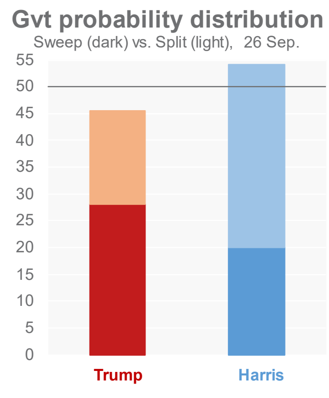
Investment View

Central bank victory, Government misery

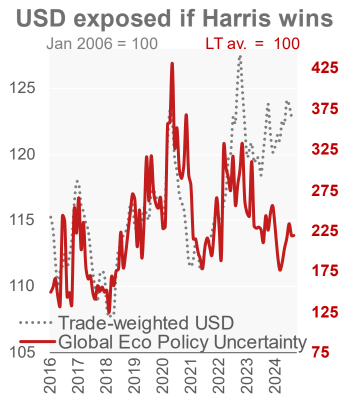
September 30, 2024

'Investment View' provides our quarterly macro & market outlook and investment recommendations

- **Central banks are close to victory, as inflation converges towards targets: the rate cut cycle is up and running. Governments around the world, instead, face stern challenges, such as large twin deficits in the US, a property overhang in China, a broken economic model in Germany and unsustainable fiscal trends in France.**
- **The financial outlook partly depends on the results of the US elections. Markets appear skewed towards a Harris victory. A split government is the most likely outcome, yet a red sweep is still more likely than a blue one. A Harris victory would be bearish USD, while a red sweep would challenge our 'buy-the dips' approach to Treasuries.**
- **We expect the global growth cycle to prove resilient, and the recent Chinese policy stimulus announcement further reduces the left tail risks. Both sides now: we see upside and downside medium-term risks for inflation, which has become harder to predict. Rates volatility should normalise further but may not return to the pre-Covid lows.**
- **The pricing of aggressive rate cuts into end 2025 has pushed bond yields lower. We are taking profit on our long duration for now but see bond yields skewed to the downside over the coming year. We continue to pre-fer Credit over Government bonds. We would use the usual pre-election correction to increase long positions in stocks.**



Source: Polymarket, Bloomberg, GenAM



Source: Fed, Baker, Bloom & Davis

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CENTRAL BANK VICTORY, GOVERNMENT MISERY

Vincent Chaigneau

- **Central banks are close to victory, as inflation converges towards targets: the rate cut cycle is up and running. Governments around the world, instead, face stern challenges, such as large twin deficits in the US, a property overhang in China, a broken economic model in Germany and unsustainable fiscal trends in France.**
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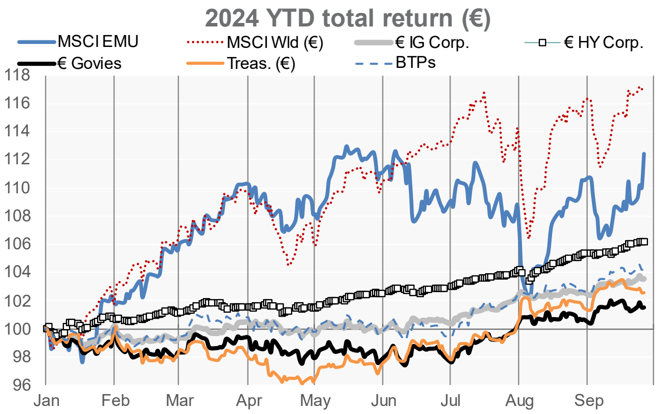
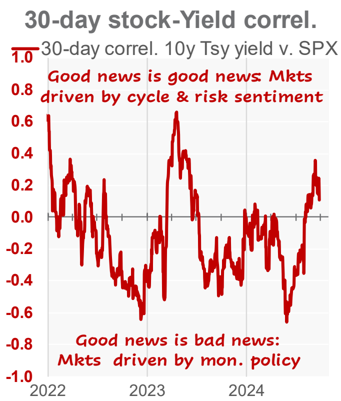
Sharp fall in Treasury yields as implied Fed path is repriced lower

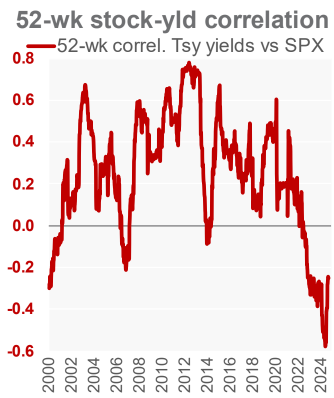
Rate cut cycle up and running. Three months left – with the all-important US elections due on 5 November – but for now the year has taken a turn for the best. The Fed's 50bp rate cut has given the global monetary easing cycle a fresh impulse, to the benefit of global markets. 3Q24 has been marked by a steady decline in bond yields, with 10-year Treasury yields down nearly 100bp from the mid-April peak, to 3.75%. The cooling of inflation has been the key driver, but partly this has also come from disappointing economic news over summer, especially for global manufacturing. The bond yield vs. stock correlation has switched to small positive – a change from the past couple of years (see charts) – suggesting that the economic cycle and investor appetite for risk are currently slightly dominating over monetary policy influence. Still, equities have managed to recover from the early August flash crash, with the MSCI World closing the quarter at a new high. As we go to press, China has unveiled a bold monetary and fiscal plan, which we think significantly reduces the risk of a local hard landing and globally threatening deflationary cycle.



Source: Bloomberg, GenAM calculations



Source: Bloomberg, GenAM



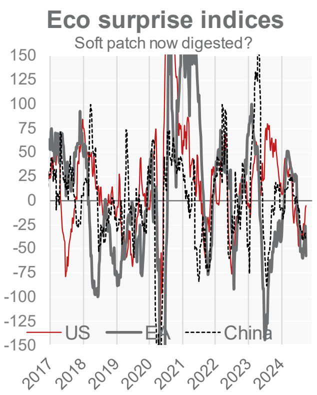
Source: Bloomberg, GenAM calculation

This cycle is not dying just yet

Steady US economy, weak Euro Area, hope for China. After a soft start to the year, US GDP growth bounced to 3% saar in Q2, and seems to be running at just about the same pace in Q3. Employment growth has slowed but not come to a halt.

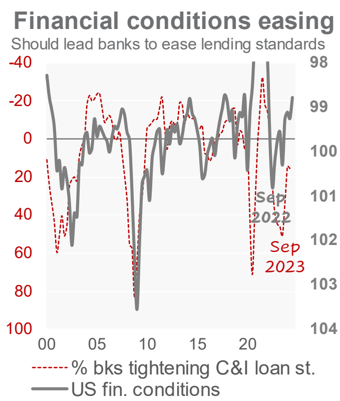
Global rate cuts and Chinese stimulus significantly reduce hard landing risks

Real disposable income is still running at a solid 3% yoy pace, enough to keep consumer trends healthy, especially with the wealth effect contributing so positively. Manufacturing activity has slowed, but services appear resilient. The rate cuts and easing financial conditions should revive the credit cycle – as the SLO survey is already starting to show (chart). China's weakness, with a credit cycle failing to react to the sharp drop in bond yields (chart), was a major headwind into autumn. Yet the just announced monetary easing (RRR and rate cuts, support to mortgage holders, funding plan for stock purchases) and fiscal package (estimated at some 2% of GDP over the next 2 years) flatten the left tail of a hard landing below 4.5% growth. The policy package appears to be a turn from the previous piecemeal approach and could be complemented by yet more fiscal spending announcements into yearend. The Euro Area remains a laggard, with economic surprises there still very negative (left chart). China's weak import demand, political troubles in France and Germany, as well as severe pressure in the mighty auto sector (13 million jobs, accounting for 7% of total EU employment) are all headwinds. That said, resilient labour markets, real income gains and a slow revival of the credit flows should keep the economy afloat.

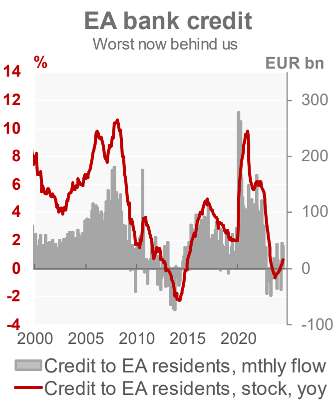


Source: Citi, Bloomberg, GenAM

Source: PBoC, Bloomberg, GenAM



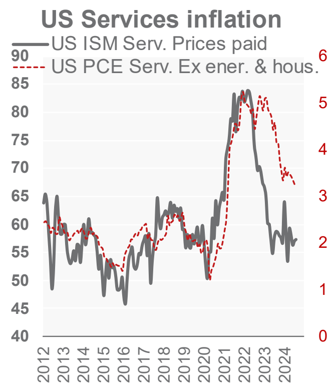
Source: Fed, Bloomberg, GenAM



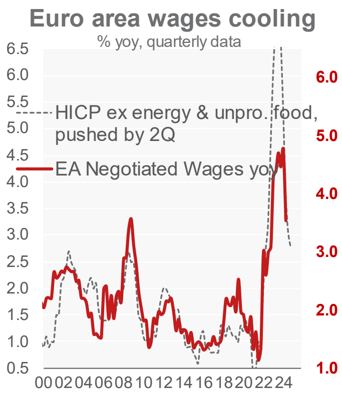
Source:ECB, Bloomberg, GenAM

Global forces suddenly raising the risk of inflation undershooting again

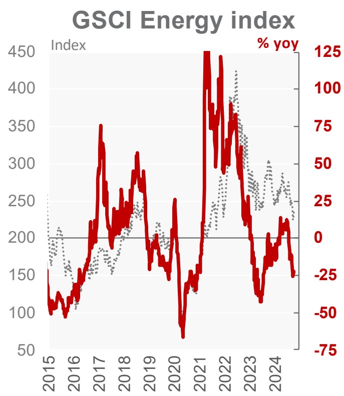
Have we under-estimated the risk of inflation under-shooting? Three months ago (Goldilocks vs. Gridlocks) we expressed confidence in renewed disinflation and falling bond yields. Now cooling labour markets and wage growth on both sides of the Atlantic should bring sticky Services inflation further down. International forces are disinflationary, not least the collapse of energy prices over the past year and China's overcapacity. Saudi Arabia's desire to ramp up production and regain market shares should keep oil prices low. China's stimulus reduces the risk of it exporting deflation, but the inflationary effect will be limited and delayed.



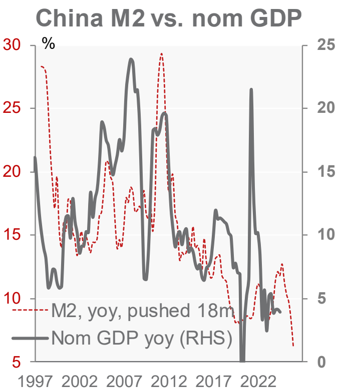
Source: US BEA, ISM, BBG, GenAM



Source:ECB, Bloomberg, GenAM



Source: Goldman Sachs, Bloomberg, GenAM



Source: NBS China, BBG, GenAM

Both sides now: upside and downside risks for inflation, which has become harder to predict

We assumed that inflation would return towards target, but not repeat the undershooting observed before Covid, when EA core inflation was trending around 1%. That is because structural factors such as deglobalisation, more frequent geopolitical shocks, greening, rising public debt etc. may keep inflation higher for longer. Suddenly this thesis appears more fragile, as counterforces (uncertain impact from demographics, Chinese overcapacity, government debt overhang causing crowding out and private demand weakness, AI productivity boost) create downside risks.

