



CIO OFFICE MORNING MARKET WRAP

13 January 2025

Last week confirmed that US growth and employment ended 2024 on a strong note. Expectations for the next Fed rate cut adjusted (later, shallower), the dollar rose, and the bear-steepening of its yield curve accelerated. The latter is not inverted anymore. The 12 month was stable at 4.2%, the 2-year added 20 basis points to almost 4.4% while the 5 and 10-year increased by 40 bps to just below respectively 4.6% and 4.8%. This pressured stock valuations, with equities down -1.6% across developed and emerging markets. Gold by contrast didn't suffer from a stronger dollar, gaining 1.9% to \$2,690 and neither did oil prices, with the Brent gaining almost \$6 to approach \$80 as the US put additional sanctions against Russia's energy ecosystem. If it wasn't enough, UK assets sold off as market participants cast doubts on the government ability to fund its policies, and Los Angeles faces one of the most devastating fires of its history. No doubt, some years have had a better start.

Last week was rich in terms of economic data. It concluded with a stronger than expected US monthly NFP job report. December saw 256,000 job creations, much more than the median forecast of 165,000. The unemployment rate thus unexpectedly fell -0.1% to 4.1%. This gives the Fed no reason to cut in the near-term. Fed funds futures now allocate a minuscule 3% probability to a January cut, and implicitly expect none before October. There was however one little good news in the report, with average hourly earnings growing slightly less than forecast: at +3.9% year-over-year, it's not outrageous. Markets also ignored a modest surprise drop in consumer sentiment, also released Friday at 73.2 versus a median expectation of 74.

Now, let's take a step back. 2024 was strong in the US, and there is no reason for monetary authorities to help a solid economy which still carries an inflation risk. This is the message from rising yields in a bear-steepening pattern, with increasing term-premia: stronger growth, with inflation and maybe even public debt concerns. It's a fact. But first, it's not a total surprise, second, a healthy Q4 is not fundamentally bad news, especially just before the start of the corporate earnings season, and third, the future state of the economy is not a given, especially as the new US administration is about to take office. If anything, a heightened inflation risk to start their mandate could temper some of the "riskiest" items of their agenda. They know that inflation is the most important single economic factor explaining the Democrats' electoral defeat. An increased service cost for the public debt, and markets starting to look at its sustainability, could also be an additional incentive to reduce the Federal deficit. The Department of Government Efficiency is probably the potential "wildcard" of the US investment landscape for the months to come. On investors' side, the volatility of interest rates is not pleasant, but the levels are. The US 5-year near 4.6% and the 10-year close to 4.8% look attractive to us. Safe bonds have also reconstituted an upside potential and thus their diversifying power against cyclical assets in case the strength of the US economy was to falter at some point. Inflation is a major risk, and markets are scared, but it has created some margin of safety in real yields for now.

This is why our positioning to start the year is fully invested, slightly above neutrality on equity, cash, and gold, overweight on government bonds with an increased duration (to 7-10 years), funded by an underweight in hedge funds. We will soon issue our 2025 Global Investment Outlook, titled "Winds of Change" with more details on why we are reasonably constructive. Robust growth is not bad news, and neither are above-average "risk-free" rates. There are all reasons to expect high volatility and many risks to the outlook, of course. But they are identified, and also balanced: some of the policy and geopolitical changes could even trigger promising developments for the medium term.

Markets this morning:

The week starts with a positive surprise coming from China's December trade numbers. Exports jumped to +10.7% YoY, faster than the median forecast of 7.5%, while imports also surprised to the upside, now entering positive year-on-year territory at +1% vs -1% expected. The absolute level of exports in 2025 is a record high at a spectacular \$3.5tn.

This is not enough however to counter the negative impact from US hawkish developments on markets. Stocks are down -1.2% in Korea and Hong-Kong, a bit less in China's domestic markets. Japan is closed for a holiday, which includes US Treasuries Asian trading. There is no significant move in major currencies where the dollar is steady, and the pound still weak at 1.215 as Mrs Reeves comes back from her China visit. The yuan is stable after the PBOC expressed verbal support for the currency. The most notable move is a +1.5% gain in oil prices, at \$81 for the Brent, which continues to reflect the last set of sanctions in the last weeks in office of President Biden, targeting exporters, insurance companies, and over 150 tankers.

Upcoming Key events/data:

The week ahead is a lot about inflation with monthly CPI reports for the US and UK on Wednesday, for the Eurozone on Friday and Dubai in the coming days. We will also get retail sales and industrial production for both the US and China, the latter also adding their first Q4 GDP estimate on Friday (which should put 2024 close to the official 5% objective). Importantly, the Q4 corporate earnings season will start with Bank of America and Morgan Stanley on Thursday.

Today we will look at India CPI at 2.30PM and at the US Federal budget balance at 11PM.

Chief Investment Office
Wealth Management,
Emirates NBD.

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