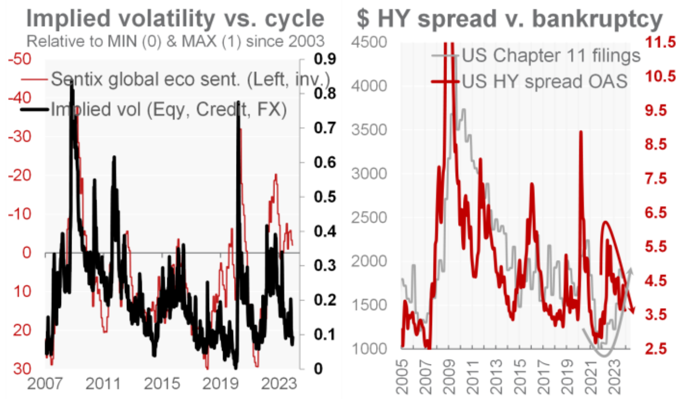
OUTLOOK 2024

The intangible cycle

December 15, 2023

Our Annual Outlook provides our key views and investment implications for the coming year

- **2023 is ending with a bang, as global investors wildly celebrate the end of the monetary tightening cycle, while anticipating quick disinflation, aggressive rate cuts and solid profit growth. The markets are not priced for perfection, but Goldilocks are increasingly consensual.**
- **We fear that the US economy will finally come to a near halt in 1H24. Central banks may also fear that the sharp easing of financial conditions will make the 'last inflation mile' more difficult, hence will not rush into Q1 rate cuts.**
- **We see more downside in bond yields, but more in the US than the EA. Instead, we prefer EUR Credit to USD. We also continue to favour Investment Grade Credit early in the year. We expect a positive year for High Yield Credit and Equities, but soft performance early on. The USD should weaken overall, if not quickly, and the Yen recover.**
- **2024 will see then great volatility convergence, with Rates vols set to fall, whilst Equity, Credit and FX vols should rise initially. Those willing to surf the late 2023 risk rally should do so via options. 2024 will offer many wild cards, from the risk of deeper China deflation to the BoJ policy turn and an exceptionally heavy electoral agenda.**



Source: Bloomberg, CBOE, JPM, GIAM calc.

Source: Admin. Off. of US Courts, BBG, GIAM

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THE INTANGIBLE CYCLE

Vincent Chaigneau

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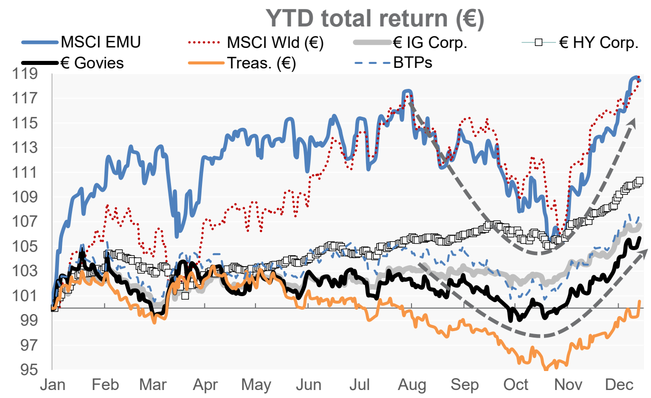
Beware the pitfalls of consensus forecasting. 2023 will be remembered as a typical year that sees a bearish consensus view being punished: markets have climbed a wall of worry (see 2023 Outlook: Blowing Hot and Cold). A broad majority of investors were much scared about the economic and financial impact of the unfolding great monetary tightening. Those fears seemingly started to materialise in March, with the US regional bank crisis, followed by the fall of Credit Suisse. Those were only hiccups. Even the Hamas-Israel war failed to derail the spectacular risk asset rally.

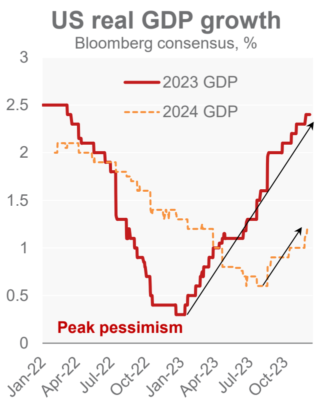
Two key surprises in 2023: exceptional US economic resilience…

Consensus embracing Goldilocks

Key questions for 2024. To start with a clean plate, two things mostly surprised us over the past year. First, the US economy proved remarkably resilient. The consensus US real GDP forecast started the year at 0.3%, and closed it around 2.5%. No matter that the Euro Area and China growth vindicated weak expectations. US resilience dominated market sentiment. One key question for 2024 is whether the tailwinds (expansive fiscal policy, consumer spending the excess savings built through the pandemic, labour hoarding) are fading fast enough to bring the US economy to a *halt*.



Source: Bloomberg, GIAM calculations



Source: Bloomberg, GIAM

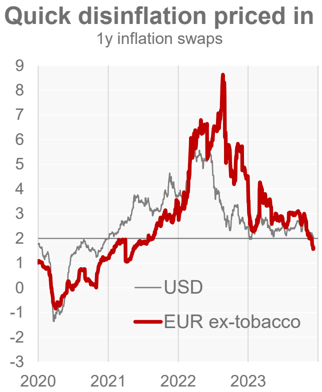
Source: MSCI, Bloomberg, GIAM

… and a decoupling between real yields and equity multiples

Secondly, equity multiples rose through the year, even as long-term US real (or inflation-adjusted) yields spent most of the first ten months rising. That decoupling came in sharp contrast to the correlation seen through the past ten of even twenty years. One partial explanation lies in the great AI breakthrough and hopes of a large positive impact on productivity. Though (poor) Euro Area productivity trends continue to be poor, the more recent US economic numbers suggest that a turn may be in the making already. The decoupling has caused a drop in equity risk premia, especially in the US, to levels not seen in more than twenty years. Another key question for 2024 is whether such *richening* of equities relative to bonds should be faded.

Markets positioned for quick disinflation, strong profit growth and large key rate cuts

Where does the consensus lie? Markets are not priced for perfection, but they have integrated a lot of good news indeed. Inflation markets see US CPI hit the 2% landmark in just ten months. EA ex-tobacco inflation is priced at just 1.65% over the next twelve months (left chart below). So investors now see quick disinflation as the core scenario. Based on consensus earnings expectations, the US economy is expected to continue thriving, with profits seen rising at an average 10% pace per year over 2024-2026. Meanwhile, central banks are seen cutting rates rather aggressively, with the Fed and ECB priced for near 150bp of cuts each in 2024. This is not much compared to the Fed's monster cuts in 2001 or 2007-08 but those were financial crisis periods that clearly are not embedded in today's market pricing. Those large rate cut expectations are at the source of the financial feast observed in the last two months of 2023.



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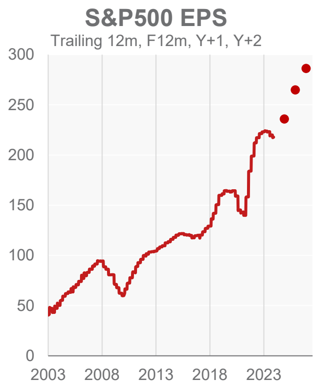

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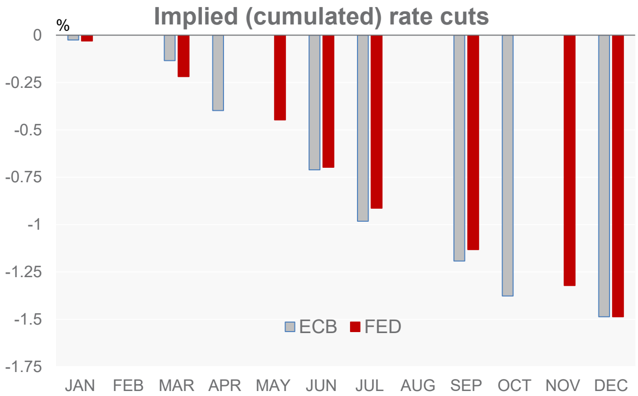


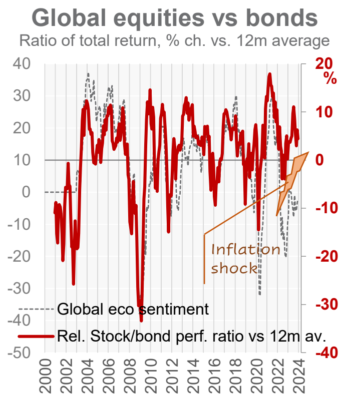
Source: Bloomberg, GIAM

Monetary policy dominance has supported positive stock-bond correlation

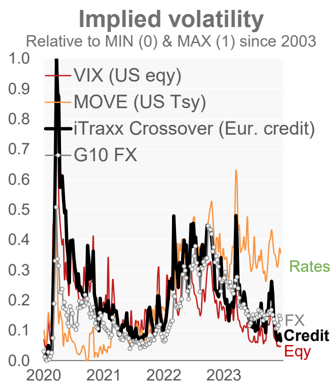
The ongoing dominance of monetary policy has heavily contributed to the positive correlation between stock and bonds prices since late July, repeating the pattern of 2022, when rate hikes fears caused bearish price action in both global markets (left chart below). In contrast, correlation tends to be lower, or negative, in markets dominated by cyclical forces, risk appetite or fiscal policy. Correlation was mostly negative in 1H23 when the consensual gloominess got punished (bond yields and equity prices up) and the US regional bank crisis caused a short-lived surge of risk aversion. It was not so surprising that global equities sold off less quickly than bonds bonds through the surge of inflation and the sharp reversal of monetary policy in 2022. But that has continued strongly over the past year, even as inflation started to retrench, and the global economy failed to impress (second chart below). That persistent gap between the soft economic sentiment and the relative stock-bond performance keeps us rather cautious in the near term. Also, we struggle to explain that risk-asset volatility (equity, credit, FX) has dropped so much while investors' sentiment about the economy remains cautious (right-hand charts below). For sure, rates volatility remains elevated. We expect a strong pullback there in 2024, even earlier in the year if central banks start to lean back against aggressive market rate cut expectations that have led to a considerable easing of financial conditions, which may make the last mile more difficult for inflation normalisation. Such pushback would create a counter force that would

2024 to see volatility convergence between Rates and risk assets likely reduce rates volatility. 2024 is likely to see the great volatility convergence between Rates and risk assets.

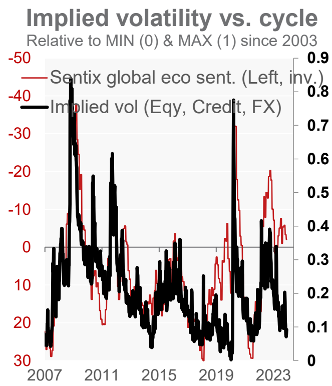
Source: Bloomberg, GIAM



Source: Sentix, MSCI, Bloomberg, GIAM



Source: Bloomberg, CBOE, JPM, GIAM calc.



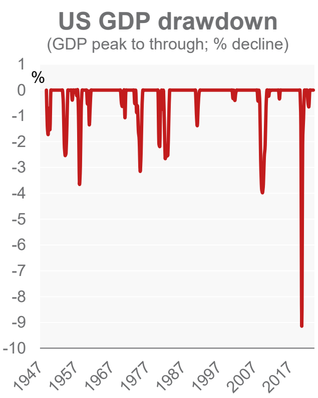
Source: Bloomberg, CBOE, JPM, GIAM calc.