It's the politics, stupid

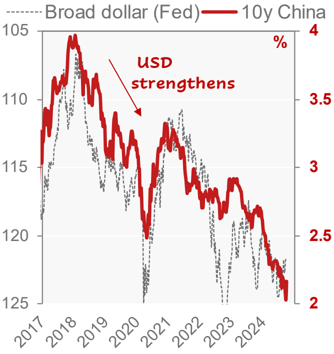
Trump victory, more so in a red sweep, would make Treasuries relatively less attractive

US election results will matter. While China's stimulus has flattened the left tail of the distribution of economic scenarios, a Trump victory could still inflict pain there. A sharp increase in tariffs towards Chinese goods – up to 60% – would aggravate the overcapacity issue. A 10% blanket tariff hike would also reduce the evasion (exporting via third party countries) that has reduced the efficacy of restrictive trade policies. While this would create a one-off inflation shock in the US, the price impact in the rest of the world would depend on retortions. For China, the heightened overcapacity issue would potentially prove deflationary. A greater exporting effort towards Europe (substitution of export destination) may also create disinflationary pressure there. In other words, Treasuries would become *relatively* less attractive in this scenario.

A Harris victory – seen as ensuring policy continuity – would likely weaken the US Dollar, which looks rich relative to measures of policy uncertainty

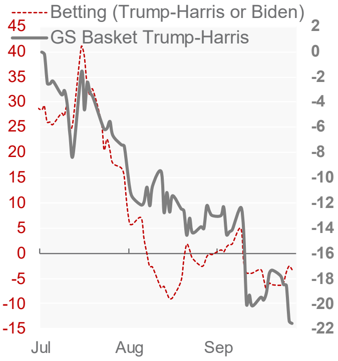
The first left chart below shows that dollar strength over the past years has coincided with the fall in Chinese long-term yields. Correlation is not causation, but the dollar rally has owed not just to US economic strength but also non-US, including Chinese, weakness. The US dollar, even if it has turned down since early July, looks rich from a long-term valuation perspective. A Trump victory, we reckon, would keep it strong or make it stronger, as US equities would outperform, and policy uncertainty would increase. Instead, a Harris victory – ensuring policy continuity – would weaken the USD, which already looks rich relative to measures of policy uncertainty (chart).

Broad USD vs 10y China



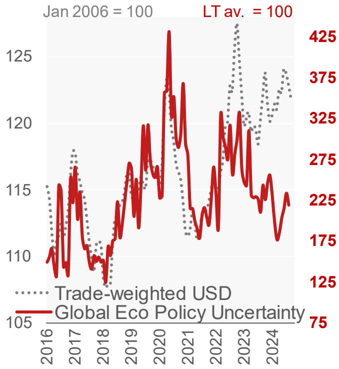
Source: Fed, Bloomberg, GenAM

Eqy baskets vs. betting



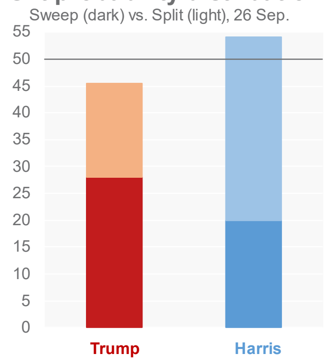
Source: RCP, Goldman Sachs, BBG, GenAM

USD exposed if Harris wins



Source:Fed, Baker, Bloom & Davis,

Gvt probability distribution



Source: Polymarket, Bloomberg, GenAM

Markets increasingly pricing Harris victory, yet red sweep more likely than blue sweep

The improving odds of a Harris victory have been priced across markets, e.g. a Democratic equity basket has strongly outperformed a Republican one since she has replaced Biden (chart above). Such pricing action may be exaggerated and underestimate the importance of government unity. Most likely the elections will result in a split government in Washington D.C., but the chance of a Republican sweep is greater than that of a Democratic sweep, because the certainty of Republicans winning the Senate is greater than that of the Democrats winning the House (top-right chart above). A Republican sweep would be bullish the US dollar, would threaten our view that US bond yields are skewed to the downside and would support US equities relative to the rest of the world.

Buy the dips in bonds

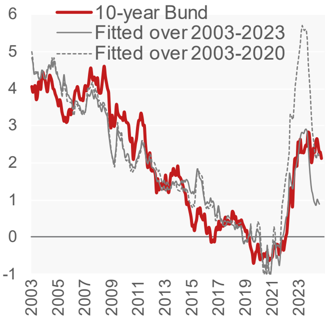
We would buy the dip in bond prices, and more so under a Harris government but Republican Senate

Bond yields skewed to the downside. Bonds have already rallied a good deal since spring, more so in the US. Near-term consolidation would not be surprising, given that markets already price nearly 200bp of Fed cuts into end 2025, on top of the 50bp delivered in September (upper end now at 5%). This would mean a fast-paced convergence towards neutrality. The 75bp priced already for the last two meetings of 2024 may be too ambitious. But we would buy the dip in bond prices, and more so under a Harris government but Republican Senate. Treasuries have already cheapened very significantly on a swap spread basis, with 10-year UST trading around SOFR+45bp. Surely this reflects growing pessimism about fiscal trends, but with SOFR itself collateralised with Treasuries, we see limited room for cheapening (baring large anomalies in funding markets). 10-year USTs also trade some 60bp above 5y3m OIS (itself fair, around 3%), a generous premium by historical standards. Barring a Republican sweep, we will be buying the likely near-term dip in Treasury prices. Likewise, ECB pricing looks ambitious, but the combination of weak growth and much softer inflation data skews risk to the downside for Bund yields (bottom-left chart).

Still downside room for rates volatility, but inflation uncertainty should prevent a collapse

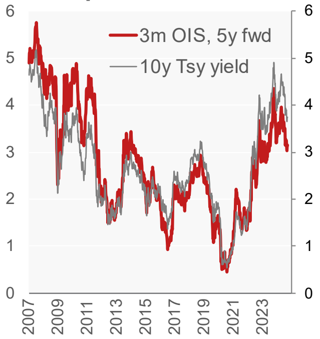
We expect bond volatility to normalise further (down), as central banks proceed steadily with rate cuts. Realised 10-year nominal US bond yield volatility has cooled off this year, while staying quite elevated by historical standards, particularly relative to inflation breakeven volatility (bottom-right chart). We see limited room for the latter to decline much in the context of elevated inflation uncertainty described above. This should prevent nominal rates volatility from returning to historically low levels.

Bund 'fair value' retreating
Model based on core CPI, EC eco sent., ECB bal. sheet, Brent EUR



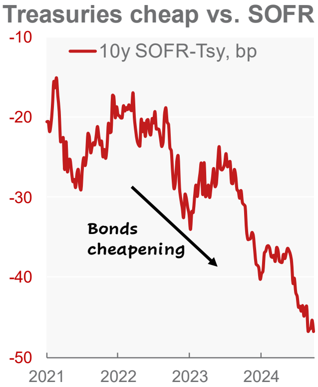
Source: Bloomberg, GenAM calculations

10yT vs. mid-term expected Fed rate



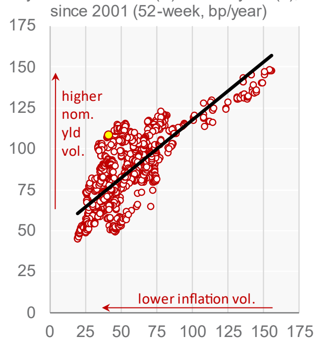
Source: Bloomberg, GenAM

Treasuries cheap vs. SOFR



Source: Bloomberg, GenAM

Realised rates volatility
10y TIPS breakeven (X) vs nom. yield (Y), since 2001 (52-week, bp/year)



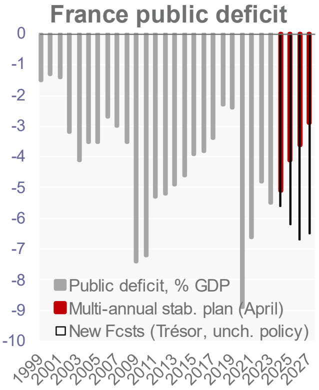
Source: Bloomberg, GenAM calc.

A new ‘impossible trinity’ for EA sovereigns?

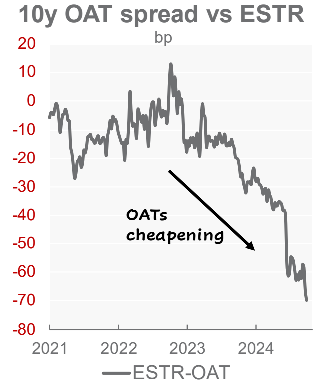
Continue to prefer Credit over Govies. This has been a structural call for us. Of course, credit spreads are now tight, and the narrowing space has sharply diminished. But the political and fiscal troubles in France only illustrate our points that 1) sovereign fundamentals have deteriorated much faster than corporate ones over the past 16 years (since the GFC). Public debt has grown much faster, even when adding Private Debt to the corporate debt tally; 2) sovereigns, more so in the euro area, face a new ‘impossible trinity’: how to operate the costly transitions (green, digital, military, demographic) without threatening debt sustainability and political or social stability? We expect the Barnier government to deliver significant spending cuts and tax hikes to address the unprecedented (outside crisis times) fiscal slippage. This may offer some brief relief to OAT spreads, but the extreme political instability – anchored in the weak democratic legitimacy of the government – suggests that risks remain skewed towards the widening side. Corporate spreads have tightened sharply vs. Bund over the past two years, but on a beta adjusted basis have lagged swap spreads (third chart

Keep High Yield over-weight small, but raise after US elections

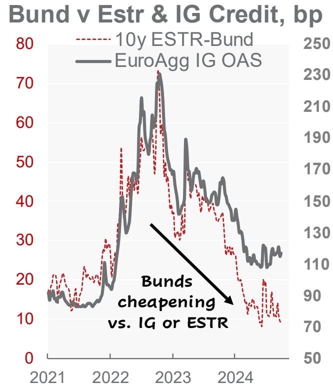
below). BBB corporates still offer a small pick-up vs. the BTP 7-10y sub-index, for an index volatility that is about half. Into the US election we prefer IG and keep any High Yield overweight marginal, but plan to increase exposure into the turn of the year. Find details about our Credit allocations in the dedicated section.



