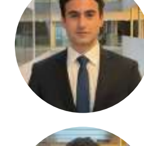
Global Outlook

Investment Research Team

Update – Friday 7 April 2023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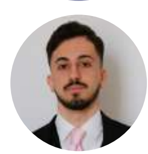
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Division Description

The Investment Research Division responsible of monitoring relevant market trends in order to periodically update the association's view and recommend the optimal exposure to the main asset classes across different geographies. Each of these exposures is discussed with and approved by the whole IR Team.

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- Bank of Japan

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- Euro
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Breakdown

Incoming relevant events

Date	Event	Date	Event
April 12	US CPI	**April 28**	BOJ monetary policy decision
April 13	US PPI OPEC monthly report	**May 2**	US JOLTS jobs openings
April 21	Germany, US, and UK PMI	**May 2 – 3**	FOMC Meeting
April 27	US quarterly GDP Unemployment claims	**April 13 – May 19**	Q1 Earnings Season

Markets Review

Macro outlook

Inflation in the **US** slowed to 6% in February 2023, in line with expectations and compared to 6.4% in January, with food and energy prices increasing 9.5% and 5.2% respectively YoY. The core gauge instead decreased from 5.6% to 5.5%, decreasing for the fifth consecutive month, showing the responsiveness of the markets to rate hikes. Indeed, the Fed increased the rates by 25bps in the February meeting and by another 25bps in the last meeting in March. This latter came in line with expectations from investors, even though some believed the central bank should pause the tightening cycle to shore up financial stability after the recent banking turmoil and contagion concerns. The monetary tightening resulted in a slight increase in the unemployment rate to 3.6%, up from a 50-year low of 3.4% seen in January.

Eurozone consumer price inflation showed a slight decrease of only 0.1% in February to 8.5%, followed by a major drop to 6.9% in March. Also the core index reading remained well above ECB's target, reaching a new high of 5.7% and putting pressure on policymakers to furtherly increase rates in an already stressed banking environment. ECB, confident in the resilience of the solid and liquid banking sector, continued its tightening path with a 50 bps increase in March, pushing borrowing costs to the highest level since 2008 at 3.5%. The unemployment rate stood at 6.6% in February, showing unresponsiveness to increasingly tight monetary policies. Still, ECB faces the tough challenge of finding a monetary policy that conciliates very heterogenic national economies, with unemployment rates going from 2.9% in Germany to 12.8% in Spain.

The **UK** environment remains troubled, as inflation unexpectedly spiked to 10.4% in February from 10.1% in the month before, despite the already high rates of 4.25%. Bank of England increased key bank rate first by 50bps in February and then by 25 in March to bring inflation back to the target.

China's inflationary pressures eased in February to 1% from 2.1% the prior month as People's Bank of China (PBoC) kept its lending rates steady for the seventh straight month at 3.65%, in line with markets expectations. On March 17th, the PBoC cut the reserve requirement ratio for financial institutions by 25bps, in a move from policymakers to further shore up the country's economic recovery.

Japan's inflation is pushing towards its historically low figures, slowing from 4.3% in January to 3.3% in February. After the change of the BOJ governor there have been talks about easing or even gradually abolishing the yield curve control policy, that would eventually increase long term interest rates. Job market remained strong, with the unemployment rate still low at 2.6% in February.

Banking crisis

The prolonged periods of low interest rates posed significant threats to the banking sector. One of the major issues was the vulnerability of banks to rapid interest rate increases.

One bank that was particularly sensitive to interest rate changes was Silicon Valley Bank (SVB). It collapsed due to a severe asset-liability mismatch problem, as the bank had a significant exposure to long duration Treasury Bonds on the asset side, which become worth less and less in recent times of high interest rates. Furthermore, most of its deposits were uninsured and its client base was concentrated and poorly diversified. This led to a massive withdrawal of deposits, resulting in the bank selling its assets, realizing losses, and quickly arriving to a default. This general panic bank run also caused the collapse of two other banks, Signature Bank and Silver Gate.

