Emirates NBD
WEALTH MANAGEMENT

"Close to the end, or **maybe even there.**" (J. Powell)

- **The Fed hiked but opened the possibility for a pause, with continued stress in the US banking system**
- **Meanwhile, global activity remains resilient, and the US job market is not sharply deteriorating**
- **Our stance is unchanged: the short-term outlook is not adverse, but some valuations are questionable.**

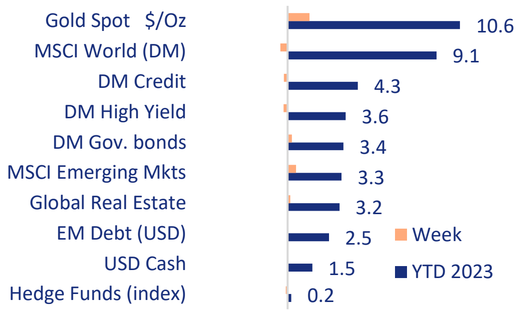
Last week was eventful and volatile but ended with pretty much flat weekly returns for most asset classes.

First things first: as expected, the Fed hiked by 25 basis points. Most importantly, their tone was a bit equivocal: opening the possibility of an imminent pause, but with ambiguity on the timing and reluctancy to talk about possible rate cuts in the future. Fed Chairman also affirmed that the US banking system is "sound and resilient". The message from share prices of US regional banks continued to be very different. Trust in banks themselves can be addressed, but the irresistible appeal from money market funds compared to plain current account deposits continues to affect liquidity.

It wasn't a bad week for activity measures: ISM and PMI highlighted strength in the services sector, and an overall marginal improvement in the global picture. The consequence is of course that inflation is not materially abating. The ECB also hiked by 25 basis points, and the mission is certainly not accomplished yet as Euro area core inflation printed at 5.60% in April. Manufacturing activity remains soft everywhere, and unexpectedly slowed in China as per Caixin PMI measure. This pushed oil prices lower, to $75 for Brent, but it wasn't a bad week for EM stocks – GCC markets were down but still outperform broader EM, China and India YTD.

Our TAA Committee, scheduled this week, is torn between a benign short-term outlook and clouds on the medium-term horizon. Our temptation is to reduce risk further and continue to increase cash. Having said that, it's more an intention that a conviction for now. We may keep our positioning unchanged for the time being: Q1 earnings are strong, investors' positioning is far from excessive, and we are already overweight cash. Stay safe.

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



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Cross-asset Update

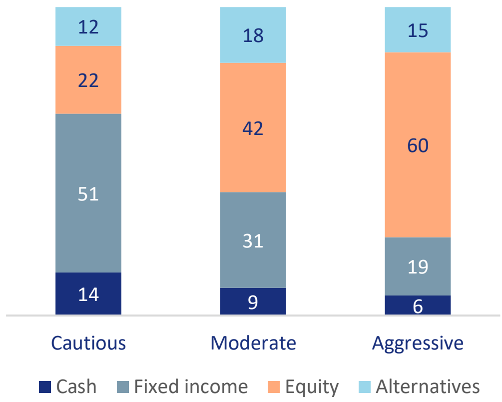
On the macro front the week started on the softer side with China's PMI data below expectations and ended on a stronger note in the United States, where a hot employment report revived animal spirits. In between, US business surveys were also leaning strong, while the JOLTS report showed the first signs of easing in the US labor market as momentum in job openings weakened to recessionary levels. The China recovery story seems to be well on track, despite cooling non-manufacturing prints, that anyway are hovering at the highest levels since 2021. On the other hand, one should not downplay the fact that the United states are slowly slowing, and that contraction risks emanate from the credit tightening expected in the banking sector, an issue possibly compounded by debt ceiling risks spiking this summer. DoubleLine Capital CEO Jeffrey Gundlach said US recession odds remain "darn high", while billionaire investor Bill Ackman and Allianz chief economic adviser El-Erian warned on ongoing risks from the banking crisis.

In this environment of slowing growth long-duration trades should be preferred, as yields are more likely to recede than rally further. Indeed, with one of the most significant contractions in money supply in US history, it is only a matter of time before inflation responds with a lag and the narrative shifts to deflation, so government bonds would be outperforming. The long-duration theme could be overcrowded in gold, since the yellow metal is already discounting a favorable policy scenario of multiple Fed rate cuts into year-end. On the other hand, the same theme should have more breathing room in treasuries, as being long duration has year-to-date been a negative-carry trade due to the inverted yield curve, so most managers have so far preferred short-duration positions.

Should one want to be positioned for growth, we still think that the developing economies geared to the Chinese recovery offer a better macro and policy mix than the Western countries. With US growth still holding up in the current quarter the emerging markets should catch up with their developed peers in the next few months. In China total property sales were positive in March on a yearly basis for the first time since the slump in the sector started in 2021. Usually, a rebound in the sector is followed by a pick-up in Chinese consumer confidence.

