Slowing growth, slowing stimulus

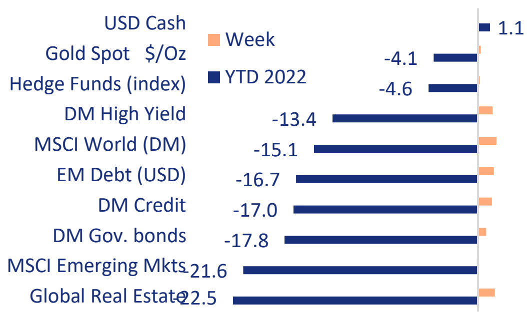
- **Flash PMIs indicated a significant slowdown in global activity, more material than expected in the US**
- **The minutes of the Fed's last FOMC confirmed a high probability of a slower pace of tightening from now on**
- **Both combined to support all asset classes, in another modestly but broadly positive week for markets.**

Week after week, the fourth quarter of 2022 continues to stand out compared to the previous ones. All asset classes were in the green, except stocks from emerging markets, down -0.1%. Stocks and REITS from developed markets gained +1.5%, closely followed by all segments of fixed income. Interest rates continued to trend lower on the longer durations. At 4.76%, the US 12-months Treasury yield was stable over the course of the week, taking into account a reasonable number of rate hikes ahead. By contrast, the 10-year lost another 15 basis points to close at 3.68%, its lowest since September, reflecting increased perception of a recession risk.

Indeed, the US flash composite PMI came out materially below expectations at 46.3, with components indicating further weakness in demand. The same measures for Europe were also in contraction territory, but at respectively 47.8 for the Euro area and 48.3 for the UK, they were better than both forecast and October numbers. This is not bad news for inflation, especially as oil prices also fell further to $83.6 for Brent crude. The FOMC minutes also explicitly said that "a substantial majority of participants judged that a slowing in the pace of increase would likely soon be appropriate". Tightening should continue at a slower pace, but inflation should also start to materially slide. Meanwhile in China, The PBoC announced a -25 basis points cut in the reserve ratio for financial institutions, another step in the direction of more stimulus. However, the current widespread protests require attention. It could either accelerate or totally delay the reopening process.

This week will provide the final PMI and ISM as well as the crucial US monthly jobs report on Friday. We wish you all a very happy celebration of the UAE's 51th National Day. Stay safe.

ASSET CLASSES USD % TOT.RETURN, YTD 2022 & LAST WEEK



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Cross-asset Update

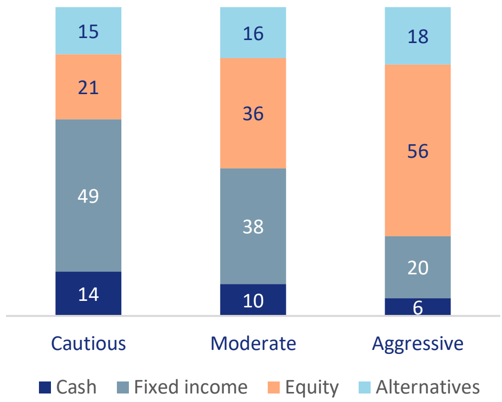
While gold has significantly outperformed equities and credit year-to-date, it has disappointed both bulls and bears and has been neglected as a diversifying asset. In 2022 it was first chased in the wake of the breakout of the Ukraine war, and then dumped following an increasingly hawkish Fed stance. The end of the Fed's tightening cycle being in sight, one should keep the yellow metal again under the radar. We hold the view that a bottoming process should have started, and that the regime shift to higher inflation and lower growth globally would be very gold-supportive in the medium to longer term.

Looking ahead to 2023, the most prominent risk looming larger is that of a US recession caused by excessive Fed's tightening. (It is not easy to argue against such a risk, with yield curves inverted and reliable leading indicators in negative territory). But even remaining agnostic about the possibility of a contraction, one has to consider that a sharp slowdown must be ahead, because this is what the Fed is striving for in order to tame price pressures. As the steepest tightening cycle in many decades makes itself felt more and more throughout next year, longer-dated yields should be expected to be lower towards 2023-end versus current levels. With the US dollar entering a slowdown phase unusually expensive, long yields eventually headed south and policy rates peaking, the bear market in gold should come to an end.

But it is the longer term that should hold the best upside surprises for gold. Disinflation is likely to be cyclical, against the backdrop of deglobalisation, climate policies, uncoordinated fiscal and monetary policies, and longer-lasting US sanctions on Ukraine. As supply chains are rearranged from low-cost to friendlier countries, as commodity-intensive investments are increased in the name of the green economy, as governments subsidise citizens to avoid social unrest due to energy crises, while the US keeps sanctions against Russia even after the long war has ended, inflation can only become structurally more entrenched and stronger. So, before rushing to the conclusion that central banks can crush it no matter what, one must first take into account the exceptional number of factors working in the opposite direction globally, and not that much under their control. And as for growth, the euro area is likely to see its expansion rates hobbled for years to come, being energy prices a primary competitive factor, while Chinese growth will be capped by the real estate crisis, with no shortcut in sight to make up for a stagnant sector accounting for at least 25% of the country's GDP.

