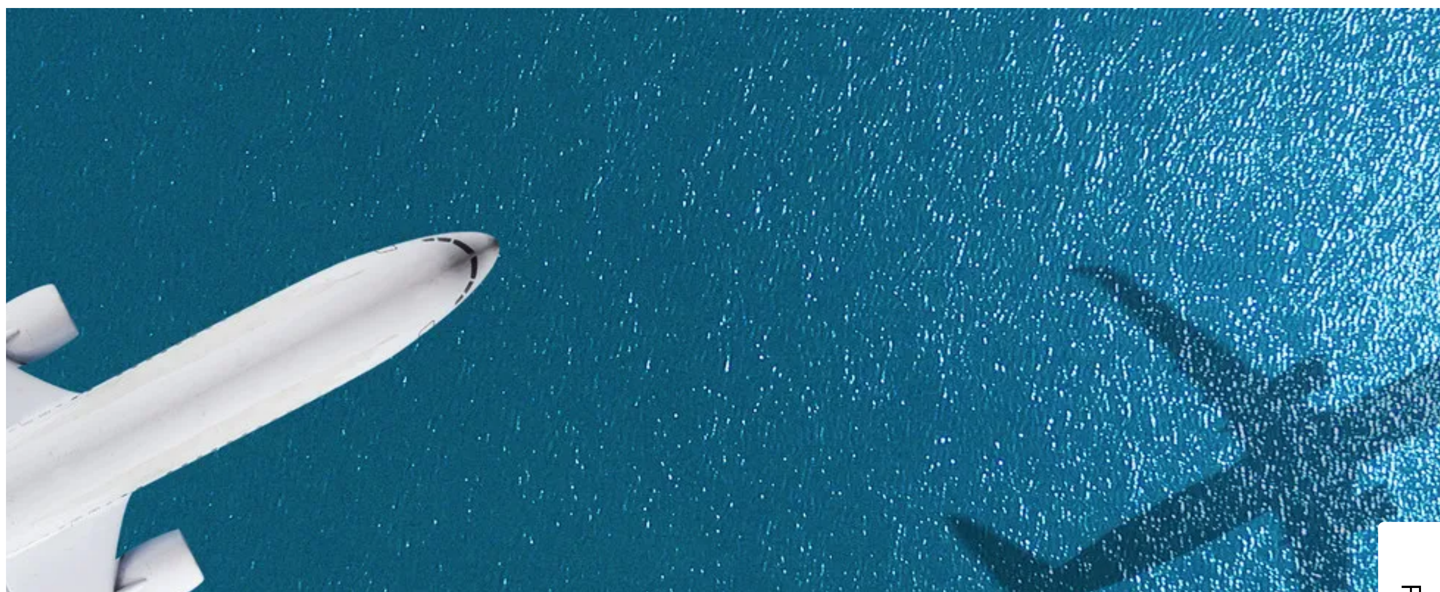

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Portfolio perspectives | Article - 7 Min

Monthly Market Viewpoint – Delayed landing

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08/05/2024 · 7 Min

After recent higher-than-expected US inflation, we see core i

In this article:

A good slowdown

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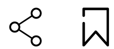
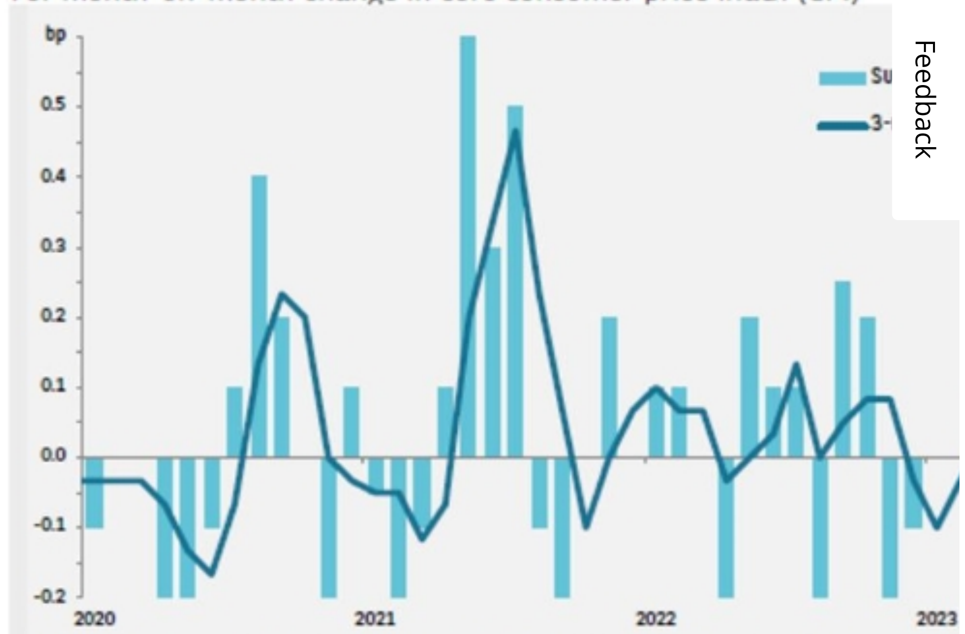


