Resilient global economy, rising **geopolitical risks**

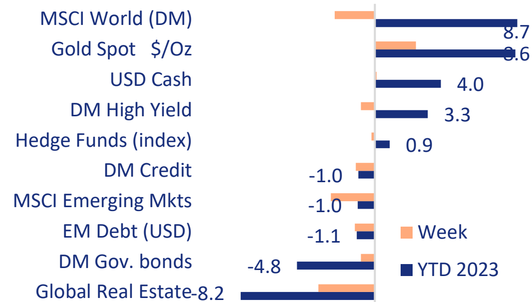
- **Macro data from the US and China were positive last week, pushing interest rates higher…**
- **… While risk aversion from geopolitical tensions took an additional toll on cyclical assets**
- **We stick to our slightly defensive positioning though we are not outright bearish**

Markets are facing a wall of worry which combines old and new fears. The old one is about the growth/inflation conundrum and the reaction function of central banks. US resilience was only confirmed by the latest data, especially retail sales and to some extent industrial production, both exceeding expectations in September. Given US exceptionalism, threats to global growth come from Europe and China: the latter moderated, with a better-than-expected Q3 GDP growth as well as with encouraging consumption and production numbers. As a result, global growth remains steady, and interest rates keep on rising – commanding lower equity multiples in an uncomfortable correlation.

The new fear is about the risk of international escalation from the current situation in Palestine and its terrible impact, especially for civilians. We continue to hope that the conflict will remain geographically contained (and pray for peace). The delay of the potential Gaza invasion and the beginning, although modest, of actual provision of aid are positive signs. However, the risk is elevated, and markets hate it. No surprise than gold was the only major asset class in the green last week, as well as cash, delivering its steady and appreciable +0.1% weekly return.

Investors will have a lot to watch this week. Geopolitical developments will drive risk-taking via safe havens. On the macro side, we'll get flash PMIs for most regions as well as US quarterly GDP, core PCE and personal income. On the corporate side, it's a crucial week for earnings, with Microsoft, Alphabet, Amazon, Intel, Meta among others. The ECB will hold their policy meeting (we expect them to hold). The year of unpredictability it certainly not over, and we keep a balanced, slightly defensive positioning. Stay safe.

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



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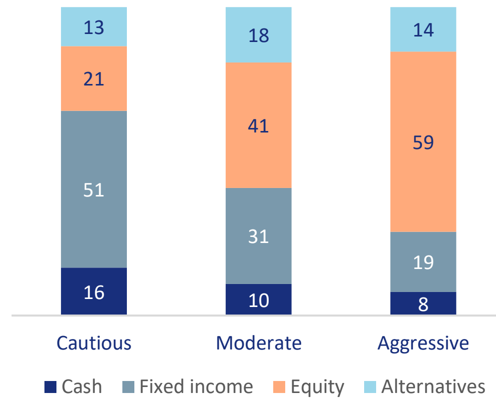
Cross-asset Update

While recent gold strength has been put down to rising geopolitical risks, we hold the view that it rather highlights growing investor focus on swelling US fiscal deficits. At first sight it is a bit of a conundrum why the yellow metal, a non-yielding asset, has been so resilient in the face of real rates at multi-year highs, defying the usual relationship that would see it at much lower levels now. And the answer could be in some of the remarks related to the US debt that Powell made last week at the Economic Club of New York. He said that the latest run-up in yields can be mostly due to a rise in the term premium, as the "heightened focus on fiscal deficits" and the "overall strength of the economy" longer term "may require higher rates". So, Powell himself acknowledged that investors are demanding a compensation for holding Treasuries against a backdrop of ever-rising deficits. Also, former Fed governor Kevin Warsh, ex adviser to George W. Bush, laid emphasis on the rising relevance of debt sustainability in reference to soaring yields, when he recently remarked that "We are witnessing the beginning of a regime change in how investors perceive America's fiscal sustainability".

Hence, while bond investors are requiring a rising term premium to take duration risk, gold investors are bidding up gold to hedge against relentlessly growing debt levels, not only in the United States, but also more broadly across the developed markets. The combination of multiplying war fronts and unchecked deficits is quite a powerful one for gold, that we would tend to see revert back to a secular bull trend once the Fed starts a new easing cycle. Although the easing phase is not round the corner, we are approaching Fed's peak rates time, a positive catalyst for the yellow metal. While it is a close call whether the Fed will be rightening policy once more by January 2024, we should keep in mind that election years tend to see rate cuts, rather than hikes. As year-end draws closer, investors will be questioning the sustainability of the 'high for longer' preached by the Fed and tend to discount rate cuts.

