

# MONTHLY INVESTMENT OVERVIEW

بنك الإمارات  
للاستثمار

EMIRATES INVESTMENT BANK

Asset Class	View	Current Allocation*	Benchmark Allocation*
 Equities		40.0%	35.0%
 Fixed Income		42.5%	52.5%
 Real Estate		5.0%	5.0%
 Commodities		2.5%	2.5%
 Cash		10.0%	5.0%

 Overweight,  Favour,  Neutral,

 Cautious,  Underweight

\* Allocations are based on a Balanced Risk Profile

## About Emirates Investment Bank

EIBank is an independent private bank based in Dubai. It offers a wide-range of investment and banking services to an exclusive, but diverse, client base of high-net-worth individuals from across the region and around the world.

Emirates Investment Bank seeks to build long-term partnerships based on a foundation of trust, stability and integrity, which allows it to appreciate the unique circumstances and objectives of each of its clients. This personalised approach guides the Bank when providing its clients with bespoke banking solutions in connection with their wealth, business, and every day affairs.

## MONTH IN BRIEF



- Risk assets in May were constrained by concerns that incrementally strong economic data, particularly in the US and the UK may result in higher inflation, forcing central banks to consider early withdrawal of stimulus and start early hikes, possibly in 2022.
- Even though the core PCE Index, the Fed's preferred inflation gauge, increased 3.1% year-over-year, far exceeding the central bank's longer-term 2% goal, the Fed continues to show little concerns about inflation and continues to drive home the "its transitory" message.
- After witnessing a double-dip recession in Q1, an increase in the pace of inoculations is fuelling optimism about Europe's economic outlook. Indicators of activity such as mobility data have rebounded rapidly through May to levels last seen pre-pandemic.
- The rapid rollout of vaccines and the easing of restrictions in the UK is leading to a near-term boom as households spend again and the rapid recovery is shifting the focus of debate within the BoE toward how and when to withdraw stimulus.
- Even the PBoC, like the Fed, sees the inflation spike as transient and prefers to ride it through although it has started tapering stimulus by tilting to a tighter liquidity bias.
- The Saudi economy looks set to gather pace in 2021 as vaccinations progress and higher oil prices provide elbow room for policy response. Business activity in Dubai also rose to the highest level since late 2019 owing to a rebound in tourism and a fast distribution of vaccines.

# MONTHLY INVESTMENT OVERVIEW

Risk assets in May were constrained by concerns that incrementally strong economic data, particularly in the US and the UK may result in higher inflation, forcing central banks to consider early withdrawal of stimulus and start early hikes, possibly in 2022. **Both growth and inflation data in the US were upbeat with PMIs beating expectations and headline inflation rising to 4.2% year-over-year for April.** Broadly, expectations for higher growth and inflation continued to favour value over growth with Emerging Markets (EM) outperforming their developed market peers. Developed equities, represented by the MSCI World Index, gained 1.3%, while their EM counterparts, represented by the MSCI EM Index, gained 2.5%. Inflation worries heightened demand for inflation-protected bonds and with stability in yields, led to the rally in precious metals (Gold and Silver up by 7.8% to 7.9%), while broadening growth prospects along with continued easing stance, pushed the Dollar Index lower by 1.6% on the month.

Even though the core PCE Index, the Fed's preferred inflation gauge, increased 3.1% year-over-year, far exceeding the central bank's longer-term 2% goal, the Fed continues to show little concerns about inflation and continues to drive home the "its transitory" message while attributing the spike to last year's low base and to reopening-related logistical disruptions. In our view, demand for labour remains below its pre-pandemic level and inflation expectations have moved up but not enough to be alarming. **Treasury markets also suggest investors expect inflation to average only a bit more than 2% over the five years starting in mid-2026.** All this suggests that the current spike in inflation will subside over the next year as supply-side issues get resolved. The US 10-year Treasury yield whipsawed with inflation and economic data and ended May lower by 3bps to 1.59%. At the

**!! Demand for labour remains below its pre-pandemic level to push up wages meaningfully and inflation expectations have moved up but not enough to be alarming !!**

time of this writing, the US 10-year yield fell below 1.5%, extending its retreat from year-to-date highs reached in late March. The next Fed policy meeting will take place June 15-16, where investors will be on the lookout for possible tapering signals coming out of the Kansas City Fed's annual gathering at Jackson Hole in August.

