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

20.12 — UK CPI
Global bonds rallied on expectations of a rapid decline in inflation, enabling central banks to pivot. Any indication to the contrary might serve as a catalyst for a retracement

20.12 — US CONSUMER CONFIDENCE
Consumer confidence may rebound following the surge in stock markets, the decline in inflation, and the Fed's pivot

22.12 — US PERSONAL SPENDING
Consumption may have continued to increase at a strong pace in November, underscoring the strength of the U.S. consumer

31.12 — CHINESE PMI
Chinese business confidence could have declined further, lacking concrete supportive measures from the government

A BRIGHTER FUTURE AHEAD?

- **The Federal Reserve made it clear at its most recent meeting that the tightening cycle has ended and that an easing cycle will begin next year**
- **The ECB took a slightly more hawkish stance, pushing back rate cut expectations for the time being and announcing a reduction in PEPP reinvestments in the second half of 2024**
- **Due to this earlier-than-expected dovish pivot, financial markets could continue their advance, aided by the "January effect," although a physiological retracement could occur at any time after the rally of recent weeks**

Last week's central bank meetings were expected to shed light on the evolution of monetary policies in the year ahead. Market expectations were high, given the extent of the rally that all asset classes have enjoyed in recent weeks. Usually, the market tends to err on the side of excessive optimism, always willing to see the glass half full. This time, however, reality exceeded the market's expectations.

The most surprising was the Federal Reserve. It was only in September when the U.S. central bank had triggered a jump in market rates by signaling (via the dots) that it expected to raise interest rates again before the end of the year, and then remain at much higher levels than previously thought in both 2024 and 2025. After that, for the first time in two years, the market had resigned itself to a fate of higher rates, Powell surprised everyone again in November by saying that he was satisfied with the tightening of financial conditions and therefore no further action was necessary.

Given the magnitude of the drop in market rates and the surge in major stock indexes, everyone's eyes were focused on what Powell would say in early December in his last official appearance before the blackout period preceeding last week's FOMC meeting. The widespread concern was that he might backtrack at least in part from his words in November. That did not happen, but Powell nonetheless anticipated that it was premature to think about a rate cut.

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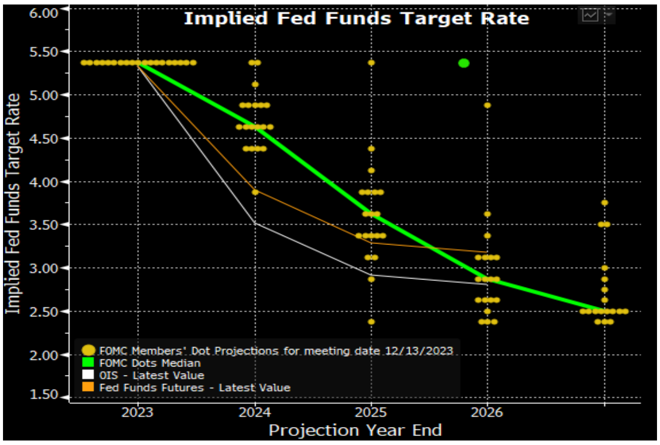
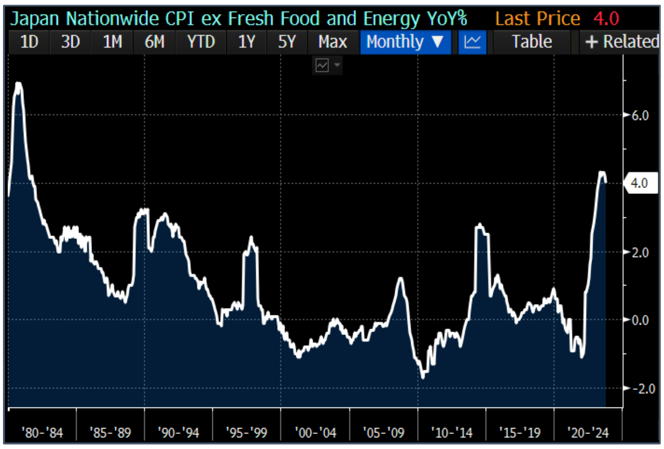


Source: Bloomberg



Source: Bloomberg

Fast forward to last week, the Federal Reserve again surprised markets by using the dot plot to provide the strongest guidance, as has been the custom since June. Expectations of where rates will be at the end of 2024 were lowered by 50 basis points from previous projections, bringing the total cuts penciled for 2024 to 75 basis points. This is still way short of the 150 basis points expected by the market, but still represents a major pivot from the remarks a few days earlier that it was premature to think about cutting rates. For end-2025, the Fed now expects rates will be at 3.6%, 30 bps lower than in September's projections.

