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Views from the desk

Monthly Global Market Overview and Outlook

Habib Investment Limited
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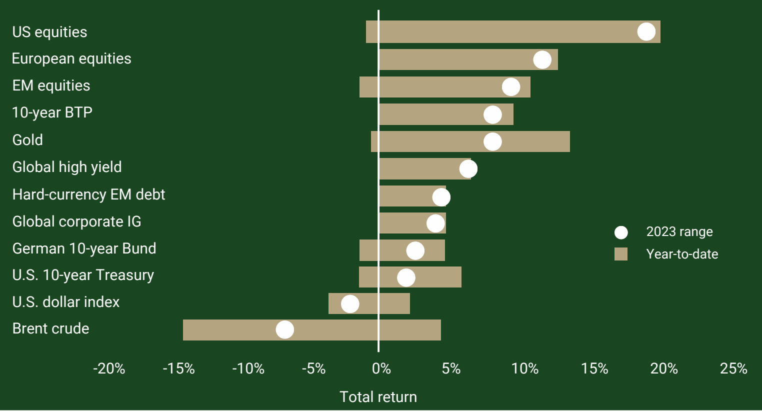
Assets in review

Selected asset performance, 2023 year-to-date return and range



Macro Overview

> *While investing in stock markets, downside protection is always more important that the upside potential."*
> *(ref: M. Daga)
>
> **— Sandeep Jadwani | ACSI**
> **Head of Investment Advisory**

The prospect of major central banks, the Fed, the ECB, the Bank of Japan and the People's Bank of China, going their own way and abandoning coordinated actions increases the probability of increased market volatility ahead across asset classes. Bond markets around the world have been under selling pressure in recent months as the US economy has remained resilient despite a string of Federal Reserve interest-rate hikes and as inflation in Europe has remained elevated. An index of global government debt has dropped and is now about 2.5% down from this year's high set in February. The investors with the broadest perspective will, as they always have, enjoy the best long-term investment returns by virtue of their broader selection of opportunities.

On the other side of the Atlantic, the US economy stands in stark contrast to Europe, with Q2 GDP growth expected to be low but positive, making it a more appealing prospect than Europe's recessionary environment.

Moreover, the nowcast for US Q2 growth indicates a good chance of positive surprises. As a result, we anticipate US yields to trend lower after the Fed meeting. This development should favor broad-based cyclical exposure.

Within the US industrial investment themes, sectors like Semiconductors, EV/Batteries, Clean Energy, Biomanufacturing, and Heavy Industry are backed by favorable policies. Staples and Industrials remain crucial stabilizers for a well-balanced portfolio. Furthermore, technology plays a crucial role in both industrial and consumption themes, and its prospects are further bolstered by declining yields.

In the Emerging Markets, the carry theme continues to be prevalent, primarily due to the weaker US dollar. However, investors should be cautious as a change in ECB communication could potentially trigger a rebound in EM currencies.

EM central banks may also capitalize on lower inflation to implement rate cuts, thereby benefiting longer duration exposures in EM.

Importantly, net inflows into ex-China Emerging Markets have exceeded those into China for the first time since 2017, signaling a shift in investor sentiment.

Turning our attention to central bank decisions, Fed policymakers are expected to hike interest rates, possibly taking them to the highest level in 22 years. Investors will closely scrutinize Chair Jerome Powell's comments for any indications about the possibility of further rate hikes in 2023.

The Bank of Japan, in contrast, is likely to maintain its negative interest rate policy and will be closely watched to see if it modifies its cap on benchmark yields, compared to other major central banks that have been more aggressive in hiking rates to tackle inflation.

Meanwhile, the Bank of England is anticipated to raise interest rates for the 14th consecutive meeting as it grapples with the highest inflation rate among the Group of Seven nations.

