GENERALI ASSET MANAGEMENT

Market Perspectives

The last mile of Fed repricing

May 2024

GenAM Macro & Market Research

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

- **Amid reaccelerating US inflation, markets have axed rate cut expectations for all major central banks. We expect the start of Fed easing to be postponed till September, but not cancelled. A first ECB rate cut remains due in June with at least quarterly cuts to follow thereafter.**
- **We acknowledge two-sided risk for yields near term, with a resilient US economy and stickier prices the most imminent risks. But with many bad inflation news now priced in, and 5-year forward 3-month rates near 4%, we see value in prudent long duration.**
- **Amid the tug of war between high valuations and higher uncertainties on the one hand and global economic green shoots on the other, we keep an overexposure in IG Credit to reap the carry from risk premia. But we keep a neutral stance on Equities and High Yield amid elevated risks of further setbacks.**

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Global View – The last mile of Fed repricing

Thomas Hempell

- **Amid reaccelerating US inflation, markets have axed rate cut expectations for all major central banks. We expect the start of Fed easing to be postponed till September, but not cancelled. A first ECB rate cut remains due in June with at least quarterly cuts to follow thereafter.**
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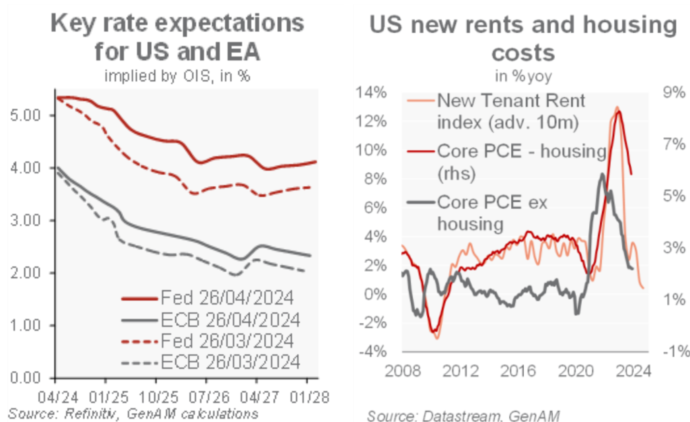
Investors seem to throw in the towel regarding rate cut hopes. Following solid US economic data and sticky inflation prints, markets are now pricing a full first Fed rate cut only for November and see the easing cycle ending above 4% (left chart), almost a full percentage point above levels we deem neutral. What is more, despite more encouraging disinflation progress in the euro area, markets also discount a striking ECB reluctance to lead the Fed in the easing cycle.



We have argued for some time that the last inflation mile would prove bumpy and that nearly seven cumulated 2024 rate Fed cuts, which markets priced around the turn of the year, reflected overblown optimism. Yet markets may be at the verge of turning overly pessimistic on that front now. Despite recent US inflation disappointment, quits rate points to moderating wage growth. After stripping out lagging housing costs, the Fed's preferred core PCE is already close to target (2.2%yoy) – while new tenant rents clearly point to a moderation of housing costs (right chart). Goods may no longer be deflationary, but the ISM points to softer inflation in Services. The Fed will wait for more reassuring data after the recent bumpy readings and we now expect the first Fed rate cut in September, rather than July (though 3 monthly prints of CPI and core PCE are still due before the 31/7 meeting). We remain convinced that inflation prints will ultimately strengthen the case for a longer sequence of quarterly Fed rate cuts.

Fears that the ECB will shy away from policy easing ahead of the Fed seem overblown too. ECB officials have already telegraphed a June cut. And ECB doves are right to stress that a hesitant Fed will tighten financial conditions also in the euro area, owing to spillovers on bond markets. We are neither overly worried by the exchange rate, since it would require a big knock in the trade-weighted euro to materially alter the EA inflation outlook. With euro area disinflation still benign, we still have 75-100bp of ECB hikes in our book for this year.

10-Year Gvt Bonds	Current*	3M	6M	12M
US Treasuries	4.67	4.50	4.35	4.10
Germany (Bunds)	2.60	2.45	2.30	2.30
Credit Spreads**				
EA IG Non-Financial	106	105	110	100
EA IG Financial	119	120	120	110
Forex				
EUR/USD	1.07	1.06	1.09	1.10
USD/JPY	156	154	150	145
Equities				
S&P500	5073	5065	5115	5210
MSCI EMU	165	163	166	171

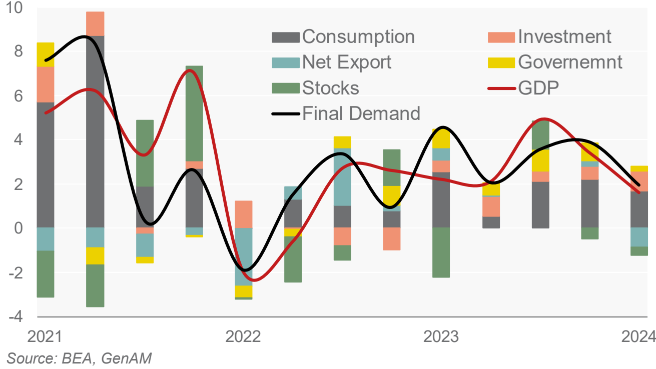
**3-day avg. as of 26/04/24 **ICE BofA (OAS)*

Preference for IG Credit and prudently for duration

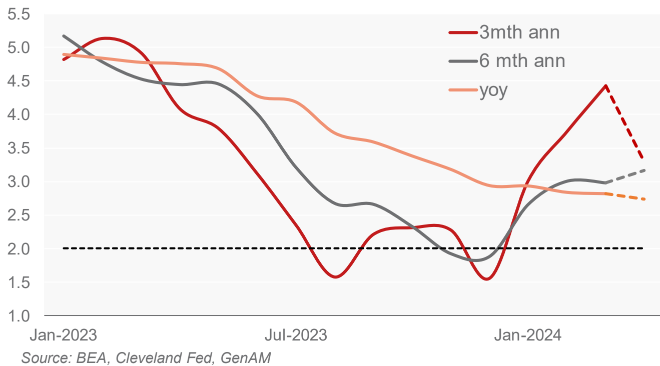
Easing inflation, prospective rate cuts and a soft landing of the US economy over the summer have been key reasons for why we have warmed up to moderately increase duration exposure. Global economic green shoots (including in the euro area) and bumpy US inflation prints keep the risks to yields two-sided in the short term, though, as evidenced in April. But we see 10-year US Treasury yields above 4.60% as a good entry level. A brighter economic outlook will keep corporate earnings underpinned, but geopolitical risks and valuations that still price a lot of cyclical optimism leave us neutral on riskier segments such as Equities and High Yields. Anticipating stable spreads on high-quality names amid green shoots in the euro area, we prefer EUR IG Credit financed by underweights in Cash and short-dated Government Bonds.

United States

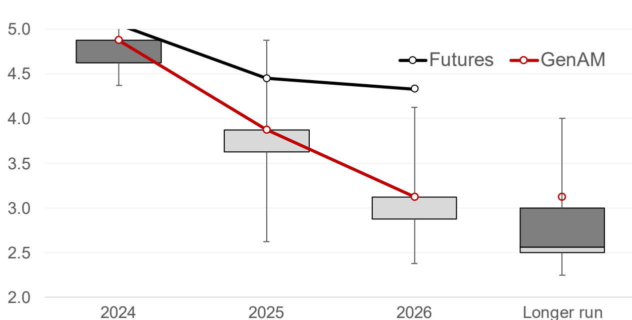
Paolo Zanghieri



Source: BEA, GenAM



Source: BEA, Cleveland Fed, GenAM



Source:Federal Reserve Board, Datastream,GenAM estimates

- **GDP for Q1 was up by 1.6% annualised, but domestic demand remained strong. We expect GDP to expand by 2.5% this year and around 2% in 2025.**
- **In March core PCE inflation stood at 2.8% yoy. The disinflationary trend has weakened significantly, due to still strong services prices. We expect the core rate to end the year at around 2.6% yoy.**
- **The Fed will postpone rate cuts into H2, as the domestic and global environment heightens the upside risks to inflation. We now see only a 50-bps easing this year.**

Despite weak headline numbers (GDP up by 1.6% annualised), domestic demand remains strong. Consumption again was the main driver (+2.5% ann.), as strong real wages and to a lesser extent, positive wealth effect are offsetting the almost completed depletion of pandemic excess savings. We expect the economy to grow at the same speed as in 2023 (2.5%).

Steady growth is accompanied by stickier than expected inflation. The Core PCE rate was up 2.8% yoy in March, as the beneficial impact from cooling goods price is fading, and services keep showing a very strong price rise. The ex-housing component reaccelerated in Match to 3.5% The gradual cooling in the labour market should dampen wage pressures, but still high margins would keep retail inflation elevate. We see Core PCE inflation at 2.7% by year end, with some upside risk.

Rate cuts delayed to September

In the March meeting the FOMC sent a strong message of clearly improving inflation data as a precondition to start cutting rates. The evidence for Q1 does not meet this standard. Over the last weeks FOMC officials called for patience, backed by the strength of the economy and the labour market. Moreover, global developments like the rise in oil prices, the risk of new supply chain disruptions and the prospects of renewed tensions, are tilting to the upside the risks to inflation, on top of the impact of fiscal profligacy. Therefore, we revise our call for the Fed. We move to September the first of the only two rate cuts we now see for this year. We also raised to 3.1% our expectation for the neutral rate at which easing will stop. Risk are tilted towards an even flatter path of easing or no easing at all. The May 1 post-meeting press conference will likely signal a more hawkish stance and, importantly should provide some initial guidance on how quantitative tightening will gradually be unwound. We expect the balance sheet runoff to slow down during the summer and to end by Q1 2025 at the latest.

