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# **Fed uncertainty** takes a toll on pretty much everything

- **Last week was negative for all asset classes, except cash, with rising yields and stronger dollar**
- **Strong US retail sales, sticky inflation, and a cautious Powell weighed on rate cut expectations**
- **We increased our allocation to DM stocks and took profits on our overweight on Gold**

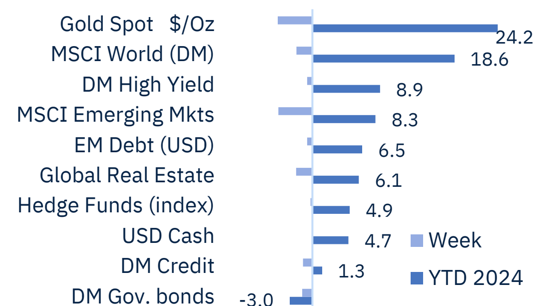
Last week looked like a sudden return to reality after the election-driven celebrations of the previous one. Except for cash, all asset classes fell. Gold and stocks from emerging markets were the most affected at -4.5%, but DM stocks were not far at -2% while bonds were pressured by rising long-dated yields and a stronger dollar pressuring international indices. The 2% rise in the dollar also hit Brent, down -3%.

Is it already the end of the market's honeymoon with Mr Trump? It's too early to say, we are in transition period. Still, policy anticipations combine with recent data to generate Fed anxiety. US retail sales were strong, while the October CPI showed no material improvement on the inflation front. Fed's chair even said there is no hurry to cut interest rates. Implied expectations from future markets now only price in 75 bps of cumulative easing between now and the end of 2025, which is half of what it was a few weeks ago and 50 bps less than the Fed's own dot plot. The dollar strengthened, long-dated yields rose, challenging equity valuations. There was nowhere to hide.

We took this opportunity to make some adjustments to our tactical asset allocation. We increased stocks from developed markets to neutral (from underweight), funded by the end of our very successful overweight on gold, now also down to neutral. Our positioning is thus now marginally defensive. We continue to overweight cash and safe bonds for their very compelling risk-adjusted expected returns. We are neutral on gold and DM stocks, and still underweight on EM stocks, real estate, and hedge funds.

The week ahead will provide flash PMIs, Eurozone inflation, a G20 summit and Nvidia results. Take care.

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





MAURICE GRAVIER
**Chief Investment Officer**
MauriceG@EmiratesNBD.com

GIORGIO BORELLI
**Head of Asset Allocation**
GiorgioB@EmitatesNBD.com

SATYAJIT SINGH, CFA
**Head of Fixed Income Strategy**
SatyajitSI@EmiratesNBD.com

ANITA GUPTA
**Head of Equity Strategy**
AnitaG@EmiratesNBD.com

NAWAF ALNAQBI
**Equity Strategist**
NawafALNA@EmiratesNBD.com

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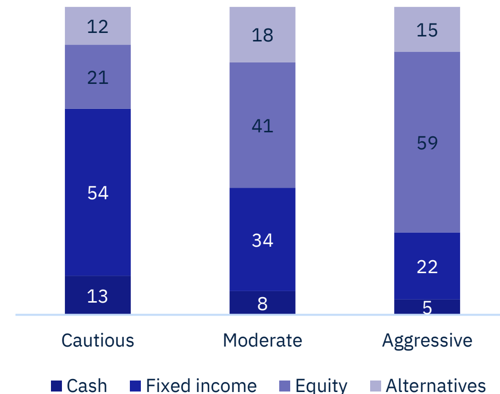
## Cross-asset Update

There is a lot of talk about the effect of Trump's policies on asset classes, although details remain undisclosed, and investors can only guess so much in this respect. What we do know is that the current economic setup is different than in 2016. At the time inflation was subdued, yields were picking up from historically low levels, and markets were not as richly valued. Also, manufacturing was in the early stages of recovery. Today we have an opposite scenario, with the disinflation process stalling, Treasury yields at high levels, and equity valuations on the expensive side. US manufacturing has been in the doldrums for two years now, one of the main reasons for the industrial Midwest's widespread discontent. This has us think that pro-growth policies, if inflationary, would not be that welcome this time, possibly causing mounting discontent and yields to rise further. The president-elect will have to duly calibrate tax cuts, while being careful about tariffs and their detrimental effect on growth and prices, if implemented broadly and indiscriminately. At the same time, Donald Trump will most likely want to make good on his campaign pledge to resurrect the US goods sector, ideally with a long-lasting manufacturing revival after decades of deindustrialization in the United States.

This leaves us with the conviction that, however Mr. Trump's policies will be shaped, a weaker dollar will eventually be necessary. It is not possible to see an industrial recovery and foreign direct investments without a devaluation of the reserve currency. Also, the gaping hole of the budget deficit will have to be reduced to cap debt levels, and rising exports would be a good means to that end. If this is the case, at the same tariffs would have to be very selective and mostly a bargaining chip, otherwise global trade disruption would negatively impact global growth as well as manufacturing, and in the process boost the reserve currency. For the same reason, yields should not overshoot, so the Fed's forward guidance should be more geared towards containing inflation expectations, than supporting the economy.