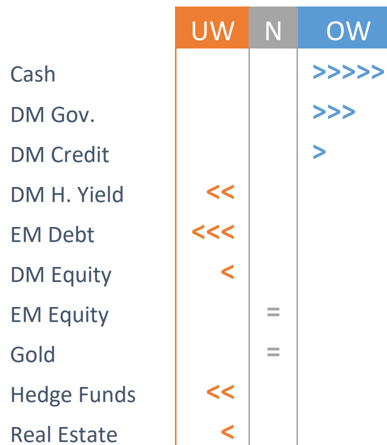
Gold has been rising to a 3-month high and is trading close to $1,980/oz, and it seems to be on track to get closer to our year-end fair value of $2,050/oz. Next year should see gold resume its bull trend under the assumption that US exceptionalism will eventually be unsustainable. Investors are advised to increase allocation accordingly.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



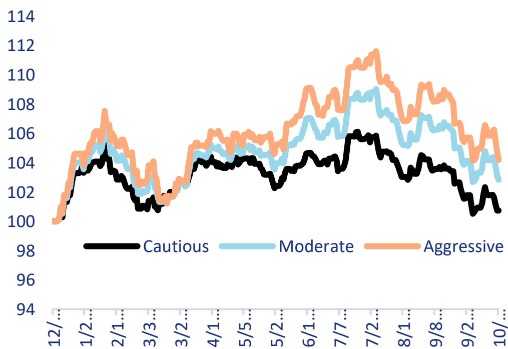
TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Treasury yields rose to the highest levels in the least 16 years this week — with the 10-year rate nearing 5% on Thursday — after stronger-than-expected retail sales data stoked concerns that the Federal Reserve has more work to do to slow inflation. The recent bearish trend can be attributed to stronger-than-expected domestic data, supply technicals, and Chair Powell's dovish stance causing the market to think the Fed might find itself behind the curve. Maintain preference for 5-year Treasuries. Bearish supply technicals should fade over the near term, and the Fed's blackout period and lack of first-tier data remove near-term headwinds. Further, valuations look historically cheap, and forward OIS pricing suggests the Fed will stay restrictive for years to come, which we think is unlikely.

According to Bloomberg, US corporate debt markets are showing early signs of weakening as rising yields and falling equities take their toll. Risk premiums, or spreads, for investment-grade corporate bonds have climbed to their highest levels since June. In the junk-bond market, where yields have climbed to their highest in a year, some companies are having a more challenging time selling debt. Still, investment-grade yields surging to the highest since 2009 has created opportunities for investors who can stomach the volatility.

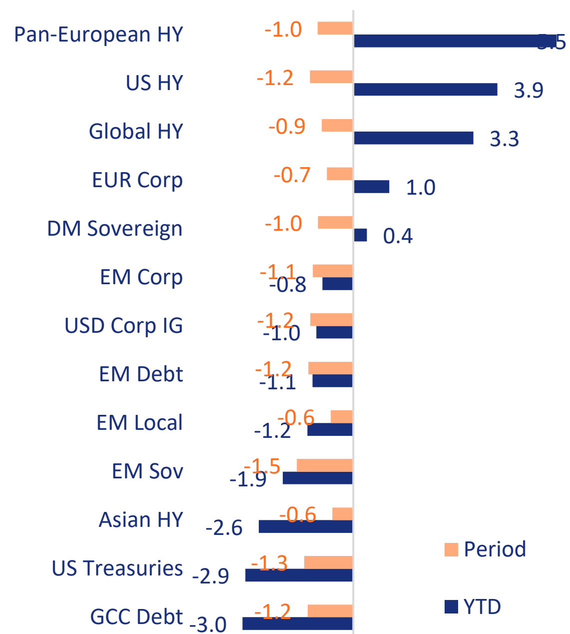
Even amidst heightened volatility, companies are still going to have to refinance in a market marked by higher rates. The amount of junk bonds maturing in the next 18 to 36 months is at the highest level since 2007, according to strategists at Goldman Sachs. The figure stands at 19% of the total high-yield market as of the quarter ending Sept. 30, compared to 13% during the year-ago quarter and 9% over the same quarter in 2021. The current average yield-to-worst of 9.42% across junk-rated debt is well above the weighted average coupon of 5.99%, which means issuers on average will have to pay 3.43 percentage points more when they get new debt compared with what they had been paying before.

S&P downgraded its sovereign credit rating on Egypt to 'B-' from 'B' and revised its outlook to stable from negative. S&P mentioned that the downgrade reflects the recurring delays to the implementation of monetary and structural reforms, exacerbating currency market imbalances, deteriorating systemic banks' net foreign asset position, and delaying critical IMF disbursements and other multi- and bi-lateral financing. S&P also highlighted the government's high debt servicing costs (domestic debt accounting for 70% of total debt) as a potential challenge to debt sustainability. Interest spending consumes over 40% of government revenues, limiting fiscal space to provide additional support to Egyptian households. Separately, due to geopolitical tensions in the middle east, Egypt is also likely to see fewer tourists, further pressuring the Egyptian economy.

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 risk averse environment, though developed market sovereign yields still on the uptrend. Global equities fell 2.5% last week, a broad sell off, with no region or sector in the green, except for a small gain in the KSA Index and the energy sector. Volatility on the rise with the VIX at almost 22. Geopolitical issues dominating markets as well as the effect of higher oil prices on inflation and the subsequent rection expected from DM Central banks.

