At the peak: easing will take time

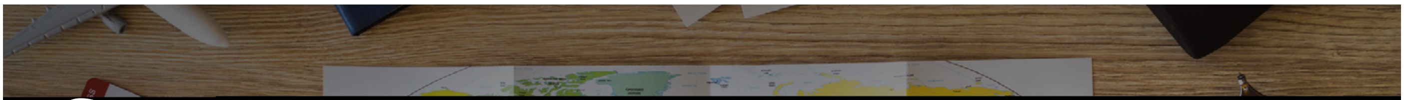
Group Investment Strategy

Monthly Outlook

October 2023

UniCredit

Index



Summary

At the peak: easing will take time

MACROECONOMIC UPDATE

The signs of a cooling global economy with decreasing inflationary pressures are becoming more and more evident.

Surprising in view of the highly restrictive monetary policy is the continued economic strength of the US. The Fed has recently revised its growth forecasts upwards for the years 2023 and 2024, while expectations for the unemployment rate were adjusted downwards. In our opinion, these revisions are too optimistic. We expect a likely deceleration in consumption in the coming quarters due to diminishing saving buffers, tighter credit conditions, and a slowdown in wage growth.

The European Central Bank has lowered GDP growth forecast for the Eurozone. However, it is important to underline that the current strength of the US economy is also fuelled by the Biden administration's fiscal measures, while against the backdrop of a massive increase in interest rates, the current economic weakness of the Eurozone can also be explained by the fact that there is no spending programme comparable with the US.

The latest data releases suggest that China may have bottomed out of its economic slowdown.Despite surprisingly better economic data, we think it is still too early to speak of a recovery. Recent government stimulus measures should support growth, although we expect more fiscal stimulus to be needed to reach the Chinese government's 5% growth target for this year.

INFLATION AND MONETARY POLICY

At its last meeting in September, the Fed left its key interest rate (upper end) unchanged at 5.50%. Nevertheless, this decision was interpreted by the financial markets as a "hawkish pause", as the Fed additionally revised its forecasts for GDP growth this year and next significantly upwards, and it now assumes that interest rates will have to remain high for longer in order to bring inflation back to the 2% target on a sustainable basis.

At its September meeting, the ECB raised its key interest rates by 25 bps and signalled that the tightening cycle is now probably over. The Governing Council acknowledged that the vigorous tightening of monetary policy (10 consecutive rate hikes) is increasingly dampening economic activity and considers that interest rates have now reached "a level which, if maintained for a sufficiently long period, will make a significant contribution to the timely return of inflation to the target level". Overall, the ECB decision was received by the financial markets as "dovish" (i.e. "soft" in terms of monetary policy) despite the interest rate hike.

FINANCIAL MARKETS

In our view, the current situation creates attractive entry opportunities in multi-asset portfolios, i.e. portfolios that combine equities and bonds with a balanced risk profile. This is because bond yields have risen sharply, providing investors with interesting coupon payments combined with possible price increases if central banks actually start to lower interest rates. The higher yields also open up the prospect for investors of being able to offset potential price losses on equities due to challenging macro conditions.

CIO’s Letter

At the peak: easing will take time

Following the September meetings of the European Central Bank (ECB) and the US Federal Reserve (Fed), the focus continues to be on the future monetary policy path of these major central banks. Notably, the recent policy decisions of the two central banks were different, as was the reception on the markets. In particular, the ECB’s interest rate hike was perceived by the market as a **“dovish hike”**[1], while the Fed’s decision to leave interest rates unchanged was interpreted as a “hawkish pause”.

We believe that the major central banks have delivered the majority of their rate hikes in this cycle. Whether there are still sporadic and small rate hikes to come should probably no longer matter much from an economic point of view. And it is not only the Fed that left interest rates unchanged in September. The central banks of the UK, Switzerland and Japan also did not turn the interest rate screw any further in September. This is because the signs of a cooling global economy with decreasing inflationary pressures are becoming more and more evident, as important economic sentiment indicators make clear – most recently the European purchasing managers’ indices, but also the German ifo index. The reported inflation figures have also cooled considerably, but still remain well away from the central banks’ 2% inflation target.

While the central bankers’ battle against inflation has not yet been won, the focus of monetary policy is shifting. Now that the interest rate peak has (likely) been reached, the question is how long interest rates will remain at the current high level. At the beginning of the year, the interest rate markets were pricing in that the Fed, for example, would make the first interest rate cuts only two to three months after reaching the interest rate peak – a hope that was probably too optimistic. The implicit expectation (i.e. derived from market prices) has meanwhile rather extended to a duration of two to three quarters between reaching the interest rate peak and the first rate cut. The “hawkish pause” should also be understood against this background. The central bankers around Fed President Jerome Powell want to prevent market participants from being seduced by the hope of interest rate cuts too quickly. Such a development would imply that long-term yields in the US bond market would fall more sharply and thus counteract a decisive part of the monetary policy tightening. This could lead to longer-lasting inflationary pressures. However, if inflation figures fall faster than expected, it also cannot be ruled out that Fed members will lower their interest rate outlook much faster than outlined so far. In this respect, the “hawkish” statements on the latest Fed decision could be interpreted more as a warning than a promise.

And indeed, the recent rise in the price of oil could be cause for some caution. However, it should not be ignored that the oil price has not risen primarily due to strong demand, but rather as a result of the supply shortage by the OPEC+ states (OPEC and non-OPEC states, such as Russia). That is why the higher oil price has a short-term inflationary effect on the one hand, but on the other hand the high oil price is hitting an already weakening economy – at least in Europe and China. In the medium term, it is even likely to be a further factor in a cooling of economic activity, which will ultimately have a dampening effect on inflation.

But why do the markets expect reasonably rapid interest rate cuts at all, given that inflation is still too high? The reason is that the current level of central bank interest rates is well within the so-called restrictive range. Central banks usually set the interest rate level relative to a so-called neutral interest rate, i.e. an interest rate that, in a state of equilibrium, neither fuels nor slows down inflation. An interest rate well below the neutral rate thus increases inflation, while a rate well above it slows it down. The difficulty with this concept is that the neutral rate is not directly

[1] A monetary policy stance is considered hawkish if it assumes a tightening of monetary policy by, for example, raising interest rates or reducing the central bank balance sheet. The opposite would be dovish.

measurable, but can only be roughly estimated. However, central banks should have a good idea of what the neutral rate is for their respective economies. The Fed's estimate in this regard is even published. It is currently 2.5% at the median of the decisive body. With an interest rate of well over 5%, the Fed is thus well into the restrictive (i.e. growth- and inflation-braking) range. And even if the Fed's own estimate of the neutral rate of 2.5% should be too low, the current "safety margin" seems high enough to assume that monetary policy in the US is cooling inflation.

Surprising in view of the highly restrictive monetary policy is the continued economic strength of the US. The Fed has recently revised its growth forecasts upwards, while the ECB has lowered them for the Eurozone. From a sober perspective, the current strength of the US economy, in addition to robust private consumption, is also fuelled by the Biden administration's fiscal measures. Against the backdrop of a massive increase in interest rates, the current economic weakness of the Eurozone can also be explained by the fact that there is no spending programme comparable with **Bidenomics**[2]. While Germany's economic weakness cannot be dismissed, the European economy as a whole appears surprisingly robust. If cooling inflation gives the ECB the leeway to cut interest rates next year (which is very likely), economic activity here should also recover. The markets expect GDP growth rates in the euro area to be similar to those in the US in 2024. While corporate earnings growth is expected to lag behind that of US firms, it should be clearly positive next year and the year after. In our view, higher expected earnings growth in the US versus the euro area is already reflected in the valuations of the respective markets, as the US equity indices are still valued significantly higher on average in terms of price-earnings ratios (P/E ratios) than their European counterparts, which are comparatively cheaply valued and thus offer selectively interesting entry opportunities.

