GENERALI ASSET MANAGEMENT

Market Perspectives

Sustained exceptionalism

December 2024

GenAM Macro & Market Research

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

- **The US economy keeps outpacing major peers in the advanced world. While high implementation uncertainties remain, Trump's policy agenda is likely to sustain US exceptionalism well into 2025.**
- **Acknowledging risks from trade and geopolitical frictions, risk sentiment should remain underpinned by tailwinds from resilient global growth, receding inflation and central bank rate cuts.**
- **Yet regional differentiation matters. Our mild over-weight in Equities is tilted towards outside the euro area.**
- **We see US yields geared to the upside short term, but warm up to higher duration in the euro area while keeping a preference for Credit. The US dollar seems poised to stay stronger for longer.**

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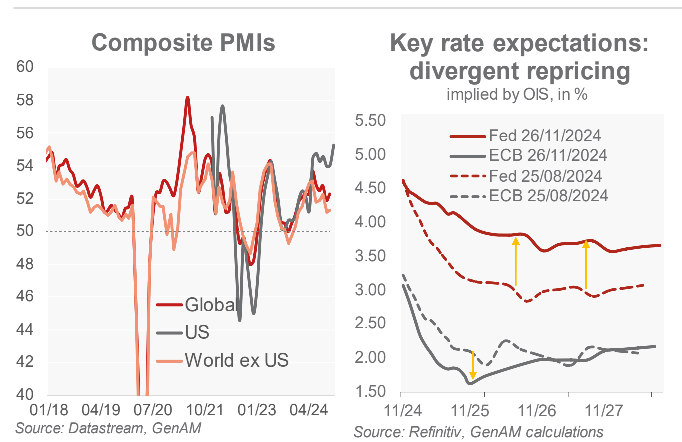
Global View – Sustained exceptionalism

Thomas Hempell

- **The US economy keeps outpacing major peers in the advanced world. While high implementation uncertainties remain, Trump's policy agenda is likely to sustain US exceptionalism well into 2025.**
- **Acknowledging risks from trade and geopolitical frictions, risk sentiment should remain underpinned by tailwinds from resilient global growth, receding inflation and central bank rate cuts.**
- **Yet regional differentiation matters. Our mild over-weight in Equities is tilted towards outside the euro area.**
- **We see US yields geared to the upside short term, but warm up to higher duration in the euro area while keeping a preference for Credit. The US dollar seems poised to stay stronger for longer.**

As Trump emerged as the undisputed winner from the US elections, markets have responded with rising stocks and yields in the US (though the latter retracing lately), contrasting respective falls in Europe. The USD gained, as did Bitcoin on hopes of a lighter crypto regulation.

US exceptionalism still has legs. US growth is set to outpace G7 peers also in 2025. Trump's sweep victory in the US elections may even deepen the diverging fortunes of the US economy versus China and Europe (left chart below). We do not expect Trump to deliver 'full-on' on his most disruptive policy proposals. In particular, on trade he may opt for using tariff threats mostly as a bargaining chip for enforcing concessions elsewhere. Meanwhile, he is likely to prioritize corporate tax cuts during his first weeks in office to underpin positive sentiment.



Source: Datastream, GenAM

Source: Refinitiv, GenAM calculations

Yet rising trade policy uncertainties and a confrontative China stance are still likely to weigh on key trading partners, while underpinning the already upbeat US expansion for now. Europe keeps suffering from high political uncertainties. Politics in Germany will be paralysed for months into snap elections on Feb 23. And the French government looks at risk of being toppled over the 2025 budget. Markets' worries about urgently needed fiscal consolidation have pushed the French sovereign risk premium above Greece's for the first time. Overall, we expect the euro area to grow only at a third of the US pace (0.8% vs. 2.4%) for another year in 2025.

Disinflation is progressing across the advanced world, but the balance of risks is also increasingly divergent: tilted to the upside in the US (strong economy, Trump policies), while much more two-sided now for the euro area. Meanwhile, China keeps struggling with deflation. After a still likely 25bp cut in December, the Fed will weigh its further easing next year more carefully. By contrast, the discussion at the ECB will be whether a 50bp 'jumbo' cut is warranted (we ultimately expect a majority for only a 25bp step).

10-Year Gvt Bonds	Current*	3M	6M	12M
US Treasuries	4.27	4.40	4.30	4.10
Germany (Bunds)	2.19	2.15	2.10	2.00
Credit Spreads**				
EA IG Non-Financial	103	100	100	100
EA IG Financial	110	110	110	110
Forex				
EUR/USD	1.05	1.04	1.03	1.04
USD/JPY	153	154	152	145
Equities				
S&P500	6003	6080	6120	6200
MSCI EMU	160	162	162	170

**3-day avg. as of 27/11/24 **ICE BofA (OAS)*

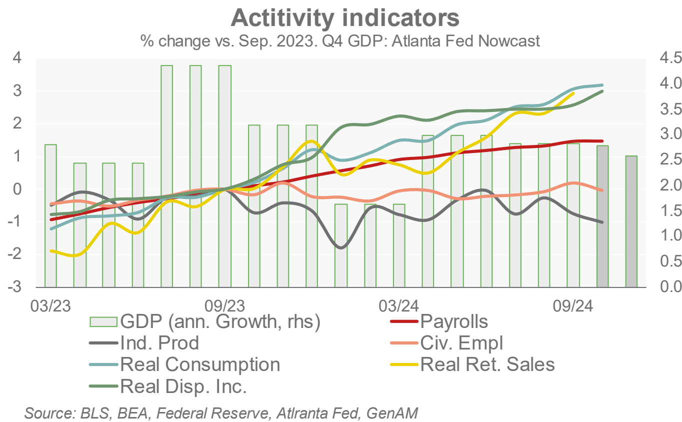
Pro-risk tilt with regional differentiation

This regional divergence is also reflected in our market outlook. We warm up to duration exposure on German Bunds as inflation continues to recede, growth risks keep lingering and the ECB proceeds with rate cuts. We are more cautious on US Treasuries near term as a solid economy and Trump's policies may push longer-dated yields to more attractive entry points. French OATs may remain under pressure for some more time amid protracted political and fiscal uncertainties.

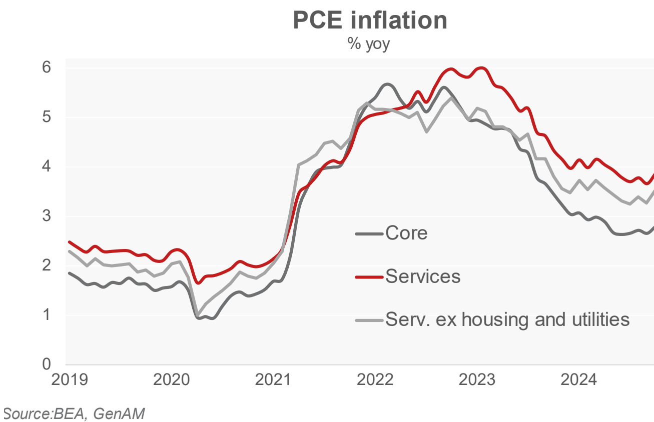
Acknowledging risks from trade and geopolitical frictions, we still expect risk sentiment to remain underpinned by the combination of resilient global growth, receding inflation and rate cuts. Given current political and cyclical uncertainties in the EA, we tilt our moderate overweight in Equities to outside the euro area, notwithstanding its record high risk-premium vs. US. With default rates stable, we keep an overweight also in EUR Credit mostly thanks to the carry and the expected mild retracement in underlying yields. Extended US exceptionalism and trade uncertainties should keep the US dollar strong for longer.

United States

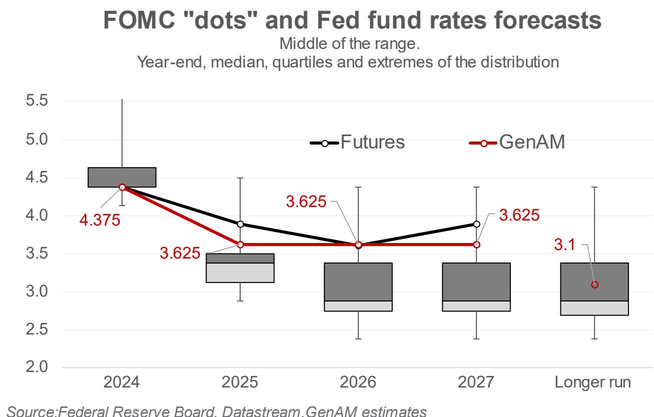
Paolo Zanghieri



Source: BLS, BEA, Federal Reserve, Atlranta Fed, GenAM



Source:BEA, GenAM



Source:Federal Reserve Board, Datastream,GenAM estimates

- **High frequency data point to strong Q4 growth. We expect GDP to expand by 2.8% this year and 2.4% next, if the new administration prioritises tax cuts over tariffs.**
- **October inflation data proved stronger than expected, but the ongoing moderation in wage growth will dampen pressures in services inflation. We see the core PCE rate at 2.2% yoy by the end of 2025.**
- **The Fed will cut at the December meeting, but we trimmed our 2025 call to three further cuts, with risks tilted to even less accommodation.**

The economy has entered Q4 on a strong note. In October real consumption was up a 3% yoy, and nowcasts point to 2.5% annualised GDP growth, implying a 2.8% increase for the year as a whole. We expect a very moderate deceleration for 2025, with real income driving a still strong consumer expansion and capex providing a higher contribution. This above-consensus forecast assumes that the new Trump administration will start with tax cuts and leave the implementation of less growth friendly measures like tariffs to the second half of next year. This tilts the balance of risks to the downside.

