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Habib  
Investment  
Limited

A photograph of a hand holding a black smartwatch. Overlaid on the image is a white line graph with several data points, showing an upward trend. To the right of the hand, there are three green squares of varying sizes arranged in a stepped pattern.

# Views from the desk

**Monthly Global Market  
Overview and Outlook**

Habib Investment Limited  
(Regulated by the Dubai Financial Services Authority)

# Market Overview

“The individual investor should act consistently as an investor and not as a speculator.”

- Sandeep.S.Jadwani (ASCI,CIB)  
Head Of Investment Advisory

At the start of the COVID pandemic, the US stock market plunged 34%. This was the strongest correction in more than a decade. Since the highs on the stock markets at the end of 2021, global indices have predominantly moved in one direction: down. But investors have not only suffered losses on the stock markets.

After more than a decade in which the ultra-expansionary monetary policy of global central banks has driven yields to historic lows, bond markets this year saw their worst losses in more than a century. Diversification through bond allocation has not provided protection at portfolio level this year. Quite the opposite. Bond losses have contributed significantly to losses at the portfolio level.

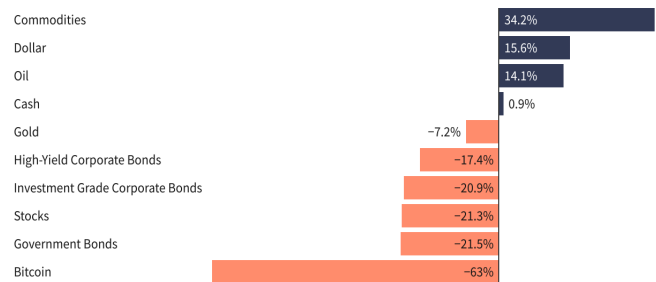
The midterm elections failed to produce the “Red Wave” that Republicans had hoped for on 8 November, as the Democrats outperformed the opinion polls leaving control of Congress hanging in the balance. Looking forward, it is likely to be a subdued year for the US economy, although the outlook looks brighter compared to its European counterparts. We expect activity to contract somewhat in the first three quarters, before recovering in the final three months of the year.

Eurozone & UK CPI numbers are still HOT and we can expect the rates to keep climbing with jumbo hikes, but there is a silver lining that they follow through in line with the US FED.



Graph 1

## Asset Classes by Year-to-Date Total Return



Source : Bank Of America Research (as on 12<sup>th</sup> November 2022)

The 10-year Treasury yield temporarily sank below 3.7%, and the spread between it and the 2-year yield continued to fall deeper into negative territory. That so called yield inversion is a warning of recession. We still think there's more downside risk for rates from here. The curve inversion 2s/10s is negative 67. That could get to negative 75 in the near term.

This earnings season has brought signs that rougher times are brewing, studded as it has been with profit warnings, job cuts and share-price volatility. Meantime, bonds keep making it clear that at least some investors are expecting that rate hikes are going to help deliver a very hard landing indeed.

# The oomph is in the PEAK

*Precisely as the FEDs indicated their path to monetary policy will be data driven, with inflation print at 7.7%, the market participants are expecting and pricing in a lower rate hike, with a lower Peak Rate*

As recent weeks have shown, even equity bear markets occasionally take a break. Indeed, investors found renewed confidence in positive earnings reports and hopes that the US Federal Reserve might soon slow or end interest rate hikes. As a result, the S&P 500 gained 11% between 14 October and 11 November. The recent Q3 2022 earnings season draws to a close with companies delivering “better-than-feared” results. As of 16 November, over 85% of the MSCI World companies have reported results, with the majority surprising to the upside on earnings. Blended Q3 2022 revenue and earnings per share (EPS) growth for the MSCI World are 15.1% and 12.8%, respectively. Of the MSCI World companies that have reported, 62% have surprised to the upside by +2.4% for earnings. At an index level (MSCI World), profit margins are at 10.5% (-34 bp QoQ, +3 bp YoY).

UK inflation reached a new 40-year high of 11.1% in October after rising 2.0% m/m, higher than forecast and up from September's 10.1%. Core CPI was unchanged at 6.5% y/y however, indicating that most the upside surprise was due to energy (24.7% m/m as the regulatory price cap rose) and food (16.2% y/y) costs. While many analysts believe that inflation may have now peaked, the data puts pressure on the Bank of England to maintain a faster-than-normal pace of rate hikes with a 50bp hike priced in for December.

