Economic resilience supports a robust outlook

- **Last week was very positive for risk assets in a clear "risk-on" pattern**
- **Economic data confirmed a loss of momentum in Q1 but also a certain resilience**
- **Our positioning is unchanged despite our expectation for short-term volatility to remain elevated**

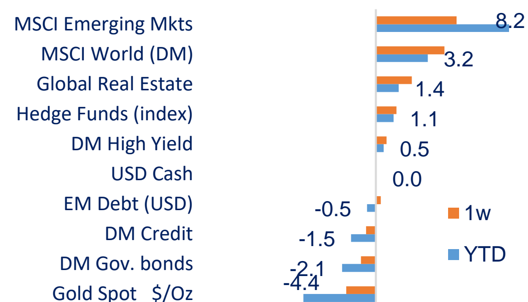
The last week of January was negative, with a combination of hedge funds' de-risking and covid-19 infections surging. The first week of February displayed a sharp contrast: global equities rallied, adding respectively +4 and +5% in developed and emerging regions. Global REITS and Hedge Funds followed, up between 1 and 2%. Within the fixed income sphere, only High Yield and Emerging Markets' debt, which happen to be our recommended segments, were in positive territory. Gold was the worst performing asset class, down 1.8%, and the US 10-year government bond yield reached 1.16%, a new high for 2021.

This market action spells "recovery". Last week was very rich in economic data. No surprise, numbers for GDP in Q4 were not good in absolute, but they were better than expected, including a significant resilience in Europe despite the ravages of the virus. PMI indices remained robust in the manufacturing sector and improved in services in some developed countries. Finally, US January job report's headline figure was disappointing, with only 46,000 job creations, but hours worked were rising. Importantly, business confidence was also solid.

Optimism was helped by several other good news. First, new Covid-19 infections are decelerating globally. Second, Q4 earnings are strong, 19% better than expectations in the US and 12% in Europe. Finally, policy support remains inflexible, with a more expansive budget in India and a market-friendly turn to Italy's political crisis as Mario Draghi, the former ECB President, is asked to form a new government.

We believe in a constructive outlook starting in Q2, which is why we keep our positioning unchanged, overweight stocks and underweight bonds. Stay safe.

ASSET CLASSES USD % TOTAL RETURN, YTD 2020, LAST WEEK



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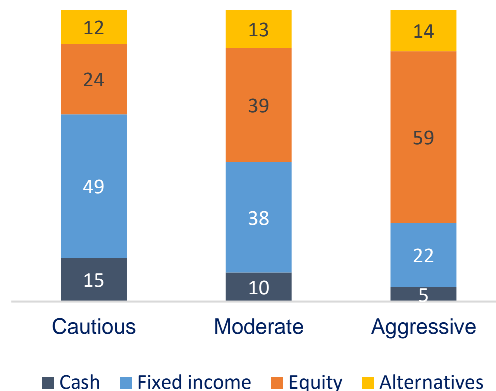
Cross-asset Update

American exceptionalism, that is the United States going through a period of robust growth and stronger market performance versus peers, is once more re-emerging. Year-to-date US stocks are leading in the developed world and local Fed governor Bullard said that domestic growth stands a chance of surpassing China's this year. The Russel 2000 Index, more sensitive to the American economy than larger-cap stocks also exposed to overseas dynamics, is already up in the mid-teens year-to-date, topping global returns alongside the MSCI China Index. Long-dated Treasury yields are at the highs of the year and expected to rise further, as investors become more constructive on the outlook. The main reason for this newfound reflationary exuberance is the expectation for outsize fiscal stimulus, to be approved by Congress by the end of Q1 in the form of pandemic relief measures, followed by an infrastructure revamp-plan possibly finalized by the end of 2021. Monetary support is also running at full-throttle, dwarfing the already sizeable Quantitative Easing programs enacted after the Great Financial Crisis. Is America great again on financial markets?

