A perfect week

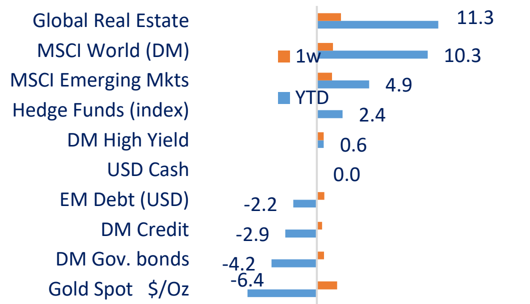
- **Last week saw upbeat economic data, positive corporate earnings and falling interest rates**
- **All asset classes delivered positive returns, with a confirmed leadership from the US**
- **Our pro-cyclical positioning looks appropriate so far and we didn't change it in April**

It was an eventful week on many fronts, with stocks, bonds and commodities registering positive returns, China on a slowdown path, the US economy turbocharged, yet long-dated Treasury yields falling, and both Fed and ECB officials making hints to the future unwinding of asset purchase programs. Developed market stocks gained 1.5% and their emerging peers were not far behind. The yield on the US 10-year note lost 8bps, now below 1.6%. Gold broke above $1,750, Brent crude rose by 6% and the US dollar fell back to mid-March levels.

This was indeed a perfect week for investors. On the economic front, data confirmed that the US didn't wait for full vaccination to rebound. Retail sales, industrial production and sentiment indices were all better than forecast, while initial jobless claims were lower. As Consumer Price Index came out at its largest increase in over 2 years, at +2.6% Year-on-year, the surprise came from the steadiness, and even, the decline, in interest rates. It may be that the communication of Central Banks has been effective: by opening the discussion on the future exit strategies, major monetary authorities may have convinced that their support will not be reversed in the shorter-term. At the same time, excellent quarterly results from US banks, especially the most exposed to market activity, provided comfort that the current sky-high equity multiples will be compressed by a sharp rise in the denominator.

Corporate results will be the focus of the week ahead, and assuming that interest rates remain quiet, we may enjoy a constructive trend, before the question of central banks starting to reduce their asset purchases takes centre stage in the summer. We haven't changed our positioning in April. Stay safe.

ASSET CLASSES USD % TOTAL RETURN, YTD 2021 LAST WEEK



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Cross-asset Update

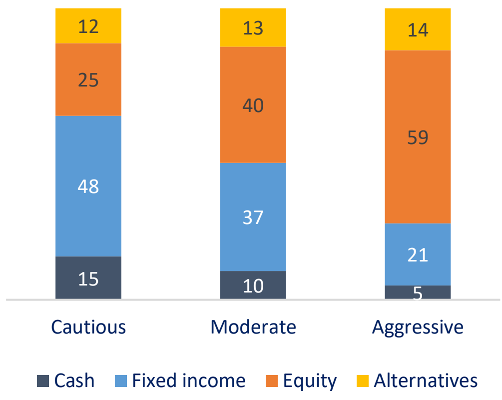
Some complacency seems to be setting in in the Treasury market in relation to long-dated Treasury yields topping out. If on the one hand the high-volatility phase of their rise should be over and leave room to less market-rattling swings, on the other it does not square up that amidst the Mother of All Public Interventions in the United States the US yield curve badly lags market-implied inflation. After all, both indicators currently express a market angle on the strength of the business cycle in America and they should move somewhat more in tandem.

