The Way We See It

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INSIDE THIS ISSUE

Outlook for markets in a higher-for-longer rates environment

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments
- Global Economies

On growth dynamics, recently-released data showed some interesting surprises, notably in the US, Germany and China.

On the relatively stronger side of the ledger, while final estimates of Q1 2024 GDP show that the U.S. economy remains the strongest amongst the G7 bloc, its real growth rate decelerated markedly in Q1 vs Q4 '23. While spending by households remained solid, a relatively high proportion was imported, hence contributing less to GDP.

On the relatively weaker end of the global growth spectrum, while the latest economic indicators of the Eurozone continued to underline a sluggish trend, the good news is that Germany and the Eurozone region have grown again.

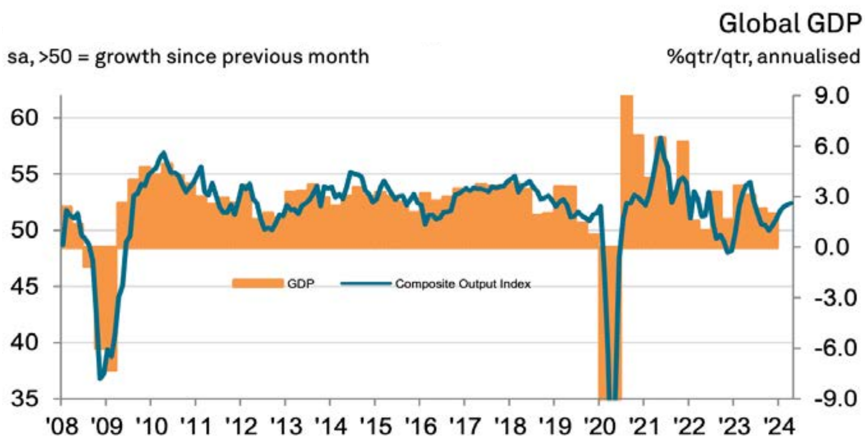
In the Asia Pacific economic zone , after a strong Q1 GDP annualised growth rate of 5.3%, recent partial economic data pointed to a potential slowdown again. Anecdotal evidence continued to point to an uncertain and volatile recovery.

On the global inflation front, while headline and core inflation indicators continued to show a decelerating annual trend elsewhere in the world, the US and a few other OECD economies experienced a short-term reversal of trend. In the US, the last three monthly data showed a renewed rising trend. As we had outlined in previous GOJI reports, this is not a surprise to us, for reasons we elaborated before. The recent pick-up in the US inflation trend has caused investors to start to worry about the hawkish sounds emanating from the Fed Chairman, following the recent May FOMC meeting.

US & selective DM saw modest inflation rises.

Finally, global geopolitical risks remain high: Russia vs Ukraine, Israel vs Hamas and Iran (quieter now, but still unpredictable). Geopolitical and trade tensions between China and the U.S. remain high, particularly as the US elections are nearing: China often finds itself the hot target for trade and technological tensions espoused by both American political parties.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global Market Intelligence

- Global Markets

Following a very strong performance in Equities in the US and other Developed Markets in the March quarter, together with a 50 bps increase in 10-year bond yields in the past two months, US and global risk assets corrected in April. There were signs of profit-taking of equities by Discretionary investors, and stop-loss selling by Systematics funds.

While there was some trimming of stock and bond exposures by both types of investors, the latest positioning data suggests that both remain overweighted in equities. While hopes for many rate cuts have diminished, Discretionary investors are still hoping for 1-2 cuts in the US (possibly more in Europe) by year-end. Fundamental investors are also predicting a continuation of a good delivery of earnings by corporates for the rest of the year, following a good Q1-to-date.

US & DM equities corrected in April; China rebounded.

Near-term performance of various asset classes

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	-4.13%	-3.67%	0.47%
3 months	4.23%	3.74%	7.92%
YTD	5.85%	5.01%	2.92%
FY 2023	27.10%	24.42%	10.27%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	-2.54%	-2.33%	-2.53%
3 months	-2.77%	-2.99%	-3.02%
YTD	-2.93%	-3.26%	-3.28%
FY 2023	8.52%	4.05%	5.53%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	-2.79%	-2.52%	0.40%
3 months	-3.80%	-3.22%	6.99%
YTD	-5.60%	-4.55%	10.47%
FY 2023	4.18%	5.71%	-5.01%

Asset Class	Asia ex Japan Equities	China Offshore	China A
Index	MSCI AC AxJ	MSCI China	MSCI China A Onshore
1 month	1.26%	6.60%	2.08%
3 months	9.70%	16.64%	12.84%
YTD	3.73%	4.27%	1.39%
FY 2023	6.34%	-11.04%	-11.46%

Source: GOJI, MSCI, Bloomberg; data as of 30/4/2024

The whole global equity universe, in USD terms, recorded a fall in the month of April. The U.S. and Developed markets fell by around -4.1% and -3.7% respectively. The China market surprised on the upside, supported by the authorities' easing measures and better-than-expected earnings of key growth stocks.

