Allianz Global Investors

House View
Q2 2024

Turning the corner

April 2024

This document reflects AllianzGI's investment leadership's views going into Q2.
Past performance does not predict future returns.

What's included in our House View

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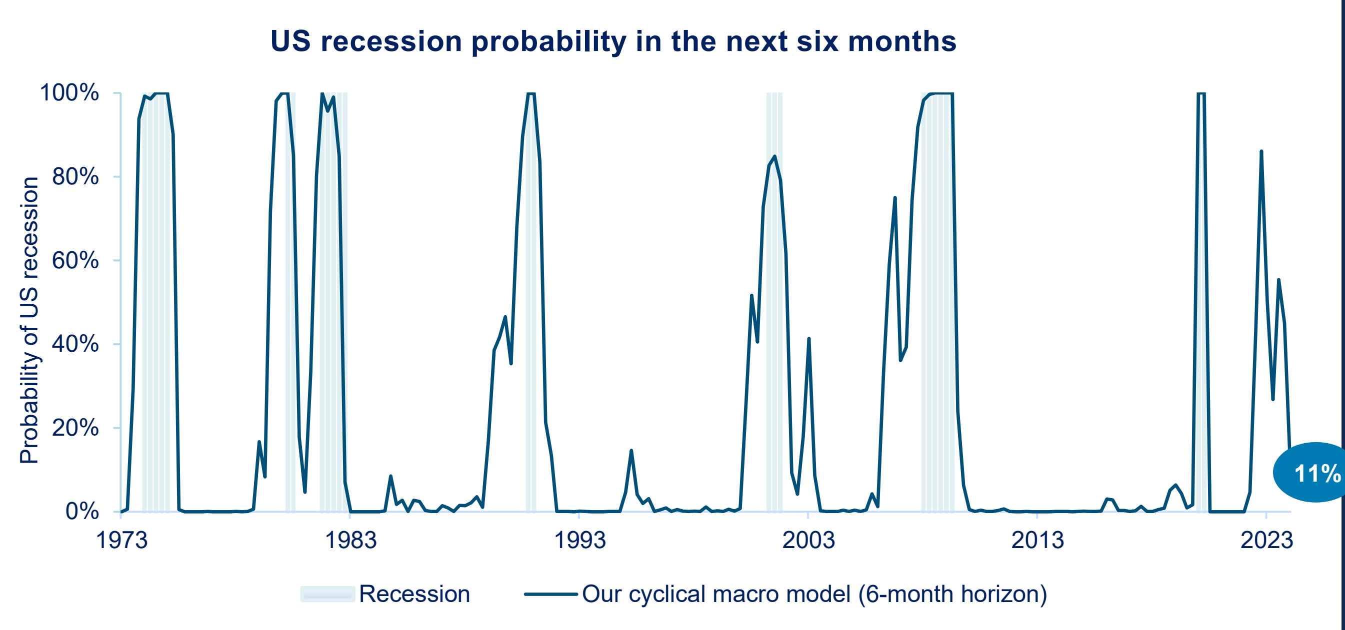
Our view of global markets

All eyes are on the US…

- With the scene set for a historic cut in interest rates, US developments are more key than usual for global markets. Based on the latest data, we think **the US economy is heading for a soft landing** – the holy grail for central banks, where they dampen inflation without tipping the economy into recession.
- With a mild slowdown in sight, the most likely date for **the US Federal Reserve (Fed) to cut interest rates is now July** – a "pivot" that represents an official invitation to re-enter markets after the 2022 reset and should provide continued momentum to bonds and equities in the coming months.
- The question then is how rapidly – and by how much – the Fed cuts rates. On this score, markets expect much less than they did in late 2023. We have thought for some time that **US rates will be only 75bps lower by the end of 2024 – at best.** US labour market resilience may give the Fed pause for thought.

Chart of the quarter: Will the Fed "stick" the landing?

Our near-term cyclical model, which relies solely on high-frequency macro data, currently suggests **only an 11% chance of a US downturn** over the next six months.



