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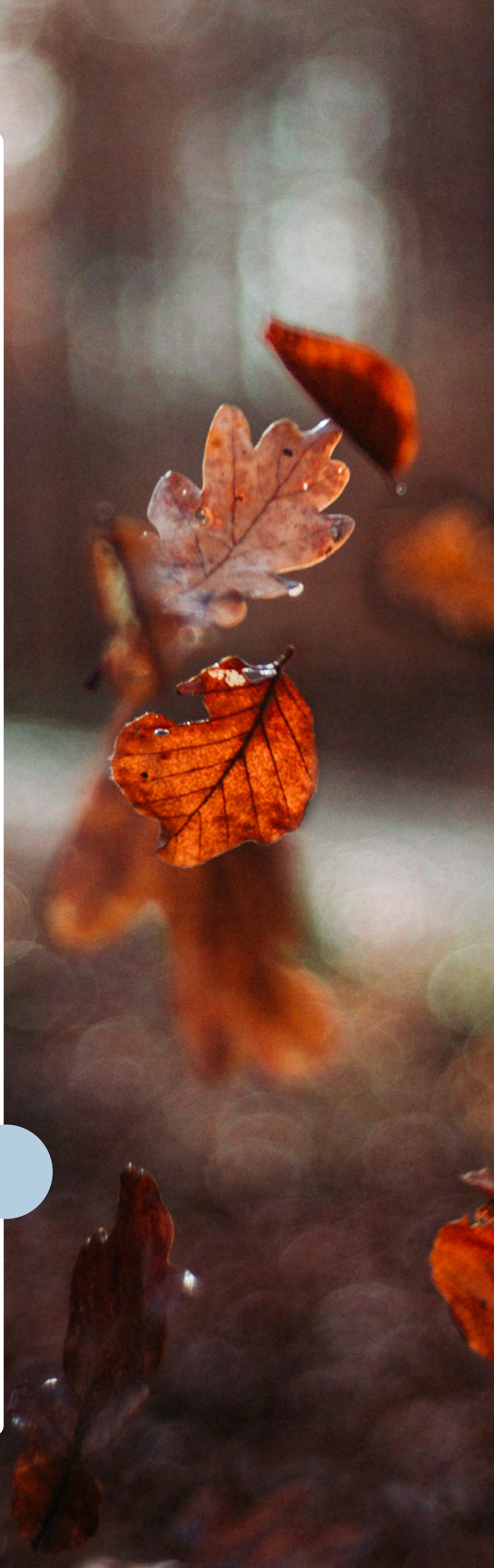
Winter looms...



SEPTEMBER 2023

Marketing communication

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Will the central banks of the developed countries succeed in returning inflation to the 2% target by the end of 2024 without triggering a recession? Can China still avoid deflation? After a few months of calm, will the recent rise in oil and agricultural prices further complicate the task of central banks?

Economic outlook: weak growth.

Global growth is set to continue... at a slow pace! The expected GDP increase of 3% in both 2023 and 2024 is well below the 3.7% average observed over the years 2004-2019. This is largely due to a slowdown in emerging economies, particularly China.

Deflationary forces in China will be hard to counter

Faced with the difficulties of the real estate giants and sluggish household demand, Beijing's response has so far been timid: down-payment requirements for home purchases have been lowered slightly, the authorities have asked banks to speed up refinancing of existing mortgages, and the government has announced an increase in tax deductions for education, childcare, etc. However, the support provided by these measures is likely to prove limited: with household confidence still depressed, they are likely to fuel savings that are already too abundant. Activity will not return to its pre-pandemic growth rate: the deflationary forces facing China will be difficult to counter.

Is the United States on track to succeed?

The US economy continues to defy the Cassandras. At the beginning of 2023, many thought the Fed's gamble impossible to win. Not only had soft landings been relatively infrequent in recent decades, but the wage deceleration needed to bring inflation back towards the central bank's target could only be achieved through a sharp rise in the unemployment rate... and hence, a recession. The central bank's 425 basis point tightening in 2022 was designed to provoke the recession "necessary" to counter inflationary pressures. Yet on the contrary, nine months later and after a further 100 basis point increase, growth is still solid (around 2% p.a. in the second quarter and probably more than 2% in the third), while in one year inflation has fallen from 8.5% to just over 3% last July, job creation has slowed sharply (from over 400,000 to 150,000 per month) and wages have decelerated from 6.5% year-on-year to 4.5%. Of course, the Federal Reserve has not yet won, but it seems to be on the right track. This is all the more so as growth is set to slow towards the end of the year, with household consumption having been abnormally boosted by exceptional effects during the summer (release of "Barbenheimer" and tours by Taylor Swift and Beyoncé!). Against this backdrop, the Federal Reserve is likely to stop raising rates, but will maintain elevated rates for many months to come, until the labour market eases, and inflation clearly approaches its 2% target.

