Emirates NBD

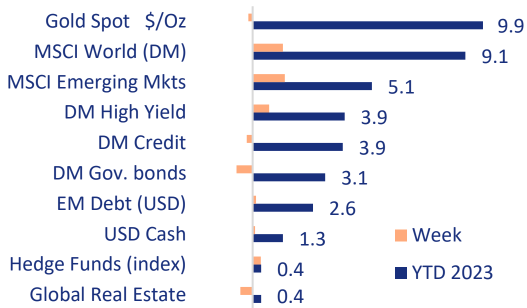
PRIVATE BANKING

- **Last week was reasonably positive for global markets on the back of equity gains**
- **US core inflation printed above expectations, but central banks confirm more nuances ahead**
- **Cash is king: we increased money markets in our tactical asset allocation, after a very positive Q1**

US monthly inflation numbers were released last week. Headline CPI moderated more than forecast, to 5% year-on-year, thanks to energy and to some extent food. Crucially, core price pressures confirmed their stickiness, picking up from 5.5% to 5.6% YoY. Factory gate prices -PPI- decelerated but the situation is clear: core inflation is way too high. Without stress in the banking sector, this would have justified an inflexible Fed for the rest of 2023. But the financial system matters. The FOMC minutes revealed staff expectation for a mild recession starting later this year, as well as a lower core PCE forecast for 2024, now at the desirable 2% mark. Banking stress will pressure credit supply, which is another way to tighten financial conditions. As a result, while we expect the Fed to increase its policy rate by 25 basis points in May, this can be the last one before a pause. Markets liked it, and they are now pricing-in, again, outright cuts into the end of 2023.

After a very positive Q1 for our strategies, which outperformed competition with returns between 3.6% and 5.1%, we decided to make some changes. We start Q2 with a material increase in our cash allocations. USD/AED cash does not only provide protection and flexibility, but also significant risk-free returns. We reduced hedge funds and the riskiest segments of fixed income against this increase. Our positioning is overweight cash, underweight alternatives (except gold, neutral), underweight fixed income (but clearly overweight the safest segments) and neutral equities (with a preference for emerging markets). A perfect scenario is possible, but it is increasingly priced-in and unfortunately never assured. Volatility could come back, and we are positioned to keep optionality, without being outright defensive. Eid Mubarak (in advance).

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



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Cross-asset Update

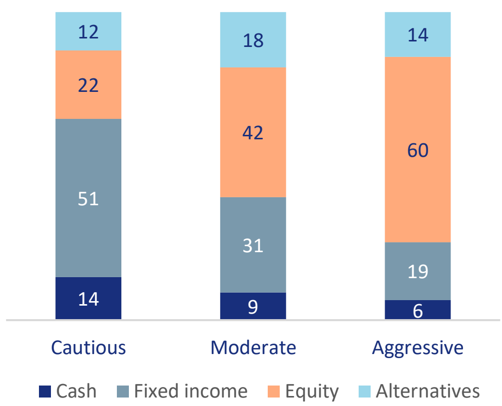
In spite of some doom and gloom revolving around the most expected US recession in history, risk assets have been quite upbeat of late, with DM equities +8.6%, their EM peers +4.6%, and global high-yielding corporate bonds +3.6% year-to-date. Still solid macroeconomic trends and the renewed expansion of the Fed's balance sheet under the Bank Term Funding Program have played a role in upholding animal spirits. Also, inflation has trended down, supporting the view that we are approaching the end of the tightening cycle. As a consequence, technicals have also developed positively, and volatility has been trending down. We hold the view that we are in a situation where the medium term outlook is negative, although the bear market rally can get extended in the shorter term. A few more acceptable macroeconomic readings plus the Fed-induced market liquidity remaining elevated for a little longer would be playing the trick, but we cannot possibly count on both to persist for too long.

Can equities have fully discounted a negative outlook given the current valuations? We would remark that they must certainly have priced in a benign inflation scenario, yet high valuations ill account for the negative bottom line growth projected by consensus. Those valuations currently imply investors are looking through any possible spell of bad news, to which equities remain vulnerable. It is difficult to be able to tell when the effects of the credit tightening due to deposit withdrawals will have a visible negative impact on the US economy. All we know is that it will, and Janet Yellen herself candidly remarked that lenders may pull back on credit in the wake of recent bank failures, and that would partially be doing the Fed's job. On top of this, the March FOMC minutes more explicitly considered a mild recession as its base case.

As for liquidity, one trigger for it to be drained from markets could be provided by the US debt ceiling issue. Awaiting its resolution the Treasury has run down its cash at the Fed and reduced its supply of Treasury bills. Once Congress either raises or suspends the limit, the Treasury will have to significantly raise debt issuance, removing market liquidity at a time when macroeconomic surprises could also be inflecting lower.

