March 2024

MONTHLY HOUSE VIEWS

UPWARD REVISIONS, FOR NOW

Macro

Consensus expectations for 2024 global real GDP growth have been revised higher since January, from 2.6% to 2.8%, on the back of resilient consumer spending driven by pandemic-era stimulus packages and signs of a pick-up in manufacturing confidence. The most spectacular revisions have been in the US where forecasts have shot higher from a 1.2% low in January to 2.0% on the back of a run of stronger-than-expected data. For example, Q4 GDP growth is estimated an annualised 3.2% rate, well above the consensus forecast of 2.0%. European economies have not yet seen the same level of upward revision, but we do see some encouraging signs. In the Eurozone, Citi's economic surprise index has been improving steadily since the start of the year, while the purchasing manager survey in services is back in expansion territory for the first time since July last year.

Central Banks

As we forecast last month, traders' expectations for 2024 Federal Reserve (Fed) rate cuts have been slashed from seven -25bp reductions to just over three since the start of this year, bringing them in line with the Fed's own projections. This reassessment has been driven by Fed policymakers' insistence that market expectations were unrealistic and by some upside surprises in recent inflation prints. A similar reappraisal has taken place in the Eurozone, from almost seven -25bp cuts forecast at the end of last year to under four at present. Although the Eurozone economy looks much more sluggish than the US, price pressures remain stickier than had been hoped. In China, the central bank continues to ease policy as we forecast last month – the People's Bank of China (PBoC) cut its benchmark mortgage rate by a record amount in an attempt to stem weakness in the property market.

Markets

The rapid rally in global equities continued for the fourth month in a row with the MSCI World index of global equities adding 4.1% to take its performance since late October to 22.1%. Growth outperformed Value again, thanks to the vast contribution to returns from segments like America's "Magnificent Seven" stocks. The reassessment of rate cut prospects put further downward pressure on bonds and the Bloomberg Global Aggregate bond index shed a further -1.3% to take year-to-date returns to -2.6%. The run of positive economic surprises also helped foster appetite for commodities which added 0.5% in February, led by Brent crude oil which is now up 8.5% for the year. On currency markets, the dollar was generally strong, adding 2.1% against the yen and 0.5% against sterling over the month.

Bottom Line

We decided to keep our overall asset allocation unchanged yet again this month with equity allocations towards the top of the neutral band. We expect some further upside in equities over the next few months before investors begin to fret about recession risks. Our favourite region remains the US which we prefer over Europe, which we prefer in turn over Asia. Our allocation to US duration (i.e., sensitivity to changes in rates) remains at Neutral while historically tight credit spreads (the yields difference between corporate and sovereign bonds) suggest investors should remain very selective.

Summary House Views

OUR ASSET ALLOCATION

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

Equities	We maintain equity allocations towards the upper end of the Neutral band and continue to recommend investors strike a balance between Value and Growth. We prefer the US to Europe, and Europe to Asia.
United States	We have adjusted our US allocation to achieve a better balance between Growth and Value. Quality and Growth stocks have dominated recent market performance, but their valuations are getting stretched.
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.
UK	The normalisation of relations with the European Union is good news for UK exporters, but the government's recent budget has done little to address the UK's growth deficit.
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.
Japan	The Tokyo Stock Exchange's efforts to improve corporate governance and the focus on shareholders' returns combined with cheap valuations have fostered a bull run in Japanese stocks.
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.

Fixed Income	Today's environment of sticky inflation, elevated policy rates, quantitative tightening and inverted yield curves will continue to prove challenging for fixed income investors.
Sovereigns	The sharp rise in policy rates and inverted yield curve have created attractive opportunities in short-dated bonds. Nonetheless, the risk of a downturn led us to rebuild exposure to duration.
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.
Inflation-linked	Inflation-protected securities tend to have very high duration, making then extremely sensitive to small shifts in inflation expectations.
Investment Grade	The sharp rise in policy rates and inverted yield curve have created some buying opportunities in short-dated EUR-denominated high-quality corporate bonds. We remain Underweight nonetheless.
High Yield	Credit spreads have tightened to unattractive levels, especially if growth weakens which could penalise risk assets like high yield bonds, given the potential for a deterioration in credit quality.
Emerging debt (in € and $)	The best opportunities lie in Latin America where central banks have hiked rates far enough to take yields above inflation. However, political risk requires careful monitoring.

