Markets see rising odds of **no-landing scenario**

- **The S&P 500 closes above 5,000 amidst relentless US exceptionalism**
- **Markets starting to discount a fully-fledged recovery as US economy continues to surprise to the upside**
- **In China balance-sheet deleveraging requires more fiscal stimulus**

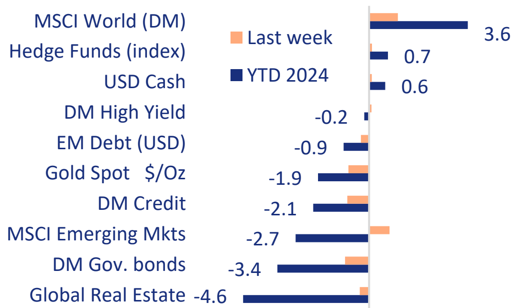
Year-to-date returns across the major asset classes are still panting the picture of US-dominated markets, with the MSCI World in positive territory followed by hedge funds and cash, while all else is failing to deliver positive performance. DM government bonds are bearing the brunt of central bank officials pushing back on early rate cuts, while EM stocks are weighed down by the slump in Chinese equities.

Yet, the broadening of the recovery to the manufacturing sector in the United States could push investors to expect a more sustainable outlook. So far, the growth factor has trumped all other investment styles, and indeed technology and healthcare stocks have topped the return list year-to-date. But a stronger economy should eventually see a broader market participation, and rising odds that an acceleration in growth will be discounted. Hence, although DM equities are expensive, they may well edge higher till the manufacturing expansion is fully priced in.

On the other side of spectrum, mainland China equities staged a forceful rebound last week only due to strong state intervention on markets. Beijing wants to avoid that slumping stocks further affect animal spirits and worsen the ongoing balance-sheet deleveraging. But failing the broad-based fiscal measures necessary to shore up sentiment in the private sector, we would not be expecting more than an interim rally.

Overall, as valuations remain expensive across asset classes, we continue to advise a blend of beta exposure and selective investment themes. Returns will be increasingly dictated by the macroeconomic news flow, with the CPI and the retail sales release top of mind in the United States this week.

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



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Cross-asset Update

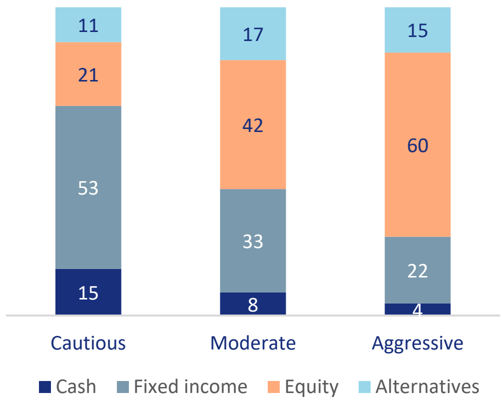
The US economy is strong and getting stronger. The much-awaited manufacturing recovery is happening, at least in the United States. While two weeks ago all eyes were on the jobs report, the ISM manufacturing release turned out to be the more relevant one. The blow-out labour report reinforced the notion of a strong US job market, a largely known fact, whereas the ISM manufacturing told us about the broadening of the recovery. Being the soft-landing scenario fully discounted, investors now must look to something different, as old news won't move asset markets, while new news will. The ISM report is the perfect catalyst, amongst others, to shift to a no-landing narrative, that is to believing that the economy will accelerate, rather than slow down.

The S&P 500 Industrials Index sort of anticipated this, by making new all-time highs in July 2023, well ahead of the major benchmarks, the AI frenzy notwithstanding. This is one more instance of markets leading fundamentals, rather than the other way around as per consensus narratives. The very cycle-sensitive transportation stocks are making new highs for the year, and financials are leading right behind pharmaceuticals and technology, now richly valued. We can suspect that markets are likely to take a more pro-cyclical bias insofar as the manufacturing sector continues to recover. Inventory replenishment should drive that recovery, at least for a few months, with new orders rising and now pointing to an expansion.

The broadening of the recovery is also impacting yields and monetary policy. Fed officials have reiterated that they push back on early rate cuts, that otherwise would be reigniting inflationary pressures, while markets are still discounting a substantial amount of easing, though in a more distant future. A stronger economy is pushing yields higher, that had fallen to depressed levels following a seemingly more dovish bias expressed by chair Powell late last year. Overall, we are back to the 'higher for longer' scenario, that at some point could cap market returns.

