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Investing for a
world of change

Multi-Asset Strategy Quarterly

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Foreword

Welcome to our latest Multi-Asset Strategy Quarterly. In this edition, Iain Cunningham outlines our current cyclical growth view – including his more benign view for US growth prospects. Sahil Mahtani examines the reasons for, and implications of, a new capex supercycle. This is being driven by a combination of the energy transition, nearshoring, geopolitics, demographics, technology, and public investment spending. Russell Silbertson discusses the latest central bank thinking and the implications for global economies.

Finally, we close with a succinct summary of our higher conviction asset class views, beginning with equities, moving on to fixed income, currency and closing out with commodities.

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General risks. The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Investment objectives and performance targets are subject to change and may not necessarily be achieved, losses may be made. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks. Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. **Emerging market (inc. China):** These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. **Commodity related investment:** Commodity prices can be extremely volatile and significant losses may be made. Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. **Equity investment:** The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company.

2024: Recession fears fade

Iain Cunningham
Head of Multi-Asset Growth

Our outlook and strategy positioning has evolved over the past quarter as we have revised the probability of US recession lower and the probability of a soft landing higher due to emerging evidence.

A more favourable US outlook

In the US, we believe monetary policy is tight and will continue to progressively feed into the economy through corporate and household refinancings, as they take place. The Federal Reserve (Fed) has however signalled a desire to cut interest rates. If the Fed's growth and inflation forecasts prove correct, then two to three 0.25% cuts will likely take place later this year. At the same time, fiscal policy in the US has remained loose and continues to support economic growth, while weak areas of the economy have begun to improve recently. This combination of prospective policy loosening, ongoing fiscal support and improvement in manufacturing and real estate has increased the probability of a soft landing in the US economy. We continue to expect growth to moderate through 2024 in aggregate, but we have revised down the probability of recession over the next 12 months.

Figure 1: US credit impulse

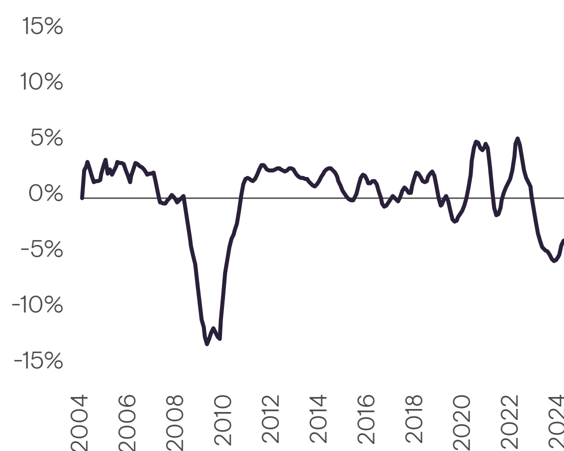
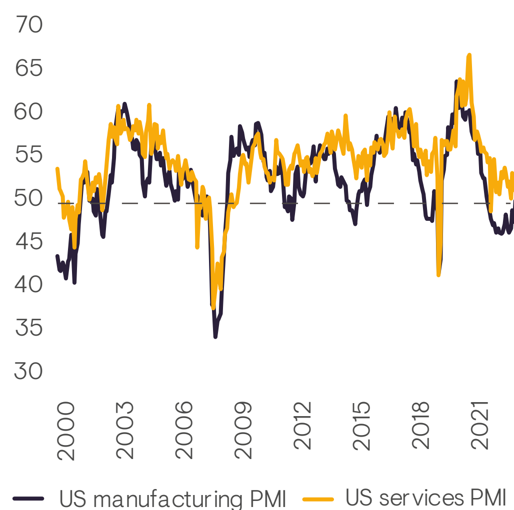


Figure 2: US PMIs



Source: Ninety One, March 2024.

Europe is not as fortunate

In Europe, we believe policy is tight and the lags are shorter than in the US due to less pandemic stimulus, higher levels of floating rate debt and notably less fiscal support. Growth indicators remain weak but appear to be showing some modest signs of improvement at a low base, although there is still prior tightening to feed through. Inflation is falling quickly, and three-month annualised core inflation statistics are currently below the European Central Bank's (ECB) target. We see an elevated risk of a deflationary period in the eurozone and believe that the ECB is likely to be one of the first major central banks to ease policy this summer.

