INVESTING STRATEGIES

Asia, dividends and diversification to matter more than ever: Eastspring mid-year outlook

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Although tariffs have dominated headlines in 2025, their economic impact has, so far, been surprisingly limited. At a media roundtable at Eastspring Investments' mid-year outlook, the firm's chief economist, Ray Farris, along with its chief investment officer, Vis Nayar, flashed a chart seeming to suggest that US import prices have not really moved much from their 2024 levels.

Another chart showed that initial jobless claims in the US have pretty much remained unchanged ever since coming back down from the 2020 pandemic levels.

So why have tariffs not hit US growth yet? Was the doom and gloom of tariffs all a facade?

"We run with the idea that growth this year would be meaningfully less than last year, probably 1% to about 1.5%, but why hasn't it happened yet? Where are the signs? The reason is that tariffs haven't really happened yet and we haven't meaningfully felt them," says Farris.

"We know that impacts of tariffs will come in June and July because the 10% universal baseline tariffs are definitely hitting. The 20% fentanyl-related tariffs on China plus the 25% tariffs on most of the automotive, steel and aluminium sectors will start hitting too and this is going to begin hitting consumers," he adds.

The rebound in US equities in the past few weeks since the post-Liberation Day lows in April has provided reprieve for many equity investors as major US indexes such as the S&P 500 and the tech-heavy Nasdaq composite made their way back into the green in May since the start of the year.

While the euphoria in the market after the announcements of 90-day pauses of so-called reciprocal tariffs paints a more bullish market emerging, it is still worth noting that the effects of the imposed tariffs have not yet meaningfully impacted the US economy and that challenges still remain for the US going into the second half of the year.

So far, the US new job market has remained robust, with about 177,000 new jobs created in April; unemployment rates have remained low at about 4.2% and real payroll income growth at just over 3%, according to Eastspring's report.

With a savings rate of about 3.9% for the US consumer currently, the strong labour market could give households the confidence to dip further into their savings to maintain lifestyles. If consumers keep spending, businesses will less likely switch from hiring to firing.

However, given the onset of incoming tariffs, Farris and Nayar still believe that this scenario would be unlikely.

"Even if the now most commonly expected tariff 'endgame' of 10% roughly across the board and 30% against China comes quickly (with some exclusions), it will still be an over 10% increase in the US effective tariff rate from last year. This would equate to a tax hike of about 1.5% of GDP, one of the largest single-year increases in decades, that would cut into household disposable income," the pair notes in their report.

Besides tariffs, harsher immigration policies are also expected to act as a headwind for the US economy's growth in 2025.

Since his presidential campaign, US President Donald Trump has vowed to tighten immigration policies and ramp up arrests and deportations, aiming to remove anyone in the country without legal permission. According to Farris, these measures could see immigration numbers drop from around 2.8 million in 2024 to about 700,000 this year.

BLOOMBERG

Protesters in Los Angeles, California on June 8. Besides tariffs, harsher immigration policies are also expected to act as a headwind for the US economy's growth in 2025

Data from the Economic Policy Institute suggests that immigrants contributed a total economic output share of 18% in 2023, or roughly US$2.1 trillion ($2.7 trillion). This means that their economic output was larger than their share of the total population, as immigrants made up 14.3% of the total US population in the same year.

"The US benefited very powerfully from very rapid immigration in 2022 to 2024 and harsher US immigration policies mean this will be no more. Reasonable estimates suggest this will cause a drag on growth, not immediately, but over time this year and early into next year, of about 0.3% to 0.4% on the downside on US growth potential," Farris states.

The risk of slowing economic growth posed by the many macroeconomic factors has also driven outflows from the US dollar (USD) over the past year, driving the USD down 8% year-to-date, according to the US dollar index.

With expected weaker US economic growth, rising US debt and ongoing geopolitical stresses, Farris and Nayar believe further repatriation of funds out of the USD will continue as they expect the still currently expensive USD to depreciate at least 4% in broad terms and possibly as much as 10% over the next year.

Shift in opportunity

With all the uncertainty and challenges facing the US economy, portfolio resilience has become a key theme this year. "Portfolio resilience in 2022 to 2024 has invariably not been a live conversation, but in 2025, the theme has come alive as we work with our clients to build portfolios that are resilient to what's been going on in the markets this year," says Nayar.

Market volatility this year began in late January, triggered by the breakthrough of China's DeepSeek, which foreshadowed a turbulent year to come. US equities have rallied and performed well since 2023, but this has resulted in stretched valuations and significant positions in many investor portfolios.

