nominal and real) wages are expected to increase in 2024.

CHART 2: NEW YORK FEDERAL RESERVE REVERSE REPO, USD BILLION



Source: Bloomberg, Indosuez Wealth Management.

QUANTITATIVE TIGHTENING REMAINS AN OPEN QUESTION

The US Federal Reserve continues to shrink its balance sheet, in close cooperation with the Treasury Department. Liquidity is drying up quickly in the US system, and the reverse repo has represented only a fraction of the needs in recent years (Chart 2, page 8).

To avoid the tensions of September 2019 in the interbank market, preventive measures will likely be announced in the coming weeks.

Lastly, positive real rates remain attractive thanks to the carry obtained, particularly on the short end of the US curve.

CREDIT MARKETS: BUOYED BY LOWER VOLATILITY

Supply and demand are in balance on the credit market as we start a particularly busy year for new issues. All sectors are going to the market to obtain funding or refinance existing debt. More than 50 billion euros has been presented to investors, which makes for an excellent performance in the first few weeks of 2024. In the United States as well, if we extrapolate the initial trends out to the rest of the year, 2024 will exceed the average of the last 10 years (Chart 3).

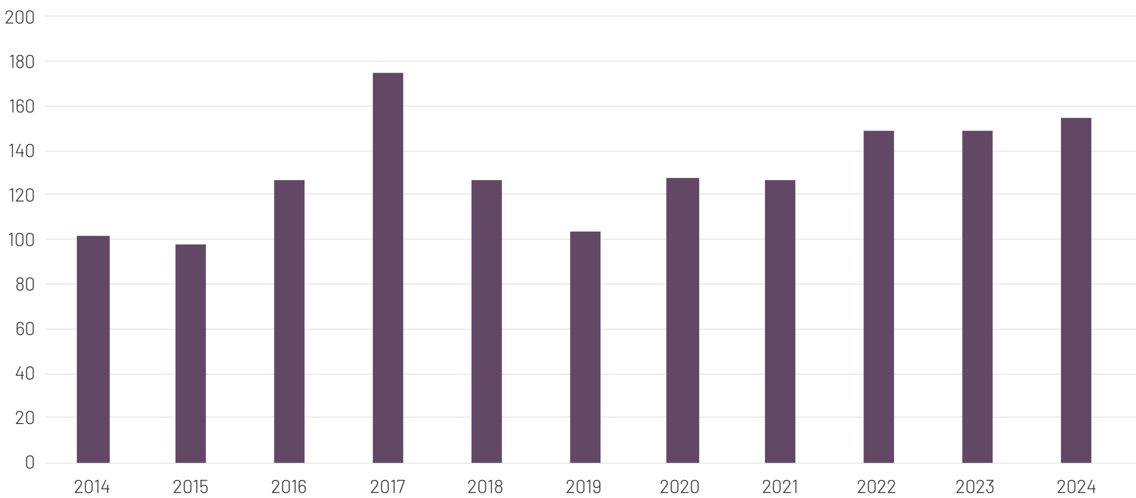
As of writing, US banks are starting to report their earnings. The increase in the returns on their reserves, without compensation on deposits, has helped them post record results. For credit cards, repayment times are growing longer and default rates are rising. It is not yet clear what impact this will have on risky loans.

In the Euro Area, amidst a context where volatility on both rates and the equity markets remains contained, we prefer the subordinated debt segment: selectivity regarding issuers, recall options in the short-term.

In the high-yield segment, the decline in rates, combined with risk premium compression in November and December, gives the most heavily indebted companies some breathing room and more flexibility to refinance their existing debt.

Lastly, the management team's convictions on emerging markets remain unchanged. Latin America (Brazil, Mexico) presents an attractive risk/return, while offering geographic diversification away from areas of geopolitical tension in Europe and the Middle East.

CHART 3: US CREDIT MARKETS, ISSUES IN JANUARY 2014-2024, USD BILLION



Source: Bloomberg, Indosuez Wealth Management.

05 • Equities

THE GOLDILOCKS ECONOMY IS KEEPING THE BEARS AT BAY

Laura CORRIERAS
Equity Portfolio Manager

With the contribution of the Equity Team

The year 2024 is off to a cautious start. Investors are awaiting any signs that would confirm a change in monetary policy tone. Bear in mind that, historically, the US equity market has risen by 10% in the 12 months following an initial rate cut by the Fed in a no-recession environment.

