Overview
Outlook - Autumn

4rd Quarter 2024

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BANCO
CARREGOSA

Editorial

By the *Chief Investment Officer*

Despite signs of a slowdown in the third quarter, the US economy continues to outperform expectations and remains resilient. The cycle of rate cuts began with a cut of 50 basis points, which should continue to support the economy. The much-feared recession has thus been avoided for the time being, defying warnings of a slowdown. With no recession in sight, equity markets have continued to perform strongly, reaching all-time highs, supported by a positive economic outlook.

Global economic growth remains moderate and is forecast to continue next year. This scenario reflects an average of varying conditions across regions and sectors. Contrary to earlier expectations of a sharper slowdown, economic performance in the US remains robust. By contrast, both Europe and China have more fragile economies, although there are significant differences within Europe itself, with southern economies more buoyant than those in the centre. Globally, the services sector drove growth, while industry, particularly in Germany, held back overall performance.

This greater variation has had an impact on the performance of different financial assets, which have different degrees of exposure to each dynamic. The absence of a significant slowdown in the world's largest economy has benefited the value of financial assets most exposed to the economic cycle, which is why the equity market and higher-risk bonds have performed well and continue to look positive based on the possible continuation of this favourable scenario. While equity markets continue to trade at somewhat elevated multiples on the back of stronger-than-expected economic performance, the market for low-risk government bonds has largely priced in expectations of interest rate cuts in the coming months and is now expected to be more neutral.

As central bank interest rates are gradually reduced, investors are likely to rebalance their portfolios, shifting their investments from liquidity and time deposits to the longer-dated bond market, and gradually from the bond market to equity markets and alternative assets such as precious metals, real estate and infrastructure.

Despite optimism, the risk of a deeper slowdown before a more sustained recovery remains. In this context, investing in high quality bonds continues to play a role in protecting portfolios. Alternatively, in a scenario of synchronised global economic acceleration in 2025, as predicted by some analysts, there is a risk of overheating that could trigger a new wave of inflation. This framework should continue to be taken into account when constructing investment portfolios. The stimulus measures recently announced by the local authorities for the Chinese economy could be crucial for a synchronised recovery in China, Europe and the US next year.

Finally, the geopolitical environment remains uncertain, with the potential for conflicts to escalate and destabilise the global economy. The US presidential election on 5 November is another factor that could significantly alter the course of events.

Against this background of uncertainty, but with a benign central scenario, investors should continue to reap the benefits of diversifying, optimising their exposure and taking advantage of the favourable risk/return performance of their investments.

Mário Carvalho Fernandes

Position

Classes	Subclasses	— —	—	Neutral	+	+ +
Liquidity	Sight deposits, Term Deposits			■		
Bonds	*Investment Grade* Europe			■	■	
	Investment Grade USA (EURHdg)			■	■	
	High Yield Global (EURHdg)			■		
	Global Emerging (EURHdg)		■			
Shares	Europe formerly UK			■	■	
	USA (EURHdg)			■	■	
	United Kingdom (EUR)		■	■		
	Emerging (EUR)		■			
Other	Gold, REITS, Infrastructures, etc.			■	■	

Macroeconomic Analysis

The eurozone economy continues to deteriorate. In September, the European Central Bank (ECB) downgraded its economic growth forecasts for this year and 2025 by 0.1 percentage points to 0.8% and 1.3% respectively, but maintained its estimates for harmonised inflation at 2.5% in 2024 and 2.2% next year. At the national level, the German economy is set to enter its second consecutive year of recession after the German government announced that it expects the economy to contract by 0.2 per cent in 2024. German harmonised annual inflation slowed to 1.8% in September, down a tenth from August, making it easier for the ECB to cut interest rates more quickly. However, underlying annual inflation in the eurozone, which excludes energy and food, was 2.7% in September, while inflation in services was 4%, making the ECB's task more difficult. In addition, the strong US employment report in September and the consequent appreciation of the dollar is an additional obstacle to a rate cut in the single currency. In September, the eurozone composite PMI fell to 49.6. The decline was mainly driven by the industrial sector, especially in Germany.

