GENERALI INSURANCE ASSET MANAGEMENT

Market Perspectives

Siren calls

December 2023

GIAM Macro & Market Research

'Market Perspectives' provide our monthly macro & market outlook and investment recommendations

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- **Amid the siren calls from lower yields, however, mind the still bleak growth outlook. We expect the lagged fallout from the Fed's tightening to send the US into stagnation, while Europe will recover only sluggishly from a moderate recession.**
- **The decline in yields still has legs, albeit more moderately so from here. With hopes of an early Fed pivot already advanced, central banks will need to keep financial conditions from easing too fast.**
- **Risk assets discount quite some optimism of a soft landing. Going forward, cyclical concerns will overshadow more strongly the disinflationary relief.**
- **We retain some caution on Equities and HY Credit near term, favouring IG Credit and longer dated Govies. Yet amid a somewhat brighter backdrop for risk assets, we trim the size of active positions.**

Content

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Global View – Siren calls

Thomas Hempell

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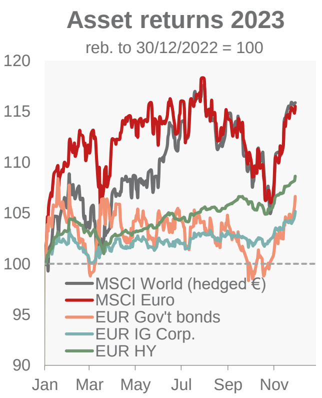
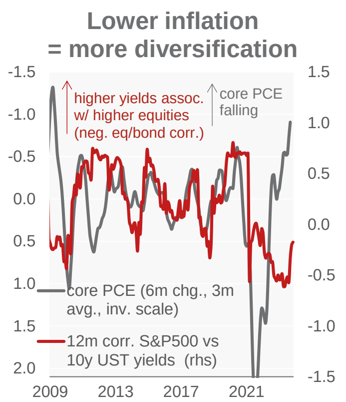
Weaker US payrolls and a pleasant inflation US and EA surprises for October fostered rate cut expectations for 2024, sending bonds and equities into a synchronized rally. Falling oil prices (Brent down almost 10%) amid easing fears of an escalation of the Israel/Hama war also helped. US equities rebounded close to summer highs, paring a steep correction in the three months to late October. We anticipated that yields were past peak, but the extent of the decline in yields (-64bp in 10y USTs by Nov. 29) was massive.



Source: Datastream, GIAM calculations



Source: Datastream, GIAM

Our outlook for yields remains geared to the downside, with long-dated rate expectations still sizeably above our estimates of neutral rates. Yet the scope for another leg down is more limited near term as self-correcting forces may kick in. The Fed and ECB have refrained from rate hikes in Oct. not only due to disinflation progress, but also thanks to much tighter financial conditions in the wake of soaring long-term yields. With these conditions in reverse, central banks fear seeing their inflation fight undermined and will keep a hawkish tone and keep the threat of rate hikes on the table. High government issuance, worries about rising interest burden and extended quantitative tightening (QT) will also insert a speed limit to the further decline in yields from here.

10-Year Gvt Bonds	Current*	3M	6M	12M
US Treasuries	4.40	4.20	4.05	3.85
Germany (Bunds)	2.56	2.40	2.35	2.30
Credit Spreads**				
EA IG Non-Financial	138	145	145	140
EA IG Financial	159	160	170	165
Forex				
EUR/USD	1.10	1.09	1.11	1.13
USD/JPY	149	148	140	137
Equities				
S&P500	4555	4560	4535	4715
MSCI EMU	147	148	144	157

**3-day avg. as of 28/11/23 **ICE BofA (OAS)*

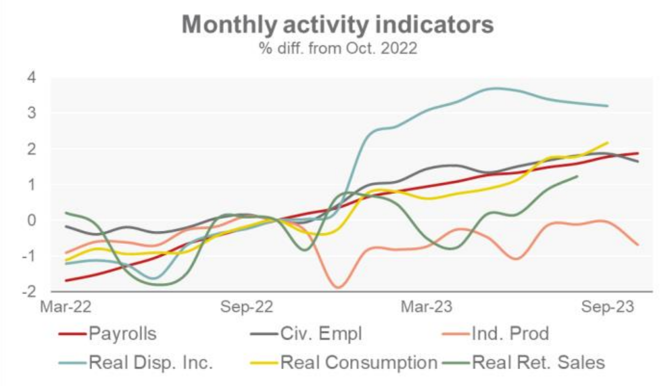
Cyclical outlook back in focus

The scope for risk assets to benefit from lower yields is also more limited going forward. During bouts of large inflation shocks, equities and bonds tend to move in tandem. Yet since the late 1990s such episodes are the exception, not the norm. Cyclical concerns may soon start to dominate, aligning the moves in yields and equities (right chart). The fallout from tight Fed policy is still to push the US into stagnation. The support from excess savings is set to fade and the past massive rate hikes are feeding through, even if with a longer lag than usual as longer-dated maturities of corporate and household debt delay the transmission. Europe will recover only sluggishly from a (moderate) recession as the lasting scars from the energy shock take their toll while restrictive monetary policy is complemented by headwinds from fiscal consolidation. With the market focus turning to the cyclical outlook and earnings prospects, this will largely offset the relief from easing yields.

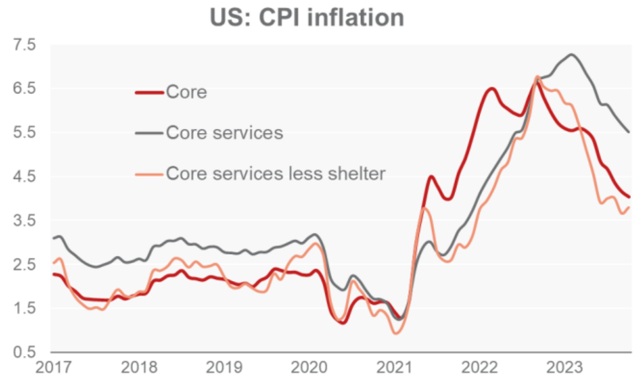
Against this backdrop, we keep a small underweight in Equities and HY Credit, but further trim active positions amid lower tail risks of a Middle East escalation and more cautious market investor positioning. We also acknowledge favourable seasonals (year-end rally) and constructive signals from our proprietary machine-learning algorithms. We still like the carry of IG Credit and see value in longer dated govies, but also trim active positions.

United States

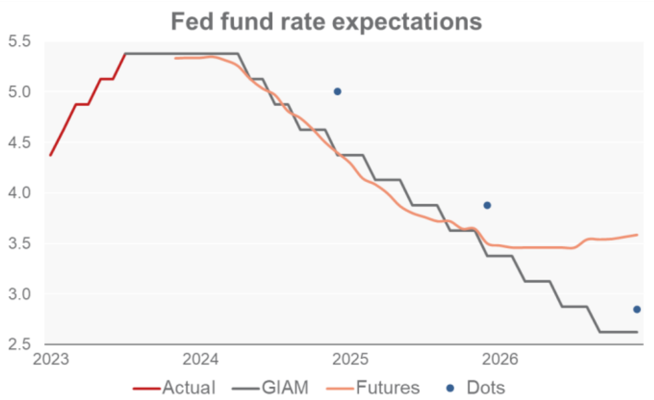
Paolo Zanghieri



Source:BLS, BEA, Fed, Refinitiv, GIAM



Source:Paweł Skrzypczyński, BLS, GIAM



Source: Federal Reserve Board, Refinitiv, GIAM

- **Early indication show that growth remains healthy in Q4. But consumption is set to slow in line with real income and a recovery in manufacturing does not look imminent. We expect rather weak growth in H1 2024.**
- **October CPI inflation was better than expected, with a weakening in the core rate and limited evidence of an impact of still strong wage growth. But we see core PCE inflation still at 2.5% by YE 2024.**
- **We move to late April the date of the first of the four rate cuts we now have for 2024. Still the Fed will have to push back against expectation of earlier rate cuts.**

Q3 GDP was revised up, to 5.2% qoq ann. and the first batch of Q4 data remains consistent with a scenario of soft landing. Job creation slowed down in October to 150k, and the rise in unemployment to 3.9% was totally due to the pick up in labour participation, which is, for the 25-64 age bracket even above the pre pandemic peak. High rates still burden manufacturing, but orders hold up and business surveys indicate that activity bottomed at rather low levels. While we have ruled out a recession, we think that tight money and sluggish income will compress growth to just above 0% in H1. But labour hoarding will limit job destruction and the unemployment rate should peak at below 4.5%.

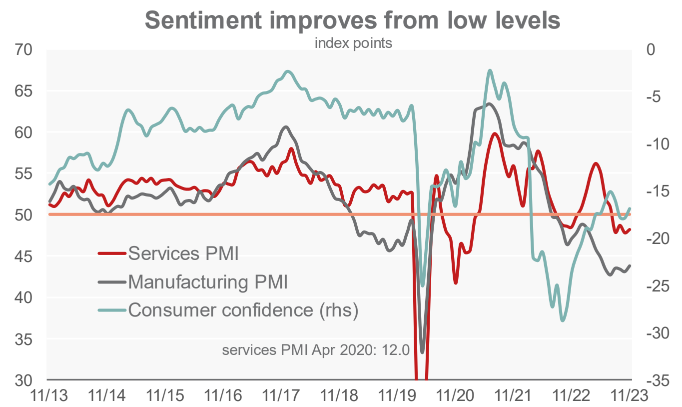
October CPI data surprised to the downside with headline inflation down to 3.2% yoy and the core rate to 4% yoy. Rents continue to ease, but still strong demand will support the rest of services inflation. As a consequence we see core PCE inflation still at 2.5% yoy by the end of next year.

