Assessing the Path Ahead

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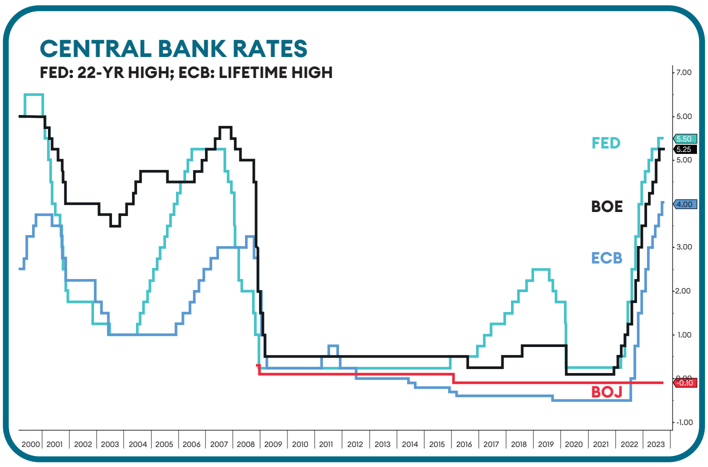
The market's assessment of interest rates has undergone numerous changes during the year. From projecting first rate cuts in June to no rate cuts in the year, the market is now considering the latest projections from the US Fed that keeps the door open for another rate hike before the end of the year. With the resolution of major supply side issues and cooling off food and energy prices, the easy part of the battle against inflation is now behind us. The path from here onwards up to the final target of 2% inflation will be more unpredictable as some factors continue to support consumer spending while others create tighter financial conditions. The path forward may be more volatile as rates may stay higher for longer and policy makers become more data dependent.

ECONOMIC UPDATE

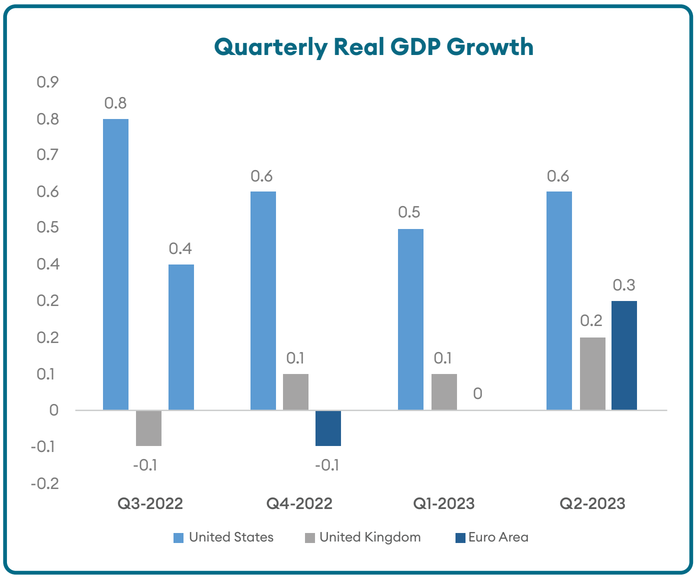
Central bank actions: As expected, the Federal Reserve left the benchmark rates unchanged at 5.25-5.50%, which are the levels last seen in 2001. However, the Fed surprised the market with a hawkish Dot Plot projections which continues to show another rate hike within 2023 and much higher rates for the coming two years while also raising the GDP growth outlook. The prospect of 'higher' and 'higher for longer' rates along with faster economic growth pushed the US Treasury yields to 16-year highs, increasing the cost of borrowing across the board. By contrast, the European Central Bank (ECB) delivered the 10th consecutive rate hike with a dovish stance, significantly downgrading GDP growth outlook. The deposit rate now stands at 4%, the highest since the creation of the common currency, and have most likely reached a peak. After 14 straight hikes, the Bank of England (BOE) surprised the markets by keeping interest rate unchanged at 5.25%. The BOE is probably trying to balance between worsening economic outlook with its mandate of price stability.

