GENERALI INVESTMENTS

Market Compass

May 2023

MARKET OUTLOOK

- Good data on the economy and earnings, in conjunction with less hawkish expectations on the FED helped markets overcome the fears about the state of the banking sector.
- Yet we expect the economic slowdown, the looming credit crunch, lower earnings and rising defaults to take their toll on financial markets.
- The war in Ukraine, simmering US/China tensions and the US debt ceiling dispute are adding to the downside risks.
- We maintain a cautious stance on Equities and High Yield (HY), while favouring Government Bonds, non-financial EUR Investment Grade (IG) Credit and – more cautiously – EM bonds. We also like US Treasuries for their hedging properties against more adverse scenarios.

Edited by

MACRO & MARKET RESEARCH TEAM

A team of 13 analysts based in Paris, Cologne, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

US

- (+) Q1 domestic demand proved stronger than expected...
- (−) ...but signs of an economic slowdown are piling up
- (!) Banks' reliance on Fed's liquidity facilities remains high
- (+) After the May meeting, the Fed will most likely stop raising rates

UK

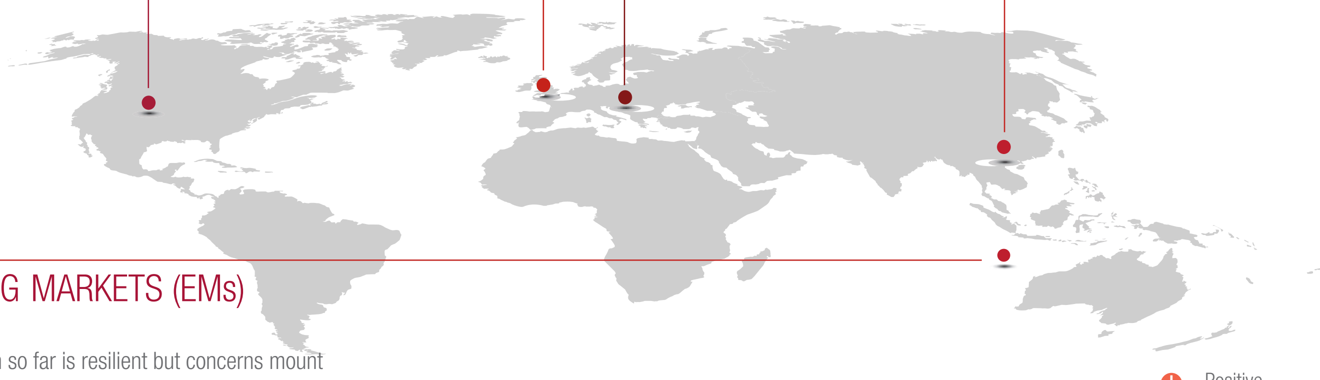
- (−) Core CPI inflation is rather sticky
- (!) Manufacturing PMI subdued but services strong
- (−) BoE likely to hike Bank Rate again

EUROZONE

- (+) April sentiment indicators further up…
- (−) …but contraction in manufacturing
- (+) Inflation to come down further on lower energy prices
- (−) Tighter credit standards and further ECB rate hikes

CHINA

- (+) China's Q1 GDP growth surprised on the upside…
- (−) …but recovery is uneven
- (+) Inflation remained subdued
- (+) Monetary policy more supportive than expected



