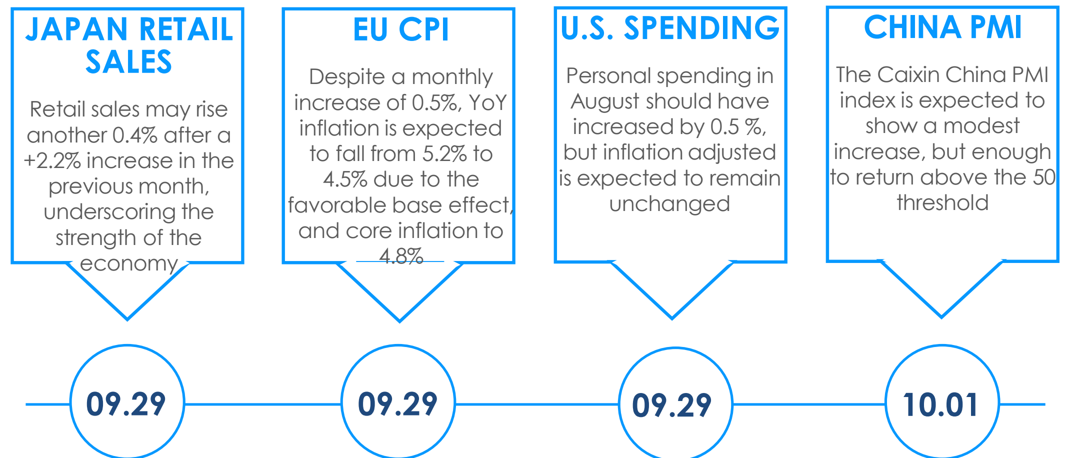
Main Events



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

HIGH FOR MUCH LONGER

- **The ECB raised rates probably for the last time, but confirmed that monetary policy will remain restrictive for a long period of time**
- **The Federal Reserve kept rates unchanged, but significantly raised its projections on where rates will be in the next two years**
- **As a result, interest rates continued to rise considerably, especially on the long end of the curves**

The past two weeks have been marked by central bank meetings. For different reasons, the ECB and the Fed both delivered a surprise.

The first to meet was the ECB. In light of the various indications of an ongoing slowdown in the eurozone, many had questioned the need for, or even pointed out the inappropriateness of, a further rate hike. t is widely known that inflation in the EU is expected to decrease in the coming months due to the base effect. Therefore, before the meeting there was much uncertainty about the real likelihood of a hike.

The hike did indeed come, immediately attracting criticism from some European governments who questioned precisely the appropriateness of the decision given macroeconomic developments. Moreover, during the press conference, Lagarde openly discussed the risks of a slowdown, drawing parallels to Trichet's infamous rate hike in June 2008.

Although further hikes have been ruled out for the time being, the ECB has insisted on the need to maintain a restrictive monetary policy in order to ensure the ultimate defeat of inflation. To achieve this goal, and since raising rates further is not an option, the ECB may seek to reduce the so-called excess reserves in the future. This refers to the excess liquidity deposited within the ECB itself. This hypothesis has been confirmed by rumors circulating in the following days."

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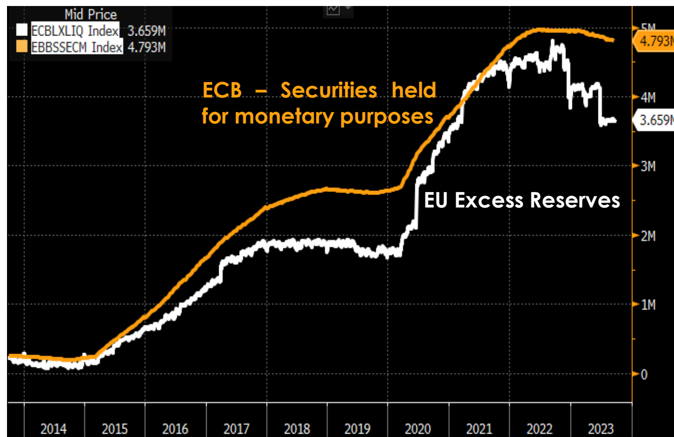
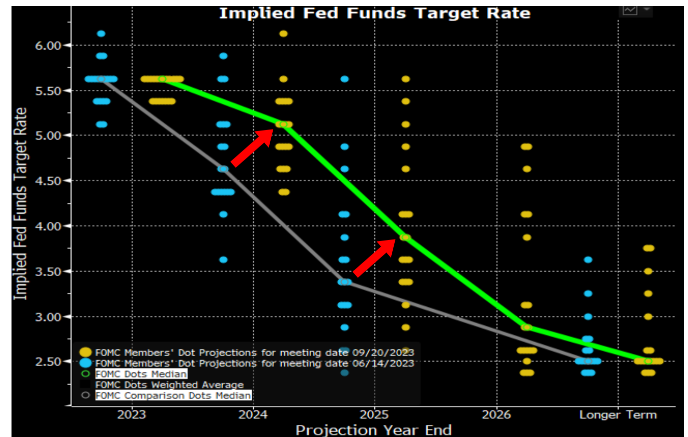


