Optimism survived an eventful week

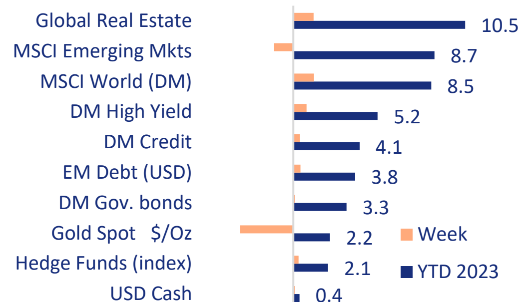
- **Amidst central banks, economic data and corporate earnings, last week was perilous…**
- **… But ended well for most asset classes, with probably, some fear of missing out**
- **Our Global Investment Outlook is out this week, themed "Adapting to Unpredictability"**

Last week was the most eventful of the still young 2023. Major central banks hiked interest rates and most renewed their commitment to fighting inflation: this was widely expected and didn't shock markets. January economic data gave an overall message of resilience, especially in services. Jobs creation in the US was astonishing, at 517K when the median forecast was for 188k. The narrative of an imminent recession in the US lost traction, but this obviously questions the relevance of the current market anticipations for rate cuts later this year. Finally, the earnings season continued to be mixed, with serious disappointments from the largest tech names Apple, Amazon and Alphabet in particular.

Still, weekly returns were positive for most asset classes, including US stocks despite a negative Friday. We are a bit perplexed. Fundamentally, valuations are now reflecting a perfect scenario of economic expansion combined with a pivot from central banks. It's not impossible, but there's some contradiction as a buoyant job market means risks of higher, not lower, terminal rates, and for longer. From a behavioral point of view however, rising markets despite mixed news is a bullish signal. We may consider reducing risk at some point: we are currently fully invested and participating to the rally; we are not convinced it is necessarily sustainable.

Our 2023 Global Investment Outlook is out this week and details why we see a new investment landscape emerging from the disruptions of the last three years. As unpredictability becomes a norm, with more inflation and less globalization in particular, we adapt both our strategic and tactical asset allocation to a new set of risks – and opportunities. We hope to discuss it with you in person at our client events next Tuesday in Dubai, after 2 years of virtual formats. Stay safe.

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



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Cross-asset Update

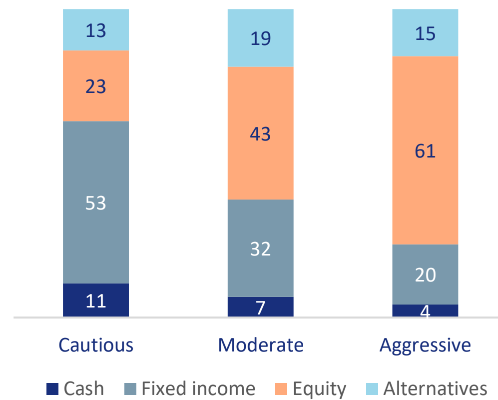
Financial markets have rushed to discount the surging of a new liquidity wave ever since it became clear that the Fed's tightening cycle was going to draw to an end. The minutes of the December policy meeting reinforced investor expectations, in that most participants emphasized that the "cumulative effect of policy tightening could end up being more restrictive than is necessary". This hardly suggests that the Committee prioritizes inflation over growth in spite of the public rhetoric to the contrary. But Friday's strong jobs report, though distorted by many a statistical adjustment typical of the month of January, throws a spanner into the newly regained trust in a goldilocks scenario where rates peak alongside inflation, even as the economy is not contracting. It seems on the other hand that growth could remain too strong and thwart the Fed's efforts to curb aggregate demand and inflation, hence forcing the Fed's hand. So, the perfectly balanced scenario whereby business activity is neither too hot nor too cold, has now a much lower chance of playing out.

And markets have suddenly started to adjust in the direction of the new wake-up call. On Friday equities retreated, bond yields rose sharply alongside the US dollar, while gold tumbled. As much as asset classes had been lifted by the hope of forthcoming higher liquidity, a reassessment has now become necessary. And all the more so, in light of the slew of Fed officials due to speak this week, including chair Powell amongst others, likely to utter hawkish messages in the wake of the recent macro data and the easing of financial conditions brought about by rising markets since the October lows.

We stick with our tactical call that it will become increasingly difficult for DM equities to make substantial gains from current levels, unless policy turns with growth, an impossible scenario given the inflation-containment goals. Real yields are set to rise as rates are kept at high levels for longer, capping gains on gold and high-yielding bonds, in our view two over-extended asset classes. But also IG credit should in the short-term have reached the limits of its possible appreciation, with capital gains harder to come by as investors reassess the case for easier liquidity. The US dollar would be a net beneficiary of the new state of affairs, and indeed last week it rebounded by almost 1%, with short positioning at record levels suggesting further upside potential.

