Main Events

Azimut Global Network

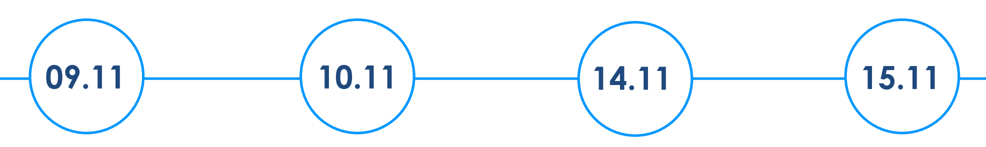
- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

CHINESE NEW LOANS — Anticipating a significant decline in new loans, highlighting China's ongoing economic slowdown

US INFLATION EXPECTATIONS — Will one-year inflation expectations fall back after last month's sharp increase?

US CPI — Inflation is expected to rise by 0.1% month-on-month, while year-on-year inflation is expected to return towards 3.4%.

US RETAIL SALES — After strong increases in previous months, retail sales are expected to contract in nominal terms



FINDING DIRECTION

- **Key events in the past two weeks shaped market trends, with a primary focus on the U.S. central bank meeting**
- **The Fed's decision to emphasize financial conditions over other metrics triggered a market rally and loosened financial conditions**
- **Earnings reports for Q3 2023 showed better-than-expected results, but there is more uncertainty about future earnings growth**

The two weeks just ended were crowded with events that will help to shape market trends through the end of the year.

The most important of these was the U.S. central bank meeting. At the previous meeting, via the dots, the Fed had indicated that there would probably be another rate hike in 2023 and that rates would remain at that level for longer, but that any decision would be based on incoming data. The emphasis had been, as it had been for several months, on employment, inflation, and the strength of the economy.

Market rates, which had already been rising for a couple of months, accelerated further, also in view of strong macro data in October, particularly on the metrics most closely monitored by the Fed.

The rise in rates, together with the ensuing slide in equity markets, resulted in a tightening of financial conditions, although these were still below the level of October 2022. Based on this evidence, several Fed members anticipated that a further hike in rates might no longer be necessary as the tightening of financial conditions was having an effect equivalent to that of another hike.

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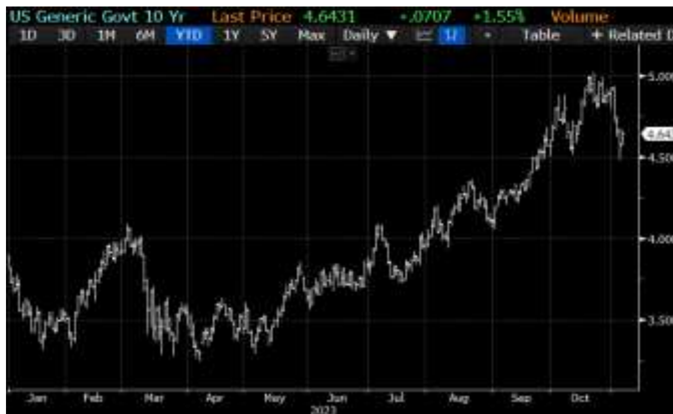
Source: Bloomberg



Source: Bloomberg

This was precisely the message conveyed at the last meeting. During the Fed's press conference, the focus was no longer on the metrics that had been the most relevant until the previous meeting (and all of which would have required another hike), but almost only on financial conditions.

This has two drawbacks. The first is that the Fed is sending the market the message that any correction (of bond and/or equity markets), having as a natural consequence a tightening of financial conditions, will result in a more dovish Fed. The side effect of this is that the 'Fed put' seems to have been reinstated again. The second is that the market reacted with a rally in all asset classes. This reaction was easily predictable, as for over a year the market has been fighting the Fed by always predicting an imminent pivot by the central bank.

In the three days that followed the Fed meeting, financial conditions loosened considerably, retracing about half of the movement since September. Similarly, the 10-year rates fell by about 50 basis points, erasing just under half of the upward movement that began in mid-July. If the decision to leave rates unchanged was justified solely by the tightening of financial conditions (otherwise a hike would have been likely), the Fed proved to be not very wise, as by not acting financial conditions immediately became much more accommodative again.

Further exacerbating the rally was the non-farm payrolls report, which showed lower-than-expected, though still strong, job growth. Excluding the distortion caused by the ongoing strikes in the automotive sector, the figure would have been much stronger. Considering, however, that after the Fed meeting the market mood had become much more prone to interpret everything favorably, the jobs data were interpreted as weak, hence positive for stocks and bonds, which extended their rally. Also contributing to the rally was a massive short squeeze, particularly on treasury bonds where investors had accumulated huge short positions in recent months. Finally, the announcement by the US Treasury Department that the issuance of long-dated bonds to finance its growing budget deficit will increase slightly less than expected helped spur the rally in long-dated bonds.

By contrast, the BoJ and ECB meetings were rather uneventful. The former continued the process of normalizing rates, always in baby steps, announcing that the 1% ceiling on the 10-year is no longer to be understood as a hard ceiling. As for the ECB, nothing new was announced, but during the press conference Ms. Lagarde emphasized the risk of an economic slowdown in Europe, cementing the view that the rate hike cycle is now definitely over.

Finally, in the past two weeks, many of the mega-caps have reported their third-quarter earnings. As reported by Factset, of the companies in the S&P 500 have reported actual results for Q3 2023, "82% have reported actual EPS above estimates, which is above the 5-year average of 77% and above the 10-year average of 74%." Also, "In aggregate, companies are reporting earnings that are 7.1% above estimates, which is below the 5-year average of 8.5% but above the 10-year average of 6.6%." Earnings growth for the third quarter is +3.7% compared to last year, the first year-over-year increase in 12 months.

