The Way We See It

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Has the December quarter rally been too exuberant ?

INSIDE THIS ISSUE

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 continued to show significant growth divergences amongst key economies.

On the relatively stronger side, partial economic indicators from the U.S. continued to show positive growth, albeit decelerating modestly from the strong pattern in Q3.

On the relatively weaker end of the growth spectrum, the latest partial indicators of Eurozone and China continued to confirm a sluggish trend.

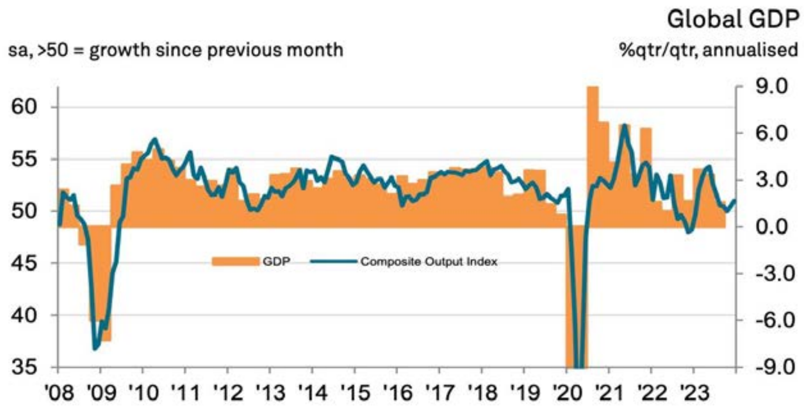
On the inflation front, thanks to the significant fall in energy prices, in most developed economies, the headline inflation trend continued to improve. Core inflation indicators also modestly decelerated. In spite of this, central bankers in the OECD bloc remain wary that the year-on-year core inflation rate remained too high relative to their 2% annual targets. Thus they are reluctant to cut rates in the short-term.

It is worth remembering that the key message from the Fed, following its December FOMC meeting (in which rates remain on hold for a consecutive third month), emphasised the need to keep rates high for a while longer. This is based on their thinking that the road to achieving an annual 2% core inflation rate remains uncertain. Despite this, the Fed's chairman mentioned that the Fed Board's average "dot plot" suggested 3 rate cuts in H2' 2024 (the market has already priced in 4-5 rate cuts). In the month of December, most other OECD central banks remain on hold.

Fed emphasized the need to keep rates high for longer.

Finally, global geopolitical risks remain high: Russia and Ukraine, Gaza and Israel, plus geopolitical and trade tensions beyond semiconductor chips between the U.S. and its partners, against China.

J.P.Morgan Global Composite PMI™



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

- Global Markets

Following the solid November bounce, December witnessed another strong month, with all non-cash assets continuing to perform very well.

It was reported that both fundamental and quant-driven investors were big buyers of bonds and stocks. The former were positively motivated by the better-than-expected fall in all inflation indicators, as well as a recent softening of the employment and consumption sectors in the U.S. domestic economy in particular. Some even start to predict an early cut in interest rates, beginning with the ECB, then the Fed, in Q1 of next year. The second type of buyers of the rally were driven by the positive momentum of rising prices, and falling volatility.

In other words, the Goldilocks soft-landing backdrop leads investors to either cover shorts and/or to start reducing their pile of cash in to re-invest in both bond and equity markets.

Goldilocks soft-landing backdrop leads to more investment in bonds and equities.

Within the global equity universe, all major markets rose. Again, the HK/Chinese and the rest of the Asian bloc performed relatively more poorly. Investors were disappointed with the continuing poor growth in Chinese exports and domestic growth, as well as continuing debt issues in its property sector.

Near-term performance of various asset classes

as at 29/12/2023

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	4.71%	4.94%	3.95%
3 months	11.95%	11.53%	7.93%
YTD	27.10%	24.42%	10.27%
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	4.34%	3.37%	3.83%
3 months	8.50%	5.66%	6.82%
YTD	8.52%	4.05%	5.53%
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	4.30%	4.16%	-3.59%
3 months	8.10%	8.10%	-7.28%
YTD	4.18%	5.71%	-5.01%
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	3.55%	-2.41%	-1.25%
3 months	6.48%	-4.21%	-3.08%
YTD	6.34%	-11.04%	-11.46%
FY 2023	6.34%	-11.04%	-11.46%

Source: GOJI, MSCI, Bloomberg

Expectations of rate cuts in the U.S. weakened the US Dollar. This is in spite of the Fed's repeated insistence on rates remaining high for longer. In addition, there were signs of short-covering of many currencies against the U.S. dollar as the latter weakened.

The Commodities complex again fell, caused by larger-than-expected falls in energy prices. Gold was the outstanding performer, as it benefited from escalating geopolitical tensions in the Middle East and elsewhere, together with a weakening of the US dollar and lower interest rates. The Crypto complex also performed very strongly, ahead of a number of ETFs being launched soon.

