November 2023

GHAM 2024 Market Outlook

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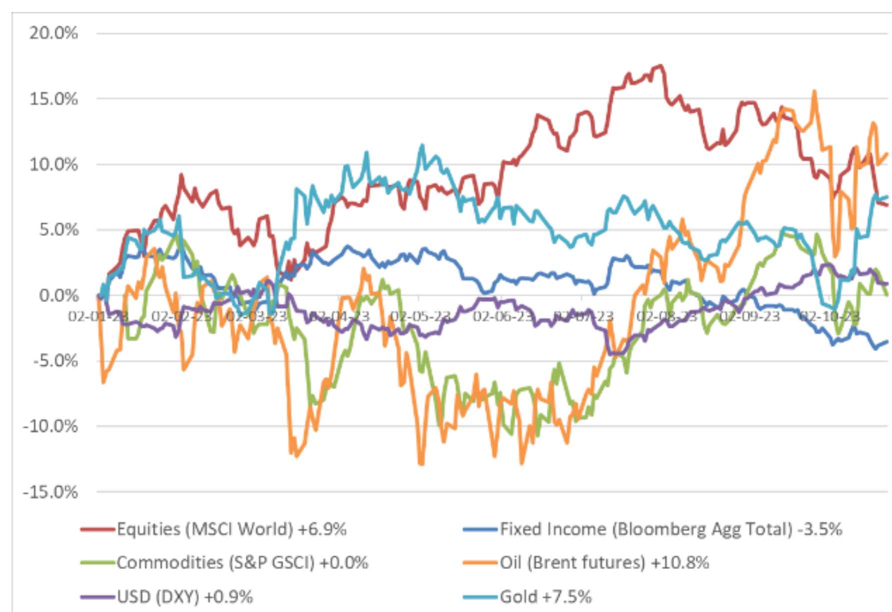
Overview

2023 was another year of heightened volatility where we saw the emergence of a conflict between Israel and Hamas, a US sovereign rating downgrade by Fitch and US treasury yields soaring to the highs last seen in 2007, the collapse of Credit Suisse and three US regional banks, heightened geopolitical tensions between US and China and central banks hiking rates to historic records.

Despite all these unprecedented events, the global economy has been extremely resilient and defied broad recession expectations in 2023. This has driven the divergence of asset classes (Fig 1), with oil and equities outperforming due to their cyclical nature but bonds underperforming as the strong economy lends confidence to key central banks to continue hiking rates to combat inflation. Bonds have suffered as benchmark rates rise to multi-year highs and financial conditions tighten globally.

Figure 1: Asset classes 10M23 performance



Source: Bloomberg (as of 31 Oct 2023)

The US economy continues to be driven by strong consumer spending and employment, while inflation gradually showed signs of peaking towards the middle of the year, resulting in a "soft landing" narrative that is becoming market consensus. The worst of the growth decline appears to be over as markets have started to price in a "goldilocks" scenario, but we remain cautious as we feel the market has priced a fair bit of this in with high equity valuations. We are also seeing structural changes in the US treasury market demand and supply dynamics driven by mind boggling fiscal deficits, that for a long time did not seem to matter but are now catching the attention of investors.

In credit, we think significant value has been priced across the forward-forward curve and turn constructive on DM IG duration above 10 years to secure yields at current levels. We are constructive on AT1s that offer the ability to lock in high absolute yields over a long duration as we think EU is at the end of their rate hike cycle. We reduce our overweight stance on Chinese bonds to neutral but still see value in selective LGFVs. Outside of China, we are constructive on Asia ex-China IG and crossovers on capital flows and see beneficiaries within Korea and Japan (Asia) and Thailand, Indonesia and Singapore (ASEAN).

In equities, we remain neutral on US equities as current high valuations leave little room for error next year where headwinds remain elevated. We are constructive on the domestic Japan

consumption story that we see as the key beneficiary of Japan's reflationary cycle and has more room to rerate. In China, despite an extremely frustrating 2023 where policy support follow-through we were expecting did not materialise, we continue to remain constructive. We think the worst is behind us in terms of newsflow, especially from the property sector. The risk-reward setup here is favourable given extremely cheap valuations, especially in offshore China and lowered growth expectations. Across ASEAN, we like SG REITs as they offer attractive yields in an environment where the rate cycle has peaked while we also like the longer-term story of Malaysia being a key beneficiary of the global semiconductor supply chain offshoring trend.

In this report, we share our outlook on the key asset classes and markets that we focus on.

2023 Key Market Events

	Key events
January	▪ Global risk assets climb as markets are optimistic about reaching soft landing scenario by year-end ▪ Chinese risk assets extend their outperformance on reopening theme
February	▪ US shot down alleged Chinese spy balloon in US airspace, heightening US-China tensions ▪ High-profile disappearance of China Renaissance chairman and CEO Bao Fan; eventually revealed to have been taken in Chinese authorities for questioning ▪ Withdrawal of fast money led to the selloff in Chinese risk assets as investors trim bullish bets on China's quick recovery
March	▪ US regional bank crisis as Silicon Valley Bank collapsed in 46 hours after a bank run, leading to the failure of other US regional banks like Signature Bank and the USD 30bn injection into First Republic Bank ▪ Emergency takeover of Credit Suisse by rival UBS, with the Swiss authorities' unprecedented decision to subvert the capital structure of CS resulting in a global selloff in AT1s ▪ Central banks continued to hike rates despite market instability: Fed +25bps, ECB +50bps, BOE +25bps, SNB +50bps ▪ Evergrande announced its offshore debt restructuring proposal that was unattractive as it offered investors to swap into long-dated bonds or a combination of shorter-dated bonds and equity
April	▪ Biden unveiled an executive order to impose investment curbs on China for high-tech industries
May	▪ Rate hikes by US, Europe, Australia and New Zealand as inflation persists ▪ Nvidia's blockbuster Q2 earnings forecast kicked off the AI wave, with semiconductor-related stocks surging globally including in the US, Taiwan, Korea ▪ US government reached a deal to suspend the debt ceiling till 2025, narrowly avoiding a government default ▪ Fitch placed US on negative credit watch, which was foreshadowed by a similar downgrade by S&P in 2011 ▪ Chinese property sector was weighed down by Wanda's failed IPO of Zhuhai Wanda, its property management services arm
June	▪ Central banks continue to stay hawkish, with Bank of England's surprise 50bps hike putting pressure on UK residential sector as mortgage rates hit 7% ▪ US economy continues to remain resilient, driven by robust labour markets and consumer spending
July	• BOJ tweaked its yield curve control policy to allow 10-year yields to rise to 1%, leading to an intramonth strengthening of the Yen

	• Chinese technology stocks surged as government bodies suggest that the multi-year tech regulatory crackdown has concluded
August	▪ Fitch downgraded US sovereign rating from AAA to AA+, citing its ballooning fiscal deficits and erosion of governance that led to repeated debt limit clashes over the past two decades. ▪ Long-end treasury bonds sold off as a larger-than-expected fiscal deficit led to worries over whether the market could absorb the increased debt supply ▪ Chinese government rolled out substantive demand-focused property stimulus, lowering mortgage rates while easing mortgage requirements and downpayments
September	▪ “Higher for longer” rate narrative takes hold as central banks remain hawkish and risk sentiment fell ▪ US treasury yields spiked to multiyear highs as the US fiscal deficit hit a high of USD 1.5tn ▪ Kevin McCarthy became the first US House Speaker to be ousted, days after passing a bipartisan stopgap funding to avert government shutdown ▪ Evergrande shares halted after the founder was investigated by the police for suspected crimes while Sino-Ocean ceased offshore debt payments
October	▪ Israel-Hamas war led to a selloff in risk assets and spike in oil prices ▪ Rout in US treasuries continued, with US 10Y and 30Y jumping above 5% ▪ Trump ally Mike Johnson was elected as US House speaker after three weeks of failed voting that froze legislative work ▪ Much-awaited Golden Week holiday failed to stimulate the Chinese economy as travel, housing and consumer spending data missed estimates ▪ Chinese property giant Country Garden defaulted after months of extensions, failing to pay USD 15m coupon by the 30-day grace period
November	▪ Risk sentiment climbed as US Fed kept rates unchanged 5.25%-5.5% at the Nov FOMC meeting and key US inflation and labour data came in softer than expected ▪ Improved US-China dynamics after Biden-Xi meeting reached a deal on curbing fentanyl ingredient exports from China ▪ Moody’s downgraded US credit outlook to negative from stable ▪ US government averted shutdown, extending funding till mid-Jan 2024 ▪ Improving CRE sentiment: government drafts a financing package for 50 developers and Sunac finalised its restructuring deal, although Wanda proposed unexpected 11-month bond extension

