UOB

In collaboration with:

J.P.Morgan ASSET MANAGEMENT

UOB Investment Insights

Market PowerBar

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TOPIC 1:

Prepare for volatility even if lower rates are expected in 2024

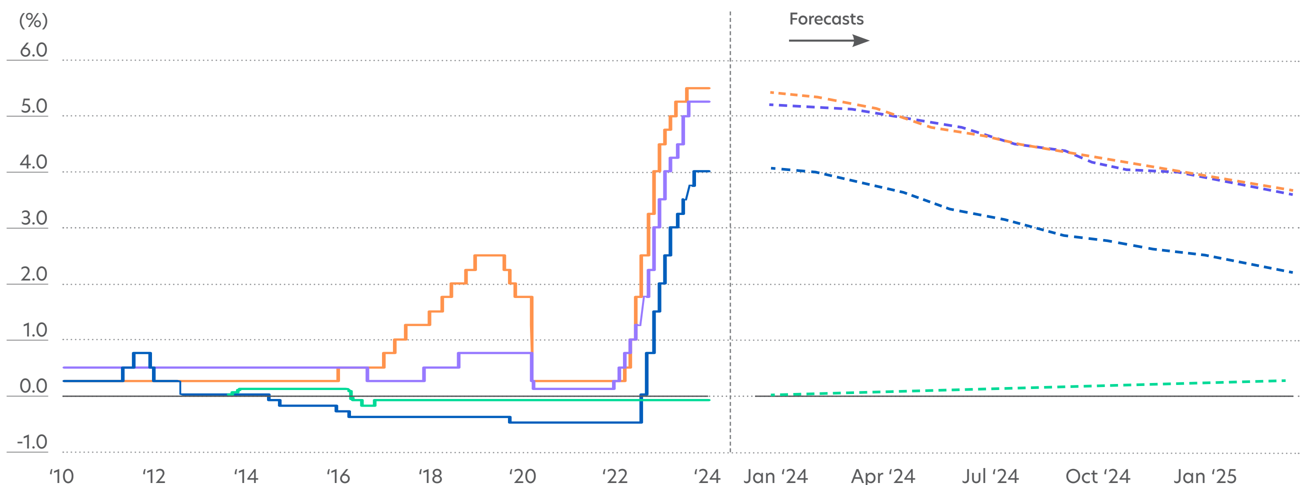
Major central banks have indicated the intention to end interest rate hikes as inflation is coming down. Market expectations on when and how much rates will be cut have been formed. As events may not go as anticipated, prepare for market volatility by staying in a diversified investment portfolio.

- Most developed market central banks had raised interest rates to stop prices from going up further. As inflation is coming down, central bank officials have indicated an end to rate hikes and for rates to eventually be lowered. When and how much rates will be cut depend on various factors like whether inflation goes up again, and largely on the health of the economy.
- Market watchers are expecting rates in developed markets to come down early in 2024 (Figure 1), the exception being Japan where economic conditions are different. UOB expects the United States Federal Reserve (Fed) to cut rates from mid-year, followed by the Bank of England (BOE) from the third quarter, and the European Central Bank (ECB) towards the end of the year.
- While investors may be eager to take on more risk on rate cut expectations, economic conditions can change quickly. When central bank actions do not meet expectations, financial markets may experience higher volatility. Diversifying investment portfolios can lower potential volatility from such uncertainties.

Figure 1:

The Fed, BOE and ECB are expected to start cutting interest rates in 2024

Current key interest rates and market forecasts



Source: Bloomberg, FactSet. Expectations are derived from overnight index swap market forward rates.

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TOPIC 2:

Opportunities in investment grade bonds when the market is volatile

While bond markets may experience some volatility in the first half of the year, investment grade bonds remain attractive, particularly when interest rates have peaked and are expected to decline from the middle of this year.

- Bond markets are expected to remain volatile before the central banks begin their first interest rate cuts, as bond yields will fluctuate when investors adjust their rate cut expectations. However, yields for investment grade bonds remain attractive and should not be overlooked.
- History shows that investment grade bonds attract high capital inflows when the Fed stopped raising rates and subsequently lowered them (Figure 2).

Demand for high quality bonds will increase as investors become cautious about a slowing economy and look to secure attractive yields before interest rates fall. The strong demand will lift bond prices and create potential capital gains for investors.

- Although volatility in bond markets will continue in the coming months, it could create buying opportunities for investors. Lock in high yields with investments grade bonds to enjoy a higher stable income even central banks start to cut interest rates.

