Main Events

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Chicago
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

EU CPI
Inflation in the Eurozone is expected to have cooled under the 2% target
04.02

ECB MEETING
Notwithstanding the sub-par growth and an inflation likely below target, the ECB is likely keeping monetary policy unchanged
05.02

US RETAIL SALES
Retail sales are expected to continue growing at a solid pace, consistent with a 4%+ economic growth
10.02

US CPI
Core inflation should show a further deceleration, putting more pressure on the Fed to cut rates
11.02

HAWKISH SURPRISE?

- **Last week Trump nominated Kevin Warsh, apparently one of the least dovish candidates as the next Fed Chair**
- **In recent remarks, Warsh advocated for a reduction in rates as the AI revolution will put downward pressure on inflation, but also for a reduction in the Fed balance sheet**
- **However, Warsh will only have 1 vote out of 12 on the FOMC, and at the last meeting, the Fed voted 10-2 to keep rates unchanged. Thus, his impact on Fed decisions is likely to be limited, at least initially, as he will need to gain the support of fellow governors**

Last Friday, President Trump announced the nomination of Kevin Warsh as the next Fed chair, pending confirmation by the Senate. As customary, Trump once again surprised the market with this nomination, as Warsh was arguably one of the (apparently) less dovish candidates among the list of potential contenders.

Warsh owes his reputation as a hawk to the fact that when he served as a member of the Fed's Board of Governors from 2006 to 2011—becoming the youngest governor in the institution's history at the age of 35—he was a long-time critic of quantitative easing (QE). Indeed, he quit the central bank in 2011, shortly after it embarked on a second round of bond purchases under then-Chair Ben Bernanke. During his term, he placed much greater importance on inflation risks than on employment risks. In April 2009, with unemployment around 9% and at the height of the great financial crisis, he stated he continued to be more concerned about upside risks to inflation than downside risks to output and employment.

That said, Warsh's thinking has evolved over time, and more recently he has become a critic of Fed policy, particularly with regard to the excessive expansion of the balance sheet, and advocating lower rates, which was likely a determining factor in Trump's choice. Warsh's most recent position was expressed in a Wall Street Journal article back in November, in which he wrote: "AI will be a significant disinflationary force, increasing productivity and bolstering American competitiveness. […] The Fed should abandon the dogma that inflation is caused when the economy grows too much and workers get paid too much. Inflation is caused when government spends too much

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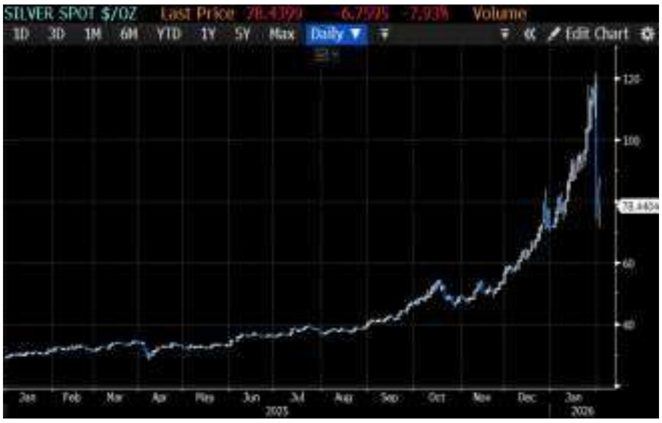
Source: Bloomberg



Source: Bloomberg

and prints too much. Money on Wall Street is too easy, and credit on Main Street is too tight. The Fed's bloated balance sheet […] can be reduced significantly. That largesse can be redeployed in the form of lower interest rates to support households and small and medium-size businesses."

In other words, in his view the AI revolution will help boost growth while reducing inflation through increased productivity, enabling the Fed to keep rates much lower, thereby will reinforce growth dynamics. Lower rates will also be supportive of the private sector and sustainability of public debt, by reducing interest expenditure. According to Warsh, the Fed has been "backward-looking" and too slow to cut rates. This is exactly what Trump is looking for.

However, the comment that he favors a scarce-reserves framework and balance sheet reduction should not be underestimated, as the wealth creation in financial assets was driven mainly by the outsized expansion of the Fed's balance sheet that started after the great financial crisis (white line in the left chart above). Part of this expansion is due to regulations imposed on US banks after 2009, which require banks to hold large reserves (orange line above), but any significant reduction in the Fed's balance sheet could put pressure on risky asset classes and hinder the "debasement trade" that has been particularly in vogue in recent months.

