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The US rate-cutting cycle **starts on a strong note**

- **The Federal Reserve cut their policy rate by half a point last week guiding for more to come ...**
- **... To support employment while expressing confidence on disinflation**
- **We keep our positioning unchanged as of now, mostly due to the valuation landscape**

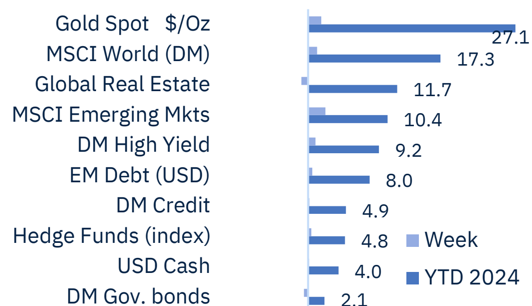
Last week was the first change in the US Federal Reserve's main policy rate in more than a year, and they went big. The central bank cut by 50 basis points, twice what we were expecting, and updated their projections for growth, employment, inflation and the future trajectory of rates. In summary, they painted a perfect "soft-landing" scenario: a bit cautious on growth and employment, but confident on inflation, they expect easing to continue at a robust pace. The median of their "dot plot" survey from voting members signals 50 bps of additional cuts in 2024, followed by 100 in 2026 and another 50 in 2027 to reach a "long-term" mid-range level of 2.875%.

We were indeed surprised by the magnitude of the cut, but understand the Fed's position. Chairman Powell talked about a "recalibration" which probably means that they should have already cut by 25bps in July, had they known that unemployment would rise. Still, they do not expect a recession and their new proactive stance aims at avoiding it. This is why longer-dated treasury yields and equities rose, while the short end fell, along with the dollar.

This sounds like a perfect scenario for risk assets, except that we still do not see considerable upside potential on the short-term, while volatility is a constant threat, especially around US elections. What is certain is that the Fed will not hesitate to act on any material deterioration of activity and employment.

In the week ahead, we will look at regional flash PMIs, listen to a just announced "briefing on the economy" from Chinese authorities, and watch the August US PCE inflation report on Friday. Have a great week.

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



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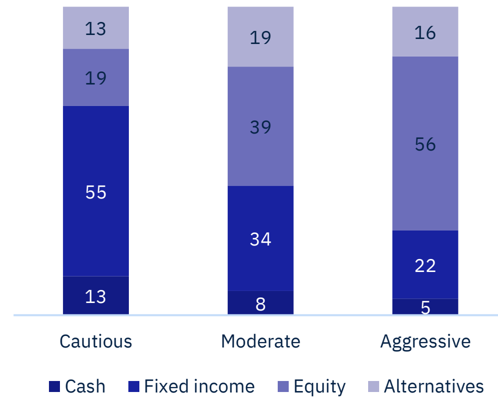
Cross-asset Update

The lowering of the policy rate in the United States last week indicates that the Fed has embarked on a multi-year easing cycle aimed at supporting the consumer and business activity. This time future market performance cannot be so easily extrapolated from historical patterns due to already high valuations. So, although in the past equities on average did rise by about 30% eighteen months after the first rate cut in the case of no recession, future returns should now be lower because of high starting multiples. Yet, selective investors by picking what was left behind in the AI-led rising market should be rewarded, as the rally is now broadening. Since June-end the MSCI World ex-US has outperformed US midcaps, that in turn have topped S&P 500's returns. Overall, smaller companies have outperformed larger caps, and value has returned more than growth, while semiconductors have trailed behind staying in negative territory. So, while on the one hand this speaks to the sustainability of the bull run, on the other hand investors must adjust to the new emerging leadership and pick and choose within the cheaper pockets of the market.

The Summary of Economic Projections released by the Fed depicts an economy marked by stable growth and employment in the next couple of years, with ongoing disinflation, though proceeding at a much slower pace. Taken at face value, this makes for a Goldilocks environment particularly supportive of credit, underpinning cahsflows, hence coupon repayment. Credit volatility compares favorably with equity volatility and coupons are appealing in absolute terms, so in risk-adjusted terms corporate bonds seem to offer a very attractive proposition. In more practical terms, as we get more extended into the cycle appropriate due diligence will be paramount while building a credit portfolio to mitigate default risk.