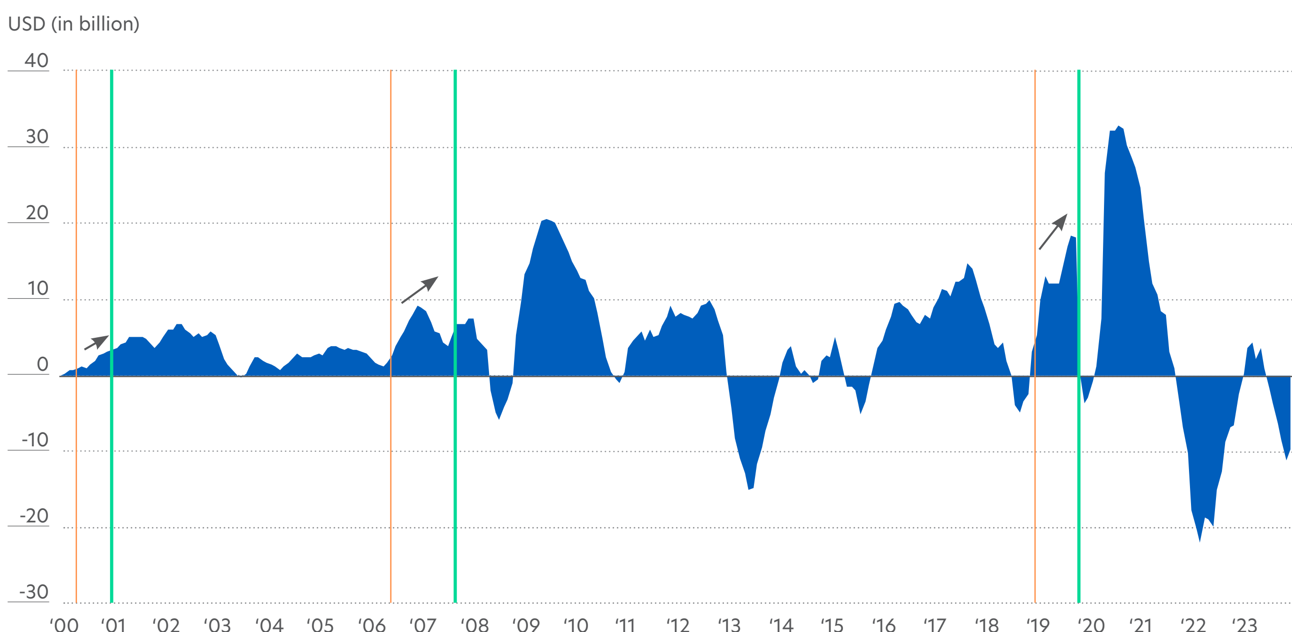
Figure 2:

Investment grade bonds attract capital inflows after the Fed pauses hikes and before cuts

Forward 6 months average net new cash flows into Investment Grade bond mutual funds

Fed pause

Fed cut



Source: J.P. Morgan Asset Management.

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TOPIC 3:

Asia benefits from artificial intelligence growth

The growth in artificial intelligence (AI), automation and digitalisation is expected to support the Asian tech sector, while these technological changes could also benefit other sectors in the region.

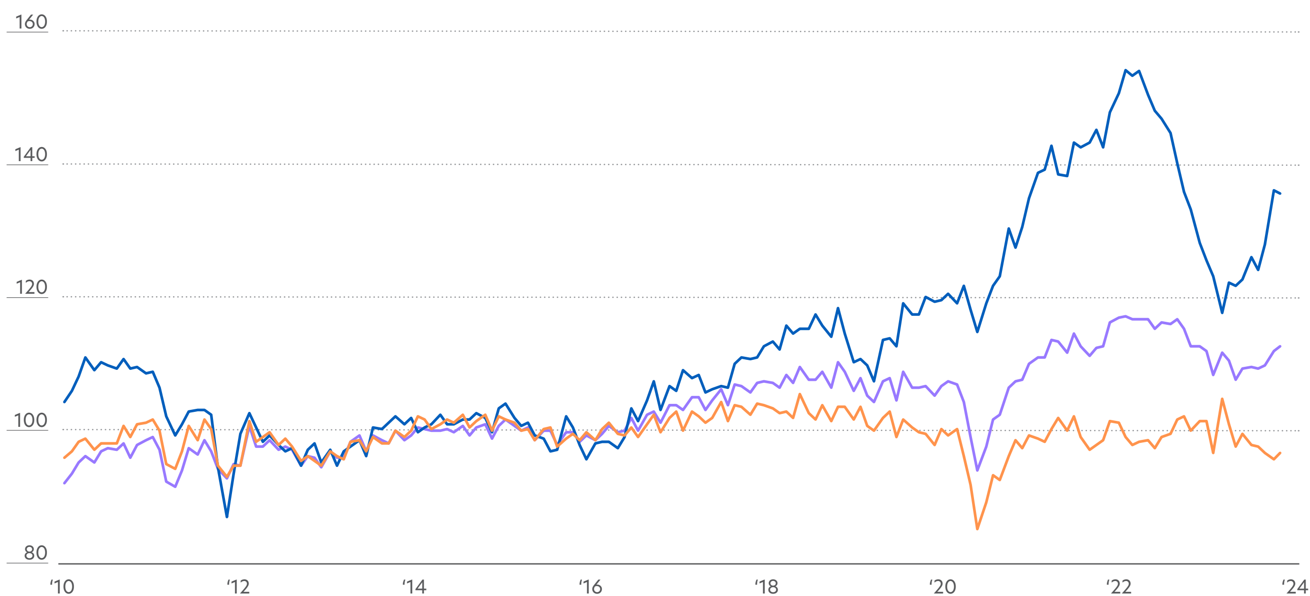
- The Asian manufacturing industry, which is increasingly dependent on the tech sector, has recently shown early signs of recovery (Figure 3). This suggests a more optimistic outlook for the Asian tech sector, especially if the US economy avoids a deep recession.
- In the short term, the demand for semiconductor chips will be supported by new launches of consumer AI-enabled devices such as personal computers and mobile phones. In the longer term, structural shifts such as growth in AI, facilitated by supportive fiscal policies in the US, could fuel demand for high performance memory chips. More importantly, more investment opportunities can be found in the region, as structural technological shifts could also spread to other sectors through improved production efficiency, enhanced quality control, and reduced operational costs.
- With the recovery in the tech sector, earnings growth for Asia is expected to reach 17.6% this year, a significant improvement from the 7.6% contraction in 2023. In the early stage of tech recovery, focus on high-quality stocks in Asia with healthy balance sheets.

Figure 3:

Tech dominates Asian[1] manufacturing and is recovering

Overall — Tech — Non-tech

Seasonally adjusted production, 2015=100



Source: National sources.
1. Japan, Korea, Taiwan, Thailand, SIngapore (export-weighted)

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