HOUSE VIEWS

April 2024

Central banks out-of-sync

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Modest spike in volatility on the back of rate pressures and geopolitical tensions. Recent data from the United States have surprised on the upside for both inflation and economic growth, raising fears the Federal Reserve (Fed) may rethink its rate cuts. Meanwhile, renewed tensions in the Middle East are unnerving already jittery markets. Despite these concerns, we stand by our scenario of positive global growth, albeit with regional disparities, and inflation falling in the world's developed economies. However, we no longer expect the major central banks to cut their rates in sync; rather we now anticipate the rate cut cycle starting later in the US than in Europe. The disparity in policy timing could widen further if tensions in the Middle East worsen and push up oil prices. An oil price surge plays differently either side of the Atlantic. For the United States, a major oil & gas producer, the big risk would be inflation. For Europe, however, the threat would be to growth. Faced with different risks, the Fed and ECB might well diverge policy further.

Overweight to developed market equities maintained. Buoyant business indicators encourage us to keep our risk exposure to equity markets. We remain Overweight European markets, which still offer good value, and US markets, mainly because of the booming American economy. We also remain constructive on sovereign and investment grade corporate debt. Both continue to pay attractive yields and offer good diversification should market tensions rise. The likely – in our view – desynchronisation of the central bank rate-cut cycles has also led us to move to Overweight on the dollar against the main European currencies.

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OUR MAIN CONVICTIONS

Positive growth dynamics but with disparities across regions

The global economy should sustain its positive growth trend in 2024 but the pace of growth will vary by region. The United States economy is set to slow but will remain stronger than other major developed economies. European growth is likely to be more fragile overall but should gradually benefit from lower inflation and easing of monetary policy. In China, the troubled property sector is likely to prove an ongoing drag on growth.

Central banks: rate cuts de-synchronised

Since the start of the year, inflation has been easing in major developed economies, reinforcing the idea that key central banks are nearing their pivot points. However, resurgent activity in the United States may prompt the Federal Reserve to tread more cautiously, pushing back its first rate cut to Q3, while the ECB could start reducing rates in June and cut by a total of 75 bps by year end.

Overweight to equities, particularly US and Europe

Despite the recent market correction, we maintain our Overweight to developed equity markets. The economic environment should remain healthy, and we still expect rate cuts from the main central banks. We favour European markets, which offer attractive valuations, and US markets, whose economy remains strong. We have also maintained our Underweight to emerging equity markets, mainly because of the continuing difficulties of the Chinese economy.

Constructive on government bonds and IG corporate bonds

Bonds continue to offer attractive carry, both in nominal and real terms, as inflation continues its gradual retreat. Sovereign and investment grade corporate bonds also offer an attractive diversification option in the alternative scenario where the world dips into recession, which would translate into much lower rates and a return to negative correlation between bonds and equities.

Overweight dollar against European currencies

Changes in monetary policy were the main drivers of currency markets moves in 2023 and should remain so in 2024. As we now expect monetary policies to move out of synch, we have switched to Underweight the EUR/USD and GBP/USD, i.e. Overweight the dollar which should strengthen against the major crosses.

Maintained Underweight to gold

Gold has been booming all year, helped in large part by heavy central bank buying and geopolitical tensions. Nonetheless, we remain Underweight as it appears less attractive in the context of high interest rates.

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OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee (GIC).

Summary house views

			UW	Slight UW	N	Slight OW	OW	Variation since previous GIC
EQUITY		GLOBAL EQUITY				X		=
		United States				X		=
		Euro area				X		=
		United Kingdom				X		=
		Japan			X			=
		Emerging		X				=
FIXED INCOME	SOVEREIGN	GLOBAL RATES			X			=
		U.S. Treasuries			X			=
		Bunds			X			=
		Gilts			X			=
		EM Govies ($)		X				=
	CORPORATE	U.S. IG			X			=
		U.S HY		X				=
		EMU IG			X			=
		EMU HY		X				=
		U.K. IG			X			=
FOREX		EURUSD		X				-
		USDJPY			X			=
		GBPUSD		X				-
		EURCHF		X				=
ALT.		Commodities			X			=
		Gold		X				=
		Hedge funds		X				=

