CURMI & PARTNERS

December 15th, 2023

Monthly Strategy Update

The month in summary:

During September and October, Central Banks pushed the narrative that rates would remain "higher-for-longer" and the resilient US economy supported their view. However, we saw a sharp reversal in risk sentiment during November, lifting both bonds and equities. The rally was primarily driven by a combination of (1) generally softer US economic data released during the month; (2) a more dovish than expected message delivered by Central Banks which suggested to us that the hiking cycle is over; and (3) more evidence of disinflation.

November was a positive month for the government bond market supported by favourable news flow around disinflation. The yield on the US 10-year treasury, that was flirting with the 5% mark for most of October, pulled back to c.4.3% by the end of November. The FED kept rates unchanged in November and despite ongoing concerns around expansive fiscal policy, there was better news in terms of issuance, with the Quarterly Refunding Announcement being $2 billion lower than expected at $112 billion. Similarly, the 10-year UK Gilt yield fell 34bp to 4.2%, whilst the 10-year German Bund yield fell 36bp to 2.5%, with European periphery outperforming core markets.

Credit markets also joined in the rally, with positive performance in all currencies we follow for both Investment Grade ("IG") and High Yield ("HY"). Unsurprisingly given the move in sovereign yields, the USD bond market was the best performing in local currency terms, with USD IG and US HY delivering a total return of 6.0% and 4.5% respectively.

Global equities rallied 9.4% in US$ terms, with US stocks outperforming the other developed market equity markets we follow. The primary driver of this US outperformance was the pullback in yields, which boosted long-duration equities (Tech) that had been under pressure since the summer months. Despite the strong rally in equities, we note that the National Association of Active Investment Managers still shows funds, on average, were underweight equities throughout November.

Finally, the US$ endured a difficult month driven by the disinflation narrative that has led to investors pricing-in rate cuts earlier than expected. As for commodities, Energy and livestock were the worst performers, while precious metals, industrial metals and agriculture achieved modest gains.

Sovereign			
		Movement in bp	
	Yield	Nov	YTD
US 10-year yield	4.3%	-60	45
DE 10-year yield	2.5%	-36	-12
UK 10-year yield	4.2%	-34	50
Credit			
LCL Total returns		MoM %	YTD %
EUR IG		2.3%	5.3%
EUR HY		3.0%	9.7%
USD IG		6.0%	4.0%
USD HY		4.5%	9.4%
GBP IG		3.6%	4.6%
GBP HY		3.7%	12.4%
Equities			
LCL Total returns		MoM %	YTD %
Global		9.4%	18.6%
S&P 500		9.1%	20.8%
Nasdaq 100		10.8%	37.0%
STOXX 600		6.6%	11.5%
DAX		9.5%	16.5%
CAC		6.3%	16.3%
FTSE 100		2.3%	3.7%
Emerging markets		5.2%	6.3%
EM ASIA		8.0%	6.0%
EM LATAM		7.0%	2.7%
EM EMEA		14.0%	22.6%
Currencies			
Total return		MoM %	YTD %
EURUSD		3.0%	1.7%
EURCHF		-1.0%	-3.7%
GBPEUR		0.9%	2.6%
GBPUSD		3.9%	4.5%
Commodities			
Total return		MoM %	YTD %
Oil WTI		-5.6%	-3.0%
Oil Brent		-4.3%	-1.5%
Natural Gas		-21.6%	-37.4%
Gold		2.6%	11.6%
Copper		4.4%	1.1%
Iron Ore		6.6%	15.2%
S&P GSCI Index		-3.7%	-8.9%

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Macro-economic views

The global economy is on track to outperform economist expectations in 2023. As Exhibit 1 shows, consensus now estimates global growth at 2.9% this year, 0.8pp above the Bloomberg Consensus forecast a year ago. The US is on track to deliver economic growth of 2.4%, a full 2pp higher than the consensus forecast a year ago, whilst the UK economy is expected to grow at 0.5% in 2023, 1.2pp ahead of the consensus forecast a year ago. Overall, current consensus forecasts for growth in 2023 for Developed economies are 1.2pp higher than a year ago, whilst for Emerging economies, growth is expected 0.1pp lower.

Moreover, global inflation (CPI) is also on track to end 2023 0.9pp higher when compared to consensus forecast last year. After years of suffering from deflation, Japan's prices accelerated at a faster pace than expected at the start of the year. Consensus expects Japan's inflation in 2023 of 3.2%, which is 1.6pp higher than the forecast last year. The uptick in Japan's inflation outweighed the declines seen in China (-1.9pp), the Eurozone (-0.4pp) and the US (-0.2pp).

As we head into 2024, the base case expectation is for growth to moderate to allow inflation to decelerate further, closer to central bank targets. Notwithstanding, we argue that uncertainty around this forecast remains elevated in view of the different outcomes that could materialise. Consensus currently expects global growth at 2.7% in 2024, with a significant slowdown in the US (-1.2pp), Japan (-0.8pp) and China (-0.7pp). Yet, the US consumer has surprised to the upside for most of this year and recent data released does not provide any support of any caution in spending. Also, recent speculation around more stimulus in China directed at the property market could help boost growth. In a recent Bloomberg article, it was reported that regulators are drafting a list of 50 developers, both private and public, that could be eligible for a range of financing measures. This could have implications for growth in China, but also to other important trading partners like Europe. On balance, we see upside risks to the inflation should growth come in meaningfully ahead of current expectations. At the other end of the spectrum, the global macro-economic backdrop could deteriorate sharply, raising the probability of recession which is not currently being priced-in by the markets. We see downside risks from the continued negative surprises in the manufacturing sector. Also, we see risks from rising geopolitical concerns.

