Preparing for more volatility ahead

- **Last week was positive across most asset-classes but witnessed the return of volatility**
- **Investors are torn between the good news on inflation and monetary policy, and the recession risks**
- **Our positioning remains fully invested yet, with clear preferences within asset classes**

Last week was undoubtedly a confirmation of a strong start to 2023, will all asset classes printing positive returns, except stocks from developed markets which were down by a modest -0.4%.

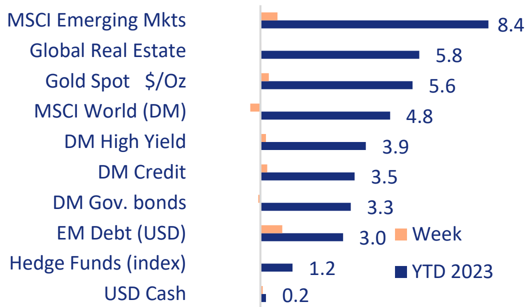
Below the surface however, it was interesting to note a significant level of volatility, especially affecting US stock markets which were in the red three consecutive days before recovering on Friday, materially helped by Google and Netflix as the Q4 earnings season is in full swing.

The reason behind the volatility is not benign. The narrative for market participants used to be exclusively focused on markets predominant, and painful, driver of last year: central banks' tightening. To that extent, news have been consistently supportive: inflation trends have improved, and despite hawkish messages being delivered by central banks' officials, there is little doubt that the pace of monetary tightening will slow. To that extent, bad economic news have consistently been taken positively by markets. But once the consensus gets more comfortable with the Fed, it becomes less comfortable with growth. Indeed, after declining soft data for months, hard data are starting to reflect a material slowdown, the latest being industrial production and retail sales in the US. As the focus turns to growth, uncertainty, and volatility, come back.

This year will be driven by macro uncertainty which requires vigilance.. We remain fully invested but prefer to use DM to generate income, while we seek capital appreciation in EM stocks. So far, so good, but the year is young and China will enter a period of holidays.

We will detail the CIO views in our Global Investment Outlook publication and events in the coming weeks.

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



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Cross-asset Update

Investors assume that central bankers are knowledgeable and powerful to the point that they can totally control the economy and have perfect foresight. So, when they talk most investors listen up and believe their whole narrative. This picture of central bankers can to a great extent be correct, but for sure today they are confronted with such issues, and of such magnitude, that they may be able to still be in control if only they are willing to give up on something. Low inflation and low rates in a decade of resource scarcity and deglobalisation, for instance, may not be possible.

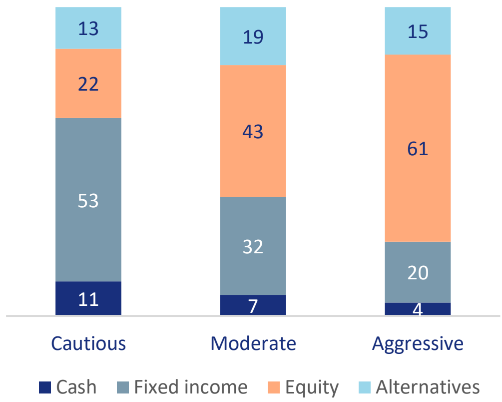
The Federal Reserve had some problem with inflation right from the start. It was both that they were unable to predict it and assess its duration, with Powell's labelling of inflation as "transitory", and that when they saw it, they still continued with their Quantitative Easing program until March 2022. That is not easily explainable, if it is true that inflation is always a monetary phenomenon, as the renowned economist Milton Friedman put it. And today they are convinced they will be able to keep rates at 5% for as long as they wish, being as confident in March 2021 that they would be keeping rates close to zero through 2023.

Christine Lagarde is quite self-assured about the necessity of being hawkish and at Davos vowed "we shall stay the course". While as late as November 2021 she was explicit in saying, amidst market bets to the contrary, that the ECB would be unlikely to raise rates in 2022. According to a close adviser to former President Draghi, the ECB could be making a mistake again today, damaging private consumption, as "we don't have inflation from demand like in the US but instead have inflation linked to gas prices".

But perhaps the currently most under appreciated central-bank policy mistake could stem from BOJ Governor Kuroda's unwillingness to remove the yield-curve control introduced in 2016, whereby the yield on the 10-year government bond is now capped at 0.5%, thanks to the BOJ direct intervention in the bond market. The ceiling was lifted already towards the end of last year from 0.25% to 0.5%. Kuroda said that controls would not be stopped until there is inflation, though nationwide inflation has reached 4%, last seen only at the end of 1990.

