GENERALI INVESTMENTS

Market Compass

July 2022

MARKET OUTLOOK

- Central banks are on a mission to fight inflation – whatever it takes, even a recession. The financial mood will remain gloomy this summer as economic data deteriorates while central banks walk their hawkish talk.
- We expect the Fed to turn less aggressive this autumn, as it faces a deterioration of the economy and, eventually, employment data. Inflation headlines will also cool off by then.
- The ECB's political and legal capacity to reallocate its huge balance sheet to fight fragmentation will be put to test.
- We confirm our view, with an underweight in equities and an overweight in high-quality credit. Increase cash over summer, whilst reducing the shorts in core Govies.

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

- ⊕ Orders remain resilient…
- ⊖ … but consumer and business moods continue to worsen
- ⊖ Inflation surprised to the upside in May
- ! The Fed is set to raise rates to 3.1% by year-end, increasing the risk of a recession

UK

- ⊖ BoE raised key rate to 1.25%, more to come
- ⊖ Inflation surging to 9.1% yoy, highest among G7
- ⊖ Consumer confidence at record low and retail sales weakening

EUROZONE

- ⊖ High inflation pressure to trigger front-loaded rate hikes
- ⊖ ECB announced rate hikes for July and Sept.
- ⊖ Consumer confidence in recessionary territory
- ⊕ Labour market remains strong and governments are taking measures to cushion inflation fallout

CHINA

- ⊖ Q2 GDP growth likely to drop to around 1% yoy...
- ⊕ … but PMIs turned into expansionary territory
- ⊕ Policy to support bumpy recovery in H2

EMERGING MARKETS

- ⊖ EM assets performance stabilised but still numerous risks
- ! EM inflation does not ease. Further central bank tightening expected
- ⊖ Rising food prices hurt the weakest EM countries (Sri Lanka)
- ! Russia even closer to a technical external debt default but this would not be a source of systemic risk

⊕ Positive
⊖ Negative
! Topics to watch

Your Partner for Progress.

DIRECTION OF TRAVEL

- Strong underweight (UW) in equity
- Increase overweight (OW) in credit, focus on IG and defensive sectors
- Shift to UW in high yield
- Trim UW in Euro area core sovereign bonds, increase that on periphery; small OW on treasuries
- Increase Cash OW

Equities

- Equities remain under pressure.
- As Central banks stay quite hawkish, the risk of a marked economic slowdown increases, and markets have yet to discount a hard landing.
- For the short term, we increase the UW equity position. We are slight OW China, US and UK; UW EMU, Switzerland and Ex China EMs; neutral on Japan.

Bonds

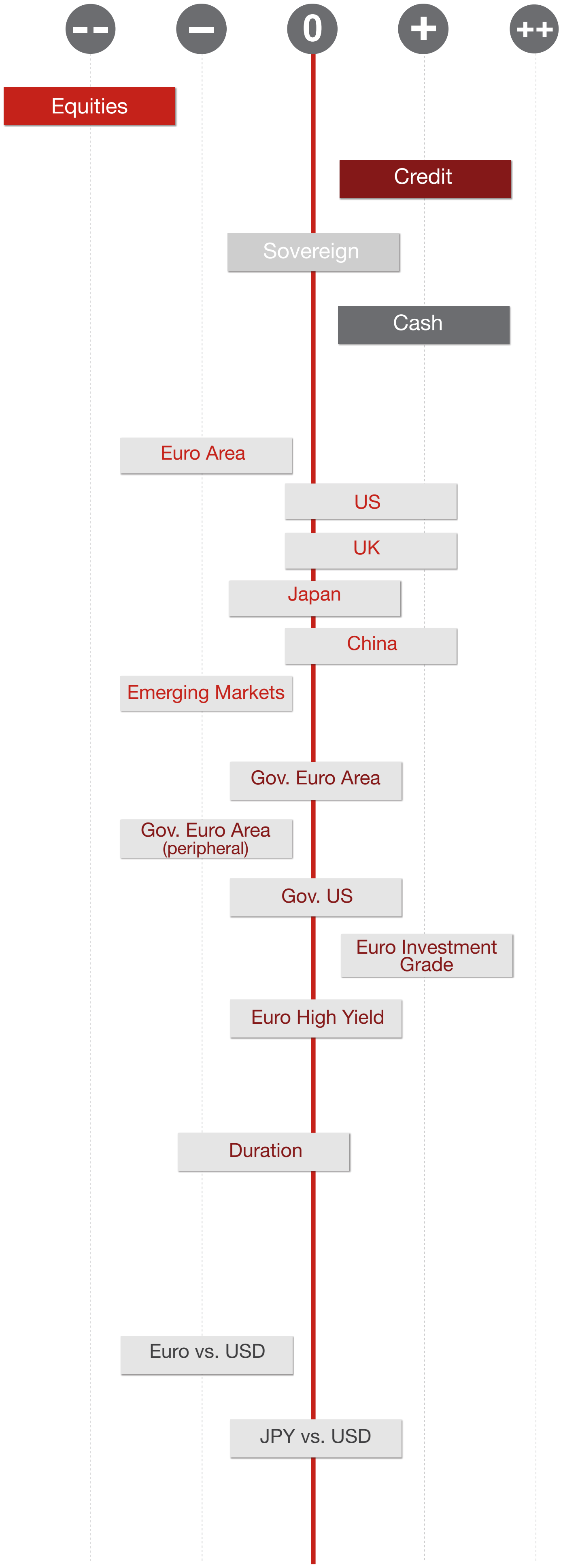
- Yield increase has not run its course as central banks continue to hike and inflation remains elevated. Sell-off to lose momentum though.
- Amid elevated expectations regarding the forthcoming ECB's anti-fragmentation tool and a challenging environment we see leeway for peripheral spreads to widen.

Duration

- Moderately short duration.

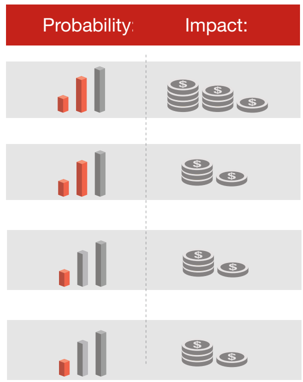
Currencies

- Geopolitical/policy uncertainties to continue to support the USD near term; looming stagnation and higher EMU spreads weigh on EUR.
- Yet, USD is broadly overvalued. If and when tensions in Ukraine ease, EUR/USD has scope to bounce back.
- JPY to remain burdened by monetary policy divergence near term as the BoJ bucks the global trend of policy normalization.



TOPICS TO WATCH

- Military escalation and severe gas supply disruptions in Europe; or surprise diplomatic shift
- Higher inflation and fast policy tightening hurt risk appetite and trigger a sharp slowdown
- Mutations challenging vaccine effectiveness and requiring new shutdowns
- Geopolitical tensions (China/Taiwan, Iran, N. Korea) add to risks around Ukraine



Probability: High ⟷ Low

Impact: High ⟷ Low

GLOSSARY

Purchasing Managers' Index (PMI)

The Purchasing Managers' Index (PMI) is an index that provides information about current and future business conditions. It consists of an index that summarizes whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting. Normally a reading below 50 indicates that activity is likely to contract over the following 3 months.

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