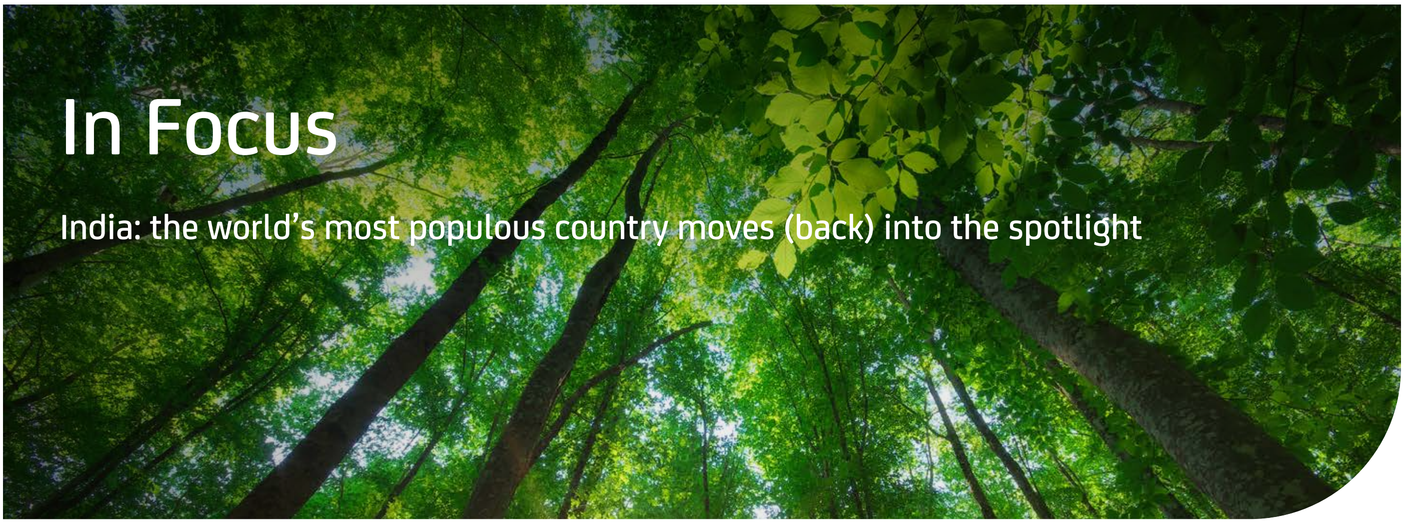
[2]The Biden administration's economic policy, called Bidenomics (a portmanteau of Biden and Economics), features relief to combat the COVID-19 pandemic, investment in infrastructure and strengthening the social safety net. Biden described his economic philosophy via Twitter in June 2023: "Bidenomics is about growing the economy from the middle and the bottom up, not the top down."

In our view, this creates attractive entry opportunities in multi-asset portfolios, i.e. portfolios that combine equities and bonds with a balanced risk profile. This is because bond yields have risen sharply. On the one hand, this development provides investors with interesting coupon payments and, on the other hand, opens up the potential of possible price increases in bonds if central banks actually start to lower interest rates. The higher yields also open up the prospect for investors of being able to (at least partially) offset potential price losses on equities with possible price gains on bonds.

MANUELA D'ONOFRIO, *Head of Group Investment Strategy*
PHILIP GISDAKIS, *Chief Investment Officer Germany, UniCredit Bank AG (HypoVereinsbank)*
ALESSANDRO CAVIGLIA, *Chief Investment Officer Italy, UniCredit SpA*
OLIVER PRINZ, *Co-Chief Investment Officer of UniCredit Bank Austria AG and Schoellerbank AG*

In Focus

India: the world's most populous country moves (back) into the spotlight



After initial hopes at the beginning of the year that the Chinese leadership's departure from "zero Covid" could lead to a rapid economic recovery in the country, investors have been disappointed in recent months. Weak global demand is hitting the export-dependent Chinese economy, while domestic consumption and the domestic real estate market are weakening. The Chinese politburo is increasingly counteracting this with monetary and fiscal stimulus measures – albeit with limited success so far – in order not to once again miss the 5% growth target it has set this year. Long overlooked in the shadow of China and the geopolitical tensions between China and the US, India, host of the recent **G20 summit**[3], is becoming increasingly important – especially economically, thanks to impressive annual growth rates. Investors should also take note of the country's potential.

INDIA'S RISE TO BECOME THE WORLD'S SECOND LARGEST ECONOMY

With a good 1.4 billion inhabitants, according to population statistics from the United Nations, India has recently overtaken its neighbour China as the most populous country in the world, given that China is struggling with an ageing and shrinking population because of its long-standing one-child policy (see chart 1). Since the mid-1990s, around 375 million people have been born in India. This number exceeds the corresponding group in China by almost 50%. This is the so-called **"demographic dividend"**[4], which opens huge potential for the country. To be sure, demographic trends alone are not enough to predict future economic development. Nevertheless, the dynamic shift in population dynamics between China and India is not likely to be without influence on the global economy, as a growing population can undoubtedly favour economic growth. Parallel to population growth, there is usually a shift in the ratio between rural and urban populations. In India, however, the **urbanisation rate**[5] is developing comparatively moderately. India showed a considerable discrepancy with China, where around two-thirds of the inhabitants were already to be found in urban areas.

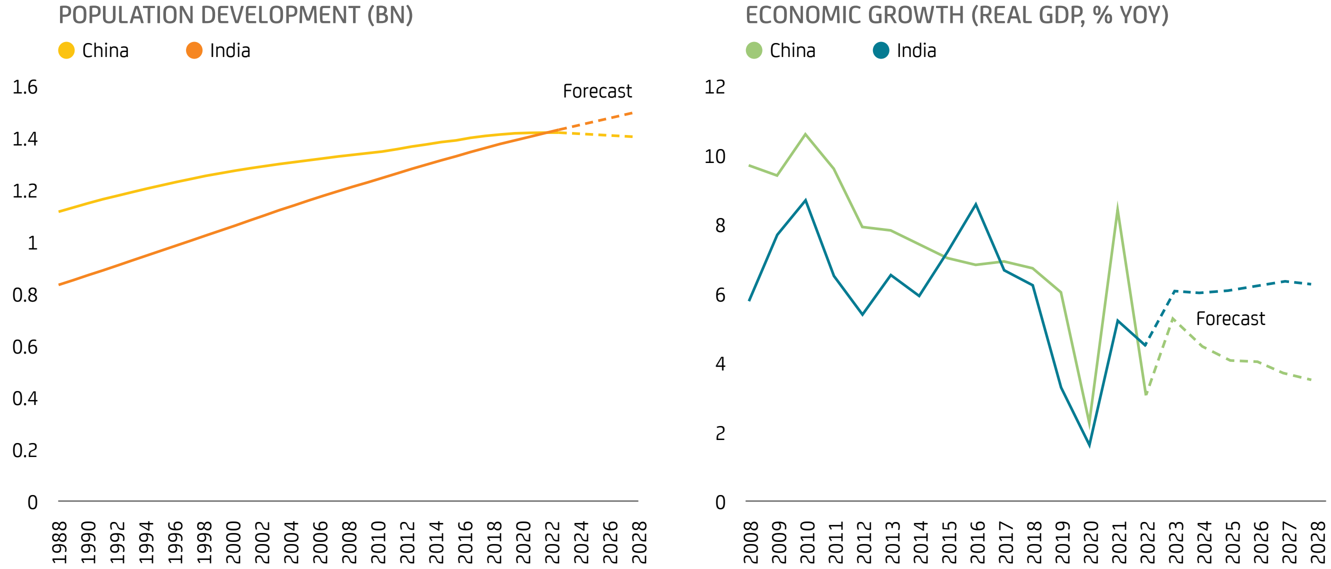
Compared to the economic might of China, the world's dominant growth engine in recent years, India's economy remains comparatively small – surpassing China's GDP by more than five times. However, given India's youthful and expansive population, the country is likely to record higher economic growth than China in the coming decades according to the International Monetary Fund (IMF). In 2022, India's economic growth reached almost 7%, whereas the latter was only around 3% in China. And the IMF's forecasts indicate that India's growth curve will remain stable in the coming years (see chart 1). The World Bank also expects India to remain the world's fastest-growing major economy in the coming years. By 2050, the country could rise to become the second largest economy globally. As the world's largest producer of generic drugs, i.e. medicines with expired patent protection, India is already a major player in the global pharmaceutical industry, and at the same time, occupies a top position in the field of information technology. However, numerous other economic sectors, such as retail and the automotive industry, are still in their infancy to a large extent.

[3] The 18th summit of the G20 heads of government took place on 9/10 September in New Delhi. The G20 is an informal grouping of 19 countries, the EU and the African Union that has existed since 1999 and represents the most important industrialised and emerging countries.

[4] The "Demografic dividend" describes the potential economic benefit that can be achieved through the development-related change in a country's age structure.

[5] The urbanisation rate refers to the proportion of urban dwellers in the total population. A higher level of urbanization often implies a progressing level of development.

