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November 2024

MONTHLY HOUSE VIEWS

SOME POSITIVE ECONOMIC SURPRISES

Macro

Citi's global economic surprise index continued its recovery from the 42-month low reached in mid-August to move back into positive territory at month-end. And economists expect further upside macro surprises – the consensus forecast for 2024 global GDP growth has risen to 3.1%, up from 2.6% at the start of the year, while similarly robust growth is expected for next year. However, the two-speed economy remains in place. Activity in global manufacturing is contracting as companies recalibrate their supply chains while business confidence in services remains robust. The US continues to lead other advanced economies while Europe has seen a steady pick-up in positive macro surprises in recent weeks. In China, it will take time for the authorities' recent support and stimulus packages to show up in stronger macro data.

Central Banks

The US consumer price index for September came in above consensus expectations which, when combined with the positive economic surprises, caused traders to revise the number of expected -25bp rate cuts from the US Federal Reserve (Fed) by end 2025 from 7.5 to 4.8 over the course of October. In the Eurozone on the other hand, the European Central Bank proceeded with its third cut of this cycle in mid-month, a unanimous decision which was driven by inflation dropping below 2.0% for the first time since 2021 and weaker business confidence reports. In Asia, the Bank of Japan kept key rates pegged at 0.25% for the second consecutive meeting. In an effort to support the government's various support packages, the People's Bank of China surprised economists by cutting its one and five-year loan prime rates to the lowest levels on record.

Markets

The MSCI World index of global equities dropped -2.0% in October, only the second monthly pullback in the last twelve months, with the bulk of the losses coming on the last trading day of the month. The weakness was broad-based with only three out of eleven sectors (energy, financials and communication services) posting positive returns. Among factors, Momentum and Growth outperformed with falls of -1.2% and -1.8% while Value and Quality lagged with declines of -2.3% and -3.0% over the month. After five months of steady gains, the run of positive macro surprises pushed bond prices sharply lower in October and Bloomberg's Global Aggregate bond index dropped -3.4%, its worst month since September 2022. In currency markets, the greenback jumped 3.2% as traders began to expect fewer rate cuts from the Federal Reserve.

Bottom Line

We have kept our recommended equity allocations unchanged at modestly Overweight and we continue to balance exposure to the major US technology and internet platform stocks with positions in mid-cap equities. For now, we continue to favour US stocks over Europe and Europe over Asia. In terms of factors, we call for keeping a balance between Growth and Value stocks. Our allocation to US duration (i.e., sensitivity to changes in rates) remains at Neutral, while credit spreads (the difference in yield between corporate and sovereign bonds) tightened further – we suggest bond investors should remain very selective.

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Summary House Views

OUR ASSET ALLOCATION

The tables below present the latest conclusions of our Global Investment Committee.

Equities	Equity performance has pushed allocations into Overweight territory. We continue to recommend investors strike a balance between Value and Growth. We prefer the US to Europe, and Europe to Asia.	Overweight
United States	We have adjusted our US allocation to achieve a better balance between Growth and Value. Quality and Growth stocks have dominated this year's market performance, but their valuations are getting stretched.	Overweight
Eurozone	The bear story for Eurozone equity markets is well-known. However, the markets are still cheap, still under-owned and still in an uptrend.	Neutral
UK	Recent macro data in the UK has shown some improvement, and the equity market has begun to catch up with its neighbours.	Neutral
Switzerland	The Swiss market is dominated by high-quality, defensive stocks, which should help cushion any downside, while inflationary pressures remain well below those suffered by its neighbours.	Neutral
Japan	Recent strength in the yen against the US dollar could encourage investors to reassess the outlook for Japanese stocks which could in turn interrupt their bull run for now.	Neutral
Emerging (EM)	The Chinese authorities have taken some measures to shore up domestic equity markets and Chinese stocks look cheap in light of expected earnings growth.	Neutral

Fixed Income	Lower inflation readings, interest rate cuts and some worries about economic growth helped bonds rally into modestly positive territory for the year to date. However, we continue to prefer equities.	Underweight
Sovereigns	As bonds have rallied, the yield curve normalised, and 10-year yields have moved back above 2-year rates. Any signs of sticky inflation combined with weak macro could accelerate this move.	Underweight
Duration	We have now rebuilt a Neutral allocation in duration which has both reduced our Underweight compared to the market and provided a hedge against macro weakness and Fed easing.	Neutral
Inflation-linked	Inflation-protected securities tend to have very high duration, making then extremely sensitive to small shifts in inflation expectations.	Neutral
Investment Grade	Elevated policy rates and inverted yield curve have created some buying opportunities in short-dated high-quality corporate bonds. We remain Underweight nonetheless.	Underweight
High Yield	Credit spreads have tightened to unattractive levels, especially if growth weakens. Investors should remain very selective given the potential for a deterioration in credit quality.	Underweight
Emerging debt (in € and $)	In recent months, we have warned that political risk in Latin America required careful monitoring. The reaction to June's presidential elections in Mexico underlined this point.	Neutral

