The Weekly Market View

August 7 2023

ADCB ASSET MANAGEMENT LIMITED

Downgrade doldrum

Global markets kick started the month of August on a subdued note as markets were caught off guard by the surprise rating downgrade of the US sovereign rating, sharp rally in UST yields and jobs report. The week started with Fitch Ratings agency surprising the markets by downgrading the sovereign rating of U.S. government debt from "AAA" to "AA+", citing "governance and medium-term fiscal challenges." In economic data, focus was on the two key labor market releases. ADP private payrolls rose more than expected but slowed to 324k in July from 455k in June. Toward the end of the week, the much-awaited non-farm payrolls report indicated that 187k jobs were added in July, almost similar to June's revised number of 185k, but lower than consensus estimate of 200K increase. More importantly, average hourly earnings rose faster than expected by 0.4% m-o-m and 4.4% y-o-y and the unemployment rate dropped to 3.5% from 3.6%. Overall jobs data pointed to continued resilience in the labor market. In Europe, 2Q preliminary GDP data showed that economic activity picked up as GDP rose at a better-than-expected rate of 0.3% m-o-m. Meanwhile, Eurozone headline inflation declined in July, rising by 5.3% y-o-y vs 5.5% y-o-y in June but core inflation was unchanged at 5.5%. In the UK, the Bank of England raised interest rates by 25bp to 5.25%, the highest level since February 2008. The central bank acknowledged the recent mixed economic data but stressed that interest rates will remain elevated. Bond market volatility jumped last week amidst the recent Fitch downgrade of US sovereign debt, US treasury announcing an increase in bond supply while markets again tested the BoJ's latest monetary policy flexibility of the YCC policy. The 10Y UST yields rose to a nine-month high of c4.20% before consolidating at near 4% level post the jobs report. Global equities recorded losses amidst rising bond yields while USD shined, strengthening against the major currencies.

Déjà vu?

Fitch ratings downgrade of US sovereign debt brought back memories of the S&P ratings downgrade in 2011 and the sell-off it triggered. We believe the recent downgrade- which did negatively impact the sentiment to some extent- is unlikely to have any material impact on the financial markets. Fitch ratings downgrade on US sovereign debt only underlines the long-term structural problems of ballooning US fiscal debt which are not new. US total government debt as a share of GDP has more than doubled over the past 20 years, reaching record high of 130% of GDP in 2020 before declining to 118% of GDP in 2023. In fact, US public debt levels have been higher than the average debt levels of "AAA" rated countries. Also, given the recent rise in interest rates, US net interest payments as share of GDP are currently at the highest level since the late 1990s. In the long-term- US needs to address the rising debt levels but we are unlikely to witness a fiscal pull-back before 2025 when the debt ceiling deal expires. We believe the impact on global fixed income is likely to be short-lived. The role of US Treasury market remains intact as the world's deepest and most liquid bond market despite being rated as "AA+" by two rating agencies. It may be appear that last week's rally in UST yields was solely on account of Fitch ratings downgrade but it was in fact, a combined reaction to other developments. This included 1) US Treasury announcing a larger-than expected issuance to offset the decline in issuance during the debt-ceiling stand-off 2) upbeat private payrolls report and 3) BoJ's new flexibility in its YCC policy putting upward pressure on JGB yields. In fact, we believe that there will be limited upside in long-term UST yields from current levels given the soft landing prospects and current late phase of central bank tightening cycle. In equity markets, the rating downgrade also triggered a pullback. However, we do not expect equities to witness similar declines seen post the S&P ratings downgrade in 2011 as macro-economic backdrop scores different compared to the 2011 episode. Growth and economic activity remains strong in the US with low employment levels and positive risk sentiment compared to 2011 when growth was slowing, unemployment was high and investor sentiment was weak with debt limit uncertainty still hanging.

