Quarterly Investment Strategy
Fourth Quarter 2023

Economic resilience continues to defy expectations

Right By You

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Summary

The fourth quarter is now upon us but there are still no signs of a recession. Not only has the economic cycle been extended but economists are having to re-evaluate the surprising strength of developed market economies. The current economic resilience begs the question: can growth be sustained at higher interest rates?

Market implications

Sustained economic growth should continue to support earnings growth which is positive for equities and credits. Moderating inflation should mean that central banks are nearly done with interest rate hikes. We would recommend being modestly overweight equities and investment-grade (IG) credits.

Long term strategy

After a decade of sub-par developed market growth, despite prolonged periods of zero interest rates, it is a big deal that we are seeing economic resilience with the US Fed funds rate at 5.5 per cent. This implies that developed markets have broken out of their disinflationary cycle and are shifting to a new era of higher-for-longer inflation and interest rates.

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Global investment strategy

Developed markets have provided a "double surprise" – falling inflation and resilient growth – that has lifted global equities. While emerging markets have been held back by weakness in China, markets overall are focused on the receding risk of a global recession.

At the start of the year, most economists held two strongly-held views. First, they did not think inflation could improve without significant "pain" in the form of rising unemployment. Second, they did not believe that major economies, faced with the fiercest rate hiking cycle in history, could possibly remain unscathed.

Economists at the end of the third quarter were doubly surprised. There were no signs of a recession and inflation was improving even though employment remained strong. Over the three quarters, US equities had risen by around 12 per cent and fixed income was showing positive gains despite interest rate hikes.

A recession can be avoided

We continue to expect a "rolling recession" in which different parts of the economy slow down at different times. Currently, we think there is evidence that the goods sector and the housing sectors are in recession. But service sectors are behaving as though they are still recovering after reopening from COVID.

Clearly, this has not been a traditional cycle and COVID has triggered many anomalies. Our view is that the service sectors will continue to expand, while the manufacturing and housing sectors will start to see signs of a recovery. As such, we are not expecting a recession over the next 12 months.

Moderating inflation, high interest rates

Inflation rose for many reasons, including COVID-induced supply chain disruptions which are now receding. As such, inflation is coming down even without painful unemployment. There will remain complications regarding inflation, but we are encouraged by the fact that minus shelter data, which is backward-looking, core inflation is already getting close to the 2.0 per cent target.

In the coming quarter of high interest rates, our view is that equities and credits will continue to be supported by economic and earnings expansion, but government bonds may face some headwinds.

Higher-for-longer is taking shape

The past decade was defined by ZIRP, that is, zero interest rate policies. But investors today are starting to appreciate that the coming decade will likely be defined by a radically different environment of higher-for-longer inflation and interest rates.

We would argue that it was in the second half of the third quarter that we truly began to see signs of this "higher-for-longer". This is when bond markets started to respond to factors beyond the Fed. Prior to this, US Treasury bond yields reflected expectations of what the US Fed was going to do – going up when the Fed was expected to hike and falling when the Fed was expected to pause.

Starting in August, something new started happening. Despite the fact that no further rate hikes were expected for the rest of 2023 or 2024, bond yields kept climbing. For us, this marked the markets' first acceptance of "higher-for-longer", that is, an era of interest rates averaging higher than levels prevalent since 2007. This acceptance helps explain why US 10-year Treasury yields have been rising in recent months.

This can be both positive and negative for investors. On the plus side, sustainably higher interest rates could offer better yields for years to come. However, yields and bond returns are likely to be more volatile than in the past decade.

Key takeaways

- Economic growth is proving resilient in 2023
- Inflation is improving in 2023 even without the pain of rising unemployment which is positive for equities
- However, yields have started to climb again even though central banks are near the end of their rate hikes
- Long-term perceptions of rates are changing. It is time for investors to start embracing the implications of a new "higher-for-longer" investment landscape

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Global asset allocation

Fixed Income: Bonds under pressure due to rising long term yields

Bond yields are higher than they have been in 15 years and future returns will benefit. But in the near-term, economic resilience is raising expectations of further upward yield adjustments that can create near-term headwinds for bond performance.

We prefer to focus on credits. Credit spreads have been tightening all year, enabling IG credits to benefit from high yields and offsetting the negative repricing effects of rising bond yields. As such, we are **underweight government bonds but overweight IG credits**.

