MACRO OUTLOOK

MIDYEAR 2024

JULY 2024

Executive Summary

The global economy is at a crossroads as monetary policy continues to define the outlook.

Global Economy

The global economy generally surprised to the upside, with steady but slowing growth, as consensus broadened over a soft-landing narrative.

However, as tailwinds to the consumer fade and monetary policy lags catch up, we can't discount the possibility of a recession completely yet.

Inflation continued trending to target levels, despite proving somewhat stickier in services, allowing central banks to move towards easing policy.

While 20 of 37 major central banks are now in easing mode, the Fed pushed back its dot plot and normalized rates in the medium term will be markedly higher than what we were accustomed to prior to this cycle.

Beyond short-term volatility in the data, we recommend looking at long-term trends in a new regime marked by active inflation and interest rates.

Global Markets

Most global equity markets and asset classes extended solid returns, though GCC markets lagged over sentiments on geopolitics and oil.

Corporate earnings have shown signs of wider rebound, however, analysts outlooks might be too optimistic considering macro uncertainty.

Valuations skew expensive as incoming earnings become crucial to sustain demand for risk assets. The UAE offers good value in this global context.

UAE

Solid growth driven by a diversified economic base as the non-oil sector is providing a counterbalance to oil production cuts.

Headwinds from regional tensions, production cuts, slower global growth and higher rates have yet to dent the post-covid UAE growth story.

While public markets have lagged, valuations are placed competitively globally, bright local macro and fundamentals should still be supportive of corporates.

Dealmaking

Dealmaking and private markets remain slower but there are encouraging signs the worst is now behind us and activity should tick up as rates pivot.

Higher capital costs have fundamentally changed the playbook for private market investors, with value creation a key lever and determinant for success.

Asset selection becomes more critical, while avenues to diversify returns will be the widest in decades under a new macro regime.

Geographic Opportunities

We continue to see the robust macro backdrop and trajectory of the UAE translating to compelling investment opportunities.

Increasing divergences in global markets are also creating opportunities elsewhere, particularly looking outside of mega-cap representation.

Opportunities are available in Brazil, China could be too big to ignore, while the breadth and quality available in Japan remain attractive.

Economic Outlook *Sec. 1*

Global growth has generally surprised to the upside

Steady but slower growth.

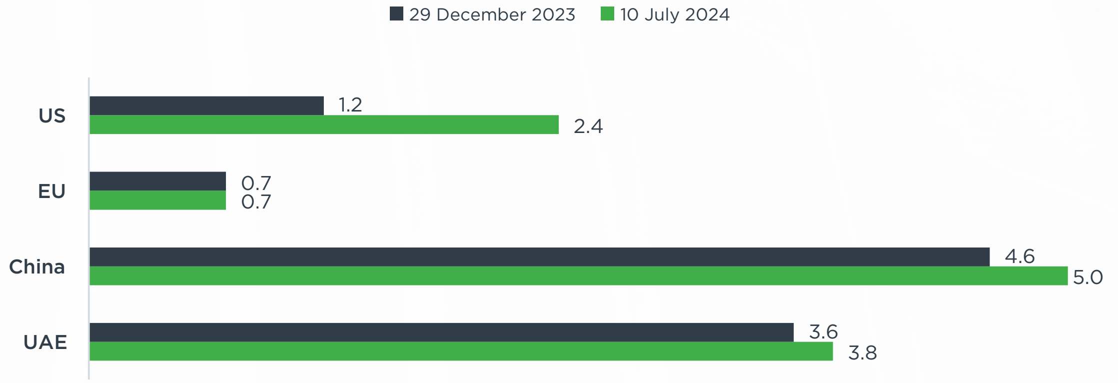
Led by US exceptionalism, the global economy has largely defied pressures of higher interest rates so far, proving more durable than expected.

In H1, major economies showed signs of stabilizing following post-COVID volatility, though growth is set to remain modest by historical standards.

The IMF projects the global growth rate to hold steady at 3.2% in 2024, while encouraging, is still below the pre-COVID decade average of 3.7%.

Even so, global corporate profits have benefited from the broader confidence and growing soft-landing narrative, rising 5.4% in Q1.

Consensus Forecast CY'24 Real GDP Growth (%)



Notes: Mean analyst forecasts for full year 2024

Source: Bloomberg

A soft landing remains the markets consensus.

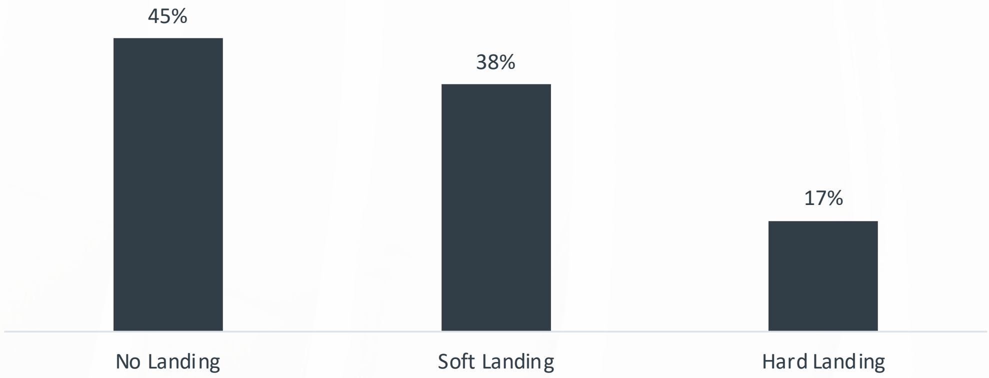
Six months ago, market consensus over the global economy featured steadily falling inflation, a slide toward recession and aggressive rate cuts.

Consensus now seems to expect continued expansion, resurgent inflation pressures, and limited easing from central banks.

A Deutsche Bank survey of its clients at the end of Q1 revealed 83% had a US soft or no landing priced in, up from 70% in Q4 last year.

While a “soft landing” is a possibility, it would be unprecedented, arguably occurring only once in 1994 when interest rates rose by just 3%.

Survey: By Year End, Which Phrase Best Describes Where The US Economy Will Be?



Notes: No landing = no recession and inflation above target, Soft landing = no recession and inflation trends to target, Hard landing = recession

Source: dbDIG Survey, Deutsche Bank

Risks to consider for short and long-term growth

We can't discount the possibility of a US recession yet.

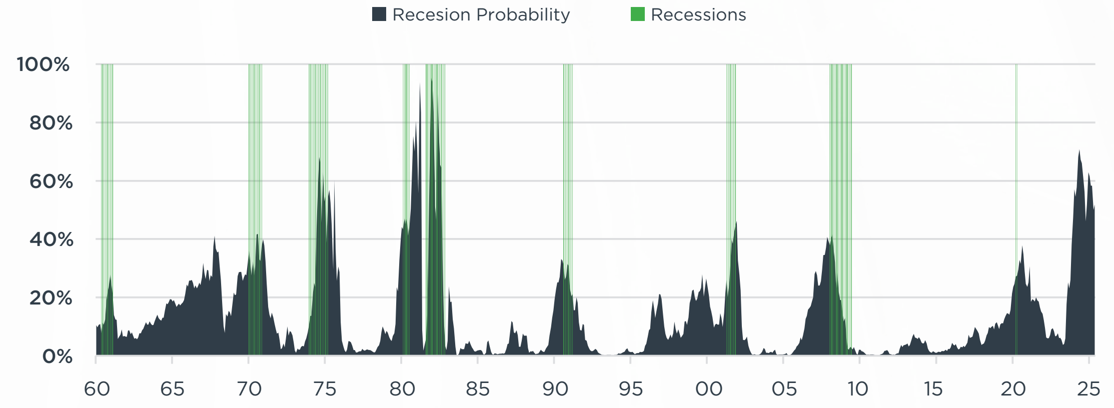
The probability of a US recession (12 months ahead) as predicted by treasury spread remains worryingly above 50%.