We do not see gold under this scenario offering significant downside protection. The yellow metal has so far been rising with equities chasing the allure of the end of the Fed's tightening cycle, and a sharp slowdown would see it pull back with them. Depending on the severity of the future slump in growth, either treasuries would be outperforming in case a recession is not avoided, otherwise IG bonds would.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

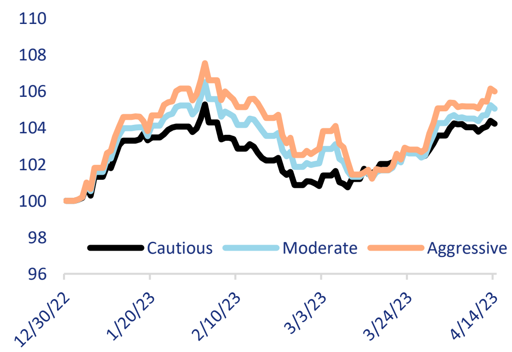


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

There is a multitude of factors influencing the rates market at present. On the one hand, we have resilient growth and sticky inflation, while on the other, we have emerging weakness in soft macro data surveys with increasing fallouts from the credit tightening currently taking place. Therefore, central bank actions and interpretation of the economy take immense importance. Our base case for a 25 bps hike in the May FOMC meeting is more than 80% likely. The DM tightening cycle has entered its last phase, and from Q3 onwards we may see the long expected central bank pause. After a sharp steepening of the 2year-10year part of the curve during the banking crisis, we have seen gradual flattening with the current inversion of the curve at 60 bps. The 10-year US Treasury yield has climbed above 3.5% again, and the 2-year closed on Friday at 4.09%.

Credits were well-behaved well last week. Spreads narrowed modestly over the previous few weeks as positive technicals balanced weaker fundamentals. The spreads were range bound heading into the earnings season. For IG, it is a mix of strong technicals due to lower issuance and other supporting factors, including a conservative balance sheet outlook and upcoming Fed pause. High Yield bond spreads tightened by 24 bps and are near the median for this year's range. Emerging Market spreads have tightened considerably since mid-March as the effects of the banking crisis seem to have moderated.

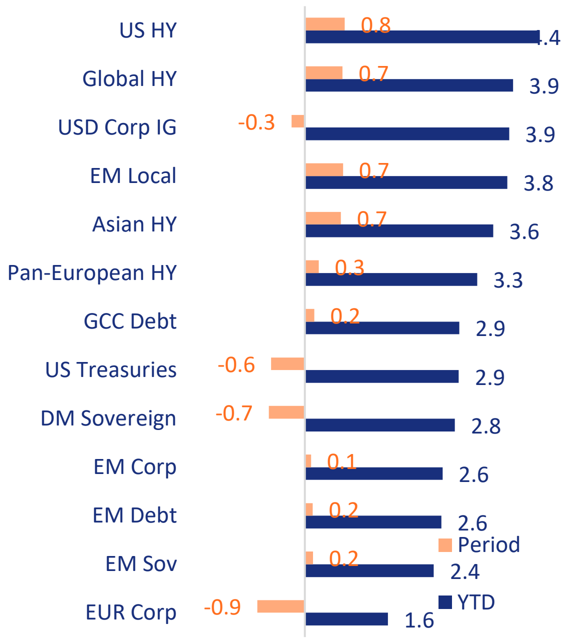
According to a recent report from S&P, following 14 defaults in March, the global corporate default tally rose to 37 this year- tied with 2016 for the highest year-to-date default tally since 2009. By region, nearly two-thirds of defaults this month were from the US, where credit conditions deteriorated further in March amid banking-sector turmoil and expectations that the US will slip into a shallow recession. The rating agency expects the 12-month default rate for the US to reach 4% by year-end. This supports our recent decrease of weight to High Yield in our Monthly asset allocation committee meeting for April. We added to DM Govt treasuries and cash to increase our ability to navigate market turbulence.

There has been a total of $132 billion in dollar-denominated primary issuance across emerging markets to date, with the GCC region contributing $28.7 billion. Last week, we saw the mandate announcement from Abu Dhabi national energy (TAQA) and DAMAC from the GCC region. TAQA's bond books are now open for a 5-year and 10-year bond. The Government of Emirates of Abu Dhabi indirectly holds 90.03% of TAQA. Also, DAMAC has issued a mandate to sell its 3-year sukuk, marking its second time in the market this year. The deal is expected to take place on Tuesday. In the fiscal year 2022, DAMAC's sales amounted to $5.4 billion, up from $2.1 billion in FY21. Mauritius Commercial Bank (MCB), the largest local bank in Mauritius with assets size of around $16 billion, has issued a mandate to sell its 5-year senior unsecured bond.

