Market Insights

Quarterly Perspectives

Uneven growth calls for more diversification

Asia | 2Q 2024

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Uneven growth calls for more diversification

Overview

- The global economic and policy outlook is increasingly uneven. The U.S. remains resilient but Europe faces more growth headwinds. While Chinese consumers are seeking leisure and enjoyment, they are doing so in a budget-friendly way. Meanwhile, its housing market consolidation continues. Asia's export performance is picking up and central banks in the region may have more flexibility to relax monetary policy later in the year.
- Steady growth in the U.S. and expected rate cuts by the Federal Reserve (Fed) in mid-2024 could provide a positive backdrop for both stocks and bonds. Notably, the divergence in expectations of the size of rate cuts between market participants and the Fed has narrowed. While some assets, such as U.S. mega cap tech companies and corporate credits, are comparatively expensive, others are still reasonably valued and can potentially benefit from the advancement of generative artificial intelligence (AI) and the rise of emerging market (EM) consumers. In health care, biotech and pharmaceuticals are also consistent themes that benefit from technological advancement.
- We believe cash is unattractive in this environment on a relative basis, given stronger income and total return potential in fixed income and high dividend stocks. An uneven growth outlook and elevated geopolitical tensions amid a busy election year underscore the importance of tapping into international opportunities to diversify asset allocation while managing uncertainties.

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United States: Economic growth and the contribution to GDP

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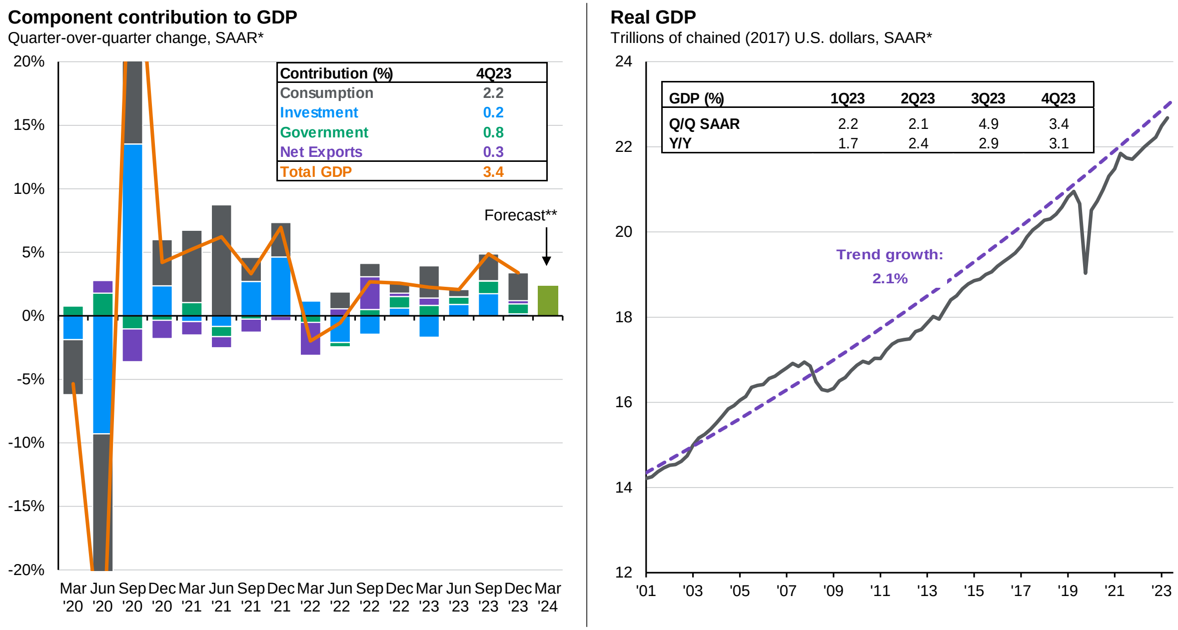
Global economy



Source: Bureau of Economic Analysis, FactSet, J.P. Morgan Asset Management. Trend growth is measured as the average annual growth rate from business cycle peak 1Q01 to business cycle peak 4Q19. Axis on the left chart is cut to maintain reasonable scaling. Real GDP growth reached a low of -28.0% quarter-over-quarter annualized during 2Q20 and a high of 34.8% quarter-over-quarter annualized during 3Q20. *SAAR stands for seasonally adjusted annualized rate. **Forecast is based on the Federal Reserve Bank of Atlanta's forecasted annualized quarterly growth rate of real GDP for the current quarter. Component contribution to GDP may not add up to the total returns due to rounding.
Guide to the Markets – Asia. Data reflect most recently available as of 31/03/24.