As of 17th of April

Equity markets: Allocation by style

	Growth	Value
United States	No Preference	
Euro area	X	
United Kingdom	No Preference	

Fixed income: Allocation by duration

	Underw.	Neutral	Overw.
United States		X	
Euro area		X	
Unitted Kingdom			X

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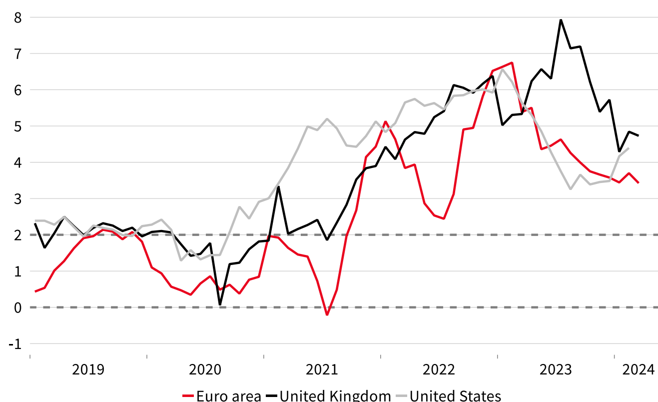
Central banks: rate cuts to be out-of-sync

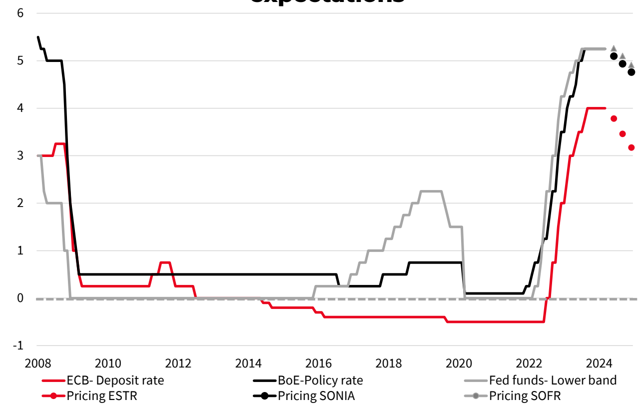
Recent data confirms our outlook of positive growth with increasing regional disparities. The United States economy continues to beat expectations, intensifying debates about how fast inflation can fall. In the euro area and United Kingdom, indicators continue to show modest growth and gradually falling inflation. 2024 still looks to be the year of the pivot for key central banks but we now see the United States first rate cut later than Europe's. Any worsening of geopolitics will likely widen this gap in policy further.

Activity remains resilient, particularly in the United States. The US economy continues to surprise on the upside, with demand still strong. This resilient performance is underpinned by a buoyant labour market, with an unemployment rate below 4% and 4% year-over-year wage growth. US growth should slow down in months to come, but only gradually, sustained by still accommodative fiscal policy and healthy private sector balance sheets. European economic data for Q1 also confirms the recent trend of barely positive growth but a stubbornly strong labour market. Looking ahead, the European economies should benefit from the easing of inflation followed by cuts to interest rates.

Rate cuts cycle to diverge. Inflation has been on the retreat all year in the major developed economies: down between December and March from 2.9% to 2.4% year-over-year in the euro area, 3.9% to 3.5% in the United States and 4.0% to 3.2% in the UK. However, the downtrend has come with some surprises, pointing in different directions either side of the Atlantic. Both the euro area and UK broadly surprised on the downside. In contrast, US inflation came down less than expected. This suggests central banks will no longer be cutting their rates in lockstep. Rather, the US may cut later and prove more gradual with its policy loosening. We still expect the ECB to cut rates for the first time in June and by a total of 75 bps by year end. The Fed is likely to start in Q3 and reduce rates by a total of 50 bp this year. Such a desynchronisation would boost the dollar and could prompt a spike in the euro price of oil, which has already been drifting upward.

