Optimal Income Strategies

U.S. stocks rally on earnings beat despite confirmation of structurally higher rates

- Strong US inflation data challenges Fed's tightening stance
- Equity market breath performance broadens, reinforcing outlook
- Disinflation is still on track in Europe

What's happening?

In today's economic landscape, there's a noticeable difference in how inflation is affecting different regions, which might lead Central Banks to make different decisions.

Starting with the US, inflation has been higher than expected recently, surprising many. Despite this, people are still spending money because more jobs are available. However, the economy didn't perform as well in the first quarter as anticipated, mainly due to lower government spending, business investments, and trade. Despite these challenges, there have been positive surprises, prompting a revision of the GDP growth forecast to +2.4% for 2024, though it's expected to slow to +1.6% in 2025.

In the Eurozone, economic growth is gradually improving, driven by advancements in the services sector, although manufacturing is still struggling. Even though service prices keep rising, overall inflation is slowing down. Growth is forecasted to be modest, at +0.3% in 2024, improving slightly to +0.8% in 2025.

China's first-quarter GDP performed better than expected, indicating that fiscal policies are working well. However, there are concerns about low inflation and the ongoing decline in the property market. Despite this, GDP growth forecasts have been raised to +5.0% in 2024, although it's expected to slow to +4.2% in 2025.

In emerging markets, high service inflation and weaker currencies are causing headaches for Central Banks, making it challenging to continue with easing policies. Central banks in Asia are maintaining their policies, while those in Latin America are slowing down, although some easing is still expected in Central and Eastern Europe. Higher real rates might pose challenges for some countries.

Market expectations for Central Banks are becoming more diverse. The US Federal Reserve might only start cutting interest rates in September, with expectations reduced to two cuts this year. Meanwhile, the European Central Bank is likely to start easing in June, with three cuts expected in total for the year. The Bank of England is also expected to cut rates in June. As for the Bank of Japan, they might cautiously raise rates again before the year ends, but they're unlikely to intervene directly to support the weaker yen.

Source: AXA IM as end of April 2024

Positioning & Performance:

	Dec-23	Mar-24	Apr-24	Dec-23	Mar-24	Apr-24	Dec-23	Mar-24	Apr-24
Net Equity	*65,5%*	82,4%	81,8%	*54,1%*	70,7%	73,1%	*34,4%*	32,2%	32,4%
Equities	*63,0%*	80,4%	82,7%	*60,0%*	72,5%	74,0%	*33,7%*	40,0%	39,3%
Equities derivatives	*8,6%*	8,4%	6,4%	*-0,8%*	0,0%	0,3%	*0,7%*	-7,8%	-6,9%
Risk Mitigation Strategies	***-6,1%***	**-6,4%**	**-7,3%**	***-5,1%***	**-1,8%**	**-1,2%**	***0,0%***	**0,0%**	**0,0%**
Fixed Income	*21,3%*	10,7%	7,9%	*33,5%*	21,1%	20,4%	*28,5%*	39,2%	55,4%
Govies	*1,0%*	0,1%	0,0%	*1,0%*	0,0%	0,0%	*0,0%*	0,0%	0,0%
Bond Derivatives	*8,1%*	20,3%	38,5%	*9,4%*	19,5%	29,0%	*17,5%*	26,1%	39,9%
High Yield Credit	*1,2%*	1,2%	1,5%	*3,4%*	3,5%	3,6%	*10,5%*	14,6%	15,8%
Investment Grade	*17,3%*	9,0%	6,2%	*26,5%*	17,4%	16,6%	*17,9%*	24,6%	39,6%
Emerging Debt	*1,8%*	0,3%	0,3%	*2,6%*	0,2%	0,2%	*0,0%*	0,0%	0,0%
Diversification	*3,4%*	3,4%	1,5%	*1,5%*	0,9%	0,9%	*5,6%*	2,3%	2,7%
Cash & Money Market	*9,8%*	3,5%	8,8%	*10,7%*	7,3%	5,6%	*31,6%*	26,2%	9,6%

Amidst the economic landscape, characterized by a slowdown in US economic growth and a resurgence in the eurozone, our portfolios maintain an overweight position in equities, perceiving the recent market pullback as transient rather than indicative of a paradigm shift.

