

Asset Allocation

DISINFLATIONARY TAILWINDS THREATENED BY YIELDS & CHINA

Andrea Cicione

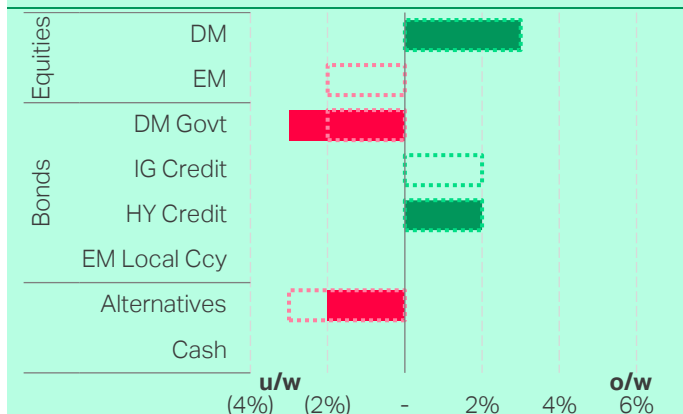
MULTI ASSET Disinflation remains the key macro story. Data surprises are strongly positive in the US and appear to have bottomed in Europe and China. DM central banks are approaching the top of their respective hiking cycles, although markets discounting early cuts may be too optimistic.

If the bottoming of macro data is confirmed, the current disinflationary trend (which probably has further to run) will prove supportive of risk asset. The main risk to this view comes from rising yields, which can create collateral shortages. China's property woes are also weighing on risk sentiment.

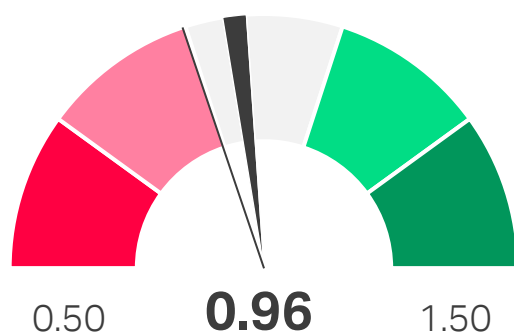
ASSET ALLOCATION We add risk this month but remain conservatively positioned, increasing EM equities and Energy Commodities at the expense of Govvies and IG Credit. We are now overweight Equities and underweight Fixed Income and Alternatives. **Our portfolio beta climbs to 0.96 from 0.90.**

MACRO OUTLOOK The DM rate-hiking cycle is entering the last mile, but the positive impulse for consumption emanating from the easing of supply-side pressures is waning. Inflation has further to fall, but the current phase of "benign disinflation" is giving way to a period in which slowing demand will play an increasingly important role.

Global asset allocation*

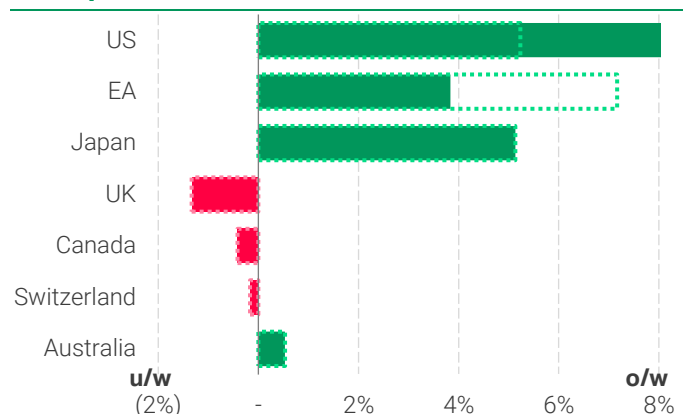


Model portfolio beta vs benchmark

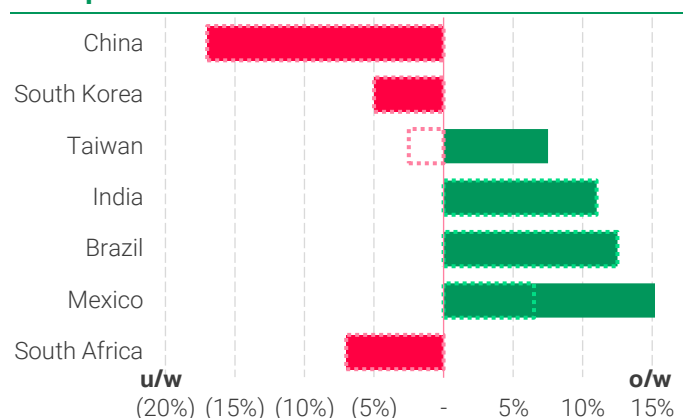


Thin line represents last month's beta

DM Equities asset allocation*



EM Equities asset allocation*



(*) Dotted lines represent last month's allocation

ASSET ALLOCATION

3 to 6-month view. Previous ratings in brackets. Monetary policy outlook changes in bold. Rationale on next page.

	Equities	Govt Bonds	FX vs. USD	Monetary policy
Developed Markets				
North America				
US	+1 (0)	0		Recession => 3% fed fund rates
Canada	0	0	+1	US recession => end-23 cuts
Developed Europe				
UK	-1	+1	0	Rates at 5.5-5.8% by yearend, active QT
Switzerland	0		-1 (0)	Hawkish bias, pro-CHF FX intervention
Euro Area			0	3.75% terminal rate; faster QT
Germany	0	0		
France	0	0		
Italy	0 (+1)	+1		
Spain	0	+1		
Asia Pacific				
Japan	+1	-1	0	Policy normalization under Ueda
Australia	0	0 (+1)	0	Data dependence => 2023 pause
Emerging Markets				
Asia				
China	-1	0	-1	Cuts to RRR and policy rate corridor
India	+1	0	0	Extended pause at 6.50%
Korea	0	0	-1	Unchanged
Taiwan	+1 (0)	0	0	Unchanged
Latin America				
Brazil	+1	+1	+1	50bp cut in August
Mexico	+1	+1	+1 (0)	On hold
Europe & Africa				
South Africa	-1	-1	-1	On hold
Alternative Assets				
Real Estate	-1			
Energy Commodities	+1 (0)			
Industrial Metals	0			
Precious Metals	0 (+1)			
Corporate Bonds				
		IG		HY
US		+1		+1
UK		+1		
Euro Area		+1		+1

Key to recommendations

+2 = strongly positive **+1** = positive **0** = neutral **-1** = negative **-2** = strongly negative

Recommendations based on expectations of **normalized local-currency total returns**. FX returns include **carry**.

Model portfolio on p. 11.

Summary of key recommendation changes

	From	To	Rationale
US Equities	0	+1	The odds of a reacceleration without a recession are improving. Investors remain underweight, excessively bullish sentiment has receded, and the market is oversold. Fast-rising yields and China are significant risks.
Italy Equities	0	+1	An unexpected GDP contraction in Q2 and the fiasco over the windfall tax on banks have weakened investor confidence in the market, especially as Financials are by far Italy's largest sector.
Taiwan Equities	0	+1	Exports appear to be bottoming out, although demand from China remains weak. If China's slowdown bottoms out in Q4, as we expect, this could help put a floor on Taiwan's equities.
Australia Government Bonds	+1	0	A gradualist approach means the RBA is credibly heading higher for longer as growth accelerates into 2024.
CHF vs USD	0	-1	Inflation below target and a dovish ECB turn mean that there is no more hawkish SNB impulse – recent CHF strength => room for depreciation.
MXN vs USD	0	+1	High real interest rates and a favourable inflation outlook support the peso.
Energy Commodities	0	+1	Following the OPEC cuts, the crude market appears finally to be in balance or slightly undersupplied (chart below right). A growth reacceleration would likely push prices higher.
Precious Metals	+1	0	Rising real yields are a significant drag. Diminishing recession risks will likely further hamper demand for precious metals.

Summary of model portfolio changes

	1-month chg	O/W (U/W)	Comments
EM Equities	+2%	-	We add 1% each to Taiwan and Mexico.
Government Bonds	-1%	(3%)	We reduce Australian Bonds by 1%.
IG Corporate Bonds	-2%	-	We cut US and EA IG Credit by 1% each.
Alternative Assets	+1%	(2%)	We add 1% to Energy Commodities.

Full model portfolio composition and performance from [p. 11](#).

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MULTI ASSET

Andrea Cicione

- Macro fundamentals are improving, with the probability of a US reacceleration rising
- Disinflation is a tailwind for stocks, although rising yields and China threaten the rally
- We add to Equities & Energy and reduce Govvies & IG; portfolio beta to 0.96 from 0.90

Go to Asset Allocation and portfolio changes

Macro fundamentals are improving. Disinflation remains the key macro story. Data surprises are strongly positive in the US and appear to have bottomed in Europe and China. DM central banks are approaching the top of their respective hiking cycles, although markets discounting early cuts may be too optimistic. EM central banks are likely to follow Brazil soon and ease.

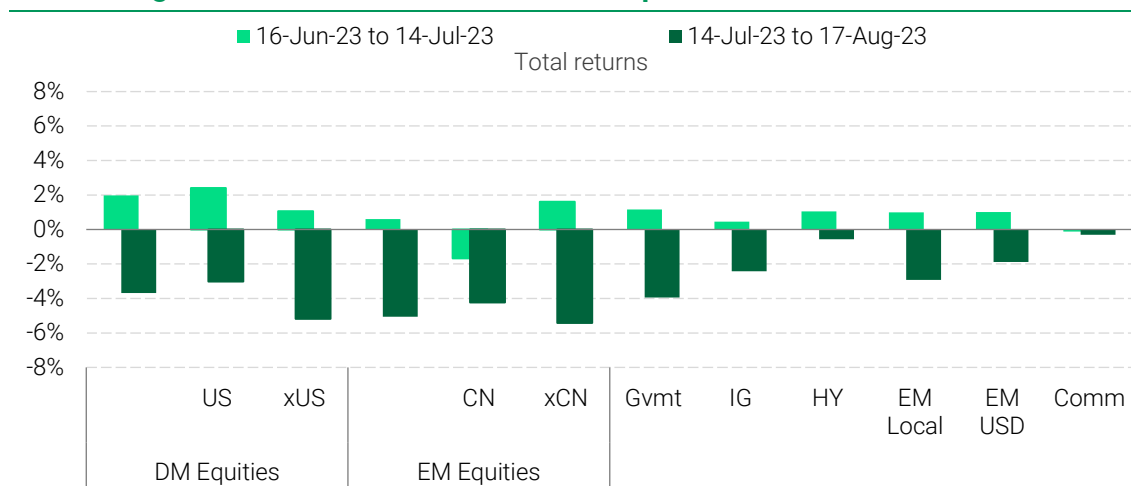
A US recession remains likely, but reacceleration is increasingly possible. We continue to expect the US to enter a mild recession around the turn of the year. However, with the Fed likely to have completed its tightening effort just when the slowdown from 2021 appears to be bottoming, the likelihood of a reacceleration is increasing.

Equities perform well in disinflationary environments. If the bottoming out in macro data is confirmed, the current disinflationary trend (which probably has further to run) will prove supportive of risk asset.

The main risks to a more bullish view are rising yields and China. With financial conditions still easing despite QT and the Treasury General Account refill, the main risk now comes from rising yields. Sharply rising yields can create collateral shortages, which, in turn, can cause bond losses to spread to other markets. China's property woes are also weighing on risk sentiment.

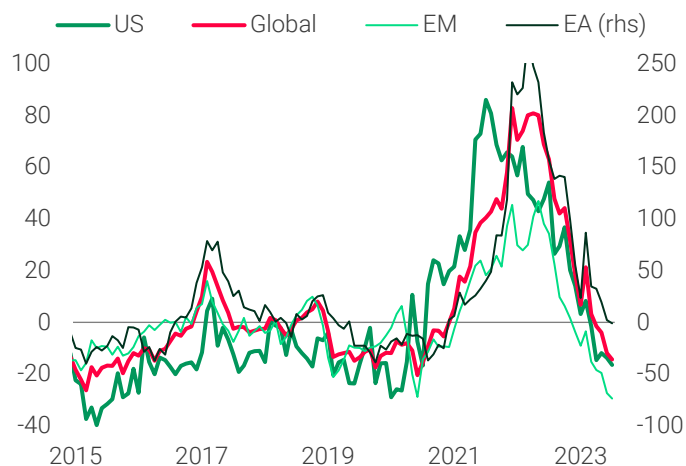
We add risk this month but remain conservatively positioned, increasing EM equities and Energy Commodities at the expense of Govvies and IG Credit. We are now overweight Equities and underweight Bonds and Alternatives. **Our portfolio beta climbs to 0.96 from 0.90.**

Returns negative across all asset classes in the past month



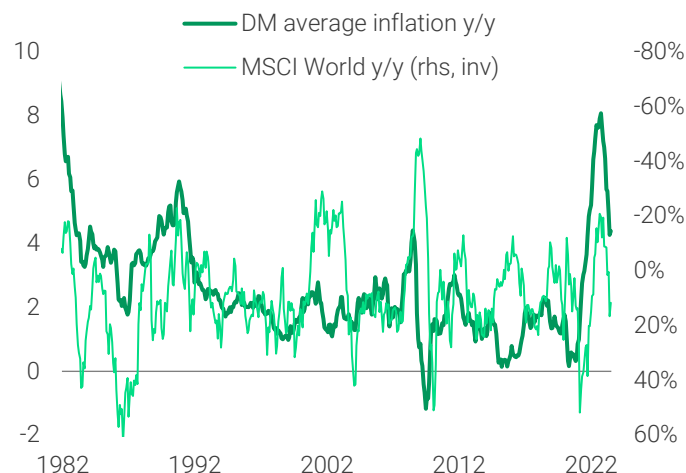
Sources: Bloomberg, GlobalData TS Lombard.

Inflation surprises negative in most regions



Sources: Citi, Bloomberg, GlobalData TS Lombard.

Disinflation is a tailwind for equities



Sources: Bloomberg, GlobalData TS Lombard.

Disinflationary trend is firmly in place

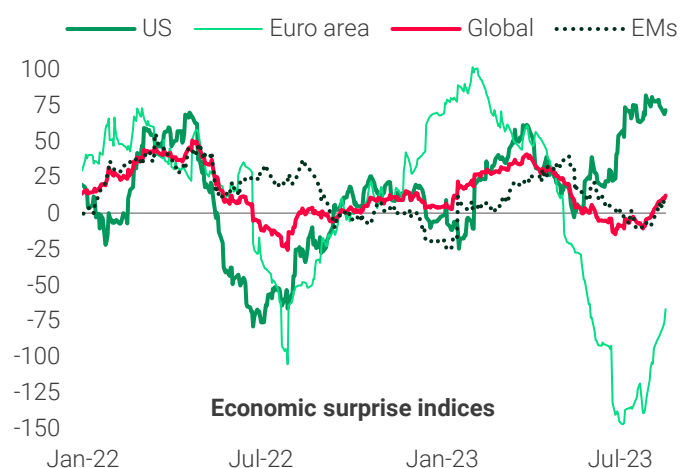
The global economy continues to slow down from the overheated conditions of the post-Covid reopening. This is due partly to normalization and partly to the cumulative impact of global monetary policy tightening. The question of where the bottom occurs remains open.

A recession in the US is still likely around the turn of the year. However, data have continued to beat expectations and, if there is no recession by the autumn, there may not be one at all. In any case, a recession would likely be mild as there are no significant macro imbalances to correct.

Disinflation is a major tailwind. Meanwhile, continued disinflation and the approaching end of the global monetary tightening cycle should provide a positive impulse for the economy. While spending power has lagged price increases over the past couple of years, this is now changing. Indeed, it could lead to a reacceleration before a recession takes hold.