Escalating tensions in the Middle East have helped foment the climate of doubt among policy-makers, particularly with major political events looming closer to home as well. The main risk from any fresh intensification of Middle Eastern tension would be a spike in the oil price. As a massive domestic producer, the United States would be able to mitigate such a risk. This could shield its domestic economic growth but could nonetheless spur resurgent inflation. In Europe, however, the danger is economic stagnation. Faced with different risks, the Fed and ECB might well diverge policy further.





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Maintain Overweight to developed market equities

Equity markets have corrected sharply since early April. This follows a prolonged rally and seems to be driven by changing expectations for Fed rate cuts and rising geopolitical tensions. Nonetheless, the economic environment remains sound and we still expect rate cuts from the main central banks. We therefore remain Overweight US and equities, despite expensive valuations, and European markets. We also retain our Underweight to emerging markets, due to the weak Chinese economy. We also like cyclical stocks, which should continue to do well in a growing economy. On the other hand, we expect small cap companies to underperform, largely because of their high debt levels.

United States. Having gained 10% in Q1, the US market lost around 2% last month, underperforming most of its major peers. Yet, its year-on-year performance remains impressive at over 20% and the correction has largely been driven by the downgrading of expectations for Fed rate cuts. Nevertheless, while its room for manoeuvre is shrinking, the Fed should still be able to trim rates in 2024. Also, US economic data continue to surprise on the upside, which should help sustain corporate profits. Stocks look expensive but momentum – measured as a 200-day moving average – and market sentiment remain bullish. We therefore stick with our Overweight on US equities. Our view on the artificial intelligence investment theme also gives us a heavier weighting to growth stocks.

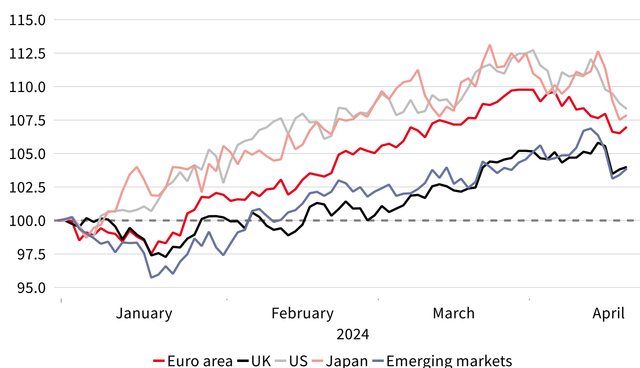
Euro area. European equities did well in Q1 and resisted well to the market correction, losing just around 0.5% on the month. In our view, they should continue to draw support from several factors. Prices are attractive, market momentum is strong, and the economic bounce-back now seems locked in as the ECB is set to start its rate-cutting cycle in June – all of which is good news for corporate profits. We therefore remain Overweight European markets and, going forward, prefer growth stocks, which stand to gain most from the support factors mentioned above.

United Kingdom. Having underperformed poorly since November, the oil-heavy UK market made up ground last month as the price of crude rose. As with the euro area, strong momentum, cheaper multiples, and the prospect of rate cuts should support this market. We remain Overweight with a preference for value stocks.

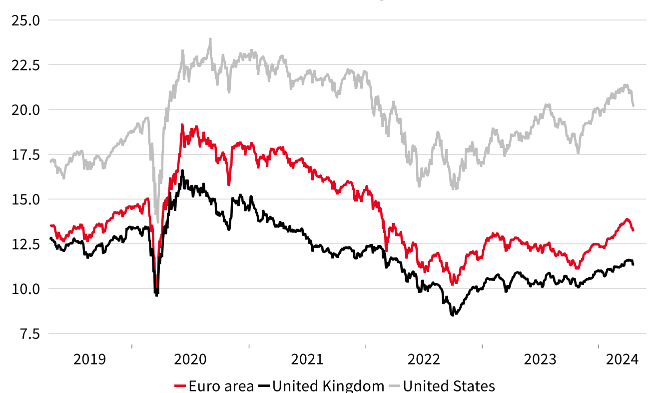
Japan. Despite having gained more than 40% in the year to end-March, the Japanese market held up well amid last month's global market slide. We remain Neutral on this market. Support factors such as the economic rebound, low interest rates and a strong tech weighting should offset the negatives (expensive valuations and weak market sentiment).