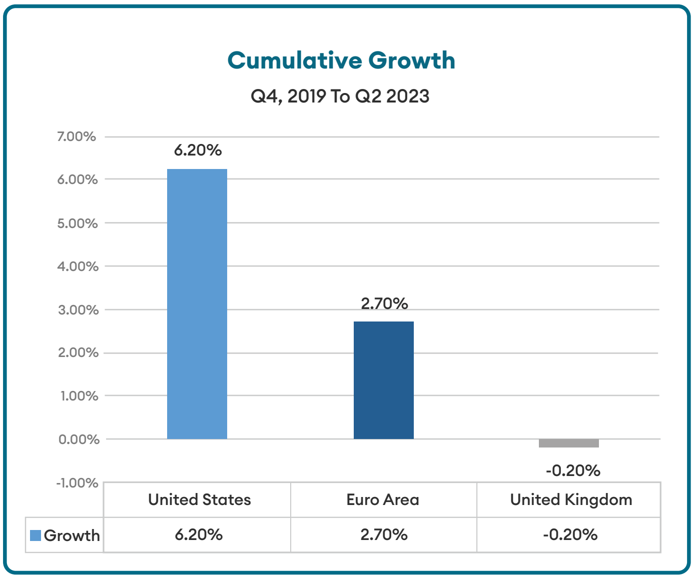
US Fed Fund Rate
22 Year High

ECB Deposit Rate
Lifetime High



US more resilient compared to UK and Eurozone: The US consumers and companies have remained less sensitive to higher interest rates than the UK and Eurozone. US economic growth has remained robust despite rising rates whereas signs of slowdown are evident in the UK, where retail sales and consumer spending sentiments have been contracting since last year, and in Germany, the largest economy in the Eurozone, manufacturing activity and household spending are shrinking. Germany was in recession earlier this year and did not grow in Q2, 2023. The UK is the only major economy that is still smaller than its pre-pandemic levels (Please see chart below). Inflation in both the Eurozone and the UK remains higher than the US, increasing the risk of stagflation: stagnant growth with high inflation.

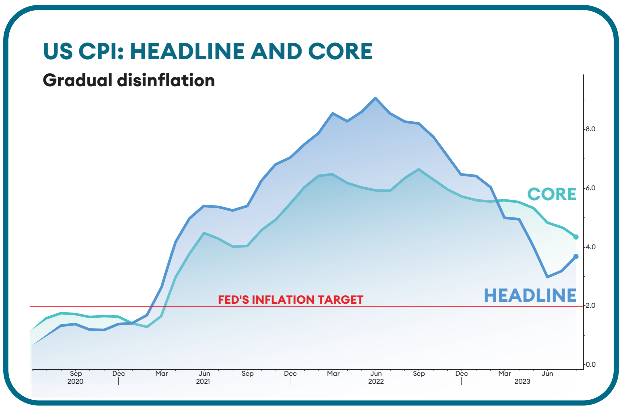


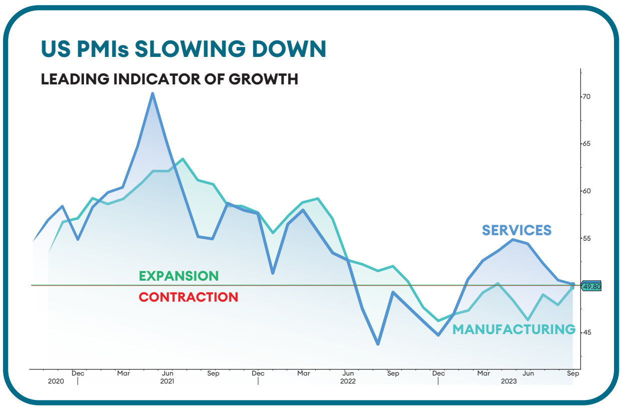


The gradual process of disinflation in the US: Core Consumer Price Index (CPI), that strips out volatile energy and food continues to move downward whereas the headline inflation in the US ticked higher for the second consecutive month due to temporary factors like energy. The favorable underlying trend remains in place, and core inflation is set to fall sharply over the next few months due to slowing rental growth and moderating wages. The lagged effects of higher rates are dragging on both growth and inflation; the forward-looking Purchasing Managers' Index (PMI) clearly shows that both manufacturing and services indices are close to the figure of 50 which separates expansion from contraction. PMIs indicate that the business activity is likely to be subdued in the months to come, making the work of the Fed easier. While higher rates may dampen economic activity, the process of disinflation is likely to be slow, gradual, and even volatile as consumers still remain quite resilient.

