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Regulated by the DFSA

On Edge

April 2024

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CIO Speaks

Between writing the below and putting the final touches to the design of this newsletter, the following happened:

(Update as on April 21st 2024)

In the early hours of April 19th, Israel reportedly carried out a strike at an Iranian air base in Isfahan not far from Iran's Natanz nuclear facilities. Iran says the attack involved drones that were neutralized by air defenses and downplayed the extent of damage. Current analysis suggests that this may have closed the loop on this tat-for-tat exchange for now. We fervently hope that this is correct but remain watchful.

US stock markets dropped sharply on April 19th, with the Nasdaq down 2.05% on the day and the S&P closing below the 5,000 level at 4,967. Stocks that were hit particularly hard included marquee names like Nvidia (-10%), Netflix (-9.09%), AMD (-5.44%), Micron (-4.61%), Meta (-4.13%) and Taiwan Semiconductors (-4.01%). Recent high-flier Super Micro Computers was down a whopping 23.14%, while ARM Holding dropped 16.90%. The sell-off is attributed primarily to investors digesting the recent pivot by the Federal Reserve towards 'higher for longer' interest rates.

Vladimir Ilyich Lenin, the leader of the Russian Revolution and the first head of the Soviet state, once said. "There are decades where nothing happens; and there are weeks where decades happen."

Are we witnessing one such week now?

Since Iran's 1979 Islamic revolution, relations between Israel and Iran have been one of mutual animosity and suspicion. While they have never engaged in direct military confrontation, both countries have attempted to inflict damage on the other through proxies and limited strategic attacks.

That conflict entered a new phase in the early hours of April 14th, 2024.

Iran unleashed a barrage of missiles and drones, targeting Israel in retaliation for the suspected Israeli strike on April 1st on its consulate in Damascus. According to a report by the Associated Press news agency, the attack involved more than 120 ballistic missiles, 170 drones and more than 30 cruise missiles.

Iran's massive aerial attack marks the first direct strike by Iran on Israeli territory from Iranian soil.

Naturally, this has brought with it a new phase of tension, uncertainty and confrontation in the Middle East. Though there is general consensus that no one really wants an all-out war, there are concerns that Israel may retaliate or that the conflict draws in other countries from within and outside the region.

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Efforts are underway from various sides to avoid escalation and limit further damage. The world is keeping its fingers firmly crossed that things will not careen out of control.

Reaction from financial markets has been far more muted than the savage sell-off that many investors were expecting. At the tof this writing, even regional stock markets, including the GCC region and Tel Aviv itself, are trading not very far off their levels before the attack.

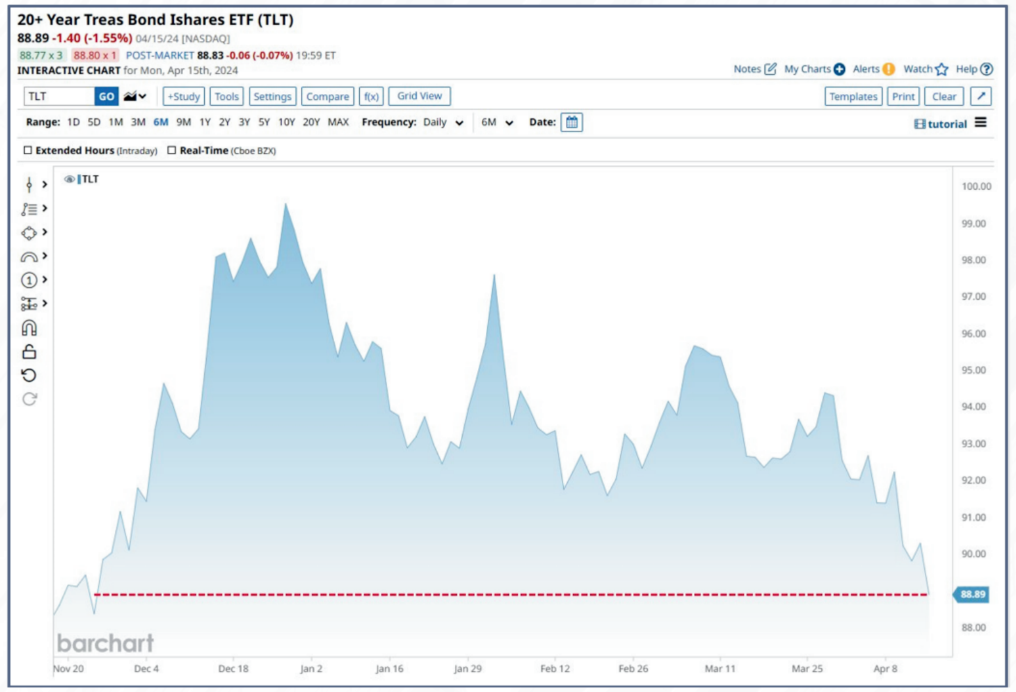
Indeed, **the attack seems to have been overshadowed by another economic development that we had flagged several weeks ago. Stickier-than-expected inflation.**

Inflation fears are rising on Wall Street. Consumer Price Index (CPI) for March rose 3.5% over the prior year, higher than the 3.2% reading in February as well as the level that economists had expected. **That makes three straight Consumer Price Index reports showing larger price increases than consensus expectations**.

In recent statements the Federal Reserve Chair Jerome Powell has conceded that it will take "longer than expected" to achieve the confidence needed to get inflation down to the central bank's 2% target, **signaling that it will also likely take longer to cut rates**. The comments mark Powell's first acknowledgment yet that inflation data in the first quarter of this year are not showing the progress that the Fed needs to begin easing monetary policy.

This new stance was a departure from comments just two weeks ago when he offered assurances that the overall outlook had not changed much despite some hotter-than-expected readings at the start of the year.

Investors have also scaled back the number of rate cuts they see this year to two, less than the median of three penciled in by Fed officials at their last policy meeting in March. Markets are pricing 85% chance of no change in rates in June, with the first cut coming in September, and only 42 bps cut this year.



The S&P 500 has dropped nearly 4% this month as investor hopes for an imminent rate cut have receded. Historically speaking, during years such as 2024 in which the index rose 10% during the first quarter, the average maximum pullback in the S&P 500 over the balance of the year was 11%. All eyes are now focused on corporate earnings due through the next few days.

Treasury yields have also risen in response to this change. The 2-year note briefly touched above 5% — its highest level since November. **The yield on the benchmark 10-year U.S. Treasury note is at 4.657% as of this writing, a jump of almost 0.8% from the level of 3.88% at which it started the year**. It is particularly remarkable that this rise in yields is happening despite the sharp uptick in geopolitical risk, which has historically been associated with a flight to Treasuries.

