AZIMUT GLOBAL VIEW

03.
04.
23

Main Events

Azimut Global Network

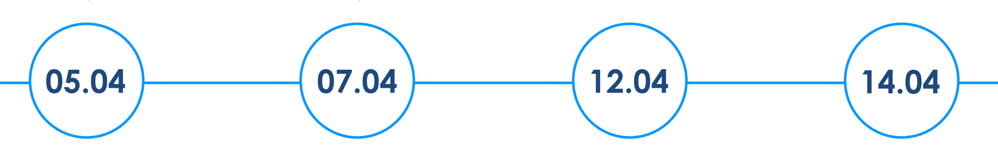
- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

S&P GLOBAL PMI — The March PMI data can help assess whether the banking crisis has had any effects on business sentiment

US PAYROLLS — A stronger-than-expected reading could raise concerns that the Fed would still hike interest rates

US CPI — Inflation is the other key data point that will guide the Fed's choices at the May meeting

US RETAIL SALES — Retail sales are expected to decline in nominal terms for the second consecutive month



NO NEWS IS GOOD NEWS

- **In the past two weeks, the lack of negative developments on banks enabled markets to fully recover the losses incurred in early March**
- **Backing the rebound was also the expectation of a dovish pivot by central banks, as well as the recent expansion of the Fed's balance sheet, which has been interpreted as the first step toward the end of QT**
- **Concerns regarding the level of valuations and the apparent disregard for risks related to a credit crunch or a global slowdown still remain.**

After the chaotic weekend that saw the collapse of Credit Suisse, no other dramatic events struck the financial markets or the banking sector. For a few days the market tried unsuccessfully to attack Deutsche Bank's CDS, and some concerns remain about a few regional banks in the US, but the danger of systemic contagion seems to have been averted at least in the immediate future.

In times of stress, no news is good news, and as a result the market began to rebound. The rebound then picked up steam, once again, on the expectation that recent events will bring central banks to the long-awaited pivot.

At its last meeting on March 22, the Fed, like many other central banks, continued to raise interest rates, despite recent events in the banking sector. It can safely be said that compared to pre-SVB statements indicating the need for several more interest rate hikes, Powell left the door open to any possibility in the near future.

On the one hand, he stated that the tightening of credit standards expected in the coming months and discussed in the previous report will have equivalent effects of a rate hike, implying that the Fed may not raise rates further. On the other hand, however, he reiterated that inflation is not yet defeated, and the newly released dot plot showed that the Fed is far from ready to lower rates as per market expectations.

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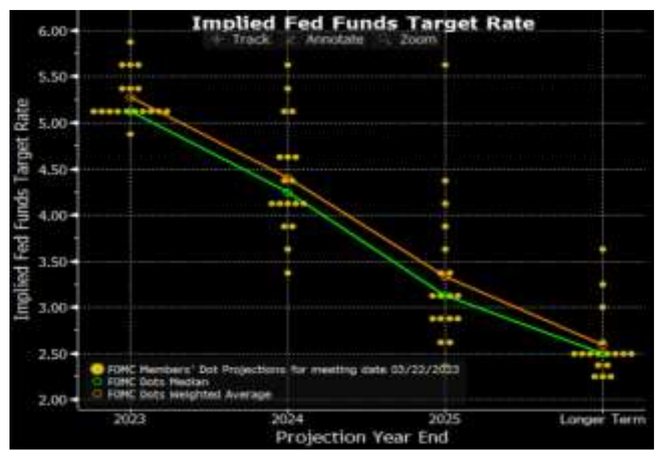
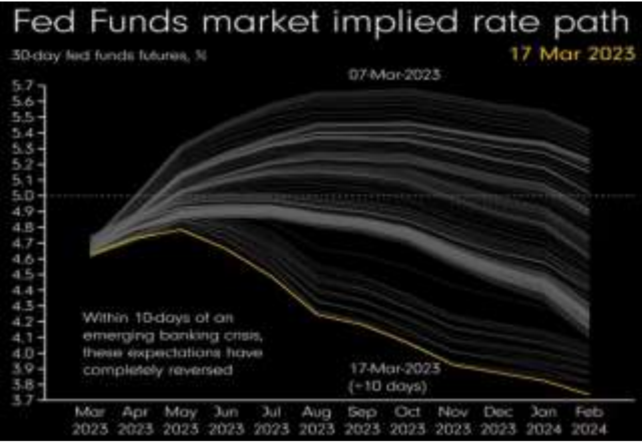


