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Views from the desk

Global Market Overview and Outlook | January '24

Habib Investment Limited
Regulated by the DFSA

Reflecting on a Prosperous 2023 and Anticipating a Promising 2024

As we welcome 2024, I am pleased to share with you a recap of the remarkable journey that we've experienced in the global markets and express my sincere gratitude for your trust and support throughout last year.

The year 2023 has been nothing short of exceptional for investors, with the S&P 500 concluding the year with an impressive gain of over 24%, and the Dow achieving near-record highs. The Nasdaq, driven by the outstanding performance of tech giants such as Nvidia, Amazon, and Microsoft, soared an astonishing 43%. These gains were fuelled by several factors, including easing inflation, a robust economy, and the prospect of lower interest rates, particularly emphasized in the last two months of the year.

The rally that initiated in November marked a significant psychological shift for investors. It was a testament to the resilience of the market and its ability to rebound. More importantly, the broadening participation in the market, extending beyond the big technology companies, affirmed the gains for smaller company stocks, which is a pivotal aspect of a healthy and sustainable market.

The Federal Reserve's December forecast, outlining its intention to cut interest rates three times in 2024, provided additional optimism to the market. This commitment from the Fed signals a belief in achieving a "soft landing" scenario, where the economy slows enough to control inflation without slipping into a recession. As a result, investors are anticipating rate cuts as early as March, setting the stage for further momentum in 2024.

At the end of 2023, most major indexes were able to recover from the challenges faced in 2022, erasing losses and reinforcing the positive trajectory. The market's optimism is grounded in falling interest rates and signs of a soft-landing scenario, providing a solid foundation for the recovery. As we navigate through these dynamics, we remain vigilant in our approach, onboarding manageable risks, and staying true to our long-term objectives to deliver favourable returns to our clients.

Looking ahead into 2024, we acknowledge the debates surrounding:

1. **The economy's trajectory**
2. **The path of inflation**
3. **The extent of the Federal Reserve's rate cuts**

However, rest assured that we maintain a prudent stance, carefully considering risks and aligning our strategies to fulfil our commitment to your financial well-being.

I extend my heartfelt congratulations to each one of you for the fantastic year we've had. Your trust and partnership have been instrumental in our success, and I am genuinely excited about the opportunities that lie ahead. Together, with faith, belief, appropriate action, and courage, we will make 2024 another successful chapter in our journey as trusted advisors to our valued clients.

Thank you for your continued confidence in our team and our strategies. Wishing you a prosperous and fulfilling 2024!

Happy Investing,

Sandeep Jadwani | ACSI, CIB
Head of Investment Advisory

Navigating Volatility and Shifting Dynamics

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total
EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 1.8%	Lg Cap 31.5%	Sm Cap 20.0%	REIT 41.3%	Cash 1.6%	Lg Cap 26.3%	Lg Cap 610.9%
HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l Stk 25.6%	HG Bnd 0.0%	REIT 28.7%	EM 18.7%	Lg Cap 28.7%	HY Bnd -11.2%	Int'l Stk 18.9%	Sm Cap 398.3%
Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%	Sm Cap 25.5%	Lg Cap 18.4%	Sm Cap 14.8%	HG Bnd -13.0%	Sm Cap 16.9%	REIT 369.4%
REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.0%	EM 11.6%	Sm Cap 14.7%	REIT -4.0	Int'l Stk -22.7%	AA 9.8%	Int'l Stk 11.8%	Int'l Stk -14.0%	HY Bnd 13.5%	HY Bnd 270.3%
Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%	AA 18.9%	Int'l Stk 8.3%	AA 10.9%	AA -16.5%	AA 12.8%	AA 196.4%
Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%	EM 18.9%	HY Bnd 7.5%	HY Bnd 5.4%	Lg Cap -18.1%	REIT 11.4%	Int'l Stk 193.3%
AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%	HY Bnd 14.4%	HG Bnd 6.1%	Cash 0.0%	EM -19.7%	EM 10.3%	EM 173.2%
HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%	HG Bnd 8.7%	Cash 0.6%	HG Bnd -1.5%	Sm Cap -20.4%	HG Bnd 5.5%	HG Bnd 46.8%
Cash 0.1%	Cash 0.1%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6	Cash 0.3%	Cash 0.8%	EM -14.3	Cash 2.2%	REIT -5.1%	EM -2.2%	REIT -25.0%	Cash 5.1%	Cash 13.5%