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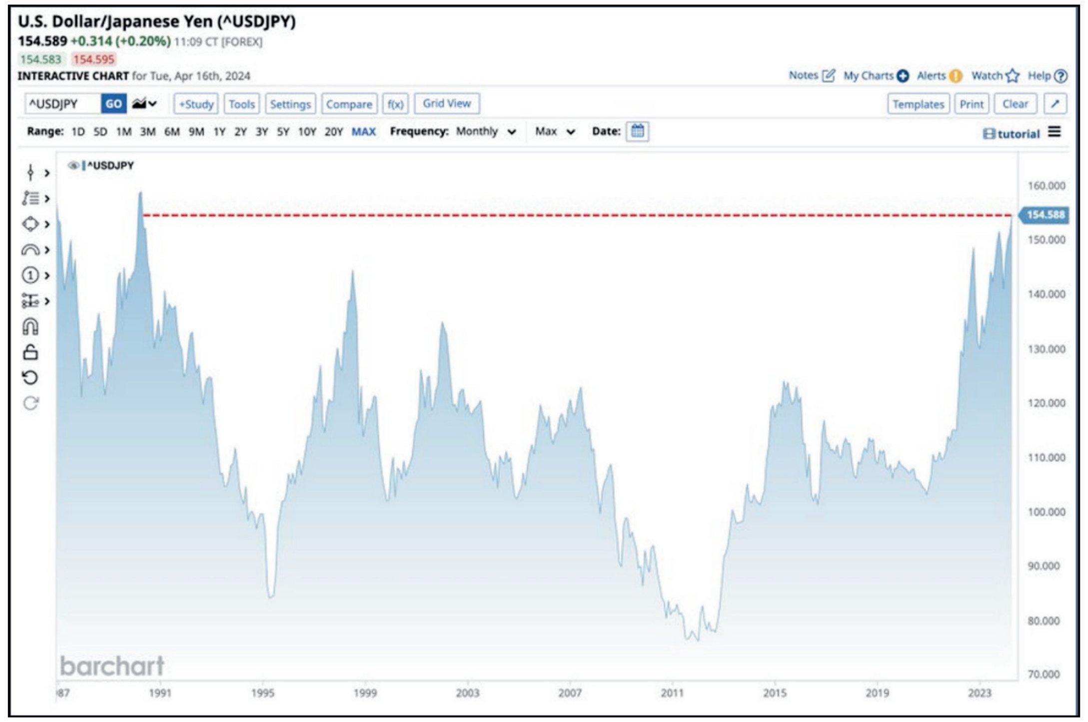
Signs that central banks in Europe may diverge from the Federal Reserve are driving the dollar to its strongest levels in months. The prospect of the Fed sustaining high interest rates has goosed **the U.S. dollar index, which tracks the greenback against a basket of six global currencies to 106.135, its highest level this year.**



Gold continues its strong run on the back of buying by central banks seeking to diversify away from US dollars as part of their overall foreign exchange mix. China is the leader in this particular de-dollarization strategy, with Turkey, Singapore, and India following suit.

CIO Speaks

According to the Silver Institute industry association, **global silver deficit is expected to rise by 17% to 215.3 million troy ounces in 2024** due to a 2% growth in demand led by a robust industrial consumption and a 1% fall in total supply. Silver, which is used in jewelry, electronics, electric vehicles and solar panels, as well as an investment, faces the fourth year of a structural market deficit.

Oil prices are relatively flat despite concerns about an Israeli response to Iran's aerial attack. Given that the attack was expected, and damage was limited, traders have seemingly shrugged off concerns about potential issues. There is also the sense that OPEC+ has sufficient spare capacity to absorb a drop in supply, should Iranian oil not be available.

Indian stock markets have been relatively flat on YTD basis, though overall sentiment has been strongly positive. As we have highlighted before, several measures like high valuations, widespread retail participation and systemic leverage (through derivatives) suggest that the market is quite frothy. While history suggests that markets irrationality can continue for long periods, we feel that risks are rising.

Even as we sign off on that relatively benign note, we remind ourselves that geopolitical events are notoriously difficult to predict. The most recent example being the Russia-Ukraine conflict. Almost everyone agreed that it was never going to happen or, if it happened, was going to last only a few days. More than two years into it, the two countries are still at war with no clear end in sight.

Broadly speaking, financial markets currently assume that there will be a soft landing for the global economy comprising lower inflation (though maybe a bit later in the US than expected), falling interest rates and the avoidance of recession.

In case the Iran-Israel conflict escalates, it will bring with it risks leading to higher oil prices, a reversal of the recent fall in inflation and a puncturing of the optimistic mood in financial markets.

Previous wars in the Middle East have led to a sharp increase in oil prices. The increased inflation that would come from higher energy prices would trigger a response from central banks that would tighten interest rates in order to secure inflation coming back to target, and that would weigh down on activity. It would do so in a context in which, in some countries, activity and growth is already fairly weak, so that might also have a strong effect there.

According to the IMF, the impact of a 15% rise in oil prices and the higher shipping costs from a conflict that was not contained would lead to a 0.7% increase in inflation and would also damage business confidence and investment.

Consequences for this region, whether in terms of foreign investment flows or tourism potential, could also be severe.

An outcome that no sane person would wish for.

US Treasuries – where will the demand come from?