Equally important is the fact that Powell did nothing during the conference call to try to push back on the possibility of a more accommodative monetary policy next year. The ritual statements about the need to remain data-dependent, that they will not hesitate to raise rates further if necessary, and that the Fed's primary goal is to bring prices back toward the 2 percent target remained, but it was clear from the tenor of the responses that the Fed's focus has shifted from a restrictive to an accommodative bias. Such a sharp change of stance took the market by surprise, as evidenced by the reaction of stocks and especially bonds. The short ends of the U.S. curve, which are more sensitive to monetary policy, experienced declines of up to 40 basis points in less than 24 hours.

In contrast, the ECB meeting the following day was a non-event. It probably would have been that way in any case, given the scale of the surprise delivered by the Fed the day before. However, the ECB also caught markets somewhat by surprise, considering that Ms. Lagarde instead clearly ruled out the possibility of thinking about rate cuts in the immediate future. Considering that economic data in Europe shows some weakness, it would have been much more reasonable to expect a dovish pivot from the ECB rather than the Federal Reserve.

The ECB also announced that it will continue PEPP reinvestments until the end of June, and then phase it out completely in the second half of 2024. The ECB probably used the last available window to announce the end of PEPP reinvestments, considering that if it starts cutting rates in 2024 (an easing measure) it would have been an inconsistent move to announce the reduction of the PEPP program (a restrictive measure) at the same time. By doing so, the ECB confirms its inability to be responsive to changes in the macroeconomic environment, unlike the Federal Reserve. It is worth remembering that in mid-2021 it announced that QE (PEPP) would continue at least until 2022 and that rates would be raised only thereafter. This is exactly what happened, despite the fact that inflation had already risen to almost 10% at the time. The ECB preferred to stick to a commitment that no longer made sense, rather than show flexibility and adjust its monetary policy. Today it is probably making the same mistake, committing to keeping a tightening bias (ruling out lowering rates and committing to a faster QT by ending the PEPP reinvestments) at a time when the EU economy is clearly showing signs of deceleration.

The last central bank that may catch markets by surprise is the Bank of Japan, which will meet tomorrow (Tuesday 19). As core inflation in Japan is also at 40-year highs and appears to be more resilient than expected, it is possible that the BoJ might decide to raise its official rates at this meeting or in early 2024.

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Should this happen, there would no longer be any central bank in the world still maintaining sub-zero rates, ending (hopefully for good) the era of negative rates.

Regardless of what the BoJ decides, the main takeaway from the last week's central bank meetings is that the Federal Reserve has clearly pivoted, and when the Fed changes its stance all other Western central banks follow shortly after. This shift toward a dovish stance was not expected to happen so quickly, and the market immediately adjusted to the new scenario with another leg up in equity and fixed income markets.

The decline in rates has brought the curves, particularly the German one, back to relatively less attractive levels. In the immediate future, there could be a physiological rebound in rates after the steep decline of the past six weeks, although limited considering that it is now certain that rates will not be raised further. From a longer-term perspective, the expectation of rate cuts by central banks in the coming months could bring the curves back to even lower levels than today. As a result, and considering that market expectations are now for a soft landing, the fixed income investors may return to yield-seeking mode (rather than duration management), leading to further compression of credit spreads.

As for equities, the comeback to the all-time-highs has brought valuations back to pricey levels, particularly in the U.S. market, but this is now less of a concern because yields have also declined significantly, so competition from bonds is less pronounced. However, also in this case a physiological correction could occur at any time. Nevertheless, a continuation of the current trend into early January cannot be ruled out, considering that the repositioning of investors after the Fed's surprise pivot may not be over. In addition, the "January effect," i.e., the tendency of markets to rise in the first days of the year, must be taken into account.

An environment that combines declining rates and a soft landing could be favorable for a large portion of the stock market: growth stocks would benefit from lower interest rates, value stocks that have been sold off out of fear of an impending recession could rebound strongly if the recession does not materialize, and high-dividend stocks because in a world of falling rates, high dividend yields become relatively more attractive. The only segment of the market that might underperform (while going up in absolute terms) is defensive stocks, because in such an environment investors' preference would go mainly to the above categories.

From a geographic perspective, this scenario could be particularly beneficial for emerging markets. We know that these tend to outperform when Western central bank rates fall and/or are at low absolute levels, as well as when the dollar weakens. Monetary easing by the Fed could cause both of these favorable conditions for emerging markets to occur. Given that valuations are particularly low in both absolute and relative terms, the potential for emerging markets to rebound could be considerable (it is worth remembering, however, that the weight of emerging markets within portfolios should still remain at reasonable levels).

In short, if the year that is coming to a close has seen a noticeable polarization of returns, in 2024 it seems that any possible further increase could be broad-based, and allow for a catch-up of what had been underperforming.

