azimut

AZIMUT GLOBAL VIEW

04.12.23

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

US PAYROLLS

The U.S. labor market is expected to remain strong, with a stable 3.9% unemployment rate

US CPI

While core inflation may increase by 0.3% MoM and stay steady at 4.0% YoY, headline inflation is predicted to rise by 0.1% MoM and annual inflation to drop to 3.1%.

FED MEETING

Now that the cycle of rate hikes has ended, will the FED keep undermining market expectations of an impending rate cut?

ECB MEETING

Will the European Central Bank (ECB) comment on the reports that PEPP reinvestments may be abruptly discontinued?

BONDS IN THE SPOTLIGHT

- **Bonds have rebounded strongly in recent weeks due to mounting evidence of a pivot by central banks as well as lower-than-expected inflation data**
- **Nevertheless, YTMs remain close to the highest levels in decades, indicating that, in comparison to prior years, exposure to bonds should be increased**
- **After CBs' pivot, short- and medium-term bonds are unlikely to see additional corrections, but long-term rates' future path is more uncertain**

The last month has been extraordinarily positive for fixed income markets. The drop in risk-free rates, which saw a 70 bps decline in 10-year rates across all western nations, 80 bps decline of the 5-year rates on the US curve, and 60 bps on the EU and UK curves, was the main driver of the rally.

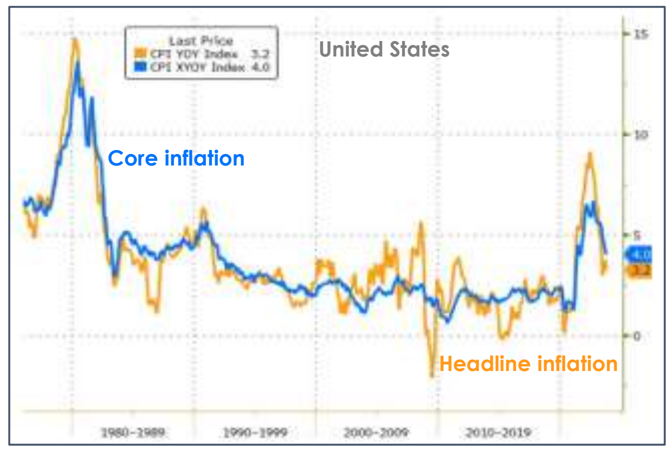
Several factors and circumstances contributed to trigger this rebound. The first and most important was Powell's unexpectedly dovish remarks following the last FOMC, in which he contended that Fed no longer needs to raise rates considering that the market had acted for the Fed by raising market rates. Therefore, the Fed was given the luxury of staying put and continuing to monitor how the economy and inflation would evolve in the months ahead.

The market, which for two years had been grappling with the Fed, always expecting an imminent end to the rate hike cycle followed by a series of cuts, interpreted Powell's statements as the definitive confirmation that the Fed's pivot had finally arrived. The simultaneous presence of sizable short positions on bonds by hedge funds, and the particularly attractive levels reached by interest rates -the highest in more than 15 years- provided additional fuel for the rally.

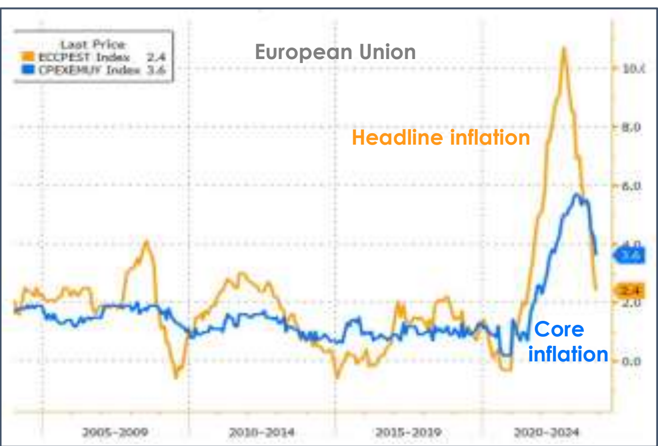
The BoJ and ECB meetings a few days earlier ended with similar indications. The inaction by the BoJ, contrary to expectations of more concrete steps towards interest rate normalization, and the ECB's confirmation that there will be no more rate hikes in Europe, reinforced the expectation that the pivot is happening on a global scale.

