Multi-Asset perspectives

Courtesy of Principal Asset Management

November 2023

Macro

- **Manufacturing indicators** were broadly stable. Our global Manufacturing PMI was at 48 from 47.7 the month prior, with US (46.7) and China (49.4) broadly unchanged. Europe ticked up to 45 from 43.8. EM PMI stayed in modest expansion at 50.5. Our Leading Regime Indicator stayed near the flat growth mark at 50.6. Global Economic Surprises remained marginally negative, with Europe the only one in positive territory. Global employment trends remained strong, continuing to drive consumption.
- **Global financial conditions** eased noticeably due to lower yields, tighter spreads, strong equity markets, and lower volatility. The easing in U.S. financial conditions was stark (-1.0 from -1.4). Fed speakers did not push back against the easing unlike in the past.
- **Global inflation** ticked down to 3.5%yoy in Oct ’23 (the peak was 7% in Sep ’22) with DM inflation at 3.4% and EMs at 3.6%. 60% of the countries saw lower inflation. Recent progress on inflation has been encouraging though more distance remains to be traveled to reach developed economy policymaker goals. Market-based inflation measures (U.S. CPI implied by TIPs) moved down 15-20bps and were comfortably within the Fed’s comfort zone of 2-2.5%.

Bottom-up

- **Global bottom-up earnings** revisions remained largely unchanged. The expected EPS growth for MSCI AC World was -1% for 2023, and 11% for 2024. The 3m Earnings Revisions Ratio was stable at 0.44 (44% upgrades, 56% downgrades) versus 0.39 as of Dec’22. Energy and consumer discretionary earnings were revised up the most, while Health care revisions remained negative (indeed, the sector has lagged all of 2023).
- **YTD ’23 Global credit rating upgrades to total changes** was marginally weaker at 44% (44/56 upgrade/downgrade ratio). IG eased to 60% from 62% (peak was 66% in Jul ’23). Global HY remained stable at 35%.

Valuations

- **Global equity valuations moved further to the expensive side after a strong November rally**. MSCI ACWI was cheaper than current levels 88% of the time in history (80% the month prior), driven largely by expensive U.S. stocks (Large caps). US small caps, however, remained very cheap. Latin America and most parts of Asia remained cheap too.
- **U.S. IG spread narrowed -21bps to 108bps and HY spread 67bps to 370bps**. Though our fair-value model implied values came in too, spreads remained expensive, and are not baking in a mild contraction that we expect in 2024. 30-yr U.S. corporate spreads remained near their long-term median.
- **The U.S. 10-yr treasury yield, at 4. 3%** was at the lower end of our model implied fair value range of 4.3%-5.2%

Markets

- **Multi-Assets**: Our global multi-asset index returned 7% in Nov ’23 which expanded YTD ’23 return to a strong 10%. All asset classes barring commodities ran on steroids as lower inflation and yields created a massive risk-on tone. In that sense, lower commodity prices played an important role in shaping the risk-on sentiment.
- **Global Equities** had their strongest month since Jan ’23, powered by lower inflation and lower bond yields, in a sharp reversal of fortunes from the prior three months when higher rates had dented equity markets substantially. Growth indicators remained stable, but the markets took comfort that easing financial conditions would limit the damage, even if the economy were to slow down next year. DM equities (9%) outperformed EMs slightly (8%), with the latter dragged down by weak performance in the China complex where the positive shift in policy sentiment has struggled to spillover to equity markets. The global market capitalization jumped to $107trillion, its highest this year. 38 of the 41 markets we track ended with gains, with Brazil (13%) leading large cap markets. The median local currency return was 6% which expanded YTD’ 23 median return to 11%. Growth and Quality outperformed, low volatility lagged. IT, consumer discretionary and financials outperformed. Energy recorded negative returns with oil prices struggling.
- **Fixed income**: Two rate hikes and three cuts made it the first month since Feb ’21 when cuts exceeded hikes. The rate-hike momentum is clearly shifting and with DM policy rates at 4.5%, there exists ample room for cuts to start in 2024 should inflation continue to ease towards policymaker goals. Taking cues from lower inflation and an absence of pushback from Central banks against dovish market moves, our Global Sovereign 10-yr yield indicator crashed -40bps to 4.3%, with DM yields -50bps to 3.6% and EM yields -25bps to 5.2%. A muted decrease in in 2-yr yields inverted the global 2-10yr yield curve to -10bps from 2bps (U.S. -35bps from -16bps). Credit spreads narrowed sharply, far more in High Yield than in Investment Grade. A combination of lower yields and tighter spreads made it a month of superlative returns for fixed income investors barring short-term money market and floating rate strategies. 20-30yr US treasuries jumped 9% but were still down -5% for the year.
- **Currencies**: Risk-on conditions and lower carry differentials (U.S. yields dropped more than other DMs) made it a very weak month for the U.S. dollar as net longs were reduced at a rapid pace. It depreciated against 87% of the currencies we track it against, weakening -3% against both DMs (DXY Index) and EMs (MSCI EM Currency Index). JPY retained its position as the cheapest currency pair on purchasing power parity, followed by the Turkish Lira. The U.S. dollar vacated its position as the most expensive currency but was roughly 10% expensive on our purchasing power parity models.
- **Commodities**: The GS commodity index dropped -4% as energy prices (-6%) tumbled yet again as signs of fissures in OPEC’s supply model emerged as they struggled to make big enough cuts to balance an oil market which has seen the U.S. oil put (13.2mbpd) exceed pre-pandemic highs, reducing its dependence on imports to an all-time low of 1.5mbpd (pre-pandemic level 2.5mbpd). Precious metal prices remained well bid as anti-fragile plays in an environment of heightened geo-political risks. Lower bond yields helped, too.