We still remain convinced that the best way to navigate the current market environment is to seek income in developed markets and look for growth in the emerging ones.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

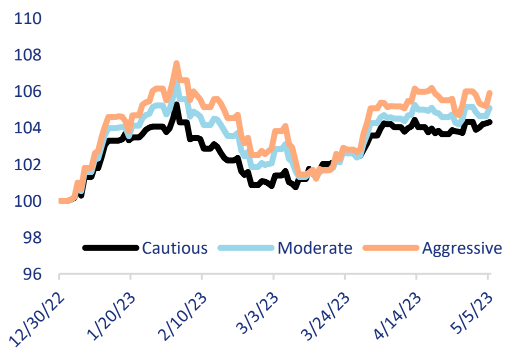


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

It feels like a weight has been lifted from the market's shoulders. Last week's FOMC decision to hike by 25 bps hopefully is the last one for this rate hike cycle. The Fed said inflation, labor market, and credit conditions data will be factored into future policy. Powell noted that the job market is still very tight, and uncertainty about how much-reduced lending from banks will contribute to a cooling in the economy is still uncertain. The Fed will also continue its balance sheet runoff. Powell said the central bank would work to strengthen both supervision and regulation for midsize banks. He also said that it's "essential" for the debt ceiling to be raised and that a US government default would be quite adverse. A day later, the ECB slowed the hiking pace to a quarter-point, as expected, and while the statement didn't offer much guidance on future moves, Lagarde said policymakers aren't done yet. Reinvestments will end in July for the Asset Purchase Program, the ECB's oldest bond-buying plan.

Despite the respite from the Fed, the US Job numbers were strong. US payroll gains unexpectedly accelerated last month, with the 253,000 increase beating median expectations from Bloomberg's survey. Average hourly earnings also came in hot, with a 0.5% increase against a median forecast of 0.3%. That was the biggest wage increase since July and brought the annual pace of gains to 4.4%, well above the 3% pace economists view as consistent with a 2% inflation rate. This resulted in the bear-flattening of the curve. The 2-year trades are above 3.9%, and the 10-year is back above 3.4%. The rate cut estimates are also slightly down, with year-end rates currently predicted at 4.35% versus 4.18% last Thursday.

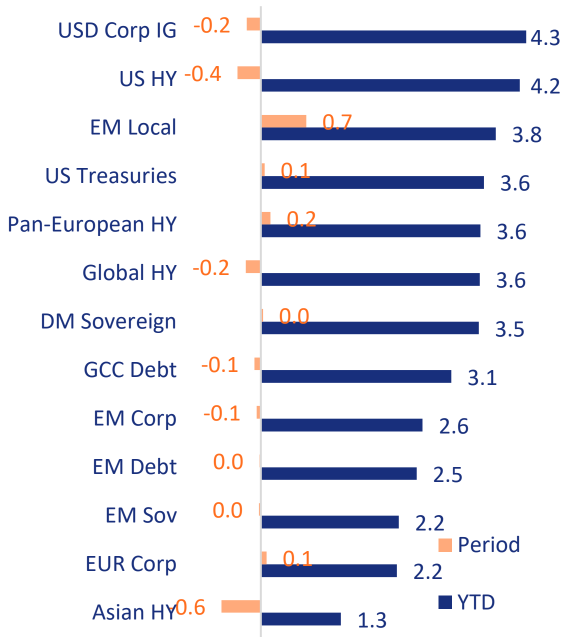
In the last seven instances of pauses, we have seen the 10-year yield go down on average by 80 bps, and there have been zero instances where 10-year yields have gone up within 180 days after the pause. IG Credit is still a preferred segment for us. US corporate default activity rose in April to a 33-month high and raised both the high-yield bond and leveraged loan default rates to 2-year highs, according to JPM. If the past is any indication, something would break before the Fed looks to cut rates, and it would be wise to avoid increasing risk at this point. The credit spreads have compressed in the six months following the pause in two instances but have blown up after that in 100% of the cases.

YTD GCC debt has outperformed the broader EM Debt by 60 bps thanks to the tilt to high-quality Investment Grade issuers. Primary issuance has seen a slowdown recently, with issuers looking to navigate the critical Fed week. UAE has announced the issuance of new AED T-Sukuks with auction dates for the 2 and 3 years announced on 9th May Tuesday. This heralds a new class of securities and presents an opportunity for investors to further diversify their currency risks.