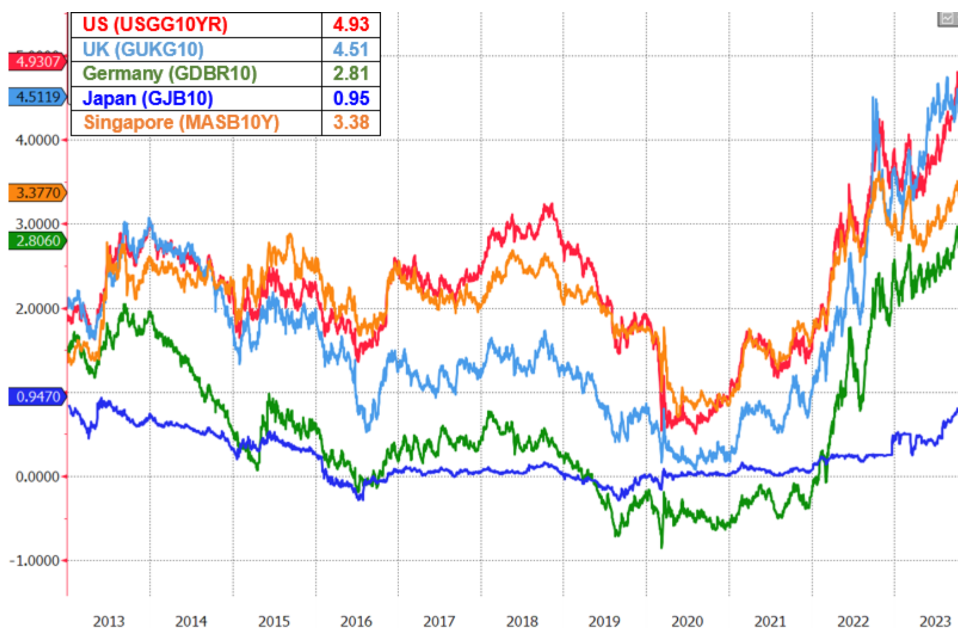
Updated as of 22 Nov 2023

Global Fixed Income

2023 Review

2023 saw bond markets wrong-footed by the divergence between rate expectations and actual inflationary data that proved more persistent. Our rate expectations were wrong as the Fed funds rate did not fall from 4.5% but instead climbed an additional 100bps to 5.5%. The Fed kept to its hawkish rhetoric as it battled with persistent inflationary pressures that were driven by a robust labour market and services sector. Other global central banks continued to hike rates too with sovereign yields surging in 3Q23 (Fig 2). Prices remained elevated worldwide and inflation consistently surprised to the upside, pushing key central banks to hike. ECB almost doubled rates from 2.5% to 4.5%, BOE hiked close to 200bps to 4.75%, RBNZ hiked by 125bps to 5.5% and RBA hiked by 100bps to 4.1%.

Figure 2: 10Y government bond yields over the past 10Y (%)

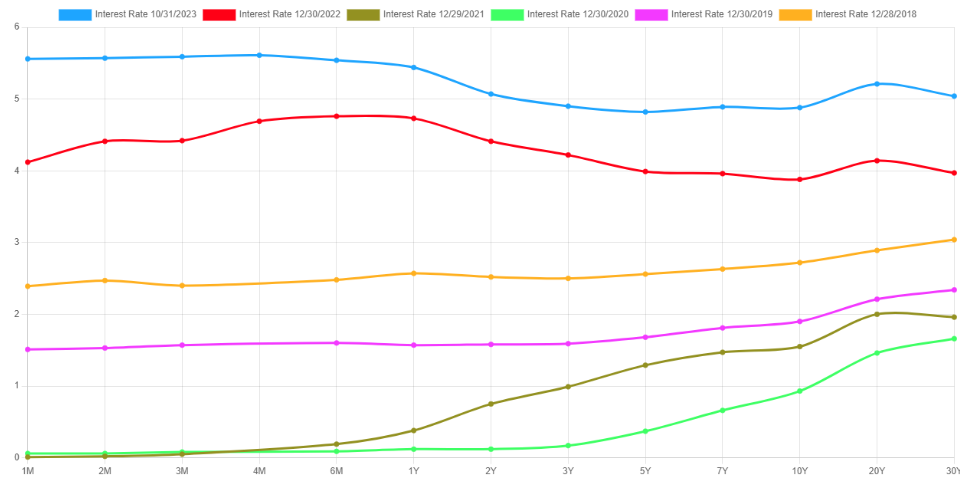


Source: Bloomberg (as of 31 Oct 2023)

The volatility in the bond market extended into 2023. While global bonds started the year weak due to the rising rate environment, the bond rout deepened in 2H due to the selloff in US treasuries. The integrity of the US sovereign credit rating was challenged after a downgrade by Fitch due to the frequency of political standoffs over the US debt ceiling. This was exacerbated by the new debt issuance required to sustain the alarming US fiscal deficit, which led to long-end yields surging to multiyear-highs as the entire US Treasury (UST) yield curve rose.

The UST yield curve remains inverted (Fig 3) in 2023. Last year, the 2Y/10Y inversion was led by the short-end as expectations of Fed funds rate kept climbing. This year, the treasuries market embarked on a huge bear steepening mode, with heavy losses seen in the 10-30 years buckets. A good part of the selloff in long-end US treasuries reflects the term premium that investors are now demanding in view of the expected huge supply pipelines and the ballooning US fiscal deficit.

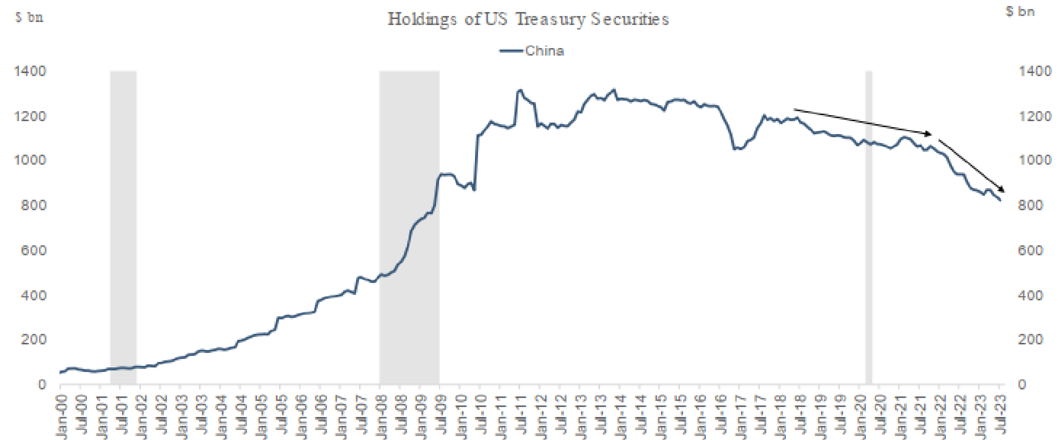
Figure 3: US Treasury yield curve remains inverted



Source: www.ustreasuryyieldcurve.com, US Treasury Department (as of 31 Oct 2023)

In addition, the demand and supply dynamics in the UST market are changing structurally. The largest foreign buyers of USTs have historically been Japan and China, but they have reduced their holdings to record lows in recent years (Fig 4). As of 1H23, Japan held USD 1.1tn (4.4% of total supply) while China held USD835bn (3.4%), much lower than the 25% overall share they held in 2007. Closer to home, Singapore has greatly reduced holdings of treasuries too. Gold has been the major beneficiary of this phenomenon, climbing back to USD2000 levels.

