CURMI & PARTNERS

February 26th, 2024

Monthly Strategy Update

The month in summary:

The last quarter of 2023 was a good one for investors as it was characterised by a strong rally in almost all asset classes that we follow. As the disinflation narrative continued to gain traction, investors became more confident that inflation could fall back close to target whilst avoiding a recession, the so-called soft-landing scenario. Furthermore, the FED shifted to a more dovish tone, and by December the FOMC projections indicated three rate cuts in 2024. The FOMC appeared to be more comfortable with the progress made in bringing inflation back towards target.

The sovereign bond market benefited strongly from the disinflation narrative in the last two months of the year as yields plummeted across developed economies. Market-implied rate cut expectations moved well ahead of the FOMC projections, with around 140bp of rate cuts priced-in at year-end. However, with the long-awaited slowdown in the US economy remains elusive, rate cut expectations were pushed back.

Overall, the US economic backdrop remains strong and more importantly, the labour market is robust, reducing the probability of rising unemployment. The January employment report in the US was also very strong, with new job additions almost double the consensus forecast and unemployment edging slightly down.

The performance within the credit market was fairly mixed, with EUR Investment Grade ("IG") paper outperforming driven by tighter spreads on rising hopes of a soft landing. As for high yield ("HY"), GBP paper was the outperformer during January as spreads tightened by c.65bp.

Equity market performance was mixed in January with developed market equities generating positive performance whilst emerging market equities saw negative returns. On balance stronger than expected economic data reduced the probability of a recession, which should support the asset class.

Finally, the persisting strength in the US economy and the pushback in rate cut expectations lead to a strengthening in the US Dollar basket of 1.9% during January. Additionally, the rising tensions in the Middle East supported commodities, with the S&P GSCI commodities index rising 3.6%.

Sovereign			
		Movement in bp	
	Yield	Jan ' 24	YTD
US 10-year yield	3.9%	3	3
DE 10-year yield	2.2%	14	14
UK 10-year yield	3.8%	26	26
Credit			
LCL Total returns		MoM %	YTD %
EUR IG		0.1%	0.1%
EUR HY		1.0%	1.0%
USD IG		-0.2%	-0.2%
USD HY		0.0%	0.0%
GBP IG		-1.1%	-1.1%
GBP HY		1.6%	1.6%
Equities			
LCL Total returns		MoM %	YTD %
Global		1.2%	1.2%
S&P 500		1.7%	1.7%
Nasdaq 100		1.0%	1.0%
STOXX 600		1.5%	1.5%
DAX		0.9%	0.9%
CAC		1.6%	1.6%
FTSE 100		-1.3%	-1.3%
Emerging markets		-4.6%	-4.6%
EM ASIA		-5.4%	-5.4%
EM LATAM		-4.8%	-4.8%
EM EMEA		-1.0%	-1.0%
Currencies			
Total return		MoM %	YTD %
EURUSD		-2.0%	-2.0%
EURCHF		0.3%	0.3%
GBPEUR		1.7%	1.7%
GBPUSD		-0.3%	-0.3%
Commodities			
Total return		MoM %	YTD %
Oil WTI		5.6%	5.6%
Oil Brent		4.7%	4.7%
Natural Gas		-16.5%	-16.5%
Gold		-1.1%	-1.1%
Copper		0.6%	0.6%
Iron Ore		-0.2%	-0.2%
S&P GSCI Index		3.6%	3.6%

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Macro-economic views

Back in July, we highlighted how the "US economy continued to defy bearish expectations as the strength of the labour market is supportive for consumer spending" whilst Europe and China struggled. Seven months on, the situation has not changed much, as data released so far this year has followed the same trend. The long-awaited moderation in the US has so far been elusive and the narrative is shifting away from "soft-landing" to "no-landing". It is still very early in the year and the situation can change over the coming weeks, but this could have implications for inflation in the coming months especially if there is no evidence of an economic slowdown.

Despite the lacklustre data published in Europe and China, we do note early signs of an upturn in global economic activity, with rates of growth in output and new orders accelerating to seven-month highs. Emerging markets continued to outperform on average, though developed economies did see output rise for the first time since July 2023. The J.P. Morgan Global Composite PMI improved to 51.8 in January from 51.0 in December, marking the highest level since June 2023. The improvement was driven by both the services sector, where the PMI reached 52.3, the highest since July 2023. Furthermore, the global manufacturing sector, which has been under pressure in the post-pandemic years, showed early signs of stabilisation. The January PMI reading came in at the expansionary threshold of 50.0 for the first time since August 2022. The improvement was primarily driven by emerging markets, particularly in Asia, but gains were widely shared across regions.

For almost a decade central banks loosened monetary policy to get inflation back to their target. The past two years, central banks had to aggressively tighten policy to get inflation under control after the disruptions to production brought about by COVID-19 and then the war in Ukraine. Yet, for inflation to persist and avoid another deflationary spiral that has negative consequences for economic growth, developed economies need to improve their return on capital returns relative to emerging economies. This will lead to rising inequality as wage growth in developed economies stagnates while corporates shift production to cheaper markets abroad leading to lower business investments. This is a negative for economic growth.

