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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 his cyclical growth view – one that encompasses a more benign view for US growth prospects, but where recession remains a risk. Sahil Mahtani examines the drivers behind the transition from a unipolar to multipolar world, and implications for investors. Russell Silberston outlines the latest central bank thinking and what this means 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 ending with commodities.

Contents

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.

Central banks navigate diverse paths

Iain Cunningham
Head of Multi-Asset Growth

Don't breathe out yet

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. Evidence of this continues to emerge with a broad-based moderation of economic activity in the last few months. While the US Federal Reserve (Fed) has backed away from rate cuts in recent quarters, the evolution of data releases is likely to allow the Bank to move towards cuts later this year, in our view. At the same time, fiscal policy in the US has remained loose and continues to support economic growth, which provides some risk to the US inflation outlook. This combination of prospective monetary policy loosening, ongoing fiscal support and improvement in some of the more rate-sensitive areas of the economy leads to our central scenario, which is for a soft landing in the US. In saying this, the risk of a recession remains elevated at present as past policy tightening continues to feed through.

Figure 1: US PMIs

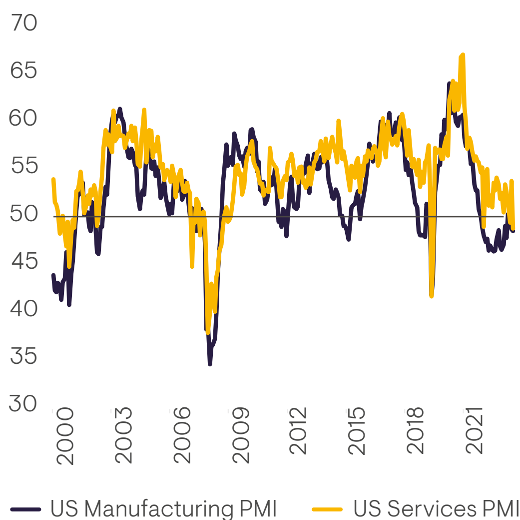
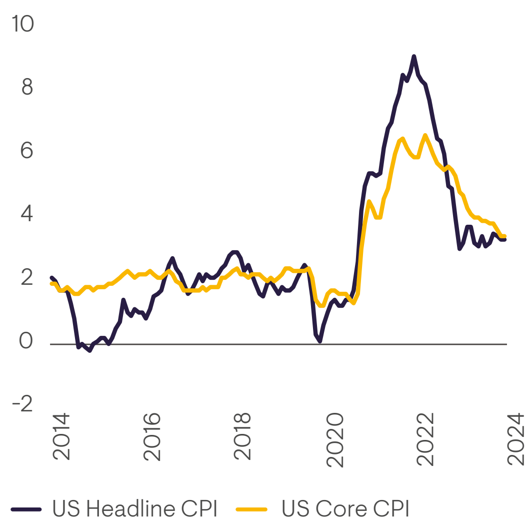


Figure 2: US inflation



Source: Ninety One, June 2024.

Euro inflation moderation

In Europe, monetary 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 despite some modest signs of improvement from a low base. We expect eurozone inflation to continue to moderate as energy price pressures abate. We see an elevated risk of a deflationary period in the eurozone and believe that the European Central Bank's (ECB) easing cycle will be more pronounced than that of the Fed.

