GENERALI INVESTMENTS

Market Perspectives

Goldilocks ‘light’

December 2019/January 2020

Content

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Global View – Goldilocks 'light'

Thomas Hempell

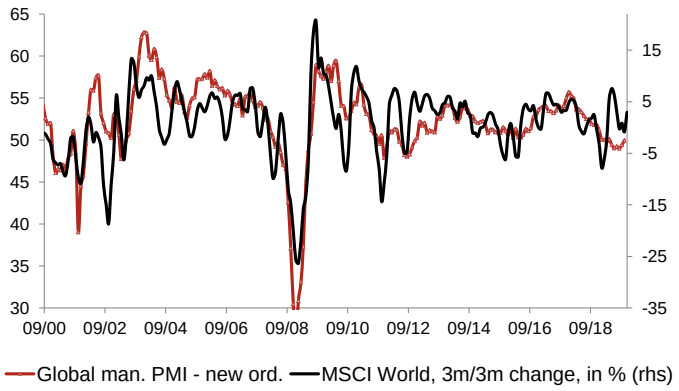
- **Receding political risks, tender economic green shoots and accommodative central banks have underpinned risk assets, benefitting our pro-risk stance.**
- **Markets are already discounting a lot of good news, warranting a somewhat more cautious tactical allocation stance into year-end.**
- **That said, a Goldilocks 'light' environment is still boding well for risk sentiment. Low inflation, bottoming but subpar growth and sustained monetary policy support will keep a lid on core yields while still underpinning risk assets.**
- **We maintain overweight in Credit and Equities vs. Core Govies and Cash, but reduce the size of active positions.**

Doomsayers are having a hard time this autumn. Receding political risk (Brexit, trade war), tender economic green shoots and tail winds from central banks have helped risky assets to advance further in November. Global equities extended their year-to-date gains to 24% (MSCI World, USD), core yields recovered a bit, while the tightening in Credit spreads was largely confined to HY. Overall, this has benefitted our pro-risk tilt in the portfolios.

Chasing a trade truce

Progress in US/China trade talks remains sluggish – with the widely anticipated "phase one" truce repeatedly delayed. The US bill supporting Hong Kong protesters is complicating the matter. Both sides remain eager to not derail the talks, though. The stakes are high, but incentives to avoid new tariffs on Dec. 15 (incl. a large list of IT Christmas devices for US consumers) remain strong. A trade truce is still within reach, not least because of the mounting risks from the conflict to the US economy. President Trump needs a de-escalation and solid economic data ahead of the election next year.

Global economy and equities



Fears of a hard Brexit have moved to the backburner. PM Johnson enjoys good prospects of securing a Tory majority in parliament at the general elections on Dec. 12. This would allow him to get an orderly Brexit done by Jan 31. Serious doubts remain about how Johnson can deliver on his promise of a trade deal with EU within the short transition period by end-2020. But for the coming weeks, market relieve will prevail if he wins a majority on 12/12.

Easing political concerns are seconded by tender economic green shoots. Global manufacturing orders are recovering, while bellwether exports in Korea have rebounded from deep contraction. Rising semi-conductor prices are signalling optimism, too. Admittedly, broader demand in Europe remains sluggish and a quick rebound is not in sight. But fears of an outright recession – widespread by late summer – are easing. Rising stock prices and a solid housing market also underpin the US consumer.

Goldilocks 'light'

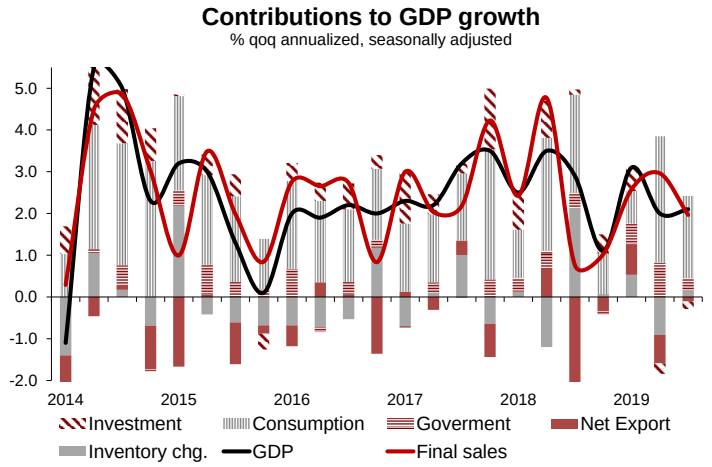
Meanwhile, central banks are in no rush to rethink their accommodative policy stances. Very muted inflation will keep the ECB locked into resumed assets purchases for much longer. And while the Fed has signalled to remain on hold after the cumulated 75 bps cuts since summer, it is extending its balance sheet and would tolerate a slight overshoot of its 2% inflation target. Tempered growth and subdued price risk now may keep a Golidlocks 'light' environment for longer.

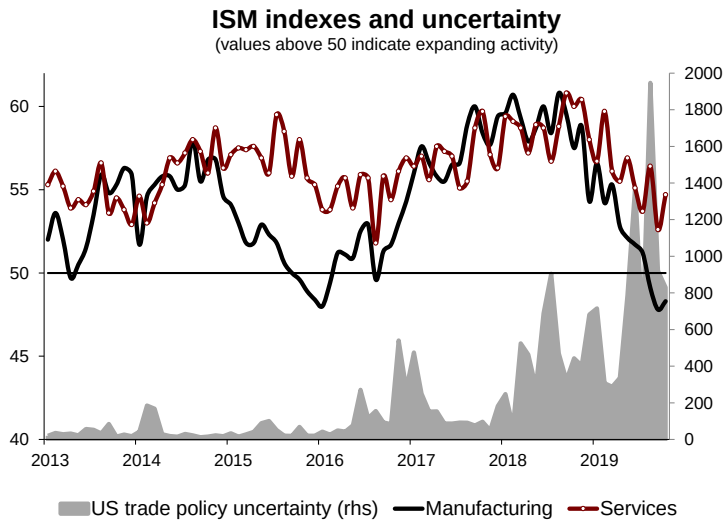
Bonds	**27/11/19***	**3M**	**6M**	**12M**
10-Year Treasuries	1.76	1.70	1.65	1.70
10-Year Bunds	-0.37	-0.35	-0.30	-0.20
Corporate Bonds				
BofaML Non-Financial	103	95	90	85
BofaML Financial	104	100	95	90
Forex				
EUR/USD	1.10	1.12	1.14	1.17
USD/JPY	109	107	105	104
Equities				
S&P500	3143	3145	3155	3175
MSCI EMU	130.8	131.5	130.0	131.5

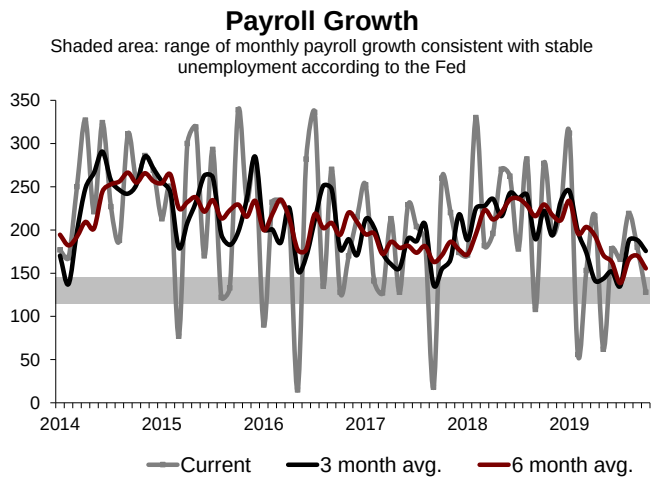
* avg. of last three trading days

Admittedly, the air is getting thinner for equities after the continued advance which is already pricing a lot of economic and trade optimism (see also chart). We scale back our overweight in risky assets as positioning looks less defensive than earlier this autumn. Structurally, however, the backdrop for Equities and Credit remains benign. Equities appear dear on some metrics, but cheap against bonds. We continue to prefer high-quality Credit in the euro area, which is receiving greater support from the ECB's asset purchases. We remain neutral on duration, with strong safe-haven flows into core bonds having largely reversed since October, while accommodative central banks, subpar growth and low inflation limit the further upside to core yields.

USA







Paolo Zanghieri

- **GDP growth remained broadly stable in Q3, but domestic demand (especially capex) weakened. We expect growth to slide to 1.6% in 2020.**
- **Confidence indicators show signs of a tentative rebound, on slightly better news on trade. We expect political uncertainty to resurface, as the campaign for the 2020 election proceeds.**
- **After the Oct. 30 rate cut, the Fed signaled a pause. The growth slowdown will most likely trigger another cut in H1 2020.**

Q3 GDP growth was revised up to 2.1% (qoq ann.). Growth is increasingly depended on consumption, which slowed but continued to prove resilient. Fixed investment continued to contract despite favorable financial conditions, dragged down by uncertainty on trade. The drag on growth is in part offset by residential investment, spurred by the sharp decline in interest rates. In 2020, consumption will have to provide much of the support to growth. A rebound in capex looks unlikely, as weakening profitability adds on uncertainty. The lagged effect of the Fed rate cuts will provide a crucial boost to interest rate sensitive components of demand like durable consumption and residential investment. We see GDP growth at 1.6%, with a weakish first half followed by an mild acceleration.