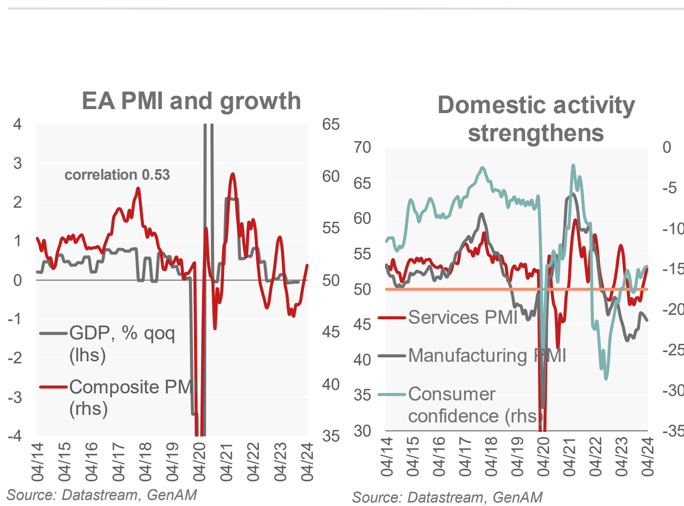
Euro Area

Martin Wolburg

- **Sentiment continued to improve in April backing our view that the economy will strengthen in Q2/2024. Growth in Q1 surprised on the upside with 0.3% qoq.**
- **There are ongoing signs for disinflation but base effects and energy price volatility likely make it more bumpy.**
- **There are very strong signals for a June ECB rate cut but markets increasingly cast doubts about a swift normalisation. We continue to look for 100 bps cuts in 2024 but acknowledge a risk of only 75 bps.**

The euro area activity is back into expansionary territory. The first (preliminary flash) estimate reported a Q1/24 growth of 0.3% qoq, better than we and markets had expected. Key sentiment indicators for April suggest that at the outset of the second quarter the economy gained further traction. The composite PMI advanced to 51.4, the highest since May last year. The signalled increase in activity rests on the domestic economy: While domestically-driven services sentiment rose, the one in manufacturing took a backlash. A somewhat surprising turn in the inventory component (mainly due to weaker orders) point to a bumpier recovery in manufacturing. All in all, we continue to see growth strengthening over the coming months and stick to our 2024 growth forecast of 0.6% yoy. Risks are now slightly tilted to the upside in our view.

Headline inflation was at 2.4% yoy in April, unchanged from March. Over the coming months we see inflation trending further down but not smoothly. Base effects in several countries from the unwinding of governmental price-cap measures and possible spikes in the oil price due to geopolitical tensions will mask fading underlying inflation pressure, e.g. due to easing wage growth and producer price disinflation. We stick to our 2024 inflation forecast of 2.4%.



Source: Datastream, GenAM

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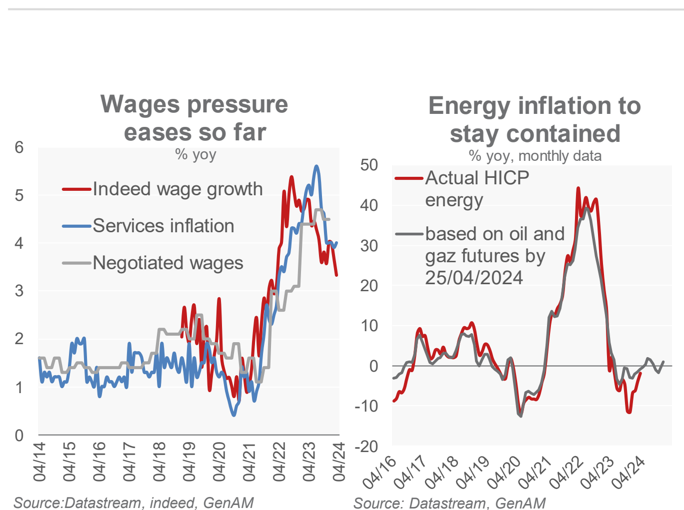
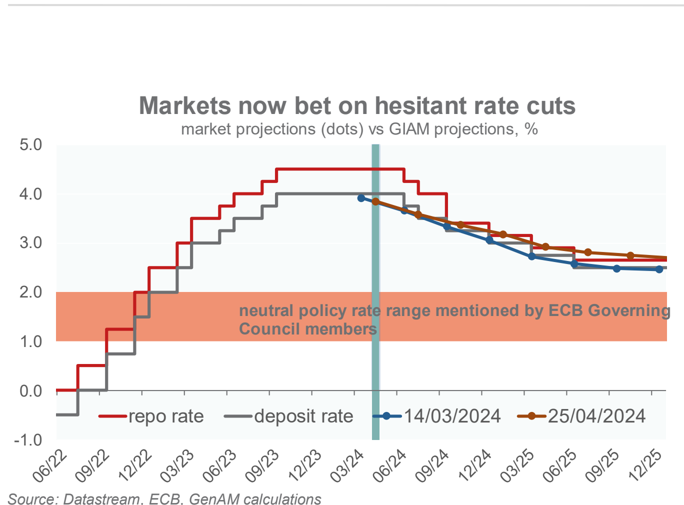


Source:Datastream, indeed, GenAM

Source: Datastream, GenAM

Markets too prudent on the ECB

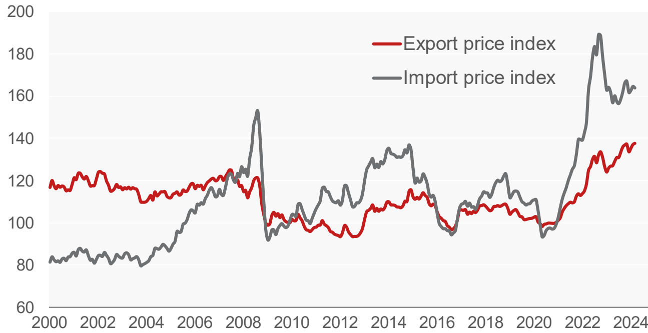
The ECB gave a broad hint about a first rate cut by June, backed also by the hawks within the Governing Council. Yet markets are neither fully convinced about a 25 bps cut by June nor about at least three 25 bps cuts in 2024. We think markets became now too cautious after they were much too enthusiastic on rate cuts at the outset of the year. A key driver was the reassessment of the Fed rate outlook. While there are clearly factors (e.g. fx) implying a more restrictive ECB stance, other (e.g. financing conditions) recommend for easing. All in all, we do not expect a major impact on euro area inflation. Unless price risks from wages or huge rises in energy prices materialize, we see the ECB easing cycle unscathed. We continue to look for 100 bps cuts in 2024 but acknowledge a risk of only 75 bps.



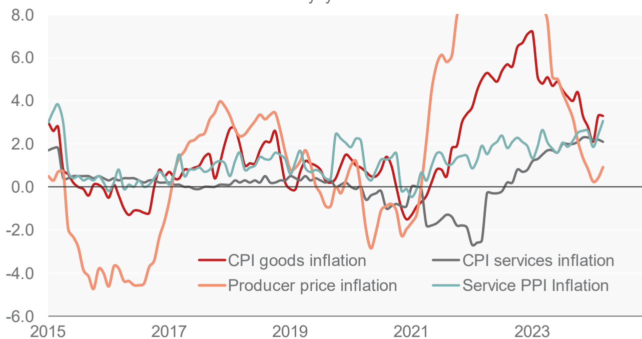
Source: Datastream, ECB, GenAM calculations

Japan

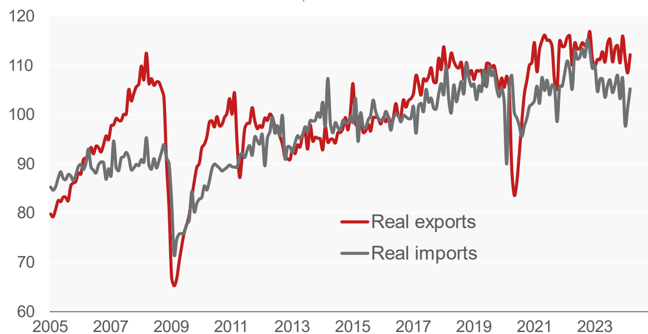
Christoph Siepmann



Source: Datastream, GenAM



Source: Datastream, GenAM calculations



Source: Datastream, GenAM calculations

- **The Bank of Japan (BoJ) kept its monetary policy unchanged in April. However, it feels more confident that the virtuous wage-price cycle will materialise.**
- **Indeed, wage growth has been stronger than forecast while the yen weakness will keep import prices high. We change our BoJ call as we see the BoJ to more decouple rate setting from its quantitative easing policy. We now expect a rate hike in Q4 to 0.25%.**

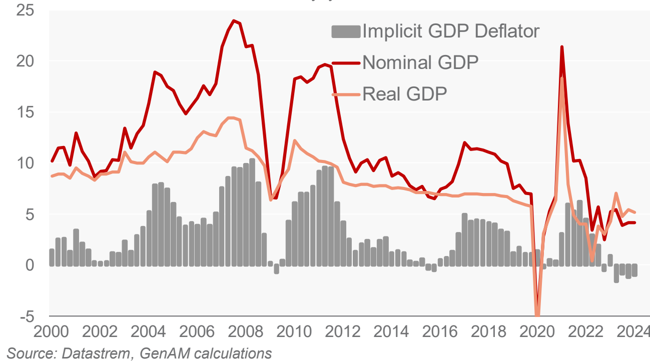
At its recent meeting, the BoJ kept its monetary policy constant, maintaining the policy rate at 0%-0.1% while also sticking to the buying of around JPY 6 tr of JGBs per month. This unchanged policy together with markets postponing expectations for a first Fed rate cut later into the year led to a further depreciation of the yen vs the US-dollar, most likely prompting FX interventions by the Ministry of Finance (MoF). In its outlook report and the press conference, the BoJ expressed more confidence that the expected virtuous wage price cycle will indeed materialize medium term. It sees now core-core CPI inflation (CPI all items less fresh food and energy) for 2026, published for the first time, with 2.1% even a bit higher than the 1.9% in this year and the next.