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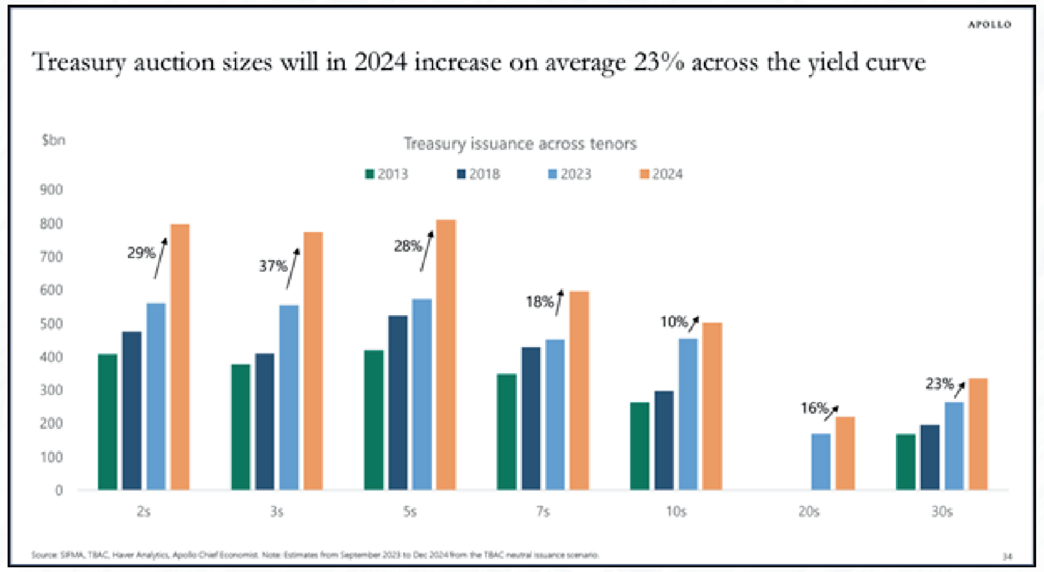
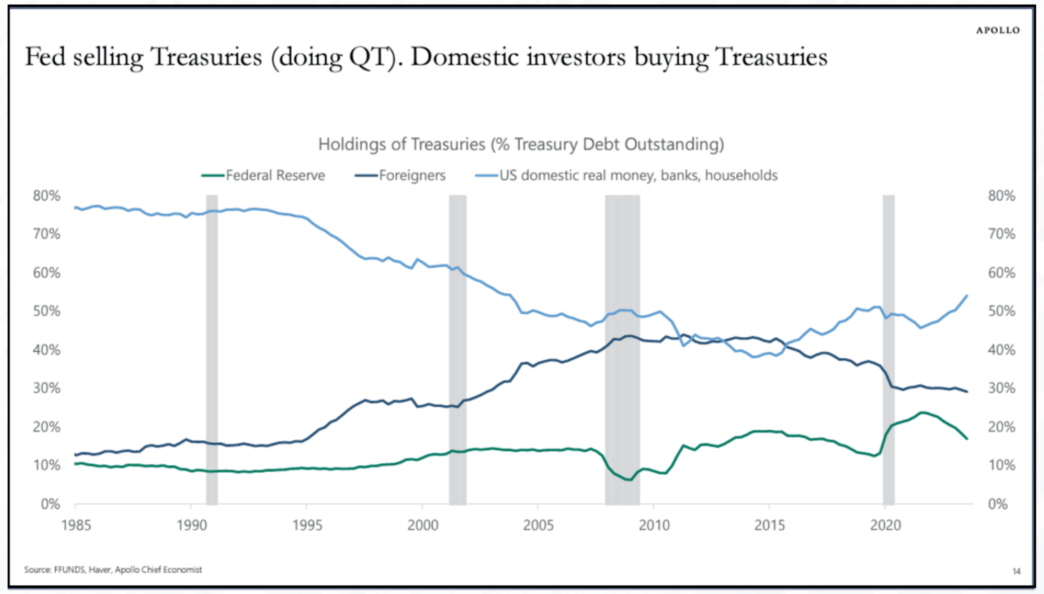
- At the end of March 2024, total **US debt stood at $34.59 trillion.**
- **$10 Trillion in US treasuries coming to the market in 2024, which includes refinancing for a record $8.9 Trillion of gov debt which will mature over the next 12 months.**
- It is a particular challenge when the **biggest holders of US treasuries – foreigners, continue to shrink their share.**
- **The buyer base for US Treasuries has shifted** from yield-insensitive buyers (sovereign wealth funds and central banks, including the Fed) to yield-sensitive buyers (US households, US pensions, US insurance).
- In the most recent auction, the **FED had to pivot to shorter term notes to entice buyers.** As of 12th Apr, The 6-month treasury bill yields 5.35% versus 4.5% for the 10-year.





Yield sensitive buyers may retreat as Fed cuts rates and continued focus on short term notes will raise interest costs further

GRANOLAS – Europe's answer to the Magnificent Seven?

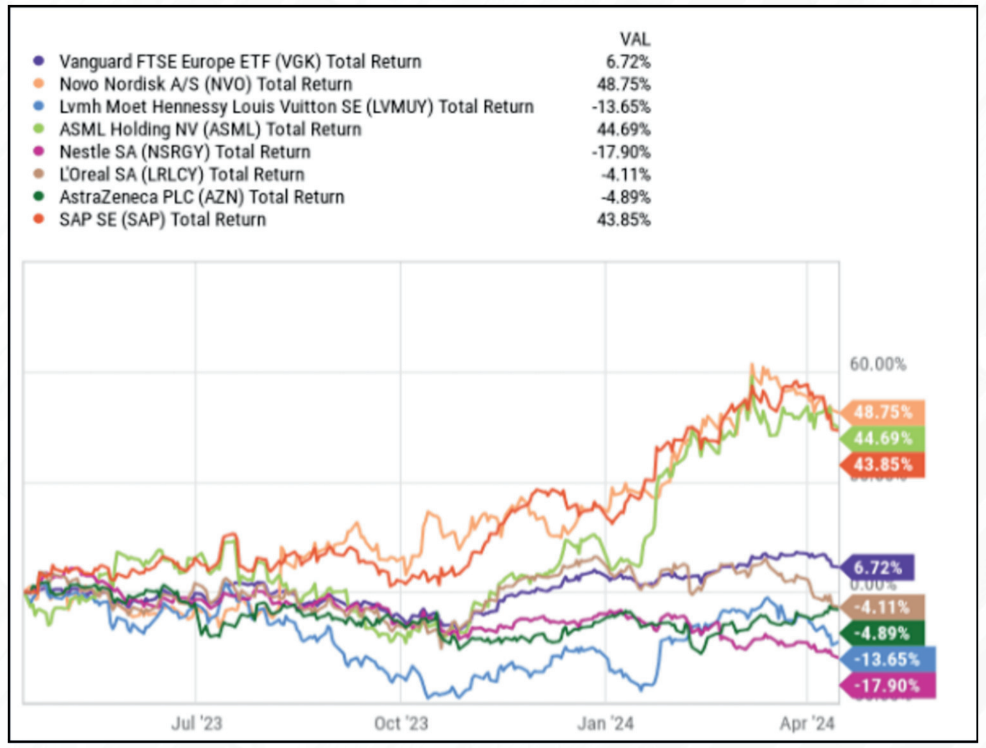
Overview:

- Coined by Goldman Sachs, GRANOLAS represents a group of 11 European companies.
- Despite sluggish domestic GDP, GRANOLAS contribute significantly, accounting for approximately 25% of the STOXX 600's market capitalization.
- While returning approximately 72% since 2021, GRANOLAS offer enhanced diversification across sectors compared to the Magnificent Seven.