All eyes will be on the Autumn budget statement today where Chancellor Hunt is expected to raise taxes and cut spending to plug a GBP 54bn budget hole over the next few years. Initial discussions in the ECB's governing council are leaning towards a 50bp hike at next month's meeting unless there is a surprise acceleration in inflation before then, according to reports by Bloomberg. The council is also weighing recession risks and the prospect of balance sheet reduction.

Given the uncertainties in the longer-term global macro outlook, investors are likely to require higher equity risk premia, putting pressure on equity multiples. In contrast, starting bond yields, which tend to be a good indicator of future returns, have increased significantly, implying attractive long-term return potential. Thus, over the secular horizon, fixed income should become structurally more attractive than equities, which have benefitted from a low rate environment for the last two decades.

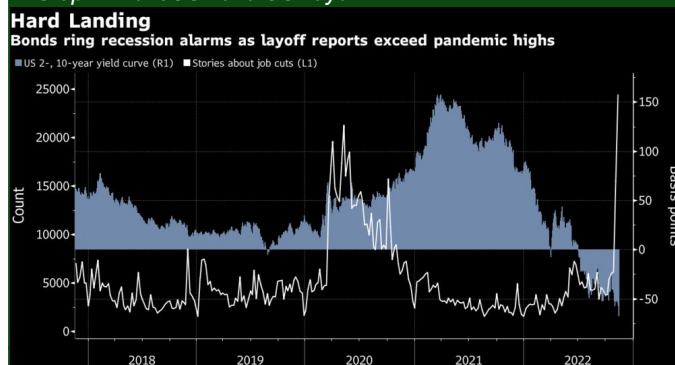
In Japan, wage negotiations appear headed toward larger hikes than in the past, but will likely fall short of levels needed to sustain 2% inflation. Any YCC revisions may also require changes to the monetary policy framework, including more flexible inflation targeting. Policy normalization faces other headwinds as well.

Meanwhile, the Chinese government has announced some adjustments to its zero-Covid-19 policy and, above all, a support package for the property sector to avoid a disorderly collapse.

Nifty rose sharply on Nov 11, hitting fresh 52 week highs, post the soft CPI data coming out of the US and closed at 18345.7. Nifty touched a 52 week high amid positive news flow on interest rate and murmurs about the endgame of Russia Ukraine conflict being closer.

We continue to expect the Fed to raise interest rates by 0.75% as on last month, followed by another 0.50% increase in December. Thereafter, while we may not hear the Fed talk about policy easing for some time, a shift to smaller hikes and then a pause may not be too far off if disinflationary forces continue to weigh more heavily on the data.