The so-called breakeven inflation, the difference between the yield on the 10-year Treasury note and the one on Treasury-Inflation-Protected Securities for the same tenor, has been rising steadily since its March-2020 pandemic low to reach its current 2.37%, almost the top-end of the historical range. Investors have been discounting a constructive, post-recession unfolding of the business cycle aided by the strong support of both the Fed and Congress. The signal is that future inflation must normalize, especially as the Fed has embraced a new regime called Average Inflation Targeting, whereby Fed officials want to materially see inflation rise above target before tightening policy. The yield curve, measured for instance as the difference between the yield on the 10-year and the 3-year note, has been steepening steadily as well, anticipating strong improvements in the economy. But given the extraordinary nature of the public interventions and strong real growth into year-end forecast at levels not seen since the ‘80s, one would expect the yield curve to steepen further to be more aligned with macro projections and what indicated by breakeven inflation. Otherwise, markets should record a huge failure in the possibility of persistently raising price pressures by pushing back down break-even inflation. Under this scenario macro projections would also be likely to somewhat disappoint.

It seems more plausible to us that markets are just taking a breather, with long-dated yields range-bound since March, ready to reassess as fresh inflation and growth forecasts are released. Also, Fed officials mentioned that towards summertime it would be appropriate to initiate talk about when to start the winding down of the program of asset purchases, the Fed Treasury-buying program currently exerting downward pressure on market rates. If economic expansion rates remain sustained, as they should since the Fed is driving a high-pressure economy, and the discussion on QE tapering gains traction, as it should, with the major investment houses expecting tapering to be started early in 2022, then most ingredients would be there for yields to start rising again.

Under this scenario, duration risks would be re-emerging later this year, with renewed downward pressure on gold and one more bounce in the US dollar.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

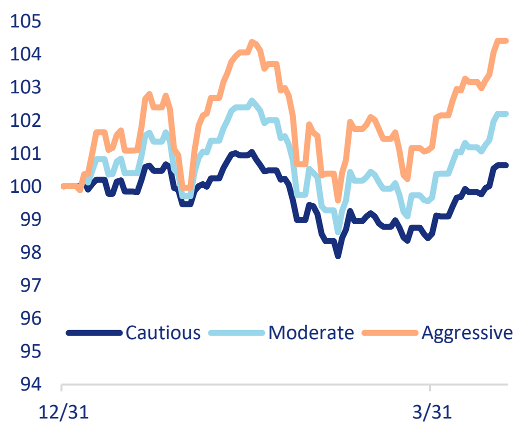


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

UW/N/OW:Underweight/Neutral/Overweight

TAA – 2021 INDICATIVE PERFORMANCE



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

Fixed Income Update

Within days of our last weekly publication, where we outlined our firm belief that most of the yield uptick is behind us, the US Treasuries caught everyone by surprise. Analysts have been scampering to explain the massive rally in the long-end of the curve on Thursday when the 10-year yields came down by seven bps to trade at 1.58% despite positive surprises in a multitude of economic data. According to a Goldman Sachs analysis, these kinds of price actions are rare, and a decline of more than 20 bps in the month following positive data surprises has never happened.

A possible explanation for the rally could be that there was a lot of short-covering as the JP Morgan Treasury Client Survey had surged to its shortest level since early February and is on the shorter end of the range we've seen over the past two years. Adding fuel to the fire was Chairman Powell's reconfirmation that conditions are not yet ripe for a rate hike before the end of 2022. This has resulted in rate hike expectations being pushed back by a quarter to April 2023. So we think the rally last week was more technical than fundamental and could be intermittent during the consolidation phase than a signal that treasuries have topped out. We do not believe the upward pressure on the yield is over yet, and this is not the time to change our views.

The sub-asset classes turned green, driven by the surge in treasuries. Spreads of different sub-sectors traded sideways. In a reversal of fortunes, the worst-performing asset class Emerging Market Sovereigns topped the weekly chart with a +1.1% return last week. Other long-duration asset classes such as GCC Debt and Investment Grade Credit also were in the top half of the chart due to the same reasons. But we continue to ask the investors to exercise caution when going into the long-duration bonds as this pause may be short-lived.