Figure 3: Euro PMIs

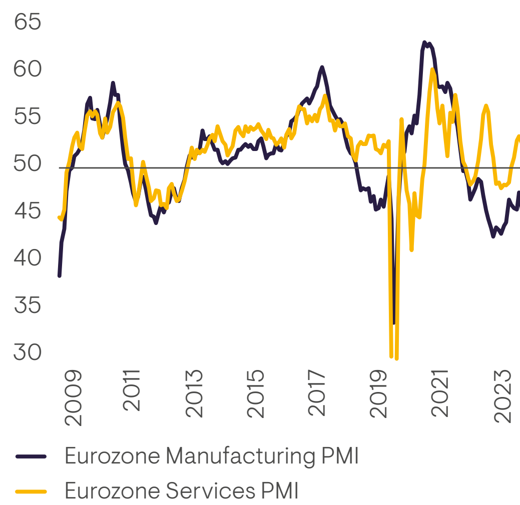
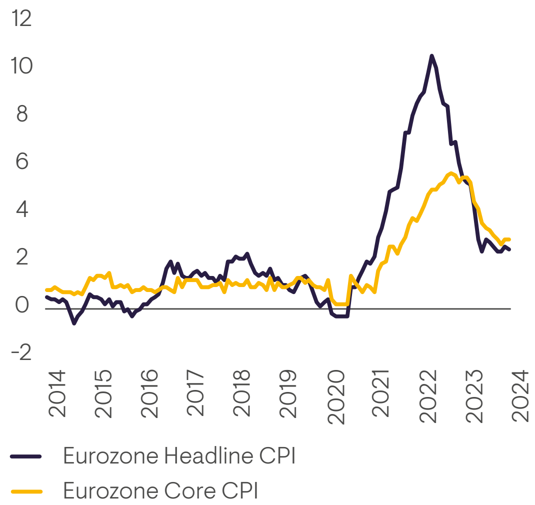


Figure 4: Euro inflation



Source: Ninety One, June 2024.

China's recovery remains bumpy

In China, policy appears loose, albeit without material easing taking place. Easing measures are, however, becoming progressively more forceful, with additional fiscal stimulus being implemented and strong efforts to clear excess housing inventory. This is being supported by funding conversions through the People's Bank of China (PBoC) into social housing. We expect policymakers to do what it takes to ensure that a sustained recovery takes hold. Growth metrics are mixed, and the recovery will be bumpy. 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 PMIs

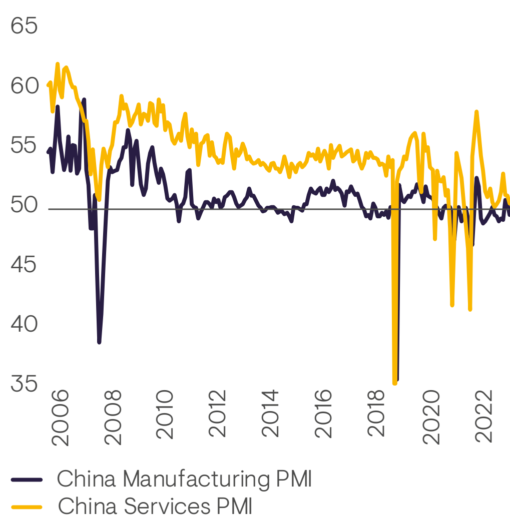
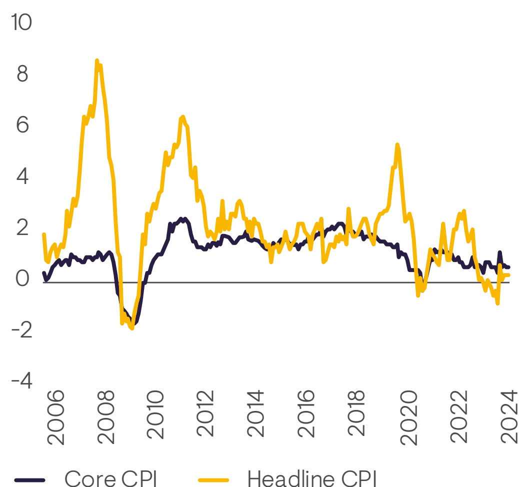


Figure 6: China inflation



Source: Ninety One, June 2024.

Looking ahead

Our central investment roadmap, as discussed above, leaves us more positive on the prospects for risk assets, particularly in Asia and the US. In fixed income, portfolio duration declined through the first half of this year post a strong rally in government bonds at the end of last year and due to an increased probability of a US soft landing. However, we maintain an overweight to defensive duration, particularly in Europe. In currency, we maintain a preference for the US dollar versus European and Asian currencies, as a diversifying portfolio position, given positive carry dynamics and our expectation that easing in these regions will be more pronounced than in the US.

