Emirates NBD
WEALTH MANAGEMENT

A **hesitant start** to 2024

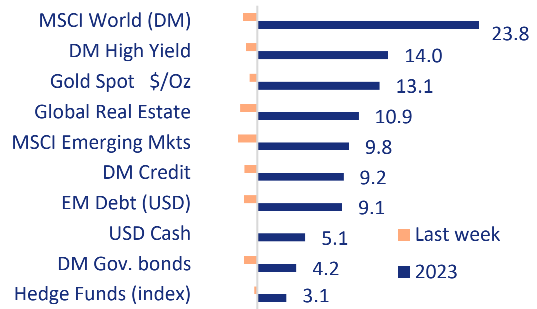
- **The new year started with negative returns across major asset classes on rising yields**
- **Economic data from last week confirmed a solid end to 2023 in terms of activity and US labor market**
- **This doesn't look consistent with markets pricing-in many more rate cuts than central banks' projections.**

As we detailed in our previous weekly publication "2023 Special", last year was spectacular, with an overwhelming proportion of the positive returns for a diversified portfolio happening in the last two-month's "rally of everything".

2024 starts on a different note, with all major asset classes losing between -1% and -2%, except of course for cash. We can suggest two explanations. First, some level of consolidation after one of the most spectacular year-end rallies is not uncommon. Second, and certainly most relevantly, economic data released last week painted an overall solid macro picture for the world in December. Composite PMIs are in expansion territory in all regions except for the Eurozone, with a few positive surprises (US manufacturing, services in China). In addition, the US monthly job report exceeded expectations once again, with 216k creations in December, a level consistent with continued labour tightness. This is positive fundamental news, but it doesn't create any need for rate cuts from the Fed. The future markets started the year with an implicit expectation for 6 cuts this year, twice the Fed's own projections. The adjustment started last week, with risk appetite also held back by a strengthening dollar and rising oil prices.

We expect high volatility and modest returns in 2024. We start the year with an overweight in money market funds and bonds (where we prefer govies, are neutral on corporate but underweight in emerging markets), funded by a modest underweight in stocks from developed markets (we are neutral on EM there) and a larger one on alternatives, except gold on which we carry a modest overweight. 2024 will be a year of answers 2023's big questions. Investors should be active on both allocation and selection. Have a great week.

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



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Cross-asset Update

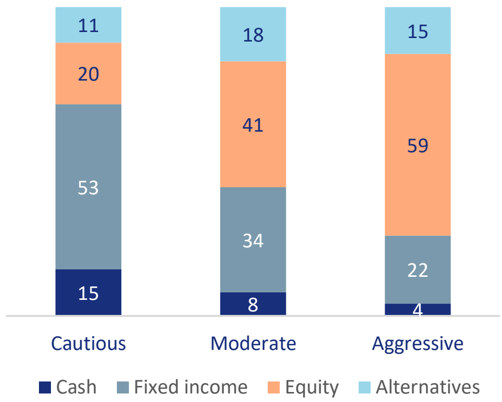
This year's outlook will be marked by the intersection of two liquidity cycles: the global one, that should have bottomed late last year with peak tightness in central bank policy, and the one driven by public debt and commercial bank lending that is currently deflating. They are actually two sides of the same coin: once disinflation has fully run its course sometime next year as the effect of post-pandemic stimulus abates, central banks should start cutting rates and get the global liquidity cycle going in full swing.

If we stay by the view that a recession in the process can be avoided, market valuations suggest that a soft landing has already been discounted, hence why risk assets currently are leaning expensive. And as the economy slows down the disinflation process should continue, that accounts for the low level of yields we see today. Rich valuations and further progress to be expected on the side of inflation have informed our tactical asset allocation process. We have been very selective in our tilts on equity and credit to limit portfolio vulnerability, while at the same have skewed preferences towards long-duration assets.

Our preference for EM versus DM equities stems from the rich absolute valuations of the latter, while the former maintains its usual discount, hence its potential appeal. In DM we prefer to take more risk in HY credit, that should benefit from a gently slowing economy, sufficient to ensure that firms can get the cash to repay coupons. Disinflation supports an overweight in government bonds and gold, while EM debt is underweighted to avoid excessive risk in longer duration assets. We see little diversification benefits in hedge funds, given high cash hurdles, hence the underweight in the former and above-benchmark allocation for the latter. Being our overall tactical bets slightly defensive, they should show some degree of resilience in case the soft-landing morphs into a contraction, though not our base case.

