UOB House View 1Q 2024

Friday, 29 December 2023

The Team
Global Economics & Markets Research
Private Bank

Global Macro

The main theme for 2024 will be the expectations for easing of interest rates by the Federal Reserve (Fed) starting in mid-2024. This is set against the backdrop of slowing US growth as inflation stabilises further. Other major central banks are likely to follow suit with differing timelines, while the Bank of Japan is likely to normalise monetary policy in early 2024, without any disorderly consequences. China's situation remains challenging with growth likely to stay soft in 2024 and that there will be a ramp-up of policy support measures to manage risk.

Asset Allocation

We have raised equities to Neutral in our asset allocation. On a full-year basis, equities are likely to outperform cash. After a robust 2023, we look to add to equities on weakness in 2024. Our bond allocation remains an Overweight while cash is reduced to an Underweight. The allocation to alternatives remains an Overweight.

Equities

Against the backdrop of a prolonged late economic cycle, non-directional trades like outperformance payoffs and 100% minimum redemption notes can help investors position defensively while staying engaged with markets. With a view to add on weakness, we remain Neutral on US equities. We also stay Underweight on European equities, Overweight on Japanese equities and Neutral on EM Asian equities.

Fixed Income

For Developed Markets (DM), we remain Overweight on DM USD IG, with the view for yield-driven demand to remain strong and as such, will limit excessive credit spread widening on quality names. We stay Underweight on DM USD HY as funding conditions and liquidity positions for weaker companies could be challenged. We are Overweight EM Asia IG given its meaningful role as portfolio stabilizers and the much desirable up in quality trait it possesses. We remain Neutral on EM Asia HY and see pockets of value in select Indonesian property developers, Indian renewables, and commodity/infrastructure credits but caution against chasing performance in EM Asia HY laggards such as China HY CRE.

Commodities

We adjust our positive Brent forecasts to more modest levels of USD 85 / bbl in 1Q and 2Q24 and USD 90 / bbl in 3Q and 4Q24. We keep our positive view for gold and forecast gold at to USD 2,050 / oz in 1Q24, USD 2,100 / oz in 2Q24, USD 2,150 / oz in 3Q24 and USD 2,200 / oz in 4Q24. We maintain our mild negative outlook for Copper, forecasting LME Copper at USD 8,000 / MT in 1Q and 2Q24 and USD 7,000 / MT in 3Q and 4Q24.

FX & Interest Rates

We are confident that DXY has already peaked at around 107 in 4Q23 and the path is clear for USD weakness in 2024. Meanwhile, we expect lower outright rates amidst monetary policy easing across 2024. We expect 3M compounded SOFR and 10Y US Treasuries yield drifting lower to 4.73% and 4.00% respectively by 4Q24.

Global Macro & Markets Strategy
2024: A year of "easing" hope

As 2023 comes to an end, and we look forward to 2024, we set out some of the key themes that define our macroeconomic outlook in the new year.

The main theme for 2024 will be the expectations for easing of interest rates by the Federal Reserve (Fed) starting in mid-2024. This is set against the backdrop of slowing US growth as inflation stabilises further. Other major central banks are likely to follow suit with differing timelines. As for the Bank of Japan, we expect the long-awaited normalisation of monetary policy to take place in early 2024, without any disorderly consequences.

While recent data points to improvement, China's situation remains challenging with growth likely to stay soft in 2024 and that there will be a ramp-up of policy support measures to manage risk. Lastly, ASEAN economic growth is expected to stabilize with external trade cycle bottoming for the region but the recovery may be lacklustre due to China's slowdown. We remain positive on ASEAN fundamentals and outlook in the medium and long term.

Another key development to watch will be the flurry of general elections in store for 2024 alongside the ongoing military conflicts in Eastern Europe and Middle East.

Slower US growth amidst easing inflation

Using the six key US economic indicators monitored by the National Bureau of Economic Research (NBER), which is the arbiter of US recession, the broad picture (Chart 1) seems to indicate that US economic growth is nearing or already at the peak. After a consumption-driven 5.2% expansion in 3Q 2023, US GDP growth is set to slow into the final 3 months of 2023 and likely to turn negative in 1H 2024 as the lagged effects of US monetary policy tightening and tighter financial/credit conditions take a more significant grip, negatively affecting business investment as interest expenses rise while for US households, the shrinking excess savings, tighter lending standards and the resumption of student loans repayments imply US consumers spending will come under pressure.

We expect the US growth slowdown to be more apparent in 1H 2024 with a technical recession (i.e. two consecutive quarters of q/q declines) but a soft landing remains possible in our base case. And inferring from the last four Fed rate hike cycles, we noted that a recession typically started between 9 and 17 months after the first Fed pause. In the current cycle, the Fed has been on pause since the last 25-bps hike in Jul 2023 (Chart 2). That said, we do not expect deep recession or an outright contraction of annual GDP due to the absence of any acute financial imbalances. Instead, we expect US growth to slow to 1% in 2024, after a projected 2.4% in 2023.

Chart 1: Six key US economic indicators broadly show US economy nearing or already at peak growth

Source: Macrobond, UOB Global Economics & Markets Research

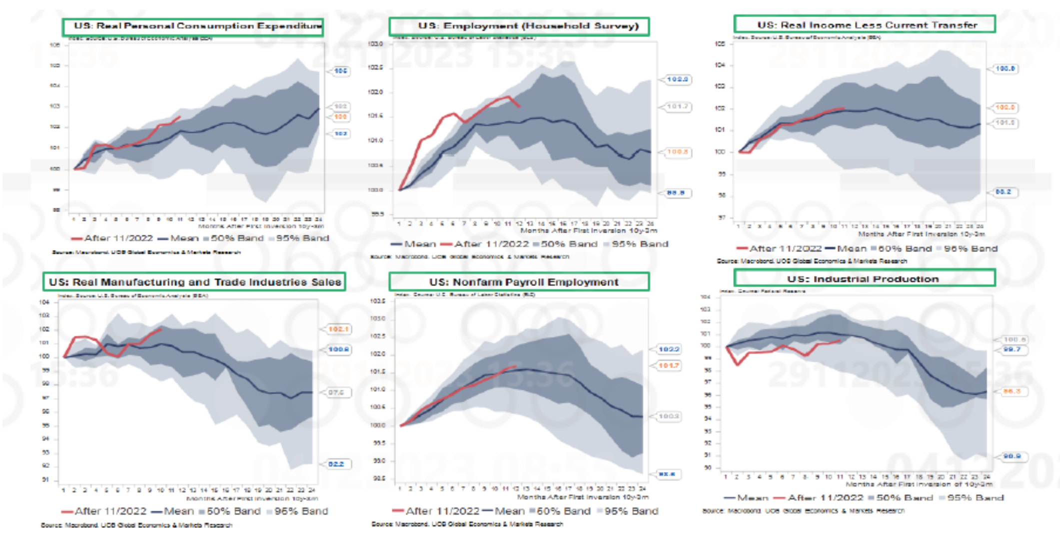
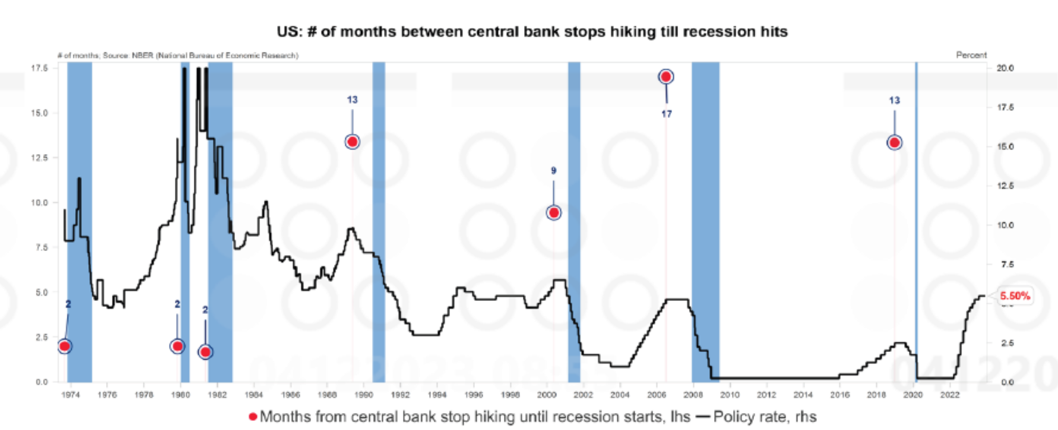


