CURMI & PARTNERS

November 16th, 2023

Monthly Strategy Update

The month in summary:

The risk-off sentiment continued in October, driven by concerns on inflation and rising interest rates driven by the unrelenting strength of the US economy. Market-based inflation expectations (USD 5y5y inflation, US 10-year breakeven rate) rose slightly during October despite the fall in the price of oil. Additionally, the uptick in tensions in the Middle-East was also a key headwind for sentiment and the performance of risky assets during October.

The rising inflation concerns driven by the strength of the US economy was the primary driver of the sell-off at the long-end of the curve during October. Also, growing concerns over US Treasury supply over the coming years also pressured yields higher. The US 10-year treasury yield peaked on 19/10 at 4.99%, before pulling back slightly to 4.93% by month end. In Europe, the German 10-year yield fell 3bp whilst the 2-year Bund yield fell 19bp as the European economy continues to show more signs of weak economic activity, making rate cuts in 2024 more likely.

On the credit front, both investment grade and high yield corporate bond spreads widened during October, indicating underperformance relative to Sovereign bonds. The spread widening was similar in magnitude for all markets we follow, c. 7bp on average for investment grade and 41bp on average for high yield. Unsurprisingly, the shift upwards in yields weighed more on the performance of US$ credit markets. US$ investment grade and US$ high yield bonds underperformed both Europe and the UK during the month.

All equity markets we follow generated negative total returns in local currency terms during October due to a combination of rising real yields, an uptick in tensions in the Middle-East and weak third quarter corporate earnings season. The US marginally outperformed Europe as Growth strategies outperformed Value. The sell-off was broad and indiscriminative, with a clear preference for relative safety within the equity space.

The S&P commodities index fell in October, with the positive performance seen in gold driven by the uptick in Middle East tensions and higher gas prices driven by higher risk of supply interruptions from pipe damage offset by the sharp fall in oil prices.

Sovereign			
		Movement in bp	
	Yield	Oct	YTD
US 10-year yield	4.9%	36	106
DE 10-year yield	2.8%	-3	24
UK 10-year yield	4.5%	7	84
Credit			
LCL Total returns		MoM %	YTD %
EUR IG		0.4%	2.9%
EUR HY		-0.3%	6.4%
USD IG		-1.9%	-1.9%
USD HY		-1.2%	4.6%
GBP IG		-0.2%	0.9%
GBP HY		0.1%	8.4%
Equities			
LCL Total returns		MoM %	YTD %
Global		-2.9%	8.4%
S&P 500		-2.1%	10.7%
Nasdaq 100		-2.8%	23.6%
STOXX 600		-3.6%	4.6%
DAX		-3.7%	6.4%
CAC		-3.5%	9.4%
FTSE 100		-3.7%	1.4%
Emerging markets		-3.8%	1.0%
EM ASIA		-3.9%	-1.8%
EM LATAM		-3.9%	-4.0%
EM EMEA		-4.8%	7.5%
Currencies			
Total return		MoM %	YTD %
EURUSD		0.1%	-1.2%
EURCHF		-0.4%	-2.7%
GBPEUR		-0.5%	1.7%
GBPUSD		-0.4%	0.6%
Commodities			
Total return		MoM %	YTD %
Oil WTI		-9.6%	3.4%
Oil Brent		-6.8%	3.6%
Natural Gas		21.4%	-20.1%
Gold		6.4%	8.8%
Copper		-1.3%	-3.1%
Iron Ore		5.3%	8.1%
S&P GSCI Index		-6.3%	-5.4%

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Macro-economic views

The October PMI release suggests that growth momentum across regions has been weakening. The J.P. Morgan global manufacturing PMI fell to 48.8 in October (from 49.2 in September), the fourteenth consecutive month of a reading below 50 (contraction). This is the longest sequence of deterioration since the downturn between December 2000 to February 2002. Europe remained the principal drag on global factory output during October (eight of the fastest contracting manufacturing nations were located in Europe), partially set-off by strong growth in India and modest expansions in Indonesia and Mexico. Additionally, the J.P. Morgan services PMI fell to 50.4 in October (50.7 in September), the fifth consecutive month of deterioration. In last month's report we suggested that data published by Europe and China was improving and an early indication of an upturn, but this strength has faded away.

China's economic situation has been a key talking point for the market for the past year. Persisting growth in China has so far proved elusive despite optimism early this year, and then again early in the summer months. The NBS manufacturing PMI fell into contractionary territory (49.5 vs 50.0 expected) in October, having moved briefly back into expansionary territory in September (50.2), whilst the NBS services and construction came in weaker than the market was expecting. Similarly, the Caixin manufacturing PMI fell in contraction territory (49.5 in October from 50.6 in September). Finally, the PMI for the steel sector remained in contraction territory (45.6 in October from 45.8 in September), which suggests a bigger drag on industrial activity was driven by the prolonged weakness in the construction industry.

The weakening in growth momentum and sentiment in China led to more stimulus being announced by policymakers. Firstly, China's top legislature approved a rare mid-year increase in budget deficit to around 3.8% of GDP from the original 3.0%, with half of the funds raised to be used this year and the other half to be used next year. Secondly, as has happened in the past years, the authorities have front-loaded a part of the local governments bond quota for next year. Finally, President Xi made his first known visit to the People's Bank of China and the State Administration of Foreign Exchange during October since he become president a decade ago. This underscores the leadership's increased focus on the economy, foreign exchange management and the coordination of monetary and fiscal policy.