Emerging markets in a multipolar world

Sahil Mahtani
Head of Macro Research
at the Investment Institute

The world order is undergoing a significant shift. The unipolar dominance of the past, characterised by the United States as the sole superpower, is transitioning to a multipolar world marked by various centres of economic, political, and military influence. This shift is being fuelled by the emergence of economies like China, India, and Brazil, which are asserting their independence on the international stage.

As these emerging powers pursue their national interests, new spheres of influence are forming, reshaping the global landscape, with profound implications for globalisation, economic policies, currency and commodity valuation, and geopolitics.

The transition to this multipolar landscape is being marked by increased geopolitical tensions, conflicts, and a more complex and fragmented global order. Simultaneously, an increasing number of countries, particularly in the so-called Global South, have chosen to remain non-aligned, unwilling to be pawns in a larger geopolitical game.

Power shifts, by their nature, create both volatility and opportunity. Countries that diversify their economies, build strong regional alliances, and can navigate between different global powers are likely to benefit. Conversely, those heavily reliant on a single economic partner or resource, or those isolated internationally, might face challenges.

Winners will also include those countries and markets that are geographically well-positioned to benefit from trends like nearshoring[1] or friendshoring[2]. For example, Mexico has benefitted as US companies build manufacturing operations nearer to home. Similarly, India has benefitted as companies like Apple, following the COVID-19-triggered supply chain crisis, has implemented a plan to ship 40% to 45% of iPhones from India, compared to a single-digit percentage in 2022[3]. These nearshoring and friendshoring strategies, aligned with companies' and countries' de-risking strategies, will reconfigure supply chains, as well as trade and investment flows, especially for strategic goods and services.

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1. Nearshoring: process of a company relocating business operations to a nearby country, often with a shared border.
2. Friendshoring: the rerouting of supply chains to countries perceived as politically and economically safe or low-risk, to avoid disruption to the flow of business.
3. Wall Street Journal, November 2022.

China’s rapid economic rise over the past two decades has been a key catalyst in reshaping global trade and investment landscapes. Once a peripheral player, China now rivals the US in terms of industrial production and trade. Moreover, China, along with powerful peers like India, is willing to leverage its economic power to achieve outcomes that serve its own interests. For instance, the Chinese government’s aggressive support of its electric vehicle industry and India’s purchases of cheap Russian oil exemplify this strategic manoeuvring.

Strategies to reduce dependency on distant markets or mitigate geopolitical risks are also driven by political pressures for supply chain independence in critical sectors like semiconductors.

Emerging markets are well positioned to capitalise on these shifts. The last decade has seen emerging economies significantly improve institutional frameworks and build fiscal sustainability. At the corporate level, companies have pushed for higher standards of performance and governance which has led to the rise of EM companies that are global leaders in their industries, as discussed in this EM paper. Progress has not been uniform across all countries and companies, but the cumulative impact of these reforms is undeniable.

Countries from Morocco to Vietnam to Mexico are positioning themselves to capitalise on these shifts. European businesses, frustrated by supply-chain disruptions from the Russian invasion of Ukraine, post COVID bottlenecks in Asia, and challenges in the Suez Canal are turning towards Romania, Turkey and Morocco as production alternatives. Since the signing of the US-Vietnam Comprehensive Strategic Partnership in 2022, Vietnam has attracted numerous manufacturing projects. The agreement recognises Vietnam’s potential to build resilient semiconductor supply chains, enabling the US to expand capacity in reliable partners where re-shoring to the US is not feasible. Mexico is also emerging as a key player and an attractive alternative for US companies looking to cut costs and reduce reliance on China. These countries have skilled labour forces and labour costs that are lower or competitive with those in China.

The seeds of change were planted long ago. As emerging economies have strengthened, their share of international trade has steadily increased. Much of this growth stems not from trade between developed and emerging economies (although that has grown too), but among developing countries themselves. According to the WTO, trade between developing economies expanded at an annual rate of 9.7%, rising from less than a tenth of global trade in 1995 to nearly 25% by 2022, reaching a total value of US$ 6.1 trillion. This trend is evident across emerging markets, but the real story lies in Asia. When combining the Association of Southeast Asian Nations (ASEAN) with Japan, China and South Korea, Asia is already more integrated than the EU. ASEAN imports from China are already larger than US imports and this figure is projected to increase sharply by 2030.