Initials as in The acronym	Name	Market Cap (bn)	Last-12-Month Revenue (bn)	Total Return (5yr) (0/0)
G	Novo Nordisk A/S	€ 497,2	€ 31,2	279
R	LVMH Moet Hennessy	€ 403,4	€ 86,2	60
A	ASML Holding N.V.	€ 342,6	€27,6	82
N	Nestlé S.A.	€ 269,9	€ 97,8	2
N	L'Oréal S.A.	€ 223,9	€ 41,2	36
N	SAP SE	€ 196	€ 31,2	64
O	Roche Holding AG	€ 191,6	€ 65,1	-21
L	Novartis AG	€ 191,4	€ 42,3	28
A	AstraZeneca PLC	€ 177,2	€ 41,2	40
S	Sanofi	€ 108,5	€46,4	24
S	GSK plc	€ 78,9	€ 35	48

Valuation:

- GRANOLAS generated €500 billion in revenue over the past year, with an 8% annual increase.
- Their 15% average gain surpassed STOXX 600's 5% growth, significantly boosting the index's performance.
- Despite a 20x P/E ratio, GRANOLAS are less 'expensive' than US counterparts, with a 30% discount.
- At 2.5%, their average dividend yield outstrips both the S&P 500 and the Magnificent Seven.



Growth Outlook:

- Forecasted 7% CAGR in STOXX 600 revenue until 2025, backed by strong barriers to entry and reinvestment.
- GRANOLAS poised for growth with robust earnings, low volatility, high margins, and solid balance sheets, capitalizing on passive investment trends and European equity market liquidity challenges.

Investment Consideration:

- GRANOLAS present an attractive investment opportunity with strong growth potential and a favorable valuation compared to US stocks.
- Investors can consider a balanced mix of both GRANOLAS and the Magnificent Seven for diversified returns.

Are European Granola stocks good for your portfolio over the pricey Magnificent 7, given their attractive valuations, steady dividends, and lower volatility?

India – Indicators indicating excess…

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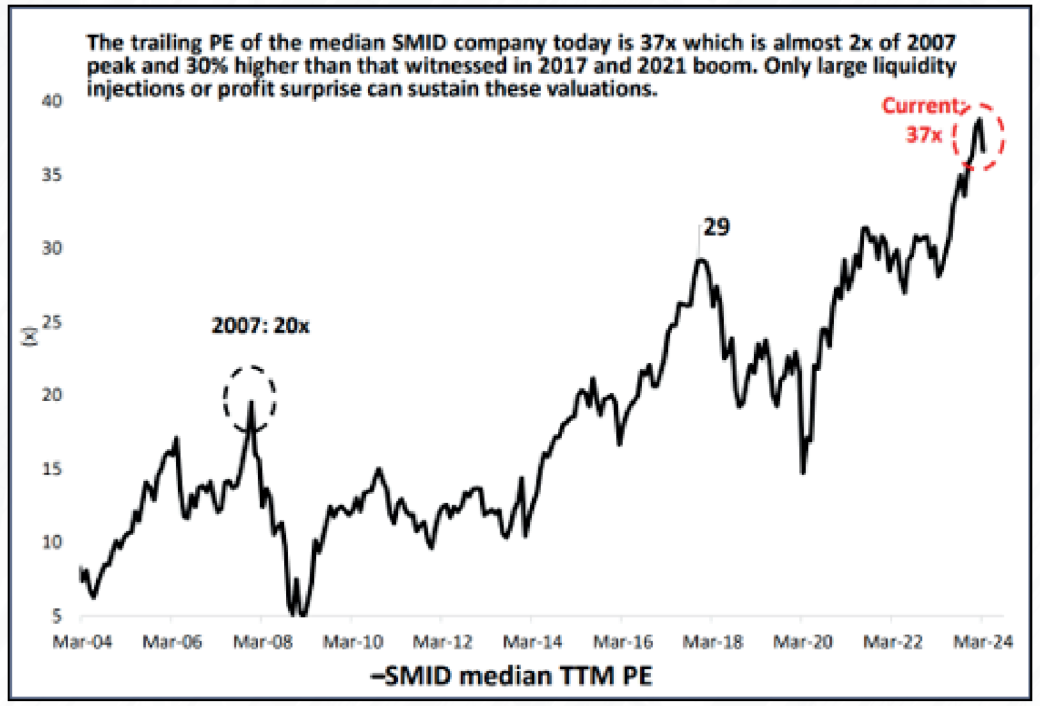
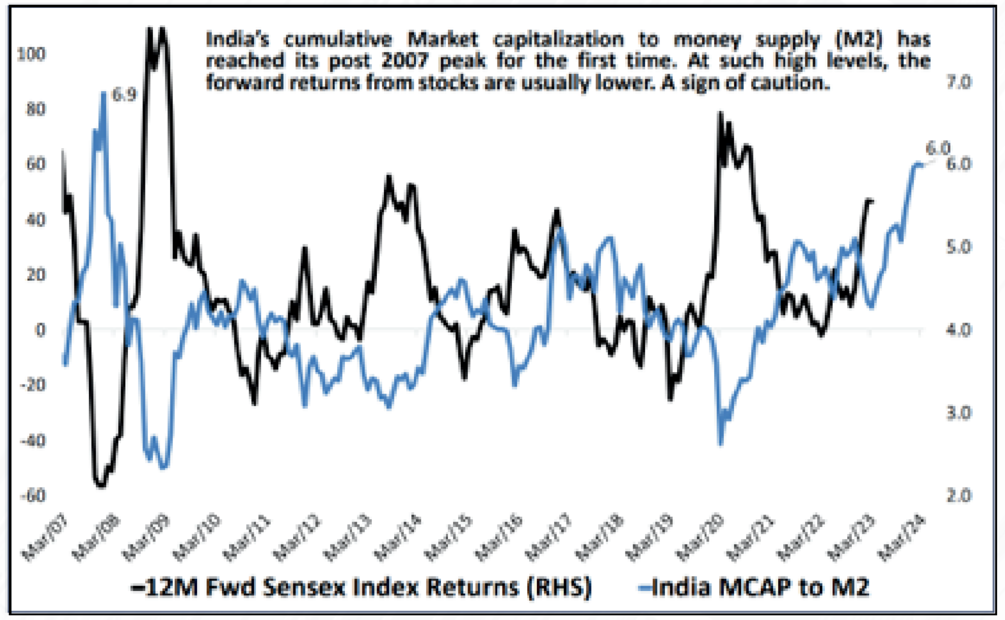
- If history is any guide, when excesses begin to pile up, they can continue in the same direction for an unknown period.
- The current valuations are stretched. Small & MidCaps (SMIDs) are trading north of 90 percentile of their valuation band. This means they are in an expensive zone.
- SMIDs Mcap to GDP is at a 79% premium to the long-term average.