Consensus expects global inflation (CPI) to remain elevated, closing 2024 at 4.4%. Yet, we note that inflation in Developed economies is expected to moderate to 3.8% by the end of 2024, driven by disinflation in the US, where inflation is expected to slow to 2.7% by year-end from 4.1% expected at the end of 2023. Prices in the Eurozone (2.7% in 2024 down from 5.5% in 2023) and Japan (2.2% in 2024 down from 3.2% in 2023) are also expected to moderate.

Exhibit 1 – Consensus real GDP growth and inflation expectations

	Consensus Forecast, % YoY								Cons. Forecast, % YoY		
Real GDP, YoY%	*1Q23A*	*2Q23A*	*3Q23A*	*4Q23F*	*1Q24F*	*2Q24F*	*3Q24F*	*4Q24F*	*FY23F*	*FY24F*	*FY25F*
United States*	2.2	2.1	5.2	1.1	0.4	0.4	1.0	1.6	2.4	1.2	1.7
Japan*	3.7	4.5	-2.1	0.9	0.9	1.2	1.2	1.1	1.7	0.9	1.0
Germany	-0.2	0.1	-0.4	-0.2	-0.1	0.1	0.5	1.0	-0.2	0.4	1.4
France	0.9	1.2	0.6	0.8	0.9	0.6	0.9	1.0	0.9	0.8	1.4
Italy	2.1	0.3	0.1	0.2	-0.2	0.4	0.6	0.9	0.7	0.5	1.2
Spain	4.1	2.0	1.8	1.5	1.2	1.2	1.3	1.7	2.3	1.4	1.8
Eurozone	1.2	0.5	0.1	0.2	0.2	0.4	0.8	1.1	0.5	0.6	1.5
UK	0.5	0.6	0.6	0.5	0.3	0.3	0.4	0.7	0.5	0.4	1.2
Developed Economies	2.0	1.7	2.4	0.9	0.7	0.7	1.1	1.5	1.7	1.2	1.7
China	4.5	6.3	4.9	5.1	4.2	4.6	4.6	4.7	5.2	4.5	4.5
Emerging Economies	3.7	5.3	4.7	4.5	3.8	4.1	4.1	4.3	3.9	4.0	4.2
Global									***2.9***	***2.7***	***3.0***

* - QoQ SAAR

	Consensus Forecast, % YoY								Consensus Forecast, % YoY		
Consumer prices	*1Q23*	*2Q23*	*3Q23F*	*4Q23F*	*1Q24F*	*2Q24F*	*3Q24F*	*4Q24F*	*FY23F*	*FY24F*	*FY25F*
United States	5.8	4.0	3.5	3.2	3.0	2.8	2.6	2.3	4.1	2.7	2.3
Japan	3.6	3.3	3.2	2.8	2.6	2.5	2.2	1.7	3.2	2.2	1.6
Germany	8.8	6.9	5.7	3.4	3.1	2.8	2.5	2.4	6.1	2.7	2.1
France	7.0	6.1	5.5	4.4	3.3	2.7	2.5	2.1	5.7	2.7	2.0
Italy	9.5	7.8	5.8	1.4	2.1	2.3	2.0	2.1	6.1	2.4	1.9
Spain	5.0	2.8	2.6	4.0	3.5	3.7	2.7	2.5	3.6	2.9	2.1
Eurozone	8.0	6.2	4.9	3.2	3.0	2.8	2.4	2.2	5.5	2.7	2.1
UK	10.2	8.4	6.7	4.5	4.2	2.7	2.8	2.6	7.4	3.1	2.0
Developed Economies	7.1	5.2	5.3	4.6	4.4	4.2	3.6	3.2	5.8	3.8	2.7
China	1.3	0.1	-0.1	0.3	0.9	1.2	1.4	1.8	0.4	1.6	1.9
Emerging Economies	6.3	2.9	3.1	6.1	7.3	8.0	7.2	6.1	6.1	6.1	4.3
Global									6.0	4.4	3.5

Source: Bloomberg Consensus Forecasts as at 05/12/2023 (A denotes Actuals and F denotes Forecasts)

