FIDEURAM INTESA SANPAOLO PRIVATE BANKING Asset Management

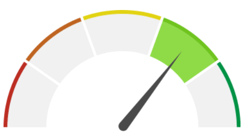
Fideuram Asset Management's View

Edition 04.2024

Macroeconomic Scenario

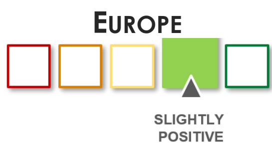
The latest upside surprise in US inflation in March has led to a significant revision in both our and the market's expectations for the Fed's monetary policy. While we have moved the Fed's first rate cut from June to September, the risk that rates will remain unchanged this year and that the Fed may even consider a new round of tightening in late 2024 or 2025 has also increased significantly. On the other hand, expectations of an ECB rate cut in June remain unchanged, as long as inflation continues to fall over the next two months. The ECB's rate-cutting cycle would be more limited than currently expected if inflation dynamics force the Fed to significantly delay the start of rate cuts in the coming months.

Equity Markets

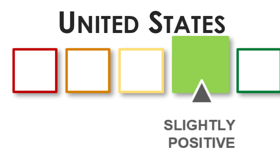


The portfolios maintained their overweight in equities, but to a lesser extent than in previous months. The reaffirmed positive view is based on the assumption that earnings growth will continue and that there will be a gradual expansion in the second half of the year in sectors that have accumulated a gap relative to technology. The reduction in the overweight is however justified by the risk of a tightening of financial conditions linked to the increased uncertainty about the timing and overall size of the Fed's rate cuts. Geographically, we continue to favour the US and European markets, while we are moving Japan to neutral following its recent strong performance. In terms of sectors, we are taking a more neutral approach as the opposing forces (improving earnings and a more uncertain outlook for monetary policy) are weighing on the more cyclical and value components in the short term. We favour the agribusiness sector as we see more favourable commodity price dynamics, a stabilising manufacturing sector and more attractive valuations.

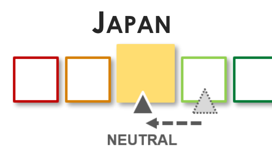
Europe



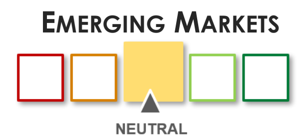
United States



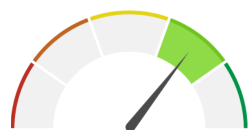
Japan



Emerging Markets



Bond Markets



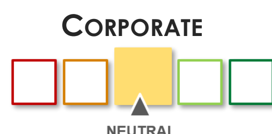
Portfolios remain slightly overweight duration, concentrated in the government sector, and underweight credit risk overall.

Recent inflation data point to a continuation of the disinflationary path in Europe and some reacceleration in the US. These developments suggest the ECB is likely to cut interest rates from June onwards, while the visibility for the Fed has diminished. The combination of short-term cyclical and longer-term structural considerations (such as the possibility of higher growth potential in the US, as suggested by J. Powell) has led us to slightly increase European government bonds relative to US government bonds of the same duration in our portfolios.

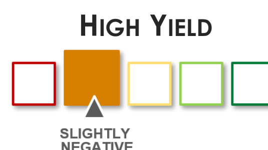
We remain cautious on credit risk, especially in the lower quality components (high yield), preferring investment grade and subordinated financials. This cautious view on spreads reflects not only a valuation element but also the risk of some tightening of financial conditions.

Government

Corporate



High Yield



Emerging Markets

Content updated as of April 24th, 2024

USA: Inflation hard to swallow for the Fed

The persistent and sizeable upward surprise in price dynamics in March led to a **significant reassessment of the monetary policy outlook in the near term**. We have **postponed the Fed's first rate cut from June to September** and expect a total of only 50 basis points over the course of 2024 (with another rate cut in December). However, a rate cut as early as July would require a significant slowdown in core inflation in the coming months, which currently seems unlikely. **Our baseline scenario remains one of a gradual decline in core inflation** over the coming quarters, but the risk that the unexpected strength of the economy and inflation will force the Fed not to cut rates later this year has certainly increased significantly.