The region is poised to see considerably more trade with China, the US, Japan, and the EU, driven by companies' desires to diversify global supply chains amid growing geopolitical tensions. Attracted by the region's lower costs and its expanding manufacturing capabilities[4], companies will foster closer economic cooperation. This, in turn, will enhance economic resilience and diversification for participating EMs.

It's not just geo-economic multipolarity that's accelerating; financial multipolarity is also on the rise. According to OMFIF, an independent think tank for central banking and economic policy, central banks in sub-Saharan Africa and the Asia Pacific region are now more inclined to increase their renminbi (RMB) holdings than their European counterparts. This makes sense since for the most part China is disproportionately their largest trading partner. In addition, these regions are less inclined to maintain the unipolar status quo. It is likely that over the next decade, central banks with stronger economic or political ties with China may gradually reduce their reliance on the US dollar and allocate more of their reserves to the RMB. However, this doesn't imply an imminent overthrow of the US dollar as the dominant reserve currency[5].

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4. Protectionism, Pandemic, War, and the Future of Trade - BCG.
5. Friendshoring gaining traction in central bank reserves - OMFIF.

The new global landscape and its implications

The evolving multipolar world presents distinct opportunities for emerging market countries able to position themselves to take advantage of geopolitical and geoeconomic trends. Will this translate into opportunities for investors? We believe it does.

Longer-term global economic momentum is shifting from advanced western economies towards emerging markets, as detailed above and here.

Emerging markets are constituting a larger share of economic activity with GDP per capita rising faster across many emerging markets than developed markets. Our research suggests that emerging market growth will probably exceed developed market growth for many decades to come, a critical finding given the connection between nominal GDP growth and company revenue growth.

Emerging market equity and fixed income market capitalisations as a share of global assets have risen, even during the last difficult decade.

Global macro-economic trends, such as the shift towards a capex supercycle and the rise of multipolarity are tailwinds in this regard.

These trends are likely to lead to a shift in market leadership, creating an environment that will ultimately create opportunities for the flexible and dynamic manager.

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4. Protectionism, Pandemic, War, and the Future of Trade | BCG.
5. Friendshoring gaining traction in central bank reserves - OMFIF.

Different tactics for different games

Russell Silberston
Investment Strategist

US Fed: Gaining greater confidence?

Last quarter, we stated that following disappointing US inflation releases early in 2024, the US Federal Reserve (Fed) was in no rush to cut interest rates. However, with the economy likely to slow as the year progressed, two to three cuts were still likely. This view remains reasonable, though only five Federal Open Market Committee (FOMC) meetings are left this year, one of which is two days after the November election. To start an easing cycle, policymakers need 'greater confidence that inflation is moving sustainably toward 2 percent[6].' Recent inflation releases support this view, but after the bump in the first quarter, the Fed will want to see a firm trend before cutting rates. The US economy is showing signs of slowing, with unemployment rising by 0.4% this year and 0.7% since the cyclical low in January 2023. With the unemployment-to-vacancy ratio having normalised after COVID-19, further labour market weakness will likely increase unemployment.

At this turning point, the Fed faces a wider range of possible economic outcomes, presenting policymakers with a communication challenge as their Summary of Economic Projections (SEP) is often seen by market participants as a promise of action. The SEP provides a snapshot of interest rate projections based on participants, economic views at the time. Mary Daly, President of the San Francisco Fed summed it up best when she said they "have two goals, one tool, and a lot of uncertainty. So, being definitive and predetermined is not that helpful." Thus, recent Fed communications emphasised that monetary policy decisions are 'conditional on the evolution of the economy rather than being on a preset path.' With the economy now showing more definitive signs of slowing and monetary policy restrictive, our next policy review is highly likely to declare the US easing cycle has begun.

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6. US Fed FOMC statement.

