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4Q23 Market Outlook

Resilient US growth drives short-term risk taking

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Market recap

"Higher for longer" narrative weighs on markets

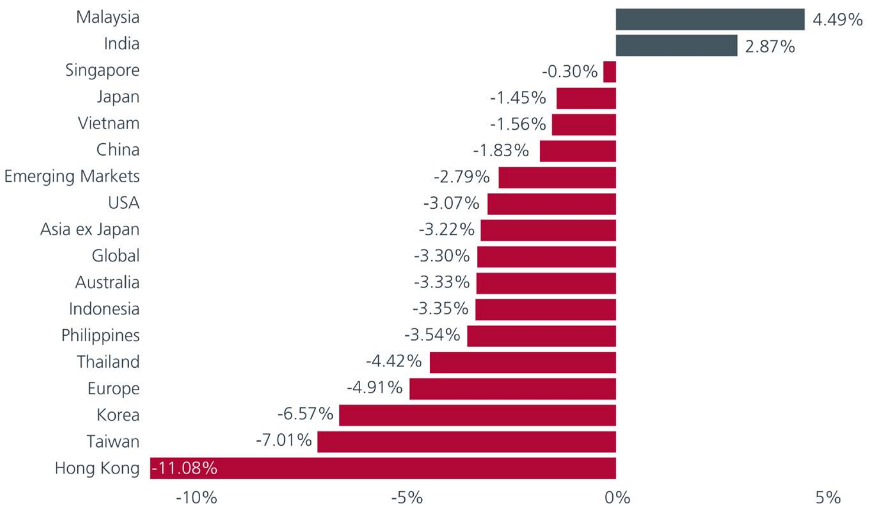
Equities

Global equities declined in the third quarter, with negative returns in August and September due to investor concerns over higher US rates. Oil prices rallied, supporting the global energy sector but potentially complicating central banks' fight against inflation. The US 10-year Treasury yield surged, weighing on global technology and growth stocks. Amid rising yields, the MSCI ACWI Growth Index underperformed its value style counterpart, declining 4.85%, while the MSCI All Country World Index was down by 3.30%. Malaysia and India led, while Hong Kong and Taiwan lagged. ASEAN markets outperformed the broader Asian region and Emerging Markets but still posted a negative return.

Bonds

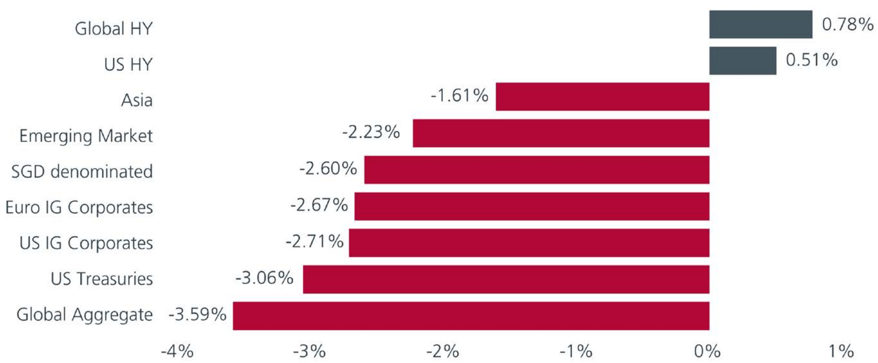
The Federal Reserve's ("Fed") "higher for longer" narrative drove US yields to their highest levels since the Global Financial Crisis. The yields on the US Treasury curve increased across all key maturities, with the 10-year and 30-year maturities leading the way with increases of 78 and 88 basis points respectively. Against this backdrop, the Barclays Global Aggregate Index, and Bloomberg Barclays US Treasury Index finished the quarter down by 3.59% and 3.06% respectively. The JP Morgan Asia Aggregate Index was primarily dragged down by US yields, finishing down 1.61%, while the JP Morgan EMBI Global Diversified Index was down 2.23%.

Global Equities – Q3 2023 Performance



Source: LSEG Datastream. Total returns as of 30 June to 29 September 2023. MSCI indices in USD terms.

Global Bonds – Q3 2023 Performance



Source: Total returns as of 30 June to 29 September 2023. In USD terms. Indices used include the ICE BofA Global High Yield Index, ICE BofA US High Yield Index, JPM JACI Index, JPM EMBI Global Diversified Index, HSBC & Markit Iboxx ALBI Singapore Index, ICE BofA Euro Corporate Index, ICE BofA US Corporate Index, BBG Barclays US Treasury Index, BBG Barclays Global Aggregate Index. IG: Investment Grade. HY: High Yield.