Political uncertainty eases (for now)

Despite the bounce in October figures, data on orders and shipping still look weak (hinting at slower growth in Q4), the latest readings of the business surveys signal a tentative rebound, in line with the decrease of the risk of an escalation in the US-China trade conflict. Mounting evidence of the costs of tariffs on consumers and business should prevent the US administration from enacting further measure, but talks with China are proceeding at a relatively slow speed. Political uncertainty has abated over the last months from the record high level. Yet, as the primaries for the Democratic runner in the 2020 presidential election and the impeachment procedure against Trump gather speed, political uncertainty (and its drag on sentiment) will resurface already in from first months of next year.

The Fed: further easing in H1 2020

After delivering a hawkish cut at its Oct. 30 meeting, Fed officials have reiterated that current data and their baseline forecast for 2020 do not warrant further easing. However, we expect one more cut in the first half of next year. The slowdown in employment and its impact on consumption around the turn of the year will provide the evidence needed for the “material reassessment” of the outlook Chair Powell set as a precondition for any action on rates. The need to stabilize the interbank market will lead the Fed to continue its T-Bill purchases at least until mid-2020.

Euro Area

Martin Wolburg

- **Q3 GDP data came in better than expected, the external environment improved, risks receded and expectations improved.**
- **We only slightly lifted our growth outlook for 2019 to 1.2% and 1.0% for 2020 as domestic activity got hit by this year's woes.**
- **We expect the ECB to stay on hold for the time being.**

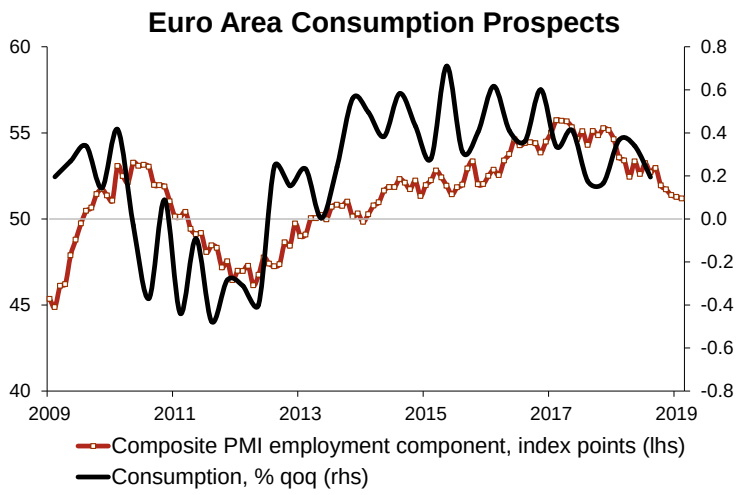
The string of predominantly bad news with respect to the euro area seems to come to an end. Q3 growth of 0.22% qoq was better than expected and to a high degree due to Germany avoiding (with a growth rate of 0.1% qoq) a recession. The turn in the global manufacturing cycle continued, supporting confidence in the rattled manufacturing sector. The corresponding November PMI (of 46.6) recovered further from its September low (of 45.7) amid higher export orders. Easing US-Chinese trade tensions, no US tariffs on EU cars and the prospect of a smooth Brexit will continue to improve manufacturing sentiment. Also, the weakening euro effective exchange rate will help. This is especially good news for the export-driven German economy for which we revised our growth expectations up by 0.1 pp in 2019 to 0.6% as well as 2020 to 0.8%.

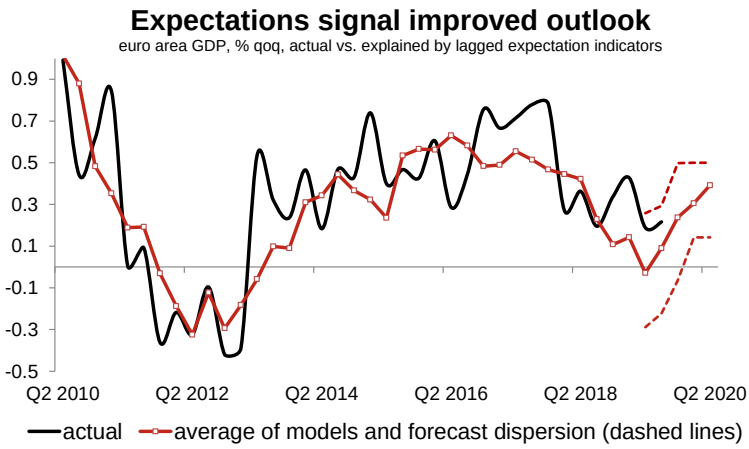
That said, we caution to become overwhelmingly optimistic on the euro area outlook. Domestic demand has been damaged as a result of this year's woes. In Q3, employment growth receded to 0.1% qoq and sentiment indicators like the composite PMI suggest that it will stay weak. Production expectations remain well below normal suggesting muted investment activity.

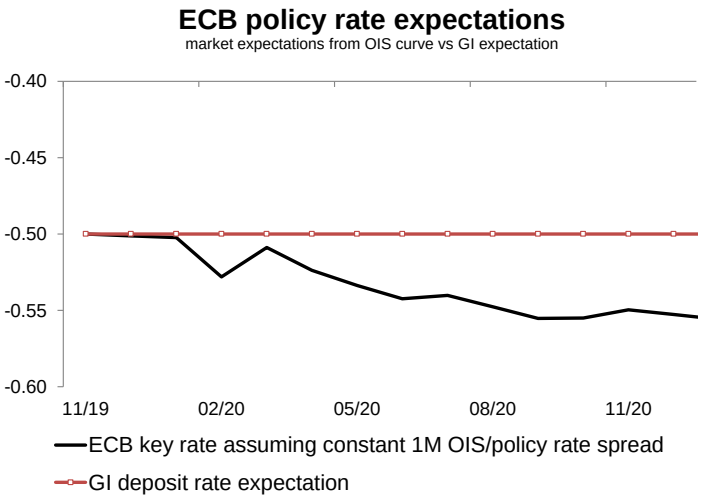
All in all, we lifted our growth forecasts slightly to 1.2% (from 1.1%) for 2019 and 1.0% (from 0.9%) in 2020. Forward-looking components of our key sentiment indicators hint at improved activity in 2020. While the range of quarterly growth remains relatively wide, the risk of a euro area recession over the coming twelve months has declined. We see it at 18%, down from 25%. Moreover, we now see the risks surrounding our outlook less biased to the downside.

Lagarde gives message of continuity

New ECB President Lagarde gave a message of monetary policy continuity in her first speech. She also urged for more fiscal spending, in line with what we heard before from Draghi. As widely expected, she also announced that a strategy review will take place in the near future. Given the latest macro developments we do not expect that the December ECB forecast update has policy implications. We see the ECB to stay on hold. More interestingly, the start of the new QE program suggests that the share of corporates in monthly QE operations will be in the 20% (€ 4 bn) to 25 % (€ 5bn) range, higher than previously.

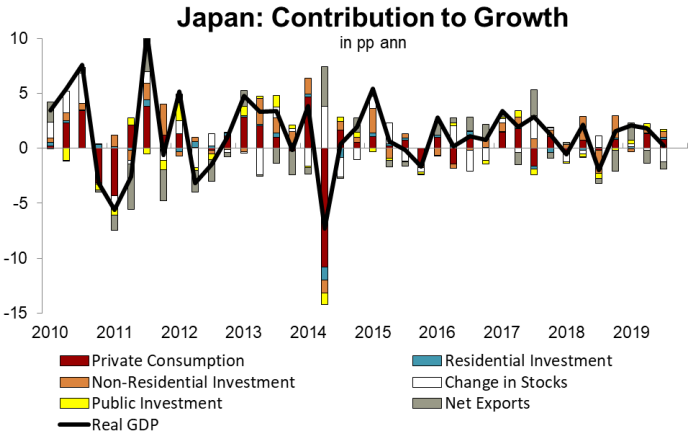


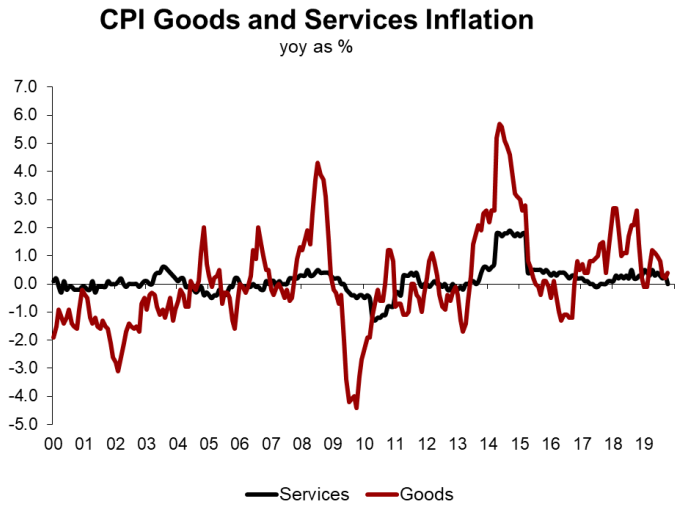


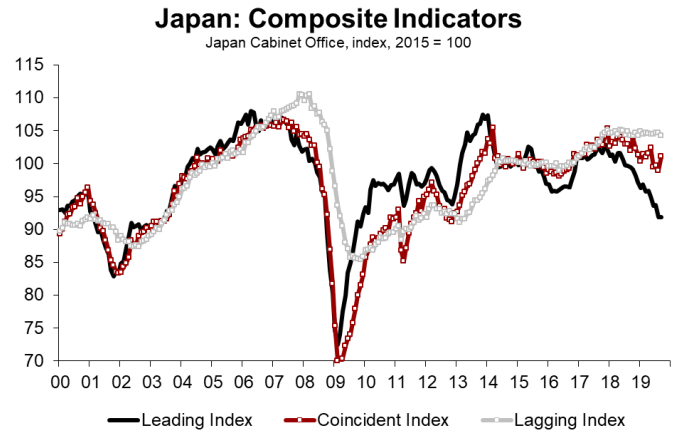


Japan

Christoph Siepmann







- **Japan saw soft GDP, export and retail sales data, which can be only partly explained by volatility coupled with the sales tax hike.**
- **Looking ahead, a fiscal package and some green shoots in global manufacturing exports led us to revise our growth forecast slightly upwards.**
- **As a consequence, we see the BoJ on hold.**

