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Views from the desk

Monthly Global Market Overview and Outlook

Habib Investment Limited
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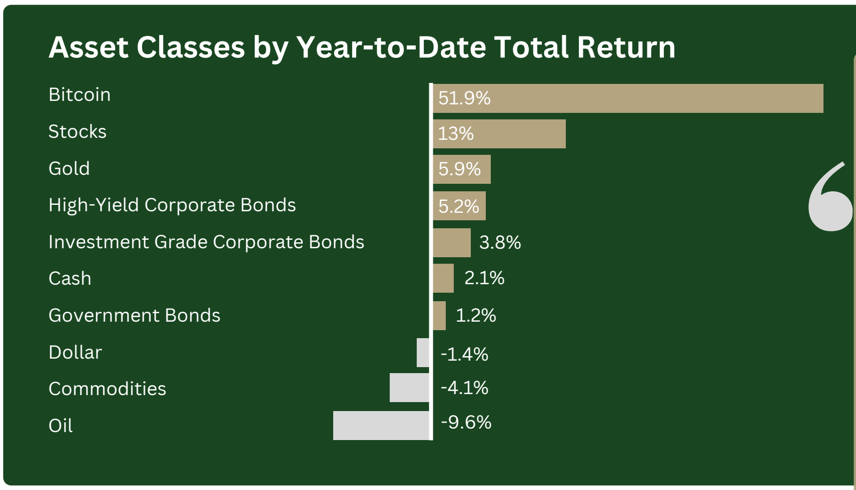
The tale of the Glitz of AI and the Gloom of Inflation

Good markets need good leadership & tech stocks were the main driver in exiting the 2022 bear market



Macro Overview

> *"The journey from Nillionaire to Millionaire can only be covered when literacy converges with access to opportunities."*
>
> **— Sandeep Jadwani | ACSI**
> **Head of Investment Advisory**

At the start of 2023, it seemed like another challenging year for the global economy, against the backdrop of heightened geopolitical tensions, the impact of elevated inflation levels on consumption and the tightening of financial conditions. The potential for an escalation of the war in Ukraine, concerns over China's intentions towards Taiwan and the intensification of the trade wars, were further risks faced by the economy.

Whilst many of these issues remain relevant, the political backdrop has been more stable than predicted and economic activity has been far more resilient than anticipated. Consumer spending has been supported by dynamic labour markets, healthy balance sheets and excess savings.

As we reach the midpoint of 2023, it's clear we are facing tremendous uncertainty and change. We are moving through a period of transition in the global economy, the financial markets and individual sectors.

And just like that, It's official! The S&P 500's longest bear market since the 1940s has come to an end. The benchmark index closed 4,294 on Thursday, 8th June, vaulting it back into bull territory with a 20% advance from its October low. The rally has been powered largely because of a handful of companies posting outsized gains, like Big Tech, Tesla and AI darling Nvidia.

There has also been somewhat of a resurgence in economic optimism, compared to the sentiment that plagued the market in 2022. After a decent, though uneven run for stocks since January, the stock market forecast for the next six months remains mildly bullish.

Good markets need good leadership & tech stocks were the main driver in exiting the 2022 bear market. In contrast to the highflying tech stocks, small caps have not excelled since the January rebound.

Certainly, this year's bull market has not seen a rapid rise off the lows. Maybe this is a reason why the stock market forecast for the remainder of 2023 lacks general enthusiasm. The resilience of growth hasn't led to market expectations of an extended period of higher interest rates. Instead, the debate in the bond market has been centered around how quickly rate cuts will be delivered. Consequently, we'd prefer to add caution to our holding and navigate the uncertainty as per below:

1. Any stock market forecast for the next six months should take into account the likelihood that rallies get overdone and sell-offs go too far. Certainly, market booms always carry some amount of investor hype.
2. We remain tactically overweight on equities but are positioned to transition to equal weight gradually.
3. Against this backdrop, we believe that investors should look to boost the resilience of equity portfolios by focusing on a combination of high-quality names, strong dividend payers and regional diversification.
4. Adding exposure to alternative asset classes, could provide a more defensive stance to portfolios, while delivering some inflation protection and attractive income.