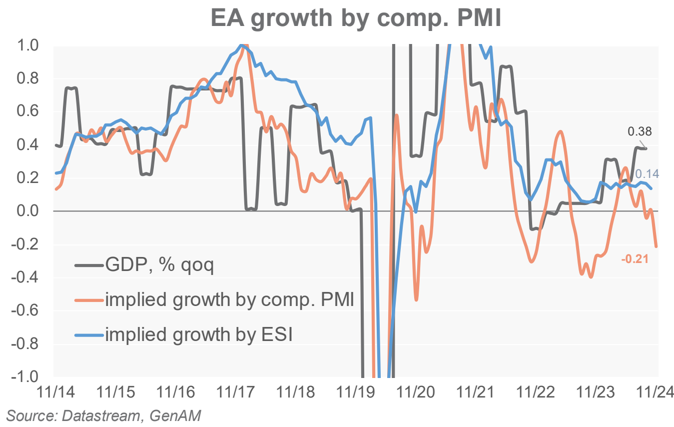
The strength in domestic demand is mirrored by the still high inflation prints. In October, core PCE inflation accelerated to 2.8% yoy. Base effects and one-off factors, like the increase in portfolio management fees, played a big role, but inflation is very likely to end the year higher than the 2.6% predicted by the Fed in September. While acknowledging the upside risks from demand pressures and the lagged effect of the rebound in house prices on rents, we think inflation remains on a downward path. Wage inflation continues to moderate; in Q3 the employment cost index grew by 3.9% yoy, down from 4.1% yoy in Q2. This will gradually spill over to inflation in labour-intensive services.

Fed funds rate to stabilise at 3.5-3.75% by YE 2025

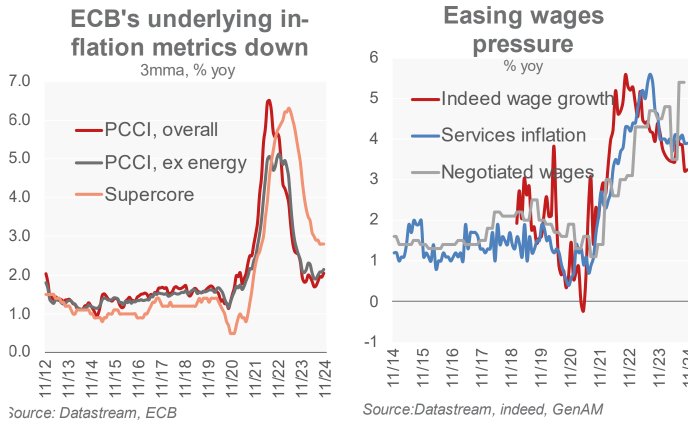
We still think that the Fed will cut rates in December, but we revised up our estimate of the landing rate. We now expect only three rate cuts for 2025 and none for the following year. This means that the policy rate will stabilise in the 3.5%-3.75% range. Good data on productivity and the coexistence of strong consumption growth with moderating inflationary pressures is evidence of a higher trend growth rate (approx. 2%) which would require less accommodation. We expect the December projection to show also another upward nudge of the neutral estimates, to around 3%. The upward tilt to risks is related to the possibility of stronger growth.

Euro Area

Martin Wolburg

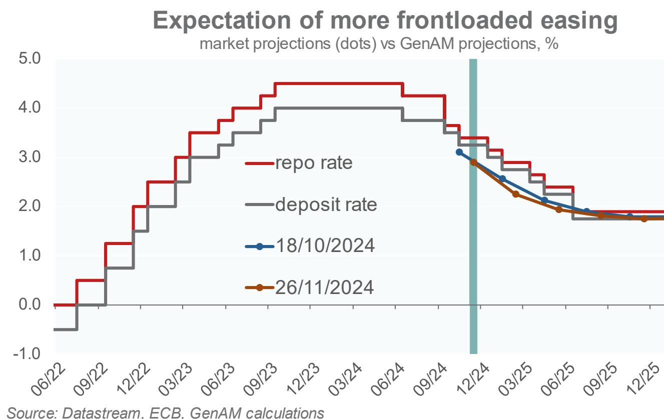


Source: Datastream, GenAM



Source: Datastream, ECB

Source:Datastream, indeed, GenAM



Source: Datastream, ECB, GenAM calculations

- **Activity indicators continued to come in weak. The threat of tariffs after the Trump victory burdens the outlook augmenting existing uncertainties.**
- **We reduced our 2025 growth outlook to 0.8%, well below the consensus of 1.2%.**
- **With inflation set to abate sustainably in 2025 we now see the ECB terminal rate at 1.75%, likely reached by mid-2025.**

While the surprisingly strong Q3 GDP growth might have triggered some hopes of a quicker recovery, the data flow since then helped to temper expectations again. The latest reading of the composite PMI (of 48.1) signals contraction and forward-looking components in various surveys also took a hit. The reasons are manifold, ranging from persistent global manufacturing weakness in the light of weak Chinese demand to deteriorating consumer confidence amid labour market worsening.

With Germany now going to the polls on February 23 domestic uncertainty increased. A new government is likely, and the course of fiscal policy is unclear. This adds to political uncertainties already emanating from France. On top of that, the election of Trump as new US President puts the risk of tariffs on EU exports again in the spotlight. While we think this will mainly serve as a bargaining chip, uncertainty increases further adding to headwinds, especially for investments.

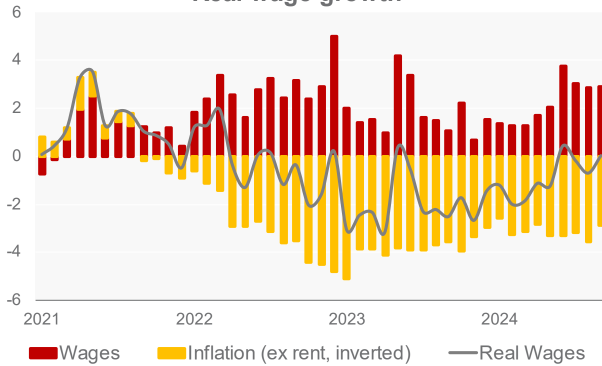
All in all, we now see annual growth in 2025 at only 0.8% (from 1.0%) , well below the consensus of 1.2%.

ECB now likely to go slightly below neutral

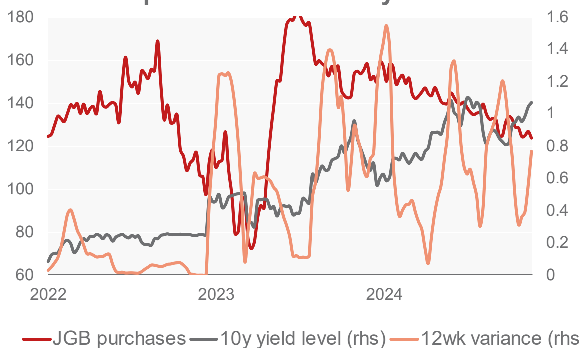
We expect the ECB to look through the Q4 inflation spike, largely driven by energy-price base effects. Fundamentally, inflation is retreating and easing wage growth will also push services inflation down next year. We expect that in the updated ECB macro projections inflation will be, for the first time since its post-pandemic spike, in line with target over most of the forecast horizon, ending in 2027. The 2025 growth outlook (of 1.3%) will be revised down backing a dovish policy tilt. But given high uncertainties and currently still stubborn core inflation we expect the ECB to stick to its gradual meeting-by-meeting approach and look for continued and steady 25 bps cuts. We now deem it slightly more likely than not that the terminal rate will be at 1.75%, somewhat below the 2.0% to 2.5% neutral rate corridor, and likely reached by Jully.

Japan

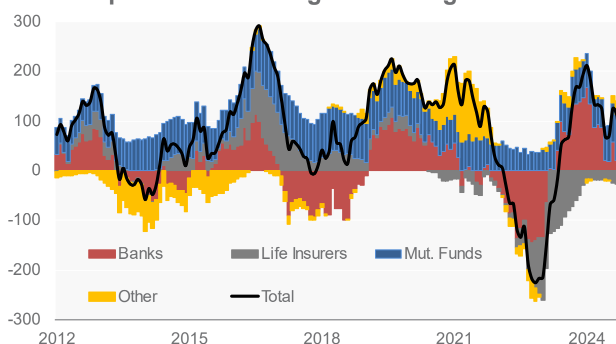
Paolo Zanghieri



Source: Refinitiv, GenAM



Source: BoJ, GenAM



Source: BoJ. GenAM

- **Strong real income growth keeps consumption strong. GDP is set to increase by slightly more than 1% in 2025. Inflation has subsided but fluctuates around the 2% target.**
- **The BoJ is increasingly confident in a "virtuous cycle of prices and wages" and is likely to raise rate in December. Two more hikes by early 2026 will bring the policy rate to the 1% neutral level**
- **Higher yields and lower liquidity could reduce the demand for foreign assets. Net purchases of foreign sovereigns weakened and are concentrated into UST.**

The "virtuous cycle of prices and wages" predicted by the BoJ to back its moderate rate rising seems to be strengthening. Core inflation (less fresh food) peaked at 4.2% at the beginning of 2023 and has declined rapidly since. In October it stood at 2.3% yoy. We expect sustained inflation for 2025 too, as a reaction to the upward trend in import prices, followed by stronger wages. After nearly three years of negative real wage growth, strong corporate earnings and elevated inflation expectations are bidding up pressures for higher wages. As a result, the strengthening in real income will sustain and increasingly consumption driven dynamics enabling GDP to increase by 1.2% next year. The prospects for capex have brightened too, helped by profitability and a tight labour market. The global trade outlook is the biggest risk, but Japan appears better insulated form tariffs on China, as it has decreased trade in intermediate inputs with that country.