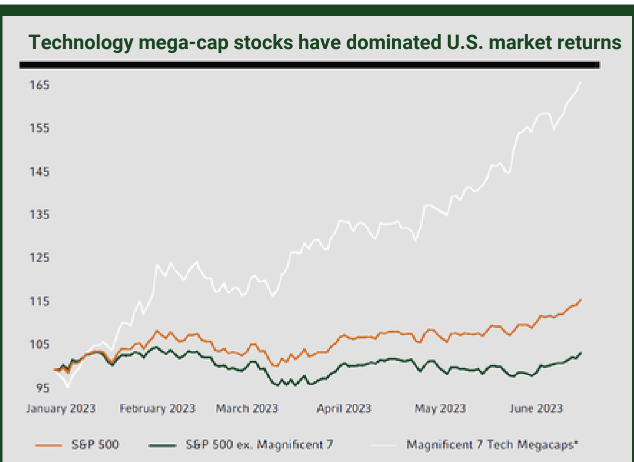
1. Market expectations point towards the conclusion of rate hike cycles for both the Fed and ECB, aligning with the current economic conditions.
2. European equities face elevated risks, with the potential for negative reactions triggered by the ECB's communication amidst the ongoing recession in Europe.
3. Emerging Markets continue to benefit from the carry theme, but caution is advised.
4. Investors should maintain a diversified portfolio, with a focus on sectors supported by favourable policies and declining yields.

Divergence Creates Opportunities

Global Outlook

The potential divergence among major central banks—Fed, ECB, Bank of Japan, and People's Bank of China—increases the likelihood of heightened market volatility across various asset classes. While this anticipated volatility entails risks, it also presents significant risk/reward opportunities. The influence of central bank policies on capital flows suggests that favorable prospects may extend beyond stock markets and encompass bond and currency markets.

Global equities presented a mixed picture during the period under review. In the US, tech stocks experienced a slip due to earnings concerns and warnings about a semiconductor slump from TSMC. Nevertheless, the S&P managed to post a slight gain. On the other hand, UK stocks rallied significantly after inflation readings eased. The Chinese equity market witnessed gains, supported by various measures implemented to bolster the country's economy. Regionally, the UAE equity markets declined, contrasting with gains seen across all other markets. Qatar's robust banking sector contributed to gains, while the Tadawul touched a 9-month high.



Source: Refinitiv® DataStream®, Russell Investments' calculations, last observation as of June 15, 2023. *The Magnificent 7 is comprised of Apple, Meta Platforms, Alphabet (Google), Amazon, Tesla, Nvidia, and Microsoft.

In the US, several economic indicators were reported. Industrial production fell by 0.5% month-on-month in June, similar to the previous month's decline. Retail sales inched up by 0.2% month-on-month in June, a slight increase compared to May. However, building permits fell by 3.7%, and existing home sales slipped by 3.3% month-on-month to 4.16 million in June, reaching the lowest level since January.

In the Eurozone, Germany's producer price index fell by 0.3% month-on-month in June, a slower decline compared to May's 1.4% drop. Meanwhile, inflation in the UK declined to 7.9% year-on-year in June, the lowest reading since March 2022. Although inflation remains above central bank targets, the easing from recent highs suggests that central banks may be nearing the peak of the current tightening cycle. However, there are indications of potentially higher food costs in the future, including India's ban on rice exports and Russia's withdrawal from the Black Sea Grain Initiative, which may lead to increased food prices.

The World Bank's Gulf Economic Report forecasts GCC growth to reach 2.5% this year (compared to 7.3% in 2022). The contraction in hydrocarbon GDP (-1.3%) is offset by a robust 4.6% growth in the non-oil sector. Among the GCC nations, growth is expected to range between 3.3% in Qatar to Kuwait's slower pace of 1.3%.

Saudi Arabia and UAE saw a decline in their holdings of US treasury bonds, ranking 18th and 23rd, respectively, among global holders. UAE's Minister of Economy revealed ambitious plans to achieve a 7% growth rate and double the economy to over USD 800 billion by the end of 2030. In Abu Dhabi, the industrial sector is targeted to contribute AED 172 billion (USD 46.8 billion) by 2031, with hopes to achieve this by increasing manufacturing operations.

