Heading for the Goldilocks Zone!

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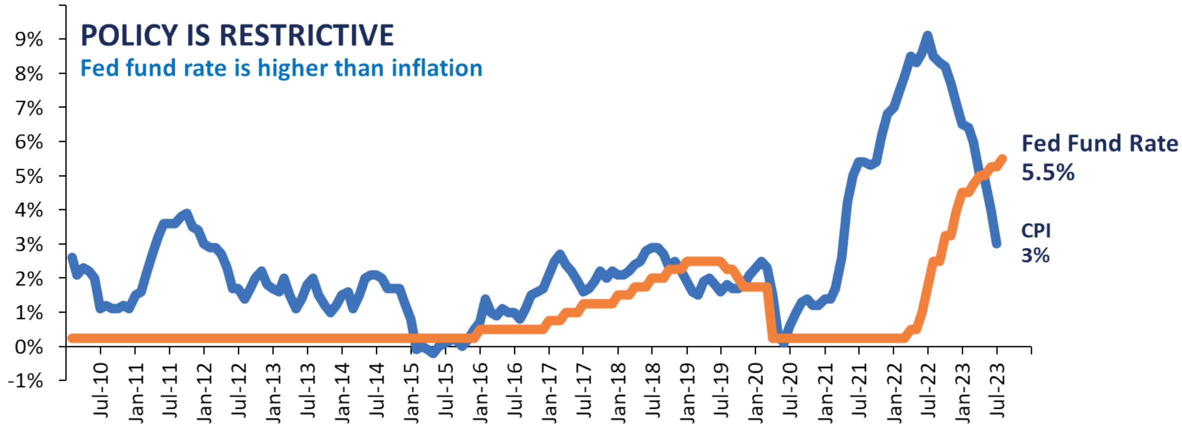
Central banks in developed markets continue to tighten whereas the economies continued to be resilient. At the beginning of the year, it was a foregone conclusion that consumers and corporates will not be able to withstand the onslaught of the historically sharp increase of interest rates; but both have held up surprisingly well. Now there is a growing belief that central banks can manage a ‘soft landing’ with weaker growth and lower inflation but no serious recession – a Goldilocks scenario for the investors.

ECONOMIC UPDATE

Closer to peak rates:
As expected, the US Federal Reserve increased rates by 25 bps on 26th July taking the Fed Fund Rate to 5.25%-5.50% range, the highest level in 22 years. The accompanying press conference was less hawkish, and more dovish, than expected. Fed Chair Jerome Powell said that labor market is ‘gradually slowing’ and on the subject of further rate hikes mentioned the risks of ‘doing too much.’ However, while referring to the sticky core inflation, he said the committee would ‘certainly hold policy at restrictive levels for some time.’

US FED
Fund Rate
5.25% - 5.50%

The Fed policy is already at a restrictive level with Fed Fund Rate at 5.5%, much higher than the headline Consumer Price Index (CPI inflation) level of 3%. The chart below shows the delay in Fed’s response to rising inflation, the aggressive hiking of rates starting March 2022 and then a sharp fall in CPI. The Fed Chair did mention in the press conference that ‘financial conditions affect economic activity and inflation with a lag that can be long and variable,’ and hence we believe the Fed is already at peak rate and will likely pause to assess its impacts on inflation and the economy.



The European Central Bank hiked by 25 bps on 27th July, taking the deposit rate to 3.75% and signaled that this could be last in cycle although upcoming decisions will be data dependent. A day later, Bank of Japan left rates unchanged at -0.10% but signaled relaxation in its yield curve control policy thereby opening the door for some gradual tightening in the months to come.

