An eventful week from China to the US

- **Volatility spiked last week, fueled by Evergrande debt crisis and by an important Fed meeting**
- **Anxiety moderated on the former, while the FOMC confirmed the imminent start of tapering**
- **The fourth quarter will be a moment of truth for growth and markets. We are reasonably confident.**

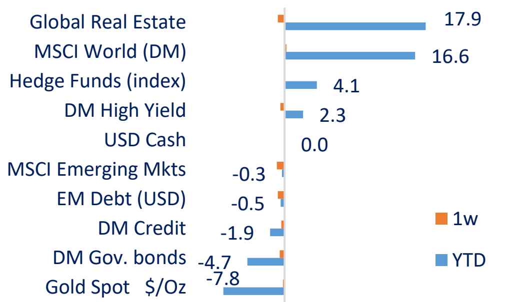
Market returns of last week looked like business as usual. Global stocks didn't move much while interest rates were firmer with the 10-year closing at 1.45%. Oil prices kept on rising, with the Brent reaching $78.

It wasn't however business as usual. The week started with markets being roiled by concerns about the ability of Chinese real estate giant Evergrande to deal with their $300bn-high mountain of debt. This situation is well known for years – which is why Evergrande was not and still isn't part of our recommended bonds- but so far many investors thought that it was "too big to fail". Concerns became panic when authorities remained silent last week, as Evergrande missed an interest payment to some banks. Anxiety moderated when Evergrande said they settled on a local note, and the PBOC made a large liquidity injection the same day.

It was indeed also an eventful week for central banks. The Fed confirmed its ability to prepare markets for less support without shocking them. The tapering of asset purchases should start in November and could be completed by mid-2022, earlier than many forecast. As per interest rates, unemployment will be the key factor to watch, but the committee doesn't exclude hiking in 2022. Closer to us, the UAE Central Bank announced the start of a carefully calibrated reduction of their highly successful pandemic support scheme. In Turkey, the CBRT unexpectedly cut interest rates despite inflation approaching 20%, in a move to support growth.

We will soon have a confirmation of the current loss of economic momentum with the September PMI data but we remain confident for Q4, as the virus situation globally improves. Less consensual optimism is not a bad thing, even if it means volatility ahead. Stay safe.

ASSET CLASSES USD % TOTAL RETURN, YTD 2021 LAST WEEK



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Cross-asset Update

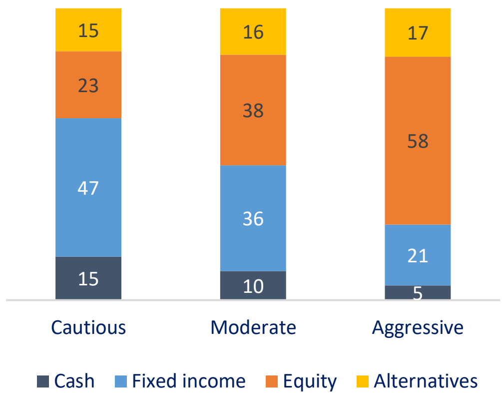
The September Fed meeting prepared markets for a change in policy, from overly dovish to more hawkish, given the announcement of a faster tapering of asset purchases, to be concluded by the first half of next year, and the possibility of an earlier tightening of policy rates. It is really not possible to know whether the Fed will implement it all, considering that it substantially represents the end of the Average Inflation Targeting framework, introduced only one year ago. If AIT was meant to be a major policy shift, whereby rates were to be low for very long to allow inflation to run above target for a while, the Fed is now suggesting the opposite, that is that there is the possibility that rates will have to be hiked sooner to quash inflation. We are not keen to quibble about message consistency, rather to point out that it is unlikely that the Fed will be able to execute thoroughly on the September announcement. A faster tapering would be negatively impacting equities and the US debt by increasing the cost of servicing it. Overall, we would not be surprised if one policy turn were to be followed by another, maybe justified by some sort of data dependency. No doubt the Fed will start the tapering, rather unenthusiastically, if anything because overly prolonged Quantitative Easing at a time when the economy has almost fully recovered is causing unsustainable imbalances, like downward pressure on shorter term rates the Fed does not want to lose control of. What is questionable is its ability to stick throughout to the plan of a faster tapering without exerting excessive upward pressure on yields, as well as its ability to start tightening soon after without crashing equities.