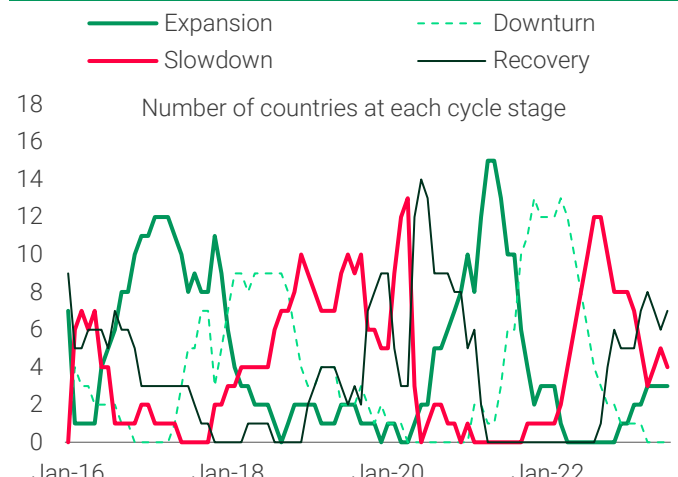
Emerging markets have been ahead in the monetary policy cycle – and still are. Brazil has already cut rates and other EM central banks are likely to soon follow. The ECB is lagging behind the Fed, but we expect a pause here, too. Absent a deep US recession, Europe should skirt one.

US & EM data surprising positively, EA improving



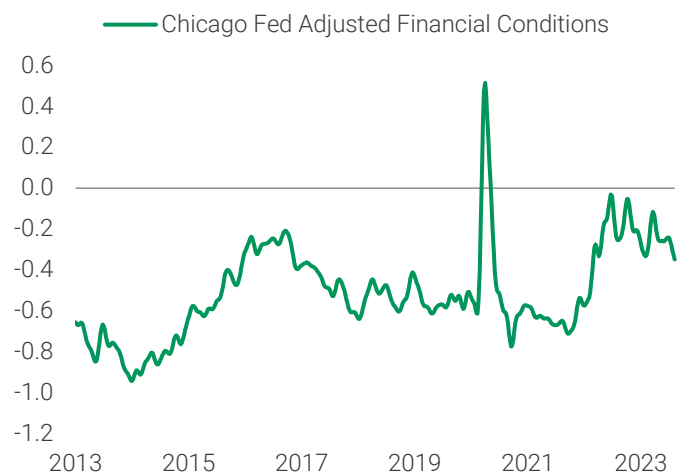
Sources: Citi, Bloomberg, GlobalData TS Lombard.

Global cycle appears to be bottoming out



Sources: OECD, Bloomberg, GlobalData TS Lombard.

US financial conditions easing



Source: Bloomberg.

TGA above pre-pandemic levels



Sources: Bloomberg, GlobalData TS Lombard.

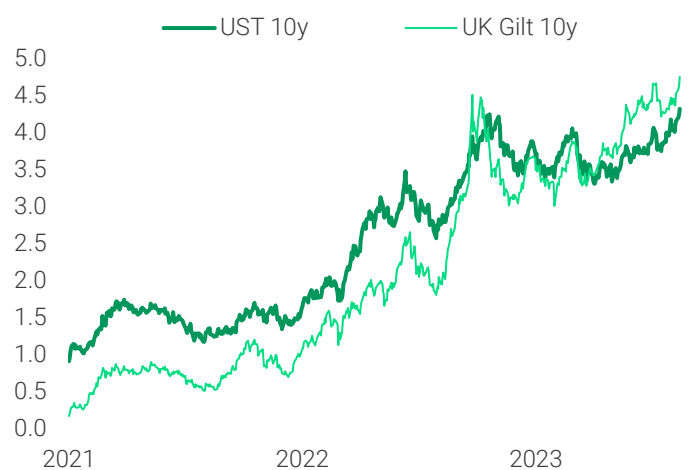
Rising yields bring back duration risk

Financial conditions continue to ease... Despite QT and the rebuilding of the Treasury General Account (TGA), US financial conditions have continued to ease. Credit spreads – the most reliable indicator of credit conditions – remain relatively tight and well behaved. The TGA is now above pre-pandemic levels. Treasury issuance will remain large owing to a wider US fiscal deficit than last year, but markets fully understand this factor.

...but rising bond yields are cause for concern. UST 10y yields are now above their 2022 highs, as are 10y Gilts. Last year the sudden surge in yields caused a collateral squeeze that led to the demise of SVB and other US banks. In the UK, the BoE had to intervene to ensure financial stability as several pension funds experienced large losses on their interest-rate hedges.

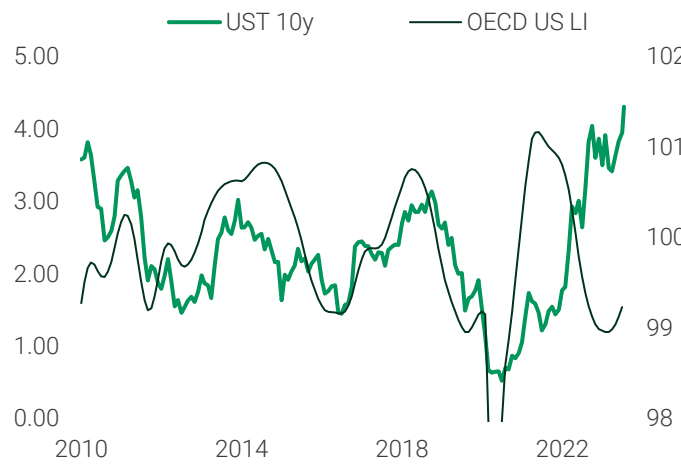
There are mitigating factors to rising duration risk. First, the speed of the rise in yields matters. When it is relatively gradual (as it has been in recent months), collateral adjustments can take place without major disruptions. Second, the reason for the rise matters, too. In 2022 it was mainly the result of sudden changes in monetary policy expectations – combined, in the UK case, with botched fiscal-policy changes. This time round, the yield rise appears to be the result, at least in part, of an improving macro outlook (chart below right).

Yields above their 2022 peaks...



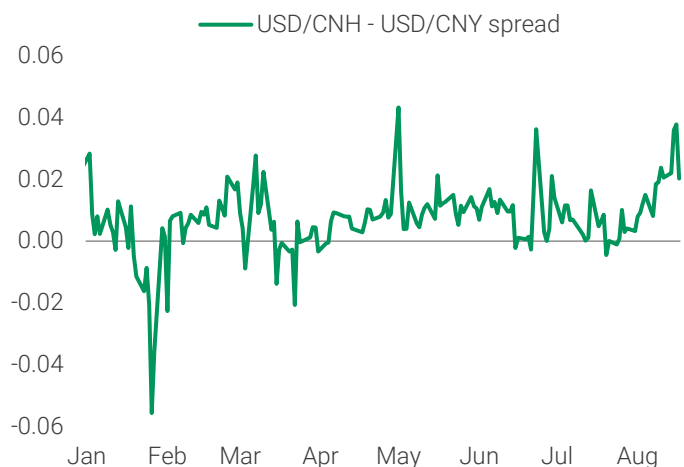
Source: Bloomberg.

...but apparently responding to improving outlook



Sources: OECD, Bloomberg.

Renminbi pressure forcing FX intervention



Sources: Bloomberg, GlobalData TS Lombard.

China data surprises reverting to mean



Sources: Citi, Bloomberg, GlobalData TS Lombard.

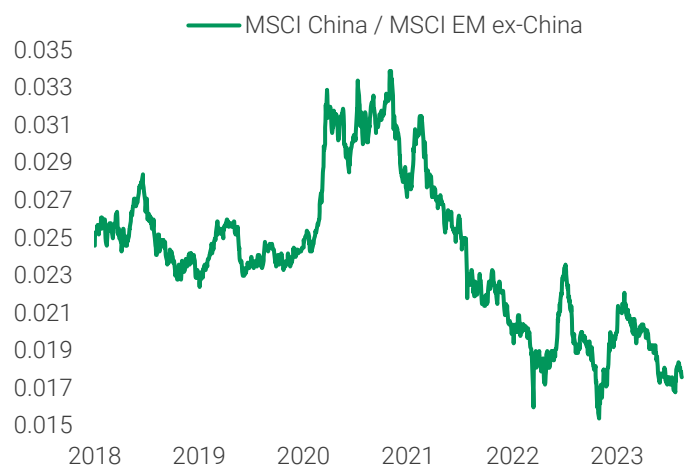
China policy response: A question of when, not if

China is weighing on risk sentiment. A second factor that has been weighing on risk sentiment is China. Bad news just keeps coming from its property sector, and the policy response has so far been underwhelming. However, this is not new news. Our Chief China Economist, Rory Green, and our Head of Asia Property, Andy Lawrence, have been flagging these issues for years and expect the drag from the overleveraged real-estate sector to continue for the foreseeable future.

More stimulus coming soon? While the government response to these issues has disappointed investors expectation so far, we think that even Xi's pain tolerance has its limits: stronger policy easing is a question of when, not if. With all three of our stimulus signals – financial contagion, unemployment and growth target risk – flashing at least amber, the time for those limits to become apparent is likely getting closer.

Meanwhile, policymakers are intervening heavily in equity and FX markets and accelerating monetary easing, even though it is ineffective in current balance-sheet recession conditions. However, Beijing is likely to gauge the impact of fiscal measures before engaging in further large-scale stimulus efforts. Data are set to decelerate further in Q3.

China equities risk-reward slowly improving



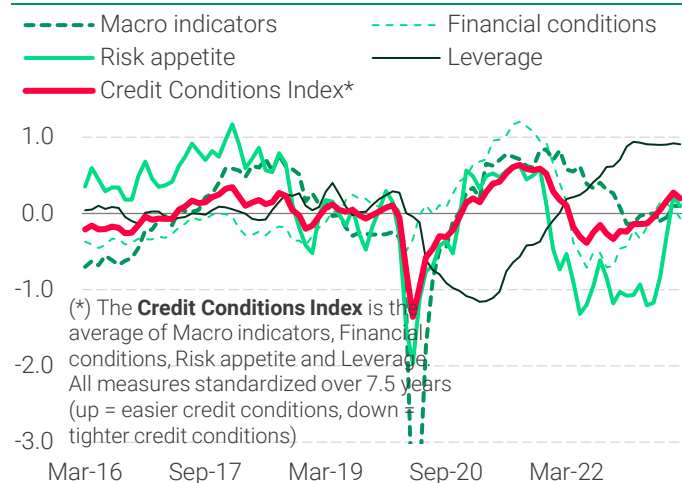
Sources: Bloomberg, GlobalData TS Lombard.

US leadership resumed



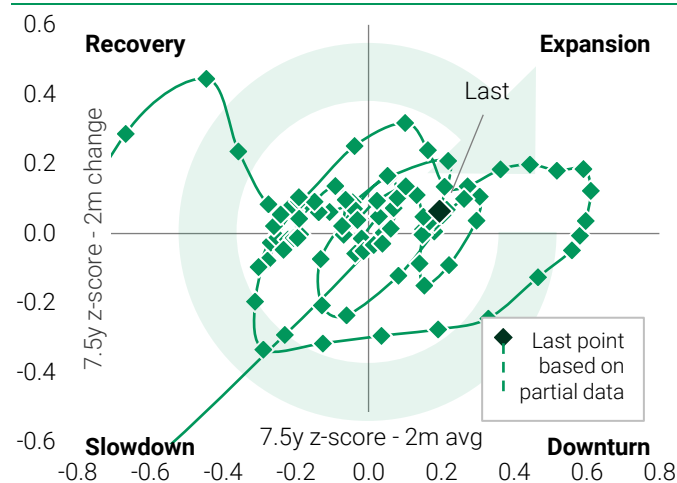
Sources: Bloomberg, GlobalData TS Lombard.

Risk appetite weighing on CyclQEST Fin Cond



Sources: Bloomberg, GlobalData TS Lombard.

CyclQEST: Temporary dip or moving to Downturn?



Sources: Bloomberg, GlobalData TS Lombard.

Asset allocation and portfolio changes

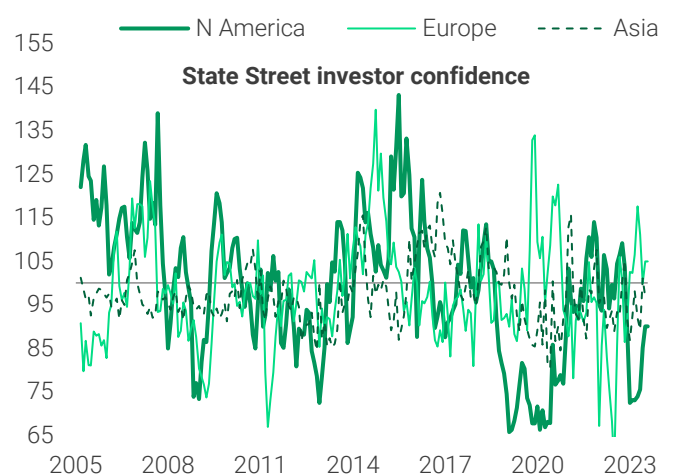
We add risk: Portfolio beta to 0.96 from 0.90. A higher probability of a US reacceleration warrants taking some more risk. We do this by increasing our Equity and Energy Commodity allocation at the expense of Fixed Income. Our central case remains a recession, however; and for this reason, we maintain a relatively conservative stance. Our model portfolio beta rises but stays below neutral, moving up to 0.96 from 0.90.

We add to EM equities and go neutral weight. In DM equities we add to the US at the expense of Italy, where the banks' windfall tax episode will have left investors less keen to be exposed to the vagaries of the Italian government. Our exposure to DM equities is unchanged, but we add to EMs (Taiwan and Mexico) and go benchmark weight there.

We also upgrade Energy Commodities to +1 and go to a small overweight in the model portfolio. Following the OPEC cuts, the crude market appears finally to be in balance or slightly undersupplied (chart below right). A growth reacceleration would likely push prices higher.

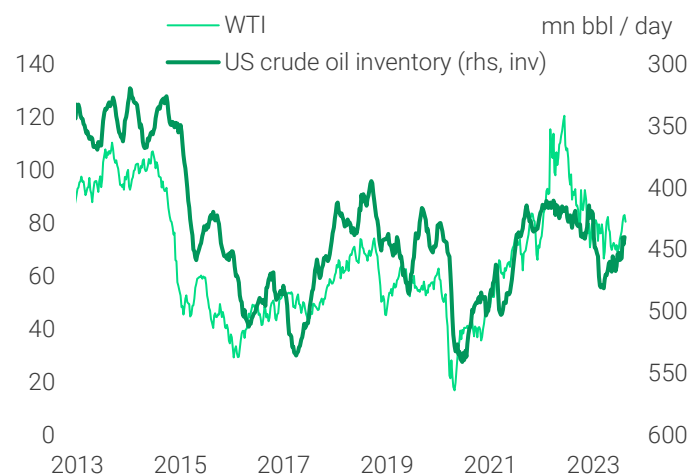
Finally, we reduce our exposure to Fixed Income by cutting Government Bonds to a larger underweight and going neutral on IG Corporate Bonds.

Investors still underexposed to US equities



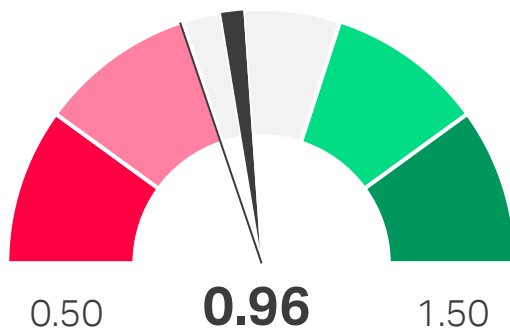
Sources: Bloomberg, GlobalData TS Lombard.