In the shorter term, all eyes will be on fourth-quarter earnings reports. The preannouncement ratio suggests a rather positive season, and companies seem confident overall in their ability to deliver earnings in line with their expectations.

2023: an exceptional YEAR FOR THE EQUITY MARKETS in the United States

EUROPE

After a strong rebound in the last two months of 2023, the European markets are catching their breath as we start 2024, with an outperformance by defensive sectors (mainly healthcare and telecommunications).

Christine Lagarde's comments on a potential soft landing for the economy were quite encouraging.

Valuation levels remain very attractive (in particular relative to US equities). Earnings revisions are stagnating and earnings per share (EPS) growth expectations for 2024 are currently around 5%, i.e. a fairly low relative level compared with expectations in other regions.

Some uncertainties remain as well, mainly on the economic and geopolitical front (impact of the US election, conflict in Ukraine). Given the more cyclical nature of the European equity market, if macroeconomic indicators are weaker than expected or the Goldilocks scenario is called into question, the region could underperform other markets. But it is too soon to move towards this scenario.

The upcoming earnings season will therefore be key, particularly with respect to company outlooks.

UNITED STATES

Given the context, 2023 defied all odds and ended as an exceptional year for the US equity markets. The S&P 500 generated an annual return of +26.3% and the traditional year-end rally did materialise, particularly for small and mid caps, which rebounded by 22% in the last two months of the year.

Even though 2023 was driven mainly by the famous "Magnificent 7" and, more generally, by tech-type growth stocks, consensus is positive for 2024. Earnings growth forecasts for 2024 are trending positively in the United States, with 11% EPS growth for the MSCI US and 23% for the Nasdaq.

From a more forward-looking perspective, 2024 will be driven by the US presidential campaign, which is expected to cause volatility, particularly around environmental and geopolitical issues. This could be positive for more domestic small and mid caps. We note that, historically, in an election year when an incumbent president is running, the S&P 500 has returned 8.8% on average (Chart 4).

ASIA

Volatility remains high on the Asian stock markets as we start 2024. Pessimism and negative sentiment toward the Chinese economy persists. New stimulus measures have been implemented to support the economy but this has had no impact on macroeconomic data or investor sentiment.

However, valuations in China remain highly attractive (and much lower for Asian equities compared with the MSCI World) and the gradual improvement in earnings in certain sectors looks like an encouraging sign.

Lastly, the expected cuts to the Fed's interest rates, the potential weakening of the US dollar, and the attractive price/earnings (P/E) ratios in North Asia could be the key drivers of emerging Asia's equity markets in 2024.

