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Investing for a
world of change

Multi-Asset Strategy Quarterly

October 2024

Foreword

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Welcome to our latest Multi-Asset Strategy Quarterly. In this edition, Iain Cunningham outlines the Multi-Asset Growth team's cyclical growth view, and explains why, despite the mixed outlook for growth, the outlook for risk assets is currently constructive. Sahil Mahtani takes a closer look at AI capex spending and wonders whether the surge in capital expenditure is justified; and Russell Silberston outlines central banks' gradual moves towards policy easing.

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.

Global growth signals are mixed

Iain Cunningham
Head of Multi-Asset Growth

US hopes for a soft landing

In the US, monetary policy is tight, and a broad-based moderation of economic activity continues. As a result, the US Federal Reserve (Fed) has begun to cut interest rates and signalled limited tolerance for further deterioration in the US labour market. Financial markets have remained volatile as investors weigh the prospect of a more pronounced slowdown and the Fed being 'behind the curve' against the prospect of a soft landing coupled with the stimulus of rate cuts and easing financial conditions. Fiscal policy in the US has remained loose and continues to support economic growth, and the election in November will likely increase uncertainty and therefore financial market volatility. In our view, the risk of a more pronounced slowdown is elevated, but the prospect of monetary policy easing, ongoing fiscal support and a still relatively robust growth picture leads us to view a soft landing as the central scenario for the US at present.

Eurozone growth likely to disappoint

In Europe, we believe policy is tight and the lags have been shorter than in the US due to less pandemic stimulus, higher levels of floating rate debt and less fiscal support. Growth indicators are weak, below trend, and close to recession in some countries, while shorter-term measures of inflation are now in line with the European Central Bank's (ECB) target. We expect eurozone growth to remain weak for the time being and for inflation to continue to moderate as energy price pressures abate. We believe that the ECB's easing cycle will ultimately prove to be more pronounced than the Fed's given structural headwinds in the eurozone against tailwinds in the US.

China recovery hangs in the balance

In China, policy appears loose albeit without material easing taking place. Easing measures are however becoming more forceful, with a broad swathe of new measures announced over the past month, causing a material rally in Chinese and Hong Kong equity markets. We expect policymakers to do what it takes to ensure that a sustained recovery takes hold. Growth metrics remain mixed, and the recovery will remain 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.

Looking ahead

Our central investment roadmap, as discussed above, leaves us somewhat more constructive on the prospect for risk assets, particularly in Asia and the US. In fixed income, a healthy exposure to defensive government bonds remains, given the elevated risk of recession. This also provides dry powder to put to work should we see episodes of volatility in the coming six months. 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.

Debating AI capex trajectories

Sahil Mahtani
Head of Macro Research
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This article is based on research presented by equity specialists William Nott, Paul Vincent, Anton du Plooy and Niall Hartnett at a recent Ninety One thematic meeting.

With hundreds of billions in capital expenditure flowing into data centres, investors naturally want to know if the spending will pay off. Venture capital firm Sequoia recently called this a US$600 billion question, referring to the gap between fast-growing AI capex and the less certain AI revenue stream that will be generated from it. But at the pace that AI capex is rising, this could easily be framed as a US$1 trillion problem. The key questions are: Will investments in AI models pay off? What valuations are the current AI leaders discounting? What scenarios might accommodate different implied valuations.

The evolution of technology investment

To assess whether the surge in capital expenditure is justified, we should consider that this isn't the first rodeo for large capex cycles driven by innovative technology. New technology tipping points have frequently been preceded by a multi-year capex buildout. In the late 1990s and early 2000s, a significant capex cycle focused on building fibre optic networks, creating the capacity that later fuelled the explosive growth in internet services, smartphones, and cloud computing from the late 2000s onwards.

Similarly, the mainframe computing era that began in the 1960s required significant capital expenditure, not just on centralised computer systems to control and process data, but also on supporting infrastructure like data centres, air conditioning, generators, and power systems. In each of these cases, early adopters thrived, while others lagged, unwilling to cannibalise their existing businesses - a concept famously captured in The Innovator's Dilemma[1].