First rate cut likely in May

Later in November, comments from FOMC member Waller showed a positive view on the inflation, and provided some hints about the timing of the first rate cut. This led us to move by one meeting (from June to early May) the timing of the first rate cut. We now expect four 25 bps rate cuts by the end of next year. A strong GDP performance and/or stickier services inflation may delay to the summer the beginning of loosening. Still communication will not abandon a hawkish tilt, especially concerning the pace of loosening, as the Fed will remain extremely keen to avoid a loosening in financial conditions that could ultimately undo some of the efforts to temper demand and inflation. We expect QT to last until the first half of 2025: by that time the level of bank reserves should have decreased to the minimum level the Fed deems compatible with effective monetary policy transmission. We estimate that in the long run the central bank will aim at a stock of assets of around 21% of GDP, some 3pp above the pre-pandemic average.

Euro Area

Martin Wolburg



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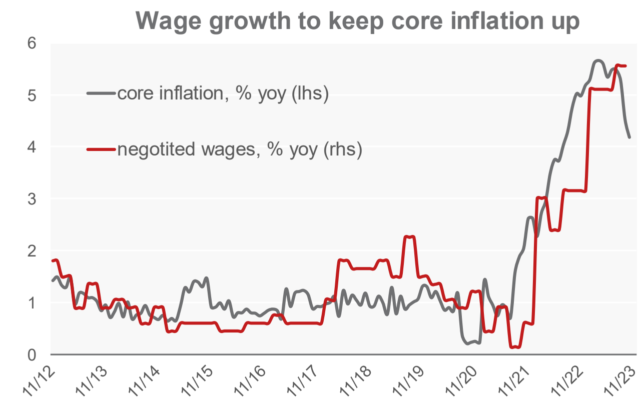
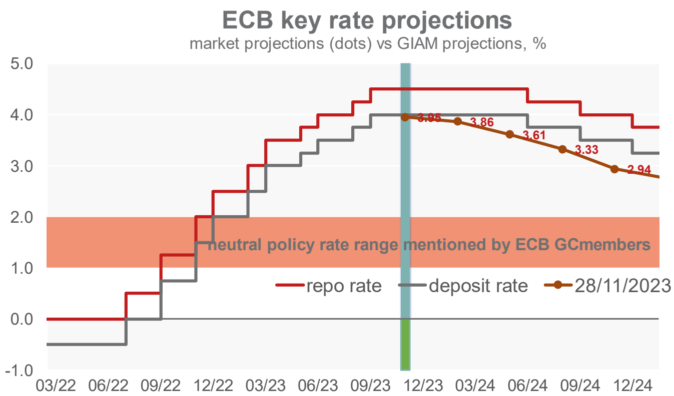


Source: Datastream, GIAM calculations



Source: Datastream, ECB, GIAM calculations

- **Sentiment continued to advance from depressed levels supporting our view that the euro area will return to growth after a technical recession in H2/23.**
- **November inflation of 2.4% yoy hints at a more favourable disinflation path but masks that underlying inflation will be more sticky due to wage growth.**
- **At its Dec. meeting we expect the ECB to acknowledge disinflation progesss but to maintain a hawkish rhetoric signalling that this will not be likely before June 2024.**

In November, key sentiment indicators continued to advance from depressed levels. Most notably, the composite PMI improved (to 47.1, from 46.5), driven by higher confidence in the services as well as manufacturing sectors. Forward-looking components all in all also advanced, in line with further improvement of activity. Hard data for the final quarter of the year are not yet out but another quarter of falling output is highly likely. Loan growth continued to decelerate and M3 falls, clear signs of contracting GDP. Also, employment growth is set to decelerate (from 0.3% qoq) if not coming to a halt in Q4 and the unemployment rate could rise somewhat. We stick to our growth forecasts of 0.4%/0.5% for 2023/24 and see the risks broadly balanced.

A more favourable disinflation path but core stubborn

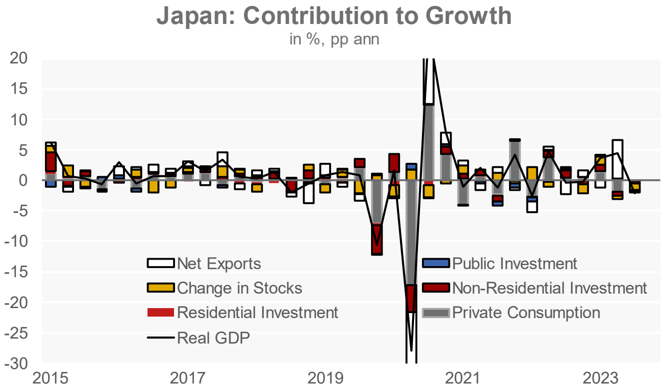
A key reason why we expect the economy to embark on growth at the outset of 2024 again is receding inflation. November flash headline inflation fell to 2.4% yoy and core to 3.6% yoy. That said, the disinflationary base effects from energy prices have now run their course, governments will continue to scrap energy price caps and underlying inflation is strongly supported by wage growth. Negotiated wages rose by unprecedented 4.7% yoy in Q3 and are set to stay strong next year. We therefore expect core inflation to recede to only 2½% by year-end 2024 and see headline inflation temporarily up again in the next quarter.

ECB to pave the way for rate cuts

At the Dec. 14 meeting, the ECB macro projections will be extended to 2026 and likely show inflation broadly in line with target towards the end of the forecast horizon. However, near-term risks from wages growth are still on the upside, as pointed out by various Governing Council (GC) members. They made clear that rate cuts are not yet on the agenda. We deem lower rates in spring unlikely but are torn between June and September. We find it slightly more likely that the ECB starts its 25 bps each quarter cutting cycle already in June. In case the GC would like to see more confirmation about inflation converging to target we look for a 50 bps cut in Sep. only. But in both cases the ECB likely cuts by 75 bps next year.

Japan

Christoph Siepmann



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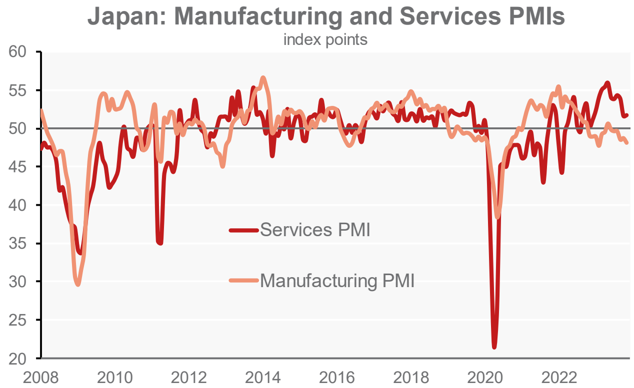

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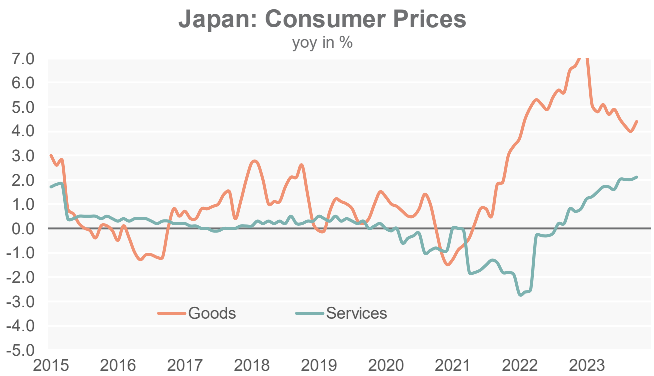


Source: Datastream, GIAM calculations

- **Q3 GDP growth surprised on the downside. Some support for private consumption is expected from the fiscal package, but exports are likely to feel the weakness in global growth going forward.**
- **Given these business cycle headwinds we still expect the BoJ to err on the side of caution and separate the exit from YCC from the negative interest rate policy (NIRP).**

According to the first print, Japan's Q3 real GDP fell by 0.5% qoq or 2.1% qoq in annualised (ann) terms. The result surprised on the downside, especially as private consumption stagnated (-0.2% qoq ann), failing to deliver at least some recovery from the already very weak (-3.5% qoq ann) previous reading. Higher frequency data have so far suggested an uptick in Q4. Nevertheless, household related activity indices from the Economy Watchers survey remained in contractionary territory. Help to mitigate the cost-of-living headwinds will come from the fiscal package. A first part was approved as a FY 2023 supplementary budget, amounting to about 2.2% of GDP. While the (typically outsized) headline figure of the package amounts to 6.4% of GDP, private consumption will benefit from an income tax refund and cash payments (0.8% of GDP). The package also extends various energy price subsidies as well as measures to ensure sustained wage increases. As the prolongation of measures will not induce an additional push, we see the growth impact of the package as limited but it will help to keep private consumption growth in positive territory.