Since 1960, there has never been a period where this indicator has crossed the 40% threshold and not been followed by a recession.

While the yield curve inversion has started to shallow, this has typically been the point when recessions begin, often by the Feds second rate cut.

US economic cycles tend to have an outsized impact on UAE businesses due to the currency/policy peg, influence on crude and weight in global markets.

Probability of US Recession Predicted by Treasury Spread



Notes: 12 months ahead (month averages), authors own calculations

Source: Federal Reserve Bank of New York

Lower global economic growth this decade could influence markets.

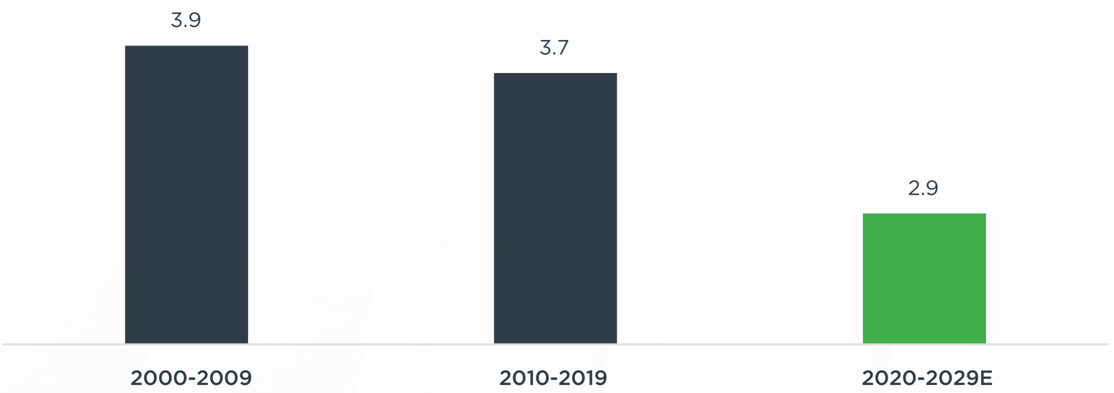
Forecasts of economic growth in the current decade are expected to, on average, be lower than the preceding two decades.

This is largely attributed to declining trends in population growth and productivity, while higher debt burdens will reduce scope for government spending.

Economic growth impacts corporate earnings, interest rates, and many other factors that influence the long-term performance of markets.

A general drawdown in earnings growth could become a drag on equities returns, as well as encouraging lower long term interest rates.

Average World GDP Growth (%)



Notes: 2024-2029 estimates from April 24 WEO

Source: IMF

Inflation has broadly come down with more to go

Nearing target levels in most major economies.

Global inflation has staged an impressive decline from 2022 peak levels of nearly 8% to around 3% today.

The big decrease in inflation from 2022 to 2023 was due to goods disinflation, which is typically the easy part of taming inflation.

This was mostly driven by an unravelling of the post-pandemic supply chain issues and business disruptions.

However, there remains a significant risk that it could reaccelerate if global growth broadens, and if policy rates come down prematurely.

There remains ground to cover and structural headwinds.

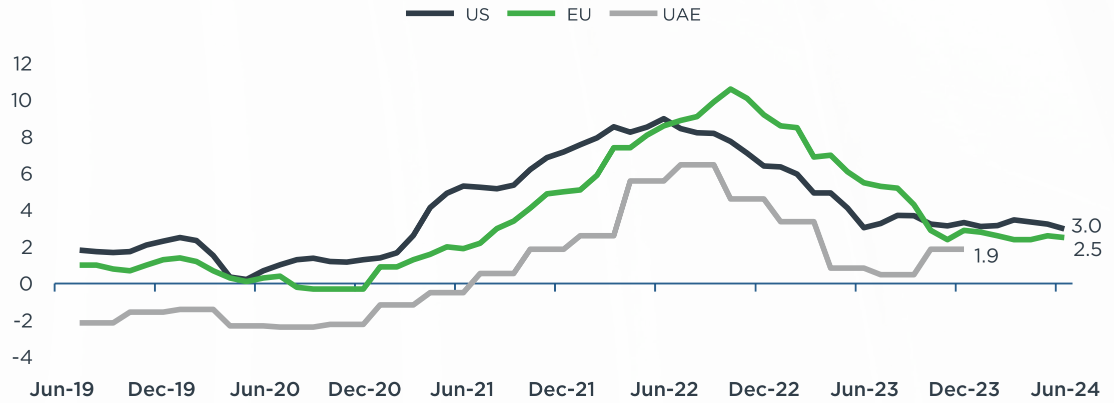
There is a big difference between 3% and 2% inflation, with the US Federal Reserve publicly declaring its commitment to the 2% target.

Now services inflation, which is proving stickier, needs to fall for central banks to feel comfortable with its progress managing price pressures.

Labor markets will have to cool as elevated wage growth, still 1% higher than trend in the US, is the primary driver of services inflation.

Sustained real interest rates will also be required to combat inflationary forces of deglobalization, energy transition and increased defense spending.

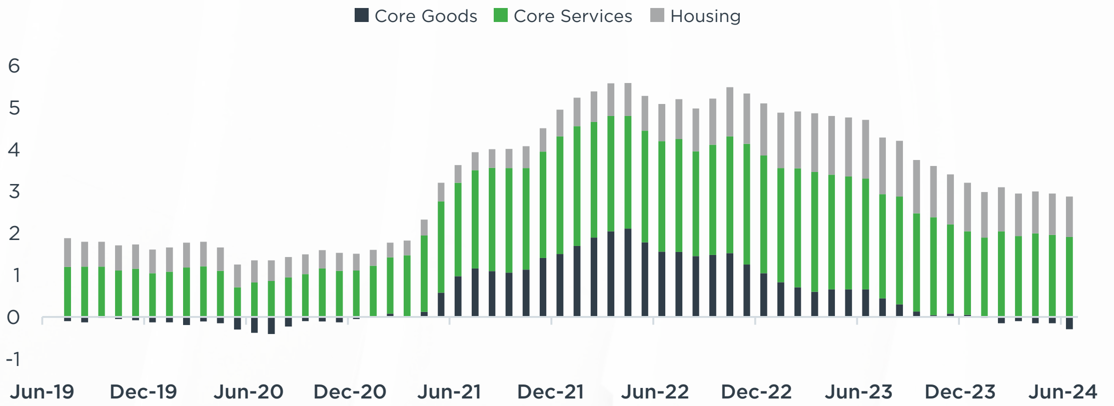
Global CPI Inflation YoY (%)



Notes: Percentage change from previous period (year-on-year)

Source: FactSet Economics

Contributions to 12-month US Core PCE Inflation (YoY %)



Notes: Price changes observed in the overall economy attributable to these specific categories

Source: US Bureau of Economic Analysis

Rates will likely remain higher for longer

Policy makers are at a crossroads.