BoJ to separate rate hikes more strongly from QE policy

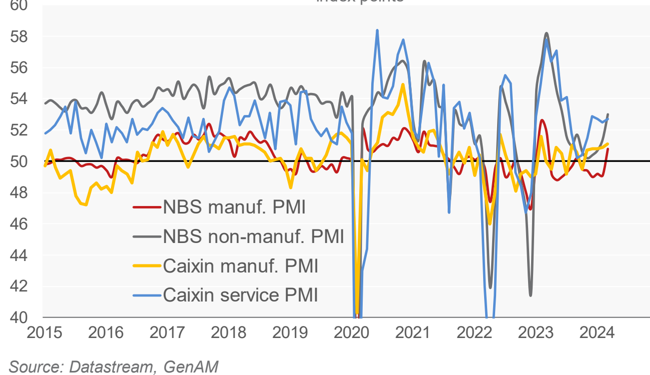
Indeed, two major developments will provide the BoJ with more room for maneuver: First, wage settlements (after well-expected large firm's high settlements) continued to surprise on the upside for SMEs with pay rises standing now at 4.8%. This gives reason to expect real income to turn positive and consumption to improve. Moreover, it will increase underlying inflation pressures, although nationwide service inflation edged down to 2.1% yoy. Secondly, market's Fed outlook has changed, implying yen weakness to be longer lasting than previously expected, keeping import prices high. Although the BoJ denied a direct impact of FX on its policy, the import price aspect will not be ignored as it is conducive to inflation. Officially, the BoJ is not in charge of FX policy but the MoF. However, as the yen mainly suffers from the interest differential to the US, only key rate hikes will have a more lasting impact. This suggests that the BoJ would increasingly decouple its QE policy (which we continue to deem necessary to finance the targeted reflation) from key rate hikes. The BoJ will be in the position to judge the wage impact in Q4, in which we now see a hike to 0.25%. However, the policy will also remain data dependent, as recent Tokyo CPI inflation surprised on the downside, and base effects will lead to more fluctuations. We revised our CPI forecast for this year to 2.3%. While the core-core inflation ex energy and fresh food softened to 2.9% yoy in March, the one excluding all food is already down to 2.2% yoy, showing uncertainties to remain high.

China

Christoph Siepmann



Source: Datastrem, GenAM calculations



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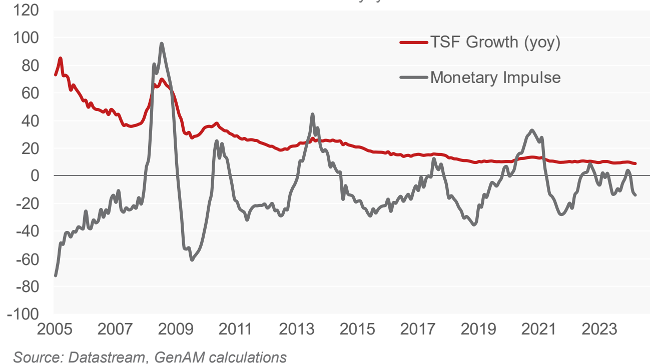


Source: Datastream, GenAM calculations

- **China's Q1 real GDP growth surprised on the upside, while nominal GDP did not improve. March monthly data mostly disappointed.**
- **We stick to the view of an L-shaped recovery driven by improving exports and – over time – a decreasing drag of the real estate sector. However, nominal GDP will be a better measure than the real growth figures.**

China's macro data has remained a mixed bag. On the one hand, Q1 2024 real GDP growth surprised on the upside, advancing by 5.3% yoy (1.6% qoq) compared to a consensus forecast of 4.6% yoy (1.4% qoq). The improvement was mainly due to the manufacturing sector. At the same time, nominal GDP growth remained unchanged at 4.2% yoy, revealing that the GDP deflator contributed again significantly to real growth (-1% yoy). Given these data, we revised our 2024 GDP growth forecast up to 5%. On the other hand, March's monthly data suggest that activity had lost some momentum. While the March NBS manufacturing PMI caught up with the Caixin version into expansionary territory, April PMIs softened again. Urban investment rose to 4.5% yoy ytd, but exports (-7.5% yoy) and industrial production (4.5% yoy) hit a soft patch, in part due to base effects. Moreover, retail sales disappointed after the Chinese New Year holidays (3.1% yoy). The real estate sector remained in the doldrums with property investment and property sales deeply in the red. Weakness in demand contributed to downside surprise CPI inflation, which dropped back to 0.1% yoy from 0.7% yoy during the holiday season. However, the main culprit is food prices (-2.7% yoy) while core inflation stayed soft (0.6% yoy). We revise our CPI inflation forecast to 0.4%, down from 0.7% before.

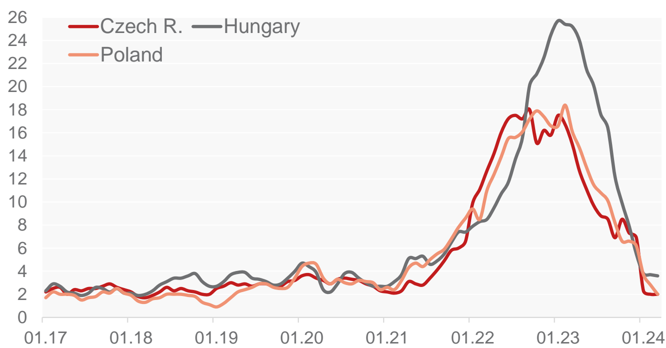
L-shaped recovery still likely but real GDP data blurred

Despite these incoherent data, we stick to our view of an L-shaped recovery which will be visible more in nominal than in real GDP. Exports – with twists and turns – should embark on an uptrend, given the global manufacturing signals (but medium-term a trade conflict seems likely). The real estate sector is expected to remain a drag on growth, but its impact is likely to moderate, given the government support (RMB 500bn approved under the whitelist mechanism, the dual-pillar "market-driven and affordable" housing policy, and the targeted fund channeling of the PBoC). The fiscal impulse is likely to be positive, while the monetary impulse has become negative on decreasing growth (8.7% yoy) of total social financing. We expect the PBoC to further cut the RRR by 25 bps around mid-year and see a 10 bps cut in the MLF rate. Moreover, we expect monetary policy to play a larger role in tackling the real estate debt worries but see no meaningful QE on the cards.

Central and Eastern Europe

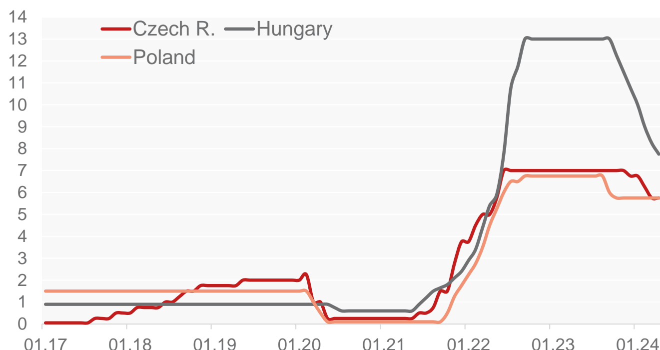
Radomír Jáč

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	2022	2023	2024f	2025f
GDP	2.4	-0.2	1.4	2.8
Consumer prices	15.1	10.7	2.0	2.0
Central bank's key rate	7.00	6.75	3.50	3.00
Hungary	**2022**	**2023**	**2024f**	**2025f**
GDP	4.6	-0.7	2.9	3.4
Consumer prices	14.5	17.6	4.0	3.8
Central bank's key rate	13.00	10.75	5.25	4.50
Poland	**2022**	**2023**	**2024f**	**2025f**
GDP	5.3	0.2	3.0	3.4
Consumer prices	14.3	11.6	4.3	3.7
Central bank's key rate	6.75	5.75	5.50	4.25

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

- **Inflation in the CE-3 economies broadly declined to central banks' targets in Q1. This enabled the Czech and Hungarian central banks to reduce interest rates further, but the extent of rate cuts was limited by the FX rate developments.**
- **While CPI fell below the inflation target in Poland, the NBP kept its key rate unchanged at 5.75% also in April, awaiting more clarity about changes in price caps of household energy prices in H2.**

Inflation behaved well across the CE-3 region in Q1. The Czech headline CPI fell to the 2% target in both February and March and is likely to oscillate around 2% in the rest of 2024. Headline CPI in Hungary stood at 3.6% yoy in March vs. an inflation target set at 3% +/- 1 pp. Base effects and stronger domestic demand are likely to limit space for further disinflation in Hungary and the annual headline CPI may exceed 4% in H2. However, this should not come as a surprise to the Hungarian central bank and interest rate cuts may continue in H2, even if at a cautious pace.