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1. The Innovator's Dilemma, introduced by Clayton Christensen in his 1997 book of the same name, explains how companies can fail by focusing on existing customers and products, allowing disruptive innovations to overtake them in the long run.

Nvidia: is the growth sustainable?

Nvidia embodies the questions around AI most clearly, having achieved remarkable growth over the past decade. Its growth, divided into two clear phases, is illustrative:

From 2015 to 2020, Nvidia rode the first major AI wave, capturing 90% of the AI accelerator market in data centres as deep learning took off. During this time, its revenue jumped nearly tenfold, driven by tech giants investing heavily in data centres. By 2020, Nvidia's AI accelerator revenue hit US$3 billion—impressive, but still a small part of the data centre market.

Since 2020, Nvidia's data centre revenue has exploded, growing more than 35 times as demand for AI infrastructure surged post-pandemic. This shift has transformed Nvidia into the biggest player in the US$100 billion data centre space.

Given the incredible pace of Nvidia's growth, the question arises: is this momentum sustainable, or a sign of market exuberance.

Different capex estimates — who is right?

Nvidia's place in the server market has grown as AI-related capital expenditures increased. By fiscal 2025, the company's revenue is projected to reach US$110 billion - a figure driven largely by explosive AI adoption. Once a small component of data centre investments, graphics processing units (GPUs) have become crucial with the rise of AI workloads, tripling in data centre share since the pre-ChatGPT era.

Consensus projections[2] imply that Nvidia's data centre revenue could outstrip the total addressable market (TAM) for data centre infrastructure. Based on Nvidia's consensus numbers, AI infrastructure spending is projected to reach US$516 billion by 2027, while hyperscalers like Microsoft, Google, Meta, and AWS are expected to generate only US$245 billion by the same year.

There are therefore three scenarios: a) both those numbers are right, and there is a good deal of capex to come from non-hyperscaler firms, implying a major broadening out of capex from beyond the tech giants and much greater fragmentation; or b) the Nvidia consensus numbers are wrong, with implications for Nvidia's share price or; c) the hyperscaler consensus capex numbers are too low, with implications for capex/sales ratios, and potentially earnings as well, for the hyperscalers.

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No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided.
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This is not a buy, sell or hold recommendation for any particular security.

2. www.visiblealpha.com.

For the capex figures implied by Nvidia's projections to be realised, hyperscalers will need to generate revenue or savings of US$600 billion to US$700 billion. To achieve this, their customers must see tangible benefits from AI. A recent example is Swedish payments company Klarna, one of the most progressive adopters of AI. AI assistants now handle two-thirds of Klarna's customer service chats, performing the work equivalent to 700 full-time agents, with customer satisfaction scores matching those of human agents. If other companies can harness AI as effectively as Klarna, the US$600 billion challenge may soon resolve itself.

Infrastructure is key

The AI stack provides a framework to understand where capital is flowing within the technology sector. This stack includes three primary layers:

- **Infrastructure layer:** This attracts the most investment and includes the physical and cloud infrastructure that powers AI. Companies like Nvidia, with strong AI hardware positions, are experiencing outsized gains as they meet the computational demands of AI. Companies focused on data centres, GPUs, and other infrastructure components could capture significant investment interest.
- **Software layer:** Perhaps the most variable and dynamic area, software is where much of the alpha will be won or lost. Companies focused on AI software, like natural language processing, autonomous systems, and predictive analytics, will face intense competition and opportunity. Success here depends on their ability to deliver solutions that drive efficiencies for end-users across sectors.
- **Application layer:** This layer includes the diverse AI-driven applications transforming industries from healthcare and finance to logistics and retail, with potential winners and losers emerging as AI adoption continues. As this layer matures, investors could see more specialised plays rather than broad technology bets.

Judging by the numbers implied in the capex estimates earlier, this technology boom is likely to have higher capital spending and revenues in the infrastructure layer. In other words, the share of the pie taken by companies in the AI boom is likely to be larger than in the software boom of the 2010s.