In Europe, the collapse of SVB UK prompted HSBC to acquire the former's English branch for one pound. In the US, instead, in order to prevent further damage to the banking sector, the Fed (in a joint statement with FDIC and the Treasury Department) announced the Bank Term Funding Program. This differed from the traditional lending system, the discount window, in the maximum maturity of the credit facilities and in that it provided credit valuing their assets provided as collateral at face value instead of market value. The program helped stabilize mid-sized and regional banks, including First Republic, which was facing difficulty due to its exposure to mortgages, which are highly sensitive to interest rates.

Only one week later, the chairman of Saudi National Bank's announcement that the Credit Suisse's major shareholder would not recapitalize the bank caused the latter's shares to collapse. The Swiss National Bank intervened to stabilize the markets by facilitating an acquisition of Credit Suisse by UBS, valuing the former 3 billion CHF.

Moreover, the unexpected choice to writedown all the AT1 bonds caused great scandal and volatility in the Fixed Income markets. As a consequence, also Deutsche Bank faced turmoil due to the sell-off of 5 million of its CDSs. However, unlike Credit Suisse, Deutsche Bank's balance sheet and operating model were solid, and the turmoil was purely psychological and short-lived.

In the end, the US banking sector seems now to have stabilized, and Citizens Bank acquired the US business of the defaulted Silicon Valley Bank, providing insurance to unsecured depositors. The lessons learned from the banking sector's vulnerability to interest rate changes have prompted banks to be more cautious in their investments and diversify their portfolios. Regulators have also implemented measures to ensure that banks are better equipped to withstand interest rate fluctuations.

Geopolitics

The tension on the Russian borders has been increasing, further worsening the relationships with Western Countries. Finland has been admitted to NATO as the 31st member, following the ratification of its membership by the Turkish Parliament. With the addition of the Nordic country, NATO has doubled its shared borders with Russia and the Kremlin has responded by announcing an increase in its military expenditure. Sweden's application to join NATO is still pending for votes from Turkey and Hungary.

Tensions have grown also among US and its allies and China, following events such as the discovery of spy balloons and the evolutions around semiconductors. Not only is Taiwan seeking the removal of double taxation with the US, which would worsen the tensions between these two countries vis a vis China, but also Japan has restricted exports on advanced chipmaking technologies, joining the US and Netherlands in the blockade against China.

This strengthening on the Western front is being balanced by improving relationships between the two eastern superpowers, China and Russia. After the recent meeting between Xi Jinping and Vladimir Putin, it has been signaled by both leaders that their alliance will be reinforcing. Contemplating a multi-polar world independent from U.S. domination, two leaders have agreed to increase their trading turnover over 200 billion USD in 2023. China will continue to export fundamental components for arms and military technology, in exchange for Russian gas and oil at discounted prices.

Russia's decision to use the Yuan as a mean of export settlements is another significant development of the relationship. The share of Yuan in Russian export settlements has skyrocketed to 15%, and this is expected to increase with the tightening of Chinese-Russian diplomacy. This move has reportedly added to the appeal of Yuan and will negatively impact, in the long term, the role of the dollar as global reserve currency. Russian industrial commodity exporters have started to issue Yuan bonds, as borrowing in stable Yuan is far cheaper than borrowing in volatile Rubles. While the use of Yuan for export settlements has eased Russian economy, it also puts Russia at risk of becoming too reliant on China. As Russia looks to strengthen its economic ties with China, it will need to ensure that it maintains its economic independence.

The geopolitical environment of today is complex and very dynamic. The tension on the Russian borders with the expansion of NATO, the growing alliance between China and Russia and the intricacies regarding the supply of semiconductors are all significant developments that have the possibility of leading to far-reaching consequences.

China reopening

Investors expected a very huge impact in the market by the reopening of China, however this is not what we have seen. Nonetheless, in 2023, China saw significant increases in consumer spending, industry production, and investment following the abolition of the Zero Covid policy. The manufacturing PMI was higher than economists' forecasts, at 51.9 in March, although it was down slightly from February's level.

