Main Events

S&P GLOBAL PMI — February's preliminary data on manufacturing and services business confidence will help assess the state of the global economy
22.02

JAPAN CPI — A further decline in inflation could jeopardize the possibility of the BoJ starting a rate hike cycle
27.02

US CONSUMER CONFIDENCE — Will the increase in consumer confidence in recent months be confirmed?
27.02

EU CPI — Thanks to the very favorable base effect, inflation in the EU is expected to show another significant drop in the year-over-year reading
01.03

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
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- New York
- Santiago
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- Singapore
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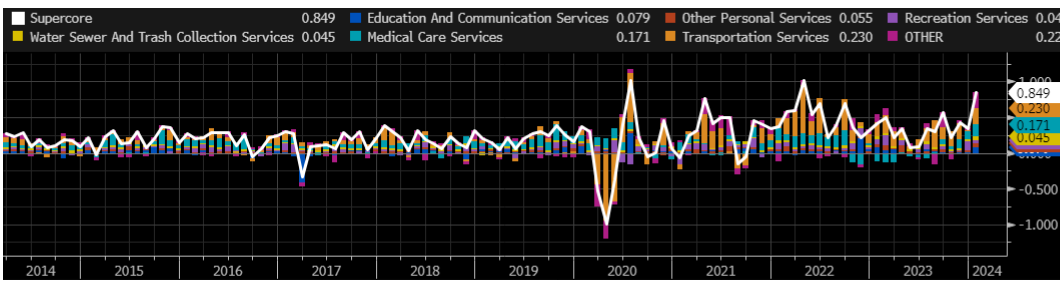
- Sydney
- Taipei

A REALITY CHECK

- **U.S. inflation unexpectedly accelerated once again, especially in the core version**
- **Despite full employment, an increase in delinquency rates has been observed within certain segments of U.S. consumer credit. Outside the United States, signs of an ongoing slowdown continue to emerge**
- **Given the recent rebound in interest rates and the overbought condition of certain equity markets, adopting a more cautious stance appears tactically prudent in the short term**

In our previous report, we compared the market and the Fed to the hare and the tortoise, respectively. The inflation data of the past two weeks seem to have proved the tortoise right.

Although inflation continued to fall from 3.4% to 3.1% in its broadest version as measured by the CPI, more disappointing if not worrisome were the developments in core and "supercore" inflation, also known as core services less housing. Following core PCE, supercore inflation stands as the Fed's most scrutinized metric for informing its monetary policy decisions. Core inflation was unchanged at 3.9% against expectations of a decline to 3.7%, while supercore rose from 3.9% to 4.3%. More specifically, the monthly change in the supercore was +0.85%, the third strongest increase in the past decade, exceeded on only twice during the recent inflationary spike.



Source: Bloomberg

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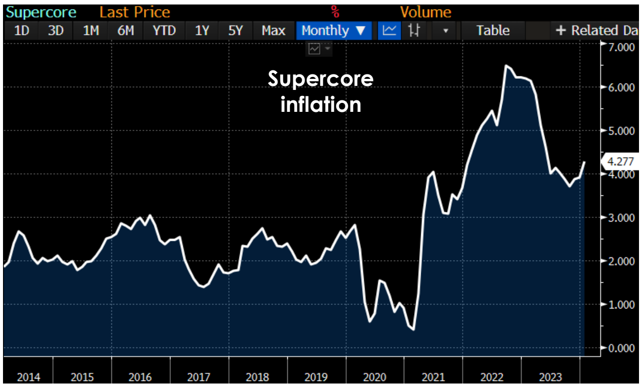

Source: Bloomberg

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At 4.3%, supercore inflation has recorded its third consecutive monthly increase in year-over-year terms, achieving its highest level in six months—a trend neither the market nor the Federal Reserve had hoped for. In addition, producer prices, which tend to be reflected in consumer prices with a lag of a few months, in the core version (ex food and energy) also registered a 0.5% month-on-month increase. On a year-on-year, the PPI rose from +1.7% to +2.0% ex food and energy.

However, the expectation remains that these fluctuations will, in hindsight, prove to be isolated incidents rather than heralding a renewed uptick in inflation. Nonetheless, in light of this data, the market could only take note that expectations of aggressive cuts by the Fed during 2024 had probably been overstated. At present, only 90 basis points of cuts are priced in, compared to the 150 basis points anticipated at the year's start.

