Allianz Global Investors

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Capital Markets Monthly

Gauging sentiment

If sentiment among single-stock analysts is anything to go by, a clear trend is emerging. The **US economy** will not manage any landing at all, hard or soft. Analysts are not convinced that **China's** economy will be able to maintain stable growth. Following a sustained phase of improving sentiment between the second quarter of 2023 and the first quarter of this year, optimism recently took a turn for the worse. Despite this, the overall picture remains positive. This is not true for **Germany**, though, where future prospects have meanwhile deteriorated; and analysts' expectations do not suggest a turnaround is in sight. That is at least what an evaluation of more than 54,000 quotes of analysts from leading global business media over the last couple of months by the media research institute Media Tenor would indicate.
Bank of America's most recent monthly Global Fund Manager Survey (as of mid-June 2024) paints quite a different picture, with 64% of fund managers expecting a "soft" landing - a significant increase on May's survey. As many as 26% anticipate a "no landing" scenario with slightly slower growth.
It is important to bear in mind that current sentiment is not a leading indicator for a future trend. Most importantly, what it does show is how there may be discrepancies between the bottom-up approach taken by corporate analysts and the top-down, macroeconomic view. Fund managers executing their strategies are caught in the middle. Gauging the prevailing sentiment should be one of many instruments in deciding how to proceed.

Sentiment Gauge 1: The macroeconomic picture.
To some extent, analysts' sentiment is at odds with macroeconomic trends. What will be interesting to see is whether sentiment among analysts in respect of the United States will pre-empt cyclical developments there. In fact, a very broad set of macroeconomic data analysed by Allianz Global Investors points to a "soft landing" scenario, which is often associated with the Goldilocks principle: the economy converges onto a path in line with its growth potential while neither overheating nor undercooling, resulting in no inflationary pressure. In the meantime, the market has got used to the prospect of only one interest rate cut by the US central bank, the Federal Reserve; but it may be quickly disappointed if inflation fails to come down. That would be consistent with sentiment in the media associated with a "no landing" scenario, for which the price would presumably be the absence of any interest rate cuts, or even a hike instead.
In **Germany**, a sharply and noticeably deteriorating economic "climate of opinion" (Nölle-Neumann) is reflected in the current economic environment there. The bounce in the ifo Business Climate Index, for instance, proved to be short lived.
Turning our attention to **China**, it remains uncertain as to whether the recent inflows of foreign capital was nothing more than a flash in the pan - as the mood among analysts would suggest - or whether measures taken by the Chinese government to stabilise the real estate market are reversing negative sentiment in the country.

Dr Hans-Jörg Naumer
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Publications

→ France elections and markets
Markets are putting a price on the political volatility in France – which may rein in the incoming government.

→ Fixed Income Forward
Much has happened in fixed income since the start of the year. But greater differentiation in bond markets has been slow in coming.

→ Laying the foundations for green construction
Targeting zero emissions from EU building stock by 2050 is the bold ambition of a new directive. Achievable? Or will it hit a brick wall?

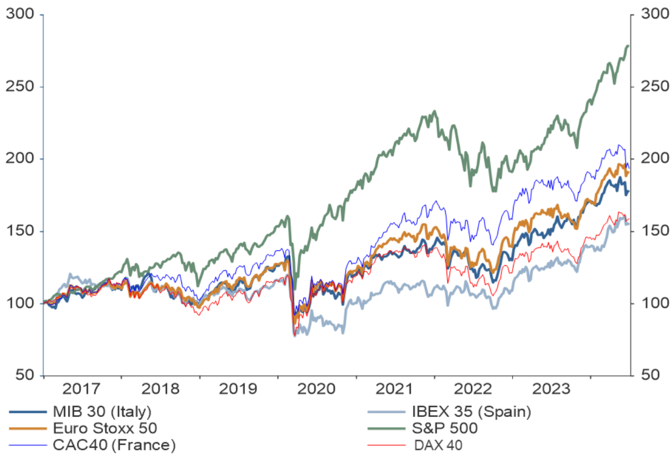
Sentiment Gauge 2: Sovereign debt is back on the agenda.
On balance, the election manifestos of both Republicans and Democrats in the **United States** contain substantial additional spending commitments. In particular, Donald Trump's presidential campaign appears to have scant regard for spelling out how tax cuts will be funded.
In **France**, the process of forming a government will begin following the second round of elections to the National Assembly. The anticipated shift in political blocs already had an impact on bonds, equities (see chart) and the euro during the run-up to the first round of voting. A growing propensity for greater public spending is also emerging in France, which is suffering from a worsening fiscal squeeze. Should the Rassemblement National be successful in pushing through its planned spending increases and tax exemptions in full, the Institut Montaigne has projected that the country's annual budget deficit would rise by an additional 3.5% of gross domestic product. Higher borrowing costs as spreads on French government bonds versus German bunds increase may have a disciplining effect. The risk premium is a warning sign and the longer it remains high, the more expensive it will become. It is worth noting that, although the **European Central Bank** (ECB) holds 21% of outstanding French government bonds in the wake of its voluminous asset purchase programmes, the proportion of non-French bondholders has not decreased in recent years; in fact, it has stagnated at around 50%.

Sentiment Gauge 3: Markets' risk-bearing capacity.
As evidenced by a wide variety of market risk indicators, the level of complacency is high. Higher spreads on French debt, which have also implicitly spilled over to Italian and Spanish bonds, appear to be very much an outlier. Credit default premiums are stable; there is no sign of any financial distress. On the contrary: The "Composite Systemic Stress Index" (CISS) calculated by the ECB has continued to fall for eurozone countries and seems to have almost brushed off the French elections. Our "weightlessness indicator" measured for the United States, which determines the price/earnings ratio for the S&P 500 in relation to the volatility index VIX as a proxy for risk, has risen to dizzying heights. With one eye to geopolitics, sentiment gauges cannot be ruled out – especially in a situation like this.