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

Equities ended higher last week with most regions in the green as the market welcomed lower inflation readings and monetary tightening that looks close to peaking. We held out tactical asset allocation meeting with no change: neutral equities, with a preference for emerging markets over developed, and a bias towards Japan, EM Asia and the UAE. We stay neutral US equities. We expect market performance to be directed by corporate guidance with tighter credit conditions impacting capex and buybacks and the demand for consumer services and would also closely watch the tech sector topline numbers. S&P 500 strength in 2023 has been driven by the mega cap companies, which have stronger balance sheets and cashflows able to better weather recessions.

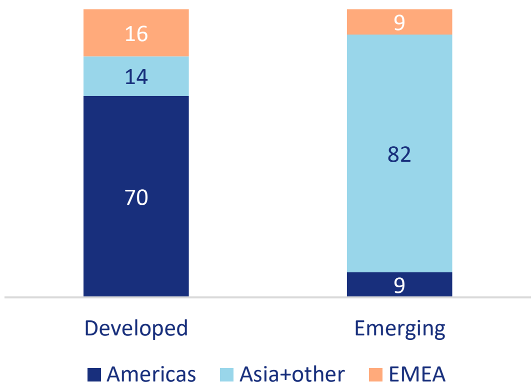
India equities are gaining slowly though China performance has recently been flat. China eco data indicates a clear pick up in domestic demand, and export numbers were also strong and along with a resumption of IPOs and big tech restructuring, we expect the rally to resume. UAE equities remain relatively upbeat with the real estate sector Aldar and Emaar gaining 5-7% last week on better volumes, with foreign ownership rising.

The S&P 500 rose 0.8%, last week with earnings from the financial sector supportive though expectations are for an overall -6.5% y/y decline in 1Q earnings.. A positive week, though decelerations in consumer and producer prices earlier in the week and surprisingly weak retail sales figures on Friday added to concerns of a mild recession, with the Fed expected to go ahead with another interest rate increase at its May meeting. Inflationary forces still strong as CPI is over 5% y/y, more than double the Fed's long-term target and oil +20% over the past four weeks. Volatility as measured by the VIX dropped to its lowest level since late 2021 at 17.

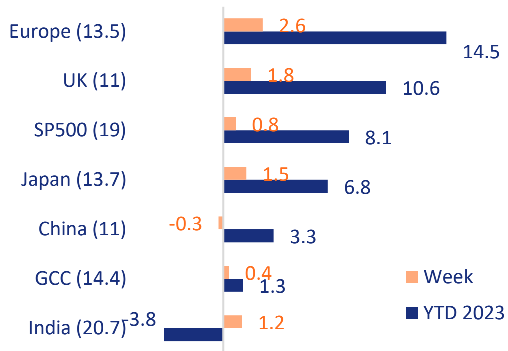
Strong asset growth from Blackrock now at $9.1 tn in assets indicative of strong inflows but profits affected by lower fees. Earnings from the big banks, took the financial sector to ytd gains but still the second worst performing sector after real estate. JP Morgan, Citi and Wells Fargo reported $22bn in profits, up by a third from a year ago. Combined revenue $80 bn, +19% from a year ago, boosted by higher net interest income, reflecting the Fed's nine rate hikes over the past 13 months. Charging higher rates on loans, without increasing the rates paid to depositors by as much. They also benefited from depositors shifting from regional banks (JPM estd +$50 bn and Citigroup $30bn in new deposits) after the collapse last month of Silicon Valley Bank and Signature. The three banks set aside nearly $2bn for potential bad loans, in particular commercial real estate as concerns about the health of the broader economy persist. "The U.S. economy continues to be on generally healthy footings—consumers are still spending and have strong balance sheets, and businesses are in good shape," JPM CEO Jamie Dimon said, but he also spoke of storm clouds and the banking industry turmoil.

We still await earnings and commentary from smaller, regional lenders and their outlook for credit contraction, deposit outflows, and commercial real estate exposure. This week, 60 S&P 500 companies report results including Lockheed Martin, JNJ, United Airlines, Tesla, and Abbott.

EQUITY RECOMMENDED REGIONAL POSITIONING

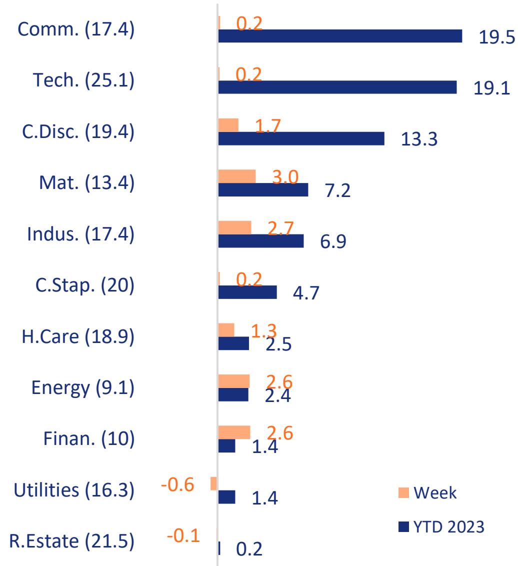


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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