# From one concern to **another**

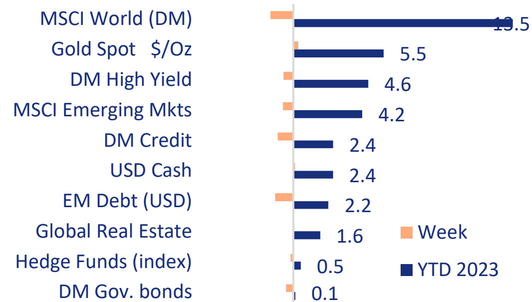
- **Last week's leading indicators were globally tepid, including some softness in services**
- **Investors are less concerned by inflation, but doubts on growth start to appear**
- **We didn't change our positioning in July: we think the "Goldilocks Interlude" is still on**

The first half of 2023 was excellent: the best H1 since 2000 for the S&P 500 in more than 20 years, to illustrate. The second half had a mixed start. Most of major asset classes had negative returns last week: stocks fell -1.4% in developed markets and -0.6% in emerging ones, while most segments of fixed income were slightly negative, following their risk hierarchy. Gold was the positive exception, up a modest +0.3%, and money markets continued to deliver their steady ~0.1% weekly return.

Last week was all about economic data, before the now imminent start of the earnings season. Overall, leading indicators were not brilliant. The gloomy picture on manufacturing activity was confirmed, but we also saw signs of softness in services, the current engine of global growth. On Friday, the US June employment report revealed 209k job creations, slightly below the consensus expectation of 230. Initial positive reaction was short-lived as markets acknowledged that it was still too strong to expect any compromise from the Fed, especially as another measure of employment from ADP was even better. A hike in July appears to be sealed, and monetary policy will not turn accommodative anytime soon, which will keep pressure on growth.

We did not change our tactical asset allocation for July. We still carry a large overweight to cash, funded by a modest underweight of all other asset classes, especially alternatives. We favor EM within stocks, and quality within fixed income. Together, this makes us slightly defensive, not outright bearish. Diversification works fine in 2023 and our level of conviction is not high enough to be more radical. The week ahead will provide corporate earnings for Q2 as well as monthly CPI and PPI reports across regions. The "Goldilocks Interlude" will end, but not necessarily right now.

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





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**Cross-asset Update**

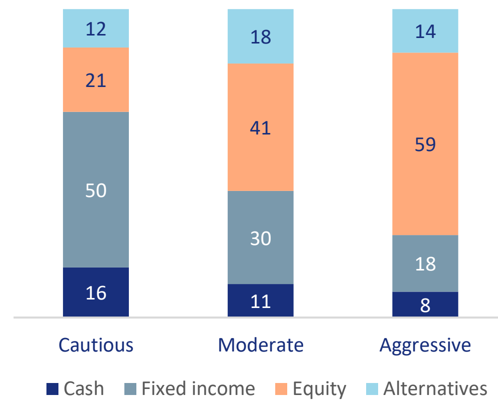
Inflation falling and growth holding up in positive territory has been a boon to financial markets, making for a very constructive macro backdrop that we can dub as the return of Goldilocks. As long as inflation continues to fall, and hard data hangs in there, markets won't buckle. Indeed, the gap between soft and hard data has continued to widen, and investors will want to see some deterioration in the real economy before they decide to sell risk assets. Yet, we hold the view that the US growth slump is delayed, and not denied. The yield curve is deeply inverted, the lagged effects of the cumulative Fed's tightening have yet to be felt and QT continues apace. This suggests that eventually the economy will have to buckle.

With no rate cuts in sight this year, at least taking Powell's words at face value, a more hawkish Fed and US activity only slowly slowing, Treasury yields are headed higher and are likely to land at higher levels at year-end than originally projected. DM government yields closed the week at a 15-year high, and the US 10-year yield settled comfortably above 4%, at 4.06%. We have revised the 10yr-yield fair-value higher to 3.4% from 3.1%. According to some studies a no-recession call would justify it lingering around 4%. Hence, the new fair value takes into account the start of a slow-down phase towards the latter part of this year, with a more marked deterioration to be expected only in 2024.

A slowing economy signified by a deeply inverted yield curve bodes well for gold, while the absence of rate cuts this year caps its upside. In the shorter term, as much as positive economic surprises and a more hawkish Fed are net negative for Treasuries, they are for gold as well, that is currently pulling back from its May highs. Yet, money markets will at some point start to discount rate cuts as the economy shows cracks, possibly in Q4, and investors ponder about the worsening trajectory of business activity for 2024. Hence, we have revised our year-end fair value slightly higher, from $1,950 to $2,050/oz. Investors are advised to buy on weakness, possibly below $1,900, to aim for $2,050, or higher, depending on the degree of resilience of the economy and how geopolitical risks evolve. Indeed, on the Russia-Ukraine front it is very hard to be optimistic. Both sides digging in and the respective regimes fighting for survival suggest an accident is just waiting to happen.