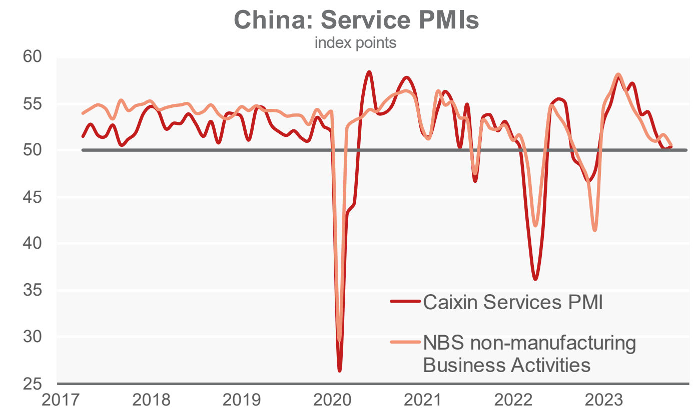
In contrast to private consumption, exports continued to increase in Q3 (2.1% qoq ann) after the strong push seen already in Q2 (16.7% qoq ann). The weakness of the yen (although receding of late) was clearly of help. Given the L-shaped recovery in China and the US stagnation in H1 2024, together with Japan's below-50 PMI (incl. output, new orders and new export orders) we expect exports growth to turn slightly negative well into next year. Weak exports typically also induce softness in private investment with a delay.

Markets speculate on early BoJ exit

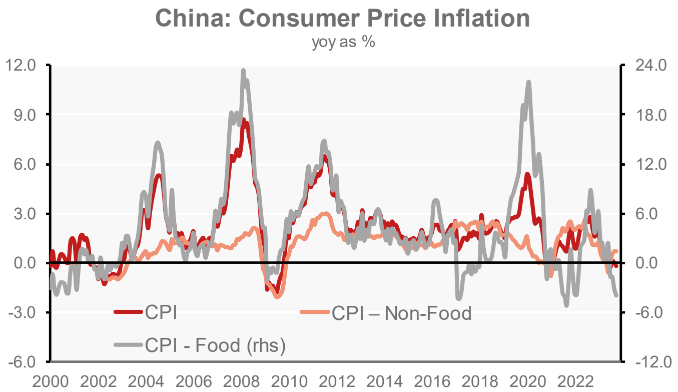
CPI inflation rose to 3.3% yoy, mainly due to a rise in energy inflation (and fresh food) following the halving of electricity and gas subsidies. Service prices rose slightly to 2.1% yoy. We expect inflation to average this year at 3.2%, but come down in 2024 to 2.2%. The outlook for another year of above 2% inflation together with news of solid winter bonusses led to more speculation of an early BoJ exit (which the BoJ rejected of late). We continue to expect the BoJ to exit YCC in spring and separate the decision from ending NIRP, given the soft global environment. However, risks have risen that the BoJ might exit both policies in one move.

China

Christoph Siepmann



Source: Datastream, GIAM calculations



Source: Datastream, GIAM

- **China's latest data set remained mixed with the real estate sector remaining the main drag.**
- **Beijing is hinting at more support for the sector. In contrast to an affordable housing programme, liquidity measures would not lead to higher demand but help stabilising the sector. However, we remain sceptical regarding any "big bang".**

China's October macroeconomic data set remained a mixed bag. The latest NBS manufacturing PMI stayed in slightly contractionary territory as export growth failed to improve while industrial production growth (4.6% yoy) was virtually unchanged. Retail sales were clearly the brightest spot, concentrated mainly in services and car sales (amid government incentives) while retailers' holiday promotions' only returned average results. Private consumption – although overall a bit sluggish – will likely remain the most stable private driver of the recovery. By contrast, urban investment surprised on the downside (2.9% yoy ytd) with real estate investment showing no improvement (-11.3% yoy). Meanwhile, the government looks willing again to step up its efforts. After the approval of an additional deficit of RMB 1 tr for local infrastructure and disaster relief, press reports suggest more funding for affordable housing and urban village re-development (RB 1 tr) via the PBoC's pledged supplementary lending. Moreover, policymakers are reportedly considering providing more liquidity support for selected developers via banks. This could deteriorate the banks' credit risk, which could reportedly be limited by a 'whitelist' of eligible developers. The discussion was recently overshadowed by the insolvency of the large shadow bank Zhongzhi, which is closely connected to the real estate sector and thus raised again fears that the property sector woes could spill over into the financial sector. While we think that Beijing would not tolerate a systemic risk, single events remain likely in our view. We also consider more fiscal support as likely, but doubt a "big bang"

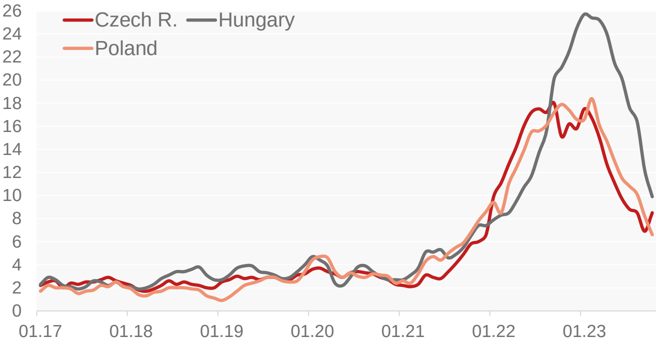
More easing measures expected

Given the large government bond issuances and low growth dynamics we also expect monetary policy to keep an easing bias. We expect a 25 bps cut in the RRR by year-end and stick to the view of an MLF cut by 15 bps. Inflation is no worry for the PBoC as consumer prices fell on average by 0.2% yoy in October, mainly reflecting dropping food prices. But also core inflation eased to 0.6% yoy. Next decisions are likely to come around the Economic Work Conference to be held in the first half of December. We see GDP growth in China at 5.2% this year and 4.5% in the next, while inflation should stay in positive territory over the next months.

Central and Eastern Europe

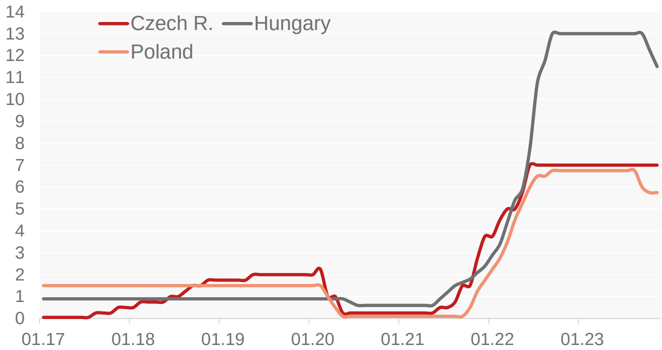
Radomír Jáč

Headline inflation
CE-3 countries (CPI yoy in %)



Source: www.czso.cz, www.ksh.hu, www.stat.gov.pl, GIAM

Monetary policy interest rates
CE-3 countries (end-of-month level, in %)



Source: www.cnb.cz, www.mnb.hu, www.nbp.pl, GIAM

Main Forecasts

Czech Republic	2022	2023f	2024f	2025f
GDP	2.4	-0.3	1.8	2.8
Consumer prices	15.1	10.8	2.4	2.0
Central bank's key rate	7.00	6.75	3.50	3.00
Hungary	**2022**	**2023f**	**2024f**	**2025f**
GDP	4.6	-0.5	3.2	3.2
Consumer prices	14.5	17.6	4.8	3.2
Central bank's key rate	13.00	10.75	5.00	4.50
Poland	**2022**	**2023f**	**2024f**	**2025f**
GDP	5.1	0.6	3.0	3.4
Consumer prices	14.3	11.5	5.0	3.2
Central bank's key rate	6.75	5.75	4.75	4.00

Source: www.cnb.cz, www.mnb.hu, www.nbp.pl, GIAM

- **Inflation in the CE-3 region has been declining but the picture is not unicolour including the reaction of the regional central banks.**
- **The Hungarian MNB is cutting rates by 75 bps each month in Q4 while the Czech CNB kept its key rate on hold also in November.**
- **Poland kept its key rate on hold in November after two cuts delivered in September and October and indicated that the next cut may come only in March.**

Inflation in the CEE has been moderating but a closer look is showing differences among individual countries. Inflation in Hungary is falling sharply, both headline and core CPI, which enables the MNB to cut interest rates from their high levels. The key rate currently stands at 11.50% and inflation reached 9.9% yoy in October, which means that Hungary has positive real interest rates not only in ex ante but also in ex post terms.

Czech headline inflation increased from 6.9% to 8.5% yoy in October due to a one-off factor. We expect CPI close to 7% yoy in December and possibly below 3% yoy in early 2024. However, the uncertainty about the increase in the regulated part of electricity prices in January and its impact on inflation expectations leads the CNB to keep a cautious stance.

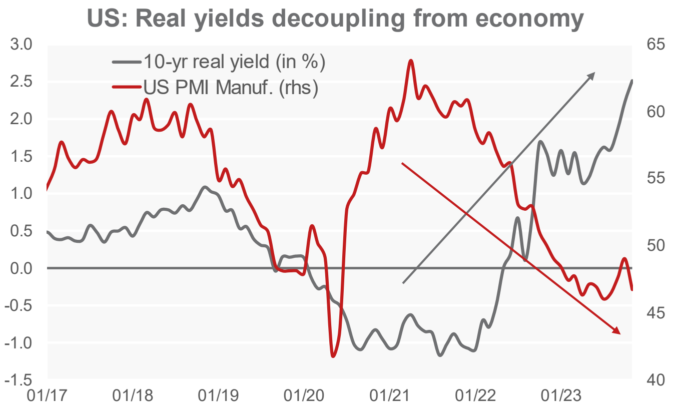
Polish headline CPI fell from 8.2% to 6.6% yoy in October while core inflation declined only from 8.4% to 8% yoy. The NBP cut rates sharply before the mid-October elections, while in November it took a pause in the cutting cycle. However, we believe that the mix of the strong zloty and lower inflation will open room for gradual rate cuts in 2024.