Chart 2: Based on history, a US recession would hit 9-17 months after the first Fed pause

Source: Macrobond, UOB Global Economics & Markets Research

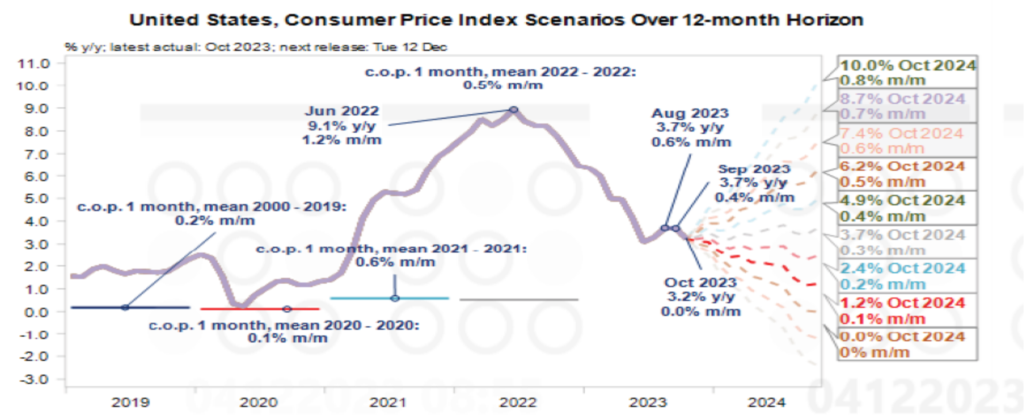


The next important question is where inflation may be heading to in 2024. The latest Oct and Nov CPI prints from US suggest that inflation continued to ease (in y/y terms) although core inflation remains stickier than headline. Subsequently, we expect US inflation to ease in 2024, with headline expected to average at 2% but core CPI still likely average above the "gold-standard" 2% objective, at 2.2% for 2024. We remain wary of US price risks from several potential inflation shocks including wage pressures arising from labor-employer tensions, resurgence in global energy prices, and renewed disruptions in supply chains.

We illustrate in a simple graph below where US inflation may be in 12 months' time. If the m/m pace stayed positive but at a more moderate 0.1% for next 12 months (it was 0.0% in Oct versus the 0.3% average in Jan-Sep), then inflation will ease to 1.2% y/y in Oct 2024. If it is 0.2%, then that will imply that inflation will be 2.4% y/y by Oct 2024. In a more extreme scenario where the m/m pace spikes higher than 0.7%, then inflation will exceed the recent high of 9.1% y/y recorded in Jun 2022. That is not anywhere near our central scenario. Instead, based on recent trends, we believe the US inflation path is tracking towards the Fed's 2% objective.

Chart 3: US CPI inflation (% y/y) projections – tracking towards 2% target

Source: Macrobond, UOB Global Economics & Markets Research



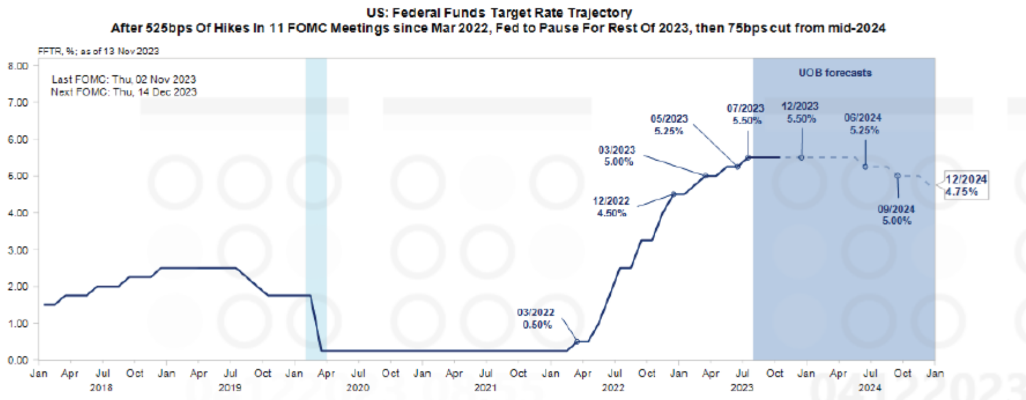
Our Fed view for 2024: 75bps of cuts

It is the combination of slower growth and stabilising inflation that drives the thinking of our Fed outlook in 2024. We expect the Fed to keep its current Fed Funds Target Rate (FFTR) range unchanged at 5.25-5.50% in Dec 2023 FOMC and maintain this terminal FFTR level till mid-2024 when we price in 75 bps of rate cuts for 2024 (i.e. three 25-bps cuts in Jun

2024, 3Q 2024 and 4Q 2024). With a US soft landing remains our central scenario, we do not expect an aggressive series of Fed cuts to counteract the prior aggressive hike cycle.

Chart 4: UOB's projected US Federal Funds target rate trajectory (as of 30 Nov 2023)

Source: Macrobond, UOB Global Economics & Markets Research



Other major central banks on the easing path, while BOJ may finally begin normalisation

Other than the Fed, it would also be a year of easing for most of the major central banks albeit likely differing timelines. The first off the block could be the Reserve Bank of New Zealand (which was one of the first central banks to hike rates in Oct 2021) sometime in 2Q 2024, followed by the Reserve Bank of Australia and Bank of England, both in 3Q 2024. The European Central Bank may only cut policy rates in 4Q 2024, as ECB policymakers may require more assurance of inflation under control at the cost of weaker growth for longer.

The BOJ is now the only major central bank that still maintains negative benchmark rate at -0.1%. But the "last central bank standing" is now poised to normalise monetary policy in 2024, in direct contrast to the other major central banking heading the opposite direction. We project BOJ's normalization to commence after 2024's Shunto Spring wage negotiations which takes place around Mar. We now expect the BOJ to begin policy normalization in the Apr 2024 MPM, starting with an exit from BOJ's negative interest rate policy (NIRP) as we expect the BOJ to lift the short-term Policy-Rate Balances from -0.1% to 0.0%, followed by the removal of YCC in the Jun 2024 MPM. Ahead of policy normalization, we anticipate a possible adjustment to BOJ's forward guidance on YCC and interest rates in the meetings prior (i.e. Jan or Mar MPM) to provide some market guidance and facilitate an orderly exit of BOJ's ultra-easy monetary policy.

China's outlook for 2024: Weaker growth with more policy easing to come

China's recent economic data continued to improve but consumer confidence remains fragile and the growth outlook for 2024 weak. Manufacturing and services sectors' activities continued to recover but real estate posed a significant drag. Land sales (which in the past was a key driver of local government revenue) has been sluggish because of the property sector woes, and thus further impacting on growth. Meanwhile, on-going trade tensions with the US will continue to drive supply-chain diversification as companies continue to shape their "China+1" or "China+N" strategy. We expect GDP growth to slow to 4.5% in 2024, from a projected 5.2% in 2023. Policy support will be ramped up in 2024 to manage risks including interest rate and reserve requirements ratios (RRR) cuts, property market stimulus measures and expansionary fiscal policy. The surge in liquidity injections in 4Q 2023 may have delayed further rate cuts, but we expect 1Y and 5Y loan prime rates (LPR) to be cut by 10 bps to 3.35% and 4.10% respectively in 1Q 2024 and held at those levels for the remainder of the year.