Delayed expectations of early rate cuts in the U.S. in this month continued to boost the value of the US Dollar. However, any sign of weaker than forecast inflation and/or growth data in the US could reverse this uptrend.

Bond markets again went through a tough time. Re-emerging inflationary pressures in the US forced a major repricing of US Fed Fund rates, which translated into a shift of the whole yield curve from 1- to 30-year bonds in April.

The Commodities complex fell, dragged down by a fall in oil prices, thanks to the easing of investors' worst fear of an escalation of war between Israel and Iran and other Gaza sympathisers. In addition, higher-than-expected inventories in the US and inconsistent demand from China helped to reduce the premium embedded in oil prices..

Market Outlook

Majority of investors reduced risky assets but remain bullish.

Despite recent adverse macroeconomic and geopolitical developments, the latest positioning of the majority of investors (both fundamental and systematics) remains bullishly positioned for a continuation of the rally in G7 equities and bonds in 2024. Having said that, in the short-term, the overall equities exposure has been recently reduced.

The attached chart illustrates the above points.

Consolidated Equity Positioning

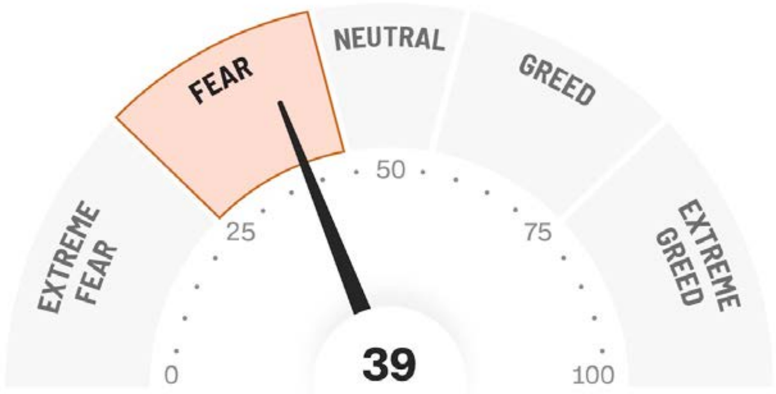
Source: Deutsche Bank Asset Allocation

Discretionary vs Systematic Equity Positioning

Source: Deutsche Bank Asset Allocation

In the short-term, traders and investors' sentiment continued to decline. The CNN Fear and Greed index fell from the "Neutral" into the "Fear" zone in the second half of April.

Fear & Greed Index
- What emotion is driving the market now?

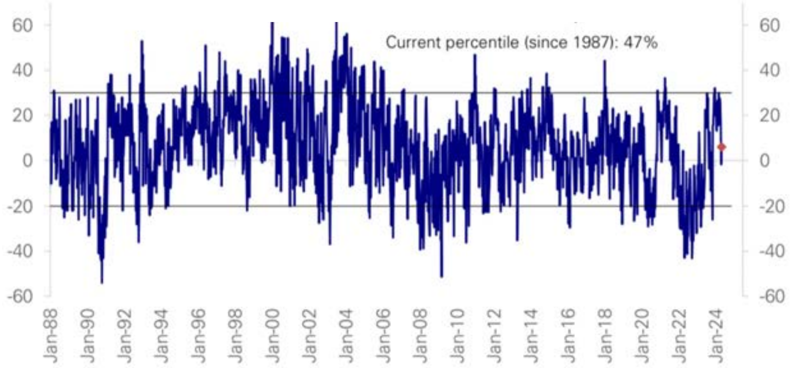


Source: CNN Business
Last update May 7 at 8:00:00 PM ET

Latest sentiment (as of May 10th) moved back to Neutral; Greed to come back again?

Another sentiment indicator also declined to Neutral, exemplified by the fall of the latest Investors' Bulls minus Bears reading (*see overpage*).

