Preparing for different **market drivers in H2**?

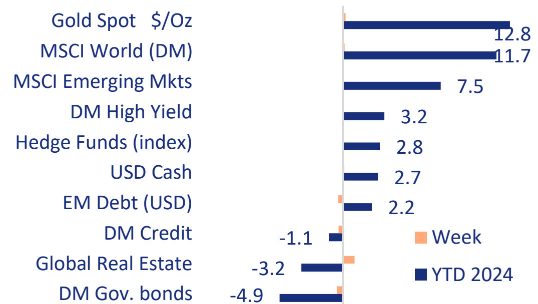
- **The first half of 2024 ended with relatively constructive fundamentals and positive market returns**
- **The data-rich week ahead should confirm better economic visibility…**
- **But other drivers of volatility, politics and geopolitics, will continue to take center stage.**

The first half of the year ended with the US core PCE coming in reassuringly in line with forecast, leading to overall stable weekly returns across asset classes. The focus was elsewhere: rising doubts about President Biden's potential to run for a second term after a terrible debate, and rising certainty that French voters are unhappy with their current leadership as the presidential party came only third in the first round of parliamentary elections.

The Year of Answers, as we called 2024 in our Global Investment Outlook, delivered a constructive first half for a diversified portfolio. Inflation was a bit stickier than we initially expected, especially in the first quarter, but growth was also overall stronger and with a better regional balance. Central banks took note but behaved in line with our conviction that they have little room for manoeuvre and a serious dose of risk aversion. All in, markets were driven by fundamentals, with, as expected, differentiated behaviours between and within asset classes, leading to positive returns for our three profiles, at respectively +2.2%, +5.4% and +7.6%.

The week ahead will be data rich, from global leading indicators to US job market updates or Eurozone inflation. They should confirm a "soft landing" scenario. Unfortunately, better top-down visibility will be countered by more political and (intertwined) geopolitical uncertainty. Our July TAA Committee will take place next week, with the learnings from this week's economic releases and the guidance from the mid-year refresh of our year end fair values. We will try to find a balance between positive fundamentals, mostly translated into valuations, and risks. Have a great week.

ASSET CLASSES USD % TOT.RETURN, 2024 & LAST WEEK



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Cross-asset Update

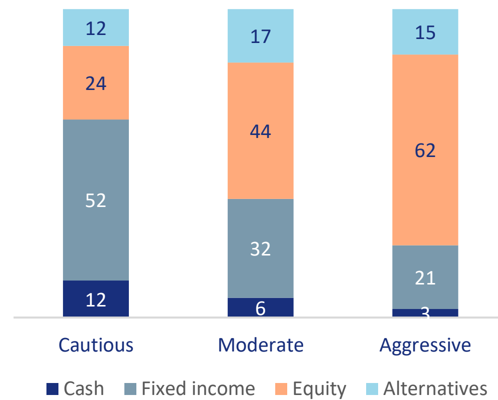
It looks like markets could soon meet some air pockets. In the United States it is not so much about the economy, as a matter of narrow equity breadth and of some signs of dwindling liquidity. The number of stocks participating in the rally is historically low and most of the action continues to be concentrated in the technology sector. In Europe there is uncertainty due to the French elections and the latest business confidence surveys have pointed to a recovery that is lacking momentum. The euro area composite advance PMI dropped below 51 two weeks ago and soon after in Germany the business outlook worsened for the first time in five months, as per the IFO survey. In China things are not looking up either, with muted domestic growth amidst a real estate crisis that needs some policy intervention. In the United States the transition from the post-pandemic boom to a normalising economy, even as the high Fed rates start to bite, is not smooth. On Friday longer-dated yields rose significantly despite a benign PCE inflation release, that caused a steepening of the yield curve. The number of cuts seen in the next twelve months was adjusted slightly lower by money markets and yields traded higher accordingly.

The growing number of headwinds indicates that markets are more likely to edge higher rather than race ahead from current levels. The Fed pivot towards the end of last year boosted liquidity conditions that can no longer be inflated without inflation becoming yet again a problem. And the stalling of the bitcoin rally and the widening of credit spreads in the weakest pockets of the high-yielding market are suggestive of a receding liquidity tide.

Views about the macro outlook are still split between a no-landing scenario, whereby the US economy remains actually quite strong, and a soft landing one, where growth slows gradually down and the disinflation process stays on track. Market signals on the other hand are in multiple directions. By focusing mainly on technology and neglecting cyclical stocks equity investors send a negative message about the prospects for business activity. On the other hand, dollar strength and rebounding yields keep the door open for a stronger outlook. The limits of the current rally will be met once IT positioning becomes overcrowded and the trade unsustainably expensive. By that time, either investors will have rotated into more cyclical sectors allowing for a broadening of the bull market, or equities will no longer be able to defy gravity.

