

Investment Views in pictures – Q2 2024

New Normal or New Bubble?

GenAM Macro & Market Research



Macro and financial market summary

Green shoots as central banks eye the last mile of disinflation

Global Macro



- **Global green shoots are mounting** as real disposable income is underpinned by solid wage growth & easing inflation while the inventory cycle is bottoming and the headwinds from drastic rate hikes in 2022/23 are fading. This will largely offset the drag on consumption from depleted excess savings in the US. We now expect a soft landing of the US economy, while the euro area will gradually return to expansion into the spring. **Inflation is set to ease further**. But the pace of **disinflation is slowing** as the support from base effects, lower energy prices and eased supply chains are fading while strong wage growth and pent-up demand keeps underpinning price pressures in the services sector.

Monetary Policy



- **Central banks are preparing the ground for rate cuts**. But they will resist calls for quick moves and await more reliable evidence of sustained disinflation, notably in services.
- We now expect **the Fed to pivot in June** (from May before) with **cumulative 75bp cuts** by year-end 2024 (close to market-implied). Given continued economic resilience, we see the **risks tilted towards later and slower cuts**.
- We continue to expect the **ECB to start cutting in June** (i.e. one week ahead of the Fed), as the ECB awaits more Q2 data on wage agreements. We anticipate a total of 100bp of cuts this year to 3.0% (dep. rate), slightly more than market-implied (85bp).

Financial Markets



- The strongly **positive Bond/Equity correlation is fading** as disinflation loosens the tight grip of monetary policy on markets. Very near-term, the yield outlook is balanced, but **we position for somewhat lower yields over the rest of the year** now that the market pricing of the CB paths looks more reasonable. An improving macro outlook (mild EA recovery, soft landing in US) **supports risky assets**; yet the advanced and concentrated equity rally, bullish investor positioning, and lingering market risks (geopolitics, CRE) bear the **risk of near-term setbacks**. We **neutralize our residual/minor UWs in Equities and HY** and **favour the carry from safer Credit** buckets over Core Bonds and Cash. We **slightly extend duration** and turn **more cautious on USD** exposure.

Asset Allocation

- Neutralize residual minor UW Equities and HY. OW safer buckets in Credit (IG, Supras), UW Cash and short-dated Core Bonds; moderately UW EM debt. Slightly extend duration to a small long.

Main Risks



- ▮▮▮ | \$ \$ A more stubborn last mile of disinflation (wages, sticky services inflation, energy prices) delaying rate cuts further
- ▮▮▮ | \$ \$ Intensified global fracturing (esp. China/US), notably on grown odds of Nov. 5 Trump victory (punitive tariffs)
- ▮▮▮ | \$ \$ \$ Cracks in financial stability as tighter conditions feed through (CRE defaults, banking, housing, non-bank liquidity...)
- ▮▮▮ | \$ \$ \$ Geopolitical stress up (Ukraine, Middle East, Taiwan)
- ▮▮▮ | \$ \$ Broader recovery, ongoing disinflation, broadening of the Tech rally (far from a bubble)

Topics

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Our key calls

New Normal or New Bubble?



Key views & where we differ:

- **US finally landing, if not hard.** But a mild **global manufacturing revival** is under way. **EA set to exit 18-month-old stagnation** from spring onwards.
- **Investors under-estimating headwinds from tense geopolitics.** Structurally, US economic & corporate hegemony has progressed, even as New World Order challenges its geopolitical dominance. **EU faces huge challenges** – fiscally and socially – of much-needed **triple transition** (energy, digital, military) at the core of its economic under-performance.
- **Markets price Fed equilibrium rate around 3.50% – too high** – hence the bias for long-term yields to the downside. But difficult (disinflation) last mile and rising odds of Trump victory **limit bullish potential for bonds. Rates vols continue to fall. Curve steepeners still too costly, except at the long end.**
- **Earnings growth in EA may surprise to the upside** in 2024. **Challenges are much greater for EA Sovereigns than high-quality Corporates.** Rising public debt and **debasement risk may have durably altered risk premia** vs. (not so) “risk-free” assets.
- Based on PER, **Tech stocks are not a bubble.** Risk lies in regulation: will States lean against monopolistic tendencies and excessive corporate power?
- **Risk asset volatility too low** at this point of eco & political cycle. **2024 sees great vol reconvergence** (Rates down, Equity up).



Key risks:

- Upside **inflation** risks; non-linear **global fracturing**; cracks in **financial stability** (CRE etc.). On the upside, max **Goldilocks**.

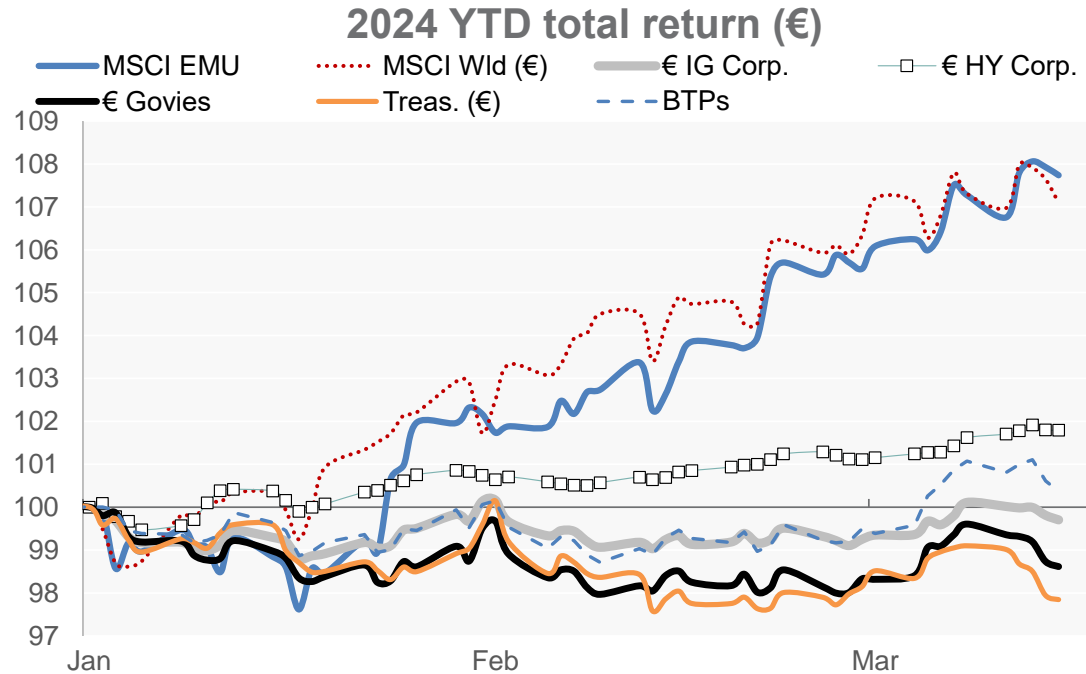


Investment implications:

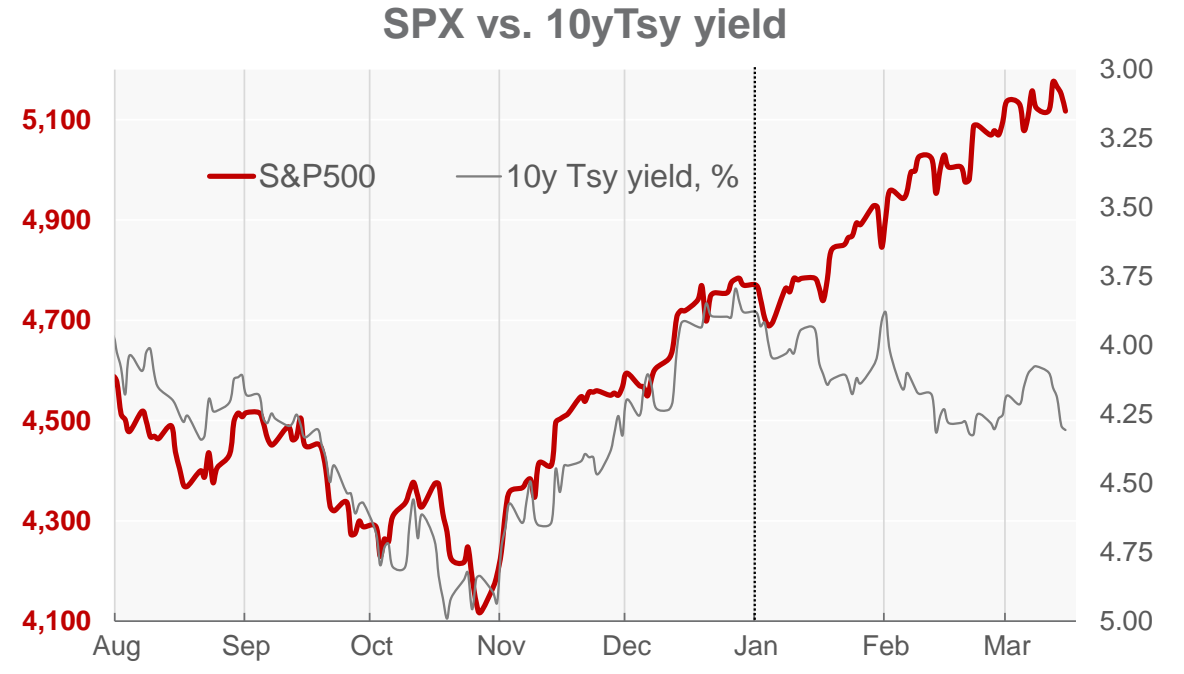
- With 10y Bund up 60bp from end-2023, we **upgrade Duration to small long**, still within trading range.
- **Stay OW EUR IG Credit** (carry); preferred bucket is 5-7Y (Long-dated IG expensive).. **Prefer EUR IG to US.** We continue to **prefer subordination risk to credit risk** for valuation reasons and lower tail risk. **OW defensive sectors and rate-sensitive ones.**
- **Neutralise High Yield** (from minor UW). Defaults have peaked but valuations appear stretched across the rating spectrum.
- **Equities: neutral** short term, still **constructive over 2024. Regional preferences:** tactically OW SMI, EMU vs. US, Japan, China, Korea, India. Still OW Japan. **Sector-wise:** OWs: Small Caps, Banks, Durables, Energy, Food Bev. Tob., Health Care, Aerospace & Defense, and Materials.
- **FX:** Turning **more cautious on USD** (even if acknowledging risks from Fed and US elections).
- **Vol. convergence.** (↓ for Bonds, ↑ for EQ, Credit). **Opportunity to position optionally** for those willing to ride the bullish wave.

2024 YTD – stocks and bonds part ways

Recession tail risk being crushed



Source: Bloomberg, GenAM calculations

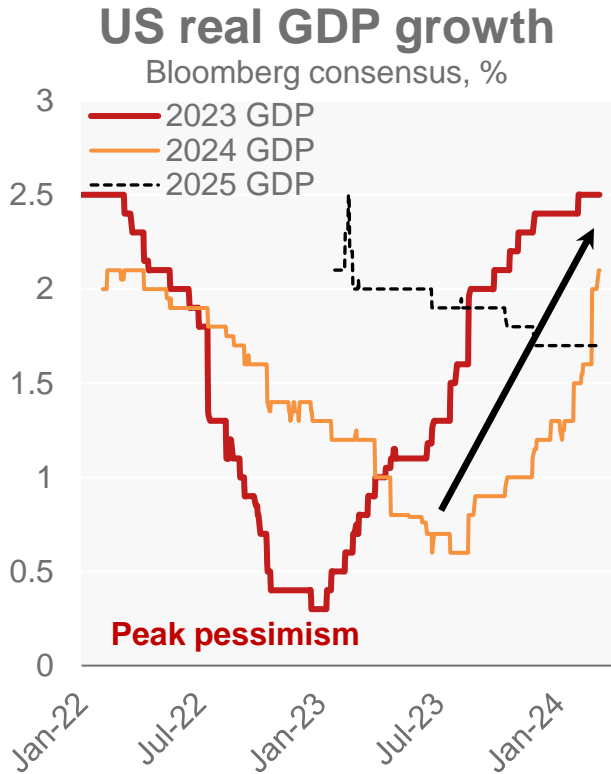


Source: Bloomberg, GenAM

- Both sides of the turn of the year have seen AI-euphoria
- Nov.-Dec. saw a wave of rate cut hopes, bullish stocks and bonds
- 1Q24 did see the hawkish CB repricing that we expected, with limited impact on long bonds, and no directional impact on stocks (growing cyclical optimism).
- Less appealing to keep cash now that the CB repricing has happened (we feared it would cause correction in both bonds and stocks).

Perfect (upside) storm

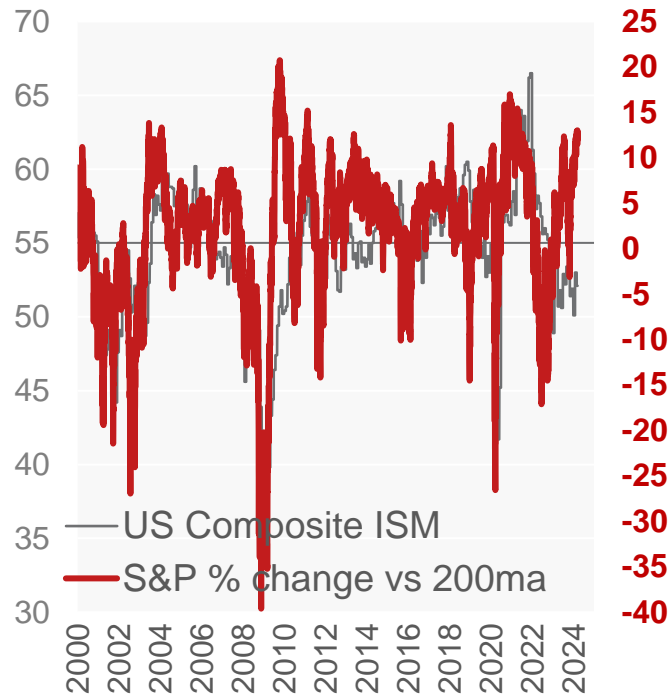
1. Exceptional US growth resilience



Source: Bloomberg, GenAM

2. Risk markets front-running recovery

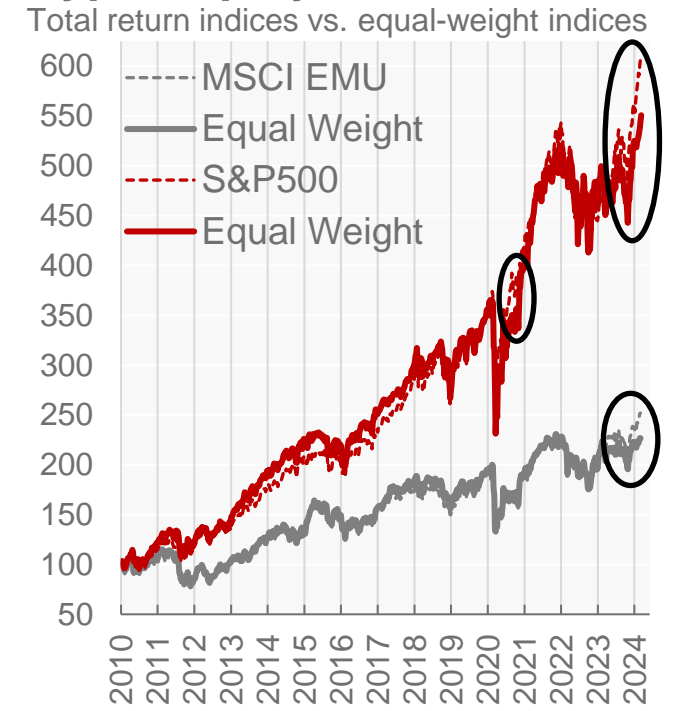
S&P500 vs US comp. ISM



Source: ISM, Bloomberg, GenAM

3. Hyper equity concentration

Hyper equity concentration

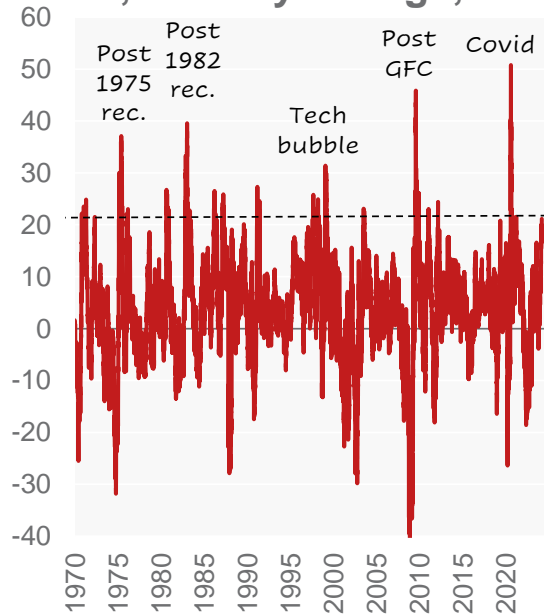


Source: MSCI, Bloomberg, GenAM

New Normal or New Bubble?

Elevated margins, vanishing risk premia, & frothy markets

S&P, 100-day change, %



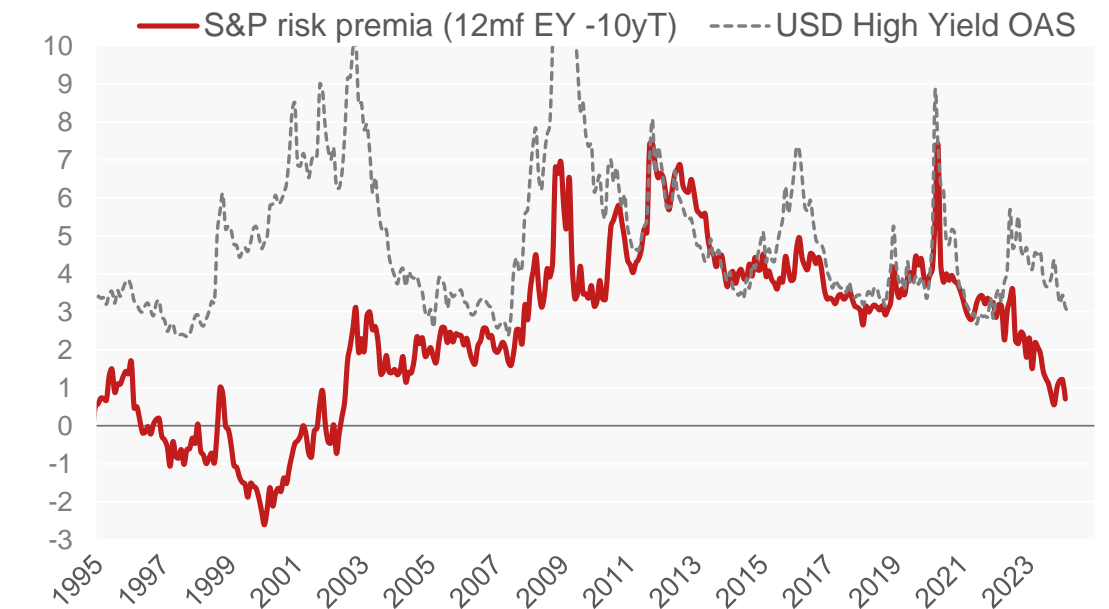
Source: Bloomberg, GenAM calculations

S&P 500 Info Tech, Price/Sales & P/E



Source: Bloomberg, GenAM

S&P vs US High Yield premia, %



Source: Bloomberg, GenAM

The vanishing of risk premia

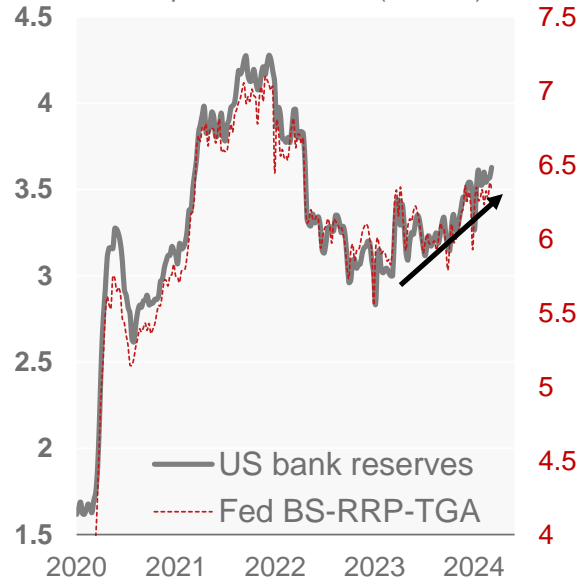
Recession fears have eased; geopolitical risk largely ignored



New Normal? High **public debt**, systematic **CB rescues**, realised **inflation** shock and **debasement** risk may have made inflation assets (inc. equities) more attractive, 'permanently' reducing risk premia vs. "risk-free" assets.

US bk reserves & proxy

Unexpected rebound! (USD tn)

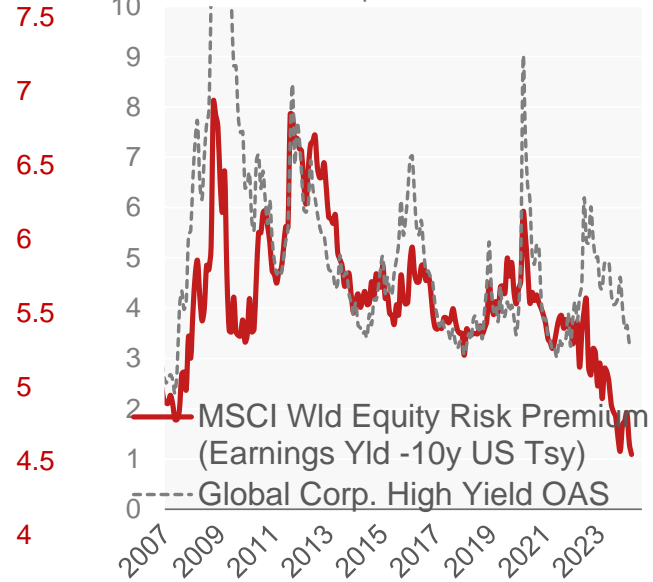


Source: Fed, Bloomberg, GenAM

- \$600+bn rise in **US bank reserves** over the past year has contributed to rally. With Reverse Repos soon no longer falling, trend should reverse mildly.

MSCI Wld v. Global HY

Risk premia, %

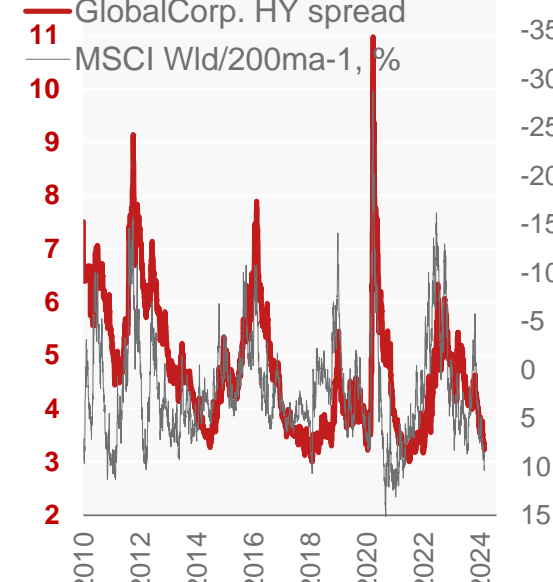


Source: Sentix, MSCI, Bloomberg, GenAM

- **Stark fall of global equity risk premia**, and to a lesser extent HY spreads.
- Risk markets are not cheap.

Strong Stocks v. HY correl.

GlobalCorp. HY spread

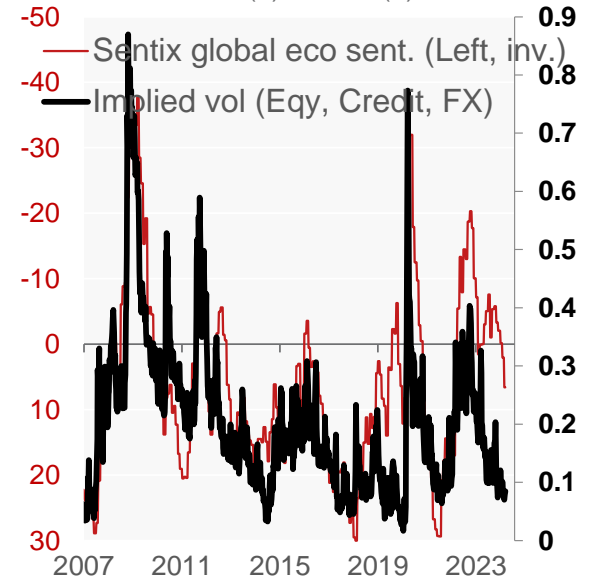


Source: Bloomberg, GenAM

- **HY spread at record low level** on rating-adjusted basis, while MSCI World is trading 10+% above 200-day moving average.

Implied volatility vs. cycle

Relative to MIN (0) & MAX (1) since 2003



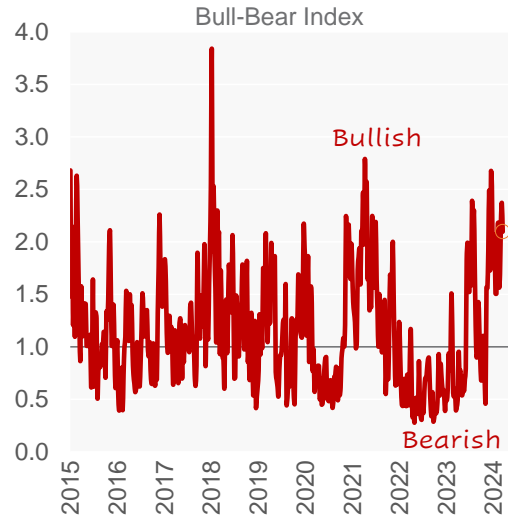
Source: Bloomberg, CBOE, JPM, GenAM calc.

- **Implied vols very low**; convergence happening via improving eco sentiment ?

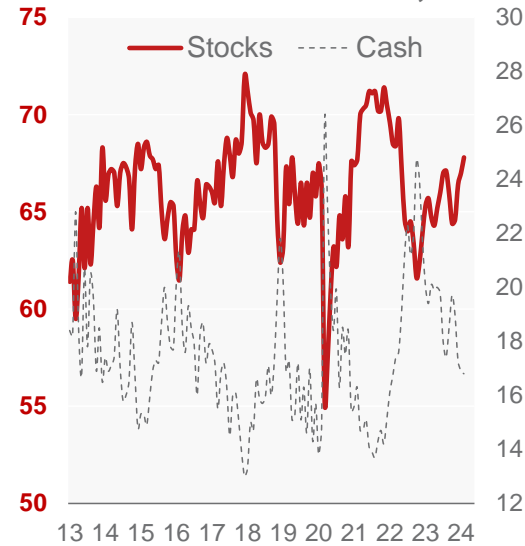
Positioning & sentiment bullish but not extreme

Some signs of fatigue?

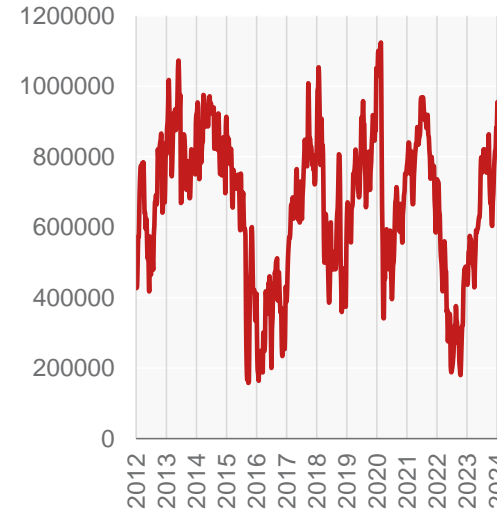
American Association of Individual Investors



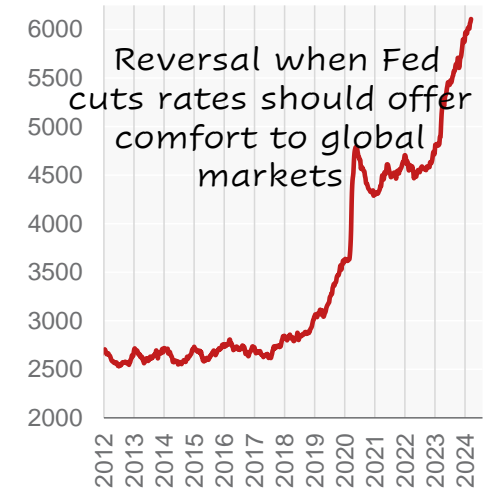
US retail allocation, %



Net long US equity futures, institutional investors



AuM of US Money Market Funds, USD bn

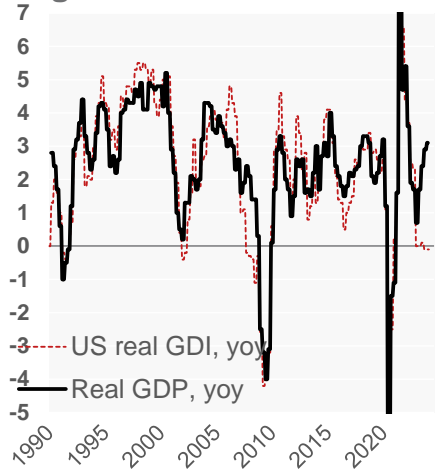


US economy landing, if not hard

Post-Covid cycle full of **surprises** and contradictions

A different cycle... Fed's Powell on 6 March: "The pandemic is still writing the story of our economy right now. We should just be prepared to be **surprised** with the next chapter."

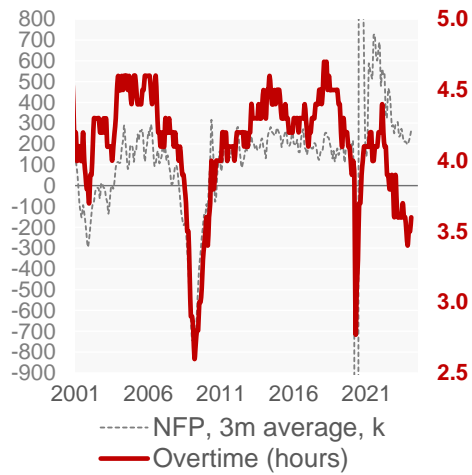
US Gross Dom. 'Income' gloomier than 'Product'



Source: BEA, Bloomberg, GenAM

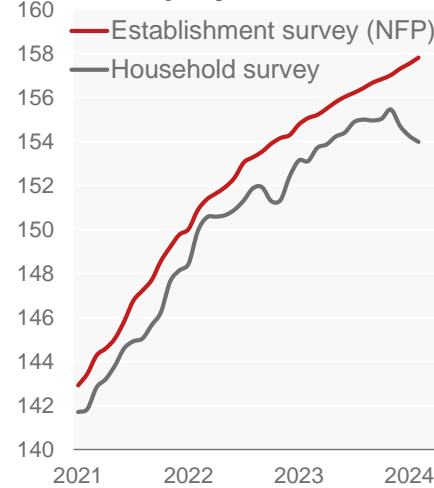
US jobs vs. overtime

Worked hours fall faster than job creations



Source: NFIB, BLS, BBG, GenAM

US employment, Mln



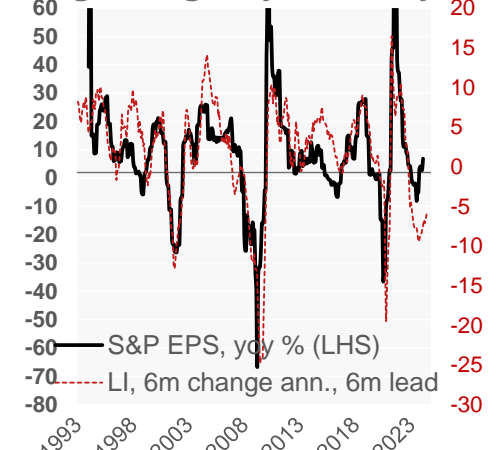
Source: BLS, Bloomberg, GenAM

Business confidence



Source: Chief Exec. Mag., NFIB, Bbg, GenAM

S&P earnings resilient but growing only modestly



Source: Conf. Board, BBG, GenAM

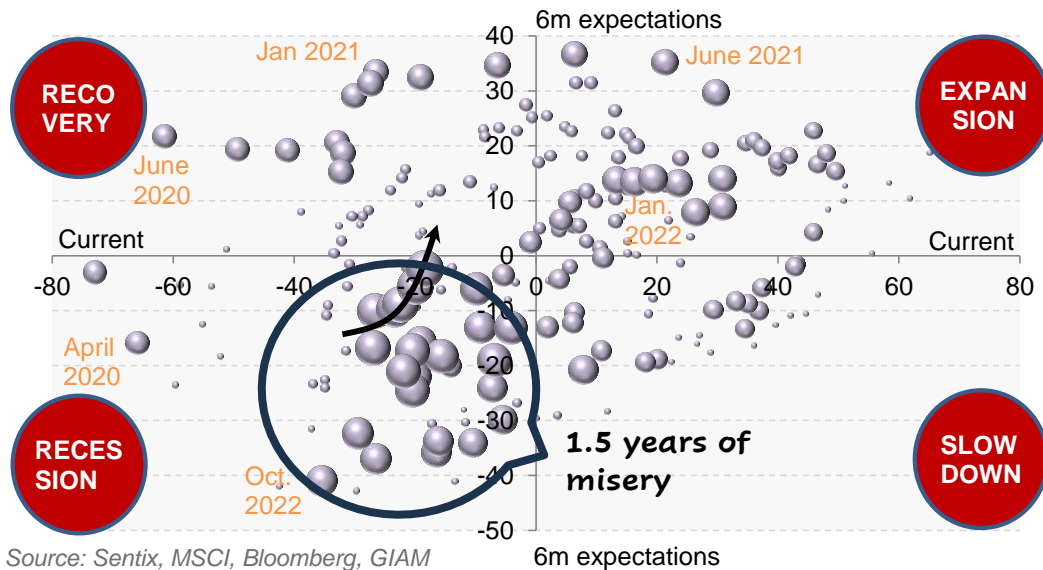
- Exceptional resilience of the US economy and carry-over effect have led us to revise 2024 growth forecast to 2.5%.
- But we are still looking for a slowdown to below potential into summer.
- Some of the data is hard to reconcile, with **NFP and real GDP looking potentially overstated**.
- That said, more globally, leading indicators (e.g. exports from Chile, Korea, semi-conductor exports) are pointing to a **global manufacturing bounce**.

Euro area slowly & finally crawling towards recovery

Tentative signs of a global manufacturing recovery

EUR Sentix Current Situation vs 6m Expectations

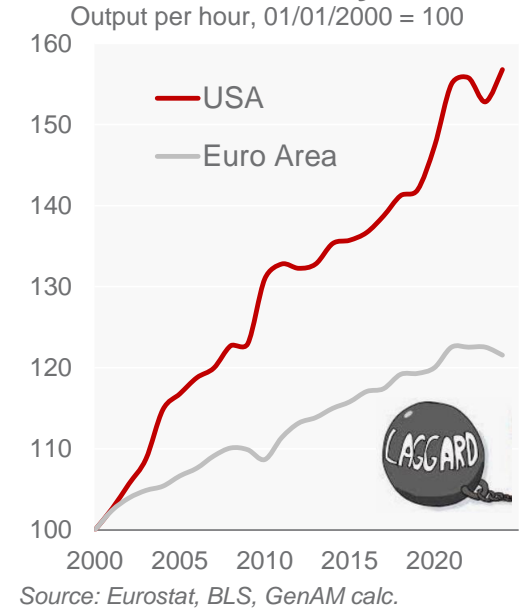
Since 2007; the bigger the bubble, the more recent



EU vs. US Nat Gas price



Productivity



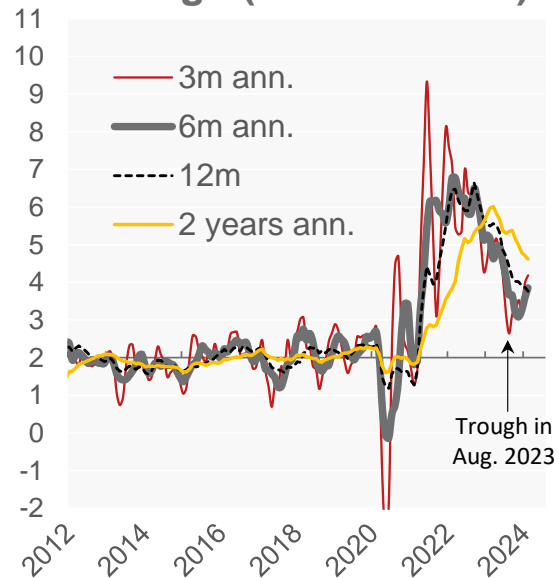
- EA economy dormant for 1.5 years. Now showing **signs of life** again.
- **H2 growth tailwinds**: drag from past monetary tightening set to ease; positive real wage growth supports consumer spending.
- **Energy** crisis badly hit countries with heavy manufacturing. Natural Gas prices now back to Spring 2021 levels. **Energy price gap to the US** remains problematic.
- EA economy **sharply lagging US** on **digital** innovation. EA productivity dormant.
- **Military** spending may support growth but make the fiscal and/or social equation harder.

Inflation normalising BUT...

... the 'LAST MILE' does appear more difficult

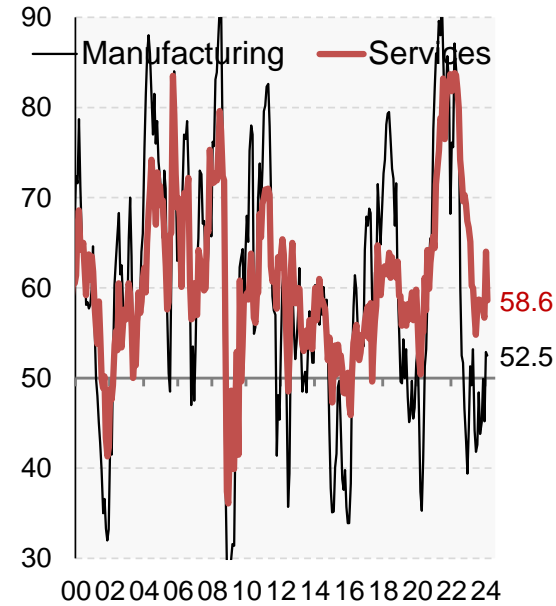


US core disinflation stalling? (3m saar 4.2%)



Source: BLS, Bloomberg, GenAM

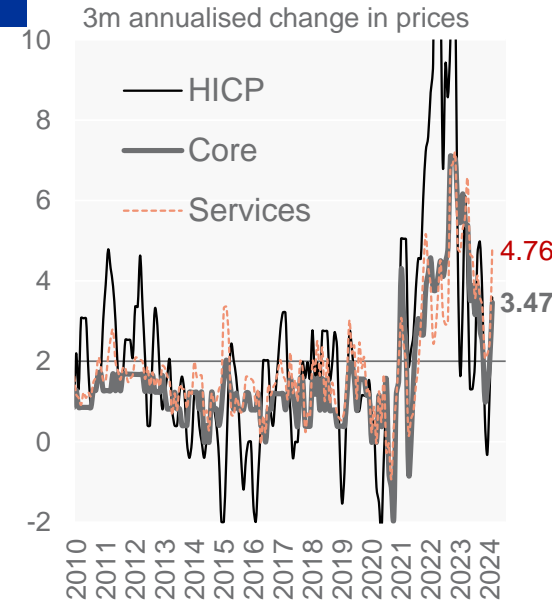
ISM price paid indices



Source: ISM, Bloomberg, GIAM

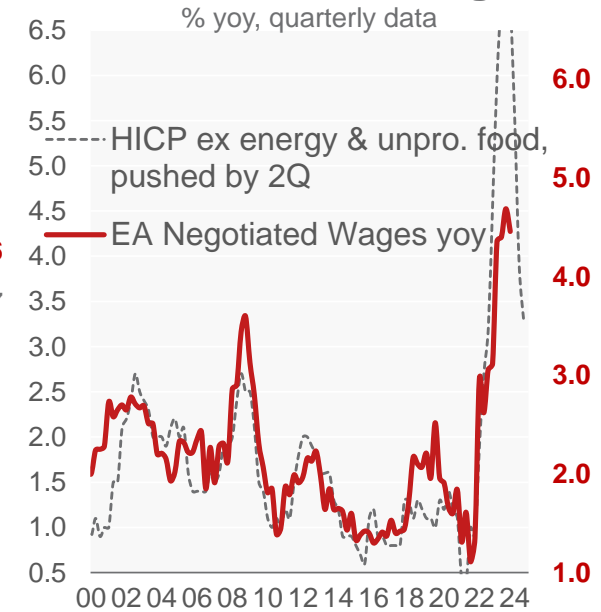


EUR inflation momentum



Source: ECB, GenAM calculations

Watch euro area wages



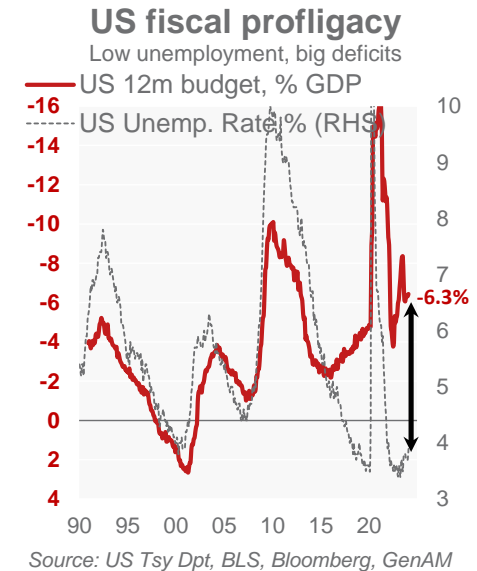
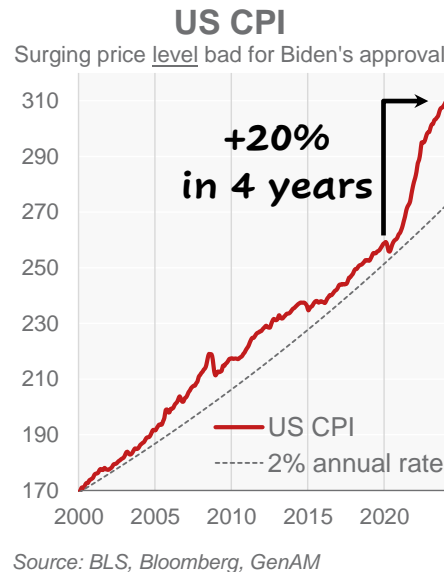
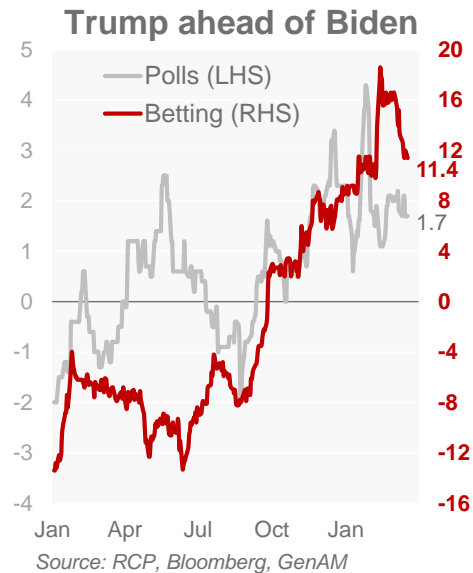
Source: ECB, Bloomberg, GIAM

- **US disinflation set to continue**, as job market cools off (falling quit rate) and wage growth slows.
- That said, **latest prints and surveys have vindicated our fears that the last mile will be harder** (Goods disinflation slows, while Services inflation is somewhat sticky).

- **Latest prints also pointing North in the EA**, though this does not seem to have dented the ECB's confidence about ongoing disinflation.
- Medium term, we **do not expect inflation to return to the pre-Covid 1% regime**.

Trump the favourite

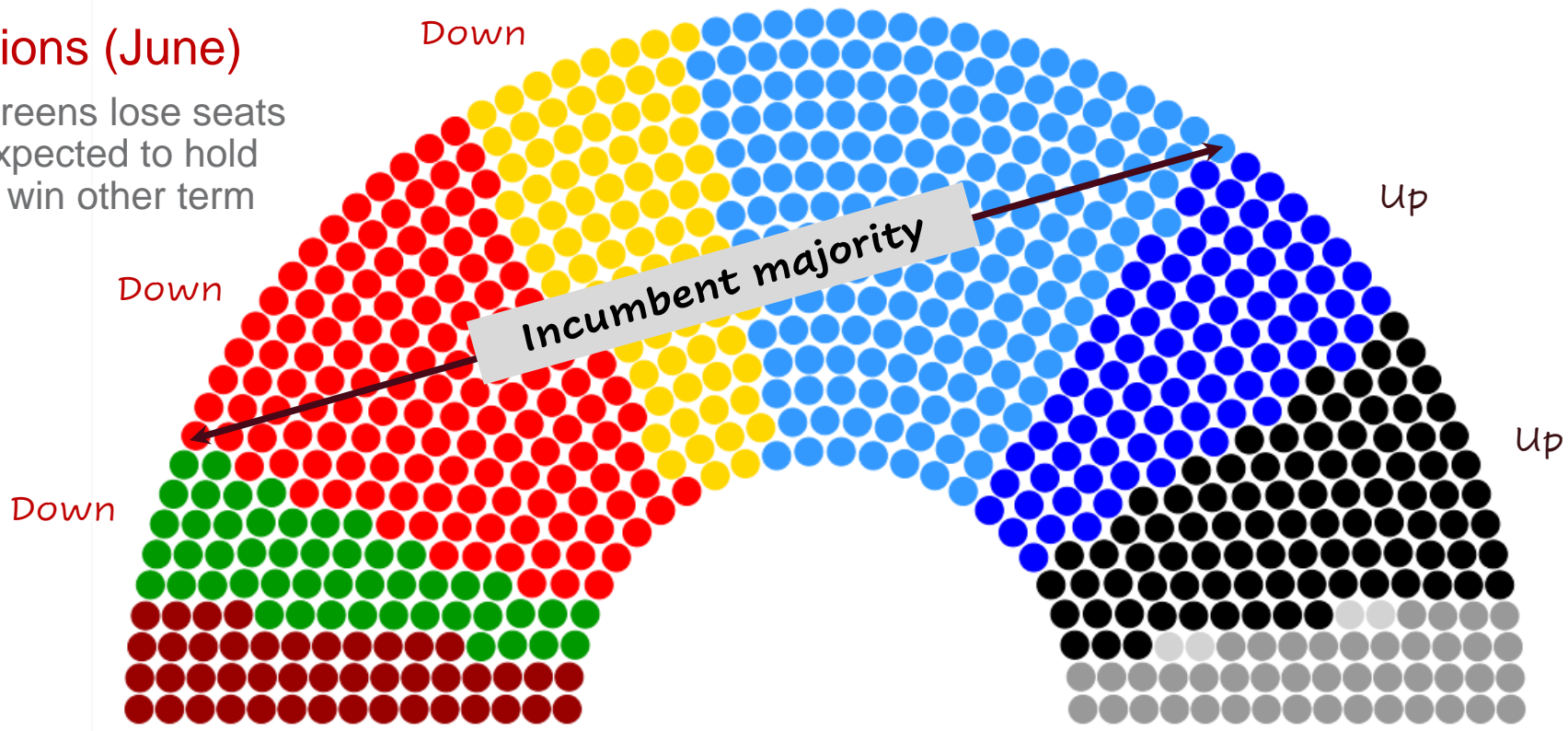
Markets to start trading elections this summer



- **Potential Trump's policies:** more conditional approach to **US alliances**; lower **Ukraine** funding; higher **tariffs**; **immigration** curbs. Depending on Congress majority: support to **fossil fuels / repeal of clean energy** tax credits; extend (& expand?) **corporate tax cuts**.
- **Caveats:** much less fiscal room than in 2016-17. Popular discontent about price level may come in the way of tariffs.
- **Presumable impact** of a Trump victory : bullish stocks (ref. 2016-2017), bearish bonds (ceteris paribus on tariffs, tax cuts, inflation), bullish dollar (expansive fiscal, restrictive monetary policy).
- **Greater detail in dive-in** (p58).