In short, while cyclical disinflation can help gold via lower bond yields, the prospect for a stagflationary scenario should be the main driver for the yellow metal to shine again, and the US dollar eventually to be headed in the opposite direction.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

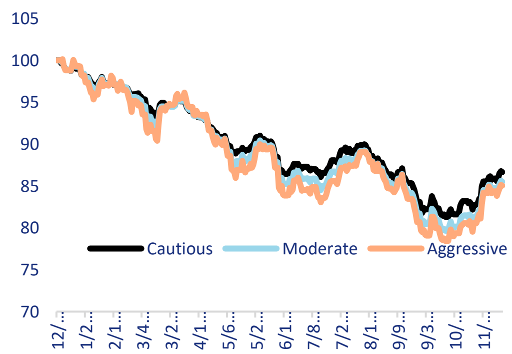


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW:Underweight/Neutral/Overweight

	UW	N	OW
Cash			>
DM Gov.			>>
EM Debt		=	
DM Credit	<<		
DM H. Yield	<<		
DM Equity		=	
EM Equity	<		
Gold		=	
Hedge Funds			>>
Real Estate		=	

TAA – 2022 INDICATIVE PERFORMANCE



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

Fixed Income Update

When hope of the beginning of the end of the tightening cycle combines with a flight to safety flamed by geopolitical crisis, developed market treasuries are the place to be. Last week, the 10-year US Treasury yields came down by 20 bps to 3.62% as the yield curve bear flattened and the 2s10s part of the curve inverted to more than 75 bps. Global treasuries as an asset class generated a 1.4% return last week, fueled by the drop in benchmark yields. Apart from the situation in China, a lot depends on the US Non-Farm Payrolls data due this Friday. If the jobs data prints above 200k, the markets will be disappointed. In addition, investors will focus on Chairman Powell's discussion on the Economic outlook and labour markets on Wednesday, 30th November. This would be the last sound byte from Powell before the blackout period kicks in prior to the December FOMC meeting. Powell is expected to indicate the downshift in rate hikes with a hawkish overlay, as the inflation and labor market data prints remain way above the Fed's target. This may result in a partial rollback of the recent rally in Treasuries, that looks a tad overdone.

According to some macro analysts, the recession indicators are flashing a stark warning. The Conference Board Leading Indicator typically warns of an impending recession seven months in advance every time it prints below 0 for two consecutive months. That trigger was hit in august this year. The NAHB housing index leads unemployment by roughly 12 months. The sharp deterioration in the NAHB index points to an increase in unemployment in H2 2023. The 2s10s is going deeper into the negative territory as well. It is at -80 bps, last seen in the 1980s. All of this indicates that we could already have hit the top for long-term yields. After the next sell-off in treasuries comes through, it may be time to lengthen the duration.

The spreads have compressed significantly across the board in November. EM Debt has been the top beneficiary as spreads have compressed by 48 bps while IG spreads have come down by 25 bps. US high Yield spreads have come down by 20 bps, while the European HY spreads have come down by 99 bps. With the above indicators flashing red, spread widening from these levels would be a very high probability. In an ominous warning last week, S&P released its base case that US HY default rates could double to surpass 3.75% by Q3 next year from the current level of 1.6%.

Closer to home, S&P had more positive news as it upgraded Oman to BB while revising Bahrain's sovereign outlook to Positive. According to the rating agency, a stronger external position due to the robust oil prices and fiscal reforms has helped both countries. Oman has been proactive in reducing debt as it used the excess oil revenues to voluntarily buy back $700 million in Eurobonds and asked the GREs to pay down their debt where possible instead of refinancing them. Bahrain's ongoing implementation of the Fiscal Balance Program (FBP) via expenditure cuts and revenue-enhancing initiatives, including the doubling of the value-added tax (VAT) rate to 10% from 5%, has resulted in a record current account surplus of about 17% of GDP in the first half of 2022.

