GENERALI ASSET MANAGEMENT

Market Perspectives

Recovery, not reflation

June 2024

GenAM Macro & Market Research

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

- **We expect the combination of a mild global recovery and a continued disinflation trend to persist into the summer. The ECB is set deliver its first rate cut in June, with the Fed likely to follow in September.**
- **This backdrop tilts the outlook for core yields mildly to the downside. Solid earnings and the outlook of lower rates may keep risk sentiment underpinned.**
- **That said, an advanced equity rally, depressed volatility and elevated investor positioning in risk assets reflect a very high degree of market optimism that keeps the risk of temporary setbacks high.**
- **We maintain a neutral stance on Equities and HY Credit and concentrate our tactical overweights in the safer buckets of risk assets, including IG Credit and Southern European debt, at the expense of Cash and short-dated core bonds. We keep a moderate long duration stance across Fixed Income classes.**

Content

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Global View – Recovery, not reflation

Thomas Hempell

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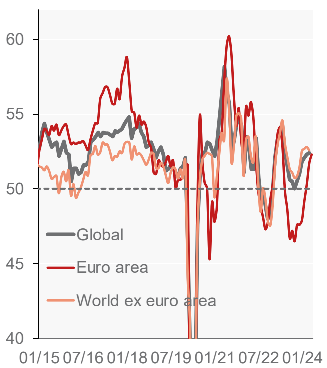
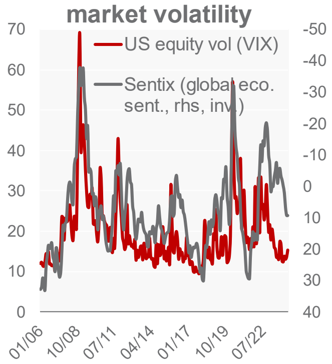
We had flagged excessive rates pessimism last month (The last mile of Fed repricing), and our inclination towards duration paid off in the first half of May with 10y UST yields falling by over 30bp before paring most of the move later in the month; Bund yields are even somewhat higher on the month. Correlation between stock and bond prices has switched back to positive in Q2, and the equity rally (through the earnings season) is showing signs of fatigue.

Global composite PMIs



Source: Datastream, GenAM

Econ. sentiment and market volatility



Source: Datastream, GenAM

Looking ahead, we expect the market-friendly setting of a mild global recovery, a softish US landing and continued disinflation to dominate. The global composite PMI has risen further, largely thanks to a marked improvement in the euro area (left chart). Global manufacturing may still be in the doldrums, but recovering trade, bottoming new orders and soaring metal prices point to some pickup in global industrial production. The US is headed for a solid Q2 expansion above 2% saar, but the buoyant pace of 2H24 has moderated and we anticipate a softish landing over summer. China is getting more serious in stopping the downward spiral in the real estate sector with bolder policy measures. Admittedly, a lot of global optimism is being discounted. Solid data have failed to impress markets, with surprise indices even falling into the red for the US. But the overall picture points to a gentle global growth backdrop ahead, with consumption underpinned by resilient labour markets.

Base effects will make annual inflation readings bumpier into H2. But we remain confident that the gradual disinflation trend remains supported by a cooling labour market and lagged rent disinflation in the US and easing wage pressure and pricing power in the euro area. While we have reduced our rate cut forecasts by 25bp for 2024 for both the Fed (-50bp) and the ECB (to -75bp), markets lean towards even more reluctant central banks. The ECB will lead the way with a (well telegraphed) cut on June 6 and – while refraining from explicit forward guidance – may reassure markets that further cuts are in the pipeline over subsequent quarters.

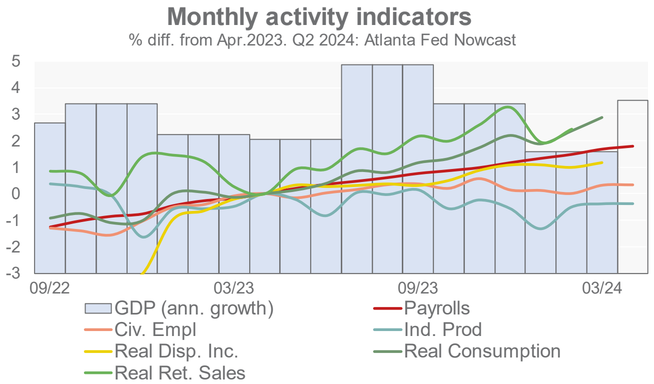
10-Year Gvt Bonds	Current*	3M	6M	12M
US Treasuries	4.49	4.45	4.35	4.20
Germany (Bunds)	2.57	2.50	2.45	2.35
Credit Spreads**				
EA IG Non-Financial	105	105	110	100
EA IG Financial	110	120	120	110
Forex				
EUR/USD	1.09	1.07	1.09	1.10
USD/JPY	157	155	151	145
Equities				
S&P500	5305	5280	5300	5350
MSCI EMU	168	168	171	172

**3-day avg. as of 28/05/24 **ICE BofA (OAS)*

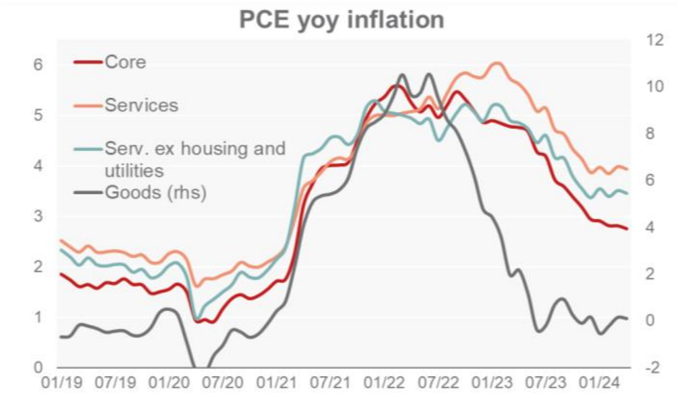
Amid the tug of war of decent activity data on the one hand and receding inflation and forthcoming rate cuts, we see the outlook for yields tilted mildly to the downside, if not in a linear fashion. With markets still strongly focussed on upcoming inflation numbers and the risk of temporary disappointment elevated, we favour an only moderate long duration exposure. The resilient corporate earnings outlook and prospects of lower rates should also buffet broader risk sentiment. That said, given the extent of the past rally, elevated valuations, crowded positioning and very low risk premia and volatility (right chart), we keep for now a neutral stance on the riskier end of our asset class universe (Equities, HY Credit). We focus our tactical overweights on higher quality spread products including IG Credit and Southern European sovereign bonds, at the expense of underweights in shorter-dated Core bonds and Cash.

United States

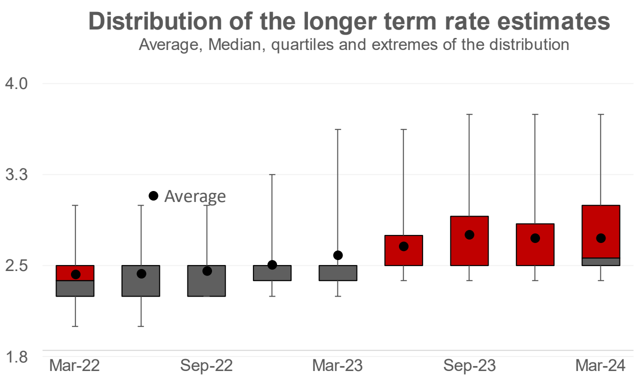
Paolo Zanghieri



Source:BLS, BEA, Fed, Refinitiv, GenAM



Source:BEA, Refinitiv, GenAM



Source:Federal Reserve Board, GIAM

- **Growth is set to rebound in Q2 after the inventory-driven Q1 slowdown. We raised to 2.6% our growth forecast for 2024 and to 2.2% for 2025.**
- **After the Q1 disappointment core inflation is now declining on the back of cooler wages. But core PCE inflation will end the year still at 2.7% yoy.**
- **Sluggish disinflation and a resilient labour market are consistent with two rate cuts this year (Sept./Dec.). The FOMC is likely to revise slightly further up its long-term rate estimate.**

Short term indicators and nowcasts point to a sizeable rebound of growth in Q2, as domestic demand keeps rising at a 2/2.5% annualised rate. Given the underlying strength of household balance sheet, we revised slightly up our growth forecast for this year, to 2.6%. Afterwards, the economy should continue to growth at around 2% per year.

The April CPI numbers provided some relief after the Q1 disappointment. Core inflation stabilised at 3.8% yoy, the ex-housing services component was up markedly, but this is mostly due to some specific items, like motor insurance, up 22% yoy. Core PCE inflation eased marginally in April, and should continue to decline very gradually from the current 2.8% yoy, and end the year at 2.7% yoy .

Job creation slowed down to 175k in April (vs. a 276k Q1 average), but hiring and jobless claims have not moved much and remain at historically very low levels. Wage growth is moderating in Q1, the Employment cost index grew by 4.2% yoy much slower than the 5.1% yoy peak seen in 2022. The strong contribution of immigration to labour supply is compressing wage growth and will boost trend growth for at least a couple of years.

