

# Market Perspectives

Closer to victory

September 2024

## GenAM Macro & Market Research

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

- Central banks are getting more confident about moving closer to victory over inflation. With risks to growth from tight policies rising, markets have boosted hopes of fast rate cuts into autumn.
- This may be prone for a partial reversal. After too much inflation pessimism in H1, markets now risk rushing into oversized hopes of fast policy easing amid high disinflation optimism and cyclical worries.
- While continued disinflation and prospective rate cuts keep yields geared to the downside medium term, we cut our recommendation for long duration exposure for now.
- Global growth has become bumpier, but we deem the moderate expansion trend still intact and US recession risks low. This is conducive to a prudent overweight in risk assets.

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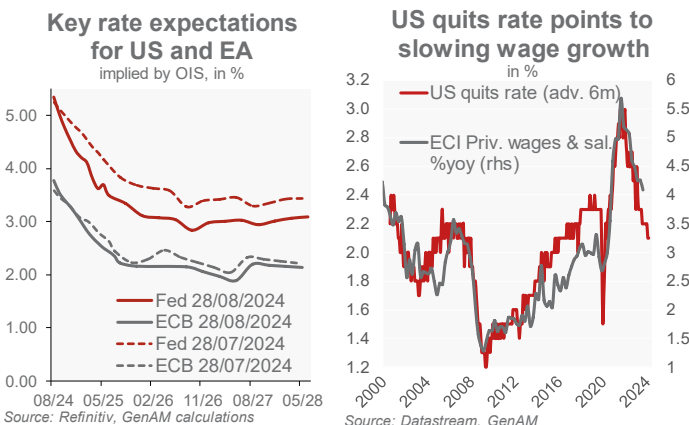
## Global View – Closer to victory

Thomas Hempell

- **Central banks are getting more confident about moving closer to victory over inflation. With risks to growth from tight policies rising, markets have boosted hopes of fast rate cuts into autumn.**
- **This may be prone for a partial reversal. After too much inflation pessimism in H1, markets now risk rushing into oversized hopes of fast policy easing amid high disinflation optimism and cyclical worries.**
- **While continued disinflation and prospective rate cuts keep yields geared to the downside medium term, we cut our recommendation for long duration exposure for now.**
- **Global growth has become bumpier, but we deem the moderate expansion trend still intact and US recession risks low. This is conducive to a prudent overweight in risk assets.**

A bounce of the Japanese yen and sharp unwinding of carry trades unsettled markets in early August amid growth worries and doubts about the AI hype. But markets were quick in paring early losses in risk assets, with global equities ending a turbulent month in the green (MSCI World: +1.7% by Aug. 29).

More reassuring cyclical US data over the course of August (incl. ISM, retail sales, jobless claims) have helped to tame recession worries following a weak labour market report for July. And a continued string of reassuring (dis)inflation data spurred expectations that the Fed would act swiftly if cyclical worries were to deepen (left chart). [We have been arguing](#) for longer that US disinflation was largely on track amid a cooling labour market (right chart) and markets kept too strong doubts about the Fed's path to victory over inflation over H1. Fed Chair Powell gave his nod for a cycle of rate cuts to start in September at Jackson Hole.



That said, with markets now pricing more than 200bp of rate

cuts over the coming 12-months, we sense a dose of high disinflation optimism (2-year inflation priced at 2.2% for US and 1.8% euro area) and somewhat exaggerated worries about the resilience of the US economy. Victory over inflation is moving closer but is not yet guaranteed, and it would probably require rising recession risks for the Fed to rush into such a sequence of rate cuts close to what we deem the neutral rate within a year's time.

We do acknowledge risen headwinds to the global economy reflected in recent data, notably in the euro area where Germany's structural and cyclical problems keep dragging on the currency union's recovery prospects. Political uncertainties in France neither help. Yet we deem the case for a continued moderate global expansion intact. Solid wage growth and receding inflation will keep consumers' purchasing power afloat while lower rates will improve financial conditions and nurture a recovering credit cycle.

10-Year Gvt Bonds	Current*	3M	6M	12M
US Treasuries	3.83	3.95	3.90	3.80
Germany (Bunds)	2.26	2.30	2.35	2.35
Credit Spreads**				
EA IG Non-Financial	110	105	100	100
EA IG Financial	122	120	120	115
Forex				
EUR/USD	1.12	1.09	1.11	1.13
USD/JPY	144	144	140	135
Equities				
S&P500	5612	5665	5665	5670
MSCI EMU	163	166	168	168

\*3-day avg. as of 28/08/24 \*\*ICE BofA (OAS)

### Some tactical caution on duration

While continued disinflation and prospective rate cuts keep the medium-term trend for yields geared to the downside, a health check on advanced rate expectations over the coming weeks make us tactically more prudent on our exposure to duration. We also sense that recent USD weakness may have gone a bit too far recently.

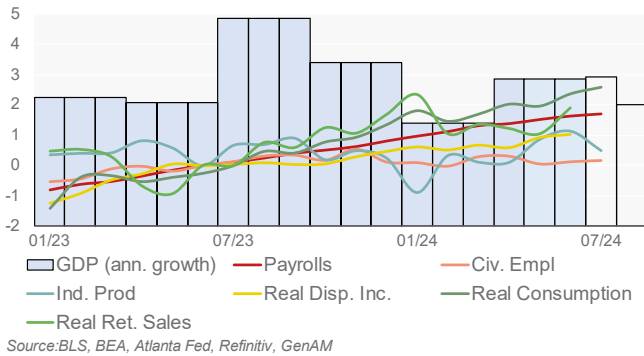
Risk assets may experience continued higher volatility amid a bunch of (geo)political risks (Mid East tensions, US elections, French government formation, 2025 budget plans). Yet the combination of tempered growth and continued disinflation still forms a conducive backdrop for risk appetite. Following the early August shake-out, risk positioning has moderated. And our proprietary AI tools still lean moderately in favour of equities vs. government bonds. This leaves us with a continued moderate preference for Credit (both IG and HY) and Equities at the expense of Cash and lower yielding core bonds.

## United States

Paolo Zanghieri

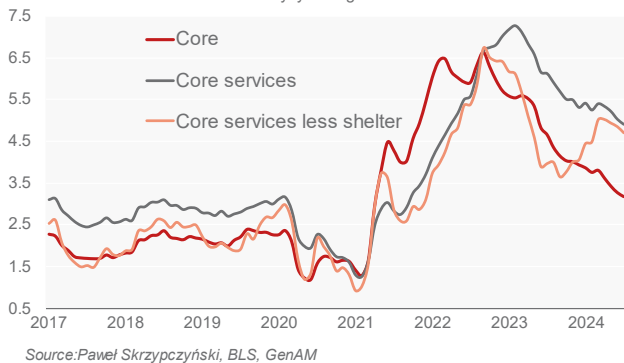
### Monthly activity indicators

% diff. from June 2023. Q3 2024: Atlanta Fed Nowcast



### CPI inflation

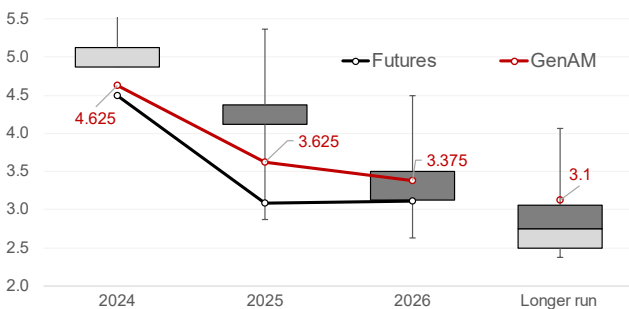
yoy % chg.



### FOMC "dots" and Fed fund rates forecasts

Middle of the range.

Year-end, median, quartiles and extremes of the distribution



- Data released over the summer and the upward growth revision to 3% annualized show that the economy is far from recession. Growth will slow down in H2 but will likely still average 2.6% this year and moderate to 1.8% in 2025.
- Inflation continued its slow descent, with core CPI down to 3.2% in July with further progress ahead thanks to the ongoing cooling of the labour market.
- We expect that higher confidence on disinflation and worries about the labour market will lead the Fed to cut by 25 bps three times by the end of the year.

The disappointing employment numbers for July (only 114k new jobs, unemployment rate at 4.3%), stirred fears that ultimately higher rates will lead to a recession. However, the 0.2pp upward revision of Q2 GDP and the data released during the summer still show that domestic demand is holding well with consumption (real PCE) up 2.6% yoy in July and durable goods orders surprising to the upside. Nowcasts point to a 2% annualised growth for Q3, we are a bit more cautious (1.8%) as households are showing distress, as pointed out by increasing credit card delinquencies. Still GDP will be up by 2.6% this year. Our 2025 forecast of 1.8%, is very far from indicating a recession.