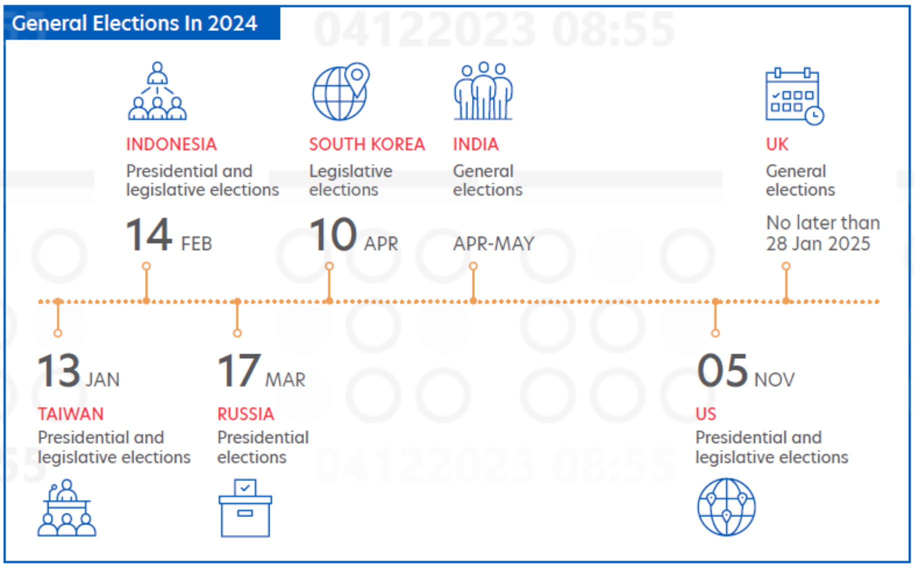
ASEAN's external trade bottoming and showing signs of a recovery

Some good news from ASEAN as the downturn in regional trade may have found its bottom and is showing signs of recovery albeit with a bumpy pace with East Asia's export recovery leading the ASEAN-6. A key catalyst is the global electronics cycle bottoming out, while a sustained and robust recovery in global semiconductor sales will also benefit heavy electronics & electrical (E&E) exporting countries in East Asia and ASEAN. A not-so-bright spot is the weak outlook for China which may slow the recovery pace. Please see [ASEAN Focus II] for a more in-depth discussion of the ASEAN trade recovery in 2024.

Of war and important elections

Another year, another war. Beyond growth and inflation worries, 2024 will also present much geopolitical uncertainty. The geopolitical event of 2023 was the Israel-Hamas war, and despite the on-going truce (since 23 Nov 2023), the war is far from ending and likely to extend well into 2024. While it remains our base case for this conflict to be contained, we do see a non-negligible risk that it may escalate and spread to other parts of Middle East and involve major oil producers like Iran, which could risk endangering crude oil supply and further providing a renewed boost for oil prices.

In addition, 2024 will bring forth many important general elections. In Asia, Taiwan, Indonesia and India are top of mind. UK's general election is not due till 28 Jan 2025, but PM Sunak could bring it forward to hold the election sometime in 2024. Russian President Putin is likely to be elected in Mar without obstruction. The most consequential election is likely the US Presidential Elections in Nov, where there is a real possibility of Donald Trump returning as President. This is viewed as a challenge for 2025 onwards, not 2024. While Trump may further harden his stance against China, he may also likely be very vocal about elevated interest rates and pressure the Fed to lower rates further in 2025. So a Trump victory may mean a lot of things, especially his incessant pressure on Powell for lower rates in 2025, just as he did in 2018/2019.



FX Strategy: Path is clear for USD weakness in 2024

We are confident that DXY has already peaked at around 107 in 4Q23. Next year, as expectations for US Federal Reserve's (Fed) rate cut intensify, there is scope for further weakness of the USD against Major FX peers alongside lower US rates. Should there be a sharper US slowdown that necessities more than 3 rate cuts in 2024 (our base case), there is likely downside risks to our current set of USD forecasts. In line for expectations of a weaker USD, our forecasts call for stronger EUR/USD, GBP/USD and AUD/USD to 1.16, 1.32 and 0.70 respectively by 4Q24. Similarly, we can expect USD/JPY to trade lower to 135 by 4Q24 as the BOJ normalizes its monetary policy as well, providing the impetus for a lower USD/JPY.

Similarly for Asia FX, it is likely that the USD will trade softer against Asia FX peers across 2024 especially when Fed rate cuts gradually come into focus. Specifically, the prevailing pessimistic views and sentiments on China's economy may be at their extreme. It looks increasingly likely the USD/CNY has peaked around 7.32 in 4Q23 and will trade lower across 2024 to 6.80 by 4Q24. In addition, after contracting for most part of 2023, we also expect exports growth to recover in the respective Asian countries and to post decent growth in 2024. This anticipated cyclical recovery in Asian exports will be a positive tailwind for Asia FX next year. As such, we see USD/MYR, USD/THB, USD/IDR, USD/VND and USD/SGD pulling back to 4.45, 33.30, 14,800, 23,500 and 1.30 respectively by 4Q24.

Rates Strategy: Lower outright rates amidst monetary policy easing across 2024

For short term rates, we expect easing monetary policy to be the main theme of 2024. As such, lower outright yield, steeper yield curve and smaller SG yield discount will feature in this new monetary policy regime. In line with our macroeconomic team's expectation of 75 bps rate cuts from the Fed across 2024, we see 3M compounded in arrears SOFR and SORA drifting lower to 4.73% and 3.28% by 4Q24, from prevailing levels of about 5.35% and 3.75% respectively.

However, for the longer end of the curve, we have the 10Y UST and SGS yields at 4.00% and 3.00% respectively by 4Q24. We forecast bond yields in the near term as staying sticky around prevailing levels. Yield declines in Nov have reversed Oct's rise, nonetheless some factors that drove the run up in yields remain substantially unchanged. These include: large US deficit, expectations of BOJ policy normalization de-anchoring low yields, and US economic resilience. In particular for the SG long term yield, our forecast assumes that the long-term relationship of SG rates adjusting lower to a lesser degree to US rate changes will continue to hold into 2024. Our forecast builds this in through narrowing SG yield discounts over time.

Commodities Strategy: Sustained break for gold above USD 2,000/oz now within sight

We keep our positive view for gold for a sustained move above USD 2,000 / oz. The anticipated retreat in both the USD and interest rates across 2024 are key positive drivers for gold. Concurrently, while sovereign demand for gold remains strong from Asia and EM central banks, gold investments from retail investors are only just starting to bottom. Specifically, ETF holdings in gold appear to have bottomed at the year's low. This should bode well for gold as retail interest return. Over the long run, gold remains a key portfolio diversifier of risk. We therefore update our forecast for gold to USD 2,050 / oz in 1Q24, USD 2,100 / oz in 2Q24, USD 2,150 / oz in 3Q24 and USD 2,200 / oz in 4Q24.

The Dec OPEC meeting ended with a fair amount of confusion. While the group claimed to commit to an additional 2.2 mio bpd of production cuts, full details of individual country quotas were lacking. Saudi Arabia did extend its 1 mio bpd production cut to end 1Q24, while Iraq, UAE, Kuwait, Kazakhstan, Algeria and Oman also joined with their additional cuts. But there remains confusion over the distribution of the rest of production cuts and this raised concerns on overall adherence to the production cuts. As such, we maintain our positive outlook for Brent crude oil, but adjust our positive price forecasts to more modest levels of USD 85 / bbl in 1Q and 2Q24 and USD 90 / bbl in 3Q and 4Q24. The USD 80 / bbl price level is likely to offer good support as it is perceived to be a key "line in the sand" for OPEC+.

