Mashreq Capital

Market Outlook and Strategy

Q4 2023

Fixed Income

MARKET OVERVIEW

BULLS OR BEARS

US Treasury yields spiked during 3Q23 on the back of strong economic data which fueled expectations of rates remaining higher for longer. The long end of the curve witnessed the largest increases as the treasury curve bear steepened.

DEVELOPED MARKET FIXED INCOME

Sovereign bond yields increased across the major developed economies as concerns over the resurgence of inflation and rising Japanese yields grabbed attention. US HY bonds outperformed IG due to the former's shorter duration.

EMERGING MARKET FIXED INCOME

Rising yields weighed heavily on EM bonds, with the EM sovereign and the EM corporate index delivering a return for 3Q23 of -2.23% and -0.26% respectively. However, spreads tightened during the quarter, particularly within the HY space on the back of positive developments in weaker-rated sovereigns such as Turkey, Nigeria, and Egypt.

GCC FIXED INCOME

GCC bonds continued to lag the EM space with investors preferring HY names over IG, supply in the region also remained high during 3Q23. JPM's GCC index declined by -2.37% during 3Q23 which took the YTD performance into negative territory as well (index lost 0.18% YTD).

NORTH AFRICA AND TURKEY

Turkey outperformed due to their efforts towards policy normalization and improved investor sentiments.

MARKET WATCH

Yields (%)	09/29/23	12/30/22
3-Month USD Libor	5.66%	4.77%
US Treasuries 2-Year	5.04%	4.43%
US Treasuries 10-Year	4.57%	3.87%
US Treasuries 30-Year	4.70%	3.96%
German Bunds 10-Year	2.84%	2.57%
Spreads (bps)	**09/29/23**	**12/30/22**
DM IG Corporates	120	130
DM HY Corporates	395	468
EM USD Sovereigns	431	453
EM USD Corporates	329	346
Returns (%)	**QTD**	**YTD**
EM USD Sovereigns	(2.23%)	1.76%
EM Local Sovereigns	(3.65%)	3.72%
EM USD Corporates	(0.26%)	3.38%
Middle East Composite	(2.37%)	(0.18%)
Sukuk	(0.59%)	1.80%

*EM USD Sovereigns= JPM EMBI Global Diversified Index, EM Local Sovereigns= JPM GBI- EM Global Diversified Index, EM USD Corporates= JPM CEMBI Diversified Index, Middle East Composite= JPM MECI Index, Sukuk= FTSE Sukuk Index

MARKET OUTLOOK

SUMMARY

We expect US yields to continue along the 'higher for longer' path with economic data releases and market technicals adding to the volatility. However, once the economic growth slows down due to elevated rates, we are likely to witness a rally in USD bonds. Absolute yields on EM bonds are offering an attractive entry point for investors.

GROWTH

We expect global growth to continue to slow down as major DM economies are struggling to contain inflation which would keep interest rates high. China's economic recovery has been slower than expected which is an important contributor to keeping EM growth in check.

MONETARY POLICY

Sticky inflation is expected to keep the central banks on their toes and unless significant weakening is witnessed, we do not expect global central banks to cut rates.

SENTIMENT

We expect sentiment to remain negative for fixed income in the near term. Nevertheless, cheap valuations, and potential softness in the US economy could boost bonds going into 2024.

VALUATIONS

We find current valuations attractive for both EM sovereigns and corporate bonds indicated by their high absolute yields versus past 3 years. We see value in both IG and HY bonds especially at the belly of the curve.

ASSET CLASS VIEWS

	Under Weight	Neutral	Over Weight
DM Sovereigns		●	
DM IG Corporates		●	
DM HY Corporates	●		
EM USD Sovereigns	●		
EM Local Sovereigns		●	
EM USD Corporates	●		
GCC			●
North Africa & Turkey	●		

Equity

MARKET OVERVIEW

The FED's action continued to be the focus for investors during the quarter as inflation cooled. The most recent September non – farm payrolls number came well ahead of market consensus, pushing yields higher. Higher oil prices coupled with concerns of global slowdown weighed down markets despite the US economy showing significant resilience. The S&P500 Index returned -3.27%, the NASDAQ 100 Index returned -2.86%, Euro Stoxx 50 posted a return of -4.83%, and MSCI Emerging Markets Index posted a total return of -2.85%. The SPACPUX Index posted a total return of -1.35% for the quarter.

