Emirates NBD
WEALTH MANAGEMENT

Are we approaching an excess of **pessimism?**

- **Last week saw geopolitically driven concerns alongside an avalanche of economic and corporate releases**
- **Risks are obviously elevated though data so far do not show signs of deterioration**
- **The week ahead should confirm a cautious Fed, divergent PMIs, and a solid US job market**

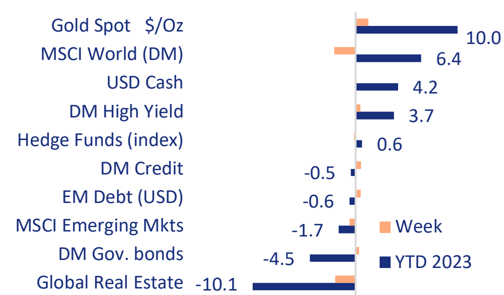
Last week was a case in point of the current unpredictability of markets. What looked like a typical risk-off pattern, with defensive assets outperforming cyclical ones, was actually weird. First, bonds and stocks had been extremely correlated for weeks, as the rise of yields was the reason for lower equity multiples. Bonds were not a haven anymore - until last week. Despite positive US economic data, yields fell but stocks did not benefit, also ignoring a good Q3 earnings season so far.

Of course, geopolitically driven risk aversion is an explanation, as the "second phase" of Israel offensive began in Gaza, while the horrific humanitarian situation raises international concerns and escalation risk. But weirdly, again, oil prices actually fell, despite a surprise fiscal stimulus plan being announced in China.

The short-term is always unpredictable, and it is particularly the case now. Factually, US Q3 real GDP growth came in at a stellar +4.9% annualized. Their October flash PMIs confirmed strength (while Europe, by contrast, is dangerously low). Adding stabilization in Asia and US companies delivering solid Q3 results on average, the fundamental picture is not that bad. Of course, it can change, and pessimism can turn into panic. But the worst is never certain, which is why our positioning remains only reasonably defensive. Last week at least shows that in case of panic, quality bonds should be safe havens again and be of help in a portfolio.

The week ahead is rich. Apart from geopolitical developments, we will watch the FOMC – we expect no hike this Wednesday, the BoJ and BoE, the US job report on Friday, and regional PMIs in the meantime. Corporate earnings will continue, including Apple, always important, on Thursday. Stay safe.

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



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Cross-asset Update

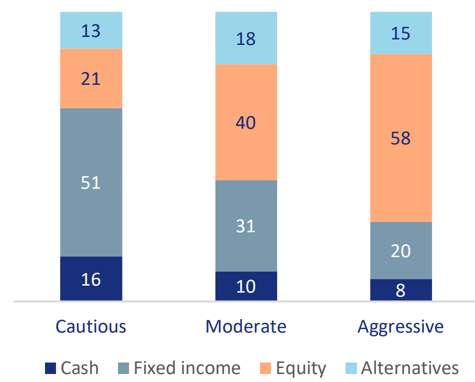
According to our analysis global equities have reached oversold levels and are overdue for a rebound, although the expected dip in Q4 growth could delay a more durable recovery. And more in general there do not seem to be many reasons to think that markets can get out of their trading range and start a new bullish phase very soon.

The growth impulse is still way too narrow and basically confined to the United States, while China is just stabilizing and Europe is mired in contraction. And there is not much in sight suggesting that a change for the better in the outlook is forthcoming. The Chinese authorities announced a new round of stimulus planning to increase the budget deficit, and while this would be enough to achieve the 5% year-end growth target, it is unlikely to generate sustainable economic momentum. Europe is still way away from being able to turn the corner, weighed down by the effects of the ECB tightening that are just starting to fully unfold. The United States remains resilient, yet asset class performance does not suggest great investor confidence in the outlook. The S&P 500 ex-IT and IT-megacaps is in negative territory year-to-date despite the positive performance of the broader market, that points to investors seeking refuge in monopolistic and high cash-generative companies. So, even where growth is more resilient, investors do not seem to be willing to take excessive risk.

US exceptionalism is not helping much either, as it brings about tighter financial conditions via higher yields that in the end make the investor darlings - IT stocks – more vulnerable. While longer-term yields are expected to inflect lower as the economy slows down, in the shorter run the excess Treasury supply and the continued positive economic surprises are going to limit the downside. Given the late stages of the credit cycle and the tighter credit conditions driven by an inverted yield curve, we continue to hold the view that investors should search for quality across fixed income, rather than sacrifice it for yield.

