Emirates NBD
WEALTH MANAGEMENT

The case for Goldilocks is still **live**

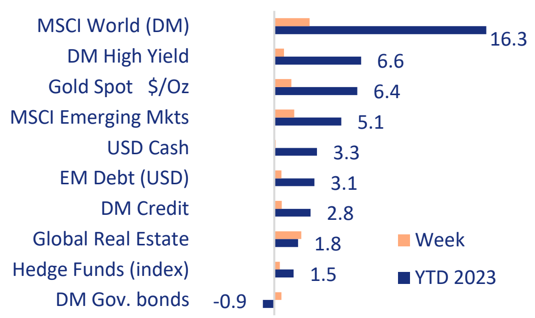
- **Risk appetite came back last week as an avalanche of data painted an overall constructive picture**
- **In the US the job market is softening while inflation continues to moderate and growth remains resilient**
- **The situation is diverse across regions but confidence on a forthcoming monetary pause is building**

We knew from Jackson Hole that Western central bankers are data-driven, a nice way to say that they keep all options open. There was no shortage of data to look at last week. In the US, the labor market showed signs of softening, with less job openings and creations, while wage growth decelerates. The core PCE measure of inflation was also favorable, and consumer confidence is in decline, while leading indicators continue to indicate that the recession risk is not material in the short-term. This supports the possibility of the Fed not hiking in September, and markets enjoyed it with a sharp drop in the front-end yields of the US Treasury curve, and a rally of pretty much everything.

Europe, by contrast, is still having a serious inflation issue, with the core CPI still way too high for their central bankers. But as their economies are also getting more vulnerable to higher interest rates seeing some moderation in tightening is also not impossible. Finally, China continues do add, now on an almost daily basis, measures to stabilize and support the economy, while carefully designing them to avoid collateral damage on excessive leverage. The latest include lower FX reserve requirement ratios for financial institutions, and an incentive for banks to lower the burden of mortgage repayments. Patience is still required there, but some stabilization in the PMIs provides some hope as well.

Our positioning remains relatively balanced in our three profiles. We keep favoring safe sources of income, including a large overweight to money market funds, but do not have large active positions – we are actually close to neutral on stocks, and not far on fixed income. Unpredictability remains the name of the game. Have a great week.

ASSET CLASSES USD % TOT.RETURN, YTD 2023 & LAST WEEK



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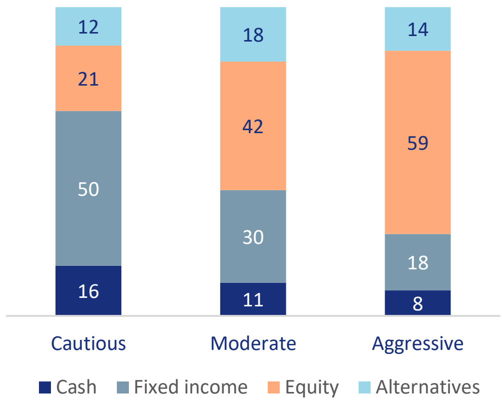
Cross-asset Update

Data releases in the United States reinforced investor confidence about the unfolding of a Goldilocks scenario, with a softening labor market and an ongoing disinflation process. If August saw the reacceleration narrative prevail, September has ushered in more evidence of a soft landing. Hence, investors extrapolated that the Fed will be on hold possibly till year-end, pointing to a still positive backdrop for stocks, and capped upside for Treasury yields. But the US story is not only about softening growth. The ISM manufacturing report, while still in contraction territory, saw activity stabilise rather than slide further, as the index climbed to its best level since February. And if a recession indeed is not in the cards, then the economy should be sustained by a manufacturing rebound as services pull back. This is in stark contrast to underwhelming dynamics in other major economies, like the euro area, where stagnation is taking hold, or the UK, where price pressures are expected to last through 2024 according to Moody's. The bottom line is that we should be in for one more bout of so-called US exceptionalism, whereby dollar-centric assets are expected to outperform. And this may be true not only of US equities, but also of the US dollar, that could surprise to the upside supported by an extremely favorable mix of loose fiscal and tight monetary policy, the former boosting growth, the latter the yield differential with other major crosses.

Beijing has been less lucky trying to boost activity with an endless list of piecemeal measures since the post-pandemic recovery lost steam. Last week the attempts continued, and Chinese stocks outperformed the broader EM benchmark. From the reduction to bank reserve requirement ratios, and fresh stimulus for the property sector, to plans to expand some tax breaks for families, the goal of such targeted efforts remains to stimulate while avoiding excessive leverage. Activity seems to be stabilising, judging from the rebound in manufacturing confidence both in the official and the Caixin indices still in contraction territory. It may take time for the effects of the latest measures to show up in the economy, but eventually the recovery should gain traction.

