AEGON Asset Management

Macro research
January 2024

AEGON INSIGHTS

Global House View

● Overweight ● Neutral ● Underweight

Asset class		Opportunity set	UW	N	OW	Change	Comments
Main asset class		Equities		●		▲	Expect modest returns in equities over the short term as financial conditions ease and central bank rhetoric softens. Some headwinds remain however given uncertain macro environment.
		Fixed Income		●		▼	A strong rally into the end of the year leads us to downgrade our fixed income position to neutral. Tightness in labor markets in particular will likely act as a buffer to any move lower in yields.
		Commodities		●			Expect commodity prices to remain choppy in the near term as both demand and supply decline.
		Cash		●		▼	Cash returns are expected to decline as central banks ensue their cutting cycles. More moderate returns are expected as interest rates fall later this year.
Preference by asset class	Equities	US		●			The rally into the end of the year was driven largely by falling yields and dovish Federal Reserve rhetoric. Recent Fed commentary has reduced the likelihood of a March cut, however, which should provide some headwinds to US equities in the near term as yields reprice higher.
		EU		●			European equities performed well last year. The economy is faltering, however the European Central Bank (ECB) has signalled we are at the peak of the rate cycle and given attractive valuations we recommend a neutral position.
		UK		●			Interest rates peaking is a potential catalyst for such a deep-value market. But other factors, including poor fundamentals and sentiment, lead us to maintain our neutral positioning.
		Japan		●			Remaining neutral on Japan equities after a strong 2023. There is some room for further gains due to corporate reforms, but the yen's volatility could dampen another rally.
		Asia ex-Japan		●			Some domestic economies like India and Indonesia are still providing solid growth. But China's domestic woes are continuing, which is a negative for the wider region.
		REITS		●			Strong rally into year-end suggests rate cuts are now fully priced in. Expect the asset class to trade in line with wider equity and rate market volatility until cuts occur, therefore positioning remains neutral.
	Fixed Income	Government bonds	●				Remain underweight sovereign debt, in particular Japanese government bonds.
		Investment Grade			●		Spread narrowing is limited at this stage but strong technical support from heavy demand and decent valuations should keep investment grade in a carry-like environment over the near term.
		High Yield			●		Some scope for further spread tightening due to decent fundamentals. Defaults are still relatively subdued and all-in yield means asset class still holds attractive carry potential.
		EM Debt		●			Preference for credit allocations in developed economies at this point in the cycle. Global growth prospects and strong USD continue to be headwinds for emerging market debt.
		Securitized		●		▼	The floating rate nature of securitized debt may lead to more modest returns as interest rates begin to fall in 2024. Some headwinds may also be expected as corporate and consumer debt increase.
	Currency	USD			●		The US dollar should be "stronger for longer" given the view of US growth outperformance, and ongoing economic struggles in the major challengers, for instance the euro area and China.
		Euro		●			Continued stability is likely as good as it will get for the euro. It is difficult to envison a rebound as the region struggles for growth momentum.
		Japanese Yen		●			The recent yen strength was on the back of a duration rally. However, ,the near-term risks of Bank of Japan disappointment and rising risk sentiment, will likely see limited scope for more substantial yen appreciation
		GBP	●				Although a lot of the weak structural backdrop is known, the key negative for GBP over 2024 is the potential for the markets to price in earlier rate cuts. Sterling will likely now return to trading by conventional metrics such as global risk and rates.

All investments contain risk and may lose value. The above overview is intended to illustrate major themes for the identified period. No representation is being made that any particular account, product, or strategy will engage in any or all of the themes discussed. Figure 1:Our asset class overweights/underweights in our model portfolio as of December 31, 2023 on a 3-month horizon. Up/down arrows indicate a positive (▲) or negative (▼) change in view since the prior quarterly global house view meeting. These views should not be construed as a recommended portfolio. This summary of our individual asset class views indicates strength of conviction and relative preferences across a broad-based range of assets but is independent of portfolio construction considerations.

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Our asset allocation decisions – in short

Cross asset allocation: We have moved all asset classes to neutral on a cross-asset basis.

For equities, the softening sentiment in the third quarter quickly dissipated in fourth quarter as the prospect of a cutting cycle emerged and bond yields declined. Although we still think equities are broadly over valued at this point in the cycle, we recognize that loosening financial conditions could help support the asset class, even if there are some earnings declines due to the softening economic environment.