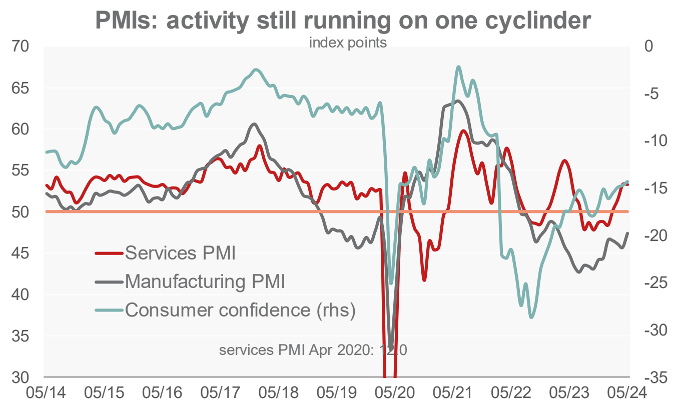
First rate cut in September. Watch for higher neutral rate

The May Fed meeting minutes, turned out to be more hawkish than the press release and the Q&A session. Fed-speaking since their release stressed again the need for patience, as the FOMC needs a long string of positive inflation data to be confident and start easing. We reaffirm our call of two rate cuts in H2, in September and December, followed by another 100bps of easing in 2025. Recently the CBO has revised up trend growth to just above 2% until 2026, on the back of stronger immigration and the cyclical increase in productivity. While not structural, we think that higher growth will be factored in by the FOMC. Specifically, it will add to worries about large fiscal and external imbalances in raising the estimate for the neutral rate. It was lifted from 2.5% to 2.6% in March, but the FOMC views are still shifting, and more upward corrections are likely.

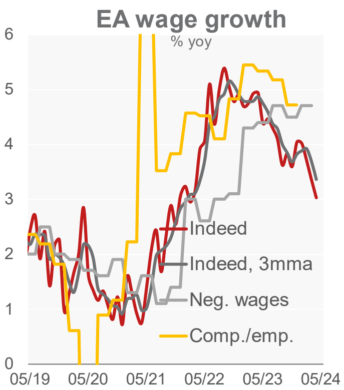
Euro Area

Martin Wolburg

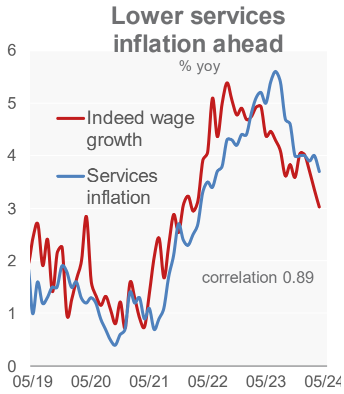
- **Sentiment improved further, backing our view that euro area activity is lastingly back into expansion. We lifted our 2024 growth forecast to 0.8% yoy.**
- **In May inflation rebounded to 2.6% yoy. Q1 wage growth was strong but we continue to look for easing underlying price pressure.**
- **The ECB will cut rates by 25 bps on June 6. We see this as the start of an easing cycle and think that markets do not sufficiently price the extent of future rate cuts.**



Source: GenAM, Datastream



Source: Datastream, indeed, GenAM



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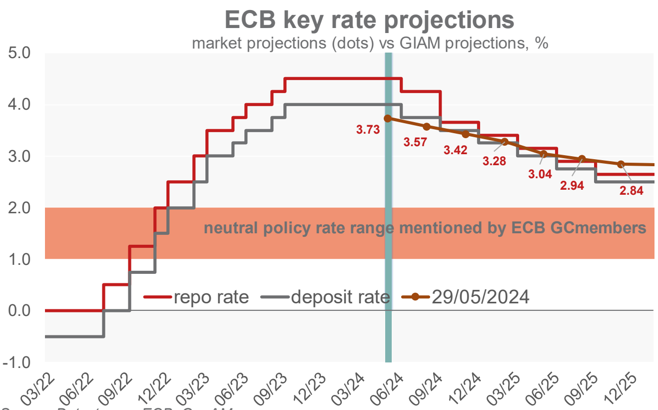


Source: Datastream, ECB, GenAM

In May, our view that the euro area has embarked on a recovery trajectory gained further support. Sentiment advanced again with the composite PMI's increase (up to 52.3) based on a further brightening of forward-looking subcomponents, better manufacturing mood and ongoing solid employment growth. With the global manufacturing recession being overcome and real income rising we expect the pace of the surprisingly strong Q1 expansion (GDP +0.3% qoq) to be maintained. As a result, we lifted our 2024 growth forecast to 0.8% (from 0.6%) which is above the current consensus of 0.5%.

Markets too cautious on the ECB

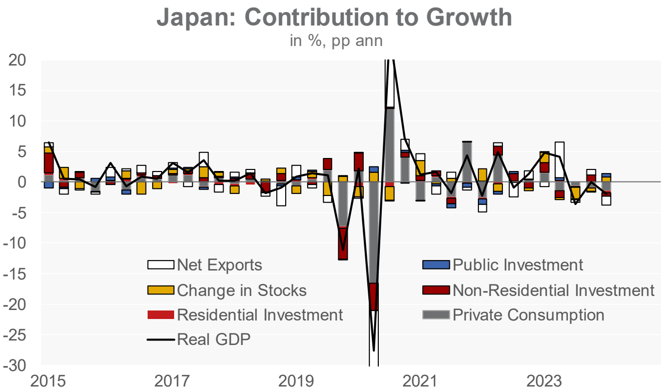
Markets remain concerned that the last mile in the fight against inflation forces central banks to ease rates only reluctantly. May (flash) inflation bounced back to 2.6% yoy, from 2.4% yoy. This related to special factors like base effects from energy prices, but also, and concerning, to the rebound in services inflation. ECB Governing Council (GC) members like Schnabel and de Guindos warned about the evolution of wage growth as an upside risks to inflation. Q1 German negotiated wages (+6.2% yoy) hinted in that direction and on the euro area level Q1 negotiated wage growth strengthened to 4.7% yoy.

That said, the German data are exceptionally boosted by one-off tax-free lump sum inflation payments to compensate for the past inflation spike; wage growth in France, Italy and Spain was only at around 3% yoy. Indeed wage growth indicator that relies on job postings signals moderating wage dynamics at the outset of Q2 (to 3.0% yoy in Apr.). The ECB's proprietary tracker suggests that negotiated wage growth averages about 4% in 2024 (from 4.5% in 2023). Services inflation will then moderate over time.

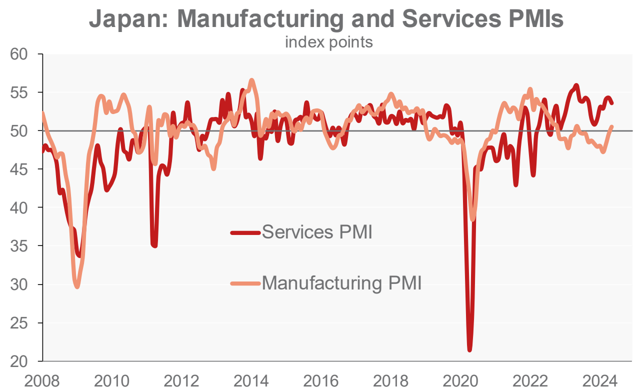
Concerns about wage growth are probably overdone. But given what GC members' said, we think that the ECB cuts only once a quarter from June 6. Therefore, markets have gone too far by scaling back its 2024 cumulative ECB rate cuts to only about 60 bps.

Japan

Christoph Siepmann



Source: Datastream, GenAM calculations



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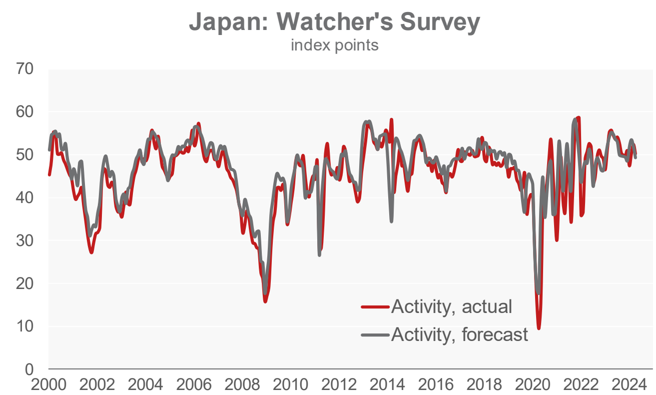


Source:datastream, GenAM

- **Japan's Q1 GDP growth surprised on the downside, nurturing questions about the stability of private demand. In addition, private consumption sentiment indicators weakened.**
- **Fundamentally, this speaks for reluctance of the BoJ to tighten monetary policy. We see a rate hike by 25 bps in Q4. However, the weakness of the yen creates pressures so that the risk of an early action (also indirectly via reduced bond purchases) is increasing.**

Japan's preliminary GDP print surprised on the downside with a drop by 2% qoq annualized (ann) and -0.2% yoy. The reasons were a mix of one-off factors and weakness in domestic demand. Regarding the first, the external sector strongly suffered from a scandal in the auto sector (cheating of car engines to meet certain standards) which was also a major reason for the drop in industrial production in Q1 by 5.1% qoq. Regarding domestic demand, private consumption diminished by 2.7% qoq ann and private capex by 3.2% qoq ann. Compensation of employees dropped by 1.5% qoq ann (-0.9% yoy, the ninth yoy drop in a row). In addition, consumer confidence weakened again and the household activity outlook component in the in the Economy Watchers' survey dropped back in slightly contractionary territory (49.3 index points). Fundamentally, this should prompt the BoJ to be cautious to see the demand side of the demand-pull part of the positive wage-price cycle as guaranteed. However, recent higher than expected wage growth together with upcoming tax cuts should improve disposable income and thus should have a positive impact on private consumption over time. The manufacturing PMI also suggest that the one-off factors could largely run their cause.