Eurozone: slow growth

In the Euro area, growth remains weak and economic surveys suggest that activity will contract in the third quarter. With demand sluggish, business investment is likely to slow and residential investment should continue to contract under the impact of rising mortgage rates and tighter credit conditions. Household consumption could, however, pick up a little early next year if inflation continues to ease, but the still-low level of confidence and the slowdown in job creation suggest that any rebound will be moderate. Overall, growth is likely to remain weak, with GDP rising by 0.7% in both 2023 and 2024. Our forecast is subject to several risks. The speed of transmission of monetary tightening in affecting the general economy is uncertain. Commodity prices could rise again, delaying the expected improvement in household purchasing power: El Niño and the Ukraine war could push up agricultural prices, and oil prices could exceed the $90 mark used in our forecasts if OPEC+ cuts production further. For several months to come, market participants and central banks alike will continue to navigate by feel, or to use J. Powell's expression in his speech at Jackson Hole on August 25, "by the stars under cloudy skies"!


Global growth
continues ...
at a slow pace.

US markets lead, with a more favorable balance between growth and inflation.

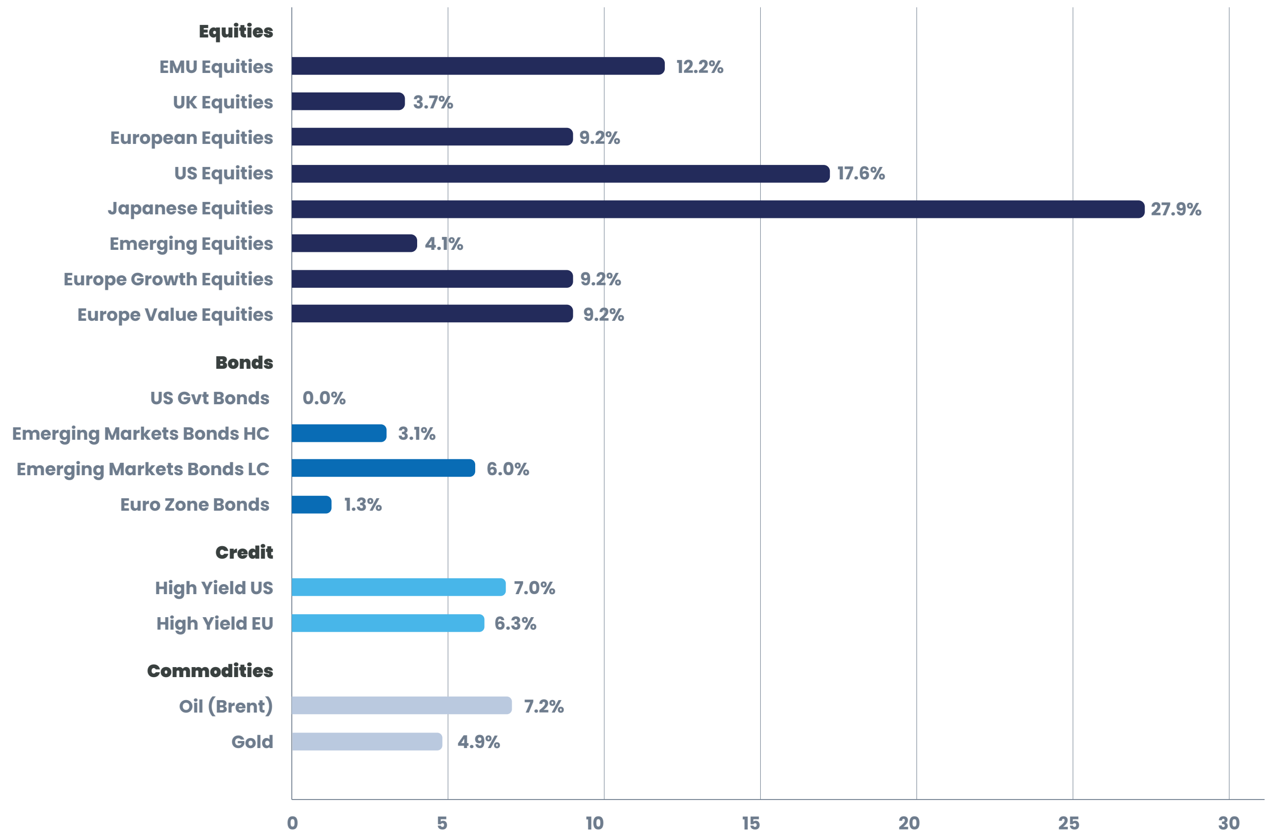
From a market standpoint, the gap between positive economic surprises in the US and disappointments in China and Europe had a direct impact on asset class performances. U.S. equities have returned +17.6% since the start of the year, while European equities have gained only 9.2%, and emerging equities rose +4.1%[1].

