Emirates NBD
WEALTH MANAGEMENT

We are not done with **unpredictability**

- **Fed chairman reminded markets that the probability of more hikes is well above zero**
- **Volatility came back last week, especially on bonds, though the "soft landing" scenario still prevails**
- **All eyes will be (again) on the US this week, amidst economic releases and frantic political negotiations**

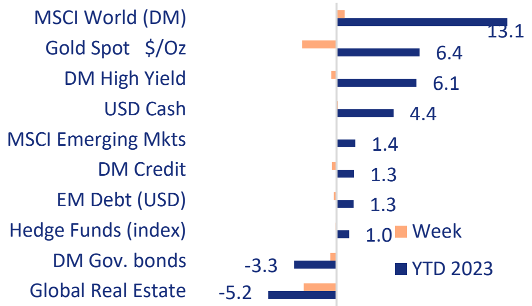
Last week was clearly less buoyant than the previous one, with some return of volatility after Fed chairman Powell delivered a speech emphasizing persistent inflation and questions on whether policy is restrictive enough. He said the Fed won't hesitate to hike if needed, which combined with a relatively disappointing US Treasury auction brought back some bond anxiety.

Markets obviously didn't appreciate, as the recent strong rally was all about the end of the current hiking cycle. But it was contained to the fixed income asset class, down with higher treasury yields across the curve, without pressuring equities. The idea of a soft landing remains the dominant narrative, with the spectacular US leadership on global growth at its core, while the rest of the world continues to evolve below trend.

The medium-term question is of course about the sustainability of US exceptionalism, with unfortunately limited probability to see the alignment coming from a massive reacceleration of Europe or EM. The more immediate, short-term question is about the inflation situation in the US: we will know more this Tuesday with the monthly CPI report. The week will also provide retail sales and industrial production for major regions. We will also probably see heated debates in Washington around the government funding, as the previous agreement comes to an end on the 18th. It's not unreasonable to think that given the geopolitical context and the recent warning from Moody's, the only major credit agency giving the US a AAA, some form of compromise should be found.

Our positioning is unchanged, with only a modest defensive tilt, but we remain vigilant. The year of unpredictability is certainly not over.

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



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Cross-asset Update

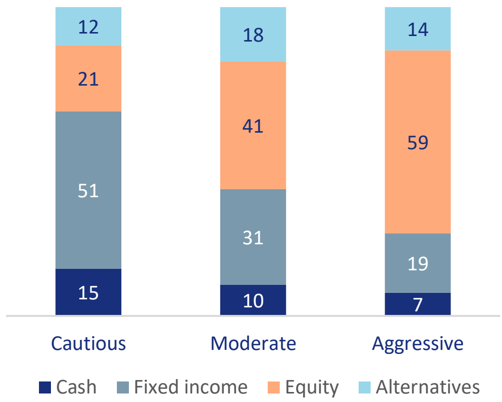
Markets continued the rebound that started two weeks ago on depressed sentiment and a benign jobs report. A whiff of Goldilocks is back in the United States, with moderating and positive growth, a disinflationary process underway and the Fed expected to be at the end of its tightening cycle. It does not matter that Powell gave a hawkish speech at the IMF, investors just go by the favorable trajectory of inflation and macro data, so no rate hikes are being priced, and actually cuts are seen starting from Spring/Summer next year. If the credit cycle holds up despite the tight credit conditions highlighted by the latest Senior Loan Officer Survey, there is reason to think markets will proceed higher. And yields will do as well, according to the new high reached by the University of Michigan long-term inflation expectations that drive the Treasury term premium.

US exceptionalism must be contrasted with the rest-of-the-world that is just holding up. Europe is in bad shape, as per the September retail sales, sinking business confidence and the yet to be felt effects of the ECB tightening. On the other hand, in China conditions are improving on the margin with the Producer Price Index versus a year ago negative but rising, and positive import prices YoY% signalling improving domestic demand. So, there is rising odds that eventually the Chinese economy will gain traction, that in turn alongside US resilience should see markets continue to edge higher.

Overall, the outlook for a soft- or no-landing is gaining traction. Equities should not sink, nor spreads widen significantly, especially considering depressed investor sentiment that usually is a contrarian indicator with regards to the performance of risk-assets. Yet, the final equilibrium is unlikely to be a stable one even in the case that a recession is avoided. The US Treasury implicitly pushed back on longer-dated yields rising above 5% by shifting auctions towards T-bills, a decision that loosened financial conditions. If this stance is maintained in future auctions and the economy remains strong, inflationary pressures could reawaken and yields go past 5%, that in turn would see markets break with tighter policy yet again in the picture.

