The Year of Answers **is talking**

- **The answers of Q1: global growth is faster and US inflation is stickier than initially expected**
- **Imminent cuts from the Fed are increasingly unlikely, pressuring bonds, while geopolitics affect risk appetite**
- **No TAA change in April. Due this week: US PCE, GDP, global manufacturing PMIs, major corporate earnings**

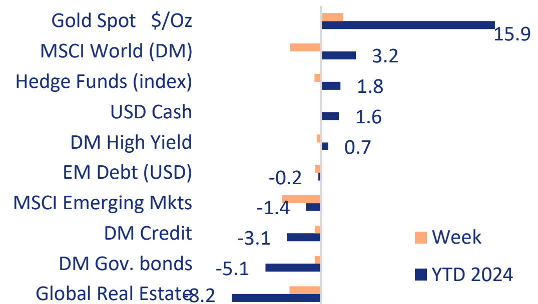
All asset classes remained under pressure for a third consecutive week, with an evolving narrative on growth, inflation, and geopolitics.

Starting with the latter, Israel's strike on Iranian soil increased the risk of escalation. Markets could not take it in their stride, although the drop in oil prices last week does not reflect outright pessimism. The US House passed a massive, combined aid package for Ukraine, Israel, and Taiwan – as well as some humanitarian aid for Gaza. This may stabilize the current tensions in our region, but potentially not so much in Eastern Europe and Asia. We still see geopolitics as a notable source of market volatility for this year, as against in 2023.

Economic data last week also confirmed upside surprises for the first quarter. China's official Q1 GDP growth was surprisingly good, and most importantly for global markets, both US retail sales and the Philly Fed manufacturing index came in better than expected. No surprise then that several Fed officials, including Chairman Powell, made more hawkish comments. Market-implied expectations from Fed funds futures are now for just below two cuts for the year. Our own scenario was also toned down to 2 rate cuts, probably starting in September.

Still, our Tactical Asset Allocation Committee didn't make any positioning change – we debated a reduction in equity risk, but decided to remain slightly overweight, as the current earnings season is promising, and as the recent market action has actually improved valuations. We confirmed our caution on duration: we overweight safe bonds, but with a ~2-year duration on govies and ~4 on segments with more carry. In the week ahead, we will look at US PCE inflation and GDP, global manufacturing PMIs, and major corporate earnings.

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



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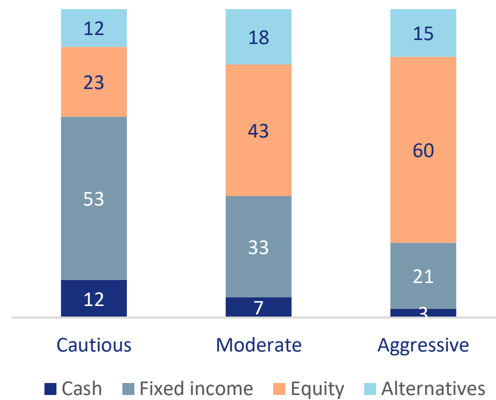
Cross-asset Update

Gold (+14.1%) is the best asset class year-to-date, so far supported by BRICS+ central bank buying and geopolitical risks. We have always been convinced that, contrary to the public narrative, to get the longer-term direction of gold right one has to look at monetary factors, rather than contingent risks that are fickle in nature. And in this respect the drivers for the yellow metal are in place: the debasement of the US dollar and more in general of the DM currencies is continuing as their debt load grows unchecked. The IMF warned in its yearly report about the outstanding economic performance of the United States as being driven by an unsustainable fiscal policy. To be sure, China was also mentioned in negative terms for similar reasons, but in our view it is the US twin deficits alongside the budget trajectory that should be concerning us the most. This sets the positive tone for gold for the longer-term, while in the more immediate future on the other hand we cannot help take notice of the mounting headwinds after the recent bull run.

Monetary policy has turned into a net challenge for gold. The pace of central bank buying will most likely slow down at the current higher prices, even as the Fed's rhetoric has changed significantly to turn more hawkish. As much as equities have yet to digest that hawkishness, gold will also have to come to terms with a much lower number of cuts discounted by money markets into year-end. We do not think that the yellow metal will be able to ignore that kind of tightening of financial conditions, hence we see it as vulnerable in the shorter term. Investors should not be buying at the current levels, but rather wait for better opportunities at lower prices. The forthcoming inflation readings are likely to keep the Fed on edge given that higher commodity prices should feed into the CPI and PCE gauges in the next couple of months. Also, the strength of the US economy is supporting the direction of travel of yields, that for now remains up. The US dollar has just broken out to the upside, on the outlook for a more favorable rate differential against G7 peers, and in particular against the euro. This represents an additional headwind, reflecting investor conviction that yields are not going to reverse course that soon.