DM EQUITIES

Despite a strong performance during Q2 2023, the narrative for developed markets during the quarter was weak, given a wide array of headwinds; expectations of high rates for longer periods of time, rising geopolitical tensions and elevated oil prices. The latest US non-farm payroll report indicates that the US economy is robust. However, valuations remain elevated in the US – trading at a premium of 20% vs. 10Y average, despite a pullback during Q2.

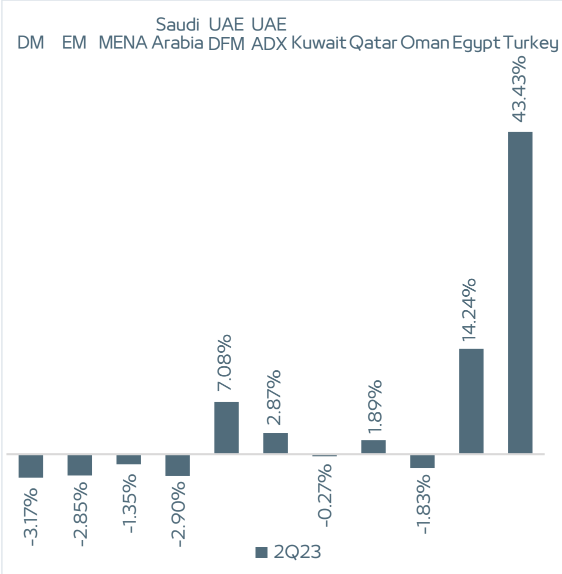
EM EQUITIES

EM equities underperformed DM equities by a large margin; YTD EM equities were only up +2.07% (vs. +13.06% for SPX Index and +35.37% for NASDAQ 100 Index). The valuations of the MSCI EM Index was approximately 1 standard deviation below the 10Y historical average, putting the asset class into marginally cheap territory. However, a strong dollar and elevated oil prices could add pressure on EMs.

MENA EQUITIES

The sentiment was muted in MENA equities, as they picked up cues from developed markets. The YTD performance of the SPACPUX was -1.24%, significantly underperforming other DM markets. During the quarter, DFM increased +7.08%, and the ADX increased +2.87%, while TASI declined -2.90%. Dubai's exceptional performance was driven by EMAAR, ENBD, and GULFNAV .

PERFORMANCE OF KEY MARKETS



*Figures in USD, Total Return basis, Actual returns.

MARKET OUTLOOK

The FED raised rates by 25 bps in July followed by a pause at the September meeting. With the most recent job print, investors now anticipate another rate hike in November. As mentioned previously, the path of inflation and unemployment will inform FED actions going forward. News around these topics should drive the direction of markets. Inflation ticked up slightly in August to 3.7% hinged on higher energy prices, while unemployment is running at decade lows. We still continue to believe that a slowdown is imminent, but the timing and magnitude continues to be a point of debate.

DM AND EM EQUITIES

We remain cautious for Q4 2023 due to rising geopolitical risks and the increased probability of a recession in the US. This argues for a continued focus on resilience in equity allocations. Inflation continues to remain elevated in DM economies; while US is the only economy that is running a positive real rate. Emerging markets are likely to face a more difficult period, as the dollar strengthens and crude oil prices remains elevated above >$85.

MENA EQUITIES

Any weakness in DM markets is likely to be felt in MENA markets despite favorable growth dynamics in the region. Accordingly, we position defensively in the region. However, we continue to remain constructive on the growth outlook for the MENA region driven by the energy capacity addition story in Saudi Arabia, Qatar, and Abu Dhabi. We continue to favor bottom up domestic demand and infrastructure plays in our favored markets.

ASSET CLASS VIEWS

	Under Weight	Neutral	Over Weight
DM Equities	●	○	○
EM Equities	●	○	○
MENA Equities	●	○	○

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CAPITAL

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