In the US, despite the visible slowdown in the labour market in the first two months of the last quarter, job creation was robust in September, with a further 254,000 jobs added. The figures for July and August were also revised upwards and the unemployment rate fell to 4.1%, reflecting a relatively resilient economy. The Atlanta Federal Reserve's latest GDP Now forecast of 2.5% real GDP growth in the third quarter

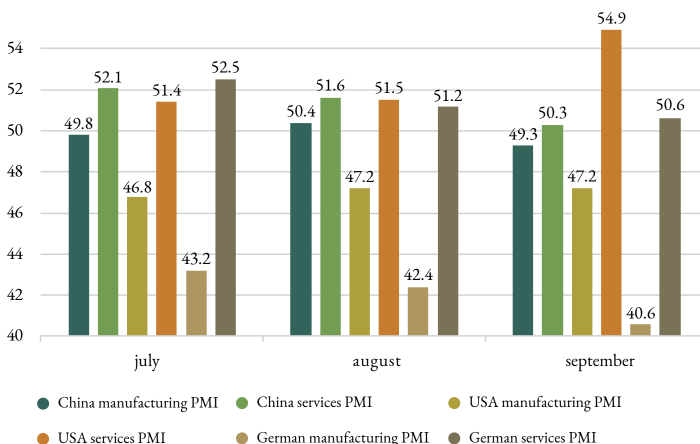
supports this scenario The Coincident Economic Index (CEI), published by the Conference Board (CB), continues to trend upwards, reflecting current economic conditions, and is highly correlated with real GDP. However, leading indicators continue to reflect weakness on the horizon. The CB's Leading Economic Indicator (LEI), which is important for anticipating changes in economic cycles, is on the brink of recession and is made up of ten leading indicators, including weekly unemployment claims, consumer confidence, housing permits, new orders and business sentiment as measured by the PMI and ISM. The positive performance is almost exclusively attributable to just two indices – the S&P 500 and the Leading Credit Index - which prevented the LEI from falling further.

The US unemployment rate has also been rising since the low of 3.4% in April 2023. Sahm's rule signals a recession when the average unemployment rate over the last three months is half a percentage point higher than the lowest unemployment rate over the previous 12 months. Currently, the gap is already half a percentage point, bordering on recession. In its quarterly outlook published on 18 September, the US Federal Reserve (Fed) predicted an unemployment rate of 4.4% in 2024.

Meanwhile, US inflation continues to slow. However, the Fed seems to have given up on a faster decline in consumer prices, as evidenced by the forceful 50-point rate cut on 18 September, and has adopted a pre-emptive stance to support the economy, focusing more on full employment in its dual mandate.

Weak Chinese consumer spending, as well as challenges such as continued weakness in the property market, an ageing population and rising global tensions, are weighing on the Chinese economy. Despite the boost from the stimulus package, the World Bank warned on 8th October that growth is likely to slow next year, with estimates that GDP will fall to 4.3% in 2025 from 4.8% in 2024. Doubts remain regarding the long-term effectiveness of Beijing's recent measures to stimulate the economy. China's manufacturing activity contracted for the fifth consecutive month in September, with the official PMI standing at 49.8. The Caixin PMI for the same period was 49.3, the biggest contraction in 14 months, hit by falling demand and a weakening labour market.

Industrial and services PMI



Source: Bloomberg; Banco Carregosa

The services sector continues to outperform industry, underpinning the economies of the world's three main economic blocs, with the US ISM services PMI rising to 54.9 in September. China's manufacturing activity, as measured by the Caixin Manufacturing PMI, fell to 49.3 in September from 50.4 in the previous month, the lowest level since July last year, reflecting the gradual decline in new orders at home and abroad, which has dented the confidence of Chinese industrialists. In the eurozone, industrial activity contracted at the fastest pace this year in September, with demand falling sharply despite price cuts by factories. The crisis has been particularly severe in Germany, where conditions in the sector have deteriorated the most over the past 12 months. US industrial activity remained weak in September, but new orders improved and input prices fell to a nine-month low, which, together with the fall in interest rates, bodes well for a possible pick-up in activity in the coming months.

Bond Market

The last three months have seen significant changes in the global macroeconomic scenario. The ECB pre-empted the Fed by cutting rates, followed by a similar move by the Fed, which alerted other central banks to the start of a new market cycle.

Short-term yields fell more than long-term yields, reflecting market expectations of faster and deeper interest rate cuts in developed economies. The latest inflation indicators suggest that inflation is under control and approaching the set targets, allowing central banks to focus on stimulating economic activity.

Central banks continue to be proactive in trying to avoid deflationary risks, which has helped to stabilise markets. Jerome Powell, Chairman of the Federal Reserve, reiterated that the US economy is in solid shape and that monetary policy will be adjusted gradually to ensure a balance between inflation control and economic stimulus.

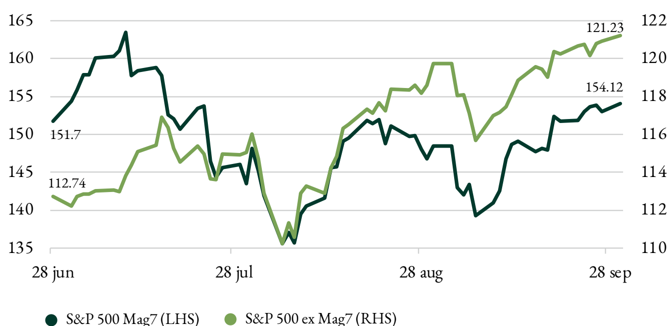
With regard to the ECB, two further cuts of 25 basis points are expected by the end of the year, with the market expecting this movement to continue until the deposit rate reaches 2%. In the UK, the Bank of England is expected to cut rates by 25 basis points. This will depend on new inflation data. For the Fed, current projections point to a 50 basis point cut by December. The labour market will play a key role in determining any further adjustments.