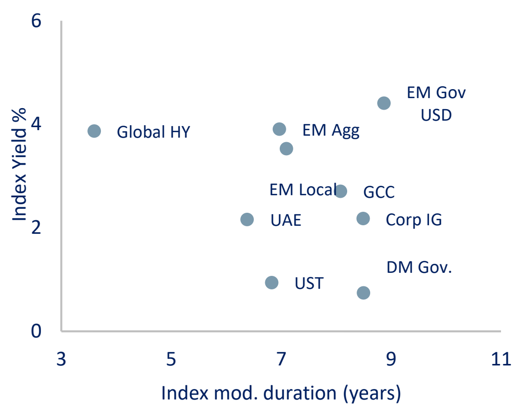
The only negative spot was Asian High Yield that returned -0.2% due to the adverse reaction to the Huarong saga. The contagion effect has been lower than what headlines had screamed. In fact, Chinese authorities directed local banks to continue to support the distressed AMC, and the regulator insisted that the company's operations are normal and the firm has ample liquidity. The bound complex of the firm rallied sharply on Friday, with 5-year CDS falling by a whooping 500 bps to 956 bps as of Friday. This gives hope that the Govt is working to contain the fallout from the event, and we maintain our positive stance on the Asian HY subsector.

GCC Debt outperformed the broader Emerging Market debt driven by a solid performance from the long-end of the sovereign curves. DIB sold its long-awaited AT1 perpetual, which could be used to refinance the outstanding Noor AT1 Sukuk that has a call date in June 2021. The new issue was oversubscribed by 5x and is an official record as the lowest ever coupon for a subordinated GCC bank debt.

FIXED INCOME KEY CONVICTIONS

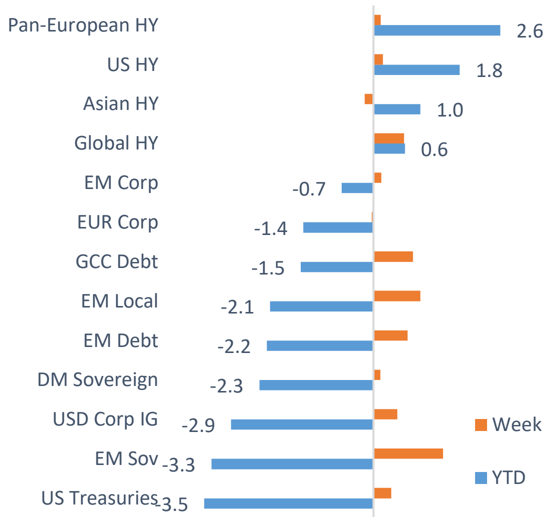
DEVELOPED MARKETS
UW DM Government
OW Credit (Cau. & Mod.)
OW High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

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



Source: Bloomberg

Equity Update

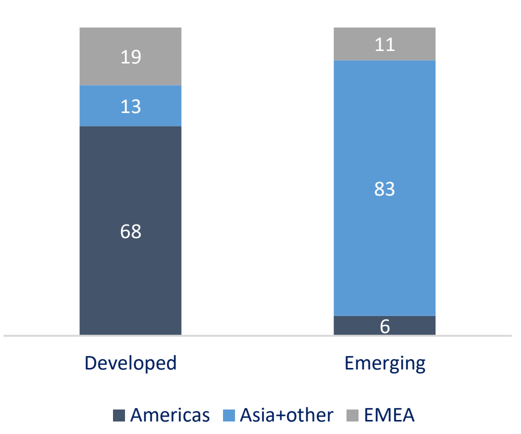
Equities continue to make new highs as better than expected Q1 earnings releases, indicate the economic and corporate recovery is well in place. This is acting as a tailwind for stocks and easing valuation pressure. Also, 2021 consensus earnings growth estimates have been moved up by 6% for the US, taking EPS growth to 27% and for Eurozone by 3% taking EPS growth to 38%. Earnings have a 6 to 7 X beta to economic growth and global real GDP is seen to be moving from -3.6% in 2020 to +6.5%, this year. The world has seen the sharpest economic "V" in history—a deep recession and rapid recovery within just five quarters. Longer-term bond yields rising have caused concerns but are reflective of the global economy's faster-than-expected recovery from the COVID-19 crisis, though worries on inflation and their impact on input costs remain. However, recent stabilization of the 10-year US Treasury yield to 1.58% has led to a rebound in growth stocks, with technology the best performing sector in April so far. The equity rally is broad based in terms of geographies and sectors with both EM and DM stocks gaining c.1.5% last week. Optimism remains elevated— improving profit margins, the Vix at low levels, improving PMI's and record inflows with $ 334 bn into equities in Q1.

