Emirates NBD
WEALTH MANAGEMENT

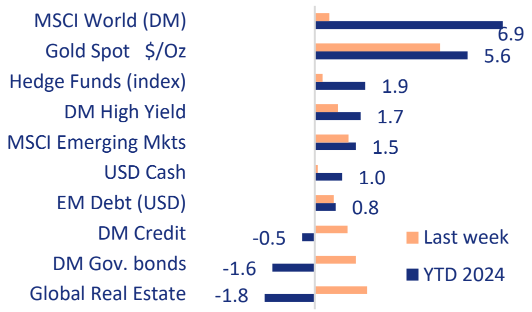
# Is inflation risk **increasing?**

- **Last week confirmed a resilient growth and a friendlier change in tone from central bankers**
- **The key risk to the soft-landing narrative could be switching from recession to inflation**
- **We'll get a clearer picture with February CPI reports this week. Ramadan Kareem!**

Last week was eventful with regards to the big picture. First, a series of economic data, especially leading indicators, confirmed that the global economy not only remains resilient, but also turns more balanced, with a broadening of growth engines. Seeing some rebound in Europe, Japan avoiding a technical recession, China setting ambitious growth targets for 2024 provides a healthy regional diversification. With regards to the US, the previous sectoral imbalance between services and manufacturing is narrowing, with the latter outpacing the former when it comes to PMIs. Finally but crucially, the tone of central banks became more friendly. While they remain cautious and data dependent, hearing the Fed's chairman saying that he is "not far" from the level of confidence needed to cut rates is clearly good news, especially as the rise in US unemployment rate and the moderation in wage increases, from Friday's monthly jobs report, provide some additional comfort. As a result, the implied number of rate cuts in 2024 from futures markets increased last week, from 3 to 4 (it had fallen from 8 at the beginning of the year). Bond markets appreciated, and stock markets didn't mind.

While we're happy with the market returns and their impact on our asset allocation profiles, vigilance is still needed. There are two variables in the soft-landing scenario: growth is fine, but market focus could switch to the trajectory of inflation. We are not overly concerned but continue to expect volatility ahead, including on currencies as monetary policies could start to diverge in the coming quarters. We will know more this week with the US CPI and PPI reports, and also watch US and China's retail sales and industrial production. We will also hold our monthly tactical asset allocation meeting. We wish you and your families Ramadan Kareem.

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





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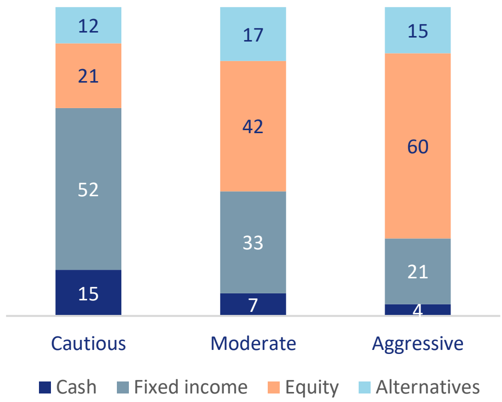
## Cross-asset Update

Looking back to the past week we maintain the impression of unrivalled US exceptionalism, while at the same time we saw a revival of animal spirits in other markets, and China setting bold economic targets for the year that renewed hopes for sizeable stimulus. Smaller companies outperformed alongside developed ex-US equities, and cyclical stocks made a new high for the year against the more defensive ones. Overall, investors must be gaining conviction that the economy will continue to do well, even as the disinflationary process remains on track.

All eyes were on the US labor market, and Powell's testimony. The former told the usual story of US economic strength, the latter confirmed that rates have peaked. We can then infer that good economic momentum should continue, a further nod to the soft-landing scenario. And the missing link of a manufacturing recovery is slowly coming into place as well, as the S&P Global US Manufacturing Index has been in expansion territory for the last two months, with the all-important gauge of new orders to inventories in the ISM release hovering close to the highs of the year. On the inflation front the week brought good news as well. The prices paid sub-index of the services PMI survey was way below expectations, pointing to still easing price pressures in the United States. Good news came also from Europe and China. Christine Lagarde and numerous ECB officials confirmed that the central bank is moving closer to rate cuts, with June being the most likely month to start the easing process. In China the ambitious economic targets for the year communicated at the NPC leave the impression that this time some sizeable stimulus is unavoidable. Unless it is accepted that animal spirits can be depressed by the failure to deliver, setting in motion a negative feedback loop from the disappointment of economic agents to the economy.