FIXED INCOME KEY CONVICTIONS

DEVELOPED MARKETS
OW US Treasuries
Selective on Credit
UW High Yield
EMERGING MARKETS
OW Asia (USD, quality)
OW GCC vs other EMEA
OW Latin America

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

Source: Bloomberg

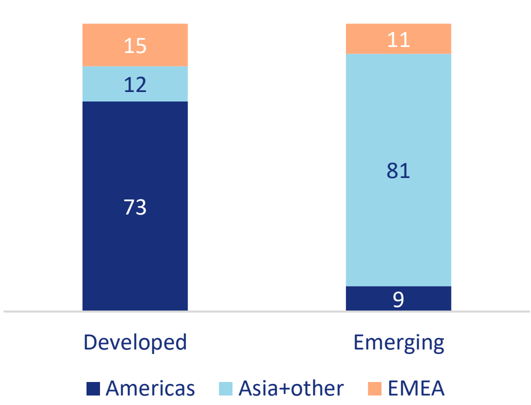
Equity Update

Equities are tracking the usual bullish seasonal year-end pattern, helped by falling bond yields. Global equities rose last week, with a broad-based sector rally and developed markets taking the lead once again. Emerging markets were flat with China losing its mojo (after clocking 20% gains in November to date), India was up for the week , and the GCC mixed with Abu Dhabi equities up and the KSA down. The rebound of the past few weeks has been due to P/E expansion and not earnings growth. Which is why this may not continue into 2023, with rates not yet having peaked adding to margin pressure. Due to lead-lag effects we are yet to see how the economy and earnings react to the higher rates environment. Personal loans, auto loans and credit card financing feel the brunt before corporates do. Mortgages vary by country with the US house buyer locked into lower rates for longer than a UK home owner.

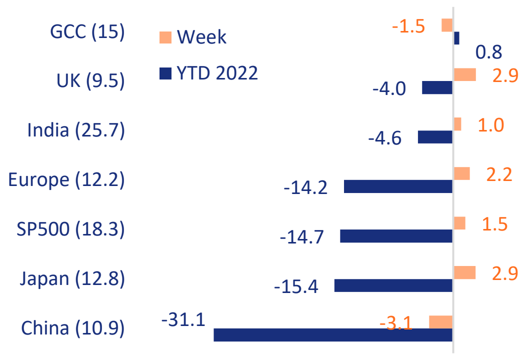
Despite the recent poor run in MENA, local markets are still amongst the best performing ones year to date; Abu Dhabi +27%, Dubai +7%, the KSA -1% on a total return USD basis. This compares to global equities -16% and the only other big market in the green LATAM +10%. In local currency India and the UK are up, with Japan flat. The USD is +11% against a basket of currencies and has affected Dollar returns, though recent weakness has given some respite. Recent issuance saw the KSA's biggest IPO this year draw orders worth $105bn and raise $1.8bn in the first-ever dual listing in Riyadh and Abu Dhabi. Americana Restaurants, the Middle Eastern operator of KFC and Pizza Hut, was priced at the top of the range, valuing the franchise operator at $6bn. Taaleem, the education venture lists tomorrow on the Dubai bourse. Both retail and education have a low representation in regional indices, hence the keen interest. We see the UAE outperformance continuing, backed by strong economic growth, again in contrast to the rest of the world. The Abu Dhabi emirate recorded real GDP growth of 11.2% y/y in H1, boosted by an 11.7% expansion in the second quarter which was the strongest growth rate in six years. The oil & gas sector accounted for just a little less than half of GDP. Other key sectors include manufacturing, and construction.

We see markets trading mostly sideways in the near term. China unrest this weekend could stall the equity rally and also once again raise concerns around a recovering supply chain. European luxury good makers had rallied recently on hopes of a China reopening as did European equities being China a major trade partner. China lifting restrictions would be a positive for global markets. Slowing demand – engineered by centrals banks – is a further headwind to markets, and indeed US retailers are expecting a slower-than-normal Black Friday, with inflation curbing purchasing power. The US consumer in aggregate looks healthy, but as rates continue to rise and the labor market slows, spending is likely to slow. Data is already pointing in this direction: auto and credit card delinquencies for subprime consumers began deteriorating at the start of the year, and recent earnings reports indicate that middle- and higher-income consumers are spending less.

EQUITY RECOMMENDED REGIONAL POSITIONING

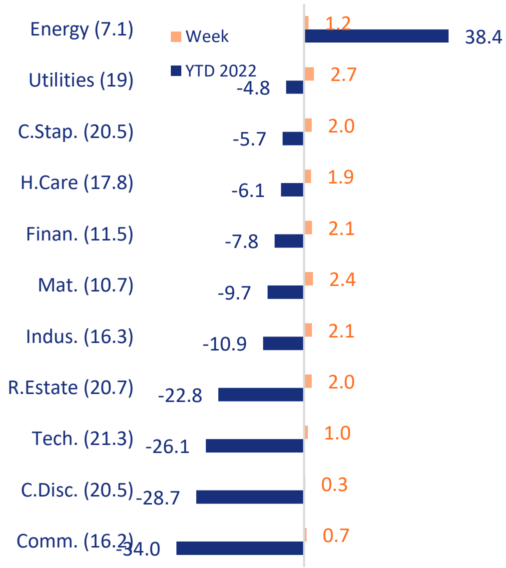


MAJOR INDICES PERFORMANCE (TR, US$) AND 2022PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2022PE



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

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