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We express tactical caution ahead of a **crucial week**

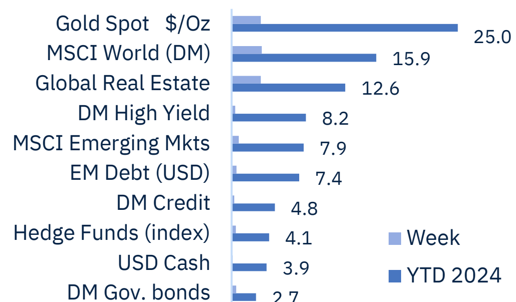
- **The Federal Reserve should announce a rate cut and update their forecast this Wednesday**
- **Last week was positive for all asset classes, with high expectations for easing**
- **For the first time in years, we have decided to go tactically underweight on equities**

Last week was the opposite of the previous one, with positive returns for all asset classes. As often in this situation, it was about central banks. The ECB cut rates and issued cautious forecasts, but the key factor behind the rally was a rise in expectations for a 50bps cut to be announced by the Fed Wednesday. Market implied probability for such a move rose to 60%, and futures markets are now pricing in 120bps of easing for 2024, and a bit more in 2025. Market celebrated, as there is no sign of imminent recession. Having both a resilient economy and monetary easing is indeed a perfect scenario for everything.

We are turning a bit more cautious. Our scenario is still constructive, expecting a “soft landing”, though it doesn’t support the considerable amount of rate cuts currently priced in by markets. As inflation is more reasonable and as the US labor market is showing signs of softening, two, maybe three cuts in 2024 are totally justified. Not 5 or 6, especially in an electoral context.

We just decided to further reduce risk in our asset allocation, by going underweight by 3 percentage points on equities, across all profiles, equally between developed and emerging regions. We are not outright bearish as fundamentals remain supportive. But we feel that the upside potential is limited, while there is no shortage of potential catalysts for volatility. Our three profiles are doing great in absolute and relative to competition, so it’s not a bad time to be a bit defensive and ready to seize future opportunities.

All eyes will be on the FOMC Wednesday, as well as on the policy meetings from both the BoE and BoJ.



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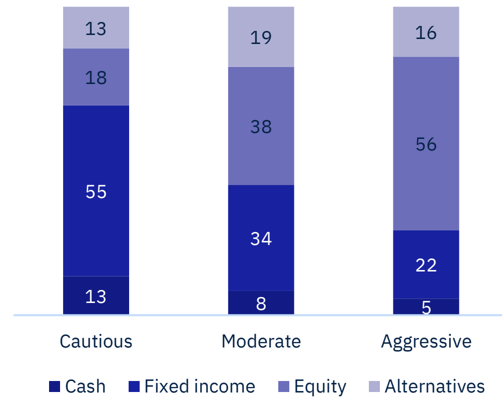
Cross-asset Update

Markets are increasingly volatile, yet undaunted by the US slowdown. Asset class returns suggest equities continue to assign a low probability to a recessionary scenario, and that actually deem the Fed to be able to pull off a soft landing by cutting rates. Historically, a moderation in activity accompanied by policy easing and not followed by a contraction has seen markets perform well both at the shorter and longer time horizons. Last week was dominated by US equities that topped the returns of all the major markets, with the S&P 500 gaining on average more than twice than the others. We hold the view that this is set to continue, if not in terms of size, at least in terms of direction. Technology and discretionaries, so long-duration and interest-sensitive stocks, led the S&P 500 higher, a clear indication that markets are being driven by the expectation for rate cuts. Also, last week small caps outperformed the broader market, a sign that investors see activity holding up nicely. Gold made new all-time highs and Treasuries new lows, reinforcing the message that the rising tide of liquidity is making itself felt.

US equities have continued to play the lion's share, and macro developments are providing no signs that this is going to change any time soon. China continues to struggle, as highlighted by retail sales, output, and investments rising at a slower pace than expected. More fiscal measures and some outsize intervention to support the real estate sector would be needed, but the authorities seem to have other priorities. The ECB cut rates, though giving little reason to think that it is going to proceed as apace as the market is currently discounting. The euro area is struggling, with the auto industry, and more in general the manufacturing sector and Germany each with their own trouble. So, there is the impression that despite the slowdown phase liquidity is going to rise faster in the United States than elsewhere. Pre-election volatility, that usually tends to peak in October, should provide further opportunities to add to risk and should be viewed in that fashion given low recession odds. Although the rally in US equities is broadening and easing cycles at the start see smaller companies outperform, IT leadership should eventually remain intact. As a matter of fact, in secular bull markets, like the current one, technology tends to dominate and this time we think it would be no different.

