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The landing seems to be a success... but the good news is widely anticipated

JULY 2023

Marketing communication

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- On both sides of the Atlantic, recession will likely be avoided, but growth should remain weak.
- We expect core inflation will gradually ease, but central banks should keep their foot on the brake.
- Equities have already integrated this "soft landing" scenario, we believe, leaving little additional rebound capacity.
- There are some interesting alternatives to equities which offer carry, notably in European investment grade credit and emerging market debt.
- To hedge risks, we prefer yen (JPY) and gold.

Economic outlook: weak growth, falling inflation.

We expect global growth to be relatively weak in 2023 and to accelerate only slightly in 2024. While emerging Asia is the exception, with relatively sustained growth this year, business in most other regions remains sluggish. However, neither the United States nor the Eurozone are likely to experience a recession in the coming quarters. In most economies, inflation should continue to fall. But persistent core inflation and tight labour markets in the developed regions should lead central banks to maintain a restrictive policy for several quarters to come.

China: activity picks up but deflationary pressures remain

The abandonment of the zero-covid policy led to a sharp rebound in activity in the first quarter. Hitherto hampered by sanitary measures, the service sector has particularly benefited from the reopening of the Chinese economy. This trend is set to continue, and despite sluggish activity in manufacturing and an apparent weakening in the service sector since the spring, growth should be high on average over 2023. Beyond that, sustained growth is far from a foregone conclusion. Weak household confidence and the high level of youth unemployment are holding back a sustainable rebound in consumer spending. Finally, while the support measures taken by the authorities have helped stabilize the real estate market, their room for maneuver - particularly budgetary - continues to shrink: the ratio of public debt to GDP is now the same in China as in the United States!

USA: the plane has touched down but is still going too fast

The Federal Reserve's slowdown led to a marked slowdown in activity. Residential investment in particular contracted sharply. The banking system faltered. And yet, for the time being, the US economy has avoided recession! Surplus savings accumulated during the pandemic and a still-buoyant labour market have supported household consumption. Over the next few quarters, stabilizing residential investment, buoyant consumer spending and buoyant construction investment in the manufacturing sector should continue to provide a foundation for growth and help avoid a recession.

To bring inflation back closer to its target, the Federal Reserve will have to ensure that activity does not accelerate in the coming quarters. Certainly, signs of disinflation are multiplying - goods inflation has fallen sharply, rents are slowing and so are wages - but job creation has remained surprisingly high, while the labour market is only slowly easing. After allowing itself a little time to assess the effect of the *500 basis points* of interest rate hikes since March 2022, we expect the Federal Reserve will adjust its monetary policy to the economic data to come: if it judges activity to be too rapid, it could raise rates a little further... especially as banking tensions seem to have eased. Above all, there is no reason to ease monetary policy until wages and inflation have decelerated.

Eurozone: at low speed

After a "technical" recession at the start of 2023, European activity is set to return to moderate growth. Natural gas prices have returned to levels close to those seen before the war in Ukraine, and the shock to purchasing power is about to be absorbed. Admittedly, underlying inflation has been controlled only slowly, but the normalisation of production chains and lower energy bills should help. With the labour market still tight, real household income is set to rise again in the second half of 2023, fuelling moderate growth in consumption. The latter would also be supported by the gradual reversal of excess household savings.

In the absence of clear signs of disinflation, and with wages continuing to grow at a steady pace, the European Central Bank is likely to maintain a restrictive monetary policy to avoid the formation of a wage-price loop. At the same time, governments should help it in its task by gradually rebalancing their public finances.


On both sides of the Atlantic, recession should be avoided, but growth will remain weak.

Asset allocation: less risky alternatives to equities.

The better-than-expected growth/ inflation mix buoyed markets in the first half. Financial markets are now incorporating a "soft landing" scenario. We believe that for the second half of the year, the risk is more asymmetrical on the downside. Restrictive monetary policies should continue to spread throughout the economies of developed countries, and inflation is likely to decelerate only gradually. We take a cautious view of developed-country equities and favor emerging equities. We are positioning ourselves in the carry assets most likely to benefit from the current cycle, such as high-quality European credit and emerging market debt.

Graph 1:
US Equities vs Bonds Performance

Past performance is not a reliable indicator of future performance. Markets may evolve very differently in the future.
Sources: Bloomberg, Datastream, Candriam. Data as of 16.06.2023.