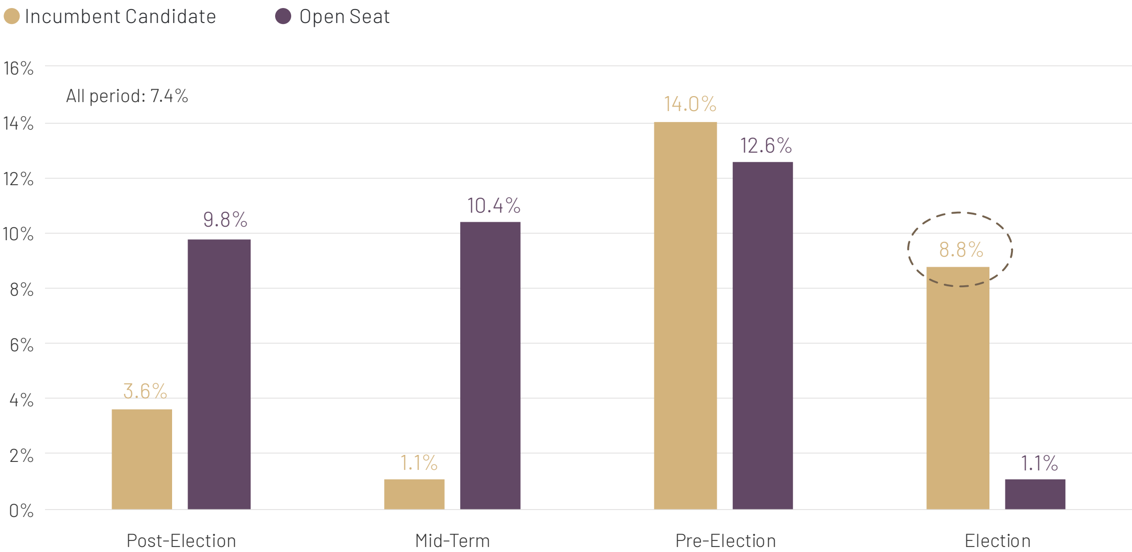
INVESTING STYLE

The rally at the end of the year, in anticipation of future rate cuts, was particularly beneficial for lower-quality companies with high or even unprofitable valuations. In this context, only the Growth style outperformed the others. The decline in rates seen at the end of the year benefited long-term business models. Despite the recent rebound, we remain constructive on the segment that is focused on key artificial intelligence (AI) players and is posting better earnings growth for 2024. Furthermore, growth companies generally have a lot of cash, which is now earning high returns given current rate levels.

We nonetheless maintain our positive view on Quality stocks, utilising a barbell approach, particularly in anticipation of a short-term rebound in long-term rates. However, this segment would become less attractive if a Goldilocks scenario were to materialise during the year.

Lastly, we think that 2024 could be the right time to come back into the Cyclical segment (chemicals, basic resources, automotive, industry, etc.) if PMI indicators rebound. Historical data confirm that cyclical sectors, in particular industry and financials, tend to outperform after a central bank pivot, while defensive sectors tend to underperform.

CHART 4: AVERAGE ANNUAL RETURN OF THE S&P 500 IN PRESIDENTIAL ELECTION YEARS IN THE 1929-2020 PERIOD, %



Source: Oppenheimer, Indosuez Wealth Management.

THE DOLLAR IS READY TO TURN THE CORNER

Maxime GARCIA
Investment Strategist

A less dovish readjustment of Fed expectations could support the dollar while the euro faces a number of risks. We believe it is still too soon to go long on the yen and we are neutral on the Swiss franc, which from now on will no longer be supported by its central bank. We continue to like gold but prefer to wait for a correction before increasing our positions.

USD

A premature decline

The market's optimistic expectations for the Fed's future rate cuts weighed on the dollar, which lost 1.9% in the last month of the year. We believe these expectations are somewhat aggressive. Disinflation is certainly likely to continue, but we expect it to settle in at a slower pace than currently anticipated by the market. We therefore believe the first rate cuts will be in the second quarter, while the market expects them at the end of the first quarter. If our scenario materialises, investors would then have to take a less dovish stance on the Fed which would be good for the dollar. That is in fact what we started to see in early January (the dollar gained 1.2% in the first 15 days). In addition, the positioning is now close to neutral on the greenback, which leaves room for some potential appreciation if flows return. For those reasons, we are taking a tactically positive view in the short-term. In the longer-term, we maintain our slightly negative view because procyclical currencies would benefit, at the dollar's expense, if the soft-landing scenario for 2024 materialises and the major central banks begin to cut rates in the second quarter. The dollar is also suffering more structurally from de-dollarisation.

We take a tactically
POSITIVE VIEW ON THE DOLLAR
in the short-term

EUR

A number of risks

The Euro Area is facing a number of risks that are casting a pall over the single currency in the short-term. First, the recent developments in the Red Sea are having a particularly strong impact on the trade route that connects Asia to Europe and, more broadly, the ongoing conflict around the Levantine basin is threatening oil prices, a significant problem for oil importers. The European monetary union therefore tops the list of regions likely to face difficulties in the event of protracted tension in the Middle East. In addition, rate cut expectations at the global level have fuelled an appetite for more cyclical currencies, thus favouring flows on the euro since December. The positioning is therefore slightly tighter, which limits the upside. Lastly, macroeconomic dynamics look more vulnerable in the Euro Area and, although we do not anticipate a recession, this risk continues to linger and is preventing the currency from taking off for now. Tactically, we are therefore slightly underweight on the EUR/USD, which is expected to trade between 1.07 and 1.10 in the short-term, with a target of 1.07. In the longer-term, waning recession risks and the start of the central banks' rate cut cycle in the second quarter should support the euro.