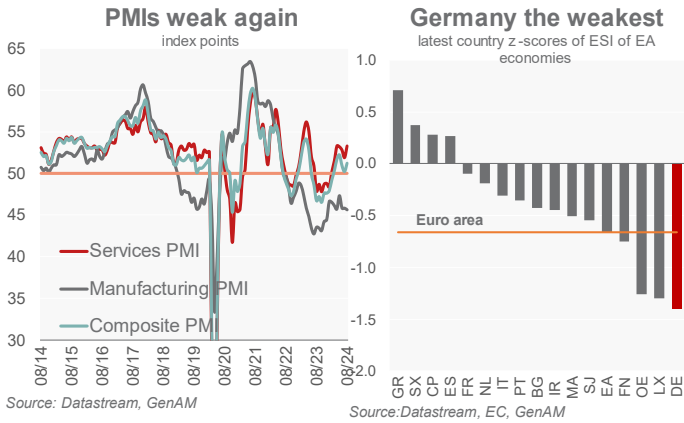
The gradual cooling of inflation continues. July core inflation came in slightly below expectation, but still at 3.2%. The ex-housing component of services points more clearly down. We expect core PCE inflation to end the year at 2.6% yoy. Wage developments will play a key role: in Q2 the employment cost index further decelerated to 4.1%. Assuming a conservative estimate of 1.8% annual trend productivity growth (in Q2 output per worker was up 2.7% yoy) it is getting closer to the pace consistent with 2% inflation.

### A weaker labour market will trigger a slightly faster rate normalisation

During the summer, the tone of the Fed communication has changed markedly, and worries about the labour market surfaced. While the recent surge in the unemployment rate it mostly due to higher labour supply, hiring intentions have dropped. As pointed out by Chair Powell in Jackson Hole, upside risks to inflation have abated but downside risk to activity have increased. The current market pricing of around 100 bps cuts by year end does not reflect the actual balance of risks. Nevertheless, we think that the gradual approach pursued by the Fed is consistent with a 25 bps cut at each of the three remaining meetings for this year. We pencil in a total of 100 bps cuts for next year, but much will depend on the fiscal and trade policies the next President will implement.

## Euro Area

Martin Wolburg



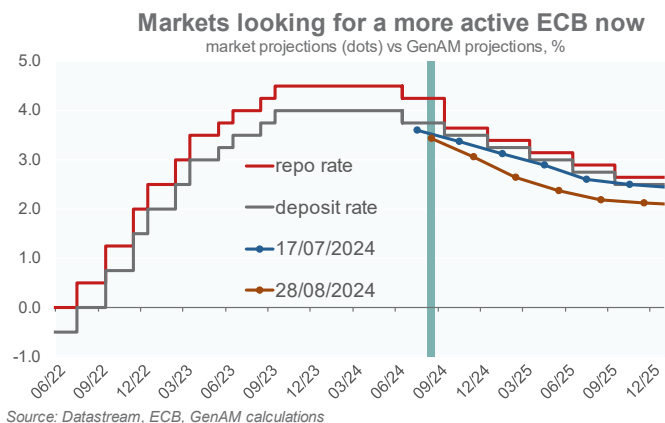
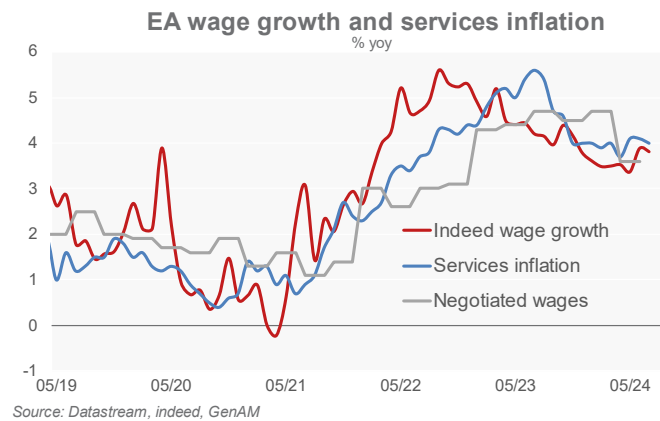
- **Subdued global growth, ongoing German weakness and political uncertainties dampened sentiment. We slightly trim our growth forecasts.**
- **But amid receding inflation, monetary easing and a US economy avoiding recession we expect ongoing output growth.**
- **The ECB's confidence in bringing inflation back to target has increased but we stick to our expectation of quarterly 25 bps rate cuts after the September one.**

There are mounting signs that euro area growth is weakening. Sentiment stayed weaker than in the previous quarter. For instance, the composite PMI's average for July/Aug implies 0.1 pp lower growth than the one in Q2. Moreover, our aggregated measure of forward-looking components for firms continued to weaken as of late. We see a number of factors standing behind: The growth environment deteriorated as global manufacturing sentiment retreated. Political uncertainties related to the global situation (e.g. Middle East, US elections) as well as within the euro area (e.g. French political stalemate, tension within the German government) are set to leave their mark too. Moreover, Germany, contributing 29% to euro area GDP, not only suffers from its strong export-dependence but also faces structural challenges (e.g. in the car sector) that are likely to make it a growth laggard for the time being.

That said, we deem concerns about euro area stagnation or even recession overdone. In the US, a key pacemaker of global activity, we expect output growth to continue. Moreover, ongoing albeit bumpy disinflation will bode well for real income growth. And with monetary policy impulses becoming supportive we look for positive quarterly growth rates of 0.2% qoq (down from 0.3%) in H2/2024. All in all, we lowered our 2024/25 growth forecasts to 0.7% (from 0.8%)/1.3% (from 1.4%).

### ECB to stick to quarterly rate cuts

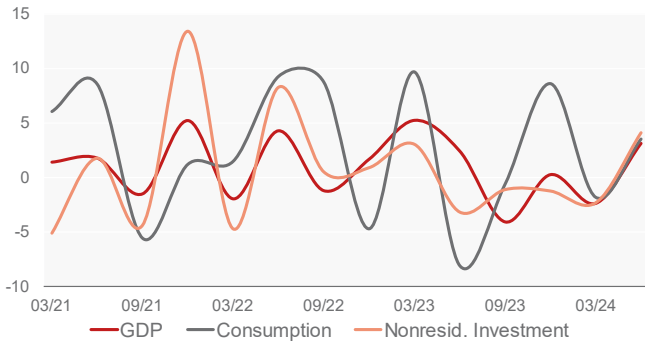
Headline inflation receded in August to 2.2% yoy while core inflation was at 2.8% yoy underlining that stripping out base and one-off effects price stability is still distant. Also, consumers inflation expectations are stubbornly above the 2% threshold (at 2.8% for 1Y and 2.4% for 3Y according to the [CES](#)). However, latest wage data (see mid chart) suggest down trending services inflation and weaker activity reduces the cyclical price pressure. ECB Chief Economist Lane recently stated that there was "good progress" in cutting inflation but that "the return to target is not yet secure". We anticipate the ECB to express higher confidence in the reduction of inflation at the Sep 12 meeting, look for another 25 bps cut and expect it to signal ongoing quarterly rate cuts for the time being.



## Japan

Paolo Zanghieri

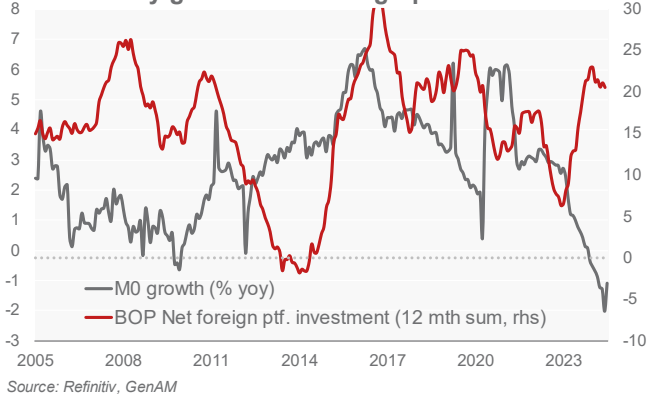
**Economic activity**  
 qoq % chg. annualised



**Wages and Prices**  
 % chg. yoy



**Money growth and foreign portfolio flows**



- The strong Q2 GDP reading and relatively good economic data over the summer back the hawkish stance taken by the BoJ in July, when it hiked the policy rate to 0.25% and announced the reduction of bond purchases.
- We now expect another hike by the end of the year followed by another one in 2025. The policy rate should reach the estimated 1% neutral level by 2026.
- Higher domestic yield and shrinking liquidity are likely to reduce appetite for foreign assets, adding to the unwinding of the carry trade, with possible repercussions on global liquidity.

July's BoJ decision to hike its key rate and the pivot to a more hawkish tone also surprised because macroeconomic data at that point only mildly backed the shift. More recent data on activity and prices seems to vindicate such a choice, though. Q2 GDP growth surprised to the upside, not just in size (3.1% qoq versus 2.3% consensus), but also for the strength of both private investment and consumption. The latter was boosted by the rise in wage growth that has started outpacing inflation. Labour income will be gradually bolstered as negotiated wage increases are implemented, and inflation subsides.

