



Market Compass

Outlook 2024

MARKET OUTLOOK

- 2023 ended with global investors celebrating the end of the monetary tightening cycle, while anticipating quick disinflation, aggressive rate cuts and solid profit growth.
- We fear that the US economy may slow significantly down in 1H24. Central banks may also fear that the sharp easing of financial conditions will make the 'last inflation mile' more difficult, hence will not rush into Q1 rate cuts.
- We see a downside in bond yields, but more in the US than the EA. Instead, we prefer EUR Credit to USD. We also continue to favour Investment Grade (IG) Credit early in the year. We expect a positive year for High Yield (HY) Credit and Equities, but soft performance early on. The USD should weaken overall, if not quickly, and the Yen recover.
- 2024 will see then great volatility convergence, with rates volatility set to fall, whilst Equity, Credit and FX volatility should rise initially. The new year offers many wild cards, from the risk of deeper China deflation to the BoJ policy turn and an exceptionally heavy electoral agenda.

Edited by
**MACRO & MARKET
RESEARCH TEAM**

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

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

US

- ⊖ Domestic demand YE2023 was helped by a series of one-off factors that are unlikely to repeat, we expect very weak growth in 1H24
- + Softer demand and a more balanced labour market will allow inflation to decline gently...
- + ...This would allow for a gradual monetary policy loosening
- ! November election: a heated electoral campaign may cause market volatility and swings in confidence

UK

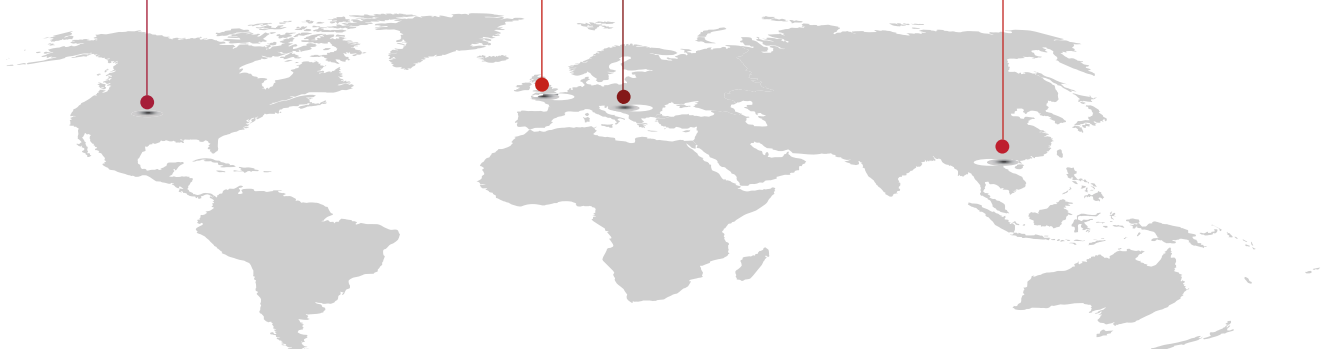
- ! Activity remains weak but the November composite PMI was back in expansionary territory
- + Low energy prices will boost income and consumption
- + Softening core inflation rises hopes of an early rate cut

EUROZONE

- + We expect activity to improve slowly over the course of 2024
- + Headline inflation is set to rebound as benign base effects fade and energy price caps expire in 1H24 but will likely fall to target in H2.
- + The thus far strong labour market will weaken mildly, supporting the case of robust real wage growth
- ⊖ ECB to stick to peak rate for longer...

CHINA

- ⊖ A soft 1H24 global backdrop, means that trade will not contribute much to growth
- + The government is likely to step-up fiscal support for the property sector. Liquidity support could be improved via bank lending...
- ! ...but this could shift some risk from the real estate to the banking sector
- + Inflation will rise to above zero over the next months on improving growth



- + Positive
- ⊖ Negative
- ! Topics to watch

DIRECTION OF TRAVEL

- For the near term, we recommend a light underweight (UW) in Equities and HY.
- We continue to favor IG Credit mostly thanks to an attractive carry.
- Given the lower yield levels and the limited leeway for a further yield decrease, we UW Euro Area Government Bonds.
- We overweight (OW) US Treasuries and EM Govies. The latter will also benefit from a subsiding USD strength medium-term.
- We keep cash to almost Neutral.

Equity

- Valuation above 4,700 for the SP500 do not point to further upside in the very short term. That said, our forecast of lower yields and markets' anticipation of rate cuts in 2024 will prove supportive further into 2024 (H2). IFO and Sentix indicators are improving, adding to a positive US corporate net cash-flow trend.