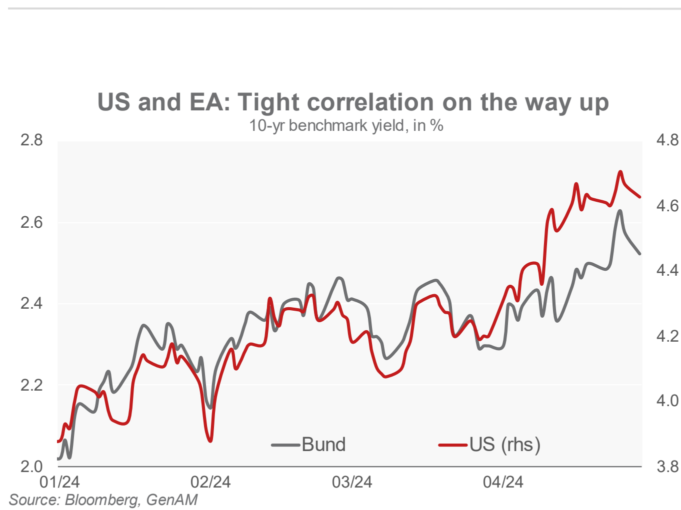
Poland reported headline inflation at 2% yoy in March vs. an inflation target set at 2.5% +/- 1 pp. Headline CPI was expected to increase in Q2, as the VAT rate on foods was raised back from 0% to 5% from April on. The government at the same time announced that electricity tariffs are going to be increased by ca. 20% in H2 while gas tariffs will remain frozen. This may lead headline inflation above 4.5% yoy in H2 but price shock should be avoided and the NBP may debate re-start of interest rate cuts in late 2024.

Czechs and Hungarians to cut rates in 50 bps steps

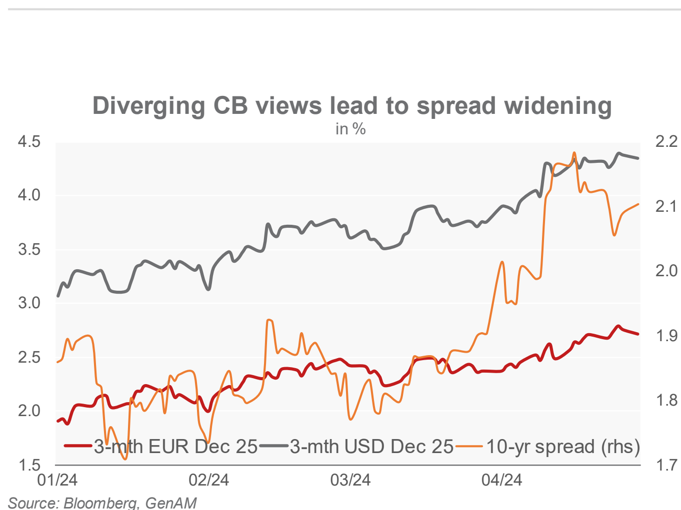
The Czech CNB cut its key interest rate by 50 bps to 5.75% in March. The key rate was reduced by the same extent as in February and another 50 bps cut is expected also for the policy meeting scheduled for early May. While a minority in the CNB called for a 75 bps rate cut in March, the prevailing support is for a cautious approach, as the CNB does not want to undermine the Czech crown FX rate. In Hungary, the MNB cut the key rate by 50 bps to 7.75% in April. This came after a 100 bps cut in February and a cut by 75 bps in March. The MNB slowed down the pace of rate cuts in order to prevent the forint from weakening. We expect the MNB cutting rates by 50 bps in May and June, and to switch to 25 bps cuts in Q3. The Polish NBP kept its key rate at 5.75% also in April. Changes in price caps for household energy, as proposed by the government, should not lead to a price shock in 2H but annual headline inflation may still exceed 4.5%. The NBP may keep its conservative approach for most of 2024 and we now expect only one rate cut in Poland by 25 bps in Q4, followed by more rate cuts in 2025.

Government Bonds

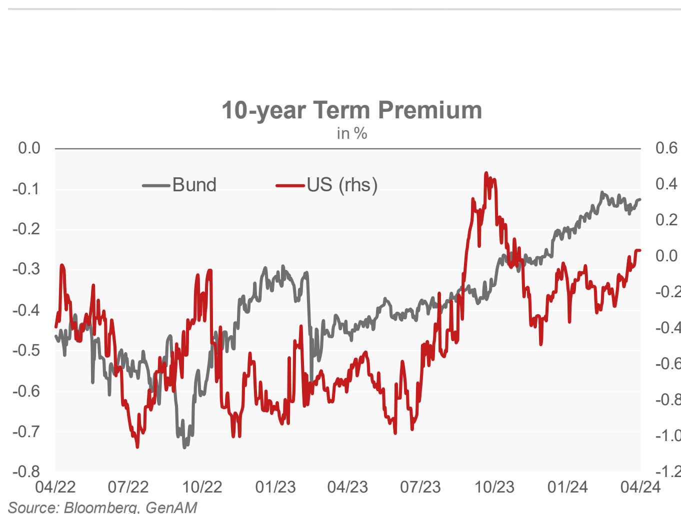
Florian Späte



Source: Bloomberg, GenAM



Source: Bloomberg, GenAM



Source: Bloomberg, GenAM

- **The rise in government bond yields driven by robust macroeconomic data and stubbornly high US inflation appears overdone.**
- **Although the exact timing is difficult to predict and even higher core yields cannot be ruled out in the short term, both US and EA yields are skewed to the downside in the medium term.**
- **EA non-core bond spreads declined slightly in April within a comparatively narrow range. The market environment is likely to remain attractive for riskier bonds. Despite a slight widening of spreads, we forecast EA non-core bonds to outperform.**

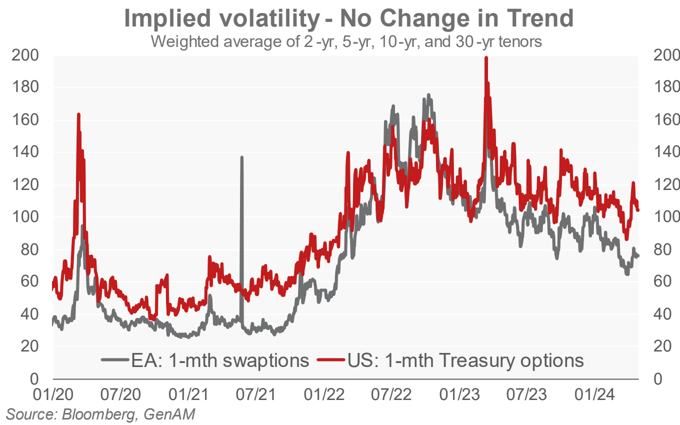
Both EA core yields and, even more so, US yields rose markedly in April. 10-year US yields (>4.7%) and the yield on 10-year Bunds (>2.6%) reached new highs for the year before falling slightly again recently. Although the key rate levels expected by the end of 2024 have also risen somewhat, market participants have particularly scaled back their medium-term key rate cut expectations. Compared to the end of March, the forecast Fed key rate level by December 2025 is now almost 60 bps higher and the ECB pricing increased by 35 bps. This has ultimately pushed yields higher, with the 10-year transatlantic spread widening to more than 200 bps.

It is mainly the economic optimism that is responsible for the increase. Although inflation expectations have also risen somewhat, real yields in particular have moved upwards. At 2.2%, real 10-year US yields are 50 bps higher than at the beginning of the year, and real 10-year Bund yields have also recently risen by more than 30 bps to 0.35%.

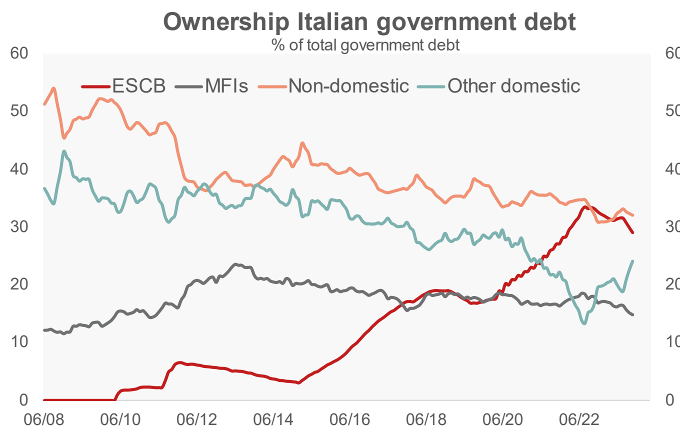
For yields to increase further from current levels, inflation concerns would have to rise further (as was last the case in autumn 2023), and/or market participants would have to reduce their expectations of key rate cuts, and/or the term premium would have to rise. We consider the first two conditions to be rather unlikely. Our macro forecasts show that inflation will continue to trend downwards (as recently shown by the April data) – although it will likely remain a bumpy development. Concerning possible key rate cuts, we see little potential for further correction. The ECB has made it clear that a first cut in June is almost a foregone conclusion (barring unforeseen events). Although a total of four cuts are on the cards, we believe that fewer than three is unlikely. For the Fed, only 35 bps by the end of the year are priced. This is also less than our (new) more cautious forecast. However, the term premium still has upside potential. Higher terminal rates and growing uncertainty about the future course of monetary policy, combined with a

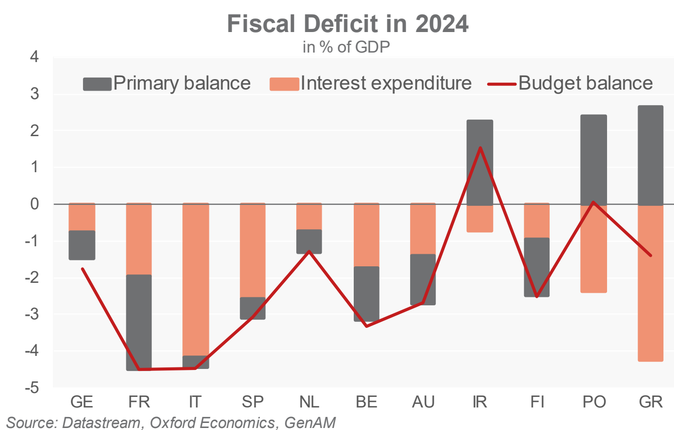
Government Bonds

Florian Späte



Source: Bloomberg, GenAM





Source: Datastream, Oxford Economics, GenAM

continuation of QT and high debt/GDP ratios, are likely to push up the term premium further. It should be noted that the years of QE and very low inflation rates are not representative and the term premium was significantly higher until 2014.