ECB Deposit Rate
3.75%

Slowing but not crashing:
Data points like Purchasing Managers Index (PMI) surveys across developed economies are confirming that growth is slowing down but on the other hand labor market and wage growth remain strong giving more confidence to consumers to continue to spend. Breaking down the PMI data further shows robust activity in services sector (which has a dominant weight in the economy) even though manufacturing sector remains in contraction territory. The labor market data in US still shows about 1.7 jobs available for every job seeker but this strength is tempered with slowing wage growth as more people come back into the labor market. Savings accumulated during the pandemic period have reduced but are still much higher than the pre-pandemic levels giving an impetus to consumer spending which constitutes over 70% of the US GDP while 60% and 52% percent of the UK and European GDPs respectively. A similar balance was seen in the US 2nd quarter GDP release. Economic growth came in well above expectations at 2.4% q-o-q on annualized basis compared to 2% in the first quarter but PCE price index (personal consumption expenditure), Fed's preferred measure of inflation, increased less than expected at 3%, its lowest level in two years.

US GDP Growth in Q2
2.4% q-o-q

IMF upgrades global growth outlook:
In the latest outlook released in July, International Monetary Fund (IMF) has raised its global growth outlook, now predicting global GDP to rise by 3.0% in 2023, compared to its April projection of 2.8%. The US growth was upgraded from 1.6% to 1.8%, eurozone from 0.8% to 0.9% and UK from a contraction of 0.3% to growth of 0.4%. At the same time, due to oil production cuts, the full year 2023 forecast for Saudi Arabia was cut from 3.1% to 1.9%.

IMF Has Upgraded Global Growth Outlook

	2023e	
	Apr Projection	**Jul Projection**
World	2.8%	3.0%
US	1.6%	1.8%
Eurozone	0.8%	0.9%
UK	-0.3%	0.4%
China	5.2%	5.2%
India	5.9%	6.1%

Source: IMF WEO

MARKET UPDATE AND OUTLOOK

Tailwinds have not been felt:

While the bull market in the US this year was led by mega-cap tech stocks and enthusiasm around AI (artificial intelligence), more recently, the rally is becoming broad-based and driven by a number of tailwinds:

- The much-anticipated recession has not materialized
- Consumer confidence is near two-year high
- Labor participation rate for prime aged workers is the highest since 2002
- Fiscal policy remains expansionary with massive incentives for domestic manufacturing
- Central banks may be nearing an end to rate hikes
- Inflation continues to cool
- Growth remains resilient
- Corporate earnings reports have been strong with 80% beating earnings per share estimates and 60% crossing revenue estimates

US Companies beating EPS
80%

Investors have been overly bearish and under-invested in equities from the beginning of this year. Clearly, the tailwinds are not felt on the face and hence easy to miss.

US Consumer Confidence
2yr high

Historic data covering the previous six rate hiking cycles suggests that S&P500 index delivers spectacular returns after the Fed pauses (please see table below):

S&P 500 Goes Boom After Fed Pauses

End of cycle	6-Month Return	12-Month Return	3-Year Return	5-Year Return
12/20/2018	19.7%	30.6%	85.1%	N/A
2/1/1995	19%	35.7%	112.9%	199.6%
2/24/1989	22.4%	14.5%	43.6%	61.7%
5/16/2000	-6.4%	-12.4%	-35.6%	-20.5%
6/29/2006	11.4%	18 1%	-27.2%	2.7%
8/9/1984	9%	13.8%	98.1%	109.6%
Average returns	**12.5%**	**16.7%**	**46.2%**	**70.6%**