Geopolitical risks remain a source of uncertainty for investors. The potential for escalation between Israel and Iran will continue to be closely monitored, although there are no immediate signs of escalation. Overall, the rate cutting trend is expected to continue.

There has been less damage than initially expected from the transition from a high interest rate environment to a cycle of cuts. Companies with higher leverage, especially those in the high yield category, have been able to refinance their debt, although the new coupons are significantly higher. However, operating margins have fallen in some sectors, such as automotive, where there have been some profit warnings. Nonetheless, default rates remain low, although caution is advised for issues rated below B, which have a higher risk of default.

In general, the credit environment remains favourable. Both high quality and more speculative credits offer attractive risk premiums. Extending the duration of positions may be an advantageous strategy in the current market environment, characterised by soft landings and interest rate cuts.

Indices: 'S&P 500 ex Mag7' vs 'S&P 500 Mag7'



S&P 500 Mag7 (LHS) S&P 500 ex Mag7 (RHS)

Source: Bloomberg; Banco Carregosa

The S&P 500 rose 5.4% in the third quarter, but unlike in previous quarters, this time the gains were driven by the 7.5% rise in the S&P 493 (i.e. excluding the Magnificent 7): Apple, Microsoft, Amazon, Alphabet, Meta, Tesla, and Nvidia), while these 7 companies rose just 1.6% in the previous quarter. Technology lost its market leadership for the first time since the fourth quarter of 2022. According to LSEG/Refinitiv, the Magnificent 7 group accounts for 31.5% of the S&P 500's market capitalisation, while its profits and revenues account for 19.4% and 10.8% respectively. Mag7 has an aggregate four-quarter P/E of 29.6x, a 38% premium to the overall index. Excluding Mag7, the forward P/E falls to 19.0x.

Equity Outlook

For most equity markets, the third quarter was again positive.

It is interesting to note that the beginning of each of the three months of the quarter was marked by significant movements. July saw a sharp rotation in style – favouring value over growth – and size – favouring small & mid caps over large caps - while the first days of August and September saw sharp declines on fears of a sharper-than-expected slowdown in the US economy. However, each of these movements was attenuated or even more than compensated for in the weeks that followed: the relative performance of the various market segments stabilised, while the indices recovered to close the two months in positive territory.

One very important theme that hasn't changed is that the quarter was characterised by sector rotation. Individual sector performance was much more uniform than in the first half of the year, with Technology even losing its lead in returns. Another highlight was Europe's renewed underperformance relative to the US, due to weakness in some of Europe's most important sectors, such as automobiles and luxury goods.

As fears of a sharp slowdown in the global economy have not materialised, at least so far, the main factor behind the positive performance of equity markets has been the start of a downward trend in interest rates in both the US and the eurozone, supported by the publication of favourable inflation data in these regions. In the closing days of the quarter, the market found further reason for optimism as China announced a broad package of monetary and fiscal initiatives aimed at accelerating local economic growth.

This economic environment is therefore consistent with the narrative of accelerating corporate earnings growth.

Development in the last 3 months

	30-jun	31-jul	31-aug	30-sep	Last 3 months	Last month (sep)
Equities						
S&P 500	5 460.48	5 522.30	5 648.40	5 762.48	5.53%	2.02%
Nasdaq 100	19 682.87	19 362.43	19 574.64	20 060.69	1.92%	2.48%
DAX 40	18 235.45	18 508.65	18 906.92	19 324.93	5.97%	2.21%
Stoxx 600	511.42	518.18	525.05	522.89	2.24%	-0.41%
Nikkei 225	39 583.08	39 101.82	38 647.75	37 919.55	-4.20%	-1.88%
Shanghai Composite	2 967.40	2 938.75	2 842.21	3 336.50	12.44%	17.39%
MSCI World	3 511.78	3 571.58	3 661.24	3 723.03	6.02%	1.69%
MSCI Emerging	1 086.25	1 084.77	1 099.92	1 170.85	7.79%	6.45%
Long-term interest rates						
10-year Treasury Yield	4.40%	4.03%	3.90%	3.78%	-61.5 pb	-12.3 pb
10-year Bund Yield	2.50%	2.30%	2.30%	2.12%	-37.7 pb	-17.6 pb
10-year OT Portugal Yield	3.25%	2.93%	2.91%	2.70%	-54.8 pb	-21.0 pb
Short-term interest rates						
3-month Libor USD	5.59%	5.50%	5.28%	4.85%	-73.3 pb	-42.5 pb
3-month Libor EUR	3.71%	3.65%	3.49%	3.28%	-43.2 pb	-21.1 pb
Exchange						
EUR/USD	1.0713	1.0826	1.1048	1.1135	3.94%	0.79%
EUR/GBP	0.8473	0.8421	0.8415	0.8325	-1.74%	-1.07%
Commodities						
Brent (USD/barrel)	82.89	79.71	76.24	71.70	-13.50%	-5.95%
WTI (USD/barrel)	79.00	76.05	72.65	68.17	-13.71%	-6.17%
Gold(USD/troy ounce)	2 326.75	2 447.60	2 503.39	2 634.58	13.23%	5.24%

