Policy Shifts and Political Swings

Rate Cuts and US Elections Under the Lens

Group Investment Strategy

Monthly Outlook

October 2024

UniCredit

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Summary

MACROECONOMIC UPDATE

The US economy continues to show signs of slowing down, particularly in the labour market and inflation. While the unemployment rate improved slightly in August, job growth outside the agricultural sector was weaker than expected, with downward revisions to previous months. However, despite a revision to growth prospects, expectations of a soft landing for the US economy remain intact. Inflation is also moderating, with the overall rate falling compared to the same period last year, driven by lower energy prices. Core inflation, which excludes energy and food, remained stable due to persistent pressures in the services sector. Nonetheless, indicators suggest that inflation in services is likely to ease gradually in the coming months. In the Eurozone, economic recovery continues at a slow pace, with modest growth supported by the service sector. Inflation decreased in August, mainly due to lower energy costs, though core inflation remains elevated, reflecting wage pressures. Meanwhile, China's economy continues to struggle with sluggish growth and rising deflation risks, as industrial production and retail sales underperformed in August.

MONETARY POLICY AND CENTRAL BANKS

The US Federal Reserve (Fed) has begun its expected cycle of interest rate cuts, reducing rates in September by a larger margin than many economists anticipated. This decision was prompted by the recent slowdown in inflation and labour market activity. According to Fed Chair Jerome Powell, these trends justify a shift in monetary policy, though the US economy remains fundamentally strong. The Fed's growth forecasts suggest steady economic performance, and inflation is expected to continue moving toward the central bank's target. Future rate adjustments are expected to be gradual, with the pace of cuts dependant on incoming economic data. Similarly, the European Central Bank (ECB) also reduced interest rates in September. Despite some adjustments to its inflation and growth forecasts, the ECB remains optimistic that inflation will return to target levels in the coming years. However, the central bank has suggested it may pause rate cuts at its next meeting, as more economic data are needed before further decisions are made. Another rate cut is expected before the end of the year.

FINANCIAL MARKETS

In August, market sentiment remained positive despite periods of increased volatility driven by concerns over a potential US economic slowdown and a rate hike by the Japanese central bank. Stocks initially saw a sell-off but recovered quickly, supported by expectations of interest rate cuts by the Fed and solid second quarter earnings. US and European equities posted significant gains by mid-September. Fixed income investments benefited from early volatility, as investors sought safe assets. The primary focus continues to be the upcoming normalisation of the yield curve, driven by a more pronounced decrease in short-term yields – due to expected interest rate cuts by central banks, and relatively stable long-term yields, reflecting growth expectations. Oil prices dropped due to global economic concerns, despite extended production cuts by OPEC+, even if more recently renewed geopolitical tensions partially boosted prices. Gold prices rose significantly, fuelled by expectations of Fed rate cuts. Meanwhile, driven by the same interest rate expectations, the euro gained strength against the US dollar.

CIO's Letter

At its most recent FOMC meeting, the US Federal Reserve (Fed) cut interest rates for the first time since 2020, as widely expected. After a heated debate on the markets in the run-up to the meeting as to whether the Fed would cut by 25 basis points (bps) or 50 bps, with the markets recently leaning towards the larger move, it heralded the rate cut cycle with a 50 bps move. Fed Chairman Jerome Powell said: "The labour market is in solid shape, and with today's move we want to ensure that it stays that way." In other words, the Fed wants to ensure that a so-called **"soft landing"[1]** occurs. Global equity markets reacted largely positively to the Fed's decision. This is good news, as markets did not interpret this major interest rate cut signalling a more difficult economic situation.

[1]Soft landing describes a phase in which economic growth slows but the economy does not enter a recession. A hard landing, on the other hand, describes a sudden and sharp slowdown in the economy, which usually leads to a recession.

For markets, the questions that are emerging now are: How much will interest rates be reduced overall in the current rate cut cycle? And how quickly will the Fed approach such a target? Markets are currently pricing in the possibility that the Fed could cut interest rates by a further eight 25 bps steps by 2026, i.e. by a total of two percentage points (pp). According to market expectations, the target is therefore between 2.5% and 3%. In addition, the market expects the Fed to have delivered half of its rate cuts by January 2025. The Fed projections themselves are somewhat more cautious, with a median of just two further rate cuts by the end of 2024 and a total of four rate cuts in the coming year. The markets and the median of the Fed governors' expectations are not far apart when it comes to forecasting the end point of the rate cut cycle. The Fed's forecast, which should be reached by 2026, is 2.875%. Incidentally, this mark also corresponds to the Fed's long-term equilibrium expectation. The latter is often interpreted as a "neutral rate", i.e. the interest rate associated with a stable inflation rate in an economy operating at full capacity in the medium term, which in simple terms has neither a stimulating nor a dampening effect on the economy.

The "soft landing" scenario is therefore increasingly gaining ground in the market as the most likely path. This scenario is not new and was already the predominant one last year and at the beginning of 2024. However, over the course of the first half of this year, there were repeated calls for a "no landing" scenario, i.e. a scenario in which the central bank succeeds in pushing inflation down to the target of 2% without a noticeable slowdown in economic activity. In the meantime, the recent weak US labour market figures have brought possible recession risks back into focus. However, there are hardly any signs today that a recession is imminent, with the US economic environment remaining impressively robust.

The situation in Europe is somewhat different. Hopes that the German economy in particular could regain its footing this year, after years of energy price shocks, have not (yet) materialised – despite the fact that the oil price is now back at the same level as before the start of the war in Ukraine. Although a recession is not expected in the eurozone or in Germany, consensus estimates (median of analysts' expectations) continue to point to low growth. Quarterly growth of 0.3% to 0.4% is expected for the eurozone in the coming quarters (i.e. annualised growth of 1.2% to 1.6%), while Germany is only expected to see growth of 0.2% to 0.3% (annualised growth of 0.8% to 1.2%). Growth expectations for Italy and France are also higher than those for Germany.

Nevertheless, both European and, in particular, German equities are proving to be impressively robust. The DAX has risen by around 12% since the beginning of the year; the STOXX Europe 600, which comprises the 600 largest European shares, has also posted double-digit gains (total return, see table). The Nikkei has also recovered somewhat from its summer weakness and is currently

up around 14% in Japanese yen terms since the beginning of the year (see table). However, the US markets are leading the major stock markets worldwide. The S&P 500 has gained almost 21% in US dollars in 2024 (see table). The surprisingly robust performance of European equities despite the disappointing macroeconomic situation could lead to uncertainty among investors, but we believe this can be explained: Stock markets do not always reflect the domestic economic situation. As is well known, the DAX tracks the performance of the 40 largest German stock corporations, which include companies from the financial sector and the technology segment (each with a strong performance this year), in addition to the large industrial stocks (some of which were rather weak, for example from the automotive and chemical industries, but others were among the top performers, for example from the equipment and plant engineering sector).

The performance of the stock markets is being driven by expectations of strong earnings growth in the coming years. German companies are expected to see earnings growth of 13% in 2025 and 10% in the following year – a strong increase compared to the disappointing years of 2023 and 2024, in which earnings have barely risen or are rising. German companies will thus achieve growth rates in expected profits that almost match the strong figures of US companies (16% in 2025 and 10% in 2026). Profit growth of 8% is expected for European companies in each of the next two years. Furthermore, valuations of European and German companies are not particularly high, measured by the price/earnings ratio (P/E ratio). The average P/E ratios are roughly in line with the long-term average. Assuming no increase in P/E ratios, the share indices should rise in line with earnings growth. For European indices, this would correspond to returns of just under 10%, while those for US companies could even rise by just over 10%. However, unchanged P/E ratios would be rather unusual by historical standards in a phase of rising profits and simultaneously falling real yields (central banks will cut interest rates while inflation rates are likely to remain stable). Based on historical experience, one could even expect slightly rising P/E ratios in such a scenario.