On balance we see Europe as exposed to this risk more than the US. Also, China's economic troubles are unlikely to fade without a more aggressive fiscal policy program. China's impressive growth over the past 30 years was driven by changes implemented in the 80s, when it was hoped that China would soon be like the US. The change in stance in recent years has led to tensions with the US and has made the Chinese economy more dependent on domestic demand. Also, other countries are competing with China on production costs which could lead to corporates opting for cheaper labour markets in the same way China benefited in 2000 and beyond.

Exhibit 1 – Consensus real GDP growth and inflation expectations

	Cons. Forecast, % YoY					Cons. Forecast, % YoY		
Real GDP, YoY%	**4Q23F**	**1Q24F**	**2Q24F**	**3Q24F**	**4Q24F**	**FY23F**	**FY24F**	**FY25F**
United States*	3.3	1.1	0.5	1.0	1.5	2.5	1.6	1.7
Japan*	1.1	1.0	1.1	1.2	1.1	2.0	0.8	1.0
Germany	-0.2	-0.2	-0.1	0.2	0.7	-0.3	0.2	1.2
France	0.7	0.7	0.4	0.7	1.1	0.8	0.7	1.3
Italy	0.5	-0.1	0.5	0.7	1.0	0.7	0.5	1.2
Spain	2.0	1.4	1.4	1.6	1.7	2.5	1.5	1.9
Eurozone	0.4	0.5	0.7	1.0	1.3	0.5	0.5	1.4
UK	0.2	0.1	0.1	0.4	0.8	0.3	0.4	1.2
Developed Economies	1.6	1.0	0.7	1.1	1.4	1.7	1.3	1.7
China	5.2	4.2	4.8	4.7	4.7	5.2	4.6	4.4
Emerging Economies	4.6	3.8	4.2	4.0	4.1	5.0	4.1	4.1
Global						***3.1***	***2.7***	***3.0***

	Cons. Forecast, % YoY					Cons. Forecast, % YoY		
Consumer prices	**4Q23F**	**1Q24F**	**2Q24F**	**3Q24F**	**4Q24F**	**FY23F**	**FY24F**	**FY25F**
United States	3.2	2.9	2.8	2.5	2.5	4.1	2.7	2.3
Japan	2.9	2.7	2.4	2.2	1.9	3.3	2.2	1.7
Germany	3.0	2.8	2.5	2.3	2.4	6.1	2.6	2.2
France	4.2	3.1	2.5	2.3	2.2	5.7	2.6	2.0
Italy	1.0	1.3	2.0	1.9	2.2	6.0	2.0	1.9
Spain	3.4	3.0	3.2	2.4	2.7	3.4	2.8	2.2
Eurozone	3.3	2.9	2.7	2.5	2.5	5.5	2.3	2.1
UK	4.2	3.6	2.1	2.1	2.3	7.4	2.8	2.1
Developed Economies	4.5	4.1	4.1	3.4	3.3	5.8	3.8	2.8
China	-0.3	0.3	0.4	0.6	1.3	0.2	1.0	1.7
Emerging Economies	2.8	8.5	9.1	8.0	6.8	3.4	7.4	4.2
Global						***6.8***	***4.1***	***3.4***

* - QoQ SAAR, shaded areas imply figures are actuals

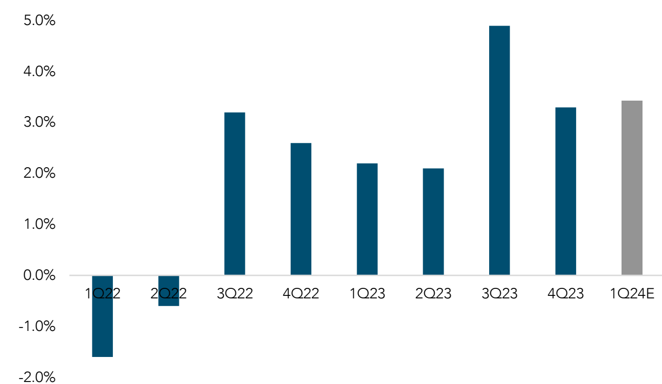
Source: Bloomberg Consensus Forecasts as at 05/12/2023 (A denotes Actuals and F denotes Forecasts)

United States

The advanced estimate showed Q4 GDP decelerated from 4.9% QoQ saar in Q3, to 3.3% in Q4, well ahead of expectations of 2% (Exhibit 2). The Atlanta FED GDP Now estimate sees GDP remaining roughly at the same levels in the 1Q24 (08/02). It is still early days, and a lot of data still must be published, but what we saw so far has been encouraging. Activity data like the composite PMI showed a further improvement into expansionary territory during January (to 52.0 from 50.9), with the services PMI (52.5, from 51.4) at levels not seen since June 2023 (Exhibit 2). Also, it is encouraging to see the manufacturing sector (50.7 from 47.9) moving back above 50 for the first time since April 2023. Other data has also dispelled the notion of a slowdown or that consumers welling pulling back on their spending, as retail sales and personal spending comfortably beat expectations.