According to the first print, Japans Q3 GDP expanded by 0.2% qoq ann, falling short of market expectations. The main drag was a strong inventory correction which hit growth by 1.3 pp ann. Moreover, net exports contributed negatively by 0.6 pp qoq ann. However, the major surprise was the rather weak expansion of private consumption ahead of the sales tax hike (from 8% to 10%) on Oct, 1. Q3 household demand rose by 1.4% qoq ann, even slowing compared to the strong Q2 with 2.4% qoq ann. This was much lower than in 2014, when consumption jumped by 8.1% qoq ann. Still, purchases of durable and semi-durable goods rose substantially. Given that the overall effect was much lower, this might suggests that also the Q4 payback effect could be more moderate. Unfortunately, retail sales data over the last two months do not yet provide some comfort. After a September rise by +9.1% yoy, October saw a drop by 7.1% yoy, much worse than the consensus forecast of -4.4% yoy. However, purchases might have been affected by the devastating typhoon Hagibis, contributing to volatility. This was likely also the case for foreign trade. Nominal exports dropped by 9.2% yoy, capturing press headlines. However, according to BoJ data, real exports decreased only by 1.5% mom, implying a weak start into the quarter. Nevertheless, some positive signs in the global manufacturing PMI suggest that the trade volume could start to improve next year, benefitting Japan.

BoJ on hold for the time being

Looking ahead, we continue to expect a negative growth rate in Q4, although less severe due to a weaker payback effect from consumption and a positive contribution of the inventory component. Moreover, following the devastating typhoon, the government prepares a fiscal package. It has been announced to be sizable (political demands reach up to 2% of GDP). “Real water” instead of headline spending is likely much lower at 0.3 pp, given Japan’s debt and limited construction capacity. The supplementary budget will probably be approved in Q1 2020. Accordingly, we revised our GDP forecast to 0.4% (from 0.2%) for 2020. BoJ Governor Kuroda welcomed the fiscal package. He also kept stressing that there is still scope for interest rate cuts. However, given that the yen did not respond much to Fed cuts, the upcoming fiscal stimulus, a cooling of the US-China trade conflict and green shoots regarding exports, we see it now more likely than not that the BoJ will not change its policy and look through the underlying weakness in inflation.

China

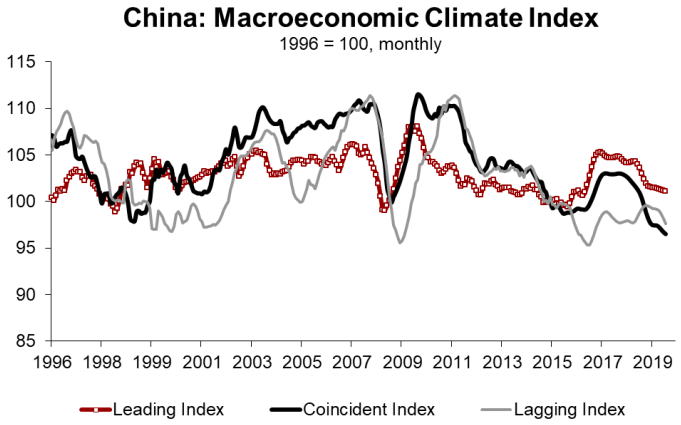
Christoph Siepmann

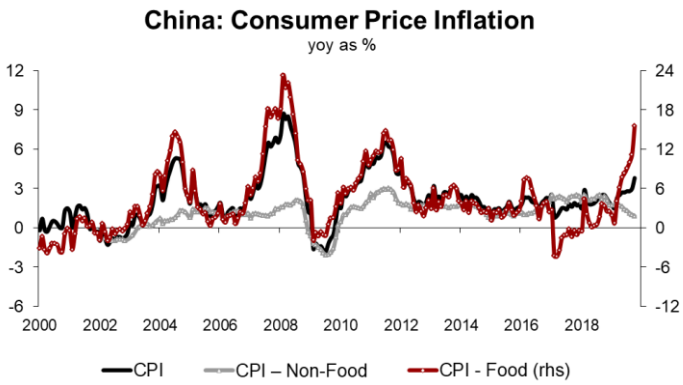
- **China's October real activity data came in soft.**
- **CPI inflation spiked on accelerating food prices.**
- **China's economic outlook depends very much on the trade negotiations with the US. We assume a "Phase 1" deal in December/ early next year with the remaining tariff hike to be cancelled.**

After China's (suspicious) September real activity data had fueled hopes of more green shoots, the latest data releases have sobered expectations. IP growth dropped to 4.7% yoy versus a reading of 5.8% yoy in the month before. IP data have been very volatile of late, so we consider the most recent results to also paint too negative a picture. Manufacturing PMIs were of little help either as both versions diverged considerably. Fixed asset investment also weakened. On a cumulative basis, its growth rate lost 0.2 pp to 5.2% yoy ytd. The main factor was infrastructure expenditure which slumped due to base effects. By contrast, investment in real estate has only been on a mild slowing. While Beijing recently strengthened the oversight on the funding channels for property developers, property sales remained close to a growth rate of 10% yoy. Finally, retail sales eased from 7.8% to 7.2% yoy, but there might be also some volatility involved ahead of the Single's Day price drops in November. Nevertheless, private consumption has also been stressed by a heavy upside surprise in inflation. It shot up from 3.0% yoy in September to 3.8% yoy in October. The increase was almost entirely driven by pork prices (swine flu). By contrast, non-food inflation as well as core inflation continued receding, suggesting that aggregate demand is under downward pressure. As rising inflation is more or less a single factor event, we do not expect monetary policy to be much affected. However, monetary data turned soft of late, after rather strong figures in September.

Partial trade deal expected

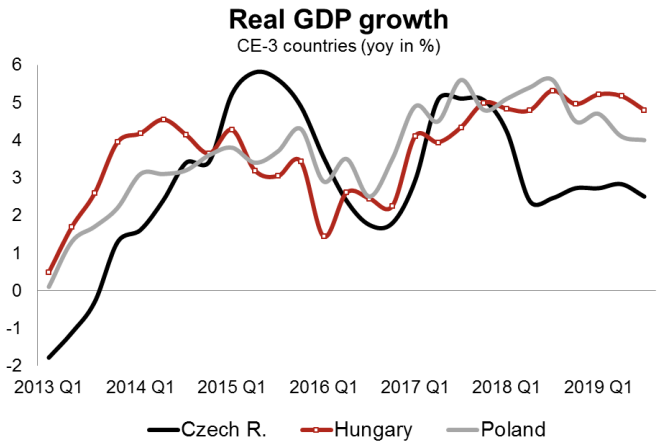
Looking ahead, China's outlook is very dependent on the development of the trade war with the US. Although news run back and forth, a "Phase 1" trade deal seems likely in December/ early 2020. China stressed the importance of tariff rollbacks to reach a deal. For the time being, we assume that the 5 pp tariff hike originally due on Oct. 15 will be canceled lastingly as well as the 15% tariffs on US$ 156 bn of remaining untaxed imports scheduled for Dec. 15. Under this assumption, the downward pressures from the trade war would be reduced from 1.5 pp of GDP to about 1.2 pp over the next twelve months. Accordingly, China's economy still needs support from economic policy. We expect fiscal support worth 0.8-1 pp of GDP by end-2020. The PBoC is likely to cut the RRR by another 125 bps until end-2020 and the LPR is likely to diminish by 30 bps. We expect China's slowing to continue but see it milder than previously expected, due to the tariff relief and positive signs from the global manufacturing cycle.