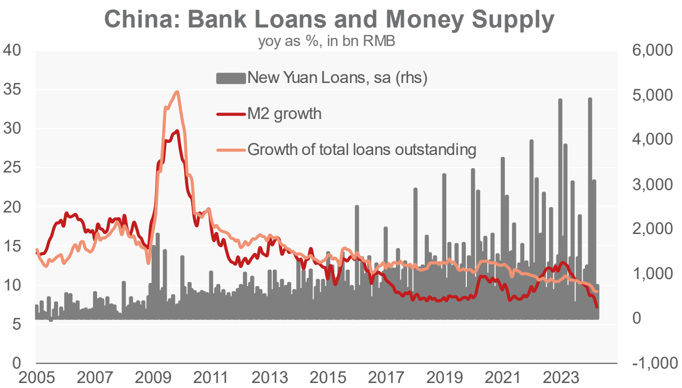
Yen weakness increases the risk of early BoJ action

Tokio headline inflation fell to1.2% yoy in May, while core-core inflation (ex fresh food & energy) lost 0.1 pp from last month to 1.7% yoy. Over the next months, inflation will become volatile as energy subsidies will be withdrawn. Import prices are on the rise again due to the weakness of the yen to the US-dollar. While this suggests inflation to reach 2.4% this year according to our forecast, and fulfills the BoJ 2% criterion, the inflation drivers are still cost-push factors. The BoJ always played down its role in supporting the yen. However, rising import prices also cut again in disposable income. Thus, the risk is rising for an earlier BoJ action. Markets already speculated about an indirect action by withdrawing some JGB buying. However, we would expect this only in a stealth way and stick to our view of a first rate hike in Q4.

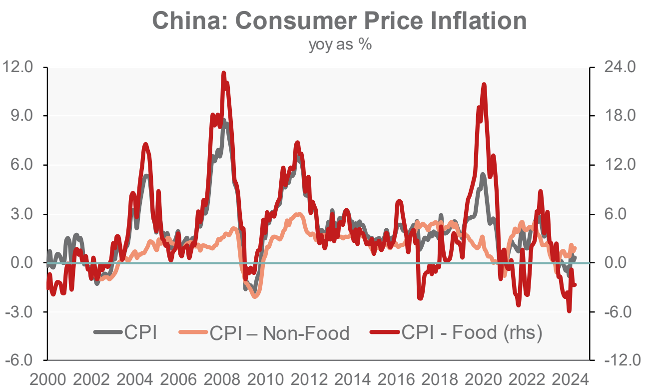
China

Christoph Siepmann

Source: Datastream, GenAM calculations



Source: Datastream. GenAM calculations



Source: Datastream, GenAM calculations

- **China's latest macroeconomic data set remained mixed. Beijing has set up the most encompassing real estate support measures, which will help China's L-shaped recovery.**
- **Geopolitical issues have heightened up with new US tariffs on imports from China and Beijing engaging in military drills around Taiwan.**

China's latest macroeconomic data set remained mixed. IP (6.7% yoy) surprised on the upside and the latest NBS manufacturing PMI even marginally improved, suggesting the sector to stay in expansionary territory. Exports stabilized (1.5% yoy) as negative base effects ebbed, and base effects will turn supportive over the next months. By contrast, retail sales (2.3% yoy) disappointed while housing data worsened. Regarding the latter, the government has announced the most encompassing property market stabilisation package so far. It targets demand, inventory and liquidity aspects of the problem. Markets responded a bit reluctant. Clearly, the funding for local governments to buy unsold homes and thus reduce the inventory of developers, supported by a PBoC relending program with a quota of RMB 300bn at an interest rate of 1.75%, looks underwhelming. Tackling liquidity stress at "selected" developers is already underway and will be further improved by the "white-list" project. Local governments to assist developers in disposing of idle land stock could increase their already high debt and suppress their funding. Nevertheless, measures to foster demand (removing the floor for mortgage interest rates, lowering the down payment ratio for first/second-time homebuyers to 15%/25%) is a step in the right direction. Whether this will be sufficient to overcome the biggest fear of home buyers, i.e to buy homes that will be finished only with long delays, is difficult to assess. Overall, we see the package to support the L-shaped recovery, but not to induce a quick turnaround. Money supply data dropped substantially but this was in part due to a government crackdown on interest arbitrage activities of large firms. CPI inflation is likely to remain soft. We expect GDP growth at 5% and CPI inflation at 0.4% in 2024. We see the PBoC to further cut the RRR by 25 bps around mid-year and a 10 bps cut in the MLF rate.

Geopolitical tensions on the rise again

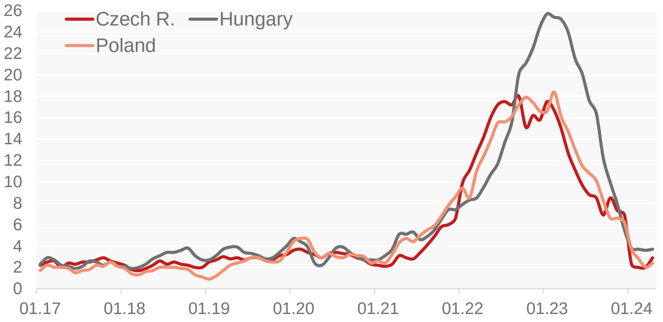
Geopolitical tensions rose markedly. China held military drills around Taiwan on alleged "separatist" rhetorics of the newly elected President. The US concluded to keep existing tariffs and add tariffs on products in "strategic sectors", mainly relating to clean energy, semiconductors, solar cells, steel/aluminum, and medical products. The direct impact on China is likely to remain limited, which is why we expect Beijing to retaliate in a limited and targeted way with some delay.

Central and Eastern Europe

Radomír Jáč

Headline inflation

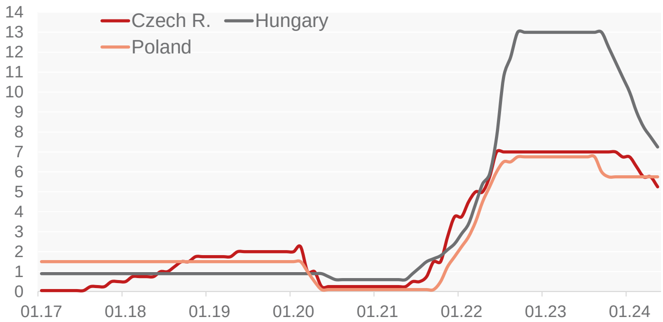
CE-3 countries (CPI yoy in %)



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	2.3	2.0
Central bank's key rate	7.00	6.75	3.75	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	6.25	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

- **Headline inflation in the CE-3 region increased in April but remained within the target range. Czech inflation should decline in May, while it may rise further in Hungary. Both central banks indicated slower paces of rate cuts for the coming months.**
- **Inflation in Poland also remained below the target, but further increases will follow in Q2 due to higher price caps of electricity prices. This likely leads the NBP to keep the key interest rate on hold at 5.75%.**

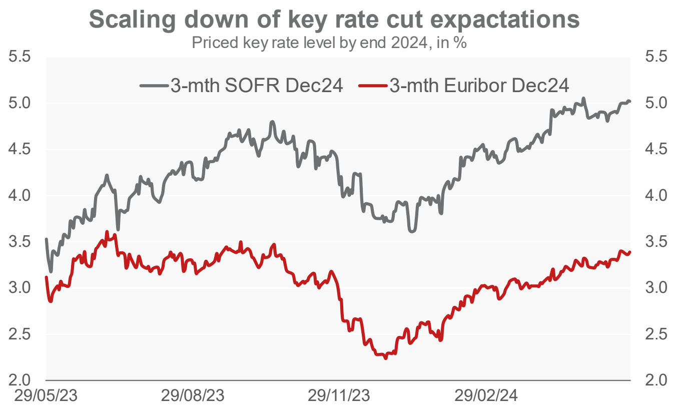
Headline CPI in the CE-3 economies reached its local low in Q1. While in April consumer price growth across the CE-3 strengthened, the annual headline CPI remained in the inflation target range in all three cases. Czech inflation rose from 2.0% to 2.9% yoy (vs. an inflation target set at 2% +/- 1 pp) due to non-core items and has likely moderated in May. In Hungary, headline CPI increased slightly from 3.6% to 3.7% yoy but base effects in non-core items are likely to lead to a further increase in Q2, temporarily above the target range set at 3% +/- 1pp. In Poland, inflation increased from 2.0% to 2.4% yoy in April (target: 2.5% yoy +/- 1 pp), as VAT rate on food was raised back from 0% to 5%. Headline CPI may test 4.5% in H2 due to an increase in electricity tariffs.