European elections (June)

Right wing gains, Greens lose seats
Incumbent majority expected to hold
VdL contested but may win other term



European Parliament Group	2019 election	February 2024 Projection	Change
● The Left group in the European Parliament - GUE/NGL (LEFT)	41	45	+4
● Group of the Greens/European Free Alliance (Greens/EFA)	74	49	-25
● Group of the Progressive Alliance of Socialists and Democrats in the European Parliament (S&D)	154	140	-14
● Renew Europe Group (RE)	108	82	-26
● Group of the European People's Party (Christian Democrats) (EPP)	182	181	-1
● European Conservatives and Reformists Group (ECR)	62	83	+21
● Identity and Democracy Group (ID)	73	92	+19
● Unaffiliated parties	0	4	+4
● Non-Inscrits (NI)	57	44	-13

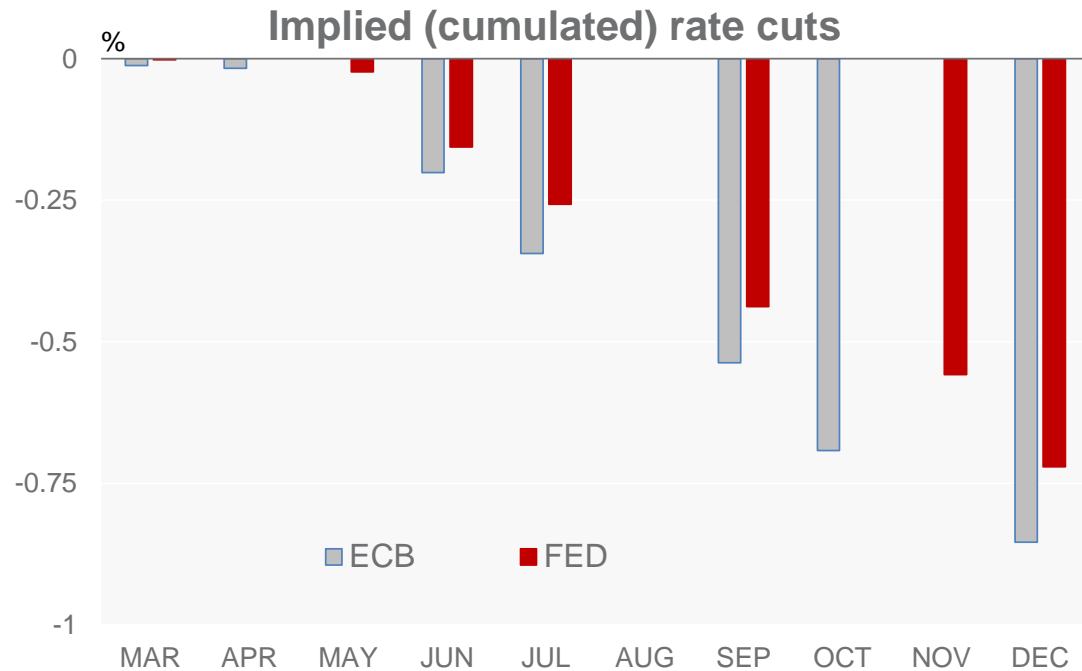
Still a comfortable, if less so, majority (400+ seats /705)

Down Significant losses for Greens, Democrats and Renew

Up Big wins for hard conservatives and far right

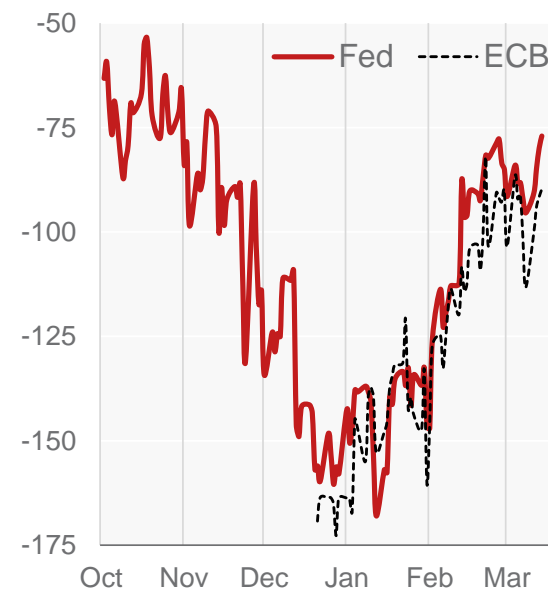
Markets pricing of CB cuts

Ambitious rate cut hopes have retraced (towards our forecast and even beyond in the US)



Source: Bloomberg, GenAM

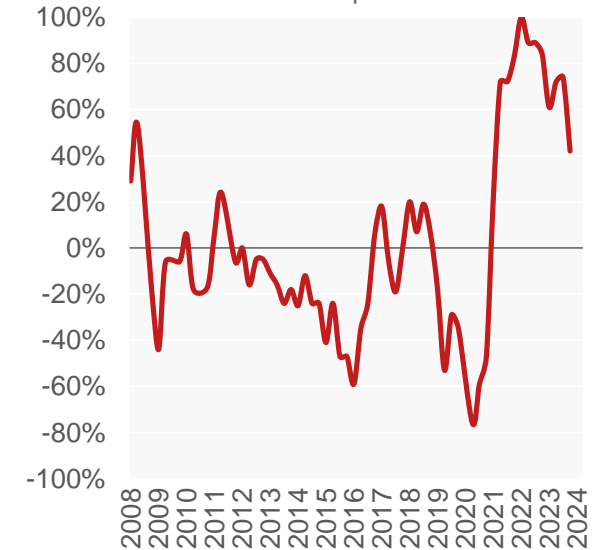
Implied 2024 rate cuts, bp



Source: Bloomberg, GenAM

FOMC starting to relax

Net % of FOMC members seeing core PCE risks to the upside

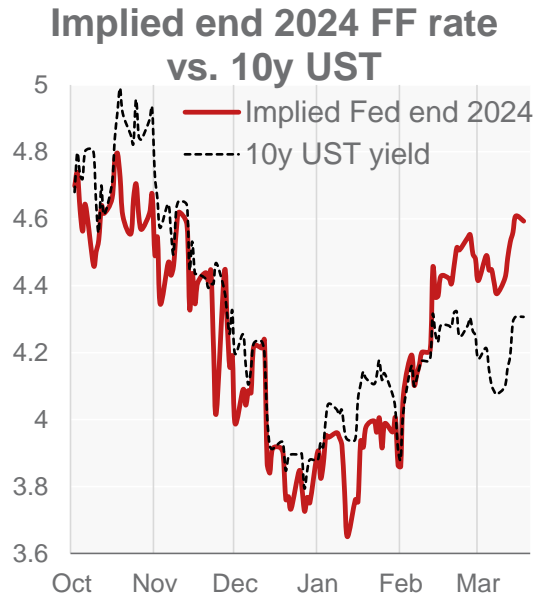


Source: Fed, Bloomberg, GenAM

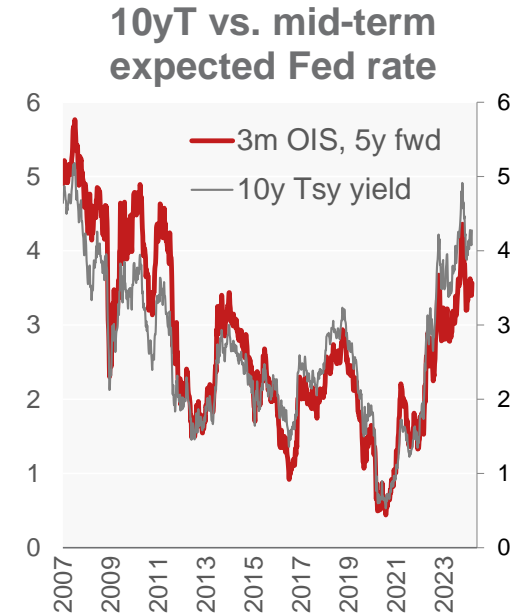
- We expect **75bp of Fed cuts in 2024**, starting in June. Market agrees, following **convergence towards us** (from near 175bp in late 2023).
- We expect **100 basis point cuts from the ECB in 2024**, starting in June. Markets pricing slightly less, despite dovish meeting in March.
- ECB is strongly focused on inflation (and EA integrity), while Fed has a dual mandate. ECB often acts after the Fed – less clear cut this time given the large EA eco underperformance.

Buy the dips in 10-year Treasuries

Buy the dip in 4.40-4.50% area (10yT)?



Source: Bloomberg, GenAM



Source: Bloomberg, GenAM

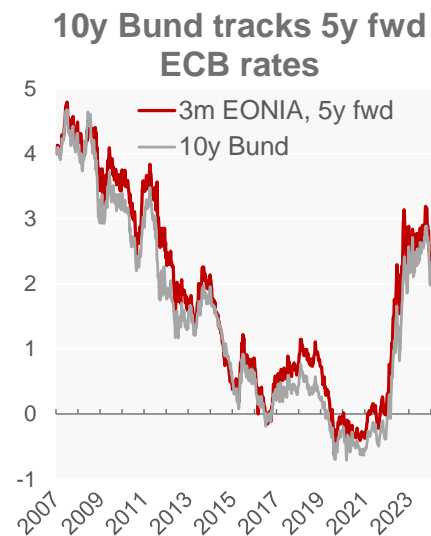


Source: Bloomberg, GenAM

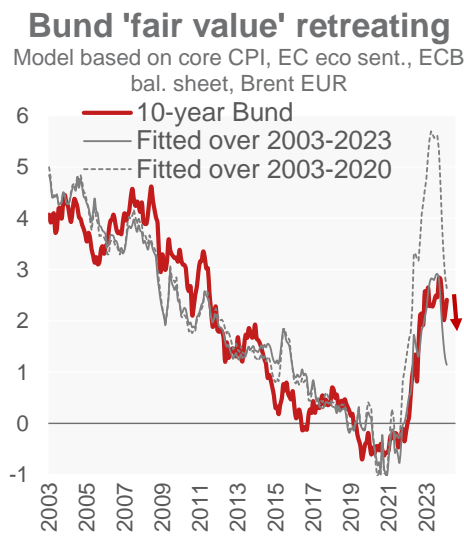
- We see medium-term value in Treasuries, with 10yT trading 70bp above 5y3m OIS (3.62%) – itself likely too high (strong correlation between the two variables).
- **Near-term outlook however exposed to further repricing of Fed**, and more so if odds of a Trump victory keep rising. Some further capitulation likely in case of elevated inflation prints.
- Less downside potential in Bund yield, but also less risk.

EUR 10y keeps winning vs 5s and 30s as vols trend lower

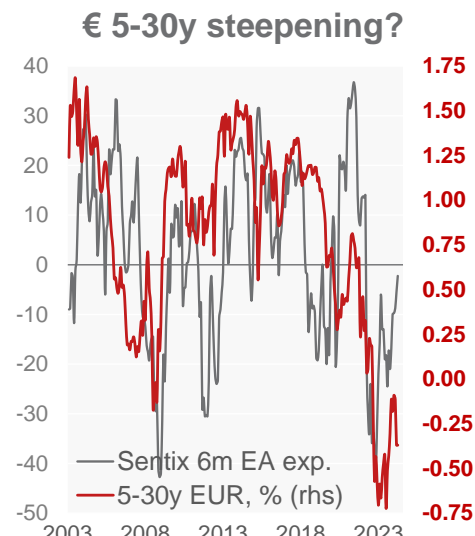
Steepeners are costly, but less so and more attractive at the back end



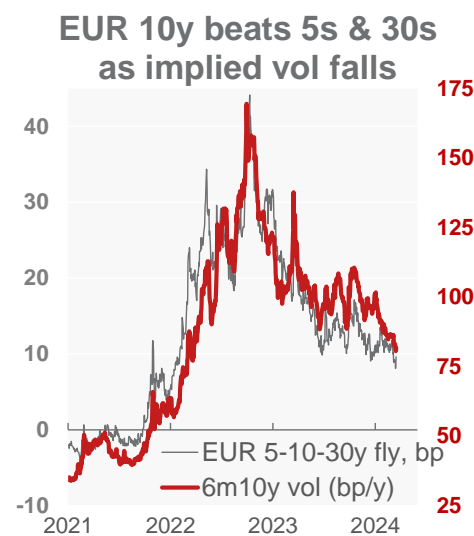
Source: Bloomberg, GenAM



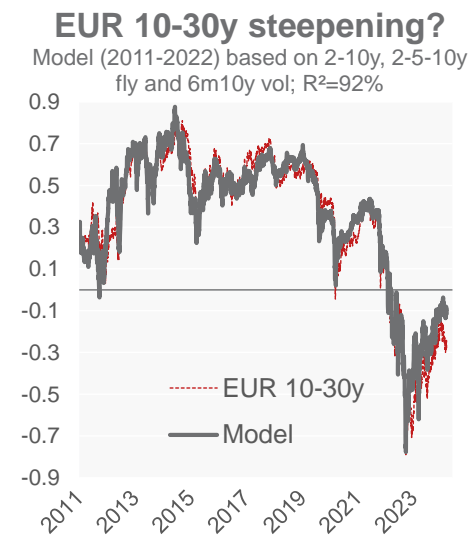
Source: Bloomberg, GenAM calculations



Source: Bloomberg, GIAM



Source: Bloomberg, GenAM

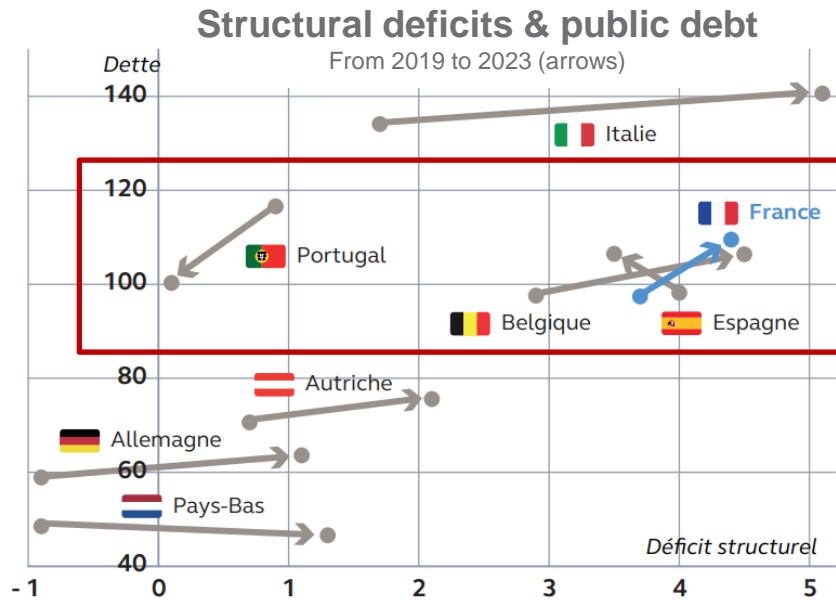


Source: Bloomberg, GIAM

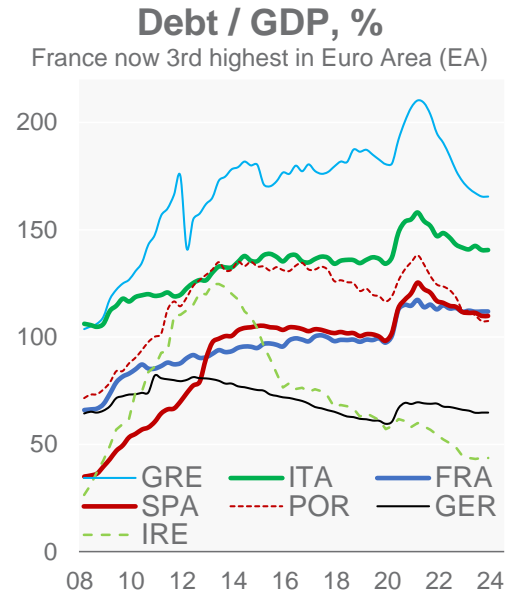
- 10y Bund skewed to the downside; model-wise that largely depends on ongoing decline in core CPI trends.
- That said, 5y3m ESTR is around 2.40%, which looks fair - suggesting not a lot of downside for Bund yield unless growth and/or inflation surprise much to the downside.
- We had little confidence on EUR curve Steepeners, given ambitious implied ECB pricing. Now a bit more comfortable following retracement. But still costly in carry and rolldown. EUR swap 2s10s 1y fwd is 52bp steeper than spot. Only 13bp for 5-30y (spot at -22bp).
- Rates volatility retracing as expected. More to come as inflation recedes. This supports **10y outperformance vs. 5s and 30s, and more so as 10-30y looks too flat** (top-right chart).

Fiscal profligacy & the EA sovereign 'Impossible Trinity'

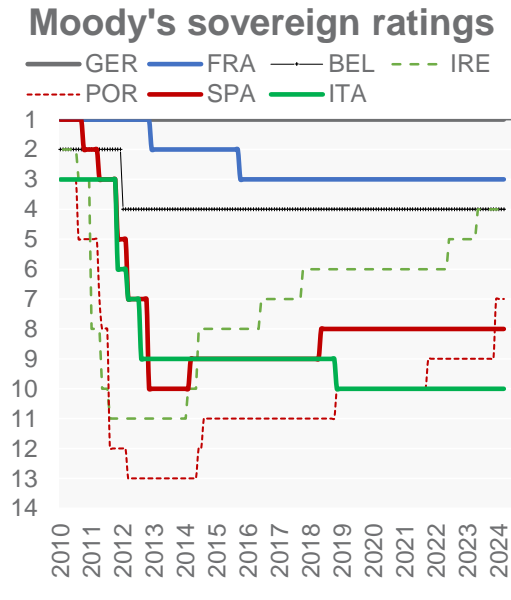
Europe needs to address triple competitive disadvantage & sovereignty issues (energy, digital & military)



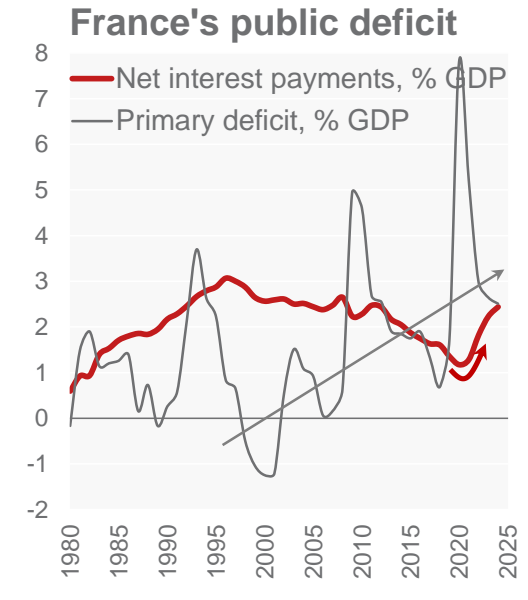
Source: European Commission, *Cour des Comptes*



Source: Eurostat, GenAM



Source: Moody's, Bloomberg, GenAM



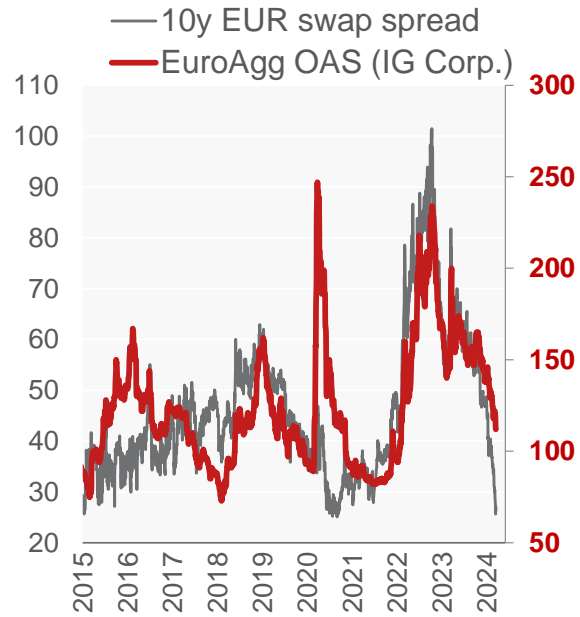
Source: OECD, Bloomberg, GenAM

- US budget deficits wide under both Trump and Biden, for different reasons (tax cuts vs. heavy spending). CBO forecasts permanently wide deficits (6% of GDP through 2034), pushing Debt/GDP from below 100% to 116%.
- EA gvts face **impossible trinity**: 1/ Fund **triple transition** (energy, digital & military). 2/ Keep **debt** sustainable. 3/ Maintain **political & social** stability.
- In the process **debt sustainability and inflation risks have increased**, as Central Banks may be tempted or forced to offer support (what independence?)
- Not all EA countries are equal. **Poor debt and rating trajectory for France** (AA Neg/Aa2/AA-) – now the third most indebted EA country. Ireland, Spain, and Portugal are on a positive rating slope (and none of those countries has a Neg. Rating Outlook).

Spread products

Still a preference for IG Corporate Credit carry, despite limited spread potential

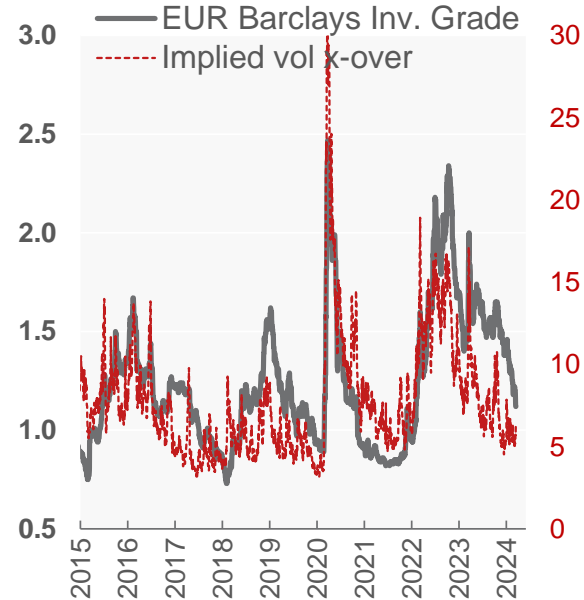
IG vs. swap spreads



Source: Bloomberg, GIAM

- **Swap spreads have collapsed** to record low, as repo rates rise vs. ESTR (as ECB releases collateral). Also potentially reflecting safer banks & more leveraged Sovereigns?

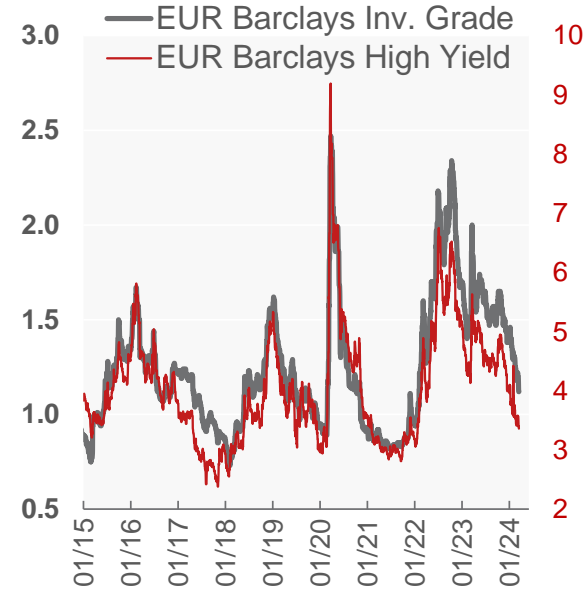
EUR IG spread v. Credit vol



Source: Bloomberg, GenAM

- **Cash IG spread** have compressed a lot, but **still offer value relative to credit vols and CDS** (both making hedging cheaper)

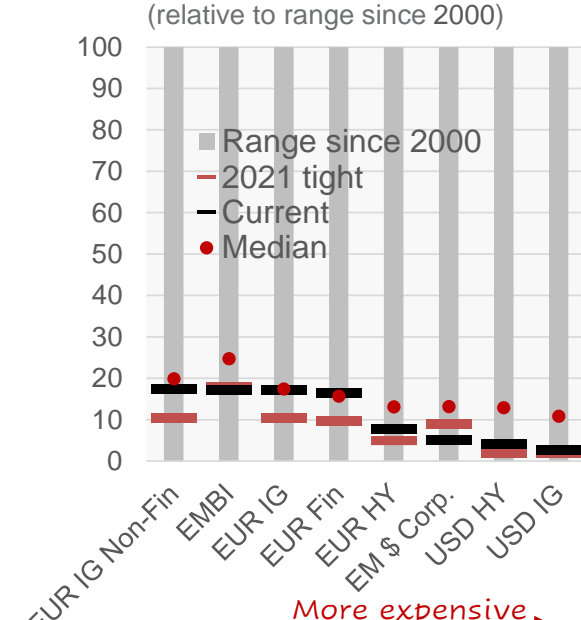
EUR corp. OAS spreads



Source: Bloomberg, GenAM

- **Cash IG spread also large relative to High Yield**

Spreads vs. History



Source: Bloomberg, GenAM calculations

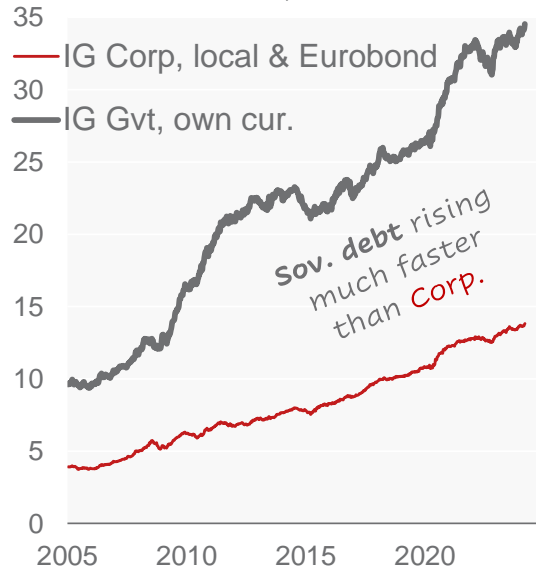
- **US spreads near record lows.** More value still in EUR IG, close to long-term median and well above all-time lows

Is IG Credit the new haven?

Still good risk-return profile

Bond market size

Face value, USD tn

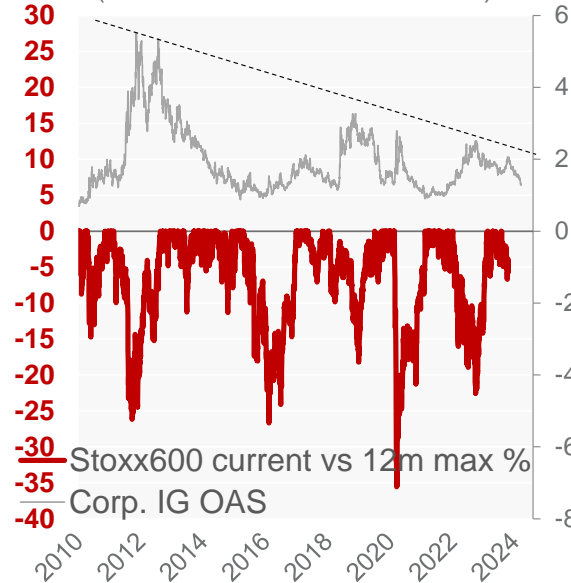


Source: BofA

- **Sovereign debt rising much faster** than corporate debt through GFC and pandemic.
- Read [Global Debt Report \(OECD\)](#)

Lower peaks in IG spreads

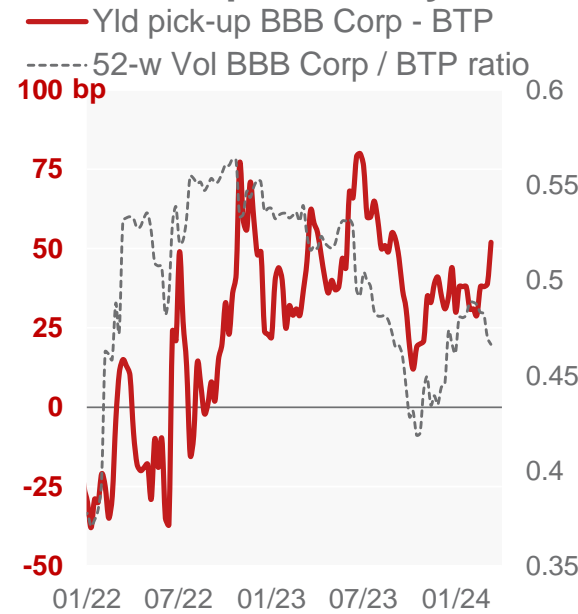
(vs. similar drawdowns in stocks)



Source: Bloomberg, GenAM calculations

- Similarly large equity market drawdowns have produced **lower credit spread peaks** through time.
- Governments and Central Banks always prone to **'save the world'**

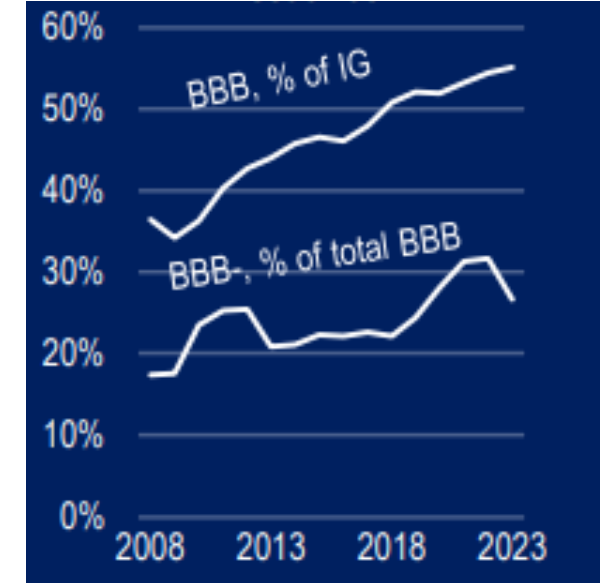
BBB Corp. vs. 7-10y BTP



Source: BofA, Bloomberg, GenAM calc.

- EUR IG BBB offers **50bp yield pick-up** vs. 7-10y BTPs.
- **Index price volatility is less than half** for BBB Corp. index than 7-10 BTP index.

Non-Fin corp. bond issuance

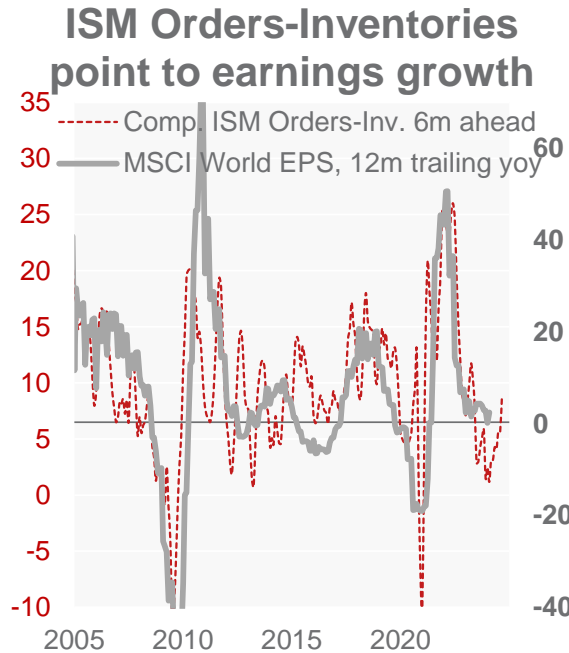


Source: OECD Global Debt Report 2024

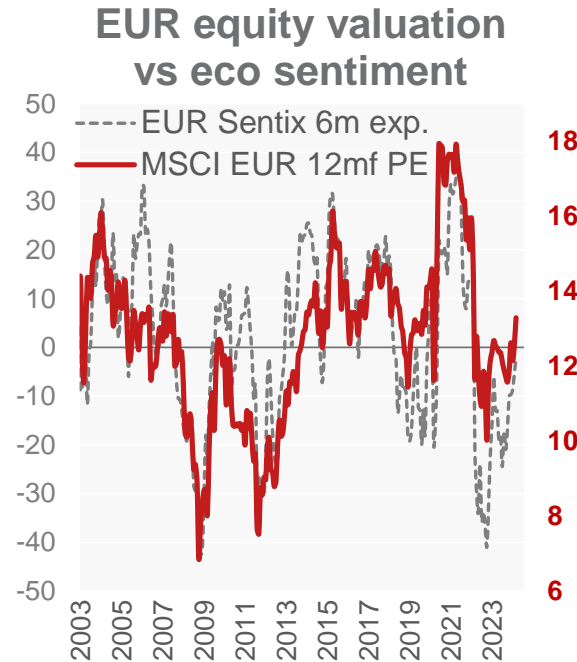
- IG Corporate issuance **increasingly skewed towards BBB segment**, which requires attention, however.

Equities not cheap, but not a bubble

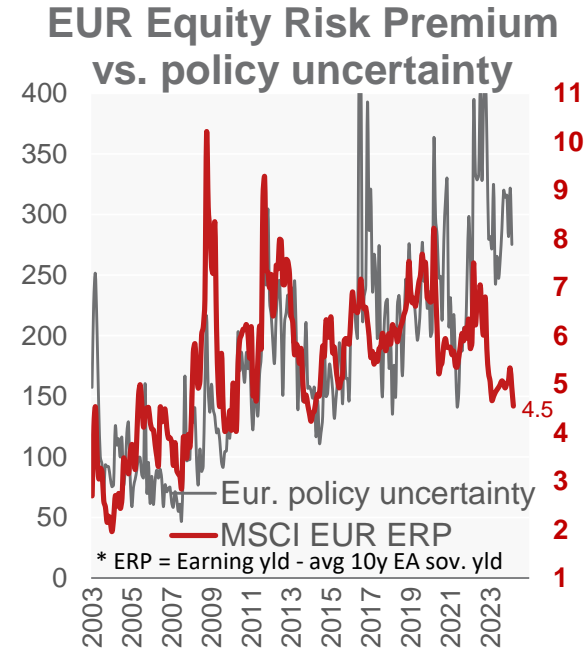
Equity Risk Premia structurally dragged down?



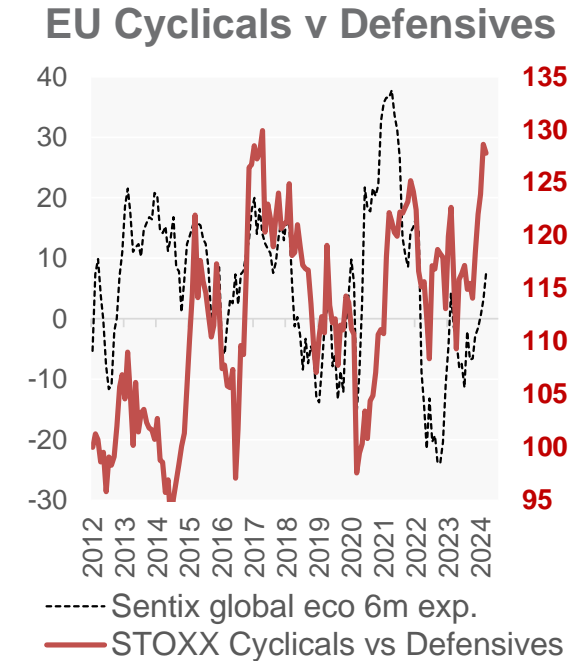
Source: Bloomberg, GenAM



Source: Sentix, MSCI, Bloomberg, GenAM



Source: Baker, Bloom & Davies, BBG, GenAM



Source: STOXX, Bloomberg, GenAM

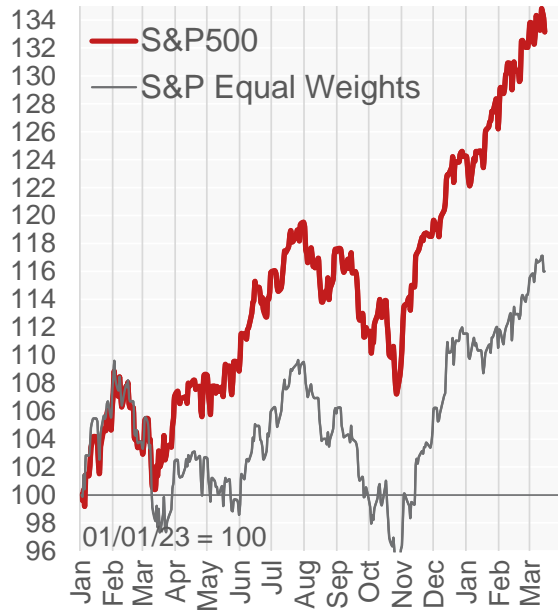
- US market now in very high valuation territory, historically, even after Tech adjustment.
- **Unless this time is different, as CBs are suspected to be forced into quasi debt monetisation?**
- MSCI World and Europe close to median hist. valuation.

- At about 4.5%, EA ERP is not particularly tight, though it does not discount much policy uncertainty.
- **EUR equity multiples can still rise** as eco slowly recovers.
- **EUR Cyclical have done well, but we see residual/lagging pockets of value** (see sector dive-in & eqy section).

Mega stock dominance

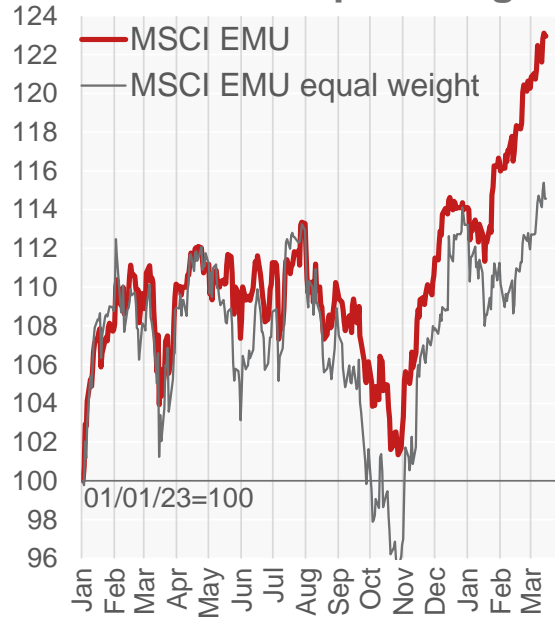
On both sides of the Atlantic this year

S&P v. Equal-Weight S&P



Source: S&P, Bloomberg, GenAM

MSCI EMU v. Equal-Weight



Source: S&P, Bloomberg, GenAM

Mega stock dominance



Source: S&P, MSCI, Bloomberg, GenAM

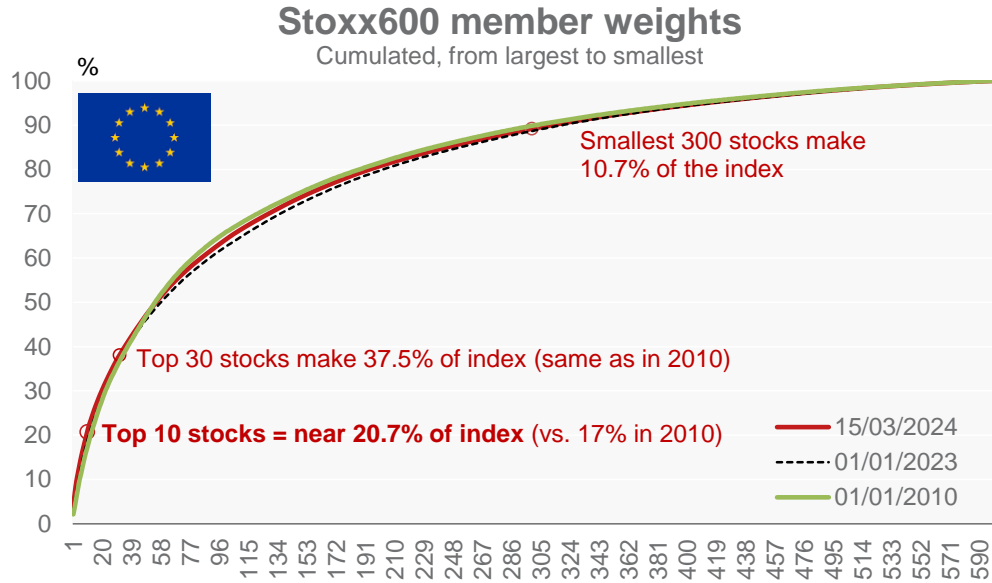
Nasdaq Mkt Cap 16% more than MSCI World ex-US



Source: Bloomberg, GenAM

Extreme US equity index concentration

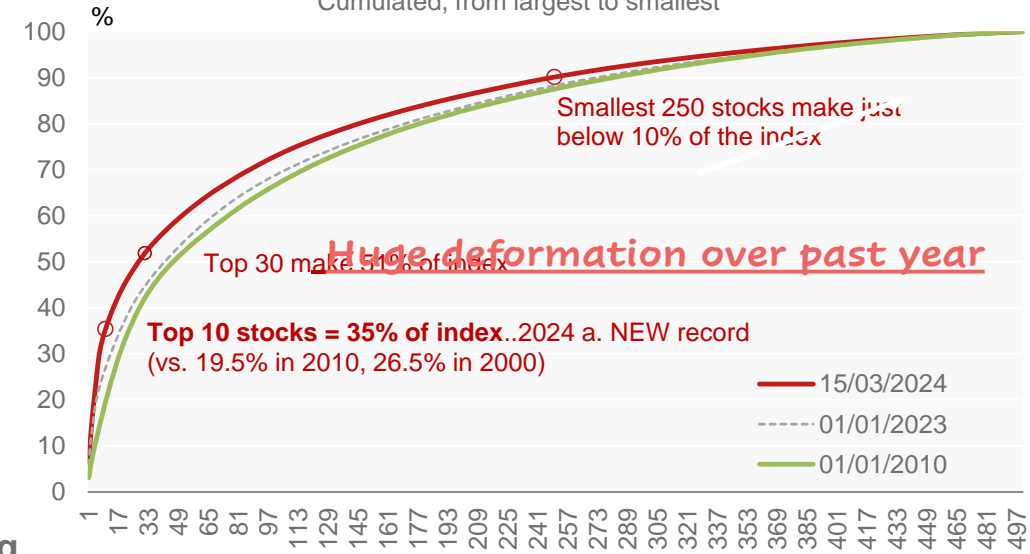
10 biggest US stocks now make ~35% of S&P500



Source: STOXX, Bloomberg, GIAM calc.

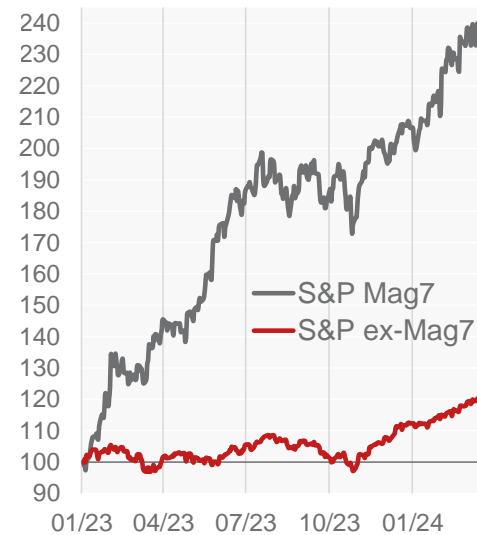
S&P member weights

Cumulated, from largest to smallest



Source: SPX, Bloomberg, GenAM calc.