In the US, economic expansion has finally moderated, contrasting with the rebounding growth observed in the eurozone. While business activity surveys stagnated in the United States, they continued to indicate robust health in the eurozone. Persistent inflationary pressures in the US have compelled the Federal Reserve to exercise patience with its rate-cutting strategy. Conversely, the European Central Bank appears content with the current trajectory of eurozone inflation, signalling a planned rate cut in June. Within our equity allocation, we retain a preference for quality stocks but are poised to incorporate more cyclical assets.

Additionally, our exposure to duration persists through Eurozone sovereign debt, with a readiness to expand into US duration, particularly favouring the short end of the curve (2-year).

Regarding diversification strategies, despite notable fluctuations in commodities such as oil, industrial metals, and gold, reflecting ongoing geopolitical tensions and signs of stabilization in the Chinese economy, the concomitant surge in long positioning has prompted a reduction in our overweight position in commodities.

Source: AXA IM as end of April 2024

Outlook

April sent financial markets back into the familiar pattern of last summer: interest rates rose, leading to a decline in bond values, while equities also corrected, leaving few places to hide in multi-asset portfolios (though our allocation to commodities proved helpful). Strong US inflation data raised doubts once again about the market's assumption that the Federal Reserve has completed its monetary tightening and is preparing for future rate cuts.

As we've previously mentioned, our positive outlook for risky assets, particularly equities, isn't dependent on a specific timing for Fed rate cuts, but rather on the subsequent direction and ultimate outcome of monetary policy. Whether we see two or three cuts this year is less important for the equity rally than the question of whether cuts will occur at all. As depicted in the chart below, equity valuations are more closely tied to interest rate volatility than to the absolute level of interest rates.

While we anticipate further market volatility in the short term, with fear gaining momentum and investor positioning reaching elevated levels, we remain confident that overall monetary tightening is behind us. Financial conditions have tightened significantly, affecting private individuals and smaller businesses primarily through bank lending. While large tech corporations benefit from high short-term interest rates due to their large savings, smaller firms and middle-class Americans are more vulnerable to monetary tightening.

As confidence in rate cuts grows among market participants, regardless of timing, we expect lower interest rate volatility, providing additional support for equities. Moreover, the broadening of equity market performance we anticipated has begun, further reinforcing our positive stance.

Meanwhile, the economic landscape in Europe diverges significantly from the US, with disinflation continuing and economic activity slowing down. Fiscal policy is moving toward contraction, contrasting sharply with the US, and unemployment is marginally rising in major Member States. This cautious economic environment aligns with our expectation of monetary policy easing by summer. Consequently, long-dated euro interest rates experienced a decline along with US Treasury yields, adding a valuation argument to our macro view.

Disclaimer

Past performance is not a guide to current or future performance, and any performance or return data displayed does not take into account commissions and costs incurred when issuing or redeeming units. The value of investments, and the income from them, can fall as well as rise and investors may not get back the amount originally invested. Exchange-rate fluctuations may also affect the value of their investment. Due to this and the initial charge that is usually made, an investment is not usually suitable as a short term holding.

This document is for informational purposes only and does not constitute investment research or financial analysis relating to transactions in financial instruments as per MIF Directive (2014/65/EU), nor does it constitute on the part of AXA Investment Managers or its affiliated companies an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities. The strategies discussed in this document may not be available in your jurisdiction.