Longer duration assets are on the backfoot amidst positive macro surprises. Yet, gold is not slumping, but rather holding its ground supported by purchases made by BRICs+ central banks. It should stage a comeback when markets have discounted a lower number of rate cuts and the timeline for the Fed to ease gets closer.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

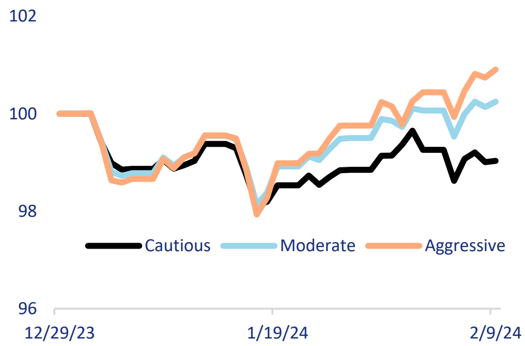


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

A string of strong macro data releases from the US continued, resulting in higher US Treasury yields. On net 10-year Treasury yields steadily drifted 16bp higher over the week as the broad 2s/30s curve steepened 4bps. ISM services survey's headline composite increased from 50.5 in December to 53.4 in January (Cons. 52.0). Initial jobless claims came in below expectations, declining 6k to 218k (consensus: 220k) as the filing level remains historically low. Meanwhile, Thomas Barkin said the Fed has time to be patient on rate cuts, pointing to solid labour market figures.

US Treasury auctioned 3, 10, and 30-year notes with increased tranche sizes. Investors received all the auctions well, thanks to the recent uptick in the yields. The end users were awarded 87% of the 10-year auction, and at $36.5bn, this was the second-highest record notionally in history. OIS swaps currently price in less than 5 rate cuts by the end of this year; a whopping 70 bps of rate cuts that were priced in at the start of the year have been phased out by now. We recommend adding duration in the belly of the curve. Yields are at their top range in the last two months, and less Fed easing is priced in now.

Worries about US Commercial Real Estate intensified last week after Janet Yellen said US regulators are monitoring risks stemming from nonbank mortgage lenders and warned a failure of one of them is possible. Nonbanks rely on short-term funding instruments and lack access to deposits and the Fed's emergency lending facility.

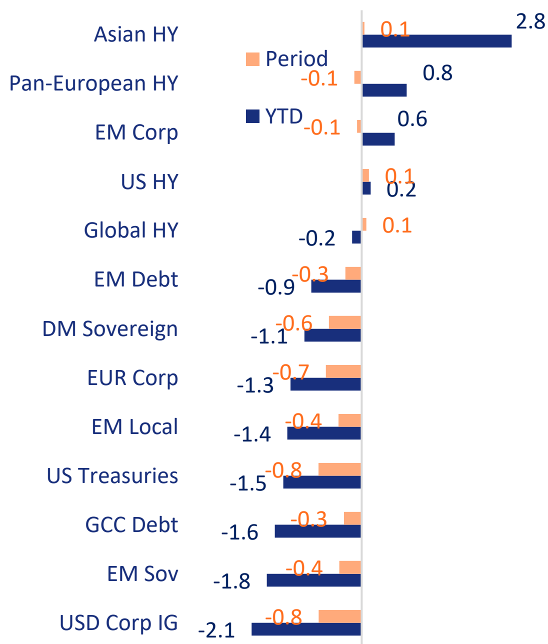
Investment-grade corporate spreads should remain rangebound. Supply in February is expected to be above average, and financials should continue to outperform non-financials. High-yield default/distress exchanges have remained at the lowest level since July last year, providing support to spreads.

Japanese bonds breathed a sigh of relief as BoJ's Deputy Governor Shinichi Uchida mentioned that it's hard to see the bank raising its policy rate continuously and rapidly even after the negative interest rate ends. Markets took it as a once-and-done kind of rate hike when it happens. On the other hand, in Emerging Markets, Mexico's Central Bank and India's RBI held their rates steady. RBI maintained its hawkish stance, leading to a slight sell-off in local government bonds. A total of five issuers priced bonds last week from the GCC. A total of $5.8bn bonds were sold with solid investor demand. This takes total issuance past $25bn for the region.

