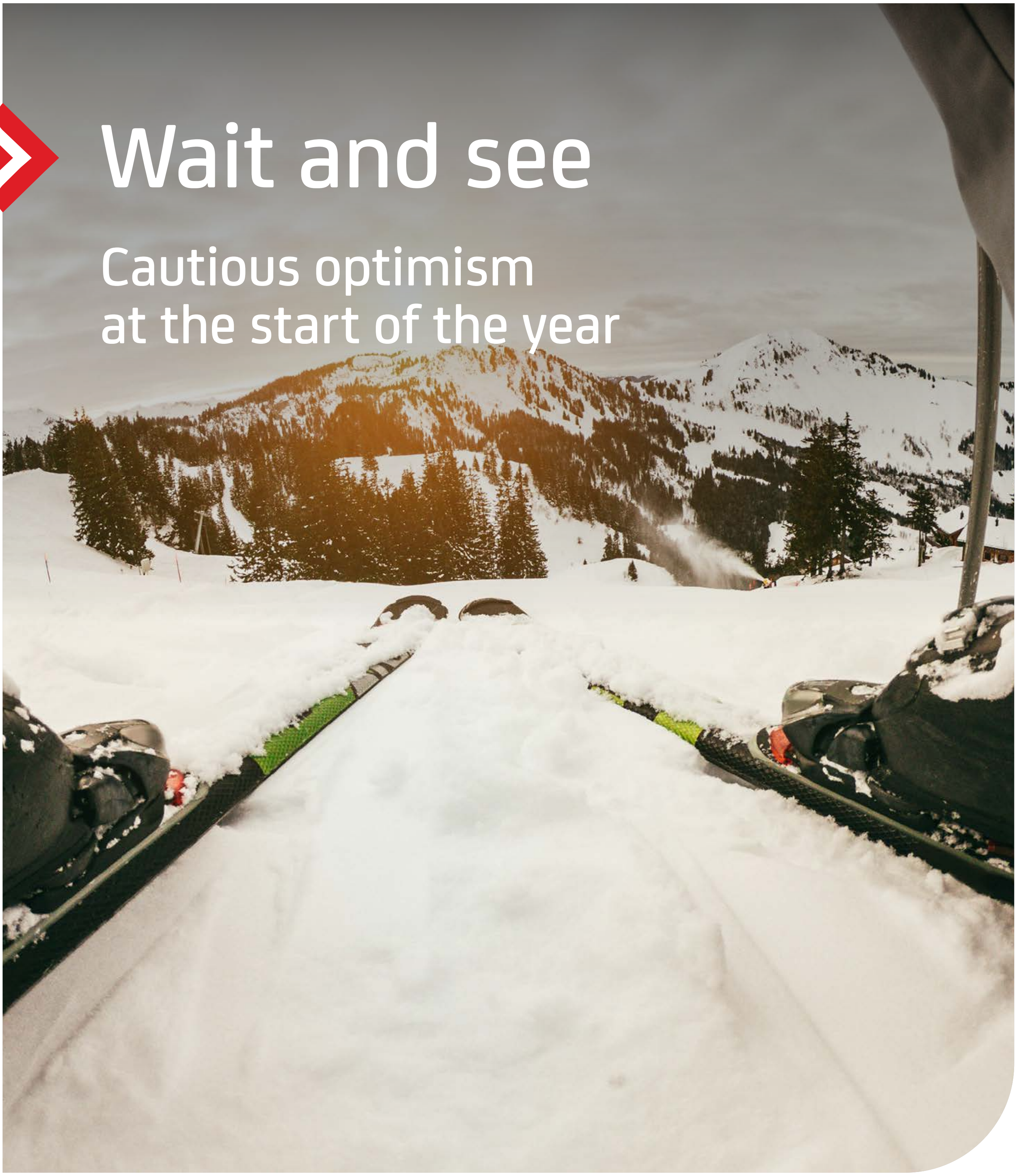
# Wait and see

## Cautious optimism at the start of the year



Group Investment Strategy

# Monthly Outlook

February 2024

UniCredit

# Index

# Summary

## Wait and see

## MACROECONOMIC UPDATE

The US economy closed the fourth quarter of 2023 on a strong note, with an annualized growth rate of 3.3%, following an even faster growth of just under 5% in the previous quarter. Private consumption, particularly on goods, played a significant role in this robust performance, fueled by a strong increase in real income. However, concerns arise as the labor market is expected to lose momentum, leading to a predicted slowdown in consumption growth in the coming quarters.

In the Eurozone, GDP stagnated in the final quarter of 2023, influenced by a slowdown in growth in Germany. However, the economic outlook suggests a moderate recovery in the first quarter of 2024, with leading indicators showing slight improvements. We expect economic activity to continue, which will also be reflected in a slight acceleration in economic growth in the eurozone in the first quarter of the year.

China's economy performed better than expected in the fourth quarter of 2023, with a GDP growth of 5.2%. Fiscal incentives for investment in infrastructure and manufacturing counteracted weakened consumer demand. Our expectation for the first quarter of 2024 is an acceleration in growth due to government support measures and increased consumption during the Chinese New Year. However, early indicators suggest a slowdown in growth momentum and persistent deflationary pressure. The Chinese government's response to the economic slowdown has been cautious, focusing on restrained fiscal policy support and industry-oriented measures.

## INFLATION AND MONETARY POLICY

The Federal Reserve maintained key interest rates at 5.5%, signaling a shift to a more neutral stance and abandoning the previous tendency to tighten monetary policy. Despite speaking against a rate cut in March, the Fed left the option open, indicating flexibility based on data. Our expectation is that interest rates may be cut by a total of 125 bps in 2024 as we expect GDP growth and inflation to weaken further.

The European Central Bank maintained key interest rates unchanged at its last meeting in January, with President Lagarde confirming her statements from the Economic Forum in Davos, according to which she continues to expect an initial interest rate cut in the summer. However, market expectations lean towards an earlier rate cut, possibly in April, supported by the latest dovish statements by some ECB representatives. The Governing Council seems determined to play it safe on inflation and keep interest rates high – at least as long as the labour market remains stable. We therefore continue to expect an initial rate cut in June, followed by a gradual reduction of 25 bps per quarter until the end of the year.

## FINANCIAL MARKETS

In financial markets, a strong rally in the fourth quarter of 2023 was followed by mixed performance in January. Economic data favoring a "soft landing" in the US and no "hard landing" in the Eurozone boosted risky assets, but led to less favorable conditions for fixed income. The S&P 500 reached a record high in mid-January, reflecting optimism, but caution arose after the Fed and ECB meetings adopted a less dovish tone. Bond markets experienced losses as interest rate cut expectations led to price declines, with yields on 10-year US and German government bonds rising. The euro depreciated against the US dollar. Oil prices rose due to tensions in the Middle East and disruptions in the Suez Canal, while gold price fell as yields increased.


Following the impressive market rally at the end of 2023, which enabled respectable returns for both equities and bonds, markets have started the new year somewhat cautiously. European and US share indices are fluctuating around their year-end closing levels, which are also close to their respective all-time highs. Bonds, on the other hand, have seen slight price setbacks, which can be attributed to the fact that, in December, markets were almost euphoric about rapid interest rate cuts. At times, a first rate cut in the US at the Federal Reserve's (Fed) meeting in March was being priced in with a probability of almost 85%. Today, however, it is considered reasonably likely that the first cut will not come until the second quarter. An interest rate cut by the European Central Bank (ECB) before the second quarter also seems very unlikely.

Market expectations regarding the expected rate cuts are likely to continue to set the tone, particularly in the first half of the year. Markets are discussing with some excitement which of the two major central banks will be the first to loosen the interest rate reins, as there is an unusual gap of several weeks between the ECB's (11 April) and the Fed's (1 May) first monetary policy meetings in the second quarter. The markets still expect a slightly higher probability that the Fed will lead the way with a rate cut and that the ECB will follow suit. Nevertheless, based on the market-implied probabilities, it cannot be ruled out that the ECB could present a rate cut as early as April.

