The prompt come-back of **Goldilocks**

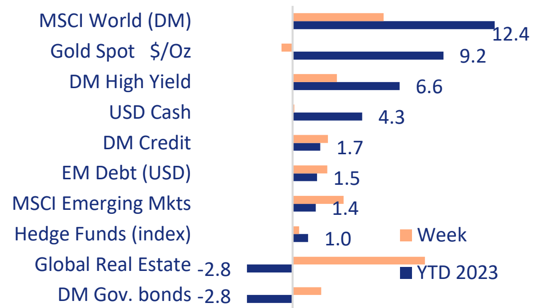
- **Just as we were highlighting excessive pessimism, the FOMC triggered a melt-up rally of everything**
- **No hike, dovish comments, signs of weakness in the US job market propelled stocks and bonds higher**
- **This was in line with our scenario and positioning, but cyclical questions for 2024 should be the next concern**

We had to start with this: the title of our previous weekly publication, released last Monday in highly volatile markets, was about the risk of excessive pessimism. Here we are, a week later, with a clear melt-up rally of pretty much everything except gold slightly down. Stocks literally jumped 5% in developed markets and 3% in emerging ones, while all segments of fixed income added between +1 and +2%, all clearly in the shadow of the 8% gain of global listed real estate. Did we anticipate what has so far been the strongest weekly returns of 2023? Certainly not. But what we knew for sure, was that between behavioral factors such as sentiment, positioning, levels of implied volatility, some inconsistencies in cross-asset signals and even, to some extent, pockets of undervaluation starting to appear in some segments, markets were not ready for good news.

But was it really good news? For the short-term, the idea that the Fed is done with hiking definitely is. The central bank held rates unchanged in November, and the tone of the press conference clearly indicated that hikes could be over. And this was before seeing some weakness in US leading indicators, and most importantly, a much lower than expected number of job creations there in October. US growth is just slowing enough to give comfort to the Fed: goldilocks, reloaded.

Of course, this may not be great news for the medium term. The recession risk is only positive for markets when the dominating narrative is about timing the end of hikes in interest rates, and the outcome is an instant rally only when behavioral factors are in excessive pessimism territory. This is not the case anymore, which is why, along with our close to neutral allocation to equities, we overweight cash as well as the safest bonds, while being cautious on the riskiest ones.

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



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Cross-asset Update

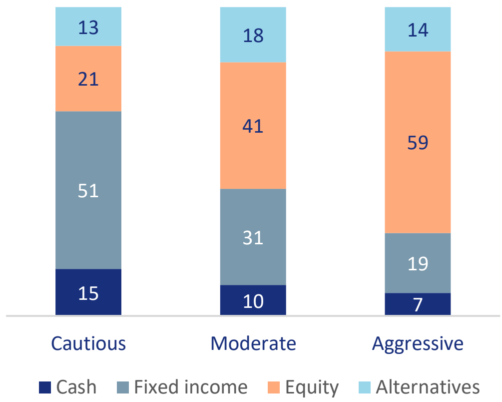
While investor focus for the week was most likely on the Fed meeting or the jobs report, we hold the view that the most significant event was the Quarterly Refunding Announcement, whereby the Treasury communicated its plan for how to fund the budget deficit for Q1 next year. As per the release the amount of longer-dated Treasuries was substantially reduced versus initial communications, to increase the share of T-bills to 58% of the funding need. This is no technicality, as it impacts market liquidity and even the fight against inflation. The shift in supply in favor of shorter-dated bonds was driven by the lack of demand at the longer-end of the curve, given projections of 6-8% budget deficits for years to come. A more prudent though painful course of action would have been to cut expenses, raise taxes, or allow 10-, 20- and 30-year yields to rise by increasing issuance, going at the same time in the direction of fighting inflation.

Yet, there is no free lunch, even for the Washington administration. Shorter-dated debt is like cash with some interest attached, hence it increases both the purchasing power of economic agents and market liquidity, running against the Fed's attempts to tame price pressures. And given the reduced supply of Treasuries longer-dated yields tanked after the announcement, further loosening up financial conditions. Hence, the 'higher for longer' mantra will not be adhered to as strictly as advertised by chair Powell, that comes alongside the risk of economic activity remaining resilient and inflation reawakening. Under this scenario the Fed would not be done tightening despite 2024 being an election year, so at some point yields at the longer end would be rising again.

Gold rebounded hard recently, possibly pointing to the dynamic of financial conditions easing temporarily, and equities started to respond as well, in particular in the longer-duration technology sector. For the same reason upside pressure on the US dollar eased.