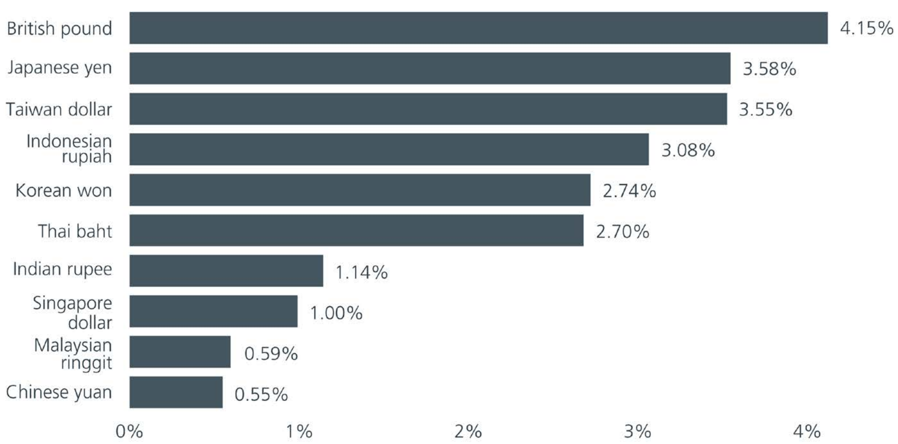
Currencies

The Fed's "higher for longer" narrative strengthened the dollar, resulting in a 2.23% increase in the USD Broad Price Index. The greenback's strength was fueled by both positive interest rate differentials and resilient US growth momentum. The US dollar outperformed all major currencies, including the British pound, the Japanese yen, and Taiwan dollar, with gains of 4.15%, 3.58%, and 3.55%, respectively.

Commodities

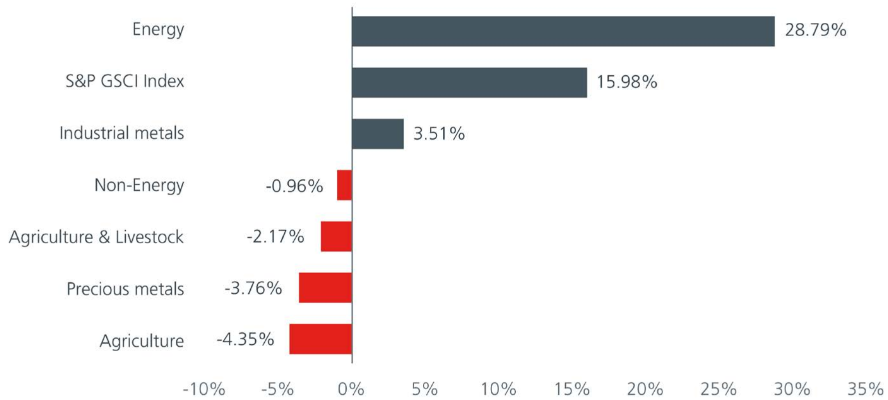
Commodities, represented by the S&P GSCI index, surged 16.0% during the quarter, led by energy. Oil prices increased sharply on the back of limited and tighter supplies, driven by the continued supply cuts from Saudi Arabia and Russia. While the agriculture and precious metals sectors were impacted by a strong US dollar, industrial metals fared better, rising by 3.51%.

USD vs Currencies



Source: LSEG Datastream. Returns against the USD as of 30 June to 29 September 2023.

Commodities – Q3 2023 Performance



Source: LSEG Datastream. Total returns of S&P GSCI Indexes in USD terms as of 30 June to 29 September 2023.

Macro outlook

Mild recession risk over the next 6-12 months

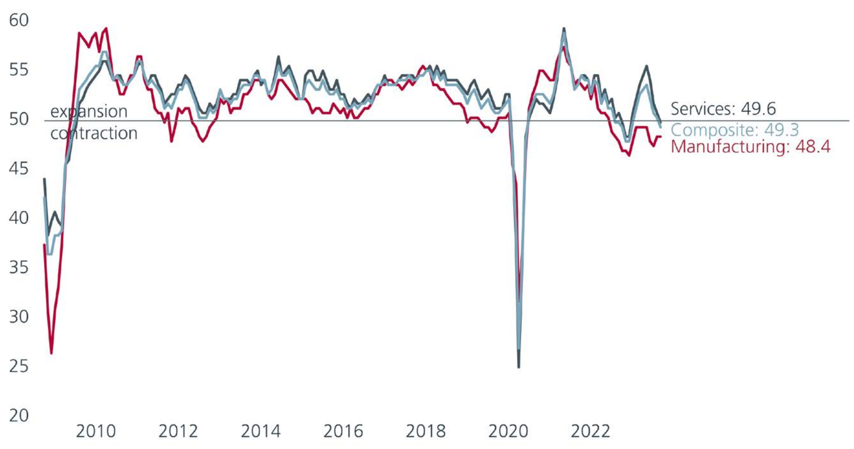
Global growth

Global growth has been stronger than expected over the past quarter, propelled by a still robust services sector and resilient consumer spending. The Services New Orders Index experienced a moderation in growth, while the Manufacturing New Orders Index rebounded, but remains in a contraction phase. Despite this, the global economic environment maintains a positive momentum with growing consensus expectations of a 'soft landing'.