Exports recovered too, but less than what was implied by foreign demand, due to supply bottlenecks in the auto sector. We maintain our 1.2% growth forecast for 2025, after a 0.2% expansion this year. Inflation will moderate to 2% in 2025.

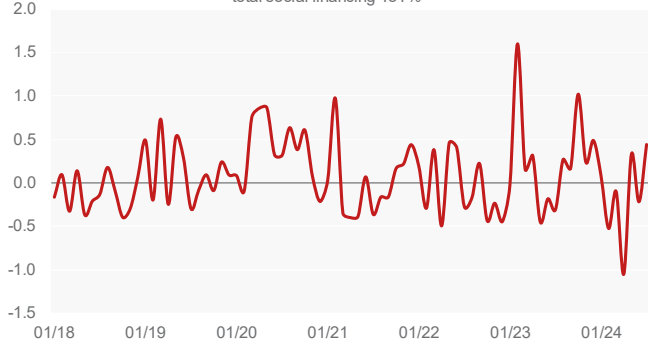
### Another BoJ rate hike likely this year

High inflation and evidence of steady domestic demand should allow the BoJ to deliver on its hawkish stance. We raise the projected path for the BoJ and see another policy rate rise (to 0.5%) by the end of the year, possibly in October, unless financial market volatility spikes up again. After that, the path to the estimated 1% neutral rate will be slow, with just one hike in both 2025 and 2026. We do not expect this very moderate tightening to impact domestic demand severely. Bond markets have digested well the much-anticipated reduction in bond purchases. The yield differential to US Treasuries will remain wide enough to not trigger large portfolio rebalancing by large institutions. Still, the reduction of the BoJ purchases marks the first liquidity drain in more than ten years. This will likely reduce demand for foreign assets and, less likely an increased switch to domestic ones. All this will affect global liquidity on top of the additional unwinding of yen-based carry trade.

## China

Guillaume Tresca

**Lackluster credit growth**  
total social financing YoY%



Source: Bloomberg, PBoC, GenAM

**Housing sector has not yet recovered**



Source: Bloomberg, NBS, GenAM

**10Y CGB keeps declining**  
10Y CGB, %



Source: Bloomberg, GenAM

- **Activity data has disappointed while credit growth is lackluster. Growth risks are skewed to the downside.**
- **The housing sector has failed to recover. Sales continue to decline as well as home prices.**

China has continued to disappoint, and few elements suggest that a significant turnaround will come soon. The July activity data came on the soft side. Fixed investment came below expectations with a weak real estate component (-10.2%ytd YoY). Industrial production was flat after a rebound in June while the unemployment rate rose further. Other high-frequency indicators so far suggest that growth will remain at low level. Fortunately, consumption is holding better and picked up moderately. Retail sales grew and some positive signs were emerging with the latest round of supportive policies.

Credit growth was also disappointing as total social financing undershot expectations. The CNY loan component posted a decline for the first time. Monetary policy is not yet supportive. The 1Y LPR was surprisingly lowered in late July, but the impact is yet to be seen. The risk is to see more easing via RRRs cut as the expected Fed cuts and the CNY appreciation provide the PBoC more room.

Thus, the risk to our 2024 5% growth forecast is skewed to the downside. Despite the policy shift during the July Politburo meeting, support has been slow to come and very gradual. In late July, the State Council outlined only 20 new small measures to support household consumption. But, as time goes by, the growth target becomes more challenging and measures less efficient.

### Real estate view: further sales decline

Despite the comprehensive May plan, the rebound in construction activity has been short-lived. New home sales in major cities continued to decline largely, though secondary home sales rebounded. Prices of new and secondary homes are declining but the adjustment is probably too small to revive the market. No new plan is in sight, and we continue to only expect targeted and calibrated measures. Thus, housing will remain a drag on growth.

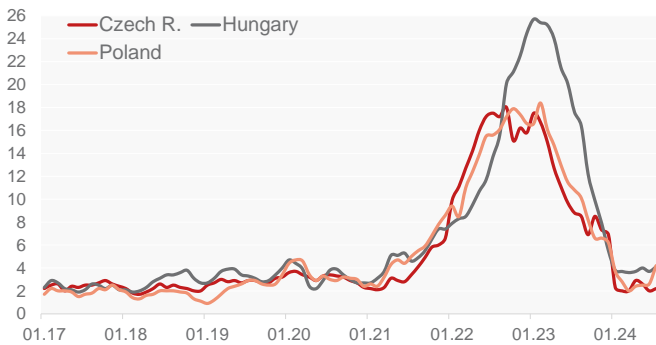
### A more active PBoC

The CNY has appreciated but the move is related to expected lower US rates rather than domestic factors. The direction is still for weaker CNY or at least more volatility ahead of the US elections. On the bond front, it is yet unclear whether and how the PBoC will intervene in the market with the purpose of taming the bond rally. That said, structural forces will limit the bond yield rebound.

## Central and Eastern Europe

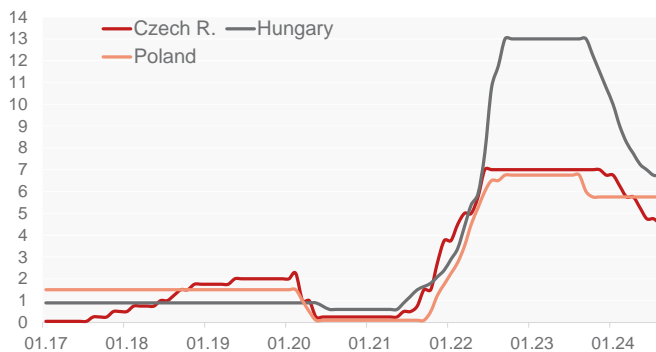
Radomír Jáč

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



Source: [www.czso.cz](http://www.czso.cz), [www.ksh.hu](http://www.ksh.hu), [www.stat.gov.pl](http://www.stat.gov.pl), GenAM

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



Source: [www.cnb.cz](http://www.cnb.cz), [www.mnb.hu](http://www.mnb.hu), [www.nbp.pl](http://www.nbp.pl), GenAM

### Main Forecasts

Czech Republic	2022	2023	2024f	2025f
GDP	2.9	0.0	0.9	2.7
Consumer prices	15.1	10.7	2.4	2.0
Central bank's key rate	7.00	6.75	3.75	3.00
Hungary	2022	2023	2024f	2025f
GDP	4.6	-0.9	2.0	3.3
Consumer prices	14.5	17.6	3.8	3.9
Central bank's key rate	13.00	10.75	6.25	5.25
Poland	2022	2023	2024f	2025f
GDP	5.3	0.2	3.1	3.2
Consumer prices	14.3	11.6	3.7	4.0
Central bank's key rate	6.75	5.75	5.75	4.75

Source: [www.cnb.cz](http://www.cnb.cz), [www.mnb.hu](http://www.mnb.hu), [www.nbp.pl](http://www.nbp.pl), GenAM

- Inflation in the CE-3 region increased in July due to food prices, core CPI items, and in Poland due to deregulation of household energy prices.
- Preliminary data for Q2 reported strong GDP growth in Poland while Hungary disappointed with a drop in GDP. Czech growth was slightly below expectations.
- Data from Poland are supportive to a scenario of stable interest rates in 2024. The Czech CNB slowed the pace of rate cuts to 25 bps. Hungary kept the base rate unchanged in August, which was the first pause in the current cutting cycle.

Preliminary data for Q2 GDP offered a mixed picture. Polish GDP grew by 1.5% qoq and data for Q1 was revised up, which led us to raise the full-year 2024 GDP growth forecast from 2.6% to 3.1%. Hungary disappointed with a GDP decline by -0.2% qoq: we cut the full-year growth forecast from 2.7% to 2.0%. Czech GDP growth at 0.3% qoq slightly undershot forecast and we now expect the full-year growth at 0.9% (vs. 1.3% expected previously).