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U.S. economy still gliding on strong tailwinds

- The U.S. economy is still growing at a brisk pace, supported by household spending. Jobs growth is still well supported by the retail and health care industries. Looking ahead, corporate investment is likely to see mixed performance. AI and the tech sector should still record strong investment spend, but higher borrowing costs could cool broader capital expenditure.
- Potential balance sheet stress for certain regional banks deserves some attention. While the Fed and U.S. Treasury Department have the tools to mitigate systemic risks in the financial system, weakened bank balance sheets could undermine banks' ability to lend.
- Given the upcoming presidential and congressional elections, government spending should also be subdued. Overall, the timing of a deceleration in growth is likely to have been pushed back to later in 2024.
- Despite inflation rebounding in January, we believe price pressures should continue to ease through 2024. Elevated shelter costs and the sharp rise in auto insurance are likely to recede as we approach the second half of the year. This should provide the Fed with the right conditions to start cutting rates.

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G4 central bank policy rates and market expectations

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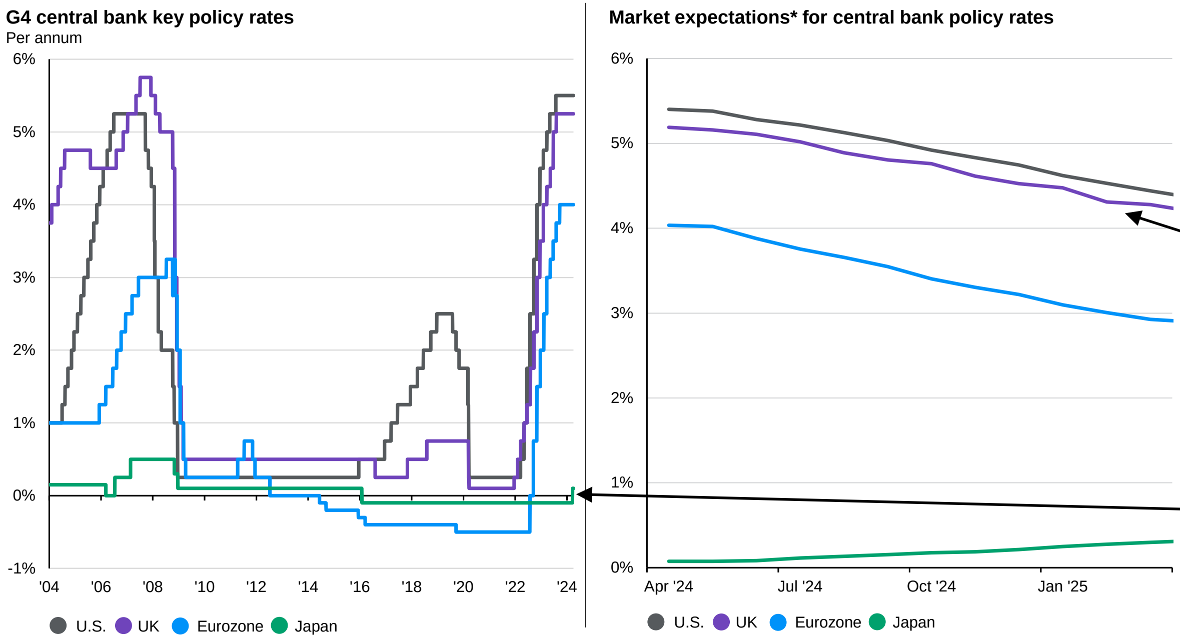
Global economy



