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MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

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GOLDILOCKS OR A STEP BACKWARDS?

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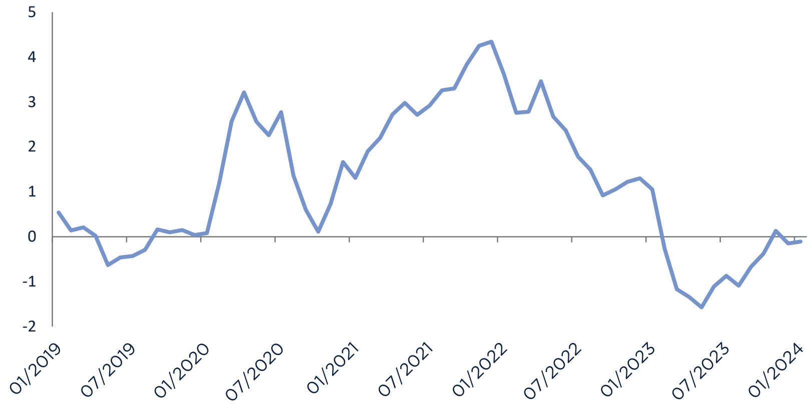
THE SPOTLIGHT IS STILL TRAINED ON CENTRAL BANKS

With disinflation picking up speed and pending a return to normal conditions, central bank moves will still play a big part in overall market momentum. That will obviously be the case for fixed income but also for equity markets: interest rates represent the biggest risk for equity markets (contracting in bank loans, deleveraging in Europe and the US), as well as for company margins (rising financial charges) and for valuations. Disinflation is continuing as expected and investors want central banks to return to normal monetary policy. Fixed income and equity returns could be significant in 2024 even if there are several reasons why earnings could disappoint. Monetary normalisation could mean significant easing in benchmark rates to close to half current levels. So investors need to heed what Jerome Powell and Christine Lagarde say when discussing the timing of the first cut at their press conferences, even if official communiques maintain a neutral bias.

US GROWTH IS STILL DEFYING GRAVITY

Central banks have corroborated several surveys which show how essential supply chain normalisation has been in getting inflation lower. But it is, however, difficult to see how long this will continue now that production has returned to normal. Faced with this uncertainty, an incipient slowdown in such strong growth would be preferable. There was no sign of this in the fourth quarter of 2023 or in January. Several indicators even suggest an unexpected re acceleration is at play. Disinflation has been fuelled by increased supply rather than falling demand so there is no doubt that a large part of this resilience is due to renewed purchasing power. Core PCE[1] has fallen to an annualised 1.9% over the last 6 months, a fall of over 2% compared to the previous six months. For consumers, that represents a big move. But as most disinflation is now over, this growth driver is about to disappear. In addition, fiscal policy will turn more neutral this year after significantly underpinning growth in 2023. As a result, we think a US slowdown is inevitable; we just have to be patient.

Supply chain normalisation is behind a vast disinflation movement



Source: Bloomberg at 31/01/2024.

1. PCE: Personal Consumption Expenditures. This refers to household consumption excluding volatile items. This indicator measures price variations from the consumer's point of view. It is a key tool for measuring changes in purchasing trends and inflation.

EUROPE'S ECONOMY IS STABILISING AT LAST!

The ECB's Bank Lending Survey points to a recovery in financial conditions from low levels. Fewer banks now want to tighten lending conditions and the number of them expecting a drop in loan demand is also down. The latest bank lending data suggest the situation is beginning to improve. And PMI surveys have also recovered a little. There is still no reason to hope for a recovery in Europe but investor pessimism on the zone was probably overdone.

NO CHANGE TO OUR OVERALL ASSET ALLOCATION BUT TACTICAL ADJUSTMENTS

We remain overweight bonds and are neutral on equity markets but we have reinforced European bonds and equities at the expense of other assets and for the following reasons:

(i) not only are investors too pessimistic over Europe but European equities stand to gain should a surprising global recovery occur and,

(ii) the US economy's resilience may pose a problem for the Fed over when and by how much to cut rates but the ECB is free to act as Europe's economy has stabilised at the bottom.

KEY POINTS

Central bank strategies continue to play a major role in market dynamics

We remain overweight bonds and neutral on equity markets

We have reinforced European bonds and equities at the expense of other assets

	Our convictions*	Changes compared to the previous month
ASSET CLASSES		
Equities	=	→
Fixed Income	+	→
Dollar	-	→
Cash	-	→
EQUITIES		
US	+	→
Europe (ex-UK)	+	↑
UK	+	→
Japan	=	→
China	=	→
Global Emerging	+	→
Convertibles	=	→
SOVEREIGN BONDS		
US	+	→
Euro Zone	++	↑
Emerging Markets	+	→
CORPORATE BONDS		
US Investment Grade	+	→
Euro Investment Grade	+	→
US High Yield	=	→
Euro High Yield	=	→

*Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 29/01/2024.

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