Main Events

US GDP	ECB MEETING	BoJ MEETING	FED MEETING
US GDP is expected to have grown by 4.6% more than twice the previous quarter's pace, driven by robust consumption	Will the ECB remain committe to battling inflation or shift focus to the ongoing EU slowdown?	Japan's central bank may announce further steps towards normalization of monetary policy	After the increase in market rates, there is growing uncertainty as to whether the Fed will actually deliver another rate hike by the end of the year
26.10	26.10	31.10	01.11

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

THE JURY IS OUT

- **Over the next two weeks, many of the uncertainties hovering over the financial markets will be cleared away**
- **The Federal Reserve has to prove whether it is effectively data-dependent or not, while the BoJ may announce further steps towards the normalization of its monetary policy**
- **The reporting season will shed light on how realistic earnings growth expectations are, especially for Nasdaq companies**

We are entering perhaps the most crucial two weeks of the year, when many of the investors' uncertainties will be cleared, good or bad.

The first category of uncertainties pertains to what central banks will do and especially what they will say.

The first to meet is the ECB, is probably the least likely to surprise the market. The September rate hike was the last in this cycle, and it is expected that the ECB will not act on rates for some time. The market also sees stable rates until at least next summer.

However, there are two elements of uncertainty, albeit minor. On the one hand, after the September meeting there was speculation that, even if rates are not raised further, the ECB still intends to increase monetary tightening through a reduction of the so-called 'excess reserves'. This would mean that the ECB might consider increasing the pace of its ongoing QT (the ECB is no longer rolling over some of its maturing bonds at the rate of about EUR 25 billion on average), which would not be welcomed by the market. Should this occur, it could lead to a strengthening of the euro, a widening of spreads, and an acceleration of the rise in long-term rates.

(continued)

Source: Bloomberg

Source: Bloomberg

On the other hand, the ECB could put the emphasis on the ongoing slowdown in Europe. If this were to happen, it would be interpreted as a first, concrete step towards a pivot. In that case, the market would start to anticipate that the first rate cut could be implemented well before the summer with positive implications for the equity markets but negative consequences for the euro.

What the Fed will choose to do, however, is much more uncertain. For months, Powell and the other Fed governors have been insisting that future decisions will be 'data-dependent'. Moreover, at the September meeting, the dots were increased by 50 basis points for 2024 and 2025, and the dots for the end of the year were confirmed at 25 basis points higher.

All macroeconomic data releases during the month indicate that the economy not only remains strong but is also accelerating. These include the creation of 336k new jobs, retail sales that increased twice as much as forecast and inflation figures that continue to exceed expectations.

Based on this evidence, if the Fed were truly data-dependent, it would have to continue raising rates. Not to do so would represent a loss of credibility and would indicate that the decision-making process is not so data-dependent, but rather, discretionary. Surprisingly, however, several governors have said in recent days that perhaps a rate hike is no longer necessary, since the market, by raising the long ends of the curve, has de facto led to a tightening of financial conditions equivalent to a rate hike.

Precisely because the Fed kept claiming for months that rates would continue to rise and monetary policy to remain restrictive for a long period of time, the market eventually resigned itself and caused the curves to almost dis-invert. If the Fed disavows these pledges, long-term rates might reverse course as well (although on market rates would continue to weigh the government's growing need to finance a rising deficit and debt).

The meeting in early November will therefore be crucial in shedding light on the future path of monetary policy in the US. Any deviation towards a more restrictive or more accommodative stance could have important consequences for the markets.

Even more uncertainty surrounds the BoJ meeting. Despite the fact that the BoJ has been gradually adjusting its monetary policy for about a year now, allowing an ever higher ceiling on 10-year rates, Japanese market rates have not kept pace with those of the rest of the world. This has led to a significant widening of the spread between Japanese and US rates, which is approaching its highest level since 2000.

This dynamic of the rate differential is clearly exerting downward pressure on the yen. Moreover, in order to defend the 10-year ceiling, the BoJ is forced to make repeated purchases of government bonds. This leads to an increase in the amount of yen in circulation, which in turn pushes to a weakening of the yen. At the same time, however, over the past three months in which Western rates moved sharply higher, the BoJ is clearly trying to defend the 150 threshold against the dollar, a level at which it had already intervened a year ago to halt a decline that was becoming politically difficult to justify, both domestically and internationally.