While this question is likely to occupy the commentary columns in the business and financial press and could possibly also cause some daily volatility, the medium-term effects on the capital market situation regarding the question of whether the first cut will come in April, May, June or July and which central bank will take the first step appear to be less decisive. In our opinion, it is much more important that the interest rate reduction cycle expected for 2024 gets underway by the middle of the year.

In our view, the base scenario for 2024 is that 1. inflation rates in the western industrialised nations should continue to normalise (it is unclear how close the actual inflation rates realised will come to the 2% target of the major western central banks by the end of 2024), and 2. the major western central banks are likely to cut interest rates (as outlined above, it remains to be seen when exactly the rate cut cycle will start and how far interest rates can be cut). We currently expect key interest rate cuts totalling 125 basis points (bps) by the Fed and 75 bps by the ECB in the year ahead. In addition, there are many indications that a so-called **"soft landing"**[1] of economic activity can be achieved on both sides of the Atlantic despite the continued restrictive level of interest rates for the time being.

The "soft landing" scenario is well illustrated by the example of the US. The consensus estimates see the economic slowdown bottoming out in the third quarter of this year, with a growth rate of 0.1% from the second quarter. This means that the 2024 consensus does not expect the US economy to contract in a single quarter. These consensus estimates are based on forecast data from over 60 research houses that publish growth forecasts for the US. The consensus figure is the **median**[2] in the distribution of the individual estimates. Incidentally, only 15% of analysts expect two consecutive quarters of negative growth, i.e. a (technical) recession, and even then, the expected contraction is only -0.1% in the second and third quarters. To summarise, it can therefore be said that only a clear minority expect a recession (slight at best).

[1] A soft landing in the business cycle is the process by which an economy transitions from growth to slow growth to a possible stall as it approaches, but avoids, a recession.

[2] The median is the value that lies exactly in the centre of a data series ordered by size. Because of this central position, it is also called the centre value. The median bisects the data series so that one half of the data lies below and the other half above the median in the ordered series. The median in a distribution is the amount at which the estimate is divided into two equal parts. This means that 50% of the estimates are below the median and 50% are above.

If our base scenario materializes, the capital market year 2024 should offer investors reasonable returns, as the changed interest rate environment is expected to provide support to the equity markets overall. Although it can be assumed that the earnings potential after the impressive rally in 2023 will probably be significantly below the previous year's level in some cases, it could be close to the long-term average returns, particularly for equities.

We see two main risks to our base case scenario: If contrary, to expectations, inflation accelerates - for example, if wage growth proves to be stubborn - the Fed may be forced to postpone interest rate cuts or even raise rates. In the event of an inflation surprise driven by strong economic data, bonds in particular are likely to come under some pressure. On the other hand, the possibility of disappointing economic growth data cannot be completely ruled out, as the delayed impact of higher interest rates and tighter financial conditions will leave a clearer mark on corporate profits. However, falling equity and corporate bond prices (as a result of higher credit spreads) due to this sharper than expected economic slowdown may be at least partially offset by price rises in high quality government bonds if central banks cut interest rates more than expected in such a scenario (although this is not guaranteed).

One thing seems clear: in an environment where interest rates are expected to fall soon, shifting money from short-term investments (such as fixed-term deposits) into longer-term bonds generally promises the chance of greater earnings potential. This is because these securities can secure the current yield level over a longer period of time than short-term investments. Bonds also offer the opportunity to realize additional price gains - namely when yields fall. However, if interest rates remain high for longer than expected, rising yields and price losses on bonds cannot be ruled out. All in all, the scenario of a promising investment year 2024 still seems intact.

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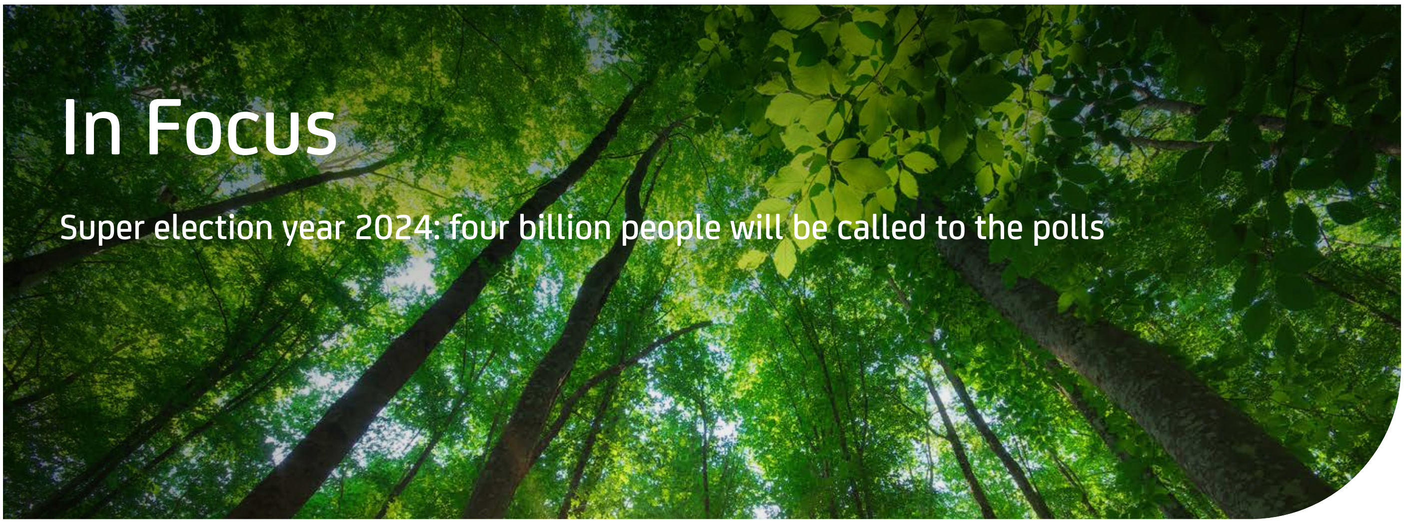