Source: Bloomberg



Source: @JamesEagle17, www.Barchart.com

Both median and average projections for the end of 2023 indicate that a further rise in rates is still possible, and that by the end of 2024, the rates will be just below the current level. Market predictions, which point to far larger and more rapid cuts, conflict with this. In just 10 days, from March 7 (pre-Silvergate Banks' voluntary liquidation) to March 17, Fed Funds implied rates (which measure market expectations of where Fed Funds will be in the near future) plummeted more than 150 bps to 3.80 percent. Today Fed Funds for January are around 4.10 percent, more than a full percentage point below the dots' level.

The Federal Reserve's balance sheet has also grown once more during the past two weeks, reaching $8.7 trillion. But, unlike in the previous 15 years, the entire rise, or around $350 billion, is not attributable to QE or other policies that promote the prices of financial assets. The emergency programs the Fed (BTFP, detailed in the last report) launched to prevent a wide spread run on the entire US banking industry are fully responsible for the growth in the Fed's balance sheet.

The total amount of 343 billion that US banks have asked the Fed for is not considerably different from the sum that banks received from the Fed in 2008 through comparable emergency measures. Indeed, the Fed is providing the market with additional liquidity, but due to the significant stress in the banking system, this liquidity is unquestionably not meant for speculation and is not intended to fuel asset inflation as in the previous decade.

Some wanted to see if this month's sudden expansion of the Fed's balance sheet was a repeat of 2019. At that time, too, the Fed was implementing a QT to reduce its balance sheet, although this had led to an increase in overnight money market rates starting in September. In the face of these developments, the Fed began injecting liquidity into the repo market in what has come to be known as "stealth QE", and shortly after decided to end QT. The recent spike in the Fed's balance sheet was therefore interpreted as the first step toward the end of QT as well, and not just of the rate hike cycle.

Source: Bloomberg

Source: Bloomberg

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Source: Bloomberg

Source: Bloomberg

A rally in risk asset classes has been sparked by a lack of negative news, the potential for no further hikes should a credit crunch follow the banking crisis, much lower market rates, and the Fed's balance sheet expansion. These factors together have led to expectations that rates and inflation will only fall from this point forward.