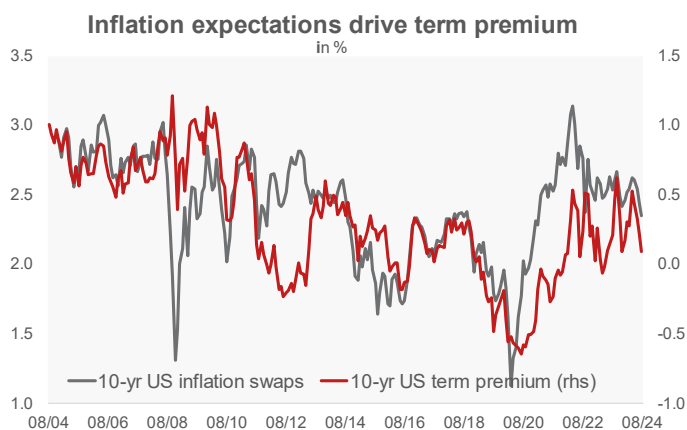
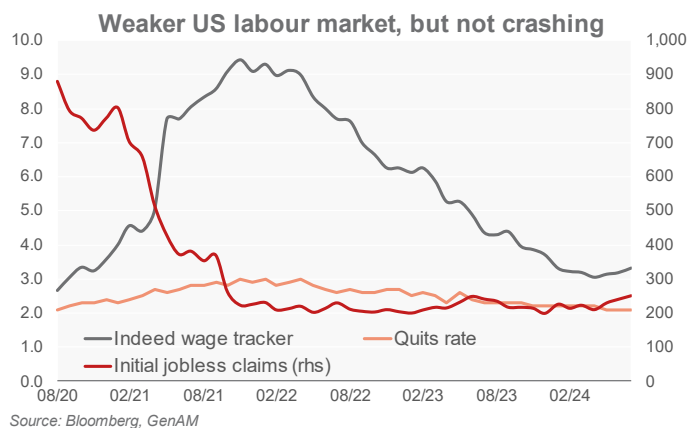
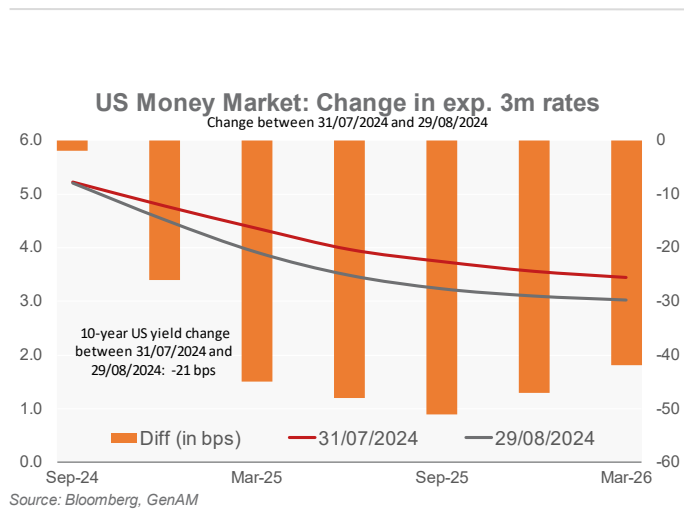
Headline CPI increased across the CE-3 in July. Polish CPI was impacted by an increase in regulated energy prices: headline inflation rose from 2.6% to 4.2% yoy, but this was slightly below expectation. In Hungary, headline CPI rose from 3.7% to 4.1% yoy and the increase in core inflation was even stronger, which resulted in the MNB's decision to keep interest rates unchanged at its August policy meeting. Czech headline inflation grew from 2.0% to 2.2% yoy and while it remained close to the 2% target, the CNB may debate a possibility of a pause in its cutting cycle.

### Czechia slowed pace of rate cuts, Hungary took a pause

The Czech CNB cut its key rate by 25 bps to 4.50% in August after cutting rates by 50 bps at all policy meetings held in H1. The CNB's new forecast operates with stable rates for the rest of 2024 but rate cuts by the Fed and the ECB may keep the CNB's door open for cautious cuts by 25 bps. In Hungary, the MNB kept its key rate on hold at 6.75% in August. This was the first pause in the current cutting cycle. The MNB said there was still room for further cautious rate cuts. We expect rate cuts (25 bps each) in September and December, i.e., at the meetings where the new macro forecast will be presented. The Polish NBP is very clear that rate cuts will not be resumed in 2024 and that the key rate will stay the whole year at 5.75%. However, growing number of MPC members mentioned a possibility that interest rate cuts may start again in H1 2025 after headline inflation (driven by deregulation of energy prices) reaches its peak in the first months of the year.

## Government Bonds

Florian Späte



- While risky assets have largely shrugged off the market turbulence of early August, government bond yields are still at much lower levels. In particular, the key rate cuts priced in appear overdone.
- We believe that the economic pessimism and inflation optimism currently expected by markets are exaggerated and therefore forecast yields to rise somewhat in the short term. In the medium term, however, a moderate downward trend is likely to resume, at least in the US.
- After a rather calm August, the EA non-core government bond market will pick up again. In particular, the difficult government formation process and the adoption of the 2025 budget in France will take centre stage and are likely to have a significant impact on market sentiment.

A combination of factors put yields under considerable pressure in early August. A weak US employment report, expectations of further BoJ key rate hikes (after the BoJ raised rates to 0.25% at the end of July), a slump in international equity markets and a significant reduction in liquidity over the summer (explicitly mentioned in the last [MP](#)) suddenly accelerated the decline in yields that had begun in mid-July. At times, the 10-year US Treasury yield fell below 3.7% and the 10-year Bund yield below 2.1%.

Since then, the situation has calmed down noticeably and risky assets in particular have recovered appreciably. However, since the end of July there has still been a marked fall in government bond yields and a significant steepening of yield curves. We believe that this move is overdone and that there is now potential for yields to rise in the short term, particularly in the US.

Since the end of April, the expected Fed funds rate at the year-end 2024 has fallen by 75 bps (30 bps in August alone). The trend for the ECB is the same, but much weaker (25 bps, including 10 bps in August). While the market is now pricing in more than 100 bps of Fed rate cuts by year-end 2024, we expect only three steps (25 bps each). Market participants are pricing in more than 225 bps cumulatively by the end of 2025. Our forecast is much more cautious at 175 bps. At less than 3.2%, the expected medium-term key interest rate (measured by 5y3m OIS) also appear somewhat too low and has upward potential. A correction in expectations, which we expect, will put upward pressure not only on the short end of the curve but also on longer tenors.

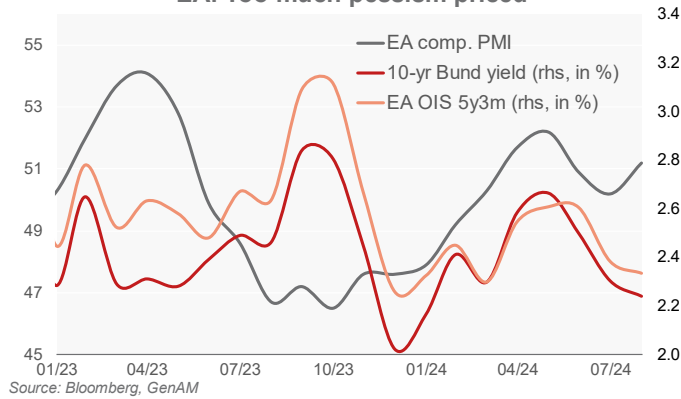
Our more dovish expectations for policy rates are also due to the fact that we believe that the interpretation of the latest labour market report as a sign of an impending recession is overdone. Rather, we see this as a normalisation.



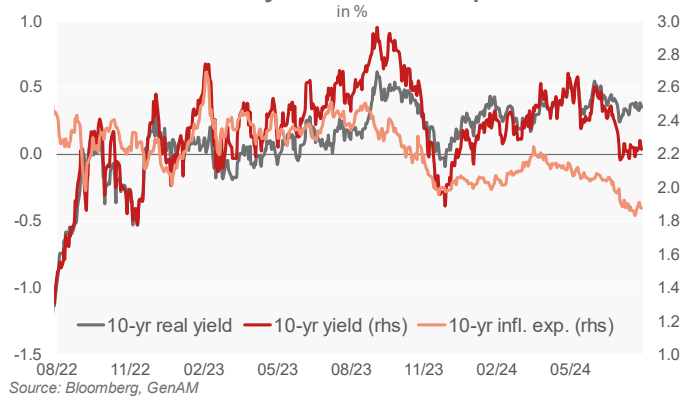
## Government Bonds

Florian Späte

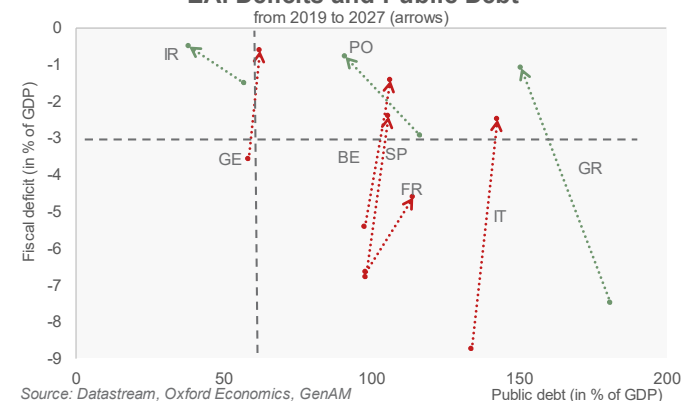
**EA: Too much pessimism priced**



**EA: Nominal yields and infl. expectations**



**EA: Deficits and Public Debt**



Finally, driven not least by declining inflation expectations the US term premium has fallen in recent months close to zero. We regard this as non-sustainable as the supply of US Treasuries will remain on a high level going forward, inflation is seen to come down further but not to levels seen in the 2010s, and the Fed's Quantitative Tightening will continue for some time to come.

