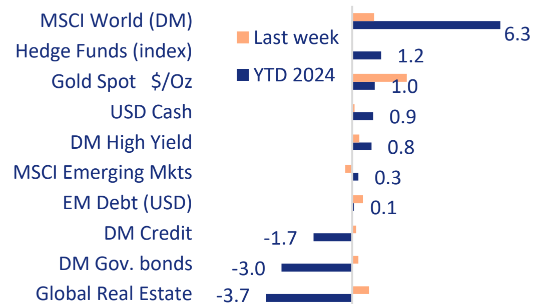
An immaculate **disintegration** (of the consensus)

- **With resilient growth and sticky inflation, market expectations for rate cuts have dramatically evolved**
- **Markets had however a good week overall, as the focus shifts away from just central banks**
- **Next week will provide some update with Fed's Powell semiannual testimony before the US Congress**

The most awaited number of last week was the January core PCE, the Fed's preferred measure of inflation, on which their 2% target applies. January's +0.4% gain was the fastest monthly increase in a year. The rolling 3-month annualized measure increased from Q4's perfect 1.6% to 2.6%. The rolling 12-month however decreased from 2.9% to 2.8%, meeting the median forecast – mathematically just because December 2022 exited the 12-month period. Markets reacted by seeing the glass as half full. Of course, the Fed will be slow and patient. But markets had already started to price out unreasonable cuts from their expectations. So, what remains is robust growth, leading to robust earnings, turbocharged by AI. Stocks printed an all-time high in the US and most major asset classes ended the week in positive territory.

A central point of our 2024 outlook is to expect central bank dominance on markets to materially fade. Last week's returns and the negative correlation between stocks and bonds so far in 2024 are consistent with this view. But even for us, this looks a bit too quick and radical. Some Wall Street gurus are now expecting 2 or even zero rate cuts in 2024 (from 6 to 8 just months ago). The monolithic "soft landing" consensus of January was a concern, though considering that all of a sudden monetary policy doesn't matter is too extreme. If inflation stops moderating, this will impact bond yields and equity multiples. If inflation moderates, we should have cuts. We haven't changed our view (soft landing, gradual disinflation, 3 cuts) but still expect volatility. The week ahead will provide colour on activity (with most of regional PMIs), on US employment (NFP Friday), on the Fed's stance with official speeches from Jay Powell, and hopefully, progress towards a cease-fire in Gaza for the holy month of Ramadan. Have a great week.

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



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Cross-asset Update

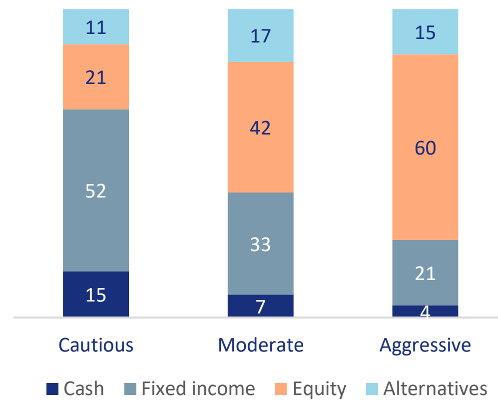
While investor interest remains riveted on the AI theme, on the resilience of the US economy and the Fed, both Brent crude and gold recorded gains for the week. Oil clung to the highest levels of the year after OPEC+ announced the rollover of some production curbs, while bullion shot almost 2% higher on Friday on steady inflation and mixed data on manufacturing confidence. Unfortunately, it would be the Middle Eastern crisis that prices are responding to, as the cartel's decision seems to have been priced in already. So, taken together, oil and gold could suggest rising geopolitical risks, even as uncertainty remains on the most cyclical sector of the economy.

The ISM Manufacturing Purchasing Managers' Index fell short of expectations, in contrast to the upside surprise in the S&P Global Manufacturing PMI and the regional surveys pointing to improved conditions. This should allow us this time to take the ISM release, usually more reliable and widely followed, with a pinch of salt. After all, although new orders surprisingly fell, the all-important new-orders-to-inventories spread remained close to the highs of the year, boding well for future developments. Meanwhile, inflationary pressures reemerged alongside strength in personal income as per January PCE data. Overall, the impression of US exceptionalism has still reason to stick, and incoming data from the ISM services to the employment report should support the assumption.

Real and nominal yields fell last week, keeping the yield on the 10-year Treasury note technically on the downward path that was started with the 5% high recorded in October last year. This would point to the US economy failing to reaccelerate and eventually the need for Fed cuts to avoid the unintended consequences of restrictive monetary policy. Although the January uptick in inflation could be a one-off caused by seasonal factors usually particularly pronounced in that month, in the end it is not easy to reconcile rising oil and gold prices with falling yields, and a manufacturing sector that gives the impression to be on the mend despite different nuances in the data.