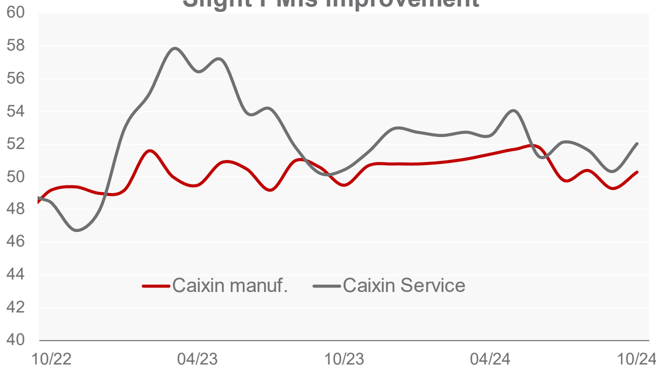
BoJ keeps tightening leading to capital repatriation

The growth/inflation outlook remains consistent with another rate rise in December or Q1 2025 at the latest. We think it will be followed by another one around mid-2025 and the estimated neutral level of 1% will be eventually reached in 2026. Next year the BoJ will revise its balance sheet policies. Consistency with the current policy stance would call for a speeding up of the shrinking in the JGB holdings, but liquidity issued which emerged with the start of the reduction in purchases in July 2024 would call for caution.

Tighter monetary policy and less ambitious fiscal consolidation plans will put upward pressure on yields and reduce the demand for foreign bonds. Net purchases have already moderated. Currently, apart from US Treasuries, Japanese investors have become net sellers in both the DM and EM space.

China

Guillaume Tresca



Source: Bloomberg, S&P Global, GenAM

Source: Bllomberg, NBS, GenAM

Source: Bloomberg, NBC, GenAM

- **High-frequency indicators indicate that the policy-induced confidence boost is bearing fruit.**
- **Yet more stimulus is needed as growing uncertainties about looming US tariffs in the wake of Trump's sweep victory burden the outlook.**
- **More hints on further fiscal support and RRR cut are expected in December.**

The Chinese environment has hardly improved, with mixed local news and the first related US tariff headlines. Uncertainty has increased in the wake of the US election results, but there is a silver lining. Indeed, policymakers' commitment to supporting the economy remains intact, even if the expected NPC Standing Committee meeting in November failed to meet the market's high expectations. We expect more guidance at the Central Economic Work Conference in early December or even later in Q125. There will be more fiscal stimulus aimed at consumer demand, but probably not the bazooka initially expected. It will allow growth to stabilise and reduce downside risks, but it may not be enough to push growth higher. The risk is some market fatigue and disappointment, as the announcement will be gradual and spread over time.

Near-term improvement in economic activity

Fortunately, high-frequency indicators have shown some improvement that needs to be confirmed. The confidence boost from policymakers in September is bearing fruit. First, official and unofficial PMIs picked up slightly in both the services and manufacturing sectors. Second, retail sales surprised to the upside. For example, car sales growth accelerated to 30% yoy in November MTD. Third, the housing sector is slowly healing. New home sales in 30 major cities rose by 11.8% yoy MTD after -3.8% in October. However, real estate investment is still declining. Fourth, local governments have started to take advantage of the new debt swap program, increasing their local issuance. This will free up some local financial resources.

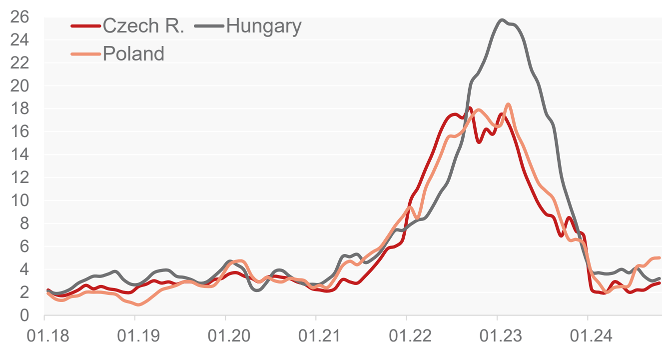
Further support

Further monetary and fiscal easing is needed as the improvement so far has been marginal. It will help boost Q4 growth and achieve the near 5% growth target, but is unlikely to be enough to provide sustained support given the threat of tariffs. Moreover, the expected 10% tariff hike will push policymakers to take bolder decisions. First, we expect the PBoC to cut the RRR further by at least 20bp in December. This will help absorb local bond supply. Second, the key policy rate will likely be cut further in 1Q25.

Central and Eastern Europe

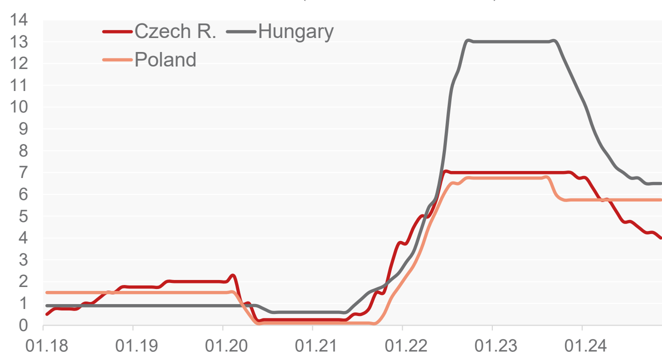
Radomír Jáč

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



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

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



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

Main Forecasts

Czech Republic	2023	2024f	2025f	2026f
GDP	0.0	1.0	2.3	2.8
Consumer prices	10.7	2.5	2.0	2.0
Central bank's key rate	6.75	4.00	3.00	3.00
Hungary	**2023**	**2024f**	**2025f**	**2026f**
GDP	-0.9	0.9	3.0	3.3
Consumer prices	17.6	3.8	4.0	3.3
Central bank's key rate	10.75	6.50	5.50	4.50
Poland	**2023**	**2024f**	**2025f**	**2026f**
GDP	0.1	2.4	3.1	3.3
Consumer prices	11.6	3.7	4.0	2.8
Central bank's key rate	5.75	5.75	4.75	3.75

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

- **Preliminary Q3 GDP data reported slightly slower-than-expected growth in Czechia and quarter-to-quarter GDP declines in Hungary and Poland.**
- **Inflation will accelerate in Czechia and Hungary in the rest of 2024 while the outlook for Polish inflation for 2025 improved as electricity tariffs will remain frozen.**
- **The Czech CNB is the only CE-3 central bank that cut rates in Q4. Hungary cut rates in September: further cuts may follow from Q1 2025. Polish rates stood on hold in 2024: rate cuts may resume in March 2025.**

The CE-3 GDP performance was weaker-than-expected in 3Q24, according to preliminary data. Hungary's GDP fell by 0.7% qoq and the economy entered a technical recession. Polish GDP decreased by 0.2% qoq. Czech GDP increased by 0.3% qoq: slightly less than expected. We lowered the GDP growth outlook for 2024 for all three CE-3 countries.

Inflation rose slightly in all CE-3 countries in October: to 2.8% yoy in Czechia (vs. a target set at 2.0% yoy +/- 1 pp), to 3.2% yoy in Hungary (target: 3% yoy +/- 1 pp) and to 5.0% yoy in Poland (target: 2.5% yoy +/- 1 pp). Inflation in Poland was affected by the July increase in energy prices. The government recently announced that power tariffs will remain frozen at their current levels in 2025, which should bring the average headline CPI in 2025 at the lower side of the NBP forecast (4.3% yoy). Headline CPI in Czechia and Hungary will increase temporarily at the turn of 2024/2025 due to base effects on food and energy prices.

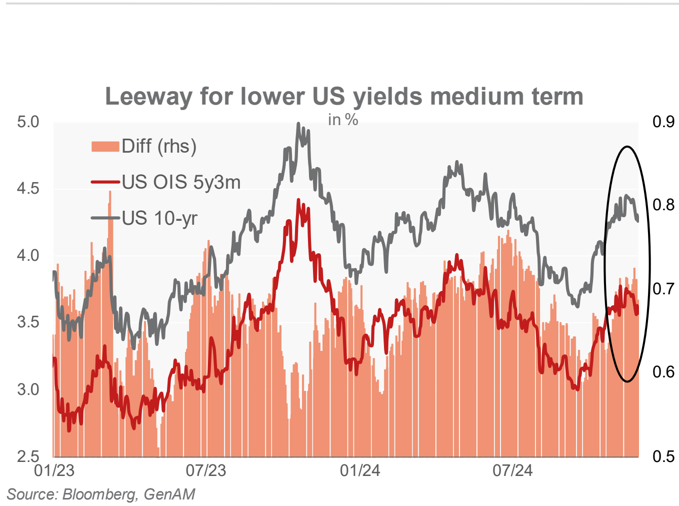
The US election has weakened the CE-3 currencies (through the behaviour of the EURUSD FX rate) but the movements were not dramatic. The CE-3 government bond yields fell, mirroring the performance of German Bunds.