source : DSP Investment Managers



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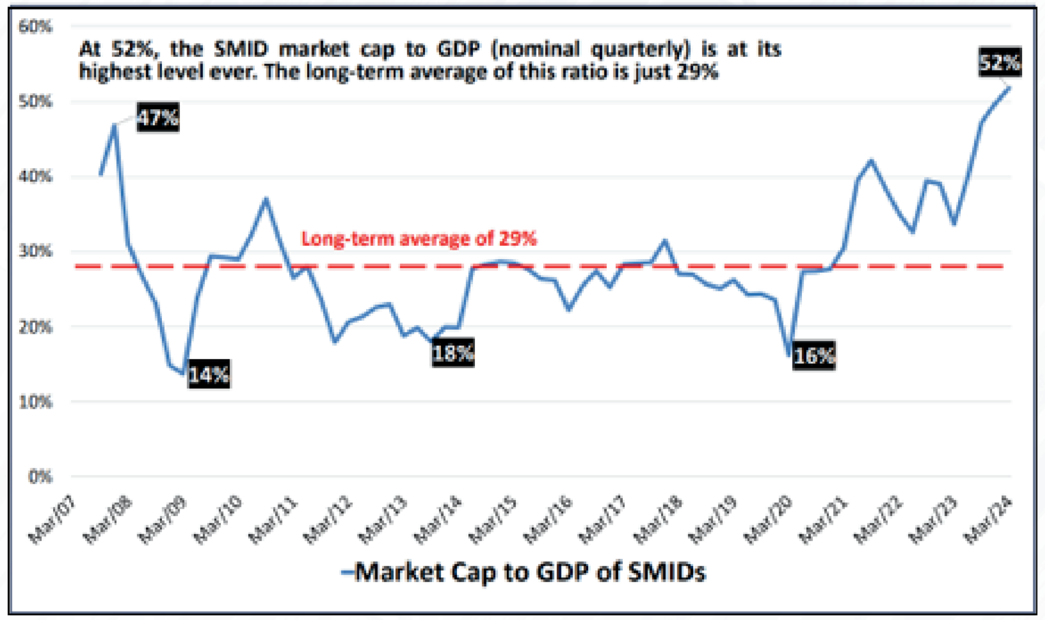
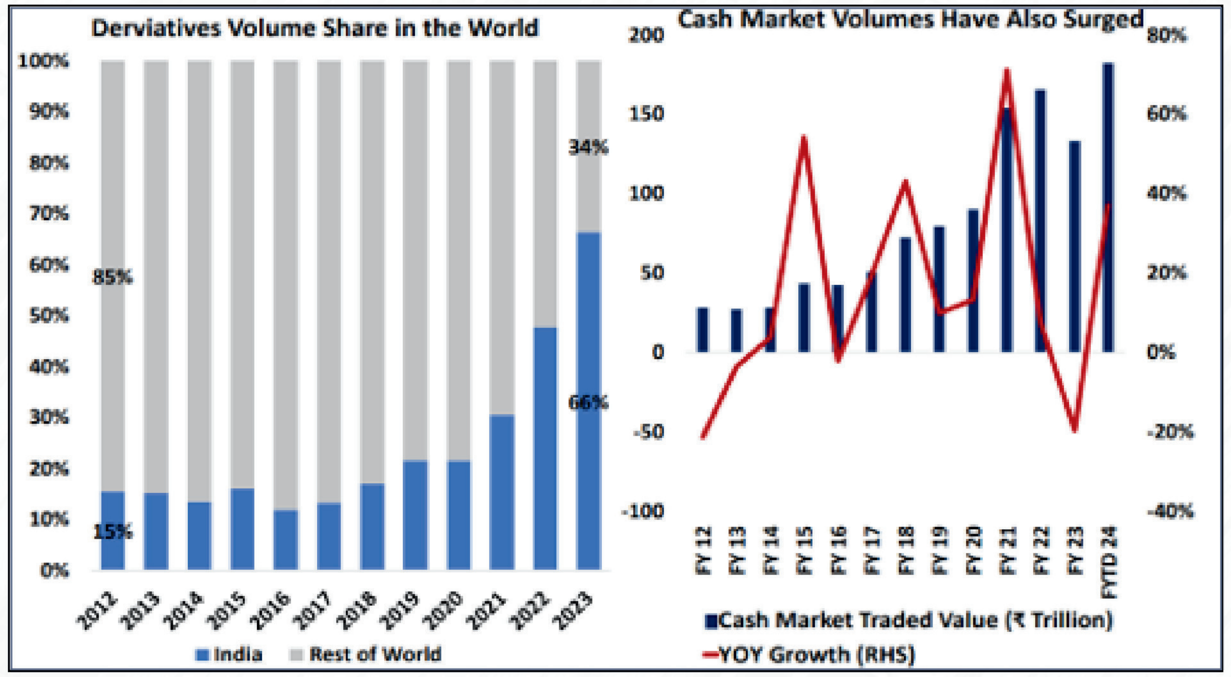


source : DSP Investment Managers

How long would the Good Times continue?

India – …Unsettling Calm

- India now accounts for two-thirds of global derivatives volume.
- Almost none of it is used for Hedging indicating a leaning towards trading and speculation.
- Historically, inclination for derivative speculation accompanied economic and market excesses which never normalized without market disruption.
- High derivative volumes and Low volatility in Indian markets indicates complacency and a confidence driven by recent easy money environment.



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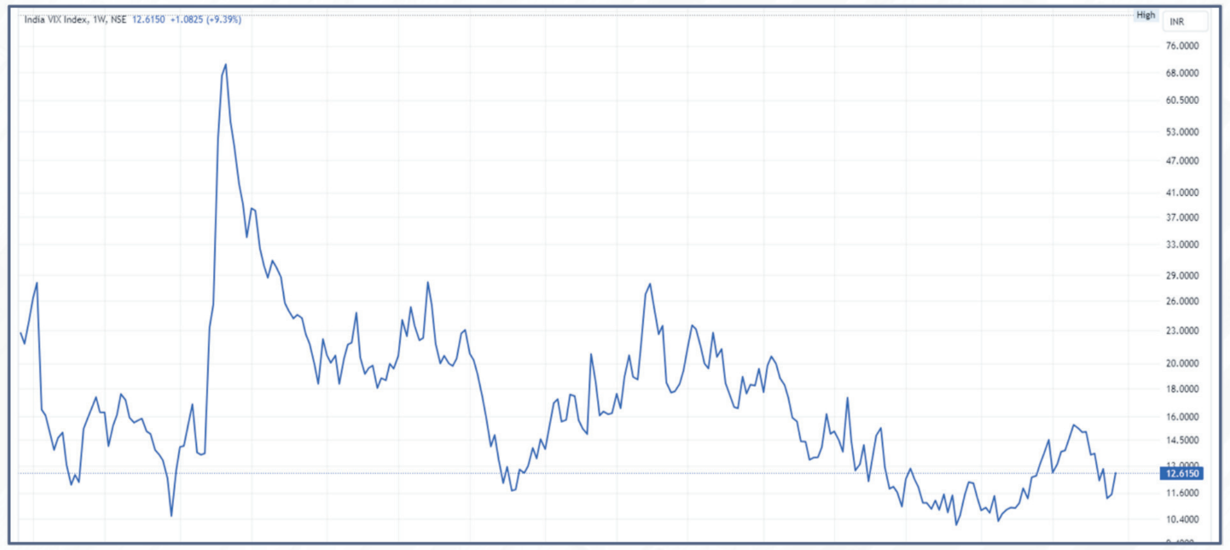