It is anyway hard to see how the current rebound could be sustainable. Technicals are favourable in view of depressed market breadth, yet valuations remain challenging and eventually inflation reawakening and yields rising once more would be self-defeating. This is a muddle-through scenario, whereby opposing forces keep markets in a range, though little is likely to happen that is benefitting portfolios. So, exposure within asset classes becomes more relevant than to exposure to asset classes. A general bias towards quality should ensure that portfolio volatility is minimised at times of growing uncertainty.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

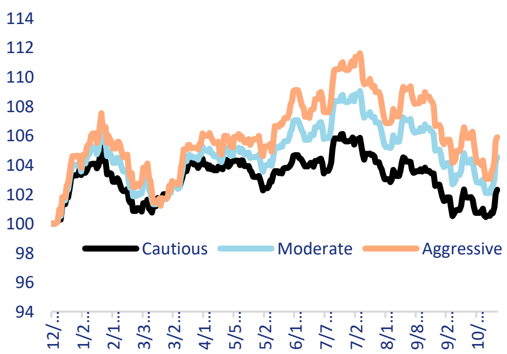


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Last week, three key central banks acted as expected. However, the week ended up being a pivotal one for the markets. Goldilocks macro releases, including weaker-than-expected NFP data, cautious treasury refunding announcement, and a patient Fed, led to a rally in both bonds and stocks. The action in the US Treasury yield curve was spectacular. In the space of three trading days, starting Wednesday, there was a significant bull-flattening. Yields onwards of 5 years dropped by more than 30 bps. Notably, the 10-year fell below 4.5% intraday on Friday, and the 2-year trades at 4.85%. Following last week's rally, yields may retrace somewhat higher again, but higher-quality credits should be supported.

Swap levels indicate the first rate cut in June 2024, and 4 rate cuts are priced in next year. Only time will tell if this enthusiasm is warranted. Markets have been wrong time and again during this rate hike cycle. Running ahead of the Fed could be self-defeating. If the financial conditions ease faster than anticipated while the US economy remains strong, the Fed will push back. Moreover, the lower increase in coupon notes issuance by the treasury has driven the rally in the US treasuries that defeats the Fed's assumptions that long-term yields remain higher for longer. This may force the Fed to act even in an election year. We would be cautious of increasing duration. It is better to nibble at than gobble up duration.

Riskier segments of the Fixed Income had a brilliant week due to spread compression. High Yield was the best-performing asset class with a 2.5% weekly return, followed by Investment Grade, returning 2.1%. All the segment spreads are currently trading around YTD median levels. Credit conditions are not the best, but the fiscal policy overpowers the monetary policy and keeps a lid on the spreads. Default activity increased in October, registering the highest number of defaults in 3 years.

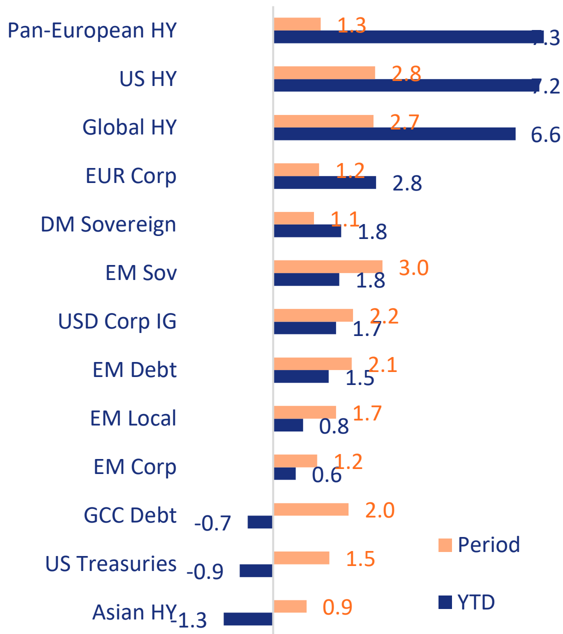
Most HG demand is yield-driven, not spread-driven, and thus, this is a negative. The result of lower yields is also higher issuance in the near term. Earnings season is nearly complete for HG companies, and results are good enough. According to JPM, this translates into rating trends where upgrades continue to occur at a 4:1 pace versus downgrades this year within HG. Last week saw the largest rising star ever, with Ford's $41bn of debt swiftly moving into IG from HY indices this past month-end. Moreover, the proportion of BBB- debt in the HG market is now at an 11-year low at just 11%, implying a significant downside cushion from a rating perspective should the economic expansion finally start to slow, as the Fed this past week argued it should. This bodes well for spreads heading into year-end.

Primary issuance markets, as expected, have opened up this week. There are expectations of more than $40bn IG bond sales. Even in the GCC, we have seen Mubadala declaring a mandate for its inaugural 5-year AED bond. This will be the first 5-year AED bond by any corporation from the UAE and will be the longest-maturity AED bond. ADIB has also issued a mandate for selling 5-year senior Sukuk.