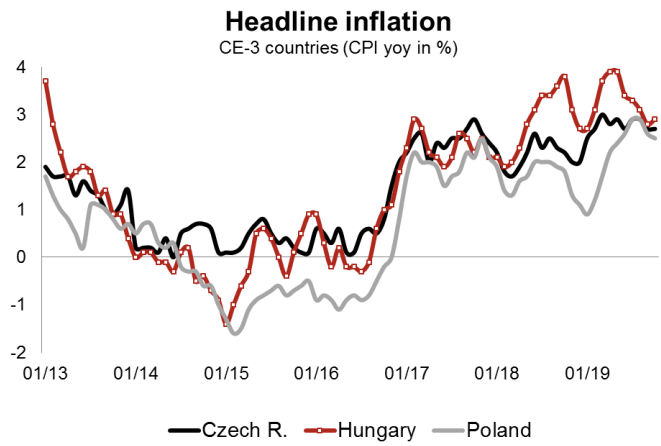




Central and Eastern Europe

Radomír Jáč





Main Forecasts	2018	2019f	2020f	2021f
Czech Republic				
GDP	2.9	2.5	1.9	2.4
Consumer prices	2.1	2.8	2.3	2.1
Central bank's key rate	1.75	2.00	2.00	2.50
Hungary				
GDP	5.1	4.9	3.4	2.9
Consumer prices	2.8	3.3	3.4	3.3
Central bank's key rate	0.90	0.90	0.90	1.00
Poland				
GDP	5.2	4.3	3.6	3.4
Consumer prices	1.7	2.2	3.0	2.8
Central bank's key rate	1.50	1.50	1.50	1.75

GDP and consumer prices: annual % change; CB interest rate: in %, year-end

- **Preliminary GDP data for Q3 show robust growth in Hungary and Poland, and still solid growth in case of the Czech Republic. All three economies operate above their potential, which leads to growing domestic price pressures.**
- **However, the respective central banks do not want to tighten their policy stance, as external conditions remain anti-inflationary. We expect stable policy rates for the rest of 2019 and into 2020. The Hungarian MNB may consider further easing via non-standard tolls.**

The CE-3 region continues to outperform the EU in GDP growth. Preliminary data for Q3 show growth at 0.3% qoq and 2.5% yoy for the Czech Republic, 1.1% qoq and 4.8% yoy for Hungary and 1.3% qoq and 4.0% yoy for Poland. All three economies operate above their potential and the Q3 data indicate that the positive output gap widened further in Hungary and Poland.

The positive output gap creates inflation pressures in the CE-3 countries. We predict both headline and core CPI to exceed inflation targets in 2020 in all three economies. The inflation target is set at 2% in case of the Czech Republic, at 2.5% in Poland and at 3% in Hungary. Overshooting of inflation targets is expected also by the regional central banks but they are reluctant to tighten monetary policy, as they perceive downside risks to their inflation forecasts. They are coming from external factors (trade wars, Brexit and related uncertainties) and via their impact on global economic activity.

Monetary policy remains focused on external risks

The Czech CNB is actually the only CEE central bank, which considers the possibility of a rate hike. However, the majority of the CNB Board continues to prefer stable interest rates, referring to external risks that are perceived as anti-inflationary. We continue to expect the CNB to keep rates on hold (with the key rate at 2.00%) well into 2020. Assuming that the global growth picture improves, we think that the next change in the CNB rates will be a hike but we would expect such step only in 2021.

The Hungarian MNB keeps its dovish bias, also referring to external factors. However, signals from the domestic economy are clearly pro-inflationary, including core CPI at 3.7% yoy and GDP growth close to 5%. We think that domestic factors are limiting space for further easing of the MNB policy stance but monetary policy tightening does not seem to be in the pipeline near term, as the MNB must first switch its policy bias to neutral.

The Polish NBP raised its outlook for headline and core CPI for both 2020 and 2021 in its fresh forecast. However, the MPC keeps its wait-and-see policy stance. We expect the NBP key interest rate to stay on hold at 1.50% also in 2020. That said: inflationary pressures in Poland are likely to grow further in early 2020.

Bonds/Fixed Income Strategy

Florian Späte

- **International government bond markets sailed in calm waters in November. Rising yields amid economic optimism and reassuring trade war news reversed amid new uncertainties towards the end of the month.**
- **Going forward, the slowing of the US economy and speculations about another key rate cut will keep a lid on any US yield increase. Euro area core yields could trend slightly higher in light of a bottoming euro area economy.**
- **Euro area peripheral bond spreads widened after a strong rally in the months before. Given the ECB's QE programme and the search for yield, there is leeway for tighter spreads further down the road.**

On balance, international government bond yields did not change much in November. The initial yield increase driven by optimism about the China/US trade negotiations and a looming economic rebound at the start of the month turned out temporary. Since then, the signing of a preliminary trade contract in December has become more uncertain again. Moreover, particularly US economic data did not meet the ambitious expectations.

Overall, 10-year US yields rose by 7 bps to 1.76% and 10-year Bund yields from -0.41% to -0.37%. With respect to a moderate scaling back of key rate cut expectations short-dated US yields climbed moderately. Then again, 2-year euro area yields inched up slightly by 3 bps.

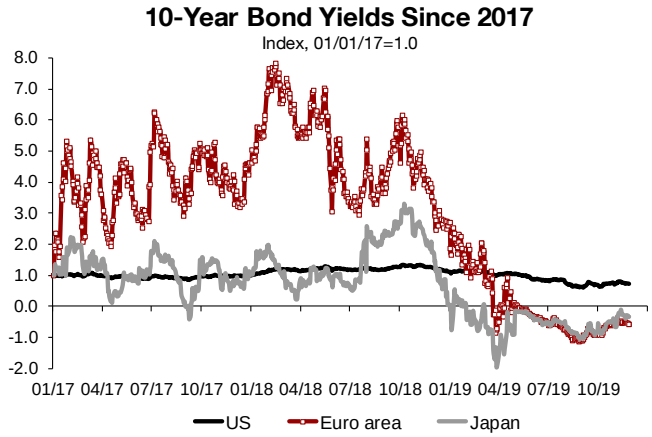
No further rise in US yields in the months to come

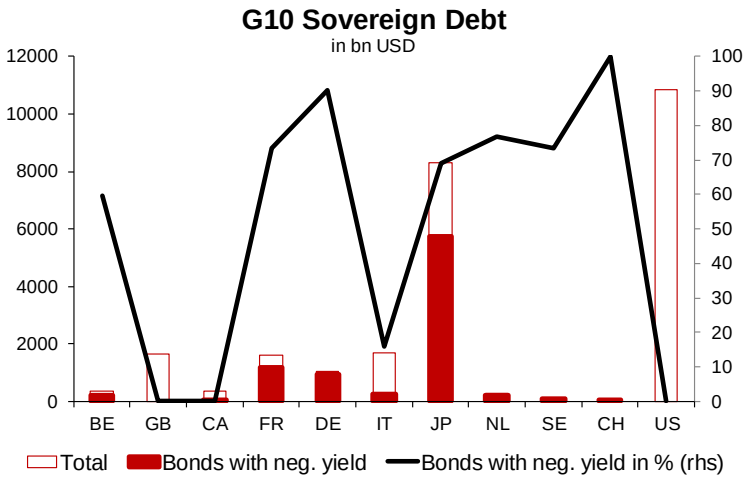
We do not regard the slight upward movement in US yields in November as the start of a new trend. Rather, the conditions for a fall in US yields are given. In international comparison US yields are still high. Already in H1 2019, there was a strong demand by foreign investors. Given the global low yield environment, US Treasuries are still attractive. Hence, we expect the flow of funds to remain supportive in the months to come.

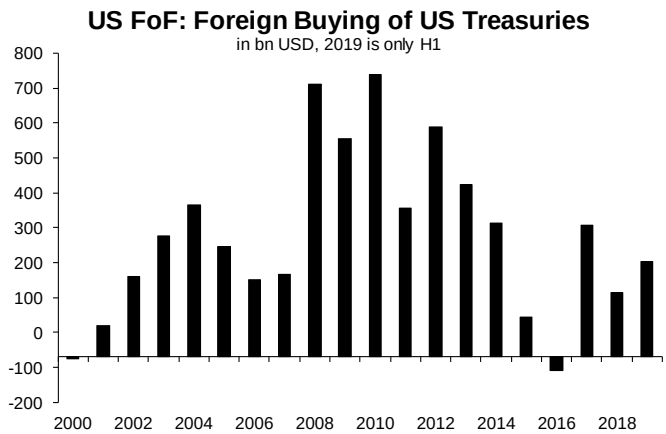
What is more, the US economy is seen to slow from the healthy growth level in Q3 (a recession is unlikely given the tight labor market and robust private consumption). This growth deceleration is still underestimated by financial markets. A lasting positive impulse from a preliminary trade agreement is unlikely as a broad-based withdrawal of tariffs is not on the cards and structural disagreements remain. In this environment, the Fed will cut once more in Q1 2020. This applies even more as the composition of the FOMC will be a bit more dovish next year.

As a result, we see some (limited) scope for lower US yields. 10-year US yields are seen to reach 1.65% in H1 2020 before they inch up again (despite the election-year uncertainty) in view of a moderate economic rebound.