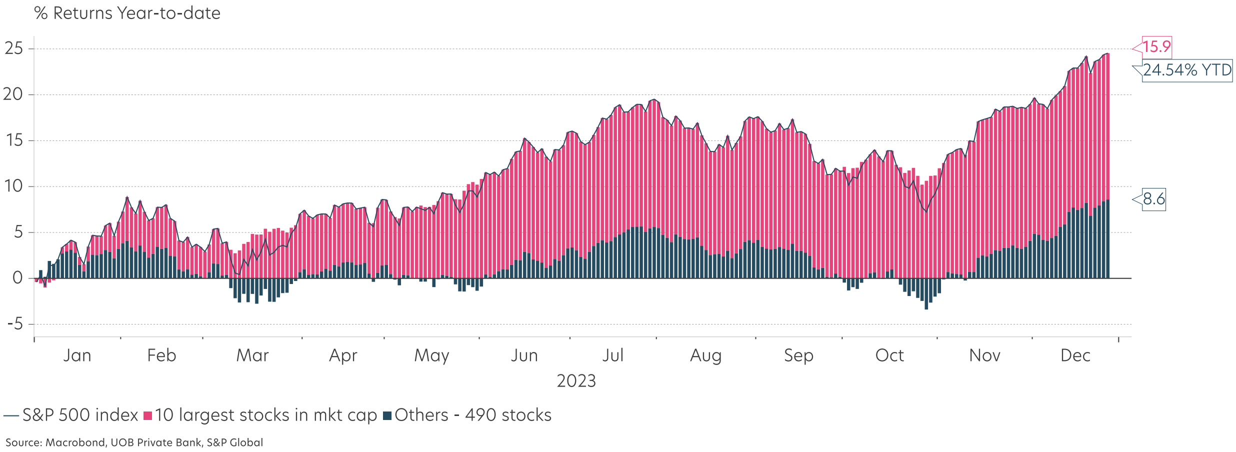
As for LME Copper, we maintain our negative outlook. The sharp retreat in 3M vs Cash spread into a deeper discount is worrying and symptomatic of weak near-term demand. Weak construction demand from China as well as risk of increasing surplus in refined balance in the months ahead as flagged by the International Copper Study Group (ICSG) are key negative drivers for LME Copper. Our updated forecast for LME Copper are USD 8,000 / MT in 1Q and 2Q24 and USD 7,000 / MT in 3Q and 4Q24.

Asset Allocation

We have raised equities to Neutral in our asset allocation. On a full-year basis, equities are likely to outperform cash. After a robust 2023, we look to add to equities on weakness. Our bond allocation remains an Overweight while cash is reduced to an Underweight. The allocation to alternatives is unchanged. Cyclical sectors could continue to perform. The top 10 stocks by market capitalisation account for over 65% of the returns in the S&P 500 in 2023 (Fig. 1). While these names will benefit from falling interest rates and the widespread adoption of artificial intelligence, investors could seek investment opportunities beyond the mega-caps. Sectors and stocks that benefit from declining interest rates will perform well in 2024.

Figure 1 - The largest stocks drive more than 65% of S&P 500's returns in 2023

Source: Macrobond, UOB Private Bank, Federal Reserve



Over in China, despite policy disappointment, equities have paused its underperformance in the third quarter. Another surprise is that Emerging Markets ex-China have performed relatively well, largely because they were ahead of most developed markets in hiking interest rates to combat inflation and correspondingly, in cutting rates as well. In our view, Chinese equities are cheap, but await a meaningful catalyst due to the government's general reluctance to deploy demand stimulus. However, there is a clear threshold of pain that is unacceptable as with the experience of the sudden abandonment of the zero-COVID policy. For now, any incremental stimulus is likely to be just enough to avoid a catastrophe. Due to attractive valuations, downside risk is limited and there could be episodes of rallies like the post-bubble Japanese stock market in the 1990s. A sustained bullish trend is unlikely under the current policy framework.

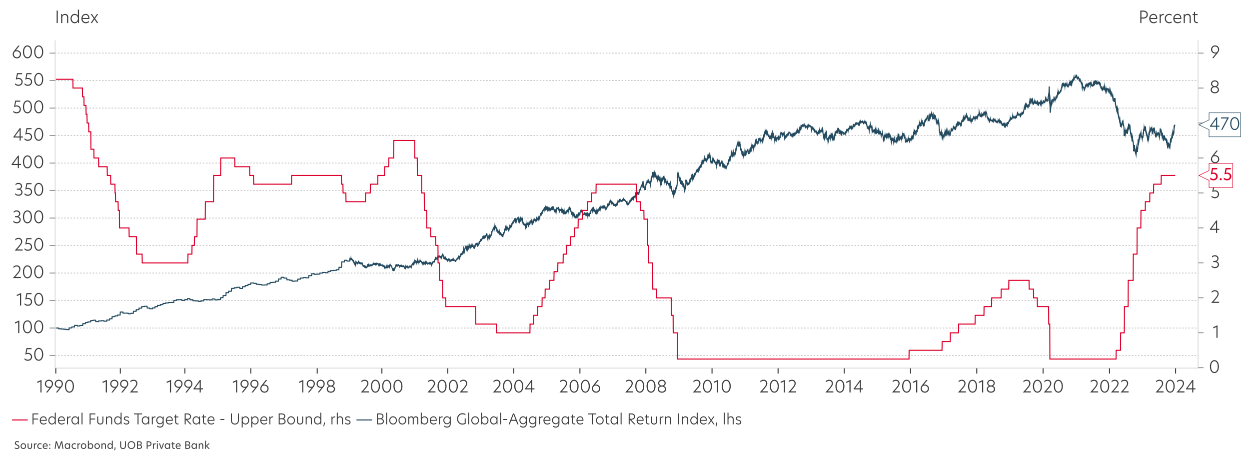
Japan will continue to perform well although the Japanese Yen could strengthen as the Fed, European Central Bank (ECB) and other central banks begin to ease monetary policies. Japanese equities will be supported on continued earnings growth, structural reforms and reasonable valuations. The currency is best left unhedged.

Fixed income will continue its 4Q23 rebound in 2024 as rates continue to fall on the Fed's easing (Fig. 2). This asset class will likely outperform cash returns as duration contributes to price gains on top of the coupon income. Credit spreads are already tight but selective opportunities remain, notably in bank capital and private credits.

Right By You

Figure 2 – Fixed income to rebound amid falling US interest rates

Source: Macrobond, UOB Private Bank, Federal Reserve



Finally, we continue to advocate an allocation to alternatives. Private assets will perform well on supportive macro factors while alternative assets also generate diversification benefits. 2024 is a year with numerous political events with elections to be held in many parts of the world including Taiwan, Russia, and the US. While most of these events do not always have a material lasting effect on economies, they may induce episodes of rising volatility. The key to successful investing is constructing a resilient portfolio that can withstand unexpected shocks.

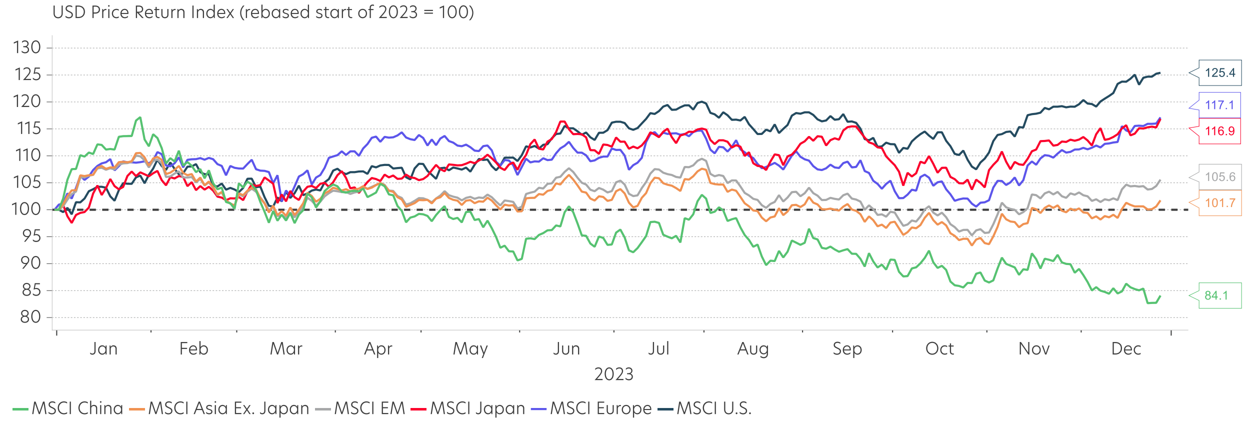
Asset Allocation Table (1Q 2024)

Asset Classes	U/W	N	O/W
Equities	○	●	
United States		●	
Europe	●		
Japan			●
EM (Asia)		●	
Fixed Income			●
DM IG			●
DM HY	●		
EM IG			●
EM HY		●	
Alternatives			●
Hedge Funds			●
Private Markets		●	
Crude Oil			●
Base Metals		●	
Precious Metals		●	
Cash	●	○	

Equities

Equity Performances

Source: Macrobond, UOB Private Bank, Federal Reserve



Source: Macrobond, UOB Private Bank

MSCI USA (+25.2% in USD terms) outperformed all other markets year-to-date (as of 26 Dec 2023). This came on the back of great economic resilience and peaking Fed-rate expectations. On the economy, headline inflation has fallen sharply across all segments except housing, which is in a clear downtrend. Wage growth pressures are also showing signs of easing as employment and the labour force participation rate returns to pre-pandemic levels. Notably, disinflation in the US has occurred without a meaningful decline in economic activity thus far. Having said that, the economy is set to slow as the lagged effect of past monetary tightening will eventually pose as a drag on growth and positive fiscal impulse fades. In this case, we expect a soft patch rather than a deep recession as the recovery in the manufacturing sector and firm labour income growth will support economic activity. Corporate earnings can continue to expand.