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Global markets' performance snapshot

Index Snapshot (World Indices)*

Index	Latest	Weekly %	YTD %
S&P 500	4,478	-2.27	16.63
Dow Jones	35,066	-1.11	5.79
Nasdaq	13,909	-2.85	32.89
DAX	15,952	-3.14	14.57
Nikkei 225	32,193	-1.73	23.36
FTSE 100	7,564	-1.69	1.51
Sensex	65,721	-0.66	8.02
Hang Seng	19,539	-1.89	-1.31
Regional Markets			
ADX	9,786	0.26	-4.16
DFM	4,083	1.15	22.39
Tadawul**	11,376	-3.98	8.33
DSM**	10,799	-0.88	1.31
MSM30**	4,783	0.07	-2.01
BHSE**	1,982	-0.50	4.56
KWSE**	7,145	-1.63	-1.86
MSCI			
MSCI World	2,987	-2.33	14.75
MSCI EM	1,018	-2.41	6.45

Global Commodities, Currencies and Rates*

Commodity	Latest	Weekly %	YTD %
ICE Brent USD/bbl	86.2	1.47	0.33
Nymex WTI USD/bbl	82.8	2.78	3.14
Gold USD/t oz	1,942.9	-0.85	6.44
Silver USD/t oz	23.6	-2.92	-1.60
Platinum USD/t oz	926.0	-1.35	-13.33
Copper USD/MT	8,450.5	-1.65	0.76
Alluminium	2,190.3	-0.33	-6.78
Currencies			
EUR USD	1.10	-0.09	2.77
GBP USD	1.27	-0.79	5.47
USD JPY	141.76	0.43	7.65
Rates	**Latest**	**Weekly (bp)**	**YTD(bp)**
SOFR	5.30	0.00	100.00
UAE Eibor 3m	5.46	40.05	114.30
UAE Eibor 12m	5.39	-20.80	28.77
US 3m Bills	5.40	-1.22	105.36
US 10yr Treasury	4.03	8.31	15.90
German 10yr Bund	2.56	6.80	-0.60
UK 10yr Gilt	4.38	5.54	71.13

Source: Bloomberg, and ADCB Asset Management
Notes: Notes: *Data as of August 4 2023 unless stated otherwise; **Data as of August 3 2023