(continued)

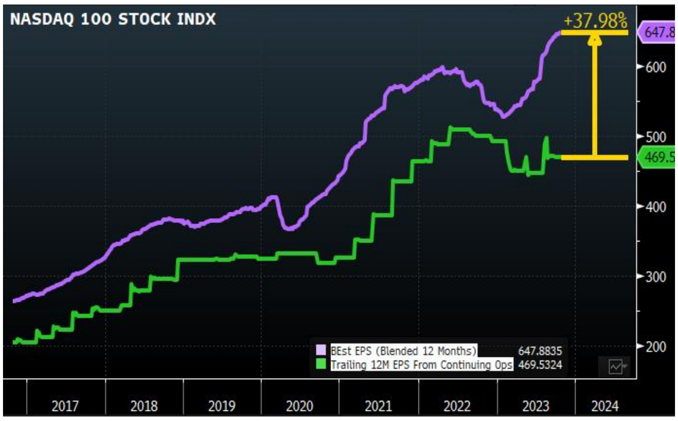
The BoJ is therefore trying to succeed in the impossible attempt to square the circle. If it continues to defend the ten-year ceiling, sooner or later it will have to let the yen depreciate, since to defend it the BoJ is forced to sell its reserves, which are in a finite amount. If it wanted to defend the exchange rate without risking depleting its foreign exchange reserves, then it would have to stop buying bonds to defend the cap on rates.

The easiest and least troublesome way out of this impasse is for the BoJ to continue the process of gradually abandoning the ultra-loose monetary policies of the past decades, preferably at a somewhat faster pace. It is not unlikely that the BoJ will take the occasion of its meeting at the end of October to announce further steps in this direction.

The second category of uncertainty is related to politics, more precisely to US domestic politics. After McCarthy's ouster earlier this month, the Republicans who hold the majority in the House have still not managed to elect a new speaker. In the absence of a speaker, the work of the House is at a standstill. This is particularly important at this stage, since a shutdown is looming and will be triggered in mid-November if Congress fails to pass the budget bill.

A possible shutdown, especially at this time when consumers are increasing their spending for the end-of-year festivities, would have negative consequences for economic growth. In addition, it is worth remembering that among the reasons adduced by Fitch for downgrading the US rating is that 'the repeated debt-limit political standoffs and last-minute resolutions have eroded confidence in fiscal management.' If the Republicans want to avoid being blamed for causing an otherwise easily avoidable shutdown, and to confirm Fitch's concerns, they need to come to an agreement and quickly appoint a new speaker.

The third category of uncertainty is related to the reporting season that has just begun. Most of the world's biggest companies will report in the coming days, including the Nasdaq heavyweights. The strong rally and massive outperformance of the Nasdaq this year was mainly driven by expectations of very high earnings growth. Until the previous reporting season, however, this growth did not materialize (the green line shows the actual recurring earnings reported by Nasdaq companies). However, expectations for the next 12 months (purple line) have only increased.



Source: Bloomberg

As of today, the market expects earnings growth of 38% for the next 12 months, a particularly high level even from a historical perspective (the gap between the two lines has never been wider). If these expectations should be disappointed, there is a concrete risk that the Nasdaq stocks, and in particular the 'magnificent 7', could undergo a correction that would bring valuations more in line with fundamentals.

The rest of the market, on the other hand, should be less vulnerable, considering that earnings growth expectations are much lower. Taking the MSCI World index as a reference, the expected earnings growth is 13%, but this value would be much lower if we excluded Nasdaq companies, which are strongly represented in the index. For the MSCI World ex-US index, earnings growth estimates are much more modest, around 4%.

In two weeks all these uncertainties will be cleared, setting the tone for financial markets until the end of the year.