The products or strategies discussed in this document may not be registered nor available in your jurisdiction. Please check the countries of registration with the asset manager, or on the web site https://www.axa-im.com/en/registration-map, where a fund registration map is available. Please note that the management company reserves the right, at any time, to no longer market the product(s) mentioned in this communication in an European Union country by notification to its authority of supervision in accordance with European passport rules. In particular units of the funds may not be offered, sold or delivered to U.S. Persons within the meaning of Regulation S of the U.S. Securities Act of 1933. The tax treatment relating to the holding, acquisition or disposal of shares or units in the fund depends on each investor's tax status or treatment and may be subject to change. Any potential investor is strongly encouraged to seek advice from its own tax advisors.

In the event of dissatisfaction with the products or services, you have the right to make a complaint either with the marketer or directly with the management company (more information on our complaints policy available in English here). You also have the right to take legal or extra-judicial action at any time if you reside in one of the countries of the European Union. The European online dispute resolution platform allows you to enter a complaint form (by clicking here) and informs you, depending on your jurisdiction, about your means of redress (by clicking here).

Due to its simplification, this document is partial and opinions, estimates and forecasts herein are subjective and subject to change without notice. There is no guarantee forecasts made will come to pass. Data, figures, declarations, analysis, predictions and other information in this document is provided based on our state of knowledge at the time of creation of this document. Whilst every care is taken, no representation or warranty (including liability towards third parties), express or implied, is made as to the accuracy, reliability or completeness of the information contained herein. Reliance upon information in this material is at the sole discretion of the recipient. This material does not contain sufficient information to support an investment decision.

Issued in the UK by AXA Investment Managers UK Limited, which is authorised and regulated by the Financial Conduct Authority in the UK. Registered in England and Wales No: 01431068. Registered Office: 7 Newgate Street, London EC1A 7NX. In other jurisdictions, this document is issued by AXA Investment Managers SA's affiliates in those countries.

In Hong Kong, this document is issued by AXA Investment Managers Asia Limited (SFC License No. AAP809), which is authorized and regulated by Securities and Futures Commission. This document is to be used only by persons defined as "professional investor" under Part 1 of Schedule 1 to the Securities and Futures Ordinance (SFO) and other regulations, rules, guidelines or circulars which reference "professional investor" as defined under Part 1 of Schedule 1 to the SFO. This document must not be relied upon by retail investors. Circulation must be restricted accordingly.

In Singapore, this document is issued by AXA Investment Managers Asia (Singapore) Ltd. (Registration No. 199001714W) and is intended for the use of Institutional Investors only as defined in Section 4A of the Securities and Futures Act (Cap. 289) and must not be relied upon by retail investors. Circulation must be restricted accordingly

For Japanese clients: AXA Investment Managers Japan Ltd., whose registered office and principal place of business is at NBF Platinum Tower 14F 1-17-3 Shirokane, Minato-ku, Tokyo 108-0072, Japan, which is registered with the Financial Services Agency of Japan under the number KANTOZAIMUKYOKUCHO (KINSHO) 16, and is a member of Japan Securities Dealers Association, Type II Financial Instrument Firms Association, Investment Trust Association of Japan and Japan Investment Advisors Association to carry out the regulated activity of Financial Instrument Business under the Financial Instrument Exchange Law of Japan. In Japan, none of the funds mentioned in this document are registered under the Financial Instrument Exchange Law of Japan or Act on Investment Trusts and Investment Corporations. This document is purely for the information purpose for use by Qualified Institutional Investors defined by the Financial Instrument Exchange Law of Japan.

In Taiwan, this document is issued by AXA Investment Managers Asia Limited (SFC License No. AAP809), which is authorized and regulated by Securities and Futures Commission. This document and the information contained herein are intended for the use of professional or institutional investors and should not be relied upon by retail investors. They have been prepared and issued for private informational and educational purposes only at the sole request of the specified recipients, and not intended for general circulation. They are strictly confidential, and must not be reproduced, circulated, distributed, redistributed or otherwise used, in whole or in part, in any way without the prior written consent of AXA IM Asia. They are not intended for distribution to any persons or in any jurisdictions for which it is prohibited.