The Euro-area's inflation also accelerated in May, largely driven by fuel prices. Headline inflation rose to 2.0% in May from 1.6% in April, slightly above consensus expectations. After witnessing a double-dip recession in Q1, an increase in the pace of inoculations is fuelling optimism about the bloc's economic outlook. Indicators of activity such as mobility data have rebounded rapidly through May to levels last seen pre-pandemic. Meanwhile, the ECB played down the spike citing the still significant amount of slack in the labour market. On the month, the EuroStoxx50 gained 1.6% while the EUR appreciated 1.7% against the USD.

**Although the UK is now more or less open for business, the government is likely to keep tight limits on international travel for the weeks ahead despite demands from industry groups to lift restrictions as planned this month.** While the successful rollout of vaccines has opened the door to much of lost economic activity to be recouped, the biggest risk is that mutations of the virus cause a delay or reversal of the easing of restrictions. Broadly, the rapid rollout of vaccines and the easing of restrictions is leading to a near-term boom as households spend again and the rapid recovery is shifting the focus of debate within the BoE toward how and when to withdraw stimulus. The FTSE100 was up 0.8% while the GBP rose sharply by 2.8% against the USD.

Japan continues to struggle with resurgences of the virus and the slow pace of inoculations while PM Suga's decision to extend the latest state of

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emergency through mid-June has heightened the risk the economy could shrink again in Q2. While the BoJ's most recent Tankan survey showed big businesses planning the biggest investment increases this year since 1990, a continued slump in consumer spending, along with a slow vaccination drive could threaten or at least postpone some of those plans. The JPY has been supportive for Japan's export-heavy economy and has weakened sharply, down 6.1% so far this year against the USD. The Nikkei225 ended flat in May.

Producer price inflation in China has rapidly increased to 6.8% year on year in April, after turning positive in January. While the latest PMIs also point to intensifying inflationary pressures, given the weak recovery in consumption, inflation pass-through could be limited. Even the PBoC, like the Fed, sees the inflation spike as transient and prefers to ride it through although it has started tapering stimulus by tilting to a tighter liquidity bias.

Chinese growth stocks, notably the tech sector, have corrected significantly since February after authorities began cracking down on the market power and reach of the country's biggest internet giants. On the month, the Shanghai Composite rallied 4.9% while the CNY appreciated 1.6% against the USD.

New infections in India held near their lowest level since early April and rate-hike expectations cooled as the RBI turned its focus back to struggling growth owing to extensive localised lockdowns across the country. While virus cases have started receding and some parts of the country look set to reopen in June, consumers are unlikely to spend freely, given the economic uncertainties and unemployment at its highest level in a year. Meanwhile, Turkey's Erdogan renewed calls for lower interest rates despite elevated inflation,

sending the TRY to a fresh low against the USD and prompting the central bank governor to push back against expectations of a rate cut anytime soon.

Overall, the coronavirus continues to spread in large swathes within EM, adding to the need for more stimulus and complicating matters for EM central banks who remain vulnerable to the Fed's moves and the direction of the Dollar Index.

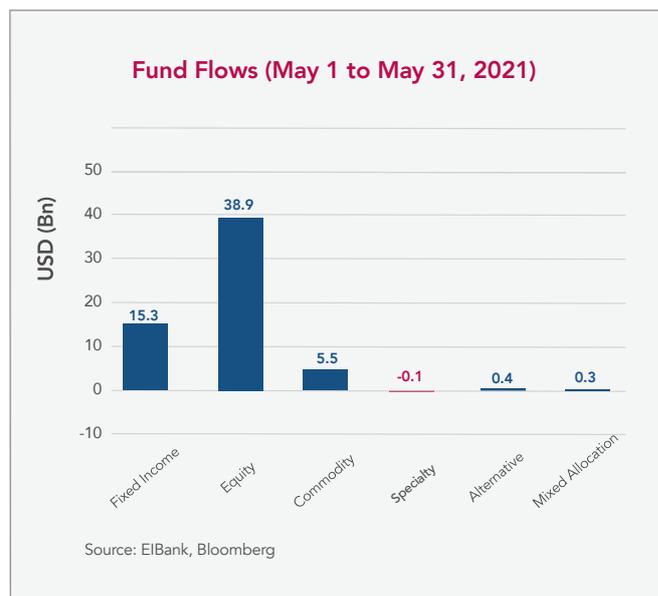
Even as the demand picture has shown clear signs of improvement as economies reopen, OPEC+ is erring on the side of caution and sticking to its plan of gradual monthly production increases until July. The agency also remains cautious about the second half with the outlook for oil dependent on two unpredictable factors - the coronavirus and the US-Iran nuclear talks. Meanwhile, the Saudi economy looks set to gather pace in 2021 as vaccinations progress and higher oil prices provide elbow room for policy response. Also, based on its strong financial flexibility, Saudi

