The Eagle and the Dragon

Unravelling the complexities behind the US-China trade dispute

Group Investment Strategy

Monthly Outlook

July 2024

UniCredit

Index

Summary

MACRO CONTEXT

The US economy is losing steam, slowed down by the Federal Reserve's (Fed) restrictive monetary policy. GDP growth was revised downwards in the first quarter of the year, marking the weakest level in recent times. However, the labour market remains robust, with employment growth exceeding expectations and an unemployment rate that has remained steadily low for several months. Leading economic indicators show a mixed picture: the manufacturing sector continues to contract, while the service sector has shown signs of recovery, raising hopes of a moderate economic slowdown. The pace of growth in consumer prices continues to remain above 3%, but core inflation, which excludes fluctuations in energy and food prices, is slowing – suggesting a structural slowdown in inflation. Finally, regarding international trade, geopolitical tensions between the US and China increased again this month when the US Trade Representative submitted a formal proposal for tariffs on a range of Chinese imports, including solar panels, electric vehicles and lithium batteries.

CENTRAL BANKS

In June, the Fed kept interest rates unchanged, but revised upwards its inflation forecasts for this year and next. Expectations of rate cuts were postponed, with only one cut expected this year instead of the three previously planned. During a press conference, Fed Chairman Powell did not give a clear indication on the timing of future rate cuts. Meanwhile, the European Central Bank (ECB) cut interest rates for the first time in almost five years, but adopted a cautious approach, without specifying the timing for further reductions. ECB President Lagarde emphasised greater confidence in reducing inflation towards the 2% target over the medium term. Markets are closely watching the ECB meetings scheduled for September and December for any further rate cuts.

FINANCIAL MARKETS

Equity markets got off to a positive start in May, but declined slightly towards the end of the month due to fluctuations in interest rate expectations. The first half of June was characterised by the ECB and Fed meetings and encouraging inflation data in the US, giving US markets a boost. On the other hand, European equities suffered declines due to the outcome of the Euro Parliamentary elections and the resulting political uncertainties, especially in France. In bond markets, US government bond yields fell significantly. German rates followed a similar trend, while fears of political instability in France drove up the spread of French bonds and those of other countries with high public debt in the Eurozone. Corporate spreads also widened moderately. At the beginning of June, the price of oil fell to its lowest level in months, only to rise again slightly. Meanwhile, the price of gold fluctuated around relatively stable levels, while the euro-dollar exchange rate initially rose in May before falling again in the first half of June.

CIO's Letter

The capital markets' reaction to the European Parliament election and the announcement of new elections in France once again illustrates how nervous investors are currently about political developments. The already impressive election calendar for the year **2024**[1] – some elections such as in India and the European elections being already behind us – is now joined by two further election dates: the parliamentary elections in France and the UK. Meanwhile, the most important election for markets, the US election, is due to take place in November (we reported on this in previous issues).

[1]In the February issue of our publication, we reported on the 2024 super election year.

Although the interest of market participants in such events is understandable, as it reflects concerns about political stability in particular, other important factors influencing market developments should not be ignored: inflation is continuing to normalise and the European Central Bank (ECB) lowered interest rates for the first time in a long time at the beginning of June. The economy and corporate profits are picking up and Europe is slowly working its way out of the weakness of the last quarters.

Let's first take a closer look at a few key data points. Since the fourth quarter of 2022, economic growth in the eurozone has hovered around zero. However, the first quarter of this year now shows growth of **0.3% on a quarterly basis**[2]. It was also characterised by positive momentum in Germany, whose economic output has even declined in some quarters since the outbreak of the war in Ukraine. The period of economic weakness appears to be over. This is also indicated by the important **ifo Index**[3]. The expectations component of the index, which is important for capital markets, has recently risen for the fourth time in a row. German companies are therefore more optimistic about the future. This now also applies to the industrial and construction sectors, which have been badly hit in recent quarters and are now also showing signs of improvement. The president of the Ifo Institute, Clemens Fuest, commented on the latest publication as follows: "It can be said that overall, the German economy is gradually working its way out of the crisis. We don't have a strong upturn, but at least things are slowly moving in the right direction."

[2]This corresponds to annualised growth of around 1.2%.

[3]The ifo Business Climate Index is a soft leading indicator for economic development in Germany compiled monthly by the ifo Institute.

The improvement in market sentiment is also reflected in growth expectations and the outlook for earnings growth for European and US equities. For the US economy, the **consensus**[4] of economists expects growth of 2.4% in 2024, followed by average growth of just under 2% in 2025-26. Growth expectations for the eurozone are significantly lower this year, at 0.7%, but are expected to reach just under 1.5% in 2025 and 2026. In addition, growth expectations for 2024 are currently undergoing positive revisions, meaning that consensus expectations are gradually brightening. For Europe, this means that growth should accelerate in the coming years, albeit from a noticeably lower level than, for example, in the US.

[4]The consensus estimate is the median in the distribution of the individual estimates. The median is the value that lies exactly in the centre of a data series ordered by size. It 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 situation is similar for profit expectations for listed companies. The expectation is that corporate profits in Europe will accelerate in the years to come, after stagnating profits in 2023 and (presumably) 2024. Consensus estimates see earnings growth of 8% for the MSCI Europe in the next two years. The earnings growth rate for the US is even likely to be in double digits. German companies occupy an interesting position because the profits of German listed companies are likely to trend sideways on average in 2024. In the following years 2025 and 2026, however, the consensus estimate sees growth in line with that of US companies. A strong signal that suggests that the weak phase could be behind us.

In this positive "triad" – inflation is normalising, interest rates are coming down (further) and growth remains robust (US) or is picking up (eurozone) – there are, however, some details that investors need to consider. On the one hand, it seems very likely that the central banks will cut interest rates (further), but at least in the eurozone it looks as if the impact of these rate cuts on long-term yield levels has already been largely reflected. For 10-year German government bonds, which are generally regarded as a "safe haven" in the eurozone, consensus expectations point to only a slight decline in yields until 2025. Investors should therefore not expect large price gains in the "safe haven" assets in the base scenario. However, bonds with a yield level above the ECB's inflation target (of 2%) generally offer a positive real return. In the case of US treasuries, on the other hand, investors can even expect price gains in the event that the Federal Reserve (Fed) cuts interest rates. However, there is still a risk that the Fed could start its easing cycle later and that the scope of interest rate cuts could be less extensive than expected.

The elections in France have now added another risk factor. The background to these concerns is that, in the past, the Rassemblement National, Marine Le Pen's party, has made economic policy demands for tax cuts and additional spending that are not counter-financed and would therefore widen the budget deficit. In autumn 2022, the then British Prime Minister Liz Truss attempted to stimulate the British economy with a budget with a large deficit. The markets reacted drastically: the pound sterling lost value and interest rates rose massively as investors panicked and tried to sell British government bonds. The episode was reminiscent of the sovereign debt crisis in the eurozone and could only be brought under control by the intervention of the British central bank through a bond-buying programme. As a result, Liz Truss had to resign and was replaced by Rishi Sunak. The global financial markets will therefore reflect both the election result in France and a corresponding government programme of the new French government. It should be noted that similar concerns spread across markets before the last change of government in Italy, but these did not materialise. Georgia Meloni's government is generally seen as constructive in terms of European and economic policy issues. Since her election victory in autumn 2022, the Italian stock market (as measured by the MSCI Italy) has risen by more than 50% (see table on page 19).

