

UOB House View 3Q 2024

Thursday, 04 July 2024

The Team
Global Economics & Markets Research
Private Bank

Global Macro

Fed rate cut expectations have been delayed and dampened since early 2024, because of resilient US growth overlaid with sticky inflation. But the US slowdown may now be in sight which is still aligned with a soft-landing scenario. We expect the Fed to cut rates in 2H2024, but the uncertain downward path of inflation will keep it in a wait-and-see mode until Sep FOMC even as other major central banks have started to ease policy.

Asset Allocation

We remain Overweight on equities in our asset allocation due to supportive earnings and peak rates cycle. We prefer to remain neutral to our bond allocation amid firm Treasury yields on the back of US economic resilience. Cash remains an Underweight as the benign macro backdrop remains supportive for risk assets and allocation to alternatives remains an Overweight too as less correlated alternatives offer benefits of diversification.

Equities

While we recommend an increase in the allocation to equities, we remain underweight to US equities on the back of corrective forces despite the cyclical bull market. We have upgraded our allocation to European equities to overweight amid an industrial investment cycle. We maintain an overweight on Japan's equities while Asia's equity exposure remains neutral, as we are cautiously optimistic on China's turnaround while preferring South Korea, India, and ASEAN.

Fixed Income

For Developed Markets (DM), we remain Overweight on DM USD IG as credit spreads are holding up while all-in yields remain attractive. We stay Underweight on DM HY as we remain cautious of the asymmetric risk-reward. We maintain Overweight EM Asia IG as fundamentals remain resilient with coupon carry in focus. We are Neutral on EM Asia HY as avoiding credit pitfall will be of utmost importance.

Commodities

We can expect gold to be propelled higher in the months ahead by renewed ETF buying, once the Fed starts its anticipated rate cuts from Sep 2024. Overall, we maintain our positive outlook for gold and continue to raise our forecast higher to USD 2,400 / oz by 3Q24, 2,500 / oz by 4Q24 and 2,600 / oz by 1Q25 and 2,700 / oz by 2Q25. In line with the nascent signs of growth stabilization in China, we raise our LME Copper forecast to USD 9,000 / MT for 2H24 and USD 10,000 / MT for 1H25. We keep to our view Brent crude oil while consolidating around the USD 80 / bbl level, needs to reflect some form of geopolitical risk premium, and therefore keep our positive forecast of Brent crude oil for USD 85 / bbl for 3Q and 4Q24.

FX & Interest Rates

Overall, we kept to our existing view that Fed will start gradual rate cuts from Sep. As such, we continue to see USD weakness towards the end of the year. Our rates outlook stays unchanged as well and we continue to see gradual pullback in rates. We expect 3M compounded in arrears Sofr at 4.97% and 10Y UST at 4.10 by 4Q24.

Global Macro & Markets Strategy

The Fed waits while others start gradual rate cuts

The US slowdown may be in sight but inflation still taking time to ease

One year ago, we were questioning why an US economic downturn has not materialized despite the very aggressive Federal Reserve's (Fed) rate hiking cycle. The main driving force for the remarkable strength of the US economy was the very resilient US labor market, with immigration likely exerted a much bigger economic impact than previously thought as the new workers fill shortages and add to demand. The Congressional Budget Office (CBO) recently estimated that the immigration factor may potentially add US\$7 trillion to US GDP through 2033.

Although a soft landing remains our base case for the US economy in the second half of 2024, we still do not expect a deep recession or an outright contraction of annual GDP due to the absence of any acute financial imbalances. That long-deferred US slowdown may be emerging. The US economy continued to expand in the first three months of 2024 but the pace was underwhelming at just 1.3% q/q SAAR, the slowest in two years. While the weaker 1Q was mainly attributed to the net exports of goods and services (which turned negative for the first time since 1Q 22), the key components of private consumption and business expenditure also recorded more pronounced growth moderations. The 1Q slowdown also coincided with a smaller number of so-called encounters between migrants and immigration authorities which fell to about 190,000/mth in Feb and Mar, well below the record of >300,000 in Dec, according to US Homeland Security data.

There are also signs that some activities and segments of the US economy are contracting. The ISM manufacturing survey, which has mostly been in contraction territory (i.e. less than 50) since Nov 2022, fell further in May at 48.7 (Apr: 49.2), dragged by weaker demand. In comparison, services – accounting for 78% of US economy and a pillar of strength for the economy, saw the services ISM rebounding strongly to 53.8 in May (after a surprise dip to 49.4 in Apr), easing concerns about a broader US economic slowdown given the sector's importance. In addition, while immigration flows were positive for 2023 growth, its potential slowing could dampen GDP expansion in 2024. The Conference Board US leading index (except for a temporary blip in Feb 2024) has been contracting on a m/m basis almost uninterrupted since Apr 2022 while the University of Michigan consumer survey which had been hovering well above 70 in the first four months of the year, recently dipped to 69.1 (May 2024), well below the pre-pandemic level of 101.0 (Feb 2020).