If the base scenario underlying current market expectations for economic and earnings growth materialises, performance expectations for global equity portfolios in the range of 8% to 10% and for fixed income portfolios with good credit ratings in the range of 3% to 5% over the next 12-18 months appear entirely plausible. In a risk scenario, however, these expectations could turn out to be too optimistic, as there is no doubt that the US economy is in a cooling phase (which is why the Fed has also started to cut interest rates). As outlined above, market expectations reflect a "soft landing" scenario. However, it is not certain whether the Fed will actually succeed in stopping the slowdown in time and avoiding a recession. The US election is also causing increased uncertainty (see Focus section). Risks, particularly for European markets, may also result from the disappointing economic development in China. A further decline in demand for European export goods from China could have a negative impact on the export economy. Finally, there are also a number of geopolitical risks (Ukraine war, Middle East and the tensions between Taiwan and China) that could prove to be negative factors. For these reasons, we are currently maintaining a neutral weighting in equities and tend to favour defensive equity strategies. From a current perspective, it seems too early for a more cyclical and optimistic positioning with regard to equities. The economic trajectory in the US and Europe, but also in China, should first turn more reliably positive.

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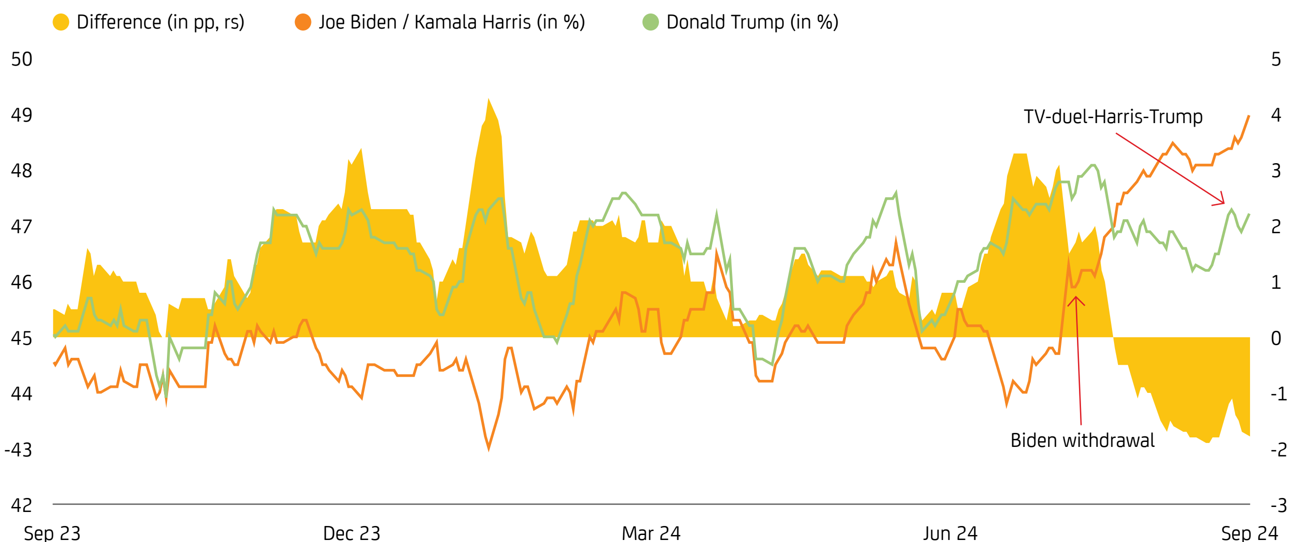
In Focus

US election campaign enters hot phase

The US presidential election campaign enters its decisive phase in October. We have already analysed the positions of the two political camps in the various policy areas in the May issue of our Monthly Outlook. In terms of content, the past few weeks have provided few new insights. However, the Democrats' election chances have improved significantly since July, when Democrat Joe Biden announced that he would not run for another term in office, and withdrew from the presidential race in favour of his deputy Kamala Harris, following the televised debate against former President and Republican candidate Donald Trump. Harris has been leading in the national polls since the beginning of August, even though her lead over Trump is hardly significant and a close race is still to be expected (see chart 1). Should Harris win the election on 5 November, in which the entire US House of Representatives and around a third of the 100 Senate seats will also be re-elected, she would be the first woman to become President of the US.

1. HARRIS HAS BEEN AHEAD IN NATIONAL POLLS SINCE THE BEGINNING OF AUGUST



Note: The chart shows average values from numerous surveys. RealClearPolitics collects the surveys from various polling institutes and calculates an average value from them. This is intended to compensate for random outliers or systematic distortions of individual institutes.
Source: Real Clear Politics, Bloomberg, UniCredit Group Investment Strategy, observation period: 15/09/2023-15/09/2024

However, one of the peculiarities of the US electoral system is that a candidate can receive the most votes nationwide (popular vote) and still lose the election. The US president is not elected directly by the people, but indirectly by the **Electoral College**[2] 41 days after the official election day by secret ballot with a simple majority. If a candidate wins the most votes in a state, he or she is awarded all electoral votes in that state, with a few exceptions. Accordingly, the election campaign is focussing on the few states where the election is likely to be decided, the so-called swing states: Arizona, Georgia, Michigan, Nevada, North Carolina, Pennsylvania and Wisconsin. According to most polls, the margins in the swing states are currently very small and are sometimes within the range of a statistical error.

[2] There are a total of 538 electors, who are distributed among the 50 federal states and Washington D.C. according to population size.

Heated exchange of blows in the TV duel on 10 September

On 10 September, the two candidates engaged in a heated exchange of blows during the TV duel in Philadelphia. Harris managed to put Trump on the defensive several times, particularly on his stance on abortion, his criminal proceedings, and his foreign policy. Her strategy of using targeted pinpricks seems to have worked: according to a **CNN poll[3]**, 63% of respondents thought that Harris emerged victorious from the TV debate. She had made her election programme public shortly before the debate. While Harris' "new way forward" would largely mean "business as usual" and would continue Biden's policies, the uncertainties under a new Trump presidency appear much greater. However, it should be noted that the implementation of the legislative agenda by one side or the other will crucially depend on which party will control Congress. Fiscal initiatives usually require congressional approval, while trade policy can be regulated mainly by executive order. According to current polls, it is unlikely that Democrats or Republicans **will have a majority in both chambers[4]**.

In the TV debate, it once again became clear that the state of the US economy is of crucial importance regarding the outcome of the election on 5 November. In terms of trade policy, the signs continue to point to protectionism – regardless of who moves into the White House. As an advocate of an aggressive, highly protectionist trade policy, particularly vis-à-vis China, Trump wants to impose additional tariffs of 10-20% on all US imports, including those from allies, and 60% (or more) on imports from China. This means that Trump's trade policy agenda is significantly more protectionist than under Harris. However, the Democrats also increasingly see the economy as a fundamental part of national security and China as its greatest threat. The Biden administration has kept most of the import tariffs introduced by Trump. The eurozone (and probably the export-dependent German economy in particular) would also suffer from a continued US hardline stance towards China, which is still struggling with a **sluggish economic recovery[5]**, or even an escalation of the trade conflict. In **tax policy[6]**, the corporate tax rate for companies in the US could rise from the current 21% to 28% under Harris, while Trump is advocating a further reduction to 15% for companies that produce in the US. In the short term, an expansion of these tax cuts could provide a tailwind for corporate earnings and positive impetus for the US equity market. In the longer term, however, they are likely to drive up US government debt, which has risen to around USD35 trillion under the current administration – and thus a so-called **bear steepening[7]** of the US yield curve could be expected. This would make debt servicing more expensive and further restrict fiscal room for manoeuvre. Trump's economic policy agenda would **fuel inflation[8]** again (assuming he would implement it as announced).