A look at the economic environment and consensus estimates shows that the current base scenario, which is priced into markets, is almost a "best-of-all-worlds" scenario for multi-asset portfolios (i.e. mixed portfolios of equities and bonds). So to say "the capital market temperature" appears to be neither too cold nor too warm – if growth were too high (i.e. the "capital market temperature" too warm), inflation would also rise which would lead to rising interest rates and putting pressure on the bond side. On the other hand, if growth was too low (i.e. the "capital market temperature" too cold), interest rates would fall, but the corporate profits would come under pressure, which in turn would fall, but corporate profits would come under pressure, which in turn would weigh on equities. The outlook for the "capital market weather" therefore appears to be well-tempered in addition to some "clouds" or in other words some risks that might come from the elections in France and the US. At present, it is difficult to assess whether they will "pass by", bring just "a shower of rain", or perhaps "a solid thunderstorm". Despite these risks, we remain confident and are looking forward to a summer-like environment for capital markets.

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In Focus

High-tech goods from China on the rise despite trade barriers

Geopolitical tensions between the US and China have recently increased once again. In mid-May, the US Trade Representative submitted a formal proposal for tariffs on a range of Chinese imports under **Section 301 of the US Trade Act**[5]. The proposal follows an earlier directive from US President Joe Biden (see **here**[6]) and the conclusion of a four-year review of tariffs imposed by the Trump administration (see **here**[7] for the report). The proposed changes include additional and new tariffs on 14 sectors affecting USD18 billion worth of Chinese imports, while existing tariffs remain unchanged. In particular, tariffs on the so-called “new trio” of imported solar panels, electric vehicles and lithium batteries will be increased from 25% (solar panels), 25% (electric vehicles) and 7,5% (lithium batteries) respectively to 50%, 100% and 25%, respectively. The additional tariffs are to come into force within two years – over the period from August 2024 to 2026.

US TARIFFS ON “NEW TRIO” LIKELY TO HAVE ONLY LIMITED IMPACT ON CHINESE ECONOMIC ACTIVITY

The “new trio” includes, in particular, exports that the Chinese government wants to drive forward as part of its growth strategy and focus on high-quality production stages. This industrial vision is a continuation of China’s “Made in China 2025” plan, which has resulted in high-tech exports from the “new trio” increasing significantly in recent years (see chart 1). Despite all the rhetoric, we believe that the impact of these new tariffs on Chinese trade and the country’s growth will be rather limited. In our view, the tariffs are (so far) primarily symbolic, as the volume of affected goods only accounts for around 4% of China’s total exports (based on monthly trade data, see chart 1), and most of the affected goods are already subject to tariffs.

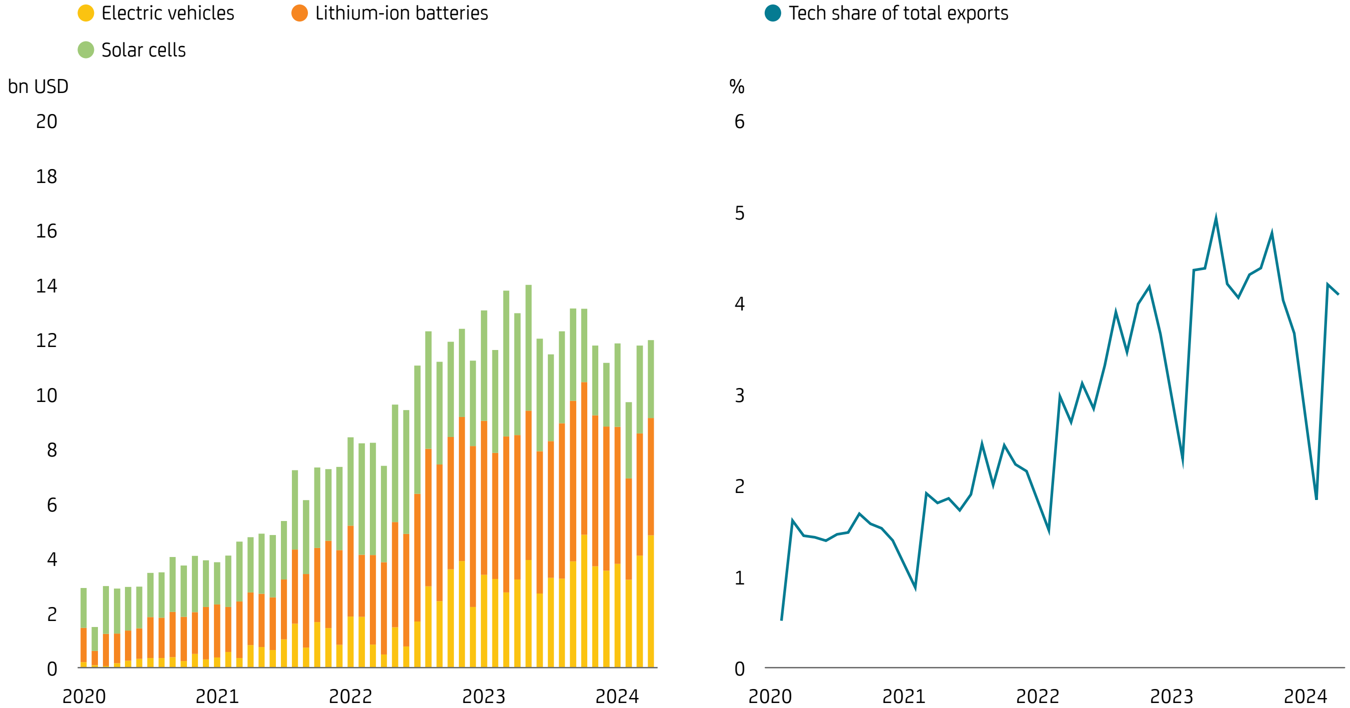
In addition to the US, the EU has now also announced that it will impose higher provisional tariffs of just under 40% on the imports of electric vehicles from China. For example, the manufacturers BYD and Geely are to be hit with additional tariffs of around 17% and 20%, respectively. They came into force in June and will be levied in addition to the existing duties. However, in view of the increased importance of trade in electric vehicles between the EU and China, this measure (compared to the measures taken by the US government) can be categorised as rather moderate. In addition, the EU Commission has left open the option of suspending the tariffs if both trading partners agree on an alternative regulation before the tariffs come into force. In particular, the German car manufacturers are threatened by the potential retaliatory measures from the Chinese government, which is why Germany has already rejected the EU tariffs. We expect to see China respond with proportionate rather than escalating measures.

[5] Section 301 authorises the US President to take all appropriate measures to address unfair acts, policies or practices of a foreign government that adversely affect US commerce.

[6] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2024/may/us-trade-representative-katherine-tai-take-further-action-china-tariffs-after-releasing-statutory

[7] https://ustr.gov/sites/default/files/05.14.2024%20Four%20Year%20Review%20of%20China%20Tech%20Transfer%20Section%20301%20(Final).pdf

1. HIGH-TECH EXPORTS ("NEW TRIO") UP SIGNIFICANTLY, BUT LOW SHARE OF TOTAL EXPORTS



Source: China General Administration of Customs, Macrobond, UniCredit Group Investment Strategy