Figure 3: Euro credit impulse

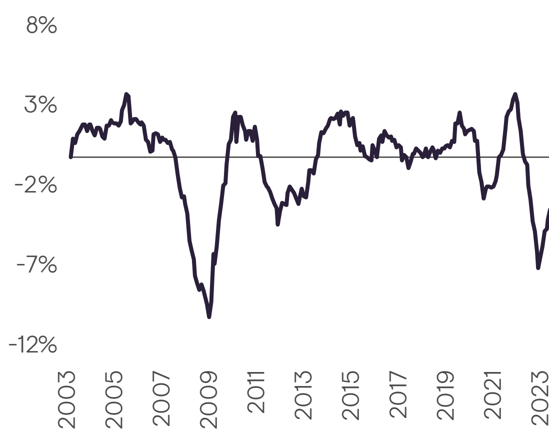
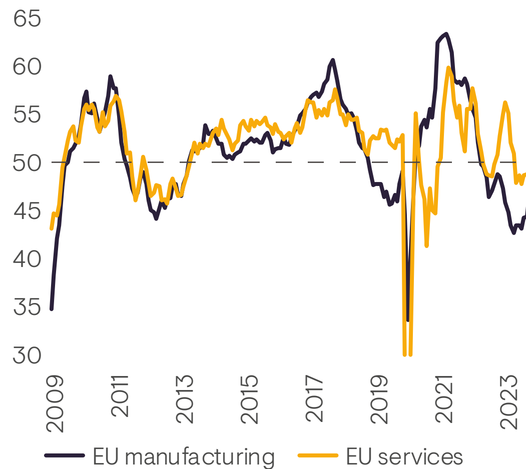


Figure 4: Euro PMIs



Source: Ninety One, December 2023.

China's recovery remains bumpy

In China, policy appears loose albeit without material easing taking place. Easing measures are however becoming progressively more forceful. The People's Bank of China's (PBoC's) balance sheet has expanded in recent quarters, while additional fiscal measures focused on boosting consumption have been announced. We expect policy makers to continue to ease through various measures as they aim to ensure that a sustained recovery takes hold. Growth metrics remain mixed, and the recovery remains bumpy. We expect it to remain so without more forceful easing measures. Inflation remains weak but base effects should begin to provide more support on a forward-looking basis. We continue to believe that the Chinese economy will experience a more benign outcome than the bearish consensus suggests.

Figure 5: China credit impulse

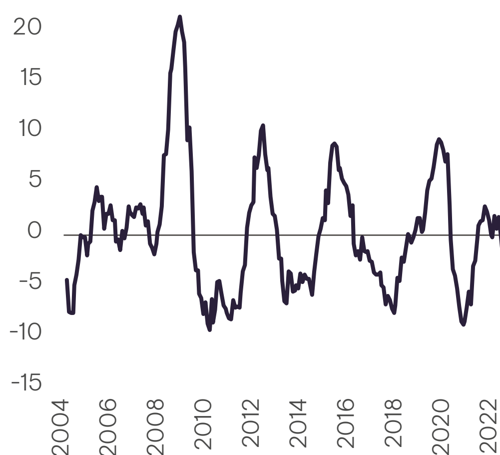


Figure 6: China PMIs

Source: Ninety One, March 2024.

Looking ahead

Our central investment roadmap, as discussed above, leaves us somewhat more constructive on the prospects for risk assets, particularly in Asia and the US. In fixed income, portfolio duration declined through the first quarter post a strong rally in government bonds at the end of last year and due to an increase in the probability of a US soft landing. However, we maintain an overweight to defensive duration, particularly in Europe. In currency we maintain a preference for reserve currencies – especially the Japanese yen vs. the euro, where we see scope for policy tightening from the Bank of Japan (BoJ) at a time when the ECB is likely to be easing policy. We also moved longer the US dollar versus Asian and European currencies over the quarter, due to the improved outlook for the US economy versus other regions.

A new capex supercycle is on the way

Sahil Mahtani
Head of Macro Research
at the Investment Institute

The combination of an energy transition, along with nearshoring, geopolitics, demographics, technology and public investment is driving a global capex cycle.

In 2013, former US Treasury secretary Larry Summers famously declared that the world's advanced economies were in a state of secular stagnation, a period of sluggish growth, low interest rates and an absence of inflation. Today, central banks find themselves worrying about the opposite: the prospect of higher-than-target inflation and the need to keep interest rates higher for longer. If these worries remain in the coming years, a key reason will be because the world is in the foothills of a global capital expenditure supercycle.

Our work suggests that transformative thematic macro trends will drive global capex spending up by US$2.5 trillion per year in a base case scenario and US$5 trillion in a higher expenditure scenario. This translates into a projected 12-24% increase in annual global gross fixed capital formation by 2030[1].

Since 1945, there have been six significant capex cycles, as defined by periods when capex growth exceeded GDP growth, with the longest stretching across two cycles from the mid-1960s to the late 1970s. Since then, US capex growth has spent as much time below trend GDP growth as above it, as the offshoring of production to Asia led to an investment boom there, especially after China's 2001 accession to the World Trade Organisation. The post-GFC period invited balance sheet consolidation in the US private sector and was not conducive to strong investment growth.