Monetary policy: Polish NBP took a pause in rate cuts

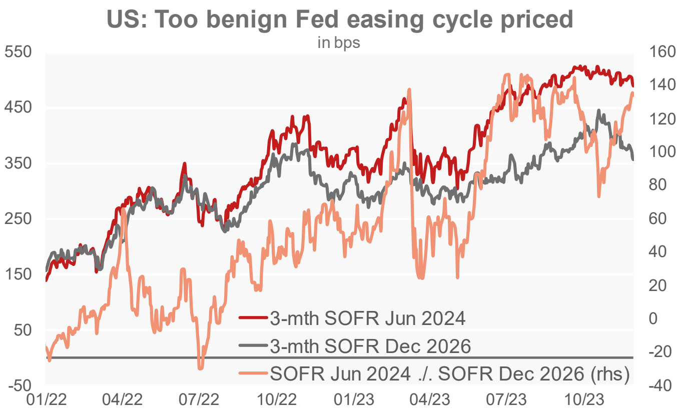
The Polish NBP kept its key rate at 5.75% in November. This was the first on-hold decision after the cumulative cuts of 100 bps delivered in September and early October, and the first MPC meeting after parliamentary elections held in October. The NBP mentioned inflation risks related to fiscal policy and indicated that the next rate cut may be debated only in March. The Czech CNB kept its key rate steady at 7% in November, but two central bankers already voted for a 25 bps cut. The CNB may start cutting rates in December. However, the uncertainty is significant, and the first cut can be postponed until February or March. The Hungarian MNB in currently the only central bank in the CEE which is regularly cutting rates. The base rate was cut by 75 bps in both October and November, to 11.50%, and a further cut by 75 bps is expected for December. For Q1 2024 we expect the MNB to slower the pace of rate cuts to 50 bps per a step.

Government Bonds

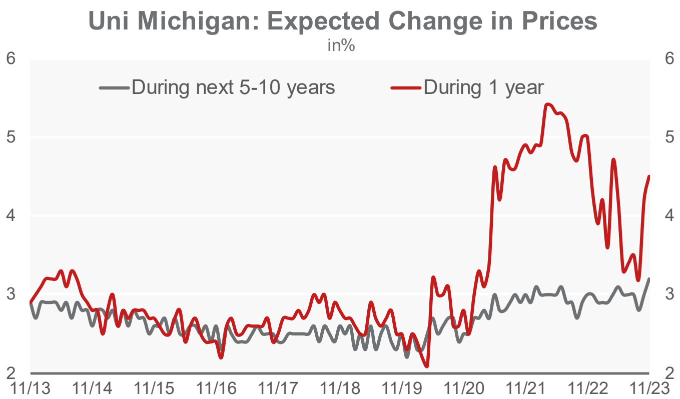
Florian Späte



Source: Bloomberg, Datastream



Source: Bloomberg, GIAM



urce: Bloomberg, GIAM

- **We expect the decrease in government bond yields to continue in the coming months – albeit at a slower pace than recently.**
- **In the US, we still see downward potential for real yields in particular given the emerging growth slowdown. In the EA, the decline is likely less pronounced given the more moderate current level. The continuation of the Quantitative Tightening (QT) will also mitigate the drop in long-term yields.**
- **EA non-core bond spreads have narrowed in recent weeks. However, given the lack of growth momentum and the elevated yield level, debt sustainability concerns will remain the focus of attention. The high net-net issuance volume in Q1 2024 in particular is likely to contribute to a spread widening.**

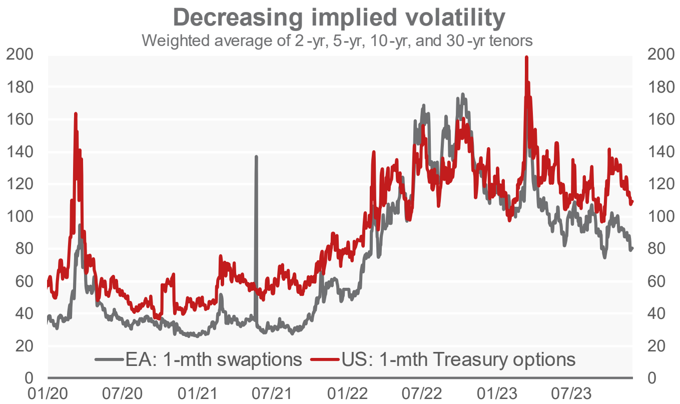
Dovish central bank comments, a weakening US growth dynamic, and a faster decline in inflation led to a strong decrease in yields across tenors and regions in November. The rally on government bond markets has some legs, but with less momentum as yields have dropped from their exaggerated levels already. The road ahead will also be bumpier because central banks would show their teeth again if bond yields were to fall too sharply. The continued high issuance volume both in the EA (see also below) and in the US (in combination with a continuation of the QT) also argues against an uninterrupted decline in yields. The US Treasury auctions in particular are currently at the centre of attention and may well lead to temporary upward spikes in yields.

Although US yields have recently fallen more sharply than EA core yields, we continue to see upside potential for the US bond market in particular. Despite a fall to 2.2% for 10-year real yields in recent weeks, they are still too high and not in line with the weakening economy. Inflation expectations also have some room to fall in both the US and the EA, despite the decline since October. However, the unsustainable situation from the summer, where long-term US expectations were at the same level as EA ones, has now been resolved. In this respect, developments on both sides of the Atlantic are likely to be similar going forward. The recent increase in short- and long-term inflation expectations released by the Uni of Michigan also shows that the possibility of a further decline looks rather limited, at least in the short term. Furthermore, we maintain our assessment that bond market volatility will continue to fall. This not only impacts riskier fixed income assets but is likely to strengthen demand for bonds overall.

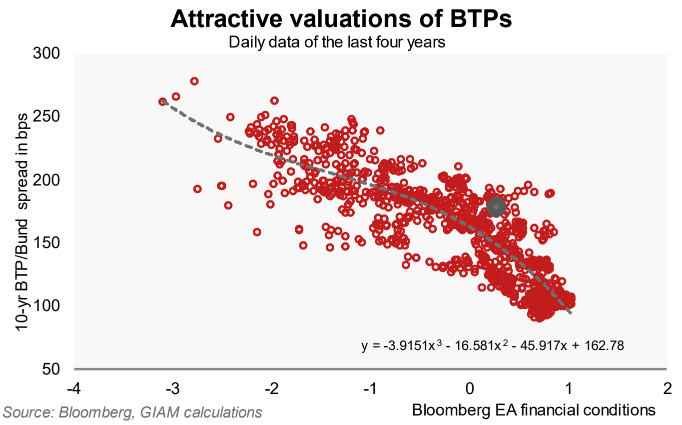
US medium-term key rate expectations also do not appear appropriate. Although key rate expectations for year-end

Government Bonds

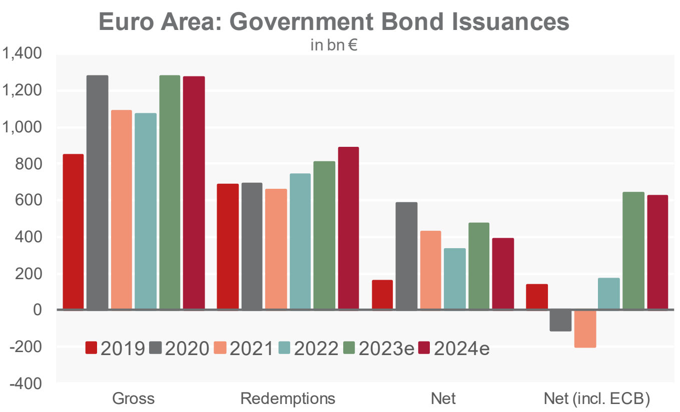
Florian Späte



Source: Bloomberg, GIAM



Source: Bloomberg, GIAM calculations



Source: Bloomberg, Datastream, GIAM calculations

2026 have fallen by almost 100 bps since mid-October. At 3.75% (upper bound) they still appear too high. On the contrary, we see central banks acting more cautiously in 2024. We consider market participants' current cumulative key rate reduction expectations of around 120 bps (ECB) and 110 bps (Fed) in 2024 to be excessive. In our base scenario, we assume 75 bps (ECB) and 100 bps (Fed). An expected correction should also be seen at the long end of the curve and limit the expected decline in yields.

Finally, we do not consider the recently observed decline in the term premium to be permanent, but rather a correction after a strong increase. Particularly, the continuation of QT is likely to counteract a sustained decline. In principle, we consider negative term premiums to be unsustainable, but rather the result of past Quantitative Easing by central banks.

Overall, we see (limited) leeway for lower government bond yields in the short term. On a 3-month horizon 10-year US yields are likely to reach 4.2% and 10-year Bund yields 2.4%. That said, there is more scope on a 12-month horizon with 10-year US yields reaching a level of around 3.85% and their EA counterparts 2.3%. Over a 1-year time horizon, the 2-year/10-year yield curve is seen to be no longer inverted in both the US and the EA but is likely to be approximately flat.

