Winds of change

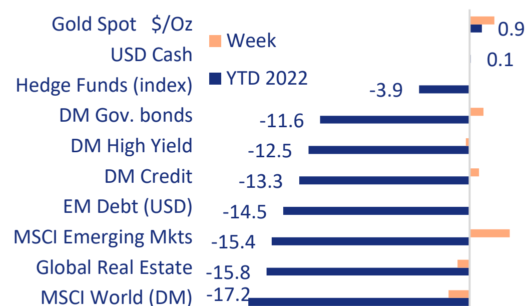
- **The current volatility results from a drastic change in the relation between central banks and markets**
- **Prioritizing the fight against high inflation means slowing growth and tolerating market turmoils**
- **An inflexion in inflation is needed for assets to thrive – it will happen, but volatility reigns in the meantime.**

The weekly returns of various asset classes last week were particularly interesting. It wasn't a crash -or a rally- of everything. Risk assets from developed markets suffered again, with the MSCI World and the Global REIT index now at the very bottom of the YTD rankings. By contrast, safe bonds were up, supporting gold, while importantly assets from emerging markets also printed positive returns. This is not totally usual.

At the heart of the current turmoil is a material change in the relation between central banks, especially the US Fed, and markets. With high inflation out of the equation for 4 decades, we were used to having the Fed protecting growth, especially through employment, and to some extent markets, the "financial conditions". They used to cut rates and purchase assets very aggressively when needed and to be very gradual in reversing course. We are experiencing the exact opposite now: with no control on supply-side issues, from the war to China's lockdowns, they fight high inflation by crushing demand, which means, intentionally slowing growth and not being too worried by the wealth reduction from falling asset prices. This phenomenon is DM centric, and is not totally bearish for long-term, safe bonds. Last week's differentiated returns tend to indicate that markets have started to acknowledge what happens.

It's just a week, and it also means that we need to see a clear inflexion in inflation before exiting this temporary but painful bear market episode. It doesn't exclude the possibility of rallies in the meantime, but patience is still required. Of course, we believe that the inflexion will happen, we just hope it's not too distant but the timing remains highly uncertain. Meanwhile, we keep a relatively neutral positioning, with only modestly constructive active deviations. Stay safe.

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



MAURICE GRAVIER
Chief Investment Officer
MauriceG@EmiratesNBD.com

GIORGIO BORELLI
Head of Asset Allocation
GiorgioB@EmitatesNBD.com

SATYAJIT SINGH
Head of Fixed Income Strategy
SatyajitSI@EmiratesNBD.com

ANITA GUPTA
Head of Equity Strategy
AnitaG@EmiratesNBD.com

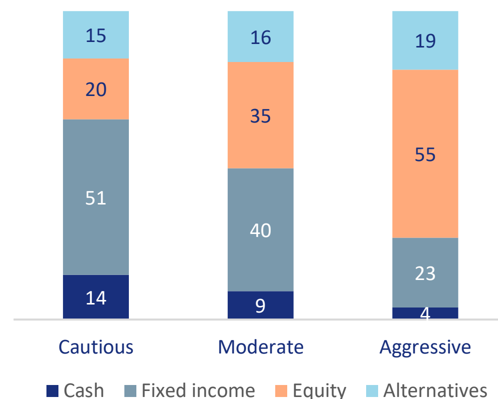
Cross-asset Update

Opportunities seem to be currently skewed in opposite directions in stocks and bonds. For equities it is very questionable to say that a lasting bottom is in sight. Sentiment remains fragile, as shown by the bearish reaction to Powell's hawkish message last week, which conveyed that the Fed won't hesitate to shift policy in restrictive territory, if push comes to shove. It will take quite some time before the overheating US economy can be slowed to levels in keeping with more moderate inflation dynamics, in the meantime with policy almost on autopilot it is difficult that markets settle definitely down. But it is quite a different story in high-quality bonds. There are the first signs that US inflation should have peaked, while concerns hinge now on the potentially recessionary effects of the removal of stimulus. So, with longer-maturity rates topping out, duration risk should be minimal, and investors can once again find some refuge in treasuries and IG corporates, adding some degree of diversification to their portfolios. At least the carnage in the bond and stock markets has produced some value in the former, but for now only the potential for rebounds in the latter, until the tightening process is more advanced and the fear of a Fed-induced recession, that we do not see this year, is more ingrained.

