

# Market Outlook and Asset Allocation

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February 2024

# Index

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# 01.

## Synthesis

# Synthesis

## MACRO



The US economy is proving remarkably resilient, and leading indicators point to improving confidence as disinflation persists. In Europe, indicators at mild recession levels suggest that growth in the eurozone should remain amorphous this year. Overall, the global economy is poised to maintain stability, thanks to several tailwinds (increasing productivity, robust balance sheets, generous fiscal policies, declining interest rates, continued trend of disinflation..)

## FINANCIAL CONDITIONS



After reversing course in late 2023, bond yields slightly rose, and markets adjusted their rate expectations to more reasonable levels. But yields remained overall low YTD, relative to late last year. For the time being, credit spreads remain low but on the back of economic uncertainties in 2024, lending can decline, and credit conditions can resume their tightening

## INFLATION



Despite a few one-off rises due to base effects, disinflation is continuing to make headway and is now in line with the 2% target for both Europe and US over recent months. Nevertheless, inflation could be slightly stickier than expected as service inflation remains relatively high, fuelled in particular by wage growth and the transport sector.

## RISKS



**Few main risks that we are monitoring in the medium term:**

- Credit tightening and credit crunch by banks and non-banks
- Recession of earnings and strong contraction of global demand.
- Hard landing with the full effect of past hikes by central banks and the end of excess cash while high energy and commodity prices are putting pressure on real wages.

## CENTRAL BANKS



Central banks have changed their rhetoric: the "higher for longer" message has given way to talk of rate cuts. The ECB is likely to remain conservative and wait for new data before making its first rate cut. The Fed, more reactive and versatile, will probably react to any further weakness in the job market. Overall, the period between April and June is likely to be the period of the first cuts for both.

## TACTICAL ALLOCATIONS



We increase our exposure to equities by overweighting US growth stocks. Even when excluding the Magnificent 7, growth outperformed in 2023, notably due to the AI theme, and we believe this trend will continue in 2024. Furthermore, growth companies are currently at reasonable valuation levels and should benefit from the interest rate decline in 2024. In line with our macroeconomic scenario, we maintain our underweight position on Europe.

## IN A NUTSHELL

Our scenario remains that of soft landing. Concerns about a highly resilient labour market fuelling wage growth are fading. Indeed, companies have managed to maintain relatively high margins thanks to increased productivity. In addition, they present healthy balance sheets and do not need to correct excess capacity. The likelihood of the Fed cutting rates without a marked slowdown is increasing. Nevertheless, the evolution of consumption remains uncertain, while the least wealthy households are prey to micro-loan repayments on credit cards and the cash surplus is fading among affluent households.

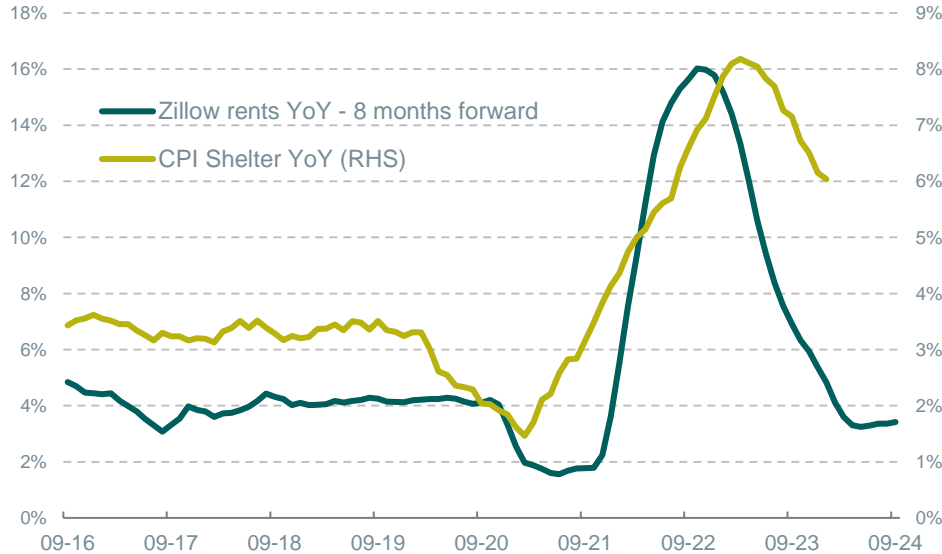
# 02.