↗ Upgrade ↘ Downgrade Overweight Neutral Underweight

Commodities	Although the long-awaited recovery in China will eventually boost demand for raw materials, worries about a slowdown in advanced economies in H2 lead us to keep allocations to commodities at Neutral.	Neutral
Energy	With OPEC+ cutting output and oil majors reluctant to invest in new production capacity, crude oil supply is constrained. However, fears of economic slowdown in the west have kept prices rangebound.	Neutral
Industrial metals	The key driver for industrial metal prices will be Chinese demand once the economy finally picks up. We also continue to highlight the attractions of transition metals like copper.	Neutral
Precious metals	Central bank demand for gold remains strong and bullion continues to provide useful diversification benefits in terms of portfolio construction.	Overweight

Currencies	The dollar index remains stuck in the wide trading range which has been in place since late 2022. After rallying 3.2% in October, the index is now up 2.6% since the start of 2024.	
EUR/USD	The euro's rally from its April lows against the dollar appears to have stalled now that the Federal Reserve has commenced its rate cut cycle.	Neutral
GBP/USD	The UK's growth outlook has begun to improve despite its structural weaknesses, and the strong majority won by Labour means the country faces little political uncertainty over the next few years.	Neutral
EUR/GBP	Both currencies face numerous challenges, but the lack of political uncertainty in the UK and the country's improved economic performance have pushed sterling higher.	Neutral
USD/JPY	Global investors began to unwind some of their "yen carry trades" (constructed by borrowing in yen to invest in higher-yielding assets in foreign currencies), but there has been renewed dollar buying recently.	Neutral
EUR/CHF	After weakening sharply from January to late May, the Swiss Franc commenced a rally which has taken it back to January's levels, despite the likelihood of further SNB rate cuts.	Neutral
Emerging	EM currencies have tracked generally lower against the US dollar in recent months, reaching new all-time lows, and have yet to show any sign of building a base.	Neutral

Upgrade Downgrade Overweight Neutral Underweight

Economic Outlook

THE OUTLOOK FOR EUROPE

Citi, the investment bank, publish daily economic surprise indices, which measure whether macro data have beaten or fallen short of consensus expectations. After over four months of sharply negative surprises, the Eurozone economic surprise index moved back into positive territory at the end of October and has strengthened further so far this month. Does this mark a turning point for the Eurozone economy? And what might that mean for financial markets?

One of the big factors behind the negative macro surprises over the summer and early autumn was business confidence. S&P Global's purchasing manager indices (PMI) are a widely followed gauge of sentiment in both manufacturing and services. The sharp declines in June, July and September were driven by disappointing PMIs, especially in manufacturing. On June 21st for example, the flash Eurozone manufacturing PMI came in at 45.6 points (50 marks the frontier between expansion and contraction) versus 47.3 in May and well below even the most pessimistic forecaster. In October on the other hand, the manufacturing PMI jumped 1 point to 46.0, in line with the most optimistic forecast. To be clear, this still leaves Eurozone manufacturing in contraction, but it does show that confidence has stopped deteriorating.

At the country level, Germany has been the weak link in manufacturing in recent years, as the country has attempted to absorb the impact of (a) the loss of its main supplier of cheap energy given the sanctions on Russia, and (b) ferocious competition from Chinese manufacturers in areas like automobiles. Although the situation remains preoccupying, as exemplified by Volkswagen's first ever plant closure announcement in late October, there have been some signs of stabilisation. Germany's manufacturing PMI jumped 2.4 points to 43.0 in October against expectations for only a 0.1 point improvement. In addition, German factory orders jumped 4.2% month-on-month in September, well above the 1.5% improvement expected, taking the year-on-year (YoY) change to 1.0%, only the fourth positive YoY change since Russia invaded Ukraine.