Source: Proprietary recession model. Our cyclical macro model (PCA, probit) is based on 14 high-frequency cyclical macro indicators (business and consumer sentiment, labour market, housing, monetary, consumption, orders). Source: Allianz Global Investors Global Economics & Strategy, Bloomberg, Refinitiv (data as at 29 March 2024). Past performance does not predict future returns.

Our view of global markets

Position for selective opportunities amid bouts of volatility

- While investors are eyeing the Fed's next move, **markets are benefiting from a global economy showing more resilience** than during previous periods of high interest rates, with signs that European and Chinese economies are also starting to bottom out.
- **Healthy company earnings in countries including the US and Japan should support risk assets**. Also: watch for the "wildcard" of artificial intelligence (AI) – any acceleration in implementation in the coming quarters could signal stronger productivity and lower inflation.
- There's also **the possibility that the Fed cuts rates less than the market** expects if the US economy holds up better than anticipated (a "no landing" scenario). While good news for equities, this scenario could be challenging for government bond yields.
- **Geopolitical risk has risen.** To date, markets have done a good job of recalibrating for an environment of conflict and global tensions, particularly in a US election year. But the risk of a **major "black swan" event** should not be ignored.
- But the recent equity market rally signals that now is not a time for investors to sit on the sidelines. We do not think markets are overbought. **There will likely be market volatility, but this can also present opportunities.**

Consider the following:

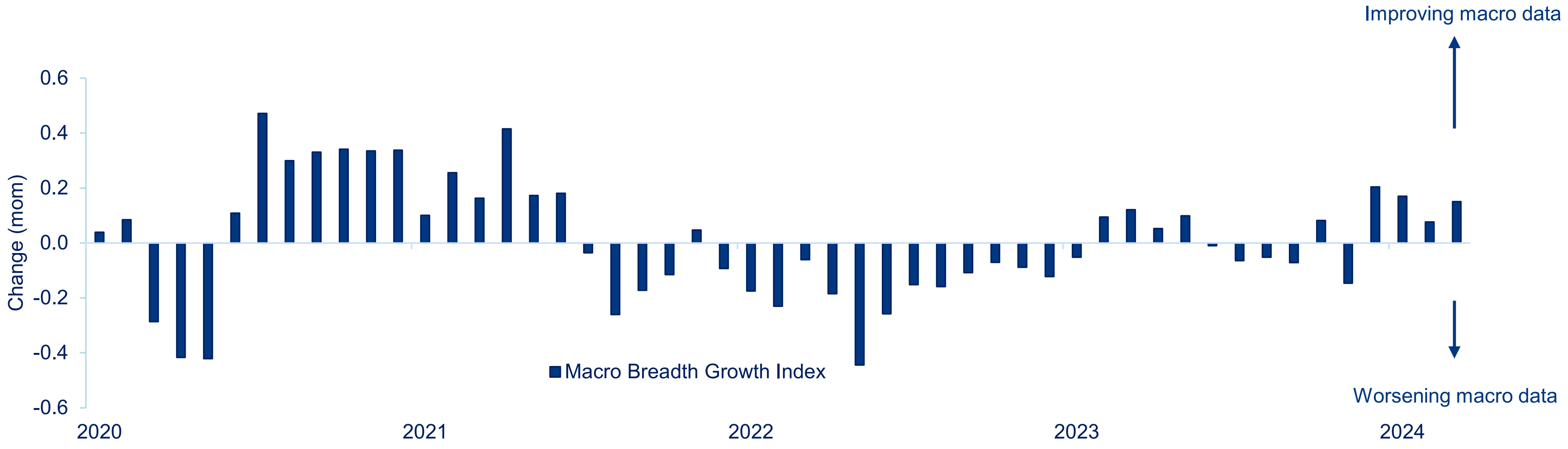
- **Equities:** We take a constructive stance on the US, where selective valuations are reasonable considering resilient earnings; China offers potentially attractive valuations and innovation potential.
- **Japan:** Improving corporate governance and the smooth normalisation of monetary policy support equity valuations.
- **Technology:** Some of the Magnificent Seven stocks are richly priced but the sector generally isn't.
- **Fixed income:** Our preferred trade is curve steepeners in the US and Europe to benefit from rate cuts and the re-emergence of term premiums. In credit, on a risk-adjusted basis our preference is for investment grade.