Exhibit 1 – Consensus real GDP growth and inflation expectations

	Consensus, YoY%			IMF, YoY%		
Real GDP, YoY%	*FY23F*	*FY24F*	*FY25F*	*FY23F*	*FY24F*	*FY25F*
United States	2.3	1.0	1.8	2.1	1.5	1.8
Japan	1.1	0.6	2.0	2.0	1.0	0.7
Germany	-0.4	0.5	1.5	-0.5	0.9	2.0
France	0.8	0.8	1.4	1.0	1.3	1.8
Italy	0.7	0.6	1.2	0.7	0.7	1.0
Spain	2.3	1.4	2.0	2.5	1.7	2.1
Eurozone	0.5	0.7	1.5	0.7	1.2	1.8
UK	0.4	0.4	1.3	0.5	0.6	2.0
Developed Economies	1.6	1.1	1.8	1.5	1.4	1.8
China	5.2	4.5	4.5	5.0	4.2	4.1
Emerging Economies	3.9	4.0	4.2	4.0	4.0	4.1
Global	***2.9***	***3.4***	***3.9***	***3.0***	***2.9***	***3.2***

	Consensus, YoY%			IMF, YoY%		
Consumer Prices, YoY%	*FY23F*	*FY24F*	*FY25F*	*FY23F*	*FY24F*	*FY25F*
United States	4.2	2.7	2.3	3.0	2.6	2.3
Japan	3.1	2.0	1.4	2.7	2.6	1.8
Germany	6.1	2.9	2.2	4.1	2.8	2.4
France	5.7	2.7	2.0	4.0	1.9	2.5
Italy	6.2	2.4	2.1	1.1	3.0	2.2
Spain	3.6	3.1	2.1	4.0	3.4	1.5
Eurozone	5.6	2.7	2.1	3.3	2.7	2.2
UK	7.4	3.0	2.2	5.2	2.4	2.0
Developed Economies	5.8	3.8	2.7	3.3	2.6	2.2
China	0.5	1.8	2.0	0.9	1.9	2.2
Emerging Economies	6.1	6.1	4.2	8.5	6.8	6.0
Global	***6.1***	***4.4***	***3.4***	***6.4***	***5.1***	***4.5***

Source: Bloomberg Consensus Forecasts as at 09/11 and IMF October 2023 forecasts

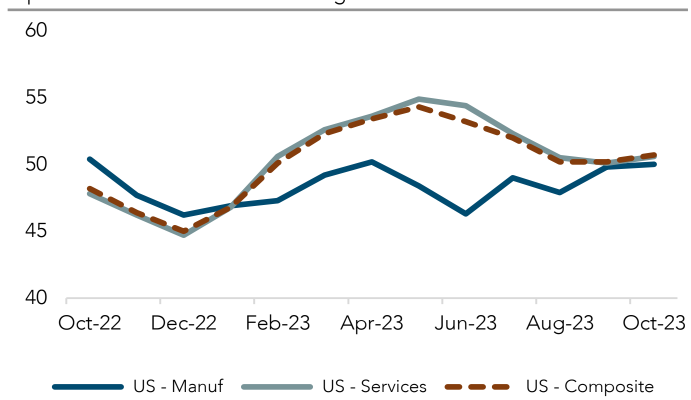
United States

The advanced GDP estimate showed growth accelerating from 2.1% in the second quarter to 4.9% QoQ saar in the third quarter of 2023. Consumer spending was again the primary driver of growth during Q3, with a contribution to growth of 2.7% (vs. 0.6% in 2Q23) during Q3. This should not come as a surprise given that retail sales averaged growth of 0.6% MoM during Q3 (compared to 0.5% in 2Q23). However, the headline growth rate was also positively impacted by a 1.3% (vs 0.0% in 2Q23) contribution from the volatile inventory investment component, which is unlikely to materialise again in the next quarter.

The expectation for some time has been that US economic activity will slow down in the fourth quarter. The data so far has been mixed, though there are early signs that the slowdown could materialise. The latest estimate by the Atlanta FED points to growth of 2.1% QoQ saar in 4Q23 (Exhibit 3). Looking at some of the important data released so far, the manufacturing PMI for October came in at 50.0 (vs 49.8 in Sep), the highest level since April (Exhibit 2). More importantly however, was the moderation in the labour market as nonfarm payroll employment rose 150k in October (vs consensus 180k), though the UAW strike temporarily removed 25k jobs (Exhibit 4). As for the household data, the unemployment rate rose 0.1pp to 3.9% driven by a 348k decline in household employment. We caution against investors relying on a single data-point however, especially given that the path and pace of inflation moderation remains highly uncertain.

Exhibit 2 – US S&P Manufacturing, Services and Composite PMI

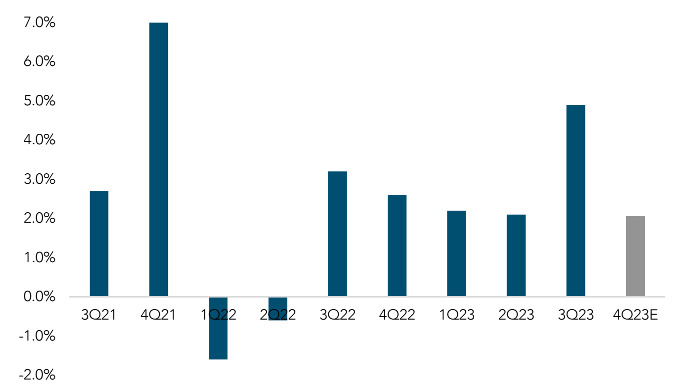
The composite PMI recovered to 50.7 in October, driven by an improvement in both manufacturing and services