If any fund is highlighted in this communication (the "Fund"), its offering document or prospectus contains important information on selling restrictions and risk factors, you should read them carefully before entering into any transaction. It is your responsibility to be aware of and to observe all applicable laws and regulations of any relevant jurisdiction. AXA IM Asia does not intend to offer any Fund in any country where such offering is prohibited.

The offer, distribution, sale or re-sale of fund units/shares in Taiwan requires approval from and/or registration with Taiwanese regulatory authorities. To the extent that any units/shares of the Funds are not so licensed or registered, such units/shares are made available in Taiwan on a private placement basis only to banks, bills houses, trust enterprises, financial holding companies and other qualified entities or institutions (collectively, "Qualified Institutions") and other entities and individuals meeting specific criteria ("Other Qualified Investors") pursuant to the private placement provisions of the Rules Governing Offshore Funds. No other offer or sale of such units/shares in Taiwan is permitted. Taiwanese purchasers of such units/shares may not sell or otherwise dispose of their holdings except by redemption, transfer to a Qualified Institution or Other Qualified Investor, transfer by operation of law or other means approved by the Taiwan Financial Supervisory Commission.

In Korea, AXA Investment Managers Asia (Singapore) Ltd is a registered Cross Border Investment Advisor/Discretionary Investment Management Company under the Financial Investment Services and Capital Markets Act (the "Act"). The activities referenced under the Act are 5-2-2 Investment Advisory Business and 6-2-2 Discretionary Investment Management Business, respectively. Its financial services are available in Korea only to Professional Investors within the meaning of Article 10 of Enforcement Decree of the Financial Investment Services and Capital Markets Act.

To the extent that any fund is mentioned in this document, neither the fund nor AXA IM Asia is making any representation with respect to the eligibility of any recipients of this document to acquire the units/shares in the fund under the laws of Korea, including but without limitation the Foreign Exchange Transaction Act and Regulations thereunder. The units/shares have not been registered under the Financial Investment Services and Capital Markets Act of Korea, and none of the units/shares may be offered, sold or delivered, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to applicable laws and regulations of Korea.

For Malaysian investors: As the recognition by the Malaysian Securities Commission pursuant to Section 212 of the Malaysian Capital Markets and Services Act 2007 has not been / will not be obtained nor will this document be lodged or registered with the Malaysian Securities Commission, the shares referred to hereunder (if any) are not being and will not be deemed to be issued, made available, offered for subscription or purchase in Malaysia and neither this document nor any other document or other material in connection therewith should be distributed, caused to be distributed or circulated in Malaysia.

For Thailand investors: Nothing in this document shall constitute in any manner whatsoever a proposal to make available, offer for subscription or purchase or to issue an invitation to purchase or subscribe for any securities in Thailand or a proposal to implement any of the foregoing in Thailand nor has this document been approved by or registered with the Securities and Exchange Commission of Thailand ("SEC"). No person receiving a copy of this document may treat the same as constituting an invitation or offer to him in Thailand and such person shall not distribute or make available this document in Thailand. The issuer of this document shall not be liable in any manner whatsoever in the event this document is distributed or made available to any person in Thailand receiving a copy of this document. Since no application for approval has been or will be made to the SEC for the offering of the securities, or for the registration of this document, the securities shall not be offered for subscription or purchased or made available, whether directly or indirectly, in Thailand. It is the sole responsibility of recipients wishing to take any action upon this document to satisfy themselves as to the full observance of the laws of Thailand, to comply with all relevant government and regulatory approvals, and to comply with all applicable laws, including but not limited to exchange control laws.

For Investors in People's Republic of China (PRC): This document does not constitute a public offer of the product., whether by sale or subscription in the PRC. The product is not being offered or sold directly or indirectly in the PRC to or for the benefit of, legal or natural persons of the PRC. Further, no legal or natural persons of the PRC may directly or indirectly purchase any of the product or any beneficial interest herein without obtaining all prior PRC's governmental approvals that are required, whether statutorily or otherwise. Persons who come into possession of this document are required by the issuer and its representatives to observe these restrictions.