The Fed has now held constant the steepest increase in the Fed Funds rate since the 1980's Volcker era for 12 months since its last rate hike.

An extended period of easy financial conditions and excess liquidity has taken longer for the lagged effects of rates to move through the system.

Policy makers will be cautious of erasing their work by easing conditions too quickly and allowing inflation to re-emerge.

They will also be concerned not to allow the increasing risks of lagged effects of rate hikes to result in a hard landing of the economy.

Fragile Policy Path

Notes: Apollo 2024 Mid-Year Outlook: An Unstable Economic Equilibrium

Source: Apollo Chief Economist, Torsten Sløk

Interest rates took the elevator going up, but they're going to take the stairs down.

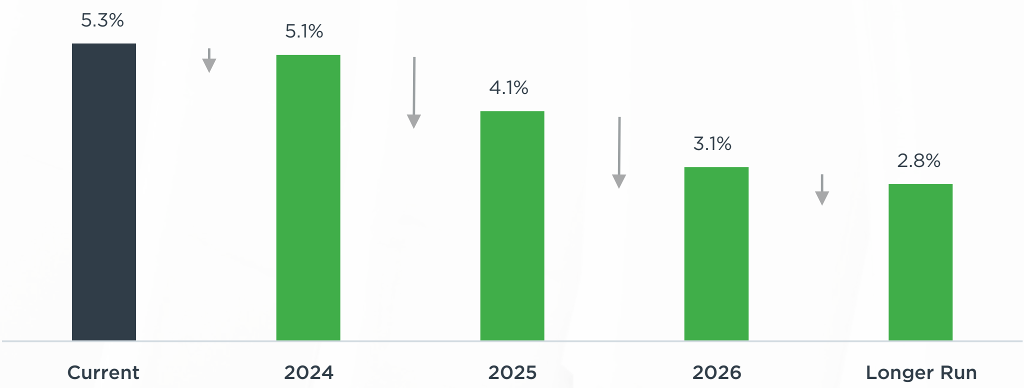
While 20 of 37 major central banks are in easing mode, the Fed (and by extension the UAE) has so far resisted urges to pivot.

The FOMC's June dot-plot sees a single 25bps cut this year, compared with the three indicated in December as the US economy remained hot.

However, following the ECB making its first cut in June, Fed Fund Futures have gained optimism for 2 to 3 cuts starting in September.

Nevertheless, a medium-term outlook of ~3% level for normalized rates remains materially higher than what we were accustomed to prior to this cycle.

The Fed's June Dot Plot



Notes: FOMC members median projections of year end Fed funds target rates, 12/16/2024

Source: Federal Reserve

Consumers are slowly feeling the pinch as savings deplete

Consumers are finally slowing down.

Consumer confidence generally declined amid concerns over inflation, the depletion of personal savings, and perceived labor market weakness.

Regionally, European consumers continued to lag the US and Asia where consumers have shown they still have some gas left in the tank.

S&P PMI of new orders for consumer goods and services averaged just 48.7 in Europe in Q2 compared with 51.4 in the US and 54.3 across Asia.

US retail sales growth edged down to 2.3% in June, versus a long-term average of 3.4%, but still, some distance away from seeing falling sales.

Impact of inflation and higher rates are catching up.

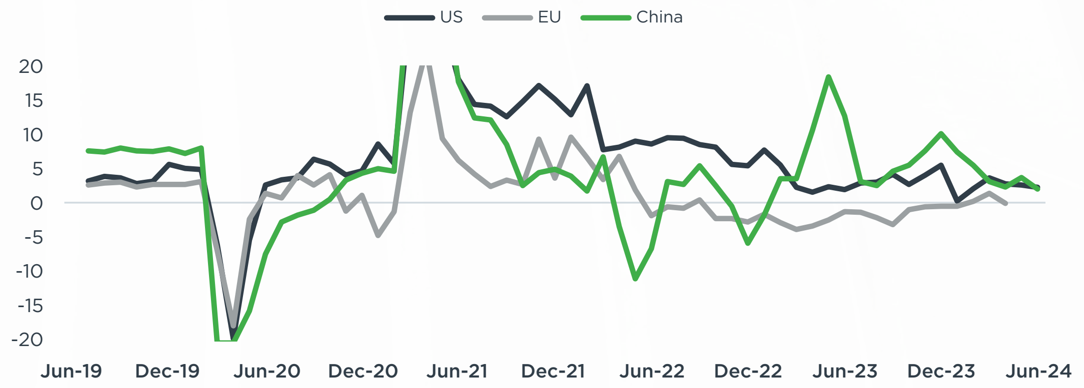
Consumer confidence has been mixed to lower globally. In 2024, consumer sentiment increased in 21 countries but decreased in 22.

Overall spending power is being influenced by inflation and diverging economic policies in different regions.

Credit card delinquency rates in the US hit a 12-year high as consumers have leaned heavily on borrowing to pay for expenses.

This comes as the average credit card charges near a record 20.6%, increasingly a burden which will dampen consumer spending power.

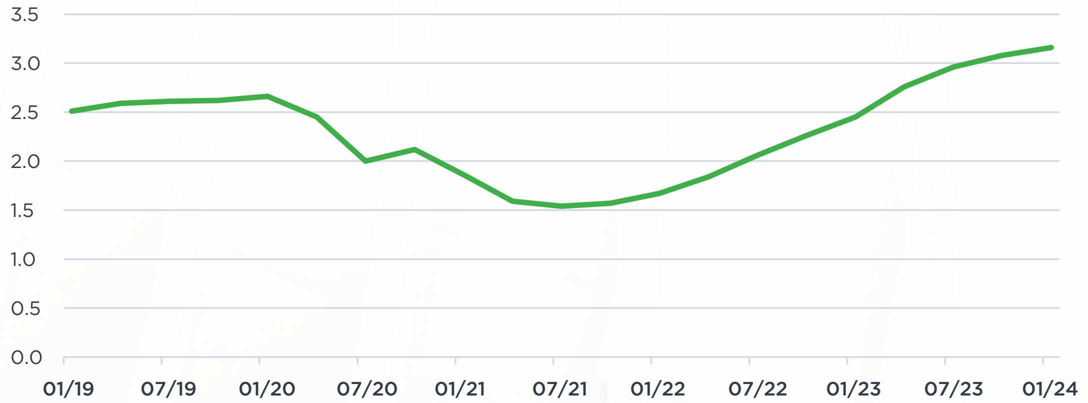
Retail Sales YoY (%)



Notes: Year on year retail sales excluding automobiles

Source: US Census Bereau, EUROSTAT, National Bereau of Statistics of China

US Delinquency Rate on Credit Card Loans (%)



Notes: Delinquency Rate on Credit Card Loans, All Commercial Banks

Source:Federal Reserve Bank of St. Louis

Regional Focus

Tailwinds / Headwinds

UNITES STATES

Tailwinds:
- Robust growth and corporate resilience
- Consumer spending still active
- Leading technological innovation

Headwinds:
- Inflation is proving stickier than elsewhere
- High debt and deficit will limit fiscal spending
- Expensive dollar weighs on exports

GCC

Tailwinds:
- Strong fiscal reserves
- Economic reforms and diversification efforts
- Rising FDI and supply chain localization

Headwinds:
- Softer global demand outlook
- Geopolitical risks and regional instability
- Oil production cuts continue to weigh

EUROPE

Tailwinds:
- Inflation is closest to target rate of major economies
- Boost from pivot in interest rate cycle
- Improved manufacturing and export sectors

Headwinds:
- Broadly anemic growth/ dynamism
- Continued risks from Russian war and energy
- Political risks and election pains

EMERGING ASIA

Tailwinds:
- Growth differentials with advanced economies
- Prospects of a softening dollar
- Growing middle class and infrastructure

Headwinds:
- Slower rate cuts due to currency weakness
- Uncertainty over Chinese economy
- Geopolitical instability

UAE Outlook

Growth story remains un-spoiled.