Source: Bank of England, Bank of Japan, European Central Bank, U.S. Federal Reserve, J.P. Morgan Asset Management; (Left) FactSet; (Right) Bloomberg L.P.
*Expectations are based on overnight index swap rates. Past performance is not a reliable indicator of current and future results.
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Central banks face a growth and inflation dilemma

- Given the U.S. economy's resilience, the Fed has the scope to remain patient as it relates to the timing of the first rate cut. As inflation cools through the year, we see June as the earliest opportunity for the Fed to start cutting rates. In its March forecast, the Fed's median projection is for 75bps cuts in 2024, followed by another 75bps in 2025.
- Investors have come to terms with the Fed's more gradual approach. The futures market is pricing a total of 67 bps of cuts in 2024. Converging rate cut expectations between market participants and the Fed are likely to help contain the upside risk to U.S. Treasury yields.
- Other central banks, such as the Bank of England and European Central Bank, are facing a more difficult dilemma as the UK and Europe continue to face weaker growth prospects with stickier inflation. For now, these policy makers are still focused on taming inflation, especially given the potential threat of a re-acceleration in wage growth. Meanwhile, the Bank of Japan has returned to positive policy rate.

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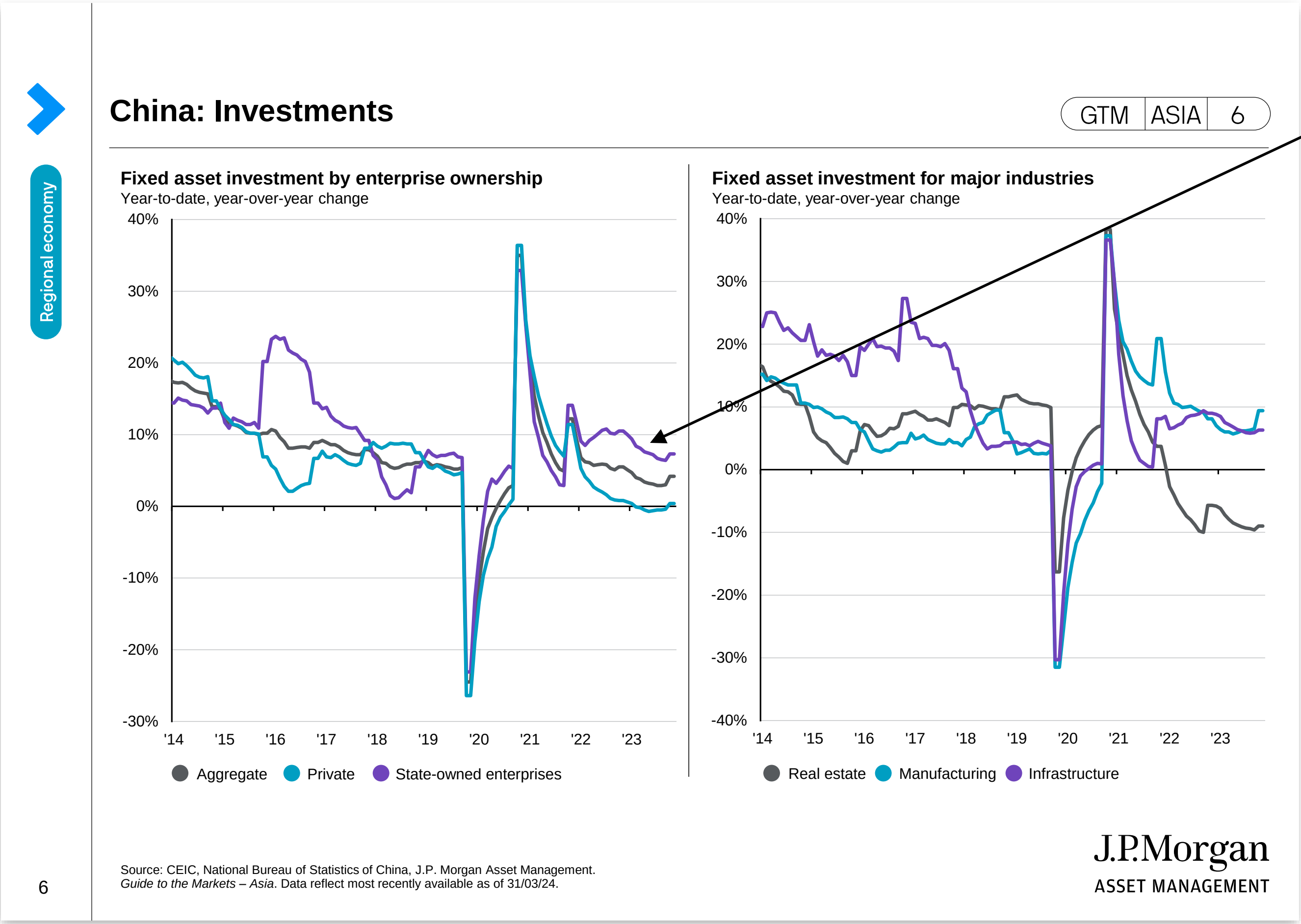