US Headline Inflation

3.7%





US Core Inflation

4.3%

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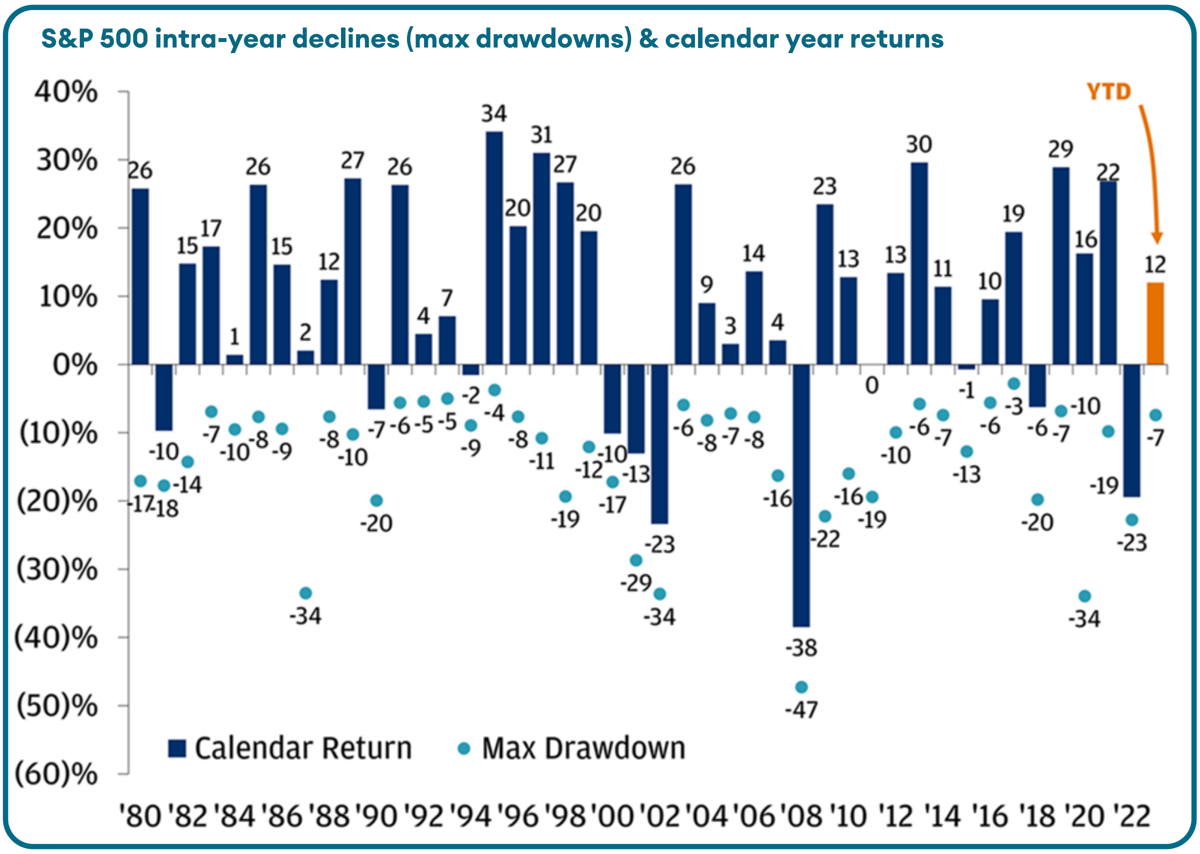
MARKET UPDATE AND OUTLOOK