## Economic and market outlook

# An upside surprise on US CPI, despite continued disinflation beneath the surface..

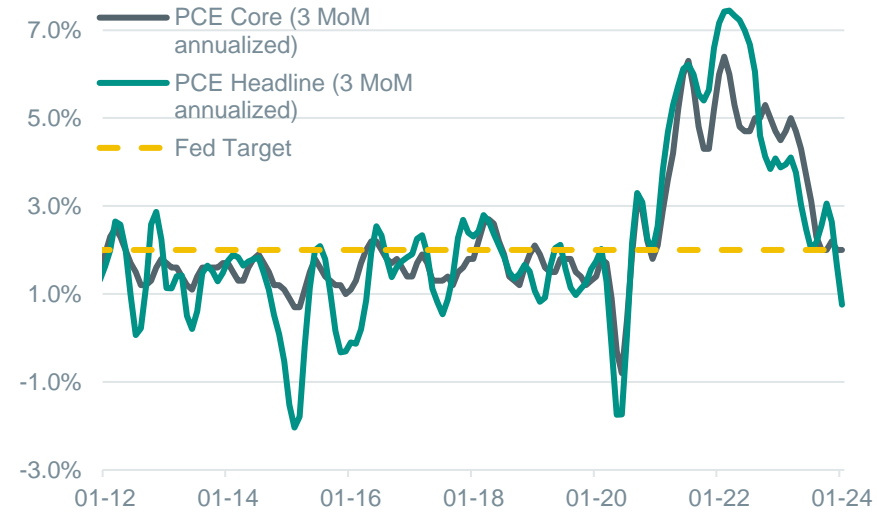
- ▶ Fed officials have already warned that the disinflation's last mile will not be as smooth as markets had expected. Indeed, US inflation in January defied all expectations, driven by shelter costs. Still, the disinflationary path is trending downwards, albeit at a slower pace.
- ▶ One detail which markets have omitted is that the shelter component as calculated in the CPI report is lagged. The Zillow rents index, a real-time measure of market rents, is now consistent with an inflation level close to the Fed's 2% target.

### Shelter CPI lags behind observed rent costs



Sources: Zillows, Reuters, monthly data from 09/2016 to 01/2024, ABN AMRO Investment Solutions

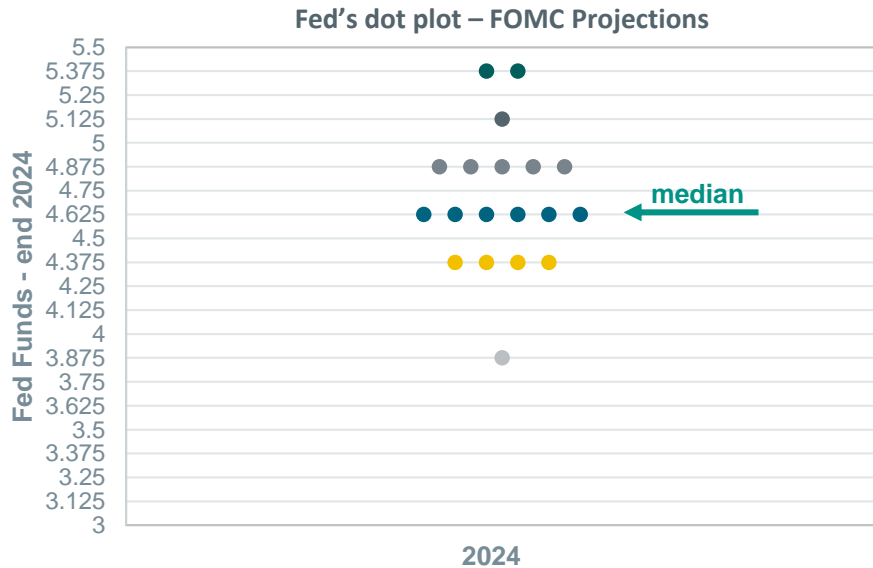
### Core & Headline PCE (3 MoM annualized)