US Housing Indicators

- U.S. home prices edged up yet again on robust demand for new homes, funded largely by savings as homes listed for sale remained at historically low levels due to high cost of refinancing mortgages. The FHFA new purchase index was up 6%yoy while the 20-city Case-Schiller Index increased 3.9% yoy in Sep ’23. Lower mortgage rates could paradoxically cause prices to soften by bringing more homes into the market.
- Lower mortgage rates caused Housing affordability to ease just a bit last month. Home prices and mortgage rates need to drop more to bring all those needing homes to the market. For context, if personal disposable incomes rose 5%, home prices and mortgage rates dropped -10% and -100bps respectively, the affordability index would recover 30% to 74 (PAA Scenario in the chart below), which would still be 20% worse than its long-term average. Having said that, strong household balance sheets imply home-seekers should be able to absorb this without much pain.

Looking Ahead

- **Growth** **Neutral**
  Macro indicators confirm a resilient U.S. economy, powered by the consumer and strong employment. Looking ahead to 2024, rising credit card lending, reduced excess savings particularly for lower income groups, waning fiscal support and refinancing of corporate debt at higher rates imply that we should get a shallow and short-lived slowdown in 2024 during which real GDP growth could contract marginally. Our outlook for Europe remains unchanged i.e., growth should remain well below trend. China's growth should be marginally lower than in 2023 as policymakers calibrate easing with prevention of systemic bubbles. Looking beyond, growth outlooks in India, Brazil, and Mexico remain robust.

- **Inflation** **Positive from neutral**
  The recent drop in inflation is a welcome development from a policy perspective. Inflation should continue to ease in coming months, driven by base effects and cyclical factors. From a longer-term perspective, however, greenification costs, peaking of China's working age population, rejigging of global supply chains for greater geopolitical security, expansionary fiscal policies, and peak globalization point towards higher inflation over the next decade than in the one gone by.

- **Global financial conditions** **Neutral but positive change at the margin**
  Lower interest rates and reduced risk premiums imply we are most likely past the tightest levels on financial conditions, unless inflation spikes up unexpectedly next year, causing central banks to start tightening again (not our base case though).

- **Valuations** **Negative from Neutral**
  - Risk-free rates continue to present meaningful positive yielding anti-fragile alternatives.
  - Equity Valuations remain very expensive in the U.S. but are reasonable in most other parts of the world.
  - Corporate spreads are on the expensive side, leaving little room for further compression. Risks are skewed to the side of widening if in case of an economic downturn.
  - Among Currencies, the U.S. Dollar is over-valued around 10% based on our valuation models.

- **Technicals** **Neutral (moving towards Overbought)**
  Speculative longs increased in both gold but eased in oil. U.S. dollar net longs were reduced. Net shorts in U.S. treasury futures were marginally lower. S&P 500 shorts were reduced only marginally despite the rally. Retail investor sentiment jumped with the AAII Bull-Bear spread at 29 from -14. Price momentum indicators for riskier assets using both 50-day and 200-day moving averages moved towards an overbought zone. Hedging through put options moved significantly below its long-term median level. Overall, the market seems to have reversed course rapidly, moving towards overbought from oversold in the space of a month.

- **Risk orientation in asset allocation** **Neutral**
  Compressed risk premia force us to retain a defensive stance in our asset allocation despite the improved growth outlook and easing of financial conditions. At current levels, several asset classes (U.S. large cap equities and global corporate credit) are primed for perfection and likely to stutter if things don't go to plan. The source of frustration could come from a deeper than anticipated slowdown caused by simultaneous belt tightening by all three drivers (Government, consumers, and companies). Alternatively, resurgence of inflation could force central banks to start tightening again, which would ultimately hit risk assets. However, since the slowdown is likely to be shallow, the market correction should also be shallow in our base case.