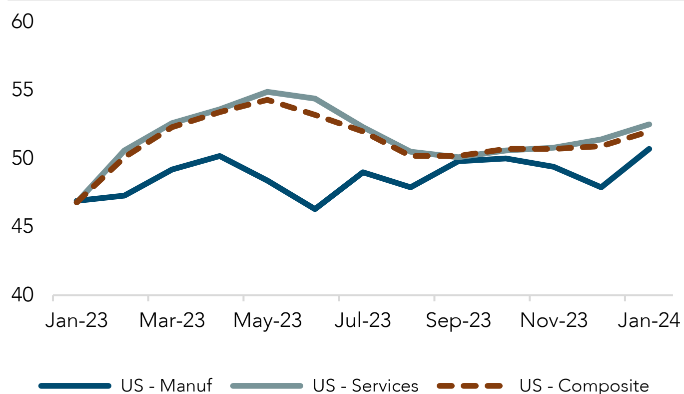
The flipside to this is obviously whether the disinflation narrative can continue, especially following the release of the very strong employment report for January. The US economy added 353k jobs, well ahead of consensus expectations (Exhibit 4). The job/workers gap re-opened to 2.9 million which could imply more wage pressures going forward, though we note that seasonal factors could be skewing data. The core CPI for January was unchanged at 3.9% compared to consensus of 3.7% (Exhibit 5). It is still too early to conclude on whether the disinflation narrative is challenged given seasonal factors, but it does raise some doubts given the persisting strength of the US economy.

Exhibit 2 – US economic growth QoQ saar
Economic growth remained well above trend in 4Q23 (3.3%) and is expected to remain at those levels in 1Q24 (3.4%)



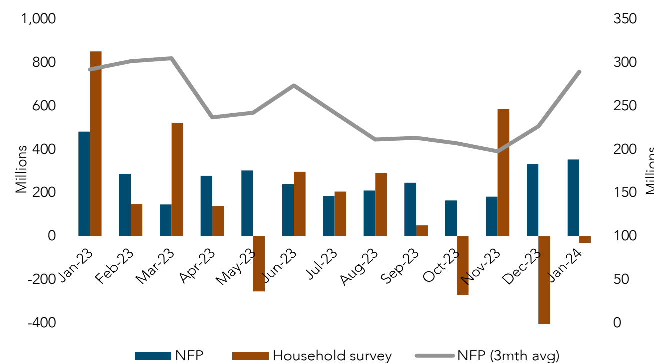
Source: Bloomberg, BEA, Atlanta FED

Exhibit 3 – US S&P Manufacturing, Services and Composite PMI
The composite PMI rose in January to 52.0 with both the manufacturing sector (50.7) and services (52.5) in expansionary territory



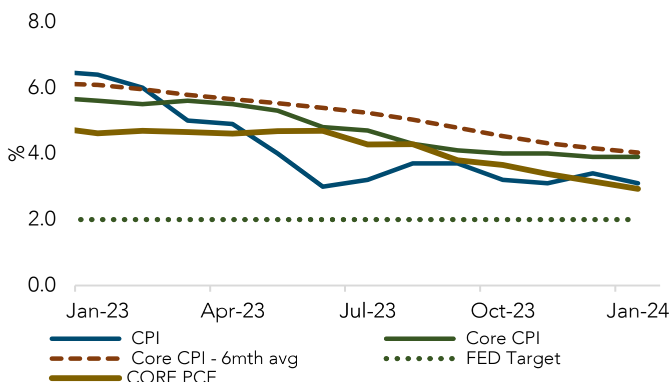
Source: Bloomberg

Exhibit 4 – Non-Farm Payrolls
The US added 353k jobs during January, ahead of consensus expectations and a 126k upward revision for the past two months



Source: Bloomberg , BLS

Exhibit 5 – US Inflation rate
Headline CPI slowed to 3.1% YoY (from 3.4% in December) in January whilst core CPI was unchanged at 4.0% YoY



Source: Bloomberg

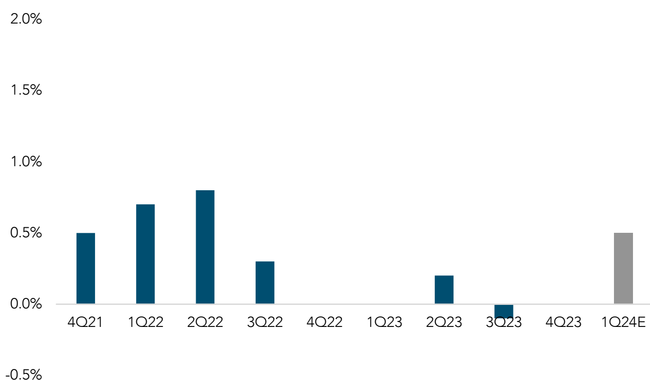
Europe

The first release of Q4 real GDP data showed that the euro-area managed to avoid a technical recession (Exhibit 6). Spain and Italy have been the outperformers during 2023, and their positive contribution continued in Q4 with growth of +0.6% QoQ and 0.2% QoQ respectively. France's real GDP growth was flat QoQ, but growth was supported by a strong contribution from net trade as imports remained fairly weak given the soft domestic demand. Finally, Germany's economic performance weakened in Q4 with real GDP of -0.3%. The data released so far this year seem to suggest that the geographic performance is still very much the same. The Eurozone's composite PMI improved to a six-month high of 47.9 (Exhibit 7). This was primarily driven by an improvement in the manufacturing sector to a ten-month high, yet still in contraction territory. In terms of country performance, both Italy and Spain marked eight and six-month highs respectively, whilst France and Germany reported two and three-month lows respectively. Additionally, we note that retail sales turned negative in December whilst industrial production deteriorated (Exhibit 8).