The performance of US equities is all the more remarkable given that US 10-year yields rose from 3.9% to 4.3% over the same year-to-date period, which could have had a negative impact on valuations. In fact, against all expectations, the United States enjoyed a quasi-Goldilocks period, with stronger-than-expected growth and steadily decelerating inflation providing de facto support for US equities.

This growth gap between the US and the rest of the world has also widened the gap between US and European interest rates, impacting the value of the US dollar, which has appreciated by 5% since its low point in July[2] and by 1.5% since the start of this year.

1 - Data in euros at September 12, 2023 - source: Bloomberg
2 - Given between July 17 and September 12, 2023

Figure 1:
YTD Performance, 12/09/2023



EMU equities: MSCI Daily TR Net EMU Loc, UK equities: MSCI Daily TR Net UK Loc, **European equities:** MSCI Daily TR Net Europe, **US equities:** MSCI Daily TR Net USA Loc, **Japanese equities:** MSCI Daily TR Net Japan, **Emerging equities:** MSCI Daily TR Net Emerging, **Europe Growth equities:** MSCI Daily TR Net Growth, **Europe Value Equities:** MSCI Daily TR Net Value, **US Govt Bonds:** JP Morgan GBI US Unhedged LO, **Emerging Market Bonds HC:** JP Morgan EMBI Global Compos, **Emerging Markets Bonds LC:** JP Morgan GBI-EM Broad Diver, **Eurozone Bonds:** JP Morgan GBI EMU Unhedged, **High Yield US:** Ice Bofa US High Yield, **High Yield EU:** Ice Bofa Euro High Yield, **Gold:** Gold Spot $/Oz