US equities remain an elementary component of a balanced, diversified asset allocation

As a result, while a Republican victory (especially if they also take Congress) poses a risk to the inflation outlook and US government bond yields, US equities remain an elementary component of a balanced, diversified asset allocation regardless of the outcome of the election. Over the past 10 years, the broad US equity market (MSCI USA) has performed significantly better than most indices of other industrialised countries or regions, such as its European counterpart (MSCI Europe) or the corresponding emerging markets index (MSCI Emerging Markets, see chart 2).

[3] Link to the corresponding CNN press release: https://edition.cnn.com/2024/09/11/politics/election-poll-trump-harris-debate/index.html

[4] The US Congress is made up of two legislative chambers, the Senate and the House of Representatives.

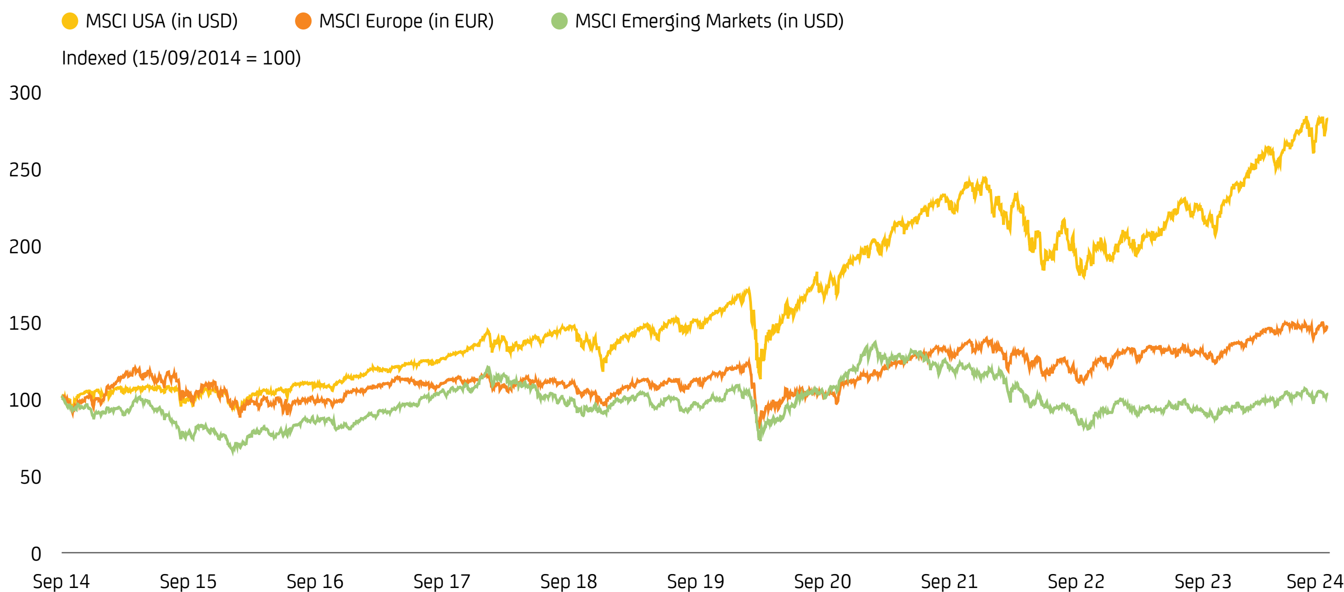
[5] In the second quarter, China's gross domestic product (GDP) only grew by 4.7%, and it is doubtful whether the official growth target of around 5% can be achieved without a major economic stimulus package (see also the Economy and markets section).

[6] However, Harris only wants to tax realised capital gains at 28%, a good 10 percentage points less than Biden.

[7] Bear Steepening is the term used to describe the steepening of the yield curve that occurs when long-term interest rates rise faster than short-term rates.

[8] Trump's immigration policy, too, would likely lead to higher inflation if consistently implemented.

2. STRONG PERFORMANCE OF THE BROAD US EQUITY MARKET IN RECENT YEARS



Note: Past performance, simulations and forecasts are not a reliable indicator of future performance. The indices cannot be purchased and therefore do not include any costs. When investing in securities, costs are incurred which reduce the performance. When investing in foreign currencies, the return may also rise or fall as a result of currency fluctuations.
Source: Bloomberg, UniCredit Group Investment Strategy, observation period: 15/09/2014-15/09/2024

Given that in recent years economic growth in the US has been higher than in the eurozone, in particular, demographic factors and productivity (among others) are likely to ensure that this will probably not change in the foreseeable future. In contrast to the eurozone, Japan or China, the United Nations forecasts that the number of people of working age in the US will not shrink in the coming decades. The considerable number of global market leaders and innovative growth companies also speaks in favour of the attractiveness of the US stock market. A large part of the market capitalisation of the MSCI USA is accounted for by the technology sector and a handful of highly valued **megacaps**[9]. Regardless of who sits in the White House in the future, there is much to suggest that these will remain in demand. This is also because artificial intelligence (AI), in particular, is fuelling a massive investment cycle that is likely to lead to productivity gains and cost savings. Accordingly, despite the uncertainty surrounding the US election, we believe that investors are well advised to maintain an appropriate weighting of US equities in their portfolios. In the short term, we only see more difficult conditions for this asset class in case of a recession. Currently, we do not anticipate such a **hard landing**[10] scenario. In the context of asset selection, it should also be kept in mind that the economic conditions of some sectors are likely to depend significantly on the election outcome – particularly those that are heavily regulated or subsidised.

[9]Megacaps have a market capitalisation or market value of over USD200 billion.

[10]A hard landing is characterized by a significant weakening of the economy, higher unemployment rates and lower economic activity.