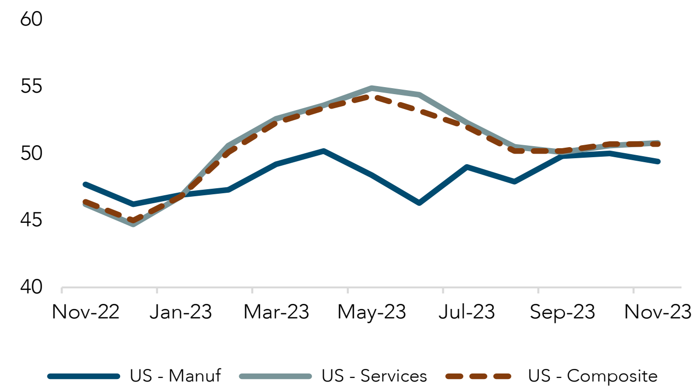
United States

The US has been the economic success story of 2023, handsomely beating (based on current estimates) consensus expectations at the start of the year despite the 525bp in rate hikes delivered since March 2022. Consensus sees growth in the US moderating over the coming quarters, before accelerating again in 3Q24, as the contribution to growth from consumer spending declines. The latest Atlanta FED forecast points to growth of 1.2% in 4Q23 (Exhibit 3). Amongst other things, the softer consumer spending is being forecasted due to the impact from the resumption of student loan repayments, higher interest rates and the replenishing of the savings rate from the current low levels. However, from the data released so far, we see little evidence of this happening as personal spending remained positive in October and the savings rate was largely unchanged at 3.8%. Also, we note that unemployment remains at very low levels compared to history, as the unemployment rate fell to 3.7% in November after 199k jobs were added during the month (Exhibit 4).

The disinflation story has been gaining momentum, with the core price pressures moderating further in October to 3.5%, down from 3.7% in September. While this is encouraging, there are some doubts about whether this pace can be sustained. We note that the moderation in core PCE was driven by the more volatile services PCE. Furthermore, for inflation to fall further we would need to see a moderation in economic activity and labour market conditions.

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

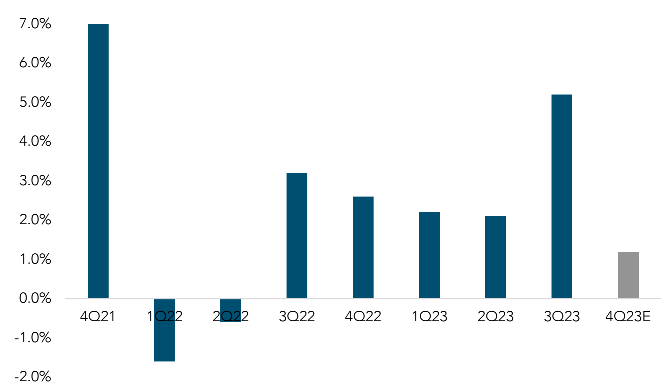
The composite PMI was unchanged at 50.7 in November, as the improvement in services (50.8) was offset by manufacturing (49.4)



Source: Bloomberg

Exhibit 3 – US economic growth QoQ saar

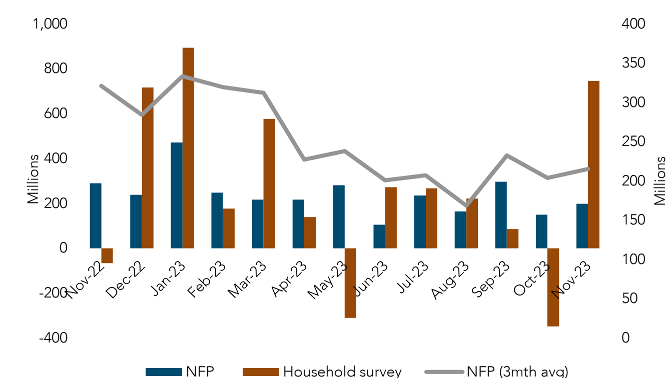
Economic growth more than doubled in 3Q but the latest Atlanta Fed forecast points (01/12) for 4Q points to a deceleration



Source: Bloomberg, BEA, Atlanta FED

Exhibit 4 – Non-Farm Payrolls

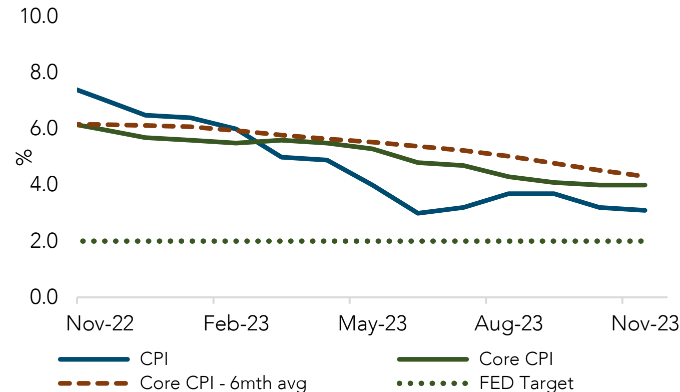
The US added 199k jobs during November, ahead of consensus expectations with a strong recovery in household employment



Source: Bloomberg , BLS

Exhibit 5 – US Inflation rate

Headline CPI slowed to 3.1% YoY (from 3.2% in October) in November whilst core CPI was unchanged at 4.0% YoY