1. INDIA HAS REPLACED CHINA AS THE WORLD'S MOST POPULOUS COUNTRY



Source: Bloomberg, IMF, UniCredit Group Investment Strategy

INDIA HAS (RE)AROUSED THE INTEREST OF INVESTORS

Unlike China, India is not an autocracy, but is considered the largest democracy in the world. Through a series of reforms, Prime Minister Narendra Modi has laid the foundation for robust economic development in recent years. With the digitisation and modernisation of the administration, the de-bureaucratisation of the state apparatus and a series of investment incentives, important steps have been taken to strengthen the conditions for growth. The country also hopes to benefit from the fact that more and more companies worldwide are working on diversifying their supply chains. The country's resilience to the global economic slowdown, combined with the **"China-plus-one" strategy**[6] of many international companies, should further benefit the Indian economy in the short and medium term. While China must reduce spending on its so-called Silk Road Initiative in the face of economic problems, it was also announced on the sidelines of the recent G20 summit that the US, Europe, India, Saudi Arabia and the United Arab Emirates are planning a new trade corridor to India. The far-reaching infrastructure initiative is expected to accelerate trade between Europe and India by around 40%.

India has (re)aroused the interest of investors, not least due to its promising growth prospects. A mixture of Indian equities – for example, via ETFs – can be considered by long-term investors, in particular those who have so far been underinvested in Asia. India is benefiting from the current mood, which is causing investors to increasingly look for alternatives to China. However, India's equity market, as measured by the **MSCI India**[7], is currently rather expensive with a price-earnings ratio (P/E) of over 25 after its recovery from the low for the year at the end of March (see chart 2). The latter – besides the country's expansion potential – is probably also related to the fact that Indian companies' focus on the local market seems to make them less vulnerable to adverse global influences. This year, Indian stock prices have also benefited from huge inflows from abroad.

[6] The "China-plus-one" strategy refers to business and production strategies of companies that consider reducing their dependence on Chinese supply chains and markets by investing or producing in at least one other country in addition to China. This strategy has gained importance as companies realise that diversifying their supply chains and markets can mitigate risks and increase their flexibility and resilience.

[7] The MSCI India Index comprises 115 companies covering approximately 85% of the Indian equity universe. It accounts for just under 15% of the 24-country MSCI Emerging Markets (compared to about 30% of the MSCI China).

2. INDIA'S STOCK MARKET IS RELATIVELY EXPENSIVE

Note: Past performance, simulations and forecasts are not a reliable indicator of future performance. The indices cannot be purchased and therefore do not include costs. When investing in securities, costs are incurred which reduce the performance. In the case of an investment in foreign currency, the return may also rise or fall as a result of currency fluctuations.
Source: Bloomberg, IMF, World Bank, UniCredit Group Investment Strategy
Observation period: 15.09.2013-15.09.2023

Like other emerging markets, however, India is also struggling with the effects of global climate change, to which India's still predominantly rural and underdeveloped infrastructure and economy shows little resistance. About half a year before the **general elections in India**[8], political risks should not be ignored when considering investment opportunities on the subcontinent. For instance, a loss of power by Prime Minister Narendra Modi's Bharatiya Janata Party (BJP), which currently holds an absolute majority, could potentially bring uncertainty and volatility to the Indian financial market. However, Modi's re-election currently seems the more likely scenario. Continuity in the country's political leadership would contribute to India's stability and would also be beneficial for the investment environment.

[8] Parliamentary elections are due from May to June 2024.

Macro & Markets

Fed and ECB between "hawkish pause" and "dovish rate hike"

"HAWKISH PAUSE": FED MAINTAINS INTEREST RATE LEVEL AND REAFFIRMS LONGER RESTRICTIVE MONETARY POLICY

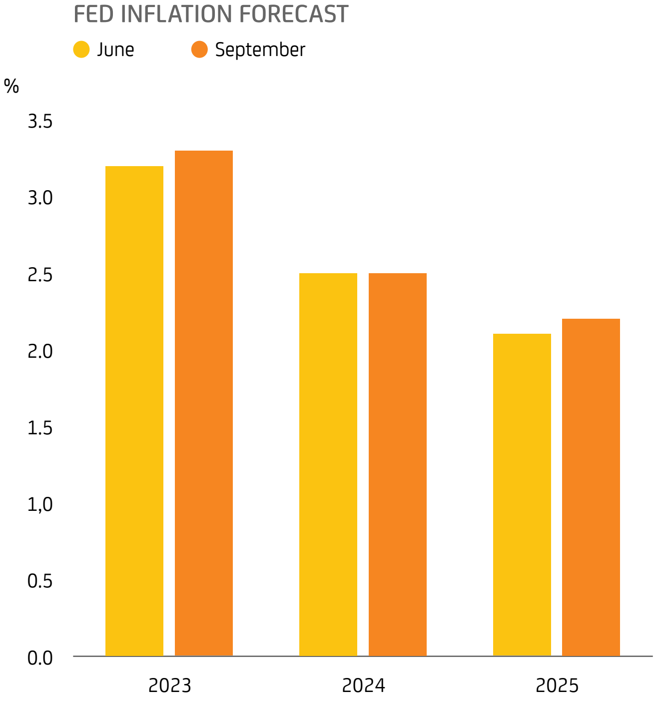
At its last meeting in September, the US Federal Reserve (Fed) left its key interest rate (upper end) unchanged at 5.50%. Nevertheless, this decision was interpreted by the financial markets as a "hawkish pause", as the Fed additionally revised its forecasts for GDP growth this year and next significantly upwards. Due to the robust economic activity, the Fed now assumes that interest rates will have to remain high for longer in order to bring inflation back to the 2% target on a sustainable basis. While the so-called "dot plot" (Fed members' interest rate outlook) still points to one more rate hike this year, it now shows two more hikes for both 2024 and 2025 (i.e. by 50 basis points, bps, each) compared to the central bank's June projections. Moreover, the Fed's monetary policy council (FOMC) now expects inflation to reach the targeted 2% target only by the end of 2026, provided interest rates remain restrictive until then. in our view, however, this target is likely to be reached earlier, as the fundamental drivers of consumer growth are likely to deteriorate further and the US economy could slip into a mild recession around the turn of the year, followed by a weak economic recovery in 2024. In such an environment, the Fed has probably already reached the peak of interest rate development. We maintain our forecast that the Fed will cut rates by 150 bps next year, starting in March.

The FOMC seems more confident about the prospect of a **"soft landing"[9]** of the US economy. Thus, GDP growth has been raised by 1.1 percentage points (pp) to 2.1% for 2023 and by 0.4 pp to 1.5% for 2024 (see chart 3). While the first of the two upward revisions mainly reflects better data this year, the upward revision for next year was more of a surprise. Forecasts for the unemployment rate were also revised downwards, to 3.8% this year (from 4.1% in June) and 4.1% next year (from 4.5%). In our opinion, this is too optimistic. Indeed, consumption is likely to slow down in the coming quarters due to diminishing saving buffers (from excess savings), tighter credit conditions (from banks), and a slowdown in wage growth. The Fed also raised its inflation forecast (**PCE inflation[10]**) for this year, albeit only slightly to 3.3% (from 3.2% previously), while the forecasts for 2024 and 2025 remained largely unchanged.

[9] A soft landing in the business cycle is the process by which an economy transitions from growth to slow growth to eventual stagnation as it approaches but avoids recession.

[10] PCE inflation measures the change in prices of goods and services purchased by private households. In contrast to the conventional consumer price index, the PCE also takes into account changes in consumption habits and includes a larger basket of goods.

3. FED REVISES GROWTH PROJECTIONS FOR 2023 AND 2024 SIGNIFICANTLY UPWARDS



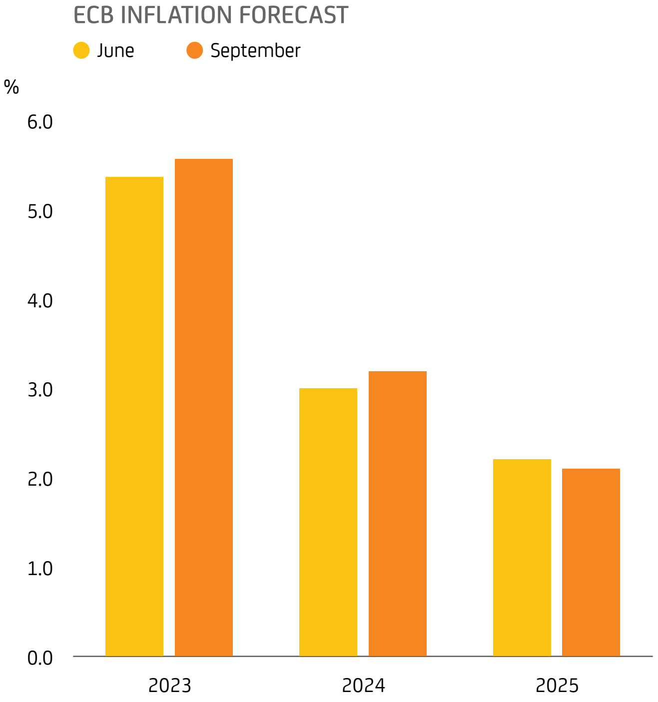
Source: Federal Reserve, BEA, BLS, Bloomberg, UniCredit Group Investment Strategy

