Emirates NBD
WEALTH MANAGEMENT

Volatile markets in **shallow waters**

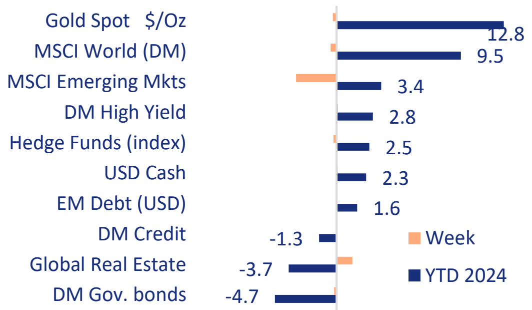
- **May was positive for markets despite ending with a week of anxiety and volatility**
- **Factually there is no groundbreaking change in the overall "soft-landing" global big picture**
- **The week ahead will provide much more color to the current backdrop with an avalanche of macro data**

The static picture of the monthly returns of May is idyllic, with absolutely all asset classes in the green, from +0.5% for cash to +4.5% for DM stocks. The ride, however, was certainly not smooth, with basically an "inverted V" shape, starting with the May FOMC driven euphoria on everything, followed by two negative weeks for pretty much everything. Central bankers did everything to avoid markets being carried away by their own previous dovishness, which, associated with the anxious wait for US inflation data, led to weak demand for US Treasury auctions and a rise in risk aversion.

The big picture however hasn't really changed – again. If anything, the shape of a "soft-landing" was confirmed: US GDP growth in Q1 was even slower than initially expected, but there was no incremental bad news on inflation: marginally revised lower for Q1, and stable in April, as per the Fed's preferred measure, the one against which their 2% magic number is to be compared: the core PCE year on year change is at +2.8%, bang in line with the consensus expectations. Meanwhile, China's official PMIs were tepid, which is also no new news and supports the idea of more stimulus to come.

Markets are currently in shallow waters, where any small change in the size of the next wave gives the feeling of a new situation – but it's not. Global growth remains resilient, inflation progress has materially slowed. Central banks will thus start cutting without committing to large easing programs. A first -25bps cut is what we expect from the ECB and Bank of Canada this very week. We will also get more color on the backdrop with monthly PMI/ISM for all major regions, as well as the always important monthly US job report, among an avalanche of data. Volatility is here to stay, but we remain pretty much fully invested as fundamentals are steady so far. Have a great week.

ASSET CLASSES USD % TOT.RETURN, 2024 & LAST WEEK



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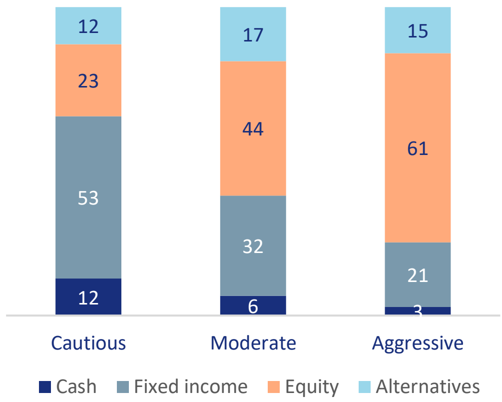
Cross-asset Update

The rally in the US equity market year-to-date has been marked by surprisingly shallow retracements, considering the adjustments to fewer Fed rate cuts investors have had to come to terms with and the growing geopolitical risks we have witnessed. This may be testimony to the fact that in an election year policymakers have not wanted to take any left tail risks and after all have done everything in their powers to support liquidity, hence markets. This is well reflected in a recent JPMorgan study on dollar liquidity, that rose impulsively between April 2023 and March 2024 according to the report, a time period that saw an everything-rally unfold. According to the same report liquidity has been in a slightly contracting phase recently, and is likely to stay like that into year-end. This of course takes into account how the balance sheet of the Federal Reserve is expected to evolve, both in terms of Treasury General Account, Reverse Repo Facility and Quantitative Tightening. And if despite the cutting of the QT rate by half from this month, a plan duly anticipated by Fed officials, financial conditions should tighten a bit, it stands to reason that markets will be somewhat challenged from now on. The Fed is fretting to ease policy, but it cannot, it is softening its QT program, but still liquidity conditions will turn out to be a bit less favourable in our forecast horizon.

A broadening of the rally outside of the United States may anyway come to the rescue. The ECB is planning to cut rates from June and according to the ZEW investor survey macroeconomic conditions are looking up in the common area. With growth accelerating from low levels and policy turning supportive there should be scope for the European market to rise further. At first sight the outlook seems to be more muted in China, with the structural drag from the real estate sector standing in the way of a full recovery in demand. And the latest business confidence readings were also slightly below expectations, further feeding doubts about a sustainable recovery. But more support for real estate should be on the way. Although the real game changer would be a package running in trillions worth of yuan, rather than billions, the authorities are well aware and should respond sooner rather than later. The recent upleg in the Chinese markets seems to be anticipating such developments. It will be important to watch how money supply evolves from here to get confirmation of this constructive view.