Stabilization of EA non-core bond spreads

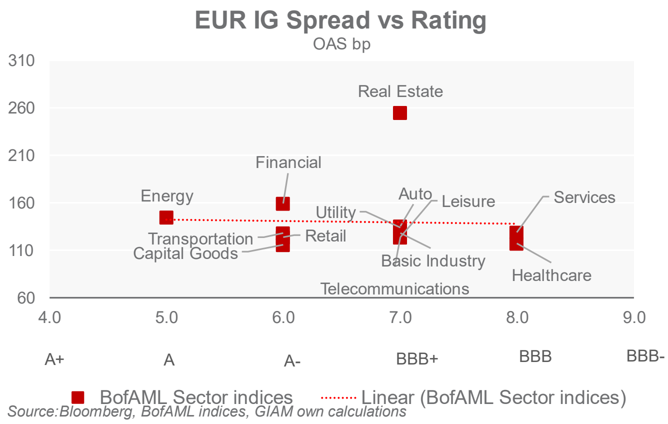
In the positive market environment, EA non-core government bond spreads tightened, supported by positive rating news and the ECB's commitment to not start PEPP QT in 2024.

Although bond market volatility and decreasing yields create a favourable environment for non-core bonds, we expect increasing headwinds. This is not only due to the (lower) spread levels that have been reached but also to the issuance activity in 2024 which will increasingly come into focus. Although the net issuance volume will fall somewhat, the full passive QT leads to an unchanged net-net issuance volume (in case the ECB will, contrary to our expectations, no longer reinvest maturing debt from the PEPP the net-net issuance volume can even increase further next year). France stands out in particular in this context. At almost € 130bn, the net issuance volume (before ECB's QT) is almost twice as high as the next country (Germany). In combination with the lacklustre growth and the still elevated yield level this will keep debt sustainability in the focus.

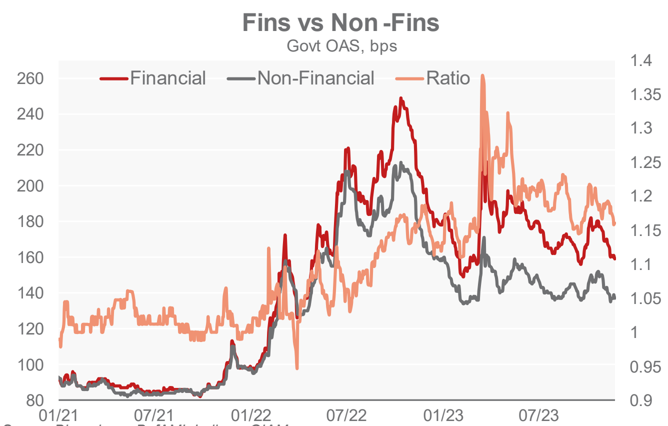
All in, we see some leeway for EA non-core bond yield spreads to widen moderately from current levels. Regardless of a possible seasonal narrowing until year-end, we see higher spreads over the course of 2024. Particularly, countries with fragile fiscal fundamentals remain at risk.

Credit

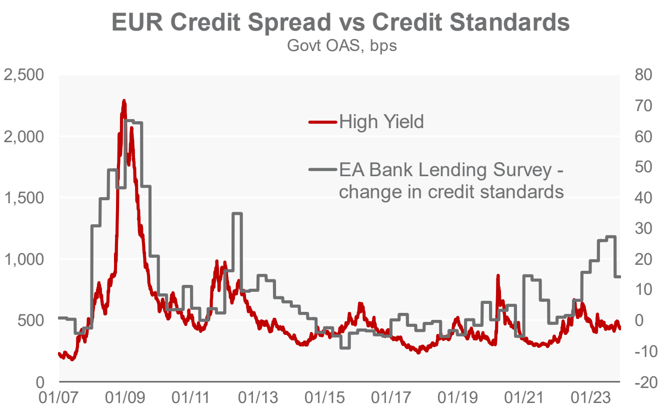
Elisa Belgacem



Source:Bloomberg, BofAML indices, GIAM own calculations



Source:Bloomberg, BofAML Indices, GIAM



Source: Bloomberg, BofAML indices,

- **We expect a modest spread widening in 2024.**
- **We continue to reduce our underweight in High Yield due to elevated carry and a stable default outlook.**
- **We are also moving to neutral non-financials relative to financials.**
- **Default rates are expected to reach 4.5% in Europe and 5-6% in the US in 2023.**
- **We prefer subordination risk to credit risk, mainly via AT1, less so via corporate hybrids and Tier 2.**

Since the start of the war in Ukraine, we have been underweighting financials relative to non-financials to reflect higher issuance needs and higher risks associated with rising defaults in the financial sector due to its exposure to smaller companies. Defaults have indeed increased, but we are not yet seeing this on banks' balance sheets, as the European banking sector has shown a declining cost of risk in recent reporting periods. The transmission of tighter monetary policy is longer this time than in previous cycles, but we still expect non-performing loans to rise in the coming quarters. The main question is whether it will exceed banks' expectations and even provisioning. Our credit research team is confident about the fundamentals of the sectors, especially given that there has been no exuberance in balance sheet expansion in recent years. Higher carry and strong fundamentals are slightly offset by the technical picture, which remains negative as financials will issue relatively more than non-financials in 2024 to continue replacing TLTRO repayments. This justifies our upgrade of financials to neutral versus non-financials.

Reducing further our short in HY but still cautious

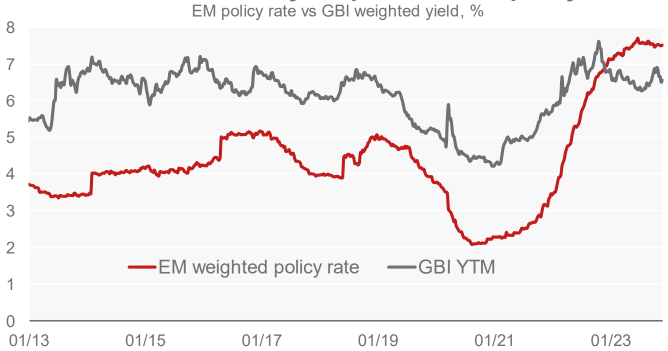
At the end of the year, given the high level of carry and no significant deterioration in our default outlook, we decided to reduce our underweight in high yield. Despite this adjustment, we still expect defaults to reach 4.5% in Europe and 5-6% in the US by the end of 2023. In this challenging environment, we continue to favour subordination risk over credit risk. On IG, we think spreads should trade in a range with a moderate widening bias. We prefer the 5 to 7-year segment as the flatness of the curve doesn't reward a long-duration position. Within non-financials, we prefer the BBBs with selective exposure to corporate hybrids. In financials, we like to diversify risk with overweight in senior bail-in bonds and additional Tier 1, while remaining underweight in senior preferred and neutral in Tier 2. Among subordinated instruments, we do think that extension risk is over compensated for and we like to cash in this premium preferring callable instruments versus non-callable ones.

EM sovereign bonds

Guillaume Tresca

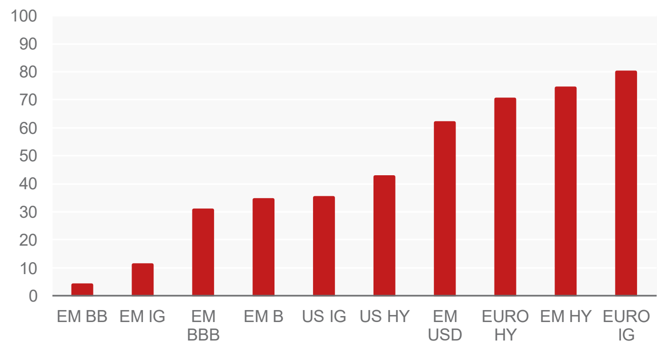
Room for local debt: yield peaks before policy rate

EM policy rate vs GBI weighted yield, %



Source: Bloomberg, JP, GIAM

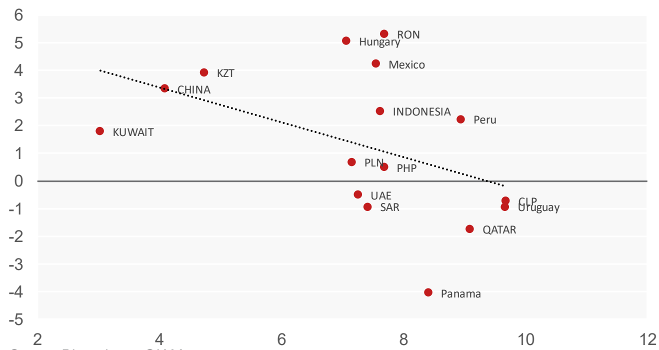
Tight valuations everywhere, especially BB



Source: Bloomberg, GIAM calcuations

Duration hits IG countries

modified duration vs YTD TR%, EMBIGD



Source:Bloomberg, GIAM

- **EMs are facing fewer tailwinds. Spreads may re-widen somewhat near term, but duration and carry point to still positive returns.**
- **We continue to prefer relatively the EM local debt over external debt amid better valuations.**
- **Valuations are still tight for external debt, and we expect a modest widening in the short term. We favour EM IG over HY, especially BBBs.**

EM global environment is facing fewer tailwinds, and the EM fixed income outlook has turned more bullish with a downward US rate outlook, a US dollar weakening, and further rate cuts from EM central banks. In the next months, total return will be essentially driven by duration and a high carry as we expect spreads to widen mostly. Indeed, EMs have seen a rapid and significant spread tightening over the past weeks, across the rating buckets in a euphoric move as the market is perfectly pricing a goldilocks scenario. It has led to tight valuations across IG and BBs leading to limited room for further tightening and thus risks skewed to the upside. It remains the outlook is constructive, and the total return will be positive both for EM IG and EM HY.