Ultimately, achieving most policy goals for Mr. Trump would be a big balancing act to say the least, and something will have to give. We can only remark that renewed growth in manufacturing, though not mentioned much in the public narrative, remains pivotal for the president-elect's popularity. The discontent sowed by decades of deindustrialization pursued by globalist agendas was one of the main reasons why Democrats lost the 2016 election. In 2024 blue-collar workers saw the insult of rising inflation being added to the injury of an ailing industrial sector. A meaningfully weaker dollar seems to be a necessary condition to meet the expectations of the lower middle class.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

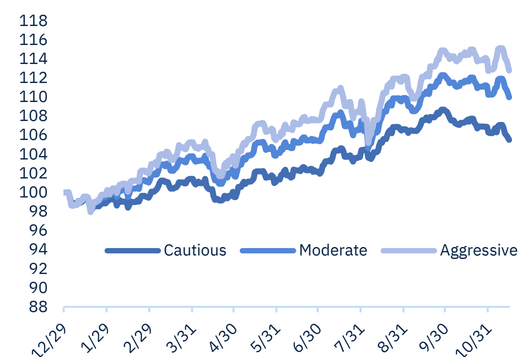



TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 | << | | |

TAA – 2024 INDICATIVE PERFORMANCE




Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

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**Fixed Income Update**

Last week, the US Treasury yield curve bear-steepened, driven by several factors. Yields on 2-year, 5-year, 10-year, and 30-year Treasuries rose by 4bps, 11bps, 13bps, and 15bps respectively, currently standing at 4.30%, 4.30%, 4.44%, and 4.62%. October's core PPI came in above expectations registering 0.3% growth. Initial jobless claims were at 217k, indicating a strong labor market. Federal Reserve Chair Jerome Powell commented, "The economy is not sending any signals that we need to be in a hurry to lower rates," while describing the PPI data as "a bigger bump than we expected." These prepared remarks suggest an intentional effort to manage market expectations with a hawkish tone. As a result, the probability of a December rate cut dropped sharply to below 65%. Markets now expect only two additional 25bps cuts in 2025, down from nearly five cuts projected a month ago.

US CPI numbers came in line with expectations. The headline CPI came in at 0.2% while the Core CPI remained strong at 0.3%. While inflation has significantly declined from its 2022 peak, recent months have shown limited progress, indicating that disinflation has lost momentum. U.S. retail sales increased by 0.4% m/m in October, lower than the upwardly revised 0.8% growth in September. However, much of October's strength came from automotive sales; excluding these, retail sales grew a modest 0.1% m/m. Separately, during the week, the Bloomberg Benchmark OAS spreads for HY debt widened by 5 bps, remaining however around their lowest levels in last one year. The same holds for IG, EM and GCC benchmark spreads.

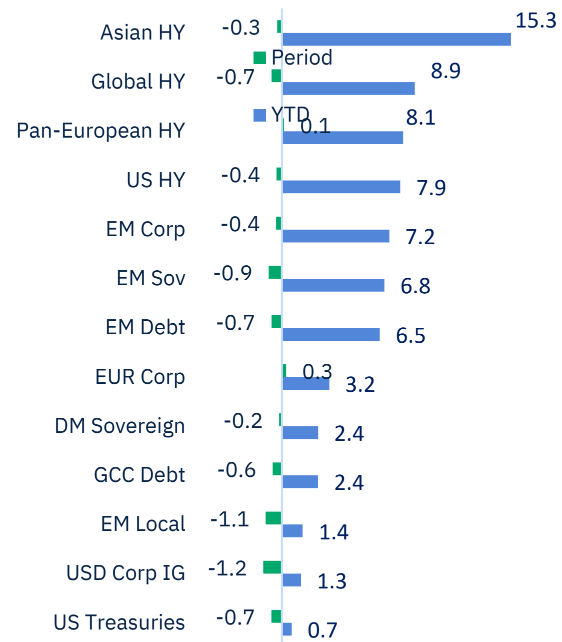
The Central Bank of the Republic of Turkey (CBRT) is scheduled to meet on 21st November, with markets expecting rates to remain unchanged as the disinflation process progresses slower than anticipated. In its recent inflation report, the CBRT raised the mid-point of its year-end inflation forecast ranges to 44% YoY for 2024 (+6%), 21% YoY for 2025 (+7%), and 12% YoY for 2026 (+3%). Turkey recorded a current account surplus of USD 2.99bn in September, down from USD 4.85bn in August. Separately, Dubai's real GDP grew by 3.3% y/y in Q2, slightly up from 3.2% in Q1.

Primary bond issuance activity gained momentum last week, with several financial institutions issuing senior and subordinated securities. In the UAE, the government plans a tap issuance on its AED-denominated sukuk maturing in 2027 and 2029. This morning in Asia, the State Bank of India, India's largest government-owned bank, issued a 5-year USD bond with IPTs at T+115bps, translating to roughly 5.45%. We expect the final pricing to be around 90bps over treasury, translating to 5.20%. Additionally, the Indonesian government issued 5.5-year, 10-year, and 30-year sukuks with IPTs at 5.30%, 5.50%, and 5.85%, respectively.