Hence, we see leeway for 10-yr US yields to rise to 3.95% on a 3-month view before the key rate cutting cycle, lower inflation, and a decreasing gap between 10-year yields and 5y3m OIS will trigger moderately lower yields (12-month view: 3.80%).

EA core yields are likely to follow US yields in the short term, but the potential for higher yields is lower. On the one hand, expectations of key rate cuts are not as exaggerated as in the US, and on the other hand, the decline in yields has been more moderate in recent months. As a result, we are making only minor changes to our Bund yield forecast and expect yields to rise slightly in the short and medium term.

However, it is worth noting that, in contrast to the US bond market, the drop in EA core yields in recent months has been entirely due to falling inflation expectations (while real yields have actually risen despite weaker economic indicators). Accordingly, the forecast rise in nominal yields is likely to be based on higher inflation expectations (while real yields are seen to fall slightly).

### France to shape EA non-core bond market sentiment

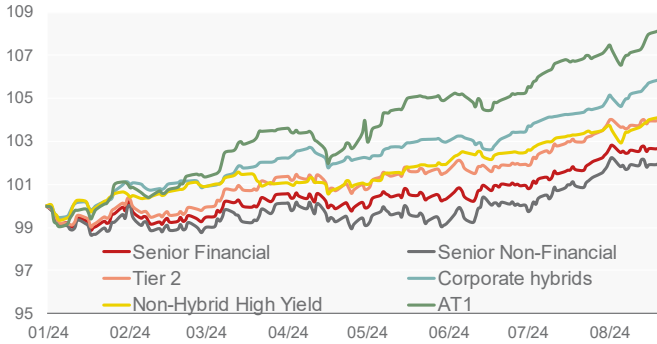
After the usual summer lull in EA non-core bond markets with limited spread movements in August, issuance should pick up again in September. However, developments in France in particular will be closely watched. With a hung parliament, a new government has still not been appointed. The most likely scenario seems to be a technical government, whose main task will be to present a budget plan for 2025 in early October. This seems challenging at least, given the lack of a majority in parliament on the one hand, and the need to comply with the new EU fiscal rules (On June 19, the EC placed France under "excessive deficit procedure") on the other. By September 20, France has to publish a fiscal structural plan to conform to the new Stability and Growth Pact ensuring a downward trend for the debt ratio in the medium term.

Past experience has shown that the level of risk premiums a country has to pay depends on sound growth and fiscal policies in the long run. The bottom chart shows that France (and Italy) still have some catching up to do. In the short term, we see the 10-year OAT/Bund spread in a range between 70 and 80 bps – with possible breakouts to the upside and downside depending on the budget structure.

## Credit

Elisa Belgacem

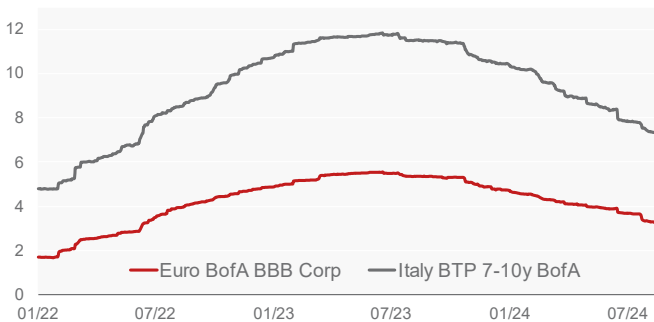
**EUR Credit market performance by segment**  
 Total return base 100 : 01/01/2024



Source: Bloomberg, BofAML indices, GenAM

**IG vs BTP volatility**

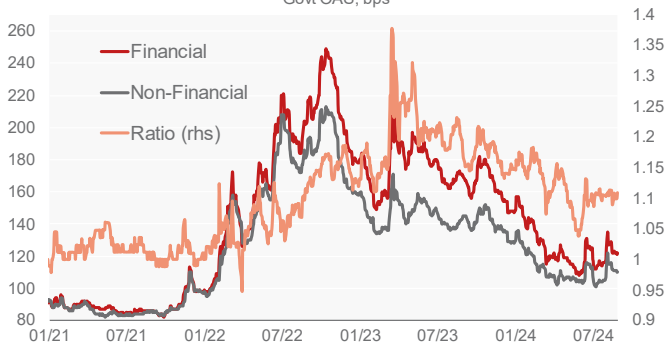
52-week realised vol, annualised, %



Source: Bloomberg, GenAM

**Fins vs Non-Fins**

Govt OAS, bps



Source: Bloomberg, BofAML Indices, GenAM

- After the short-lived August volatility move, Credit continues to be appealing compared to sovereigns, so we maintain our long position in investment-grade securities.
- The relative resilience of high yield has been impressive this summer. We also maintain a slight overweight there, as the anticipated supply will likely be offset by the attractive carry and an improving default outlook.
- CDS have outperformed in the rebound and we like to buy credit protection at those levels, especially the iTraxx Main, and subordinated financials
- We continue to favor non-financials over financials, given the ongoing French political risk as we approach year-end.

In recent weeks, equity volatility has surged significantly higher than credit volatility. Despite this, credit markets, especially high yield, have shown remarkable resilience. This is mostly due to the appealing all-in yields that continues to drive demand, even after risk-free rates have substantially declined. Also, volatility of investment grade remains much below the one of peripheral government bonds. We believe that investors will continue to chase credit into year-end for this reason.

### Defaults are declining but rating are still deteriorating

Corporate fundamentals are likely to face headwinds from here. This will lead rating agencies to continue to downgrade more companies than they would upgrade. However, the number of fallen angels moving from IG to HY should remain very limited. However, this credit cycle is very peculiar in the sense that defaults numbers are starting to decline both in the US and in Europe. This is likely because we are looking at different cohort of companies, defaults stemming from smaller enterprises while defaults are measure on the entire credit markets, and larger companies have shown very resilient results up until now.

### Strong demand for credit will support spreads

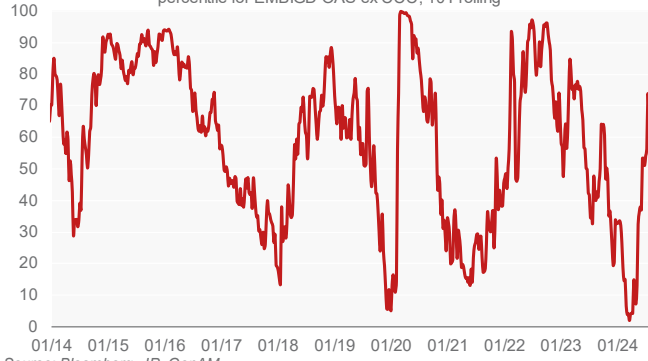
We expect IG spreads to hover around current levels in the coming months, keeping carry elevated. Valuation considerations also lead to a preference for Europe over the US. We prefer long IG and subordination risk to pure HY. While extending duration may not be favourable from a spread perspective, a positive view on rates justifies a long position, especially in the 5-7 year bucket. AT1 has been the best performing asset class within credit so far this year and despite the limited spread tightening potential going forward, we continue to favour it in particular versus single-Bs.

## EM sovereign bonds

Guillaume Tresca

### Better valuations: EM spread back to median

percentile for EMBIGD OAS ex CCC, 10Y rolling

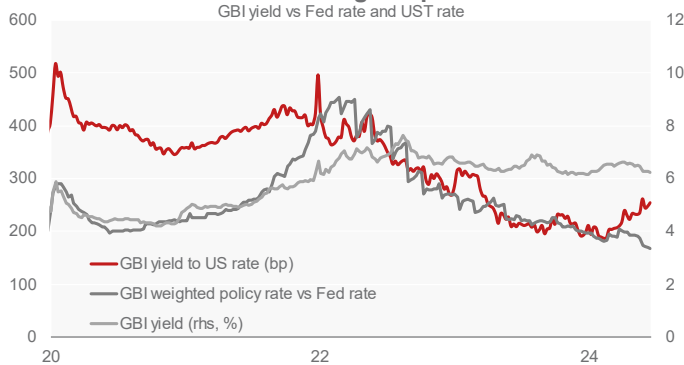


- The EM debt outlook remains supportive even in a US soft landing scenario.
- Valuations have improved and the Fed rate cuts should support local and external debt spread.
- We still favour external debt, but the local debt proposition is turning more compelling.

After wild moves during the summer sell-off in late July, EM markets have eventually proved resilient and are almost back to their early July levels. The narrative has changed only marginally with the US soft landing now the dominant market narrative. It does not change our positive EM view and our overweight stance. The soft landing, if a recession is avoided and inflation is under control, is still a positive environment for EMs. It is also compounded by the clear expectations of a first Fed rate cut in September that historically tends to support EM spread compression.

