MARKETING MATERIAL

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INVESTMENT INSIGHTS

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The urge to travel

EDITORIAL VIEW

- Travel industry stocks have – for the most part – strongly rebounded this year
- Current trends are certainly supportive, in terms of both demand and pricing power
- The good times will not last forever though, warranting a selective investment stance

GLOBAL STRATEGY

- Macro: soft landing, ongoing disinflation process and peak rates in sight
- Unappealing valuations on the surface and stretched sentiment call for caution & selectivity
- Recent USD weakness not overly worrisome: it may bend, but it will not break

ASSET ALLOCATION

- Allocation – No change, maintaining a guarded stance overall
- Equities – Neutral: all-terrain approach focusing on high-quality cash-rich stocks
- Bonds – Slight underweight, with still contained duration and credit risks

EDITORIAL VIEW

The urge to travel

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- Current trends are certainly supportive, in terms of both demand and pricing power
- The good times will not last forever though, warranting a selective investment stance

The travel industry is on fire in this 2023 summer season. A sharp recovery in demand, record-breaking customer bookings, China's reopening, renewed pricing power: most companies are currently enjoying margins at or above pre-pandemic levels.
Beware, however, not to fully give in to the prevailing euphoria. In a world of high interest rates and slowing economic growth, demand is set to recede.
One needs thus adopt a selective investment approach, favouring niche companies and those with business models that combine low capital intensity, healthy balance sheets and strong cashflow generation.

Short-term winds are indeed very buoyant, making for a solid year-to-date stock market outperformance by airlines, cruise operators, hotels and casinos, as well as booking platforms. But there is no guarantee that the rally will continue across the board.

Keep in mind that some companies in the sector came, in the recent past, very close to bankruptcy because of excessive leverage – Carnival in the cruise sector, for instance. Or that others still have margins well below what they were prior to Covid, and for good reason.

In short, there clearly is value to be found all along the travel industry value chain, provided the wheat is sorted from the chaff. Amongst airlines, for example, we steer clear of the major long-haul operators, clearly preferring low-cost carriers.

Ryanair leads the pack there, although WizzAir does seem to offer some interesting potential in the short term, having been particularly impacted by the Russo-Ukrainian conflict (given its large customer base in Eastern Europe).

Within cruises, Royal Caribbean is the "best in class'" but we view the considerable leverage that characterises the entire segment as an obstacle.

What is more, despite the strong demand they are currently enjoying, both airlines and cruise operators seem to us less attractive – on a medium-term horizon – than asset light companies, i.e. ones that operate with lesser capital intensity.
These include booking platforms of the likes of Booking Holdings, Airbnb Inc. and Amadeus IT Group, as well as the food services segment, with indirect beneficiaries such as Edenred and Compass.
Hotels, for their part, are benefiting not only from greater private demand, but also that of business travellers. The strong brands at the top end of the market warrant particular attention, namely Hilton, Intercontinental and Marriott.

At the very upstream of the travel value chain, also note the aerospace segment, with equipment manufacturers such as Safran enjoying very high barriers to entry and a significant contribution from highly profitable maintenance services. Vinci, Ferrovial and Flughafen ZH are also interesting players in the more defensive infrastructure segment.
It is hard to predict how long this travel frenzy will last. Households still have savings that they accumulated during the Covid era, but the economic clouds that are gathering on the horizon could well eventually curb their appetite.

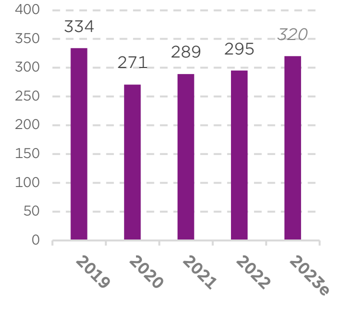
On the supply side, alongside a growing debt burden for the capital-intensive segments, the entire industry is facing staff recruitment issues and, as a result, wage inflation. The glorious days will not last forever…

Written by Sandro Occhilupo, Head of Discretionary Portfolio Management

GRAPH OF THE MONTH

Number of international tourist arrivals worldwide from 2000 to 2022, with an estimate for 2023 (in millions)

Number of travel & tourism jobs worldwide (in millions)



GLOBAL STRATEGY

Goodbye recession, hello soft landing

- Macro: soft landing, ongoing disinflation process and peak rates in sight
- Unappealing valuations on the surface and stretched sentiment call for caution & selectivity
- Recent USD weakness not overly worrisome: it may bend, but it will not break

Despite latent recession risks, the odds of a global soft landing have further increased with more resilient than expected US activity, inflation past its worst and central banks nearing peak hawkishness. By contrast, China's post-reopening recovery is already fizzling out, calling for additional government support, while European growth continues to slow down according to the latest July flash PMI – although the dreaded recession and associated credit crunch are probably postponed.
This suggests that central banks will now pause, but there is still a long way to go before they pivot.