FIXED INCOME KEY CONVICTIONS (2024)

| **DEVELOPED MARKETS** |
|---|
| Overall overweight DM FI |
| OW Government Bonds |
| Neutral corporate (IG & HY) |
| **EMERGING MARKETS** |
| Neutral 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

Neutral DM: OW US/UK, Neutral Japan, UW Eurozone

Underweight EM: OW China/ UAE, Neutral India

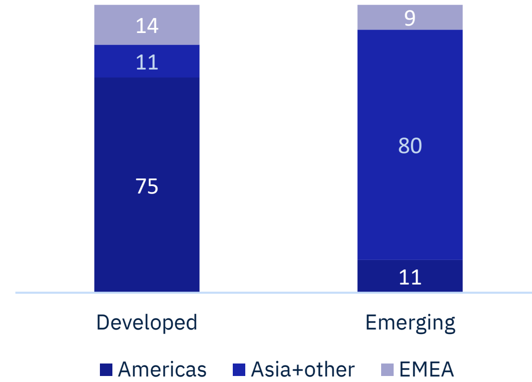
Our positioning post our asset allocation meeting last week: Neutral DM equities (shift from underweight) and continued US overweight. Underweight EM equities and a shift back to an overweight positioning on India and neutral China.

The UAE market has hit the trillion-dollar cap, putting it ahead of most other emerging markets. In the last three years it has increased not only in size, but also in diversification, with more companies in the retail and AI sectors, away from crowded banking and real estate. The UAE indices bucked the downward move seen across global equities last week with gains on the DFM as real estate stocks continued a strong rally. The Lulu Retail Plc listing on the ADX saw $37bn of demand, and the stock close the week flat. Currently Talabat, the regional leading online delivery service in the GCC, has an offering in progress. 25 IPO's the last 3 years across DFM and ADX with average gains of 42%.

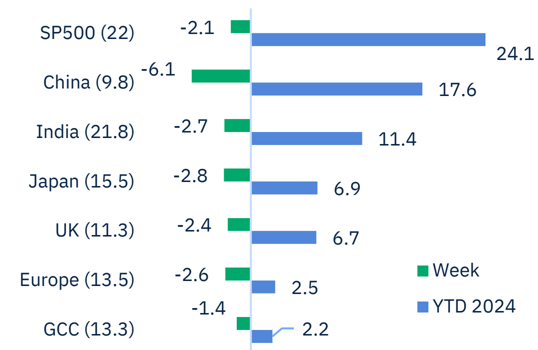
Last week inflation was up in the US along with strong retail sales signalling a sturdy economy, and a slower pace of cuts from the Fed, resulting in higher Treasury yields and leading to a sell off on equities on Friday. Overall, global equities were down for the week (-2.3%). The USD has continued to strengthen against major G7 and emerging currencies. Fed Chair Powell is backing a gradual approach to lowering rates, saying no need to be "in a hurry". Next big catalyst in the market is Nvidia's results due on 20th November. Consensus expects Nvidia to report 3Q y/y sales growth of 82% to $33 billion. If these estimates prove correct, the Magnificent 7 will have grown aggregate earnings by 30% y/y during 3Q 2024. The Mag 7 stocks have collectively returned 53% YTD and comprise 35% of the market cap of the S&P 500. The 7 stocks account for half of the S&P 500 return YTD. Tesla was the last to join the rally taking all seven into positive territory.

After a rally in US stocks, in regional banks as well as tech post the Republican sweep, last week saw a global pullback. The S&P 500 and Nasdaq were down 2% and 3% respectively with Japan and European markets much in line. The European Commission downgraded its 2025 Eurozone growth target to 1.3%. In the US there have been clear winners and losers and last week vaccine stocks were badly hit as the designated Health Secretary Robert F Kennedy has been a vocal critic of vaccines and Big Pharma in general. In Asia the MSCI China fell 6%, whilst the MSCI India was down 2.7%.

EQUITY RECOMMENDED REGIONAL POSITIONING

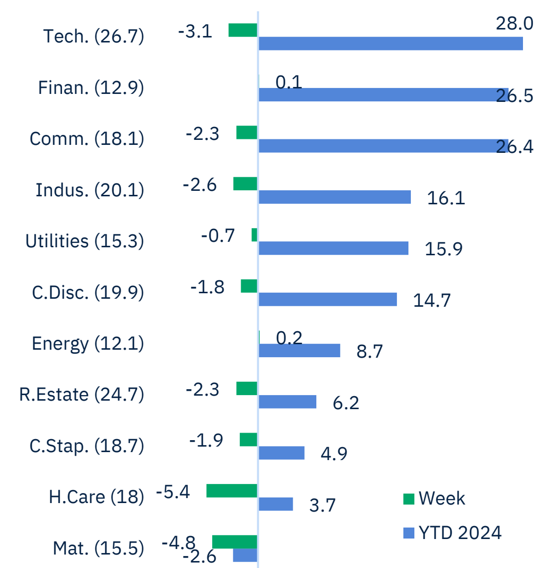



MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets




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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