بنك الإمارات دبي الوطني
Emirates NBD

# Has the US Fed waited too long to **cut interest rates?**

- **US data exacerbated growth anxiety, pressuring all cyclical assets and treasury yields**
- **Pressure is mounting on the Fed to accelerate rate cuts from this September**
- **We still see a soft-landing rather than something more sinister, but the Fed will act on it**

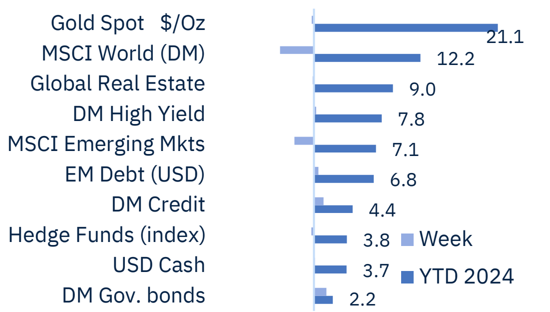
Last week wasn't a great start to September. While August was about celebrating the perspective of rate cuts, the focus is now on the second unknown of the "goldilocks" scenario: we want rate cuts, with a resilient growth. Instead of reassuring, data only fuelled anxiety: unconvincing US ISM indicators, a disappointing drop in job openings, and finally, a mixed monthly NFP labour market report. The already shocking July number of job creations was revised even lower, to a terrible 89k. By comparison, August was decent at 142k, but underwhelmed the median forecast of 165k. Anxious market participants decided to ignore the reassuringly stable unemployment rate and weekly hours worked, as well as a modest but unexpected rise in hourly earnings: stocks fell, treasury yields dropped, and market expectations for the Fed became even more radical: now -110 basis points of easing for 2024 alone, and a bit more in 2025.

Pressure is mounting on the Fed: they are not anymore credited with the prodigy of soft-landing, but now highly suspected of being "behind the curve". The US CPI report will help them make their difficult decision.

The good news is that, as highlighted in our 2024 Outlook, diversification works: bonds gain, when equity valuations don't leave room for multiples expansion, as markets are concerned by future earnings, in general as well as for big tech in particular.

This week, our monthly Asset Allocation Committee will assess the top-down scenario (a priori still soft landing) and the opportunity set. Our only certainty remains high volatility, which is the guiding principle of our portfolio construction. Have a great week.

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





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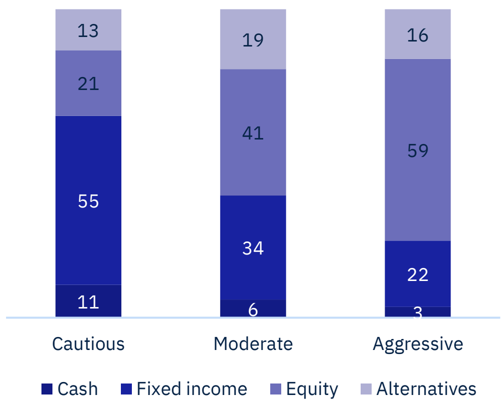
## Cross-asset Update

The sell-off that started in late July and saw a knee-jerk retest of the highs in August has resumed. At the time it was about a US growth scare, jitters about AI future profitability, and the unwinding of yen carry trades. And today we still have the deflating of AI valuations, even as concerns about the slowdown of the US economy are growing more pervasive. Our Risk-On Risk-Off indicator, an average of risk premia across asset classes measuring the degree of risk taking in markets, has been in negative territory since mid-June and points to more downside. Its equity component, the ratio of some cyclical to defensive sectors we consistently track, is entering negative territory, while the FX component, measuring volatility across EM and DM crosses , remains elevated. The credit component is more well behaved, but should soon take cue from the spreads widening we saw last week in the HY and IG markets in the United States. While we maintain soft landing as a base-case scenario, equities are still trading too rich versus the current scenario dominated by increasing uncertainty about a future recession. Price to earnings ratios at historical highs point to complacency, rather than a slowdown ahead. Equities are currently misaligned with yields and commodities, that did ring alarm bells about a soft patch in activity last week by recording new lows for the year.

Yield curves entering positive territory have historically been a bad omen for the economy, being usually followed by a recession. We expect the Fed to be able to avert a contraction by starting a monetary easing cycle at the September meeting. And while investors are focusing on rate cuts, Fed officials can as well resort to balance-sheet management via changes to the Quantitative Tightening program, with immediate effect on liquidity, hence on markets. Considering the breadth of tools Powell has at his hands, and the lack of deep imbalances in the private sector, we hold the view that the current volatility bout will eventually lead to a buying opportunity. The current macro newsflow does not seem to be indicating an outright contraction either. The US services sector remains firmly in expansion territory, and the proportion of countries that globally have expanding activity in services is not in keeping with past recessionary dynamics.