Czechia and Hungary will slow rate cuts to 25 bps steps

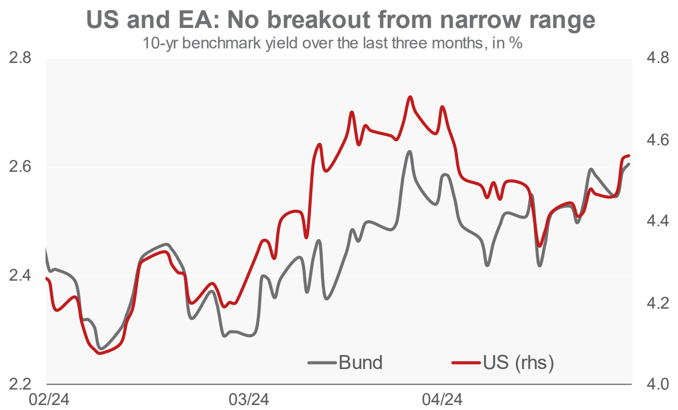
The inflation outlook provides room for further interest rate cuts in Czechia and Hungary but both central banks indicated a slower pace of monetary policy easing. The Czech CNB cut its key interest rate by 50 bps to 5.75% in May, which was the third cut by 50 bps in a row. However, the central bank sent a clear signal that it may switch to cuts by 25 bps already at its next policy meeting in late June. A new forecast, presented by the CNB, expects the key rate at 4% at the end of 2024 and at 3% by end-2025. In Hungary, the MNB cut the key rate by 50 bps to 7.25% in May. This was the same step as in April, but the MNB indicated it will slow the pace of rate cuts to 25 bps from June or July and will likely take a pause in the cutting cycle later in H2 to keep the key rate marginally above 6% at the end of 2024. The reason is to keep the real interest rate positive in the current inflation environment. The Polish NBP kept its key rate at 5.75% also in May and there does not seem to be any rate cut on horizon at least before Q4. The central bank does not want to cut rates in a situation where headline CPI will grow above the inflation target range in H2 due to changes in price caps for energy prices. We keep our view that the NBP may restart policy easing in Q4 with one rate cut by 25 bps.

Government Bonds

Florian Späte



Source: Bloomberg, GenAM



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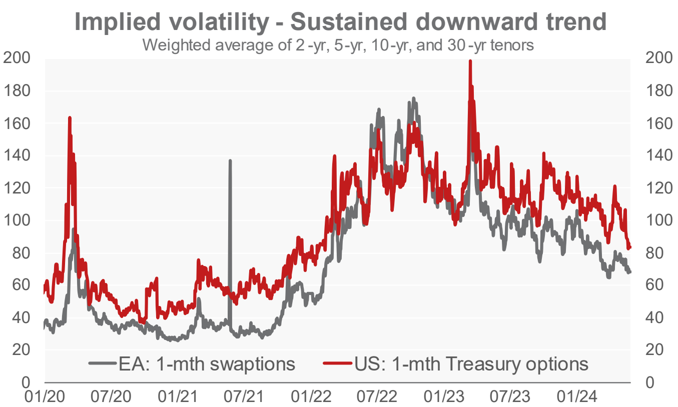


Source: Bloomberg, GenAM

- **While EA core yields continued to rise moderately in May, US yields moved slightly lower. Accordingly, the transatlantic yield spread narrowed noticeably across all tenors.**
- **Given our somewhat reduced key rate cut expectations and the positive economic data, we are also raising our yield forecast slightly. Nevertheless, our expectation that yields will tend to fall remains unchanged.**
- **EA non-core bond spreads have tightened slightly. The narrow trading range and the associated low volatility of spreads were particularly striking.**

May saw the relatively rare constellation of EA core yields moving upwards while US yields fell slightly. This led to a narrowing of the transatlantic spread across all maturities. This was due to a number of factors: market participants further reduced the extent of the expected key rate cuts this year. In the meantime, only 31 bps of reduction have been priced in for the Fed and 59 bps for the ECB. We are somewhat more optimistic and forecast 50 bps for the Fed and now 75 bps for the ECB (see EA section for details of our new forecast). In addition to the market's short-term key rate expectations, however, it is above all the medium-term assessments that are decisive for the development of yields. The US 5y3m OIS recently rose to 3.85% (from 3.20% at the end of 2023) and the EA 5y3m OIS to 2.55% (from 2.25%).

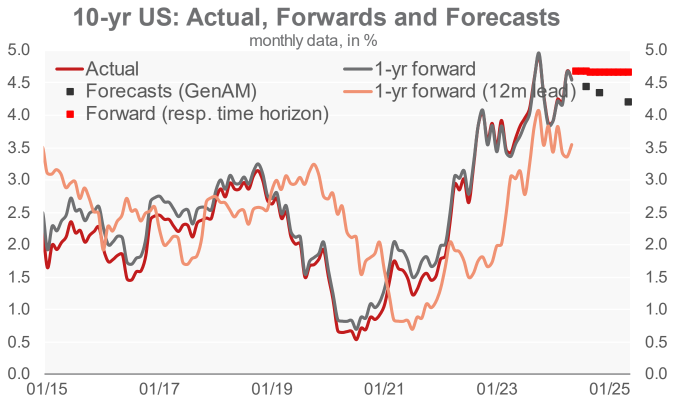
In addition, unexpectedly robust economic data (particularly from the EA) contributed to the rise in yields. Rising PMIs show that the economy is slowly recovering. At the same time, still elevated wage growth in the EA has made clear that the path to the target rate of 2% will remain bumpy. The market is correspondingly cautious about further ECB key rate cuts after the one in June that is close to be certain given recent Board members' comments.

Although EA core yields in particularly have risen recently, the trading range for US and EA core yields remains intact. We consider it likely that little will change in the next few weeks. On the one hand, Fed members have not ruled out the possibility of a further key rate hike (signalling at least a "higher for longer" stance) and the slow normalization of the US inflation is also continuing. On the other hand, US leading indicators show that the economy is losing momentum and, in particular, the labour market is gradually cooling. Moreover, EA inflation continues to decline and headline rate should approach the 2% ECB target rate in late summer.

We have recently repeatedly pointed out the tense fiscal situation in some EA countries. Given the high US yield level

Government Bonds

Florian Späte



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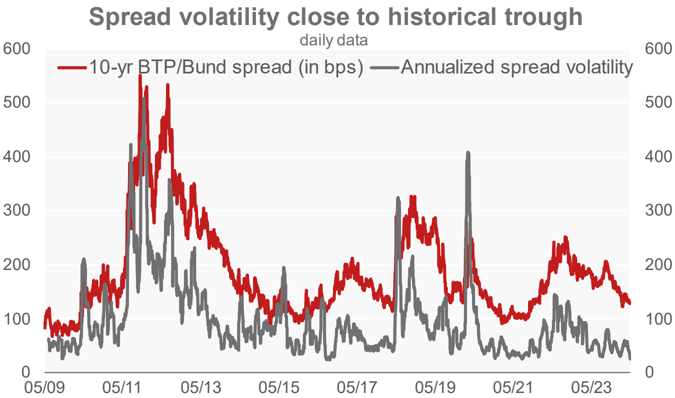

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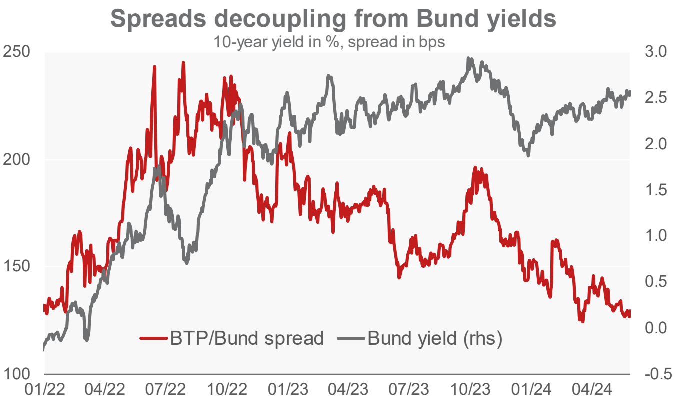


Source: Datastream, GenAM

in conjunction with a debt ratio of around 100% of GDP, the US government's interest expenditure will be above 3% in 2024. Almost 35% of marketable US debt will mature within one year. Hence, without a sustainable fiscal consolidation, the debt ratio will rise further and the fiscal leeway will become significantly smaller in the future.

Overall, we see (moderate) downside potential for yields in the next few weeks. On the one hand, yields have currently reached the upper end of the range and a lot of economic optimism has already been incorporated. On the other hand, our key rate expectations for 2024 are still below market consensus. If the correction in market pricing realizes as we expect, this should also trigger somewhat lower yields.

Over the next three months, we forecast 10-year US yields to fall to 4.45%. On a 12-month view they are seen to decrease to around 4.20%. This should then also contribute to falling 10-year JPY yields. Driven by rising US yields and the expectation that the BoJ will hike already in July and more vigorously than we expect they exceeded the 1% mark for the first time in over 12 years. The decline in 10-year EA core yields is likely to be somewhat smaller, to 2.50% (3-month) and 2.35% (12-month). This means that we are noticeably below the forwards, particularly for US Treasuries. However, using the example of 10-year US yields the chart shows that forwards correlate strongly with current yields and are only of very limited use as a forecast indicator.