A US soft landing and China stabilizing would be quite supportive of EM stocks, and we still think that a rally in the asset class is overdue. Even renewed US dollar strength would not be a challenge to that rally, considering how weak the reserve currency still is as compared to last year's peak, and how much cheaper EM stocks are versus DM peers. In summary, it seems to us that equities in the developing countries are now vulnerable to upside surprises after a poor performance so far this year, and catalysts supporting the investment case are now in place.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

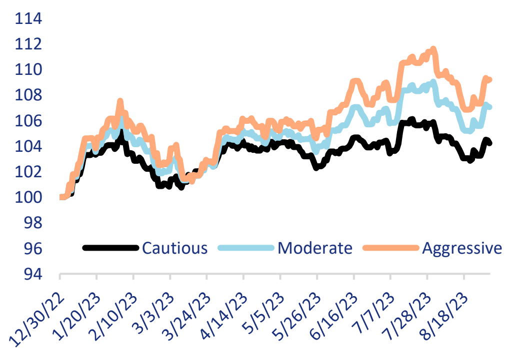


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW: Underweight/Neutral/Overweight

	UW	N	OW
Cash			>>>>>>
DM Gov.			>>
DM Credit			>>
DM H. Yield	<<		
EM Debt	<<<		
DM Equity	<<<		
EM Equity			>>
Gold		=	
Hedge Funds	<<		
Real Estate	<		

TAA – 2023 INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

US non-farm payrolls painted the picture of a robust employment market. But there were some green shoots for anyone looking at a Fed pause in September. The unemployment rate went up to 3.8%, the highest since February 2022. Meanwhile average hourly earnings increased only 0.2% last month, the lowest sequential increase since February 2022, bringing the year-ago gain down to 4.3%. The slight slackening of the jobs market gives impetus to the case for a Fed on hold later this month. We did not see a large movement in the future rate path expectations post the Friday release. The UST yield curve bear-steepened with the long-end moving up by 7 to 8bps as the front-end remained anchored.

In credit, we continue to like the attractive returns in IG debt from a total return standpoint as the yields hover around the highest percentile in the last 15 years. Moreover, carry will likely be the dominant component of future returns, with upside from spread compression likely to remain muted given current valuation constraints as marked by the small yield pick-up of IG versus cash. According to a recent analysis by GS, at around 37bps, the extra yield provided by the USD IG market over cash remains at historically depressed levels. Under the surface, the share of bonds yielding less than 3-month Treasury bills has declined to 31% from a peak of 62% in May - using the constituents of the iBoxx index - but remains elevated by historical norms.

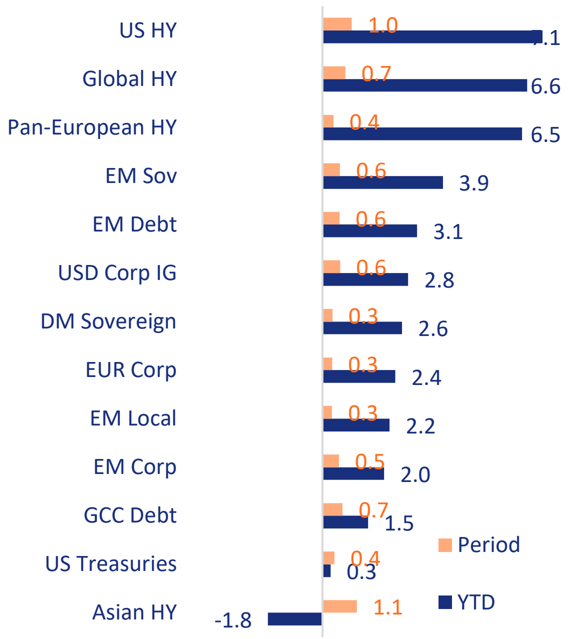
One key point that has supported credit spreads is the lack of transmission of the current high rates to the actual interest expenses on the company balance sheets for both IG and HY. The 5.25% worth of cumulative hikes delivered by the Fed over the last year and a half have had a limited impact on interest expenses, which have only modestly increased due to the large refinancing that happened in 2021. However, there is continued deterioration of liquidity positions on balance sheets. The ratio of cash to total assets moved to the low end of its post-global financial crisis period range in both the IG and HY markets. This decline should stimulate refinancing activity on a forward basis which would impact the debt servicing costs going forward.

As we have mentioned several times earlier, we like the financials space within credit. Central bank stress tests in the US, the EU and the UK have demonstrated resilient balance sheets and limited impact to capitalization ratios in the case of a turbulent market event. Hence, we believe subordinated debt of the banks offers a nice yield pick-up to fixed income investors. We prefer sub financial debt to corporate HY for this reason. For perpetual AT1 securities, we think non-call is the biggest risk. However, it doesn't impact bond holders much as the reset rates then to be pretty high due to the increased level of yields. For example, Banco Santander repeated its 2020 policy to avoid calling a EUR perpetual with 5.25% last week. But the coupon would reset higher to around 8.2% on 29th September benefitting the bond holders.