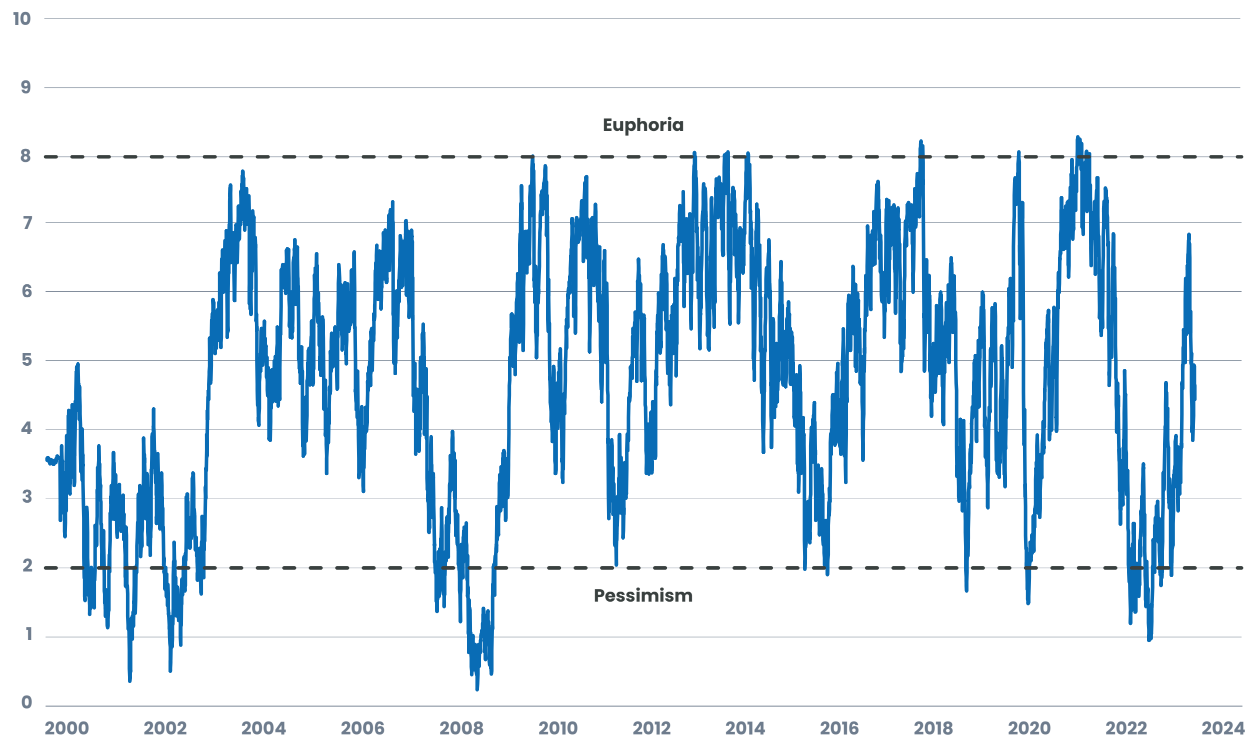
Past performance is no reliable indicator of future returns.
Source: Bloomberg

Markets anticipate a soft landing, making equity risk more asymmetrical

Market sentiment has improved significantly since January. We began the year with a positive view on equities, in contrast to investors' overall underweight in equities and their very cautious market sentiment. Today, formerly excessive pessimism has returned to normal, particularly concerning the United States.

The market's positioning on equities and overall investor sentiment are in the 'neutral' zone. Risks now seem more asymmetrical for equities, justifying our cautious view.

Figure 2:
Candriam Sentiment Indicator



Past performance is no reliable indicator of future returns.
Source: Candriam

Can U.S. equities continue their provocative upward trajectory, risking rising rates?

US equities can continue to benefit from the current favorable environment. Our economic analysis shows that the Fed is engineering a soft landing for the economy and is nearing the end of its tightening cycle. Nevertheless, we expect economic growth to slow in 2024, with lower inflation likely to weigh on corporate earnings growth. The analyst consensus anticipates 12% growth in US corporate profits in 2024 (compared with +1.5% in 2023)[3], which seems high given the slowdown in nominal economic growth.

The valuation of the US market is currently above its historical average, with a 12-month Price-Earnings Ratio (PE) of over 19 vs. a 10-year historical average of 18[4], leaving little room for further appreciation if rates remain persistently high. The expected return on US equities in our best-case scenario is therefore positive but limited.

Can emerging countries and Europe deliver positive surprises?