Figure 4: China holding USD 300bn less in US Treasuries than in 2021



Source: Apollo Global Management (as of 8 Nov 2023)

The increase in long-term rates, especially in the US 10/30Y rate that is typically regarded as the global benchmark for risk-free rates, will tighten financial conditions significantly. With long-end yields expected to remain structurally higher, we see significant deterioration in economic performance in Q1 2024. While labour markets remain tight, a deeper inspection of data reveals that most of the employment data strength arose from second jobs that are more part-time in nature due to rising costs of living. Core PCE inflation, the Fed's preferred inflation gauge, finally fell below 4% in August after two years. However the reading of 3.9% is still significantly above the Fed's 2% target. Goods inflation has slowed below 1%, but core services inflation which constitutes two-thirds of core PCE, remained sticky as it hovered near historic highs of 5% (Fig 5). The resulting situation is tricky because the labour market has been structurally tilted towards being tight in the long run (i.e. aging population, higher costs of living). Without a correction in the labour market dynamics, tightness in the US labour market (Fig 6) could result in wage growth remaining elevated for a sustained period.

Figure 5: Core PCE inflation is driven by services inflation

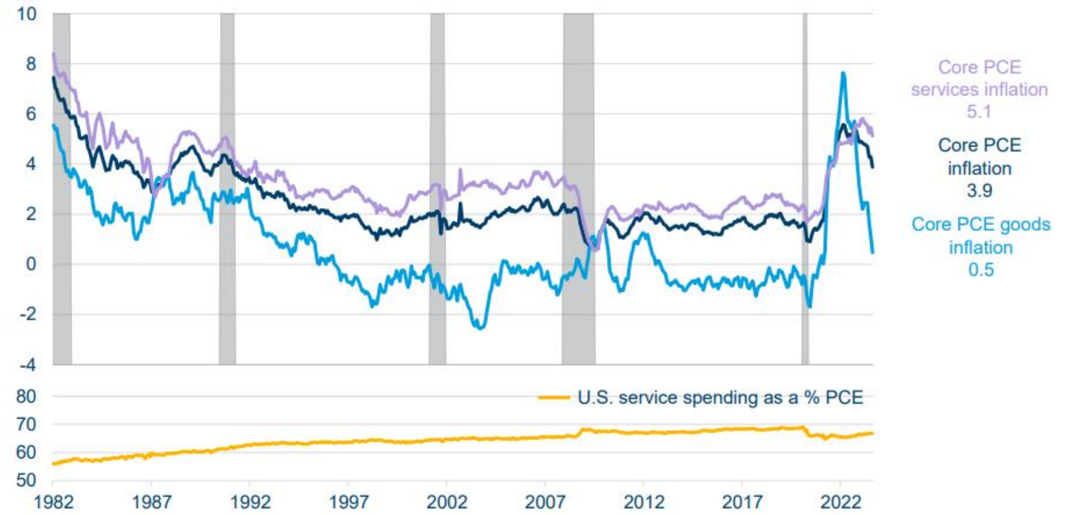
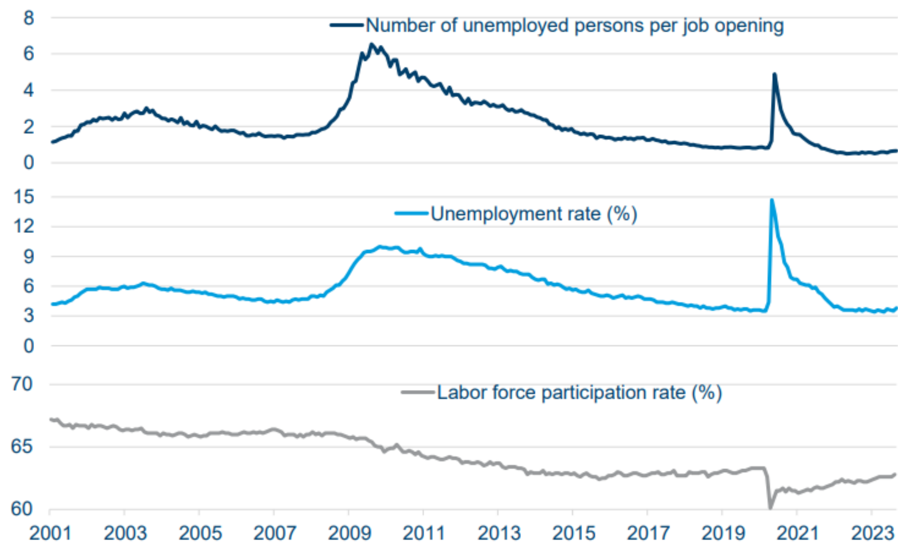


Figure 6: US labour market remains tight post-pandemic



Sources: Columbia Threadneedle Investments (as of 29 Sep 2023)

Developed Markets (DM)

United States

Forward-forward projections of UST curve reflect a new era of 4.5-5% implied yields across the next 15-20 years (Fig 7). This is significantly higher than historical projections of 2-3% range, and we believe these rates are unsustainable for a normal functioning economy. Markets have possibly overpriced the medium- and long-term policies as such high yields would likely result in a market correction.

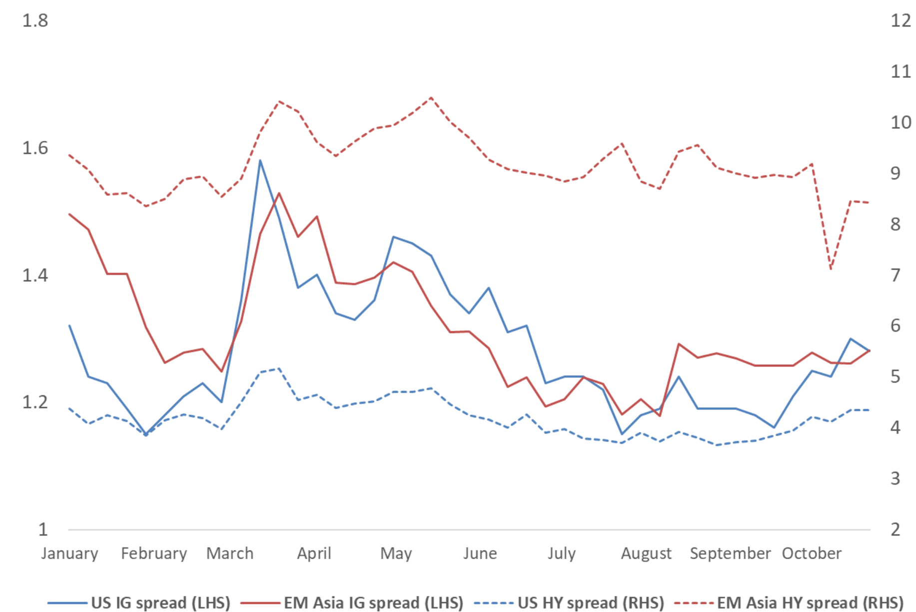
We think significant value has been priced across the forward-forward curve and turn constructive on DM IG duration of 10 years and above to lock in yields. We see market rate projections as too hawkish and believe that there is a higher chance rates will revert back to historical real rates of 1-2% (nominal 3-4%), albeit taking longer than expected. Ultimately bonds are trading at historically high yields across IG/HY papers, and even though UST yields could rise further due to volatility these absolute levels are attractive.