In general, while last year surprised to the upside, the current one is hard to gauge given the numerous moving parts all revolving round the willingness of central banks to provide the necessary liquidity that would ensure a smoother ride.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

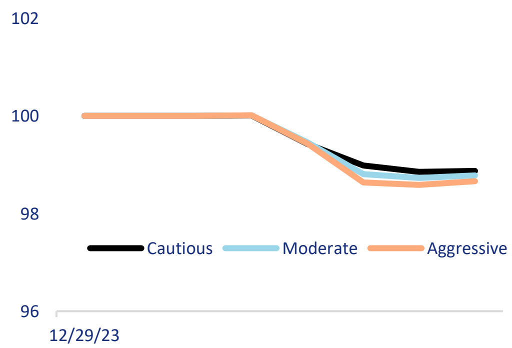


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 first trading week of the year saw the US Treasury yield curve bear-steepen. As we had mentioned last week, the aggressive forward 12 month rate cuts priced in at the end of 2023 had raised the spectre of a yield curve sell-off. And sure enough the strong NFP report last week acted as the catalyst to a sell-off already underway. US payrolls climbed by 216,000 in December, the most in three months, beating almost all economist forecasts. Wage gains outpaced expectations, with average hourly earnings up 0.4% for a second straight month, generating a year-on-year increase of 4.1%. The unemployment rate held at 3.7%, against expectations for a rise to 3.8%.

On the last day of 2023, more than six fed rate cuts were priced in by Dec 2024. This aggressive estimation has moderated slightly as 5.5 fed rate cuts are now priced by the year's end. As a result, the long-end yields increased. The yields from 5 to 30-year maturities increased by more than 15 bps. The benchmark 10-year had hit an intraday high of 4.09% on Friday during the release of the NFP data. Front-end 2-year UST yields went up by 13bps. This week the main source of volatility will be the US CPI, which is due for release this Thursday. The Headline CPI is expected to increase to 3.2% from the prior 3.1%, even as the core CPI could decrease to 3.8% from 4% the previous month. with the Fed on a pause employment and inflation are the two key drivers of future rate path trajectory.

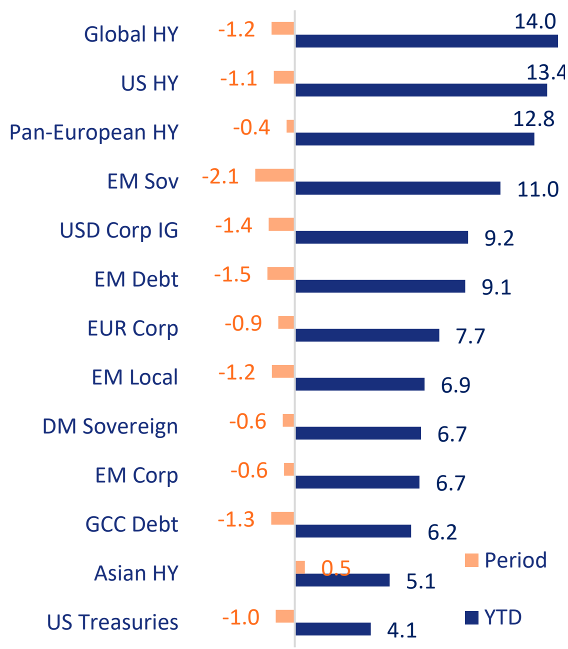
Credit has followed the same trajectory with long-duration assets suffering. EM Debt has been the worst performer so far. Spreads have widened for all the credit segments. High Yield spreads have widened by 16 bps while EM Debt spreads have increased by 6 bps. Investment Grade credit has been more resilient as spread have traded in a tight range of 4 bps last week.

Primary issuance in the GCC has kicked off with FAB announcing the first sukuk deal of the year as IPTs came in at 10 bps above 5-year Treasury. Similarly, KSA is off the blocks as the first sovereign issuer from the region. It announced a three-tranche bond deal with 6, 10 and 30-year IPTs translating to 5.15%, 5.4% and 6.15% respectively. This would be the first major issuance from the region. We expect the issuance calendar to be robust this year as more than $33bn of fixed income securities from the region mature. We should see a lot more refinancing deals along with high yield issuers who missed out last year coming to the market.

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

The first week of 2024 was not great for the equity asset class, not surprising, after the spectacular returns of 2023. Global stocks were down -1.5% in developed markets and -2.1% in emerging markets, with China being the clear drag with regards to the latter. India and the GCC continue the 2023 trend and delivered positive weekly returns.