↗ Upgrade ↘ Downgrade ⊕ Overweight ⊜ Neutral ⊖ Underweight

WOOD MAN.

Commodities	With reopening in China likely to gradually boost demand for raw materials, we maintain our modestly Overweight allocation to commodities.	Overweight
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 as the economy picks up. We also continue to highlight the attractions of transition metals like copper and nickel.	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	After weakening in Q4, the rangebound dollar index has gained 2.8% so far in 2024, as traders have turned less optimistic on Fed rate cuts this year.	
EUR/USD	The European Central Bank (ECB) president has insisted that rate cuts are coming this summer, which may remove one of the single currency's supports.	Neutral
GBP/USD	Although the growth outlook still looks bleak given the UK's structural weaknesses, sterling remains heavily under-valued.	Neutral
EUR/GBP	Both currencies face strikes and political challenges, and the advantage conferred by the Eurozone's better budget discipline is offset by sterling's higher rates.	Neutral
USD/JPY	The shift in official statements about yen weakness suggests that the authorities may intervene to prevent further dollar strength at some point.	Neutral
EUR/CHF	The Swiss National Bank will keep a close eye on ECB rate hike plans – CHF strength has been to the SNB's strategy to keep inflation under control, which appears to have worked for now.	Neutral
Emerging	Attempts by EM currencies to build a base after hitting a new multi-decade low against the US dollar in early October appear to be running out of steam.	Underweight

Upgrade Downgrade Overweight Neutral Underweight

Economic Outlook

THE FED'S REACTION FUNCTION

Market forecasts of changes in the Federal Reserve's (Fed) key rates have waxed and waned in recent months, as indeed have the Fed's own projections. In September, the Fed's Summary of Economic Projections (colloquially known as the "dot plot") showed little intention to cut rates in 2024, with a median projection for key rates at 5.1%, only one -25bp cut below the 5.3% effective rate at that time. By December, policymakers had shifted to a more dovish stance and had cut the median to 4.6%, meaning three -25bp cuts this year. Traders took this change to mean that the Fed was worried about the economy and promptly increased their estimates to seven rate cuts in 2024 from less than three last September. Since the start of the year however, the Fed's message has been consistent – no cuts in the short term, and no more than three over the whole year – and market forecasts have reconverged with the dot plot.

The macro backdrop has also provided some justification for the reassessment of likely rate cuts. S&P Global's purchasing manager survey of manufacturers in February reached its highest level since July 2022, while the Atlanta Fed's GDPNow forecasting model for Q1 suggests that growth will hit an annualised quarter-on-quarter rate of 2.6%. Moreover, job growth in February remained robust with non-farm businesses adding 275'000 new workers to payrolls, well above the 230'000 average over the previous twelve months. With inflation well down from its June 2022 peak, the Fed's dual mandate – low inflation and high employment – looks as if it's being achieved.

However, the situation may not be as rosy as all that. For example, the Institute of Supply Management's survey of manufacturers has diverged from the S&P Global index with a surprise drop in February. Moreover, retail sales dropped -0.8% in January taking the year-on year (YoY) change to only 0.6%, the lowest level since the pandemic. This sign that all is not well for households was followed by disappointing consumer confidence surveys in February from both the Conference Board and the University of Michigan.

Further, despite the strong non-farm payrolls reports, the job market may be showing signs of underlying weakness. the Bureau of Labor Statistics publishes two monthly reports – the "establishment" or non-farm survey which focuses on companies and the household survey. The two reports have diverged notably over the past 18 months with companies continuing to report rising numbers of jobs while households say there are fewer people in employment. How can the two be reconciled? The main explanation in our view is people holding down several jobs – if an employee with company A takes a part-time job with company B, that counts as a new job for the establishment survey but not for the household one.

Another sign of labour market weakness is in the type of jobs. In February, the number of full-time jobs in the US economy fell YoY for the first time since the pandemic. And such declines are extremely rare outside of recessions. In addition, the number of non-farm employees in temporary jobs has declined sharply from its peak in March 2022 to reach the lowest level outside of the pandemic since 2014. The difficulties in attracting employees back after the pandemic has meant that companies have preferred to hoard labour and run down the number of temporary staff. But now, full-time jobs are being cut too.

