# Markets start H2-2024 on a **strong note**

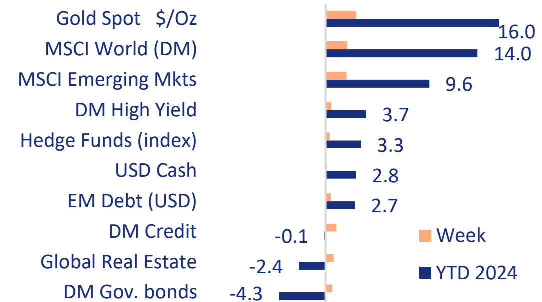
- **The second half of 2024 starts well for all asset-classes, with more signals of a soft-landing**
- **The other sources of volatility, especially politics, could become increasingly important**
- **We will hold our Mid-Year tactical asset allocation committee this week, more updates to come**

Last week saw a deluge of economic data releases and political events. Starting with the former, the final June PMIs were overall reassuring about the state of the global economy. There was no drama in manufacturing indicators, and resilience in services overall, which increases further the probability that a "soft landing" scenario is on track. In the US, the minutes from the Fed's FOMC meeting were overall balanced between the battle against inflation and the willingness to avoid employment and financial shocks. The week ended with the US monthly job report: while job creation in June was a bit stronger than expected at 206k vs 190k, the same May number was sharply revised, from 272k to 218k. Bottom-line, hopes for rate cuts are justified, and markets loved it. US Treasury yields dropped by an impressive -15 basis points across the curve, and equities rallied, across regions, especially as the dollar weakened against trade-weighted counterparts. Gold benefitted, and oil prices were steady. It was a good week, lifting the YTD returns of our TAA to respectively +3%, +7% and +9%. Interestingly, this is not far from what we initially expected for the entire year.

Last week was also about elections: the results in the UK and in Iran are probably not game changers, while France delivered a big surprise in snap parliamentary elections: the left came first, followed by the presidential formation, while the right came third. Crucially, no group has a majority, and the house is as split as ever in recent institutional history. This illustrates why we keep on thinking that more volatility could come especially as we approach the US elections.

No doubt, our mid-year TAA Committee will be intense, taking these developments into consideration and refreshing our year-end fair values. Have a great week.

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

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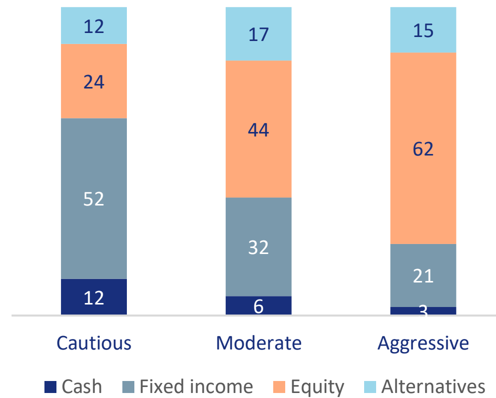
### Cross-asset Update

The main global economies are decelerating or stabilising as per the latest releases, with underwhelming US ISM prints, a US labour market strong in government and healthcare and softening in the other sectors, disappointing PMI indices in Europe, and stable but muted PMIs in China. At a more aggregate level the OECD Composite Leading Indicators deliver the same message, as the proportion of countries with CLIs that are rising versus the previous month is inflecting lower, pointing to a slowdown in the DM economies. Should investors be concerned or take the data in their stride? Markets are opting for the latter. Cross-asset relationships suggest that market participants are quite unconcerned. DM equities are not faltering, EM stocks are keeping their momentum, oil is rallying, copper rebounding, and the Australian dollar has broken out to the upside against the US dollar. This is the Goldilocks scenario, where weaker growth comes alongside the prospect for rate cuts, in particular two cuts by year-end according to US money markets. The steepening of the 2y10y US Treasury yield curve in the past few weeks confirms that investors see the Fed's easing round the corner. For the same reason, in the five days through Friday EM equities recorded new highs for the year, gold rallied almost 3%, and the US dollar lost 0.9% against its DM peers.