Overall, it seems that there is scope for the broadening of the rally, with rotations to more pro-cyclical themes supported by the strength of the economy. Both the Fed and the ECB suggested that policy direction is now towards easing, with gold rallying well in advance of the public announcements. As inflation concerns are for now in the rear-view mirror, rate cuts seem all but assured in investor minds, so animal spirits live on. Markets are now overbought and overdue for a pause. Either a pullback will occur, or the rate of ascent will be slower. Which is which is, as usual, impossible to tell.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

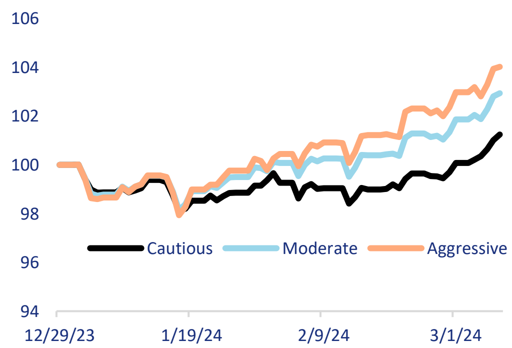



TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Finally, a good week for bonds as central banks changed their hawkish tune, and US unemployment numbers reached a two-year high of 3.9%. The belly of the curve outperformed as the 5 and 10 years moved down by 10 bps while the front-end stayed anchored and the long-end moved down by 7 bps. Last week, during the two-day congressional testimony, Chairman Powell hinted that the Fed members were comfortable with the trajectory of inflation and not worried about the surprise in January inflation. A significant portion of his comments were identical to his prepared remarks at the January FOMC press conference, indicating the strength of the January labor market and inflation data hadn't materially changed his view on the economy. He suggested the central bank is getting close to the confidence it needs to lower interest rates. Markets ran with the theme that the Fed is close to rate cuts, with OIS swaps suggesting a full rate in the June FOMC meeting. Tomorrow's CPI numbers will be closely watched as economists anticipate the Headline CPI to accelerate to 0.4% on a monthly basis, even though Core CPI is expected to increase at a slower pace of 0.3%.

Last Thursday, the ECB stayed on hold as expected. Still, changes in the forecasts were more dovish than expected, mainly because officials cut their 2024 inflation and GDP forecasts to 2.3% and 0.6%, respectively. This spurred expectations that the ECB may be the first big central banks to cut rates. Governor Christine Lagarde mentioned that the ECB is now "more confident" in disinflation and "there are signs that growth in wages is starting to moderate." Similar to the Fed, markets are expecting a rate cut in June.

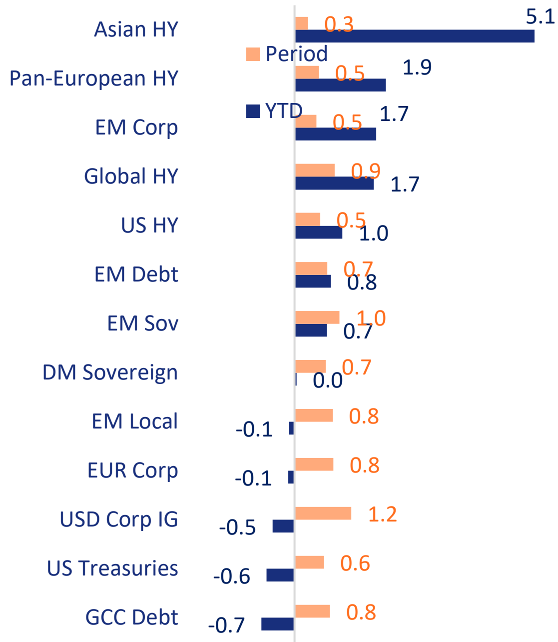
Egypt hiked its policy rates massively by 6% to 27.25% on Wednesday. The government also abandoned the previous exchange rate regime. As a result, the Egyptian Pound devalued to trade above 50. This removed the final hurdle for the IMF deal, resulting in the latter agreeing to more than double the support package to $8bn yesterday. CBE also lifted limits on FX overseas credit card use, giving rise to the hope that the strict controls that had been in place since October last year would be gradually removed. The UAE's pledge to invest $35bn in Egypt through ADQ catalysed these positive developments. This investment dwarfs Egypt's current annual deficit of $4.3bn as of Sep 2023. Even though inflation will spike in response to the major currency devaluation, stable currency in the months ahead will ensure inflation subsides thereafter. Taken together, these should help domestic bond yields to head lower over the coming year.

We recommend investors take advantage of this by entering the Egyptian Pound carry trade, where they borrow in USD and invest in local currency 1-year Egyptian T-Bills unhedged. Despite withholding tax, this should generate double-digit returns for investors, given the extent of the devaluation and the high nominal yields expected to be on offer. Hard currency Egyptian bonds have rallied significantly and are not offering a similar high-return opportunity anymore.

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

Elections, hopes of disinflationary trends, central banks turning dovish and big tech continue driving market moves in 2024. A positive week for most markets, except the US, which saw tech lose some of its mojo, with chip stocks having a bad Friday. A soft-landing narrative in data flow has been received well by markets with renewed conviction on cuts by DM central banks starting June. Encouraging signs that the Fed's efforts to tame inflation, partly through slower wage growth. US equities will likely be supported if we get confirmation that the disinflationary trend is in place.