Gold made new all-time highs last week, consolidating above our $2,550/oz fair value for the current year. Although it has to an extent discounted the Fed's easing cycle, with the major central banks adding to liquidity and the global economy in slowdown mode the backdrop remains favorable for gold to overshoot. Supportive longer-term drivers remain in place, from the issue of the untackled debt burden of the large Western countries, to the de-dollarization push of the BRICS+ that sees their central banks as steady buyers of the yellow metal.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

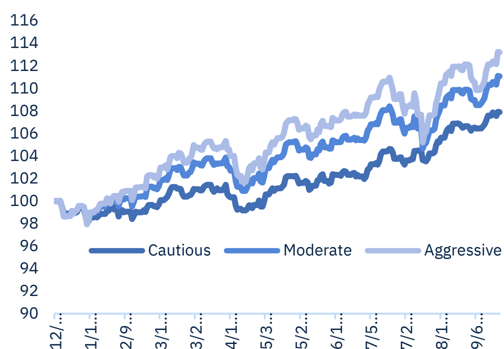


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 Fed surprised the forecasters (including us) with a 50-bps rate cut. The scale of surprise can be gauged by the fact that out of 113 economists surveyed by Bloomberg, only 9 had predicted a 50-bps cut. Chairman Powell in his press address made it clear that the central bank wanted to make a decisive statement against the deterioration in the labour market in a bid not to be behind the curve. He reiterated that the US economy was in a strong position but stopped short of declaring a victory on inflation when pressed about it.

Chairman Powell touched upon the Quantitative tightening aspect of the balance sheet normalization during Q&A as well. He noted that "reserves are still abundant and expected to remain so for some time. The shrinkage has come out of the overnight RRP." He also mentioned that "for a time, you can have the balance sheet shrink while also cutting rates," as both actions can be viewed as policy normalization. Even though both the policy measures look contradictory to each other, further QT taper would take more time.

The treasury curve bear steepened which means the bond markets consider the above cut as hawkish. The 10-year 10 treasury yields are now firmly above 3.73%. The rate cuts and yield movements do not always go in tandem. In our strategy Note titled "T Bill & Chill ... No More" released last week, we had mentioned that the movement of yields post the first rate cut depends on the progress of the unemployment rate rather than the magnitude of rate cuts pencilled in. It is interesting to note that despite projecting a total of 200bps rate cut by 2025, the policymakers expect the unemployment to increase to 4.4% from the current levels. In the last 50 years, every time the unemployment has crossed 4%, it has gone on much higher to touch at least 6%. Would this time be any different?

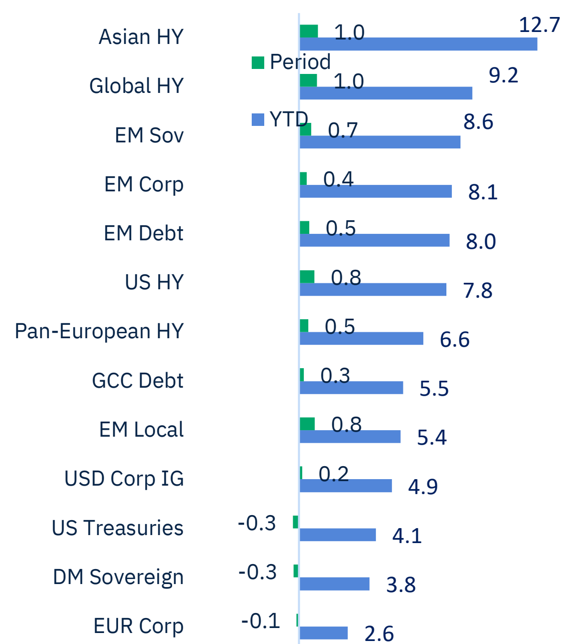
Credit spreads tightened with markets expecting the frontloaded rate cuts to help the expansion continue. IG spreads compressed by 4 bps while the HY spreads compressed by 20 bps last week. High yield was the best performing segment with Investment Grade returns negative due to the longer duration nature of the asset class.

The primary issuance pipeline remains robust, with new mandates announced from QIIB (AT1) and Arada tap issuances in the GCC region. In the US, Aercap, the world's largest owner of commercial aircraft and a leader in aviation leasing, is issuing a 5-year sukuk. In the EM region, today's issuances include REC's 5-year senior unsecured bonds with IPTs at T+160bps and AIA Group's 10.5-year and 30-year subordinated bonds with IPTs at T+155bps and T+175bps, respectively. Additionally, Shriram Finance has announced a mandate for a 3.5-year and/or 5-year USD-denominated bond.