The information reported in this document has been extrapolated from Bloomberg and external research sources, and subsequently re-elaborated by Azimut Investments S.A. Please read the disclaimer at the end of this document

(continued)



Source: Bloomberg



Source: Bloomberg

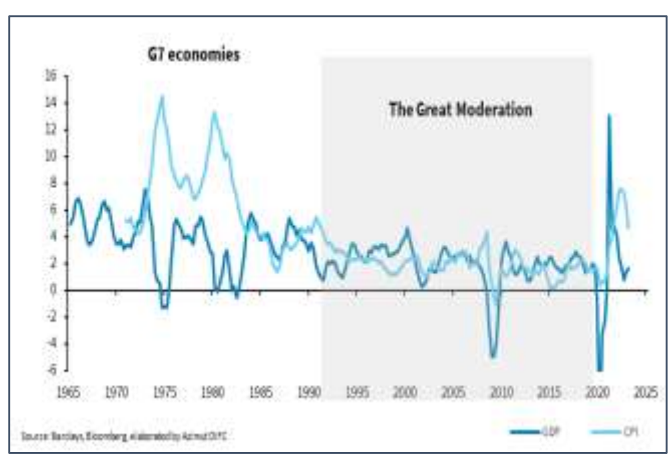
The bond rally continued over the rest of the month, supported by evidence that inflation continues to fall fairly linearly in both the headline and core versions in Europe and the US, with official rates in both areas now above core inflation.

The simultaneous increase in bonds and stocks in November led to increasingly accommodative financial conditions. Given that Powell justified not raising interest rates by claiming that the market had completed the Fed's work due to tightening financial conditions, the market was apprehensive about the Fed's potential to return to a more hawkish stance. However, the fact that financial conditions were becoming increasingly accommodative—almost at their loosest point in over a year—added to the market's unease. This fear has not come true. Several Fed members in November and Powell himself on December 1st confirmed that they were comfortable with what was happening on the market.

In light of the aforementioned, there seems little doubt now that central banks will no longer raise rates. However, the market has gone much further, factoring in rate cuts as early as March, and five rate cuts totaling 125 bps by the end of 2024. This contradicts the central banks' continued assertion that monetary policy must remain tight for a considerable amount of time. Such a large rate cut would be consistent with an economic slowdown, which if it is happening elsewhere in the world already, still seems a long way off in the U.S.

It makes sense to increase the weight of bonds and fixed income funds if the rate hikes can be considered completed and if a faster-than-expected decline in inflation and/or an economic slowdown could result in a rate cut sometime in 2024. Doing so reduces reinvestment risk (i.e.: the risk that rates will be lower than their current level in the future) securing for a larger portion of the portfolio YTMs that, although slightly lower than those reached a few weeks ago, are still at their highest levels in 15 years.

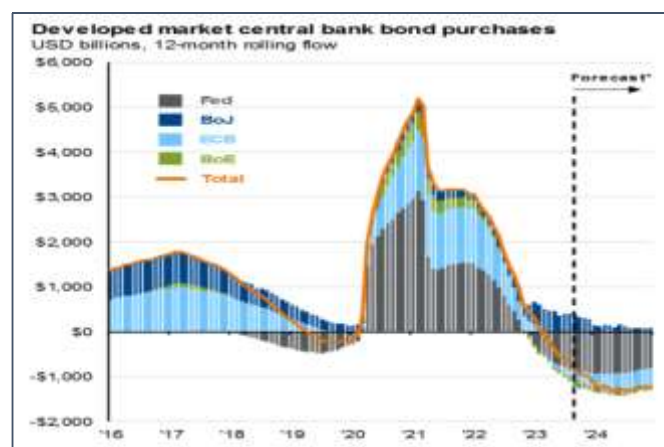
Source: Bloomberg



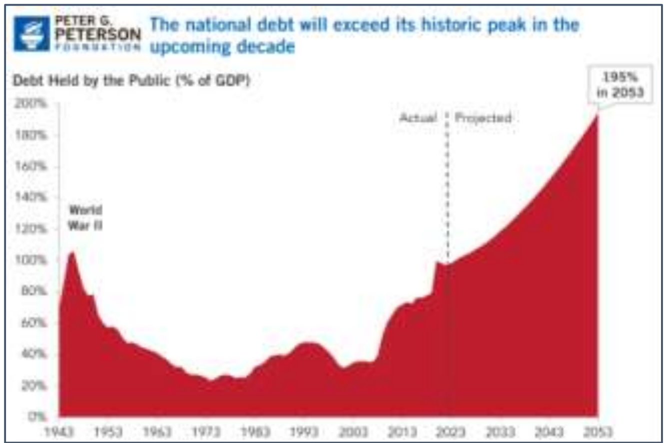
Source: Barclays, Bloomberg, Azimut DIFC