JPY

Too soon to turn positive

We still do not expect any major changes in Japanese monetary policy, as the economy is not currently facing sustained inflation or upward pressure on wage growth. Renewed geopolitical tensions could support the yen but, if they come with higher oil prices, the terms of trade would deteriorate and ultimately so too would the Japanese currency. As a result, the yen could remain depressed until the first Fed and ECB cuts. We therefore prefer to wait until the USD/JPY is at around 152 and the EUR/JPY near 164 before going long on the Japanese currency.

CHF

The SNB stalwart pulls back

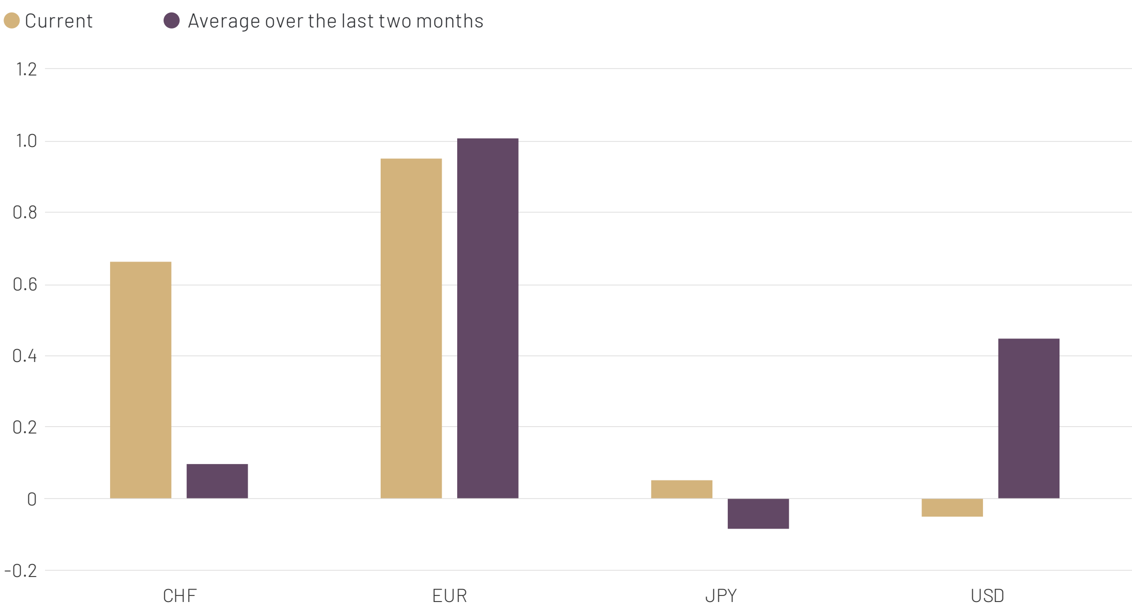
The Swiss franc ended 2023 as the top-ranked G10 currency, largely supported by the Swiss National Bank (SNB) which tapped its currency reserves to keep the CHF strong and thus limit imported inflation. Investors should no longer count on its backing in 2024, as the central bank's chairman made clear when he said that the Swiss franc's gains had become significant enough to materially affect the inflation outlook. In addition, the USD/CHF and EUR/CHF are still trading near their all-time lows. We have therefore adopted a tactically positive view on the USD/CHF, with a target of 0.88, and on the EUR/CHF, with a target of 0.95. In the longer-term, we remain neutral on the Swiss franc, as it could appreciate if conflicts recur or persist around the world.

GOLD

The ultimate hedge

We continue to like gold, which is the ultimate asset to protect against increased risk. Demand from central banks, as part of their currency reserve diversification strategy, is also a structural factor that could continue to keep the shine on gold. Lastly, the start of rate cuts by the US central bank should support the yellow metal. We therefore maintain our positive view but will wait for gold to return to 1'930-1'950 dollars/ounce before we raise our stance and target a price of 2'050-2'100 dollars/ounce.

CHART 5: CURRENCY POSITIONING



Source: Refinitiv, CACIB, Indosuez Wealth Management.