### Local debt: widening of spread to UST

GBI yield vs Fed rate and UST rate



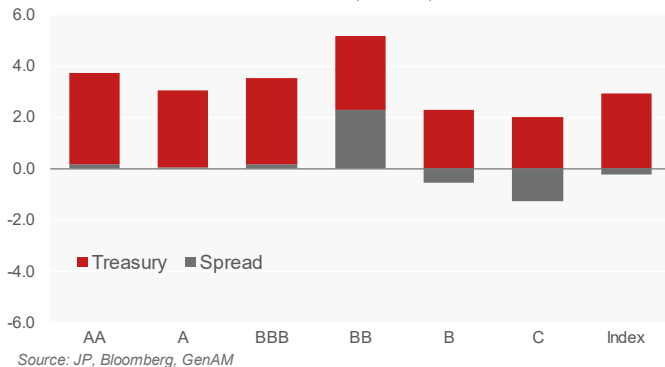
That said, we see three elements that can cap the positive performance in the short term. First, the market has been pricing in an aggressive easing cycle and the risk is to see a modest depricing. Long-term US rates have declined meaningfully supporting EM duration. A US rate rebound would dent EM duration. Second, the US dollar weakening has been a strong support to EM FXs and so to EM local debt. Third, the upcoming US elections will bring more volatility. While it is too early to globally affect the EM complex, it can affect the risk appetite for certain countries.

### External debt: resilience

We still favour external debt vs local debt. For external debt, valuations have turned more supportive. EM IG is still lagging US IG ytd and it should attract crossover inflows. That said, we fear a US long-term rate rebound and so tactically we would favour relative value and spread trades. In IG, we still like Panama which outperformed BBB, Hungary, and Morocco. In HY, BBs have turned even more expensive, and value is more attractive in the quality B bucket that has lagged the August recovery.

### Almost no change through the sell-off

Return since 26/07, EMBIGD, %

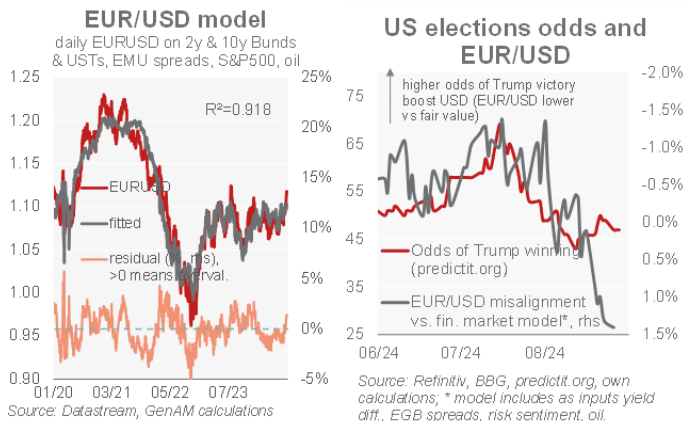
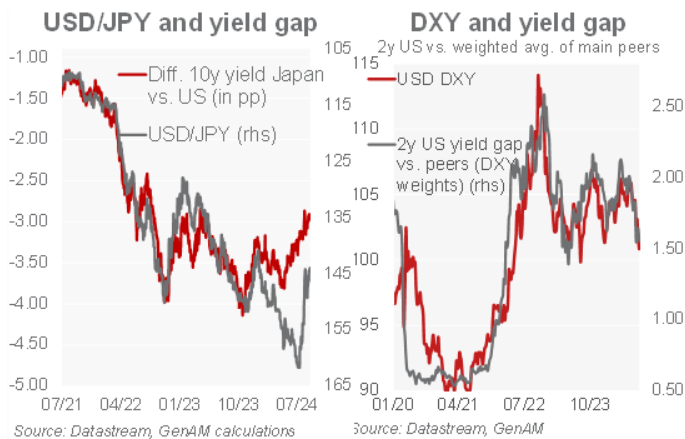
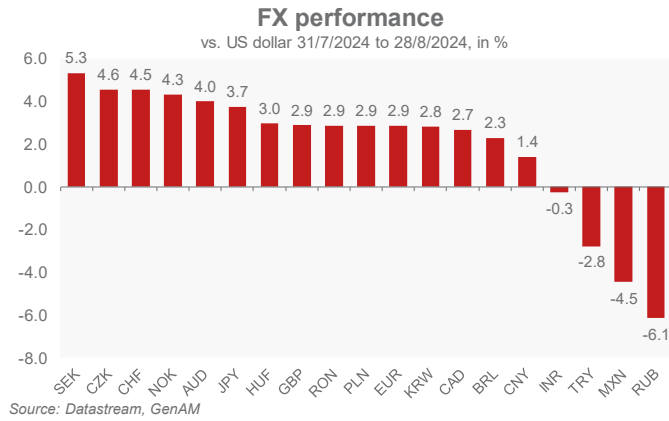


### Local debt: turning more attractive

The expected Fed rate cuts and the US slowdown form a more supportive environment for EM local debt. Combined with a continuous decline in inflation, it provides EM central banks more room to ease, especially in Asia. After the rapid USD weakening, we still expect most of the return to be driven by the rate component rather than by FX. Geopolitics, the US elections, and past losses will dent the appetite for carry trades. Local factors in Mexico and Turkey still require a high-risk premium. At the region level, Asia rates have turned more attractive and we see value in EMEA rates.

## Currencies

Thomas Hempell



- The yen's sharp rise over August is set to flatten out near term, but we see more upside in the medium term on closing valuation gaps and Japan's opposed monetary policy vs. the USD.
- Recent USD weakness may have gone too far as markets have started to price in too fast and deep rate cuts by the Fed.
- After the euro's ascent in August, a partial EUR/USD reversal looks likely even if this may later give way to more structural USD depreciation pressures into 2025 over the course of Fed rate cuts.

Sharp bouts of volatility shook FX markets in August as US recession worries and hawkish signals by the BoJ sent the Japanese yen soaring and undermined global carry trades. High-yielding currencies have suffered (including the USD) while low yielders soared (incl. JPY, CHF but also several Asian EM FX). Even following its recent bounce, the yen remains cheap. Yield differentials with the US – a strong USD/JPY driver over the past years – alongside an opposed monetary policy outlook point to further appreciation potential for the yen (mid left chart). We mark to market our 6- and 12m forecasts to 140 and 135 USD/JPY.

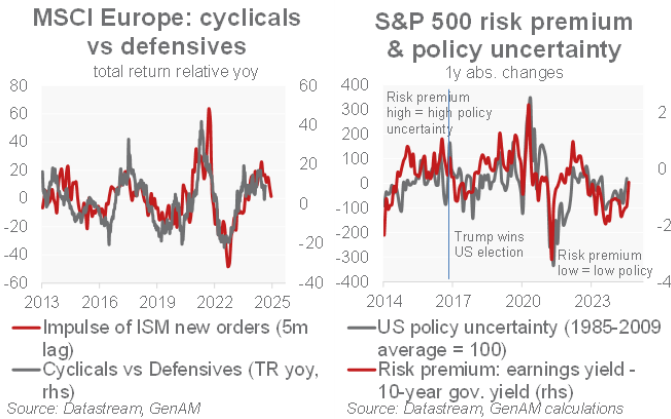
Short term, however, we are reluctant to write off the USD prematurely. US inflation progress (sustainable) and US recession worries (overdone) have compressed US rates expectations too much in both speed and total amount of rate cuts (see US part). With the rate gap between the US and major peers remaining the key driver for the broader USD, the oversized slump in US rates expectations (2y US yields down by >80bp since early July) has eroded the yield gap vs. major peers by about 40bp since early July and facilitated a 5% drop in the USD DXY (mid right chart). Looking ahead, a modest reversal in Fed easing expectations over the coming weeks could help a modest recovery of the USD.

### EUR/USD bounce looks stretched

This holds in particular for the EUR/USD, whose almost 3% rise over August has overshot values implied by key financial market drivers (bottom left chart). This EUR/USD move from undervaluation into overvaluation over summer may be partly attributed to US election odds. The USD-bullish Trump trade has been eroded as Democrat's new candidate Harris entered the race (bottom right). To some further extent, however, it may also reflect an overreaction amid the unwinding of long USD carry trades. Persistent economic and political uncertainties in the euro area are unlikely to abate quickly, also making the recent EUR/USD bounce looking overdone in the short term.

## Equities

Michele Morganti and Vladimir Oleinikov



- Market bounced back after overreaction to recession fears, albeit global macro surprises remain negative. Positioning is also still above average, while politics represent concerns, both probably triggering an enduring high volatility.
- Against this backdrop, we remain constructive on equities. Monetary policy is more market friendly, and both financial conditions and credit cycle should improve. Net cash-flow is also positive, together with market technicals: very low IPOs and positive buybacks. Ex-US, valuations are attractive, too.
- We see a TR of 7% for ex-US markets and 4% for the US in 12 months, and a fundamental-driven rotation out of US IT into other sectors and ex-US countries. We are neutral on US IT, China (new), and EMU vs. US. OW EU ex-EMU, EU small cap, UK FTSE 250, India, Korea and Japan.
- EU sectors: OWs: Banks, Energy, Food, Defence, Materials, Semis, Transportation, Utilities. UWs: Autos, Cap. goods ex. A&D, Comm. Prof. Svs., Media, Retailing, Software, and Telecoms.