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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		Upgrade	
Emerging Markets		Upgrade	
Commodities			
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

Developed Markets

UNDER OVER
NEUTRAL

We upgraded our recommendation on Developed Markets Equities to **Slightly Overweight**. This shift is influenced by the central banks' pivot, notably the Federal Reserve, which has indicated the potential for multiple interest rate cuts in 2024. This could contribute to the ongoing bullish momentum, further fueled by the "January effect" – the historical tendency for markets to rise in the initial month of the year. However, caution is advised due to elevated valuations and the overbought condition, which could trigger a retracement at any moment.

US	**Europe**	**Japan**

Emerging Markets

UNDER OVER
NEUTRAL

We also increased our recommendation on Emerging Markets Equities to **Slightly Overweight**. The pivot of Western central banks and the potential weakening of the dollar, contingent on the Fed implementing the projected rate cut indicated by the new "dots," historically favor an outperformance by emerging markets. Given their starting point at low valuations both absolutely and relatively, we recommend maintaining a slight overweight position in emerging countries. However, we are adjusting our preference away from the Latin America region. If a rebound materializes, it is likely to be led by the countries that lagged behind in 2023.

Asia ex-Japan	**EEMEA**	**LATAM**

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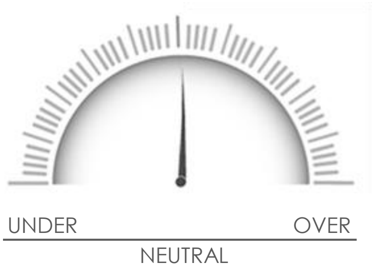
Fixed Income

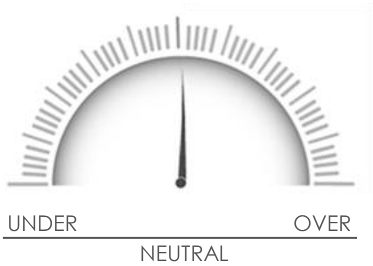
Developed Markets Sovereign



We keep the **Neutral** stance on Developed Markets Sovereign Bonds. After the rally of recent weeks, a retracement of bonds is possible and physiological. However, given the central banks' pivot, it is challenging to envision rates rising significantly from their current levels, unless unexpected inflationary developments occur, which are not anticipated in the short term. When assessing various curves, we exercise greater caution regarding the German curve, as the potential for further rate declines now appears more limited.

EU Core	EU Periphery	US Treasury	Japanese JGB

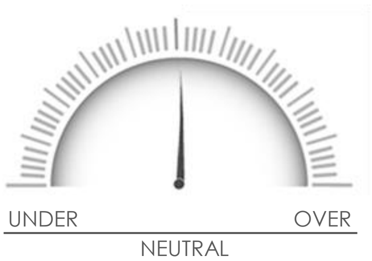
Developed Markets Corporate



We upgraded our recommendation on Developed Markets Corporates to **Neutral**. After the central banks' pivot and the reduction of risk-free rates in the last month, investors' focus will shift more toward yield-seeking, so spreads have a chance to compress further, even if they are quite narrow. We continue to favor investment grade corporate bonds and recommend avoiding high-yield bonds.

IG Europe	IG US	HY Europe	HY US

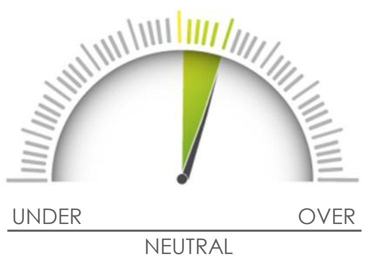
Emerging Markets



We also upgraded our recommendation on Emerging Market bonds to **Neutral**. The expectation of more accommodative monetary policies from Western central banks could foster a return of interest towards the asset class from international investors, especially should the dollar weaken from current levels.

Local Currency	Hard Currency IG	Hard Currency HY

Commodities



We kept our **Slightly Overweight** recommendation on Commodities. Precious metals may have room to extend their advance, as the central banks' pivot adds to the other factors that have promoted the recent rally, namely a possible weakening of the U.S. dollar and the fact that precious metals tend to act as a portfolio hedge in the event of rising geopolitical tensions. The committee remains more cautious on other commodities, as they are linked to the evolution of the business cycle, and it is too early to be confident that a soft landing will actually occur.

Precious	Energy	Industrial	Agricultural

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Currencies

The Committee kept the **Neutral** stance **with a bearish bias** on the US Dollar. The Federal Reserve's change of course implies that the Fed has probably reached peak hawkishness relative to other central banks, raising the possibility that the U.S. dollar might weaken further.

The view on the Euro remains **Neutral with a bullish bias**, not only because the dollar may weaken further for the reason mentioned just above, but also because at the last ECB meeting Ms. Lagarde was more hawkish than expected, dismissing the possibility of any imminent rate cut.

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.** The change in stance by Western central banks and lower rates are supportive for emerging currencies. We continue to remain relatively more optimistic about Latin American currencies.

Euro	=	USD	=	CNY	=	Other EM	=

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