There is little doubt that the negative start of 2024 is due to some extent to some natural consolidation after the tremendous appreciation of the last two months of 2023. Some tactical profit taking is illustrated by the underperformance of the so called Magnificent 7 (Apple, Amazon, Meta, Microsoft, Netflix, Nvidia, Tesla) which lost -3% last week after having more than doubled in 2023. Another more fundamental reason for the weekly sell-off is of course to be found in rising interest rates, due to overall positive economic data, which have a compressing impact on valuation multiples.

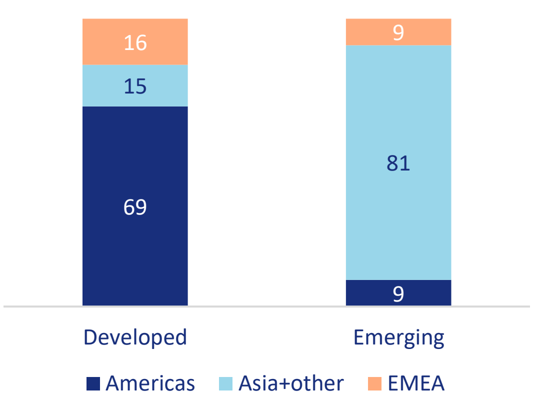
Looking into 2024, we will communicate our year-end fair values in our upcoming Global Investment Outlook. Our view is reasonably constructive when it comes to earnings growth, with an overall supportive macro environment, even if we are, once again, less optimistic than the consensus of sell-side analysts. As always, the most important point of the exercise is to assess the right valuations multiple. Our 2024 exercise shows positive but limited upside potential in most developed markets, and better in selective emerging markets, at the price of higher volatility.

We thus start the year with a modest underweight in DM stocks and a neutral stance in EM. As clarity should improve on economic fundamentals, we believe that selectivity should be rewarded. At the regional level, we start with carefully calibrated overweight on Japan in DM and on India in EM. Within DM we start the year with a neutral US positioning, will look to add based on earning growth resilience. In EM, we are neutral on China: on one hand, the well-known concerns on growth and political action do not convince international investors as yet, but on the other, valuations are compelling especially with regards to expected 10% growth in earnings.

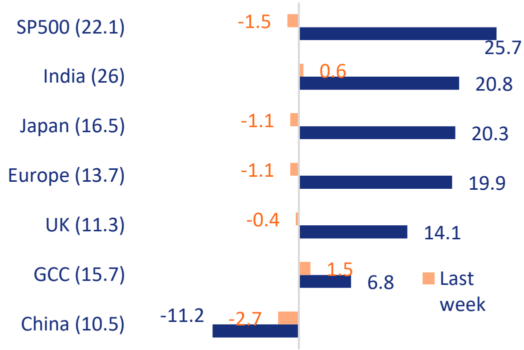
Most importantly, we believe that stock selection should make a come-back in 2024, with markets rewarding the specific attributes and numbers of individual companies rather than blindly propelling, or dismissing, entire segments. In that logic, we are not radical in terms of segment preferences, but would highlight quality in terms of selection. We find great opportunities, including within growth sectors such as tech and healthcare, where selectivity particularly matters.

The week ahead will see the beginning of the 2023-Q4 earnings season, with major US banks announcing Q4 and full year results.

EQUITY RECOMMENDED REGIONAL POSITIONING

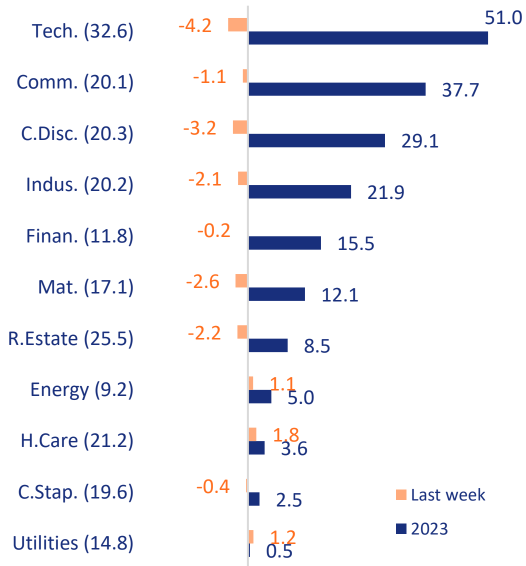


MAJOR INDICES PERFORMANCE (TR, US$) AND 2023PE



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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