“The time has come” for **US rate cuts**

- **FOMC Minutes, Fed Chair speech cemented expectations for September rate cuts…**
- **… Which supported all asset classes last week and weakened the US dollar further.**
- **Markets have now fully reversed the early August turmoil, on track for a positive month.**

For anyone coming back from a long summer holiday and looking at August’s market performances so far, it would seem like not much has happened. All asset classes are in the green, from gold to equities, including bonds and real estate, the latter topping the monthly hierarchy after an impressive recovery.

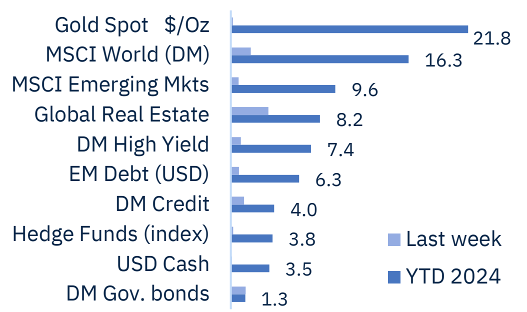
Of course, much happened. The month started with a spectacular spike in risk aversion, fuelled by a combination of synchronized concerns: US recession risk, a sharp appreciation of the yen ravaging a popular carry-trade, geopolitical heat, more uncertainty in US politics and even questions on the actual return on AI investments. Risk assets fell off a cliff, but then sharply rebounded in the last two weeks.

Did all concerns disappear? Not at all. US future policies remain uncertain, the geopolitical backdrop has arguably worsened, Nvidia results will provide indications on AI spending but not on their payback, and the yen is rising. For the US economy, data is also mixed. July retail sales and industrial production were reassuring. However, the number of job creations for the 12-month period ending in March 2024 was massively revised downward last week: -818,000 job creations for the period.

Bottom-line, the rebound is all about the US Federal Reserve. The minutes from the July policy meeting were dovish, and after the revision in job numbers, chairman Powell almost explicitly said that rate cuts would start in September.

Our positioning didn’t change: it works, and our “soft landing” scenario remains valid. Still, we expect high volatility and see limited short-term upside potential.

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



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Cross-asset Update

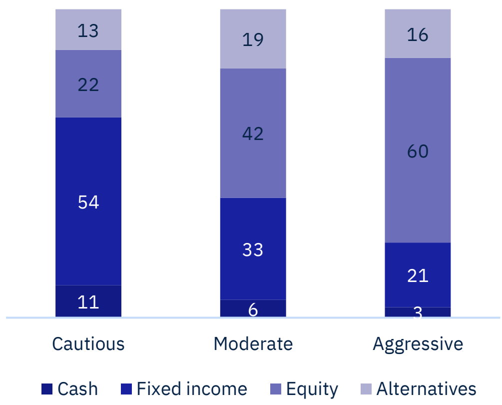
As we write today, looking at the returns as of Friday 23rd of August, our three profiles so far this year have gained respectively +6.8% for the cautious, +9.8% for the moderate and +11.9% for the adventurous. These are of course very appreciable numbers in absolute, and according to our research, they also compare favourably to our international peers. What's not to like?

Well, we have one concern: this is more than what we initially expected and expressed during our 2024 Global Investment Outlook. Of course, there are a few good reasons for that. First, the global economy did better than our forecast especially in the first half of the year. Second, we haven't been unlucky in navigating markets' volatility, as we were extremely diversified, which was another key view from our annual outlook. We also had a sizable overweight in gold, 2024's best performing asset class, a constant preference for Indian equities, and implemented some tactical changes such as reinforcing rate sensitive assets in July. But there is also a worrying reason for our returns: markets have quickly reached, and sometimes exceeded, our own estimates of the year-end fair values, under the very scenario that seems to be unfolding.

This is not the first time it happens, as we are a bit conservative in our forecasting exercises, and as markets are very reactive to any change. The current narrative behind relatively rich valuations for everything is as follows: the US economy is slowing down, but not derailing into an imminent recession. Disinflation continues, the Fed will cut rates. A lot, according to future markets: they are pricing-in 100 basis points of rate easing for 2024, starting in September, and then even more in 2025 (-120 bps). This may of course happen, but it is certainly not a given. The Fed will be "data-driven" with a focus on employment. This means that volatility will continue to be material, for all asset classes: triggered by economic data as well as of course by political and geopolitical developments. It could even be amplified by the current ambiguity about what is good or bad for markets. With such a starting point in expectations for monetary easing, would bad news for the economy really be beneficial? And would better growth push equities higher, or trigger painful uncertainty about the future trajectory of policy rates? Will inflation come back to the 2% target, or stay at 2.5/3%? As the assets parked in money market funds are considerable, where will this money be redeployed when short-term rates will be less attractive?

