azimut

AZIMUT GLOBAL VIEW

08.01.24

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

11.01 – US CPI
It is anticipated that core inflation will continue to drop. The possibility that the Fed would make more than three cuts in 2024 would rise if this were to occur

12.01 – CHINA CPI
A further decline in inflation could suggest that the Chinese economy is continuing to lose traction

17.01 – US RETAIL SALES
The December figure will help assess the strength of U.S. Consumer during the holiday period

19.01 – JAPAN CPI
A worse-than-expected reading could put additional pressure on the BoJ to accelerate its exit from negative interest rate policy

TAKING A BREATHER

- **After a strong rally in 2023, the first days of the new year began with a mild correction in equities and bonds**
- **The possibility of a reduction in the QT already in 2024, as hinted at in the most recent FOMC minutes, was not expected and could prove to be yet another supportive factor for bonds, especially in the long ends of the curves.**
- **The increased likelihood of a soft landing, thanks to a softer but still resilient labor market and a continued decline in inflation, should allow financial markets to resume their upward trend in the coming weeks.**

After 2023 ended with returns that were as positive as could be hoped for at the start of the year, 2024 began with a general decline in both stocks and bonds. Given the outsized gains that all asset classes experienced in the last two months of last year, this dynamic is neither surprising nor cause for concern.

A retracement following such a long move is healthy and welcome because it allows the market to rest, exiting an overbought condition and allowing the upward trend to continue. Furthermore, none of the rally's supportive elements have faded, and they are unlikely to do so in the near future. To the contrary, the most recent data and statements have been particularly supportive.

One of the supporting elements came from the minutes of the most recent FOMC meeting, which revealed that the governors began discussing the possibility of slowing down QT. Although the market has "fought" the Fed for two years, first speculating about a premature end to rate hikes, followed shortly thereafter by a series of rate cuts, the possibility of QT slowing was almost completely off investors' radar.

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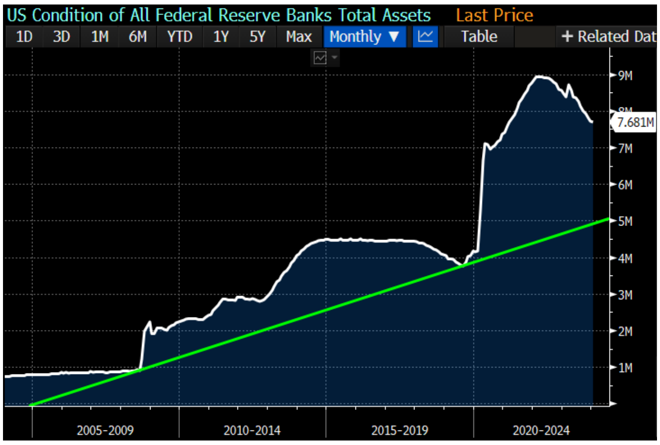
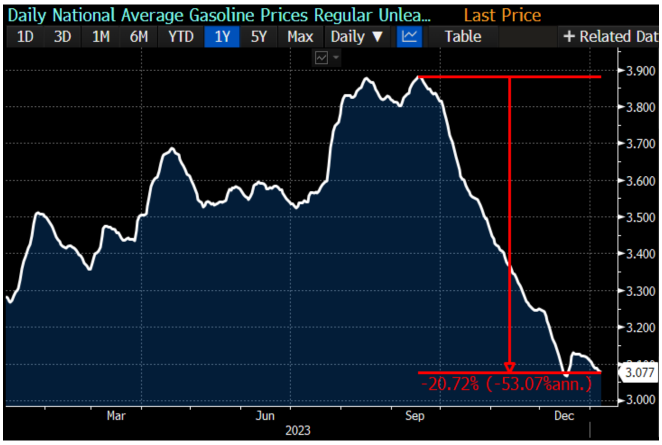


Source: Bloomberg



Source: Bloomberg

Looking at the Federal Reserve's balance sheet, the 1.2 trillion reduction from the 2022 high has resulted in the unwinding of only a small fraction of the liquidity injections made in the aftermath of Covid. Analyzing M2 data would yield similar results. Shortly after the Fed's minutes were released, Lorie Logan of the Dallas Fed emphasized the need for a tapering of the QT, noting that the overnight reverse repurchase facility, a place where counterparties can park excess cash, has shrunk dramatically.

The possibility of a QT reduction as early as 2024 should be supportive particularly for the long ends of the curves, which are more sensitive to changes in net bond supply than to official rates. Any announcement of QT tapering could thus allow long-term rates to settle at a lower level than previously thought, with positive implications for all asset classes.

An additional supportive factor for bonds could be a further decline in inflation, especially in the United States, where energy prices, and gasoline in particular, have fallen sharply in recent weeks. This could have a strong disinflationary effect on the CPI. If the year-over-year change in rents (one of the most important components of core inflation) begins to fall, which is long overdue, the possibility of the Fed cutting interest rates more than previously indicated grows.