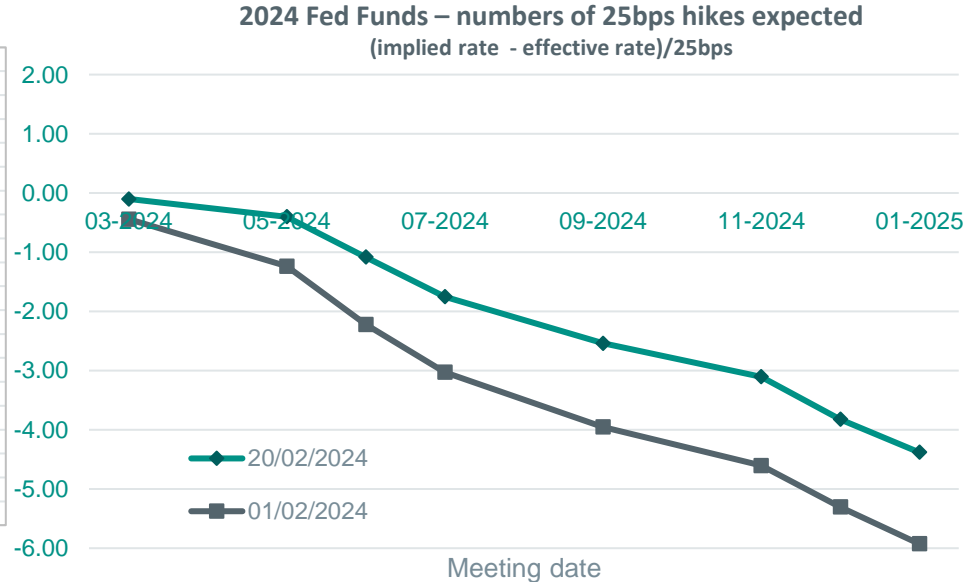
Sources: FRED, monthly data from 01/2021 to 01/2024, ABN AMRO Investment Solutions

# Pushed markets to revise their aggressive rate cut bets..

- ▶ After markets priced-in about 6 cuts for the Fed at the beginning of the month, they now only see between 3 and 4 cuts this year. This view is consistent with the last FOMC dot plot projections.
- ▶ As Fed officials have already been pointing out, the cutting cycle is likely to begin by summer (June). The Fed will probably not wait for an economic slow-down to start easing, as has been the case in the past ...



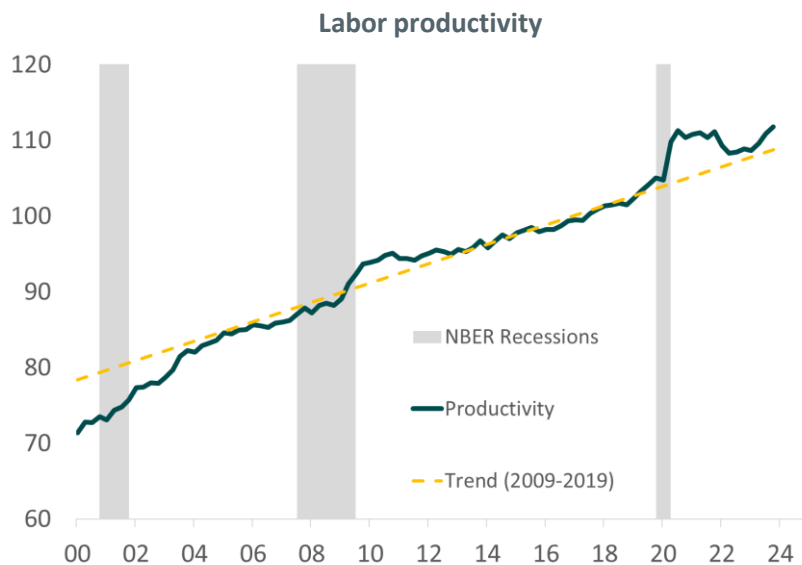
Sources: Fed Watch tool data, as of 20/02/2024, each dot corresponds to an FOMC member projection, ABN AMRO Investment Solutions