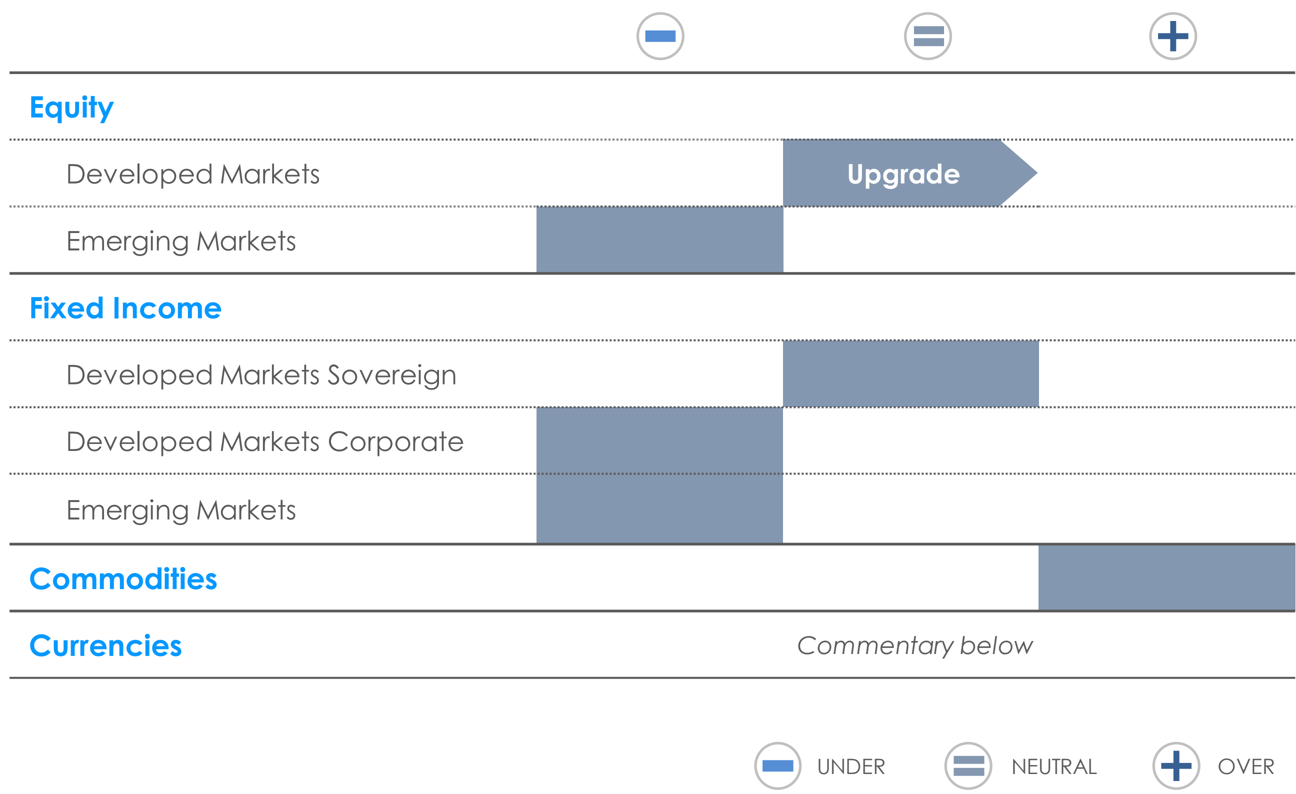
As if nothing had happened, all of the major stock markets are currently trading at levels that are either equal to or higher than those that existed prior to the start of the US banking crisis and the collapse of Credit Suisse. As if that weren't enough, EPS forecasts have been rising since March despite statements from central banks and numerous economists that the probability of a recession is considerably higher now than it was a month ago.

Growth companies, which are more sensitive to interest rates, have led the surge. The sustainability of this rally will be seen in the coming weeks. Here, we simply point out that the current P/E of the Nasdaq is 29, one of the highest levels ever, if we exclude the 2020-2021 period when earnings were depressed by lockdowns, or the 2000 bubble. It is relatively normal for the P/E calculated using current earnings (those of the previous 12 months) and not forward-looking earnings (those projected for the next 12 months) to be higher than average during recessionary periods, because the denominator (E, earnings) is temporarily depressed. The reverse is also true. The combination of high P/E multiples based on abnormally high current earnings should be interpreted as a warning bell. The current P/E of 29 is not only historically high, but it is also calculated over a period, 2022, when companies made record profits thanks to an economy that grew much faster than average, to the point where not even the fastest rate hike in decades could slow it down.

The market is now unconcerned with this risk and is instead concentrating on the multiple on projected earnings, which is at a more "acceptable" level of 24. However, 24 is obtained based on the projections that profits will increase by 20 percent in the next 12 months vs the current earnings. These are perhaps a bit too optimistic assumptions, considering that inflation is expected to decline (no longer supporting nominal EPS growth) and that the economy could transition from exceptionally strong to weaker (or much weaker).

Past experience shows that the market can temporarily believe to a different (and always rosier) reality than the actual one, as happened as recently as 2021, when the threat of inflation and the consequent need to raise rates were snubbed by both central banks and the market. Since the focus now seems to be only on liquidity (the only metric that is going up and that the bulls can cling to, as rates are still at high levels, particularly in the short end of the curves), it is possible that this bullishness will persist until the next piece of bad news forces another repricing.