The information reported in this document has been extrapolated from Bloomberg and external research sources, and subsequently re-elaborated by Azimut Investments S.A. Please read the disclaimer at the end of this document

(continued)



Source: J.P. Morgan



Source: Peter G. Peterson Foundation, Congressional Budget Office

There is greater uncertainty regarding the potential evolution of the long- or very long-ends of the curves if the trajectory of rates in the short- and medium-ends of the curves appears to be relatively delineated.

On the one hand, it is possible that the world will return to a period of moderate growth and inflation, similar to what was the case in earlier decades (the so-called "great moderation"), after the unanticipated shocks of the past few years (covid-19, excessive fiscal and monetary stimulus, the highest inflation of the last 40 years, etc.). Similar conditions of muted growth and inflation may occur again due, respectively, to higher levels of debt and taxation that reduce the growth potential of economies, and the deflationary impact of technology and more particularly artificial intelligence.

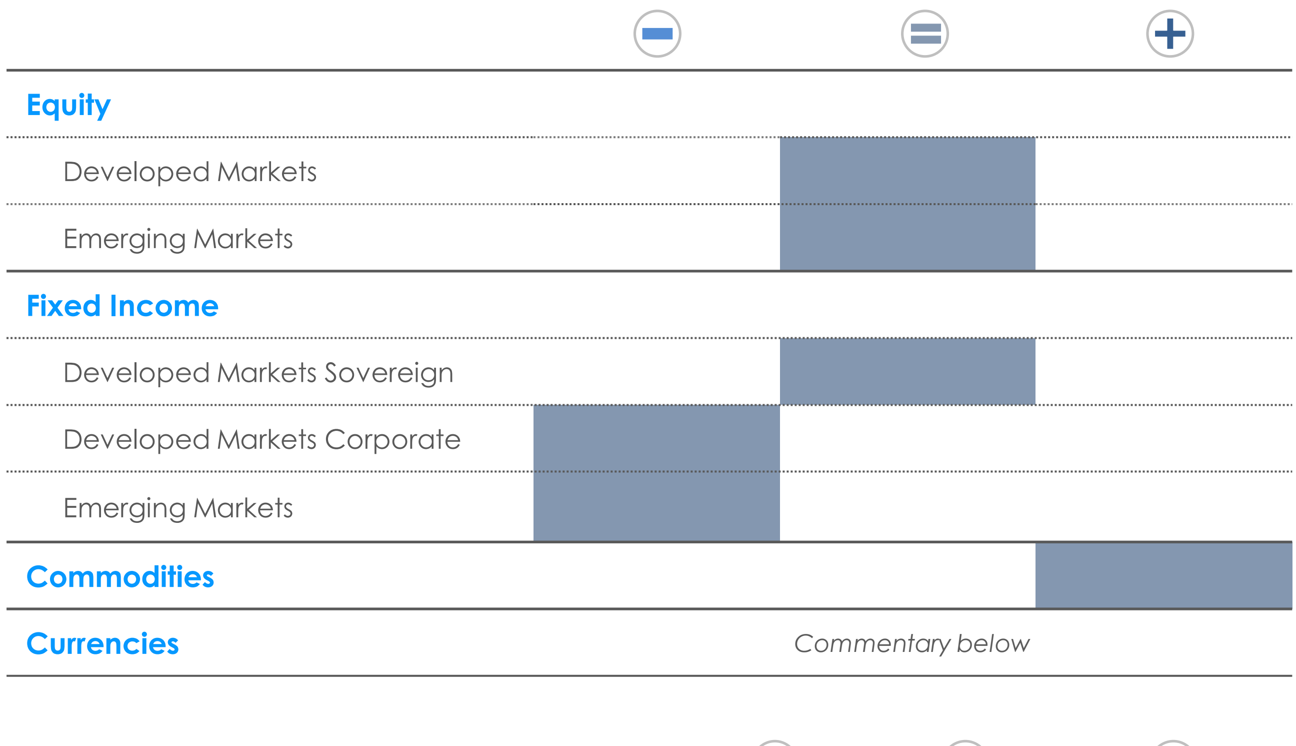
On the other hand, two other dynamics could instead lead to higher rates. Similar to how QEs caused rates to generally decline and the disappearance of the term premium (i.e.: the higher yield typically offered by the long ends of the curves compared to the short ends), the implementation of significant QTs (around USD 1.5 trillion expected for 2024) should have the opposite effect, thus leading to higher rates, particularly on the long ends.

