GENERALI INVESTMENTS

Market Compass

May 2024

MARKET OUTLOOK

- Amid reaccelerating US inflation, markets have axed rate cut expectations for all major central banks. We expect the start of Fed easing to be postponed until September, but not cancelled. A first ECB rate cut remains due in June with at least quarterly cuts to follow thereafter.
- We acknowledge two-sided risk for yields near term, with a resilient US economy and stickier prices the most imminent risks. But with a lot of bad inflation news now priced in, and 5-year forward 3-month rates near 4%, we see value in prudent long duration.
- Amid the tug of war between high valuations and higher uncertainties on the one hand and global economic green shoots on the other, we keep an overexposure in Investment Grade (IG) Credit to reap the carry from risk premia.
- Yet we keep a neutral stance on Equities and High Yield amid elevated risks of further setbacks.

Edited by

MACRO & MARKET RESEARCH TEAM

A team of 13 analysts based in Paris, Cologne, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

US

- (+) Q1 growth slows but domestic demand remains strong
- (−) Core inflation stronger than expected…
- (!) …with strong wages despite a cooling labour market
- (!) We revised to 50bps our expectation for rate cuts this year, risks tilted to the upside

UK

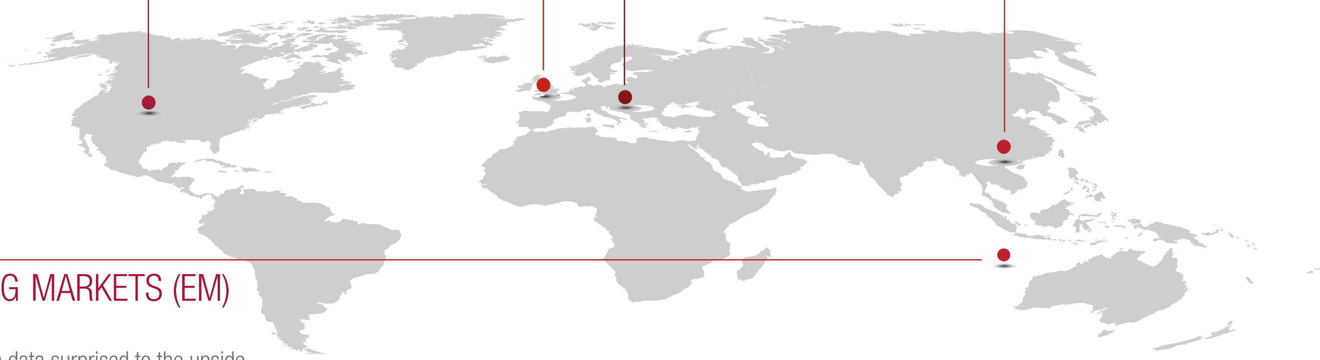
- (−) UK manufacturing PMI dropped back into contractionary territory
- (−) CPI inflation remained a bit stickier than expected while employment disappointed
- (−) First rate cut by BoE not expected before August and risk of further delay rising

EUROZONE

- (+) Q1 GDP growth above expectations
- (+) Turnaround in manufacturing sector gains traction
- (+) Core inflation eases further in April, thanks to services
- (+) ECB to cut rates in June. We expect 100bps of easing at most

CHINA

- (!) Q1 real GDP surprised on the upside but monthly March data disappointed
- (−) CPI inflation down again mainly due to food prices
- (+) More incremental fiscal support likely
- (−) Real estate sectors remain in the doldrums



EMERGING MARKETS (EM)