Investors may have been positively surprised in the first half of this year, as sentiment was extremely negative at the end of 2022. After the rally of the first semester,[1] sentiment is now much more positive, with the consensus now anticipating a "soft landing" by the US economy and no upturn in inflation in the coming months. It seems to us that the risk is now much more asymmetrical on the downside. Positive surprises may give way to disappointments: higher Fed and/or ECB terminal rates, stronger deceleration in developed economies, underlying inflation more resilient than expected... We are therefore more cautious on developed-country equities, positioning ourselves for an economic deceleration by favoring defensive sectors (healthcare, non-cyclical consumption). In this context, we prefer government bonds and high-quality credit as sources of carry. We have also chosen to remain exposed to emerging countries (debt and equities) in order to benefit from the desynchronisation of their monetary and fiscal cycles.

Bonds: take advantage of diversification and carry trades

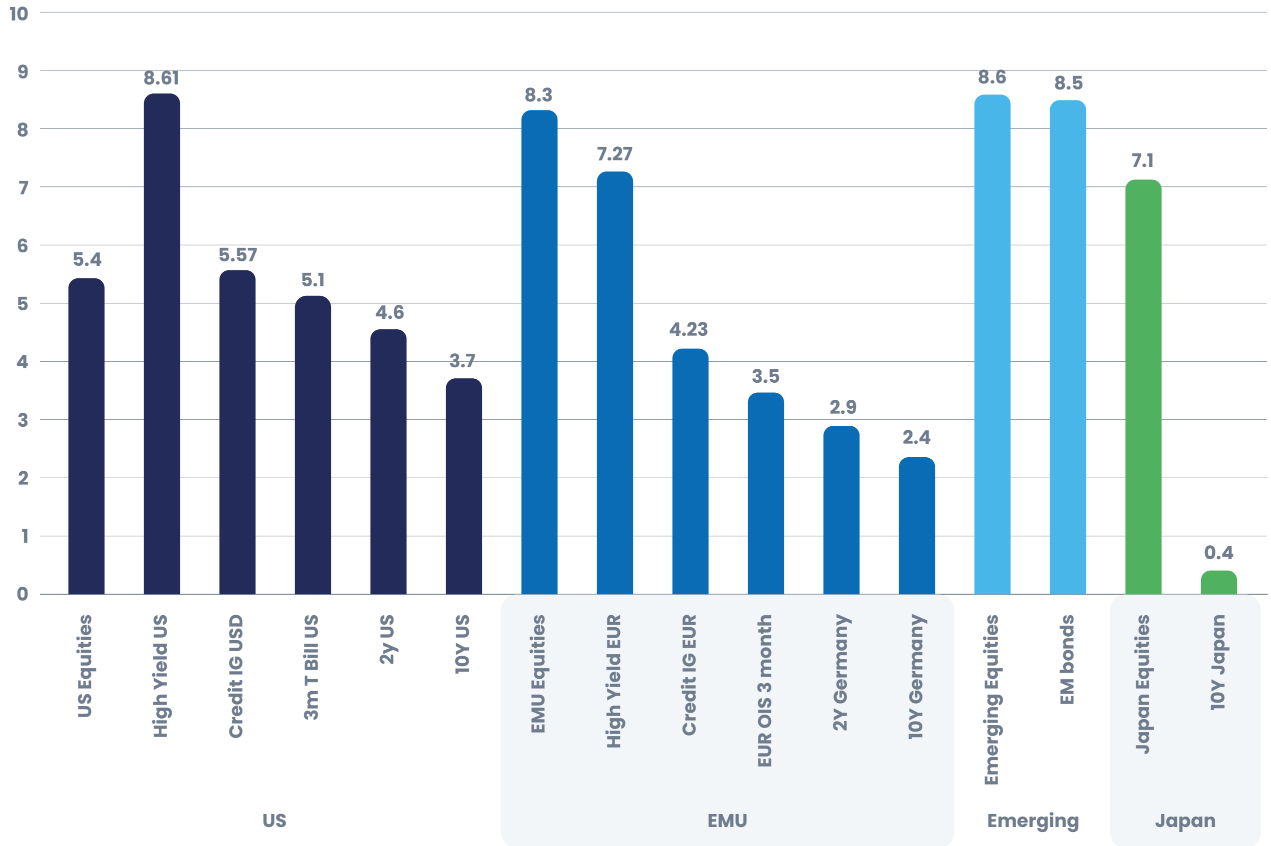
In the bond market, the asset class is regaining its credentials with a return to diversification and carry. We adopt a long duration bias and overweight high-quality European credit, which offers an attractive risk/return profile. We are taking advantage of a more accommodating central bank environment in emerging countries to overweight their local currency debt.