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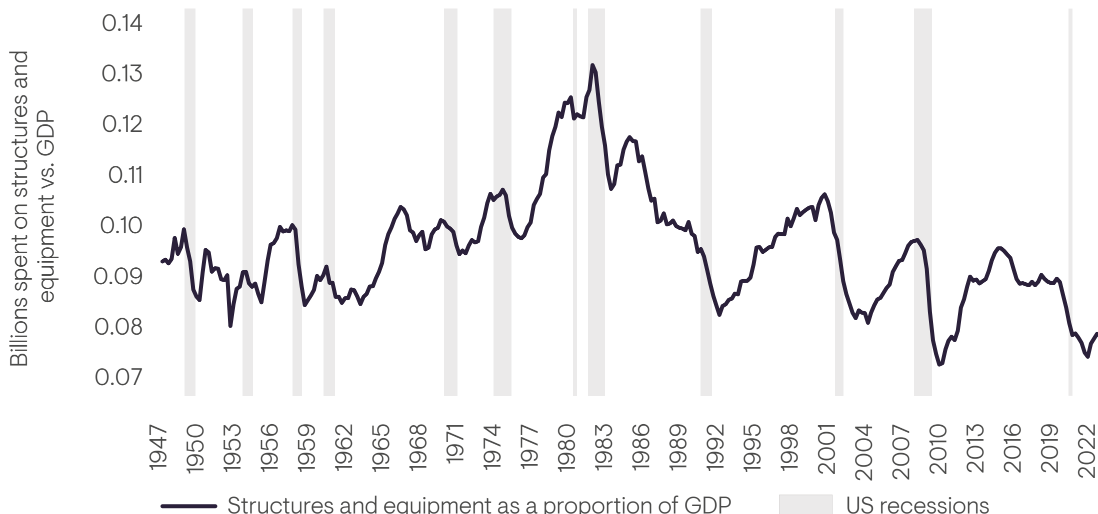
1. Ninety One, A new capex supercycle: driving powerful and transformative growth (2024).

Figure 7: US private non-residential fixed investment (1947-2023)



Source: US Bureau of Economic Analysis, 2023.

The emerging capex cycle is underpinned by a multitude of structural drivers including the shift towards net zero, efforts to enhance supply chain resilience underpinned by persistent national security concerns, demographics, fast-rising defence spending, and public infrastructure spending across the developed and developing world.

The move toward a green economy is the largest component of increased infrastructure investment. BloombergNEF forecasts that investment spending will reach between US$2 trillion and US$4.5 trillion per annum, by 2030[2]. Defence spending estimates since the Ukraine war have structurally increased by US$300 billion to US$700 billion p.a.[3] The decline in working age population ratios is leading to a structural labour shortage, which is compelling employers to substitute labour for capital, by several hundred billion dollars per annum. Meanwhile, technological development particularly in AI is fuelling major investments, with AI data centre expenditures projected to rise by US$100 billion per annum by 2027[4]. Public infrastructure plans in the US and elsewhere, the reshoring of supply chains, as well as mining capex for the energy transition, add their own hundreds of billions to the figures.

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2. BloombergNEF, New Energy Outlook 2022 (2022).
3. The Economist, The cost of the global arms race (2023).
4. Intelligent Data Centres, Bulk Data Centers unveils plan for data centre expansion following unprecedented demand (2024).

What a new capex cycle means for investors

If we are on the verge of a multi-year capex-driven and resource-intensive cycle, that is likely to lead to a different market leadership than in the last cycle. Indeed, according to our analysis, stock beneficiaries are likely to be primarily in physical asset intensive areas of industrials, resources, and utilities. These are all sectors that lagged or tracked the market in the post-GFC period[5].

Key beneficiaries include companies across a range of different industries:

- Semiconductor manufacturing
- Factory automation
- Construction and engineering
- Renewable energy producers and electric grid infrastructure
- Electronic components and equipment
- Metals and miners
- Defence

Stock beneficiaries are also spread across geographies, not just concentrated in the US. In other words, the investing playbook for the secular stagnation cycle, which favoured long-duration assets, often in the technology sector, often in the US, will be different for one driven by a capex supercycle.

Moreover, it will influence the broader macroeconomic landscape, potentially spurring higher inflationary impulses and sustained increases in bond yields at cyclical peaks. Our research suggests the structural thematic drivers outlined here are durable, substantial, and are likely to play out over many years. While the impact on productivity may take time to materialise, the changes are palpable and poised to exert a tangible influence.

For further analysis, please read our paper:

A new capex supercycle: driving powerful and transformative growth

5. This is not a buy, sell or hold recommendation for any particular security.

What's the rush?