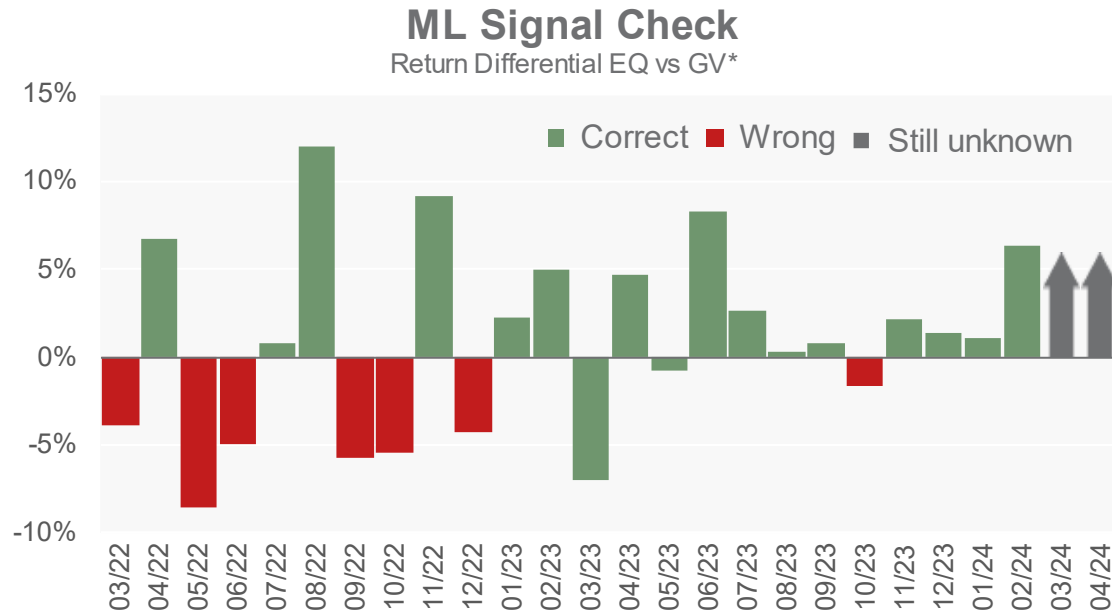
Magnificent 7 soaring



Source: Bloomberg, GenAM

NEW! AI-driven TAA

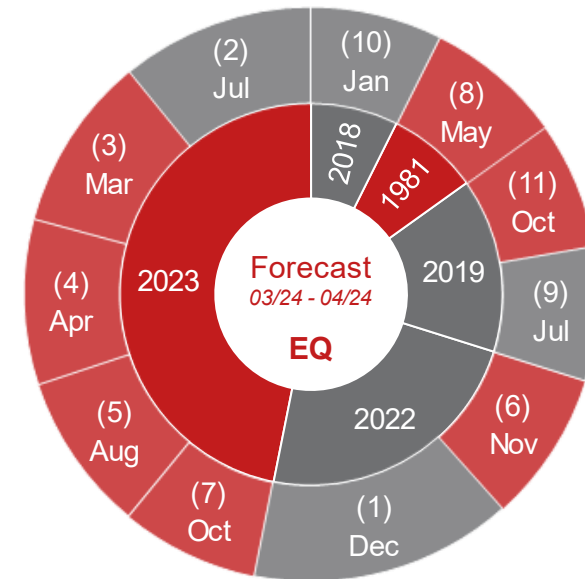
ML still favours Equities over Bonds but with a distinctively smaller margin



Source: Datastream, GenAM

*Based on average mid-month data for the United States-Datastream Market Index (EQ) and BBG US Government Bond Index (GV)

Neighbourhood Structure



Source: GenAM

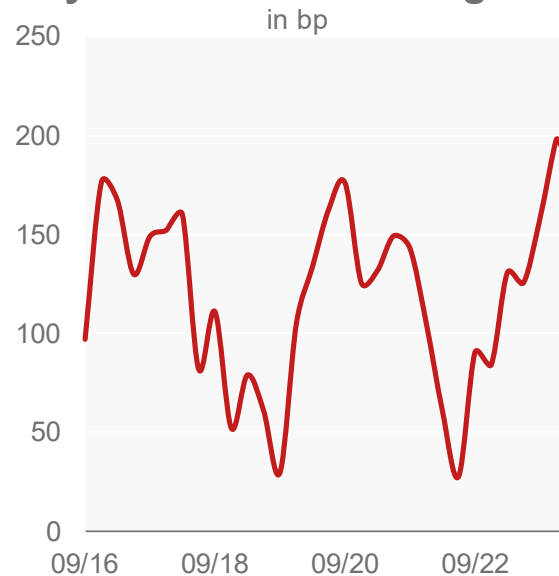
FRED-MD database status: early 03/24; red/grey segments in favour of EQ/GV; numbers in brackets denote the proximity rank

- So far, the model was able to continue its good track record from 2023. The market regimes for 01/24 and 02/24 were correctly forecasted.
- Since 06/23 all signals were in favour of Equities
- The current forecast confirms this preference, yet the clarity of the voting went down to 59% (83% prev. month / 70% avg. over 12 months)
- The two most similar neighbours (Dec/22 and Jul/23) represent Govie regimens
- Our Machine Learning (ML) model uses a kNN-approach to identify past periods as similar as possible to the current one based on 120+ monthly macroeconomic time series from the FRED-MD database provided by the Fed of St. Louis. It generates a binary forecast for the upcoming market regime (US-Equities vs US-Govies) as a weighted majority vote amongst 11 most similar periods (neighbours).

NEW! Private Assets (1/2)

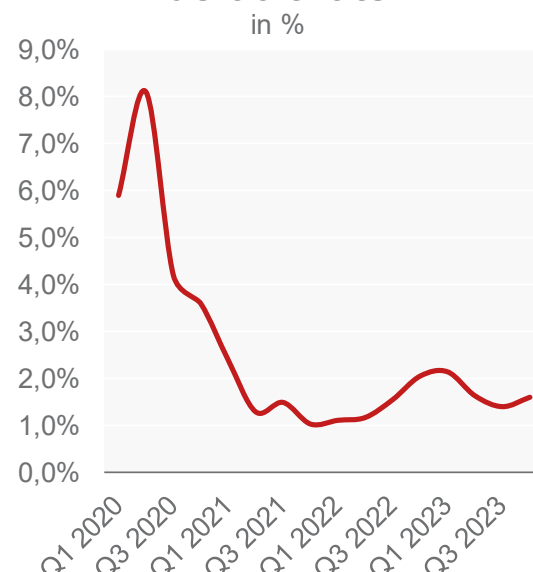
Private Debt: lower return & risk, though PD keeps taking on the worst-rated issuers in the Levfin space

Direct lending vs broadly syndicated loans margins



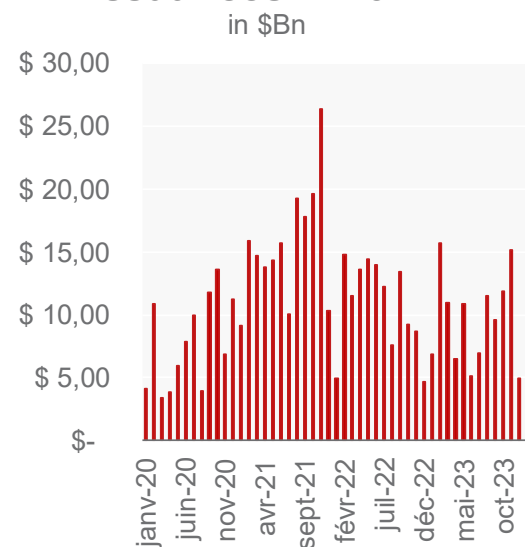
Source: BofAML, GenAM own calculations

Proskauer private credit default rate



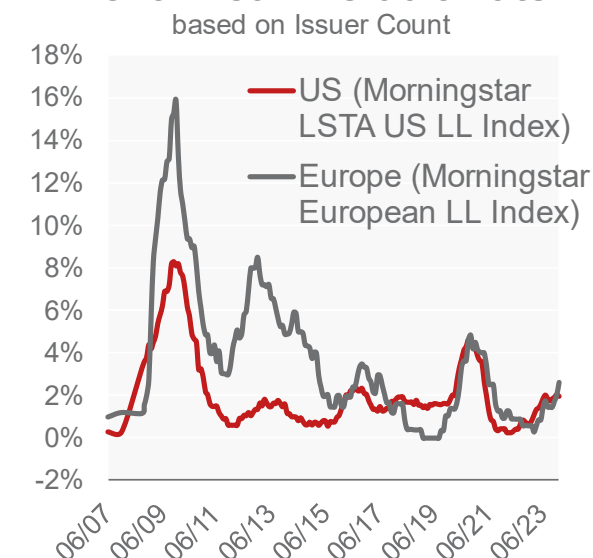
Source: Proskauer, GenAM

Huge pick-up in CLO issuances in 2024



Source: LCD Pitchbook, GenAM

Euro vs. US Lagging 12-Month Loan Default Rate



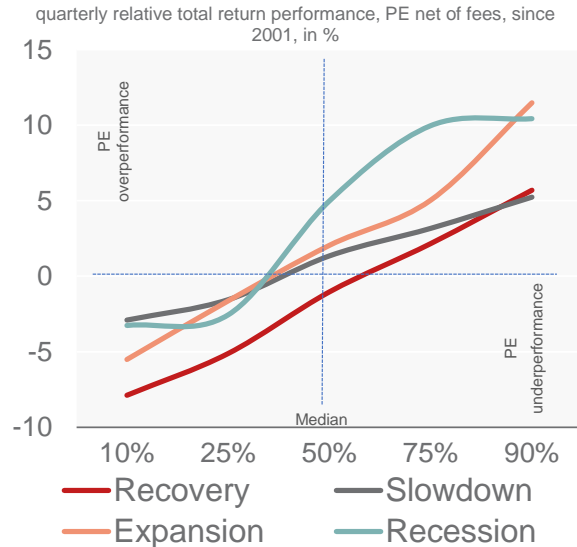
Source: LCD Pitchbook, ELLI, GenAM

- Access to capital for LevFin issuers across public and private sources has increased, with strong demand from CLOs and yield-sensitive HY players.
- As a result, we have seen a return of loans issuance relative to private credit & HY except in the CCC space.
- **Lower refinancing risk has reduced default pressures**, in addition to an improved backdrop for US corporates amid easing credit conditions, declining dispersion and earnings recovery.
- Overall, we believe the **risks associated with private debt are lower compared to end-24**, but they have mostly taken on the worst-rated issuers in the Levfin space.
- **With rate cuts on the horizon, returns will also fall relative to fixed rates products, especially HY.**

Private equity: M&A on the rise. The relative benefit of expansionary cycle only by 2025

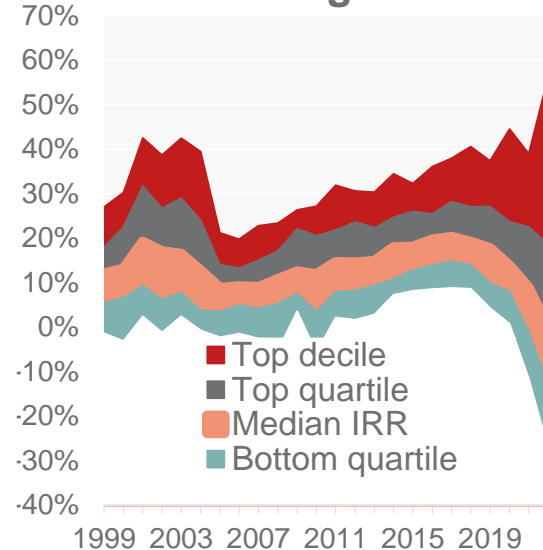
US M&A rebound: lower interest rates, dovish monetary policy, lower PE valuation and progressive better macro

US margin cycle: PE vs S&P500



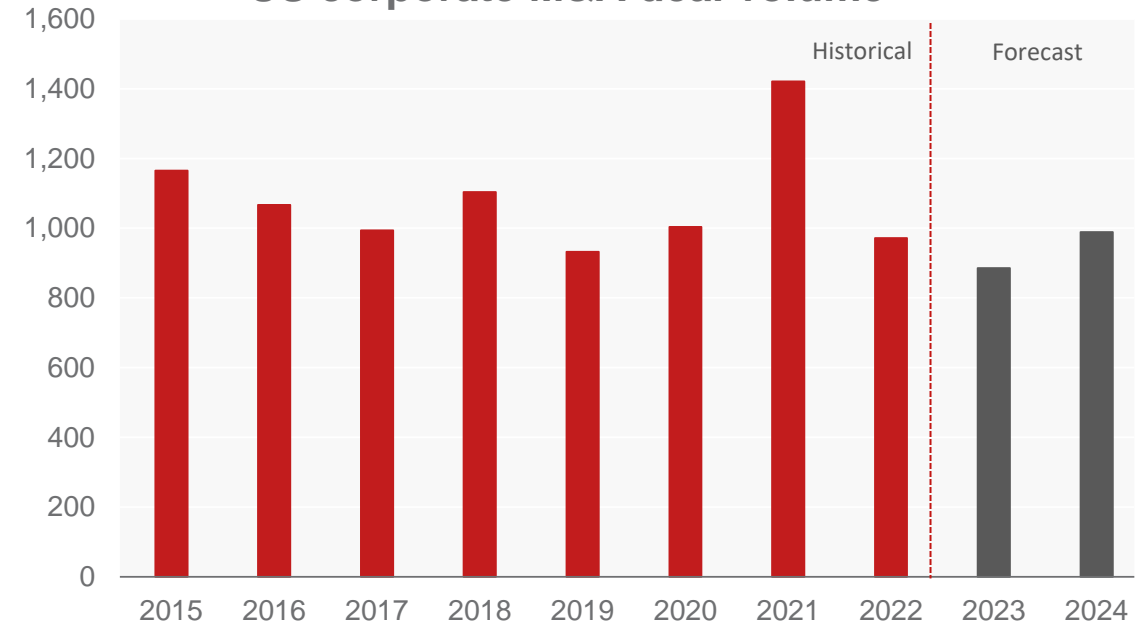
Source: Datastream, GenAM Research

PE - IRR dispersion by vintage



Source: Pitchbook, GenAM Research

US corporate M&A deal volume



Source: EY

- 2024-26 PE return projections: IRR at 9% in base scenario for New Vintages, 7.2% for in-force. In Goldilocks scenario +12% and +10.7% respectively.
- **IRR vs S&P500: slight overperformance** in slowdown phase **up to 2Q24**. Underperformance from 3Q (recovery). The benefit of expansionary cycle only by 2025
- **Increasing dispersion in PE funds performance** is driven by 2023 higher interest rate and **pressures on GPs to distribute cash** this year. This will decide which portfolio companies to sell, which to write off and which to further restructure, delaying sale (Bain, 2023). **Size matters**: small funds deliver higher returns but more volatile → GP selection increasingly key
- **Positive signals for PE: M&A deal volume to gradually pick up** in 2024; **valuations** are more aligned to Listed Equity and **new hype on IPO** → IPO Topic in Google Trends Worldwide News more than doubled in 2H23 vs 2022.
- (Italian) **Pension Funds** are discussing the **need to increase liquidity** to counterbalance: PA increase, aging-induced portfolio volatility, lapses and geopol.risk

NEW! Private Assets (2/2)

Private Equity: benefit of expansionary cycle only by 2025, as M&A rebound on lower interest rates, better valuation & macro

- **IRR vs S&P500:** slight overperformance in slowdown phase **up to 2Q24**. Underperformance from 3Q (recovery). Benefit of expansionary cycle only by 2025.
- **Increasing dispersion in PE funds performance** driven by higher interest rates and **pressures on GPs to distribute cash** this year. This will decide which portfolio companies to sell, which to write off and which to further restructure, delaying sale (Bain, 2023).
- **Size matters:** small funds deliver higher returns but more volatile → GP selection increasingly key.
- **M&A deal volume to gradually pick up** in 2024; **valuations** are more aligned to Listed Equity and **new hype on IPO** → IPO Topic in Google Trends surging
- (Italian) **Pension Funds** discussing **need to increase liquidity** to offset private asset illiquidity and portfolio risks (ageing & lapses, geopolitical risk etc.)
- 2024-26 PE return projections: IRR at 9% in base scenario for New Vintages, 7.2% for in-force. In Goldilocks scenario +12% and +10.7% resp.

Forecast Overview

Financial Market Forecasts

Key Rates	Current*	3M		6M		12M	
		Forecast	Forward	Forecast	Forward	Forecast	Forward
US (upper bound)	5.50	5.25	5.14	5.00	4.76	4.50	4.09
Euro area	4.00	3.75	3.65	3.25	3.28	2.75	2.56
Japan	-0.10	0.00	0.11	0.00	0.18	0.00	0.35
UK	5.25	5.25	5.00	5.00	4.71	4.50	3.98
Switzerland	1.50	1.50	1.25	1.25	1.06	1.00	0.91
10-Year Govt Bonds							
US Treasuries	4.23	4.15	4.21	4.05	4.20	3.85	4.20
Germany (Bunds)	2.35	2.30	2.33	2.25	2.30	2.25	2.29
Italy	3.66	3.65	3.69	3.65	3.71	3.70	3.77
Spread vs Bunds	131	135	136	140	141	145	149
France	2.83	2.80	2.84	2.75	2.83	2.80	2.85
Spread vs Bunds	48	50	51	50	53	55	56
Japan	0.73	0.70	0.81	0.70	0.85	0.65	0.94
UK	3.97	3.95	3.95	3.85	3.93	3.65	3.96
Switzerland	0.66	0.65	0.62	0.65	0.61	0.65	0.60
Credit Spreads**							
EA IG Non-Financial	108	110		110		100	
EA IG Financial	120	120		120		110	
EA HY	349	375		375		340	
EM Sov. (in USD)	260	284		303		284	
Forex							
EUR/USD	1.08	1.09	1.09	1.11	1.09	1.13	1.10
USD/JPY	151	147	149	144	147	142	144
EUR/JPY	164	160	162	160	161	160	158
GBP/USD	1.26	1.27	1.26	1.29	1.26	1.31	1.27
EUR/GBP	0.86	0.86	0.86	0.86	0.86	0.86	0.87
EUR/CHF	0.97	0.98	0.97	0.99	0.96	1.00	0.95
Equities***							
S&P500	5,219	5,210 (0.2%)		5,270 (1.7%)		5,380 (4.5%)	
MSCI EMU	166.7	164 (0.6%)		167 (2.7%)		173.5 (7.3%)	
TOPIX	2,791	2,780 (0.1%)		2,825 (2.3%)		2,915 (6.5%)	
FTSE	7,926	7,900 (0.7%)		8,015 (3.3%)		8,255 (8.3%)	
SMI	11,656	11,525 (0.9%)		11,815 (3.5%)		12,300 (8.8%)	

*3-day avg. as of 26/03/24; **ICE BofA (OAS); ***numbers in brackets denote total returns incl. expected dividends

Macro Forecasts

Growth	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	
US	2.5	2.5	0.4	1.7	0.0	1.9
Euro area	0.5	0.6	0.1	1.3	- 0.0	1.2
Japan	1.9	0.7	- 0.0	0.9	- 0.1	0.5
China	5.2	4.7	0.1	4.4	0.1	4.1
World	3.0	2.8	0.1	3.0	0.1	2.9

Inflation	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	
US	4.1	2.6	- 0.0	2.2	- 0.0	2.1
Euro area	5.5	2.4	0.1	2.2	0.2	2.0
Japan	3.3	1.9	- 0.4	1.6	0.0	1.4
China	0.2	0.7	- 0.2	1.6	- 0.0	2.0
World	5.3	3.7	- 0.1	2.9	- 0.6	2.8

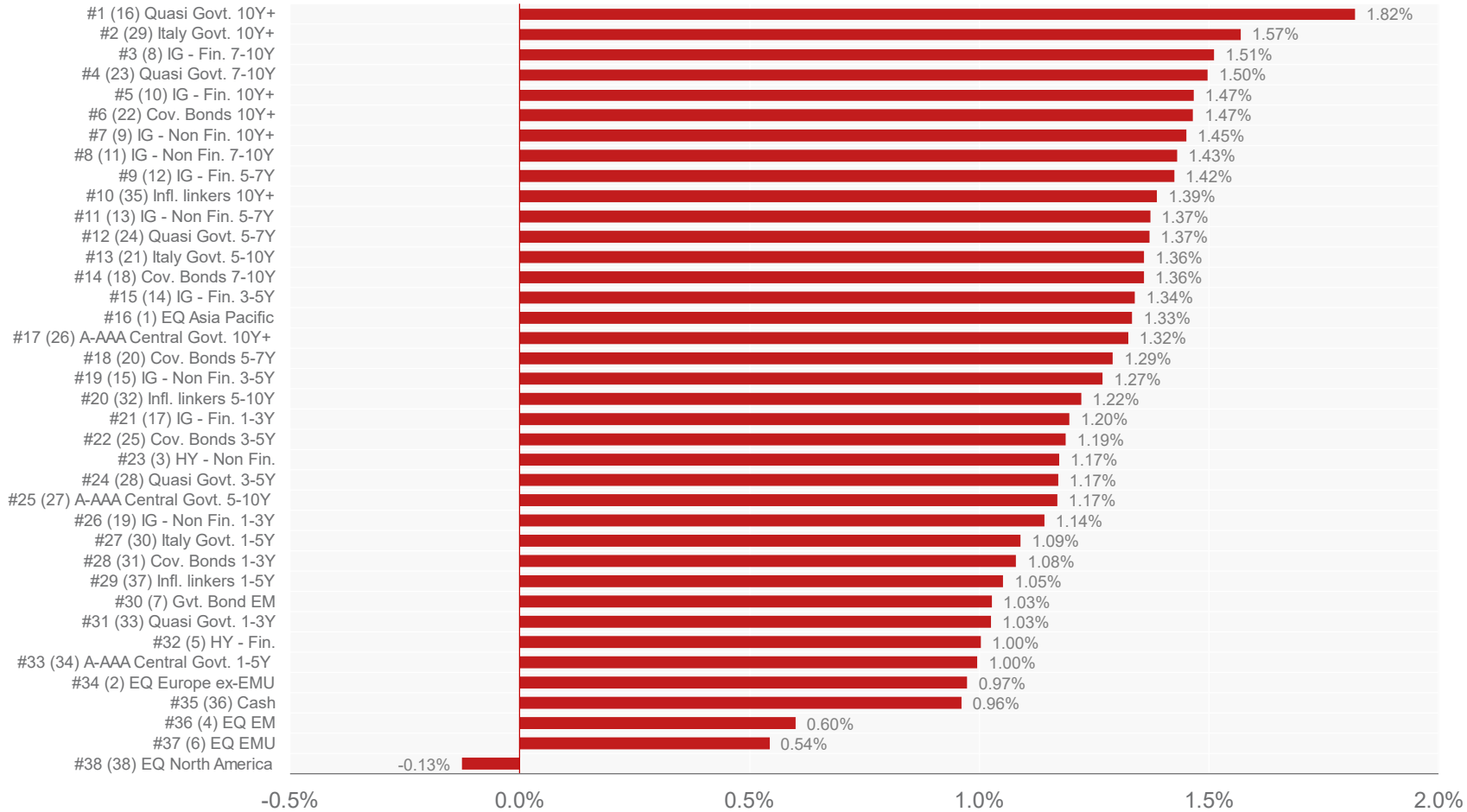
Key Rates*	2022	2023	2024		2025	
			forecast	cons.**	forecast	cons.**
US	4.50	5.50	4.75	4.60	3.50	3.50
Euro area	2.00	4.00	3.00	2.90	2.50	2.15
Japan	- 0.10	- 0.10	0.00	0.11	0.00	0.26
China	3.65	3.45	3.35	n.a.	3.30	n.a.

* year-end forecasts; Fed: FFR upper bound, ECB: deposit rate, BoJ: Policy Rate Balance, China: Loan Prime Rate 1Y; ** mean forecasts BBG

Source: Datastream, Bloomberg, GenAM

Total return expectations

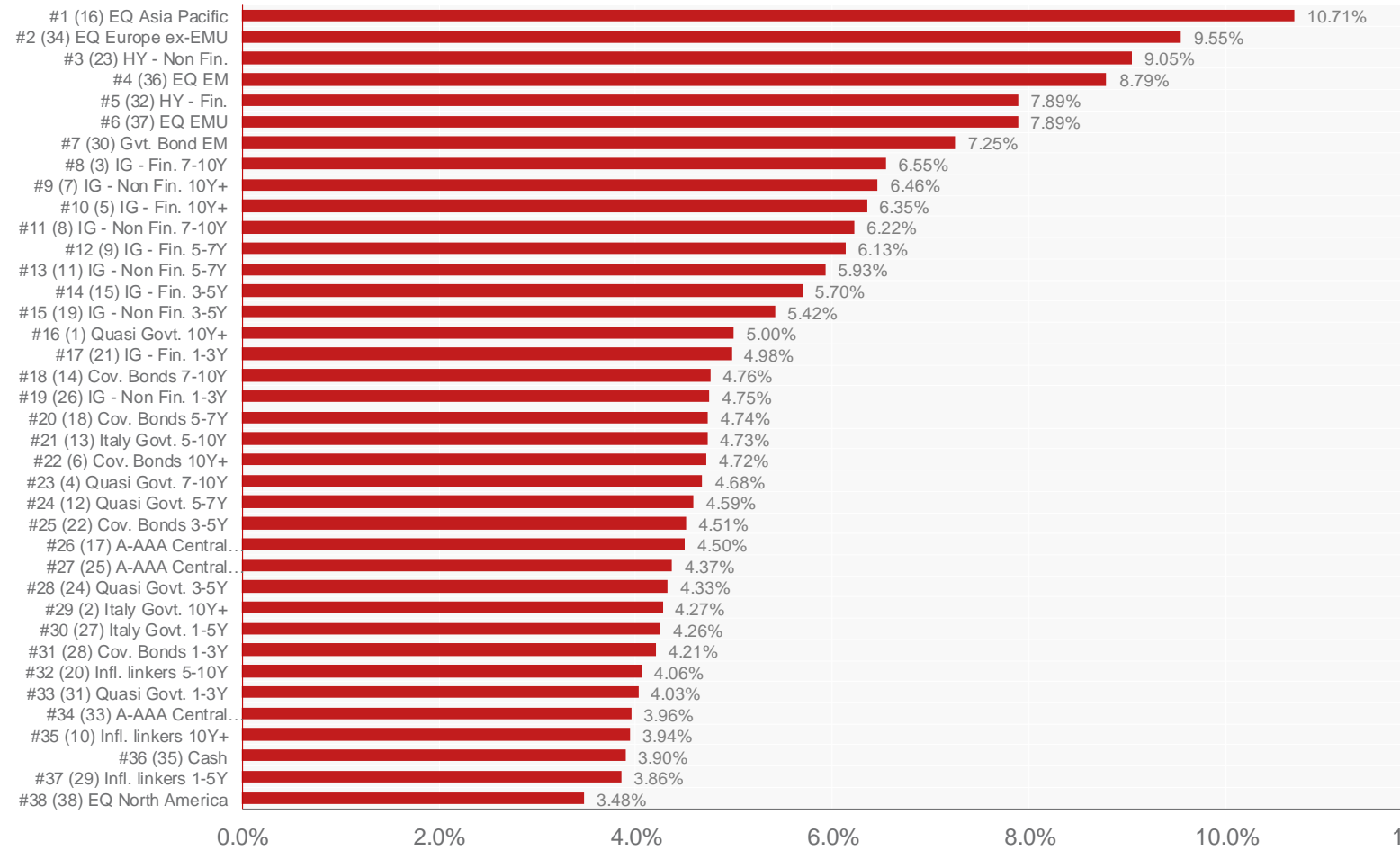
3M Total Return Forecasts hedged into EUR



Source: Datastream, GenAM calculations; cutoff: 05.03.24; figures in brackets denote total return ranks on a 12M view

Total return expectations

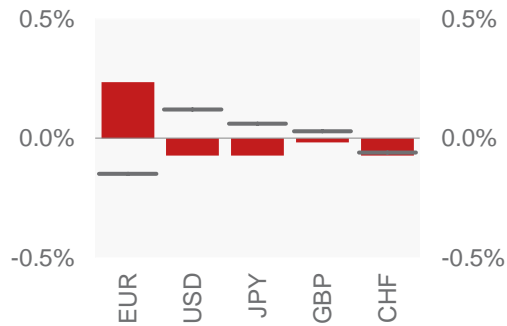
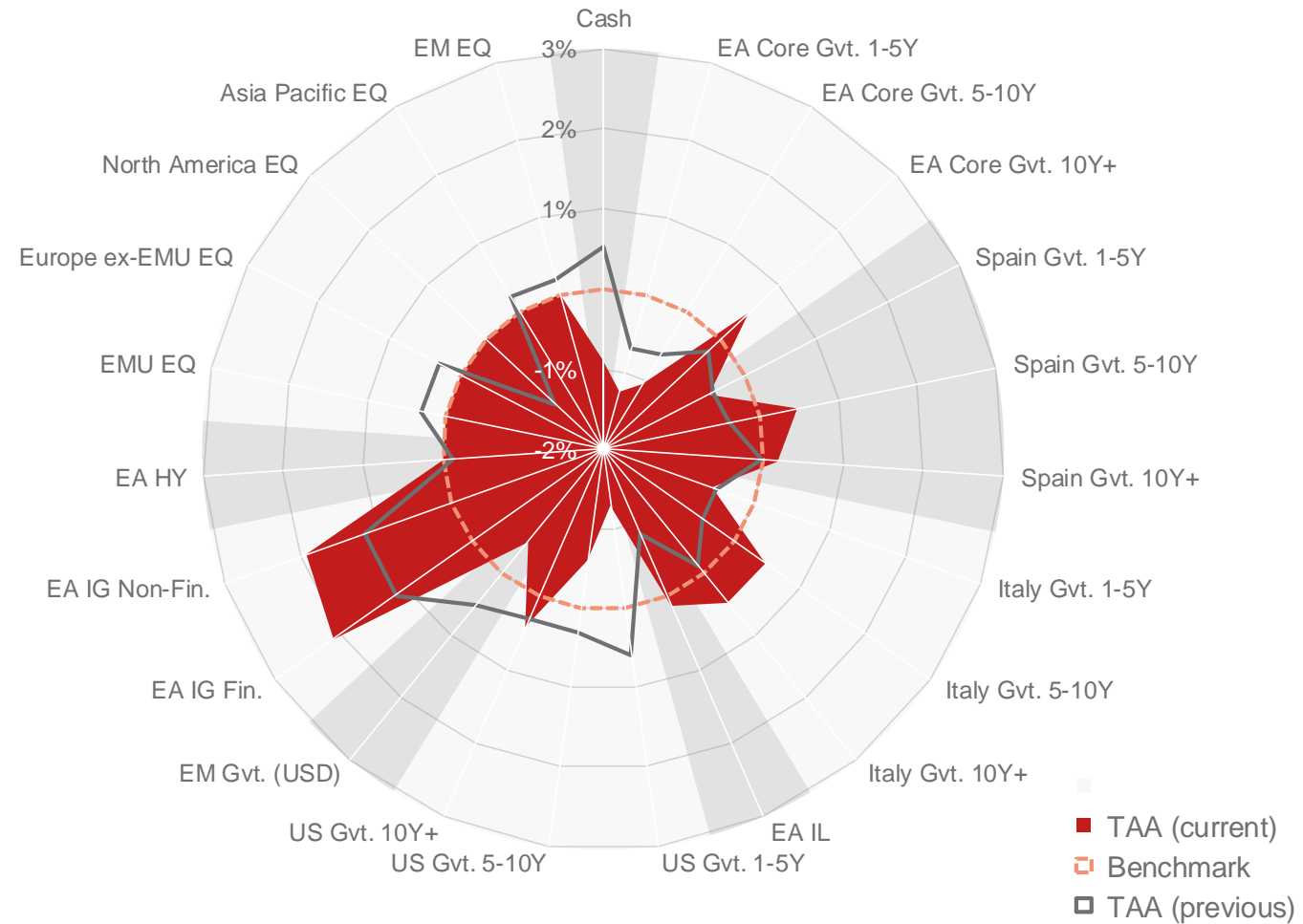
12M Total Return Forecasts hedged into EUR



Source: Datastream, GenAM calculations; cut-off: 05.03.24; figures in brackets denote total return ranks on a 3M view

Asset allocation recommendation

Balanced MtM-Portfolio (active positions)



Source: GenAM

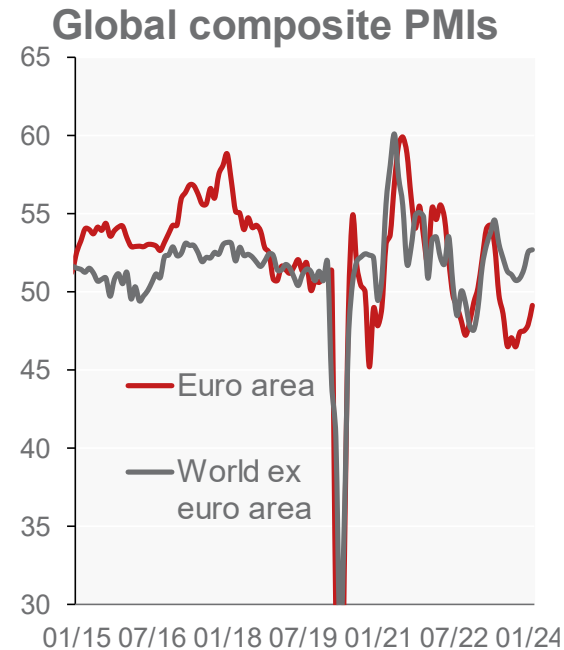
Topics

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1. Investment Strategy New Normal or New bubble?	<u>4</u>
<i>Financial market forecasts, return exp. and tactical allocation</i>	<u>28</u>
2. Global Macro : Green shoots	<u>33</u>
<i>Macro forecast tables</i>	<u>51</u>
3. Asset class views	
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b. Credit: Expensive but for good reasons	<u>58</u>
c. EM Sovereign Bonds: At the Crossroads	<u>65</u>
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Global macro: Green shoots

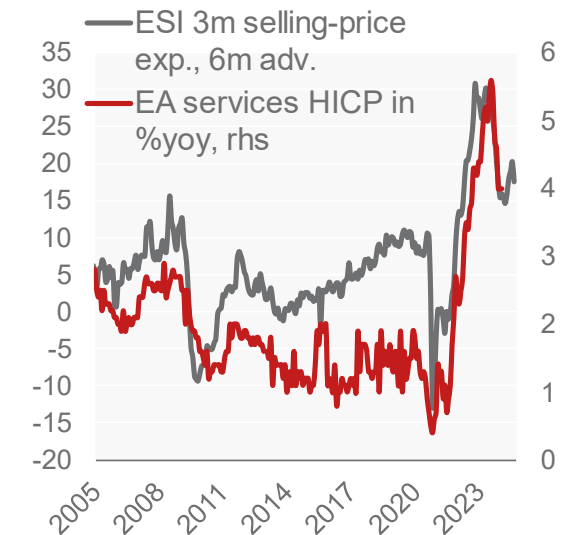
Inflation will continue to ease, but more sluggishly than over the past year

- Global green shoots are mounting as real disposable income is underpinned by solid wage growth & easing inflation while the inventory cycle is bottoming and the headwinds from drastic rate hikes in 2022/23 are fading.
- These drivers will largely **offset the drag on consumption** from depleted excess savings in the US. We now expect a **soft landing of the US economy** with growth falling only mildly below potential over the summer.
- After a year of stagnation, the **euro area will gradually return to expansion into the spring**, underpinned by rising real disposable income and the prospective rate cuts. The needed fiscal consolidation, however (EU rules start applying again), remains a headwind.
- **Inflation is set to ease further**. But the pace of disinflation is slowing as the support from base effects, lower energy prices and eased supply chains are fading while strong wage growth and pent-up demand keeps underpinning **price pressures notably in the services sector**.
- We anticipate a **lukewarm recovery in China** helped by further policy stimulus. Yet the continuing trouble in the property sector will make GDP growth struggling to reach the 5% target just announced by China's National People Congress, while inflation will remain very low.
- **Central banks are preparing the ground for rate cuts**. But they will resist calls for quick moves and await more reliable evidence of sustained disinflation, notably in services. We now expect **the Fed to pivot in June** (from May before) with **cumulative 75bp cuts** by year-end 2024 (close to market-implied). Given continued economic resilience, we see the **risks tilted towards later and slower cuts**.
- We continue expect the **ECB to start cutting in June** (i.e. one week ahead of the Fed), as the ECB awaits more Q2 data on wage agreements. We anticipate a total of 100bp of cuts this year to 3.0% (dep. rate) – slightly more than market-implied (85bp). We **anticipate the BoJ to scrap its YCC and NIRP by April** (possibly already in March) but aa more gradual pace of policy normalisation than currently priced by markets thereafter.



Source: Datastream, GenAM

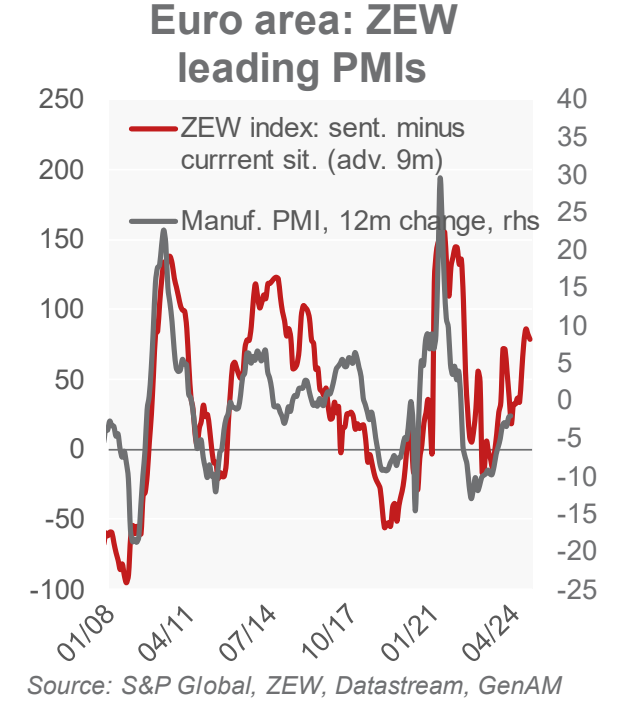
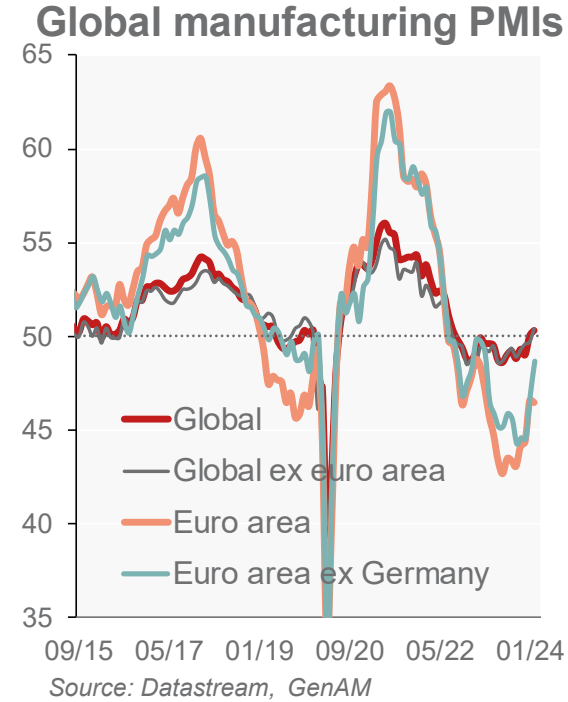
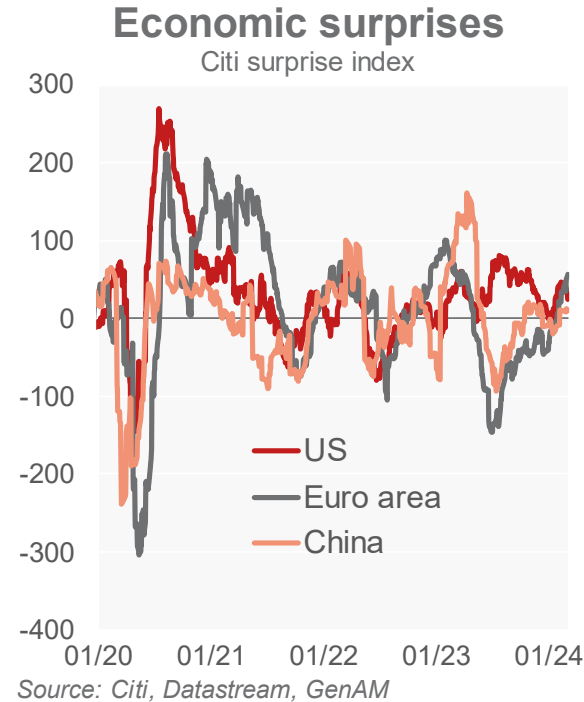
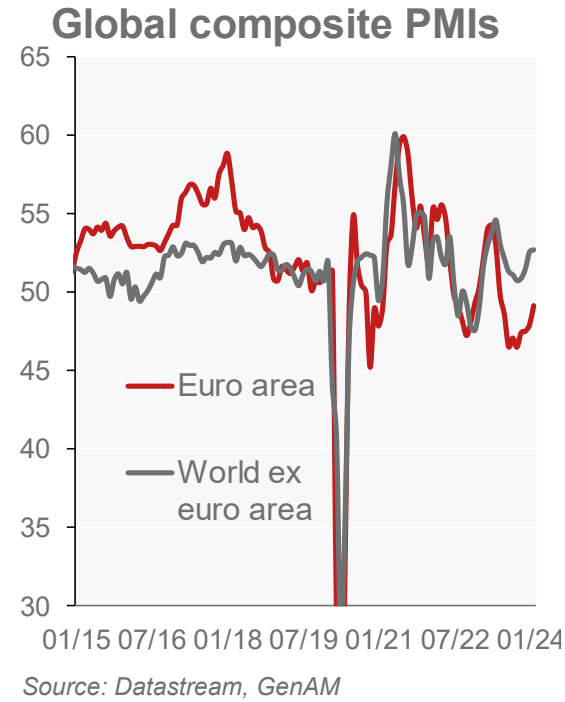
A challenging last mile for services prices



Source: Datastream, GenAM

Global economy: green shoots

Inventory cycle has turned, trade is bottoming, drag from monetary tightening eases

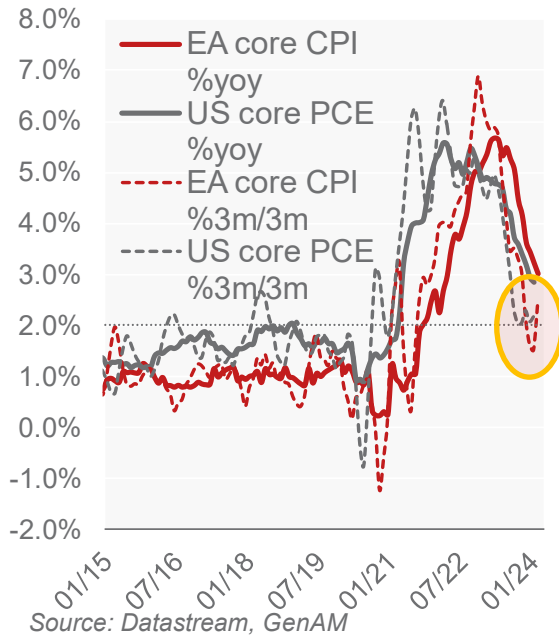


- Tentative green shoots are mounting as **receding inflation underpins real incomes** and the **drag from global monetary tightening is easing**.
- The **inventory cycle is recovering**. Bellwether Korean exports are expanding even if PMI exp. orders are lagging (muted contraction but improving).
- We now expect the **US to be headed for a soft landing**. The euro area remains the global growth laggard, dragged by the ailing German economy. But even here signs of a **recovery into spring** are mounting.

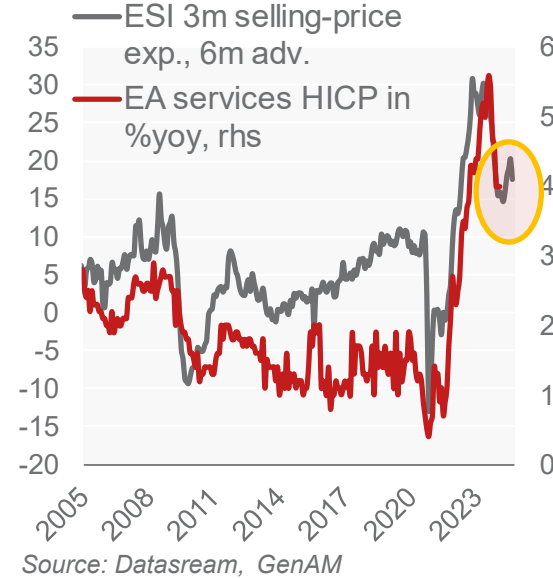
Disinflation progressing, but last mile warrants caution

Amid sticky inflation in services central banks still wary of declaring victory over inflation

Descending core inflation



A challenging last mile for services prices

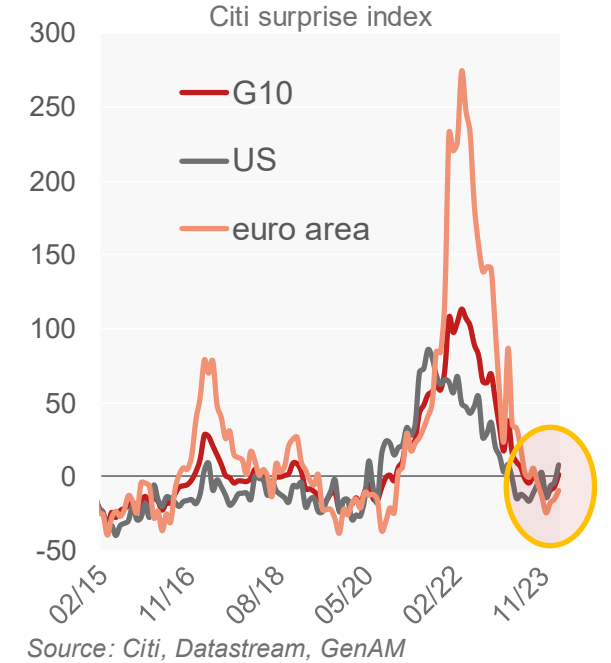


Wage growth US vs. Euro area

in %yoy



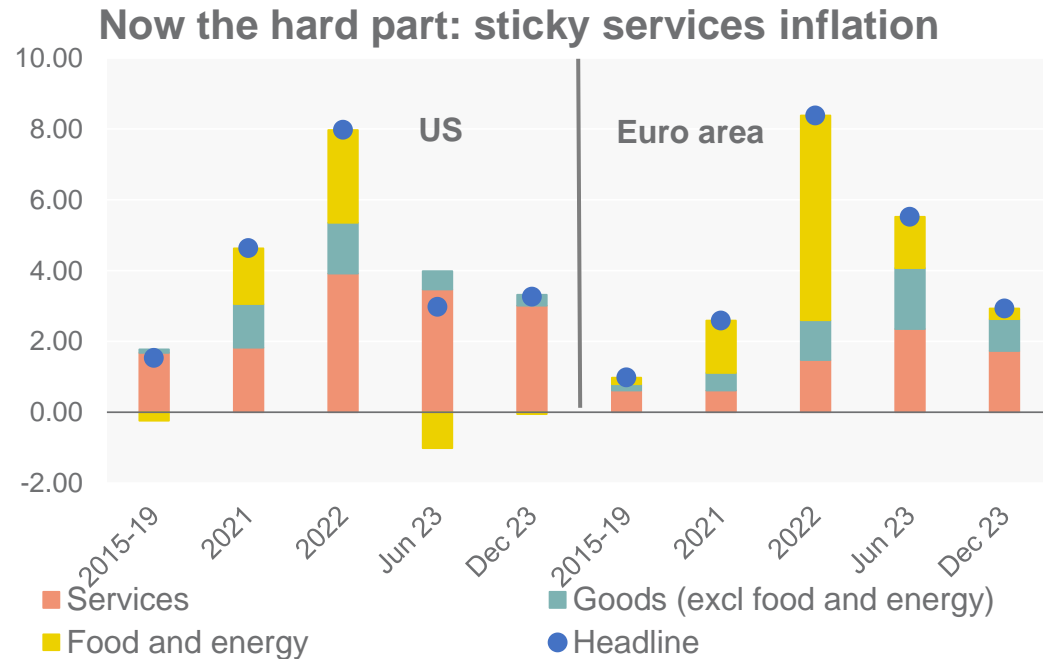
Inflation surprises



- **Disinflation continues to progress** in most major economies: **3m/3m ann. core rates have fallen within 2% target**,
- **Risks still looming around the last mile:** yoy CPI continues to ease, but quarterly rates have re-accelerated. EA selling price exp. in services a warning sign. Resilient labour markets will keep wage moderation muted. Bottoming EA activity may strengthen firms' pricing power. Inflation surprises recently rising.
- Mind the **transatlantic productivity gap**: US +2.7yoy (Q4), EA -1.3%yoy (Q3) – sending ULC in opposed directions (US 2.25% trending lower, EA +6.7%, rising) → US wage gains backed by higher productivity (= less output price pressures), but not so in the euro area.
- **Trade disruptions in the Red Sea** and uncertainties about Hamas/Israel war still bear risks for the global disinflation process.