ECB: Kicks for touch

As widely expected, the European Central Bank delivered its first interest rate cut in this cycle in June, based on its latest analysis which pointed toward slow but steady disinflation in the months ahead. Like their US counterparts, the Governing Council is cautious and wants to ensure that a full reversal of the inflation surge is secured quickly and sustainably. The Bank wants data that consistently confirms a disinflationary path, relying on the quarterly Staff Macroeconomic Projections for reassurance. The key inputs into this analysis include those slow-moving factors that could keep persistent elements of inflation relatively high such as wages, company margins and productivity. Given these inputs are only released quarterly, it seems unlikely that the Governing Council would implement a speedy rate reversal outside of major economic stress. With the next staff forecast published in September, another 0.25% reduction seems likely, and if the economy continues to track expectations, a further reduction should be seen before year end.

BoJ: Holds the line

After ending negative interest rates earlier this year, the Bank of Japan (BoJ) sat on its hands this quarter despite signs that the era of disinflation has ended. However, with interest rates (just about) in positive territory again, the Bank is attempting to reduce its substantial footprint in the government bond market, announcing in June that it will reduce its regular buying of Japanese Government Bonds (JGB) 'by a reasonable scale' this month. This, in effect, is quantitative tightening, with Governor Ueda stating that "as we reduce our JGB purchases going forward, the Bank's outstanding holdings of JGBs will decrease as they mature." Looking ahead, the Bank aims to raise interest rates toward a neutral level, stating at its April meeting it would expect to achieve this in the second half of the forecast period if inflation aligns with expectations. With an exceptionally weak currency and solid wage increases, there can be little doubt these expectations will be met. The second half of the forecast period starts in March 2025 and the Bank estimates the neutral rate to be between 1% and 2.5%. Currently, markets are only pricing short rates at 0.5% in 12 months' time. If the BoJ's view is correct, and they follow through, short-dated Japanese yields have a lot further to rise.

PBoC: A flexible approach to an intractable problem

China continues to grapple with the aftermath of the housing market slowdown, with inflation close to zero and consumer caution evident in many indicators. The People's Bank of China (PBoC) has maintained loose monetary policy, guided by the ruling Politburo to use interest rates flexibly and to inject long-term liquidity into the market by cutting banks' reserve ratio requirements. This flexibility includes subsidised lending rates for policy and commercial banks to support State-Owned Enterprises in purchasing unsold homes. On the demand side, property buying restrictions are being rolled back, with reduced down payments and lower mortgage rate floors.

In June, Governor Pan made a rare speech, outlining the PBoC's future monetary policy, which sees it adopting a corridor system for liquidity, with tighter upper and lower interest rate bands than the Bank has implemented historically. The Bank is also shifting away from targeting the quantity of money in the economy, likely in response to a post-bust focus on the quality of lending, not the quantity. With western central banks adopting an easing bias, the Governor indicated that this would allow the PBoC to loosen policy further in the months ahead. Finally, the Bank has committed to increase its activity in the government bond market. It will sell bonds when it perceives yields as too low, potentially undermining financial stability and buy bonds as necessary to increase base money. This approach resembles quantitative easing, although the scale of these interventions remains unclear at present.

BoE: On target

As expected, the Bank of England became the first major western central bank to hit its 2% inflation target, prompting a shift towards more dovish communication. At June's Monetary Policy Committee (MPC) meeting, the decision to keep Bank Rate unchanged was 'finely balanced.' Although July's election prompted a communication black-out from the Bank, MPC members had told us that the August forecast round will assess whether the risks of persistent inflation are still diminishing. Depending on this assessment, they will review the duration of the current rate level. On this basis, a rate cut looks likely. Given the tightness of monetary policy and the lacklustre economy, we expect the Bank to initiate an easing cycle that exceeds current market expectations.

Summary of high conviction asset class views

Defensive bonds

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

max positive · positive · neutral · negative · max negative

Positive: Australia, Czech Republic, New Zealand, UK

Summary

While central banks are generally considered to be at the peak in their hiking cycles, there are emerging risks that growth momentum is stabilising, supported by easing financial conditions which lowers the impetus for aggressive cutting cycles in the short term. We have moderated developed market duration positions and our conviction in broader duration exposure. Within portfolios we still prefer to take exposure in areas such as the $bloc which have repriced significantly above medium-term fair value and remain attractive in light of structural challenges and areas such as the UK where market pricing appears disconnected from underlying fundamental momentum.