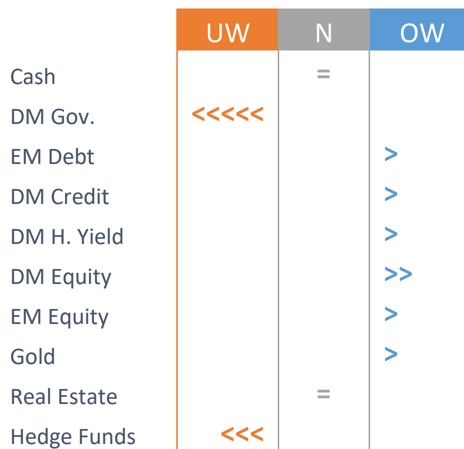
On the one hand, the current returns are heavily borrowing from the future, with easy money either from the government or the Fed eventually meeting their limits in terms of sustainability. Concerns about financial stability and almost a quarter of the Russell 2000 companies fitting the 'zombie' label, whereby EBIT - a measure of operating margin - is lower than interest expenses for a sustained period, are tell-tale signs. On the other hand, record liquidity and fiscal measures are undoubtedly going to provide strong support for US risk assets through 2021, whatever the longer-term unaddressed issues may be. The dollar has already taken notice and strengthened against most of its G10 peers year-to-date, in spite of largely-held expectations to the contrary. With the yield differential widening in favour of the US currency and real growth consistently revised higher, structural imbalances related to debt dynamics and trade deficits have soon taken a backseat in investor minds. At the same time, Europe lagging in terms of vaccinations and being entangled in longer-lasting lockdowns weighing on growth is reinforcing the bias towards US assets. To be sure, the EM countries are partaking in the strong global recovery as well, as it should be, led out of the crisis by China and benefitting both from rising liquidity and trade coming back.

In the end, it is not so much about US exceptionalism, as the ability of the non-US DM economies to grow at a faster clip in this expansion. The dollar should resume its downtrend once the European countries lift restrictions and the summer pick-up in growth mentioned by the ECB president Lagarde starts. That would help investors focus on the broadening recovery and on the imbalances underlying the US currency. It may be tougher for the euro area to show it can accelerate faster than the United States once the virus loses its grip, though this is required for US equity exceptionalism to subside as well.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



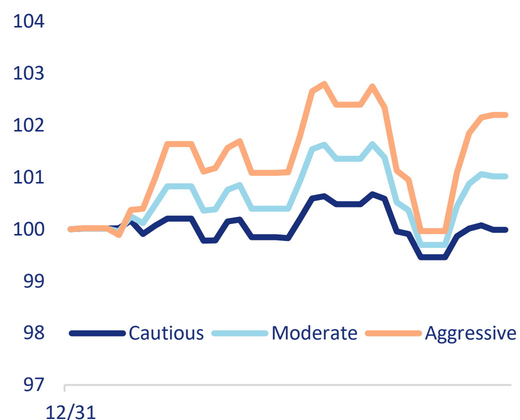
TAA – RELATIVE POSITIONING – MODERATE PROFILE



	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.

Emirates NBD PRIVATE BANKING

Fixed Income Update

As we had mentioned in our previous publications, the bear steepening of the US Treasury yield curve continues. The 5s30s part of the curve, which is the difference between the 30 year yield and five year yield, crossed a significant level of 150 bps last week for the first time since 2015. Both the 10 and 30-year yields touched their highest levels since March last year. This is despite the fact that in the January FOMC meeting, Chairman Powell had set aside any rumours about decreasing FED asset purchases and emphasized achievement of full inclusive employment as critical take-off criteria. This indicates how fragile the current balance is. The FED needs to repeatedly hammer the above points this year for fixed-income markets to remain less volatile.

Despite spreads tightening further across the fixed income asset class, the returns diverged across sub-sectors due to the yield curve movements. The safe-haven asset flagship indices of Developed Market bonds and Investment Grade credit were in the red, providing -0.64% and -0.46% last week, respectively. This is despite the Bloomberg Barclays Agg. Credit index, which represents IG credit trading at its tightest spread of 89 bps since March 2018. This indicates the dangers of taking a position in lower-yielding assets whose returns would be dominated by the yield curve movements this year.