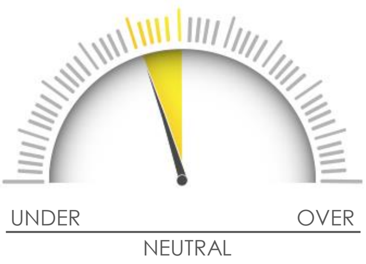
Asset Allocation View

	− (Under)	= (Neutral)	+ (Over)
Equity			
Developed Markets	X		
Emerging Markets	X		
Fixed Income			
Developed Markets Sovereign		X	
Developed Markets Corporate	X		
Emerging Markets	X		
Commodities			X
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

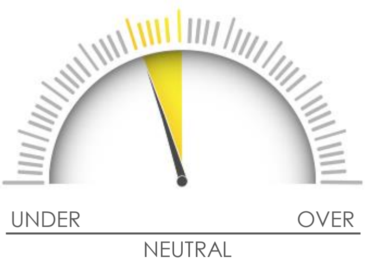
Developed Markets



We maintained our **Slightly Underweight** recommendation on Developed Markets Equities. Although the recommendation has been kept unchanged for the time being, there is growing caution toward equities. Weighing on equity markets are uncertainties related to what might be announced at upcoming central bank meetings, increased competition from rising rates, geopolitical tensions, and whether the reporting season will be able to confirm the earnings expectations (particularly high for growth companies). Any negative surprises could provide the market with a pretext for a correction.

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

Emerging Markets

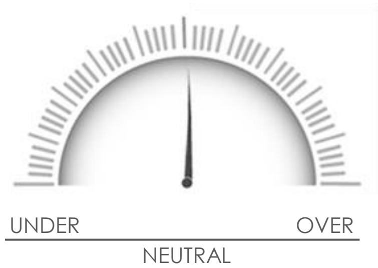


We kept our recommendation on Emerging Markets Equities at **Slightly Underweight**. The risk factors listed above also apply to emerging countries, but geopolitical tensions weigh much more heavily on them.
Furthermore, there is a notable absence of initiatives aimed at revitalizing the Chinese economy. Among emerging nations, our preference still lies with Latin America.

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

Fixed Income

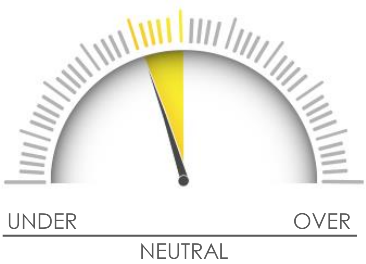
Developed Markets Sovereign



We maintain our **Neutral** stance on Developed Markets Sovereign Bonds. The committee remains convinced that the recent surge in long-term rates may continue. Several factors support this perspective: central banks' commitment to prolong elevated rates, typical yield curve steepening when rate hikes cease, robust negative momentum in long-term bonds, and augmented bond supply attributed to Quantitative Tightening (QT) and expanding fiscal deficits. Consequently, the committee presently favors 2 to 5-year maturities, while acknowledging that a substantial increase in long-term rates would present an excellent buying opportunity.

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

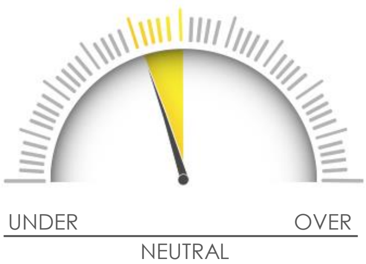
Developed Markets Corporate



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, considering all the risks lingering in the market. We continue to favor investment grade corporate bonds and recommend avoiding high yield bonds.

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

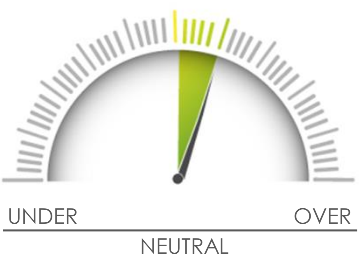
Emerging Markets



We maintained 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 corrections.

Local Currency	+	Hard Currency IG	−	Hard Currency HY	−

Commodities



We kept our **Slightly Overweight** recommendation on Commodities. Precious metals could further appreciate in the short term due to their function considering the growing geopolitical tensions. Oil and energy commodities should benefit for the same reasons. The committee is instead more cautious on other commodities, more sensible to the economic cycle.

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, the fate of the dollar will depend heavily on the outcome of the Fed meeting at the beginning of November.

The view on the Euro is also **Neutral**. On the one hand, the euro could rebound after the depreciation of recent months, but on the other hand it could be exposed to further downside should the ECB become concerned about the strength of the European economy.

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**	=