

# Multi-Asset Solutions Strategy Report

## Global markets and multi-asset portfolios

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### In brief

- Chinese and Japanese economic and equity market performance has diverged sharply over last couple of years as Japan reaped the benefits of reflation while China faced a deflationary demand environment.
- Recently, a weaker yen has weighed on the prospects for stronger real wage growth in Japan, leading to a slower than expected recovery in domestic consumption. With room for further growth in domestic demand and continued momentum in corporate governance reforms, the structural case for Japanese equities remains intact.
- Beijing's recent policy announcements delivered a boost to Chinese equities. However, market participants remain concerned about the scale of policy easing and what its economic impact might be. Although cheap valuations provide near-term support to Chinese equity markets, long-term performance will depend on policy delivery and implementation.

## Shifting dynamics in Asian markets

Over the past three years, Chinese and Japanese equity markets moved in dramatically different directions. The MSCI China Index has plunged more than 50% from its peak in early 2021, while the Nikkei 225 Index made all-time highs in March. But as the second quarter got underway, the pattern shifted. MSCI China has rallied sharply since mid-April, while Japanese equities have been trading water.

Is China's equity market outperformance sustainable? Will Japanese stocks shake off the economic drag from a weaker yen? We consider the prospects for both Asian markets in this report.

### China: Unbalanced recovery with positive policy signals

In China, incoming data point to stabilization in growth momentum, bolstered by robust external demand and policy-supported manufacturing and infrastructure investment. However, the growth recovery remains unbalanced with still-soft domestic demand, especially in goods consumption.

In our base case outlook, we expect China's real GDP growth to reach 5.0% in 2024, in line with the government's target. At the same time, we believe China will remain in a low inflationary environment this year as policy easing measures have been more focused on supporting supply than demand.

We see balanced risks around our base case. The key downside risk is a further deterioration of the property sector. Recent data suggest China's property sector has yet to bottom out. Both new home sales and property investment remain in double-digit year-on-year contractions amid further declines in new home prices.

On the other hand, more fiscal easing and support for the property sector has been rolled out in the past few weeks following the dovish April Politburo meeting. However, the overall size of the policy support is modest so far. How the policies are implemented will be key.

For example, property support measures have aimed to boost demand and reduce primary property inventory with cheap funding from the People's Bank of China (PBoC). The size of the announced PBoC funding support from local government purchases of completed but unsold properties at RMB300 billion is relatively modest when compared with the roughly RMB3-4 trillion needed to reduce primary property inventory to more reasonable levels. That said, we note an upside risk to that view: faster usage of the PBoC funding may lead to additional funding support from the central bank.

We expect that funding support which addresses unfinished pre-sold projects may be more effective in boosting home buyer sentiment than support for completed unsold properties. However, that stance could present moral hazard concerns – essentially looking like a developer bailout. Thus, we think the government would likely opt to hold off on such an approach, at least for the time being.

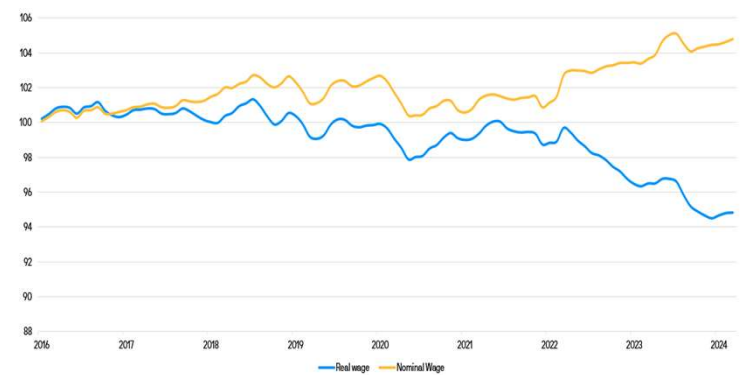
### Japan: Continued recovery amid sticky inflation

We remain constructive on Japan's economic outlook given solid wage growth and improved corporate capex. Companies plan meaningful capital investment in the coming quarters and structural labor shortages will likely continue to support labor-saving, productivity enhancing capex. We expect consumption to recover as real incomes creep higher after two years of negative real income growth. But the move will probably be more gradual than expected as inflationary pressure on consumer spending proves persistent amid a weaker yen.

Of course, after decades of deflation, inflation is generally welcome in Japan. We do see growing evidence of sustained inflation, supported by a virtuous wage-price cycle. We expect Japan's core inflation (ex fresh food and energy) to stay above the Bank of Japan's (BoJ's) 2% inflation target this year. With the strong spring wage negotiation result this year (a base pay hike of 3.6%), wage growth will likely continue to trend higher. In turn, real income growth could turn positive toward the start of Q4 (Exhibit 1).

### Wage growth will likely continue to trend higher

Exhibit 1: Japan: Per worker wage indices (2015=100 SA, 3mma)



Source: Bloomberg, Haver, J.P. Morgan Asset Management Multi-Asset Solutions

Although domestic demand was sluggish in Q1, we think gradual monetary policy normalization will proceed given the BoJ's strengthening conviction that underlying inflation will approach 2%. The yen's recent weakness will likely nudge consumer inflation expectations higher and we think the BOJ will look to avoid being excessively behind the curve in raising rates. We expect the central bank will increase the policy rate to 0.25% in July, followed by two additional hikes in January and Q2 2025.