Source: Bloomberg



Source: Bloomberg

If this is confirmed, the consequences for markets could be more profound than apparently realized so far. Prior to 2015, excess reserves were essentially nonexistent. Only since 2015, i.e., since QEs have been repeatedly carried out (even if the actual need for some of them was questionable), have excess reserves started to increase, at a pace very similar to that of the ECB's purchases of government bonds (top left graph). If the ECB began to target a reduction in excess reserves as its next monetary policy tool, this would mean that the pace of QT could be increased, which could have consequences for European government bonds. But this will be the subject of another report.

Regarding the Federal Reserve, it kept rates unchanged as expected before the meeting. It reiterated that the focus now is not on whether there will be another 25 basis point rate hike (as predicted by updated dot projections by the end of the year), but on determining how long interest rates need to remain elevated.

As in previous meetings, Powell also reiterated the notion that the Federal Reserve intends to keep real rates at or above current levels for an extended period of time to ensure that inflation is permanently defeated. What caught the market by surprise, however, was precisely the manner and vehemence the Fed went against market expectations, that took the financial community by surprise. As was the case in June, the dot plot was the tool used to convey this message (as a reminder, the dot plot is the chart that shows individual Fed governors' expectations of where interest rates will be at the end of this year and the next three years, as well as for the very long term).

Recall also that throughout the rate hike cycle of the past 18 months, the market has always mistakenly expected that the Federal Reserve would never raise rates as much as the Fed itself had anticipated, and that in any case the Fed would begin cutting rates aggressively shortly after the end of the rate hike cycle. Over the past year, the market has consistently been on the wrong side, and the Fed has missed no opportunity to reiterate its determination to first raise, and then hold rates higher for a long period of time.

Well, the dot plot showed that in addition to another hike for this year, interest rates will be 50 basis points higher than in the previous projections in both 2024 and 2025. A median estimate of 5.12 percent at the end of 2024 indicates that at best there will be a 25 bps rate cut from the current level, and that at the end of 2025 rates will still be around 4 percent, a level that until two weeks ago the market thought could be reached as soon as early 2025.

Creating additional stress for market participants was the comment that although it is difficult to estimate where the neutral rate (the rate that neither stimulates nor restrains the economy) is, it is possible that it has at least temporarily shifted upward as a result of all the unprecedented events since 2020. Stating that the neutral rate could be higher than before implies that higher interest rates than before are now required to achieve the same monetary policy objective. In this specific case, it means maintaining a restrictive monetary policy."

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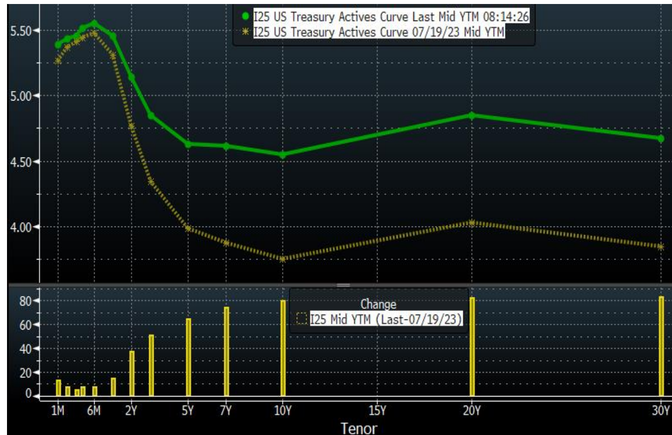

Source: Bloomberg

Source: Bloomberg

The market movements in recent weeks and especially in the last few days are consistent with this "new" scenario in which we are approaching the end of the rate hike cycle, but the expectation of an imminent interest rate cut is fading: since mid-July we have witnessed a noticeable bear steepening of the curves, with the short ends remaining essentially unchanged, while the long ends have seen increases of 80 basis points, a movement of unusual magnitude. Also from a technical point of view, all curves experienced major breakouts above previous highs for maturities of 10 years or more, followed by an acceleration, suggesting that rates still have room to rise in the near future.