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However, Factset also highlights how analysts are lowering EPS expectations for the next quarter by 3.9%, double the average revision (-1.7%) of the last 20 years. Finally, "in terms of revenues, 62% of S&P 500 companies have reported actual revenues above estimates, which is below the 5-year average of 68% and below the 10-year average of 64%."

So far, the reporting season exceeded expectations in terms of earnings, yet future growth might be more moderate than anticipated.

Looking ahead, there seems to be a brighter future now that the biggest uncertainties have been cleared: central banks no longer seem willing to tighten monetary policies further, economic growth remains more resilient than expected, and the reporting season has provided comfort that EPS expectations may still be within reach. Barring an unexpected escalation of geopolitical tensions, the rest of the year could be rather calm in the financial markets.

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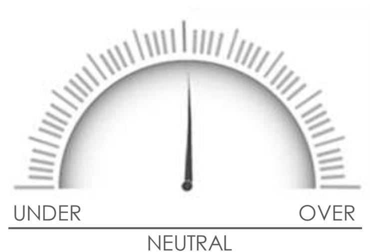
Asset Allocation View

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

(−) UNDER (=) NEUTRAL (+) OVER

Equity

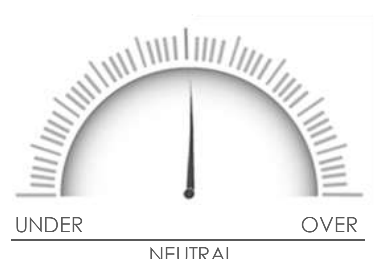
Developed Markets



We upgraded our recommendation on Developed Markets Equities to **Neutral**. This adjustment is prompted by several significant factors: a substantial decline in nominal and real interest rates, the growing likelihood that central banks have concluded their rate-hiking cycle, and a better-than –expected reporting season. These factors have contributed to a substantial equity rebound, possibly amplified by a notable short squeeze. Taking into account the robust economic growth and the favorable reporting season, the committee is inclined towards favoring investments in the US and Japan. However, there is a note of caution when it comes to Europe.

US	Europe	Japan
+ (Over)	= (Neutral)	+ (Over)

Emerging Markets



We increased our recommendation on Emerging Markets Equities to **Neutral**. The substantial drop in interest rates in Western countries is a very supportive factor, as emerging countries are more sensitive to interest rates than developed countries. Furthermore, if it is confirmed that the Fed has also concluded its rate hike cycle, it is possible to witness a weakening of the US dollar, which is also a supportive factor for emerging countries.

Asia ex-Japan	EEMEA	LATAM
= (Neutral)	− (Under)	+ (Over)

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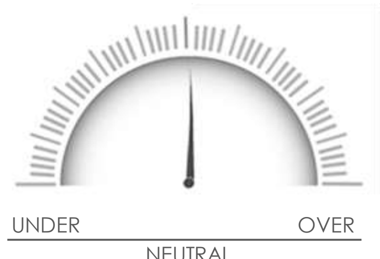
Fixed Income

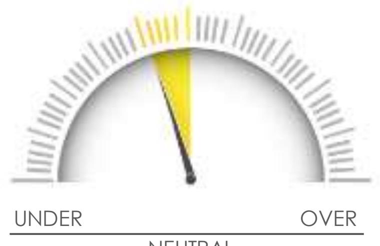
Developed Markets Sovereign



We maintain our **Neutral** stance on Developed Markets Sovereign Bonds. The sharp fall in rates since the beginning of November has wiped out just over a third of the increase since the summer, particularly on the medium to long end of the curves. The committee believes the move was probably excessive, considering the supportive factors of higher rates (QT, growing fiscal deficits to finance, growth remaining solid for the time being) persist. We therefore continue to favors the short/mid segment of the curves.

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 continue to be seen as too narrow. Also in relative terms, although equities have suffered a discrete correction since August, corporate bond spreads have not widened significantly. 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**. We prefer to maintain a cautious stance in view of geopolitical risks and the fact that the substantial drop in interest rates since the beginning of November may be at least partially retraced. In view of the possibility that the dollar could weaken should the Fed confirm that the rate hike cycle is over, we continue to prefer local currency debt.

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 not only should the US Dollar weaken further, but also due to their function as a portfolio hedge considering the growing geopolitical tensions. Oil and energy commodities should benefit for the same reasons. The committee is instead more cautious on other commodities.

Precious	+	Energy	+	Industrial	=	Agricultural	=

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Currencies

The Committee kept the **Neutral** stance on the US Dollar, but now **with a bearish**. The increasingly likely possibility that the Fed's hiking cycle is over could be the pretext for a physiological correction of the US dollar.

Likewise but in reverse, the view on the Euro has been upgraded to **Neutral with a bullish bias**. Although Lagarde emphasised the ongoing slowdown in Europe, there has been no change in the monetary policy stance and thus in relative terms the euro is in a stronger position than before.

The view on the **Chinese Renminbi** remains **Neutral,** with a bearish bias. In the absence of adequate stimulus measures, and with persisting geopolitical tensions, the renminbi can have further downside.

The outlook for other **emerging market currencies** has been review to **Neutral with a bullish bias.** Lower rates in Western countries are a breath of fresh air for emerging currencies, which would be the first beneficiaries of a possible weakening of the dollar. We continue to remain relatively more optimistic about Latin American currencies.

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