The intangible cycle

> A very unusual economic situation, with both mid and late cycle features

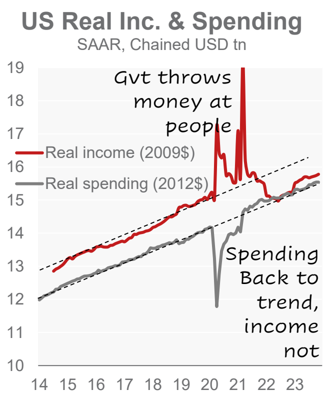
Recession eschewed or delayed? The remarkable resilience of the US economy to a 525bp (plus QT) monetary tightening raises important questions about the position in the cycle – a defining feature of fundamental investment strategies. Typically, rate hikes tend to be delivered in late cycle, often precipitating the downturn in the cycle. This time was somewhat different, as the inflation surge was partly exogenous, owing to the supply chain disruption through the pandemic, the revenge spending and the war in Ukraine. The Covid-related massive policy mix easing obviously contributed to the inflation surge. Precisely, this was a response to an extraordinarily deep real GDP drawdown – more than 9 points in the US (see left chart below). That recession was deep but very short-lived, with the trough reached in 2Q20. That is now 3.5 years ago, yet from that perspective the cycle is still quite young. As such, we are in a very unusual economic situation, with both mid and late cycle features. That said, we still expect the US economy to slow down sharply in 1H24. This is happening already in Q4, with annualised growth tracking just above 1% in Q4 – though this means little following a massive 5.2% s.a.a.r. gain in Q3. US growth has defied the stagnation signals sent by leading indicators, usually very reliable. We still expect some delayed payback, including from the seemingly invincible consumer. Arguably real income will

> A very unusual economic situation, with both mid and late cycle features

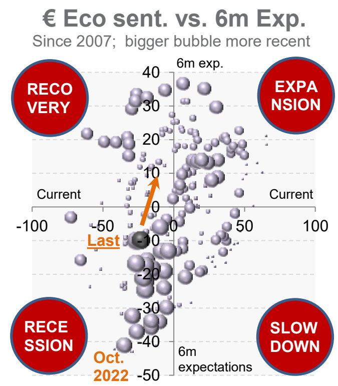


Source: BLS, Bloomberg, GIAM calculations

Source:Conf. Board, BBG, GIAM



Source: US BEA, Bloomberg, GIAM



Source: Sentix, MSCI, Bloomberg, GIAM

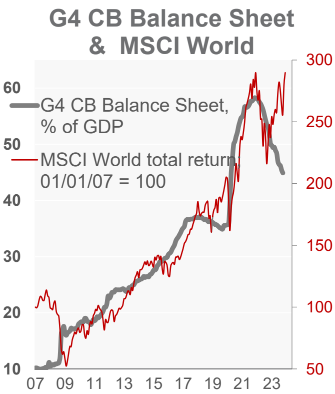
pick up as wage growth outpaces CPI, but slower job trends will cap those gains, keeping income away from its pre-Covid trend (see chart). Instead spendings are back to trend already, thanks to the heavy usage of excess savings – but that tailwind is

EA and China do not appear in position to offset slower US trends in 1H24

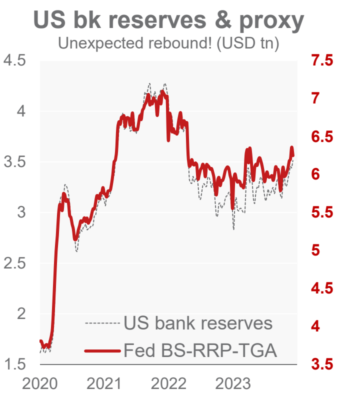
fading. See the macro section for details. This unusual cycle is also marked by a strong de-synchronisation, with the EA and China growth respectively meeting and undershooting earlier expectations. The EA has been on a flat line for the past year, but based on investor sentiment it has even been mired in recession (top-right chart above). Expectations are improving however, and we expect a slow transition towards ‘recovery’. Still, the EA and China do not appear in position to offset the slower US trends in the next couple of quarters.

US bank reserves will soon stop rising, which may tame financial exuberance

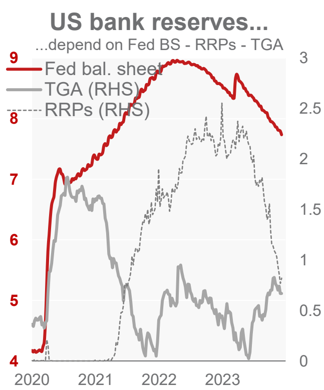
QT is not over. While investors have positioned for large rate cuts, they appeared unfazed by the continuation of Quantitative Tightening (QT). Another surprise in 2023 was that global equity markets proved completely immune to the further compression of the central banks’ balance sheets (left chart below). Partly, this reflects the decoupling between the Fed’s balance sheet and US bank reserves; the latter even increased by some $400bn in 4Q23, thanks to the accelerated fall in Reverse Repos (money market funds putting money to work in the market). That trend is likely close to an end and may contribute to taming financial exuberance in early 2024. The good news is that the Fed may consider slowing QT at some point in 2024, once bank reserves are closer to the target level. In contrast, the ECB will accelerate QT as it intends to reduce its PEPP portfolio by €7.5bn per month on average in 2H24 and to stop reinvestments at the end of 2024. Such divergence we think will contribute to support Treasury outperformance relative to Bund. But for the earlier part of the year, one key message is that ongoing QT, associated with a sharp US slowdown, may tame the risk rally.



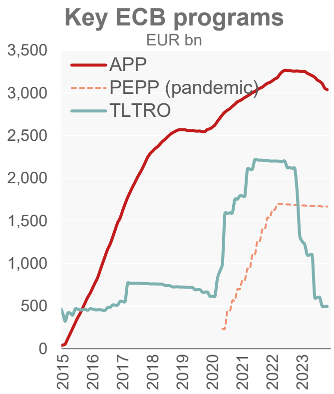
Source: MSCI, Bloomberg, GIAM



Source: Fed, Bloomberg, GIAM



Source: Fed, Bloomberg, GIAM



Source: ECB, Bloomberg, GIAM

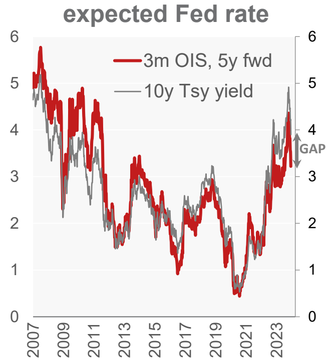
Rates: Prefer Treasuries to Bund

Risks skewed towards significantly lower Treasury yields in the next 6 months

It’s inflation, stupid. Our bullish bond views by late summer 2023 (The (not so) great escape) proved right, and we stay skewed towards lower yields in 2024, as inflation continues to pull back and central banks deliver on rate cuts. However, the 100bp rally in 10-year UST (from 5% to just below 4%) and 90bp fall in 10-year Bund yields mean that investors have largely front-run that easing. We see the Fed and ECB deliver “only” 100bp of cuts in 2024, hence our positive bond views are now measured. For choice, we continue to prefer Treasuries over Bund. Relative QT paths are a factor. Also 10-year yields tend to move in sync with medium-term rate expectations, for instance 5y3m OIS, and the latter has more downside in USD than EUR. USD 5y3m OIS has dropped sharply, from a peak around 4.40% in October to about 3.25%, as we expected, but faster. There is still some downside, as the Fed’s median medium-term dot still stands at 2.50% (arguably a debated topic at the Fed, with three members in the 3.50-3.75% camp). Also, 10-year Treasury yields are still trading near

70bp above that forward, which is high by historical standard. That spread is set to decline as the Fed proceeds with rate cuts and the money market curve dis-inverts (second chart below). Our forecasts set a 12-month target at 3.75% for 10-year yields by end 2024, but risks are skewed towards significantly lower levels in the next 6 months. With the global economy showing signs of stabilisation by mid-year, bonds might then trade more sideways. In contrast, EUR 5y3m has already dropped to 2.25% (even slightly below what we consider as equilibrium value) and 10-year Bund is already trading some 20bp through that, with the Constitutional Court decision and related fiscal tightening likely contributing to this richness.

10yT vs. mid-term expected Fed rate

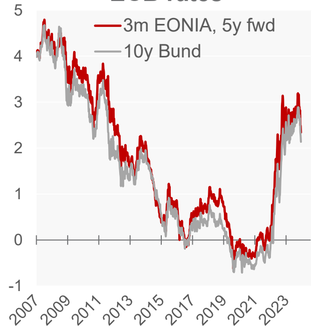


Source: Bloomberg, GIAM

Gap to diminish/close as Fed cuts rates

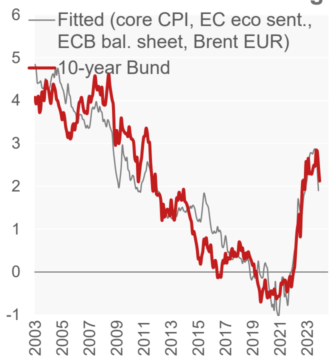
Source: Bloomberg, GIAM

10y Bund tracks 5y fwd ECB rates



Source: Bloomberg, GIAM

Bund 'fair value' retreating



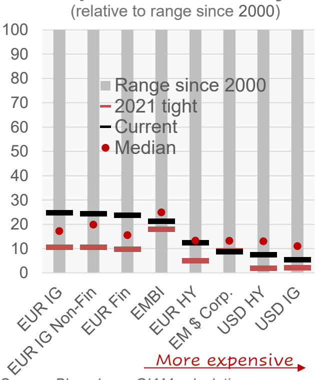
Source: Bloomberg, GIAM calculations

We prefer EUR IG Credit to USD; prefer EM sovereign debt to HY

IG Credit still offers attractive risk-reward, more in EUR than USD

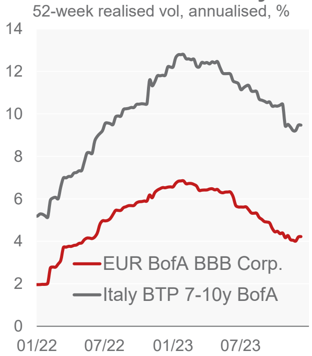
Still an attractive risk-reward. Credit spreads compressed nicely in the last couple of months of 2023, with both the fall in risk-free rates and equity rally fuelling the rally. With the Aggregate Corporate OAS around 100bp, US IG spreads are now getting close to historical lows. EUR IG spreads appears less stretched from a historical basis (left chart) – we still find that segment attractive. EUR BBB Corporates still offer a yield to maturity close to 4%, about 40bp more than 7-10y BTPs, but for a volatility (second chart below) and risks that are significantly lower.

Spreads vs. History
(relative to range since 2000)



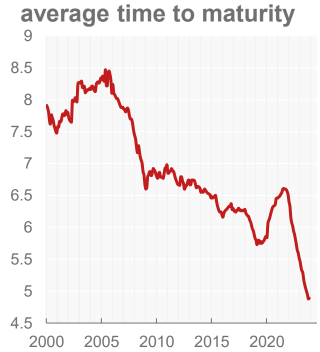
Source: Bloomberg, GIAM calculations

IG vs BTP volatility
52-week realised vol, annualised, %



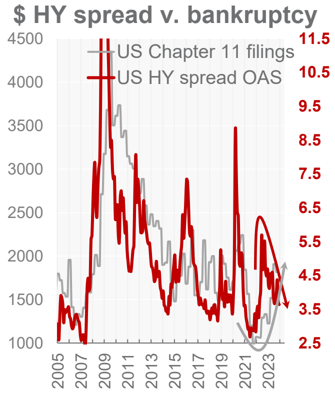
Source: BofA, Bloomberg, GIAM calc.

