Azimut Global Network

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

Main Events

12.01 – US CPI
Thanks to the sharp decline in energy prices, particularly gasoline, inflation may continue to drop

13.01 – UK IP
The slump in industrial production is expected to continue, reaching -2.9% YoY

17.01 – CHINESE DATA
Will there be a significant improvement in retail sales, fixed asset investments, and industrial production in light of the ongoing reopening?

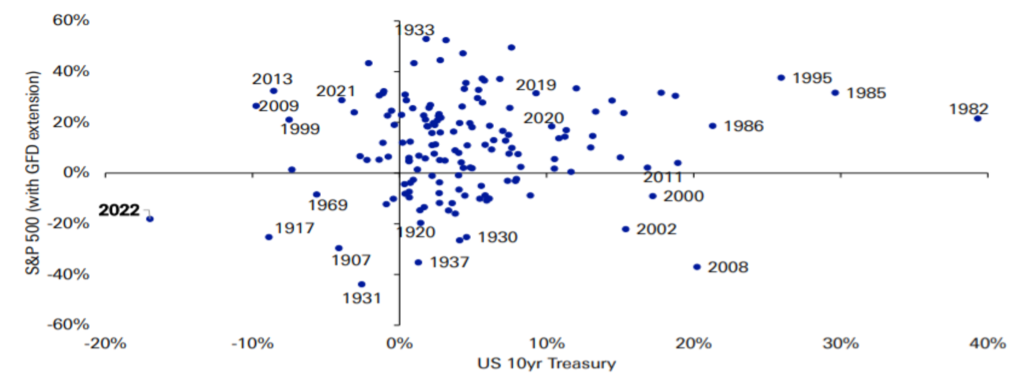
18.01 – US RETAIL SALES
Retail sales in nominal terms are expected to show a back-to-back decline; a warning that the economy may soon begin flirting with a recession

LET'S ENJOY THE PARTY WHILE IT LASTS

- **After a terrible 2022, the new year started with a more bullish attitude, thanks to favorable inflation readings in the EU and supportive measures in China.**
- **U.S. markets continued to underperform, suggesting that investors are diversifying their portfolios away from the United States, and benefiting from much lower valuations in the rest of the world**
- **If U.S. inflation slows more sharply than expected, there is a possibility that the current rebound will continue until the Fed meeting in February**

We have finally left behind a truly horrific year. The best way to illustrate this is through the chart below, courtesy of Deutsche Bank: in the 150-year history of U.S. financial markets (such a long time series is only available for the U.S.) it has never occurred that stocks and bonds both lost more than 10% in the same calendar year. To be more precise, the performance of the two asset classes was closer to -20% than -10%. Cryptocurrencies suffered even deeper corrections. Only commodities managed to close the year barely positive, but still suffering declines of more than 20 percent from the highs, reached shortly after the invasion of Ukraine. There was literally no place to hide.

Figure 1: Annual total return performance of the S&P 500 and US 10yr Treasury since 1872



Source: Deutsche Bank

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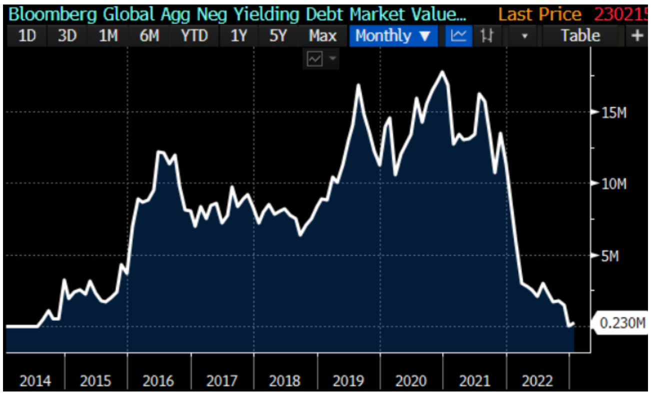

Source: Bloomberg

Source: Bloomberg

The start of the New Year was more promising. This is due to a variety of factors. Investors frequently increase portfolio exposures at the start of a new year because, typically, years ending with significant corrections are followed by years with positive performance. In addition, interest rates have returned to their highest levels in more than a decade, so the hope for positive returns from the fixed-income component is real (for just one day, on January 4, 2023, there were no more negative-yielding bonds, when only two years earlier there were as many as $18 trillion of them outstanding). In addition, the extremely oversold condition in which many asset classes were in, encouraged a rebound.