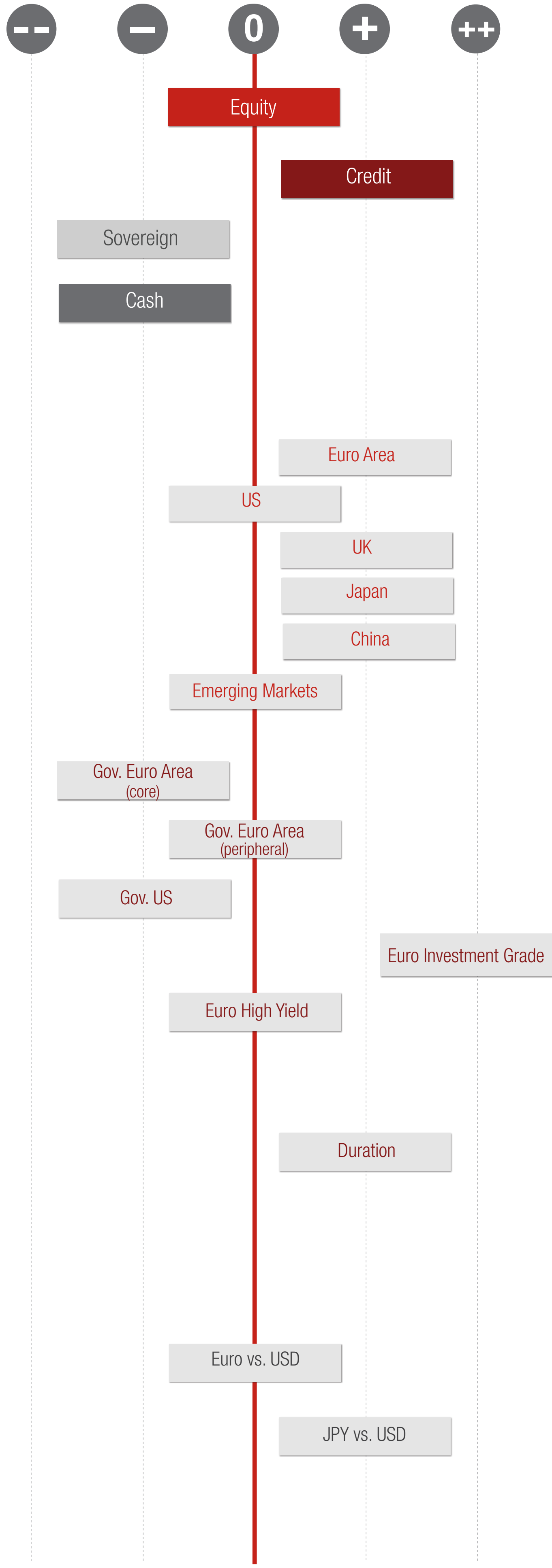
- (!) EM growth data surprised to the upside
- (+) Disinflation to lose steam but rate cuts continue
- (+) Spreads tightened meaningfully

(+) Positive
(−) Negative
(!) Topics to watch

Your Partner for Progress.

DIRECTION OF TRAVEL

- We remain neutral on the riskiest parts of our portfolio (Equities, HY).
- We increase the overweight (OW) in IG Credit as spreads can tighten further.
- We increase the OW in long-dated Govies, both core and periphery.
- We fund this more aggressive stance by going underweight (UW) in short-dated Bonds and Cash.



Equity

- Markets are repricing CPI and interest rate expectations once again. We remain neutral short term.
- That said, we remain constructive in 12 months and expect a positive 12-month TR: 4% SPX and around 7% for EMU.
- We are tactically OW EU vs. US. OW Japan, OW India, Korea and slowly accumulating China.

Bonds

- Increase in core gov. bond yields appears overdone. While a temporary further increase cannot be ruled out, both US and EA yields are skewed to the downside medium term.
- A slight widening of EA non-core gov. bond spreads is likely, but EA non-core bonds are still seen to outperform EA core bonds.

Duration

- Long duration.

Currencies

- US resilience and curbed rate cut expectations keep the USD underpinned. We raise our forecasts for the greenback for major crosses.
- That said, key triggers for renewed USD weakness later in the year keep looming if more mildly so than before.
- And on various measures the USD bounce already looks stretched.

TOPICS TO WATCH

Topic	Probability	Impact
A more stubborn last mile of disinflation (wages, sticky services inflation, energy prices) delaying rate cuts further.		
Intensified global fracturing (esp. China/US), notably on grown odds of Nov. 5 Trump victory (punitive tariffs).		
Cracks in financial stability as tighter conditions feed through (CRE defaults, banking, housing, non-bank liquidity…).		
Broader recovery, ongoing disinflation, broadening of the Tech rally (far from a bubble).		

Probability: High ←→ Low

Impact: High ←→ Low

GLOSSARY

CARRY

The cost of holding an investment, whether positive or negative, taking into account income minus cost of funding. For example, investors can sometimes employ a positive carry strategy by investing borrowed capital and making a profit on the difference between the interest earned and interest paid.

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