And here comes the **volatility**

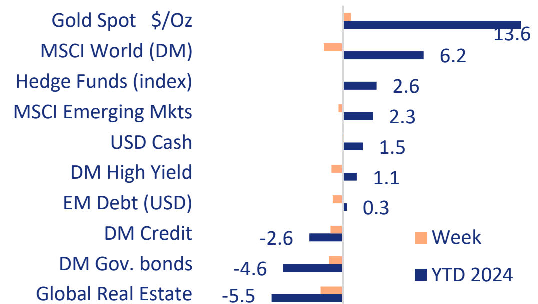
- **Hotter than expected inflation and geopolitical developments are putting pressure on all asset classes**
- **This may be the beginning of a more volatile phase for markets, as expected in our 2024 Outlook**
- **Our tactical positioning is risk-neutral vs our strategic allocation, ready to seize opportunities**

The base line of our 2024 Global Investment Outlook is an expectation for reasonably positive returns, at the price of elevated volatility. We particularly highlighted the uncertainty surrounding the relative trajectories of growth and inflation, as well as the importance of intertwined political and geopolitical factors. Bottom-line, growth should support markets, with high volatility from three sources: economic data, geopolitical developments, and elections, especially in the US.

And here we are. US March CPI inflation report surprised to the upside: both core and headline rose more than forecast, tempering expectations with regards to the timing and magnitude of future rate cuts from the Fed. This pushed bond yields higher and stock prices lower. Then, Iran's direct strike on Israel as a response to a previous attack on their embassy compound in Syria further fuelled volatility, lifting gold prices to a record high. Meanwhile however, economic data remains consistent with global expansion being more resilient than many had expected. The risk of recession is lower on the short-term, while the probability of higher for longer interest rates is rising.

Our temporary investment conclusion against such a backdrop is: wait, see, and get ready to react rather than trying to predict short-term direction. Our current positioning is more neutral than defensive. There are reasons to believe that we are not on the brink of a radical geopolitical escalation, at least in the shorter term, while the Q1 earnings season which has just started should reflect the constructive economic activity. Still, markets hate uncertainty which could provide some tactical opportunities down the road. We will pay attention to this week's data (retail sales and industrial production for US and China, inflation in Europe) and corporate earnings. Stay safe.

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



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Cross-asset Update

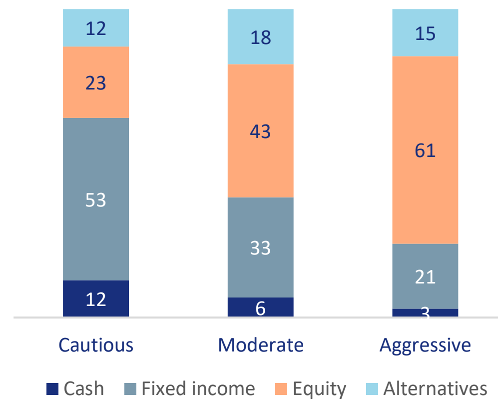
An impressive stretch from November to February where the S&P 500 was higher for 14 consecutive weeks was eventually followed by a decline in the last two weeks. Interest rate-sensitive sectors, from real estate, to regional banks, housing, and utilities led the market lower on resurfacing inflationary threats. In previous writing, we had correctly suggested that the US economy was running out of disinflation drivers, given the manufacturing recovery extending outside of the US and the rally in commodities spurred by the anticipation of rate cuts from the major central banks. The Iran-Israel confrontation also played a role in tempering animal spirits. After such a rally in risk assets investors must be wondering whether equities will crack under the weight of price pressures ticking higher and rising geopolitical tensions. Our final take is that the strength of the US economy, marked by resilience in services combined with accelerating manufacturing activity, alongside a much milder recovery both in the euro area and in China, should support earnings, hence markets.

Despite the still inherently positive macroeconomic backdrop, our proprietary indicators point to significant odds of a deeper tactical retracement. This pullback could be forthcoming as per our sentiment gauges, with breadth measures on top of it that deteriorated significantly in the last two weeks, and our market internal gauges that reached levels consistent in the past with market drops. A volatility bout may well be triggered by a repricing of monetary policy expectations expressing the market view of a later and shallower Fed's easing cycle. After all, the rally since the October lows has been predicated on investors discounting an outsize number of rate cuts for the current year, a number that has been consistently adjusted lower on a stronger than expected economy that also allowed markets to take more hawkish views in their stride. Rising tensions in our region would also be playing a role in the same direction, with rich global equity and credit valuations further adding to vulnerability. A flight to quality seems to corroborate this view, with the US dollar making a significant breakout higher for the first time since late 2021, as per the technicals we follow. On the inflation front, we cannot ignore that commodities tend to lead headline inflation gauges by a couple of months. Hence, the least we can say about future price pressures, is that commodities point to still rising inflation for two more months. And this signal is perfectly in line with the recent strength in the manufacturing sector, that has just started and seems set to persist in the immediate future, given the rise in the forward-looking new-orders-to-inventory ratio.

