Central banks under increased pressure due to concerns over the economic situation

September 9th, 2024

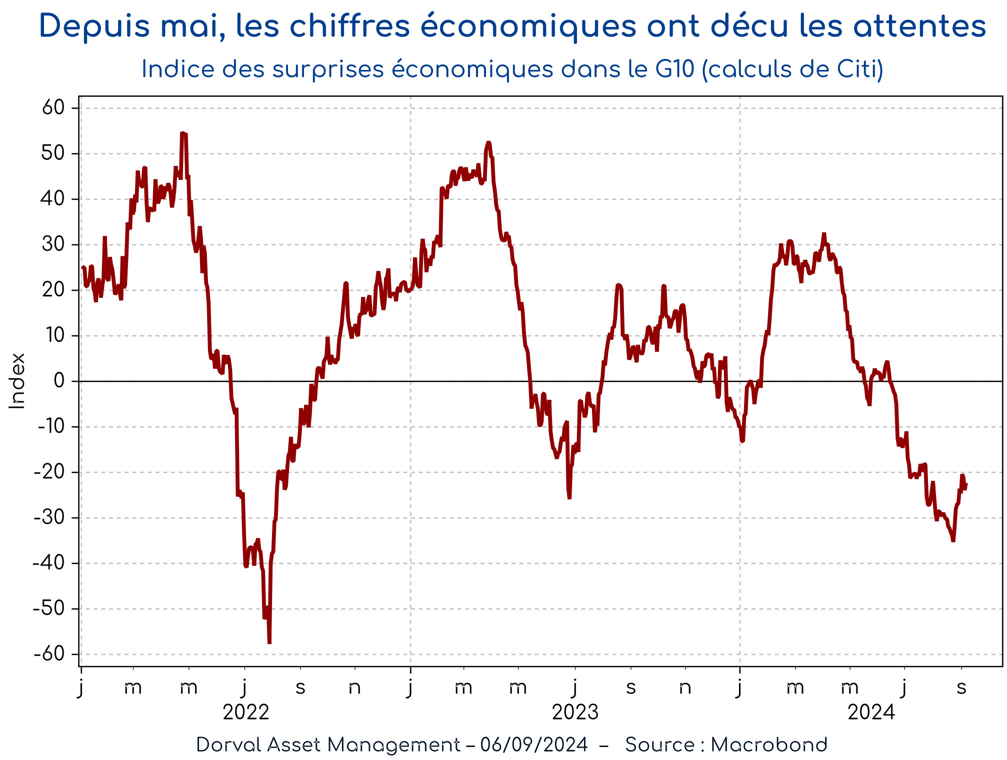
Dear Clients and Partners,

Economic figures have generally proved disappointing since the end of spring, but investors are torn between several perspectives. Should the focus be cyclical risks, the stabilising effects of rate cuts, or even the increased potential for welcome surprises that comes with growth expectations being revised downwards?

Perceived economic momentum, boosted by good US and European figures in early 2024, has weakened markedly since May. The Citi index shows that aggregate economic surprise in major economies has reached its lowest level since the summer of 2022 (cf. chart 1). First occurring in China and then Europe, economic disappointment is now spreading to the US economy, where consumer and labour market momentum are carefully scrutinised.

Economic figures below expectations since May

G10 Economic Surprise Index (Citi)