On the contrary, our favored asset classes of High Yield and Emerging Market indices posted positive returns as the spreads tightened by 24 and 14 bps, respectively, beating the US Treasury 10-year yield increase. Moreover, both these indices have a lower duration of 4.2 and 7, respectively, compared to the IG index, which has a duration of 7.3, which makes them less sensitive to the increasing yields. We continue to advise our clients to avoid any fresh positioning in the longer duration bonds as even a small rise in the 30-year yields would wipe out years' worth of income in capital loss.

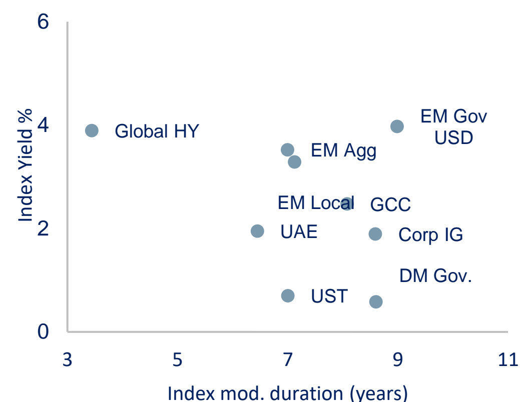
After peaking at 95 in Q2 last year, corporate defaults have been coming down significantly due to the opening up of the funding markets for the riskiest issuers. YTD defaults have reached eight. According to S&P, although it's still early in the year, the global default tally is below the year-to-date totals for each of the past three years (at ten each). 12-month trailing speculative-grade default rate globally hit 5.5%, and for the US, the figure is at 6.6%.

GCC fixed income markets ended the month of January with the highest ever issuance of bonds, hitting the $16 Bn mark for the first time. The corresponding figures for 2019 and 2020 were circa $ 9 Bn. This indicates a massive jump driven by a fear of increasing borrowing rate in the coming quarters resulting in front-loaded bond sales by the regular issuers. We continue to like the investment-grade SOEs, which trade wider to the sovereign curves, HY sovereigns from the region, and subordinated debt of champion banks to pick-up alpha and enhance returns.

FIXED INCOME KEY CONVICTIONS

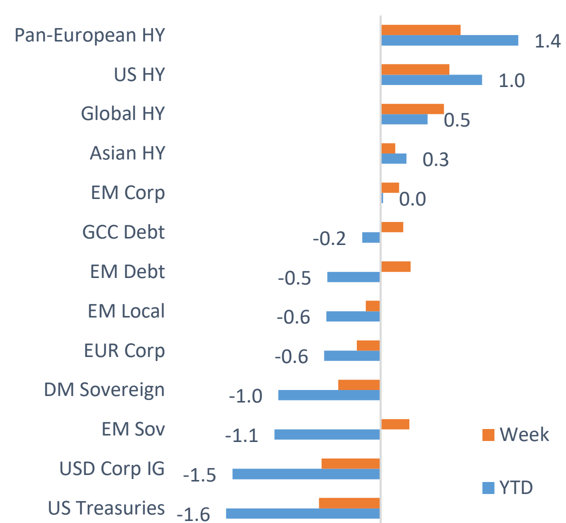
DEVELOPED MARKETS
UW DM Government
OW Credit (Cau. & Mod.)
OW High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