The catalyst igniting the rebound was the remarkably favorable inflation numbers in Europe, down nearly a full percentage point to +9.2% YoY. Undoubtedly aiding the decline in inflation was the drop in the gas prices, which are now back around 70 euros per MWh after reaching 350 in the summer (down 80 percent since then). This was made possible by a particularly mild winter to the extent that the gas storage levels in Europe are not even declining. In the same way that the surge in gas prices contributed significantly to euro area's underperformance during the summer, its decline is enabling Europe to fully recover from its poor performance. This is also evident when looking at the Credit Suisse Economic Surprise Index (CESI) indicator, which measures whether macroeconomic data are better or worse than expected. The "CESI EUR" continues to rise, reflecting the resilience of the European economy, and is decoupling from the U.S. economy (the "CESI USA" remains flat).

Even China is experiencing a strong recovery in its financial markets, despite having significantly underperformed until October, much like Europe had. The MSCI China All-Share index, which measures the performance of Chinese stocks listed in mainland China and/or Hong Kong, and the Bloomberg China Credit High Yield index are both down by only 18 percent since the beginning of 2022, after a decline of around 40 percent. Besides heavily discounted valuations compared to other developed and emerging markets, bolstering the rebound in Chinese assets has been the government's change in attitude after protests erupted in different parts of the country over discontent with covid-related restrictions and the deepening crisis in the real estate sector. Since then, China has consistently announced measures to either remove the remaining covid-related curbs or to foster the recovery of the real estate sector.

Source: Bloomberg

Source: Bloomberg

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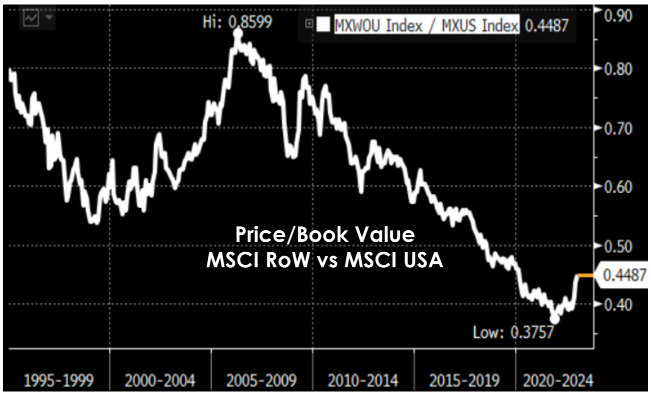

Source: Bloomberg

Source: Bloomberg

On the other hand, the US market has remained remarkably weak, underperforming both in December and in these early days of 2023. This year's underperformance is even more significant when one considers that growth stocks, which should have been the main beneficiaries of the drop in rates that occurred this year, are significantly over-represented in the U.S. indexes.

This dynamic may be explained by the fact that, after almost 15 years of U.S. outperformance, the valuation gap with the rest of the world has widened to the point where investors are starting to rebalance their portfolios by taking a larger position in the rest of the world. When we look at the price-to-book ratio, we can see that the MSCI World ex-US reached a record discount to the MSCI US of -60% a year ago. The gap has been gradually closing ever since. Probably too soon to declare with certainty that the long-term trend has changed. But if it has, the United States' poor performance has only just begun.

While in the medium to long term, underweighting the U.S. and growth seems to be a rational choice given the fundamentals, in the short term it is possible that they could rebound in relative terms given that both, the U.S. and growth, have severely underperformed in the past two months (all the more so considering the correction suffered by the dollar).