There was further encouraging news from the recent Eurozone Q3 GDP report. Real growth came in an annualised rate of 1.6%, double the consensus forecast. This was the best quarterly increase since Q3 2022 and marks a real improvement from the aggregate 0.1% growth achieved between Q4 2022 and Q4 2023. The improvement was driven by strong consumption data across the major economies. In France for example, household consumption expenditure rose at an annualised 2.0% rate while Spain saw household consumption jump an annualised 4.3% taking the YoY change in real GDP to 3.4%.

Robust consumption levels help explain the divergence between the manufacturing and services PMIs. After six months of contracting activity, the Eurozone services PMI moved back into expansion territory in January this year where it has remained ever since, with October outperforming consensus forecasts. Moreover, retail sales have improved across the single currency zone. In September, sales were up 2.9% in volume terms, the fastest pace since April 2022. And given that consumption represents the bulk of activity across the Eurozone, the composite PMI suggests that GDP growth should remain positive in Q4.

It should be noted that financial conditions remain tight across the Eurozone. Goldman Sachs publishes a daily index which blends five underlying indicators (ECB policy rates, long-term sovereign yields, corporate credit spreads, equity valuations and the trade-weighted exchange rate) in such a way that scores over 100 points denote tight conditions with easier conditions below 100. Conditions remain tight although they have become somewhat easier recently.

But accommodative financial conditions could lie ahead. For example, the euro has fallen against the dollar in the run-up to the US presidential election as the greenback has strengthened across the board. In addition, the European Central Bank looks set to continue to cut deposit rates. According to Bloomberg's rate probability calculator, traders expect at least five -25bp cuts over the next five meetings, taking rates back below 2.0%.

An area that could remain under pressure near term is sovereign bonds. One worry for traders is supply. For example, France's 2025 budget aims to rein in the deficit from 6.1% of GDP this year to 5.0%, which still remains elevated. But the European Commission is sceptical that this can be achieved, especially given that the government has still not been able to get parliamentary approval for its draft budget – higher deficits and so higher borrowing requirements could ensue. Moreover, the collapse of Germany's coalition could result in a temporary shift away from its "schwarze null" balanced budget requirement, again a recipe for more borrowing to stimulate the economy.

Bottom Line

It has long been easy to be bearish on European equity markets given the macro backdrop and the continent's proximity to the unresolved conflicts in Ukraine and between Israel and Iranian proxies. In addition, investors continue to shy away from European equity funds – according to EPFR, 45 of the past 52 weeks have seen redemptions which now total -$49.0bn since the start of this year. In valuation terms, European equities continue to look cheap compared to history and to other markets, notably the US. The MSCI Europe index trades at 14.3x trailing earnings versus 25.8x for its US counterpart. Moreover, European stocks are expected to pay investors a handsome 3.3% dividend yield in 2024, more than twice the forecast 1.3% yield on the MSCI US index.

EQUITIES

After reaching new all-time highs in mid-month, the MSCI World index of global equities fell back to end October down -2.0%, taking year-to-date returns to 15.1%. The decline was broad-based across factors – Growth, Quality, Value, High Dividend Yield and Momentum all dropped between -1.2% and -3.0%. After underperforming in July and August, the very largest global companies remained at the top of the leaderboard for the second straight month – the Magnificent Seven index of the biggest US tech and internet platform companies eased only -0.4% lower in October. Smaller companies, on the other hand, underperformed – the MSCI World Small Cap index lost -2.7% last month. At the regional level, Europe underperformed the US sharply (-5.8% versus -0.8% on the MSCI indices) while emerging markets dropped -4.4% over the month (all data in dollar terms).

US . After rising steadily from its low for the year in mid-April to its late-September high at 85%, the proportion of US stocks trading above their 50-day moving average (DMA) plummeted to 48% over the course of October. In terms of factors, Momentum and Growth outperformed, both shedding only -0.3% while Quality brought up the rear with a -1.8% drop. At the sector level, only energy, communication services and financials managed gains for the month, up 1.1%, 2.0% and 2.9% respectively, while health care struggled again, dropping -4.6%. The equal-weighted version of the S&P500 index slightly underperformed its market-cap-weighted sibling in October, down -1.7% versus -1.0%. And smaller companies underperformed again – the S&P Small Cap 600 index fell -2.7% last month.

