Emirates NBD
WEALTH MANAGEMENT

Potentially higher, most probably for **longer**

- **The Fed pause is not a pivot: interest rates should remain higher for longer than markets anticipated**
- **A sharp repricing of rate expectations triggered a sell-off across asset classes last week…**
- **… Especially as risks are on the rise with regards to global growth.**

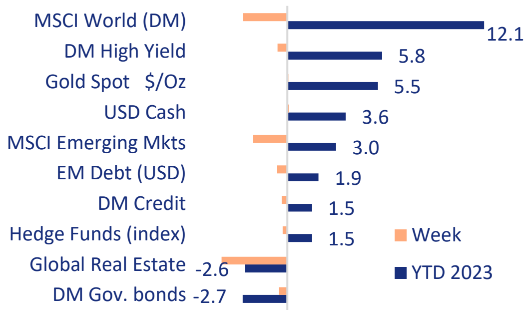
Last week was definitely tough for financial markets, hurt by the combination of two factors. First, while the Fed's September FOMC didn't hike interest rates in September, they clearly delivered the message that the mission was not accomplished yet. With stronger forecast for growth and employment ahead, their "dot-plot" projections maintained an additional hike for this year, and implied only two 25 basis points cuts for 2024, versus four priced-in by the futures markets. The second factor affecting markets was a confirmation of some risks to developed economies' outlook: a potential US government shutdown, steady oil prices, as well as weak flash PMIs, especially in Europe.

Against such a backdrop, global sovereign yields broadly rose to levels unseen in the last 15 years, at 5.1% for the US 2-year treasury yield or 4.4% for the 10-year. Stocks sold off as a consequence of higher yields alongside more macro uncertainty affecting risk-appetite.

Our own scenario from ENBD Research remains unchanged when it comes to US monetary policy: no additional hike this year, and three cuts in 2024. We were actually expecting a "hawkish pause" from the Fed, after the "dovish hike" from the ECB. This is why we favored shorter duration when we increased our allocation to government bonds recently. We however acknowledge that uncertainty is higher, and that the strong consensus for a US soft-landing may be challenged, increasing volatility. Our positioning still carries a large overweight on money market funds, and an overall "quality" bias.

The week ahead will provide more color on the global inflation picture, and market action will be important to understand the actual level of stress.

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



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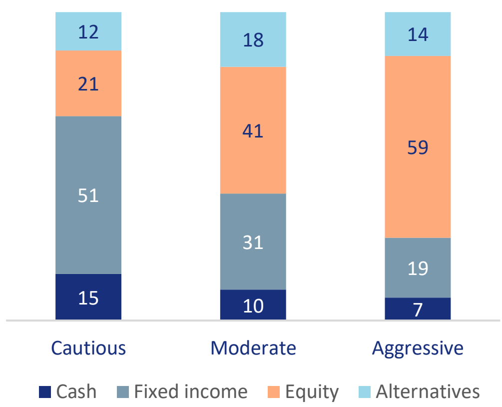
Cross-asset Update

Last week investors repriced equities lower and yields yet again higher in the face of meaningfully tighter financial conditions to be expected in the future following Powell's hawkish stance. We hold the view that the pullback will continue, until markets focus again on the net positive of peak central bank rates. Historically, the last rate cut has seen financial conditions loosen up as Fed funds flattened out with no more hikes in sight. Also, investors could see the glass half full in the immaculate disinflation scenario implied by the latest Summary of Economic Projections shared by Powell, where US growth was revised meaningfully higher for 2024 and 2025. Yet, we hold the view that sometime in 2024 the higher level of Treasury yields should start to bite alongside the delayed effects of monetary tightening, halting the current bullish phase. So far, tighter policy has been offset by the generous fiscal outlays of the Biden administration, as well as the large post-pandemic transfers to households. Both impulses should eventually fall off next year, negatively affecting growth that should eventually be reset lower.

Unless other large economies join in as drivers of global growth, US exceptionalism will soon hit its limits against the backdrop of a fragile outlook. While last Thursday the above-consensus jobless claims release confirmed the resilience of the US economy, the other major regions are not faring that well. In the euro area business confidence surveys showed a fourth consecutive drop in output, with rising odds of a contraction in the third quarter. Recession risks are rising in the UK as well, with the private sector shedding workers at the fastest pace since the depths of the Great Financial Crisis. Only China remains as a good candidate to aid global growth, yet Beijing seems unwilling to go big on fiscal stimulus, hence activity in China is more likely to sputter along than to recover significantly.