With growth expected to slow and inflation to ease between now and the end of 2024, interest rates are set to fall further, prompting us to adopt a long duration bias in portfolios. At this stage, we prefer US duration, given its relative advance in the monetary tightening cycle. We are waiting until closer to the end of the European monetary tightening cycle before adding duration to this region too.

Despite the compression of spreads in 2023[2], the credit market offers attractive yields. We are positive on high-quality credit, particularly European credit, which we believe offers a particularly favorable risk/return profile.

1 - +14% for global equities - MSCI World at 22/06/2023.
2 - -30% for European GI credit, -21% for US GI credit compared with spreads at December 30, 2022 - data at 06/22/2023

Chart 2:
Cross Asset Yields (%)

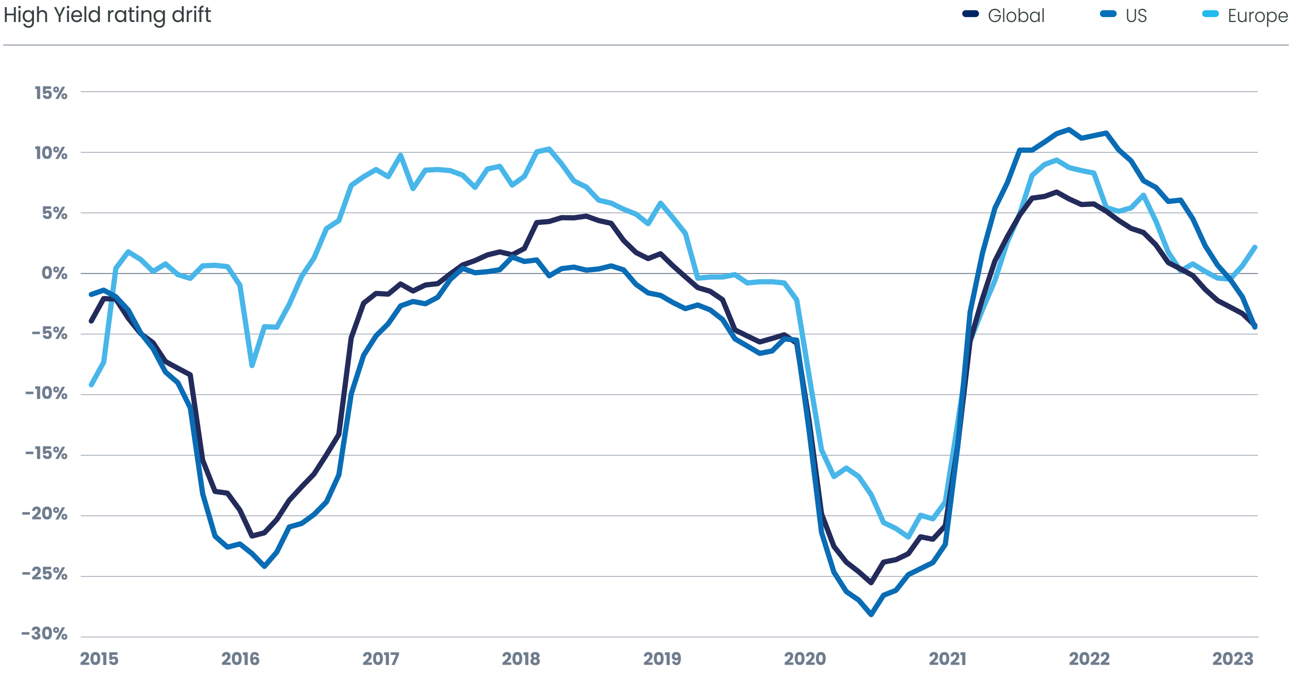


Past performance is not a reliable indicator of future performance. Markets may evolve very differently in the future.
Source: Bloomberg - Data at 05/31/2023

On the other hand, we remain neutral on high-yield credit. While the asset class offers yield, ratings downgrades in an environment of tightening credit conditions could weigh.

Chart 3:

High Yield rating drift



Past performance is not a reliable indicator of future performance. Markets may evolve very differently in the future.

