Emirates NBD
WEALTH MANAGEMENT

Heightened uncertainty is the **new normal**

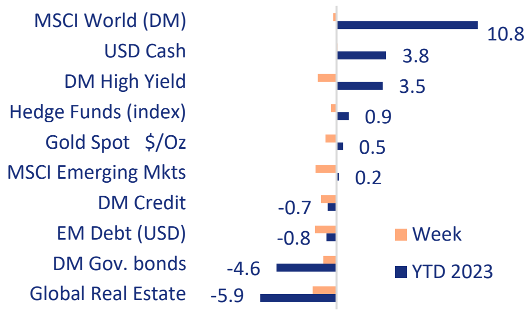
- **An eventful week, from Washington to Israel, marked by major macro releases**
- **High unpredictability is here to stay; though the big picture for global markets hasn't drastically changed**
- **The future path of interest rates, US inflation and policy, as well as oil prices are the key drivers to watch**

It's been an astonishingly eventful week. It started with a last-minute compromise in Washington, which later cost the House Speaker his position, and ended with Hamas's surprise attack on Israel. In the meantime, Fed officials were hawkish, global PMIs painted a continued slowdown, oil prices fell, while US interest rates further rose, with a strong US labor market release.

Let's start with the latter. First, US job openings came in much higher than expected and then, the September jobs report printed a spectacular 336k new jobs for the month, almost twice the median forecast. No doubt, headline numbers support a more hawkish Fed. But details are less binary. Below the surface, between falling quit rates and no acceleration in hourly earnings, we see strength rather than overheating. The same nuances apply to the PMIs: the global economy continues to slow, but it's not collapsing. All in, considering that higher interest rates are helping the Fed in their battle against inflation, we are still not sure that more hikes are a given.

With regards to the geopolitical situation, the implications for global markets will certainly depend on whether the conflict escalates, involving more parties, or not. If it does, oil prices should rise further, with also potential trade sanctions, both hitting global activity and investors' risk appetite. If it doesn't, the US economy will keep its dominant role in the current market narrative, with Thursday's CPI inflation release providing an important datapoint. As we prepare to review our tactical allocation, we also note that investors' sentiment has materially deteriorated. This is not bad news. The imminent start of the corporate earnings season will also help assessing the fair valuation of stock markets as well. Stay safe.

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



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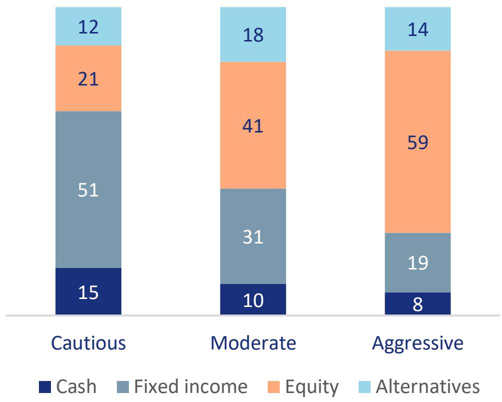
Cross-asset Update

Markets have not been cheap in the post-pandemic period dominated by multiple policy interventions both on the monetary and fiscal front. Repeated liquidity injections have rerated risk assets, while at the same time one of the steepest Fed's tightening cycles has made government bonds way cheaper. It is now quite glaring that US equities are indeed expensive relative to bonds, though investors do not seem to care as the main benchmarks remain pretty resilient. The 10-year TIPS yield last traded at almost 2.5% on Friday, a fifteen-year high and above the long-term growth rate of the US economy, currently estimated at somewhat below 1.8%. Given the degree of DM leverage, one would have expected a less composed reaction of the markets, that have not even lost 10% from their highs. On the other hand, since 2022 the main DM government bonds have underperformed not only equities, but also their EM sovereign peers, unprecedented for past tightening cycles.

This tells us there is two sides to repeated fiscal interventions in the DM countries: on the one hand growth was boosted, on the other debt levels reached uncharted territory. Investors are for now focusing on the former, still giving the benefit of the doubt on the latter to the DM countries. In the United States in particular, where public outlays were largest and fiscal largess is projected to negatively affect finances for the longer term, effects on growth were most prominent. Both the still sanguine equity markets and the multi-year highs in real rates reflect a stronger conviction amongst investors that the equilibrium growth rate of the economy has reached a higher level. So, equities can continue to be expensive in the face of rising yields as long as activity remains sustained. On the one hand labor demand is still very strong according to the latest jobs report, on the other at some point in 2024 the effects of restrictive policy will make themselves felt. We hold the view that the outlook is still relatively benign into yea-end, so markets could still surprise to the upside from current levels.