OPEC cuts have started biting into inventories



Sources: Bloomberg, GlobalData TS Lombard.

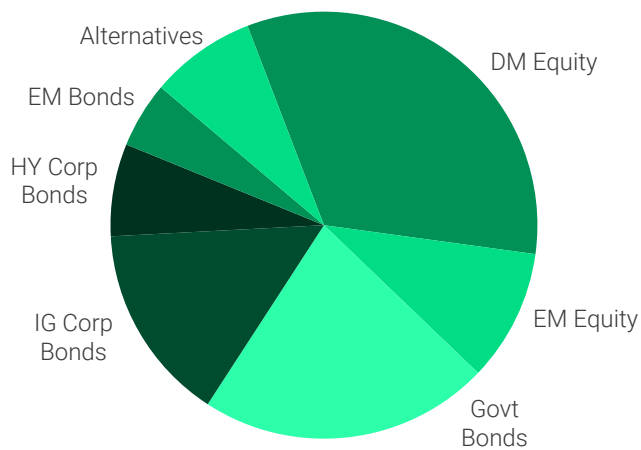
Model portfolio beta to benchmark



Source: GlobalData TS Lombard.

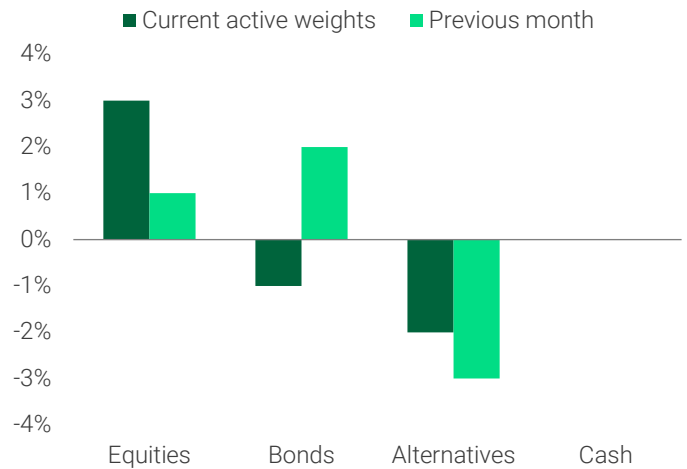
Thin line = last month

Model portfolio composition



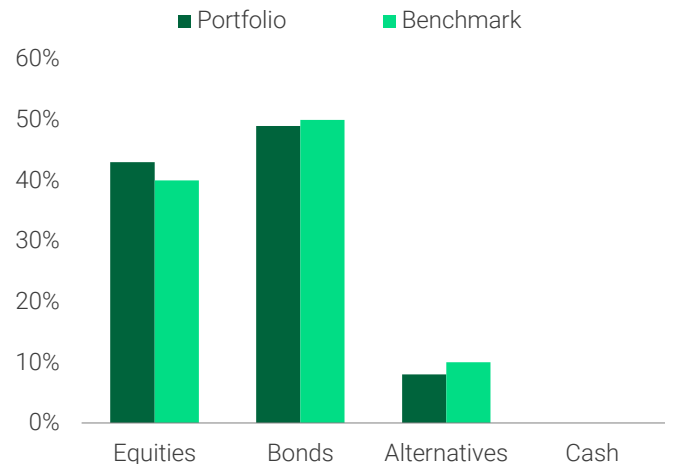
Source: GlobalData TS Lombard.

Model portfolio changes



Source: GlobalData TS Lombard.

Model portfolio vs benchmark



Source: GlobalData TS Lombard.

Multi asset dashboard

	Total Return LC			Volatility			Sharpe Ratio			1Y Correlation			3Y Beta		
	1y	3y	5y	1y	3y	5y	1y	3y	5y	LI	Infl.	Rates	LI	Infl.	Rates
DM Equities	4.2	9.6	8.6	14.8	14.8	17.7	0.0	0.5	0.4	39.3	-19.2	-38.7	7.0	-3.8	-5.9
EM Equities	0.7	0.5	3.5	13.3	14.3	15.2	-0.3	-0.1	0.1	41.7	-0.2	-48.4	6.1	0.0	-6.2
DM Govt Bonds	-3.9	-6.4	-1.3	7.7	5.9	5.4	-1.1	-1.4	-0.6	34.4	-5.7	-78.8	2.7	-0.5	-5.6
DM Corp Bonds	-4.2	-5.8	1.0	10.1	8.4	8.5	-0.9	-0.9	-0.1	22.3	-9.4	-72.7	2.2	-1.1	-6.6
EM Bonds	7.1	-1.5	1.8	6.6	6.6	6.8	0.4	-0.5	0.0	31.7	-10.9	-56.5	2.9	-1.2	-4.7
Energy	-5.6	35.6	4.2	32.4	35.4	42.2	-0.3	1.0	0.1	7.1	-20.5	3.4	2.4	-7.7	1.0
Industrial Metals	-4.1	7.7	4.3	20.9	20.9	18.4	-0.4	0.3	0.1	36.6	5.0	-29.2	7.8	1.3	-5.5
Precious Metals	7.6	-2.9	8.7	15.3	16.4	16.6	0.2	-0.3	0.4	3.2	-9.8	-36.0	0.5	-1.8	-4.9
DM Currencies	5.1	-9.0	-5.7	8.7	7.0	6.5	0.1	-1.5	-1.1	31.2	-15.5	-58.2	2.3	-1.4	-4.0
EM Currencies	-53.9	-53.6	-54.0	54.8	31.8	24.8	-1.1	-1.7	-2.2	40.1	17.1	14.1	1.9	6.7	4.2

All figures % except 3Y Beta.

MODEL PORTFOLIO

Andrea Cicione

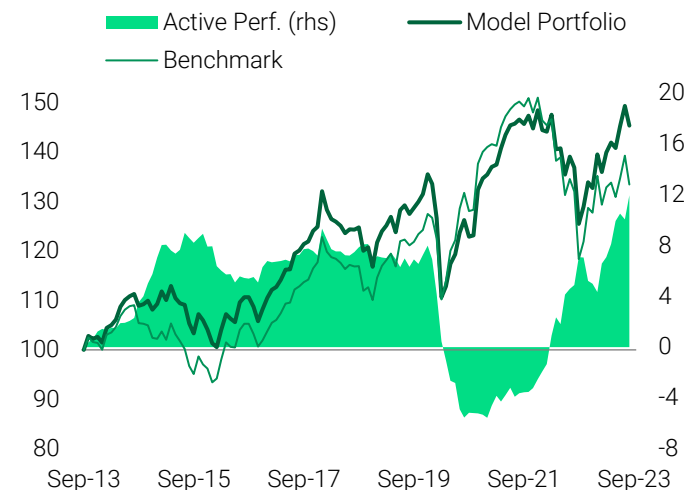
- We increase Equities & Energy Commodities and cut Government Bonds & IG Credit
- Our model portfolio beta increases to 0.96 from 0.90 but remains below neutral risk
- Our portfolio outperformed the benchmark by 21bp over the past month
- **We add more risk but maintain a somewhat defensive stance.** We increase our equity exposure by 2% and Energy Commodities by 1%, while reducing Government Bonds by 1% and IG Corporate Bonds by 2%.
- **We add 2% to EM equities.** In DM, we add 1% to the US and reduce Italy by 1%. In EM, we add 1% to both Taiwan and Mexico. We stay 3% overweight DM and go benchmark weight in EM.
- **We cut DM Government Bonds by 1% and reduce IG by 2%.** In Fixed Income, we reduce Australian Bonds by 1% following the downgrade to 0. In Investment Grade, we reduce the US and the EA by 1% each. As a result of these changes, we are now 3% underweight Govvies and neutral IG Credit.
- **We add 1% to Energy Commodities.** In Alternative Assets, we increase Energy Commodities by 1% to a small overweight following the upgrade to +1.
- **Our model portfolio beta increases to 0.96 from 0.90.**
- **Our portfolio outperformed by 21bp over the past month,** having lost 2.63% vs 2.83% for the benchmark. EM Equities and Bonds contributed 14bp and 5bp, respectively. Government Bonds added another 5bp and currency hedging a further 11bp. DM Equities were a drag, costing us 16bp of active performance.

Model portfolio statistics

	Model Portfolio	Benchmark
Returns (since Sep-13)	45.3%	33.4%
YTD	9.5%	4.4%
2022	-10.6%	-15.4%
2021	10.2%	7.8%
Annualized return	3.8%	2.9%
Volatility	9.2%	9.5%
Sharpe Ratio	0.35	0.25
Sortino Ratio	0.64	0.49
Beta	0.93	
Alpha	1.1%	
Tracking error vol	2.5%	
Information ratio	0.36	

Sources: Bloomberg, GlobalData TS Lombard.

Model portfolio performance



Sources: Bloomberg, GlobalData TS Lombard.

	Portfolio	Benchmark	O/W (U/W)	1m change
DM Equities	33%	30%	3%	-
US	20%	17.4%	2.6%	+1%
Canada	1%	1.1%	(0.1%)	-
UK	2%	2.4%	(0.4%)	-
Switzerland	1%	1.1%	(0.1%)	-
Germany	1%	1.1%	(0.1%)	-
France	1%	1.1%	(0.1%)	-
Italy	1%	0.3%	0.7%	-1%
Spain	1%	0.4%	0.6%	-
Japan	4%	2.5%	1.5%	-
Australia	1%	0.8%	0.2%	-
Others	-	1.8%	(1.8%)	-
EM Equities	10%	10%	-	+2%
China	1%	2.7%	(1.7%)	-
South Korea	1%	1.5%	(0.5%)	-
Taiwan	2%	1.3%	0.8%	+1%
India	2%	0.9%	1.1%	-
Brazil	2%	0.8%	1.3%	-
Mexico	2%	0.4%	1.7%	+1%
South Africa	-	0.7%	(0.7%)	-
Others	-	1.9%	(1.9%)	-
Government Bonds	22%	25%	(3%)	-1%
USTs	10%	10.0%	-	-
Canada	-	0.4%	(0.4%)	-
Bunds	1%	1.7%	(0.7%)	-
Gilts	3%	2.1%	1.0%	-
JGBs	2%	4.4%	(2.4%)	-
OATs	1%	1.9%	(0.9%)	-
BTPs	3%	1.9%	1.1%	-
BONOs	2%	1.0%	1.0%	-
Australia	-	0.4%	(0.4%)	-1%
Others	-	1.4%	(1.4%)	-
IG Corporate Bonds	15%	15%	-	-2%
US	9%	8.6%	0.5%	-1%
EA	4%	3.0%	1.0%	-1%
UK	2%	1.1%	1.0%	-
Others	-	2.4%	(2.4%)	-
HY Corporate Bonds	7%	5%	2%	-
US	4%	2.8%	1.3%	-
EA	3%	0.9%	2.1%	-
Others	-	1.3%	(1.3%)	-
EM Bonds	5%	5%	-	-
China	-	1.0%	(1.0%)	-
Brazil	2%	0.5%	1.5%	-
Mexico	2%	0.5%	1.5%	-
India	1%	0.5%	0.5%	-
Taiwan	-	0.5%	(0.5%)	-
South Africa	-	0.5%	(0.5%)	-
South Korea	-	0.5%	(0.5%)	-
Others	-	1.1%	(1.1%)	-
Alternative assets	8%	10%	(2%)	+1%
Real Estate	4%	5.0%	(1.0%)	-
Energy Commodities	4%	3.5%	0.5%	+1%
Industrial Metals	-	0.3%	(0.3%)	-
Precious Metals	-	0.2%	(0.2%)	-
Other commodities	-	1.0%	(1.0%)	-
Currency Hedging	(3%)	-	(3%)	+1%
JPY	-	-	-	-
GBP	-	-	-	-
EUR	(3%)	-	(3.0%)	+1%
AUD	-	-	-	-
Cash	-	-	-	-

EQUITIES

Andrea Cicione

- A higher probability of US reacceleration without recession warrants an upgrade to +1
- Rising yields and China are risks to this view, but short investor positioning is a plus
- We downgrade Italy to 0 but remain overweight in our portfolio; Taiwan raised to +1

Market verdict: No recession. The US equities market has been following the path of a typical no-recession bear market followed by recovery. Given that there has not yet been a recession (the 2022 bear was caused by a Fed-induced derating), this seems sensible. The question is whether the recovery path will continue following the typical no-recession trajectory.

We continue to think that a recession around the turn of the year is more likely than not.

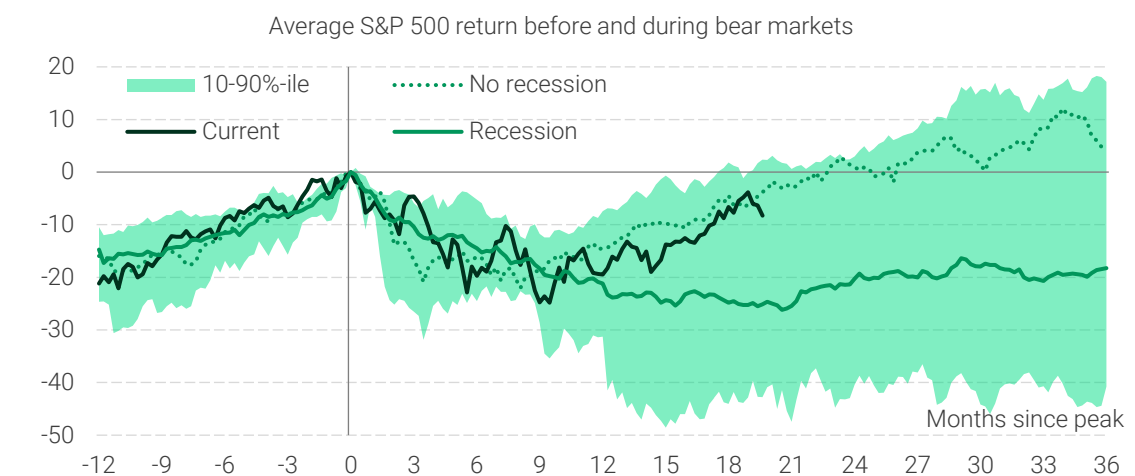
However, the odds of a reacceleration before the recession materializes are improving. This is because the Fed is done (or is close to being done) hiking rates at a time when US growth seems to be bottoming out. If there is no recession by the autumn, there may not be one at all.

The shifting balance between upside and downside risks warrants our upgrading to +1. We have been overweight US stocks since June, as we shifted away from the preference for Europe within DMs that we had at the start of the year. The upgrading of the US to positive should be seen more as confirmation of this changed bias than a bullish turn.

To be sure, the US market faces several challenges. As we argue in the Multi Asset section, fast-rising yields risk creating a collateral squeeze, just like in late 2022 – although there are a few mitigating factors this time round. China's property woes are also weighing on risk sentiment.