Source: Bloomberg

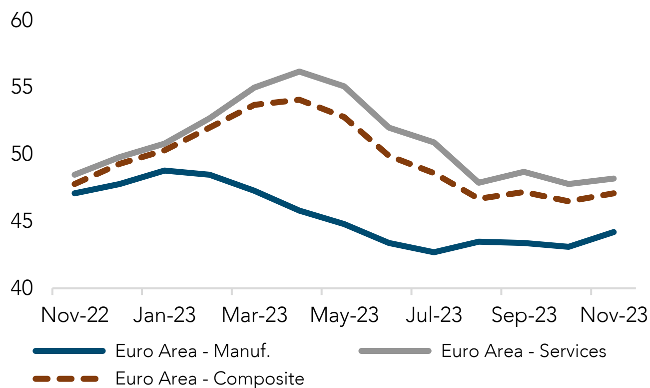
Europe

Economic growth in the Eurozone has stagnated and a technical recession in 2H23 remains the more likely outcome. The Euro-area now-cast points to growth of -0.5% QoQ in 4Q23 (Exhibit 7). The downturn in economic activity continued as the Composite PMI remained in contractionary territory for the sixth consecutive month in November, though the reading was up when compared to October (Exhibit 6). Perhaps, the more important takeaway is that the labour market showed signs of stress, as the employment index fell for the first time since January 2021. This is generally a forward indicator of worsening employment market conditions, though unemployment remained at all-time lows of 6.5% in October. We see the lower headwind from global supply-side constraints (Exhibit 8), as well as the lower energy prices to help boost growth in 2024. Also, falling inflation should lead to positive real disposable income growth (absent a significant uptick in unemployment).

The EA Core HICP fell to 3.6% YoY in November, down from 4.2% in the previous month. The upcoming inflation releases will provide us with a better understanding on the trajectory for inflation. On the one hand, weak aggregate demand will likely make it more difficult for corporations to pass on inflation to customers. On the other hand, nominal wage growth remains elevated and accelerated in Q3, which could support consumer spending, and hence inflation. Therefore, although it looks likely that inflation is on a downward cycle, we emphasise that more data points are needed.

Exhibit 6 – EU S&P Composite, Manufacturing and Services PMI

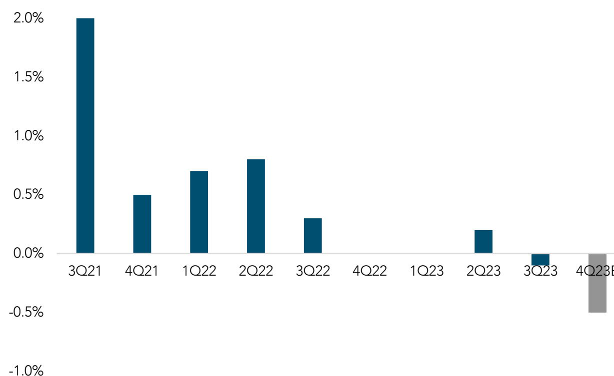
The Composite PMI improved to 47.1 in November driven by persisting weakness in manufacturing (43.1) and services (47.8)



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, Euro-area now-cast

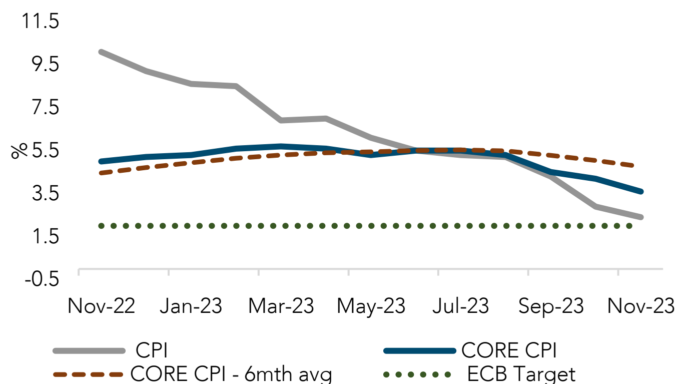
Exhibit 8 – NY FED Global Supply Chain Pressure Index

The global supply chain pressure index fell to the lowest level on record in October

Source: New York FED

Exhibit 9 – HICP headline and core inflation

The deceleration in inflation continued with both headline HICP and core HICP moderating in November

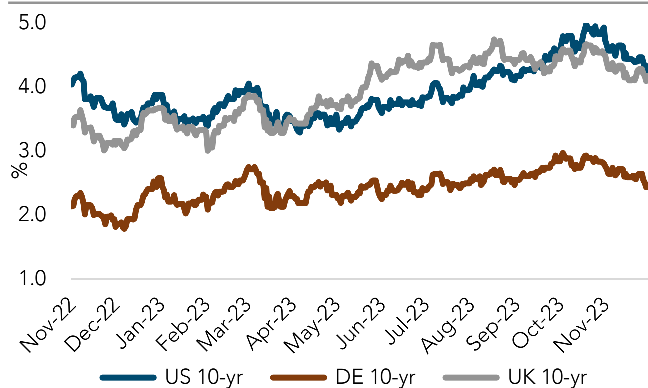


Source: Bloomberg

Rates

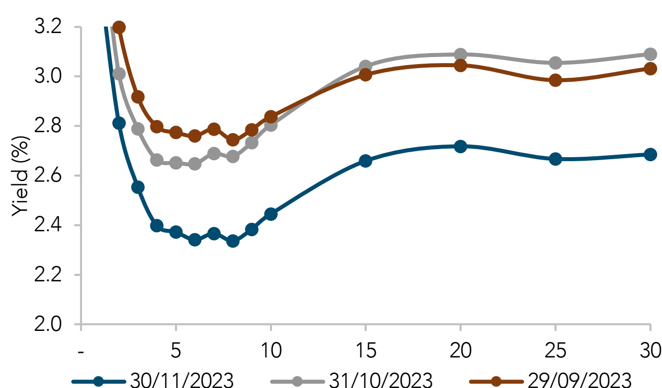
November saw a dramatic pullback in yields following some weaker economic data releases in the US, and some dovish language used by major Central Banks. This led to the market updating their rate cut expectations, bringing down as far forward as March in certain cases. This generally reflects the view that Central Banks tend to move together, as has happened in the past. However, we note that the beginning of this hiking cycle was not synchronized, with the Bank of England (16/12/2021) hiking first, followed by the Federal Reserve (16/03/2022), with the European Central Bank (21/07/22) hiking a while later. We believe that the differences in inflation and growth dynamics is more likely to imply divergence in monetary policy action. **Our view on the rates market is that it should provide investors with protection against a growth shock, absent which we cannot currently see scope for significant rate cuts.**