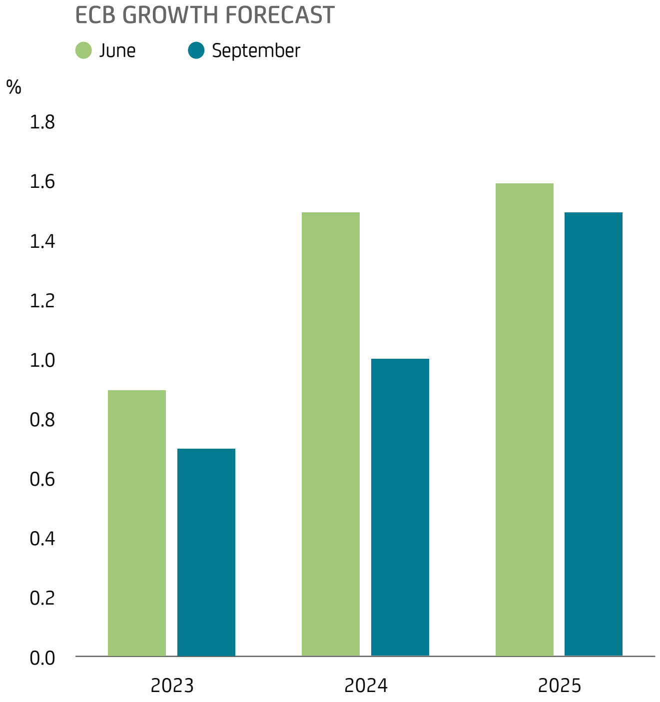
"DOVISH INTEREST HIKE": ECB RAISES KEY INTEREST RATE AND LOWERS GROWTH OUTLOOK

At its September meeting, the European Central Bank (ECB) raised its key interest rates by 25 bps and signalled that the tightening cycle is now probably over. This decision is largely in line with our assessment. The deposit rate now stands at 4%, the refinancing rate at 4.5%. The Governing Council acknowledged that the vigorous tightening of monetary policy (10 consecutive rate hikes) is increasingly dampening economic activity and considers that interest rates have now reached "a level which, if maintained for a sufficiently long period, will make a significant contribution to the timely return of inflation to the target level". In our view, the decision to take another interest rate hike was balanced: on the one hand, the "hawks" got their rate hike, on the other hand, the "doves" got the signal that interest rates have probably peaked. There was no news on the reduction of the central bank balance sheet and the future of the bond buying programme. Overall, the ECB decision was received by the financial markets as "dovish" (i.e. "soft" in terms of monetary policy) despite the interest rate hike. With regard to our interest rate outlook, we continue to expect a long phase in which interest rates are likely to remain at their current levels, with a first rate cut in mid-2024.

In addition to the interest rate decision, the ECB also published new forecasts for inflation and economic growth in the euro area (see chart 4). As expected, the GDP forecast was lowered noticeably, by a total of 0.8 pp over the three-year period (from 2023 to 2025). Most of the downward revision is accounted for by the second half of 2023, for which the ECB expects the economy to largely stagnate. Due to carryovers, this has the strongest impact on the average value for 2024 (which is lowered from 1.5% to 1.0%). This weaker growth path will lower the path for core inflation by a cumulative 0.2 pp, with the impact spread evenly across 2024 and 2025. The ECB forecast for headline inflation has been revised upwards for the next few quarters due to higher energy price assumptions, while the path at the end of the forecast horizon is now slightly weaker than in June (penultimate forecast release), with inflation expected to fall to the target level of 2% in the second half of 2025. Overall, the inflation forecast for 2025 has been lowered to 2.1% from 2.2%, while it has been raised for 2023 and 2024 – to 5.6% (from 5.4%) and 3.2% (from 3.0%), respectively. Overall, the ECB sees downside risks to the euro area growth outlook, while the risks to inflation are rather unclear. In our view, given the economic weakness of the euro area, the ECB is probably overestimating the upside risks to inflation. But even then, the inflation picture should still be consistent with the ECB's assessment of prolonged high interest rates.

4. ECB RAISES INFLATION FORECAST SLIGHTLY, BUT LOWERS GROWTH OUTLOOK NOTICEABLY





Source: ECB, Eurostat, Bloomberg, UniCredit Group Investment Strategy

CHINA: WEAKENING ECONOMY SHOWS FEW SIGNS OF RECOVERY, FURTHER SUPPORT MEASURES NECESSARY

The latest data releases suggest that China may have bottomed out of its economic slowdown. Year-on-year industrial production growth accelerated to 4.5% in August (from 3.7% the previous month), beating the consensus forecast of 3.9%. Retail sales surprised even more, rising to 4.6% year-on-year (from 2.5% the previous month). The consensus forecast here was only 3.0%. The strong growth was partly due to the increase in spending on fuel and jewellery. Despite this surprisingly better economic data, we think it is still too early to speak of a recovery. Production and consumption remain below their historical trends, even after the latest releases. The real estate sector, in particular, is still in a marked phase of weakness and is thus noticeably weighing on overall economic growth. Recent government stimulus measures should support growth, although we expect more fiscal stimulus to be needed to reach the Chinese government's 5% growth target for this year.

The biggest economic risk, in our view, is whether the government's planned support measures are sufficiently large and timely. This is because any policy stimulus will have to compensate for a number of negatively related factors. For example, Chinese domestic travel, which has supported economic activity in the services sector over the summer, will come to an end with the end of the school holidays. In addition, transactions in the residential market of smaller cities do not show the positive developments that can be observed in some large cities. In other words, the real estate sector is not showing any improvement trend across the board so far. The policy measures we expect are likely to affect both the monetary and the fiscal side. We expect the Chinese central bank (PBoC) to cut medium-term credit facility rates and the reserve requirement ratio further before the end of the year. On the fiscal side, government spending on infrastructure projects is very likely to accelerate in order to meet the set budget. In addition, the government is likely to significantly increase the quota for special bonds issued by local governments to finance large projects.

Asset Allocation – How we manage our portfolio mandate

Asset		Investment Universe	Underweight	Neutral	Overweight
			Investment View		
Main Asset Classes		Global Equities	○	●	○
Main Asset Classes		Global Bonds	○	●	○
Main Asset Classes		Money Markets	○	●	○
Main Asset Classes		Alternatives	○	●	○
Main Asset Classes in Detail	Equities	US	○	●	○
Main Asset Classes in Detail	Equities	Europe	○	●	○
Main Asset Classes in Detail	Equities	Pacific (DM[1])	○	○	●
Main Asset Classes in Detail	Equities	Emerging Markets	○	●	○
Main Asset Classes in Detail	Bonds	EMU Government Bonds	○	●	○
Main Asset Classes in Detail	Bonds	Non-EMU Government Bonds	○	●	○
Main Asset Classes in Detail	Bonds	EUR IG Corporate Bonds	○	○	●
Main Asset Classes in Detail	Bonds	HY Corporate Bonds	●	○	○
Main Asset Classes in Detail	Bonds	Emerging Market Bonds (Hard Currency)	○	●	○
Main Asset Classes in Detail	Bonds	Emerging Market Bonds (Local Currency)	○	○	●
Main Asset Classes in Detail	Commodities	Oil	○	●	○
Main Asset Classes in Detail	Commodities	Gold	○	●	○

[1]DM= Developed Markets (Australia, Japan, Hong Kong, New Zealand, Singapore)