Ripple effects across industries

The transformative potential of AI is not confined to technology firms alone. As AI expands, so do its implications for other industries, especially those linked to the growing need for data centres and the associated energy demands. Here are a few areas outside of tech that may offer unique investment opportunities:

Energy: The energy-guzzling requirements of AI-focused data centres are creating an urgent need for clean energy solutions. This has implications for utility providers, renewable energy companies, and even traditional energy firms working on efficiency technologies. As big tech firms strive for sustainable data centre operations, energy companies that offer scalable and renewable solutions are likely to benefit.

Industrials: Companies involved in the construction and maintenance of data centres, from real estate to specialised materials, could benefit. The expansion of data centres is fueling demand for industrial equipment, energy-efficient heating, ventilation, and air conditioning (HVAC) systems, and other infrastructure-related products.

Utilities: With big tech firms rapidly building new data centres, utility providers face increased demand for reliable energy and water sources. Companies that can meet these needs sustainably will be particularly attractive, as they align with the green mandates of tech firms and regulatory requirements.

Conclusion

The outlook for AI capital expenditure varies widely, reflecting the challenges of forecasting AI-related spending. What is clear, however, is that the infrastructure layer will remain central to investment and revenue generation. This marks a shift from past tech cycles, with a greater share of economic value likely to be captured by companies focused on infrastructure rather than purely on software.

Moreover, AI investment is expected to extend beyond the technology sector. Industries such as energy, industrials, and utilities are set to see increased spending as AI adoption spreads, creating a broader and more diverse impact. This expansion signals the deeper integration of AI technologies across the global economy.

Global easing is upon us

Russell Silberston
Investment Strategist

The Fed signals confidence

We closed last quarter's US policy commentary by stating that '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.' But the size of the recent reduction in US rates was more aggressive than most, including us, expected three months ago. The 0.5% reduction reflected the US Federal Reserve's (Fed) 'growing confidence that, with an appropriate recalibration of our policy stance, strength in the labour market can be maintained in a context of moderate growth and inflation moving sustainably down to 2 percent[3].' In other words, with a dual mandate that promotes both maximum employment and stable prices, the rebalancing of labour supply back to demand that we have seen over the past twelve months, alongside the notable decline in inflation over the past four months, opened the window for the Fed to shift monetary policy back towards a less restrictive level. These actions clearly illustrate how the Fed differs from a pure inflation targeting central bank, as a strong labour market, and by implication, solid economic growth, is not an impediment to rate cuts if prices are well behaved. This approach has a bearing on policy; if inflation continues to moderate as forecasted, there is no obvious reason to keep interest rates above their neutral setting (the rate consistent with inflation at target and full employment).

Of course, this level is unobservable, but the Fed helpfully publishes its own assessment on a quarterly basis. In the latest Summary of Economic Projections, published alongside September's rate decision, neutral rates were assessed to be 2.9%. It should come as no surprise, therefore, that policymakers expect interest rates to fall slowly but surely back to this level over the next two years with only a modest rise in unemployment and economic growth close to trend. If the Fed manages to pull this off, it will be a remarkable feat of central bank policymaking in the aftermath of extraordinary economic events. In practice, this assessment is a snapshot in time, reflecting policymaker's views at the time of writing. As Tom Barkin, President of the Richmond Fed said recently, "as we decide how fast to move and how far to go during this rate reduction cycle, we are just going to need to be attentive and learn as we go". In other words, they will, as ever, be data dependent, but the end point is to get rates back to a more neutral level, and indeed lower if economic growth stalls or inflation slips below target.

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3. Speech by Chair Powell, 30 September 2024.

The ECB's handbrake turn

The European Central Bank surprised nobody by reducing official interest rates by another 0.25% in September, having teed up such a move back in June. President Christine Lagarde then executed the central bank equivalent of a handbrake turn, as softer-than-expected inflation data and weak economic data, notably in Germany, led to a shift in tone. In September her stance was decidedly non-committal: 'I'm not giving you any commitment of any kind as far as that particular date [October] is concerned. And our path is not predetermined at all.[4]' But just two weeks later she was far more explicit: 'The latest developments strengthen our confidence that inflation will return to target in a timely manner. We will take that into account in our next monetary policy meeting in October[5].' For central bank watchers, such an emphatic statement all but guaranteed another 0.25% reduction when the Governing Council met on 17th October. For a data dependent institution, this suggests that recent economic releases were weak enough to question forecasts made just three weeks ago. That said, we've long believed the Governing Council has been setting policy by looking through the rear-view mirror, focusing on slow-moving factors – such as wages, company margins and productivity - that could keep persistent elements of inflation elevated, while economic growth stagnates. Germany, in particular, could see its economy contract 0.2% this year. Hopefully September's volte-face will get interest rates back to a less restrictive stance quickly enough to avoid further economic damage. Markets believe this level is close to 2%, but with no growth, inflation is likely to subside quickly, and the risk is for interest rates to sink below this level next year.