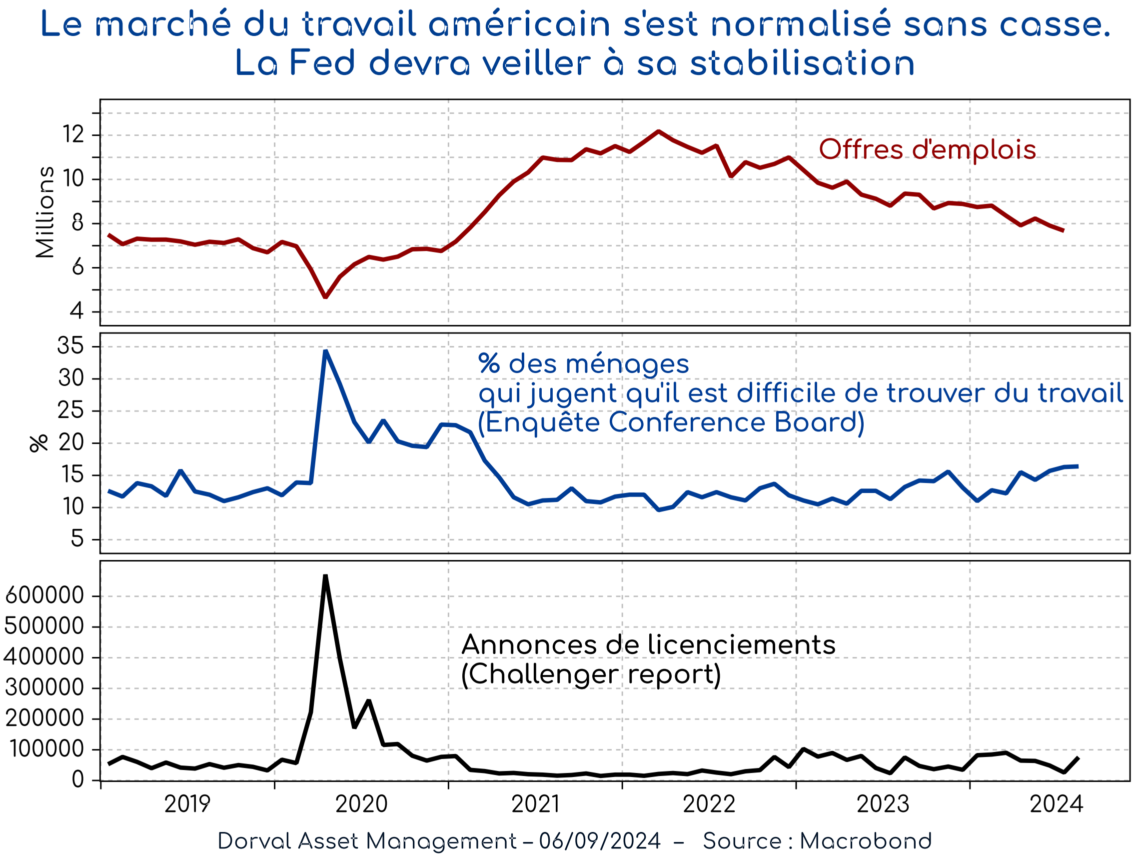


After a brief but significant anomaly on the equity market at the beginning of August, the effect of this economic climate change has, for the time being, been offset on the stock market by the positive effect of interest rate cuts. However, as is often the case with markets, debates are raging. Though currently modest, will economic deterioration accelerate, bringing about a global recession? Or should focus be on the renewed willingness of central banks to stabilise growth expectations by easing credit conditions?

Our diagnosis, at this stage, is that the economic momentum now requires central banks to intervene. We expect these interventions to be sufficient to prevent a vicious circle leading to recession. We believe that action is necessary in view of decreased US labour market momentum, the decline in the global manufacturing industry business climate, and low consumption in certain regions (particularly in Europe).

In the US labour market, indicators show that the overheating resulting from Covid has ended, but without a significant rise in redundancies (cf. chart 2). However, the US Federal Reserve will need to ensure that the job market slowdown does not endure. As Jerome Powell highlighted at the Jackson Hole Symposium last month, the Fed has ample room to ease credit conditions, and will begin cutting interest rates as early as 18 September.