Our overweight on US equities is supported with US GDP growth estimated at 6 to 8% this year—the fastest pace since 1983 and reflected in the almost 12% ytd S&P 500 gains with the Nasdaq close behind. Increased optimism, with a strong start to Q1 earnings season. The banking sector earnings surprised positively, though a large part of earnings beats was a release of loan loss reserves. Financials remain our top call in global sector positioning and we see more upside driven by the economic recovery. Market sentiment remains positive for continued US equity performance as better-than-expected housing construction activity added to other strong economic data, despite the April University of Michigan Consumer Sentiment Index below forecasts and with near-term inflation expectations rising. Favorable earnings from Daimler and LVMH indicate an auto and luxury demand rebound in Europe, which ended the week with widespread gains. We have a relative overweight call on the UK, as energy and commodity prices remain supportive.

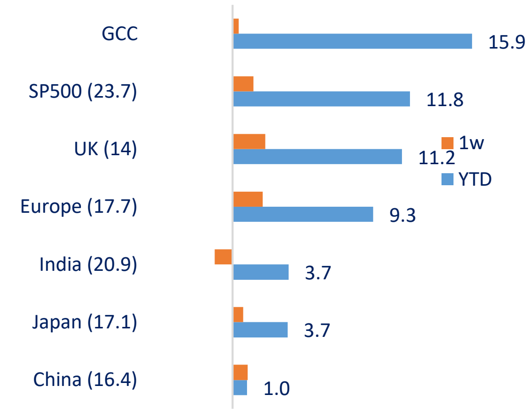
Our region sees continues outperformance from the UAE, with Dubai real estate rallying last week. We are also seeing an upswing in the logistics sector with Air Arabia and Aramex recent share price rise, indicative of resuming economic activity with the robust vaccination rollout. The UAE is seeing continued end user house purchases and longer-term vacationing from Asian and European tourists, as the strong social distancing measures and COVID monitoring in place, give comfort.

Markets in Asia rose towards the end of the week, with China leading the way following a sharp acceleration in Q1 GDP. As the regulatory overhang is now dissipating to some extent, with the record fine on Alibaba providing a closure hopefully, we would add to Asia equities. Consensus expectations are for 38% EPS growth for EM in 2021, though upward revisions by 1.5%, have lagged the developed markets.

EQUITY RECOMMENDED REGIONAL POSITIONING

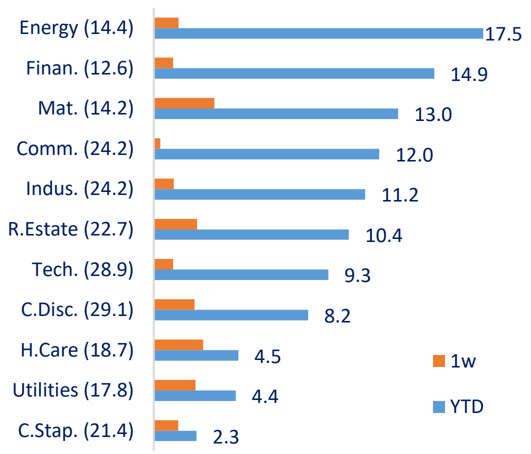


MAJOR INDICES PERFORMANCE (TR, US$) AND 2021PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2021PE



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

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