# No recession, no disinflation?

- **Activity data and surveys confirm a strong growth, potentially above-trend in the first quarter of 2023**
- **February Euro Area core inflation surprised to the upside, and other regions could follow**
- **Markets have revised their monetary policy forecast higher, without too much damage yet**

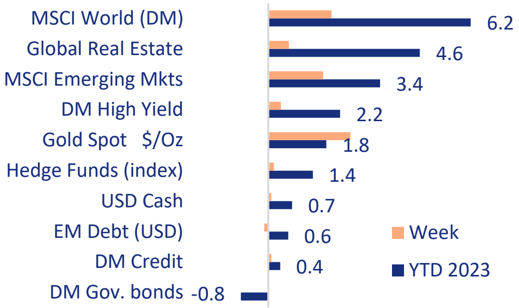
Last week was broadly positive for cyclical assets, with a rebound in stocks across developed and emerging markets in particular, while most segments of the fixed income asset class were flat or mildly positive.

This obviously feels better than the broad-based sell-off of the previous week, but it is also good news with regards to the message delivered by the avalanche of activity data and surveys released last week. Without doubt growth is better than expected, both in terms of magnitude and breadth. The crucial US ISM Services index was almost unchanged versus January at 55.1 versus 55.2, and clearly above the median forecast of 54.5. This signals robust growth, in the most relevant sector for employment in the US. This wasn't isolated. From Europe to Japan, including our region, India and China, manufacturing indices were resilient and services were in clear expansion territory, most of the times above expectations. This is good news for growth, but it obviously means that demand and jobs, the drivers of core inflation, continue to spur it. So far only one inflation report was out for February, and it wasn't good: Euro area core inflation rose 0.7% month on month.

Markets took note by repricing implied expectations for global policy rates materially higher, though with no impact on risk-aversion. Either markets are not worried and think that activity and inflation eventually will cool down, or they just welcome the stronger growth and consider they can stomach tighter financial conditions?

Time will tell. Meanwhile, our positioning is unchanged. Our allocation to risk assets favors emerging markets where, under China's leadership, policies are more pro-growth than anti-inflation. Stay safe.

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

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## Cross-asset Update

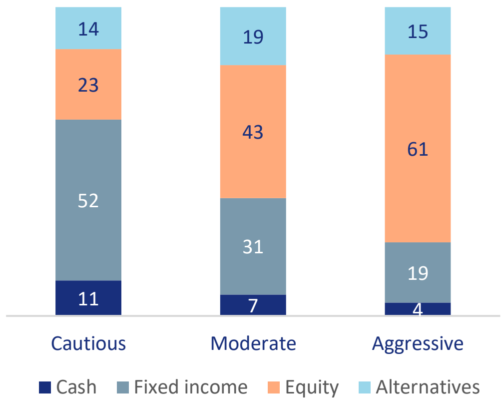
In the weekend during the annual parliamentary assembly held in March the Chinese government highlighted the achievements of the past year and submitted the budget and the target growth for 2023, set at 5%. This is a prudent objective likely reachable after the disappointments experienced in 2022, when the policy goal was missed by a wide margin. Not only must credibility be regained, but excessive stimulus is also to be avoided in Beijing's view, so as not to set off boom and bust periods, while moderate and achievable growth remains the main focus. The Chinese recovery is expected to be consumer driven, and it could not be otherwise, with the outlook for exports dominated by the uncertainty of the global business cycle, domestic infrastructure investments saturated, while consumers can tap large savings accumulated during the prolonged lockdowns. At the assembly the government said that the priority would be the boosting of domestic demand, a reference to consumer spending and business investment.

Investors could be concerned that poorer stimulus would translate into a poorer showing for Chinese markets. We view such apprehensions as misplaced. The latest business surveys portrayed a booming economy, with strength across both the private and public sectors, demand and supply. The manufacturing and the services sectors roared back into expansion territory, driven by very solid output and new orders. It is usually the case that liquidity injections lead soft data, that in turn leads hard data. Hence, the tailwinds should persist, with the economy that has just reopened and consumers unlikely to spend as big a share of their savings in the no longer so vibrant real estate sector, driving more expenditure in other items.

Since the Chinese credit impulse leads equities by about 12 months, we should expect the continuation of the current bullish leg into the first half of this year, before it runs out of steam, with the peak in equities ideally aligning with that in the impulse, projected for next June. This rally might not match the vigor, nor the time extension of the previous bull markets, supported by outsize stimulus measures, yet, it seems it is way too soon to call and end to it. Also, Beijing's cautious stance sets an important precedent in the attempt to strive for achievable growth, at the expense of leveraging shorter term gains at all costs. Going all-out on stimulus could risk an unnecessary devaluation of the yuan as investors would question the sustainability of a liquidity-driven economy amidst the dusting up of a known playbook.

