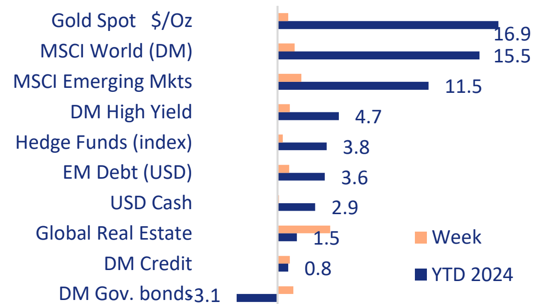
# Special **2024 Mid-Year Update**

- **As expected, markets were volatile, differentiating but positive in H1 for a diversified portfolio**
- **We enter H2 with overall supportive fundamentals, well reflected by asset valuations**
- **We tactically take some profits in stocks and add selectively to fixed income and alternatives**

2024 so far is a great vintage for diversified portfolios. From our yearly Outlook, we expected the "Year of Answers" to be volatile, differentiated between and within asset classes, but overall positive. So far, so good: the negative performance from safe government bonds of long duration are more than offset by the spectacular returns of gold and equities in particular. Our three profiles are, as we write, up respectively 4.4%, 8% and 10.5% so far in 2024 (Friday 12th of July).

The answers of 2024 with regards to the economic backdrop are consistent with our expectations for a global soft landing. If anything, inflation has been a bit stickier, but growth has been more resilient than we initially expected. This explains why our YTD returns are currently close to what we initially expected for the entire year. As we start the second half of 2024, it's fair to say that fundamental visibility has improved: the global economy is gently decelerating, but not to alarming levels. Disinflation is slow, but not dead, while central banks are more risk-adverse, also validating our view that they have limited leeway for action. The backdrop is thus supportive. Having said that, we continue to expect volatility. It shouldn't be only linked to economic data like it was in H1, but also increasingly to political and geopolitical developments. As equity valuations are close to our fair values, we decided to take profit on our overweight to go neutral. We increased our positions in fixed income, reduced our underweight in global listed real estate and increased our long-held overweight in gold. Overall, we remain broadly invested but have reduced risk, from a bit bullish to more neutral. We are ready to seize the opportunities that will emerge from earnings, political events, especially in the US, and of course the next economic developments from the Year of Answers.

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

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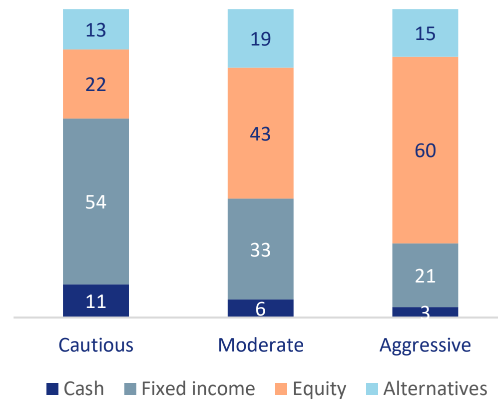
## Cross-asset Update

Although it may sound like an oversimplification, a slogan that could befit the second half of the year is that investors will tend to focus more on Fed rate cuts as the US elections initially take a backseat. So far, the first presidential debate between Trump and Biden has failed to affect US Treasury yields for more than a couple of sessions, when they jumped on concerns about Mr Trump's more inflationary policies. Market progress could be shaped accordingly, with investors inflating asset prices as they obsess about the Fed, till volatility rises when it is no longer possible to ignore the uncertainty of the forthcoming elections. So, markets would grind higher well into August, to be challenged during the seasonally more difficult autumn period, particularly in October. And this would indeed reflect what in general happened in past election years, should one average them out to get an overall pattern. For the next couple of months, we should see bond yields fall, commodities rebound, and equities continue their run, alongside some softening of the US dollar. Across asset classes the Goldilocks trade would be unfolding, with investor's animal spirits boosted by the outlook for lower yields as the economy slows down or stabilises, not only in the United States, but also in Europe and China where lack of momentum is apparent. Although markets are not cheap, a backdrop of positive economic growth and moderating price pressures historically has been the best for stocks and bonds. Amidst a dearth of candidate countries to lead the rally as growth softens globally, US exceptionalism would be back supported by the promise of rising liquidity tied to lower future rates. With multiples leaning expensive and having little room to expand further, earnings strength will be important, and both for Q2 and Q3 estimates are growing, to then decelerate in Q4. The main risk to the scenario is that the disinflation process in H2 could be bumpier on rebounding commodity prices and improving manufacturing activity, further delaying Fed cuts. And October could feature as a higher-volatility month, with presidential election uncertainty peaking and investors tending to focus more on the impact of the inflationary policies of the overpromising candidates, rather than other factors. There is also the possibility that the prospect for easier policy in the absence of a recession could prove to be stimulative for the economy, setting the stage for a no-landing scenario where growth would be picking up. This would see a change of leadership in terms of sectors and countries and would be coming alongside renewed inflationary pressures.

