Season greetings **from the Fed**

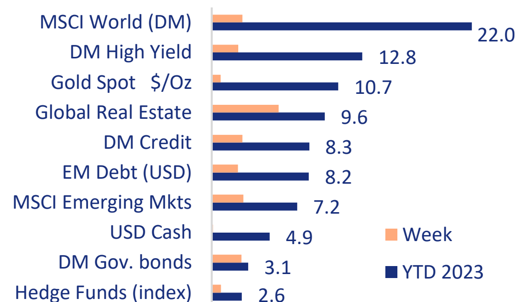
- **The last policy meeting of 2023 from the Fed was more optimistic than widely expected…**
- **… Amplifying the current year-end rally across asset classes, all in the green last week.**
- **Our recommended profiles make for a great year so far as we're actively preparing for 2024**

Last week was all about major Western central banks holding their final meeting of 2023, starting with the mighty Fed on Wednesday. Policy rates were left unchanged, as expected by most, especially by our very own Chief Economist who had called for the end of hikes since July. But there was more: the outlook for rates (the dot-plot) implied 3 rate cuts for 2024, without any previous hike, and both the economic projections and chair Powell's commentaries painted the picture of a perfect soft-landing ahead. This sounded a lot like a "pivot", where the next decision would unambiguously be a cut. Markets of course celebrated, especially as both the ECB and the Bank of England also left their rates unchanged. To illustrate, the US 10-year Treasury yield dropped below 4% - what a change! The Bank of Japan will meet later this week, most likely with focus on the 2024 outlook. They have ample leeway to tighten as their key policy rate is the only to be in negative territory.

Against almost all predictions, 2023 so far is very positive. At respectively 8%, 12% and 14% (rounded), the returns of our profiles are not only great in absolute, but also materially better than our global competition. In all honesty, they also exceed our own expectations – we were indeed right to call 2023 the year of unpredictability. By contrast, 2024 should be a year of answers, and we are working on our annual Global Investment Outlook, which will be released in January.

The week ahead will see the BoJ meeting, Europe CPI, US PCE, personal income and spending, and a few more. We do not expect dramatic market action or shifts in narrative. Since this is our last weekly letter of 2023, we wish you and your beloved ones a wonderful end of the year, and a peaceful, healthy and prosperous 2024.

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



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Cross-asset Update

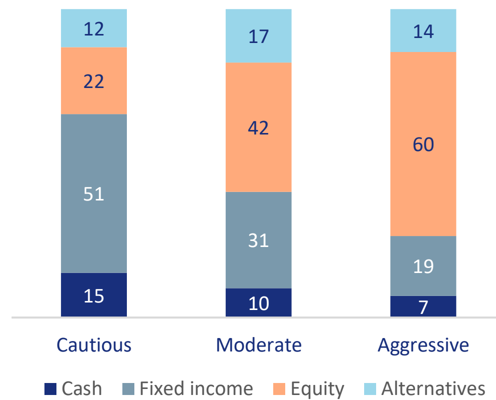
The year is drawing to a close with a bang, as Powell's dovish words spurred an everything rally across asset classes, from equities, to Treasuries, corporate credit, and commodities. Investors must think that the Fed's pivot is going to support the economy, embracing the view that recession odds now are negligible. Indeed, last week the Dow Industrials made new all-time highs, and cyclical sectors like real estate and materials led broader gains. There is some reason for optimism, as forward-looking indicators like Korean exports suggest that corporate earnings will be inflecting higher, following the earnings recession that started in 4Q22. Also, business confidence surveys point to an improvement in the manufacturing cycle, as the leading new-order-to-inventory ratio has been rising for some months now. Overall, we think we can count on activity to sustain markets in the next few months, keeping in mind at the same time that the reality of the lagged effects of monetary tightening could suddenly catch up with the economy and markets calling for new policy intervention.

Under these conditions value stocks should at least partially close the performance gap with the so-called magnificent 7 and more in general the technology sector, and EM equities finally rebound. Credit spreads are likely to remain tight, with yields still appealing in absolute terms despite the recent rally. Amidst this cyclical turn we continue to advise clients to maintain an at least neutral allocation to gold. The Fed is likely to err on the side of easing during an election year, and yields should eventually be suppressed to avoid the unsustainable costs for the servicing of the huge US debt burden. Also, should the dreaded recession materialize against consensus expectations, the yellow metal would be outperforming risk assets.

China has remained out of sync with other markets, with a negative performance year-to-date and repeated disappointments in terms of expected stimulus measures. We think that this will continue, as there is no easy solution to the structural drag of the ailing real estate sector. Also, at the Communist Party's Annual Economic Work Conference the key commitment was for the building of a "modern industrial system", code words for a technology and artificial-intelligence-based system able to compete with the West, US export curbs notwithstanding. Fiscal measures would only be "appropriately stepped up", and monetary policy "prudent".