For the future, we can therefore expect the short ends of the curves to be the segment of the bond market where there is currently little or no downside, while offering considerable carry. The long ends, as mentioned above, may be exposed to further downside in the short term, but the absolute level of rates we are reaching is starting to look interesting from a historical perspective, returning to levels not seen since before the Great Financial Crisis. Therefore, it is likely that the long ends of the curves, in addition to offering an attractive yield, will also resume their fundamental role of hedging the portfolio in the event of unforeseen troubles, particularly if an economic slowdown were to materialize.

his role as a portfolio hedge is particularly valuable now, as equities currently appear to be largely ignoring the increase in fixed income rates, maintaining close to record valuations. The big question mark is how long equities can continue to withstand increasing competition from bond yields.

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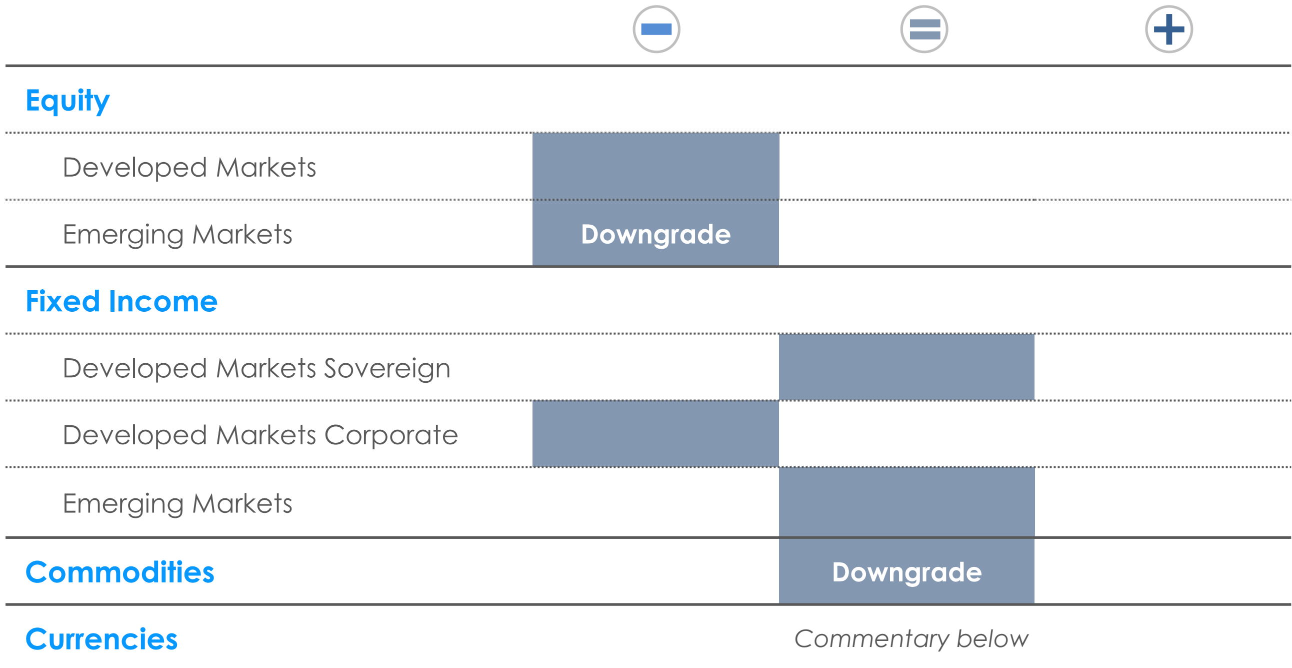
Asset Allocation View

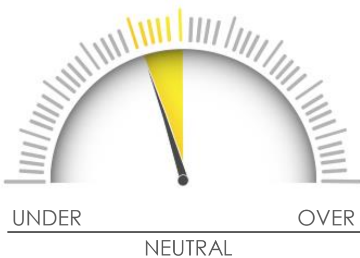


	Under	Neutral	Over
Equity			
Developed Markets	■		
Emerging Markets	Downgrade		
Fixed Income			
Developed Markets Sovereign		■	
Developed Markets Corporate	■		
Emerging Markets		■	
Commodities		Downgrade	
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

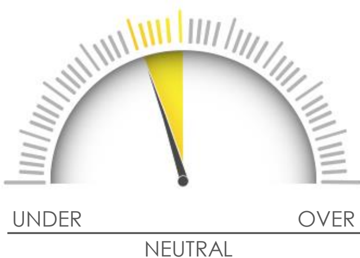
Developed Markets



We maintained our **Slightly Underweight** recommendation on Developed Markets Equities. Equity indices of developed countries have so far withstood the impact of higher rates, and even the prospect that these might remain at a high level for a much longer period of time than expected so far (as argued in the prologue) has not been able to change investor sentiment. Although sentiment is still supportive, the risk that a correction could start at any time cannot be disregarded, especially should the macroeconomic data ahead signal a more concrete risk of an economic slowdown.

