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

JAPAN CPI — 24.02
Japanese inflation is expected to rise to 4.3 percent, the highest level since 1981

US HOME PRICES — 28.02
Has the drop in 30-year mortgage rates over the past two months helped ease pressures on U.S. real estate?

EU CPI — 02.03
The pace of the decline in European inflation will be critical in shaping future actions by the ECB

GLOBAL PMI — 03.03
Business confidence data for major world countries released by S&P will help gauge the effective strength of the global economy

STRONGER ECONOMY, HIGHER RATES

- **Macroeconomic data released in the past two weeks have shown that the U.S. economy is much stronger than previously anticipated**
- **Fixed income markets reacted by revising upwards the Fed terminal rate expectations, while substantially reducing the possibility and magnitude of rate cuts in the second half of the year**
- **Equity markets remained stable, offsetting the prospects of higher rates for longer with the expectation that the strength of economy may allow avoiding a recession**

In the previous report, we pointed out that in their latest meetings, central banks have paved the way for a less hawkish attitude than in the past. In the days that followed, macroeconomic data suggested that restrictive monetary policies may be needed for longer than expected, especially in the United States.

Nonfarm payrolls increased by 517k in January, nearly three times the expected number, and the previous figure was revised upward as well. As a result, the U.S. unemployment rate fell to 3.4 percent, matching the low of 1968-1969. This is a sharp reversal from the recent trend that had seen a softening in the labor market, with new jobs gradually falling from 350k in August to around 250k in December. This dynamic was welcomed by the Fed, which had sought precisely to orchestrate labor market softening as a necessary condition for reducing inflationary pressures.

The same day saw the release of the ISM Services, an indicator we referred to two reports ago as one of the few confidence indices that had shown no signs of slowing down in recent months, contrary to most confidence indicators that have long erroneously predicted a recession without it then materializing. This indicator fell from 55.5 to 49.2 in December, suggesting that indeed a slowdown was taking hold. In the January reading, the ISM Services index returned exactly to where it started (55.2), implying that the December drop was a statistical error and not meaningful.

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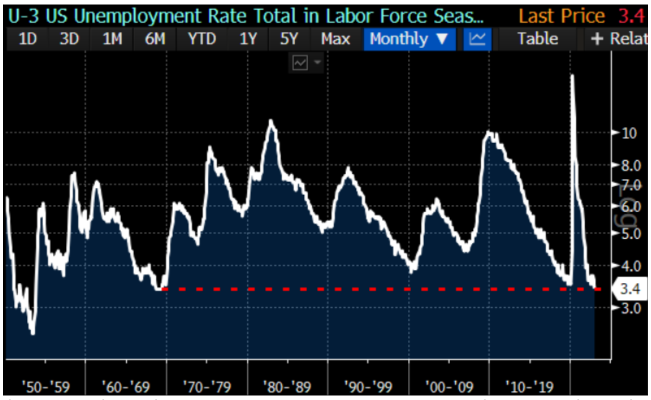


Source: Bloomberg

Source: Bloomberg

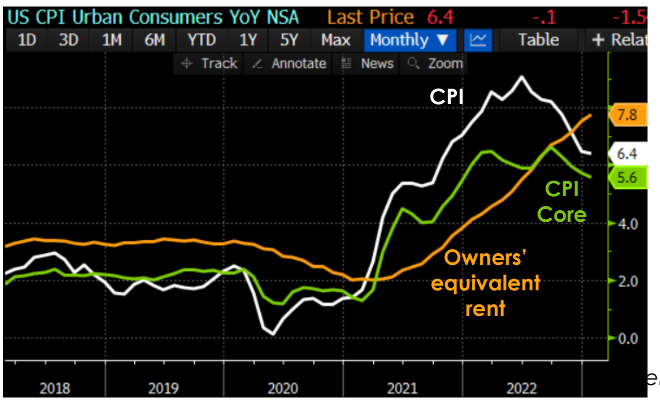
In mid-February, inflation data threw cold water on the expectations of those who were hoping for a rapid decline in inflation. The CPI effectively fell from 6.5 percent to 6.4 percent, which was less than expectations that pointed to 6.2 percent. The surprise came particularly from the "owner equivalent rent" component (as explained in previous reports, this is an indirect measure of the cost of housing), which climbed to 7.8 percent year-on-year. This component accounts for one-third of core inflation, which, as a result, fell by only 0.1% to 5.6 percent. The more resilient core inflation proves to be, the more the Federal Reserve will be forced to raise rates and/or keep them at a high level for a long time.