07 • Asset Allocation

INVESTMENT SCENARIO AND ALLOCATION CONVICTIONS

Grégory STEINER
Global Head of Multi Asset

Adrien ROURE
Portfolio Manager

Moving closer to
SYNCHRONISED RATE CUTS

INVESTMENT SCENARIO

- **Growth:** our macroeconomic scenario is still that of a soft landing for the global economy, especially the US one. We do not foresee a recession in the United States, despite the slowdown expected in the coming months. We believe the economic dynamics in the Euro Area are more vulnerable, although an improvement in household purchasing power will be a positive catalyst for 2024. Emerging countries will continue to drive global growth once again this year.
- **Inflation:** the disinflation process will continue in the coming quarters but with some volatility expected in the short-term. Overall, risks are to the upside given the persistent inflationary pressures in services and the potential impacts of the current tensions in the Red Sea.
- **Central banks:** we still think that the market's rate cuts expectations for the Fed and the ECB are overly aggressive. However, we are adjusting our scenario and believe that the ECB's cuts could be more in sync with the Fed's. Like the latter, the European institution is thus expected to begin its rate cut cycle during the second quarter. We expect approximately 100 bps of rate cuts on both sides of the Atlantic in 2024.
- **Corporate earnings:** despite higher earnings expectations in the United States, we remain more confident in the ability of US companies to deliver on earnings forecasts for 2024 than their European counterparts.
- **Risk environment:** although most of the risks we faced in 2023 have receded, some potential risks remain in 2024. Debt problems in the Euro Area and the United States could be back in the spotlight after several years of fiscal profligacy. On the political front, a record proportion of the global population will go to the polls this year, which is likely to increase market volatility in the short-term (with the US presidential election topping the list). Lastly, we will be closely monitoring the global geopolitical situation as the number of conflicts rises.

ALLOCATION CONVICTIONS

Equities

- The resilient macroeconomic environment, combined with companies' strong financial health and the gradual redeployment of capital (currently sitting in money-market funds) to risky assets over the course of the year, leads us to maintain a positive view on the equity markets for 2024. In the short-term, the fact that some stock market indices neared record levels at the end of 2023 explains why we have put off adding to our equity exposures.
- We maintain our preference for US equities. However, given the stock market indices' focus on a few specific stocks, it may be worthwhile to consider rebalancing this allocation in favour of a greater number of sectors.
- In relative terms, despite low valuation levels on a historical basis, we believe European equities are trending less positively, as the economic growth outlook for the region remains less appealing.
- Aside from the equity markets of advanced economies, we maintain a constructive view on emerging market equities, which are expected to benefit from a favourable growth differential. Some regions could also benefit from a possible reversal of the manufacturing cycle during the year, and from a favourable global cycle for the semiconductor industry.

Bonds

- After the bond rally at the end of 2023, we believed the market had been too quick to anticipate the central banks' rate cuts. Our scenario is materialising as we write this, with long-term rates recovering some of their sharp decline. We expect this movement to continue in the very short-term, which is why we remain tactically underweight duration *vis-à-vis* our benchmarks.
- We therefore continue to favour sovereign bonds with short maturities (up to five years) as the longer and more volatile maturities are more risky: the rate curves remain inverted, the central banks' balance sheet reductions are still underway, and questions about debt sustainability could lead to a repricing of term premiums.
- In the credit segment, we reiterate our preference for high-quality corporate debt with short maturities, which we believe offers the best risk/return. We continue to steer clear of high-yield bonds, which we view as richly valued.
- From a diversification perspective, we maintain a strategically positive view on emerging market debt in local currencies, although it could prove vulnerable to dollar appreciation in the short-term.

Forex market

- If our macroeconomic scenario materialises, investors are likely to take a less dovish view of the Fed's stance, which will be good for the dollar in the short-term. In the medium-term, we nevertheless believe that the greenback could turn lower once the rate cut cycle begins, as other structural factors, including currency reserve diversification, will weigh on the currency over a long period of time.
- The Swiss franc benefited significantly from its status as a safe haven and from the central bank's efforts to support its currency and limit imported inflation. The trend could reverse in 2024 as the Swiss National Bank has now indicated that it is more comfortable with the Swiss franc's current levels.
- In the short-term, gold could prove vulnerable to a partial rise in long-term rates after the strong easing observed. However, over the medium-term, real rates are expected to decline, the central banks' appetite for this asset remains intact, and the more complex geopolitical environment has been taken into account. These are some of the reasons we remain strategically positive on the yellow metal.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
EUR 2-Year	=	=
EUR 10-Year	=/-	=/-
EUR Periphery	=/-	=/-
US 2-Year	=/+	+
US 10-Year	=/-	=
EUR Breakevens Inflation	=/+	=/+
US Breakevens Inflation	=/+	=
CREDIT		
Investment grade EUR	=/+	+
High yield EUR	=/-	=
Financials Bonds EUR	=	=/+
Investment grade USD	=	=/+
High yield USD	-	=/-
EMERGING DEBT		
Hard Currencies	=	=/+
Local Currencies	=	=/+
EQUITIES		
GEOGRAPHIES		
Europe	=/-	=/-
United States	=/+	=/+
Japan	=	=
Latin America	=	=
Asia ex-China	=/+	=/+
China	=	=/-
STYLES		
Growth	=/+	=/+
Value	=	=
Quality	=/+	=
Cyclical	=	=
Defensive	=/-	=/-
FOREX		
United States (USD)	=/+	=/-
Euro Area (EUR)	=/-	=/+
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=/-	=
Japan (JPY)	=	=/+
China (CNY)	=	=
Gold (XAU)	=/-	=/+