Growth bonds

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

max positive · positive · neutral · negative · max negative

Positive: Brazil

Negative: Peripheral spreads

Summary

The EM macro score has become more supportive as inflation pressures abated after aggressive hiking cycles across most regions. Our quality scores continue to be inhibited by weak institutional strength scores which have been eroded by the high inflation period and deteriorating fiscal scores. Valuations remain attractive across the board, in particular real interest rates on a relative basis. We are neutral the asset class but favour those areas that have 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	30 Jun 24	31 Mar 24	31 Dec 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 remain rich, particularly in EM credit which has seen significant inflows. Earnings weakness is becoming evident due to negative operating leverage. Layoffs are extending beyond the tech megacaps. The technical backdrop has improved with strong flows across asset classes and a more favourable issuance environment. Despite the weak macroeconomic conditions, deteriorating valuations have led to a maximum negative downgrade from DM credit spreads.

FX

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

max positive | positive | neutral | negative | max negative

Positive: Norwegian krone, Turkish lira, Polish zloty, Colombian peso
Negative: Chinese renminbi, Czech koruna, Swedish krona, British pound, New Zealand dollar

Summary

There is little evidence of potential policy divergence between the major regions at this juncture with the Federal Reserve and ECB both looking to ease policy over the coming quarters adding uncertainty to the performance of major currencies in the near term. While we maintain a positive view on the USD given structural support and greater persistent inflation risks, we have reduced our long USD exposure and prefer to express any remaining exposure against the Chinese renminbi given the continued easing from Chinese authorities and the depreciation pressure this is likely to put on the currency, particularly given the deflationary environment and small open economies such as the Czech koruna and British pound where markets are underpricing the potential for further easing from domestic central banks given weak fundamentals.

Regional equity

View as at	30 Jun 24	31 Mar 24	31 Dec 23
US	neutral	neutral	max negative
Europe ex-UK	neutral	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	max positive	positive

max positive · positive · neutral · negative · max negative

Positive: Asia ex Japan, EM vs. DM, Brazil, Mexico

Summary

The Asian region 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 maintain our neutral view on US equities. While Europe ex-UK and UK continue to face additional structural headwinds the cyclical outlook has improved with a stabilization in economic momentum supported by central banks moving towards easing policy.

Asset heavy equity

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

Summary

The semiconductor sector has entered a cyclical recovery phase, additionally supported by structural growth tailwinds from the artificial intelligence (AI) theme. While financials are expected to face headwinds to net interest margins from lower interest rates, the easing in financial and credit conditions adds upside risks to credit growth and a more balanced outlook for the sector. 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 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 increasingly interesting as valuations have reset significantly, but higher cost of capital remains a headwind and fundamental momentum remains weak across several of sub-sectors.

Equity views

In the **US** we maintain our neutral overall position given the risks to the outlook for the region. While growth momentum is slowing, evidenced by orders rolling over sharply and inventories climbing, there remains ongoing support from US fiscal policy and strong consumer and corporate balance sheets. The shift in the Federal Reserve outlook towards potential easing at a time when nominal growth rates remain attractive, increases the chance of a soft landing being achieved. 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 have upgraded our outlook on **Europe ex-UK** equities to neutral given an improvement in forward-looking growth indicators. While structural challenges exist in the eurozone the headwinds from the energy price shock, the confidence impact of the Russia/Ukraine war and drag on manufacturing from weak external demand are all waning. With an easing cycle now underway and an economy that is highly sensitive to interest rates, the upside risks to growth are increasing at the margin despite absolute policy remaining restrictive and the outlook appears more balanced overall.