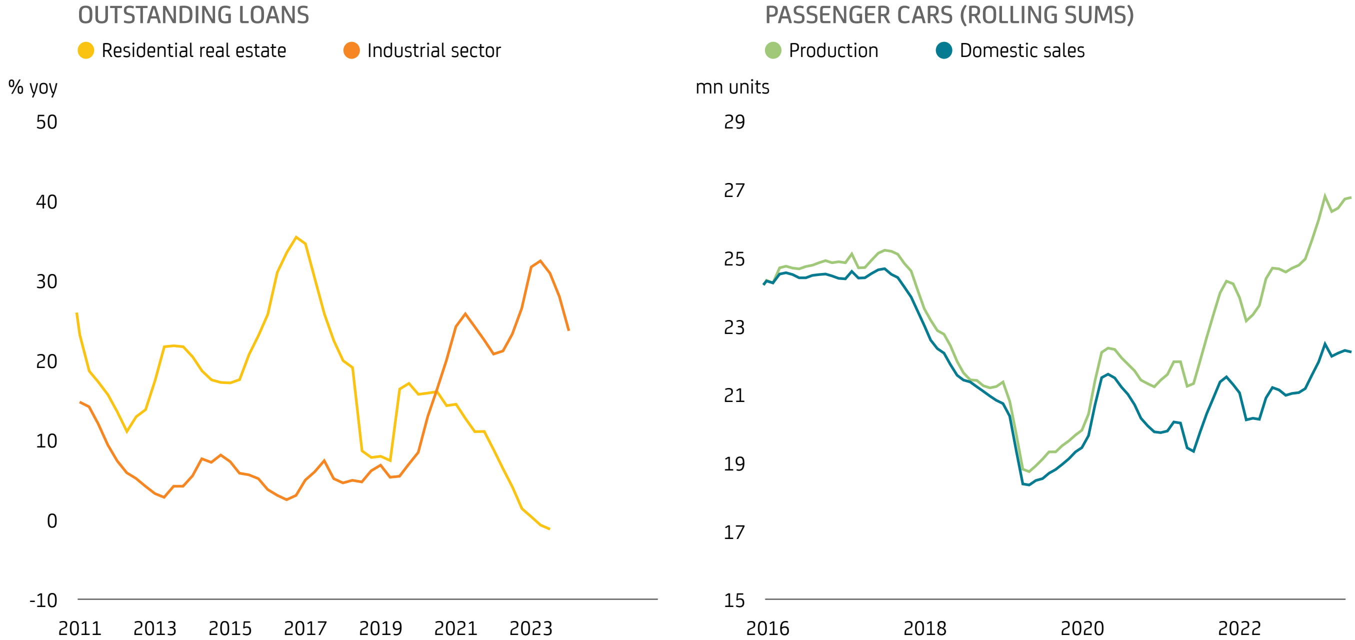
GROWING CONCERN ABOUT POLITICAL INFLUENCE ON IMPORTANT HIGH-TECH GOODS

The introduction of tariffs on Chinese imports on both sides of the Atlantic is a response to growing concerns that China is deliberately creating growing imbalances between supply and demand in key industrial sectors in order to secure competitive advantages in the global market. One possible explanation, in line with the Section 301, is that generous industrial policies have led to over-investment in the strategic sectors (such as the "new trio" of high-tech goods). The resulting overcapacity has in turn led to an over-production problem, meaning there is more production than can be absorbed in China itself. This harbours the risk that foreign companies that do not receive similar state support will be squeezed out of the market and will have to close a significant competitive gap with their Chinese competitors.

So far, Beijing has supported the economy through tax credits, production subsidies and ad-hoc credit facilities, with many policies directly targeting the high-tech manufacturing industry. According to some estimates, over 99% of listed Chinese companies received some form of direct government subsidy in 2022. In an effort to reduce the Chinese economy's dependence on the property sector, lending has been redirected from the property sector to the manufacturing sector (see chart 2). This re-direction of lending, which is also attributable to the bursting of the property bubble itself, is therefore also in line with Beijing's intention to strengthen the economic transformation of Chinese industry by focussing on higher-value production stages. At the meeting of the Central Commission for Economic and Financial Affairs in May 2023, Chinese President Xi Jinping declared that the industrial system should be "comprehensive, advanced and safe".

A look at the automotive sector, which has benefited from generous government policies in recent years, can shed light on how national imbalances are spreading globally. As early as 2001, the focus on electric vehicles was included in the Chinese five-year plan as a priority scientific research project. From 2009 to 2022, the government was set to provide corresponding subsidies and tax breaks. Figure 2 in the chart 2 shows the gap that has opened up between car production and domestic car sales in the post-pandemic phase. This is due to both the increase in supply above the pre-pandemic level and the weak demand compared to the 2016-17 period.

2. CHINA GOVERNMENT SUPPORT FOR INDUSTRY AND WEAK DOMESTIC DEMAND LEAD TO OVERCAPACITY



Source: People's Bank of China (PBoC), China Association of Automobile Manufacturers, Macrobond, UniCredit Group Investment Strategy

CONCLUSION

While the geopolitical and geoeconomic motivations for building domestic capacity in certain sectors are clear, the macroeconomic intentions are less so. The aforementioned Section 301 report on China points out that the lead in Chinese manufacturing is due to forced technology transfer from foreign companies. To address this problem, it seems advisable that appropriate countermeasures are taken within the framework of a rules-based world trade system, as epitomised by the World Trade Organisation (WTO), rather than unilateral protectionist measures that could set in motion a global protectionist spiral. The focus on China's forced transfer of intellectual property also neglects the domestic technological breakthroughs of recent years, as evidenced by China's progress in developing advanced microchips despite the export ban imposed by the Biden administration.

The claim that Beijing's industrial policy distorts international competition also ignores the fact that there is a growing consensus among economic experts that emerging green and digital industries need government support, as shown by the **CHIPs and Science Act**[8] or the **Inflation Reduction Act (IRA)**[9], which were passed by the Biden administration itself. From this perspective, China's trade competitiveness, even if partly achieved through government intervention, can be seen as a product of the comparative advantages claimed by China. If Beijing were to focus its policy efforts more on stimulating demand and not just expanding supply, its growth model would certainly be more balanced in the long term.

[8] The CHIPS and Science Act is a US law that has been in force since August 2022 and focuses on the development of new resources to promote national semiconductor research and production in the USA.

[9] The Inflation Reduction Act is another US law that has been in force since August 2022 and aims to curb inflation by potentially reducing the federal government's budget deficit, lowering the price of prescription drugs and investing in domestic energy production while promoting clean energy.

Macro & Markets

ECB heralds interest rate pivot, Fed maintains high level for the time being

US: ECONOMY LOSES MOMENTUM, LABOUR MARKET REMAINS ROBUST, FIRST INTEREST RATE CUT STILL TO COME

Slowed by the US Federal Reserve's (Fed) restrictive monetary policy, the US economy continues to lose momentum. The second estimate for the US GDP growth in the first quarter was revised downwards from 1.6% to 1.3% (annualised) – which is the weakest GDP figure since the second quarter of 2022, when the US economy actually contracted. This can largely be explained by the correction in private consumption (from 2.5% to 2.0%). In the final quarter of 2023, GDP growth (annualised) was still at 3.4%. Meanwhile, the latest US labour market report (for May) clearly exceeded consensus expectations of 180,000 newly created jobs (non-farm payrolls) with 272,000, after a revised 165,000 in April and 315,000 in March. The unemployment rate in the US has now been at or below 4% for 30 weeks, the longest period since the 1960s.

A look at the leading indicators shows a rather mixed picture. The purchasing managers' index for the manufacturing sector calculated by the Institute for Supply Management (ISM) fell further in May, from 49.2 to 48.7 points, which was also below the consensus estimate of 49.5. Following the prolonged period of weakness – the sentiment barometer has been below the threshold of 50, which signals a contraction, in 18 of the last 19 months – there are still no signs of a turnaround for the manufacturing sector. Incoming orders for new goods fell by 3.7 points to 45.4, the sharpest fall in almost two years. In contrast, the ISM index for the service sector, following a brief dip in April (49.4 points), returned clearly to the growth zone in May, reaching 53.8. The service sector thus continues to support hopes of an only moderate slowdown in the US economy.