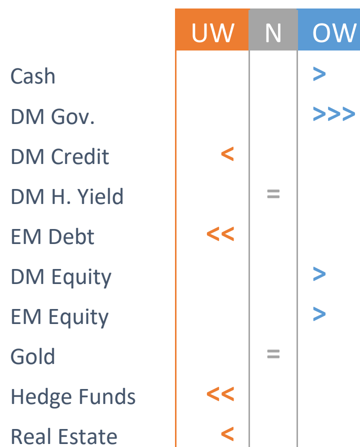
Overall, we retain the view that gold is going to outperform equities should the expected downside materialize, but also that at these levels it is offering little value unless one is willing to ride out forthcoming market volatility. Gold has gone up with equities and we except that it would be pulling back with them eventually. Please do not focus on its supposed safe-haven status, but rather on monetary factors.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING



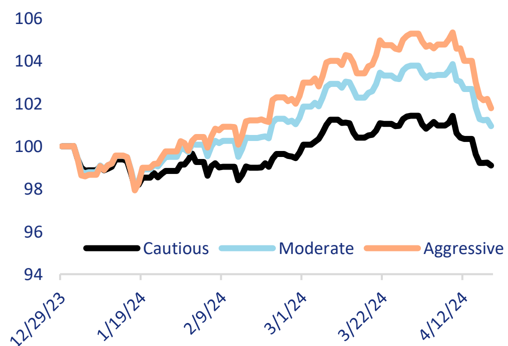
TAA – RELATIVE POSITIONING – MODERATE PROFILE

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

The Treasury curve bear steepened with the 2-year hovering around 5%. The 10-year yield is firmly above 4.5%. Markets now discount less than 2 rate cuts by end of the year and the first full rate cut only by September. We held our monthly tactical asset management committee meeting and retain our preference for cash and sovereign debt in the front-end of the curve. We haven't added to duration and are hesitant to do so. It will take multiple softer inflation and labour market reports for markets to regain confidence in a more dovish Fed path.

Our inhouse economist view is that geopolitics could have an upside risk to US inflation. Headline inflation could tick a little higher in the next few months and the strength of the US economy doesn't warrant cuts. We have pushed our outlook to two rate cuts this year with July/September the first and the second expected in the 4th quarter. For the ECB we expect 3 cuts, probably the first in June. For the BOE 2 cuts this year, not too aggressive. The UK has seen some improvement in economic data. Treasury yields continued higher, and spreads widened following a week of hawkish Fedspeak and strong economic data.

The market must absorb a combined $183 billion calendar of two-, five- and seven-year note sales this week. The 2 year at 5% marks an interesting flux point for investors. We suggest clients to move to 2-year treasuries from T-Bills or money market funds since the 2-year is trading close to the Fed policy rate lower bound of 5.25%. This allows investors to lock-in these high yields for 2 years while avoiding long duration exposure.

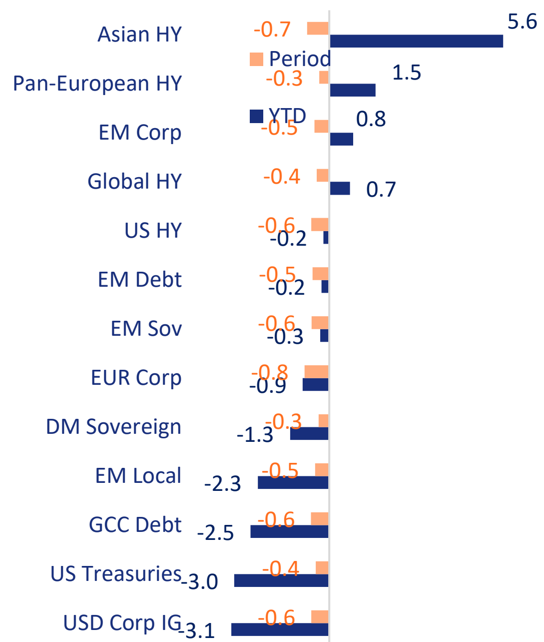
The most important driver for yields this week is the Fed's preferred inflation gauge (PCE) releases due on Friday. It is seen accelerating slightly to 2.6% on an annual basis as energy costs rise. Any upside surprise would lead to a sell-off in bonds. We also have the preliminary readings of the PMI data on Tuesday and consensus estimates point to a confirmation of the manufacturing rebound that is underway. Yields should have an upward bias this week with all these data points in play.

We have experienced insensitivity of spreads to yields at the current level of yields. Investors continue to believe that these yield levels are very attractive, and this is limiting the spread volatility even as broader volatility gauges are higher, as is currently the case with the MOVE index. Looking ahead, the focus is going to be on earnings, with 32% of the S&P reporting results this week. Any weakness in earnings is set to exacerbate the move in spreads.