The oil market exhibited optimism, with hopes of a soft landing in the US and increased stimulus in China supporting firm oil demand growth through the year-end. Oil prices saw an increase, with Brent futures reaching USD 83.6/b, and WTI rising to USD 79.6/b, representing multi-month highs.

In our view, we have transitioned to an environment in which the USD is rangebound. As the end of the Fed's tightening cycle approaches, the downward pressure on an overvalued US dollar may limit upside potential, unless a global recession occurs (which is not expected). However, any downside in the US dollar may be capped by the relative outperformance of US economic growth compared to other major regions and the attractive carry of US dollar positions compared to other G10 FX, in our view.

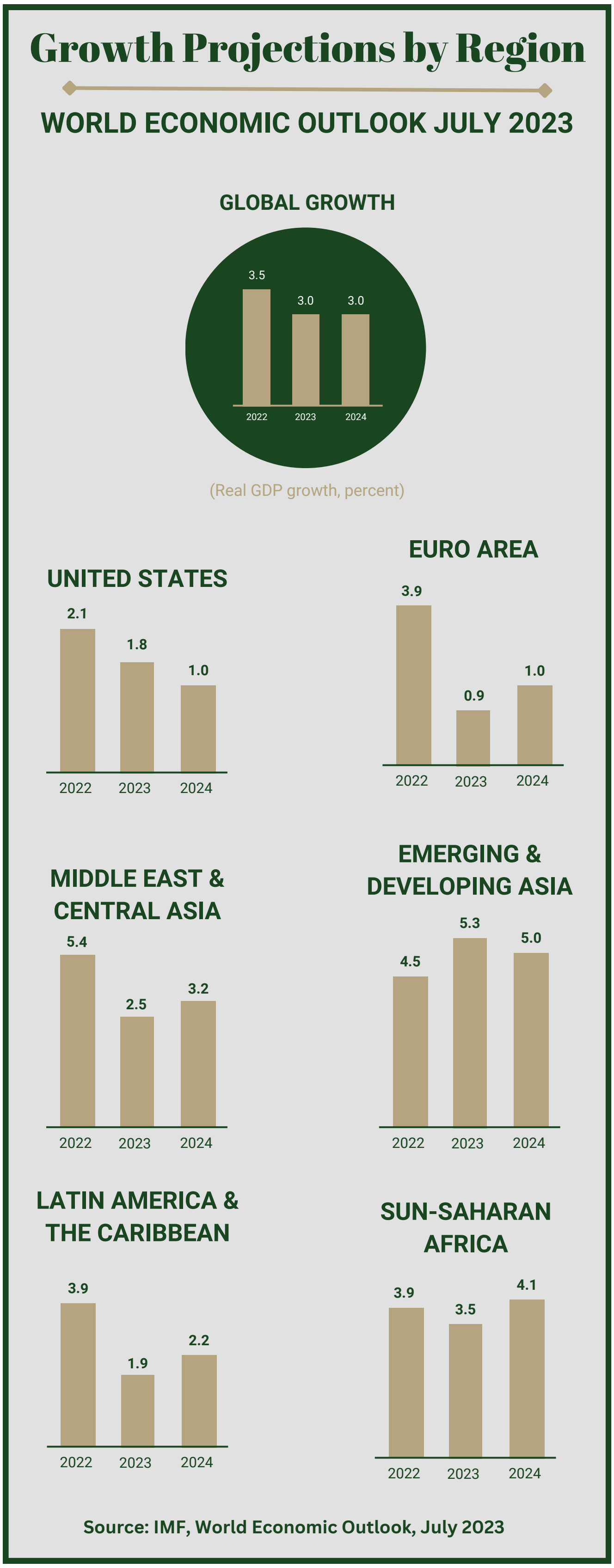
The divergences among regions & sectors provide scope for diversification

On the other hand, gold prices began the year with strong momentum, nearly touching a new record high in May. However, the rally faced rejection, and the precious metal has been drifting lower since, falling back into the sideways range that has contained the price action since 2020. The risks surrounding gold over the coming months seem tilted to the downside, as the US economy appears resilient with growth running around 2%, a recovering housing market, and a robust labor market, suggesting elevated interest rates for a longer period. This environment poses challenges for gold, with higher bond yields and a relatively strong US dollar exerting downward pressure on the precious metal.

