Emirates NBD
WEALTH MANAGEMENT

Are we getting used to **unpredictability?**

- **With the ongoing US debt ceiling negotiations, last week was positive for stocks and negative for bonds**
- **Stocks discount an ideal scenario of resilient growth and an imminent pause from central banks…**
- **… Which may or may not take place: unpredictability remains as high as ever**

A look at last week's performance scorecard without any context would give the impression of a pro-cyclical rise in risk appetite. Defensive assets were all in the red, from gold to bonds, while stocks gained across regions.

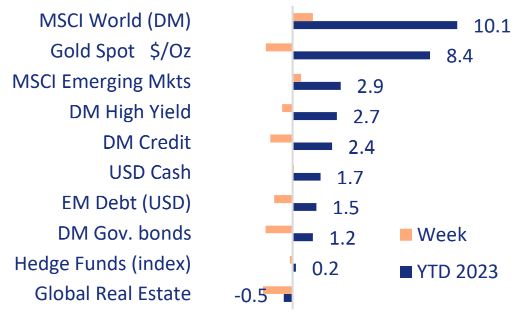
Indeed, activity continued to be strong, the mood was constructive on the US debt ceiling negotiations, and commentaries from central banks were logically more hawkish, without explicitly excluding a potential pause now in the US, and later in Europe. Growth is good for stocks and pushes yields higher, especially as the Fed may hike again (we don't think they will) and as a debt-deal voted in Washington would trigger a deluge of T-bill supply. Markets are not illogical.

Except, of course, for the fact that none of the above is a given. We are convinced that the US will not default, but no deal has been inked yet. Growth is resilient for now, but the risk of recession in the next 12 months is arguably rising. Finally, a pause is probable, but it is not a pivot towards rate cuts. Given the inflation picture, markets will have to live for some time with high interest rates, unless activity suddenly collapses.

We are not outright bearish. But implied volatility is abnormally low and there is no "unpredictability discount" in the current valuations of some assets. Our current positioning thus simply reflects a cold analysis of fundamental risk-adjusted potential returns rather than a strong scenario. On a tactical horizon, we overweight cash and quality bonds, and are cautious on the riskiest segments of fixed income and on DM stocks.

The week ahead will be all about talks and votes in Washington, but will also provide many activity data, especially with flash manufacturing PMI, as well as the US April core PCE inflation measure. Stay safe.

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



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Cross-asset Update

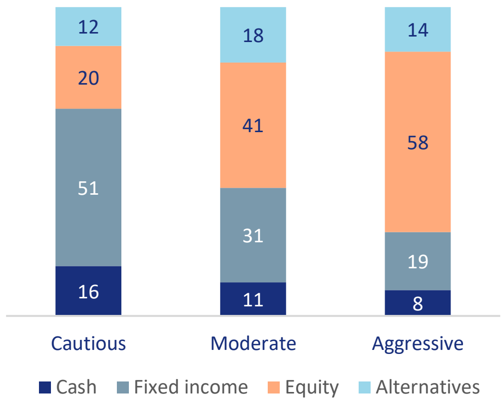
Our gold fair value remains unchanged for the year, at $1,950/oz, reflecting a view that is neutral in the shorter run with the yellow metal range-bound between $1,900 and $2,100/oz, but very bullish in the medium to longer term.

Our more neutral stance at shorter time horizons is driven by the market currently reassessing the future Fed rate path in more hawkish terms, following recent remarks by some Fed members and the latest release of the University of Michigan Consumer Sentiment Survey. According to the preliminary May report 5-10 year ahead consumer inflation expectations surged to 3.2%, the highest level since 2008. Since expectations can feed into actual price pressures, if the higher print is confirmed in the final report at month end, chances of the Fed hiking in June or July would be rising materially. Also, according to overnight index swap markets investors currently see at least a 30% probability of a rate increase in June or July, following the Fed Dallas president statement that a June raise may be needed. If inflation proves to be sticky, actually July would be in play versus June given the long summer break before the September FOMC meeting. Gold had also over discounted future cuts, with three being projected into year-end as of very recently versus just two currently. And the gold long positioning as a duration trade may be overcrowded, not showing the negative carry that one on the other hand has to sustain if one wants to be long the US 10-year note, yielding less than the two year.

There are anyway secular factors supporting gold that keep us constructive irrespective of today's overbought conditions. The United States will be better off with lower borrowing costs given its swelling debt load, a challenge in the case of higher inflationary pressures driven both by the push for the green economy and deglobalization. Also, demand for Treasuries could run lower if Japan givens up its yield-curve-control system repatriating capital, and China decides to lower its US debt purchases significantly. All of this would most likely push yields higher, hence require the Fed to suppress and control them outright, adopting the YCC framework currently implemented by the BOJ. Lower yields in the presence of higher inflation would constitute an ideal backdrop for a gold bull market. The so-called de-dollarisation is another factor playing in favour of gold. In today's fractured world more countries are trying to avoid using the dollar in international trade, and in doing so exporters may be left with a currency they do not know how to spend. Unless the importing country agrees for instance to exchange gold held by its central bank for its own currency in order to support trade. The exact mechanism may be different, but the main point is that de-dollarisation implies increased demand for gold as a means of exchange to make the transition to a multi-polar currency system smoother.