In terms of equities investment flows and positioning, both fundamental and quantitatively-driven funds bought risk assets, as both were slightly underweight equities, relative to their historical norm. Fundamental investors were the key aggressive buyers. At the end of December, both types of investors were reported to be moderately overweight equities.

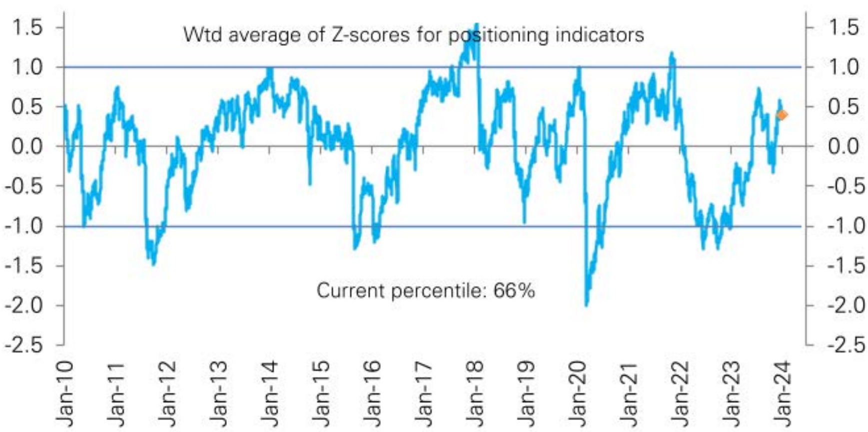
Amongst Systematics, the more flexible and aggressive CTAs were reported to be doing lots of short-covering in U.S. and global equities.

Market Outlook

Investors appear bullish and have room to buy more.

The majority of investors (both fundamental and systematics) already appear to bullishly positioned for the continuation of a rally in G7 equities and bonds in 2024. Having said that, they can certainly buy quite a bit more in the future under the right circumstances, as their bullish positioning hasn't yet reached historical peaks. The enclosed chart below illustrates the above points.

Consolidated Equity Positioning



*Weights based on explanatory power in regression of equity performance on indicators

Source: Deutsche Bank Asset Allocation

Their bullishness is based, firstly, on the soft landing economic scenario (slowing growth and falling inflation); secondly, corporate earnings recovery; and finally, the commencement of the monetary easing phase in the U.S. and other developed nations.

Consequently, both institutional and retail fundamental investors' risk appetite has been increasing significantly, thus pushing the CNN Fear and Greed index to "Greed / Extreme Greed" levels. The strong positive momentum in equity and bond markets has encouraged both fundamentally- and quant-driven investors to take risk and buy aggressively. The fear of making losses has been played down significantly.

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

Source: CNN Business
Last update Jan 19 at 6:59:47 PM ET

GOJI's own fundamental research is pointing to a scenario where growth is expected to be stronger in H1, and that inflation may make a surprise return. Hence, we only expect a modest easing of monetary policy of the U.S. Fed, towards the end of the year (ECB in H1).

As a result, our view is more prudent in the next few months. In summary, we believe that there is a better entry point for risk asset set buyers.

The Way We See It
- Global Markets and Investment Thematics

To adopt a contrarian, i.e. more prudent investment stance at present, is definitely not a popular thing to do. Again, we, at GOJI, wish to stress that we do not propose a different view to the market consensus just for the sake of being contrarian.

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 (*see the poll below*) and paid up for a very optimistic, best case scenario of slowing but not recessionary growth, falling inflation and lower interest rates. A Goldilocks scenario.

GOJI: we believe that there is a better entry point for risk asset set buyers.

Source: MarketWatch, 12/1/2024

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 recommends to stay modestly underweight risky assets and overweight cash and low-beta quality assets.

We would also suggest to build a modest exposure to commodities. Lastly, we think that the U.S. Dollar will rebound in coming months against most liquid currencies.

Short-term Technical Analysis

After some early profit taking in the month of January, the wave of buying re-emerged, inspired by the Goldilocks scenario (depicted by hopes of falling inflation hence interest rate cuts, plus solid economic and earnings growth).

At the time of writing, US equity indices, led by Technology, recorded all time highs. Commentators in the financial social media labelled this positive technical development the start of a new bull market.

S&P 500 Stock Price Index

Source: MarketWatch.com

GOJI: FOMO rather than positive change in fundamentals.

As outlined earlier in our report, we believe it's more to do with crowd FOMO buying, rather than one which is based on a positive change in fundamentals. If we are right, then it's likely that new highs may be recorded a few more times, but they may not last.

In other words, despite the semblance of a sustainable strong rally, we feel that the markets will revert back to fundamentals at some stage. This would then mean a correction, the size of which depends on how high and how euphoric the equity indices are.

Hence, our recommendation to long-term investors is not to chase this short-term rally. For those who can act based on short-term trends, some profit taking of expensive names would be a sensible tactic.

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