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MACRO & MARKETS: GLOBAL & GCC

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April 2024 turned out to be a sour month for global markets, especially the S&P 500 index, which tanked 4.2%. It is also the first negative month so far in 2024, probably setting a new trend with a confusing macro back drop. In the past Fed rate hikes since the 1950's, markets have always reacted negatively as high interest rates tend to affect business operations, borrowing, investments, etc. However, this time around, despite Fed jacking up rates from zero to 5.25% between 2020 and now, markets kept marching ahead on the back of a strong U.S. economy, low unemployment, and record stimulus. Many believe that the record stimulus unleashed by the U.S. post-Covid is still working through the system and may be behind the continuous rise of S&P 500, Gold, Bitcoin et all.

While the economic growth number in the US is still looking good (above trend GDP growth), labor market tightness seems to be slightly giving in with a lower number of jobs created in April'24 than in March'24. However, this can also just be a false indication, given the fact that labor market strength is not a recent phenomenon. The Fed decided to hold rates steady with eyes firmly on containing inflation, some parts of which continue to be sticky, especially the services-led inflation. From an ambitious 7 cuts expected at the beginning of the year, people will be dancing if they get 2 cuts in 2024. Some are even arguing for no cuts in 2024.

These dithering views are reflected in the bond yields where the 10Y treasury's range of volatility has widened during recent times. At some point, experts pointed for yield to hit 5% though it is now at 4.5%. The question is - from here where does it go? Obviously, with the Fed pivoting at some point in future, yields should also plummet. Falling yields will be good for bond investors, but as they say, markets can remain irrational for longer than what investors can hold. The same applies to treasury yields where options can range from 4% to 5%. For now, markets predict 2 cuts of 25 bps starting somewhere in September 2024. Let us see.

The magnificent 7 stocks (except Tesla) still drive S&P 500 on the back of AI optimism. Even among M7 stocks, Nvidia has a clear lead with a staggering YTD of 80% on the back of 240% return in 2023 for its stock price. Earnings growth at 10% for overall market for 2024/2025 should justify the rise in the index but the p/e for S&P500 being very close to +1 standard deviation above mean looks worrisome. To sustain this level, earnings growth should come in higher, or stimulus from the Fed towards increasing liquidity should continue to pour. The latter looks a little unrealistic while the former also looks difficult given the high financing conditions.

Japan's TOPIX is also partying hard with YTD returns of 15% on the back of 25% returns in 2023. At the center of this rise is the currency fall of Yen, which has briefly touched 160 (remember it was 100 a few years ago). The Yen weakness is unprecedented indeed where the Yen has fallen to a 34 year low against the USD. While this is bad news for imports, it certainly is good news for Japan's exports and hence the dilemma. Japan's economy is both exports and

imports driven and hence Bank of Japan has reluctantly intervened in the market to prop up the currency, which did work for a while. Amidst this great Yen fall, tourism to Japan is booming as Europeans, Australians and Chinese find it very affordable to sight-see Japan.

Corporate issuances from both Investment Grade and High yield picked up smartly from their recent lows, supported by strong capital markets and expected rate cuts. While yield spread continues to be the tightest ever, there are some anomalies and therefore opportunities noticed. For e.g., the US Corporate High Yield index spread to treasuries is at 3.4% while the EM Sovereign bond index spread is 0! No reward for the additional risk!

REITs are performing poorly as an asset class with YTD returns of -8%. However, the Commercial RE segment is down nearly 11% and mixed use at -13.8%. High mortgage rates, high residential prices, low occupancy, and reluctance of employees to move away from work-from-home are some of the defining themes within the sector. It will be interesting to note how the office segment performs from this point forward. If work from home takes a strong structural root, then the loss in the office segment can lead to a gain in the residential segment. But with residential prices where they are, affordability becomes a key question especially at current mortgage rates. Many homeowners who have locked-in at low rates will be reluctant to sell in this high-rate environment, which explains the tight supply in the segment.

GCC markets sometimes take cue from high oil prices, but many times choose to ignore it as well. Strong oil prices need not be an outcome of the orchestrated supply cuts by OPEC+ but can also be triggered by geopolitics. However, the narrative that high interest rates will ultimately bite economic growth is taking hold now more than supply tightness. Oil at $83/bbl. reflects these goldilocks scenario where geopolitical uncertainty in the Middle East and OPEC+ triggered production cuts will define the floor (at about $80/barrel) while the much-awaited US recession as well the Shale button at the hands of U.S. provides the ceiling (at $100/bbl.). Hence, Oil will gyrate between $80-$90/bbl. for some time now.

The GCC composite index is mildly negative for the year after clocking 6.2% in 2023. Earnings season has started and results coming in so far seem mixed. Aldar Properties announced 81% Q1-24 y/y growth over a similar period last year while SABIC reported earnings drop of 62% for a similar period. Hence, there is wide variation observed among blue chip stocks. Kuwait is the top performer in 2024 with YTD return of 5.5%, followed by Saudi Arabia at 3.5%. However, Qatar struggles at the bottom of the table with a loss of 10% after a meekly performance of 1.4% in 2023. Natural gas prices at $2.1/MMBtu have seen one full circle post covid and can explain the reason for Qatar's underperformance.

GCC contract awards continue to be skewed towards Saudi Araia and UAE. Saudi Arabia awarded contracts worth $24 billion while

UAE awarded roughly $11 billion in Q1 2024. Apart from these two markets, we notice good traction in Qatar and Oman while Kuwait and Bahrain lag.