***Refer to legend on page 8*

With 2023 in the rear-view mirror, global capital markets open a new chapter in 2024 with a mix of possibilities and uncertainties. In the wake of recent developments in week 1 of 2024, the global financial markets have experienced heightened volatility, spurred by a combination of factors, notably the release of the Federal Reserve minutes, the Nonfarm Payrolls (NFP) report, and the Services ISM data.

Fed Rate Expectations in Flux: A notable feature in the recent market landscape has been the oscillation in expectations regarding Federal Reserve rate cuts. Initially projected at 6, then revised to 5, and subsequently reverting to 6, these fluctuations reflect the delicate balancing act the central bank faces in responding to evolving economic indicators.

Job Report Signals Cooling Markets: Despite the market's uncertainty, a closer analysis of the job report suggests a discernible trend. The cooling of the job market appears to be underway, a sentiment reinforced by the Services ISM data. This insight positions volatility not as a cause for concern but as an opportunity for medium-term investors to capitalize on evolving market dynamics.

US CPI Inflation and Market Sentiment: Anticipation surrounds the upcoming US Consumer Price Index (CPI) Inflation report, expected to echo the message of a gradual decline in inflation. While acknowledging the time it takes for this shift, the trajectory is unmistakable. This aligns with our perspective that market sentiment can find short-term relief through Q4 earnings. Inflation has decreased in 2023; however, it remains above the Federal Reserve's target of 2%.

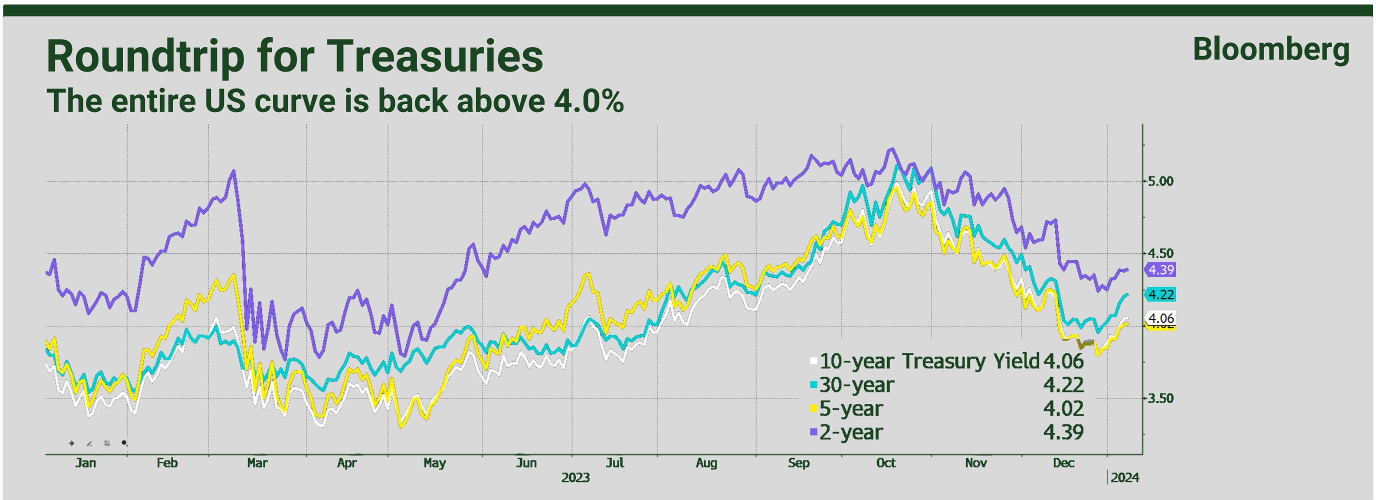
The labour market is performing well, but any unexpected data reports could potentially disrupt the expectations that the Fed will initiate rate cuts within this year