Russell Silberston
Investment Strategist

Back in December, US Federal Reserve Chair Jerome Powell stated that the Federal Open Market Committee (FOMC) had started to think about the appropriate time "to dial back on policy restraint," in response to a run of favourable inflation data. Fast forward three months, however, and while policy easing is still on the table, rate setters are asking themselves 'what's the rush?' This change of emphasis has been in response to disappointing inflation data and sustained economic resilience, especially the labour market, which continues to create plentiful jobs despite one of the fastest hiking cycles in economic history.

The Fed may have time on its side

In recent weeks, the perplexing strength of the US economy has become a little clearer, with the release of new immigration data from the Congressional Budget Office (CBO). Over the period 2021 to 2023, the CBO revised up its immigration estimates by four million people and its 2024 to 2026 projection by another 4.3 million. This huge new supply of labour, which on average earns 85% of that earned by native-born US citizens, has meant the US has experienced a supply side labour shock, which has filled the post-COVID vacancies in leisure, hospitality, health and social care without causing a corresponding wage shock. In turn, demand has held up, and this is leading some members of the FOMC to ask if monetary policy might not be quite as tight as they thought and if this is the case, why rush to cut rates? Of course, with a dual mandate of maximum employment and low inflation, growth in and of itself will not stop the FOMC from cutting rates, a point made several times by Chair Powell. But equally, with a weather eye on the premature easing of the 1970s, the Committee is quite happy to sit on its hands for now.

On balance, we still expect rates to be reduced this year as inflation heads down after the bump at the beginning of the year, but rather than the aggressive cycle priced at the beginning of this year, two to three cuts look far more reasonable against the current economic backdrop.

The ECB reaches the brink

Last quarter we stated that 'with growth close to stall speed, we believe it is only a question of time before the European Central Bank (ECB) is forced to recognise economic reality and ease its restrictive stance of monetary policy.' This recognition occurred in March, when the Governing Council (GC) felt much more confident about the inflation outlook due to the continued easing of price pressures. In a hat tip to the FOMC's language, ECB President Christine Lagarde said this allowed the conversation to turn toward "dialling back our restrictive policy stance[6]." But to be completely confident that this view is correct, the GC needs "a lot more information coming in in the next few months to be sufficiently confident." In practice it "will have a lot more of that for our June meeting" which sent an unambiguous message to the market. We would argue that the GC continues to drag its feet, with the latest inflation data surprising to the downside again. But the ECB strives hard to bring a wide range of views together, and despite pretty clear signs that policy is far too tight in the eurozone, the Bank will wait until the end of this quarter before cutting. With neutral interest rates somewhere in the region of 2%, once the GC takes the monetary plunge, they have plenty of scope to ease further.

The BoJ takes historic step

The Bank of Japan (BoJ) finally garnered the confidence to end negative interest rates in response to continued signs of inflation in the economy, with the latest Spring wage round essentially sending the message that its job is done. But the Bank continues to hold the bond market's hand, by promising to maintain the government bond buying programme, albeit as a backstop rather than a systematic purchase programme. This was perceived by the market to be a 'dovish hike'. However, we would argue that participants still underestimate the scale of the change in the Japanese inflation outlook. The BoJ's action is more of managing an exit that avoids widespread market disruption, rather than making a statement about the price outlook. The widespread weakness of the yen adds further fuel to the inflationary impulse. Looking ahead, further increases in Japanese interest rates look likely in the aftermath of this year's wage round and continued labour market shortages. Of course, given its economic history, the BoJ will likely remain cautious, keeping rates below neutral, but if the inflation outlook has changed as much as we think, it will be playing catch up eventually.

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6. BIS, March 2024. Christine Lagarde: Building confidence in the path ahead.

The PBoC's confidence boosters

With Chinese CPI 2% below Japan's and the authorities trying to deal with the aftermath of the property downturn, the People's Bank of China (PBoC) continued to ease monetary policy last quarter, reducing the benchmark five-year Loan Prime Rate by 0.25% and releasing long term liquidity into the market through a reduction in the Reserve Ratio Requirement. With widespread 'cash for clunkers' schemes, in which people are incentivised to swap their old consumer goods and cars for new, continued easing of house purchase restrictions and fiscal policy being kept loose through the issuance of 'special bonds,' the Chinese authorities are hoping to manage the fallout from the property bust by refocusing the economy and boosting confidence. These efforts were reflected in the State Council's relatively upbeat GDP outlook for this year, which was set at 'around 5%.' From an international perspective, no major economy has managed to solve a property crisis without the state bailing out lenders or borrowers – a so-called 'whatever it takes' moment. So far, this is the path China has chosen. With recent economic data releases picking up modestly, and financial markets turning more positive in the face of solid state support, perhaps this time will be different? Nonetheless, the Governor of the PBoC is clear: the bank will continue to support the economy and still has room to ease policy and so maintain its easing bias.

