

# **EYES ON MARKETS**

#### **GLOBAL MARKETS**

Inflation expectations have moderated, but not enough to comfort the Fed. Powell will stop tightening when he is confident that inflation is on course to head back to 2%. Until then he will continue to tighten monetary policy. This tightening will inflict pain on the US economy and financial markets.

Equity valuations have closely tracked real interest rates until recently. Real yields have soared from 0.4% to 1.3% during the past month and could reach 1.5% by year-end. For context, real yields were negative 1% at the start of the year when the S&P 500 index hit an all-time high of 4800 and traded at a P/E of 21x.

In the near term, investor focus will soon turn from valuations to earnings. The surprisingly high August inflation reading was a pivotal event for macro investors regarding the path of Fed hikes. The analogue for stock investors is 3Q earnings season where record high profit margins will be under scrutiny.

The good news is that Markets have entered the capitulation phase after the latest Fed's 75bps hike and its ripple effect across asset classes. The bad news, though, is that - while an opportunity might be arising amidst the turmoil, risks are still plentiful down the line in 2023.

### REGIONAL MARKETS

SPSHDSLT decreased by 7.1% as cumulative outflows from the Saudi Net Foreign Portfolio Investment (NFPI) for the month were more than USD631mn. Saudi cement sales recorded 10.1% YoY increase in August vs 3.3% in July 2022 mainly due to sharp recovery in mortgages. Saudi PMI for August 2022 increased to 57.7 vs 56.3 in July 2022, banking deposits also grew 10.3% YoY in August vs 9.3% in July, inflation also climbed to 3.0% in August 2022 vs 2.7% in July. Value of POS + ATM transactions per terminal in KSA decreased by 15.3% YoY in August vs 17.2% decline in July. KSA Mortgages sales amounted to SAR12.7bn in August, flat 23% YoY.

2Q 2022 KSA real GDP rose 12.2%, Industrial Production Index increased by 17.7% YoY and S&P affirmed Saudi's A-/A-2 rating with Outlook 'Positive' while forecasting 7.5% real GDP growth for 2022.

Aggregate KSA unemployment declined by  $0.8pp\, YoY\, to\, 5.8\%$  in 2Q 2022 and official reserve assets inched up 0.58% YoY to USD457bn in August.

Pre budget 2023 announcement came through estimating 2022 surplus at USD24bn whereas USD36bn surplus is already recorded for 1H 2022; hence, deficit of USD12bn is estimated for 2H 2022. 2022 budgeted expenditure was USD255bn which is likely to reach SAR1, USD302bn.

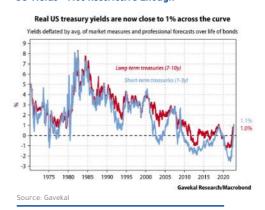
In terms of reforms, Public Investment Fund launched a company that aims to digitize local real estate sector through a comprehensive digital platform, 18 more professions were identified for full Saudization over the next 12 months, Cabinet approved duty-free shops at the ports and five renewable energy projects generating 3,300 MWs were launched.

In terms of key developments, OPEC+ agreed to cut oil production by 100KBPD in October, reverting to Aug-22 production levels, Central bank appointed dedicated chief for crypto / virtual assets programs, Finance ministry signed SAR25bn agreements with banks for infrastructure projects and tourism recorded 121% increase from pre-pandemic levels. PIF delivered 25% return in 2021 and Moody's Investors Service assigned top rating, (P)A1, to the PIF-backed Euro Medium-Term Note (EMTN).

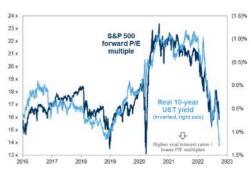
Brent recorded 8.3% decline in September, MSCI Emerging Market Index declined 12.1% and MSCI World Index registered 8.6% decrease. Bloomberg Commodity TR Index also decreased by 7.2% reflecting impact of aggressive stance by US FED. Key highlight of the month was US CPI for August coming in at 8.3% against expectation of 8.1% and subsequently aggressive comments from FED embracing a recession to cull inflation down to 2%.

Going forward, we believe that US Core CPI downside risks over the first half of next year are rising as a result of a slowdown in commodity prices, increasing probabilities of a recession and statistical year-over-year base effects. This expected move might force the FED's hands toward first pausing the tightening cycle and then cutting interest rates outright. If so, equity markets are likely to respond positively in advance anytime between the latter part of 2022 and the early part of 2023. Therefore, we believe that TASI might test the 12800 level before or around the turn of the year.

#### US Yields - Not Restrictive Enough

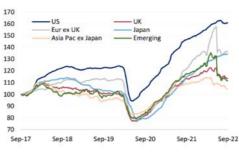


## **US Equities - Final Call?**



Source: Goldman Sachs

#### **US Earnings - Make Or Break**



Source: (Wilshare)



## **GLOBAL MARKET INDICES**

Region/sector	Index	Quote	MTD (%)	YTD (%)	1Y (%)	2Y (%)	3Y (%)	5Y (%)	10Y (%)	2019 (%)	2020 (%)	2021 (%)
World	DJIM World TR	7,615.86	0	(20.7)	(17.5)	4.6	10	9.5	9.6	30.9	28.2	19.7
Developed	DJIDEV TR	4,297.40	0	(20.8)	(16.9)	6.1	10.7	10.3	10.2	31.6	27.4	23
Emerging Markets	DJIEMG TR	4,590.91	0	(20.4)	(22.9)	(6.7)	4.6	2.6	4.4	22.7	35.3	(4.7)
Saudi	TASI	12,530.66	0	11.9	11.2	23.3	16	11.6	6	7.2	4.4	27.9
NAREIT	All REITS (EM Inc) TR	2,868.19	0	(18.2)	(13.4)	7.9	(1.6)	2	4.7	23.6	(9.2)	23
GSCI	All Commodities	702.23	0	25.1	28.6	42.1	18.7	12	0.6	23.6	(9.2)	37.1
Currencies	Euro	1.00	0	(12.1)	(14.8)	(7.4)	(3.1)	(3.5)	(2.6)	(2.2)	8.9	(6.9)
	Yen	138.72	0	(17)	(20.5)	(12.8)	(8.1)	(4.2)	(5.6)	1	5.2	(10.3)
	GBP	1.17	0	(13.5)	(14.7)	(4.1)	(2)	0	(0.4)	3.9	3.1	(1)

Source: Global Data as end of 23 September 2022. Saudi Market Data as end of 25 September 2022

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<sup>\*</sup> All values beyond 1 year are annualized