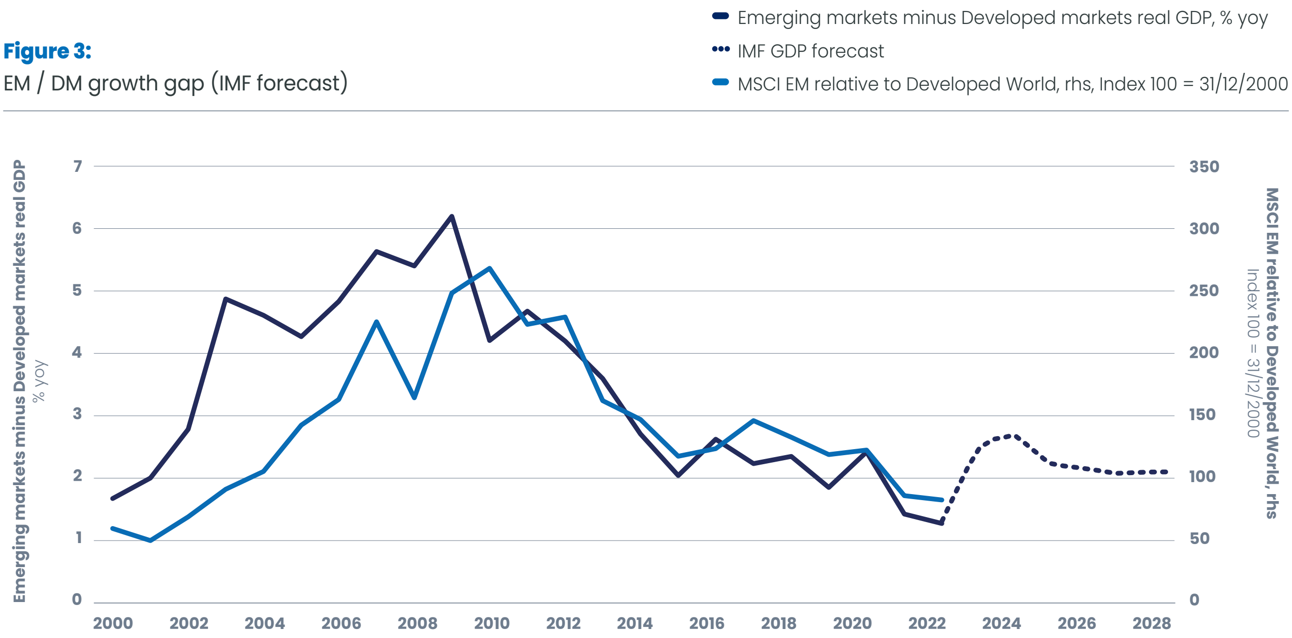
In Europe, the situation is quite different. The valuation of the equity market is much more attractive (12-month PE of 11.8 vs. 10-year historical average of 14 for the Eurozone)[5], and justified by a gloomier growth outlook and a bearish risk on the economic outlook for the coming months. As a result, expectations for 12-month corporate earnings growth (+6%)[6] could continue to be revised downwards. Earnings prospects and valuations could only improve when the economic outlook improves in 2024. So it is still too early to increase our allocation to European equities, as the economy is likely to remain stagnant in the final quarter of this year.

3 - Source: Bloomberg, MSCI USA data at 12.09.2023
4 - Ibes Consensus
5 - Source: Bloomberg, MSCI USA data at 12.09.2023
6 - Ibes Consensus

We prefer to maintain our overweight on emerging markets, whose performance has been particularly disappointing since the start of the year. China is the country that has weighed most heavily on the global emerging index. Investors' cautious stance on China's economic development reached new heights. The measures taken by the Chinese authorities should stabilize growth at around 4-5%, but are not providing sufficient positive impetus to restore confidence. These measures should nonetheless improve visibility of growth momentum in emerging countries. We therefore favor the emerging countries excluding China index. With disinflation well underway in emerging countries, their monetary cycle is ahead of that of developed countries. We believe that better growth momentum than in Europe or the US, combined with monetary easing, should support both valuation and earnings growth in emerging countries.

This desynchronization of economic and monetary cycles in emerging countries brings diversification to our allocation decisions.

Figure 3:
EM / DM growth gap (IMF forecast)



Past performance is no reliable indicator of future returns.
Source: Bloomberg

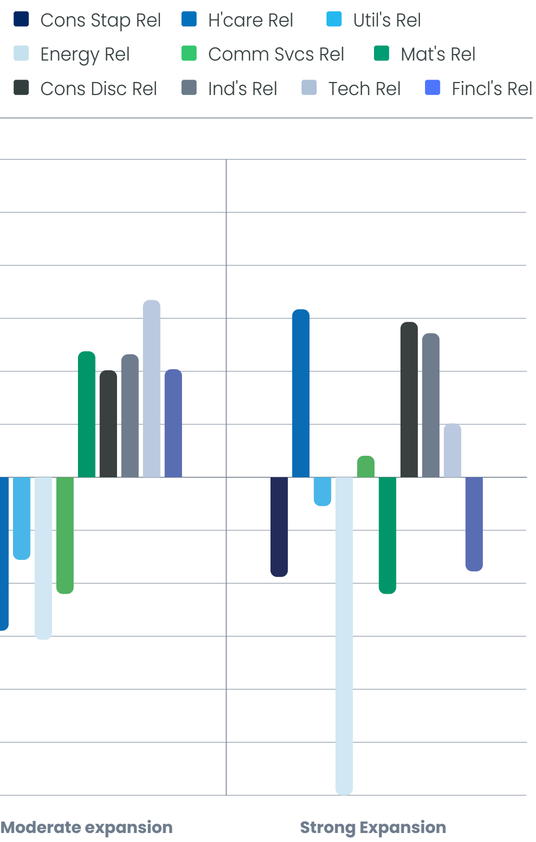
***In terms of style, we favor defensive sectors -- particularly in Europe, which are performing better in this phase of economic slowdown.* We are also overweight long-term themes such as energy transition and automation.**

