GENERALI INVESTMENTS

Market Compass

September 2022

MARKET OUTLOOK

- Hawkish speeches at Jackson Hole have poured cold water on nascent hopes that policy setters may blink soon and slow or stop rate rises amid rising recession risks.
- Equity valuations and (thus far resilient) earnings will face stiffer headwinds into winter, with a recession in Europe looming amid an energy crunch and higher rates.
- Investor positioning remains very bearish, leaving scope for selective bounces. Yet we still favour an underweight in riskier assets. The strong demand for the stretched USD is unlikely to reverse soon.

Edited by

MACRO & MARKET RESEARCH TEAM

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

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

US

- (+) Consumption remains resilient, confidence bolstered by lower energy prices
- (−) … but tighter monetary policy may lead to a recession in H1 2023 (50% probability)
- (−) Falling oil prices dragged down inflation, but the core rate remains well above the target
- (−) The Fed is set to raise rates to 3.5% by year-end, and will not cut before 2024

UK

- (−) Increase in energy price cap to push inflation further up
- (−) Manufacturing PMI slumped, stagflation underway
- (−) BoE to hike Bank Rate further

EUROZONE

- (−) Key sentiment indicators heralding recession
- (−) Aug. inflation at a new record high of 9.1%
- (−) Hawkish ECB set to continue hiking rates
- (+) Labour market remains strong and governments are taking measures to cushion inflation fallout, only shallow recession expected

CHINA

- (−) China's recovery saw setbacks, Corona lockdowns rising
- (−) Real estate sector is weak. More public support needed
- (+) PBoC cut rates, fresh policy package announced

EMERGING MARKETS

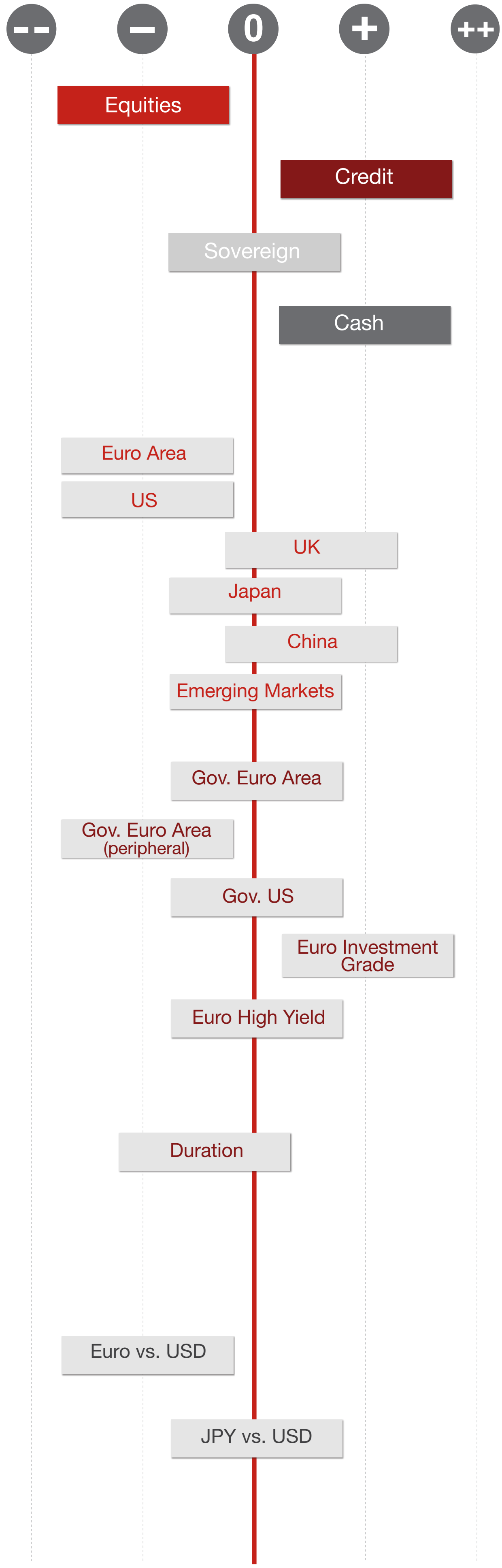
- (−) EM debt rallied but it should be short-lived
- (!) EM inflation eased but still stands at high level
- (−) Central banks turned less hawkish, focusing more on growth

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

Your Partner for Progress.

DIRECTION OF TRAVEL

- Keep underweight (UW) in Equity and Euro area peripheral bonds
- Maintain overweight (OW) in Credit, slight preference for Financials. UW in High Yield
- Neutral in core sovereigns, prefer US Treasuries
- Strong Cash OW



Equities

- We stay UW on equities but still expect slightly positive total returns in 12 months.
- Within countries, we are slight OW China, we prefer UK vs. EMU, neutral on Japan. We remain neutral on EMs.

Bonds

- EA core yields have more leeway to rise amid hawkish ECB and rather low real yields. Peak in US yields is getting closer.
- Political risks in Italy and weakening growth in combination with higher core yields do not bode well for EA non-core spreads. Prepare for some further widening.

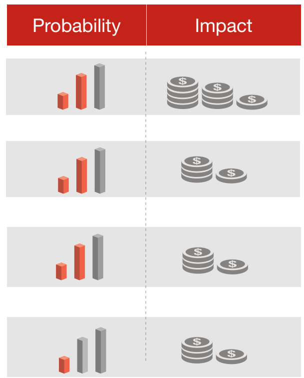
Duration

- Moderately short duration.

Currencies

- Even after hitting fresh records, USD strength has scope to extend somewhat further, boosted by the global slowdown and the European energy crunch in particular.
- Monetary policy divergence burdens the JPY. But given already very cheap valuations, risks of a rebound are rising.

TOPICS TO WATCH



- Severe gas supply disruptions trigger recession in Europe
- Persistent inflation and fast policy tightening hurt risk appetite & trigger sharp slowdown
- Geopolitical tensions around Taiwan add to geopolitical risks
- New Covid-19 variant trigger shutdowns (milder in advanced economies than in EMs)

Probability: High ⟷ Low

Impact: High ⟷ Low

GLOSSARY

Stagflation

Stagflation refers to a simultaneous strong increase in inflation and declining/slowly growing economic output and possibly rising unemployment.

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