### Diverging fortunes of the Asian majors

The weaker yen has provided a tailwind for Japanese equities, helping them outperform their global peers since early 2023. But the performance of Japanese equities has been roughly flat since the start of Q2. That partly reflects slowing macro momentum, but investor concerns about the negative impact of a further weakening in the yen is likely the more important causal factor.

Those concerns began to build after the BoJ's dovish April meeting, while the narrative of "higher for longer" rates in the U.S. weakened the yen further and increased investor focus on faltering domestic consumption in the Japanese economy. Market participants worry that excessive yen depreciation could cause higher imported inflation and thus challenge the progress made on real wage growth. USDJPY above 157 level can potentially offset the 3.6% wage growth delivered during the spring wage negotiations, delaying the recovery of domestic personal consumption.

On the corporate front, the outlook is mixed. Japanese corporates continued to post double-digit growth in profits during the latest reporting season. But they have guided cautiously on the back of higher wages and a difficult pricing environment. We also saw a sharp pickup in the buyback announcements this year, but they failed to translate into further share price gains. This suggests that investors are mindful of higher valuations and more attentive to corporate fundamentals.

Corporate governance reforms have played an important role in driving Japanese stocks higher over the past year. Now that nearly 70% of the TSE Prime listed companies have issued disclosures on governance reforms, we believe investors' focus will shift from the quantity to the quality of the capital efficiency reforms.

Over the long term, improvement in corporate governance will be a structural support for Japanese equities. In the near term, U.S. policy rate expectations will lead to yen market volatility, which could in turn keep Japanese equities trading in a tight range.

Turning to Chinese equities, over the past six weeks their trading range has been anything but tight as prices rallied more than 12% since mid-April. Expectations of further policy easing started to build heading into the April Politburo meeting and policy news flow since then has kept the rally going.

However, recent performance has been largely driven by valuation re-rating from suppressed levels

(accounting for 95% of the return contribution). Very light investor positioning has played a role as well. Inflows into the Chinese equity market appear to have come mainly from tactical investors with very short investment horizons. Most investors remain skeptical about the prospects for a sustainable recovery as fundamentals and earnings expectations have moved sideways at best.

A lot of good news already seems to be priced in and the focus is now on the policy implementation and its actual impact on the economy. That leaves considerable room for disappointment. So far, the policy announcements seem to be relatively modest in size and have generally come with a delay. They have failed to improve consumer confidence as home prices continue to remain depressed across the major cities.

Labor market slack also remains high, challenging Chinese companies' revenue streams and pressuring profits. In the first quarter, many corporates reported earnings below analyst expectations and they continue to see a weak inflationary environment pressuring their margins.

In our view, a sustainable rally in Chinese equities will require meaningful policy easing measures to stabilize the property sector. We also need to see an improvement in earnings revision ratios which remain stuck in negative territory

### **Asset class implications**

In the near term, we expect Japanese equities to face two way risks from monetary policy and a gradual recovery in economic fundamentals. Over the longer term, we think further improvement in return on equity (ROE) metrics could enable Japanese equities to move higher. Chinese equities, on the other hand, may find some near-term support from attractive valuations and still-light positioning of Chinese stocks in global equity portfolios. Policy delivery remains key for sustainability of equity market gains, but any delays in policy implementation may weigh on investor sentiment. Manufacturing overcapacity and potential new U.S. tariffs could pose additional risks to Chinese equities.

In our multi-asset portfolios we broadly maintain a pro-risk stance via an overweight to equities (with a preference for U.S., Europe and Japanese stocks) and credit. We continue to hold a neutral stance on duration.

Asset class	Opportunity set	UW	N	OW	Change	Conviction	
Main asset classes	Equities	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>		Moderate	
	Duration	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	▼		
	Credit	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>		Moderate	
	Cash	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>		High	
Preference by asset class	Equities	U.S. large cap	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>		Moderate
		U.S. small cap	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>		
		Europe	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	▲	
		UK	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	▼	
		Japan	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>		Moderate
		China	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	▼	Low
		EM ex-China	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	▲	Low
		Fixed Income	U.S. Treasuries	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	▼
	G4 ex-U.S. sovereigns		<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>		
	EMD hard currency		<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>		
	EMD local FX		<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	▲	Low
	Corporate investment grade		<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>		
	Corporate high yield	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>		High	
	Currency	USD	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	▲	
		EUR	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>		Low
		JPY	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	▼	
CHF		<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	▼	Low	

The tick chart and views expressed in this note reflect the information and data available up to March 2024.

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**Multi-Asset Solutions’ asset allocation views are the product of a rigorous and disciplined process that integrates:**

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- Quantitative analysis that considers market inefficiencies, intra-and cross-asset class models, relative value and market directional strategies
- Strategy Summits and ongoing dialogue in which research and investor teams debate, challenge and develop the firm’s asset allocation views

As of March 31, 2024.

### Next steps

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