Only the Czech CNB continues to reduce interest rates

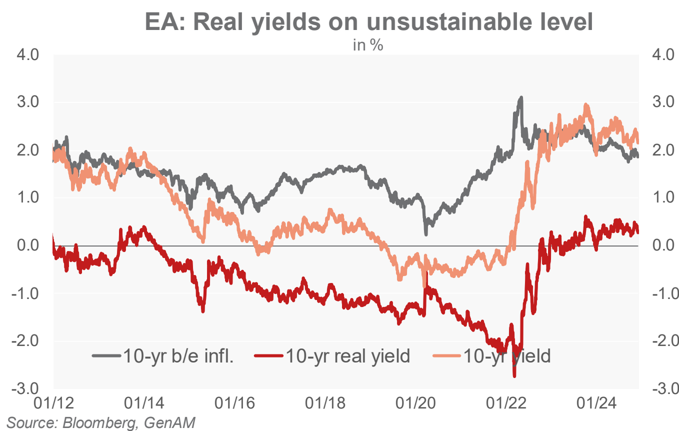
The Czech CNB cut its key rate by 25 bps to 4.00% in November. Its new forecast expects the key rate at 3.00% by mid-2025. However, the CNB Board looks more cautious. We see a high probability that the CNB will keep rates on hold in December and will be cutting them by 25 bps per quarter in 2025, gradually to 3.00%. In Hungary, the MNB kept the base rate at 6.50% in both October and November and indicated that rates would remain stable also in December. We expect monetary easing to resume in Q1 2025 with rate cuts by 25 bps per quarter. Poland left its key rate unchanged at 5.75% in November and stable rates are expected also for December. Several MPC members said rate cuts could resume in March (but not before), as the freeze of electricity tariffs improved the outlook for inflation in 2025.

Government Bonds

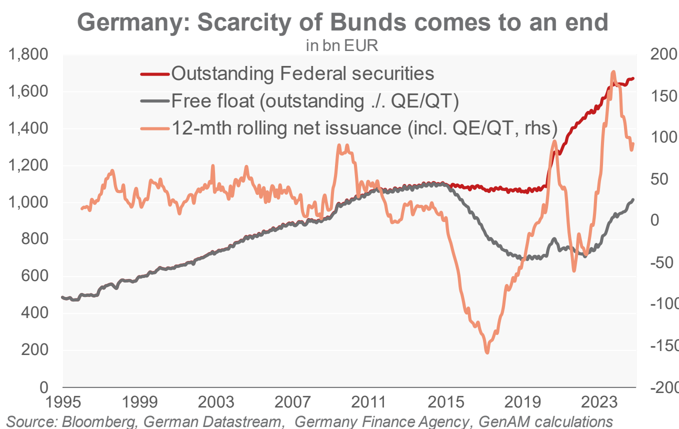
Florian Späte



Source: Bloomberg, GenAM



Source: Bloomberg, GenAM



Source: Bloomberg, German Datastream, Germany Finance Agency, GenAM calculations

- **The election of Trump as US president has largely led to the expected reaction on the international bond markets. While US yields initially rose, EA core yields fell across all maturities. The 10-yr transatlantic spread has risen well above 200 bps.**
- **This pattern is unlikely to change much in the short term. In the medium term, however, we also see downside potential for US yields in view of further reductions in key interest rates, falling inflation and a normalisation of growth.**
- **While EA non-core government bond spreads have changed little overall in November, French OATs have recently moved back into the spotlight. In view of the political uncertainties, we are maintaining our cautious approach despite the increased spread level.**

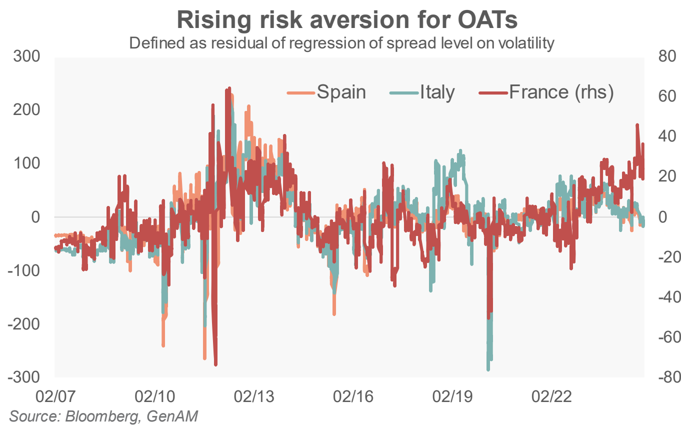
The economic policy programme of the new US administration expected by the financial market - an expansive fiscal policy, immigration cuts and (inflation-increasing) tariff hikes - has noticeably increased the transatlantic spread across all maturities. However, after US yields had already risen sharply in the run-up, the further increase remained limited and 10-yr US yields even fell slightly month-on-month. This is also because there is still a great deal of uncertainty as to the extent to which the programme will be implemented. The appointment of Scott Bessent as Finance Minister should therefore be seen as a signal that the US fiscal deficit will return to a sustainable level in the medium term.

In the short term, however, we still see some upside potential – especially after the decline of the last few days. This is all the more true as the US economy is currently still running smoothly and Trump will continue to propagate the desired measures, at least verbally, before taking office. In the medium term, however, a moderate slowdown in growth, falling inflation and further key rate cuts by the Fed are likely to be reflected in lower yields. In view of the measures described above, however, we have adjusted our yield forecast upwards and now only expect 10-year yields to fall to 4.10% over the next 12 months.

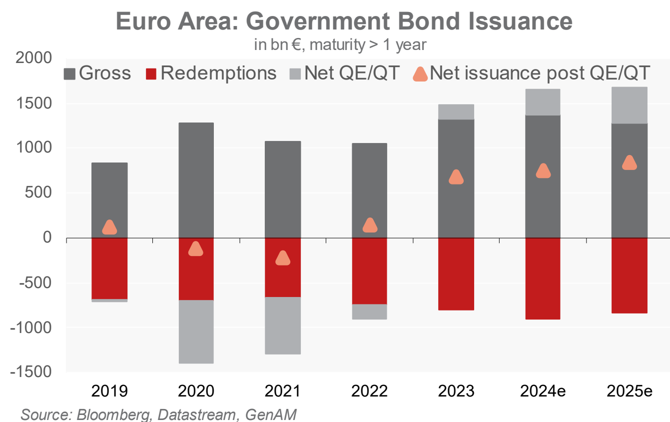
Political uncertainty in the EA and a looming trade conflict with the US have contributed to a clouding of the economic outlook for the EA. However, real yields are still relatively high. On the other hand, inflation expectations have been revised too far downwards. The continuation of the downward trend in yields, which we expect, is likely to be driven mainly by lower real interest rates, while inflation expectations (10-yr b/e < 1.90%) have some upward

Government Bonds

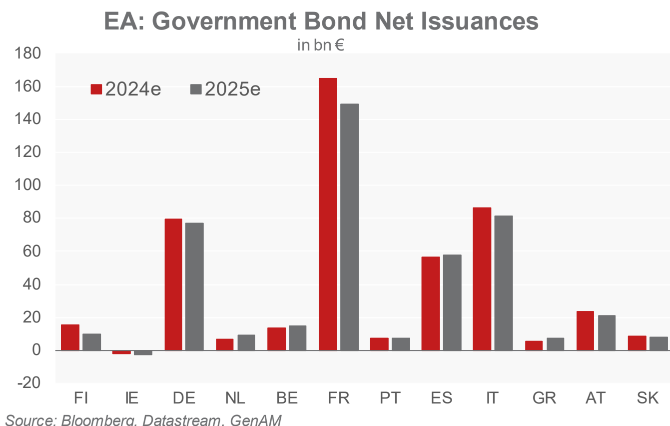
Florian Späte



Source: Bloomberg, GenAM



Source: Bloomberg, Datastream, GenAM



Source: Bloomberg, Datastream, GenAM

potential in view of the green transition, higher long-term military spending and declining labour supply. We forecast 2.15 (3-mth) and 2.00% 12-mth) for 10-yr Bund yields.

Given the sharp decline, swap spreads have recently come under increased scrutiny. 10-year EUR swap spreads have fallen from +20 bps to -6 bps since the start of October before rising slightly to +6 bps recently. There are several fundamental factors behind the decline. The scarcity of government bonds is over due to increased budget deficits and, above all, the ECB's Quantitative Tightening (QT). Increased bank capital requirements are also contributing to tighter swap spreads in the longer term. Although we believe that current swap spreads are fundamentally too low, we are searching hard for the catalyst that can move them higher in the short term.

