GENERALI INVESTMENTS

Market Compass

April 2023

MARKET OUTLOOK

- Despite gains in economic confidence and inflation stickiness in Q1 2023, bouts of banking stress have led the market to reprice the Fed path lower: a friendly combination for markets.
- Such a win-win situation will prove short lived. Following recent banking events, it is likely that lending standards will continue to tighten. This is not good news for growth.
- Known unknowns include the US debt ceiling negotiation, the so-far dormant EU bank-sovereign nexus, and US-China tensions.
- That said, 2023 is not 2008: rated-induced (unrealised) losses are less toxic than bad loans, policymakers have learnt the GFC lesson. Still, given the weak and risky growth prospects we prefer Cash, IG Credit and Core Govies to Equities, High Yield and Pheripheral Bonds.

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

- (−) Tighter bank lending standards to impact the economy from Q2 2023 on
- (+) Labour market remains tight but increasing labour supply points to a rebalancing
- (−) Core inflation proves stickier than expected despite the cooling in import prices
- (+) Fed (almost) done with rate increases

UK

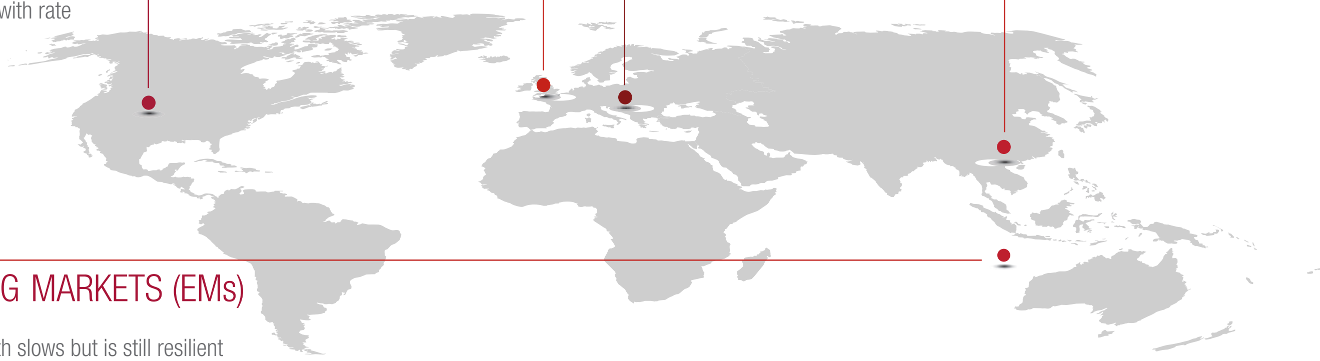
- (−) BoE hiked Bank Rate by 25 bp
- (+) Fiscal budget slightly expansionary
- (−) PMIs deteriorated again

EUROZONE

- (+) March sentiment indicators further up
- (+) Inflation to come down on lower energy prices
- (−) Tighter bank lending standards to dampen activity
- (+) ECB to become less hawkish

CHINA

- (+) China's post Covid recovery is well underway
- (+) PMIs confirm services as a driver
- (+) PBoC cut reserve requirement ratio (RRR) by 25 bp