Friendly environment for EA non-core bonds to continue

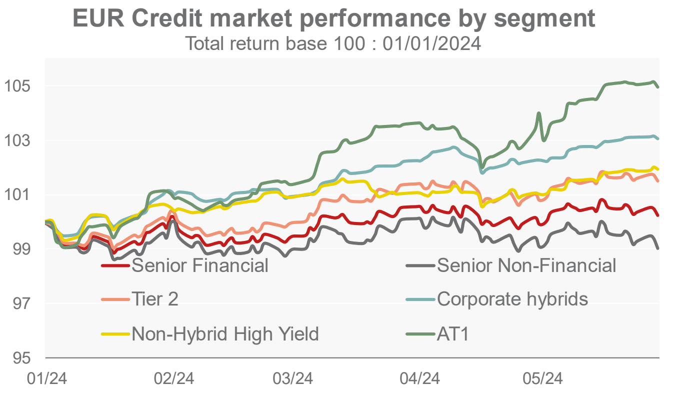
EA non-core bond spreads narrowed moderately in May. The most noticeable aspect was the tight trading range. Although there were days with stronger movements in one direction or the other, these were corrected after a short time. Given the lack of negative political news and the emerging economic recovery, the market environment remained favourable. Volatility (and particularly the spread volatility) continued to decline, and the increased core yields also had no lasting negative effect.

Stability should prevail in the next weeks. In our opinion, even an increase in votes for extreme parties in the upcoming European elections is largely priced and is unlikely to have a lasting impact on sentiment. Accordingly, the outperformance of EA non-core bonds versus core bonds is seen to continue.

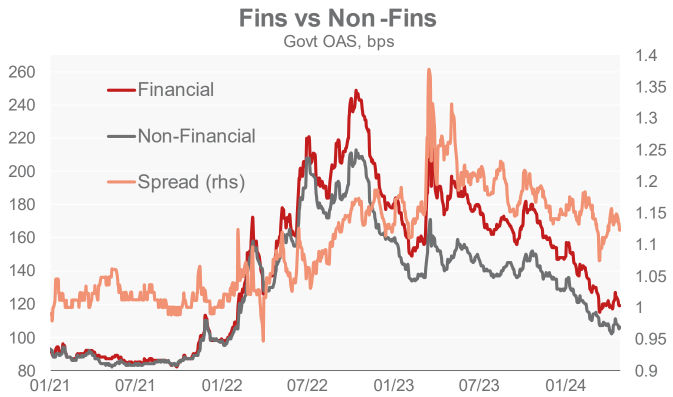
Although not imminent, the inclusion of EU bonds by leading index providers remains a subtle topic. Semi-core EA bonds look most exposed amid the still attractive valuation of EU bonds in connection with front-running by active portfolios.

Credit

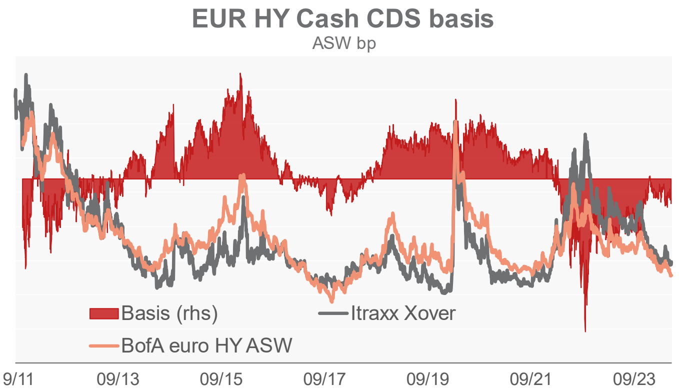
Elisa Belgacem



Source: Bloomberg, BofAML indices, GenAM



Source:Bloomberg, BofAML Indices, GenAM



ce:Bloomberg, BofAML Indices, GenAM own calculations

- **IG Carry remains attractive versus sovereign but spreads start to look tight from many angles. Hence we slightly trim our long IG.**
- **We keep our neutral view on HY due to stretched valuations and elevated expected supply mitigated by the elevated carry and improving default outlook.**
- **We believe CDS are expensive and offer an attractive entry point to implement hedging strategies.**
- **Despite tightness, we continue to like corporate hybrids and AT1 as yield enhancement alternatives.**

So far in 2024, significant issuance in the credit sector has alleviated some of the pressure on HY refinancing needs. However, HY issuance is expected to pick up in the second half of 2024. Default rates are likely to peak below 4% in Europe and 6% in the US by the end of 2023, supported by tight credit standards. From this point, these rates are expected to decline as financing conditions improve significantly.

Record high supply seamlessly absorbed

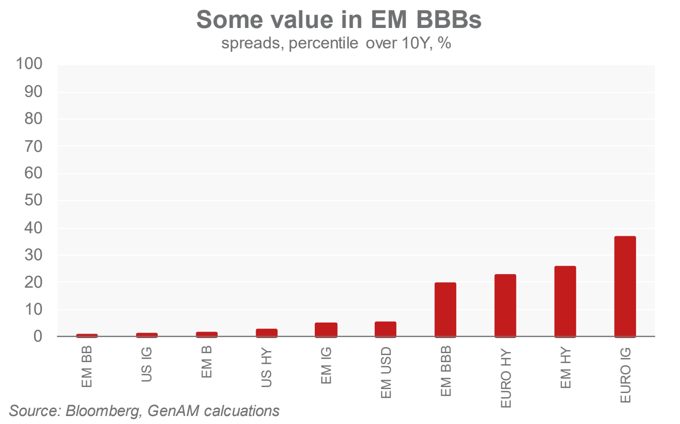
Corporate fundamentals are likely to face headwinds from here. This will lead rating agencies to continue to downgrade more companies than they would upgrade. However, the number of fallen angels moving from IG to HY should remain very limited. Therefore, despite tight valuations, the absolute yield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

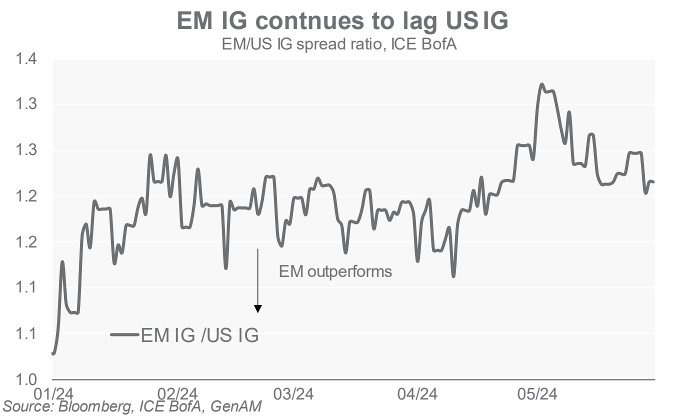
Valuations stretched but carry still attractive

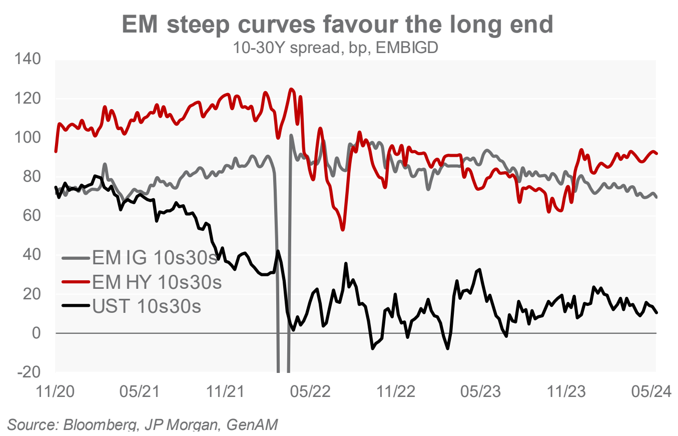
We expect IG spreads to hover around current levels in the coming months, keeping carry elevated. Valuation considerations also lead to a preference for Europe over the US. We prefer long IG and subordination risk to pure HY. With rates likely to plateau and uncertainty surrounding defaults in the HY space, a strategic move would be to play leveraged IG to enhance credit returns. 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







- **We turn overweight as the EM environment has been resilient. We maintain a low beta exposure.**
- **We lower our external debt spread forecasts and favour the long end of EM IG and BBBs.**
- **Local debt is less compelling, but returns will be positive.**

The EM environment has been more resilient than expected with more lights turning green. We have turned OW in our global allocation. Indeed, EM growth has been reaccelerating in LatAm and CEE countries while the China real estate supportive measures have partially alleviated concerns. Moreover, the US economy resilience and the prospects of lower DM rates are strong anchors for EM fixed income Arguably, risks are more symmetric with a higher chance for US rates to move upward. However, as long as it is driven by growth expectations EMs will be immune. Thus, globally, we continue to maintain a low beta exposure and favour relative value trades. We also maintain a neutral stance for external debt over local debt, but the slowdown in EM disinflation and the USD strength makes EM local less attractive.