The BoJ's knee-jerk reaction

Despite stating its intention to move interest rates toward a more neutral setting if inflation continued to track expectations, the Bank of Japan (BoJ) rattled markets by raising official interest rates by 0.15% to 0.25% in July. This prompted a fast and furious rally of the yen, while equities plunged 12% before rebounding. This market reaction has understandably unsettled the BoJ, leading the Policy Board to initiate research aimed at improving communication with market participants when there is a disconnect between the Bank's views and market expectations.

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4. Speech by ECB President Lagarde, 12 September 2024.
5. Speech by ECB President Lagarde, 30 September 2024

Additionally, the Bank has introduced a market stability clause to its rate guidance, indicating that while further rate hikes are likely if inflation becomes entrenched in the Japanese economy, it will refrain from implementing these hikes if markets become dysfunctional. The BoJ is also closely monitoring the US economy; given Japan's long history of disinflation, it wants to avoid tightening policy in the face of a sharply slowing US economy.

Despite this less hawkish tone, evidence continues to suggest a long-awaited change in Japanese price-setting behaviour, which if sustained means interest rates are far too low to be consistent with inflation at 2%. We believe the BoJ will hike rates further, aiming for a more neutral policy setting. Nobody is quite sure where this level stands, with the Bank's current best guess stating it's anywhere between 1% and 2.5%. Markets, however, do not see rates above 0.75% in four years' time.

PBoC's policy dilemmas

With economic growth threatening to fall short of this year's target, the Chinese authorities have finally shifted from piecemeal easing to an all-together more dovish stance, co-ordinating both monetary and fiscal policies. On the former, the People's Bank of China (PBoC) used the 0.5% reduction in US rates to shift its own rates down by a relatively aggressive 0.2% and release RMB 1 trillion of long-term liquidity into money markets by reducing reserve requirements. This leaves official interest rates at just 1.5%. At the time of writing, it is not clear how much fiscal policy will be eased, but the Politburo was emphatic that the economy needed 'counter-cyclical fiscal policy' and the government must 'face the [economic] difficulties squarely and take steps to achieve this year's growth target. This is all very positive, if a little vague, but markets have rallied massively in response. From here, policy faces a fork in the road: this is either China's 'whatever it takes moment' that finally deals with the property bust debt overhang and sees confidence rebuild. This, ultimately, would lay the ground for rate normalisation further down the road as consumption and inflation begin to rise again. However, if China is in a balance sheet recession, where any amount of policy easing fails to have an impact amid massive deleveraging, it is not clear what options the authorities have other than to go down the western route of unconventional policy.

The BoE's divergence of opinion

Finally, in the UK, the Bank of England made a reluctant 0.25% cut in Bank Rate and continues to grapple with effectively communicating the Old Lady's view amid differing opinions on the inflation outlook among members of the rate-setting Monetary Policy Committee. This range of views centre around the persistent element of prices, with members believing that they are likely to decline now that headline inflation is close to target, while others argue that growth needs to slow materially for this to happen or indeed, that there has been a permanent change to prices, wages and margin-setting that would require monetary policy to remain restrictive for much longer.

This divergence makes the Governor's job hard, as he typically tables a motion for the Committee to vote on. However, with concerns about inflation persistence being difficult to assess in the short term, it is uncertain whether a sensible quorum can be achieved.

That said, we believe that price rises in the UK are quite narrow, concentrated in specific sectors such as care homes, where the previous government raised the minimum salary threshold for work visas. Additionally, most service-based evidence suggests the UK labour market is slowing quickly, with the vacancy-to-unemployment ratio returning to pre-COVID levels. As such, we expect the Bank's deliberations to ultimately favour the more dovish perspective, leading to a more gradual normalisation of inflation. This may well be hastened if the coming Budget tightens fiscal policy notably.