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

Geopolitical tension on the rise, with an escalating Israel Iran standoff, so far contained has led to a stronger USD, higher oil and gold. At the same time a still strong US economy and low unemployment, inflation numbers above estimates are indicating higher rates and yields for longer. So far in April, global equities have fallen 5% leaving YTD gains at 2.7%. Close to flat performance in April or slightly positive are the KSA, India, UAE and the UK. Sharply lower are the US and Japan. Still leading USD YTD returns are India, Japan and the US though leadership has shifted away from Japan. In global sectors energy leads, with tech/ communication services a close second, in spite of the recent dip. All three sectors have gains of c. 10% YTD. Expect more volatility in markets till the earnings season in the US is almost done.

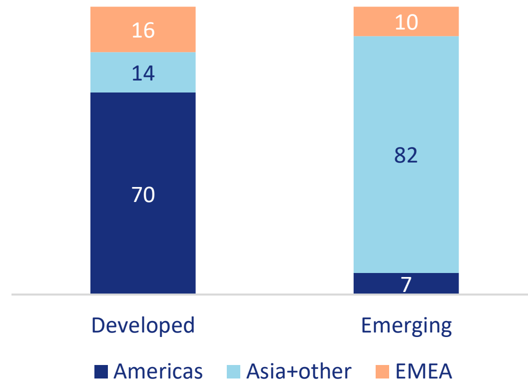
At our monthly tactical asset management committee meeting, post a quarter end reset we are slightly overweight equities. While higher rates could impact profits the consumer stays strong in the developed market regions. We prefer Japan and are neutral the US. We will look to be more active and add tactically if a further correction occurs. The mid- to longer-term horizon looks well supported. What's good for US equities is that in spite of the higher rates the consumer is in good shape and if people are employed will keep spending money. Rates are higher but financial conditions have eased as the strong 2023 equity rally continuing into 2024 has been good for wealth creation. Housing ok as mortgages tied at 2% for most borrowers.

In emerging market equities, a preference for India for growth and the UAE for dividend income. Neutral China as debt, deflation, demographics and increased US tariffs remain long term challenges. Reflationary measures and debt restructuring are getting into shape, but more is needed to deal with the property crisis. A contrast with India with domestic and international inflows into equities. Indian economic and productivity growth stand out as does its resilient earnings growth. In the UAE expect capital issuance to continue adding breadth and depth. Higher oil prices and increasing non-oil revenue will continue to raise economic growth. Increasing population and economic reforms are encouraging industry and global financial firms to set up base in the UAE.

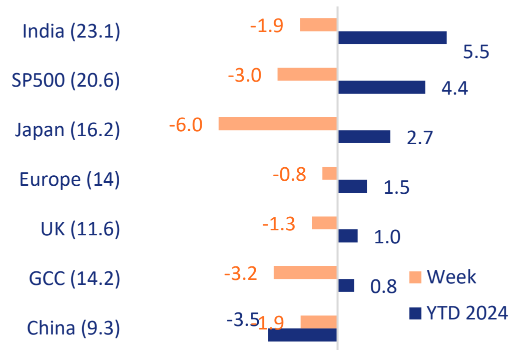
US earnings so far more about reaction to guidance than numbers. Earnings growth +6/7% y/y for banks yet mixed performance. Netflix grew paid subscribers, but shares fell post the call. LVMH grew revenue as Japan saw increased demand but China disappointed.

On tec: TSMC shares fell 6% after it cut back its outlook for a chip market expansion. Q1 results beat with fastest revenue growth since Nov-22, and better than expected Q2 revenue forecast. TSMC still positive on longer-term AI chip trends, seeing AI processor revenues doubling this year, however more uncertainty around broader chip demand, particularly after ASML reported disappointing net bookings. Big tech has Nvidia with 50% YTD gains, with Tesla at -40% in 2024 so far. Plenty of tech earnings this week with 40% of the S&P 500 reporting.

EQUITY RECOMMENDED REGIONAL POSITIONING

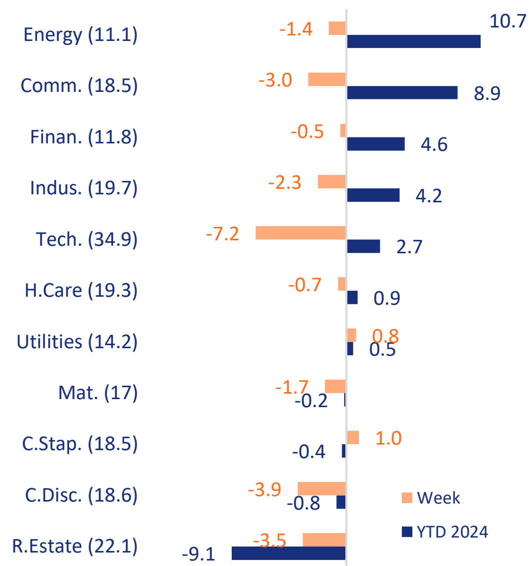


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



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$.

Emirates NBD
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