Source: Bloomberg

Exhibit 3 – US economic growth QoQ saar

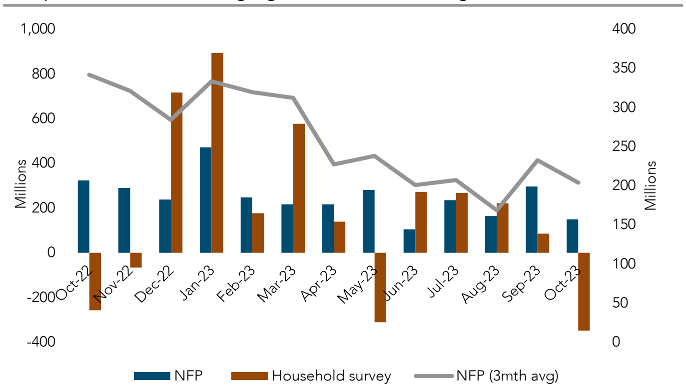
Economic growth more than doubled in 3Q but the latest Atlanta Fed forecast points (08/11) for 4Q points to a deceleration



Source: Bloomberg, BEA, Atlanta FED

Exhibit 4 – Non-Farm Payrolls

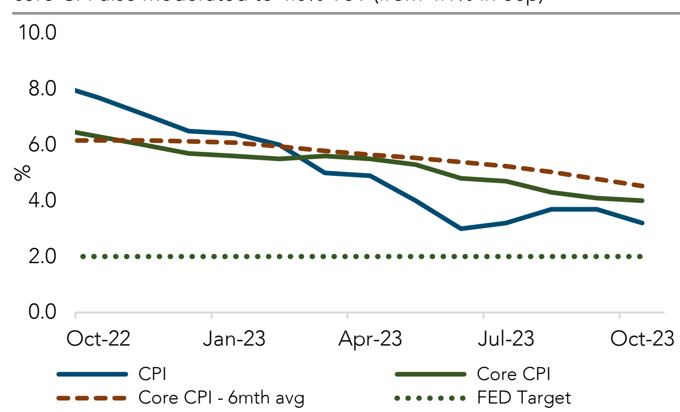
The US economy added 150k jobs during October, 147k lower than the previous month bringing the 3-month average down to 204k



Source: Bloomberg , BLS

Exhibit 5 – US Inflation rate

Headline CPI slowed to 3.2% YoY (from 3.7% in Sep) in October whilst core CPI also moderated to 4.0% YoY (from 4.1% in Sep)



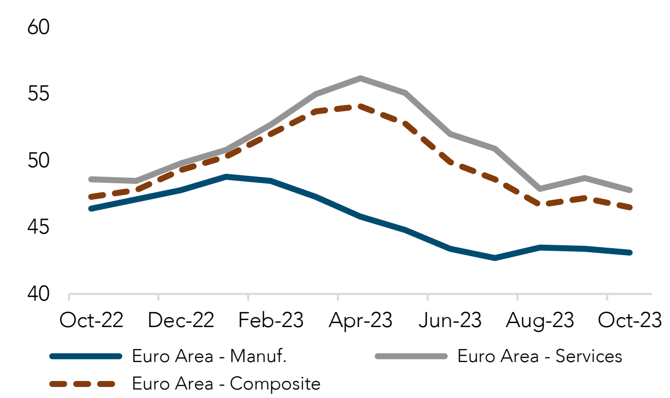
Source: Bloomberg

Europe

In Europe, the data released throughout October brought more signs of weak economic activity and a likely technical recession in 2H23, dispelling any belief that a recovery had started last month. The Composite PMI deteriorated further to 46.5 (down from 47.2 in September), marking the fifth consecutive month of a reading in contraction territory (Exhibit 6). This was driven by weakening in both manufacturing (43.1) and services (47.8). The manufacturing PMI has now been in contraction territory for sixteen consecutive month, and more importantly, the survey data signalled the fastest reduction in factory employment since August 2020 as business confidence fell to an 11-month low, the clearest indication yet that the region's growth prospects are bleak.

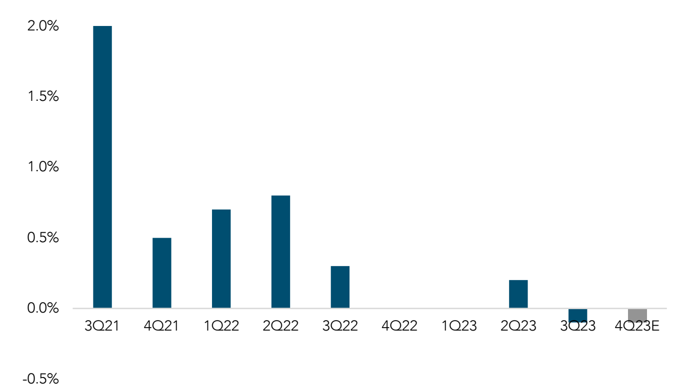
The official GDP growth estimate showed growth of -0.1% QoQ in 3Q (Exhibit 7). Yet, we note that the headline figure was impacted by Ireland's volatile data (GDP -1.8%). Excluding Ireland, the Bloc's GDP growth for 3Q would have been flat. The Euro now-cast GDP estimate for the 4Q currently stands at -0.1%, which would imply a prolonged period of stagnation. Furthermore, the ECB published the bank lending survey in October, which showed that demand conditions in Q3 proved much weaker than banks were expecting in Q2 and see further weakening in Q4. Furthermore, banks tightened credit standards for business loans broadly in line with their own expectations in Q2 and expected further tightening in Q4.

