Risk of sharp economic slowdown at the end of the year | Andrea Scauri's latest view

We translate and publish the market view of our portfolio manager Andrea Scauri, taken from Milano Finanza. The original article in Italian can be found at this link: https://bit.ly/3mJ6ebs

> *As of today, the likelihood of a recession in the first half of 2023 remains low, and the soft landing scenario remains the most likely for markets. However, this process of rapid monetary policy adjustment increases the risk of an unintended sharp economic slowdown by central banks in the second half or early 2024, with risks to corporate profits*

This is the view of Andrea Scauri, fund manager of **Lemanik High Growth** fund.

Tight monetary policies **may be needed longer than expected**. In particular, labor market data in the United States have been significantly stronger than expected, as well as inflation has proved more resilient, consequently increasing the likelihood that the Fed and the ECB will be forced to raise rates more than markets initially discounted, with risks to the economy as well.

The data show that demand is proving **more resilient** in the face of the current monetary tightening and that lingering supply-side damage from the pandemic is limiting the moderation of inflation. In fact, the euro area and U.S. PMIs continued their rebound in February, at 51 and 49, respectively, thanks to the easing of headwinds from the EU energy crisis and an improvement in consumer purchasing power due to falling inflation in recent months. The U.S. 2-year breakeven rate, which reflects the market's estimate of 2-year inflation, rose to 3.1 percent from 2.3 percent earlier this month, well above the Fed's inflation target of 2 percent. In addition, market expectations now point to a peak in U.S. interest rates at 5.4 percent from 4.8 percent in early February, followed by a decline to 5.1 percent in January 2024. In Europe, the ECB deposit rate is currently at 2.5 percent and the market expects an increase to 3.7 percent by September 2023. Higher real rates imply higher discount rates for stock valuations, which must be more than offset by higher valuations to lead to higher stock prices (a scenario that seems unlikely to us in the short term).

The sectors most sensitive to interest rates at this stage are **already showing sharp slowdowns**: mortgage demand in the U.S. is experiencing the sharpest contraction in at least 30 years (-57% y/y in February), with current rates suggesting further deterioration. The US 10Y-2Y rate curve remains sharply inverted (-87bps from -72bps at the beginning of the month), continuing to signal a high probability of recession. Our conclusion is that in the longer term, that is, in the second half of 2023, **risks are tilted toward more central bank action that could impact the economy and corporate profits**. In the short term, however, investor participation in the stock market is still underweight, and so we still see room to position ourselves in equities at full strength, but favoring quality stocks over cyclical stocks.

The reopening of China and the easing of concerns related to the energy crisis have improved the short-term picture. Likewise, **we believe that excessive government borrowing and rising government requirements will necessitate negative real rates in the medium term**. In the longer term, we see the risk of a loss of growth momentum in the EU and the U.S. in the second half of 2023, due to ongoing monetary tightening (which is transmitted with a lag to the economy), combined with a market that now seems to be pricing in too low a probability of an economic slowdown.

> *In this context, our portfolio positioning focuses on issues related to so-called green capex, with stocks such as Danieli and Prysmian, and telecommunications, with stocks such as Inwit and Ray Way.*

We also follow the gas sector. With the recent shortage of gas due to the lost flows from North Stream 1 and the resulting potential cap on gas prices that may act as a ban on the Russian oil market as well, there could be a large production shortfall, favoring drilling activity in the United States for shale oil and shale gas. This is why Tenaris remains a key holding, along with Saipem.”

Andrea Scauri

More than 20 years of experience in equity markets, developed both within Asset Management firms and at leading investment banks both domestically and globally. In these contexts, Andrea lived between Milan and London before joining Lemanik Invest SA in 2019, he has been directly involved in IPO processes of several companies…

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