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



Source: Bloomberg

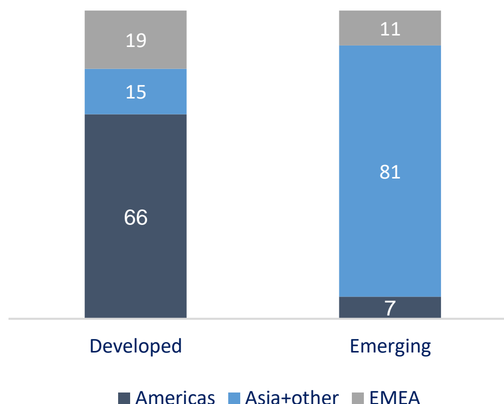
Equity Update

Global equity markets rebounded strongly from the prior week's pullback. We expect emerging market out performance to continue (+8% year to date) and our overweight equities positioning is so far holding ground with global equities up 3.8% year to date. U.S. equities had a strong week with the S&P 500 up c. 5% and the Nasdaq Index 6%. Banks were the best performer as yields rose, while Staples lagged. The volatility from last week's retail trading frenzy cooled and optimism on further fiscal relief with the new bill overshadowed the softer-than-expected jobs report. Signs that the containment of the COVID-19 virus and variants may be beginning to turn a corner, along with further progress on the vaccine rollouts and strong Q4 earnings led to the snap back. Johnson & Johnson is the latest to file for an EUA of its single-shot candidate. Europe posted widespread gains for the week, as did Asia. UAE equities were close to flat for the week but are up 10% year to date. The Indian Sensex Index closed above 50,000 for the first time, with weekly gains c. 8%. India looks to reset its economy post-COVID with a budget focused on growth. The Vix Index is at 20.8 close to the average since 1990 of 19.5. However, volatility will be seen as the year progresses as the recovery trade has gone a long way and many risks persist. Yet we think equities will continue to move higher. Growth remains supported by monetary and fiscal policy and stimulus and overall positioning is still not stretched.

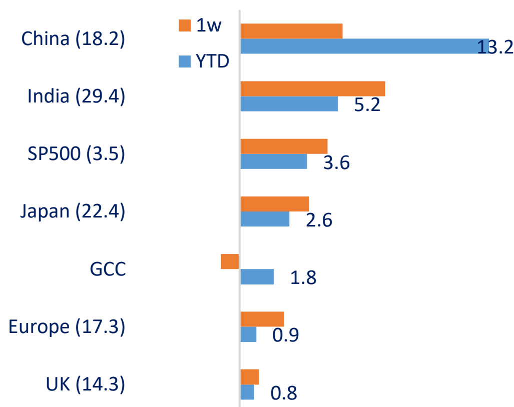
While Q4 earning beats were large, guidance has come down, as companies navigated renewed lockdowns and falling mobility. This could start to improve as restrictions ease and the vaccine rollout gathers pace. Over 50% of the S&P500 companies and 25% of Stoxx600, have reported Q4 results. Revenue growth in the US is +2% y/y. Earnings growth is much stronger in the US, at +6% y/y, vs -11% y/y in Europe. In the US 7 of the 11 sectors are reporting double-digit growth with energy and airlines, reporting weak numbers. In Europe energy and commodity sectors have been a drag. Japan EPS growth is at +14% y/y. FAANGs and other technology companies are powering ahead driven by corporate digital transformation and also the secular shift toward e-commerce. Amazon remains well positioned to prosper from this shift, with particular strength in groceries and staples. During the course of 2021, CEO Jeff Bezos will step down to be replaced by the CEO of AWS which is an important business as cloud is 10% of Amazon revenue but over 40% of operating profit. Alphabet also beat expectations with strong fourth-quarter EPS and revenue driven by digital ad spending and growing demand for cloud services.

Previous week's Reddit inspired squeeze of over shorted stocks in the US brings to the fore the importance of social media's impact on markets. A combination of lockdowns, record disposable income and savings, low trading fees and margins along with ease of use have driven rising retail stock market participation. The internet has also played a pivotal role with the availability of online trading platforms with social media posts propagating new trade ideas. This retail trend could get further impetus from additional stimulus. Last week communication services stocks were the best performer.

EQUITY RECOMMENDED REGIONAL POSITIONING

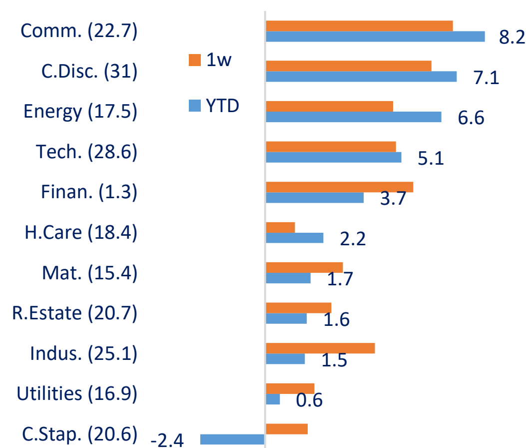


MAJOR INDICES PERFORMANCE (TR, US$) AND 2021PE



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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