Figure 7: US Treasury Actives forward curve matrix

		Forwards								
Tenors	Coupon	3Mo	6Mo	1Yr	2Yr	3Yr	4Yr	5Yr	10Yr	15Yr
1Mo	5.3855	5.3859	5.0050	4.4886	4.0313	4.0595	4.0595	4.4749	5.2541	5.2541
2Mo	5.3910									
3Mo	5.3953	5.3736	4.9820	4.5297	4.0674	4.0957	4.0957	4.5165	5.3063	5.3063
4Mo	5.4270									
6Mo	5.4407	5.2091	5.0066	4.4803	4.0203	4.0490	4.0715	4.4671	5.2534	5.2534
1Yr	5.2473	4.9822	4.7463	4.4910	4.0539	4.0824	4.1190	4.5041	5.2968	5.2968
2Yr	4.8819	4.6836	4.5102	4.2763	4.0680	4.1013	4.3075	4.4990	5.2968	5.3039
3Yr	4.6062	4.4857	4.3691	4.2146	4.0840	4.2296	4.3666	4.4420	5.3015	5.3018
5Yr	4.4236	4.3604	4.3064	4.2493	4.2395	4.2964	4.3514	4.4016	5.2997	5.2941
7Yr	4.4479	4.3901	4.3446	4.2901	4.2616	4.3067	4.4673	4.6285	5.3009	4.9177
10Yr	4.4149	4.3944	4.3802	4.3797	4.4397	4.5587	4.6773	4.7972	5.2973	4.6310
20Yr	4.7547	4.7292	4.7097	4.6853	4.6735	4.6951	4.7155	4.7342	4.7157	4.2967

Source: Bloomberg (as of 21 Nov 2023)

Figure 8: Global IG/HY credit spreads over 10M23



Source: Bloomberg (as of 31 Oct 2023)

Option-adjusted spreads for US credit had a volatile year relative to its EM Asia peers, widening at the start of the year due to rising rates and then tightening as USTs sold off (Fig 8). While long end rates and risk premia are likely to persist, we expect tightening of credit

spreads on demand and supply shifts i.e. UST supply continues to increase amidst concerns of rating downgrade, IG supply to fall due to higher cost of debt and structural shifts as funds allocate less to "risk-free" treasuries and switch to top IG names.

Given the increasing focus on US debt, its fiscal deficit and the risk of another US credit downgrade, we expect fiscal discipline could be a big theme leading to the 2024 elections. This would be a huge reversal from decades of politicians that have advocated for increased spending to win electorate votes.

European Union/United Kingdom

While sovereign rates have risen dramatically this year, we believe EU and UK are at the trough of their rate hike cycles. The poor economic performance and huge debt burden by weaker EU members, similar to the PIGS during the European debt crisis post-2008, may force ECB to reverse course even in the light of higher inflationary pressures. This is exacerbated by cracks emerging in the EU/UK banking sector on exposure to commercial and residential real estate, along with investment losses in asset and liability management books, all of which increase the risk of smaller banks like Metro Bank getting into liquidity issues due to weaker capital buffers.

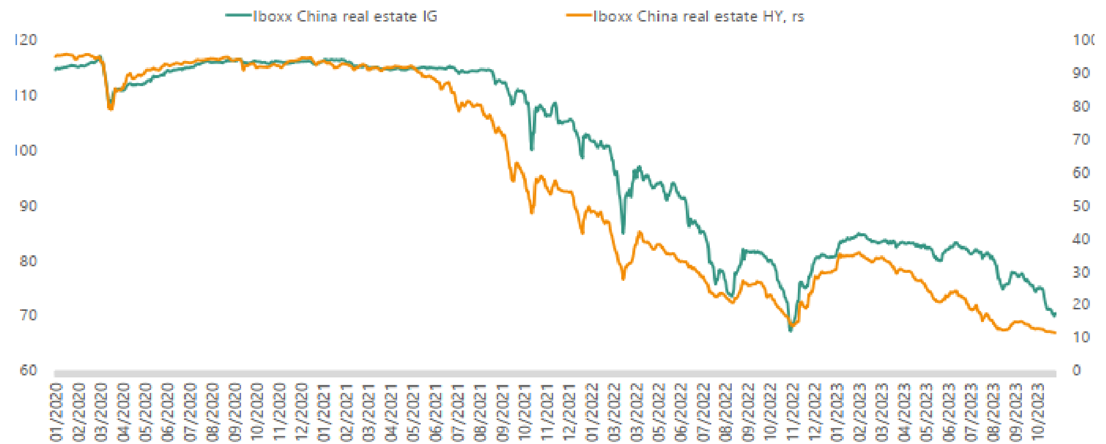
Hence, we are constructive EUR and GBP-denominated IG duration on a currency-neutral basis. We think ECB/BOE is likely to reverse course and cut rates ahead of Fed, given the significant economic headwinds they are facing, with rates potentially being lowered more than in US. We are also constructive on selective AT1s from Tier 1 banks, particularly lower cash value papers with 6-7% coupon and higher reset spread feature, for more favourable slide and carry profile and potential capital gains. Following the dramatic USD17bn write-off of CS AT1s earlier this year, sentiment has improved significantly as major banks like BNP Paribas and UniCredit called their bonds and restarted issuance. UBS saw overwhelming demand for its first AT1 issuance since its merger with Credit Suisse, with its USD 3bn sale 5x oversubscribed and final price coming in 100bps tighter than its initial price talk and trading 2 points higher on the market immediately. We see buyers returning as risk appetite and liquidity increase, with non-call risks remaining low and financial institutions backed by healthy capital ratios.

Emerging Markets (EM)

China

The rout in credit has been driven by the China real estate (CRE) crisis since 2021, with the selloff extending in 2023 for both IG and HY developers (Fig 9). Despite the government rolling out a slew of new easing measures in H2, market optimism has been short-lived due to scepticism over implementation and effectiveness of policies. Government stimulus came in too little too late, with prolonged poor contracted sales leading to mounting liquidity concerns as developers announced debt extensions, restructurings and default warnings successively. Following Country Garden's default in October, the risk-reward dynamics in Chinese property bond sector have changed significantly as privately-owned developers now face the threat of default regardless of how "infallible" they appear. Given the historical size and strength of China's largest private developer, investors saw this as an extremely negative development, dealing a huge blow to already fragile sentiment.

Figure 9: Selloff in CRE IG and HY over the past 3Y



Source: Apollo Global Management (as of 8 Nov 2023)

However we are marginally optimistic that the government may arrest this existential crisis for POEs, following the series of support from parent companies of quasi-SOE developers in Oct-Nov. Vanke, China's second largest developer in terms of 2022 contracted sales, received a rare pledge of support from Shenzhen Metro and Shenzhen SASAC (28% stake) in an investor call when these state-backed organisations vowed to inject up to RMB 10bn of liquidity through purchasing the developer's bonds and urban redevelopment projects. Vanke announced that it will repay its debts on time after the meeting, sending its bonds surging 20-30pts intraday. Another quasi-SOE developer, Jinmao, has also been displaying the company logo of SOE investor Sinochem (36% stake) in its showrooms for several months, which may have led to much lower volatility in Jinmao's offshore bonds in recent months. Meanwhile Ping An Insurance was reported to explore providing RMB 30bn of capital support to its subsidiary and property investment arm Ping An Real Estate, resulting in a 10-20pts rally in PINGRE offshore bonds.

The outlook for CRE bonds remains weak in the near-term, but given that most CRE offshore bonds are trading under 10 cents on the dollar, we reduce our "overweight" stance to "hold" with cash values significantly below our estimated worst case recovery values.

We see pockets of value in the local government financing vehicle (LGFV) sector too, after the government announced fresh state support and announced measures to shift debt from LGFV level to provincial level. Local media has also reported that state-owned banks have been asked to rollover LGFV loans at lower rates in October, with more debt relief measures to be rolled out in Q4. However the RMB 1.5tn state-led debt swap programs announced are a fraction of the total LGFV debt that is estimated to be RMB 56tn at end-2022. While analysts believe there will be blanket support for the sector, we see higher quality LGFVs and those with closer ties to provincial governments to benefit disproportionately and prefer shorter duration papers.

Asia ex-China

Outside of China, we are constructive on Asia ex-China IG and crossovers on capital flows. With the drought in EM issuance, the reduced supply would be spread across new capital allocation that could arrive potentially on stablisation of rates cycle globally. We foresee investors who wish to diversify away from UST due to supply concerns, switch their allocations to better quality names in the EM space. If and when new money does come in, there will be limited options to deploy capital. This will drive demand in Asian IG names such as Korea and Japan, and in ASEAN names within Thailand, Indonesia and Singapore.