Policy stimulus now, confidence recovery later

- Lunar New Year tourism data shows a rise in tourist volumes but softer per capita spending. This is consistent with the more cautious consumer sentiment on account of a comparatively weak labor market and dampened wealth effect due to the correction in housing and stock prices. Fixed asset investment is still largely supported by state spending on infrastructure. Private investments may remain subdued for now as manufacturers work through excess capacity.
- Beijing continues to implement policies to support the real estate sector. A “white list” of residential projects was drafted to guide banks to provide liquidity to developers. This is likely to help ease the financial stress of some real estate developers and improve buyers’ confidence on project completion. That said, as expectations of property prices remain subdued, more time is needed to reinvigorate sector momentum.
- The government’s 5% GDP growth target would require both monetary and fiscal policy to be stepped up. Private businesses will also need more policy transparency to restore their confidence to invest.

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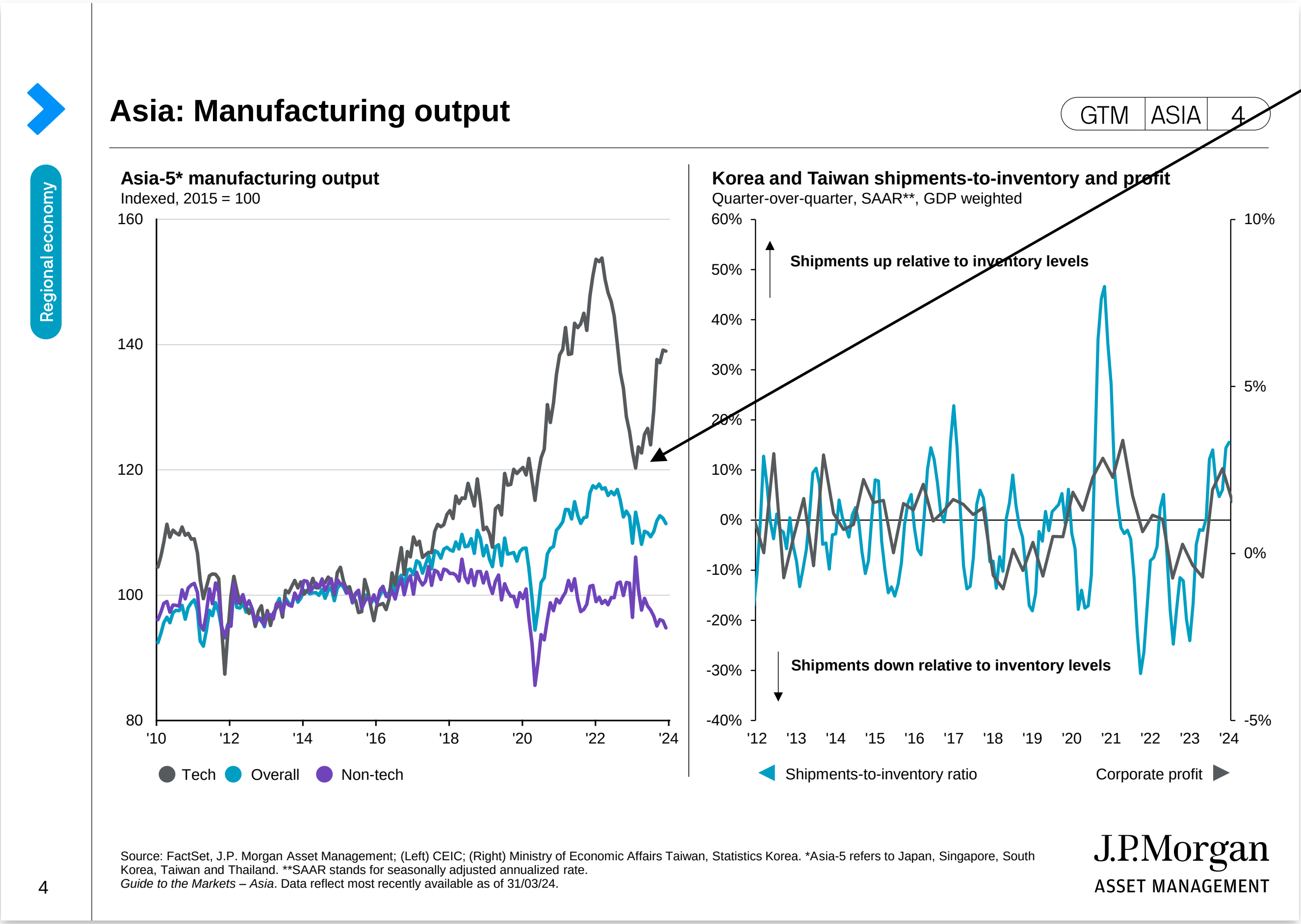