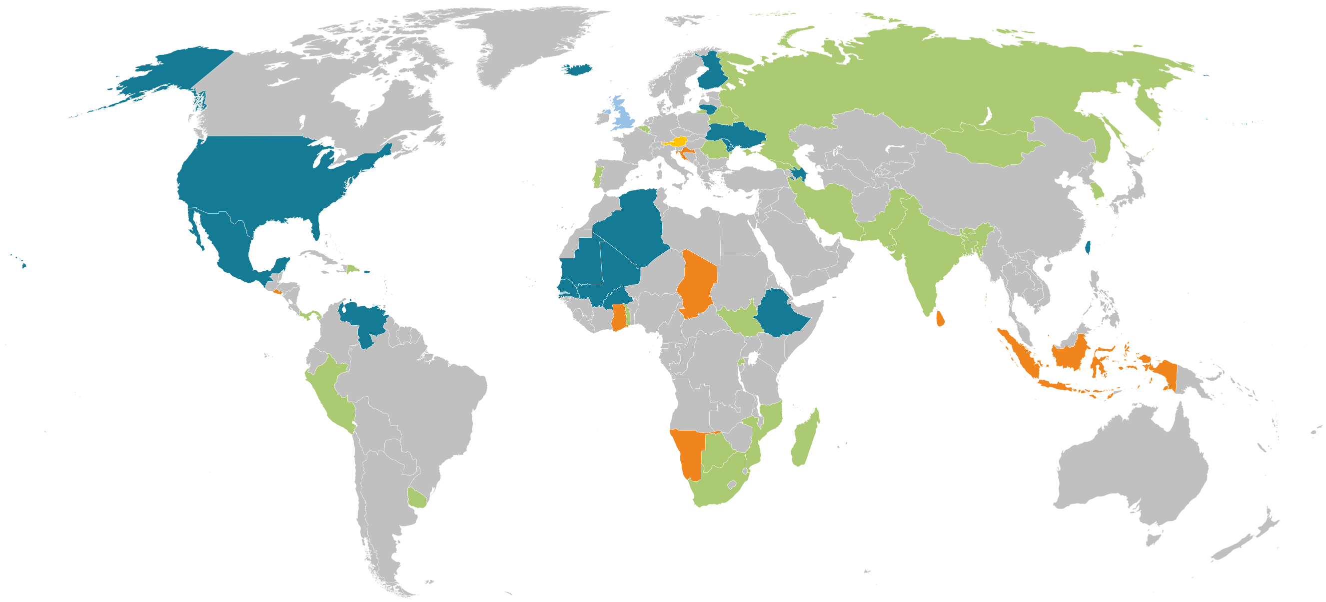
# In Focus

## Super election year 2024: four billion people will be called to the polls

Market participants have been paying close attention to geopolitical developments even before Russia's war against Ukraine began. A look at the past few years shows the impact that these developments can have on the global financial markets. For example, the Brexit referendum in 2016 and the election of Donald Trump as US president a year later, as well as the political reaction to the Covid pandemic, highlight how political decisions do not leave markets and market participants unaffected. The latter are therefore looking ahead to 2024 with mixed feelings – the super election year in which citizens in more than 70 countries, which, according to calculations by the British business magazine Economist, represent more than 50% of the world's population and a large proportion of global gross domestic product (GDP), are called upon to cast their votes in presidential, parliamentary or local elections. We provide an overview of the most important elections in 2024 and briefly categorise them in terms of their potential implications for investment strategy. Not all of them will be significant for the global financial markets, as they take place in countries with too little economic or geopolitical influence to attract attention on global markets. And indeed, the focus of the global financial markets will undoubtedly be on the US presidential election in November.

### 1. OVER FOUR BILLION PEOPLE WILL BE CALLED UPON TO CAST THEIR VOTE IN 2024

National elections, European elections
Parliamentary and presidential elections
Parliamentary elections
Presidential elections
House of Commons elections



Source: profil, datawrapper, UniCredit Group Investment Strategy

## TAIWAN (JANUARY): RELATIONS WITH CHINA OVERSHADOW EVERYTHING

The pro-freedom Democratic Progressive Party (DPP) won the presidential elections in Taiwan for the third time in a row, albeit with significantly fewer votes than last time, but more clearly than expected. Due to its economic and geopolitical significance, the outcome of the election was followed with great interest internationally. In particular, it plays a significant role in Taiwan's relationship with its neighbour China, which regards the island state as part of its own territory. Experts described the Chinese government's reaction to the outcome of the election as rather moderate. The response by US President Joe Biden ("We do not support Taiwan's independence") highlights the recognisable efforts of the **US**[3] not to risk (further) diplomatic tensions with China.

[3]According to the official Taiwan Doctrine from the 1970s, the US recognises the People's Republic of China as the only legitimate government in China. It therefore respects the Chinese position that Taiwan is part of China ("One China"), but does not share it.

## RUSSIA (MARCH): CAN THE OPPOSITION SEND A SIGNAL OF RESISTANCE?

In Russia, incumbent President Vladimir Putin is planning to be re-elected for a six-year term in office from 15 to 17 March. He could receive around 80% of the vote. Elections are also to be held in the so-called "new territories", i.e. the partially occupied regions of Ukraine that Moscow claims to have annexed last year. In a society without political competition, the elections create a kind of legitimisation for Putin: although their actual votes are of secondary importance, Russians demonstrate that they accept the mechanisms prescribed by the Kremlin in principle simply by taking part in the elections. It remains to be seen whether the opposition will be able to send a signal of resistance despite all the adversities.

## IRAN (MARCH): RESIGNED REFORM FORCES

Parliamentary elections are also due in Iran in March, which is once again at the centre of tensions in the Middle East. There is no classic party system in Iran. There are mainly various factions competing with each other. Conservative hardliners currently dominate the House of Representatives. Politicians from the reform movement have been seen as massively weakened for years. The regime in Tehran has excluded numerous candidates for parliamentary seats from the election, including current MPs, due to "insufficient ideological qualifications".

## INDIA (APRIL/MAY): PRIME MINISTER MODI THE CLEAR FAVOURITE

In India, Prime Minister Narendra Modi is the favourite to win the election in the world's largest democracy in April and May. Due to its size – almost one billion eligible voters can cast their vote – the election will take several months. 73-year-old Modi enjoys good poll ratings thanks to strong economic growth in India at almost 7%. In recent years, he has also tried to raise India's international profile. The country is being courted by the West due to its enormous potential. Conversely, good relations with the West are also important for India against the backdrop of its rivalry with China.

## EUROPEAN PARLIAMENT (JUNE): TEST FOR THE RIGHT-WING POPULISTS

The elections of the 720 members of the **European Parliament**[4] (EP), the only directly elected EU body that will decide on the new leadership of the EU Commission, will take place in all 27 EU member states at the beginning of June. The focus has shifted to the performance of populist and/or anti-European parties, which are fuelling a mixture of fears of war, decline and foreigners. In Hungary, the right-wing populists are already the heads of government; in Slovakia and Finland, they are junior partners in the government with Christian Democrats. In Sweden, they support the governing party, while in Germany, France and Austria, they are enjoying good poll ratings. In Italy, anti-EU rhetoric could resurface in parts of the right-wing ruling coalition as elections approach. The elections will therefore also decide the future path and future of the European project.

[4]The number of MEPs that a member state may send is roughly based on its population: each country has a minimum of six and a maximum of 96 MEPs. The competences of the EP have continuously expanded over the past decades. For example, MEPs are centrally involved in EU legislation.

## MEXICO (JUNE): FIRST WOMAN PRESIDENT?

The presidential elections in Mexico could see a woman become president for the first time in June. Two women are considered favourites to succeed incumbent Andrés Manuel López Obrador: the former mayor of Mexico City, Claudia Sheinbaum, from the left-wing governing party Morena and Senator Xóchitl Gálvez, candidate of the opposition alliance. The election of a female president would be a strong signal in a country characterised by a traditional masculine culture where an average of eleven murders of women are committed every day.

## GERMANY (SEPTEMBER): STATE ELECTIONS IN SAXONY, THURINGIA AND BRANDENBURG – A SIGNAL AGAINST THE RIGHT?

Elections will be held in the eastern German states of Saxony and Thuringia on 1 September and in Brandenburg on 22 September. Polls suggest that the Alternative for Germany (AfD) could become the strongest force in all three states. It also seems possible that parties such as the Greens, FDP and SPD could fail to reach the 5% hurdle, while the CDU and the Left Party together could win fewer seats than the AfD. An AfD prime minister could then not be prevented. However, it also seems conceivable that the democratic parties could join forces to form a minority government without an absolute majority. In none of the three states is a democratic party prepared to form a coalition with the AfD.

## US (NOVEMBER): IS TRUMP COMING BACK?

In the US, there are many indications that the 2020 duel between incumbent Joe Biden and former President Donald Trump will be repeated on 5 November, even though it will not be officially known until the summer who the Republicans and Democrats will send into the race for the presidency. Trump, who was charged with incitement to sedition but acquitted in the Senate, clearly won the first **Republican primaries**[5] in the states of Iowa and New Hampshire. According to a **poll published last December by the "New York Times" and the renowned Siena College**[6], he is ahead of Biden in five out of six traditionally decisive US states, which still have nine months to reverse the trend. The robust economic development of the US could be helpful here. Trump's chances could also be damaged by his numerous lawsuits. In his second term of office, he could rely more than ever on hardliners and attempt to turn the world's oldest democracy into an autocratic state.