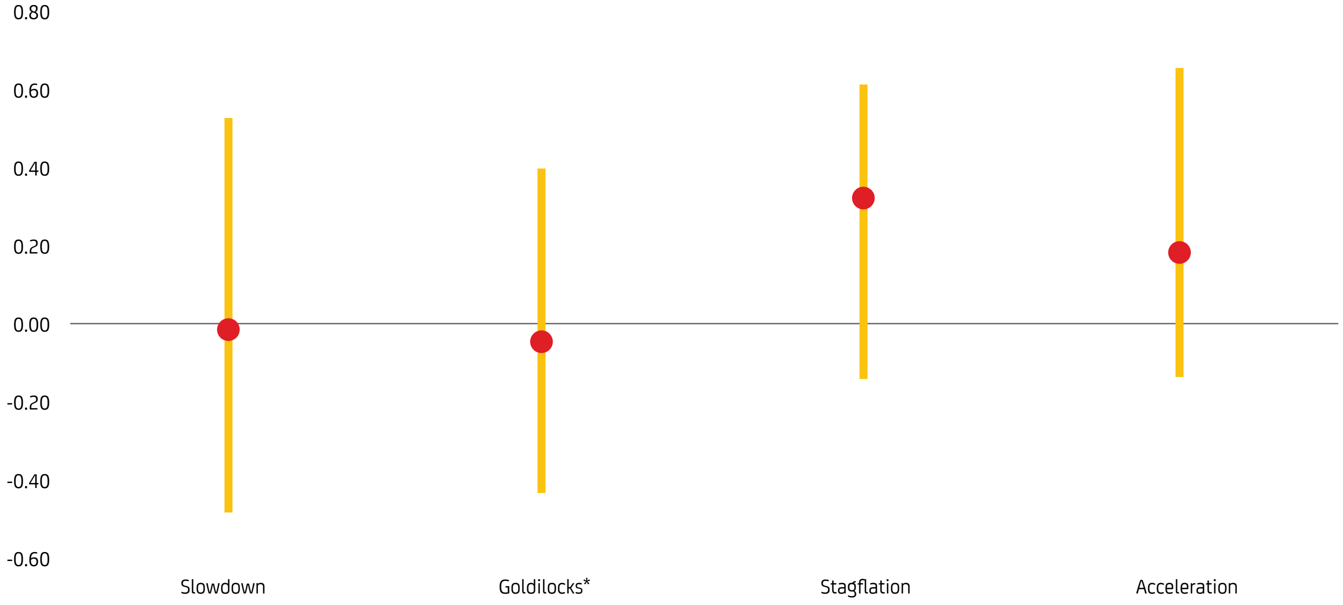
A deterioration of global economic growth and the expectation of falling inflation this year and early next year, in combination with the recent rise in bond yields, lead us to reiterate our strong focus on high quality bonds, particularly government bonds.

We remain constructive on long-term equities, but we are staying defensive, as equities will likely have to face challenging macro conditions. Given their year-to-date appreciation, equities present short-term asymmetric risks.

High quality bonds should play a macro hedging role versus equities, offering higher diversification benefits (i.e. negative correlation) in our "slowdown" base case macro scenario, which is already underway in Eurozone and China, with the so far very notable exception of the US.

However, we must highlight a rising risk of a "stagflation" scenario, although this is not our central scenario. In this sort of scenario, which is favoured by the recent increase in oil prices due to the oil supply squeeze, the diversification benefit of bonds will disappear (as there will likely be a positive correlation between bonds and equities).

5. TWELVE-MONTH CORRELATION BETWEEN EQUITIES AND BONDS



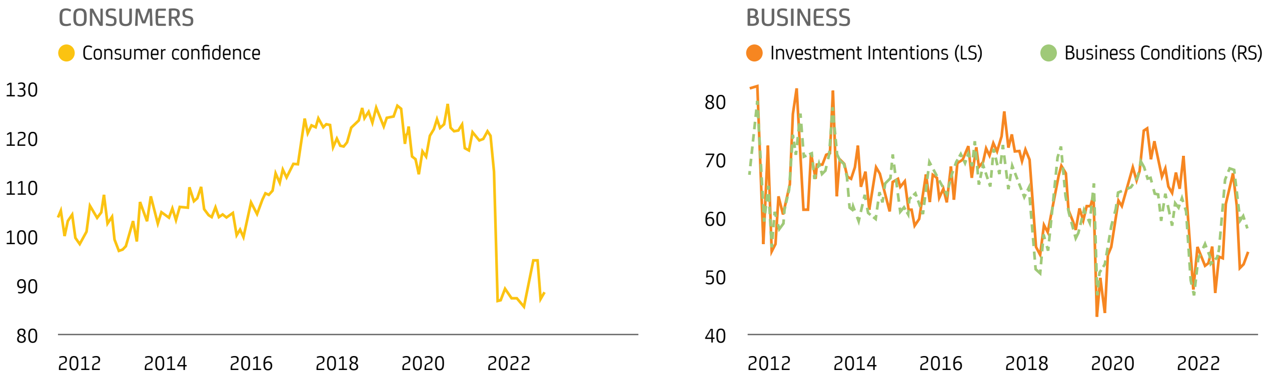
*The Goldilocks scenario is one of moderate economic growth and low inflation.
Source: UniCredit Research, UniCredit Group Investment Strategy

In terms of a regional equities allocation, we confirm our neutral stance on US equities, given the solid economy and resilient corporate earnings. However, there is uncertainty about the extent of the economic slowdown in the coming months. The full valuation of equities makes the asset class vulnerable in the event of an economic downturn.

We remain neutral on European equities, given lacklustre growth, a restrictive ECB, and the vulnerability to rising oil and gas prices. However, the asset class offers good opportunities for value and quality-oriented investors.

We also confirm our neutral positioning on Emerging Markets. China's economy is undergoing a structural (aging population and low productivity of the public sector) and cyclical (real estate crisis) slowdown. Consumer and business confidence are heavily depressed by the real estate crisis, which accounts for about 70% of private wealth and 25% of GDP.

6. CHINA REAL ESTATE CRISIS IS WEIGHING ON CONSUMER AND BUSINESS CONFIDENCE

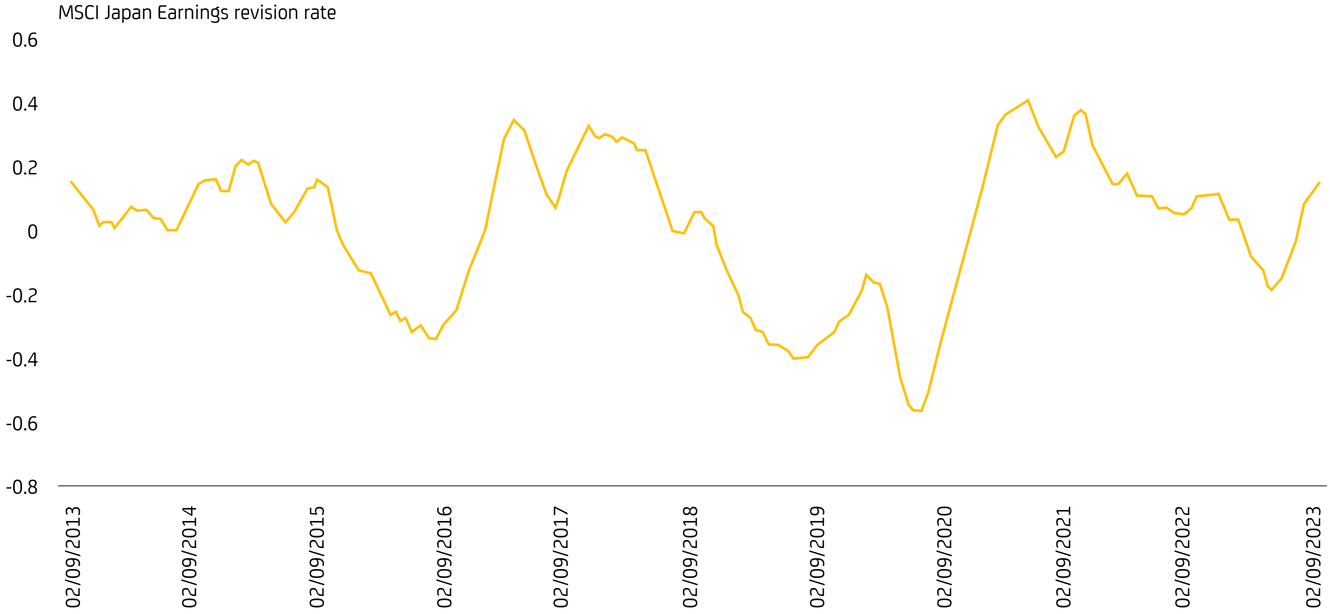


Source: China National Bureau of Statistics (NBS), Cheung Kong Graduate School of Business (CKGSB), UniCredit Group Investment Strategy

We see better prospects for India, which is benefitting from its consumption growth and from the retreat of foreign investors from China, and for Brazil, given expectations of lower rates, as inflation is falling and fiscal action likely. Overall, valuations are cheap for EM equities. Careful country and sector selection is highly recommended.