Ultimately, however, we expect the emerging US slowdown, the impending ECB key rate-cutting cycle, a correction in unsustainable real yields, and an adjustment in currently excessive US medium-term key rate expectations to prevail. The US 5y3m OIS is currently above 3.9%. This is well above our forecast (around 3%) and especially above the Fed's 2.6%. In addition, 10-year US yields are again more than 70 bps above the (too high) medium-term key rate expectations. Accordingly, we forecast 10-year yields in both the US and the EA to decline by around 15 bps over the next three months. As the year progresses, this downward trend is seen to continue and the transatlantic spread is likely to narrow again.

Carry-friendly bond market environment to prevail

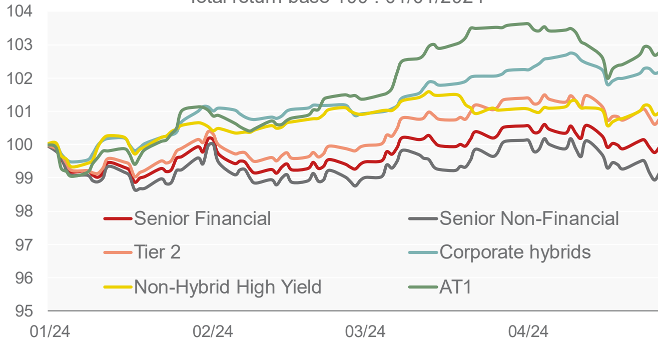
After geopolitical tensions, weak EA fiscal data, and rising key rate expectations weighed on EA non-core bonds at the beginning of the month, a benign trend set in from mid-month, with spreads narrowing moderately month-on-month. The fact that France's rating and outlook remained stable at Moody's and Fitch also contributed to the positive sentiment. We forecast a further decline in bond market volatility supporting the carry-friendly environment. In particular, the positive trend in inflation, combined with a moderate economic rebound and the beginning of the key rate-cutting cycle should further reduce bond market volatility, which is still above the long-term average.

We therefore forecast non-core EA bonds to outperform core bonds in the coming months, despite a slight widening of spreads. However, this should not hide the fact that investors will likely be more discriminating in a less friendly bond market environment. The good performance of BTPs in recent months has largely been driven by the increasing share of the domestic retail sector. The question is whether this is sustainable in the medium term. Similarly, the stable OAT/Bund spread is synonymous with the underperformance of OATs relative to other EA bonds.

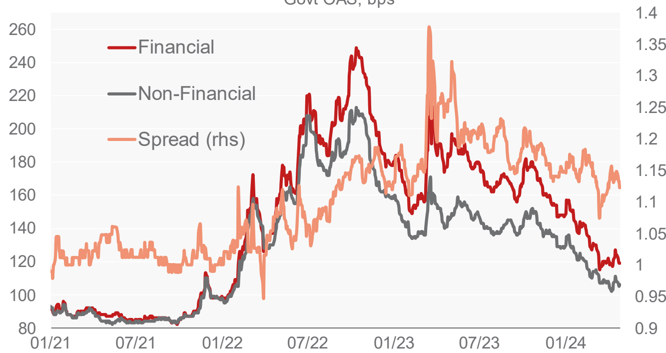
Both France and Italy have the highest deficits of all EA countries, not only this year but also in the following years. The debt/GDP ratio tends to rise accordingly. Higher yield levels combined with weak growth will further limit fiscal room for manoeuvre. From a strategic point of view, we therefore recommend investing in bond markets of countries that are fundamentally better positioned.

Credit

Elisa Belgacem



Source: Bloomberg, BofAML indices, GenAM



Source:Bloomberg, BofAML Indices, GenAM

Source:Bloomberg, BofAML Indices, GenAM own calculations

- **Credit spreads start to look tight from many angles but carry remains attractive versus sovereign.**
- **We remain long IG for the carry while we think fundamentals will prove resilient**
- **We keep our neutral view high yield due to elevated carry and improving default outlook.**
- **Default rates are expected decline from current levels to 3.5% in Europe and 4-5% in the US by year end.**
- **Even after the strong rally we see value in subordinated instruments versus pure HY.**

Thus far in 2024, substantial issuances in the loan sector have relieved some of the pressure on HY refinancing demands. However, HY issuances are anticipated to ramp up as we progress into the latter half of 2024. Default rates likely peaked below 4% in Europe and 6% in the US by the end of 2023, bolstered by stringent credit standards. These rates are expected to diminish from this point onward due to significantly improved financing conditions.

Elevated yield continues to drive demand

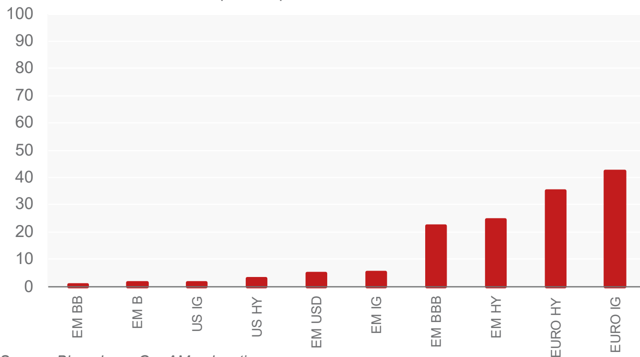
Corporate fundamentals will likely face headwinds from here. This will lead rating agencies to continue downgrade more companies than they would upgrade. However, the numbers of fallen angels going from IG to HY should remain very constrained. Hence despite tight valuations, the absolute yield offered by sub investment grade bonds continues to drive demand.

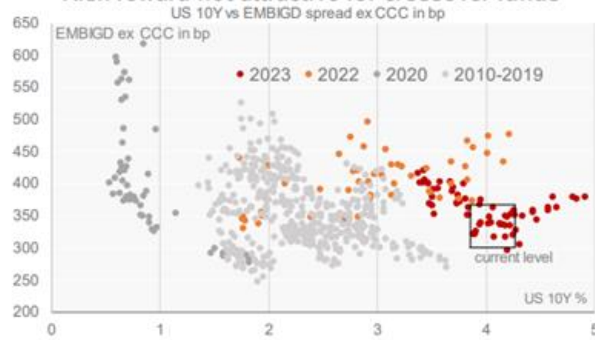
Stretched valuations but still likable carry

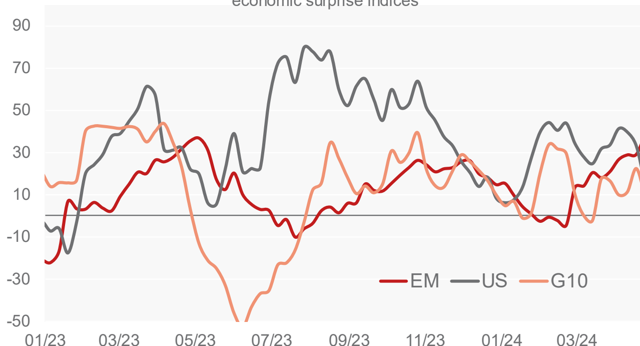
We believe IG spreads will oscillate around current levels for the months to come, ensuring elevated carry. Valuation considerations also lead to a preference for Europe over the United States. We do prefer long IG and subordination risk to pure HY. In the context of likely plateauing rates and uncertainty surrounding defaults in the HY space, a strategic move is proposed to play leveraged IG to enhance credit returns. While extending duration may not be favorable from a spread perspective, a positive rates view justifies a long position, particularly in the 5-7 year bucket. AT1 are the best performing asset class within credit year to date and destie limied spread pick-up we still favour them.

EM sovereign bonds

Guillaume Tresca







- **After the recent rise of UST rates, the EM outlook has hardly changed. We are slightly underweight.**
- **The macro environment is supportive, but valuations are still tight. We keep a low beta exposure.**
- **We favour EM BBB names and see some spread widening. We dislike Asia local and favour LatAm.**

The sharp repricing of Fed rate cut expectations and the subsequent sell-off in US Treasuries have not changed our EM outlook: we maintain a slightly UW stance on EM external debt and a neutral stance on external vs. local debt. The EM macro environment remains supportive as the macro surprise index continues to rise. Similarly, Fed repricing driven by better growth data is not problematic for EM external debt, as the resilience in early April showed. Thus, external debt spreads have ultimately been resilient. The small correction is welcome in a context of stretched valuations, but it has not been enough to create compelling opportunities across all EM assets. As a result, returns are still expected to be positive, but mainly driven by carry and a positive duration effect. We therefore maintain a low beta exposure globally and favour relative value trades.

Resilience of EM external debt

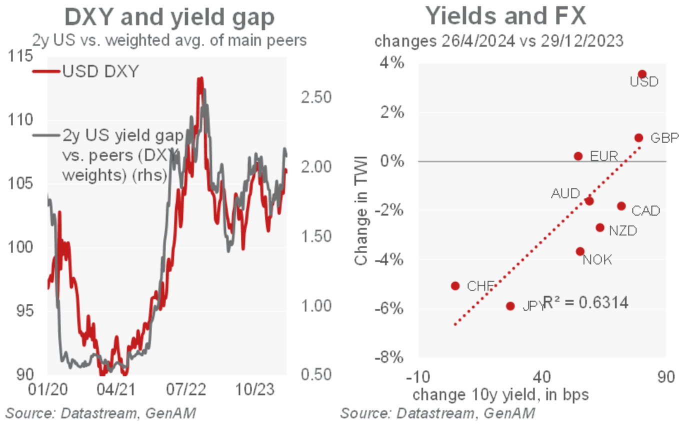
External debt benefits fully from the no-landing scenario, and the recent rise in the UST means that one of the risk factors we highlighted is fading, opening the doors to a stronger positive duration effect on returns. However, valuations remain an issue: spreads offer a limited buffer and crossover fund inflows, which could tighten spreads further, are limited given the poor risk/reward. The only value is in distressed HY, but the strong USD combined with higher for longer UST rates makes this bucket less attractive than before. We therefore maintain a cautious approach in BBBs, which we prefer to EM IG. In this bucket, we continue to like Romania and Hungary, and Chile over Peru. In HY, the BB bucket is too expensive and we only like Colombia, which is too wide compared to Panama. Despite the rise in the UST, bonds denominated in EUR still offer an advantage over USD for European investors (Xccy hedge, same issuer/maturity).