An extension of OPEC+ cuts has seen a slower recovery in oil GDP growth, mitigated by robust but declining growth in the non-oil sector.

Prudent fiscal policies, foreign investment flows, strong financial buffers and diversification strategies have proven effective.

By virtue of its currency peg, a delayed impact of US monetary policy could increasingly take effect until interest rates come down next year.

We see growth falling slightly short of central bank estimates, at around 3.8% this year and 4.2% next year, as non-oil growth normalizes.

Why is economic strength not translating to market returns?

Despite a brilliant economic backdrop and strong fundamentals, Dubai and Abu Dhabi each find their stock markets in the red for most of the year so far.

Uncertainty and concerns over Fed policy, oil revenues and escalating conflicts in the region have weighed on sentiments.

There is also questions over liquidity following an unprecedented IPO drive and slowing foreign flows, reflected by more cautious IPO roll-outs.

Valuations (particularly an issue in Abu Dhabi in recent years) have come down to reasonable levels, offering great value for patient capital.

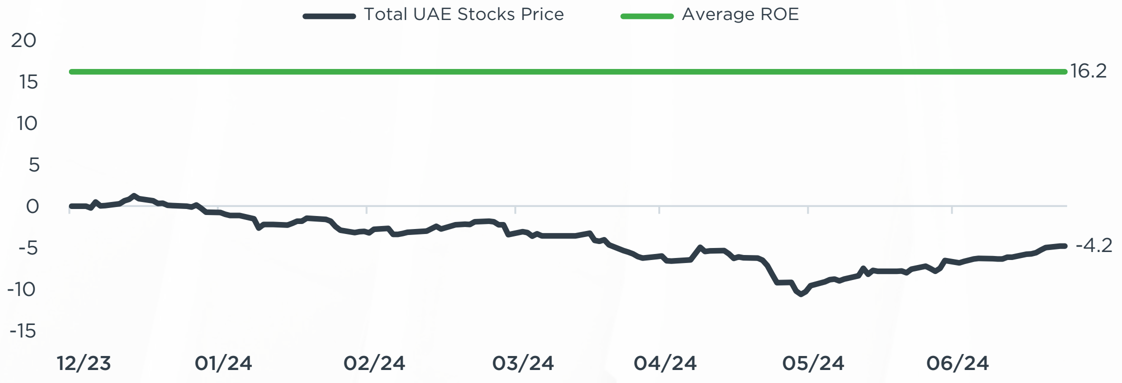
The UAE Central Bank's Forecast of Real GDP Growth

	2021	2022	2023E	2024F	2025F
Overall GDP	4.4	7.9	3.1	4.2	5.2
Non-oil GDP	6.5	7.2	5.9	4.7	4.7
Oil GDP	1.1	9.5	-3.9	2.9	6.2

Notes: Percentage CBUAE for 2023-2025, Federal Competitiveness and Statistics Centre for 2021-2022, E= Estimate and F= Forecast

Source: CBUAE, Federal Competitiveness and Statistics Centre

YTD UAE Stock Market Returns vs ROE (%)



Notes: FactSet market index of total UAE stock market returns YTD vs average weighted return on equity of participants in this period

Source: FactSet

Market Outlook *Sec. 2*

Market performance

Global equities delivered solid returns in the first half of 2024.

Gains in most global equity markets have continued, once again spearheaded by U.S. mega-cap growth stocks.

Optimism has stemmed from resilient growth, rebounding corporate earnings, disinflation, expected rate cuts and a possible soft landing.

Fixed income also looks attractive with high real yields and diversification potential should an adverse economic scenario materialize.

GCC stocks have lagged as concerns over regional tensions and adverse effects of oil production cuts increasingly weighed on sentiment.

Macro data, valuations and earnings importance in H2.

Markets are pricing in a positive macro forecast, with data each month now either further confirming or contradicting the uplifted sentiment.

While analyst estimates for 10.3% global earnings growth by year end may justify market jubilation, further macro deterioration remains a risk.

In an environment of such uncertainty an increased sensitivity to valuation and attention to incoming earnings results is advised.

Fundamentals should take precedence as we can expect divergences of performance amongst regions, sectors and corporates.

Equity Market Performance (%)

		2022	2023	YTD
US	S&P 500	-19.4	24.2	13.8
Abu Dhabi	FTSE ADX General Index	20.3	-6.2	-3.3
Dubai	Dubai DFM General Index	4.4	21.7	3.6
Saudi Arabia	Saudi Arabia All Share (TASI)	-7.3	14.1	0.0
EU	Euro STOXX 50	-17.2	23.4	5.7
UK	FTSE 100	-10.4	10.0	6.8
Japan	Japan Nikkei 225	-20.9	20.0	7.6
China	MSCI China	-21.9	-11.2	3.2
India	Nifty 50 Index	-6.3	19.3	11.6
Turkey	Turkey BIST 100	110.4	-14.1	32.3

Notes: Returns in USD terms, as of 25/07/2024

Source: FactSet, Bloomberg

Asset Class Performance (%)

			2022	2023	YTD
Public Equities	Global	MSCI ACWI	-18.4	22.2	11.5
	DM Ex-US	MSCI DM Ex-US	-14.3	17.9	7.1
	EM	MSCI EM	-20.1	9.8	7.5
Private Equities	Global	Cambridge Associates PE & VC	2.9	9.3	4.7
Fixed Income	Global Agg	Bloomberg Global Aggregate	-16.2	5.7	-1.6
	High Yield	Bloomberg Global High Yield	-12.7	14.0	4.8
	EM Debt	Bloomberg EM USD Aggregate	-15.3	9.1	3.2
Alternatives	Commodities	Bloomberg Commodity Index	16.1	-7.9	1.7
	Real Estate	FTSE EPRA Nareit Global	-24.2	8.7	0.4
	Infrastructure	DJ Brookfield Global Infra Composite	-4.9	6.2	5.1
Cash	Cash	ICE BofA US Treasury (9-12 M)	-0.3	5.0	2.7

Notes: Returns in USD terms, as of 25/07/2024

Source: FactSet, Bloomberg

Beginning of an earnings recovery

Earnings rebound evident.

Higher interest rates and slower economic growth tempered the pace of corporate earnings growth in 2022, a trend that continued until 23Q3.

Corporate bottom lines have now benefited from renewed economic resilience and improving sentiments as recession fears ebbed.

Analysts' earnings outlook are generally favorable throughout 2024, led by an IT earnings windfall of 22% in Q1, and projected to broaden throughout the year.

Consumer spending power has shown it still has some gas left in the tank, with consumer sectors having extended its run beyond previous analyst forecasts.

Overoptimism around earnings-growth expectations?

