Markets focused on **positive growth** and Fed rate cuts

- **Benign PCE inflation fuels animal spirits as investors see forthcoming Fed cuts**
- **Macro data still points to US exceptionalism amidst broadening of global recovery**
- **Rally in commodities highlights bumpy road to 2% inflation goal**

The drivers for further economic expansion and disinflation are still in place, even as the Fed is expected to go ahead with rate cuts, alongside the major DM central banks waiting to ease policy. The impression is that growth remains above trend in the United States, while also picking up globally, spurring a broadening of the rally within equities and across geographies.

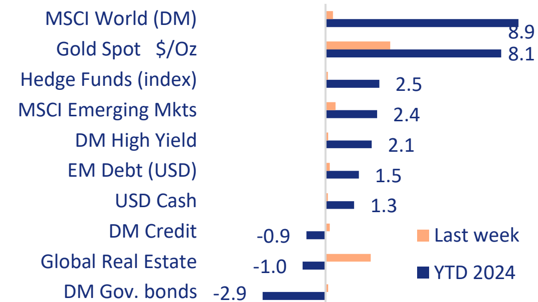
Last week, the PCE inflation release was in line with expectations, with the headlined at 2.5% suggesting that the Fed's 2% goal could soon be in sight. Consumer confidence reached a 3-year high, and inflation expectations moderated. This favourable mix of growth and abating price pressures supports the notion that the Fed will be soon cutting rates, as highlighted by 2-year Treasury yields inflecting lower, usually leading the Fed funds rate by a few months. And this morning the China Caixin PMI confirmed the positive message of an expanding manufacturing sector delivered by the official PMI release on Sunday.

Commodities are rallying with other growth-sensitive assets, and although at some point challenges could emerge to the disinflation narrative, for now investors have reason to focus on the outlook for easier policy and its positive implications.

The highlight of the current week will be the payrolls report on Friday, providing cues about the outlook for the US job market. Also, many Fed officials will be speaking, with Powell scheduled on Wednesday, and the ECB minutes will be released on Thursday, rounding out the picture on monetary policy.

Have a great week.

ASSET CLASSES USD % TOT.RETURN, 2024 & LAST WEEK



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Cross-asset Update

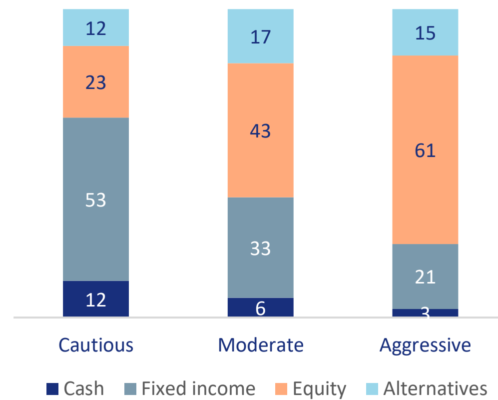
The PCE inflation release, that printed in line with expectations and according to the Fed better represents price pressures, relieved investor anxiety stoked by the previous CPI report that showed higher headline and core numbers. Monetary policy has reached peak tightening and is now restrictive, if one considers that the Fed funds rate is above 5% and the PCE below 3%. With historically high rates and the disinflation process carrying on, investor attention is now firmly focused on rate cuts. The first one is given over 60% probability for June according to money market funds, even as the economy remains resilient. And the prospect for easier policy and an expanding business cycle will keep stocks going. The rally is broadening to the more cyclical sectors as recessionary risks have been dispelled, with energy and real estate leading and small caps outperforming last week, the latter picking up on the persistently strong macro signals and pointing to some fatigue in IT megacaps.

The outlook is brightening in Europe and China as well. In the eurozone business and investor surveys indicate an improvement of future versus current conditions, pointing to a mild recovery in the offing. And in China manufacturing is finally in expansion territory and services are accelerating. Beijing is expected to further add to fiscal stimulus, that should eventually put the economy on a more solid footing.