EM local: cautious receiver

The no-landing scenario and the stickiness of inflation in both the US and the EMEs are not supportive of local debt. The correction has been modest and valuations are still stretched. Meanwhile, we are noticing more cautious rhetoric from EM central banks, which leaves the door open for surprises (e.g. Indonesia rate hike). We maintain our preference for LatAM, dislike Asia and are selective in CEE with some value in the belly of the curve in HUF and CZK.

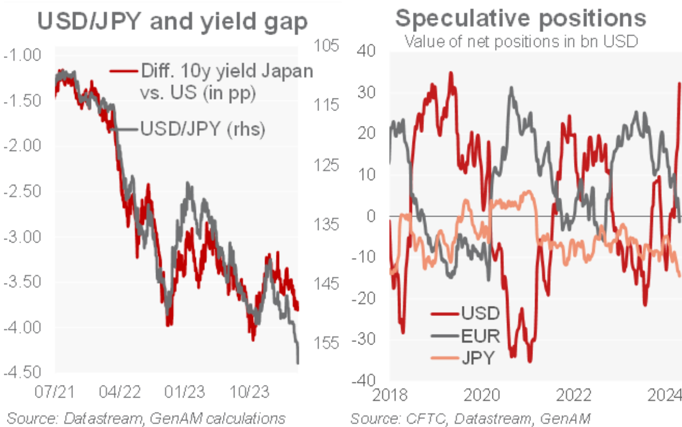
Currencies

Thomas Hempell



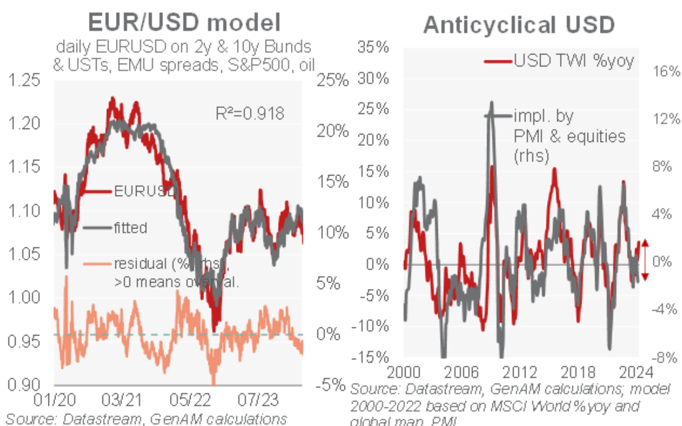
Source: Datastream, GenAM

Source: Datastream, GenAM



Source: Datastream, GenAM calculations

Source: CFTC, Datastream, GenAM



Source: Datastream, GenAM calculations

Source: Datastream, GenAM calculations; model 2000-2022 based on MSCI World %yoy and global man. PMI

- **US resilience and curbed rate cut expectations keep the USD underpinned. We raise our forecasts for the greenback for major crosses.**
- **That said, key triggers for renewed USD weakness later in the year (fading US exceptionalism, easing rates uncertainties, and narrowing yield gaps) keep looming if more mildly so than before.**
- **And on various measures the USD bounce already looks stretched, cautioning also against exaggerated tactical bets on the greenback.**

The continued repricing of key rate expectations and the resulting rise in US 10y and 2y yields extended this year's USD ascent over April (top charts). In earlier reports, we had flagged that the outset of the year could still see a stronger USD, whereas the medium-term outlook was geared to the downside, mainly on three grounds: a. fading US exceptionalism (US landing vs. EA & global recovery), b. easing rates uncertainties (a key pillar of earlier USD strength) as inflation eases and monetary easing cycle kicks off; and c. a narrowing US yield advantage, mostly driven by the bigger scope of cumulative Fed rate cuts over the cycle than most peers.

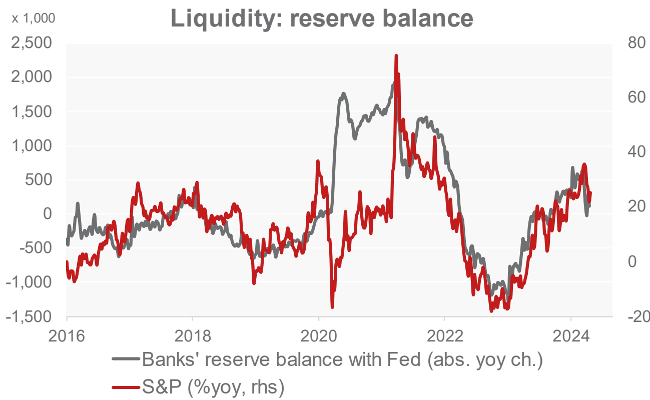
Resilient US growth and sticky inflation have blurred these prospective drivers, but not erased them. We still believe that Fed rate cuts for 2024 are postponed, not cancelled. But sticky US inflation numbers and extended economic resilience limit the scope of USD weakness further ahead. This holds in particular for USD/JPY which is particularly sensitive to US yields. We still expect receding US yields to take pressure off the deeply undervalued yen. After the yen had fallen to fresh long-term lows, the BoJ seems to have finally delivered on its intervention threats, with further action likely over the coming weeks. Yen weakness looks also stretched both vs. yield differentials (left mid chart) and amid elevated speculative short JPY positions (mid right). While still looking for a mild yen recovery also thanks to the upgraded forecast of another BoJ hike in H2, we have raised our USD/JPY targets for both 3-months (154 from 147) and 12-month (145, from 142) along with upgraded Fed and US yield forecasts. We trim our EUR/USD to 1.06 (3-month, from 1.09) and 1.10 (12m, from 1.13) respectively amid the more discernible lead by the ECB vs. the Fed in the prospective easing cycle.

USD bull run looks advanced

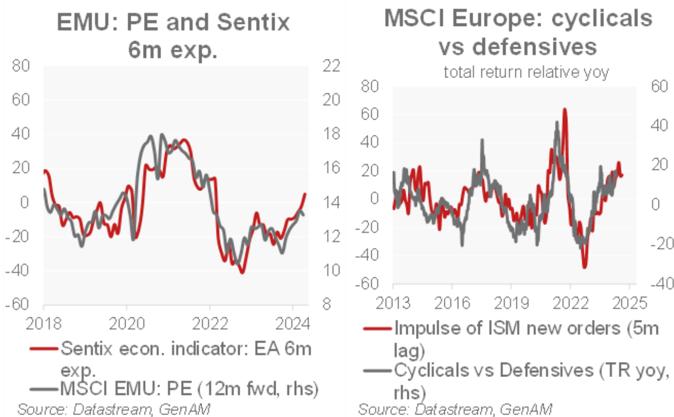
Yet, barring nasty US inflation surprises, we do not expect the USD rally to advance much further from here. On various measures, the recent USD bull run looks stretched, not only vs. yield moves (top charts) but also amid soared USD speculative long positions (mid right), global green shoots (bottom left), and vs. EUR/USD fair value (bottom right).

Equities

Michele Morganti and Vladimir Oleinikov



Source: Datastream, GenAM



Source: Datastream, GenAM

Sector	S&P	Stoxx	Euro Stoxx	S&P	Stoxx	Euro Stoxx
	earnings growth, yoy: Q1 2024			earnings surprise: Q1 2024		
Energy	-25.4%	-30.2%	-34.5%	0.9%	2.2%	-2.7%
Materials	-13.4%	-23.2%	-15.0%	9.1%	13.6%	22.7%
Industrials	3.9%	-9.1%	-8.4%	10.3%	-2.0%	-12.3%
Cons. Discretionary	1.3%	-23.9%	-34.4%	11.7%	-5.3%	-2.7%
Consumer Staples	7.6%	-4.2%	-33.2%	8.9%	1.3%	-15.0%
Health Care	-35.6%	-1.7%	-16.3%	10.1%	5.3%	-0.3%
Financials	5.9%	16.2%	11.2%	8.8%	15.8%	15.2%
IT	28.4%	-23.9%	-26.1%	6.9%	5.4%	3.0%
Comm. Services	41.5%	1.2%	3.9%	13.2%	-20.3%	-17.1%
Utilities	14.3%	11.3%	11.3%	9.8%	3.5%	3.5%
Market	**3.4%**	**-7.0%**	**-16.8%**	**9.1%**	**6.5%**	**4.1%**
Median (all sectors)	**4%**	**-4%**	**-16%**	**9%**	**2%**	**-1%**
Median stock	**8%**	**-2%**	**-2%**	**6%**	**1%**	**-1%**

Source: Bloomberg, GenAM

- **Markets are repricing CPI and interest rate expectations once again. We remain neutral short term.**
- **Toppish Fed's bank reserves, increased investor positioning and VIX, deteriorating ML models, high SPX PE and geopolitical risks are not helping either.**
- **That said, we remain constructive in 12 months and expect a positive 12-month TR: 4% SPX and around 7% for EMU. The Q1 reporting season is delivering nice surprises vs. analyst expectations. We expect mid-single-digit earnings growth in 2024 and 2025.**
- **We are tactically OW EU vs. the US (N US Tech). That said, the long-term US leadership remains intact.**
- **OW Japan (valuation, restructuring), OW India ("growth" hedge), Korea (valuation, bottoming global cycle) and slowly accumulating China.**
- **EU sectors: OW Banks, Durables, Energy, Food, HC, Transport, Materials, Defense, Small Cap. UW: Auto, Comm. Svs., Telecoms, Insurance, Media, Software.**

The market is experiencing yet another repricing of inflation and Fed cut expectations. Indeed, this was one of the risks for which we decided to maintain a neutral position in the short term, which we confirm this month. The "last mile" of disinflation provides surprises and that's a trigger for higher rates and volatility. Toppish Fed's bank reserves, a normalised positioning, deteriorating ML models and high SPX PE do not help either. Lastly, geopolitical risks are unlikely to escalate significantly from here, but the situation in Ukraine and Israel remains very fluid.