Bonds

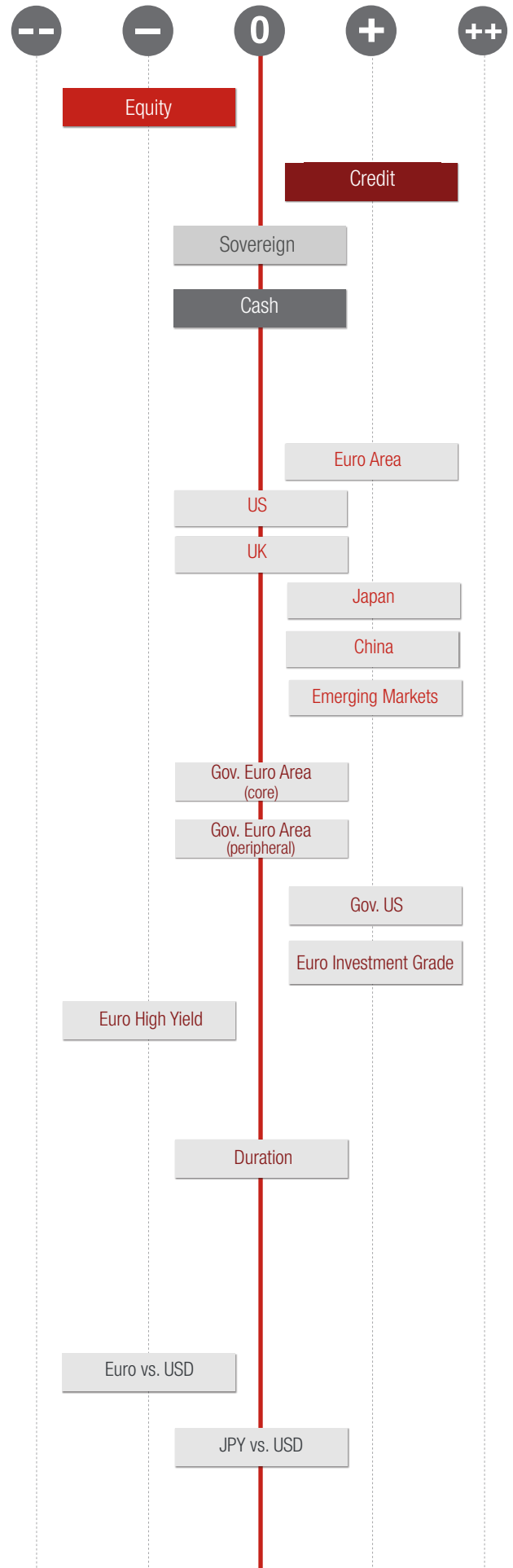
- A faster yield decrease in US vs. EMU will lead US Treasuries to perform better than Bunds in 2024. In addition to the drop in yields, the higher coupon also contributes to the attractiveness of US Treasuries.
- We continue to prefer Investment Grade (IG) as valuations are attractive, the fundamental deterioration should remain limited.

Duration

- Neutral duration.

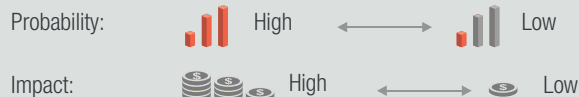
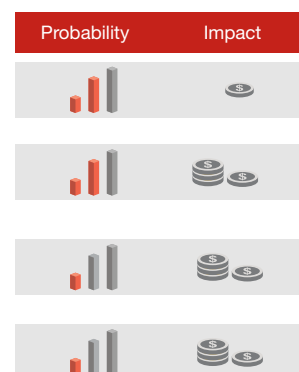
Currencies

- We expect some short-term USD resilience as the global economy cools and risk sentiment looks fragile after the recent rally. But better global prospects will weigh on the USD in H2.
- The Yen has bottomed. Lower US yields and the BoJ's cautious steps towards policy normalization will provide increasing tailwinds.



TOPICS TO WATCH

- Deflationary pressures emanating especially from China, threatening to undermine global corporate pricing power.
- Hawkish repricing of central banks policies.
- Two-sided risk in Ukraine (escalation vs. peace talks) or new severe geopolitical tensions (China/Taiwan, Iran, N. Korea).
- Extreme weather events having a disproportionate impact on the growth-inflation mix.



GLOSSARY

LAST INFLATION MILE

Several central bankers have recently insisted that the 'last mile' in the marathon towards the inflation target may be the most challenging. The 'last mile' thesis implies that inflation initially declines swiftly and subsequently more slowly. The swift drop in inflation in the early phase of the 'disinflation marathon' is intuitively clear when the initial increase in inflation was caused by a negative supply shock, such as a jump in energy prices. When the latter stabilise or even decline, favorable year-over-year comparisons -base effects- can cause a quick drop in inflation. However, the thesis looks less clearcut when thinking in terms of core inflation. Monetary transmission works with long and variable lags, which means that some degree of cumulative tightening is necessary before the impact on activity and demand starts to become visible. During this phase, it is unlikely that inflation would decline significantly, and further increases can't be excluded.



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