Investment Strategy

Tactical Asset Allocation | September 26 2023

بنك أبوظبي التجاري
ADCB
ASSET MANAGEMENT LIMITED

Tactical Asset Allocation: Trade the curves

- **We retain a constructive macro outlook with no global recession in our base-case.**
- **We stay OW equities and UW fixed income in our asset allocation.**
- **Here we make changes to our TAA; and update our trade ideas.**

Growth: Global growth will likely hold up well over the next 3 months. While yield curves remain inverted and signal recession, we note that several other indicators including job market point to resilience. Broadly, US consumer remains in good shape. We see global manufacturing close to bottoming out. Services sector continues to be strong across the board but moderating. Tight labor market is driving the need to automate and indirectly helping the medium-term growth in productivity. Uncertainties around the growth trajectory are plenty.

Inflation: In absence of any major inflationary shocks, disinflation process should continue over the next 3 months. We are watching the risks emerging from the recent sharp rise in oil prices. Inflation could prove to be sticky in Europe. In the US, inflation should continue to surprise on the downside as movements in rental component turn favorable. Despite concerns, we do not yet see tangible signs of a wage-price spiral. Long-term inflation expectations remain well-anchored too.

Monetary policy: We believe that the Fed is close to being done with interest rate hikes for this cycle. However, we do not rule out another 25bp rate hike from the Fed and markets seem to have priced that in after the recent FOMC meeting. We do not see rate cuts till late H1'24 or early H2'24. We do not fight the Fed till it remains data dependent. ECB and to a less extent BOE, may have further tightening to do. BOJ should turn hawkish at some point.

Asset classes: Fixed income markets are now pricing in a better economic outlook and thus, a more hawkish Fed. Yet, the uncertainty about the timing of the first rate-cut is likely be a source of volatility in financial markets – especially for bonds. Equity sentiment has improved sharply but positioning is still light. While there is value in bonds over the long-term, near-term trajectory is unclear. Our strategy is to be OW equities, and UW fixed income. Further upside in equities is conditional on a revival in manufacturing activity and resilient earnings growth – we expect both.

Risks: A sharp deterioration in the global growth outlook owing to an escalation in unforeseen systemic risks, much stickier inflation needing central banks to turn even more hawkish, and investor sentiment deteriorating rapidly are key risks to our positioning. Consumer health risks are also worth watching.

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Exhibit 1: Tactical Asset Allocation with a 3-month view

	Positioning*					Balanced**		
Asset Class	**SUW**	**UW**	**N**	**OW**	**SOW**	**SAA**	**TAA**	**Active**
Equities				■		**35.0**	**37.2**	**2.2**
North America				■		22.0	24.0	2.0
Europe	■					6.0	4.0	-2.0
Japan			■			1.9	1.9	0.0
APac ex Japan				■		4.3	5.3	1.0
EM ex Asia		■				0.8	0.5	-0.3
Japan (JPY) off BM				■		0.0	1.5	1.5
Fixed Income		■				**50.0**	**47.8**	**-2.2**
DM Treasuries IG		■				27.2	25.2	-2.0
DM Corporate IG			■			10.4	10.4	0.0
EM USD Sov. IG			■			0.7	0.7	0.0
EM LCY IG				■		4.3	5.3	1.0
EM Corporate IG		■				0.5	0.2	-0.3
Global HY		□	■			5.0	5.0	0.0
Cash		■				2.0	1.0	-1.0
Alternatives						**15.0**	**15.0**	**0.0**

Colour legend ■ Current □ Previous

Source: Bloomberg, Bloomberg BGN, Bloomberg Indices, Hedge Fund Research, MSCI, Standard & Poor's, DataStream, Refinitiv, and ADCB Asset Management | Notes: *Positioning recommendations: SUW = Significant Underweight; UW = Underweight; N = Neutral; OW = Overweight; SOW = Significant Overweight. **Based on balanced risk profile. SAA = Strategic Asset Allocation; TAA = Tactical Asset Allocation; Active weight = TAA weight – SAA weight. Weights may not sum to 100% due to rounding.

Changes to our TAA

Asset Management Investment Committee (AMIC), in its meeting on September 20 223, made the following changes to our TAA and our view on currencies.

- **Trim overweight on off-benchmark position on Nikkei 225 in JPY terms**
  We remain positive on the outlook for Japanese equities. Corporate governance related reforms and the resultant increase in interest from foreign investors are likely to support valuations while the corporate earnings are helped by the strength of the domestic economy and weaker yen of the past several months. Given the yen sensitivity of the equity index, we still prefer an FX-hedged route; after the recent rally we trim our off-benchmark position from 2.5ppt to 1.5ppt but maintain a constructive outlook for Japanese equities. A sharp hawkish pivot from the Bank of Japan and a global recession are key risks to our constructive view.