Inflation

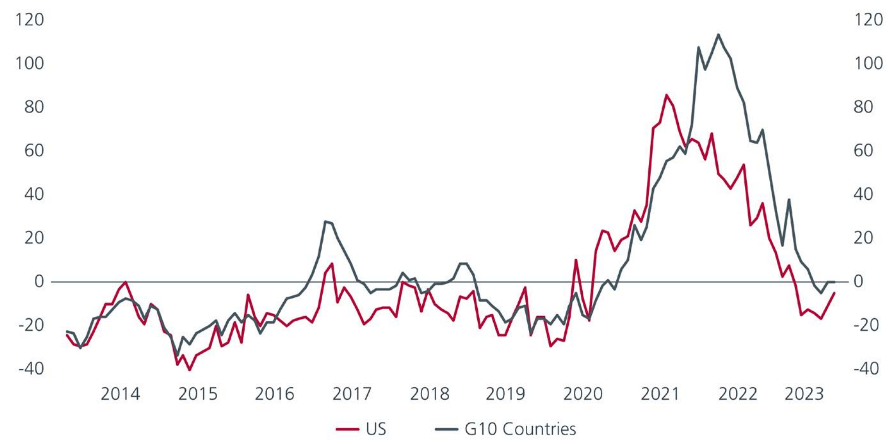
Inflation pressures have generally been easing in the past few months, notably within the G10 economies. However, wage inflation, which is a significant structural driver of core inflation, needs to fall convincingly for core inflation to start decreasing meaningfully and for central banks to achieve their price stability objectives. While inflation readings appear to be higher versus expectations recently, our Multi Asset Solutions (MAPS) team believes that the momentum, and direction of inflation are likely to continue on a downward trend.

Global PMI New Orders, September 2023



Source: LSEG Datastream. 13 October 2023

Citi Inflation Surprise Index (US, G10)



Source: LSEG Datastream, 13 October 2023. Weighted average standard deviation of inflation surprises, expressed in basis points. A positive reading of the index means that CPI, PPI and wage releases have on average been higher than expected (Bloomberg surveys) in recent history (half-life of three months).

Interest rates

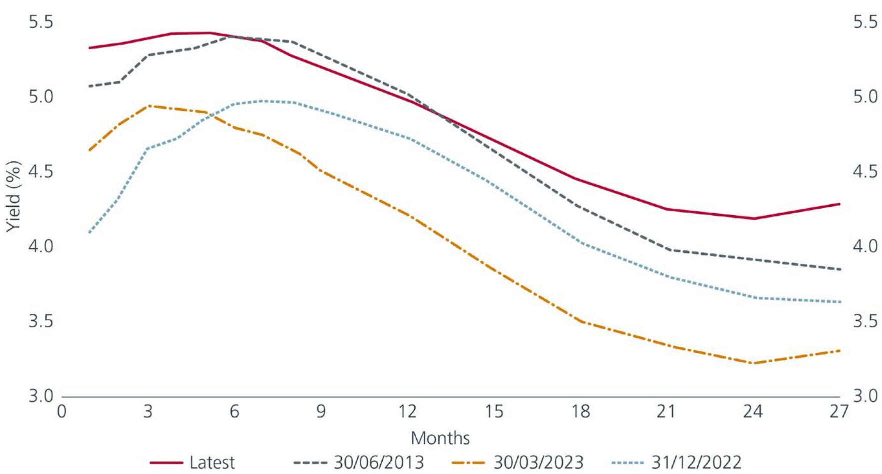
With US inflation surprising higher recently alongside resilient growth data, there are increased market expectations of "higher for longer" rates. This has caused the 10-year US Treasury yields to reach a 16-year high. While the Fed recently held rates steady, expectations for another rate hike are growing. If growth and labour market data continue to surprise to the upside, an additional rate hike may be in store. Our MAPS team expects the rate hikes to eventually slow the labour market and allow the Fed to start cutting rates. However, we may still be a few months away as the labour market takes time to adjust.

Looking ahead

Recession risk is higher over the next 6-12 months, especially on the back of tighter financial conditions. We are currently in the "late" cycle and both monetary and fiscal policy tightening will likely curtail growth further. Any recession is likely to be concentrated in the developed market economies.

As a base case, our MAPS team does not anticipate the upcoming recession to be very deep i.e. no significant contraction. In their view, US corporate credit profiles are generally starting from a position of fundamental strength in terms of leverage, liquidity, and maturity schedules. And notably, the underlying balance sheets of non-financial corporates and US households are looking relatively strong. US household debts also remain at very manageable levels despite the recent drawdown in savings. However, the current expectations of a 'soft landing' appear too benign relative to the team's base case scenario.

Fed funds futures forward curve



Source: LSEG Datastream. 13 October 2023.

Citigroup Economic surprise index

Source: LSEG Datastream. 13 October 2023.

Heatmap - Key economic indicators

Source: Eastspring Investments. LSEG Datastream. 20 October 2023.