Global Equities

2023 Review

Global equities climbed as strong economic data defied recession expectations, with MSCI World +9.6% in 9M23 vs -21.2% in the same period last year (Fig 10). Markets were pricing in a recession this year, but a resilient US economy has led to strong earnings seasons where corporates continually topped lowered estimates. Equities were also rejuvenated by the Artificial Intelligence (AI) hype in 1H after Nvidia reported breakthrough earnings and broke into the trillion-dollar megacap club. This supported the global AI supply chain, carrying hardware and software companies to record highs across US, Taiwan, Japan and Korea. Even the collapse of two US regional banks and Credit Suisse resulted in a short-lived banking crisis, with major financial institutions emerging unscathed and stronger.

Figure 10: Global equity indices 10M23 performance

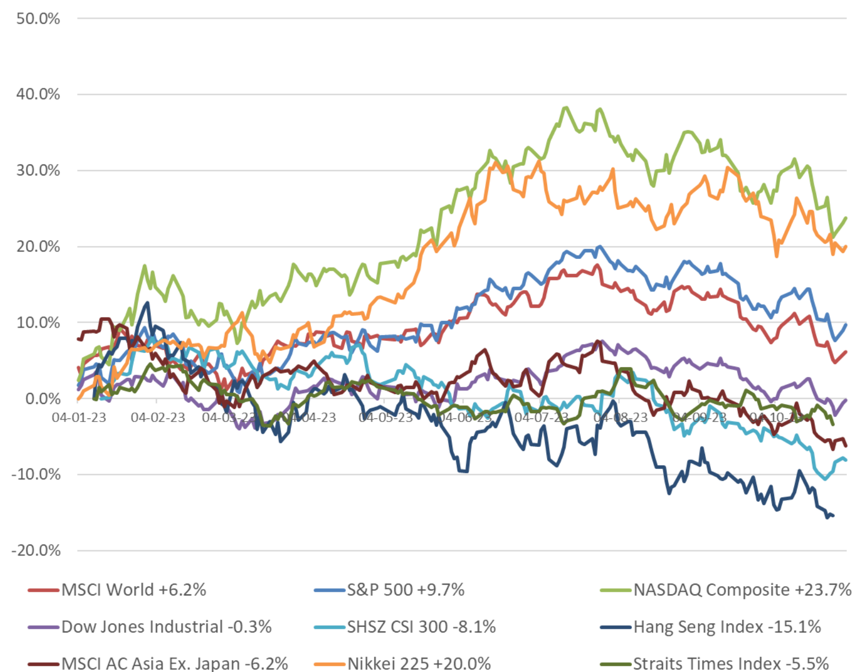
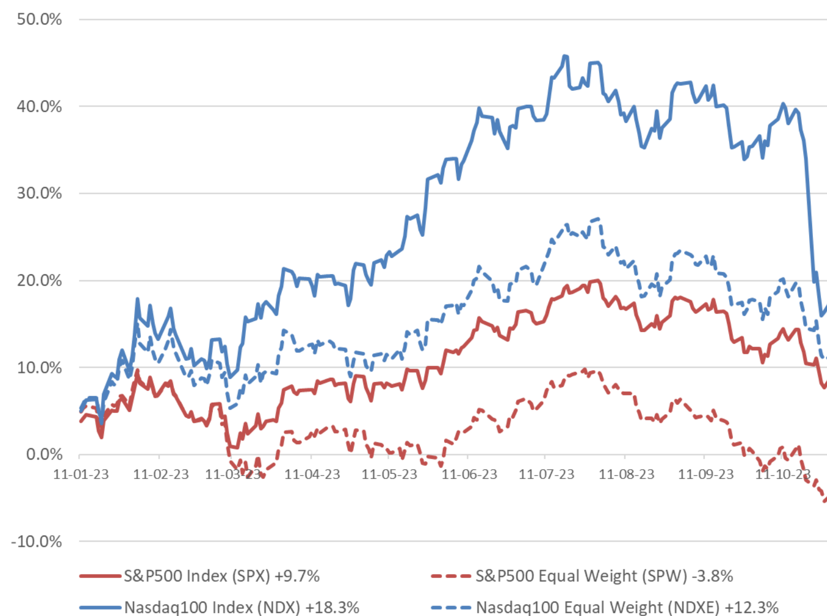


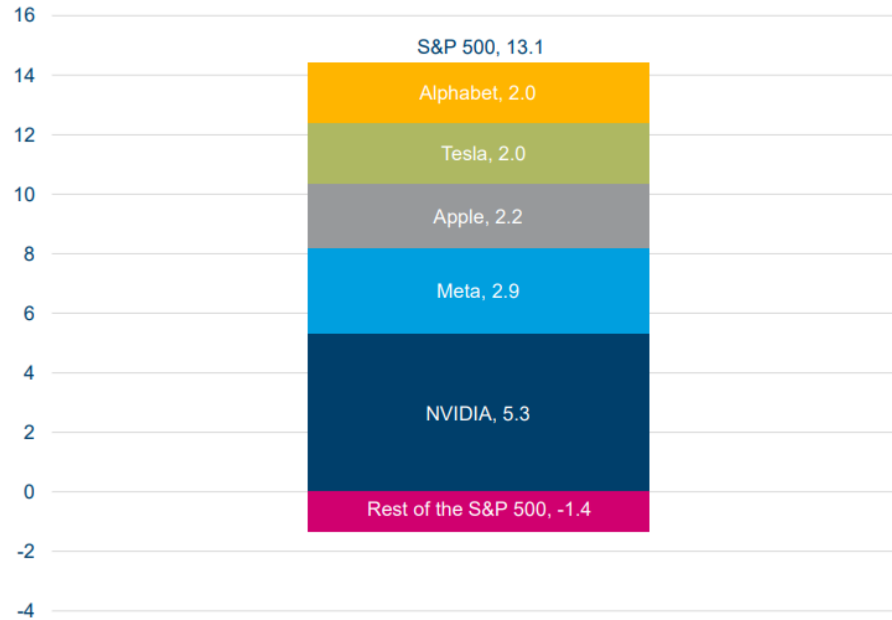
Figure 11: US equities vs their equal-weighted indices for 10M23



Sources: Bloomberg (as of 31 Oct 2023)

On an equal-weighted basis, the market would be underperforming by a much larger magnitude YTD (Fig 11) as the remaining constituent companies grapple with slowing global growth, rising cost pressures and increased geopolitical tensions. Most of the major indices were driven by outsized returns from the "Magnificent Seven", with the top five stocks contributing over 110% of S&P500 gains YTD and the top four stocks contributing 95% (Figs 12 and 13). Despite that, US consensus earnings growth seems to reflect a soft landing. 2023 earnings growth is still positive, with double-digit growth anticipated in 2024 and 2025.

Figure 12: Five stocks contributed to 110% of S&P500 gains YTD



Source: Columbia Threadneedle Investments (as of 29 Sep 2023)

Figure 13: Top and bottom contributors to S&P500 in 9M23

Top 25 contributors to YTD S&P 500 return

Ticker	Company	Sector	Starting mkt cap weight	Total return	Contribution to index return
NVDA	NVIDIA Corp.	Information Technology	1.1 %	198 %	225 bp
AAPL	Apple Inc.	Information Technology	6.1	32	197
MSFT	Microsoft Corp.	Information Technology	5.6	33	182
GOOGL	Alphabet Inc.	Communication Services	3.1	48	151
META	Meta Platforms Inc.	Communication Services	0.8	149	127
AMZN	Amazon.com Inc.	Consumer Discretionary	2.3	51	120
TSLA	Tesla Inc.	Consumer Discretionary	1.0	103	107
LLY	Eli Lilly & Co.	Health Care	0.9	48	43
AVGO	Broadcom Inc.	Information Technology	0.7	51	36
ADBE	Adobe Inc.	Information Technology	0.5	52	25
BRK.B	Berkshire Hathaway	Financials	1.7	13	23
CRM	Salesforce Inc.	Information Technology	0.4	53	22
GE	General Electric	Industrials	0.3	69	20
AMD	Advanced Micro Devices	Information Technology	0.3	59	19
COST	Costco Wholesale	Consumer Staples	0.6	24	15
CMCSA	Comcast Corp.	Communication Services	0.5	29	14
MA	Mastercard Inc.	Financials	0.9	14	13
BKNG	Booking Holdings	Consumer Discretionary	0.2	53	13
XOM	Exxon Mobil Corp.	Energy	1.4	9	13
JPM	JPMorgan Chase	Financials	1.2	10	13
INTC	Intel Corp.	Information Technology	0.3	37	13
ORCL	Oracle Corp.	Information Technology	0.4	31	12
V	Visa Inc.	Financials	1.1	11	12
NFLX	Netflix Inc.	Communication Services	0.4	28	12
AMAT	Applied Materials	Information Technology	0.3	43	11
Top 25 contributors			**32 %**	**44 %**	**1437 bp**
S&P 500			**100**	**13**	**1307**