The return of the export engine

- The Asian export revival continues with Singapore, South Korea and Taiwan posting double-digit year-over-year growth in January. Despite the prospects of weaker growth in the U.S. and Europe later in the year, demand for electronic components is likely to remain strong. This is expected to be fueled by the rising demand for AI processing power across both data centers and consumer electronics.
- While inflation in the region is easing toward central bank targets, there is little urgency to cut rates among policymakers. In 2H 2024, potential rate cuts by the Fed and other developed market central banks should widen the scope for some gradual easing of monetary policy.
- The U.S. presidential election in November and U.S.-China tensions are likely to prompt questions about the future state of manufacturing supply chains in the region and globally. This could create opportunities in infrastructure and labor development in South and Southeast Asia.

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Policy rate cycles and market performance

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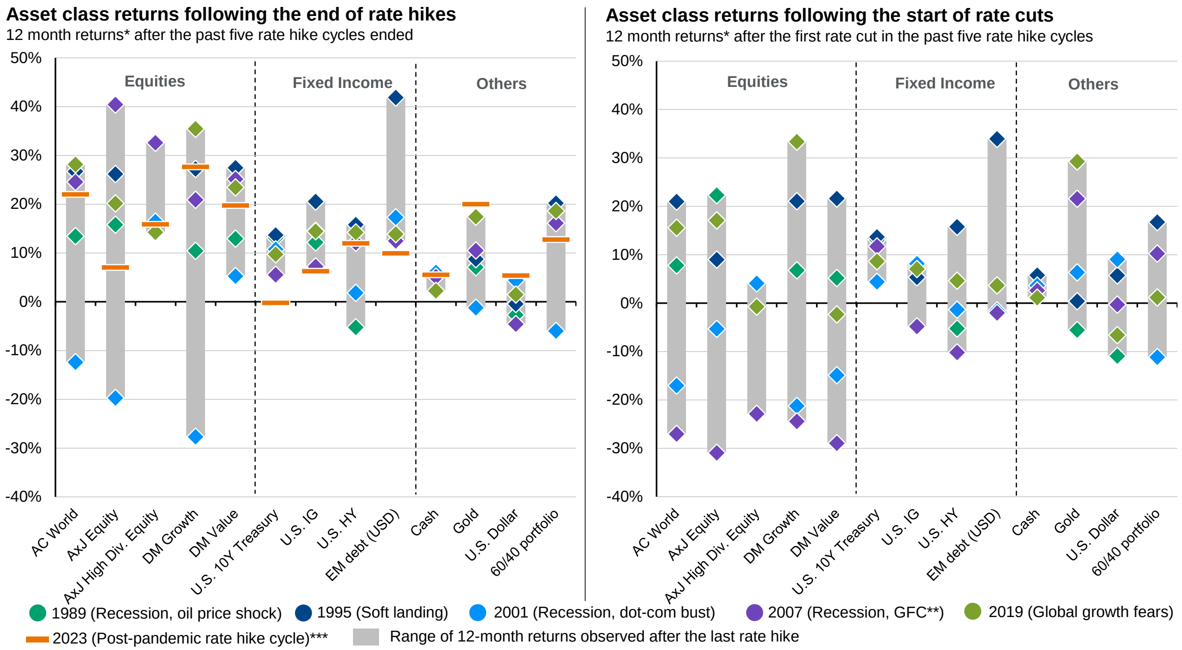

