Emirates NBD
WEALTH MANAGEMENT

A very **strong** first half of the year

- **The first half of 2023 ended with another positive week, and month, across most asset classes**
- **Inflation numbers were slightly better than expected in the US, but not in Europe**
- **Our monthly asset allocation committee will take place later this week**

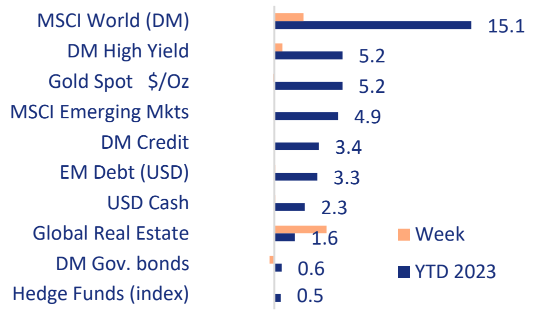
The first months of 2023 were tumultuous and volatile, amidst rapidly changing perspectives and nervous investor sentiment. However, with the picture of resilient growth and more hawkish central banks became consensual from March, volatility has started to abate, sparking a rally in risk assets. Q2 was strong, with all major asset classes in the green except for gold giving back part of its 2023 gains. The month of June displayed the exact same picture: stocks gained 6% in developed markets and almost 4% in the emerging ones, corporate credit and even listed real estate gained. Defensive assets were less sought after, with gold down -2.2% and DM govies marginally lower. Last week, finally, was all about risk assets celebrating a slightly lower than expected core PCE in the US, and ignoring the multiple hawkish comments from Fed officials.

The backdrop is actually not new, but confidence is rising about an ideal scenario combining resilient growth with abating inflation. Patience is required to get an answer, but market valuations seem to have decided that the glass is half-full rather than half-empty.

Our three investment profiles obviously had a good H1-2023 in terms of absolute return, but we are happy to say that they also did very well compared to our international competitors. We will review our positioning later this week. As we wrote many times, we see some reasons for hope to continue to support markets in the short-term but are concerned about the medium-term. As timing is certainly the most difficult item to get right, we lean towards a modestly defensive positioning.

The week ahead will be about PMIs, minutes from the last FOMC and the always-important US jobs report.

ASSET CLASSES USD % TOT.RETURN, YTD 2023 & LAST WEEK



MAURICE GRAVIER
Chief Investment Officer
MauriceG@EmiratesNBD.com

ANITA GUPTA
Head of Equity Strategy
AnitaG@EmiratesNBD.com

GIORGIO BORELLI
Head of Asset Allocation
GiorgioB@EmitatesNBD.com

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

Cross-asset Update

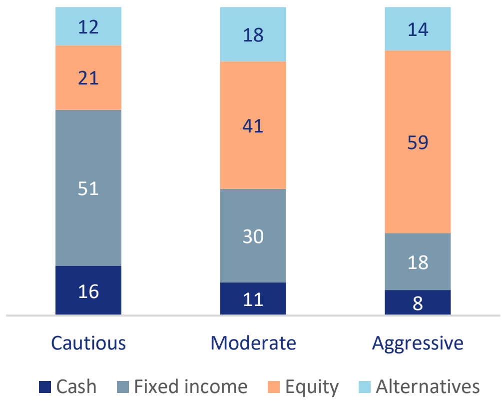
Investors have recently turned more bullish about the state of the US economy, hence about risk assets, leaving aside concerns related to growth being curbed by the Fed's tightening cycle. Since the robust May jobs report the more cyclical pockets of the market that had lagged have seen a re-rating, with industrials and materials leading right after consumer discretionary stocks. This is rational, under a scenario that we have dubbed as a 'Goldilocks interlude', that is a positive-growth-and-falling-inflation mix that historically has been supportive of equities and credit. That economic growth is positive does count, and that inflation is falling does as well, so much so that the MSCI World is +14% year-to-date, while DM credit spreads are the at their tightest for the year. Yet, although this state of affairs can last a while longer, one should not be tempted to extrapolate it indefinitely.

Strategists have been crying out about the outlook for a recession for quite some time, and we think that the dreaded event could be just delayed, rather than being outright denied. It is the transition from the Goldilocks interlude to its end that eventually should see US growth slump under the burden of tightening credit conditions. The extra buffer provided by the exceptional pandemic transfers to households should be exhausted by October-end, and policy rates will be kept high for as long as necessary according to Powell's unequivocal message at the Sintra central-bank gathering. Meantime, Quantitative Tightening should continue apace, even as the yield curve stays at deeply inverted levels, making for challenging credit conditions. All of this suggests that at some point we will be witnessing a growing tension between expectations that Goldilocks continues and fresh evidence of its demise. When that demise might occur is anybody's best guess, although most forecasts now see some marked economic deterioration towards year-end or early in 2024.