The S&P 500 ended the week at 5124 (-0.3% last week) and the Nasdaq at 16085 (-1.2% last week) retreating from record highs with a sell-off in semiconductor shares. Both indexes are still up over 7% YTD and the rebound in earnings growth remains in favour of range bound trading. The SOXX Index while falling 4% on Friday, closed the week up and is +18% YTD with Nvidia +77% YTD. News of a stock split for Nvidia is unconfirmed. A small correction for big tech would not be surprising, after the huge rally but probably leaving most with positive YTD gains. About $4.4bn was pulled from tech funds in the week through March 6, according to BofA strategists. Small-cap stocks held up relatively well. The Russell 2000 closed near its two-year high +0.3% for the week, its fourth weekly gain in the past five. Japan and European equities rose 2.5% in USD last week, with both the yen and the Euro strengthening.

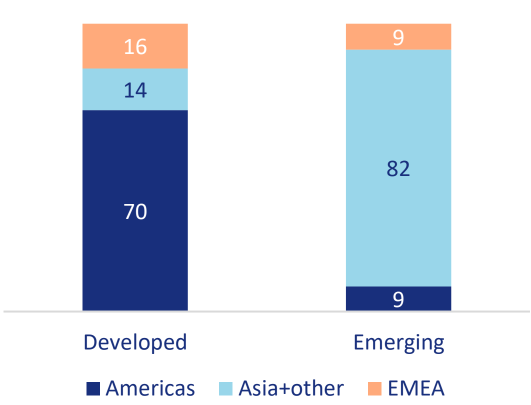
UAE and KSA companies have raised dividends: notably the banks in the UAE and more recently Saudi Aramco in the KSA. Total payments this year expected at about $124.3 bn — up 66% since 2021. Oil prices trending above $75/bbl for Brent are positive for Saudi Aramco cash flow.

Our DM overweight region Japan has outperformed in both local currency and dollar returns. However, as the Yen continues to strengthen, exporters are starting to have concerns.  A drop of at least 2% in the Topix triggers BOJ buying of ETFs, supporting the market. The focus in Japan remains on shareholder returns and earnings yield: dividend and buybacks is around 5% for Japanese equities, we stay overweight.

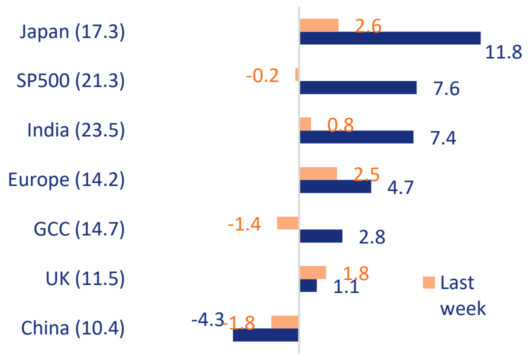
Emerging market equities are more in the green now +1.5% YTD with India and the Dubai Index leading. China equities have been in an uptrend since early Feb but still negative YTD and last week saw negative returns. Mainland China indices have performed better than the MSCI China and Hang Seng Index. A-shares look better positioned with liquidity and valuation support, given the A-share investor base and the government's stabilization effort. The National People's Congress has concluded, largely seen as underwhelming. We remain neutral China equities.

Novo Nordisk best seller drug Wegovy got expanded US approval on reducing the risk for heart attacks and strokes. This could widen use and insurer coverage of the popular anti-obesity medication. However Eli Lilly, also a leader in obesity therapeutics saw Alzheimer's disease drug Donanemab face further delays in gaining US approval. We recommend adding healthcare stocks to portfolios as strong growth beneficiaries and a hedge against a concentrated tech portfolio.

EQUITY RECOMMENDED REGIONAL POSITIONING

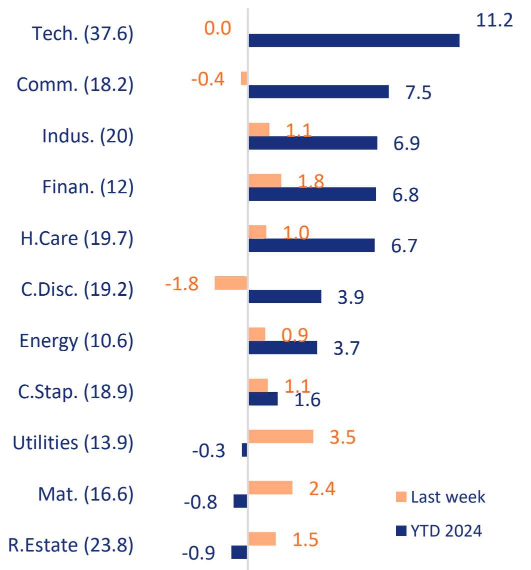



MAJOR INDICES PERFORMANCE (TR, US$) AND P/E




Source: Bloomberg consensus. MSCI Indices unless specified.

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




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

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