Q4 Earnings, A Shifting Focus to Corporates: As the S&P Q4 earnings season commences, attention turns towards US corporates. Earnings expectations parallel the ISM indices, providing optimism for positive surprises. This optimism is grounded in the declining yields and easing price pressures witnessed in Q4.

European Pressures and Attractive US Exposure: In Europe, the pressure on the European Central Bank (ECB) to enact rate cuts earlier and more aggressively is palpable, given the region's recessionary environment. German and Euro area data fail to signal a recovery, making US exposure more appealing. The prospect of looming rate cuts and lower natural gas/energy prices further enhances this attractiveness.

UK Inflation Outlook and Robust Service Sector: The UK is poised for a faster decline in inflation, affording the Bank of England (BOE) greater leeway for accelerated rate cuts throughout the year. Notably, the robust growth in the UK service sector remains a positive indicator amid these economic shifts.

Emerging Markets, Low Alpha & High Beta: China and Hong Kong continued to disappoint investors, despite an early bounce, we didn't see returns even close to what we expected. The common prosperity and quality growth goal from the Government has given way to a lower growth regime for the country. Add that to the property woes, draconian government measures and crisis of confidence among the people and you have a market that no one wants to invest in. Not this year at least.



India certainly had a very interesting year. Starting off with a very bumpy quarter after allegations of wrongdoing against the Adani's, the market not only recovered but soared from there on end. YTD the Sensex has returned a whopping 18.6%! Looking at their fundamentals, we don't think it's done! GDP growth continues to remain strong, and the Indian Rupee has stabilized remarkably.

For the Middle East, the story was all around OPEC cuts and restricting supply. With some final drama of Angola leaving the OPEC altogether. And we still remain in a situation where supply will remain tight in 2024.

Commodities: Oil prices rose as tensions in the Middle East continued to disrupt supply chains through the Red Sea. WTI and Brent crude ultimately finished higher at $73.81 and $78.76/bbl (at the time of writing), respectively, as US crude inventories declined. Meanwhile, the price of gold ended the first week of 2024 at $2069.70/troy oz.

Bitcoin (BTC-USD) rang in the new year by scaling new heights, surpassing $45,000 for the first time since April 2022 amid growing expectations that the SEC could approve a spot bitcoin ETF as early as second week of January. The imminent approval caused bitcoin to more than double in value over the past year, outperforming gold and global equities, although it is still well below its 2021 peak of $69,000.

'Carry' as a Dominant Theme in '24: Declining rates set the stage for 'carry' to be a prevailing theme in 2024. Emerging Markets (EM) bonds and stocks are positioned to benefit from lower US yields and the stability of the US dollar.
**Refer to Figure 1.

Political Year Ahead

The spectre of lower growth rates looms over major economies, suggesting shorter trends in equities. Anticipating a moderately stronger global growth in 2025, the world is heading towards a new economic landscape characterized by subdued growth.

As 2024 unfolds, it promises to be a political year with elections in the US, UK, EU, India (IN), and Taiwan (TW). While positive impacts are expected in the US, UK, and IN, the EU and TW present wild cards, introducing an element of unpredictability into the geopolitical landscape.

In terms of broad market performance in 2023, Developed markets outperformed Emerging Markets and even Frontier Markets. A strong dollar and episodic spikes in energy & commodity prices held back a great many of the EMs. Not to mention, China didn't help at all. Investors should look at top and worst performers, and then consider stock and cash allocation strategies for 2024.