For now, we can conclude that the rally in equities remains strong and supported by the business cycle, crude oil seems to be on the verge of a relevant upside breakout, while gold keeps on being bought on weakness. Indeed, gold should be the long-term winner of rising geopolitical risks, untamed inflationary pressures, and inflated debt levels across the Western economies. Eventually, yields would be suppressed by central banks to avoid that debt burdens become unsustainable, in a coherent picture marked by currency debasement.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

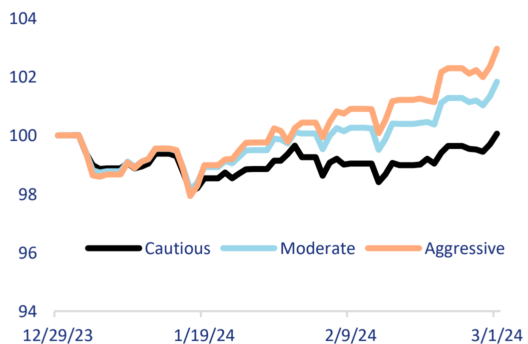


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Last week, markets reached a state of Zen. Despite solid macro data, we failed to see yields move up from their current trading range. Treasury yields declined sharply on Friday, leaving 2-year yields 13bps lower as the ISM Manufacturing printed a weak 47.8. Indeed, the most anticipated data release came in line with consensus but underscored the elevated uncertainty over the near-term direction of policy; as core PCE rose 0.4% in February, the firmest monthly pace since January 2023. Personal income came in strong at 1% versus the consensus estimate of 0.4%. However, we see a reversal of the market consensus as more solid data prints are revealed. Goldman Sachs revised its rate cut assumptions till the end of the year to 2. This indicates a possibility of the 10-year to touch 4.5%. It was a sharp turn for the firm, which started the year with a rate-cut bet in March. We started the year with a neutral duration bet and still hold the view.

This week brings elevated event risk with Chair Powell's Congressional testimony on Wednesday and Thursday and the February employment report due on Friday. We don't expect Chair Powell to stray much from recent messaging, which several Fed members have reiterated in the past couple of weeks. We expect he will convey that the FOMC plans to start lowering rates at some point but that the Committee wants more confidence that inflation is moderating before these cuts occur. Dallas Fed President Logan commented Friday that it would be appropriate to slow the pace of QT as the RRP facility drains, while also noting that the appropriate long-run size of the ON RRP program should be close to zero. It would be interesting to note if Chair Powell sheds some light on the Fed balance sheet during his testimony.

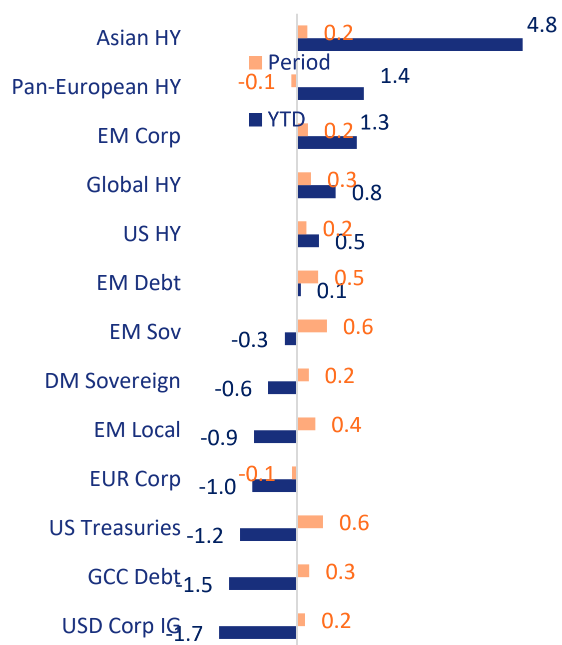
Investment grade credit spreads have remained within a tight 4bps range between 90-94bps in recent weeks, as another record month of supply was relatively well absorbed. February has brought $194bn in paper to IG markets, 28% above the previous $152bn February record set last year, as YTD supply has risen by a record $388bn over the first two months of the year (+30% yoy). According to JPM, 16% of the S&P 500 has yet to report earnings, only about 19% of what analysts deem as "frequent borrowers" have yet to issue a bond YTD, and issuance sizes have been lumpier as of late. Meanwhile, global high-yield spreads have touched 400 bps and are off their YTD tights. The HY rating distribution indicates a bias towards quality BBs at 46%, remaining 600bp above the long-term average.

Emerging Market debt issuance remains robust, with GCC leading the way. We had four deals from the region last week. Three of them were sukuks. The pricing of the recent deals has been towards the lower range of our estimates. A-rated names from the region currently trade 85 to 95bps above treasury. The perpetuals of strong banks trade at least 150 bps below Euro Area banks. We perceive the debt from the region to be fairly valued with limited capital appreciation opportunities.