We would expect volatility to be high into October, possibly right before the presidential elections, as historically has been the case. IT stocks are suffering due to exceedingly high valuations, while cyclicals that previously trailed behind are outperforming. This is normal during pullbacks in bull markets and should offer a buying opportunity for growth versus value stocks down the road. Yields should not have significant downside in a no recession case, hence upside on gold should be capped from current levels unless central bank buying resumes actively.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

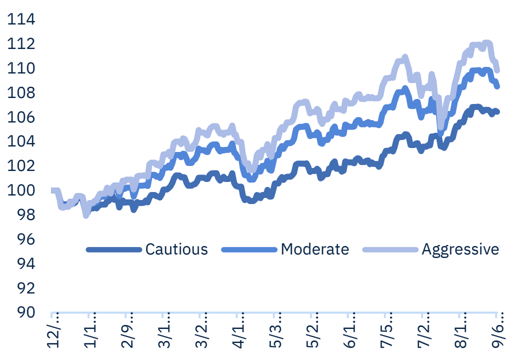



TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 week's soft macro data resulted in the bull-steepening of the US yield curve. The 2s10s part of the curve has disinverted after the 2-year dropped by 27 bps to trade below 3.65% while the 10 year closed the week around 3.7%. We had warned at the start of the year that every recession has historically been preceded by bull-steepening and reinversion of the curve. The credit spreads have slightly last week with the HY spreads underperforming the other segments increasing by +15 bps.

Now the biggest question is whether the Fed will go for a 50 or 25 bps rate cut in September. Markets currently price in 32bps. The Fed blackout period before the 17th and 18th FOMC meeting has already started. President Williams' and Governor Waller's Friday speeches offered the last glimpse into policymakers' thinking. While Williams' comments didn't offer Fed watchers much color on the size of the next rate hike, Waller's speech hinted at an initial 25bps cut, with potential larger cuts down the line. He stressed it was "important to start the rate cutting process at [the Fed's] next meeting" but that "determining the pace of rate cuts and ultimately the total reduction in the policy rate are decisions that lie in the future". Markets currently price in 235bps of rate cut in the next 12 months which means traders view the soft landing paradigm with a dose of skepticism.

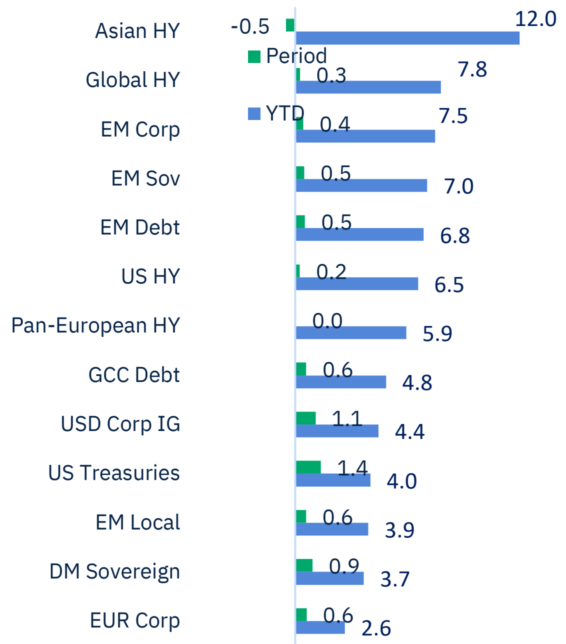
Fitch has upgraded Turkey's sovereign rating from B+ to BB-, marking the second upgrade in 2024. This improvement is due to a significant rise in net reserves. Fitch highlighted factors such as reduced financial dollarization, lower FX demand, capital inflows, and increased access to external borrowing, which have boosted reserves to USD 149 billion, with net reserves at USD 41 billion. Turkey's net foreign asset position improved from a negative $75 billion in April to a positive $6 billion in August. Inflation in Turkey dropped sharply from 61.8% YoY to 52% YoY in August, in line with consensus. Fitch forecasts Turkey's current account deficit to remain low, averaging 1.7% in 2025-2026, after more than halving year-on-year to 1.9% of GDP in 2024

In the last week, bond issuances from the GCC region amounted $7.55 bn. ADNOC raised $4 bn across three maturities, with final pricing for the 5-year, 10-year, and 30-year bonds set at 4.28%, 4.62%, and 5.23, respectively. Additionally, there were two subordinated bond issuances from UAE. First, ADCB issued $500mn and the final yield was set at 5.361%. Second, RAKBANK with a $250mn issuance and was priced at 5.875%. Bank of Sharjah has issued $500mn 5-year senior unsecured bond which was priced at 5.48%. From the KSA, PIF issued a 3-year sukuk of $1.5 bn, along with a tap issuance of $500mn of its existing 32s. The final yield for the sukuk was 4.49%. Most of the IPTs tighten by 25-40 bps. Lastly, ABK (Al Ahli Bank of Kuwait) issued a $300mn junior subordinated bond and the yield was set at 6.5%, tightening by more than 50 bps from the IPTs. The orderbook coverage ranged between 3 to 5 times for these GCC issuances.