Irrespective of the future developments, since nobody wants to fight the Fed, markets will at least in the shorter term get aligned with the Fed’s narrative, which is bullish for the US dollar and for US equities as well, as a stronger dollar would be keeping domestic costs in check and driving exports. Insofar as investors have the impression that the Fed is following the new hawkish framework, Treasury yields will tend to rise, and gold will be leaning weaker. This scenario would not be the most favourable for EM assets, which usually do not outperform in periods of dollar dominance. This could be intersecting with not-so-temporary Covid-19 and supply disruptions, which would in turn be giving rise to a more volatile macro backdrop, an incentive itself to exit QE policies, inadequate for addressing supply-side issues.

Overall, it seems that the new Fed course alongside Covid-related issues could be marking the end of the Goldilocks period and the 60-40 equity-bond portfolio, a very resilient benchmark at times of falling yields and low macroeconomic volatility.

Overall, dollar-centric risk-assets should still enjoy a bout of outperformance into year-end, when it will be time to reassess and mark the Fed progress against its own plans.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

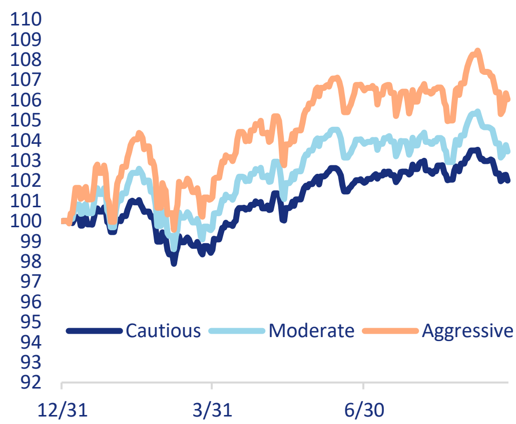


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	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

The narrative for last week can be split into two parts. It started with a large risk-off driven by the Evergrande meltdown at the start of the week. The week ended with the US Treasury yield curve steepening on the backdrop of a more hawkish than expected FOMC meeting outcome. The 10-year yields ended the week at 1.45%, i.e., 27 bps above the 2021 lows achieved in mid-August. Despite this, the yield curve looks flat in the long end. Debt ceiling resolution could lead to a steepening of the yield curve with TGA balances bolstered with larger issuance coinciding with the FED taper.

Across different segments within the asset class, we saw negative returns last week. As expected, long-duration segments such as Developed Market Treasuries, GCC Debt, Emerging Market Sovereign debt performed badly compared to short-duration assets such as Global High Yield and Emerging Market Corporate. On the other hand, Asia High Yield returns were positive due to idiosyncratic improvements in investor risk sentiments towards the end of the week.

Evergrande's $300bn liabilities include $20bn offshore bonds. We believe the Chinese authorities will move aggressively to ring-fence the fallout to protect the middle class ahead of the upcoming November Plenary meetings in line with the current theme of "Common Prosperity". The volatility should remain till the details of the restructuring are known, and as of now, we don't have a clear view of these timelines given the complex nature of both on and off-balance sheet items. The priority of the restructuring process would be to rescue the middle class who have brought Evergrande projects through upfront payments in Pre-sales deals followed by the onshore lenders, including local banks. The offshore creditors may rank the lowest in terms of recovery even though the offshore bonds have a "Senior" payment rank, effectively relegating them to the "Subordinated" level. But the news of "settlement" of onshore bonds interest payments on Wednesday and the announcement of Chinese government advice not to default on short-term dollar notes to Evergrande has improved the risk sentiment in the property sector.