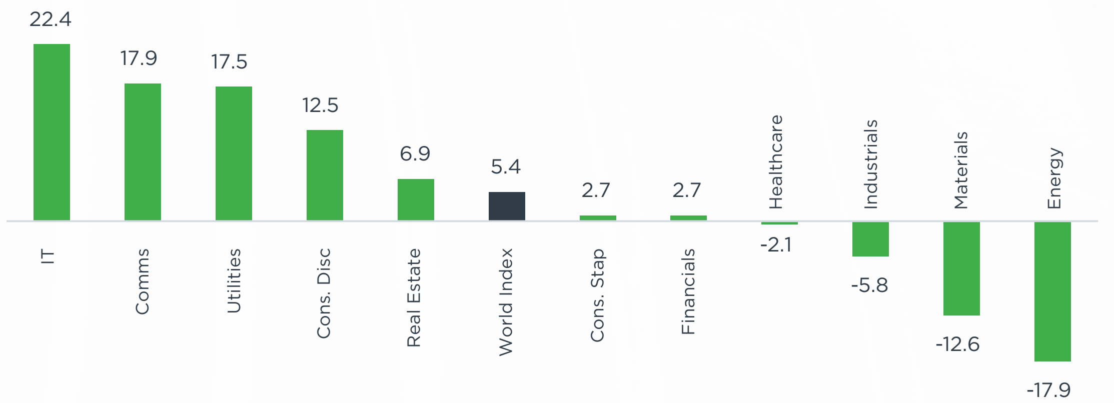
Markets are backing a soft-landing scenario and faster drop-in rates than the Fed, with minimal damage priced into corporate profit estimates.

However, the market may be underappreciating the risks of a steeper slowdown and a higher for longer rates regime.

While there is some upside to markets if a soft landing materializes, there is a potentially significant drawdown in a recession scenario.

EPS estimates in most markets for 2024 have been marked down since the end 2023 with the UAE an exception (amid higher bank NIMs and non-oil resilience).

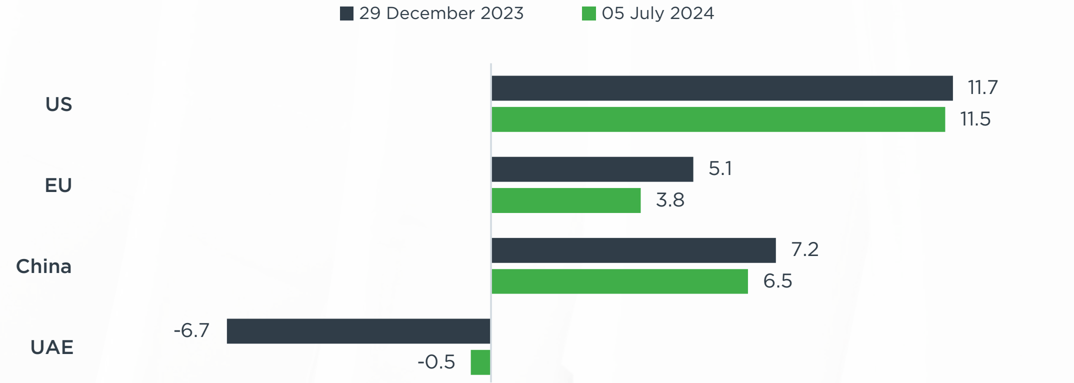
Global Q1 YoY EPS Growth (%)



Notes: FactSet World Index, average global weighted sector EPS growth

Source: FactSet

Consensus Forecast CY'24 EPS Growth (%)



Notes: Analyst' mean estimate for calendar year, S&P 500, Euro STOXX 50, MSCI China, UAE weighted index of analyst covered stocks.

Source: FactSet

Valuations remain generally stretched

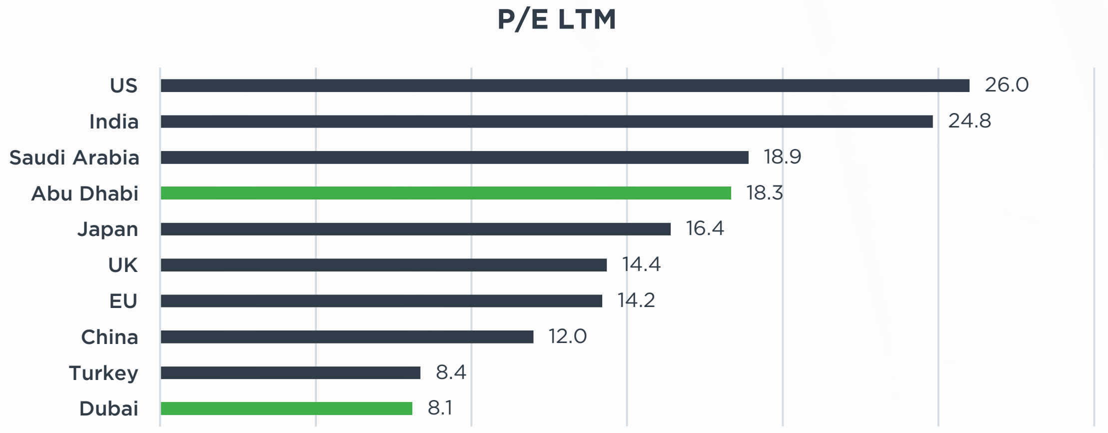
Valuations skew expensive.

Global equity market valuations continue to trend, on average, well above their historic averages.

The Buffett Indicator for the US, which compares total market capitalization to GDP, is around 195%, also suggesting stocks are priced above historical norms.

While there is some concern valuations may limit upside in rich markets like India and the US, current analyst earnings forecasts remain supportive.

On the other hand, Dubai and Abu Dhabi (removing IHC weighting) remain affordable and competitively placed in the wider global context.



Notes: : As of 16/07/2024, Nikkei 225, Nifty 50, S&P 500, TASI. ADX General, Euro STOXX 50, FTSE 100, MSCI China, DFM General, BIST 100

Source: FactSet

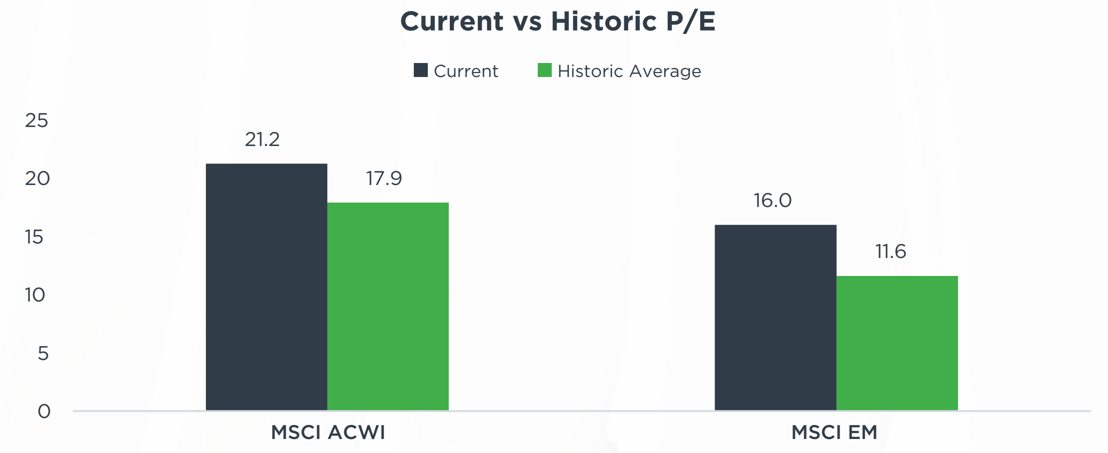
Rotation to value.