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

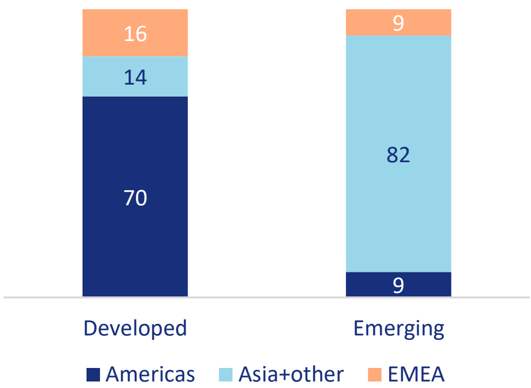
US and European equities fell last week as both the Fed and ECB announced rate hikes, with the Fed indicative of pausing but not the ECB. The Nasdaq was flat, outperforming the S&P 500 –0.78%. Continued US bank stress and concerns over US debt ceiling negotiations led to a pick-up in volatility, with the VIX spiking, after a fairly benign April. Emerging market equities+0.5%, had small gains from China, India and Dubai. Markets are still defensive with opposing forces: Q1 corporate earnings and revenue a positive catalyst, indicative of demand not waning in spite of Central bank tightening but headwinds from US bank turmoil and tougher lending conditions, looming US debt ceiling and geopolitics. Future performance remains dependent on corporate margins and the outlook for profit growth (as always).

Why have developed markets continued to rally with higher borrowing rates, tightening bank credit, slowing economic growth and higher labour costs, with the economy starting to feel the lagged effects of tighter monetary policy? Recent stresses in the banking system are further tightening financial conditions. A peak in the rate-increase cycle alongside lower positioning by institutional investors during 2022, somewhat explains why equity markets have performed better than expected. Mega-cap tech has outperformed the S&P 500 by 23% in 2023 and accounts for most of the index's 8% YTD return. The returns of Microsoft, Apple, Alphabet, Meta and Amazon have ranged from 19% to 94%. Mega-cap tech's weight in the S&P 500 index has rebounded from 18% in December 2022 to 22%. During 2022, analysts lowered mega-cap tech firms' 2023 EPS estimates by an average of 27%, as growth decelerated sharply amid post-pandemic normalization. But 1Q 2023 results for mega-cap tech saw earnings and margins beating consensus with upward revisions to EPS as generative AI is seen to aid profits over time.

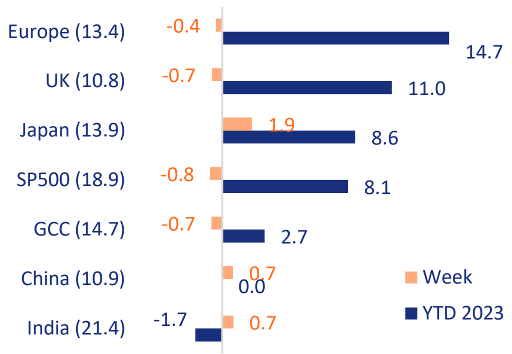
Q1 earnings season has 60-75% of companies having reported in Europe and the US. Earnings growth is tracking at -3% y/y in both regions, a positive surprise of 6% and 9% vs consensus estimates, respectively. Japan is on track for EPS growth of +14% y/y/. Apple, 6% of the S&P 500 market cap reported its second straight quarter of declining revenue $95 bn, -3% y/y but said iPhone sales surged due to strong demand in emerging markets, (India), though global declining Mac and iPad sales.

Worries about the banking sector resurged and the Global Banking index fell 2% last week, the regional US banks fell 8%. Banks' quarterly earnings have differentiated the 'haves' and 'have-nots' when it comes to deposit flows and asset sales and with four U.S.-based regional lenders having collapsed since March. Investors are concerned other banks could see their depositors flee. PacWest shares, First Horizon and Western Alliance which saw extreme sell offs have shown signs of recovering this week as no deposit runs were triggered . Shareholders of troubled banks can get wiped out, triggering a potentially self-fulfilling run on the stocks and generate a deposit flight and also make it impossible to raise equity or achieve a sale prior to a closure by regulators. . The FDIC plans to charge big banks with fees to refill the deposit insurance fund, leaving smaller lenders exempt.

EQUITY RECOMMENDED REGIONAL POSITIONING

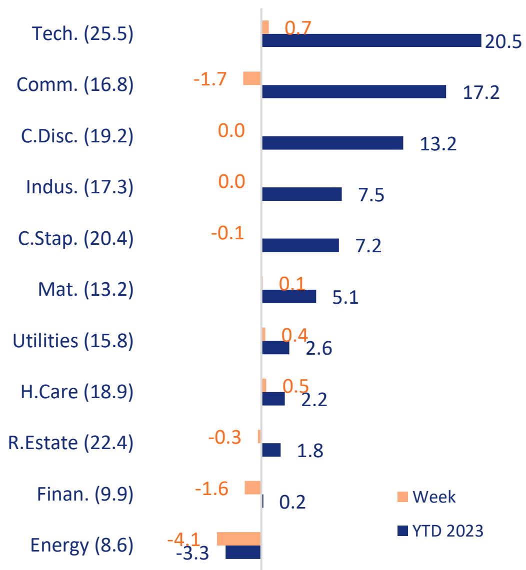


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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