Summary market outlook

Global Yields	Yields on 10Y USTs rose for a third week in a row on upbeat private payroll report, Treasury increasing the bond issuance and Fitch ratings downgrade. 2Y UST yields declined with the 10-2Y UST curve steepening. German 10YR bunds and UK10YR gilts rose over the week. 10YR JGB bond yields increased as well. Bond yields and prices are inversely correlated. i.e. yields rise when prices fall and vice versa. Overall, we maintain our slight duration exposure with preference for USTs (7-10Y segment) over other DM sovereigns.
Stress and Risk Indicators	VIX index (measure of implied volatility in equities) increased over the week. MOVE Index (measure of bond volatility) rose over the week as well. We expect recession probabilities and uncertainty around the timing of the first rate cut from the Fed to feed into financial market volatility
Equity Markets	
Local Equity Markets	Most GCC equity markets declined with the exception of UAE stocks which gained on the back of solid corporate earnings and strong oil prices. Saudi declined on weak banking sector performance. We stay neutral GCC equities within our global equity framework. Stable oil prices, potential for revival in growth prospects, and scope for reversing the underperformance of the past several years are all balanced by lack of structural growth plays in the equity market indices. We would look to play benchmark transformation over next years.
Global Equity Markets	Global equities declined last week as markets digested the surprise Fitch ratings downgrade, mixed corporate earnings, rally in UST yields and US jobs report. EM equities underperformed DM equities. Within DM, Europe and UK were the worst performers while Japan outperformed peers. We are overweight North America, and Asia Pacific; underweight EMs outside Asia and significantly underweight Europe. Our strategic preference is for large cap non-cyclical growth with focus on quality. We prefer Japanese equity exposure through local indices in local currency terms. Our other high conviction ideas include HK equities and Chinese hotels & leisure (beneficiaries of the post-pandemic reopening of the Chinese economy), and Cybersecurity and Chinese Semiconductors (play on rising deglobalisation risks and national security prominence). For long-term investors, we have identified 13 different themes to play disruptive trends in the global economy.
Technology Segments	Nasdaq-100 index declined 3% while HK Tech index rose 0.52% over the week.
Commodities	
Precious Metals	Gold, silver and platinum declined weighed down by a stronger dollar. We prefer gold as a hedge against potential inflation, growth, and geopolitical risks.
Energy	Oil prices rose for a sixth consecutive week, after Saudi and Russia extended supply cuts through September. Over the near-term to medium-term, we expect oil prices to move sideways but with significant volatility.
Industrial Metals	Industrial metal prices declined with Copper declining more than aluminum, particularly during the latter half of the week on China economic activity concerns. Dollar strength added to the weakness. Another commodity super-cycle is difficult, yet demand for commodities linked to “green infrastructure” is likely to sustain. We prefer copper for the near-term.
Currencies	
EURUSD	The EUR weakened versus the USD for the second week in a row. We expect euro to stabilize and record a better performance in 2023 compared to 2022.
Critical levels	R2 1.1038 · R1 1.1002 · S1 1.0948 · S2 1.0930
GBPUSD	The GBP/USD declined over week despite the BoE signaling an aggressive stance. We expect GBP to strengthen versus the USD with the BoE likely to remain the most hawkish of the lot.
Critical levels	R2 1.2785 · R1 1.2754 · S1 1.2702 · S2 1.2681
USDJPY	JPY weakened versus the USD on account of broad USD strength. Yen is likely to remain weak in the near-term in absence of hawkish BoJ bias, but could strengthen once the Fed takes a dovish turn.
Critical levels	R2 143.05 · R1 142.72 · S1 141.79 · S2 141.19

Forthcoming important economic data/events

United States

Date & Time (GST)	Indicator	Period	Expected	Prior
08/08/2023 14:00	NFIB Small Business Optimism	Jul	--	91
08/08/2023 18:00	Wholesale Inventories MoM	Jun F	--	-0.30%
08/09/2023 15:00	MBA Mortgage Applications	4-Aug	--	-3.00%
08/10/2023 16:30	CPI MoM	Jul	0.20%	0.20%
08/10/2023 16:30	CPI Ex Food and Energy MoM	Jul	0.20%	0.20%
08/10/2023 16:30	**CPI YoY**	**Jul**	**3.20%**	**3.00%**
08/10/2023 16:30	**CPI Ex Food and Energy YoY**	**Jul**	**4.80%**	**4.80%**
08/10/2023 16:30	**CPI Index NSA**	**Jul**	**305.835**	**305.109**
08/10/2023 16:30	CPI Core Index SA	Jul	--	308.309
08/10/2023 16:30	Real Avg Hourly Earning YoY	Jul	--	1.20%
08/10/2023 16:30	Initial Jobless Claims	5-Aug	--	--
08/10/2023 16:30	Continuing Claims	29-Jul	--	--
08/11/2023 16:30	**PPI Final Demand MoM**	**Jul**	**0.20%**	**0.10%**
08/11/2023 16:30	**PPI Ex Food and Energy MoM**	**Jul**	**0.20%**	**0.10%**
08/11/2023 16:30	**PPI Final Demand YoY**	**Jul**	**--**	**0.10%**
08/11/2023 16:30	**PPI Ex Food and Energy YoY**	**Jul**	**--**	**2.40%**
08/11/2023 18:00	**U. of Mich. Sentiment**	**Aug P**	**--**	**71.6**
08/11/2023 18:00	U. of Mich. Current Conditions	Aug P	--	76.6
08/11/2023 18:00	**U. of Mich. Expectations**	**Aug P**	**--**	**68.3**
08/11/2023 18:00	**U. of Mich. 1 Yr Inflation**	**Aug P**	**--**	**3.40%**
08/11/2023 18:00	**U. of Mich. 5-10 Yr Inflation**	**Aug P**	**--**	**3.00%**