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

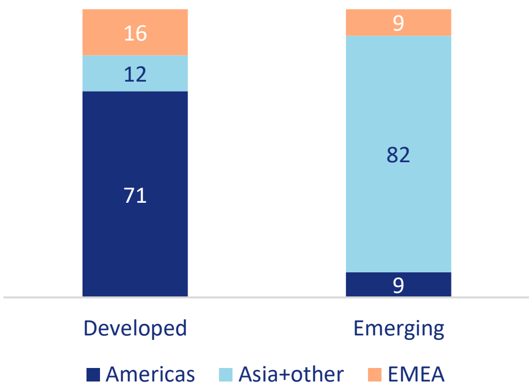
Global equities closed +5% last week, as the upward pressures on interest rates showed signs of abating. The S&P 500 ended the week 5.9% higher and the Nasdaq 6.6%. Support from central banks as the Fed kept its policy rate steady, while the US Treasury Department indicated that it intends to slow the pace of longer-dated debt issuance in coming months. US Treasury yields have the 10-year at 4.59% and a respite from the earlier 5% level which had spooked equity markets in October. European equities also up last week, though less, +3.4% with inflation easing to its slowest pace of growth in over two years. The VIX lower at 15 from a high of 22 mid-October. Year to date, DM equities are up 12.4% with the US leading returns +15%, the Nasdaq is +30% YTD. and the Eurozone and Japan in USD terms, positive but lower returns. EM equities are close to flat +1.4%, the Dubai Index leads, followed by LATAM, then India. China markets remain volatile and negative YTD, with sizable stimulus still on the horizon.

The month of October was negative for all asset classes except for gold and money markets. Global equities fell -3%, a broad sell off, with no region in the green. The global tech sector fell just 1% in Oct, with higher yields no longer a boogey man. The selloff in October for DM equities can be attributed to higher interest rates seen for longer, raising the cost of borrowing for companies. EM equities were a little worse off in October -3.9%, with a stronger USD and China underperformance weighing on returns. Geopolitical issues have been dominating markets as well as the effect of higher oil prices on inflation and the subsequent rection expected from DM central banks. Now, the risk-averse environment is abating with developed market sovereign yields seen to be range bound.

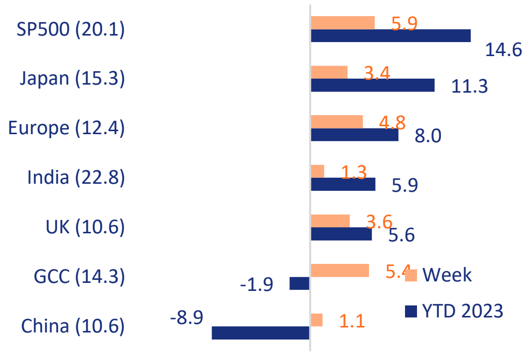
To date, 81% of the companies in the S&P 500 have reported earnings for the 3Q and the blended (y/y) earnings growth rate is 3.7%. Margins are resilient and consensus expectations are for CY 2023, earnings growth 0.6 % and revenue growth 2.4% and for CY 2024, earnings growth of 11.9 %; revenue growth 5.5%. Mixed signals for equities which have in the first ten months of 2023 risen largely on the performance of the magnificent tech 7 (+90% YTD, even after the October slide) and their AI growth opportunity. Microsoft, Nvidia, Apple, Amazon, Meta, Tesla and Alphabet, make up more than 25% of the S&P 500's market cap, so their outlook matters. These are among the world's most remarkable companies with earnings growth records that can sustain high valuations. All except Nvidia have reported Q3 earnings. Nvidia's AI oriented earnings growth has more potential. Tesla however, is under challenge from China EV makers and Toyota but its Cyber truck holds promise. Meta could gain from cost cutting and Microsoft from its cloud business. Apple though revenues are stagnating has services gaining traction. Alphabet could continue to see growth potential in search and YouTube. So not another 90% but 10- 20% upside next couple of years could continue.

We recommend being patient: Our positioning is close to neutral in equities with a tactical overweight to the US in developed markets and India in the emerging markets and a quality focus. Stay invested as per the recommended asset allocation for the best risk adjusted returns.

EQUITY RECOMMENDED REGIONAL POSITIONING

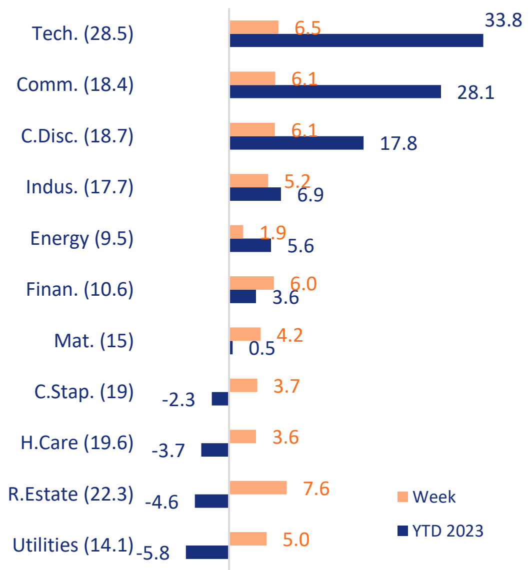


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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