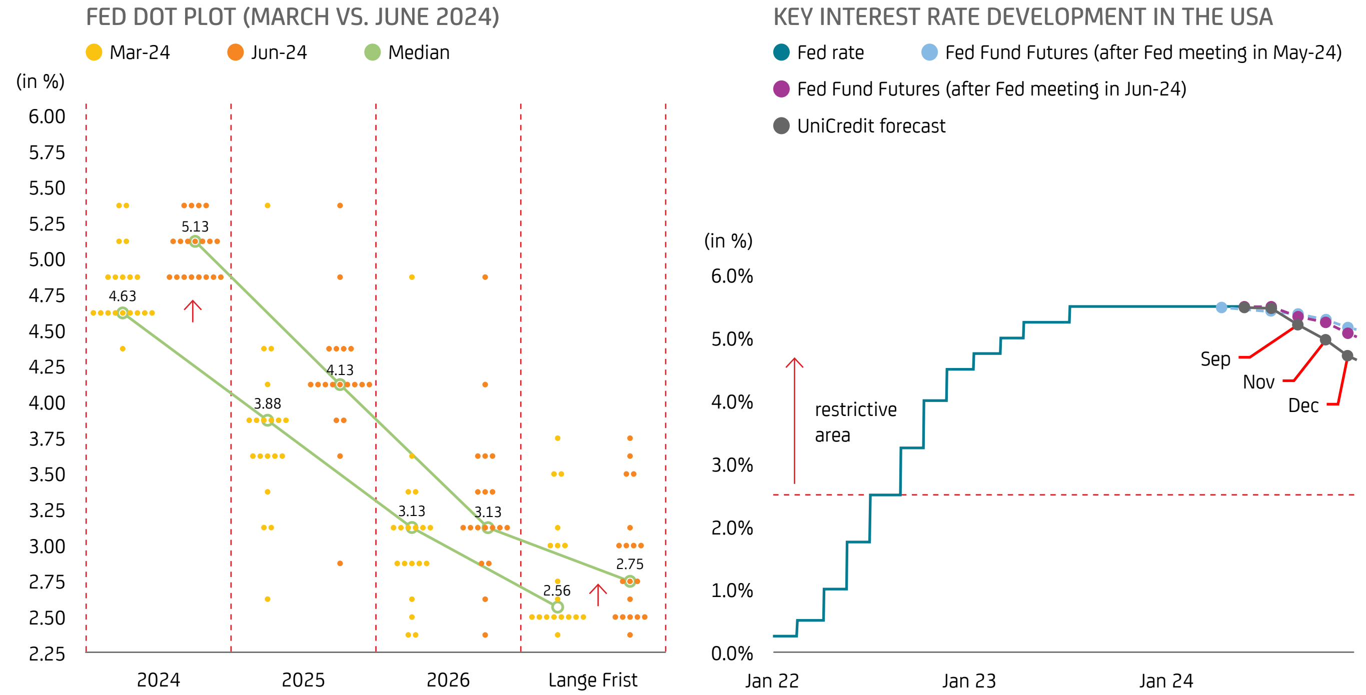
US consumer prices rose by 3.3% in May compared to the same month last year. The core inflation rate, which excludes the strongly fluctuating energy and food prices, was 3.4% in May from 3.6% in April; the consensus expectation was 3.5%. The pace of inflation in the US has thus slowed. The Fed's preferred price indicator, the so-called **PCE deflator**[10], remained unchanged in April at 2.7% year-on-year, as expected in March and by the consensus; the core PCE rate also remained unchanged at 2.8%. In view of the downward revisions to the GDP figures for the first quarter and recent weak retail sales, this data keeps the window open for the Fed's Monetary Policy Council to cut interest rates this year, whereby the slowdown in US growth should contribute to further progress in the inflation outlook.

In June, however, the Fed left the target range for the key interest rate at 5.25-5.50% for the time being, as expected. Reflecting higher inflation forecasts for this year and next, the median of the **"dot plot"**[11] now only shows one rate cut in 2024 instead of the three cuts previously priced in (see chart 3). The value for 2025 shifted upwards by 25 basis points (bps), while it remained unchanged for 2026. In other words, the rate cuts were postponed, but the total number remained unchanged. During the press conference, Fed Chairman Jerome Powell gave no indication as to when the Fed will initiate the rate cut cycle. The markets are currently pricing in two rate cuts this year (see chart 3). We continue to expect a first rate cut in September and a total of three rate cuts this year, as we expect that economic activity and inflation could be weaker than what the Fed expects. However, the risk that the scope of interest rate cuts could be smaller overall in 2024 has clearly increased.

[10] The PCE deflator is an alternative indicator for measuring inflation in the US that is based on data on personal consumption expenditures and therefore covers a larger sample than the basket of goods on which consumer price inflation is based.

[11] The dot plot shows where each FOMC member expects interest rates to be at the end of the current year, in two or three (depending on the time of year) consecutive years and in the "longer term". Each "dot" represents a member's individual view.

3. FED REMAINS CAUTIOUS, UPDATED DOT PLOT SIGNALS CONTINUOUSLY RESTRICTIVE STANCE



Source: Fed, Bloomberg, UniCredit Group Investment Strategy

EUROZONE: GROWTH GETS UNDERWAY, ECB CUTS RATES FOR THE FIRST TIME IN ALMOST FIVE YEARS, OUTLOOK REMAINS VAGUE

After the eurozone economy stagnated last year, growth was stronger than expected at the beginning of this year. With the unemployment rate falling to a low of 6.4% in April, the labour markets in the member states continue to record high employment rates and are stable, while consumer purchasing power is increasing again. The gradual recovery in economic activity is likely to continue over the rest of the year. Although the difference in growth between the US and Europe is still considerable, it is shrinking. The Olympic Games in Paris could have a positive special effect on growth in France in the third quarter, and the European Football Championship could act as a catalyst for German GDP growth in the best-case scenario.

Leading indicators also suggest that the recovery in GDP growth should continue in the second quarter. The composite Purchasing Managers' Index (PMI) rose to 52.2 in May, up from 51.7 in April. This was slightly above the consensus, with the services sector remaining the main driver despite stagnation (53.2 points, up from 53.3 in April). At the same time, the downturn in the manufacturing sector appears to be coming to an end, meaning that industry could soon contribute to growth again. In particular, the PMI for the manufacturing sector rose slightly in May, to 47.3 after 45.7 in April.

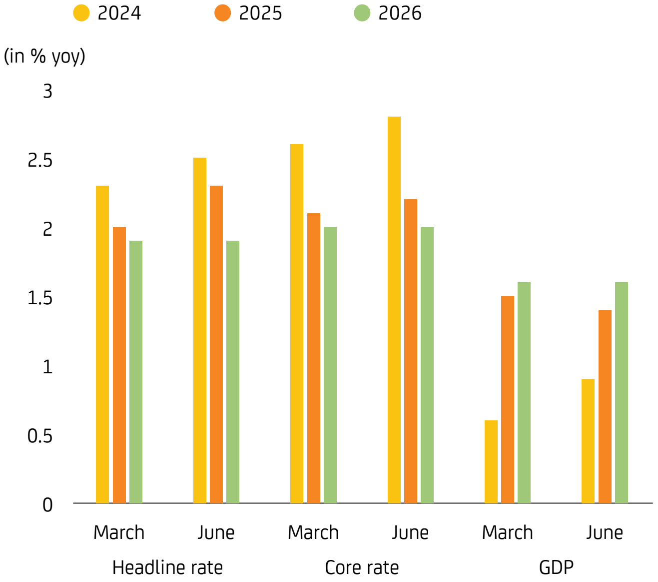
Meanwhile, the disinflation path remains bumpy. Consumer prices in the eurozone rose again in May – for the first time this year – to 2.6% year-on-year, after remaining at 2.4% in April. The consensus had expected a slight increase (to 2.5%). In addition to general inflation, core inflation also increased by 0.2 pp to 2.9% in May. The above-average rise in wages in the service sector remains the price driver. In Germany, where the harmonised annual rate rose significantly from 2.4% to 2.8%, **base effects**[12] made themselves felt. Overall, it will probably be some time before eurozone inflation falls below the European Central Bank's (ECB) target of 2%, but the fundamental picture remains intact. Geopolitical developments remain a risk factor.