Exhibit 10 - 10-year nominal bond yield for the US, Germany and UK
November saw a dramatic pullback in yields as investors grew more confident that the hiking cycle is over



Source: Bloomberg

Exhibit 11 – US Yield Curve
Yields fell across the curve during November with a bigger move at the long-end of the curve compared to the short-end



Source: Bloomberg

United States

After flirting with the 5% market, the yield on the US 10-year treasury pulled back sharply in November, closing the month at 4.3% which represents a c.60bp downward move since the end of October. Softer employment data for October, a more dovish than expected FED and more signs of disinflation were the main drivers behind the significant move during the month. Market-implied rate cut expectations have also been brought forward, with over 140bp of rate cuts now expected in 2024 with the first rate cut as early as March 2024, an increase from the 100bp expected at the end of November.

We also note that financial conditions have eased significantly since the last FOMC meeting held during November. During the press conference Chair Powell had emphasised that market-led tightening in financial conditions needs to be “persistent” to influence policy. We were therefore surprised by the dovish message at the December meeting held on 13/12. The FOMC kept the fed funds rate target range unchanged at 5.25-5.50% as expected and kept its tightening bias in its statement. However, the latest FOMC’s Summary of Economic Projections indicated three 25bp rate cuts next year, with the 2024 median dot revised down 50bp to 4.6%, followed by four additional cuts in 2025. This move was supported by a downward revision to core PCE inflation projections for 2023 of 2.8% (down 0.5pp from the September meeting), 2.4% in 2024 (down 0.2pp from the September meeting) and 2025 of 2.1% (down 0.1pp from the September meeting).

Europe

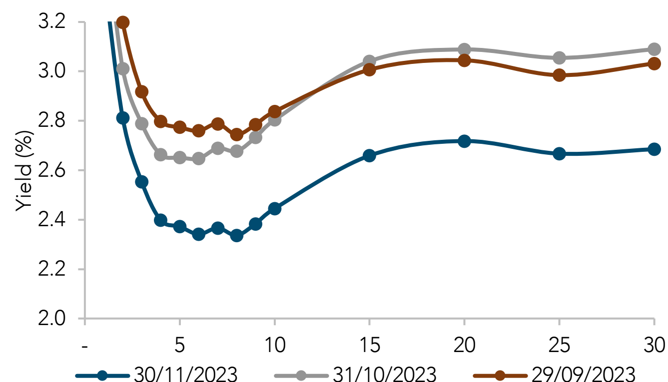
Similar to what happened in the US, yields on the 10-year German bund fell 36bp to 2.5% by month end. The current expectation is for the current economic stagnation in Europe to persist further, with growth below potential but accelerating in both 2024 and 2025. Despite this, most ECB officials have continued to refuse talks of rate cuts early in 2024. Bank of France Governor Villeroy emphasized that faster disinflation in the region means that rate hikes are over absent a shock, which was interpreted by the market as a signal that rate cuts could be on the table. Obviously, the wording could suggest a change in tone by the ECB, especially given President Lagarde's insistence that rate cuts have not yet been discussed. As recently as 10/11, President Lagarde was quoted by the Financial Times as saying that "It is not something that [means] in the next couple of quarters we will be seeing a change. 'Long enough' has to be long enough."

Despite this, market-implied rate cut expectations have moved significantly during November, with c. 145bp of rate cuts now being priced-in for 2024 compared to c. 77bp at the end of October. At the most recent meeting, the Governing Council kept policy rates and guidance unchanged as expected but downgraded the inflation assessment in the statement with core inflation expected to average 5.0% in 2023, 2.7% in 2024 and 2.3% in 2025. On the other hand, economic growth is expected to pick-up from an average of 0.6% in 2023 to 0.8% in 2024 and 1.5% in 2025. Also, the Governing Council stated its intention to scale back PEPP reinvestments by half from 2H24 and discontinue reinvestments at the end of 2024.

In the UK, the 10-year Gilt yield fell 34bp to 4.2%, reversing the tightening seen during October. Data released by the Bank of England's Decision Maker Panel ("DMP") and the BRC shop price index at the end of November were both supportive of near-term disinflation, notably in core goods and food. The DMP survey showed that firms' expectations of their own price growth in November for the coming year fell to 4.3%. There was also a sharp deceleration in food inflation as showed by the BRC survey.