The good news is that in the month, markets are on average basically unchanged in terms of short-term Value gap momentum notwithstanding higher yields. This is because while equities have pulled back a little and yields have risen, 12-month earnings (EPS) have also risen slightly. US IT, for example, posted a nice EPS increase of +1.5%, and with the price at -3.3%, value gap momentum deteriorated by only 1%, despite 10-year yields rising by around 40 bps. At the extreme, we have the MSCI China (-8% value gap delta), mostly due to its rally (+7%). Here we have to take into account the huge undervaluation which China shows on a mid-term perspectives (OW). Having said that, we note that Japan and India (both OW) had the most limited rise in yields and a higher positive change in earnings, which is a good portfolio hedge. Korea was a loser (-6%) but remains the most attractive market according to our composite valuation ranking, with EPS up by 1.8% over the month.

As said, we remain cautious short term, but still constructive in 12 months. Firstly, the EPS outlook still looks decent.

Equities

Michele Morganti and Vladimir Oleinikov

Sectors Europe & US	Exp. Tot. Ret. (DY + eps grw)	PEG adj. (with FY3 EPS) low=cheap	Comp. Sector Valuation Rank 1 = cheap 52 = expensive	Markets	Exp. Tot. Ret. (DY + eps grw)	PEG adj. (with FY3 EPS) low=cheap	Comp. Country Valuation Rank 1 = cheap 52 = expensive
US Aero&Def.	22%	1.7	14	KOREA	45%	1.5	1
MSCI Europe	11%	1.8	18	CHINA	17%	1.0	2
EU Aero&Def.	21%	1.0	21	BRAZIL	12%	1.9	8
MSCI US	14%	1.6	32	Japan	12%	1.9	23
EU Durables	12%	2.0	39	Switzerland	14%	1.6	25
US IT	20%	1.5	41	UK	10%	1.7	30
EU Software	10%	2.7	48	EA	10%	1.8	36
EU Small	14%	1.7	-	India	15%	1.9	38
EU Large	11%	1.7	-	MSCI US	14%	1.6	43

Note: Exp. Tot. Ret. is derived using DY, next year's exp. eps growth, ROE and payout ratios. PEG adj. is FY3 PE divided by expected long-term EPS growth (3-5yrs), modified by the ratio COE/ROE.

Source: Datastream, GenAM calculations

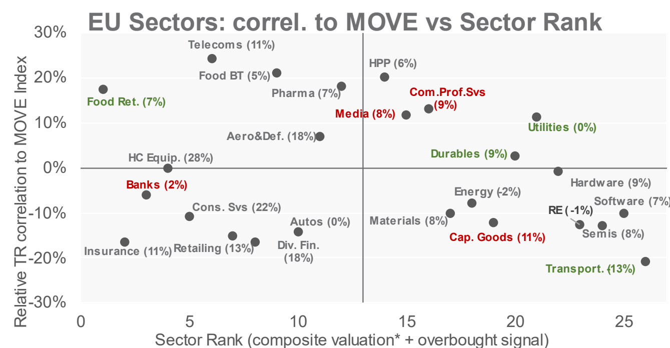
Note: Exp. Tot. Ret. is derived using DY, next year's exp. eps growth, ROE and payout ratios. PEG adj. is FY3 PE divided by expected long-term EPS growth (3-5yrs), modified by the ratio COE/ROE.

Source: Datastream, GenAM calculations

Average qoq return of MSCI Europe and sectors, based on CPI and global LI, since 1999

	STAGFLATION	HEATING UP	GOLDILOCKS	SLOW GROWTH
MSCI EU	**-2.0**	**5.1**	**5.1**	**-1.7**
Financials	-2.7	6.0	6.1	-4.5
Banks	-2.8	6.7	6.5	-6.2
Insurance	-1.9	5.5	5.3	-2.6
Div. Financials	-4.1	5.4	6.3	-3.5
Industrials	-3.0	6.9	7.9	-1.7
Capital Goods	-3.1	7.8	8.5	-2.0
Transportation	-3.2	6.0	6.8	-1.4
Comm. & Prof. Services	-2.3	4.7	5.0	-0.5
Health Care	1.2	2.3	2.7	1.3
Pharma	1.6	2.2	2.4	1.4

Note: 1) Stagflation: slowing growth and rising inflation, 2) Heating up: rising growth and inflation *3) Goldilocks: rising growth and falling inflation, 4) Slow growth: falling growth and inflation*
Source: Datastream, GenAM calculations



*includes Fed Model gap, exp. TR, PEG adj. (for ROE and COE), Shiller PE, 3 -stage EPS growth model, mkt multiples, PE vs hist. avg. excl. bubble years. 12m EPS growth = 12m fwd EPS vs 12m trailing EPS

Green/Red name = positive/negative machine learning (ML) models

in (X%): 12m EPS growth

Source: Refinitiv, GenAM calculations as of 29/04/2024

The Q1 reporting season helps sentiment. We refer to the positive EPS surprises vs. analyst expectations: 9% for the US, 6.5% for Europe, 12% for Japan (very negative EPS yearly growth in the EU, though). Our models point to mid-single-digit yearly growth for both the reminder of this year and in 2025. The ULC-CPI trend suggests that margins are also safe near term. Tech earnings look relatively strong for now. The US macro outlook remains quite solid, and the EA one is improving (Sentix supporting EMU PE). Interest rates should fall a little from here as disinflation is expected to linger. This will also trigger a decline in bond volatility (MOVE index), which will further help sentiment. Corporate Cash Flow minus Capex spread remains very high, too, with equity issuances low and elevated buybacks. This translates into a very positive market technical, which significantly limits the chances of a prolonged and deep downside from here.

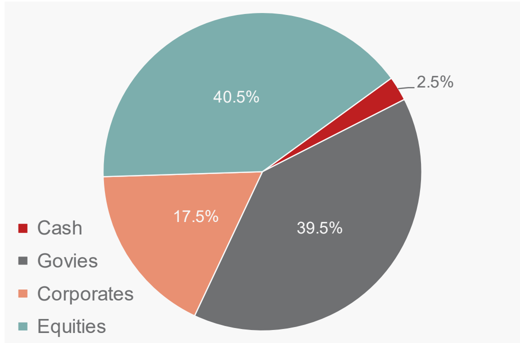
Our models support our expectations of positive 12-month total returns: 4% for the SPX and around 7% for EMU. We are tactically OW EU vs. the US (neutral US IT due to higher yields and antitrust risks, while valuation and EPS growth look ok) as the huge valuation discount is no longer coupled with meaningful weaker EA macro surprises. Furthermore, higher rates and CPI should favour the Value sectors and indices such as EMU. That said, the structural US leadership remains intact: EPS growth (US PE adjusted for growth - PEG - is not that far from the EMU's), tech leadership, energy independence, higher Capex-on-sale, etc. OW Japan (good valuation score, attractive CAPE yield gap, corporate restructuring), OW India (not cheap but "growth" hedge), Korea (best global valuation, bottoming global cycle) and slowly accumulating China (OW, deep undervaluation, supportive economic policy). India should benefit from structurally strong growth, although volatility is likely to be elevated during the seven phases of general elections, though (19 April to 1 June 2024).

European sector allocation

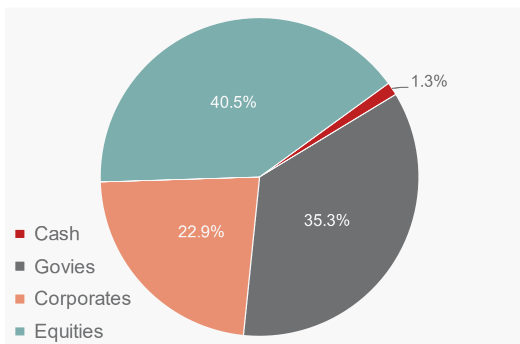
OW Cyclical laggards and value. We are neutral cyclical/defensive after the rally. Supports to cyclicals comes from ISM, lower CPI and bottoming global cycle ("Goldilocks phase"). We are OW Small vs Large cap: toppish yields, better economic momentum, and M&A pick-up. OWs: Banks, Durables, Energy, Food, HC, Transportation, Defense and Materials. UWs: Auto, Comm. Prof. Svs., Insurance, Telecom, Media, Software. Looking at the PEG ratios we notice that, despite a sustained rally so far, India, Japan, and the Defense sector still show valuation similar to EMU. They help to diversify portfolios while exposing them to structurally higher growth.