Japan

Date & Time (GST)	Indicator	Period	Expected	Prior
08/08/2023 03:50	**BoP Current Account Balance**	**Jun**	**¥1207.5b**	**¥1862.4b**
08/09/2023 03:50	**Money Stock M2 YoY**	**Jul**	**--**	**2.60%**
08/09/2023 03:50	**Money Stock M3 YoY**	**Jul**	**--**	**2.10%**
08/10/2023 03:50	PPI MoM	Jul	0.20%	-0.20%
08/10/2023 03:50	**PPI YoY**	**Jul**	**3.50%**	**4.10%**

Eurozone

Date & Time (GST)	Indicator	Period	Expected	Prior
08/07/2023 10:00	**Germany Industrial Production SA MoM**	**Jun**	**--**	**-0.20%**
08/07/2023 12:30	Eurozone Sentix Investor Confidence	Aug	--	-22.5
08/08/2023 10:00	Germany CPI MoM	Jul F	--	0.30%
08/08/2023 10:00	**Germany CPI YoY**	**Jul F**	**--**	**6.20%**
08/08/2023 10:00	**Germany CPI EU Harmonized YoY**	**Jul F**	**--**	**6.50%**
08/10/2023 12:00	**Italy CPI EU Harmonized YoY**	**Jul F**	**--**	**6.40%**
08/11/2023 10:45	**France CPI EU Harmonized YoY**	**Jul F**	**--**	**5.00%**
08/11/2023 10:45	France CPI MoM	Jul F	--	0.00%
08/11/2023 10:45	**France CPI YoY**	**Jul F**	**--**	**4.30%**

United Kingdom

Date & Time (GST)	Indicator	Period	Expected	Prior
08/11/2023 10:00	Trade Balance GBPMn	Jun	--	-£6578m
08/11/2023 10:00	**GDP QoQ**	**2Q P**	**--**	**0.10%**
08/11/2023 10:00	**GDP YoY**	**2Q P**	**--**	**0.20%**
08/11/2023 10:00	**Private Consumption QoQ**	**2Q P**	**--**	**0.00%**
08/11/2023 10:00	**Government Spending QoQ**	**2Q P**	**--**	**-1.80%**
08/11/2023 10:00	Gross Fixed Capital Formation QoQ	2Q P	--	2.40%
08/11/2023 10:00	**Exports QoQ**	**2Q P**	**--**	**-6.90%**
08/11/2023 10:00	**Imports QoQ**	**2Q P**	**--**	**-3.80%**
08/11/2023 10:00	**Total Business Investment QoQ**	**2Q P**	**--**	**3.30%**
08/11/2023 10:00	**Total Business Investment YoY**	**2Q P**	**--**	**5.80%**

China and India

Date & Time (GST)	Indicator	Period	Expected	Prior
08/08/2023	**China Exports YoY**	**Jul**	**-12.60%**	**-12.40%**
08/08/2023	**China Imports YoY**	**Jul**	**-5.30%**	**-6.80%**
08/08/2023	**China Trade Balance**	**Jul**	**$66.91b**	**$70.62b**
08/09/2023 05:30	**China CPI YoY**	**Jul**	**-0.50%**	**0.00%**
08/09/2023 05:30	**China PPI YoY**	**Jul**	**-4.00%**	**-5.40%**
08/09/2023 08/15	China Money Supply M2 YoY	Jul	10.80%	11.30%
08/10/2023 08:30	**India RBI Repurchase Rate**	**10-Aug**	**6.50%**	**6.50%**
08/11/2023 16:00	**India Industrial Production YoY**	**Jun**	**5.10%**	**5.20%**

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