  Within Japan, we prefer: 1) beneficiaries of corporate governance reforms (autos and industrials have a good representation here); 2) by style, growth over value (after the recent outperformance of the latter); 3) by size, large cap (beneficiaries of weaker yen in the past months and increased foreign investor interest); 4) dividend growers (banks and insurance have a good representation here)

- **Upgrade Global HY to Neutral from Underweight**
  We move Global HY from “underweight” to “neutral”. Global HY has been one of best performers since the beginning of the year. The outperformance has been led by US HY which has benefitted the most amidst the bear curve trend driven by rising rates. Since the beginning of the year, in 5 out of 8 months, the yield curve shifts have been driven by rising rates. The asset class tends to do well due to its short-duration characteristics and has even outperformed global equites in August. Better cash holdings of US HY companies and lower funding needs have also made resilient to tightening bank lending to corporates. We expect bear curve trade moves in the UST yield curve i.e. bear flattening in the near term before full blown bull steepening occurs later during 1Q 24. Under such a scenario, US HY could still benefit and drive performance given its short-duration characteristics. However, risks remain especially amidst the extremely tight valuations and spread compression being near record lows.

- **Positive on USD in the next three months; negative on EUR, GBP and JPY**
  We expect USD to remain strong in the near term but the strength to fade in 2024. The USD has been one of best performers compared to other asset classes and witnessed a strong summer, helped by the resilient US economic data versus the peers. Going into last four months of the year, there is increasing possibility of the USD to end 2023 on strong YTD levels. We believe that the US growth outperformance should continue to drive the USD rally as economic confidence particularly in the Eurozone and the UK deteriorates. Also on the interest rates front, we are reaching a point where the Fed may begin to appear hawkish compared to other central banks. This should bolster the possibility of the US interest rate differentials remaining wide versus peers. Our expectations of bear flattening of the UST curve should keep the USD strong.

  However, the possibility of the USD returning to 2022 high levels is low for the following reasons- 1) We are in the late phase of the Fed tightening cycle and historically the USD tends to peak before the last Fed rate hike 2) US growth differential with peers should normalize in 2024 (In July 2023 outlook- the IMF forecasts US growth underperformance in 2024) 3) our expectation of bull steepening to begin in 1Q 24 and the USD tends to underperform during bull steepening episodes.

  We highlight that *Asset Management Investment Committee (AMIC)* had divergent views regarding currencies and therefore we have low conviction on our FX calls at the moment.

Exhibit 2: Strategic Asset Allocation

	Cautious	Balanced	Aggressive
Investment objective	**Capital Preservation & Moderate growth**	**Growth & Income**	**Growth & Moderate Income**
Investor Suitability	**Moderately Conservative**	**Moderate**	**Moderately Aggressive**
Asset Allocation			
Equity	20%	35%	65%
Fixed Income	65%	50%	20%
Alternatives	15%	15%	15%

Source: ADCB Asset Management

Exhibit 3: Our high conviction tactical investment themes/trade ideas

Open positions	Asset class	RV?	BBG ticker		Date opened	Current date	Performance
Prefer UST (7Y-10Y) over other DM Sov.	Fixed income	Yes	LT09TRUU Index	LGTRTRUU Index	5-Jul-22	20-Sep-23	-1.2%
EU IG Corp over US IG Corp	Fixed income	Yes	LECPTRUH Index	LUACTRUU Index	9-Jan-23	20-Sep-23	3.5%
HK equities	Equities		HSI Index		14-Nov-22	20-Sep-23	1.7%
Chinese hotels & leisure	Equities		CSIH3204 Index		14-Nov-22	20-Sep-23	-8.7%
Cybersecurity	Equities		HXRTR Index		22-Mar-23	20-Sep-23	9.9%
Chinese semiconductors	Equities		FDSSMNTR Index		22-Mar-23	20-Sep-23	-19.7%
Indian equities	Equities		M1IN Index		22-May-23	20-Sep-23	10.7%
Dow Jones World Consumer Goods	Equities		W1NCY Index		25-Aug-23	20-Sep-23	1.3%
Copper	Commodities		LOCADY Comdty		15-Jun-23	20-Sep-23	-2.1%
Average							**0.8%**

Closed positions	Asset class	RV?	BBG ticker		Date opened	Closed date	Performance
GBPUSD higher	FX		GBPUSD Curncy		15-Jun-23	20-Sep-23	-3.4%
US Diversified banks over US Regionals	Equities	Yes	S5DBNKTR Index	S5RBNK Index	13-Mar-23	13-Jun-23	24.8%
Asia investment grade credit	Fixed income		I10550US Index		9-Jan-23	14-Jun-23	1.8%
USDJPY lower	FX		USDJPY Curncy		9-Jan-23	14-Jun-23	-6.1%
GBPEUR lower	FX		GBPEUR Curncy		9-Jan-23	14-Jun-23	-2.9%
Gold	Commodities		XAU Curncy		14-Nov-22	14-Jun-23	9.7%
Gold miner equities	Equities		M1WDS1MI Index		14-Nov-22	14-Jun-23	13.1%
Average							**5.3%**

Source: Bloomberg, and ADCB Asset Management

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