The rally in risk assets is predicated on the so-called immaculate disinflation carrying on, till price pressures reach the 2% Fed's target. The major DM central banks, with the exception of the BOJ, are in wait and see mode ready to switch to an easier policy stance. Yet, the last mile to the 2% goal, given somewhat for granted, is far from being that easy to achieve. Commodities are rearing their head again, with copper and oil, the key basic materials most sensitive to growth, up for the year. Historically, commodities have rallied when central banks cut rates, bolstering the case for a positive view into year-end. Gold is accelerating in record-high territory, and more often than not leads the way in the commodity complex. The United States may not be able to import that much disinflation from China anymore, now that the CPI has emerged from negative territory and efforts to reflate the broader economy are starting to bear their fruit. And the recovering US manufacturing sector, with China joining in as per Friday's data, will no longer be able to contribute via goods disinflation to the lowering of price pressures. Overall, the immaculate process will be hitting snags on the way eventually with a repricing across asset classes.

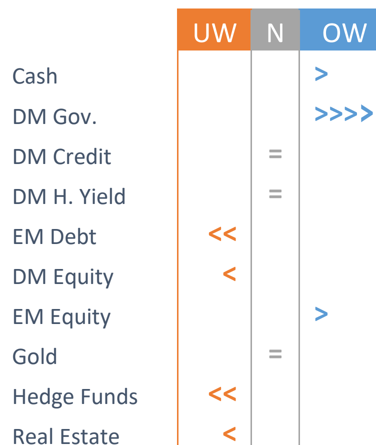
If growth fails to remain more than resilient, the current constructive scenario could turn into a stagflationary one. A hedge against such risk is represented by defensive stocks and stocks that act as commodity proxies in the materials and energy sectors, as well as by gold, and Treasury inflation-protected securities, or TIPS.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



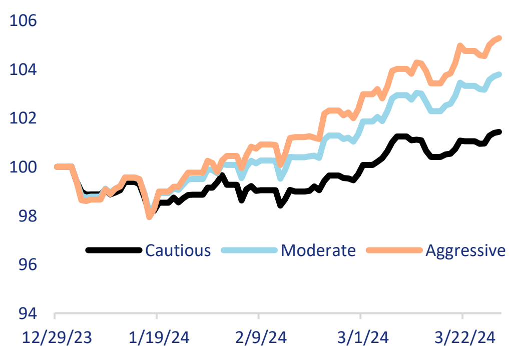
TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW: Underweight/Neutral/Overweight



	UW	N	OW
Cash			>
DM Gov.			>>>>
DM Credit		=	
DM H. Yield		=	
EM Debt	<<		
DM Equity	<		
EM Equity			>
Gold		=	
Hedge Funds	<<		
Real Estate	<		

TAA – 2024 INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

The first quarter of the year is behind us. The year began with very high conviction from analysts on early rate cuts from the Fed. However, strong growth and inflation data combined with hawkish Fedspeak has pushed rate cut expectations back. The market now expects a mere three rate cuts by the end of the year in line with the Fed Dot Plots. Last Friday, Chair Powell said the central bank's preferred inflation gauge was "pretty much in line with our expectations." He also added that lowering rates wouldn't be appropriate until officials are sure inflation is in check. A host of Fed members are set to speak this week, with Powell being the most important one on Wednesday. The lineup includes Lorie Logan, Mary Daly, and John Williams.

The global economy is precariously perched between slowing growth outside the US and stubborn inflation. The US Treasury yield curve has bear-flattened this year, with the long-end increasing by around 30 bps. The belly of the curve has been the best performer. As a result, most of the bond indices have generated negative returns so far, with a couple of exceptions. High Yield tops the returns chart with a +2.1% gain, followed by Emerging Markets at +1.5%. Our call for a bar-bell approach should have provided resilience in the face of yields ticking up.