Exhibit 6 – EU S&P Composite, Manufacturing and Services PMI
The Composite PMI deteriorated to 46.5 in October driven by persisting weakness in manufacturing (43.1) and services (47.8)



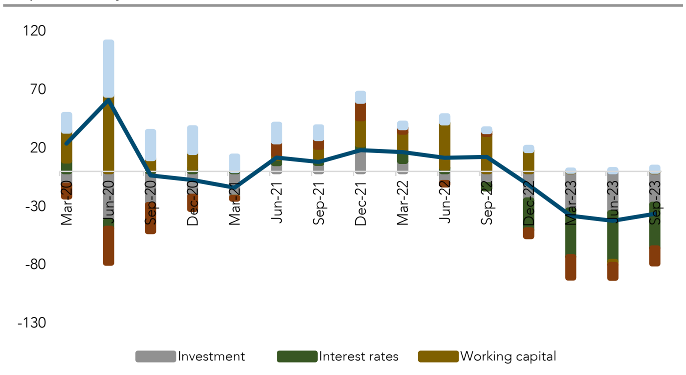
Source: Bloomberg

Exhibit 7 – EU Q4 GDP Growth Tracker
Euro-area's GDP growth contracted in 3Q23 and the latest estimate points to another quarter of contraction in 4Q



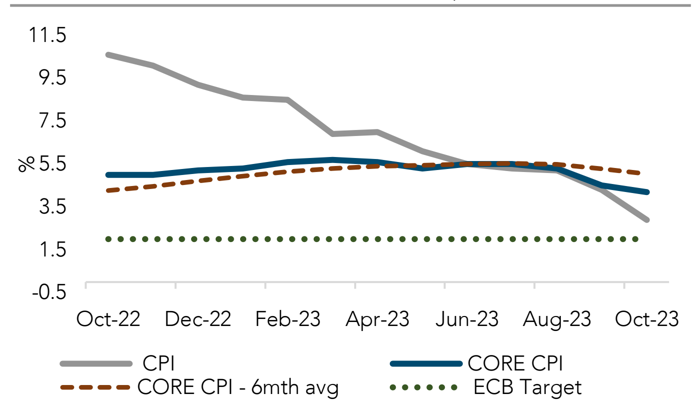
Source: ECB, Bloomberg, EurocastNow

Exhibit 8 – Bank Lending Survey
Demand for business loans in Q3 deteriorated at a faster rate than expected by banks in Q2



Source: ECB

Exhibit 9 – HICP headline and core inflation
Headline HICP slowed sharply to 2.9% (4.3% in Sep) whilst core HICP also moderated to 4.2% (from 4.5% in Sep)

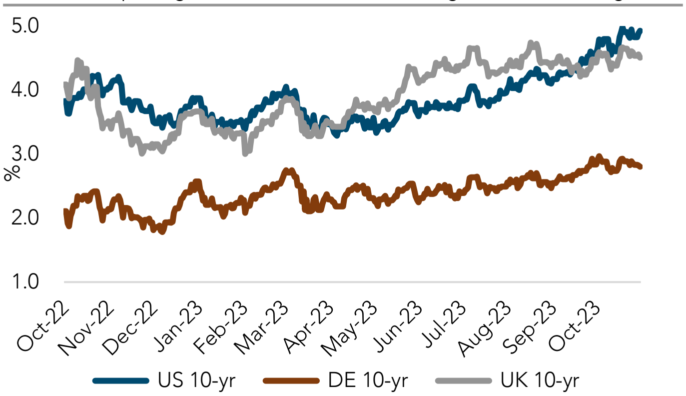


Source: Bloomberg

Rates

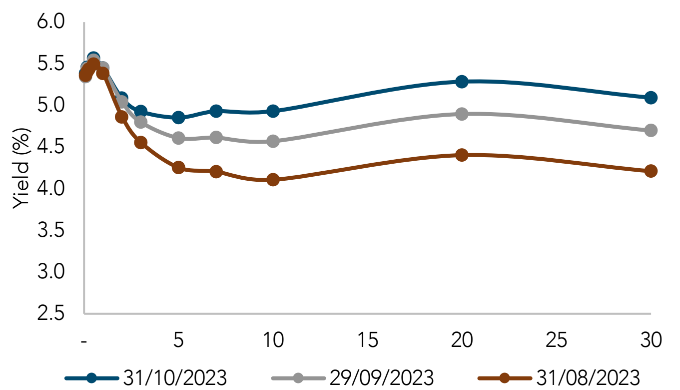
October was a quiet month in terms of central bank action, with only 3 out of the ten central banks with the most heavily traded currencies holding meetings. The ECB, the Bank of Japan ("BoJ") and the National Bank of Canada all kept rates unchanged in October. The BoJ meeting was hugely anticipated by investors, and though they fell short of abandoning their yield curve control policy ("YCC"), it made significant progress towards it. Namely, the BoJ decided to treat the 1% upper bound for yields merely as a "reference" point, rather than as a hard cap at which it would start to buy JGBs every business day. Japanese investors own a large proportion of foreign bonds, especially US Treasuries, and as policy in Japan starts to normalise and JGB yields rise, there will be a higher motivation for Japanese money to move out of foreign bond markets into domestic bonds, which could create a lot of volatility in rates markets due to a liquidity squeeze in foreign bond markets.