Source: Indosuez Wealth Management.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 18 JANUARY 2024

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10-year	4.14%	25.39	26.29
France 10-year	2.85%	37.50	28.80
Germany 10-year	2.35%	38.40	32.60
Spain 10-year	3.27%	37.50	28.70
Switzerland 10-year	0.90%	19.50	19.80
Japan 10-year	0.63%	5.50	2.40

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Government Bonds Emerging Markets	36.21	-0.98%	-1.39%
Euro Government Bonds	201.88	-1.25%	-1.11%
Corporate EUR high yield	216.12	0.09%	-0.10%
Corporate USD high yield	331.90	-0.51%	-0.91%
US Government Bonds	306.42	-0.25%	-0.53%
Corporate Emerging Markets	43.87	-0.18%	-0.59%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	0.9442	0.15%	1.65%
GBP/USD	1.2706	0.13%	-0.20%
USD/CHF	0.8680	1.38%	3.16%
EUR/USD	1.0876	-1.23%	-1.48%
USD/JPY	148.16	4.25%	5.05%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	14.13	0.48	1.68

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'780.94	0.72%	0.23%
FTSE 100 (United Kingdom)	7'459.09	-3.06%	-3.55%
STOXX 600	470.45	-1.36%	-1.78%
Topix	2'492.09	7.14%	5.31%
MSCI World	3'143.20	-0.06%	-0.82%
Shanghai SE Composite	3'274.73	-1.69%	-4.56%
MSCI Emerging Markets	961.34	-3.70%	-6.10%
MSCI Latam (Latin America)	2'491.27	-5.21%	-6.44%
MSCI EMEA (Europe, Middle East, Africa)	196.04	-0.96%	-2.36%
MSCI Asia Ex Japan	597.63	-4.09%	-6.84%
CAC 40 (France)	7'401.35	-2.25%	-1.88%
DAX (Germany)	16'567.35	-0.72%	-1.10%
MIB (Italy)	30'350.53	0.25%	0.00%
IBEX (Spain)	9'880.30	-2.22%	-2.20%
SMI (Switzerland)	11'185.88	0.48%	0.43%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	3'787.00	-4.80%	-6.26%
Gold (USD/Oz)	2'023.34	-1.11%	-1.92%
Crude Oil WTI (USD/Bbl)	74.08	0.26%	3.39%
Silver (USD/Oz)	22.81	-6.17%	-5.31%
Copper (USD/Tonne)	8'310.00	-3.32%	-2.91%
Natural Gas (USD/MMBtu)	2.70	4.86%	7.28%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

MONTHLY INVESTMENT RETURNS, PRICE INDEX

FTSE 100 · Topix · MSCI World · MSCI EMEA · MSCI Emerging Markets
STOXX 600 · S&P 500 · Shanghai SE Composite · MSCI Latam · MSCI Asia Ex Japan

BEST PERFORMING (+)

OCTOBER 2023	NOVEMBER 2023	DECEMBER 2023	4 WEEKS CHANGE	YTD (18.01.2024)
-2.20%	12.99%	7.74%	7.14%	5.31%
-2.97%	9.21%	4.81%	0.72%	0.23%
-2.98%	8.92%	4.71%	-0.06%	-0.82%
-3.00%	7.86%	4.42%	-0.96%	-1.78%
-3.17%	6.86%	3.77%	-1.36%	-2.36%
-3.68%	6.45%	3.75%	-1.69%	-3.55%
-3.76%	6.32%	3.71%	-3.06%	-4.56%
-3.91%	5.38%	3.35%	-3.70%	-6.10%
-3.94%	1.80%	-0.36%	-4.09%	-6.44%
-4.96%	-2.14%	-1.86%	-5.21%	-6.84%

(−) WORST PERFORMING

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

Basis point (bps): 1 basis point = 0.01%.