Macro & Markets

Fed heralds interest rate pivot, ECB makes gradual move

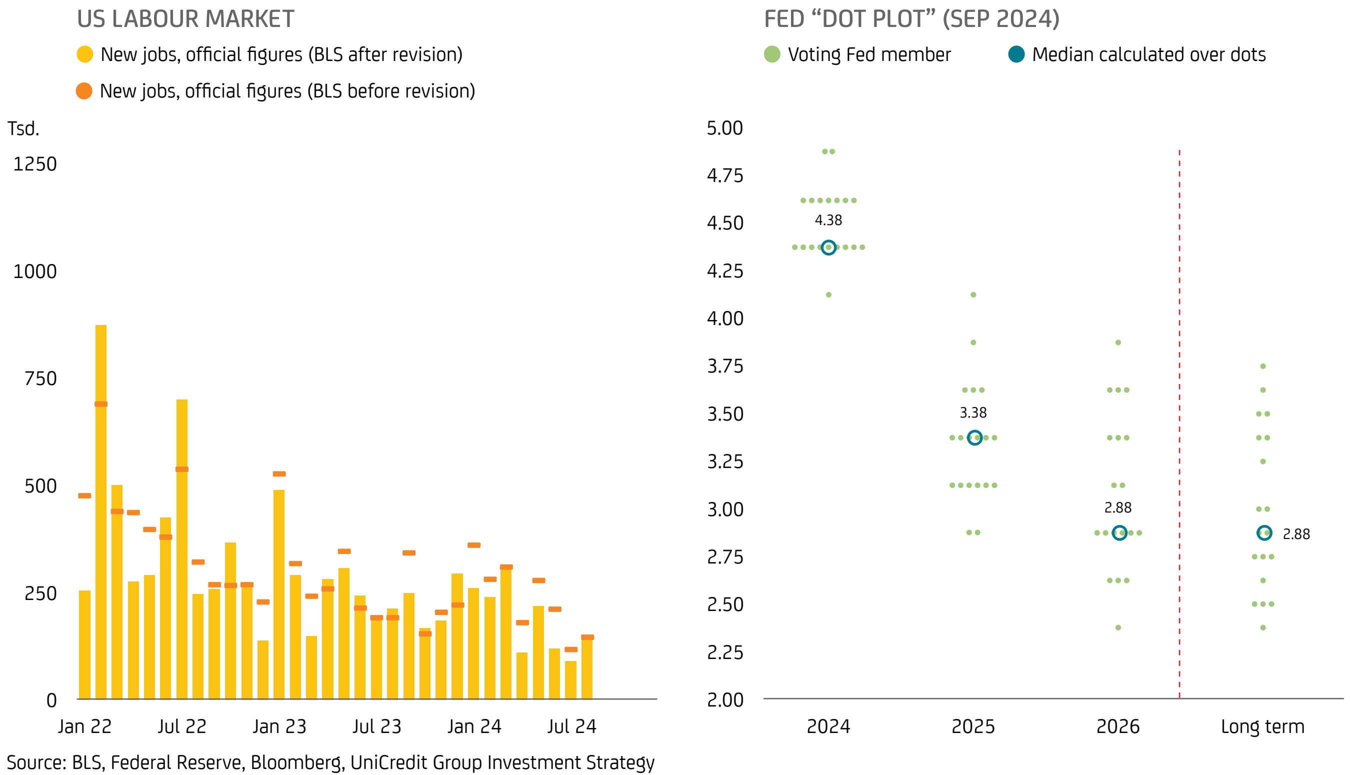
US CENTRAL BANK INITIATES RATE-CUTTING CYCLE AND CONFIRMS SOFT LANDING SCENARIO

The US economy continues to lose momentum. The labour market, which is particularly important for the US, presented a mixed picture in August: While the unemployment rate fell, the rise in employment (excluding agriculture) was disappointing. In particular, the sharp downward revisions to employment figures in the previous months weighed on the growth picture on the financial markets. Despite the data revisions, we believe that our base scenario of a soft landing for the US economy remains intact and do not expect a recession (see chart 3). The slowdown in momentum is also evident on the inflation side. The overall rate fell further in August to 2.5% compared to the same month last year (previously 2.9%), which is primarily due to a decline in energy cost inflation. The core rate (overall rate excluding the volatile energy and food components) remained at 3.2% in August, primarily due to stubborn inflation in the services sector. However, several leading indicators suggest that price pressure in the services sector should also gradually ease in the coming months.

As expected, the US Federal Reserve (Fed) initiated its cycle of interest rate cuts at its meeting in September. The rate cut of 50 basis points (bps) to 5.00% (key interest rate at the upper band) was a bigger step than most economists had expected, although the financial markets had already priced in this sized rate cut in the run-up to the meeting. According to Fed Chairman Jerome Powell, the progress made on **disinflation**[11] and the slowdown in the labour market make a realignment of monetary policy necessary. According to the Fed, the US economy is basically in good shape and the interest rate cut serves to keep the economy there. This is also reflected in the Fed's updated growth forecasts for this year and the following three years, which continue to assume solid growth of 2%. The inflation forecasts have been revised further downwards and emphasise that the Fed sees itself on the way towards the 2% target. The updated **"dot plot"**[12] shows a more gradual rate cut cycle (see chart 3), with the Monetary Policy Committee roughly fluctuating between cumulative rate cuts of 25 bps and 50 bps in the remaining two meetings of this year, and a median projection of 100 bps for next year. However, Powell emphasised at the press conference that all options remain open, and the actual extent and pace of rate cuts will depend on the totality of incoming economic data. We assume that the Fed will cut interest rates by a further 50 bps by the end of the year.

[11] Disinflation refers to a situation in which inflation rates fall over time but remain above zero. If inflation rates fall below zero, disinflation becomes deflation.