See pages 11-13 for more details of our asset class convictions.

With the prospect of the first US Federal Reserve rate cut in four years, we see a turning point ahead for the global economy, which should create new openings across asset classes.

Economic growth: encouraging start to 2024

Our Macro Breadth Growth Index[1], measuring macroeconomic data from around the world, has improved for a fourth consecutive month



- Better data across most of the developed world reflects robust growth so far in 2024 – even if momentum has slowed since last year.
- Gains were primarily driven by a strong rebound in the euro zone and a moderate uptick in the US.
- Positive data from emerging economies has largely been driven by India and China; macro indicators strengthened for the seventh month in a row in China.

[1] Our proprietary Macro Breadth Growth Index tracks the direction of 354 global, regional and country macroeconomic data on a monthly basis. The monthly change of the index is scaled from -1 to 1, with a value of 1 (-1) implying an increase (decrease) of all underlying indicators. By focusing on the direction rather than the magnitude of change, the indexes enable the evaluation of the broadness of underlying macro trends and are less prone to any historical revisions of the underlying data. Source: Allianz Global Investors Global Economics & Strategy, Bloomberg, Refinitiv (data as at 31 March 2024)

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In short: key data by region

- **US** – The US economy is losing steam and, in our view, heading for a soft landing. But our outlook is generally positive for the next six months. Beyond that time horizon, we think the chance of recession is minimal, with “no landing” a more likely scenario**. Overall, we think inflation will continue its gradual descent in the months ahead**, sufficient to allow the Fed to begin lowering rates as soon as July.
- **Europe** – We foresee another year of tepid growth in the euro zone but with some possible green shoots (economic sentiment, manufacturing orders). **We think inflation will fall enough for the European Central Bank (ECB) to start lowering rates in June (delivering 100bps of cuts in 2024).** We see the UK economy faring little better than last year, but pricing pressures will likely mean that rate cuts there are postponed until the autumn.
- **Asia** – In China, we think the government will continue to help steady growth amid lingering challenges facing the property sector. **Our data shows India is a bright spot and a standout performer in Asia and emerging markets**. An easing of deflationary forces has allowed the Bank of Japan (BoJ) to abandon its long-held negative interest rate policy, lifting rates for the first time in 17 years. We await more signs of gradual monetary policy normalisation.

Economic growth: growth in 2024 is generally slowing – but not by much

Real GDP, year-on-year %

	2023	2024 Bloomberg consensus*
World	3.0	2.8
US	2.5	2.2
Euro zone	0.5	0.5
Germany	-0.1	0.1
UK	0.3	0.3
Japan	1.9	0.7
China	5.2	4.6