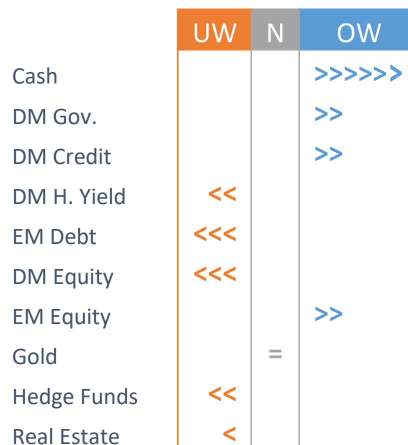
In summary, while in the shorter term long-duration assets like gold and Treasuries could see further modest losses, cracks in the economy should eventually offer some support later this year. We hold the view that gold and Treasury weakness should be faded.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



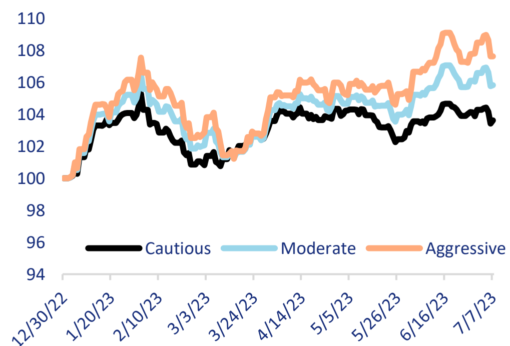

TAA – RELATIVE POSITIONING – MODERATE PROFILE

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**

On Friday, the yield on the 2-year Treasury note decreased to 4.95% after touching a 16-year high yield of 5.12% during the week. The week was data-driven. The FOMC meeting minutes showed that "almost all" participants expected further rate increases this year. The US NFP data released on Friday showed a slightly lower number of 209K compared to the market expectation of 230K. The unemployment rate fell to 3.6%, while average hourly earnings rose 4.4% from the previous year. Despite the numbers falling below expectations, the labor market remains robust. The yield on the 10-year Treasury note increased by approximately four basis points to 4.06%. Traders, however, continued to anticipate more rate hikes. Investors are now focusing on September and eagerly await the upcoming inflation data on Wednesday, which will be a crucial point of information.

The stronger demand for investment-grade bonds has led to a compression of spreads in the investment-grade segment. The spreads are near the medium of the 20-year horizon and remained unchanged during the week. We have also witnessed a compression of spreads in the high-yield segment on a YTD basis. However, the spreads in the global high-yield segment widened by 10 basis points during the week. The strong economic growth is keeping high-yield spreads low, but concerns about higher bankruptcy filings and future recessions may lead to spreads widening down the road. We maintain an underweight position in the high-yield segment.

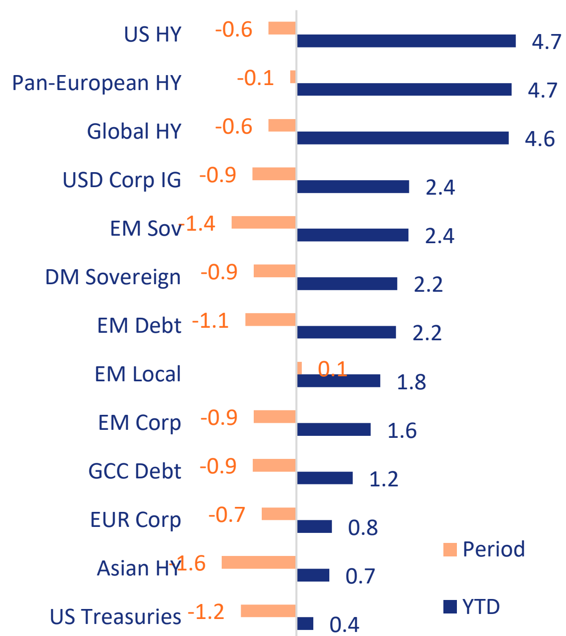
Starting in 2021, the Bank of England has implemented thirteen rate hikes, resulting in a significant increase in UK Gilts. The yields on 2-year and 10-year UK Gilts are currently near their highest levels since 2008. Market expectations imply a policy rate hike of 150 basis points within a year. The 10-year UK Gilt has risen by 100 basis points, from 3.7% in January to its current rate of 4.68%. Furthermore, during the week, the UK conducted an auction of two-year government bonds, selling £4 billion at an average yield of 5.668%, the highest yield for that maturity in this century. The gilt, with a maturity date of October 2025, was initially launched in January with a yield of 3.634%.

Moving on to the region, the week began with primary issuances. One real estate 5-year sukuk will be priced today, while we expect the ADIB perpetual sukuk to hit the market tomorrow, subject to market conditions. The proceeds from the ADIB's issuances are expected to be used for refinancing the existing AT1, which has a call date in September 2023. During the week, we saw Egypt's spreads widen by 30-50 basis points.