Source: Eurostart, France FinMin, GenAM



Source: Bloomberg, GenAM



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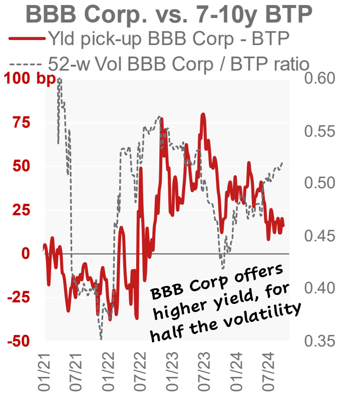
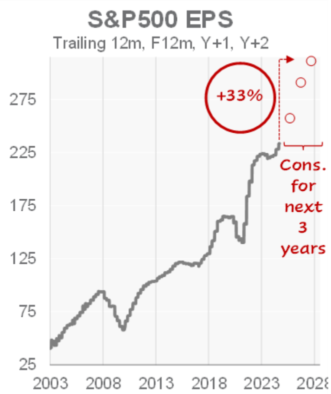


Source: BofA, Bloomberg, GenAM calc.

Moderately bullish equities

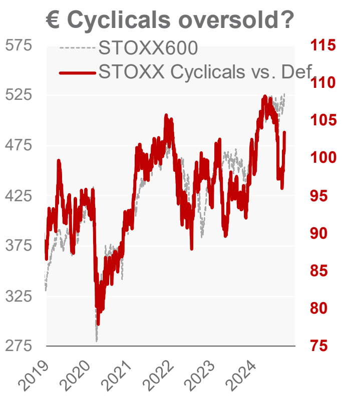
Increase US equity exposure into the turn of the year, positioning for moderate but broader gains

Humbling rally. Equities have travelled the Quantitative Tightening remarkably well over the past couple of years – better than we and most analysts thought. Partly this reflects the phenomenal AI rally, but not just. It is hard to be exuberant when the consensus already expects S&P500 earnings to grow some 10% p.a. on average over the next three years, quite a feast. Still, global expectations are less demanding, and valuations tend to improve as long-term real yields pull back (chart). Historically global equities tend to consolidate right into the US election, and rally afterwards. We recommend caution into the US election but plan to extend exposure (Overweight) this fall. European equities have lagged again this year but should benefit from signs of a greater stimulus in China. Already EU cyclicals have bounced back; our equity portfolio composition is balanced but still long selected Cyclicals, such as banks. EM equities look generally cheap. EA small and mid-caps (SMID) need both a resilient cycle and lower rates and should get enough of this to continue to recover (bottom-right chart). More details in our Equity sections, and in the Asset Allocation recap at the end of this report.

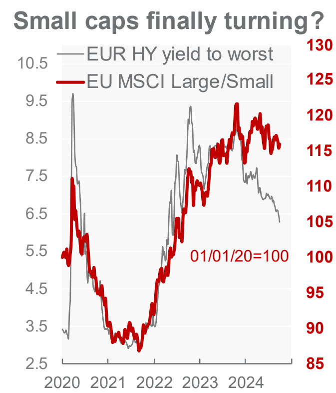


Source: Bloomberg, GenAM

Source: MSCI, Bloomberg, GenAM



Source: Stoxx, Bloomberg, GenAM calculations



Source: MSCI, Bloomberg, GenAM

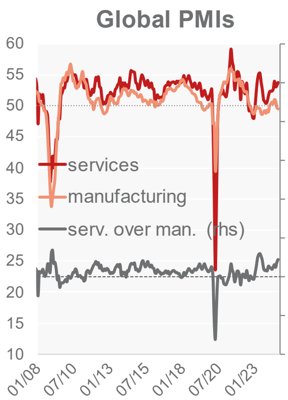
MACROECONOMIC OUTLOOK

Thomas Hempell, Guillaume Tresca, Martin Wolburg, Paolo Zanghieri

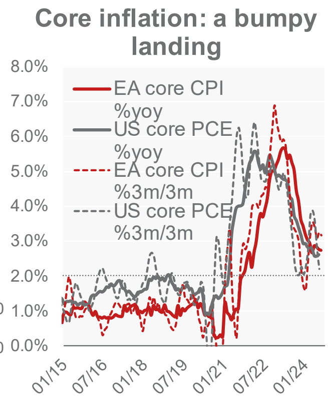
- **The green shoots in global manufacturing spotted in spring have not survived the summer, with both activity and expectations rolling over. The Chinese economy keeps struggling to gain traction amid persistent property woes.**
- **Yet the situation and outlook for services remains quite resilient, US consumption is solid and leading indicators for advanced economies point to further moderate expansion. Lower rates will support the recovering credit cycle. And Chinese policy makers are warming up to bolder support measures. We expect a soft landing of the US economy and a continued muted recovery of the euro area.**
- **The big disinflationary impulse from goods has run its course, but easing demand and China's deflation worries will limit any rebound. Cooling labour markets point to a further moderation in wage growth while US housing costs will finally ease, which will help to cool still elevated services inflation.**
- **The ECB will maintain its data dependence, but with inflation set to ease sluggishly further, we have a protracted series of quarterly 25bp rate hikes over 2025 in our books, with the terminal deposit rate now forecasted at 2.25% by end-2025 (vs. 2.5% before). Following recent data disappointment, the risks are clearly tilted towards faster and potentially even deeper cuts.**
- **After the Fed kicked off its easing cycle on Sept 18 with a 50bp jumbo hike, we expect a series of further 25bp cuts at each subsequent meeting until Q1 2025, implying further 50bp easing this year and another 125bp next to 3.25% (upper bound) by YE25. This is more cuts than forecast thus far but less than priced by markets (70bp+130bp).**

Sentiment in global manufacturing has soured over the summer…

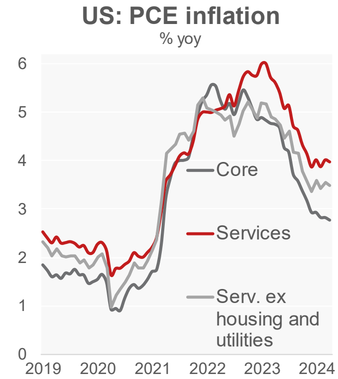
Global green shoots in manufacturing spotted in the spring have not survived the summer as industrial order books and activity indicators have deteriorated sharply. Headwinds are particularly strong in the euro area, where lost competitiveness, high energy prices and spluttering car production are weighing. Sluggish demand in China neither helps, as the ailing property sector keeps weighing on growth and consumer sentiment. This implies downside risks to the further recovery.



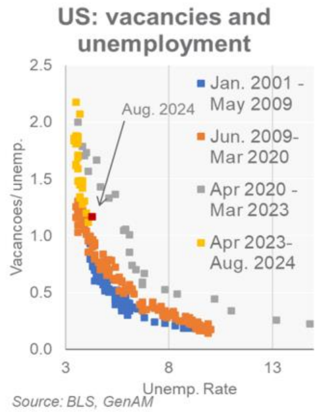
Source: Markit, Datastream, GenAM



Source: Datastream, GenAM



Source:BEA, Refinitiv, GenAM



Source: BLS, GenAM

… but the prospects of services are still solid

Yet we caution against exaggerated cyclical pessimism. The outlook for services remains resilient. Notably US consumption is solid and leading indicators for the advanced economies point to further moderate expansion. Lower rates and more ample credit availability will support the recovering credit cycle and underpin investment. Consumers continue to benefit from the tailwinds of rising real disposable income amid rising nominal wages and falling inflation rates. We expect a soft landing of the

US economy and a continued muted recovery of the euro area. China is poised to undershoot its 5% growth target for this year. But recent support measures indicate that policymakers are waking up to the challenge, with the odds of some more meaningful fiscal policy stimulus rising.

Disinflation is well under way, but markets may currently overestimate the depth and speed of prospective rate cuts

The big disinflationary impulse from goods has run its course, but easing demand and China's deflation worries will limit any rebound. Cooling labour markets point to a further moderation in wage growth. US housing costs - which are still a source of stronger price increases – will finally ease, helping to cool high services inflation.

The shift from acute inflation worries to a greater focus on growth and employment is opening the doors for a protracted series of rate cuts by central banks in the advanced world, even though the actual pace by the Fed and ECB is likely to turn out somewhat more prudent than currently priced by markets.

US: growth holds steady, the Fed starts loosening with a bang

GDP growth will exceed 2.5% in 2024.

Q2 growth surprised to the upside at 3% annualised. Consumption remains very strong (2.8% annualised), and, despite high borrowing costs, non-residential capex kept growing steadily (3.9% ann.), due to higher corporate expenditure in IT and software. Housing activity seems to have bottomed. Slower H2 growth on the back of cooling consumption will lead GDP to expand by 2.6% this year and 1.9% in 2025.

The labour market is showing signs of weakness as job creation during the summer slowed markedly: nonfarm payrolls grew by 117K per month between June and August, versus 225k in the first five months of the year. The share of job openings to employed persons declined to around 1.1 in line with the pre-pandemic average. This helped reduce wage growth. Moreover, the ongoing increase in productivity, pushed unit labour cost growth to 0.3% yoy, the lowest level in more than ten years. This should keep underpinning the disinflation process over the coming months: core PCE inflation stood at 2.6% in July, mainly due to still high rents.

Fed to cut by at least 100bps this year

Yet the progress on inflation was strong enough for the Fed to start cutting rates, by larger than expected 50bps. The FOMC played down concerns about the labour market and reckoned that the large cut was just a way to maintain the satisfactory momentum of the economy. Following a trend visible since 2022, the long term (neutral) policy rate was nudged up again, to 2.9% and we expect a further convergence to our 3.1% projection. We see another 50bps of reduction by year-end, and 125bps in 2025. Risks are tilted to more accommodation this year, while the outlook for 2025 hinges on the outcome of the November election and whether the new president would have a majority in the Congress enabling the implementation of the electoral manifesto. Both parties have policy agendas which would raise inflation, with the combination of tariffs and tax cuts proposed by the Republicans positing the largest risk to price stability.

EA: recovery lags behind expectations, ECB to become more dovish

Weak indicators in Q3 raise concerns about receding activity …

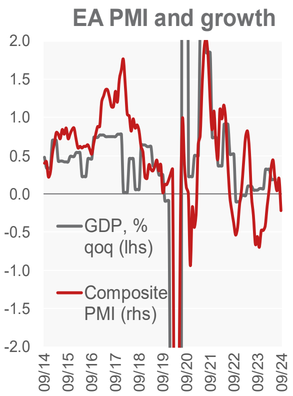
Hopes of a sustained euro area recovery proved wrong so far. Following a good start into the year, quarterly growth lost momentum. Even more worrisome, sentiment indicators for the third quarter deteriorated sharply with some, like the composite PMI, even having started to signal contracting activity. We see two main reasons behind this: First, the weakening of the manufacturing sector related to lacklustre growth in China and a weaker US economy. Second, domestically policy uncertainty in German and France soared strongly over the past months thereby dragging on consumer confidence and reducing investment.

That said, we deem it premature to write the recovery off. Receding inflation amid solid to strong wage growth will back real income growth. Moreover, consumers are still sitting on huge piles of excess savings. And the savings rate that rose to the post-pandemic high of 15.4% in Q1 should come down again. There is indication from the ECB's Bank Lending Survey that the demand for investment increases and the peak of monetary policy restrictiveness will likely be passed in the coming months. Together with China and the US not falling off the cliff we look for ongoing muted expansion in the months to come. But the risks to our annual growth forecasts of 0.7% for 2024 and 1.1% for 2025 are clearly tilted to the downside.