We remain overweight on Japan equities, which currently rank well in terms of earnings revision ratio (see Chart 7 below), while the increase in inflation is not over-worrying the Bank of Japan (BoJ) so far. Solid wage growth and rising inflation – with a low risk in the short term of a more restrictive BoJ and yen appreciation – are positive factors for Japan, which is emerging from a long phase of deflation. In addition, the increasing corporate profits and the reform of the Tokyo Stock Exchange are encouraging intense share buyback activity.

7. JAPAN EARNINGS REVISION RATE IS IMPROVING



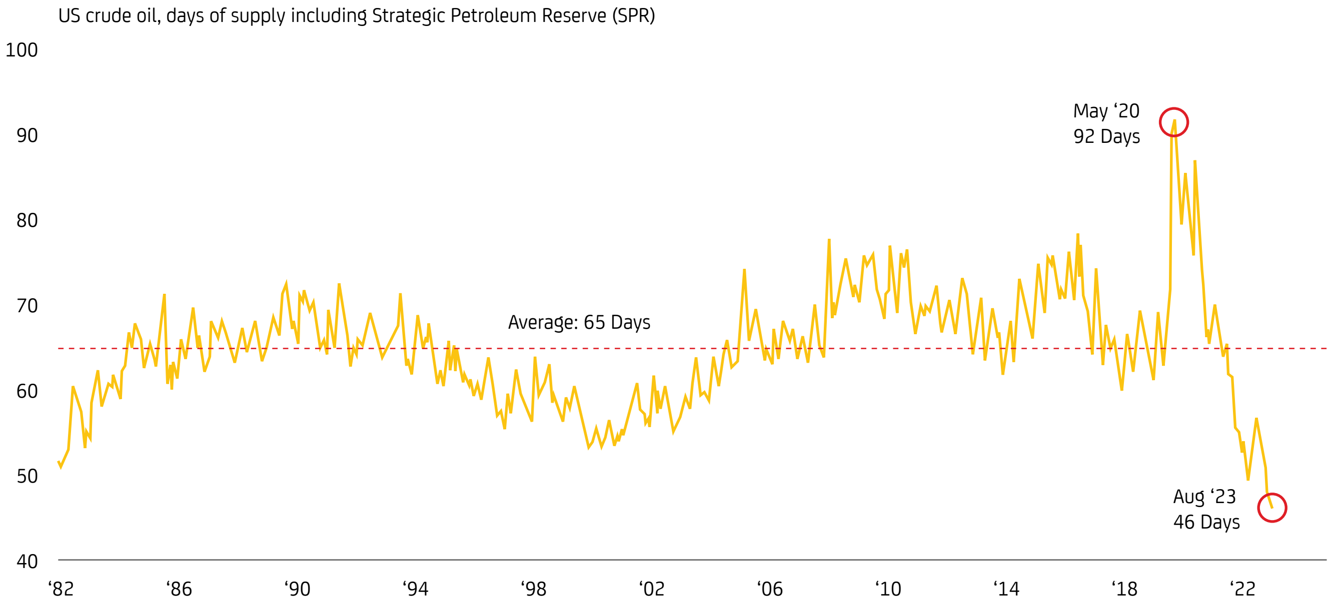
Source: MSCI, Bloomberg, UniCredit Group Investment Strategy
Observation period: 02.09.2013-02.09.2023

As for the bond allocation, in addition to our preference for high quality bonds, such as government and corporate investment grade bonds, we stick to our neutral stance on Emerging Market bonds. They offer an attractive carry, and they will benefit from the interest rate easing process already underway in some important countries such as Brazil. We remain selective, avoiding countries with high external debt and current account deficit.

We remain cautious on high yield corporate bonds, whose spreads are not yet fully discounting the economic slowdown. The asset class also has less liquidity.

As for commodities, oil prices in the short-term are supported mostly by the supply squeeze due to OPEC+ oil production cuts, low inventories, but also from rising demand due to China's reopening.

8. US CRUDE INVENTORIES AT 40-YEAR LOW



Source: BofA Global Investment Strategy, Bloomberg, UniCredit Group Investment Strategy

As for the USD, in the short term it is sustained by superior US growth vis a vis the slowdown in China and the Eurozone.

UniCredit Group Investment Strategy – Asset Allocation Stances

NEUTRAL ON GLOBAL EQUITIES

Equities resilience and confidence that the hard landing will be avoided. However, the negative lagged effect of higher interest rates is yet to be felt.

NEUTRAL EUROPEAN EQUITIES

Weakening macro momentum while the ECB remains restrictive in the short term. However, European equities offer good opportunities for value and quality investors.

NEUTRAL US EQUITIES

Robust although weakening job market, earnings resilience, but uncertainty on the magnitude of the economic slowdown. Excessive S&P500 market concentration.

NEUTRAL EMERGING MARKET EQUITIES

China's recovery is losing steam and we expect more targeted monetary and fiscal easing. In Latin America, Brazil is becoming a bright spot due to expectations of rate cuts, as inflation is falling, and fiscal reforms are likely. Overall, valuations are cheap for EM equities. Countries and sectors selectivity among EMs is strongly recommended.

OVERWEIGHT ON PACIFIC EQUITIES

Wage growth and rising inflation – with the BoJ set to remain expansive – are positive factors for Japan, which is emerging from a long phase of deflation. In addition, the increase in corporate profits and the reform of the Tokyo Stock Exchange are encouraging intense share buyback activity.

NEUTRAL GLOBAL BONDS

Weakening growth and a cooling inflation support our preference for "high quality bonds", such as Euro Investment Grade corporate and government bonds.

OVERWEIGHT ON EURO INVESTMENT GRADE CORPORATE BONDS

Appealing yields but given the relatively tight spreads we are increasing our high quality, selective and defensive tilt in the case of a sharp weakening of the macro picture.

UNDERWEIGHT ON HIGH YIELD CORPORATE BONDS

The spreads in the asset class do not yet fully discount the possible economic slowdown, especially in the US, due to more restrictive lending conditions. Also, the asset class is relatively less liquid.

NEUTRAL EMU GOVERNMENT BONDS

Worsening macro picture and cooling inflation maintain a constructive view on this asset class despite a still hawkish ECB.

NEUTRAL NON-EMU GOVERNMENT BONDS

Supported by expectations of falling inflation and Fed easing around mid next year.

NEUTRAL ON EMERGING MARKET BONDS IN HARD CURRENCY

Interesting carry but we prefer focusing on "high quality bonds". We stay defensive and selective, avoiding countries with high external debt and current account deficit.

OVERWEIGHT ON EMERGING MARKET BONDS IN LOCAL CURRENCY

Supported by expectations of Fed easing around mid next year and US dollar weakening. In LatAm, falling inflation opens the way for material central banks easing.

NEUTRAL MONEY MARKETS

Interesting yields, but we prefer to invest in higher yielding fixed income asset classes such as government bonds and Euro corporate IG.

NEUTRAL ALTERNATIVES

They offer portfolios de-correlation opportunities, while real assets benefit from their inflation-hedging role.

NEUTRAL COMMODITIES

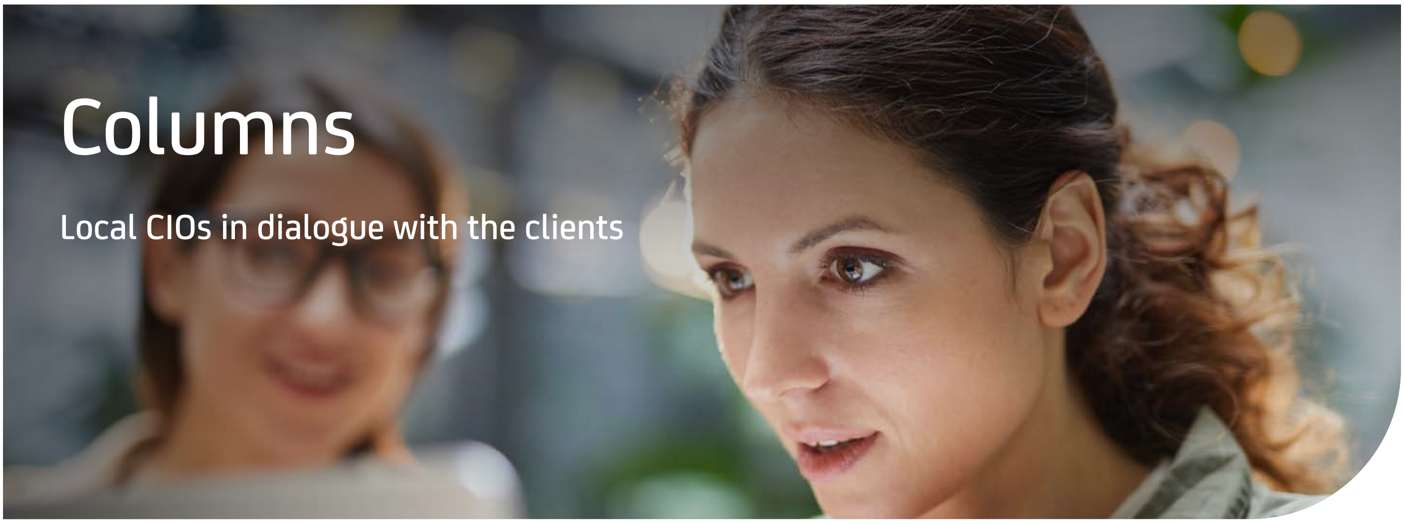
Oil prices are supported by the undersupply. However, the price of other cyclical commodities, such as copper, are not rising.