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

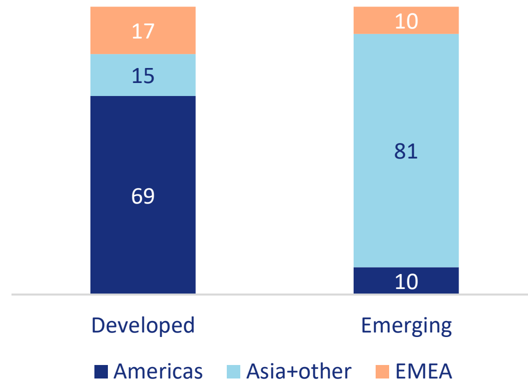
Equities broadly lower last week and developed market sovereign yields higher, however, no sell off on longer duration sectors i.e., technology. Emerging markets had a better week than developed though both ended down. The GCC was the best performer last week with the Dubai Index a standout +4.5% and India next best, though unchanged. We held our tactical asset allocation meeting and reduced the underweight on equities (post a reset of our models following the strong equity June rally), leading to a smaller Developed market underweight and a smaller Emerging Market overweight positioning. We see DM equities as range bound with limited upside (quality the focus) and a 10%+ return for EM equities.

DM valuation multiples have been revised higher, on a stronger economy and the AI factor pushing up equities, and we have a 4,500 year-end fair value for the S&P 500. Remain neutral US equities and overweight Japan. A strong labour market is a positive sign for the US economy, but the Fed would see this as support for rate rises and we see credit tightening a concern for US corporates (smaller cap). Japan equities remain the best performing DM and the Bank of Japan is expected to continue its accommodative monetary policy. This should boost exports as low rates would support corporate access to low-rate funding and profits. The yen trading at 145 to the USD also favours exports.

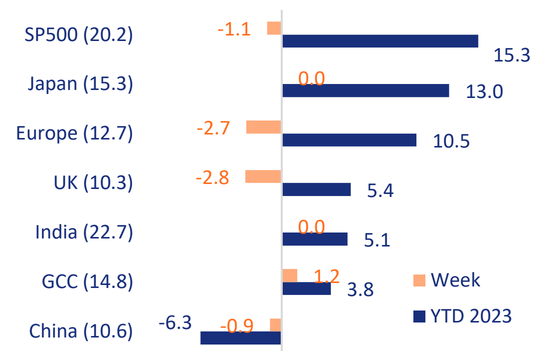
Within emerging markets we continue to have a preference for the UAE, the Dubai Index is +24% YTD, while the Abu Dhabi Index -4.5% YTD. Real estate development sector is supporting Dubai Index performance and in both markets IPO performance has been stellar. Close our call on EM Asia and move that to a preference for India, with secular support from higher growth potential with favourable demographics, supply-chain relocations, as well as stable political alliances. In China a post-pandemic rebound has not materialized as yet. The economic recovery has not shown the expected consumption-led upswing amid a slower rebound in spending, while stimulus measures have so far been limited to minor interest rate cuts. Chinese consumers, worried about financial stability post harsh Covid restrictions remain reluctant to make major purchases. China is imposing restrictions on exports of gallium and germanium, and the supply conflict with the US around tech and essential minerals continues as the Biden administration plans to restrict Chinese companies' access to U.S. cloud-computing services. Treasury Secretary Yellen's visit to China could ease tensions. Chinese stocks have fallen more than 20% from their peak in late January, into a bear market at a time when global equities have risen above expectations.

Technology continues to trend up aided by AI momentum (the big 7 over 50% YTD). Another stand out are global EV stocks (Tesla, Rivian, Byd) that continue to rise. New social platforms: Meta said more than 30mn people had signed up to Threads in two days, its competitor to Twitter. We would continue buying profitable tech, and we also see upside in defensive healthcare with medicines treating obesity the latest trend. Eli Lilly became the world's biggest health-care company by market value, the leader in drugs to treat obesity.

EQUITY RECOMMENDED REGIONAL POSITIONING

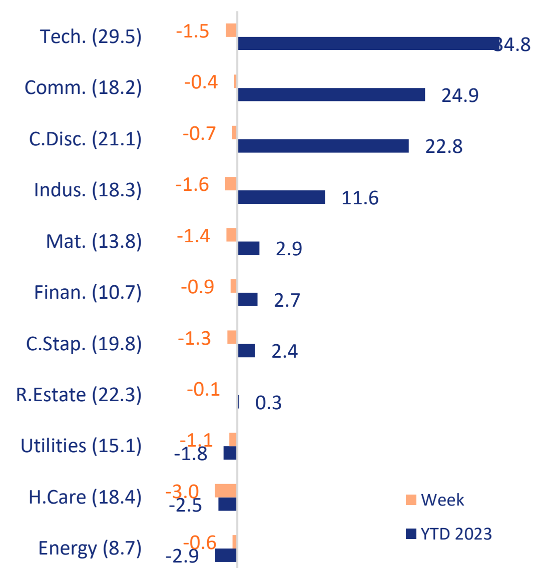



MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE




Source: Bloomberg consensus. MSCI Indices unless specified.

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




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

Emirates NBD
WEALTH MANAGEMENT

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