On markets, the top 10 stocks by market capitalisation account for over 65% of the returns in the S&P 500 in 2023 before market breadth improved towards the end of the year.

While this has driven elevated valuation for the NASDAQ 100, 12MF P/E of ~24.5x remains below the excesses observed during the 2001 dot-com crisis. The broader S&P 500 trades at 12MF P/E of 19.5x, in-line with the 2-year average but near the upper end of the 10-year trading range. While US equities appear expensive relative to history, the equity valuations can be sustained with the US 10-year yield trading between 3% and 4%.

Against the backdrop of a prolonged late economic cycle, non-directional trades like outperformance payoffs and 100% minimum redemption notes can help investors position defensively while staying engaged with markets. Selling puts on indices and key blue chips also makes sense on expectations for limited drawdown in the S&P 500. With the litany of geopolitical risks in 2024, investors could consider positioning to buy into weakness. Finally, the US interest rate cuts are expected to begin around the middle of 2024. While long-duration tech stocks will benefit from falling US interest rates as well as the widespread adoption of artificial intelligence (AI), investors could consider seeking investment opportunities outside of the mega-caps. Cyclical sectors including tech hardware (e.g., semiconductors) and energy could continue to perform in this environment. Following the recent Fed-fueled rallies, near-term setbacks can be expected. **With a view to add on weakness, we remain Neutral on US equities.**

MSCI Europe (+16.0% in USD terms) continued to trail behind the US but outperformed all other markets year-to-date (as of 26 Dec 2023). This might have come as a surprise for many investors especially against a backdrop of recessionary Eurozone PMIs. Forward earnings growth momentum has notably picked up for 2024 and 2025 following a 3% decline in 2023. European equities also rode on the positive US market sentiments from rising Fed rate-cut expectations, re-rating positively towards end-2023. In particular, the 12MF P/E expansion has taken it slightly above the 2-year average of ~12.5x.

On the economy, activity in the Eurozone is expected to remain muted amid weak domestic consumption. Meanwhile, weaker foreign demand for exports and tight financing conditions are likely to dampen growth, especially within the manufacturing sector. The services sector, which had been resilient so far, is also starting to soften. In emerging market (EM) economies, a failure to raise growth could further delay income convergence with the continent's advanced economies. We continue to expect the Eurozone economy to expand by 0.5% in 2023 and 0.6% in 2024. The latest growth and inflation backdrop certainly adds to the case of the European Central Bank (ECB) staying pat, as it reaffirmed that borrowing costs would remain at record highs at the Dec 2023 meeting. Having said that, investors are currently leaning heavily towards a dovish camp and are anticipating ECB to cut interest rates sooner than previously expected, as many cling to dovish comments shared by officials.

On markets, it is worth mentioning the respectable returns MSCI Europe saw in 2023 were partly held up by the Financials sector, which accounted for 17% (highest) of the overall index. The MSCI Europe Financials Index witnessed a strong +18% earnings per share (EPS) growth projection. Having said that, the sector is expected to moderate significantly from 2024 onwards due to high base effect and the eventual narrowing of net interest margins amid lower interest rates. To this end, a relatively robust growth outlook has been priced in by the markets despite its lackluster economic backdrop. Overall, we favour Healthcare for its defensiveness and certain growth characteristics. **Defense stocks can continue to perform well amid heightened geopolitical and war tensions. We also like quality dividend stocks with a solid track record of stable payout. Overall, we remain Underweight on European equities.**

MSCI Japan (+15.3% in USD terms) has outperformed all regional markets except the US and Europe (as of 26 Dec 2023). Global investors' interest in Japan had already been rising after Japan loosened its pandemic-related inbound travel restrictions since Oct 2022. Interest saw another boost after new corporate governance reform initiatives triggered by the Tokyo Stock Exchange (TSE) since Mar 2023. TSE's strategy of raising returns by encouraging companies to improve capital efficiency (ROE), particularly those trading at discounts to book value, has led to a re-rating of Japanese equities.

On the economy, Japan's consumer price inflation (CPI) has slowed in line with expectations to 2.8% in Nov 2023 as falls in energy costs deepened while gains in processed food prices eased. Core inflation which strips out fresh food and energy prices has also decelerated. The latest inflation figures are consistent with the Bank of Japan's (BOJ) view that price pressures will gradually cool as import-push inflation subsides. The focus is now for underlying services price growth to spread more widely in the economy before the BOJ pares back its stimulus in the coming months. The BOJ decided to stand pat at its latest policy meeting in Dec 2023 as policymakers sought to gain confidence that the 2% stable inflation target can be reached. Meanwhile, exports remain sluggish amid external headwinds. Manufacturing activity appears to be deteriorating again amid weak domestic demand.

On markets, earnings momentum for Japan's equities remains favorable. The sharp depreciation in JPY provided a tailwind for corporate earnings, especially for the exporters. Looking ahead, the JPY could strengthen as the Fed, ECB and other major central banks begin to ease monetary policies. In terms of valuation of the index, MSCI Japan trades at 12MF P/E of 14.6x, which is close to the 10-year median 12MF P/E of 14.7x, with the high and low trading multiple of 19.9x and 11.2x respectively. Overall, Japan's equities are likely to be well-supported on continued earnings growth, structural reforms and reasonable valuations. Investors can consider gaining exposure with positively skewed asymmetric payoffs (e.g., with 100% minimum redemption features) to improve risk-reward and protect against reversal risks from JPY strength. Investors can also consider gaining exposure via diversified vehicles like funds. The currency is best left unhedged. **Overall, we remain Overweight on Japan's equities**.

MSCI Asia ex-Japan was almost flat through the whole of 2023, dragged by MSCI China (-17.3% in USD terms) which languished after a strong start (as of 26 Dec 2023). On the economy, China continues to face macro challenges amid a loss of momentum following the initial rebound after the unwinding of the zero-COVID policy. China's economy ought to be in a sweet spot with a weak economy culminating in strong policy reflation efforts. However, China faces several key challenges domestically, including fragile domestic confidence, the beleaguered property sector, rebalancing towards higher productivity, and securing greater self-sufficiency. These deep-seated issues have fueled deflation fears, with high debt and an aging population further constraining the long-term growth outlook.

Previous bull markets have been led by accommodative monetary policy, but total M1 money supply growth is near a two-decade low, while real interest rates are at a decade-high, suggesting an urgent imperative for policy change. It is critical that China boosts aggregate demand via aggressive policy stimulus. In addition, foreign investors are faced with the challenge of navigating a complex landscape mired by persisting Sino-US tensions and policy uncertainties. Taiwan's Presidential Election in Jan 2024 could be a geopolitical flashpoint between the US and China. At the same time, the National Press and Publication Administration (NPPA) published a new draft regulation on the online gaming industry on 22 Dec 2023, seeking to limit excessive spending and addiction. Renewed regulatory hurdles could hinder a broader Chinese valuation re-rating as investor jitters prevail.

On markets, MSCI China's valuation is undemanding with well-telegraphed headwinds largely priced in. However, there is no sign of a sustained valuation multiple expansion given a lack of visible catalyst. Chinese equities could see wide swings amid a sideways trend, where the bottom has likely been marked already, but gains will remain transient in the absence of structural improvements. Within China, investors can consider sell-put strategies on deep-value SOEs and secular growth sectors which are past the peak of policy intervention risks. **Across EM Asia, we like selected equities in South Korea and Taiwan which can participate in the modest tech up-cycle. We also like Singapore REITs as key beneficiaries of falling US interest rates. Against this backdrop, we remain Neutral on EM Asian equities**.