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

Equity Update

Global equities ended the week higher, with the MSCI ACWI gaining 1.3% as optimism on the Fed's ability to engineer a soft-landing buoyed investor sentiment. In the U.S., the S&P 500 closed the week up 1.4% at 5702, rallying on Thursday following the Fed's 50bps cut. Volatility surged later in the week due to the expiration of $5.1 trillion in options and futures contracts during the "triple witching" event, contributing to the highest trading volumes of the year. The S&P 500 equal-weighted index reached a record high, signalling a broadening of market gains beyond tech megacaps. Our preferred regions performed last week i.e. the UAE, India in EM allocation and the US in DM allocation. China was a standout performer as hopes on stimulus to spur consumption and the ailing real estate industry increase. Tech remains the best performing sector YTD but utilities are fast catching up.

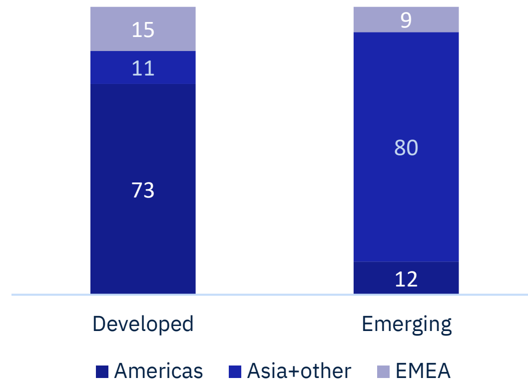
On Friday, the S&P 500 wavered between gains and losses in the final minutes of trading before closing down 0.2%, as investors shifted into defensive sectors like utilities, which rose 2.7%. Constellation Energy rose 22% after securing a deal with Microsoft to help revive the Three Mile Island nuclear plant. Nike also rose on the announcement of Elliott Hill's return as CEO, a move expected to reinvigorate the company as it navigates a competitive retail environment. Meanwhile, Intel's stock rise was driven by reports that semiconductor giant Qualcomm had approached the company with a potential takeover offer.

In Asia, Japan's TOPIX Index gained 2.8% for the week, recovering from earlier losses and is now 9.8% away from its all-time high. Tech stocks, such as Tokyo Electron, which initially faced declines, rebounded by week's end. The yen fell back to 143.9 per dollar, as the BOJ holds for now and signaled less urgency to hike rates, yet Banking stocks maintained their gains. In China, the MSCI China Index rebounded sharply by 4.4% as hopes of further stimulus rekindled risk appetite and reports that regulators are preparing to ease property restrictions leading to a strong rebound in Chinese property stocks.

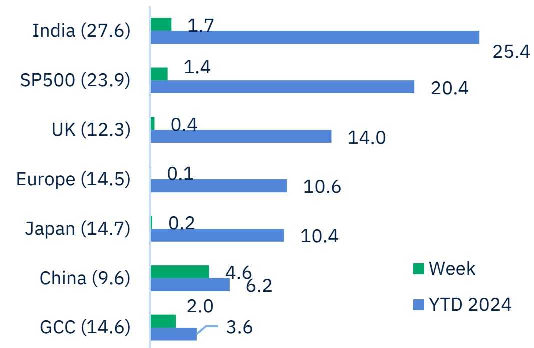
Meanwhile, European stocks ended lower, with the MSCI Europe Index losing 0.4% for the week. Luxury goods stocks faced pressure due to weakening demand from Chinese consumers, a crucial market for Europe's high-end brands. Brands were further threatened by the rise of online Chinese discounters like Temu, which offer ultracheap "dupes" of high-end goods. However, European energy stocks showed resilience, supported by rising oil prices amid geopolitical risks and tightening supply. These gains in energy helped offset some of the broader market weakness tied to global trade uncertainties.

As September draws to a close, sector rotation continues to dominate market dynamics, with defensive plays in utilities, industrials, and consumer staples showing strength, while cautious on tech and growth stocks due to heightened valuations.

EQUITY RECOMMENDED REGIONAL POSITIONING

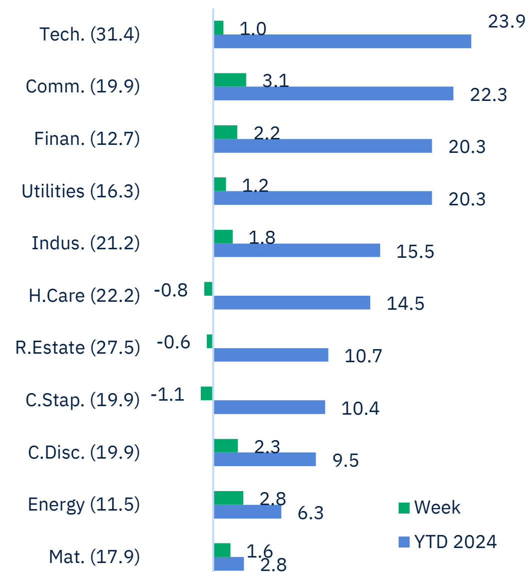


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



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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