Main Events

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

U. MICHIGAN INFLATION EXPECTATIONS
Trends in 5- to 10-year inflation expectations are one of the metrics most closely watched by the Fed
10.02

EU GDP
Eurozone economy should have avoided a contraction in the fourth quarter of last year
14.02

US CPI
Inflation is expected to slow further to 6.2 percent although it should increase by 0.5 percent MoM
14.02

US RETAIL SALES
After two consecutive readings of about -1%, retail sales are expected to rise 2% MoM, fully recovering the previous decline
15.02

CONFUSING MESSAGES

- **The latest central bank statements have not always been aligned with what has been said before, causing confusing reactions on rates and stock markets**
- **Powell downplayed the relevance of the recent easing of financial conditions, suggesting that the Fed is not against the recent recovery in financial markets**
- **Ms. Lagarde signaled that ECB has made no irreversible commitment to implement a series of 50 basis point hikes, and that risks to inflation appear more balanced**

The central bank meetings held last week were expected to bring clarity on monetary policy stance and the path of interest rates.

Unfortunately, the opposite happened, and as a consequence, markets reacted in a disorderly manner to the confusing messages conveyed by central bankers. Probably, the most effective commentary was the one by BlackRock's Jeffrey Rosenberg (referring to the Fed but also applicable to the ECB): "There's a real disconnect between what he [Powell] said, what the statement said, maybe what he wanted to say, and what the markets heard".

The tone of the press release was quite hawkish with the statement that "ongoing increases in the target range will be appropriate," implying that speculation that there would only be one more 25 bps increase in March was unfounded. It also stated that "Inflation has eased somewhat but remains elevated," as if the recent decline in inflation was not considered sufficient.

At the beginning of the press conference, the tone was consistent with the statement: "we will need substantially more evidence to be confident that inflation is on a sustained downward path," and "although inflation has moderated recently, it remains too high."

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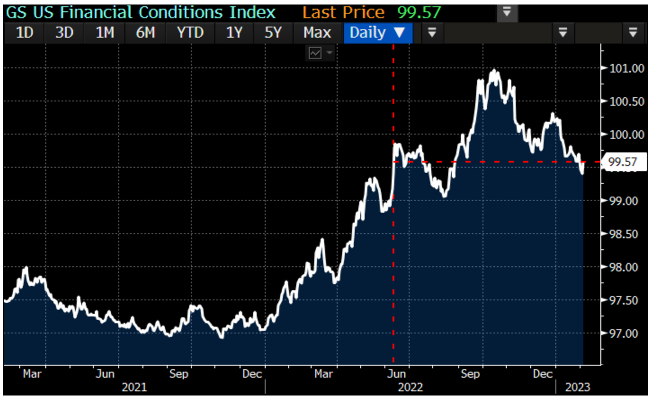

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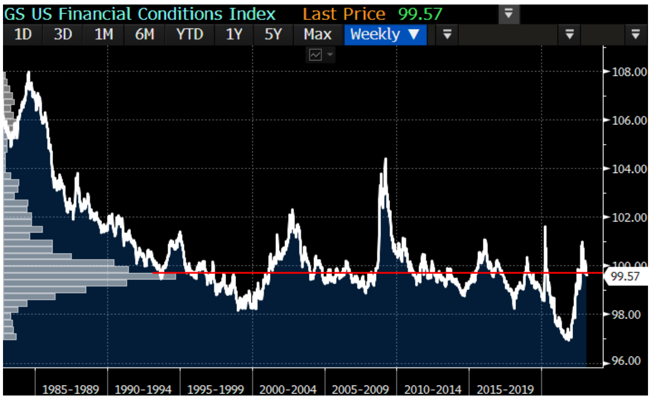


Source: Bloomberg

The tone, and especially the market's reaction, changed dramatically since two reporters asked Powell if he was concerned that the recent surge in financial markets and the resulting easing of financial conditions was threatening to undermine the central bank's tightening effort.

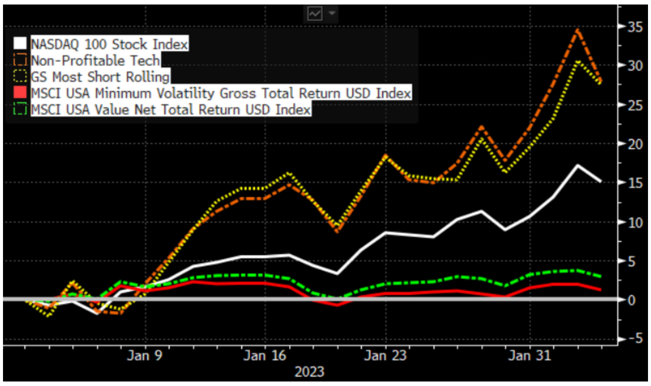
Powell responded by saying that "financial conditions have tightened very significantly over the past year," but more importantly that "financial conditions didn't really change much from the December meeting to now. They mostly went sideways or up and down, but came out in roughly the same place." The market interpreted the last statement as the Fed having no problem if the stock market continued to rise and risk-free rates continued to fall as sharply as they have since the beginning of the year. As a result, the rally in various asset classes accelerated even further.