At its meeting at the beginning of June, the ECB completed the expected turnaround and lowered interest rates for the first time in almost five years, but deliberately left it open as to when further interest rate cuts might be made. The deposit rate now stands at 3.75%, down from 4.00% previously. Regarding economic growth, the ECB was somewhat more optimistic in the short term than in March (see chart 4). The fact that it raised its inflation forecasts for the current year (see chart 4) may be interpreted by some market participants as meaning that interest rates will remain stable in the coming months. However, ECB President Christine Lagarde emphasised that confidence has increased that wage growth will slow, and inflation will fall towards 2% in the medium term. A data-dependent approach remains the mantra. The markets recently focussed on the meetings in September and December for possible (further) interest rate cuts, when the ECB Governing Council will have new economic and inflation forecasts. They are now pricing in one to two further interest rate cuts this year (see chart 4). Similar to the consensus, we expect two further 25 bps cuts in the second half of the year, in September and December.

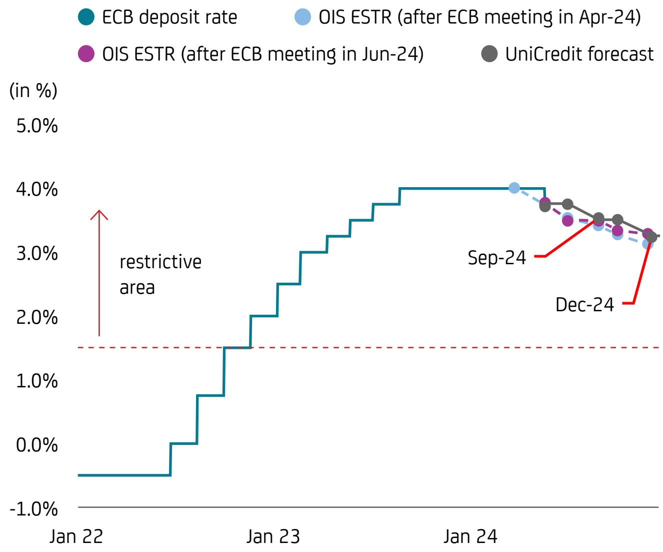
[12] The introduction of the 49-euro ticket in May last year dampened the rate in the past twelve months; this effect has now come to an end.

4. ECB RAISES INFLATION FORECAST FOR 2024 AND 2025 SLIGHTLY, BUT LOWERS KEY INTEREST RATES FOR THE FIRST TIME SINCE 2019

ECB PROJECTIONS FOR INFLATION AND GDP GROWTH IN THE EUROZONE



KEY INTEREST RATE TREND IN THE EUROZONE



Source: ECB, Bloomberg, UniCredit Group Investment Strategy

FINANCIAL MARKETS: NO "SELL IN MAY AND GO AWAY" THIS YEAR, (GEO)POLITICAL FACTORS WEIGH ON EUROPEAN MARKETS

May was initially a positive month for equity markets, although they reacted sensitively to monetary policy signals and the associated fluctuating interest rate expectations at the end of the month, falling slightly. The first half of June was characterised by the ECB and Fed meetings, which went as expected, as well as encouraging inflation data from the US, which provided a significant tailwind for US markets. European equities, however, slipped in the aftermath of the European Parliament elections, because French President Emmanuel Macron dissolved the French National Assembly in response to the clear defeat of his party and announced early elections (see also the "Column" section). In addition, the EU Commission's decision to further increase certain tariffs on imports from China and concerns about further retaliatory measures by China weighed on export-oriented EU stocks (see also the "In Focus" section). The bottom line for the reporting period (1 May to 14 June) was a significant gain for the broad equity markets in the US; the European markets, on the other hand, had to give up most of their previous gains driven by the developments in France (see table on page 19).

Inflation trends and market expectations regarding the monetary policy decisions of the major Western central banks also continue to be key factors for bond markets. The weaker-than-expected US inflation data, in particular, caused US Treasury yields to fall sharply in June, and the new **"hawkish"**[13] dot plot from the FOMC participants hardly slowed things down. Compared with the beginning of May, the yield on 10-year US government bonds fell significantly and stood at around 4.2% at the end of the reporting period (i.e., as of 14 June, see table on page 19). By and large, 10-year Bunds followed this positive trend; their yield most recently stood at about 2.4% (see table on page 19). Meanwhile, concerns about political instability in France caused the yield premium on 10-year French bonds over German bonds to rise to its highest level since 2017.

[13] If the Fed adopts a hawkish stance, this means that it prioritises the fight against inflation over the promotion of economic growth.

The oil price fell to its lowest level in almost four months at the beginning of June. Demand growth, responsible for a large part of the price increase this year, is slowing down and the risk premium for the Middle East conflict has largely evaporated. In addition, OPEC+ (countries of the Organisation of the Petroleum Exporting Countries plus Russia) confirmed that **production**[14] will remain limited to 39 megabarrels per day (mb/d) until the end of 2025. However, following the publication of important US economic data and OPEC's announcement that it was basically sticking to its positive outlook for global oil demand, the oil price was able to recoup some of the previous losses. A barrel of Brent crude is currently trading slightly below its level at the beginning of May at around USD83 (as of 14 June, see table on page 19). In the reporting period (1 May to 14 June), the price of a troy ounce of gold fluctuated between USD2,300 and USD2,400; the gold price was only briefly higher in mid-May. The troy ounce is currently trading at USD2,333 (as of 14 June, see table on page 19). In this environment, the EUR-USD exchange rate initially rose in May before falling again in the first half of June. It is currently trading at around 1.07 (as of 14 June, see table on page 19).

[14] Additional voluntary curbs of around 2 mb/d will remain in place until the third quarter of this year and will be phased out for eight countries from October, while voluntary curbs by Saudi Arabia and Russia will remain in place beyond October.

Asset Allocation – How we manage our portfolio mandate

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)

Overall global GDP growth is expected to reach around 3% in 2024. In particular, although the US economy is cooling, the risk of a hard landing still seems low. Meanwhile, growth prospects in the eurozone are brightening. The recovery in China, where consumption continues to be burdened by the real estate crisis, appears to be underway, but remains less dynamic than hoped. In addition, major Western central banks have either already embarked on a cautious and pragmatic path of monetary easing (the ECB), or are expected to do so later this year (the Fed). However, as inflation in the service sector remains sticky on both sides of the Atlantic, the monetary easing cycle could prove to be choppy.

In this environment, the UniCredit Group Investment Committee has confirmed the current global portfolio asset allocation, reiterating our strategic focus on "high-quality bonds" such as Euro investment grade corporate bonds and Euro government bonds. Our neutral stance towards equities also remains unchanged, with a preference for companies with high pricing power and superior cash flow generation.

EQUITIES

GLOBAL EQUITIES: NEUTRAL

The environment for global equity markets has been favourable since the beginning of the year, and both the latest economic data and the quarterly reports for the first quarter of 2024 have recently provided largely positive surprises. The US economy remains robust despite signs of a slowdown, and it is becoming increasingly clear that the European economy has also bottomed out. Earnings expectations are correspondingly constructive. In addition, the prospect of less restrictive monetary policy continues to provide support. At the same time, there are significant risks – from high valuations in some areas, to geopolitical risks, to uncertainty regarding the start (in the US) or the extent of the expected cycle of interest rate cuts by major Western central banks. We are maintaining a neutral weighting in global equities.

EQUITIES EUROPE: NEUTRAL

The recent more favourable macroeconomic data, which has often exceeded expectations, indicates that the European economy is gaining momentum. The labour market in the eurozone remains solid and cooling inflation is supporting real incomes. However, the strong performance of right-wing parties in the EU elections could slow down EU integration and weigh on European markets. The still comparatively favourable valuations of European equities support this asset class, which offers correspondingly good opportunities for value and quality-oriented investors. We continue to favour a neutral weighting.