The BOJ risks to eventually succumb to market speculation. Two major risks would come from a disorderly exit from the current regime. One is that decades of easy money could have unduly boosted leverage in the Japanese system, making some economic agents particularly vulnerable to abrupt changes in rates. The other is that decades of search for yield via overseas investing now see Japan holding, as a percentage of GDP of the country where Japan is invested, 7.3% of stocks and bonds in America, 7.5% in France and 8.3% in Australia. A sudden shift higher in yields into a new regime could spark divestments and volatility in foreign markets.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

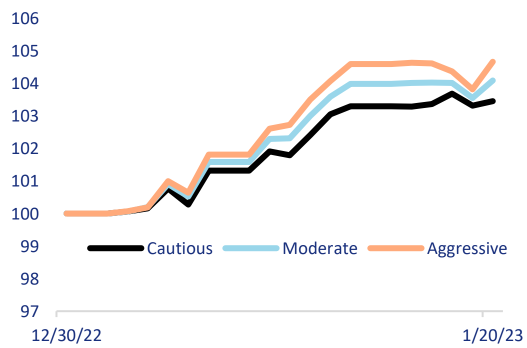


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW:Underweight/Neutral/Overweight

	UW	N	OW
Cash			>>
DM Gov.			>
EM Debt			>>
DM Credit	<		
DM H. Yield	<<		
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.

Emirates NBD PRIVATE BANKING

Fixed Income Update

There is no free lunch anymore in the fixed income asset class. The YTD returns have been nothing short of spectacular. The decreasing yields combined with tightening spreads have taken valuations towards the richer end. YTD 10-year US Treasury yields have come down by c.40 bps. Though it is slightly higher than the 52-week low of 3.37% achieved last week, it is still below the YTD average of 3.54%.

Similarly, several sub-segment spreads have compressed between 8 to 35 bps, with most of them currently trading at the lower end. Investors have high hopes of an approaching Fed pause and a higher probability of a soft landing. These high returns so early this year have made the outlook slightly muddled for the rest of the year. Unless we see a significant drawdown, the capital appreciation potential seems low for all the segments. So, it is prudent to stock up on high-quality bonds and avoid iffy issuers.

Last week, US Treasury yields were again volatile as the benchmark 10-year notes swung between 3.37 and 3.55. On Wednesday, treasuries hit their lowest, aided by soft macro data. We like the 6-month and 2-year US Treasuries as they offer relatively chunkier yields. US HY was the only segment where spreads widened significantly as a result. This is the segment where we need to be very cautious and selective. Investment Grade spreads have tightened to 127 bps, and only Financials offer decent yield pick-up in that space. European and UK Banks underperformed US GSIBs in 2022. Despite the recent rally, a benign economic environment in UK and Europe coupled with investor positioning should result in Euro Area financials providing decent returns this year.

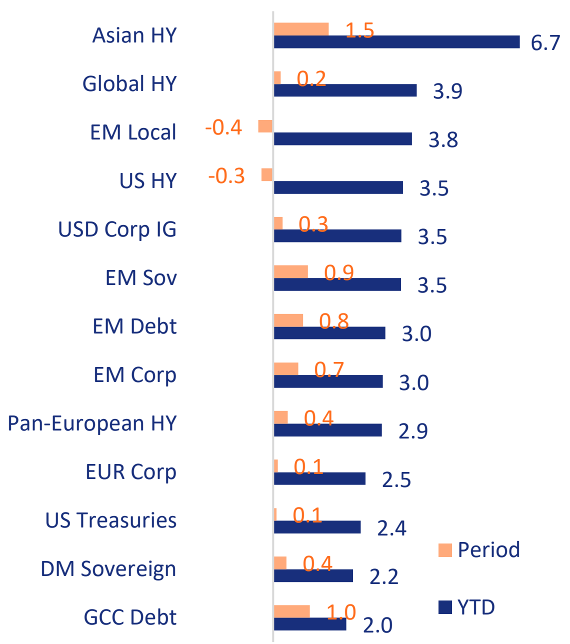
Emerging Market Debt has also rallied though its overall return at 3% is lower compared to both HY and IG. A lot of the China reopening optimism is already priced in, according to a recent JPM analysis.

GCC Debt has been off to a slow start, though we have seen some Investment Grade issuers offering juicier yields in the primary market. The HY names should be well supported based on lower supply and high oil price expectations. We would not suggest going long duration in GCC HY names, but it is the perfect opportunity to lock in some decent IG yield available on the longer end of GRE IG curves. Last week there was only one notable issuance from the region, as FAB issued a 5.25yr conventional bond which saw demand of over $1.45bn for a $600mn issue. The pricing tightened by 25 bps on the back of demand from Asset Managers.