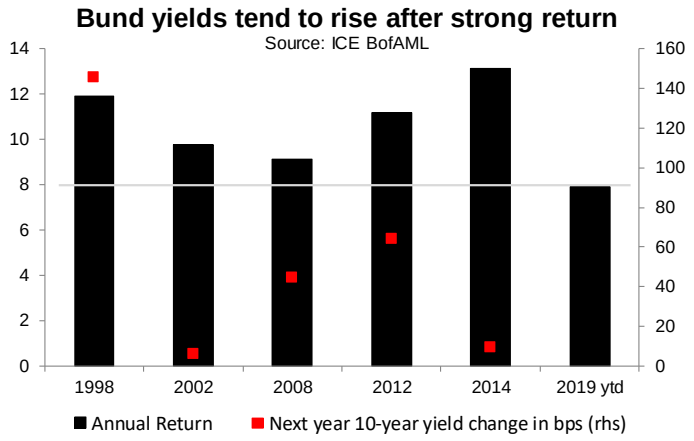
The outlook for euro area core yields is a little more promising. For the time being, there are no further policy

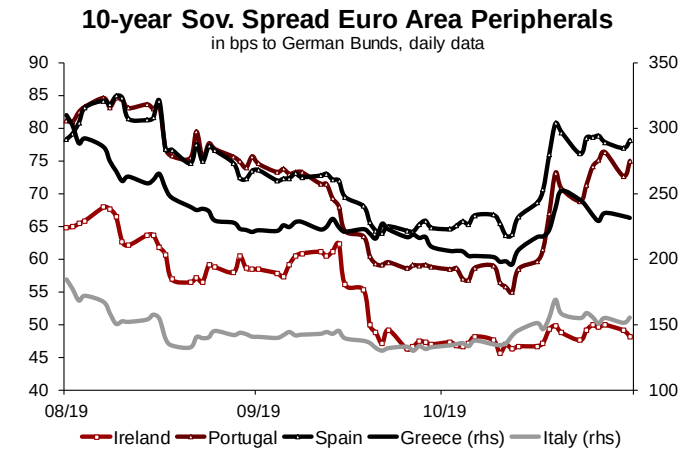


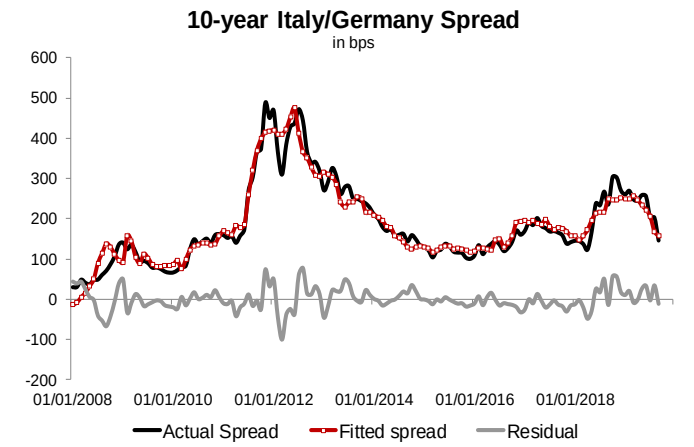




Bonds/Fixed Income Strategy







measures by the ECB on the cards. In particular, we do not expect the ECB to lower the deposit rate further into negative territory. Although we do not forecast a broad-based fiscal easing, the expectation of new fiscal measures in case of an unexpected economic weakening provides at least a floor for yields. In addition, the euro area economy has already reached the bottom and – not least due to the fading uncertainty about the Brexit – is seen to improve in the quarters to come.

The issuance of government bonds in 2020 appears to be manageable. The gross and net issuance is expected to increase only slightly. Though, in contrast to 2019 (except November and December), the ECB will take down most of the supply. Although the share of public assets in the new QE programme will decrease according to first data the central bank will soak up almost the entire net supply. However, the issuance activity is usually particularly heavy in the first quarter. At least 30% of the annual issuance will be placed until the end of March. This can still put some upward pressure on yields in Q1.

In all, euro area core yields are likely to trade in a range in the coming months. But, the improving macroeconomic situation is seen to be sufficient to create a slight upward trend for long-dated yields. This is also backed by the stylized fact that yields tend to rise after government bonds had a strong year. Accordingly, there is leeway for the transatlantic yield spread to tighten more.

Idiosyncratic periphery widening unlikely to last

After peripheral bond spreads had tightened to a long-term trough at the end of October, they widened moderately. As this widening was only partially accompanied by higher risk premiums of euro area semi-core government and corporate bonds, we regard mainly idiosyncratic factors as responsible for the underperformance. The events to be mentioned are the inconclusive election outcome in Spain and the tensions within the Italian government. Overall, 10-year peripheral spreads widened by up to 20 bps in November.

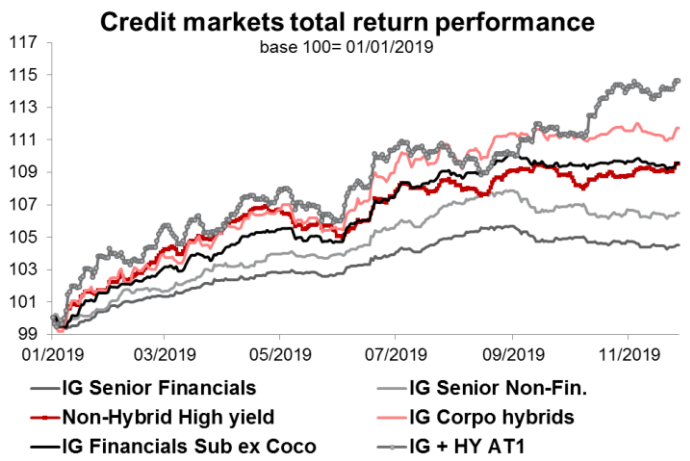
Notwithstanding, the environment will remain favorable for higher yielding government bonds as the search for a yield pick-up will last in 2020, too. Moreover, the ECB will purchase a low double-digit billion volume each month. This inelastic demand remains an important supporting factor for Southern European government bonds.

Generally, we expect the convergence of higher-yielding bonds towards lower-yielding ones to prevail next year. This means that Greek and Italian sovereigns are forecast to perform better than Iberian ones which are likely to do better than core euro area bonds. However, the extent of the convergence will be much more modest than in 2019. Furthermore, there will be periods of volatility (triggered e.g. by political uncertainty in Italy) during which spreads will likely re-widen again.

Corporate Bonds

Elisa Belgacem

- **After a strong tightening in October IG credit spreads have evolved sideways in November threatened by higher Bund yield, while HY has continued to tighten.**
- **Better macro prospects are helping to ease the pressure somewhat on the lower end of the rating spectrum except on CCC.**
- **Technicals remain supportive as the ECB has resumed its CSPP that is as expected heavier concentrated in corporate bonds compared to past levels**
- **Overall, we expect technicals to be stronger until year-end resulting in tighter spreads, led by both duration and risk-appetite.**



The main game changer in November for credit has definitely been the first data release of the new ECB QE starting with CSPP 2. As anticipated, we have seen in the first weeks of purchases the share of credit going significantly up compared to the previous program, going from below 15% on average to currently above 20% of the overall program size of EUR 20 bn.

We think that there is still room for further valuation divergence between eligible and non-eligible assets. Later on, we think there is leeway to move our recommendation towards ineligible assets to catch less distorted prices.

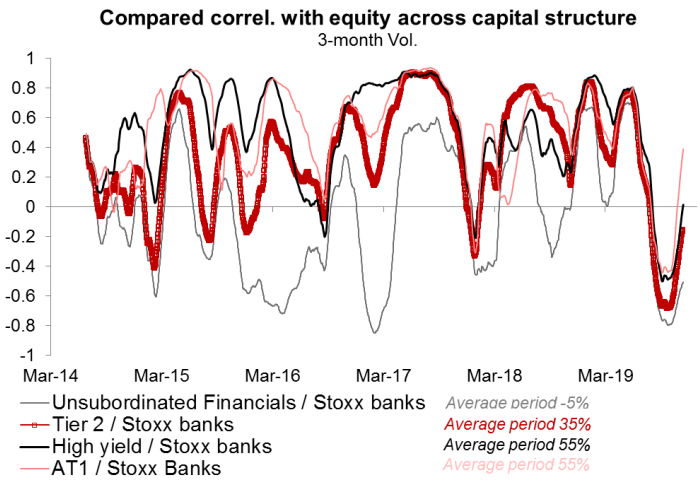
The upward move in 10-year Bund yields is currently stabilising around -0.35% in line with the start-of-month level, which is supportive as it takes credit out of negative territory, but does not really enter into yield conflict with the highest segments of the credit markets.

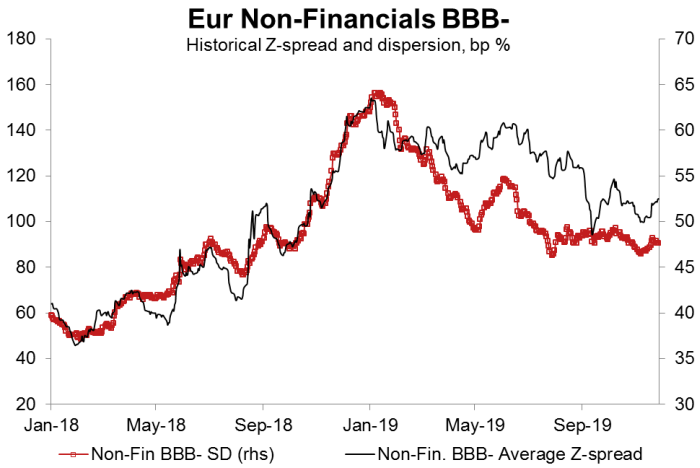
Against this background we keep our positive stance on credit toward the end of the year. Overall, we forecast EA IG corporate bond spreads to tighten by up to 15 bps over the next six months. We also keep our preference for long-dated credit vs. short-dated.

At current yield levels we also reiterate our preference for non-financials versus financials going forward.

As we are expecting the global growth environment to stabilise if not pick-up we still see headroom for risky assets in credit to perform.