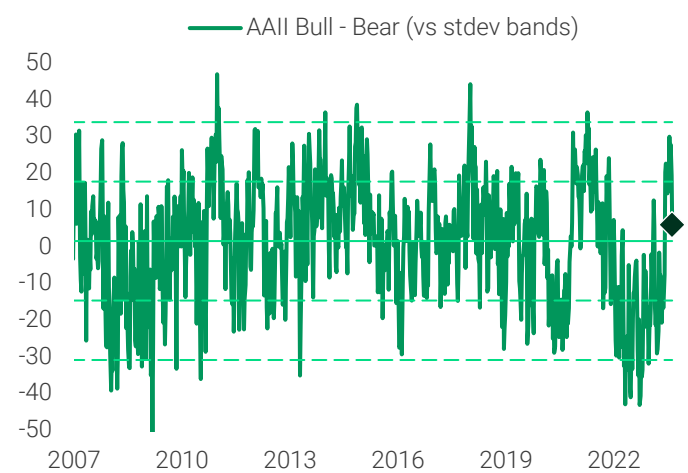
However, these could also be seen as reasons for being constructive. Short-term sentiment became quite exuberant in July and the market looked overbought. Sentiment has largely normalized now; and the S&P 500, if anything, appears oversold today. At the same time, investors remain underinvested in US equities. As a recession remains elusive, allocation to those assets will likely continue to increase.

The S&P 500 is following a typical no-recession recovery path



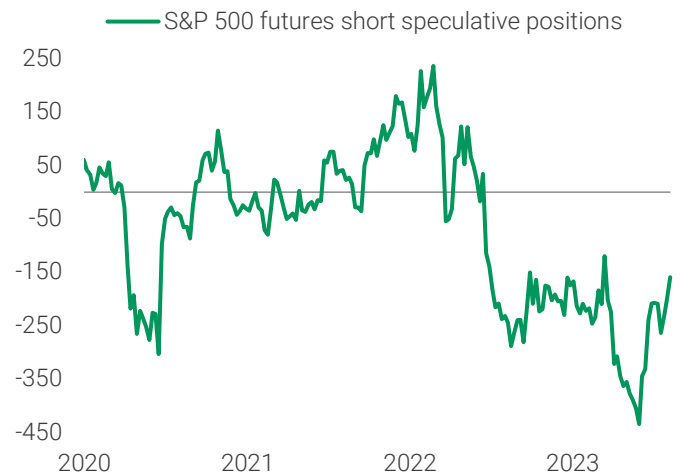
Sources: Bloomberg, GlobalData TS Lombard.

Investors sentiment is no longer exuberant



Sources: Bloomberg, GlobalData TS Lombard.

Positioning is improving but still short



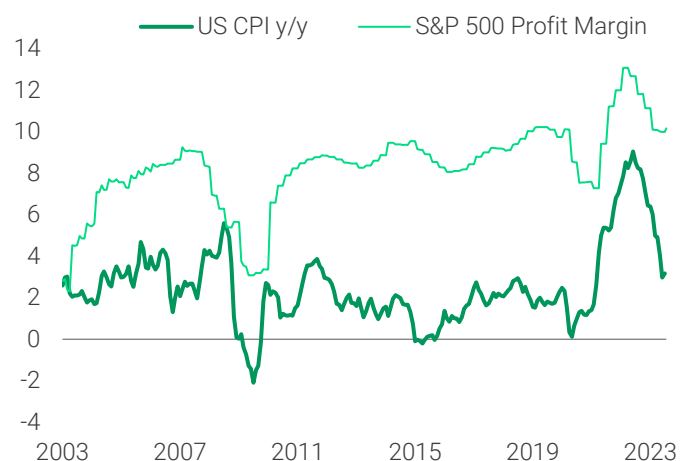
Source: Bloomberg.

US fundamentals may be bottoming, too. Just like the economy, US corporate fundamentals could be bottoming. Margins have been rising and falling in line with inflation. In fact, corporate margin expansion was one of the main causes of inflation in 2021-22. Following five quarters of steady decline, corporate fundamentals appear to have stabilized in Q2 2023. The chart below right shows that, after excluding the outliers Financials and Energy, margins are little changed since a year ago and even somewhat higher in aggregate.

Earnings hiatus or earnings recession? The top-left chart on the next page shows that earnings have stalled in the past year or so amid contracting margins but sales have been growing at a healthy clip. With inflation and margins normalizing, what follows next is likely to be a function of the economy: if a recession is avoided and US growth reaccelerates, EPS will probably do so, too; but if the economy contracts meaningfully, so will earnings. Under our central case of a mild recession, earnings should [continue?] to flat-line until yearend and then start recovering.

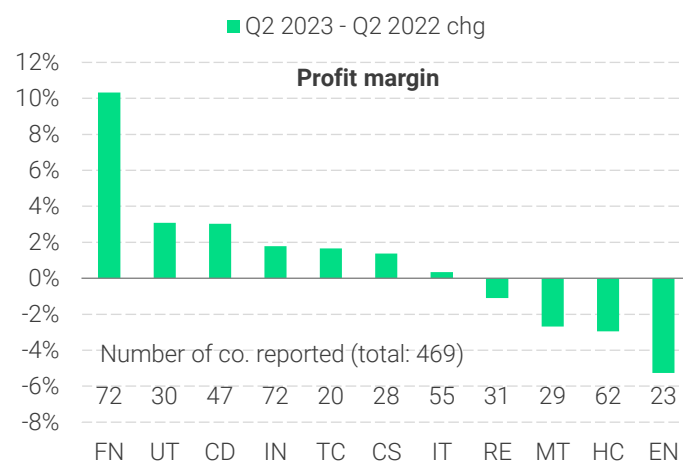
Valuations remain rich, mostly because investors are looking through the EPS lull. As the top-right chart on the next page shows, while 12-month forward p/e remains expensive at 18.8x, the 24-month forward is at a more reasonable 17x. This is fairly typical when an earnings contraction or stagnation is forecast: equities are initially priced off 2-year EPS and p/e ratios tend to fall as earnings begin to recover.

Margins appear to be bottoming at high levels



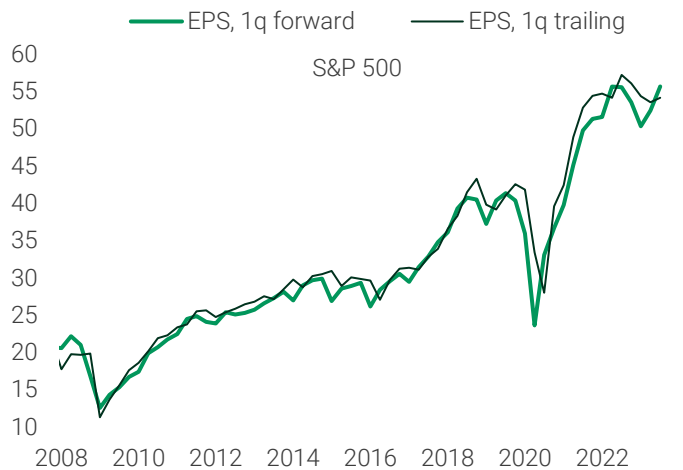
Source: Bloomberg.

Financials and Energy are major outliers



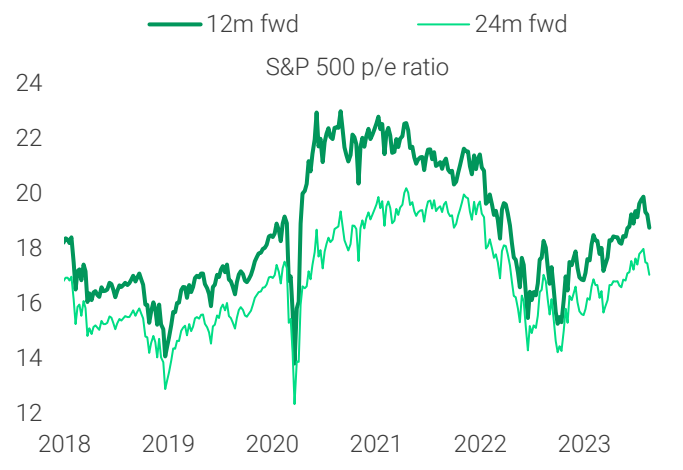
Sources: Bloomberg, GlobalData TS Lombard.

EPS lulls rarely last more than a few quarters



Sources: Bloomberg, GlobalData TS Lombard.

Equities are being priced off 2-year forward EPS



Sources: Bloomberg, GlobalData TS Lombard.

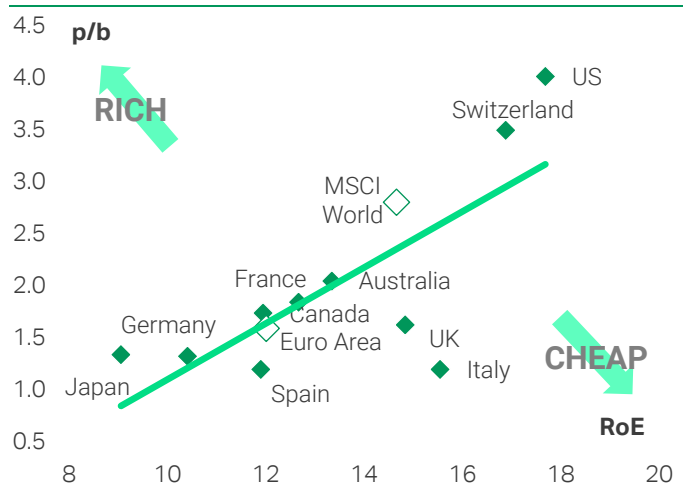
Recommendation and portfolio changes

US upgraded to +1 from 0. For the reasons given above, we upgrade the US to positive this month. As we had already tilted from Europe to the US earlier this year and gone overweight US in our model portfolio in June, we believe an upgrade to our directional call is warranted. We acknowledge near-term risks from rising yields and China, but we think that a more attractive entry point, a mildly oversold market and still-short positioning offset the negatives.

Italy cut to 0 from +1. An unexpected GDP contraction in Q2 and the fiasco over the windfall tax on banks have weakened investor confidence in the market, especially as Financials are by far Italy's largest sector. However, valuations remain attractive and fundamentals are improving, with analysts continuing to upgrade EPS estimates. We go neutral for now but stay overweight in the model portfolio.

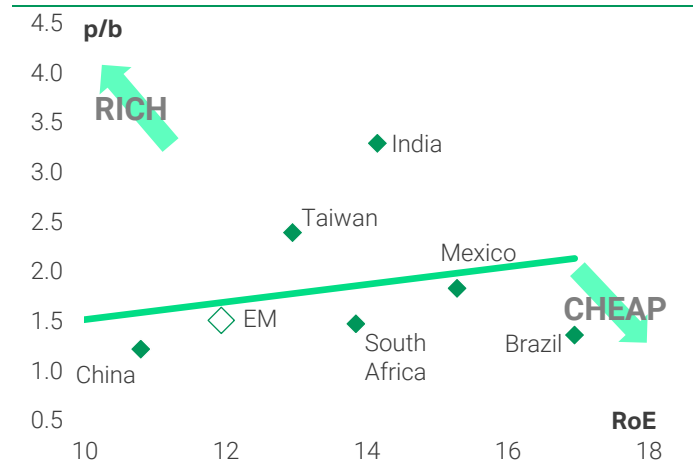
Taiwan raised to +1 from 0. July exports showed tentative signs of bottoming out, but demand from China remains weak. If we are right that China's slowdown will bottom out in Q4, this could help put a floor on Taiwan's equities, while a more positive outlook for US equities will provide further support. In addition, US-China decoupling, especially the US CHIPS act, will support semiconductor manufacturing in Taiwan.

DM price-to-book ratio vs RoE



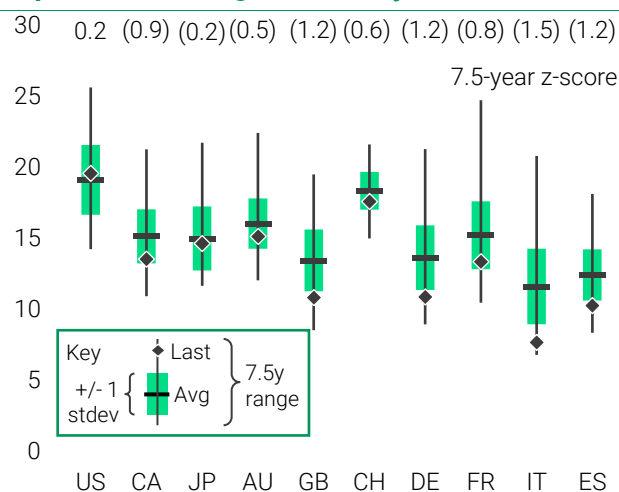
Source:

EM price-to-book ratio vs RoE



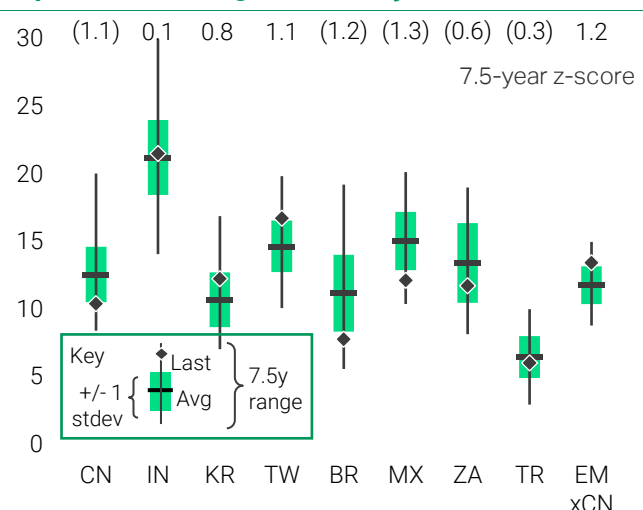
Source: Bloomberg.

DM price-to-earnings ratio vs cycle



Sources: Bloomberg, TS Lombard.

EM price-to-earnings ratio vs cycle



Sources: Bloomberg, TS Lombard.