Supportive environment for EA non-core bonds

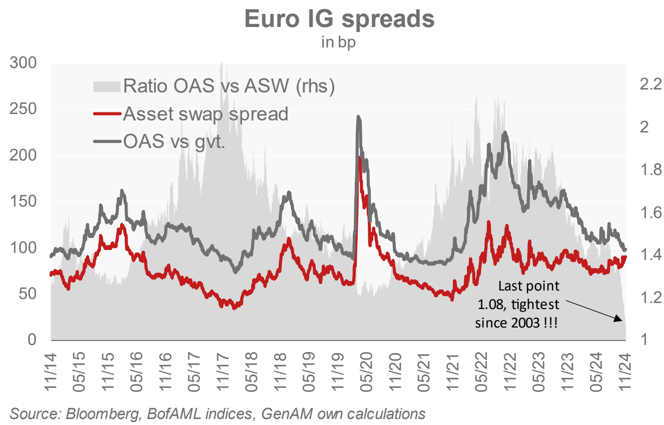
While the EA non-core government bond segment sailed in relatively calm waters in November, the 10-year OAT/Bund spread widened to over 80 bps. In particular, the uncertainty surrounding the adoption of the 2025 budget and the possibility of a vote of no confidence in the parliament has led to 10-year OATs now trading at par with Greek bonds. Although we believe France's fundamentals are much better, we remain cautious on OATs given financial market participants' high risk aversion and the possibility of negative news flow in the coming weeks. A negative rating outlook from S&P (Nov 29), on the other hand, is probably already priced in and will not lead to further spread widening.

Notwithstanding the high level of uncertainty regarding government bond issuance in 2025 (several EA countries have not yet adopted a budget for next year), we can already say that net-net issuance (hence, including the ECB) will again reach a new record level next year. Although gross issuance will decline moderately from € 1.37tr to € 1.27tr due to slightly lower net issuance (from € 470bn to € 440bn) and lower redemptions (from € 900bn to € 830bn), the ECB's QT will push net-net issuance close to € 850bn.

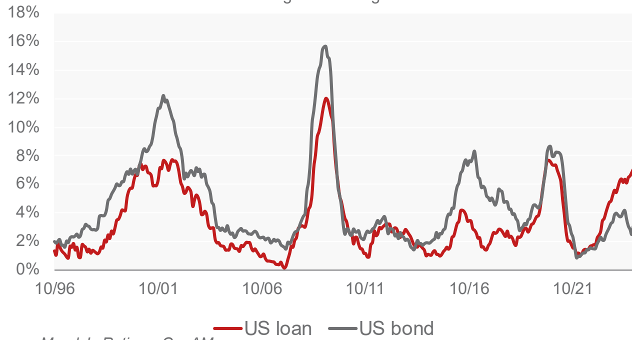
At the country level, France will be the main issuer both in terms of gross (€ 328bn) and net (€ 149bn) issuance. Although net issuance will decrease moderately from very high levels in 2024, France's net-net issuance will even rise by around € 10bn to a record level of € 234bn. Italy's gross issuance will decrease to € 318bn (from € 373bn) but mainly due to lower redemptions. Noteworthy, with a primary surplus targeted for 2025, Italy's net funding needs are exclusively for debt servicing. In addition to France, Italy will set a record for net-net issuance in 2025. On the contrary, some smaller countries will benefit from their sound fiscal policy.

Credit

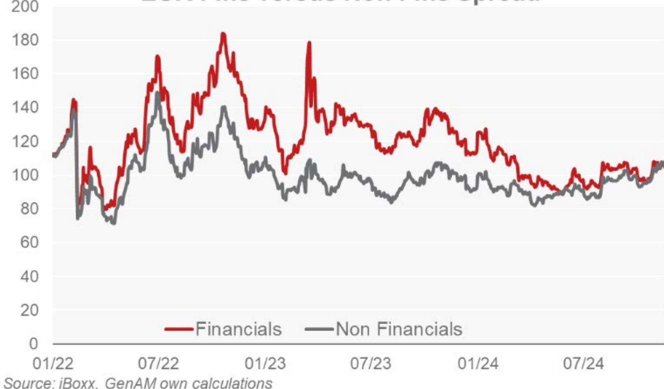
Elisa Belgacem



Source: Bloomberg, BofAML indices, GenAM own calculations



Source: Moody's Ratings, GenAM



Source: iBoxx, GenAM own calculations

- **We continue to favor investment-grade securities over sovereigns, maintaining our long position. Although spreads appear expensive relative to Bunds, they are less so compared to swaps, which supports strong demand.**
- **Despite high yield underperforming IG in spread terms since this summer, the carry remains elevated. We maintain a slight overweight in HY, bolstered by an improving default outlook.**
- **Cyclical sectors, particularly Autos, have significantly underperformed. We are shifting our recommendation from a defensive sector positioning to a more balanced one, as many risks seem to be already priced in.**
- **We favor non-financials over financials due to ongoing French political risks as we approach year-end.**

After reaching multi-year tights versus Bunds, credit spreads have been moderately under pressure over the recent days, being weighed down by Trump's comments on tariffs, as after the appointment of the moderate Bessent to the Treasury, Trump sent a clear signal that he is going to proceed on his promise to raise tariffs.

Turning more positive on cyclical sectors

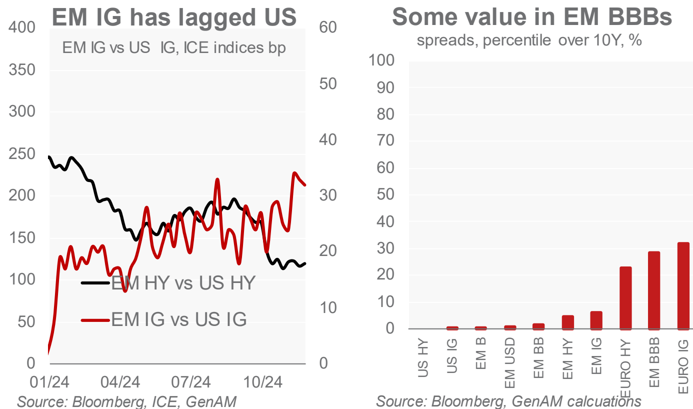
The most exposed sectors have been underperforming, particularly the Automobile sector. The transition to electric vehicles, intense competition from Chinese manufacturers, and sluggish demand from China are creating significant challenges. However, we believe that most of the bad news is already priced in. Therefore, we are shifting from a defensive sector allocation to a more balanced one, anticipating that investors will start chasing market laggards as the demand for credit remains strong into the new year.

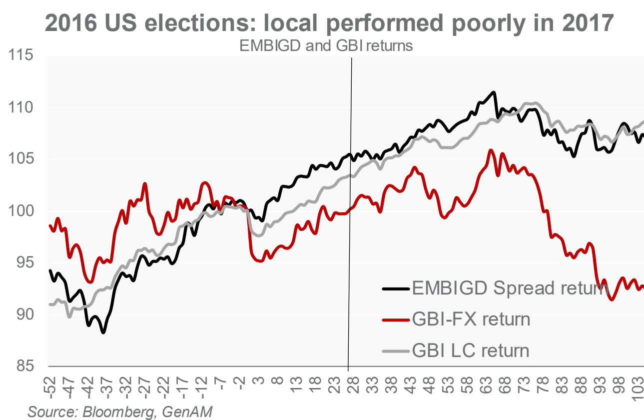
Credit expensive vs. Bund, much less so vs swaps

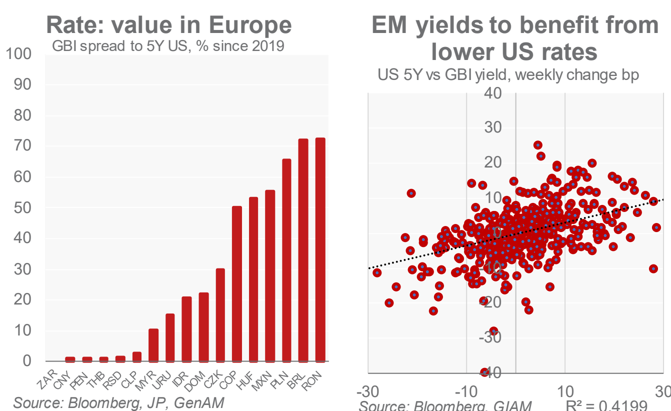
We anticipate that credit spreads will remain around current levels in the coming months, maintaining elevated carry. Valuation considerations favor Europe over the US. We prefer long IG securities and subordination risk over pure HY, while maintaining a slight overweight in HY. Although HY defaults are declining, fundamentals are under slight pressure. Strategically, leveraging IG to enhance credit returns is advisable. The unstable political situation in France is expected to impact Financials more significantly, despite their resilience to the elevated OAT-Bund spread volatility. Therefore, we reiterate our preference for non-financials, except for the subordinated space where we continue to favor AT1 securities.

EM sovereign bonds

Guillaume Tresca







- **EMs face new challenges with the US Republican sweep. Uncertainties will weigh on EM debt in the short term, even if the medium-term outlook remains positive.**
- **EM macro fundamentals are sound and better than in 2016/17, providing some protection. Risk will be localised rather than global.**
- **We prefer external debt that benefits from US exceptionalism, especially in the long term. Local debt will be under pressure, especially via EM FX.**

EMs face new challenges with the US Republican victory, and we are reducing our stance. However, sound macroeconomic fundamentals will provide some protection and increasing differentiation across the EM complex is needed more than before. Indeed, EM fundamentals are much better than in 2016/17, with resilient growth, limited external vulnerabilities but slightly more fiscal deterioration. Trump's recent announcement on tariffs shows that the risk of a deterioration in EM risk sentiment is real. Even if the new US trade policy is unclear, it will weigh on business sentiment and investment in the short term. The impact is likely to be localised (Asian producers, Mexico, China) rather than global. So far, the market reaction has been heterogeneous across countries and asset classes, with external debt outperforming. In the short term, we are more inclined than ever to favour external over local debt, which will be vulnerable to a firm USD and US exceptionalism.