Inflation: we broadly agree with consensus forecasts for global inflation

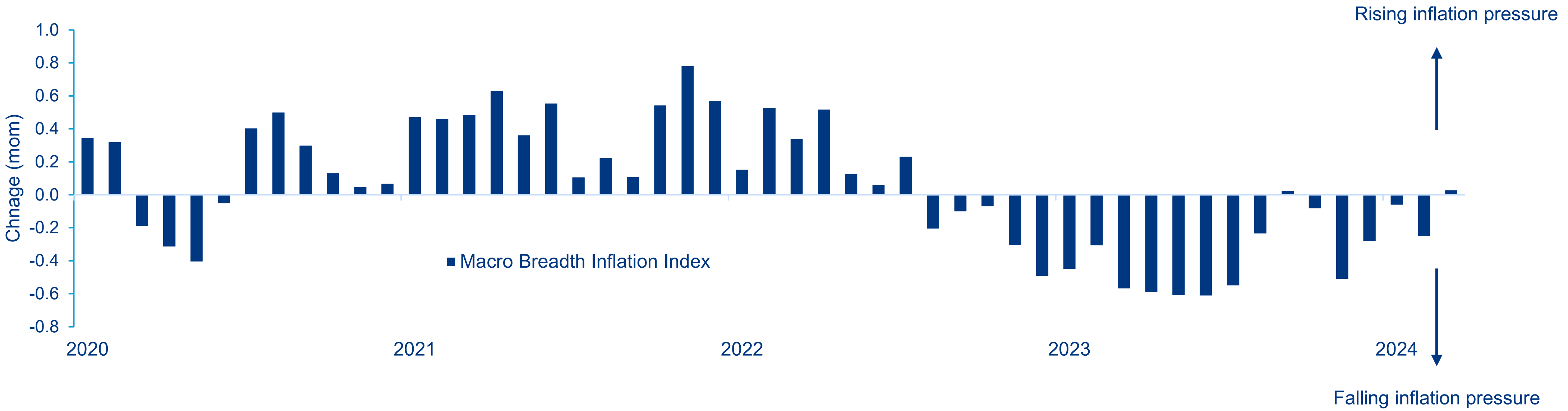
Inflation, year-on-year %

	2023	2024 Bloomberg consensus*
World	6.0	4.0
US	4.1	2.9
Euro zone	5.4	2.4
Germany	6.0	2.5
UK	7.3	2.5
Japan	3.3	2.3
China	0.2	0.8

*AllianzGI 2024 forecasts are broadly in line with consensus, apart from GDP growth in China, where we’re more optimistic. 2023 forecasts shown represent Bloomberg consensus. Data as at 4 April 2024.

Inflation: falling pressures…but the last mile is hardest

Despite cyclical disinflation, as measured by our Macro Breadth Inflation Index[2], underlying inflationary pressures have not disappeared



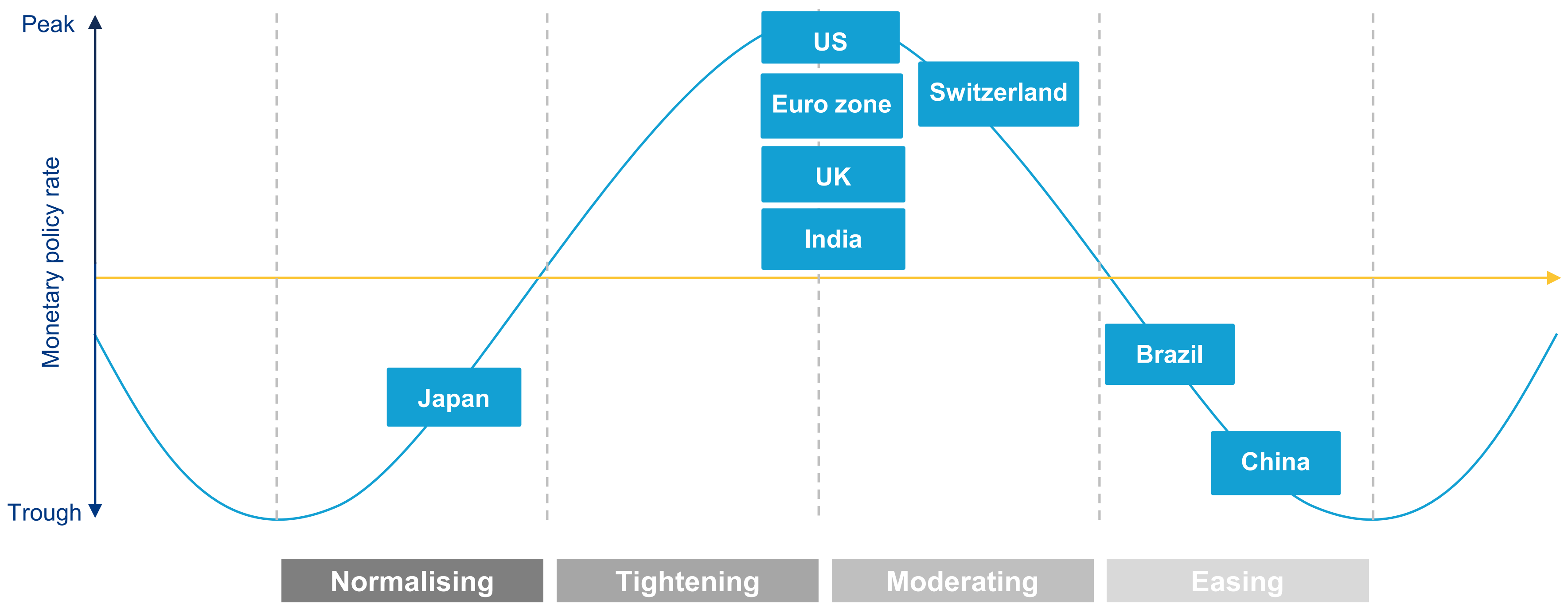
- We think the easy phase of disinflation may be over. While broad inflation trends are easing – and may have more room to cool as the economy slows – the numbers have already benefited from the base effects of higher energy prices and a normalisation of supply chains post-Covid.
- Now comes the hard part: getting to grips with structurally tight, still buoyant labour markets, robust wage growth and sticky core inflation (stripping out food and energy).
- We see global core inflation settling at rates uncomfortably above central banks' targets over the medium term due to factors like the regionalisation of supply chains and the drive to decarbonise the planet. The demographic trend of ageing populations is also inflationary.