Asset Allocation

Thorsten Runde



Source: GenAM



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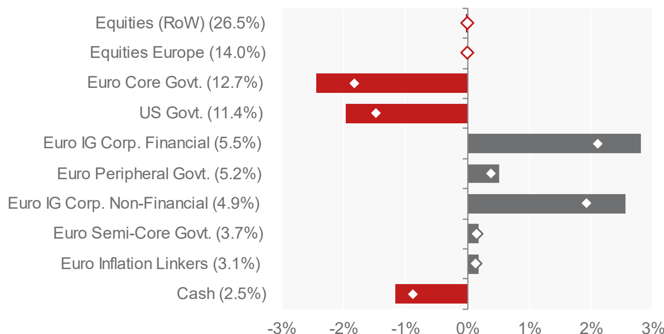


Source: GenAM; Benchmark weights in parentheses, diamonds indicating previous recommendations

- **In April 2024 (26.04.24), most of our actively covered asset classes find themselves in negative territory.**
- **The performance of long-dated Government Bonds proved particularly bad. With -6.0%, US Treasuries Y10+ are taking the last place of the ranking by some distance.**
- **The performance on the equity side is mixed. The MSCI Europe EM and ex EMU made it to the top of the ranking (+0.8% and +0.6%) while the MSCI North America and Pacific find themselves at the lower end of the ranking (-2.8% and -2.9%).**
- **Overall, EA HY Credit again outperformed EA IG (+70 bps). Within IG, Financials were again slightly superior to non-Financials (+31 bps).**
- **Continued disinflation and rate cuts in sight argue for a moderate downside tilt in the yield outlook with the recent yield backup considered just temporary. Brighter macro perspectives support risk assets. Yet the advanced rally bears risks of set-backs.**
- **Thus, we stay neutral on Equities and EA HY. We increase OWs in EA IG and long-dated Govies at the expense of Cash and short-dated Bonds. As a result, the small long duration is slightly expanded.**

In April 2024 (26.04.24) our model portfolio underperformed its benchmark by -4.4 bps. All in, the OW positions in EA IG Credit paid off the most throughout (+3.5 bps). By contrast, underweighting Core Govies (-2.7 bps) and US Treasuries (-2.5 bps) as well as underweighting Cash (-1.8 bps) proved particularly painful.

The disinflation and rate cut environment generally tilts the yield outlook to the downside. Recent yield setbacks as a market reaction on further US inflation overshoot surprises are seen as entry points for a further moderate duration lengthening. With the rally being already quite advanced we consider risks of a correction outweighing the support for risk-assets by a benign macro-outlook.

Stay neutral in risk assets / carefully lengthen duration

Against this backdrop, we confirm our neutral positioning in Equities and EA HY Credit. For the remaining asset classes, we raise the overall aggressiveness of our tactical calls, thus increasing our exposure to safer Credit buckets like EA IG and BTPs. Given our preference for long-dated over short-dated bonds, this leads to a moderate prolongation of our active duration stance.

Forecasts

Macro Data

Growth[1]	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	forecast
US	2.5	2.5	0.3	2.0	0.4	1.9
Euro area	0.5	0.6	0.1	1.4	0.1	1.2
Germany	- 0.1	0.1	- 0.0	1.3	0.2	1.5
France	0.9	0.8	0.1	1.5	0.2	1.6
Italy	0.7	0.6	0.0	0.5	- 0.5	0.2
Non-EMU	0.2	0.6	0.1	1.5	0.1	2.0
UK	0.1	0.4	0.2	1.3	0.2	2.1
Switzerland	0.8	1.1	0.0	1.6	0.0	1.8
Japan	1.9	0.8	0.2	0.9	- 0.2	0.6
Asia ex Japan	5.2	5.0	0.1	4.8	0.2	4.6
China	5.2	5.0	0.3	4.5	0.1	4.1
CEE	2.9	3.1	0.7	3.1	0.6	2.8
Latin America	2.2	1.3	0.0	2.3	0.0	2.5
World	**3.0**	**2.9**	**0.2**	**3.1**	**0.2**	**3.0**

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

Inflation[1]	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	forecast
US	4.1	3.0	0.2	2.4	0.2	2.2
Euro area	5.5	2.4	0.1	2.2	0.2	2.0
Germany	6.0	2.5	- 0.0	2.3	0.2	2.0
France	5.7	2.5	0.0	2.2	0.3	2.0
Italy	5.2	2.1	0.3	2.1	0.2	2.0
Non-EMU	6.5	2.3	- 0.1	1.9	- 0.1	1.9
UK	7.4	2.4	- 0.1	2.1	- 0.1	2.0
Switzerland	2.2	1.4	- 0.0	1.1	0.0	1.2
Japan	3.3	2.3	0.0	1.6	- 0.0	1.6
Asia ex Japan	2.1	1.9	- 0.2	2.3	- 0.0	2.6
China	0.2	0.4	- 0.4	1.3	- 0.3	2.0
CEE	20.4	17.4	- 1.0	9.8	- 0.9	6.6
Latin America[2]	5.1	4.0	0.0	3.6	0.0	3.0
World	**5.2**	**3.8**	**- 0.1**	**3.0**	**- 0.0**	**2.8**

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

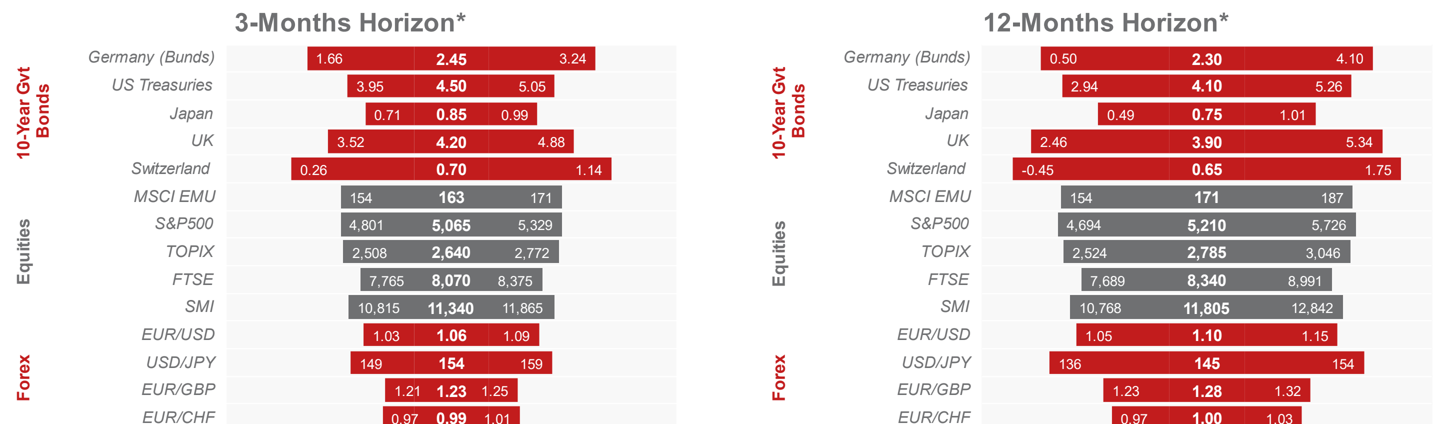
Financial Markets

Key Rates	Current*	3M		6M		12M	
		Forecast	*Fwd*	*Forecast*	*Fwd*	*Forecast*	*Fwd*
US (upper bound)	5.50	5.50	*5.25*	5.25	*5.04*	4.75	*4.60*
Euro area	4.00	3.75	*3.60*	3.25	*3.35*	2.75	*2.84*
Japan	0.05	0.00	*0.16*	0.00	*0.26*	0.25	*0.41*
UK	5.25	5.25	*5.02*	5.00	*4.86*	4.50	*4.44*
Switzerland	1.50	1.50	*1.25*	1.25	*1.12*	1.00	*1.01*
10-Year Gvt Bonds							
US Treasuries	4.67	4.50	*4.67*	4.35	*4.66*	4.10	*4.66*
Germany (Bunds)	2.60	2.45	*2.58*	2.30	*2.57*	2.30	*2.55*
Italy	3.94	3.85	*3.98*	3.75	*4.02*	3.80	*4.10*
Spread vs Bunds	*135*	*140*	*140*	*145*	*145*	*150*	*155*
France	3.09	2.95	*3.11*	2.85	*3.11*	2.85	*3.13*
Spread vs Bunds	*50*	*50*	*53*	*55*	*55*	*55*	*58*
Japan	0.89	0.85	*0.95*	0.80	*1.00*	0.75	*1.10*
UK	4.35	4.20	*4.34*	4.05	*4.33*	3.90	*4.36*
Switzerland	0.77	0.70	*0.72*	0.65	*0.70*	0.65	*0.69*

**3-day avg. as of 26/04/24*
***ICE BofA (OAS)*

Credit Spreads**	Current*	3M		6M		12M	
		Forecast	*Fwd*	*Forecast*	*Fwd*	*Forecast*	*Fwd*
EA IG Non-Financial	106	105		110		100	
EA IG Financial	119	120		120		110	
EA HY	356	380		380		355	
EM Sov. (in USD)	257	260		265		260	
Forex							
EUR/USD	1.07	1.06	*1.07*	1.09	*1.08*	1.10	*1.09*
USD/JPY	156	154	*154*	150	*152*	145	*148*
EUR/JPY	167	163	*165*	164	*164*	160	*161*
GBP/USD	1.25	1.23	*1.25*	1.27	*1.25*	1.28	*1.25*
EUR/GBP	0.86	0.86	*0.86*	0.86	*0.86*	0.86	*0.87*
EUR/CHF	0.98	0.99	*0.97*	1.00	*0.97*	1.00	*0.95*
Equities							
S&P500	5,073	5,065		5,115		5,210	
MSCI EMU	164.9	162.5		165.5		170.5	
TOPIX	2,687	2,640		2,725		2,785	
FTSE	8,086	8,070		8,160		8,340	
SMI	11,325	11,340		11,590		11,805	

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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