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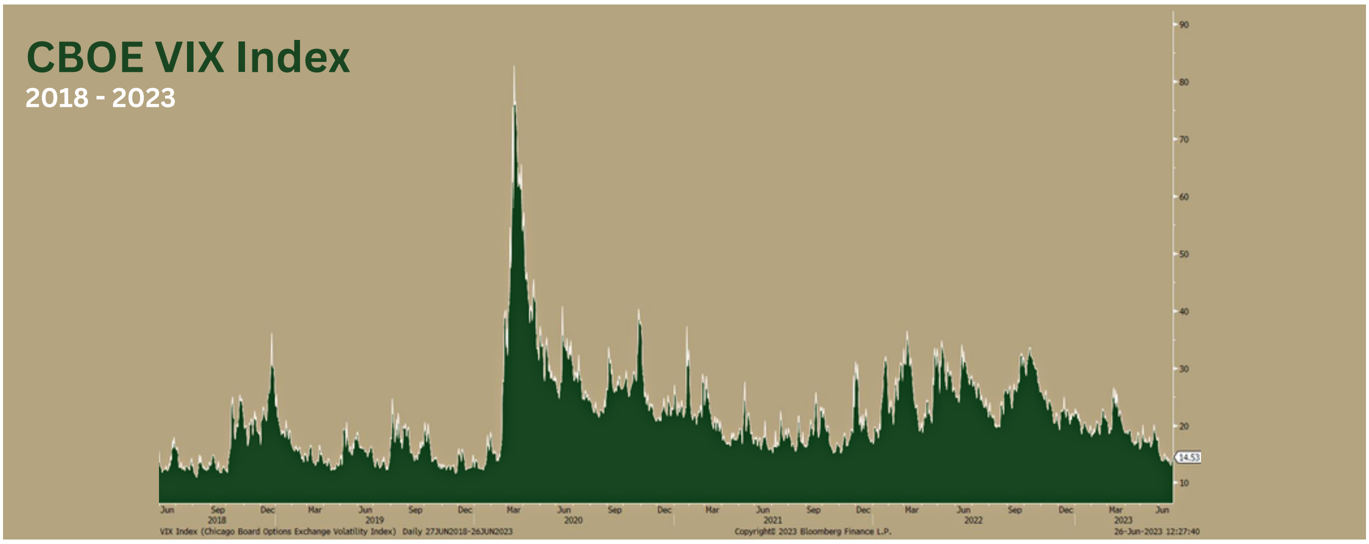
The calm before the Storm, and the rout after

The VIX index is at levels that shows investors are calm , but what lies ahead?



Global Outlook & Overview

The data released in June has given the recession argument a serious foothold and it is expected to continue. Gilt yields are already elevated, and have more potential to rally on recession fear relative to Bunds or to US Treasuries.

Taking data releases ahead, June saw flash PMI prints released for multiple regions including the US, UK, and Euro area, signalling continued **deceleration in global manufacturing**. In the US, the composite PMI decreased from 54.3 to 53.0, missing consensus expectations of 53.5. In Europe, the composite PMIs for the UK and Euro area decreased to 52.8 and 50.3, respectively, both also missing consensus expectations.

The US dollar remained relatively stable, appreciating 0.57% against a basket of currencies as investors digested Powell's hawkish forward guidance in his congressional testimony. Elsewhere, the euro and pound sterling weakened to $1.0892 and $1.2710, respectively, following persistent UK inflation prints.