Assessment of key risks – Inflation and recession remain key risks

	Likelihood	Negative Impact
Financial and economic		
Inflation persisting at levels higher than what is being priced in the markets.	Low	High
Limited timely follow-through and implementation of stimulus by China may warrant concerns for further China macro risk.	Low	Medium
Stubbornly strong US growth challenges the MAPS team's 12-month bearish outlook.	Low	Medium (on the positive)
Global recession as the impact of the concerted global central bank monetary tightening is felt.	High	Medium
Geopolitical		
Israel-Hamas Crisis may broaden Middle East conflict to drive oil volatility and heighten energy-related inflation.	Medium	High
Taiwan Straits Crisis risk with increasing tensions between China and Taiwan.	Low	High
Russia Ukraine Crisis remains a significant source of risk, with a chance of a geopolitical mis-step being a key concern.	Medium	High
Cyberattacks are emerging as a threat to economic and financial stability.	Medium	Medium

Source: Eastspring Investments (Singapore) Limited, October 2023

Asset allocation

Opportunistically "risk-on"

The current market environment is supported by a robust US economy and increasing market expectations of a soft landing, with recession likely to transpire in 2024. In Asia, the recent China policy stimulus is moving in the right direction, and there is optimism that policy effectiveness will improve in the coming months. Given this backdrop, our MAPS team believes that risk assets have further room to grow in the short-term investment horizon. However, if risk assets become overstretched, the team will dynamically allocate into safe haven assets and vice versa.

While our MAPS team's base case is for a mild recession 6-12 months from now, the team is opportunistically "risk-on" in their positioning. The following table summarises the the team's tactical (3-month) and strategic (12-month) views and rationales for broad asset classes.

Asset allocation views

	3-month view			12-month view			Rationale
	Under-weight	Neutral	Over-weight	Under-weight	Neutral	Over-weight	
Equities			●	●			There is still scope for near-term upside if fundamentals remain constructive. Weakening fiscal impulse and labour market are likely to slow growth which should in turn drive equities lower over the medium-term.
10Y Government Bonds			●			●	US 10Y yields appear attractive at around 4.80% currently. As the US economy slows over the medium-term, markets will price in more rate cuts, driving a bull steepening of the US yield curve.
Corporate bonds	●			●			The maturity wall from 2023 to 2025 appears high for US Investment Grade (IG) corporates. Over the near-term, we prefer to fund the overweight in equities with a lower allocation to US IG.
Cash		●				●	Positioning for risk-off assets over a 12-month time horizon keeps us overweight cash over the medium-term.
Equities							
US			●	●			Underweight position in the medium-term is driven by decelerating growth and cumulative effects of Fed hikes.
Europe		●		●			Weak Euro Area data (e.g., manufacturing) and restrictive ECB policy weigh on economic conditions. European equities are likely to move lower over the next year, in line with recessionary trends.
Emerging Markets	●				●		Though partly driven by China macro data, Emerging Market (EM) equities remain the bright spot over the medium-term as the global recession is driven by the Developed Markets (DM).
Asia Pacific ex-Japan	●				●		APxJ valuations are relatively attractive within EM. Asian equities are likely to be range-bound over the medium-term as global headwinds are offset by China's improving fundamentals and recessions in the DMs.
Government Bonds							
US			●			●	As the US economy slows, markets will price in more rate cuts, driving a bull steepening of the US yield curve.
Europe		●			●		Following a recent 25bp rate hike, the ECB acknowledged that although inflation is easing, it is expected to stay higher for longer, thus driving our less bullish views on European duration.
Singapore			●			●	With a narrowing growth forecast and easing inflation outlook, the Monetary Authority of Singapore does not seem likely to adjust its NEER policy. Current yield levels are attractive entry points.
Corporate Bonds							
US High Yield			●	●			The rating migration continues to be supportive in the short-term. However, despite relatively lower default rates, corporate refinancing risk may be underpriced as the maturity wall swells in the next few years.
US Investment Grade	●				●		IG credit may trade sideways over the next 12 months as higher spreads are offset by lower base rates.
Emerging Markets			●		●		EM central banks have remained relatively dovish, which should help support overall EMBI spreads.
Asian Credit			●		●		As growth slows in the region (though not as much as in DM economies), corporate bond yields in Asia are likely to be better behaved relative to DM counterparts.
FX							
USD			●			●	Higher real yields and growth are expected to hold up USD in the near-term. The recessionary environment will generally drive investors into safe-haven currencies, such as the USD.
EUR	●			●			The persistence of weaker Eurozone data will likely weigh on the EUR/USD.
SGD		●			●		With the recent decision by the Monetary Authority of Singapore to hold on the policy band and the mixed economic fundamentals, the SGD should be expected to stay rangebound in the short term.

Source: Multi Asset Portfolio Solutions team. Asset class views are as of the team's most recent monthly meeting in October and should not be taken as a recommendation. The information provided here is subject to change at the discretion of the Investment Manager without prior notice.

Equities

Asian equities poised for medium-term outperformance

Going into 2023, most equity investors were positioned for downside scenarios with increased holdings of "dry powder" or cash, and an underweight in equities. Since then, equity positioning among global investors, based on a recent Bank of America survey, showed that investors are the least bearish since February 2022.