> *Our investors are not chasing the past, rather envisioning the future. They see potential in businesses and invest in their growth with optimism and confidence.*
>
> **— Masroor Zaidi**
> **Managing Director**

In summary, the global markets showed mixed performance, with some economies displaying signs of recovery and growth. While oil prices reached multi-month highs, concerns lingered over inflation and the potential impacts of central bank actions. The Gulf region also revealed ambitious plans to bolster economic growth and diversify sectors. We continue to monitor economic indicators and policy announcements for further insights into market movements.

At Habib Investment Limited, we believe a comprehensive outlook will undoubtedly benefit, as they historically have, from superior long-term investment returns. By exploring a wider array of opportunities, we position and allocate into solutions to make the most of the dynamic market landscape. As central banks chart their own paths, staying attuned to diverse investment options will be key to capitalizing on potential growth prospects and mitigating associated risks.



Market Definitions 101

Compound Interest

Compound interest is the interest earned on both the initial amount (principal) and any previously accumulated interest.

Return on Investment (ROI)

A percentage that measures an investment's profitability by comparing its net profit to the initial cost. Higher ROI means a better run.

Internal Rate of Return

A metric used to gauge an investment's potential profitability by finding the rate at which its future cash flows balance out its initial cost.

Asset Class Views

Asset Class	Sub-Class	View (Jun'23)	View (Jul'23)
Main Asset Class	Equities	=	▲
	Fixed Income	=▲	=▲
	Commodities	=▲	=▲
	Currencies	=▲	=▲
Equities	USA	=	=
	EU (Ex UK)	=▲	=▲
	Japan	▲	▲
	UK	=	=
	EM (Ex MENA)	▲	▲
	MENA	=▲	=▲

Asset Class Views

Asset Class	Sub-Class	View (Jun'23)	View (Jul'23)
Fixed Income	US Treasuries	=	=
	Euro (Bunds)	▼	▼
	UK Gilts	▼	▼
	US IG	=▲	=▲
	US HY	=	=
	Europe IG	▼	▼
	EM	=	=
Commodities	Oil	=	=
	Precious Metals	=▲	=▲
Currencies	USD	=▲	=
	EUR	=	=
	GBP	=	=
	EM	=	=