Summary of high conviction asset class views

Defensive bonds

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

max positive · positive · neutral · negative · max negative

Positive: Australia, New Zealand, UK, US curve steepeners, EU 2y vs. US 2y

Negative: China, Poland

Summary

Economic data across the EU and US is no longer supportive, leading central banks to continue easing, supporting central banks in their efforts to continue easing policy from its current restrictive stance. We prefer to be overweight duration, primarily focusing on areas that face structural headwinds due to over-indebted households, such as Australia and New Zealand, as well as in the UK where the economy has a higher sensitivity to interest rates. Curve steepener positions have been added given the expectation of ongoing cutting cycles across major central banks. Given the lags in economic data and ongoing structural headwinds we also have a preference to receive the European short end relative to the US based on the view that the market is currently mis-pricing the ability of the ECB to catch up with and likely out ease the Fed.

Growth bonds

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

max positive · positive · neutral · negative · max negative

Negative: Peripheral spreads

Summary

Overall, we are neutral on emerging market fixed income given the uncertainty in the global macro-economic outlook. While certain areas have succeeded in gaining control of inflation through early and effective policy responses the outperformance of the US economy and its support for the USD creates capital flow challenges in emerging markets.

Credit

View as at	30 Sep 24	31 Jun 24	31 Mar 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 generally remain richly valued across sub asset classes. We don't believe these valuation levels compensate investors for taking credit risks here given limited upside and the elevated risk of recession.

FX

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

■ max positive ■ positive ■ neutral ■ negative ■ max negative

Positive: Brazilian real, Colombian peso, Japanese yen, Turkish lira, US dollar

Negative: Chinese renminbi, Czech koruna, Swiss franc

Summary

The outlook for the USD appears to have turned bearish with the acceleration of easing cycles in both the US and China. Historically, when we have seen such periods of coordinated easing they have been supportive of an acceleration in global trade and growth and bearish for the US dollar. As a result, we have moderated our USD exposure within our strategies although maintain some exposure vs. Swiss francs where asymmetry looks stretched with the Swiss National Bank looking to take policy easy given deteriorating fundamentals.

Regional equity

View as at	30 Sep 24	31 Jun 24	31 Mar 23
US			
Europe ex-UK			
UK			
Japan			
Asia ex-Japan			
EM vs. DM			

max positive   positive   neutral   negative   max negative

Positive: Asia ex Japan, EM vs. DM, US small caps

Summary

The Asian region benefits from structural tailwinds and is seeing earnings dynamics trough as regulatory incursion lessens and macro policy becomes more supportive. This, at a time when valuations in the region are depressed. 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. Given a balanced growth outlook and tail risks in both directions we take a neutral view on US equities although prefer sectors with structural underpins like semiconductor stocks and US small caps, which should benefit as the market broadens in a soft-landing scenario. Europe ex-UK and UK continue to face structural headwinds.

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 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.

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

After an extended period of underperformance, the commencement of easing cycles across the developed world and falling cost of capital has supported a recovery in momentum across a number of defensive sectors. High quality defensives continue to present opportunities with valuations still below historical averages.

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 a deterioration in manufacturing data, orders rolling over sharply and inventories climbing, there remains ongoing support from US fiscal policy and strong consumer and corporate balance sheets. The Federal Reserve (Fed) has initiated a rate cutting cycle at a time when nominal growth rates remain attractive, which increases the chance that the US could achieve a soft landing. This improves the outlook for smaller companies in the US which are typically more leveraged and have experienced a sharper cyclical downturn in profits than larger companies. Small cap valuations are at 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 eases and economic growth slows but remains positive. Our outlook on **Europe ex-UK** equities remains neutral. The region faces structural challenges and the drag on manufacturing from weak external demand remains. 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 held interest rates steady, following an initial cut in August, and has promised a 'gradual approach' to rate cutting. Price and earnings momentum have improved in absolute terms, although relative performance remains low.