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

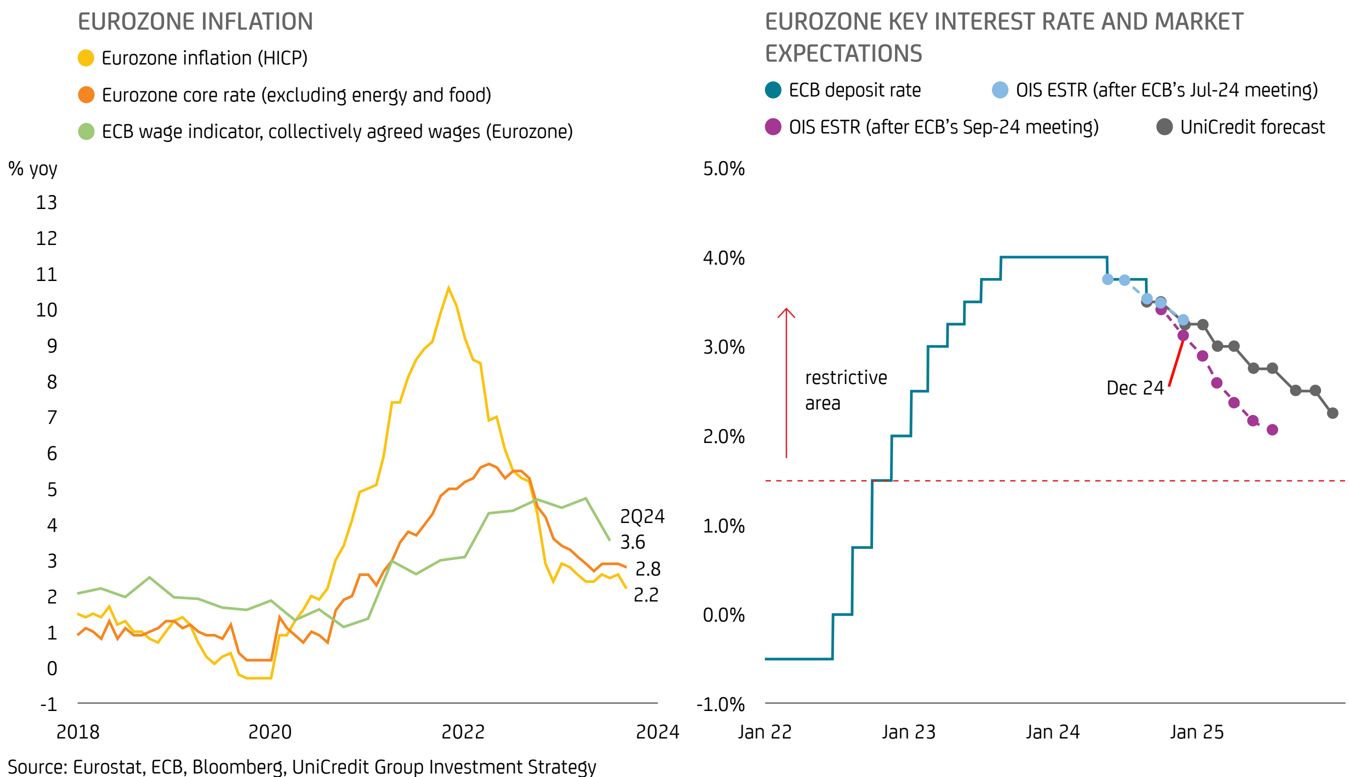


Source: BLS, Federal Reserve, Bloomberg, UniCredit Group Investment Strategy

EUROZONE: ONGOING DISINFLATION TREND, ECB CONTINUES TO CUT INTEREST RATES

The economic recovery in the eurozone continued in the second quarter. Revised GDP growth totalled 0.2% compared to the previous quarter and was therefore only 0.1 percentage points (pp) below the figure for the first quarter of the year. Supporting signals for a sustained recovery are coming from company surveys, particularly the purchasing managers' indices. Although these continue to indicate that the weak phase in industry has not yet been overcome, the service sector is clearly in expansion mode and should therefore support the eurozone economy. Overall inflation fell to 2.2% year-on-year in August (from 2.6% in July), mainly due to lower energy prices (see chart 4). Core inflation fell only slightly to 2.8% from 2.9% in the previous month. The stubborn inflation in the services sector, which rose again slightly to 4.2% in August, must continue to be monitored. Here too, however, we expect the core rate to fall further towards the central bank's target of 2% in the coming quarters due to declining wage pressure (in the second quarter of the current year, there was a significant decline to 3.6% from well over 4% in the previous quarter).

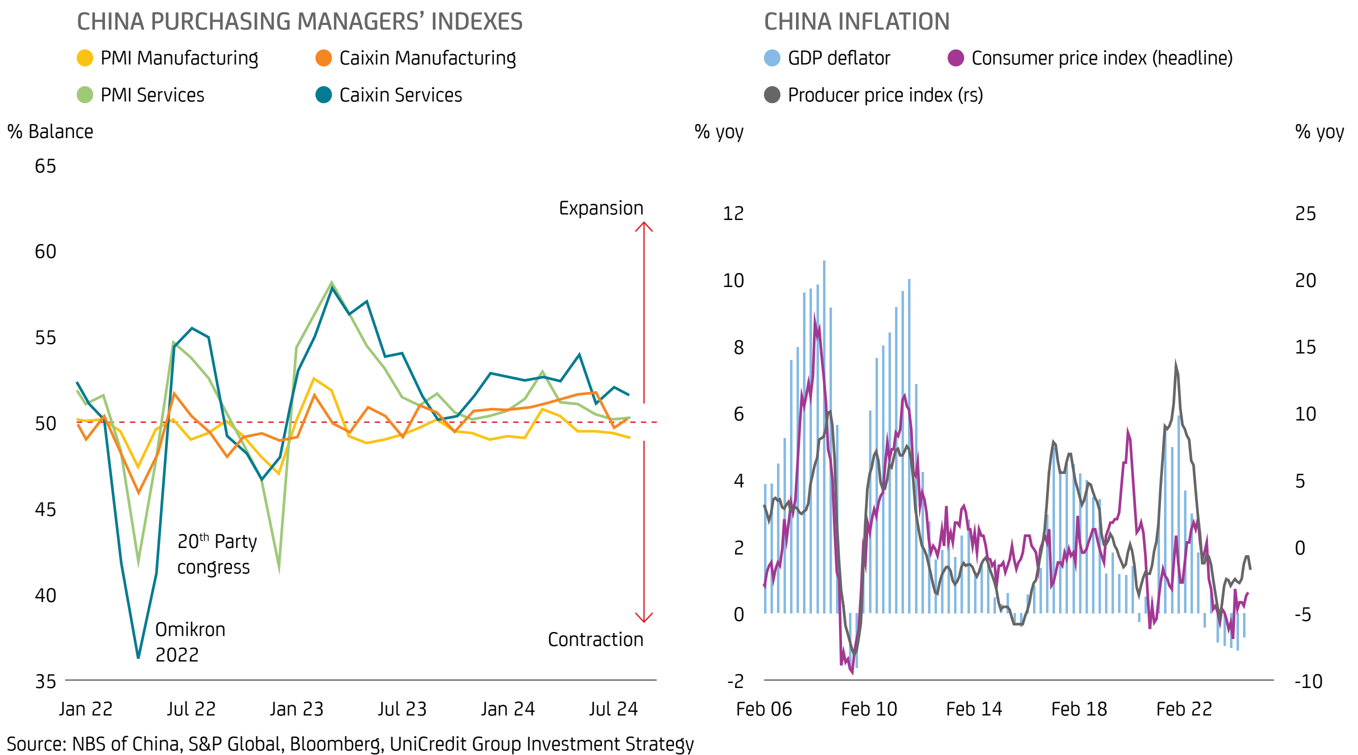
As expected, the European Central Bank (ECB) lowered the deposit rate by 25 bps to 3.50% at its meeting in September (see chart 4). The refinancing rate was lowered from 4.25% to 3.65%, reflecting the reduction to 15 bps in the gap between the two key interest rates announced for September. In addition to the interest rate decision, the central bank also presented revised growth and inflation forecasts. The new forecast for overall inflation remained unchanged compared to June, while the forecast for core inflation was raised slightly. Despite this announcement, the ECB continues to expect both core and headline inflation to move towards 2% by the end of 2025. The central bank has revised its growth forecasts slightly downwards for the individual years of the forecast period (2024 to 2026), primarily due to the weak development of private consumption. Nevertheless, the ECB does not anticipate a recession and is maintaining its overall constructive economic outlook for the coming years. At the press conference, ECB President Lagarde remained vague about the timing and amount of the next interest rate cut. However, one indication that the central bank will probably pause on interest rates at its next meeting in October is the statement that there is a "relatively short period of time" between now and the meeting. This suggests that the ECB will not have enough information before then to take a further step. We therefore maintain our expectation that the ECB will cut interest rates once again this year, by 25 bps, at the December meeting.



CHINA: ECONOMIC RECOVERY REMAINS WEAK, DEFLATION RISKS INCREASE

The most recently published leading indicators, in particular survey and sentiment indicators, suggest that the persistently weak momentum of the Chinese economy is likely to continue in the third quarter of the current year. The purchasing managers' indices for the manufacturing sector are still close to or in contraction territory (i.e. below the 50 index point mark). The only supporting factor is the services sector, which is still in expansion territory but has recently lost further momentum. The "hard" economic data, such as industrial production and retail sales, also point to less dynamic economic development. Both industrial activity and retail sales fell short of expectations in August.

The weak economy is also reflected in persistently low inflationary pressure. Various measures of inflation continue to show subdued monthly growth rates. Consumer price inflation rose only slightly by 0.6% year-on-year in August, while producer prices fell significantly to -1.8% (compared to -0.8% in the previous month of July). The rather broad-based GDP deflator, which includes price trends for all goods and services in the Chinese economy, has now been in negative territory for five consecutive quarters, signalling structural deflationary tendencies. This means that all key Chinese inflation indicators are below historical levels, highlighting the challenges of revitalising domestic demand and price stability.