Emerging markets. Emerging markets retreated in line with the global index last month, despite sitting on a massive year-on-year underperformance. We remain at Underweight to emerging markets, partly because of the Chinese economy's fragility but also because other markets in the index look overpriced, particularly in Asia.

Equity indices in EUR



Price to earnings ratio



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We remain constructive on bond markets

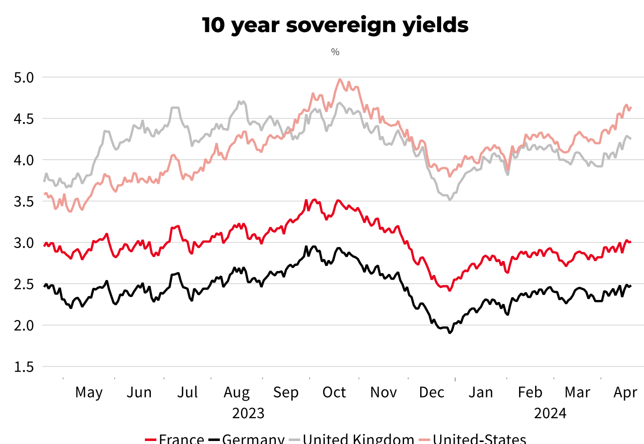
We remain Neutral on fixed-income products. With inflation easing, sovereign and corporate bond yields remain attractive both in nominal and real terms. Although volatility may likely stay high in the short term, the interest rate cuts expected in H2 should boost total returns.

United States. US Treasuries rallied significantly last month. Yields on 2-year bonds – a proxy for where the market sees monetary policy a year from now – rose from 4.5% to 5%. The 10Y Treasury yield went from 4.2% to 4.6%, its highest since their October 2023. This upward drift mainly reflects renewed fears of overheating in the US economy and the pushing back of expectations for Federal Reserve (Fed) rate cuts. Data for Q1 show the economy is still growing at close to 3% while inflation figures have surprised on the upside, particularly in services, where inflation actually edged up. With this in mind, we now expect the Fed to start cutting rates in Q3-2024 with a second cut to follow in Q4. In these circumstances, we remain at Neutral on Treasuries, reflecting their attractive carry and our scenario of H2 rate cuts. We have also moved back to Neutral on duration.

Euro area. Unlike Treasuries, yields on euro area sovereign debt have held broadly stable over the last month. The 10-year Bund is hovering around 2.4% and the 10-year OAT around 2.9%. Risk premiums on peripheral debt widened only modestly, with the Italian risk premium rising to 145 bp on a worse-than-expected 2023 budget deficit. This relative stability reflects greater certainty in Europe than in the United States that inflation is beaten. The scenario of lower inflation and lacklustre growth should be enough for the ECB to start trimming rates in June, making synchronised rate cuts both sides of the Atlantic less likely. We remain at Neutral on euro sovereign debt. Volatility may be high for the short term but carry remains attractive and the start of the rate-cutting cycle persuades us to stay in this market. On duration, we have moved to Neutral, favouring 7 years duration.

United Kingdom. Gilt yields have tracked their US equivalents, rising from 3.9% to 4.3% over the past month. However, we remain Neutral on this market. Core inflation continues to fall, and given the weak economy, the Bank of England is likely to start cutting rates in the summer and continue at a similar pace to the ECB.

Credits - Developed markets. We remain Neutral on investment grade corporate bonds (companies with good credit scores), which still have an attractive 4% carry rate and healthy balance sheets. We remain Underweight high yield credits (poorly rated companies), which look expensive and are generally issued by highly indebted companies that are currently more at risk.



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Overweight to US Dollar

We have switched to Underweight the EUR/USD and GBP/USD. We are thus Overweight the dollar which should strengthen in its principal crosses as monetary policy at central banks falls out of sync.