2025 and expect policy rate cuts to begin only in the fourth q
soft landing by the US economy is still likely and that growth
through 2025.

One might have thought that four years after the start of the par
have some confidence in the outlook for economic growth and ir
is not the case.

The long series of mostly upside surprises to inflation from 2020
more predictable (and falling) inflation last year, leading to a str
economic 'soft landing' in the US.

The start of 2024, however, has seen three months in a row of hi
inflation (see Exhibit 1).



Data as at 5 May 2024. Sources: FactSet, BNP Paribas Asset Management.

Given the persistence of inflation, the question then became wh
accompanied by robust growth — raising the risk of a newly ove
slower growth and a potentially stagflationary outlook.

February retail sales and March non-farm payrolls supported th
expectations for the number of times the US Federal Reserve (Fe

this year fell to close to zero. Benchmark US 10-year Treasury yi

Subsequent data, however, has pointed to unexpectedly slower g
GDP (1.6% versus 2.2% forecast), followed by purchasing manag
forecast for the Institute of Supply Management series, and leve
contraction), and finally private, non-farm payrolls, which came
adjusted) below consensus estimates.

A good slowdown

This slowdown is encouraging, insofar as inflation is unlikely to
quickly that happens, and how far the slowdown needs to go, is
Our view is that the soft landing has not been aborted, only dela
remain above the long-run trend rate of 1.8% through next year.

While monthly core inflation has been high, the year-on-year ch
consumption expenditures index (PCE), the measure favoure
and currently stands at 2.8%. The Fed's forecast for the end

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We do still anticipate the Fed will cut rates by the end of th
2025. Markets currently place around a 50% probability of a
Treasury yields have fallen back towards 4.4%.

The Fed itself seemed to endorse the view that a soft landing wa
recent press conference, Fed Chair Powell pushed back against t
need to increase policy rates, pointing out that they are already
high to do the job.

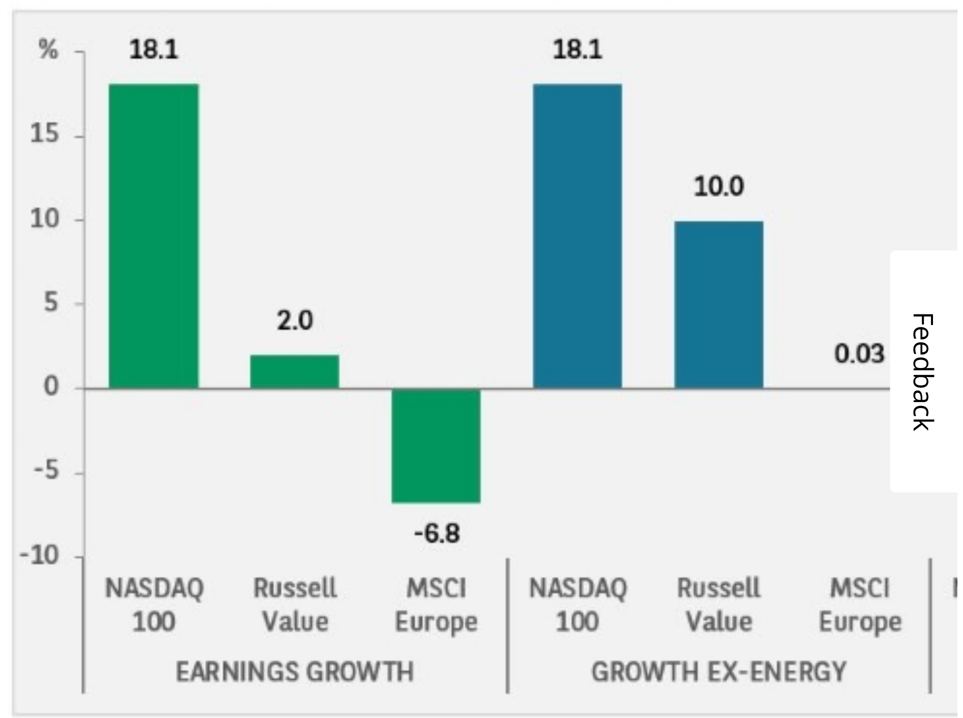
Equity market reaction

The increase in interest rates (particularly real yields) that we h
had the predictable effect of weighing on equity market prices, p
the NASDAQ 100 is 1.3% off its peak from late March (as of 7 Ma