Key risks

- Policy mistakes by Central banks in tightening too much.
- The global real estate sector faces a hard landing, led by the challenged office sector.
- Geopolitical risks worsen relating to the Israel-Hamas conflict or the ongoing fight between Russia and Ukraine. U.S. elections could put an end to the seeming thawing of frosty relations between U.S. and China.
- Tax rates rise globally as governments try to flatten the income curve.

Risk considerations
Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed.

Important information
This material covers general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, a recommendation, or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. The information presented has been derived from sources believed to be accurate; however, we do not independently verify or guarantee its accuracy or validity. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that the investment manager or its affiliates has recommended a specific security for any client account. Subject to any contrary provisions of applicable law, the investment manager and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided.

This material may contain 'forward-looking' information that is not purely historical in nature and may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

Proprietary model output is based upon certain assumptions that may change, are not guaranteed, and should not be relied upon as a significant basis for an investment decision. Forecasts for each asset class can be conditional on economic scenarios; in the event a scenario comes to pass, actual returns could be significantly higher or lower than forecasted. Because of the inherent limitations of all models, potential investors should not rely exclusively on the model when making an investment decision. Forecasts of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice.

Indices are unmanaged and do not consider fees, expenses and transaction costs are not available for direct investment. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation.

This material is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

© 2021 Principal Financial Services, Inc. Principal, Principal and symbol design and Principal Financial Group are registered trademarks and service marks of Principal Financial Services, Inc., a Principal Financial Group company. Principal Global Investors leads global asset management at Principal®. Principal Global Asset Allocation is a specialized investment management group within Principal Global Investors

Disclaimer:
Ahli United Bank B.S.C.(c)

Bahrain: The views contained herein has been obtained from sources that **Ahli United Bank B.S.C.(c) ("AUB"**) deems to be reliable but Ahli United Bank B.S.C.(c) makes no representation about the accuracy, completeness or timeliness of any information prepared by a third party and assumes no liability for the reliance thereon. The opinions and predictions expressed in the materials are subject to change without prior notice and has not been prepared by or with the involvement of Ahli United Bank B.S.C.(c); however, Ahli United Bank B.S.C.(c) does not independently verify or guarantee its accuracy or validity. Subject to any contrary provisions of applicable law, Ahli United Bank B.S.C.(c) and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only and derived from numerous sources, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. IMPORTANT – If you are in any doubt about the contents of this document you should seek independent professional advice. AUB will not act and has not acted as your legal advisor to you in connection with this, and/or any related transaction and no reliance may be placed on AUB for advice or recommendations and/or solicitation of any sort. Ahli United Bank B.S.C.(c) is Licensed as an Islamic Retail Bank by the Central Bank of Bahrain ("CBB"). For additional information about Ahli United Bank B.S.C.(c), please visit www.ahliunited.com/bh.

Dubai International Financial Center: This material is for distribution by Ahli United Bank B.S.C (DIFC Branch) which is regulated and authorized by the Dubai Financial Services Authority (DFSA). This document is for information purposes only and is not an offer to sell or a solicitation to buy any fund, units, shares, securities, or financial products. Reliance should not be placed on the views and information in these presentations when making individual investment and/or strategic decisions. It is only intended for Professional Clients and/or Market Counterparties as defined by the DFSA rulebook. No other person should act upon this material or publication. It is not intended for Retail Clients. In addition to the above, this material or publication and information within it are not directed at any person resident in the territory or any country or jurisdiction action where such distribution will be contrary to local law or regulation. Nothing herein constitutes investment, legal, accounting or tax advice, or a representation that any particular investment (if any) mentioned herein is suitable for or appropriate to your investment objectives, financial situation, and particular needs, or otherwise constitutes a personal recommendation to you. All investments carry varying levels of risk, and the value of your investment may go up or down depending on several factors, including market movements. Past performance is not an indicator of current or future returns. The recipient(s) before acting on any information herein should make his/their own investigation and seek appropriate professional advice prior to any investment decision or entering any financial obligation based on information, statement or opinion which is expressed herein.

Egypt: The views contained herein has been obtained from sources that **Ahli United Bank (Egypt) S.A.E. ("AUBE")** deems to be reliable but AUBE makes no representation about the accuracy, completeness or timeliness of any information prepared by a third party and assumes no liability for the reliance thereon. The opinions and predictions expressed in the materials are subject to change without prior notice and has not been prepared by or with the involvement of AUBE; however, AUBE does not independently verify or guarantee its accuracy or validity. Subject to any contrary provisions of applicable law, AUBE and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only and derived from numerous sources, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. IMPORTANT – If you are in any doubt about the contents of this document you should seek independent professional advice. AUBE will not act and has not acted as your legal advisor to you in connection with this, and/or any related transaction and no reliance may be placed on AUBE for advice or recommendations and/or solicitation of any sort. Ahli United Bank (Egypt) S.A.E. is licensed and regulated by the Central Bank of Egypt. For additional information about Ahli United Bank (Egypt) S.A.E., please visit www.ahliunited.com/eg.