Graph 2: 2/10UST and US Layoff



Source : Bloomberg

# Asset Class Views

Asset Class	Sub-Class	View (Sep)	View (Oct)	Rationale
Main Asset Class	Equities	=	=	In broad terms, global equities require continued earnings growth to offset any further normalization of valuations. Earnings expectations remain elevated and vulnerable to downgrades. Tightening monetary policy has led to a rise in volatility, which offsets longer-term equity fundamentals that are still relatively supportive. We remain nimble in our level of conviction but continue to reflect mounting reasons for concern in a more defensive stance toward global equities relative to bonds.
	Fixed Income	= ▲	= ▲	Long-term valuations are fair, in our assessment, and monetary policy is still expected to tighten sharply. However, decelerating growth and heightened global uncertainties balance this view. Corporate bond spreads have risen sharply and largely reflect an anticipated increase from currently low default rates. We have moved to a more constructive view of bonds at the asset allocation level, at notably higher yields, reflecting the pace of rate hikes that is already discounted.
	Commodities	= ▲	= ▲	Commodities have remained the best-performing major asset class in 2022, bolstered by high inflation and supply disruptions. Yet, many individual commodities have had significant corrections since June. This, we believe, is due to concerns over a looming recession. We are not overly concerned, however, as supply imbalances remain a long-term positive for many commodity prices. After facing headwinds throughout 2022, primarily a strong U.S. dollar, year-end gold target range \$1,800–\$1,900.
	Currencies	= ▲	= ▲	We think interest rate differentials still support the greenback, especially against EUR and GBP, but the upward momentum may be slowing.
Equities	USA	=	=	We are underweight US equities. The Fed intends to raise rates into restrictive territory. The year-to-date selloff partly reflects this. Yet valuations have not come down enough to reflect weaker earnings prospects.
	EU (Ex UK)	▼	▼	In Europe, we continue to forecast a deeper recession compared to the economic slowdown expected in the United States. This is largely due to more problematic inflation tied to the ongoing energy crisis overseas that could very well worsen during the winter. The CPI in the eurozone surged 10.7% year-over-year in October, constituting a fresh record high and spurring the European Central Bank (ECB) to raise borrowing costs to the highest level in over a decade.
	UK	=	=	The domestic political chaos, uncertainty over fiscal policy and the near-miss of UK LDI systemic risk weighed on recent domestic performance. Nevertheless, a lot of the bad news has been priced in and a U-turn in policy has occurred. We remain concerned on the domestic consumer's health, yet the large cap index continues to benefit from its sector construct, rising yields and a weak currency.
	EM (Ex MENA)	=	=	While monetary and fiscal policies are becoming more supportive, China's near-term outlook is poor due to Covid, softer consumer sentiment and regulatory uncertainties. LatAm and certain ASEAN countries are seeing better activities and earnings outlooks. The strong dollar remains a headwind for EM. India is in a better position with policies and global co-operative partner.
	MENA	= ▲	=	Scaling of capital markets by divesting PSU, Range bound Oil prices, Rising USD IR and key structural reforms make GCC a key low beta, attractive return allocation.
Fixed Income	US Treasuries	= ▲	= ▲	CPI surprised to the upside making Fed's job even harder. There are signs of labour market slack appearing in the JOLTs data, and indications of caution from some Fed speakers and the FOMC minutes. But given that inflation remains the priority, we do not expect the pivot to come soon.
	Euro (Bunds)	▼	▼	With the energy disruptions worsening, recession risks stay high. Europe's fiscal response to the energy crisis is still unclear. We expect the ECB to under-deliver compared to the market's expectations for hikes because of the poor growth outlook.
	UK Gilts	▼	▼	We are underweight UK gilts following the UK government's fiscal splurge. The Bank of England will need to hike rates higher to rein in price pressures, and we believe the move raises serious questions about the UK's fiscal credibility.
	US IG	▲	= ▲	We have a neutral view of IG credit. High-quality IG credit can allow portfolios to generate excess yield through spread premium (also known as carry) that is meant to compensate investors for perceived issuer credit risk. Although credit spreads have widened and the attractiveness of investment grade corporates has increased somewhat, we still believe that the potential for further widening exists as the risks of an upcoming recession increase. We reiterate our bias toward selectivity.
	US HY	=	=	HY has attractive yields and strong fundamentals. However, default rates and rating migration could soon turn less positive and may not be fully compensated by spread levels.
	Europe IG	▼	▼	Our UW stance on EU IG remain as we derive alpha from the US or the EM counter parts and avoid a further aggressive draw down participation.
	EM	=	=	We remain neutral on EM sovereign debt denominated in dollars, but we believe that the outlook may brighten once inflation is seen to be falling back and once U.S. interest rates have peaked.

Asset Class	Sub-Class	View (Sep)	View (Oct)	Rationale
Commodities	Oil	= ^	=	Global supply disruption to support Oil whilst a sluggish demand and slowing economic activities put pressure on Oil. Supply reductions & winters to provide some support.
	Precious Metals	=	=	Heightened geopolitical risks amidst recessionary fears, US-China tension, Russia-Ukraine and market volatility to drive safe haven demand, however, strengthening USD could pull the metal down.
Currencies	USD	= ^	=	Bad news on inflation has resulted in good news on USD and any reversal will have an impact on the USD. USD remain the safe haven global currency.
	EUR	=	=	Weak economic outlook but technically overvalued USD and valuations can give an upside lift in the mid-term.
	GBP	=	=	Weak economic outlook, and anticipation of aggressive BOE rate hike until end of 2022.
	EM	=	=	Benign USD, compelling currency valuations, consolidating energy/commodity prices may support EM currencies.

## Market Definitions 101

### STRATEGIC ASSET ALLOCATION

Strategic Asset Allocation (SSA) is a long-term portfolio investment strategy whereby investors maintain a fixed proportion of assets in their portfolio by rebalancing it at regular intervals. This strategy enables investors to attain their financial goals by balancing risk and returns through a diversified portfolio.