The catalyst for this relative rebound could be a better-than-expected U.S. inflation figure. The market consensus expects the CPI to fall from 7.1 percent to 6.5 percent. The base effect accounts for the entire 0.6 percent decline: in December of last year, prices increased by 0.6 percent month-over-month, and this increase will drop out from the year-over-year data, which will be revealed on Thursday. The cost of gasoline, which has dropped more than 15% in the US since the previous reading, is one volatile component that has continued to fall sharply. There is therefore a chance that the inflation data will be even lower than anticipated.

Recall that the Fed never stopped raising interest rates until they were higher than inflation. If inflation were to subside sooner and faster than expected, the Fed would have the option of stopping the rate hike cycle at a lower level. In that case, it would be reasonable to expect that risk-free rates could fall further from current levels, with positive effects on equity markets. The main beneficiaries should be growth stocks and consequently, the United States.

In the medium term, the picture is more uncertain.

Unlike Europe, where the CESI EUR, as mentioned above, indicates that the European economy is still strong, we are beginning to see some signs of weakening in the United States. The only notable exception is the labor market, which continues to remain remarkably strong. However, retail sales are expected to decline in nominal terms for the second consecutive month, and the housing market is experiencing a serious downturn, as touched upon in the previous report. Among the confidence indexes, there are certainly several that have provided misleading indications over the past two years. Among those that have not, remaining at high levels consistent with an economy that has actually remained strong, is the ISM Services PMI index.

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Now it happens that even this indicator representing the service sector, thus 70 percent of U.S. GDP, has literally collapsed in the latest survey, at a pace seen only at the onset of the recessions of the past decades.

And here lies the problem:

It's possible that interest rates will decrease and stock markets will rebound in January, if the inflation reading is favorable and there are no surprises from the reporting season. However, this would result in further loosening of financial conditions, which might not be to the Federal Reserve's liking given that the U.S. central bank's strategy over the previous year appears to have been focused on regaining credibility with the "transitory inflation" narrative through an outright hawkish stance. Therefore, there is a chance that the Fed will make another policy error at its meeting on February 1 in response to a previous policy error (failing to raise rates when it was necessary) by raising interest rates excessively despite some signs of an economic slowdown on the horizon.

Let's enjoy the party while it lasts. But we must exercise caution to avoid being caught off guard.

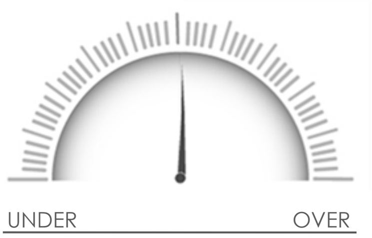
Asset Allocation View

	−	=	+
Equity			
Developed Markets		Upgrade	
Emerging Markets			Upgrade
Fixed Income			
Developed Markets Sovereign			
Developed Markets Corporate			
Emerging Markets			
Commodities			
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

Developed Markets



We **upgraded** our recommendation on Developed Markets Equities to **Neutral**. Better-than-expected readings on EU inflation in the near term, as well as the potential for a similar pattern to emerge in the US, could reignite hopes for an early policy shift by central banks, as was mentioned in the prologue. This might cause bond yields to further fall and stock prices to generally rise. On the other hand, if concerns about lower-than-expected EPS growth prompt fears during reporting season, the market's upside potential may be more limited.

US	=	**Europe**	=	**Japan**	=

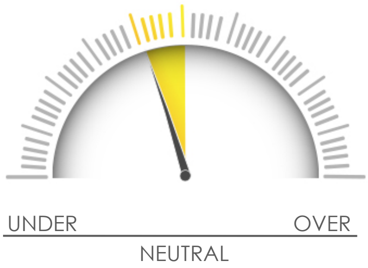
Emerging Markets

We **upgraded** our recommendation on Developed Markets Equities to **Slightly Overweight**. Given their still-low absolute and relative valuations, the possibility of a further decline in rates would be a tailwind for emerging market equities, should U.S. inflation slow more than expected. This is particularly true for Chinese equities, which may outperform other emerging countries due to the numerous support measures approved by the Chinese government in the past two months. In light of this and the political unrest in Brazil, we now prefer Asia ex-Japan region.