In conclusion, while volatility prevails, astute investors can find opportunities amidst the shifting tides. The macroeconomic indicators suggest a nuanced understanding of the global financial landscape, emphasizing adaptability and strategic positioning in the months ahead.

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Cumulative	Annualized
BTC 5,516%	SPX 12%	BTC 37%	BTC 119%	BTC 1,300%	AGG 0%	BTC 92%	BTC 302%	BTC 58%	CMT 20%	BTC 156%	BTC 315,678%	BTC 124%
SPX 26%	AGG 5%	AGG 0%	HY 17%	EM 35%	HY -2%	SPX 29%	Gold 24%	CMT 30%	Gold 1%	SPX 25%	SPX 226%	SPX 13%
HY 6%	HY 2%	SPX -1%	EM 15%	SPX 18%	Gold -3%	EM 21%	SPX 15%	SPX 29%	HY -11%	HY 12%	HY 64%	HY 5%
AGG -1%	EM 1%	HY -4%	CMT 14%	Gold 12%	SPX -7%	Gold 18%	EM 14%	HY 5%	AGG -12%	Gold 12%	EM 35%	EM 3%
EM -3%	Gold -3%	Gold -11%	SPX 11%	HY 7%	CMT -9%	HY 14%	AGG 7%	EM 0%	EM -18%	EM 9%	Gold 18%	Gold 2%
CMT -9%	CMT -18%	EM -14%	Gold 7%	CMT 6%	EM -15%	CMT 10%	HY 7%	AGG -1%	SPX -20%	AGG 5%	AGG 17%	AGG 2%
Gold -29%	BTC -58%	CMT -25%	AGG 2%	AGG 3%	BTC -73%	AGG 8%	CMT -3%	Gold -6%	BTC -65%	CMT -2%	CMT -4%	CMT 0%

Figure 1

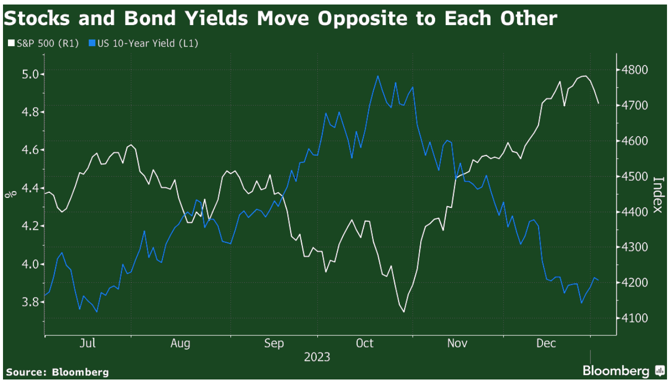
Treasuries are threatening to upend global financial markets

The threat of rising yields is putting assets from stocks to corporate bonds to real estate at risk. Yields are already climbing in 2024 amid signs the economy is doing pretty well. That means the Fed won't have to cut interest rates as much as some investors expect and yields will rise.

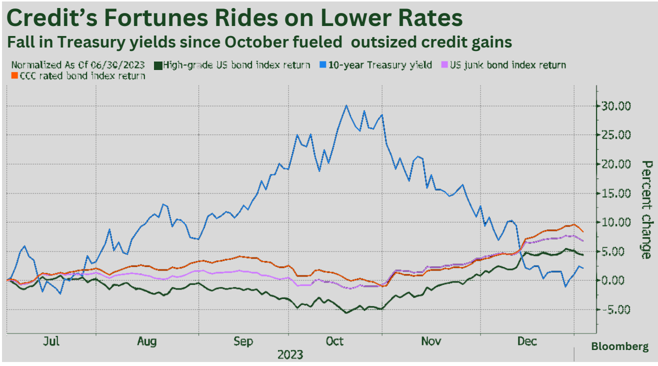
Here are some of the dangers:

- Stocks will fall on fears that higher yields will damp growth
- Corporate bonds are increasingly sensitive to rising yields after pricing in swift and aggressive 2024 Fed easing.
- Better quality bonds have longer durations, signifying steep losses for blue-chip bonds in a rates rout
- The dollar stands to gain as rising Treasury yields attract foreigners
- Bitcoin and gold are vulnerable because they don't pay interest, making them less attractive as bond yields advance
- Real estate will suffer because higher mortgage costs will bite

Here are three charts that highlights some of the biggest risks:



Stocks and bond yields are moving inversely to each other, demonstrating how sensitive equities are to the bond market. Their 90-day correlation stands at -0.3. This puts stocks at risk at the wrong time — just as investors are rushing to stock ETFs.



Most of last year's credit gains came from the steep decline in yields over the fourth quarter. Both high-grade and junk bonds are priced for perfection, with razor-thin spreads, leaving them exposed to disappointment on Fed easing.

Lastly, the dollar is moving in sync with yields. Strength in the US currency helped send a majority of G-10 currencies lower. Continued dollar strength also threatens to draw money out of emerging markets.

Market Definitions 101

Developed Markets

Mature and stable economies with advanced infrastructure, high-income levels, and established financial systems.

e.g, US, UK, Japan

Emerging Markets

Economies in transition, showing potential for rapid growth, but with less developed infrastructure and institutions compared to developed markets.

e.g, India, China

Frontier Markets

Characterized by lower development, often in regions with less-established financial systems and a higher degree of risk and uncertainty for investors.

e.g, Africa

Asset Class Views

Asset Class	Sub-Class	View (Dec '23)	View (FY '24)
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 (Dec '23)	View (FY '24)
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

Jan 23: BoJ Meeting

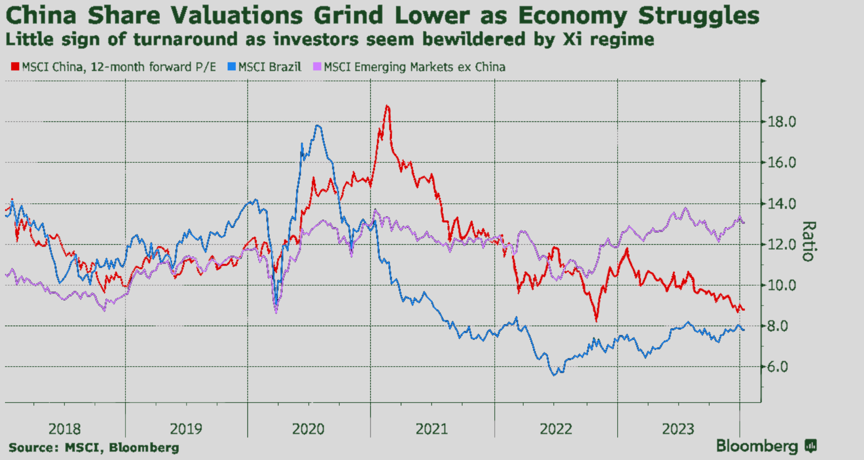
Jan 25: ECB Meeting

Jan 31: FOMC Meeting

Feb 1: BoE Meeting

Emerging Market Paradigm Shift: China to Saudi Arabia

> *Choose investments for their fundamental value, not their popularity and always invest with a margin of safety.*
>
> **- Sandeep Jadwani | ACSI, CIB**
> **Head of Investment Advisory**