Oil markets appear to have taken the events in Russia over the last several days in their stride with both Brent and WTI not spiraling down as rising interest rates and soft manufacturing activity suggested demand weakness. Specifically, the BoE’s higher-than-expected rate hike of 50 bps surprised investors and led to oil price decline. There appears to be no material threat to Russia’s oil production from the political unrest, leaving markets to remain focused on tighter central bank policies and a general slowdown in economic activity.

Major economies of the GCC are showing some resilience in the face of slower global activity with the non-oil sectors of the UAE and Saudi Arabia set to report strong levels of growth. OPEC+ has extended their production cuts until the end of 2024, meaning that the oil sector will remain a drag on growth.

For the US, A recession is likely to begin Q3 2023 due to the lagged impact of cumulative monetary policy tightening and headwinds to credit. Its now widely expected the Fed to hike in interest rate in July, with risk of an additional hike in November if incoming data are stronger than we anticipate. Despite near-term strength, we expect the labor market to weaken beginning Q3 2023 and a 5.4% unemployment rate by end-2024. Inflation should moderate over 2023, with risks balanced, given elevated wage inflation and headwinds to bank lending. Post-debt-ceiling treasury issuance has gone smoothly, but issuance will remain elevated amid continued risks of financial disruptions.

In the Eurozone, the euro area entered into a technical recession, although we see the worst as being behind us. While euro area inflation is likely to fall sharply in 2023, it should be well-above target for some time, and notably core inflation. Market participants expect one final 25bp hike in July, bringing the depo rate to a 3.75% peak, with cuts only from Q4 2024. The ECB announced full APP portfolio redemption roll-off from July 2023, after an average of €15bn per month from March to June 2023.

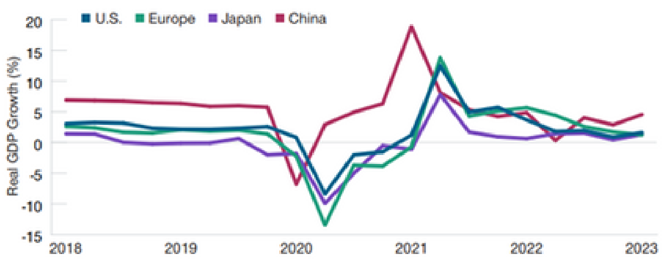
The UK has been a surprise, UK activity has proved more resilient than expected, lower energy prices and base effects should help cut inflation this year, though not back to target until 2024. We expect 25bp BOE hikes in August, September and November, with a terminal rate of 5.75%. We don't see cuts until Q4 2024. During 2023, we expect the BoE to allow c. £35bn of its balance sheet to roll-off, and for it to actively sell £40bn of gilts.

Japan is where the Sun is rising after 3 decades, Japan's recovery should continue, driven by consumption, capex and inbound tourism in 2023 and goods exports and capex in 2024. While core CPI inflation (less fresh food) will likely decline, it should gradually become stickier. The BOJ will likely tweak YCC in July 2023 or after with July being the most likely to enhance the sustainability of the policy.

Asia (Ex China) We expect weaker growth in Q2 2023, due to a deeper export and industrial downturn and an inventory destocking cycle, however, a better H2 for exports. It would be safe to expect investment and consumption demand to weaken due to lagged monetary policy effects, uncertainty and US recession spillovers. A turn in the tech cycle may improve the outlook for Northeast Asia, but we see India and ASEAN as the medium-term champions. Faster disinflation is still likely from Q2 2023, amid low wages and aided by lower commodity prices and weak growth since the rate hiking cycle is largely over. Largely, an extended pause and rate cuts in H2 2023 (BOK and RBI) is expected. India: As growth and inflation moderate, we expect an extended policy pause followed by 50bp of rate cuts to 6.00% by end-2023. Australia in the near term, could slide towards recession, as rate hikes bite. As inflation cools, rate cuts in Q1 2024 are anticipated.