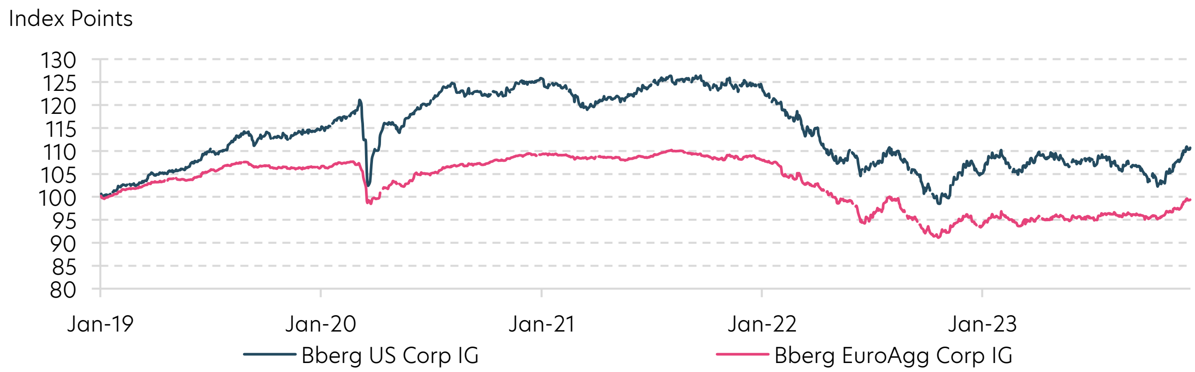
Fixed Income

Developed Markets Investment Grade Credits

We believe the US economy will enter a prolonged late-cycle environment in 2024 given uncertain fiscal policy backdrop (due to US elections), building monetary headwinds, and diminishing residual post-pandemic tailwinds. Eurozone economies will unlikely experience any meaningful uplift in exports given concerns over China's lackluster growth outlook in 2024. Collectively, we see lower government bond yields across developed economies in 2024. This, in our opinion, will drive bond returns next year. Our UOB Global Economics & Markets Research team forecasts the Fed to cut by 25bps each in 2Q24, 3Q24 and 4Q24 respectively. UST10 year yields are forecasted to settle around 4% by 4Q 2024.

US IG & EUR IG total returns (rebased start of 2019 = 100)

Source: Macrobond, UOB Private Bank

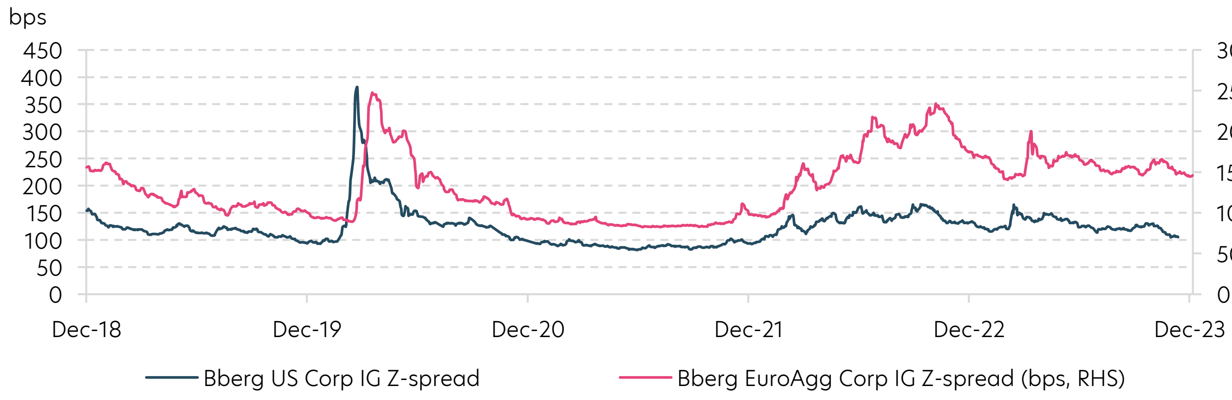


Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

While we see a skew to downside risks on fundamentals next year, credit profiles for solid IG credits should hold up relatively well amidst a sluggish-but-still-positive growth environment. Hence, we favor adopting a up-in-quality and defensive sector (i.e., healthcare, consumer goods, non-cyclical) bias to hedge against slower growth. IG valuations are tight and may not leave much cushion for idiosyncratic risks and black swan events.

US IG & EUR IG credit spreads

Source: Macrobond, UOB Private Bank



Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

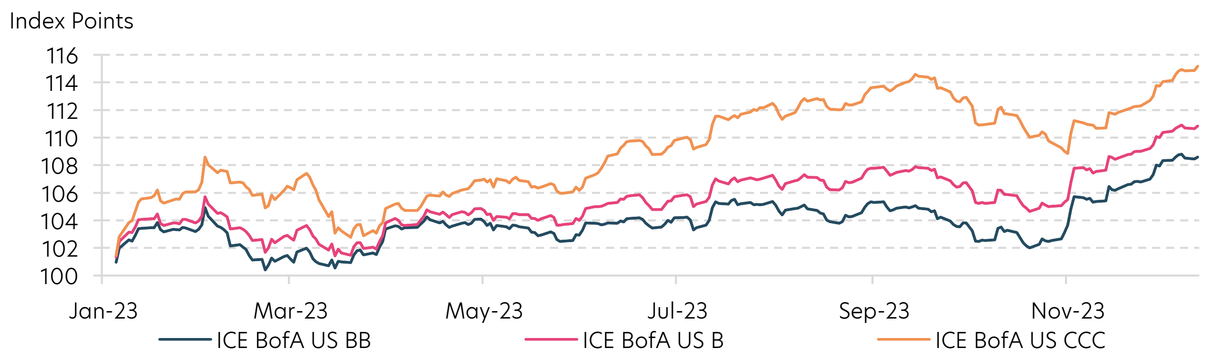
We expect yield-driven demand to remain strong and as such, will limit excessive credit spread widening on quality names. Stringent credit selection remains key, and we believe investors can benefit from adding duration exposure (to 5-8 years average mod. duration on portfolio basis) on the Fed's rate-cutting cycle. **Overall, we remain Overweight on DM IG credits.**

Developed Markets High Yield Credits

The US economy was more resilient than expected in 2023. This led to US HY outperforming its IG counterpart despite the Fed's hawkish narrative. Nonetheless, the labour market tightness is showing signs of easing but could still remain tight into 2024 in our view, even as growth slips below trend. US monetary policy is expected to remain restrictive and therefore, pile on more growth headwinds in 2024. Similarly, high policy rates in the Eurozone would erode credit fundamentals going forward; and may set forth a credit rating downgrade cycle.

US HY total returns (rebased start of 2023 = 100)

Source: Macrobond, UOB Private Bank

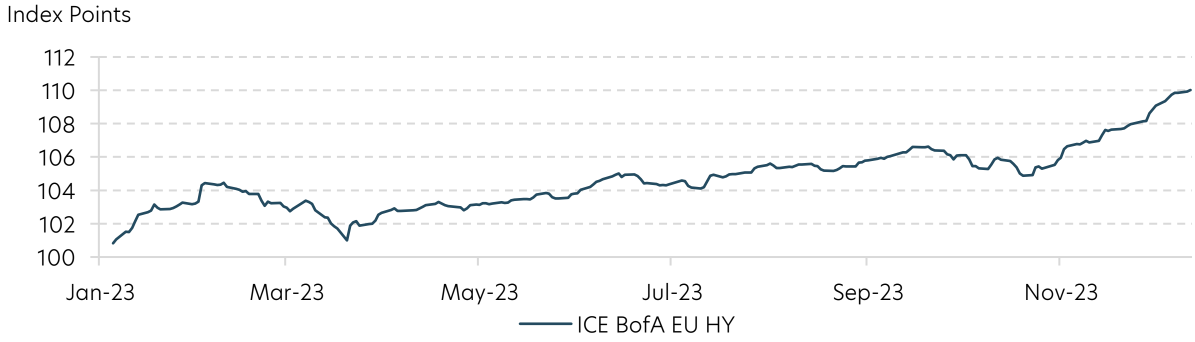


Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

With both the Fed and ECB currently on pause, the next move is likely going to be rate cuts on the back of moderating inflation and growth. We believe the balance of risk is gradually shifting from policy rate risks to credit risks. As such, the case for positioning in duration and better-rated credits (i.e., IG) is even more compelling. Higher default rates and material credit spread widening are notable risks on weaker credits (i.e., HY) in a maturing credit cycle. We expect the lagged effects from higher borrowing costs and dampened access to financing channels to adversely impact the financial flexibility of weaker companies. Funding conditions and liquidity positions for these weaker companies could be challenged and as such, **we are Underweight DM HY**.