Dollar index. The dollar continued its rally against most currencies as markets bet that booming prospects for the US economy would lead the Fed to delay the start of its monetary easing cycle.

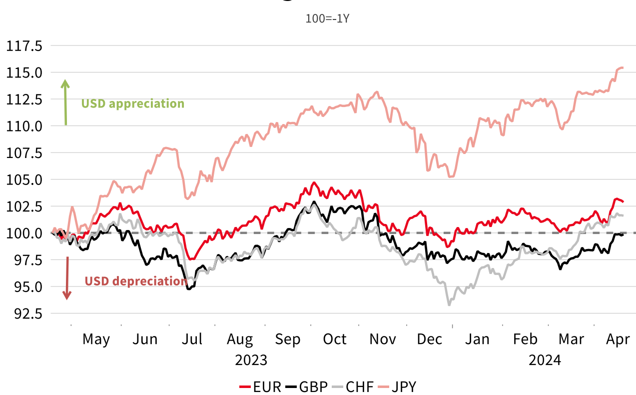
EUR/USD. The euro fell over 2% versus the dollar to 1.06 EUR/USD this month, due to the likely desynchronisation of monetary policies between the Fed and the ECB. Favourable economic data and stubborn inflation in the US have been driving the Fed to hint at a delay of its first rate cut. As a result, the ECB seems likely to move first, not waiting for the Fed, which could strengthen the dollar against the euro. We have therefore moved from Neutral to Underweight on this cross, seeing further upside for the greenback versus the euro.

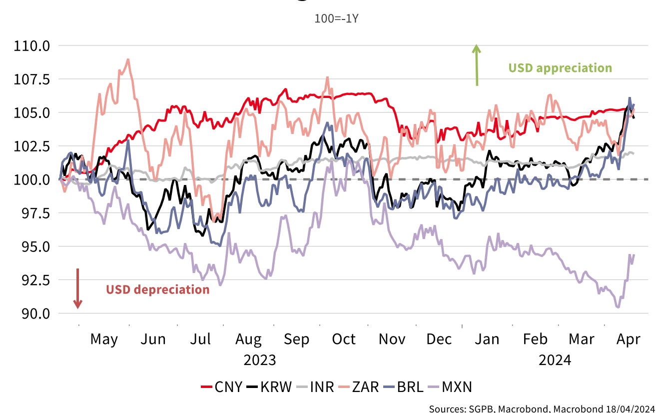
GBP/USD. Sterling lost more than 2% against the dollar during the month for reasons similar to the euro. Given the economic data, it seems equally likely the Bank of England will be bringing down rates before the Fed. We are therefore also moving from Neutral to Underweight on Cable.

USD/JPY. The yen continues to decline against the dollar, which rallied more than 3.5% against the Japanese currency this month, to 154.6 yen. The Bank of Japan may have hiked rates for the first time in 17 years last month – from 0% to 0.1% – but it will be some time before Japanese monetary policy gets back to normal. In the meantime, the spread to US rates will remain in play. That said, we remain Neutral on this cross. Japan still runs a large current account surplus and has substantial foreign exchange reserves which should cushion any fall in the yen. Finally, if pressure builds, the Japanese authorities have not ruled out coordinated action with the US.

EUR/CHF. The euro continues to claw back some ground against the Swiss franc, rising more than 0.5% on the month. The Swiss central bank was the first to lower policy rates, removing one of the props for its currency. Even so, we remain Underweight the cross as the ECB will shortly follow suit with rate cuts and the Swiss currency still has points in its favour, including its low inflation, strong current account surplus and safe-haven status.

EM currencies. Emerging market currencies fell back sharply against the dollar last month as markets revised the likely timing of Fed rate cuts and US long yields rose. Latin American currencies fell hardest, being highly sensitive to dollar rates. The Brazilian real lost 4.1% and the Mexican peso 1.0%. In Asia, the Korea's won had the biggest drop versus the dollar, slipping 2.9% on a wide rate spread.





