Markets resilient in the face of looming credit tightening

- **Four central banks raised rates while Powell warned of impact of tightening conditions**
- **Banking crisis backstopped against backdrop of still resilient economy**
- **Geopolitical risks could intensify if China peace plan fails to ease tensions**

The week was defined by central bank continued monetary tightening, and reassurances on capital adequacy in the banking system, and further hikes to be measured against the broader health of the economy and financial stability. The outlook for markets remains centered around monetary policy, the banking system, and economic data, although at the March FOMC chair Powell warned of "tighter credit conditions" down the road following "recent developments".

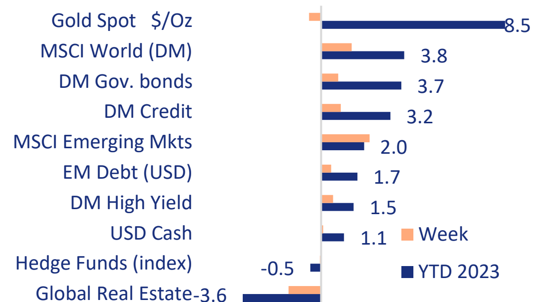
It was a good week for global equities, more so for the emerging markets, that are not seeing any fall-out from the banking stress in Europe and Asia. Money market funds saw record inflows as did gold, that briefly touched $2000 on flight to quality. Technology outperformed, while real estate lagged on rising concerns about the commercial segment.

Markets were resilient on upside surprises in business confidence surveys both in the United States and in the euro area. The temporary expansion of the Fed's balance sheet via the Bank Term Funding Program also tempted investors to see in the new crisis measure a form of QE, though such an interpretation is misplaced.

We hold the view that, rather than focusing mainly on central bank liquidity and temporary rebounds in surveys, one should as well be mindful of the inevitable credit crunch down the road due to bank retrenchment. Also, geopolitical risks seem to be on the rise in spite of China's peace plan proposed for the Russia-Ukraine conflict.

We advocate for a quality bias both in the equity and fixed income asset classes, as wells as for adding to gold as a hedge amidst rising macro and geopolitical risks.

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



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Cross-asset Update

We hold the view that the time has come to look again to gold as a portfolio hedge, against rising macro and geopolitical risks. Despite the high-single digit year-to-date performance, a confluence of favourable factors speaks to further upside potential.

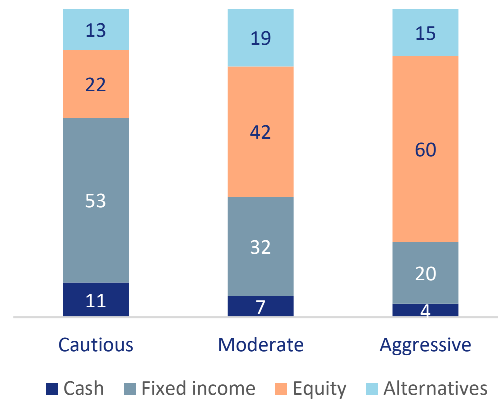
The uncertainty caused by the banking crisis in the Western world has pulled forward the start of the next recession in the United States. Banks will not be comfortable to expand lending when deposits rates are very low as compared to the now very competitive money markets funds. Lenders remain exposed to the risk of having to tackle substantial withdrawals, even as the lagged effects of the past tightening on the economy have yet to be felt. Chair Powell at the FOMC press conference said that, although the US banking system is “sound and resilient”, we are likely to see “tighter credit conditions” down the road weighing on “economic activity, hiring and inflation”. The sooner conditions deteriorate, the sooner investors will be looking forward to the start of the next easing cycle. Indeed, according to Powell Fed officials “don’t see rate cuts this year - they just don’t”, yet policy makers could panic if the concerns expressed about the credit crunch come true and cause more institutions go under. Each Fed tightening cycle has ended with some sort of crisis that required repair, and the failure of Silicon Valley and Signature Bank are a symptom of a system-wide problem, rather than isolated issues representing the problem themselves.

President Xi’s trip to Moscow and the subsequent release of a Chinese peace proposal last week for the Russia-Ukraine war were met with quite some scepticism in the West. This is the first peace attempt made by a third party to the conflict that would have the required clout to make an impact and open the door to an easing of the tensions. If, whatever the reasons, it falls on deaf ears, then odds rise substantially that events precipitate further, before they eventually take a turn for the better. This would be unexpected, after the Ukraine war has taken a backseat in investor minds.

Last but not least, in the fight against inflation central banks are challenged by some secular factors fostering price pressures. The list is long, and they range from the push towards the green economy, requiring commodity-intensive investments, to the global fragmentation and reshoring, whereby manufacturing would be relocated from most efficient to friendlier countries, to the demographics of aging populations that would tend to save less and spend more.