Allocating to potentially stretched valuations poses a risk to investors with such uncertainty surrounding the macro-outlook.

Any deterioration in already fragile market conditions will leave investors vulnerable to disappointment.

Growing risk sensitivities have emerged as we see rotations to value friendly regions and sectors, with profit taking in areas like technology.

However, a granular approach shows there remains opportunities across markets, particularly outside of large-cap representation.



Notes: Price-to-earnings LTM vs 20-year historic average.

Source: MSCI

Investment Outlook *Sec. 3*

Dealmaking is at a crossroads

Global M&A still faces challenges.

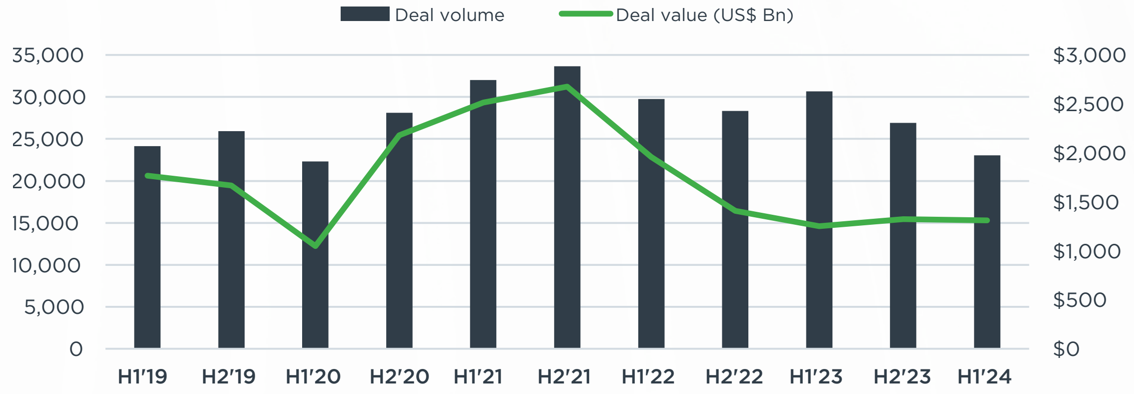
Entering the year dealmakers were primed for rates to come down and an end to the deal slump grappling markets since 2022.

While some megadeals have gone through, momentum fizzled as central bankers pushed back their policy timelines earlier in the year.

The combination of a higher hurdle rate (cost of capital and higher valuations) and macro uncertainty will continue to keep buyers cautious in the short-run.

According to PWC, the value of M&A deals increased by 5% in H1 compared to the same period in 2023, but transaction volumes fell 25%.

Global Deal Volumes And Values



Source: PWC

There remains optimism for a rebound.

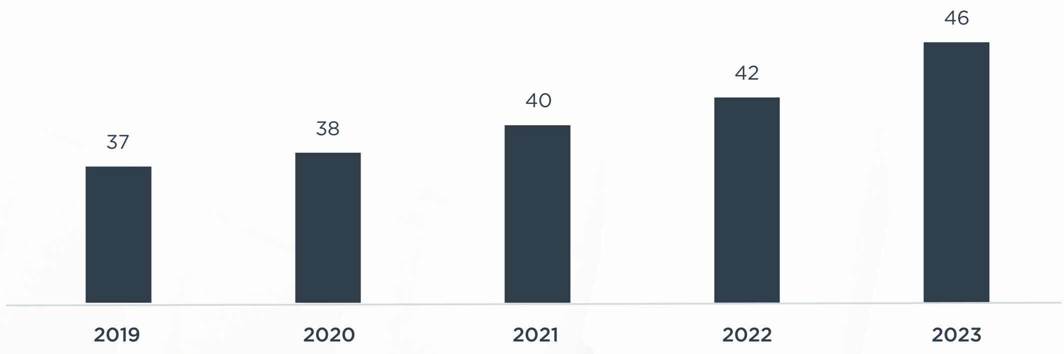
There is a growing but cautious optimism regarding the global economic outlook and impetus for monetary policy easing among investors.

Sectors benefitting from global megatrends like technology (boosted by AI), energy and healthcare have already seen promising upticks in activity.

Pressure on GPs to clear backlogs and return capital, as well as a narrowing valuation gap, should also increase the trajectory of exits.

Higher public market valuations should lead to increased appetite for IPOs, while eventual rate cuts will be the major catalyst for deal activity.

Share Of Buyout-backed Companies Held For At Least 4 Years (%)



Notes: Survey of active buyout-backed companies that have spent at least four years in portfolio as percentage of total portfolio

Source: Bain

Time to recalibrate the playbook

Higher capital costs requires adapting approach to private deals.

Between 2010 and 2021, the use of leverage in global buyout deals drove 1/3 of realized investment returns.

A higher hurdle rate could continue to squeeze returns for the next 5 years or more as monetary policy is unlikely to return to ultra-low levels.

With diminished effectiveness of leveraged buyouts, prudent asset selection becomes a critical determinant of investment outcomes.

Operational enhancements and value creation are core levers for success in this new regime over a reliance on financial engineering in the past.

Multiple avenues to returns.

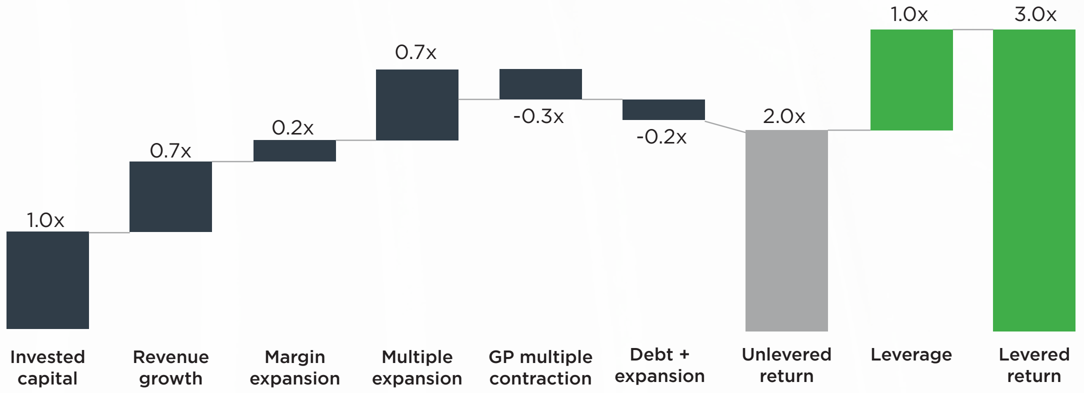
Divergence in global macro and the shift to a new regime/business cycle creates opportunities as well as an increased need for diversification.

Investing in opportunities set to benefit from long-term thematic and disruptive trends in technology and demographic changes.

The widest options of performing asset classes in decades are now available as active rates have brought income investments back into play.

Greenfield, capex and debt heavy industries face headwinds, however, may bring discounts in areas like infrastructure and real estate assets.