US EQUITIES: NEUTRAL

The robust macroeconomic environment in the US is positive for US equities, even though recent macro data suggests that growth is slowing. With inflation remaining stubbornly high, there is still uncertainty over the timing and the extent of the Fed's expected rate cut cycle. US equity valuations remain high, and the S&P 500 index has an extreme market concentration (Nvidia alone accounted for 34.5% of returns in the S&P 500 in the first few months of 2024). Overall, we maintain a neutral weighting.

EMERGING MARKET EQUITIES: NEUTRAL

In Asia, we remain strategically cautious on Chinese equities. The (somewhat sluggish) recovery there is being driven by exports. However, the fairly favourable valuations could argue for a limited tactical catch-up in view of fiscal and monetary stimulus measures. Taiwan equities, on the other hand, are supported by the boom in the semiconductor sector. In Latin America, the Fed's cautious stance could limit the extent of expected rate cuts in Brazil. Overall, however, the valuations of emerging market equities appear comparatively favourable. We continue to favour a neutral weighting, although a selective approach to emerging markets by country and sector remains essential.

ASIA-PACIFIC EQUITIES (DEVELOPED MARKETS): OVERWEIGHT

Solid wage growth remains a supporting factor for Japanese equities. The fact that the Bank of Japan (BoJ) ended the era of negative interest rates and abandoned its yield curve control policy was also largely welcomed by the markets. The rise in corporate profits and the reform of the Tokyo Stock Exchange also encouraged extensive share buybacks. Both the number and the associated volume of share buybacks announced in the annual report are at their highest level since 2009. Valuations do not appear expensive despite the recent performance. However, as Japan is a major importer of food and energy, a sustained weakness of the Japanese yen could have an impact on inflation – and thus also on the Bank of Japan's monetary policy. Overall, we remain overweight on Asia-Pacific equities.

BONDS

GLOBAL BONDS: OVERWEIGHT

Given current yields and the (expected) monetary policy shift by major Western central banks, global bonds continue to offer a competitive, attractive risk-return profile. With inflation continuing to cool (but with some uncertainty over the convergence of inflation towards the central banks' 2%, mainly due to persistently sluggish inflation in the services sector), we reiterate our strategic preference for "high-quality bonds", such as Euro investment grade corporate and Euro government bonds. Long duration government bonds may play a precious "macro-hedging" role in the event of a significant economic slowdown (although this is not our baseline scenario). We are maintaining our overweight on global bonds.

EMU GOVERNMENT BONDS: NEUTRAL

After the ECB announced the interest rate pivot, we are maintaining our constructive view of this asset class against the backdrop of cooling inflation and in anticipation of further interest rate cuts in the second half of the year. However, despite the recent encouraging data, it cannot be completely ruled out that inflation will remain stubborn and that interest rates will therefore remain at a higher level for longer than generally expected (risk scenario). Our neutral weighting for this asset class therefore remains unchanged.

NON-EMU GOVERNMENT BONDS: NEUTRAL

Signs of a slowdown in the US economy have recently become more visible. The risk that the Fed could start its easing cycle later and the scope of interest rate cuts could be less extensive than expected remains despite the recent positive surprise in inflation data. We are maintaining a neutral weighting in this asset class.

EURO INVESTMENT GRADE CORPORATE BONDS: OVERWEIGHT

Credit spreads on euro-denominated corporate bonds, which continue to be supported by the resilience of the economic cycle and investors' ongoing search for yield, are at historically tight levels despite recent developments in France. Overall, the fundamentals of IG companies are expected to remain robust thanks to healthy balance sheets, higher-than-expected earnings, strong cash balances and low leverage levels compared to the long-term averages. Default rates could rise, but this is no cause for concern. We are maintaining our overweight for this asset class.

HIGH-YIELD CORPORATE BONDS: UNDERWEIGHT

The credit spreads of high yield (HY) corporate bonds, particularly those of companies with low credit ratings, still do not appear to fully reflect a possible noticeable slowdown in the economy. In addition, HY bonds are not sufficiently liquid and therefore still appear less interesting in the current phase of the economic cycle. HY bonds therefore remain underweighted.

EMERGING MARKET BONDS (HARD CURRENCY): NEUTRAL

Emerging market bonds in hard currencies generally offer an interesting carry (yield advantage over euro government bonds), but our focus remains on high-quality bonds. Credit and currency risk should always be considered when investing in emerging market bonds. We remain defensive and selective and continue to avoid countries with high foreign debt and current account deficits. Accordingly, we continue to favour a neutral weighting.

EMERGING MARKET BONDS (LOCAL CURRENCY): OVERWEIGHT

Emerging market bonds in local currency also offer an interesting carry. There is room for interest rate cuts, which could benefit this asset class. In addition, emerging market currencies appear undervalued and are likely to regain ground when the Fed starts to cut interest rates. In the short term, however, emerging market bonds could be burdened by the Fed's wait-and-see attitude and a stronger US dollar. It should also be noted that potential credit risks and foreign currency fluctuations, which are often higher in emerging markets, can affect potential returns. Emerging market bonds in local currency remain overweighted.

MONEY MARKETS: UNDERWEIGHT

Cash generally offers interesting returns, but we favour investments in higher-yielding fixed income asset classes such as euro-denominated corporate bonds with good credit ratings, as we continue to expect interest rates in the US and the eurozone to fall (further). We are underweight in this investment segment.

ALTERNATIVES: NEUTRAL

Alternative investments continue to offer diversification potential for the portfolio. Real assets benefit from their role as instruments for hedging against inflation. We are maintaining a neutral weighting for alternative investments.

COMMODITIES: NEUTRAL

Low oil inventories, production cuts by OPEC+ (the major oil-producing countries and Russia, totalling 23 states), geopolitical tensions and higher economic growth are supporting oil prices. However, OPEC+ will gradually phase out the cuts of 2.2 million barrels per day from October 2024. We continue to favour a neutral weighting in this asset class.

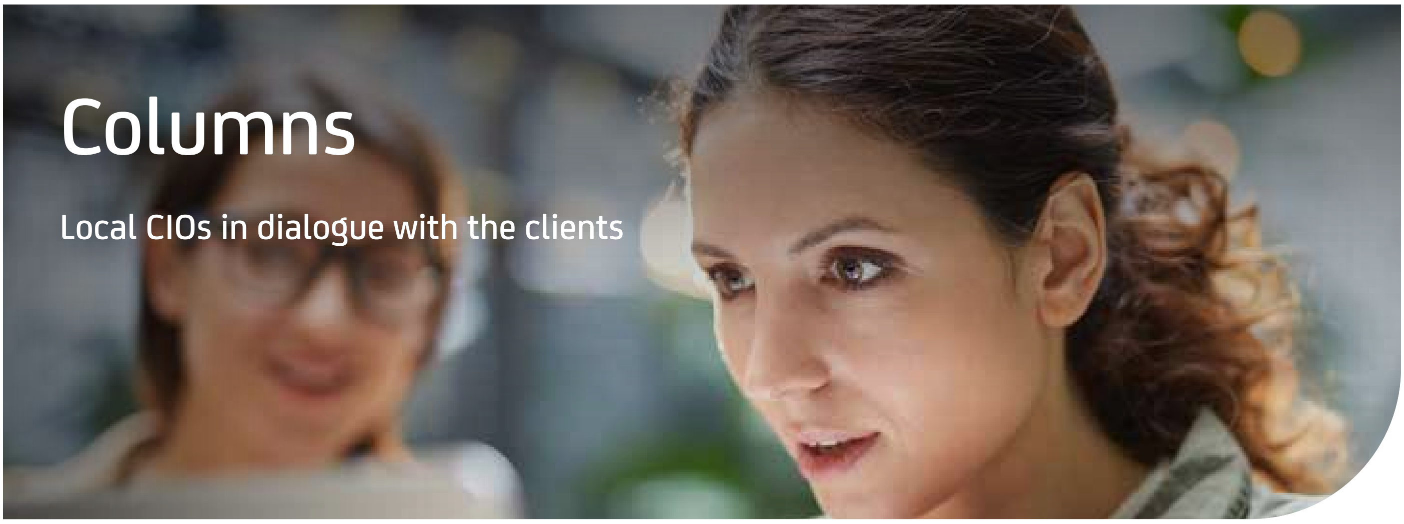
GOLD: NEUTRAL

Gold continues to benefit from increased central bank purchases – particularly by the People's Bank of China after the US and EU decided to freeze the currency reserves of the Russian central bank. The expectation of lower interest rates and geopolitical uncertainties also remain supportive factors. We are maintaining a neutral weighting.