Overall, we continue to see the bullish case for gold as compelling, once the US recession overhang is behind us.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

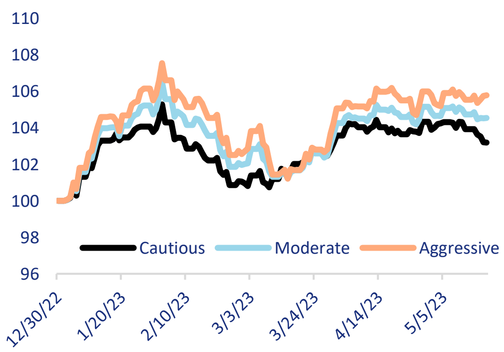


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

The market is currently repricing the future Fed rate path to the upside. Traders have also moved the year-end rate cut expectations to 45 bps from 68 bps a week earlier. This percolates to the treasury curve, with yields pushing higher. The treasury curve moved up last week, with the front-end 2-year yields crossing 4% to end the week at 4.22%. The 10 and 30-year ended the week at 3.67% and 3.92%, respectively, up by more than 15 bps.

The positioning is still light in US Treasuries. The record net shorts in the CFTC data are being distorted by basis trades – with leveraged investors short futures & long cash. While there's no doubt that there is some buying by hedge funds and long-only institutions this year, there's plenty of room for longs to build ahead of any Fed easing cycle. Given the 2-way risks to bond positioning, there's a high premium on getting the next move in macro right. Growth momentum is currently on a knife edge, with most sentiment data starting to bounce back from their cycle lows, while hard data like Korean exports and jobless claims have softened in recent months.

In the case of new ISM orders, regional US PMIs will offer insight into whether business activity remains in the recessionary territory over the next ten days. Labor data also remains crucial. The UK jobs report last week may have been a canary in the coal mine for the global labor market, with the first signs of cracks starting to show. According to the WARN Act, US employers must give at least 60 days advance notice of mass layoffs. Similar notifications are also required in the UK. In the case of the WARN data, this is estimated to lead the US jobless claims by around two months. While potential redundancies haven't quite reached 'escape velocity,' they are at levels that require close monitoring. Based on past easing cycles, we may need to see the trend of NFP falling below +100k for the Fed to consider lowering rates. So all we could say is that the bond yields are poised on a knife's edge with a sharp tilt to yields coming down in the future.

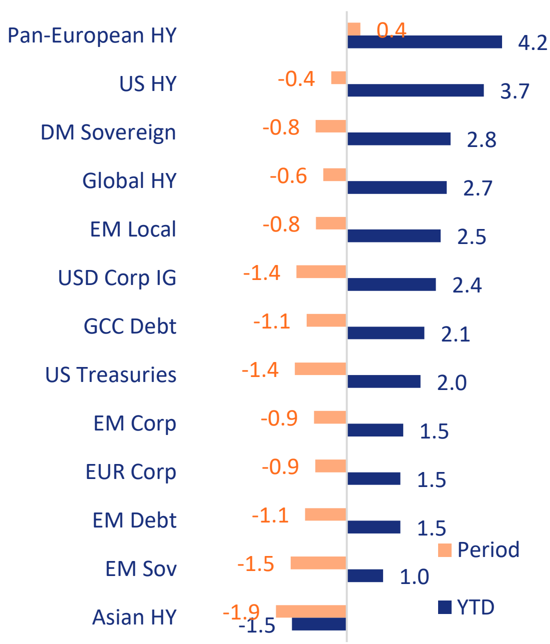
Lastly, touching on the debt ceiling issue, we are still not out of the woods there. Treasury cash balances are at levels where the market could panic if a deal isn't reached early this week. GS economists predicted that Treasury's cash levels would drop below $30bn, a bare minimum threshold to meet federal obligations, by June 8th or 9th. We should tread carefully around such events and not take outsized bets.

Coming to the GCC primary issuance market, it is raining sukuks. After Aldar and Nogaholding priced a couple of sukuks last week, we have new mandates from Banque Saudi Fransi for a 5-year senior sukuk and from MAF for a 10-year senior sukuk that should price this week.