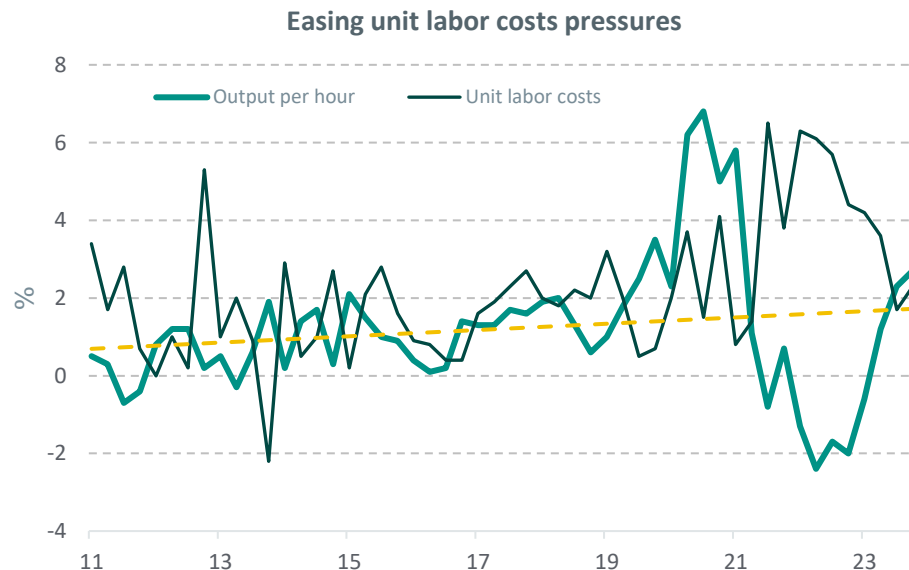
Sources: Bloomberg, ABN AMRO Investment Solutions

## But US high productivity will make the Fed's job easier ..

- ▶ A new paradigm has now emerged, justifying the current environment characterized by high interest rates, resilient wage growth with ongoing disinflation and high profit margins. Labour productivity in the US is above its long-term trend and is supportive of a soft/no landing scenario in the US, despite the Fed's past hiking cycle.
- ▶ Current and Former Fed officials have lately been highlighting this key point, while the Eurozone is suffering relatively low productivity, making the ECB's mission more challenging.



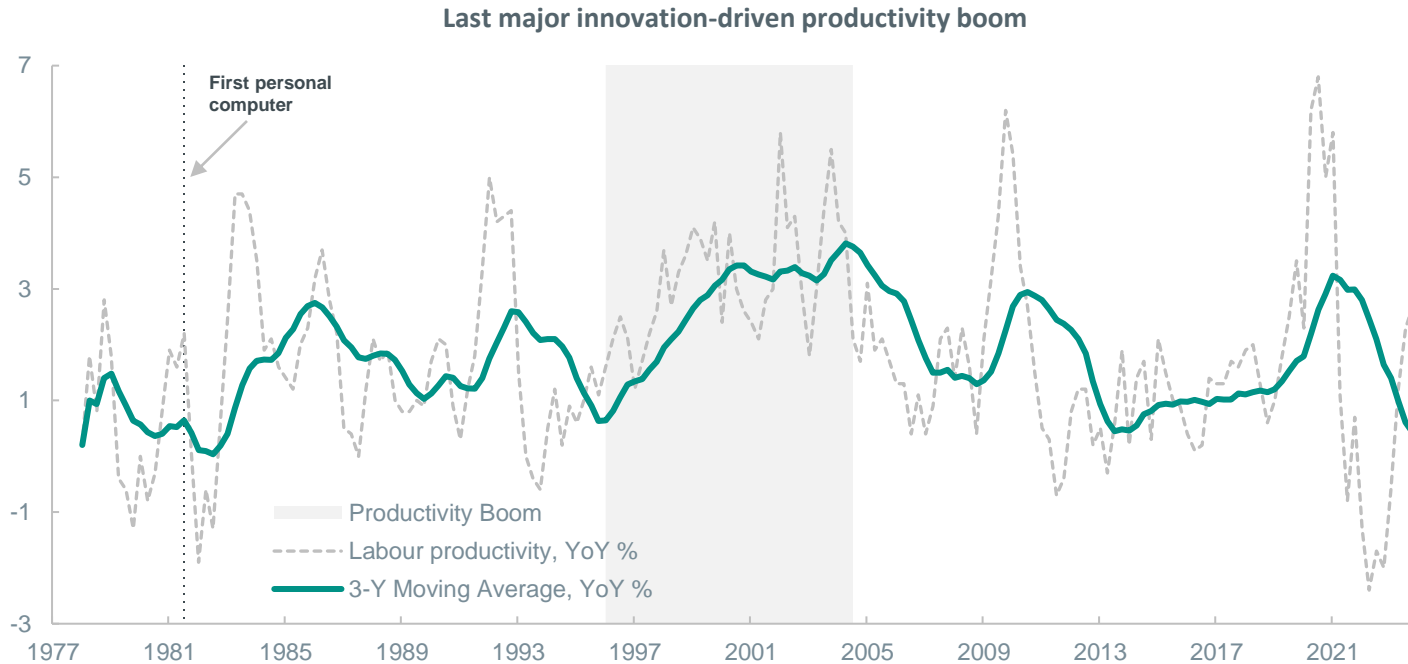
Sources: Bureau of labor statistics , quarterly data from Q1 2000 to Q4 2023, output per hour rebased to 100 as of 2017, ABN AMRO Investment Solutions