Source: NBS of China, S&P Global, Bloomberg, UniCredit Group Investment Strategy

FINANCIAL MARKETS: INTEREST RATE CUTS BY CENTRAL BANKS CREATE A POSITIVE MOOD

August was generally characterised by positive market sentiment. The market's focus on growth themes and weaker economic data, as well as the associated concerns about a more significant slowdown in the US economy, repeatedly led to increased volatility across the stock markets. Overall, however, the narrative of a "soft economic landing" remained intact. The recovery phase following the sharp sell-off on the global equity markets, which took place after the unexpected interest rate hike by the Japanese central bank and led to the liquidation of a considerable proportion of yen carry trade positions at the end of July and beginning of August, is also likely to have had a supportive effect. However, the sell-off on the stock markets was short-lived. After an initial rise in volatility, the prospect of interest rate cuts by central banks and a solid reporting season for the second quarter, which showed few signs of an imminent economic slowdown, have provided support. Most markets were able to recoup their losses by the middle of the month. Over the entire reporting period (1 August to 20 September), US equities rose significantly, as did their European counterparts (see table).

August was also a positive month for fixed interest investments. The volatility observed at the beginning of the month led to a flight to quality (government bonds with good credit ratings), while the prospect of (further) interest rate cuts by central banks caused yields on the bond markets to fall further and prices to rise. However, as a large proportion of the expected interest rate cuts had already been priced into the markets, movements in bond yields were largely limited overall in the reporting period (see table). However, the main theme remains the imminent normalisation of the yield curve (steepening) with a stronger decline in yields at the short end (due to the expected interest rate cuts by central banks), while yields at the long end remained relatively firm (growth prospects). However, the Fed's most recent interest rate decision, which confirmed the expected "soft landing" scenario as well as an increase in the neutral long-term interest rate, has recently also pushed yields at the long end slightly higher again. The steepening of the yield curves can therefore be observed not only at the short end, but also at the long end.

Oil prices tended to fall in the reporting period (see table), which is primarily due to the global economic slowdown. The extension of the production cuts by the OPEC+ countries (Organisation of the Petroleum Exporting Countries plus Russia) by a further two months (now also October and November) did little to change this. The renewed geopolitical tensions in the Middle East have recently boosted oil prices again. The gold price rose significantly in the reporting period (see table), driven by the prospect that US monetary policy would initiate its interest rate reduction cycle at its meeting in September, which it then did with a sharp interest rate cut. In this environment, the euro exchange rate was well supported and continued to gain against the US dollar (see table).

Asset Allocation – How we manage our portfolio mandate

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

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

EQUITIES

GLOBAL EQUITIES: NEUTRAL

The environment for global equities remains favourable: despite signs of a slowdown, the US economy remains resilient, and the trend towards rate cuts by the major western central banks is expanding, with the Fed having ample room to further ease rates. Despite a few exceptions, earnings and revenue expectations have not disappointed so far. Moreover, the European economy is more fragile but nonetheless in decent shape, and the prospect of a less restrictive monetary policy continues to provide support as well. The fourth quarter traditionally offers positive seasonality for equities. On the other hand, valuations are relatively high in some areas and geopolitical risk remains meaningful. We are therefore maintaining a neutral weighting for global equities.

EQUITIES EUROPE: NEUTRAL

Recent macroeconomic data indicates that the economic environment in the eurozone remains weak. However, we do not expect to see another strong decline in economic activity. The labour market remains solid, inflation is cooling, and consumer confidence is regaining ground. Nonetheless, the manufacturing sector PMI remains sluggish and exposed to the risk of deterioration of global trade. The still comparatively favourable valuations with respect to US stocks support European equities, which offer correspondingly good opportunities for value and quality-oriented investors. Overall, we think the outlook for the fourth quarter remains constructive and confirm a neutral weighting on the asset class.

US EQUITIES: NEUTRAL

US economic growth is undoubtedly losing momentum, as weakening labour market data show, but we think a soft landing remains more likely than a hard landing. The fact that the Fed has initiated its easing cycle after the last encouraging inflation reports, in combination with its constructive messages on the economy and inflation, should support equity markets. However, valuations remain quite high both in historical terms and with respect to the rest of the world. Overall, we prefer to maintain a neutral stance on the asset class.

EMERGING MARKET EQUITIES: NEUTRAL

We remain strategically cautious on emerging market (EM) equities, mainly because of our gloomy outlook on Chinese stocks. Although the latest data highlights China's persistently weak import demand and, depending on the outcome of the US presidential election, with external headwinds likely to build, pessimism for the country's stock market may have reached its peak. Nevertheless, obstacles remain for the broad market due to some structural problems and geopolitical concerns. Overall, valuations of EM equities, in turn, appear comparatively favourable. We continue to favour a neutral weighting and to stress the need for a selective approach to EM by country and sector.

PACIFIC EQUITIES (DEVELOPED MARKETS): OVERWEIGHT

The end of the negative interest rates era and of the yield curve control policy by the Bank of Japan (BoJ) has positive implications for the Japanese yen. The rise in corporate profits and the reform of the Tokyo Stock Exchange are boosting equity prices, encouraging extensive share buybacks by Japanese companies. While valuations still do not appear expensive, the potential headwind for earnings from a stronger yen and some mixed policy signals from the BoJ must also be taken into consideration. Overall, we remain overweight on Pacific equities.

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 remain underweight in this investment segment.

BONDS

GLOBAL BONDS: OVERWEIGHT

Given current yields and prospective monetary policy easing by major western central banks, global bonds offer attractive risk-adjusted returns, supported by ongoing disinflation and slowing, though resilient, economic growth. Historically, a period of rate cuts has been a compelling time for fixed income investments. 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 thus maintaining our overweight on global bonds.

EMU GOVERNMENT BONDS: NEUTRAL

Euro Government bonds (govies) should benefit from the ongoing disinflation process supporting the ECB's easing cycle. However, future cuts seem already fairly priced in at the current level of yields, and only further deterioration of the economic outlook and labour market data could possibly reflect into additional gains for the asset class. We are therefore maintaining a neutral view on this asset class.

NON-EMU GOVERNMENT BONDS: NEUTRAL

The still robust US economy is supporting non-EMU government bonds, even though signs of a slowdown have recently become clearer. The decision by the Fed to start cutting interest rates boosted the asset class. However, even if marginal, the risk of higher-than-expected inflation and fewer-than-expected interest rate cuts by the Fed remains. We therefore 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. Overall, the fundamentals of investment grade (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. 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 (which is not our base case). In addition, low liquidity of HY bonds makes them less appealing in the current phase of the economic cycle. HY bonds therefore remain underweighted.

EMERGING MARKET BONDS (HARD CURRENCY): OVERWEIGHT FROM NEUTRAL

Emerging market bonds in hard currencies generally offer an interesting carry (yield advantage over euro government bonds). Moreover, the continuing monetary easing by the Fed and a weaker US dollar should benefit emerging markets economies. Accordingly, we have moved the asset class from neutral to overweight.

EMERGING MARKET BONDS (LOCAL CURRENCY): OVERWEIGHT

Emerging market bonds in local currency also offer an interesting carry. Ample room for interest rate cuts by central banks of emerging countries should benefit the asset class. In addition, emerging market currencies appear undervalued and are likely to regain ground when the Fed continues to cut interest rates. Emerging market bonds in local currency remain overweighted.

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

On the one hand, low oil inventories, production cuts by OPEC+ (the major oil producing countries and Russia, totalling 23 states), as well as geopolitical tensions, continue to support oil prices. On the other hand, demand has gradually normalized, with the deterioration of the global outlook, but lower rates may provide tailwinds for energy demand. We continue to favour a neutral weighting in this asset class.