Equities dashboard

	MktCap		Total return LC			P/E (x)			P/B (x)			RoE			EPS growth			Dividend yield		
	Memb.	(US\$)	1m	ytd	2022	Trail.	Fwd	ZScr	Trail.	Fwd	ZScr	Trail.	Fwd	ZScr	Fwd	3m	trail.	fwd	ZScr	
World (AC)	2933	62,091	-3.9	12.1	-17.9	19.1	16.4	-0.2	2.7	2.5	0.7	13.8	14.3	0.9	-5.7	-0.6	2.2	2.3	-0.5	
United States	627	38,684	-3.5	15.2	-19.5	22.2	19.6	0.2	4.2	3.8	0.8	17.1	17.9	0.9	-1.0	0.7	1.6	1.6	-1.0	
Canada	87	1,754	-1.7	4.7	-5.8	12.4	13.6	-0.9	1.9	1.7	-0.7	12.3	12.1	0.3	-6.3	-4.8	3.4	3.6	0.9	
Japan	237	3,388	0.0	21.3	-4.1	16.2	14.7	-0.2	1.4	1.3	0.6	9.4	8.9	0.4	-3.2	3.5	2.3	2.4	0.2	
Australia	59	1,088	-1.4	5.4	3.6	14.0	15.2	-0.5	2.2	2.1	0.5	17.1	13.6	0.8	-3.6	-2.4	4.9	5.1	1.2	
UK	82	2,227	-0.5	0.3	7.0	10.3	10.9	-1.2	1.6	1.6	-1.2	15.9	13.7	0.8	-9.8	-5.1	4.3	4.6	0.9	
Switzerland	44	1,536	-1.1	4.4	-16.5	19.6	17.6	-0.6	3.9	3.5	2.0	16.7	18.3	3.1	-2.3	0.0	3.0	3.2	0.1	
Germany	59	1,299	-2.2	13.0	-16.5	12.4	10.9	-1.2	1.4	1.2	-1.7	9.8	9.8	-0.4	2.1	0.5	3.8	4.6	3.0	
France	63	1,865	-1.6	13.0	-7.0	14.0	13.4	-0.8	1.9	1.8	1.2	11.4	13.3	1.7	-4.9	-1.1	3.1	3.3	0.0	
Italy	23	390	-1.7	21.6	-7.7	6.6	7.7	-1.5	1.2	1.2	0.8	15.0	15.4	1.9	-6.4	7.5	5.0	6.1	1.7	
Spain	19	393	-1.9	17.5	0.6	10.7	10.3	-1.2	1.3	1.2	0.1	12.1	11.8	1.6	-1.6	4.5	4.2	5.5	1.8	
Euro Area	228	5,079	-2.6	12.6	-11.7	13.0	12.2	-1.1	1.7	1.5	0.0	11.5	12.0	1.2	-1.9	1.1	3.4	4.0	1.5	
DM ex-US	885	16,839	-4.6	8.7	-13.7	16.2	13.2	-1.0	1.7	1.6	0.1	11.8	11.8	1.1	-3.9	-0.8	3.4	3.6	1.1	
China	756	1,976	-3.8	-4.2	-21.7	11.8	10.4	-1.1	1.2	1.2	-1.3	9.8	11.1	-1.2	1.6	-5.3	2.5	2.5	0.5	
India	114	970	-1.1	6.2	3.0	25.4	21.5	0.1	3.4	3.4	0.5	13.1	15.0	0.1	17.2	1.0	1.3	1.7	0.9	
Korea	102	792	-4.7	16.6	-24.7	17.3	12.3	0.8	1.0	0.9	-0.3	5.3	7.8	-0.9	-77.1	0.0	2.1	2.6	0.9	
Taiwan	90	989	-5.2	19.6	-21.5	17.3	16.8	1.1	2.4	2.3	0.8	14.0	13.5	-0.1	-6.5	-5.4	3.7	3.3	-1.4	
Brazil	47	348	-2.3	4.6	8.6	6.6	7.8	-1.2	1.4	1.3	-1.3	21.4	16.3	0.2	-17.4	-9.3	6	7	0.8	
Mexico	23	185	-1.1	10.7	-6.3	14.6	12.2	-1.3	2.0	1.8	-1.0	16.6	14.6	0.7	5.9	6.3	3.9	5.1	1.8	
South Africa	37	213	-4.0	4.2	3.4	14.2	11.8	-0.6	1.7	1.5	-1.8	16.2	14.2	-0.4	-3.8	-7.1	4.4	4.2	0.5	
EM ex-China	665	4,607	-5.4	8.2	-18.9	14.8	13.5	1.2	1.7	1.7	0.7	11.9	12.2	-0.2	-34.6	-5.2	3.2	3.4	-0.1	

ZScr is the number of standard deviations from the 7.5-year avg (numbers below -1 and above 1 highlighted). All figures % unless stated otherwise. P/e, p/b, RoE and DY ZScr are over 7.5y on 12m forward measures. EPS growth is forward / trailing. EPS 3m growth is on forward earnings.

MSCI sector weights

	%	US	Canada	Japan	Australia	UK	Switzerland	Germany	France	Italy	Spain	Euro Area	Brazil	China	Taiwan	India	Mexico	South Africa	Korea	DM	EM
Industrials		9.1	12.8	24.4	5.6	11.0	9.1	18.8	22.5	6.0	8.6	16.1	8.3	10.4	3.1	7.0	15.7	2.3	12.0	11.2	8.6
Energy		4.4	17.9	0.8	6.1	13.4			7.8	11.5	4.8	4.7	18.7	2.3	0.3	9.8		1.4	1.3	4.9	6.2
C. Discr.		10.7	3.8	18.1	5.6	6.0	5.3	16.1	20.3	23.4	18.5	16.5	2.4	19.4	2.1	9.7		17.8	8.0	10.8	11.9
Healthcare		13.7		8.7	9.7	13.3	36.4	10.6	10.8	2.8	1.2	8.2	3.9	7.1	0.3	4.5		1.7	4.7	13.2	4.7
Financials		12.4	34.0	11.2	31.8	19.4	16.2	17.9	11.4	34.0	31.9	17.8	31.5	17.6	13.8	32.9	14.7	37.2	8.1	14.8	22.5
Real Estate		2.5		3.0	5.6	0.9						0.9		2.4	0.2			3.4		2.4	1.8
Utilities		2.5	3.3	1.2	1.5	4.1	0.2	4.1	2.5	18.7	24.9	5.9	7.6	2.3		3.5			0.5	2.7	2.4
Tech		27.2	7.7	13.4	1.7	1.0	1.1	15.3	4.5	1.2		11.4	0.7	11.2	71.2	11.3			48.8	21.3	18.2
Communications		8.6	4.5	7.9	3.7	2.8	1.0	5.7	2.7	1.9	10.2	4.1	1.6	10.2	2.6	2.3	15.9	7.5	6.5	7.3	7.4
Materials		2.5	10.7	4.9	23.7	8.3	7.8	6.7	5.9			6.4	17.4	7.8	4.9	8.5	20.5	20.3	8.0	4.1	8.6
C. Staples		6.4	4.4	6.4	4.9	19.8	22.4	3.0	10.6	1.8		8.0	7.9	9.2	1.6	10.1	30.6	8.4	2.2	7.3	7.6

Largest three sectors for each market highlighted

Sector price-to-earnings ratio (12-month trailing)

	US	Canada	Japan	Australia	UK	Switzerland	Germany	France	Italy	Spain	Euro Area	Brazil	China	Taiwan	India	Mexico	South Africa	Korea
Market	22.1	13.8	13.8	13.6	9.8	21.5	12.3	15.0	7.2	9.6	12.8	6.5	10.1	15.2	24.5	11.2	9.3	11.4
Industrials	21.6	24.4	11.8	43.3	28.2	21.4	12.3	18.2	9.6	21.0	15.7	35.9	5.6	5.7	43.8	14.2	16.8	11.5
Energy	8.1	13.0	8.7	8.4	6.3			7.7	5.4	5.5	7.5	3.1	4.9	32.8	18.2		3.7	18.9
C. Discr.	31.9	19.1	13.7	25.2	17.6	19.9	6.8	20.2	5.7	22.2	11.2	19.4	28.6	25.4	42.6		11.6	5.7
Healthcare	26.9		27.8	37.4	21.8	24.7	24.7	17.8		64.1	21.1	37.9	15.8	497.2	40.1		13.1	57.7
Financials	13.6	11.1	11.1	14.0	7.1	11.3	9.2	7.4	6.7	5.6	7.2	8.2	4.1	18.0	20.3	8.3	9.5	4.4
Real Estate	30.4	37.9	13.8	14.2	7.5	15.3	35.6	29.7			45.6		6.4	19.1	65.6	3.4	6.8	
Utilities	19.0	14.5	6.8	18.2	17.5	14.4	15.6	22.0	11.1	11.8	13.6	13.8	9.4		13.7			66.9
Tech	34.8	75.6	21.7	89.1	38.3	38.5	36.2	15.7		36.1	29.0	32.0	12.1	14.8	25.5			13.7
Comms	22.9	19.5	10.6	30.5	4.2	16.8	11.6	14.0	53.9	20.7	15.6	15.8	16.7	23.6	35.8	8.1	11.9	30.6
Materials	17.4	18.8	11.2	10.8	9.6	20.5	12.6	17.2			13.0	4.3	8.4	40.5	19.2	12.9	5.8	26.5
C. Staples	25.3	15.5	24.0	23.5	12.6	28.3	27.6	26.6			21.0	18.7	22.4	15.4	53.9	17.7	28.3	15.8

Sector 12-month total returns (local currency)

	%	US	Canada	Japan	Australia	UK	Switzerland	Germany	France	Italy	Spain	Euro Area	Brazil	China	Taiwan	India	Mexico	South Africa	Korea
Market		3.4	1.7	15.5	8.1	0.0	-0.9	13.7	11.5	27.6	16.4	11.4	5.6	-5.6	7.6	4.8	30.3	5.6	4.7
Industrials		8.1	3.5	19.4	6.8	10.2	12.0	18.5	12.2	-1.9	20.0	13.5	13.2	-14.5	-12.1	13.2	28.9	21.5	6.2
Energy		14.3	2.6	15.7	31.6	11.3			15.2	24.6	11.7	11.4	30.4	19.1	-6.8	6.3		-20.2	-9.5
C. Discr.		-3.6	6.6	12.8	8.8	3.3	13.5	9.0	13.1	28.0	32.2	13.5	-28.7	-6.9	6.2	15.3		22.6	2.8
Healthcare		2.3		1.1	-7.1	1.0	-3.4	-3.5	14.2		1.6	6.7	-20.7	-20.0		21.1		29.2	-16.9
Financials		-2.5	-3.1	36.7	4.6	5.5	5.2	29.4	18.2	54.2	45.2	28.1	6.6	0.9	-0.1	5.5	41.2	8.2	10.2
Real Estate			7.4	2.3	0.9	-26.0	-3.9	-32.8	-5.3					-15.6	-21.0	17.9	56.8	14.7	
Utilities		-16.1	-17.6	26.5	12.6	-10.8		6.3	19.3	14.2	-1.1	3.7	-0.9	-15.7		-32.4			-15.7
Tech		9.2	28.6	16.0	23.9	14.7		31.3	-5.4			7.8	-5.9	-19.6	13.6	-0.5			8.7
Comms		9.5	-5.9	6.2	11.0	-17.8	6.5	1.8	6.8	17.7	-13.6	0.4	12.8	8.8	-1.6	11.7	2.1	-9.2	-22.7
Materials		2.5	4.1	22.0	19.6	-12.8	2.4	13.2	16.6			7.8	3.2	-16.1	-7.3	3.6	38.6	-8.7	30.1
C. Staples		-1.5	4.9	12.0	-5.6	-6.2	-8.9	8.6	6.8			3.9	-12.8	-14.8	10.9	9.6	39.7	11.3	-11.1

FIXED INCOME

Skylar Montgomery Koning

- There's been a perfect bearish storm in FI; yields will be supported near term, but an eventual recession and Fed cuts will drive a strong UST rally
- A gradualist approach means the RBA is credibly heading higher for longer; we downgrade Aussie government bonds to 0 from -1

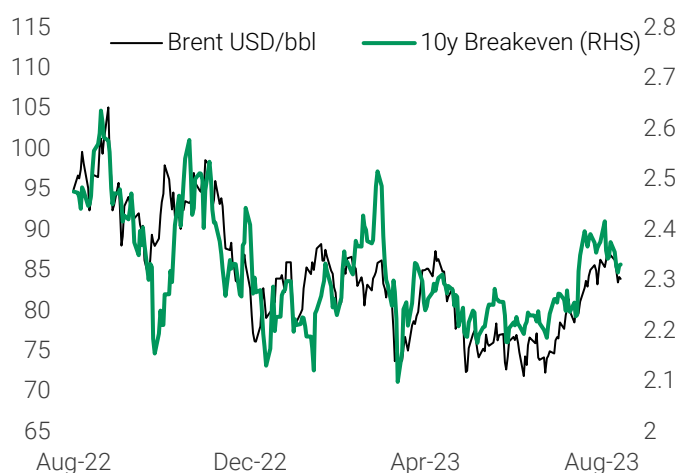
A perfect bearish storm

Recently, we have seen yields surge with the curve steepening and a rise in term premia. Rather than just one factor driving the sell-off, it was a perfect storm of headlines feeding the bear, combined with a BoJ yield curve tweak, the US debt downgrade, increased US issuance, resilient growth and rising energy prices. The culmination of all these factors pushing up on yields points to some overexuberance in the move above 4% for the 10y. No doubt, some of these forces will provide continued support for yields, especially with upward momentum dominating ([see here for a rundown on each driver](#)); but with so much bearishness having hit the market at once, it is hard to envisage another impulse for higher yields. In the medium term, fixed income is dependent on the economic and Fed outlook.

Growth remains resilient... This is not a new story. [Last month's rise to the highs in real yields](#) – which we have now returned to – was on the back of the surge in the US economic surprise index. Signs of continued disinflation have led to a pullback in the meantime. But throughout the ESI has continued to march higher, validating the markets' soft landing view and higher-for-longer policy rates, which also feeds into a steeper curve.

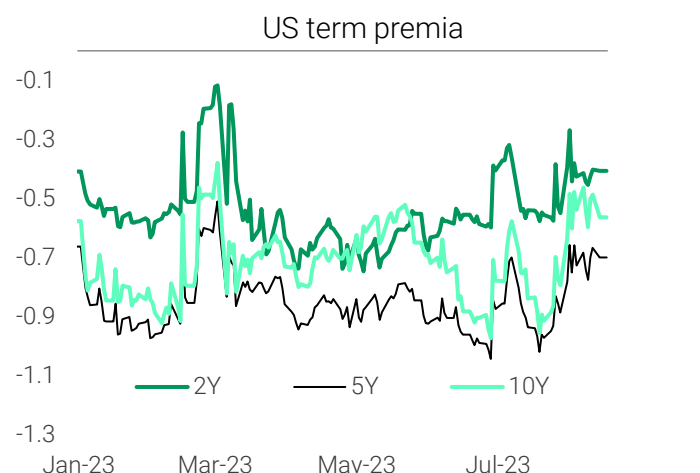
...but the recession is still coming. [Our Chief US Economist, Steve Blitz](#), has built his recession call on the disruption to the zero-carry industries that have propelled the economy since 2009 (tech, finance), flat-lining loan growth, tightening credit and Treasury pulling record amounts of cash from the economy. [As we have written previously](#), elevated ESI and real yields can become self-defeating. Moreover, [Steve notes](#) that if real yields are rising because there is more pressure

Oil is driving breakevens



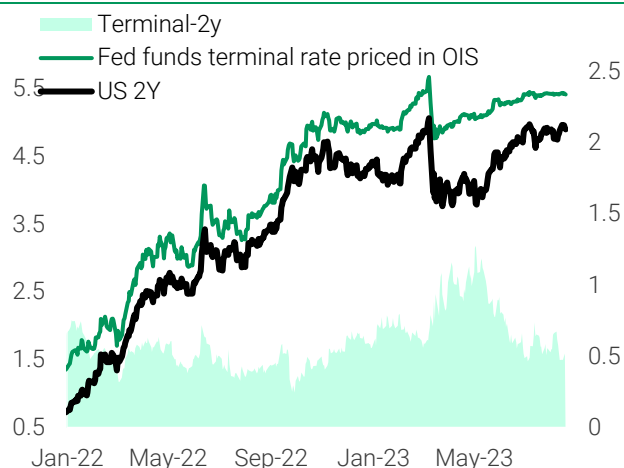
Sources: GlobalData TS Lombard, Bloomberg.

Term premia are ticking up, led by the 10y



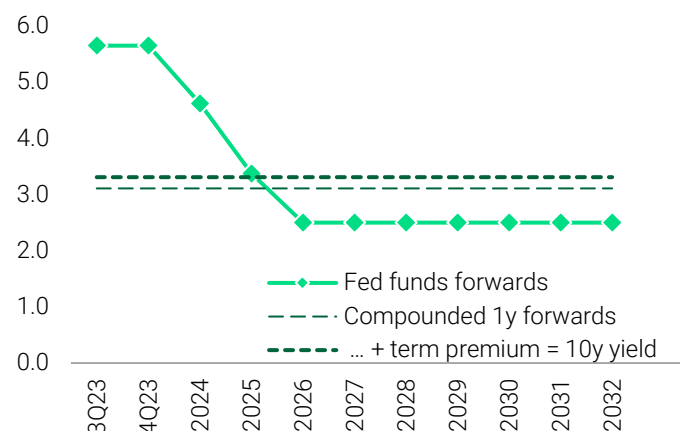
Sources: TS Lombard, Bloomberg.