But if restrictive policy is now the root cause of all evil in investor minds, policy divergence should also be a source of relative opportunity. Chinese banks just cut the five-year loan prime rate to boost credit, while it is estimated that the authorities will overall provide monetary and fiscal measures in the order of almost one-third of GDP in the whole of 2022. Yes, this comes in the wake of an unprecedented regulatory crackdown, but this is also why Chinese stocks are sporting multi-decade cheap valuations. It is now well discounted that real growth could drift below 4% this year, which last happened in 1990 if we don't count the Covid-crisis year, and as much as investors wondered whether China stocks were investable, they may now be wondering why not invest in them. The wild card remains the lockdowns, as people will not be enticed to spend whatever form of stimulus, until they are allowed to get out.

In such an uncertain world gold should be shining more than it has so far this year. We do not see a bull market based on the new normal of higher inflation and more volatile growth. At least not until the global tightening cycle is behind us, which would be more of a 2023-end event than the forthcoming trigger we are looking for to change our stance today. Yet, we would tend to see a gold rebound unfolding from the currently oversold levels, as Powell's hawkish language pledging more 50-basis-point hikes is nothing new, even as the gap with higher real rates capping returns to the upside remains firmly in place.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

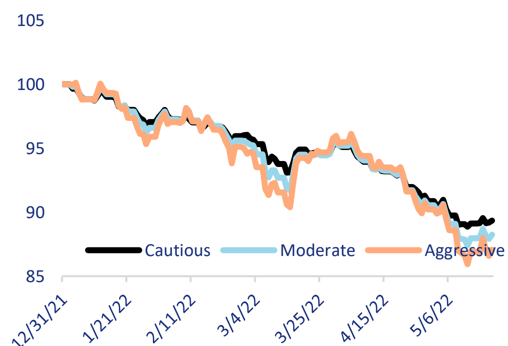


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW:Underweight/Neutral/Overweight

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

TAA – 2022 INDICATIVE PERFORMANCE



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

Fixed Income Update

As recession worries mount, risk-off sentiments across segments resulted in a rally in the US Treasury bonds. Yields across the curve moved lower, with the US 10-year lower by about 14 bps and 30-year by nine bps. Investors are worried about the implications of high inflation leading to higher interest rates, resulting in a material slowdown next year. The Fed's "soft landing" theory seems to be up for debate as markets believe this delicate balancing act between controlling inflation and maintaining growth needs a fair bit of luck. The forward-looking indicators suggest some softening, particularly in the most interest-rate sensitive sectors of the economy. The Russia-Ukraine conflict and China's localized shutdowns remain the unknown factor in determining the long-term yields. The yields moved down despite the most hawkish statement to date by Chairman Powell last Tuesday, where he outlined a whatever-it-takes approach to fighting inflation that had resulted in a temporary spike in the bond yields.

According to a recent JP Morgan study, the high volatility in the treasury markets is exacerbated by low liquidity conditions. Treasury market depth remains severely depressed since dropping notably in the aftermath of the Ukraine invasion. Meanwhile, the price impact of each trade in the market has risen sharply in recent weeks. As per the study, a $100mn trade in the treasury impacts the underlying price by close to 1/32th of 100, markedly higher than the long term range of 0.2-06 x of 1/32th.