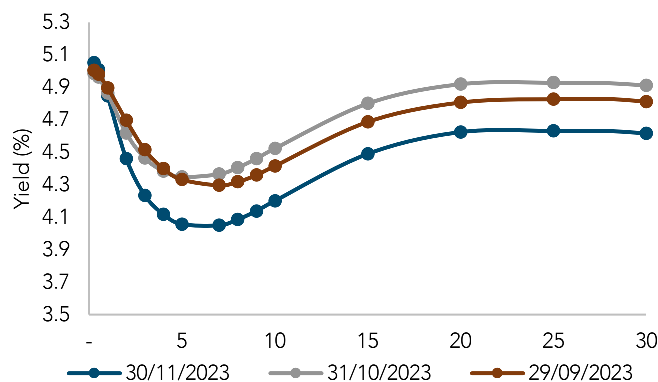
Market-implied expectations in the UK have also been pushed forward during November. Currently, the market is expecting c. 60bp of rate hikes in 2024, compared to just 25bp of rate cuts expected at the end of October.

Exhibit 12 – German 10-year yield curve
Yields fell across the curve during November as confidence the disinflation will persist grew



Source: Bloomberg

Exhibit 13 – UK 10-year yield curve
UK yields shifted downwards across the curve throughout November as inflation concerns eased



Source: Bloomberg

Credit

Credit markets had a positive month during November, lifted by the disinflation narrative and spread contraction. USD paper was the best performer in both IG and HY markets, and November marked the strongest month of performance for USD credit markets on a YTD basis. USD IG delivered a total return of 6.0% driven by a 60bp pullback in the US 10-year treasury yield during the month. Furthermore, the USD HY credit market delivered a total return of 4.5% during the same period. The performance of GBP credit was also respectable in both IG (+3.6%) and HY (+3.7%), whilst EUR paper lagged behind following outperformance in recent months.

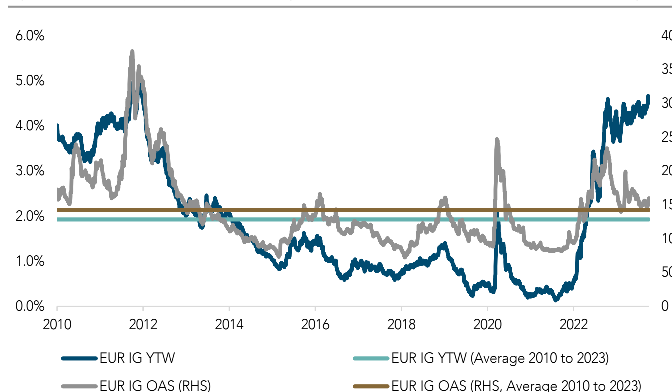
Overall, we believe the stronger yields should support higher total returns in 2024 for both IG and HY, though upside is constrained to a certain extent from tight spreads. Yields are currently at levels not seen for several years after the very aggressive tightening cycle that started in 2022. Yields on offer in the EUR IG market rank in the 84th percentile at 3.9% (04/12) compared to an average yield of 1.9% over the period 2010 to 2023. Additionally, looking at the period starting in 2012 (yields drifted lower due to the lower political risk following then ECB President Draghi's whatever it takes speech) to 2021 (before the hiking cycle started), the yield on offer on average was that of 1.0%. It is a similar story in EUR HY, where the current yield on offer ranks in the 76th percentile at 8.0% (04/12), which compares well to the average since 2010 of 5.9% and an average yield of 4.9% during the period 2012 to 2021. Therefore, we see the current yield levels as attractive for investors.

On the other hand, we note that tight spreads could act as a headwind for credit throughout 2024. The current spread of 146bp for EUR IG (compared to an average of 135bp since 2010) and 433bp for EUR HY (compared to 501bp on average since 2010) is tight compared to history and limits the upside for both markets. We also see less motivation for new issuance in 2024 given the higher financing costs. Furthermore, we remain cautious around credit quality with the default rate expected to rise over the coming year driven by higher funding costs and refinancing needs that are expected to weigh on highly-leveraged issuers.

On balance, we see scope for having exposure to both IG and HY in 2024 to benefit from the higher yields. Credit should also benefit from interest rate cuts should they materialise. However, our recommendation is to manage exposure to both IG and HY given the tight spreads, and to go higher up the credit quality ladder especially in HY.

Exhibit 14 – EUR IG YTW and OAS

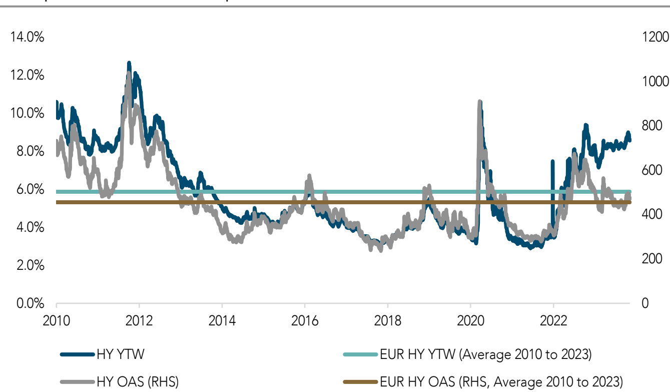
Spreads are currently close to historical levels implying less scope for upside absent a significant improvement in the economic backdrop



Source: Bloomberg

Exhibit 15 – EUR HY YTW and OAS

Similar to IG, HY spreads are also very close to the 10-year average despite the risk of an uptick in the default rate



