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AZIMUT GLOBAL VIEW
03.06.24

Azimut Global Network

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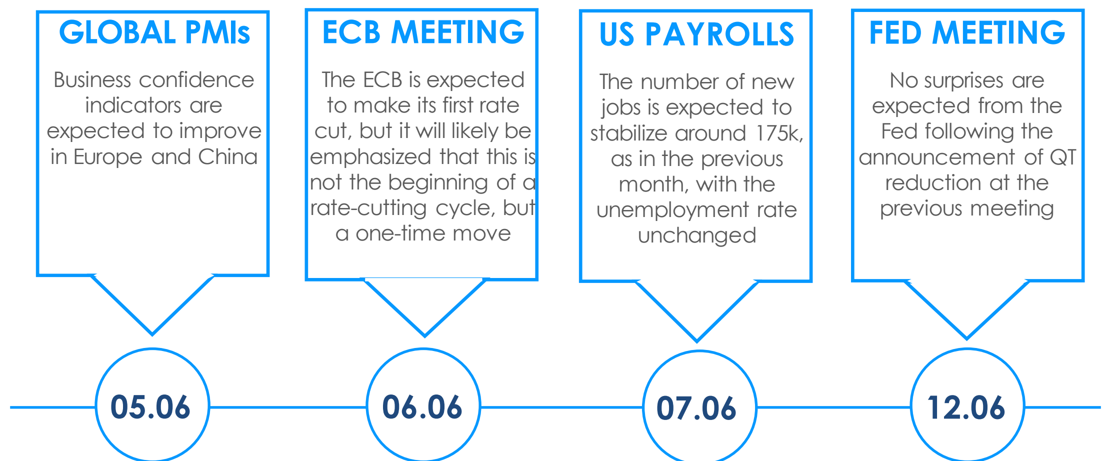
Main Events



TOWARD THE FIRST CUT

- **The ECB is expected to cut rates at this week's meeting, but for the moment it will likely be only a one-off move and not the start of a rate-cutting cycle**
- **No move is expected from the Fed next week, but considering the U.S. central bank's renewed focus also on the job market, it is crucial to monitor how it evolves**
- **Indeed, although the U.S. labor market is still strong, we are beginning to see some signs of weakening**

After two years characterized by the biggest-ever coordinated rate hike by the world's central banks, this week the ECB will be the first major central bank to start taking the opposite path.

However, this is not likely to be the beginning of a rate-cutting cycle but rather a one-time drop followed by a period of observation of how macroeconomic data evolve. After more than a year of zero growth, we are seeing a tentative re-acceleration in Europe, reducing the urgency for a cut. GDP has come out slightly positive (+0.3% QoQ, +1.2% annualized). Some confidence data are rising rapidly, though still in territory denoting lingering weakness.

More generally, macroeconomic data are coming out better than expected, with the Citi Economic Surprise Index (CESI) Europe in firmly positive territory. Add to this the fact that inflation in Europe is also proving more resilient than expected, with core CPI rebounding to 2.9% from 2.7% YoY. All in all, no hope for a series of cuts. At least, not for the moment.

The following week will be the Fed's turn. No surprises, and even less action, are expected from the U.S. central bank following the announcement of the tapering of QT from the beginning of June at the previous meeting. However, we recall that in May it was widely emphasized that now that we are likely exiting the period of red-hot inflation, the focus of monetary policy will no longer be exclusively on inflation but also on full employment, in line with the Fed's dual mandate.

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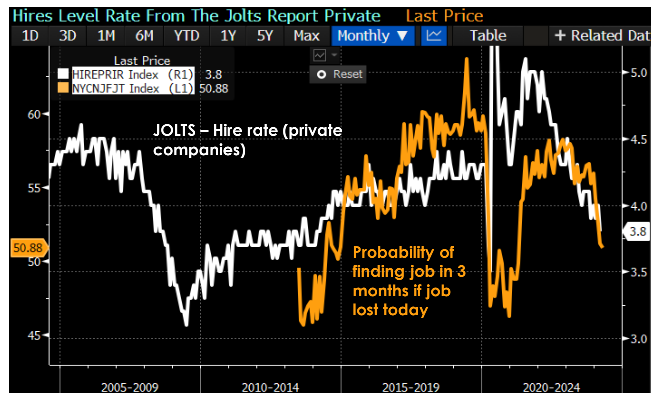

Source: Bloomberg

In this regard, we note how the CESI for the United States shows that in recent weeks the majority of macroeconomic data have turned out worse than expected, with the indicator falling from around +50 to slightly negative. And it is in the labor market, precisely the Fed's new focus according to Powell's statement in the last FOMC conference call, that some softening dynamics are being observed. For the time being, these dynamics are seen as positive, indicating a better balance between labor supply and demand. But a prosecution of this trend, sooner or later, could prove more worrisome.