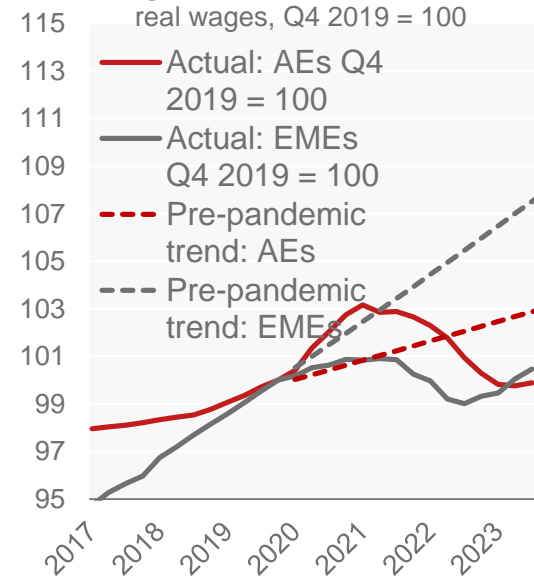
Now the hard part of disinflation

Services inflation to give in much more reluctantly



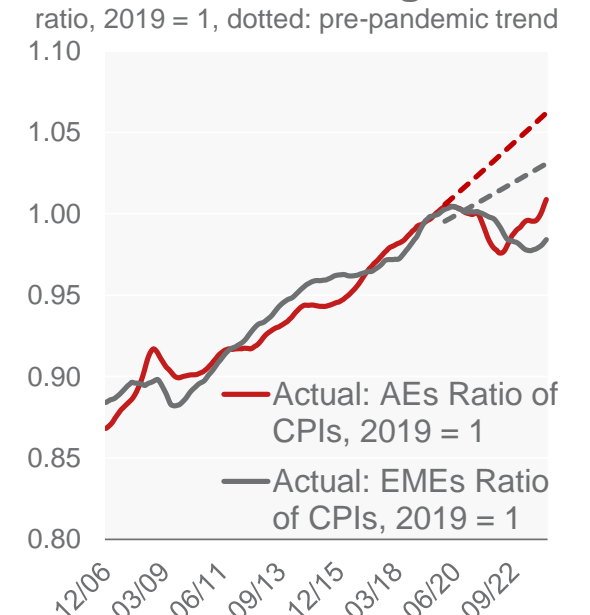
Source: BIS, GenAM

Real wages still below pre-pandemic trend



Source: BIS, GenAM

CPI services vs. goods

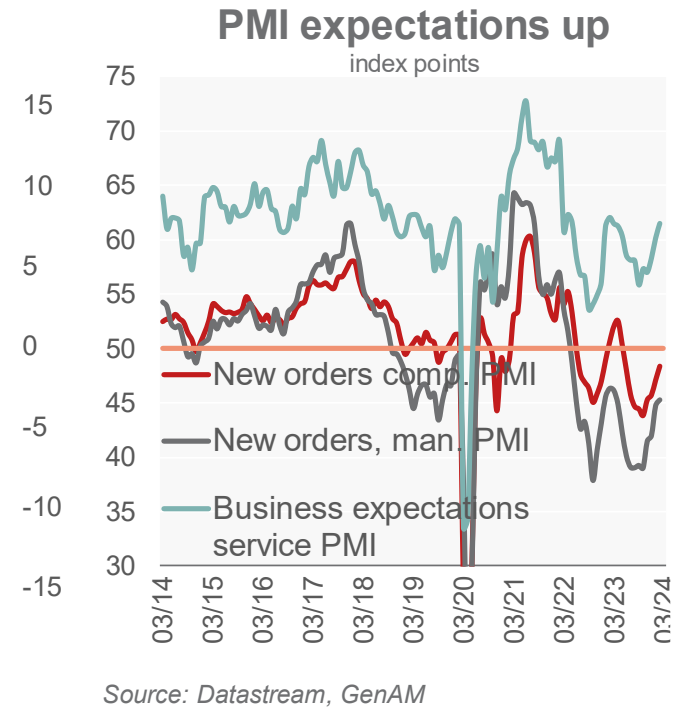
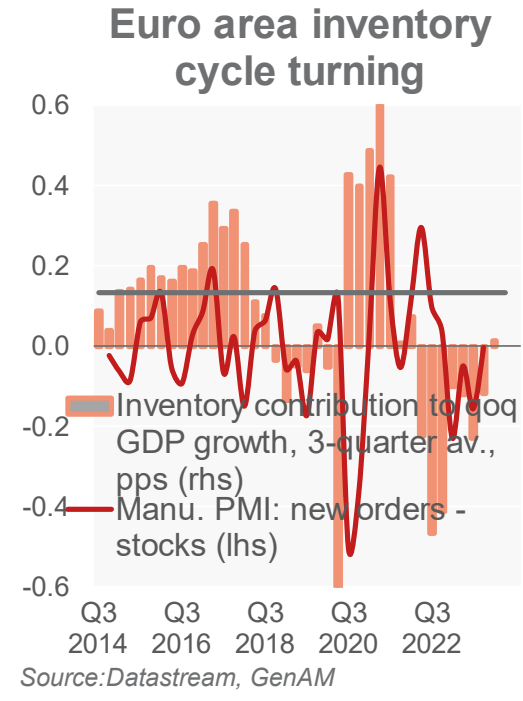
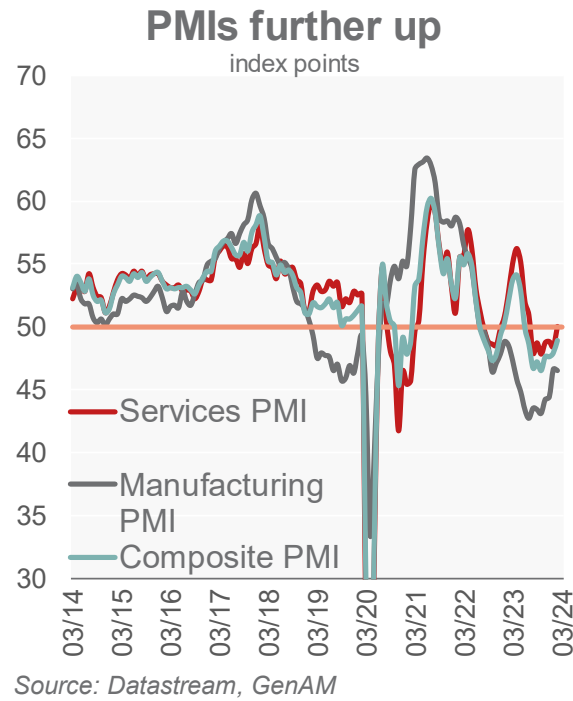
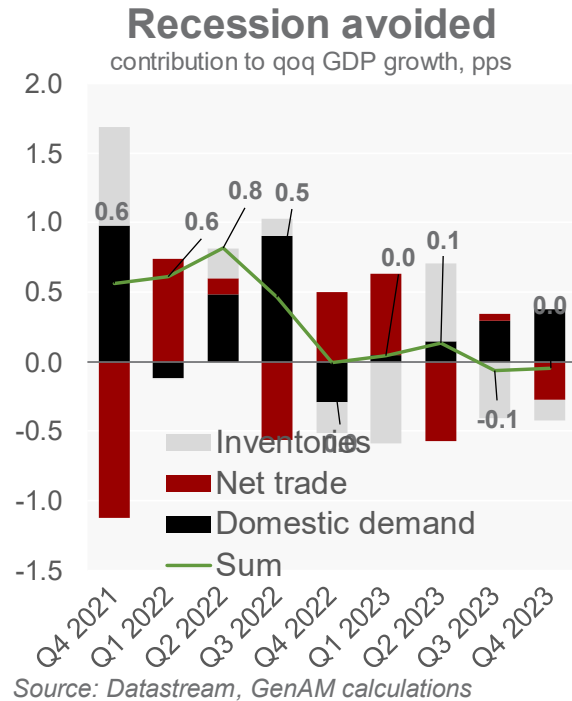


Source: BIS, GenAM

- Central banks have brought down inflation by more than 2/3 from the 2022 peak. **Eased bottlenecks in manufacturing** (as the pandemic boost faded) and **retreating energy prices** have been the **low-hanging fruits of disinflation**.
- Yet as flagged in a [BIS study](#), **services inflation may prove especially stubborn this time**:
 - **Housing costs** may ease only sluggishly as house prices soared over the pandemic
 - Tight labour markets keep wage pressure high; **real wages may catch up further to the pre-pandemic trend**; labour shortage a prod. constraint for 20% of EU firms (almost 3x pre-pandemic avg.)
 - Pandemic demand distortions have depressed the rel. prices of services vs. goods, leaving **upside risks to services prices**

Euro area: A cumbersome return to expansion

A turn in the inventory cycle positive but first hard data for Q1 suggest only meagre growth short-term



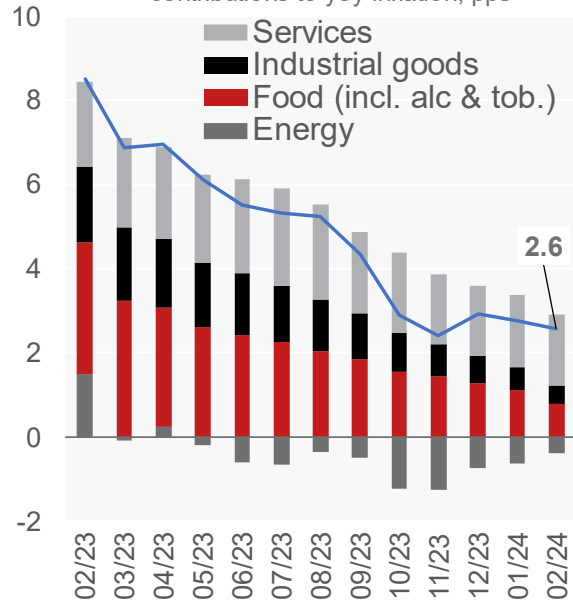
- The **Q4/2023** GDP breakdown shows that **stagnating exports**, **weak private consumption** (+0.1%qoq) and **de-stocking** (-0.3% contr.) kept activity down.
- Consumer confidence rises and the labour market stays strong (e.g., UR at low of 6.4% in Jan) but weak Jan. RS (+0.1% mom) suggest still spending reluctance.
- Exports likely improve on the back of higher orders but likely to stay subdued but the **inventory cycle is turning**.
- All in all, we look **for meagre growth in Q1/24** but see an **acceleration over the course of the year**, falling inflation being a major driver.
- We stick to our **2024 growth forecast to 0.6%**, vs. consensus of 0.5%, and see the **risks balanced**.

Euro area: Disinflation to continue but services inflation still sticky

Stubbornly high services inflation fuelled by wage growth

EA inflation

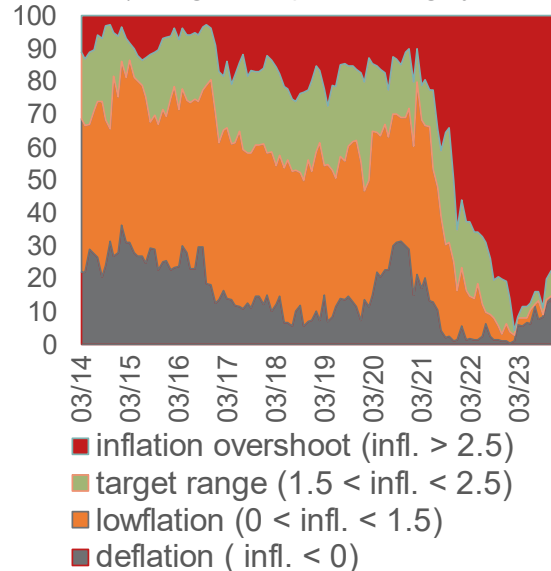
contributions to yoy inflation, pps



Source: Datastream, GenAM calculations

Inflation broadness

weighted sum of % yoy inflation (HICP - 3) falling into respective category, %



Source: Datastream, GenAM calculations

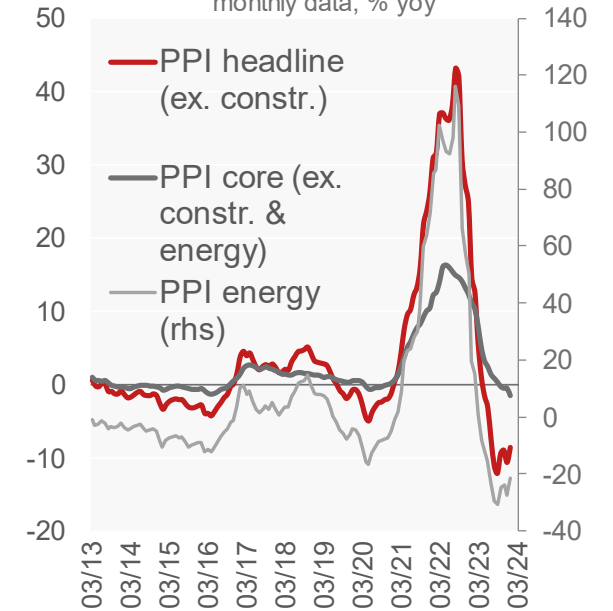
Wage growth sustains high services inflation



Source: Datastream, GenAM calculations

Producer prices

monthly data, % yoy



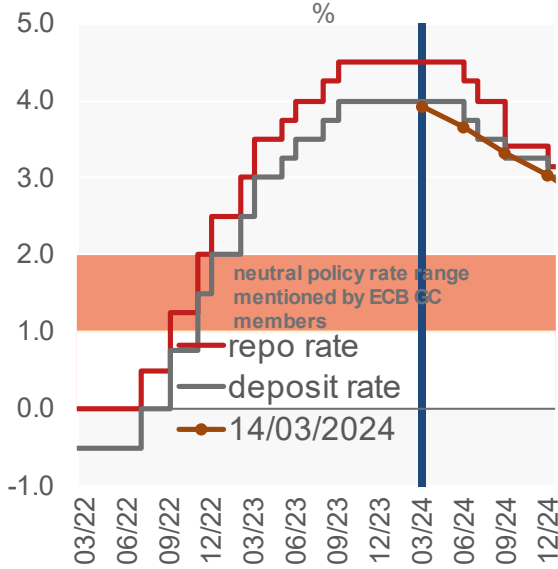
Source: Datastream, GenAM

- **February inflation receded** to 2.6% yoy (-0.2 pp), **core** (ex-energy & food) 3.1% yoy (-0.2 pp). The former was less than expected.
- Key reasons was services inflation stayed with 3.9% yoy high (after 4.0% yoy for 4M before). It is closely linked to wage growth which is set to stay strong.
- That said, we see ongoing signs of **fading underlying price pressure**: The ECB's proprietary core inflation metrics are trending down, core PPI inflation is negative (-1.5% yoy 01/24) and import prices recede too (-2.5% yoy in 12/23). The share of items with inflation > 2.5% yoy fell to 71% in Jan, from a 96% peak in 02/23.
- All in all, we **stick to our 2024 forecast to 2.4%**, slightly above the consensus of 2.2%. We see the risk that high services inflation prevents headline inflation from moving closer to the 2% threshold in the second half of the year.

ECB: A first rate cut in June

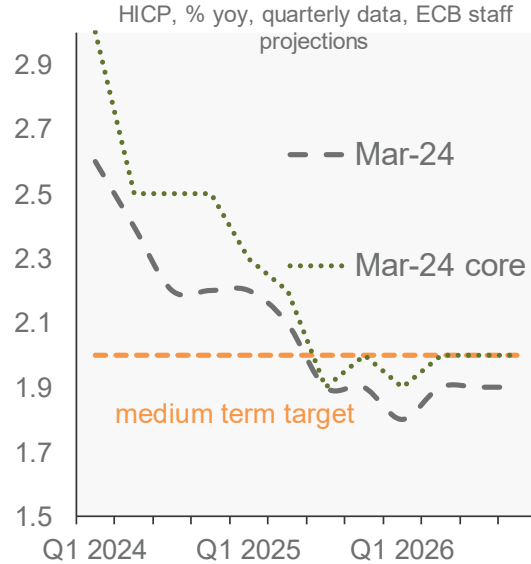
Following hawkish repricing, market expectations now more aligned with ours (25bp cut in June, total -100 bps in 2024)

Markets now in line with our ECB view



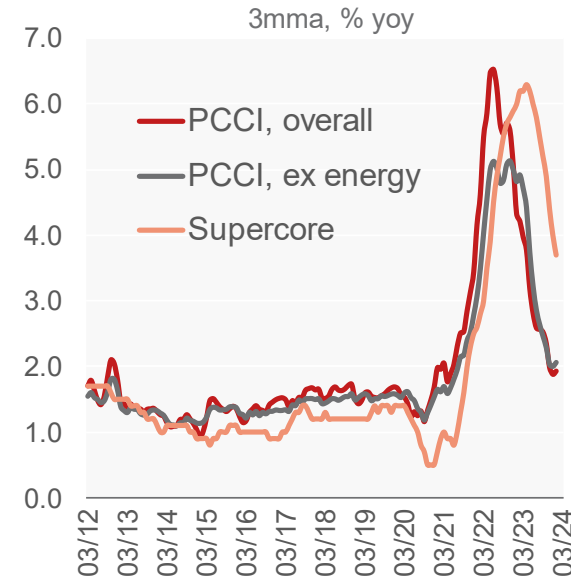
Source: Datastream, ECB, GenAM calculations

Inflation target in sight



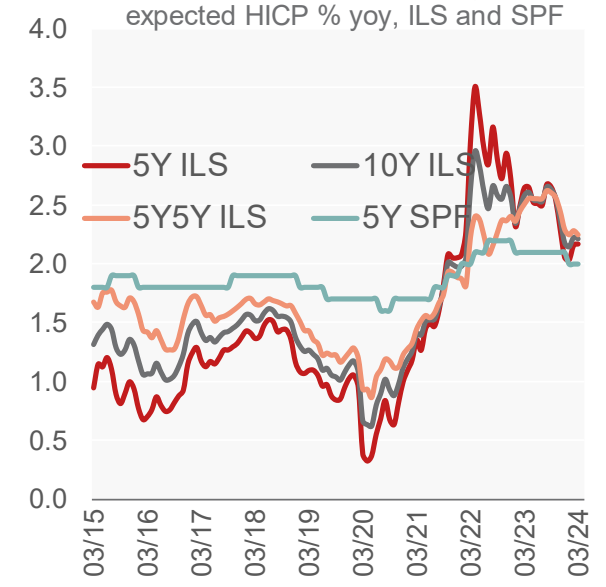
Source: Datastream, ECB, GenAM calculations

ECB's underlying inflation metrics down



Source: Datastream, ECB

Inflation expectations improved strongly



Source: Datastream, ECB, GenAM calculations

- At the March 7 meeting the GC noted that “**inflation has declined further**”. In the updated projections the expected inflation path has shifted down and annual headline as well as core inflation are now expected to be in line with target by 2026 while **high domestic price pressure** “*in part owing to strong growth in wages*” persists.
- The GC’s confidence in the decline of inflation increased but it is not yet sufficiently high to act. Rate cuts were not discussed while awaiting pivotal wage data over the second quarter.
- We continue to look for a first rate cut by June** (-25 bps) and look for cumulatively 100 bps cuts in 2024. **Markets** have priced out aggressive cutting and **expectations are now more in line with ours** (market even more hawkish now, at -85bp over 2024).

ECB: New operational monetary policy framework

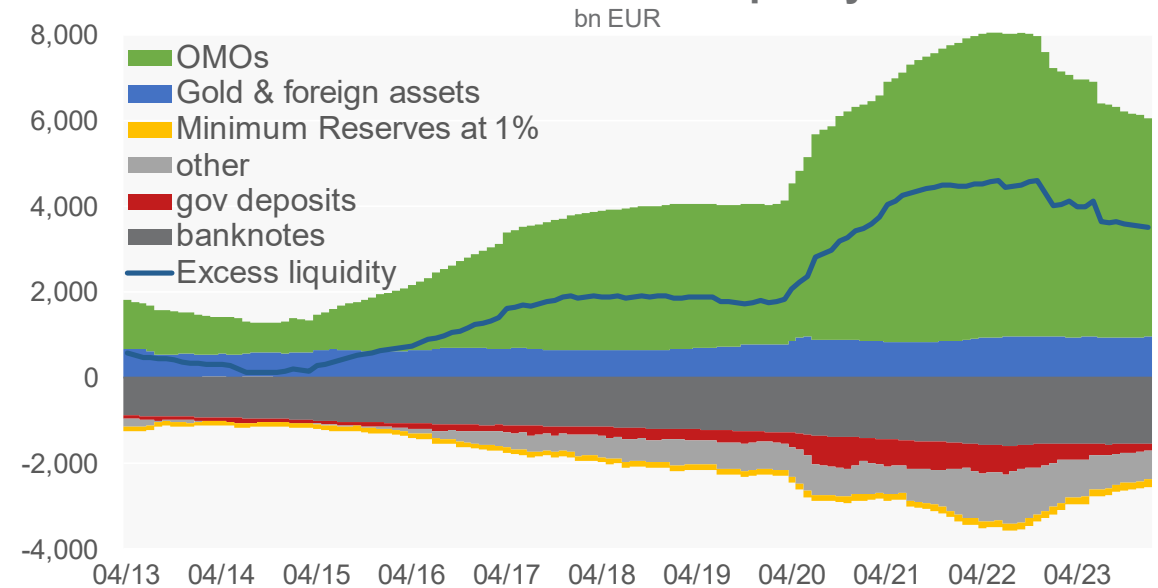
Deposit rate steers monetary policy, APP/PEPP will run off, liquidity through structural credit operation and a bond portfolio

Changes in the ECB's operational monetary policy framework

Item	Operational monetary policy framework from 18 September 2024 onwards
Policy rate	Deposit facility rate (DFR) main tool to steer monetary policy. Spread to MRO reduced to 15 bps (from 25 bps now) while spread to MLF will remain unchanged at 25 bps.
Liquidity provision	Maintaining short-term credit operations (e.g. MROs) and 3M LTROs and at a later stage adding structural longer term credit operations and a structural portfolio of securities
Tenders	3M LTROs will be conducted through fixed-rate tender procedures with full allotment
APP/PEPP	GC expects APP/PEPP to continue to run off
Reserves	The minimum reserve requirement ratio (RRR) stays at 1%
Next overhaul	GC will review the key parameters of the operational framework in 2026 and stands ready to adjust the design and parameters of the framework earlier, if necessary

source: ECB, GenAM

Drivers of excess liquidity

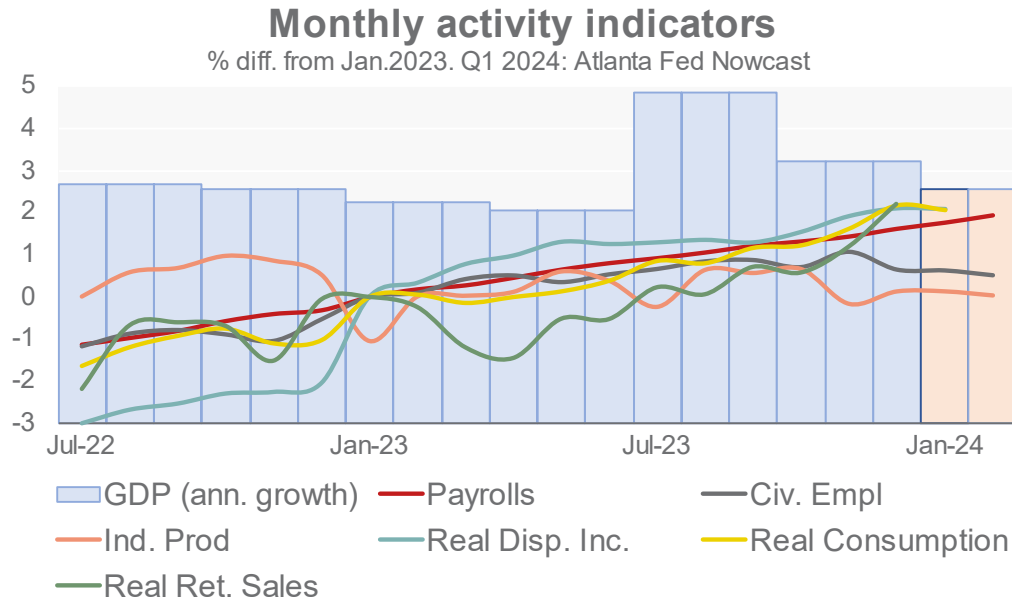


Source: Datastream, ECB, GenAM

- The GC presented its new operational policy framework on March 13 (see table). There will be **less ESTR volatility** as the DFR/MRO spread is reduced to 15 bps. **RRR unchanged at 1%** positive for banks.
- **Open issues** that could impact markets:
 - **Size of new credit and bond portfolio.** Studies suggest that excess liquidity of EUR 1 to 1.5 tr is needed to fix money market rate at DFR.
 - Bond portfolio: likely shorter maturities than APP/PEPP. Any kind of key for sovereign bonds, a mix or focus on core govies?
 - Credit operations to become green?

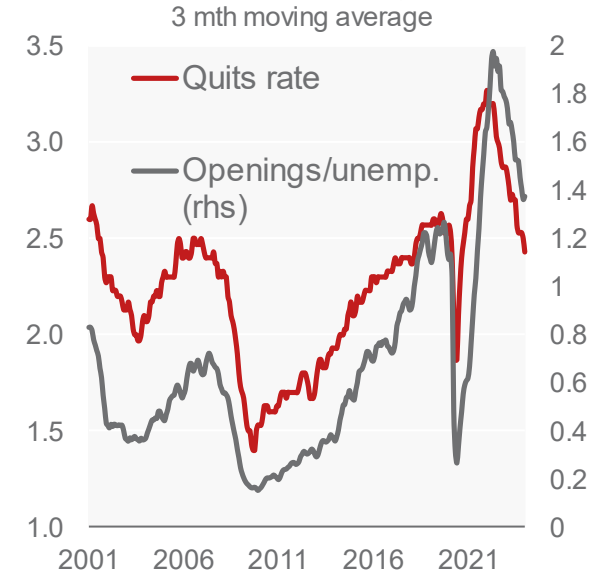
US: A very soft landing

Strong carryover boost 2024 growth to 2.5%. The labour market continues to cool.



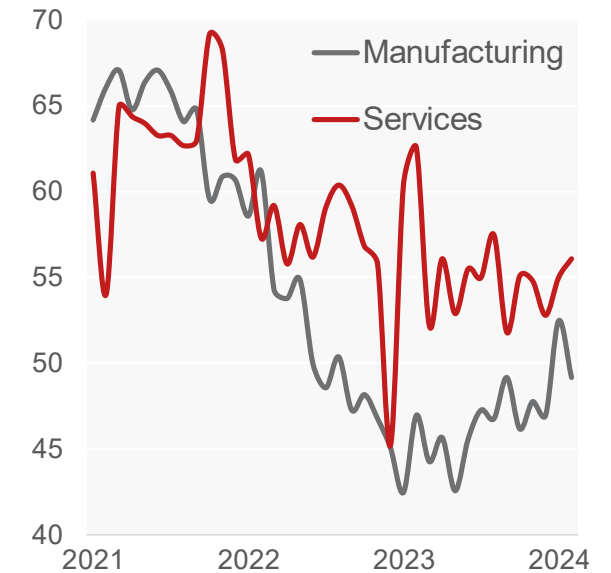
Source: BLS, BEA, Fed, Refinitiv, GenAM

Labour market tightness



Source: BLS, Refinitiv, GenAM

ISM-New Orders



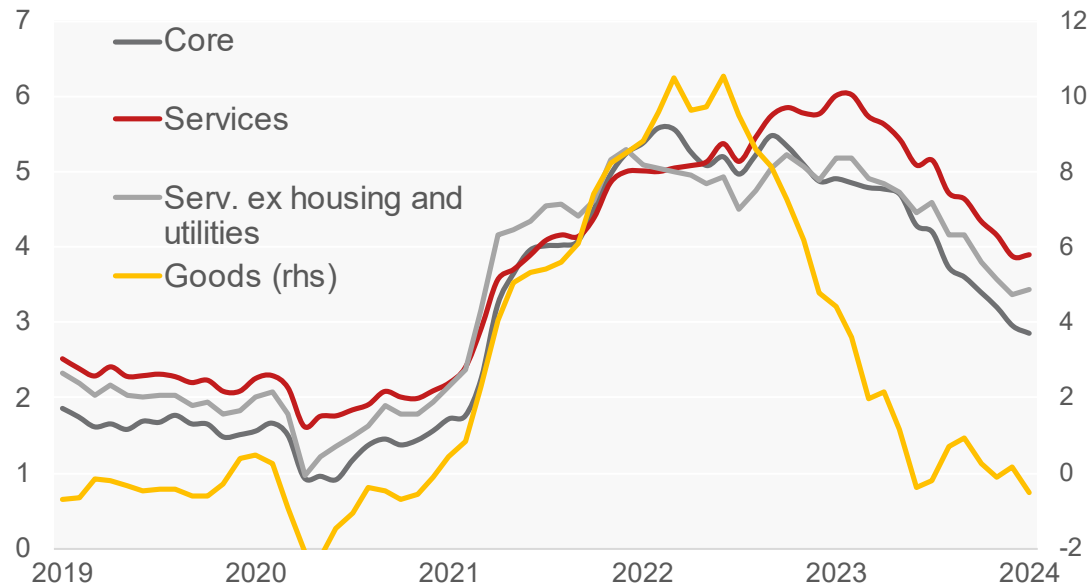
Source: ISM, Refinitiv, GenAM

- January consumption data were weaker, but bad weather played an important role. **Consumer sentiment improved markedly.**
- The forward-looking components of ISM point to **renewed strength in services**. The Beige Book points to a **slight increase in economic activity** and moderating wage pressures.
- The labour market continues to cool, as non-cyclical sectors increasingly drive job creations. **Labour market tightness is back to around the pre-pandemic peak**, this should contribute to further moderation in wage growth.
- Nowcasts point to 2.4% annualised Q1 growth. **We expect GDP to expand by 2.5% this year**, but with a strong (1.3 pp) carryover from 2023.

US disinflation: now for the hard part

Rising house prices may dampen rent disinflation later this year

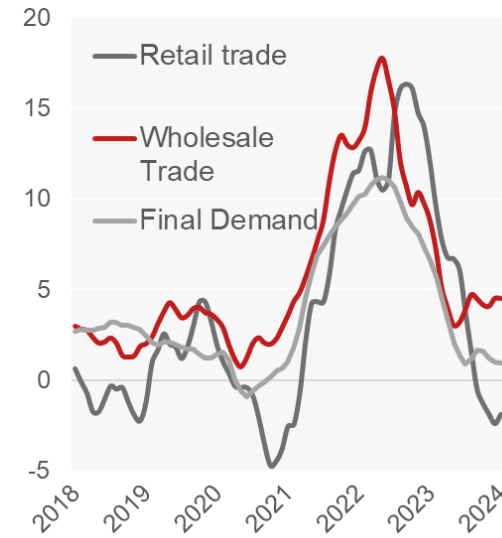
PCE yoy inflation



Source: BEA, Refinitiv, GenAM

Production prices

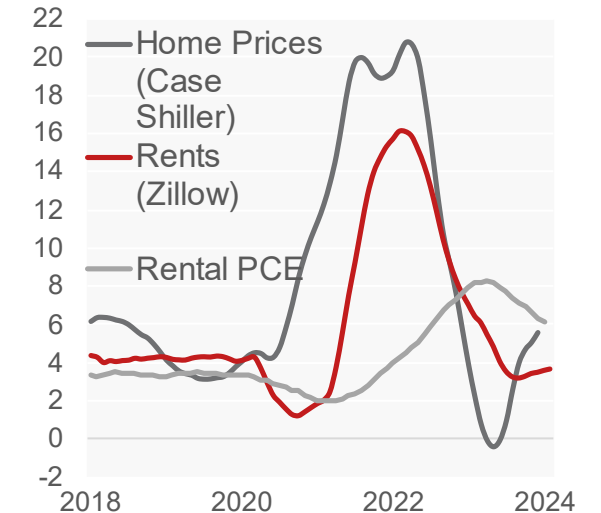
% chg. y/y - Trade PPIs are a proxy for margins



Source: BLS, Refinitiv, GenAM

Home prices and Rents

% chg. y/y



Source: S&P, BEA, Zillow, Refinitiv, GenAM

- The first data for 2024 show some air pockets in the disinflation trend. Most of the volatility is due to specific components (OER in CPI, second hand cars), but illustrate that a **smooth downward path cannot be taken for granted**.
- Goods are no longer likely to provide much of downward pressure. **The bulk of disinflation will not have to come from labour intensive services**. Falling margins and the productivity driven moderation in ULC is welcome, but risks remain tilted towards even more sluggish disinflation.
- We have revised slightly up our inflation forecast, and see core PCE ending the year at 2.3%, upside risks remain significant. Later, **disinflation may be at risk from the rebound in house prices**, which tend to translate into rents with a 3-4 quarter lag.

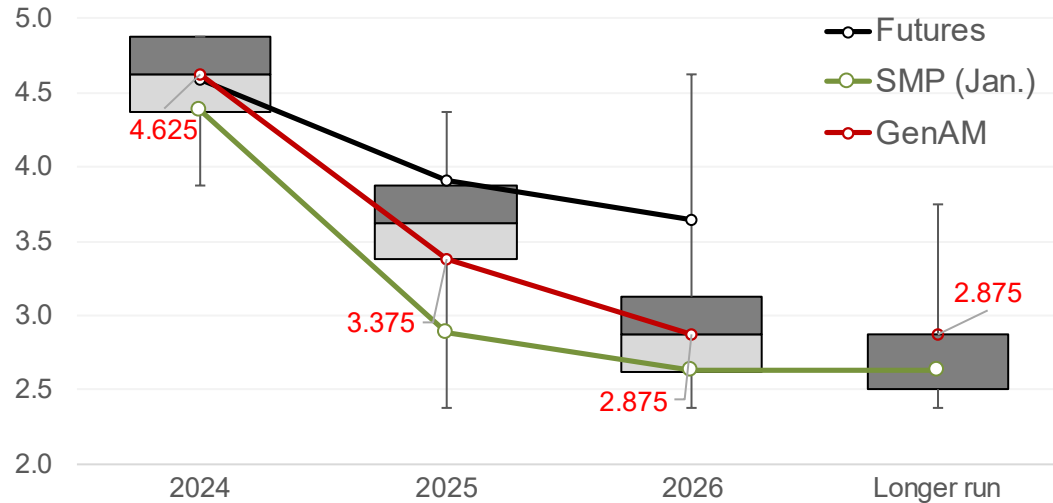
Fed: determined but not rushed to cut. QT runoff expected for the summer

We see 75 bps easing from June, but later and less pronounced easing is a possibility

FOMC "dots" and Fed fund rates forecasts

Middle of the range.

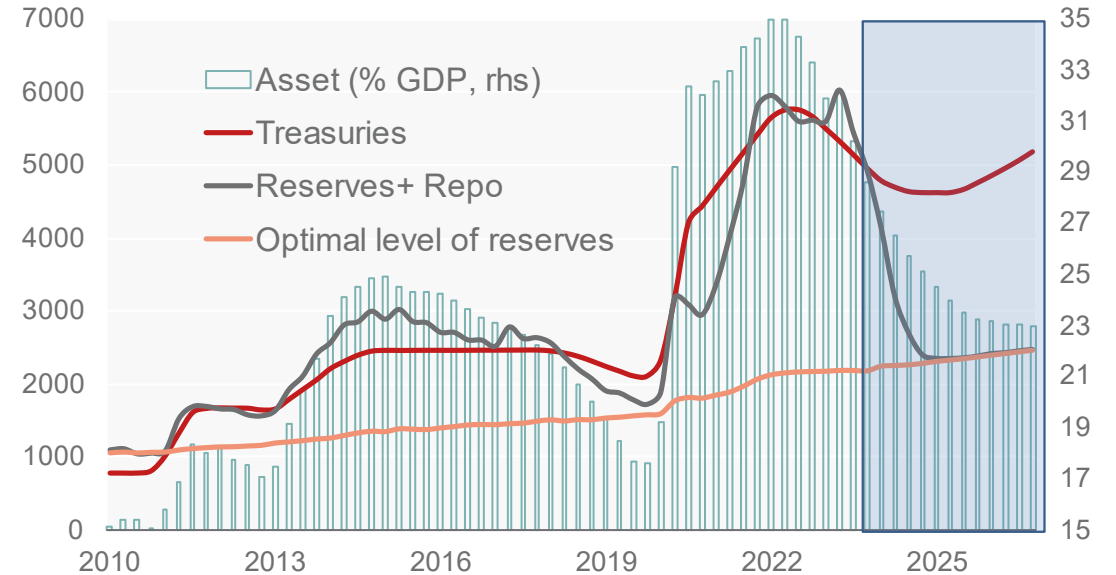
Year-end, median, quartiles and extremes of the distribution



Source: Federal Reserve Board, Datastream, GenAM estimates

Fed balance sheet

US\$ bn



Source: Federal Reserve Board, GenAM

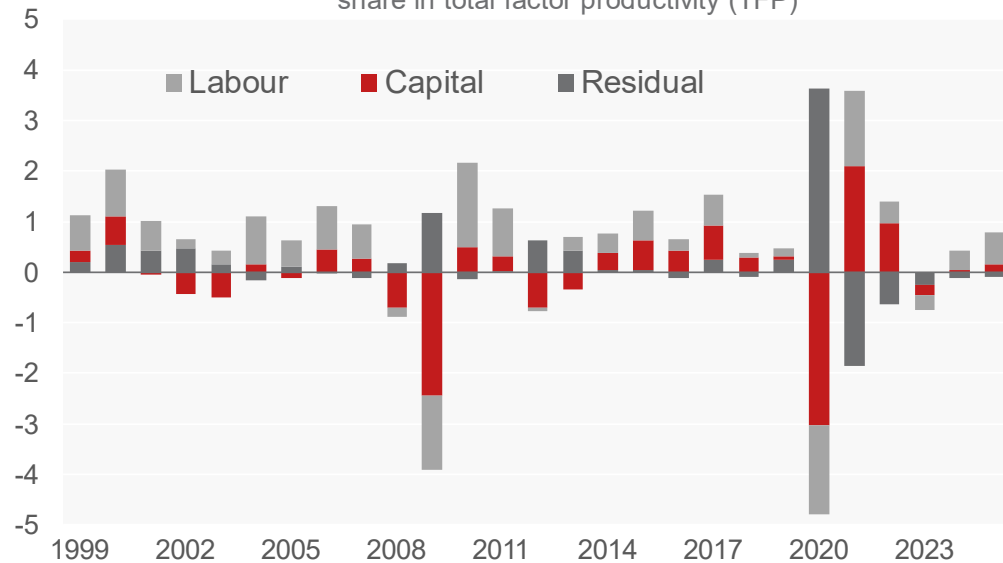
- Speaking before the Congress, Chair Powell stated that real rates are high and reaffirmed the **Fed's intention to cut rates in 2024**. but also underlined that the FOMC will keep a cautious approach. Therefore, **our projection of a 75 bps cut this year, starting in June, is subjected to substantial upward risk.**
- The March meeting's projections should see a mark to market upward revision of growth and some concern about stickier than expected inflation. Some guidance on QT is also likely: **the balance sheet run-off should slow down during the summer and end at the beginning of next year.**
- The resilience of the economy to high borrowing costs and the prospects of higher fiscal deficit have reignited the debate on the level of the neutral rate. **The FOMC median projection is 2.5%, which appears low, but raising it will not be easy politically.**

Productivity: Muted near-term outlook for EA but some recovery thereafter

Longer-term uncertainty from effect of AI and aging populations

EA factor productivity breakdown

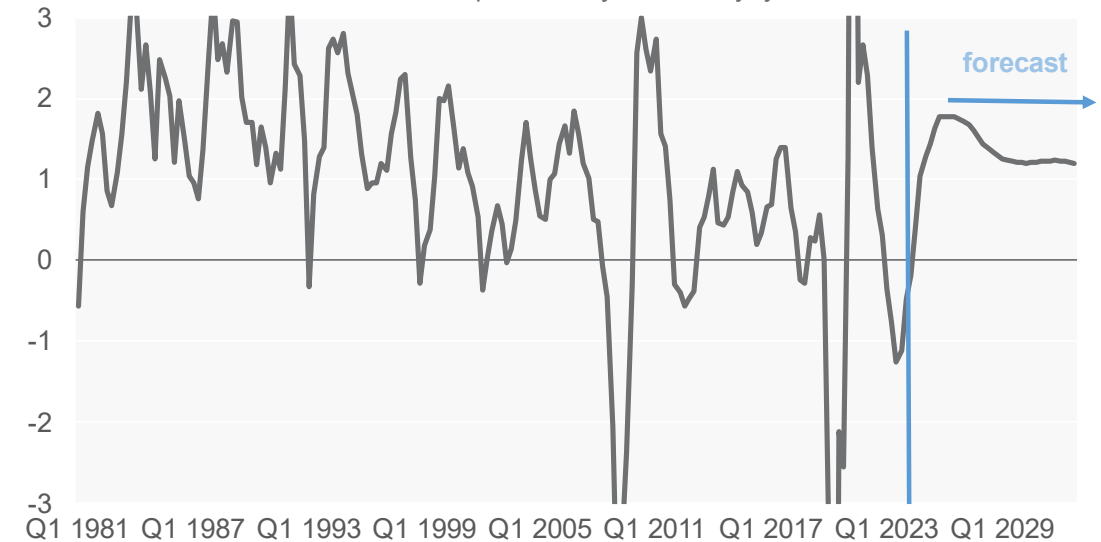
share in total factor productivity (TFP)



Source: Datastream, EC

Euro area productivity

productivity trend, % yoy



Source: Datastream, Oxford Economics

- EA growth has been trending over past decades. This is partly due to slower **productivity growth trending down** since the 1980s.
- The current economic weakness amid labour hoarding drags on the short-term productivity outlook. **We expect labour productivity to recover gradually from the second part of this year and to grow in 2025 broadly in line with the pre-Covid average.**
- Further out, **demographics will be a drag** in the decades ahead while **AI and fostered automatization could work in the opposite direction.** But history shows that gains from new technologies come many years after the technology was first invented, due to lags such as slow diffusion into the capital stock.

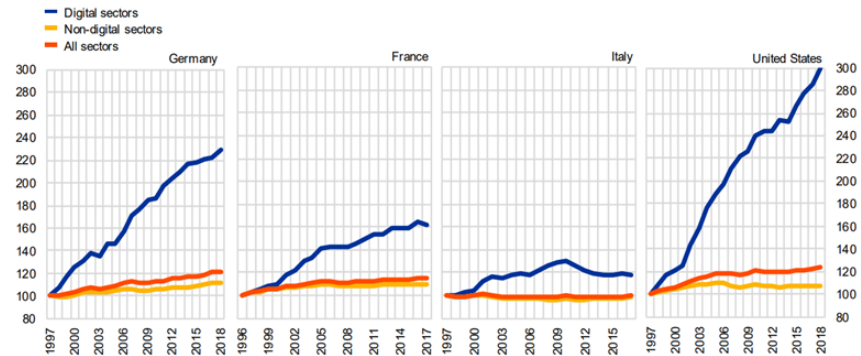
Productivity: Diffusion of ICT (Information & Communication Tech) key for the euro area

EA considerably lagging the US on digitalisation

Chart A

Total factor productivity between 1997 and 2018*

(1997=100, log scale)



Sources: EU KLEMS, European Commission and Bundesbank calculations.