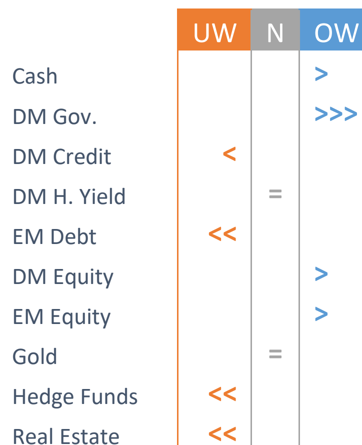
Risk assets are for now blissfully ignoring geopolitical and election risks. The latter will be rising as US elections get in full swing, adding to the growing number of headwinds spurring market volatility.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



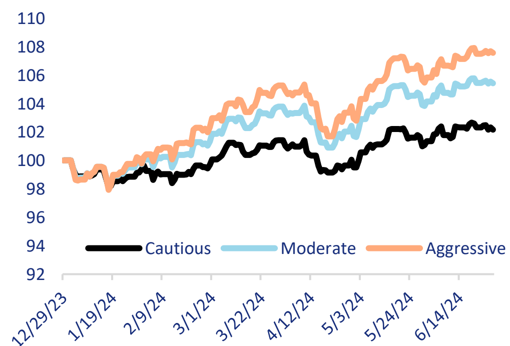
TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 – 2024 INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

The first half of 2024 is over and we stand in a very different macro environment as compared to how the year started. Geopolitical risks have definitely increased. This was one of our top risks for the year as discussed in our Global Investment Outlook 2024. Early elections have been called both in the UK and France where incumbents are expected to lose. Last Friday's disastrous live debate has put President Biden's campaign under the scanner. Meanwhile, markets seem to have suddenly started noticing the ballooning fiscal deficits of developed market economies. French OATs have been punished with the spread to German Bunds increasing to 80 bps.

Meanwhile, after a high turnout in the first phase of French elections held last weekend, Marine Le Pen's National Rally was projected to get between 33% and 34.2% of the vote lesser than earlier estimates. The bond markets have taken this positively as expansive monetary policies odds in the country has decreased slightly. The focus now turns to the next phase of voting that takes place next Sunday. The country could be looking at an extended period of gridlock in National Rally doesn't win majority. We continue to like the French bank subordinated debt which are off their tights.

US economy remains strong albeit with a dose of weakening giving rise to more probability of a soft landing. Fed rate cut bets for the year are down to two for the year as employment still looks robust even though Dot Plots show only one rate cuts till the end of the year. However, Friday's debate in favour of candidate Trump has resulted in the US long-end yields increasing. The 10-year yield jumped by 10 bps on Friday despite PCE data in line with expectation and softer than expected personal spending data.

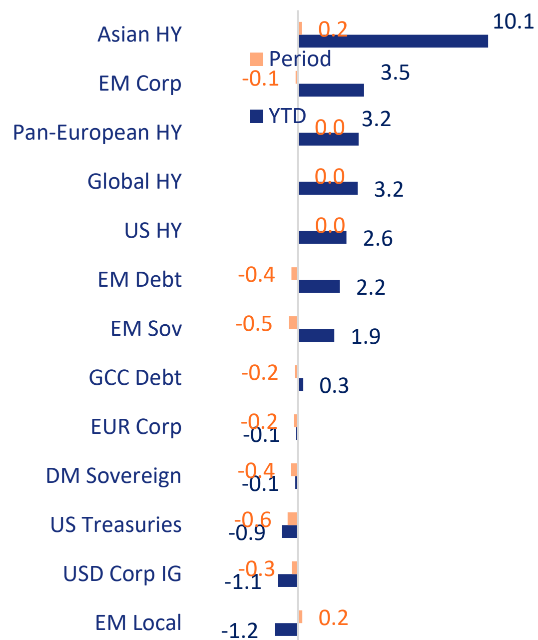
Bond markets have struggled as rate cut bets have been pared and the US Treasury yields have remained high. Developed Market Govvies have lost close to 5% while High Yield and Emerging Market Debt have provided 3% and 2% return. Carry trade opportunities in Turkey, Egypt and more recently in India due to its JP Morgan index inclusion have gained investor interests. Already close to $8bn has flown into Turkey and India expects close to $40bn passive index tracking fund inflows. We advise long-duration positioning in Indian G-Secs which are already the best performing Asian rates market this year.

Credit markets currently trade slightly below their median spreads for this quarter. According to JP Morgan, HY balance sheets are in a good position with leverage only 0.2x above a decade low and coverage metrics still 0.5x above the long-term average. Access to capital is broadening with 2024's $235bn of B3 or lower rated issuance. Credit should provide carry returns over the next six months and spreads will remain rangebound.