Growth Has Slowed but Major Economies Are Not in Recession—Yet

(Fig. 1) Growth in real gross domestic product (GDP), year over year



As of March 31, 2023.
Sources: Haver Analytics/U.S. Bureau of Economic Analysis, Statistical Office of the European Communities, Cabinet Office of Japan, Japan Ministry of Internal Affairs and Communications, International Monetary Fund.

The opaqueness in China has led to analysts cutting their growth forecasts amid rising evidence that the post-Covid recovery has been rapidly losing steam. It is believed that sequential growth has already peaked in Q1 and could drop significantly in Q2. The property sector recovery seems to have stalled, while exports still face strong headwinds. Given weak growth and inflation, we expect the PBoC to cut benchmark lending rates in mid-June. That said, Beijing still has no appetite to launch a massive stimulus as it appears to be prioritizing national security over growth.

Here is when Bitcoin comes to the rescue, The price of bitcoin (BTCUSD) soared to its highest level this year, and is up almost 90%, as investors return to the largest cryptocurrency by market cap after a tumultuous 13 months for crypto markets that brought multiple bankruptcies and exchange failures. Bitcoin's price hit a year-to-date high above $31,000 Friday. BlackRock's ETF application has increased investor appetite for the cryptocurrency. The SEC also approved a two-times leveraged ETF that is slated to start trading 27th June 2023. In summary, H2 outlook will be supported by Business investment, and confidence, are expected to remain constrained by heightened economic uncertainty, rising wages and higher borrowing costs. Meanwhile, government spending is anticipated to be inhibited by high debt levels and limited fiscal headroom.

The recovery in emerging markets should help to partially offset the weakness in advanced economies, as they continue to benefit from pent-up demand, improving industrial production levels and strong secular growth. That said, weaker external demand and trade conflicts could slow growth prospects.

Turning to prospects for next year, GDP growth is anticipated to remain below trend, with the world economy predicted to expand by just 2.4%. The good news is that easing inflationary pressures and interest rate cuts should help to stabilise sentiment and allow activity to gradually improve in 2024.

Market Definitions 101

ESG: *Environmental, Social, Governance*

Article 6

Article 6 compliant funds lack a long-term investment goal and do not prioritize investing in assets that promote social or environmental benefits.

Article 8

Article 8 compliant funds are ones that promote environmental or social characteristics and focused on positive environmental or social impacts.

Article 9

Article 9 compliant funds seek to make a positive impact on society or the environment through sustainable investments. Typically a non-financial objective at the core of their offering.

Asset Class Views

Asset Class	Sub-Class	View (May'23)	View (Jun'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 (May'23)	View (Jun'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

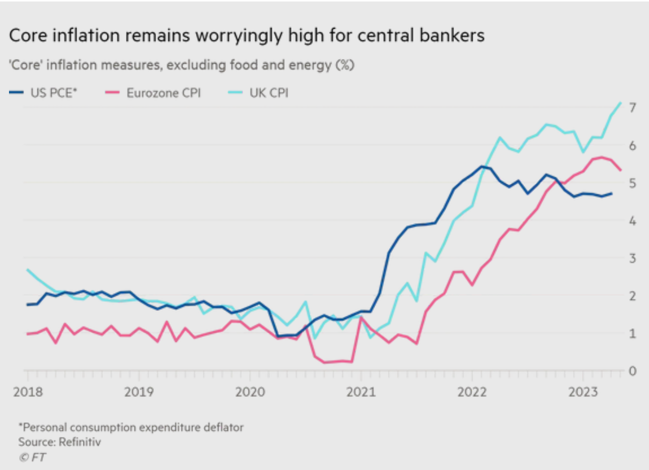
July 26: FOMC Meeting

Aug 3: BoE Meeting

July 27: ECB Meeting

Cracking DaVinci's code.

Rate cuts, hikes and pauses: The world's central banks just made very different decisions.