Source: FactSet, U.S. Federal Reserve, J.P. Morgan Asset Management. Based on MSCI AC World Index (*AC World*), MSCI Asia Pacific ex-Japan Index (*AxJ Equity*), MSCI Asia Pacific ex-Japan High Dividend Yield Index (*AxJ Equity High Div. Equity*), MSCI World Growth Index (*DM Growth*), MSCI World Value Index (*DM Value*), Bloomberg U.S. Treasury Bellwethers 10Y (*U.S. 10Y Treasury*), Bloomberg U.S. Corporate Investment Grade Index (*U.S. IG*), Bloomberg U.S. Credit Corporate High Yield (*U.S. HY*), J.P. Morgan EMBI Global (*EM Debt USD*), Bloomberg U.S. Treasury Bills 1-3M (*Cash*), Gold New Spot price (*Gold*), U.S. dollar index (*U.S. dollar*), 60% AC World and 40% Global Bonds (*60/40 portfolio*). The last rate hikes referred to in the charts occurred in Feb '89, Feb '95, May '00, Jun '06 and Dec '18. The first rate cuts occurred in Jun '89, Jul '95, Jan '01, Sep '07, Aug '19. *Total returns in local currency are used, unless otherwise specified. **GFC stands for global financial crisis. ***Returns are annualized and calculated from the assumed last rate hike date (26/07/23) to date. Past performance is not indicative of current or future results.
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Other asset classes

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Soft landing and pre-emptive rate cuts should benefit risk assets

- With the U.S. economy expanding at a brisk pace and the Fed is expected to bring monetary policy closer to neutral levels in the next 18 months, the backdrop for risk assets, such as equities and corporate credits, remains constructive. We believe cash remains a less attractive asset class given the reinvestment risk associated with expected falling deposit rates in the quarters ahead.
- Some risk assets, such as mega cap U.S. technology companies and corporate credits, continue to face valuation challenges. Credit spreads in the U.S. continue to price in solid economic growth and low corporate defaults. We believe greater geographical diversification is critical to achieve robust risk-adjusted returns as well as consistent income.
- Given significant divergence in manager performance and emerging headwinds in selective alternative asset classes, we believe active management is critical to navigate private market opportunities, including private equities and private credits, as well as infrastructure.

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Global fixed income: Return composition