We remain neutral on **Japanese** equities. While growth momentum has turned positive, supporting corporate earnings the Bank of Japan is expected to continue with its cautious normalisation of policy as policy peaks in other markets which is expected to lead to yen appreciation over time and inhibit exporters. Valuations of the Japanese market have moved from expensive towards neutral, providing opportunities for the bottom-up investor.

We remain positive on **Asia ex-Japan** equities. Growth momentum remains positive in Taiwan and Korea but may be slowing in line with technology and global trade cycles. In **China**, policy remains supportive, with the People's Bank of China unveiling a raft of stimulus measures designed to support the economy. The Government has indicated that further measures are likely. China's equity market should continue its cyclical recovery as policy conditions allow confidence and activity to gradually recover. While valuations have risen following the recent stimulus, the Chinese market still offers the potential for strong returns over time. Overall, we are positive on **emerging markets (EM) vs. developed markets**. EM has firmer growth momentum and less expensive valuations, and price and earnings momentum have converged. 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.

Within equity sectors, 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 strong 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 also remain positive on the **metals and mining** sector where the medium term demand outlook is supported by the energy transition and by growth in infrastructure investment.

Fixed income views

Most major central banks have now shifted to a view that policy restrictiveness can be reduced, and interest rates lowered towards neutral. However, the specific path of further cuts remains data dependent and will be influenced by the degree to which inflation remains benign or growth weakens.

The **US's Federal Reserve (Fed)** surprised the market with a larger than expected 0.5% rate cut, signalling the Fed's growing confidence that, with an appropriate recalibration of policy, the strength of the labour market can be preserved amid moderate growth and a sustainable move in inflation toward the 2% target. Indeed, it now seems possible that if inflation continues to moderate in line with forecasts, interest rates could move back to their neutral setting, guided to be 2.9%. As always though, the timing and size of cuts remains dependent on incoming data. **The European Central Bank (ECB)** cut rates at its October meeting, having adopted a cautious tone in September. **The Bank of Japan (BoJ)** is increasingly confident that wages and inflation are in the required virtuous circle and is likely to continue shifting policy incrementally tighter. However, it remains cautious, closely monitoring the economy's response to the rate hikes as it seeks the neutral level. 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 positive on **US** government bonds and are positive on real yields. The Federal Open Market Committee has initiated a rate cutting cycle with a cut that was larger than expected. The future path of interest rates from here will be dependent on the evolution of the US economy but rates are expected to progressively be taken down towards neutral. We continue to express a preference for short-dated yields, through a US yield curve steepener position (long 3Y vs 10Y) which should benefit as the cutting cycle progresses and the restrictiveness of policy is reduced.

We remain positive on **European** government bonds given the ongoing 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 has begun reducing rates at a gradual pace. Given the structural challenges in the eurozone and the lagging nature of economic data we expect the ECB to become more aggressive in its cutting cycle as we move forward and bond yields to fall further. As a result, we have a bias to add positions in short-dated European rates on selloffs. We similarly remain positive on UK government bonds where we believe the market and the BoE are overestimating the stickiness of inflation and economic strength and bonds are trading at attractive valuations as a result.

We remain neutral on **Japanese** government bonds but continue to watch for opportunities to position for higher yields in the short end of the yield curve to reflect an expectation of continued rate adjustments.

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 compared to 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

We remain neutral on the US dollar **(USD)**, reflecting continued evidence of slowing growth and a somewhat better outlook for inflation and thus for a reduction in rates. This shift is likely to lessen the benefits of divergent policy between the US and other major region economies that are also facing cyclical headwinds. Despite this neutral stance, we recognise the benefits of the dollar for diversification and hold a positive view on the USD compared to the NZD, GBP, CHF and CNH.

The **Chinese yuan (CNY)** faces ongoing negative data flow, further monetary easing, and depressed sentiment and hence we maintain our negative outlook. However, the Chinese authorities continue to target currency stability, and the greater use of fiscal policy relative to monetary may support sentiment and the currency.