[5]The primaries are the basis for who will be chosen as the presidential candidate at the Republican Party conference in the summer.

[6]The swing states of Nevada, Georgia, Arizona, Michigan and Pennsylvania would go to Trump as things stand, with Biden trailing by up to 11 percentage points. Only in Wisconsin would Biden have a small lead of two percentage points. Link: https://www.nytimes.com/news-event/times-siena-poll-coverage

## UNITED KINGDOM (TBD): LANDSLIDE VICTORY FOR LABOUR?

**The British are also likely to elect a new House of Commons in May, October or November**[7]. After the reputation of Prime Minister Rishi Sunak's Conservative governing party suffered enormously from the long Brexit chaos under Theresa May, the lockdown parties under Boris Johnson and the only narrowly avoided financial crisis under short-term Prime Minister Liz Truss, all polls for the past two years have put Keir Starmer's Labour Party up to 20% ahead of the Conservatives, who have governed the UK since 2010. Under British majority voting law, this gap would mean a landslide victory for the opposition.

[7]According to the rules, nationwide parliamentary elections must be held by January 2025 at the latest. Sunak, who as Prime Minister sets the election date, has already indicated that he does not want to wait until the last minute.

## CONCLUSION

2024 will not only point the way for the future development of the numerous conflicts that are currently dominating world affairs. The outcome of the many elections will also provide important insights into the state of democracy worldwide. With regard to the global financial markets, it should be noted that political elections and their results can often cause short-term irritation and volatility, while academic studies generally come to the conclusion that there is no statistical evidence of a significant, long-term influence of election results on the earnings potential of the broad equity market, for example.

Significant megatrends – such as the transformation of the economy and society towards climate neutrality, demographic change in many western industrialised nations and advancing digitalisation, which has gained further momentum thanks to the AI hype – will hardly be halted by the elections and their outcome. Nevertheless, there will always be sectors whose success is closely linked to political decisions, particularly due to their dependence on regulation and subsidies. This applies in particular to heavily subsidised sectors such as renewable energies. For example, while the Biden administration ushered in an era of climate leadership for the USA, a President Trump would probably cut climate subsidies in favour of higher oil production. However, this would not change the fact that companies must prepare for a climate-neutral economy – or otherwise risk being squeezed out in the long term by competitors who see the transformation as an opportunity for innovation.

Against this backdrop, diversification remains one of the simplest but also most sound investment principles in our investment strategy. At the same time, we consider it highly likely that high-quality companies with a functioning business model are well-positioned to continue outperforming in 2024. Opportunities could arise in particular if existing uncertainties in connection with the elections dissipate. This could become particularly relevant towards the end of the year, after the US elections.

# Macro & Markets

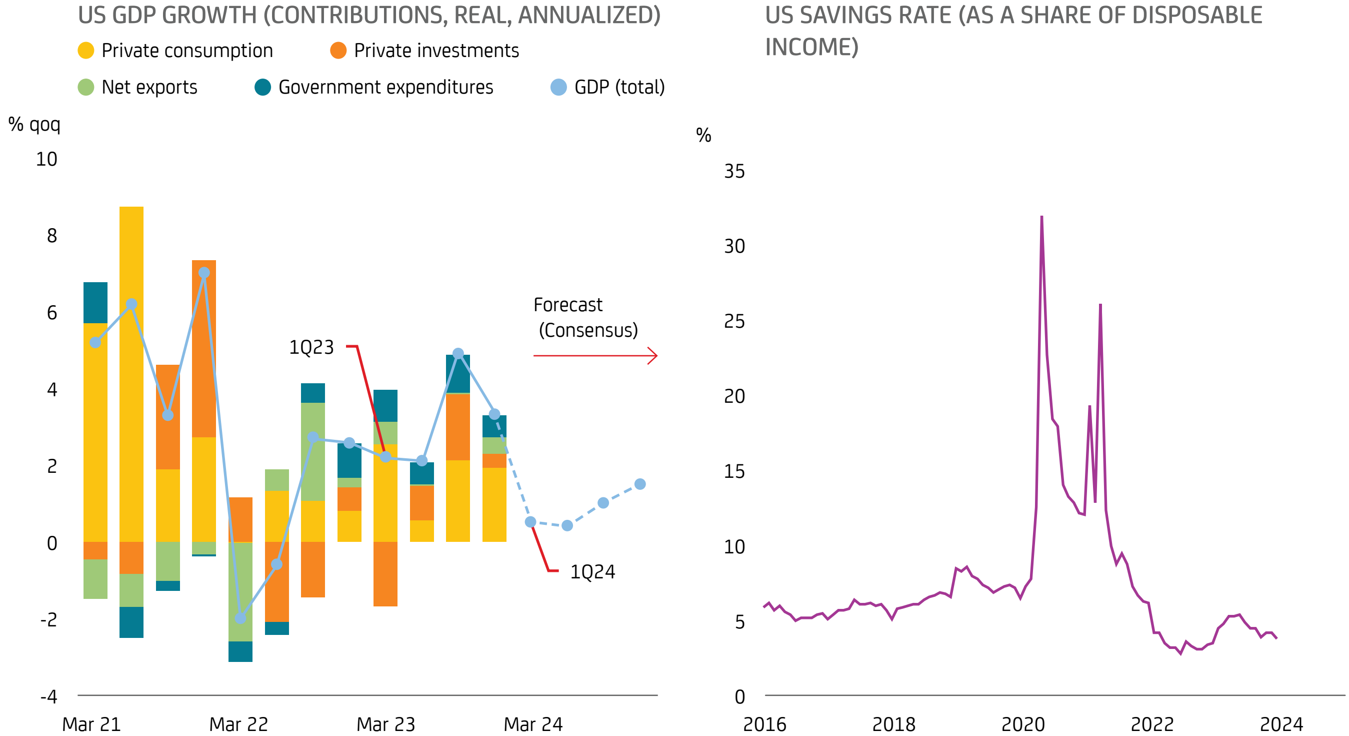
## Robust economic development makes premature interest rate cuts unlikely

### US ECONOMY CLOSES 2023 WITH STRONG QUARTERLY GROWTH, BUT WEAKER ECONOMY LIKELY IN 2024

Recently, the US economy has been unexpectedly robust. It closed the fourth quarter of 2023 with an annualised annual rate of 3.3%, after growing even faster at just under 5% in the previous quarter (see chart 2). Once again, US consumers surprised with noticeably robust private consumption, which contributed almost two thirds to GDP growth in the fourth quarter. Private consumer spending on goods rose even more strongly than on services. This was primarily financed by a strong increase in real income and, to a lesser extent, a further slight decline in the savings rate (see chart 2). However, we expect consumption growth to slow down in the coming quarters, as the labour market in particular will continue to lose momentum – and private households are likely to save more than they consume in such an environment.

On the monetary policy side, the US Federal Reserve (Fed) left key interest rates unchanged at 5.50% (at the upper end of the interest rate band) in January, as expected. However, there were some important changes in the Fed's view and direction. For example, the tendency to tighten monetary policy was abandoned and replaced by a more neutral stance, as the risks to achieving the Fed's objectives (i.e. price stability with a solid labour market) are now seen as more balanced. In addition, the Fed has spoken out against a rate cut at the next meeting in March, but reserves the flexibility to take such a step. It is signalling this by continuing to emphasise its dependence on data. There was no real news regarding the plans to slow down the balance sheet reduction, except that this topic will be discussed in detail at the upcoming meeting in March. Overall, we maintain our view that the Fed is likely to start cutting rates in June. We expect interest rates to be cut by a total of 125 basis points (bps) this year as we expect GDP growth and inflation to weaken further, giving the central bank the opportunity to further normalise interest rates.