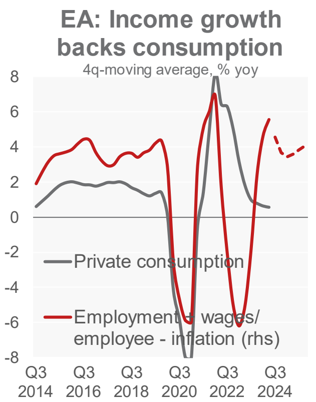
… but domestic activity should stay strong enough to avoid a recession

Inflation has continued to trend down but core inflation was still at 2.8% yoy in August. Given the weaker than expected economic situation not only the confidence in reaching the inflation target by the ECB increased but inflation risks have now somewhat moved to the downside as also wage growth could ease more visibly. With a key rate of 3.5% after two 25 bps cuts, monetary policy is still clearly restrictive. The ECB will become more dovish. It might speed up its easing cycle, making our expectation of no action in October a very close call. From December onwards we now think that the ECB switches towards rate cuts at each meeting so that it reaches our end 2025 expectation of 2.25% earlier with the risks tilted towards even more cuts.

More dovish ECB might speed up its easing cycle



Source: Datastream, GenAM calculations



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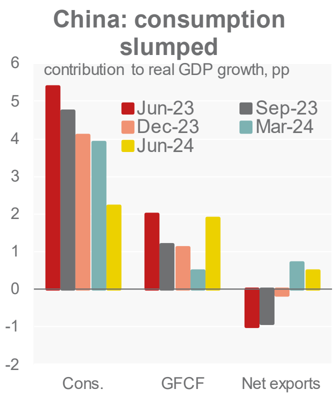
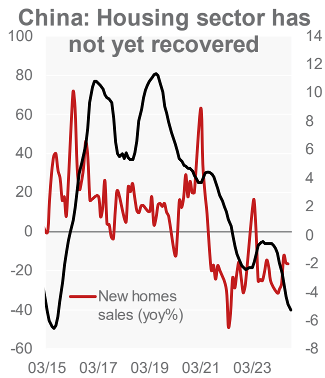


Source: Bloomberg, SG, GenAM



Source: Bllomberg, NBS, GenAM

China: a new round of monetary easing and upcoming fiscal support

Given the downside risk to activity, we revised our GDP growth to 4.8% from 5.0% in 2024. Indeed, the latest activity data came on the soft side with the housing sector still a drag on the economy and no noticeable improvement. New home sales and prices have continued to decline while investment, hampered by the construction sector, came below expectations. Meanwhile, private credit demand has remained lacklustre and consumer confidence is low. Given the risk of deflation and of undershooting the growth target, policymakers have turned proactive with several decisions and bolder rhetoric. First, the PBoC recently implemented a broad easing of key rates and has adopted dovish forward guidance hinting at further cuts in Q4. Second, in an unusual move, the September Politburo meeting insisted on actions to turn around the housing market for the first time and pledged for a long-awaited fiscal support. The concomitant measures are steps in the right direction and show a clear will to support the economy and consumer confidence. Attention will now focus on the size and the form of the fiscal stimulus that should be announced later in October.

China: new monetary easing and pledge for fiscal stimulus

GOVERNMENT BONDS

Florian Späte

- **Given exaggerated key rate cut expectations, prevailing growth concerns and somewhat too optimistic inflation expectations, we believe there is potential for slightly higher government bond yields in the short term.**
- **However, the potential for a strong increase is limited given the cycle of key rate cuts that has begun. If pessimistic growth expectations are realised, we can expect even lower yield levels in the coming months.**
- **When it comes to euro area non-core bonds, there is still some differentiation to be made. While French OATs should continue to be avoided due to structural and political risks, the more fundamentally well-positioned countries have reached or even fallen below pre-European election spread levels. The environment for these countries remains favourable, so it is still appropriate to invest in these bonds.**

Expectations of key rate cuts rose sharply in the third quarter, driven by a marked decline in inflation combined with weaker economic data. This led to a significant steepening of the yield curves, but ultimately also pushed down long-term government bond yields. However, we now consider the rally to be somewhat overdone and see slightly higher short-term yields at the long end of the curve in the short term.

Key rate cut expectations overdone

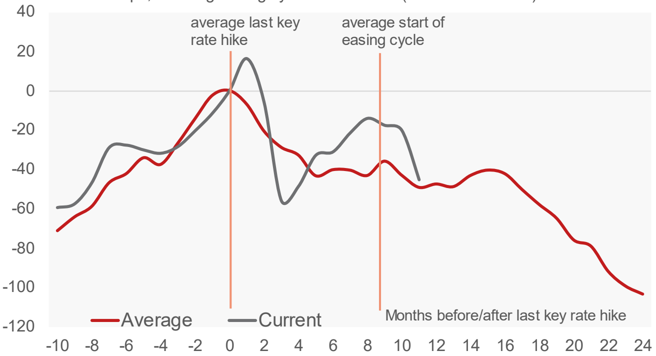
The Fed is expected to cut rates by almost 200 bps over one year, while the ECB is priced in for cuts of around 165 bps. Although inflation rates on both sides of the Atlantic have eased noticeably recently, not least because of the sharp drop in the price of crude oil, it would be premature to claim victory over inflation. The core rate is still well above the 2% target both in the US and in the EA. However, medium-term inflation expectations (5-year 5-year inflation swaps) in the US and the EA are only just above 2.4% and 2.0%, respectively. These are the lowest levels for two years and do not adequately reflect the difficult path to lower inflation. Financial markets expect a significantly more favourable inflation picture for the next years than the central banks. Moreover, in our baseline scenario we do not see a recession but forecast a soft landing in the US and a continuation of moderate growth in the EA and no further economic setback as some market participants are currently fearing following the recent disappointing data. As a result, we also see central banks taking a more gradual approach. Over the next 12 months, we forecast the Fed to cut rates by only 150 bps and the ECB by 100 bps. As a result, the bond market rally is likely to run out of steam and yields at the long end are seen to even rise slightly in the short term.

Limited upside in long-term yields in monetary easing cycle

Having said that, we regard the leeway for significantly higher yields as limited. Typically, long-term bond yields fall during a rate-cutting cycle. Irrespective of possible temporary rebounds, the yield trend between the first and the last rate cut is downward (see chart). In this respect, the risks are asymmetric, and we recommend buying during periods of rising yields. This view is supported by the political gridlock in the EA and the restrictive fiscal policies, as well as the fact that the gap between 10-year US bond yields and the expected medium-term US policy rate (as measured by the 5y3m OIS), which has narrowed slightly recently but still exists, will ensure falling yields in the medium term. On a 12-month horizon, we forecast in our base scenario 10-year US yields to reach 3.5% and 10-year Bund yields to decline to 2.1%. While the transatlantic yield spread is unlikely to change much in the next three months, we reckon it will narrow to 140 bps in the medium term. If the currently priced-in key rate expectations and growth concerns materialise, the decline could be even more pronounced. This is all the more true if the deflationary tendencies emerging in China are also felt more strongly around the world.

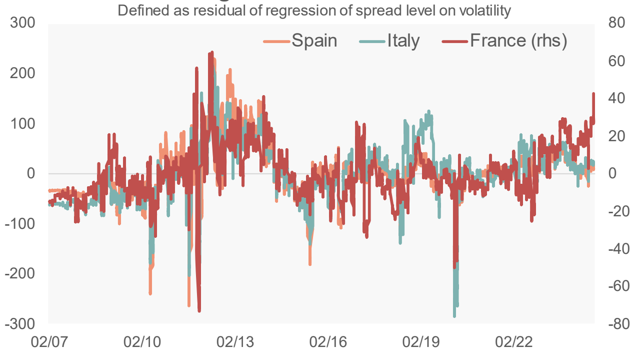
We consider a scenario of rising yields as a result of the US presidential election to be particularly relevant for the US. If the new president also has a majority in Congress, it can be assumed that the goals set out in the election manifestos will be implemented. In particular, a Republican sweep is likely to slow down the cycle of key rate cuts due to the inflationary impact of higher tariffs. The combination of even higher budget deficits and higher inflation should also lead to an increase in the term premium, limiting the expected decline in yields forecast in our base scenario.

10-yr Bund yield in the easing cycle
in bps, covering easing cycles since 1960 (until 1998 Dt. Bbk)



Source: Datastream, GenAM

Rising risk aversion for OATs
Defined as residual of regression of spread level on volatility



Source: Bloomberg, GenAM

Markets regard French problems as idiosyncratic with limited spillovers

Developments in the EA non-core government bond segment were very heterogeneous and it was difficult to identify a single trend in the third quarter. While French OATs moved volatile sideways and is almost back to the peak from June, Italian, Irish, Greek and Portuguese bonds even reversed more than the full widening since the European elections.

We remain cautious on French OATs

We remain cautious on French OATs. Not only did the previous government fail to significantly reduce the budget deficit after the Covid pandemic, but there is a risk that it will widen again. The new government faces the difficult task of drawing up the new budget in line with EU rules and significantly reducing the deficit without a stable and reliable majority in parliament. This fundamental problem is exacerbated by the fact that more than 50% of French bonds are held by foreign investors. They are particularly risk-averse. Data shows that Japanese investors sold JPY 3000bn worth of OATs in July and August alone. France has a relatively high savings rate, so domestic investors can fill the gap. However, given the expected negative news flow (France will probably have to cope with rating downgrades from several agencies in Q4), this is likely to happen only at higher spread levels.

Our view on other EA non-core bonds is quite constructive, as it has been shown that investors still appreciate solid fiscal and growth track records especially in a difficult market environment. Fundamentally, government bond issuance is well underway. Even considering the ECB's PSPP and PEPP QT, 80% of all net issuance has already been placed in the market. The ECB will continue to cut rates. Demand from both retail and institutional investors remains robust.

Against this background, we continue to recommend buying Portuguese and very long-dated Irish bonds. Given the good performance of Italian BTPs, we see no further spread tightening potential and recommend staying on the sidelines despite the low political volatility.

CREDIT

Elisa Belgacem

- **Our investment strategy maintains an overweight position in Investment Grade (IG). We like the carry versus government bonds. We also keep our mild long HY as we believe that the demand for the asset class will remain strong.**
- **Given persistent pressure on the OAT/Bund spread we remain underweight financials vs non-financials as we believe the unstable political situation may continue translate into wider French financial credits.**
- **We believe credit spreads will oscillate around current levels into year-end as we believe that overall there is still a strong appetite for credit as, despite relatively tight valuations, the all-in yield remains elevated to many types of investors**
- **We recommend either extending duration in IG non-financial, the 5-7Y bucket, or preferring subordination risk to credit risk with AT1 corporate hybrids remaining more attractive than BBs.**
- **CDS remain tighter than cash, making credit protection an attractive option.**

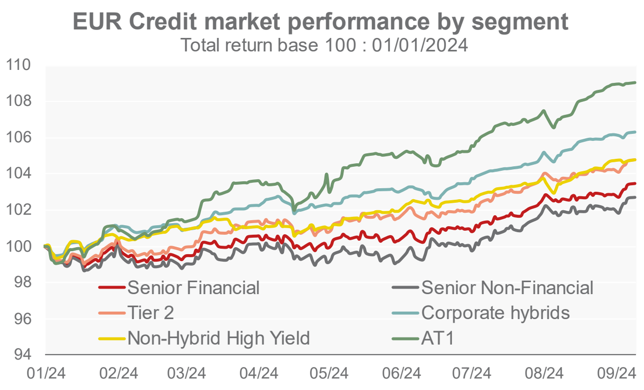
Over the last few weeks, the aggressive dovish repricing of major central banks is setting a new landscape for the end of the year. During the era of very low interest rates, credit was bought as investors were desperately hunting for yield. But evidence show that this still holds true as interest rates are above their equilibrium level.