External debt: value in the long-end of BBBs

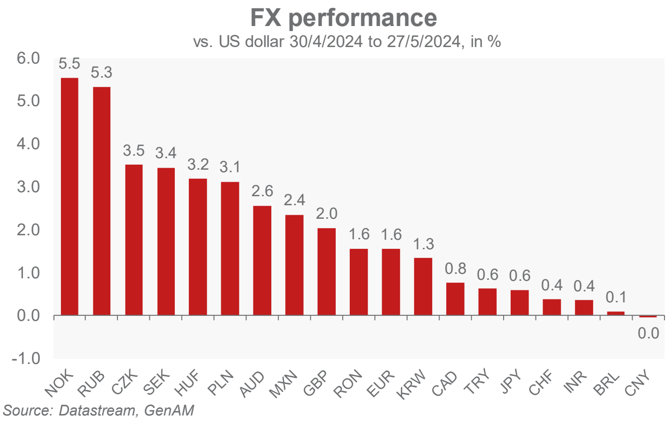
The setup for EM external debt is more supportive as global growth and risk appetite are resilient. We modestly lower our spread forecast expecting a 15bp tightening by year-end. The expected UST decline will lead to positive returns north of 5% by year-end. However, valuations are stretched but not everywhere. So, it is better to reduce the beta exposure and focus on the long end of EM IG, especially in BBBs. Indeed, EM IG has lagged US IG and the curves steepness makes the long-end attractive. We still like Romania and Mexico. Pemex has already compressed significantly vs Mexico but there is some value in the EUR long end. Panama could benefit from a relief rally. Elsewhere in IG, we still like Chile and turn neutral on Saudi Arabia given the large supply. In HY, BBs are very tight historically, but good fundamentals should maintain spreads flat. B and distressed names are cheap but driven by unexpected local factors.

Local debt turning less attractive

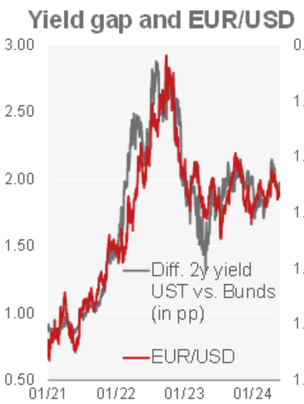
The slowdown in EM disinflation, the USD resilience and the renewed cautiousness of EM central banks complicate the outlook. We still expect a positive return driven by a strong carry but the FX risks favour the external debt over local debt. Region-wise, we favour LatAm (Mexico) over CEEMEA (Hungary) and Asia (India). EM FXs will trade sideways but carry is compelling in Egypt and especially in Turkey where reforms are bearing fruits.

Currencies

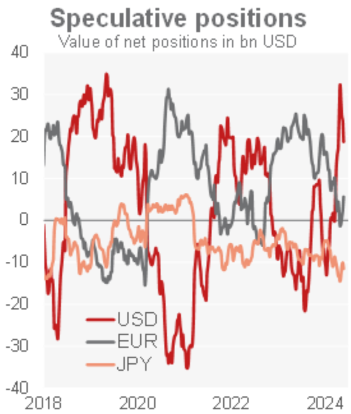
Thomas Hempell



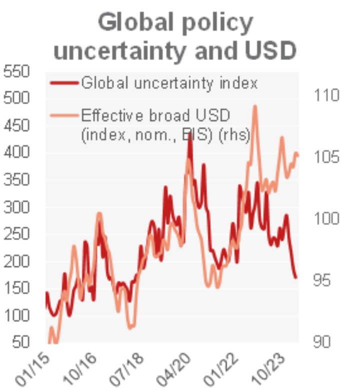
Source: Datastream, GenAM



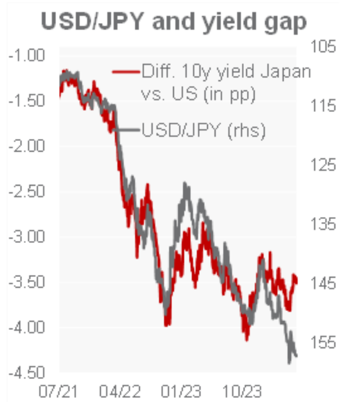
Source: Datastream, GenAM



Source: CFTC, Datastream, GenAM



Source: www.policyuncertainty.com, Datastream, GenAM



Source: Datastream, GenAM calculations

- **With only little scope for a narrower transatlantic yield gap in sight, we see only muted upside for the EUR/USD in the wake of fading US exceptionalism and easing rates uncertainty.**
- **Tactically, we would not be surprised by a mild USD bounce if the ECB complements its impending first cut in June with stronger hints towards further easing over H2.**
- **The deeply undervalued JPY will keep struggling until policy divergence materializes more visibly with a Fed first rate cut in September, contrasted by a hike by the BoJ.**

Monetary policy remains in the driving seat on FX markets. The more reassuring US inflation prints for April and retracing speculative long USD positions have stopped the USD advance, with all major currencies gaining some ground over May (top chart).

A tighter transatlantic yield gap was a key ingredient for our call of a weaker USD at the outset of the year (mid left chart). As we lower the expected cumulative US rate cuts over the cycle further to 200bp (see US part), we no longer expect significant tailwinds from a tighter transatlantic spread. With the expected speed of this year's ECB cuts also lowered from 100bp to 75bp, the impact on our tactical EUR/USD is not huge. We keep the 12m target for the EUR/USD – trimmed a month ago to 1.10 –, as easing rates volatility and fading US exceptionalism (US soft landing vs euro area recovery) offer residual moderate upside for the euro. Short term however, the risks to the EUR/USD look more finely balanced. With the ECB set to start its easing cycle ahead of the Fed in June, the EUR may face some pressure if the decision is enriched by an expressed inclination towards further rate cuts over the remainder of 2024. Mind also that the USD keeps profiting from the attractive carry vs. all major peers. The USD may help to hedge against escalating US/China trade tensions and policy uncertainties (left bottom chart), notably in case of a Trump victory in the November US presidential elections.

Despite FX intervention by the BoJ and rising Japanese yields (10y JGBs broke through the BoJ's soft 1.0% cap), the yen keeps struggling to find sustained support, even if remaining fundamentally very cheap, also compared to yield differentials (bottom right). It may require the delivery of a first rate cut by the Fed in September and a rate *hike* by the BoJ thereafter for the yen to sustainably recover lost ground.

The GBP may benefit from the BoE's reluctance to cut rates and prospects of a more pro-European stance by a Labour-led government in the wake of July 4 elections. Yet these supporting factors seem largely priced, and with the EUR itself supported by improving activity, the outlook for the EUR/GBP remains roughly balanced.

Equities

Michele Morganti and Vladimir Oleinikov

S&P	479 reported	478 reported				
Sector	earnings growth, yoy		sales growth, yoy		margin trend *	
	Q4 2023	Q1 2024	Q4 2023	Q1 2024	Q4 2023	Q1 2024
Consumer Discretionary	31.3%	29.6%	6.8%	5.8%	24.4%	23.7%
Financials	5.7%	11.3%	7.6%	7.9%	-1.9%	3.5%
Information Technology	24.0%	27.0%	7.6%	7.8%	16.4%	19.2%
Communication Services	48.8%	41.4%	6.6%	6.7%	42.1%	34.7%
Real Estate	8.6%	10.5%	8.2%	7.4%	0.4%	3.2%
S&P 500	**8.0%**	**7.7%**	**3.9%**	**4.1%**	**4.1%**	**3.6%**
S&P 500 ex M7	**-0.7%**	**-0.7%**	**2.5%**	**2.9%**	**-3.2%**	**-3.6%**
Magnificent 7 (M7)	**56.0%**	**52.5%**	**15.0%**	**14.0%**	**41.1%**	**38.5%**
Middle caps (< 0.8 x avg index MV ex. M7)	**1.9%**	**5.1%**	**2.1%**	**2.4%**	**-0.2%**	**2.7%**
Large caps (> 0.8 x avg index MV ex. M7)	**-1.8%**	**-3.0%**	**2.7%**	**3.2%**	**-4.5%**	**-6.2%**
median stock	**6.6%**	**6.9%**	**3.7%**	**3.2%**	**2.9%**	**3.7%**
Median (all sectors)	6.9%	10.5%	6.6%	5.8%	0.3%	4.7%
Median, ex. Energy & Materials	8.6%	11.3%	6.8%	6.0%	1.7%	5.4%

Source: Bloomberg, GenAM calculations
Note: proxy for margin trend = earnings growth - sales growth

Source: Datastream, GenAM calculations

Source: Datastream, GenAM

GenAM earnings forecasts

	US NIPA profits pre-tax		S&P earnings		EMU earnings	
	bl$	yoy	level	yoy	level	yoy
2023 Q4	3,414.2	5.1	216.8	-0.6	16.5	3.7
2024 Q1	**3,416.0**	**7.9**	223.2	3.4	16.6	4.3
2024 Q2	**3,423.0**	**7.9**	**231.5**	**7.8**	**17.2**	**6.8**
2024 Q3	**3,447.2**	**5.1**	**235.6**	**9.0**	**17.6**	**7.5**
2024 Q4	**3,513.7**	**2.9**	**234.8**	**8.3**	**17.6**	**6.7**
2025 Q1	**3,552.4**	**4.0**	**238.9**	**7.0**	**17.5**	**5.4**
2025 Q2	**3,551.6**	**3.8**	**247.2**	**6.8**	**18.0**	**5.1**
2025 Q3	**3,557.7**	**3.2**	**252.8**	**7.3**	**18.5**	**5.4**
2025 Q4	**3,615.5**	**2.9**	**251.5**	**7.1**	**18.5**	**5.1**