Equities: Potential to perform on a multi-year basis

We think global equities have already significantly benefited from the surprising resilience of developed market economies. We expect continued expansion, leading to further earnings growth, which should be good for equities in the coming quarter. Growth risks remain, but we think expectations are not overly elevated. For the coming quarter, we are holding global equities based on a **modest overweight** position.

Cash: Consider deploying to lock in yields

As most asset classes performed poorly in 2022, investors are likely to be comfortable with cash especially as current cash rates are higher than they have been in over a decade. However, we would stress that "higher-for-longer" does not imply that cash rates will stay at current ultra-elevated levels. Investors may want to think about locking in today's higher yields via slightly longer (1 to 3 years) duration fixed income and to **underweight** cash.

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Asset allocation strategy

Sector	View	Notes
Equities	+	**Rationale:** Even after strong gains in the first half of the year, earnings look set to keep growing and supporting equities. **Risks:** Business and consumer sentiment could wane amid dwindling excess savings and slowing loan growth, putting earnings under pressure.
Fixed Income	N	**Rationale:** Bond yields are more attractive than they have been in a decade and inflation has peaked. But the "higher-for-longer" theme is driving up bond yields. **Risks:** Inflation could surprise on the high side and trigger further rate hikes.
Commodities	N	**Rationale:** Economic resilience is good for commodities but China's growth weakness offsets much of that benefit. **Risks:** Higher-than-expected interest rates could drag down both growth-related commodities and the gold outlook.
Alternatives	N	**Rationale:** Stocks and bonds are doing well and reducing the focus on alternatives. However, alpha opportunities should improve as the expansion matures which is a source of attraction for alternatives. **Risks:** Market breadth has been weak and thus limits alpha opportunities.
Cash	-	**Rationale:** Short term yields could be tempting to investors. But short term yields are already falling and investors may wish to lock in good yields for longer. **Risks:** The global economy could end up trapped for an extended period in the slowdown quadrant where cash outperforms and thus is a risk to our underweight view.

++ : Strong Overweight + : Overweight N : Neutral - : Underweight -- : Strong Underweight

Global equity outlook

DEVELOPED MARKETS: At the start of the year, US economic growth was expected to be the slowest given its central bank actions were the most aggressive. Instead, US economic data has surprised the most to the upside. Japan is also performing well, while Europe's economic trends have disappointed.

At the start of the year, Europe markets outperformed when it became clear that the winter energy shortage was not likely to materialise. In the second quarter, US economic data started to fit a "goldilocks" outlook with economic growth staying positive and inflation improving. Given that recession fears are the greatest in the developed markets, these offer an upside if they can continue to defy expectations. Japan has quietly turned into an outperformer.

DEVELOPING MARKETS: Asian economies are performing despite China's weakness.
China has not benefitted from their reopening in 2023. Instead, the market has been mired in concerns over their property and manufacturing sectors. The country's previous high dependence on property as a growth driver has backfired now that the sector is struggling.

However, we note a degree of decoupling between China and the rest of Asia. In the past, Asia would tend to perform poorly whenever the China market was under water. But we find it encouraging that this is less the case, and markets such as Taiwan, Korea and Indonesia are currently prospering, despite China's lacklustre performance.

Equities regional strategy

Country	View	Notes
US 	+	**Rationale:** Despite raising interest rates the most, the US has proved so far to be the country most resilient to higher rates. **Risks:** Growth risks remain elevated. It could be that there is a lag in the impact of interest rates on the economy, and if so, this will start to show up in the coming quarters.
Europe 	-	**Rationale:** Economic surprises have been weaker in Europe than in other regions. Also, Europe tends to be more affected by weaker China growth than the North American markets. **Risks:** Europe still faces risks of energy constraints and other negative effects arising from the war in Ukraine.
Japan 	+	**Rationale:** Japan has quietly become a 2023 global outperformer. It is a cyclical beneficiary of upside global economic surprises and a structural beneficiary of a fresh focus on shareholder returns and corporate efficiency. **Risks:** The monetary policy that has been very accommodative for years may finally start to normalise in the coming quarter which could trigger more volatility.
Asia 	N	**Rationale:** We expect China to remain volatile as it deals with the structural challenges of diversifying its economy away from property. But we think the rest of Asia can perform without China, and in particular we see good earnings growth in ASEAN markets. **Risks:** Markets appear focused on the developed markets and may continue to ignore Asia despite better economic growth.

++: Very positive +: Positive N: Neutral -: Negative --: Very Negative

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Asia equity

Growth expectations for the Asian region continue to moderate, causing us to retain our defensive positioning. We have turned less bearish on China but retain our underweight.