Bottom 25 contributors to YTD S&P 500 return

Ticker	Company	Sector	Starting mkt cap weight	Total return	Contribution to index return
PFE	Pfizer Inc.	Health Care	0.9 %	(33)%	(30)bp
NEE	NextEra Energy Inc.	Utilities	0.5	(30)	(15)
JNJ	Johnson & Johnson	Health Care	1.4	(10)	(14)
SCHW	Charles Schwab	Financials	0.4	(33)	(13)
RTX	RTX Corp.	Industrials	0.5	(27)	(13)
BAC	Bank of America	Financials	0.7	(15)	(11)
DG	Dollar General	Consumer Staples	0.2	(57)	(10)
CVS	CVS Health Corp.	Health Care	0.4	(23)	(9)
BMY	Bristol-Myers Squibb	Health Care	0.5	(17)	(8)
NKE	NIKE Inc.	Consumer Discretionary	0.5	(17)	(8)
MRNA	Moderna Inc.	Health Care	0.2	(42)	(8)
KO	Coca-Cola Co.	Consumer Staples	0.8	(10)	(8)
EL	Estee Lauder Companies	Consumer Staples	0.2	(41)	(7)
VZ	Verizon Communications	Communication Services	0.5	(13)	(7)
AMT	American Tower	Real Estate	0.3	(21)	(6)
ABT	Abbott Laboratories	Health Care	0.6	(10)	(6)
ENPH	Enphase Energy Inc.	Information Technology	0.1	(55)	(6)
UNH	UnitedHealth Group	Health Care	1.6	(4)	(6)
T	AT&T Inc.	Communication Services	0.4	(14)	(6)
HON	Honeywell Intl	Industrials	0.5	(12)	(6)
ELV	Elevance Health	Health Care	0.4	(14)	(5)
TFC	Truist Financial	Financials	0.2	(30)	(5)
TMO	Thermo Fisher Scientific	Health Care	0.7	(8)	(5)
CCI	Crown Castle Inc.	Real Estate	0.2	(29)	(5)
TGT	Target Corp.	Consumer Staples	0.2	(24)	(5)
Bottom 25 contributors			**13 %**	**(18)%**	**(223)bp**
S&P 500			**100**	**13**	**1307**

Source: Goldman Sachs Global Investment Research (as of 31 Oct 2023)

China was the major underperformer this year, contrary to our expectations. The deepening property sector rout cast an overhang on the country's post-pandemic economy, driving down consumption and investment activities. The expectation of a stronger response by the central government did not materialise despite acknowledgement of the risks of a fast-deteriorating economic climate. Subsequent policies to address growth were more drip feed than water hose, and sentiment remained weak as the lack of follow-through led investors to price in heightened policy risk for Chinese assets.

Our strategy for 2024 will be to stay defensive by having a mix of both growth and value stocks across several geographies. We remain neutral on US due to its premium valuations, but stay constructive on Japan domestic consumption names and select relative value opportunities in China. We are also overweight certain sectors in ASEAN, namely Singapore for its oversold REITs in a peaking rate environment and Malaysia benefiting from the global semiconductor offshoring trend, and we share more details below.

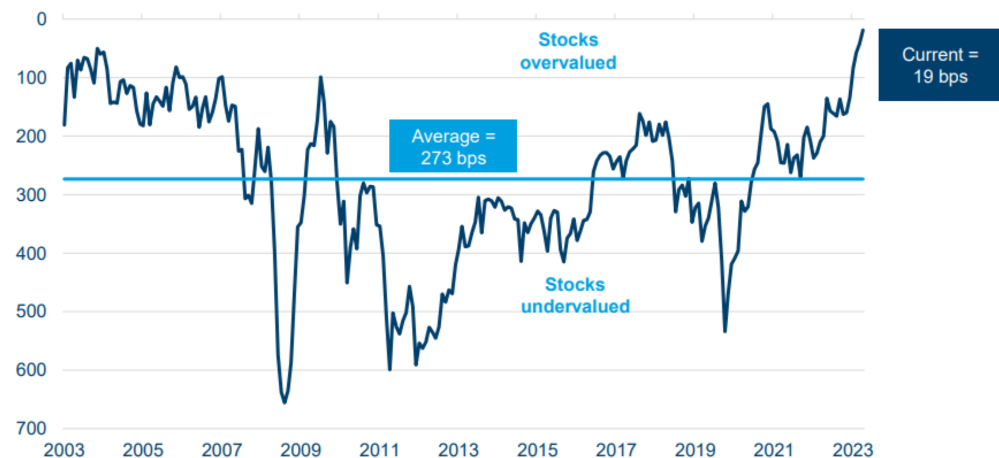
Global Equities 2024 Outlook

Developed Markets (DM)

United States

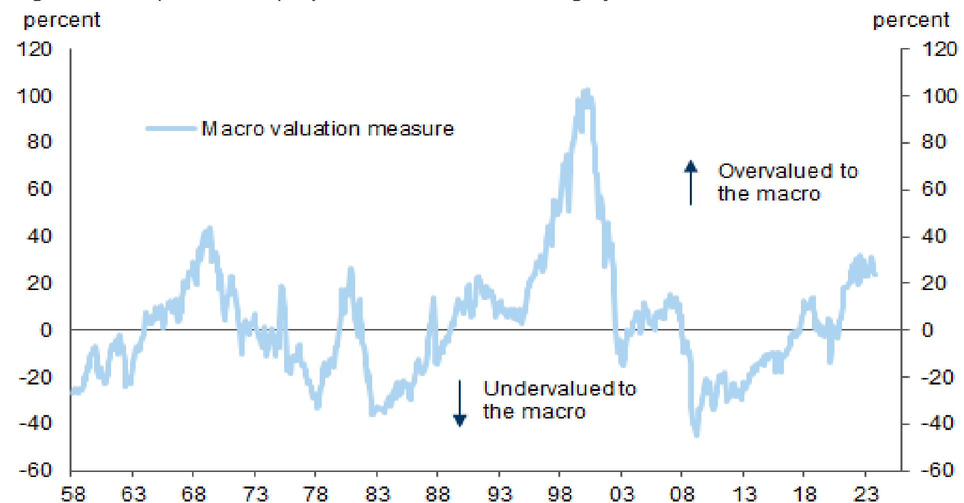
The negative correlation between UST bond yields and US equities was reversed in 2023. Despite treasuries offering higher (and supposedly risk-free) yields, investors still chose to put their money into stocks with S&P500 returning +11.3% in 9M23. We note that it was largely driven by the hype over AI and expect the relationship to normalise through the price correction of equities given their extreme overvaluations (Figs 14 and 15). The S&P500 earnings yield has returned an average 273bps spread over the US 10Y treasury yield for the past 20 years. As of 3Q23, S&P500 was trading at 292bps spread, 19bps higher and more than 2SD above this historical average. Markets are pricing in a soft-landing scenario, supported by optimistic earnings growth consensus.