Unsurprisingly, precious metals were the hardest hit. Silver, which had risen about 60% in the month through Thursday—its best monthly performance since the US Civil War in 1864—fell about 30% on the day of Warsh's announcement, its worst day since 1980. Gold followed with a decline of about 10%, another move not seen in more than four decades.

However, Warsh will be one voter out of the 12 voting members in the Federal Open Market Committee. As such, it is reasonable to expect that his views will not be widely reflected in the Fed's actions, or at least not immediately. At the latest FOMC meeting last Wednesday, the central bank voted 10-2 to keep rates unchanged, and outgoing Fed Chair Jerome Powell indicated that this decision had broad support among both voting and non-voting members. In remarks following the FOMC, both Federal Reserve Vice Chair for Supervision Michelle Bowman and St. Louis Federal Reserve Bank President Alberto Musalem expressed their support for keeping rates unchanged for some time. Furthermore, there is currently broad support within the FOMC for the policy of maintaining ample reserves, as evidenced by the decision taken in December to halt QT and immediately initiate a stealth QE, whereby the Fed will purchase at least $40 billion of Treasuries until at least April.

Therefore, the most accurate interpretation of the market's reaction to Warsh's appointment is that it was a pretext to take profits on a number of trades that had become parabolic, rather than an indication of fears about a tightening stance by the Fed, which currently seems highly unlikely. To the contrary, it is probable that Warsh's first priority will be to persuade other members to lower rates, rather than to intervene on the balance sheet.

Another positive aspect is that Warsh is a highly credible candidate, an ex-Governor with extensive private sector experience in financial markets, and a degree of ex-ante nonpartisanship. To this extent Warsh's nomination should be welcome news in terms of deflating the risk premium associated with concerns about the Fed's subservience to political interests.

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In terms of possible impacts on financial markets, Warsh's nomination should be supportive for the front end, less clear for longer maturities, as improved institutional credibility clashes with the prospect of a smaller balance sheet. In this respect, the administration's focus on affordability and the Fed's recent expansionary adjustment to the trajectory of the balance sheet make an abrupt shift unlikely.

As for equities, while re-iterating that an abrupt shift in balance sheet policy is unlikely, the overarching principle of supporting Main Street over Wall Street, reflected in a bias towards lower policy rates, is likely to foster a continuation of the broadening trade in place over the past months.

With regard to currencies, increased institutional credibility reduces the left tail risk for the US dollar. However, in the medium term, it is expected that the greenback could continue to weaken in the wake of likely lower interest rates and a White House that appears unconcerned about the depreciation that has occurred over the past year.

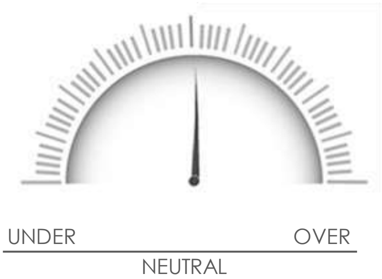
Asset Allocation View

	Under (−)	Neutral (=)	Over (+)
Equity			
Developed Markets		■	
Emerging Markets		■	
Fixed Income			
Developed Markets Sovereign			■
Developed Markets Corporate			■
Emerging Markets			■
Commodities		■	
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

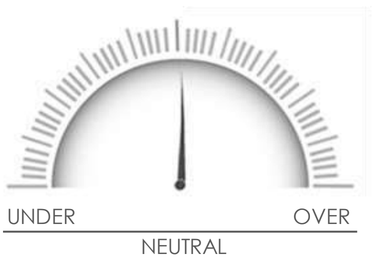
Developed Markets



We maintained our **Neutral** recommendation on Developed Market equities. The recent nomination of Warsh as the next Fed Chair is not expected to materially alter the market outlook, at least in the near term. A healthy pullback following recent gains remains possible; however, with economic growth still solid, any retracement should be viewed as a buying opportunity. We continue to recommend broad diversification across styles, sectors, and regions, with a majority of committee members favoring non-US markets over the US.