On the US labour market, we are also seeing signs of cooling with supply and demand converging to a better balance. The number of job openings (based on the Job Opening and Turnover Survey or JOLTS) dipped to 8.1 million positions in Apr (from 8.3 million in Mar), the lowest in more than three years, and brought the number of vacancies per unemployed worker down to 1.20 in Apr (from 1.30 in Mar), the lowest in nearly three years. While the US economy continued to add more jobs in Apr (the 40th consecutive month of job gains since Jan 2021), it turned out to be underwhelming, coming in at 175,000, lowest in 6 months while the jobless rate climbed to 3.9% (Mar: 3.8%). We expect US jobless rate to rise above 4% to 4.3% by end-2024. Wage growth remained positive but moderated in pace (3.9% y/y in Apr, the first sub-4% wage growth since Jun 2021) and together with the shrinking excess savings, will imply less support to private consumption.

Reaffirming our US GDP outlook – expecting a technical recession in 2024

We believe US economic growth is nearing or already at the peak and is likely to turn lower in mid-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 stay elevated. For US households, the shrinking excess savings, tighter lending standards and elevated services costs (including housing) imply US consumers spending will come under more pressure and pull back from spending, especially for discretionary goods and services. Unemployment will pick up more meaningfully as the spokes of Fed cumulative rate hikes further wear down demand amidst a rise in delinquencies for credit card and car loans.

Our projections imply that US will experience a “technical” recession in 2Q-3Q 2024 (i.e. two consecutive quarters of negative q/q headline GDP data). When we look at the y/y figures, GDP is only expected to turn negative in 4Q 2024 temporarily before rebounding in subsequent quarters very much in line with a soft-landing scenario, based on our latest projections. Our annual GDP growth projections of 1.2% (2024) and 2.5% (2025) deviate to some extent from the US Fed's Jun 2024 SEP (Summary of Economic Projections) forecasts of 2.1% and 2.0%, respectively.

Concurrently, we revised our forecasts for US jobless rates to edge to 4.3% at end-2024 and improving to 3.9% at end-2025 which is also a deviation from the Fed's revised median projections of 4.0% and 4.2%, respectively.

US Forecasts – Technical recession mid-2024, but no outright annual GDP contraction					
<u>GDP (% q/q SAAR)</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>	<u>Full Year</u>
2024	1.3	-2.0	-1.2	1.4	--
2025	4.9	4.0	3.0	2.7	--
<u>GDP (% y/y)</u>					
2024	2.9	1.8	0.3	-0.2	1.2
2025	0.7	2.2	3.3	3.7	2.5
<u>Unemployment (%)</u>					
2024	3.8	4.0	4.2	4.3	4.3
2025	4.5	4.3	4.1	3.9	3.9

Source: Global Economics & Markets Research (as of 6 Jun 2024)

Inflation outlook is tricky although we still see gradual softening ahead

That said, the trickier part of the equation is on inflation. Underlying inflation for the US, as reflected by core PCE – which excludes food and energy and is the Fed Reserve's preferred price measure – proved to be stickier than what markets were hoping for and re-accelerated back to an uncomfortably elevated level as it spiked to 3.6% y/y in 1Q from 2.0% in 4Q & 3Q. There was some reprieve subsequently as both Apr's CPI and PCE deflators were seen as cooling in the right direction after the 1Q upside surprise. Key price drivers in Apr were housing and gasoline prices while insurance premiums for cars and homes were markedly higher (albeit smaller contribution due to their smaller weight in CPI). Core inflation measures were also in line with expectation, but services inflation remained stubbornly elevated.

If inflation resumes to "behaving badly" in the next few months, then that "easing" equation from the Fed will be in further doubt. 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 pace of 0.1% for next 12 months, then inflation will ease to 1.2% y/y in Apr 2025. However, if the m/m pace stays at the latest print of 0.3%, then that will imply inflation reaccelerating to a much faster rate of 3.7% y/y by Apr next year, certainly well above the Fed's 2% objective.

Nonetheless, with base effect, improved supply chains and stabilizing energy/food prices, we still expect inflation to cool with headline CPI inflation to average 2.5% in 2024 (against 4.1% in 2023), while core inflation may also ease but at a higher average of 2.8% in 2024, a significant moderation from 4.8% in 2023, but still above the Fed's 2% objective. We continue to monitor for upside risks which include a resilient jobs market with reaccelerating wage growth pressures adding to services inflation and renewed external supply chain/commodity risk factors.

Still expecting 2 rate cuts in 2024 but with lower confidence

Thus, the softening growth outlook keeps our expectations for Fed to cut rates this year intact, but the uncertain downward path of inflation will hold the Fed's hand and keep it in a wait-and-see mode until policymakers "gained greater confidence that inflation is moving sustainably toward 2 percent."