Against this muddle-through scenario we see a rare bright spot in gold. We are approaching peak rates time in the Fed's tightening cycle and soon investors will be looking to the possibility that the Fed loosens policy up in 2024. It is well known that gold tends to outperform when yields fall. Also, gold's resilience is rooted in apprehensions about the sustainability of the US debt's trajectory, unlikely to dissipate anytime soon. And it is indeed the increased focus on rising debt across the DM countries that most likely has seen gold hold up nicely despite rising real rates. Overall, the advice is to hold at least a neutral allocation to the yellow metal, a safe-haven asset amidst growing uncertainty.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

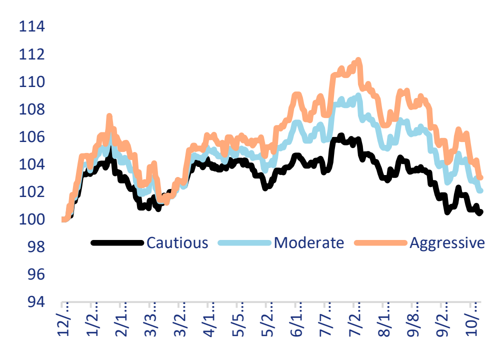


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Three key central banks in the foray this week. BoJ, an outlier among its peers, having stuck to ultra-loose policy settings despite the inflation backdrop kicks off on Tuesday. Some in the market speculate it could tweak its policy of yield targeting in response to higher global rates. The Fed is expected to extend its pause. Fed chairman Jerome Powell will speak after the rate decision and any comments about the toll of rising bond yields will be of special interest. Across the Atlantic, the BoE is expected to keep its 5.25 per cent bank rate on hold. British consumer price inflation unexpectedly held at 6.7 per cent in September, remaining the highest of any major advanced economy and keeping alive the possibility of another rise in interest rates.

Treasury Department's new borrowing plan is due hours ahead of the interest-rate decision. The quarterly refunding announcement will reveal the extent to which the Treasury will ramp up sales of longer-term debt to fund a widening budget deficit. The recent selloff has sent yields to the highest levels since before the global financial crisis — making longer-term Treasuries more costly for the government. We would do well to remember that August announcements were the catalyst for the sell-off. Treasury Secretary Janet Yellen last Thursday rejected the idea yields were climbing due to swelling federal debt, but Powell this month did list a focus on deficits as a potential contributing factor.

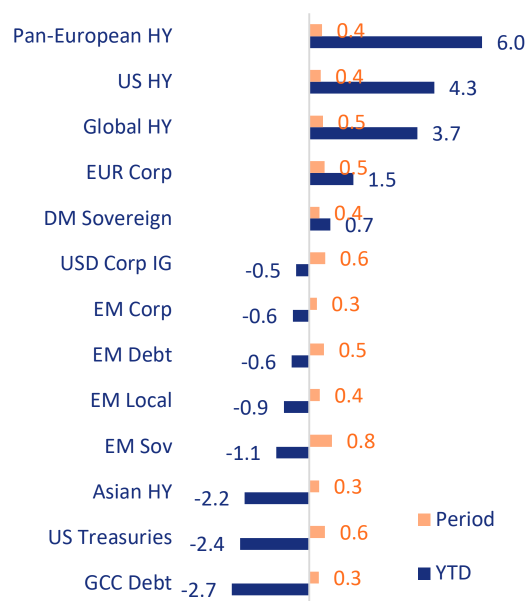
The outperformance of HG spreads was evident this week once again, driven by a technical picture which is very strong. Supply MTD at $56bn is contributing to market strength, as it is $30bn below the recent October average with four business days to go. According to JPM, data shows that dealers have net sold $5bn of bonds to investors over the past week and $9.8bn over the past two weeks. This highlights that demand remains strong and, with light supply, investors are adding risk in the secondary market. As a result, dealer positions are near a 3m low – which is contributing to the positive technicals. The risk to HG spreads is that growth slows, leading to lower yields and some weakness in credit metrics. Fundamentally, lower EBITDA has pressured the credit metrics but not to an extent that offsets positive technicals.

The first two occasions 10-year Treasury yields moved above 4% something broke; specifically, UK pension fund LDI portfolios in October 2022 followed by the failure of Silicon Valley Bank, and Signature Bank, then Credit Suisse in March 2023. However, with yields north of 5%, recent default/distressed exchange volume across high yield bonds and leveraged loans totalled $11.5bn in 3Q, which was down from elevated totals of $30.8bn in 2Q and $20.8bn in 1Q. Including distressed exchanges, the par-weighted US high yield bond and loan default rates ended 3Q at 2.11% and 2.66%, respectively, which is up from 1.65% apiece at YE22. Most of the rating agencies forecast the default rate to end around 4% to 5% in HY within a 12-month time frame.

