Disinflation is not **dead**

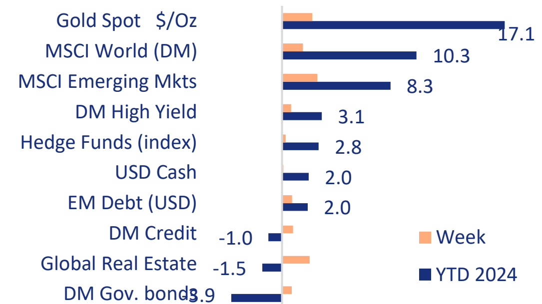
- **US April CPI inflation report was a relief for markets, as disinflation resumed in line with forecast.**
- **Soft retail sales and manufacturing activity indicators also temper the risk of US overheating.**
- **We enjoyed a positive week across asset classes, but still expect high volatility ahead.**

The long-awaited signs of moderation in both growth and inflation from the almighty USA are finally gaining enough traction to damp the risk of overheating and its dire consequence for markets, overtightening.

The US CPI inflation report showed both headline and core measures moderating to respectively 3.4% and 3.6% year on year. It wasn't a surprise, as it exactly matched median forecast, and it wasn't even a strong drop. But coupled with disappointing retail sales and various signs of softness, from manufacturing activity to confidence, it confirms that a US soft-landing may be finally happening. Markets are yet not concerned about recession risk, for good reasons: unemployment remains low, fiscal support continues (and both presidential candidates should maintain some form of support), and the global picture is not adverse.

There was also interesting news from Asia. Japan's Q1 GDP disappointed, adding another layer of complexity to their monetary policy dilemma, as the yen suffers from its yield differential with other major currencies. China continues, layer after layer, to deploy support measures for an economy which clearly needs it, especially on the consumption side. The latest initiative is aimed at unsold properties within the critical real estate sector. Time will tell whether this is a game changer, but the +15% US$ return of the MSCI China so far in 2024 is painful to many international investors who were a bit quick to consider China as un-investable. Our tactical asset allocation was kept unchanged in our May Committee: we are overweight cash and safe bonds of reasonable duration to grab low-risk yields, but also stocks, especially from emerging markets, including a small overweight on China. This week will see speeches from central bank officials as well as the FOMC minutes and Nvidia results.

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



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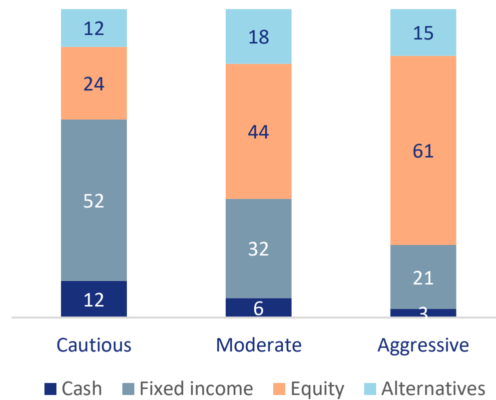
Cross-asset Update

In China the economy continues to suffer from demand-supply imbalances, as industrial production accelerated, while consumption and investments weakened further as shown in a key economic release at the end of the week. But on Friday Beijing announced its most forceful attempt to support the ailing property market, relaxing mortgage rules and urging local governments to buy unsold homes. While the litany of unhappy analysts that say that more is needed continued, we think that the package is a net positive for China's real estate sector, and that more measures could follow. Investors are much less sceptical, with the MSCI China Index up 15% for the year in local currency, outperforming the S&P 500, that has to-date gained 11%.

The package swiftly followed up after the April politburo meeting. The most significant measure is the bailout program for unsold homes. The PBOC will provide an initial sum of CNY300bn to local governments for them to acquire unsold homes to be used as public housing. While there remains uncertainty as to whether the sector will reach a bottom on the back of the new measures given its three-year decline, government intervention raises those chances sensibly. In the short-term the rally in Chinese equities could stall, as the planned intervention underwhelmed some estimates, and the main benchmarks went up in a straight line. But as long as the valuations gap with DM (or other EM) stock markets remains large, investors will be looking to the July third communist party congress as the next catalyst with room -or fear of missing out- for the further rerating of the Chinese market.