China: Policy momentum is picking up with multiple measures to support the property sector. However, markets remain uncertain about the efficacy of these measures. Despite attractive valuations, China's market upside will likely remain capped pending a sustainable turnaround of the housing sector.

Korea remains an underweight. The battery-related plays driving the domestic market rally year to date (YTD) lacks breadth and appears vulnerable to a market pullback.

We maintain overweight on **Taiwan** as valuations for the tech sector and in particular AI-exposed stocks have turned more attractive post recent market corrections.

On a more positive note, we upgrade **Hong Kong** from underweight to overweight. Private consumption strength and continued momentum in inbound tourism are likely to sustain the pace of economic recovery.

We are also upgrading **India** from underweight to overweight. The country's GDP growth is the highest in the Asia region. Supply-side reform along with the government's focus on macro stability is supportive of a strong capex cycle and corporates' profitability outlook.

Within **ASEAN**, Singapore and Malaysia remain our preferred overweight. **Singapore** is a relatively safe harbour and valuation is attractive against a positive earnings momentum. Likewise, **Malaysia** is a relatively defensive and low-beta market. The lifting of the overhang from recent State elections could spur renewed foreign interest.

We remain neutral on the Philippines, Thailand, and Indonesia. In the **Philippines**, the rollout of monetary and fiscal policies could potentially offset the consumption slowdown. Over in **Thailand**, valuations are uncompelling although the appointment of Prime Minister Srettha Thavisin has removed the short-term overhang and there is potential for government stimulus in the near term.

Indonesia's domestic market has outperformed YTD and strength in GDP growth appears partly discounted. Potential pre-election goodies could drive spending and support private consumption. We retain underweight on **Vietnam** due to dual headwinds from corporate bond default risk and a stagnant domestic property market.

Our defensive positioning is tilted towards sectors such as Consumer Staples, REITs, and Utilities. We are selective in the Consumer Discretionary and Industrials space. On the other hand, we are reducing our exposure to the tech sector.

Key risks to our cautious outlook include a stronger-than-expected rebound in China's economy, extended above-trend inflation, and reduced geopolitical tensions between the US and China.

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Asia ex Japan country strategy

Country allocation	View	Notes
China	-	**Rationale:** Policy momentum to support the property sector picking up but uncertainty over its efficacy remains in the near term. We suggest staying cautious pending a sustainable turnaround of the housing sector. **Risks:** The real estate market recovers earlier/greater than expected, domestic consumption accelerates, geopolitical relationship improves.
Hong Kong	+	**Rationale:** Private consumption strength and continued momentum in inbound tourism likely to sustain pace of economic recovery. **Risks:** China/HK political relationship deteriorates, inbound tourism disappoints.
India	+	**Rationale:** Supply-side reform along with the government's focus on macro stability supports a strong capex cycle and corporates' profitability outlook. **Risks:** Spike in inflationary pressures, delays in infrastructure spending.
Indonesia	N	**Rationale:** Potential pre-election goodies could spur spending and support private consumption. **Risks:** Spike in commodity prices, strong Rupiah.
South Korea	-	**Rationale:** Market rally YTD lacks breadth and appears vulnerable to a pullback. **Risks:** Global semis downcycle normalises earlier-than-expected, strong non-tech consumption growth, improved geopolitical risk (US, Japan, China).
Malaysia	+	**Rationale:** Relatively defensive and low beta market within ASEAN. Removal of overhang from State elections could spur renewed foreign interest. **Risks:** Delays in implementation of fiscal policies.

++: Very positive +: Positive N: Neutral -: Negative --: Very Negative

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Asia ex Japan country strategy

Country allocation	View	Notes
Philippines	N	**Rationale:** The rollout of monetary and fiscal policies could potentially offset consumption slowdown. **Risks:** Inflationary pressures easing faster than expected.
Singapore	+	**Rationale:** A relatively safe harbour. Valuations attractive against a positive earnings momentum. **Risks:** Inbound tourism disappoints. Drastic slowdown in growth with major trading partners (US, EU, China).
Taiwan market	+	**Rationale:** Tech sector valuation turning more attractive again post recent market correction. **Risks:** Global tech sector recovers faster than expected, cross-straits relationship improves.
Thailand	N	**Rationale:** Valuation uncompelling though the appointment of PM has removed short-term overhang and there is potential for government stimulus. **Risks:** Slump in oil price, earlier-than-expected government stimulus.
Vietnam	-	**Rationale:** Dual headwinds from corporate bond default risk and a stagnant domestic property market. **Risks:** Recovery in domestic property market, corporate bond default risk recedes.

