Market Compass

June 2023

MARKET OUTLOOK

- Hopes of a last-minute deal on the US debt ceiling, resilient US activity and an AI boost to IT chip producers have helped risk assets to digest rising yields well in May.
- But mind the various gaps that are emerging. Pent-up demand in services is deeply overshadowed by mounting trouble in manufacturing.
- Equity and High Yield (HY) Credit resilience contrasts strong signs of a looming US recession, markedly higher real yields and evidence of a credit crunch.
- We stick to a prudent tactical tilt in our portfolios, moderately underweighting Equities and HY. We favour the carry from Investment Grade (IG) Credit and Government Bonds while avoiding unhedged USD 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

- (+) Consumption remained strong despite gloomy surveys
- (+) The labour market is easing gradually
- (−) Inflation remains too sticky
- (!) The Fed is done tightening but may keep rates high for longer compared to market expectations

UK

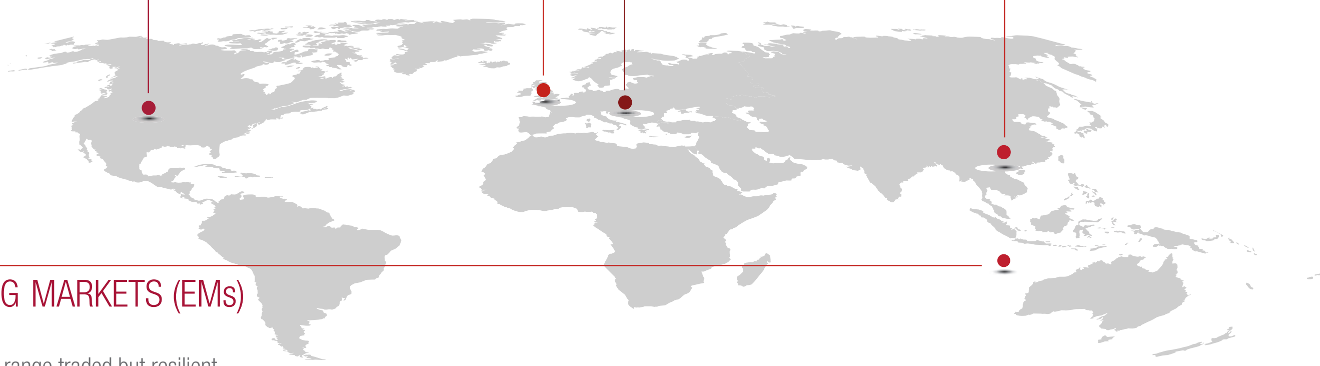
- (−) BoE raised Bank Rate again to 4.5%
- (−) Manuf. PMI deeper in contractionary territory
- (+) Q1 flash GDP better than expected

EUROZONE

- (−) May sentiment indicators moderated…
- (+) …but inflation receded to 6.1% yoy…
- (+) …and there are indications of a further downshift
- (−) Tighter credit standards and further ECB rate hikes

CHINA

- (−) PMIs slowing further amid uneven recovery
- (+) Inflation remained subdued
- (−) Growth is losing momentum fast



EMERGING MARKETS (EMs)