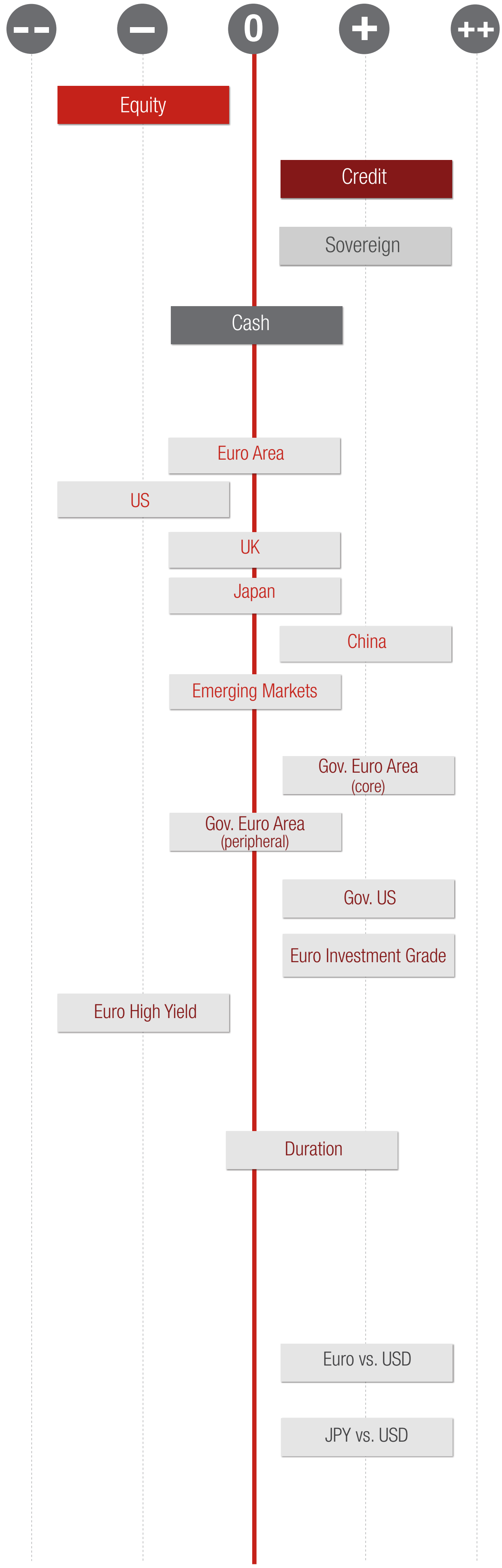
EMERGING MARKETS (EMs)

- (+) EM growth so far is resilient but concerns mount
- (−) Core inflation is sticky, rate cuts postponed
- (−) EM assets underperformed despite stronger risk appetite

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

DIRECTION OF TRAVEL

- Keep underweight (UW) on risky assets like Equity and HY credit
- Keep overweight (OW) on Non-financial European IG credit
- OW sovereigns in particular mid-dated Bunds and short maturity BTPs
- Maintain OW in US Treasury as a hedge
- Cautious OW in EM bonds



Equity

- Valuations remain expensive when compared to real yields and credit spreads. Thus, decreasing GDP growth and earnings momentum ahead could represent headwinds
- We maintain a tactical slight UW position on equities: pessimism is already high and investors positioning remains below average. We are more constructive on World ex-US

Bonds

- Moderately declining government bond yields amid lasting risks to the banking sector. Transatlantic yield spread to tighten more
- Further spread widening of EA non-core gov. bonds as draining liquitidy and high valuation hurt

Duration

- Modestly long duration

Currencies

- There is more downside for the USD as rates volatility is set to subside and the Fed is about to terminate its hiking cycle. Stretched speculative positions, however, increase the risk of setbacks in EUR/USD
- JPY should benefit from lower US yields, even though the new BoJ's new governor's dovish tilt has been a drag

TOPICS TO WATCH

	Probability	Impact
Stronger cracks in financial stability as tighter cond. feed through (banking, housing, CRE defaults, …)		
Two-sided inflation risks tilted towards the upside (even faster policy tightening)		
Debt ceiling crisis leading to US rating downgrade/UST disruptions		
Escalating war in Ukraine or new severe geopol. tensions (China/Taiwan, Iran, N. Korea)		

Probability: High ↔ Low

Impact: High ↔ Low

GLOSSARY

DEBT CEILING

The debt ceiling is the maximum amount that the U.S. government can borrow by issuing bonds, if this is reached, Congress must legislate to raise or suspend it, otherwise, the US federal government would not be able to fund its functioning and pay back its debt. This could theoretically lead to a default. The debt ceiling has been raised or suspended several times to avoid the risk of default, but the current situation in Congress with a Republican majority in the House of Representatives and a Democrat one in the Senate makes it more difficult to reach a deal.

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