Sources: Moody's, Candriam

We favor emerging bonds, which offer carry and should benefit from an accommodating central bank environment as inflation in emerging countries begins to ease. A less vigorous dollar would also be a positive catalyst. We overweight this asset class via local currency.

Graph 4:

Local currency - Yields and Spreads above 1 SD

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Sources: Bloomberg, Datastream, Candriam

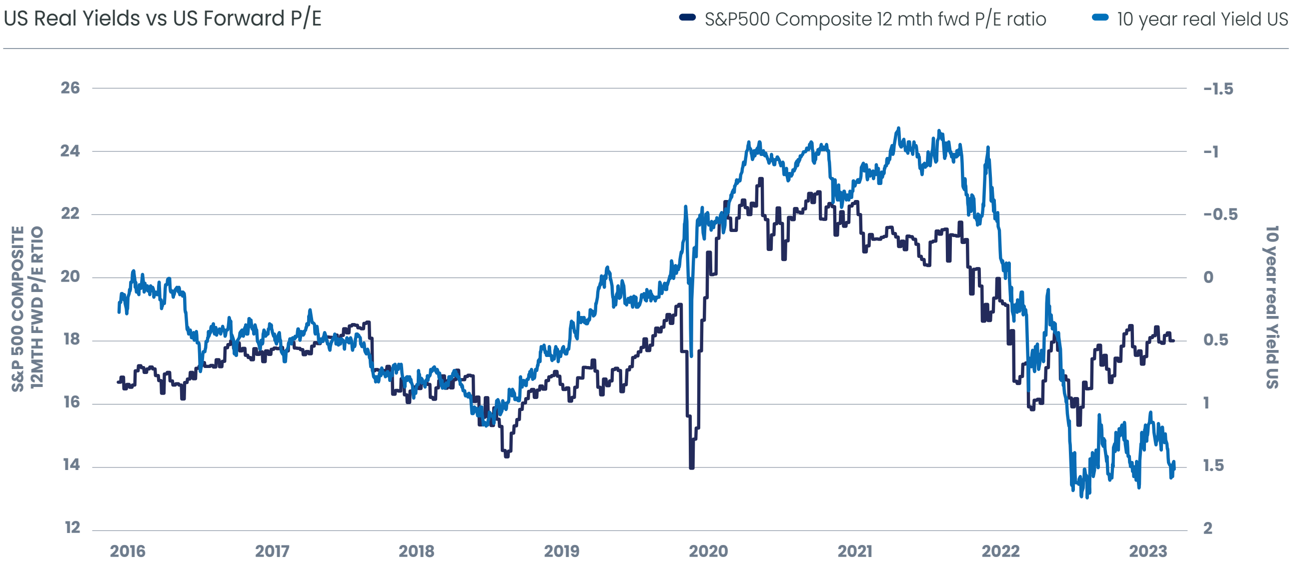
Equities: The best is already in

In equities, despite relatively favorable economic conditions (soft landing for the economy), the market seems to be in a range with limited upside potential. We are overweight emerging markets, neutral on the United States and underweight the Eurozone.

We are taking a neutral stance on equities. Indeed, despite a positive growth/inflation mix forecast for 2023 and 2024, the market rebound observed in developed countries already seems to us to incorporate this good news. Valuations are relatively high, particularly in the United States, where they are in the 87th percentile relative to a 20-year history[3], out of line with current expectations for inflation and real interest rate levels. In addition, earnings growth forecasts for the US and Europe already seem to incorporate our expectations for positive economic growth for 2023 and 2024, leaving little margin for error.

Graph 5:

US Real Yields vs US Forward P/E



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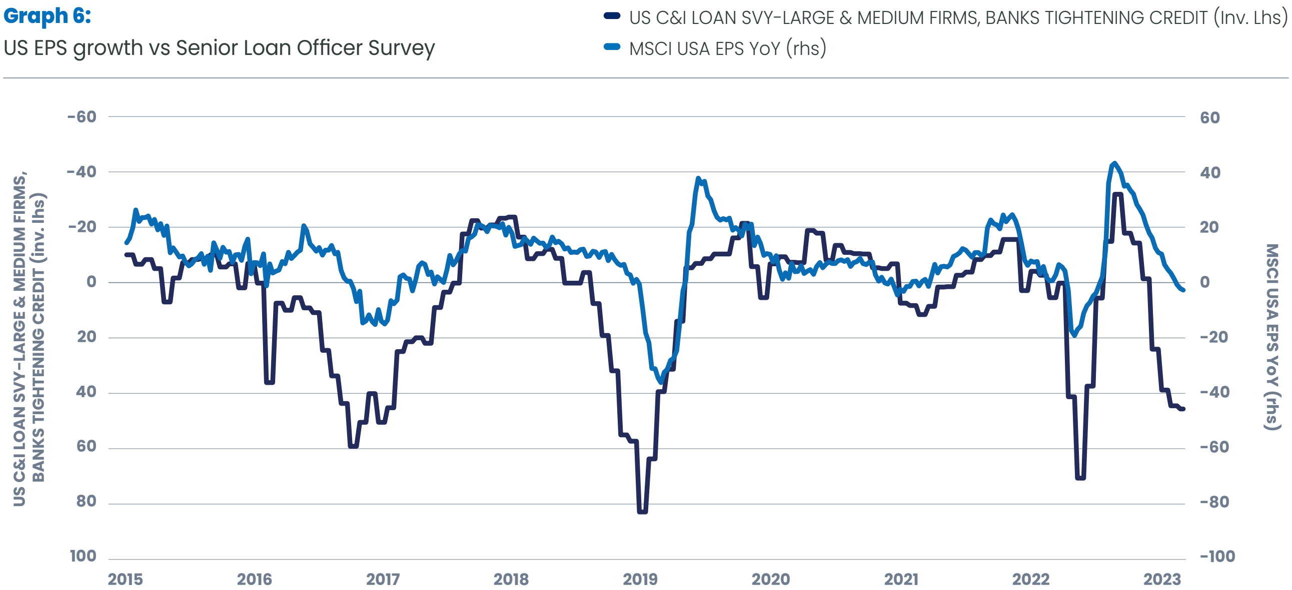
Sources: Bloomberg, Datastream, Candriam

3 - Sources: Bloomberg, Candriam

We therefore see limited upside potential in the absence of a further acceleration in growth, while many uncertainties remain.

In the United States, margins are expected to rise over the next few months, even though the slowdown in inflation in a persistently tight labour market seems to be holding back margin expansion. Further, the sharp downturn in leading credit indicators suggests that we should be cautious about expecting positive earnings in the months ahead.

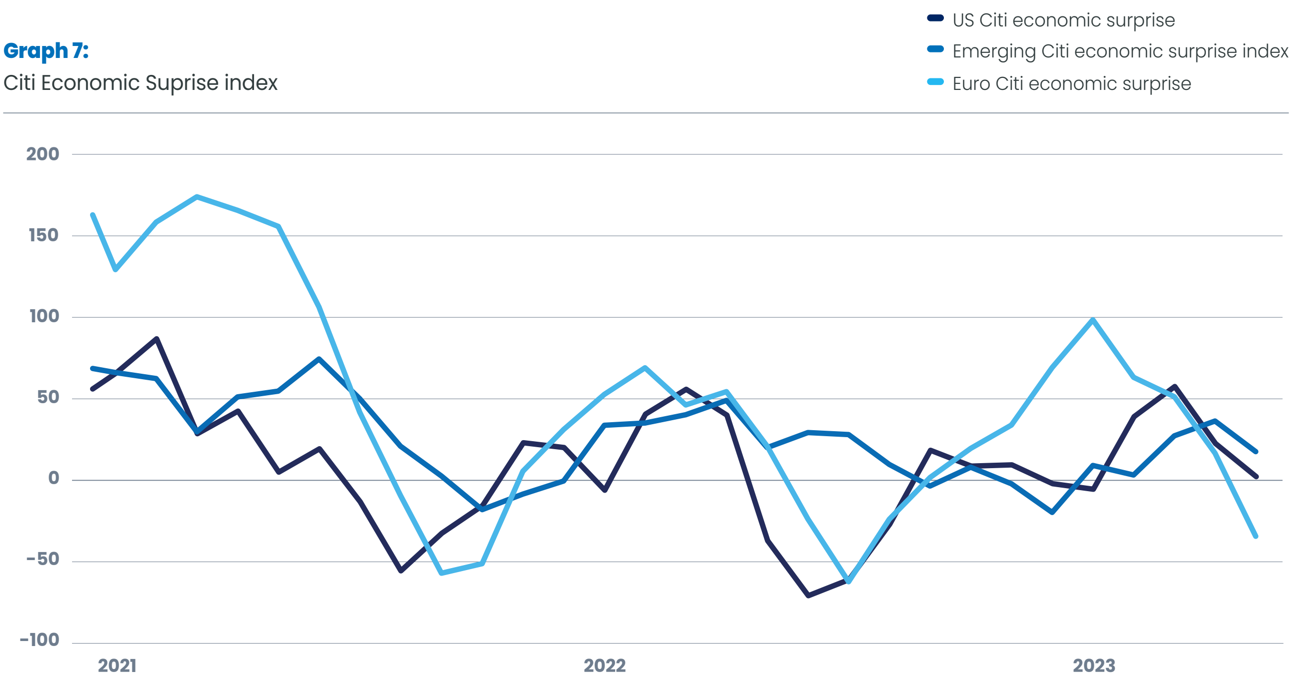
Graph 6:
US EPS growth vs Senior Loan Officer Survey