Similarly, the average number of hours worked has declined from a peak of 35.0 in March 2021 to 34.3 in February. This suggests that companies are asking their employees to work fewer hours as they adjust their cost base in light of rising wages and sluggish demand. Moreover, companies are scaling back their hiring plans – the National Federation of Independent Businesses' February hiring plans index hit its lowest level outside of the pandemic since 2016.

The other part of the Fed's dual mandate is price stability, which it defines as core personal consumption expenditure (PCE) prices rising at or below 2.0% YoY. However, the core PCE deflator was still up 2.8% YoY in January. Moreover, the Fed keeps an eye on the consumer price index (CPI), which is the inflation measure most households are familiar with and which is proving stickier than hoped – since hitting its low nine months ago, the headline CPI has tracked sideways. In February, it came in 0.1pp above expectations, as did core CPI which hit 3.8% YoY. One area of particular concern for the Fed must be inflation in services, which make up 61.0% of the CPI basket – prices rose 0.5% in February after 0.7% the previous month, a 7.4% annualised rate for 2024 so far.

Bottom Line

So, what does all this mean to the Fed? For now, the widespread perception that growth will remain strong means there is no urgency to cut rates, especially as inflation remains well above target. No surprise therefore that no cuts are expected before June. However, the Fed typically doesn't like to make adjustments to interest rates just ahead of presidential elections to avoid accusations of political interference. This year's election will be on Tuesday November 5th which means that if the Fed does decide not to move in September, that only leaves the June and July meetings for potential rate cuts before the last two meetings this year in early November and mid-December.

The definitive timing of the first rate cut will depend on whether our prudence on the US economic outlook proves well-founded or not. But given that we expect inflation to remain sticky and weaker activity to unfold only in H2, the Fed may prefer to wait until its July meeting before moving, suggesting a single rate cut before the election rather than the three expected by the consensus.

EQUITIES

February saw a 4.1% jump in the MSCI World index of global equities, its fourth consecutive monthly advance, recording seven new all-time highs in the process. US equities, driven by the 12.0% surge in the Magnificent Seven, outperformed Europe for the second time in a row – the S&P500 index gained 5.2% versus 1.4% for the STOXX600 index. Emerging market stocks outperformed global equities for the first time in five months with a 4.6% advance (all data in dollar terms).

US . Participation in the rally remained broad-based – the proportion of stocks trading above their 200-day moving average (DMA) remained above 70.0% at end February, close to the highest level since mid-2021. The dispersion between factors remained relatively elevated – MSCI's US factor index for Momentum led the way with a 10.0% jump while Value, which last outperformed in December, gained only 3.2%. All eleven sectors gained ground in February – cyclical areas like consumer discretionary and industrials topped the month's leader board with advances of 8.3% and 6.9% respectively while laggards included defensives like utilities and consumer staples, which only gained 1.0% and 2.3% over the month. Small and medium-sized stocks outperformed in February for the second time in three months with the Russell 2000 small-cap index gaining 5.5%.

The recent surge in prices has pushed S&P 500 valuations considerably higher, from 19.1x trailing earnings at end October to 22.9x at present. The 21.5% pace of the advance in prices since end-October has not been matched by upward revisions in forward earnings expectations, which have only risen 2.7% since then, according to Bloomberg. Moreover, the trailing valuation premium over European stocks rose sharply over the period, from 8.0 to 9.7 points. This premium has little to do with the market-dominant positions of the Magnificent Seven stocks – US information technology stocks trade at a premium of only 23.1% over their European peers while the biggest overvaluations are in consumer discretionary and financial stocks, which are 113.0% and 104.9% more expensive respectively. The same holds true for factor indices – according to MSCI, US Growth stocks trade at a 58.7% premium to Europe and US Value 82.2% higher. We continue to call for a blend of Growth and Value stocks in portfolios.

Europe . The bear case for European equities is well known. Economic growth is sluggish at best – the consensus forecast for 2024 's real GDP growth has been revised steadily lower from 1.2% this time last year to 0.5% at present and the composite PMI business confidence surveys have been stuck in contraction territory since last May. As a result, corporate earnings have disappointed – according to Bloomberg, earnings for the MSCI Europe index fell -3.9% last year and are now expected to fall -3.2% in 2024. Moreover, investors have been steady sellers of European equity funds in recent quarters – Europe is the only region to have seen outflows year-to-date according to EPFR, adding to 52 weeks of steady outflows in the past 53. And finally, the geopolitical backdrop remains worrisome – the war in Ukraine has reached stalemate while the conflict in the near east looks like spilling over to the broader region with knock-on effects to supply chains and inflation from Houthi attacks on cargo ships in the Red Sea. And yet, Eurozone equity markets continue to perform satisfactorily – since bottoming at the end of September 2022, the STOXX 600 index has provided a 31.6% net total return versus 31.0% for the S&P 500 in euro terms.