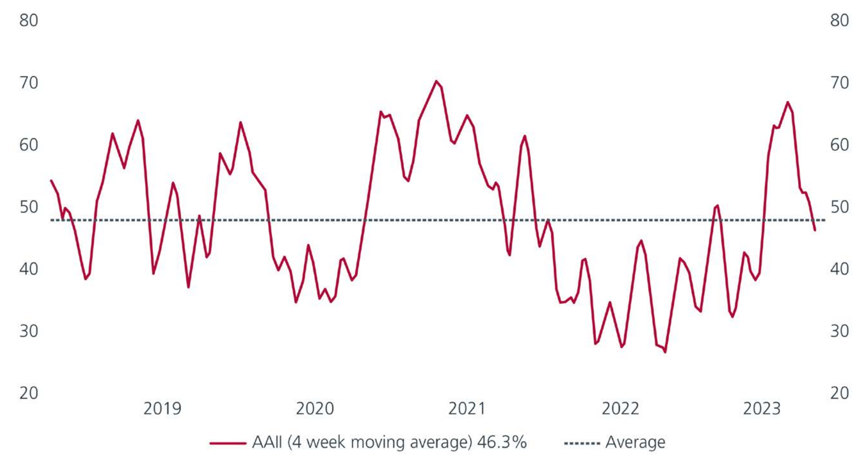
Global equities rallied amid volatility during the first half of 2023, but hit a rough patch in the third quarter, as US yields surged. Emerging markets lagged developed markets on the back of higher US yields (and a strong US dollar) alongside underwhelming China growth.

Despite the recent surge in US yields, our MAPS team sees potential for global equities to continue benefiting over the near term on the back of relatively healthy corporate fundamentals.

IBES MSCI 12m forward P/E (x)

Source: LSEG Datastream, 13 October 2023.

AAII Sentiment



Source: LSEG Datastream, 13 October 2023.

Valuations

US equities remain in expensive territory but are tactically favoured considering broader fundamentals. Asian equities continue to offer better value relative to the US over the medium term, as forward P/Es trade at 12x in Asia ex-Japan versus the above 18x in the US.

Sentiment

In general, we have found that forward equity returns are highest when sentiment is bearish but improving, and lowest when sentiment is bullish, but deteriorating. Investor sentiment for the shorter-term outlook for equities, as represented by the American Association of Individual Investors (AAII) Sentiment Survey (which canvasses opinions of individual investors regarding where markets are headed in the next 6 months), has in recent months been trending into the "bearish" territory, below its historical average. The "bearish" territory is a "contrarian" indicator of sorts, helping to signal that stocks may be oversold and as such represents a good opportunity to stay invested in the short term.

Positioning

Despite the recent surge in US yields, our MAPS team sees potential for global equities to continue benefiting from relatively healthy corporate fundamentals over the next 3 months. However, over the medium term, the team acknowledges that deteriorating global growth and a highly-anticipated economic recession, albeit delayed, will drive risk assets such as global equities lower.

The team is constructive on Asia ex-Japan equities over the medium term, given the resilient Asian exports and upward-trending economic data. Supportive policies implemented by Chinese leaders/regulators have stabilised the country's property market, and in turn the broader region.Valuations (12.1x P/E) remain cheap relative to other regional markets. While Asian equities will not be immune to global growth headwinds, the team expects valuations to trade range-bound as the global slowdown is concentrated in the developed economies. Improving China fundamentals should also help offset some of the volatility, making Asian equities less affected by a global recession and positioning it well for the longer horizon.

Bonds

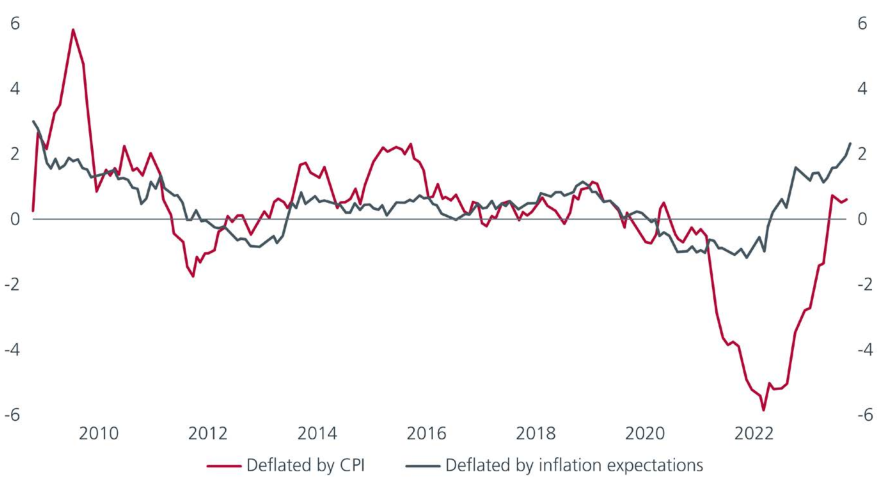
US Treasuries remain attractive over a 12-month horizon

Resilient labour market and US growth have led bond investors to believe that rates may remain "higher for longer" . The US banking fallout in March, in which the Silicon Valley Bank was the largest bank to fail since 2008, led to relatively short-lived contagion effects as resilient corporate balance sheets ultimately bolstered investor sentiment. However, our MAPS team's analysis suggests that there is a higher probability of the US economy entering a recession in the next 6-12 months due to the lagged cumulative effects of rate hikes. A repricing of US yields downwards, reflecting increased probability of rate cuts is likely to play out. The Fed wants to maintain its credibility on price stability, as well as to bring wage inflation, a structural driver of core inflation, under control. Until then, the Fed will likely remain hawkish. The US labour market should normalise to a new steady state with job openings eventually adjusting to pre-pandemic levels. The Fed's hawkish stance will impact growth negatively, which will likely be reflected in upcoming macroeconomic data releases, in the team's view.