Overall, we still think that outright pessimism is not warranted, given that the US economy not only has avoided a recession, but is also driving a global recovery.

Yet, in the shorter term investors may find muted comfort in Treasuries this time, as concerns about inflation are driving market volatility and the risk premium on longer-dated bonds remains historically low. It is also debatable whether gold is to be preferred as a long duration asset in the immediate future, having already rallied significantly. We anyway retain strong conviction on gold on longer time frames.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

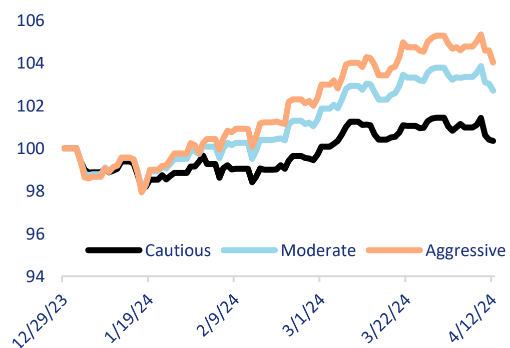


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Treasury yields rose sharply and risk assets weakened following the third consecutive upside surprise in CPI inflation. The Treasury curve bear flattened with the 2-year rising by 20 bps. The 10-year yields are firmly above 4.5%. Markets now discount less than 2 rate cuts by end of the year and the first full rate cut only by September. However, we are hesitant to add duration yet, as it will take multiple softer inflation and labor market reports for markets to regain confidence in a more dovish Fed path. Monetary policy appears less restrictive than we previously thought and the shifting of Treasury demand to price sensitive buyers may require a higher term premium and hence steeper curves. The Treasury General Account (TGA) should rise sharply in the coming days amid tax receipts with a decrease in issuance of T-Bills.

The minutes to the March FOMC meeting didn't add much to the discussion around the outlook for the funds rate but did offer a little more information about how Fed officials are thinking about the balance sheet reduction process. The Committee appears broadly inclined to cut in half the monthly cap on Treasury runoff (currently $60 billion), but to leave the $35 billion monthly cap on MBS unchanged. The minutes weren't specific on the timing of this action but did indicate an inclination towards "sooner rather than later." Analysts believe that they may announce a halving of the Treasury cap at the next FOMC meeting in early May.

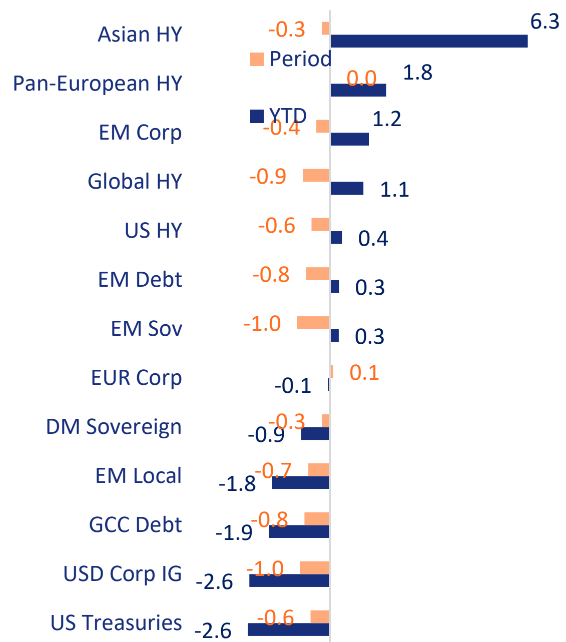
ECB policy meeting last week indicates a divergence from the US policy. The ECB strengthened the guidance towards a June cut and embraced the need to adjust the level of restrictiveness of policy, acknowledging more clearly the progress on disinflation. The Committee officially agreed to maintaining the meeting-by-meeting approach past the first cut, keeping optionality to act at every meeting. Through various answers on the topic, President Lagarde emphasised a divergent policy message to the US, subsequently reinforced by ECB communication on Friday.

Spreads have exhibited impressive resilience since the start of the move higher in rates while the long-end of curves has remained stubbornly flat in the USD IG market. IG have outperformed as more attractive yields and lighter supply have more than offset Fed and inflation concerns but are off their tightest levels of 88 bps achieved last week. A firmer than expected CPI and repricing of the Fed produced the highest HY bond yields since December and spreads only 18bp above Thursday's low since January 2022.

