



Market Compass

February 2024

MARKET OUTLOOK

- “Immaculate disinflation” is getting increasingly consensual and brightening the 2024 market outlook, leading to a further increase in risk appetite.
- Rate cut expectations are flattening out. 2H23 US economic strength has likely caused complacency about actual risks, helping risk assets to perform positively again in January.
- Stagflationary geopolitical risks in the Middle East may challenge the increasingly consensual Goldilocks view (continued disinflation, resilient growth).
- Even with a soft landing more likely, we see limited value in extending risk-taking right now – we prefer safer buckets in Fixed Income (IG) and tactically raise cash exposure.

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

- + The year ended with much stronger than expected growth
- + But inflation continues to decrease
- + The labour market remains very strong adding to upside risks to growth
- ! The Fed will cut rates, but later than what the market expects

UK

- + UK's flash manufacturing PMI improved from low levels. The composite PMI is in expansionary territory
- + The BoE maintained its monetary policy but softened its tone a bit
- + Wage growth receded and retail sales were especially poor in January, allowing inflation to trend lower

EUROZONE

- + Activity set to sluggishly improve
- + Inflation is temporarily lifted by base effects but weaker than expected
- + ECB increasingly hinting at rate cuts
- ! We deem a June cut most likely but risks of earlier cuts rose causing market volatility

CHINA

- Manufacturing PMI remained in contractionary territory
- + The central bank cut the reserve requirement ratio by 50 bps
- The property sector remains the main drag on growth
- In Dec 23 inflation was again negative

EMERGING MARKETS (EM)

- ! Stabilisation of EM growth but downside risks in CEE
- + EM disinflation to continue, allowing further rate cuts
- + Still positive outlook for EM fixed income after a recent correction

- + Positive
- Negative
- ! Topics to watch

DIRECTION OF TRAVEL

- We maintain a very moderate underweight (UW) in Equities.
- We trim our overweight (OW) in Sovereign bonds, exposed to the risk of repricing of monetary policy expectations.
- We continue to favour IG Credit and Quasi Sovereigns while trimming our UW in HY.
- We moderately raise our cash position.

Equity

- Bullish positioning has visibly increased, while we expect a softening in GDP growth in Q2-Q3 2024. This makes us favour a cautious stance on equities in the short term.
- We have a more positive view over 12M: central bank's easing stance is normally supporting and stabilising EMU sentiment.

Bonds

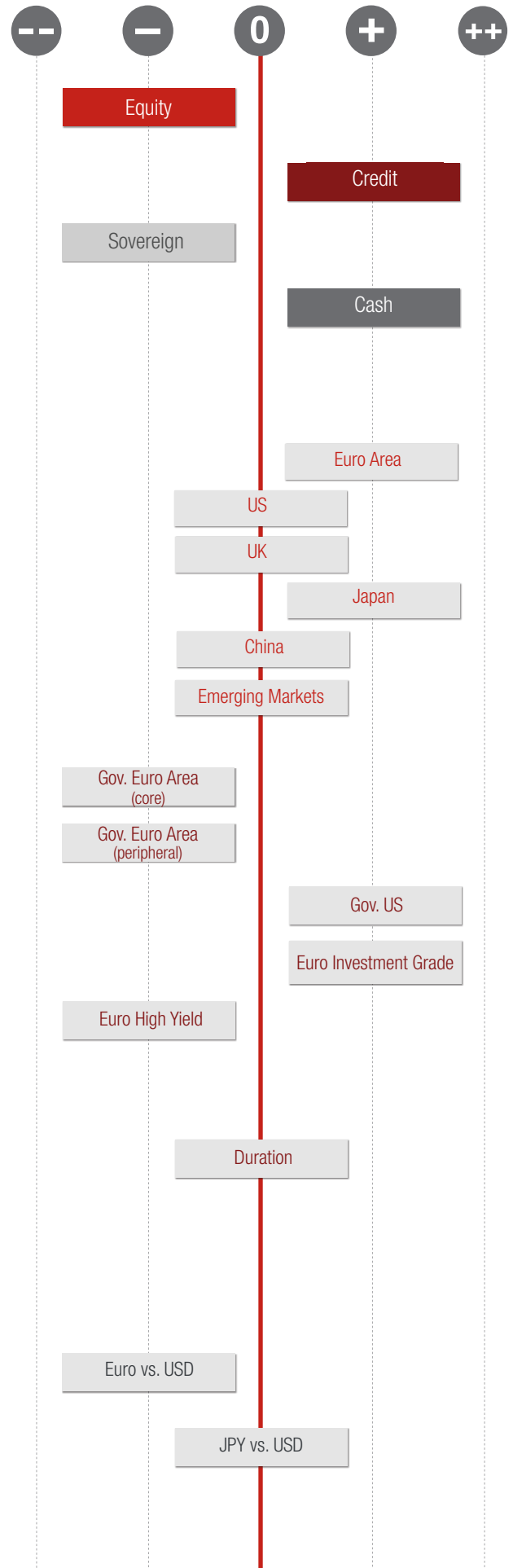
- Despite an expected rise in the **term premium**, the ongoing decrease in inflation and looming key rate cuts will lead to declining core yields.
- Amid high bond supply and increasing momentum of QT, we consider current EA non-core spread levels too low and advise caution.

Duration

- Slightly long duration.

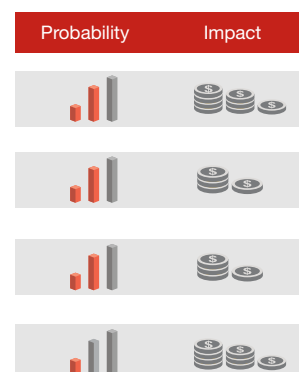
Currencies

- An improved US macro outlook still bolsters the USD short term.
- But continued disinflation, a receding US yield advantage and lower rates uncertainty point to a weaker greenback over the full year, which will show up in a higher EUR/USD and lower USD/JPY.



TOPICS TO WATCH

- Cracks in financial stability as tighter conditions feed through (banking, housing, CRE defaults, non-bank liquidity...).
- Two-sided inflation risks (bouncing energy prices, sticky wages, weather events vs faster disinflation in case of recession).
- Intensified global fracturing, notably China/US around elections (Nov 5, 2024).
- Geopolitical stress up (Ukraine, Middle East, Taiwan...), or down (de-escalation relief more muted but regionally significant).



GLOSSARY

TERM PREMIUM

The term premium is the part of sovereign bond yields not explained by the expected path for the monetary policy rates, and reflect the extra return requested to hold a long term bond. It is driven by several factors, among which inflation expectations and the net supply of bonds, in turn due to fiscal policy and the evolution of central banks' balance sheets.



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