The evolution of the business cycle, however, will also play a critical role in determining the trajectory of interest rates. So far, "hard data" (such as employment, consumption and investment), have consistently shown that the U.S. economy is in very good shape, even as soft data (confidence indicators) have hinted at a potential slowdown for months. There is still no evidence of a change in the status quo. Even the unexpected decline in retail sales, particularly in the "control group" version which is the one most correlated with GDP consumption data, at present can only be regarded as a blip, especially after the sharp increases in previous months.

In the background, however, certain metrics often viewed as early warning signs are starting to exhibit developments that merit close monitoring, though none currently raise immediate concerns.

Although data on initial jobless claims remain near historic lows, data on continuing jobless claims are on the rise. Historically, reversals in the trajectory of continuing claims have anticipated that of the unemployment rate. After an initial and physiological upward movement in 2022, when tensions in the labor market began to ease, continuing claims has started to rise again in recent months, surpassing its previous highs. This could portend an unemployment rate toward 4%-4.5%, in line with the Fed's forecast.

The resilience of the labor market also bears significance as delinquency rates in certain consumer credit segments start to increase. This is an unusual development, since historically significant increases in delinquency rates occur only following a slowdown in the labor market (top left chart on the next page, where delinquency rates on credit cards are compared with the unemployment rate). In other words, although at current levels the delinquency rate is not worrisome in absolute terms, it is at odds with such a strong labor market. If the unemployment rate were to rise, delinquency rates have room to rise further.

Another vulnerability can be identified if we break down the delinquency rate by age group of borrowers. The delinquency rate of older people is still at very low levels, while the younger cohorts experience a rapid increase.

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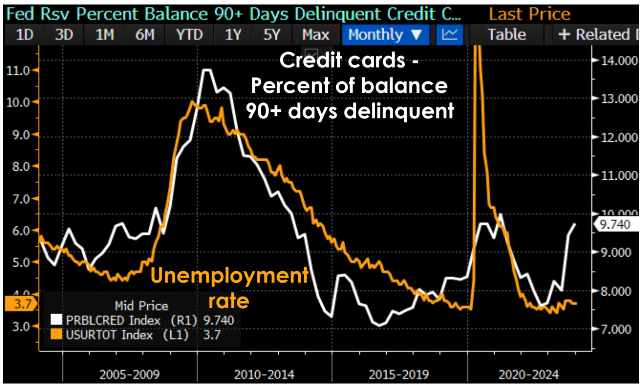

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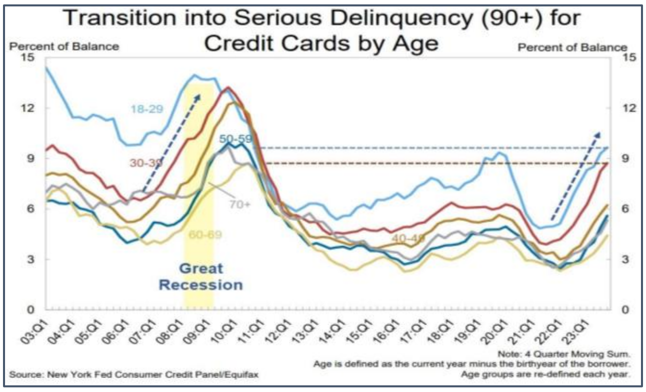


Source: Mishtalk

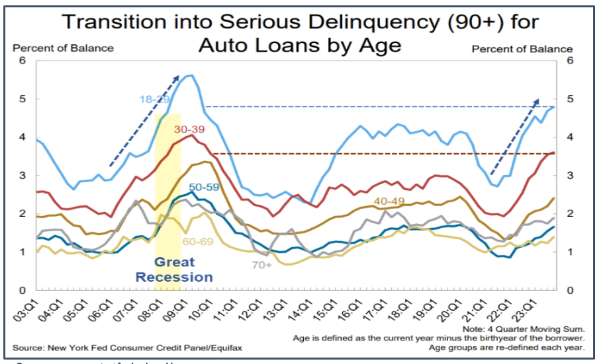
This can be easily explained by recognizing that older generations, who hold most of the assets, have consequently benefited the most from the recent increases in stock and real estate values. Their financial stability is not in danger. The opposite is true for the younger generations, who typically do not own assets. They have seen their purchasing power shrink as wages have not kept pace with inflation, despite the recent but partial recovery in real terms. The same pattern is observed from delinquency rates on auto loans.