[2] Our proprietary Macro Breadth Inflation Index tracks the direction of 354 global, regional and country macroeconomic data on a monthly basis. The monthly change of the index is scaled from -1 to 1, with a value of 1 (-1) implying an increase (decrease) of all underlying indicators. By focusing on the direction rather than the magnitude of change, the indexes enable the evaluation of the broadness of underlying macro trends and are less prone to any historical revisions of the underlying data. Source: Allianz Global Investors Global Economics & Strategy, Bloomberg, Refinitiv (data as at 31 March 2024)

Interest rates: centrals banks at an inflection point

While the Fed and ECB are yet to cut rates, this process has already begun elsewhere

Global monetary policy cycle: current state



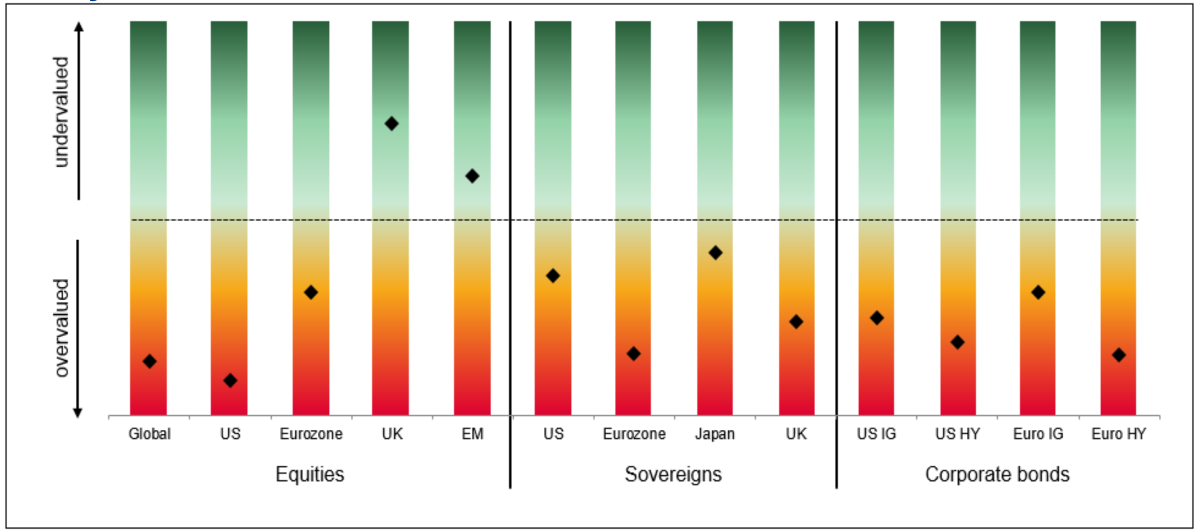
- As inflation gradually falls, more central banks are beginning to lower rates. March was the fifth month in a row that the number of central banks in our universe that cut rates exceeded those that hiked. The Swiss National Bank (SNB) became the first major central bank to cut in the current cycle.
- The Fed and the ECB should follow suit once sustained evidence emerges of falling inflation.
- Against a still inflationary backdrop, we think rates will stay high for longer over the next two years.