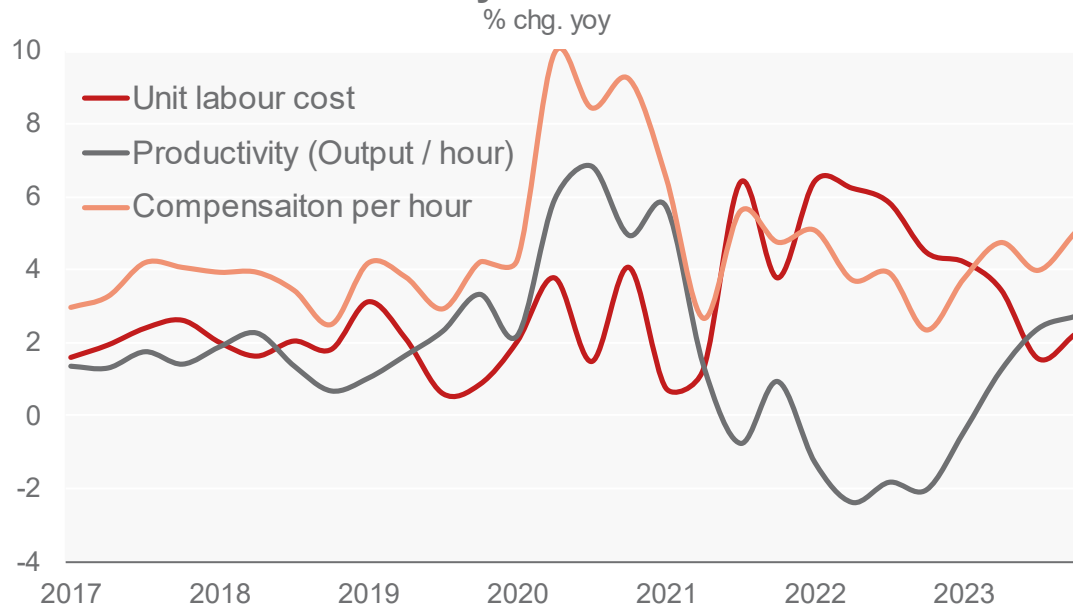
Notes: * Calculated using a prototypical Solow decomposition and an econometric model to adjust for changes in the degree of capacity utilisation. 1 NACE divisions C26-C27 (manufacture of computer, electronic and optical products as well as electrical equipment) and NACE section J (information and communication). 2 NACE sections D, E, F, G, H, I, K, M, N, R-S and NACE section C (excluding divisions C26-C27 and C19). 3 Digital and non-digital sectors. 4 Series for Italy end in 2017.

- In a recent ECB [study](#) key reasons for the **lagging** EA productivity growth were provided:
 - About **80% of patents concerns the non-ICT** sector vs 70% in the US
 - **Digital gap between SMEs and large firms** regarding use of advanced digital technologies (around 60% of SMEs compared with around 80% of large firms).
 - **Higher investment needs**: A 1 pp increase in digital investment is associated with an acceleration in the average firm's TFP growth by roughly 0.02 pp.
 - A **lack of strong institutions and governance structures** may help to explain why digital diffusion is proceeding slower than expected, why it is slower in some countries than others and why the expected productivity benefits from digitalisation have yet to be fully achieved.
- **If productivity growth were to rise** along with digitalisation in the coming years, **it would raise the natural rate of interest** and give monetary policy more room for manoeuvre.

Productivity: Improvement in US mostly cyclical thus far

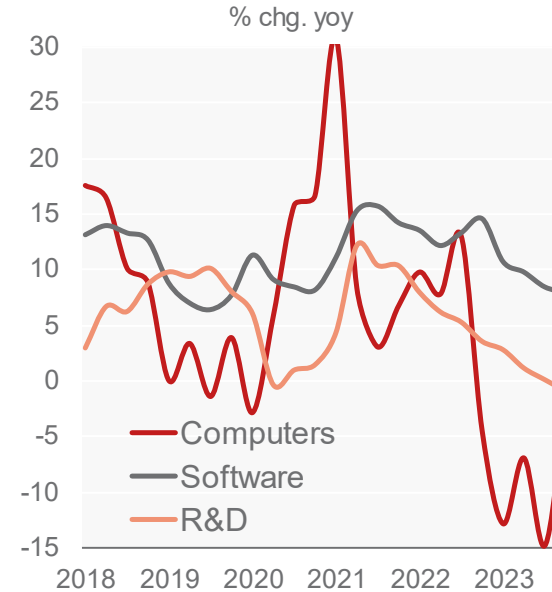
Tighter labour market and past investment boosted productivity. AI-related boom not expected soon

Productivity and labour costs



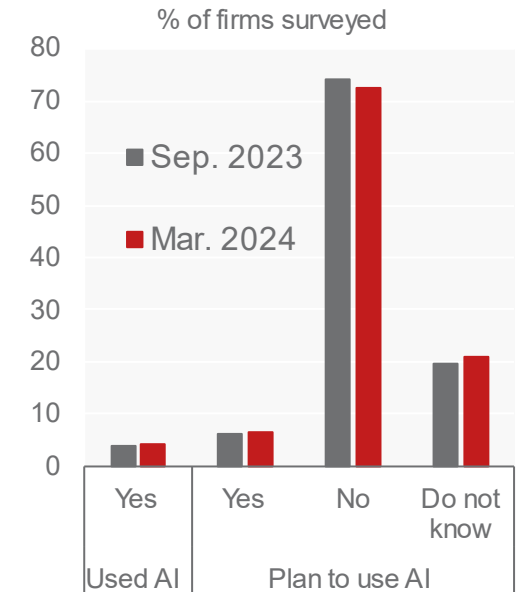
Source: BLS, GenAM

Business investment



Source: BEA, GenAM

AI diffusion



Source: Census Bureau, GenAM

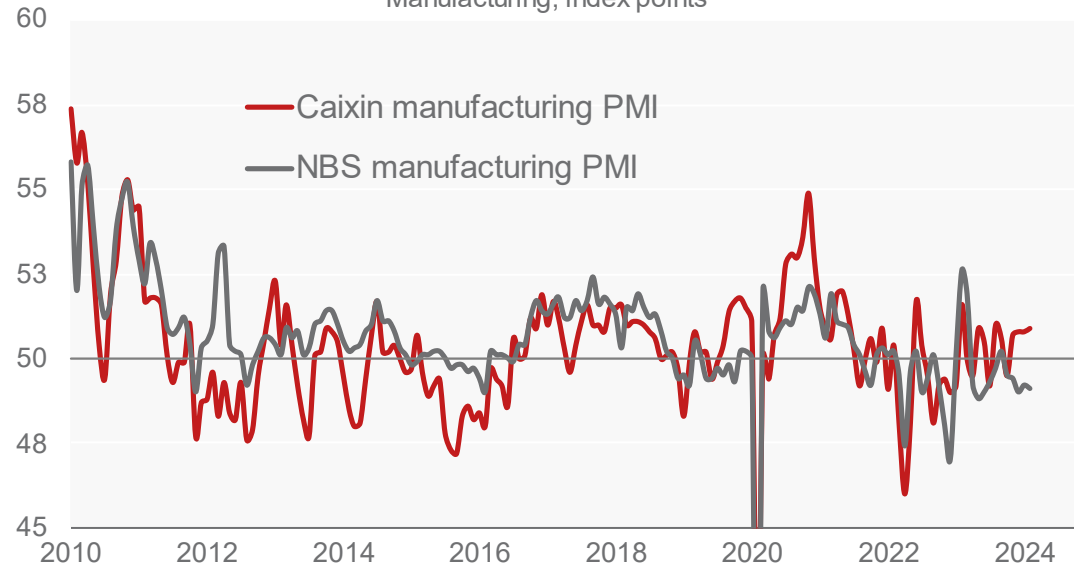
- **Solid wage growth has been compensated by a productivity surge over the past three quarters; this brought ULC growth back within the long-term range.** The move up seems to be related to the ongoing readjustment of the economy. The rebalancing of job creation towards more productive sectors, strong wages spurring firms to innovate, and past investment related to Working From Home.
- **AI has not played a big role yet:** diffusion remains limited, and the pandemic-related IT investment surge has not continued. Short-term prospects for AI adoption do not necessarily look bright (top-right chart).

China: NPC meeting without surprises

Lack of concrete measures for supporting the real state sector and private consumption, but slightly better fiscal impulse

China Purchasing Manager Indices

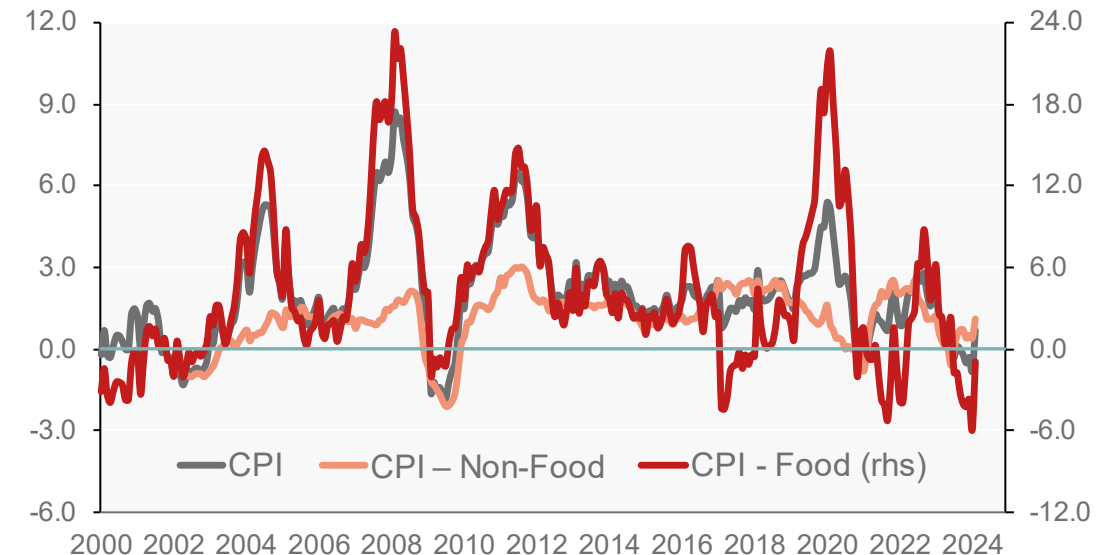
Manufacturing, index points



Source: Markit, Datastream, GenAM

China: Consumer Price Inflation

yoy as %



Source: Datastream, GenAM calculations

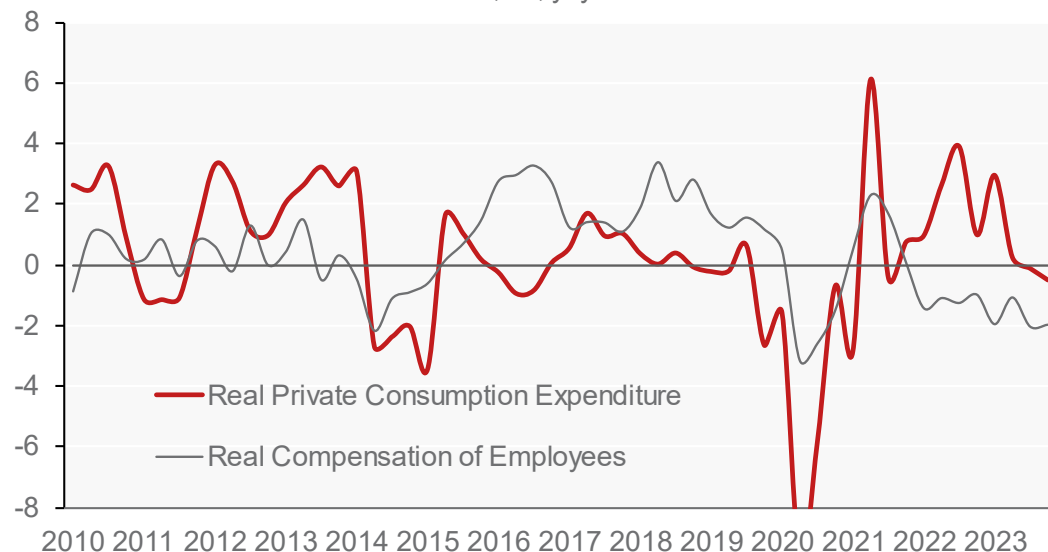
- China's National People Congress (NPC) developed largely in line with expectations: The growth target was set at "around 5%". The budget deficit is planned at 3% of GDP plus 0.8% of GDP in special ultra-long term treasury bonds. The special bond quota for loc. Gov. was raised slightly to RMB 3.9 tr. (+0.1 tr). However, the broad **fiscal impulse could be more expansionary, driven by less realised expenditures last year**. Accordingly, we fine-tuned GDP growth slightly up to 4.7%, but revised 2025 GDP growth marginally down (Trump uncertainty).
- Latest real activity data better than expected** (IP, Inv., but not retail sales), slightly improving from Dec. 2023. We expect the housing market to remain the main drag on growth. Monetary policy is likely to further ease by another RRR cut by 25 bps around mid-year and 10 bps cut in the MLF rate. CPI inflation surprised on the upside in Feb. (New Year vacation) (0.7% yoy) but we see **2024 inflation to stay low at 0.7%**.

Japan: BoJ ended NIRP and YCC in mid-March

Core of policy measure have been maintained

Consumption and Compensation of Employees

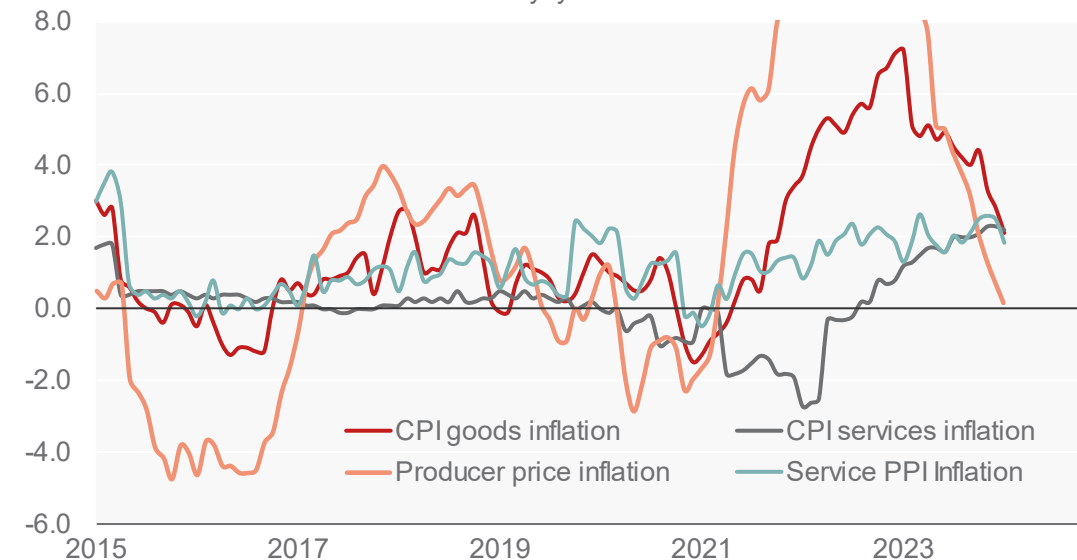
real, sa, yoy in %



Source: Datastream, GenAM calculations

Japan: Consumer and producer inflation

yoy in %



Source: Datastream, GenAM calculations

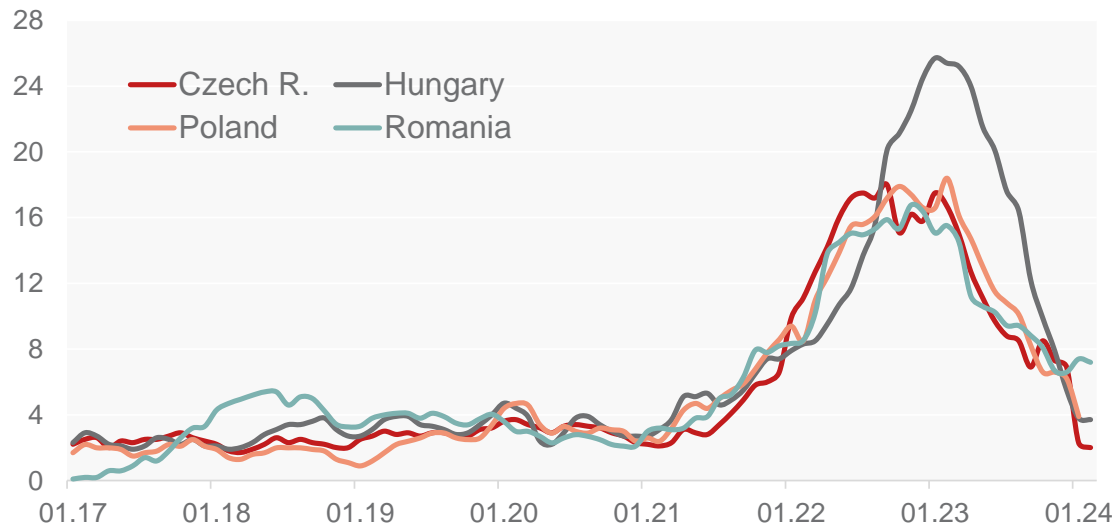
- Japan's Q4 **GDP growth was revised out of recession (+0.1% qoq)** but stayed softer than expected (+0.3% qoq). The main reason was weak private consumption, but capex was revised up. CPI inflation remained above the BoJ's inflation target (2.2% yoy). Inflation readings will remain noisy.
- **The Bank of Japan has ended NIRP as well as its YCC policy in a single move in mid-March**, one month earlier than we had expected. However, the core of its buying policy remained in place. The BoJ will continue JGB purchases with broadly the same amount as before at around JPY 6 tr per month. It also clarified that in case of a rapid rise in long-term interest rates, it stands ready to intervene, regardless of monthly schedules.
- **Japan still needs monetary accommodation.** Inflation is expected to come in at 1.9% in 2024 and 1.6% in 2025 while growth should stay slightly below potential. We expect no further rate hike this year.

CEE: Economic growth recovers, inflation is on declining trajectory, but picture is not homogeneous

Monetary easing is led by Hungary and Czechia; Romania to launch rate cuts in Q2, Poland to restart policy easing in H2

Headline inflation

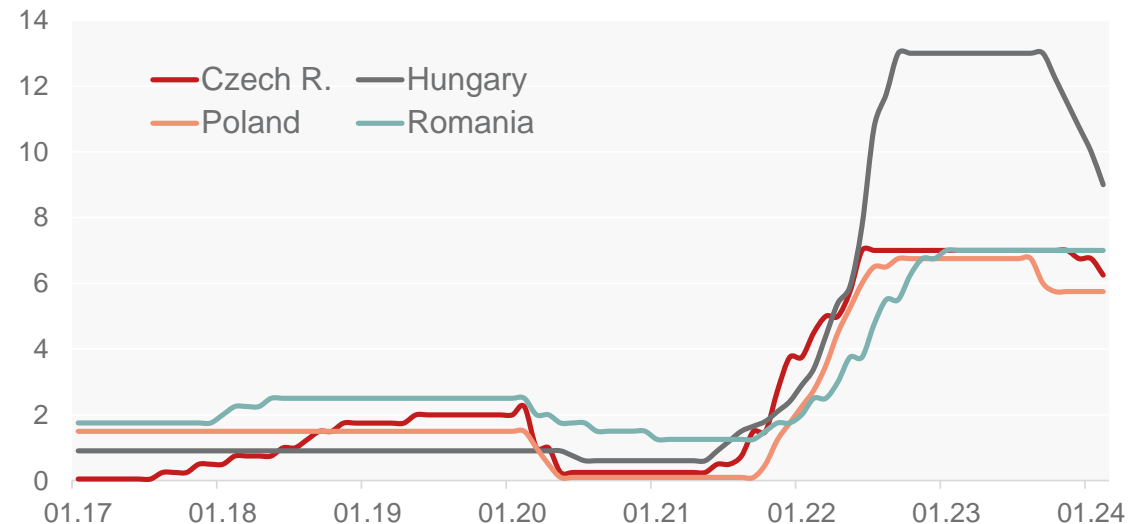
CE-4 countries (CPI yoy in %)



Source: www.czso.cz, www.ksh.hu, www.stat.gov.pl, www.insse.ro, GenAM

Monetary policy interest rates

CE-4 countries (end-of-month level, in %)



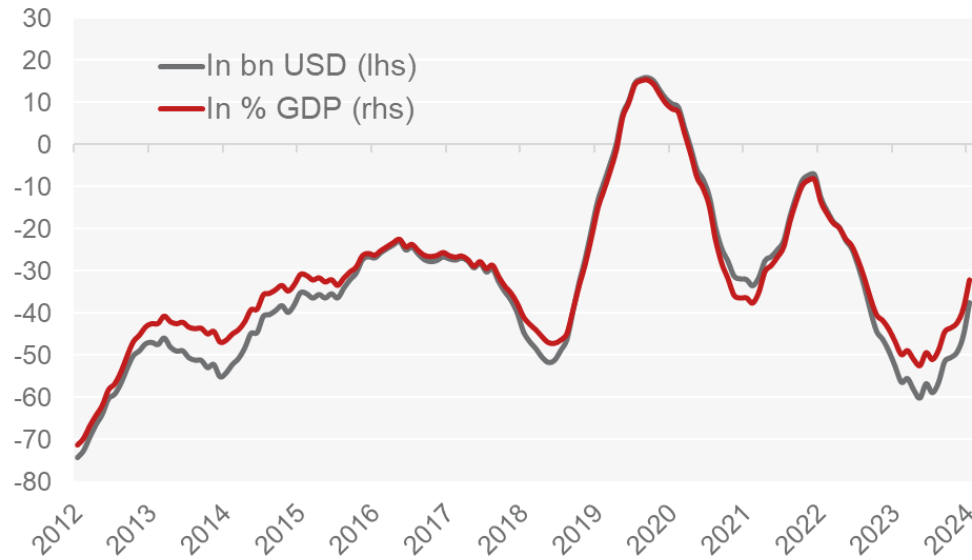
Source: www.cnb.cz, www.mnb.hu, www.nbp.pl, www.bnr.ro, GenAM

- **Inflation is close to CPI targets range in most of CE4 economies at start of 2024, but actual monetary policy steps and outlook differ across the region:**
 - Disinflation is driven by base effects on energy and food prices, and by moderation in underlying inflation amidst rather weak GDP performance recorded in 2023 with a full-year GDP contraction in Czechia and Hungary, and only a meagre growth in Poland. Household consumption should support GDP recovery in 2024.
 - Inflation already at 2% target in Czechia, at target range of 3% +/-1pp in Hungary and just slightly above target range of 2.5% +/-1pp in Poland. However, uncertainty about outlook of regulated prices forms upside risk for Polish CPI for H2. Romania: CPI increased due to tax changes in early 2024 but should return to disinflation.
 - The Hungarian MNB cut the base rate by 75 bps in January and by 100 bps in February to current 9%; we expect slower cuts in coming months. The Czech CNB cut its key rate by 50 bps to 6.25% in February and may continue cutting by 50 bps in H1. Poland stood on hold at 5.75% after rate cuts delivered in Sept./Oct. 2023. Rate cuts in Poland may be restarted in H2. Romania is expected to start cutting rates in Q2, most likely in May.

Türkiye: Restrictive policies maintained

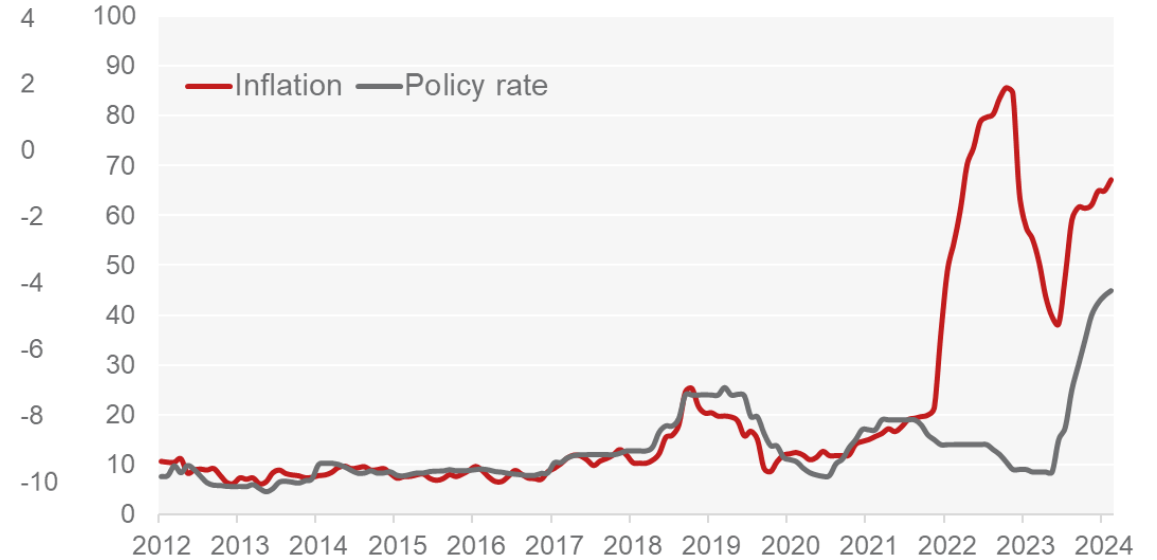
Credibility of Türkiye's policies increases. External accounts improved further.

Türkiye - Current account balance



Source: Generali Investments CEE, www.tcmb.gov.tr, www.tuik.gov.tr

Türkiye - Inflation and policy rate



Source: Generali Investments CEE, www.tcmb.gov.tr, www.tuik.gov.tr

■ Restrictive monetary policy maintained under new governor.

- Central bank raised policy rate to 45% and introduced additional restrictive measures to limit credit growth and support lirization. CBT Governor Erkan resigned for personal reasons. Policy continuity does not seem to be at risk under the new governor Karhan.

■ External vulnerability declines while data surprised to the upside.

- Real GDP rose by 1% qoq and 4% yoy, being driven by consumer demand while investment activity was sluggish. Current account deficit narrowed sharply to 3.9% GDP thanks to lower imports of gold and strong export performance. YTD decline in FX reserves caused by capital outflow seen as temporary.
- Inflation fluctuates close to 70%, decline towards 40% later this year seems to be realistic.

■ No signs of political interference ahead of March 31 local elections. President Erdogan indicated he won't seek re-election after his terms expires in 2028.

■ Fitch raised Türkiye's rating from B to B+ with positive outlook.

Growth and inflation forecasts

Growth	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	forecast
US	2.5	2.5	0.4	1.7	0.0	1.9
Euro area	0.5	0.6	0.1	1.3	- 0.0	1.2
Germany	- 0.1	0.1	- 0.2	1.6	0.5	1.9
France	0.9	0.8	0.1	1.5	0.2	1.7
Italy	0.7	0.6	0.1	0.5	- 0.5	1.1
Non-EMU	0.2	0.5	0.0	1.5	0.1	2.0
UK	0.1	0.3	0.0	1.3	0.2	2.1
Switzerland	0.8	1.1	0.0	1.6	0.0	1.8
Japan	1.9	0.7	- 0.0	0.9	- 0.1	0.5
Asia ex Japan	5.2	4.8	- 0.0	4.8	0.1	4.6
China	5.2	4.7	0.1	4.4	0.1	4.1
CEE	2.5	2.2	0.1	2.8	0.5	2.8
Latin America	2.2	1.4	0.0	2.1	0.0	2.2
World	3.0	2.8	0.1	3.0	0.1	2.9

Inflation	2023	2024		2025		2026
		forecast	Δ vs. cons.	forecast	Δ vs. cons.	forecast
US	4.1	2.6	- 0.0	2.2	- 0.0	2.1
Euro area	5.5	2.4	0.1	2.2	0.2	2.0
Germany	6.0	2.5	0.0	2.3	0.2	2.0
France	5.7	2.5	0.1	2.2	0.3	2.0
Italy	5.2	2.1	0.2	2.1	0.3	2.0
Non-EMU	6.5	2.3	- 0.1	1.9	- 0.0	2.0
UK	7.4	2.4	- 0.2	2.1	- 0.0	2.0
Switzerland	2.2	1.6	0.0	1.2	0.0	1.5
Japan	3.3	1.9	- 0.4	1.6	0.0	1.4
Asia ex Japan	2.1	2.0	- 0.1	2.5	0.2	2.6
China	0.2	0.7	- 0.2	1.6	- 0.0	2.0
CEE	20.4	17.3	- 0.4	8.3	- 8.6	6.6
Latin America	5.1	4.0	0.0	3.1	0.0	3.0
World	5.3	3.7	- 0.1	2.9	- 0.6	2.8

- **Global green shoots are mounting** as real disposable income is underpinned by solid wage growth & easing inflation while the inventory cycle is bottoming and the headwinds from drastic rate hikes in 2022/23 are fading. This will largely offset the drag on consumption from depleted excess savings in the US. We now expect a soft landing of the US economy, while the euro area will gradually return to expansion into the spring.
- **Inflation is set to ease further.** But the pace of **disinflation is slowing** as the support from base effects, lower energy prices and eased supply chains are fading while strong wage growth and pent-up demand keeps underpinning price pressures in the services sector.

Key Rates*	2022	2023	2024		2025	
			forecast	cons.**	forecast	cons.**
US	4.50	5.50	4.75	4.60	3.50	3.50
Euro area	2.00	4.00	3.00	2.90	2.50	2.15
Japan	- 0.10	- 0.10	0.00	0.11	0.00	0.26
China	3.65	3.45	3.35	n.a.	3.30	n.a.

* year-end forecasts; Fed: FFR upper bound, ECB: deposit rate, BoJ: Policy Rate Balance, China: Loan Prime Rate 1Y; ** mean forecasts BBG

Source: Datastream, Bloomberg, GenAM

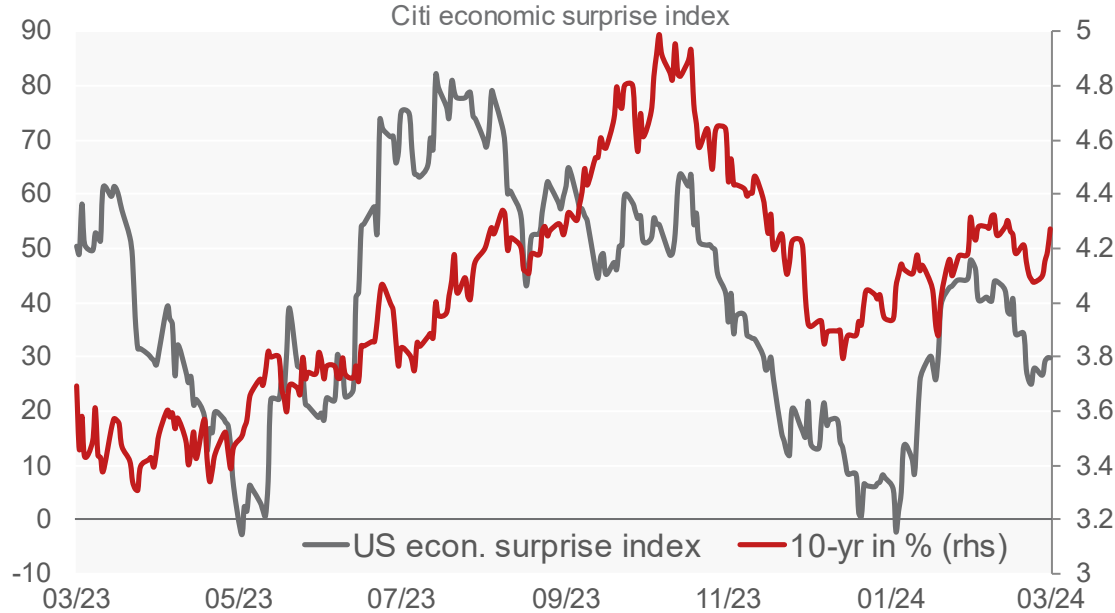
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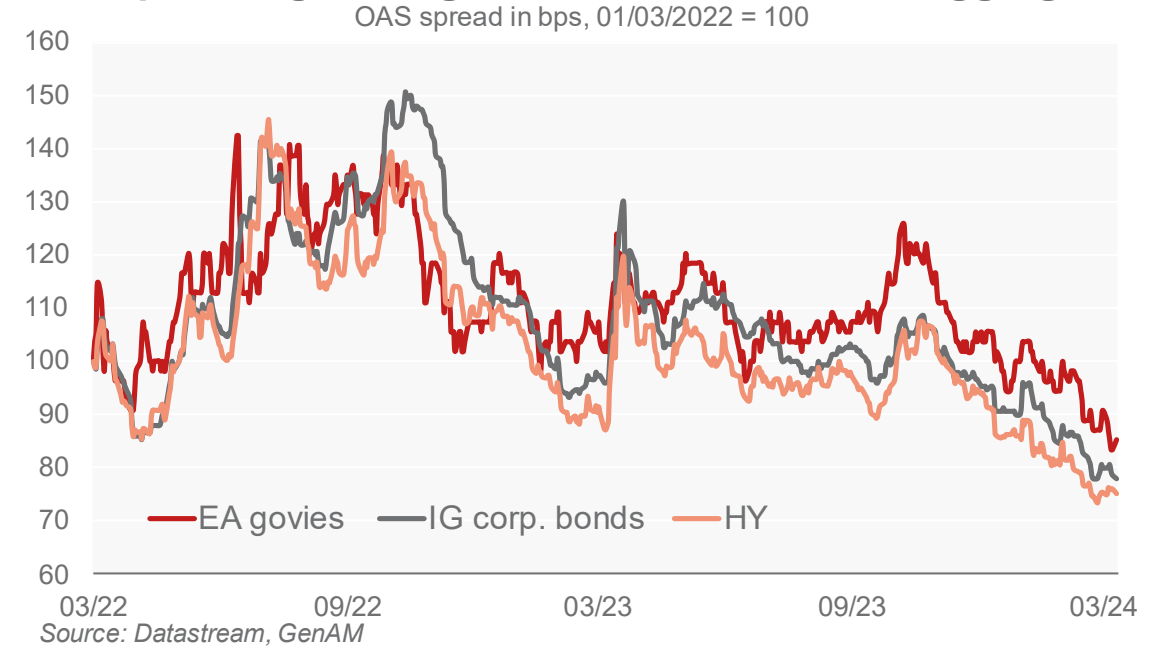
Government Bonds: After the recent yield increase, yields skewed to the downside again

Carry-friendly environment to support EA non-core bonds in Q2

Economic slowdown to trigger lower yields



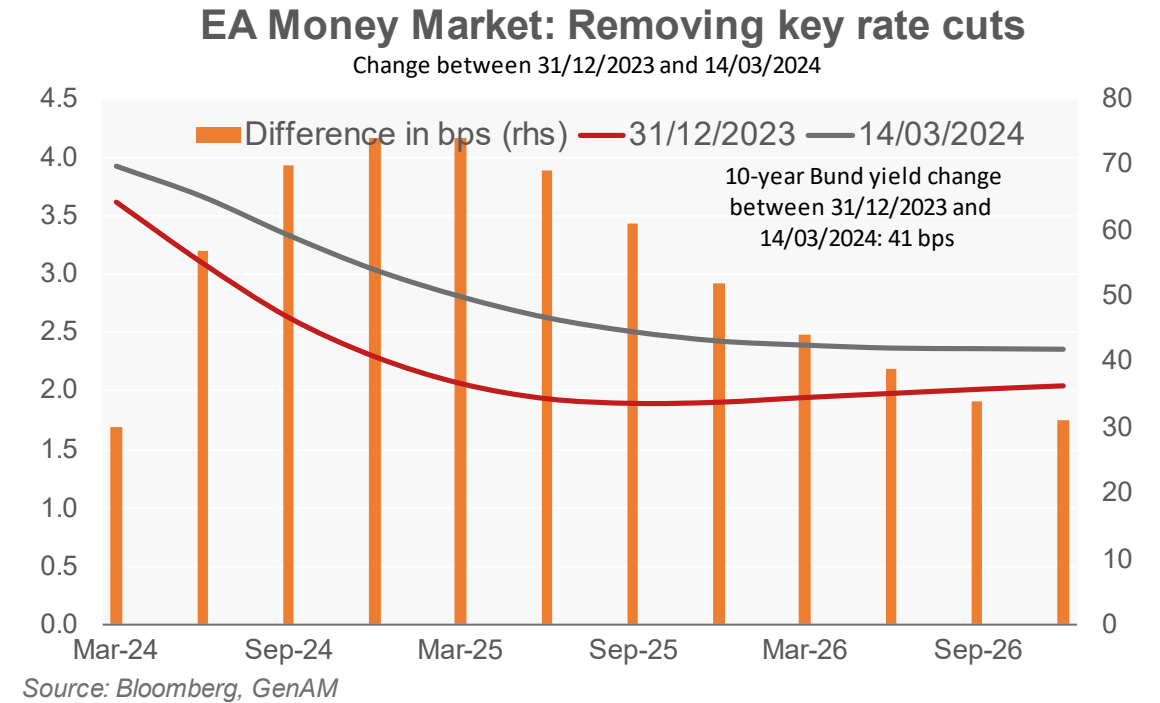
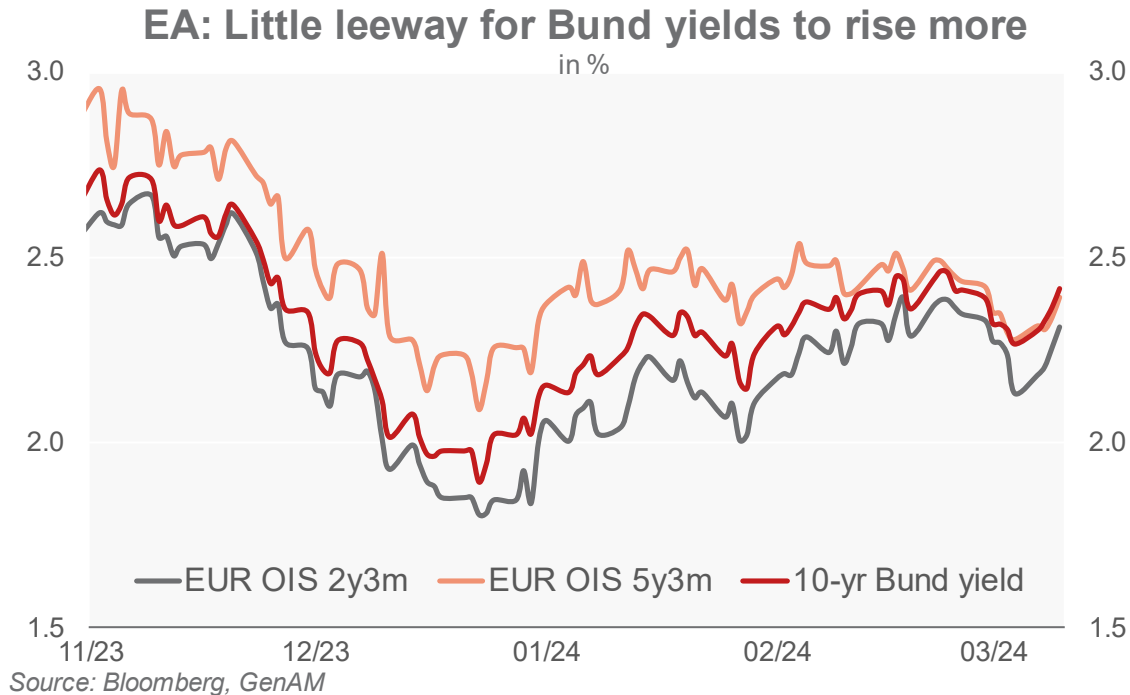
Spread tightening of EA non-core bonds lagging



- With key rate cuts on the horizon, **core yields are likely to decline moderately in Q2**.
- However, structural and geopolitical developments (defence spending, supply chain disruptions, energy system transformation) are inflationary. Hence, yields are likely to move away from the upper end of the trading range, but **a large bond rally is unlikely** (pricing ECB key rate trough at 2.25%).
- **Transatlantic yield spread** to move sideways in Q2 but tighter on a 1-year horizon.
- Despite the strong performance, in relative terms **EA non-core government bonds are still somewhat lagging**. The wall of supply has been absorbed very well.
- As there is no catalyst for a lasting turnaround in sight, we recommend **investing in riskier government bond segments to earn the carry**.

Core yields at the upper end of the trading range – small long duration recommended

Central bank pricing about fair now, looming key rate cuts to support core yield decline



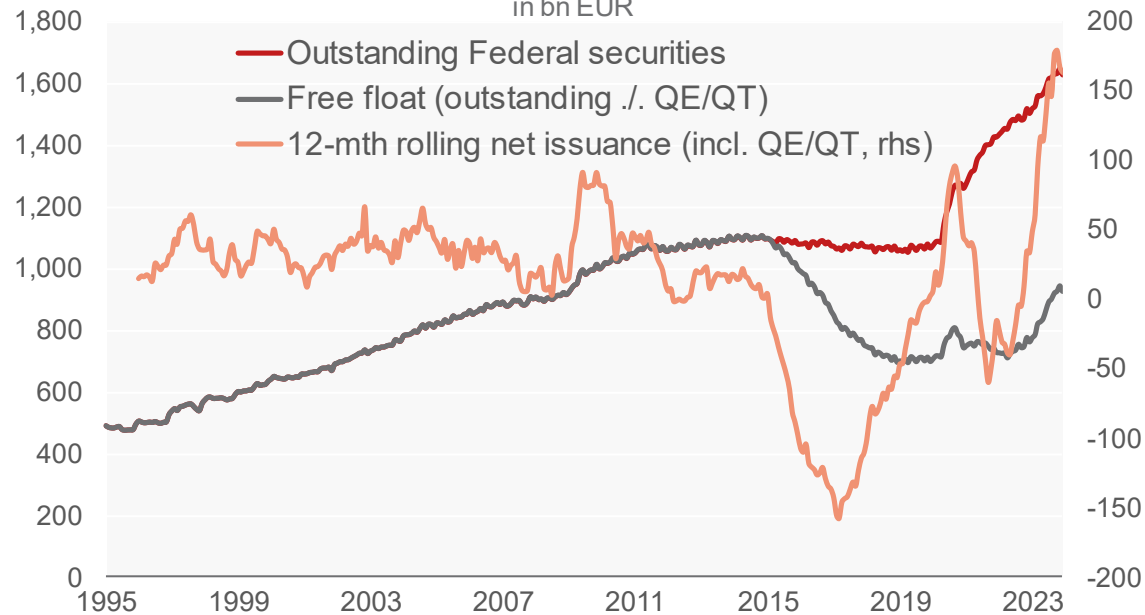
- While key rate pricing for the Fed and ECB is now broadly in line with our forecasts (removing the main driver for higher yields), we expect the US economy to cool somewhat and inflation rates to decline slowly. The **main driver for lower nominal yields is real yields**, as we do not see much leeway for inflation expectations to fall (in the short term).
- EA leading indicators are starting to improve but forthcoming key rate cuts are likely to gain the upper hand (once the cycle starts **additional key rate cuts are likely to be priced**).
- Amid the bumpy decrease in US inflation the **transatlantic yield spread** is seen to move sideways short term. Further out, 10-yr US/EA spread of 185 bps is too high (considering only a small gap in r^*).

Swap spreads have tightened significantly – some leeway left

SSA bonds are likely to benefit and deliver a higher total return than core bonds

Germany: Scarcity of Bunds comes to an end

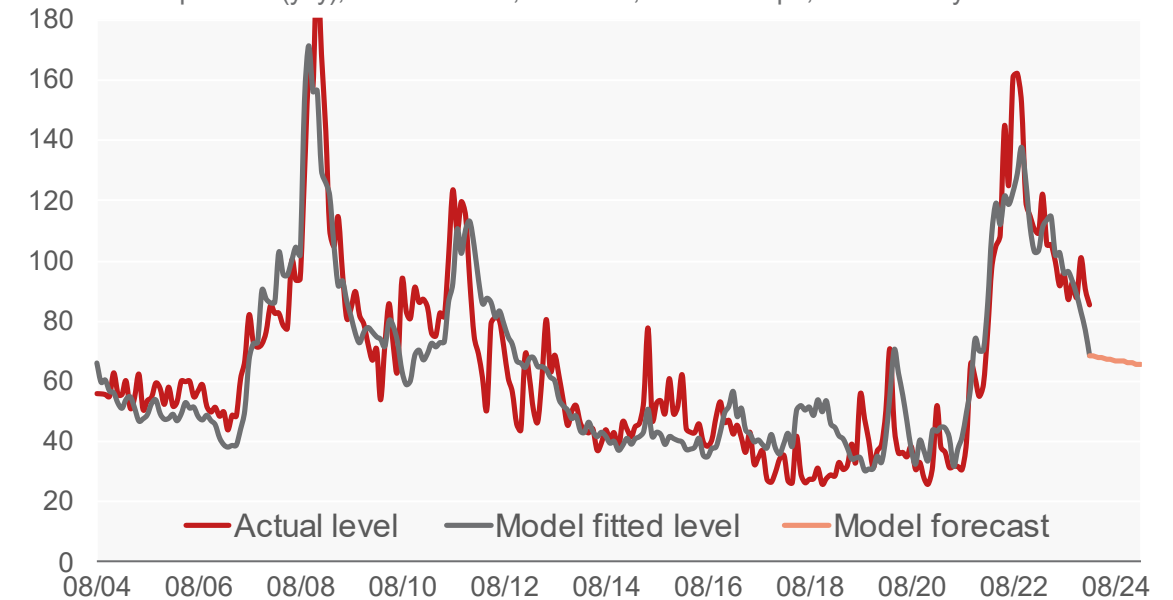
in bn EUR



Source: Bloomberg, German Datastream, Germany Finance Agency, GenAM calculations

EA Implied Volatility on 1m Swaptions

Input: CPI (yoy), Ec. sentiment, fin. cond., LT infl. swaps, CPI volatility

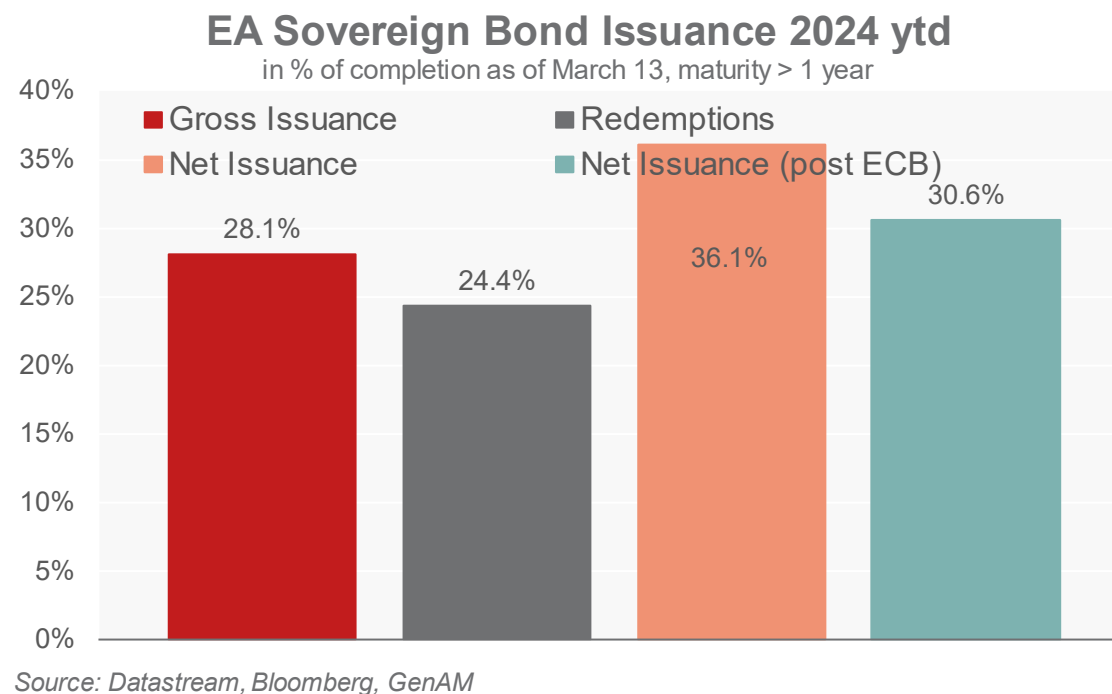
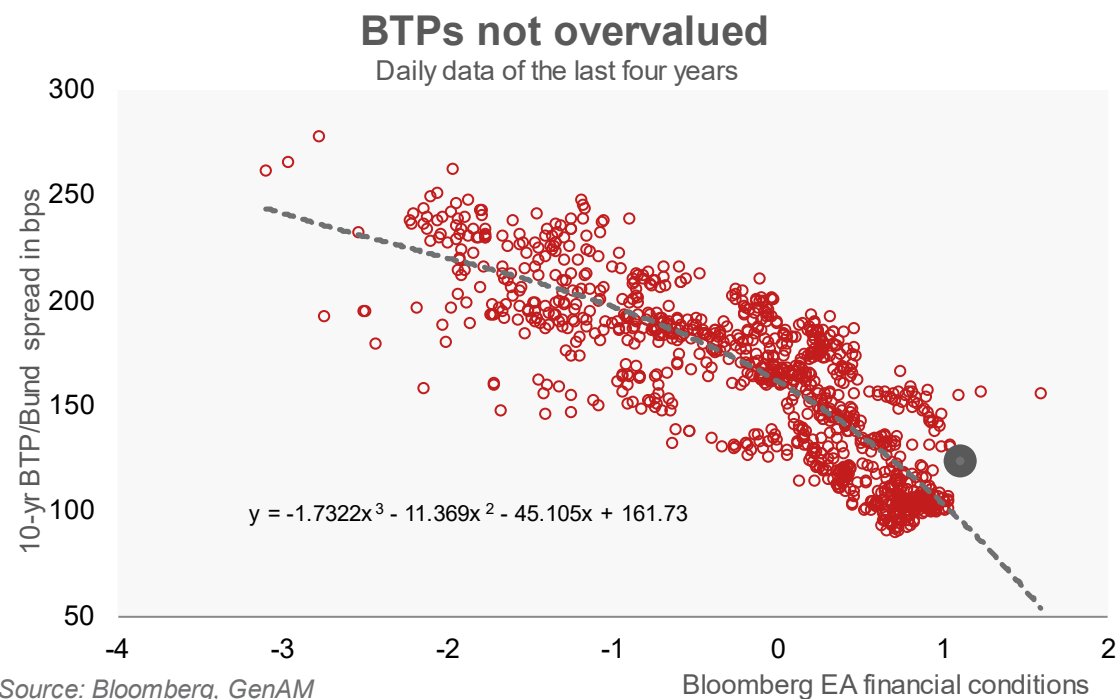


Source: Bloomberg, Datastream, GenAM

- 10-yr EA swap spreads have **tightened to long-term lows** (but remain above the trough marked in 2014). 30-yr swap EA swap spreads have even fallen into negative territory.
- Although the air is getting thinner, the **factors for a further narrowing are in place**. Bond market volatility has more leeway to fall (amid decreasing inflation, lower inflation volatility, and forthcoming key rate cuts). The 12-month rolling net issuance of Bunds is close to a historical high (supported by ECB's QT), and the expected steepening of the yield curve usually goes hand in hand with tighter swap spreads.
- Accordingly, we remain **constructive on SSA bonds** as their performance is still lagging and the mild EA economic recovery will support a market-friendly environment.