Furthermore, the government must continue to finance ever-increasing public debts in relation to GDP as well as in absolute terms. It is possible that, in order to absorb growing issuances of government debt (particularly now that central banks have stopped QEs and are instead implementing QTs) the market might demand higher rates. It is equally possible that investors, especially for long-term bonds, will demand a larger premium to compensate for the diminishing soundness of government debt. Using the U.S. as an example, the Congressional Budget Office projects that the country's debt-to-GDP ratio will be almost 200% in 2053, the year that the 30-year bonds that are currently in circulation mature.

Taking into account everything mentioned above, it is possible that rates will stay near the levels they have been trading in recent months; more likely, they will be slightly lower in the short ends and slightly higher in the long ends of the curves (mainly because of QT). We still favor investment grade companies, because they are better able to cope with rising financing costs. We confirm our cautious stance on high yields, considering that spreads are fairly tight despite the continued rise in default rates, which could worsen further in the event of a slowdown. Having said that, potential losses brought on by a widening of spreads or an increase in default rates could be substantially, if not entirely, offset by the YTM provided by high yields. We continue to believe that the best investments in fixed income are subordinated and hybrid bonds, whose issuers' stability is far stronger and whose yields are comparable to those of high-yield bonds.

The information reported in this document has been extrapolated from Bloomberg and external research sources, and subsequently re-elaborated by Azimut Investments S.A. Please read the disclaimer at the end of this document

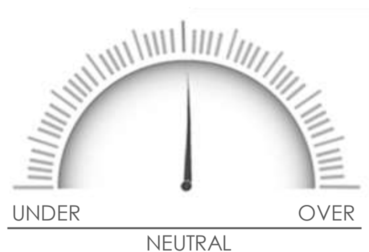
Asset Allocation View



UNDER NEUTRAL OVER

Equity

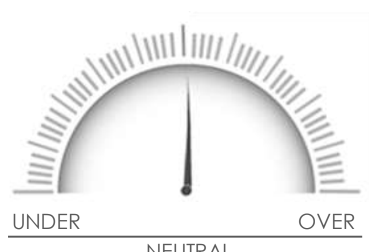
Developed Markets



We confirmed our **Neutral** recommendation on Developed Markets Equities. The continued decline in market rates, combined with a generally positive reporting season and favorable market seasonality, could allow the market to extend its current uptrend, despite unappealing valuations and ongoing geopolitical tensions. After exceptional returns in November, we might experience some pull backs and continues up and downs in the equity markets until the end of the year.

US	+	Europe	=	Japan	+

Emerging Markets



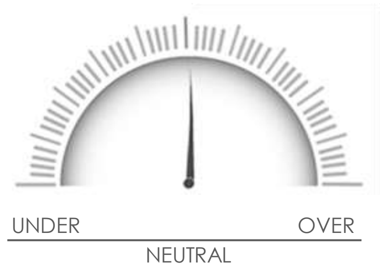
We maintained our **Neutral** recommendation on Emerging Markets Equities. The same positive factors mentioned for developed countries also apply to emerging countries, where valuations are lower. Another supportive factor is the recent weakening of the dollar, which, if sustained, could be a further driver for a rebound. On the other hand, geopolitical tensions weigh more heavily on emerging countries than on developed countries. Due to window dressing, China could keep remaining the weakest area whilst India, Brazil and Taiwan could still be amongst best performing areas.