External debt: still positive but in the medium term

External debt will continue to benefit from the firm US growth. Thus, we see only modest spread widening to reflect Trump risk and uncertainty. It is true that valuations are expensive, but not everywhere. There is some value in B and CCC, and we still prefer the BBB bucket to A and AA. In addition, US credit provides an anchor for EM credit, limiting the risk of sharp spread widening. So, returns will be largely driven by the UST rate and risks are skewed to the upside, weighing on the total return of external debt in the short term. However, our medium-term outlook for EM remains positive, with high single-digit returns expected. It is just better to wait for better entry points and clarity.

Local debt: unsupportive environment that favour rates

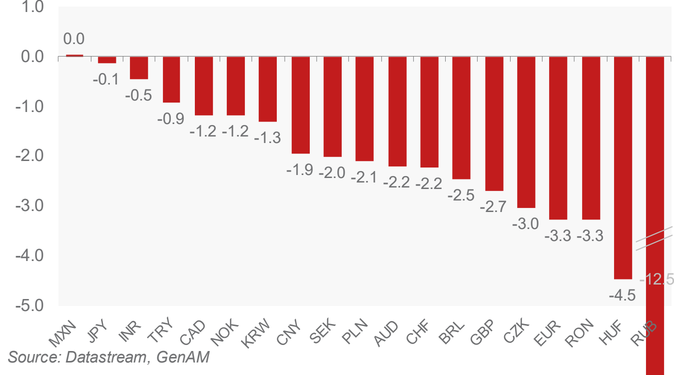
Local debt will remain under pressure in the short term, especially via weak FX, as long as trade uncertainty persists. Higher volatility will dampen carry trade appetite. Similarly, EM rates will have to command a higher premium, even if they eventually fall in line with US rates. There is still value in rates and we prefer CEE rates to LatAm and Asia.

Currencies

Thomas Hempell

FX performance

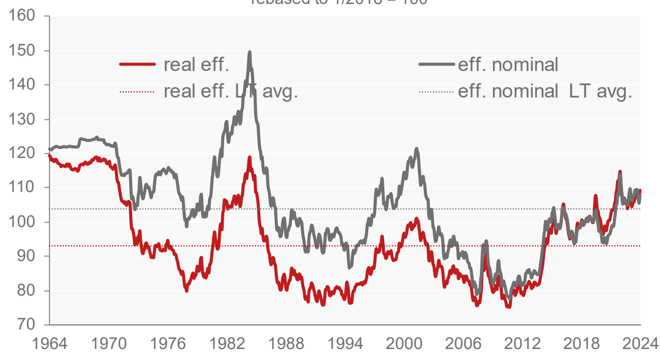
vs. US dollar 5/11/2024 to 28/11/2024, in %



Source: Datastream, GenAM

Effective USD

rebased to 1/2018 = 100



Source: BIS, Datastream, GenAM

Trade war worries and USD

Source: Datastream, GenAM; *equally weighted Stoxx600 vs auto sector, Fathom US China Exposure Index (inv.), JPY/KRW and

DXY and yield gap

Source: Datastream, GenAM

- **We expect a strong US dollar for longer after Trump's victory in the presidential elections.**
- **It is still unclear to what extent he will deliver on his campaign pledges and the USD is historically dear, limiting further gains.**
- **But tariffs and tax cuts will be supportive for the USD via higher inflation risks while attracting net FDI into the US.**
- **Furthermore, the greenback tends to benefit from trade uncertainties which may rise further over the coming weeks.**

We argued last month that US elections were pivotal for the USD outlook, arguing that a Trump victory may push the EUR/USD below 1.05 on worries about stringent US tariffs, stickier US inflation and a less dovish Fed. These predictions materialized well: The EUR, alongside several European peers, lost 3% since Nov. 5 to temporarily below 1.04, helped by pared US rate cut expectations. It is still unclear to what extent Trump will deliver on his election campaign pledges. But given his agenda on tariffs, tax cuts, deregulation and immigration curbs, we see the outlook tilted towards a stronger USD for longer.

High valuation a USD a speed limit for further strength

Admittedly, the USD is historically dear and in real effective terms not far away from levels last seen during the 1980s Volcker era (mid chart). But this comes amid continued US exceptionalism, with 2025 set to be another year of US growth outperformance vs. G7 peers. Leading indicators do not point to any material US cooling, while the euro area is burdened by lost competitiveness, dear energy and political uncertainties in Germany and France. Productivity growth is advancing healthily in the US but stagnant in the euro area.

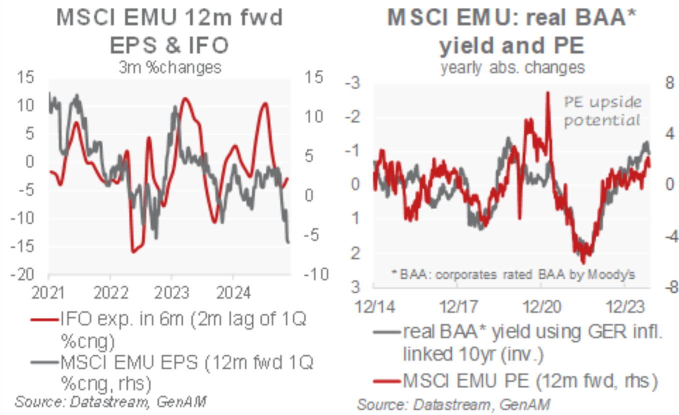
Trade uncertainties boost the USD as experienced in 2018/19 (bottom left chart). Trump's recent announcement of tariffs on China, Mexico and Canada have already sent their currencies lower. European car exporters may well be the next target to the EUR's detriment. Trump will be also keen to swiftly deliver on promised corporate tax cuts, that may attract further capital inflows alongside political pressure on global producers to re-shore production to the US.

Markets have already adjusted their Fed expectations significantly, and probably by too much, on the hawkish side. An advanced yield gap may be a source of higher volatility going forward (bottom right). Overall, however, we see the EUR/USD lower at 1.04 on 3 months and even lower by mid-2025, with the risks tilted even towards parity in case Trump sticks more literally to his most radical proposals on tariffs.

Equities

Michele Morganti and Vladimir Oleinikov

- **Resolved election uncertainty adds to dovish CBs and a decent macro trend, especially in the US. EMU is more at risk, but should see an improving momentum in the coming quarters.**
- **The EMU's higher risk premium over the US (all-time high) may persist in the short term as investors assess political risk and wait for concrete US tax, tariff and deregulation measures. We OW EU ex-EMU.**
- **The US Q3 reporting season shows a positive EPS surprise of 6.9% (2.3% for EU) and resilient margins, which are also confirmed by recent PMI expectations.**
- **We see 9-17% TR for EU and 4-8% for the US in 12 months, plus a fundamentally driven rotation out of US IT into other sectors and ex-US countries. EMU could benefit from stabilizing growth ahead and possible Trump-induced wars' ceasefire.**
- **Neutral US IT, and OW EU-ex EMU over EMU and the US (slight OW US vs EMU). OW EU small cap, UK FTSE 250, Japan, slight China, India. Diversify US into equally-weighted SPX & Russell 2000.**
- **EU sectors: OWs: Financials, Aero&Defense, Food retail, HPP, Retailing, Construction, Pharma, RE, Semis, Tlc. UWs: Autos, Comm. Prof. Svs., Durables, Energy, Food, Media, Transportation, Utilities.**



Source: Datastream, GenAM

Source: Datastream, GenAM

Analysis of the median stock: Q3 2024 reporting season

Median stock	Earnings Growth		Sales Growth		margin trend *		availability
	Q2 2024	Q3 2024	Q2 2024	Q3 2024	Q2 2024	Q3 2024	Q3 2024
S&P	8.3 %	5.8 %	4.8 %	4.7 %	3.5 %	1.1 %	96.2%
Stoxx	5.4 %	4.9 %	2.9 %	2.2 %	2.5 %	2.7 %	77.1%
Euro Stoxx	4.5 %	3.6 %	2.7 %	1.9 %	1.8 %	1.7 %	86.7%
Topix	12.0 %	0.5 %	5.7 %	4.9 %	6.2 %	(4.4)%	95.3%

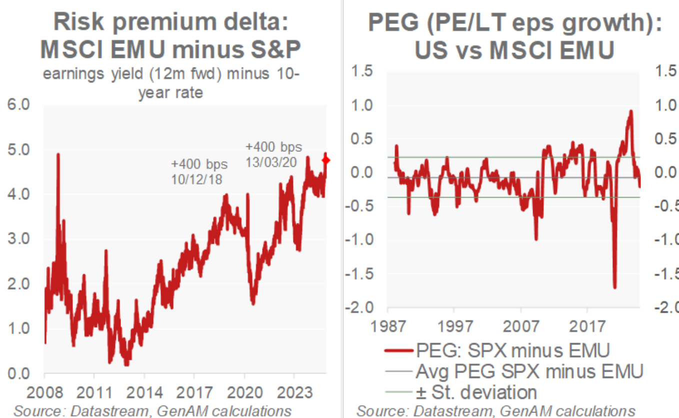
Median stock	Earnings Surpr		Sales Surpr		margin trend *		availability
	Q2 2024	Q3 2024	Q2 2024	Q3 2024	Q2 2024	Q3 2024	Q3 2024
S&P	4.2 %	3.9 %	0.4 %	0.7 %	3.8 %	3.2 %	96.2%
Stoxx	2.5 %	2.5 %	0.6 %	(0.1)%	2.0 %	2.6 %	77.1%
Euro Stoxx	4.3 %	2.5 %	0.6 %	(0.0)%	3.7 %	2.5 %	86.7%
Topix	10.6 %	(3.6)%	1.5 %	0.2 %	9.1 %	(3.7)%	95.3%

Note: numbers for Q1 are calculated only for the companies which have so far reported in Q2
proxy for margin trend = earnings growth - sales growth

Source: Bloomberg, GenAM calculations

After the US elections, we added to our OW equity position (still small one). Three legs are at work: The post-election cycle is usually positive, the Fed's easing one is too, and we see a continued rotation from US Tech into ex-Tech sectors and countries. Furthermore, free-cash flow is very positive, and financial conditions are improving via rate cuts, rising money aggregate (M2) and still attractive corporate bonds.