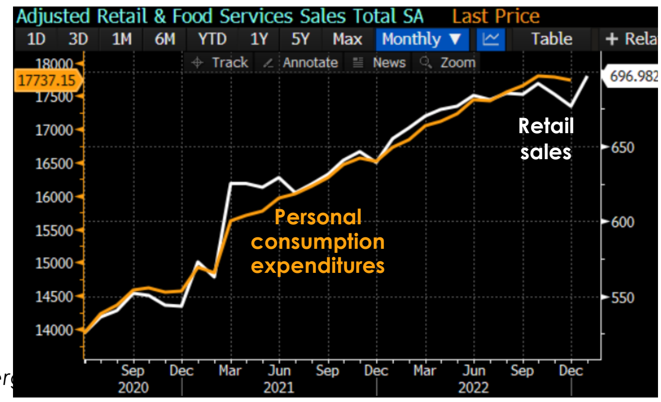
Producer prices also fell, but in this case the decline was even more contained: the core PPI fell from 6.5 percent to 6.0 percent, versus forecasts of 5.4 percent, while the PPI excluding food and energy fell from 5.8 percent to 5.4 percent, versus expectations of 4.9 percent.

Finally, retail sales, which had shown a rather pronounced decline in the last two readings (especially considering that they are expressed in nominal and not real terms), roared back, growing by 3 percent MoM. For the past two months, there had been a wide divergence between retail sales and personal consumption expenditure (PCE), which had instead remained fairly stable. The most recent retail sales reading appears to indicate that the PCE data were correct. If confirmed, signs of a slowdown in consumption needed to achieve the Fed's goal of containing inflation have been belied.

In light of all this data signaling an exceptionally strong labor market, robust consumer spending, and resilient inflation, it is not surprising that the various Fed governors have delivered hawkish messages in recent days. Some have stressed the need to raise rates, even higher than previously communicated, with Bullard not even ruling out the possibility of resorting back to increases of 50 basis points.

Fixed income markets could only note that expectations of an imminent end to the rate hike cycle, and even more so of possible Fed rate cuts, were unfounded.





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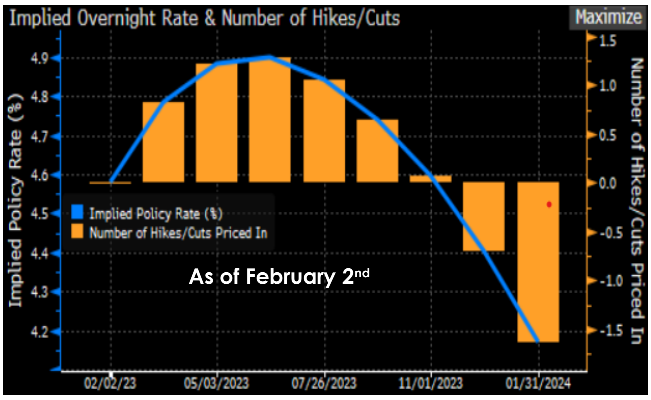
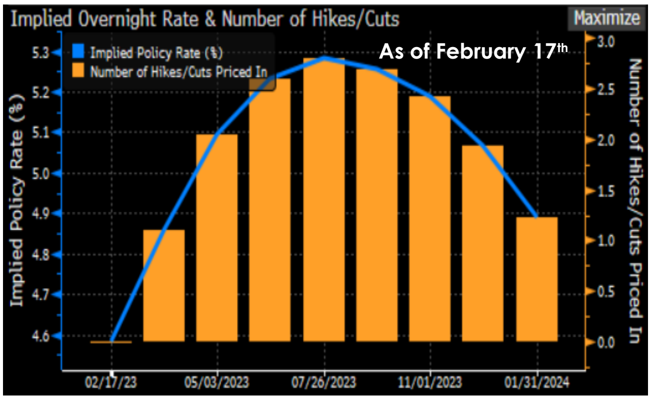