Sources: Bureau of Labor Statistics, change in % from year ago, quarterly data from Q1 2011 to Q4 2023 for Non-Farm business sector, ABN AMRO Investment Solutions

## And will progressively be boosted by AI in the years ahead...

- ▶ AI has been the trending theme in 2023. Although it will take time to incorporate Artificial Intelligence into the company's supply chain, this theme will only foster labour efficiency going forward and contribute to strengthening economic growth.
- ▶ Going back to the last major innovation, we see a strong (lagged) productivity growth that was sustained for years starting from 1996.

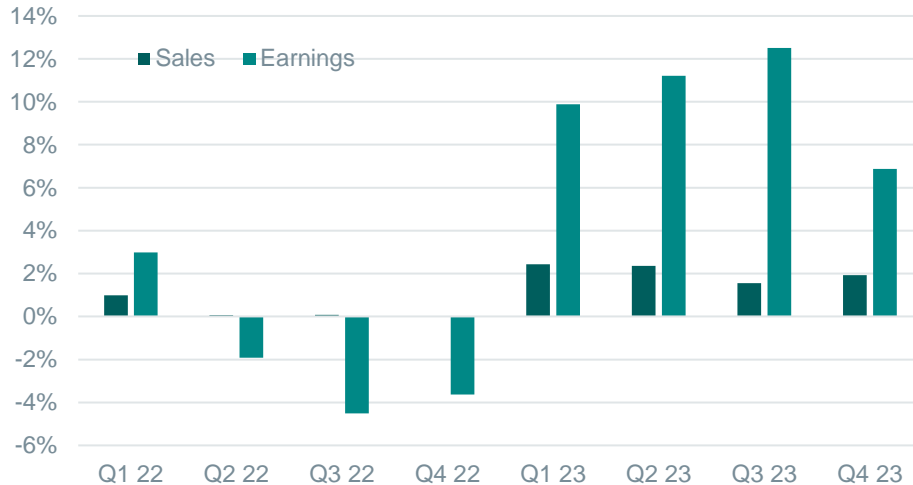


Sources: Bureau of Labor Statistics, quarterly data from Q1 1978 to Q4 2023, Grey-shaded area corresponds to the late 1990s-2000s productivity boom, ABN AMRO Investment Solutions