EA non-core government bonds – Risk-on sentiment the main driver for a strong performance

No sharp reversal in expected in Q2 – good performance seen to continue



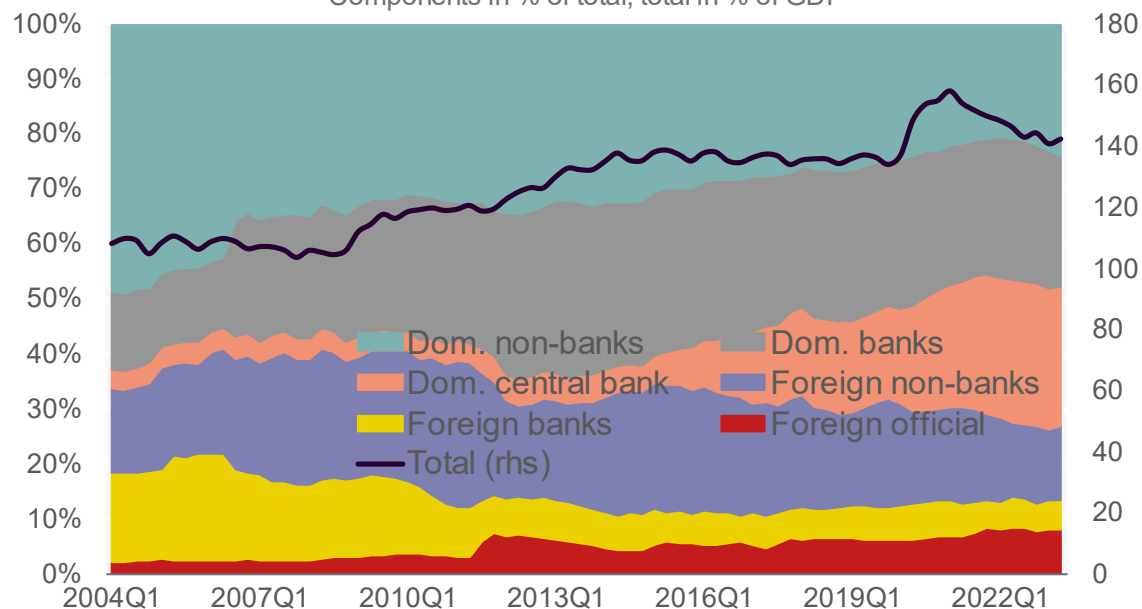
- Despite the strong performance of EA non-core government bonds, they **do not appear overvalued** (particularly in relative terms). The market environment is seen to remain friendly (few catalysts for a significant spread widening), **and investors should earn the carry**.
- A further **decline in bond market volatility** in combination with a mild economic recovery and forthcoming ECB rate cuts suggest that the market environment will remain stable going forward.
- **Issuance activity is well advanced** with almost 30% of annual volume already placed (and even more in net terms). Demand is widespread – both from abroad and domestic investors.

EA non-core government bonds – Sideways movement on a low level

Carry friendly environment expected to last

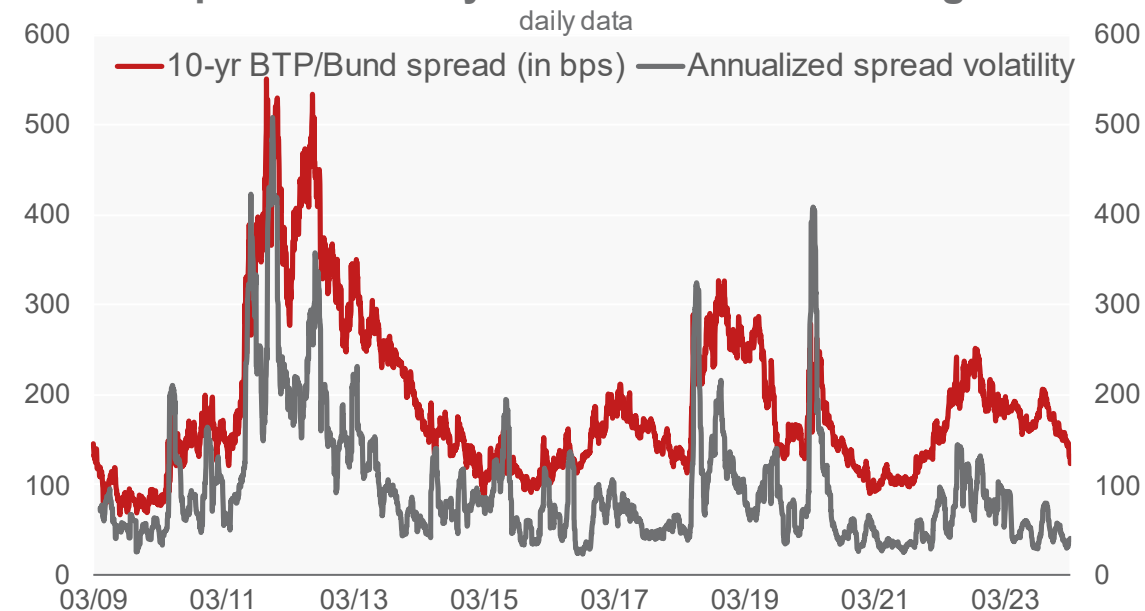
Italy: Holders of Government Debt

Components in % of total, total in % of GDP



Source: IMF. GenAM calculations

Spread volatility close to historical trough



Source: Datastream, GenAM

- After years of cutbacks, **Italian non-banks** have started to increase their investments in BTPs again (BTP Valore raised € 18bn) – substituting ECB holdings.
- A further decline in **bond market volatility** and spread volatility on a very low level imply still **attractive risk-adjusted spread levels**. Any speculation about further steps towards a fiscal union (driven by geopolitical risks, defence spending) supports. Outperformance of EA non-core bonds vs. core bonds in the short term.
- Markets digested the **Portugal election** well despite the inconclusive outcome, political stalemate not welcome (but, even a far-right party support for conservatives is probably a lower market risk than in the past (see Italy)).
- Medium-term challenges remain (ECB's QT gaining momentum, still high debt ratios and fiscal deficits – at least in some countries).

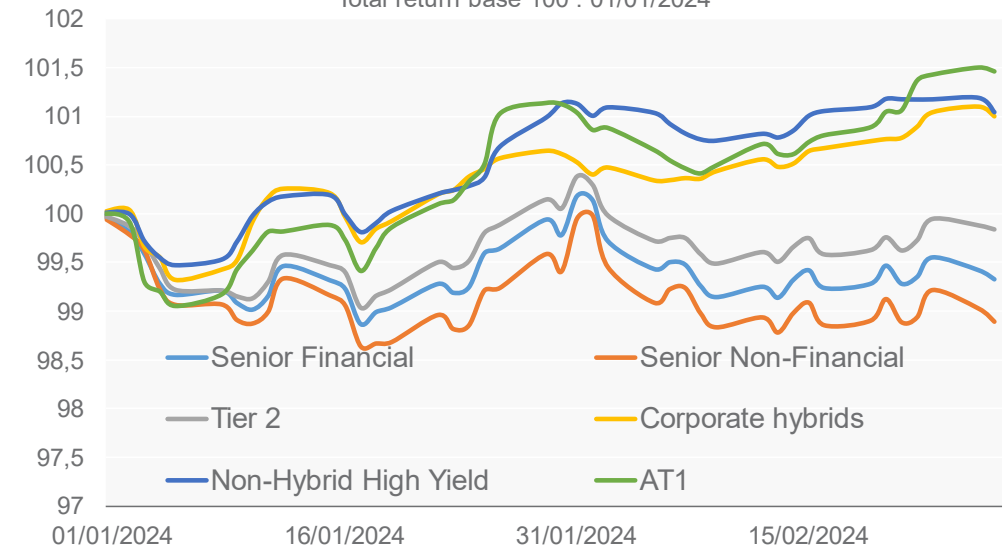
Credit: Expensive but for good reasons

Longer IG – neutralising HY

- We do not think credit spreads are cheap - but we further increase our long IG and upgrade HY to neutral on the back of elevated carry and no further deterioration in the default outlook.
- We remain long non-fins IG especially in euros. We like to **extend credit duration in Europe rather than increasing credit risk**. Our preferred bucket is 5-7Y. Long dated IG is expensive, but we expect it to remain so despite inverted curves at the back end.
- We remain **neutral on financials relative to non-financials**. Lower rates mean less risk on the asset quality side. **CRE concerns are seen as idiosyncratic** German bank risk. However, overall supply is heavier in financials; so far spreads have been resilient as much of the new issuance is dollar-denominated.
- **Defaults have probably peaked below 4% in Europe and below 6% in the US and will start decreasing from now.** The question is whether this will also apply to loans and private credit.
- **Rating migration will be concentrated at the lower end of the rating spectrum** and in highly cyclical sectors. BBB should be less affected than during Covid as the fundamental trend is decent.
- We continue to **prefer subordination risk to credit risk** for valuation reasons and lower tail risk. Strong issuance has eased the refinancing burden in HY leveraged loans and retail credit, but we still prefer to err on the side of caution given stretched valuations across the rating spectrum.
- We **prefer EU credit to US credit due to cheaper valuations** although US credit would be more resilient under Trump 2.0 especially in case of a republican sweep.
- The cyclicity premium is very low, but we recommend to **OW defensive sectors** as well as rate-sensitive ones like real estate where spreads have compressed a lot but we see no short-term catalyst for a widening.

EUR Credit market performance by segment

Total return base 100 : 01/01/2024



Source: Bloomberg, BofAML indices, GenAM own calculations

Credit: Turning slightly more constructive

We expect tighter IG spreads by year end – flat HY spreads

IG vs HY

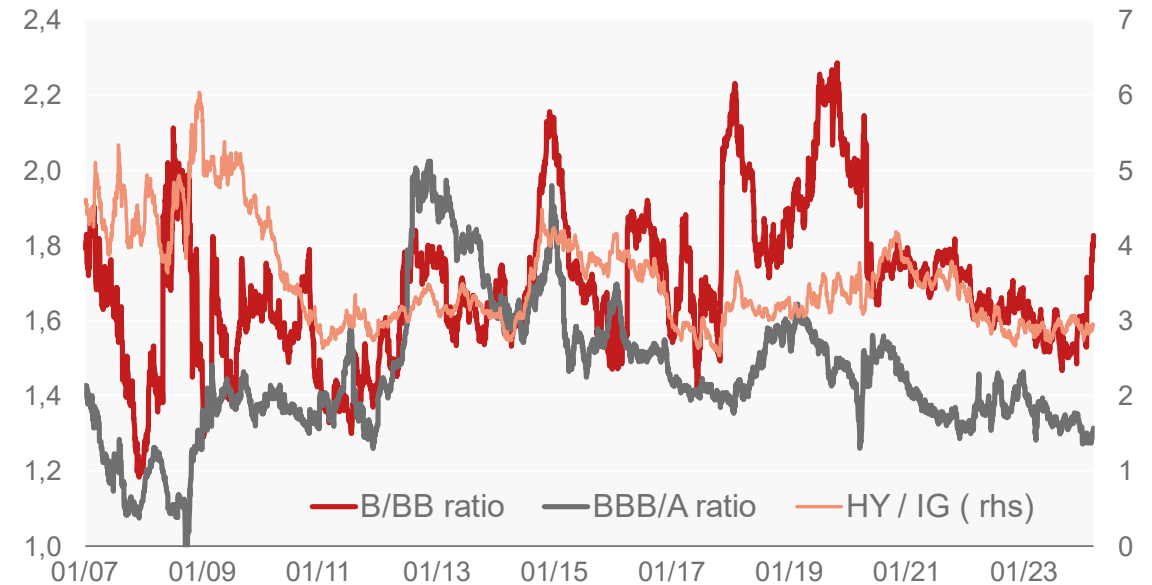
Govt OAS, bps



Source: Bloomberg. BofAML Indices. GenAM

IG vs HY valuation ratios

in Govt OAS terms



Source: Bloomberg. BofAML Indices. GenAM own calculations

- We do not think the credit spread are cheap– but we further reduce the HY UW on the back of elevated carry and no further deterioration of our default outlook.
- **Defaults have probably peaked below 4% in Europe and below 6% in the US and will start to decline from here.**
- We continue to **prefer subordination risk to credit risk** for valuation reasons and lower tail risk. Strong issuance has eased the refinancing burden in HY leveraged loans and retail credit, but we still prefer to err on the side of caution given stretched valuations across the rating spectrum.
- We **favour EU credit to US credit** although US credit would be more resilient under Trump 2.0 especially in case of a republican sweep.
- The cyclical premium is very low, but we recommend to **OW BBB defensive sectors, and real estate.**

Credit volatility has returned to pre-pandemic levels

Very attractive CDS levels to buy credit protection

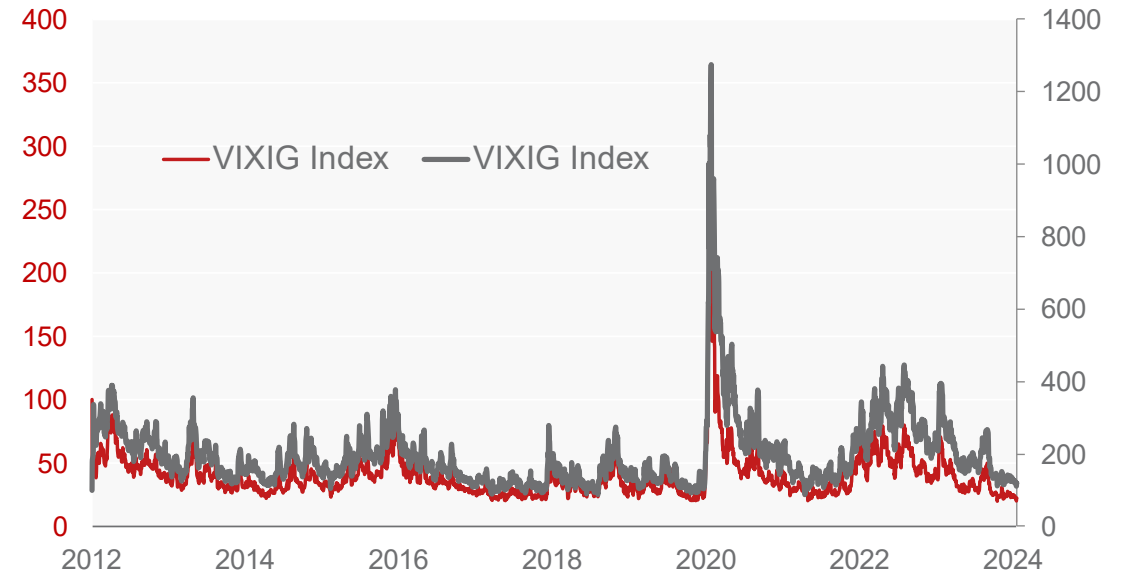
CDS market valuation (since 2012)

	iTraxx Europe	iTraxx Crossover	iTraxx Sr Financial	iTraxx Sub Financial	CDX Investment Grade
Min	41	204	41	75	44
Max	185	761	310	529	152
Mean	76	351	95	179	71
Current spread in bp	53	305	60	109	50
Stdev	28	115	48	77	17
Z score	-0,83	-0,40	-0,71	-0,92	-1,25
Percentile	0,19	0,46	0,21	0,10	0,05
(Current-Low) / (Max-Low)	0,08	0,18	0,07	0,07	0,06

Source : Bloomberg, GenAM own calculations

Implied volatility levels in IG and HY

1-Month Volatility Index (BP Volatility)

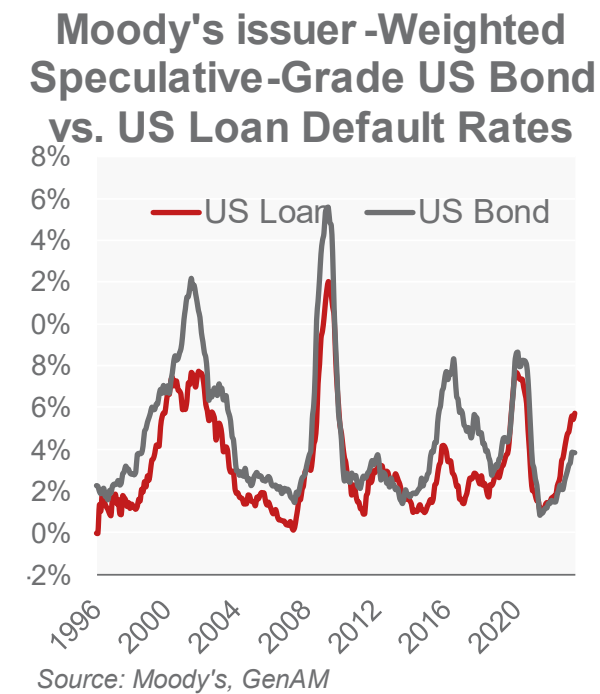
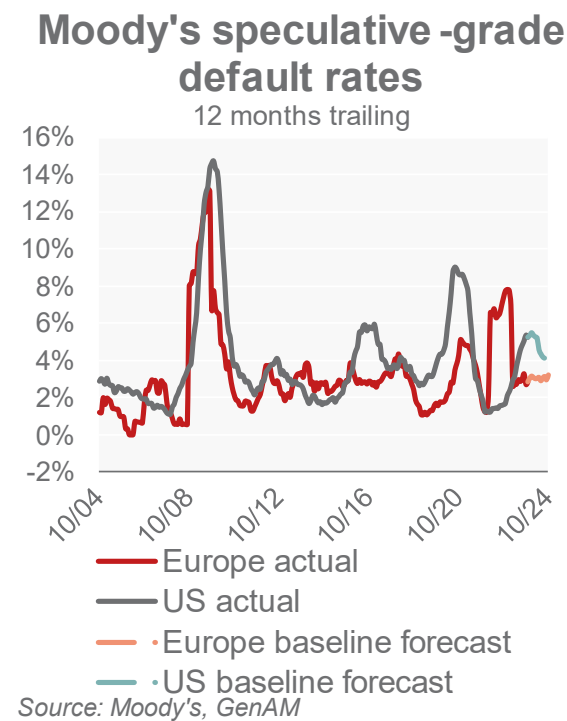
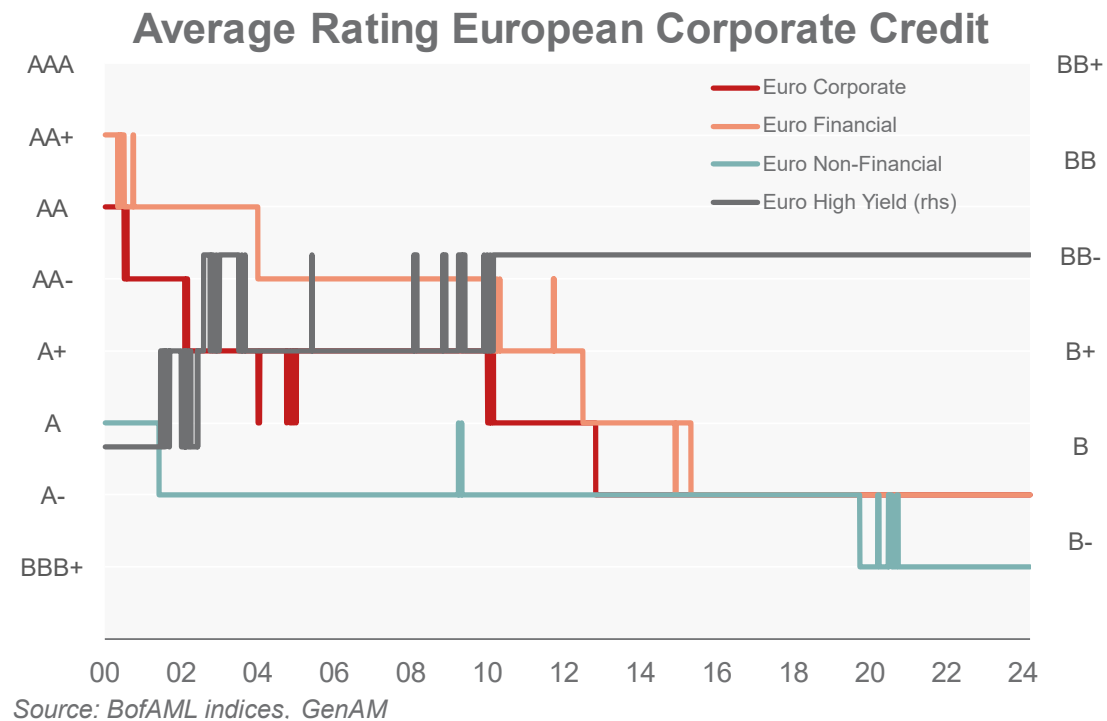


Source: CDX/CBOE, Bloomberg, GenAM

- The CBOE has launched two new measures of implied volatility for IG and HY, calculated daily, Bloomberg tickers are VIXIG and VIXHY.
- **VIXIG and VIXHY show that credit vol has decreased recently and returned to pre-pandemic levels.**
- **CDS levels are also very attractive to buy credit protection -> large negative basis versus cash.**
- **Best buy opportunities 1/ CDX 2/ iTraxx Sub Financial 3/ iTraxx Main**
- The iTraxx Xover is less appealing du to several distressed names widening the index

Credit: Fundamentals will keep deteriorating – though defaults have probably peaked

Credit quality will slowly deteriorate – mostly for low-rated HY



- The expansion of the private credit space replacing public HY issuance has supported HY valuation in 2023.
- So far in 2024, heavy issuances in the loan space have alleviated the pressure on HY refinancing needs. Yet HY issuances should intensify into H24.
- **Defaults have probably peaked below 4% in Europe and 6% in the US end 2023 as tight credit standards and will start to decline from here as financing conditions have eased a lot.**
- **The heavy issuance pipeline in the loan space driven by elevated CLO activity is good news for the refinancing risk of the levfin space globally.**

Credit: Lofty valuations but high-quality carry should continue drive demand

Especially as cash remuneration is set to decline with rate cuts

Euro and US credit markets levels (since 2007 in OAS vs gvt,)																
	IG Non-fin	IG Non-fin AA	IG Non-fin A	IG Non-fin BBB	IG Fin,	IG Fin, AA	IG Fin, A	IG Fin, BBB	HY	HY BB	HY B	HY CCC	US IG	US IG Non-Fin,	US IG Fin,	US HY
Min	47	25	43	58	41	31	56	89	178	116	200	322	86	86	90	241
Max	373	188	324	530	468	316	652	1875	2291	1551	2598	6571	622	622	589	2147
Mean	132	78	106	168	161	104	165	294	524	390	645	1254	165	165	159	540
Current OAS	107	69	86	124	115	79	108	142	332	215	415	1625	94	92	98	315
Stdev	53	28	45	78	76	57	108	230	320	223	337	783	88	89	74	271
Z score	-0,48	-0,31	-0,45	-0,57	-0,60	-0,44	-0,53	-0,66	-0,60	-0,78	-0,68	0,47	-0,81	-0,83	-0,82	-0,83
Percentile	0,33	0,45	0,36	0,30	0,30	0,46	0,37	0,15	0,18	0,06	0,13	0,87	0,06	0,04	0,05	0,05
(Current-Low) / (Max-Low)	0,18	0,27	0,15	0,14	0,17	0,17	0,09	0,03	0,07	0,07	0,09	0,21	0,01	0,01	0,02	0,04

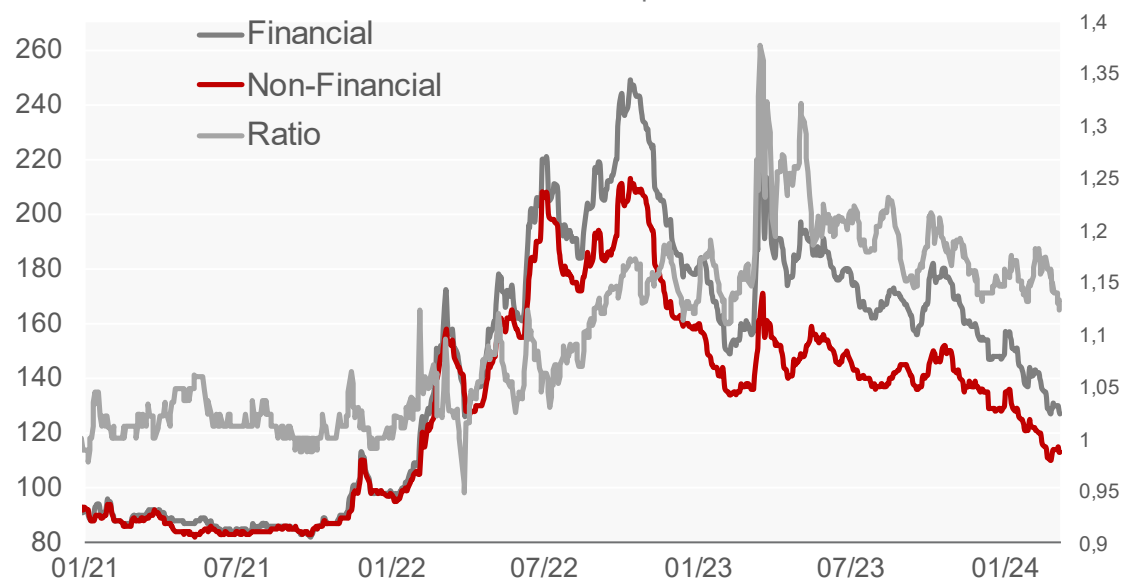
- HY valuation is very expensive. Especially in the US. – **underpinning our preference IG vs HY call.**
- BBB are also going to suffer some rating migration but likely manageable in our central scenario – hence we like the carry compared to single-As that will suffer in a higher rates scenario. – **OW BBB vs single-A**

Credit: Financials no longer underperforming on CRE worries – we remain neutral

Heavy supply in fins – rising share of yankee

Fins vs Non-Fins

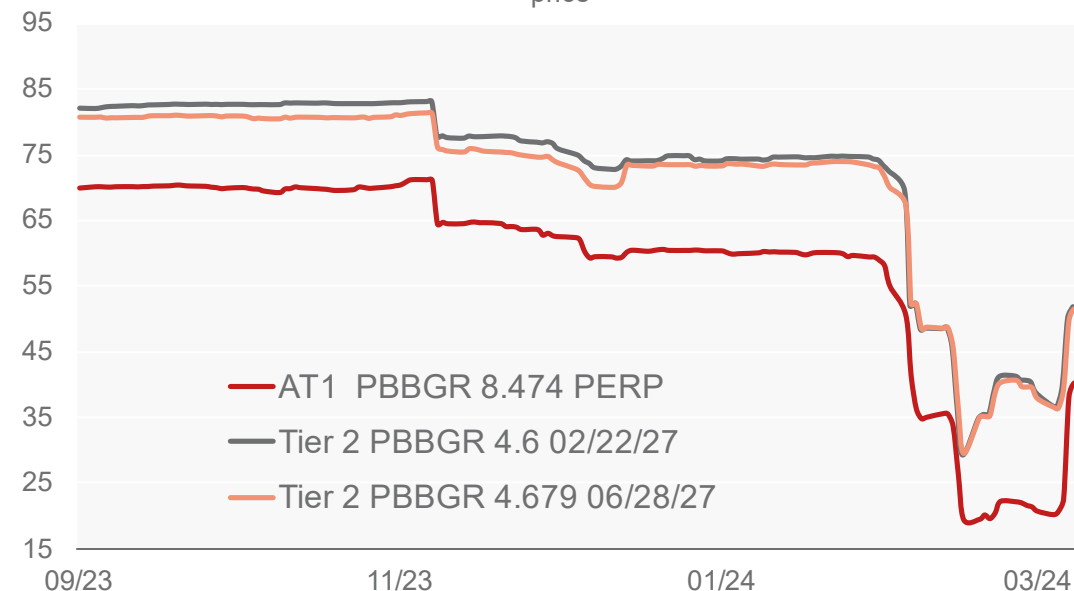
Govt OAS, bps



Source: Bloomberg, BofAML Indices, GenAM

Deutsche Pfandbriefbank Subordinated notes

price



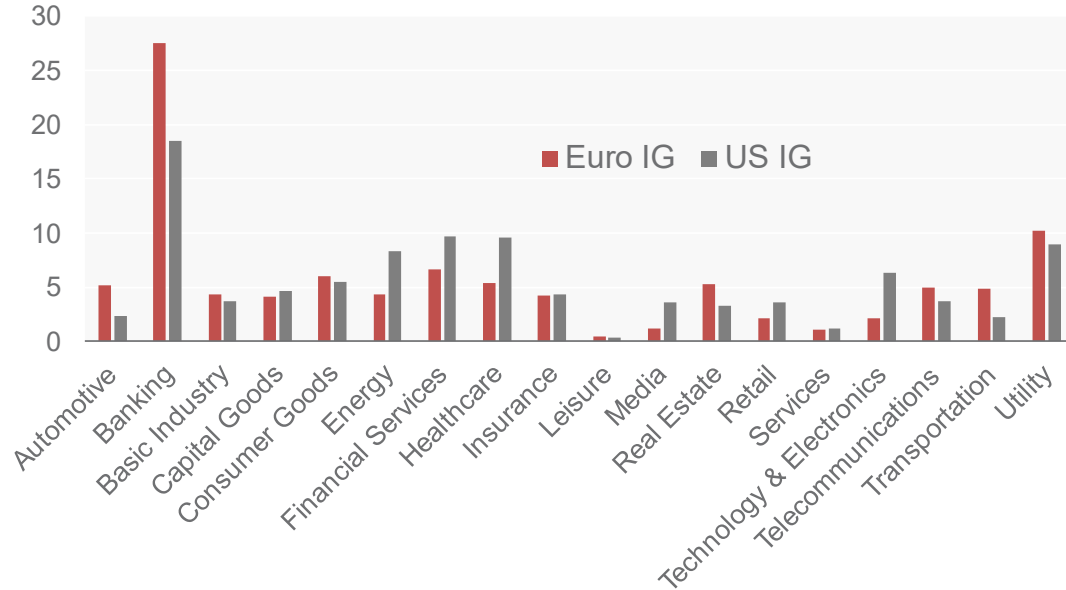
Source: Bloomberg, GenAM

- **Financials no longer underperforming on CRE worries.**
- The risk of PBB and Aareal is perceived as idiosyncratic.
- Even PBB's AT1 bond is rallying on the news that the coupon will be paid in April.
- **We remain neutral on fins versus non fins, as we expect more supply in the fin space and more resilient fundamentals.** European banks have issued more in 2024 than in 2023, but much of it has been in dollars, supporting euro spreads.

Continue to favour EU over US credit

On more appealing valuations

Euro vs US IG composition
in % of the benchmark



Source: Bloomberg, BofML indices, GenAM own calculations

US vs EUR IG
Govt OAS, bps

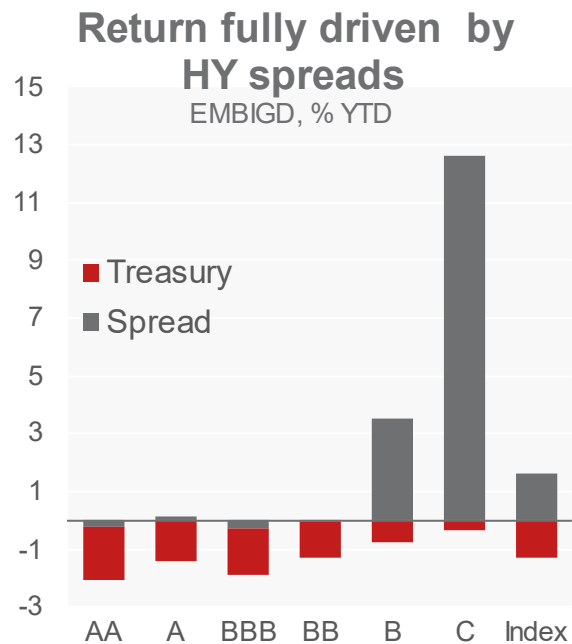


Source: Bloomberg, BofAML indices, GenAM

- Prior to the war in Ukraine, European credit was always tighter than US credit.
- **US valuation remains more expensive relative to Europe hence our OW EU vs US preference.**
- The composition of the US credit index is also more cyclical by nature and defaults have been structurally higher over the past decade which should be also the case this time.

EM sovereign bonds: at the crossroads

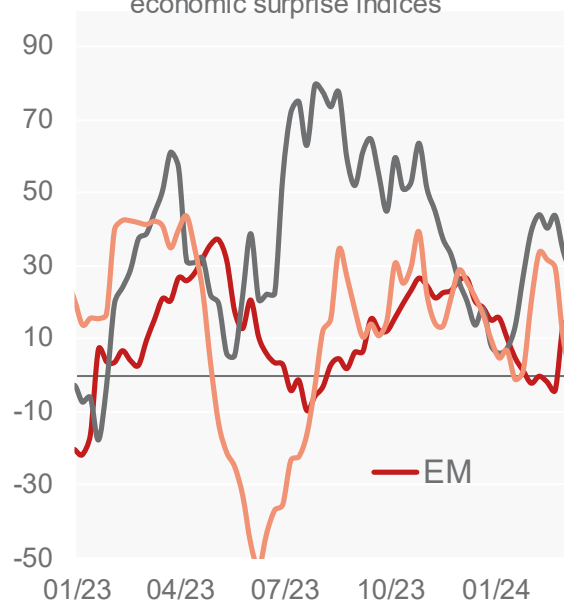
Positive return but reduce the beta exposure on tight valuations



Source: JP, Bloomberg, GenAM

EM surprises turn positive

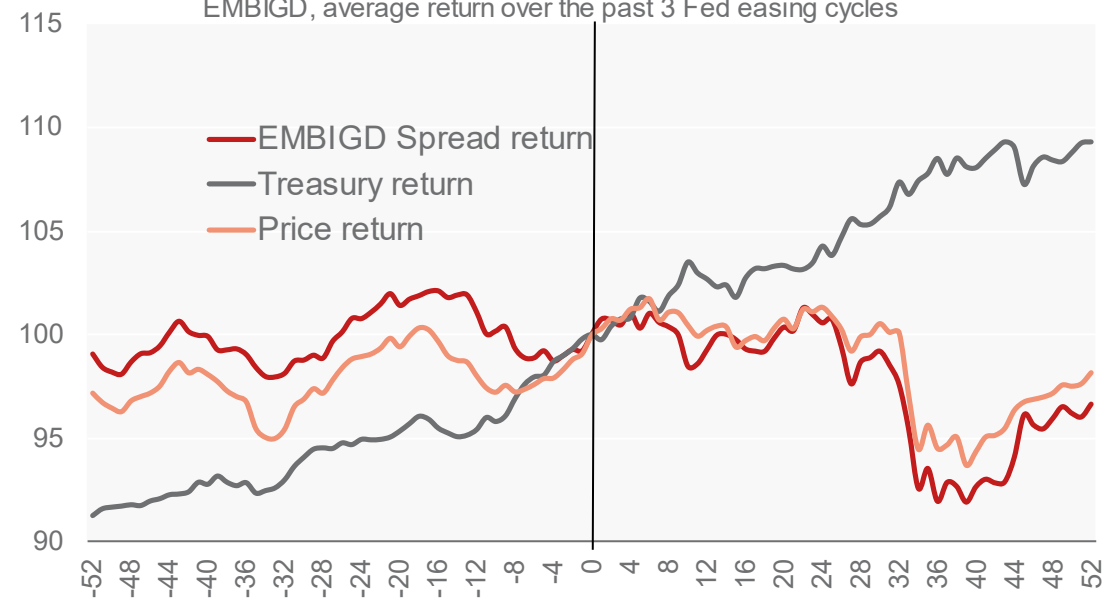
economic surprise indices



Source: Bloomberg, Citi, GenAM

Further return coming from duration

EMBIGD, average return over the past 3 Fed easing cycles

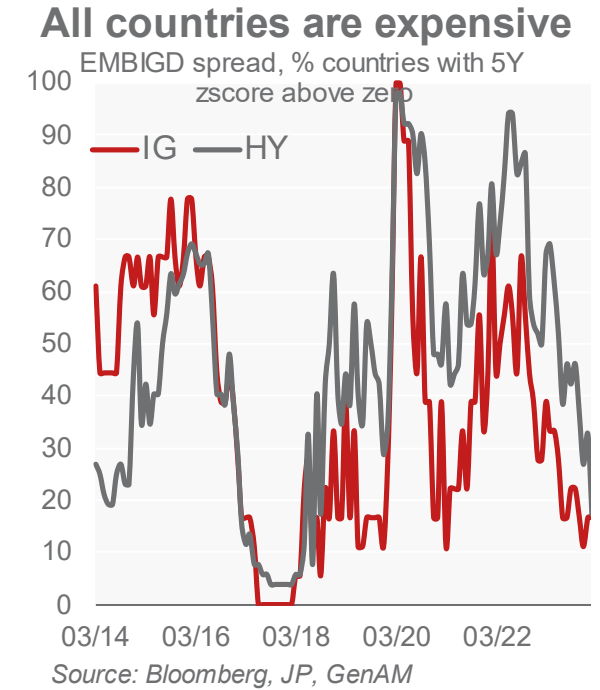
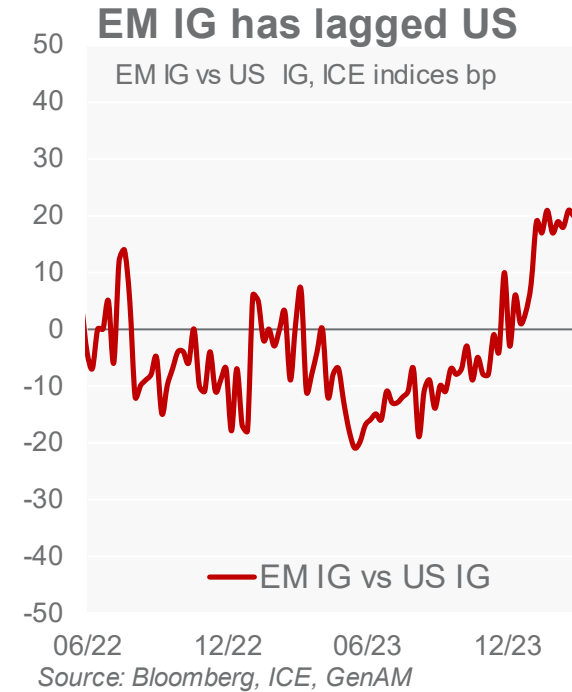
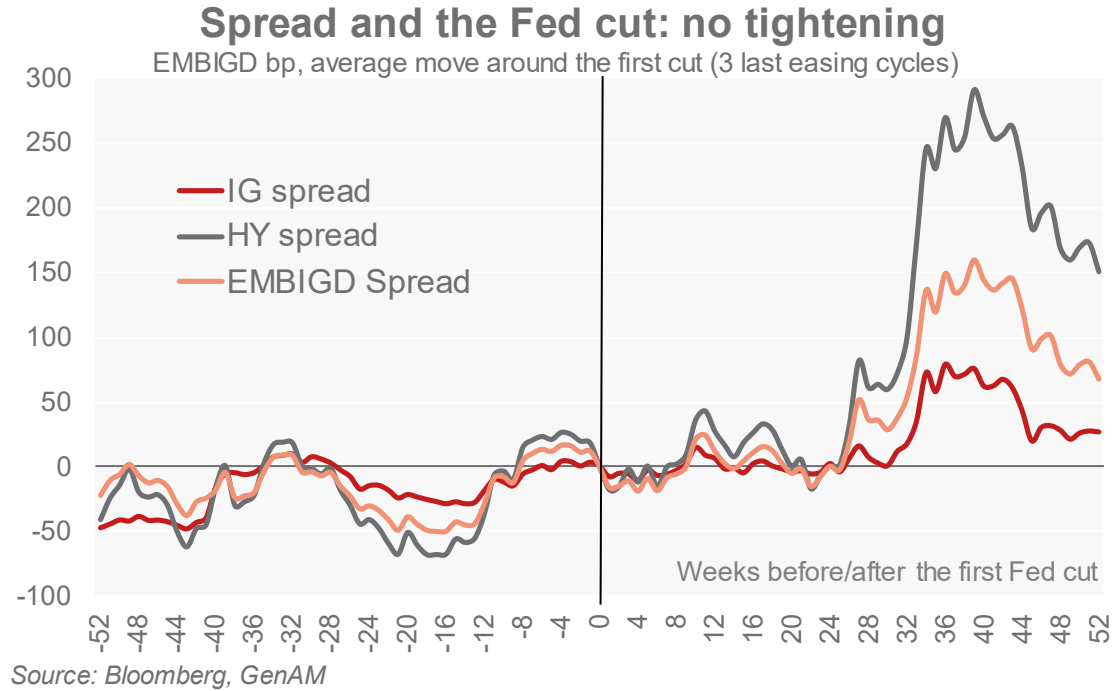


Source: Bloomberg, GenAM

- **The EM environment has remained a bullish one** with resilient macro data (upward surprises), strong disinflation and still ongoing monetary easing cycle. Better primary market access for low-rated countries coupled with idiosyncratic resolutions have also spurred risk sentiment.
- **Positive returns are still expected in the medium term** but short-term movement to be more tactical given the very tight valuations in external and local debt. Further short-term return will hinge on lower core rates.
- **The higher-for-longer rate environment is not EM negative** if it comes with resilient growth. The real risk is higher inflation that would derail the Fed easing, all the more since the spread buffer is minimal.
- **We reduce our beta exposure, favour relative value/curve trades. We now turn neutral EM external vs local and reinforce our IG preference over HY.**

EM external debt: Don't chase the spread rally

Limited pockets of value driven by idiosyncrasies



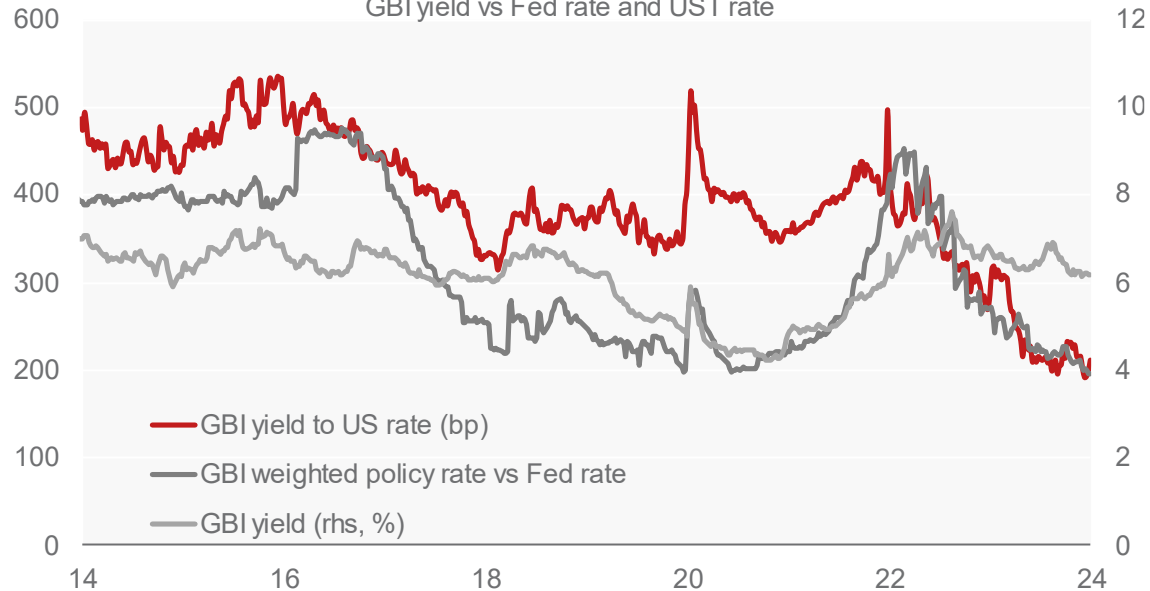
- **Wider spreads amid tight valuations.** EM IG almost back to pre-Covid levels, EM BBs close to 10Y lows. Recent spread tightening driven by distressed names only. **Further tightening would be essentially driven by idiosyncrasies as lower-rated HY is the only very cheap part of the index.**
- **At the macro level, stronger growth without inflation will be a positive driver but the impact will be marginal** since risk appetite has been stretched. We do not expect tighter US spreads that can lead to tighter EM credits. Crossover inflows are absent because EM is too exotic and US yields are attractive.
- Cheap countries: CEE (Ukraine, EU slowdown), LatAm HY (Panama), SSA countries but they need better fiscal fundamentals.
- **Conclusion:** wait for better entry levels as spreads can tighten after the first Fed rate cut. Market to be more directional in H2.

