Emirates NBD
WEALTH MANAGEMENT

Questioning the **consensus**

- **US inflation unexpectedly rebounded in January, which pushed Treasury yields materially higher**
- **Equities had a mixed week, with ex-US markets outperforming, and cyclicals beating tech**
- **The good news: market-implied expectations for rate cuts have become much more reasonable**

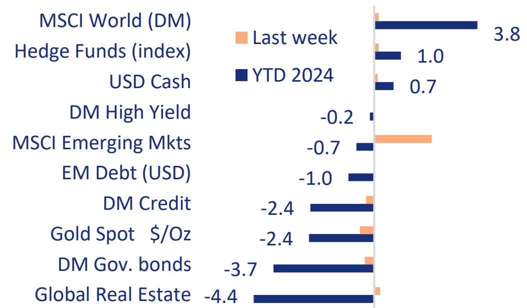
The bottom-line of our 2024 Global Investment Outlook, titled "The Year of Answers" is that we expect modest returns with high volatility, but higher rewards from diversification and selectivity. The foundation of this view is the acknowledgment of a strong consensus for a perfect "soft-landing" scenario, with slower growth and continued moderation of inflation. As it's at least partially priced-in, upside potential is modest, and as it's consensual, it will be questioned, especially by data.

Consensus was indeed questioned last week. First, the US January CPI report didn't please investors with a clear uptick in inflation. A single datapoint doesn't make a trend, but markets reacted swiftly with an aggressive repricing of rate cut expectations for the year, now much closer to the Fed's guidance of 3 times 25 basis points, pushing the implied first cut to June, and a sharp rise in US Treasury yields: +20 basis points for the 2-year and +10 on average for longer maturities, putting pressure on the bond markets. Elsewhere, Q4 GDP releases revealed an also unexpected technical recession in both the UK and Japan.

Now the good news: diversification. Global stocks as an asset class rose last week, even if the US didn't, with a rotation towards other regions: emerging markets, Japan, Europe. The same happened at the sector level with energy and materials topping the weekly hierarchy. 2024 is all about diversification and selectivity.

We are neither surprised nor really unhappy to see volatility materializing, as it will provide tactical opportunities down the road, and as the most dangerous situation would be outright euphoria. Our positioning is unchanged for now. The week ahead will provide plenty of information, from flash PMIs to the FOMC minutes. Have a great week.

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



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Cross-asset Update

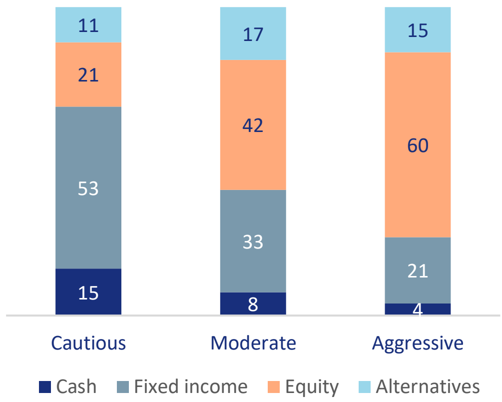
Equity performance in the past week suggest that the dominating theme of US exceptionalism tied to growth stocks could soon be in retreat allowing for other markets and the more cyclical sectors to catch up. The US economy provided hints of a fatigued consumer even as the goods sector improved, with some green shoots emerging in the euro area as well. Losses were concentrated in the large caps, with the S&P 500 losing 0.4%, the Nasdaq 1.5% down, and small caps (+1.1%) bucking the trend. Information technology led losses, while materials and energy were the top gainers. EM stocks (+2.1%) were the best performers, and Europe (+1.1%) closed higher as well. Overall, equities showed a pro-cyclical bias, as highlighted by the less US-centric performance and by the positive returns in some old-economy sectors and in small caps. Some consumer fatigue that emerged in the retail sales release was contrasted by strength in two regional manufacturing surveys, as both the NY Fed Empire index and the Philadelphia Fed activity index jumped more than expected. These rises seem to corroborate the recent improvement in the ISM manufacturing.

With large-cap benchmarks close to all-time highs and the prospect for lower ECB rates investors raised their expectations about the economic outlook in Germany according to the ZEW survey. A positive divergence between the expectation and the current condition index usually correlates with rising business confidence and positive equity returns. It could be the first green shoots of a manufacturing revival in Europe as well, possibly favouring a rotation towards cyclicals within equities.

China seems to remain the outlier, with no significant change in economic conditions and negative investor sentiment. Yet, the authorities do not want to see lower equity prices, and valuations have reached levels that historically have sparked at least vigorous rebounds.