Fortunately, the elephant in the room—real estate mortgages—exhibits no worrying trends. All cohorts show stable delinquency rates around historic lows. This stability is because less than one-tenth of U.S. mortgages are variable-rate, and many fixed-rate mortgages were refinanced in 2021, during a period of exceptionally low interest rates. The surge in interest rates over the past two years, therefore, has not impacted existing mortgages, only the newly originated ones.

Therefore, as anticipated, there appears to be insufficient evidence to suggest a tangible threat of an economic slowdown in the United States.

Having said that, it is worth mentioning that the United States is currently the sole engine of global growth. Japan has just experienced two consecutive quarters of GDP contraction, thus entering a technical recession. Europe has stagnated throughout 2023, and preliminary data for 2024 show further contraction in both retail sales and industrial production. China's problems are well known. The evidence is that the rest of the world is already experiencing a slowdown, as it normally happens after such a sharp rise in interest rates. It is therefore necessary that employment and economic growth remain robust in the United States, otherwise the "soft-landing" or "no-landing" narrative would be in jeopardy. And so, in turn, would the optimism in equity markets.

We emphasize once again that this is not the baseline scenario. In the base case scenario, the global economy will continue to grow, avoiding a significant slowdown. However, given the recent rise in market rates and the overbought condition of some stock markets, adopting a tactically cautious stance seems prudent at this juncture, with an eye to reaccumulating equities should a correction occur.



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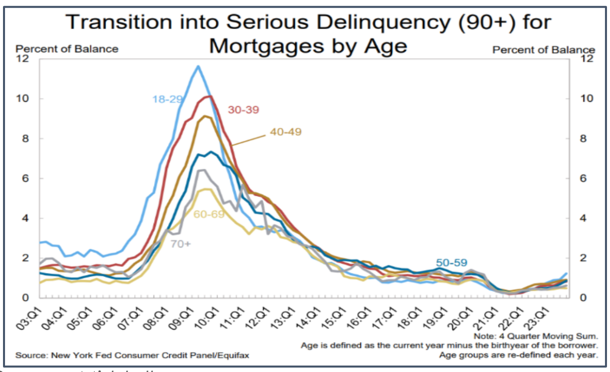


Source: Mishtalk

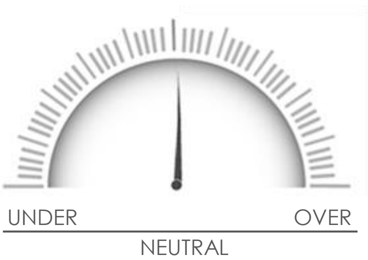
Asset Allocation View

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

− UNDER   = NEUTRAL   + OVER

Equity

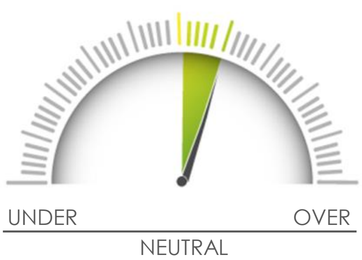
Developed Markets



We lowered our recommendation on Developed Markets Equities to **Neutral**. The strong rally since the beginning of the year has led markets increasingly into an overbought territory, heightening the vulnerability of equities. This trend is particularly concerning given the escalating valuations that persist despite a generally favorable earnings season. Furthermore, latest inflation figures have stoked fears that inflation is not falling as fast as hoped. This has precipitated a marked increase in market rates, thereby bolstering their appeal in comparison to equities. Nonetheless, our medium-term outlook for equities remains optimistic, and we view any forthcoming adjustments as potential investment opportunities.