The longer-term picture is much more problematic, and the odds that US growth will have to reset lower in 2024 remain high. Allocations should be leaning defensive, with a focus on the longer time horizons, rather than on the current misleading calm. Absolute-return strategies with the least correlation to market direction should be part of the portfolio.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

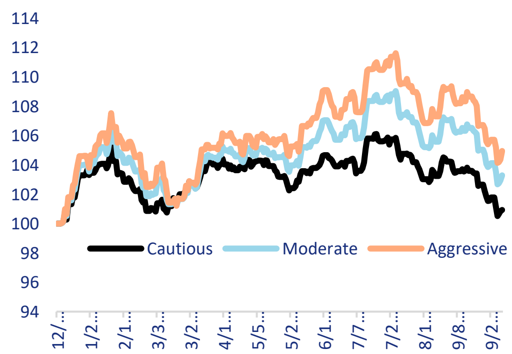


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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, jobs-related data confirmed strength in the US labour market. Last Tuesday, The August JOLTS report surprised on the upside with 9.61m job openings, up from 8.92m a month earlier and beating market expectations of a slowdown. On Friday, the US nonfarm payrolls report showed employers quickened the pace of hiring, with 336,000 jobs added in September — more than double economists' estimates. The unemployment rate held steady at 3.8%. This led to a straight 5th week of bond losses. The US Treasury curve bear steepened with the 10 and 30-year closing at 4.8% and 4.96% last week, up more than 20 bps each.

Though valuations are cheap, we remain neutral on duration, given positioning is not entirely neutral. According to Vanda Research, the investor positioning in 10-year US Treasuries is only modestly bearish and not at levels that make being long bonds a no-brainer like it was this time last year. Markets currently assign a 20% rate hike probability for the next FOMC meeting. According to Bloomberg, the chance of one rate hike before the end of the year is 40%. Both probabilities have become lower due to the recent geopolitical risks in the Middle East. However, several technical factors should keep the yields elevated. The ongoing QT, elevated treasury issuance, and decreased foreign central bank demand for the Treasuries would force investors to ask for a high term premium, putting a floor on long-dated yields in the short term. Hence, we are in no hurry to change our view. We would wait for weaker macro data before increasing our preference for the long-duration trade.

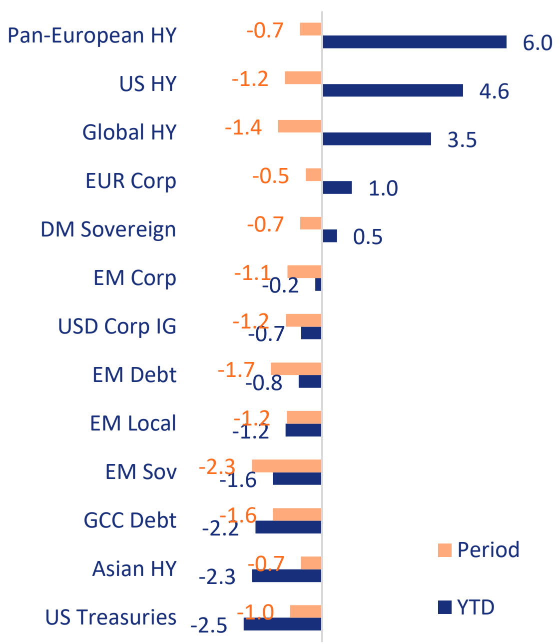
Credit spreads for weaker Fixed Income segments had a rare double-weekly dip this year. After staying resilient for most of the year, the last two weeks have seen High-yield spreads widen by 40 bps, and the high-yield spreads have increased by more than 15 bps. EM Debt has been the worst performer in the last two weeks, returning -3.4%. IG credit spreads have been more robust, increasing by only 5 bps. However, the long-duration nature of the asset class resulted in a -2.8% return.

Moody's has downgraded Egypt's credit rating to Caa1 from B3 with a stable outlook after putting it on review since May. This came after comments from the IMF chief saying, 'Egypt will bleed precious reserves unless it devalues its currency again.' Analysts expect the IMF program to resume in the first half of 2024. Since bonds are already trading at historically low levels, especially at the long end, we might not see a significant decline. However, we expect the curve to flatten further as this adds to the repayment concerns over the medium term, with front-end bonds bearing the brunt. There is a chance of S&P following suit this month as well.

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 financial markets already nervous with elevated interest rates and strong jobs data from the US, face new geopolitical uncertainty following the surprise attack on Israel this weekend and the ensuing conflict. Oil, gold and Treasury yields become important metrics to watch. The conflict in Israel triggers a new risk paradigm. The KSA market fell 1.6% on Sunday. The positive was Saudi Aramco that closed up, in line with higher oil prices. Whilst UAE economic growth and the trickle down to economy remains strong we would go neutral UAE equities tactically (we maintain our positive strategic outlook) and recommend holding the strong cash flow companies in the UAE long term for dividends.