Against this backdrop gold has started to struggle. Slightly less liquidity can imply that the yellow metal may be going to drift sideways for some time. All the more so, after hitting overbought territory and rising in the face of a less favourable monetary policy outlook.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

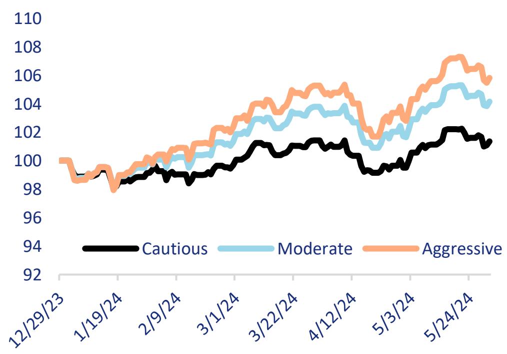


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 – 2024 INDICATIVE PERFORMANCE



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

Fixed Income Update

Last Friday, the Fed's crucial measure of inflation, core personal consumption expenditure, recorded the smallest increase this year. In line with expectations, this data provides a key insight into the Fed's future rate path. In addition, the actual personal spending component was lower than anticipated, indicating a potential slowdown in consumer activity. Moreover, on Thursday, the US Q1 GDP growth came in at +1.3%, a tepid figure, while the core PCE in the same period was revised slightly lower, at +3.6%. Throughout the week, weak Treasury auctions had seen the long-end yields rise up. The US Treasury yield curve twisted with the front-end dropping by 6 bps while the long-end increased by almost the same amount.

This week, the market is eagerly anticipating a mix of important macro data and central bank policy decisions. Of particular interest is the European Central Bank's decision on its policy rates this Thursday, with markets predicting a 95% probability of a rate cut. This would make it the third DM central bank to start the easing cycle, following the SNB and Riksbank in cutting policy rates. Our house view anticipates 3 rate cuts for the Eurozone for 2024. The next day, we will see the all-important US Non-Farm Payrolls report, with a consensus expectation of +190k. The unemployment rate is expected to be stable at 3.9%. Apart from this we have a string of ISM and PMI data from the US and Europe which will determine short term direction of the rates.

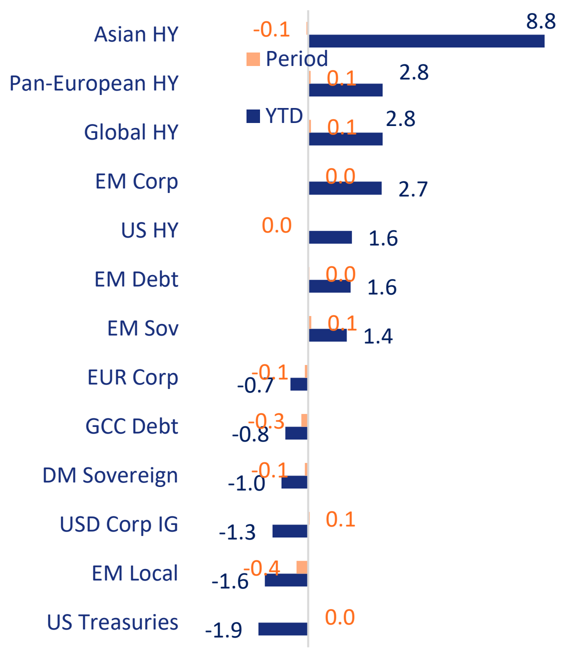
Investment-grade credit metrics have deteriorated in Q1 2024, according to JPM's analysis of non-financial IG companies. Leverage and interest coverage metrics for HG credit continue to deteriorate and are weaker than pre-COVID. Leverage was up by +0.2x y/y to 3.3x, so it continued to deteriorate but more so in higher quality names. Leverage ex-Utilities is at 2.8x. Interest expense increased by 15.9% y/y, with all sectors rising due to higher coupons and more debt outstanding. Interest coverage saw a sharp 2.2x erosion to 9.6x y/y. However, EBITDA growth for these companies was the strongest in seven quarters when excluding the commodity sectors. If bullish earnings forecasts prove correct, IG corporate credit metrics can improve this year.

Turkey's CPI inflation print was 75.5%, higher than the previous print and consensus expectations. Monthly price growth, the central bank's preferred gauge, also quickened and hit 3.4%. Policymakers anticipate Turkey's inflation will end the year at 38%. Our discussions with the S&P rating analyst give us confidence that the lack of elections would keep the focus on conventional macro policies till Q1 next year, at the least. Moreover, large FPI inflows doubled Turkey's FX reserves last month. This presents a good opportunity for aggressive clients to perform Turkish Lira carry trades by buying govt T-Bills less than one year in maturity. We don't provide a view on the FX risks, but with 45% yields on offer and economists largely anticipating the worst to be behind us, the investors are compensated for the risk they take.

FIXED INCOME KEY CONVICTIONS (2024)

DEVELOPED MARKETS
Overall overweight DM FI
OW Government Bonds
Neutral corporate (IG & HY)
EMERGING MARKETS
Overall UW EM Debt
Favor quality and selectivity

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



Source: Bloomberg

Equity Update

May was a good month for global equities, more so for the developed markets. We remain constructive with a small overweight positioning for both developing and emerging markets with the Eurozone and the UK as overweight within DM allocation, US neutral and Japan underweight. India a continuing overweight in emerging market allocation, China the recent tactical overweight.