The rally in stocks over the past twelve months has pushed S&P 500 valuations up from 19.1x trailing earnings to 24.4x. At these levels, hopes are high that analysts' optimism will prove well-founded. Currently, they expect S&P500 index earnings to grow by 14.5% over the next twelve months according to Bloomberg, and early results from the Q3 earnings season have been encouraging – some 70% of members have published, with earnings-per-share up 8.3% year-on-year. This has pushed the trailing valuation premium over European stocks to 10.4 points on MSCI data, well above last October's 7.9 points. This premium cannot fully be explained by the market-dominant valuations of the Magnificent Seven stocks – the valuation premium of US information technology stocks over their European peers is one of the lowest among sectors at 23.7%, well below consumer discretionary and financial stocks, which are 119.2% and 78.9% more expensive respectively. The same holds true for factor indices – according to MSCI, US Growth stocks trade at a 55.0% premium to Europe and US Value 83.7% higher. We continue to call for a blend of Growth and Value stocks in portfolios.

Europe . As highlighted on page 4, European stocks have struggled recently compared to the US. Indeed, US equities have dramatically outperformed Europe since 2009. The scale of outperformance far surpasses anything that we saw in the aftermath of the Nifty 50 bubble in the early 1970s or during the dot-com bubble in the late 1990s. Nonetheless, it should be noted that European equity markets continue to perform satisfactorily – over the past two years, the EUROSTOXX 50 index has provided a net total return of 40.5% versus 47.1% for the S&P 500 in euros, despite underperforming by -12.4% since end September.

Emerging Markets . There was broad-based weakness in emerging market regions last month – Eastern Europe and Latin America tumbled -7.4% and -5.2% respectively while Asia outperformed slightly with a -4.5% drop. Within Asia however, there was great divergence – Taiwan actually rose 1.5% in October taking year-to-date performance to 21.5% while China and India fell -4.5% and -6.6% respectively (all data in dollar terms).

In China, the euphoria which met the authorities' latest support package, sending the CSI300 index 22.2% higher in September, has begun to wear off as investors question whether the measures will be sufficient to pull the economy out of the doldrums). This scepticism notwithstanding, Chinese equities look attractive compared to international peers. Analysts expect CSI300 members to see 20.4% earnings growth over the next twelve months, taking the forward price/earnings ratio to 12.8x. This compares to 14.6% and 21.3x for the S&P500 and 4.7% and 13.5x for Europe's STOXX600 index.

Factors . Growth stocks outperformed Value for the second month in a row according to MSCI's factor indices. As is to be expected, earnings forecasts for Value are modest – the consensus expects only 6.4% growth over the next twelve months versus 23.3% for Growth. But this is reflected in valuations – global Value stocks trade at 15.3x trailing earnings versus 32.9x for Growth.

Bottom Line

Our Investment Committee has decided to keep equity allocations unchanged for now, at a modestly Overweight allocation to stock markets. Our geographic preferences remain unchanged, with the US preferred to Europe and Europe to Asia. The discrepancy between Value and Growth has become extreme and we reaffirm our suggestion to take some profits in megacap technology stocks and to add to holdings in small and mid-caps.

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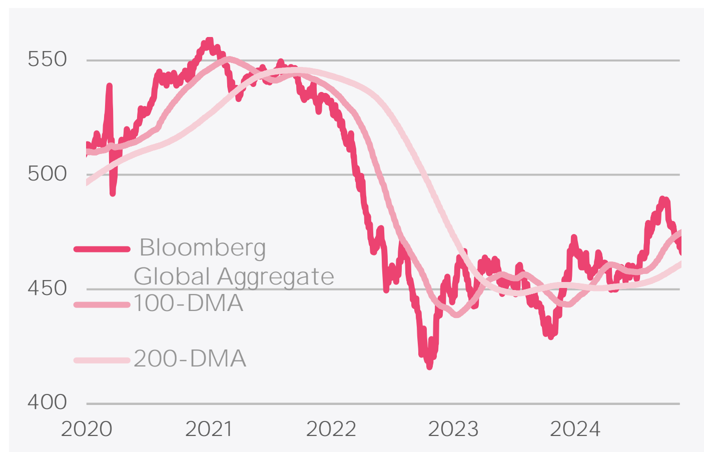
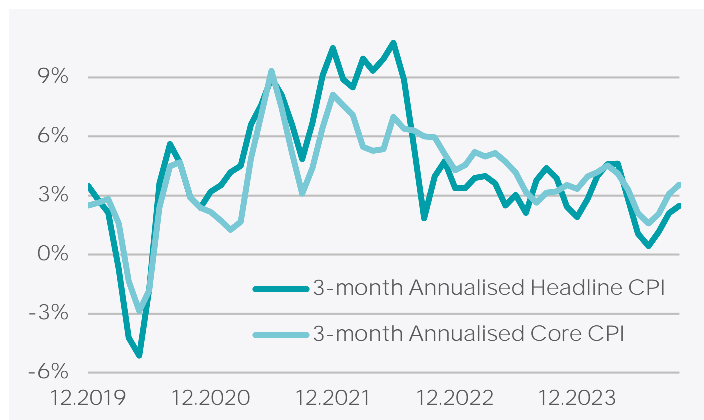
FIXED INCOME