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

- **Investors are focused on good Q1 results as well as improving confidence and ex-US growth indicators. The Q1 reporting season helped sentiment as it showed nice surprises vs. analysts' expectations.**
- **We see good earnings growth this year and the next, as well as decent 12-month total returns ex-US.**
- **Short term, we are more cautious due to toppish Fed's bank reserves, weaker ISM and increased positioning. High SPX valuation and geopolitical risks do not help either. Lastly, the choppy disinflation trend could keep central banks nervous for a while.**
- **We remain constructive in 12 months and expect a positive 12-month TR: 4% SPX and 6% for EMU. Tactically OW EU vs. the US (N US Tech).**
- **OW Japan (valuation, restructuring), OW India ("growth" hedge), Korea (valuation, bottoming global cycle) and accumulating China.**
- **EU sectors: OWs: Banks, Durables, Energy, Food, HC Equip, Defense and Materials. UWs: Auto, Comm. Prof. Svs., Insurance, Telecom, Media, Software.**

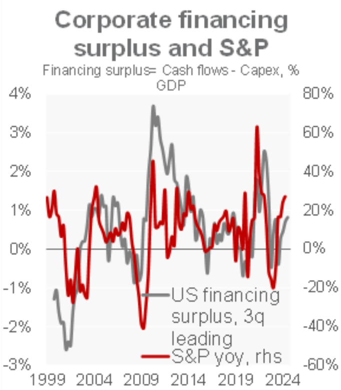
After a substantial repricing of inflation, rates stabilised in the US, but growing doubts about the disinflationary trend spread to the euro area also due to better economic data. Implied ECB cuts are now reduced, and Bund yields are higher by 10 bps in May. That said, markets are up in the month, and FAANG posted a +10%. Indeed, investors were focused on good Q1 results (Nvidia posted a 33% return after their above consensus results) as well as confidence and growth indicators. The latter are improving ex-US. In this respect, the Q1 reporting season helped sentiment as it closed with nice surprises vs analysts' expectations: 8.4% in the US, higher than in Q4 '23 and much above the average over the last 3 years of 5.6%. The earnings growth came out at 7.7% around Q4 levels. The sales growth improved from 3.9% to 4.1%. The bulk of US earnings comes from the Magnificent 7, which reported an earnings growth of 52.5%. The market ex. M7 stocks had slightly negative earnings growth, which was more driven by larger stocks. The good news is that also Europe surprised on the upside by 9%, albeit the yearly growth remained negative at -6%. Such surprises and better macro data triggered positive revisions. We updated our earnings models which are adjusted slightly upward vs. 3 months ago. The result is that we see 9% and 7.5% growth this year for the US and EMU, respectively. For the latter we continue to be above consensus by 4%. For 2025 we see 9% growth for US and 5% for EMU which are below consensus. The result is that we forecast potential 12-month total return of 6% for EMU and Japan, 4% for the US and more in UK and especially in Switzerland (+7.5%).

Equities

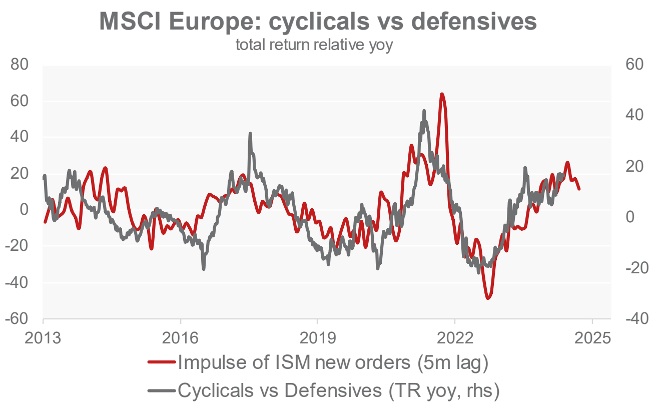
12m targets

Market Index	composite LT models (Shiller approach for US)	of which: PE-based valuation	CAPE yield gap vs real yield 1yr fwd spread, % to avg since 2003
S&P 500	5,000 - 5,350	-4.7%	-1.6%
MSCI EMU	2.0%	11.1%	-0.6%
FTSE 100	8.5%	11.5%	0.9%
SMI	5.3%	10.5%	-0.1%
TOPIX	4.5%	5.8%	-0.5%

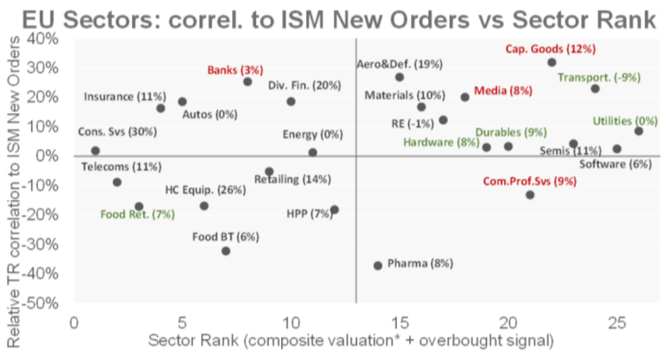
Source: Datastream, Bloomberg, GenAM calculations
Note: LT models: PE tgt (US 18.2x, EMU 13.4x, JP 14.3x), Fed model, EY-BY, DDM, and 3-stage eps growth model
excess CAPE yield = 1/CAPE - (10yr rate - avg inflation over 10yr)



Source: FRED eco data, GenAM calc.



Source: Datastream, GenAM



*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
Source: Refinitiv, GenAM calculations as of 29/05/2024
in (X%): 12m EPS growth

The ULC-CPI trend suggests that US margins are also safe near term, as Tech ones, at least in the short term. With tight labour market, firms look to be searching for higher productivity, both re-engineering their processes as well as investing in technology, AI included. The US macro outlook also remains quite resilient and, as said, the global trade and EA one improving. In one year, we could expect Central banks to become more dovish, which in the end would trigger a lower bond volatility (MOVE index) and probably some outflows from MMF into bonds and equity. Finally, corporate Cash Flow minus Capex spread also remains very high, with net equity issuances low and buybacks high. This translates into a very positive market technical midterm, which significantly limits the chances of a prolonged and deep downside from here.

For the short term, we are more cautious. The US cycle is resilient, but ISM momentum looks toppish at the moment, along with the banks' liquidity at Fed. Furthermore, the positioning looks higher, with cash positions quite low at the moment, and the seasonality not in favour as usually June is a negative month in the year. Furthermore, US valuations are not distant from our 1-year target and CPI uncertainty could eventually continue to linger for a while triggering a prolonged hawkish stance by central banks. Geopolitical risks also look increasing again (Ukraine).

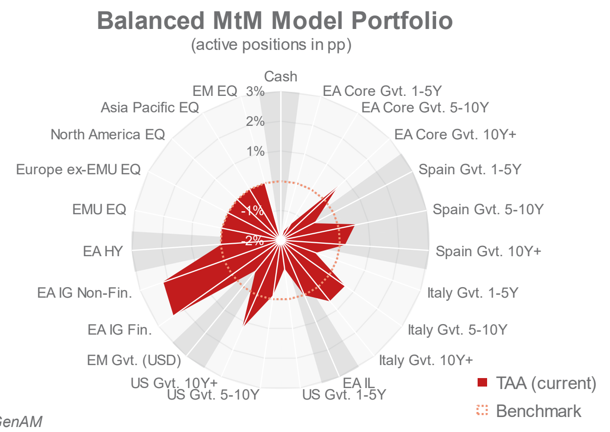
We OW EMU vs US mostly due to valuation gap, better short-term macro surprises trend, ML models, and declining relative dispersion in earnings forecasts. Structurally, US remains more attractive. OW Japan (good valuation score, attractive CAPE yield gap, corporate restructuring), reduced OW on India (not cheap but "growth" hedge), Korea (best global valuation, bottoming global cycle) and still accumulating China (OW, deep undervaluation, supportive economic policy).

European sector allocation

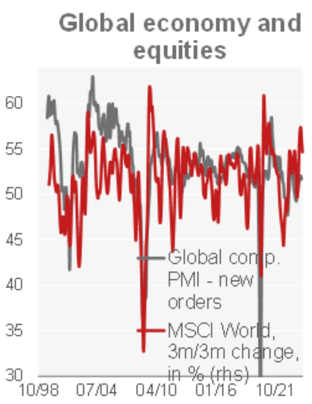
We are neutral cyclical/defensive, with a tilt on cyclical laggards and value. While ISM looks toppish, lower CPI in Europe and bottoming global cycle still point to a lingering "Goldilocks phase". We are also positioned to benefit from a fall in 10-year rates through HC Equip. and Food. We reduce out UW in Telecoms (cheap valuation) and go neutral on Pharma (from OW, negative correlation to ISM). We remain OW Small vs Large cap as Small cap should benefit from lower yields, better economic momentum ahead, and a bottoming in the M&A cycle. OWs: Banks, Durables, Energy, Food, HC Equip, Defense and Materials. UWs: Auto, Comm. Prof. Svs., Insurance, Telecom, Media, Software.