Exhibit 10 - 10-year nominal bond yield for the US, Germany and UK
The US 10-year yields flirted with the 5% mark for the first time since 2007 before pulling back in November following the FED meeting



Source: Bloomberg

Exhibit 11 – US Yield Curve
The US yield curve steepened further during October as strong economic data supported the "higher-for-longer" narrative



Source: Bloomberg

United States

October was another strong month in terms of economic data which pressured yields higher. Consumer spending has been a key contributor of growth for the US economy, and there have been no signs of this slowing, as retail sales came in way ahead of economist expectations in September. Although the expectation has been for some time that the US economy, and consequentially inflation, would moderate in Q4, this was unlikely to happen unless an uptick in unemployment and a slowdown in wage growth materialised. So, it was a relief for the markets when the non-farm payrolls published on 03/11 showed signs of weakening in the labour market.

Additionally, the FED meeting held on 01/11 was more dovish than the market had expected. Chair Powell emphasised that despite the strong data, the fed funds rate target range would be maintained due to a "significant" tightening of financial conditions driven by higher long-term yields and other factors. Chair Powell also seemed to suggest that the strong economic activity in 3Q would be temporary, and that progress had been made on reducing price and wage pressures.

The dovish FOMC combined with the soft October payroll data and the Treasury announcing its intention to slow down its issuance have led to a substantial market reaction. Over the first week of November, the US 10-year treasury yield declined c.44bp, the DXY index fell 1.0% and the S&P 500 rallied 5.1%. These moves have to some extent already reversed some of the tightening in financial conditions that stopped the FED from hiking in November. This is important given that Chair Powell emphasised that market-led tightening in financial conditions needs to be "persistent" to influence policy.

Europe

Economic data published in Europe has been weakening, with the positive surprises in September proving to be short-lived. As expected, the Governing Council kept all monetary policy instruments unchanged at its October meeting, whilst confirming that the economy is moving in-line with their expectations communicated at the September meeting. However, markets were surprised by President Lagarde's comments during the press conference that the Governing Council has not yet started to discuss ending PEPP reinvestment earlier (end-2024). Lagarde's comments came at the same time when several Governing Council members had indicated in the weeks preceding the meeting that they would prefer to get the conversation started sooner rather than later.

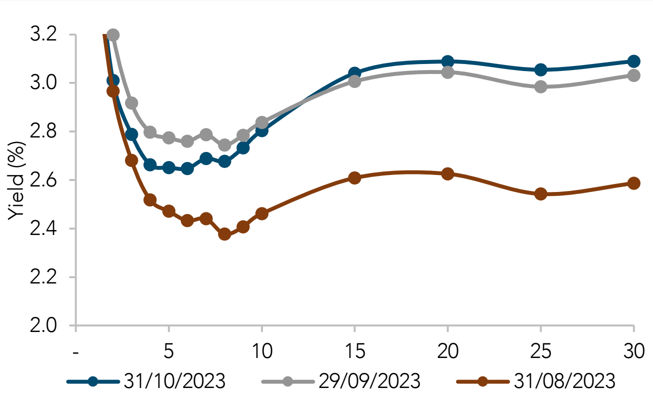
The decision by the Governing Council not to discuss PEPP reinvestments may have been influenced by the current uncertain backdrop, more specifically the rising geopolitical tensions in the Middle-East, the spill-over for the US rates volatility and Italy's fiscal position. On the latter point, we note that Fitch affirmed the rating on the Italian sovereign at BBB with a stable outlook. However, the market is still awaiting Moody's decision (17/11) which could be more consequential, since a downgrade would place the Italian sovereign in speculative grade. Earlier in the month S&P kept Italy's sovereign credit rating unchanged at BBB and outlook stable. Despite the lower growth, higher interest rate expense and worsening fiscal position, we note that the BTP-Bunds spreads were largely unchanged in October, after a significant widening in September (+31bp).

In the UK, as expected, the Bank of England kept rates unchanged during its November meeting with a 6-3 votes split. Like Europe, economic activity in the UK has deteriorated over the past months and inflation is showing signs of moderation, reducing scope for additional rate hikes. The MPC retained the part of its forward guidance that conditions further tightening on upside surprises to economic data. Furthermore, the MPC downgraded the UK's economic forecast, with growth in 4Q now expected at 0.1%, and forecasts 0% growth in 2024 (vs 0.1% in August). On the flipside, the MPC revised up its inflation forecast driven by persistent wage growth.

The projections for the UK economy were supported by the GDP release the following week. Data released by the ONS showed that the UK economy flatlined in 3Q when compared to the previous quarter, as the impact from the high interest rates is starting to feed into the economy.