It goes without saying that emerging markets will benefit from the spill-over effects of the Chinese recovery. We remain convinced about our overweight EM-versus-DM-equities call, whereby it would be preferable to be invested in cheaper markets leveraged to expansive policies driving a recovery, than in more expensive ones potentially capped by higher rates.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

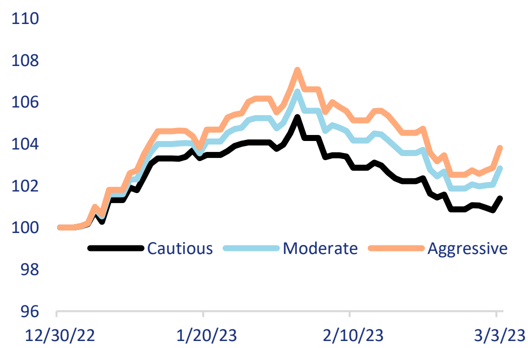



TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

The macro data released both in Europe and the US remained upbeat. The Euro flash PMIs meant the ECB would remain aggressive in the foreseeable future. The US ISM Services Index beat market expectations with a print of 55.1, cementing higher peak rate expectations. Markets currently price in a 5.44% peak rate and rates to stay above 5.3% for most of the year, with rate cut expectations towards the end of the year fast disappearing. This week we will see the crucial US Jobs data on Friday, the 10th of March.

The US 10-year yield has decreased slightly after touching 4% last week to end the week at 3.93%. The 2s10s part of the curve remains inverted at 91 bps. The yields could touch fresh highs if the Fed mulls a jumbo rate hike in March, which is still not priced in. The Fed officials, including Mary Daly and Thomas Barkin, stuck with an aggressive stance.

The OAS spreads remained range-bound last week as solid data supports credit. High Yield was the chief beneficiary of the spreads rally, and US HY returned +0.4%. It also leads the YTD returns chart, helped by its shorter duration and tighter spreads. The upward yield movement means the safest segments of Fixed Income have languished at the bottom of the table. Treasuries are the only Fixed Income segment that has posted a negative return YTD. Anecdotal evidence, such as Blackstone defaulting on one of its REITs, showcases the dangers of higher interest rates. A mismatch of cash flows when the funding markets are challenging could play havoc on any company's balance sheet. Hence, despite the recent underperformance, we stick to our call to invest in quality securities while avoiding overexposure to high yields.

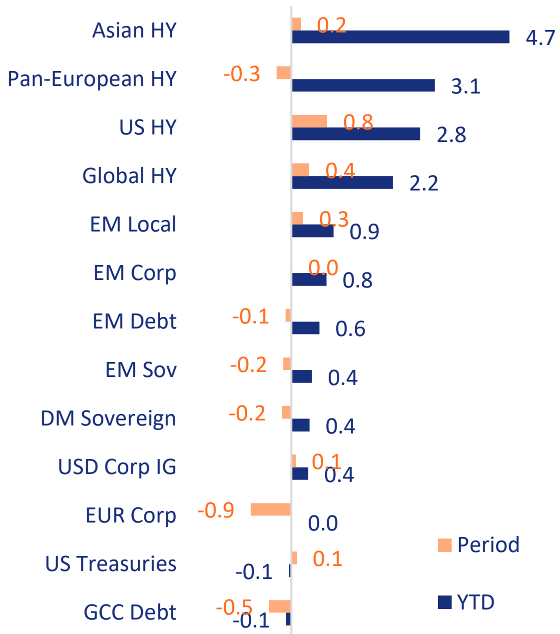
Hopes of a strong rally in Emerging Market debt received a fact check this weekend as China set a modest GDP growth target of 5% for the year. Moreover, the fiscal deficit is set to widen as the govt plans to sell 20% more govt bonds. This would put upward pressure on the yields of Chinese Govt bonds. However, there was good news for the battered Chinese real estate sector; the government announced it would target "unregulated" expansion and seek to shore up the balance sheets of high-quality developers.

Emerging Market Corporate spreads look very tight, close to one standard deviation below the historical average and at the tighter end relative to US credit. We like BBB credit from Asia, including the GREs from India, Indonesia, and Korea. Highly rated GCC quasi-sovereign and project bonds offer a decent spread pick-up to DM comparables and better stability. Some of these bonds offer high yields for longer duration and are part of our top picks for the month.