Given the size of the increase in yields, however, one might have

in equity prices. What has sustained the market has been a good
US and European equities.

The NASDAQ 100 was expected to see a double-digit year-on-yea
the first quarter, while a decline was foreseen for the Russell Val
companies in the MSCI Europe index were also forecast to drop.
been better. Earnings surprises have been 6-9%, when a typical
3-4% higher than forecast (see Exhibit 2).



Assuming the policy rate expectations (and real yields) do not m
should remain the primary driver of equity indices. And if the slo
does not go too far, earnings should continue to rise.

China

Data for China has shown ongoing resilient growth, supported by
exports and holiday-related travel activity. These positive factor
by the drag from weak property investment. The Chinese govern

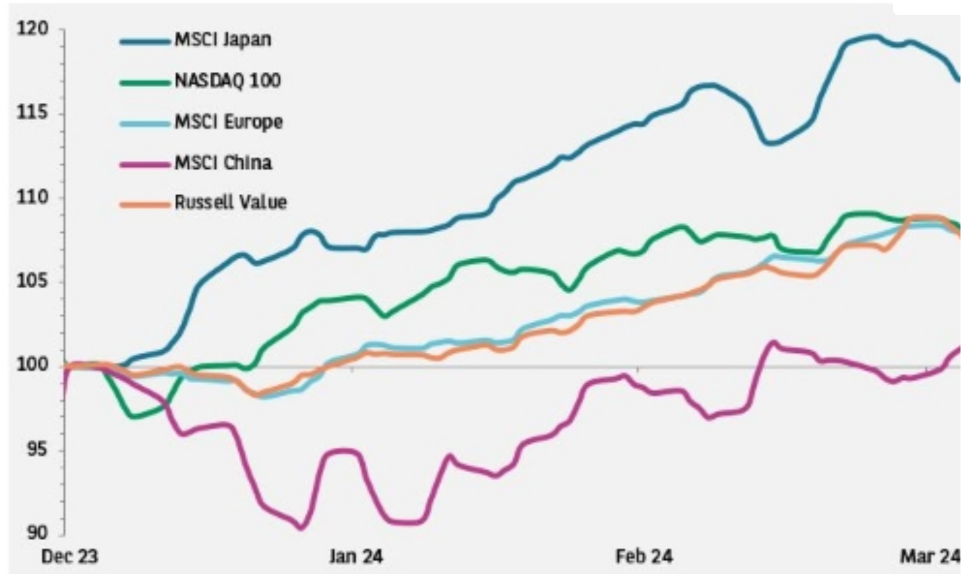
and we anticipate policy support will be stepped up in the comir
likely to be the key tool, and this may be used sooner rather thai

Already since the 'two session' conference in March, equity marl
impressive rally; the MSCI China index has outperformed global
end of March.

A recovery in valuations has been the primary driver. Prior to th
price-earnings ratio of the MSCI China index versus developed m
two standard deviations below average; it has now recovered to
scope for a further revaluation of the market.

Earnings expectations, however, have not (yet) played much of a
forward earnings per share (EPS) estimates for companies in the
changed, in contrast to those in most other major market indice
degree that foreign investor sentiment on China is beginning to
weaken further), valuations could (partially) normalise, but ever
take over as the motor for price appreciation.

Feedback



Data as at 6 May 2024. Sources: FactSet, BNP Paribas Asset Management.

Technology sector

The increase in earnings expectations for the NASDAQ 100 index
the immediate impact of increased investment in the semicondu
US CHIPS Act, spending on artificial intelligence (AI) model devel
earnings from AI as companies learn how to use the technology
reduce costs.