Asia ex-Japan	=	EEMEA	−	LATAM	+

The information reported in this document has been extrapolated from Bloomberg and external research sources, and subsequently re-elaborated by Azimut Investments S.A. Please read the disclaimer at the end of this document

Fixed Income

Developed Markets Sovereign



We keep the **Neutral** stance on Developed Markets Sovereign Bonds. The recent fall in rates has brought the curves back to somewhat less attractive levels, particularly at the medium-long ends. Being the US core inflation at 2.5% in the last 6 months put the analysts to believe that central banks have completed their rate hikes. Expectation on future rate cuts from the FED are well priced in with 125 bps cuts in the next 12 months. On the other hand, the need to finance rising government deficits as well as the ongoing QT may continue to put upward pressure on interest rates, particularly at the long end.

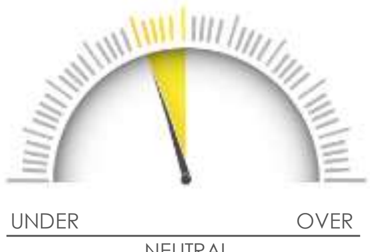
EU Core		EU Periphery		US Treasury		Japanese JGB	

Developed Markets Corporate

We maintained our **Slightly Underweight** recommendation on Developed Markets Corporates. The committee believes that spreads in both investment grade and high yield bonds are still too narrow and reached really low levels especially in the high yield spectrum . Moreover, because of the withdrawal of liquidity caused by QTs and the need for governments to finance growing fiscal deficits, companies will have to pay wider spreads to refinance their debt. 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 other factors mentioned for developed market corporate bonds. Given the possibility that the dollar will weaken if the Fed confirms that the rate-hike cycle has ended, we continue to favor local currency debt. In case of spike in volatility is probably the first asset class to experience a draw down.

Local Currency		Hard Currency IG		Hard Currency HY	

Commodities

We kept our **Slightly Overweight** recommendation on Commodities. Precious metals may rise further in the short term, not only if the US dollar continues to fall, but also as a portfolio hedge in light of rising geopolitical tensions and inflows in the asset class. Oil and energy commodities come back to neutral due to the chronic oil weakness. The committee is more cautious on other commodities.

Precious		Energy		Industrial		Agricultural	

The information reported in this document has been extrapolated from Bloomberg and external research sources, and subsequently re-elaborated by Azimut Investments S.A. Please read the disclaimer at the end of this document

Currencies

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

The view on the Euro remains **Neutral with a bullish bias**, mostly due to the possibility of a weakening of the US Dollar and the Japanese Yen.

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** is confirmed **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.

The information contained herein is confidential and proprietary and intended only for use by the recipient. The materials may not be reproduced, distributed or used for any other purposes. The information contained herein is not complete and does not contain certain material information about the investments described in the present document, including important disclosures and risk factors associated with these investments, and is subject to change without notice. This document is not intended to be, nor should it be construed or used as, an offer to sell, or a solicitation of any offer to buy, shares or limited partner interests in any funds managed by Azimut Investments S.A. If any offer is made, it shall be pursuant to a definitive Prospectus / Private Placement Memorandum/Offering Memorandum prepared by or on behalf of a specific fund which contains detailed information concerning the investment terms and the risks, fees and expenses associated with an investment in that fund.

In addition, the market trend information herein has been prepared by or on behalf of Azimut Investments S.A. and has not been independently audited or verified. Investment returns may vary materially from the stated objectives and/or targets so that investors may have a gain or a loss when they redeem their investment. As with any investment (vehicle), past performance cannot assure any level of future results. Forward looking statements constitute the opinion of Azimut Investments S.A. does not guarantee any specific outcome or performance.

All investments entail substantial risk. The profitability and return of investments are dependent upon numerous factors, which may include the active management of securities, across global markets.

Opinions expressed are current opinions as of the date appearing in this material only. The information provided in these materials is illustrative and no assurance can be provided that any of the future events referenced herein (including projected or estimated returns or performance results) will occur on the terms contemplated herein or at all. While the data contained herein has been prepared from information that Azimut Investments S.A. believes to be reliable, Azimut Investments S.A. does not warrant the accuracy or completeness of such information. The underlying managers used by Azimut Investments S.A. in its portfolios are subject to change in the future and there will likely be additional managers added to the portfolio.

The information reported in this document has been extrapolated from Bloomberg and external research sources, and subsequently re-elaborated by Azimut Investments S.A. Please read the disclaimer at the end of this document