Fonte: Bloomberg; Banco Carregosa

For example, the S&P 500 is currently expected to grow by 11% in 2024 and by 15% in 2025 (excluding energy) - and thus keep equity prices at historically high levels. However, we reiterate that technology, the only sector in the S&P500 with a P/E above its 10-year median, continues to distort the multiples of the indices.

A degree of mistrust in the ability of the major Western economies to avoid recession has led to the outperformance this year of companies perceived as having higher quality – those with a history of less volatile earnings. We believe this outperformance will continue and therefore favour investments in companies that are exposed to long-term structural growth trends and can generate attractive cash flows. However, in the economic context described above, we recognise the tactical interest in selectively picking companies that have the potential to reactivate their more cyclical businesses or that have relatively leveraged balance sheets.

Outlook for Alternatives

Investing in alternative assets has become more attractive as a result of interest rate cuts by the major central banks, but the usual dispersion of performance calls for rigorous selection.

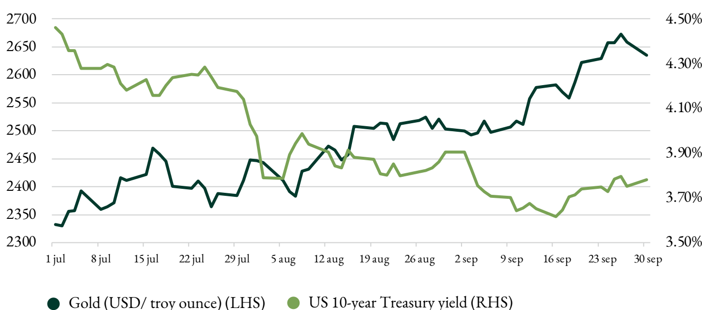
After hovering around $80/bbl until August, oil has become more volatile and is expected to move sideways in the coming months, with demand rising until 2025 and supply dependent on OPEC+.

Energy markets could come under downward pressure due to moderate global GDP growth and robust supply. At the same time, the risk of an energy crisis in the European Union (EU) is reduced thanks to high gas storage and LNG import capacity. However, tensions in the Middle East could push prices higher. After an initial rise, copper fell in the third quarter before recovering in September. In the long term, the plans for the energy transition are favourable for copper, but the uncertainty about demand in China could prevent a steady recovery before 2025.

Gold reached new highs on the back of a weaker dollar, expected interest rate cuts and geopolitical tensions. The metal remains attractive due to central bank buying, geopolitical risks and the prospect of lower opportunity costs as interest rates fall. In the long run, expansionary fiscal policy can put pressure on fiat currencies, helping to make gold appealing as a store of value.

The property sector offers opportunities in real assets such as infrastructure, benefiting from inflation protection and the growth of artificial intelligence (AI). Macro events, relative value and long/short funds are seen as promising, as are the private debt and equity markets that are leading innovation in AI and healthcare outside the public markets.

Gold price and US 10-year treasury yield in Q3 2024



Source: Bloomberg; Banco Carregosa

On the demand side, the main drivers of the gold price are central bank monetary policy, interest rates, geopolitical uncertainties, economic developments, inflation and the dollar. On the supply side, production costs are key to determining the price. The price of gold tends to rise in times of falling interest rates, economic recessions and high inflation, but also when robust demand outstrips supply, as is currently the case with growing interest, especially from China, pushing the price to all-time highs of $2685.49. Rising tensions in the Middle East and falling interest rates, as shown in the chart, are also helping gold. In the second half of the 19th century, the USA and Australia were the largest producers, but in the 20th century South Africa dominated the mining industry. At the start of the new millennium,

China became the world's largest producer, reaching 330 tonnes/year in 2023. Production has tripled and 60% of all existing gold has been mined in the last 60 years. As a precious metal, gold is considered a speculative asset because it generates no income, and there are risks to economic growth if its relative value exceeds that of useful assets – those that generate income.

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