With no recession for now looming on the horizon, the implication of softening activity supported by easier policy down the road is that the equity rally should eventually broaden on a global level from IT to more pro-cyclical sectors and extend from the US to other countries. There are a few flies in the ointment of the overall picture, though. Usually, a rotation out of a key sector comes with some volatility. Also, bitcoin is not participating in the rally, maybe for idiosyncratic reasons, nor are the weakest pockets of the HY market, where minor signs of stress are emerging. This could suggest that equities are overextended, and some consolidation is now overdue. While we are ready to accommodate the market's exuberance, some profit taking in DM stocks seems appropriate. As for EM assets, the third plenum of the communist party in China to be held one week from now will constitute one major catalyst investors are looking to. With expectations quite low, the stage could be set for some positive surprise.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

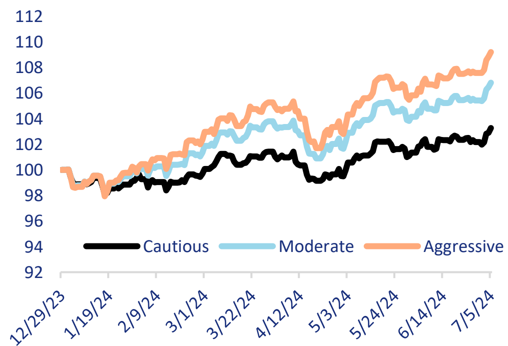



TAA – RELATIVE POSITIONING – MODERATE PROFILE

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**

In a year, which has 52 weeks roughly, one week may not matter much. But, for the US Treasuries and by an extension the fixed income segment, last week's macros data releases could have been the most important set of numbers to come out last quarter. Services strength and consumer spending had been the main stays of this economic cycle. Consumer spend had been slowing down as the post-pandemic savings are exhausted. However, the ISM Services saw a sharp 5-point drop in June to 48.8 vs consensus estimates of 52.7. This is the lowest measure for the data point since 2020. Initial Jobless claims for the week ending 29th June increased by 5k to 238k and seem to have settled for a higher range than earlier this year. Friday's NFP numbers were slightly higher than expected, but the unemployment ticked up to 4.1%. Also, the three-month moving average is down to 177k, its lowest level since January 2021. German Factory orders disappointed last Thursday. The month-on-month contraction deepened to 1.6% in June from a contraction of 0.6% in May.

These are indications that global growth momentum is slowing down. Treasury yields should reflect this. From the earlier 4.3% to 4.7% range for the 10-year US Treasury yield we expect a lower trading range of 4% to 4.5%. For 10-year yields to extend below 4% would require an economic shock which is not yet priced in. Thus, extending duration slightly above index duration makes sense for Fixed Income portfolios. This Thursday's inflation data remains important. All the above soft data means the Fed can no longer ignore the weakness in labour. Our base case for a September cut gains more credibility. Markets are now pricing in close to a three-quarter probability of a rate cut in September and 110 bps of rate cuts in the next 12 months up from 95 bps last Thursday.

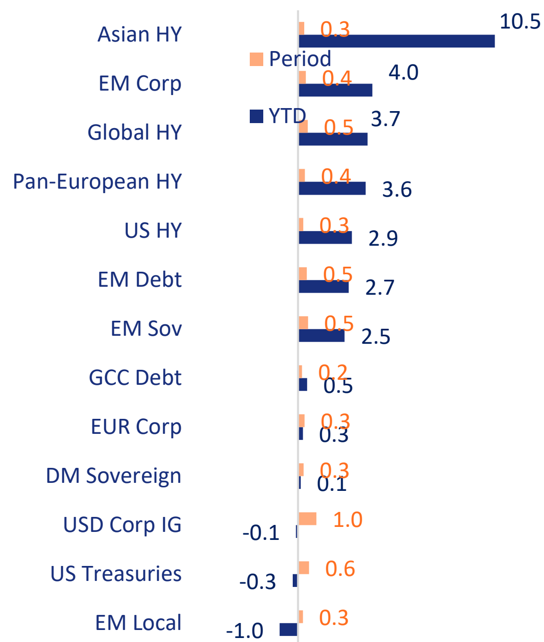
Credit segments are reflecting similar sentiments with spreads widening for the riskier segments while compressing for the Investment Grade issuers. The Bloomberg Benchmark OAS spreads for HY and EM Debt widened by 3 bps, whereas IG benchmark spreads tightened by 2 bps. Both HY and EM Debt spreads are trading wider to their 3-month averages, while the IG spread is at its median for the same duration. In case of a soft landing, we expect spreads to initially widen before the Fed steps in.

The weakness in A-rated bonds from the KSA provides investors with an opportunity to play the GCC bonds markets in a couple of ways. Firstly, the quasi-sovereigns and the government-owned banks for the region that trade at least 25bps above the underlying sovereign curve with duration of 5 to 10 years seem a good trade and should outperform the EM IG benchmark in the next 12 months. Secondly, a barbell approach with 10+ years of A rated GREs combined with short duration (less than 3 years) HY names from the region is a slightly aggressive way of investing in the regional bonds.