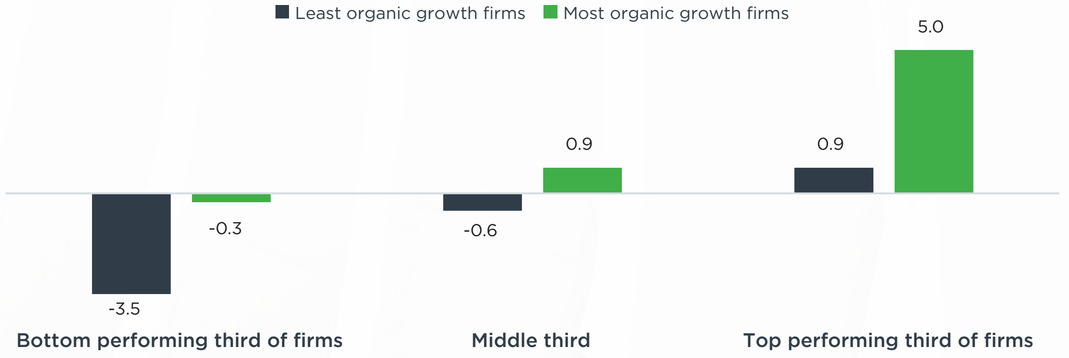
Drivers of Investment Returns for Realized Deals, 2010-2021



Notes: Sample includes 2,512 buyout deals entered on or after Jan 1 2010, and exited on or before Dec 31 2021

Source: SPI by Stepstone

Annualized Excess Shareholder Returns (%) of Developed Markets Stocks 2005-2019



Notes: Top 1000 US and EU stocks by market cap, firms broken down by the top and bottom half of organic revenue growth as a % of total revenue, classified into the top, middle and bottom performing stocks by TSR.

Source: McKinsey

Key Takeaways

The macro regime has fundamentally changed.

In the short term

While recession worries have come down, but the risk remains elevated, it is advised to maintain flexibility to maneuver and take opportunities.

Rates are likely to come down more slowly than markets anticipate if a recession is avoided, with a real possibility of no cuts at all this year.

The UAE should remain a relative haven economically amongst the wider uncertainty we see are seeing globally.

Compared to the last decade

While global growth may be supportive of earnings in the short-term, long-term growth prospects will be lower than previous decades.

Inflation is unlikely to rebound to previous levels, but new structural pressures will continue to make it a more noticeable issue for corporates.

Interest rates will need to be meaningfully higher than the rate of inflation, so recalibrate for a long-term norm of at least 2.5%-3.5%.

Investors will need to recalibrate their strategy

Easy returns of the 2010s are unlikely to repeat themselves as we enter a new business cycle and thus the same strategies are unlikely to.

A lower premium for risk taking in the current environment makes quality asset selection and operational enhancement the core levers of returns.

It may also slow down the pace of deal flow, making patience for good opportunities a valuable trait to hold.

Seismic macro shifts, like we face today, bring about new opportunities for those with the capacity and agility to react.

Managing a portfolio of companies

While the ability to execute organic growth is stressed time and time again, it is rarely impactful, often stemming back to poor asset selection.

Investors should be able to reasonably (and honestly) assess the potential growth that their acquisition and input could be able to unlock.

Having said that, inorganic growth may become a useful tool if a slowdown materializes, though with added cost and risk.

It is also prudent to actively monitor portfolios and rebalance as necessary, with exits providing interest free liquidity to re-enter better deals.

Attractive Geographies

Brazil: Value on offer

Economic tailwinds

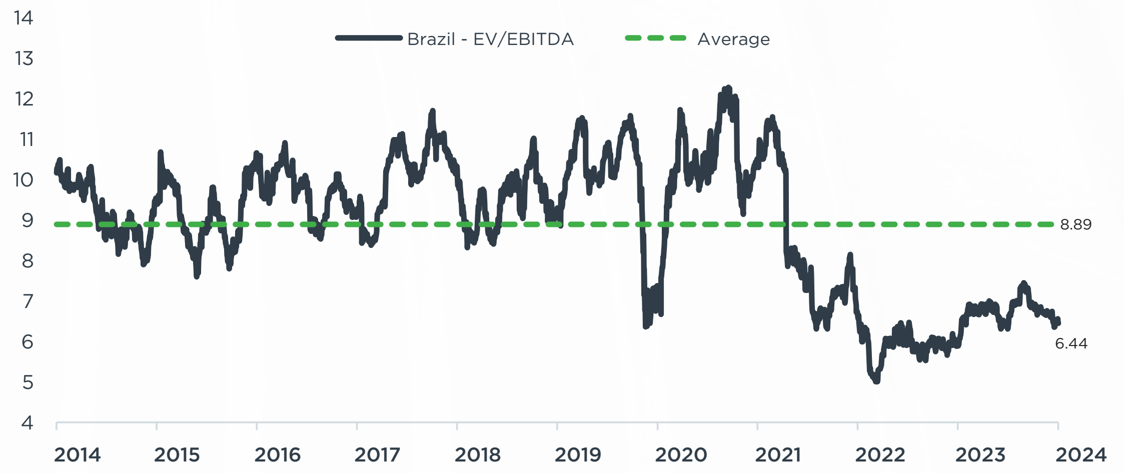
- GDP has grown above consensus for 14 consecutive quarters.
- Brazil is already four cuts into its monetary policy cycle.
- Currency set to benefit as US begins cutting rates.

Opportunity

- Valuations multiples are ~25% below their historic average.
- Return on equity (ROE) of over 15% and dividend yield above 7%.
- Encouraging analyst earnings estimates in both 2024 and 2025.

Risks

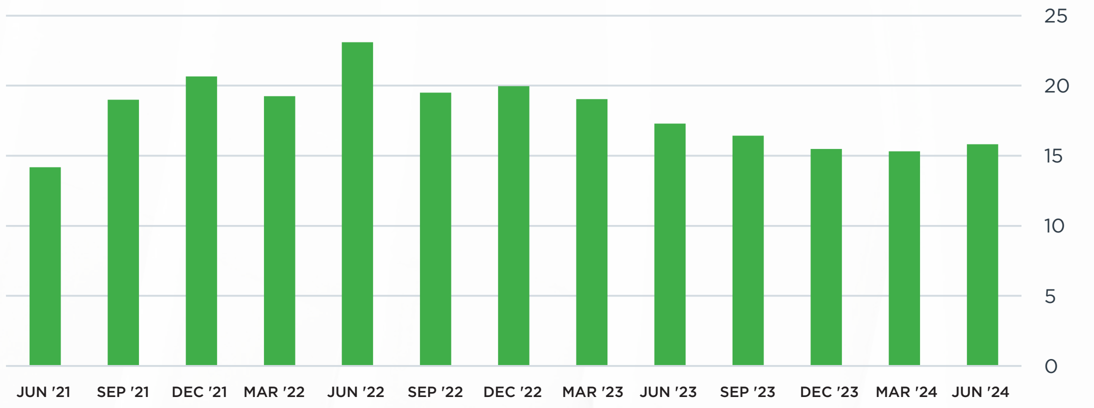
- Higher for longer rates in the US.
- Fears over potential for political interventions.
- Economy is vulnerable to commodity prices.