FIXED INCOME KEY CONVICTIONS

DEVELOPED MARKETS
OW Quality corporates
OW Government Bonds
UW High Yield
EMERGING MARKETS
Overall UW EM Debt
Favor quality and selectivity
OW Selectively Asia,

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

Last week was volatile but a very positive one across regions. The main driver was not optimism about the economy and its impact on future earnings, but as often, another bit of multiples expansion backed by falling interest rates, as the case for a moderation in monetary tightening is still live, following the deluge of data from last week.

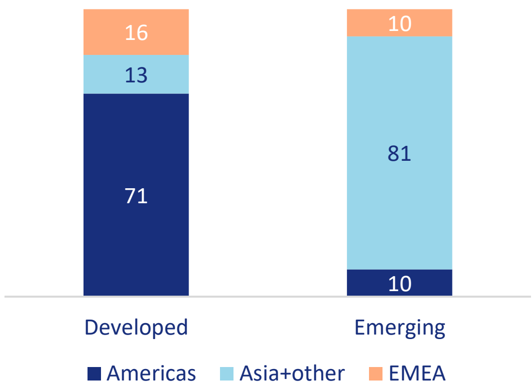
All regions were in the green for different reasons. The US obviously enjoyed hopes on the Fed outlook, with lower treasury yields propelling further the tech sector, now approaching year-to-date the +40% mark. European stocks were also driven by central-bank speak, though in a subtler way: inflation remains an issue, but as the PMIs highlighted a material risk of recession the overall sentiment was that the room of maneuver of the ECB might be less ample than their comments suggest. This in turn supported a stronger dollar, which is a positive for European stocks. As well as for Japan, which had another week of outperformance.

Our positioning remains unchanged. We overweight emerging markets within our broad allocation to the equity asset class, but this is not massive. Within this universe, India and the UAE remain our preferred regions, while we are close to neutrality on China. Valuations, earnings growth prospects, and a low level of ownership among international investors are reasons not to be too underweight. Having said that, the never-ending financial issues on the real estate sector, and some uncertainty regarding the trajectory of economic growth, are reasons to be patient. It will take time and probably some back-to-back convincing sets of numbers before more international inflows materialize. We however were pleasantly surprised to see Chinese authorities announce measures targeting the stock market. This is a change compared to the crackdown measures on various private sectors from the previous years.

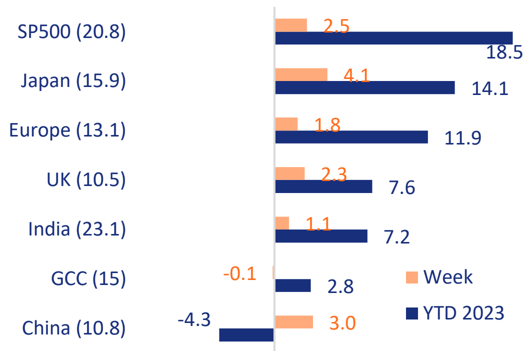
Within developed markets, our positioning is also balanced, in line with our theme for 2023 which is all about unpredictability. We are close to neutral on most regions, even if the euro area is certainly our least preferred due to a higher recession risk. Among sectors, while our constant presence in tech continues to deliver, we keep on recommending healthcare as one of the best defensive areas – even if it hasn't delivered so far.

As a conclusion, diversification is the main recommendation, rather than radical active positioning. This is especially true in terms of regions, with very different top-down dynamics taking place between and within the large DM and EM groups.

EQUITY RECOMMENDED REGIONAL POSITIONING

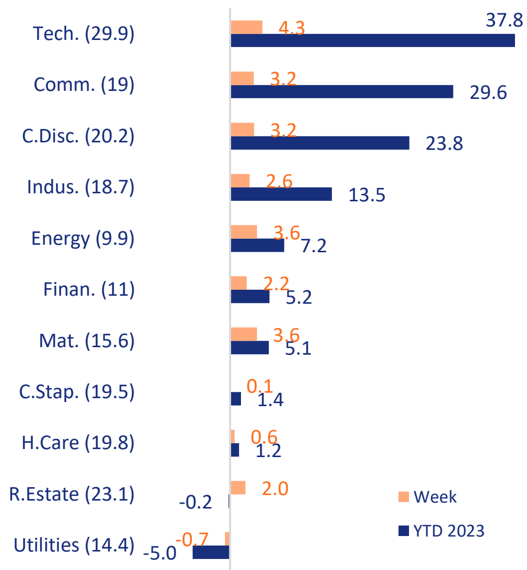


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2023PE



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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