Either way, low recession odds with the Fed ready to have investors' back should make for a positive second half of the year, barring pre-election volatility.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

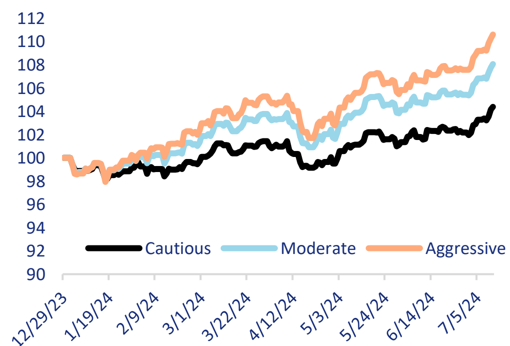



TAA – RELATIVE POSITIONING – MODERATE PROFILE

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**

In the last 52 years, we have seen 13 US elections. Analyzing these election periods, we have seen that the Fed has been on pause six times, they have hiked rates 3 times and cut rates 4 times in the preceding three months. The Fed would be ready to cut to avoid any tail risks before the US elections. The recent data releases point to a slowdown in growth momentum in the country. June NFP numbers were slightly higher than expected, but the unemployment ticked up to 4.1%. Also, the 3-month moving average moved down to 177k after recent revisions to the May numbers, its lowest level since early 2021. The ISM Services saw a sharp 5 points drop in June to 48.8 vs consensus estimates of 52.7. This is the lowest measure for the data point since 2020. This gives us confidence that there is a high probability that the Fed will start its rate cut cycle in September this year.

We have analysed the last 4 rate cut cycles and have found that the 10-year yield drops by 50 bps within three months prior to the first cut. Most of the times after the rate cuts yields continues to trend lower, except in 1995 when they rose after the cut. We anticipate that this year's rate cut cycle will be shallow and hence the resultant magnitude of move in the yields will be lower than previous periods. Our year-end fair value estimate for the US 10-year yield is unchanged at 4%. The 10-year yield to extend sustainably below 4% would require an economic shock which is not yet priced in, and not probable in the short-term. Duration management remains important under such a backdrop, and we prefer 7 to 10 year duration in Investment Grade portfolios.

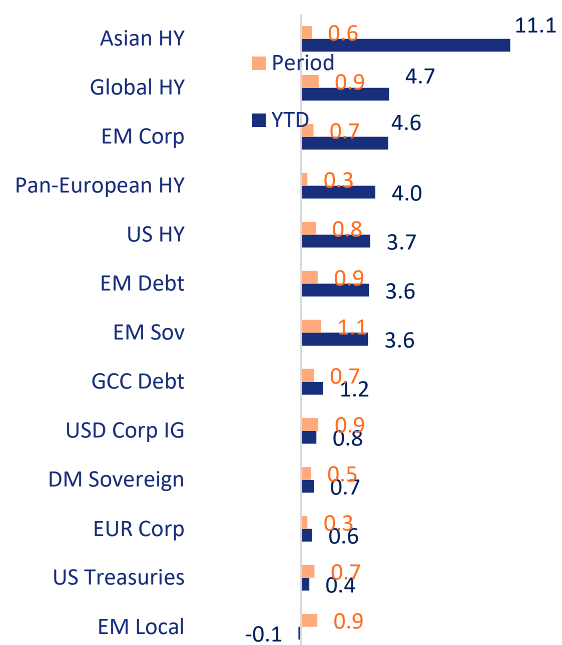
Credit Spreads remain tight across different segments. For Investment Grade, we believe that both technical (less supply and high demand due to >5.5% starting yields) and fundamental factors (trough in deterioration of credit metrics due to predicted growth in earnings) support range-bound spreads. High Yield defaults are low and the pace of refinancing in the first of the year has pushed maturities further out. However, the weakest links in the consumer sector remain elevated and as the economy slows down, we may see spreads widen a bit. In EM Debt, we find the spreads extremely tight, especially the Asia IG credit that has been cheaper 95% of the time in the last 20 years. As DM growth slows, we should see minor widening of the EM credit spreads. However, we like local currency carry trades in Egyptian Pounds and Turkish Lira due to moderation in inflation expectations and lower volatility in the respective currencies.

We have seen more than $65bn of dollar bond issuance in the GCC which is more than the full year 2023 figure with KSA taking the lion share. We see two strategies to invest in the GCC. Firstly, the quasi-sovereigns and the government owned banks for the region that trade at least 25 bps above the underlying sovereign curve with duration of 5 to 10 years provide good opportunity. Secondly, a barbell approach with 10+ years of A rated GREs combined with short duration (less than 3 years). HY names from the region is a slightly aggressive way of investing in the regional bonds.