Exhibit 12 – German 10-year yield curve

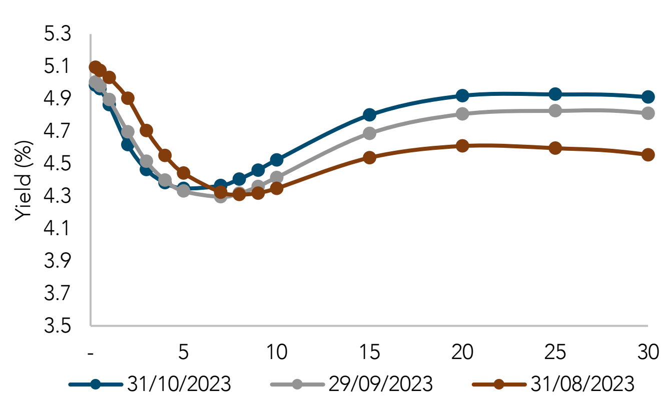
The 10-year Bund yield was largely unchanged over October as economic weakness reduced the probability of additional rate hikes



Source: Bloomberg

Exhibit 13 – UK 10-year yield curve

The move in the 10-year Gilt was more contained, though a similar level of tightening in the 2s10s (32bp) was observed



Source: Bloomberg

Credit

October has not been a kind month for financial markets, and the Credit market was not spared. From the regions we follow, only EUR IG (+0.4% MoM) and GBP HY (+0.1%) delivered a positive return for the month, whilst EUR HY (-0.3%), USD IG (-1.9%), USD HY (-1.2%) and GBP IG ended October in the red. Naturally, the performance of the USD market was primarily driven by the expectation that yields will remain higher for longer, which led to a sell-off at the long-end of the curve. Apart from the extreme volatility in rates, the third quarter earnings season was also another contributor to performance last month.

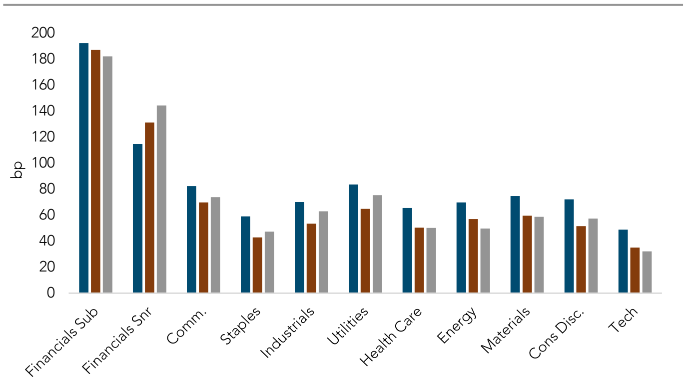
During October, EUR IG credit spreads widened by 7bp whilst USD IG credit spreads widened by 8bp. The move wider in credit spreads within the IG space appears to have so far been orderly, with the current OAS at similar levels seen in June (163bp as at 30/06 compared to 160bp as at 31/10). Looking at spreads from a sector level, we note that, on average, spreads for the Financial sector are 10bp tighter on average since June 2023 (-17bp for Senior paper and +5bp for sub-ordinated). Yet, spreads on non-financial paper widened by 13bp on average over the same period, with consumer discretionary reporting the largest widening compared to other sectors (Exhibit 14). On balance, we continue to see the EUR IG space as attractive as it is less exposed to the macro-economic backdrop and investors will be able to benefit from: (1) higher yields on offer (at index levels, yield offered is currently 4.5% vs 10-year average of 1.4%); and (2) possible rate cuts in 2024.

There is no doubt that the current backdrop for High Yield has gotten a lot more difficult since the start of the year when compared to other safer credit markets like IG and Sovereign. The EUR HY index delivered a negative return of 0.3% driven primarily by rates volatility during the month. The EUR IG index generated a total return of -1.6% in the month up to 20/10, whilst at the same time yields on US and EUR 10-year sovereign paper had widened 51bp and 19 bp respectively. In the final 10 days of the month, the EUR HY index rose 0.9%, as yields were largely flat in the US and tightened 8bp in Europe. Although we expect rates volatile to be less of a headwind going forward, the current uncertain macro-economic backdrop remains a concern for the HY market.

Overall, we maintain our preference for EUR IG over EUR HY given the uncertainty around the global economic outlook, as well as the tighter spreads for the EUR HY, which implies much less cushion despite the higher yield (Exhibit 15).

Exhibit 14 – EUR IG OAS by sector

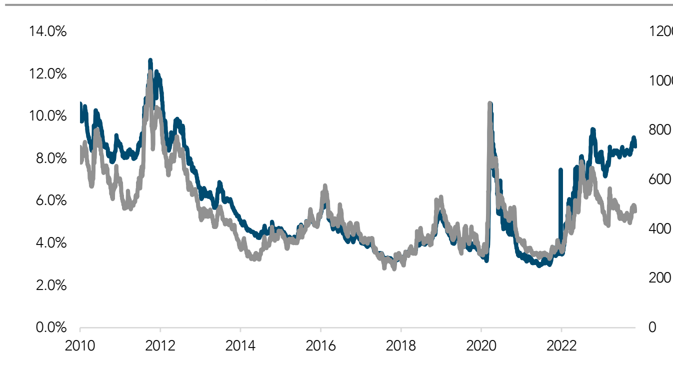
EUR-IG spreads have widened over the past months, but shift has been orderly



Source: Bloomberg

Exhibit 15 – Euro-Area HY OAS compared to YTW

Although YTW for HY bonds appears to be attractive relative to history, the cushion from spread is limited



Source: Bloomberg

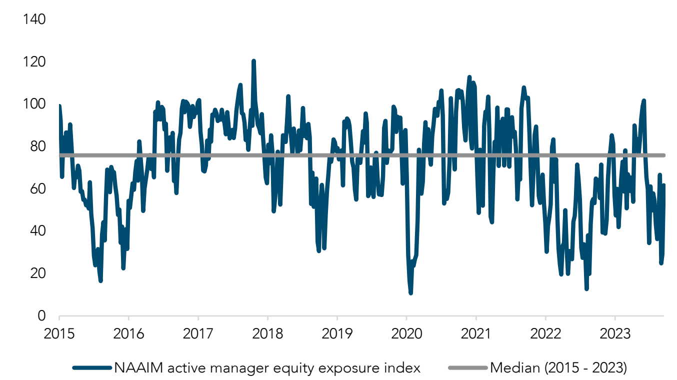
Equity

Global equities pulled back 2.9% in October, making it the third consecutive month of negative performance that started in August. We believe that this risk-off sentiment over the past three months was driven by a combination of (1) Long-end real yields edging higher; (2) Signs of economic stagnation in Europe and disappointing macro data coming out China; (3) The uptick in geopolitical tensions in the Middle East that started early in October; and (4) Mixed earnings for the third quarter of 2023, which saw earnings misses severely punished. During October, US equities outperformed most of the other developed markets we follow, probably because of the Middle East induced flight to safety.