2. US ECONOMY CONTINUES TO BE ROBUST – CONSUMPTION FACING WEAKENING, BUT WILL STILL GROW IN 2024




Source: BEA, Consensus, Bloomberg, UniCredit Group Investment Strategy

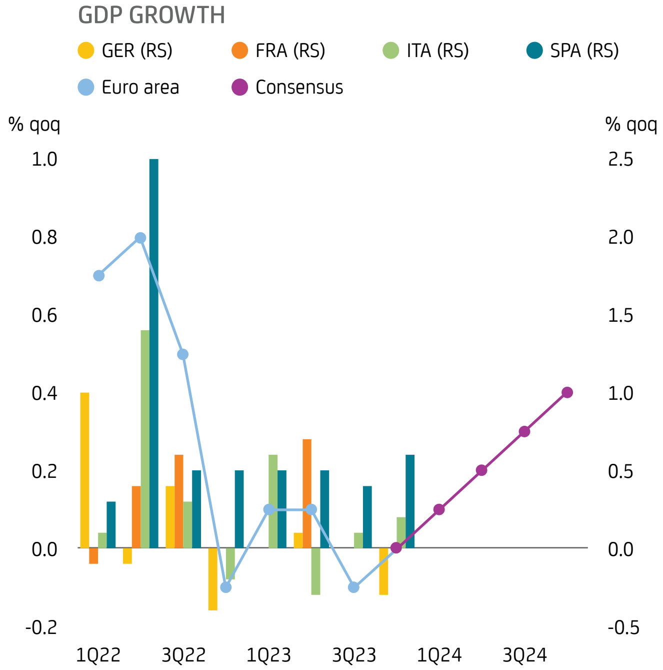
## EUROZONE: ECONOMY DEFIES (TECHNICAL) RECESSION, MODERATE ECONOMIC RECOVERY EXPECTED

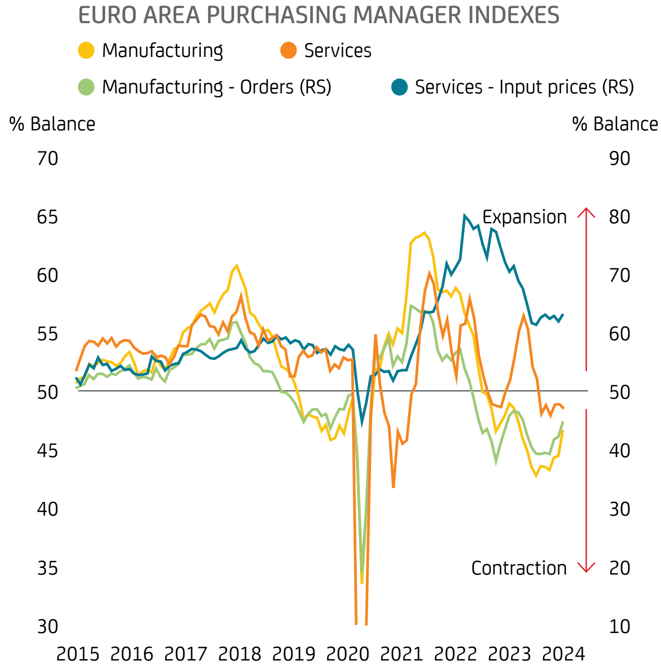
According to the latest data, GDP in the eurozone stagnated in the final quarter of 2023. At the national level, the slowdown in growth in Germany weighed on the entire region (see chart 3). However, the development in Italy, Spain, Portugal, Belgium and Austria compensated for this decline. In addition, a look at the economic development in the first month of 2024 points to a moderate recovery in economic momentum. Specifically, the leading indicators for the eurozone (purchasing managers' indices for January) have recently slightly improved, although they are still in contraction territory (see chart 3). The improvement reflects a combination of continued stabilisation in the manufacturing sector (bottoming out) and a further slight decline in the services index. While economic activity in all sectors remains at a low level, the first signs of a recovery in new orders and production indices in manufacturing are encouraging – however, a temporary risk factor is delays in shipments due to the unrest in the Red Sea and the Houthi attacks remains. This is also reflected in longer delivery times for suppliers, but we do not currently see any lasting negative impact on our base scenario. We therefore expect economic activity to continue, which will also be reflected in a slight acceleration in economic growth in the eurozone in the first quarter of 2024.

As far as monetary policy in the eurozone is concerned, the European Central Bank (ECB) left key interest rates unchanged at its last meeting in January, as expected. The information available since the December meeting has largely confirmed the central bank's assessment of the medium-term inflation outlook, meaning that the ECB's Monetary Policy Council wants to continue to wait and see before taking any further steps. At the press conference, ECB President Lagarde confirmed her statements from the Economic Forum in Davos, according to which she continues to expect an initial interest rate cut in the summer. However, financial market participants were not very convinced by this statement. Together with the latest **dovish**[8] statements by some ECB representatives, this is now fuelling expectations on the markets that the first interest rate cut will take place at the April meeting. While the ECB forecasts for economic growth and inflation are likely to be revised downwards in March, the Governing Council seems determined to play it safe on inflation and keep interest rates high – at least as long as the labour market remains stable. We therefore continue to expect an initial rate cut in June, followed by a gradual reduction of 25 bps per quarter until the end of the year. However, as there have hardly been any significant statements from ECB members to date that would dampen market expectations of an earlier rate cut, an earlier rate cut – as in April – can no longer be completely ruled out.

[8]This refers to statements by central bank members that indicate a less restrictive monetary policy.

## 3. GROWTH IN THE EUROZONE STAGNATES TO THE END OF 2023, INDUSTRY LEAVES THE VALLEY FLOOR BEHIND



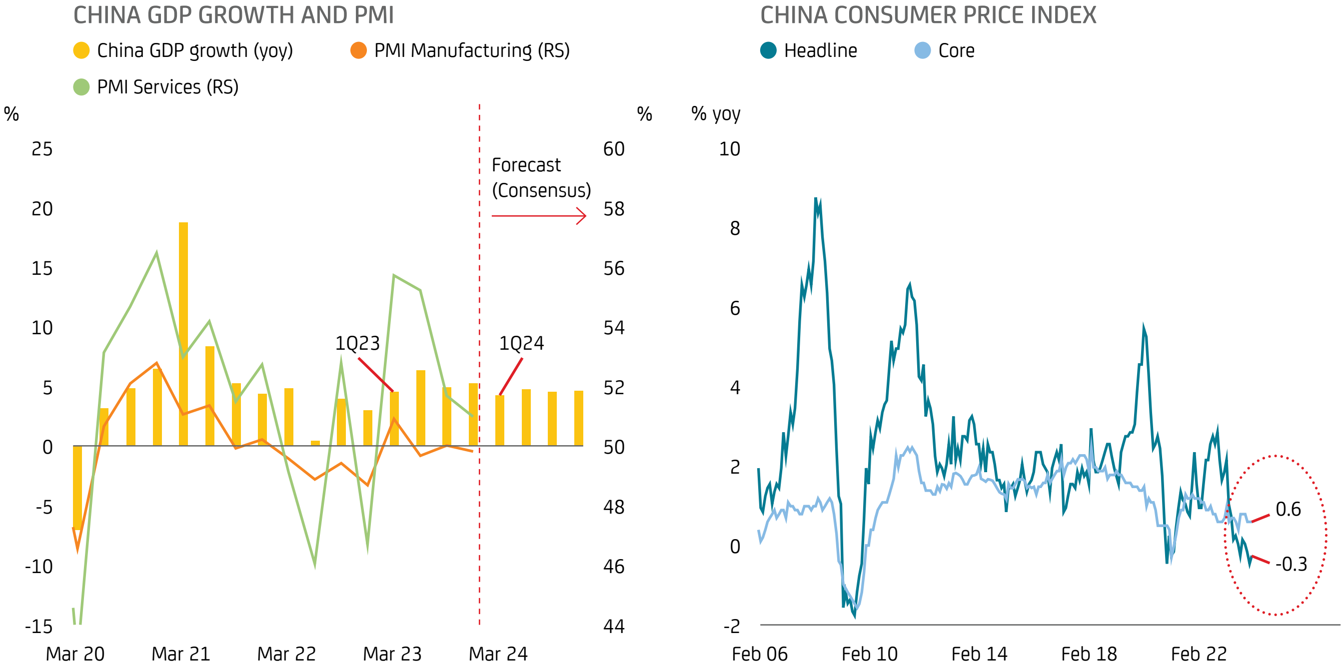

Source: Eurostat, Consensus, S&P Global, Bloomberg, UniCredit Group Investment Strategy