Headline and Core HICP eased by 0.1pp to 2.8% YoY and 3.3% YoY respectively, but the decline was lower than expectations. We note that the January print is generally volatile and should not be relied upon to determine whether the disinflation trend is over or not. The final prints for January and February will provide more clarity, though we note that we see very limited evidence that core inflation will pick-up strongly from here.

Exhibit 6 – EU Q4 GDP Growth Tracker

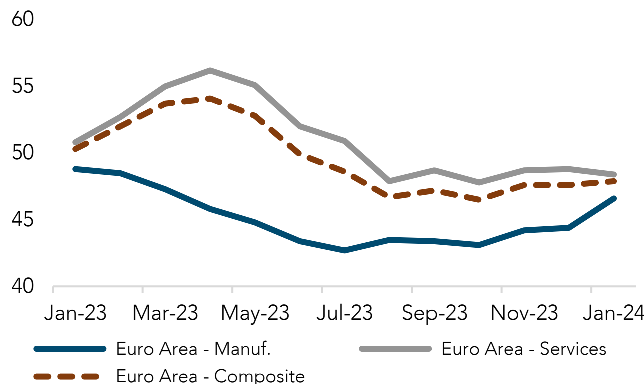
The Euro-area avoided a technical recession in 4Q23 with real GDP of 0.0% QoQ though economic activity is expected to pick-up in 1Q24



Source: ECB, Bloomberg, Euro-area now-cast

Exhibit 7 – EU S&P Composite, Manufacturing and Services PMI

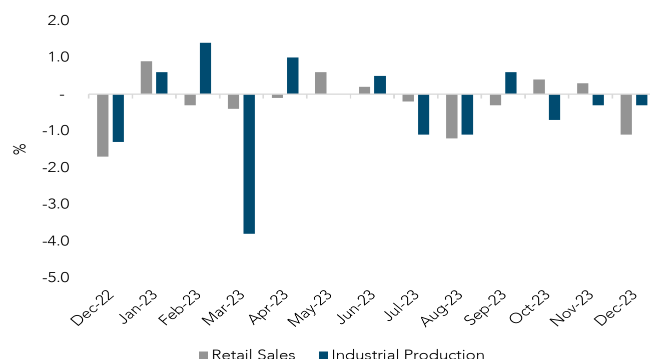
The Composite PMI improved to 47.9 in January driven by an improvement in the manufacturing sector



Source: ECB, Bloomberg, Euro-area now-cast

Exhibit 8 – EU Retail sales and Industrial production MoM

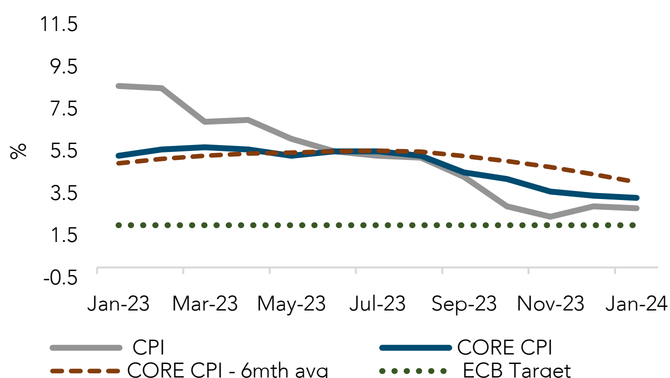
Retail sales and industrial production within the Euro-area remained subdued at the end of 2023



Source: Bloomberg

Exhibit 9 – HICP headline and core inflation

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

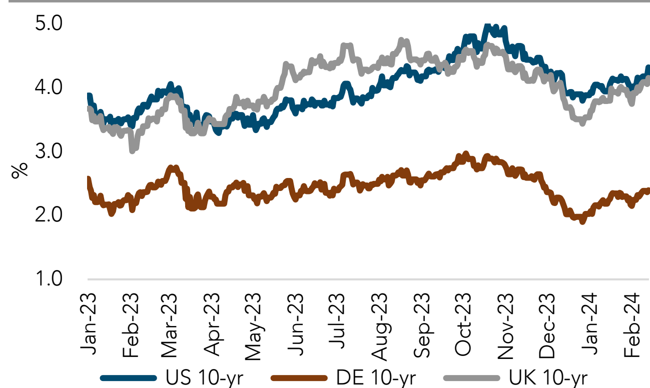


Source: Bloomberg

Rates

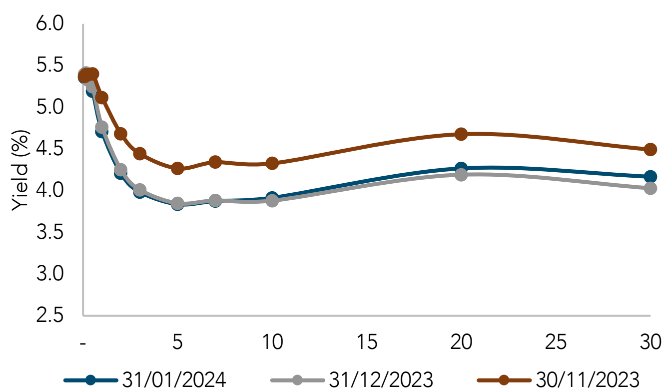
The hawkish narrative for most of 2023 had driven developed market sovereign yields to levels not seen for a very long time. The yield on the US 10-year treasury was hovering around the 5% mark at the of October. However, the change in narrative by central banks, especially the far more dovish dot plot with more than 75bp of rate cuts for 2024 took investors by surprise, which led to a c.100bp pullback in yields in the final two months of 2023. The start of 2024 has been slightly more complicated, with central banks pushing against market-implied rate cut expectations which were out of synch with their projections. 5 (ECB, FED, BoJ, Norges and RBC) out of the ten central banks with the most heavily traded currencies held meetings during January with an additional two (BoE and Riksbanken) holding meetings in February. All central banks that held meetings in 2024 have opted to keep rates unchanged.