# Which has already driven the stock market into the bullish mood...

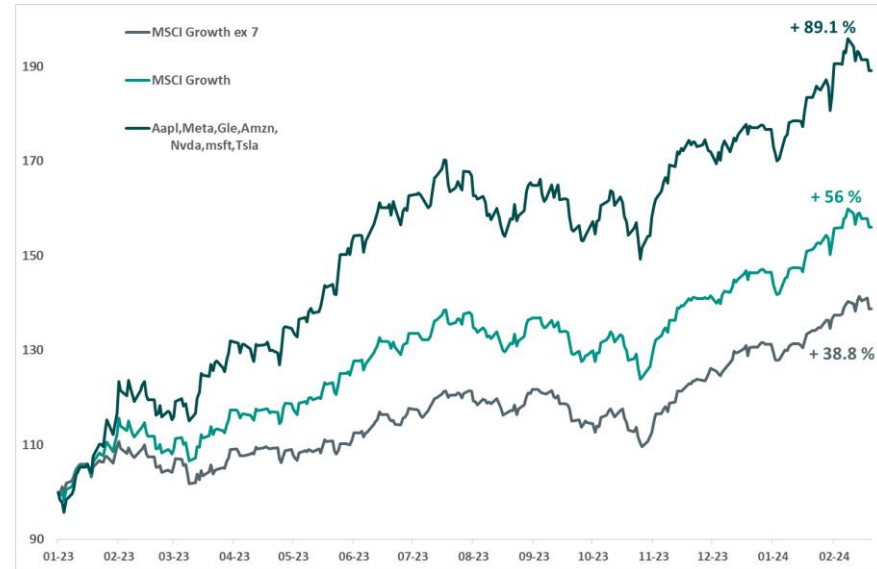
- ▶ The 7 magnificent led the outperformance of US stocks, rising close to double their value since the end of 2022. Still valuations seem historically reasonable, if compared to the peak of the internet bubble.
- ▶ The earnings season for these stocks during the whole year 2023 was also an upbeat. Companies' overall profit margins are currently far from recession levels.

Magnificent 7 – Positive earnings surprises in 2023



Sources: Bloomberg, Average earnings surprises in % for the Magnificent 7, UBS Magnificent 7 index, ABN AMRO Investment Solutions

Returns of the MSCI Growth and MSCI Growth ex 7





Sources: Bloomberg, Daily data from 30/12/2022 To 21/02/2024, ABN AMRO Investment Solutions,


# Business cycle – Leading indicators (PMI surveys)


- ▶ The composite PMIs are improving and are in expansion territory for all developed countries except those in the Euro area. The services sector remains the main driver behind these strong PMIs, while manufacturing PMIs are in contraction territory for almost all advanced economies.
- ▶ PMIs for all emerging countries remain in expansion territory but are slightly decreasing for Russia and China. Taiwan and Turkey Manufacturing PMIs are approaching the expansion threshold.

	Composite						Manufacturing						Services					
	08-23	09-23	10-23	11-23	12-23	01-24	08-23	09-23	10-23	11-23	12-23	01-24	08-23	09-23	10-23	11-23	12-23	01-24
Global	50.6	50.5	50.0	50.5	51.0	51.8	49.0	49.2	48.8	49.3	49.0	50.0	51.0	50.7	50.4	50.6	51.6	52.3
USA	50.2	50.2	50.7	50.7	50.9	52.0	47.9	49.8	50.0	49.4	47.9	50.7	50.5	50.1	50.6	50.8	51.4	52.5
Euro area	46.7	47.2	46.5	47.6	47.6	47.9	43.5	43.4	43.1	44.2	44.4	46.6	47.9	48.7	47.8	48.7	48.8	48.4
France	46.0	44.1	44.6	44.6	44.8	44.6	46.0	44.2	42.8	42.9	42.1	43.1	46.0	44.4	45.2	45.4	45.7	45.4
Germany	44.6	46.4	45.9	47.8	47.4	47.0	39.1	39.6	40.8	42.6	43.3	45.5	47.3	50.3	48.2	49.6	49.3	47.7
UK	48.6	48.5	48.7	50.7	52.1	52.9	43.0	44.3	44.8	47.2	46.2	47.0	49.5	49.3	49.5	50.9	53.4	54.3
Japan	52.6	52.1	50.5	49.6	50.0	51.5	49.6	48.5	48.7	48.3	47.9	48.0	54.3	53.8	51.6	50.8	51.5	53.1
Spain	48.6	50.1	50.0	49.8	50.4	51.5	46.5	47.7	45.1	46.3	46.2	49.2	49.3	50.5	51.1	51.0	51.5	52.1
Italy	48.2	49.2	47.0	48.1	48.6	50.7	45.4	46.8	44.9	44.4	45.3	48.5	49.8	49.9	47.7	49.5	49.8	51.2
Brazil	50.6	49.0	50.3	50.7	50.0	53.2	50.1	49.0	48.6	49.4	48.4	52.8	50.6	48.7	51.0	51.2	50.5	53.1
Russia	55.9	54.7	53.6	52.4	55.7	55.1	52.7	54.5	53.8	53.8	54.6	52.4	57.6	55.4	53.6	52.2	56.2	55.8
China	51.7	50.9	50.0	51.6	52.6	52.5	51.0	50.6	49.5	50.7	50.8	50.8	51.8	50.2	50.4	51.5	52.9	52.7
India	60.9	61.0	58.4	57.4	58.5	61.2	58.6	57.5	55.5	56.0	54.9	56.5	60.1	61.0	58.4	56.9	59.0	61.8
South Korea							48.9	49.9	49.8	50.0	49.9	51.2						
Taiwan							44.3	46.4	47.6	48.3	47.1	48.8						
Turkey							49.0	49.6	48.4	47.2	47.4	49.2						