Amidst rising uncertainty gold has been resilient, though it has failed to surprise to the upside, struggling under the burden of higher US rates. A new easing cycle would be restarting a gold bull market, and next year it could happen sooner than expected if the soft-landing scenario depicted by the Fed will fail to materialize, as per our view. Also, on a longer time frame gold would be thriving under a scenario where the Fed is forced to implement yield curve control in order to avoid that resurfacing inflationary pressures make the cost of servicing US debt unsustainable. The advice continues to be to buy gold on weakness.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

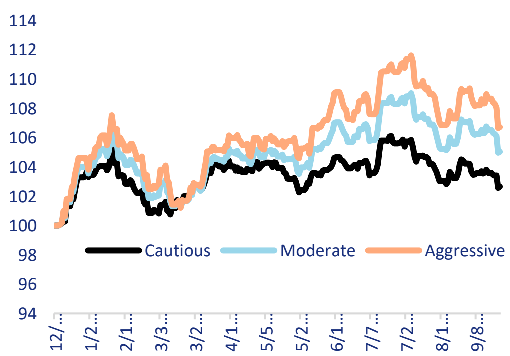


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 recent altercation between Bill Gross and Jeffrey Gundlach clearly outlines that in the bond markets currently central banks are the kings. Last week the Fed provided a hawkish pause with the dot-plot removing not one, but two rate cuts next year. The plots still indicate one rate hike till the end of this year. Investors give it a 50% probability now. The new projections took markets by surprise we had a bear flattening of the US Treasury yield curve. The 10-year went up by a brutal 10 bps and currently trades around a psychological 4.5% level, where we should see some institutions enter new duration trades. The BoE provided a dovish pause, partially balanced by unchanged forward guidance and a clear tightening bias affecting the currency negatively. Rhetoric of “higher for longer” allow CBs to deliver forward guidance against early rate cuts, to anchor inflation expectations and to prevent premature easing of financial conditions.

HG credit continues to grind tighter with spreads hovering around 117bps according to a Bloomberg gauge, roughly unchanged since the beginning of the current tightening cycle. This means that in the battle between yields and spreads, yields are winning. Spreads are overly tight, hence ‘expensive’, with 12-month-forward excess returns at this level historically negative. But we think that with such attractive carry returns, even a marginal widening of spreads due to increased supply in September, should that happen, would not be delivering negative forward returns.

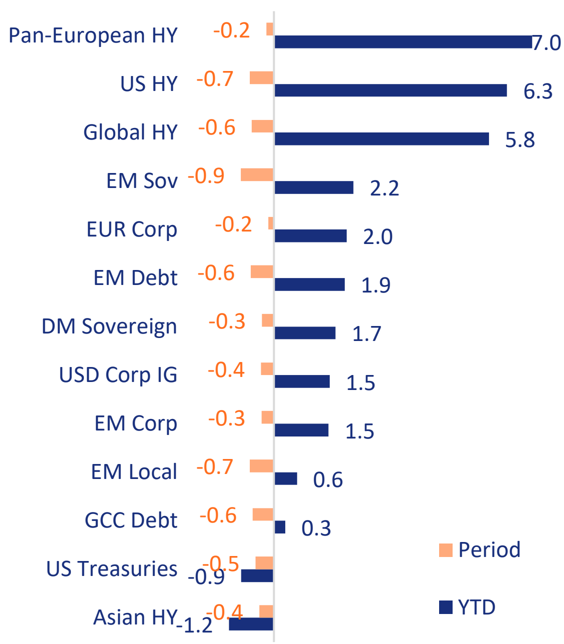
High-yield bond spreads, on the other hand, pushed 7bp wider on the week amid a weakening in risk sentiment following the Fed’s hawkish hold. This comes against the backdrop of deteriorating fundamentals. According to JP Morgan, a review of 2Q23 credit fundamentals revealed HY revenues (-2%) and EBITDA (-4%) contracted for the first time since 4Q20, though notably leverage remains low by historic standards while interest coverage has declined only slightly below its 3Q22 record high.

Within EM, India’s inclusion in the JP Morgan indices was exciting news. However, this was more of a “buy the rumour and sell the news” kind of trade. Indian Government Bond yields steadily increased in the last month despite the RBI being on hold. Currently, the 10-year IGB yields around 7.14%. Within the GCC, the flow of primary issuance deals gathers pace. Last week, the Govt of the UAE tapped the markets for a $1.5bn bond sale priced at 60bps above treasuries. This is 40bps tighter to the 10-year bond issued in 2022. This week, FAB announced the second Tier 2 bond deal from the UAE and FIVE announced IPTs of 9.75% for its 5NC2 inaugural $ bond.

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 hawkish Fed, a stronger USD, Treasury yields higher, oil higher, equities broadly lower. However, upgrades to US and global growth. The major equity indexes fell last week as an ongoing climb in Treasury yields and the prospects for another Fed rate hike unnerved markets. The only market to end the week up was the UAE, which saw a real estate sector rally.