Euro Area: Signs of growth and subdued inflation

The improvement in the Composite PMI between February and March supports the expectation that the **Euro Area will emerge from the stagnation it has been experiencing since the end of 2022 this spring**: after still very weak GDP growth in the first quarter, we expect an increase of 1% qoq in the second quarter. **Inflation continues to slow** and surprised to the downside in March, falling to 2.4% (from 2.6%), with core (excluding food and energy) coming in at 2.9% (from 3.1%). Prices for services have risen steadily over the past five months (4%), but are expected to slow in April. Tensions in the Middle East have pushed up energy prices, but only modestly for now. **The ECB confirmed at its April meeting that it is ready to cut rates in June**. We expect three more cuts before the end of the year

China: Not all that glitters is gold

GDP growth was particularly robust in the first quarter, rising to an annualised 6.6% from 4.9% (revised from 4.1%) in the previous quarter. **As a result, we have raised our growth forecast for 2024 from 5.0% to 5.2%**, as the government's growth target ("around 5%") now looks more achievable and no further fiscal stimulus should be needed. Exports and investment (excluding construction) have been the primary drivers of growth, boosted by supportive government policies, while consumption has struggled to pick up due to a lack of targeted policies and deteriorating consumer confidence. **The crisis in the residential housing sector remains the primary risk factor**.

Consumer confidence has not recovered since collapsing during the pandemic

Source: National Bureau of Statistics

Fideuram Asset Management Economic Forecast

	GDP			Inflation			Monetary Policy Rate		
	2023	2024*	2025*	2023	2024*	2025*	2023	2024*	2025*
US	2,5	2,5	1,8	4,1	3,2	2,3	5,38	4,88	4,13
Eurozone	0,5	0,5	1,2	5,5	2,4	2,1	4,50	3,50	2,75
Japan	1,9	0,6	1,2	3,2	2,4	2,0	-0,10	0,25	0,50
China	5,2	5,2	4,6	0,2	0,7	1,5	2,50	2,30	2,30

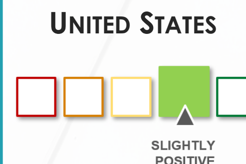
Annual average growth, monetary policy rates are end of period. Refi rate for ECB. ** Fideuram Asset Management Forecasts*

INVESTMENT VIEW

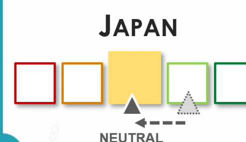
Equity Markets

Valuations are relatively low and, in relative terms, at a significant discount compared to the US. The macroeconomic momentum is less strong and the sequential growth of profits weaker than in the United States, also due to the different sectoral mix and the lower weight of technology. However, we see the manufacturing sector beginning to stabilise and believe that earnings could improve in the second half of the year. Since the beginning of the year, we have started to increase our exposure, which is now moderately overweight.

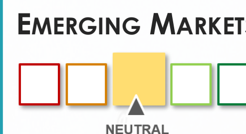
Basically speaking, we continue to favour the US market due to the higher quality of companies and the profit growth that has so far been above expectations and that we expect to be robust in the coming quarters. Uncertainty about the Fed's actions opens up a period in which valuations are unlikely to rise and, at the margin, there may even be some periods of limited vulnerability. In this situation of heightened uncertainty, the portfolios have no significant sector exposures. In addition to the exposure to technology, we have started to gradually diversify by sector and style into those components that have built up a performance and valuation gap with the mega-cap growth stocks and that have improved earnings prospects for the second half of the year.



We are reducing the position to neutral after the sharp rise in recent months and aim to reduce the size of the overall equity overweight. From a longer-term perspective, we continue to see attractive valuations and rising earnings in the Japanese market, linked to rising inflation expectations and the process of balance sheet restructuring and increased capital spending.

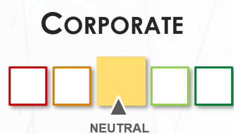


We maintain a neutral approach to emerging equity markets. There are still some structural issues in China (such as the real estate sector), and the impact of dollar appreciation and geopolitical risks are also weighing. However, valuations are attractive and local and global cyclical conditions are improving. While we are not overly optimistic, we believe the relative performance of the Chinese market is stabilising.

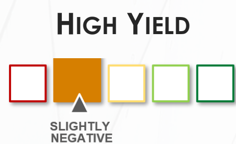


Bond Markets

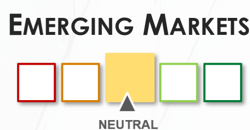
We remain overweight in the government component, with a preference for European bonds. In the US, while we confirm the fair value range of 4.3-4.5% for the 10-year Treasury, we believe it can trade above these levels as long as the market is pricing in the risk of another rate hike by the Fed. Although the probability of this risk is low, its impact is significant and the upcoming inflation data will be crucial in determining the central bank's actions. In Europe, our strategic view is favourable based on cyclical considerations, real interest rate levels, inflation trends and the outlook for monetary policy. We see any further increase in exposure at the upper end of the 2.3%-2.5% range for 10-year Bunds. Peripheral spreads are tight from a valuation perspective, and a tightening of financial conditions could lead to some volatility. However, we do not expect any abrupt widening, especially for shorter maturities.