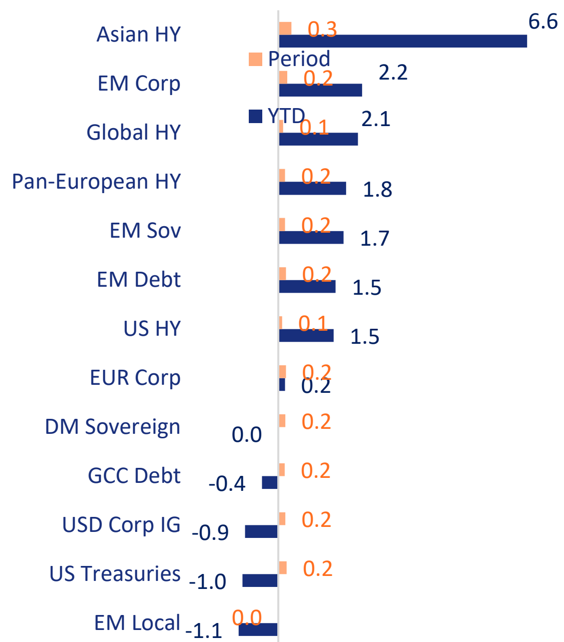
This week has a critical data dossier. Friday's March Payroll report may show healthy US employment gains likely continued in March while wage growth moderated. Economists expect NFPs to be +200k while average hourly earnings climb to 4.1% yoy. Economists expect unemployment to come down to 3.8% after it hit a two-year high in February. On Tuesday, we have the JOLTS data, which may show that vacancies remain above their pre-pandemic level. Apart from this, we have the US ISM Manufacturing today. US ISM services come out on Wednesday, and factory orders are due on Tuesday. German inflation on Tuesday is anticipated to show further weakening toward the 2% target. The European Central Bank will unveil its survey of consumer expectations the same day. The euro-zone inflation number will be published on Wednesday. Outcomes anticipated by economists at 2.5% cement the belief that the ECB will be one of the early central banks to cut rates.

Spreads have been tight across IG and HY. Despite delayed expectations of rate cuts, strong activity data and demand technical present a favourable scenario for the spreads. Focusing on HY segment we see an increase in secured bond issuances. A recent GS report has highlighted that Secured bonds now contribute 32% to the $ HY universe. Issuers have been employing this strategy of refinancing unsecured borrowing with secured debt to keep their funding costs in check. The report highlights that on average issuers pay 70 bps less for secured debt. The rise of such debt and high proportion of BB+ gives resiliency to the HY segment.

FIXED INCOME KEY CONVICTIONS (2024)

DEVELOPED MARKETS
Overall overweight DM FI
OW Government Bonds
Neutral corporate (IG & HY)
EMERGING MARKETS
Overall UW EM Debt
Favor quality and selectivity

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

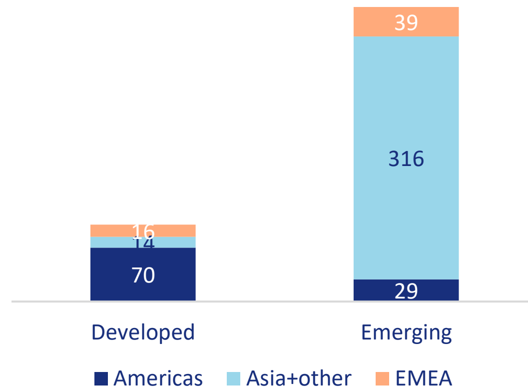
A great Q1 for most markets with the MSCI All Country World Index up 8.2%, and all major regions barring China positive. We remain overweight Japan and India and select tech and healthcare within sectors. Would add to energy stocks globally as oil (Brent) remains well above $80. US big tech exceptionalism remained a key driving factor for US markets, which gained c.10% in Q1 and not even the lowered expectation of fewer cuts (three now expected by the Fed into year end, though this has been our house view for some time), with higher 2 and 10 year Treasury yields, dented the market rally. The S&P 500 has made 22 new highs so far this year. Leading Developed market returns is Japan +11% in USD with local indices +17% in Q1, the change in yield curve control did not shake the rally and the Yen continues to hover around 150 to the USD, good for exporters. Europe lagging the US and Japan but not far behind and banks there have seen a rally. FY1 Price to Earnings consensus estimates are not far from 5-year averages in developed markets so valuations look high on trailing but not forward metrics. Whilst the tech sector leads returns with the AI theme well entrenched, boosting markets broadly is monetary easing and resilient economic growth.