FIXED INCOME KEY CONVICTIONS (2023)

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

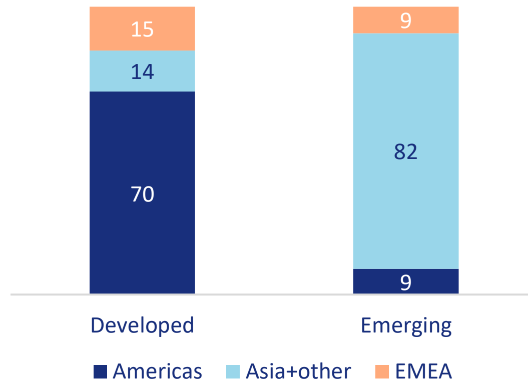
Last week saw equity indices make new highs: the Nasdaq benefitting from the Magnificent six or now four charging on. New highs by the S&P 500, and the European Stoxx600, with Japan indices close to all-time highs. Developed Market equities over 6% YTD, with a strong February adding +4.2%. Japan leading YTD returns at +9% in Dollar returns, the US at +8% not far behind.

Our Japan overweight is working so far and catalysts for further performance from Japan include strong consumer demand and dominance in robotics, and effective capital market reforms aided by stocks trading at low price-to-book giving room for valuations expansion. Emerging market equities are finally in the green, with February adding 4.8%. China YTD returns at -2.5%, even after a substantial rally in February. India, the UAE and the KSA more consistent at 6-7% gains this year, less volatile and our tactical and strategic preference for the UAE and India is reiterated. US banking woes largely ignored by markets with New York Community Bank's exposure to commercial real estate seen as contained.

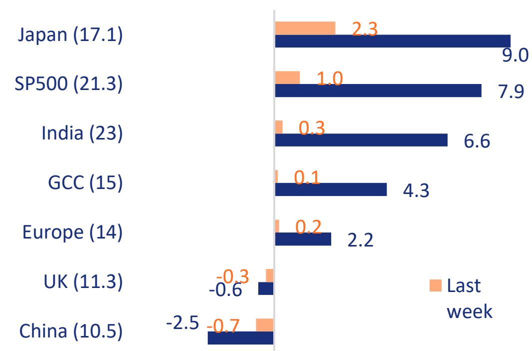
Interesting statistic: from 1926 to now, the S&P 500 has traded at a record high 30% of the months. We don't need to sell if the Index has made a new high, but watch the underlying growth fundamentals, fiscal and monetary policy, higher yield impact on bottom lines, consumer demand and geopolitical risks. Since November, stock indices have risen regardless of what rates were doing. There is growing optimism around central bank easing and the equity/bond correlation has reversed. Since the start of 2024, despite the rate sell-off, equities have returned 6%, with market focus shifting from rates relief to better growth. US growth and slowing global inflation remain supportive. US equity markets have been dominated by the performance of mega-cap tech, raising concerns about its narrow breadth and valuations, but this has been backed by strong earnings. Also, the rally is wider than just the megacap techs with Japan the best performing major index in 2024, Europe's healthcare and luxury companies also performing well, even without the boost from AI and tech, so breadth continues to build.

The efficiency of AI adding to corporate bottom lines has dwarfed recent US and Europe inflation readings and central banks holding on cutting rates. AI is adding to infrastructure spend on datacentres, revolutionizing healthcare but comes with the pitfalls of increased consumer mapping on social media channels with targeted advertising and raising doubts about privacy of data and influence in elections, with 40% of the world in elections this year. Also, we have to separate the wheat from the chaff as not everything AI goes up and is not Nvidia, AMD or other chipmakers There will be a shake out so stay with growth companies with clear business plans and products that can keep up with the fast pace of technologies evolving around data and computing speed. And diversification always works. Yes, hold onto your US (the core of the portfolio) and chipmakers and platform company stocks, but look at AI adopters and healthcare and geographies outside the US like Japan and India.

EQUITY RECOMMENDED REGIONAL POSITIONING

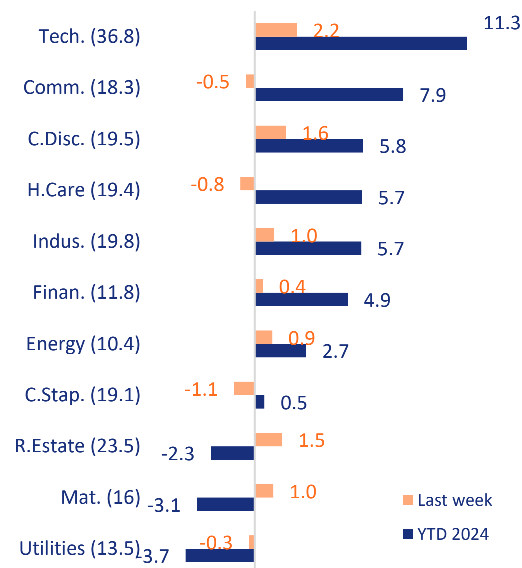


MAJOR INDICES PERFORMANCE (TR, US$) AND P/E



Source: Bloomberg consensus. MSCI Indices unless specified.

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



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

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