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

Emirates NBD WEALTH MANAGEMENT

Equity Update

Equities had a mixed performance last week but remain the second-best performing asset class YTD, after gold. Japan, the Dubai Index, India and the US lead equity returns. A small shift to safe havens was seen, with increased geopolitical tension, pushing gold and the US Dollar higher. Last week global equities fell -1.4% and barring Japan and India, most major markets ended the week down. UAE and KSA markets were closed last week. US stocks yoyo 'ed with the tech sector upbeat on Thursday but Friday saw US markets lower on news around the escalating Israel and Iran standoff.

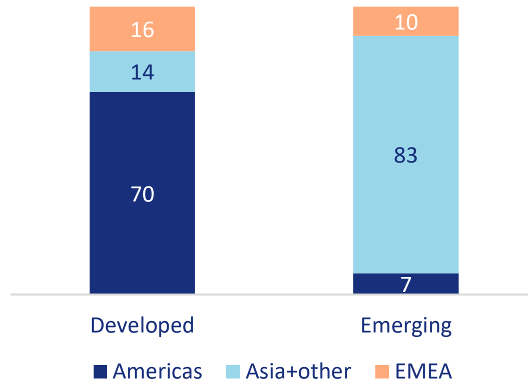
In the US, firm consumer price growth has led to increased conviction that monetary easing might occur later than anticipated. The S&P 500 closed the week -1.5% lower. In the Euro area, the STOXX 600 closed the week almost flat while the FTSE 100 closed lower too but traded above its all-time closing high in morning trading on Friday, as rising commodities prices boosted stocks in the energy and mining sectors.

Emerging Markets had a better week than developed regions but no major rally seen from China as yet. China's State Council has released guidelines on strengthening regulation, forestalling risks, and promoting the high-quality development of the capital market. India heads closer to elections and supporting the market are expectations the current government will continue. The US goes to elections in November and President Biden is seeing an improvement in polls.

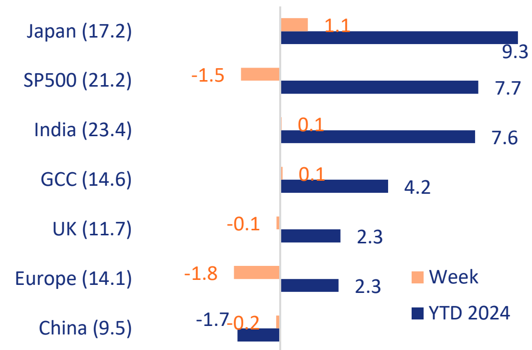
The effect of the Iran and Israel conflict is currently leading to higher inflation expectations with oil trading higher and some supply chain disruptions. Too early to quantify the impact on markets but staying with quality in equity is recommended. Also, economic growth expectations for the US, UAE India and Japan are resilient and would reflect in equity market performance. We are currently overweight India and the UAE in EM and Japan in DM. We are neutral the US but like select sectors and themes such as AI enablers and healthcare. We think gold stocks have more upside and energy stocks too. Energy is the best performing sector in April so far.

44 S&P 500 companies report this week. Earnings season has begun last week with the financial sector: JPMorgan Chase profits surpassed analysts' forecasts up 6% in Q1 y/y, despite paying an extra $725mn charge by US regulators to cover the costs from last year's regional bank failures. Shares fell -6% on Friday on worries on falling net interest income once rates start going down. Citigroup, fell -1.7% though reporting better than expected quarterly profits. Blackrock profits grew 36% y/y and their assets under management reached USD 10.5 trillion. As of today, the S&P 500 is reporting blended earnings growth of +0.9% for the first quarter, the third-straight quarter of y/y earnings growth. However, the index will likely report y/y growth in earnings of more than 7% for Q1 (Factset). Big expectations from Nvidia and other big tech though Apple estimates lower as Apple's iPhone shipments dropped almost 10% in the first quarter (IDC).

EQUITY RECOMMENDED REGIONAL POSITIONING

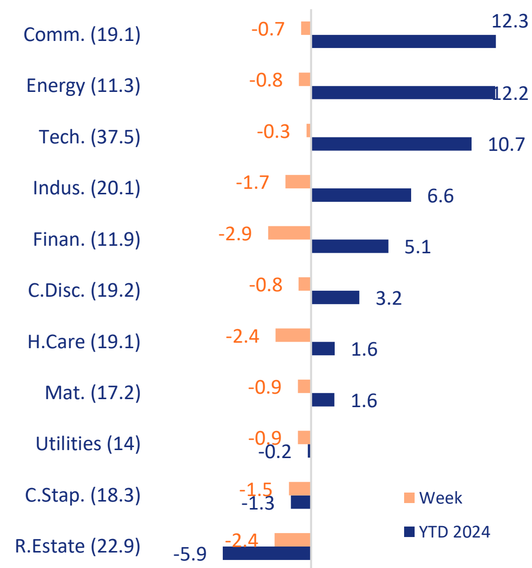


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



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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