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

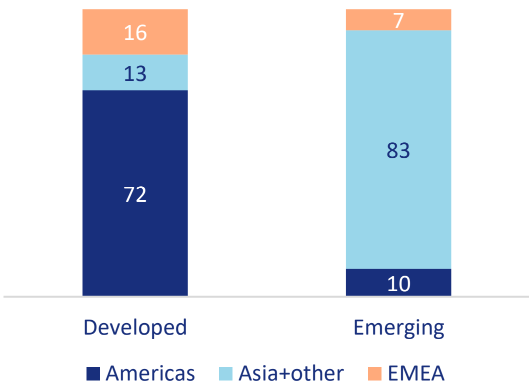
A slightly negative week for global markets after a great start to 2023. Emerging market equities did better than Developed markets for a 3rd week, with China maintaining the lead. However, a return of volatility with sharper daily moves. Positive for equities, Treasury yields are trending lower and markets reacting rationally to economic data releases. On the headwinds, monetary policy continues to deal with still above trend inflation. Equity performance in the first three weeks of 2023 has been a mirror image of 2022. Most regions and all sectors are positive ytd with global equities +5.2%. Technology is outperforming after a dismal 2022, as are China equities which began a turnaround in November last year. UAE markets have small gains this year, following their large outperformance last year. Capital issuance in the region is kickstarted with Oman energy firm OQ SAOC with an IPO of its oil drilling unit Abraj Energy Services. Many major exchanges in Asia are closed for Lunar New Year celebrations until midweek with mainland China trading to resume Jan. 30th.

The S&P 500 had a slightly negative performance last week, after two weeks of gains (+3.5% ytd) and is outperforming the Dow Jones which has a higher mix of traditional industries and was the better performer in 2022. Both the S&P and Dow ended 2022, down 18% and 7% respectively. The steady stream of hawkish headlines from Central Banks (Fed, ECB) remains a significant headwind however US equities gained on Friday after Fed Governor Waller said mid-day that policy looked pretty close to sufficiently restrictive and he backed moderation in the size of rate increases.

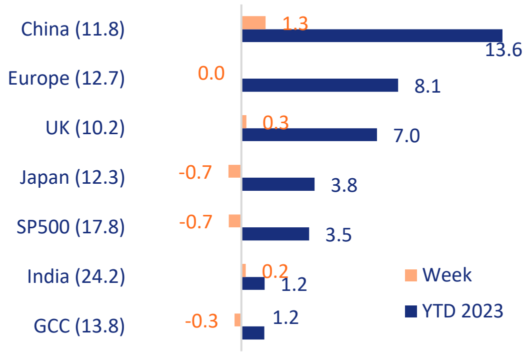
Earnings at the big 6 US banks fell 30% in 4 Q 2022 with $7.2 bn set aside for loan losses. Investment banking revenues were down by 50%. The consumer banks did better i.e. JPMorgan and Bank of America, closely connected to consumer data and spending habits and both CEO's see a mild recession in the US.

A busy Q4 earnings week ahead with 93 S&P 500 companies reporting with trillions of dollars in market cap. Microsoft, Tesla, J&J, Visa, Southwest Airlines, Boeing, Verizon, AT&T, American Express to name a few and representative of most sectors. The tech sector has shed 200,000 jobs in the last year with Google the latest at 12,000, citing weaker economic conditions. This follows a period of outsize hiring during the COVID lockdowns, when demand for digital services rose exponentially. Hope remains that big tech companies will show resilience, even in markets that could be most exposed to economic contraction like online advertising and selling expensive gadgets to consumers Revenue growth for the biggest companies (Alphabet, Amazon, Apple, Meta and Microsoft) is expected to slow to 7% this year, down from 29% two years before. A supportive message from Big Tech – they will do what is needed to protect margins as they look to service models to scale, maintain geographic and business diversity and deep-rooted business models and market leadership to ride out a downturn. The lower prices of big tech post the 2022 share price declines are making them attractive. Hedge fund Elliott Investment Management has taken a substantial activist stake in Salesforce. Salesforce has also laid off employees recently.

EQUITY RECOMMENDED REGIONAL POSITIONING

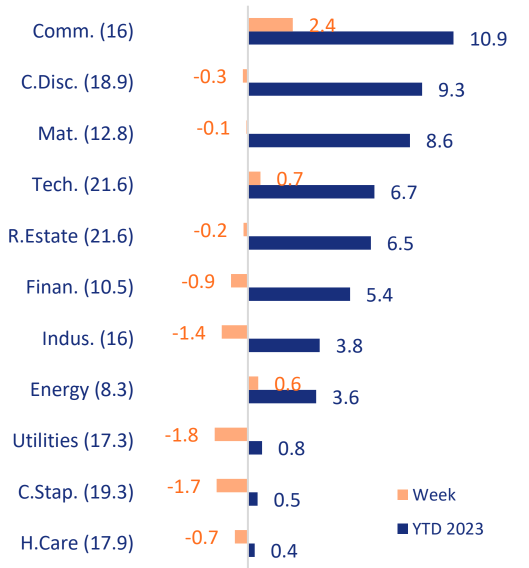


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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