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Maintain gold and hedge fund Underweight

High interest rates continue to undermine the appeal of hedge funds and gold in our view, despite the recent strong performance of the precious metal. On Thematics, we are sticking with Artificial Intelligence and Clean Energy and adding two new themes: Reshoring and European Excellence.

Commodities. The price of a barrel of Brent experienced high volatility last month as intensifying tensions in the Middle East and industrial recovery in China were balanced by a continued rise in US production. Even if US output should limit the upside, the oil price will depend on what happens in the Middle East for the next few weeks. In Europe, natural gas prices rose around 15% on the month amid supply concerns.

Gold. Gold continued its strong rally to near USD 2,400/oz, up nearly 10% on the month, on the back of geopolitical tensions and sustained purchases by emerging economies' central banks (Russia, China and India). Given the current level of interest rates (nominal and real) and the jump in the gold price over recent months, we continue to Underweight gold.

HF- Long/Short Equity. Long/short equity funds, which specialise in non-directional strategies, could do well in the current climate of high volatility and dispersion and the current stage of the economic cycle.

HF- Event Driven. High interest rates and a shortage of liquidity continue to discourage firms from embarking on mergers and acquisitions. Funds specialising in such deals look unattractive for now.

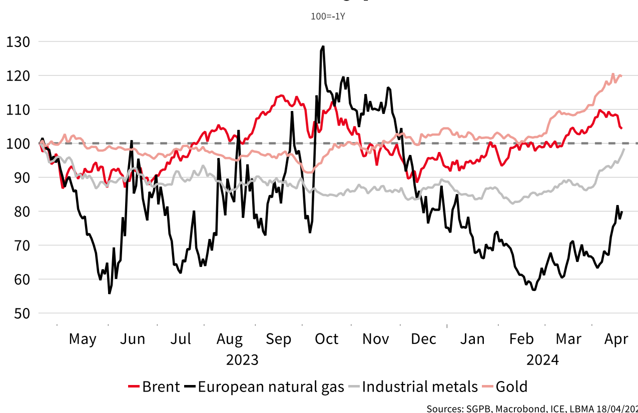
HF- Fixed Income Arbitrage. Some sovereign bond funds could benefit from higher interest rates. We retain our relative interest in funds positioned in the credits segment.

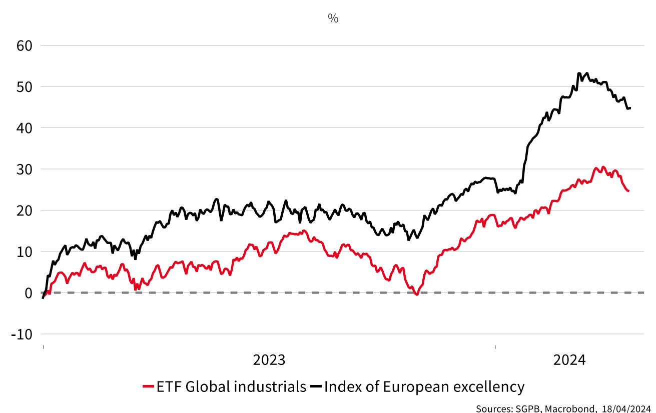
HF- Global Macro/CTA. Commodity trading advisors (CTAs) are generally useful to hedge market volatility. However, their recent performance has left them looking insufficiently attractive in our view.

Themes

Reshoring. The Reshoring theme should benefit from resurgent national industrial policies following supply chains disruptions and trade and geopolitical tensions. These core of these policies lies with stimulus packages in both the United States (Inflation Reduction Act) and Europe (Next Generation EU). The theme has performed well on equity markets. Since late-2022, the index of industrial stocks in developed economies has had a positive dynamic, outperforming its benchmark.

European Excellence. After two tough years for the European economy, retreating inflation should not only allow the ECB to start its rate-cutting cycle but should also support household purchasing power and hence economic activity. Besides an economic upturn, the European equity market should also benefit from attractive valuations. To fully benefit from this combination of favourable factors, we favour international companies who are leaders of their market segment.





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