Are we prepared for an Unknown Shock?

Do Boeing's troubles mean Airbus' gain?

Boeing has been in the news recently for all the wrong reasons. Starting in 2018 – 2019 when 2 Boeing 737 Max 8 planes came down and caused +500 causalities.

The recent nonstop streak of bad news began during the last week of 2023, when an airline discovered a potential problem with a key part on two 737 Max aircraft, part of Alaska airline blowing off, whistleblowers coming forward etc.

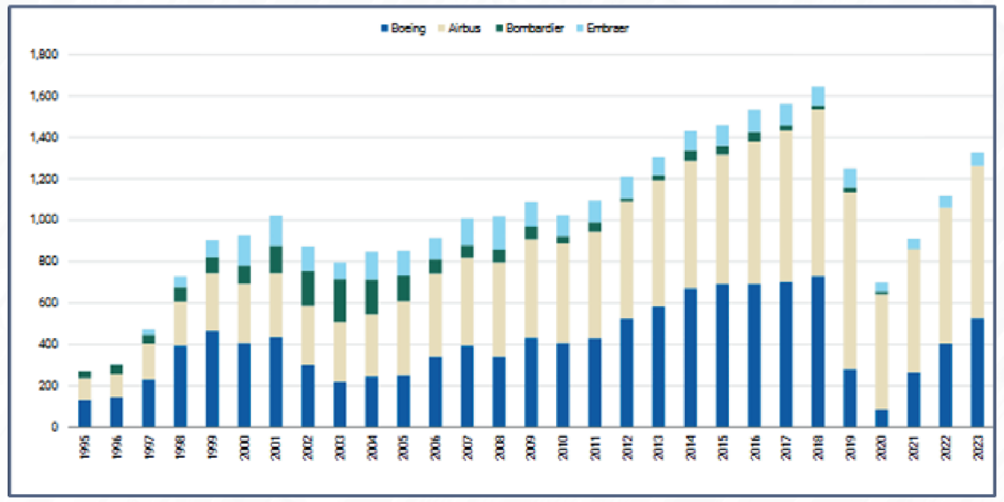
What does this mean for the duopoly competitor Airbus?

- In the 1st 2 months of 2024, Boeing has delivered 54 planes and Airbus has delivered 79.
- Southwest that flies only Boeing 737s announced it will trim capacity plans.
- American airlines (which was entirely Boeing), announced an order for 260 narrow-body airplanes split between Boeing, Airbus and Embraer.
- United Airlines Holdings Inc. (Boeing's biggest customer) is close to securing +36 Airbus A321neo jets from aircraft lessors to replace Boeing Co. 737 Max 10 orders that are at least 5 years behind schedule.

In the 2nd chart you can clearly see that Airbus stock has outperformed Boeing since 2018. Let us look at the nos.

	Airbus	Boeing
2023 revenue	EUR 48bn	$33.9 bn
2023 last qtr growth	12.2%	33%
Revenue CAGR (since 2018)	-8.4%	0.04%
Operating profit	8%	-1%
Book/Bill	2.85	2.49

**We have considered only commercial revenue



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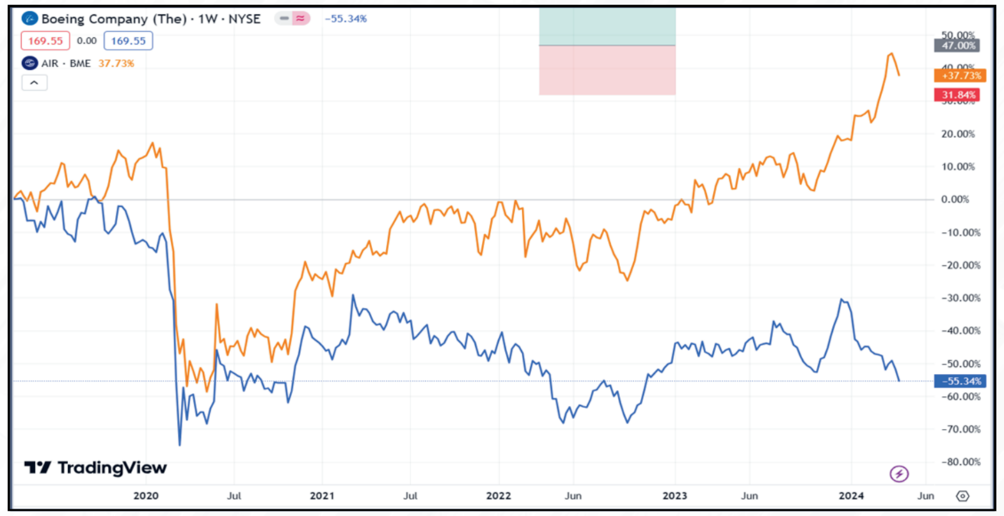


Aircraft supply chain issue

Boeing's troubles have proven to be beneficial for Airbus, however duo to a duopoly industry which is highly capital intensive, Airbus is struggling to fulfill the increased demand and **new aircrafts deliveries are planned as late as 2028 – 2029.** Due to these factors and aircraft specialization airlines are not able to switch away from Boeing. Let us see the impact aircraft supply chain issue is causing :

Boeing 737 top 5 customers (order book based) : United, Southwest, Flydubai, Lionair and Ryanair
Airbus A320 neo top 5 customers : IndiGo, AirAsia , easyJet, Lufthansa, China Eastern and Wizz.

How to invest in airlines and airline manufacturers :

- For aircraft manufacturer, **we prefer investing in Airbus based on the strong financials** and orderbook growth.
- Airlines on the other hand are dependent on many other factors and is a highly cyclical business. To invest in airlines, a tactical short-term option-based strategy would be most appropriate.