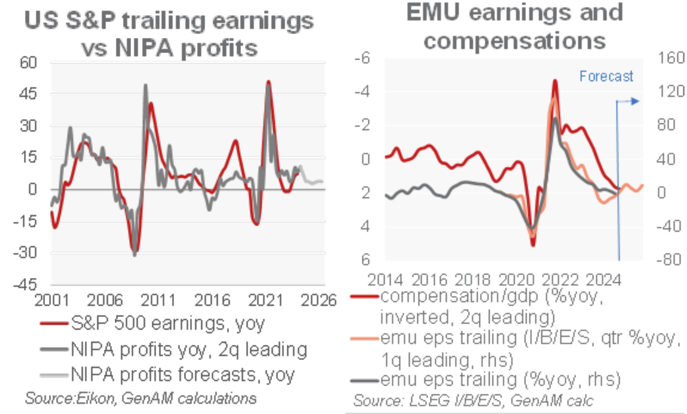
The Q3 reporting season shows a positive US EPS surprise of 6.9% (5.9% the avg. in the last 9 quarters) - +3.9% for the median stock, see table - and 2.3% for EU. At the index level, the earnings growth of S&P500 has fallen to 8.2% from 8.5% in Q2, whereas the sales growth has increased to 5.1% (from 4.8%). Rotation is ongoing: the lower eps growth is due to large caps, which show a growth of 2% vs 10.2% in Q2. The eps growth of Mag.7 has decreased as well: from 36.2% to 32.7%. The mid-cap, on the other hand, have shown a turnaround from -5.7% in Q2 to 3.3%. The US EPS yoy growth could top in Q1'25 and slowdown thereafter, but it should remain at healthy rates. EA earnings decelerated in 2024H2. We expect EA earnings to have better growth in the second part of 2025, thanks to normalizing growth and a pick-up in capacity utilization. EPS revisions have already visibly underperformed IFO expectations, which we expect to have a positive momentum ahead.

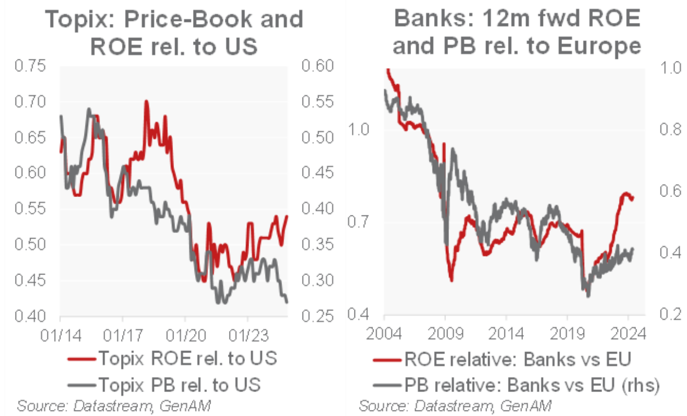


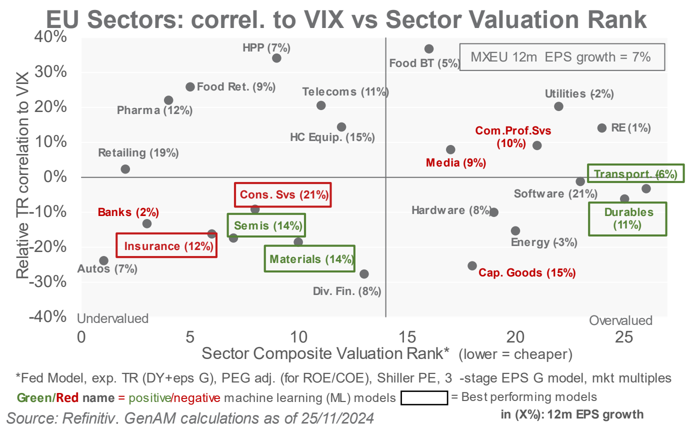
Source: Datastream, GenAM calculations

Source: Datastream, GenAM calculations

Equities







Furthermore, the world trade volumes look safe, Chinese and US macro surprises are positive, and monetary policy should remain dovish. This should offset at least some of the negative sentiment emanating from politics (Fra and Ger), especially if China provides further stimulus as we expect. In 2025 we see a decent earnings growth of 9.7% and 8% for the US and EMU, being under consensus for the US by 4%. EMU risks being on the downside. Earnings growth should decline to 6% for both indices in 2026, where we are below consensus by 10% in the US and 5% for EMU.

We see nearly 4%-8% TR for the US and 9%-17% for Europe over 12 months. In the medium term, if Trump succeeds in bringing the two conflicts close to a ceasefire, risk aversion could decrease further, and firms would be more willing to invest. Short-term risks: possible war escalation, EU politics, higher US rates and rich SPX valuation. The EMU's relatively higher risk premium over the US (all-time high) may persist in the short term as investors assess political risk and wait for concrete US tax, tariff and deregulation measures. Meanwhile, EU stocks are pressured by domestic political uncertainty and lower expected long-term earnings growth: the US PEG (PE divided by the expected long-term EPS growth) is lower than that of the EMU. Our trade fear indicator also points to continued risk for EMU. That said, EMU has a higher 12m TR potential given valuation, stabilizing growth and possible Trump-induced ceasefire in the Russia-Ukraine conflict.

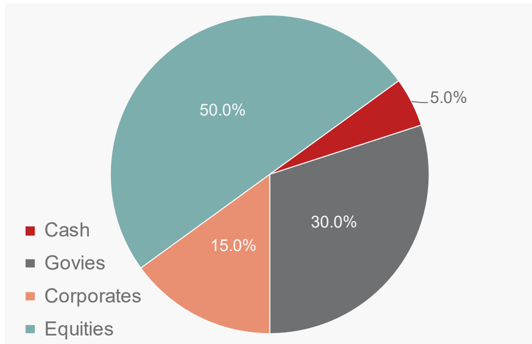
We are neutral on US IT (valuation slightly cheap but risks from growth normalization, antitrust and trade frictions), and OW EU-ex EMU over EMU and the US. Slight OW US vs EMU, though valuation gap is quite extreme. Diversify US into equally-weighted SPX and US small cap (Russell 2000, OW).OW EU small cap, UK FTSE 250, China (tactically slight OW), India (low positioning, structural high growth, lower trade uncertainty), and Japan.

European sector allocation

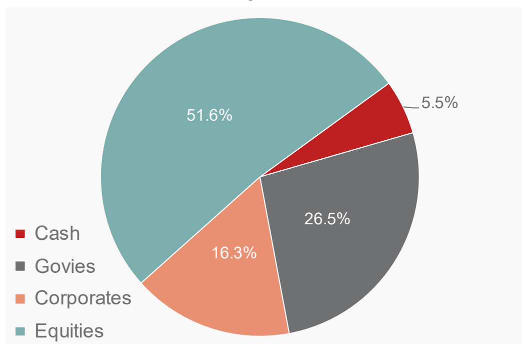
We judge to be still in the Goldilocks phase and thus continue to maintain some cyclicality in our allocation, although overall balanced. In our decision, we also took into consideration sectors' rate sensitivity, good revisions' momentum and negative correlation to lower equity volatility (VIX, after elections). We increased Cap. Goods (to N), construction and RE (lower rates and increasing mortgage demand), Retail, Div. Financials (from N), Insurance and A&D (EPS revisions), Pharma (good rank, attractive defensiveness), and Telecoms. We lower UW in Energy, Food (to UW), Transportation and Utilities. Still OW Small vs Large Cap (lower rates, M2 Impulse). Other OWs: Banks, Cons. Staples, Semis. UWs: Autos, Comm. Prof. Svs., Durables, Media.