In summary, macroeconomic uncertainty pulling forward the easing cycle, alongside geopolitical risks lasting much longer than we all could envisage, constitute positive catalysts to add to gold positions, against a backdrop of secular factors supporting higher inflation despite central bank efforts.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

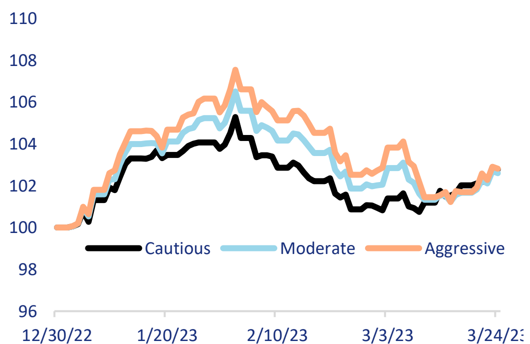


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Markets and the Fed are in a staring contest, and who blinks first remains to be seen. Last week's FOMC meeting went along the expected lines with a 25bps hike. The Dot Plot for 2023 was not changed, while there were a few more hawkish plots for the year. On the other hand, markets price in 80bps of rate cuts by the end of the year. For the time being the Fed is espousing a preference for "Price Stability" over "Financial Stability" and thinks it has the tools to prevent a banking crisis. Only time will tell if the Fed can maintain this stance in the case of a recession. The Fed also announced no change to the pace of QT. The ongoing liquidity support through the BTFP will not impact the balance sheet drawdowns. But Chairman Powell anticipates the banking crisis to lead to tighter lending conditions. In the Q&A, he mentioned that the resultant tightening could be equivalent to at least one quarter-point hike.

The 2s10s part of the yield curve is headed for the steepest bull-steepening since October 2008. From a high of 107bps in early March to the current44 bps inversion indicates markets are anticipating a recession and significant policy responses towards the end of the year. This move would have been fantastic for clients with long-dated treasuries or IG bonds in their portfolios.

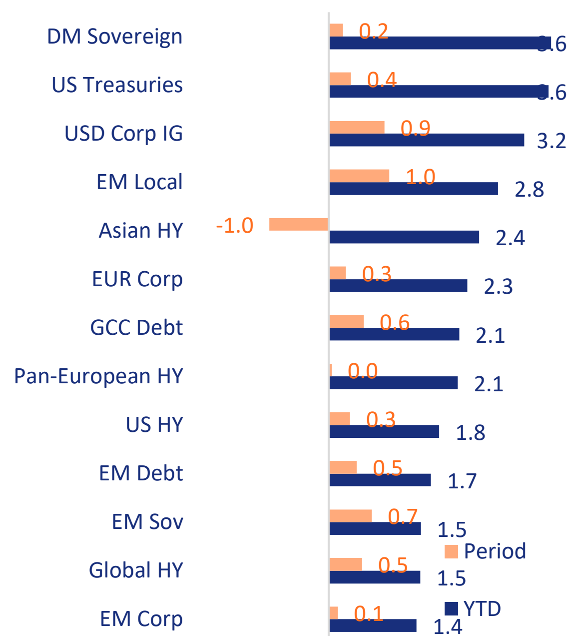
The long-dated treasury index is up 5% since 8th March, and the IG Index Is up 2.7% MTD vs. HY return of -0.7% and EM Return of +0.7%. YTD, the former asset classes are ahead by 200bps. In the last month, HY and EM debt spreads have widened by 100 and 50bps respectively, while the IG spreads have widened only by 26 bps. Thus the high beta segments (HY and EM Debt) did not benefit from the recent decrease in the US Treasury yields, while IG yields have come down, providing outsized returns. If we are correct about our assumptions of an oncoming slowdown, this outperformance will only increase.

GCC primary markets opened after a hiatus. Al Rajhi Bank issued a mandate for selling the inaugural 5-year USD sustainable sukuk. It is the largest Islamic bank in the world, with Assets of more than $200bn. It is the second largest bank in the KSA, with around 21.1% market share in domestic banking assets. As of FY22, the capitalization ratios of the bank improved and remained strong, with CET-1, Tier-1, and Total CAR at 17%, 20.3%, and 21.4%, respectively. The loan portfolio is $153bn, of which around 75.7% is retail portfolio (reduced from 81% in FY21). The deposits stand at $150bn. NPL of the bank remains low at 0.54% vs. 0.65% in FY21 and has a provision coverage ratio of 260%. The bank generated an RoA of more than 2% in the last four years. ARB's cost efficiency is the strongest in KSA, with cost to income ratio of 26.1%. The deal is expected on Wednesday or Thursday.