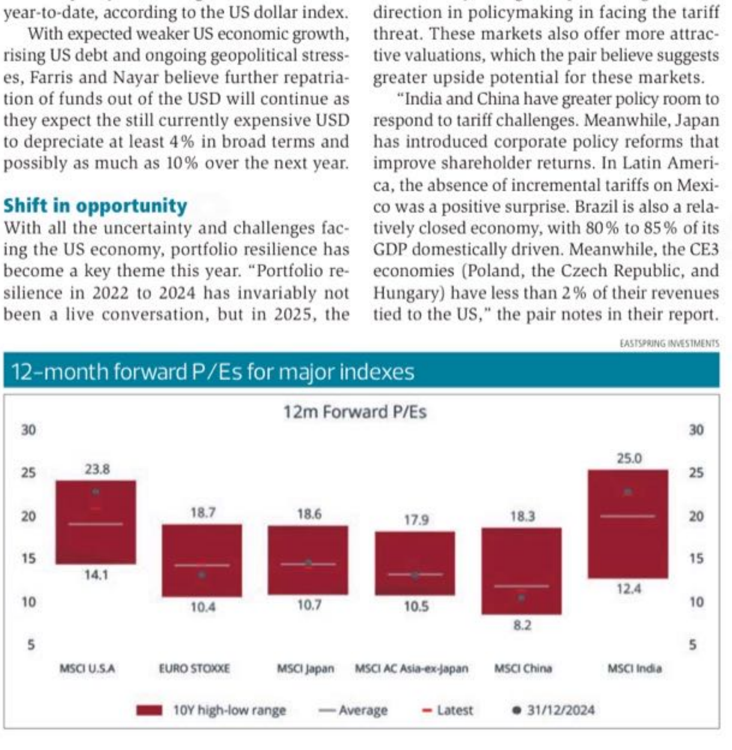
"We sometimes lose track of how rich valuations in the US are, but the US is priced for superior growth, and there is no debate about it; it is really priced for perfection. But the challenge now is that, given the environment the US is in today, it is just simply not what one could have accepted a year ago and six months ago," Nayar adds.

On the other hand, several Asian and emerging markets stand to benefit from dominantly domestic drivers of growth powering the economy, along with possessing a clearer direction in policymaking in facing the tariff threat. These markets also offer more attractive valuations, which the pair believe suggests greater upside potential for these markets.

"India and China have greater policy room to respond to tariff challenges. Meanwhile, Japan has introduced corporate policy reforms that improve shareholder returns. In Latin America, the absence of incremental tariffs on Mexico was a positive surprise. Brazil is also a relatively closed economy, with 80% to 85% of its GDP domestically driven. Meanwhile, the CE3 economies (Poland, the Czech Republic, and Hungary) have less than 2% of their revenues tied to the US," the pair notes in their report.

EASTSPRING INVESTMENTS

12-month forward P/Es for major indexes



In China, the artificial intelligence (AI) innovation theme is very much alive. China's DeepSeek large language model (LLM) is expected to benefit many Chinese companies materially, particularly AI-enablers and adopters in the e-commerce, smartphone and semiconductor sectors, just to name a few.

This provides investors with an investment opportunity in China, especially with the cheap valuations in the market.

"China, as a market, has a valuation advantage. All things being equal, investors would rather pay $1 rather than $10, right? So yes, China markets are cheap and we think they are a good place to invest," Nayar adds.

Encouragingly, the pair also point out that recent data suggests a rather resilient domestic market in China. In the recent May Day holiday, China's tourism traffic and revenue rose 6.4% and 8% respectively y-o-y, while restaurant and retail sales gained 6.3%. Macau's gross gaming revenue, a proxy for small and medium-sized enterprises' sentiment, rose 12%.

Investing in Japanese reform

In the US equity market, corporate earnings are huge drivers of growth, often being a key driver of return on equity (ROE) for shareholders of US equity compared to some other drivers of ROE, such as providing shareholder equity through share buybacks and dividends.

With an uncertain US economic outlook, focusing on dividends can be a compelling strategy, especially in uncertain or low-growth environments.

"Dividend returns are much more stable than corporate earnings. Focusing on dividend yields can allow you to build much more resilient portfolios. For dividends, Asia is the market; it's a global leader on high-dividend and cash-resilient companies," states Nayar.

Historically, the Singapore and Hong Kong markets have been favoured for their average dividend yields of 4%, well above the MSCI World average of 1.9%.

More recently, however, corporate reform in Japan, driven by the Tokyo Stock Exchange's push for improved governance, has offered investors a distinct and uncorrelated source of alpha, with higher returns on equity supported by increased dividends and share buybacks.

For 2024, Nikkei estimates indicated that publicly listed Japanese companies were estimated to pay about JPY18.3 trillion ($163 billion) in dividends, topping records for the fourth straight year.

Similarly, share buybacks of Japan Inc also reached a record high in 2024, hitting JPY18 trillion, which is roughly double the amount of share buybacks in 2023, which stood at JPY9.57 trillion.

The recent transition of the Japanese economy from deflation to reflation is also helping real wages to recover, supporting domestic consumption and buffering against external shocks. The trend has also been a supporting factor, prompting companies to shift towards using hoarded cash to improve equity returns for shareholders.

"Japan remains one of the cheapest markets globally as the corporate governance reform in Japan is pushing up return on equity, and that's having a positive impact for investors in pulling up price book value," the pair note.

"Earnings growth and free cash flow are also relatively strong. With robust corporate reforms and rising wage growth, Japan equities offer a compelling long-term proposition for global investors." ■