 > 50 and Increasing

 < 50 and increasing

 > 50 and decreasing or unchanged

 < 50 and decreasing

Sources: Bloomberg, final Markit PMI published at the beginning of each month following the survey, monthly data from 08/23 to 01/24. Note: The Composite Activity Index is a weighted average of the Manufacturing Activity Index and the Services Activity Index. ABN AMRO Investment Solutions.

# 03.

## Economic calendar

# Main economic releases published last weeks

Date	Zone	Event	Period	Consensus (Median)	Actual	Prior
30-Jan-24	Euro Area	GDP SA QoQ	4Q A	-0.10%	0.00%	-0.10%
30-Jan-24	United States	Conf. Board Consumer Confidence	Jan	114.8	114.8	110.7
31-Jan-24	China	Manufacturing PMI	Jan	49.3	<b>49.2</b>	49
31-Jan-24	United States	ADP Employment Change	Jan	150k	<b>107k</b>	164k
31-Jan-24	United States	Employment Cost Index	4Q	1.00%	0.90%	1.10%
31-Jan-24	United States	FOMC Rate Decision (Upper Bound)		5.50%	5.50%	5.50%
1-Feb-24	Euro Area	CPI Estimate YoY	Jan	2.70%	<b>2.80%</b>	2.90%
1-Feb-24	United Kingdom	Bank of England Bank Rate	Feb 1	5.25%	5.25%	5.25%
1-Feb-24	United States	ISM Manufacturing	Jan	47.2	49.1	47.4
2-Feb-24	United States	Change in Nonfarm Payrolls	Jan	185k	353k	216k
2-Feb-24	United States	Unemployment Rate	Jan	3.8%	3.7%	3.7%
2-Feb-24	United States	U. of Mich. Sentiment	Jan F	78.9	79	78.8
8-Feb-24	China	PPI YoY	Jan	-2.60%	-2.50%	-2.70%
8-Feb-24	China	CPI YoY	Jan	-0.50%	<b>-0.80%</b>	-0.30%
9-Feb-24	China	New Yuan Loans CNY	Jan	4500.0b	4920.0b	1170.0b
13-Feb-24	United States	CPI YoY	Jan	2.90%	<b>3.10%</b>	3.40%
14-Feb-24	United Kingdom	CPI YoY	Jan	4.10%	4.00%	4.00%
14-Feb-24	Euro Area	GDP SA QoQ	4Q P	0	0	0
15-Feb-24	United Kingdom	GDP QoQ	4Q P	-0.10%	<b>-0.30%</b>	-0.10%
22-Feb-24	United Kingdom	S&P Global UK Manufacturing PMI	Feb P	47.5	<b>47.1</b>	47
22-Feb-24	United States	S&P Global US Manufacturing PMI	Feb P	50.7	51.5	50.7