Source: Allianz Global Investors Global Economics & Strategy, Bloomberg (data as at 1 April 2024). We track the monetary policy cycles of up to 37 central banks depending on the respective analysis. The chart represents a sample of the banks in our universe.

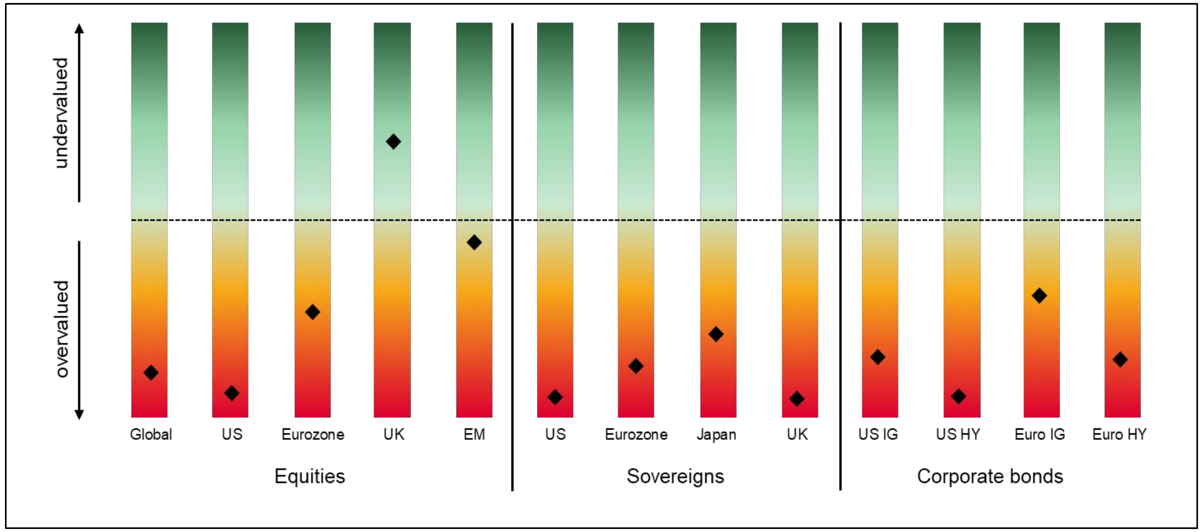
View on valuations: think selectively

Some asset valuations are rich – but not all

Early 2024



End 2021



- Assets appear better valued than at the end of 2021 when financial markets (equities in particular) were boosted by stimulus and economic recovery from the Covid-19 pandemic. In general, however, most assets are not yet undervalued.
- UK and emerging market equities look cheap by historical standards, while US and Japan sovereign bonds are not far from fair value.
- With markets positioned for a positive soft-landing scenario, a “buy everything” rally has gained traction. But we would caution about the risk of further volatility: risk assets are not yet cheap. Slower economic growth may present buying opportunities for equities and spread products.

Valuation score = current score relative to historical distribution of scores. Equity valuation based on Shiller-PE, price/book, 12-month forward PE. Sovereign valuation based on 10-year real interest rate and term premium. Corporate bond valuation based on implicit default probability and respective sovereign valuation. Source: Allianz Global Investors Global Economics & Strategy, Bloomberg, Datastream (data as at 29 March 2024). Past performance is not an indicator of future results. The statements contained herein may include statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. We assume no obligation to update any forward-looking statement. Valuations are based on the latest assumptions about the economic growth outlook.