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

Emirates NBD
PRIVATE BANKING

Equity Update

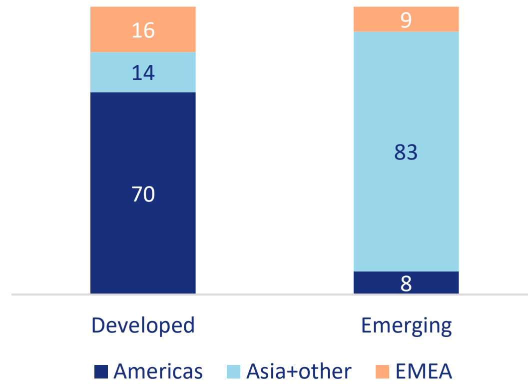
Markets were reassured by central banks that "all is well" and that they would deal with bank stress on a case by case basis but act to prevent the spreading of contagion. For the week, global equities rose 1.5% with emerging markets China, the KSA and the UAE the better performers. U.S. stock indexes ended slightly higher on Friday, with weekly gains at 1.5%, however with intraday and daily volatility now a persistent pattern. The Nasdaq rose for a second week and is +13% YTD, buoyed by lower Treasury yields, compared to global equities at +3.7% YTD. Investors are favoring profitable growth i.e. big tech is outperforming, and also staying defensive as money market funds are seeing massive inflows. Super cap tech is once again in favour. Microsoft and Apple currently account for 13.3% of the S&P 500, the most on record. Not since AT&T & IBM in the late '70s have two stocks been so dominant. European equities gained over 2% last week but Europe's outperformance vs the US is likely to stall in the near-term given a rotation away from Financials and Value. Europe's strong start to this year was driven by strong outperformance from both financials and cyclicals.

Our positioning favours EM over DM and within that broad Asia i.e. Japan and EM Asia. Quality corporates with strong balance sheets will continue to outperform and we reiterate that with slowing growth and tightening lending low leverage and sustainable cash flows are even more important.

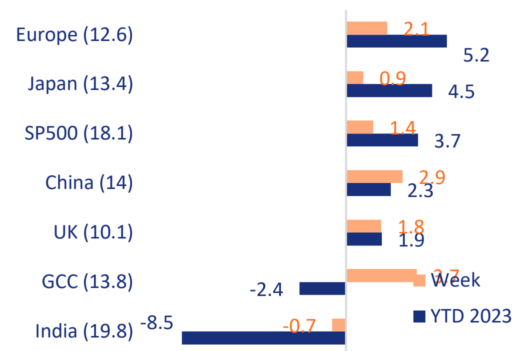
UAE equities had a good week with IPO's receiving strong interest. Al Ansari Financial Services shares will start trading on April 6 after it raised $210mn, pricing shares at the top of the range at AED1.03, valuing the company at $2.1 bn. The IPO had an AED200mn commitment from cornerstone investor National Bonds Corp. and excluding that, the IPO was oversubscribed about 22 times. Adnoc Gas has surged 27% in Abu Dhabi since it raised $2.5bn in the world's biggest IPO of the year earlier this month. Presight AI Holding, a G42 spin-off specializing in data analytics powered by AI, listed on ADX today, more than doubling its share price on debut. The IPO which raised US$496mn was oversubscribed 136 times, excluding the commitment from cornerstone investor, IHC.

The Global banking sector which rallied in February and March has fallen 16% month-to-date. EM economies have seen banks face less downside and so far immune to banking woes. In the past fortnight, four banks have collapsed in the US and Europe with extraordinary swiftness with digital platforms providing 24 hour access to depositors. There have been interventions to protect customers, from emergency-lending facilities to takeovers. In the US, small and medium banks are feeling the brunt of higher interest rates, whilst depositors would be supported through varied measures, though full guarantees were not explicitly mentioned by regulators. Banks are tightening lending standards, especially to smaller corporates, limiting growth. The $5.6tn US commercial property loan market is the first to be facing tighter lending conditions. The auto sector is also under increased scrutiny given the dependency of the sector's profits on financing.

EQUITY RECOMMENDED REGIONAL POSITIONING

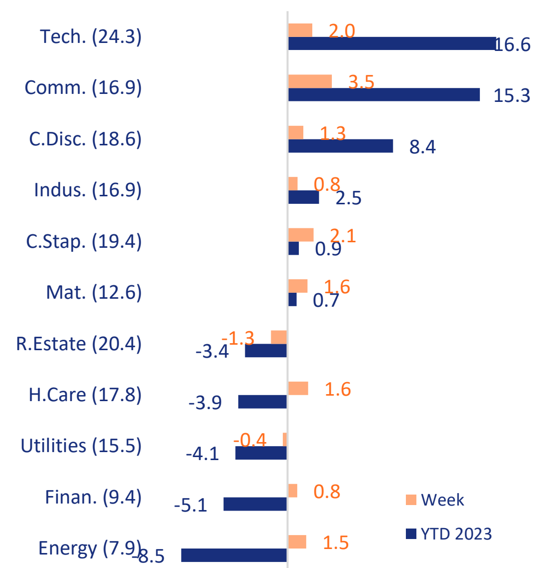


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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