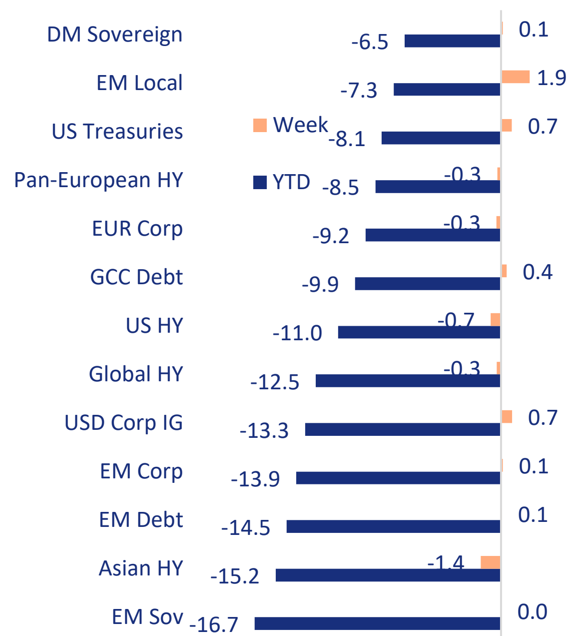
Most of the segments except High Yield generated positive returns last week owing to the yield's downward movement. High Yield spreads continue to widen on the risk of slowdown and growth fears. Asia HY remained under pressure despite dovish measures taken by various banks to boost lending to the real estate sector in China. The lack of growth in property sales and increasing defaults soured the mood of the investors. According to a recent GS report, 22 Chinese HY issuers have defaulted on their obligations YTD. GS has also increased its default rate to 31.6%, which was their bearish case at the start of the year. China IG had a fantastic week, with the Yuan gaining as US recession fears took the front seat and US President Biden's remarks that the China tariffs imposed by the Trump administration were under consideration.

In line with the US Treasury yield movements, the local GCC long duration IG bonds traded up last week, with 30-year high-grade names from UAE, Qatar, and KSA closing higher by 1-1.5 points, while the 10-year paper was up by about 0.5 points. We like the champion banks' perpetual from the region and short-duration real estate high yield notes. On the other hand, Turkey and Egypt remain under pressure as the risk-off sentiment holds across various segments.

FIXED INCOME KEY CONVICTIONS

DEVELOPED MARKETS
UW Government bonds
Selective on Credit
NEUTRAL High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

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



Source: Bloomberg

Emirates NBD PRIVATE BANKING

Equity Update

A seventh week of decline for global equities, taking year to date performance to -17% with mounting concerns around the growth outlook, recession risk and Central Bank hawkishness to combat inflation. DM equities continued a downward trend with US equities dropping 3% last week and briefly entering bear market territory. Key retail sector earnings exacerbated inflation concerns. Other DM fared better as did EM: the UAE, China, India and LATAM.

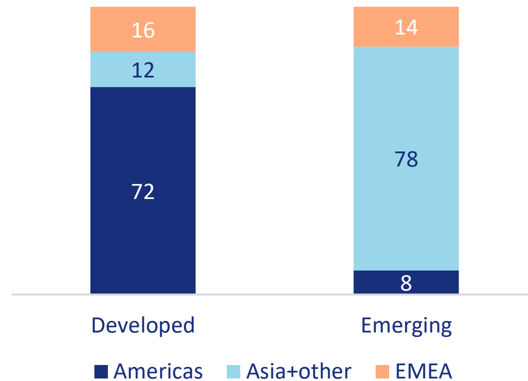
Equities are seeing outflows but still a small percentage of the inflows seen over the past 2 years. GCC markets have outperformed EM the last one year with increased weight in EM indices. We maintain our UAE overweight but retain our preference for strong and consistent dividend payers i.e. banks. The Fed rate hikes in 2022 and higher oil prices, along with IPO and project pipelines, should aid near-term revenue growth for UAE banks. A real estate rebound provides comfort.

Recession is not around the corner with the possibility of 2023 at the earliest and many economic indicators remain expansionary. However, a deterioration in real income can be felt in almost every region, with inflation and supply chain issues plaguing the world. The Goldman Sachs Financial Conditions Index has been tightening. China retail sales fell 11% y/y in April. Sri Lanka has defaulted on a foreign debt payment. Whilst rising energy costs with energy seen to be 50% of the 7.4% y/y inflation growth in Europe compared to one third of the US 8.3% y/y April number, food is an important component for many lower income economies.