Exhibit 10 - 10-year nominal bond yield for the US, Germany and UK
Sovereign yields have partially reversed some of the aggressive pullback seen in November and December



Source: Bloomberg

Exhibit 11 – US Yield Curve
The US yield curve was largely unchanged in January after the steepening seen in December



Source: Bloomberg

United States

After flirting with the 5% market, the yield on the US 10-year treasury pulled back sharply in the following two months, closing 2023 at 3.88% which represents a c.105bp downward move since the end of October. Yields held steady in January, closing the month at 3.91%, but have risen in the February to 4.3%. In the first meeting of 2024, the FOMC kept its policy unchanged in a range of 5.25% to 5.50%, marking the fourth straight meeting at which the FED has decided to hold interest rates steady. This relative period of calm followed a stretch of eleven consecutive meetings in which the FED hiked interest rates by 525bp since March 2022.

The post-meeting press conference offers more insight into the direction the FOMC will be moving in the upcoming meetings. However, those looking for confirmation that rate cuts were imminent came out of the meeting disappointed. Chair Powell noted that "inflation is still too high" and added that "I don't think it's likely that the committee will reach a level of confidence by the time of the March meeting". This led to a significant change in market-implied rate cut expectations to c. 77bp on 14/03, down from 140bp at the end of 2023.

Additionally, the persisting strength of the US economy, especially the strength of the labour market, complicates the situation further. The latest Core CPI reading beat expectations but can be attributable to the "January effect". The first cut is now expected at the May meeting, but economic data released in the meantime should provide more clarity on this.

Europe

We see a clear divergence in economic performance between the US, where data seems to keep improving, to Europe which is facing stagnation. Although this in itself would make rate cuts much more urgent in Europe, the price-action followed a similar path to that observed in the US. The yield on the 10-year German bund peaked at 2.97% on 02/10 last year. From then to year-end, the yield pulled back 95bp, closing the year at 2.02%. However, despite no meaningful improvement in economic activity, in January yields on the 10-year bund climbed 14bp to 2.17% and is currently at 2.39% (+23bp). This represents a 37bp in 2024.

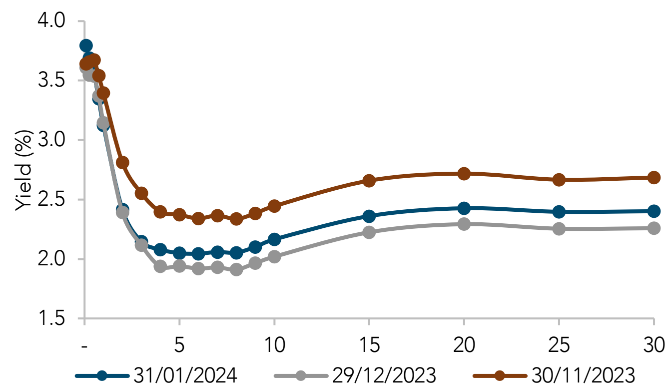
During its meeting in January the ECB left its three interest rates unchanged and noted that the incoming information has broadly confirmed the Governing Council's previous assessment of the medium-term inflation outlook. During the post-meeting press conference, President Lagarde noted that "the consensus around the table of the Governing Council was that it was premature to discuss rate cuts". On the other hand, French Governor Villeroy raised expectations of an April rate cut when he said that "regarding the exact date, not one is excluded, and everything will be open at our next meetings". This seems to suggest that all upcoming meetings are live. Finally, more recently, ECB chief economist Lane noted that "the trend is very good, we want it to continue, and we have some time left". He noted that the ECB should not rush to cut rates. The market is currently expecting c. 113bp of rate cuts this year, down from c. 147bp at the start of the year.

We believe that the deterioration in economic activity in Europe should lead to an acceleration in disinflation, which should favour longer duration. Also, given the recent re-pricing of the market-implied rate cut expectations, the possibility of the ECB surprising with more hikes is increasing.

We see the UK's situation is very similar to Europe, in that the economy is showing signs of stagnation which should fuel disinflation in the coming weeks. Despite this, the yield on the UK 10-year Gilt is currently at 4.15%, 61bp above the level seen at the end of December. The UK reported inflation for January at 4.0% YoY, unchanged when compared to December and below consensus expectations. Core inflation was also unchanged at 5.1%. Although we see scope for the BoE to surprise in terms of rate cuts, we would avoid exposure to UK Gilts given FX volatility (for Euro denominated portfolios).