The low level of spreads is a cause for caution given the risk of tighter financial conditions as the Fed delays its actions. However, the overall yield is attractive and remains our preferred segment within corporate credit risk.



Default rates, despite worsening lending standards and the impact on lower-quality loans of an increase in the cost of capital are still relatively low. Expected yields are attractive from a historical perspective, but we remain underweight in order to limit any credit risk that may arise from a prolonged tightening of monetary conditions. We prefer to take on risk through equities.



Overall, we remain cautious of the more volatile and lower quality components of the bond segment. The position in emerging markets is neutral overall, as the carry offered is relatively generous in absolute terms, but we still do not see macroeconomic conditions favourable enough to take an overweight position. On the currency front, the strength of the dollar and China's monetary policy choices are sources of volatility.

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EQUITY MARKETS

OVERALL EQUITY OVERWEIGHT REDUCED

The macroeconomic data on real growth, and in particular the three consecutive upside surprises on inflation, have changed the probability distribution regarding the path of US monetary policy.

Compared with the end of last year, **the market is pricing in a delayed start to the expansion** and a smaller overall expected rate cut. In addition, the risk has reemerged, although **the probability seems limited at the moment**, that the Fed might even move to raise interest rates further.

While this possibility represents a tail scenario, if inflation were to remain persistently high, **it would imply that financial conditions would have to tighten** for the Fed to cut rates.

The risk of an unexpected tightening of **financial conditions would generally lead to a period of greater uncertainty for equity markets**, also given the historically high multiples.

In response to this market trend, **we are reducing the size of the overall equity overweight in the portfolios**, which is geographically concentrated in the US and Europe. Exposure to Japan is being moved from overweight to neutral, following recent performance, **to support the move to reduce overall equity exposure**. **From a medium- to long-term perspective, there are still favourable elements** for Japan, such as attractive valuations and rising earnings, both of which are linked to rising inflation expectations, balance sheet restructuring and increased capital spending.

Despite the increased uncertainty surrounding the scenario, **we maintain our overall overweight in equities on the assumption that earnings will continue to grow sequentially**. This is particularly true for the US, where **we remain relatively positive, albeit to a lesser extent than in previous months**. We remain slightly overweight in European markets, where **we see an improvement in expected earnings momentum from the second quarter onwards**, supported by a more favourable comparison effect and less uncertainty about the ECB's monetary policy cycle.

We remain neutral on emerging equity markets, where China's macroeconomic underperformance has **reduced expected earnings growth estimates**. However, valuations are supportive and expectations remain for a period of **greater stability** and additional stimulus from the Chinese government, although the measures taken so far have fallen short of investors' expectations.

BOND MARKETS

THE START OF THE FED'S EXPANSIONARY PHASE IS PUSHED FURTHER OUT

The still buoyant US economy, coupled with inflation that is surprising to the upside, led **the market to price in a delayed start to the expansionary phase**, reducing the overall size and introducing a slight possibility of another rate hike.

These developments have pushed Treasuries **above the fair value range**, which has not changed despite these new factors, remaining between 4.3% and 4.5%. The fair value range does not change significantly as the possibility of a Fed rate hike seems **very remote** and affects short-term expectations rather than longer-term rates.

Overall, the portfolios remain slightly overweight in duration, concentrated in the government sector, against an overall underweight in credit risk. The sum of short-term cyclical and longer-term structural considerations **leads us to favour European duration over US duration**, even in this more delicate phase of the Fed's monetary policy management. Operationally, we **have slightly increased our exposure to European versus US government bonds**, keeping the same duration.

At its April meeting, the ECB stated its **intention to cut interest rates if inflation converges towards the target**, declaring itself data-dependent but not dependent on the Fed. Monetary policy expectations have risen more modestly than in the US, **but rates are also feeling the pull of US rates. We confirm the fair value of the Bund until the start of the rate cuts in the range of 2.3-2.5%** and we are more confident in exposure to European duration compared to the US due to differences in the economic cycle, the differences in inflation concerns, and potentially lower levels of productivity and GDP.

Peripheral spreads are trading at low levels relative to credit risk, but should move within a range of normal volatility even as global financial conditions tighten, partly due to the ECB's actions.

We remain cautious on credit risk, especially on lower quality (high yield) components, **while preferring higher quality** (investment grade) **issues and financial subordinates**. The cautious view on spreads reflects not only a valuation element but also the risk that the Fed's achievement of its inflation targets may require **some tightening of financial conditions.**

We are increasing exposure to the dollar to overweight as a form of portfolio protection should the Fed keep official interest rates higher for longer.

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