Amidst a more hawkish Fed's rhetoric and a more resilient economy longer-dated US Treasury yields should be expected to stay firm, and in the end pull back less that originally projected this year. Also, the US dollar should be in the process of bottoming out, to strengthen further once weakness in the US economy comes to the fore. Gold will have to digest the additional tightening of financial conditions, before it is ready for the next up leg.

Overall, the transition phase between the Goldilocks interlude and its end is not an easy one. The key suggestion we have for investors is that they maintain a somewhat defensive and well-diversified allocation. The CIO-Office tactical allocation tilts implemented in our Signature Funds have seen us so far this year in the first quartile against competition. We are holding back from adding to risk across the board, keeping in mind that extrapolating current conditions could cost us dearly.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

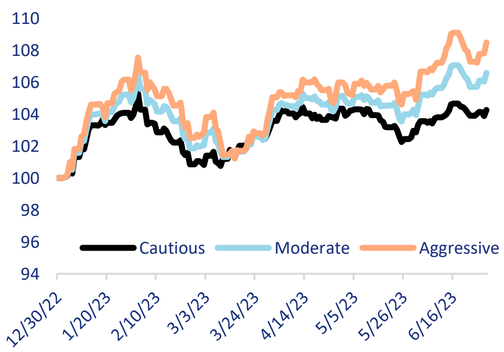


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW:Underweight/Neutral/Overweight

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

TAA – 2023 INDICATIVE PERFORMANCE



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

Fixed Income Update

Hawkish comments from Powell, an upward revision in GDP, and softer weekly jobless claims drove the rise in yields last week. The US Q1 GDP was revised higher to 2%, surpassing the previous reading of 1.3% and the consensus forecast of 1.4%. Additionally, Thursday's initial jobless claims dropped to 239k from 264k the previous week, falling below the consensus forecast of 265k. This strong economic resilience in the US has led markets to consider further rate hikes, with an 81% probability of a rate hike in July being priced by traders. The yield on the 10-year treasury touched 3.89%, the first time since March, although it settled at 3.84% after the core PCE was released. The latest core PCE index indicated some easing inflation, providing some relief to yields. On a YoY basis, the core PCE deflator dipped to 4.6%, slightly below the consensus expectation of 4.7% YoY. The yield curve inversion also deepened to 106bps, marking it the largest disparity between the 2Y and 10Y since late 1981. Contrary to yields, credit spreads have been range bound and have mostly tightened.

Short-term UK gilts experienced a 10-15bps increase during the week, with the 2-year yield near its highest level since 2008. The market is pricing the UK terminal rate at fresh highs, with policy rates around 6.20% expected by February 2024. However, analysts believe the market may be pricing too high of a probability for consecutive 50bp hikes in August and September, viewing it as an opportunity to secure some of the highest bond yields in the developed world. The UK rates spread is at multi-decade wides, both against the US and Europe.

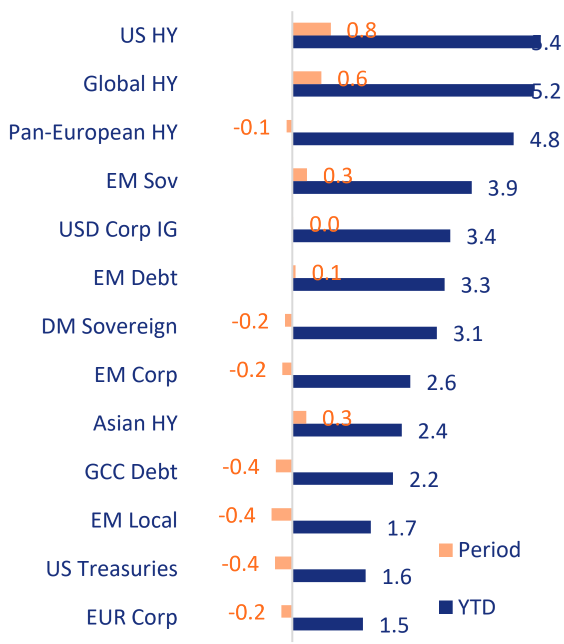
Banks maintain strong capitalization and adequate liquidity, as indicated by the results of the Fed stress test covering 23 banks. The test showed that banks have sufficient capital to absorb over $541 billion in losses, which is significantly higher than the cumulative losses during the Global Financial Crisis. All banks comfortably meet the minimum capital requirements, although they await regulatory clarity regarding the Basel III endgame and the Fed's holistic capital review. Selectively, some financials offer spread pick up.

According to the credit sights report, the US high-yield default rate is projected to be 3%, while the Euro high-yield default rate is expected to be 2% in 2023. The Euro high-yield default numbers have been revised lower due to unexpected resilience in the market. In the 12 months to May 2023, 20 US high-yield issuers and five Euro high-yield issuers defaulted on a total face value of $34.2 billion and €4.8 billion, respectively. S&P reports that global corporate defaults in 2022 exceeded the total for 2021 by 15% (83 defaults in 2022 versus 72 in 2021). These defaults reflect vulnerabilities in specific regions and sectors.