Figure 14: Spread between S&P500 earnings yield and 10Y UST yield (in bps)



Source: Colombia Threadneedle Investments (as of 29 Sep 2023)

Figure 15: Gap between projected and actual earnings yield



Source: Goldman Sachs Global Investment Research (as of 31 Oct 2023)

We remain neutral on US equities. Current high valuations of US equities leave little room for error next year where headwinds remain elevated due to structurally tighter labour markets driving inflation, and the huge fiscal deficit that the US government needs to sustain as political tensions build in the lead up to the 2024 presidential election. While slowing inflation could support a stable macroenvironment, it would require much more positive news than just a soft landing to support higher equity upside given how expensive stocks are trading at.

Japan

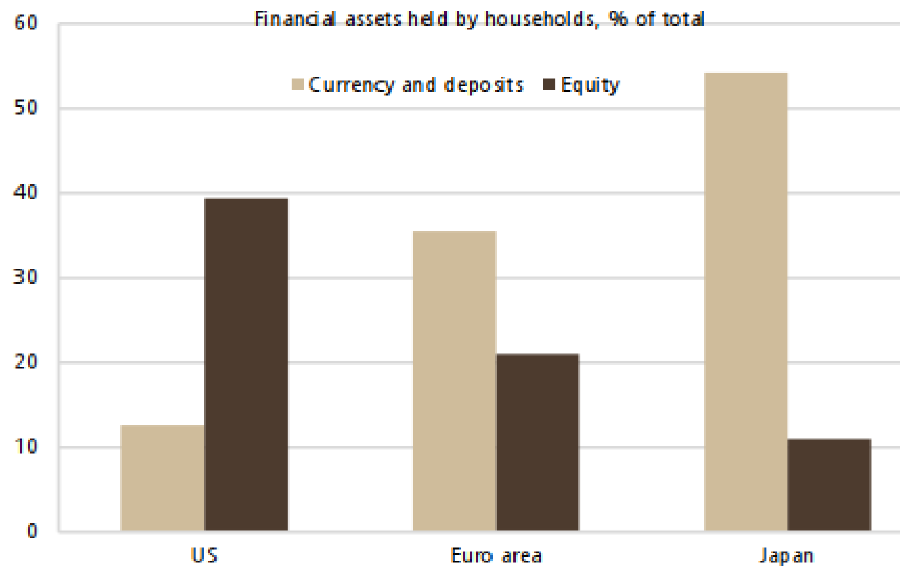
Japan equities were the outperformers in 2023, with its 9M23 gain of 25.7% almost double that of S&P500's 13.1% returns. The weak yen drove this outperformance, with the yen down almost 15% and USDJPY surging to a 30-year high of 150 (Fig 16). Main beneficiaries were the large cap names in export-focused sectors such as manufacturing, consumer discretionary and automobiles. In USD terms, the outperformance was less glaring but still did better than the rest of Asia due to BOJ keeping its easy monetary policy in place, but with slight tweaks to the YCC policy.

Figure 16: USDJPY over past 3Y

Source: Bloomberg (as of 31 Oct 2023)

We think Japanese equities are poised to extend their outperformance in USD terms as we think the monetary policy can only tighten from the current ultra-easy levels. Corporates and the domestic investor continue to hold a substantial portion of their wealth in cash, and a reflationary environment could see this cash being put to work. 54% of financial assets in Japan are held in cash compared to just 12% of financial assets in equities. Japan is facing post-pandemic structural adjustments to its domestic economy, entering into what we think is a coming reflationary environment as it slowly sees the return of wage growth and companies passing on price increases to consumers. While this supports strong corporate earnings driven by margin protection, real rates are expected to remain negative in the near-term and would fuel the switch from cash into real assets especially given years of under-allocation (Fig 17).

Figure 17: Significant scope for asset allocation shift in Japan



Source: UBS (as of 31 Oct 2023)

This is further supported by higher forecasted government bond yields, after BOJ adjusted its YCC policy in July and raised the 10Y JGB ceiling from 0.5% to 1%. Growing expectations of BOJ to turn more hawkish and move away from its negative interest rate policy also increases the attractiveness to hold JPY assets. In the medium to longer-term, Japanese equities will also benefit from stronger corporate governance driven by the Tokyo Stock Exchange's initiatives to drive shareholder returns such as share buybacks and larger corporate capex plans.

We are constructive on the domestic Japan consumption story and think there is more room to rerate, as the key beneficiary of Japan's reflationary cycle. We prefer to focus on domestic consumer names as a play on the domestic wage reflation story given tight labor conditions, along with sectors that will benefit from a strengthening JPY. Going forward, we think continued JPY weakness will not be a driver of equity returns as we believe we have seen a peak in the US rate environment.

Emerging Markets (EM)

China

China diverged from global peers as its economic recovery was not able to sustain the pace seen in the first quarter post reopening. Unrelenting weakness in the property sector and labour market dampened confidence in both consumers and business, resulting in lower consumption and economic activity throughout the first three quarters of the year (Figs 17 and 18).

The property sector was also less resilient than expected, performing poorly against expectations. Even large industry leaders like Country Garden and Longfor and state-backed names like Sino-ocean and Greenland were not spared and eventually defaulted. The lack of strong policy support has been frustrating for investors with exposure to China, as weakness in the property sector worsening consumption sentiment across the country and spilled across to other key industries such as manufacturing and e-commerce.

Figure 17: China real estate has been in recession territory for past 3Y

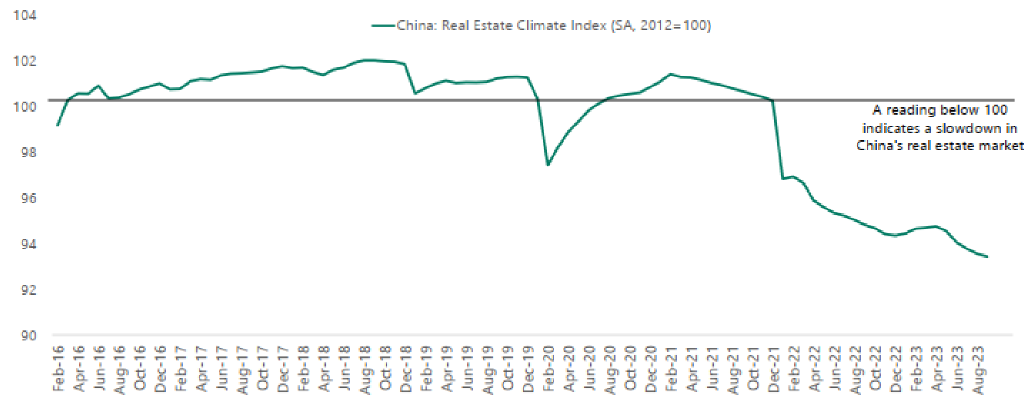
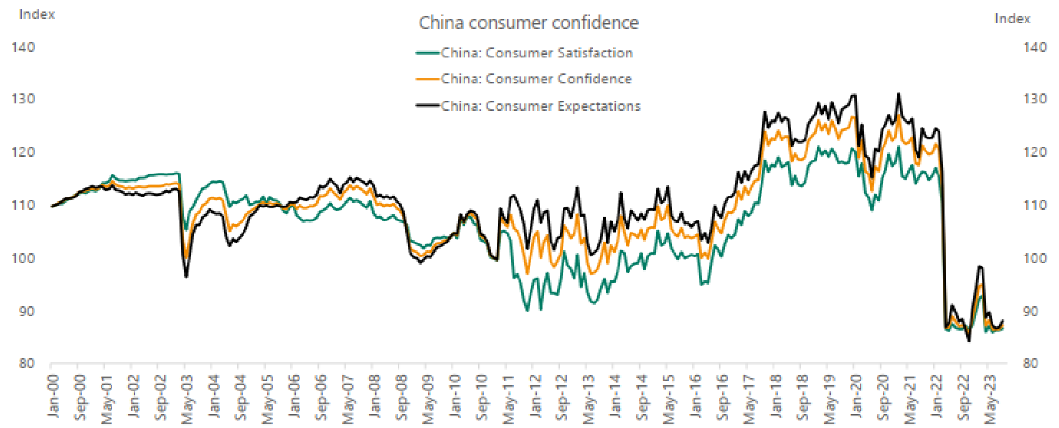