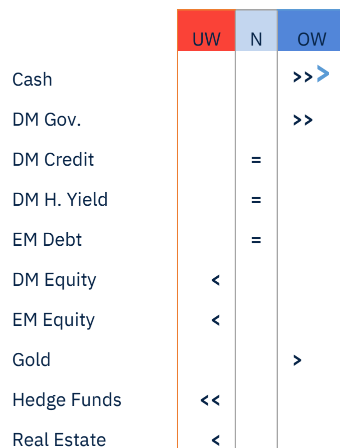
Gold has reached our fair value of $2,550/oz for the year. It is difficult to see the yellow metal weaken significantly till we get deeper into the easing cycle. But at some point, investors will start to question the outsize number of cuts discounted for 2025, deemed excessive in case of no recession. That should throw a spanner in gold's rally, further down the road. For now, the direction of travels seems still to be higher for long-duration assets.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



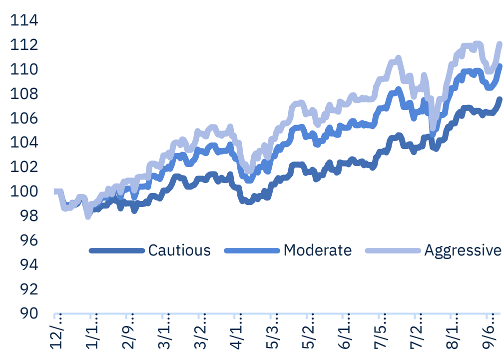
TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

Today probably heralds the most important week of the year. The Fed is expected to start its first rate cut since 2020 on Wednesday. The market has been swinging between expectations of a 25 or a 50bps rate cut with latest expectations implying a 60% probability of a 50-bps move. Our House View is for a 25bps cut in September. We also believe there is a distinct possibility of a larger move post the US elections if the Fed wants to frontload and be pre-emptive. In addition, it will be crucial to listen to the press event and the Q&A session as a dovish tilt from chairman Powell would be taken positively by the bond markets that would limit the ability of the yields to grind higher.

Apart from the big Fed decision, the BoE would also take a rate decision on Thursday with market expecting a Hold. BoJ also meets on Friday as traders would parse the press briefing for hawkish tones. The Central Bank of Turkey will also meet this week and should hold the overnight rates at 50%. The ECB delivered the second quarterly 25b0p cut last week signalling continuity in the process of policy rate normalization. The bar for a third cut in October is quite high and it will require a large disappointment on the macro side to follow through.

The credit environment continues to be benign. All-in yields which were a key driver of demand despite tight spreads in the first half have come down substantially. US Investment Grade senior bonds trade sub 5% and High Yield now provides 6% to 7% carry. If the US economy continues to grow at 1% to 2%, the impact of slowdown on spreads should be largely mitigated. Unless we see a significant uptick in inflation, the Fed Put will continue to dominate the narrative and returns.

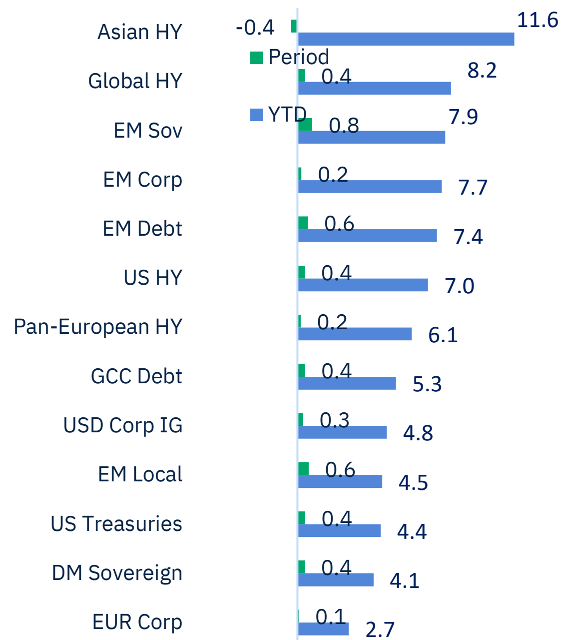
In our last TAA, we closed our EM Debt underweight. With the Fed, to start the rate cut cycle, we believe the EM debt would be supported. Most of the EM countries have their current inflation with central bank target ranges. This would allow the EM central banks to cut rates and stimulate growth without worrying about the impact on their currencies.

Our preference remains for neutral duration Govvies and Investment Grade at the moment. We continue to prefer subordinate debt from financials as well as pockets of High Yield within emerging markets including, Asia and GCC HY. Carry trades from Turkey and Egypt remain attractive for another couple of quarters where clients can expect decent double-digit returns.