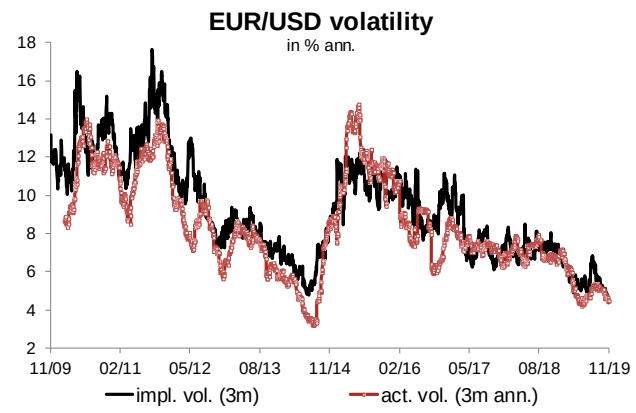
Nonetheless, we expect default rates to increase moderately – staying to idiosyncratic levels – although we continue to prefer taking risks via duration and subordinated notes of IG rated instruments versus high yield embedding higher risk of defaults. In terms of sectors, we expect the most de-rated sectors of the IG space to benefit the most from the ECB action including Autos retail real estate. In contrast, we would rather recommend a defensive positioning in HY preferring defensive and domestic players.

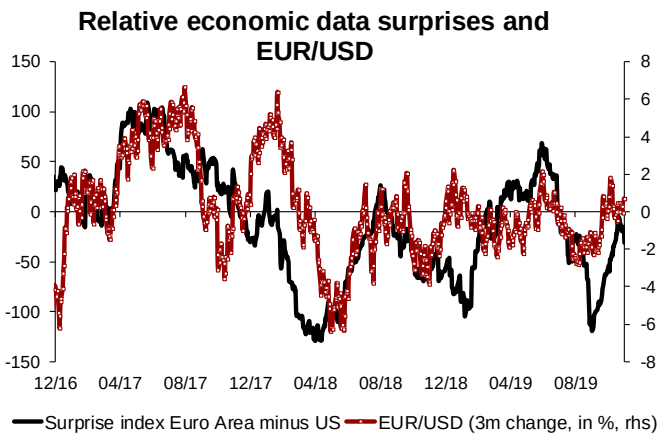




Currencies

Thomas Hempell





- **A still likely trade US/China truce may take USD/CNY below the 7.00 threshold while benefitting EM FX more generally.**
- **The EUR/USD will be less affected, with the euro's funding currency status largely offsetting its exposure to harmed global trade.**
- **We see stronger upside for the EUR/USD in 2020, but more reassuring EA economic data will be needed to trigger the foreseen more sustained rebound.**

Global FX markets are tranquil, with both implied and realized volatility at multi-year lows. EUR/USD 3m vol is even below 4.5, the lowest on record. This is largely a reflection of monetary policy. With the ECB and BoJ rates close to the lower limit and the Fed signalling a wait-and-see stance, monetary policy divergence is off the table as a trigger for sharper FX moves currently.

The USD has gained mildly in broader terms in November. The hawkish Oct. 31 rate cut by the Fed and repeated delays and doubts about a 'Phase one' trade deal with China have supported the USD. The EUR was held down by a disappointing flash PMI for November.

CNY and EM FX would benefit from trade truce

New US bills on Hong Kong complicate the negotiations even further. But we see incentives for a trade truce still strong, with Trump having stronger reasons to be concerned about the trade war's impact on the US economy ahead of the 2020 presidential elections. Quite some optimism is priced´. But a trade truce, incl. the removal of looming Dec. 15 tariffs and of those raised in Sept., could still help to lower USD/CNY to below 7.00, while also benefitting EM currencies more generally.

EURUSD recovery requires more reassuring EA data

The impact of the trade war on EUR/USD is much more muted, with the euro's funding currency status largely offsetting the impact stemming from the euro area's exposure to global trade. We still see stronger upside for 2020 on more evidence of growth convergence (US slowing vs. EA bottoming), stronger FDI inflows into the euro area, persistent reserves diversification out of the USD and fair value considerations (USD dear, EUR cheap).

While there are mounting green shoots in manufacturing, the euro area's Nov. flash PMIs were a reminder of the still only very gradual recovery of economic momentum. Evidence of a more vigorous rebound will be needed, however, to kick-start the EUR/USD recovery. We see the EUR/USD only moderately higher at 1.12 on a 3-months view, with some clearer upside over the course of 2020 though (YE target: 1.17).

Equities

Michele Morganti / Vladimir Oleinikov

- **In the last month, the global equity prices have been pushed up by the seemingly positive news related to the trade conflict.**
- **Q3 earnings season provided reassuring results. 2020 estimates remain too bullish (growth of 10% vs our estimate of 3-to-4%) but equities are to be supported by reduced risks, early signs of macro stabilization, and global dovish monetary policies**
- **After the rally, we prefer EMU to the US only in euro hedged terms and remain neutral on Japan and EMs.**

Over the last month, equities extended their rally. The MSCI EMU did slightly worse than the S&P 500 (+3% vs 4%) and the MSCI EM index underperformed (+1%) together with the Topix (+2.6%, notwithstanding a weaker yen). The performance of the FTSE 100 and the SMI index was aligned to that of the MSCI EMU.

Lower risks and early signs of macro stabilization

Last month we cited the abating risks on trade and Brexit which induced a better investors' sentiment and higher bond yields. These ultimately favored riskier assets, namely equity indices vs government bonds, cyclicals vs defensive and Value vs Growth style.

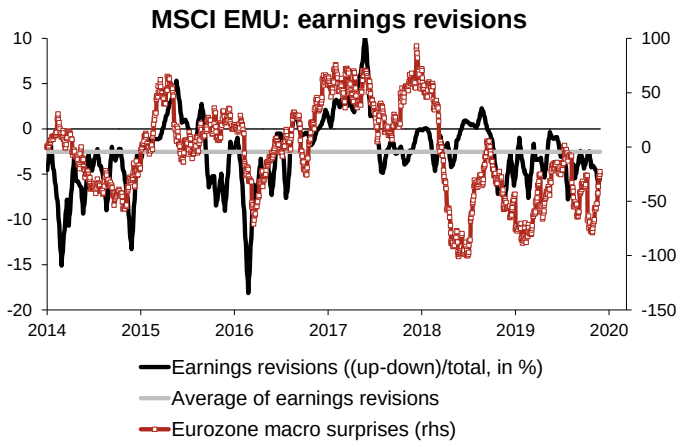
Furthermore, in the last month, we continued to receive early signs of a macro stabilization in the cyclical, manufacturing and export-oriented sectors of the economy.

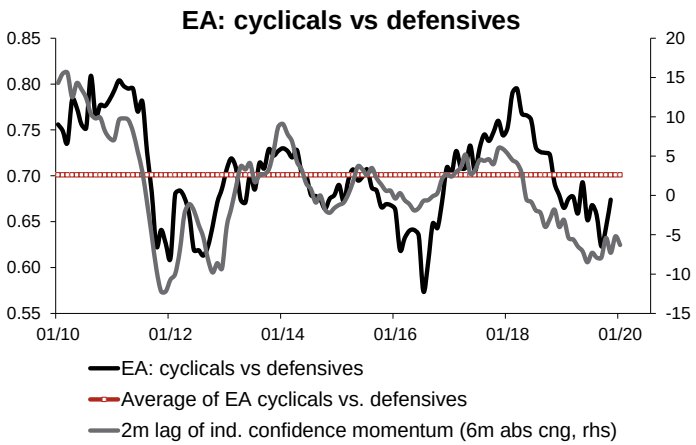
Such signs are still fragile and the sectors mentioned remain in a recession phase. The negative tendency, however, seems to be on pause for the time being.

The momenta of the global PMI new orders and the IFO expectation index are signaling a possible bottom of the cycle which is mirrored by more stable or even marginally higher bond yields. While firms' capex re-mains subdued, the index aggregated from US companies capex expectations during the reporting season has already reached the bottom of the previous economic cycles.

Such early positive signs have already triggered some better equity inflows in the month. Indeed, the relative equity/bond fund flow indicator has recently touched a cyclical low and is starting to rebound. Since 2005, the relative equity/bond indicator has been weaker only in 2008-09 and 2011-12.

In the end, the stabilizing economic momentum and bond yields plus better funds' inflows, are continuing to promote a rotation within the European sectors (favoring underowned value sectors), thus representing an additional trigger for the good equity performance. Even if we do not see much upside for interest rates, their stabilization could be enough for investors to start chasing Value and cyclical stocks.





Markets	Price / Earnings *		Price / Book *		Price/ Cash Flow *		Dividend Yield *		Avg.	Avg.
	current	hist. avg.	current	hist. avg.	current	hist. avg.	current	hist. avg.	Discount, %	Disc. (-1M), %
WORLD	16.7	16.0	2.3	2.0	10.9	8.8	2.5	2.7	13.7	11.0
USA	18.0	15.4	3.2	2.4	12.6	10.0	2.0	2.2	21.7	18.0
JAPAN	14.0	15.3	1.2	1.2	7.9	7.1	2.4	2.0	-7.0	-10.0
UK	12.9	13.8	1.7	1.8	8.2	7.9	4.6	4.1	-5.9	-7.4
SWITZERLAND	17.0	15.4	2.6	2.3	11.9	11.2	3.2	3.3	9.2	7.4
EMU	14.2	14.1	1.6	1.5	8.1	6.6	3.5	3.9	9.6	7.6
FRANCE	14.8	14.3	1.6	1.5	8.7	7.0	3.4	3.7	11.8	8.9
GERMANY	14.0	15.0	1.5	1.5	8.4	6.8	3.1	3.4	6.8	3.9
GREECE	13.2	12.8	2.2	1.6	7.2	6.1	5.0	4.0	8.4	10.5
ITALY	11.7	15.1	1.3	1.2	5.5	4.7	4.5	4.7	1.1	-2.0
PORTUGAL	16.0	12.8	2.0	1.7	5.8	5.9	4.6	4.5	9.2	7.7
SPAIN	11.6	12.9	1.1	1.6	5.0	5.1	4.8	5.1	-8.6	-7.5
EURO STOXX 50	14.2	13.2	1.6	1.5	8.2	6.3	3.6	4.2	16.3	14.0
STOXX SMALL	17.0	14.5	1.9	1.7	10.1	8.4	2.8	3.2	14.9	6.9
EM, $	12.2	14.4	1.5	1.6	7.3	7.5	3.1	3.1	-6.7	-6.5
BRAZIL	12.4	9.2	2.1	1.7	7.8	13.4	3.5	4.3	8.9	10.2
RUSSIA	6.0	7.0	0.8	0.9	4.2	4.4	7.8	4.0	-32.1	-32.3
INDIA	19.0	14.6	2.6	2.7	12.0	11.5	1.7	1.6	6.3	3.6
CHINA	11.3	12.9	1.5	1.7	7.4	7.5	2.5	3.0	-3.1	-4.0

