The soft-landing scenario **gains traction**

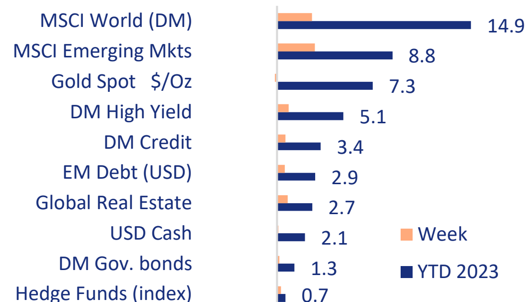
- **Last week saw four major central bank meetings, though few surprises with markets broadly appreciating**
- **Fed paused but was hawkish, ECB hiked and guided for more, BoJ didn't move and PBOC marginally cut rates**
- **Our three profiles are now at their year high, with YTD returns ranging between +5% and 9%**

Last week was extremely busy with four major central banks holding their policy meetings, as well as important data being released, from CPI inflation in the West to retail sales and industrial production in both the US and China.

To summarize: inflation remains too high in the West, and too slow to normalize. Both the Fed and the ECB responded with a hawkish tone, slightly more than what markets were expecting. The latter hiked and guided for another increase in July, while the former paused but opened the door to resume, with heightened levels of rate projections from voting members. By contrast, the PBoC cut two policy rates and injected more liquidity than expected, providing oxygen to banks, and the Bank of Japan stuck to their outright accommodative policy. Meanwhile, activity releases were underwhelming overall, especially in China, but the global economy is only slowly slowing, displaying, once again, resilience.

Markets didn't dislike such an outcome. The prevailing scenario is that central banks will continue to pressure demand, but that economies should avoid a recession. Market action last week, with positive returns across most major asset classes, indicates that this "soft-landing" scenario is gaining traction, by enough at least to push conservative investors into more neutral positioning. We retain a slightly more cautious approach: our Chief Economist just changed their Fed forecast for "at least one more hike" and it's pretty clear that we won't have rate cuts anytime soon. This, we think, increases the risk of recession ahead and probably caps some of the returns to be expected in the medium-term. In the shorter run, our three profiles are fully benefitting and just reached new 2023 highs, though we maintain a marginally cautious positioning.

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



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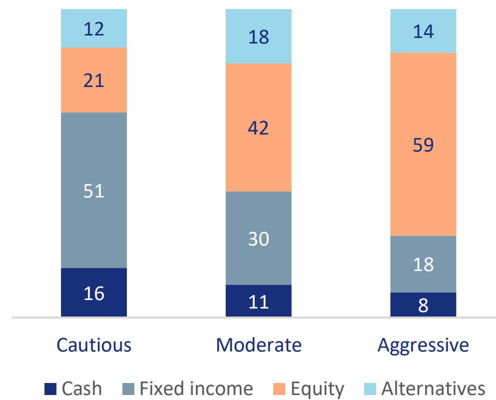
Cross-asset Update

The US May jobs report has undoubtedly made for a significant positive macro surprise, with monthly payrolls way above expectations and markets taking a pro-cyclical turn since then. Consumer discretionary stocks have continued to lead, yet closely followed by industrials and materials, rather than technology, pointing to a broadening of the rally to sectors more leveraged to the cycle, that to-date had achieved muted returns. Also, EM stocks have outperformed the S&P 500, the former up almost 4.7% in dollar terms, the latter 3%. And this can be traced down to a renewed prospect for additional stimulus by the Chinese authorities as well. Indeed, industrials and materials are exposed to the EM theme, alongside copper that has been rising for three weeks back-to-back from the lows of a protracted slump, a sign that further public intervention by Beijing is starting to get priced in. A delay in the much-expected US downturn, combined with positive news from China could sustain the current rally somewhat further, with the more pro-cyclical pockets of the market taking the baton from the so far dominating technology sector. We are not pushing back on a possible deterioration of the outlook, rather acknowledging that the recent events, alongside the backstop offered to US banks by the Fed, are going to delay a slump in US growth.

The backdrop remains constructive in the shorter term. Our cross-asset leading indicators point to an improvement in business confidence in the West, while expectations are growing for the announcement of a Chinese package at the July Politburo meeting. Yet, the bar is high for the rally to extend significantly, especially as far as the hopes-for Chinese measures are concerned. What would be needed from Beijing is not so much more cosmetic interventions on the supply side, but rather support on the demand side, that is currently flagging both in terms of private consumption and investments. On the one hand President Xi has been unwilling to flood the economy with public money in the more recent years, aiming more for the quality of growth, on the other something will have to be done for the yearly GDP target of 5% for 2023 to be met. For now, we would tend to see markets rising into the late-July announcement, with what is happening next being highly dependent on the content of the package. Late July will also by coincidence see more clarifications coming from the Fed, following the last policy meeting before the summer break.