Let's start with the JOLTS report. The number of job openings, 8.5 million, is back in line with the trend in place from 2009 to pre-pandemic. We are not at worrisome levels, far from it. Relative to the total number of unemployed, 6.5 million, it indicates a still tight labor market. But job openings are still nearly 4 million less than the peak reached in 2022.In addition, the latest non-farm payrolls showed that not only there has been the most limited new job creation in more than a year (175k), but also the share of government-created jobs has risen sharply (one-third of the total). The reduction in new jobs from the private sector is in line with the JOLTS hire rate by private companies, which is falling back to normal levels. In addition, the survey on workers' perceptions of the likelihood of being able to find work within three months if they are laid off is falling rapidly. This also explains the rapid reduction in the "quit rate".

Another curious dynamic to monitor is the evolution of the difference between the number of employed measured by the two main employment surveys, the Establishment and Household surveys. For nearly 20 years, the difference between the two statistics has always been between 6 and 8 million, with an average of 7 million. Since 2022, this difference has rapidly narrowed from 7 million to the current 3.2 million. It is even more remarkable that in just six months, the two statistics diverged by almost 2 million.

The fact that the unemployment rate has risen from 3.4% in April 2023 to 3.9% today, and that the number of full-time jobs is now lower than a year ago, suggests that it is the Household survey that better represents the dynamics of the labor market. However, another possible explanation is that while in the non-farm payroll survey an individual can have more than one payroll job during a specific month, in the Household survey, that is not possible. The narrowing in the difference could therefore be explained by the fact that those who are most affected by the higher cost of living are increasingly resorting to dual employment (if so, this should be interpreted as a sign of distress, at least for a portion of American consumers). Whatever the reason for the narrowing in the gap, it will be worth monitoring future data on non-farm payrolls, as they seem to be the ones most vulnerable to negative surprises.

Another statistic worth monitoring is the evolution of the total number of people unemployed (the absolute number, not the unemployment rate), as this indicator has probably been the most reliable and timely of all predictors of a recession: over the past 70 years, whenever the indicator 1) has risen above its 2-year moving average and 2) its year-over-year change was over +15%, a recession has always followed immediately thereafter, or had just started. Today, we are not that far from meeting both conditions.

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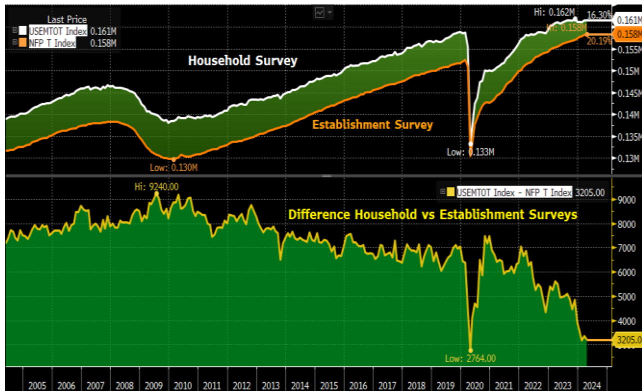

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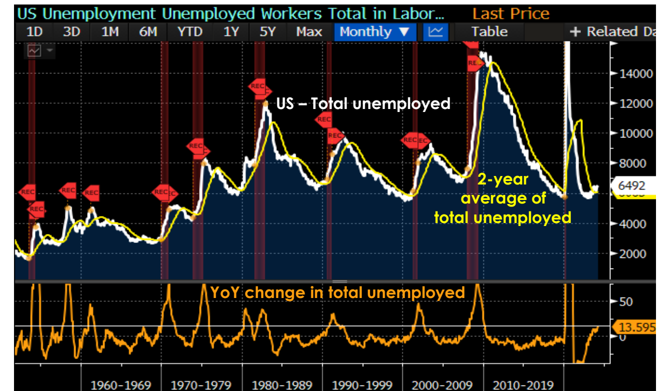

Source: Bloomberg

These dynamics are likely the reason why, in the press conference following the May FOMC meeting, Powell stressed the importance of also looking at the labor market and not just at inflation. He stated that a rate cut would be possible even if inflation remained at current levels, should the labor market begin to deteriorate.