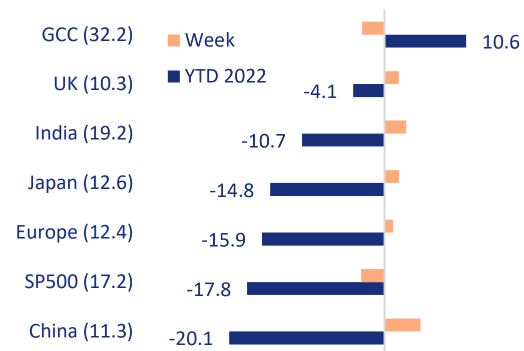
Central banks creating liquidity and the equity market's rise have been highly correlated and the last 2 years markets rose, with surplus liquidity boosting savings. And now the opposite is happening. Market performance is seen as a leading indicator of where the economy is trending. What could move markets up as fundamentals i.e. earnings and growth are taken off the leader board by investors? We still see earnings growth as an important catalyst, which though lower is still at trend. A benign resolution to Russia/Ukraine and China resumption of activity would dampen inflationary pressures. China has been working on domestic stimulus and last week lowered a key mortgage lending rate. Reopening will drive consumption and productivity. Finally, the Fed and central banks turning less hawkish would boost investor sentiment.

Pulling US performance down last week was surprisingly not technology but the consumer sector. as companies disappointed on profit and guidance. Big cap consumer companies Walmart and Target shares sold off over 20% last week. Rising transportation, warehousing and wage costs along with higher prices of products with supply chains in disarray are hurting retail companies. Not all the costs or higher prices can be passed onto the consumer and with inflation tracking over 8% in the US, consumers have been lowering discretionary purchases. The above-average Ebitda margins due to strong consumer demand paired with lower inventories, led to higher pricing and lower discounting during the last 2 years. This scenario is changing.

EQUITY RECOMMENDED REGIONAL POSITIONING

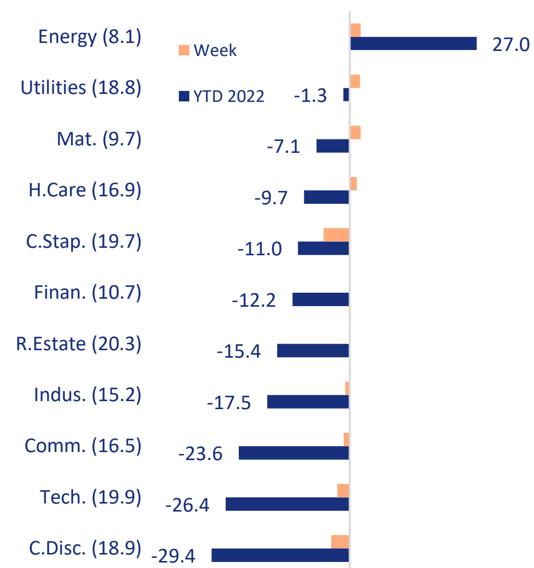


MAJOR INDICES PERFORMANCE (TR, US$) AND 2022PE



Source: Bloomberg consensus. MSCI Indices unless specified.

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



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

DISCLAIMER

Reliance

Emirates NBD Bank PJSC ("Emirates NBD") uses reasonable efforts to obtain information from sources which it believes to be reliable, however, Emirates NBD makes no representation that the information or opinions contained in this publication are accurate, reliable or complete and should not be relied on as such or acted upon without further verification. Opinions, estimates and expressions of judgment are those of the writer and are subject to change without notice. Emirates NBD accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this publication. Data/information provided herein are intended to serve for illustrative purposes and are not designed to initiate or conclude any transaction. In addition this publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to the determination of whether a particular investment activity is advisable. This publication may include data/information taken from stock exchanges and other sources from around the world and Emirates NBD does not guarantee the sequence, accuracy, completeness, or timeliness provided thereto by unaffiliated third parties. Moreover, the provision of certain data/information in this publication is subject to the terms and conditions of other agreements to which Emirates NBD is a party. Anyone proposing to rely on or use the information contained in this publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts. Further, references to any financial instrument or investment product are not intended to imply that an actual trading market exists for such instrument or product. The information and opinions contained in Emirates NBD publications are provided for personal use and informational purposes only and are subject to change without notice. The material and information found in this publication are for general circulation only and have not been prepared with any regard to the objectives, financial situation and particular needs of any specific person, wherever situated