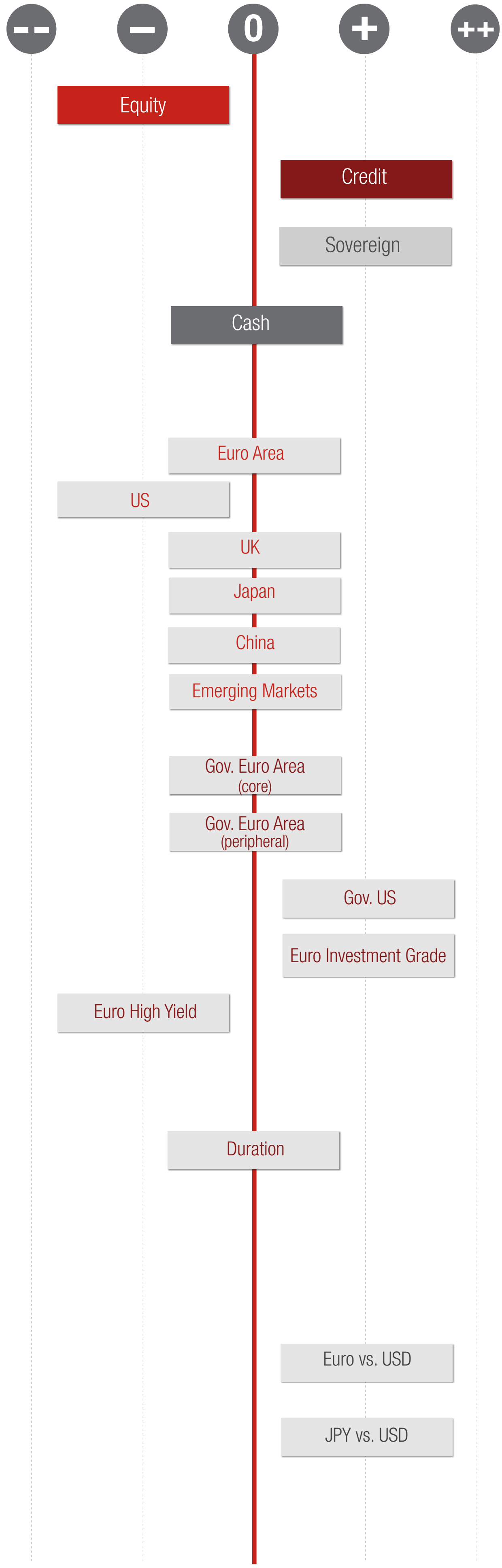
EMERGING MARKETS (EMs)

- (+) EMs growth slows but is still resilient
- (−) EMs inflation proves stickier than expected, CBs on hawkish hold
- (+) EMs assets resilient to global banking worries

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

DIRECTION OF TRAVEL

- Increase underweight (UW) on Equity and Euro Area HY
- Overweight (OW) IG Credit as carry is still appealing, but cut Financials to UW
- Toppish yields make Core Govies appealing
- Maintain OW on US Treasuries as they remain a safe haven asset
- OW EMs Sovereign



Equity

- Hawkish CBs and tighter lending standards will not trigger a major profit downturn but analysts' consensus is likely to be reduced. We look for better entry levels once the effects of lending restrictions and lower profits are fully discounted
- US riskier than EA

Bonds

- As further banking stress-induced turmoil cannot be ruled out, safe haven flows should trigger lower yields, more so in the US than in EA. High volatility
- Despite the resilience of EA non-core gov. bonds so far, weak fundamentals and ECB's QT are likely to trigger a moderate spread widening

Duration

- Neutral duration

Currencies

- High uncertainties favour USD short term. Yet with the Fed likely largely done in tightening policy and a pivot on the cards for Q4, USD is facing headwinds from tighter yield gaps. Easing rates volatility will remove a key pillar of USD support
- The USD/JPY is past peak, driven by prospective lower US yields and the BoJ's likely exit from yield curve control

TOPICS TO WATCH

	Probability	Impact
A even stronger cracks in financial stability as tighter conditions feed through (banking, housing …)		
Two-sided inflation risks (now more balanced as banks tighten credit belts)		
Debt ceiling crisis leading to US rating downgrade/UST disruptions		
Escalating war in Ukraine or new severe geopol. tensions (China/Taiwan, Iran, N. Korea)		

Probability: High ↔ Low

Impact: High ↔ Low

GLOSSARY

BANK'S RECENT STRESS AND MONETARY POLICY

The recent stress will increase banks' caution in lending. This will weaken demand and, with lag inflation. In some sense, this is similar to an increase in the policy rate. This is the reason why the SVB wobbles have induced the Fed and the ECB to tame their dovish stance.

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