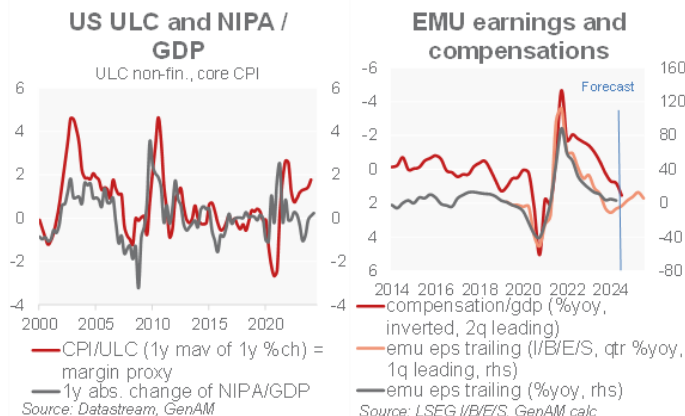
### Analysis of the median stock: Q2 2024 reporting season

Median stock	Earnings Growth		Sales Growth		margin trend *		availability
	Q1 2024	Q2 2024	Q1 2024	Q2 2024	Q1 2024	Q2 2024	
S&P	7.0 %	8.1 %	3.4 %	4.7 %	3.6 %	3.4 %	95.4 %
Stoxx	1.3 %	4.9 %	1.4 %	2.7 %	(0.1) %	2.2 %	76.7 %
Euro Stoxx	1.7 %	3.5 %	0.7 %	2.3 %	1.0 %	1.2 %	85.7 %
Topix	16.3 %	11.9 %	5.0 %	5.7 %	11.3 %	6.1 %	95.7 %

Median stock	Earnings Surpr		Sales Surpr		margin trend *		availability
	Q1 2024	Q2 2024	Q1 2024	Q2 2024	Q1 2024	Q2 2024	
S&P	5.2 %	4.2 %	0.8 %	0.4 %	4.4 %	3.9 %	95.4 %
Stoxx	4.0 %	2.7 %	0.2 %	0.6 %	3.8 %	2.1 %	76.7 %
Euro Stoxx	4.6 %	4.1 %	0.3 %	0.6 %	4.3 %	3.5 %	85.7 %
Topix	12.4 %	10.7 %	0.7 %	1.4 %	11.7 %	9.3 %	95.7 %

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



In a still constructive equity context, the market carried some risks before the recent slump started. We refer to high positioning, negative macro surprises, tight US valuation and French politics. Additional headwinds became then unbearable: increased US recession fears, reversal of yen carry trade, doubts about returns on Big tech's huge AI capex and, finally, poor consumer-related firms' results in 2024 Q2.

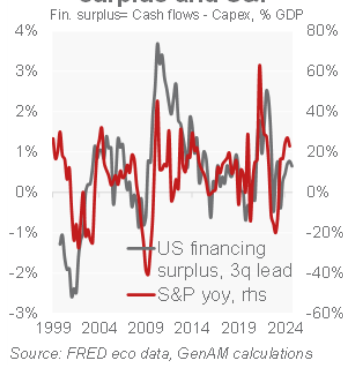
That said, markets were able to recover quickly as subsequent news flow helped to contain slowdown fears. In addition to this, both the credit cycle and M2 look bottoming and, more importantly, central banks are increasingly on the investors' side, triggering better financing conditions ahead. The market is expecting nearly 50 bps of additional cuts till January '25, when compared to expectations on July 12th (when a soft US CPI was released). Such monetary policy's "put option" helps to justify our slight OW stance on equities as it should be able to offset some of the remaining risks, including likely high volatility ahead (both VIX and bond-related one, MOVE). Indeed, political uncertainty is increasing, representing headwinds for the equity risk premium. EU politics, global geopolitics, imminent US elections, and euro area (EA) plus Chinese macro weakness are all sources of concern. Lastly, confidence indicators are weaker, while institutional investors' positioning on equities and the US retailers' ones on Tech still lie above average. Our OW stance on equities is also derived from our constructive view on fundamentals. The Q2 reporting season showed a positive earnings surprise of nearly 5% both for 13

## Equities

### Global liquidity and MSCI World



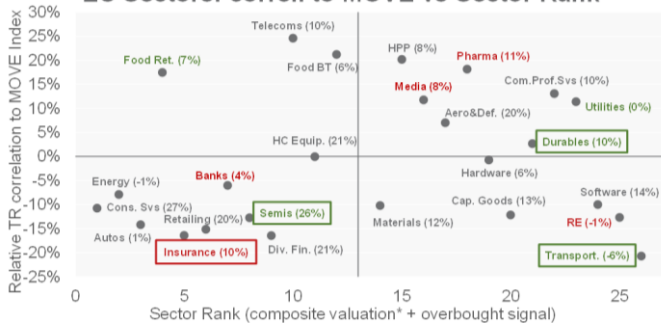
### Corporate financing surplus and S&P



as of 27/08/2024	2024 EPS growth	2025 EPS growth	12m fwd PE	2025 PE	Avg 12m fwd PE since 1995
<b>S&amp;P 500</b>	10%	15%	20.7	20.6	16.8
<b>SPX (median stock)</b>	7%	11%	18.8	18.1	17.5
<b>Mag. 7 (median stock)</b>	32% →	14%	30.8	29.4	26.2
<b>SPX 493 (median stock)</b>	7% →	11%	18.6	17.9	17.3
<b>AI Basket 175 (ex. Mag 7)</b>	8% →	14%	20.5	19.9	17.0
<b>MSCI US IT</b>	19%	21%	28.3	28.4	21.4
<b>MSCI EMU</b>	2%	10%	12.3	12.7	14.4
<b>MSCI EUROPE</b>	4%	10%	13.2	13.5	14.5

PE are Price / 12m fwd EPS and 2025 YE EPS. Median values are computed on the individual components of the index or index subset, considering current S&P 500 members. Values for the indexes are computed on consensus index estimates. AI Basket 175 is a proprietary basket which includes 175 AI-related companies (60% US, 40% RoW), value refer to the median stock.  
 Source: Datastream, IBES Estimates, GenAM calculations

### EU Sectors: correl. to MOVE vs Sector Rank



\*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 28/08/2024

the US and EMU. The beat was particularly widespread through US sectors (80%), less so for EMU (60%). Thirty five percent of EU firms increased their guidance, against 25% which lowered it. In the US, firms are still reluctant to spend, while noticing a building pent-up demand. Destocking looks to be over albeit restocking is still weak. Client activity seems to be postponed but not cancelled and companies on average see no signs of recession. They seem confident of a pick-up after more clarity emerges on the macro and politics front: inflation and high rates being negative for firms, short term, together with political uncertainty (US and international one). Optimism among international mid-market business leaders (last Grant Thornton's International Business Report) has also rebounded to pre-COVID levels, with a record 71% of leaders being optimistic about the next 12 months. Furthermore, US unit labour costs look supportive for corporate margins and US GDP figures are not falling over the cliff. G4 Cash Flow minus Capex spread remains high and positive, net equity issuances low, while buybacks linger. We expect a decent earnings growth ahead albeit below consensus in 2025. Finally, ex-US valuations are not expensive, and we see a TR of around 7% for ex-US markets and 4% for the US over 12 months. In conclusion, fundamentals remain reasonably strong for the time being and we still believe in a fundamental-driven rotation out of US tech into other sectors and ex-US countries. Tech's relative growth is falling, and investors have reason to look for assets that deserve a rebound in growth, lower positioning and valuation. We remain neutral on US IT. Our ML Nasdaq model has reached a deep undervaluation level, and the PE adjusted for the expected EPS growth looks fair. We remain neutral on EMU vs. the S&P 500 as a weaker EMU macro and lower EPS growth perspectives are partly offset by a peaking EMU undervaluation. Despite attractive China's valuations, we became neutral on China due to deflationary macro and lack of policymakers' clear view to address the economic challenges. OW EU ex-EMU, India, Korea, and Japan. We also OW EU small cap and UK FTSE 250.

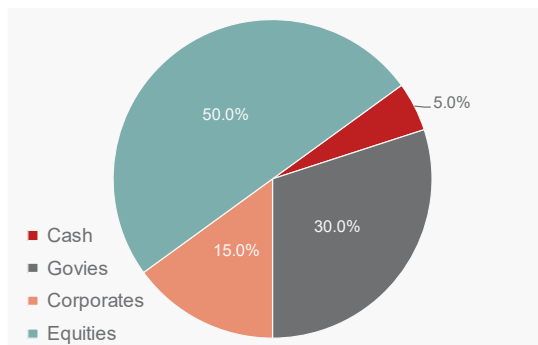
### European sector allocation

EU is still in goldilocks phase (declining CPI; increasing global leading indicator) but gradually shifting to slow growth, with also the ISM impulse pointing south. Our references are low relative valuation (and positive ML models), negative sensitivity to MOVE and contained cyclicality. We buy the dip on semi (strong ML-model signal). We reduce Transportation and Auto and reduce the UW on Telecoms & Media. We add a small OW in Food Retail (valuation), while we marginally decrease banks due to risks coming from lower yields and performance in a slow growth phase. Within Cap. Goods, we increase A&D reducing the rest of the sector (valuation, long-term trend).