Confidentiality

This publication is provided to you upon request on a confidential basis for informational purposes only and is not intended for trading purposes or to be passed on or disclosed to any other person and/or to any jurisdiction that would render the distribution illegal. The investor may not offer any part of this publication for sale or distribute it over any medium including but not limited to over-the-air television or radio broadcast, a computer network or hyperlink framing on the internet without the prior written consent of Emirates NBD or construct a database of any kind.

Solicitation

None of the content in this publication constitutes a solicitation, offer, opinion, or recommendation by Emirates NBD to buy or sell any security, or to provide legal, tax, accounting, or investment advice or services regarding the profitability or suitability of any security or investment and further does not provide any fiduciary or financial advice.

Third party

The security or investment described in this publication may not be eligible for sale or subscription to certain categories of investors. This publication is not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law or regulation. It is the responsibility of any person in possession of this publication to investigate and observe all applicable laws and regulations of the relevant jurisdiction. This publication may not be conveyed to or used by a third party without the express consent of Emirates NBD. The investor may not use the data in this publication in any way to improve the quality of any data sold or contributed to by the investor to any third party.

Liability

Anything to the contrary herein set forth notwithstanding, Emirates NBD, its suppliers, agents, directors, officers, employees, representatives, successors, assigns, affiliates or subsidiaries shall not, directly or indirectly, be liable, in any way, to you or any other person for any: (a) inaccuracies or errors in or omissions from the this publication including, but not limited to, quotes and financial data; or (b) loss or damage arising from the use of this publication, including, but not limited to any investment decision occasioned thereby. Under no circumstances, including but not limited to negligence, shall Emirates NBD, its suppliers, agents, directors, officers, employees, representatives, successors, assigns, affiliates or subsidiaries be liable to you for direct, indirect, incidental, consequential, special, punitive, or exemplary damages even if Emirates NBD has been advised specifically of the possibility of such damages, arising from the use of this publication, including but not limited to, loss of revenue, opportunity, or anticipated profits or lost business. This publication does not provide individually tailored investment advice and is prepared without regard to the individual financial circumstances and objectives of person who receive it. The appropriateness of an investment activity or strategy will depend on the person's individual circumstances and objectives and these activities may not be suitable for all persons. In addition, before entering into any transaction, the risks should be fully understood and a determination made as to whether a transaction is appropriate given the person's investment objectives, financial and operational resources, experiences and other relevant circumstances. The obligations relating to a particular transaction (and contractual relationship) including, without limitation, the nature and extent of their exposure to risk should be known as well as any regulatory requirements and restrictions applicable thereto.

Forward looking

Past performance is not necessarily a guide to future performance and should not be seen as an indication of future performance of any investment activity. The information contained in this publication does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. Certain matters in this publication about the future performance of Emirates NBD or members of its group (the Group), including without limitation, future revenues, earnings, strategies, prospects and all other statements that are not purely historical, constitute "forward-looking statements". Such forward-looking statements are based on current expectations or beliefs, as well as assumptions about future events, made from information currently available. Forward-looking statements often use words such as "anticipate", "target", "expect", "estimate", "intend", "plan", "goal", "seek", "believe", "will", "may", "should", "would", "could" or other words of similar meaning. Undue reliance should not be placed on any such statements in making an investment decision, as forward-looking statements, by their nature, are subject to known and unknown risks and uncertainties that could cause actual results, as well as the Group's plans and objectives, to differ materially from those expressed or implied in the forward-looking statements. Estimates of future performance are based on assumptions that may not be realized.