US	+	**Europe**	−	**Japan**	=

Emerging Markets

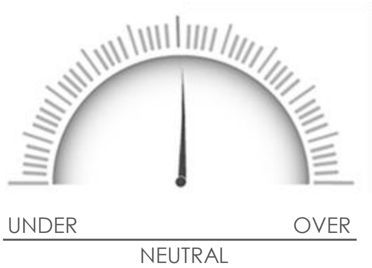


We kept our **Slightly Overweight** recommendation on Emerging Markets Equities. Emerging country valuations continue to be attractive on both an absolute and relative basis. Regarding China, recent data have shown some improvement, and the government seems more open to considering some measures to support the economy, favoring a rebound in sentiment towards Chinese stocks. However, geopolitical tensions continue to weigh on potential upside.

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

Fixed Income

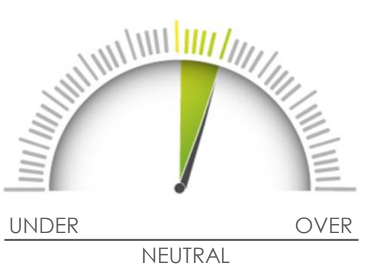
Developed Markets Sovereign



We maintained the **Neutral** stance on Developed Markets Sovereign Bonds. The rebound in market rates has continued over the past two weeks, mainly due to higher-than-expected inflation data that forced the market to further delay the timing of the first rate cut. The rise in market rates was so pronounced that the short-to-medium ends of the curves, particularly the US curve, have returned to attractive levels even considering the more uncertain inflation outlook. Some caution remains on the long ends, which could still be vulnerable should inflation fail to show rapid signs of easing.

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

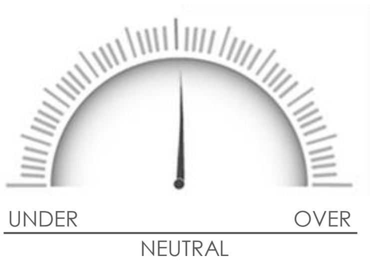
Developed Markets Corporate



We kept our **Slightly Overweight** recommendation on Developed Markets Corporates. Although the timing of the first rate cut has been pushed forward after the recent inflation data, the downward path of rates does not seem to be in question. Moreover, the Fed is expected to shed light on QT tapering at its next meeting, a step that could lead to further spread compression. We continue to favor investment-grade corporate bonds and advise against high-yielding bonds.

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

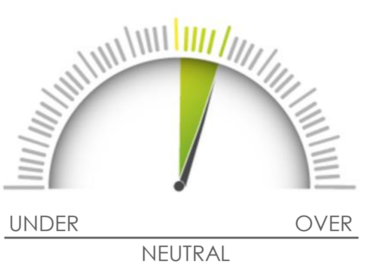
Emerging Markets



We also maintained our **Neutral** recommendation for Emerging Market bonds. Expectation of more accommodative monetary policies from Western central banks could foster a return of interest towards the asset class from international investors, also considering that EM spreads are wider than those of DM bonds. On the other hand, continued geopolitical tensions and still cautious sentiment towards emerging countries suggest that some caution is still needed.

Local Currency	=	**Hard Currency IG**	−	**Hard Currency HY**	−

Commodities



We kept our **Slightly Overweight** recommendation on Commodities. Precious metals continue to be the preferred commodities as they serve as a portfolio hedge in the event of escalating geopolitical tensions and are the ones that should benefit the most when the interest rate cut cycle begins. The committee remains more cautious on other commodities, as they are linked to the evolution of the business cycle.

Precious	+	**Energy**	=	**Industrial**	=	**Agricultural**	=

Currencies

The Committee kept the **Neutral** stance on the US Dollar. The higher-than-expected inflation data resulted in a widening of the rate differential in favor of the dollar, which led to a strengthening of the US Dollar. At current levels, the new scenario seems to have already been fully priced by the market.

The view on the Euro is **Neutral** as well. The soft economic data of recent weeks is nothing new and confirms that European interest rates will soon have to be cut, as anticipated by the ECB at its last meeting.

The view on the **Chinese Renminbi** remains **Neutral,** with a bearish bias. The slightly better-than-expected economic data in recent weeks is not likely to change the scenario for the renminbi.

The outlook for other **emerging market currencies** is **Neutral.** We continue to remain relatively more optimistic about Latin American currencies.

Euro	=	USD	=	CNY	=	Other EM	=