Sources: Bloomberg, Datastream, Candriam

In Europe, the risks to growth appear to be on the downside. These nations benefited from a particularly favorable environment in the first half of the year due to lower gas prices, the reopening of China and a relative reduction in geopolitical risks. As a result, European indices ranked among the best-performing regions since the start of the year (when measured in euros). These events will no longer provide such strong support in the second half of the year, while persistent inflation could force the ECB to continue raising rates, impacting credit conditions and hence the European economy.

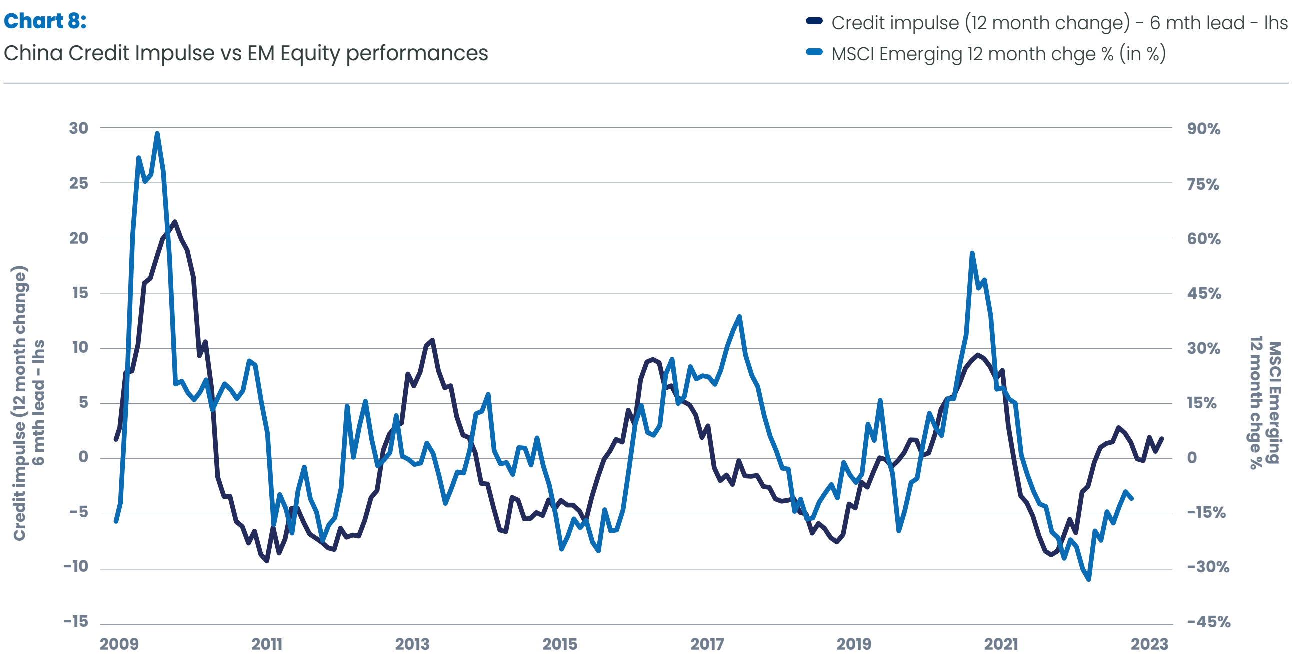
Graph 7:
Citi Economic Suprise index



Sources: Bloomberg, Datastream, Candriam

In emerging countries, the situation seems relatively more favorable. Given the sustained fall in inflation figures and a cycle of monetary tightening begun earlier to central banks in developed countries, financial conditions should be less restrictive. In addition, given our expectations of a weaker US dollar, these nations should benefit. Finally, although China's reopening is disappointing for the time being, we do not rule out the possibility that more massive monetary and/or fiscal measures could support the region.