US High Yield index average time to maturity



Source: Bloomberg, GIAM

$ HY spread v. bankruptcy



Source: Admin. Off. of US Courts, BBG, GIAM

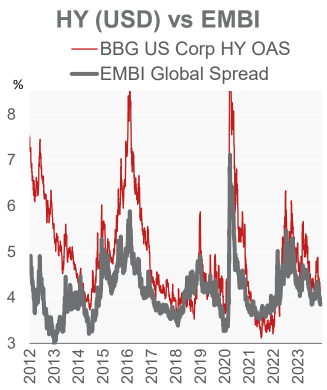
HY spreads very tight by historical standards

High Yield and the debt wall. Light issuance for most of 2023, until a late pick-up, contributed to the strong performance oh High Yield markets. Yet the average time to maturity of the asset class has now declined sharply, with refinancing needs now higher for 2024 and even more so for 2025. Companies tend to act early to roll the debt, so supply pressures will likely be rising – expect a strong start to 2024 on that

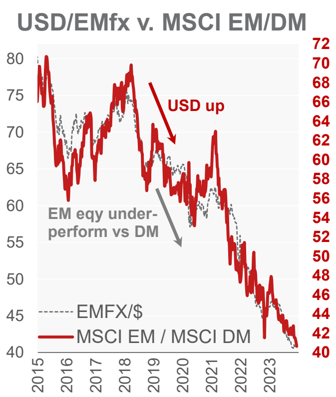
Only a small underweight, though US spreads look stretched

Selectively positive on EM markets, HC debt in particular

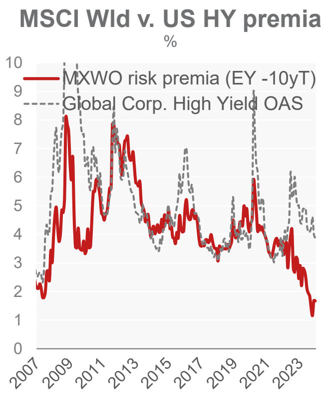
front. How much relief will come from the private credit markets remains an important topic, but we worry that spreads have proven so extremely immune to deteriorating fundamentals, namely a strong pick-up in bankruptcies (chart above) and a rise in defaults (even more so in loans than HY bonds). We will start the year with a cautious view on the asset class, though falling risk-free yields and the perspective of a mild recession (if any) argue for only a small underweight. By comparison, we find EM Hard Currency spreads less tight than HY spreads on a historical basis. EMBI spreads offer similar pick-up to US High Yield, with much lower volatility through financial shocks. We generally find EM countries healthier (idiosyncratic factors matter) from a fundamental point of view, with local markets also set to benefit from the Fed's rate cuts. Thanks to carry, EM currencies offered solid total return in 2023, but spot exchange rates have continued to depreciate, while EM equity markets have lagged DM markets dramatically. That latter story is primarily a Chinese one, but even there, after 3 years of property crisis and incremental policy support building further (especially on the monetary side), we now see less downside. The USD stance will matter; near term we expect weaker global cyclical conditions and less buoyant risk conditions to support the USD, but Fed cuts will eventually take their toll.



Source:JPM, Bloomberg, GIAM



Source: MSCI, Bloomberg, GIAM calculations



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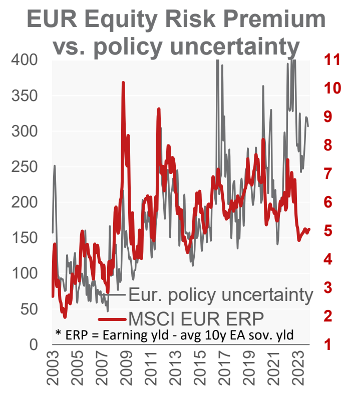


Source: Baker, Bloom & Davies, BBG, GIAM

Equities offer decent perspectives over 2024, with a cautious start.

Positive 2024 equity views, but cautious start

The breath-taking equity rally since early November will leave investors in a tricky position at the start of 2024. Positioning is not stretched but has moved from very short to now long/overweight. Long-term valuations are not stretched – if anything slightly cheap in the EA. But the global Equity Risk Premia (ERP) have dropped significantly over the past couple of years, making equities relatively less attractive in terms of risk-reward (3rd chart above). The ERPs are more generous in Europe, but not necessarily high enough considering the economic and political risks. We will start with a marginally underweight position, but a diversified regional, style and sectoral exposure. EUR cyclical stocks have outperformed Defensives by near 10% over the past year, with investors partly front-running the transition to a EA recovery discussed above. We still see room for selected cyclical sectors, not least Banks, Energy and Small Caps. Our asset classes sections offer many more details on investment opportunities.

Many wild cards in 2024

In all we foresee a pause following the broad cross-asset rally at the end of 2023, with slower US economic trends, a reluctance by central banks to reverse policy too quickly, heavy supply and positioning arguing against financial exuberance. 2023 taught us once again the pitfalls of the consensus. As we turn the year, investors seem to be increasingly embracing the Goldilocks scenario of quick disinflation, solid profit growth and quick rate cuts. Hence our more cautious stance. But 2024 as a whole looks positive for balanced portfolios, as markets will integrate key rate cuts and a transition, by mid-year, towards a slow recovery.

Upside risks coming from AI revolution and improvement in both the supply of and demand for credit

Upside risks. We discussed the unusual nature of this cycle; signals on this front may also be distorted by structural forces such as technological breakthrough (AI), the changing world order (multipolar and more volatile), deglobalisation (we prefer to talk about de-risking), climate change and demographics. **AI** may be the most impactful for markets, presenting upside risks for markets: strong productivity gains would help contain inflation and support margins and profits. Another upside risk lies in a pick-up in the **demand for credit** as rates fall and tail economic risks diminish, as well as the potential **easing of lending standards** as banks compete with private credit firms (much dry powder there). We strongly recommend to those willing to surf the bullish equity and credit wave of late 2023 to take advantage of the low volatilities to position via options.

Downside risks from China deflation and BoJ tightening. Geopolitical risks are two-sided.

Downside risks instead come from deflationary pressures emanating from **China**, and further RMB downside, threatening to undermine global corporate pricing power. A prudent **BoJ** tightening is likely in Spring and could unveil repatriation flows that will be a headwind for western bonds. Finally, the 2024 calendar year is exceptionally busy, starting with the presidential election in Taiwan in January and peaking with the US November elections. We find that geopolitical risks are two-sided, e.g. progress towards diplomatic talks in Ukraine may, somewhat paradoxically, offer some relief to the lagging EA economy and stock markets. Surely those multiple events will offer tactical investment opportunities. For now, we hope our readers will enjoy this report and wish them all a happy holiday and year 2024.

MACROECONOMIC OUTLOOK

Thomas Hempell, Christoph Siepmann, Martin Wolburg, Paolo Zanghieri

- **After striking resilience in 2023, the global economy is set to slow in early 2024. The euro area is flirting with a mild recession. Persistent scars from the energy shock and a looming fiscal tightening weigh on the outlook.**
- **The US will (finally) feel stronger headwinds as high interest rates bite while the support from excess savings and fiscal profligacy fade. A tepid Chinese recovery will not provide broader relief.**
- **Yet we expect the global outlook to stabilise by mid-year on the back of a bottoming global inventory cycle, and somewhat resilient labour markets and real incomes. Fading headwinds from monetary policy may help growth to gain some traction later in the year.**
- **Core inflation rates are set to ease further, but unlikely to fall below 3% yoy before mid-2024 amid still high wage pressure. Fading base effects and expiring energy price caps will trigger more volatility in headline CPI rates.**
- **Central bank rates have reached their peaks, but these are likely to prove extended plateaus. As core inflation comes down at a slow pace, central banks will be wary of declaring premature victory on inflation. We expect first rate cuts by the Fed in May and by the ECB in June, with cumulatively 100bp by year-end 2024.**

2024: a year of two halves, with a more discernible recovery on the cards only for H2

After a past year of overall resilience, 2024 looks set to prove a year of two halves. The first months are likely to see the US economy to slow down into stagnation as high rates bite and the support from fiscal profligacy and excess savings fades. The euro area will struggle to gain traction amid headwinds from tight financing conditions and the fiscal side. China will benefit from further stimulus measures, but these will be measured and the drag from the property woes will keep a lid on the recovery.

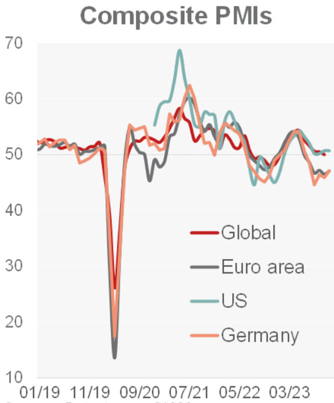
The process of disinflation will proceed, even if sluggishly so

The process of disinflation will proceed, even if sluggishly so. After eased supply bottlenecks and lower energy prices have reduced inflation by almost two thirds from its peak a year ago, the last mile towards central bank targets may prove bumpier. Services inflation and wage growth are still high. And labour shortages – notably in the euro area – still bear the risk of pressures on prices and wages perpetuating each other. Historical analysis shows that only 60% of high-inflation periods in the past could be resolved within five years. This record challenges markets' optimistic stance that inflation will be back fully under control already over the next twelve months from the 9.1% (US) and 10.6% peaks seen last year.

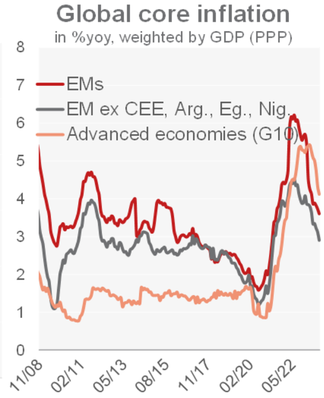
Yet disinflation will be reassuring enough for central banks to pivot in the spring 2024. With the reversing drag from monetary policy will ultimately lay the ground for a mild recovery in H2 2024. Fiscal consolidation and headwinds from a more fragmented global economy will keep the recovery shallow, however

Key downside risks arise from more stubborn inflation and vulnerabilities in the financial system

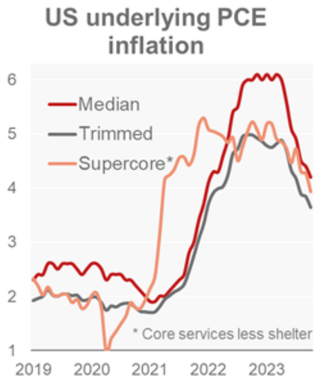
A key risk is that inflation rates prove much more stubborn, especially as wage growth remains high or renewed geopolitical costs raise energy and commodity prices. Further downside risks arise from cracks in the financial plumbing. Barring the contained banking woes in March 2023, the global financial system has digested the stark rate hikes strikingly well. Yet vulnerabilities remain, probably most so in the commercial real estate (CRE) and shadow banking sector.



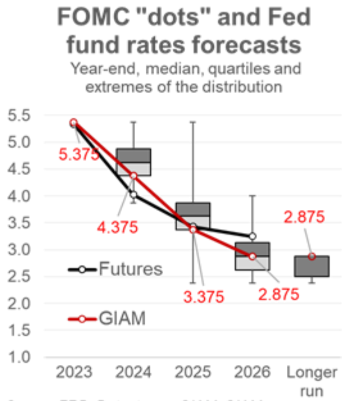
Source: Datastream, GIAM



Source: Datastream, GIAM calculations



Source: Clev. Fed, Dallas Fed, BEA, GIAM



Source:FRB, Datastream,GIAM GIAM

US: softish landing, helped by rate cuts

> From strong growth to near stagnation in H1

The US economy proved more resilient than expected amid the sharp hike in borrowing costs. GDP is likely to have grown by around 2.5% in 2023. Domestic demand was helped by a series of one-off factors that are unlikely to repeat in 2024. First of all excess savings from the pandemic was higher than expected and compensated for weakening in real disposable income, allowing for consumption to grow steadily. But it is now depleted. The savings rate dropped to an historical low, which will weigh on consumption over the coming quarters. Corporate investment slowed but not collapsed as firms were able to lock in funding at very low rates before the Fed hiking cycle. Next year part of this debt will have to be rolled over at higher rates and this may prove a headwind. A longer lasting positive driver was the labour market: labour demand slowed down over the course of the year but remained strong and has been accompanied by a steady increase in supply. Therefore, the unemployment rate is likely to end the year below 4%, but wage growth is softening. This is helping the moderation of inflation, adding to lower energy prices, and falling good prices inflation.

The headwind from past rate hikes will materialise in full in H1 next year when GDP will basically stagnate. However, this will not result in a marked rise of unemployment as, as firms will prefer to hoard labour given the hiring difficulties. This will prevent consumption from collapsing and help to speed up the recovery in the second part of the year. All in all, we see GDP up by around 1.5% in 2024. Softer demand and a more balanced labour market will allow inflation to decline gently, even though the last leg of disinflation may be harder as more geared on sluggish wage dynamics.