US	−	**Europe**	=	**Japan**	=

Emerging Markets

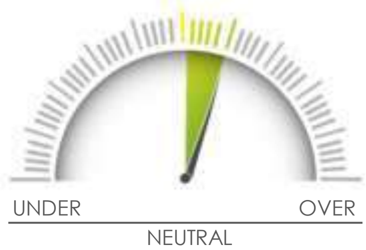


We confirm our **Neutral** stance on Emerging Market equities. Emerging market valuations remain attractive, despite the re-rating of recent months, albeit a risk of a short-term correction have increased following the recent outperformance. Expectations that the US dollar will remain weak in the medium term, the strength of commodities—which emerging countries are typically richly endowed with—and the breaking of multi-year highs by the MSCI Emerging Markets Index suggest that the current bullish trend in emerging countries still has room to run.

Asia ex-Japan	=	**EEMEA**	−	**LATAM**	+

Fixed Income

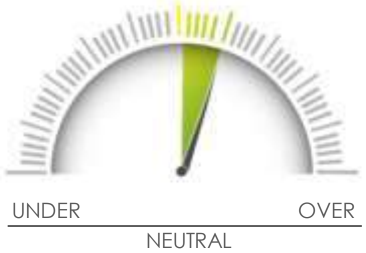
Developed Markets Sovereign



We maintain our **Slightly Overweight** recommendation on Developed Market sovereign bonds. Our preference remains for segments of the curve up to seven years, while we are more cautious on longer tenors. This is particularly true in the United States, where recent macroeconomic data point to an acceleration in economic activity. By contrast, we are more constructive on Japanese government bonds, as recent data suggest an economic slowdown; however, we continue to recommend caution until at least this week's election.

EU Core	=	EU Periphery	=	US Treasury	=	Japanese JGB	=

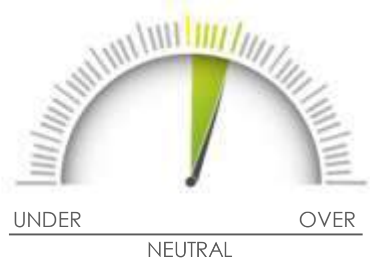
Developed Markets Corporate



We maintain our **Slightly Overweight** recommendation on Developed Market corporate bonds. Demand for credit remains robust, even if spreads have tightened to record lows. With no major drivers on the horizon to materially increase volatility, near-term market moves are expected to remain contained given the continued resilience of the U.S. and European economies. We continue to recommend a focus on high-quality issuers, while avoiding excessive exposure to high-yield instruments.

IG Europe	+	IG US	+	HY Europe	−	HY US	−

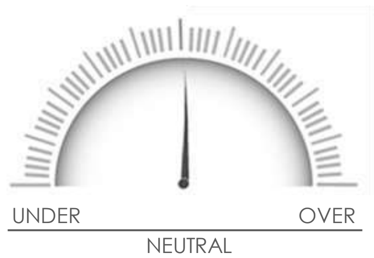
Emerging Markets



We continue to maintain our **Slightly Overweight** recommendation on Emerging Market Bonds. The rapid tightening of spreads in developed market bonds makes emerging market spreads comparatively more attractive versus similarly rated developed issuers. U.S. dollar weakness, along with ongoing diversification away from U.S. assets by international investors, could further support capital flows into emerging markets. Valuations remain compelling across much of the asset class, offering investors a higher yield without taking on excessive credit risk.

Local Currency	=	Hard Currency IG	=	Hard Currency HY	=

Commodities



We maintain a **Neutral** recommendation on Commodities. Precious metals suffered a sharp correction following their parabolic rise in recent months. Such a correction was overdue, and Warsh's appointment merely provided a catalyst for the retracement. While we recommend some caution in the near term given elevated volatility, our medium-term view remains constructive: precious metals still have room to advance and can continue to serve as a portfolio hedge. As for other commodities, industrial metals and energy may have further scope to extend their recent rally, supported by solid economic growth.

Precious	=	Energy	=	Industrial	=	Agricultural	=

Currencies

We maintained our **Neutral** recommendation on the US Dollar. Warsh's appointment could be a pretext for a temporary strengthening of the dollar, but in the long term, the US currency is poised to weaken further owing to the likelihood of a more accommodative Fed under the new leadership, as Warsh is expected to push for lower rates.

The view on the Euro remains **Neutral**, as the common currency trade exactly in line with the level suggested by the rate differential with the US and other countries

We have maintained our **Neutral** stance on the **Chinese Renminbi**.

The outlook for other **emerging market currencies** has been confirmed as **Neutral with a bullish bias**. The recent outperformance of emerging debt strategies has been gaining momentum among investors, despite the uncertainties still surrounding trade relationships and Warsh's appointment.

Euro	=	USD	=	CNY	=	Other EM	+