After missing last year's GDP target for the first time ever, former Premier Li Keqiang revised downwards his estimate of GDP growth to 5%. The new Premier of China, Li Qiang, in office since March 2023, said that the growth target is not easy stuff and will demand redoubled efforts; the nation will prioritize stable growth and prices and employment. In order to sustain growth and restart the economy, the PBOC increased liquidity injections into the financial system to their highest level since December 2020 by providing banks with additional resources to satisfy the rising demand for loans.

These interventions, together with a series of supportive policies aimed to sustain the troubled real estate market, once a pillar of China's economic growth (accounting for up to 20% of China's GDP) before being devastated by multiple crises since the middle of 2021, will yield positive results for this sector. In fact, effects of these expansionary policies can already be observed: new house sales increased 31.9% in February and 55.7% in March, and home prices increased last month at the quickest rate in three quarters as a consequence.

In addition, China is on course to create almost three times more electricity from wind turbines and solar panels than government targets predict by the end of the decade; by 2060, the country might become energy independent.

Finally, the country, striving in a battle with the US, has plans to boost its competitiveness in its domestic semiconductor industry, which plays a fundamental strategic role in a more and more digitalized and technology driven world. Among others, the Government has budgeted an investment of $1.9 billion in its largest memory chip maker. Moreover, a new front was opened in the expanding semiconductor war with the United States, when a cybersecurity examination of imports from the United States' memory-chip manufacturers was started.

Concluding, it is anticipated that the reopening will also benefit China's North and South-East Asian neighbors, as well as commodity-sensitive emerging economies in the Middle East, Africa, and Latin America.

Bank of Japan

"There is plenty of room for monetary easing" – Haruniko Kuroda, February 2013

Ten years ago, Haruniko Kuroda was very clear on his intentions as newly nominated Governor of the Bank of Japan. Through the last decade, indeed, he was a pioneer in experimenting accommodative unconventional monetary policies, including negative interest rates, from 2016, and massive quantitative easing. In recent times, a tool has been particularly under the lens of investors and the press: the yield curve control (YCC) policy, aimed to influence the whole yield curve by keeping the yield on 10-year bonds within a tight range, which until December 2022 was set in the -25 to 25 bps corridor. During the last months, speculation has been increasing that this policy would be loosened or even dropped. A first shocking move happened when, at the end of December, the BOJ was forced to widen this yields range to 0.5 percentage points either side. Members of the central bank promptly made clear that the choice was not to be intended as a first step towards monetary policy normalization but justified by the need to improve the functioning and sustain the liquidity of the Japanese bond market. However, this announcement pushed Yen swaps above 0.5%, up to 0.8%, and the 10-year yield breached the upper bound multiple times.

Another relevant and unexpected event was the nomination of Kazuo Ueda as new BOJ Governor, slated to start on April 9. Member of the Central Bank board until 2005, through the years he has anything but lost contact with it, moderating various workshops and conferences hosted by the BOJ. From the very beginning he, neither a strong dove nor strong hawk, will deal with a difficult situation. Markets speculate on the new Governor soon tweaking or even abandoning the YCC policy at his first meeting, scheduled April 27-28, in an effort to fix the bond market and, lately, tame inflation, now riding around twice the unchanged 2% target. Thus, Ueda will have to accurately choose his moves, in the fear, as he pointed out in an interview, of massive bonds sell-off if the YCC corridor will be changed, as happened earlier in December.

All the above leaves us with a concern. Over the years of accommodative monetary policies, Japanese investors allocated their money all over the world, becoming, for instance, the major foreign holders of US Debt and owners of 8% of New Zealand’s securities. It is estimated that their overseas investments amount to more than $3 trillions. In the expectation of higher and higher domestic debt yields and currency strength, they will bring more and more money back to Japan, starting a relevant sell-off in any kind of foreign financial securities they hold. Hence, the question is: how will a monetary policy tweak affect the markets, and will any specific financial security be impacted more than others?