Valuations

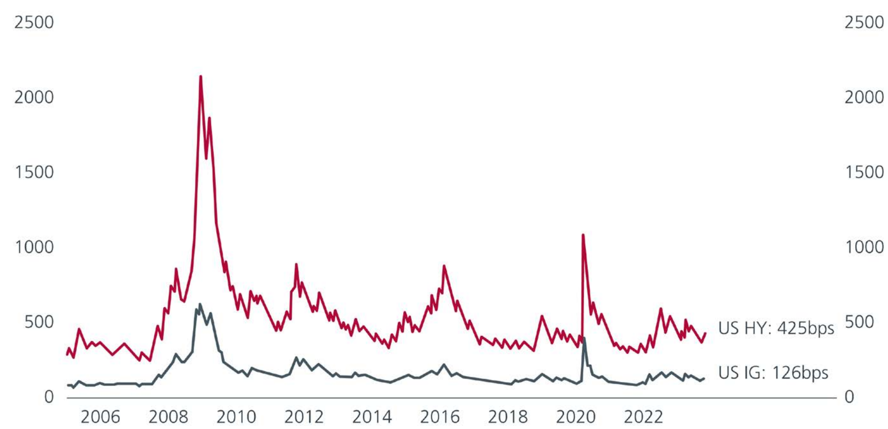
The recent surge in US Treasury nominal yields has caused real yields on US 10-year Treasuries to rise near 2.5%, which is close to a 16-year high. This indicates that the US government bond market is currently relatively attractive. The chart shows two measures of real yields - one based on actual changes in prices (deflated by CPI), and the other based on expected changes in prices (deflated by inflation expectations). The 10-year real yields adjusted by inflation expectations and CPI are both positive, indicating a positive return on investment.

US real yields (%)



Source: LSEG Datastream, 13 October 2023.

US IG and HY index option adjusted spread (OAS; bp)



Source: LSEG Datastream, 13 October 2023.

Positioning

As global growth decelerates, most economies, particularly the US, are nearing the end of their rate tightening cycles. As such, our MAPS team expects that US rates have more scope to decrease than to increase, moving forward. Despite the hawkish pause by the Fed at its most recent meeting and the Fed Funds Futures market still pricing in a higher for longer rate scenario, our MAPS team believes that the odds of a recession have increased, and US duration is attractive over a 3-month horizon. As mentioned previously, the real yields on US 10-year Treasury have trended higher and likely to constrain growth, while the lagged cumulative effects of policy tightening should start kicking in. Over a 12-month horizon, US Treasuries are attractive and will likely regain their roles as effective diversifiers, especially in a recessionary environment.

The impact of higher interest rates is still making its way through the US economy and is likely to affect corporate margins and earnings eventually. This is the reason for our more defensive positioning within the US credit space, as IG corporate bonds are more interest rate sensitive and less cyclical relative to their US High Yield (HY) counterpart. Assuming our MAPS team's base case of a mild recession over the next 6-12 months, spreads have room to widen significantly, and we would expect HY spreads to widen more. IG credit may trade more range-bound as higher spreads are potentially offset by falling US yields. A faster than expected deterioration of the US economy could prompt the Fed to pivot earlier and in such a scenario, US HYs are likely to be more vulnerable, with an increase in defaults and a significant amount of debt set to mature in the next few years.

Currencies

US dollar still powered by US growth and high yields

The recent rise in US bond yields has made the US dollar an attractive currency for investors, with market expectations of higher US rates contributing to its appeal. While we believe the US dollar can rally in the short term, its performance over the medium term will depend on the potential path of the US economy. During a growth slowdown, the US dollar may act as a safe haven and risk-off hedge.

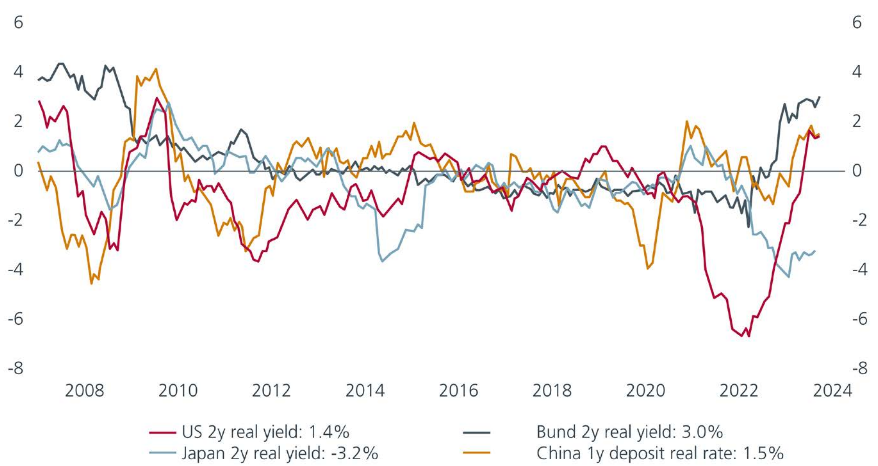
Valuations

The US dollar appears expensive as it is currently about two standard deviations above its historical average on a real effective exchange rate (REER) basis.