CURRENCIES

EUR-USD

Continued robust US growth (which is stronger than in other regions such as the eurozone) and a patient Fed, which is still adopting a wait-and-see stance in the face of persistent inflation in some areas, should continue to support the US dollar in the coming months.



Answers from Italy

IS THERE A RISK OF A SECOND "EURO DEBT CRISIS"?

The results of the recent European Parliament elections and the decision of French President Macron to call early elections have had a significant impact on the financial markets of the euro area. The spread of yields on 10-year French government bonds compared to the corresponding German government bond stands at around 80 bps at the time of writing, up from about 50 bps at the end of May. The spread of Italian government bonds compared to Bunds also increased, in the same period of time, from 130 bps to almost 160 bps. These are significant movements, which bring to mind certain difficult historical phases for the debt of the so-called peripheral countries of the Euro area – in particular, the period known as the Euro area debt crisis, which took place between 2010 and 2012.

However, although it is likely that uncertainty and volatility will continue until the French elections, we do not think that we are near a crisis that would require a review of the strategic approach of our investment portfolios.

Let's start from the general macro context. The events of the 2010-2012 period were first and foremost a consequence of the difficulties in the public finances of the most indebted countries in the Euro area, following the global recession of 2008-2009. The peak of the crisis was in fact reached with the restructuring of the Greek debt. In systemic terms today, it is true that the pandemic has caused an increase in the average level of public debt, but this has happened in a substantially uniform manner among European countries, so there are no issues of relative worsening or countries whose financial condition is particularly worse than others. Furthermore, the health crisis and the conflict in Ukraine have made economic policies supporting businesses and consumers at the expense of the public budget substantially acceptable and almost necessary. In addition, over the years, the European Union and the ECB have refined the monitoring, support and intervention mechanisms to stem the risks of an excessive increase in the cost of debt of the countries in the area. Another element of significant difference is that the financial system today and banks in particular are much more stable and equipped with significant capital to manage phases of stress.

We also analyze the current market context. This widening of spreads essentially occurred due to a significant contraction in the yields of German government bonds, which partially benefited from their role as a safe haven in the event of financial tensions. But this contraction also occurred in relation to a similar downward movement in US government bond yields. In fact, investors are slowly re-evaluating the reading of the latest Fed meeting in light of recent data on the labor market and inflation, which paint a more favorable picture for a start of rate cuts later on this year.

Another mitigating element is the direction of ECB policy – following the first cut in June, we expect two more cuts, one per quarter, to reach a deposit rate of 3.25% at the end of the year. The most restrictive phase of monetary policy is therefore behind us, both in terms of the level of the cost of money and its implications on the cost of debt, and in terms of the reduction of negative flows on the government bond market as a result of a reduced central bank balance sheet (i.e. quantitative tightening).

Finally, we consider our portfolio construction policies. The majority of our bond portfolios are invested in high quality instruments, in terms of liquidity and creditworthiness: government bonds and investment grade corporate bonds. Therefore, the impact of this spread widening is mitigated by the allocation to German government bonds and corporate bonds, which, thanks to their carry, can absorb adverse movements in some components of the portfolio. It is also important to remember our global approach to equity investments and therefore the presence of another factor mitigating political risks – here, we are talking about the natural presence of US dollars as a result of our positions in US stocks. In recent days we have seen an appreciation of the US dollar against the euro, which has helped maintain the overall value of our portfolios.

In summary, despite a further element of political uncertainty appearing on the landscape, we believe we are best equipped to deal with any phase of volatility.

ALESSANDRO CAVIGLIA, *Chief Investment Officer Italy, UniCredit SpA*

WHAT ARE THE IMPLICATIONS OF DONALD TRUMP'S CONDEMNATION WITH REGARDS TO THE US PRESIDENTIAL ELECTION?

Donald Trump has become the first former US president that has ever been convicted of a crime. The presiding judge, Justice Juan Merchan, now faces the unprecedented task of sentencing Trump. On July 11th, four days before the Republican National Convention begins, Judge Merchan will decide what sentence will be most suitable – either prison, probation or an unconditional discharge, which means no penalty at all. There is also the possibility for an imprisonment, but given that Trump is a first-time offender, he is unlikely to be incarcerated. Trump can also appeal the decision, which could take month or years to resolve.

In addition, Trump faces another three prosecutions: two over his alleged efforts to overturn President Biden's 2020 election victory, and one alleging he illegally retained classified documents after leaving the White House. Trump has been successful in delaying these three other criminal cases he faces, so much so that none of them may come before election day in November.

Despite these criminal cases, Trump is still able to run for US president, given that nothing in the US Constitution prohibits a convicted criminal from holding office. And if re-elected as president, Trump will become the first convicted felon to be the US commander-in-chief.

Interestingly, markets do not seem to be much impacted by this development. Specifically, only the shares of Trump's social media companies fell significantly after the guilty verdict, but then recovered slightly afterwards.

While this verdict does not necessary mean that Trump's chances of winning in November have gone down, such a decision should create a more volatile political environment – which we are likely to see spread to markets. We also need to remember that Biden's family are also facing their own legal battles. In particular, Hunter Biden, the president's son, is on trial for allegedly lying about his drug use while buying a handgun. A poll by an analytical company in May found that 46% of registered voters said the current US president had done something illegal in relation to his son. For comparison, this is not much lower than the 54% of registered voters who said the same of Trump in the Manhattan case.

The Trump campaign stated it had raised nearly $53 million in the 24 hours after the verdict. And more than a third of the donors had donated funds for the first time. This can be interpreted as a conviction might not reduce the support for Trump within the Republican party. In addition, Trump has also attracted some well-known names among his supporters. For example, hedge fund billionaire Bill Ackman is reportedly leaning towards backing Trump in the US election.

All in all, it seems too early to form a conclusion around what this conviction will mean for the final US election. But one thing is for certain – political uncertainty might be heightened, and part of this uncertainty might be transferred to the market.

OLIVER PRINZ, *Co-Chief Investment Officer of UniCredit Bank Austria AG and Schoellerbank AG*

WHAT DO YOU THINK WILL BE THE IMPACT OF THE EUROPEAN PARLIAMENT ELECTIONS?

Following the clear victory of the centre-right alliance of the European People's Party with German lead candidate Ursula von der Leyen in the European Parliament elections, the 65-year-old can hope for another term as President of the European Commission. At the same time, the political centre was able to assert itself in the election: the moderate, pro-European parties, which include the Social Democrats, the Greens, and the Liberals in addition to the European People's Party, still have a clear majority in the European Parliament (even if it has become smaller compared to 2019). This is good news for the time being. Overall, the election result is unlikely to result in any fundamental upheavals, even if the rather weak performance of the Greens reflects the fact that the issue of security has apparently (temporarily) overtaken climate protection in this election in view of the tectonic shifts of recent years.

