Multi-Asset perspectives

Courtesy of Principal Asset Management

July 2024

Macro

- **Manufacturing indicators were weaker.** Our global Manufacturing PMI index contracted for a fourth straight month to 48.6 with U.S. (46.8 from 48.5) contracting the most. China (49.4) and Euro Area (47.2) were stable. Our leading regime Indicator was stable at 50.1, implying borderline growth. Economic Surprises were negative in all major regions globally.
- **Global financial conditions** (FCIs) were easier, helped by lower rates and tighter credit spreads. Equity momentum and monetary growth were stable. Lower rates are likely to ease financial conditions further in coming months.
- **Global inflation** was slightly lower at 3.2%yoy in Jun'24, with seventeen countries recording lower inflation and nine lower. Inflation in developed economies was at 2.4%, and 4.3% in emerging economies (both lower than the month prior). Global inflation surprise was negative for a second month running. U.S. policymakers would be encouraged by the recent decline in implied break-even inflation rates from TIPS, with 2-yr finishing at 1.78%, 5-yr at 2.14% and 10-yr at 2.23%.

Bottom-up

- **Global bottom-up earnings revisions** had a positive tilt. 3-month **Earnings Revisions Ratio** improved, with upgrades edging up to 49% from 47% (41% at the start of the year). Expected earnings growth for 2024 for MSCI AC World was steady at 10%.
- **Global credit rating upgrades to total changes** ticked up to 52% relative to 43% on 12/31/2023. Global IG was at 70% vs. 58% while Global HY was at 40% vs. 35%. Ratings momentum could improve further if the expected earnings growth materializes.

Valuations

- The **U.S. 10-yr treasury** yield, at 4% moved below our model implied fair value range of 4.2-5.1%.
- **U.S. IG spread was stable at 93bps (29th %ile in history) while HY spread widened a little to 314bps (15th %ile).** 30-yr U.S. corporate bond spreads moved to 48th %ile (A rated) and 30th %ile (Baa rated) as long corporate bond yields could not keep pace with rapidly declining sovereign yields. Both corporate and structured product demand remained strong. Credit spreads continue to bake a blue-sky scenario (solid economic growth and persistent demand for spread products).
- **Global equity valuations remained expensive.** MSCI ACWI was cheaper than current levels 94% of the time in history, driven by expensive U.S. stocks (Large caps). US small caps, however, were fair value. Latin America and most parts of Asia remained cheap.

Markets during the month

- **Global Equities** turned positive with 73% of the countries recording gains. The median local currency return was 1.9% (YTD 9%). U.S. Small Caps (10%) led the rally as sentiment flipped spectacularly from large cap, technology, and momentum towards laggards for the year. Nasdaq clocked a return of -1% (YTD 17%). Value and minimum volatility were winning styles. U.S. Reits (6%) made a comeback, riding a spectacular show by Office (16%). Materials, financials and industrials outperformed IT and consumer discretionary stocks.
- **Fixed income**
  - **Policy Rates:** There were four cuts (Canada, China, Colombia, and Hungary) and two hikes (Japan and Russia). Market pricing has moved to significant rate cuts in coming months, which should push our global policy rate indicator towards 4.5% by the end of 2024 from 5.2% currently.

- **Bond Yields:** Our Global Sovereign 10-yr yield indicator crashed -58bps to 3.95%, with every country barring Türkiye experiencing lower yields. Slowing growth and rising rate cut prospects were behind the aggressive move. Yield curves flattened, with the 2-10 U.S. treasury spread ending at -23bps from -36bps.
- **Credit Spreads:** Credit spreads were stable for U.S. investment grade at 93bps but slightly wider at 314bps for U.S. high yield. Demand for spread products remained strong.
- **Returns:** Returns were strong, with duration scoring over spread. Long-end U.S. treasuries gained 4% as yields crashed.