Exhibit 16 – S&P 500, STOXX 600 and UST 10-year real yield (inverse)
The rise in real yields that started late in the summer months has weighed on equity market performance

Source: National Association of Active Investment Managers

Exhibit 17 – NAAIM active manager exposure to equity markets
The NAAIM exposure index suggest that investors reduced their exposure to the asset class further during October



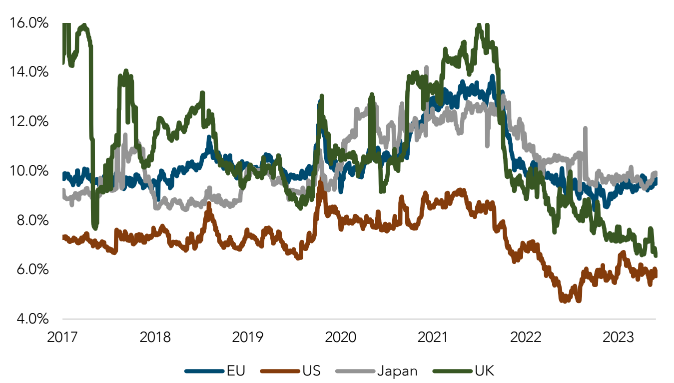
Source: National Association of Active Investment Managers

The inverse relationship between real yields and equity market performance has been discussed on several occasions in earlier versions of this report. During 2022 and the first five months of 2023, equities moved in the opposite direction of the real yields as expected (Exhibit 16). However, the relationship seems to have uncoupled around May to July, when the US 10-year real yield rose 37bp. During this period, despite the shift upwards in real yields, the S&P 500 gained 10.9%, driven by the hype around Artificial Intelligence that had taken over sentiment. Investors looked beyond rates volatility and focused on what potentially could be a new corporate earnings growth driver that could last for the foreseeable future. In fact, the performance of the STOXX 600, which has less exposure to the AI story, was much more muted (+1.7%). The relationship has since stabilised however, as the 78bp rise in US 10-year real yields to 2.5% by the end of October was accompanied by an 8.4% sell-off in the S&P 500.

The primary driver of higher yields during October was the continued resilience of the US economy which continued to surprise the market. Economic data published by the US throughout October showed no sign of this strength easing, which drove further flight to safety. Active managers continued to shed their exposure to equities during October, with the National Association of Active Managers index (NAAIM member firms who are active managers are asked each week to provide their overall equity exposure) falling to 29.2% by month end, down from 43.0% at the end of September (Exhibit 17). Furthermore, it is worth noting that the NAAIM level at the end of July stood at 101.8% and shows how quickly sentiment can turn in the equity market.

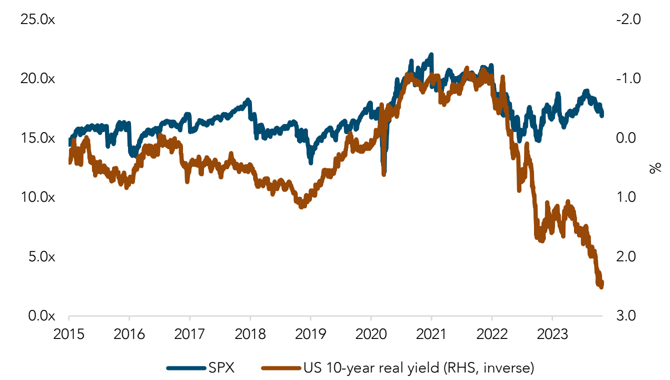
As we approach the end of 2023, we are encouraged by signs that inflation and interest rates appear to have peaked. Additionally, the current consensus expectation is for economic growth to moderate in 2024 but for a hard landing to be avoided, which reduces downside risk for equity investors. However, we note that upside is also limited by a very low equity risk premium ("ERP") and the low earnings growth expectations for 2024. The ERP for many regions has been on a downward trend for some time, before spiking in 2020 at the onset of COVID-19, before moderating to the current low levels as bond yields (driven by term premia) continued to rise (Exhibit 18).

Exhibit 18 – Equity risk premium
The equity risk premium is low compared to historical levels and could limit upside in the future



Source: Bloomberg

Exhibit 19 – S&P 500 FWD P/E and US 10-year real yield
The higher-for-longer interest rates make valuation expansion difficult to justify from current levels



Source: Bloomberg

The US equity market remains the most expensive and seems to be the most vulnerable from a possible rates induced sell-off. Valuations have moderated slightly over the past three months, but they remain high compared to historical levels. We believe that earnings growth will drive returns in 2024, as the higher-for-longer interest rates make valuation expansion difficult to justify from current levels (Exhibit19). Nevertheless, we continue to like tech stocks that can generate high earnings growth and strong free cash flows. Though the rally seen in AI stocks might look to be overdone, we believe that this new technology could drive profit growth for companies that are exposed to it. Overall, our recommendation for holding a diversified equity portfolio remains, with a combination of companies that can deliver growth (Tech) and companies that provide a high return to shareholders but where fundamentals are improving (Banks).