The BoE may surprise

Finally, in a strange twist of fate, having seen inflation rise faster and further than its counterparts, the Bank of England (BoE) may turn out to be the first major western central bank to hit its 2% inflation target, as the recent fall in the Office of Gas and Electricity Markets (OFGEM) price cap affects CPI this month. Beyond the mechanics of the price cap, there are now several signs that the labour market is turning, with vacancies falling sharply and wage expectations moderating. And with the economy experiencing a shallow recession and GDP per capita falling for two years, it was no surprise then that the most hawkish members of the Monetary Policy Committee have stood down from their call for further rate hikes. For the majority, the question has now changed to how long do they need to maintain their current stance and is there enough evidence to loosen policy? With a new round of economic forecasts being presented on 9 May, the odds of the Bank reducing rates before both the ECB and Fed should be higher.

Summary of high conviction asset class views

Defensive bonds

View as at	31 Mar 24	31 Dec 23	30 Sep 23
US	max positive	max positive	max positive
Euro zone	max positive	max positive	max positive
Japan	neutral	max negative	max negative
UK	positive	positive	neutral
China	negative	negative	negative

max positive · positive · neutral · negative · max negative

Positive: Australia, Germany, Korea, New Zealand, UK, US
Negative: China

Summary

With (a) central banks generally considered to be at the peak in their hiking cycles, (b) growth momentum slowing (particularly in Europe) and (c) breakeven inflation off its highs, we expect real yields and inflation premia to face downward pressure and hence have a maximum positive view on nominal bonds in the US and Europe. However, we prefer to express this positive duration view through regions that face structural challenges from higher rates but with limited fiscal concerns such as Germany, Australia, New Zealand and Korea. Given the higher sensitivity to interest rate cuts we have continued to shift our exposure shorter down the curve in Europe and Korea, where macro drivers are deteriorating quickly.

Growth bonds

View as at	31 Mar 24	31 Dec 23	30 Sep 23
EM HC	neutral	neutral	neutral
EM LC	negative	negative	negative

max positive · positive · neutral · negative · max negative

Positive: Brazil, Chile, Mexico, Peru

Negative: Peripheral spreads

Summary

The EM macro view has shifted to neutral given softening inflation and tight policy. Valuations, in respect of the compression in spreads relative to DM, have deteriorated. We favour those areas that have maintained nominal and real rate advantages to DM, as well as attractive carry dynamics, as these should continue to benefit from yield advantages to DM.

Credit

View as at	31 Mar 24	31 Dec 23	30 Sep 23
US IG	max negative	max negative	max negative
US HY	max negative	max negative	max negative
EU IG	max negative	max negative	max negative
EU HY	max negative	max negative	max negative

max positive · positive · neutral · negative · max negative

Positive: Asian HY

Summary

Credit spreads are increasingly rich across DM and EM asset classes. Earning weakness is beginning to become evident as negative operating leverage comes through. The asset class score remains at negative levels reflecting the challenging macro and technical dynamics. A reversal in policy or significantly stronger growth environment is required for a further tightening given narrow spreads across the asset classes.

FX

View as at	31 Mar 24	31 Dec 23	30 Sep 23
USD	neutral	neutral	neutral
EUR	max negative	max negative	negative
JPY	max positive	max positive	max positive
CNY	negative	neutral	neutral
EM	neutral	neutral	negative
Gold	neutral	neutral	neutral

max positive · positive · neutral · negative · max negative

Positive: Japanese yen, South African rand, Chilean peso, Turkish lira

Negative: Euro, Taiwanese dollar, Thai baht, Chinese renminbi, New Zealand dollar, British pound

Summary

While the outlook for the USD remains balanced and dependent on the broader macro environment, the ongoing strength and relative outperformance of the US economy means the dollar is likely to continue outperforming those that face more cyclical headwinds. The Chinese and Asian currencies in particular face continued negative data flow, further monetary easing, and depressed sentiment, and hence have been downgraded to negative. The EUR looks further challenged with the eurozone further diverging to the downside from other major regions as growth decelerates rapidly. As a result, the EUR is at maximum negative. Large upside asymmetry on the other hand exists in the JPY given its exposure to a broader global growth slowdown and potential dovish policy shift by central banks.