Chart 8:
China Credit Impulse vs EM Equity performances



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Sources: Bloomberg, Datastream, Candriam

Certain themes remain promising

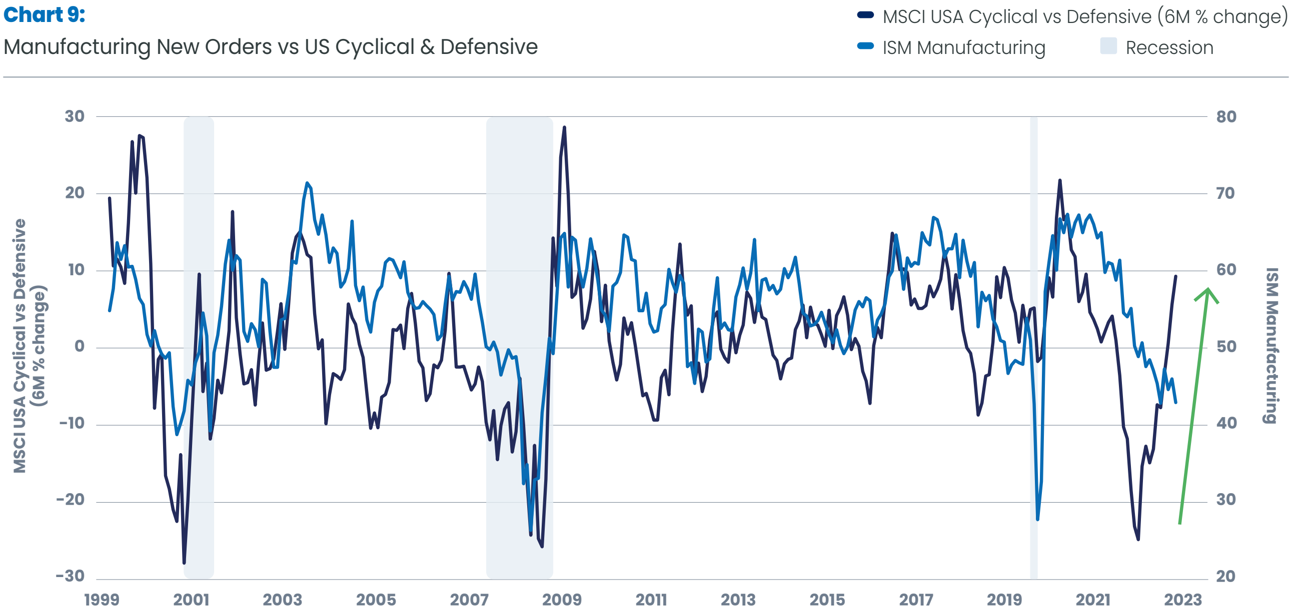
Given the economic slowdown, we are overweighting quality defensive stocks such as healthcare and consumer staples. We are also overweighting long-term themes such as energy transition and automation.

Despite deteriorating activity indicators, particularly in the manufacturing sector, cyclical stocks outperformed defensive stocks year to date (see chart below), anticipating a reacceleration in activity, which is not our central scenario.

At the same time, it seems to us that defensive and quality stocks are better able to cope with the type of slowdown which could be brought about by persistent inflation, and for which tthe companies' pricing power will be paramount.

We also favor long-term themes connected with energy transition and automation. These stocks should be less affected by economic cycles, and benefit from structural geopolitical issues such as the reduction of our environmental impact, the need to repatriate certain activities that contribute to the sovereignty of states, and the development of artificial intelligence.