Despite activity indicators showing a slowdown in the economy, particularly in the manufacturing sector, cyclical stocks outperformed defensive stocks, anticipating a reacceleration in activity, which is not our central scenario.

At the same time, it seems to us that defensive and quality stocks are better able to cope with a slowdown cycle associated with persistent inflation. In such a scenario, their price-determining power will be paramount.

We also favor long-term themes around energy transition and automation. Stocks corresponding to these themes should be less impacted by economic cycles and benefit from structural geopolitical issues around the reduction of our environmental impact, the development of artificial intelligence and the need to repatriate certain activities that contribute to the sovereignty of states.

Figure 4:
Sector performance depends on the stages of the cycle



Past performance is no reliable indicator of future returns.
Sources: Cadriam, Barclays. European sector indices since 28/02/2013, relative performance vs MSCI Europe.

An allocation to bonds that provide yield and protection.

We consider the allocation to government bonds to be attractive, with a gradual increase in the portfolio's duration. We are nearing the end of the monetary tightening cycle, but central bank statements remain very cautious.

Short-term rates are likely to remain at fairly high levels until central banks are certain that the deceleration in inflation is sustainable. Long-term interest rates should stabilize, with inflation under control and growth slowing. Given this outlook and current yield levels (2.7% for German 10-year yields[7]), we think government bonds offer attractive yields. For the time being, we favor the intermediate segment of the curve (3-5 years).

More broadly, we feel that an allocation to developed-country government bonds is particularly attractive in a diversified portfolio, given the diversification and protection provided by this asset class. Indeed, its impact would be positive in our central scenario, but also in the event of an alternative scenario resulting from a deterioration in the inflation/growth mix, with weaker growth or higher inflation than expected.