Regional equity

View as at	31 Mar 24	31 Dec 23	30 Sep 23
US	neutral	max negative	max negative
Europe ex-UK	max negative	max negative	max negative
UK	neutral	neutral	neutral
Japan	neutral	neutral	neutral
Asia ex-Japan	max positive	max positive	max positive
EM vs. DM	max positive	positive	positive

max positive · positive · neutral · negative · max negative

Positive: Asia ex Japan, Brazil, Mexico

Negative: Europe ex-UK

Summary

Asia has structural tailwinds and is beginning to see earnings dynamics trough as regulatory incursion lessens and macro policy becomes more supportive. 'Right tail' risks in US equities appear to have increased given the potential combination of easier monetary policy, robust growth and a dominant market narrative around AI and its world changing potential. Given a balanced growth outlook and tail risks in both directions we now take a neutral view on US equities. Europe ex-UK and UK continue to face additional structural headwinds and a weaker cyclical outlook as tight policy has caused a sharper slowdown in activity.

Asset heavy equity

Positive: Gold Miners, Metals and Miners, Semi-conductors

Negative: European Banks

Summary

The semiconductor sector has entered a cyclical recovery phase, supported by structural growth tailwinds from the artificial intelligence (AI) theme. Financials increasingly face headwinds from a deteriorating growth outlook and peaking rate environment particularly those in structurally challenging areas such as the eurozone. Opportunities are emerging within the resource sectors that benefit from structural tailwinds from the energy transition (steel, miners etc). There is limited value in other cyclical sectors which are anticipating a strong recovery in the manufacturing cycle.

Asset light equity

Summary

The richest opportunity set is to be found across areas which benefit from accelerating structural change in the technology and healthcare sectors. Valuations are demanding in some of these areas meaning that selectivity is required.

Stable return

Summary

Higher quality defensive sectors are attractive given the growth outlook. Valuations have become less stretched across key sectors such as real estate and utilities although margin pressures do remain.

Equity views

In the **US** we now have a neutral overall position, balancing structural strengths and current growth momentum against the downside risks from tighter for longer monetary policy and elevated valuations. The US cyclical outlook is more evenly balanced than current market pricing implies. Policy tightening has resulted in negative credit and fiscal impulses which pose downside risks in services, while there are signs of a trough emerging in manufacturing and residential investment which have seen downturns over the past 18 months. Alongside a reacceleration in US growth, signs of somewhat slower progress on disinflation have pushed back the timeline for US interest rate cuts. This has remained a difficult environment for smaller companies in the US which are on average more leveraged and have experienced a sharper cyclical downturn in profits than larger companies. This has taken small cap valuations to very attractive levels both in absolute and relative terms and we would expect **US Small Caps** to be the greatest beneficiaries of a soft-landing scenario where monetary policy is eased and economic growth slows but remains positive.

We maintain our negative view on **Europe ex-UK** equities given the weak growth outlook and expensive valuations. While some recent economic data in Europe has surprised positively, we do not yet see convincing evidence of a cyclical trough as the European manufacturing sector remains in a protracted downturn with volumes continuing to contract in the face of an ongoing inventory overhang. In our view, the downside risks in European equities remain greater than other regions because of structural challenges, tight monetary and liquidity conditions weighing on growth and persistent downgrades of overly optimistic earnings expectations.

We are neutral on other developed equity markets. Structural constraints in the **UK** economy are contributing to a weak outlook for growth while higher interest rates have put pressure on the housing market and highly leveraged households. As a result, inflation has fallen rapidly and there is now scope for the Bank of England to reduce interest rates earlier than previously expected. Earnings momentum remains weak, and valuations are not sufficiently attractive to offset the downside risks from an ongoing weak growth environment.

In **Japan**, exceptionally loose monetary policy and yen depreciation have been positives for outward-facing corporates, while the corporate governance reform programme has continued to invite international investor attention. With the recent Bank of Japan policy changes, a tightening cycle has begun as policy peaks in other markets, which is expected to lead to yen appreciation over time. Overall valuations of the Japanese market have returned to expensive levels and bottom-up opportunities are more limited.

We have a positive view on **Asia ex-Japan** equities. Growth momentum is positive in **Taiwan and Korea**, on the back of an upturn in technology and global trade cycles. In **China**, policy remains supportive, with a moderately positive fiscal impulse announced for this year. China's equity market should continue its cyclical recovery as policy conditions allow confidence and activity to gradually recover. Valuations and growth expectations are very depressed in the Chinese market which offers the potential for strong returns over time.

Overall, we remain positive on **emerging markets vs. developed markets** because of the balance of the regional views above and a positive view on Latin American equities. Economies including Brazil and Mexico have scope for substantial policy easing and are beneficiaries of adaptations in global trade patterns, with Mexico the primary beneficiary of nearshoring of production for the US market and Brazilian commodities exports growing strongly.