Exhibit 12 – German 10-year yield curve

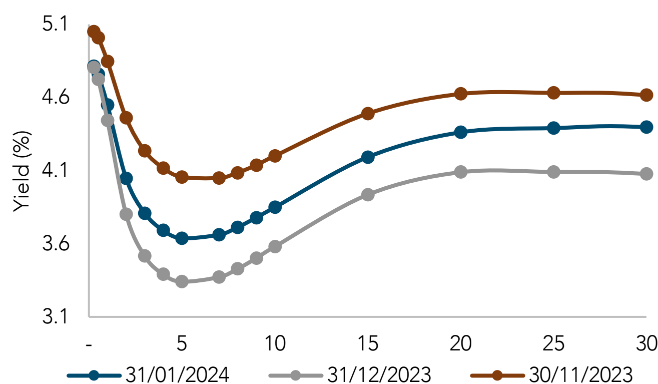
The German yield curve has steepened in January with the short-end largely unchanged when compared to December



Source: Bloomberg

Exhibit 13 – UK 10-year yield curve

The Gilt yield curve was largely unchanged at the short-term, with yields rising the most at the long-end of the curve



Source: Bloomberg

Credit

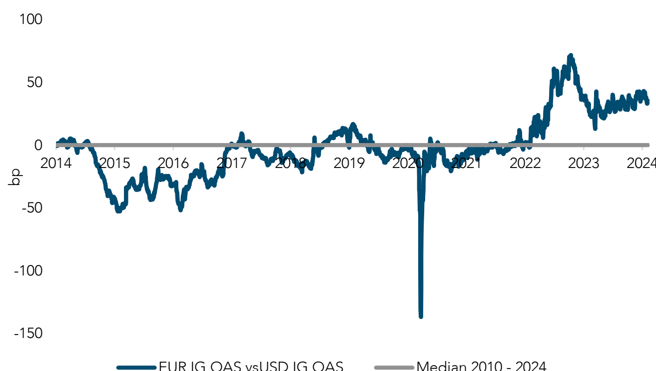
The pushback by central bankers against aggressive market rate cut expectations weighed on credit market performance during January, except for EUR paper where both IG and HY delivered positive returns in local currency terms. Although the ECB meeting seems to have little impact on EUR credit, we believe that the strong beat in US Q4 GDP, combined with core PCE printing in-line with market expectations reinforced the soft-landing view. Furthermore, news late in January that New York Community Bancorp had reduced dividends to increase capital led to some volatility in the $IG space so far in February and was an unpleasant reminder of the SVIB crisis last year.

We retain our preference for EUR IG paper over USD IG, and the recent regional bank related pressures only adds to reason to favour the former. Also, we see the strength in the US economy as potentially adding to rates volatility, especially if rate cut expectations are pushed back further. Looking at valuations, EUR IG trades wider than US IG pre-Ukraine invasion and above the median calculated since 2014 (Exhibit 14). The US economy has gone from strength to strength, though consensus expects some moderation in the upcoming quarters (Exhibit 1). This implies that positive economic surprise are probably more likely in Europe than in the US (if the US continues the current trend of economic surprises, then we believe that inflation could become an issue, which could pressure USD credit). This implies that even though the current economic growth differential between Europe and the US is substantial, the spread differential could offer more upside to EUR IG.

As for our preference of EUR IG relative to EUR HY, we are still of the opinion that the rising default risk could have an impact on asset class performance in 2024. In our opinion, the current higher yield environment supports a neutral position in the credit asset class. The way we prefer to play it is by being overweight IG and underweight HY given that the latter is more exposed to the risk of default, in our opinion. We believe that our view (i.e. OW IG/UW HY) is further supported by the spread differential, which suggests more upside from current levels for EUR IG. The current spread for EUR IG is that of 127bp (14/02) which is slightly wider than the 10-year average of 121bp. On the other hand, the current spread for EUR HY stands at 364bp, which is tighter than the 10-year average of 396bp (Exhibit 15). Therefore, we believe that IG could outperform in multiple scenarios where either if (1) spreads converge to the 10-year average; or if (2) economic conditions improve, which is the current economic base case scenario or deteriorate, especially in view of the weak data that has been published by the region over the past months.

Exhibit 14 – EUR IG OAS vs USD IG OAS

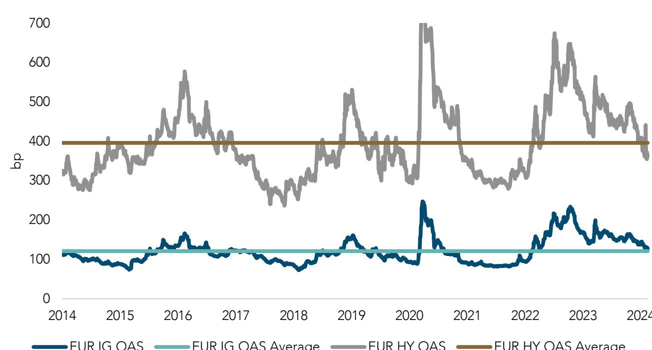
EUR IG is still trading wider to USD IG than before the Ukraine invasion of Russia



Source: Bloomberg

Exhibit 15 – EUR IG OAS vs EUR HY OAS

Credit spreads are much tighter relative to history in EUR HY than in EUR IG suggesting less of a cushion for negative surprises