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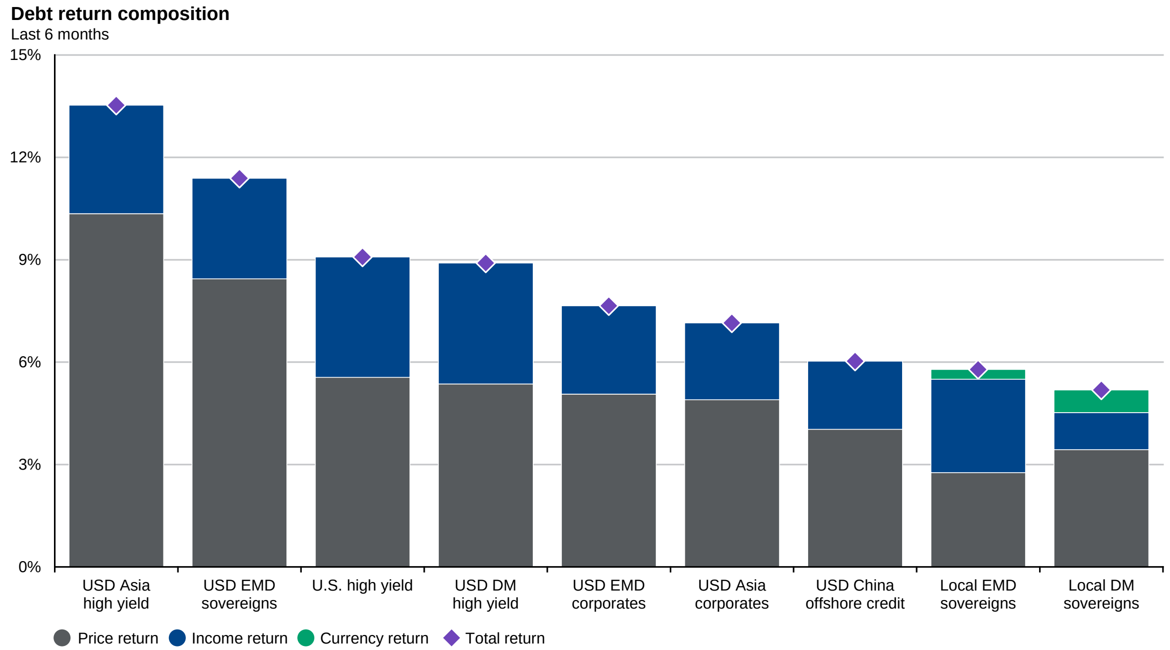
Fixed income



Source: J.P. Morgan Economic Research, J.P. Morgan Asset Management. Based on J.P. Morgan Asia Credit High Yield Index (*USD Asia high yield*), J.P. Morgan CEMBI (*USD emerging market debt (EMD) corporates*), J.P. Morgan EMBI Global (*USD EMD sovereigns*), J.P. Morgan Asia Credit Corporates Index (*USD Asia corporates*), J.P. Morgan Asia Credit China Index (*USD China offshore credit*), J.P. Morgan Developed Market HY Index (*USD DM high yield*), J.P. Morgan Domestic High Yield Index (*U.S. high yield*), J.P. Morgan GBI-EM Global Diversified (*Local EMD sovereigns*), J.P. Morgan GBI-DM (*Local DM sovereigns*). Past performance is not a reliable indicator of current and future results.
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Manage downside risks with fixed income

- With the divergence in rate cut expectations between market participants and the Fed narrowing, this could be a good opportunity to extend duration in developed market government bonds. Volatility in fixed income markets has also receded with softer inflation prints, allowing bonds to once again play a role as a traditional diversifier in portfolio construction.
- On U.S. corporate bonds, we reiterate the importance of understanding the sources of potential return. Generally, lower risk-free rates and falling bond yields can provide reasonable returns for investors. Meanwhile, investment-grade and high yield corporate credit spreads could remain tight as fundamentals look sound. This implies a narrower scope for additional returns from spread compression.