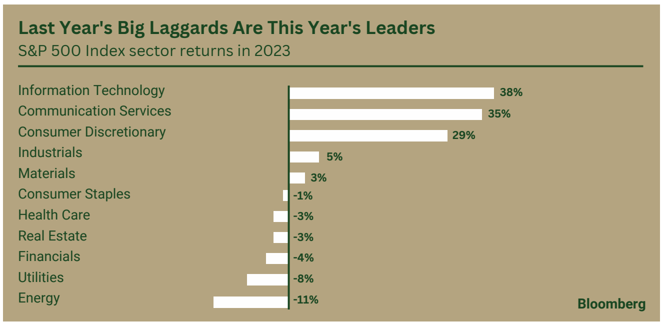
So that was it with June monetary policy decisions by the world's major central banks. The Federal Reserve paused, the European Central Bank met expectations, the Swiss National Bank hiked by less than priced in while the Bank of England and Norges Bank tightened by more than expected.

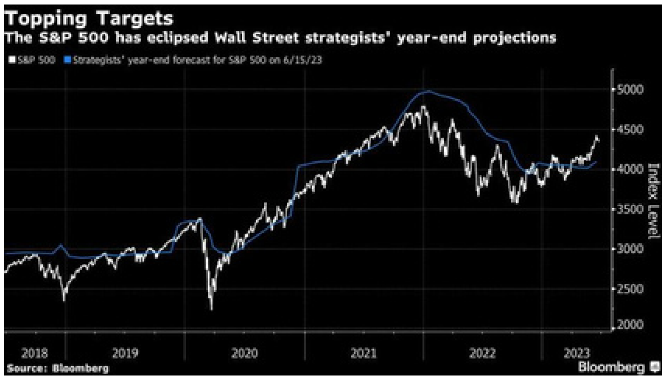
What we understand from price action in the past couple of sessions is that the currency market may be at the early stages of pricing in a multi-month pause from the Fed while pound bulls may be facing an unsolvable puzzle.

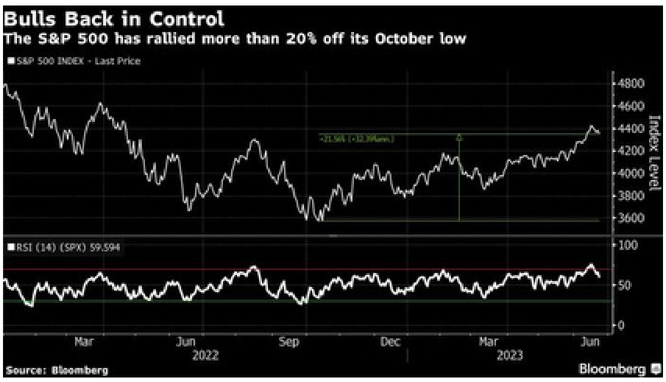
The Bloomberg Dollar Spot Index was heading for its narrowest weekly range since April until Thursday's London-New York crossover. Fed Chair Jerome Powell's comments that more hikes may be needed this year sent Treasury yields higher and the greenback followed suit as it enjoyed its best day in a month. His congressional testimony wasn't a game changer as it essentially went in line with guidance at the Fed's meeting last week.

But the more I think of it, the more it strikes a dovish tone to me. The uncertainty surrounding the time lag for policy adjustments to work their way through the real economy and his disinflationary comment on housing suggest that July is indeed a live meeting but the odds may be in favor of another pause — in contrast to money market pricing that assigns a 80% chance for a quarter-point hike. As he said, rates have been hiked to an appropriately restrictive level and further tightening will be needed if the economy performs about as expected.

It's all about data dependency right? Well, Bloomberg's Economic Surprise index stands at its strongest level in more than two years. Shouldn't the Fed be more resolute in tightening policy, given that it seems to have caused only minor cracks in the weakest links of the banking sector? We may have entered an era where it will take strong beats in tier-one data releases for the Fed to move again. Something tells me the Jackson Hole symposium in late August will be quite the interesting one.







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