## CHINA'S ECONOMY FACES A DIFFICULT YEAR OF RECOVERY

The Chinese economy performed better than expected in the fourth quarter of 2023. GDP growth in the fourth quarter was 5.2% compared to the previous year, which corresponds to an acceleration of 0.3 percentage points compared to the third quarter (see chart 4). While consumer demand weakened after the summer tourism season, targeted fiscal incentives for investment in infrastructure and manufacturing partially offset this and supported growth. In the property sector, however, there are no signs of a turnaround, although local incentives for the purchase of residential property have been introduced since August and there are signs of additional financing support for property developers.

We expect growth in China to accelerate in the first quarter of 2024 as government support measures take effect at the start of the year. In addition, consumption usually picks up during the Chinese New Year, which should also support growth. For 2024 as a whole, we also expect further fiscal policy support and targeted measures for the property sector, with the easing of monetary policy also playing an important role. From today's perspective, however, it is rather unlikely that the stimuli will be sufficient to accelerate growth compared to the previous year. Early indicators (e.g. purchasing managers' indices) also point to a slowdown in growth momentum, while deflationary pressure persists (see chart 4). The Chinese government has so far reacted rather hesitantly to the economic slowdown, as there are fears of renewed misallocation, e.g. in the property sector. We therefore continue to expect rather restrained fiscal policy support measures and more industry-orientated than consumption-orientated measures, which means that the risk of a debt-deflation spiral remains.

4. CHINA'S GDP GROWTH RIGHT AT THE END OF THE YEAR SOLID BUT DYNAMIC WEAK - FURTHER STIMULUS NEEDED




Note: Purchasing Managers' Indices (PMIs) are averages of official and private sector indicators.
Source: NBS of China, S&P Global, Bloomberg, UniCredit Group Investment Strategy

## FINANCIAL MARKETS: BETTER ECONOMIC DATA FAVOURS RISKY ASSETS

Following the strong rally in the fourth quarter of 2023, the performance of the various asset classes was mixed in January. Strong growth data combined with resistance from some central bankers to the dovish market outlook for rate cuts in the near future led to a less favourable environment for fixed income. In contrast, risky assets received a boost as economic data fuelled hopes of a "soft landing" in the US and no "hard landing" in the eurozone. This optimism was dampened slightly towards the end of the month when the two most important central banks, the Fed and the ECB, adopted a less dovish tone at their meetings in January.

In the US, the S&P 500 index reached a record high in mid-January as optimism over a "soft landing" continued the rally of the **"Magnificent Seven"[9]**. A series of data releases pointed to continued resilience in the US economy. After a strong start, the S&P 500 index ended the month slightly weaker as the hawkish tone of the Fed meeting towards the end of the month was met with caution by the financial markets. Nevertheless, the index achieved a remarkable performance of just under 4% in January. The EuroStoxx 50 index also recorded a positive performance of just under 3% in January, not least due to the improvement in the purchasing managers' indices.

On the bond side, the pricing in of imminent interest rate cuts in the first quarter of 2024 led to price losses for government bonds, which had to give up some of the gains of the previous year. Yields on 10-year US government bonds rose by 10 bps in January, while yields on 10-year German government bonds rose by just under 20 bps. The euro lost around 2% in value against the US dollar. Oil prices rose due to escalating tensions in the Middle East and the ongoing disruption to shipping through the Suez Canal. In particular, Brent crude rose by just under 1.5% in January. The price of gold was unable to really capitalise on its status as a safe haven due to the rise in yields, and it fell by around 2% in the same period.

[9]These include Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

# Asset Allocation – How we manage our portfolio mandate

## Staying defensive

| Asset | | Investment Universe | Investment View: Underweight | Investment View: Neutral | Investment View: Overweight |
|---|---|---|---|---|---|
| Main Asset Classes | | Global Equities | ○ | ● | ○ |
| Main Asset Classes | | Global Bonds | ○ | ○ | ● |
| Main Asset Classes | | Money Markets | ● | ○ | ○ |
| Main Asset Classes | | Alternatives | ○ | ● | ○ |
| Main Asset Classes in Detail | Equities | US | ○ | ● | ○ |
| Main Asset Classes in Detail | Equities | Europe | ○ | ● | ○ |
| Main Asset Classes in Detail | Equities | Pacific (DM[1]) | ○ | ○ | ● |
| Main Asset Classes in Detail | Equities | Emerging Markets | ○ | ● | ○ |
| Main Asset Classes in Detail | Bonds | EMU Government Bonds | ○ | ● | ○ |
| Main Asset Classes in Detail | Bonds | Non-EMU Government Bonds | ○ | ● | ○ |
| Main Asset Classes in Detail | Bonds | EUR IG Corporate Bonds | ○ | ○ | ● |
| Main Asset Classes in Detail | Bonds | HY Corporate Bonds | ● | ○ | ○ |
| Main Asset Classes in Detail | Bonds | Emerging Market Bonds (Hard Currency) | ○ | ● | ○ |
| Main Asset Classes in Detail | Bonds | Emerging Market Bonds (Local Currency) | ○ | ○ | ● |
| Main Asset Classes in Detail | Commodities | Oil | ○ | ● | ○ |
| Main Asset Classes in Detail | Commodities | Gold | ○ | ● | ○ |

[1]DM= Developed Markets (Australia, Japan, Hong Kong, New Zealand, Singapore)

## NEUTRAL GLOBAL EQUITIES

Equities are showing resilience as investors are confident that the hard landing will be avoided, and the central banks will start their easing cycle by mid-2024.

## NEUTRAL EUROPEAN EQUITIES

The economy is stagnating but so far has avoided a recession. However, the job market is solid, while falling inflation will increase real income. European equities offer good opportunities for value and quality investors.

## NEUTRAL US EQUITIES

Supported by a macro Goldilocks scenario of above trend growth and falling inflation. However, valuations are high and the megacaps concentration in the S&P500 is extreme.

## NEUTRAL EMERGING MARKET EQUITIES

We stay cautious on Chinese equities given the structural slowdown of the economy and no signs of turnaround in the property sector. However, valuations are cheap and a limited catch-up may occur in case of strengthening of the fiscal and monetary rescue packages. In Latin America, Brazil is a bright spot due to expectations of rate cuts as inflation is falling, and Mexico is a “friends-shoring” play. Overall, valuations are cheap for EM equities. Countries and sectors selectivity among EMs is strongly recommended.

## POSITIVE ON PACIFIC EQUITIES

Wage growth – with the BoJ so far remaining expansive – is a positive factor for Japan, which is emerging from a long phase of deflation. In addition, the increase in corporate profits and the reform of the Tokyo Stock Exchange are encouraging intense share buyback activity. Despite the recent performance, equities valuations are not expensive.

## POSITIVE GLOBAL BONDS

They present an attractive risk-reward profile given their current yields and the policy pivot of major central banks. In detail, we reiterate our strategic preference for “high quality bonds”, such as Euro Investment Grade corporate and government bonds.

Overweight Euro Investment Grade corporate bonds

Supported by the resilience of the economic cycle and the persistent search for yield by investors Overall, IG corporate fundamentals are expected to remain solid thanks to healthy balance sheets, better than expected earnings, strong cash balances and low leverage levels relative to long-term averages.