Source: Bloomberg

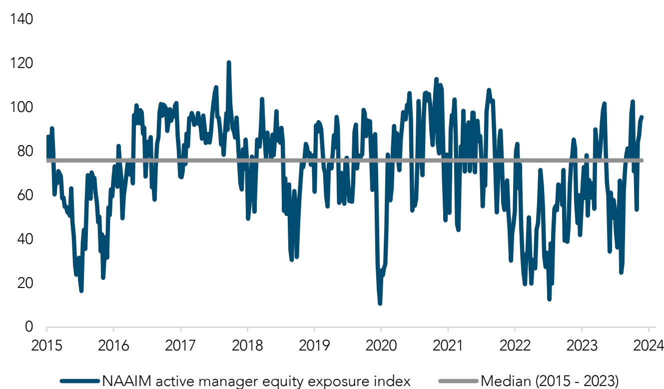
Equity

Equity markets were mixed in January, with most developed markets generating positive total returns in local currency terms, while emerging markets saw negative returns in general. Japanese equities had a strong start to the year, generating a total return of 8.4% in local currency terms (6.4% in EUR terms), in-line with our view highlighted in the December report that country-specific economic fundamentals were favourable for Japanese equities. European and US equities also had a positive month in January, generating close to 2% total returns in local currency terms. At the other end of the spectrum, Chinese equities lagged other emerging equity markets, with a total return of -6.3%, with South Korea (-6.0%) and Brazil (-4.8%) the other notable underperformers.

Exhibit 16 – S&P 500, STOXX 600 and UST 10-year real yield (inverse)
US real yields were largely unchanged during January but a strong earnings season in the US supported equities

Source: Bloomberg

Exhibit 17 – NAAIM active manager exposure to equity markets
The NAAIM exposure index suggests that funds have closed their underweight



Source: National Association of Active Investment Managers

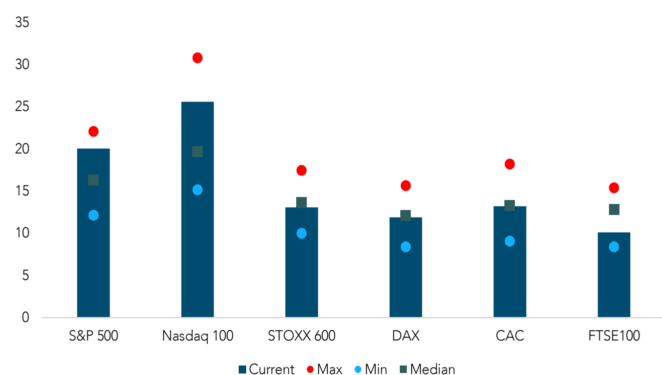
The dovish narrative from central banks, especially the FED in the latter weeks of 2023,as well as inflation prints, reinforced the disinflation view. Real yields were slightly lower by mid-January and the S&P 500 had gained 1.9% during the period. The backdrop of falling interest rates combined with positive earnings growth supported growth stocks. Yet, in the second half of January, the narrative adopted by the FED changed leading to an uptick in rates volatility. FED speakers, including FED Governor Waller and Bostic urged caution, whilst FED Chair Powell surprised the market during the press conference following the January FED meeting when he effectively ruled out imminent rate cuts. This, combined with a strong employment report for January led to a significant change in market-implied rate cut expectations. Despite this, equities kept on grinding higher, supported by a strong earnings season in the US (Exhibit 16).

Throughout 2023, active fund managers held a below average exposure to the equity market. Data provided by the National Association of Active Managers index shows that the average exposure held by asset managers in 2023 stood at c.65%, compared to an average since 2015 of c.75%. Additionally, exposure to equity increased from 29.2% on 01/11 to 102.7% by 27/12, as FOMO crept in fund managers as the equity rally gained more steam (Exhibit 17). Since then, the exposure has bottomed out at 53.5% on 17/01, but has since recovered to 95.6% on 14/02 as the backdrop of falling interest rates coupled with positive economic growth is seen as supportive of the equity market. Furthermore, the positive corporate earnings season in the US has boosted sentiment, leading to an improvement in risk sentiment. It seems that uncertainty over rates and the uptick in volatility is being offset by improving earnings growth expectations.

Equity market valuations are elevated, especially in the US where both the S&P 500 and Nasdaq 100 are trading well above 10-year median levels (Exhibit 18). Although longer-term we believe that high valuations could constrain upside for the asset class, we note that absent a recession, high valuations could persist for longer, especially with falling rates. The recent outperformance of the US economy has reduced the probability of a recession, a positive for equities. Economic growth expectations in the US for 2024 have been revised upwards from 1.3% YoY growth at the end of December to 1.6%, which could lead to positive earnings growth revisions. In fact, we believe that this was reflected in the guidance provided by companies during the past earnings season.