FIXED INCOME KEY CONVICTIONS (2024)

DEVELOPED MARKETS
Overall overweight DM FI
OW Government Bonds
Neutral corporate (IG & HY)
EMERGING MARKETS
Overall UW EM Debt
Favor quality and selectivity

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

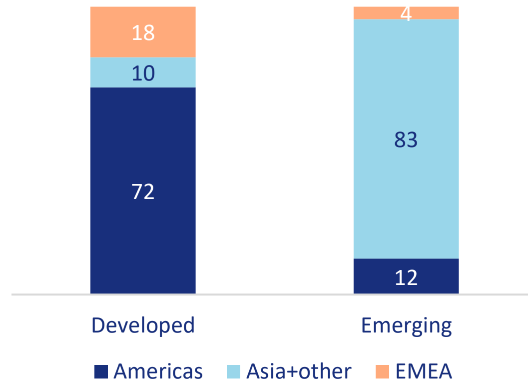
A growth-driven rally in the first half of 2024– with the tech Mag 7 up 37%, Indian equities leading among regions +17% and the US S&P 500 +15%. The laggards are China and the GCC, though the latter gained traction in June. Tech (+31%) and Communication services lead sector returns. Sentiment has been backed by strong earnings growth from the high performers and resilience from the Mag 7 in terms of price momentum and earnings revisions. Historically, a strong first half tends to be followed by above-average second-half returns and seasonal trends suggest momentum could continue. However, statistics don't drive markets, H2 starts with worries on valuations, election impact on policy and the dominance of tech in earnings and performance.

We were overweight/neutral the US in H1 and would continue with that positioning, as AI driven profit growth is there to stay. Many new highs seen in H1 from the S&P 500 and tech leaders. We now have three USD 3 trillion market cap companies. Comparison to the 2000 dot.com bubble with a concentrated rally, elevated valuations, overbought conditions, underwhelming market breadth. Add the Presidential debate with uncertainty around policy/ tariffs. A slowing inflation trend, but high wage costs and interest rates for longer, along with increasing delinquency in Commercial real estate are worrying. But no red flags as large US banks announced higher payouts after passing the Fed's annual stress test.

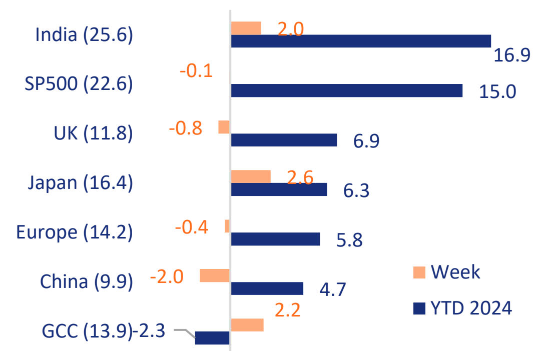
Unlike the dot.com bubble where the tech companies were largely unprofitable todays tech sector is low leverage with high margins. Valuations are worrying and any earnings miss will be punished. Consensus expects +9% y/y EPS growth for the S&P 500 in 2Q 2024 and double that for the tech sector and margins are being maintained (12% expected for Q2) which offsets the 22X forward earning valuation for the S&P 500. The biggest risk is a lack of positive guidance from the big 6 tech behemoths any quarter. Disappointing June Europe performance as the announcement of snap elections in France led to a sell off. Japan we are UW as strong local currency returns but the weak Yen is affecting USD returns. Higher rates may help the Yen and wages growth consumption.

A good month for UAE and KSA equities. Valuations remain attractive and oil prices steady. Real estate transactions in the UAE have been resilient as has economic growth driven by both oil and non-oil sectors. Expect more capital market activity. We favour banks, real estate developers and the Abu Dhabi based ADNOC companies – a mixture of dividend yield and growth. India overcame early election market volatility and is the only big economy (apart from the US) that has been a consistent compounder with 7% CAGR returns (in $ terms) since 1991. China is -2% in comparison. A balanced growth model focused on domestic consumption and manufacturing. Aiding the boom is US and European companies shifting manufacturing away from China to India.

EQUITY RECOMMENDED REGIONAL POSITIONING

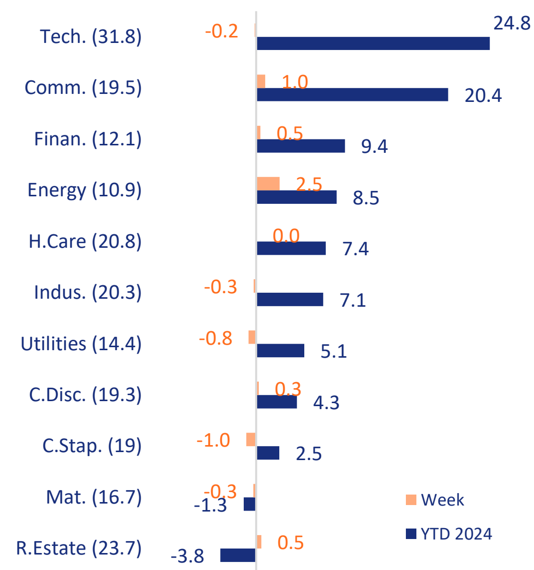


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$), P/E in brackets



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

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