Positioning

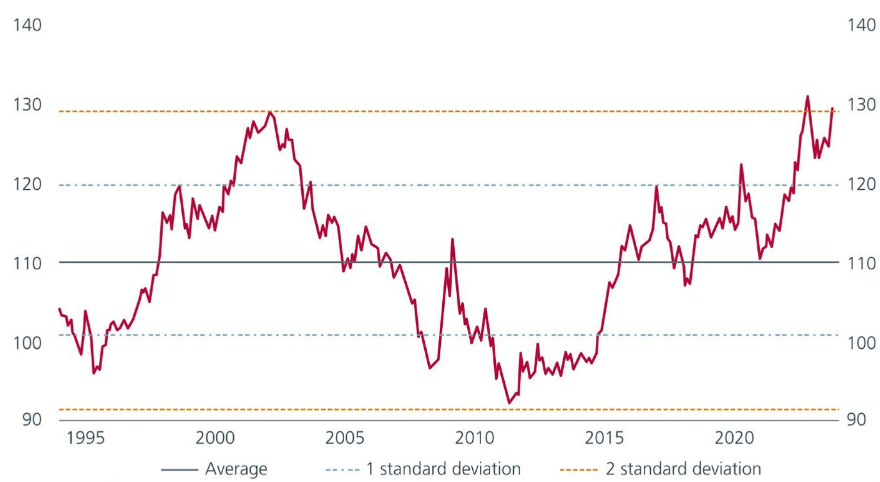
The MAPS team is overweight the US dollar, based on expectations of "higher for longer" US rates and widening interest rate differentials. Various data indicators are also signaling resilient fundamentals and optimistic market sentiment. Additionally, the team recognises the counter-cyclical nature of the US dollar, which tends to outperform during a recession. Thus there is potential for higher performance from the US dollar over the medium term given the team's expectations of a recession within the next 6-12 months.

Global short-duration real interest rates (%)



Source: LSEG Datastream, 13 October 2023.

JP Morgan US Dollar REER (CPI)

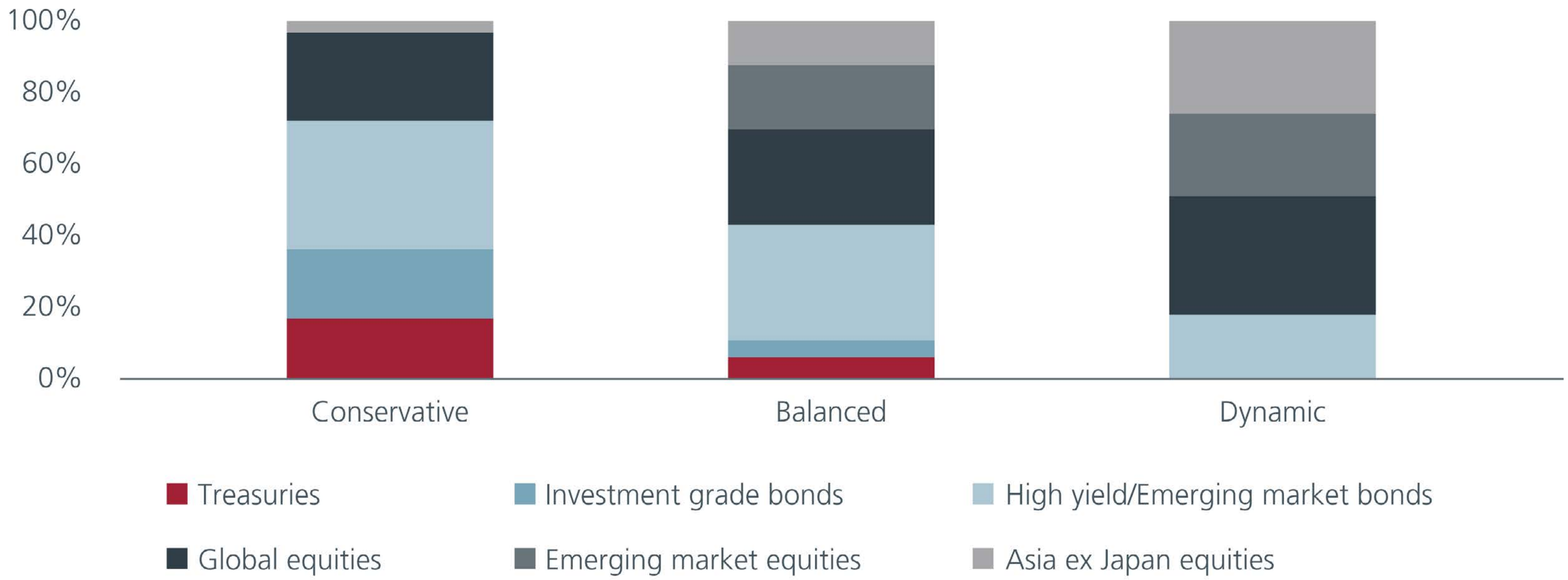


Source: LSEG Datastream, 13 October 2023.