GOLD: NEUTRAL

The gold price reached a new record high in September., as gold continues to benefit from central bank purchases – particularly by the People's Bank of China and the Central Bank of India. Upcoming interest rate cuts may support gold, while a weaker US dollar and the moderation of geopolitical uncertainties represent curbing factors for the demand for gold. We are maintaining a neutral weighting.

CURRENCIES

EUR-USD

Latest macro data, particularly the cooling of US inflation, support monetary easing by the Fed, reducing the interest rate gap with respect to ECB rates. This combines with our forecast for slower economic growth in the US and a rebound of economic activity in Europe next year, removing the major sources of strength for the greenback. We therefore see the potential for a partial depreciation of the US dollar against the euro in the medium term.

Columns

Local CIOs in dialogue with the clients

Answers from Italy

IS IT TIME TO REDUCE EXPOSURE TO EQUITIES?

We are finally heading into a promising market phase for bond investments. The economic slowdown and falling inflation are allowing central banks to maintain a firm pace towards lower levels of interest rates. What does this imply for equity markets? Is it time to take home at least some of the significant gains made since the beginning of the year? Can the August turmoil, and the approach of the US presidential election, be considered alarm bells? Our simple answer is no. We do not consider it useful at this stage to intervene in the overall weight of equity exposure in portfolios. It is true, however, that some portfolio changes can help maintain the growth trajectory and reduce the risks of violent corrections. As usual, let's go into the reasons why.

First, it is true that the outlook for fixed income for the next nine to 12 months is positive, and we should indeed seek to increase duration and credit risk positions. But we do not want to finance these increases with reductions in the equity portion. We will do so by using the cash component and short-dated government and corporate bonds. In fact, the return potential of that component is now limited, as the monetary curves already price substantial cuts by both the ECB and the Fed.

We now come to our equity portfolios construction process. Our approach, which we implement in our discretionary and advisory portfolios in Italy, is global. We have a significant weight of US equities at around two-thirds, in line with the weight in the world equity indices. To complement this, other preferred areas are European and Japanese equities. Now, exposure to emerging markets is residual, and in particular we express caution on Chinese equities.

Let us deep dive on Japanese equities, which saw a correction of historic magnitude in early August and only a partial recovery thereafter. Our fundamental view has not changed: On the one hand, the real economy, for the first time in decades, finally has a chance to defeat the specters of deflation, and on the other hand, companies, driven also by profound changes in stock market governance rules, are committed to a long-term path aimed at increasing capital efficiency and shareholder returns. But in the face of the volatility we have recently experienced, we are taking action to slightly reduce positions: We are dealing with an ingredient that we believe is very valuable but should be used in the right (reduced!) dosage.

Another "hot" topic is the valuations of US companies and especially the so-called "megacap" companies that dominate the technology environment. Here is precisely the point. It is true that current valuations appear expensive in a historical perspective, but these valuations are the consequences of two main elements. The first is that the macro sector of these companies, technology in the broadest sense, is the most promising long-term investment theme. It will not be a linear path, we will have "stop and go", but the effects on global consumption and production of technological innovation are not in question and we are already experiencing the initial stages of such transformations. The second is that these companies have almost absolute leadership positions in their target segments. So, investors are willing to pay a premium for the scarcity effect and lack of competition. Notably, our experience is that such competitive advantages do not last forever. For example, in the future we will likely have many more manufacturers of super chips dedicated to artificial intelligence and much more competition, and therefore lower valuations. Of course, this will not happen tomorrow, but it will be a path. We now consider exposure to that sector and the companies in it to be a foundational element of the investment strategy.

Let's close on the changes we are implementing to give our portfolios more road holding. We are in a cyclical slowdown, so we do not want to increase our positions on those sectors and companies that are more dependent on discretionary domestic consumption. But there are sectors that instead combine characteristics of potential return and defense, and we are working on these with a view to gradual accumulation. Meanwhile, we refer to the health care and pharmaceutical sector, a sector that is supported by the demographic dynamics and lifestyles of the Western world – but at the same time has a high rate of natural competitive innovation. Another interesting sector is the Financial sector. It is true that future lower rate levels will act negatively on the overall level of margins, but positively sloped interest rate curves will offset this effect as will the transformation of business models increasingly oriented towards generating fees from services. Finally, the Utilities sector. Companies in this sector are nerve hubs for the transformations that our economies and societies have chosen to face: the technological revolution, which requires unimagined amounts of energy and infrastructure capable of transporting and storing it, and the energy transition, which requires research and deployment of multiple competing options to energy production from fossil fuels. And in these areas, the European market also has interesting companies and global champions.

In summary, rather than asking what the right weight of the equity component is, we think the activity of selecting sectors, themes and companies is essential. Building a sector allocation that combines the propulsive power of the Technology sector with the stabilizing effects of some defensive sectors is, in our view, the ideal solution for navigating the current equity market environment.

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

TACTICAL INCREASE IN LOCAL CURRENCY EMERGING MARKETS BONDS

The Fed lowered its key interest rate by half a percentage point in mid-September. This interest rate turnaround in the US is starting with a big step and is intended to boost the labour market and keep the economy on a growth path. This was the first easing in more than four years and should not only support the US, but also emerging markets. In particular, the lower yields on US government bonds are making the yields in emerging markets more attractive once again. An expected, future increases in the inflow of capital into emerging markets should also have a positive impact on currency trends. Historically, emerging market currencies have performed well on average six months after the start of the Fed`s easing cycle. We assume that currencies could also have a good chance of appreciating in the current easing cycle.

Other possible arguments in favour of this asset class are the conservative financial policy and the lower inflation in many emerging markets countries. Their governments continue to pursue a conservative fiscal policy and keep their external balance sheets under control. The number of countries with high budget and current account deficits is falling steadily in 2024, and most countries are reporting overall inflation that is back within the target range of their respective central banks. Despite the significant decline in inflation, emerging markets central banks have been cautious in their pace of easing given the uncertainty surrounding the Fed`s interest rate path and the continued volatility in US yields. Real GDP growth within this asset class should outpace developed market growth over the next few years and should also support currency appreciation.

Our view is that local currency emerging markets bonds offer an attractive carry and could receive a tailwind from interest rate cuts. In addition, local currencies appear undervalued and are likely to regain ground if the Fed cuts interest rates further. A wait-and-see approach by the Fed and a stronger US dollar would weigh on the asset class (which is not our base scenario). It should also be noted that potential credit risks and foreign currency fluctuations, which are often higher in emerging markets, can have a negative impact on potential returns. Given the compelling opportunities offered by emerging markets bonds in local currency, which we believe outweigh the risks, we are increasing our overweighting in this asset class.

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

WHAT DO YOU THINK OF THE DRAGHI REPORT ON EU COMPETITIVENESS?

After the EU Commission asked the former ECB President and former head of government of Italy, Mario Draghi, to analyse how the EU can remain competitive around a year ago, he presented the corresponding strategy report at the beginning of September. Draghi considers increasing the EU's productivity to be an "existential challenge" to avoid falling behind in competition with the US and China in the long term, and is calling for massive additional investments of EUR750-800 billion per year in the digitalisation and decarbonisation of the EU economy and in the EU's defence capabilities. This corresponds to 4.4% to 4.7% of European gross domestic product (2023) – levels last seen in the 1970s. The most important of his proposals include the relaxation of competition rules, the integration of capital markets, the increased use of joint procurement procedures in the defence sector, and a new trade agenda to strengthen the EU's economic independence. According to Draghi, historically around four-fifths of productive investment in Europe has been made by the private sector, with the remaining fifth coming from the public sector. Accordingly, Draghi pleads for joint EU debt, i.e. the issue of joint bonds, as the EU has already launched on the market as part of its fund to combat the consequences of the coronavirus pandemic (Next Generation EU, NGEU).