We haven't changed our positioning. Not because it works, as we constantly project ourselves in our investment horizon, but because we are reasonably confident in the probability of a "soft landing" scenario which is not adverse in the short-term, even if many asset classes are priced for it. But we will remain extremely vigilant, with probably an inclination to consider more defensive adjustments rather than to increase risk.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

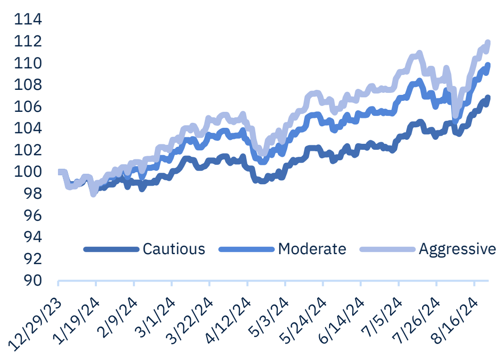


TAA – RELATIVE POSITIONING – MODERATE PROFILE

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 talk of the town is Powell's pivot. Last Friday, during the Jackson Hole conference, he mentioned that "The time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook and the balance of risks." FOMC minutes released last weeks also indicated widespread support from the members for a rate-cut. The minutes mentioned that "Several observed that the recent progress on inflation and increases in the unemployment rate had provided a plausible case for reducing the target range 25 basis points at this meeting or that they could have supported such a decision,"

This clearly indicates the Fed is ready to cut rates in its 18th September FOMC meeting as the central bank prioritises its employment mandate over the price stability one. Meanwhile NFP revisions of 818k indicates that the US job growth was probably far less robust in the year through March than previously reported. It was the largest downward revision since 2009. August payroll numbers which come out in a couple of weeks will be crucial.

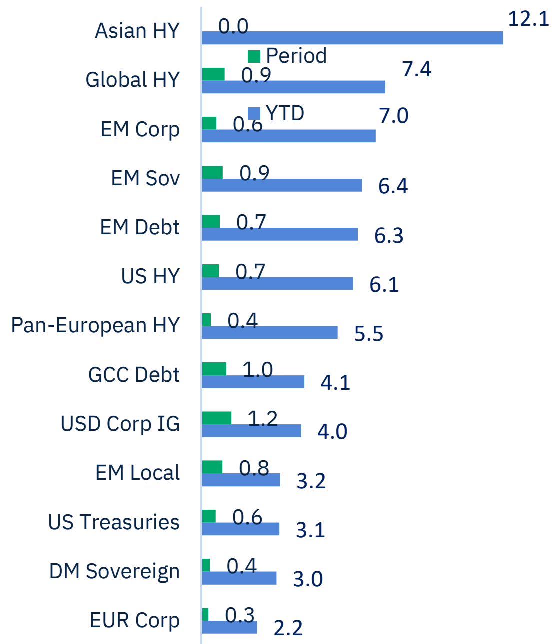
The credit spreads have completed a round trip after widening significantly post the July Unemployment report. The market currently doesn't believe that the Fed is behind the curve. But, there are 4 rate cuts priced till the end of the year a total of 200 bps rate cuts in the next 12 months according to OIS swaps which seems a bit excessive if the widely held belief of soft landing takes place. Bond yields have continued to move down with the 10-year treasury yields below 3.8% in early trading this morning. The Treasury curve bullishly steepened last week supported by the July FOMC meeting minutes and Chair Powell's speech at Jackson Hole, as both indicated a step in the dovish direction.

IG spreads have remained rangebound last week while HY spreads have widened slightly. IG supply has been active with $103bn priced in August, surpassing the historical average of $85bn. We expect IG spreads to remain tight given the background of anticipated Fed rate cuts and slowing down economy. According to GS, in both the USD and EUR markets, the marginal cost of refinancing for BB and B-rated issuers has declined to its lowest level since early 2022, which should allow earnings growth to easily absorb rising interest expenses going forward. We have seen tightness in supply in GCC markets over the summer. However, as we enter the last quarter of the year, we anticipate to see more number of deals as issuers try to refinance their 2025 obligations.