Multi asset: asset allocation views

OVERALL RISK

- Resilient growth data with inflation indicators trending lower is a sweet spot for markets. “No landing” scenario a risk for government bonds.
- We maintain a constructive view on risky assets, with momentum and earnings as key drivers.
- For equities, watch for potential exuberance in sentiment and positioning as a key risk in the coming months.

EQUITIES

- Japan – our preferred region – continues to offer an attractive mix of solid earning growth, supportive monetary policy and strong momentum.
- European equities also profit from positive momentum, with an improving fundamental picture. The UK may be a bright spot in the quarter. We like the Netherlands on AI exposure.

CREDIT

- Risk appetite is fuelling positive momentum, but valuations appear quite high.
- Momentum is particularly strong in high yield, but potential is limited as spreads hardly compensate for default risk.

EM EQUITIES

- EM equities look attractive on many metrics. Thailand is our regional favorite in Asia Pacific.
- China could yet be a game-changer. Valuations are positive and sentiment is rock-bottom, but a catalyst for significant re-rating remains absent for now.

COMMODITIES

- Better than expected economic data in China and in Europe, OPEC+ supply restrictions and rising geopolitical tensions should support commodities in the coming months.
- We view gold as an excellent diversifier in multi asset portfolios.

GOVERNMENT BONDS

- Conditions are supportive for US Treasuries, though oil price dynamics could slow down that momentum. Opportunities for yield curve steepeners are open in various markets.
- “No landing” scenario is a risk for our long duration positioning.

USD

- Recent USD weakness against EUR is driven by the Fed’s pivot, but bond spreads are still supportive for USD.
- Negative view of CHF due to low inflation and SNB activity. JPY may be the most undervalued currency in the long term.

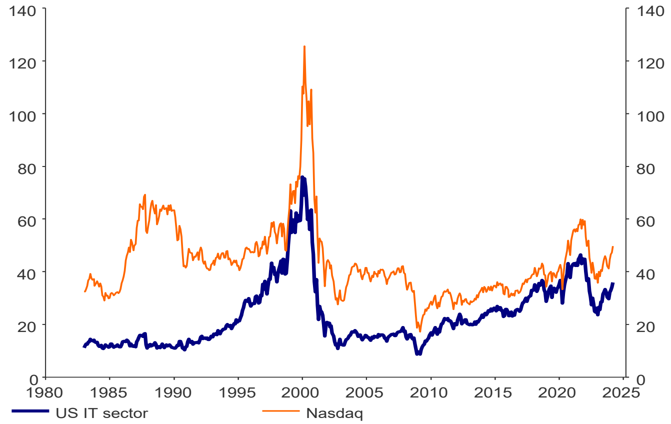
Asset class convictions: equities

Tech sector – still value for astute stock pickers

The well-documented rise of the Magnificent Seven tech stocks has left them looking richly priced. However, **valuations for the sector overall are not excessive** (see chart). As AI moves from building the "plumbing" to more applied benefits for software firms and others, we expect to see wider opportunities in the sector.

Overall tech valuations are not excessive

Cyclically-adjusted price-to-earnings ratio (CAPE) for US IT sector, Nasdaq



Source: LSEG Datastream, AllianzGI Economics & Strategy 3/12/2024

We also expect **geopolitical tensions to present opportunities** in the tech sector. The **divergence in standards between China and the rest of the world,** and further breakdown of cooperation, could create investment opportunities. In our view, national security concerns and the wider use of AI are creating **strong opportunities in the cyber security space**.

Focus on quality and volatility for entry points

The expectation of a soft landing is an obvious positive for the macro environment. Consumers will benefit from resilient economies and job markets while a **disinflationary environment increases real purchasing power**. But we expect volatility around the timing of potential rate cuts, and from elections, which may present opportunities. We will be focused on **quality indicators, such as strong balance sheets and leadership, when evaluating companies across growth, value and income styles**.