# Main economic releases to watch in the coming weeks

Date	Zone	Event	Period	Consensus (Median)	Prior
27-Feb-24	Euro Area	M3 Money Supply YoY	Jan	--	0.1%
27-Feb-24	United States	Conf. Board Consumer Confidence	Feb	114.8	114.8
29-Feb-24	US	PCE Deflator YoY	Jan	2.40%	2.60%
29-Feb-24	United States	Personal Spending	Jan	0.2%	0.7%
1-Mar-24	China	Manufacturing PMI	Feb	49.5	49.2
1-Mar-24	Euro Area	CPI Estimate YoY	Feb	--	--
1-Mar-24	United States	ISM Manufacturing	Feb	49.2	49.1
7-Mar-24	Euro Area	ECB Deposit Facility Rate		--	4%
7-Mar-24	United States	Trade Balance	Jan	--	-\$62.2b
8-Mar-24	United States	Change in Nonfarm Payrolls	Feb	150k	353k
8-Mar-24	United States	Unemployment Rate	Feb	3.8%	3.7%
9-Mar-24	China	CPI YoY	Feb	--	-0.8%
9-Mar-24	China	New Yuan Loans CNY	Feb	--	4920.0b
12-Mar-24	United States	CPI YoY	Feb	--	3.1%
15-Mar-24	United States	U. of Mich. Sentiment	Mar P	--	--
20-Mar-24	United Kingdom	CPI YoY	Feb	--	4%
20-Mar-24	United States	FOMC Rate Decision (Upper Bound)		5.5%	5.5%
21-Mar-24	Euro Area	HCOB Eurozone Manufacturing PMI	Mar P	--	--
21-Mar-24	United Kingdom	S&P Global UK Manufacturing PMI	Mar P	--	--
21-Mar-24	United Kingdom	Bank of England Bank Rate		--	5.25%
21-Mar-24	United States	S&P Global US Manufacturing PMI	Mar P	--	--
22-Mar-24	GE	IFO Business Climate	Mar	--	--

# 04.

## Tactical allocation grids

# Tactical allocation on equities: February 2024

- ▶ We shift from a neutral position to an overweight position on equities. Upside risks are dominating downside risks, as US consumption and labour market proved resilient in the face of high interest rates, driven by high productivity gains.
- ▶ In the Eurozone, output and consumption indicators are contracting, but the slight improvement in leading indicators and confidence points to a slightly better outlook. The Eurozone is likely to experience sluggish growth in 2024 but avoid a severe recession. Disinflation and interest rate cuts could revive activity from the end of 2024.
- ▶ We expect a stronger resilience of the US economy and markets with the IT/AI thematic. We think Tech valuations remain reasonable and thus increase our allocation on US Growth stocks.

Asset Classes in local currencies	Δ	Negative	Neutral	Positive
<b>Equities (World)</b>	↑	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>Europe</b>		<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Small vs Large		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Value vs Growth		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>US</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Small vs Large		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
Value vs Growth	↓	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>Japan</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>Emerging</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>

Note:    Max Negative;  Neutre;    Max Positive; ↑ Upgrade; ↓ Downgrade

# Tactical allocation on fixed income: February 2024

- ▶ Even if short-term interest rates are currently high after policy normalization, we think the risk-return trade-off of equities is more attractive and decrease our allocation on cash back to neutral.
- ▶ The main risk remains a policy error by the ECB with too much tightening (i.e.: holding rates high for too long) while economic growth is stagnating and a potential wage-driven inflation. Low productivity in the Eurozone might contribute to the delay of inflation goal timing.
- ▶ High yield still offers an attractive carry and some companies have started to refinance before the 2025 maturity wall. Nevertheless, caution is called for, as spreads are at historically slightly less attractive levels and interest rates could penalise the lowest-rated segments of HY companies.

Asset Classes in local currencies	Δ	Negative	Neutral	Positive	Relative duration (years)
<b>Fixed Income</b>		<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
<b>Euro</b>		<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
GOV core		<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
GOV periph.		<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
IG		<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
<b>US</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
GOV		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
IG		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
<b>Global HY</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
<b>Global EM Debt</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	
<b>Global Convertible</b>		<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	

Note:    Max Negative;  Neutral;    Max Positive;  Upgrade;  Downgrade

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