EM local: Turning neutral vs external debt

Duration rally to hinge on core rates

Spread at the lows because US rates are high

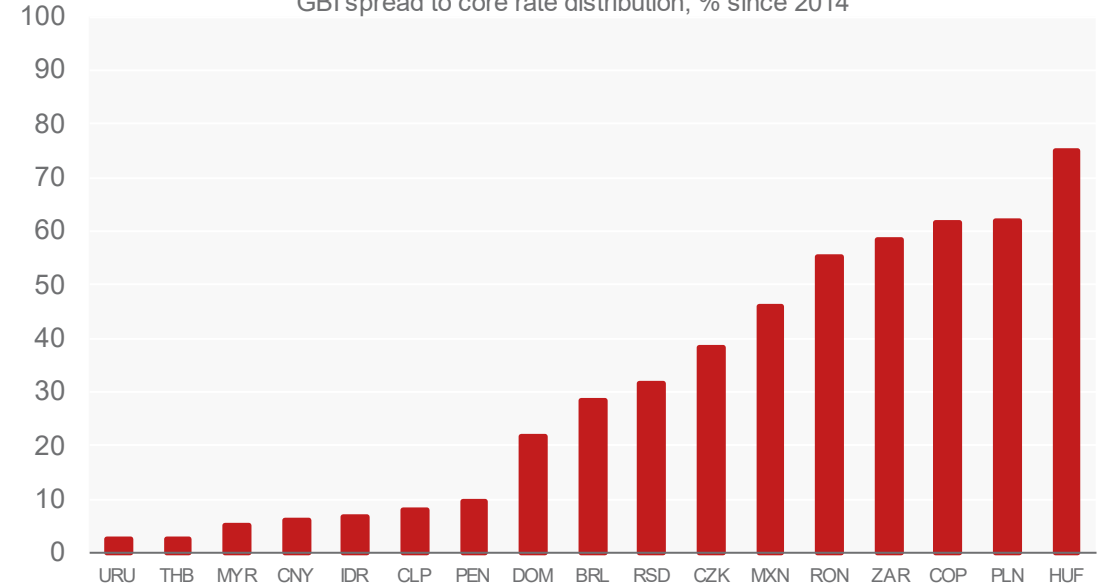
GBI yield vs Fed rate and UST rate



Source: Bloomberg, JP, GenAM

Value in Europe and Mexico

GBI spread to core rate distribution, % since 2014



Source: Bloomberg, JP, GenAM

- **We turn neutral EM local over external (from OW)** on the back of tighter valuations, more symmetric risks on US rates, and soft landing.
- **EM policy rates vs US rates have reached all-time lows as EM disinflation surprised.** For further rally, EM local rates decline will hinge on lower core rates as valuations are tight and spreads offer limited cushion.
- **Cycle is turning less favourable for local debt** that usually performs in mild recession vs external debt that benefits from the soft landing and lower US rates. Risks of delayed DM rate cuts can be problematic for EM central banks and thus for local debt.
- **More selective and favour curve/relative value trades to avoid directionality.** We still like Mexico 3-5Y part, belly of the CEE curve. In Asia, we favour FX over duration given the low level of rates.

NEW spread fair value model: Theoretical framework

Country specific assessment and differential impact of global shocks

- We build an econometric framework to assess the fair value of the Spread on USD external debt for 50+ emerging Markets over the 2015 to present period.

$$SPR_{it} = \alpha_i + \beta_1 \frac{DEBT_{it}}{GDP_{it}} + \beta_2 growth_{it+12}^e + \beta_3 D12\%(FXRES_{it}) + \log(VIX_t) * RATING_{it} + BBB_SPREAD_t * RATING_{it}$$

COUNTRY-SPECIFIC FUNDAMENTALS:

- Debt to GDP
- One-year ahead Growth (IMF forecast)
- FX reserves (yoy % chg)

COUNTRY-SPECIFIC REACTION TO GLOBAL SHOCKS

- Average of S&P, Moody's and Fitch rating (linear scale)
- VIX: proxy for market uncertainty
- Spread on US BBB corporates: risk appetite/opportunity cost

- The model is estimated on monthly data using an unbalanced Fixed Effect model.
- The residual of the equations represent the over/undervaluation of each country
- Aggregating them using the time varying weights of the ICE-BofA index gives us a measure of global over/undervaluation

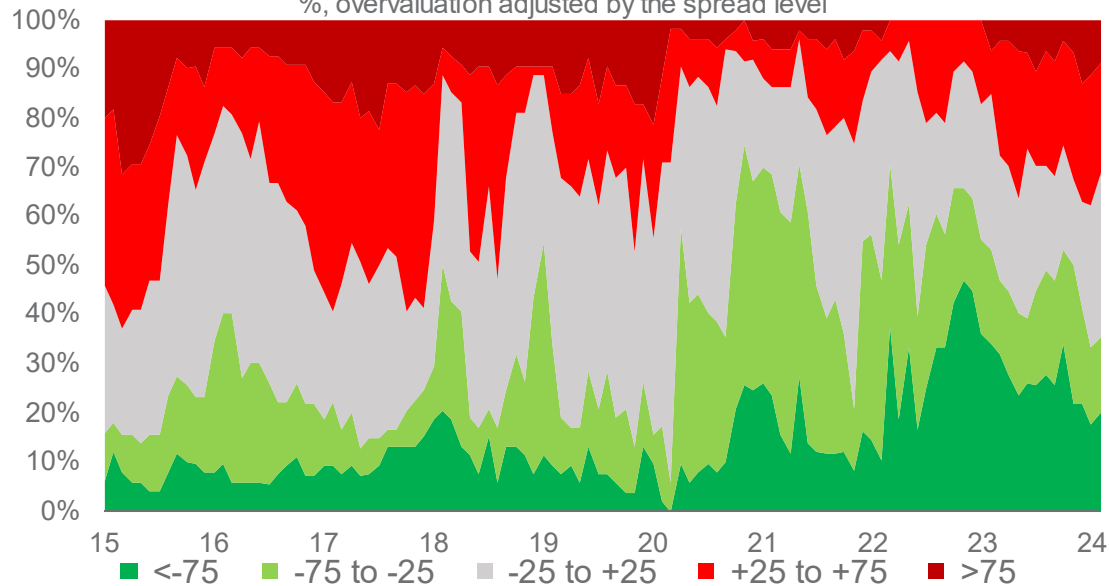
Dependent Variable: USD Spread				
Variable	Coeff	Std. Err	t-Stat.	Prob.
Debt to GDP	8.41	0.77	10.89	0.00
Growth (1 yr ahead fcst)	-26.68	5.81	-4.59	0.00
FX reserves (ann. % chg)	-3.23	0.26	-12.44	0.00
LOG(VIXCLS)*RATING	14.06	1.82	7.72	0.00
(BBB_SPREAD)*RATING	0.09	0.02	4.30	0.00
Adjusted R-squared	0.64			

New spread fair value model: no overvaluation

Local cheapness in HY countries

Distribution of countries by valuations

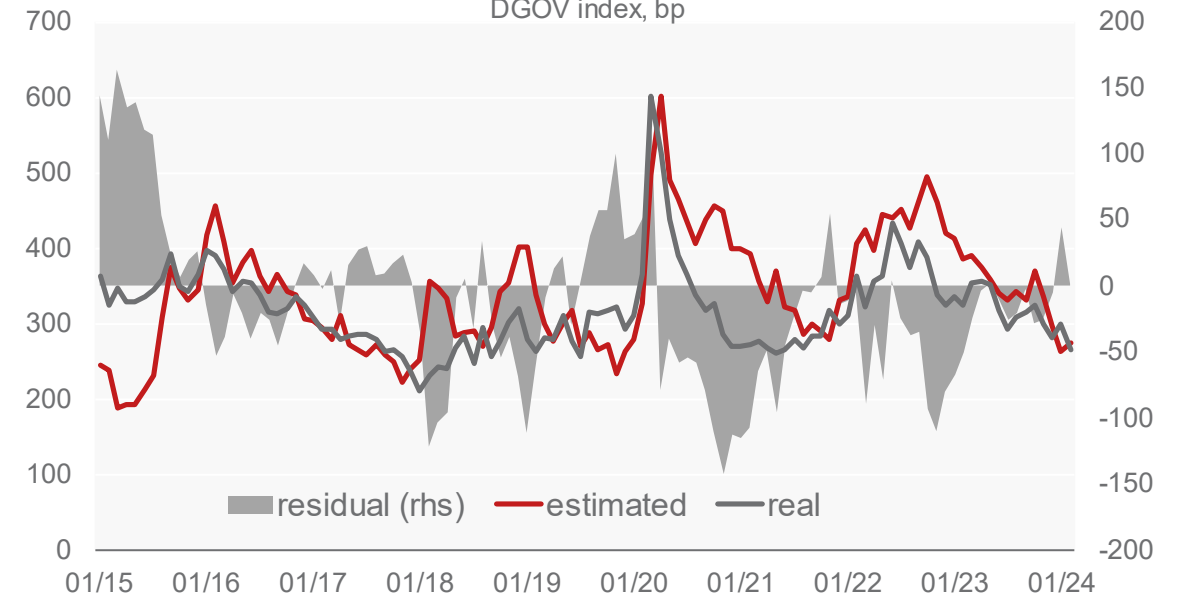
% , overvaluation adjusted by the spread level



Source: Bloomberg, ICE, IMF, GenAM

EM USD spread model

DGOV index, bp

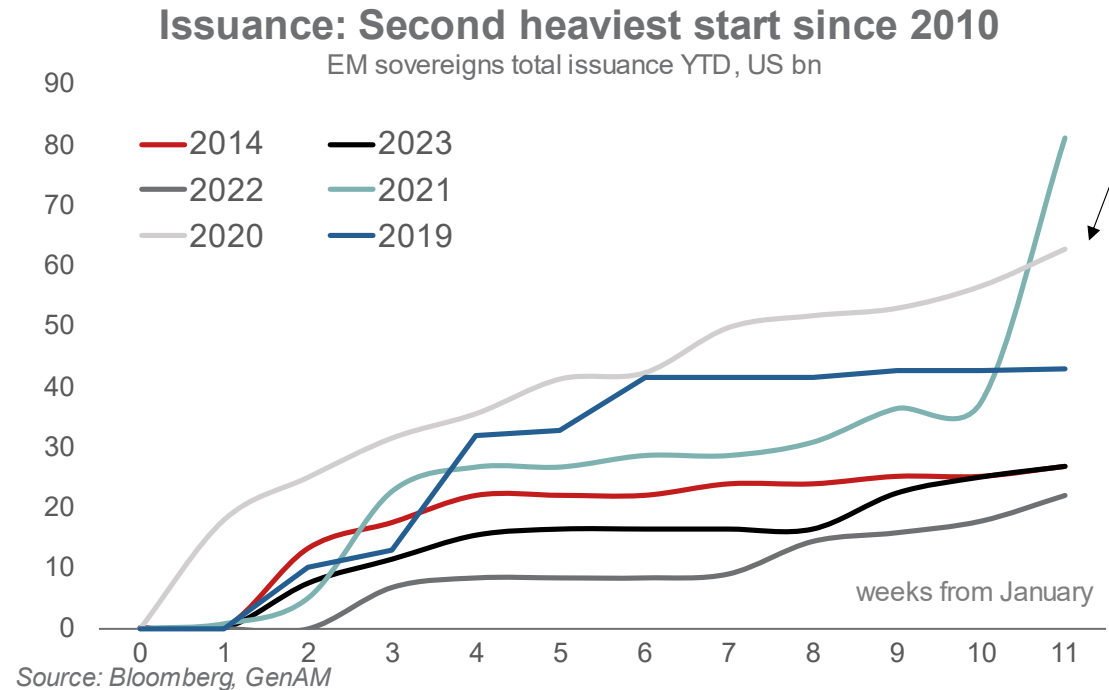


Source: ICE, GenAM

- Model tends to overestimate the USD spread since the Covid. Despite the overvaluation, current level is seen close to the fair value.
- More cheapness at the local level with several EM HY countries being cheap even after the recent rally.

Technicals are okay: US crossover on the sidelines

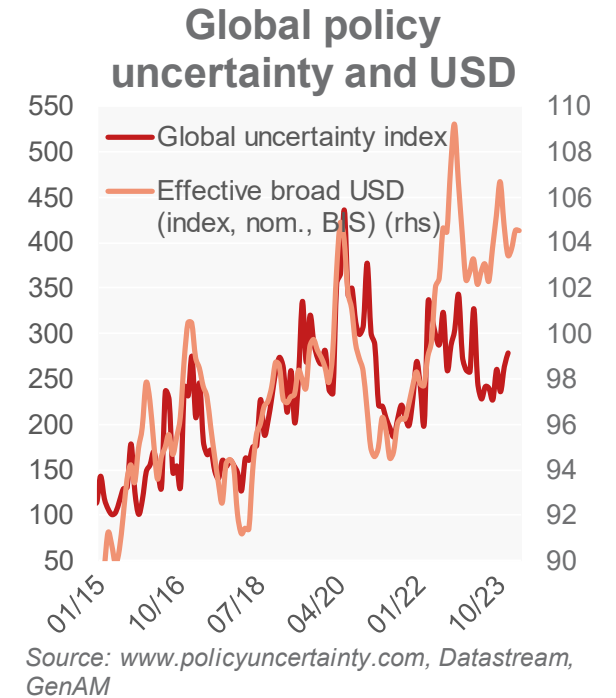
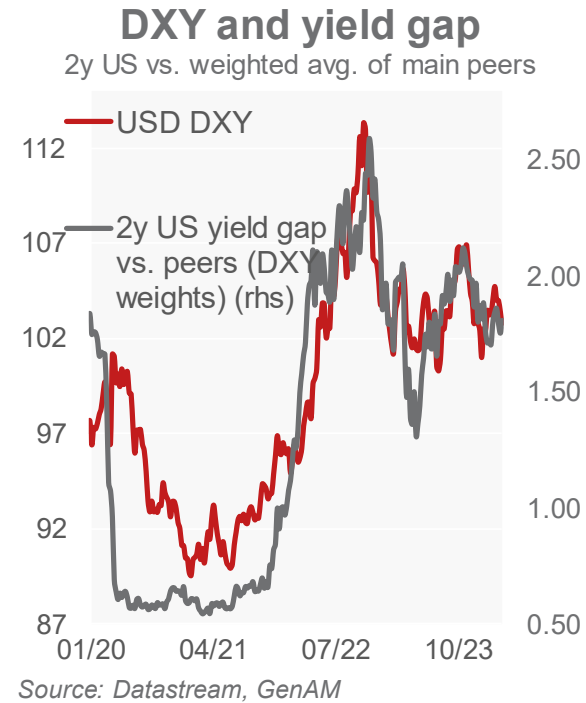
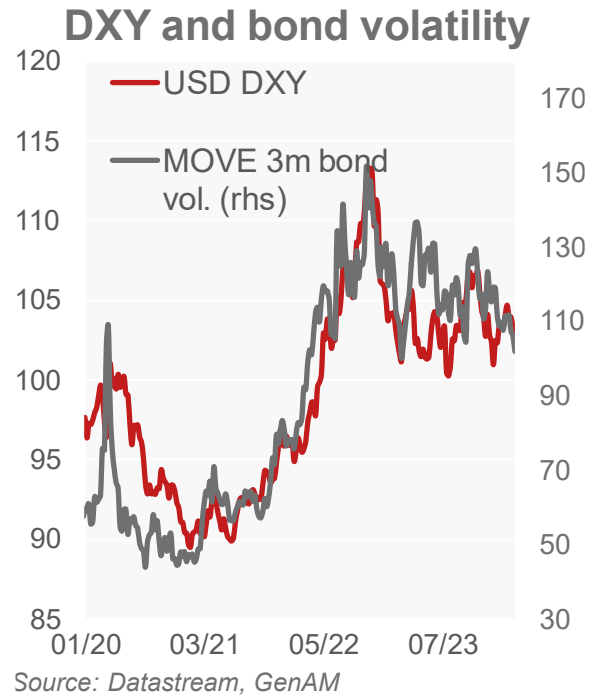
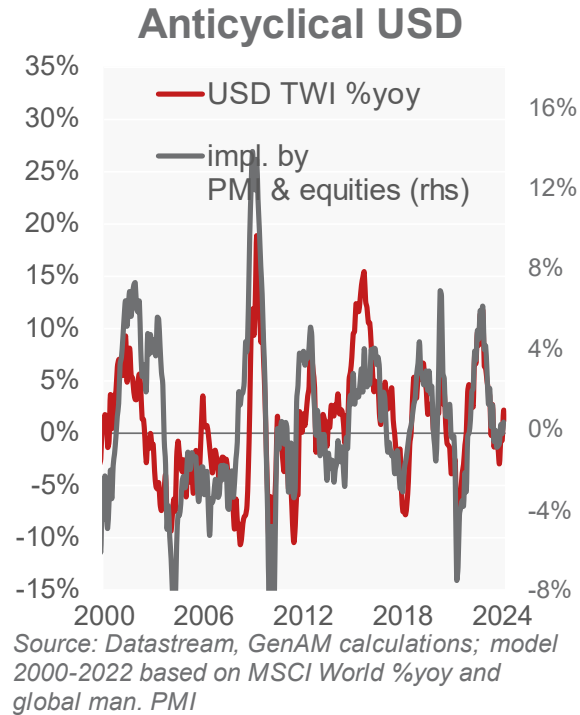
Default risk has declined even when issuing at a 10% yield



- **Mild technicals as sovereign issuance rebounded sharply** (net positive issuance YTD) with EM HY back in vogue (34% share of issuance). The reopening of the primary market eased the refinancing concerns for HY. We do not see risks of indigestion as demand was solid.
- **Inflows to improve, but marginally:** US IG crossover sentiment about EM has improved but demand to be tepid as EM IG offers limited pickup for an exotic product. US yields are too attractive.
- **Default risk has declined. Risk premia for Bs will decline further.** Issuing at 10% like Kenya is not necessarily problematic. Since 2008, only 5 out of 15 issuers of double-digit coupon bonds have defaulted. What matters is also the spread to US Treasury and the current prospect is fine.

FX: Time to turn more cautious on USD

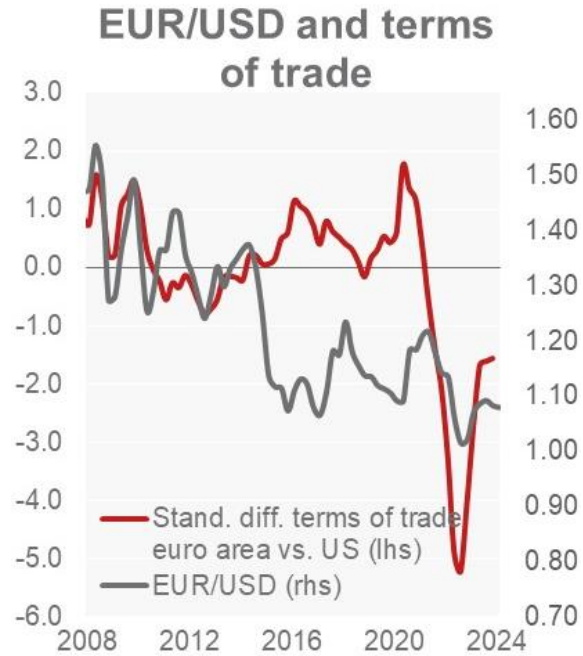
Still choppy near term, but start of rate cuts will erode rates uncertainty and US yield advantage



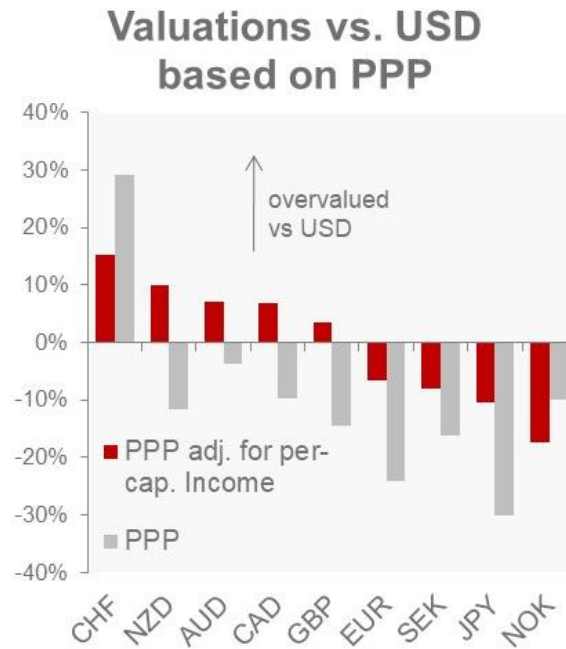
- We benefitted tactically from the USD bounce into 2024 on pared rate cuts expectations (DXY +3.6% '24 by mid-Feb). We are **turning more cautious on USD now**.
- **Cyclical forces** (risk sentiment, growth) and **yield differentials** still in the driving seat for the USD, which fundamentally remains **dear**. Prospective Fed easing points to **tighter ST yield differentials and lower rates uncertainty over 2024** – both USD headwinds. ECB and Fed may both pivot in June, but prospective rate cuts by Fed (-225bp) will exceed ECB (-150bp) over next 2 years. Short-term, choppy risk sentiment and geopol. risks may keep any USD weakness still moderate.
- A key **wildcard are US elections**. As markets may start to price a Trump victory and rising trade/geopol. tensions, the USD will be cushioned by safe-haven flows.
- The **JPY will benefit** as the BoJ will scale down policy accommodation. Eased Swiss inflation will help **SNB tolerate a weaker CHF**.

EUR tailwinds to become more visible

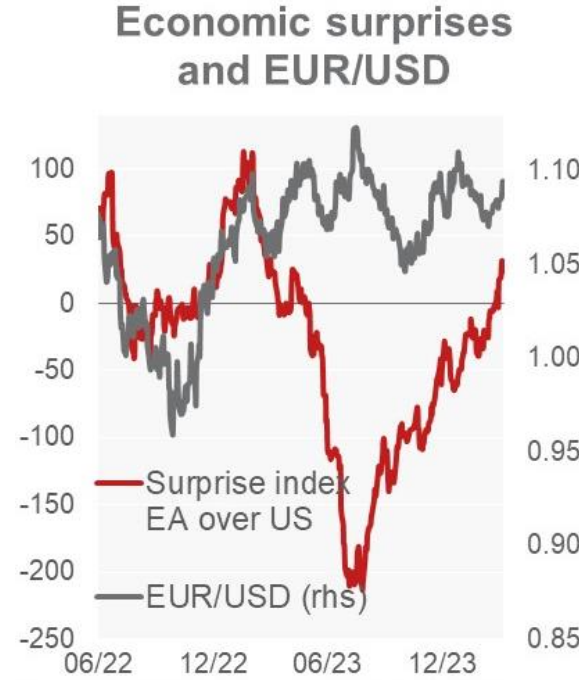
Fading energy shock and cyclical recovery into summer



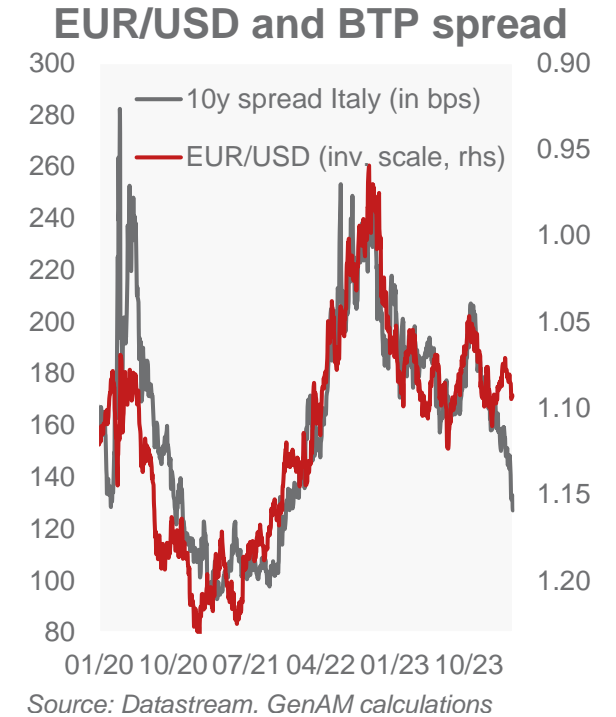
Source: Datastream, GenAM
terms of trade as std. from long-term mean



Source: OECD PPP based on GDP deflators, own calculations



Source: Citi, Datastream, GenAM calculations

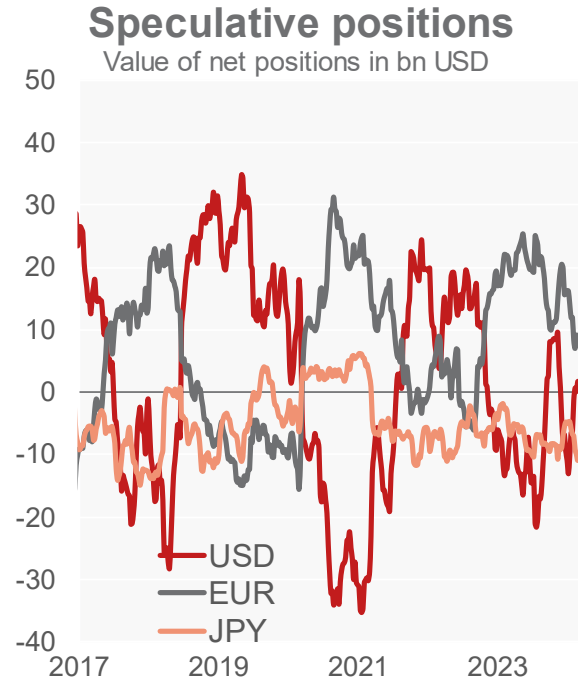


Source: Datastream, GenAM calculations

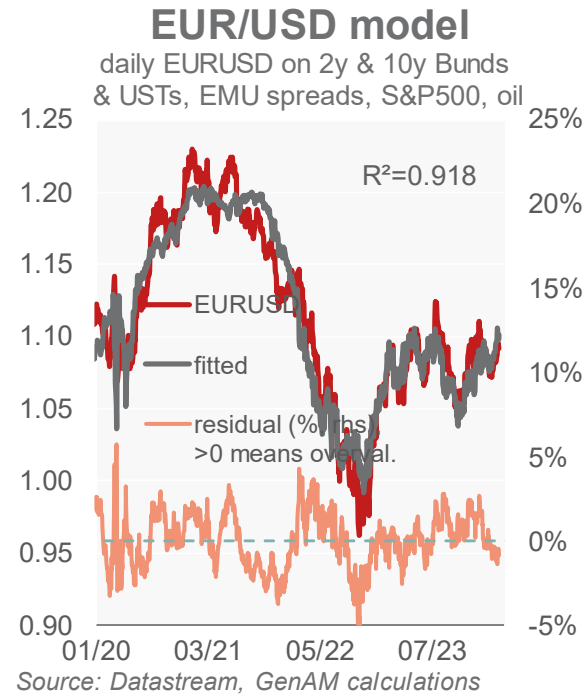
- A substantial part of the **terms-of-trade shock** seen in the wake of Russia's invasion of Ukraine **has reversed**, notably helped by eased energy prices (notably gas).
- On fundamental grounds, the **USD remains dear**, **EUR mildly cheap**, even accounting for per cap. Income differentials.
- The **relative econ. surprises of euro area vs. the US has strongly recovered** from last year's troughs. With the US decelerating (even if only to a soft landing) and the EA recovering, the tailwinds to EUR should become more visible over the coming months.

Several short-term drags on EUR/USD have eased

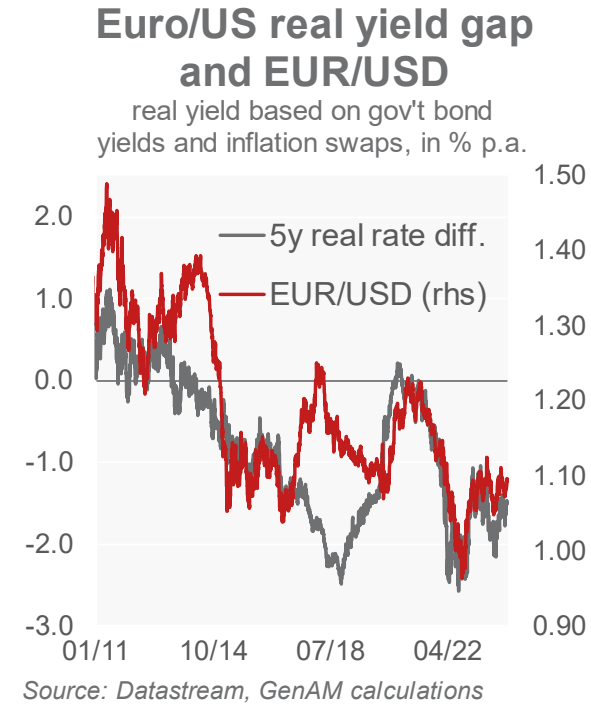
Normalised positions and eased short-term valuations



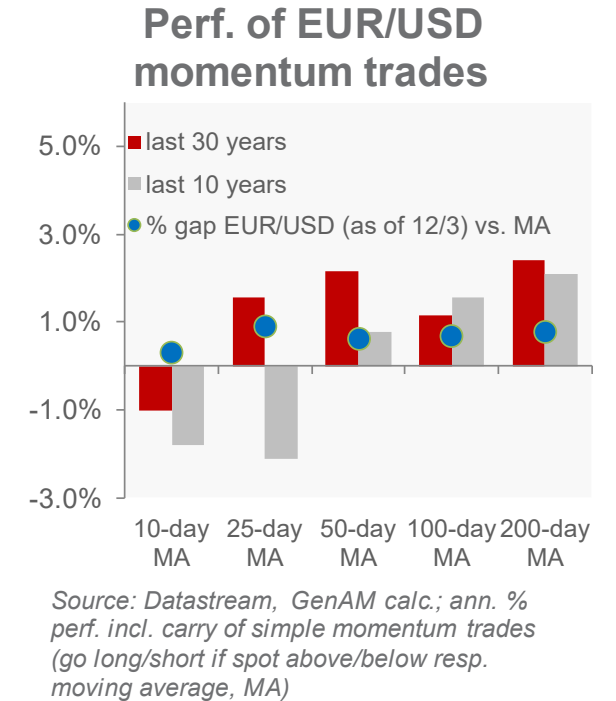
Source: CFTC, Datastream, GenAM



Source: Datastream, GenAM calculations



Source: Datastream, GenAM calculations

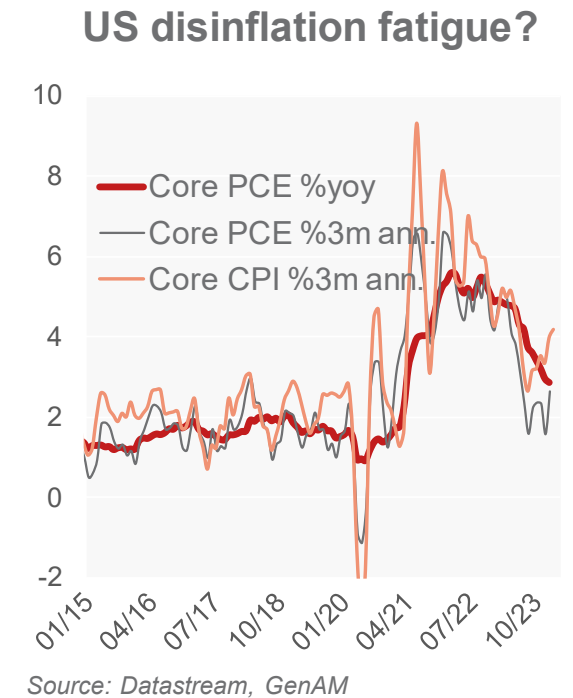
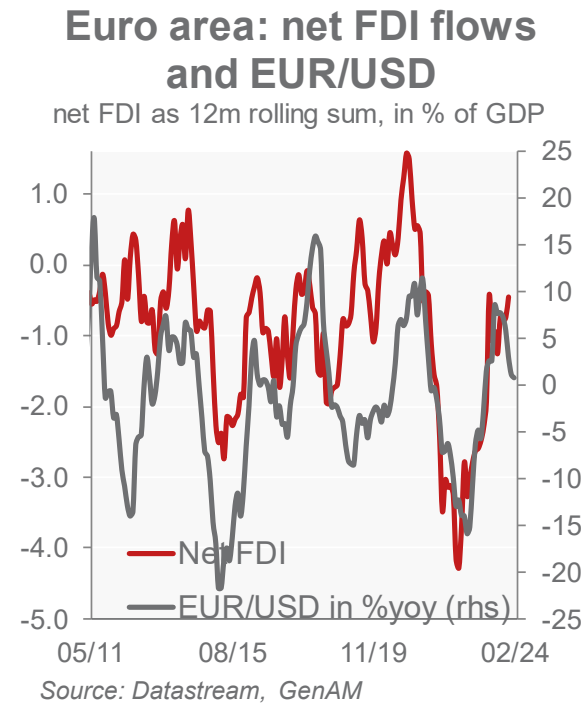
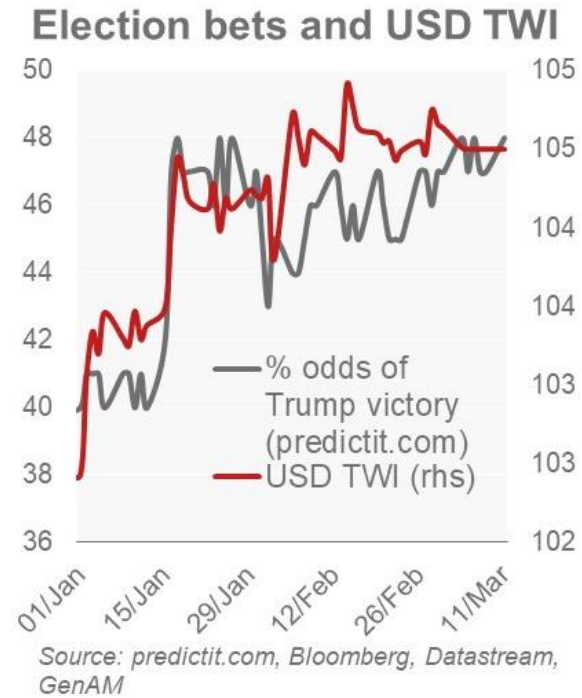
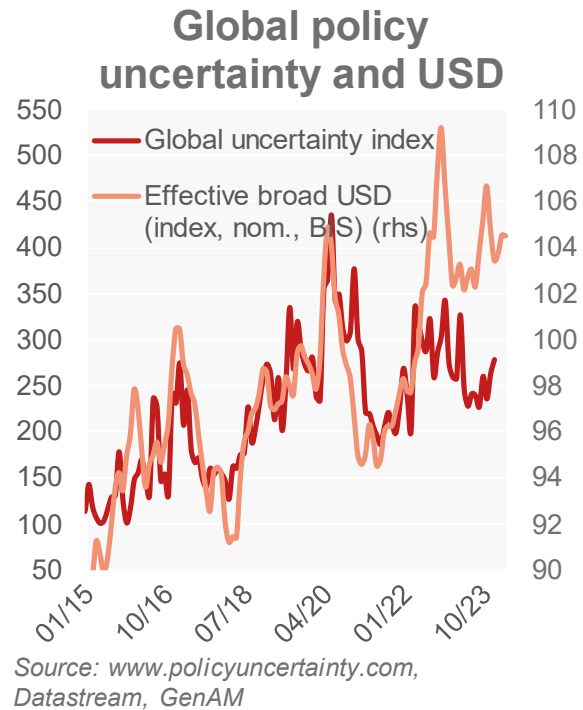


Several sources of tactical USD support have vanished since December:

- Speculative no longer stretched: **EUR long positions reduced; USD shorts neutralized..**
- EUR/USD no **longer looks dear vs. financial correlates** (yields, BTP spreads, risk sentiment, oil), with the valuation gap closed.
- Also broadly **aligned with real yields.**
- EUR/USD is a **momentum trade**, key metrics (notably gap vs. 200d MA) **now more supportive.**

What could derail the EUR/USD ascent?

Geopolitics/US elections, sluggish capital inflows into EA and public debt are key signposts to watch



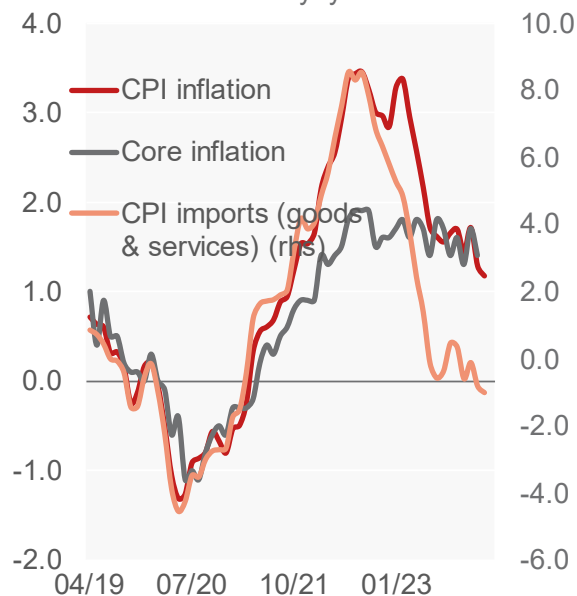
- **Rising geopolitical tensions** may trigger renewed safe-haven bids on the USD
- **A Trump victory** would reignite fears of a trade war: tariffs and delayed/slower Fed rate cuts would boost the USD.
- EUR rebound will require resuming capital inflows (incl. net FDI) amid the economic recovery. **Europe's persistent competitive disadvantage** (geopol., energy, US IRA) a risk.

Headwinds to CHF over 2024, GBP solid

Eased inflation makes SNB more tolerant about weaker CHF

Inflation in Switzerland

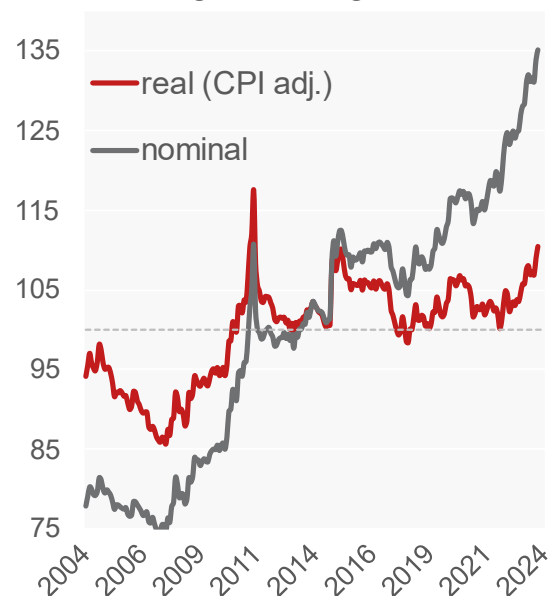
in %yoy



Source: Datastream, GenAM

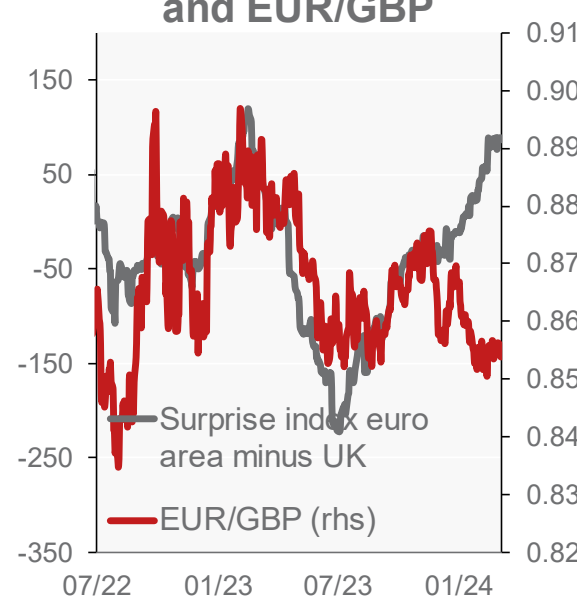
Trade-weighted CHF

Long-term average = 100



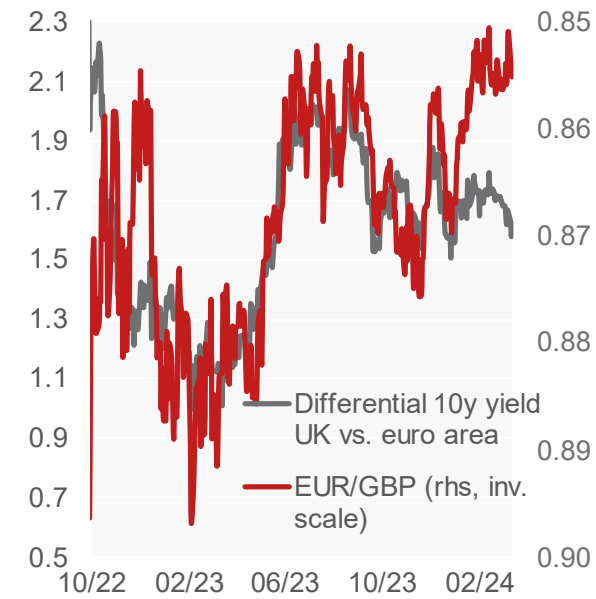
Source: Datastream, GenAM

Economic data surprises and EUR/GBP



Source: Datastream, GenAM

EUR/GBP and yield diff.