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

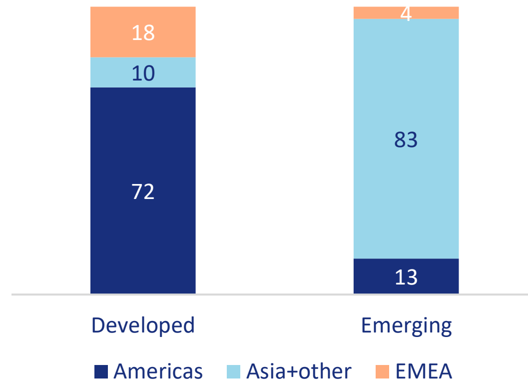
All about growth so far this year with market leaders featuring the growth companies (semis, big tech, obesity), regions (India and the US) and sectors ( tech and comm. services). A good start to July, with UK markets stabilizing with a majority Labour win, US markets continue to be driven up by tech (the mag 7 and semis) and lower inflation is supporting rate cuts for later this year. Global equities are at all-time highs gaining 2% last week, both developed and emerging markets in sync, however more vulnerable to any disappointment in earnings specially from the tech giants or escalation in geopolitical (elections and regional conflict) risks. A goldilocks scenario and the central bank put continue to provide support to markets.

Election outcomes in India and the UK are seen as providing certainty to policy and markets for both regions. We expect the UK FTSE Index to rally, though its companies are more global than local with commodity, oil and consumer concentration – as policy stability post-election plus the rate-cut path looks positive for market performance. Also, high dividend yields, low valuations and mid-single digit earnings growth stand out. France is in limbo with election results looking like a standoff and for the US it's too early for direction.

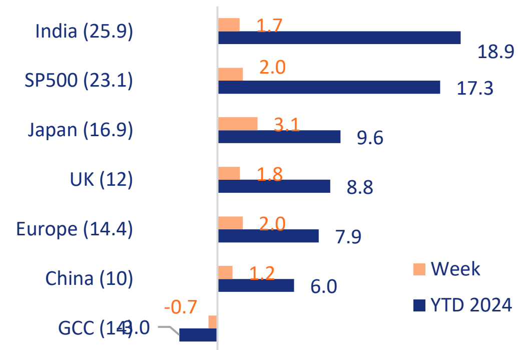
Another good week for US equities, the S&P 500 is at 5567, gaining 17.6% year to date with the Nasdaq +22.7%. The tech sector gained almost 4% last week, with semi stocks still the favourites. Nvidia has been range bound. Disinflation remains on track, with more central bank easing expected. US earnings season kicks off this week with the big banks and tech next week. 9% earnings growth expected for the broader Index for Q2 y/y with double that for the tech sector and 30% for the Mag 7. Global growth may be cooling off, but is close to trend, which backstops earnings and margins. AI still a large part of the corporate earnings growth narrative and companies investing in AI are aiding the Tech Mag 7 top and bottom lines. Tesla last in the pack to get positive for the year. Concentration risk to be watched with 10 companies constituting 40% of the S&P 500.

Following a good June performance, the UAE markets were flat last week, with utilities and industrials rallying - Dewa, Dubai Taxi and Parkin gaining c. 5%. Attractive valuations and dividend yield at play. Investment in the region is gaining with Shell, BP among firms taking stakes in ADNOC's LNG project export project plant in Ruwais, as per reports. Capital issuance in the region stays strong and the KSA has the Al-Hokail Academy Specialized Digital Polyclinics Co IPO on offer. Asian markets have Japan continuing to gain in local currency terms and China lackluster with the Plenum not expected to have major announcements. In Asia too, semis stand out with both TSMC and Samsung with robust revenue growth, though the latter has a worker strike currently on. India still the best performer amongst regions globally, aided by strong earnings growth. We will publish our H2 strategy next week.

EQUITY RECOMMENDED REGIONAL POSITIONING

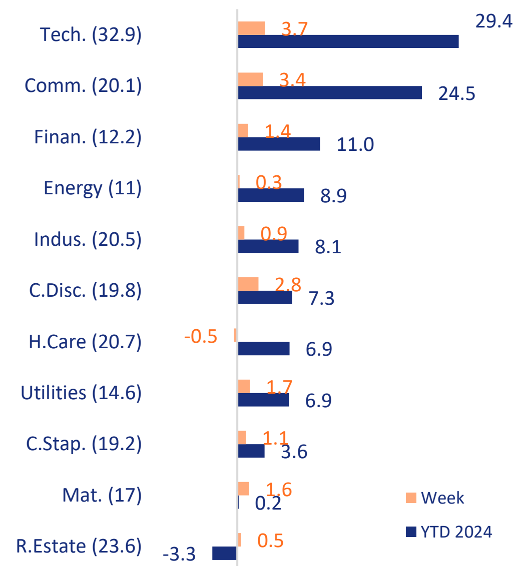



MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets




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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