Moreover, although at one point Powell stated that "I don't see us cutting rates this year," he also added that if "inflation does come down much faster than we expect, which is possible [...] we would take that into account." So even the promise to keep rates high for a long enough period of time regardless of the inflation dynamics is no longer a certainty, becoming instead conditional on the level of inflation.

To imply that current financial conditions are at acceptable levels is difficult to understand, given that we are below the 100 mark that separates the restrictive and expansionary conditions. We are certainly close to the previous meeting's levels, but by December, financial conditions had already eased considerably and were back to June levels, before the Fed began its series of 75 bps hikes.

Extending the time horizon, we can see that in the 1980s (the time series only begins in late 1982), when the Fed actually decided to fight inflation aggressively, financial conditions were around 108, and remained above 100 for a decade. In contrast, the current level is even lower than the average of the past 30 years (red line in the graph above), a time frame that can hardly be characterized as a period when the Fed has been restrictive. Even the distribution of financial conditions (horizontal bars on the left axis) reveals that the current level is in the bottom third of all historical levels.

As mentioned, these remarks spurred further gains in both bonds and equities, and particularly in stocks that were hit the hardest last year and/or fundamentals, in what appears to be a short squeeze rather than the beginning of a new bull market: the indices of non-profitable tech and most shortest stocks rose between 30% and 35% YTD. The Nasdaq (+15% YTD) largely outperformed US value and US minimum volatility indices, both barely positive YTD.



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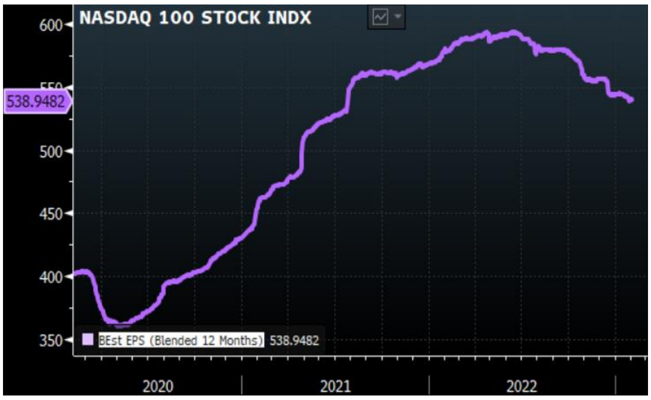


Source: Bloomberg

Source: Bloomberg

It should be noted that Nasdaq earnings expectations for the next twelve months continue to fall despite the continued strength of the economy. They are back to July 2021 levels in nominal terms, despite inflation having risen 10 percent since then. The premium given to growth stocks is entirely due to supposedly stronger-than-average earnings growth. Why pay a premium if earnings are falling rather than rising, even in an inflationary environment?

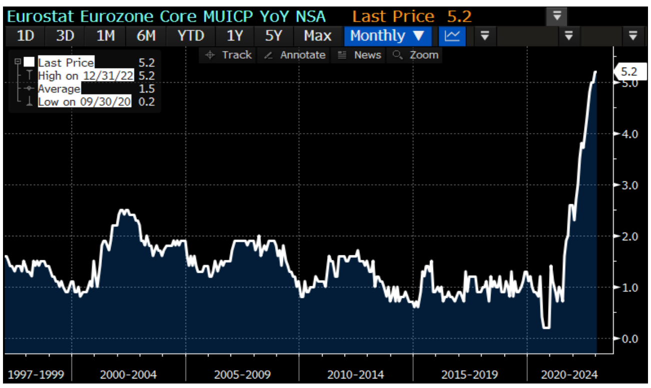
Furthermore, due to the combined effect of the decline in earnings and the +15% YTD performance, Nasdaq's P/E (green line above) has returned to the 24 area, close to the record and unsustainable levels of 2020-2021. We have also pointed out in the past that there is a rather strong relationship between the Nasdaq P/E and real rates (white line, inverted scale in the same graph). Since Jackson Hole, the gap between the two metrics has continuously widened, but it is expected to close eventually.

But let us now turn our attention to Europe, where the ECB has not missed an opportunity to further lose credibility. Just two weeks ago, at the World Economic Forum in Davos, Ms. Lagarde promised that the ECB "will stay the course" in its monetary policy and baldly warned traders who've taken dovish rate wagers "to revise their position. They would be well advised to do so." Last Thursday all of those claims were proved futile.

During the press conference, Lagarde said that the "risks to inflation have become more balanced". One has to wonder again how such a statement can be made given that inflation is declining, but still close to double digits (+8.5% YoY), and a core inflation has yet to show any signs of retracement, remaining at +5.2% YoY.