While we continue to see limited downside risk for equities, with the pain trade still to the upside for most investors, equity markets globally, and especially in the US, look expensive by almost all metrics, seriously impairing their relative appeal in today's more attractive bond/cash yield environment. Interestingly however, looking beneath the index surface, all multiples are not that stretched.

Outside of the US, or more specifically of the growthier parts of the US market, the valuation landscape looks much brighter. As regards pushback pertaining to the narrow market breadth, we note that participation has improved lately – as we had been expecting.
A gradual non-linear convergence of stocks beneath the index surface over the coming months will likely underpin further equity factor, style and sector rotations. In other words, we still see attractive pockets of value in equities today but requiring nimbleness and selectivity. With unappealing valuations and stretched near-term sentiment indicators still calling for caution, particularly given the limited economic visibility, we are retaining our broadly neutral equity stance.

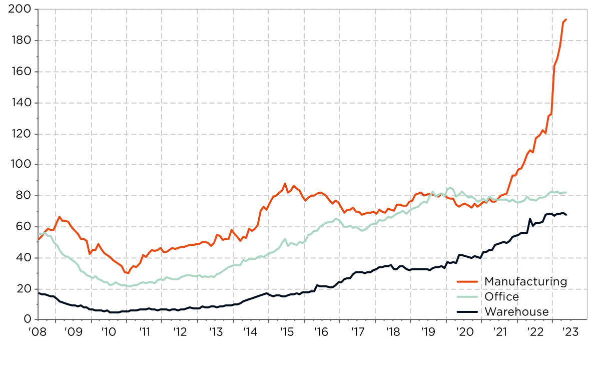
Within fixed income, we remain slightly underweight with contained duration and credit risks.
While government bond duration may help mitigate equity losses related to an earnings recession, we question their buffer benefits in our scenario of sticky inflation, "hawkish hold" monetary policy and a not so severe recession in the foreseeable future. Furthermore, cash offers a higher yield than long-term bonds and is undoubtedly the most uncorrelated asset… Other hedging methods, such as put spreads on equity indices, may be thus more efficient. As a result, we still prefer cash instruments and the short end of the curve (over long-term bonds) given the current steep yield inversion and sticky inflation. Finally, we prefer corporates to sovereigns in Europe, as valuations remain cheaper than in the US, and continue to target the upper end of the credit spectrum.

Elsewhere, we keep our slight overweight of gold and slight underweight of other materials. Both are facing cyclical downside risks (higher real rates for gold and slower economic growth for energy and industrial metals), but also enjoying the benefit of supportive structural trends on the back of an overall lack of investment amid increasing geopolitically-related demand (de-globalisation and gradual de-dollarisation), inflation that exceeds central bank targets, as well as the energy transition.

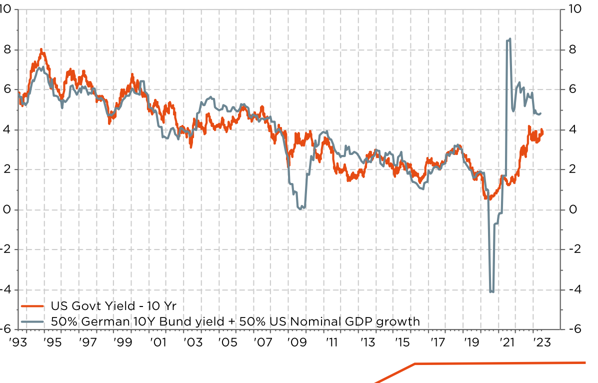
Finally, we now see a lack of direction for the major currencies over the next few months, in what remains a scenario of low but positive global growth without significant monetary policy divergences. In this context, we do not consider recent USD weakness as worrisome.
We do not expect the Fed to pivot soon, US growth seems more resilient and there is a lack of better alternatives for world reserve currency status in the near term (we do not foresee global appreciation of the euro or Chinese renminbi). On a structural basis, the Swiss franc remains our preferred currency, supported by still-rock solid fundamentals.

Written by Fabrizio Quirighetti, CIO, Head of multi-asset and fixed income strategies

The visible hand of the Biden administration IRA
Private non-residential construction ($bn, annual. rate)



Long-term rates: now close to fair value
Gundlach model on UST 10y yield



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External sources include: Refinitiv Datastream, Bloomberg, FactSet, Goldman Sachs, Statista, World of Statistics

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