> Moderating inflation to allow sizeable rate cuts

The picture for next year looks then close to the soft(ish) landing the Fed has advertised. This would allow for a gradual loosening of the monetary policy stance. At the December meeting the FOMC indicated its willingness to cut rats by a total of 75 bps: we expect even 100 bps, based on less rosy growth expectations.

The November Presidential and Congress elections are the key event and the main risk to the outlook as tight polls and a heated electoral campaign may cause bouts of market volatility and swings in business and consumer confidence.

Euro area: a cumbersome way out of recession

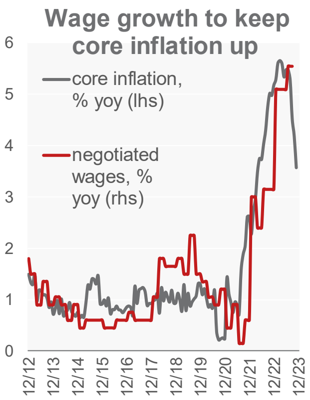
> Euro area in recession H2/23 but a return to growth in 2024 ahead

2023 was another hard year for the euro area. Following some improvement at the start, the combination of weak global growth, still high inflation and the effects from policy tightening likely pushed the economy into a mild recession over H2. That said, we expect activity to improve over the course of 2024, even if sluggishly so. With the inventory cycle turning and the global outlook stabilizing there is some light at the horizon for the manufacturing sector. But even more important are further cooling price pressures. Headline inflation receded already to 2.4% yoy in November. It is set to rebound somewhat as benign base effects fade and energy price caps expire in H1 2024 but will likely fall below current readings H2. The thus far strong labour market will weaken only mildly, supporting the case of ongoing robust real wage growth.

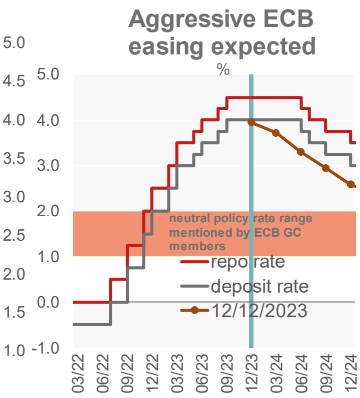
We remain cautious about the strength of the 2024 recovery. The headwinds from the unprecedented ECB 450 bps key rate tightening have not yet fully run their course and will continue to drag on demand. With the suspension of the Stability and Growth Pact coming to an end, fiscal consolidation will need to continue. We see activity still muted and shaky in the first half of 2024 but look for strengthening thereafter. All in all, we forecast annual growth in 2024 at 0.5%, somewhat below potential.

ECB likely to start key rate easing cycle in June 2024

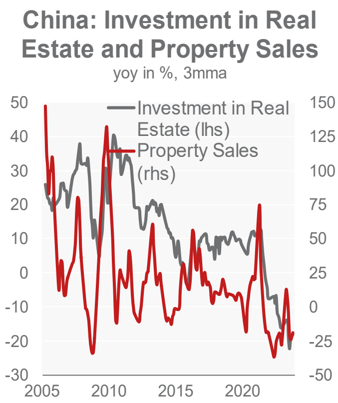
As inflation recedes, the ECB will start easing its restrictive policy stance Timing and speed will crucially depend on the incoming inflation data and the outlook. Wage agreements and the risk of protracted well above target underlying inflation will take centre stage in this assessment. We see a first rate cut only by June 2024 likely and consider market expectations of earlier cuts overdone. We look for cumulatively 100 bps cuts next year and see the risks on the dovish side.



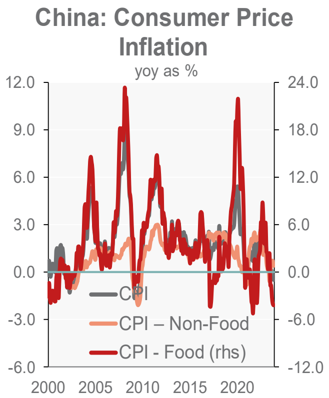
Source: Datastream, GIAM calculations



Source: Datastream, ECB, GIAM calculations



Source: Datastream, GIAM calculations



Source: Datastream, GIAM

China: L-shaped recovery remains likely

China's macroeconomic data have remained mixed. While exports stabilised, the main private support comes from retail sales, especially services consumption, whereas the real estate sector continued to be the major drag. Looking ahead we expect a soft H1 2024 global backdrop, so that China's trade will likely help only very limited. Reportedly (but not yet confirmed), Beijing is mulling more support for the property sector by first a programme for affordable housing (RMB 1 tr.), financed via the PBoC's pledged supplementary lending. Secondly, liquidity support for selected developers could be improved via bank lending. In the longer term, this could shift some risk from the real estate to the banking sector. Risks remain substantial as the insolvency of the large shadow bank Zhongzhi made clear. Consumer prices have flirted with deflation (CPI -0.5% yoy in Nov.) but the downward pressures were very much caused by negative food inflation while core inflation stayed positive (0.6% yoy). We see inflation to stay below zero over the next months but to return into more positive territory thereafter on improving growth. Monetary policy is expected to remain supportive but only limitedly with a RRR cut by 25 bps and an MLF cut by 15 bps. We see growth at 4.5% in 2024 after 5.2% in 2023.

Beijing is mulling more support for the ailing real estate sector

GOVERNMENT BONDS

Florian Späte

- **In the first months of 2024, the downward trend in government bond yields in both the US and the euro area (EA) is likely to continue, supported by falling inflation rates and speculations about deeper key rate cuts.**
- **While yields in the US still have the potential to fall slightly in the second half of the year, we expect a slight reversal in the EA. Excessive key rate cuts expectations, a slight upturn of the economy and inflation's persistent overshoot may lift 10-year Bund yields back above 2%.**
- **2024 will be a challenging year for EA non-core government bonds. Amid falling bond market volatility, declining key rates over the year, strong bond issuance and the ECB's Quantitative Tightening (QT) we anticipate a moderate spread widening.**

Decent year for bond investors. After it looked like it would be another disappointing year for government bond investors until autumn, the situation changed fundamentally in the last quarter of 2023. Yields have fallen significantly across all tenors supported by falling inflation rates and a dovish turn by central banks.

Bond market rally continues for now – albeit with setbacks and less momentum

Downward trend in yields continues short term. We expect the trend to continue in the coming months as falling inflation rates will fuel key rate speculations. We also forecast the US economy to virtually stagnate in H1 – our growth forecast is below the market consensus for H1. However, given the lower yield level, momentum will slow considerably. Market participants' expectations appear to be too optimistic amid forecast inflation rates of 2% by year-end and more than six key rate cuts in both the US and the EA in 2024. Having said that, the downtrend is unlikely to be a one-way street and surprisingly resilient economic data and/or more hawkish central bank comments have the potential to trigger temporary setbacks. This applies even more as a sharp decrease in yields is hardly in the central banks' interest as it would slow the fall in inflation. Accordingly, we forecast central banks to show their teeth from time to time and caution market participants not to expect exaggerated key rate cuts.

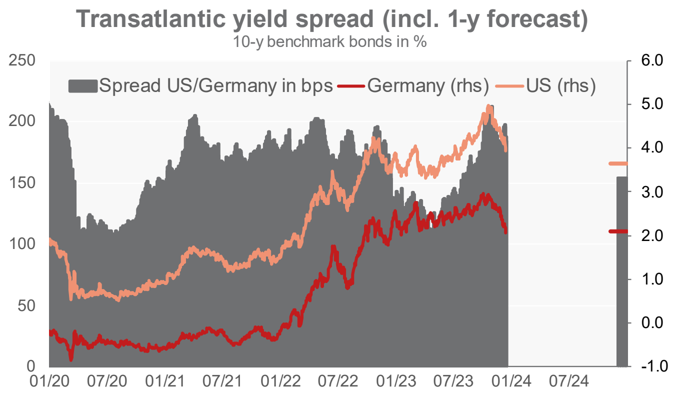
Lower medium-term US key rate expectations to trigger a continuation of downtrend in US yields in H2

US yields also fall in H2. We expect US yields to decline further in H2, although the US economy is likely to gain traction again. This is primarily due to the market's still too high medium-term key rate expectations. Despite a decline of 100 bps in the last two months, key rates are still priced at over 3% by the end of 2026. This appears too high amid the forecast economic slowdown and an inflation rate on target by then. In fact, during the last three easing cycles, the Fed has cut key rates by an average of 425 bps, demonstrating its willingness to act decisively if needed. Accordingly, we forecast lower medium-term key rate expectations, which will then also be reflected at the long end of the yield curve. This is all the more true as the 10-year US yield is currently even more than 65 bps above the 5y3m OIS level – a spread we regard as unsustainable. The potential for a decrease exists particularly with real yields. The 10-year real US yield of almost 1.7% is still too high given the expected weak growth. In contrast, we see hardly any downward potential for 10-year US inflation expectations at around 2.2%. Overall, we forecast 10-year US yields to fall to 3.65% by the end of 2024 – noticeably below the level of 3.90% indicated by forwards.

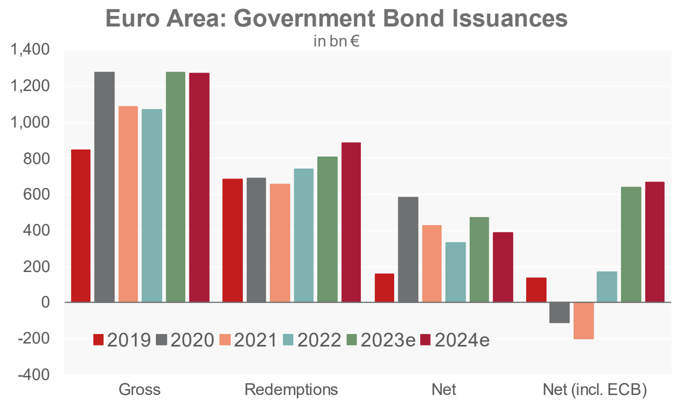
Bund yields rebound in H2. On the contrary, we see only limited leeway for a sustained drop in Bund yields. Admittedly, the ongoing disinflation in combination with a decreasing inflation volatility and a looming key rate easing cycle bode well for a further drop in bond market volatility from still elevated levels. This will result in a general increase in demand for bonds, including core bonds. However, several factors suggest that the 10-year Bund yield will be above the 2% threshold by year-end 2024. To start with, in contrast to the US, the yield on 10-year Bunds is not above the 5y3m OIS, but around 20 bps below. If the convergence we expect occurs, this will not lead to falling yields but to rising ones. Additionally, the level of 2.3% does not appear excessive, but rather fair (if anything, we consider it to be a little too low). Like the US, we see a sideways movement in inflation expectations as likely. However, at 0% the 10-year real Bund yield tends to be too low. Furthermore, the Bund term premium has some further leeway to rise from still depressed levels. Finally, only moderate fiscal consolidation also contributes to a high issuance volume. In combination with a higher dynamic of QT (see below), this also contributes to rising Bund yields. Accordingly, we forecast on balance a sideways movement of 10-year Bund yields over the year.

Decoupling of Bunds from US Treasuries later in the year

US Treasuries outperform Bunds. We assume that the transatlantic yield spread tightening will occur across all tenors. Hence, US Treasuries will perform better than Bunds in 2024 (both, in local currencies and hedged). In addition to the drop in yields, the higher coupon also contributes to the attractiveness of US Treasuries.



Source: Bloomberg, GIAM calculations



Source: Bloomberg, Datastream, GIAM calculations

Higher QT burdens EA non-core government bonds

Challenging year for EA non-core bonds ahead. After a solid year, we forecast a somewhat more difficult time for EA non-core bonds in 2024. Given the tightening of spreads in recent weeks, we consider the levels reached to be ambitious and see the potential for higher spreads, especially for fundamentally weaker countries. Continued low growth and the higher level of yields reflected in countries' interest expenses also point to a moderate spread widening. Although further RRF disbursements, falling bond market volatility, and the beginning of a key rate easing cycle will also provide positive impetus, the decisive factor will ultimately be the deteriorating supply/demand ratio. The net issuance volume will only fall moderately compared to 2023, but the ECB's QT volume will increase noticeably (by more than € 100bn to around € 270bn). Not only will the complete non-reinvestment of maturing PSPP bonds continue in 2024, but in H2 the central bank will also begin to no longer reinvest some of the PEPP bonds (initially, with € 7.5bn/month).