Exhibit 20 – Valuations – Developed markets
Valuations in the US are in the 90th percentile and screen as expensive compared to other international markets

Historical Data	SPX	NDX	SXXP	SX5E	DAX	CAC	FTSE100	FTSE250
Current Forward PE ratio (FPE)	17.2x	22.2x	11.4x	11.2x	10.0x	11.4x	10.1x	9.3x
Forward PE ratio (31/12/2022)	16.8x	21.1x	11.9x	11.3x	10.5x	11.3x	10.0x	11.1x
10 Year data								
Highest	22.1x	30.8x	17.5x	18.0x	15.7x	18.2x	15.4x	17.9x
Highest (date)	31/12/2020	25/01/2021	29/12/2020	29/12/2020	28/12/2020	04/12/2020	02/12/2015	29/12/2020
Lowest	12.2x	15.2x	10.0x	9.0x	8.4x	9.1x	8.4x	8.3x
Lowest (date)	23/03/2020	15/04/2014	18/03/2020	18/03/2020	18/03/2020	18/03/2020	03/10/2022	23/03/2020
Median	16.3x	19.6x	13.7x	12.8x	12.2x	13.3x	12.8x	13.7x
95th percentile	20.4x	28.2x	16.0x	16.4x	14.5x	15.9x	14.9x	15.2x
5th percentile	14.2x	16.8x	11.7x	11.5x	10.9x	11.1x	10.0x	10.3x
Historical rank (since 2006)								
Percentile	82.0%	82.0%	29.8%	34.2%	19.5%	32.9%	21.9%	8.9%
Current FPE, % above/ (below) 10-YR median	5.6%	13.1%	-16.4%	-12.7%	-17.8%	-14.1%	-21.2%	-32.3%
Current FPE, % above/ (below) Dec 22	2.1%	5.5%	-3.4%	-0.8%	-4.4%	1.2%	0.8%	-16.5%

Source: Bloomberg

Key – Our view

Positive | Positive /neutral | Neutral | Neutral/ negative | Negative

Key – Allocation

Overweight | Neutral | Underweight

Asset Class	Positioning
Developed Market Sovereign Bonds	We have continued to moderate our view on Developed Market Sovereign bonds given that we are, in our opinion, close to peak terminal rates in most developed economies. In view of this we have recently added duration to our sovereign portfolio despite the re-pricing higher in yields driven by the "higher-for-longer" narrative. We expect that there will be policy divergence in 2024 and beyond, with the ECB and BoE having grown more confident that their fight against inflation is complete, whilst the FED looking more likely to hike a final time.
Investment Grade Corporate Bonds	The IG space has so far delivered positive returns in both Europe and the US despite an additional 200bp and 100bp tightening by the ECB and FED respectively. The recent re-pricing in the rates market to the "higher-for-longer" has weighed on the IG space, though the base case remains of continued moderation in economic growth and inflation going forward. The YTW for EUR-IG is currently at c4.4% (08/11) which ranks in the 95th percentile since 2010. Additionally, the risk of rising defaults should the economic situation deteriorate further is much lower in IG when compared to HY. Yet, the uncertainty around the economic health of the region is a key risk for IG. On one hand, the ECB could have no option but tighten monetary policy further or keep rates at these levels for longer if inflation proves to be stickier than currently expected. Also, assuming growth does not pick-up, the risk of stagflation will also rise, which could see investors preferring to hold cash or cash-like instruments.
High Yield Corporate Bonds	We maintain our underweight in HY given the current uncertainty around the economic outlook and the higher idiosyncratic risk. Although the current yield on offer is high relative to history as the YTW has been lower 88% of the time since 2010. However, the spread differential of 473bp has been lower 66% of the time, which implies that the cushion should the economic situation deteriorate further is much lower today compared to history. We believe that this is particularly important today given the uncertainty around the economic outlook and the deterioration in economic data we have observed over the past months in Europe. The higher-for-longer narrative could have greater implications for HY issuers, especially the lower-rated corporates that will have to refinance bonds (2025/2026 maturities) over the coming months with funding costs significantly higher. That said, current debt levels seem sustainable, which should imply a lower probability of a significant uptick in the default rate.
Developed Market Equities	Rates volatility has been a headwind for equity market performance since central banks started to tighten monetary policy in 2022. The fact that we are at or close peak inflation and interest rates is therefore a clear positive for the equity market. Also a positive is the expectation that the global economy will moderate and not fall into recession. This implies the downside risk to equities is limited given that a bear market rarely materialises outside a recession, and corporate profit growth is rarely negative outside a recession, which implies a lower probability of a bear market. Notwithstanding this, the upside from here is constrained by the high valuations, especially in the US. With interest rates expected to remain higher-for-longer, the scope for valuation expansion is low. Furthermore, we note that the higher interest rates could provide motivation for investors to move down the risk scale, given the higher yields on offer compared to the past years.
Emerging Market Equities	EM equities have so far underperformed their DM counterparts, not helped by the strengthening in US Dollar and the slow China economic growth. EM equities ex-China have performed relatively strongly, but valuation in these pockets is now looking stretched. China's growth momentum faded early in 2023 and challenges remain, but policy has become much more accommodative and Chinese equity valuations are low compared to history.

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