Source: Bloomberg

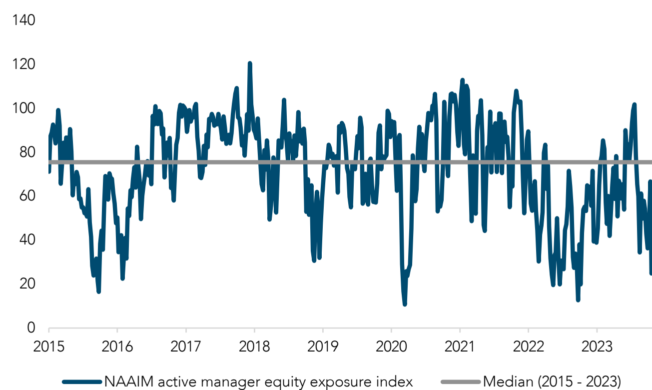
Equity

Risk sentiment recovered sharply in November with global equities delivering their best returns since November 2020. The risk-on rally was primarily driven by encouraging data around inflation in developed economies which led to investors pushing forward their interest rate cut expectations. This led to strong performance in long-duration equities as well as interest sensitive sectors (like real estate) that have been under pressure for several years. Additionally, the news-flow around the Middle-East conflict was more favourable in November adding to the bullish sentiment, as this essentially reduces the possibility of supply shocks in energy markets. Oil and commodity prices drifted lower during the month.

Exhibit 16 – S&P 500, STOXX 600 and UST 10-year real yield (inverse)
US real yields declined 32bp during November after a steep rise of 61bp in September and October

Source: Bloomberg

Exhibit 17 – NAAIM active manager exposure to equity markets
The NAAIM exposure index suggests that funds were underweight equities during the strong November rally



Source: National Association of Active Investment Managers

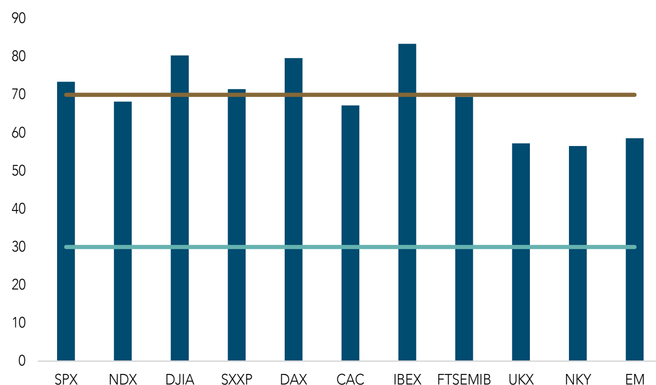
The disinflation narrative and the expectations that Central Banks will cut interest rates sooner than expected led to a 32bp decline in the US real yield during November (Exhibit 16). This followed the steep rise since the summer months, when US real yields climbed 61bp over the two months of September and October. This pullback in yields boosted long-duration and interest-rate sensitive sectors. As for geographical performance, as is a typical during rates-induced rally, the US outperformed Europe during November, whilst the FTSE 100 (commodity exposed) lagged. Developed Market equities outperformed emerging markets, despite the weakness in the US Dollar as China's economic outlook remains difficult given the structural issues within the property market. As for performance by sector, in Europe, the best performing sector in November was Technology (long-duration), followed by Real estate (interest-rate sensitive). At the other end of the spectrum, the sell-off in the commodities market weighed on the Energy sector, November's worst performing sector.

Despite a very strong performance by equities during November it was a painful one for active fund managers. This is because according to the National Association of Active Managers index, fund managers were still underweight equities during November (Exhibit 17). The average position at month-end was that of 81.4%, a significant increase from the 29.2% at the start of the month. The current NAAIM exposure index level is slightly above the average calculated since 2015, which suggests less scope for further buying absent an improvement in the economic outlook. Additionally, the big move in equities have led to most indices we follow moving in overbought levels which could weigh on performance over the short-term (Exhibit 18).

Equity market performance has been constrained by the rising interest rates since 2022. Going forward, the outlook for the equity market in 2024 is more favourable, given we are close to or at peak rates. We believe that this reduces the downside risk for the asset class. However, we note that the equity risk premium is very low when compared to history, which limits the upside from current levels. Also, the moderation in economic growth expected in 2024 will probably weigh on earnings growth. Central Bank action could have implications on equity market performance in 2024. The rate cut outlook in the US could lead to some valuation expansion, even though valuations are generally high, especially in the US.

Exhibit 18 – Relative Strength Index ("RSI")

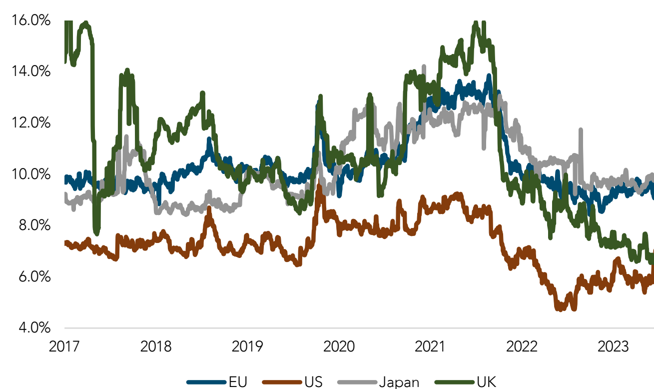
The RSI levels have picked up significantly over November which most indices moving in overbought levels