Healthy normalisation of the US labour market. The Fed will need to guide its stabilisation

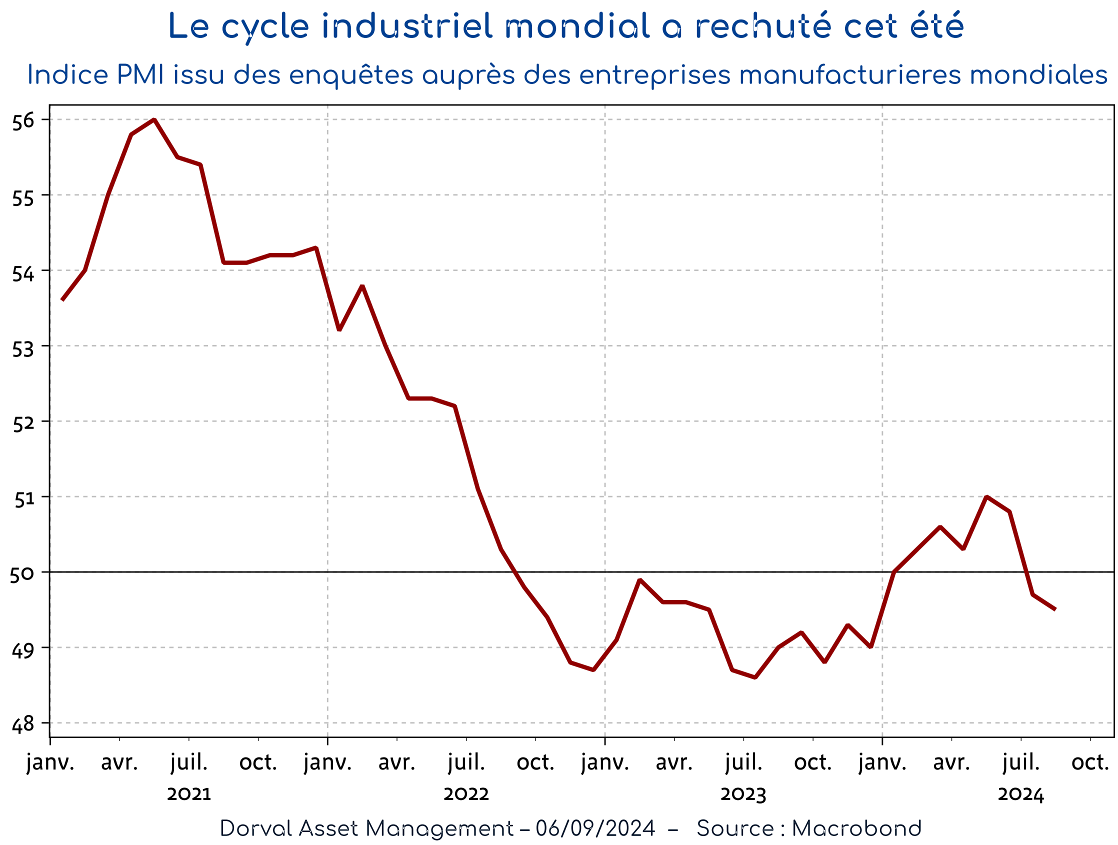


Job openings / % of households that consider it difficult to find work (Conference Board survey) / Layoff announcements (Challenger Report)

On a global level, the latest surveys cast doubt over the hopes of stabilisation and industrial recovery that had emerged earlier this year. The global manufacturing PMI fell slightly below 50 this summer (cf. chart 3). The automotive sector and construction-related sectors (metals, materials) have been hit hardest.