US	Europe	Japan
Neutral	Neutral	Over

Emerging Markets



We downgraded our recommendation on Emerging Markets Equities to **Slightly Underweight**. The downgrade is justified by the large increase of interest rates in developed countries, particularly in the long ends of the curves, a circumstance where emerging countries have historically tended to underperform.

Asia ex-Japan	EEMEA	LATAM
Neutral	Under	Over

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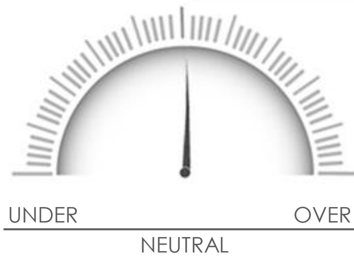
Fixed Income

Developed Markets Sovereign

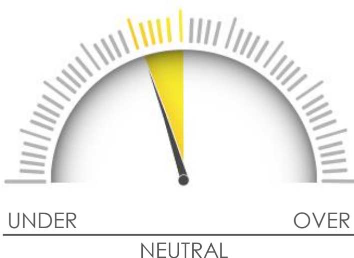


UNDER OVER
NEUTRAL

We kept our **Neutral** recommendation on Developed Markets Sovereign Bonds. Since the hiking cycle by central banks seems to be coming to an end, the Ccommittee believes that the short ends of the curves is the place with the best risk-reward, offering a high carry and limited downside. Conversely, the likelihood of a sustained higher neutral rate suggests that the long end may face additional downside pressure, a possibility supported by the breakouts above previous highs.

EU Core		EU Periphery		US Treasury		Japanese JGB	

Developed Markets Corporate

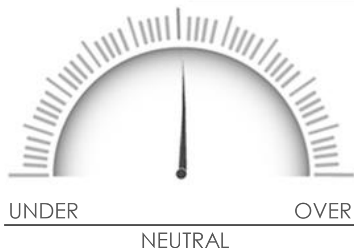


UNDER OVER
NEUTRAL

We maintained our **Slightly Underweight** recommendation on Developed Markets Corporates. The committee considers that spreads in both investment grade and high yield bonds have tightened too much and are now too narrow, particularly if a slowdown or recession occurs. We continue to favor investment grade corporate bonds over high yields bonds.

IG Europe		IG US		HY Europe		HY US	

Emerging Markets

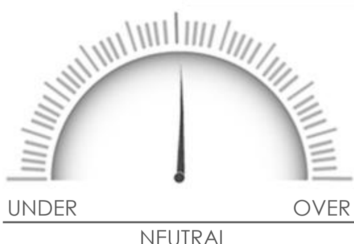


UNDER OVER
NEUTRAL

We maintained our **Neutral** recommendation on Emerging Market bonds. Considering the current macroeconomic landscape, emerging market debt spreads are not exceptionally wide. Nonetheless, in certain countries, inflation has markedly declined, prompting some central banks to contemplate initiating interest rate cuts, a development that could positively impact bond prices.

Local Currency		Hard Currency IG		Hard Currency HY	

Commodities



UNDER OVER
NEUTRAL

We downgraded our recommendation on Commodities to **Neutral**. The persistence of tight monetary policies for an extended period of time, along with rising nominal and real rates, is diminishing the short-term appeal of precious metals, despite their potential as a hedge against geopolitical risks or upside surprise in inflation. Regarding other commodities, we remain cautious, as some countries/regions begin to show symptoms of slowing, though this trend is not yet evident in the United States.

Precious		Energy		Industrial		Agricultural	

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Currencies

The Committee confirms the **Neutral** stance on the US Dollar. The Federal Reserve did not raise rates, as expected, but it lifted the dots for 2024 and 2025 by 50 bps, which surprised the markets and forced the medium/long parts of the curves to rise sharply. Nevertheless, considering that the greenback has strengthened recently, it is possible that the dollar could consolidate around current levels.

The view on the Euro is also **Neutral**. The ECB's rate hike was not a given, and could have led to a recovery of the single currency. However, the emphasis on the risk of an economic slowdown in the EU made up for the surprise on rates.

The view on the **Chinese Renminbi** remains **Neutral,** with a bearish bias. China continues to suffer from a lack of positive catalysts, therefore it is possible that the weakening of the yuan might extend further.

The outlook for other **emerging market currencies** remains **Neutral,** although we remain more optimistic about Latin American currencies, which might benefit from some of the world's highest real rates.

Euro		USD		CNY		Other EM	

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