Deteriorating technical situation affects EA non-core bonds

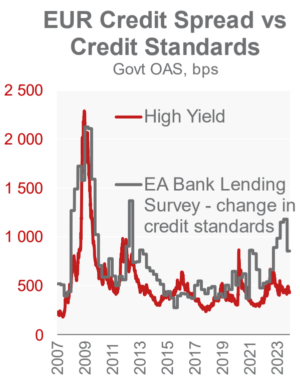
Preference for shorter-dated EA non-core bonds. Overall, the spread widening is seen to remain moderate, so that the expected total return of EA non-core bonds does not lag significantly behind the performance of Bunds. Generally, we recommend preferring shorter-dated maturities in the non-core segment to reduce the sensitivity to spread widening but still benefit from the higher carry.

CREDIT OUTLOOK

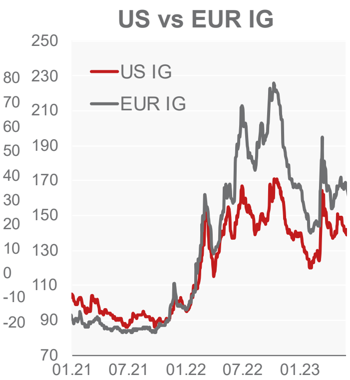
Elisa Belgacem

- **We continue to prefer Investment Grade (IG) as 1/ valuations are attractive both vs. other asset classes and within the credit space, 2/ the fundamental deterioration should remain limited and 3/ technicals should be relatively supportive.**
- **On HY we keep a cautious stance as the poor economic landscape is not reflected in valuations and we expect fundamentals to deteriorate further in 2024. Defaults are already near our peak expectations and will remain there for a few months. Ratings will deteriorate implying wider spreads.**
- **We see cash bonds as more attractive than synthetic exposure via CDS, as bond supply will be lower than in 2023.**
- **Lower interest risk means that the asset quality of financial will be more resilient. Hence we upgrade financials to neutral versus non-financials on the back of a higher carry, heavier financial supply notwithstanding. Within financials we overweight non-preferred senior and Additional Tier 1 over senior preferred and Tier 2.**
- **We prefer EUR over USD Credit on cheaper valuation amid a stronger decline in the US growth momentum.**
- **Within IG our preference goes to BBBs and corporate hybrids selectively as we see the fallen angel risk as limited outside the real estate sector.**

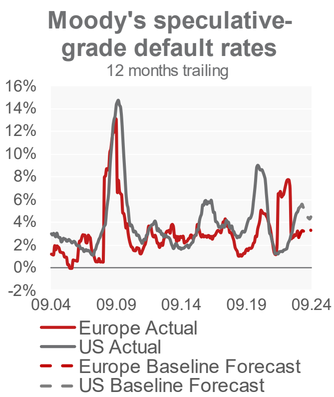
Overall, we do prefer IG to semi-core and peripheral sovereigns, and we prefer Europe to the US on valuation grounds. In Europe IG spreads are not ending the year at particularly attractive levels but we foresee elevated total returns. We expect spreads to trade around current levels over the course of next year. For HY, we think that defaults have already increased, but risks remain elevated and current levels do not reflect for the downside risks to our economic scenario. Consequently, we expect spreads should widen nearly 60bp in the first half of 2024 before ending the year 20 -30p wider compared to current levels.



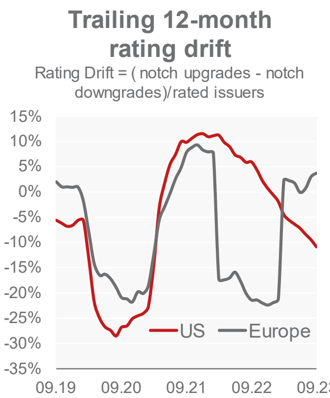
Source: Bloomberg, BofAML indices, GIAM



Source: Bloomberg, BofAML indices, GIAM



Source: Moody's, GIAM



Source: Moody's, GIAM

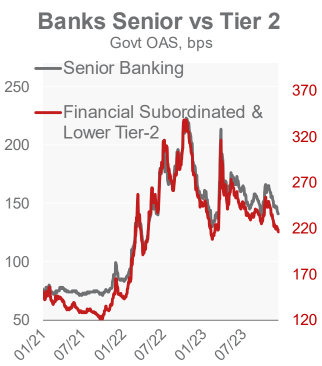
Favour Euro over US credit on valuation grounds

Indeed, metrics continue to suggest that European investment grade (IG) is currently the cheapest relative to US IG and both European and US high yield (HY). As a result, we see strong potential for European outperformance relative to the US over the coming months. However, one scenario that could change this outlook would be a decision by the ECB Governing Council to accelerate the reduction of its balance sheet, potentially involving asset sales, which is not yet part of our base case.

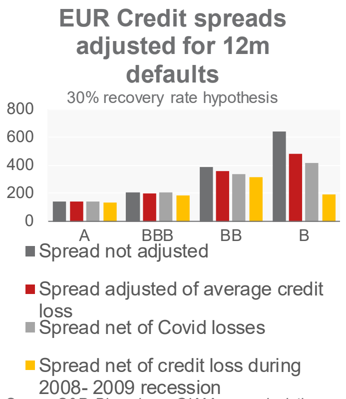
Defaults will plateau around 4-4.5% in Europe and 5.5-6% in the US

Defaults are already near peak but ratings will trend downwards

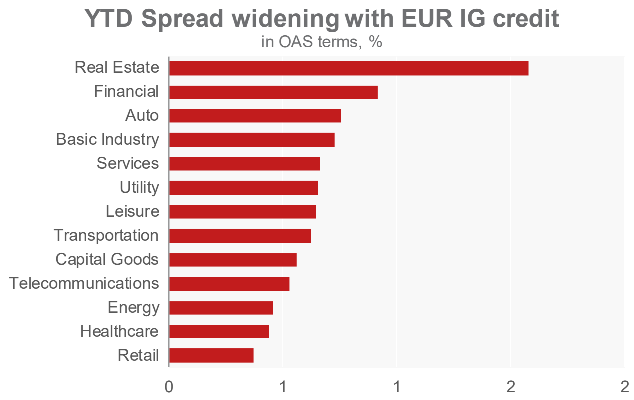
Fallen angel risk is limited outside the real estate sector. As they did in 2020, we expect rating agencies to revise in priority the notations of companies at the lower end of the rating spectrum. Indeed, nearly 50% of HY-rated companies were downgraded by at least one notch, while IG has been mostly put on a negative outlook. Hence, we do believe that credit migration will not be an issue in IG except in the real estate sector while in HY the fundamental deterioration is underpinning our bearish spread view. Defaults are already higher than long-term average, above 3% in Europe and 5% in the US. We think that we will modestly increase further with a 3-6m target at 4-4.5% in Europe and 5.5-6% in the US. If anything, banks' lending standards will ease and lower rates mean as well lower risks of defaults. This is why we upgrade financials to neutral versus non-financials. Smaller companies are much more vulnerable to the monetary tightening as the duration of their debt is shorter, they have less highly remunerated cash, and also less funding options. But they will also be the first to feel the oxygen provided by the very rapid drop in interest rates.



Source:Bloomberg, BofAML Indices, GIAM



Source:S&P, Bloomberg, GIAM own calculations



Source:Bloomberg, BofAML indices, GIAM own calculations

Prefer long IG and subordination risk to pure HY

With rates likely plateauing, in a context of elevated uncertainty regarding defaults in the HY space, it makes sense to play leveraged IG to enhance returns in credit. Extending duration doesn't make sense from a sperad perspective as curves are extermely flat if not inverted at the end but given our positive rates view it makes sense to be long. Our preffered segment is the 5-7Y bucket. Similarly, subordinated bonds are issued by IG rated issuers are mostly compensating for extension risk and coupon risk. Following the unorderly write-down of Credit suisse AT1 have never fully recovered and we see pick-up versus single Bs. The corporate hybrid space is less cheap but still interesting versus BBs, and adding on new deals will make a lot of sense. We do prefer Banks to insurance Tier-2 on lighter supply and stronger fundamentals, and overall like to buy callable bonds to enjoy the call convexity implied by lower interest rates.

Prefer cash to CDS as supply will be lighter

CDS are much tighter than cahs indices as people expect that the heavy maturity wall will imply heavy supply that will weigh on cash. We think that IG non-financial companies will issue 10 to 15% less compared to 2023 as cash on balance-sheet remains elevated and a lot of pre-funding as already been done in H223. Hence we expect a compression of the basis between CDS and cash.

EM SOVEREIGN CREDIT

Guillaume Tresca

- **2024 will be a sweet spot for EM fixed income with returns north of 10% driven by a high carry, lower core yields, weaker US, and better technicals. Disinflation will allow deeper easing cycles also supporting the EM assets.**
- **After a strong rally, a temporary pullback is likely. The beginning of the year will be bumpier, favouring a tactical approach and preference for IG names. Cyclical forces will be more powerful in the second part with less heterogeneity across the EM universe.**
- **Risks are balanced. The EM financing threat has eased, the peak of default is behind us but pressure on low-income countries remains. US elections tend to benefit to EM debt but a busy political calendar will create noise.**

Bullish everywhere, all at once. 2024 will be a sweet spot with EM fixed income, both for local and external debts, likely posting returns north of 10%. Indeed, it will benefit from the perfect conjunction of lower core yields, one of the highest carry levels since the GFC, and a weaker USD. This positive troika comes with a better EM environment, expected to continue. Growth (ex-China) will be resilient, decelerating slightly but with no major drawdown. It is supported by still elevated private sector savings together with an absence of excess credit growth. More importantly, continuous EM disinflation will lead to broad and deeper monetary easing cycles across most of the EM countries.

If history is any guide, EM fixed income performed strongly after the last Fed hike with total return performance ranging from +11% to +42% within a year over the last 5 cycles. However, the past two months have seen one of the strongest rallies since 2022 and the risk is for a temporary pullback. Some tactical repricing is likely with a widening of spreads, especially given the tight valuations at the spread levels. Likewise, the US growth deceleration and the low point in terms of economic activity in Q1 will prove to be a more difficult environment for EMs Thus, we would expect Q1 to be more driven by tactical opportunities and relative value trades. From Q2, as the Fed starts easing, cyclical forces should be more dominant paving the way for a supportive EM fixed-income environment.