Despite China's lingering woes commodities year-to-date are up in the high single-digits according to the Bloomberg commodity index. This in the end will have repercussions on yields and headline inflation. We have a fair value for the 10-year Treasury yield of 4%, where consensus has now shifted to, that was initially based on three rate cuts for the year, a soft-landing scenario, and consensus inflation forecasts that now have changed significantly as compared to the start of the year. Considering the recent upward inflation surprises, and the reduced number of cuts into year-end, a sharper slowdown would be required to justify the 4% fair value. At first sight this seems unlikely, considering that the Fed from June will reduce the pace of Quantitative Tightening by more than half, capping yields on the one hand and supporting financial markets and the economy on the other. Overall, fair value for the yield on the 10-year note should be somewhere between the current 4.4% and our estimated target of 4% as of the start of the year.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

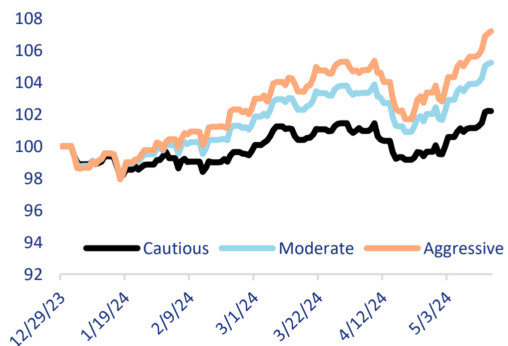


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 drifted lower after underwhelming CPI and retail sales data prints from the US. Chairman Powell was more hawkish than the last FOMC press Q&A. However, markets have brushed aside the comments. The UST yield curve has bull-flattened with long end-yield dipping by more than 7 bps where as the front-end dipped by 3 to 4 bps.

We held our tactical asset allocation committee meeting last week. We did not make any changes to our current positioning. However, looking at weaker macro data we were in favour of increasing duration to become more neutral. We remain neutral duration due lack of near-term bullish catalysts and risks of a later-than-expected rate-cut. The current average US Treasury duration is 6.1 years and Investment Grade Credit duration is 6.2 years. We recommend holding 5 to 10 year bonds in Investment Grade and 3 to 5 year duration in corporate high yield.

Credit spreads were more rangebound than yields last week. The Investment Grade index spread compressed by 1 bps where as the High Yield spreads compressed by 7 bps. MTD IG supply reached $87bn, suggesting that May total is likely to surpass the historical May average of $120bn. The spread compression in Investment Grade has also been reflected in Financial Vs Nonfinancial issuers. Drivers of this compression include the strong market environment and also a step down in Financial supply. MTD financial bonds make up a third of issuance versus the YTD average share of 40%.

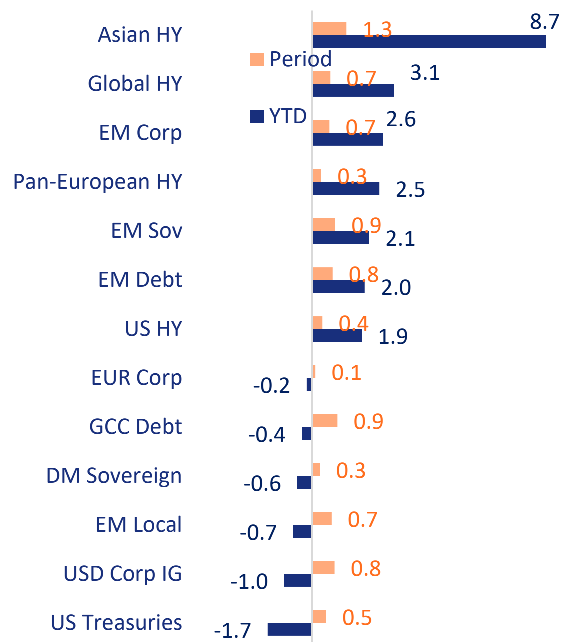
High-yield refinancing activity has gathered pace this year. According to JP Morgan, a considerable $280bn of bonds/loans have been refinanced YTD following $334bn in FY23, a 15yr low $132bn in FY22, and a record $512bn in 2021. Notably, a mere $30bn of HY bonds and loans mature by YE24, which rises to $138bn in 2025, $303bn in 2026, $439bn in 2027, and $844bn in 2028. This implies lower default rates and tight spreads.

GCC issuance has moved to a slower gear since April. Al Dar tapped markets in early May as part of refinancing process and issued a tender for its existing 2025 bonds at 99 cents to a dollar. A total of $38 Bn equivalent of bonds have been issued so far this year from the region. This week Emirates Islamic has issued a mandate to sell a 5-year senior unsecured sukuk. We expect good demand for the issuance given that this is a well-known name and the overall yield for 5-year senior banking sukuks from the region have been attractive recently.