In summary, the outlook for asset classes remains cloudy, with higher-quality bonds still the winners as against DM risk assets, yet themselves no longer outright cheap. In this environment security selection is to be preferred to broader beta exposure, that is still possible though in EM equities, much less expensive than their DM peers and driven by the no means exhausted Chinese recovery. As already mentioned in the previous issue of this publication, gold has reached our $1,950/oz fair value too soon and too fast and is now vulnerable to rising real yields. Patience and focus on security selection is warranted across asset classes.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

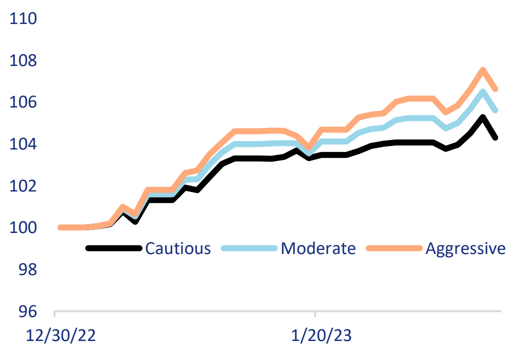


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW:Underweight/Neutral/Overweight

	UW	N	OW
Cash			>>
DM Gov.			>
EM Debt			>>
DM Credit	<		
DM H. Yield	<<		
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

Last week was dubbed the critical central Bank week, where major central banks had to take rate decisions. The week started innocuously, with policy and market directions diverging more and more. Both the Fed Chairman Powell and ECB Chair Lagarde failed to convince investors of the “Higher-for-longer” rhetoric, even though both promised more hikes were to come. BoE indicated it might be nearing the end of this rate hike cycle, and the Bank of Canada was on a pause. Both Us Treasuries and German Bunds rallied till Thursday. However, the narrative changed on Friday post the robust US Jobs Market Data of 517,000 jobs added in January that came in way above expectations, followed by ISM Services, which beat estimates to come in at 55.2 and emerge out of the contraction territory.

When data hits this hard, investors are forced to listen. The short-maturity US Treasury yields advanced by as much as 20 bps. The 10-year US Treasury yields surged above 3.5%. Markets increased their peak rate expectations by 15 bps to 5.05% from the earlier 4.9%. Paradoxically, High Yield rallied further with US High Yield OAS spreads below 400 bps for the first time since May 2022 and returned +1.2% last week. Global HY now leads the YTD returns chart at +5.17%, followed by IG credit at 4.06%. EM Debt spreads have tightened 26 bps YTD and have returned +3.8%. We are very cautious of these tight valuation levels in the riskier segments and don’t want to go long in overbought conditions.

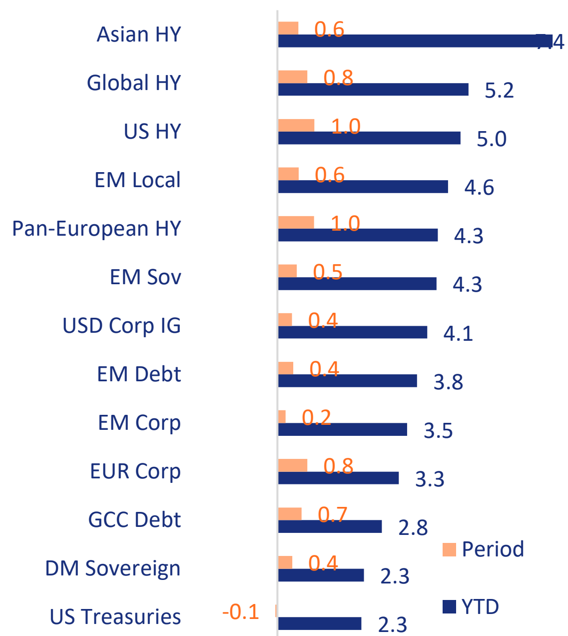
January issuance of Investment Grade bonds was scorching, even though traditional heavyweights Financials shied away. However, there is an interesting pattern with most issuers preferring to issue shorter-duration bonds. Only about 55% of the bonds issued last month were more than ten years of maturity, against a figure of 67% for January 2022. The companies want to avoid locking in high coupons for the longer term and hope for yields to come down before lengthening their maturity profiles. The tight supply and the decrease in Treasury yields resulted in bonds maturing in 10 years or more, surging 6.9% last month, their best January in decades.

GCC primary markets took a breather, with only one mandate issued last week. DIB has announced that it would issue a long 5-year sustainable sukuk which could come to the markets this week if conditions remain favourable. This week Sharjah issued a mandate for a 12-year inaugural sustainable bond which should come to the markets next week. We are yet to see High Yield issuers from the region tapping the market.