## NEGATIVE HIGH YIELD CORPORATE BONDS

Their spreads, especially for the lower quality bonds, do not yet fully discount the risk of a material economic slowdown. Also, the asset class is relatively less liquid.

## NEUTRAL EMU GOVERNMENT BONDS

Weak macro picture, cooling inflation and the expectation of ECB cutting rates by mid-2024, lead us to stick to our constructive view on this asset class. We also consider a gradual increase in duration, given that inflation, apart from some unfavourable base effect in the short term, is in a downtrend path.

## NEUTRAL NON-EMU GOVERNMENT BONDS

Supported by expectations of falling inflation and Fed easing by mid-2024.

## NEUTRAL ON EMERGING MARKET BONDS IN HARD CURRENCY

Interesting carry but we prefer focusing on “high quality bonds”. We stay defensive and selective, avoiding countries with high external debt and current account deficit.

## POSITIVE ON EMERGING MARKET BONDS IN LOCAL CURRENCY

Attractive carry. Supported by expectations of Fed easing by mid-2024 and US dollar weakening. In Latam, declining inflation opens the way for material easing by central banks.

## NEGATIVE ON MONEY MARKETS

Interesting yields, but we prefer to invest in fixed income asset classes such as government bonds and Euro corporate IG given expectations of Fed and ECB starting the easing cycle by mid-2024.

## NEUTRAL ALTERNATIVES

They offer portfolios de-correlation opportunities, while real assets benefit from their inflation-hedging role.

## NEUTRAL COMMODITIES

Better supply conditions as a result of the production boom in North America, as well as weak demand, are weighing on oil prices. However, prices are benefitting in the short term from geopolitical tensions in the Middle East.

## NEUTRAL GOLD

Supported by expectation of lower interest rates and a weakening USD.

## CURRENCIES

We expect a mildly weaker USD. The Fed will cut rates in 2024 and 2025 but slow growth outside the US, and other major central banks starting their easing cycles as well, will limit the downside in USD.

# How to invest

Investment ideas in the current scenario

## EQUITY INVESTMENTS

### OUR IDEA: JAPANESE EQUITIES

Japan has long been a disappointing market for global investors. Flat growth, negative interest rates, lack of attention to shareholders, and better investment opportunities elsewhere in Asia either kept foreign investors away or made Japan only a tactical play in the context of a weakening Japanese yen. However, this narrative rapidly changed in 2023 given the improvements in corporate governance and the shift from deflation to moderate inflation. As a result, the MSCI Japan rose 26% in local currency in 2023, with positive contributions from all sectors.

In December 2023, 35% of Japanese companies were selling for less than 1x Price-to-Book ratio versus 1% in the US, a reflection of poor focus on value creation. In April 2023, the Tokyo Stock Exchange (TSE) demanded such companies to present a plan to improve capital efficiency or else face delisting. In January 2024, the TSE also followed up with the announcement that it would publish a list of companies disclosing their capital improvement plans and would provide monthly updates to put pressure on corporates to reach the highest transparency. As companies still hold plenty of cash on their balance sheets, 2024 looks to be another transformational year.

The second game changer is the shift from years of chronic deflation to inflation, which finally jumped in 2023 amid a decade-long journey of fiscal and monetary policy actions to jumpstart the economy. The Bank of Japan then started its policy normalisation process by relaxing yield curve control and will likely raise interest rates from April – once a virtuous cycle of rising wages and services prices is confirmed. This new inflationary era has supported the expansion of profit margins among Japanese companies including banks, whose index gained 26% in 2023.

Those structural changes attracted 6.3 trillion yen ($43.4 billion) worth of foreign inflows in 2023, further boosted by flows leaving China. This year, foreigners will remain net buyers, while at the same time, domestic individual investors will be lured by the new Nippon Individual Savings Account (NISA), a tax-free stock investment program for individuals that aims at turning trillions of yen held in cash by households into equity investments.

We consider the extremely positive longer-term structural changes underway in Japan as the main source of Japanese corporates' above-average earnings growth, which makes the Nippon listing an appealing solution for investors looking to diversify their geographic exposure.

## BOND INVESTMENTS

### OUR IDEA: HIGH-QUALITY CORPORATE BONDS

After an extremely positive 2023, thanks to the sharp decline in rates between November and December, the outlook for the fixed income market remains attractive, especially for high-quality corporate bonds. For 2024, UniCredit Research forecasts a slight recovery in the Eurozone economy, following stagnant growth in the second half of 2023, and a significant decline in inflation. Stabilising growth, lower inflation and the expected end of the central bank rate hike cycle create an ideal environment for high-quality corporate bonds. The asset class, in terms of risk/reward ratio, continues to have an attractive profile, combining good credit fundamentals and compelling yields (e.g., as of 25/01/2024, the highly-rated Euro investment grade segment has a yield of 3.76%, with a duration of 4.45).

Overall, the fundamentals of investment grade (IG) companies will remain strong thanks to healthy balance sheets, better-than-expected earnings, positive cash balances, and low levels of leverage relative to long-term averages. In addition, the technical scenario will remain favourable. In particular, net supply is expected to remain low, thanks to companies' strong liquidity positions, limited M&A activity, and prudent financial policies pursued by companies. On the other hand, inflows into the asset class are expected to remain strong, limiting any spread widening in the coming months. Even for investors with a very low risk profile, the IG credit universe represents a good opportunity. The 1-3 year segment has a yield to maturity of 3.84% (data as of 25/01/2024) with a very low exposure to interest rate volatility (duration at 1.9).

However, for 2024 we do not expect the same returns as last year. The strategy will reward the "carry trade" rather than a further spread tightening relative to government bonds. In fact, we expect default rates to rise, albeit moderately, with the ratio expected to remain well below 4%, and looking ahead, rising interest costs will weigh on corporate balance sheets. This will be especially true for high yield bonds, the weakest segment of the market, where refinancing costs for some companies currently exceed 10%. Against this backdrop, investors should focus on selecting stocks of companies with robust balance sheets and strong fundamentals, avoiding names that will face particularly high refinancing risks.

In terms of sector allocation, we continue to be cautious, preferring defensive sectors such as telecommunications, utilities, and health care over retail, chemicals, travel and leisure, and industrial goods.

In financials, banks' fundamentals are likely to remain strong, supported by net interest income, asset quality and high asset capitalisation. Despite the gradual increase in corporate credit default rates and the growth of Non-Performing Loans in 2024, banks' profitability is likely to remain high compared to the levels recorded over the past decade.

This year the outlook for emerging market bonds is expected to improve as well. The level of returns offered by the asset class, around 8% (data as of 25/01/2024), allows for a thick "pillow" in the event of rate volatility and a possible widening of their spreads compared to US Treasuries. In addition, the asset class has historically seen positive returns once the Fed interest rates have peaked, and market expectations are for more accommodative monetary policy going forward.

Emerging market bonds have suffered a large outflow of capital over the past two years due to sharp increases in policy rates in developed countries, but the technical picture is expected to improve in the second half of the year with the expected rate cuts by the US central bank. Locally, many emerging market central banks have already started cutting rates, and further reductions are expected in 2024.

However, given the many unknowns in the current environment (geopolitical tensions, high debt level for a lot of countries, elections, etc.), issuer selection and diversification across countries and companies will be crucial to achieve a positive return at the end of the year.