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**

H1-2024 saw a growth driven rally, with the tech sector up 26%, the Mag 7 up 37%, while India and the US lead EM and DM respectively. Markets were driven by AI sentiment, expectations of accelerating earnings growth and less restrictive DM Central Bank policy. H2 starts with concerns about overall high valuations, and high concentration of the Mag7 in terms of index weight and earnings contributions. To continue, the rally needs to broaden. Worries about AI overheating is offset by the lack of rise in tech volatility and the continuing secular growth and productivity tailwind. Election outcomes have impacted Eurozone markets but not India, or the UK with US elections some time away.

We start H2 moving from an overweight to a neutral positioning for both DM and EM equities. Our Year end Index Fair values are close to where indices are currently trading with a little upside for EM regions (China, India and the GCC). We recommend booking partial profits on tech/ semis but staying invested for the longer term. A transformational decade, from a focus on connectivity and data, to an investment boom in data centres, driven by the use of AI for consumer mapping, productivity in industry, healthcare (predictive and obesity focus), however with rising privacy and security concerns.

**Developed market: US/ UK OW, N Japan, UW Eurozone**

**U.S.:** Accelerating earnings growth, resilient margins, an election cycle, buybacks, monetary easing and the AI tailwind should support US equities and mitigate the higher valuation (23x forward earnings). Earnings growth for the S&P 500 for CY 2024 (our YE fair value is 5475) is estimated. at 9% with revenue growth at 5%. The outlook for big tech remains good: earnings growth estimated at 18% and for the Mag 7 Group 30%. Election risk is around changes in trade/foreign policy, environment/energy, anti-trust regulation and fiscal/tax policy.

**U.K.:** The commodity, oil and consumer companies comprising the FTSE Index are more global-than local but policy stability post the Labour win plus the rate cut path favourable along with high dividend yields/low valuation.

**Japan:** The weak yen benefits exporters, but contributes to inflation via imports, holding down real wages, critical for Japanese consumer demand to grow. Focus on ROE and CAPEX in capital market strategy.

**Eurozone:** Declining earnings expectations. Accommodative Central bank policy with lower inflation not sufficient. The French elections have raised concerns around policy impact on corporate profitability.

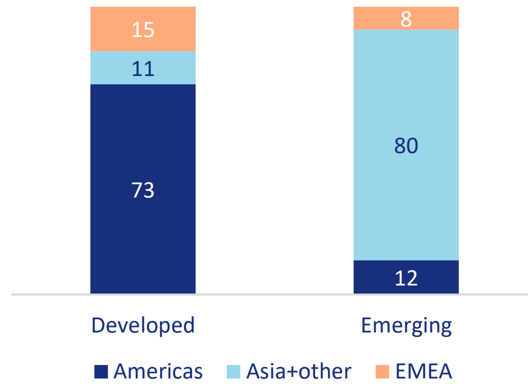
**Emerging Markets: OW India for growth / UAE for income, N China**

**UAE:** Economy growing with increased investment from government and expat population. Broadening of the market with IPO's. High quality dividend yields.

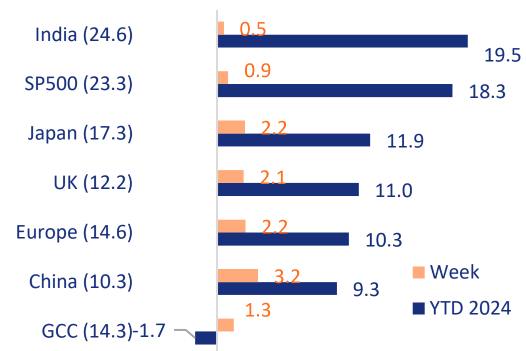
**India:** A continued runway for growth led by infra build-up, digitization and consumption story. A valuation premium at 23x earnings and 4.1x book value, offset by strong economic and corporate growth metrics. Increased offshoring, leading to a manufacturing boom.

**China:** China is in deflation. The stimulus for real estate is not enough. Equity valuations are low but earnings growth is in question. Await the Plenum for direction.

EQUITY RECOMMENDED REGIONAL POSITIONING

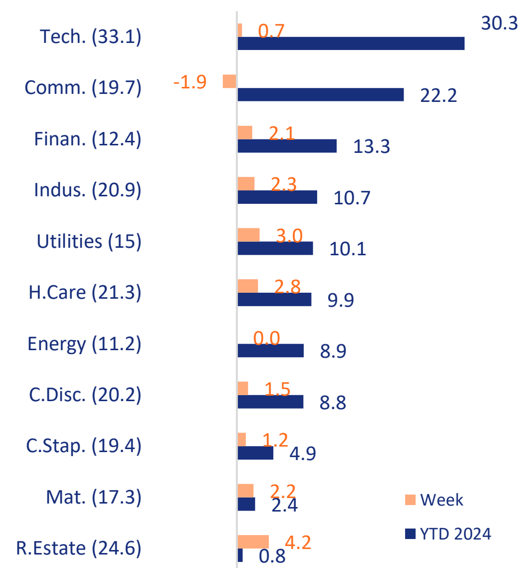



MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets




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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