After being wrongfooted at the beginning of the year by discounting up to 7 rate cuts by the Fed in 2024, the market might suffer a similar fate once again now that it is discounting just one cut for this year, should employment data surprise to the downside.

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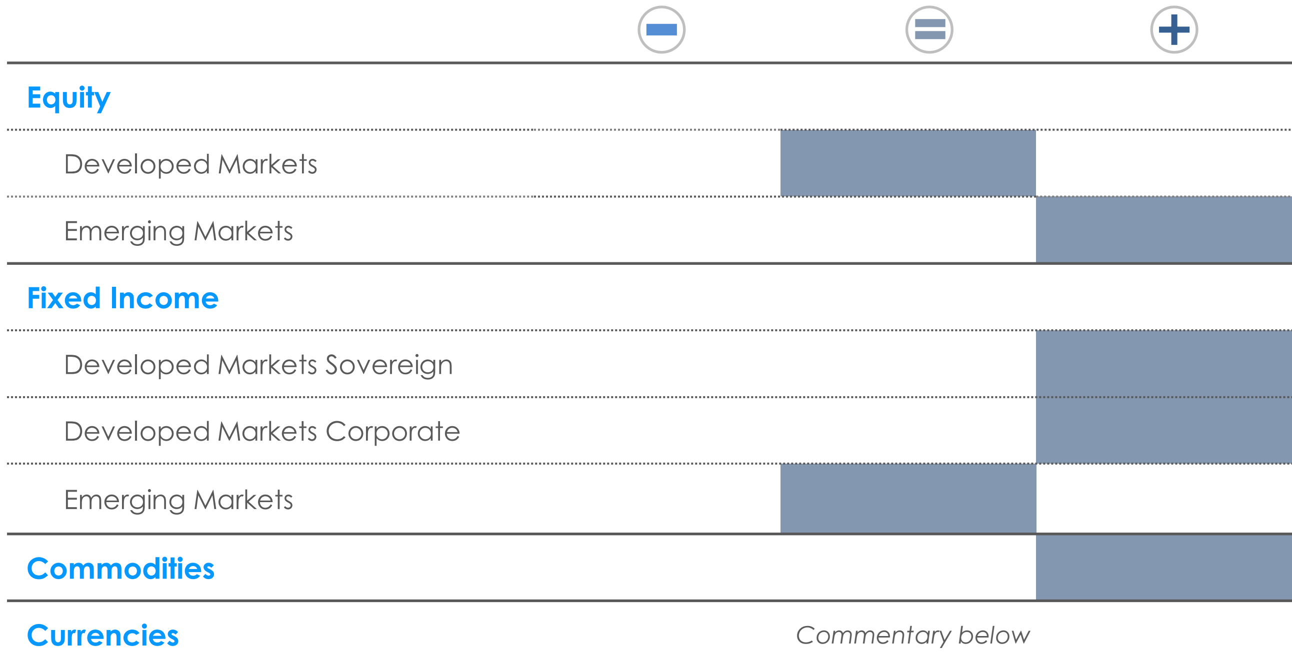
Asset Allocation View

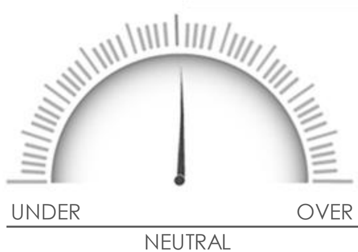


	− (Under)	= (Neutral)	+ (Over)
Equity			
Developed Markets		■	
Emerging Markets			■
Fixed Income			
Developed Markets Sovereign			■
Developed Markets Corporate			■
Emerging Markets		■	
Commodities			■
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

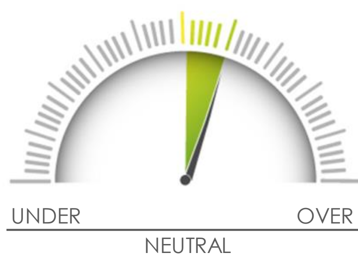
Developed Markets



We maintained our recommendation on Developed Market Equities as **Neutral**. Nothing material has changed in the past two weeks. Equity markets continue to be supported by positive momentum and a still strong economy, but they are still vulnerable to a correction because of increased competition from rates and high valuations.