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Aramco plans to raise around USD5 bn from the bond markets to help fund a USD75 bn annual dividend commitment. Business activity in Dubai also rose to the highest level since late 2019 owing to a rebound in tourism and a fast distribution of vaccines. The S&P Pan Arab Composite Index has been outperforming global equities and gained another 1.7% in May while Brent rallied 3.1%.

## Fund Flows

- Net flows into global equity funds remained strong but decelerated moderately in May compared to the previous month, as EM-dedicated fund flows decelerated. Funds focused on western European markets (ex-UK) saw a notable increase in net inflows and flows in US-dedicated funds remained stable with value getting the lion's share of equity flows. By sector, the largest net inflows were into commodity/materials, energy, and infrastructure.
- Fixed-income ETFs are having a relatively steady 2021 on rising growth and inflation expectations. Meanwhile, ETFs focused on Treasury Inflation-Protected Securities (TIPS) are taking in record flows amid speculation over whether the recent inflationary pressures are transitory or here to stay. Overall, investors continued to reduce exposure to government debt as well as IG bond funds.
- Money market fund assets rose and benefitted from investor concerns around central bank moves.
- Cross-border FX flows accelerated and weighed on the Dollar Index, favouring the GBP and the CNY.



## The S&P 500: Expectation versus Reality

The dramatic gains of the last 12 months can be attributed to almost entirely to rising EPS expectations, after markets reached a bottom with collapse in yields and a large inherent risk premium for equities. So far, markets have behaved in line with theory which is to track earnings growth expectations.

**Chart 1** shows how closely the S&P500 has tracked the rising forward EPS growth expectations since June 2020 while the forward P/E has remained more or less stable.

**Chart 2** shows the gap between earnings over the last 12 months (LTM) and estimates for the next 12 months (NTM). The infeasibly large gap is worrisome as the already lofty EPS growth expectations face multiple headwinds. The underlying economic improvement picture has improved dramatically, but a lot of that is priced in. There are no obvious catalysts on the horizon and some inflation-related concerns.

The Fed's "Beige Book" report said that "looking forward, companies anticipate cost increases and hence would be charging higher prices in coming months." While firms will try to hike prices as factory inflation rises, companies will find it difficult to pass on all their costs to consumers.

Meanwhile, May's job report which showed robust wage growth, could leave the Fed on course to send some signalling in June of a gradual movement toward eventually reducing asset purchases. Debt servicing costs will rise if interest rates rise, denting corporate profit margins.

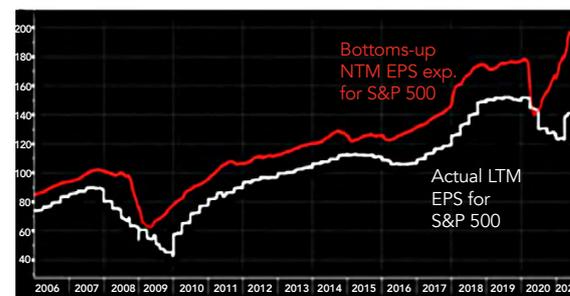
Also, chances remain high that the Biden administration will be able to push through tax increases to fund its massive deficit. All these factors are expected to act as headwinds to upbeat earnings expectations as we move forward from here.

