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

US CPI — 12.10

Inflation is expected to climb to 3.7%, and core inflation to 4.3%. Anything higher-than-expected would likely imply another rate hike in November

US RETAIL SALES — 17.10

Will U.S. consumption take a hit because of ever-higher rates and the resumption of student loan repayment?

CHINESE GDP — 18.10

China's economy should have grown 4.5% from last year, a very disappointing figure compared to expectations after the lifting of the covid restrictions

UK CPI — 18.10

Thanks to the favorable base effect, inflation in the U.K. may cool enough to allow the BoE not to tighten further.

MARKETS CATCH UP WITH CENTRAL BANKS

- **Financial markets are beginning to accept the reality that interest rates may persist at elevated levels for an extended period. This is in line with the long-standing guidance from central banks.**
- **The increase in rates has been remarkable, not only in nominal rates but also in real rates, which have risen by about 150 basis points since mid-July**
- **The drop suffered by Treasuries in the last three years is unprecedented and is offering an increasingly attractive investment opportunity, although some caution is needed in the short term to avoid catching a falling knife**

In the previous report, we reported how Western central banks, in their September meetings, did everything possible to reiterate and emphasize the message that interest rates would remain high for an extended period of time.

Lately, it seems that the market is finally resigning to accepting this fate, after more than two years of fighting central banks by stubbornly assuming imminent and large rate cuts, with the result that curves have remained deeply inverted so long.

The increase in long-term rates, which was already underway since July, accelerated sharply after the Fed raised its projections on where rates will be in 2024 and 2025 by 50 basis points and Powell declared in the conference call that neutral rates could be higher than previously estimated.

These remarks by central banks, the breaking of some technical resistance on interest rates and the presence of outsized long positions by real money investors who have rushed to lengthen the duration of portfolios to lock in rates not seen in over a decade and/or to protect portfolios in the event of a recession (which, by the way, has not materialized so far) have led to the sharp acceleration of rates in recent weeks, probably also due to the closure of some of these long positions that were only generating deep losses.

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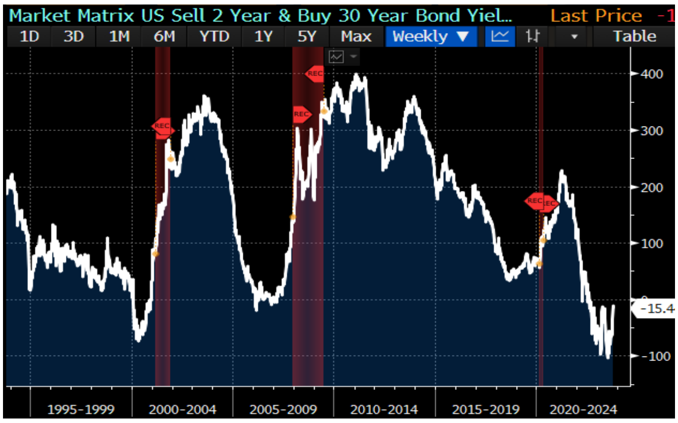

Source: Bloomberg

Source: Bloomberg

As a result, at the beginning of October the US 30-year touched 5% for the first time since 2007, when only in mid-July it was still at 3.8%, a remarkable increase in such a short period of time. Considering that the short end of the curve remained essentially unchanged as the hiking cycle is coming to an end, the increase in long term rates implies that the US curve is about to dis-invert. However, any dis-inversion of the curve should not be interpreted as a sign that a recession has been averted. Indeed, historically, yield curve inversion has consistently preceded recessions. However, it's important to note that by the time the recession actually occurs, the yield curve often returns to its normal state, or "dis-inverts".

Even more remarkable than the movement in nominal rates was the movement in real interest rates. The increase in real 10-year rates has been about 150 basis points in just three months, from about 1% in July to 2.5% today. Excluding three brief spikes between 2006 and 2008, real rates are currently at their highest level since 2002 and well above the levels prevailing when central banks implemented their monetary experiments (zero or sub-zero interest rates, QEs) over the past 15 years.

Similar indications arise when looking at the term premium, i.e. the compensation investors require to bear the risk of holding bonds with longer maturities, since the longer the duration, the higher the volatility (riskiness) of the bonds. In theory, the yield of a long-term bond should be higher than that of short-term bonds precisely to compensate for this additional riskiness. Over the past 10 years, the term premium has almost always been zero or negative. This can be explained by the fact that, in a world of zero or sub-zero rates, investors have had to resign themselves to accept less than fair compensation for holding long-term bonds. With the normalization of interest rates, investors once again have the opportunity to park their money in short-dated bonds that have essentially no volatility and offer attractive returns. Consequently, it is reasonable to expect that the term premium may continue to rise until the long ends of the curves start offering sufficiently higher yields than the short ends.

Considering that the term premium has just returned to positive territory, but that we are still well below the levels prevailing prior to the implementation of QEs, it is likely that the recent rise in long-term rates still has room to extend. For this reason, it may still be too early to aggressively accumulate in the long ends of the curves, although the index of long Treasuries (those maturing in 10 years or more) has already lost almost 50% from its highs (chart in the next page), a decline of record magnitude.

Even if, on the one hand, given the strength of the current selloff, some caution is needed to avoid catching a falling knife, it's also important to recognize that the extent of the decline in long-term Treasuries presents an increasingly attractive investment opportunity. This is particularly noteworthy because, in over 200 years of history, Treasuries have never experienced three consecutive years of decline, as they are currently doing.