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

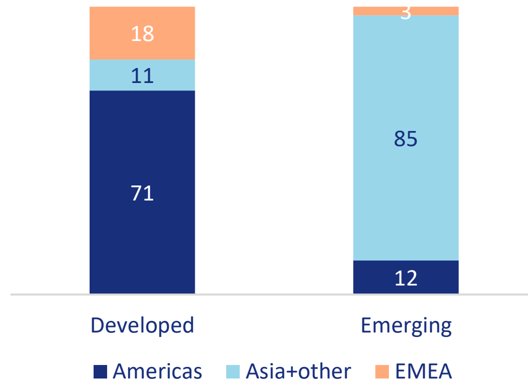
We remain constructive equities with a small overweight positioning for both developing and emerging markets. A slight shift with the Eurozone and the UK as overweight within DM allocation, with the US neutral and Japan now underweight. With the Eurozone and the UK seen as the first to cut rate, we see that as a positive boost for corporate margins and sentiment. Our relative positioning within EM is a shift to a China overweight, we retain India and the UAE as overweight. Neutral the rest of Asia and underweight Eastern Europe and LATAM. China looks ready for a rally with the real estate sector finally getting some support, and good tech earnings.

Global equity markets are at record highs with the latest US CPI data indicating inflation is moderating, and the Fed seen to cut rates this year. The MSCI ACWI index, gained every day last week (+1.6% for the week). EM had a better week +2.7%, DM equities gained 1.6%. In the US, the S&P 500 (+1.4%) back at 5,300 and tech which has been lagging this year, has Nasdaq YTD gains higher than the S&P 500 at 11.5%. The VIX, the volatility gauge, ended the week at below 12, the lowest since November 2019. S&P 500 companies' Q1 earnings, blended growth is 5.7%, with 93% having reported. Surprises reported by companies in the communication services, financials, info tech and consumer discretionary have been the largest contributors to the increase in the earnings growth rate. Analysts have boosted expectations for the upcoming quarter as the economy looks resilient with robust consumer demand, with expected (y/y) earnings growth rates of 9.2%, 8.2%, and 17.4% for Q2, Q3, and Q4 2024. Reports from private unlisted companies with a larger share of domestic vs international revenue mix, soft data has profit margins of 17% in Q1 y/y but wage growth at 5% is a worry. Capex is focused on AI software as for the larger listed companies. Nvidia's report on Wednesday will be critical for equity markets as it will set and confirm the tone for AI demand, which was recently reinforced by big tech and chips companies, especially TSMC.

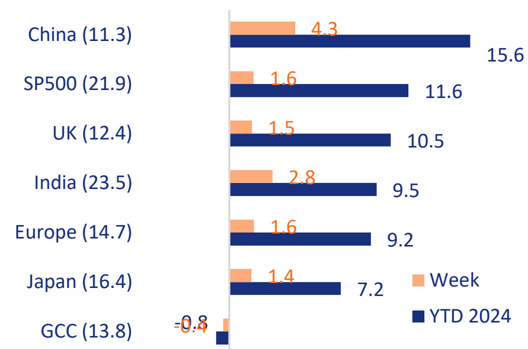
European and UK markets had a good week too + 1.6%. Japanese equities TOPIX +0.8%, sentiment boosted by Sony, the third largest component in the index, profits above expectations, robust mid-term plans and shareholder return policy, and a five-for-one stock split.

Within EM, the MSCI China Index, now the best performing large Index YTD, ended the week +4.2%. Tech companies announced good results with gains from Alibaba, JD.com 5% and other China tech. Chinese valuations remain cheap, the MSCI China Index trades at 11.3x forward P/E. Following President Biden's tariffs on strategic Chinese sectors, EV giants like BYD are now looking at Latin America, especially Brazil, as a key market. Within the GCC, SALIK and Spinneys both reported results last week with SALIK posting the highest revenue-generating trips since inception supported by Dubai's continued growth in tourism, business and commercial activities. Spinneys, recently listed on the DFM, reported record sales in Q1 results last week; and expects to launch in Riyadh in H1 2024, marking its first expansion into Saudi Arabia.

EQUITY RECOMMENDED REGIONAL POSITIONING

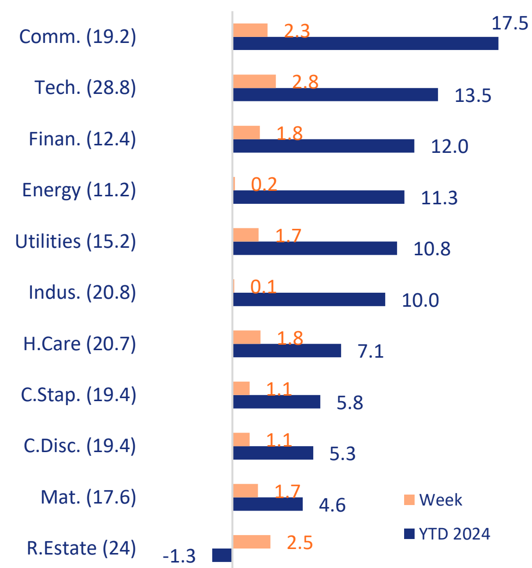


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



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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