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: Our outlook for 2024

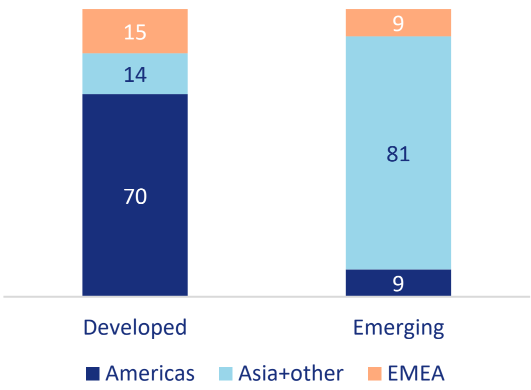
Broadly a good week for global equities and most markets were up and performing in line with economic growth data, with the US showing remarkable resilience, European growth weak, and confidence yet to rebound in China. Tech had a good week with semis still at the forefront and everything AI rallying. Year to date leading regional equity returns is the US, in line with the Nasdaq and broader global tech sector. Earnings season has been supportive There are concerns globally about commercial real estate, beyond the US in Japan too, but risks should remain contained. India and Japan markets too continue an upward trajectory, slow and steady and we retain our overweight positioning on both.

UAE markets are in the midst of earnings season. Real estate developers i.e. the Emaar group which is keenly followed had better than expected earnings growth and is reflective of the strong UAE economy following the banks which overall posted good Q4 and 2024 numbers. Double-digit tourism growth and healthy resident spending indicate upside risks to 2023 dividends and valuation is compelling. Utility companies had mixed results but dividend payout remains resilient.

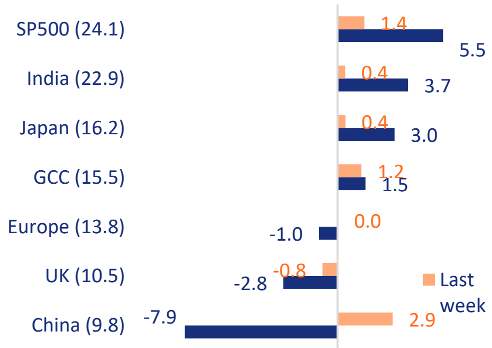
China markets are closed this week for the Lunar New Year holiday. China A shares (+5%) and the Hang Seng (+1.4%) Index were both up last week, are recovering somewhat Januarys 10% drop. China A shares are our preference currently, as we expect the China authorities to focus on the mainland in any stimulus package rather than foreign investors. Policymakers are becoming increasingly wary of a worsening cycle between falling investor sentiment and a negative wealth effect in the real economy. This is against the backdrop of property market overleveraging, slowdown and deflation. The breakdown in sentiment that has occurred over the past year reflects both cyclical and structural concerns and impacted both local and foreign investor confidence. Margin considerations may have added to the selling pressure.

The S&P 500 has risen by 5,5% YTD. 80% of the YTD return has been driven by valuation expansion. The compression in the equity risk premium has more than offset the increase in 10-year real yields, leading to valuation expansion. However, Mega-cap tech stocks have driven most of the aggregate returns, while the equal-weight S&P 500 is roughly flat for the year and trading at a valuation discount to the S&P 500. Our year end estimate at 20.5X P/E for the S&P 500 indicates further returns to the index will be earnings driven. Upside risks to our 4,850 level are better-than-expected EPS growth or a broadening of the valuations expansion. Mega-cap leadership isn't a sign of limited breadth for equities, as more than 70% of the S&P 500 trades above its 200-day moving average. More than 80% of large-cap stocks are up over the past three months. However, downside risks are large/ mega cap failing to meet growth expectations, as earnings growth is currently largely driven by mega tech. But most election years have positive outcomes for markets though fundamental growth and valuation metrics remain the most important factors.

EQUITY RECOMMENDED REGIONAL POSITIONING

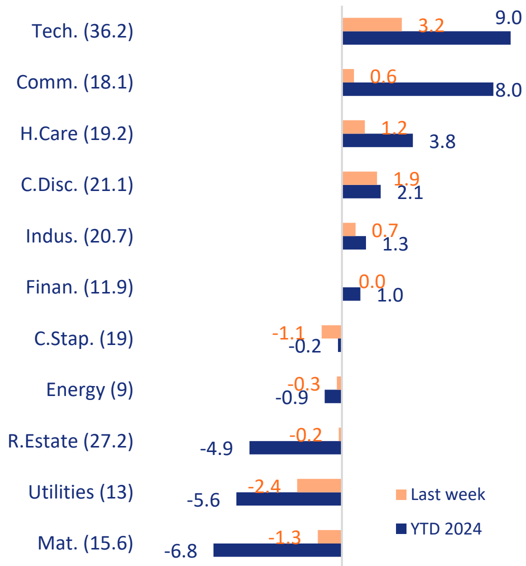


MAJOR INDICES PERFORMANCE (TR, US$) AND P/E



Source: Bloomberg consensus. MSCI Indices unless specified.

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



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

Emirates NBD WEALTH MANAGEMENT

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