Are lower rates a risk for credit?

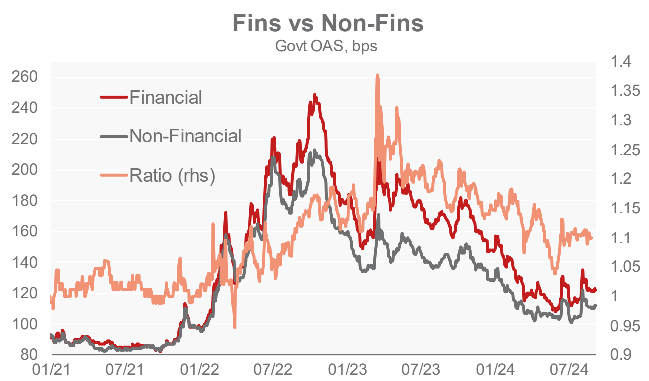
This year the demand for credit has been steadily growing despite relative richness of valuations giving little spread tightening perspective. The reason motivating this strong appetite for the asset class is, beyond relative benign default outlook, the elevated all-in yield that investors can get on their credit investments.

> IG will likely continue further to benefit from the dovish repricing of central banks.

As both the ECB and the Fed have now started to ease their monetary policy, investors are trying to move out of the once yieldy money market funds into other altgernatives to preserve their return profile over the coming years. Inflows since the beginning of the year have been particularly strong in IG as the risk profile is relatively close to money markets funds while the duration is much longer offering this level of rates boosted by the credit spreads over a time-horizon longer than five years.



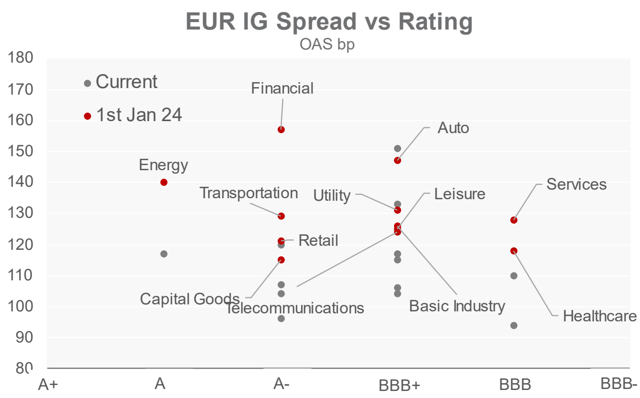
Source: Bloomberg, BofAML indices, GenAM



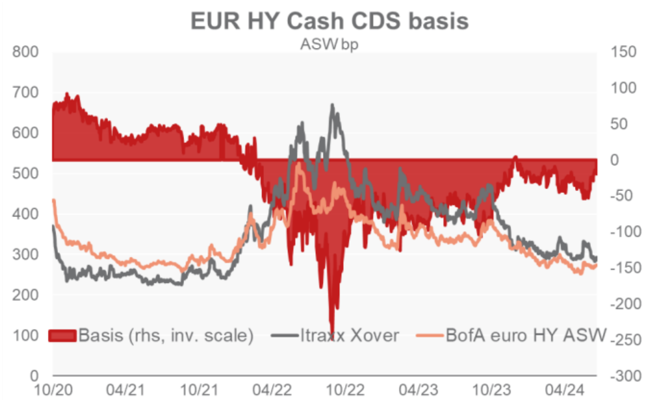
Source:Bloomberg, BofAML Indices, GenAM

For HY however, the picture might be slightly different as it is obviously a significantly riskier asset class compared to money market. HY bonds might it harder to find buyers if interest fall too quickly as the all-in yield provided by the asset class might no longer be attractive enough to entice total return investors.

Hence in our view, the main risk for credit spreads is to see an acceleration of the pricing of rate cuts that would mechanically supress part of the demand that currently supports credit spreads.



Source:Bloomberg, BofAML indices, GenAM own calculations



Source:Bloomberg, BofAML Indices, GenAM own calculations

We retreat to the safest spots – safer and not that costly.

> Single-As might outperform in spread terms but BBBs will deliver better total returns.

We generally position for defensive carry, within IG where we prefer BBBs versus single-As in total return terms. IG spreads are likely to fluctuate around current levels in the coming months. With interest rates likely to fall on the back of central bank rate cuts, it makes sense to look to long-dated IG for enhanced credit returns, as we expect the fallen angels risk to remains very limited.

However, we believe that HY spreads are expensive but should be resilient near term, thanks the attractive all-in yield continues to attract strong demand. We believe that defaults have probably peaked already but, this cycle is very peculiar, and we expect that ratings will continue deteriorate nonetheless. It is particularly the case in the lower end of the rating spectrum in single-Bs and CCCS, whereas IG should remain relatively immune to that risk.

OW non-financials versus financial We believe that the widening of the OAT-Bund spread should imply further pressure on French financial names. Given the large share of French names within the financial index (25%) we prefer to be exposed to non-financials.

We remain long cash over CDS as we believe that current expensive CDS valuation make it a good entry point for putting hedging strategies in place, in the iTraxx Main or iTraxx subordinated financials.

Subordination risk still preferred to credit risk Similarly, we find subordinated bonds attractive relative to pure high yield, and we continue to prefer corporate hybrids to BB-rated companies and AT1s to single B-rated companies.

Overweight defensive sectors cyclical sectors are currently being under pressure given the worries on both the US and Euro Area growth. This has been particularlyu the case for Autos. But the cyclicality premium in our view isn't yet large enough to justify buying the dips. The rating agencies have continued to upgrade cyclical companies, but we believe they will reverse course shortly. Hence we have a preference for Utilities, Telcos and also Real Estate over Automobiles and Industrials.

EM SOVEREIGN CREDIT

Guillaume Tresca

- **The EM macro environment has still been supportive, but more risks are emerging that lead to a reduction in beta and a focus on quality.**
- **EMs are more vulnerable to a Republican victory in the US elections, especially North Asia and Mexico. Fortunately, the Fed easing cycle will provide support to EM fixed income.**
- **We maintain our preference for EM external over local debt and for IG over HY. Valuations have improved but are far from being attractive. Returns will be essentially driven by rates as the EM FX environment will be challenging.**

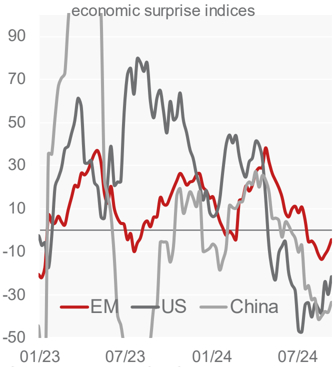
Still a positive macro environment but growing risks. The EM macro environment has still been supportive with only a modest growth slowdown expected in Q4 while disinflation should continue but a more moderate pace as core inflation has proved sticky. More risks have been emerging that should fuel volatility ahead.

The first one is obviously the US elections which will have a short-term impact given the level of uncertainty but also long-term EM impacts as it can affect geopolitics, the USD, and UST rates. Second, it is the growth slowdown in the US and above all in Europe. As long as it remains contained, the EM impact should be limited. Finally, it is the downside risks to growth in China where we revised lower to 4.8% from 5.0% our 2024 GDP forecasts. The latest announcement from the PBoC and the September Politburo meeting show a clear will to support the economy and consumer confidence. They are partially lifting some of the market concerns, but details on the size and the form of the long-awaited fiscal stimulus are still lacking.

Reduce risk, up in quality. It is hard to rule out that the backdrop is supportive for EM risky assets with the Fed dovishness and the reprising of Chinese expectations. However, the US elections are an elephant in the room and it is difficult to increase EM risk given the expected volatility. Therefore, we maintain our preference for quality names, reduce beta and favour external debt over local debt.

EM in a better stance

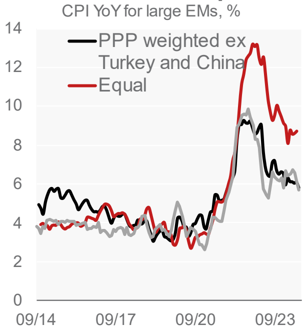
economic surprise indices



Source: Bloomberg, Citi, GenAM

Disinflation continues at a more moderate pace

CPI YoY for large EMs, %



Source: Bloomberg, countries, GenAM

Impact of possible Republican policies

Policies	Decisions	Winners	Losers	Trades
Tarriff and trade	Higher tariffs with China and EM with trade surplus	Mexico (rerouting)	AXJ, Mexico (USCMA), CEE exporters (tariffs), EM importers (stronger USD), AGOA and CAFTA at risk	long USD/CNH, KRW, USD/MXN, Asia rate receivers
Foreign	Less financing support and push for deals. More opportunistic approach. Pressure on Iran	Ukraine and CEE (ceasefire), KSA, Turkey	Ukraine (less support), Gulf (higher premium), Israel	Sold Israel, buy Gulf CD
Immigration	Lower migrants to the US and lower remittances	Brazil (vs. Mexico)	Central America, Mexico	Sell CAC sov. Bonds, B BRL/MXN

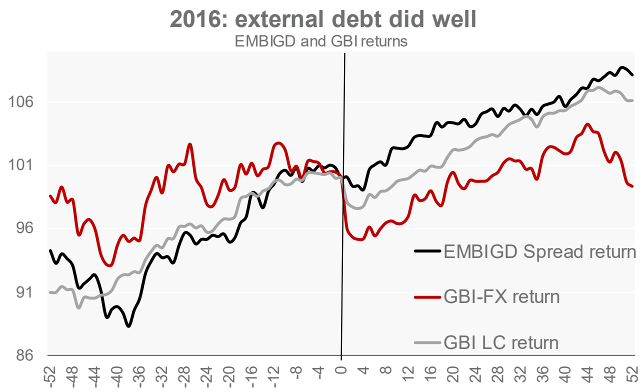
Source: GenAM

Fed and US elections: local debt and North Asia the most sensitive

> A Republic victory is the worst outcome for EMs

The Fed easing cycle and the US elections are two conflicting factors that should fuel EM volatility in the quarter ahead. Given its long-lasting ramifications, the US election will have pivotal impacts, but it is hard to disentangle the initial impact. A Trump victory will be the less favourable outcome for EMs. If history is any guide, in 2016, EM assets performance was initially poor as EM FX high yielders depreciated the most but EM external debt sharply recovered in 2017. In the current set-up, North Asia (especially China) and Mexico will be the most sensitive.