FIXED INCOME KEY CONVICTIONS

DEVELOPED MARKETS
OW Quality corporates
OW Government Bonds
UW High Yield
EMERGING MARKETS
Overall UW EM Debt
Favor quality and selectivity
OW Selectively Asia,

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



Source: Bloomberg

Equity Update

A good week, month, quarter and first half of 2023 with last week adding 2% to global equity gains, taking the first-half gains to 14% with the tech sector up +37%. June saw all major regions positive, with developed markets maintaining the lead. The surprising resilience of the U.S. economy even with higher rates led the S&P 500 to its highest close in 14 months (+17% for the first half of 2023) and the Nasdaq to its strongest first-half performance in four decades (+32%). The VIX at 13.4 is supportive of strength in the US market.

UAE markets were closed most of last week. The Dubai Index has been a strong performer with the real estate sector supported by strong off-plan sales and is up close to 20% this year. India equities continue to build on gains and consumer demand remains strong with electric vehicles in the forefront along with smartphones as digitization in the financial services grows. China is the only large region with negative YTD equity performance. Stimulus has been slow and markets still await some concrete measures.

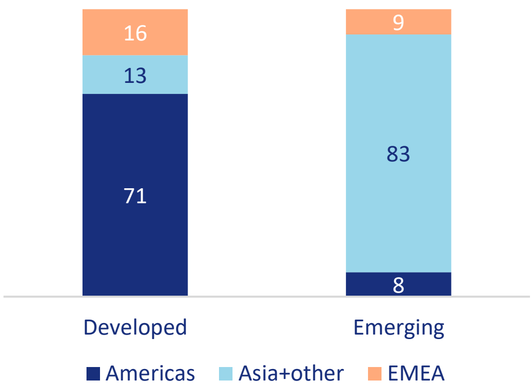
Apple hit the $3 trillion mark and the technology sector could see further (muted) gains as it continues to reinvent itself. We don’t see this as a dot.com repeat as the shares rising are largely profitable tech companies. Apple’s balance sheet is robust with plenty of cash, dividends are growing and people are spending more time on devices. The US Big 7 tech rally has led to gains of over 50% YTD with Nvidia up almost 200%. The EV sector has also rallied with Tesla stock having more than doubled and is the one sector standing out in China equities, with EV deliveries rising exponentially from China EV makers.

The narrowness of the markets remains noticeable and while cyclicals should rally next, nothing can match the phenomenal tech gains. We advocate selectivity in the tech space, with high valuations now in play. Expected stability in rate hikes is keeping growth (tech) in favour, but a well-diversified quality portfolio will counter volatility, yet take advantage of continued equity rallies.

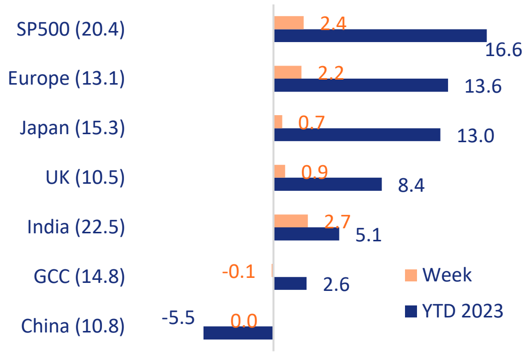
A noticeable shift to more positive positioning by investors, with hopes of interest rates peaking this half across the US, UK and Eurozone, the tail risk of the US debt ceiling removed, fears of regional banks causing a systemic financial meltdown fading and the narrative around AI which has ignited the longer duration equity sector performance. The 23 big US banks saw their first monthly gain since January after passing the Fed’s stress test and many announced higher dividends.

The US Q2 earnings season announcements start next week and is expected to be the trough in earnings, which should provide stability. Margins have been resilient as revenue growth stays positive. EM corporate earnings remain at growth levels of 10 to 20% but investor sentiment and momentum still hinge on AI.

EQUITY RECOMMENDED REGIONAL POSITIONING

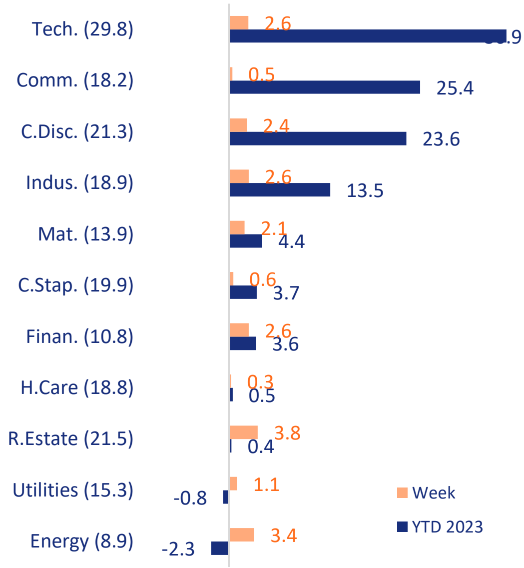


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2023PE



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

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