eastspring investments

A Prudential plc company

February 2024

Monthly Investment Views

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Summary – February 2024

Macro Overview

Growth: Economic forecasters have raised their estimates for global growth, buoyed by a more benign inflationary environment and rate cut optimism. Hopes of a soft landing in the US are supported by better-than-expected economic data, declining inflation and the strong performance of risk assets since October 2023. The IMF lifted its 2024 global growth projection to 3.1% in January 2024 from 2.9% in October 2023. In addition, headline inflation is projected to decline, on account of the restrictive monetary policy and lower commodity prices. That said, given the ongoing conflict in Ukraine, coupled with the geopolitical events in the Middle East and the upcoming US presidential race, the year is unlikely to be plain sailing.

Inflation: January 2024's US CPI data printed hotter than expected, with shelter prices accounting for much of the increase. This has further lowered the odds of a rate cut at the upcoming FOMC meeting in March. Much attention will be fixated on the upcoming US core CPE price index data (the Fed's preferred measure of inflation) release on February 29. The Multi Asset Portfolio Solutions (MAPS) team still believes that the disinflation trend will continue to play out over the medium-term, especially as the labour market starts to cool.

Monetary Policy: Developed Market (DM) central banks are likely to be at the end of their respective rate-hiking cycles, as the Fed held its key rate steady in January for the fourth straight meeting. While the exact timing of the first Fed rate cut is still uncertain, the MAPS team believes that as inflationary pressures ease, global DM rates will trend lower over the medium-term. However, we remain cautious about the Fed prematurely declaring victory over price increases.

Key Risks

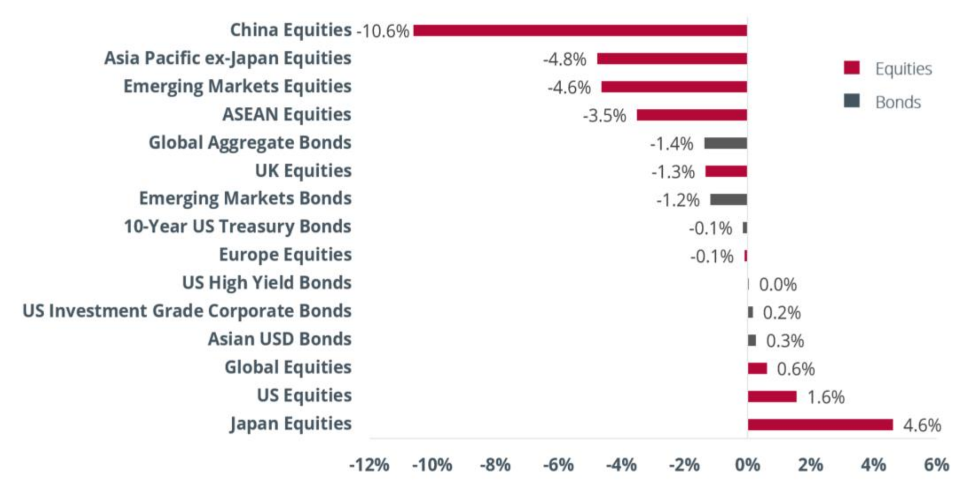
Geopolitics: Investor sentiment continues to be affected by rising political risks and social instability; complacency on war risks is ill-advised. Middle East tensions stemming from the Gaza-Israel conflict as well as the recent incident in the Strait of Hormuz may cause further oil volatility. This could heighten energy-related inflation and increase global trade costs (i.e., rising shipping costs). Geopolitical tensions can cause supply disruption (i.e., oil flows) and hence, upward pressure on prices. The team will also continue to monitor the potential of a US-Iran escalation, among other concerns.

Political Elections: 2024 is a heavy calendar year for elections in numerous countries. Election outcomes (e.g., U.S., India) can potentially result in significant policy changes that can impact financial markets and increase volatility.

Robust US Growth: Growth risks have become more balanced in view of the recent robust US economic data. The MAPS team is monitoring both upside (i.e., persistent inflation) and downside (i.e., deteriorating growth) growth risks. The relatively strong US consumer and tight labour market remain key to both the resilience of the US economy and a potential "soft landing" scenario. The upside growth risk scenario would challenge the MAPS team's 12-month defensive positioning.

Market Recap and Update

Global Financial Assets – Monthly Performance (As of 31 January 2024)
% Monthly Gross Returns (in USD)*



Equities: US and Global equities continued their rise in January, gaining 1.6% and 0.6%, respectively. The S&P 500 Index achieved a new record high as the "Magnificent Seven" stocks continued their rally. Japan equities outperformed with a 4.6% return, on the back of a weaker Japanese yen. However, the ebullient investor sentiment was slightly tempered at the end of the month when the Fed struck a less dovish tone at its January meeting. The Fed held interest rates steady, dashing hopes for a March cut. Over the month, growth stocks outperformed their value counterparts. Emerging Markets ("EM") equities were down 4.6%. China was amongst the largest underperformers, falling 10.6%, despite the People's Bank of China announcing new policy stimulus.