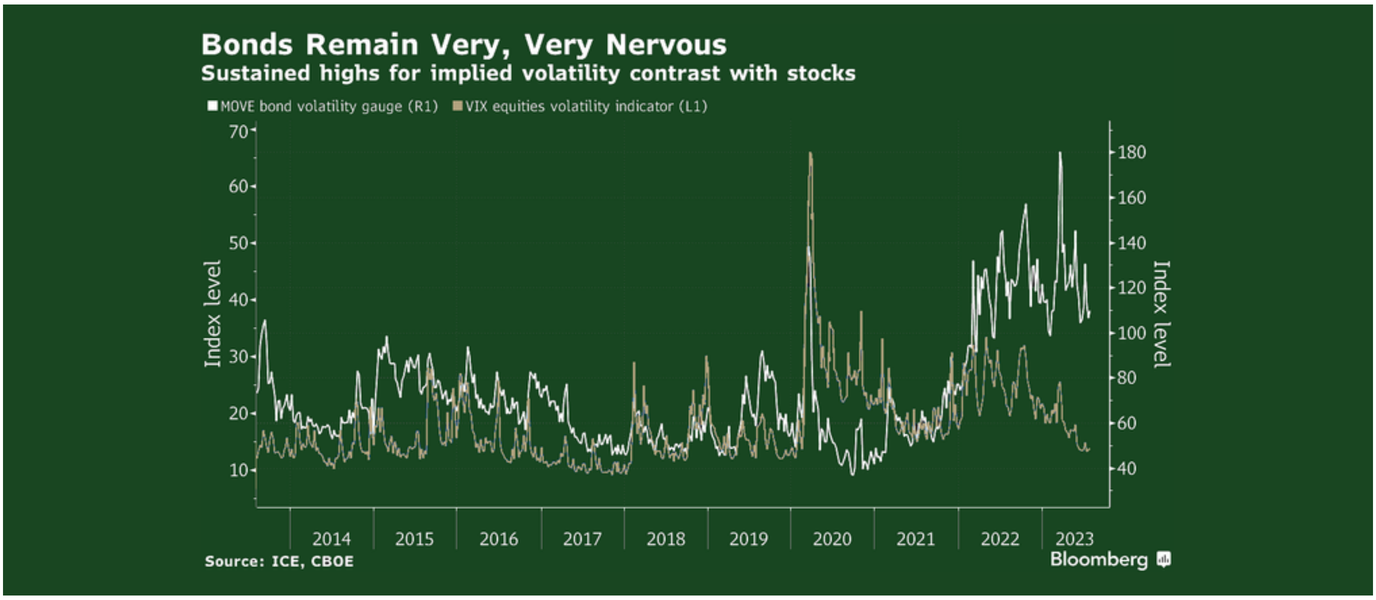
▲ overweight = neutral weight ▼ underweight ■ negative tilt ■ positive tilt

Critical Future Events

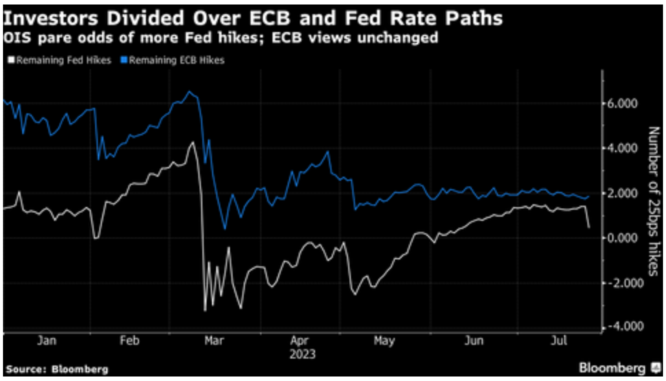
Aug 3: BoE Meeting

Even the Asset class faces a "Goldilocks" situation

Sustained highs for implied volatility contrast with stocks



In the current market climate, fear is notably pervasive, with bond traders expressing much greater concern over potential price fluctuations compared to their calmer counterparts in equities. The "fear gauge" for Treasuries, represented by ICE BofA's MOVE Index, remains elevated above 100, akin to levels observed during the 2007-08 global financial crisis, despite its retreat from March's peak. Conversely, the VIX index, measuring expected swings for the S&P 500, is currently at its lowest point since early 2020.



This positioning highlights the bond market's uncertainty regarding the Federal Reserve's future interest-rate hikes and how its tightening campaign might impact Treasuries. The question of whether a substantial slowdown, leading to substantial gains for Treasuries, will result from the central bank's actions remains uncertain.

On the other hand, equities seem to be focused on the resilience of the US economy in navigating through March's banking-sector instability, leading to a perception that the likelihood of a recession is diminishing. However, this optimistic outlook could render them vulnerable to potential shocks during this week's earnings season coinciding with a Fed meeting. Such shocks would be exacerbated by apparent unpreparedness among investors.

In summary, market participants are experiencing a clear divergence in fear levels between bond and equity markets. The uncertainty surrounding the Fed's future actions and their potential consequences looms large, and investors should remain vigilant and well-prepared for potential surprises and volatility in the coming days.

While the overall market sentiment remains positive, being mindful of potential fluctuations and central bank decisions is prudent.

Source and Sighting: IMF, BJSS, Bank of America, Bloomberg, Nomura, JB, Goldman Sachs Asset Management, Barclays, T row price, UBS