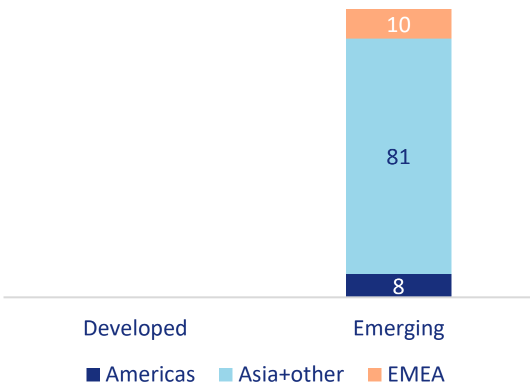
Last week global markets fell, though less than half a percent, however adding to 2 weeks of losses. Several contrarian "buy signals" were triggered with 88% of global equity indices trading below the 200 & the 50-day moving averages and fear gauges at extremes. But current geopolitical developments could overshadow what was developing into a rally from oversold levels.

YTD the MSCI ACWI is at c. +10%, largely driven by developed market performance. Positive weekly closes from the US and Nasdaq, though Treasury yields trended up. All other major markets ended the week with losses. India and the UAE outperformed the rest of EM, with China equities on a downtrend again -1.8% on the week and -10% year to date. All the major developed markets are positive YTD, surprisingly the higher rates not yet affecting consumer demand. However, borrowing rates for autos and mortgages have risen in line with rates. We retain our US overweight in preference to the Eurozone and Japan with the USD positioned to retain strength and the US market more immune to geopolitical risk and higher oil prices. In EM we continue to prefer India on the back of strong eco growth but would watch the impact of higher oil prices.

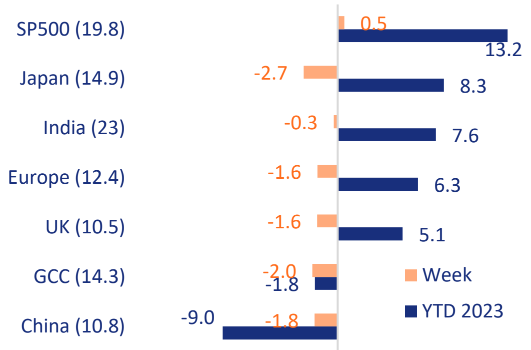
We reiterate our 2023 ($222) S&P 500 EPS estimate (flat y/y). Companies start 3Q 2023 reporting season this week. Consensus (FactSet) expects 1.6% sales growth, 55bps of margin contraction to 11.2%, and flat EPS relative to last year. Earnings season focus is Friday's Bank Reports with Blackrock, Citi, JPM. Outside of banks we have Pepsi, United Health, Walgreens, Delta Airlines, Schwab reporting this week. Near-trend economic growth and moderating inflation pressures will support sales growth and margins. However, in the headlights are mixed signals: the “higher for longer” interest rate regime, resilient wage growth, and AI development adding to positive sentiment for tech firms.

Quality companies with low leverage and strong cash flows should continue to outperform. The magnificent 7 tech giants whilst leading + 96% YTD average returns and classified as quality companies are all in the high growth tech sector, so whilst we think AI remains an important factor for equity performance, we would look to diversify beyond tech to healthcare and other defensive plays. We add an ESG screening to our stock selection, however ESG driven businesses have unfortunately not been performing recently as the impact of high interest costs have affected profits.

EQUITY RECOMMENDED REGIONAL POSITIONING

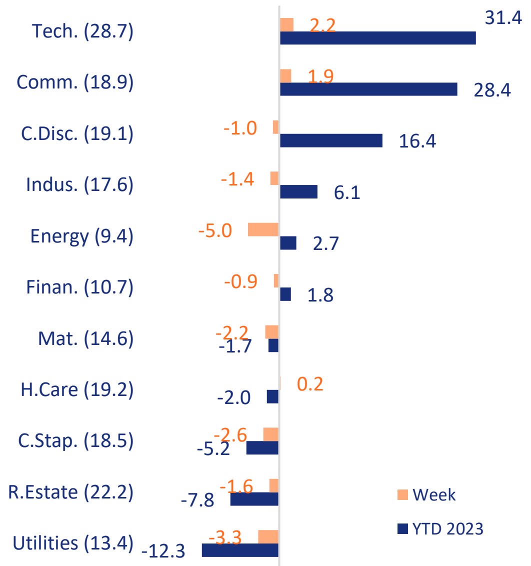


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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