Still favouring EM local

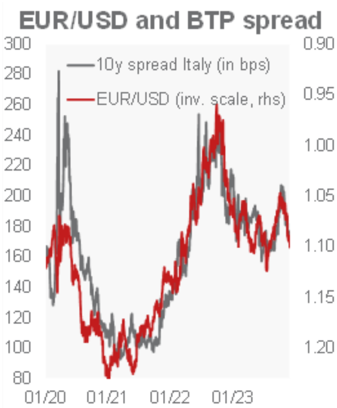
Across EM debt, we continue to prefer local debt over external debt, but the arbitrage is less straightforward. The spread between EM local yield and the UST rate has reached a new low. EM FX high-yielders have also seen their best monthly performance since late 2020. However, valuations are also extremely tight in the external debt segment, and terminal rates priced by the market in the local space are still above the neutral rates. Thus, we expect broader rate cuts to support EM local debt.

IG to benefit from the US rate decline

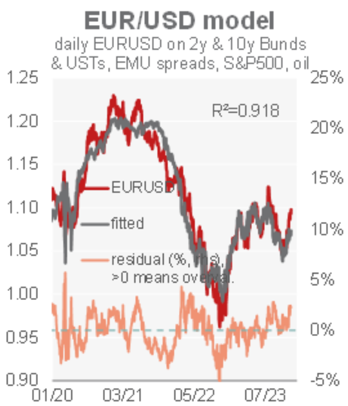
We maintain our preference for EM IG over HY and more specifically our overweigh on EM BBBs. Indeed, BBBs will continue to benefit from their higher duration but also better spread valuations. Valuations have been extremely tight across the rating buckets, especially in BBs. EM HY distressed names are the only ones that could tighten significantly and drive tighter the whole EMBIGD index. However, this tightening is above all driven by idiosyncratic and not beta factors. Within the BBBs bucket, news flow has been fluid: we maintain our preference for Romania, especially the EUR curve and we turn more negative on Panama with a clear risk of a downgrade to HY. More globally, given the overall richness of the index, we also see value in cheap hedges via 5Y CDS.

Currencies

Thomas Hempell

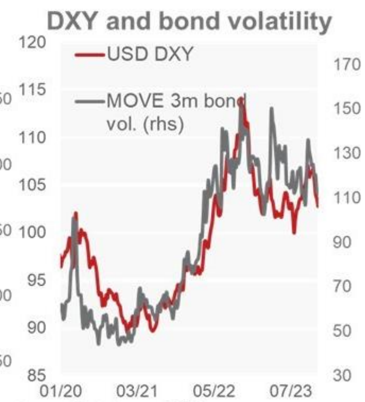


Source: Datastream, GIAM calculations



Source: Datastream, GIAM calculations

Source: Datastream, GIAM



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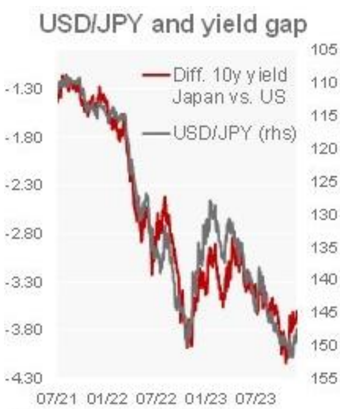
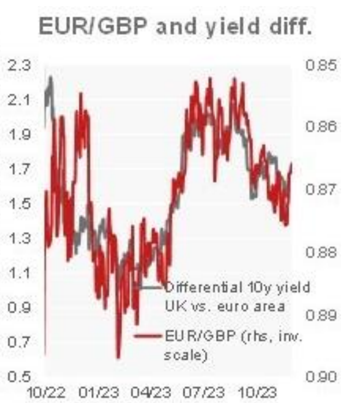


Source: Datastream, GIAM calculations



Source: Datastream, GIAM

- **Following the surge in November, the EUR/USD looks vulnerable to a correction near term amid more fragile risk sentiment, Europe's ongoing economic challenges and wider EGB spreads.**
- **While the USD may stabilize near term, we expect further weakness over 2024 as speculation about a Fed pivot will erode the US yield advantage and reduce bond volatility. Anticipated BoJ rate hikes in H2/24 will additionally weigh on the USD.**
- **We expect continued range-trading for EUR/GBP with improved UK indicators tilting risks slightly to the favour of sterling.**

The USD slumped over November amid rebounding risk appetite, US disinflation fuelling speculation about an earlier Fed pivot in 2024 and easing fears of escalation in the Middle East. The USD DXY is down 3.7% (Nov. 28), with the EUR/USD up almost 4%.

Short term, we still see scope for some moderate payback to the EUR/USD surge. We deem risk sentiment still fragile amid sluggish global growth and a mild euro area recession, with renewed safe haven flows helping the USD to stabilize. Furthermore, the euro's ascent appears fragile, given Europe's economic woes, the risk of re-widening EGB spreads (top left chart and Bonds section), and still strong speculative long EUR positions. The amount of the recent EUR/USD surge also looks somewhat excessive vs. the moves in key financial market drivers, incl. yields and equities (top right). Near-term, we expect the USD to stabilize and would not be surprised by a modest EUR/USD setback.

Recent USD weakness a precursor for 2024

Yet the recent USD weakness is likely a precursor of more weakness over 2024. Mounting speculation about a Fed pivot (for which we now have May 2024 in our books) will not only erode the dollar's yield advantage vs. major peers but will also undermine safe-haven bids as bond volatility is set to come down much further (mid-charts). The upswing in the EUR/USD will be muted, given the euro area's only sluggish economic recovery. But a BoJ rate hike expected for H2/24 would additionally pressure the USD via an appreciating yen, which for now struggles to gain traction despite the sharp drop in US yields (bottom left).

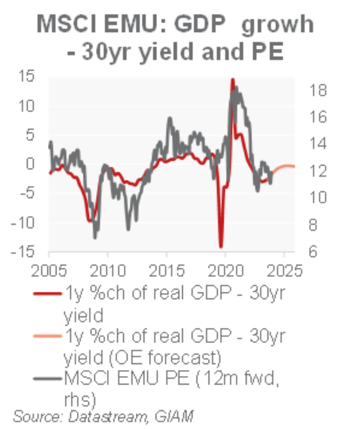
We anticipate EUR/GBP to keep trading in a relatively narrow range, with no stronger divergence in 10-year Gilts/Bunds in our books (bottom right). Recent soft indicators in the UK, incl. the Nov. PMIs and consumer confidence, have surprised on the upside and our growth forecasts for 2024 are slightly above consensus, which keep the risks tilted slightly to the upside for sterling for now.

Equities

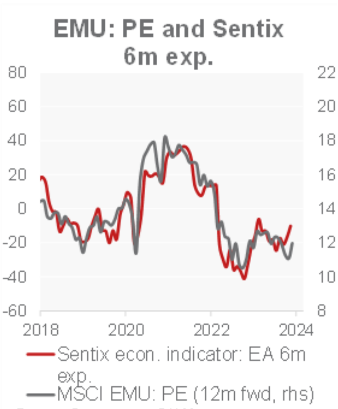
Michele Morganti, Vladimir Oleinikov

Market Index	Quant models (3m TR)	ML models (rel. TR vs World)	Com-posite rel. val. score*	LT models, 12m up /downside
S&P 500	=	-	- -	=/-
MSCI EMU	=	=	+	++
FTSE 100	- -	+	- -	++
SMI	=	++	+	++
TOPIX	=	=	+	+
Brazil	n.a	- -	- - -	n.a
China	n.a	+	+++	n.a
India	n.a	+	+	n.a

* composite valuation score is taken across 45 equity markets and is based on various valuation measures



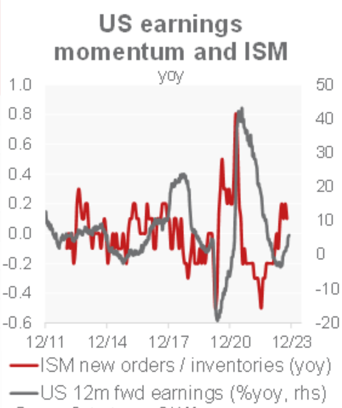
Source: Datastream, GIAM



Source: Datastream, GIAM

	Current 12m fwd PE	Average 12m fwd PE since 1995
S&P 500	18.9	16.7
S&P big 7	28.7	25.8
S&P 493	16.7	16.4
MSCI EMU	11.8	14.4
Topix *	13.8	13.7
UK	10.4	14.1
EM	11.5	13.1
China	9.5	12.8

Source: Datasteam, GIAM
S&P 493 & S&P 7 are based on current index composition of S&P500. * Topix's avg PE is since 2012 (after PE normalization vs World)



Source: Datastream, GIAM

- **After the rally, +9% for the S&P 500 over the month, we maintain a cautious view. Valuation at levels above 4,500 for the SPX is starting to look rather fair in the very short term.**
- **Weakness in the economy over the next few months, as well as a lower fiscal impulse in 2024 and the negative lagged effects of monetary policy, could trigger spikes in volatility - which remains very low. Finally, previous episodes of declining inflation from very high peaks would suggest some caution after almost 15 months of huge equity outperformance versus bonds since mid-2022.**
- **That said, our conviction in future lower yields and the potential anticipation of rate cuts in 2024 is gaining momentum. IFO and Sentix indicators are showing a better momentum, adding to a positive US corporates' net cash-flow trend.**
- **We see a 12-month TR of around 10% for ex-US indices, and a more limited 5% for the US. We look for a better entry point to exploit such potential. OW: EMU vs. US, Japan, SMI, China, Korea, and India.**
- **EU sectors: OWs: Banks, Durables, Cons. Services (new), Energy, Food Bev. Tob., HC Equip. & Svs., Pharma, Telecom. Svs. (new), Utilities. UWs: Capital goods, Div. Fin. (new), Insurance, Materials, Media, Semiconductors (new), Real Estate.**

A more dovish stance by central banks, lower inflation and further decrease in volatility triggered a rally in equities. Given its magnitude for the S&P 500, +9% over the month and +20% year-to-date, a cautious approach in the very short term would be appropriate. Previous episodes of declining inflation from very high peaks would suggest some cautiousness after nearly 15 months of huge equity outperformance vs bonds since mid-2022 (+25% total return differential). Furthermore, valuation at levels above 4,500 for the SPX is starting to look rather fair in the very short term, with only a small upside left. Lastly, economy softness over the next months plus a lower fiscal impulse in 2024 and the negative lagged effects of monetary policy could trigger spikes in volatility (which currently stays very low).