Notes: Total universe of listed entities

Source: FactSet

Brazilian Public Equities: Return on Equity LTM (%)



Notes: Total universe of listed entities, ROE LTM

Source: FactSet

Attractive Geographies

Japan: Breadth and quality

Economic tailwinds

- Shift from deflation to inflation transforming consumer behavior.
- Fiscal measures to stimulate domestic consumption and investment.
- BOJ continues to maintain an ultra-easy monetary policy.

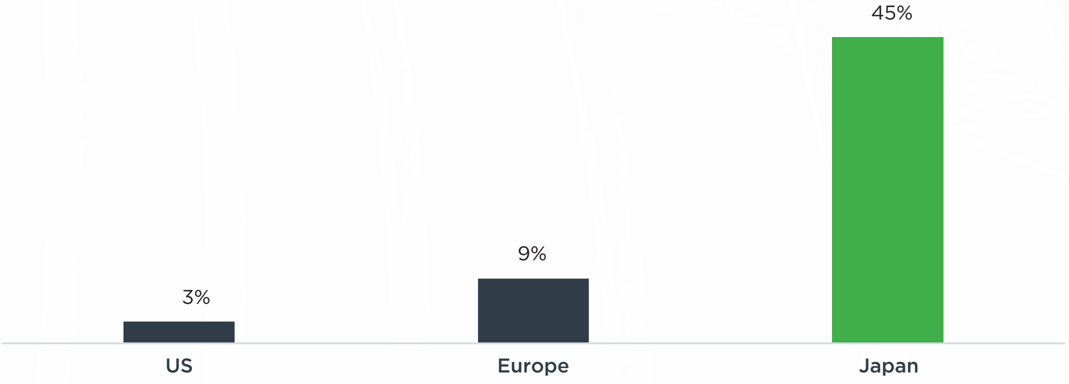
Opportunity

- Positive governance developments driving better capital efficiency.
- EV/EBITDA ratio significantly lower than in other developed markets.
- Deep market breadth and quality.

Risks

- Political uncertainty in September, concerns about policy continuity.
- Yen fluctuations against major currencies have added complexity.
- Export-led economy is susceptible to global economic slowdowns.

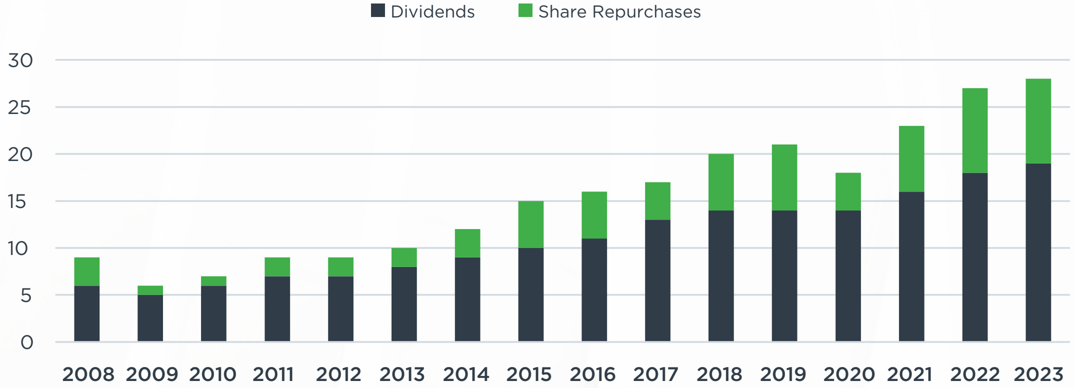
Share Of Companies Trading Below Book Value



Notes: Total universe of listed entities

Source: FactSet

Governance Drive Is Translating to Shareholder Returns (Tn Yen)



Notes: Okasan Securities calculations

Source: Bloomberg

Attractive Geographies

China: Unavoidable market in the long run?

Economic tailwinds

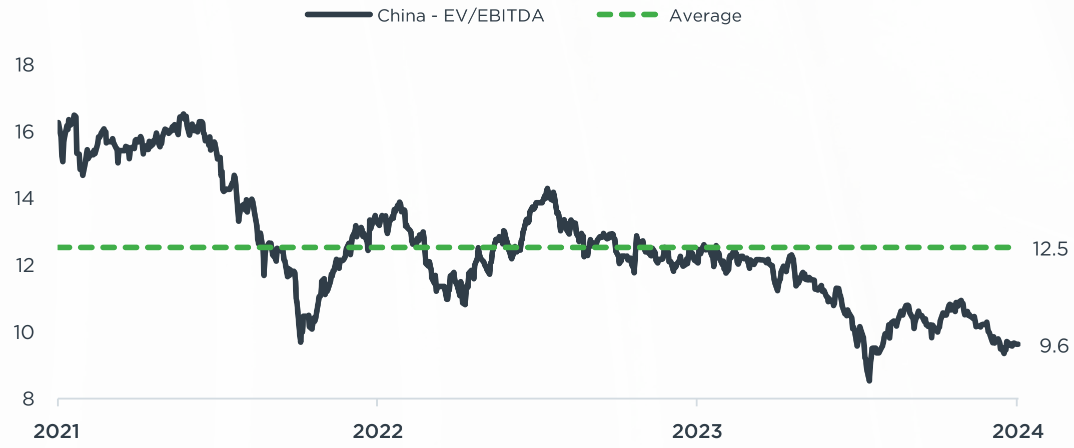
- Despite recent headwinds, economy is showing signs of recovery.
- Stimulus for key industries and infrastructure stabilizing growth.
- Third largest consumer market and second largest economy.

Opportunity

- Currently trading at historically low valuations.
- Globally competitive growth sectors like technology, renewables.
- Long term perspective could reward patient capital.

Risks

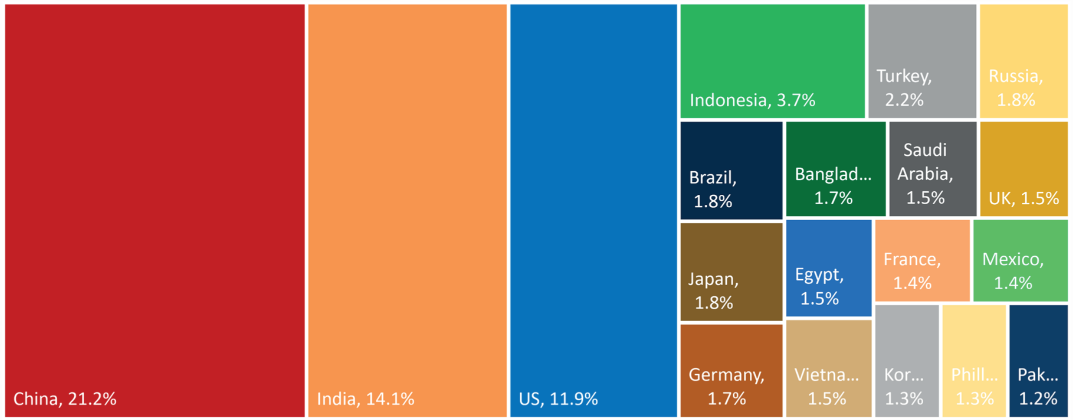
- Ongoing tensions with the US and risk of a tougher Trump next year.
- Sudden policy changes and reporting/regulations remains a concern.
- Slower stimulus, growth and higher debt levels.



Notes: Total universe of listed entities

Source: FactSet

World Economy Contribution, 2024-2029



Notes: Analyst forecast

Source: Bloomberg

MULTIPLY
GROUP