Optimal Income Strategies

Growth Risks Top Investor Concerns Amid US Resilience

- Strong optimism for U.S. equities, driven by favourable macroeconomic and financial conditions.
- Monitoring the outcome of the U.S. elections closely.
- Initiating an increase in duration with a focus on core Euro markets.

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What's happening?

The U.S. presidential election remains a central focus, with significant implications for economic policy and growth trajectories. The pace of central bank easing also weighs on investor sentiment. The U.S. economy itself shows resilience; economic activity remains solid, with employment picking up again in September, rebounding from a temporary summer lull. We expect a robust GDP growth figure for Q3, with growth likely to soften next year. The extent of this deceleration, however, will depend largely on the election outcome. Our forecast suggests GDP growth of +2.7% for 2024, slowing in 2025 to slightly over +2% in the case of a Trump victory, or just under +2% if Harris were to win.

In the Eurozone, economic activity remains subdued. Planned fiscal adjustments to address public finances point to a sharp tightening that may further dampen growth. We anticipate inflation will fall short of the ECB's 2% target for much of 2024 and therefore maintain a below-consensus growth outlook of +0.7% for 2024, improving modestly to +0.9% in 2025.

China's economy showed tentative signs of improvement in September, with incremental policy support measures introduced in recent weeks. However, these actions remain limited in scope and are unlikely to fully address the persistent challenges posed by the faltering housing market and other structural issues. Nevertheless, we anticipate more substantial policy moves following the U.S. election. Our GDP growth forecast for China remains at +4.8% in 2024, with a slight moderation to +4.4% in 2025.

Emerging markets reveal a divergence in economic approaches, with continued policy easing in Asia and Latin America, while central Europe experiences mixed dynamics. Notably, inflation in Poland may delay rate cuts until the first half of 2025.

As global central banks turn towards easing, the focus has shifted to the pace of rate cuts. Following the Fed's significant 50 basis point cut in September, we expect two further 25 basis point cuts by year's end. The ECB is likely to pursue consecutive cuts through June, while the BoE, which paused its August cuts, may resume with another cut in November. The BoJ is expected to hold rates steady until Q1 2025.

Source: AXA IM as end of October 2024

Positioning & Performance:

	GLOBAL OPTIMAL STRATEGY			OPTIMAL STRATEGY			DEFENSIVE OPTIMAL STRATEGY		
	Dec-23	Sep-24	Oct-24	*Dec-23*	Sep-24	Oct-24	*Dec-23*	Sep-24	Oct-24
Net Equity	*65,5%*	94,2%	69,7%	*54,1%*	78,5%	72,0%	*34,4%*	33,7%	34,4%
Equities	*63,0%*	86,8%	84,6%	*60,0%*	76,6%	76,1%	*33,7%*	41,7%	34,6%
Equities derivatives	*8,6%*	14,2%	3,0%	*-0,8%*	3,6%	0,5%	*0,7%*	-8,0%	-0,2%
Risk Mitigation Strategies	***-6,1%***	**-6,8%**	**-17,9%**	***-5,1%***	**-1,7%**	**-4,6%**	***0,0%***	**0,0%**	**0,0%**
Fixed Income	*21,3%*	5,1%	4,4%	*33,5%*	20,7%	22,1%	*28,5%*	62,7%	62,1%
Govies	*1,0%*	0,0%	0,0%	*1,0%*	0,0%	0,0%	*0,0%*	0,0%	0,0%
Bond Derivatives	*8,1%*	46,8%	59,1%	*9,4%*	33,6%	31,9%	*17,5%*	22,6%	28,1%
High Yield Credit	*1,2%*	0,8%	0,9%	*3,4%*	4,8%	5,2%	*10,5%*	13,7%	14,8%
Investment Grade	*17,3%*	4,3%	3,4%	*26,5%*	15,5%	16,6%	*17,9%*	48,8%	46,8%
Emerging Debt	*1,8%*	0,0%	0,1%	*2,6%*	0,3%	0,3%	*0,0%*	0,1%	0,4%
Diversification	*3,4%*	3,9%	10,4%	*1,5%*	0,9%	0,9%	*5,6%*	4,8%	7,1%
Cash & Money Market	*9,8%*	-3,2%	15,5%	*10,7%*	0,0%	5,0%	*31,6%*	-1,3%	-3,5%

We maintain an overall positive outlook on global equities, particularly in the U.S., where both macroeconomic and company-level fundamentals remain supportive. Despite recent yield increases, financial conditions have eased over the year, bolstering the equity market outlook. Though the U.S. earnings season and elections introduced volatility, so we tactically reduced risk exposure, yet believe there is still upside potential given a strong fundamental backdrop and a more balanced investor positioning.

We favour rate-sensitive equities, particularly in the U.S., and expect the global stock market rally to broaden as we approach year-end, despite slightly higher U.S. rate expectations. Key holdings include U.S. small-cap stocks and European real estate (REITs), both well-positioned to benefit from a gradually easing rate environment.

In sovereign bonds, we see a renewed opportunity in long-dated EU bonds following the U.S. rate cut, which prompted a revaluation of future rate paths and led to a sharp increase in yields. This shift allows us to extend duration in core EU bonds, as the ECB is likely to continue easing in light of sluggish economic prospects in Europe. Global bond positions are now better aligned, and with weak activity data from key European economies, we are beginning to engage more deeply in long-duration holdings within core Euro markets.

Outlook

Historically, bond investors have been seen as cautious or cautiously optimistic, while equity investors are viewed as perennial optimists. Recent events challenge this view, with bond markets showing unexpected optimism. Since the Fed's 50bp cut in September, however, that optimism has again proven misplaced, and the subsequent unwinding of long positions, especially in the U.S., has been painful.

Over the summer, the Fed shifted focus from inflation to employment, effectively reviving the Fed Put. The recent 50bp cut may have been aimed at easing financial pressures on smaller corporates and households borrowing at floating rates, as signs of strain have emerged with rising credit card delinquencies and small business loan defaults. Although not an immediate threat to the broader economy, these trends warrant attention, as small businesses are key employers, and household consumption drives GDP.

For the U.S., where our equity exposure is focused, growth remains solid. Since August, the Atlanta Fed's nowcast of GDP has risen from 2% to around 3.5%. Core inflation remains sticky (+3.3% YoY), with slowing wage and rent growth delaying the Fed's inflation target. The labor market remains resilient, as shown by the recent NFP report (+254k).

Source: AXA IM as end of October 2024

Given this backdrop, it's unsurprising that U.S. yields have risen sharply, driven more by position unwinding than macro acceleration or Fed rhetoric. Our patience has been rewarded, with improved entry points in core Eurozone bond markets as U.S. yields lift Euro rates. We are now adding duration with the 10-year German Bund yielding over 2.2%.

This duration increase is our only significant change for now. Our global equity positions, with a positive overlay and exposure to rate-sensitive sectors, are supported by the macro backdrop. While central banks will likely cut rates further, we expect this to be more gradual than initially forecast in the U.S. Meanwhile, we maintain confidence in a divergent path for the ECB, which has favored our relative value positioning on the 5-year U.S.-Germany bond curve.

We now turn to Q3 earnings, with strong initial results from U.S. financials. Analysts note a low bar for earnings, indicating potential upside. In Europe, recent downgrades have weighed on indices, with disappointments from ASML and LVMH.

Finally, with U.S. elections near and polling close, recent gains by Trump may pressure bond markets, given his inflationary policy stance. Nonetheless, our outlook for equity risk remains positive in the short to medium term.

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