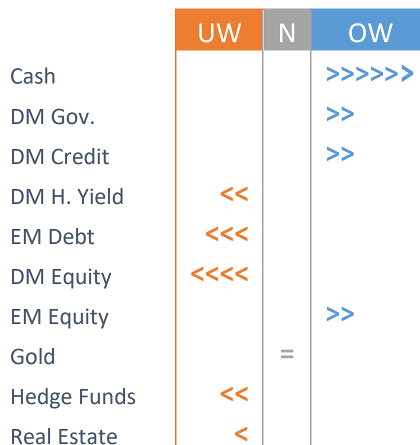
Altogether, from a broader portfolio perspective we do not see reason for investors to take higher risks across the board. For instance, the earnings yield on the S&P 500 is about in line both with the USD cash yield, and the yield on IG corporate bonds, making US equities no longer the only game in town. A bias towards higher quality bonds, EM equities and the more undervalued pockets of DM stocks offers a more selective, hence sensible approach in our view.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



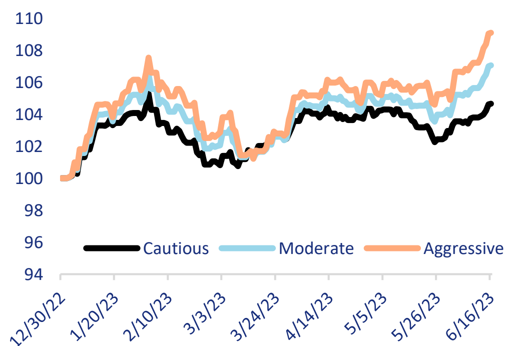
TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Last week four key central banks met with varying monetary policy decisions. The Fed finally paused, with Powell avoiding the word 'skip' in the presser while trying to sound hawkish. However, the markets believe the hawkish rhetoric sounds hollow, and June could be the true pause since the available data led them to increase the Dot plots for this year's terminal rates by 50 bps without hiking this time. As we have mentioned earlier, 'pause is not pivot.' The actual pivot will be when the Fed starts cutting rates which seems quite some time away.

The UST yield curve bear flattened, laying waste to the re-steepening trades. The 10-year yield ended the week at 3.76%, while the 2-year was at 4.71%. We find the front-end of the treasuries attractive again. With a 25bps hike priced in by the markets for the July FOMC meeting and the fed jawboning the markets with its latest dot plots, it is highly unlikely that we would see a sharp reprieve anytime soon. YTD HY spreads have compressed by more than 50bps and IG spreads have compressed by only 7bps. The HY vs IG spread at 368bps is below the median in the last 20 years. We are not being paid enough to hold high-yielding corporates at current prices and would suggest going the IG route.

On the other hand, the ECB failed to surprise by increasing rates by 25bps, with Governor Lagarde promising more hikes to come. PBoC cut its one-year policy rates by 10 bps. At the same time, according to a WSJ article, the government readies a fiscal stimulus package to revive the economy, including loosening property buying restrictions in top-tier cities, more infrastructure support, and targeted consumption subsidies. According to Reuters, the central bank is widely expected to cut its benchmark loan prime interest rates on Tuesday. BoJ meanwhile continued its dovish policy and remained on pause. Concerns are growing that the BoJ could end up falling behind the curve on inflation, similar to the Fed in 2021.

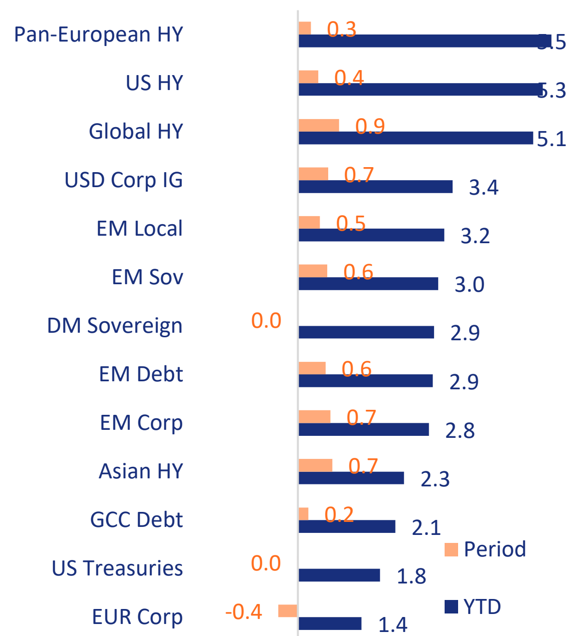
With BoE's meeting approaching this Thursday, the larger-than-expected acceleration in UK private sector pay growth will make for uncomfortable reading at the central bank. The central bank meets on Thursday when it is set to raise interest rates by a quarter point to a 15-year high of 4.75%. The balancing act for BoE becomes increasingly challenging as the economists warn that the UK economy faces a sharp recession rate hit the 6% level financial markets expect. We had highlighted the opportunity in GBP bonds earlier. BlackRock, Invesco, and Royal London are already dipping back into the market, arguing that traders are anticipating more hikes than the BOE is likely to deliver, and it's an opportunity to lock in some of the highest bond yields in the developed world.