This increase has not been limited to the 'Magnificent 7' stocks.
expectations have risen by 18% over the last year for the index e
forecasts in our view are unlikely to continue rising at the same
there is no sign yet of a deceleration), they will nonetheless likel
parts of the market (as represented by the Russell Value index),

Alongside this positive earnings outlook, valuations are reasonab
prices have fallen slightly while earnings expectations have cont
price- earnings ratio for the NASDAQ 100 today is one of the leas
(see Exhibit 4).

Exhibit 4

Z-scores for forward price-earnings ratio

Calculated relative to each market's own history from index inception

Market	P/E	Market
United States	1.4	EM ex-China
Japan	0.9	NASDAQ
Russell Value	0.9	Emerging Marke
US Small Cap	0.8	Europe
Developed Markets	0.7	China

Data as at 8 May 2024. Sources: FactSet, IBES, Bloomberg, BNP Paribas Asset Ma

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As we have already seen this year, were inflation to again come i
and policy rate forecasts to rise, valuations and prices would fal
earnings trend should eventually reassert itself.

Asset class views

Recent changes

MULTI-ASSET

- **Going long Japanese equities**, where both fundamentals and Japan stands out as the only area where expected earnings ha has rallied, preserving a 15% forward price-earnings (P/E) and (P/B) discount to global stocks.

- Implementing a modest **tactical long to domestic China**, wh depressed and where triggers for unlocking this value – in the incipient manufacturing recovery – are increasingly present.

- **Closure of our European equity short**, where bad news may and expectations, and economic data is increasingly surprisin outlier. With a more constructive bottom-up picture following recession, we turn neutral. We also closed our relative-value t Europe – as part of this.

- **Reducing our long US TIPS exposure**: on strong rallies, a narrative shifts.

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- As a result, we are now **mildly overweight select equities** (b duration remaining our largest risk position. Risk taking rema relative to the maximum.

FIXED INCOME

- **Rate cuts are on the agenda** in 2024 in the US and within eu have tried to push back the presumption of an imminent cut i June to be the start the first round of cuts.

- Following the recent increase in rates, we increased our **expo** an overweight. We do prefer euro duration versus the US dura years segment that could benefit from this context.

- We expect the **curve to steepen** as cuts emerge at a time whe additional pressure on the long end.

- With low growth in Europe, high-yield spreads appear stretch **emerging market debts in hard currency to be more resilie**

EQUITIES

- We have a **constructive view on global equities** for 2024 unc fundamentals with:

- Earnings recovery: **earnings growth is set to resume** in 2024 double digit earnings growth in the US market. This comes aft and importantly, more sectors are seeing a pick-up in EPS gro broadening of leadership. Indeed, the post COVID years have b synchronisation between goods and services. We saw stark di markets with, for instance, a healthy recovery in air travel wh depressed owing in part to inventory normalisation in goods.

- **Stronger economic growth**: US GDP growth has been surpris Fed recently revising its forecasts for 2024.

- This very much looks like **a goldilocks scenario** for equit risk has been reduced, geopolitical risk remains elevated. marginally adding to beta in our portfolio: it is now slight adding to small and mid-cap stocks, which should benefit fro prospects. Regionally, we prefer the US and Japan where earn

Feedback

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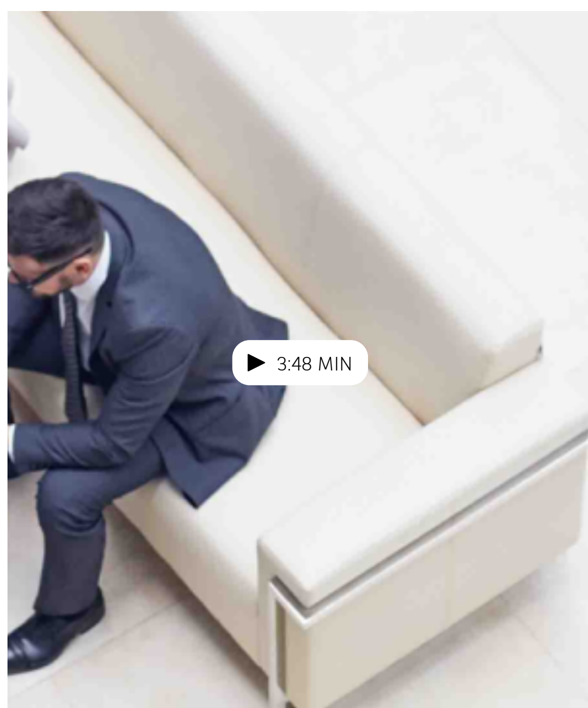

Asset allocation - Still looking to buy dips

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