We have a positive view on the **semiconductor** sector as the clearest 'picks and shovels' beneficiary of the major investment cycle in Artificial Intelligence. Momentum has been exceptionally strong in the sector over the last 12 months, driven by the AI theme and anticipation of a cyclical upswing across the sector after a deep downturn in 2022-23, but we remain in the early stages of both this structural growth opportunity and the more typical semiconductor cycle. Positive revisions to sales and earnings expectations are expected to persist for some time after this initial turn in the cycle and delivery of underlying growth potential can result in a period of further strong returns from the current elevated level of valuations.

Equity views (cont)

We remain positive on the **metals and mining** sector. The medium-term demand outlook is supported by the energy transition and by growth in infrastructure investment. Valuations are attractive and Chinese demand has continued to exceed expectations, especially for iron ore.

We remain negative on **European financials**. The European economy looks increasingly credit constrained, credit growth has stalled and is expected to contract with limited opportunities for banks to expand new loans in a cyclical slowdown with interest rates at restrictive levels. Eurozone banks have rerated back to the top of their post-GFC price to book range, the net interest margin tailwind from higher rates is exhausted and banks have historically peaked with the final hike in the interest rate cycle.

Fixed income views

As discussed in the policy review chapter, central bankers have adopted a slightly more dovish tone and have indicated that rates may have peaked. However, they have not yet committed to reducing rates within a particular time frame and urge patience. The **US's Federal Reserve (Fed)** remains committed to ensuring that policy remains sufficiently restrictive for long enough to bring inflation back to target. The risk to the Fed is that rates may be on hold for longer in the face of strong economic and inflation momentum. The timing and size of cuts from here will be dependent on incoming data. The **European Central Bank (ECB)** has revised its inflation and growth forecasts down; falling wage growth is also encouraging for the ECB. If the data remains supportive, it is likely that the Bank will cut rates in June. The **Bank of Japan (BoJ)** is likely to continue shifting policy incrementally tighter. Meanwhile in **China** policy is being loosened to stimulate growth. The risk remains that this will not have a substantial impact on growth, possibly leading to a liquidity trap.

Government bonds

We remain maximum positive on **US** government bonds and are positive on real yields. The Federal Open Market Committee has indicated that policy is at a peak but has pushed back on providing exact timing of rate cuts, which remains data dependant. As previous tightening increasingly inhibits growth and inflation, we expect downward pressure on both nominal bonds and real yields which have both repriced notably higher.

We remain maximum positive on **European** government bonds given the rapid deterioration in economic data in the region as restrictive policy feeds through to the real economy. With inflation and the economy slowing markedly, the ECB is likely to reduce rates earlier than expected and hence we expect bond yields to fall going forward. As a result, we have moved incrementally more positive on shorter maturities which have a higher correlation with rate cuts. We remain positive on UK government bonds given increasing signs of disinflationary trends within the UK economy, domestic macro weakness and attractive valuations.

We have upgraded our position to neutral on **Japanese** government bonds given the repricing of the curve following the BoJ's recent move to end the era of negative interest rates.

We remain negative on **China** government bonds given the continued use of alternative policy easing measures as opposed to traditional monetary channels. We note the recent positive momentum, but maintain that valuations look challenging given the yield level is below both structural and cyclical valuations.

Credit

We maintain a maximum negative view on developed market credit given the potential impact on corporate earnings of prior policy tightening and subsequent increase in default risk. Neither of these outcomes are adequately compensated for by the level of spreads on credit instruments. Credit spreads are tighter versus the last quarter, and from these levels have historically offered poor risk-return relative to traditional government bonds. The resilience of the US economy to higher rates appears to be taking longer to play through than has historically been the case, however, lower quality businesses will have to prioritise interest payments and debt refinancing above growth and this may have knock-on impacts in credit markets. To become more positive on credit, without wider spreads, a quicker easing of central bank policy than currently expected, or a reacceleration in growth would be required.

Currency views

While the outlook for the **USD** remains balanced and dependent on the broader macro environment, the ongoing growth strength and relative outperformance of the US economy means the dollar is likely to continue outperforming those currencies that face more cyclical headwinds. The **Chinese yuan (CNY)** and broader Asian currencies **(Taiwan dollar and Thai baht)** in particular face ongoing negative data flow, further monetary easing, and depressed sentiment. While Chinese authorities continue to target currency stability, this is inconsistent with the ongoing deflationary forces and economic challenges the economy faces and hence, we believe currency depreciation is likely.

We remain maximum negative on the **euro**. Restrictive policy is now feeding into the real economy in the eurozone with growth momentum slowing rapidly. It appears unlikely that a recession will be avoided over the coming months given the extent of previous policy tightening. Recent ECB communication suggests the bank will ease rates in June. We have also initiated positions in USD vs. British pound (GBP) given the increasing evidence of emerging deflationary forces and potential dovish implications these may have on the Bank of England's policy outlook.