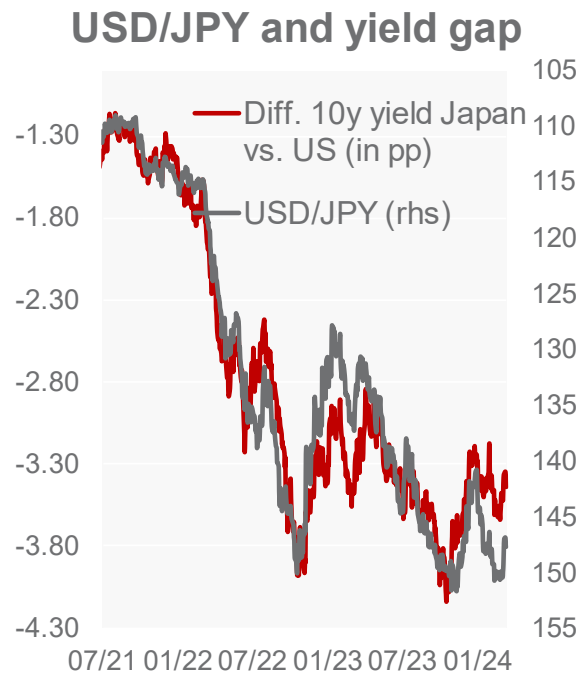


Source: Datastream, GenAM

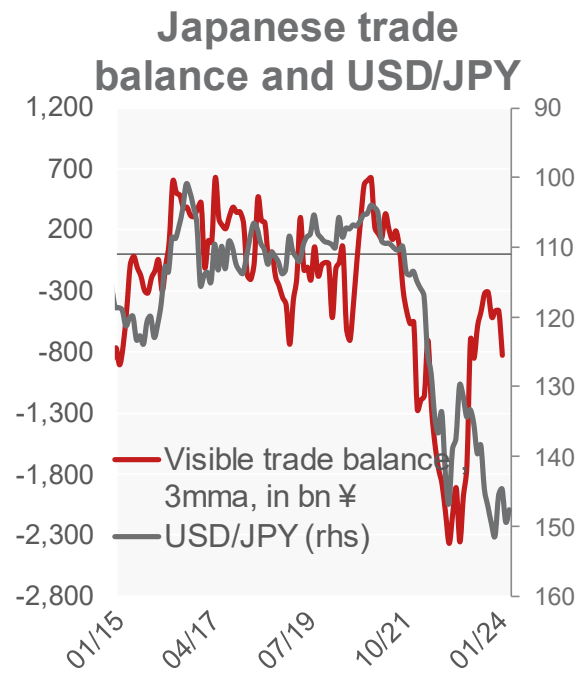
- **After CHF has tested new highs**, with pared ECB rate expectations more than offsetting the drag from the bounce in risk sentiment, we anticipate the EUR/CHF to recover ground towards parity over 2024 in a backloaded fashion.
- With price pressures now much better behaved, the **SNB is tolerating a weaker CHF**. The nominal appreciation clearly overstates the effective (CPI-adj.) value, but the CHF nevertheless is on the dear side.
- We anticipate **EUR/GBP to keep trading in a relatively narrow range**, with a tilt towards a mildly higher EUR/GBP. The slightly stronger GBP has defied the marked improvements in rel. econ. surprises for the EA vs. UK and the tighter GBP yield advantage. Yet mind the high prospects of a Labour victory in 2024 elections that may help improving ties with the EU. It may also trigger fiscal expansion and thereby high rates for longer, keeping a lid on EUR/GBP

JPY upside on lower US yields, BoJ policy normalisation

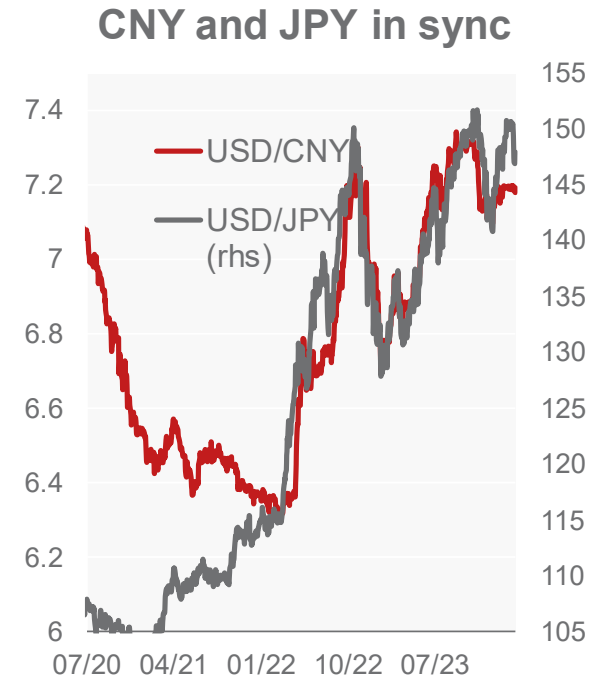
Prospect of only gradual US yield decline and no continued BoJ rate hikes limits JPY upside



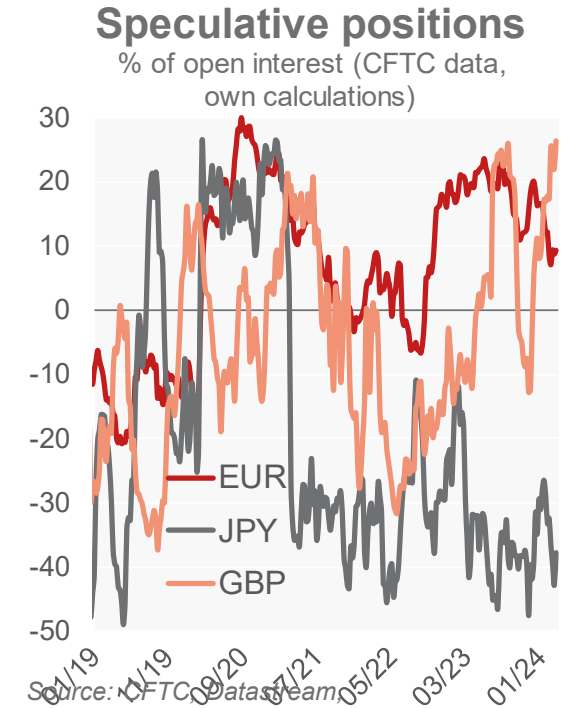
Source: Datastream, GIAM calculations



Source: Datastream, GIAM



Source: Refinitiv, GIAM

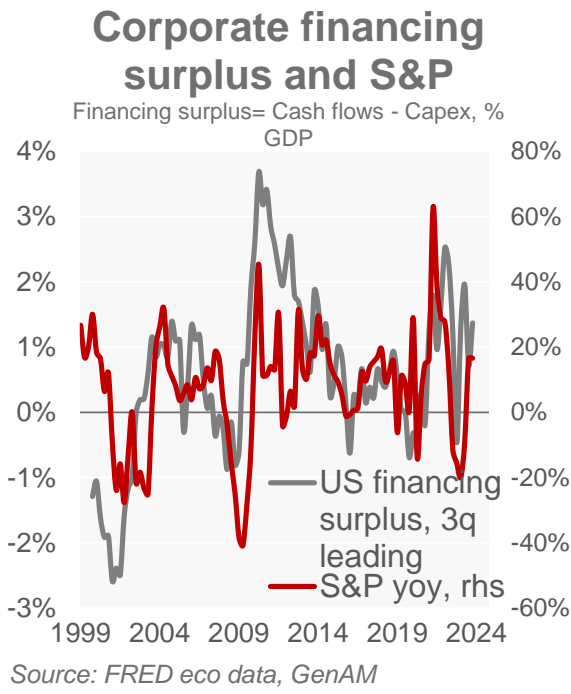
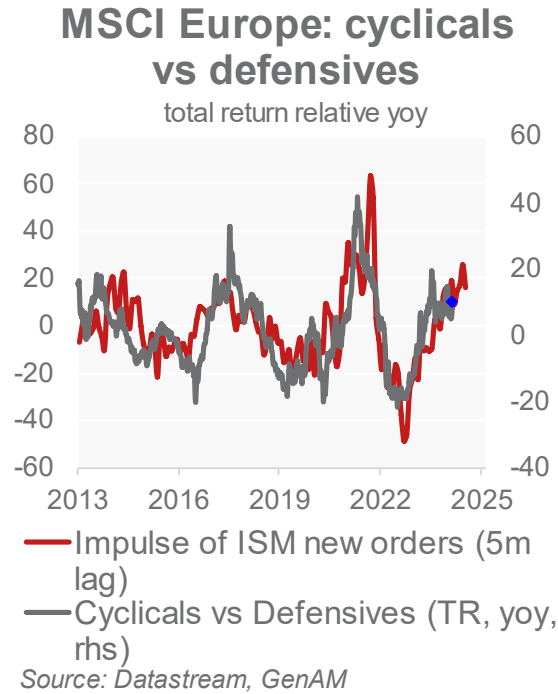
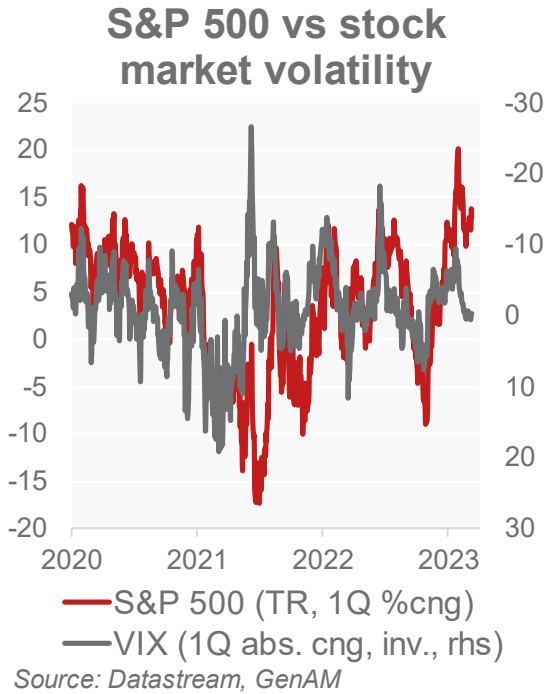


Source: CFTC, Datastream

- Lower US yields will **tighten US/Japan yield gaps** to the **benefit of the JPY**. The **JPY also looks cheap** vs. current yields, Japan's improved trade balance / terms of trade and even the USD/CNY which it tracked closely for longer.
- Speculators are keeping sizeable JPY short positions, rendering also potential for a yen recovery.
- First rate hike by the BoJ is on the cards for April, if not March, though this is now widely anticipated. **Markets may overprice prospects of further BoJ hikes thereafter, which may cap the yen's prospective ascent.**

Equities: tactically neutral. Positive returns in 12 months: EMU +8%

The mid-term outlook is decent, but prone for setbacks short term: positioning, VIX, quant models, US valuation



12m targets

Market Index	AVG LT model valuation	PE-based valuation	Shiller LT risk premium for target inflation (US)
S&P 500	-12.0%	-7.2%	4,900 - 5,500
MSCI EMU	8.3%	12.6%	
FTSE 100	11.1%	10.2%	
SMI	6.1%	7.7%	
TOPIX	3.7%	4.1%	

Source: Datastream, GenAM calculations
Note: LT models: PE tgt (US 17.3x, EMU 13.1x, JP 14x), Fed model, EY-BY, DDM, and 3-stage eps growth model

- Positives: better macro outlook, easier financial conditions, CF-Capex spread and strong Tech earnings. The reporting season surprised positively. **The mid-term equity outlook is decent, but prone for setbacks short term:** Positioning (>80% pc), bottoming VIX, overbought mkt, negative ST models, Tech PEG slightly dear, ML models deteriorating, pension funds rebalancing, geopol. risk. SPX approaching the upper band of our 12m target range : 5,500 → **tactically neutral**.
- OW: SMI, EMU vs. US, Japan, China (slight, slowly accumulating positions), Korea, and India. Still OW Jap** (lower OW after the rally - quant models): restructuring, increasing ROE, buybacks, composite valuation rank, attractive CAPE yield gap.
- 12m TR still positive (LC):** EMU +8%, US +5%, Japan 7%, EM +10%. Furthermore, the macro cycle is stabilizing and is set to rebound in H2, with lower yields and a more dovish monetary policy.

US and EMU earnings set to bottom out

US NIPA profits, which lead SPX and EMU EPS, started growing again (y/y) in Q423

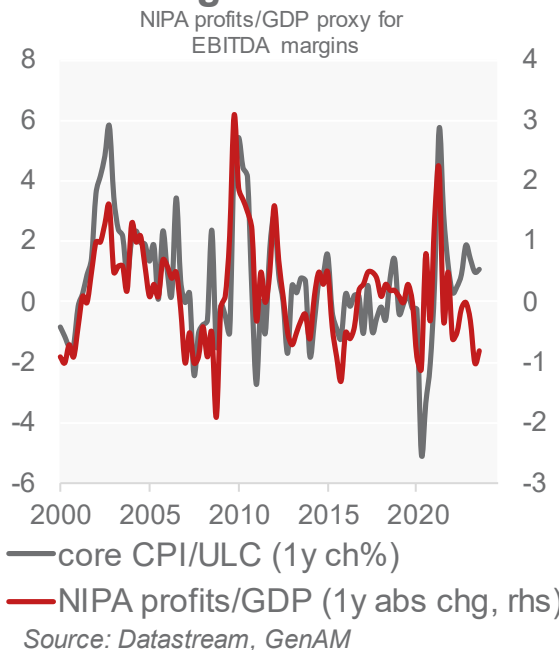
GenAM earnings forecasts

	US NIPA profits pre-tax		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	3,280.7	-0.6	216.2	-0.9	16.4	10.5
2023 Q4	3,277.2	0.9	216.8	-0.6	16.5	3.7
2024 Q1	3,318.7	4.9	221.9	2.8	16.6	4.0
2024 Q2	3,337.2	5.2	225.5	5.0	17.0	5.5
2024 Q3	3,410.1	3.9	229.6	6.2	17.3	6.0
2024 Q4	3,407.8	4.0	230.8	6.5	17.5	5.8
2025 Q1	3,455.5	4.1	232.0	4.6	17.5	5.5
2025 Q2	3,454.0	3.5	236.7	5.0	17.9	5.3
2025 Q3	3,522.7	3.3	241.9	5.4	18.2	5.1
2025 Q4	3,548.7	4.1	244.7	6.0	18.4	5.2

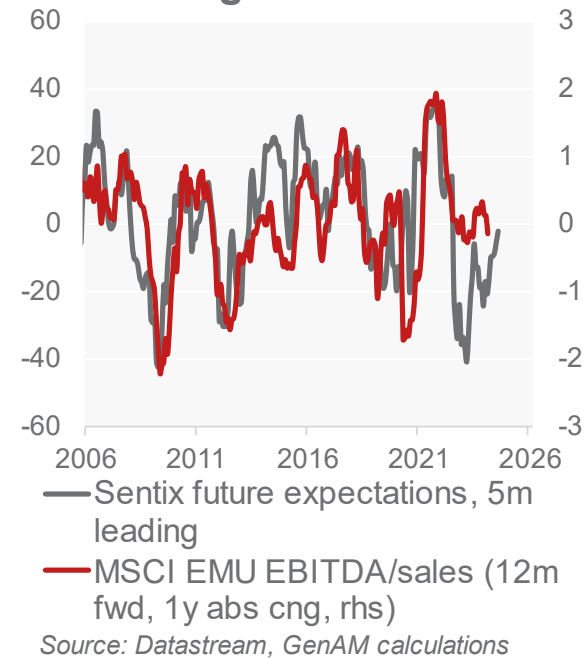
Source: LSEG, GenAM calculations

Note: S&P and EMU trailing earnings as of end of qtr; they are derived from NIPA; forecasts in bold

US Margins & CPI/ULC



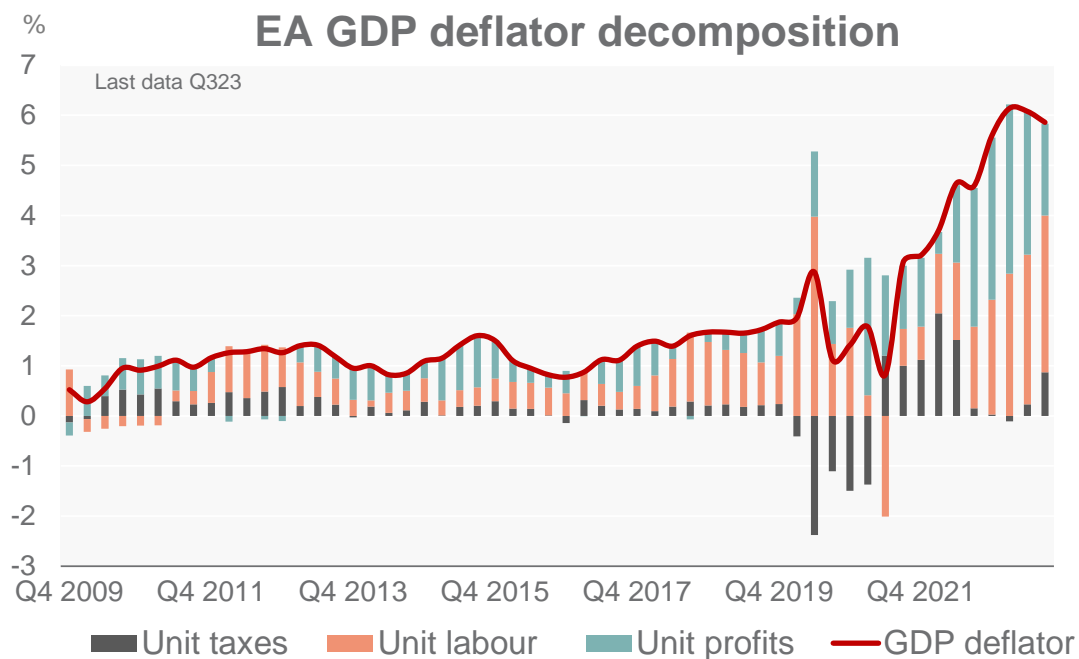
EA Margins and Sentix



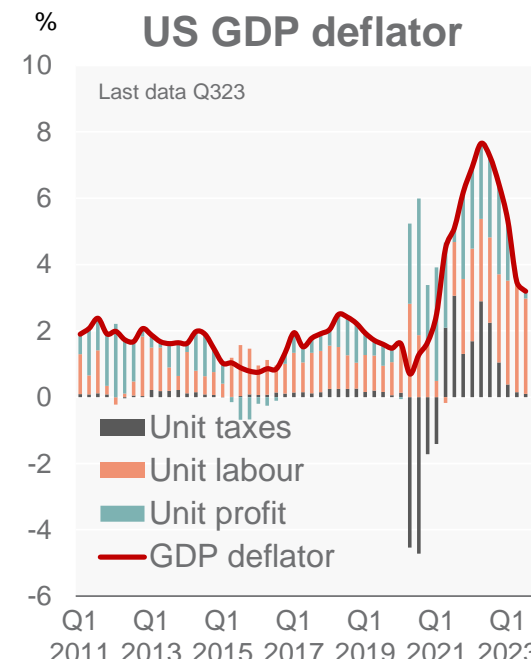
- **S&P earnings growth** (year-on-year) likely bottomed out in Q323. Financing conditions have improved, and leading indicators are becoming more supportive.
- **EA earnings** are showing more resilience than previously expected, notwithstanding a weak macro momentum. Sentiment continued to improve in Q1 in line with expectations that the economy will be expanding from Q124: **we see a positive earnings growth in 2024, slightly above consensus. That said, risk comes from margin trend**: current capacity utilization, CPI/ULC trend and Mfg PMI remain very weak, while, on the contrary, wages growth stays high (above 4% yoy).

US Unit profit correction well advanced; EA ones lagging

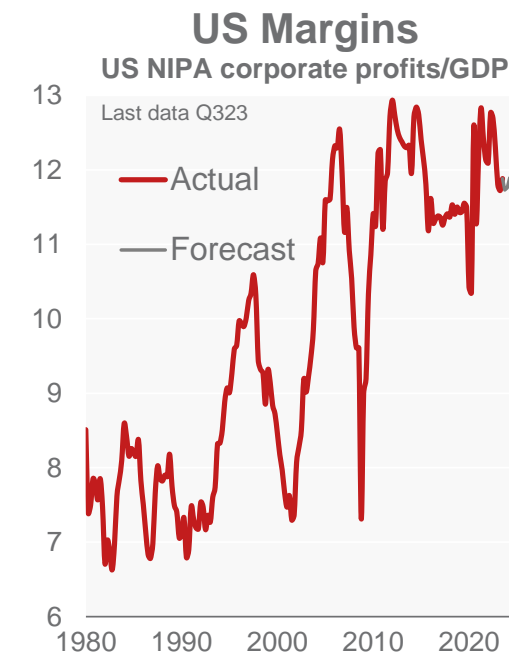
We expect a decline in the growth of EA Unit profits ahead, in line with what happened in the US



Source: Eikon, GenAM calculations



Source: Eikon, GenAM calculations

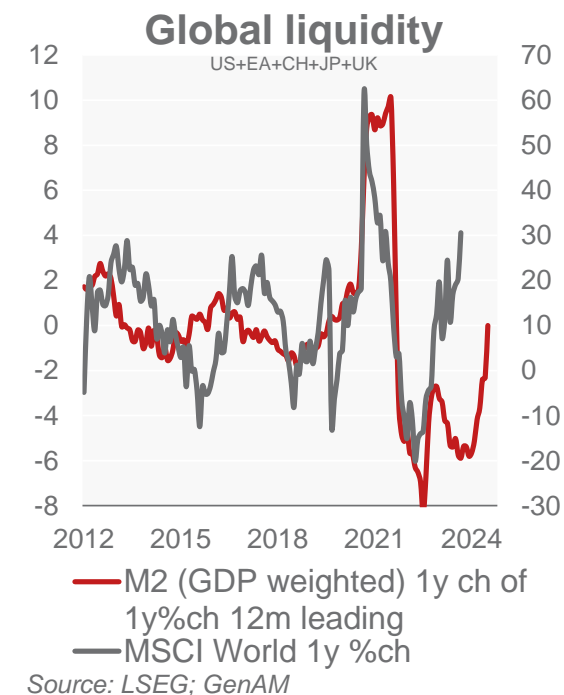
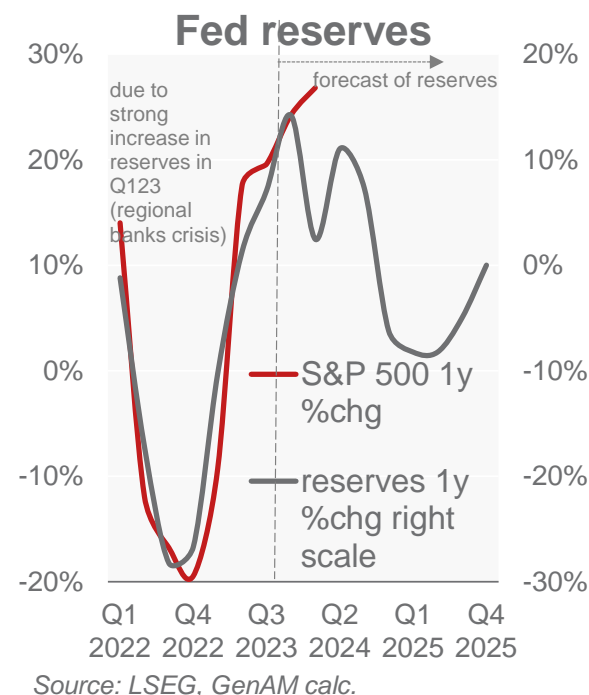
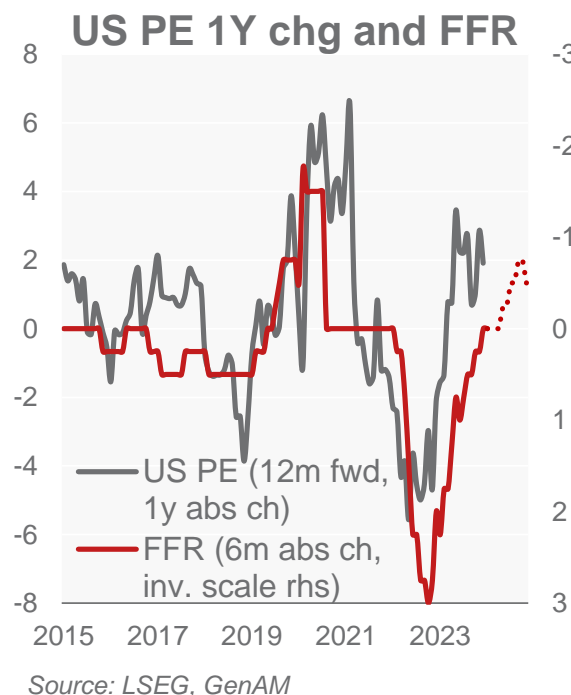
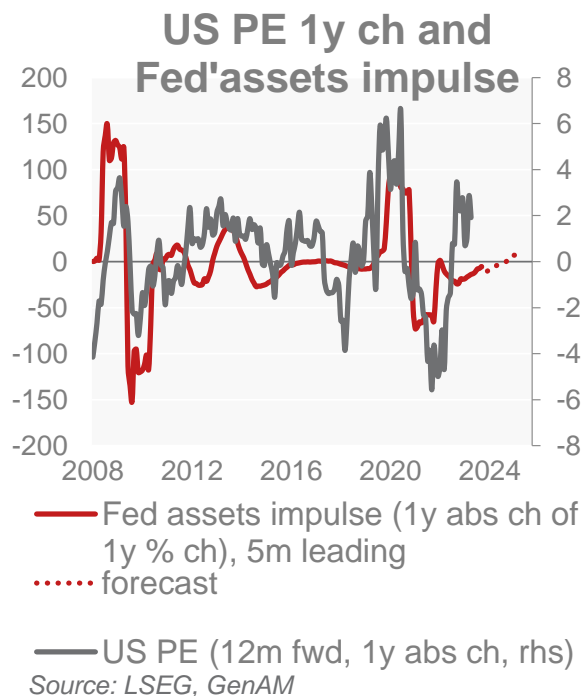


Source: LSEG, GenAM calculations

- The growth of **US Unit profits** has been **slowing down since Q422** and could be closed to bottom - in line with **our expectations on NIPA profits/GDP**. The contribution to the GDP deflator of **EA ones is declining more slowly, but** exceptional factors which contributed to growing margins are fading (the unwinding of pent-up pandemic-related demand, the easing of supply bottlenecks and the dampening impact of monetary policy tightening).
- **ECB:** [disinflation will depend on] “**..firms buffering rising labour costs with a slowdown in profit growth**. Since the aggregate level of profits surged in 2021-2022, **there is some room for profit compression without driving profitability to below-average levels**. The contribution of unit profits to domestic price pressures continued to fall in the third quarter of 2023, suggesting that unit profits are absorbing some of the price pressures coming from rising unit labour costs. **The profit margin proxies derived from the responses to recent corporate telephone surveys also suggest that this buffering process is at work**”.

US PE have increased slightly more than suggested by Fed policy (FFR and assets)

PE is not going to fall significantly, unless earnings surprise on the upside



- **PE expansion has slightly anticipated a more dovish monetary policy.** We see some stabilization, but **not a significant repricing**, unless earnings rise faster than expected
- **Bank reserves** have increased despite the Fed's QT, but will slow down, which will be a headwind for equities (but not negative growth).
- **Global liquidity**, measured as GDP weighted M2 growth in US, EA, JP, China and UK, has accelerated in recent months. This is supportive for equities, albeit part of the movement has already been anticipated by the market.

Ex-US valuations show good Total Return potential over 12m

US TR is more debatable, but we think the SPX valuation range in 12m is 4,900 – 5,500. Our target is 5,350.

CAPE yield analysis (based on IBES earnings): updated on 12/03/2024

Equity Index (using IBES earnings)	(A) Curr. CAPE yield gap vs 10y rate minus 10y avg infl. *	(B) 1yr fwd CAPE yield gap	(C) CAPE yield gap, AVG (since 2003)	(D) = A-C Current spread, % to avg since 2003	(E) = B-C 1yr fwd spread, % to avg since 2003	(F) excess CAPE yield, 1yr fwd (point fcast for 10y real rate - BL)	(G) excess CAPE yield, 1yr fwd (point fcast for 10y real rate - BL), AVG (since 2003)	(I) = F-G spread, % to avg since 2003
USA	2.2%	2.8%	4.2%	-2.0%	-1.4%	2.4%	4.6%	-2.2%
JAPAN	4.7%	4.4%	4.8%	-0.1%	-0.3%	5.5%	5.4%	0.1%
UK	6.9%	7.6%	6.4%	0.5%	1.1%	6.9%	7.1%	-0.1%
SMI	4.8%	4.9%	4.9%	-0.1%	-0.1%	5.5%	5.0%	0.5%
EMU	5.9%	6.2%	6.7%	-0.8%	-0.5%	5.9%	7.2%	-1.3%
CHINA	11.0%	10.7%	5.9%	5.1%	4.8%	10.0%	5.6%	4.5%

Note: data since 1993; World and EMs are based on MSCI, for other markets local indices are used. Earnings are from IBES.

CAPE (cyclically-adjusted PE) = index price divided by earnings averaged over a 10-year period adjusted for inflation,

excess CAPE yield = 1/CAPE - (10yr rate - avg inflation over 10yr) = real earnings yield minus real rate, using 10-yr avg for CPI and earnings

Source: Thomson Reuters Datastream, IBES estimates, Bloomberg, GenAM

Risk-premium based approach to valuation, using long-term Shiller series since 1872

US CAPE-based valuation (adj. for inflation)	10Y	CPI	EPS
Scenario 1 (cons. est's in 1 yr)	3.8	2.7	275.4
Scenario 2 (GI exp. in 1 yr)	3.8	2.3	263.0

index FV derived from tgt ERP coherent with inflation ranges

	Scen. 1	Scen. 2 (GenAM)
using avg ERP for tgt CPI 2.5 - 3.0	4,974	4,481
using avg ERP for tgt CPI 3.0 - 3.5	4,912	4,427
using median ERP for tgt CPI 2.5 - 3.0	5,227	4,710
using median ERP for tgt CPI 3.0 - 3.5	5,522	4,943
Average S&P500 valuation	5,159	4,640
Current value: 5,096	1.2%	-8.9%

Note: Target ERP (3.9) is calculated assuming CPI in the range b/w 2.5% and 3.5%. We used 25% of current risk premium's SD.

Market index	exp. TR return (DY + eps growth)	PEG adj (using eps FY3 and LT growth)
S&P 500	14%	1.6
MSCI EMU	9%	1.9
FTSE 100	10%	1.5
SMI	13%	1.7
TOPIX	11%	1.8

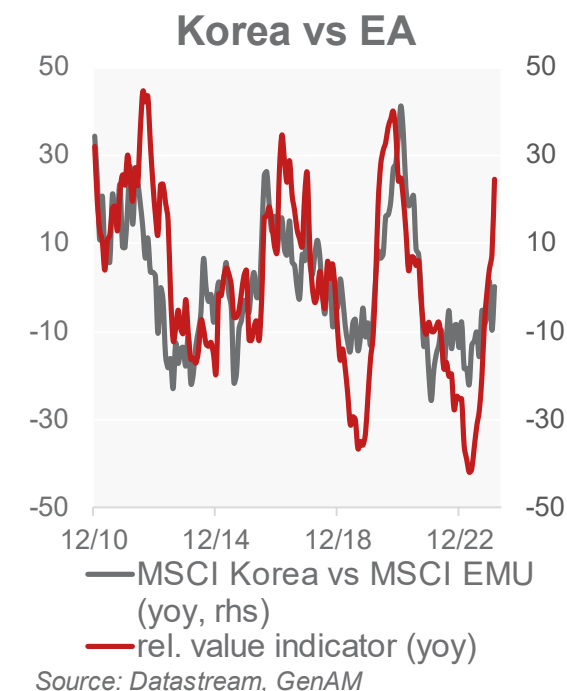
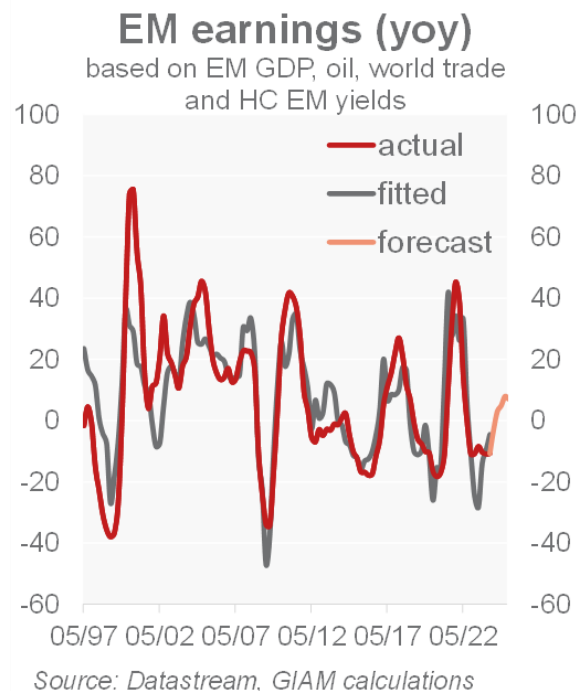
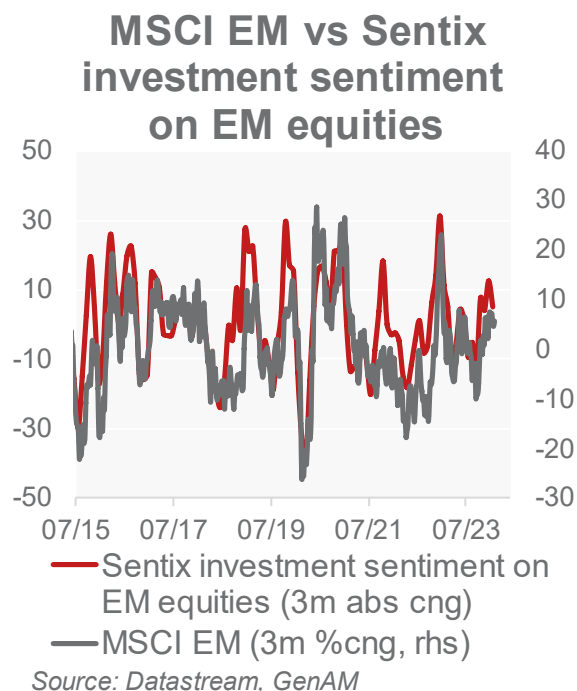
Source: Datastream, GenAM calculations

PEG adj. (higher = expensive): PEG is modified by the ratio COE/ROE which signals the ability to produce a return on capital higher than the cost of it.

- The lower gap between the **CAPE yield and the real interest rate** shows US to be expensive vs. history (2.8% vs avg of 4.2%), though not at all comparable with the one in 2000 when it was even negative (-1%). It was +2% in H1 2007 and +2.2% in 10/2018. **The euro area is on the contrary fair**, which means that equities can eventually outperform bonds in line with history. This is even more true for China, where the gap is meaningfully positive, but of course we know China's issues.
- The US market looks 12% expensive on average, using **traditional valuation, based on market multiples** and 10-year yields.
- Our preferred methodology for the US considers the long-term series of the risk premium from the **Shiller** series and its consistent target - judging by history - when the expected level of inflation in 2024 is considered. The result is the fair value of the SPX is between 4,900 and 5,500. Our target is 5,350. **Both the PEG-adjusted and TR methodology** suggest US is more attractive than EMU. That said, we bet tactically on EMU as its macro surprises have turned positive.

EM equities: maintain neutral stance, slight OW on China, OW India and Korea

Affected in the short term by weakening sentiment



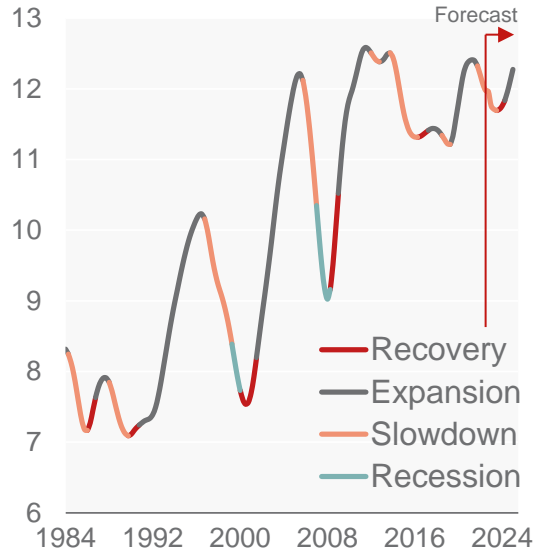
- EMs earnings are likely to remain weak. Global export orders are still in contractionary territory and our model expect a low earnings growth of around **4% in 2024** and 8% in 2025. That said, we **remain neutral** as EMs have depressed valuations (at almost 1 st.dev. vs MSCI World).
- China** discounts a lot of negative news and M2 impulse is becoming more supportive, thus offsetting some risks we see in the short term as economic policy has few chances to become too aggressive (accumulate slowly).
- OW India** (val., eco) and **Korea** (val., eco). The latter has the highest country score among 45 covered equity markets: highest consensus earnings growth in both 2024 (67% vs 8% for MSCI World) and 2025 (27% vs 12% vs World). Korea is to benefit from a strong growth in semis and the auto sector. Furthermore, a possible win of the democratic party in April 2024 should trigger higher hopes for market reforms, increasing Korea's attractiveness for global investors.

Cross Asset: historical analysis: not bad for Equity, but be careful into summer

Looking at historical relative performance through the cycle (free of any valuation consideration)

US Margin cycle indicator

based on US corporate profits/GDP



Source: LSEG, GenAM calculations

Relative average qtr returns of asset classes

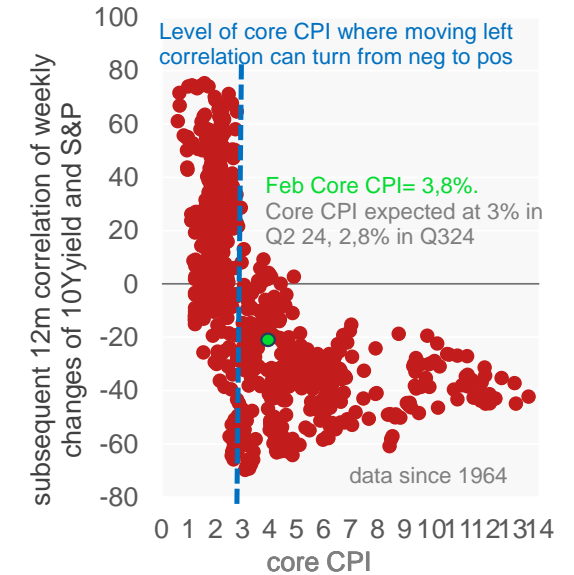
since 1980 ('97 for HY)	Recovery	Expansion	Slowdown	Recession	full period
E-10Y Treas	3.9%	1.6%	1.7%	-10.5%	1.4%
E-IG	1.4%	0.8%	1.5%	-7.0%	1.2%
E-HY	-1.6%	0.9%	2.2%	-3.5%	0.7%
IG-10Y Treas	1.4%	0.3%	0.0%	-3.3%	0.1%
HY-10Y Treas	3.2%	1.0%	0.5%	-6.8%	0.4%
n° obs since '80	22	84	59	8	173

Median 3M return since 2000

	10Y yield		10Y real yield (using breakeven inflation)		Fed funds rate	Real Fed funds rate (using CPI)		realized bond vola		move*	
07/03/2024	4.1		1.8		5.5	2.4		7.9		105	
	[3.5 4]	[4 4.5]	[1 1.5]	[1.5 2.0]	[5.0 5.5]	[1 2]	[2 3]	[7.1 8.6]	[> 8.6]	[90 109]	[> 109]
Equity vs Govies	✗	✓	✓	✗	✓	✓	✗	✗	✓	✗	✗
Equity vs IG	✗	✗	✓	✗	✓	✓	=	✗	✗	✗	✗
Equity vs HY	✗	✗	✗	✗	✓	✓	✓	✗	✗	=	✗
IG vs Govies	✓	=	✓	✗	✓	✓	✗	✓	✓	✓	✓
HY vs Govies	✗	✓	✓	✗	✓	✓	✗	✗	✓	✗	✗

* The move index is a measure of US interest rate volatility

US yield/Equity correl

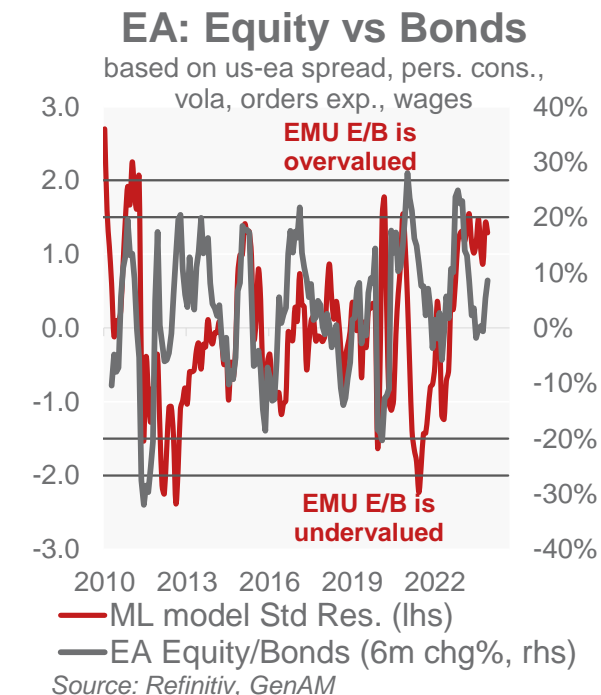
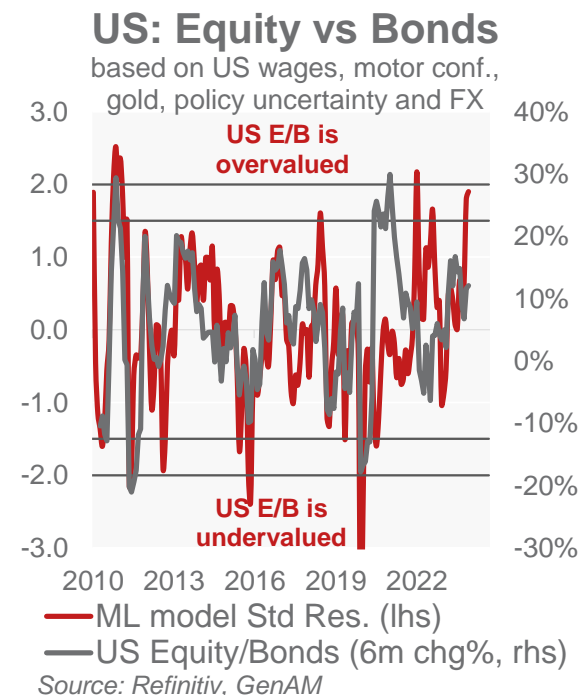
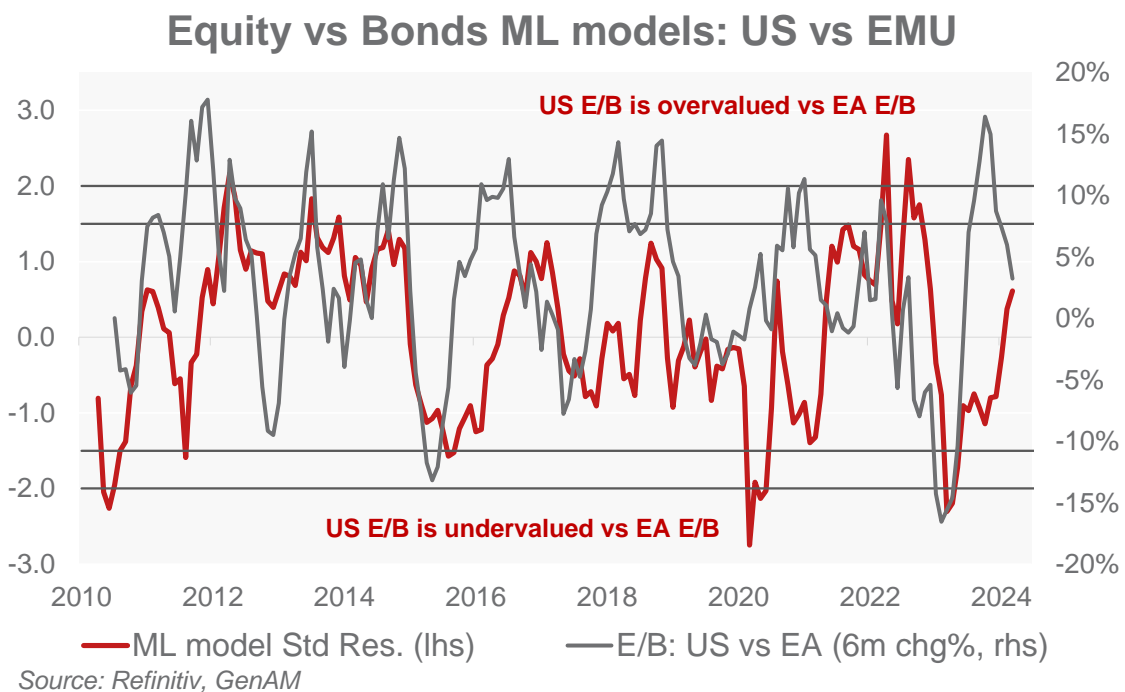


Source: LSEG, genAM calc. based on Yared, Duetsche Bank

- Looking at the cycle through the lens of US Margins (left chart and upper table), our indicator, NIPA Profits/GDP, points towards continuing **Slowdown till Q224**. In this phase quarterly returns of **equities (E) have usually been higher than FI ones**. As we get nearer to June, our indicator signals a **Margin Recovery: E could continue to beat fixed income but not HY**. Credit beats Treas. by a greater amount than in Slowdown.
- The **past relative performance at certain yield and vol levels** (lower table) suggests **E and IG may be in a good position vs UST (but bond vol could hurt E)**.
- Yield/equity **correlation** (right chart) could continue to be negative in Q2: we expect **core CPI** at 3%; Q3 could be a change game as core CPI is expected at 2.8%
- Focus on **E vs HY: less clear picture**. The current Margin Slowdown would favour E, but E outperformance has already been huge and current yield levels and bond volatility are not supportive. Furthermore, we are moving towards Margin Recovery, which would suggest a more prudent stance on E vs HY.

Quant model: Equity/Bond neutral in EMU, bonds marginally favoured for the US

When a model (EA) is neutral, it still points to an average Equity overperformance vs. bonds



- Our Equity/Bonds **Machine Learning (ML) models** are based on Genetic Algorithm (see methodological note [here](#)).
- In short, we have **enhanced our traditional econometric model selection with Genetic Algorithm (GA)**. Which is an efficient search-based method that reduces model development time while improving predictive power. It mimics 'survival of the fittest' to refine investment models, aiding our selection process.
- The models are signalling a **slight overvaluation for US**, while they are still **neutral EMU**. In **relative terms (US/EMU Equity/Bonds) the models are Neutral**.
- **According to real-life tests, when a model (US or EA) is neutral, it still points to a normal Equity overperformance. For the relative E/B one (US vs EMU) neutral is signalling a flat performance (mean-reverting).**

APPENDIX – IMPRINT

Macro & Market Research team

Head of Research:

Vincent Chaigneau (vincent.chaigneau@generali-invest.com)

Head of Macro & Market Research:

Dr. Thomas Hempell, CFA (thomas.hempell@generali-invest.com)

Team:

Elisabeth Assmuth (elisabeth.assmuth@generali-invest.com)

Elisa Belgacem (elisa.belgacem@generali-invest.com)

Radomír Jáč (radomir.jac@generali.com)

Jakub Krátký (jakub.kratky@generali.com)

Michele Morganti (michele.morganti@generali-invest.com)

Vladimir Oleinikov, CFA (vladimir.oleinikov@generali-invest.com)

Dr. Martin Pohl (martin.pohl@generali.com)

Dr. Thorsten Runde (thorsten.runde@generali-invest.com)

Dr. Christoph Siepmann (christoph.siepmann@generali-invest.com)

Dr. Florian Späte, CIIA (florian.spaete@generali-invest.com)

Guillaume Tresca (guillaume.tresca@generali-invest.com)

Dr. Martin Wolburg, CIIA (martin.wolburg@generali-invest.com)

Paolo Zanghieri, PhD (paolo.zanghieri@generali.com)

Issued by:

Generali Asset Management S.p.A. Research Department

Sources for charts and tables:

Refinitiv/Datastream, Bloomberg, own calculations

Version completed: April 3, 2024

In Italy:

Generali Investments
Europe S.p.A SGR

Piazza Tre Torri, 1
20145 Milano MI, Italy

Piazza Duchi degli
Abruzzi 1,
34132 Trieste TS, Italy

www.generali-investments.com

In France:

Generali Investments
Europe S.p.A SGR

2, Rue Pillet-Will
75009 Paris Cedex
09, France

In Germany:

Generali Investments
Europe S.p.A. SGR

Tunisstraße 29
50667 Cologne,
Germany

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