In valuation terms, European equities continue to look cheap compared to history and to other markets, notably the US. As highlighted above, the MSCI Europe index trades at 13.5x trailing earnings versus 23.2x for its US counterpart. Moreover, European stocks are expected to pay investors a handsome 3.4% dividend yield in 2024, well above the forecast 1.5% yield on the MSCI US index.

Emerging Markets . After lagging the broad emerging market index throughout 2023, emerging Asian equities have staged a recovery since mid-January, recording a 5.8% advance in February in the process. The other major regions lagged with Eastern Europe gaining 4.1% and Latin America easing -0.5% lower. Argentinian stocks continued their yoyo performance, dropping -21.0% after jumping 32.7% in January, while regional heavyweight Mexico shed -2.8%. In Asia, China, the largest weight in the index, led the way with an 8.4% surge for the MSCI China index, followed by its tech-heavy neighbours South Korea and Taiwan which added 5.4% and 5.0% respectively.

As we highlighted last month, the Chinese authorities have taken steps to shore up the market after sustained underperformance since reaching a 28-year high in February 2021. These measures included replacing the stock market regulator and instructing state-controlled investors to buy up equities. The initial impact of these measures appears to have been positive, helped no doubt by China's cheap valuations – the MSCI China index trades at 8.9x forward earnings which are expected to grow 16.4%, versus 18.5x and 5.1% for the MSCI World index. Nonetheless, we would caution that more fundamental reforms will be necessary to address China's fundamental weaknesses – the implosion of China's residential real estate bubble has weakened both the banking system and local government finances while defaults on developers' debt have hurt bond investors.

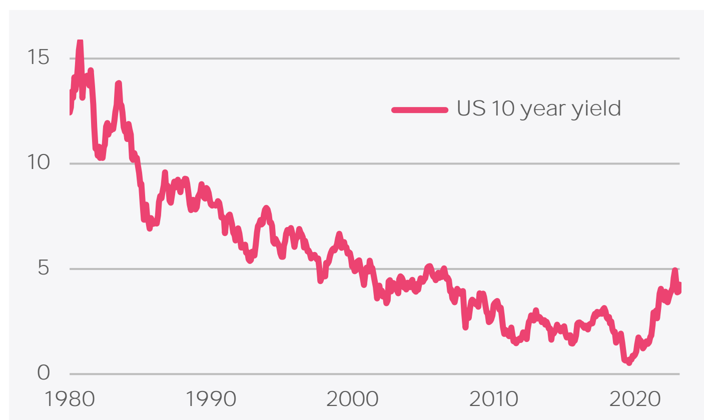
Bottom Line

We have decided again to keep our overall equity allocation unchanged at the upper end of the Neutral band. Within that allocation, we prefer US equities to Europe, and Europe to Asia. If we are right in expecting a slowdown in H2, investors should expect more volatility later this year after what we expect to be a decent first half.

FIXED INCOME

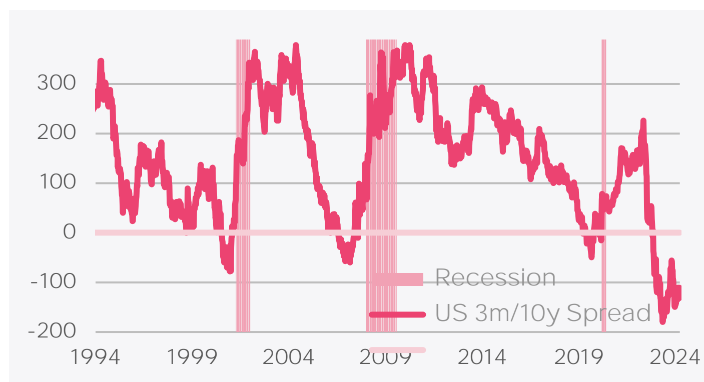
Following the trend outlined in last month's House Views, the Bloomberg Global Aggregate Bond Index ended February down -1.3% as interest rates continued to rebound.