Asset Allocation View

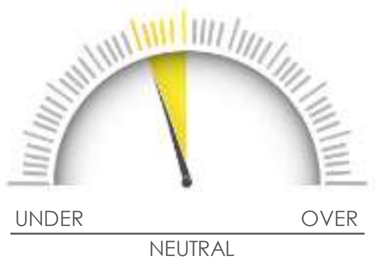


	−	=	+
Equity			
Developed Markets		Upgrade	
Emerging Markets	■		
Fixed Income			
Developed Markets Sovereign		■	
Developed Markets Corporate	■		
Emerging Markets	■		
Commodities			■
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

Developed Markets



We upgraded recommendation on Developed Markets Equities back to **Slightly Underweight**. Having averted the risk of an immediate widening of the banking crisis, the market rebounded in reaction to a positioning of extreme bearishness, on the expectation that central banks are nearing the end of the rate hike cycle, and of the Federal Reserve's balance sheet expansion, as discussed in the prologue of this report. In the absence of negative news in the short term, the current uptrend may still have room to continue, but we remain cautious in the medium term because the market does not seem to have fully discounted the risks of a slowdown.

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

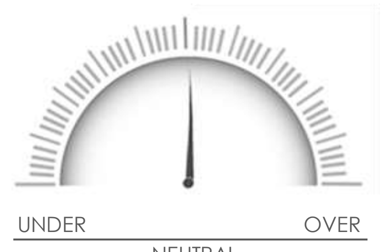
Emerging Markets

We kept our recommendation on Emerging Markets Equities unchanged at **Slightly Underweight**. On the one hand, emerging countries could be hurt more in the event of a global credit crunch and/or a slowdown, a possibility that cannot yet be ruled out. On the other hand, they continue to trade at much lower multiples than developed countries. Among emerging countries, we are relatively more positive on Asia ex-Japan, considering that sentiment data on China suggest an acceleration in economic growth.

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

Fixed Income

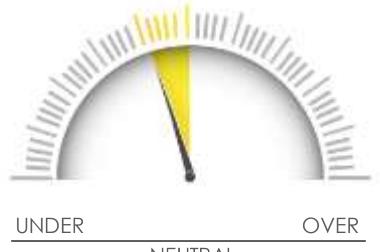
Developed Markets Sovereign



We maintained our **Neutral** recommendation on Developed Markets Sovereign Bonds. With the rate increases announced during their meetings in March, central banks might have completed or be very close to completing their cycle of rate increases. If so, interest rates might remain in the same range going forward.

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

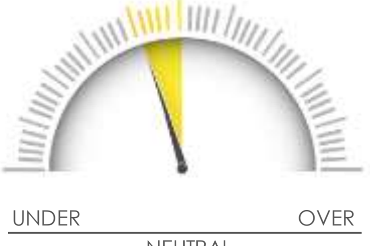
Developed Markets Corporate



We have changed our recommendation on Developed Markets Corporates to **Slightly Underweight**. Other than the European AT1s following the collapse of Credit Suisse, corporate bonds have not seen a sharp widening in credit spreads; instead, they have recently reverted to their levels from the start of the year, excluding the additional risks brought on by the banking crisis. We are more constructive on investment grade corporate bonds over high yield bonds.

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

Emerging Markets



We kept our recommendation on Emerging Market bonds as **Slightly Underweight**. Emerging country bond spreads have not widened significantly since the March events, and do not adequately reflect the risks of a credit crunch or global economic slowdown.

Local Currency	+	Hard Currency IG	−	Hard Currency HY	−

Commodities

We maintained our **Slightly Overweight** recommendation on Commodities. Fears unleashed by the banking crisis in the U.S. and Europe, coupled with expectations that this will lead to a premature end to the rate hiking cycle, are both driving forces for the price of precious metals. Furthermore, we believe there is room for a rebound after other commodities experienced a sharp correction due to fears of an impending recession, in particular on energy commodities after OPEC's surprise production cut.

Precious	+	Energy	+	Industrial	=	Agricultural	=

Currencies

The Committee confirmed its **Neutral** view on the US Dollar, but **with a bearish bias**. After the last FOMC meeting, it seems likely that the Fed's rate hike cycle has come to an end, or that there will be only one more rate hike, while other central banks may be asked to stick with it. This could lead to a narrowing of the U.S. rate differential vs. the rest of the world, with negative implications for the dollar.

The Euro is also **Neutral**, but **with a bullish bias**. Inflation data that continue to surprise to the upside in Europe could force the ECB to keep raising rates longer than other central banks, supporting the single currency in the medium term.

The view on the **Chinese Renminbi** and on **other emerging market currencies** is also confirmed **Neutral** waiting for more clarity about the effective impact of a possible credit crunch and/or an economic slowdown.

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