EM assets performance during past Fed easing cycles

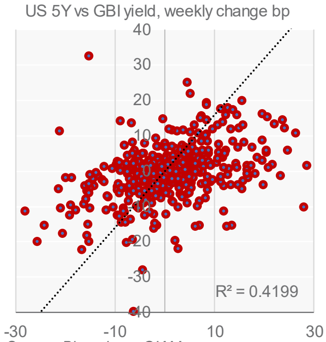
	1994					1997									
Months before/after last hike	-6	-3	3	6	12	-6	-3	3	6	12					
GBI-EM hedged															
GBI-EM															
DXY	-4.2	-3.6	-3.9	-0.4	0.4	-7.2	-7.0	1.0	2.5	7.2					
EMBIGD	-13.2	-12.9	**17.2**	**23.1**	**41.9**	8.2	0.3	**9.1**	**16.3**	**16.5**					
CEMBI															

	2000					2006					2018				
Months before/after last hike	-6	-3	3	6	12	-6	-3	3	6	12	-6	-3	3	6	12
GBI-EM hedged						0.8	2.0	3.8	8.0	12.9	-3.1	-2.8	2.7	6.9	12.3
GBI-EM						4.9	7.6	**4.6**	**15.6**	**26**	-0.2	-2.1	**2.9**	**8.7**	**13.5**
DXY	-6.2	-2.6	4.1	0.8	9.9	4.5	1.1	1.0	-1.8	-3.8	-1.8	-1.1	1.2	0.0	0.2
EMBIGD	4.3	-2.2	**9.7**	**11.7**	**21**	-1.8	-2.2	**6.4**	**10.4**	**11.4**	1.0	-1.3	**7.0**	**11.3**	**15.0**
CEMBI						-1.1	-0.6	4.9	7.6	9.9	1.3	0.0	5.2	8.8	13.1

Source: Bloomberg, GIAM

EM yields to benefit from lower US rates

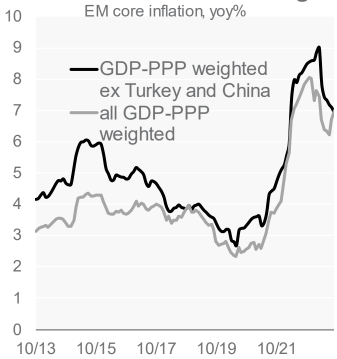
US 5Y vs GBI yield, weekly change bp



Source: Bloomberg, GIAM

EM inflation is declining

EM core inflation, yoy%



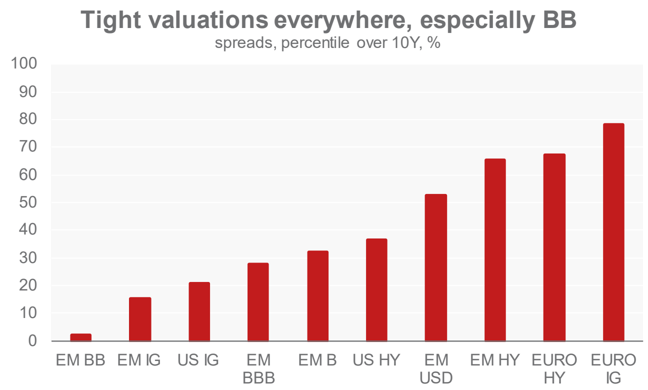
Source: Bloomberg, countries, GIAM

The year of external debt

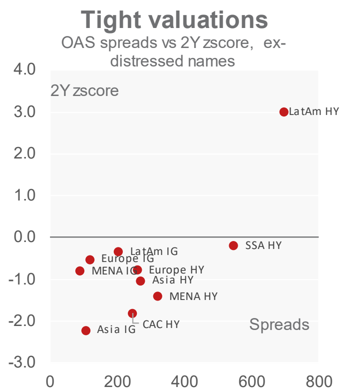
EM external debt will enter 2024 in a much more positive setup than in 2023. The bulk of the return will be provided by the duration and the carry. The outlook is less clear at the spread level given the tightness, both on a historical perspective and on a relative value basis. We still expect some spread tightening over the next 12 months supported by renewed portfolio inflows and less net primary issuance.

There has been a broad consensus on the decline of core yields. The recent rapid decline can jeopardize the expected positive return, but it is worth highlighting the strong buffer provided by the carry. In a worst-case scenario where the 10Y rate went to 5.00%, with stable spreads, the carry would still have a c. 2% return. Likewise, in a very recessionary scenario, carry will provide a buffer to a 50bp spread widening.

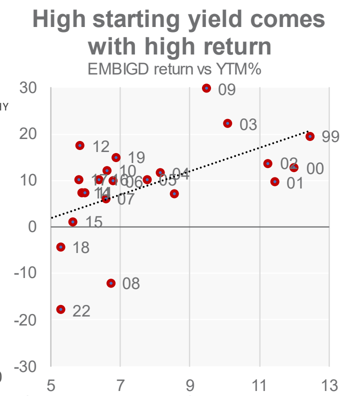
Globally, we prefer EM IG over HY as IG is in the best position to benefit from the duration effect. In Q1, IG should be more immune to an economic slowdown. On the other hand, HY will see a better setup from mid-year with the DM central bank easing in full swing and a weaker USD. Within IG, we prefer the BBBs that offer the best combination in terms of spread valuation, absolute yield, and duration. Our top picks remain Romania and in a lesser extent Mexico. In the A/AA space, we favour Chile. In the HY space, so far, only the B and distressed names have the potential to lower the spread at the index level. It will much depend on idiosyncratic factors. BBs spreads are too stretched in our view and positioning is heavy. However, their absolute yield can attract inflows from crossover funds. Our top pick is Colombia.



Source: Bloomberg, GIAM calcuations



Source: Bloomberg, JP, GIAM



Source: Bloomberg, JP, GIAM

Easing of the EM debt financing challenge

EMs will face a less complicated financing environment in 2024. First, EMs are less vulnerable to the high-rate environment than previously. We have argued for a while that it is not necessarily problematic if it is representative of resilient economy activity. Second, the deterioration in debt metrics have been limited and there is still room to run primary deficit compared to the interest rate-growth differential. Debt ratios are even due to improve, except for low-quality credits. Third, with a weaker USD and lower core yields, we see the door opens for a better primary financing environment. The new IMF facilities put in place over the past two years ease the pressure too. Thus, the peak of default is likely behind us even if it remains a medium-term challenge. A new wave of default is unlikely, and we expect more sporadic defaults.

High political risk to remain with busy calendar

EMs will face a conjunction of elections but also still high geopolitical risks which will continue to foster the regionalisation move and new alignments. There have been many talks on the rise of the Global South. The direct market impact is hard to measure but at least it can mean more daily noise and a new will for more EM independence. Regarding elections, the US ones tend to benefit to EM fixed income. EM local elections can trigger more fiscal profligacy on average and potential disruption, especially in Taiwan, Mexico and more political instability in Romania.

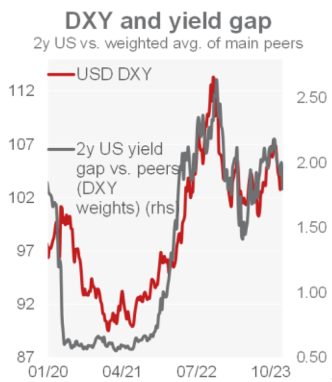
CURRENCIES

Thomas Hempell

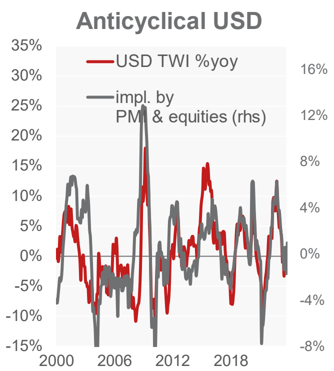
- **Swings in the global cycle (both in terms of growth and risk sentiment) and yield differentials are set to remain the key USD drivers over 2024. This implies some short-term USD resilience as the global economy cools and risk sentiment looks fragile after the recent rally.**
- **But the mild recovery further into 2024, an eroding yield advantage and better prospects for risk assets will then weigh on the USD especially in the second half of the year. Still elevated USD valuation and the expected pullback in rates uncertainty will add to headwinds.**
- **The EUR will benefit from fading recession worries, but the only shallow euro area recovery and public debt concerns will keep a lid on the EUR/USD ascent.**
- **The yen has bottomed. Lower US yields and the BoJ's cautious steps towards policy normalization (end to YCC and NIRP in spring in our base case) will provide increasing JPY tailwinds.**

USD still driven by yield differentials and cyclical forces

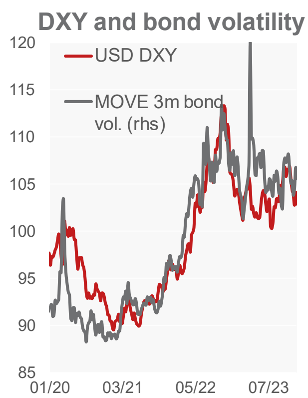
At the outset of the year, we forecasted 2023 to bring about a broadly weaker USD, mildly higher EUR/USD and a rebounding yen. While EUR/USD is at our 1.10 target, the broader USD proved overall more resilient than foreseen as the anticipated key trigger (Fed pivot) has been postponed into 2024 and the first BoJ hike seems now due only for next spring. Net USD moves have been contained year-to-date (USD DXY -0.6% as of Dec. 13), but there have been significant swings dominated by yield differentials and tides in risk appetite (two left charts below).



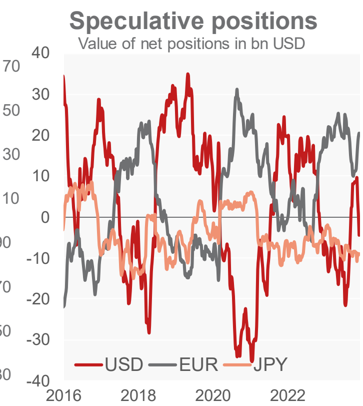
Source: Datastream, GIAM



Source: Datastream, GIAM calculations; model 2000-2022 based on MSCI World %yoy and global man. PMI



Source: Datastream, GIAM



Source: CFTC, Datastream, GIAM

USD weakness to resume in 2024

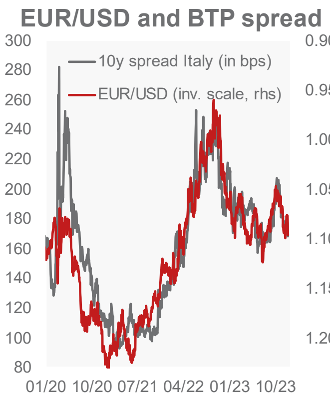
USD weakness delayed, but not cancelled

Looking ahead, we deem a more significant leg down in the USD delayed, but not yet cancelled. The USD remains fundamentally dear and thus vulnerable to a correction. Surprising US economic resilience in the wake of the cumulative 525bp hikes have bolstered capital inflows into the US and the dollar in 2023. But as excess US households savings are depleted and past rate hikes bite, this support is facing cracks.

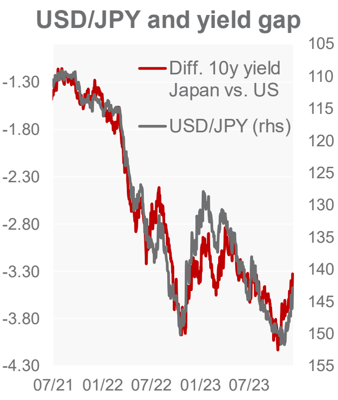
We expect the Fed to pivot in May, with a total cumulative total of 200bp cuts over 2024 and 2025. This will narrow the 2-year yield differentials vs. peers to the detriment of the USD. This effect will partially be cushioned by relatively synchronized cuts by the ECB and the BoE (but amplified by BoJ tightening), even though their easing moves over the next two years are likely to be shallower. The global central banks' pivot will also help to unwind the still high rates uncertainty, which has been a powerful driver of USD strength in the wake of the pandemic too (3rd chart above).

EUR/USD still vulnerable near term

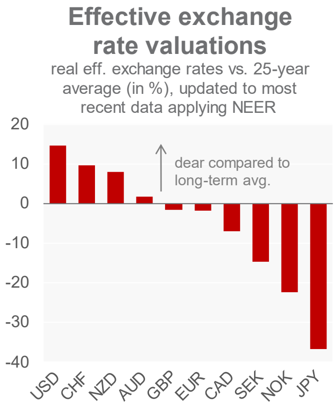
However, we are reluctant to position for a higher EUR/USD at the outset of 2024. Stretched speculative long EUR positions (right chart above) leave the single currency vulnerable to a correction. And the current mild EMU recession and only sluggish recovery we have in our books for 2024 will keep a lid on capital inflows into the euro. We are also cautioning against positioning for a strong 2024 ascent of the EUR/USD as a rewidening of currently compressed peripheral bond spreads may prove a more persistent burden (left chart below). Our 1.13 YE24 target implies only a modest move.



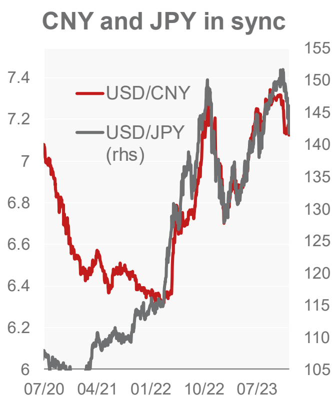
Source: Datastream, GIAM calculations



Source: Datastream, GIAM calculations



Source: Datastream, GIAM



Source: Refinitiv, GIAM

Stronger yen

Lower US yields and a rate hike by the BoJ will finally open the path towards a stronger yen

Betting on a rising yen has been a widow-maker for more than a year now. The massive Fed hikes in 2023 dwarfed the BoJ's very cautious steps in removing its yield-curve control (YCC), sending the USD/JPY temporarily above 150. With a Fed pivot now in sight and the BoJ warming for a rate hike (April), 2024 is set to (finally) prove the year of the yen as falling US yields will contrast a further rise in JGB yields (2nd chart above). The JPY is deeply undervalued (3rd chart) and short speculative positions may be prone for a reversal. A likely drag will be the beleaguered CNY to which the yen has been more closely tied over the past quarters (top right chart) and which will remain burdened by Chinese monetary easing and persistent property market woes. We have a YE24 target for the USD/JPY of 137 but see the risks tilted towards an even stronger move into the lower 130s.