Asset Class Preferences

Overview

	Strategic view	Tactical view	Comments
BONDS			With the global tightening cycle towards an end and Central Banks' reference rates reaching their target, we are generally bullish on fixed income. Indeed, tight labor market and price pressure data had recently moved up the expected terminal rate, but the banking sector turmoil counterbalanced this effect. Consequently, we think the markets will soon start pricing lower returns, shifting the whole yield curve downwards. However, two risks should be carefully monitored in the medium term: the possible resurgence of inflation and the increasing probability of defaults.
GLOBAL EQUITY			As a general view on global equity markets, we prefer to be slightly underweight within the tactical timeframe as we have concerns about the US markets considering speculations on an incoming recession and decreases in the value of USD. Although we have somewhat overweight views for several markets like Europe, US' high volume offsets our bullish perspective. Considering the sectoral analysis we rather express a neutral opinion on the strategic view as we expect some improvements in critical sectors, especially in the US, if rate hike cycle comes to an end.
COMMODITIES			Prices are being driven in different directions by multiple factors. On the one hand, the slowdown in Western economies is contributing to a decrease in the demand levels for goods, leading to a decrease in the usage of fuels deployed for industrial production and transportation, ultimately triggering a fall in commodity prices. On the other hand, the potential reduction in Russian supply, coupled with the reopening of China's economy, the US dollar depreciation, and the growing demand for safe havens and shelters represent the primary factors driving prices upward. We are slightly overweight.
EURO			We anticipate the Euro to strengthen mainly due to a lag from the ECB in implementing a hawkish monetary policy with respect to the American counterpart. Moreover, thanks to a more resilient banking sector, the ECB has more room for further rate hikes. In the longer term, though, we have growth-related concerns.

Breakdown

FIXED INCOME		
US Treasuries short duration		We are overweight. On the one hand, short duration Treasuries have an interestingly high yield; on the other hand, we expect the yields be headed downwards.
US Treasuries long duration		We see a great opportunity in the high sensibility of long duration bonds to lowering interest rates. However, taking into account risks of an adverse movement, we prefer to be only slightly overweight.
Euro Area Government bonds		After the last 50 bps hike, ECB members have different views on further increases. Moreover, we observe signs of inflation easing significantly in some countries, but still persistent in others, as well as headline and core gauges diverging. Given this uncertainty, we prefer to be conservative.

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Global IG Credit

Given the higher rates and cost of debt, we expect reluctancy to issue new debt, hence decreasing supply of IG credit. Nevertheless, we are concerned about possible generalized worsening of credit ratings, probabilities of default, and increasing spreads.

EM Government bonds

China's reopening and plans to sustain growth and digitalization come with considerable cash needs. We foresee a growth of both demand an supply, hence higher liquidity and valuations. The weakening dollar will contribute to this effect. In LATAM, we expect Central Banks' efforts to effectively tame inflation and governments to take advantage of weakening US$, leading to cuts to very high reference rates and decrease in bond yields.

Inflation Linked Bonds

Central Banks reference rates likely staying at current levels or above for a while and inflation and headed downwards, we expect nominal values of these securities to increase. Moreover, they provide good hedge against inflation.

EQUITY – Regions

North America

Considering current foreign investments in US markets are near peak, we believe recession fears and decreasing value of US$ will trigger divestments. Furthermore, weak economic outlook and sticky inflation will decrease consumer spending and companies margins.

Europe

We are overweight. Valuations are attractive with relatinvely low PE multiples. The energy crisis and war in Ukraine have been discounted in EU markets. We also expect capital flows from US to Europe as US$ decrease in value.

UK

We are underweight. Inflation is still persistent at high levels despite the effort of the central bank. Overall price do not reflect the negative economic outlook we see ahead.

Japan

As we expect Japan to unwind its yield curve control policy, we see an increase in the value of Yen and a subsequent decrease in the export of the country. It is also important to notice the amount of japanese debt flowing into markets and further increasing supply, hence yields.