Concerning the labor market, nonfarm payrolls released last week confirmed that the normalization of the labor market is underway. Payrolls increased by 216k in December, 40k more than expected, but data for previous months were revised downward by 71k. Wages grew 4.1% year-on-year, 0.1% higher than the previous month, a pace that is not inconsistent with inflation returning toward 2% (thanks to productivity gains).

All in all, the engine of global growth in recent years, the United States, confirms that its economy remains resilient and that past excesses are gradually receding in a nontraumatic manner, making a soft landing more likely and allowing the Fed to begin cutting rates in the coming months. Barring surprises due to factors exogenous to markets, after the modest correction in the early days of the year, it is likely that financial markets will continue their upward trend, maybe until the Fed's meeting in late January, but some cautious is still needed considering the high valuation.

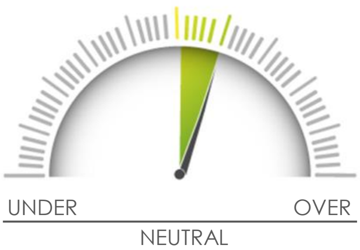
Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

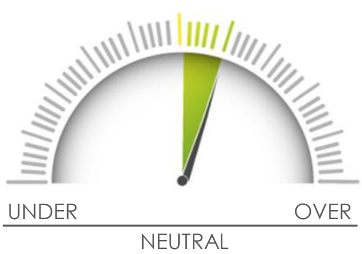
Developed Markets



We maintained our **Slightly Overweight** recommendation on Developed Markets Equities. The correction in the early days of the year should be seen as a physiological retracement after the powerful rally in late 2023. The "January effect", the resiliency of the global economy as well as the positive momentum could lead to a resumption of the bullish movement, but caution is needed considering that valuations are quite high and sentiment is still extremely bullish, a factor that normally exposes to some vulnerability.

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

Emerging Markets

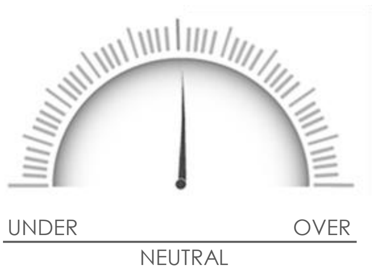


We kept our **Slightly Overweight** recommendation on Emerging Markets Equities. On the one hand, emerging country valuations continue to be attractive on both an absolute and relative basis, and on the other hand geopolitical tensions as well as negative sentiment are capping the potential upside. Any positive catalyst (economic stimulus, fading of some of the tensions) could allow emerging countries to rebound significantly.

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

Fixed Income

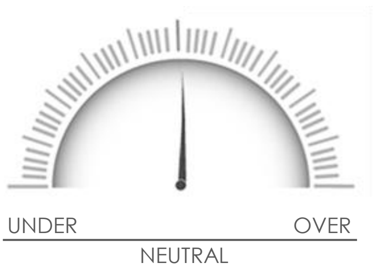
Developed Markets Sovereign



We keep the **Neutral** stance on Developed Markets Sovereign Bonds. As for equities, the increase in market rates since the beginning of the year is to be interpreted as a physiological retracement of the significant decline in the last two months of last year. It is likely to expect that the market may continue the adjustment in the short term, hovering around current levels for some time. Over the medium term, the central bank pivot suggests that the expected direction for rates will continue to be downward, albeit with a much slower pace than in the recent months.

EU Core	−	**EU Periphery**	=	**US Treasury**	=	**Japanese JGB**	=

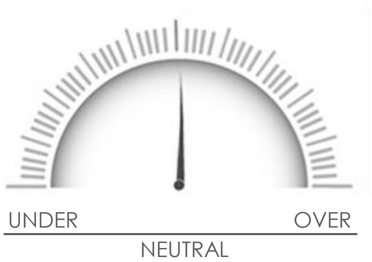
Developed Markets Corporate



We maintained our **Neutral** recommendation on Developed Markets Corporates. 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**	−

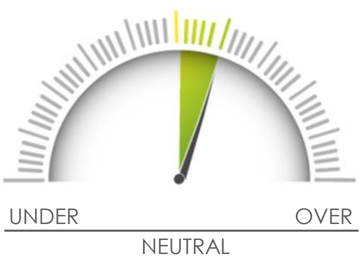
Emerging Markets



We also kept our **Neutral** recommendation on Emerging Market bonds. 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, thanks to the central banks' pivot and the fact that they 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**	=

Currencies

The Committee kept the **Neutral** stance on the US Dollar, dropping the bearish bias after the correction of the past weeks. No particular short-term catalysts are seen that could significantly influence the currency market.

Similarly, the view on the Euro as been changed to **Neutral**, no longer with a bullish bias.

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 **Neutral.** The change in stance by Western central banks and lower rates are supportive for emerging currencies, while local bonds may also benefit from a reduction in rates by the central banks of emerging countries. We continue to remain relatively more optimistic about Latin American currencies.

Euro	=	USD	=	CNY	=	Other EM	=