Asset Allocation

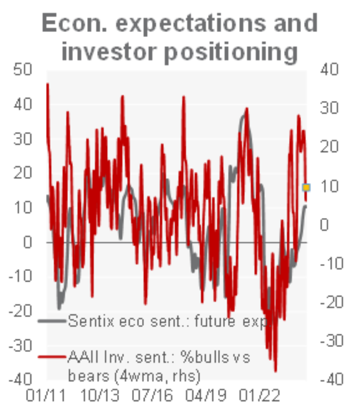
Thomas Hempell



Source: GenAM

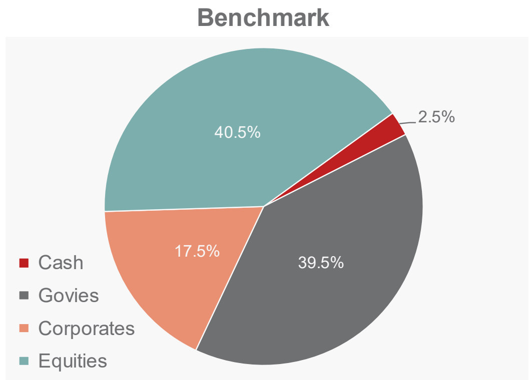


Source: Markit, Datastream, GenAM

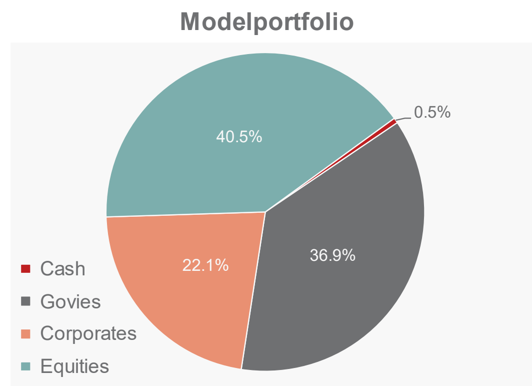


Source: Datastream, GenAM

- **Our higher inclination towards duration paid off in the first half of May with 10y UST yields falling by >30bp before paring most of the move by end of the month, with short-dated Bund yields even slightly higher on the month. Equities surged regardless amid reassuring earnings and ebbing inflation worries.**
- **Amid the tug of war of decent activity data on the one hand and receding inflation and forthcoming rate cuts, we see the outlook for yields tilted mildly to the downside, if not in a linear fashion.**
- **With markets still strongly focussed on upcoming inflation numbers and the risk of temporary disappointment elevated, we favour an only moderate long duration exposure.**
- **The resilient corporate earnings outlook and prospects of lower rates should also buffet broader risk sentiment.**
- **That said, given the extent of the past rally, elevated valuations, elevated pro-risk positioning and very low risk premia and volatility we keep for now a neutral stance on the riskier end of our asset class universe (Equities, HY Credit).**
- **We focus our tactical overweights on higher quality spread products including IG Credit and Southern European sovereign bonds, at the expense of underweights in shorter-dated Core bonds and Cash.**



Source: GenAM



Source: GenAM

Forecasts

Macro Data

Growth[1)]	2023	2024 forecast	2024 Δ vs. cons.	2025 forecast	2025 Δ vs. cons.	2026 forecast
US	2.5	2.6	0.3	2.2	0.5	2.1
Euro area	0.5	0.8	0.3	1.4	0.0	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	0.9	0.8	0.1	0.9	- 0.1	0.7
Non-EMU	0.2	0.7	0.2	1.5	0.2	1.9
UK	0.1	0.5	0.2	1.4	0.2	1.9
Switzerland	0.8	1.2	0.0	1.6	0.0	1.8
Japan	1.9	0.6	- 0.0	0.9	- 0.3	0.8
Asia ex Japan	5.2	5.0	0.1	4.8	0.1	4.6
China	5.2	5.0	0.3	4.5	0.1	4.1
CEE	2.9	3.0	0.6	3.1	0.6	2.8
Latin America	2.2	1.3	0.0	2.3	0.0	2.5
World	**3.0**	**3.0**	**0.2**	**3.1**	**0.2**	**3.0**

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

Inflation[1)]	2023	2024 forecast	2024 Δ vs. cons.	2025 forecast	2025 Δ vs. cons.	2026 forecast
US	4.1	3.1	0.2	2.4	0.2	2.3
Euro area	5.5	2.4	0.1	2.2	0.3	2.0
Germany	6.0	2.5	0.1	2.3	0.3	2.0
France	5.7	2.5	- 0.0	2.2	0.3	2.0
Italy	5.6	1.3	- 0.3	1.7	- 0.1	1.8
Non-EMU	6.5	2.3	- 0.0	2.0	- 0.0	2.0
UK	7.4	2.4	- 0.1	2.2	- 0.0	2.1
Switzerland	2.2	1.4	0.1	1.1	0.0	1.2
Japan	3.3	2.4	- 0.0	1.7	- 0.1	1.7
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	18.8	0.5	9.9	- 0.7	6.7
Latin America[2)]	5.1	4.1	0.0	3.6	0.0	3.0
World	**5.2**	**3.9**	**0.0**	**3.0**	**- 0.0**	**2.8**

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

Financial Markets

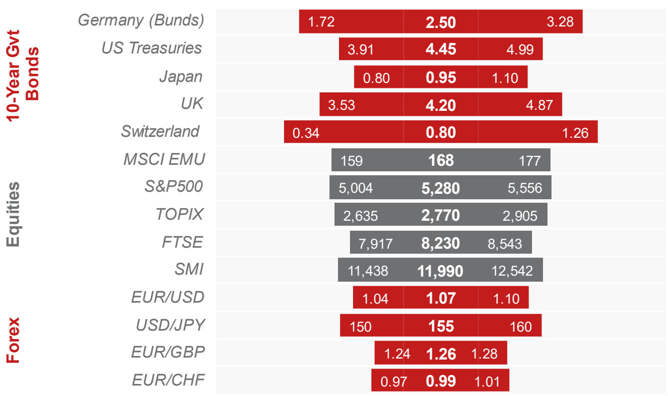
Key Rates	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
US (upper bound)	5.50	5.50	5.28	5.25	5.03	4.75	4.55
Euro area	4.00	3.50	3.59	3.25	3.38	2.75	2.95
Japan	0.05	0.00	0.18	0.00	0.31	0.25	0.49
UK	5.25	5.00	5.10	4.75	4.93	4.25	4.46
Switzerland	1.50	1.25	1.31	1.25	1.20	1.25	1.17
10-Year Gvt Bonds							
US Treasuries	4.49	4.45	4.47	4.35	4.46	4.20	4.45
Germany (Bunds)	2.57	2.50	2.56	2.45	2.54	2.35	2.53
Italy	3.87	3.85	3.89	3.85	3.92	3.80	3.98
Spread vs Bunds	130	135	133	140	137	145	146
France	3.06	3.00	3.07	2.95	3.07	2.90	3.08
Spread vs Bunds	49	50	51	50	52	55	55
Japan	1.02	0.95	1.09	0.90	1.14	0.85	1.24
UK	4.27	4.20	4.26	4.15	4.25	4.00	4.27
Switzerland	0.83	0.80	0.76	0.80	0.74	0.75	0.71

**3-day avg. as of 28/05/24*
***ICE BofA (OAS)*

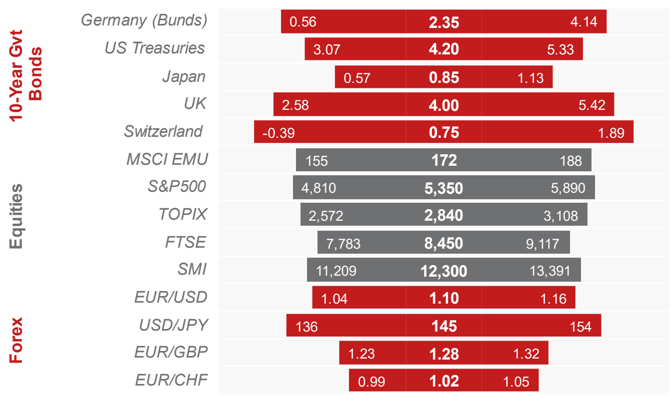
Credit Spreads**	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
EA IG Non-Financial	105	105		110		100	
EA IG Financial	110	120		120		110	
EA HY	326	380		380		355	
EM Sov. (in USD)	254	245		235		235	
Forex							
EUR/USD	1.09	1.07	1.09	1.09	1.10	1.10	1.11
USD/JPY	157	155	155	151	153	145	149
EUR/JPY	171	166	169	165	167	160	165
GBP/USD	1.28	1.26	1.28	1.28	1.28	1.28	1.28
EUR/GBP	0.85	0.85	0.85	0.85	0.86	0.86	0.86
EUR/CHF	0.99	0.99	0.99	1.01	0.98	1.02	0.97
Equities							
S&P500	5,305	5,280		5,300		5,350	
MSCI EMU	168.4	168.0		170.5		171.5	
TOPIX	2,759	2,770		2,795		2,840	
FTSE	8,296	8,230		8,320		8,450	
SMI	11,916	11,990		12,235		12,300	

Forecast Intervals

3-Months Horizon*



12-Months Horizon*



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

Imprint

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