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

Market direction continues to be influenced by geopolitical events, yields and earnings. We are in the heart of the US Q3 earnings season, with heightened geopolitical risk, rising yields and yet economic growth, as indicated by labour-market and service-industry data, stays resilient in many parts of the world. Mixed signals for equities which have in the first seven months of 2023, risen largely on the performance of the magnificent tech 7 (+78% YTD, even after the recent slide) and their AI growth opportunity. Now, a risk averse environment, though developed market sovereign yields still on the uptrend. Global equities fell 4% October to date, a broad sell off, with no region in the green. Volatility on the rise with the VIX at 21. Geopolitical issues dominating markets as well as the effect of higher oil prices on inflation and the subsequent rection expected from DM Central banks.

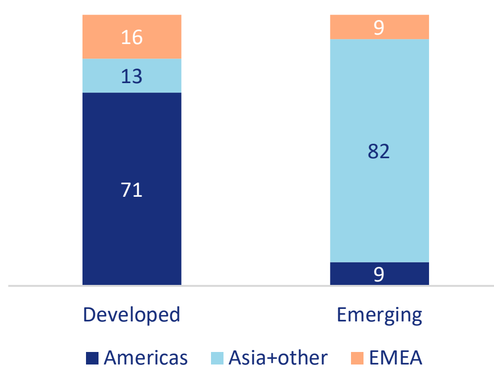
US exceptionalism continues with US 3Q GDP above estimates, Core PCE below estimates, an earnings trough established for Q2 with big tech by and large showing strong growth, though any disappointment severely punished. YTD DM equities are up 6.5% with the US leading, and the Eurozone and Japan in USD terms showing positive but lower returns. The DM-equity selloff in October can be attributed to interest rates seen higher for longer, raising borrowing costs for companies. EM equities negative YTD, the Dubai Index leads, followed by India. China markets remain volatile and negative YTD, with sizable stimulus not yet looming.

Our fair values for the main equity indexes predicate c.10% returns from DM and c.15% from EM into year end. Our positioning is close to neutral on equities (small underweight). We see volatility continue, a marked preference for quality in a risk averse environment with the US our preference in developed markets. In Emerging Markets, we prefer India and await better visibility in China.

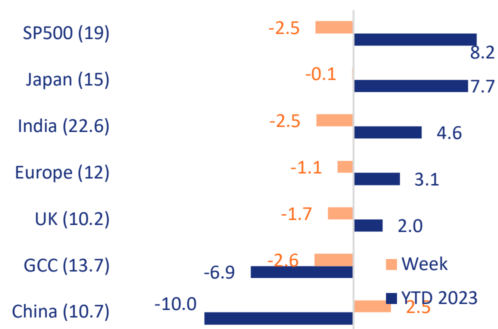
For Q3 2023, 49% of S&P 500 companies have reported, blended earnings growth rate for the index is 2.7% y/y. Mixed earnings from big tech. Meta, Alphabet shares falling post results that were below estimates and Apple trading below its 200-day moving average (announces this week). Microsoft traded up on strong Azure cloud services growth +28% y/y and Amazon shares rose as revenue topped estimates, with rising sales in its retail and cloud computing units. Intel shares traded up after predicting a return to sales growth in this quarter. Payment companies Visa and Mastercard have disappointed and said US payment volume growth slowed in September and October, though consumer spend has been fairly stable, and don't forecast a recession.

European Automakers fell following disappointing quarterly results from Mercedes-Benz and Volvo. Consumer products and luxury goods-makers also underperformed, while real estate and chemicals gained. Banks have disappointed from Barclays to Standard Chartered and BNP, and stocks fell after the banks reported disappointing earnings. Advertising giant WPP also ended lower after cutting its outlook for revenue growth.

EQUITY RECOMMENDED REGIONAL POSITIONING

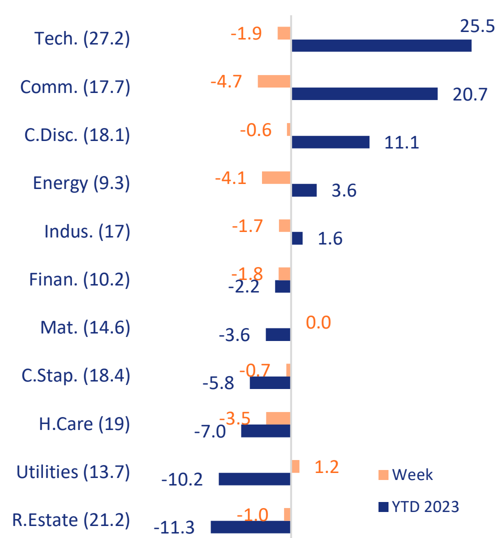


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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