Emerging markets are trailing developed market returns at +2.4% in Q1. India is leading and while it does look expensive, both economic +7% GDP and corporate profit +15-20% (3-year CAGR growth) continues to be the highest amongst major regions. A ROE-focused corporate sector. With 10-12% USD CAGR returns over the last 20 years; India is now the 5th largest equity market with market cap estimated to reach US$10trn by 2030. Continued reforms should maintain India's fastest growing large economy status. Strong trend in domestic flows have reduced market volatility. Within the GCC, the UAE has the Dubai Index outperforming for a second year and we await more IPO issuance from the private and public sector. In the last 3 years 20 companies have listed with average gains from listing of 38%.

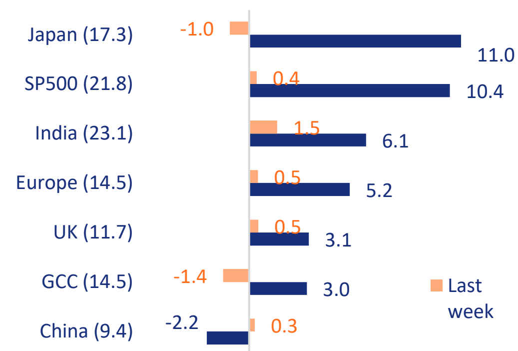
US S&P 500 profit growth accelerated in Q3 and Q4 led by domestic consumption. Manufacturing profits, a highly pro-cyclical sector, grew by 5.0% q/q. The manufacturing industry was the largest contributor to Q4 GDP growth. These results are consistent with strong US economic momentum powered by resilient consumer spending, and a US-led improvement in global manufacturing activity. We expect this momentum to continue into first half 2024. However, the pandemic-era excess savings are dwindling, lending standards to consumers are tight and a softening labor market could lead to decelerating wage growth.

Coming to tech, the magnificent 7 are +17% YTD (Apple and Tesla are down YTD), double the performance of global equities. Nvidia is responsible for 20% of global equity gains in Q1 with other semi stocks also up but not comparable to the 240% gain last year and 80% this year for Nvidia. Other semis have rallied including AMD and Micron and data Centre costs are reducing with the higher end computing power being provided by the newer generation of chips. Quality important and to watch are companies with high profit growth and sustainable innovative business models. Recommend not investing blindly in everything AI related.

EQUITY RECOMMENDED REGIONAL POSITIONING

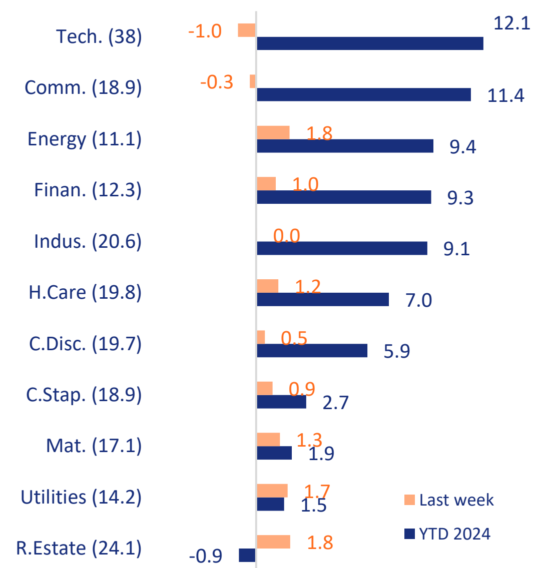


MAJOR INDICES PERFORMANCE (TR, US$) AND P/E



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND P/E



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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