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
Including in GCC

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

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Equity Update

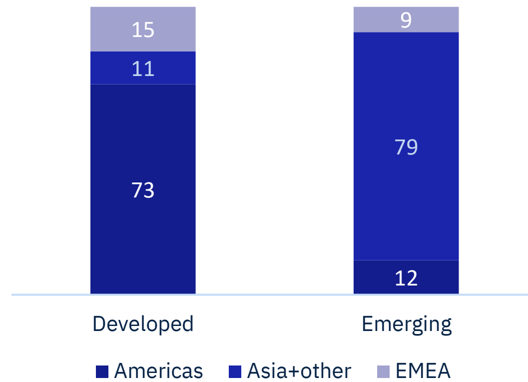
Last week the US Presidential candidates' debate was centre stage, with the implications of policy changes, however the markets were more focused on the Fed, inflation, labour markets, the ECB and tech (Nvidia) updates. DM Central banks are on a more certain rate cut path – better for consumer credit, mortgages, and corporate borrowing.

We are slightly underweight equities in September as agreed at our last tactical allocation committee, with a preference for the US in developed markets and India and the UAE in emerging markets. We were OW equities in H1 and neutral in July August which worked well. Though volatile, global equities have had a stellar performance and are up 15% YTD with India and the US leading returns. We continue to favour the growth segments, within regions (US, India) and within sectors, technology and healthcare, while staying cognizant of valuations. We expect volatility as many major equity indices are trading at higher valuations and any news around earnings, elections or geopolitics could upset the equilibrium. Limited scope for P/E expansion with the US forward P/E at 23X well above 5 and 10 year averages.

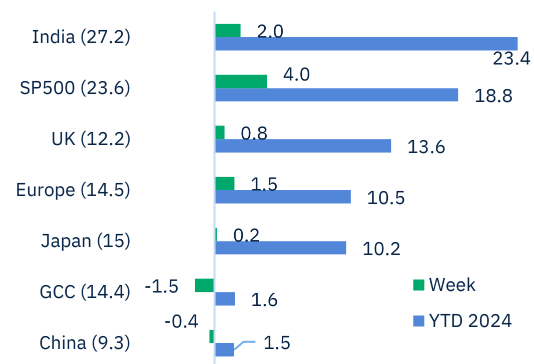
We stay overweight U.S. equities, driven by the AI mega force. The slowdown in the economy (we do not see a recession) is resulting in a balance between moderating inflation and labour markets. The S&P 500 is close to its all-time high, (+19% YTD) as GDP growth numbers and a resilient US consumer give greater conviction the economy is holding up fine. Both US tech and the broader market had a positive week but outperformance from defensive sectors in the past month was significant: healthcare and consumer staples have done well. The Mag 7 stocks were up 7% last week on the back of Nvidia CEO talking of the magnifier impact of the $1 trillion data centre roll out in progress. Stronger-than-expected U.S. corporate earnings, especially in tech, Q2 earnings growth for tech vs non-tech sectors at 20% and 5%, respectively, however earnings are broadening out as the year progresses. We expect volatility leading up to the US elections less than 3 months away, as the Presidential candidates talk on economic and international policy.

The UAE has some interesting equity issuance before year end which broadens the market and dividend payouts remain key. The energy unit of NMDC Group, raised AED 3.22 bn the biggest IPO in the UAE this year. The offering was 31.3 times oversubscribed, excluding cornerstone investors. China a little negative last week with disappointment around China tech. Tariff worries and real estate woes continue. Our India overweight continues to work. India saw new highs – a slow and steady year with great demand for new issuance: the Bajaj Housing IPO had shares double on listing.

EQUITY RECOMMENDED REGIONAL POSITIONING

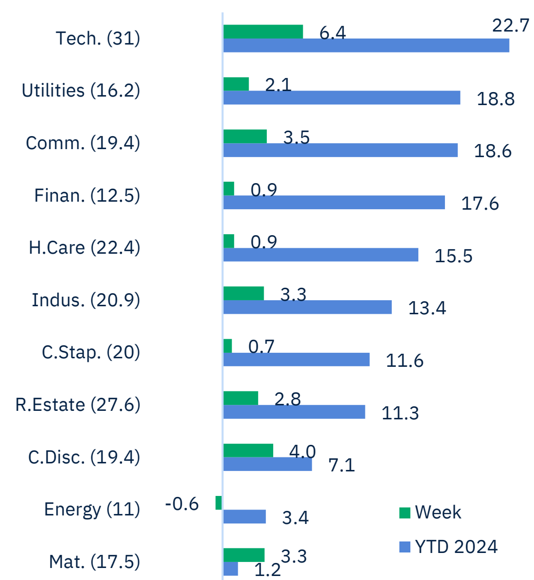


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



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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