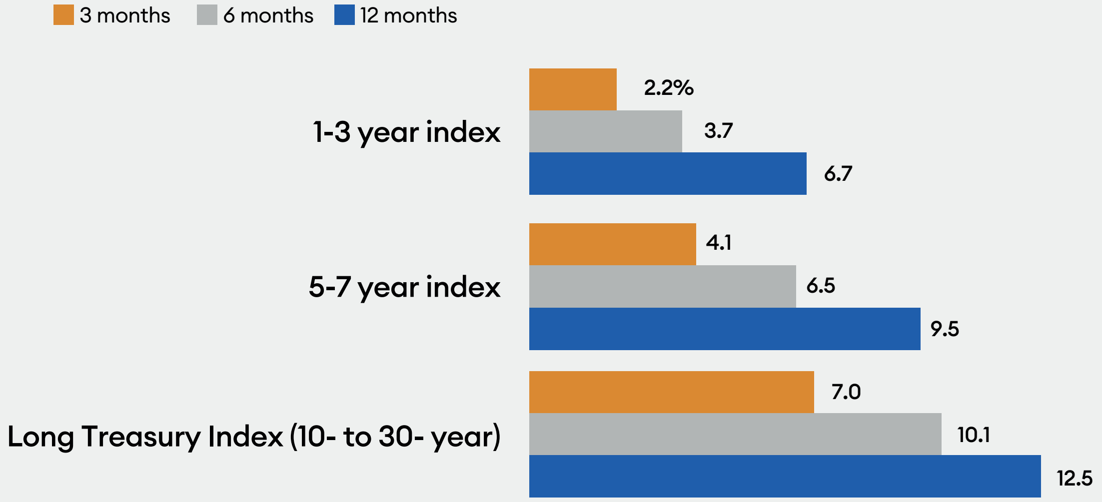
Table: Derek Saul Source: FactSet Get the data Created with Datawrapper

Equity-like returns from bonds:

As we have noted in the previous months, after more than a decade-and-a-half of ultra-low yields, income is back in fixed income. The level of yields available on bonds are extremely attractive and can be locked in for the long-term. Investors can benefit from durable income by buying high quality bonds and also benefit from capital gains as inflation comes under control and eventually central banks start to loosen their aggressively tight policy.

Historic data (see chart) has shown long duration bonds tend to benefit the most in the following months after the Fed has paused increase of interest rates. Clearly, the returns on long-dated bonds over the next 6 to 12 months are similar to equity-like returns.

Long-Maturity Treasuries Outperform After Last Fed Rate Increase



Source: Bloomberg
Note: Indexes' average performance during three, six and 12 months after end of Fed's four tightening cycles since 1995.

MARKET DATA

Global Equities	Last price	YTD 2023
MSCI World	3064.3	17.74%
Dow Jones Ind.	35559.53	7.28%
S&P 500	4588.96	19.52%
NASDAQ COMP	14346.0195	37.07%
EUROSTOXX 600	471.35	10.87%
FTSE 100	7699.4102	3.32%
India Nifty50	19753.8	8.93%
Nikkei 225	33172.22	28.29%
Shanghai Comp	3291.04	6.40%

Currencies	Last price	2023 Chng
Dollar Index	101.855	-1.51%
Euro	1.1007	2.50%
GBP	1.2858	6.09%
JPY	142.12	-8.13%
CHF	0.8695	5.90%
AUD	0.6725	-2.32%
CNH	7.1433	-3.49%
INR	82.2546	0.54%
SGD	1.3285	0.50%

Regional Equities	Last price	2023 Chng
Dubai DFM	4059.27	21.82%
Abu Dhabi ADX	9787.13	-4.21%
Saudi Tadawul	11,692.23	11.58%

Commodities	Last	2023 Chng
WTI Crude	81.8	1.92%
Brent Crude	85.56	-0.41%
Nat Gas	2.634	-40.54%
Gold	1971.04	7.24%
Silver	24.802	2.67%
Copper	400.8	4.68%
Corn	504	-25.68%

Market Data As of 31st July 2023

CBD INVESTMENT SOLUTIONS

CBD offers a range of solutions that can help you manage wealth for short-term or long-term objectives:

ASSET CLASS	SOLUTIONS
FIXED INCOME	• A large range of regional and international bonds, perpetuals and sukuks • Top-rated global and regional mutual funds investing in bonds and sukuks and distributing regular income • Both Sharia-compliant and conventional fixed income solutions are available
EQUITIES	• International equity and ETF trading on CBD's award-winning mobile app CBD Investr • Trading in UAE equities with CBD Financial Services mobile app or with brokers
MULTI-ASSET	• Income distributing mutual funds, from leading fund managers in the world, investing in equities and fixed income
SYSTEMATIC INVESTMENT PLAN	• Invest regularly in globally diversified and actively managed portfolios on CBD's award-winning mobile app CBD Investr
ALTERNATIVES	• Mutual funds investing in US senior secured loans delivering regular income

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