Draghi's concerns that the EU has "largely missed out on the digital revolution led by the internet and the [associated] productivity gains", and is losing ground to the US and China when it comes to new technologies, can hardly be denied. Only four of the 50 largest technology companies in the world are European. His criticism of the fragmentation of the EU single market, which remains unfinished 30 years after its birth, and the lack of a genuine capital markets union, which has so far prevented more risk capital from flowing into start-ups, also seems justified. It is undisputed that research and development (R&D) and the associated innovations are of fundamental importance for the competitiveness of national economies. As early as 2000, the EU set itself the goal of sustainably increasing the competitiveness of the European economy with the so-called Lisbon Strategy. To achieve this, total R&D expenditure was to rise to 3% of GDP within 10 years. With expenditure of around 2.2% (Eurostat data for 2022; by comparison, 3.4% in the US), this target has so far been missed by a wide margin.

Irrespective of the question of financing – EU Commission President Ursula von der Leyen also described instruments for joint financing as important but also sees so-called own resources as conceivable – the report should serve as an important counterweight to the advocates of strict fiscal rules in the general EU budget discussions and support fiscal incentives. In principle, we also believe that more Europe, is the right way to bring the EU forward again in terms of competitiveness. In addition to mastering digital transformation, progress in the sustainable decarbonisation of the EU economy towards a clean and competitive circular economy is of central importance in this context.

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

The table

DEVELOPMENT OF SELECTED FINANCIAL MARKET INDICES

From	**20.09.23**	20.09.19	20.09.20	20.09.21	20.09.22	20.09.23	20.09.19	**01.01.24**
To	**20.09.24**	20.09.20	20.09.21	20.09.22	20.09.23	20.09.24	20.09.24	**20.09.24**
Stock market indices (total return, in %)								
MSCI World (in USD)	**29.9**	9.8	31.1	-14.4	17.5	29.9	85.3	**17.7**
MSCI Emerging Markets (in USD)	**19.1**	11.9	16.1	-22.3	5.8	19.1	24.8	**10.7**
MSCI US (in USD)	**33.7**	14.2	34.1	-12.1	15.9	33.7	106.3	**20.4**
MSCI Europe (in EUR)	**16.3**	-4.9	26.1	-6.6	18.2	16.3	51.6	**10.2**
MSCI AC Asia Pacific (in USD)	**20.1**	12.4	18.4	-23.0	10.5	20.1	33.5	**12.3**
STOXX Europe 600 (in EUR)	**16.8**	-3.3	26.4	-8.3	18.0	16.8	52.0	**10.5**
DAX 40 (Germany in EUR)	**20.2**	5.3	15.4	-16.3	24.6	20.2	50.1	**11.8**
MSCI Italy (in EUR)	**26.1**	-13.3	28.8	-7.4	41.6	26.1	81.0	**18.3**
ATX (Austria, in EUR)	**20.5**	-27.5	66.0	-14.7	17.3	20.5	42.9	**10.6**
SMI (Switzerland, in CHF)	**11.2**	8.2	14.9	-8.5	10.0	11.2	38.4	**10.6**
S&P 500 (USA, in USD)	**33.6**	12.5	33.3	-10.2	16.1	33.6	106.6	**20.8**
Nikkei (Japan, in JPY)	**18.0**	8.2	32.7	-7.4	22.0	18.0	88.4	**13.8**
CSI 300 (China, in Yuan)	**-10.3**	23.2	4.3	-17.3	-3.4	-10.3	-8.9	**-4.2**
Bond market indices (total return, in %)								
US Government Bonds 10Y (in USD)	**10.4**	13.7	-3.1	-16.6	-3.0	10.4	-2.7	**4.0**
US Government Bonds (ICE BofA, in USD)	**9.8**	8.9	-2.1	-13.2	-1.4	9.8	-0.6	**4.3**
US Corporate Bonds (ICE BofA A-BBB, in USD)	**13.8**	9.1	3.0	-17.0	2.6	13.8	7.9	**6.0**
German Bunds 10Y (in EUR)	**7.2**	0.0	-1.2	-17.9	-3.6	7.2	-16.5	**0.5**
EUR Government Bonds 1Y-10Y (iBOXX, in EUR)	**7.7**	1.0	-0.5	-16.7	-2.7	7.7	-12.4	**1.2**
EUR Corporate Bonds 1Y-10Y (iBOXX, in EUR)	**8.7**	0.7	1.8	-14.6	2.2	8.7	-2.9	**3.2**
Bond yields (change in basis points = 0.01 percentage points)								
US Government Bonds 10Y (in USD)	**-76**	-108	62	226	80	-76	197	**-14**
US Government Bonds (ICE BofA, in USD)	**-113**	-132	37	297	92	-113	191	**-39**
US Corporate Bonds (ICE BofA A-BBB, in USD)	**-127**	-106	0	326	65	-127	169	**-44**
German Bunds 10Y (in EUR)	**-57**	2	17	225	74	-57	267	**15**
EUR Government Bonds 1Y-10Y (iBOXX, in EUR)	**-60**	-8	11	239	81	-60	268	**15**
EUR Corporate Bonds 1Y-10Y (iBOXX, in EUR)	**-101**	4	-17	347	45	-101	282	**-9**
Spreads on government bonds (credit spreads, change in basis points)								
US Corporate Bonds (ICE BofA US Corporate Master)	**-27**	16	-44	56	-27	-27	-26	**-11**
US Corporate Bonds (ICE BofA US High Yield)	**-74**	139	-193	165	-111	-74	-66	**-19**
Euro Corporate bonds (ICE BofA Euro Corporate AAA-A)	**-24**	-3	-15	91	-41	-24	9	**-18**
Euro Corporate Bonds (ICE BofA Euro High Yield)	**-76**	94	-146	251	-131	-76	-1	**-53**
Money market rates (change in basis points)								
Libor (USD, 3 months)	**-71**	-193	-10	348	206	-71	282	**-64**
Euribor (EUR, 3 months)	**-52**	-11	-4	165	283	-52	383	**-47**
Euro exchange rates (change in %)								
US Dollar (EUR-USD)	**5.0**	6.9	-1.0	-14.7	7.2	5.0	1.2	**1.0**
British Pound (EUR-GBP)	**-3.2**	2.9	-6.1	2.0	-1.0	-3.2	-4.9	**-3.4**
Swiss Franc (EUR-SFR)	**-1.5**	-1.8	1.0	-11.4	-0.4	-1.5	-13.3	**2.4**
Japanese Yen (EUR-JPY)	**2.4**	3.4	3.8	11.8	10.4	2.4	35.2	**3.0**
Commodities (change in %)								
Commodity Index (GSCI, in USD)	**35.6**	27.0	-11.0	-6.2	16.9	35.6	64.8	**26.4**
Industrial metals (GSCI, in USD)	**10.4**	5.5	38.7	-11.9	-0.5	10.4	38.8	**6.8**
Gold (in USD per fine ounce)	**36.2**	30.3	-9.7	-5.6	16.7	36.2	73.8	**26.6**
Crude oil (Brent, in USD per barrel)	**-19.9**	-33.0	72.0	22.1	3.2	-19.9	15.1	**-3.8**

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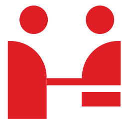

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