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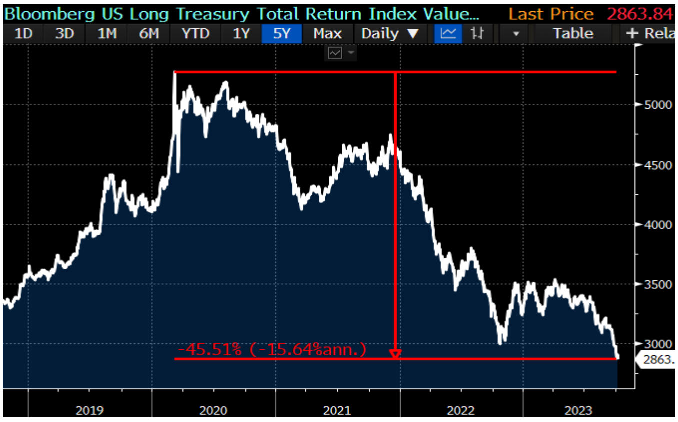


Source: Bloomberg

Source: Bank of America

Moreover, it must be considered that the higher the level reached by long-term interest rates, the greater the potential for long government bonds to serve as a portfolio hedge in the event of adverse shocks. These shocks could include a further deterioration of geopolitical tensions (such as the recent outbreak of the conflict in Israel) and/or a slowdown or recession.

Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

Developed Markets

UNDER OVER
NEUTRAL

We maintained our **Slightly Underweight** recommendation on Developed Markets Equities. On the one hand, rising nominal and real interest rates, heightened geopolitical tensions, and elevated valuations suggest that it is advisable to maintain a cautious approach. On the other hand, the robustness of the labor market in the United States may allow the economy to continue to grow at a strong pace, and recent corrections have led to more attractive valuations in some segments of the stock market.

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

Emerging Markets

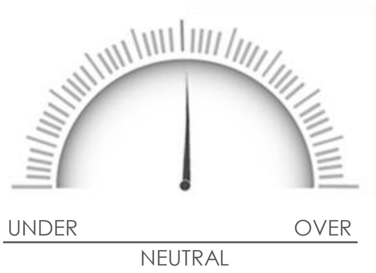
UNDER OVER
NEUTRAL

We kept our recommendation on Emerging Markets Equities at **Slightly Underweight**. The attack on Israel will inevitably be followed by a phase of increasing risk aversion towards emerging countries due to fears of a potential escalation of the conflict. This concern is compounded by the stress induced by the significant increase in nominal and real interest rates in Western countries, which typically has a negative spillover effect on emerging market equities. Consequently, caution remains advisable, despite the favorable valuations that persist.

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

Fixed Income

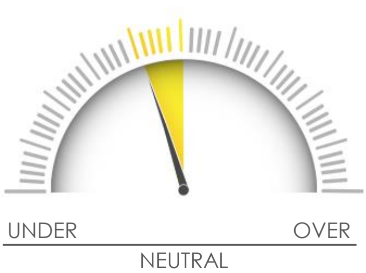
Developed Markets Sovereign



We kept our **Neutral** recommendation on Developed Markets Sovereign Bonds. After the significant rise in interest rates over the past three months, those who are still significantly underweight duration are advised to take advantage of the recent spike in rates to reduce the underweight. The preference remains at the moment for the short and medium ends of the curves, while some further downside is possible on the long ends. As the ECB is expected to have concluded its interest rate hike, the committee has a preference for EU core bonds

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

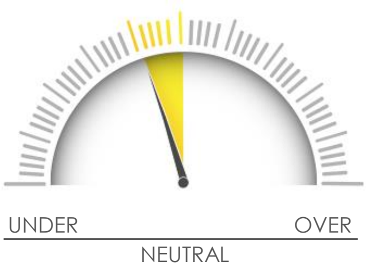
Developed Markets Corporate



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	−

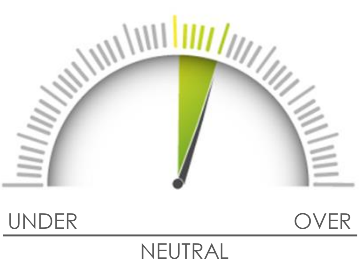
Emerging Markets



We downgraded our recommendation on Emerging Market bonds to **Slightly Underweight**. The combined effect of ever-higher nominal and real rates in Western countries, a strengthening dollar and a renewed flare-up of geopolitical tensions after the attack on Israel may make the asset class vulnerable to correction.

Local Currency	+	Hard Currency IG	−	Hard Currency HY	−

Commodities



We upgraded our recommendation on Commodities back to **Slightly Overweight**. Precious metals could appreciate in the short term due to their function as a portfolio hedge in the event of geopolitical tensions. Additionally, the correction suffered in recent weeks due to rising rates has provided an attractive entry point. Oil should benefit for the same reasons. The committee is instead more cautious on other commodities.

Precious	+	Energy	+	Industrial	=	Agricultural	=

Currencies

The Committee confirms the **Neutral** stance on the US Dollar. After the steady strengthening of the past three months, the dollar may be vulnerable to at least a short-term retracement. However, any further increase in geopolitical tensions could lead to a further appreciation of the dollar, as is often the case during phases of increased risk aversion.

The view on the Euro is also **Neutral**. Barring unforeseen developments, there should be no particular catalysts in the short term that could lead to a significant strengthening or weakening of the euro.

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 with a bearish bias,** given that the sharp rise in nominal and real interest rates in Western countries could put pressure on emerging market currencies. We continue to remain relatively more optimistic about Latin American currencies.

Euro	=	USD	=	CNY	=	Other EM	=