This is again a week of central banks with as many as 19 banks set to meet. Within the Emerging Markets, the key meetings include Turkey, where the new governor is expected to reverse the trend of rate cuts to announce a significant hike in interest rates. Bloomberg consensus puts median estimates at 20% from the current 8.5%. This, and other policy tweaks could bolster investor sentiment on Turkey. Other key EM central banks scheduled this week are Indonesia, Egypt, Mexico, and Brazil.

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

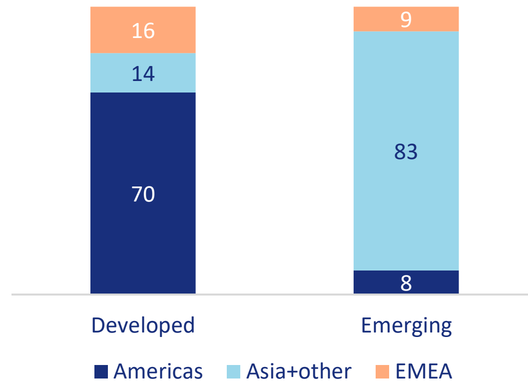
Another upbeat week, with the first half of June adding 6% to global equity returns. Tech leads YTD returns at +37%, in spite of rising yields, but all global sectors were positive the last fortnight, with consumer and industrials outperforming. Emerging markets lead regionally in June with strong gains from China. In developed markets, Japan stands out in Yen returns, but overall in USD all 3 developed markets are parallel at +16% YTD total returns. . Except for Friday, which saw a small decline in the S&P 500, as it was a big day for options trading, the whole week saw positive closes. Small caps and regional banks are playing catch up, broadening the US equity rally. Not even hawkish Fed language - inflation lower but on an evidently longer trajectory - or rising geopolitical tensions around Russia/ Ukraine had an impact on markets.

Mixed uptakes from various half yearly outlooks from the big investment houses, with increases in expected returns to still anticipation of a sharp S&P 500 sell off. Our outlook will be out mid-July. We say this repeatedly, most years see two 5% and one 10% draw down. But average returns over the century have been 7% and over the last decade 10% for US equities. Very rarely are there 2 negative years. What's making us optimistic about equities ending the year somewhere where they are now is the second quarter being the trough in earnings declines, peaking central bank tightening and still strong consumer demand. The S&P 500 ROE rose by 34bps to 20.4% in 1Q 2023, after declining for four straight quarters reflecting a better-than-expected 1Q earnings season and that the worst of the profit margin reset is likely behind us. Margins are lower than a year ago but no longer falling.

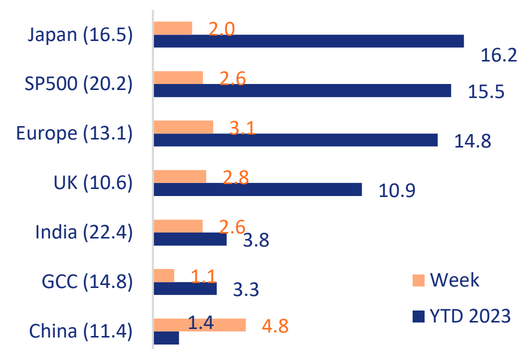
Also, the boost in productivity from AI progress is the one common factor all investment houses acknowledge. However, like .com investing that had largely unprofitable companies which went bust and caused the market crash in 2000, there are going to be plenty of .ai companies too with no worth. So, value and returns lie in being selective in tech and otherwise too while broadly investing in equities and remaining on the quality spectrum.

UAE markets continue to see a better performance from the Dubai bourse. Two sectors where we see upside in the UAE are banks and real estate. On banks the focus is Islamic banks with higher non-interest-bearing deposits. UAE banks are down 7% YTD with large dispersion within the sector. Real estate is seeing good offtake for off-plan developments and Emaar's recent launch of the Oasis high-end villas seems to be getting good traction. The fundamental backdrop is supportive as PMIs and GDP growth remain amongst the best globally. However, profitability in 2024 will see the introduction of the corporate tax and potentially lower interest rates.

EQUITY RECOMMENDED REGIONAL POSITIONING

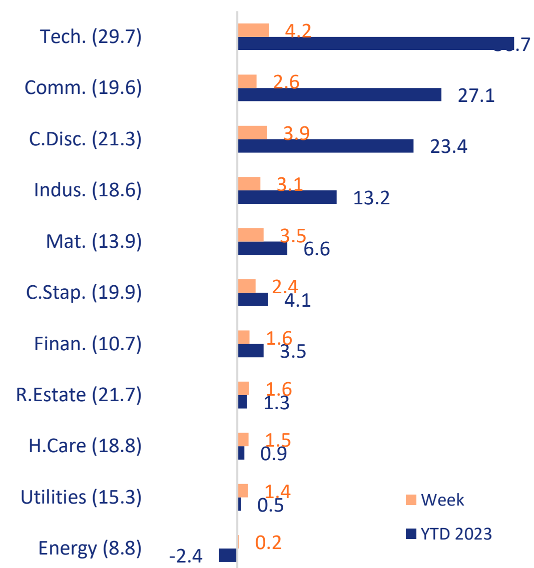


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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