Front-end yields are limited by Fed funds terminal



Sources: GlobalData TS Lombard, Bloomberg.

Fed dots => a lower 10y



Sources: GlobalData TS Lombard, Bloomberg.

on private markets to fund a greater portion of the deficit, that is not a good outcome for the economy or for capital markets.

While both we and consensus expect a mild recession, it is the case that when the data begin to slow, no one will know how deep or how long the economic pain will be. In this scenario, it is not hard to envisage investors rotating away from the risks assets they chased on the upside into risk-free assets with a decent yield, despite the increased issuance. The rally in FI on the mixed jobs report, which saw continued labour market slowing, speaks to the trepidation over recession.

Regardless, we are at the end of the Fed tightening cycle. This means limited upside to yields from the Fed, while the downside could be considerable. In the chart above right, we assume Fed funds follows the Fed dots. We then compound the forwards and add a term premium of 20bp (the 10y term premium is currently -55bp) to arrive at a 10y yield of 3.3%. A recession would see the Fed cut aggressively to <3%, justifying an even lower 10y.

Being in restrictive MoPo means we will get cuts eventually; what a recession does is increases the speed and magnitude of those cuts. The short-term interest rate (STIR) market is essentially pricing in a soft landing, where a resilient economy and continued declines in inflation allow a higher-for-longer policy rate before gradual declines in 2024; this means risks are asymmetrically skewed towards the market pricing in more dovishness as the economy slows and more downward pressure on yields increases as the perfect storm of bearish drivers fade.

We stay neutral USTs. Our US FI view continues to be that yields will remain rangebound until we get recession and cuts, which will see FI rally. Thus, in line with rangebound yields, we are neutral. In our more tactical Macro Strategy publication, we have written that faced with a high likelihood of a recession in the next 12 months but unsure of the timing, we think it makes sense to see surges in yields to the top of the range as opportunities to buy the dip, especially with current yield levels providing a decent carry and making return profiles asymmetrically skewed to the upside.

But we have been expressing this view through the front-end of the curve (we also like steepeners), where, now that the Fed tightening cycle is essentially over, losses are more limited and the inverted curve means a higher yield than in AA, where we are allocated to the 7-10y sector of the curve. There is also the opportunity cost of not being allocated in risk assets, especially as the probability of a US re-acceleration has increased. Moreover, this part of the curve has been edging to price in the secular bear market we see in the post-Covid economy with higher more

volatile inflation requiring higher policy rates, a higher term premium and thus structurally higher yields.

The RBA is credibly heading higher for longer

Priced-in RBA hawkishness has receded. The Australia ISI has been negative for three months in a row. This, combined with the latest RBA minutes indicating that “members observed that there was a credible path to the inflation target with the cash rate staying at its present level”, has fed into the markets’ RBA outlook. STIR markets have reduced expectations for the terminal rate by 50bp – from 4.8%, to 4.3%.

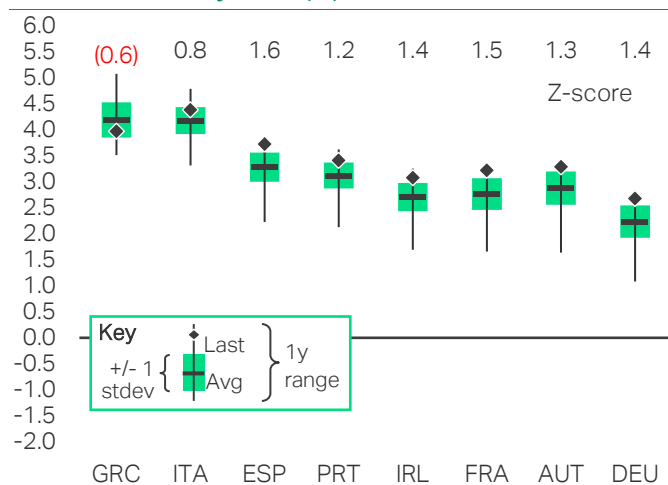
Throughout this tightening cycle, the RBA has taken a gradualist approach. With around 70% of Australian mortgages at a variable rate, the pass-through of interest rates is faster than in many other DM economies; for this reason, the bank would rather see how the tightening done so far feeds through before it risks forcing the economy into an unnecessarily deep recession. So, with a negative ISI, it has paused at its last two meetings.

Wait and see ≠ no further hikes... The main worry about raising rates too high too fast has been the housing market, but recent data show that regional house price declines have stabilized or rebounded. At the same time, the absolute level of inflation remains very high, with headline CPI having fallen just 1.8pp from 7.8% to 6% (by contrast, the US has fallen 5.9pp from a peak of 9.1% to 3.2%). With the RBA having already shown willingness to continue tightening after a pause, it is not hard to see another hike if inflation surprises to the upside again.

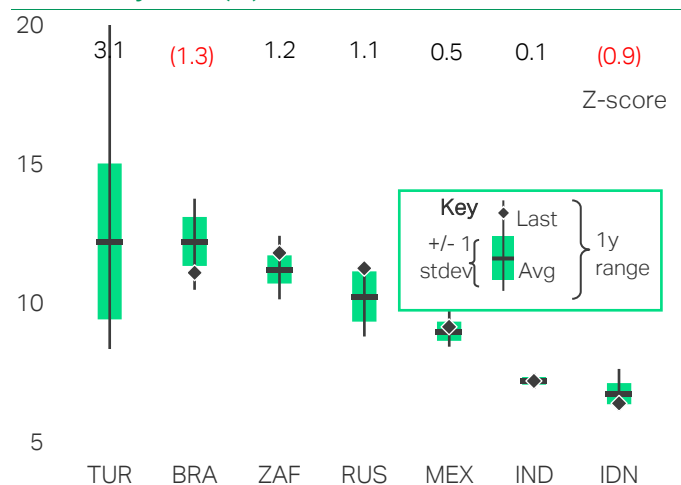
...which increases the likelihood of avoiding recession and higher for longer. The tightening this cycle has not been aggressive enough for the fixed income market to find its terminal tipping point and the Australian curve inverted only briefly. In line with this, the quarterly growth forecasts show an acceleration into 2024 (most of DM has seen the forecasted recession pushed into 2024). This fits with the bottoming of activity data in China that we expect in 4Q. It also means that even the RBA’s own forecasts see inflation falling very slowly and only reaching the top of the bank’s forecast range (2-3%) in 2025. The implication of persistent inflation and resilient growth into 2024 is that policy can stay higher for longer.

We downgrade Australian government bonds to 0 from +1. With RBA hawkishness priced out and the RBA more credibly heading higher for longer, it no longer makes sense to be overweight. But an underweight does not make sense either; markets have somewhat priced in higher for longer in rates (the first cut is priced in at the end of 2024), and the 10y trades above the policy rate and high correlations across DM government bonds mean that Aussie govies will get swept up in UST gyrations.

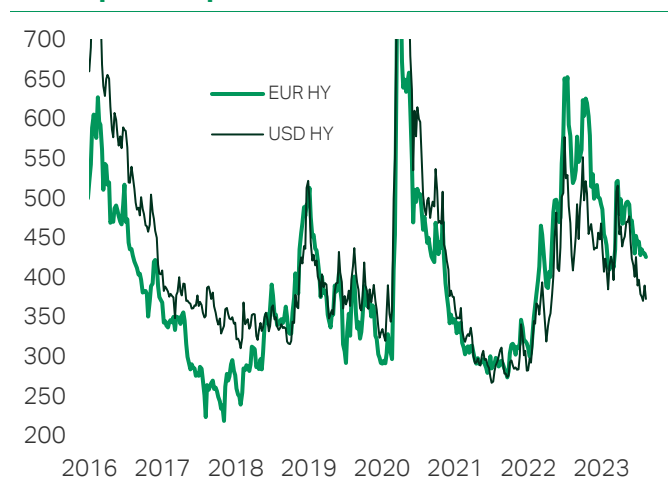
Euro area bond yields (%)



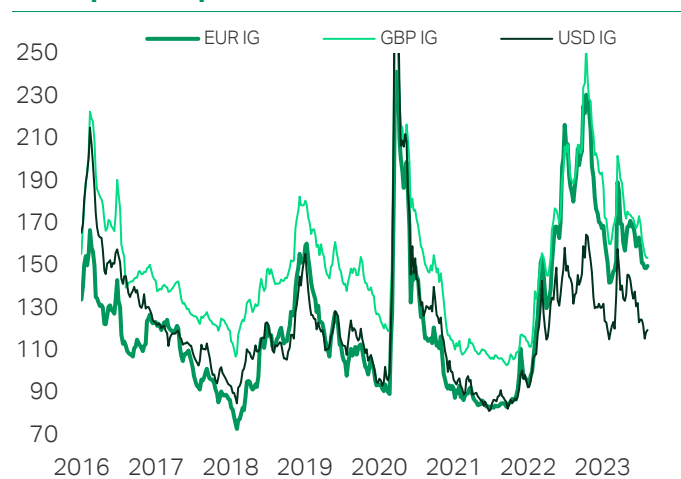
EM bond yields (%)



HY corporate spreads



IG corporate spreads



Government bond dashboard

	Policy	Inflation		2y yield		10y yield		7-10y total return			5y CDS (bp)		Money grth		Budg	Debt	GDP
	rate	Rate	Target	Last	Zscore	Last	Zscore	1m	ytd	2022	Last	StDev	Narrow	Broad	%GDP	%GDP	y-y
US	5.50	4.1	2.0	4.90	2.3	4.22	2.3	-3.0	-3.5	-11.0	49	0.1	22.9	-3.6	-8.4	82	2.6
Canada	5.00	3.3	1.0-3.0	4.77	2.6	3.77	2.5	-1.8	-5.4	-6.1	49	-0.3	-7.7	5.5	-0.5	90	3.1
Japan	0.10	3.3	2.0	0.02	1.4	0.64	3.5	-0.9	0.8	-3.6	21	-0.4	-1.3	2.4	-4.3	236	2.0
Australia	4.10	6.0	2.0-3.0	3.92	2.1	4.23	2.2	-1.8	-1.3	-11.5	15	-1.3	-3.0	4.3	-2.7	42	2.3
UK	5.25	6.8	2.0	5.21	3.3	4.67	3.2	-2.6	-7.2	-13.8	30	0.8	N.A.	0.1	-2.3	87	0.4
Germany	4.25	5.3	<2.0	3.03	2.9	2.61	2.6	-1.4	-2.6	-15.5	16	0.4	-8.0	0.6	-2.6	64	-0.2
France	4.25	5.3	<2.0	3.29	2.9	3.15	2.6	-1.4	-2.9	-15.1	26	0.0	-8.0	0.6	-4.7	97	0.9
Italy	4.25	5.3	<2.0	3.74	2.7	4.30	2.0	-1.8	-0.2	-15.3	91	-1.0	-8.0	0.6	-8.0	132	0.6
Spain	4.25	5.3	<2.0	3.41	2.9	3.65	2.4	-1.6	-2.3	-15.7	52	-0.4	-8.0	0.6	-4.8	98	1.8
Brazil	13.25	4.0	2.5-6.5	10.27	0.4	11.23	0.5	-5.0	13.7	18.9	188	-0.5	-1.0	10.4	-6.4	84	4.0
Mexico	11.25	4.8	2.0-4.0	10.37	1.8	9.32	1.8	-3.9	11.7	12.2	112	-0.4	4.3	9.2	-6.2	54	3.7
India	6.50	7.4	4.0	7.17	1.0	7.20	0.5	-1.2	2.0	-5.3	N.A.	N.A.	7.2	10.6	-6.8	70	6.1
Taiwan	1.88	1.9	5.0	0.00	N.A.	1.18	1.1	-1.9	-4.1	-11.9	N.A.	N.A.	0.3	5.9	-4.7	35	1.4
S Africa	8.25	5.4	3.0-6.0	N.A.	N.A.	11.93	2.7	-1.3	0.0	7.0	265	0.6	24.6	11.2	0.2	53	0.2
Korea	3.50	2.3	2.0	3.78	2.2	3.96	2.3	-6.1	-9.8	-9.4	34	-0.3	-1.4	2.8	1.7	40	0.9

Zscore is number of standard deviations from the 7.5-year average (numbers <-1, >1 highlighted). All figures % unless stated otherwise.

CURRENCIES

Skylar Montgomery Koning

- A turn from the Fed is needed for sustainable dollar depreciation; the yen is the favoured long when that turn comes, but we aren't there yet
- Inflation below target and a dovish ECB turn means there is no more hawkish SNB impulse - recent CHF strength => room for depreciation; we move to -1

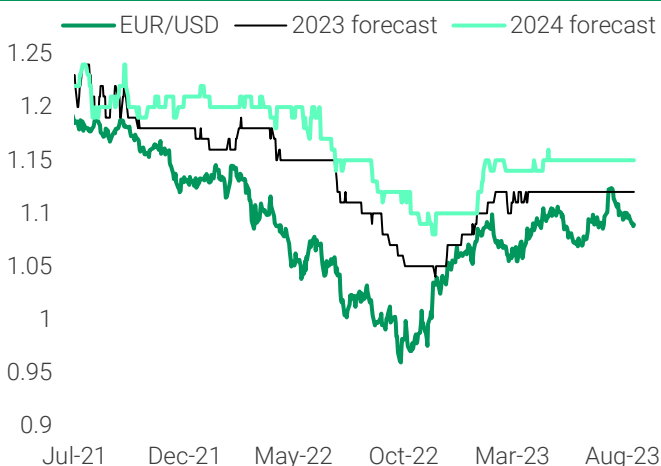
It's hard being a dollar bear

Consensus is overwhelmingly bearish the dollar. USD is forecast to fall 5.5% vs the euro, 14% vs the yen and 2% vs the pound to the end of 2024. This is also reflected in positioning, where real money and leveraged funds are net short dollars on an absolute basis but also relative to the past year. But as the dollar has the highest policy rate in DM and thus the best carry, shorts are expensive and under pressure, with DXY bouncing 4% from its trough amid mounting near-term dollar tailwinds.

China weakness is supporting the dollar. Historically, a rebounding Chinese economy is how we have reached the middle of the dollar smile, but right now China is working against the benign global backdrop that has been supported by a remarkably strong US economy. China's disappointing rebound is now feeding negatively into global sentiment and growth, as well as feeding into dollar strength. Authorities in Beijing have been pushing back – and will continue to push back – against one-way depreciation bets on CNY, but the downward direction of travel is clear. Slower growth, limited stimulus, trade decline and capital outflows all point to further CNY weakness this quarter. We maintain our CNY allocation at -1.