Model portfolios

These model portfolios include potential allocations to asset classes and markets. The model portfolios help investors achieve portfolio diversification while leveraging the MAPS teams' insights and expertise. The portfolios are reviewed quarterly to align with the team's views on the markets and asset classes and take into consideration opportunities that may arise.

Model portfolios



Source: Eastspring Investments Multi Asset Portfolio Solutions team. End September 2023. These model portfolios are for reference only and do not consider your risk tolerance and investment goals. Please reach out to your financial advisor to discuss your asset allocations and potential strategies to diversify your investment holdings. The information shown is derived from a model portfolio deemed to approximate the management styles herein. Each investor's portfolio/fund may vary from the information shown.

A stubbornly resilient US economy?

The US economy has been surprisingly strong despite the Federal Reserve (Fed) raising rates more aggressively than ever before. It usually takes some time for monetary policy to affect the economy, although the lag can vary.

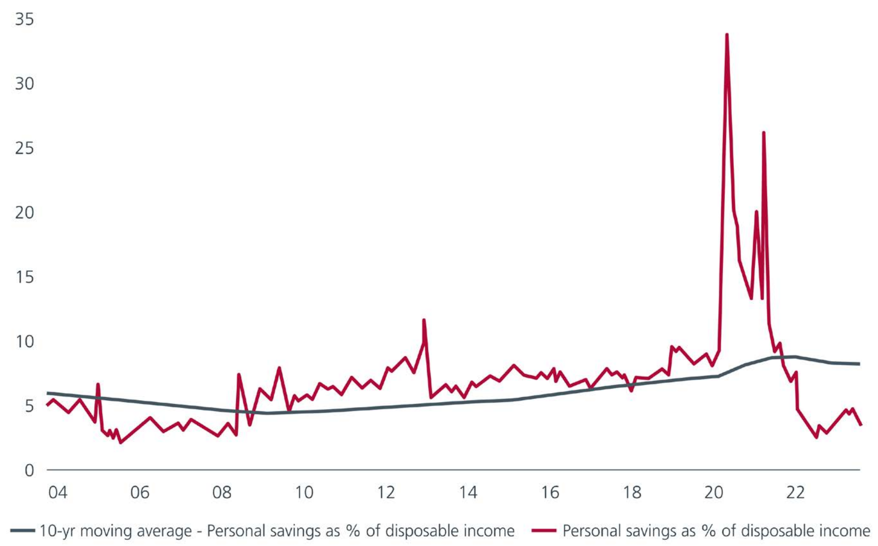
History suggests that it usually takes between 2 to 8 quarters for US GDP growth to feel the effects of tighter monetary policy. Similarly, higher interest rates can start to slow down the labour market and wage growth after 3 to 7 quarters. Meanwhile, core inflation can take 4 to 8 quarters to respond to tighter financial conditions.

How different is this cycle? The Fed's rate hikes over the last 18 months seem to be taking even longer to affect the US economy. This is because COVID-related fiscal handouts, lower household savings and post-pandemic related supply tailwinds are offsetting the tighter financial conditions. The labour market, meanwhile, has started to feel the pressure of higher rates since the first quarter of 2023 - the Job-Workers Gap, which shows the difference between the number of jobs and workers available, has begun to shrink. On the other hand, core PCE inflation has reacted faster than usual to higher rates, but it is also coming down from a very high level.

The US consumer is key to the resilience of the US economy and consequent investor expectations of a soft landing. Consumption growth in the US is currently supported by the low household savings rate and positive real income growth. US household savings rate currently stands at 3.5%, materially below the 7% average seen pre-pandemic. If households start to save more, slower consumption will in turn slow GDP growth. Meanwhile, wage growth has been high in the US over the last two years, but real disposable income growth has been negative due to elevated inflation. With inflation falling, real income growth has turned positive. Although interest expenses have started to climb, the impact on consumption is mitigated as households have less debt in the current cycle. Higher interest rates have however slowed mortgage and consumer credit growth.

Investment implications. We believe that the Fed's actions will continue to slow the US labour market and economy over the next 6-12 months. A US recession in mid-2024 is likely as the tailwinds from US household savings and fiscal handouts fade. We expect inflation to gradually decelerate until mid-2024 as long as there are no material commodity price shocks. That said, the Fed is unlikely to be too dovish if inflation remains elevated. Current market pricing is too benign and we expect the US Treasury yield curve to steepen. We remain vigilant in our duration exposure and look for opportunities to incorporate risk-off hedges in our portfolios.

Low household savings rate versus long term average (%)



Source: LSEG Datastream, September 2023.

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