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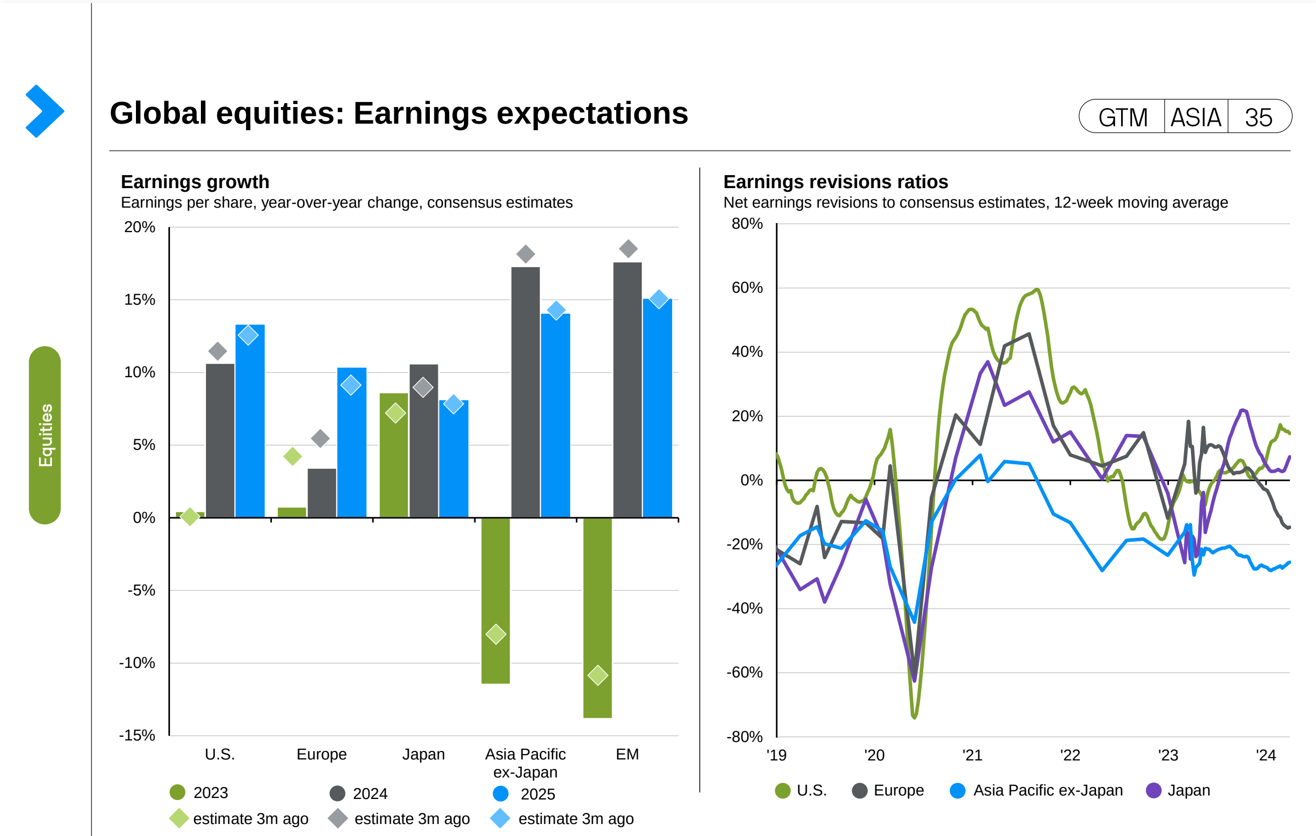

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Asia Pacific ex-Japan, emerging markets (EM), Japan, Europe and U.S. equity indices used are the MSCI AC Asia Pacific ex-Japan, MSCI Emerging Markets, MSCI Japan, MSCI Europe and S&P 500, respectively. Consensus estimates used are calendar year estimates from FactSet. Revisions are based on the current unreported year. Net earnings revisions is (number of companies with upward earnings revisions minus number of companies with downward earnings revisions) divided by the number of total companies. Past performance is not a reliable indicator of current and future results.
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Harness global diversification to navigate an uneven growth outlook

- Given the uneven growth and inflation outlook around the world, as well as international and domestic political uncertainties, we believe a globally diversified equity allocation is an optimal way to tap into opportunities presented by cyclical and structural growth themes while managing risks.
- Investors are rightfully questioning the sustainability of the rally in U.S. mega cap tech stocks, which have generated outsized returns over the past year on the back of optimism about generative AI. A potential short-term pull back could be triggered by regulatory changes or other challenges to earnings growth, while a wider adoption of AI across industries could help broaden market performance. We believe there are still opportunities to be found in U.S. large cap stocks, but stress the importance of bottom-up stock picking to uncover companies that can harness this new technology to drive earnings growth.
- We stay constructive on Asian equities on the back of the export recovery. Tech exporters, including South Korea and Taiwan, could continue to enjoy potential positive surprises in earnings outlooks. Improvement in Japan's corporate governance continues to be rewarded by investors, while South Korea is looking to adopt similar reforms. China and Hong Kong offer interesting value opportunities despite the cyclical and structural challenges facing the Chinese economy. We believe Asian markets offer a good mixture of growth and dividend opportunities.

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Diversification does not guarantee positive returns or eliminate risk of loss.

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