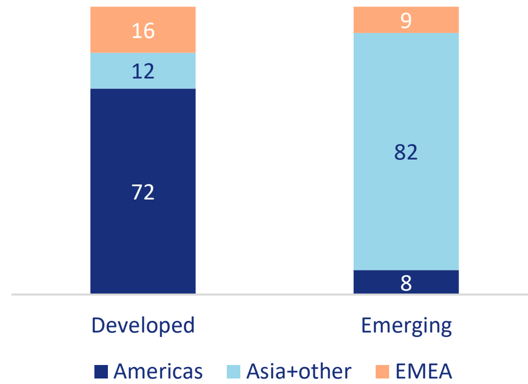
Our positioning is close to neutral on equities, with emerging markets neutral at our last asset allocation committee. We reduced our developed market underweight. We retain our US overweight in preference to the Eurozone and Japan with the USD expected to retain strength. In EM we continue to prefer India on the back of strong economic growth but would watch the impact of higher oil prices. We shifted to a neutral stance on the UAE given the strong YTD performance.

DM equity indices fared just a little bit better than EM with the S&P 500 falling 2.4% last week, trading at 4224 at the 200-day moving average, a key technical level to watch. The Nasdaq fared worse at -3.2% last week, however still amongst the best performers ytd at +25%. Spiking rates continue to penalize long-duration equities, despite better-than-expected earnings results so far this season. This could stabilize, given that the Fed has finally normalized rates (our inhouse view). All global sectors (except energy) fell last week with real estate -4.2% and consumer discretionary -3.7%, the former on higher mortgage costs and the latter on expectation of slowing demand, though September US retail numbers were strong. US airline shares saw steep falls with forecasts impacted by elevated oil prices and wages. Eurozone equities fell 2.7% last week and the luxury sector was amongst the most down. Japan equities fell in line with broader DM performance.

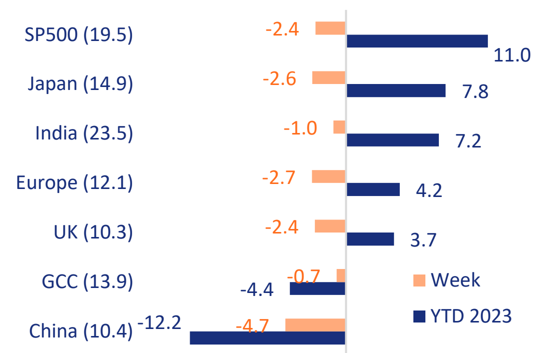
Emerging markets saw the MSCI China fall -4.7% last week. Property woes and mixed economic data are not boosting investor confidence. With China property developers under cash flow stress, defaults could continue following Country Garden last week which failed to make payments on its US dollar bonds. Chinese equities are seeing accelerating outflows, with the onshore CSI 300 index down -13% since early August. There is talk of an official stock market stabilization fund. UAE equities have fallen in October on the back of heightened regional tension though the growth fundamentals remain strong as does property offtake.

For Q3 2023, 17% of S&P 500 companies have reported, blended earnings growth rate for the index is flat y/y. The Technology sector will be in focus over the next two weeks, as most of the magnificent 7 (+87% YTD compared to the S&P 500 +11%, ACWI +8% YTD) report including Apple, Alphabet and Microsoft. Nvidia which reports in November is expected to be the largest contributor to earnings growth for the entire S&P 500 for Q3. All about tech as OpenAI is looking at a valuation of $86bn in a planned IPO, three times what it was worth six months ago. Focus remains on investing in quality companies, preference for select technology (AI, data, Semis, EVs), obesity in healthcare and given the 20%+ run-up in oil prices over the last month we expect energy stocks to catch up.

EQUITY RECOMMENDED REGIONAL POSITIONING

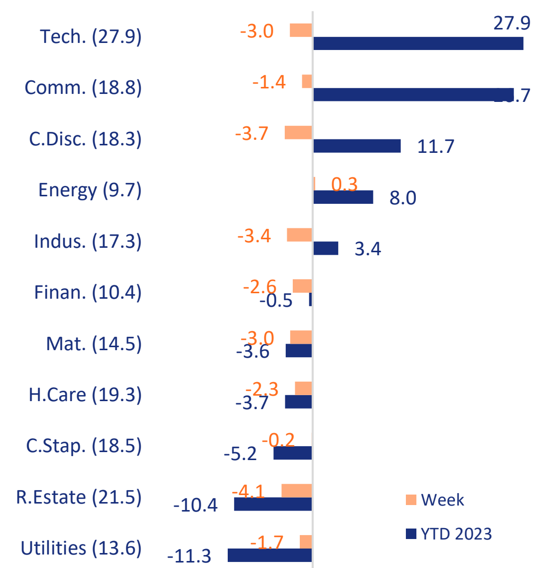


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2023PE



Source: Bloomberg consensus. MSCI All Country World sectors US$.

Emirates NBD
WEALTH MANAGEMENT

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