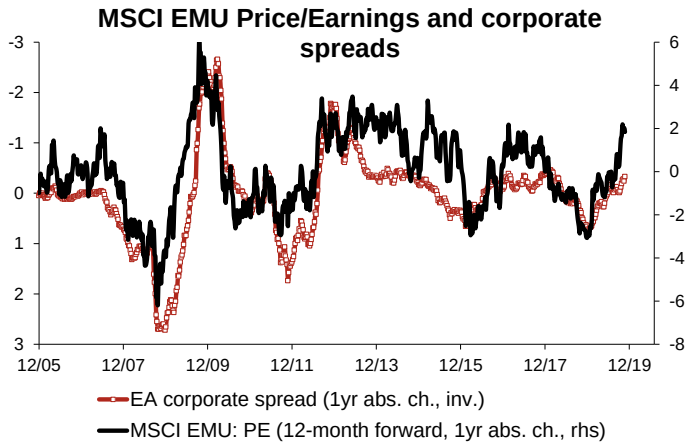
Note: The first four markets (ex. World) are based on the main local indices, the rest on the corresponding MSCI indices.
Multiples are based on 12m forward estimates; PEs are since 1987, the rest is since 2003.
Discount in % to historical average: blue and negative numbers = undervaluation. Red and positive numbers = overvaluation.
Source: Thomson Reuters Datastream, IBES estimates.

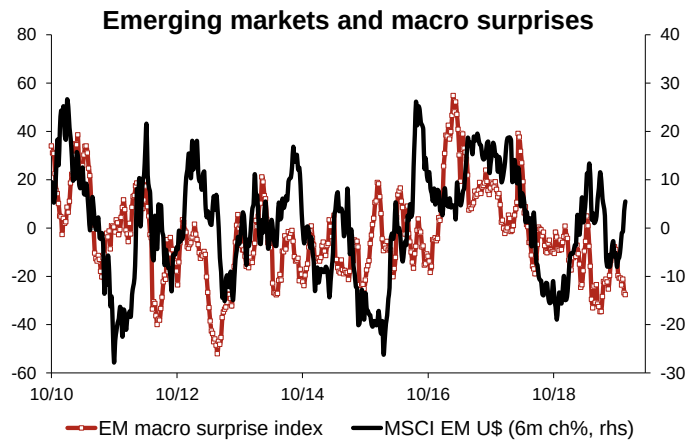
Equities

Analysis of the median stock: Q3 2019 reporting season

Median stock	Earnings Growth		Sales Growth		availability
	Q2 2019	Q3 2019	Q2 2019	Q3 2019	Q3 2019
S&P	6.16 %	5.84 %	3.01 %	3.16 %	93.4%
Stoxx	3.35 %	3.20 %	4.42 %	5.18 %	91.8%
Euro Stoxx	3.37 %	2.64 %	4.05 %	5.53 %	93.0%
Topix	(4.09)%	3.48 %	1.68 %	2.54 %	95.9%

Median stock	Earnings Surpr		Sales Surpr		availability
	Q2 2019	Q3 2019	Q2 2019	Q3 2019	Q3 2019
S&P	2.70 %	3.53 %	0.21 %	0.36 %	93.4%
Stoxx	2.25 %	2.32 %	0.53 %	0.57 %	91.8%
Euro Stoxx	3.96 %	2.56 %	0.69 %	0.80 %	93.0%
Topix	0.52 %	3.76 %	(0.71)%	0.00 %	95.9%





Q3 earnings season provided reassuring results

Q3 earnings season is almost finished showing decent results, which improved since October. Around 80% of companies have beaten analysts' expectations for earnings and sales. In the US, the earnings guidance improved and is above norm. The US capex increased in Q3 vs Q2 but capex intentions remain subdued at a cyclical low. Ex-Energy & Materials, US yearly growth is in positive territory: at 2.4% and 3.6% for earnings and sales, respectively. In Europe the earnings growth increased in Q3 vs Q2 (from -0.4% to -0.1%) while the sales growth slowed (from 2.2% to 1.1%). The median stock results for Q3 - yearly growth and surprise vs expectations in the US and Europe, see table - are in positive territory and stable vs Q2. The beat ratio is above history for both indices. After having being cut, Q4 expectations are not so exuberant anymore. That said, 2020 estimates remain too bullish with risks of further negative revisions going forward.

Maintaining constructive stance on equities

After the rally, the upside potential for equities diminished as the PE expansion, lacking an earnings increase, shows signs of exuberance in the short term. That said, marginal positive earnings growth in 2020 (3-4%), global dovish monetary policies, low positioning and early signs of a macro stabilization should continue to support equities, notwithstanding a possible reduction in earnings estimates for 2020. The relative equity appeal vs the fixed income is high, being historically associated with positive quarterly relative returns of equities over bonds (risk adjusted) on average as well as during drawdowns.

Inside equities, we prefer EMU vs US (euro hedged). We stay neutral on EMs, Japan, cyclicals vs. defensives and OW only on Utilities and discretionary. UW: Real Estate, Materials and IT. Limited OW on Momentum, Low Leverage and Growth vs Value. Neutral on Quality.

EM: to be impaired by weak macro surprises

In November, EM equities have participated in a global rally while underperforming the MSCI World (1% vs 3.3%). The main positive trigger was represented by positive news flow on US-China trade. The performance was dampened by increased EM yields (+8 bps) and appreciated dollar (+0.7%). EM multiples vs history are now trading at a discount of 8% vs norm. While earnings seems to be stabilizing, their estimates for 2019 and 2020 have been lowered in November by 1.2% and 0.3%, respectively. Money supply (M1) is not supportive for EM stocks and EM prices have recently increased beyond their earnings trend (in terms of 3-month changes). Within the EM universe, we favor Brazil and CEE markets (ex. Turkey). On India we are tactically neutral but still constructive mid-term..

Asset Allocation

Thorsten Runde

- **In the course of November (*until November 26th*) the majority of asset classes in our investment universe revealed negative total return figures again.**
- **Once more, just equities together with EA HY corporates managed to stay in positive territory so far.**
- **Also like in the previous month, the 10Y+ fixed income segment accounts for the largest losses However, this month, not core but long-dated Italian (-3.3%) and Spanish (-2%) government bonds performed particularly badly.**
- **Equities rose by just about +3% on average over the past four weeks thereby clearly marking the top of the performance ranking again.**
- **Looking ahead, we basically maintain our general pro-risk stance. Though, following the strong recent risk rally and given the now less defensive investor positioning, we recommend to reduce active positions across the board.**

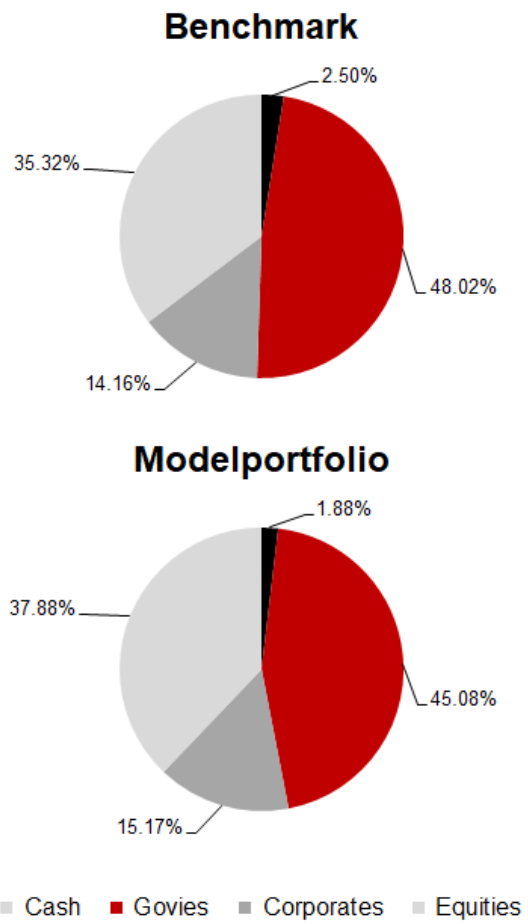
Global risk sentiment has recovered significantly since the second half of October. Economic data – notably in the euro area – proved less disappointing than feared. Furthermore, there was some relief on the key tail risks front (hard Brexit, US/China trade war), which particularly lent support to equities. By contrast, a resurgence of political concerns in Italy and an inconclusive general election outcome in Spain boosted spreads on Southern European debt.