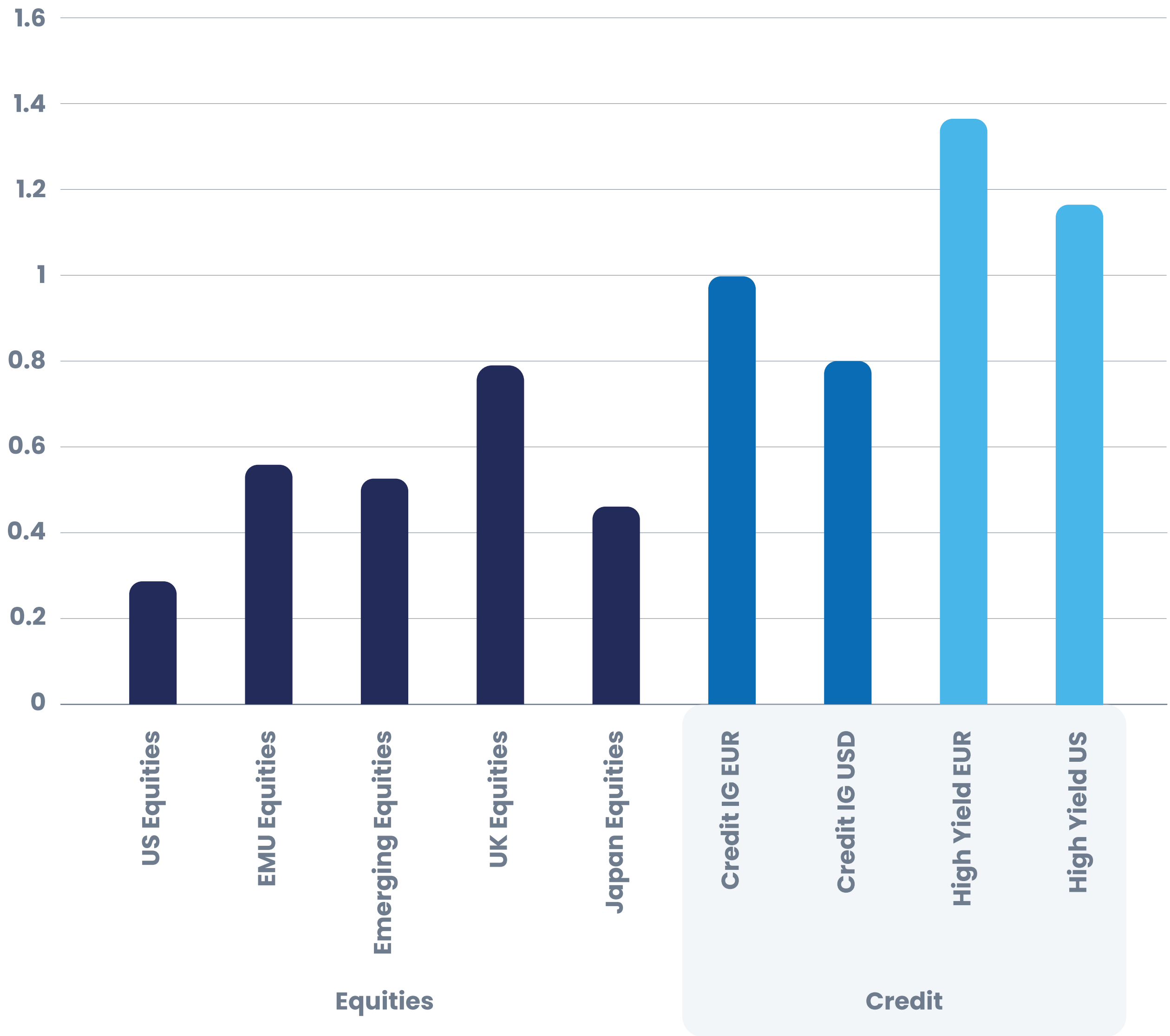
Both risks would be negative for equity markets (downward earnings revisions and lower valuations). For bonds, the implications would be different. In the event of weaker-than-expected growth, interest rates would fall, having a positive impact on bond prices. In the event of higher inflation, the impact would be negative in the short term, as central banks would need to be more aggressive in raising key interest rates. On the other hand, this would be positive in the medium term, as the rise in key rates would cause the economy to slow down, bringing down long rates.

7 - Source: Bloomberg. Data as of September 12, 2023.

At this stage of the cycle, we also favor investment-grade corporate bonds. Despite the compression of spreads in 2023 (-10% for European IG credit[8]), the credit market continues to offer a particularly favorable risk/return profile, especially compared with equities, with a European carry of over 4% and volatility below 5% (compared with 8.5% and 16% respectively for European equities).

On the other hand, we remain neutral on high-yield credit, which offers an attractive yield but whose ratings downgrade dynamic in an environment of tightening credit conditions could weigh on the asset class.

Figure 5 :
Cross Asset Carry to Volatility (%)



Past performance is no reliable indicator of future returns.
Source: Boomberg

8 - Ice Bofa Euro High Yield- Source: Bloomberg. Data as of September 12, 2023.

With weak but positive growth holding recession at bay on both sides of the Atlantic, and underlying inflation easing only gradually, central banks will not be able to ease financial conditions between now and the end of the year.

Financial markets are already incorporating a soft economic landing, justifying the good performances seen since the start of the year. With the positive surprises now largely priced in, there seems little room for further appreciation in equity markets, suggesting a degree of caution on risky assets.

We prefer to position ourselves in those carry assets most likely to benefit from the current cycle, such as developed nation government bonds and high-quality European credit. We are cautious on equities, preferring emerging market equities to European equities.

€144 B

AUM at end June 2023*

+600

Experienced and committed professionals

+ 25 years

Leading the way in sustainable investing

*As of 30/06/2023, Candriam changed the Assets Under Management (AUM) calculation methodology, and AUM now includes certain assets, such as non-discretionary AUM, external fund selection, overlay services, including ESG screening services, [advisory consulting] services, white labeling services, and model portfolio delivery services that do not qualify as Regulatory Assets Under Management, as defined in the SEC's Form ADV. AUM is reported in USD. AUM not denominated in USD is converted at the spot rate as of 30/06/2023.

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