Bloomberg's Global Aggregate bond index tumbled -3.4% in October, its first monthly decline in six months, leaving the index virtually unchanged for the year so far at +0,1%. As illustrated on the chart below, this leaves the pattern of higher highs and higher lows which commenced in October 2022 unbroken.



Source: Bloomberg

US . In the United States, economic surprises have been positive since the summer and growth estimates have been revised higher. Although the annualised rate of inflation over the past six months continues to come down, the three-month annualised figure rebounded last month as shown on the chart below. We will monitor this measure closely, as does the Federal Reserve – the near-term trend in inflationary pressures is likely to have a significant impact on how rapidly the Fed cuts rates going forward.



In the wake of the Fed's -50bp rate cut, longer term yields have moved significantly higher. This suggests that traders are worried about sticky inflationary pressures and believe that the magnitude of future rate cuts might be less than had been expected. Although key rates are still well above the high than they reached in the last hiking cycle from 2016 to 2018, that has not prevented GDP growth from reaching similar levels at close to 3.0% annualised.

Currently, 10-year yields stand around 4.3% which is a touch lower than nominal US GDP growth. Moreover, nominal GDP growth is expected to be around this level for the next two years which means that, barring an extraordinary event, we expect long-term rates to be anchored around this level. However, there are upside risks to yields – first, the US election is likely to cause some volatility and second, the high and growing federal budget deficit will remain a major source of concern. Of course, the obvious way for governments to deal with high debt burdens is to stimulate high nominal growth so that the denominator of debt/GDP grows faster than the numerator. And given that high nominal growth can only be achieved if inflation remains sticky, upside in yields might follow.

Europe . In Europe, rates remain much lower and the risk-reward prospects for duration are also not attractive. Moreover, we have seen markets punish fiscally profligate countries there, which has not yet happened in the US so far. In 2022, the Bank of England was forced to intervene when Liz Truss's short-lived government attempted to push through unfunded tax cuts. More recently, France, which is experiencing a toxic combination of political uncertainty and out-of-control government spending, has seen borrowing costs rise above Spain's and close to Greece's – French ten-year yields ended October at 3.12% versus 3.09% for Spain and 3.29% for Greece.

Credit . The outlook remains positive for corporate bonds (credit). US corporations have been deleveraging and the amount of corporate debt is growing more slowly than nominal GDP. This means that companies should have more cash to repay debt and that demand for corporate bonds should remain supported. However, the reward for taking credit risk is very low – high yield spreads have reached the tightest levels since 2007. Moreover, an economic slowdown would surely hurt companies and their ability to service their debt obligations – we will keep a close eye on recession signals and favour companies that can do well throughout the cycle. In summary, we remain constructive but selective.

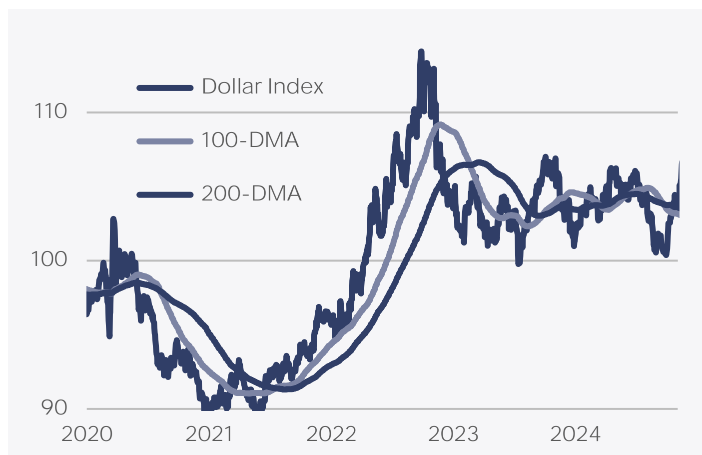
Bottom Line

Although we remain defensive overall in our fixed income allocations, with a clear focus on high quality credit, we have now rebuilt a Neutral allocation in duration given the risk that we could see some economic weakness in coming months.