DISCLAIMER

Risk

Data included in this publication may rely on models that do not reflect or take into account all potentially significant factors such as market risk, liquidity risk, and credit risk. Emirates NBD may use different models, make valuation adjustments, or use different methodologies when determining prices at which Emirates NBD is willing to trade financial instruments and/or when valuing its own inventory positions for its books and records.

The use of this publication is at the sole risk of the investor and this publication and anything contained herein, is provided "as is" and "as available." Emirates NBD makes no warranty of any kind, express or implied, as to this publication, including, but not limited to, merchantability, non-infringement, title, or fitness for a particular purpose or use.

Investment in financial instruments involves risks and returns may vary. The value of and income from your investments may vary because of changes in interest rates, foreign exchange rates, prices and other factors and there is the possibility that you may lose the principle amount invested.. Before making an investment, investors should consult their advisers on the legal, regulatory, tax, business, investment, financial and accounting implications of the investment.

In receiving this publication, the investor acknowledges it is fully aware that there are risks associated with investment activities. Moreover, the responsibility to obtain and carefully read and understand the content of documents relating to any investment activity described in this publication and to seek separate, independent financial advice if required to assess whether a particular investment activity described herein is suitable, lies exclusively with the investor.

Intellectual property

This publication has been developed, compiled, prepared, revised, selected, and arranged by Emirates NBD and others (including certain other information sources) through the application of methods and standards of judgment developed and applied through the expenditure of substantial time, effort, and money and constitutes valuable intellectual property of Emirates NBD and such others.

All present and future rights in and to trade secrets, patents, copyrights, trademarks, service marks, know-how, and other proprietary rights of any type under the laws of any governmental authority, domestic or foreign, shall, as between the investor and Emirates NBD, at all times be and remain the sole and exclusive property of Emirates NBD and/or other lawful parties. Except as specifically permitted in writing, the investor may not copy or make any use of the content of this publication or any portion thereof. Except as specifically permitted in writing, the investor shall not use the intellectual property rights connected with this publication, or the names of any individual participant in, or contributor to, the content of this publication, or any variations or derivatives thereof, for any purpose.

This publication is intended solely for non-commercial use and benefit, and not for resale or other transfer or disposition to, or use by or for the benefit of, any other person or entity. By accepting this publication, the investor agrees not to use, transfer, distribute, copy, reproduce, publish, display, modify, create, or dispose of any information contained in this publication in any manner that could compete with the business interests of Emirates NBD. Furthermore, the investor may not use any of the trademarks, trade names, service marks, copyrights, or logos of Emirates NBD or its subsidiaries in any manner which creates the impression that such items belong to or are associated with the investor or, except as otherwise provided with Emirates NBD, prior written consent. The investor has no ownership rights in and to any of such items.

Emirates NBD is licensed and regulated by the UAE Central Bank.

United Kingdom

This publication was prepared by Emirates NBD Bank PJSC in the United Arab Emirates. It has been issued and approved for distribution to clients by the London branch of Emirates NBD Bank PJSC which is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority in the UK. Some investments and services are not available to clients of the London Branch. Any services provided by Emirates NBD Bank PJSC outside the UK will not be regulated by the FCA and you will not receive all the protections afforded to retail customers under the FCA regime, such as the Financial Ombudsman Service and the Financial Services Compensation Scheme. Changes in foreign exchange rates may affect any of the returns or income set out within this publication.

Singapore

This publication was prepared by Emirates NBD Bank PJSC in the United Arab Emirates. It has been issued and approved for distribution to clients by the Singapore branch of Emirates NBD Bank PJSC which is licensed by the Monetary Authority of Singapore (MAS) and subject to applicable laws (including the Financial Advisers Act (FAA) and the Securities and Futures Act (SFA). Any services provided by Emirates NBD Bank PJSC outside Singapore will not be regulated by the MAS or subject to the provisions of the FAA and/or SFA, and you will not receive all the protections afforded to retail customers under the FAA and/or SFA. Changes in foreign exchange rates may affect any of the returns or income set out within this publication.
Please contact your Relationship Manager for further details or for clarification of the contents, where appropriate.

For contact information, please visit **www.emiratesnbd.com**