That said, our conviction in future lower yields and possible anticipation of rate cuts in 2024 is gaining momentum, even in the last few days. The picture remains constructive based on other factors, too: the two wars (in Israel and Ukraine) probably not escalating, neutral investors' positioning, IFO and Sentix showing a better momentum, positive US corporates' net cash-flow momentum, the trend in US banks' reserves balance with Fed and the US M2 impulse. Finally,

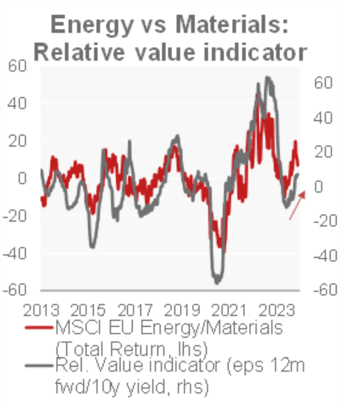
Equities

Michele Morganti, Vladimir Oleinikov

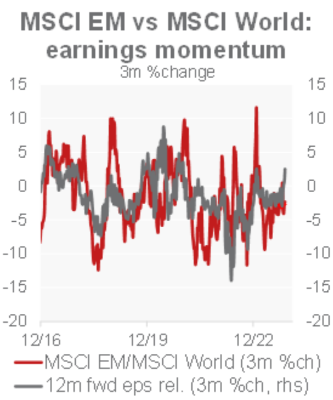
GIAM earnings forecasts

	US NIPA profits pre-tax bl$	yoy	S&P earnings level	yoy	EMU earnings level	yoy
2023 Q1	3,165.1	4.6	215.8	2.6	15.9	16.9
2023 Q2	3,172.1	-2.7	214.8	-0.7	16.1	12.8
2023 Q3	**3,282.8**	**-0.5**	216.2	-0.9	16.4	10.5
2023 Q4	**3,310.1**	**1.9**	**220.3**	**1.0**	**16.1**	**0.9**
2024 Q1	**3,288.6**	**3.9**	**222.2**	**3.0**	**16.0**	**0.8**
2024 Q2	**3,298.9**	**4.0**	**222.4**	**3.5**	**16.3**	**1.3**
2024 Q3	**3,361.6**	**2.4**	**224.5**	**3.8**	**16.5**	**1.1**
2024 Q4	**3,432.6**	**3.7**	**230.6**	**4.7**	**16.6**	**3.1**

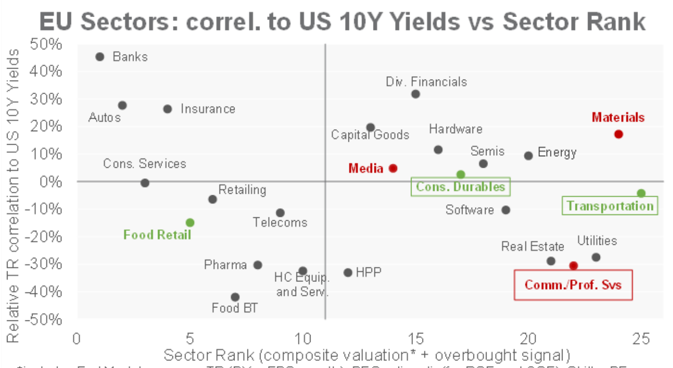
Source: Datastream, GIAM calculations
Note: S&P and EMU earnings as of end of qtr; they are derived from NIPA; forecasts in bold



Source: Datastream, GIAM calculations



Source: Datastream, GIAM



*includes Fed Model gap, exp. TR (DY + EPS growth), PEG ratio adj. (for ROE and COE), Shiller PE, 3-stage EPS growth model, mkt multiples, and PE vs hist. avg. excl. bubble years
Red = negative machine learning quant models; **Green** = positive machine learning quant models; [box] = stronger signals (> 2 SD)
Source: Refinitiv, GIAM calculations as of 28/11/2023

Our machine-learning models (ML) for equity vs. bonds returns are neutral, thus not in a dangerous zone for equities. We updated our earnings forecasts for 2024 which are based on our macro projections. We remain below consensus by 4.5% in the US and 3% in the euro area (EA). For 2025, we cautiously continue to stay below analysts' estimates by nearly 5%. For the US, the earnings growth bottom (year-on-year) should have already occurred in Q3 2023, albeit the recovery from now on should be slow. As for the EA, the trough in earnings could lag the US one by two quarters (Q1 2024).

The net result is that in the case of ex-US indices, we see a TR of around 10% in 12 months and a more limited 5% for the US. For EMU in particular, we see the chance to have a higher PE (at 12.8x from 12x), which adds to a dividend yield of nearly 4%, a limited earnings growth of 5% and a buyback yield of 0.9%. That said, the target PE would remain below the historical average (14x, s. previous page). Regionally: OW EMU vs. US (peak US valuation premium and less divergent macro surprises), OW Japan (valuation, reforms), SMI (valuation), China (val., stimulus), India (val., eco) and Korea (val., eco).

EMs: supported by improving investment sentiment

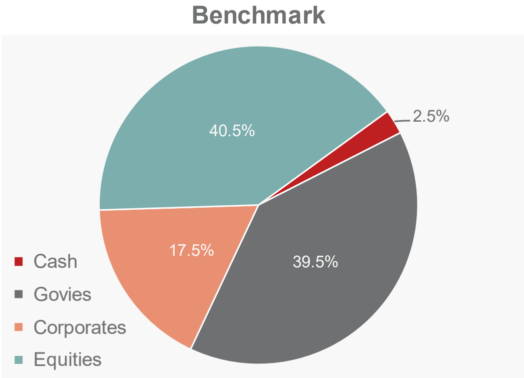
EMs are likely to remain affected in the short term by global macro uncertainty and growth headwinds coming from both the US and China. But the risks appear to have diminished. Investment sentiment seems to have bottomed out and started to improve. China has continued to step up its easing measures (including bond issuance and liquidity injections) and we prefer to stay OW, albeit we see an L-shaped recovery and consequent elevated volatility. Additionally, we are OW on India (eco) and Korea (new), which started to look increasingly attractive (best country score, improving 2024 outlook).

European sector allocation

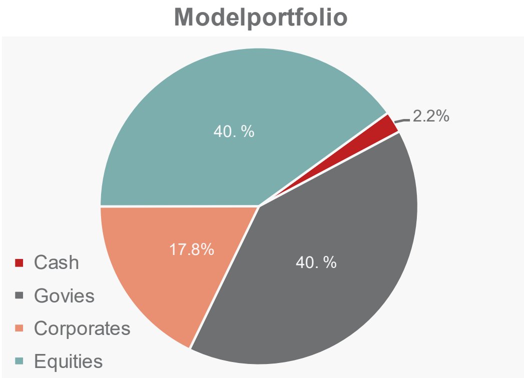
We maintain a balanced portfolio with a defensive tilt, suggesting a few tweaks to be positioned for lower yields. We move to neutral Comm. Prof. Svs. (from UW) and Food Retail (from OW). We tactically move Div. Fin. (yields sensitivity) and Semis to UW (earnings revisions). We marginally increase Media (still slightly UW) while decreasing Materials (earnings momentum). We upgrade Consumer Svs. and Telecom. Svs. to a small OW (earnings and valuation). OWs: Banks, Durables, Cons. Services (new), Energy, Food Bev. Tob., HC Equip. & Svs., Pharma, Telecom. Svs. (new), Utilities. UWs: Capital goods, Div. Fin. (new), Insurance, Materials, Media, Semiconductors (new), Real Estate. OW small vs Large cap EU.