Asset Allocation

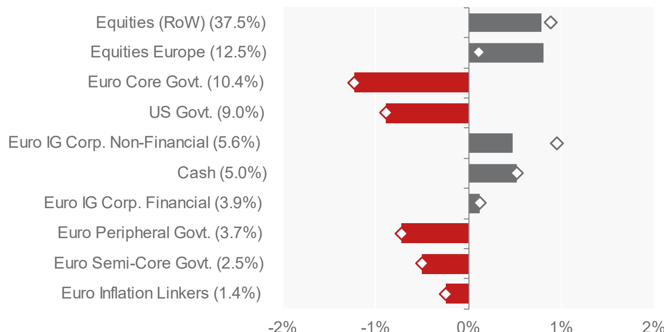
Thorsten Runde



Source: GenAM



Source: GenAM



Source: GenAM; Benchmark weights in parentheses, diamonds indicating prev. recommendations

- **In November 2024 (27.11.24), apart from the MSCI EM (-1.9%) and the MSCI EMU (-1.2%), all our actively covered asset classes find themselves in positive territory.**
- **North-American Equities are by far the best performing asset class (+5.6%) followed by long-dated EA Govies (around +3% for Bonos, BTPs, and Core).**
- **EA HY Credit underperformed EA IG by -77 bps on average. Within IG, non-Financials outperformed Financials by +15 bps.**
- **We expect world growth to remain resilient overall, but with marked regional differences. Whereas the US is expected to slow marginally (solid consumption, anticipated tax cuts), prospects for the EA are less bright (US tariffs, trade uncertainties, and political turmoil in Germany and France).**
- **In general, we see a conducive backdrop for risk assets. With the uncertainties around the US election resolved, we slightly increase our moderate active Equity position. We keep our preference for EA IG Credit over Govies on carry grounds. We prefer to lengthen our duration stance for the EA while staying more defensive in the US.**

In November 2024 (27.11.24) our model portfolio slightly outperformed its benchmark by +0.5 bps. The overweight in US Equities were most rewarding (+2.1 bps), followed by the underweight position in medium to long-dated US-Treasuries (+1.2 bps). The overweight positions in Cash and EA Credit proved most painful with -0.8 bps and -1.5 bps respectively.

With the uncertainties around the US election out of the way, we see scope for further moderately tilting our TAA stance towards Equities as already announced in the previous month. Although Credit spreads have tightened substantially the carry offered remains quite attractive compared to the alternatives amongst Govies. Given the different risk environment in the US (resilient consumer demand, trade and fiscal policies) and the EA (slow services inflation and political turmoil in Germany) we prefer to stay duration-short in the former and lengthen our duration in the latter.

Slightly relaxing overall prudence in TAA stance

We expand our overall Equity exposure remaining prudent thereby shifting the focus from the US to Europe where we see some backlog and rather cheap valuations. We reduce our OW in EA IG-Credit given the recent spread tightening preserving our overall preference for Credit over Govies. With prospective Trump policies not seeming fully reflected in FX, we see further upside for the USD and increase our overweight here.

Forecasts

Macro Data

Growth[1]	2023	2024 forecast	2024 Δ vs. cons.	2025 forecast	2025 Δ vs. cons.	2026 forecast
US	2.5	2.8	0.2	2.4	0.6	2.5
Euro area	0.5	0.8	0.1	0.8	- 0.4	1.4
Germany	- 0.1	- 0.1	- 0.1	0.3	- 0.4	1.4
France	0.9	1.0	- 0.1	0.5	- 0.5	1.3
Italy	0.9	0.8	0.0	0.6	- 0.3	0.6
Non-EMU	0.2	1.1	0.0	1.4	0.0	1.9
UK	0.1	1.0	0.0	1.3	0.0	1.9
Switzerland	0.8	1.4	0.0	1.5	0.0	1.8
Japan	1.9	- 0.1	- 0.1	1.2	- 0.0	0.9
Asia ex Japan	5.3	5.1	- 0.0	4.9	0.1	4.6
China	5.2	4.8	- 0.0	4.5	0.1	4.1
CEE	3.1	2.9	- 0.2	2.2	- 0.2	2.3
Latin America	2.1	1.6	0.0	2.1	0.0	2.6
World	**3.2**	**3.1**	**0.0**	**3.1**	**0.1**	**3.1**

1) Regional and world aggregates revised to 2024 IMF PPP weights

Inflation[1]	2023	2024 forecast	2024 Δ vs. cons.	2025 forecast	2025 Δ vs. cons.	2026 forecast
US	4.1	2.9	- 0.0	2.4	0.2	2.3
Euro area	5.5	2.4	0.0	2.0	0.1	2.0
Germany	6.0	2.4	0.1	2.0	0.1	2.0
France	5.7	2.3	0.1	1.7	0.1	2.0
Italy	5.6	1.3	0.1	1.8	0.1	1.8
Non-EMU	6.6	2.4	0.0	2.0	0.0	1.9
UK	7.4	2.6	0.0	2.3	0.0	2.1
Switzerland	2.2	1.4	0.2	0.9	0.0	1.0
Japan	3.3	2.3	- 0.3	2.4	0.3	2.0
Asia ex Japan	2.2	2.0	0.1	2.4	0.2	2.7
China	0.2	0.4	- 0.1	1.3	0.1	2.0
CEE	19.0	19.2	0.4	11.4	0.8	7.4
Latin America[2]	5.1	4.5	0.0	3.8	0.0	3.1
World	**5.1**	**4.0**	**0.1**	**3.2**	**0.2**	**2.9**

1) Regional and world aggregates revised to 2024 IMF PPP weights ; 2) Ex Argentina and Venezuela

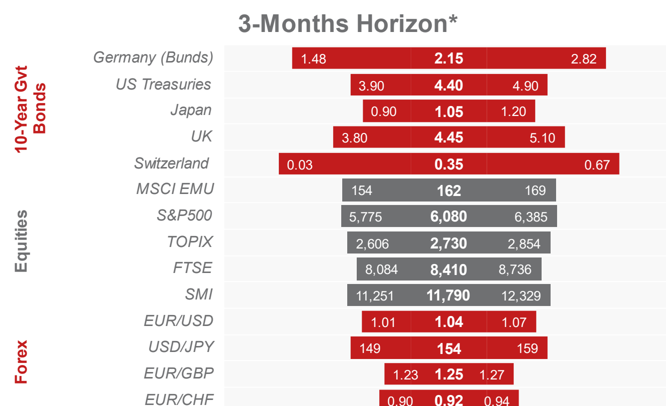
Financial Markets

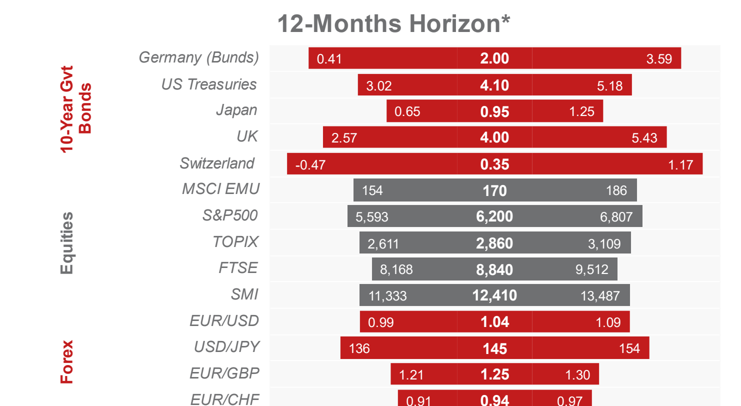
Key Rates	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
US (upper bound)	4.75	4.50	*4.33*	4.25	*4.09*	3.75	*3.80*
Euro area	3.25	2.75	*2.33*	2.00	*1.93*	1.75	*1.69*
Japan	0.25	0.50	*0.45*	0.75	*0.59*	0.75	*0.72*
UK	4.75	4.50	*4.46*	4.25	*4.22*	4.00	*3.93*
Switzerland	1.00	0.75	*0.46*	0.50	*0.22*	0.25	*0.10*
10-Year Gvt Bonds							
US Treasuries	4.27	4.40	*4.28*	4.30	*4.29*	4.10	*4.33*
Germany (Bunds)	2.19	2.15	*2.21*	2.10	*2.21*	2.00	*2.25*
Italy	3.45	3.45	*3.48*	3.40	*3.54*	3.35	*3.66*
Spread vs Bunds	*126*	*130*	*128*	*130*	*133*	*135*	*141*
France	3.02	3.00	*3.05*	2.95	*3.08*	2.90	*3.17*
Spread vs Bunds	*83*	*85*	*84*	*85*	*87*	*90*	*92*
Japan	1.07	1.05	*1.13*	1.00	*1.18*	0.95	*1.27*
UK	4.33	4.45	*4.35*	4.30	*4.35*	4.00	*4.38*
Switzerland	0.32	0.35	*0.30*	0.35	*0.31*	0.35	*0.33*

***ICE BofA (OAS)*

Credit Spreads**	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
EA IG Non-Financial	103	100		100		100	
EA IG Financial	110	110		110		110	
EA HY	334	335		335		335	
EM Sov. (in USD)	226	235		240		245	
Forex							
EUR/USD	1.05	1.04	*1.06*	1.03	*1.06*	1.04	*1.07*
USD/JPY	153	154	*151*	152	*150*	145	*147*
EUR/JPY	161	160	*160*	157	*159*	151	*158*
GBP/USD	1.26	1.25	*1.26*	1.26	*1.26*	1.25	*1.26*
EUR/GBP	0.83	0.83	*0.84*	0.82	*0.84*	0.83	*0.85*
EUR/CHF	0.93	0.92	*0.93*	0.92	*0.92*	0.94	*0.91*
Equities							
S&P500	6,003	6,080		6,120		6,200	
MSCI EMU	159.8	161.5		162.0		170.0	
TOPIX	2,690	2,730		2,750		2,860	
FTSE	8,275	8,410		8,525		8,840	
SMI	11,652	11,790		11,725		12,410	

Forecast Intervals





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

Imprint

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