eastspring investments

A Prudential plc company

January 2024

Monthly Investment Views

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Summary – January 2024

Macro Overview

Growth: Global growth has held up stronger than expected in 2023, bolstered by the especially resilient US economy. However, the positive momentum in the global economy is likely to trend lower in 2024 given that China, another key engine of global growth, is facing headwinds from weak domestic demand alongside a slow recovering property market and deflationary backdrop. Given the market's current base case for a US soft landing, a shallow recession remains probable over the next 6-12 months in our view. While growth is likely to decelerate from here, the balance sheets of US corporates and households remain strong. Additionally, the Fed has likely built sufficient firepower in terms of its progress on quantitative tightening (QT), to put them in a strong position to better navigate any risk of recession.

Inflation: Based on current trends, it seems that global inflation has likely hit its peak and the disinflationary trend remains intact. The MAPS team believes that the disinflation trend is likely to persist into 2024. However, we note that the US core PCE (personal consumption expenditures), the Fed's preferred measure of inflation, remains some ways from its 2% target.

Monetary Policy: DM central banks are likely already at the end of their respective rate-hiking cycles, especially on the back of the Fed holding its key rate steady in December while indicating potentially three rate cuts in 2024. The MAPS team believes that as inflationary pressures ease, global DM rates will likely trend lower. However, we remain cautious about declaring victory over price increases too quickly. Although much attention is now on the Fed pivot, significant policy easing is unlikely to transpire without a recession.

Key Risks

Inflation: Current trends show core inflation in developed market countries has generally been moderating, though we remain wary of factors that may still reignite inflationary fears. For example, the US job market remains relatively strong and voluntary crude oil production cuts by Saudi Arabia/Russia may persist. And more recently, the Red Sea crisis may contribute to higher shipping costs and insurance premium over time.

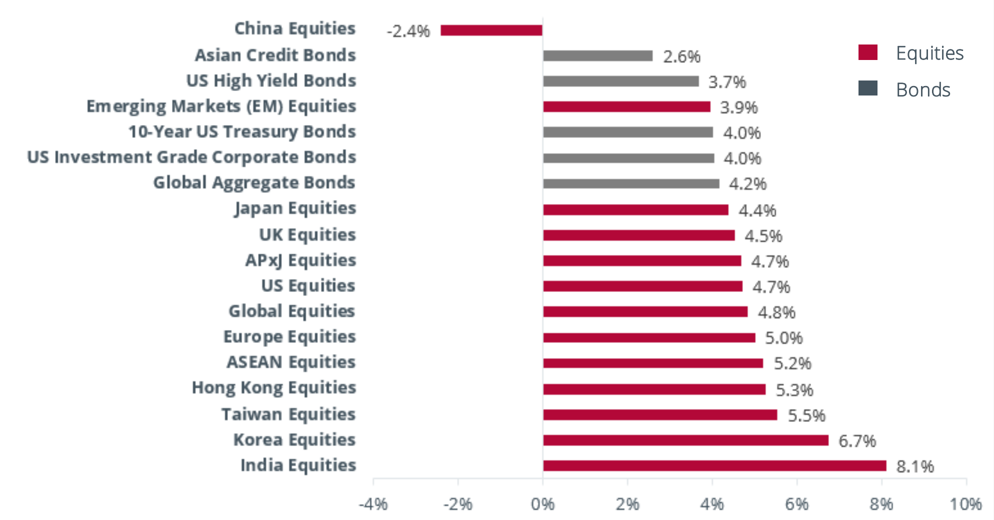
Geopolitics: Investor sentiment continues to be affected by rising political risks and social instability; complacency on war risks is ill-advised. The team continues to monitor updates on the Gaza-Israel Crisis, Russia-Ukraine Crisis, Taiwan Straits Conflict, etc.

Political Elections: Election outcomes in Taiwan, India, and the US, among others, are crucial to monitor as they can result in significant policy changes that can impact financial markets and increase volatility.

Robust US Growth: The relatively strong US consumer and tight labour market remain key to the resilience of the US economy and a potential soft landing scenario, as the propensity to spend remains relatively high. This upside growth risk may challenge the MAPS Team's 12-month investment preference for high quality, safe havens.