- **Currencies:** The broad trade weighted U.S. Dollar dropped 1% as the greenback was down -2% against developed market currencies. A rate hike by the Bank of Japan caused the Yen to rip 7% against the greenback. Markets priced aggressive rate cuts by the U.S. Fed, which created headwinds for the greenback. However, year till date, the greenback has made gains against every currency barring four (GBP, Ruble, South African Rand, and Malaysian Ringgit).
- **Commodities:** The GS commodity index dropped -5% on growth worries. Precious metals (5%) were the only ones to defy the gloom, rising as U.S. treasury yields collapsed.

U.S. Property Indicators

- U.S. housing affordability has been hovering around 60% of its 15-year average due to a combination of higher mortgage rates and rising home prices (monthly mortgage servicing costs have jumped 120% between 2021 and 2024 using the 30-yr mortgage rate as proxy). While there are offsets in the form of strong macro factors i.e., low U.S. mortgage debt/GDP of 46% vs 70% pre-GFC, lower home ownership rate (66% vs 69% pre-GFC), and low mortgage rates on existing mortgages (3.9% vs new 30-yr mortgages at 7%), prospective homeowners would dearly welcome a decline in treasury yields which pulls mortgage rates down.
- The commercial property sector remains challenged. However, green shoots could be emerging. Public Reits markets recovered smartly in July, led by the challenged office sector as capital markets started unfreezing primarily due to lower yields. Real Capital Analytics' (RCA) indices showed that commercial property prices were up 2% yoy in June. Industrials gained +8%. Apartment prices were down -7% (peak -14%), while office prices dropped -12% (peak -17%).

Summary

1. Growth — **Neutral from Positive**

We are moving our growth outlook to neutral in recognition of slowing growth. Our global PMI index has contracted for four successive months. U.S. ISM Manufacturing (3-month average 48) and Service Indices (3-month average 50.7) have been soft lately. U.S. employment growth is ebbing, with non-farm payrolls growing at an average of 170k in the last three months versus 218k in the prior period. Job opening and quit rates have peaked, jobless claims are higher, and wage growth has slowed. China's recovery has stalled, with 2Q'24 GDP growing at 4.7%yoy versus 5.3%yoy in 1Q'24. On the other hand, Europe and other Emerging markets are holding up well.

2. Inflation — **Neutral**

Softer releases in the last few weeks have raised hope that inflation is headed towards policymaker targets. 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 in the next decade than the one gone by.

3. Global financial conditions — **Positive from Neutral**

While credit spreads remain tight, and equity momentum extended, lower interest rates (both policy rates and yields) should help ease overall financial conditions from current levels, which causes us to move this factor to positive.

4. Valuations — **Negative**

- **Risk-free rates** continue to present meaningful positive yielding anti-fragile alternatives.
- **Equity Valuations** remain expensive in the U.S. but are reasonable in other parts of the world.
- **Corporate spreads** remain tight, leaving little room for further compression.

5. Technicals **Neutral**

Price Momentum weakened for technology and large cap stocks, providing a boost to small cap stocks. Retail investor sentiment was positive but was not in overbought zone (the AAII Bull-Bear spread eased to twelve from sixteen). Market hedging through put options remained near its long-term median. Hedge funds, however, were still running extended net longs in momentum stocks.

6. Asset allocation orientation **Neutral**

Compressed risk premia keep our stance defensive. Asset classes like U.S. large cap equities and global corporate credit are pricing goldilocks and could stutter if things do not go to plan. The source of frustration could come from-

- Uptick in credit card delinquencies as lower income households exhaust excess savings.
- Floating rate borrowers see weaker earnings growth relative to the cost of borrowings.
- The commercial real estate sector sees a hard landing, led by the challenged office sector.
- Geopolitical risks worsen (the Israel-Hamas conflict, Russia-Ukraine war).
- The relationship between U.S. and China adds volatility as U.S. elections approach.
- Tax rates rise globally as governments try to flatten the income curve and fund their expanding deficits.

Dubai International Financial Center: This material is for distribution by Ahli United Bank B.S.C (C) (DIFC Branch) which is regulated and authorized by the Dubai Financial Services Authority (DFSA). This presentation/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.