Global manufacturing cycle in decline this summer

PMI index from surveys of global manufacturing companies



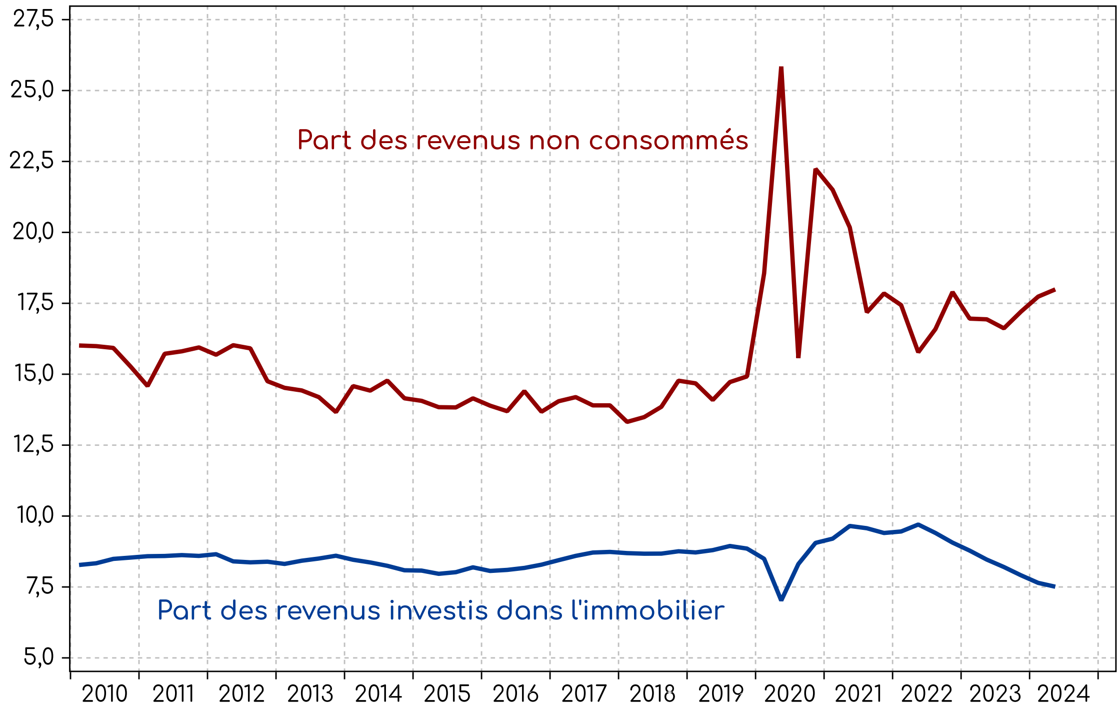
Lastly, in addition to manufacturing difficulties, demand in Europe is continuing to suffer – in particular household spending. Despite the rise in household purchasing power over the past year and the historically low level of unemployment, spending is stagnating. In France, for example, household savings have never settled down to pre-Covid levels. They have even risen in recent quarters (cf. chart 4). So what will it take for households – in France and some other European countries like Germany – to at least stop over-saving? With fiscal policies paralysed, it seems down to the ECB alone to create positive momentum in this regard. With credit conditions beginning to improve, ECB rate cuts should help change household spending habits. For example, some banks are already anticipating a rise in demand for property loans in the fourth quarter. And lower interest rates could help normalise savings rates.

Savings in France up, pending ECB intervention?

as a % of household disposable income

Remontée du taux d'épargne en France, en attendant la BCE ?

en % du revenu disponible des ménages



Dorval Asset Management – 06/09/2024 – Source : Macrobond

Proportion of revenue unspent / Proportion of revenue invested in property

In our flexible global and European strategies, our portfolios therefore retain a higher level of equity investment. However, we have profited from the overexposure we implemented after the sharp market decline in early August, and reduced exposure to the themes that are most sensitive to the manufacturing cycle (the "industrial recovery" basket in global portfolios and "small caps" basket in European funds). We have also reduced the size of the basket of securities invested in the AI and productivity theme ("New Capex").

Our exposure rates are as follows:

- **Dorval Convictions** : 60% d'exposition nette aux actions dont panier cœur Euro Stoxx 50 ISR 60%, panier financières 6.5%, Panier petites capitalisations 7%. Couvertures en futures Euro Stoxx 50.

Dorval Asset Management

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