	Airbus	Boeing
Deliveries	112	67
Net orders	699	369
Gross orders	807	371
Backlog	587	302
Production rate	60	48

Data for Dec 2023

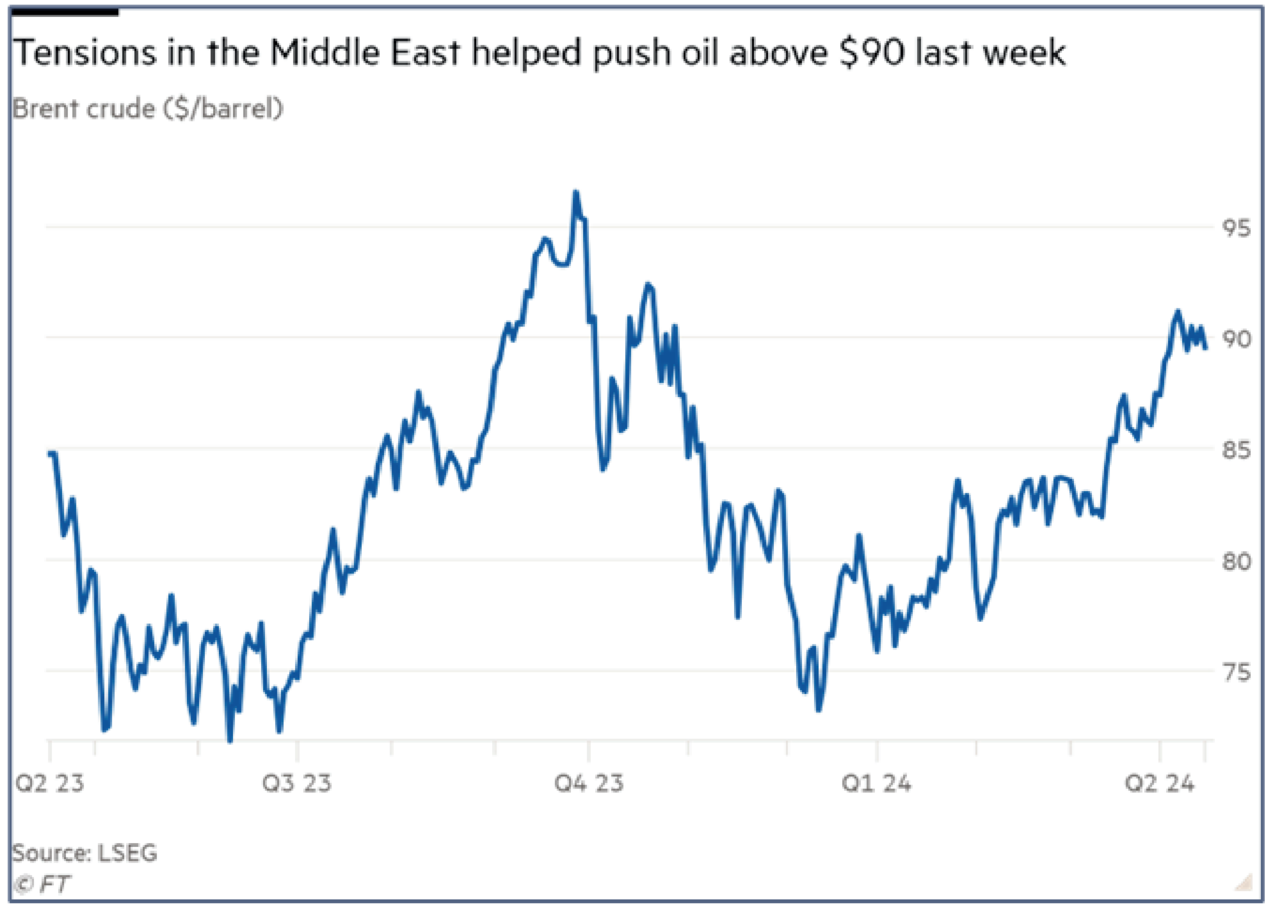
Let us look at the top 2 customers of Boeing and Airbus in terms of financials :

Airline provider	Market cap	Current price	2019 price	Consensus 12 month target	Potential upside	2023 operating profit	2019 operating profit	P/E	Dividend	Aircraft commitment	Delivery post 2025	Comment
United airlines	13.65	43.5	88.37	75	72.4%	5,291	4,568	4.1	0	725	41%	A mix of Boeing and Airbus and now Emraer
Southwest airlines	16.78	28	54.64	35	25.0%	879	2948	18	1.2	694	60%	Entirely dependent on Boeing
Lufthansa	7.65	6.39	11.99	8.9	39.3%	2,081	1,457	5.7	3.7	253		A mix of Boeing and Airbus

Data as of 16 Apr 2024

Crude Oil prices look evenly balanced

The outlook outlines two primary scenarios: a bullish outlook shaped by geopolitical factors and supply constraints, and a bearish perspective influenced by a waning market sentiment and economic deceleration.



Geopolitical Considerations

- Middle East tensions boost oil prices to $90/barrel, unlikely full conflict due to economic concerns, but tension drives market sentiment.
- Post-9/11, oil prices rose 5% then fell 25% in 14 days due to recession fears.
- 2022 Russia-Ukraine conflict spiked oil prices by 30% in 2 weeks, returning to pre-conflict levels afterward.
- 2023 Hamas attacks briefly raised oil prices by 4% before dropping.
- Oil prices sustained above $90 except during 2022 Russia-Ukraine conflict due to global supply shifts amid sanctions.

Supply-Side Dynamics:

- Saudi production cuts tighten market, key amid geopolitical uncertainties.
- Potential Russian, Venezuelan exports add to global supply amid uncertainties.
- OPEC+ contributes around 40% of the global oil output.

Demand Outlook:

- Western demand stagnant due to full employment and efficiency improvements.
- China's growth subdued amid economic challenges and electric mobility transition.
- Global oil demand to moderately expand in 2024, reaching 101-102 million bpd.