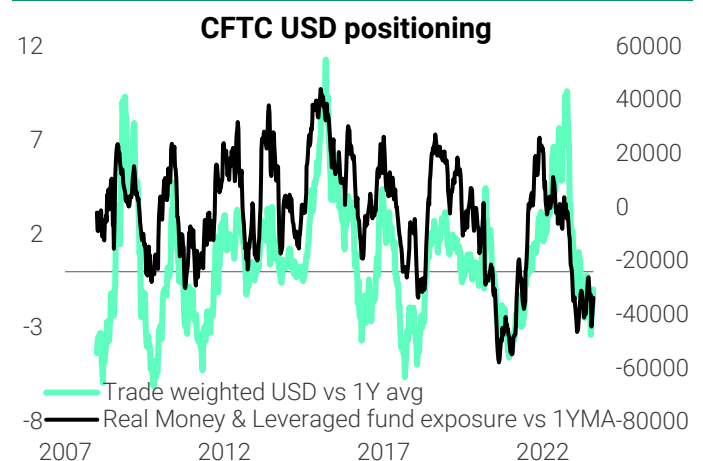
US exceptionalism points to the RHS of the dollar smile... The slowdown in China has fed into weakness in developed markets, with European growth, in particular, under pressure over the past few months. While the European economic surprise index (ESI) has rapidly fallen, the US ESI surged to a two-year high, meaning the differential (EU-US ESI) heavily favours dollar strength (see left-hand-side chart on next page). The differential is now bottoming as the EU ESI rebounds;

Consensus consistently forecasts dollar downside



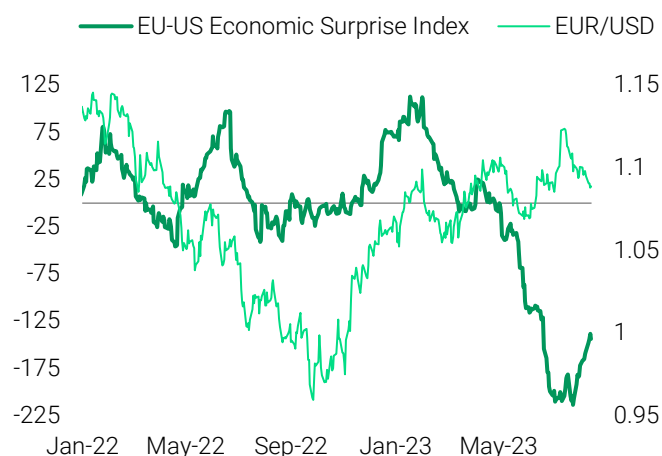
Sources: TS Lombard, Bloomberg.

Dollar positioning is net short



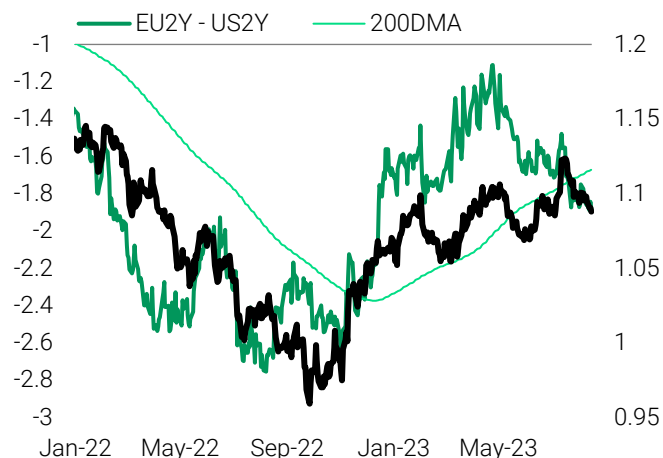
Sources: GlobalData TS Lombard, Bloomberg.

US exceptionalism is back...



Sources: GlobalData TS Lombard, Bloomberg.

...as the ECB has turned dovish



Sources: GlobalData TS Lombard, Bloomberg.

but for FX directionality, it matters whether the differential is above or below zero – and there is still a way to go to positive territory. The mean-reverting nature of the ESI, combined with the stabilization we forecast in China in the fourth quarter, means we'll get there eventually, but we're not there yet.

...a key feature of the right-hand side of the smile is Fed tightening. The dollar outperforms in the right-hand side of the dollar smile because economic outperformance allows the Fed to tighten – and more than the rest of DM. Rate differentials have moved to favour the dollar (see chart above right), as a perfect bearish storm puts upwards pressure on US yields. But they have also done so as the ECB has made a dovish turn. From here, though, the upside for yields looks limited (see the Fixed Income section for more) and the Fed's tightening cycle is over. This means disinflation is a headwind for the dollar as it allows the Fed to cut.

The key to sustained dollar weakness is a turn from the Fed. Of the majors, the US has made the most progress on inflation and thus is expected to cut first, regardless of whether there is a recession. But a mild recession would speed up the cuts, while not materially changing the international growth outlook. With regard to EUR/USD, while the ECB may be at the end of its tightening cycle, the fear of second-round effects, compounded by the bank's backward-looking nature, means it is maintaining an overtightening bias and will keep policy at terminal as long as possible. This points to a short period of policy divergence that should support EUR/USD, especially as China bottoms.

But the real strength should come from the low-yielding, undervalued, underinvested currencies that have been continually under pressure from Fed tightening. Currency depreciation vs the dollar in 2022 created a toxic circle of currency depreciation and inflation that forced central bank hawkishness. However, this hawkishness came at the expense of growth; and still being behind the Fed meant these currencies did not become attractive vs the dollar. A turn from the Fed would significantly lessen the pressure on these central banks and their currencies. This is especially true for the yen, not only because it has a high correlation to US interest rates but also because a dovish Fed and the corresponding economic backdrop provides an opportunity for the BoJ to normalize policy.

BoJ has provided only short-lived support for the yen. The BoJ has been able to provide temporary support for the yen this year, but that support has consistently proved temporary because policy normalization is extremely gradual. The bank has widened the trading range for

the 10y JGB to +/-100bp. But, as it has continued buying JGBs in the past week, it has indicated that any yield rise will be gradual – as will any further policy moves. And this has been confirmed by the bank's below-target inflation forecasts for 2024 and 2025. The BoJ does not want to inject volatility into the JGB market; waiting until pressure on DM yields is downward to tighten policy lessens the risk of a spike higher in artificially suppressed JGB yields.

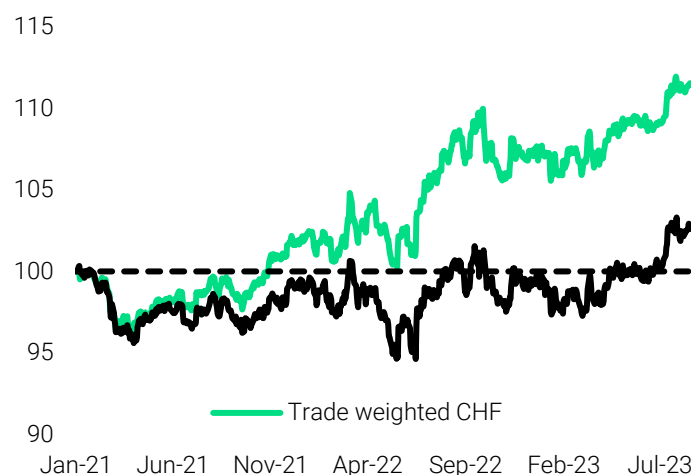
JPY is the favoured long when the Fed turns, as it will rise in response to Fed cuts – regardless of whether those cuts are motivated by a gradual normalization accompanied by a soft landing or a hard landing and safe-haven bid. Moreover, Fed cuts change the calculus for Japanese holders of USTs, as they imply lower UST vs JGB yields, decrease unrealized losses and put upward pressure on the yen (i.e., subjects unhedged positions to pressure). Thus, Japanese investors returning home will likely exacerbate dollar weakness. The extreme downside we have seen since the Fed tightening cycle began means the yen is historically cheap. Moreover, we expect BoJ policy normalization to be in sharp contrast with dovishness in DM. But, once again, we're not there yet.

Summer holding pattern. In the short term, the US outperforming economically and the next FOMC a month away means that there is no obvious catalyst for the market to move to price in more aggressive cuts. Moreover, risk should continue to be supported by disinflation. This likely means a return to the carry trade and pressure on the low yielders.

We downgrade CHF to -1 from 0. Despite the relative low policy rate in Switzerland (1.75%), amid the pressure experienced by the other low yielders, the Swiss Franc has been the second best G10 currency this year. This can be attributed to the SNB managing the currency to keep real trade-weighted CHF stable to prevent imported inflation. And this approach has been successful: headline CPI has been below the bank's 2% target for the past two months. From here, inflation is expected to reaccelerate modestly but be domestically driven. At the same time the economy has been slowing with a negative ESI. That means we will get the preannounced hike from the SNB in September. But it seems unlikely there will be another hawkish impulse, especially as the ECB has turned dovish. Additionally, there is room for CHF to the downside, as its recent strength has gone beyond levels consistent with stability (see chart below left).

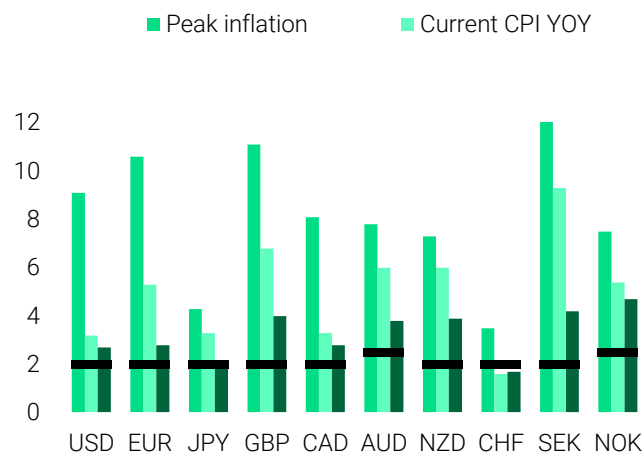
We upgrade MXN to +1 from 0. High real interest rates and a favourable inflation outlook support the peso.

Room for CHF depreciation



Sources: GlobalData TS Lombard, Bloomberg.

Switzerland - the only DM with below-target inflation



Currencies Scoreboard

(Scoreboard primer)

FX RANK		Momentum		Carry	Surprise Index		Valuation		Positioning		NTM GDP f/c	CA
		direction	accel.	3m chg	level	1m chg	REER level	1y chg	level	1m chg	3m chg	1y chg
1	GBP											
2	CHF											
3	JPY											
4	SEK											
5	EUR											
6	NOK											
7	NZD											
8	USD											
9	CAD											
10	AUD											

As of 17-Aug-23

Currencies dashboard

FX	spot	12m		Spot chg		REER chg			Policy			Inflation		CA %GDP		ToT		Money grth		Budg.		Debt	GDP
		fwd		ytd	y-y	ytd	y-y	ZScr	Rate	Rate	Target	Last	ZScr	Last	ZScr	Narrow	Broad	%GDP	%GDP	%GDP	%GDP	y-y	y-y
USD	103.27	—	-0.25	-3.10	0.8	0.5	1.3	5.50	3.2	2.0	-3.4	-1.2	-12.4	0.1	22.9	-3.6	-8.4	82	2.6				
EUR	1.089	1.109	1.77	7.01	4.6	9.9	1.0	4.25	5.3	<2.0	-0.2	-1.9	-8.2	-0.2	-8.0	0.6	-3.6	91	0.6				
JPY	145.9	137.6	-10.10	-7.40	-7.0	-5.0	-2.1	0.10	3.3	2.0	2.2	-1.8	-29.6	-0.3	-1.3	2.4	-4.3	236	2.0				
GBP	1.276	1.271	5.6	5.9	8.7	7.5	2.6	5.25	6.8	2.0	-2.1	1.2	5.7	-0.8	—	0.1	-2.3	87	0.4				
CAD	1.350	1.346	0.38	-4.37	2.2	-4.4	0.2	5.00	3.3	1.0-3.0	-0.7	1.1	14.2	0.9	-7.7	5.5	-0.5	90	3.1				
AUD	0.644	0.650	-5.53	-7.18	-0.9	-3.3	0.2	4.10	6.0	2.0-3.0	1.4	0.7	37.1	0.4	-3.0	4.3	-2.7	42	2.3				
CHF	0.877	0.844	5.38	8.51	4.7	3.1	2.0	-0.75	1.6	<2.0	9.6	1.4	-9.8	-1.0	-23.9	-1.2	0.4	43	0.6				
SEK	10.892	10.737	-4.3	-4.66	-3.4	-3.2	-1.3	3.75	9.3	2.0	4.8	0.3	-8.5	-1.0	-6.1	-4.0	0.7	41	0.8				
NOK	10.554	10.481	-7.11	-7.98	-3.6	-7.8	-0.9	3.75	5.4	2.5	28.4	2.1	86.4	0.6	-1.5	-2.0	16.2	37	-2.9				
SGD	1.358	1.334	-1.35	1.73	3.3	6.5	2.9	N.A.	4.5	—	18.1	0.6	-8.5	-0.7	-8.5	3.2	8.6	111	0.5				
CNY	7.283	7.091	-5.28	-6.89	-6.8	-10.4	-2.1	4.35	-0.3	3.5	2.2	1.0	-24.3	-0.5	9.9	10.7	-4.7	48	6.3				
BRL	4.992	5.201	5.78	3.13	11.2	7.7	-0.1	13.25	4.0	2.5-6.5	-2.7	-0.4	9.7	0.9	-1.0	10.4	-6.4	84	4.0				
INR	83.15	84.47	-0.50	-4.45	4.6	-0.3	0.3	6.50	-1.4	2.0-6.0	-2.0	-0.9	-38.1	-0.1	7.2	10.6	-6.8	70	4.7				
ZAR	19.04	19.69	-10.53	-12.57	-8.5	-12.6	-0.7	8.25	5.4	3.0-6.0	-1.3	-0.1	18.3	0.0	24.6	11.2	0.2	53	0.2				
MXN	17.09	18.23	14.1	16.9	16.2	20.0	3.3	11.25	4.8	3.5	-1.3	-0.4	9.9	-0.4	4.3	9.2	-6.2	54	3.7				
KRW	1342	1311	-5.69	-2.34	-2.4	1.3	-0.5	3.50	2.3	2.0	0.6	-2.4	-30.9	-0.4	-1.4	2.8	1.7	40	0.9				
TWD	31.98	30.82	-3.94	-6.21	0.6	-3.0	-0.2	1.88	1.9	—	12.1	-0.7	-16.7	-0.6	0.3	5.9	-4.7	35	1.5				
HKD	7.828	7.774	-0.34	0.20	4.0	4.7	1.0	5.75	1.9	—	8.9	0.7	0.2	0.2	-21.7	-0.1	N.A.	N.A.	N.A.				
PHP	56.78	57.12	-1.84	-1.58	2.1	3.6	1.2	6.25	4.7	3.0-5.0	-4.4	-1.4	-17.0	-0.5	17.7	23.7	-2.0	38	4.3				
PLN	4.105	4.159	6.57	12.49	11.5	17.2	3.4	6.75	10.8	1.5-3.5	3.2	1.7	-6.5	-0.3	-0.8	7.9	-3.7	51	-0.5				
CZK	22.10	22.17	2.11	9.05	7.1	9.5	2.4	7.00	8.8	1.0-3.0	-5.1	-1.8	-8.8	-0.2	12.3	9.4	-3.6	35	-0.6				
HUF	353.6	369.7	5.59	12.13	8.5	20.7	1.5	13.00	17.6	3.0	-7.1	-1.7	-5.4	-0.1	101.8	-1.3	-6.2	70	-2.4				
TRY	27.101	35.650	-31.0	-33.8	-16.0	-12.8	-1.6	17.50	47.8	5.0	-5.7	-1.3	-23.0	-0.7	N.A.	N.A.	1.5	29	3.1				
IDR	15283	15474	1.86	-3.37	6.0	1.0	0.3	5.75	3.1	3.5-5.5	1.2	1.7	-3.9	0.0	5.4	6.1	-1.8	29	5.2				
THB	35.44	34.35	-2.36	-0.07	-0.4	1.0	0.0	2.25	0.4	0.5-3.0	-2.4	-1.4	-21.2	-0.1	3.6	1.8	0.3	42	2.7				
MYR	4.654	4.549	-5.38	-4.02	-2.2	-1.6	-1.4	3.00	2.4	—	2.8	-0.2	-6.8	-0.4	-0.6	3.6	-4.4	54	5.6				
CLP	869.4	885.3	-2.10	1.31	2.8	8.4	0.1	10.25	6.5	2.0-4.0	-6.3	-0.6	38.1	1.1	-16.1	4.7	-0.3	24	-0.6				
COP	4132	4486	17.44	2.80	24.5	11.0	0.1	13.25	11.8	2.0-4.0	-6.7	-1.6	59.5	0.9	N.A.	N.A.	-5.4	49	0.3				

ZScr is the number of standard deviations from the 7.5-year avg (numbers below/above -1/1 highlighted). All figures % unless stated otherwise.