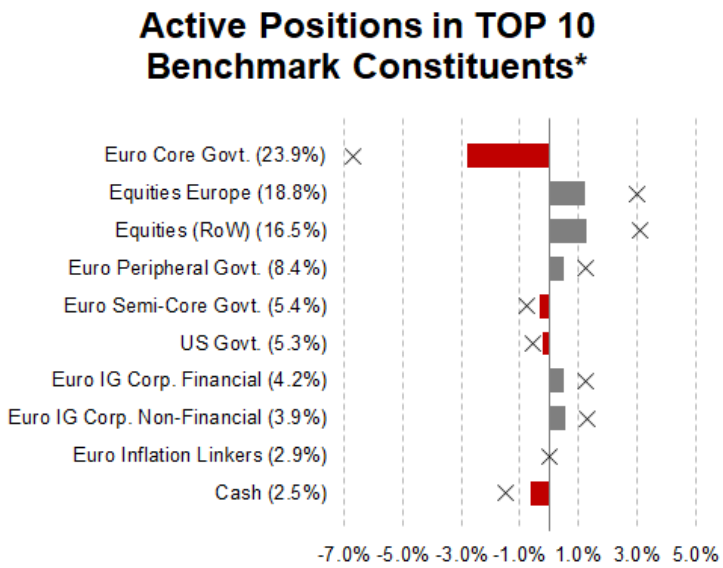
Although no longer marking the end of the performance ranking, core govies remained in the camp of underperformers. Thus, like in October, the active positions in equities (overweight) and euro area core govies (underweight) contributed most significantly to the overall tactical allocation result. Admittedly, the overweight in peripherals did hurt to some degree given the spread widening. All in all (until November 26th), the model portfolio could still stand its ground with an outperformance of roughly 14 bps compared to round about 15 bps in October.

Pro-risk tilt to be maintained at reduced levels

Against the backdrop of the most positive developments (US/China trade war, Brexit) already largely priced in, we deem the risk of a technical setback risen.

Thus, looking ahead we recommend to reduce the active positions across the board. This particularly implies shifting exposure from equities into euro area core government bonds. We maintain a slight preference for euro area credit due to the ECB's new APP. The duration stance should also be maintained at broadly neutral (marginally long) level.





**Benchmark weights in parentheses, crosses indicating previous recommendations*

Forecast Tables

Growth

	2018	2019f	2020f	2021f
US	2.9	2.2	1.6	1.8
Euro area	1.9	1.2	1.0	1.1
Germany	1.5	0.6	0.8	1.3
France	1.6	1.3	1.2	1.3
Italy	0.7	0.1	0.4	0.6
Non-EMU	1.5	1.2	1.1	1.5
UK	1.4	1.1	1.0	1.4
Switzerland	2.5	1.0	1.3	1.6
Japan	0.8	0.9	0.4	0.8
Asia ex Japan	6.2	5.4	5.4	5.4
China	6.6	6.1	5.9	5.7
Central/Eastern Europe	3.0	1.9	2.7	2.9
Latin America	0.1	- 0.1	1.7	2.0
World	**3.6**	**2.9**	**3.0**	**3.1**

Inflation

	2018	2019f	2020f	2021f
US	2.4	1.9	2.0	2.1
Euro area	1.7	1.2	1.2	1.4
Germany	1.8	1.4	1.5	1.5
France	1.9	1.2	1.3	1.3
Italy	1.1	0.8	1.1	1.1
Non-EMU	2.3	1.8	1.9	1.8
UK	2.5	1.9	2.0	1.8
Switzerland	0.9	0.5	0.7	0.9
Japan	1.0	0.5	0.7	0.7
Asia ex Japan	2.6	2.8	2.8	2.5
China	2.1	2.8	2.6	2.1
Central/Eastern Europe	6.0	6.6	5.0	5.0
Latin America	4.0	4.0	3.7	3.6
World	**2.7**	**2.6**	**2.5**	**2.5**

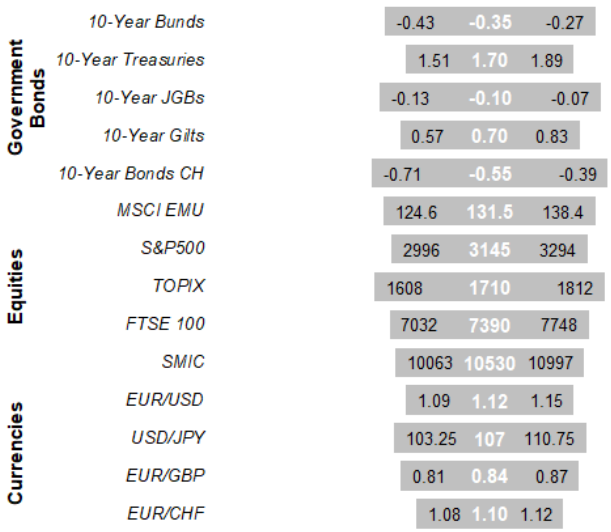
Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

Financial Markets

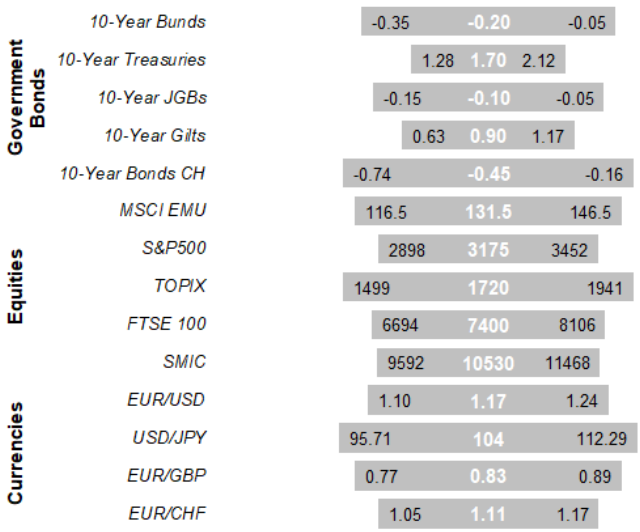
3-month LIBOR	**Current**	**3M**	**6M**	**12M**
USD	1.91	1.90	1.70	1.70
EUR	-0.44	-0.45	-0.45	-0.45
JPY	-0.09	-0.10	-0.10	-0.10
GBP	0.79	0.80	0.80	0.80
CHF	-0.72	-0.75	-0.75	-0.75
10Y Government Bonds	**Current**	**3M**	**6M**	**12M**
US	1.76	1.70	1.65	1.70
Euro-Area	-0.37	-0.35	-0.30	-0.20
France	-0.05	-0.05	0.00	0.05
Italy	1.29	1.15	1.15	1.20
Japan	-0.10	-0.10	-0.15	-0.10
UK	0.68	0.70	0.75	0.90
Switzerland	-0.60	-0.55	-0.50	-0.45
Spreads	**Current**	**3M**	**6M**	**12M**
GIIPS	118	115	110	105
BofAML Covered Bonds	42	40	40	40
BofAML EM Gvt. Bonds (in USD)	334	320	330	335

Corporate Bond Spreads	**Current**	**3M**	**6M**	**12M**
BofAML Non-Financial	103	95	90	85
BofAML Financial	104	100	95	90
Forex	**Current**	**3M**	**6M**	**12M**
EUR/USD	1.10	1.12	1.14	1.17
USD/JPY	109	107	105	104
EUR/JPY	120	120	120	122
GBP/USD	1.29	1.33	1.37	1.41
EUR/GBP	0.86	0.84	0.83	0.83
EUR/CHF	1.10	1.10	1.10	1.11
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	3143	3145	3155	3175
MSCI EMU	130.8	131.5	130.0	131.5
TOPIX	1707	1710	1705	1720
FTSE	7410	7390	7365	7400
SMI	10502	10530	10345	10530

3-Months Horizon



12-Months Horizon



*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, exponentially weighted. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

Imprint

Head of Research: Vincent Chaigneau (vincent.chaigneau@generali-invest.com)

Head of Macro & Market Research: Dr. Thomas Hempell, CFA (thomas.hempell@generali-invest.com)

Team:
Elisabeth Assmuth (elisabeth.assmuth@generali-invest.com)
Elisa Belgacem (elisa.belgacem@generali-invest.com)
Radomír Jáč (radomir.jac@generali.com)
Jakub Krátký (jakub.kratky@generali.com)
Michele Morganti (michele.morganti@generali-invest.com)
Vladimir Oleinikov, CFA (vladimir.oleinikov@generali-invest.com)
Dr. Martin Pohl (martin.pohl@generali.com)
Dr. Thorsten Runde (thorsten.runde@generali-invest.com)
Dr. Christoph Siepmann (christoph.siepmann@generali-invest.com)
Dr. Florian Späte, CIIA (florian.spaete@generali-invest.com)
Dr. Martin Wolburg, CIIA (martin.wolburg@generali-invest.com)
Paolo Zanghieri, PhD (paolo.zanghieri@generali.com)

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In Italy:
Generali Insurance Asset Management S.p.A. Società di gestione del risparmio

Piazza Tre Torri
20145 Milano MI, Italy

Via Niccolò Machiavelli, 4
34132 Trieste TS, Italy

In France:
Generali Insurance Asset Management S.p.A Società di gestione del risparmio

2, Rue Pillet-Will
75009 Paris Cedex 09, France

In Germany:
Generali Insurance Asset Management S.p.A Società di gestione del risparmio

Tunisstraße 19-23
50667 Cologne, Germany

www.generali-investments.com