China

As the country re-opens from the pandemic lockdown, consumer spending, accumulated savings and a weakening dollar will boost China's economy.

Emerging Markets (excl. China)

While a weakening dollar will help emerging economies, we beleive that political instability and volatility are still factors to take into consideration.

EQUITY – Sectors

Telecom

Some factors, such as large recent investments and infrastructure expansion, are promising. Others, including excessive leverage and high volatility, make us sceptical about future performance.

Consumer Discretionary

The prospect of recession is a threat for this cyclical sector. We expect a reduction in consumer spending and a cut on unnecessary expenses first. In addition, this effect will be amplified by a likely credit crunch, triggered by the recent turmoil in the banking sector.

Consumer Staples

As opposed to discretionary, we expect this anticyclical sector to be resilient and gather momentum. Whether a recession comes or not, we foresee a stable demand for primary goods and relatively high dividends.

Industrials

The sector heavily consists of logistics and manufacturing both of which depend on energy consumption. We recognize the upward pressure on oil prices, high fixed costs of companies, slow production chain adaptation in case of a recession, and thus remain underweight.

Underweight Neutral Overweight Previous view

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Energy		Sector characterized by a low adaption rate and that require a large amount of investment, thus a relevant amount of loans. In the current environment, this could negatively impact the margin profits and margins of energy companies. Focusing on renewable energy sector, we expect a good performance thanks to the growing relevance and strong public commitment; the effects, though, will likely be seen in the long term.
Information Tecnhnology		We are concerned about chip shortage and we think that the recession, whose odds are increasing, has not yet been fully discounted by the market. However, there are some virtuous factors to be considered: the good valuation of some companies, the impressive growth in artificial intelligence and the recent job cuts.
Financials		After the banking turmoil, we expect fund transfers from smaller banks to banks with more market capitalization. Increasing interest rates suggest higher margins for loans, although the demand for loans will certainly decrease. Also, financials sector has consistently paid stable dividend yields. Although these are positive factors we still need to consider the high leverage of banks, high entanglement of the sector, the possibility of manipulation in CDS markets and that financials historically has shown underperformance.
Healthcare		Considering the counter-cyclical nature of most healthcare related industries, combined with exponential growth in healthcare innovation, decent dividend yields and low volatility in the sector, our verdict gravitates towards overweight.

CURRENCIES

US Dollar		We expect a further depreciation in the USD, due to a deterioration in the US economy and the expectancy of a more accommodative monetary policy by the Fed. This behavior has been partially displayed by the recent liquidity injection following the turmoil in the banking sector.
Pound		Both headline and core inflation rose in February, and this may force the BoE to further hike rates, thus supporting local currency. However, we will be closely monitoring deteriorating growth outlook, stagflation concerns, and employment and wage growth, which slowed in March.
Yen		We anticipate a robust Yen in the short run, given the weakening of the dollar and the markets expecting a possible abandonment of the yield curve control, which may trigger massive sell-off of bond, hence more attractive yields, money inflow, and a stronger currency.

COMMODITIES

Oil		The reopening of China will drive price upwards; however, it is primarily driven by demand for services rather than goods, the former having lower impact on transportation costs and therefore contributing less significantly to driving up oil prices. However, rising demand and the recent production cut by the OPEC+ will have a positive impact on price.
Natural gas		Natural gas prices are anticipated to stay elevated, as Europe braces for another winter without gas and the rising demand from China puts upward pressure on the liquefied natural gas (LNG) market.
Industrial metals		In the short term, our stance on industrial metals is neutral due to the tensions resurfacing in Taiwan and the better-than-anticipated performance of the industrial sector. Moreover, the slowing of production in heavy industry-centric countries remains a concern.
Gold		Threats of recession and accumulation of gold reserves by Central Banks are factors that may positively affect gold prices. However, price is already near its ATH and expectations of US rates reaching their peak may counterbalance the positive drivers.

MINERVA

Underweight Neutral Overweight Previous view

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