The path forward: While in January it was believed that historically aggressive rate hikes will quickly lead to a 'hard landing' or recession that would force the Fed to cut rates, now there is a belief that there is a golden path to 'soft-landing' which means that the Fed will be able to lower inflation without really pushing the economy into a recession. Historically, a recession is inevitable when interest rates are increased aggressively. This time around the situation has been different. Tightening monetary policy of the Fed has been countered by two key factors: 1) the US consumer has been strong given accumulated savings during the pandemic period and reduced interest rate sensitivity due to fixed rate mortgages and 2) expansive fiscal policy with the government spending trillions on promoting domestic manufacturing under the Inflation Reduction Act and the Chips Act. As a result, the much-anticipated recession has also become the most postponed one and it is likely that there will be none while inflation gradually recedes. However, the process will take time and therefore the rates are likely to stay higher for longer.

Equity markets: Equity markets performed very well in the first half of the year as inflation pressures eased giving way to expectations that the Fed will pivot before the end of the year. However, lately it is becoming clear that the path to normalization will be gradual and long drawn. The markets are facing numerous headwinds including a hawkish Fed, spike in bond yields and strengthening US dollar. However, from the earnings perspective, the worst for the S&P 500 index may be behind us. Following three consecutive quarters of contraction, earnings are expected to rise going forward, not fall. This does not mean that there will be no volatility going forward. In fact, the volatility in equity markets is normal and should not derail your long-term investment plans. Over the medium to long-term time horizon, equities have consistently outperformed bonds and cash by a margin. Please see the chart below: the blue bars in the chart below show the annual returns delivered by the S&P 500 index over the last 43 years while the green dots show the worst drawdown during the year. It is clear that despite the index dropping intra-year, every single year, it has delivered positive performance in 33 of the 43 years. The positive performance has averaged about 17% per annum. While pullbacks are painful, selloffs aren't all that unusual.



Source: JP Morgan Private Bank; FactSet.

Data as of: September 28, 2023.

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Bond markets: Rising rates have been a headwind for bond prices. The broad based Bloomberg US Aggregate Bond Index, that tracks the total performance of investment grade USD bonds is down for the third consecutive year, which is unprecedented. Right now it is trading at its lowest level of 2023. However, this has resulted in the yields rising further and has made high quality bonds even more attractive for long-term investors. But a higher-for-longer interest rate policy should, over time, bring inflation down toward the Fed's 2% target. At that stage, as the Fed starts cutting rates, investment grade bonds are likely to generate equity like returns. In the meanwhile, investors can enjoy high level of safe and durable income and lock it for the long term. It is important to note that today's cash yields, that make time deposits attractive, will not last forever; however, higher yields on bonds can be locked in.

US Bond Index
Down for 3rd Year

MARKET DATA

Global Equities	Last price	YTD 2023
MSCI World	2853.24	9.63%
Dow Jones Ind.	33507.5	1.09%
S&P 500	4288.05	11.68%
NASDAQ COMP	13219.32	26.30%
EUROSTOXX 600	450.22	5.96%
FTSE 100	7608.08	2.10%
India Nifty50	19638.3	8.47%
Nikkei 225	31,857.62	22.09%
Shanghai Comp	3110.475	0.69%

Currencies	Last price	YTD 2023
Dollar Index	106.264	2.65%
Euro	1.0568	-1.28%
GBP	1.2195	0.93%
JPY	149.67	-12.39%
CHF	0.916	0.93%
AUD	0.64135	-5.55%
CNH	7.3047	-5.24%
INR	83.04	-0.37%
SGD	1.3672	-2.03%

Regional Equities	Last price	YTD 2023
Dubai DFM	4163.58	24.80%
Abu Dhabi ADX	9785.32	-4.17%
Saudi Tadawul	11,060.00	5.60%

Market Data As of 30 Sept 2023

Commodities	Last	YTD 2023
WTI Crude	90.98	13.36%
Brent Crude	92.37	7.52%
Nat Gas	2.902	-35.15%
Gold	1847.28	1.28%
Silver	22.057	-7.92%
Copper	373.2	-2.06%
Corn	476.75	-29.73%

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ALTERNATIVES	• Mutual funds investing in US senior secured loans delivering regular income

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