EU HY total returns (rebased start of 2023 = 100)

Source: Macrobond, UOB Private Bank



Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

Performance dispersion between credit rating spectrums is likely to reverse from 2023 trends as greater emphasis is placed on credit risks. We are of the view that credit selection and timing will be central in capturing excess return in 2024. Allowing macro-driven volatilities to create valuation dislocation and evidence of central bank pivot will lead to value opportunities that delivers superior risk-reward payoffs.

Credit spreads in 2024 are likely going to be driven by sector differentiation and underlying fundamentals in our view. Hence, we are motivated to dial down on credit risk and seek shelter in BB credits over lower-rated ones within the HY complex.

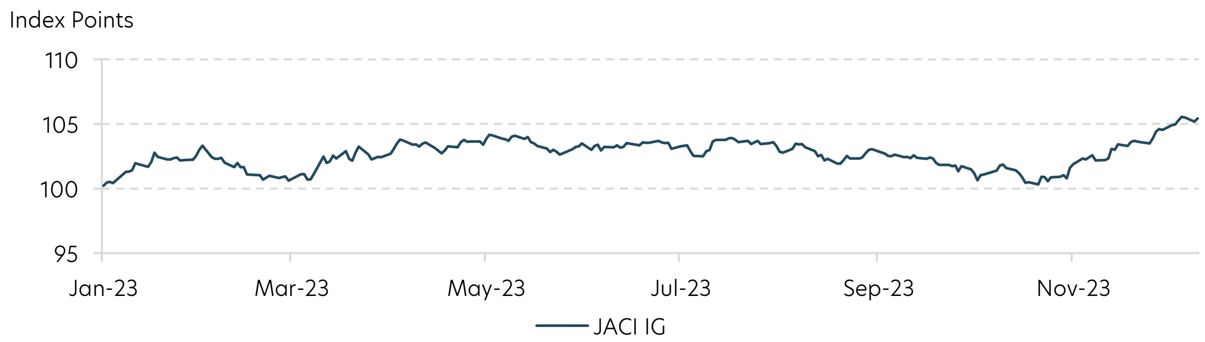
We expect select financials and corporates in the commodity sector to be beneficiaries of sector differentiation. These corporates are also better equipped to navigate an economic downturn having shored up their balance sheet leading up to 2024. **Overall, we remain Underweight on DM HY credits**.

Emerging Markets Investment Grade Credits

EM Asia IG had a resilient showing against a backdrop of elevated rates in 2023. The J.P. Morgan JACI IG (JACI IG) index delivered a total return of +5.43% YTD (as of 12 Dec'23) as yield carry mitigated the price-dampening impact from higher US treasury (UST) yields. JACI IG credit spreads tightened ~34bps YTD as global economic growth remained resilient with the impact from post-pandemic monetary easing and fiscal stimulus still being keenly felt. The absence of significant corporate earnings recession also supported credit valuations. Additionally, benign credit rating actions (i.e., upgrades, removal of negative outlook) on corporate issuers further reinforced well-behaved credit spreads.

JACI IG total returns (rebased start of 2023 = 100)

Source: Macrobond, UOB Private Bank



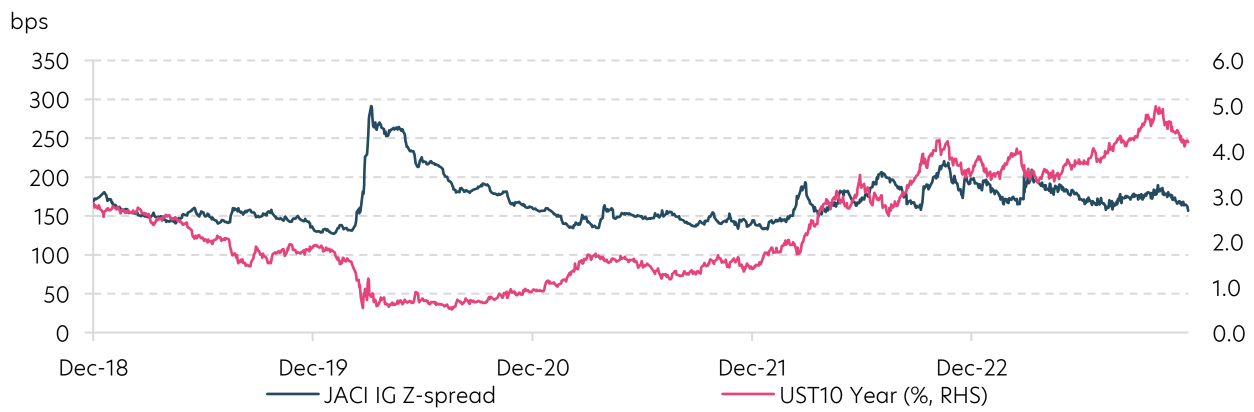
Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

As we head into 2024, we are Overweight EM Asia IG given its meaningful role as portfolio stabilizers and the much desirable up in quality trait it possesses. This in turn, will help cushion drawdowns on risk assets during episodes of market volatility. Bond yields on IG credits remain compelling when compared to the past decade. This is due to elevated benchmark rates and stable credit spreads. As such, income strategies and cashflow-based investing styles will be attractive in 2024.

Within EM Asia IG, we have preference for select credits within the Indonesian quasi-sovereign and top-tier China SOE (State-owned Enterprises) universe. Strategic importance and thus, high likelihood of support from their respective governments underpins our assessment criteria. We also like select non-government corporates that not only exhibit fundamental resilience but also hold competitive market shares in their sectors. In terms of duration positioning, **we are focused on taking a diversified approach by targeting an average modified duration of 5-8 years at the overall bond portfolio level.**

JACI IG - Stable IG credit spreads

Source: Macrobond, UOB Private Bank



Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

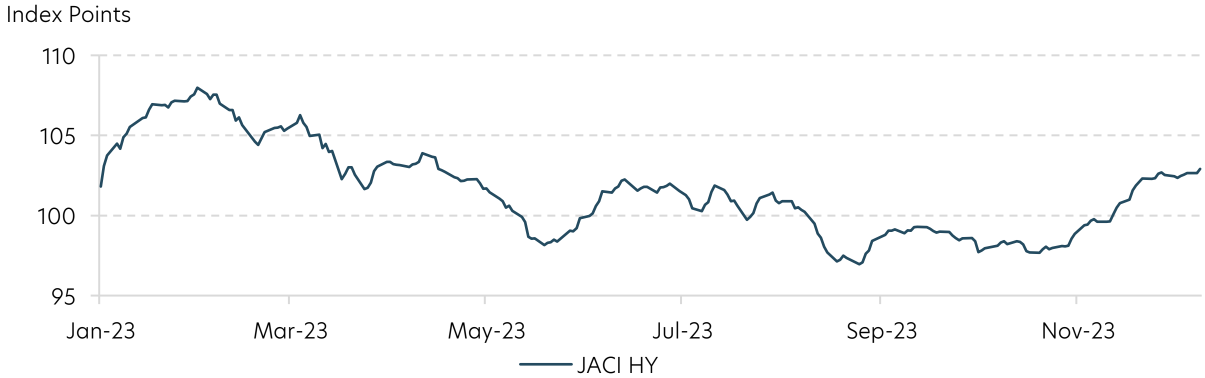
We do not expect bond yields to decline in a linear or parabolic fashion in 2024. As such, there will be opportunities to implement buy-on-dips strategies to achieve yield enhancement without compromising credit quality. Therefore, it is important for investors to boldly lock-in in attractive quality yields when this happens. As with DM IG, we expect carry to remain an important return driver in 2024 with rates providing additional return tailwinds on the Fed's pivot. **We remain Overweight on EM Asia IG credits**.