Overall, while in the West there is a procyclical turn in the economy that sooner rather than later should be reflected in a rotation from growth to value stocks, in China odds for some significant upside have been rising substantially. This leaves room for equities to continue to edge higher, alongside Treasury yields. Indeed, as much as the good sector improves, yields should follow suit. And never mind whether we have already reached a point where expectations of rate cuts are more in line with what pencilled in by the Fed in the dot-plot. Investors overshot to the downside on the dovish Fed pivot late last year and may well do it to the upside if the economy continues to improve.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

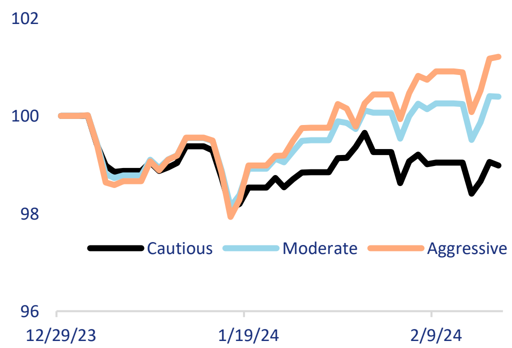


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

It was a mixed bag of macro releases last week. On Tuesday, we had impressive CPI data that resulted in a massive bear steepening of the curve. The benchmark 10-year yield touched a high of 4.3 before retreating slightly. On Thursday, the initial claims came in pretty strong, while retail sales on the same day were weaker than anticipated. We had the US PPI on Friday, which was hotter than anticipated. According to BCA research, the hot PPI suggests that the price pressures are sticky and could lead to an elevated PCE number due on Feb 24th. Overall, the 2-year moved up by more than 16bps even as the 10 and 30 years by over 10 and 6 bps, respectively.

This week, bond markets await FOMC meeting minutes on Wednesday and auctions of 20-year bonds and 30-year inflation-protected securities. Six Fed officials speak Thursday with the market likely to pay attention to Fed governor Christopher Waller. Post-CPI price action saw cash spreads exhibit remarkable resilience in the face of a sharp move higher in rates. Credit spreads continued to tighten further. All the spreads across segments are at their 52-week lows. This is despite large issuance happening YTD in both IG and HY. HY issuance of $54bn in Jan is the highest since 2021. For spreads to move lower, we need Financials and CCC-rated bond spreads to compress as other segments are trading below the 10th percentile, according to a recent report by GS. This indicates that it would take a lot of work for markets to reach their June 2021 tights.

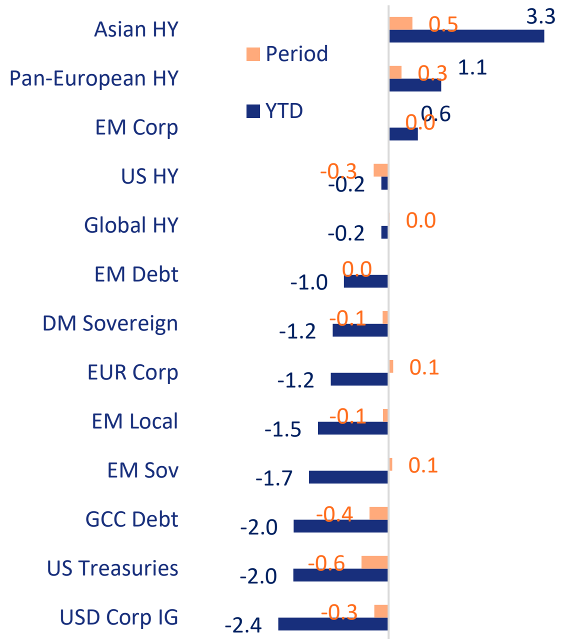
S&P reported that we had the highest number of defaults in January since 2010. There were 14 global corporate defaults in January, well above the long-term average of nine. Analysts expect bankruptcies to remain high as the number of rating transitions in the 'CCC+' and below rating categories continues to be elevated, particularly in North America. Risky credits (issuers rated 'CCC+' and below) in the U.S. and Europe are still above their five-year averages. S&P Global Ratings expects the U.S. speculative-grade corporate default rate to reach 5% by September 2024, while the European corporate speculative-grade default rate could reach 3.75% by September 2024. These are not very different from the trailing twelve-month default rates for both regions.

GCC primary issuance is expected to remain hot this week. GCC's third largest bank by asset, Saudi National Bank, has announced a mandate for selling senior 5-year $ sukuk. The pricing could be as early as tomorrow. We expect pricing to be around 95bps above treasury in peer comparables.