Investor Sentiment
- Investor bull minus bear spread



Data as of 1 May 2024
Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

As outlined back in our February report, GOJI's own fundamental research continues to point to a scenario where growth is expected to be stronger and that inflation may make a surprise return. Hence, we only expect a modest or no easing of monetary policy of the U.S. Fed towards the end of the year. The European Central Bank, the ECB, is most likely to cut rates first, since its economy is so much weaker than that of the U.S.

No change in our view: stronger growth in H1 & inflation may surprise.

As a result, our view continues to stress prudence and efficient diversification in the next few months.

The Way We See It
- Global Markets and Investment Thematics

Thus, we, at GOJI, continue to prefer to adopt a moderately cautious investment strategy.

As outlined in our Global Investment Outlook for 2024 and in the two sections above, it is our belief that both fundamental and quant-driven investors have priced in, positioned for and are prepared to pay up for a best-case scenario of slowing but not recessionary growth, falling inflation and lower interest rates. A Goldilocks scenario.

As a result, based on our perspective of stronger than consensus growth, more sticky inflation and interest rates, plus an overvalued US equity market, our strategy recommendation is to stay modestly underweight risky assets and overweight cash and low-beta quality assets.

We would also suggest to continue to build a modest exposure to commodities.

Lastly, we think that the U.S. Dollar is more likely to consolidate, rather than continuing to steadily rise. Heavy overweight positions in the USD / HKD, which have worked well over the past 6 month, should be reduced.

USD is more likely to consolidate.

Short-term Technical Analysis

Soon after Q1 2024, US and global equity indices, led by AI and Semiconductor stocks, have been encountering some profit-taking by Discretionary investors and stop-loss selling by Systematics. Markets are expected to continue to consolidate within a +/- 5 to 7% range in coming months.

SPX to consolidate in coming months.

S&P 500 Stock Price Index

Source: MarketWatch.com

Hence, our recommendation to long-term investors is be patient and only buy on weak days, and take some profit on euphoric days.

Postscript

Has the Chinese market truly recovered and ready to take off ?

Many of our clients have asked us whether the strong rally of HK/ Chinese equities will last.

We offer our view below.

First, based on many years of analysing and investing in global economies and financial markets, we would like to share a number of personal key observations on what distinguishes a sustainable bull market in equities to one which has tended to only enjoy short and sharp rallies.

Two key criteria for a strong & sustainable stock market.

We highlight two key criteria which provide a foundation for a strong and sustainable stock market:

1. For a country's stock market to have the potential to rise solidly and healthily on a sustainable long-term basis (such as that in the US), the government's philosophy tends to involve a clear commitment to nurture and grow its private sector. It also tends to encourage flexibility and freedom for private corporations to grow and become big and make as much profits as they possibly can, domestically and in offshore markets. The senior management of these corporates also tends to be allowed to do whatever they want with their company's after-tax profits. The less the government interferes with the natural workings of the private sector, the better it is and the more sustainable the profitable virtuous cycle for corporations and shareholders is.

2. Secondly, the private sector needs to operate in a politically-stable and policy-transparent environment. In addition, it would be most encouraging for the private sector and the stock market if they operate within an economic framework which can produce a steady and sustainable positive nominal GDP growth environment, where inflation is reasonably well controlled.

Lastly, if the above trends can be supported by a healthy banking system and a relatively good liquidity environment, the strength of the country's private sector and stock market can last longer.

NET NET, based on the above two criteria, we believe that the recent strong stock market rally in HK/China may not last long over the long-term, ie, over the next 3 to 5 years, unless there are clearly enunciated profound changes by the Chinese government, regarding the private sector and the management of its economy.

Chinese equity rally to run further.

Having said that, the Chinese equity rally could certainly last another few months. In particular, this assumes and requires that the Chinese government continues to implement market-friendly measures. These include including a more friendly relationship with the private sector, providing more protection for its banking system, continuing to help to solve the debt crisis in the property market, providing excess liquidity for markets, cutting rates further, and implementing some form of QE (*which some commentators in the market believe this has been done recently*), and so on.

The valuation of HK/Chinese stocks is not expensive and most local and offshore investors are quite underweighted. Both are positive factors.

In brief, assuming that recent growth-friendly initiatives towards private companies and easier liquidity conditions persist, then the rally can last longer.

However, whether these positive market-boosting short-term measures would continue to prevail in coming years is a big ponderable.

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