Source: Bloomberg

Exhibit 19 – Equity risk premium

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



Source: Bloomberg

In terms of style, we would recommend a barbell approach rather than a clear tilt towards a particular strategy given the risks currently in the outlook. We prefer a portfolio with a mix of equities that can provide earnings growth, strong balance sheet, strong margins and significant returns to shareholders. We emphasise that diversification along geography and styles is essential given the current backdrop. European equities have underperformed their US counterparts so far this year, but we believe that their cheap valuation could make them attractive (assuming no hard landing or a deterioration in risk sentiment). US equities, though expensive, offer exposure to growth stocks. Finally, we note that economic fundamentals for Japanese equities are also favourable given the expectation for rising inflation and potential for additional government reform.

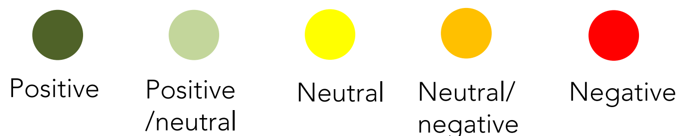
Exhibit 20 – Valuations – Developed markets

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

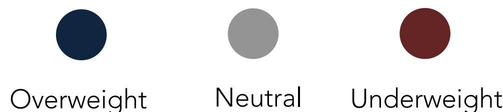
Historical Data	SPX	NDX	SXXP	SX5E	DAX	CAC	FTSE100	FTSE250
Current Forward PE ratio (FPE)	17.2x	22.2x	11.4x	11.2x	10.0x	11.4x	10.1x	9.3x
Forward PE ratio (31/12/2022)	16.8x	21.1x	11.9x	11.3x	10.5x	11.3x	10.0x	11.1x
10 Year data								
Highest	22.1x	30.8x	17.5x	18.0x	15.7x	18.2x	15.4x	17.9x
Highest (date)	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



Key – Allocation



Asset Class	Positioning
Developed Market Sovereign Bonds	The current expectation is that sovereign yields should end 2024 slightly below or at current levels. Inflation remains elevated relative to history and unemployment remains at all-time low, which sets a higher bar for rate cuts. The rate hike cycle should be over for G10 countries (excluding Japan), but we believe that the current market-implied rate cut expectations are too optimistic, both in terms of timing and size. Also, we note that uncertainty remains elevated. Against the current base case we would recommend a Neutral allocation to Sovereign market, allowing investors to benefit from the higher yields and rate cuts in 2H24. Also, we see the Sovereign bond market as a protection from growth shocks as the disinflation process continues.
Investment Grade Credit	The higher yields on offer in the IG credit market should support higher total returns in 2024, though we see upside constrained to a certain extent from tight spreads. Yields are currently at levels not seen for several years after the very aggressive tightening cycle that started in 2022. Yields on offer in the EUR IG market rank in the 84th percentile at 3.9% (04/12) compared to an average yield of 1.9% over the period 2010 to 2023. At an asset class level, we continue to recommend an Overweight allocation, whilst also extending duration exposure, a process we started in 2023, given the expectation that Central Banks could start to ease monetary policy over the coming months.
High Yield Credit	We maintain our underweight in HY due to a combination of (1) tight spreads relative to history; and (2) higher default rates. The current yield on offer in HY credit ranks in the 76th percentile at 8.0% (04/12) and compares well to the average since 2010 of 5.9%. However, spreads are tight relative to history which could also limit upside in 2024. Spreads in EUR HY of 437bp (04/12) are below the average since 2010 of 456bp. This should provide only limited protection to investors should the economic macro-economic backdrop deteriorate from here. Furthermore, the current expectation is that that the default risk should rise from current levels in 2024 driven by pressures from higher funding costs. Overall, we believe that this supports our underweight recommendation. Similar to IG, we recommend extending duration to benefit from future rate cuts if they materialise. Finally, we also recommend moving up the credit quality ladder to reduce the credit risk within the HY portfolio.
Developed Market Equities	Equity market performance has been constrained by the higher interest rates since 2022. Most equity markets we follow are flat or down when compared to 2022, when the tightening cycle began. The good news for equity investors is that we should be at or close to peak rates, which should limit downside risk. Yet, we note that upside is limited by a combination of: (1) High starting valuation; (2) limited earnings growth potential; (3) A lot of the good news already being priced-in; and (4) Absent a deep recession, current interest rate cuts priced-in are too optimistic. European equities continue to trade at a significant discount to the US, but the valuation gap is unlikely to narrow given the weaker economic growth and higher risk premium in Europe. We recommend closing the underweight in DM equities as the base case scenario would still see positive earnings growth. Given the expectation for higher-for-longer rates and moderate economic growth, we recommend increasing sector and geographic diversification. We expect 2024 to be a mixed year for equities with no clear or consistent direction.
Emerging Market Equities	The outlook for EM is largely dependent on the policy response in China. The two pain points for China remain low consumer spending and the property market. A stronger than expected policy response should provide some relief for Chinese equities. We continue to like China, but we also like Mexico (should benefit from monetary policy shift in LATAM) and India (offers relatively "safe" returns in 2024 given the high EPS growth expectations).

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