Fortunately, the Fed easing cycle may help dampen the US election volatility, but it is not a sufficient condition. Historically, performance is the largest before the first rate cut, when the Fed rhetoric pivots. As the market is already aggressive in terms of easing pricing, the risk is for a depricing that could dent a bit EM debt return via higher core rates.



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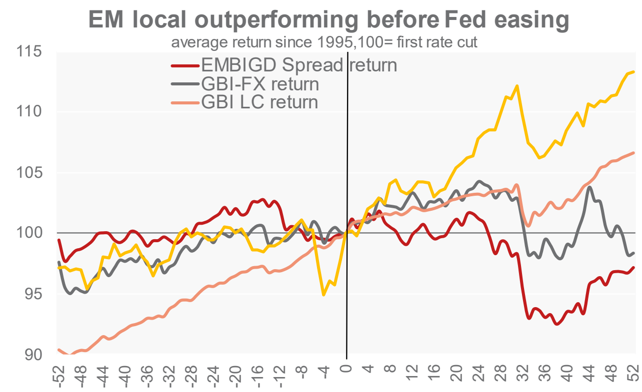


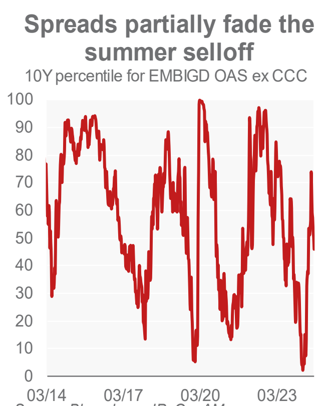
Source: Bloomberg, GenAM

Still a preference for EM external debt

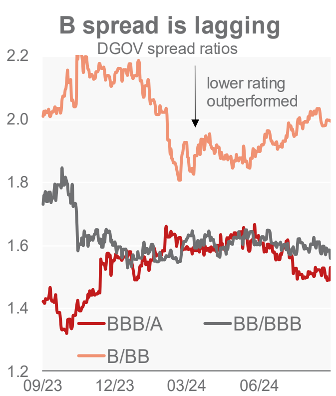
> Valuations have improved but still far from being attractive

We maintain our preference for EM external debt over local debt. Even if the environment has turned more supportive for EM local debt than before given the USD weakening and the global bid for rates, it is more sensitive to the US elections. In EM external debt, we maintain a prudent approach that favours IG over HY and a low beta exposure. Valuations have been improving but are far from being attractive. Only B spreads have been lagging and can catch up. BBs are the most expensive even if they reflect improvement in fundamentals. We add Bulgaria to our like list alongside Romania, Morocco, and Panama. Mexico is cheap but it is too early to take a position ahead of the budget presentation in November.

In the local space, valuations have been improving as rates have lagged the rally. Spreads to US rates widened and the DM central bank easing cycle is now providing room for Asia central banks to cut rates and for other central banks to fine tune their easing cycles. We prefer steepeners and receivers in the 2-3Y area. Returns will be more driven by rates as the EM FX environment is challenging. Asia FX outperformance has been astonishing, and we now see more value in LatAm FXs where the risk premium is more attractive.



Source: Bloomberg, JP, GenAM



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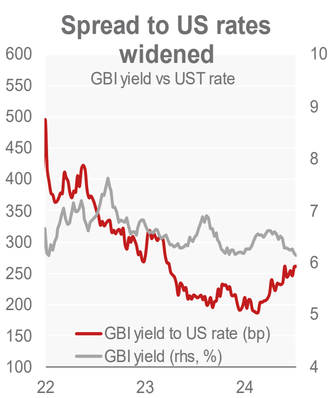

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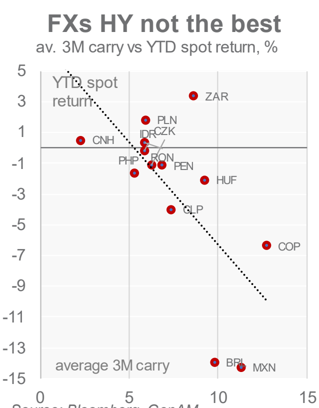


Source: Bloomberg, GenAM

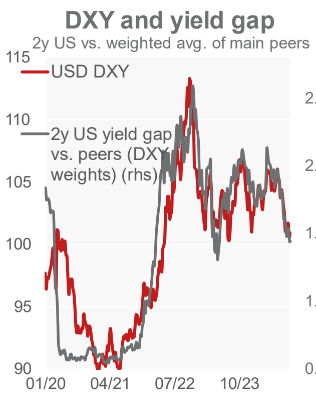
CURRENCIES

Thomas Hempell

- **The USD has taken a hit over the summer, mostly on an eroding US yield advantage. Short-term, a partial correction of excessive Fed rate cut expectations and relief about a soft landing of the US economy may provide a respite for the greenback.**
- **Similarly, recent EUR strength seems stretched. Renewed cyclical worries, political uncertainties in France and Germany and fiscal consolidation do not bode well for the near-term outlook. We do see some modest EUR/USD recovery in the medium-term, however, as the euro area recovery ultimately plays out, the yield gap vs. the trend of a narrower US yield advantage resumes and rates uncertainty recedes.**
- **The sharp unwinding of JPY-funded carry trades has boosted the yen. Short-term, the outlook for the USD/JPY seems balanced, but there is more upside for the yen into 2025 amid ongoing monetary policy divergence.**
- **Receding inflation worries and concerns about exporters' competitiveness in Switzerland will make the SNB lean towards a somewhat weaker CHF. Our outlook for the EUR/GBP is roughly balanced.**

Some short-term USD respite seems on the cards as Fed rate cut expectations look over-done

The dollar's sharp retreat over the summer (DXY close to -5% since end-June) can be almost fully attributed to the erosion of the US yield advantage vs. major peers (left chart below). The sharp repricing of (faster) Fed rate cuts and a soaring yen in the wake of a hawkish BoJ at the end of July were key drivers. Tactically, we see the outlook tilted to some USD respite near term as the speed and depth of priced Fed rate cuts seem overdone and may be prone for some correction. The upcoming US presidential election remains a wildcard. With current polling odds so tight, a Trump victory would likely give the US an additional boost (on concerns about US tariffs, higher geopolitical uncertainties, US capital inflows), whereas a Harris presidency would keep mild US downside forces prevailing mid-term (see also 2nd chart).



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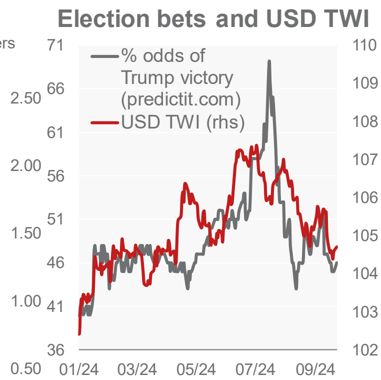
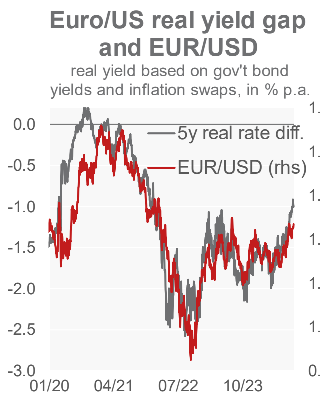
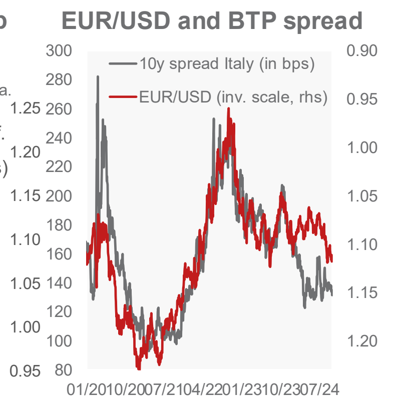


Source: predictit.com, Bloomberg, Datastream, GenAM



Source: Datastream, GenAM calculations



Source: Datastream, GenAM calculations

EUR/USD: not so fast

EUR/USD has more upside into 2025, but short-term we are more prudent

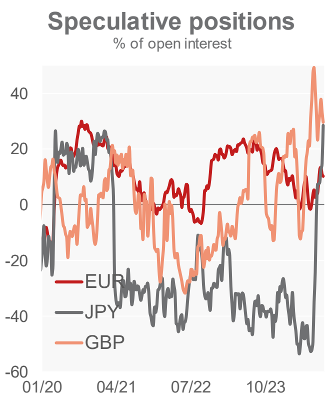
The EUR/USD has broken above 1.10. Real yield gaps and the EMU risk premium (proxied by BTP spreads, right charts above) even point to some further upside. Fair values based on multivariate models to EUR/USD (which include yield gaps, BTP spreads, risk sentiment, oil price), however, show no major misalignment. USD weak-ness amid retracing yield gaps, fading US exceptionalism and a moderately stronger euro area recovery bode well for some further ascent of the EUR/USD in 2025.

Short-term, however, we see the outlook tilted towards a lower EUR/USD. Political uncertainties in France and Germany and unsolved fiscal consolidation challenges weigh on the EUR's near-term outlook, adding to likely headwinds from moderating Fed rate cut expectations. Furthermore, lost global competitiveness makes the single currency union an unlikely target for quickly surging FDI inflows that would help to support the EUR.

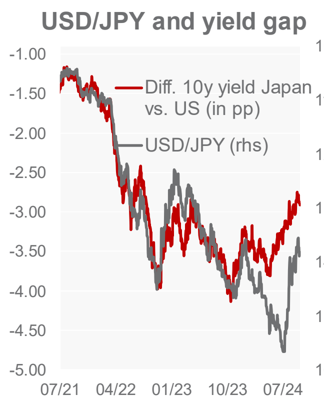
JPY with more upside medium term

> USD/JPY is likely to consolidate in the 140-145 range near-term, but to head lower into 2025

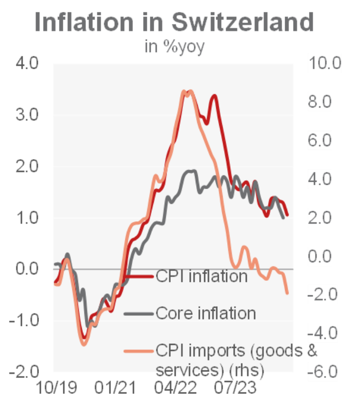
After testing levels above 160, the USD/JPY has sharply reversed course since August. A late July BoJ hike with somewhat more hawkish comments has triggered a massive unwinding of speculative JPY shorts that had underpinned carry trades prevailing for years. CFTC speculative positions in JPY were hovering between -30 to -40% of open interest for most of the past three years but have turned sharply JPY bullish to almost 30% of open interest (left chart below), the highest since 2016. Following the recent yen surge, we expect USD/JPY to stabilize in the 140-145 range over the coming weeks, with US yields mildly geared to the upside. Yet the still deep fundamental undervaluation of the JPY, the persistent gap vs. yield differentials (2nd chart below), improved terms of trade in Japan (largely thanks to moderating energy costs) and further moderate rate hikes by the BoJ point to some further JPY recovery in the mid-term.