CURRENCIES

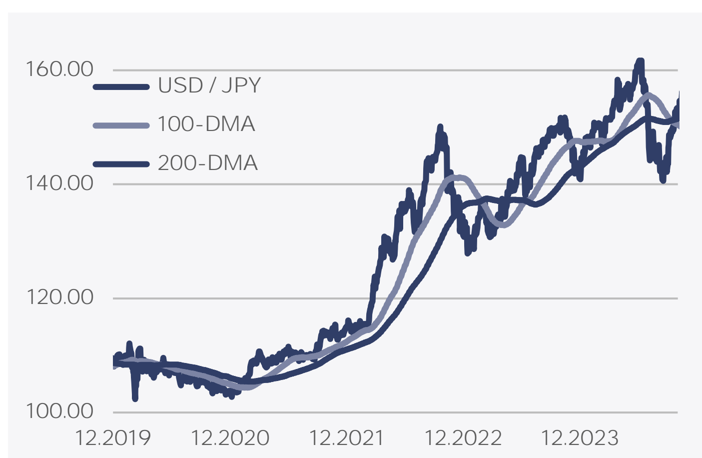
Since late 2022, the dollar index has been stuck in wide trading range between 100 and 107 points. Higher-than-expected inflation and fewer expected rate cuts helped the index rally 3.2% last month to the middle of its range.

USD . It is not clear how the dollar will react after the US election. The cost of hedging dollar exposure has fallen recently but could increase again, at least for European investors, as sluggish growth in Europe will likely lead the European Central Bank to cut more than the Fed. However, the US continues to attract capital flows which supports the dollar – the economy is growing fast and its stock market with its innovative companies continues to outperform global averages. Moreover, it is possible that countries like China might see currency devaluation against the dollar as a way to offset higher tariffs.



Source: Bloomberg

JPY . In Japan, the 30-year bond yield (which was not subject to yield curve control) is still in an uptrend which suggests that interest rates there may have more room to rise. This could be marginally supportive for the yen which has been very weak in recent years. The market expects the Bank of Japan to hike by 25bp in the next six months in contrast with the rate cuts expected in other advanced economies.



Source: Bloomberg

COMMODITIES

Global spot commodity prices rose 0.2% in September, their first advance in four months, pulled higher by rising energy prices and a jump in precious metals while industrial metals shed -2.5%.

Energy . As tensions between Israel and Iran heightened in early October, a sharp rally took Brent crude oil briefly above $80 per barrel (/b) before prices eased lower to end the month up 1.9%. This leaves Brent towards the lower end of the broad trading range between $70 and $90 per barrel (/b) which has been in place since Q4 2022. This weakness reflects worries that China's latest support package may not be sufficient to boost demand, and also OPEC+'s decision to allow members to gradually increase output. However, the Financial Times reported in early November that OPEC+ have decided to delay their planned hike in production until the end of the year, leaving current output curbs in place for now.

In its October report, the International Energy Agency (IEA) highlighted the sharp slowdown in world oil demand growth, from roughly 2 million barrels per day (mb/d) in the immediate aftermath of the pandemic to 0.9mb/d this year and almost 1.0mb/d next. On the supply side, output slumped by 0.4mb/d in September on disruptions in Libya and maintenance work in Norway and Kazakhstan. These factors notwithstanding, non-OPEC supply is expected to increase by around 1.5mb/d this year and next, the bulk of which will come from the US, Canada, Brazil and Guyana. Indeed, US crude output ended October at 13.5mb/d, the highest level on record and cementing the country's status as the world's largest oil producer. For now, the IEA expects the oil market to enter 2025 in sizeable surplus, barring an unforeseen disruption in the interim.

Gold . Gold prices jumped 4.2% in September, after hitting another new all-time high at $2'788 per ounce just before month-end, taking year-to-date performance to 33.0%. Central banks, notably in developing markets, have emerged as a significant source of demand as they seek to diversify their foreign exchange reserves away from G7 currencies. After a pause in buying in August, purchases resumed in September with 40 tonnes (t) added to reserves. Year-to date, central bank purchases have now reached 268t, led by Poland, Turkey and India which have each bought more than 50t so far this year.

At long last, retail and institutional investors have begun to participate in the bull market, as witnessed by flows in gold exchange-traded funds (ETFs). The last six months have seen uninterrupted inflows to gold ETFs totalling 163.3t, taking year-to-date buying into positive territory for the first time. In addition, the strong rally in gold prices means that assets under management in gold ETFs ended October at a new all-time high of $286bn, up around 32% year-to-date.

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