### Percent Change in S&P 500 Index, EPS and P/E

Chart 1



Chart 2



Source: Bloomberg, Morgan Stanley Research

## Multi Asset Strategies

Asset Class	Conservative		Balanced		Aggressive		Views
	Current Weight	Strategic Weight	Current Weight	Strategic Weight	Current Weight	Strategic Weight	
<b>Fixed-Income</b>	<b>67.5%</b>	<b>75.0%</b>	<b>42.5%</b>	<b>52.5%</b>	<b>15.0%</b>	<b>25.0%</b>	
Developed Markets	60.8%	71.3%	34.0%	44.6%	10.1%	18.8%	
US Sovereigns	3.3%	7.5%	1.1%	2.6%	0.2%	0.6%	
Developed Market Sovereigns	3.4%	7.5%	1.1%	2.6%	0.1%	0.6%	
Developed Market Aggregate (IG)	47.3%	56.3%	19.1%	28.9%	4.5%	10.0%	
Developed Market High Yield	6.8%	0.0%	12.7%	10.5%	5.3%	7.5%	
Emerging Markets Fixed Income	6.7%	3.8%	8.5%	7.9%	4.9%	6.3%	
<b>Equities</b>	<b>20.0%</b>	<b>17.5%</b>	<b>40.0%</b>	<b>35.0%</b>	<b>65.0%</b>	<b>60.0%</b>	
Developed Markets	15.0%	13.6%	30.0%	27.1%	48.8%	46.5%	
US Equities	10.5%	8.8%	21.0%	17.5%	34.1%	30.0%	
European Equities	4.0%	3.5%	8.0%	7.0%	13.0%	12.0%	
Japanese Equities	0.5%	1.3%	1.0%	2.6%	1.7%	4.5%	
Emerging Markets Equities	5.0%	3.9%	10.0%	7.9%	16.2%	13.5%	
<b>Real Estate</b>	<b>2.5%</b>	<b>2.5%</b>	<b>5.0%</b>	<b>5.0%</b>	<b>5.0%</b>	<b>5.0%</b>	
<b>Commodities</b>	<b>0.0%</b>	<b>0.0%</b>	<b>2.5%</b>	<b>2.5%</b>	<b>5.0%</b>	<b>5.0%</b>	
Gold	0.0%	0.0%	1.5%	1.9%	3.0%	3.8%	
Silver	0.0%	0.0%	1.0%	0.6%	2.0%	1.3%	
<b>Cash &amp; Equivalents</b>	<b>10.0%</b>	<b>5.0%</b>	<b>10.0%</b>	<b>5.0%</b>	<b>10.0%</b>	<b>5.0%</b>	

Underweight Cautious Neutral Favour Overweight

## Asset Allocation Views

- We remain modestly overweight risk assets given the booming global growth, reopening from the pandemic amid the uncertainty around policy shifts and rising inflation along with its endurance. With central bank easing and the ensuing valuation multiple expansion largely behind us, growth momentum remains key to further upside in risk assets.
- Given our pro-cyclical stance, our portfolios are geared to above-trend growth as the economic and policy backdrop calls for a pro-risk tilt. We recommend increased allocation to cyclicals (financials, materials, energy, autos), health care and consumer discretionary sectors.
- In fixed income, we see credit returns being primarily driven by carry and favour HY over IG. Growth uptick underpins HY while IG remains an underweight due to its longer duration and rich valuations. We recommend shorter duration as the Fed remains firm on accommodation. EM credit still offers good income potential selectively.
- Uneven recovery due to slow vaccination in several parts of the world would prolong the global cyclical rotation and prevent yields from rising too fast and destabilizing equity multiples. As a result, we continue our strategic preference to select large tech companies in the US with pricing power, structural tailwinds, strong balance sheets.
- Growth unknowns and monetary-policy uncertainties in the medium term would prompt a rethink in strategies and risk tolerance at a later stage. While major economies posted remarkable Q1 GDP growth, there is concern about inflation, evident in the US CPI YOY growth of 5% and level of US 10-year inflation breakeven rate, which stands at 2.34%, down from 2.56% in May. Our view remains that inflation should stabilize and rise gradually after a spike in the next couple of months. We continue to advocate meaningful allocation into inflation beneficiaries (banks, commodities). We recommend decent exposure to precious metals (gold, silver) and TIPS for tail risk hedging and our outlook on the USD remains neutral.
- We favour EM countries with strong export prospects as the developed world leads the global recovery. GCC credit, notably Sukuk, is expected to remain in decent demand amid favourable risk-reward dynamics, improving macro and scarcity of supply.
- Despite heightened concerns on rising inflation expectations, we are still in a supportive policy backdrop for risk assets. We seek to diversify portfolio risks across equities, fixed income, income-generating assets and cash. We prefer to use cash as a buffer against risks around regime shifts that could drive both equity and fixed income markets lower.

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