We remain neutral on the **euro (EUR)**. The ECB embarked on its easing cycle in June and while future decisions will be based on the inflation outlook given incoming data, the bank is expected to continue easing in the coming months as economic data catches up with that of the US albeit with a lag. The coordinated easing across the US and Europe adds uncertainty to relative currency performance. We have added short positions in the Swiss franc (CHF) however as the SNB look set to take policy easy to offset rapidly deteriorating domestic conditions.

While we remain neutral on the **Japanese yen (JPY)** overall, given its sensitivity to interest rate expectations and the risk of a more benign outcome in the US than the market is pricing, we note that valuations remain supportive following the recent pullback. 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. We see the Swiss Franc as the best expression of this convergence with the SNB likely to take policy loose in the coming quarters and hence have a preference to use it as a funder for the JPY.

We remain neutral on $ Bloc economies (AUD, NZD, CAD) overall and note that sentiment towards Chinese growth beneficiaries remains depressed. We maintain 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

Energy

Oil markets are experiencing crosscurrents: the physical market is tight due to low inventories, while financial markets are bearish as money manager positioning in Brent Crude Oil is at multi-year lows. Looking ahead to 2025, oil markets look over-supplied, with demand growth projected at 1-1.5 million barrels per day (mb/d), against a potential 1.5 mb/d of non-OPEC supply growth (from US, Canada, Kazakhstan, Guyana, Brazil) and up to 1 mb/d of OPEC supply growth, representing the averaged return of 2 mb/d through the year.

Our base case for 2025 assumes that Israel refrains from attacking Iranian upstream infrastructure (downstream is more likely), OPEC decides not to add back supply at its December meeting, and the market interprets this as a negative signal, suggesting excess capacity on the sidelines and OPEC's concerns over weak 2025 demand. However, we expect demand estimates to be revised upwards during 2025, driven by Fed cuts, China stimulus, and greater price elasticity. Meanwhile, shale supply estimates are likely to be revised downwards due to continued capital discipline, which should result in oil prices bottoming in the first half of 2025.

While we remain cautious in the near term and maintain an underweight position in the energy sector, we hold a longer-term positive view on oil, expecting shale supply to peak in 2027, but oil demand peaking in the mid-2030s.

Metals receive support from Chinese stimulus

After a 'game of two halves' in Q3, copper broke back above US$10,000 in late September, driven by renewed Chinese demand and a sharp decline in inventories. Aluminium prices also rose over the quarter, despite a 9% correction in July. The quarter ended with news about monetary and fiscal stimulus measures announced by the Chinese government. In the near term we need to see how these measures are implemented practically, and further details on the fiscal aspects are needed. However, we see this news, coupled with a declining interest rate environment in the US and Europe, as supportive for base metal demand going into 2025.

Iron ore suffered a challenging Q3 on weak steel production rates in China, but short covering in the last week of September erased earlier losses. The market remains sceptical about iron ore's prospects, but as an oligopolistic market, producers continue to emphasise value over volume. This suggests they intend to meet global steel demand without oversupply. In this context, we expect prices to remain steady over the next three months.

Gold consistently set new records throughout Q3. A combination of lower interest rate expectations, concerns about high US government debt, and retail/household buying drove the market higher. Gold reached an intraday high of US$2,686 before consolidating between US$2,600 and US$2,650. We expect gold to hold these gains in the near term, with some upside risk heading into Q2 2025. Gold equities also appear promising, showing strong margins and significant free cash flow generation.

Agriculture: big crops get bigger

Grain and oilseed markets remain sluggish as the northern hemisphere enters the harvest season for summer crops. US corn and soy yield estimates, which began the year at or near record levels, have been continuously revised upward. With elevated inventories in on-farm storage, growers now need to destock to make room for the new crop. Export demand for US corn and soybeans remains relatively healthy, but competition from abundant Brazilian supply is strong. Livestock feed demand is gradually improving. We continue to expect a recovery in corn prices towards US$5 per bushel in 2025, driven by anticipated supply cuts.

Protein markets have shown new dynamics this past quarter. We believe Brazilian poultry margins may have peaked for the time being, and our focus has shifted to Chinese pork markets, where demand appears to be recovering. While salmon prices are expected to strengthen toward year-end, we have lowered our price expectations due to weaker near-term demand.

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CS_713 10/2024 - MACS18110