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Global fixed income outlook

Central banks appear close to the end of their rate hiking cycle but continued US economic expansion could temper market expectations of rate cuts in 2024.

Growth prospects in the US and Japan are relatively stronger than that of the Eurozone and UK. Nevertheless, we believe that G7 countries are close to, if not already at the end of, their interest rate hiking cycles.

Despite this, higher-for-longer expectations have caused US Treasury yields to tick slightly higher since the last quarter. Going forward, we expect yields to stay in a trading range with an upward bias. Assuming this "higher-for-longer" macro cycle holds true, yield curves are expected to steepen and approach normalisation in the coming months.

The continued economic expansion suggests that, on a risk-reward basis, investors may wish to neutralise or reduce mid-to-long duration fixed income plays.

Fixed income sector strategy

Sector	View	Notes
Developed Market (DM)	N	**Rationale:** Developed market economies have trudged along steadily with consumer spending and capital investment data holding up. **Risks:** Inflation has proven to be sticky in developed economies such as Eurozone and UK and core inflation may remain above central banks' inflation targets.
DM Government	-	**Rationale:** As the global growth expansion continues, markets will price out rate cuts, driving a bear steepening of the yield curve. **Risks:** Growth disappointment could see yields move lower.
DM Credit	+	**Rationale:** While corporate fundamentals remain strong, risk-reward considerations will likely focus on carry trades given narrow spreads. **Risks:** Credit spreads could widen should recessionary fears take hold.
Emerging Market (EM)	N	**Rationale:** EM central banks have remained relatively dovish. This is supportive of spreads and markets exposed to Chinese growth. **Risks:** EM credit markets exposed to Chinese growth may be more vulnerable to a continued slowdown in the Chinese economy.
EM Government	N	**Rationale:** Credit spreads are range-bound, justifying our view that carry - also known as interest income - will remain as the main driver of returns. **Risks:** An external tail risk event such as a reversal of the disinflationary trend led by commodity prices, coupled with a global growth slowdown.
EM Corporate	-	**Rationale:** EM corporates have performed mostly in line with EM sovereigns, and we expect this to continue. **Risks:** An extended period of high interest rates could start to weigh on corporate profitability, especially for those companies that are highly leveraged.

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Global fixed income outlook

Sector	View	Notes
EM Local Currency	N	**Rationale:** EM central banks are ahead of DM central banks in terms of inflation control, and their bond yields are higher and more attractive. **Risks:** The EM local currency space could see losses should the US dollar strengthen more (in a "no-landing" scenario).
Duration	-	**Rationale:** Against a base case of continued US expansion, we expect yields to be range-bound over the coming months. Additionally, growth acceleration could exert upward pressure on yields. **Risks:** Rates could rally should there be growth disappointments, or if disinflationary pressures increase.
Yield Curve	+	**Rationale:** The yield curve can continue to steepen in a "higher-for-longer" macro cycle. **Risks:** Should the Fed hike the policy rate further, we could see the yield curve further invert.

++: Very positive +: Positive N: Neutral -: Negative --: Very Negative

Emerging market fixed income

Sector	View	Notes
Latin America	+	**Rationale:** We favour LATAM as a source of beta over Africa given relative metrics. Carry is also selectively more attractive in some countries. **Risks:** Politics remains a strong headwind for the region.
CIS/EE*	-	**Rationale:** Carry remains limited in the majority of these countries with spreads at extreme tights. **Risks:** The region stands to benefit if the Russia-Ukraine war comes to an unexpected end.
Middle East	N	**Rationale:** The rise in oil prices has yet again benefitted the region as a whole. **Risks:** The deficits of the whole region could widen out if oil prices start falling again.
Africa	N	**Rationale:** With carry remaining our main theme through till the end of the year, it would be hard to underweight the region. **Risks:** Certain countries are facing walls of financing in 2024 which we would selectively underweight.
Asia	-	**Rationale:** Spreads are at historical tights with some short duration IG names trading at negative nominal spreads. **Risks:** Should a hard landing occur, we expect this region to outperform the high beta regions.
Singapore	-	**Rationale:** Growth is slowly declining with a chance of easing further into the year. **Risks:** Growth could prove to be resilient once non-oil domestic exports (NODX) rebounds.

* Commonwealth of Independent States and Central and Eastern Europe
Views above are hard currency-based unless stated otherwise

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Global currencies outlook

We expect the USD to be neutral and range-bound against other major currencies, but to strengthen against Asian currencies.

