

Optimal Income Strategies

US & European equities reach record levels!

- Soft landing is the base case scenario this year
- Easier monetary policy coming but magnitude and timing in question
- Positive on global equities favouring developed market

What's happening?

Global economic growth is expected to slow, prompting Central Banks to proceed with interest rate cuts mid-year.

US growth remained strong at the end of 2023. Despite weaker retail sales growth in January, it still suggests firm activity. Strong labour supply growth, rising productivity, and a higher neutral rate might partly explain this growth resilience. However, slower income growth, a rising tax contribution, and an increasing saving rate are all expected to slow growth over the coming quarters. We have revised our 2024 GDP growth forecast to +2% from 1.4% previously, although it is expected to slow to +1.5% in 2025.

Eurozone economic activity continues to lack momentum. GDP should rise as employment and real disposable income growth pick up. While the latest services surveys show improvement, manufacturing activity remains weak. We anticipate growth to remain anaemic at +0.3% in 2024, with a slight improvement to +0.8% in 2025.

China's economic weakness persists, with recent stock market declines echoing concerns. However, concerted fiscal support from last year has seen credit growth accelerate, while recent accelerated monetary easing suggests a more preemptive policy. We maintain a deceleration in GDP growth to 4.5% in 2024 and 4.2% in 2025.

Emerging market economic activity is diverging, with robust economic growth in most Asian economies. Central European economies weakened, with a rebound expected this year, while economic activity appears to be tapering off in Latin America amidst falling inflation.

There's a material shift in market expectations for Central Banks, aligning with our expectations. The US Fed is expected to cut rates in June and could ease faster if inflation falls. The ECB is also likely to begin easing in June but could embrace aggressive rate cuts. The BOE is apparently considering when, not if, to cut rates. The BOJ indicates a small hike (10 bps) most likely in April.

Positioning & Performance:

	GLOBAL OPTIMAL STRATEGY			OPTIMAL STRATEGY			DEFENSIVE OPTIMAL STRATEGY		
	Dec-22	Jan-24	Feb-24	Dec-22	Jan-24	Feb-24	Dec-22	Jan-24	Feb-24
Net Equity	29,6%	66,2%	75,9%	32,5%	57,9%	65,9%	6,0%	31,3%	35,0%
Equities	71,4%	67,4%	74,2%	62,6%	63,3%	71,0%	33,8%	35,1%	39,0%
Equities derivatives	-38,3%	6,8%	8,9%	-26,3%	-1,8%	-1,4%	-26,0%	-3,8%	-4,0%
Risk Mitigation Strategies	-3,5%	-8,0%	-7,2%	-3,8%	-3,6%	-3,7%	-1,8%	0,0%	0,0%
Fixed Income	10,7%	21,3%	17,6%	27,4%	32,0%	23,7%	36,9%	28,5%	29,0%
Govies	0,0%	0,8%	0,5%	0,0%	0,8%	0,4%	0,1%	0,0%	0,0%
Bond Derivatives	24,2%	14,5%	27,8%	12,1%	15,2%	21,8%	26,5%	20,0%	21,9%
High Yield Credit	2,4%	1,4%	1,2%	5,0%	3,6%	3,2%	-7,8%	10,1%	10,5%
Investment Grade	5,8%	17,3%	14,7%	22,0%	26,0%	18,9%	44,5%	18,4%	18,4%
Emerging Debt	2,5%	1,8%	1,2%	0,4%	1,7%	1,2%	0,0%	0,0%	0,0%
Diversification	9,2%	3,5%	3,5%	3,2%	1,3%	1,0%	10,4%	3,1%	3,1%
Cash & Money Market	50,5%	9,0%	3,0%	37,0%	8,7%	9,4%	46,8%	37,1%	33,0%

The economic growth of the United States has been stronger than anticipated in recent months, with the second half of 2023 consistently above trend and the first quarter of 2024 closely tracking at 3%. While this context of robust growth in 2023 has been accompanied by relatively stable disinflation, the dynamics may face challenges in the future. A soft landing remains the baseline scenario for this year. The recent stock market rally was justified as it became increasingly probable that an environment of above-trend growth and normalization of inflation was on the horizon.

While central banks are poised to cut rates, the timing may not align precisely with initial expectations. A fairly synchronized global easing cycle is still expected, even if the path of inflation data proves bumpy. Consequently, a neutral stance on duration is held, with the past two months providing the technical consolidation in rates anticipated after a rapid rally at the end of 2023. European bonds may be gaining appeal with improving valuations, and this attractiveness is likely to amplify if the timing of ECB easing closely coincides with actions by the Federal Reserve. Building a higher duration position starting from current levels aligns with our multi-asset strategies.

Furthermore, a positive outlook on global equities is maintained, particularly in Developed Markets, where a macroeconomic soft landing converges with strong microeconomic fundamentals, suggesting further upside potential. Over the month the equity exposure was largely reinforced with US large capitalisation and European large capitalisation for the European fund.

Additionally, a positive view on the US dollar, particularly against the GBP, is upheld, as economic surprises in the US remain largely favourable, while idiosyncratic factors in the UK continue to weigh on the GBP.

Outlook

Markets have experienced significant volatility in outlook over the past three months, shifting from a consensus view of a soft landing that supports all asset classes to a growing concern, albeit slight for some and significant for others, about the possibility of no landing at all. This latter scenario would mean a higher required level of neutrality for monetary policy in the US. Despite US GDP growth consistently exceeding potential, some still advocate for a recession. Since October, short-term interest rates have fluctuated between three and nearly seven expected Fed rate cuts over the next twelve months. However, actual volatility measures in the fixed income market have remained relatively calm compared to last year's disruptions.

Although there are still factors that could potentially slow down the US economy or push Europe into recession, they have not disappeared; they are just trailing behind other news developments. Our Macroeconomic Research team anticipates some weakness ahead, as the positive factors that drove US activity last year struggle to maintain momentum in 2024. This weakness, particularly in the labour market and wages, will likely prompt the Fed to begin policy normalization this year.

Last year, demand in the US was initially fuelled by excess savings, followed by positive real wages, and increased fiscal spending, leading to a budget deficit of around 10%. These conditions are unlikely to repeat, and there's a noticeable divergence in financial conditions between Main Street and Wall Street. Concerns persist about the impact of commercial real estate on the balance sheets of small and mid-size banks, which could hinder their ability to extend credit. Additionally, there seems to be little enthusiasm from Chinese authorities to counter demand deflation in the world's second-largest economy, potentially necessitating policy support from markets to maintain the positive momentum seen at the beginning of the year. If recent inflation and job reports prove to be temporary setbacks rather than permanent shifts, and if disinflation trends persist over the next few months, the Fed might prioritize implementing a series of rate cuts to improve the US economic outlook. This, in turn, could lead the ECB to also reduce its interest rates.

While fast money positioning has decreased in rates, institutional investor demand remains strong despite heavy supply, suggesting the need to build a stronger duration position in multi-asset strategies. A clearer path to lower rates may emerge if the negative news from Main Street persists in the coming months. Additionally, softer financial conditions could provide support to equities, which are currently at high, though not extreme, valuation levels.

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