NEUTRAL GOLD

Upside limited by the last hawkish Fed meeting and by the stronger US dollar.

CURRENCIES

Short-term support by the last hawkish Fed meeting and the stronger momentum of the US economy.



Answers from Italy

SHOULD WE BE WORRIED ABOUT THE RECENT RISE IN OIL PRICES?

Since the recent lows in June, the price of oil has risen by around USD20. There are a number of reasons for this, which stem from both the supply and demand sides. In terms of supply, the production cuts in oil amid the OPEC+ agreements came as a surprise. This showed a firm conviction from Saudi Arabia and Russia, the main oil exporting countries, to put a stop to the decline in the price of oil, a crucial variable for the stability of their economic systems. Furthermore, in the US, the world's leading producer thanks to unconventional extraction techniques (shale oil), production increases were at very low rates, and the number of active extraction plants reduced by 100 units since the start of the year (number at 15 September: 515). These factors raised doubts about the prospective ability to maintain current production levels. On the other hand, on the demand side, demand in the US remains strong as economic growth was more resilient than expected, causing inventories to shrink. In Asia, China, the world's largest consumer, continues to see high demand, despite the lackluster phase of the real cycle. Meanwhile, consumption in India (the world's third largest consumer after the US) is recording constant and considerable increases. Based on this scenario, it is difficult to imagine a pronounced correction in the price of oil. However, what matters most is whether we will have a new acceleration in inflation and whether this movement will have lasting effects. In fact, the risk is that central banks will have to resume a path of increases to counter the inflation phenomenon with consequent negative effects on the bond market. The short answer to this question is that we believe that this risk, that of stagflation (a horrid combination of low growth and high inflation!) is remote.

More specifically, the Fed and the ECB have entered a wait-and-see mode as inflation remains above target but is steadily falling. The contraction in the price of oil was certainly one of the main drivers of the reduction in the total inflation rate, and also, through transmission effects, in the inflation rate net of energy and food components (particularly volatile elements) – the so-called "core" inflation. It is this, in particular, that is considered more reliable for understanding future inflationary developments. So certainly, the recent movement in oil will have an upward impact on the overall inflation rate. However, we must not forget that the post-COVID double-digit inflation phenomenon was caused by two extraordinary events: the disruption of global production and distribution chains, and Russia's invasion of Ukraine. Therefore, the simple increase in the price of oil, in the current "normal" context, is unlikely to have such devastating and long-lasting effects on price dynamics. Furthermore, in "core" inflation, the most significant component is housing costs, which in the US are experiencing a significant and prolonged contraction. This could equalize or more than compensate for the increase in oil prices. This interpretation is also supported by expected inflation rates (calculated as the difference in the yield between nominal government bonds and government bonds with protection from inflation) which show substantial stability in recent months. These considerations lead us to confirm one of our main investment theses, which sees well-rated bonds (government bonds and corporate bonds with a rating higher than BBB) as an investment that combines good potential returns with the ability to defend in the event of a more severe economic slowdown.

ALESSANDRO CAVIGLIA, *Chief Investment Officer Italy, UniCredit SpA*

TIME DEPOSITS OR INVESTING IN SECURITIES?

For more than a year, central banks have been fighting the sharp rise in inflation with various monetary policy measures. The latest interest rate move by the ECB is good news for savers. It has raised interest rates for the tenth time since the middle of last year and raised the deposit rate, which commercial banks receive from the central bank for parking surplus funds, to a new record high of 4%. This is the highest level since the start of monetary union in 1999.

Many experts expect interest rates to pause and reach their peak. This interest rate level is an attractive environment for savers and discussions are building as to whether it would not be more interesting to park savings in time deposits instead of investing in securities. However, last year was unsettling for many investors as it had shown that even government bonds can sometimes lose more than 10%. We have not seen such losses in bond prices on this scale in the last 50 years, and this has had a negative impact on the performance of many portfolios. In addition, many investors are unsettled by the great uncertainty about how inflation and the economy in the Eurozone will develop. Is it now advisable to secure high interest rates by investing in fixed-term deposits or is a diversified investment in securities the better option?

At first glance, the interest rates on time deposits seem interesting and offer an alternative to investing in securities. However, the risks of reinvestment when the interest rate agreement expires seem considerable. In a year's time, the first interest rate cuts that may take place could have a negative impact on the reinvestment environment. Timely exploitation of opportunities on the capital market is difficult to assess from the point of entry. However, the yields on many bonds are now very attractive again due to the dramatic rise in interest rates. A not insignificant part of the offerings of government bonds in the 5-year maturity range are again above the currently priced-in inflation expectations and thus positive real yields (yields minus the inflation rate) are again possible in the safest of all segments. One can confidently speak of a new era. From this final maturity perspective alone, bonds have once again become interesting. Should economic growth become gloomier, then the possibility of declining yields will also come to life. The price gains that are possible in this way can also serve as a buffer against possible price declines in riskier investments, especially in mixed strategies – with both equities and bonds. The risk, however, is that rising yields will continue to weigh on bond prices. In our view, the rate hike cycle is already well advanced, which is why we assign a low probability to this scenario. We took advantage of this environment in the summer to invest the liquidity created at the beginning of the year in European government bonds. A small part was also invested in global bonds (bonds of developed countries outside the euro area). This move allows us to benefit more from any falling yields. We locked in the attractive yield levels for a longer period of time than would have been possible with a money market commitment.

OLIVER PRINZ, *Co-Chief Investment Officer of UniCredit Bank Austria AG and Schoellerbank AG*

IS THE SURGE IN NEW FACTORY CONSTRUCTION IN THE US BECOMING A SOURCE OF CONCERN FOR THE FED?

In the US, the Biden administration is striving to reduce economic dependencies on foreign countries, improve the resilience of global value chains, accelerate the green transition, and revitalise industrial regions that have been hit hard by globalisation and technological progress. Unlike in previous episodes of (aggressive) monetary tightening, manufacturing in the US is experiencing an extraordinary boom in the construction of new production facilities thanks to the appropriate regulatory and fiscal policies (such as the Infrastructure Investment and Jobs Act, CHIPS Act, as well as the Inflation Reduction Act), and generous subsidies. Manufacturing spending on construction has increased rapidly since the beginning of 2022, especially in computer, electronics and electrical manufacturing, where real construction spending nearly quadrupled during this period, according to the US Treasury.

Although robust US economic growth of late is likely to have been driven primarily by strong private consumption (rather than by the US government's industrial policy measures), the latter carry the risk of disconnecting business investment decisions from the business cycle. In this respect, the recent boom in new factory construction may be symptomatic of a broader phenomenon that could complicate the Fed's task in containing inflation by expanding the economy's productive capacity in the medium term (with disinflationary effects), but boosting demand in the short term (with inflationary effects). If companies want to use the existing fiscal stimulus and expand, the US labour market might cool down less quickly than hoped. It cannot be ruled out that the Fed's monetary policy will have to remain restrictive for longer against this backdrop, especially since the expansion of domestic production capacities potentially comes at the expense of efficiency gains from international trade and specialisation – and industrial policy could also create inflationary pressures in this way in the medium term.