The fact that there will be more members of the European Parliament (MEPs) from right-wing parties in the European Parliament in the future is a cause for concern. In the two largest member states of the European Union, France and Germany, two Eurosceptic, right-wing nationalist parties – Marine Le Pen's Rassemblement National and the Alternative for Germany – also received the most votes. The focus is particularly on France, where President Emmanuel Macron dissolved the French National Assembly immediately after the election and surprisingly announced new elections in two rounds on 30 June and 7 July. Now that France's governing coalition has not had an absolute majority in the National Assembly for almost two years, Macron could, in the worst-case scenario, be forced to spend the last three years of his presidency in **"cohabitation"**[15] with a legislature dominated by Le Pen. This would likely significantly limit his influence on domestic political affairs. The new election in France will also coincide with that in the UK, where almost all polls predict a clear defeat for Prime Minister Rishi Sunak and the Tories at the beginning of July.

Europe is clearly experiencing turbulent times in political terms – and this is also likely to have an impact on the financial markets. The European stock markets were initially weighed down by the outcome of the EU election, presumably because of uncertainty regarding the fiscal policy course in France and a possible weakening of the Franco-German alliance. While it seems premature to make a final judgement on what implications the election result could have for the financial markets in the medium term, investors are primarily interested in (political) stability. We therefore believe that they are all the more well advised not to be alarmed by short-term upheavals and to stick to their medium to long-term plans. Despite the political volatility, it is above all the comprehensive analysis of macroeconomic conditions and market fundamentals that, in our opinion, make it possible to make well-founded and promising long-term investment decisions. Appropriate diversification of the portfolio remains a central component of our investment strategy.

[15] With "cohabitation", the president and the head of government belong to different parties. If the Rassemblement National wins a majority in parliament, Macron would have to appoint someone from the ranks of this party as prime minister, who would then appoint their ministerial colleagues.

PHILIP GISDAKIS, *Chief Investment Officer Germany, UniCredit Bank GmbH (HypoVereinsbank)*

DEVELOPMENT OF SELECTED FINANCIAL MARKET INDICES

From	**14.06.23**	14.06.19	12.06.20	14.06.21	14.06.22	14.06.23	14.06.19	**01.01.24**
To	**14.06.24**	14.06.20	14.06.21	14.06.22	14.06.23	14.06.24	14.06.24	**14.06.24**
Stock market indices (total return, in %)								
MSCI World (in USD)	**20.1**	3.6	42.2	-14.7	19.0	20.1	81.8	**11.3**
MSCI Emerging Markets (in USD)	**8.5**	-0.7	43.5	-24.4	3.2	8.5	22.5	**6.5**
MSCI US (in USD)	**24.6**	7.9	43.9	-12.9	19.1	24.6	103.4	**14.1**
MSCI Europe (in EUR)	**13.8**	-5.5	32.4	-7.0	18.2	13.8	57.0	**9.5**
MSCI AC Asia Pacific (in USD)	**9.2**	3.8	36.8	-22.0	8.6	9.2	32.2	**7.2**
STOXX Europe 600 (in EUR)	**13.8**	-4.4	33.1	-8.3	17.9	13.8	56.9	**9.3**
DAX 40 (Germany in EUR)	**10.5**	-1.8	31.2	-15.1	22.6	10.5	48.8	**7.5**
MSCI Italy (in EUR)	**25.4**	-9.2	36.9	-11.3	33.4	25.4	84.2	**11.9**
ATX (Austria, in EUR)	**17.2**	-21.0	60.0	-8.7	8.7	17.2	46.5	**7.9**
SMI (Switzerland, in CHF)	**10.0**	2.7	24.8	-7.3	8.7	10.0	42.6	**11.5**
S&P 500 (USA, in USD)	**24.6**	7.3	42.1	-10.9	19.1	24.6	104.3	**14.6**
Nikkei (Japan, in JPY)	**18.1**	8.4	32.8	-6.9	28.7	18.1	102.9	**16.9**
CSI 300 (China, in Yuan)	**-7.4**	11.1	33.0	-17.7	-6.3	-7.4	8.1	**4.0**
Bond market indices (total return, in %)								
US Government Bonds 10Y (in USD)	**-0.2**	17.1	-4.9	-14.8	0.9	-0.2	-3.8	**-0.9**
US Government Bonds (ICE BofA, in USD)	**1.7**	11.0	-3.4	-11.2	0.4	1.7	-2.3	**0.0**
US Corporate Bonds (ICE BofA A-BBB, in USD)	**6.4**	10.0	4.0	-15.0	3.0	6.4	7.2	**1.1**
German Bunds 10Y (in EUR)	**3.9**	2.2	-1.4	-16.5	-3.1	3.9	-15.9	**-1.5**
EUR Government Bonds 1Y-10Y (iBOXX, in EUR)	**3.9**	3.1	0.9	-15.6	-2.0	3.9	-11.1	**-1.3**
EUR Corporate Bonds 1Y-10Y (iBOXX, in EUR)	**6.9**	0.5	3.7	-13.6	0.9	6.9	-3.4	**0.7**
Bond yields (change in basis points = 0.01 percentage points)								
US Government Bonds 10Y (in USD)	**50**	-139	80	198	32	50	212	**35**
US Government Bonds (ICE BofA, in USD)	**25**	-145	38	260	75	25	243	**34**
US Corporate Bonds (ICE BofA A-BBB, in USD)	**-13**	-104	-29	289	62	-13	196	**21**
German Bunds 10Y (in EUR)	**-17**	-20	19	199	70	-17	259	**34**
EUR Government Bonds 1Y-10Y (iBOXX, in EUR)	**-9**	-29	-3	217	68	-9	250	**39**
EUR Corporate Bonds 1Y-10Y (iBOXX, in EUR)	**-59**	7	-48	308	67	-59	284	**24**
Spreads on government bonds (credit spreads, change in basis points)								
US Corporate Bonds (ICE BofA US Corporate Master)	**-42**	37	-80	57	-8	-42	-37	**-9**
US Corporate Bonds (ICE BofA US High Yield)	**-92**	204	-311	173	-72	-92	-94	**-5**
Euro Corporate bonds (ICE BofA Euro Corporate AAA-A)	**-28**	18	-42	86	-21	-28	12	**-11**
Euro Corporate Bonds (ICE BofA Euro High Yield)	**-75**	117	-234	229	-83	-75	-48	**-40**
Money market rates (change in basis points)								
Libor (USD, 3 months)	**9**	-209	-20	189	351	9	320	**1**
Euribor (EUR, 3 months)	**17**	-5	-18	30	377	17	403	**-19**
Euro exchange rates (change in %)								
US Dollar (EUR-USD)	**-1.2**	0.1	7.1	-13.7	3.4	-1.2	-5.1	**-3.3**
British Pound (EUR-GBP)	**-1.6**	0.8	-4.2	0.8	-1.3	-1.6	-5.5	**-3.1**
Swiss Franc (EUR-SFR)	**-2.3**	-4.6	1.8	-4.5	-6.2	-2.3	-15.0	**3.0**
Japanese Yen (EUR-JPY)	**9.8**	-1.0	9.6	5.8	7.5	9.8	37.7	**7.3**
Commodities (change in %)								
Commodity Index (GSCI, in USD)	**18.6**	27.7	4.9	-3.6	7.9	18.6	65.3	**12.9**
Industrial metals (GSCI, in USD)	**8.2**	-6.6	60.8	1.5	-11.3	8.2	47.9	**9.0**
Gold (in USD per fine ounce)	**19.4**	29.6	7.5	-2.7	8.0	19.4	72.7	**12.9**
Crude oil (Brent, in USD per barrel)	**9.1**	-37.1	87.8	65.9	-39.5	9.1	32.7	**6.3**

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