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

Fixed Income

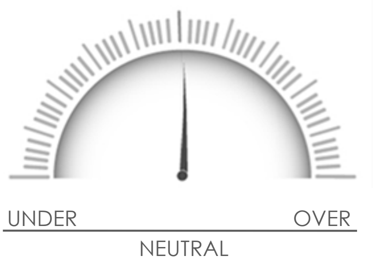
Developed Markets Sovereign



We maintained our recommendation on Developed Markets Sovereign Bonds to **Slightly Underweight.** The stronger-than-expected decline of inflation in Europe has encouraged a rebound in bonds (lower rates) after the heavy correction that hit them following the central bank meetings in December. A further decline in interest rates from these levels becomes possible only if U.S. inflation data proves more benign than expected. We still maintain a cautious stance on government bonds until central banks clearly signal that the rate hike cycle is indeed coming to an end. Among the curves, we maintain a more negative stance on the European YC.

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

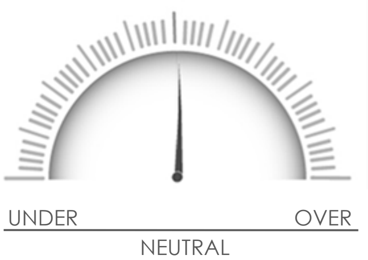
Developed Markets Corporate



We have kept our **Neutral** recommendation on Developed Markets Corporates. Spreads are at acceptable levels for investment grade bonds, whilst too narrow for high yield bonds, especially in case a marked slowdown or outright recession should materialize. Additionally, the potential for further decrease in risk-free rate is quite limited, unless global inflation data continues to surprise to the downside.

IG Europe	+	**IG US**	+	**HY Europe**	–	**HY US**	–

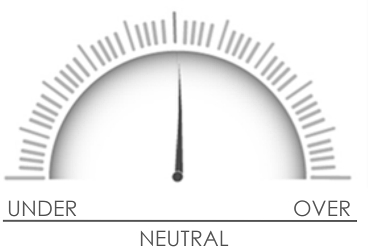
Emerging Markets



We maintained our **Neutral** recommendation on Emerging Market bonds. While emerging market bonds could benefit from a dovish pivot by central banks, which seems more likely in the near future if inflation continues to abate, they would also be exposed to downside risks in the event of a global slowdown or recession. Within the asset class, local currency bonds continue to remain in favor.

Local Currency	+	**Hard Currency IG**	–	**Hard Currency HY**	–

Commodities



We maintained our **Neutral** recommendation on Commodities. Energy and industrial commodities should benefit from the increasingly tangible easing of Covid-related restrictions in China as well as from measures to support the Chinese economy. Precious metals could benefit from a further weakening of the dollar and a disinflationary environment, and they can serve as portfolio hedges in case of unexpected troubles, especially those that could arise from geopolitical tensions.

Precious	+	**Energy**	=	**Industrial**	=	**Agricultural**	=

Currencies

The Committee confirmed its **Neutral** view **with a bearish bias** on the US Dollar. Although the Federal Reserve has confirmed its hawkish stance, it is expected to be the first central bank to slow the pace of rate hikes in 2023, which could lead to further weakness for the greenback.

The view on the Euro has been upgraded to **Neutral with a bullish bias**. The particularly aggressive stance of the ECB regarding rate hikes and QT could enable Euro to regain further ground against the dollar and other major currencies. In addition, the easing of concerns over gas prices during the winter is helping to rebuild confidence in the region.

The view on the **Chinese Renminbi** has also been increased to **Neutral with a bullish bias**. The easing of Covid measures, the approval of measures to support the real estate sector, and the inflows of foreign investors repositioning themselves on China will likely keep the Renminbi strong.

On the **other emerging market currencies,** we maintain a **Neutral** stance taking into account both the risk of a potential global slowdown and the potential weakness of the US dollar.

Euro	=	USD	=	CNY	=	Other EM	=