Looking ahead, higher for longer will certainly bite companies and therefore stock markets. However, there is no visible sign of this so far for the US and other developed markets. For GCC markets, oil prices will be a key determinant. Signs of US slow down along with China slowdown can keep the oil price in check barring any major geopolitical developments.

Marmore's recent research analyzing the Net Interest Margins for Saudi Arabia and Kuwait Banks provides an excellent connect between interest rate cycles and NIM behavior.

Asset Class	Close	Returns	
		YTD-24	2023
Global Equities			
Global (MSCI World)	3,305	4.3%	21.8%
USA (S&P 500)	5,036	5.6%	24.2%
Japan (TOPIX)	2,743	15.9%	25.1%
GCC Equities			
GCC (S&P GCC Composite)	147	-0.5%	6.2%
Saudi Arabia (TASI)	12,395	3.6%	14.2%
Abu Dhabi (FTSE ADX General Index)	9,067	-5.3%	-6.2%
Dubai (DFM General Index)	4,156	2.4%	21.7%
Kuwait (Boursa Kuwait All Share TR)	9,433	5.5%	-3.1%
Commodities			
Oil (Brent Crude in USD/bbl.)	87.9	14.0%	-10.3%
Gold (in USD/oz.)	2,286	10.8%	13.1%

Fixed Income	Yields	
	Apr-24	2023-end
U.S. Treasury 10Y Sov.	4.68%	3.87%
Saudi Arabia 10Y Sov.	5.32%	4.39%
Abu Dhabi 10Y Sov.	5.19%	4.32%
Kuwait 10Y Sov.	5.29%	4.34%

Source: Refinitiv, YTD and Yields as of April 30, 2024

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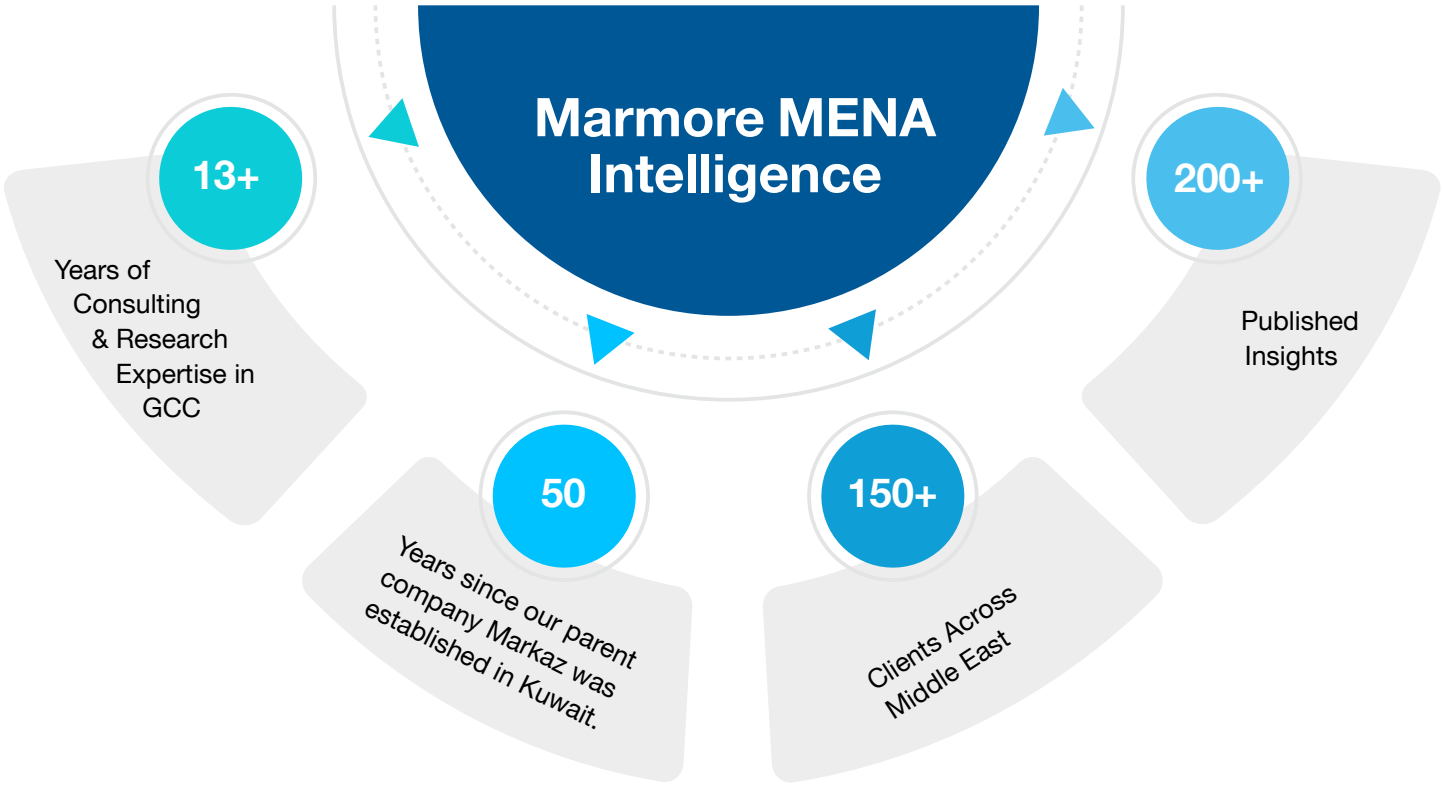

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