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 |
| Including in GCC |

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




Source: Bloomberg

## Equity Update

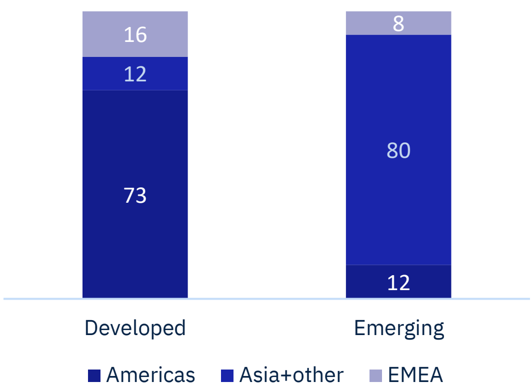
The 8-month rally has taken a more convincing pause in September as markets await Fed direction on the trajectory for rates. Some moderation in US labour data is leading to weaker sentiment around the path of economic growth. Nothing has changed regarding corporate profit growth expectations or consumer demand as evidenced in Q2 earnings, +11% y/y, however US elections are gaining importance for markets with each candidate's views on taxes and tariffs awaited and the potential impact on inflation and demand, consumer sentiment and earnings. The ramifications of any major hike in US tariffs will affect global supply chains, with more onshoring and higher input costs. Markets will be choppy into year end with a changing Central Bank trajectory and US elections in late November, some defensive positioning amidst volatility is warranted.

Last week global equities fell 3.7%, led by tech with the Mag 7 stocks down 5.5%. All global regions fell except the UAE. The Dubai Index is +13% YTD with real estate, bank and utilities rallying and IPOs getting good traction. UAE markets have held up well against a turbulent backdrop of global equities. Three banks in the UAE at new all-time highs at the close of last week. Real Estate also has the Emaar Group/ Aldar at double digit returns as is the ADNOC group going onto to new highs. Growth markets like the UAE should do well in lower rate environments and some sustainable high dividend yields.

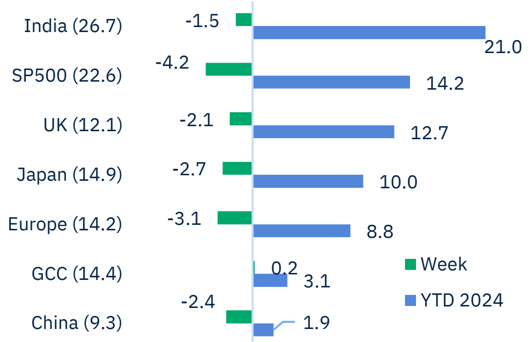
On sectors and themes: real estate and healthcare fared better last few weeks but all discretionary sectors including autos, luxury and athleisure are seeing a slowdown. The Mag 7 saw resilience only from Amazon last week and Apple has "Its Glowtime" event today expected to showcase Apple Intelligence's new Siri user interface in iOS18 and this remains the key to unlocking pent-up iPhone demand and an accelerating replacement cycle, though iPhone pricing and iPhone battery life will also be key. The semi sector saw Nvidia and Broadcom fall – both strong earnings growth y/y and met analyst expectations but "more" has become the norm for anything AI. Our outlook is to stay invested in profitable tech and in those companies using AI to enhance productivity (the adopters).

Negative for the week but less than the US, were India and the UK. India has held its highs but valuations like the US are trending on the higher side. We still prefer it for growth to China which is trading at record low valuations. China is seeing a slowdown in economic growth with the real estate market still in trouble aa is consumer demand and is in line with European luxury seeing a slowdown. Analysts are cutting profit forecasts for China and Europe luxury companies. Market cap for Europe luxury is down by a quarter-trillion dollars from a March peak. Burberry is down 70% the past one year and is leaving the FTSE 100 Index. Hermes and LVMH have been more resilient, but the share prices are still down in 2024. A similar story for Athleisure. We currently prefer consumer staples and healthcare – a more defensive play.

EQUITY RECOMMENDED REGIONAL POSITIONING

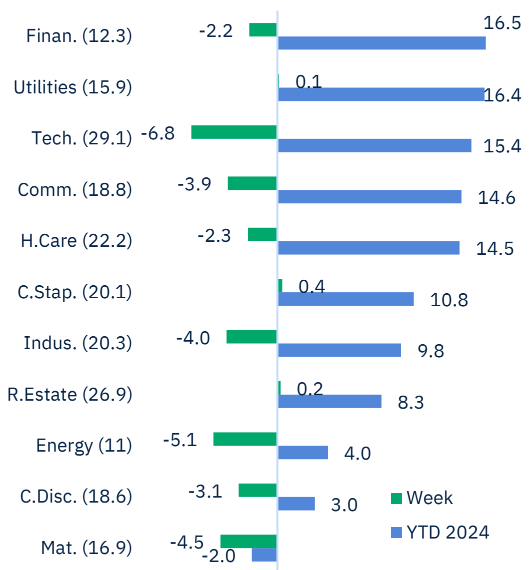



MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets




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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