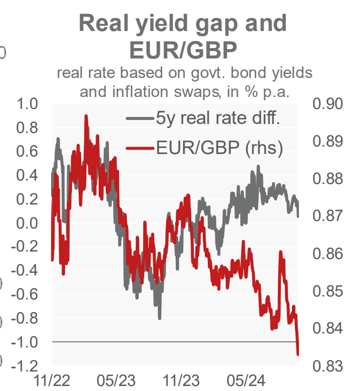
Source: CFTC, Datastream, GenAM



Source: Datastream, GenAM calculations



Source: Datastream, GenAM



Source: Datastream, GenAM calculations

> Easing inflation makes the SNB more tolerant about a weaker CHF going forward

The Swiss Franc was temporarily boosted by renewed political worries (notably France) and cyclical euro area weakness over the summer. That said, even though the SNB opted for a conventional 25bp rate cut in its recent meeting on Sept 26, further cuts are on the cards. And with inflation receding (3rd chart above) and headed towards below 1% over 2025 as well as import prices now deflationary, we expect the SNB to welcome a somewhat weaker CHF to ease the burden for Swiss exporters. Going further into 2025, we also anticipate mild EUR strength to further underpin the recovery of the EUR/CHF.

The improved UK external balance and a pro-EU tilt of the new Labour government bode overall well for the GBP. High fiscal consolidation needs notwithstanding, the British economy is still holding up well within the advanced world. This points to some more upside for sterling. Yet the fundamental valuation is already dear, and the recent further fall in EUR/GBP has further widened the gap vs. real yields (right chart above). We therefore anticipate a rather stable EUR/GBP from here, with the higher carry, however, mildly favouring exposure to sterling over euro.

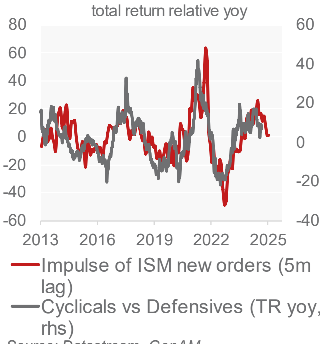
EQUITIES

Michele Morganti and Vladimir Oleinikov

- **After the bounce back, markets are left with high short-term US valuation, negative global macro surprises (though bottoming in the US), possible higher volatility in October via US elections, geopolitical risks, EMU political impasse and slightly elevated positioning: we are neutral on equity in the very short term, as well as on EMU vs the US.**
- **Our stance over 3 and 12 months is instead positive. Rate cuts and improving financial conditions will alleviate slowdown fears, as well as political risks and higher volatility. Very high cash-flow minus capex spread, lingering buybacks and still low IPOs are likely to keep the supply-demand imbalance favourable for equities.**
- **We see TR for S&P 500 at 4% (5,200-6,000) and 7-16% for EMU over the next 12 months. Neutral on US IT. OW EU ex-EMU, UK FTSE 250, China (slight), India (lowered), Korea, and Japan (lowered).**
- **Within EU sectors, OW Banks, Aero&Defense, Food, Insurance, Materials, Real Estate, Semis, Transportation, Utilities, and small caps.**

Over the last quarter, particularly US equities benefitted from realised Fed easing expectations, increasing by 5%, whereas EMU stocks only have hardly increased. Apart from slowdown fears, the EA has been subject to more uncertain political environment, while EPS revisions remain negative. In August, stocks experienced a meltdown due to growth fears, after which they have bounced back by around 7%. Markets are still left with high short-term US valuation, weak ISM momentum, negative global macro surprises (though bottoming in the US), possible higher volatility in October via US elections, geopolitical risks, EMU political impasse and slight above average positioning. Against this backdrop, we remain positive on equities in 3 and 12 months but are more cautious in the very short term, being neutral EMU vs US. Financial conditions are improving thanks to CB cuts, lower real yields and credit spreads, increasing M2 and bottoming credit cycle. Global liquidity, measured as GDP-weighted M2 growth in US, EA, JP, China and UK, has been accelerating in the last months. Furthermore, very large firms' CF gap vs. capex add to good market technicals, i.e. low IPOs, bottoming M&A, lingering buybacks, sector rotation inducing a higher market breadth. Lastly, ex-US, valuations are attractive, too. We see TR for S&P 500 at 4% (with a possible range 5,200 – 6,000) and at 7% for EMU (upper bound at +16%) over the next 12 months. Historically, both the US and EMU equities have gained post-election: in 1996 (some resemblance: Fed rate levels and degree of SPX overvaluation), DM markets gained 30% in following 12 months. Fed cuts are positives as

MSCI Europe: cyclicals vs defensives



Source: Datastream, GenAM

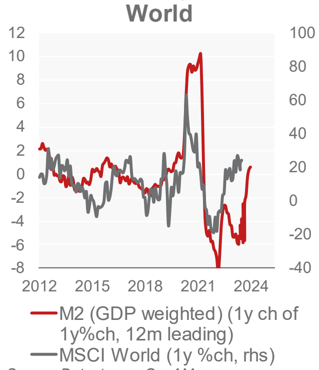
12m targets (as of 19.09.24)

Market Index	composite LT models (Shiller approach for US)	of which: PE-based valuation	CAPE yield gap vs real yield 1yr fwd spread, % to avg since 2003
S&P 500	5,200 - 6,000	-7.5%	-1.4%
MSCI EMU	6.4%	15.8%	-0.2%
FTSE 100	8.6%	14.0%	0.7%
SMI	5.4%	8.9%	0.0%
TOPIX	16.9%	15.2%	0.1%

Source: Datastream, Bloomberg, GenAM calculations

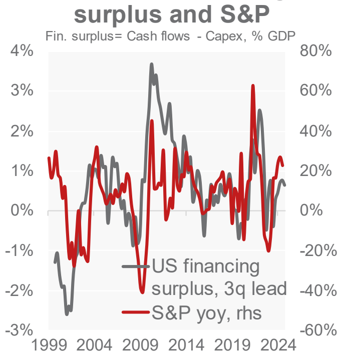
Note: LT models: PE tgt (US 18.5x, EMU 13.4x, JP 13.8x), Fed model, EY-BY, DDM, and 3-stage eps growth model excess CAPE yield = 1/CAPE - (10yr rate - avg inflation over 10yr)

Global liquidity and MSCI World



Source: Datastream; GenAM

Corporate financing surplus and S&P



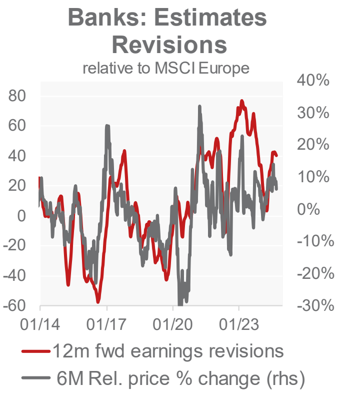
Source: FRED eco data, GenAM calculations

> Better financial conditions and high TR potential to keep EMU attractive in 12 months (+7% to +16%)

well: +12-month historical average performance of 8-10%, following first Fed cut since 1995, excluding GFC.

In Europe, buyback activity has remained very strong recently and it is expected to linger, as 24% and 80% of the 2024 and 2025 buyback programmes remain to be executed. Strong FCF generation (5.4%, SXXP 600) makes buybacks sustainable. The upper band of the EMU TR range (+16% in 12 months) is almost equally split into EPS growth, PE expansion and cash yield to shareholders (DY and Buybacks).

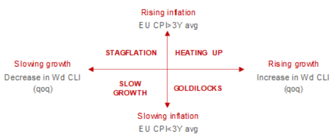
Within the SPX, we stay neutral US Tech: valuation is fair and peaking rates are positive for growth sectors, but EPS growth normalization in 2025 vs. ex-AI stocks (SPX 493) and risks from anti-trust add to possible higher trade frictions. The fall in Tech relative growth, and the relatively lighter positioning in SPX 493 and ex-US countries, has already led to higher market breadth & rotation vs. other US and EU sectors with lower positioning and valuation, including small caps.



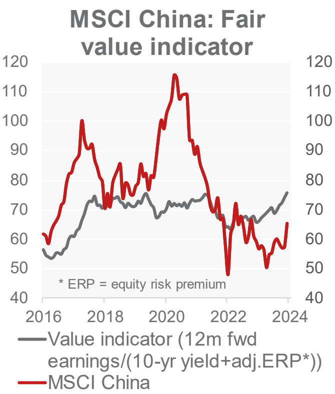
Source: Datastream, GenAM calculations

Average QoQ return of MSCI Europe and sectors, since 1999

	STAG-FLATION	HEATING UP	GOLDI-LOCKS	SLOW GROWTH
MSCI EU	**-2.0**	**5.1**	**5.2**	**-1.9**
Financials	-2.7	6.0	6.4	-5.0
Industrials	-3.0	6.9	7.9	-1.8
Health Care	1.2	2.3	2.9	1.1
Energy	2.0	4.7	3.3	-3.7
Communication	-3.4	3.4	4.1	-0.7
Utilities	0.0	2.8	4.3	-0.6
Materials	-1.6	7.1	7.7	-3.4
Staples	0.4	2.1	3.6	1.4
Discretionary	-3.4	6.5	6.3	-1.3
IT	-5.1	8.9	6.9	-1.6



Source: Datastream, GenAM



Source: Datastream, GenAM calculations

> Historically, Fed's easing and US election cycles usually are not enough for an EM overperformance vs DM

EMs: Following the pledge from China's top leaders for more fiscal spending and the raft of easing measures, we go tactically OW on China, waiting for further fiscal support to be announced (potentially late October during the next national committee meeting). This should also be positive for EMs as China is getting less of a problem. Furthermore, benign CPI in Asia will allow for rate cut cycles via lower yields, which should stabilise PE via lower yields, while the Value momentum is already increasing (+15% YTD). We see a slightly weaker dollar over 12 months, which would be only marginally supportive. Within EM (slight OW), we also prefer India (lower OW due to higher valuation, strong nominal GDP growth, support from macro stability) and Korea (very attractive valuations, push for reforms).

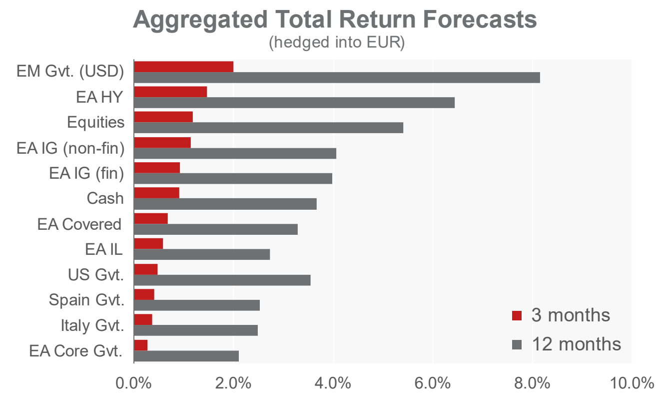
EU Sectors: As we see *goldilocks* to be phasing out to *slow growth*, we tilt our allocation to be only slightly defensive, with selective cyclical bias (Small cap, Banks, A&D, and Semis). Our references are low relative valuation (and positive ML models), negative sensitivity to MOVE (bond vol), relative earnings revisions and rotation to lower position sectors. Banks OW – strong cash generation and high total yield including sustainable buybacks – paired with an UW in Energy – similar cash generation and yield, but worse earnings revisions and unsupportive oil prices. We also position to benefit from lower yields through an OW in Food, Utilities and Real Estate vs. an UW in Autos and Durables. Still OW Aero & Defense: long-term structural trend (higher EU defense spending), strong 12m earnings growth and still positive revisions. OWs: Banks, Aero&Defense, Food, Insurance, Materials, Real Estate, Semis, Transportation, Utilities. UWs: Autos, Cap. goods ex A&D, Comm. Prof. Svs., Durables, Energy, Media, Retailing, Telecoms.