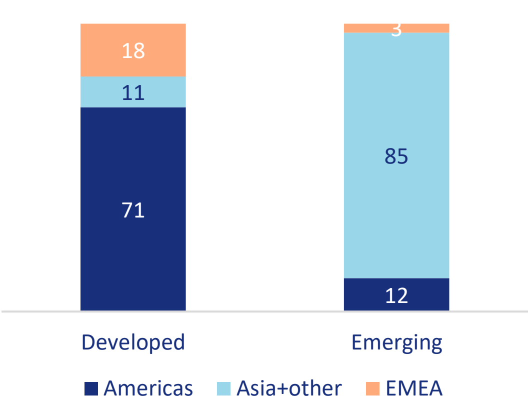
In the US tech and the communications sector outperforming, with Nasdaq and the S&P 500 with high May and YTD gains. The Comm Services sector reported the highest (y/y) earnings growth rate of all eleven sectors at 33.9% (the S&P 500 is at 6%). The Information Technology sector the third highest at 25.2%. Nvidia is the largest contributor to earnings growth for the entire S&P 500. If excluded, the blended earnings growth rate for the index would fall to 3.3% from 5.9%. The blended net profit margin for the S&P 500 for Q1 2024 is 11.7%, a healthy number. We expect the S&P 500 to trade sideways near term (+/- 5% not unusual) with the rally broadening as earnings look set to pick up into year end.

India election outcome looks to have a large majority for the incumbent party. The MSCI India (USD) is up 9% YTD with the INR supporting USD returns, unlike the yen whose weakness has affected Japan equity returns. India is the only big economy (apart from the US), a consistent compounder with 7% CAGR returns (in $ terms) since Dec-92. Despite high valuations at 23.5X forward price/ earnings we see a continued long runway for growth led by infra build-up and a large consumption story. At 7.8% y/y the March quarter GDP growth is amongst the highest globally. Corporate earnings growth is estimated at 15- 20% CAGR over the next 5 years. India will benefit from shifting global supply chains and scaling of manufacturing in electronics, auto, pharma and textiles in the next decade. The government support, increasing ease of doing business and improving labour laws make India a partner for companies looking to shift manufacturing away from China. The third year of a multi-year capex upcycle led by rising GDP/capita, large Gen Z and Millennials who are a mobile first generation.

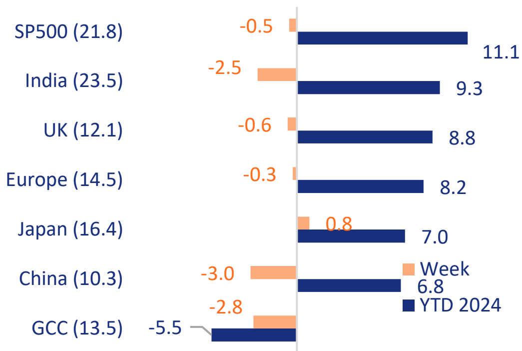
We remain tactically and strategically overweight the UAE markets and see the recent underperformance a factor of retail investors selling post dividend payouts in May. Also, there are concerns that lower rates (cuts by the Fed) could affect bank net interest margins and profits. But cuts are some time away and there is also a lead and lag effect for deposit and loan rates to adjust. Bank profitability is more a function of the economy and UAE economic growth is resilient (higher than most other economies), credit card and personal lending is growing with an increasing expat population which is more affluent. We also like govt backed entities i.e. the ADNOC group of companies across retail, gas, refining and logistics at lower valuations than the broader ADX market and growth through strong operations and acquisitions internationally adding to inorganic growth.

Saudi Aramco, the world's largest oil company has an add on offering this week. The USD 1.8 trillion USD market cap company is currently trading at 6.6% dividend yield, attractive for income seekers.

EQUITY RECOMMENDED REGIONAL POSITIONING

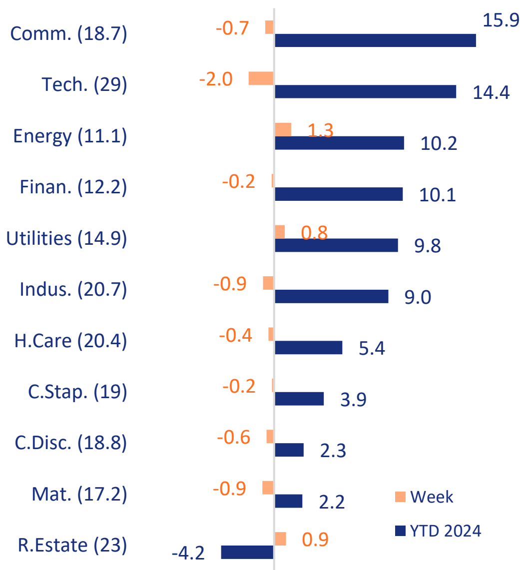


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$), P/E in brackets



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

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