In summary, although US exceptionalism is upholding domestic equities and markets globally, doubts about its sustainability remain. Investors are advised to focus on quality investments across asset classes, giving up some gains should markets skyrocket higher, not our base case, while increasing chances of outperformance under conditions of rising volatility.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

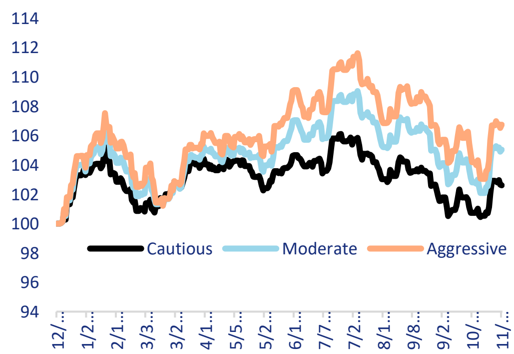


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 was not a heavy macro data week. However, recurring applications for US unemployment benefits rose for a seventh straight week, adding to evidence that the labor market is cooling. Continuing jobless claims, a proxy for the number of people receiving unemployment benefits, increased to 1.83 million in the week ending 28th October. Initial claims ticked lower to 217,000 in the week ending 4th November. These two releases are crucial to forecasting unemployment trends. As long as they stay in the range last seen pre-COVID, analysts predict US employment rates will remain below 4%.

However, the whole focus was on the first coupon note issuances from the US Treasury after the Quarterly Refunding Announcement of 1st November. This is what had started the bond rally after all. The 3 and 10-year note auctions went on smoothly last Tuesday and Wednesday. However, an ugly 30-year auction reversed market sentiment on Thursday. The earlier 50-bps Treasury rally had reduced the long-end yields to unpalatable levels for investors. According to Bloomberg, the auction of 30-year bonds tailed the when-issued by more than 5 basis points, one of the worst results this decade in the sector. The 24.7% primary dealer award was the highest in two years as the indirect award fell to 60.1%, indicating poor investor demand in the auction. We saw immediate repricing of the whole curve led by the long end. The 10 and 30 years went up by around 20 bps intraday before settling slightly lower at 4.62% and 4.76%, respectively.

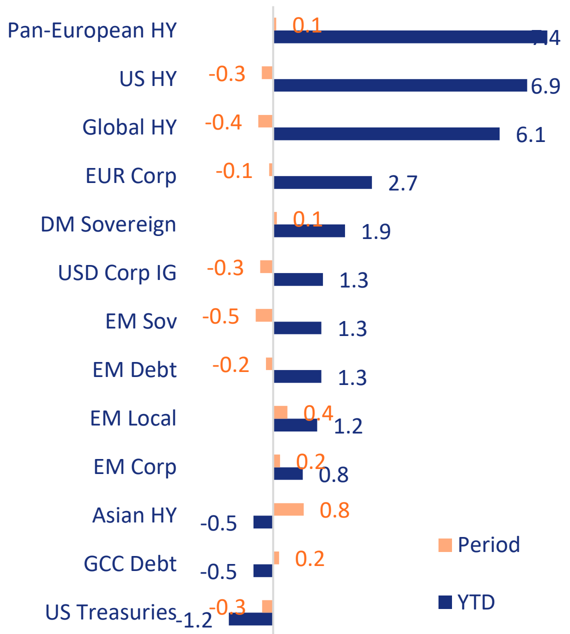
Then came Powell with his hawkish tilt at the IMF annual research conference. He pushed back on the idea that the US central bank is done with rate hikes. He said officials are not confident they have reached a stance that will get them to 2% inflation and emphasized that they will “not hesitate” to tighten more if needed. While many analysts believe that the Fed is done for this cycle, the hawkish rhetoric may continue until we see significant inflation improvement.

Last but not least, Moody’s, the last major rating agency to maintain the highest rating of Aaa for the USA, announced that it had downgraded the outlook to negative on the US sovereign debt while maintaining the rating. The agency highlighted rising political polarization and increased fiscal spending as two of its major concerns. It is difficult to find fault with the rationale. The debt to GDP ratio has crossed 130%, and interest cost to revenue has also crossed 30%. While we do not assume for a moment that US default is approaching, investors will continue to demand higher premiums to hold Treasuries. This should serve as a wake-up call to the country's policymakers to get their act together so that the plumbing system of the global debt markets remains intact.