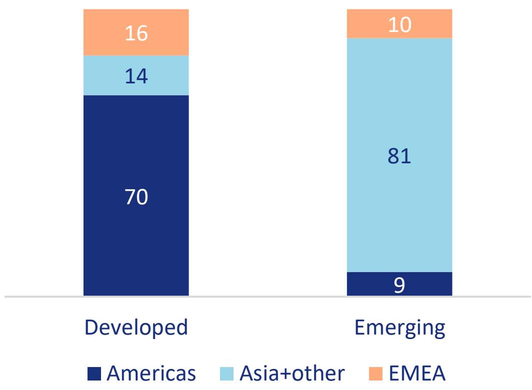
The Volatility Index (VIX) is up at 17. Month-to-date global equities have fallen 3%, with US equities falling more at 4% and the Nasdaq down almost 6%. Eurozone equities fell 3.6%, as luxury and basic materials stocks fell on recession and demand concerns. Eurozone banks saw a sell-off and in in the US the regional bank index lost 7%. The FTSE 100, which has many companies that earn revenues in dollars but report earnings in sterling was up 0.4%. Sectors most sensitive to interest rates such as real estate, consumer discretionary, and financial companies were among the poorest performing sectors with the KBW Regional Banking Index at an 11-week low. Emerging markets fared better than developed in September, with India and UAE equities up, and China equities down just 1.5%.

US equities fell last week, the S&P 500 –2.9% as concerns grew on a government shutdown and weakening consumer activity. Whist the Fed focus is on core inflation that excludes the more volatile food and energy prices, higher oil prices raise transportation costs and trickle into the economy overall. Airline fuel is up 30% since July and gasoline prices are up by 11%. Treasury yields, near a 16-year high, and higher oil prices, with the lower-than-expected August housing starts reported last Tuesday could dent consumers' spending power. Outside the US, equities also experienced losses but showed some resilience on the back of further disinflation.

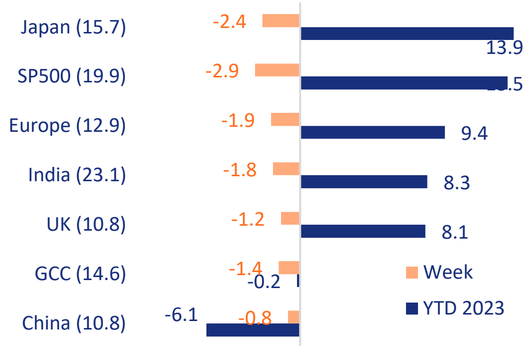
Developed markets continue to lead global equity returns +12% YTD, supported by the performance of the magnificent 7 tech stocks. The Nasdaq still +27% YTD, though higher yields are weighing in recently. Our fair value for the S&P 500 is at 4500 and S&P 500 earnings y/y are expected to stay flat in Q3 and return to positive growth in Q4, supporting US equity performance. The US economy has so far withstood the higher rates, with a still strong labour market. We recommend quality at a reasonable price. The three recent US listings: have seen muted gains. Klaviyo, Instacart and Arm.

The KSA's Tadawul Index has gained +7.7% YTD and like the UAE, plenty of high-dividend-paying companies and a high beta to oil prices, with listed entities that include oil producers i.e. Aramco. The KSA has also seen successful listing of IPO's, broadening the market. New issuance continues: the latest coming to market is "SAL" Saudi Logistics Services Co., an airlines cargo company. Saudia owns 70% of SAL, while Tarabot owns 30% of the firm. Today car rental firm Lumi Rental Co. is set to debut. Oil driller ADES Holding Co., backed by the KSA sovereign wealth fund, last week drew $76.5bn in orders for its $1.2bn IPO, the KSA's largest this year. Recent KSA IPO's average return is 94% from listing.

EQUITY RECOMMENDED REGIONAL POSITIONING

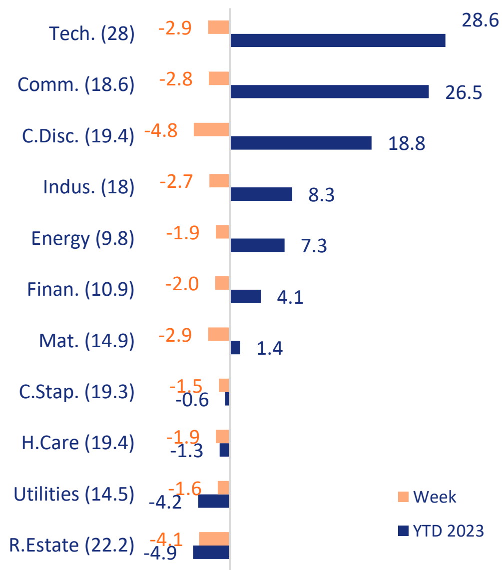


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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