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, LatAm

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



Source: Bloomberg

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PRIVATE BANKING

Equity Update

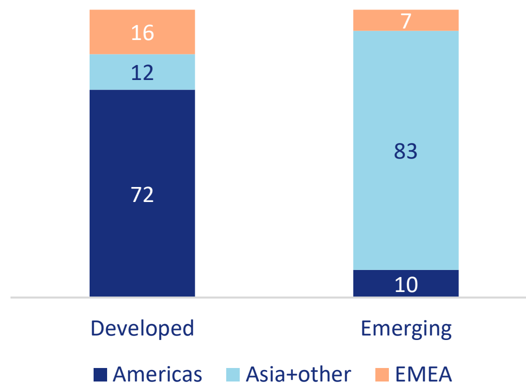
A better week for developed markets with a tech rally taking Nasdaq performance to +15% and making it the best performing large Index year to date. Last week saw plenty of macro releases, with a benign trajectory of inflation data, 3 key central bank meetings that added no new hawkish impetus and a third of S&P500 reporting Q4 & full year results. A greater probability of soft landing in the US, as the labour market showed unexpected strength, but without a corresponding inflationary impulse. Growth stocks rallied after the Fed signaled some progress in bringing down US inflation. EM and DM equities are up in parallel +8.5% YTD as US and Eurozone equities had a good week. China equities fell 5% after a week of being closed for the lunar new year holiday. However, the relaxed real estate lending norms and IPO listing rules should boost markets as will the pent-up consumption demand. Indian equities fell less than a percent last week, not too affected by the Adani conglomerate stocks which have been suffering on the back of a short seller report.

A strong week for UAE equities in spite of the fall in oil prices. Earnings have been encouraging as has economic data. Whilst the Dubai Index is still heavy weighted by banks, Abu Dhabi is more diversified with holding companies such as IHC, Abu Dhabi Ports and the recently listed chemical company Borouge. Valuations and dividend yield remains attractive, however more so for Dubai equities.

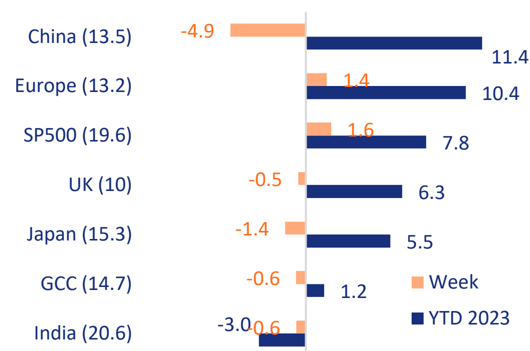
The blended earnings decline for the S&P 500 Index for Q4 is -5.3% and the blended revenue growth rate +4.3%, with 50% of the S&P 500 and 70% of market cap having reported. Apple, Alphabet and Amazon combined market cap of over $5tn had earnings affected by the cyclical slowdown, but let's not forget the double digit growth from most segments from a higher base after years of 30% +growth. Headwinds kept the consumer sentiment weak in 2022' but the Tech CEOs highlighted the use of AI in search and consumer mapping. Demand for electronics, e-commerce and digital advertising is slowing as is cloud computing, though still at +20% growth. The 3 major US cloud computing providers Microsoft Azure (+31%), Amazon Web Services (+20%) and Google cloud (+32%) reported a slowdown in cloud revenue growth y/y and about 4/5% below the prior quarter. Apple also had overall revenues fall on a stronger US Dollar, on slower purchases of iPhones, Ipads and Macs and production problems in China. Alphabet overall revenues grew just 1% y/y with a 4% fall in digital ad revenue. Amazon revenues grew 9% y/y, but also spoke of the impact of the stronger US dollar and soft consumer demand for products sold online.

Mentions of "AI," "machine learning" and related terms have risen in the latest round of company earnings calls, as have cost reduction plans. Big tech players are continuing to invest heavily in AI and we remain confident of the technology sector returns leading over the longer term. This week, 95 S&P 500 companies are scheduled to report results.

EQUITY RECOMMENDED REGIONAL POSITIONING

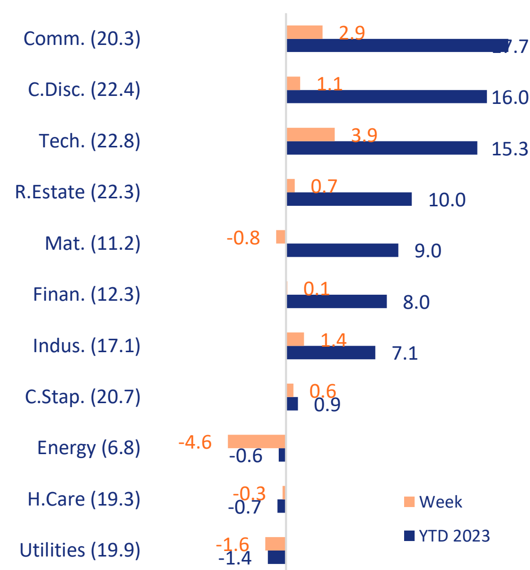


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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