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

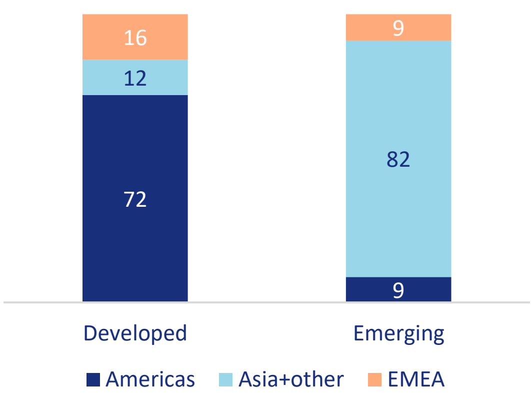
Another positive week for equities (+0.5%) following the earlier week's mega 5% gain, though not as broad based, with only the established year-leaders adding to their performance. Technology led returns with the Nasdaq +2.4% last week, the S&P 500 +1.4% at 4415 (above the key 4000 level and the 100-day moving average, seen as bullish) and Japan equities +2%. The Nasdaq is now up 10% in 11-days, and the big 6 tech +15%. Global tech gained 4% with YTD returns now at 40%. Microsoft made a new high and Nvidia has gone up for 8 straight sessions. In emerging markets, India and the UAE gained around a percent. Oil is lower, positive for Indian markets. What hasn't worked this year: China equities, global banks, utilities, Russell 2000 and real estate.

The US 10-year yield is recently in a range hovering around 4.6%, more favourable for growth equities. Last week saw China's biggest bank ICBC hit by a cyber-attack, a somewhat disappointing 30-year US Treasury auction, a stern tone from Fed Chair Powell, ECB President Lagarde talks of higher rates for longer, resulting in slightly higher DM sovereign yields. A continuing toll from the Hamas Israel conflict, weighing on sentiment.

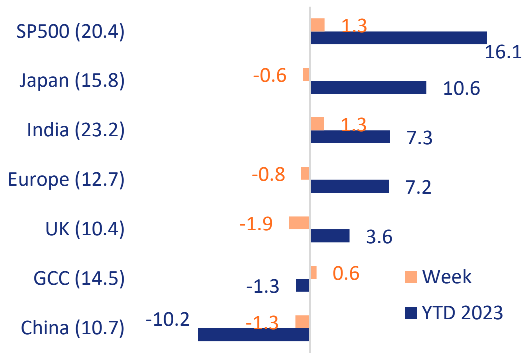
China's CPI fell back into deflation territory in Oct (-0.2% vs. 0.0% in Sept) while PPI deflation deepened to -2.6% (vs. -2.5% in Sept). Alibaba and JD.com saw low-single digit growth in gross merchandise value during the Singles Day sales and deep discounts, as per early reports. The debate on investing in China is around long-term structural challenges on debt and deflation fronts, and could continue well into 2024. A sustainable China equity market recovery is still some time away, with mounting macro pressures on earnings coupled with currency weakness. Reflationary measures and debt restructuring are getting into shape but more is needed. We are neutral China.

For Q3 2023, with 92% of S&P 500 companies reporting actual results, 81% have reported a positive EPS surprise and 61% a positive revenue surprise (FactSet data). The blended earnings growth rate for the S&P 500 is 4.1% YoY. While we are nearing the end of the earnings season, big consumer companies report this week: Home Depot, Target, Tyson, and Walmart. Cost pressures have returned to the top of S&P 500 management's minds in 3Q. Labor is being discussed more frequently on earnings calls. Rate-sensitive sectors, like real estate and financials, have the most pessimistic forward guidance, while sentiment in the energy industry remains positive.

EQUITY RECOMMENDED REGIONAL POSITIONING

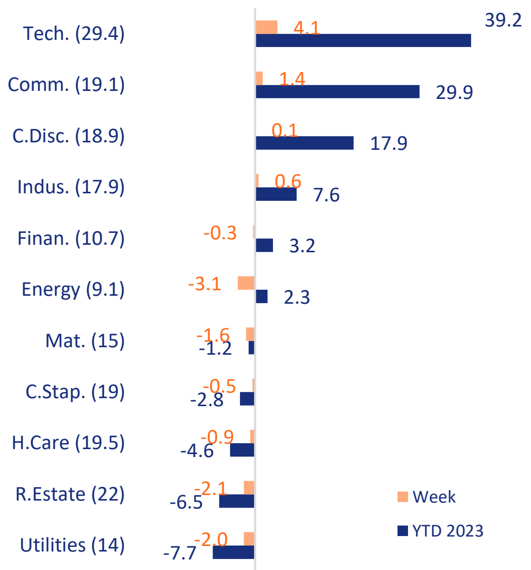


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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