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

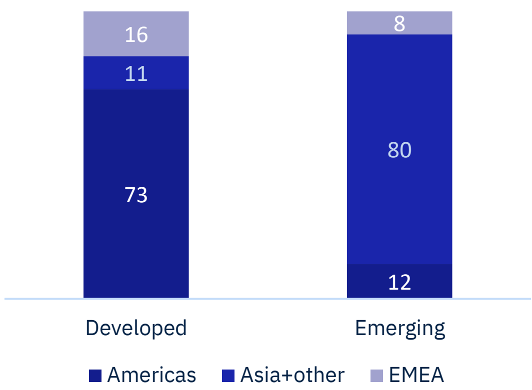
What a recovery from Black Monday in early August! Month to date global equities (the ACWI) are up 2% along with positive performance from most regions and sectors. Japan Indexes which saw a 12% drop on 5th August have recovered, down only 4% in local currency for August to date (flat in USD). Key catalysts in play for equity markets: Fed speak at Jackson Hole was supportive with dovish price action across rates and the USD and boosted US equities on Friday. The narrative is heading towards easier Fed policy and a soft landing. The Fed is expected to cut in September –25 bps the sweet spot. more would seem the economy is causing concerns. The S&P 500 has been up in 11/12 of the last easing cycles. We expect the S&P500 to trade around the 5475 level (our year end fair value) +/- 5%, currently it is at 5635. Earnings have been broadening but the rally is still narrow driven by the Mag7, one third of the Index. Of course, our view is data dependent like the Central banks! Nvidia earnings this week will guide market expectations on demand for the high-end GPU's which Nvidia is a key manufacturer of and will drive AI market sentiment. Also, US elections are less than 3 months away.

Our shift to a neutral positioning for equities (both DM and EM) in H2 is working. YTD global equities are up 16%. India and the US are leading returns with the tech sector +25% and the Mag 7 Index +38% continuing to outperform. A broader rally with all global sectors in the green but no rotation to small and mid caps. Expect a pick up as lower rates will aid the smaller domestic businesses in the US. A shift however to defensive sectors i.e. healthcare. We continue to favor growth segments, regions (US, India) or sectors, while staying conscious of valuations. We expect volatility and do not exclude the possibility of serious turbulence. We still like profitable tech. Earnings are broadening out. We stay overweight U.S. equities, driven by the AI mega force. Stronger-than-expected U.S. corporate earnings, especially in tech, Q2 earnings growth for tech vs non-tech sectors at 20% and 5%, respectively. Non-tech sectors will see their first earnings growth since late 2022 with moderating inflation.

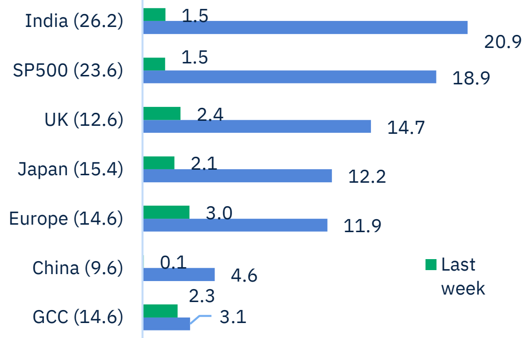
Neutral Japan and China. Japan's TOPIX experienced -24% peak-to-trough correction over 11 July - 5 August, with BOJ and FOMC policy meetings. The USDJPY fell from ¥162 to ¥142. Japan equities subsequently rebounded from the lows - we remain constructive on the longer-term outlook. Our 2024 year-end target is 2900, implying 8% upside.

China equities had a good August so far. We do not expect large-scale fiscal stimulus given that demand conditions are merely sluggish, not collapsing. Walmart sold its stake in JD.com as faith in a revival in the China consumer pickup wanes. Tensions remain on US China trade. The outlook for Chinese equities remains uncertain, low valuations should cushion the downside.

EQUITY RECOMMENDED REGIONAL POSITIONING

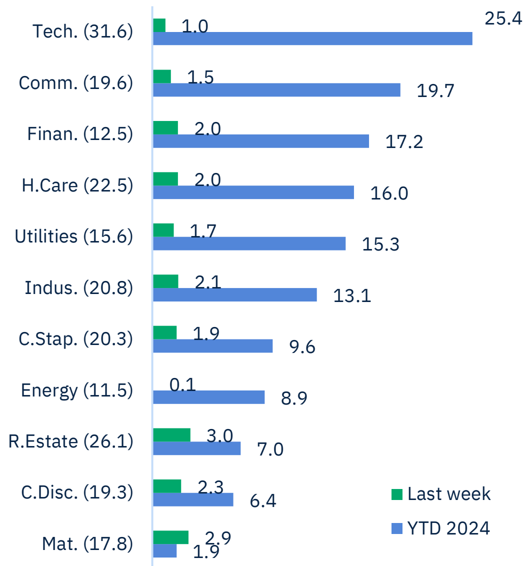


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



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$.

بنك الإمارات دبي الوطني
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