## DEVELOPMENT OF SELECTED FINANCIAL MARKET INDICES

| From | **31.01.23** | 31.01.19 | 31.01.20 | 31.01.21 | 31.01.22 | 31.01.23 | 31.01.19 | **01.01.24** |
|---|---|---|---|---|---|---|---|---|
| To | **31.01.24** | 31.01.20 | 31.01.21 | 31.01.22 | 31.01.23 | 31.01.24 | 31.01.24 | **31.01.24** |
| **Stock market indices (total return. in %)** | | | | | | | | |
| **MSCI World (in USD)** | **17.6** | 18.4 | 14.6 | 17.0 | -7.0 | 17.6 | 77.4 | **1.2** |
| **MSCI Emerging Markets (in USD)** | **-2.5** | 4.2 | 27.1 | -6.9 | -11.7 | -2.5 | 8.4 | **-4.6** |
| **MSCI US (in USD)** | **21.1** | 21.9 | 17.9 | 20.9 | -9.0 | 21.1 | 96.6 | **1.6** |
| **MSCI Europe (in EUR)** | **10.9** | 18.0 | -3.4 | 22.7 | 0.5 | 10.9 | 57.8 | **1.6** |
| **MSCI AC Asia Pacific (in USD)** | **1.9** | 8.9 | 26.0 | -7.4 | -6.3 | 1.9 | 23.0 | **-1.7** |
| **STOXX Europe 600 (in EUR)** | **10.8** | 18.6 | -2.1 | 21.6 | -0.3 | 10.8 | 57.8 | **1.5** |
| **DAX 40 (Germany in EUR)** | **11.7** | 16.2 | 2.1 | 15.2 | -2.2 | 11.7 | 51.2 | **0.9** |
| **MSCI Italy (in EUR)** | **23.0** | 20.1 | -10.2 | 27.7 | 3.8 | 23.0 | 79.5 | **2.1** |
| **ATX (Austria. in EUR)** | **7.3** | 6.9 | -4.8 | 37.6 | -8.6 | 7.3 | 37.9 | **0.6** |
| **SMI (Switzerland. in CHF)** | **3.6** | 22.5 | 2.0 | 18.8 | -5.1 | 3.6 | 47.6 | **1.8** |
| **S&P 500 (USA. in USD)** | **20.8** | 21.7 | 15.2 | 23.3 | -8.2 | 20.8 | 96.8 | **1.7** |
| **Nikkei (Japan. in JPY)** | **35.6** | 14.1 | 22.7 | -0.8 | 3.5 | 35.6 | 95.1 | **8.4** |
| **CSI 300 (China. in Yuan)** | **-20.7** | 27.9 | 36.5 | -13.2 | -6.8 | -20.7 | 13.1 | **-6.3** |
| **Bond market indices (total return. in %)** | | | | | | | | |
| **US Government Bonds 10Y (in USD)** | **0.0** | 12.6 | 7.1 | -3.2 | -12.2 | 0.0 | 2.8 | **-0.3** |
| **US Government Bonds (ICE BofA. in USD)** | **1.1** | 9.2 | 4.5 | -3.1 | -8.9 | 1.1 | 2.0 | **-0.2** |
| **US Corporate Bonds (ICE BofA A-BBB. in USD)** | **4.7** | 14.8 | 6.1 | -2.8 | -9.2 | 4.7 | 13.0 | **0.2** |
| **German Bunds 10Y (in EUR)** | **3.8** | 6.4 | 1.3 | -4.4 | -17.1 | 3.8 | -11.4 | **-0.6** |
| **EUR Government Bonds 1Y-10Y (iBOXX. in EUR)** | **4.1** | 8.2 | 2.0 | -3.9 | -15.6 | 4.1 | -6.8 | **-0.6** |
| **EUR Corporate Bonds 1Y-10Y (iBOXX. in EUR)** | **6.0** | 6.4 | 1.5 | -2.3 | -11.1 | 6.0 | -0.4 | **0.1** |
| **Bond yields (change in basis points = 0.01 percentage points)** | | | | | | | | |
| **US Government Bonds 10Y (in USD)** | **42** | -112 | -46 | 69 | 175 | 42 | 125 | **8** |
| **US Government Bonds (ICE BofA. in USD)** | **27** | -107 | -86 | 90 | 228 | 27 | 149 | **2** |
| **US Corporate Bonds (ICE BofA A-BBB. in USD)** | **13** | -136 | -76 | 89 | 226 | 13 | 110 | **2** |
| **German Bunds 10Y (in EUR)** | **-12** | -58 | -11 | 52 | 227 | -12 | 200 | **13** |
| **EUR Government Bonds 1Y-10Y (iBOXX. in EUR)** | **-11** | -80 | -19 | 51 | 241 | -11 | 181 | **12** |
| **EUR Corporate Bonds 1Y-10Y (iBOXX. in EUR)** | **-40** | -94 | -13 | 61 | 294 | -40 | 205 | **5** |
| **Spreads on government bonds (credit spreads. change in basis points)** | | | | | | | | |
| **US Corporate Bonds (ICE BofA US Corporate Master)** | **-23** | -29 | -4 | 8 | 15 | -23 | -37 | **-2** |
| **US Corporate Bonds (ICE BofA US High Yield)** | **-71** | -34 | -16 | -16 | 67 | -71 | -77 | **25** |
| **Euro Corporate bonds (ICE BofA Euro Corporate AAA-A)** | **-12** | -32 | 0 | 15 | 34 | -12 | 2 | **-4** |
| **Euro Corporate Bonds (ICE BofA Euro High Yield)** | **-56** | -114 | 7 | 24 | 74 | -56 | -71 | **-10** |
| **Money market rates (change in basis points)** | | | | | | | | |
| **Libor (USD. 3 months)** | **76** | -99 | -156 | 11 | 450 | 76 | 284 | **-2** |
| **Euribor (EUR. 3 months)** | **139** | -9 | -15 | 0 | 306 | 139 | 421 | **0** |
| **Euro exchange rates (change in %)** | | | | | | | | |
| **US Dollar (EUR-USD)** | **0.0** | -3.8 | 10.0 | -8.1 | -2.9 | 0.0 | -5.2 | **-1.9** |
| **British Pound (EUR-GBP)** | **-3.0** | -3.9 | 5.0 | -5.9 | 5.9 | -3.0 | -2.2 | **-1.7** |
| **Swiss Franc (EUR-SFR)** | **-6.8** | -6.3 | 1.0 | -3.6 | -3.6 | -6.8 | -18.0 | **1.0** |
| **Japanese Yen (EUR-JPY)** | **13.4** | -3.6 | 5.9 | 1.4 | 9.7 | 13.4 | 28.1 | **2.5** |
| **Commodities (change in %)** | | | | | | | | |
| **Commodity Index (GSCI. in USD)** | **5.7** | 19.0 | 13.3 | -3.6 | 7.3 | 5.7 | 48.5 | **-0.7** |
| **Industrial metals (GSCI. in USD)** | **-15.2** | -10.3 | 27.3 | 33.3 | -4.1 | -15.2 | 24.4 | **-1.6** |
| **Gold (in USD per fine ounce)** | **6.2** | 20.0 | 17.4 | -3.3 | 7.3 | 6.2 | 56.2 | **-0.8** |
| **Crude oil (Brent. in USD per barrel)** | **-3.7** | -6.5 | -4.8 | 63.3 | -6.9 | -3.7 | 31.5 | **5.5** |

Please note: Past values and forecasts are not a reliable indicator of future performance. Indices cannot be purchased and therefore do not include costs. When investing in securities, costs are incurred which reduce the performance. The return on investments in foreign currencies may also rise or fall as a result of currency fluctuations. So-called synthetic bonds are calculated to reflect the performance of government bonds in a fixed maturity range. In each case, the most “suitable” real federal bond at the relevant time is used as a reference for the yield opportunity of the synthetic bond. The development of the expected yield to maturity is shown under the following conditions: servicing of interest payments and redemption in accordance with the terms and conditions and holding until maturity. In this respect, it is a yield opportunity. The yield opportunities reflect the different risk assessments of the investors for the respective products or countries (higher yield opportunity=higher risk assessment). The synthetic bonds cannot be purchased and therefore do not include any costs. In the case of currencies and commodities, acquisition and/or custody costs incurred are not included. Source: Refinitiv Datastream. Data as at 31.01.2024.

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