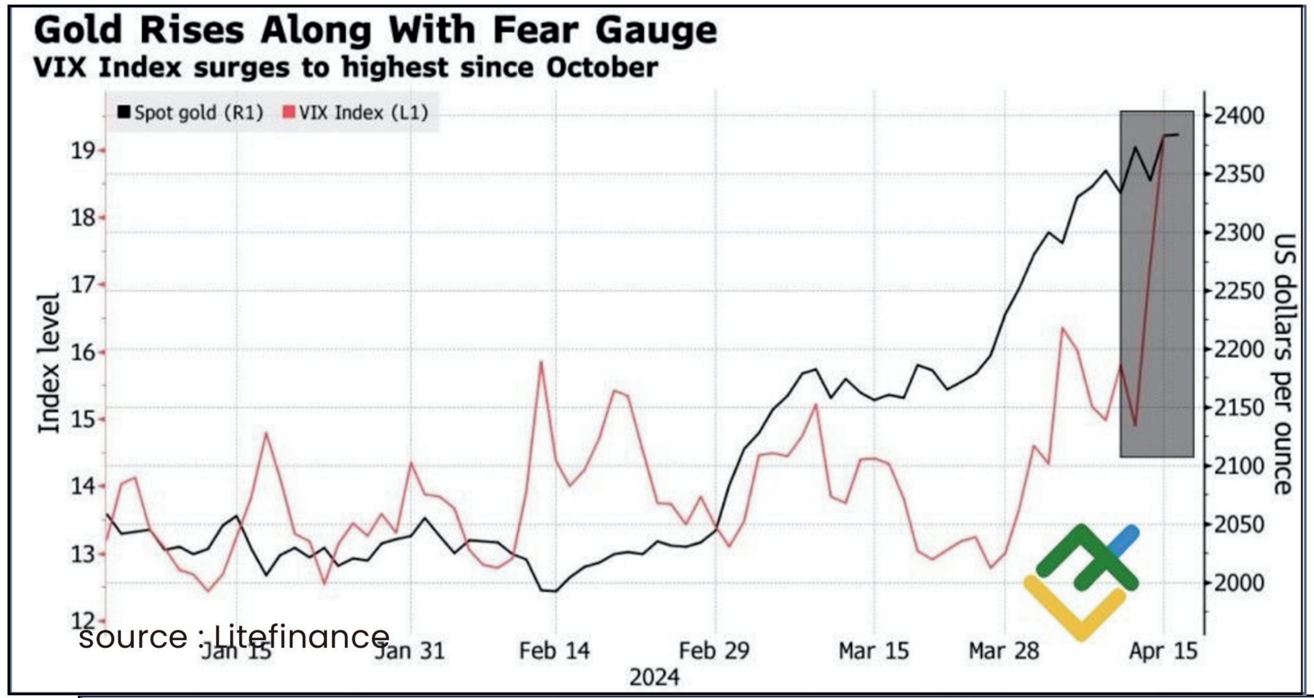
Given current geopolitics and past trends, will oil prices stay high?

Gold has the wind on its back

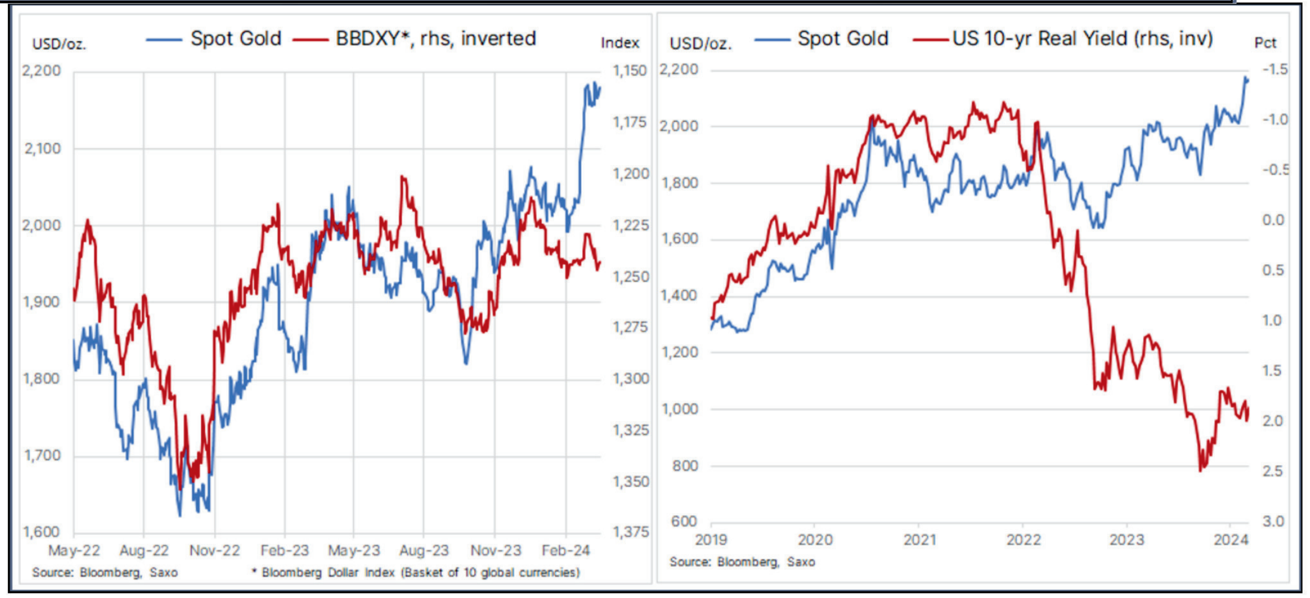
Gold has hit record highs due to a mix of factors like geopolitical tensions, anticipated U.S. rate cuts, and economic uncertainty. Understanding these dynamics is crucial for gauging gold's near and medium-term prospects in global markets.

Key Drivers:

- Anticipated 75 basis points easing by the FOMC in 2024 enhances gold's attractiveness as a hedge against currency depreciation.
- Heightened Middle East tensions prompt investors to flock to safe-haven assets like gold, driving a substantial 15% price surge.
- Amid economic unpredictability, gold's appeal as a hedge against market volatility strengthens, driving up demand and prices.
- Elevated inflation levels reinforce gold's effectiveness as an inflation hedge.
- Central banks' consistent annual purchase of over 1,000 tonnes of gold underscores their enduring confidence in its value, supporting gold prices.



Source : Litefinance



Will the gold rate continue to rise in the coming days after soaring 16% this year?

Convictions By Asset Class

	Strong Under Weight	Under Weight	Neutral	Overweight	Strong Overweight
EQUITIES					
Global Equity			✓		
United States			✓		
Eurozone			✓		
Japan				✓	
India			✓		
GCC			✓		
Emerging Markets				✓	
FIXED INCOME					
U.S. Investment Grade				✓	
U.S. High Yield		✓			
EM Investment Grade				✓	
CURRENCY					
EURUSD			✓		
USDJPY		✓			
GBPUSD			✓		
EM FX (vs. USD)			✓		
COMMODITIES					
Crude Oil		✓			
Copper			✓		
Gold			✓		

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