US	Europe	Japan
= (Neutral)	= (Neutral)	= (Neutral)

Emerging Markets



We also kept our **Slightly Overweight** recommendation on Emerging Markets Equities. The overbought situation in the Chinese market has vanished following the physiological correction we had predicted over the previous two weeks, allowing the recovery to potentially restart. Another positive development is Modi's reelection in India, as demonstrated by the performance of regional stock markets. Hence, taking into account the more favorable valuations as well, we continue to have a relative preference for emerging markets collectively.

Asia ex-Japan	EEMEA	LATAM
= (Neutral)	− (Under)	= (Neutral)

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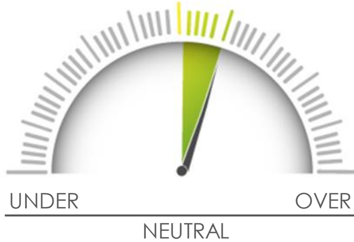
Fixed Income

Developed Markets Sovereign



We kept our **Slightly Overweight** recommendation for Developed Markets Sovereign Bonds. Given that the ECB is going to begin reducing interest rates and that the Fed now is assessing the developments in the U.S. labor market, which seems to be softening, when determining interest rate decisions, we continue to expect that rates will not rise above their current levels. The committee continues to prefer the short and medium segments of the yield curves. Conversely, we remain cautious about the long end, since the ongoing bull steepening could extend further in light of the large issuances made by the government to finance their deficits.

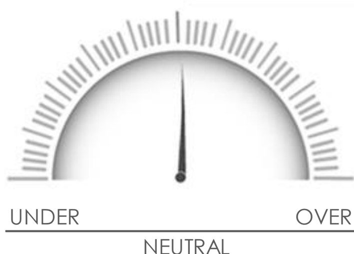
EU Core		EU Periphery		US Treasury		Japanese JGB	

Developed Markets Corporate

We kept our **Slightly Overweight** recommendation on Developed Markets Corporates. We maintain our preference for investment grade corporate bonds due to their persistently narrow spreads. Given the current low volatility environment, the carry trade strategy remains paramount.

IG Europe		IG US		HY Europe		HY US	

Emerging Markets



We also maintained our **Neutral** recommendation for Emerging Market bonds. On the one hand, the stabilization of interest rates in Western countries and the possibility of them being cut in the second half of the year represent a positive development for the asset class. On the other hand, any weakening of global growth would represent a headwind. Consequently, we advise a relatively more cautious recommendation compared to other bond strategies.

Local Currency		Hard Currency IG		Hard Currency HY	

Commodities

We confirmed our **Slightly Overweight** recommendation on Commodities. Precious metals remain as our preferred commodities, serving as a portfolio hedge amid unexpected geopolitical tensions and sustained inflationary pressures. Additionally, precious metals are gaining from substantial purchases by central banks, particularly by the Bank of China. Energy commodities could see a boost from increased demand for electricity necessary for artificial intelligence, while industrial commodities may benefit from rising demand in China.

Precious		Energy		Industrial		Agricultural	

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Currencies

The Committee kept the **Neutral** stance on the US Dollar, as it currently trades aligned with the rate differential with the other major currencies.

The view on the Euro is **Neutral** as well. Unless the ECB will convey unexpected messages at its next meeting, the euro is expected to remain around the current levels.

The view on the **Chinese Renminbi** is confirmed to **Negative**. For several weeks, the Renminbi has been trading near the upper boundary of the permitted fluctuation band with respect to the central bank's fixing. In the past, when such a situation persisted for a while, it was followed by a devaluation of the Chinese currency. As of late, China has started to let the official Renminbi fixing to weaken.

The outlook for other **emerging market currencies** is **Neutral**. Among emerging currencies, the Committee favors the Turkish Lira.

Euro	=	USD	=	CNY	=	Other EM	=

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