Fixed income markets also rallied significantly in the fourth quarter due to the similar core themes of declining growth signals and dovish central bank rhetoric. From a peak in mid-October of 4.99%, yields on the US 10-year Treasury have since declined to finish the quarter at 3.88%. Similarly strong returns were also felt in global investment grade and high yield markets. All in all, the fourth quarter marked one of the strongest quarters for fixed income in history. However, we believe the market has overdone itself, leading us to move our score from overweight to neutral on a tactical basis, until we see more compounding evidence from central banks that they are prepared to begin their rate-cutting cycles.

Finally, while the possibility of lower interest rates helped propel equity and fixed income markets to higher returns, we see the end of the rate cycle as being a negative for cash rates and therefore are downgrading our score from positive to neutral.

Within fixed income: Within fixed income we remain overweight in spread categories relative to sovereigns.

In our overweight spreads preference, we have downgraded our securitized debt score from overweight to neutral. Given the strong rally in sovereign bonds in the fourth quarter, we are more neutral on duration overall.

Within equities: We have kept all of our regional equity preferences at neutral.

The rally into year-end was led predominantly by a fall lower in government bond yields and therefore a softening in financial conditions. However, given our view that this rally appears overdone, we could expect some choppiness in equities in the short term—especially given how strong their performance was in aggregate over 2023.

Within currencies: We remain overweight the US dollar against the British pound.

While the Fed appears to be turning toward rate cuts as a policy preference, cuts already priced in and being delivered in some other jurisdictions—especially the euro area and China—look like much more of a policy necessity. The Fed has already shown its dovish hand, but the ECB for example could shift. For the dollar to weaken, it would require better growth in Europe and China, along with continued disinflation. There would also be a need for the Fed to be aggressively cutting more than elsewhere, which seems unlikely at this point.

For sterling, the potential key negative will be for markets to price in more rate cuts due to slowing economic growth. Fewer rate cuts are currently being priced in by the markets next year compared to in the US and euro, which may change if the UK's economic growth decline more rapidly, which would be negative for GBP.

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Market Commentary

If the third quarter was the uncomfortable ride to the top of the roller coaster—where nerves start to rise and you wish there was an option to turn around—then the fourth quarter was the exhilarating ride to the bottom, where fears suddenly subside and everything feels great. That is certainly what it felt like for Treasury investors, who have struggled with rising yields for much of 2023. Longer-dated US Treasury yields had been rising for most of the year, guided higher by fears that monetary tightening wasn't working and that the US Federal Reserve would have to continue its hiking policy. Yields on the US 10-year Treasury reached 5.00% in mid-October, with some market participants thinking it could still rise higher. But what followed was a series of economic data prints in late October and November that pointed to both inflation and the economy cooling. Investors began to price in easier financial conditions in 2024 as a result. And Fed-funds rate futures showed a change in expectations from two cuts priced in for 2024 at the start of the quarter, to six by the end of November. A repricing to softer monetary policy led to a rally in US Treasury yields, as well as just about everything else. Risk assets, in particular more rate-sensitive ones, like global REITs, growth and small-cap equities outperformed. Most of the fixed income spectrum, including sovereign debt, emerging market debt and credit, also bounced back strongly, having suffered from the prior period of high inflation.

Heading into December, markets turned to the Fed to pour some cold water on the growing excitement that a cutting cycle was coming quicker than anticipated. But instead, to the surprise of investors, the Fed issued a revised dot plot that showed policymakers too were considering cuts in 2024, causing markets to rally further into year end. Having touched 5.00% at the beginning of the quarter, US Treasury yields finished the year at 3.88%, marking one of the best quarters for fixed income in history. Gilts and bunds acted in a similar fashion as inflation began to fall at a much quicker speed, leading the markets to forecast that the ECB and the Bank of England were also at the end of their hiking cycles. The global loosening in market liquidity therefore meant that the rally in risk assets was seen in most regional equity and fixed income markets. Only Chinese equities, which continue to be hampered by low consumer sentiment and an ongoing property and banking crisis, were negative.

Going forward, we expect markets to be firmly focused on the pathway of inflation, central bank messaging and whether or not global economies can be guided to a soft landing. Yields at the beginning of 2024 have re-priced higher following some push back from monetary policy makers that central banks remain data dependent and that the cutting cycle that the market wants is not a foregone conclusion. Recent labor data has proved that the jobs market—and wages—are still sticky, so a "higher for longer" interest-rate environment is still very much a possibility. Unlike the market's current expectations of the Fed cutting cycle beginning in March, we instead believe this will begin in the summer, so we would expect to see some repricing in the near term as the market re-adjust its forecasts. How central banks actually act therefore, will be key as we head into the new year.

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