GENERALI INVESTMENTS

Market Compass

December 2023

MARKET OUTLOOK

- Progress on disinflation and easing fears of escalation in the Middle East have fueled a broad-based market rally in November.
- Amid the siren calls from lower yields, however, mind the still difficult growth outlook. We expect the lagged fallout from the Fed's tightening to send the US into stagnation, while Europe will recover only sluggishly from a moderate recession.
- The decline in yields still has legs, albeit more moderately so. With hopes of early Fed and ECB pivot already advanced, central banks will need to keep financial conditions from easing too fast.
- Risk assets discount quite some optimism and cyclical concerns will overshadow more strongly the disinflationary relief. We retain some caution on Equities and High Yield (HY) Credit near term, favouring Investment Grade (IG) Credit and longer-dated Govies. Amid a somewhat brighter outlook for risk assets, we trim the size of active positions.

Edited by

MACRO & MARKET RESEARCH TEAM

A team of 13 analysts based in Paris, Cologne, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

US

- ⊕ Q4 slowdown likely to be mild
- ⊕ Disinflation smoother than expected...
- ⊕ ...with little or no harm to the job market
- ! First cut in Q2/24, but the Fed needs to push back against too rosy expectations on loosening

UK

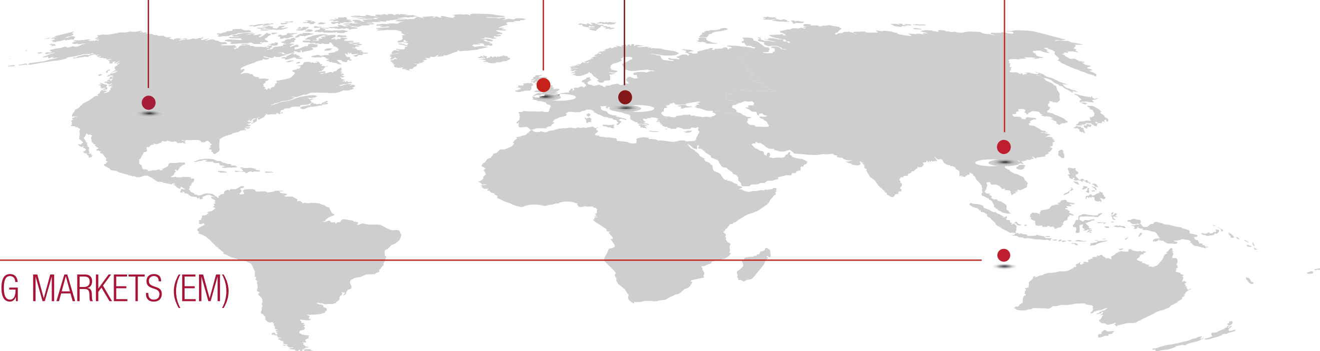
- ⊕ BoE to keep Bank Rate on hold
- ⊕ PMIs surprised on the upside
- ⊖ GDP growth stagnated in Q3

EUROZONE

- ⊖ Economic indicators show protracted weakening into Q4
- ⊕ Inflation receded significantly in October
- ⊕ Labour market remains solid
- ! ECB may stick to peak rate for longer

CHINA

- ⊖ China's data remained mixed
- ⊕ Fiscal policy likely to support real estate sector
- ⊖ Insolvency of large shadow bank shows risks from ailing property sector



EMERGING MARKETS (EM)

- ⊕ EMs face fewer headwinds
- ⊕ EM fixed income outlook turns more bullish
- ⊕ Resilient activity and disinflation continues

⊕ Positive
⊖ Negative
! Topics to watch

DIRECTION OF TRAVEL

- We further trim our underweight (UW) equity and HY, as tail risks decreased.
- We continue to prefer IG credit, as carry remains attractive.
- We still see value in longer dated sovereign bond, but trim the overweight.
- Within EM we prefer local currency debt and the IG segment, especially BBB rated.
- We keep cash to almost Neutral.

Equity

- Cautious view after the rally, supported by expected slowdown in the next months and very low market volatility.
- Our conviction in future lower yields and the potential anticipation of rate cuts in 2024 is gaining momentum. We see a 12 months Total Return (TR) of 10% for the ex-US and 5% for the US. Overweight (OW) EMU vs US, Japan.