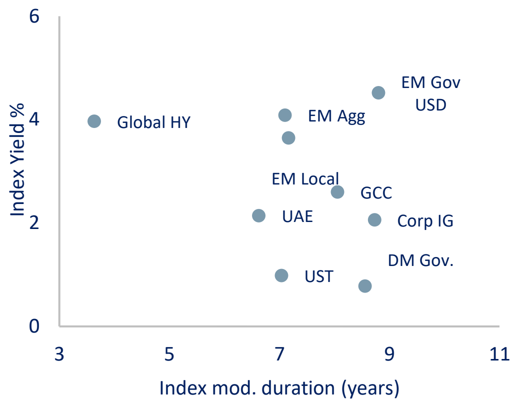
We believe current high spread levels provide an opportunity to the investors. The best route is to invest in broader Asia HY-focused funds with a clear strategy of not chasing the yield and instead focusing more on quality credits to generate returns. Such funds may sacrifice a few basis performance points in good times but would protect the portfolio against significant tail risks.

GCC debt had a comparatively weak performance last week due to its longer duration. Wider MENAT region high yield issuance from Turkey and Egypt have been under pressure. Turkey's unexpected 100 bps rate cut put a lot of pressure on the Lira and resulted in Turkish bonds selling off towards the end of the week. A lot of supply in the B grade papers, including Nigerian bonds and Thursday's three-tranche Egypt supply, has resulted in Egyptian bond prices down 3% to 5% over the week.

FIXED INCOME KEY CONVICTIONS

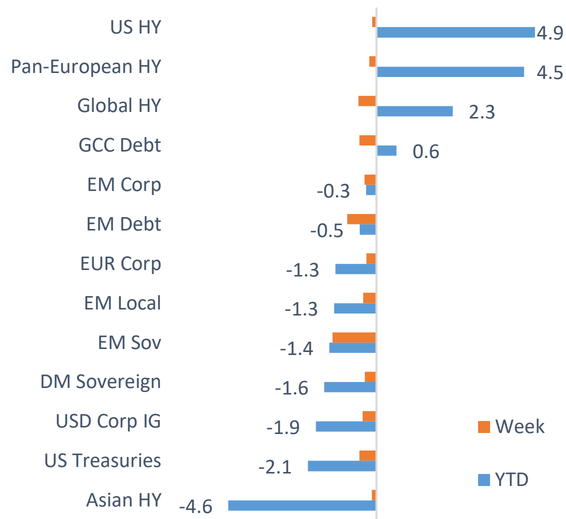
DEVELOPED MARKETS
UW Government bonds
Selective on Credit
Now NEUTRAL High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

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



Source: Bloomberg

Equity Update

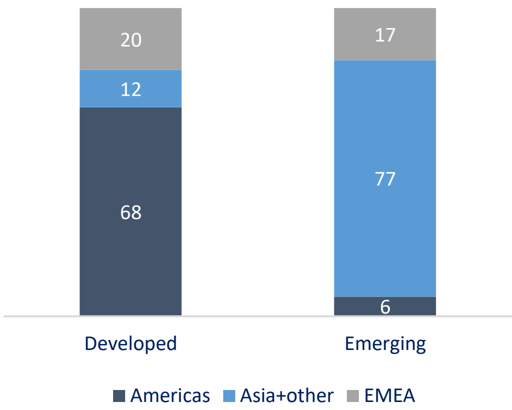
Much optimism on global travel recovery with many countries now easing restrictions. A sneak peek into the preopening of the Expo2020: some marvellous architecture with innovation and sustainability the buzz words, but also a new world order with vaccinated visitors and social distancing norms.