This would suggest the **following tactical allocation for equities and bonds**:

- Equities should benefit from the expectation of markets that central bank rates will fall at the same time as growth remains positive.
- US equities point to higher valuations at index level, reflecting an anticipated "soft landing". Overall, euro area equities appear to have a neutral valuation, while those in the United Kingdom and emerging markets would seem to be priced attractively.
- Given political uncertainty in France and Europe, international investors would be wise to favour the US dollar. This is regarded as a "safe haven" and should continue to benefit from a positive interest rate differential against the euro.
- It is likely that we are at the beginning of an interest rate cutting cycle, which a number of central banks, including the ECB, have already (cautiously) embarked upon. Over the last seven months, there have been more policy rate cuts than hikes worldwide.
- The interest rate cutting cycle suggests that yield curves in the euro area will normalise/steepen.
- In the course of this, higher breakeven yields than we have seen over the past ten years should gradually take hold.

Equity markets (rebased 01/01/2017 = 100, total return)



Source: LSEG Datastream, AllianzGI Global Capital Markets & Thematic Research 01.07.2024

Past performance, or any prediction, projection or forecast, is not indicative of future performance.

UPCOMING POLITICAL EVENTS 2024

07 July	FR	National Assembly
09 July	NATO	NATO Summit
15 July	US	Republican National Convention
18 July	EC	ECB Governing Council meeting
24 July	CA	Bank of Canada meeting

→ Overview political events 2024 (click here)

Investment topic:
Never put all your eggs in one basket

- Equity markets have had a good run of it. Growth is proving to be resilient. Both the Fed and the ECB's monetary policies are little cause for disruption; indeed, the outlook for (further) cuts in interest rates will tend to act in their favour.
- Despite this, a legitimate question remains: Is this going to change? If nothing else, it is likely that geopolitics will be a constant source of surprise.
- While equities are likely to remain an indispensable factor in accumulating private wealth, an old adage is gaining new-found relevance: "Never put all your eggs in one basket". Spreading assets across a range of investment opportunities ("multi asset") enhances diversification and stabilises the portfolio.
- An interesting point here is that, following the reversal of central banks' expansionary monetary policy, which had fuelled both equities and bonds, the correlation between these two major asset classes has normalised again. It would appear that the previous phase in which they were in lockstep with one another has come to an end.
- As a result, there should be nothing standing in the way of a multi asset comeback. We have entered a favourable period for investors to reassess the long-term structure of their investments based on their own risk appetite and return expectations.
- It is worth the effort since, once you have established a strategy, you can commit to it and, like Odysseus, sail around any potential storms on the capital markets.

Hoping that your sentiment is positive

Dr Hans-Jörg Naumer

Market overview as of 01.07.2024

Equity Indices		
DAX		18.291
Euro Stoxx 50		4.930
S&P 500		5.475
Nasdaq		17.879
Nikkei 225		39.631
Interest Rates %		
USA	3 Months	5,59
	2 Years	4,77
	10 Years	4,37
Euroland	3 Months	3,71
	2 Years	2,99
	10 Years	2,46
Japan	3 Months	0,31
	2 Years	0,33
	10 Years	1,03
FX		
USD/EUR		1,075
Raw Materials		
Oil (Brent, USD/Barrel)		86,2

Calendar Week 28

Monday			Consensus	Previous
EC	Sentix Investor Confidence	Jul	--	0.3
GE	Exports SA MoM	May	--	1.60%
GE	Imports SA MoM	May	--	2.00%
JN	Labor Cash Earnings YoY	May	2.10%	2.10%
JN	BoP Current Account Balance	May	¥2273.4b	¥2050.5b
JN	Trade Balance BoP Basis	May	-¥1056.0b	-¥661.5b
US	Consumer Credit	May	--	$6.403b
Tuesday				
JN	Money Stock M3 YoY	Jun	--	1.30%
JN	Money Stock M2 YoY	Jun	--	1.90%
JN	Machine Tool Orders YoY	Jun P	--	4.20%
Wednesday				
CH	PPI YoY	Jun	--	-1.40%
CH	CPI YoY	Jun	--	0.30%
JN	PPI YoY	Jun	--	2.40%
Thursday				
JN	Core Machine Orders YoY	May	--	0.70%
UK	Industrial Production YoY	May	--	-0.40%
UK	Manufacturing Production YoY	May	--	0.40%
UK	Construction Output YoY	May	--	-3.30%
UK	Trade Balance GBP/Mn	May	--	-£6750m
US	CPI YoY	Jun	--	3.30%
US	CPI Ex Food and Energy YoY	Jun	--	3.40%
US	Real Avg Weekly Earnings YoY	Jun	--	0.50%
US	Initial Jobless Claims	Jul 06	--	--
US	Continuing Claims	Jun 29	--	--
Friday				
CH	Exports YoY	Jun	--	7.60%
CH	Imports YoY	Jun	--	1.80%
CH	Trade Balance	Jun	--	$82.62b
GE	Current Account Balance	May	--	25.9b
JN	Capacity Utilization MoM	May	--	0.30%
US	PPI YoY	Jun	--	2.20%
US	PPI Core YoY	Jun	--	2.30%
US	U. of Mich. Sentiment	Jul P	--	68.2

The calendar data for the current week comes directly from Bloomberg. They are published in the week in which "The Week Ahead" appears. These are economic data that come from official sources. Where available, the previous figure is collected together with the consensus estimate. The consensus estimate is collected by Bloomberg through a survey of analysts and economists. It is the average of all estimates submitted.