Overall, with Europe handicapped by higher energy costs in the foreseeable future and China prioritizing financial stability, the current expansion phase remains predicated on US exceptionalism, that is on past exceptional stimulus in the end set to fade.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

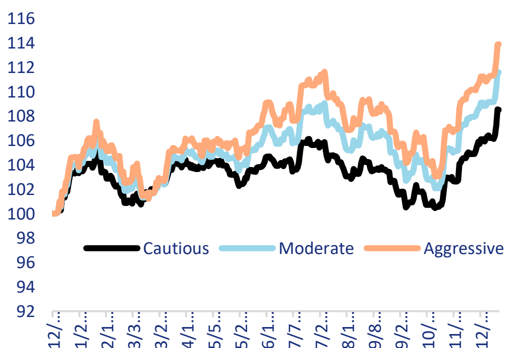


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

US Treasury bonds rallied sharply, with front-end 2-year yields dropping by 30bps to 4.42%. The 10-year dropped below 4% to 3.91%, and the 30-year ended at 4.01% last week. The rally comes after the FOMC meeting; with the rate pause at 5.25-5.50% widely expected. The 2024 median dot now indicates 75 bps of rate cuts (vs. 50 bps expected in September) and an additional 100 bps of cuts in 2025. Markets are now pricing nearly 120 bp of cuts in 2024. The US CPI increased by 0.1% MoM in November and was up 3.1% from the previous year. US core CPI rose 0.3% MoM in November, in line with consensus expectations. US retail sales unexpectedly jumped 0.3% in November as the holiday shopping season started strongly despite deep discounting.

Like UST, we have seen gains in European instruments, with the 10-year UK gilt yield falling 35bps over the week to 3.68%, while the 10-year German bund dropped 26bps to 2.01%. Both the ECB and BOE kept their policy unchanged. The ECB forecast inflation slowing over 2024 but still not reaching its 2% target until 2025. The ECB also plans to accelerate its pace of quantitative tightening. Markets expect a first cut in ECB policy by early Q2 next year, with as many as five cuts priced in for 2024. Meanwhile, the BoE maintains hawkish language in its statement, saying that "monetary policy is likely to need to be sufficiently restrictive". Markets are pricing in a first cut from the Bank of England as early as May next year. The BOJ is scheduled to meet on 18-19 December, with the market expecting a hold.

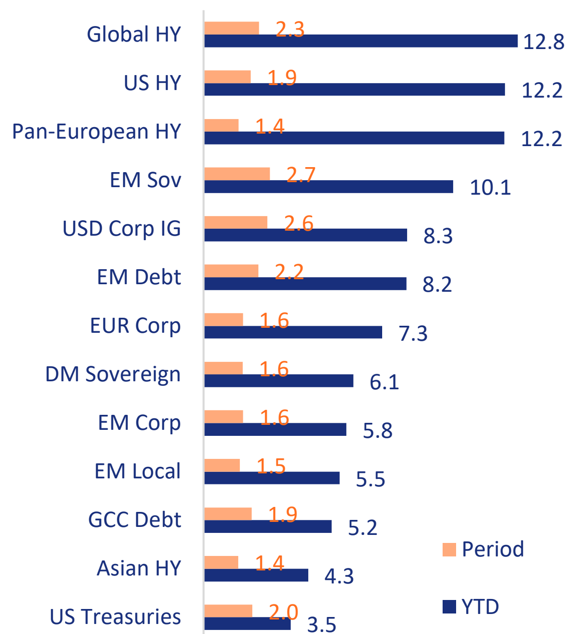
The IG index tightened by 3bps to 106bps this week, while the HY index tightened by 20bps to 430bps. Spreads tightened across the IG sub-indices, led slightly by the Financials sub-index. EM debt spreads remained resilient. JPM highlighted that EM's low debt and high savings at the start of the hiking cycle helped blunt the impact of the tightening. As the easing cycles begins, EM credit growth should rise and the debt service burden fall, and this should prop up EM growth. The GCC index spreads widened by 4bps to 119.

The Central Bank of Egypt and the Central Bank of Turkey have their policy meeting due this week. CBE is expected to keep rates on hold, while the market expects CBRT to raise rates by 250bps to reach 42.5%. CBRT has cumulatively raised 31.5% since May. Last month, S&P revised its outlook on Turkey from stable to positive. Turkey's CDS declined by 40-50bps across the curve during the month. The inflation in Turkey remains high at 62% in November and is expected to rise further before decelerating. Türkiye's twin deficits are declining. S&P projects that the fiscal deficit for 2023 will be lower than targeted at 4.3% of GDP and that the current account deficit will gradually narrow as imports decline sharply during the last four months of the year and into 2024.