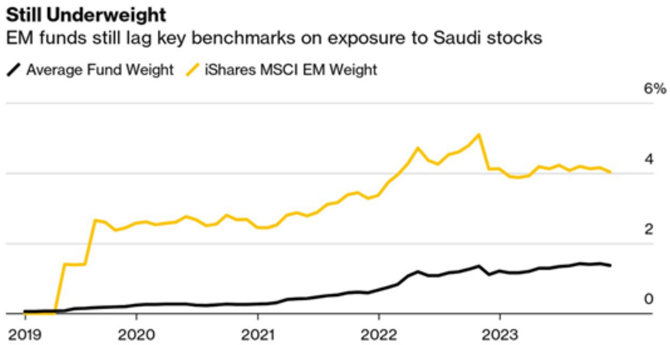


China's markets opened 2024 very much stuck in the mire that had afflicted them for much of last year. It's early days as yet, of course, but there's little sign as that investors are being drawn back in by some of the cheapest valuations on record for the country's stocks. That helps to highlight the contrast with other emerging markets, where forward price-earnings ratios rebounded in November and December as global bond yields tumbled. There are concerns that investors have experienced a sea change in the way they regard China, which stands out as a rare venue that has yet to experience a sustained turnaround in valuations in the post-pandemic era.

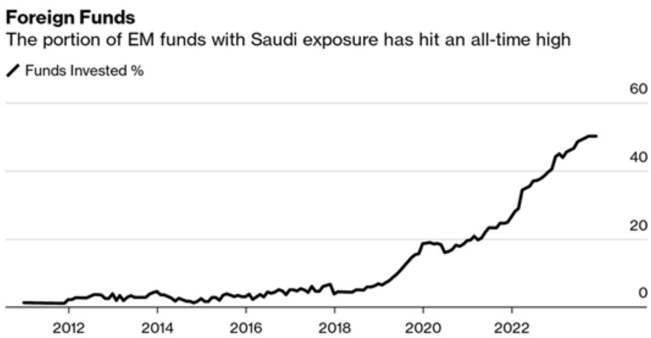
That likely owes much to the failure of the Asian behemoth's economy to rebound, especially given the authorities seeming inability to work out how to achieve a return to robust growth. There are also plenty of signs that investors are giving up on a country where opaque government policy shifts disrupt businesses with alarming frequency. President Xi Jinping rang in the new year by declaring China's progress in pursuing "high-quality development" a key goal. He ramped up his usage of the term in 2023, even as there's a lack of clarity as to what it might mean in practice. For investors already bruised by "common prosperity," that may underscore the dangers that the risks in China may again outweigh the rewards this year.

Saudi Arabia is the new China, for investors hunting down growth.

The kingdom, which only joined the MSCI Emerging Markets index in 2019, has historically attracted very little from the billions of dollars that stock investors allocate to global stock markets. Fund managers were put off by the lack of liquidity in the Tadawul All Share Index, which limits full foreigner ownership, and by the nation's over-reliance on fossil fuels.



Now, with Russia sanctioned out of the benchmark index and China losing its allure due to an economic slowdown, some investors are starting to view Saudi Arabia in a new light, attracted by a steady stream of reforms designed to encourage more foreign investment and the vast sums being thrown at Crown Prince Mohammed Bin Salman's Vision 2030 transition plan.



Saudi Arabia is still "very underrepresented" in investor portfolios even after the Tadawul index attracted net foreign inflows of over $3 billion this year.

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks – S&P 500 Index	13.97%	32.4%	-18.1%
Sm Cap	Small Cap Stocks – Russell 2000 Index	11.30%	38.8%	-20.4%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	7.44%	32.5%	-14.0%
EM	EM Stocks – MSCI Emerging Markets Index	6.93%	79.0%	-19.7%
REIT	REITs – FTSE NAREIT All Equity Index	10.86%	41.3%	-25.0%
HG Bnd	High Grade Bonds – Bloomberg Barclays U.S. Agg Index	2.59%	8.7%	-13.0%
HY Bnd	High Yield Bonds – ICE BofA US High Yield Index	9.12%	57.5%	-11.2%
Cash	Cash – S&P U.S. Treasury Bill 0-3 Mth Index	0.85%	5.1%	0.0%
AA	Asset Allocation Portfolio*	7.51%	24.6%	-16.5%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/23.

*Asset Allocation Portfolio is 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Source and Sighting: Goldman Sachs, HSBC , Jsafra , Nomura, JB, Bloomberg, Bank Of America, Blackrock