On the other hand, we remain maximum positive on the **Japanese yen** (JPY) given the pullback in valuation and its sensitivity to interest rate differentials. Our central case remains for a period of policy convergence between major central banks such as the Fed and ECB as they shift towards easing while the BoJ slowly normalises policy, which should provide a tailwind for the currency. The risk is that rate expectations are pushed out, particularly in the US, which may weigh on the currency.

We remain neutral on $ Bloc economies (Australian dollar, New Zealand dollar, Canadian dollar) overall and note that sentiment towards Chinese growth beneficiaries is increasingly depressed. However, we have re-engaged in certain positions that suffer from structural headwinds; particularly where they may also act as a hedge to our positive China view expressed in portfolios. Hence, we have maintained our position in short NZD vs. USD.

Commodity views

Strong oil market, but for how long?

The US$75-US$95 per barrel oil price band has become the 'new normal' for oil prices in the aftermath of the Russia/Ukraine crisis and the first cuts to Saudi supply in October 2022. Prices rallied substantially in Q1 2024 moving from the bottom of that range to US$90 per barrel, driven by a tightening in physical markets, an increase in speculative buying, and an elevated geopolitical risk premium. The OPEC supply cuts have been extended, while supply and shipping routes have been disrupted, and demand has been moderately higher than forecast. On a single day in early April, we saw 317,000 contracts traded on call options, dominated by calls in the high US$90s and at US$100 per barrel.

This was the heaviest volume since 2019, and equivalent to over 300 million barrels of crude oil, as traders hedged against an increase in Middle East tensions. However, as we have been saying for some time, there is now considerable OPEC spare production capacity on the sidelines, and we would not be surprised to see another strong year of US shale production. This would test Saudi Arabia's resolve as guardians of the market, and if they decide to reclaim market share and increase their own supply – as they very well might – then investors should prepare for lower oil prices.

Copper and gold break out as bulks settle

In a reverse of Q4 2023, base metals enjoyed a strong rally late in Q1 2024, led by copper as the fundamentals we discussed last quarter started to become evident. Supply constraints in copper, zinc and aluminium began to bite and the prolonged destocking in the US and Europe abated. Having said that, the reaction in prices has been swift with copper now up nearly 10% year-to-date, driven by excitement over potential power demand growth from AI data centres. For prices to push higher from here, physical indicators, such as premia and lead times, will need to show some real tightness. With PMIs starting to turn up and destocking seemingly coming to an end, this could happen in the next month or so, but it may take until after the summer holidays before it is clear.

Iron ore drifted back to just below US$100/t over the quarter as a slow restart for China's construction industry post Chinese New Year and good supplies from Australia and Brazil saw support rise to comfortable levels. However, with a significant amount of high-cost production in the market, the supply reaction under US$100/t was swift and prices have already recovered to US$105/t as mills' margins improve. We still expect prices to remain above US$100/t for most of the year supported by high-cost marginal supply which means the large low cost suppliers should continue to enjoy very strong margins and cash flow.

Gold broke out through its old nominal highs in early March and has continued to break records as it climbed to US$2350/oz recently. Central bank buying and Asian retail customers, from China and Japan, have been the big drivers as they look to hedge geopolitical risks and currencies. Silver also followed in recent weeks, though still far off its record high of close to US$50/oz. With prices in uncharted territory for gold, it is even harder to forecast where prices might go but, on the downside, the old record of US$2075/oz should provide a strong floor. If that is correct and gold is in a new range, then equity valuations look compelling as cash flows look set to jump after these latest rises.

Agriculture: forecasting brighter horizons

The outlook remains challenging in the near term for grain and oilseed markets. High inventories, especially in on-farm storage, have contained any price rallies over the last few months and we expect this to continue as growers need to destock to finance inputs for the new crop cycle and create space for that harvest. Demand is relatively healthy in the export markets for corn and soybeans although pockets of weakness still exist within livestock feed, especially cattle. Argentina is an interesting dynamic this year given potential liberalisation in export regulation and taxes which could increase soybean shipments into the export market. Overall, we expect a recovery in corn prices towards US$5 a bushel to happen via supply cuts, but this is only expected to manifest late this year or into 2025.

Commodity views (cont)

Protein markets continue to offer good investment opportunities in our view. In the land-based sector, poultry margins are strong because of better demand and cost deflation linked to feed and logistics. Within aquaculture, salmon prices continue to trade at or near record levels at NOK120 a kilogram on rising demand from China and the US, coupled with anaemic supply growth from all the key producer countries, notably Chile and Norway. Companies that manage biological challenges and costs the best are expected to earn higher margins and increase cash returns to shareholders.

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