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

A broad global equity rally in its 7th week with developed-market central banks pausing rate hikes, after two years of tightening. All global sectors are now up for the year. It is a bit worrying on valuations for developed markets, so earnings growth becomes even more important, to maintain market levels, as we roll into 2024.

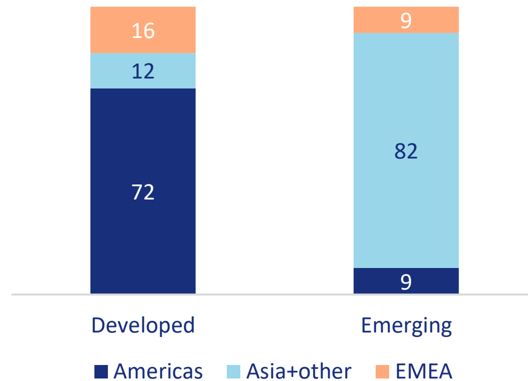
Another positive week for equities with December to date global equities up +3%, adding to a 9% November rally. Year to date global equity returns at +20% look stellar, but half the years in the last decade, the MSCI ACWI has been close to a +20% annual return, so not that surprising after all. Whilst a broad rally more recently, global tech is leading, up over 50% year to date. The magnificent 7 tech stocks are on average up 108% year to date, but it's a broader rally then just them with the semiconductor Index, the SOX up 63% YTD, its second-best year in 20 years.

In the US, the S&P 500 ended the week +2.5% higher, taking YTD net returns to +25%, while the Dow and Nasdaq made new highs. Broad market gains in the US with optimism over inflation, the economy, expectations the Fed will begin cutting interest rates next year, stronger-than-expected retail sales and falling bond yields. The 10-year US Treasury yield is down 20% from October highs of c. 5%. Eurozone and Japan equities are also close to 20% returns in USD terms. However, Japan equities reacted to the stronger Yen, and the rally has been muted recently.

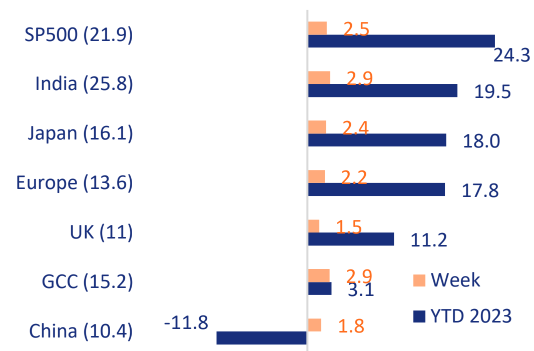
In Asia, Indian equities made new highs and USD returns are c. 20%. China equities remain the only large market negative year to date. For the week China equities up, on a record PBOC liquidity boost and property stocks gaining on loosened buying restrictions. However, China's economic recovery remains uncertain and mixed economic data is unlikely to quell growth worries as retail sales missed expectations, a sign of weak consumer demand. Industrial output rose, however from a low base. The annual economic work conference made industrial policy the top economic priority next year, a let down on expectations of stimulus to boost growth. Policymakers put greater emphasis on developing cutting-edge technology and artificial intelligence.

UAE markets gained a percent last week. The Dubai index is +26% year-to-date recovering from an October sell off. Dubai unveiled a new investment fund to drive investments in strategically important projects, adding to several state-backed wealth funds in the region that manage close to $4 trillion. The Dubai Investment Fund will house invest government money locally and internationally, and as per media reports will include stakes in DEWA, Salik and Dubai Taxi, all of which were privatized over the past year. We expect more listings in the UAE and the broadening of the market to continue. The banking sector looks undervalued and we expect further upside as dividend payments get announced in early 2024.

EQUITY RECOMMENDED REGIONAL POSITIONING

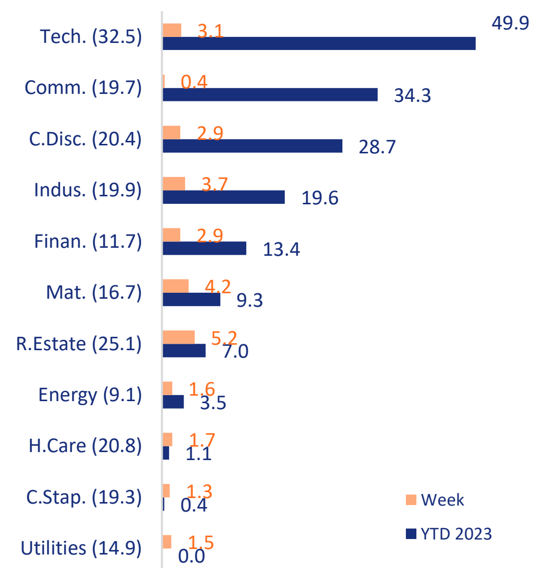


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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