PHILIP GISDAKIS, *Chief Investment Officer Germany, UniCredit Bank AG (HypoVereinsbank)*

DEVELOPMENT OF SELECTED FINANCIAL MARKET INDICES

From	**22.09.22**	22.09.18	22.09.19	22.09.20	22.09.21	22.09.22	22.09.18	**01.01.23**
To	**22.09.23**	22.09.19	22.09.20	22.09.21	22.09.22	22.09.23	22.09.23	**22.09.23**
Stock market indices (total return, in %)								
MSCI World (in USD)	**18.2**	2.7	9.2	33.7	-17.4	18.2	45.9	**12.5**
MSCI Emerging Markets (in USD)	**7.8**	1.4	9.5	19.3	-24.5	7.8	5.7	**3.3**
MSCI US (in USD)	**16.8**	4.1	14.8	35.4	-15.2	16.8	60.3	**14.2**
MSCI Europe (in EUR)	**17.4**	6.6	-7.4	32.7	-9.3	17.4	37.9	**10.2**
MSCI AC Asia Pacific (in USD)	**11.8**	-0.2	10.2	19.4	-24.0	11.8	10.2	**5.0**
STOXX Europe 600 (in EUR)	**17.2**	6.5	-5.8	33.0	-10.9	17.2	37.5	**9.8**
DAX 40 (Germany in EUR)	**24.1**	1.2	2.0	23.1	-19.2	24.1	25.2	**11.7**
MSCI Italy (in EUR)	**38.0**	8.4	-15.4	36.3	-9.6	38.0	53.9	**25.3**
ATX (Austria, in EUR)	**16.9**	-5.8	-29.2	76.1	-17.8	16.9	12.0	**5.9**
SMI (Switzerland, in CHF)	**10.3**	15.5	7.1	17.8	-10.5	10.3	42.9	**5.9**
S&P 500 (USA, in USD)	**16.9**	4.2	13.0	34.6	-13.2	16.9	60.8	**13.9**
Nikkei (Japan, in JPY)	**22.0**	-4.7	8.0	29.0	-6.6	22.0	50.1	**25.7**
CSI 300 (China, in Yuan)	**-0.9**	21.7	21.6	5.9	-18.1	-0.9	22.0	**-1.2**
Bond market indices (total return, in %)								
US Government Bonds 10Y (in USD)	**-2.3**	15.7	13.3	-3.5	-17.4	-2.3	2.4	**-1.9**
US Government Bonds (ICE BofA, in USD)	**-1.1**	10.3	8.7	-2.4	-13.7	-1.1	0.1	**-1.0**
US Corporate Bonds (ICE BofA A-BBB, in USD)	**3.1**	12.8	8.6	2.9	-17.7	3.1	7.3	**1.6**
German Bunds 10Y (in EUR)	**-3.5**	11.1	-0.6	-1.2	-18.2	-3.5	-13.6	**1.0**
EUR Government Bonds 1Y-10Y (iBOXX, in EUR)	**-2.8**	10.5	0.6	-0.6	-16.9	-2.8	-10.4	**0.6**
EUR Corporate Bonds 1Y-10Y (iBOXX, in EUR)	**2.6**	5.8	0.3	2.0	-15.0	2.6	-5.5	**2.7**
Bond yields (change in basis points = 0.01 percentage points)								
US Government Bonds 10Y (in USD)	**72**	-131	-104	67	238	72	136	**60**
US Government Bonds (ICE BofA, in USD)	**79**	-115	-127	42	309	79	183	**61**
US Corporate Bonds (ICE BofA A-BBB, in USD)	**53**	-109	-99	2	339	53	181	**44**
German Bunds 10Y (in EUR)	**73**	-100	8	18	230	73	225	**14**
EUR Government Bonds 1Y-10Y (iBOXX, in EUR)	**83**	-103	-3	13	243	83	228	**25**
EUR Corporate Bonds 1Y-10Y (iBOXX, in EUR)	**37**	-80	11	-19	358	37	306	**9**
Spreads on government bonds (credit spreads, change in basis points)								
US Corporate Bonds (ICE BofA US Corporate Master)	**-28**	6	18	-47	58	-28	7	**-18**
US Corporate Bonds (ICE BofA US High Yield)	**-98**	56	161	-236	182	-98	68	**-86**
Euro Corporate bonds (ICE BofA Euro Corporate AAA-A)	**-40**	2	-1	-17	92	-40	36	**-9**
Euro Corporate Bonds (ICE BofA Euro High Yield)	**-127**	-1	115	-170	256	-127	77	**-73**
Money market rates (change in basis points)								
Libor (USD, 3 months)	**202**	-23	-188	-9	351	202	329	**89**
Euribor (EUR, 3 months)	**284**	-7	-11	-4	166	284	428	**183**
Euro exchange rates (change in %)								
US Dollar (EUR-USD)	**7.7**	-6.3	6.9	-0.1	-15.7	7.7	-9.5	**-0.2**
British Pound (EUR-GBP)	**-0.5**	-0.4	3.8	-6.3	1.5	-0.5	-2.9	**-2.1**
Swiss Franc (EUR-SFR)	**-0.4**	-3.3	-1.3	0.7	-10.5	-0.4	-14.1	**-2.0**
Japanese Yen (EUR-JPY)	**13.4**	-9.8	4.0	4.7	8.3	13.4	19.2	**12.2**
Commodities (change in %)								
Commodity Index (GSCI, in USD)	**14.9**	24.4	21.5	-7.7	-6.4	14.9	52.9	**5.5**
Industrial metals (GSCI, in USD)	**-0.5**	-3.5	4.5	43.2	-14.5	-0.5	18.3	**-8.5**
Gold (in USD per fine ounce)	**15.4**	24.9	24.8	-6.7	-6.0	15.4	60.9	**6.2**
Crude oil (Brent, in USD per barrel)	**3.3**	-17.5	-35.1	82.7	18.4	3.3	18.4	**9.9**

Please note: Past values and forecasts are not a reliable indicator of future performance. Indices cannot be purchased and therefore do not include costs. When investing in securities, costs are incurred which reduce the performance. The return on investments in foreign currencies may also rise or fall as a result of currency fluctuations. So-called synthetic bonds are calculated to reflect the performance of government bonds in a fixed maturity range. In each case, the most "suitable" real federal bond at the relevant time is used as a reference for the yield opportunity of the synthetic bond. The development of the expected yield to maturity is shown under the following conditions: servicing of interest payments and redemption in accordance with the terms and conditions and holding until maturity. In this respect, it is a yield opportunity. The yield opportunities reflect the different risk assessments of the investors for the respective products or countries (higher yield opportunity=higher risk assessment). The synthetic bonds cannot be purchased and therefore do not include any costs. In the case of currencies and commodities, acquisition and/or custody costs incurred are not included. Source: Refinitiv Datastream. Data as at 22.09.2023.

Disclaimer

This publication of UniCredit S.p.A., UniCredit Bank Austria AG, Schoellerbank AG and UniCreditBank AG (hereinafter jointly referred to as the "UniCredit Group") is addressed to the general public and is provided free of charge for information only. It does not constitute investment recommendation or consultancyactivity by the UniCredit Group or, even less, an offer to the public of any kind nor an invitation to buy or sell securities.

UniCredit Group, including all its group companies and the other companies of the UniCredit Group may have a specific interest in relation to the issuers, financial instruments or transactions detailed herein. Please refer to https://www.unicreditresearch.eu/index.php?id=disclaimer. Any estimates and/or assessments contained in this publication represent the independent opinion of the UniCredit Group and, like all the information contained therein, are given in good faith on the basis of the data available at the date of publication, taken from reliable sources, but having a purely indicative value and subject to change at any time after publication, on the completeness, correctness and truthfulness of which the UniCredit Group makes no guarantees and assumes no responsibility. Interested parties must therefore carry out their own investment assessments in a completely autonomous and independent manner, relying exclusively on their own considerations of the market conditions and the information available overall, also in line with their risk profile and economic situation.

It should also be noted that:

1. Information relating to the past performance of a financial instrument, index or investment service is not indicative of future results.
2. If the investment is denominated in a currency other than the investor's currency, the value of the investment can fluctuate strongly according to changes in exchange rates and have an undesirable effect on the profitability of the investment.
3. Investments that offer high returns can undergo significant price fluctuations following any downgrading of creditworthiness. In the event of bankruptcy of the issuer, the investor may lose the entire capital.
4. High volatility investments can be subject to sudden and significant decreases in value, being able to generate significant losses at the time of sale up to the entire capital invested.
5. In the presence of extraordinary events, it may be difficult for the investor to sell or liquidate certain investments or obtain reliable information on their value.
6. If the information refers to a specific tax treatment, it should be noted that the tax treatment depends on the individual situation of the customer and may be subject to change in the future.
7. If the information refers to future results, it should be noted that they do not constitute a reliable indicator of these results.

The UniCredit Group cannot in any way be held responsible for facts and/or damages that may arise to anyone from the use of this document, including, but not limited to, damages due to losses, lost earnings or unrealized savings.

Information and data contained in this document is updated as at 22 September 2023.

UniCredit Spa
Client Solutions

Address
Piazza Gae Aulenti, 3
20124 Milano

Online
unicreditgroup.eu/clientsolutions