## Asset Allocation

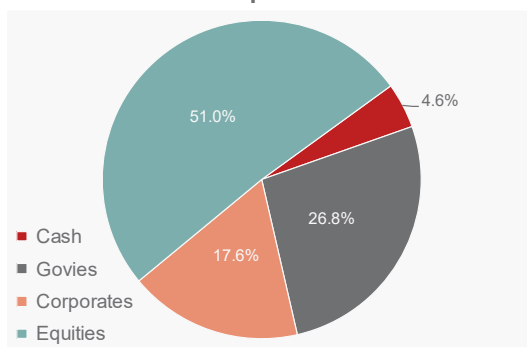
Thorsten Runde

**Benchmark**



Source: GenAM

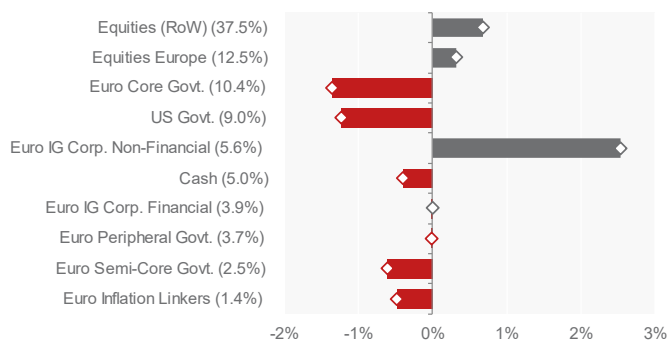
**Modelportfolio**



Source: GenAM

**Active Positions**

TOP 10 Benchmark Constituents



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

- In August 2024 (28.08.24) almost all our actively covered asset classes rendered positive returns or at least were very close to the zero line.
- The bottom of the performance ranking is held by the MSCI Asia Pacific (-2.0%) and EA Infl. Linkers (-0.1%).
- The top is dominated by long-dated US Treasuries (+2.3%) and EM Govies (+1.8%).
- EA HY Credit outperformed EA IG by +66 bps on average. Within IG, Financials were moderately superior to Non-Financials (+7 bps).
- After the turmoil at the beginning of the month risk assets recovered and made their way back into normal territory. Looking ahead, we acknowledge risks stemming from the political imponderables in France and, to a lesser extent, in Germany which could weigh on the economic sentiment.
- For the time being, we confirm our prudent tilt towards risk assets (Equities and EA HY). We keep our OW in EA IG non-fin and stay neutral in EA IG fin. With respect to duration, we keep a moderately long stance.

In August 2024 (28.08.24) our model portfolio slightly underperformed its benchmark (-0.6 bps). The overweight positions in EM Govies (+0.9 bps) and the MSCI North America (+0.3 bps) as well as the underweight in EA Infl. Linkers (+0.3 bps) proved most rewarding. On the other side, the overweight in EA IG Non-Fin (-0.8 bps) and underweight in long-dated US Treasuries (-0.7 bps) were most painful. The slump in risk-assets particularly hurt the portfolio in the first days of the month (-10.7 bps) but it also benefitted to a comparable amount from the following recovery.

With an ongoing retrieval of risk-assets and the general economic setup basically unchanged compared to the last month, we confirm our prudent tactical tilt towards risk. Acknowledging the political situation in France but also in Germany we refrain from expanding our risk position for the time being as market sentiment might be burdened.

### Still keep the prudent pro-risk tilt

Thus, we just confirm our moderate overweight positions in Equities and EA HY. We keep our OW in EA IG non-fin as our largest active position while staying neutral in EA IG fin. We stick to our preference for long-dated over short-dated bonds, thus maintaining our moderately long active duration stance.

## Forecasts

### Macro Data

Growth <sup>1)</sup>	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	forecast
US	2.5	2.6	0.3	1.8	0.1	2.1
Euro area	0.5	0.7	- 0.0	1.3	- 0.1	1.2
Germany	- 0.1	0.0	- 0.2	1.0	- 0.1	1.5
France	0.9	1.1	0.2	1.1	- 0.1	1.6
Italy	0.9	0.8	- 0.1	0.9	- 0.1	0.7
Non-EMU	0.2	0.9	0.0	1.4	0.0	1.9
UK	0.1	0.8	0.0	1.1	0.0	1.9
Switzerland	0.8	1.4	0.0	1.5	0.0	1.8
Japan	1.9	0.2	0.1	1.2	- 0.1	0.8
Asia ex Japan	5.2	5.0	- 0.1	4.8	0.1	4.6
China	5.2	5.0	0.1	4.5	0.1	4.1
CEE	2.9	3.2	0.1	2.8	0.2	2.8
Latin America	2.2	1.4	0.0	2.3	0.0	2.5
<b>World</b>	<b>3.0</b>	<b>3.0</b>	<b>0.0</b>	<b>3.0</b>	<b>0.1</b>	<b>3.0</b>

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

Inflation <sup>1)</sup>	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	forecast
US	4.1	3.1	- 0.0	2.4	0.1	2.3
Euro area	5.5	2.5	0.1	2.2	0.2	2.0
Germany	6.0	2.4	0.1	2.3	0.2	2.0
France	5.7	2.4	0.0	2.0	0.2	2.0
Italy	5.6	1.3	0.1	1.7	- 0.0	1.8
Non-EMU	6.5	2.4	0.0	2.0	0.0	2.0
UK	7.4	2.6	0.0	2.3	0.0	2.1
Switzerland	2.2	1.4	0.1	1.1	0.0	1.2
Japan	3.3	2.3	- 0.2	2.0	- 0.1	1.7
Asia ex Japan	2.1	1.9	- 0.0	2.3	- 0.0	2.6
China	0.2	0.4	- 0.2	1.3	- 0.2	2.0
CEE	20.4	19.9	0.6	11.7	1.0	8.4
Latin America <sup>2)</sup>	5.1	4.2	0.0	3.7	0.0	3.0
<b>World</b>	<b>5.2</b>	<b>4.1</b>	<b>0.0</b>	<b>3.2</b>	<b>0.1</b>	<b>2.9</b>

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	5.00	4.54	4.75	3.78	4.25	3.17
Euro area	3.75	3.50	3.17	3.25	2.69	2.50	2.13
Japan	0.25	0.50	0.28	0.50	0.36	0.75	0.48
UK	5.00	4.75	4.65	4.50	4.30	4.25	3.72
Switzerland	1.25	1.00	0.77	1.00	0.65	1.00	0.57
<b>10-Year Gvt Bonds</b>							
US Treasuries	3.83	3.95	3.81	3.90	3.81	3.80	3.84
Germany (Bunds)	2.26	2.30	2.25	2.35	2.25	2.35	2.26
Italy	3.63	3.75	3.69	3.80	3.73	3.85	3.84
Spread vs Bunds	137	145	144	145	149	150	157
France	2.98	3.05	2.97	3.10	2.98	3.15	3.04
Spread vs Bunds	72	75	72	75	74	80	78
Japan	0.89	0.95	0.97	0.95	1.03	0.90	1.12
UK	3.97	4.05	3.96	4.00	3.96	3.95	3.97
Switzerland	0.46	0.50	0.41	0.50	0.40	0.50	0.39

\*3-day avg. as of 28/08/24

\*\*ICE BofA (OAS)

Credit Spreads**	Current*	3M		6M		12M	
		Forecast	Fwd	Forecast	Fwd	Forecast	Fwd
EA IG Non-Financial	110	105		100		100	
EA IG Financial	122	120		120		115	
EA HY	355	350		350		350	
EM Sov. (in USD)	271	265		255		255	
<b>Forex</b>							
EUR/USD	1.12	1.09	1.12	1.11	1.12	1.13	1.13
USD/JPY	144	144	142	140	141	135	138
EUR/JPY	161	157	160	155	158	153	157
GBP/USD	1.32	1.30	1.32	1.31	1.32	1.31	1.32
EUR/GBP	0.84	0.84	0.85	0.85	0.85	0.86	0.86
EUR/CHF	0.94	0.95	0.94	0.97	0.93	1.01	0.92
<b>Equities</b>							
S&P500	5,612	5,665		5,665		5,670	
MSCI EMU	163.3	165.5		167.5		167.5	
TOPIX	2,678	2,700		2,740		2,775	
FTSE	8,339	8,410		8,485		8,550	
SMI	12,333	12,590		12,815		12,790	

### Forecast Intervals



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



 **Imprint**

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