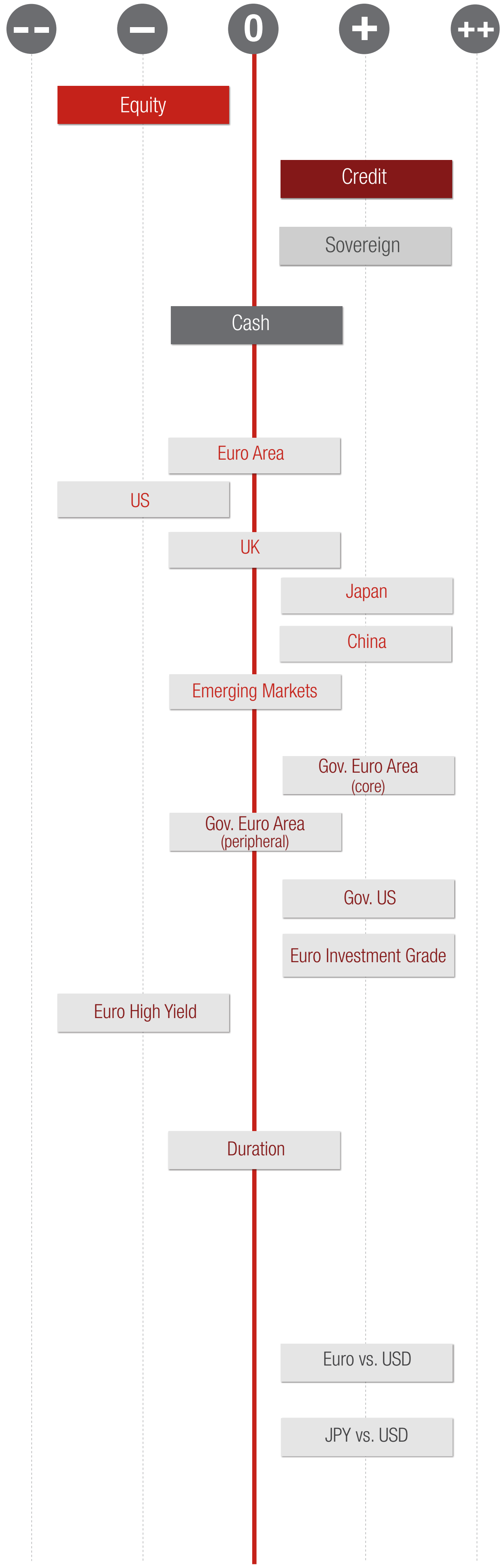
- (+) EM assets range traded but resilient
- (−) First EM central banks to cut rates but inflation is still sticky
- (!) Case for EM growth outperformance weakens

(+) Positive
(−) Negative
(!) Topics to watch

Your Partner for Progress.

DIRECTION OF TRAVEL

- Keep moderate underweight (UW) on Equities and HY
- Keep overweight (OW) on Non-financial European IG credit
- Maintain OW on sovereigns. Medium duration for core EA, shorter date for peripherals. OW in US Treasury as a hedge
- Reduce OW in EM bonds
- Avoid unhedged exposure to USD



Equity

- Financial conditions should continue to tighten, while macro surprises and confidence indicators are pointing south
- We see a slowdown in earnings growth of around 2%-3% for the US and EA in 2023, with positive growth thereafter
- Remain cautions on equities short term, in particular on cyclicals and value names, favouring ex-US equities

Bonds

- Lower yields across the curve, particularly in the US as current Fed pricing appears ambitious and recession looks inevitable
- EA non-core bond spreads to widen moderately given the challenging growth outlook and accelerated quantitative thightening. But, low spread volatility supports carry trades

Duration

- Neutral duration

Currencies

- The USD respite in May is not a trend reversal. Tightening yield gaps, easing rates volatility and an H2 US recession will still erode the greenback's appeal
- Yet the path is set to be choppy near term amid global growth worries, fragile risk aversion and stretched speculative EUR long positions

TOPICS TO WATCH

	Probability	Impact
Cracks in financial stability materialise (CRE, Banks, etc.), hitting growth		
Stronger/rebounding inflation prevent Central banks easing		
Escalating war in Ukraine or new severe geopolitical tensions (China/Taiwan, Iran, N. Korea)		

Probability: High ⟷ Low

Impact: High ⟷ Low

GLOSSARY

AI boost to IT chip

Shares in chip company - chips used to power artificial intelligence (AI) technology - recently soared amid hopes of rising demand from AI applications since the introduction of OpenAI's ChatGPT in November, and this helped risk assets to offset the rise in yields.

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