Lagarde also reneged on the commitment announced at the very previous meeting to conduct a series of 50 basis point hikes. Although the ECB "intends" to hike rates again in March, the "word 'intend' isn't irrevocable" because "an intention isn't a 100% commitment" and "today's decision wasn't a decision for March." It makes no difference that it was also announced that "significant rate hikes are required in all reasonable scenarios," because the market correctly understood that there is no forward guidance and that decisions will be made meeting by meeting.

What is most perplexing is the apparent coordination of central bankers in failing to refute the market's interpretation of the most recent policy meetings. When the market misinterpreted a central bank's message in the past, one or more of its governors quickly corrected course. Although the Fed, BoE, and ECB all reiterated their determination to keep financial conditions tight, none of them bothered to warn that market rallies were unwelcome because they had the opposite effect that they desired.



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The outlook for interest rates thus becomes much more complicated to predict, considering that on the one hand market rates are significantly lower than official rates, which is an anomaly in comparison to the previous report's argument.

On the other hand, the time window for central banks to raise interest rates is getting increasingly narrow, as the effects of the previously implemented rate hikes are expected to begin to be felt in full soon. With the global economy expected to slow in the coming months, it is difficult to imagine that the rate hike cycle could extend beyond the spring (US) or summer (EU and UK), unless there are new inflationary flare-ups, for which there are no signs yet.

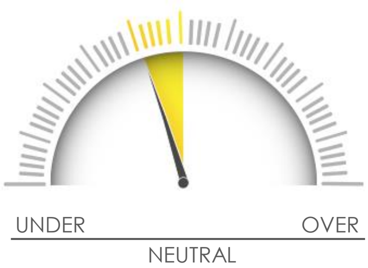
Asset Allocation View

	Under	Neutral	Over
Equity			
Developed Markets	Downgrade		
Emerging Markets		Downgrade	
Fixed Income			
Developed Markets Sovereign		Upgrade	
Developed Markets Corporate		■	
Emerging Markets	Downgrade		
Commodities		■	
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

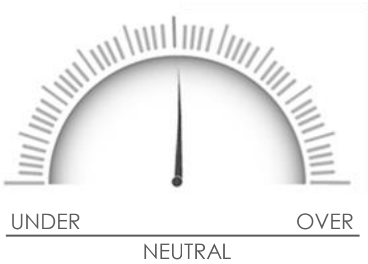
Developed Markets



We downgraded our recommendation on Developed Markets Equities to **Slightly Underweight**. Stock market gains since the beginning of the year, combined with lower expected earnings per share have once again pushed multiples to less attractive levels. Furthermore, the rally appears to be more of the result of a short squeeze enabled by falling interest rates rather than an improvement in fundamentals. It is therefore considered appropriate to reduce the recommendation, while waiting for a more attractive entry point.

US	Neutral	**Europe**	Neutral	**Japan**	Neutral

Emerging Markets



We reduced our recommendation on Emerging Markets Equities to **Neutral**. Renewed geopolitical tensions between the United States and China over China's spy balloon may be the pretext for profit-taking on Chinese stocks after the rally of the past three months. The news of a 200% tariff on Russian aluminum imports into the United States is also hurting emerging market stocks. While we wait to see if these are isolated incidents or a new escalation of geopolitical tensions, it is considered appropriate to return to a neutral recommendation, despite valuations remaining largely supportive.

Asia ex-Japan	Neutral	**EEMEA**	Under	**LATAM**	Neutral

Fixed Income

Developed Markets Sovereign

We upgraded our recommendation on Developed Markets Sovereign Bonds to **Neutral.** Ambiguous comments on upcoming monetary policy decisions delivered by central banks last week, together with a narrowing of the time window when significant rate hikes can be implemented suggest that a more neutral stance on rates is appropriate for the near future. We continue to favor shorter maturities (maximum 6-9 months) over longer maturities.

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 the event of a marked slowdown or outright recession should materialize. Furthermore, unless global inflation data continues to surprise to the downside, the potential for further reductions in the risk-free rate is quite limited.

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

Emerging Markets

We lowered our recommendation on Emerging Market bonds to **Slightly Underweight**. The significant tightening of spreads in recent weeks and renewed geopolitical tensions after the Chinese spy balloon episode could fuel a correction in the asset class.

Local Currency	+	Hard Currency IG	−	Hard Currency HY	−

Commodities

We maintained our **Neutral** recommendation on Commodities. 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 on the US Dollar. Among central banks, the Federal Reserve has changed its stance on future rate hikes the least, while renewed geopolitical tensions and an oversold situation suggest a possible strengthening of the dollar in the short term.

The view on the Euro remains **Neutral**. Lagarde's questioning of the commitment to multiple rate hikes of 50 basis points could lead to a widening of the 2-year rate differential in favor of the United States, thus reducing the appeal of the euro.

The view on the **Chinese Renminbi** is also confirmed **Neutral**. Capital inflows from foreign investors who are repositioning themselves on China could be jeopardized by the Chinese spy balloon episode, even though the Chinese economy is still expected to accelerate in the coming quarters.

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

Euro	=	**USD**	=	**CNY**	=	**Other EM**	=