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, LatAm |

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




Source: Bloomberg

**Equity Update**

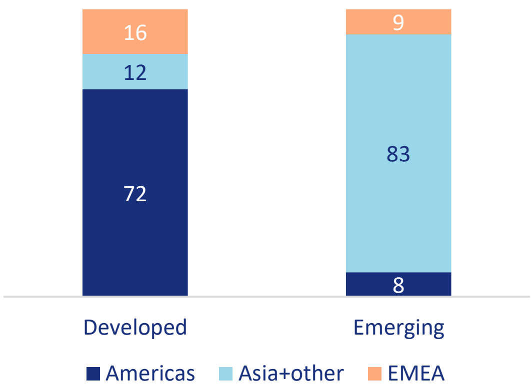
Though US yields rose with the 2 and 10 reaching close to 5% and 4% respectively, as did yields for German Bunds and UK gilts, equities had a positive week including the tech sector. Last week saw global equities +1.7%, a broad rally, largely reversing the previous week of declines. We reiterate that volatility will persist and the rise in yields is worrying, ultimately slowing growth, though current data has been upbeat and Central Banks are not yet in a "pause" mode, with inflation far from target.

Year to date the S&P 500 is +5.7% with the Nasdaq +11.9%. The US economy and earnings have been strong in 2023, termed a 'no landing' scenario, thanks to robust labor and consumer spending data and the strong performance of cyclical equities. However, higher rates could increasingly weigh on performance. It's been surprising how resilient US equities have been in the face of choppy earnings, inflationary data, and the continued shift higher in yields. The S&P 500 is close to our year-end fair value of 4000. Summing up recent economic data: headwinds include January core CPI inflation slightly stronger than expected; the service industry continues to benefit from pent-up COVID demand and labor market resilience in spite of the Fed's effort to curtail demand. Mixed signals from retail data indicating demand remains robust, as does the passing on of higher costs to consumers with revenues growing even with declining earnings, while the rate impact of "higher for longer" is yet to materially impact corporates or individuals. European equities +1% last week, lower than the US which was up almost 2%, as inflation data from Europe indicated little respite on rate rises.

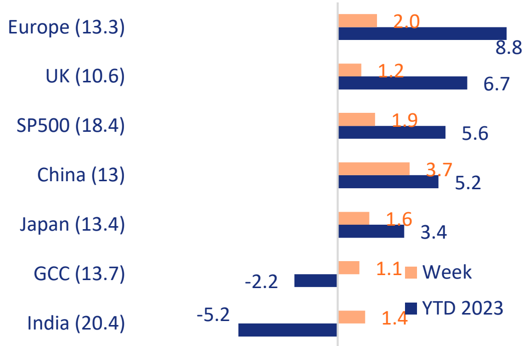
UAE equities were largely unchanged with focus on the ADNOC Gas IPO which raised USD 2.5 bn. Another eight companies including family businesses and tech entities are expected to list in Abu Dhabi this year as per the DG of Abu Dhabi's Dept. of economic development. G42, the Abu Dhabi-based AI company, is considering at least six more IPOs, including G42 Healthcare, Presight.AI and AIQ, its joint venture with UAE national energy firm Adnoc, as per Bloomberg. G42 listed its Bayanat AI Plc unit last October. Five IPOs in Abu Dhabi raised $5.37bn last year with state-related entities dominating. Abu Dhabi Ports raised $1.09bn and Burjeel Holdings $299.9mn. The government's AED5bn IPO fund is taking on IPO costs for some firms. We remain overweight UAE equities as the region continues to demonstrate economic resilience in a world with slowing growth.

China equities rallied 5% last week with PMI's supporting confidence in the reopening. We think short term should see more upside as valuations are low historically and compared to the rest of the world. China will target GDP of around 5% for 2023, Premier Li Keqiang said at the National People's Congress and also spoke of boosting domestic demand, i.e. consumer spending and business investment, would be the government's top priority this year, while imports and exports would steadily increase. Again, like India the focus is on consumption and decarbonization. India equities too, saw gains as the Adani Group continues to make efforts to reassure investors. We are overweight EM Asia.

EQUITY RECOMMENDED REGIONAL POSITIONING

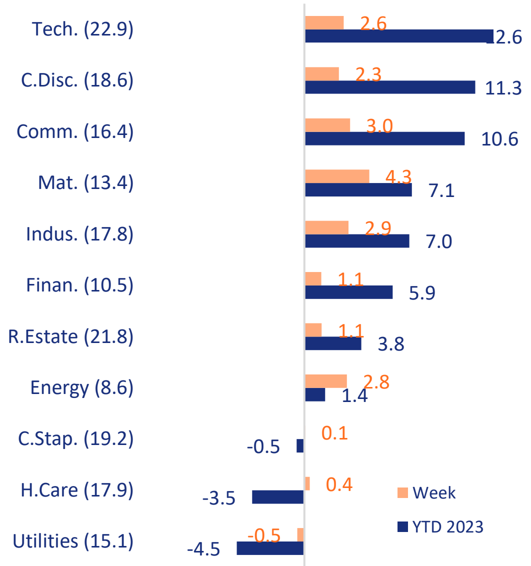



MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE




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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