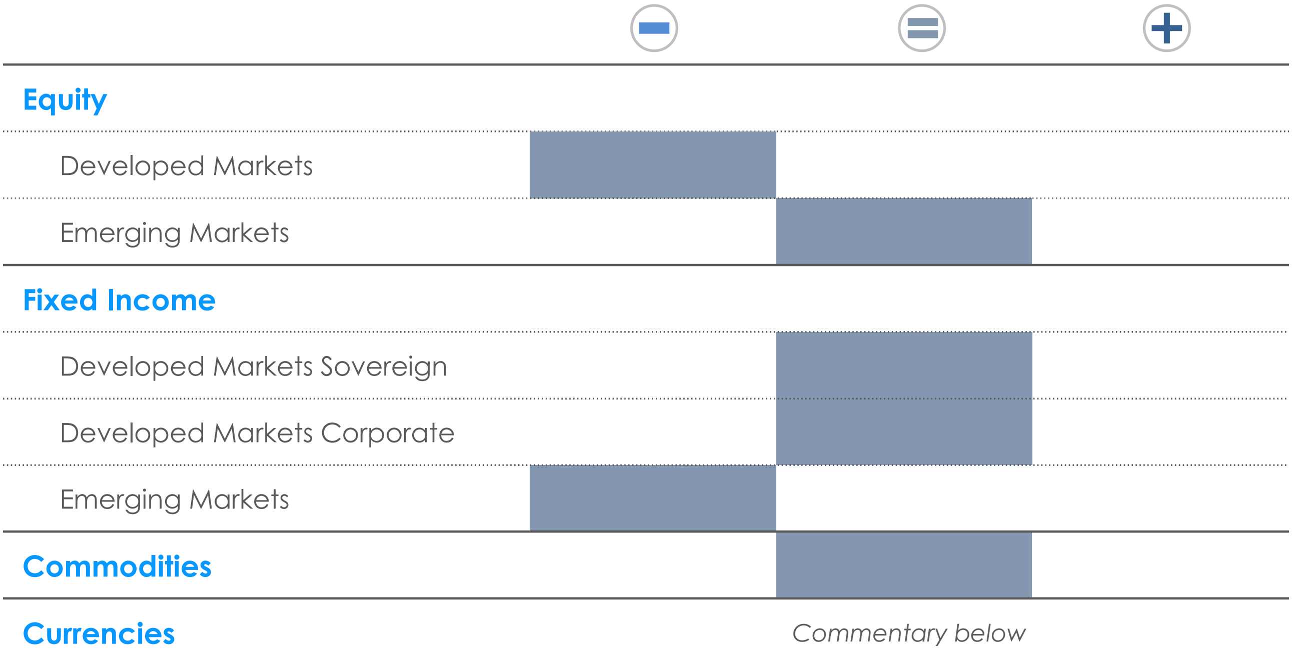
Source: Bloomberg *Source: Bloomberg*

As of February 2nd, immediately following the previous FOMC meeting, market expectations were that the Fed would make a final 25 basis point hike in March, raising rates to 4.9 percent (with the Fed Fund Rates range rising from the current 4.50-4.75 percent to 4.75 - 5.00 percent), and then lowering them starting in the summer to levels below 4.2 percent by January 2024. Fast forward to February 17th, market expectations now point to a peak rate of about 5.3% (implied range of Fed Fund Rates 5.25%-5.50%) followed by a still significant, but more modest, decline to 4.9% by January 2024.

Should this scenario materialize, it means that starting in the second quarter of this year, we will have the opportunity to accumulate government bonds with very attractive yields to maturity. This assumption will likely apply to European bonds from the third quarter. In addition, starting from such high levels, should a slowdown or recessionary scenario actually occur at some point, it is reasonable to expect that in addition to the elevated carry, sovereign bonds can again function as portfolio hedges, with rates falling and bond prices rising.

The scenario for equities, on the other hand, is more uncertain. The prospect of higher rates for longer, which seems increasingly likely, is expected to weigh on stock prices since the consequence of a rise in risk-free rates is that the implied returns of all other asset classes must also increase, and the only way to achieve this result is through a correction in prices. For the time being, such a correction has not occurred because higher rates have been offset by the expectation that a stronger-than-expected economy may translate into higher earnings and/or avoiding a recession. But if and when a slowdown materializes while rates are still at such high levels, the stock market may prove vulnerable, while sovereign bonds may be the best place to be.