Fixed Income: US Treasury yields moved modestly higher in January, steepening in the process as the market reduced their Fed rate cut expectations. The 10-year yield rose 11 bps to 3.99% and the 30-year yield increased 19 bps to 4.22%. The Bloomberg Barclays Global Aggregate Index was down 1.38% amid higher yields. The ICE BofA US High Yield Constrained Index returned 0.02% on the back of positive technicals, and resilient economic data. The J.P. Morgan Asia Credit Index returned 0.27%, with the High Yield issuers (2.67%) outperforming their Investment Grade (-0.12%) counterparts.

*Source: Eastspring Investments, Refinitiv Datastream. *Equity returns are proxied by the respective MSCI market indices. "Asian USD Bonds": J.P. Morgan Asia Credit Index. "US Investment Grade Corporate Bonds": ICE BofA US Corporate Index (USD) TR Index gross. "US High Yield Bonds": ICE BofA US High Yield Index (USD) TR Index gross. "Global Aggregate Bonds": BBG Barclays Global Aggregate (USD) TR Index gross. "10-Year US Treasury Bonds": ICE BofA Current 10-Year US Treasury Index (USD) TR Index gross*

Asset Class Views

Underweight	Neutral	Overweight

Asset	Rationale
Equities 3m 12m	Although we remain tactically constructive, we scaled back our overweight view as that recent trading sentiment has turned overly bullish. While there is upside potential in the short-term if the fundamental data remains supportive, we are cognizant that the “Magnificent 7” driven rally may be susceptible to future sell-offs, especially when/if corporate profits get squeezed. Fading US pandemic savings and a weakening labour market are likely to cause a more meaningful deceleration in US growth over the medium-term, and hence lower equity valuations overall.
10Y Government Bonds 3m 12m	We tactically upgraded our US duration view on expectations of deteriorating US economic surprises. In line with our risk-off positioning over the 12-month horizon, US duration stands to benefit from a backdrop of moderate growth and disinflationary trends, in addition to its inherent flight-to-safety characteristic.
Corporate Bonds 3m 12m	US credit spreads are much tighter following the strong late-2023 rally. Over the 3-month horizon, we prefer equities over US investment grade bonds.
Cash 3m 12m	Our defensive / risk-off positioning over the 12-month horizon keeps us overweight cash over the medium-term.

Equities	
US 3m 12m	While there is room for further upside in the near-term, the underweight position in the medium-term is driven by decelerating growth and cumulative (and lagged) effects of previous Fed hikes which will weigh on already over-extended valuations.
Europe 3m 12m	We tactically downgraded European equities as earnings are still lagging the US’ meaningfully. European equities likely to trend lower over the year, in line with a weaker growth backdrop.
Emerging Markets 3m 12m	We maintain a tactical neutral stance on EM equities as there are no major changes in the team’s model data indicators. Over the medium-term, EM earnings growth can potentially outpace that of DM countries, contributing to better relative valuations.
Asia Pacific ex-Japan 3m 12m	Asian valuations remain relatively attractive though the earnings revision ratio is turning lower. Asian equities are likely to trade range-bound over the medium-term as global recession is likely to be concentrated in the DM countries (e.g., US, Europe).

Source: Asset class views are as of the investment team’s most recent meeting in early February 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. 3m = 3-month view. 12m = 12-month view.

Asset Class Views

Underweight	Neutral	Overweight

Asset class	3m	12m	View
Government Bonds			
US	Neutral → Overweight	Overweight	We have turned tactically more positive on US government bonds given the recent improvement in fundamental indicators (e.g., G10 economic surprise data).
Europe	Neutral	Overweight	The rising odds of a recession on the back of poor GDP growth data, Germany's weakening economy, and the lagged effects of higher interest rates, make bonds attractive over the medium-term.
Singapore	Neutral → Overweight	Overweight	As Singapore's growth trajectory follows those of the DM countries closely, our more positive view on Singapore bonds is linked to our overall more constructive views on US government bonds (See above).
Corporate bonds			
US High Yield	Overweight	Underweight	We are tactically less constructive on US High Yield bonds given the current very tight spreads. While still-stable US growth suggests room for further upside in the near term, valuations will be subject to volatility over the medium-term. Despite relatively lower default rates, corporate refinancing risk may be underpriced as the maturity wall swells in the next few years.
US Investment Grade	Underweight	Neutral	We maintain a tactical underweight given the very tight spreads. Over the medium-term, falling US yields may offer some price appreciation.
Emerging Markets	Overweight → Neutral	Neutral	We believe that EM bonds are potentially underpricing geopolitical risks which makes current valuations less attractive.
Asian Credit	Overweight	Neutral	We believe that developing Asian economies should continue to see growth on the back of stable consumption and investment trends. Over the medium-term, corporate bond yields in Asia are likely to be better behaved relative to the DMs.
FX			
USD	Underweight → Overweight	Overweight	We are more constructive in the near term as our model fundamental indicators (e.g., economic surprises) turned more positive. Over the longer-term, the recessionary environment will generally drive investors into safe-haven, counter-cyclical currencies such as the USD.
EUR	Neutral → Underweight	Underweight	Euro area growth is expected to stagnate in the first half of 2024 as the impact of tighter ECB monetary policy is realized. The persistence of weak Europe data will weigh on the EUR.
SGD	Neutral	Underweight	The SGD should remain relatively higher to keep inflation expectations under control in the wake of the 2nd Goods and Services Tax hike.

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