MARCH 2024 | ISSUE # 120318

Views from the desk

Monthly Global Market Overview and Outlook

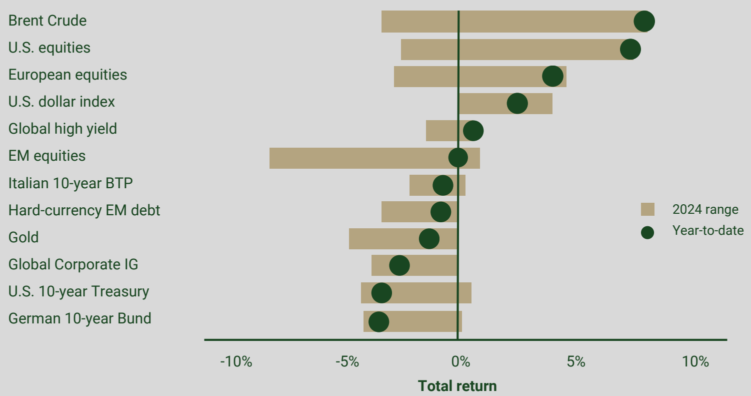
Habib Investment Limited
Regulated by the DFSA

A month of record breaking performances across global markets

Gradually approaching the goldilocks situation

Assets in review

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



Market Overview

As central banks navigate the delicate balance between curbing inflation and sustaining growth, the global economy stands at a crossroads, with the path forward fraught with challenges and uncertainties."

– Sandeep Jadwani | ACSI, CIB
Head of Investment Advisory

In February, US equities performed positively, with both headline and core inflation aligning closely with consensus expectations. The S&P 500 returned 5.3%, marking its strongest February since 2015. Similarly, the STOXX 600 ended the month up 2%, while the FTSE 100 saw a slight decline of 0.33%, largely due to weaker-than-expected earnings releases.

A significant milestone was achieved in Japan on February 22, 2024, as the Nikkei 225 surpassed its previous record from December 1989 after 34 years. This achievement sparked discussions about whether the market is entering a bubble territory once again, reminiscent of the late 80s. However, a stark contrast exists between the market conditions then and now. In 1989, Japan accounted for 37% of global stocks by market cap, with the Nikkei 225 trading at 60 times its earnings and over 8 times its Price to Book ratio. Today, the Nikkei 225 trades at around 16 times its Price to Earnings ratio, twice its Price to Book ratio, and a significant portion of companies included in the index have a market price lower than their book value.

Moving to commodities, oil prices climbed as OPEC+ signalled its intent to extend production cuts through the second quarter. WTI and Brent crude closed at $79.97 and $83.62 per barrel, respectively. Gold prices also rose to $2116.00 per troy ounce amid tensions between NATO countries and Russia.

In the fixed income market, global sovereign yields saw mixed movements. In the US, the 2-Year and 10-Year Treasury yields decreased to 4.53% and 4.18%, respectively, while the 10-Year German Bund yield stood at 2.41% despite a decline in Euro area inflation.

The US dollar remained relatively stable against a basket of currencies, while the euro appreciated, and the pound sterling depreciated. In Japan, the yen strengthened against the dollar to ¥150.10 on the back of higher-than-expected inflation and expectations of a policy shift by the Bank of Japan.

On the inflation front, the core PCE price index rose 0.42% month-over-month in January, with the year-over-year rate declining to 2.85%. Similarly, the headline PCE increased 0.34% month-over-month, with the year-over-year rate falling to 2.40%. In the Euro area, February inflation exceeded expectations, with the ECB now expected to begin cutting its policy rate in June.

In the US, congressional leaders reached a deal to avoid a government shutdown, extending spending bills to March 8th and 22nd. The ISM Manufacturing PMI contracted for the 16th consecutive month in February, while real GDP growth for 4Q2023 was revised down to 3.2% annualized. Consumer confidence in the US also declined, with the Conference Board index dropping to 106.7. In the Euro area, the unemployment rate edged lower to 6.4% in January, indicating tight labour market conditions.

Major moving parts that may impact global capital markets in 2024:

1. **Elections**
2. **Inflation**
3. **Monetary & Fiscal Policy**

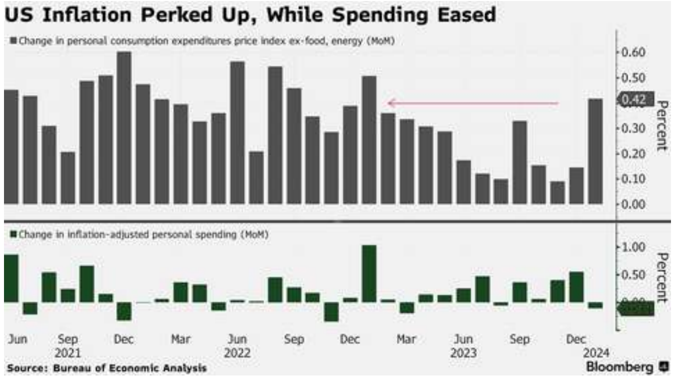
Earnings Outlook: In the rear view

In the fourth quarter of 2023, US markets saw a clear divide in performance, with tech and internet companies excelling while other sectors lagged behind. This divergence was evident in the S&P 500 earnings, which remained positive for a second consecutive quarter. The growth in Q4 was primarily driven by the strong performance of tech and internet stocks, which had been leaders in the market throughout 2023. Despite the overall positive growth of 4.4% at the index level, there was significant dispersion in year-over-year results, both between and within sectors.