Chart 9:
Manufacturing New Orders vs US Cyclical & Defensive



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Sources: Bloomberg, Datastream, Candriam

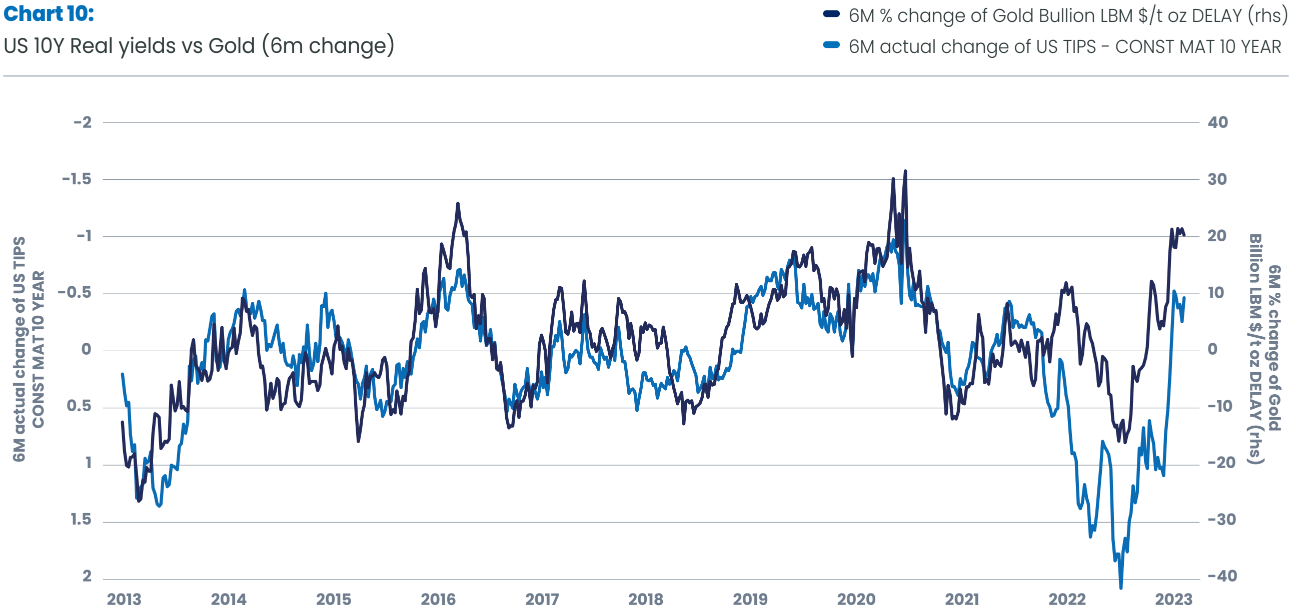
Yen and gold as safe havens

The end of the Federal Reserve's monetary tightening cycle is prompting us to position ourselves in non-USD currencies. We are positive on the Japanese yen and also on gold, which provide a hedge in the event of renewed market stress.

With the anticipated end of US monetary tightening and lower relative growth in Europe and emerging countries in 2024, we prefer non-USD currencies in our portfolio, particularly emerging currencies via our exposure to emerging debt in local currency.

We are also positioned in safe-haven assets such as the yen and gold. The yen could also benefit from the possible end of the BOJ's yield curve control, given recent inflation figures above the Japanese central bank's targets.

Chart 10:
US 10Y Real yields vs Gold (6m change)



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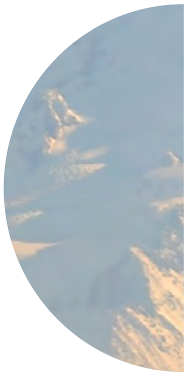

With weak but positive growth likely avoiding recession on both sides of the Atlantic, and underlying inflation easing only gradually, central banks will need to keep their foot on the brake in the second half of the year.

Financial markets are already incorporating this positive "soft landing" scenario, justifying the strong performances seen since the start of the year. Positive surprises are likely to be rarer in the second half of this year, advocating a degree of caution on risky assets.

We are positioning ourselves in those carry assets most likely to benefit from the current cycle, such as high-quality European credit and emerging market debt. We are cautious on equities, favoring emerging equities over European equities, and hedging the risk in our portfolios with positions in yen (JPY) and gold.

€139 B

AUM at end December 2022*

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*As of 31/12/2022, Candriam changed the Assets Under Management (AUM) calculation methodology, and AUM now includes certain assets, such as non-discretionary AUM, external fund selection, overlay services, including ESG screening services, [advisory consulting] services, white labeling services, and model portfolio delivery services that do not qualify as Regulatory Assets Under Management, as defined in the SEC's Form ADV. AUM is reported in USD. AUM not denominated in USD is converted at the spot rate as of 31/12/2022.