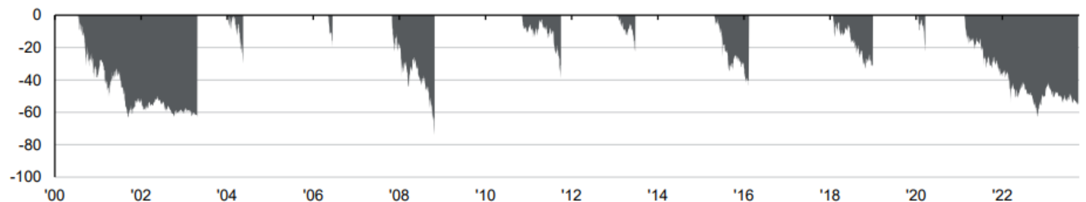
Figure 18: China post-pandemic consumer confidence is stuck at multi-year lows



Sources: Apollo Global Management (as of 8 Nov 2023)

Geopolitics played a key role in also driving fund flows away from China to North Asia and India. Chinese equities saw the largest drawdowns in over 20 years as investors reduced or entirely cut exposure to China (Fig 19). According to the Institute of International Finance, foreign investors withdrew USD15bn of Chinese stocks in Sep 2023 versus the YTD outflow of USD13bn. This is the largest monthly outflow since 2015. A new "Asia ex-China" investment theme emerged, one that mirrors the separation of Japan from general Asian-based strategies.

Figure 19: MSCI China historical drawdowns since 2000



Source: J.P. Morgan Asset Management (as of 31 Oct 2023)

The above backdrop is probably as bleak as it can get for making a case to invest in China. Since the pre trade war peak in the HSI of 33,484 seen in early 2018, vs the current level near 17,000, the near 50% drawdown is painful, but when juxtaposed against the performance of the US, Japanese and Indian equity markets, you can understand why there is deep frustration with investors. That said, every dog has its day, and a pendulum swung too far

towards one end will come back eventually. We think that enough downside has been priced into the Chinese markets and by all measures, valuations are at an extreme level.

There has been a significant amount of literature written by Western media on the Japanification of China, but we think this line of thought is rather lazy. While comforting to market historians more concerned with trying to find a fitting and convenient analogue for what is happening in China, we see more differences than similarities. We hold a contrarian view and see a different outcome for the Chinese economy. We think the worst is behind us in terms of newsflow from this sector. While we understand why Chinese equities have been unloved, these companies still serve an economy of 1.4bn population made up of a sizable segment of middle-class consumers.

We see relative value opportunities in strong companies, and believe it is wise to have measured allocations to China to participate in any upside recovery that could prove colossal. There are still numerous levers left to push in the toolkit of the policymakers and we do expect additional stimulus, or policy easing (particularly at CEWC in December for more clarity) going into 2024. Risk-reward setup here is favourable given extremely cheap valuations, especially in offshore China and lowered growth expectations. Given such a low level of expectations, we think a stabilization of the macroeconomic outlook could provide a catalyst for the market to outperform in 2024.

Asia-Pacific: Singapore

Within Singapore, we think REITs offer attractive yields as rates peak. REITs have a negative correlation with high interest rates, and the sector fell out of favour this year over a continually hawkish Fed. The selloff was exacerbated by the surge in UST yields in Q3 as increased treasury issuances led to a rise in risk-free rates. The rising rate environment punished REITs with weaker fundamentals and capital structures, and this was especially evident in companies that had exposure to US commercial sector as reflected in Manulife US REIT's unprecedented breach of gearing limit and Digitalcore REIT facing tenant bankruptcy. However this also led to other REITs strengthening their balance sheets, divesting assets to lower their gearing ratios as they defend against rising rates.

While EBITDA/interest coverage ratios may continue to decline in a high rate environment, capitalisation ratios and valuations remain healthy across the sector especially in Singapore commercial. We think the absolute yields that these REITs are trading at offer significant risk-adjusted rewards, and provide sufficient buffer against the downside of rates remaining higher for longer.

Asia-Pacific: Malaysia

Malaysia is a beneficiary of the global semiconductor supply chain offshoring trend. Heightened US-China geopolitical tensions have driven global semiconductor companies to de-risk their supply chains through China+1 policies. Malaysia is already plugged into the global supply chain through its growing chip assembly and testing plants, where Penang is known within the industry as the Silicon Valley of the East. Global industry leaders like Intel and Advanced Semiconductor Engineering have invested billions of dollars to set up facilities, with German chipmaker Infineon announcing an additional EUR 5bn to build the world's largest factory for silicon carbide power chips in August.

The government has also indicated that it wants to move up the value chain from manufacturing status as it signalled its openness to foreign investments in high-value industries. Furthermore, the weak ringgit that has fallen 6% against the dollar YTD makes it cheaper to do business, which should boost its attractiveness as a supply chain hub. The slide in the ringgit was largely driven by political-risk premium due to the country's fragmented political landscape, but we see increased odds of Prime Minister Anwar Ibrahim's government

lasting the next four years. The new ruling coalition led by Anwar is likely to boost political stability given his fiscally responsible and pro-business administration.

We believe Malaysian equities are trading at low valuations that offer significant upside within select technology stocks as the chip sector approaches the end of its cyclical downturn. Its equity benchmark is currently trading at a price-to-book valuation of 1.3x, near pandemic-lows and considerably lower than its 10-year average.

Risk Events for 2024

Investors have witnessed unprecendented market events in the past two years, and structural changes in market dynamics appear to keep volatility elevated. We believe it would be useful to flag out potential risk events that could lead to sudden market downswings.

1. Inflation persists, Fed continuing to stay hawkish beyond 2H24
    - Financial conditions tighten significantly, leading to distressed market players that could spark a broader contagion.

2. US entering a deep recession
    - Financial markets are not pricing in the possibility of a sudden and deep recession in US. Several thought leaders including Jamie Dimon and Ray Dalio have in recent months voiced their huge concern that the Fed is running the risk of doing too much and too long, and that the extent of the financial tightening may be reaching a breaking point.

3. US elections
    - Could worsen US-China relations if candidates take harsh anti-China narrative or push for stricter policies. More volatility if Trump gets re-elected. Increased factions within the White House that could lead to more US government shutdown episodes.

4. Further US sovereign rating downgrade
    - Continued political tensions in the White House could lead to disruptions in the daily legislative operations of the government. This could see the integrity of USD as reserve currency being challenged. US deficit will become a key concern.

5. BOJ full abandonment of the YCC policy
    - A potential sharp policy shift may further create a kneejerk reaction in the demand/supply dynamics of the US treasuries market, leading to further non-policy induced financial tightening.

6. Surge in oil prices
    - OPEC+ dissonance as certain players like Russia, Saudi Arabia extending supply cuts to end-2023 to support oil prices, weakening US-Saudi relations. The Israel-Hamas war would also create volatility. Iran is a major oil producer and key backer of the Hamas group, and could extend its support by shutting down the Strait of Hormuz, the vital shipping artery and the only sea passage from the Persian Gulf to the open ocean, further disrupting supplies.

7. Further deterioration in commercial real estate in US/UK
    - Prolonged weakness in the commercial real estate sector could arise due to higher interest rates, more delinquencies and lower demand due to weaker economic activity. This could lead to widespread bankruptcy that will strain balance sheets of not just real estate companies, but banks and the wider financial sector too.

About Golden Hill Asset Management

Golden Hill Asset Management is a Singapore-based asset management firm with multi-family office capabilities, delivering comprehensive and independent solutions to high-net-worth individuals and families.

With an experienced team of professionals equipped with multi-assets expertise, we work with our clients to provide tailored investment and wealth solutions.

Our commitment to building a long-term partnership based on integrity and trust provides us with an edge.

We are regulated by the Monetary Authority of Singapore (MAS) as holders of a Capital Market Services License CMS-101035 under the Singapore Securities and Futures Act, offering wealth management services to accredited/institutional investors only.

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