Global market performance was flat with the U.S. and India amongst the few to have a positive week with EM equities down a percent with the MSCI China Index losing 2.8%. The past two months have seen successive regulatory resets from China and this week's focus on property developers facing near-term funding pressures has further impacted investor sentiment. The policy goals of these measures are to promote social stability and make economic growth more sustainable by reducing income inequality and addressing imbalances. This will continue to be painful short term though will pay off in the longer term. Property developers are required to adhere to the "three red lines" – maintaining healthy liabilities-to-assets, net gearing and cash-to-short-term debt ratios –announced in August 2020, aimed to reduce systemic risks with benchmarks to curb excessive property sector borrowing.

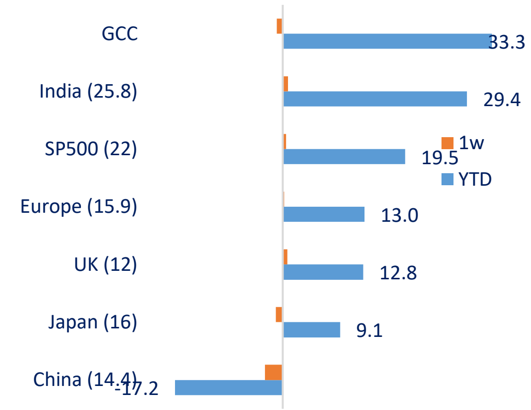
US indices erased Monday's fall to end the week positively. They reacted well to tapering getting closer and US Treasury yields up, as rate hikes are some time away. However real estate debt concerns out of China, continued stalemate among lawmakers on the debt ceiling, the Delta variant, remain concerns. Also weighing on markets is forward guidance with warnings of inflation and supply chain challenges, with Nike lowering its full-year revenue outlook. The company said it expects all geographies to be impacted from supply chain impacts, with Asia experiencing a disproportionate impact. Costco warned of higher inflation-related expenses, around freight, labor and food. European equities finished the week flat, though bond yields rose as the ECB said that it will recalibrate its monthly asset purchases with rising inflation pressures.

IPO's globally taking off with Universal Music in Europe and Toast in the U.S. with the latter's successful listing indicative of a return of restaurant business. This sets the path for listings from the internet-based shoemaker Allbird and clothes rental service Rent the Runway. Close to 300 companies have IPO'd in the US this year, raising $110bn, according to Dealogic data and including SPACS $235bn has been raised across more than 700 deals. The UAE has seen strong interest in the IPO of ADNOC's drilling unit, with 11% of shares offered at a value of $1.1bn. Abu Dhabi Exchange Chairman has said the bourse may see 10 new listings this year, following satellite operator Yahsat which kicked off the IPO rush in July, becoming the first listing on the exchange in nearly four years. As per reports Sovereign wealth fund Mubadala is preparing an IPO of Emirates Global Aluminium and ADNOC is planning to list its fertilizer joint venture in October. ADQ is possibly preparing an Abu Dhabi Ports listing . In the KSA the $1.2 bn IPO by ACWA Power is drawing tremendous interest. Saudi Telecom Co. said that its internet-services raised $966 million from an IPO, which was multiple times oversubscribed.

EQUITY RECOMMENDED REGIONAL POSITIONING

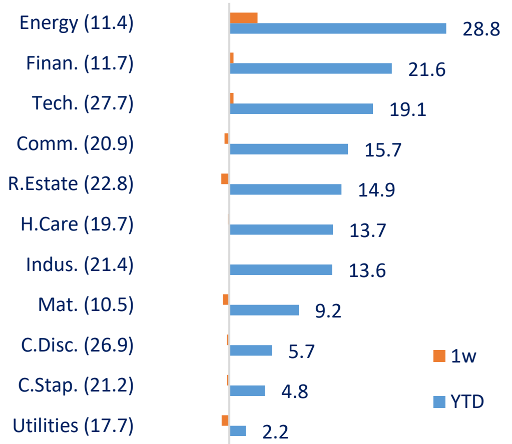


MAJOR INDICES PERFORMANCE (TR, US$) AND 2021PE



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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