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

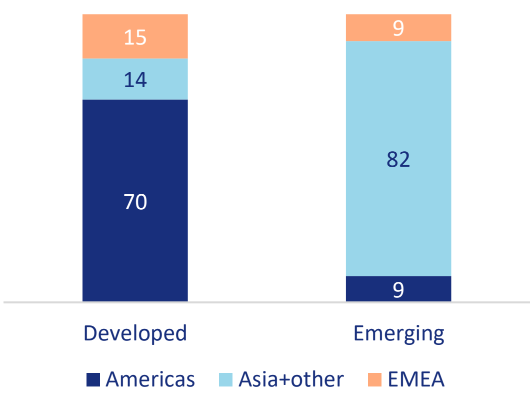
A good week for emerging market stocks +2.1%, largely driven by China performance: the Hang Seng and the Golden Dragon China Index (China companies that trade in the US). China mainland markets were closed for the lunar New Year holiday. EM performance YTD is still negative, though last week the GCC, LATAM, India and Asia markets were all up. Developed markets were largely flat: US equities saw the S&P 500 and the Nasdaq end the week down, though close to all-time highs, offset by Europe and Japan having a positive week. US markets had a volatile week with the hot CPI print, a corresponding rise in Treasury yields and a disappointing retail sales report. Overall markets have traded along our calls: we are overweight Japan and India and neutral the US and China.

The lunar new year break saw a surge in consumer spending and travel in China, the first in five years with no restrictions, with tourism spending 9% and domestic trips 19% over pre-pandemic levels in 2019. Last year, consumption drove China's recovery, with 5.2% GDP growth, but off a low 2022 base. A lack of demand in the housing market continues and will continue to curb overall investment. Stimulus plans are reactive. What is needed is policies that boost household income and give Chinese consumers confidence rather than money through offshore routes into China markets.

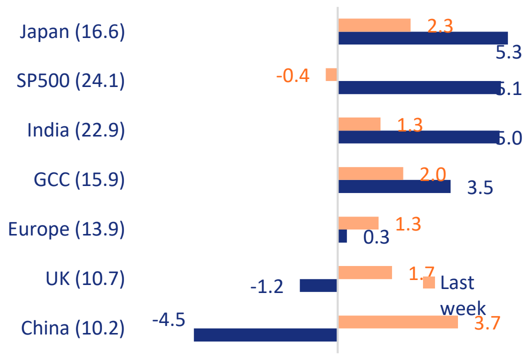
With the earnings season in the US nearly over, what has emerged from earnings calls are capex on AI, (the potential productivity boost and cost savings), worries around supply chains and the labor market. For Q4 2023, the blended (y/y) earnings growth rate for the S&P 500 is 3.2% and revenue 4.0%. 54 S&P 500 companies are slated to release quarterly results this week. Walmart and Home Depot sales growth will serve as a barometer for how the retail industry is managing the moderating inflation. Closely watched will be Nvidia the AI favorite on Wednesday, possibly the most important earnings report of the year, the quantum of market cap priced for gain or loss is close to $200bn, a 11% move on earnings. This could direct future movement around the A.I. trade. Nvidia stock is +46% YTD, surpassing Alphabet and Amazon in market cap. Investors are looking for Nvidia to deliver a clear beat-and-raise and forward-looking commentary about sustained growth.

We recommend within AI a shift to companies that are adopters versus enablers and also recommend holding a diversified portfolio. Other growth sectors include healthcare. Bloomberg estimates the obesity market will reach $80 billion by 2030. Eli Lilly could be the first $1 trillion biopharma stock with continuing upgrades and its now in the top 10 by market cap in the S&P 500 Index. Zepbound, for weight loss, is predicted to become the best-selling drug in history. Novo Nordisk is already Europe's biggest company. Our preferred growth region is India which has seen EPS growth upgrades to its equity indices for the next fiscal year. At 20%+ this was already the highest amongst major markets. India has currently the 4th biggest globally by market cap.

EQUITY RECOMMENDED REGIONAL POSITIONING

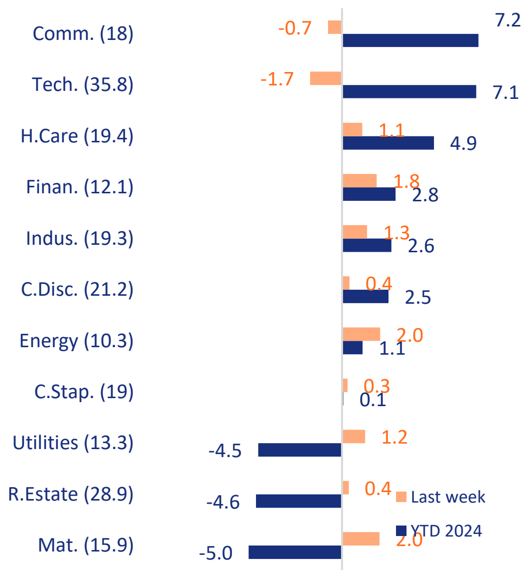


MAJOR INDICES PERFORMANCE (TR, US$) AND P/E



Source: Bloomberg consensus. MSCI Indices unless specified.

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



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

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