US . The US CPI release for January was certainly a turning point, prompting traders to start to revise lower the potential number of interest rate cuts this year. Despite falling sharply in November and December, long term US yields are still in a clear uptrend.



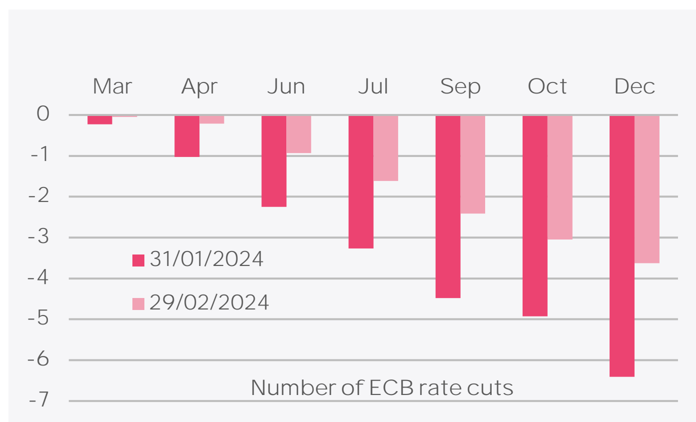
Source: Bloomberg

While we are likely to see lower rates in due course, the timing remains impossible to predict accurately. Fortunately, the inverted yield curve allows us to receive higher interest by keeping our duration risk low.

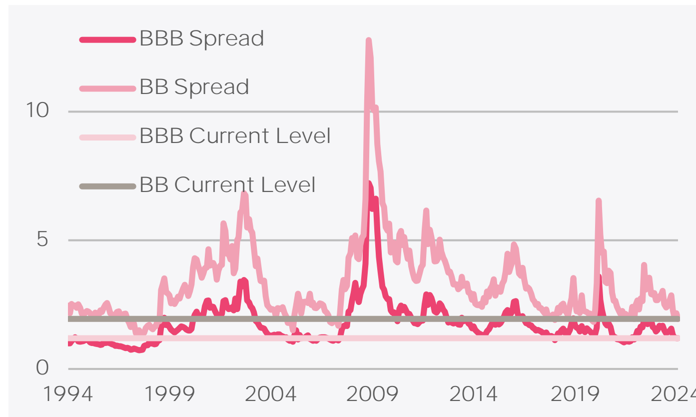


Source: Bloomberg

Europe . In Europe, rates and credit spreads followed a similar path. Inflation and economic growth have responded more rapidly to higher rates than in the US and it looks as though the ECB could be more comfortable than the Fed in cutting rates this summer. This being said, yields on European longer-dated bonds are much lower than the American equivalents, which makes the segment rather unattractive in our opinion.



Credit . On the credit front, corporate spreads (the difference in yields versus sovereign bonds) have continued to narrow to a point where there is little potential for further tightening. While recent US economic data have been encouraging, the Fed is still tightening liquidity via quantitative tightening while real rates have been rising as yields move higher and inflation comes down. Therefore, we do not see much upside from here with credit spreads close to historical lows for BBB and BB-rated bonds, which is where we usually like to take credit risk. Currently, with relatively high yields at the short end of the curve, we are focused on short-dated, good quality corporate bonds for the carry.



Source: Bloomberg

Bottom Line

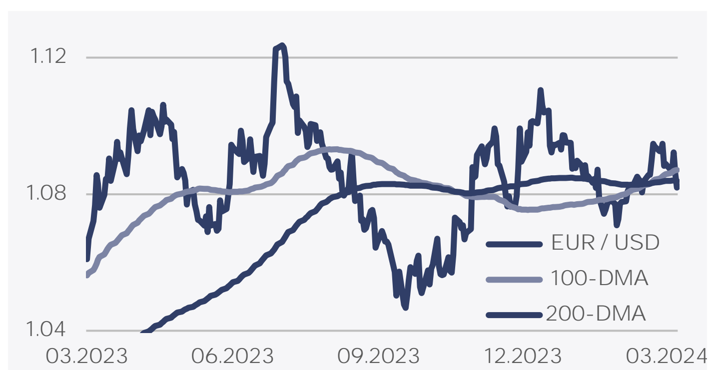
Although we remain defensive overall in our fixed income allocations, with a clear focus on high quality credit, we have now rebuilt a Neutral allocation in duration given the likelihood of some economic weakness later this year.