After CHF has tested new highs, we anticipate the EUR/CHF to recover ground towards parity over 2024 in a back-loaded fashion. Swiss inflation defied expectations of a rebound in November (1.4%yoy) and with price pressures now much better behaved, the SNB may soon rethink its preference for a stronger CHF.

We anticipate EUR/GBP to keep trading in a relatively narrow range. A narrowing yield gap of 10-year Gilts/Bunds will underpin the EUR/GPB, but that may be outweighed by the UK's improved external balance. A Labour victory in 2024 elections, would help improve ties with the EU and favour fiscal expansion. This would favour more prudent BoE rate cuts, keeping the risks tilted slightly to the upside for sterling.

EQUITIES

Michele Morganti and Vladimir Oleinikov

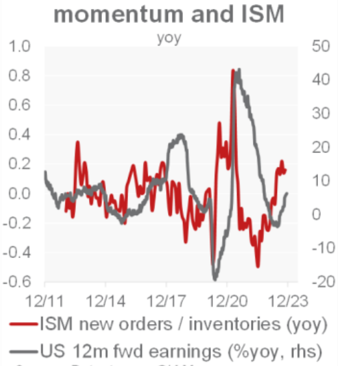
- **After the rally, we remain cautious. Valuation above 4,700 for the SPX do not point to further upside in the very short term.**
- **Weakness in the economy over the next few months, a lower fiscal impulse in 2024 and the lagged negative effects of monetary policy could trigger spikes in volatility – which remains very low. Furthermore, previous episodes of declining inflation from very high peaks would suggest some caution after almost 15 months of huge equity out-performance versus bonds since mid-2022.**
- **That said, our forecast of lower yields and markets' anticipation of rate cuts in 2024 will prove supportive further into 2024. IFO and Sentix indicators are improving, adding to a positive US corporate net cash-flow trend.**
- **We expect ex-US indices to render total returns around 9% in 2024 and the US more limited +4%. We are looking for a better entry point to exploit this potential. OW: EMU vs. US, Japan, SMI, China, Korea, and India. Within EU sectors: OWs: Banks, Durables, Cons. Services (new), Energy, Food Bev. Tob., HC Equip. & Svs., Pharma, Telecom. Svs., Utilities. UWs: Capital goods, Div. Fin., Insurance, Materials, Media, Semiconductors, Real Estate.**

SPX valuation in the range 4,730 -5,230: based on the LT Shiller series using GI expectations (low range SPX tgt) and consensus data (high range SPX tgt) for CPI, yields and earnings

Bottoming confidence indicators (IFO, Sentix etc.) and future trough in earnings by Q2 2024 are two positive factors for 2024, especially for the EU total returns. Furthermore, EU valuations remain attractive despite our expectation of below-consensus profit growth in 2024 and 2025 (by 3% and 5% respectively). Indeed, market multiples remain cheap versus average and the cycle-adjusted earnings yield shows a spread to real bond yields which is in line with history. This means we could expect EU equities to outperform EU bonds over the mid-term, i.e. in the next 12 months, as well as in the next 5 years (see our latest publication, "5-year total return forecasts", Oct. 2023).

The US assessment is more complex. In the end, we conclude that the S&P 500 is relative expensive and could generate lower returns in 12 months vs EU: +4%, at 4,730 for the S&P 500 vs. +9% for the EU. Should earnings consensus be right, the

US earnings momentum and ISM



Source: Datastream, GIAM

EMU: PE and Sentix 6m exp.

Source: Datastream, GIAM

Market Index	Quant + ML (rel. TR vs World) models	Com-posite rel. val. score*	LT models, 12m up /downside	PE target (1y fwd)	TR resulting from PE target, %
S&P 500	=/-	- -	=/-	17.0X	-1.4
MSCI EMU	=	+	++	12.8X	17.0
FTSE 100	=/-	- -	++	11.0X	16.4
SMI	+	+	++	16.0X	15.6
TOPIX	=	+	+	14.0X	9.9
Brazil	- -	- - -	n.a		
China	+	+++	n.a	11.1X	26
India	+	+	n.a		

* composite valuation score is taken across 45 equity markets and is based on various valuation measures. ML = machine-learning

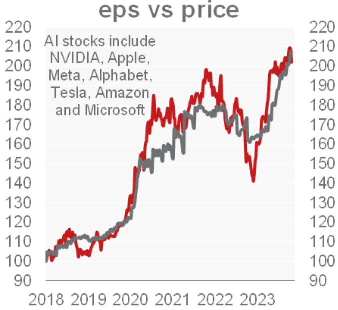
S&P 500 could reach 5,230 (+14% TR) and the EU TR +15% - 20%. US market multiples are above norm while the earnings yield gap vs. real yields is below. Thus, we could expect lower equity returns vs bonds reletive to history over a mid-term view. That said, some caveats are due that suggest a better risk-return profile for the US than implied by traditional valuations. First, buybacks remain quite high, at almost 1% net, which mitigates the lower equity yield vs bonds. Second, when adjusted for the expected earnings growth over the next few years, US PE is more like EU one (PE divided by future EPS growth = PEG ratio). The same is true for AI stocks, whose performance in recent years has reflected superior earnings revisions, ROE and margins. Finally, from a structural point of view, we continue to recognise the superior quality of the US index in many respects: greater policy flexibility (monetary + fiscal), stronger US geopolitical role, technology leadership, energy independence, population growth and quality of education. Ultimately, while we are tactically overweight the EMU vs. US - also due to a peak in the traditional valuation differential and less divergent macro surprises - over a longer time horizon the EU overperformance remains at risk.

GIAM earnings forecasts

	US NIPA profits pre-		S&P earnings		EMU earnings	
	bl$	yoy	level	yoy	level	yoy
2023 Q1	3,165.1	4.6	215.8	2.6	15.9	16.9
2023 Q2	3,172.1	-2.7	214.8	-0.7	16.1	12.8
2023 Q3	**3,282.8**	**-0.5**	216.2	-0.9	16.4	10.5
2023 Q4	**3,310.1**	**1.9**	**220.3**	**1.0**	**16.1**	**0.9**
2024 Q1	**3,288.6**	**3.9**	**222.2**	**3.0**	**16.0**	**0.8**
2024 Q2	**3,298.9**	**4.0**	**222.4**	**3.5**	**16.3**	**1.3**
2024 Q3	**3,361.6**	**2.4**	**224.5**	**3.8**	**16.5**	**1.1**
2024 Q4	**3,432.6**	**3.7**	**230.6**	**4.7**	**16.6**	**3.1**

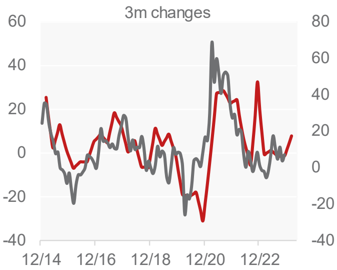
Source: Datastream, GIAM calculations
Note: S&P and EMU earnings as of end of qtr; they are derived from NIPA; forecasts in bold

S&P 500: AI stocks vs SPX, eps vs price



Source: Datastream, GIAM

MSCI India vs Business Confidence



Source: Datastream, GIAM

For equities in general, we believe that sentiment is getting too optimistic in the shorter term, thus we adopt a more cautious view after the recent rally. This is supported by an expected macro slowdown in the coming months and very low market volatility at present. Furthermore, previous episodes of declining CPI from very high peaks would also suggest some caution after almost 15m of huge equity outperformance versus bonds, since mid-2022. Lastly, from a fundamental perspective, a further upside potential beyond 4,700 for the S&P looks limited short term. Regionally: OW EMU vs. US, Japan (valuation, reforms), SMI (valuation), China (val., stimulus), India (val., eco), and Korea (val., eco). As for the EU sectors,we maintain a balanced portfolio with a defensive tilt, suggesting a few tweaks to be positioned for lower yields: neutral Comm. Prof. Svs. (from UW) and Food Retail (from OW). Move Div. Fin. (yields sensitivity) and Semis to UW (earnings revisions). Increase Media (still slightly UW) while decreasing Materials (earnings momentum). We upgrade Consumer Svs. and Telecom. to a small OW (earnings + valuation). OW: Banks, Durables, Cons. Services (new), Energy, Food Bev. Tob., HC Equip. & Svs., Pharma, Telecom. Svs. (new), Utilities. UW: Capital goods, Div. Fin. (new), Insurance, Materials, Media, Semiconductors (new), Real Estate. OW small vs Large cap EU.

EMs: keep neutral, to be affected in the short term by global macro uncertainty

EM Equities: neutral but window of opportunity is starting to open

EMs are likely to remain affected in the short term by global macro uncertain-ty and growth headwinds coming from both the US and China. But the risks appear to have diminished. Investment sentiment started to improve again. China has continued to step up its easing measures (including bond issuance and liquidity injections) and we prefer to stay OW (slight), albeit we see an L-shaped recovery and elevated volatility. Additionally, we are OW on India (val., eco) and Korea (val., eco). The latter started to look increasingly attractive: best country score, improving 2024 outlook.

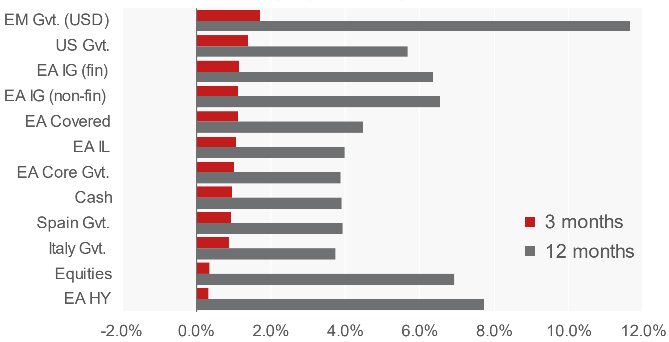
ASSET ALLOCATION

Thorsten Runde

- **The global economy particularly in the US have proved exceptionally resilient in 2023. Despite surging real long-term yields, global equities gained strongly, also helped by an exceptional autumn rally, defying our overall prudent stance on risk assets for most of the year.**
- **For 2024 the outlook should generally brighten, but not before some further pain at the beginning of the year, with the euro area already slipping into a technical recession and the US finally feeling the impact of monetary tightening. Against this backdrop we deem market expectations too sanguine, pricing early and fast rate cuts and risk assets discounting the quite optimistic view of a soft landing.**
- **For the near term, we recommend a small underweight in Equities and HY. We continue to favour IG Credit mostly thanks to an attractive carry. Given the lower yield levels and the limited leeway for a further yield decrease, we underweight EA Government Bonds. The opposite holds for US Treasuries and EM Govies with the latter will also benefit from a subsiding USD strength medium-term. We tactically trim our duration stance to neutral.**

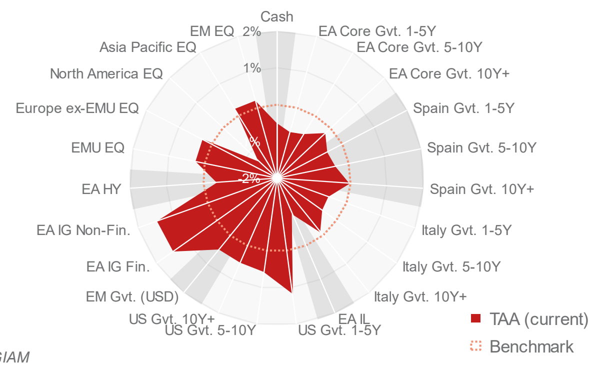
In general, we expect a brightening outlook for 2024. That said, it might be too early to tactically position for it already at the beginning of the year. As markets are priced for near perfection there might be some leeway for a correction after the recent rally. Thus, we remain underweight in Equities for the time being. HY is likely to suffer a repricing of credit risk on the back of expensive valuation and weak technicals. We stay underweight here. On the Government Bond markets, the recent rally should generally limit the further decline in yields, less so for the US, given the still high real yields. Additionally taking the higher carry into account, we recommend overweighting US Treasuries at the expense of euro area Govies including the non-core segments. The latter should be burdened by some spread widening due to excessive valuations, strong issuance activity, and weak growth in the EA.