Consumer discretionary and communication services sectors, which include four of the "Magnificent 7" mega-cap stocks, stood out with earnings growth of 52% and 43% respectively. In contrast, energy and materials sectors were the main laggards, experiencing declines of 25% and 20% respectively due to falling commodities prices. Healthcare also saw negative earnings, but this was driven by only a few companies within the sector.

Looking ahead, we anticipate the market to broaden in the coming quarters, providing a wider range of opportunities for stock pickers. While tech stocks have been driving market returns and exceeded expectations in Q4, we believe their momentum may slow down as comparisons become tougher and earnings decelerate. On the other hand, we expect earnings growth to pick up in other sectors of the S&P 500 as they continue to recover from the impacts of the COVID-19 pandemic.

One area of concern is the slowdown in demand for electric vehicles (EVs) and other big-ticket items, which reflects a more cautious consumer sentiment amidst higher interest rates. This trend underscores the importance of identifying companies that are best positioned to navigate through potential consumption slowdowns and maximize return prospects.



Overall, we see a fertile hunting ground for active stock pickers to source greater alpha opportunities in an environment where beta, or market return, could fall short of expectations. While there is dispersion in earnings between and within sectors, we believe this presents opportunities for investors who are diligent in their research and selective in their stock picking.

Way Forward :

To thrive in the current environment, it's crucial to dive into details and stay agile to capitalize on emerging opportunities. As inflation eases and the Federal Reserve prepares for interest rate cuts, it's a pivotal moment for strategic investment decisions.

With this more favourable landscape for risk-taking in mind, we are strategically overweight in euro area high yield credit, dollar-denominated emerging market debt, and U.S. stocks. Previously, we favoured investment grade credit, but we are now shifting our focus towards fixed income investments where spreads have not yet tightened significantly. This adjustment reflects our commitment to maximizing returns in the evolving market conditions.

Market Definitions 101

Fiscal Policy

Fiscal policy refers to government actions regarding taxation and spending to influence a nation's economy.

Monetary Policy

Monetary policy involves central bank actions to regulate the money supply, interest rates, and credit to achieve economic goals.

Supply Side Policy

Supply-side policy focuses on stimulating economic growth by enhancing productivity and increasing the availability of goods and services.

Asset Class Views

Asset Class	Sub-Class	View (FY '24)	View (Mar '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 (FY '24)	View (Mar '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

Mar 20: FOMC Meeting

Mar 21: BoE Meeting

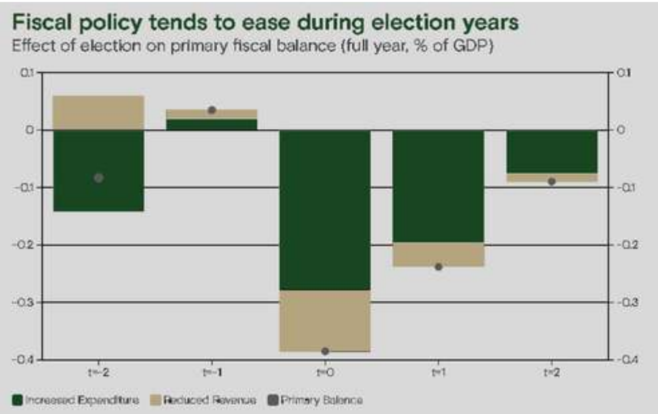
Apr 11: ECB Meeting

Apr 26: BoJ Meeting

Inflation's Thorny Grip: A Global Economic Balancing Act

Navigating the Tightrope Between Growth and Stability and NO QUICK CUTS

The latest inflation data has thrown a curveball at those hoping for a US Federal Reserve interest rate cut, with January 2024 seeing the Fed's preferred measure of underlying inflation spiking at its fastest rate in nearly a year. This surge highlights the ongoing struggle to rein in price pressures, despite a robust labour market, strong growth, and a resilient American consumer.



Similar challenges are being faced in other major economies. In Europe, inflation has moderated less than expected, prompting officials to tread cautiously on rate cuts. This cautious approach is mirrored globally, with central banks aiming to raise rates to combat inflation without stifling economic growth. The G20 finance chiefs have acknowledged this tightrope walk, expressing optimism about a soft landing for the global economy as inflation stabilizes, supported by a strong US economy and Chinese fiscal stimulus.

However, significant risks remain, including the spectre of deflation and escalating conflicts, particularly in the Middle East. Despite these challenges, it is crucial to reflect on the progress made in overcoming past hurdles, such as the pandemic and ongoing geopolitical tensions.

What is China upto ? Or Not ...

China's stimulus plans are under scrutiny from Wall Street economists, who doubt the country's ability to achieve its GDP target of around 5% this year without additional policy support. The implied target for the GDP deflator, a key measure of inflation, is set at 2.4%, which is considered overly ambitious. Insufficient fiscal stimulus could worsen the "debt-deflation loop" and increase equity market volatility.

Beijing's efforts to boost confidence seem contradictory to what's necessary to lift China out of deflation, especially considering the housing crisis and low consumer and corporate confidence. President Xi Jinping's strategy focuses on controlling debt levels and refraining from intervening to assist troubled property developers or financially strained consumers. Instead, the government is prioritizing supply-side measures to achieve industrial policy objectives and ensure self-sufficiency, particularly in light of tensions with the US.

However, this focus on supply could lead to a mismatch in supply and demand, potentially hampering China's nominal growth and putting downward pressure on corporate earnings.

The decline in China's benchmark yields to a new low indicates that investors believe Beijing's current measures are insufficient to stimulate the economy.

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