Emerging Markets High Yield Credits

The troubling downward spiral EM Asia HY experienced for the past 2 years has eased as the J.P. Morgan JACI Non-Investment Grade (JACI HY) index delivered a positive total return of +2.90% for YTD 2023 (as of 12 Dec'23). This coincides with what appears to be the peak of the distressed cycle in China's corporate real estate (CRE) sector. Correspondingly, default rates in the Asia HY universe has also declined from ~13.2% (in 2021) and ~16.8% (in 2022) to ~4.7% (in 2023) by estimates.

JACI HY total returns (rebased start of 2023 = 100)

Source: Macrobond, UOB Private Bank

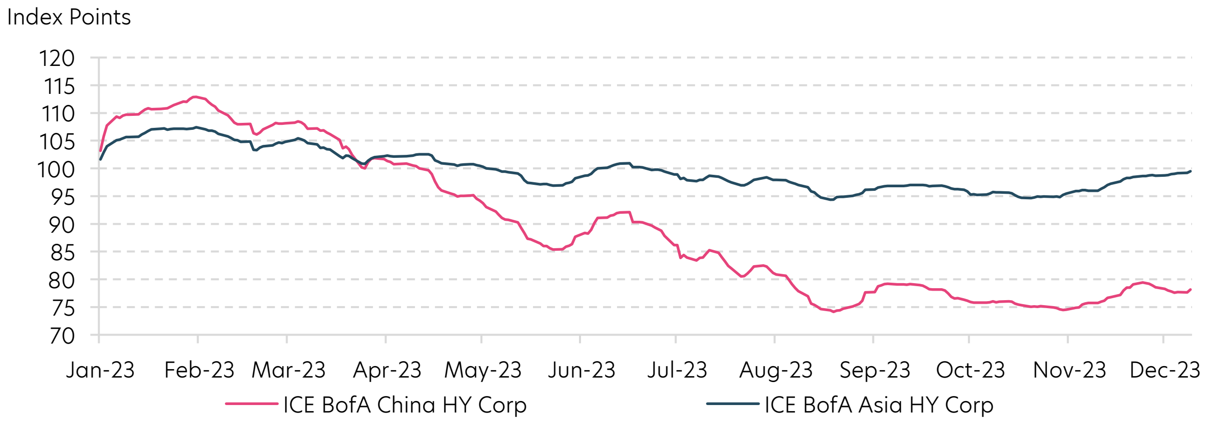


Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

The China HY CRE sector, which has been a notable underperformer for some time, continues to be policy-driven and rightfully so given distressed bond trading levels. We argue that whilst liquidity initiatives for developers may have sparked relief rallies, the damaged confidence of physical markets are still not exhibiting meaningful recovery. We have seen a slew of measures implemented in 2023 (i.e., bond state guaranteed program, fiscal incentives, mortgage cuts) that yielded limited impact in terms of preventing more default-contagion events. Liquidity pressures continue to loom large and even though policy intent is commendable, we see the need for more drastic steps or a stronger display of support (i.e., capital injection, intervention from state-owned distressed asset management companies, etc.) for us to revisit our cautious view on the sector.

China HY underperforms Asia HY

Source: Macrobond, UOB Private Bank



Source: Bloomberg, UOB Private Bank, as of 12 Dec 2023

Away from China HY, we see pockets of value in select Indonesian property developers, Indian renewables, and commodity/infrastructure credits. In 2023, stronger single-line corporates delivered some of the highest total returns within the EM Asia HY universe, even surpassing IG in some instances. These include corporate issuers that have improving or stabilizing credit profiles. On the same note, fallen angel risks remain more idiosyncratic than systematic in nature. Hence, avoiding credit events will meaningfully influence return profiles in 2024 as it did for 2023.

A more benign macroeconomic backdrop may have suppressed acute credit fundamental deterioration, but it certainly does not eliminate it. **We caution against chasing performance in EM Asia HY laggards** (e.g., China HY CRE), and prefer adopting a stringent bottoms-up analysis when engaging in any special situation trade ideas. **Overall, we remain Neutral on EM Asia HY credits for 2024**.

FX, Interest Rate & Commodities Forecasts

FX	30 Nov	1Q24F	2Q24F	3Q24F	4Q24F
USD/JPY	148	146	142	138	135
EUR/USD	1.09	1.11	1.13	1.15	1.16
GBP/USD	1.27	1.28	1.30	1.31	1.32
AUD/USD	0.66	0.67	0.68	0.69	0.70
NZD/USD	0.62	0.63	0.64	0.65	0.65
DXY	103.30	102.2	100.3	98.6	97.6
USD/CNY	7.14	7.10	7.00	6.90	6.80
USD/HKD	7.81	7.80	7.80	7.80	7.80
USD/TWD	31.31	30.8	30.4	30.0	29.6
USD/KRW	1,300	1,280	1,260	1,240	1,220
USD/PHP	55.53	55.2	54.8	54.4	54.0
USD/MYR	4.67	4.60	4.55	4.50	4.45
USD/IDR	15,510	15,400	15,200	15,000	14,800
USD/THB	35.22	34.8	34.3	33.8	33.3
USD/VND	24,262	24,000	23,800	23,600	23,500
USD/INR	83.40	83.0	82.0	81.0	80.0
USD/SGD	1.34	1.32	1.31	1.30	1.30
EUR/SGD	1.46	1.47	1.48	1.50	1.51
GBP/SGD	1.69	1.69	1.70	1.70	1.72
AUD/SGD	0.88	0.88	0.89	0.90	0.91
SGD/MYR	3.50	3.48	3.47	3.46	3.42
SGD/CNY	5.34	5.38	5.34	5.31	5.23
JPY/SGDx100	0.90	0.90	0.92	0.94	0.96

POLICY RATES	27 Dec	1Q24F	2Q24F	3Q24F	4Q24F
US Fed Funds Rate	5.50	5.50	5.25	5.00	4.75
JPY Policy Rate*	-0.10	-0.10	0.00	0.00	0.00
EUR Refinancing Rate	4.50	4.50	4.50	4.50	4.25
GBP Repo Rate	5.25	5.25	5.25	5.00	4.75
AUD Official Cash Rate	4.35	4.35	4.35	4.00	3.75
NZD Official Cash Rate	5.50	5.50	5.25	5.00	4.75
CNY 1Y Loan Prime Rate	3.45	3.35	3.35	3.35	3.35
HKD Base Rate	5.75	5.75	5.50	5.25	5.00
TWD Official Discount Rate	1.88	1.88	1.88	1.88	1.88
KRW Base Rate	3.50	3.50	3.50	3.25	3.00
PHP O/N Reverse Repo	6.50	6.50	6.25	6.00	5.75
MYR O/N Policy Rate	3.00	3.00	3.00	3.00	3.00
IDR 7D Reverse Repo*	6.00	6.00	6.00	6.00	6.00
THB 1D Repo	2.50	2.50	2.50	2.50	2.50
VND Refinancing Rate	4.50	4.50	4.50	4.50	4.50
INR Repo Rate	6.50	6.50	6.50	6.50	6.25

INTEREST RATES	30 Nov	1Q24F	2Q24F	3Q24F	4Q24F
USD 3M SOFR (compounded)	5.35	5.31	5.20	4.98	4.73
SGD 3M SORA (compounded)	3.75	3.72	3.64	3.47	3.28
10Y US Treasuries Yield	4.32	4.30	4.20	4.10	4.00
SGD 10Y SGS	2.96	3.15	3.10	3.05	3.00

COMMODITIES	30 Nov	1Q24F	2Q24F	3Q24F	4Q24F
Gold (USD/oz)	2,042	2,050	2,100	2,150	2,200
Brent Crude Oil (USD/bbl)	81	85	85	90	90
Copper (USD/mt)	8,465	8,000	8,000	7,000	7,000

Updated 22 December 2023
* Forecast updated as compared to previous report dated 01 December 2023
Source: UOB Global Economics & Markets Research

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