We maintain our neutral view on the **UK**. While growth signals have been positive, these are largely due to faster-moving surveys and soft data. Hard data has not shown a similar pickup, leaving it uncertain whether a more dynamic and broad-based recovery will take hold. The labour market appears to be weakening more quickly than in other markets, introducing new downside risks to growth. The Bank of England is close to initiating a rate-cutting cycle, which could impact the rate-sensitive UK economy. Price and earnings momentum have improved in absolute terms, although relative performance remains low. Stock and sector performance suggests somewhat better expectations for most cyclical parts of the UK economy.

We remain neutral on **Japanese equities** where growth momentum has turned positive, supporting corporate earnings. While the Bank of Japan has been clear that monetary policy normalisation will be cautious and data-dependent, the tightening cycle has begun as policy peaks in other markets. This is expected to lead to yen appreciation over time. Valuations of the Japanese market are moving from expensive levels towards neutral, providing opportunities for the bottom-up investor.

We remain positive 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 are neutral on **emerging markets vs. developed markets**. EM has firmer growth momentum and less expensive valuations, but weaker inflation and price inflation. Economies such as Brazil have scope for substantial policy easing and are beneficiaries of adaptations in global trade patterns, while Mexico is the primary beneficiary of nearshoring of production for the US market. Valuations in South Africa are attractive and are supported by growth momentum, but earnings delivery remains in question.

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 driven by the AI theme but we remain in the early stages of this structural growth opportunity. The delivery of underlying growth potential can result in a period of further strong returns from the current elevated level of valuations. 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.

Fixed income views

As discussed in the policy review chapter, central bankers have maintained their dovish tone and have indicated that rates may have peaked. However, while committed to reducing rates they have not committed to reducing rates within a particular time frame and insist this will be data dependant. The view remains that rate cuts are a means of reducing policy tightness rather than explicitly making conditions easier.

The **US's Federal Reserve (Fed)** is committed to ensuring that policy remains sufficiently restrictive for long enough to bring inflation back to target. Recent data suggests inflation is slowing, however risks to this outlook include continued strength in the labour market, sticky inflation on the supply side and easier borrowing. The timing and size of cuts remains dependent on incoming data. The **European Central Bank (ECB)** cut rates at its last meeting in June, noting that conditions warranted a loosening of policy. However, the Bank remains cautious about further rate cuts until a disinflationary trend has been firmly established. The **Bank of Japan (BoJ)** is increasingly confident that wages and inflation are reaching their target and 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 maintain a neutral outlook for **US** government bonds. While policymakers continue to suggest that policy is at a peak, the strength in the underlying economy and upside risks from ongoing fiscal spending, investment and immigration suggests that there is a chance cuts may be pushed out further. Given current valuations we don't assess that these risks are appropriately compensated for at these yield levels and hence remain neutral on the asset class.

We remain positive on **European** government bonds given the deterioration in economic data in the region as restrictive policy feeds through to the real economy. While there has been some stabilisation in data in the short-term it is not yet clear that the conditions have been met for a sustained reacceleration and on balance, given the headwind restrictive policy is expected to continue placing on growth and inflation, bond yields are expected to fall going forward. We similarly remain positive on UK government bonds given increasing signs of disinflationary trends within the UK economy, domestic macro weakness and attractive valuations. 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 is adequately compensated for by the level of spreads on credit instruments. Credit spreads remain tight across asset classes, 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

We have moved neutral in terms of our outlook for major currencies **(USD, EUR and JPY)** given a lack of conviction on potential future policy divergence among central banks. The stabilisation in European data at a time when there is increased evidence of slowing growth in the US has ended the period of US outperformance and cyclical support of the USD on a broad basis. While the ECB embarked on its easing cycle in June, this slowing in US growth and somewhat better progress on inflation is also expected to allow the Fed to ease soon and adds uncertainty to relative currency performance. Within the euro bloc we have maintained our negative view on the **British pound (GBP)** given the evidence of emerging deflationary forces and potential dovish implications these may have on the Bank of England's (BoE) policy outlook. We have a preference for inter-bloc positions between currencies where domestic central banks are facing persistent inflationary pressures and those where further easing is likely given weak fundamentals. These include the Polish zloty (PLN) vs. Czech koruna (CZK) and Norwegian krona (NOK) vs. Swedish krona (SEK).