Asset Allocation

Thorsten Runde



Source: GIAM



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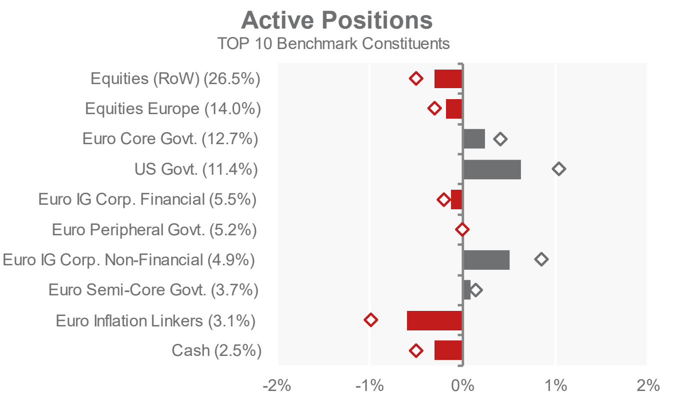


Source: GIAM; Benchmark weights in parentheses, diamonds indicating previous recommendations

- **In a sharp reversal to October, in November the returns of all our covered asset classes find themselves in positive territory (28.11.23).**
- **Over the entire month, all covered Equity markets (apart from the MSCI Europe ex EMU) together with long-dated Government Bonds hold to the top positions in the performance ranking. With +8.7% for North American Equities and +8.1% for long-dated US Treasuries, US clearly outperformed Europe.**
- **Overall, EA HY Credit outperformed EA IG (+38 bps). Within IG, Non-Fin was superior to Fin (+35 bps).**
- **We still act on the assumption of slowly declining yields with disinflation progressing on the one hand but central banks maintaining a hawkish stance on the other hand. Economic prospects should weigh on risk sentiment. That said, some relaxation in the Middle East conflict argue for a less restrictive positioning in risk-assets.**
- **Thus, by cutting all active positions nearly by half, we basically confirm our prudent stance on risks assets albeit to a lower degree. We keep but also trim the already moderate long duration stance.**

With +3.0 bps our model portfolio slightly outperformed its benchmark in November (28.11.23). All in, the underweight positions in short-dated Core Govies (+4.2 bps) and in inflation-linked bonds (+2.4 bps) proved most rewarding. With -2.4 bps and -2.1 bps, the overweights in medium-dated Core Govies and EA IG Non-Fin were the most painful active positions.

We deem the disinflational trends in the US as well as in the euro area basically intact. That said, the continued hawkish bias in the central banks' forward guidance should particularly limit the speed of the decline. Thus, there should be some relief to Equity valuations. Furthermore, lower tail risks of a Middle East escalation also argue for a tactical reduction in risk-off positions. Yet, cooling down economic activities, with a technical recession likely for the euro area in Q3, will keep risk sentiment vulnerable.

Reduction in risk-off positions

As there is no clear-cut conclusion we are cutting all active positions in the model portfolio nearly by half. In that way, we reduce the UWs in Equities and EA HY thereby raising our exposure to risk assets. Simultaneously reducing the OWs in Govies and IG Credit Non-Fin reflects our expectation of only gradually falling yields in the near-term. Yet, we keep our moderately long duration stance though at a slightly reduced level.

Forecasts

Macro Data

Growth[1]	2022	2023 forecast	2023 Δ vs. cons.	2024 forecast	2024 Δ vs. cons.	2025 forecast
US	2.0	2.4	0.2	1.4	0.3	1.8
Euro area	3.3	0.4	- 0.1	0.5	- 0.1	1.4
Germany	1.8	- 0.2	0.2	0.1	- 0.4	1.7
France	2.5	0.3	- 0.5	0.8	0.0	1.6
Italy	3.9	0.7	- 0.0	0.6	0.0	0.5
Non-EMU	3.5	0.2	- 0.2	0.7	0.1	1.5
UK	4.1	0.1	- 0.3	0.5	0.2	1.5
Switzerland	2.1	0.8	0.0	1.2	0.0	1.2
Japan	1.2	1.7	- 0.2	1.2	0.3	1.0
Asia ex Japan	4.1	4.9	0.1	4.6	- 0.2	4.8
China	3.0	5.2	0.2	4.5	0.1	4.5
CEE	1.9	2.6	0.7	2.3	0.3	2.8
Latin America	4.0	2.0	0.0	1.4	- 0.0	2.1
World	**3.3**	**2.9**	**0.1**	**2.6**	**0.1**	**3.0**

1) Regional and world aggregates revised to 2020 IMF PPP weights

Inflation[1]	2022	2023 forecast	2023 Δ vs. cons.	2024 forecast	2024 Δ vs. cons.	2025 forecast
US	8.0	4.1	- 0.1	2.5	- 0.1	2.2
Euro area	8.4	5.6	0.0	2.8	0.3	2.3
Germany	8.6	5.6	- 0.5	2.9	0.2	2.5
France	5.9	5.3	0.3	2.8	0.1	2.2
Italy	8.2	5.2	- 0.8	2.4	- 0.1	0.6
Non-EMU	8.0	6.6	0.1	2.8	- 0.1	2.1
UK	9.1	7.5	0.1	3.0	- 0.1	2.1
Switzerland	2.8	2.2	0.0	1.5	- 0.1	1.3
Japan	2.5	3.2	0.0	2.2	0.0	1.6
Asia ex Japan	3.5	2.1	- 0.1	2.4	- 0.1	2.5
China	1.9	0.4	- 0.2	1.4	- 0.3	1.7
CEE	29.6	20.8	0.3	17.5	1.2	8.3
Latin America[2]	7.8	5.2	0.0	3.9	0.0	3.1
World	**7.8**	**5.3**	**- 0.0**	**4.0**	**0.0**	**3.0**

1) Regional and world aggregates revised to 2020 IMF PPP weights ; 2) Ex Argentina and Venezuela

Financial Markets

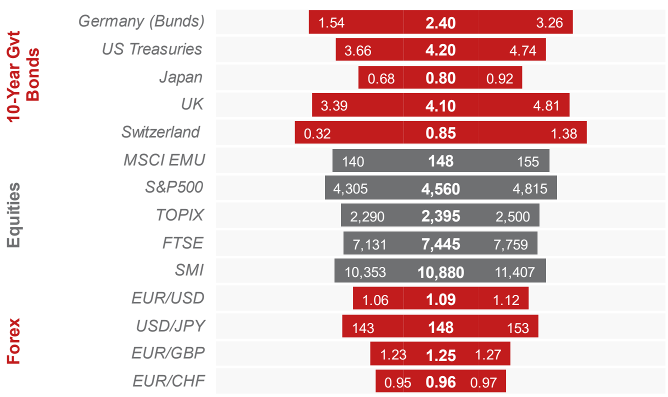
Key Rates	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
US (upper bound)	5.50	5.50	5.35	5.25	5.02	4.75	4.28
Euro area	4.00	4.00	3.86	3.75	3.64	3.25	2.87
Japan	-0.10	-0.10	0.02	-0.10	0.08	0.00	0.27
UK	5.25	5.25	5.24	5.00	5.15	4.50	4.50
Switzerland	1.75	1.75	1.68	1.50	1.61	1.50	1.25
10-Year Gvt Bonds							
US Treasuries	4.40	4.20	4.38	4.05	4.37	3.85	4.37
Germany (Bunds)	2.56	2.40	2.56	2.35	2.54	2.30	2.52
Italy	4.32	4.25	4.32	4.25	4.36	4.35	4.44
Spread vs Bunds	176	185	176	190	182	205	192
France	3.13	3.00	3.12	2.95	3.12	2.95	3.15
Spread vs Bunds	56	60	56	60	58	65	62
Japan	0.77	0.80	0.84	0.85	0.89	0.90	0.99
UK	4.22	4.10	4.24	4.05	4.22	3.90	4.25
Switzerland	0.97	0.85	0.91	0.80	0.90	0.80	0.89

*3-day avg. as of 28/11/23
**ICE BofA (OAS)

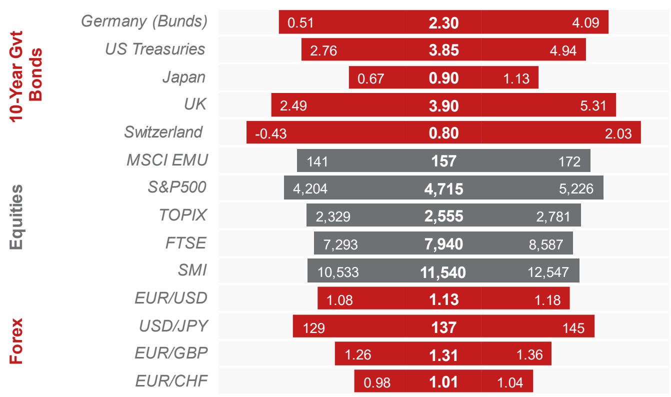
Credit Spreads**	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
EA IG Non-Financial	138	145		145		140	
EA IG Financial	159	160		170		165	
EA HY	432	500		515		500	
EM Sov. (in USD)	320	330		310		290	
Forex							
EUR/USD	1.10	1.09	1.10	1.11	1.10	1.13	1.11
USD/JPY	149	148	147	140	145	137	141
EUR/JPY	163	161	161	155	160	155	157
GBP/USD	1.26	1.25	1.26	1.28	1.26	1.31	1.27
EUR/GBP	0.87	0.87	0.87	0.87	0.87	0.86	0.88
EUR/CHF	0.96	0.96	0.96	0.97	0.95	1.01	0.94
Equities							
S&P500	4,555	4,560		4,535		4,715	
MSCI EMU	147.0	147.5		144.0		156.5	
TOPIX	2,383	2,395		2,360		2,555	
FTSE	7,468	7,445		7,325		7,940	
SMI	10,820	10,880		10,555		11,540	

Forecast Intervals

3-Months Horizon*



12-Months Horizon*



*Forecast ranges of ±1 stdv. centred around point forecasts; based on historical volatilities; length of bars indicative only

GENERALI INSURANCE ASSET MANAGEMENT

Imprint

Issued by: **Generali Insurance Asset Management S.p.A. Società di gestione del risparmio | Research Department**

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This document was completed on 31 October 2023.