Market Recap and Update

Global Financial Assets – Monthly Performance (December 2023)
% monthly total returns (in USD unless otherwise stated)*



Equities: Global equities continued to rise in December, with sentiment supported by the ongoing optimism that global central banks will cut rates sooner than previously expected. Softer inflation data and more dovish messaging from the Fed further supported sentiment. The US 10-year Treasury yield ended the year at around 3.8%, significantly down from its mid October 2023 peak of almost 5%. All major markets posted positive absolute returns (on a USD basis). The exception was China which declined on continued weak economic data and lack of meaningful government support. India notably outperformed, returning 8.1% (on a USD basis), with growth coming in at a better-than-expected 7.6% year-on-year for the September quarter.

Fixed Income: In the fixed income markets, expectations of US interest rate cuts in 2024 led to a rally in the US government bond market. The US Treasury yield curve bull flattened with yields on the 2-year, 5-year and 10-year notes falling by 43 bps, 42 bps and 45 bps to 4.25%, 3.85% and 3.88% respectively. The US high yield market returned 3.7% (as proxied by ICE BofA US High Yield Constrained Index) as expectations of an easier Fed monetary policy supported the tightening of spreads. Asian USD credits extended gains for the second consecutive month as the JP Morgan Asia Credit Index rose 2.60%; both investment grade and high yield ended in positive territory.

Source: Eastspring Investments, Refinitiv Datastream. *As of 31 December 2023.

Asset Class Views

	3-month view			12-month view			Rationale
	Underweight	Neutral	Overweight	Underweight	Neutral	Overweight	
Equities			●	●			The short-term upside potential continues to hold if constructive fundamental data indicators persist. Q3 earnings were quite strong, and the overall positive earnings optimism (and stable growth) should continue to support equities Over the medium term, the fading fiscal impulse and weakening labour market are likely to slow growth, lead to a recession, and drive equities lower.
10Y Government Bonds		●				●	While yields are most likely headed lower in 2024 due to disinflationary trends and potential recession, the pace remains unknown especially if the still tight US labour market poses some upside risk to high price pressures. In line with our risk-off positioning over the 12-month horizon, US duration stands to benefit from a backdrop of decent growth and disinflationary trends.
Corporate bonds	●			●			For US corporates, we are cognizant that the maturity wall from 2023 to 2025 is approaching. Over the near term, in aggregate, our tactical overweight in equities is funded with a lower allocation to US IG bonds.
Cash		●				●	Our risk-off positioning over the 12-month time horizon keeps us overweight cash over the medium term.
Equities							
US			●	●			While the upside potential in the near term remains, the underweight position in the medium term is driven by decelerating growth and the cumulative (and lagged) effects of Fed hikes thus far.
Europe		●		●			Weak economic growth data (e.g., manufacturing) and a still restrictive ECB policy, for now, continue to weigh on economic conditions; European equities are likely to decline over the year, in line with recessionary trends.
Emerging Markets	● →	●			●		Tactically upgraded to neutral on upgraded fundamentals. Partly driven by China macro data, EM equities (and their idiosyncrasies) remain a potential bright spot over the medium term as the recession will likely to be concentrated in the DMs.
Asia Pacific ex-Japan	● →	●			●		Asian valuations remain relatively attractive to other regional markets; Asian equities are likely to trade range-bound over the medium term with global recession likely to be concentrated in DM countries.
Government Bonds							
US		●				●	Neutral for near term, but if the job market deteriorates meaningfully, US duration will be more attractive to add.
Europe		●				●	Rising recession odds on weak GDP growth data and Germany faltering, make bonds attractive over medium term.
Singapore		●				●	Weaker recent technicals drove the team's tactical positioning for Singapore Bonds to neutral.
Corporate Bonds							
US High Yield			●	●			Stable growth should continue 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	●				●		Investment Grades may trade sideways over the 12-mth period 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			●		●		The region may start to experience slower growth, though not as much as in DM economies). Corporate bond yields in Asia likely to be better behaved relative to DM counterparts.
FX							
USD	● ←	←	●			●	MAPS models signal a downgrade in technical indicators over the shorter term. Over the longer term, the recessionary environment will generally drive investors into safe-haven, counter-cyclical currencies (e.g., USD).
EUR	● →	●		●			Upgraded to neutral as Fed may cut before ECB; though the persistence of weak Europe data still weighs on EUR.
SGD	● →	●		●			The SGD should remain relatively higher to keep inflation expectations under control post the 2nd GST hike.

Source: Asset class views are as of the investment team's most recent meeting in early January 2024, and should not be taken as a recommendation. The information provided herein is subject to change at the discretion of the Investment Manager without prior notice.

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