Exhibit 18 – DM Equities 12-mth Forward P/E

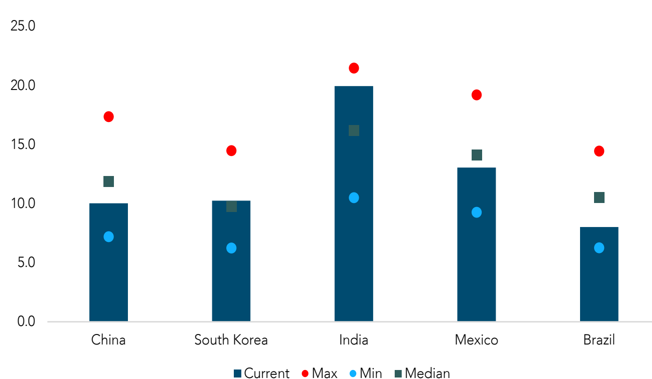
Equity markets screen as expensive relative to history in most countries we follow



Source: Bloomberg

Exhibit 19 – EM Equities 12-mth Forward P/E

China, Brazil and Mexico are trading at a discount to 10-year median P/e while India is trading at a premium



Source: Bloomberg

Global equities markets have started 2024 on the strong foot and are now up 3.8% (up to 16/02). The disinflation narrative, along with the strong US economic data have driven equities higher, with the S&P 500 returning 5.1% in local currency terms. Despite what we describe as a supportive backdrop of positive growth and falling rates, we think that a lot is being priced-in currently. On balance, we are of the opinion that the asset class could deliver positive returns in 2024, but the asset class seems to be susceptible to short-term volatility. On the EM front, India seems to screen as the most expensive compared to history, as the index is trading at a premium to the 10-year median though we think that this could be justified by the higher EPS growth expectations (Exhibit 19). Brazil, China and Mexico are trading at a discount to history, though they could benefit from the monetary policy shift (LATAM) and possible fiscal policy programs (China).

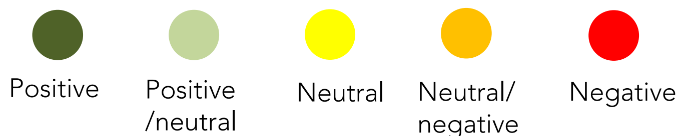
Exhibit 20 – Valuations – Developed markets

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

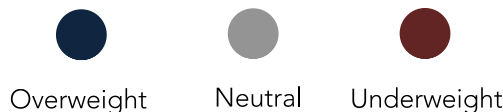
Historical Data	SPX	NDX	SXXP	SX5E	DAX	CAC	FTSE100	FTSE250
Current Forward PE ratio (FPE)	20.1x	25.6x	13.1x	13.1x	11.9x	13.2x	10.1x	10.2x
Forward PE ratio (31/12/2023)	19.6x	25.0x	13.1x	12.5x	11.6x	12.8x	11.1x	11.1x
10 Year data								
Highest	22.1x	30.8x	17.5x	18.0x	15.7x	18.2x	15.4x	17.9x
Highest (date)	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	19.7x	13.7x	12.8x	12.1x	13.3x	12.8x	13.7x
95th percentile	20.5x	28.2x	16.0x	16.4x	14.6x	15.9x	14.9x	15.2x
5th percentile	14.3x	16.8x	11.7x	11.5x	10.9x	11.1x	9.9x	10.1x
Historical rank (since 2006)								
Percentile	94.5%	91.8%	60.5%	77.0%	58.9%	69.4%	22.4%	19.3%
Current FPE, % above/ (below) 10-YR median	22.8%	29.8%	-4.5%	2.0%	-1.9%	-0.8%	-21.0%	-25.3%
Current FPE, % above/ (below) Dec 23	2.3%	2.3%	0.0%	4.4%	2.8%	3.3%	-8.5%	-7.5%

Source: Bloomberg

Key – Our view



Key – Allocation



Asset Class			Positioning
Developed Market Sovereign Bonds			The current expectation is that developed market central banks will start cutting rates this year, with the FOMC projecting 3 rate cuts. Market-implied expectations had moved rapidly, pricing in over 130bp of rate cuts in Europe and the US. Since then, the US economic outperformance has driven a moderation in rate cut expectations in both the US (down to 77bp from 141bp on 31/12) and Europe (down to 113bp from 147bp on 31/12). Our current view is that there is a higher probability of a surprise (more rate cuts) by the ECB than the FED given the current economic divergence. Also, we believe that rates volatility will be higher in the US than in Europe, which is further compounded by FX risks. Therefore, whilst maintaining our neutral recommendation at an asset class level, we would recommend shifting exposure to Europe.
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 83rd percentile at 3.8% (14/02) compared to an average yield of 2.0% over the period 2010 to 2024. At an asset class level, we continue to recommend an Overweight allocation, whilst also extending duration, a process we started in 2023 given the expected tightening bias by central banks
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 75th percentile at 7.8% (14/02) 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 364bp (14/12) are below the average since 2010 of 455bp. 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			The backdrop of positive economic growth coupled with falling inflation and interest rates has been supportive for the equity market. Although earnings reported have so far been mixed, we note that guidance has been more positive and solid economic growth should boost corporate earnings growth. The premium to the 10-year median P/E and the low equity risk premium suggests that a lot of good news is already being priced-in. Notwithstanding, we note that absent a recession, valuations can remain above median for several months as equities continue to grind higher, especially if the inflation news flow remains supportive of the disinflation narrative. Given this, we upgrade our asset class view to neutral, despite our allocation still being negative. We believe that investors should not rush to add equities at this stage but wait for a better entry point. Overall, the given the current backdrop the asset should deliver a positive return in 2024 though the higher than expected US CPI print was a reminder that the inflation problem cannot be overlooked.
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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