So far this year, the USD has traded with an upward bias in line with the uptrend in US Treasury yields. However, for the rest of the year, we would expect the currency to trade sideways against the major currencies. The high-rate differentials between the US and other G4 economies tend to be supportive of a stronger USD, but an increasingly risk-on environment can be expected to exert an opposite force. The result is a net zero impact.

That said, we are constructive on the USD's strength against Asia currencies, particularly the CNY and SGD. This is because we see more subdued China growth also affecting Singapore's growth prospects.

Currency strategy

Currency	View	Notes
US Dollar **USD**	N	**Rationale:** Despite real rate differentials between the USD and other major currencies, an improvement in risk appetites is typically associated with a weaker dollar. **Risks:** Should disinflationary pressures increase, the USD would weaken as this would enable the US Fed to dial down on their restrictive policy stance.
Euro **EUR**	N	**Rationale:** Much like the US Fed, the ECB appears to be approaching the end of its hiking cycle, as growth concerns – including in the services sector - would likely outweigh inflation concerns. **Risks:** Should markets reprice the terminal rate of the ECB much higher, the EUR could gain further strength.
Japanese Yen **JPY**	N	**Rationale:** While the BoJ has tweaked its yield curve control policy and is expected to tighten policy further, the JPY remains highly correlated with the CNY, which has been weakening against the USD since the start of the year. **Risks:** The BoJ could potentially end its yield curve control policy abruptly which would see yields spike higher.
Singapore Dollar **SGD**	-	**Rationale:** Growth risks are tilted towards the downside as the outlook for the export sector remains challenging. **Risks:** Should export figures rebound quickly, we might still see full-year growth surprises on the upside.
China Renminbi **CNY**	-	**Rationale:** High-frequency leading economic indicators have not picked up, and the structural rebalancing towards more sustainable growth engines remains a headwind to short term growth. **Risks:** The Chinese government could introduce even more policy measures, including yet more fiscal stimulus to boost growth prospects, thereby strengthening the CNY.

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Global commodities outlook

Global commodities started the year generally supported by expectations of a robust China reopening. But this has not materialised and most commodities have been rangebound at best.

That said, the backdrop for commodities is still strong, supported by cyclical and structural trends. Cyclically, even though the China reopening is occurring more slowly than expected, it remains a powerful force to support the commodities cycle. Structurally, the electric vehicle (EV) and green energy trends are going to support metal commodities for many years to come.

We expect the outlook to be more neutral in the near term as gains from China's growth are offset by slowing global demand.

Commodity sector strategy

Sector allocation	View	Notes
Commodities	N	**Rationale:** The commodities outlook is mixed. Safe haven assets like gold and green energy-related metals are likely to perform while energy and other commodities are likely to be soft due to weaker global growth. **Risks:** China's growth is disappointing due to the continued weakness in housing. US Fed overtightening could both slow growth and raise real rates.
Gold	+	**Rationale:** The case for gold remains strong. Recession risks and financial concerns in the banking sector should boost the appeal of gold as a safe-haven asset. Interest rates are peaking and the prospect for rate cuts has improved. Furthermore, emerging market buying of gold appears set to rise, and significant supply constraints exist. Additionally, when the US seized Russia's USD reserves, it made many countries realise that they may need to diversify their reserves and gold is a prime candidate. **Risks:** If central banks turn overly hawkish, and rapidly control inflation then the usefulness of gold for diversification decreases.
Base Metals	N	**Rationale:** We think the multi-year outlook will be strong as new green technologies are creating high demand for many of the metal commodities. **Risks:** Most base metals are very sensitive to global demand and any unexpected slowdown will weaken the outlook.
Energy	-	**Rationale:** Oil demand remains healthy as the global economy has been resilient and miles driven remains high. Additionally, OPEC continues to try to cut production to prop up prices. But overall investment demand has been weak and oil prices remain volatile despite OPEC's best efforts. **Risks:** There are both upside and downside risks in oil prices. If the US avoids recession and China's reopening gets back on track, energy prices could surge again. On the other hand, macro disappointments could continue to support the weak pricing trends in energy.
Others	-	**Rationale:** The demand for other broad commodities such as agriculture appears to have peaked and has declined over the past couple of quarters. Many global producers are seeing a supply response to higher prices of the past year which likely risks future price weakness. **Risks:** As always, supply disruptions remain a key risk to the strengths and weaknesses of many commodities.

++: Very positive +: Positive N: Neutral -: Negative --: Very Negative

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