We anticipate regional opportunities as the monetary policy cycle turns. **US valuations are up but still reasonable** in a global context of earnings growth and anticipated rate cuts. The normalisation of monetary policy and improving corporate governance, along with geopolitical tailwinds, support the case for Japanese equities (also see page 13). **China appeals as the most under-owned market** offering attractive valuations and innovation potential. **Europe is also showing attractive valuations** and some green shoots.

Asset class convictions: fixed income

Seek relative value in government bonds

Slow growth momentum, abating inflation risks, expected rate cuts and geopolitical risks appear positive for developed market government bonds.

We see **increased scope for relative value** as government bond markets decorrelate in response to diverging growth outlooks. Major government bond markets have moved in lockstep in recent years, but we expect this to change going forward given **differences in debt fundamentals, the transmission of monetary policy and fiscal support**. In the US, for example, investment incentives under measures such as the Inflation Reduction Act seem to be underpinning economic activity significantly.

This gives us a **preference for US Treasuries** over other government bond markets, while the core euro area is also beginning to look more attractive as more balanced growth and inflation risks should allow the ECB to soften its policy stance.

We prefer to position portfolios to benefit from yield curve steepening, which can work as a longer duration proxy.

Maintain carry – and caution – in credit

Credit spreads – the premium offered by corporate bonds over sovereigns – appear relatively tight, but **valuations are supported by solid fundamentals** and we see no negative catalysts for credit in the short term.

On a risk-adjusted basis, our preference is for investment grade over high yield. But remaining invested for **the carry offered by IG and HY corporate bonds** appears advantageous, and we will look to hold select higher beta assets with high yields in both markets. There could be opportunities in areas such as **subordinated bank bonds** (for example Additional Tier 1s) and real estate, where risks look well priced and central bank rate cuts should support a market recovery.

That said, we maintain **caution in credit given the slim spreads**. We are wary of cyclical sectors in IG, and **security selection remains paramount in HY** given the risks presented by tighter financial conditions.

Asset class convictions: multi asset

Better governance benefits Japanese equities

Japanese equities combine a **reasonable valuation with a supportive growth environment** and decent momentum. Japanese companies – especially exporters – are geared towards growing their global footprint and harnessing long-term trends like robotics, automation and digitalisation. They are **repairing their balance sheets** as Japan's economy emerges from a period of stagnating growth and deflation.

More shareholder focus, better governance, improved capital allocation and higher profitability are part of a transformation of Japan's business landscape resulting in **strong recent earnings**. We see the recent all-time high for the Nikkei index as just the latest step on a **sustained transformation journey** – and a sign of greater investor interest in Japanese assets.

The recovery process should be supported by **the BoJ's continued efforts to stimulate growth**. While Japan recently exited negative interest rates (after 17 years), we expect monetary policy to be normalised only cautiously. Investors seem to have accepted this approach and the recent move was met with little market disruption.

Gold's shine may last

Gold prices are surging – and have shown little sign of losing momentum. A **weaker US dollar, purchases by central banks and strong appetite for physical gold** from emerging market retail investors have underpinned its upward trajectory.

Amid **geopolitical tensions and a rise in government debt and defence spending**, demand for gold from emerging market central banks has increased for two reasons. First, it is an alternative to government bonds and the US dollar and, second, it supports de-dollarisation efforts in response to geopolitical risks. Central bank purchases should continue to support gold. **In a multi asset portfolio, gold should outperform US Treasuries due to the surge in government debt.** We maintain a positive stance on gold over the next 12 months.

In the short term, gold has surpassed the **psychological threshold of USD 2,100/oz** and **short covering** (buying back gold previously sold to close a short position) may accelerate the recent rally. Gold holdings among exchange traded funds remain relatively low, potentially serving as an additional catalyst for gold's gains once positions align with the recent price rise.

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