We have also downgraded our outlook for the **Japanese yen (JPY)** to neutral given increasing evidence that the Bank of Japan remains behind the curve in terms of its policy-setting relative to underlying fundamentals. While valuations are highly attractive for the JPY, with growth risks globally looking more supportive as central banks look to ease, there are risks that the JPY continues to face depreciation pressure outside of a further material deceleration in global growth.

The **Chinese yuan (CNY)** faces ongoing negative data flow, further monetary easing, and depressed sentiment and hence we maintain our negative outlook. Chinese authorities are expected to maintain this current stable depreciation path to support sentiment and hence positions in USD vs. CNY provide attractive hedge positions in a portfolio context for broader Asian risk exposure.

We remain neutral on $ Bloc economies (AUD, NZD, CAD) overall and note that sentiment towards Chinese growth beneficiaries remains depressed. However, we have re-engaged in certain positions such as USD vs. NZD, that suffer from structural headwinds; particularly where they may also act as a hedge to our positive China view expressed in portfolios.

Commodity views

Energy

The demand outlook is currently mixed. China, a key driver of demand growth over the last decade, is experiencing slower economic growth, reducing its need for crude oil imports. On the supply side, we've noted considerable OPEC spare production capacity. Additionally, production growth in US shale and new projects in Canada, Brazil and Guyana are expected to lead to a weaker period as we move into 2025. According to the latest IEA report, oil demand is projected to peak by 2030, creating a bearish medium- to long-term outlook. While we believe demand may remain resilient in the long term, our short-term concerns are reflected in our continued underweight position in the energy sector.

Metals settle at higher levels and prospects look bright

After spiking to nearly US$10900/t, driven by a squeeze on Comex in mid-May, copper settled back to mid-US$9000s/t as concerns over Chinese demand persist. A buyers' strike in China due to high prices and a pickup in scrap supply have tempered prices for now, with the true strength of demand likely becoming more evident by the end of summer. The diversion of material to the USA because of the Comex squeeze is likely to distort trade data over the next month, adding to the uncertainty.

Other base metals also rallied through Q2. Zinc performed well, supported by earlier production cuts, while aluminium faced significant disruption to alumina supplies, likely supporting prices in H2. Overall, we believe that base metals will trade stronger in H2 as industrial production accelerates following the end of destocking. The main downside risk is that Chinese demand disappoints but the Government seems committed to preventing a major downturn.

Iron ore has remained above US$100/t as forecast, and we see prices staying at current levels through the rest of the year.

Coking coal has picked up due to fires in Australia and the US which have removed over one percent of global seaborne supply but thermal coal continues to drift downwards as supply remains good.

Gold prices have held above US$2300/oz, while silver is consolidating its March/April gains at around US$30/oz. We remain bullish on both metals, particularly with the increased likelihood of a Republican victory in the US presidential race and a possible rate cut in September. Central bank buying continues, despite China pausing purchases in Q2. The prospect of ETF buying resuming alongside the start of rate cutting gives us confidence that prices are likely to rise in the second half of the year.

Agriculture: a mixed bag

The outlook remains challenging for grain and oilseed markets in the short term. US corn and soy crops are developing well post-planting, with yield estimates rising. The June survey showed a surprising increase in planted area, putting pressure on old and new crop futures. In a period of elevated inventories, especially in on-farm storage, price rallies in the coming months should remain contained as growers need to destock and create space for the new crop harvest in the Northern Hemisphere autumn. Demand in exports markets for corn and soybeans is relatively healthy, with livestock feed demand also improving. Overall, we still expect a recovery in corn prices towards US$5 a bushel, driven by supply cuts, but this might only manifest in 2025.

Protein markets continue to offer differentiated investment opportunities in our view. Brazilian poultry margins are very strong due to cost deflation and strong product pricing, while salmon prices should strengthen again over the rest of the year, after a correction from NOK120 a kilogram. Strong Chinese and US demand, coupled with limited supply growth should provide support. Finally, Chinese pork markets are gradually improving after a multi-year period of structural oversupply.

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