Blockchain: A technology for storing and transmitting information. It takes the form of a database which has the particularity of being shared simultaneously with all its users and generally does not depend on any central body.

BLS: Bureau of Labor Statistics.

BNEF: Bloomberg New Energy Finance.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Cyclicals: Cyclicals refers to companies that are dependent on the changes in the overall economy. These stocks represent the companies whose profit is higher when the economy is prospering.

Defensives: Defensives refers to companies that are more or less immune to the changes in the economic conditions.

Deflation: Deflation is the opposite of inflation. Contrary to inflation, it is characterised by a sustained decrease in general price levels over an extended period.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates. This value is expressed in years. The longer the duration of a bond, the more sensitive its price is to interest rate changes.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to non-operating expenses.

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and Euro Area member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

Economies of scale: Decrease in a product's unit cost that a company obtains by increasing the quantity of its production.

EPS: Earnings per share.

ESG: Non-financial corporate rating system based on environmental, social and governance criteria. It is used to evaluate the sustainability and ethical impact of an investment in a company.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

Growth: Growth style refers to companies expected to grow sales and earnings at a faster rate than the market average. As such, growth stocks are generally characterised by a higher valuation than the market as a whole.

IEA: International Energy Agency.

IMF: The International Monetary Fund.

Inflation breakeven: Level of inflation where nominal bonds have the same return as inflation-linked bonds (of the same maturity and grade). In other words, it is the level of inflation at which it makes no difference if an investor owns a nominal bond or an inflation-linked bond. It therefore represents inflation expectations in a geographic region for a specific maturity.

Inflation swap rate 5-Year, 5-Year: A market measure of what 5-Year inflation expectations will be in five years' time. It provides a window into how inflation expectations may change in the future.

IPPC: The Intergovernmental Panel on Climate Change.

IRENA: International Renewable Energy Agency.

ISM: Institute for Supply Management.

Japanification of the economy: Refers to the stagnation the Japanese economy has faced in the last three decades, and is generally used to refer to economists' fears that other developed countries will follow suit.

Metaverse: A metaverse (portmanteau of meta and universe) is a fictional virtual world. The term is regularly used to describe a future version of the internet where virtual, persistent and shared spaces are accessible via 3D interaction.

OECD: Organisation for Economic Co-operation and Development.

Oligopoly: An oligopoly occurs when there is a small number of producers (supply) with a certain amount of market power and a large number of customers (demand) on a market.

OPEC: Organization of the Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

PMI: Purchasing Managers' Index.

Policy mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

Pricing power: Refers to the ability of a company or brand to increase its prices without affecting demand for its products.

Quality: Quality stocks refers to companies with higher and more reliable profits, low debt and other measures of stable earnings and strong governance. Common characteristics of Quality stocks are high return to equity, debt to equity and earnings variability.

Quantitative easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

Secular stagnation: Refers to an extended period of little or no economic growth.

SRI: Sustainable and Responsible Investments.

Stagflation: Stagflation refers to an economy that is experiencing simultaneously an increase in inflation and stagnation of economic output.

TPI: An addition to the Eurosystem's toolkit that can be activated by the ECB to counter unwarranted, disorderly market developments if these pose a serious threat to the smooth transmission of monetary policy across the euro area. The ECB Governing Council approved the instrument on the 21 July 2022.

Uberisation: Term derived from the name of US company Uber which develops and operates digital platforms that connect drivers and riders. It refers to a new business model that leverages new digital technologies and is part of the sharing economy, insofar as it puts customers in direct contact with service providers, at a reduced cost and with lower prices.

Value: Value style refers to companies that appear to trade at a lower price relative to its fundamentals. Common characteristics of value stocks include high dividend yield, low price-to-book ratio, and a low price-to-earnings ratio.

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: World Trade Organization.

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