ASSET ALLOCATION

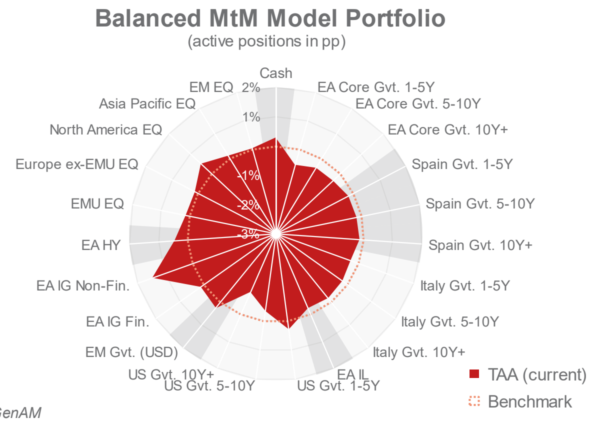
Thorsten Runde

- **The summer months were characterised by a sharp decline in Equity prices as well as in yields. While the former successfully made up most of the ground lost in August even despite a further setback early September, yields have barely recovered. Thus, our long duration stance has proved quite rewarding in Q3.**
- **Despite manufacturing deteriorating further over summer, leading indicators for advanced economies still point to further moderate expansion. Rate cuts should support the credit cycle. That said, near-term risks point to the downside, with China continuing to struggle, a partial rates repricing likely, and the uncertain outcome of the imminent presidential election in the US.**
- **Against this backdrop we recommend a moderate overweight position in Equities – preferably to be implemented after the US election – favouring Japan and the US to EMU. On the Credit side we stay overweight in EA HY as well as EA IG with a preference for non-Financials. Except for EMs, we underweight government bonds overall. Tactically, we prefer a moderately short duration stance near-term, given the repricing risks. We stay positive for the USD given the political imponderables in the euro area and real yield gaps.**

In August Equity markets were hit by a sharp correction as a surging yen wiped out wide-spread carry trades and sent volatility higher. Despite a further setback in September, Equities were able make up most of the ground lost in this phase. But also, rate cut hopes in the US underpinned risk appetite, with yields correcting sharply without recovering so far, thus, making the optimal duration positioning currently a particular tricky one.



Source: GenAM



Source: GenAM

With leading indicators for advanced economies still pointing to further moderate expansion, we see some upside potential for Equities on a 3 to 6-month horizon. Thus, we recommend a moderate overweight here. That said, given the risks and the seasonal patterns around the US elections, an implementation only afterwards seems advisable. We still prefer Credit over Govies as the former is still benefitting from somewhat tighter spreads and the carry in a monetary easing environment. We confirm our preference for non-Fins over Fins given the latter's close link to sovereign risk. Overall, we stay underweight in Govies with a short duration as a pure tactical call, in the view of the risk of a partial correction in easing expectations. Mid-term, however, the support from rate cuts and lower inflation will regain the upper hand. We deem the USD weakness overdone. Given, the turmoil around French politics and structural problems in Europe, a short-term recovery appears likely. Thus, we stay overweight USD versus the European currencies in the portfolio.

FORECASTS

Macro Data

Growth	2023	2024 forecast	2024 Δ vs. cons.	2025 forecast	2025 Δ vs. cons.	2026 forecast
US	2.5	2.6	0.1	1.8	0.1	2.1
Euro area	0.5	0.7	- 0.1	1.1	- 0.2	1.4
Germany	- 0.1	0.0	- 0.1	0.9	- 0.1	1.5
France	0.9	1.1	0.0	1.0	- 0.2	1.6
Italy	0.9	0.8	- 0.0	0.9	- 0.1	0.7
Non-EMU	0.2	1.0	0.0	1.4	0.0	1.9
UK	0.1	1.0	0.0	1.2	0.0	1.9
Switzerland	0.8	1.4	0.0	1.5	0.0	1.8
Japan	1.9	0.2	0.2	1.2	- 0.0	0.8
Asia ex Japan	5.2	4.9	- 0.2	4.8	0.1	4.6
China	5.2	4.8	- 0.1	4.5	0.1	4.1
CEE	3.1	3.2	0.1	2.8	0.2	2.8
Latin America	2.2	1.4	0.0	2.2	0.0	2.5
World	**3.1**	**2.9**	**- 0.0**	**3.0**	**0.1**	**3.0**

Inflation	2023	2024 forecast	2024 Δ vs. cons.	2025 forecast	2025 Δ vs. cons.	2026 forecast
US	4.1	3.1	0.1	2.4	0.2	2.3
Euro area	5.5	2.5	0.1	2.2	0.2	2.0
Germany	6.0	2.4	0.0	2.3	0.2	2.0
France	5.7	2.4	0.1	2.0	0.2	2.0
Italy	5.6	1.3	0.1	1.8	0.0	1.8
Non-EMU	6.5	2.4	0.0	2.0	0.0	2.0
UK	7.4	2.6	0.0	2.3	0.0	2.1
Switzerland	2.2	1.4	0.1	1.1	0.0	1.2
Japan	3.3	2.3	- 0.2	2.0	- 0.1	1.7
Asia ex Japan	2.1	1.9	0.1	2.3	0.1	2.6
China	0.2	0.4	- 0.1	1.3	- 0.0	2.0
CEE	20.4	19.9	0.1	11.7	0.9	8.4
Latin America	5.1	4.5	0.0	3.8	0.0	3.0
World	**5.2**	**4.1**	**0.0**	**3.2**	**0.1**	**2.9**

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

Financial Markets

Key Rates	Current*	3M Forecast	3M Forward	6M Forecast	6M Forward	12M Forecast	12M Forward
US (upper bound)	5.00	4.50	*4.06*	4.00	*3.32*	3.50	*2.87*
Euro area	3.50	3.25	*2.94*	2.75	*2.34*	2.25	*1.74*
Japan	0.25	0.50	*0.28*	0.50	*0.34*	0.75	*0.43*
UK	5.00	4.75	*4.55*	4.25	*4.08*	4.00	*3.42*
Switzerland	1.00	0.75	*0.63*	0.50	*0.48*	0.50	*0.39*
10-Year Gvt Bonds							
US Treasuries	3.77	3.80	*3.77*	3.70	*3.78*	3.50	*3.85*
Germany (Bunds)	2.17	2.20	*2.17*	2.15	*2.16*	2.10	*2.20*
Italy	3.50	3.60	*3.50*	3.60	*3.54*	3.60	*3.66*
Spread vs Bunds	*133*	*140*	*133*	*145*	*138*	*150*	*146*
France	2.95	3.00	*2.95*	2.95	*2.97*	2.95	*3.05*
Spread vs Bunds	*79*	*80*	*78*	*80*	*80*	*85*	*84*
Japan	0.82	0.85	*0.92*	0.90	*0.97*	0.90	*1.07*
UK	3.98	3.85	*3.98*	3.80	*3.97*	3.70	*4.01*
Switzerland	0.48	0.50	*0.42*	0.50	*0.41*	0.50	*0.41*

**3-day avg. as of 26/09/24*
***ICE BofA (OAS)*

Credit Spreads**	Current*	3M Forecast	3M Forward	6M Forecast	6M Forward	12M Forecast	12M Forward
EA IG Non-Financial	111	105		100		100	
EA IG Financial	120	120		120		115	
EA HY	348	350		350		350	
EM Sov. (in USD)	261	260		250		250	
Forex							
EUR/USD	1.12	1.10	*1.12*	1.11	*1.12*	1.13	*1.13*
USD/JPY	144	144	*143*	139	*141*	135	*139*
EUR/JPY	161	158	*160*	154	*159*	153	*157*
GBP/USD	1.34	1.33	*1.34*	1.32	*1.34*	1.31	*1.33*
EUR/GBP	0.83	0.83	*0.84*	0.84	*0.84*	0.86	*0.85*
EUR/CHF	0.95	0.96	*0.94*	0.97	*0.93*	1.01	*0.93*
Equities							
S&P500	5,734	5,760		5,770		5,790	
MSCI EMU	165.5	166.0		168.5		169.5	
TOPIX	2,676	2,695		2,710		2,765	
FTSE	8,279	8,300		8,355		8,490	
SMI	12,136	12,280		12,380		12,580	

Forecast Intervals

3-Months Horizon

		Low	Mean	High
10-Year Gvt Bonds	US Treasuries	3.49	**3.95**	4.41
	Germany (Bunds)	1.62	**2.30**	2.98
	UK	3.45	**4.05**	4.65
	Switzerland	0.15	**0.50**	0.85
Credit Spreads*	EAIG Non-Financial	90	**105**	120
	EAIG Financial	97	**115**	133
	EAHY	302	**350**	398
	EM Sov. (in USD)	235	**265**	295
Forex	EUR/USD	1.06	**1.09**	1.12
	USD/JPY	139	**144**	149
	GBP/USD	1.28	**1.30**	1.32
	EUR/CHF	0.93	**0.95**	0.97
Equities	S&P500	5,380	**5,665**	5,950
	MSCI EMU	157	**166**	174
	TOPIX	2,577	**2,700**	2,823
	FTSE	8,081	**8,410**	8,739
	SMI	12,019	**12,590**	13,161

*ICE BofA (OAS)

12-Months Horizon

		Low	Mean	High
10-Year Gvt Bonds	US Treasuries	2.81	**3.80**	4.79
	Germany (Bunds)	0.73	**2.35**	3.97
	UK	2.62	**3.95**	5.28
	Switzerland	-0.40	**0.50**	1.40
Credit Spreads*	EAIG Non-Financial	68	**100**	132
	EAIG Financial	74	**110**	146
	EAHY	252	**350**	448
	EM Sov. (in USD)	191	**255**	319
Forex	EUR/USD	1.07	**1.13**	1.19
	USD/JPY	126	**135**	144
	GBP/USD	1.27	**1.31**	1.36
	EUR/CHF	0.98	**1.01**	1.04
Equities	S&P500	5,103	**5,670**	6,237
	MSCI EMU	151	**168**	184
	TOPIX	2,527	**2,775**	3,023
	FTSE	7,873	**8,550**	9,227
	SMI	11,650	**12,790**	13,930

*ICE BofA (OAS)

*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5-year history of percentage changes, equally weighted in the case of the 12-month forecast and exponentially weighted in the case of the three-month forecast. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

IMPRINT

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