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

Global equities up a percent last week, with the Nasdaq standing out at 3% higher. All about mega tech's performance as long-term growth prospects potentially stand to benefit from advances in generative AI. Developed market equities all in the green with US equities +1.7% supported by margin improvement for corporates in Q1 and optimism for a debt ceiling resolution ahead of the House vote. However, concerns over additional rate hikes resurfaced, as initial jobless claims fell more than consensus expected, indicating a still tight labor market. Europe also up last week saw first quarter earnings results above consensus expectations. The week ended with debt ceiling negotiation roadblocks, hawkish chatter from Fed Chair Powell on inflation targets, and US Treasury Secretary Yellen stating that more bank mergers may be necessary, indicating more bank trouble could be brewing.

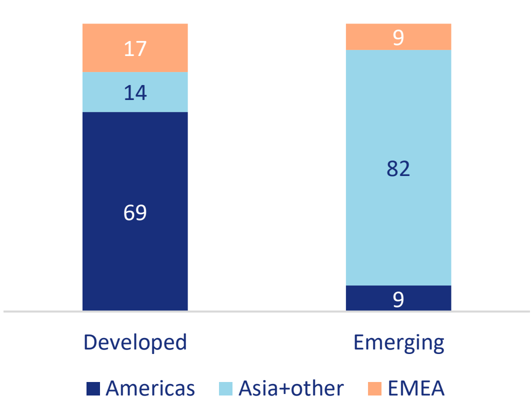
UAE markets lower last week with ADX -1.62% and DFM -0.41%. New issuance well received including the current ADNOC Logistics & Services IPO price range set at AED 1.99 to AED 2.01 per share, implying an equity value of $4.01bn to $4.05 bn and IPO cornerstone investors commit approximately $180mln.

Japan equities have recently been on a tear, and we were fortuitous (and the fundamentals looked all set for a rally) to put in an overweight positioning 3 months ago. Focus on ROE, and ongoing improvements in corporate governance along with the beta to China opening have aided stock performance. While rates continue to remain high in many other developed markets, the Bank of Japan still employs its accommodative monetary policy and sees a lower impact of inflation.

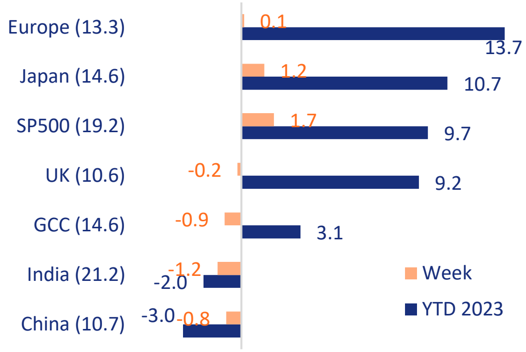
The big catalyst for markets, the earning season is over and the 3-5% beat (US and Europe) has aided market performance but it was big tech providing most of the profit and performance for the S&P 500. Three themes dominated earnings calls: banking stress returning cash to shareholders and AI. Credit tightening already evident from recent data on borrowing (small businesses and CBRE the most affected). Buybacks and dividends lower as corporates keep cash aside but still at high levels. The topic of AI was frequently discussed on company earnings calls particularly within the Information Technology and Communication Services sectors. Companies are discussing existing investments in AI, where they see AI impacting their businesses, and potential avenues for additional investment. Estimated that AI could potentially drive roughly $7 trillion in global economic growth.

Big differentiation on performance with big tech, big banks and luxury outperforming within sectors. It's not about value this year. We have been bullish on select tech and luxury. Bank of America has called them the "The Magnificent Seven"…the big 7 US Tech stocks Apple, Microsoft, Google, Amazon, Nvidia, Meta, Tesla (up 61% YTD) even though trading on 30x PE vs 17x for the rest of the S&P500. The big 7 European Luxury stocks LVMH, L'Oreal, Hermes, Christian Dior, Richemont, Kering, Ferrari. (up 25% YTD) trading on 36x PE vs rest of the Stoxx 600 trading on 12x PE. Consumption is back and luxury tourism in Europe is seen as a big growth area.

EQUITY RECOMMENDED REGIONAL POSITIONING

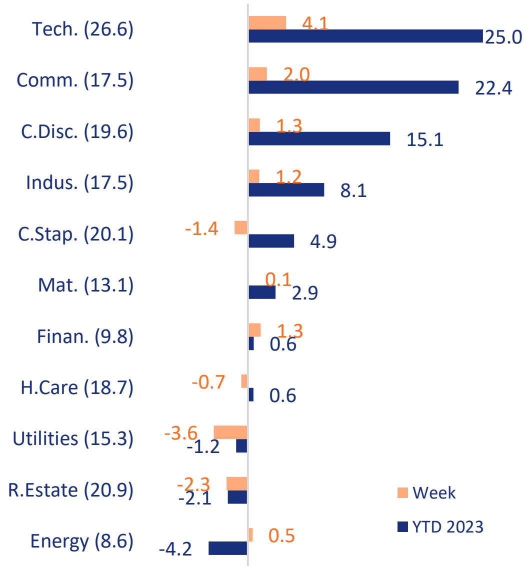


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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