### TACTICAL ASSET ALLOCATION

Tactical Asset Allocation (TAA) strategy takes a more active approach that responds to changing market conditions. Although one may have a long-term strategy in place, regularly make changes along the way for short-term returns. With a tactical asset allocation, the goal is to maximize your portfolio's performance on an opportunistic basis.

### REBALANCING

Rebalancing of investments is a strategy of bringing a portfolio that has deviated away from one's target asset allocation back into line. This can be implemented by selling investments of an asset class that is overweight and using the money to buy investments in a class that is underweight, but it also applies to adding or removing money from a portfolio.



# FTX : The Madoff and Lehman Moment

## Crypto's Most Urgent Question: Where Will FTX's Aftershock Be Felt?

Digital assets have also had an eventful last few week, but not in a good way. The crypto industry is still reeling from last week's shocking death spiral of digital currency exchange FTX. The company's bankruptcy filing has left financial backers in the lurch — including the usual suspects in Silicon Valley, from Masayoshi Son's SoftBank to VC firm Sequoi FTX is systemically relevant in the digital asset ecosystem, as it was the second-largest exchange in the sector behind Binance.

Interestingly, digital assets and technology stocks (measured by the Nasdaq index) almost traded in lockstep during the 2022 downturn, which is consistent with the idea that investing in crypto is akin to holding a high-beta technology stock, but recently this has started to reverse, as shown in our chart of the week.

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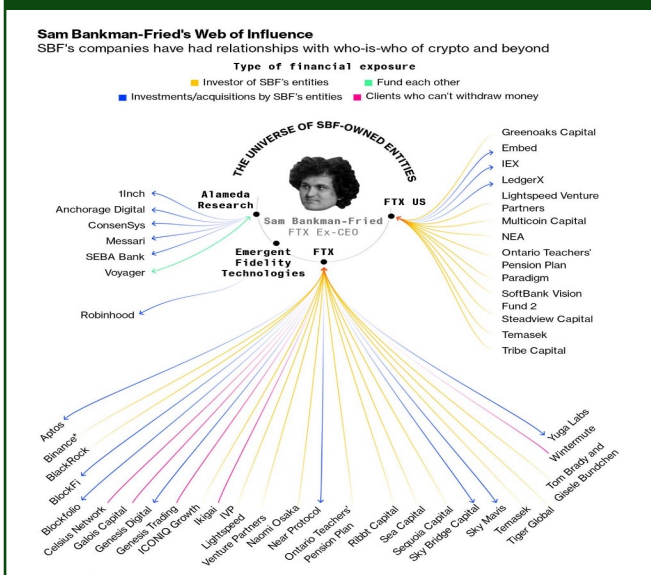
*FTX's new CEO John J. Ray remarked in its filing on Thursday that “never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here.”*

The events that led to the filing for bankruptcy protection at FTX are slowly coming to light, allowing us to understand how similar the situation that digital assets are facing is to that of the financial system in 2008, whose crisis culminated in the bankruptcy of Lehman Brothers. Ironically, digital assets were precisely born out of the idea that governments and the international financial system are not trustworthy. In other words, assets encrypted on a blockchain were precisely intended to annihilate counterparty risk. The only good news at this point is that the basic principle is not in question.

As wealth managers, we adhere to a multi-year investment horizon, and we know that we add value for our clients by making fewer mistakes than the average. We are therefore conservative by design but at the same time, aware that capitalism involves creative destruction, with new innovations replacing existing products and services. We are therefore not only conservative but also careful not to end up as an exhibit in a museum, having missed a major innovative trend. As a result of these principles, we systematically underestimate the cycle of greed and fear of third-party actors.

Investors who hold their digital assets on a decentralized personal wallet to which they alone hold the keys can remain serene. On the other hand, those who held cash or tokens on FTX are facing a long liquidation process with little prospect of recovering a significant portion of their assets given the figures revealed on the assets and debts of FTX and its affiliates. We are talking about a shortfall of some USD 8 billion and a million customers trapped in this Bahamas-based operator. Is this crisis the death knell for digital assets? What conclusions can we draw?

Graph 4



Source: Bloomberg

Note: \* Exited FTX stake in 2021

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