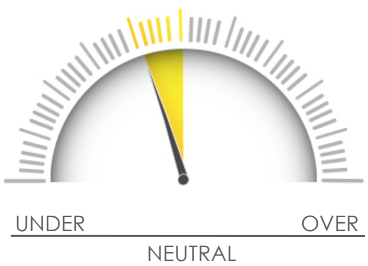
Asset Allocation View



UNDER NEUTRAL OVER

Equity

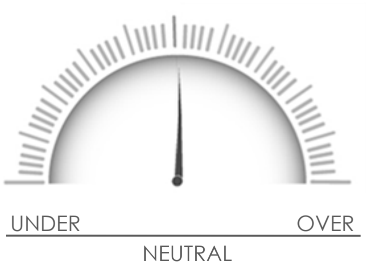
Developed Markets



We kept our **Slightly Underweight** recommendation on Developed Markets Equities. Stock market gains since the beginning of the year, combined with lower expected earnings-per-share have pushed multiples to less attractive levels. Equity markets are expected to remain range-bound for the immediate future, and are currently trading in the upper end of the trading range. However, the AA committee believes that at the moment, given the strength of macroeconomic data, markets are not exposed to excessive drawdown risks from current levels either.

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

Emerging Markets

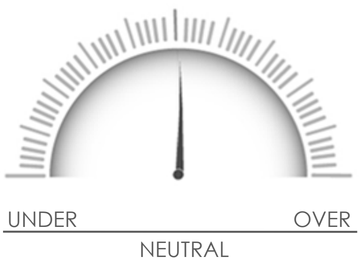


We maintained our **Neutral** recommendation on Emerging Markets Equities. Renewed geopolitical tensions between the U.S. and China over the Chinese spy ball could cause some volatility in the short term, but in the absence of a major escalation the ongoing retracement in emerging markets could be seen as a buying opportunity for those who are underweight. In addition, also the strength of economic data supports the positive view on emerging markets. We, therefore, suggest continuing to gradually accumulate emerging markets as the place with the best fundamentals in relative terms.

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

Fixed Income

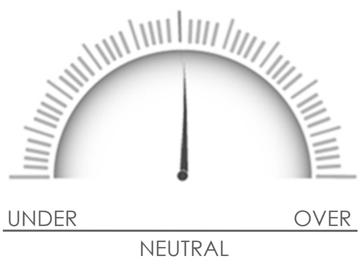
Developed Markets Sovereign



We maintained our recommendation on Developed Markets Sovereign Bonds to **Neutral.** After the sudden and deep decline following central bank meetings, interest rates have resumed their rise in Western countries, approaching the highs reached in October. On the one hand, hawkish rhetoric from central banks suggests that there may still be limited downside on bonds (upside on rates); on the other hand, the current level of rates is increasingly attractive in absolute terms and sovereign bonds could also serve as portfolio hedge in case of an economic slowdown.

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

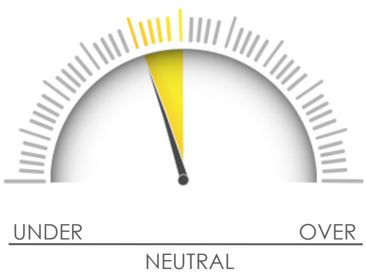
Developed Markets Corporate



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**	−

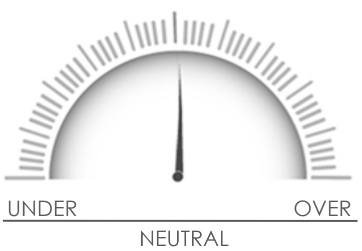
Emerging Markets



We kept our recommendation on Emerging Market bonds to **Slightly Underweight**. The significant spread tightening 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 rebound when central banks will finally halt their hiking cycle, and they can serve as portfolio hedges in case of unexpected issues, especially those that could arise from geopolitical tensions.

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

Currencies

The Committee confirmed its **Neutral** view on the US Dollar. After the central bank meetings, the Federal Reserve is the one that passed the most hawkish messages, suggesting that official rates could rise even to higher levels than the market expected. This stance should be supportive of the dollar in the short term.

The view on the Euro remains **Neutral**. Unlike the Fed, which defended the idea of a rate hike in response to strong economic data, several ECB members reiterated that rates are likely to be raised only until the summer, and none of them suggested raising rates by 50 basis points after the March meeting, reducing the relative attractiveness 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.

Euro =	USD =	CNY =	Other EM =