Aggregated Total Return Forecasts
(hedged into EUR)



Source: GIAM

Balanced MtM Model Portfolio
(active positions in pp)



Source: GIAM

We see EA IG Credit trading range-bound in the coming year, thus continuing to provide an attractive carry. We particularly upgrade IG Fin due to lower risks on the asset quality side implied by lower rates and cheaper valuations. All in, we overweight EA IG Credit staying neutral between Fins and Non-Fins. We see the best performance in 2024 for EM Govies supported by a large decline in core rates, a strong carry, and less USD strength. Thus, we overweight EM Govies too. Given the limited leeway for yields to decline further from here, we tactically take a neutral duration stance.

FORECASTS

Macro Data

Growth	2022	2023 forecast	2023 Δ vs. cons.	2024 forecast	2024 Δ vs. cons.	2025 forecast
US	2.0	2.5	0.1	1.5	0.2	1.8
Euro area	3.3	0.4	- 0.1	0.5	- 0.1	1.4
Germany	1.8	- 0.2	0.2	0.1	- 0.4	1.7
France	2.5	0.3	- 0.6	0.8	- 0.0	1.6
Italy	3.9	0.7	- 0.0	0.6	0.1	0.5
Non-EMU	3.5	0.4	- 0.0	0.6	0.2	1.4
UK	4.1	0.4	- 0.0	0.5	0.3	1.3
Switzerland	2.1	0.8	0.0	1.2	0.0	1.2
Japan	1.2	1.7	- 0.2	1.1	0.1	1.0
Asia ex Japan	4.1	4.9	0.0	4.6	- 0.2	4.8
China	3.0	5.2	0.0	4.5	- 0.0	4.5
CEE	1.9	2.6	0.6	2.3	0.4	2.8
Latin America	4.0	2.1	0.0	1.4	- 0.0	2.1
World	**3.3**	**2.9**	**0.1**	**2.6**	**0.0**	**3.0**

Inflation	2022	2023 forecast	2023 Δ vs. cons.	2024 forecast	2024 Δ vs. cons.	2025 forecast
US	8.0	4.1	- 0.1	2.5	- 0.2	2.2
Euro area	8.4	5.5	- 0.0	2.7	0.1	2.3
Germany	8.6	5.6	- 0.4	2.9	0.2	2.5
France	5.9	5.3	0.3	2.8	0.2	2.2
Italy	8.2	5.2	- 0.7	2.4	- 0.1	0.6
Non-EMU	8.0	6.5	- 0.0	2.8	- 0.1	2.1
UK	9.1	7.4	- 0.0	3.0	- 0.1	2.1
Switzerland	2.8	2.2	0.0	1.5	- 0.1	1.3
Japan	2.5	3.2	- 0.0	2.2	0.0	1.6
Asia ex Japan	3.5	2.1	- 0.0	2.4	- 0.1	2.5
China	1.9	0.4	- 0.1	1.4	- 0.2	1.7
CEE	29.6	20.8	0.2	17.5	0.3	8.3
Latin America	7.8	5.1	0.0	3.9	0.0	3.1
World	**7.8**	**5.3**	**- 0.0**	**3.9**	**- 0.1**	**3.0**

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

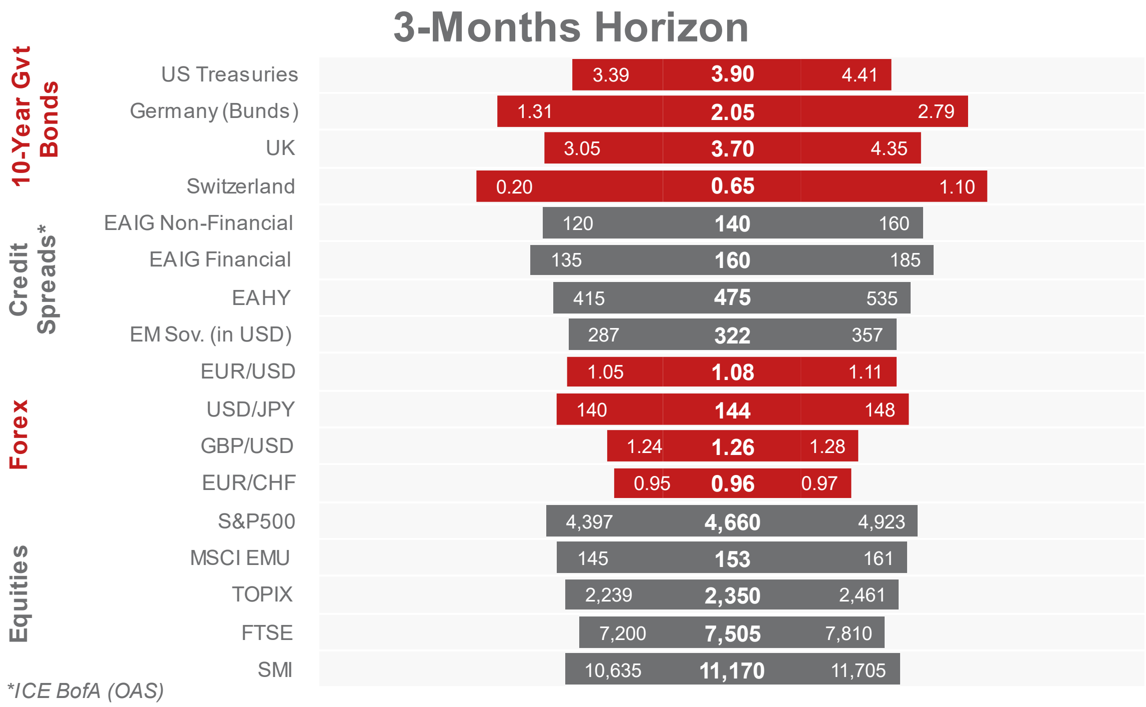
Financial Markets

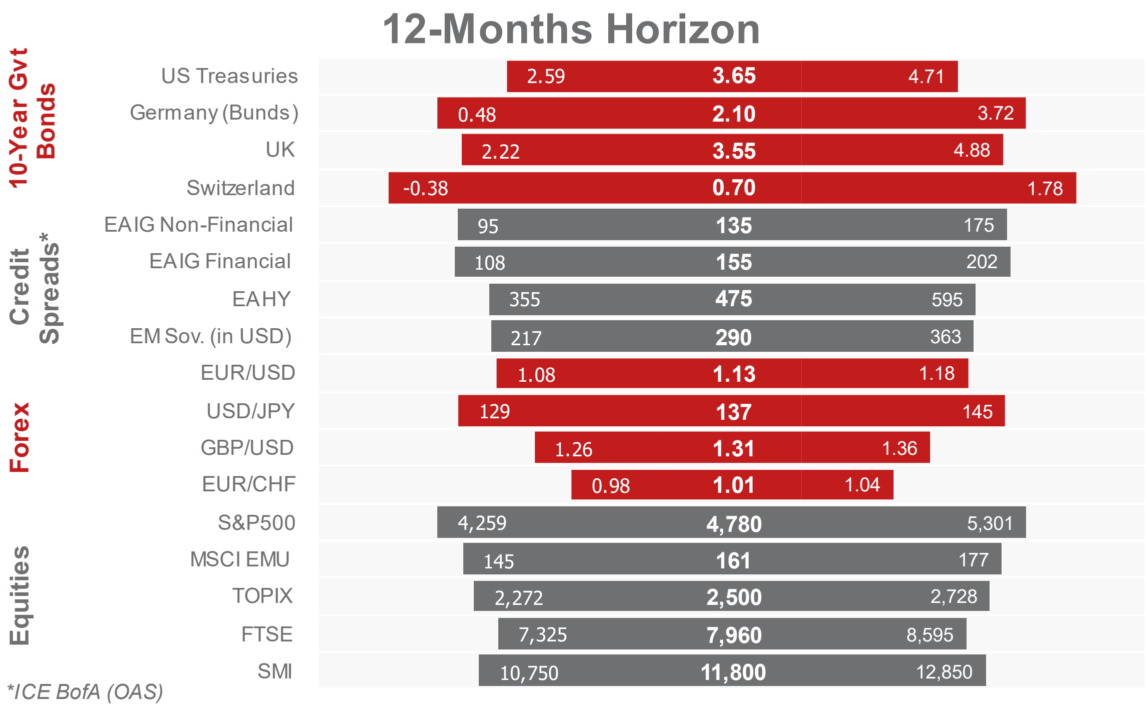
Key Rates	Current*	3M Forecast	3M Forward	6M Forecast	6M Forward	12M Forecast	12M Forward
US (upper bound)	5.50	5.50	*5.22*	5.25	*4.74*	4.50	*3.93*
Euro area	4.00	4.00	*3.77*	3.75	*3.28*	3.00	*2.40*
Japan	-0.10	-0.10	*0.05*	0.00	*0.11*	0.00	*0.26*
UK	5.25	5.25	*5.17*	5.00	*4.97*	4.50	*4.15*
Switzerland	1.75	1.75	*1.55*	1.50	*1.36*	1.25	*0.98*
10-Year Gvt Bonds							
US Treasuries	4.16	3.90	*4.13*	3.75	*4.11*	3.65	*4.11*
Germany (Bunds)	2.22	2.05	*2.21*	1.95	*2.18*	2.10	*2.17*
Italy	4.00	3.85	*4.01*	3.80	*4.04*	4.05	*4.13*
Spread vs Bunds	*178*	*180*	*180*	*185*	*186*	*195*	*196*
France	2.77	2.60	*2.76*	2.50	*2.76*	2.70	*2.78*
Spread vs Bunds	*55*	*55*	*56*	*55*	*58*	*60*	*61*
Japan	0.73	0.75	*0.80*	0.80	*0.86*	0.85	*0.95*
UK	3.96	3.70	*3.99*	3.60	*3.97*	3.55	*3.98*
Switzerland	0.74	0.65	*0.67*	0.65	*0.65*	0.70	*0.63*

**3-day avg. as of 13/12/23*
***ICE BofA (OAS)*

Credit Spreads**	Current*	3M Forecast	3M Forward	6M Forecast	6M Forward	12M Forecast	12M Forward
EA IG Non-Financial	135	140		140		135	
EA IG Financial	154	160		160		155	
EA HY	418	475		485		475	
EM Sov. (in USD)	309	322		310		290	
Forex							
EUR/USD	1.08	1.08	*1.08*	1.11	*1.09*	1.13	*1.10*
USD/JPY	145	144	*144*	140	*142*	137	*138*
EUR/JPY	156	156	*155*	155	*154*	155	*151*
GBP/USD	1.25	1.26	*1.26*	1.29	*1.26*	1.31	*1.26*
EUR/GBP	0.86	0.86	*0.86*	0.86	*0.86*	0.86	*0.87*
EUR/CHF	0.95	0.96	*0.94*	0.97	*0.93*	1.01	*0.93*
Equities							
S&P500	4,658	4,660		4,635		4,780	
MSCI EMU	152.4	153.0		149.0		161.0	
TOPIX	2,356	2,350		2,325		2,500	
FTSE	7,545	7,505		7,395		7,960	
SMI	11,157	11,170		10,880		11,800	

Forecast Intervals





*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5-year history of percentage changes, equally weighted in the case of the 12-month forecast and exponentially weighted in the case of the three-month forecast. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

IMPRINT

Issued by: **Generali Insurance Asset Management S.p.A.**
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