REAL ESTATE

Andrew Lawrence

- Global real-estate total returns were +1.6% in 1H23, supported by a shift in consensus towards a soft landing for the global economy
- At the regional level, North America outperformed Asia and Europe thanks to its economic resilience
- Data centres proved the best-performing sector in 1H23 as part of the broader equity market interest in the impact of artificial intelligence

The FTSE EPRA/NAREIT Global Developed Total Return Index recorded a rise of 1.6% in 1H23, helped by a positive performance from North America in the second quarter. First-half performance was held back by lingering US banking sector concerns, a rise in real bond yields as inflation proved stickier than anticipated across the world and the on-going slowdown in the Chinese economy.

On a global basis, the data centre sector recorded a strong 1H23 performance (+19.4%), followed by single-family rental properties (+17.7%) and manufactured homes (+10.2%) as investors sought value in 2022's most sold-off sectors. At the other end of the performance scale, traditional core office sectors were once again lower: the office sector was down (-9.1%) in the first half of the year, as were mall returns (-3%).

Following their 24.8% decline in 2022, North American stocks rebounded by 5.3% in 1H2023, making the Americas the best-performing region in 1H23. Real estate stocks were up 5.3% in the first half of the year in US and up 4% in Canada. However, they failed to keep pace with the rise in the general equity markets owing to concerns about higher interest rates and negative sentiment towards the office sector, in particular.

In the second quarter, office and data centres outperformed on the back of transaction announcements and growing optimism that AI would lead to better earnings for data centre landlords. At the same time, strong leasing trends supported positive performance from apartments and the single-family rental sector. The self-storage and manufactured housing sectors lagged owing to interest rate concerns and following their strong performance in the first quarter.

Europe was the worst-performing region in 2022 (-40.4%) and the worst-performing region in 1H2023 (-5.4%). The FTSE EPRA/NAREIT Developed Europe ex-UK Index fell 6.7% and the FTSE EPRA/NAREIT UK was down 3% for the first half of the year. Continental Europe underperformed in the first quarter (-4.9%), while the UK underperformed more materially in the second quarter (-4.2%). In Continental Europe, economic data surprised to the downside, while the BoE was forced to further raise interest rates to try to regain some control over an inflation rate that was the highest in the G7.

In second quarter, Continental European total returns were helped by positive news of asset sales by leveraged German residential stocks. The weaker performers were largely in the UK. Self-storage stocks were dragged down by rising mortgage rates and concerns about a material housing market downturn, while London office developers were impacted by slowing demand and the rising cost of capital.

While APAC was the most resilient regional performer in 2022 (-11%), the region's returns were only marginally better than Europe's in 1H2023. Total returns for Asia fell 4.7% over the first half of the year, while total returns for 2Q23 were the worst of all three regions (-3.2%). Hong Kong was the worst-performing region globally in 2Q23, with total returns of -10.8%. Negative total returns were recorded by Japan (-4%) and Australia (-3.6), while Singapore managed to produce only a small positive return (+0.5%).

Hong Kong's disappointing performance was largely a result of the slowdown in Chinese economic growth, the collapse in property sales and continued geopolitical tensions. Singapore developer returns were impacted by the government's introduction of cooling measures, including an increased stamp duty levied on foreign purchases of residential properties. Within Japanese property stocks, the large developers were the best performers, helped by a weaker Yen – the currency tends to be correlated with higher inflation expectations.

As central banks prepare for the last rate hikes expected for this tightening cycle and because monetary tightening has not caused the collateral damage that many investors anticipated, the consensus among investors has shifted towards a "soft landing" for the global economy. This shift has helped the property sector find a footing. But investor concerns will now likely turn towards the potential for a greater softening in demand than currently expected. Those regions and sectors that are able to demonstrate resilient demand and a lack of oversupply of new property will likely outperform in 2H23

Chart 1: FTSE EPRA Nareit – Global TR



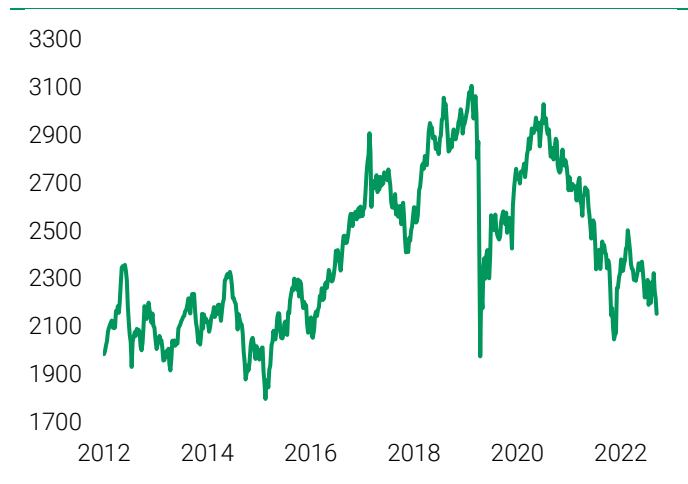
Source: Bloomberg.

Chart 2: FTSE EPRA Nareit – Europe TR



Source: Bloomberg.

Chart 3: FTSE EPRA Nareit – Asia Pacific TR



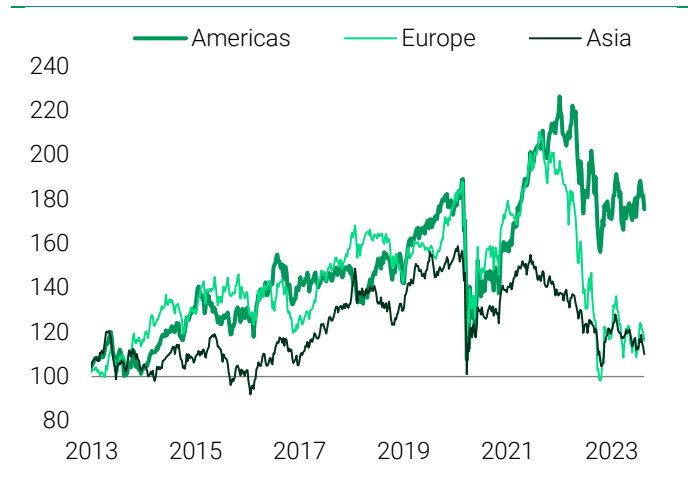
Source: Bloomberg.

Chart 4: FTSE EPRA Nareit – Americas TR



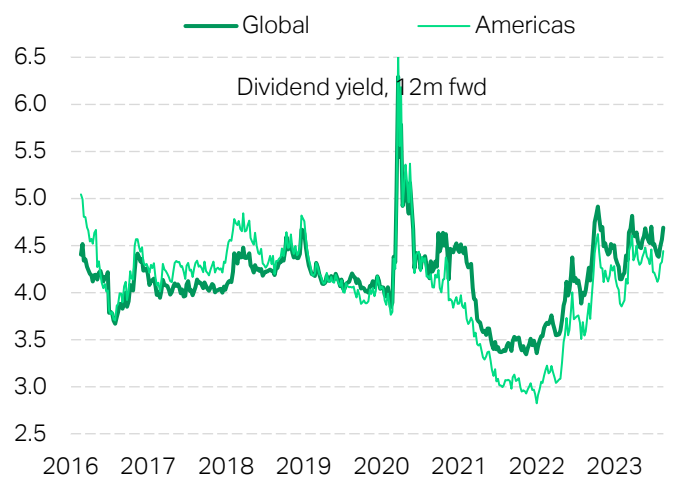
Source: Bloomberg.

Chart 5: FTSE EPRA Nareit – Rebased TR

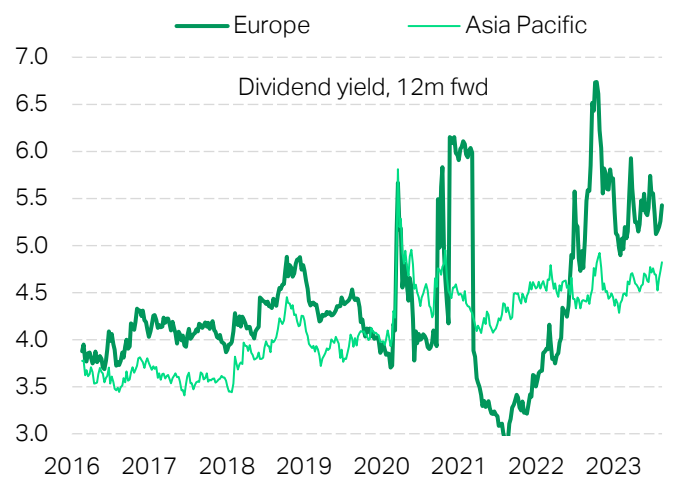


Source: Bloomberg.

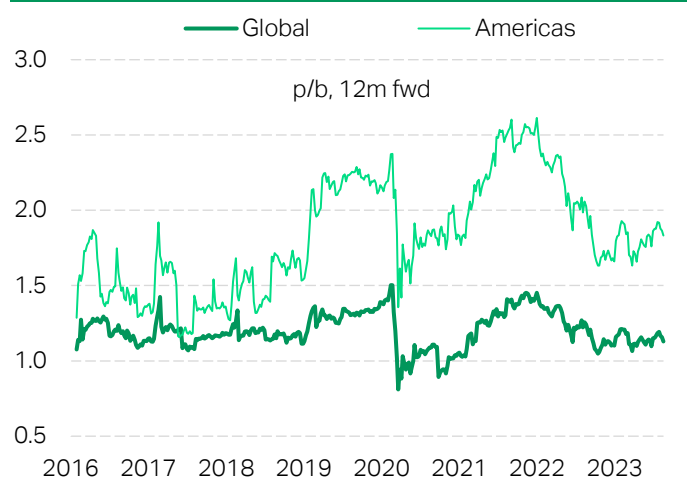
Dividend yield: Global and Americas



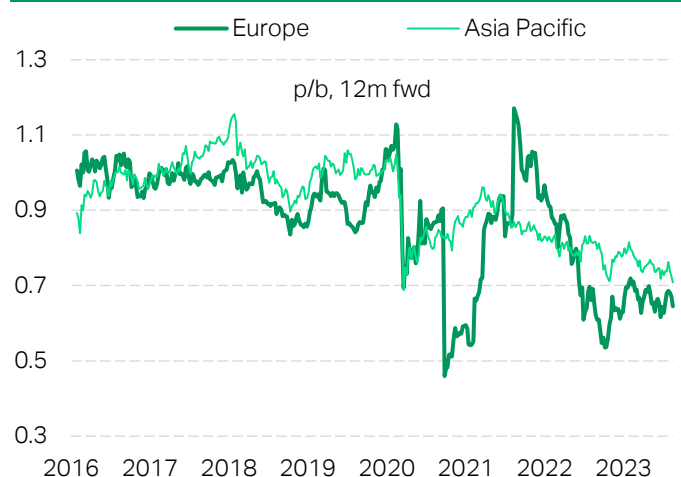
Dividend yield: Europe and Asia Pacific



Price-to-book: Global and Americas



Price-to-book: Europe and Asia Pacific



Real Estate Dashboard

	MktCap		Total return (US\$)			P/E (x)			P/B (x)			RoE			EPS growth		Dividend yield		
	Mem.	(US\$)	1m	ytd	2022	Trail.	Fwd	ZScr	Trail.	Fwd	ZScr	Trail.	Fwd	ZScr	Fwd	3m	Trail.	Fwd	ZScr
Global	498	2,015	-5.4	-1.1	-23.6	26.0	20.6	-0.4	1.1	1.1	-0.1	2.3	3.5	-1.1	-33.7	-4.4	4.4	4.6	1.4
America	151	1,043	-5.8	2.5	-24.4	36.4	32.1	-0.8	1.8	1.8	0.2	5.9	5.7	0.8	-54.4	-2.0	4.2	4.4	0.5
Europe	115	252	-2.8	-1.5	-40.2	20.3	14.4	-1.4	0.6	0.6	-1.1	-1.4	-4.0	-2.1	N.A.	-3.1	4.5	5.4	2.0
Asia Pacific	197	664	-5.6	-8.9	-12.4	16.9	13.9	0.7	0.7	0.7	-1.9	4.4	5.1	-2.2	6.8	-7.7	4.6	4.8	1.8

ZScr is the number of standard deviations from the 7.5-year avg (numbers below -1 and above 1 highlighted). All figures % unless stated otherwise. P/e, p/b, RoE and DY StDev from 7.5y average are on 12m forward measures. EPS growth is forward / trailing. EPS 3m growth is on forward earnings.

MACRO OUTLOOK

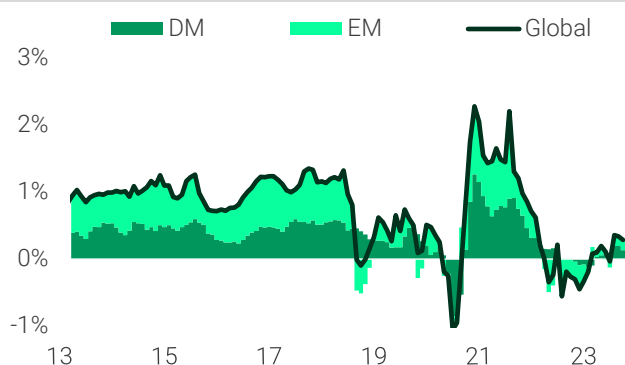
Global Team

- Just as this DM rate-hiking cycle enters the last mile, so the positive impulse for consumption emanating from the easing of supply-side pressures is starting to wane.
- Inflation has further to fall, but the current phase of "benign disinflation" is giving way to a period in which slowing demand will play an increasingly important role.
- If the loss in momentum currently implied by the PMIs persists as Chinese activity continues to disappoint and falling inflation erodes pricing power, the hurdle for sustaining this equity market uptrend is shifting higher

Read more in the latest Global Macro Monthly

Global macro at-a-glance

TSL Global leading indicator



TSL Global growth forecasts

	2023	2024
US	1.0	2.5
China	5.7	4.9
EA	0.6	0.8

Bold indicates changes from last month

Recession pendulum will keep swinging

- The probability of a US economic resurgence is low. If there is no recession between now and October, the Fed will work harder to create one by yearend.
- China's recovery is "L-shaped" from here. Property stimulus and the chunk of the economy tied to real estate are likely to disappoint, resulting in a weak rebound that reinforces the cyclical stagnation in Europe.
- Souring services momentum suggests resilience in UK private spending is fraying while the BoE signals that this rate-hiking cycle is getting long in the tooth.
- Improving labour market dynamics coupled with a loose policy mix cast a positive light on the Japanese economy.

Major risks

- Central banks continue to be whipsawed into aggressive monetary tightening, amplifying the volatility of this fake cycle and raising the risk of a global recession.
- For equity investors, the most dangerous point lies in the period where true recessionary dynamics take hold, but policymakers have not yet switched their focus away from inflation.
- Financial market dislocation and/or sharp deterioration of labour market conditions trigger an abrupt policy U-turn from central banks.

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