Bonds

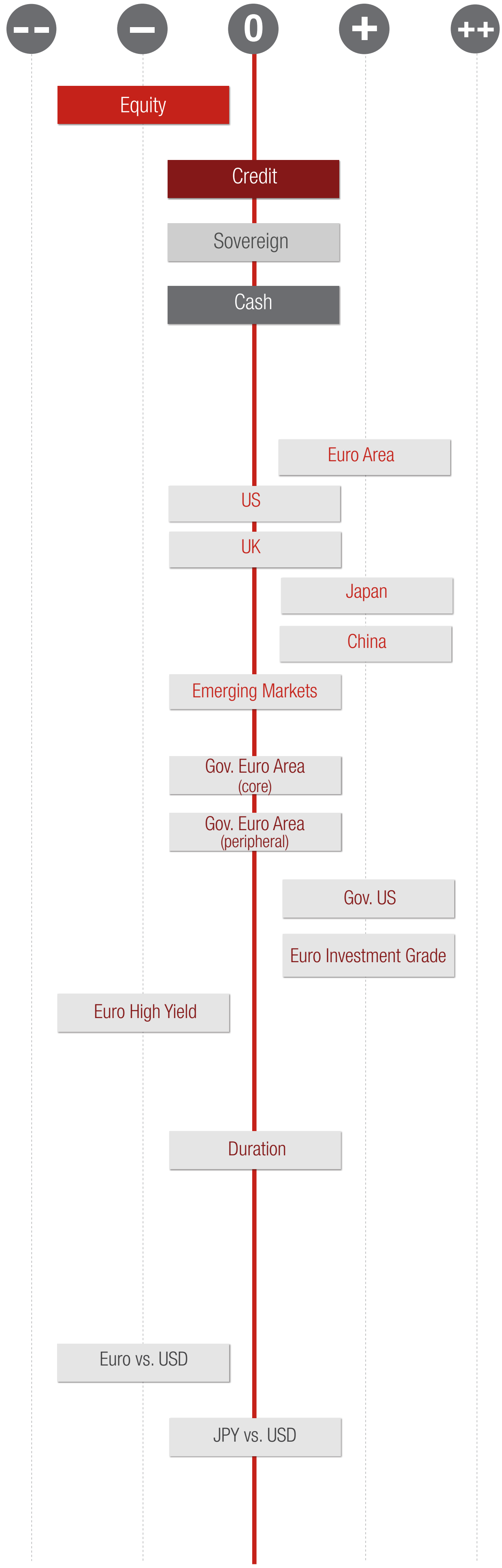
- Yield decrease to continue, but with less momentum considering the reached levels and the already priced key rate expectations. 2yr/10-yr curve to steepen.
- EA non-core bond spreads to widen moderately amid the challenging supply and meagre growth outlook. Lower bond market volatility supports.

Duration

- Neutral duration.

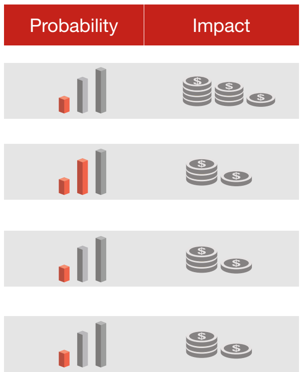
Currencies

- EUR/USD is vulnerable to a correction near term amid fragile risk sentiment, Europe's economic challenges and wider Euro Area spreads.
- Yet we expect further USD weakness over 2024 as a Fed pivot will erode the US yield advantage and reduce bond volatility. Anticipated BoJ rate hikes in H2/24 will additionally weigh on the USD.



TOPICS TO WATCH

- Cracks in financial stability as tighter conditions feed through (banking, housing, CRE defaults, non-bank liquidity...).
- Two-sided inflation risks (Goldilocks vs. bouncing energy prices, extended policy tightening leading to boom & bust).
- Escalating war in Ukraine or new severe geopolitical tensions (China/Taiwan, Middle East).
- Extreme weather events having a disproportionate impact on the growth-inflation mix.



Probability: High ↔ Low

Impact: High ↔ Low

GLOSSARY

FINANCIAL CONDITIONS INDEX

Financial Conditions Indexes are a proxy of the borrowing costs, computed as a combination of equity prices trade weighted currency, market volatility, credit spreads, long-term interest rates and other variables.

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