CURRENCIES

Currency markets have been surprisingly quiet despite uncertainty about rates and inflation.

USD . The dollar index has spent much of 2023 and 2024 in the 100-105 range. This is likely due to the widespread belief that the two major Asian economies, Japan and China, stand ready to intervene to prop up their currencies.

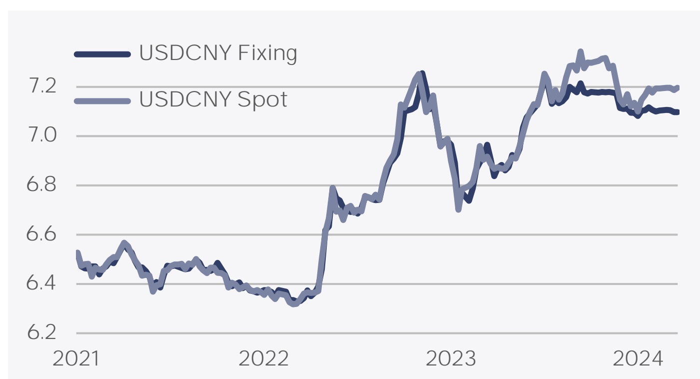
EUR . The Euro remains in the middle of the range of the last twelve months, despite increased likelihood of early ECB rate cuts.



Source: Bloomberg

JPY . It should be noted that in 2023, when the yen last traded around 150 per dollar, the Japanese government signalled their readiness to take measures to prevent further currency weakness. Despite the attractive yield differential in favour of the dollar, the market remains cautious around these levels – the upside in USDJPY seems limited, the yen is strongly undervalued, and it would not take much good news to push it higher against the greenback.

CNY . In China, the renminbi is once again trading weaker than the daily fixing of the mid-point USD/CNY rate set by the People's Bank of China. Here too, there are reasons to be cautious – the last few times this happened, the CNY fell back in line after a short period,



Source: Bloomberg

COMMODITIES

Global spot commodity prices rose a further 0.5% in February, boosted by a recovery in energy prices.

Energy . Brent crude prices have started the year on the front foot after Q4's sharp -19.2% correction – prices rose 6.1% in January and a further 2.3% last month. This rally has been driven by a number of factors, most notably rising geopolitical tensions in the Middle East – the retaliatory strikes by the US and the UK on Houthi rebels have raised concerns that the flow of oil from the Persian Gulf could be disrupted while, so far, no end to the crisis in Gaza is in sight. In addition, Arctic weather in North America pushed US and Canadian output sharply lower in January. Moreover, the OPEC+ cartel recently prolonged its late-November decision to implement output cuts totalling some 5.3m barrels per day (mb/d), around 5% of global supply.

These cuts were designed initially to keep supply tight in light of fears of economic weakness leading to lower energy demand. Since then, however, economic data has mostly surprised on the upside, helping bolster this year's rally in crude prices. However, the outlook for oil remains uncertain. According to the International Energy Agency (IEA) February report, global oil demand growth slowed to only 1.7mb/d year-on-year in Q4, mainly due to a sharp drop in China, down from 3.2mb/d in Q2 and 2.8mb/d Q3, and is projected to slow further to 1.2mb/d this year. Moreover, world oil supply is forecast to rise to a new high of 103.8mb/d in 2024, well above the IEA's 103mb/d demand forecast, thanks to surging output in the US, Brazil, Guyana and Canada. All in all, crude prices should continue to trade in a wide band this year.

Gold . Gold prices edged 0.2% higher in February, still within a whisker of late December's all-time high at $2,077 per ounce. As noted last month, the previous peaks above $2,000 – in August 2020, August 2022 and March 2023 – were all short-lived but gold's resilience in this latest break-out attempt looks encouraging. In addition, it comes against a backdrop of dollar strength and rising bond yields – the dollar index rose 0.9% over the month while 10y Treasury yields jumped 34bp. Gold is of course traded in dollars and tends to strengthen when the greenback falls while the opportunity cost of holding gold, a non-interest-bearing asset, tends to fall when rates decline. Interestingly, gold's strong performance has not attracted buyers of gold-backed ETFs – January saw redemptions equivalent to 49 tonnes, the ninth consecutive month of outflows.

On the other hand, demand for gold from emerging world central banks and consumers in China and India remains robust. With little growth forecast in mining output, the longer-term picture for gold prices remains bright.

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