We continue to hold the view the Fed will keep its current the Fed Funds Target Rate (FFTR) steady at 5.25-5.50% for Jul FOMC, and subsequently start to ease monetary policy only in late 3Q, where we factor in 50 bps of rate cuts for the remainder of 2024, (i.e. two 25-bps cuts, one each in Sep 24 and Dec 24). Admittedly, the risk continues to be tilted towards the Fed delaying its actions further, nudged by a slow and challenging inflation descent. Even if the Fed starts to ease, we do not expect an aggressive series of cuts to counteract the prior aggressive hike cycle as a soft landing remains to be our central view. In the run up to the Fed's FOMC meeting in Sep, key to watch will be the upcoming CPI and PCE reports as well as the annual Jackson Hole meeting in Aug.

Central banks' policy direction: divergence in monetary policy cycle as Developed Market central banks cuts away while the Fed patiently waits

By now it is clear that some Developed Market (DM) central banks are diverging from the Fed and forging ahead with their rate cut cycle or setting their intentions to do so in the near future. The Fed has made it clear of its patience stance even though Fed Chair Powell also said that further hikes are unlikely.

The BOC led the way for the easing cycle among the G7 economies with a 25-bps cut on 5 Jun, its first rate reduction since 2020, joining the Swiss National Bank (SNB) and Sweden's Riksbank which have started their respective policy easing earlier in 2Q. The BOC also signalled more cuts to follow although it will remain dependent on the inflation progress which it projected "likely to be uneven" and Governor Macklem said the path of interest rates is likely to be gradual and does not need to move in lockstep with the Fed. The BOC was followed closely by the ECB the next day (6 Jun) in what was a well-telegraphed 25-bps cut although its guidance was less clear on the timing of the next cuts, citing it will follow "a data dependent and meeting-to-meeting approach".

The BOE is also projected to cut rates and we believe their easing to start in Aug just ahead of the Fed, and we are pricing in 75 bps worth of cuts from UK central bank in 2024, similar to the ECB but more than the Fed. We project both the RBA and the RBNZ could pivot to easing sometime in the second half of 2024 but the upside risks to inflation may see both to stay on hold for longer, and that risk of delay in cutting rates is likely more acute for RBNZ despite it being among the earliest DM central banks to undertake monetary policy tightening and its most aggressive tightening since 1999. At the opposite end of the DM spectrum is the BOJ although we believe it will adopt a cautious approach to further rate normalisation, with just another 15 bps hike to bring the policy call rate to 0.25% in 4Q 2024.

Whereas for Asian central banks, we believe the majority may be more inclined to adopt a wait-and-see approach to their own rate cut cycle, especially with regards to the uncertain start to Fed's policy easing cycle. Jumping the gun ahead of the Fed will exacerbate the risks of a widening interest rate differentials with the US which in turn, put depreciation pressure on the domestic currencies and capital outflows. Case in point is BI surprise rate hike in Apr to 6.25% to anchor the rupiah's stability. While we expect the BSP to start its rate cut cycle only in 4Q24 (by 25bps to 6.25%) when there are significant signs of inflation moving sustainably down to its midpoint target and Fed confirming its rate cut path, BSP Governor Eli Remolona has repeatedly signaled the central bank will cut its interest rates in Aug or 3Q24.

At the forefront of the monetary policy cycle in Asia is of course PBOC which has been progressively loosening policy on a targeted basis over the past years, in contrast to the significant policy tightening globally over 2022-2023 period. The beginning of Fed's rate cut cycle which we expect to be in Sep, would create the space for further monetary policy easing by the PBOC. As such, we still expect the 1Y loan prime rate (LPR) to fall to 3.20% by end-4Q24 (current 3.45%) while the 5Y LPR may stay on hold at 3.95% through the rest of 2024 after the 25 bps reduction earlier in Feb.

FX Strategy: Keeping faith for a weaker USD in 2H24

The USD was little changed against Major FX in the second quarter-to-date despite fluctuating Fed rate cut expectations. Overall, we reiterate our view of renewed USD weakness starting 3Q24 ahead of our expectations of Fed rate cuts in Sep and Dec. In line with this trajectory of gradual softening of the USD in line with the start of Fed rate cuts, we see Majors recovering against the USD towards the year end. As such, our 4Q24 forecasts for EUR/USD, GBP/USD, USD/JPY and AUD/USD are 1.12, 1.32, 149 and 0.69 respectively. The key risk to our bearish USD view is that if the Fed keeps its rates unchanged across 2024 should US inflation stay even more stickier and fail to come down further. In such a backdrop where other Major central banks would have already eased in 2H24, the USD would likely stay strong into end-2024.

The picture is somewhat different for Asia FX which are on track for more losses for a second straight quarter. While most Asia FX continued to bear the brunt of the "higher-for-longer" Fed rhetoric, intensifying efforts by Chinese authorities to stabilise its economy helped limit the downside risks to the CNY and spillover to the other regional peers. We have also seen some Asian central banks step up efforts to smooth currency volatility. After weakening in the 1H24, we expect Asia FX to recover modestly in 2H24. Firstly, the USD is expected to gradually lose its interest rate advantage, hence weaken anew as the Fed kickstarts its rate cut cycle in Sep. Secondly, a brighter economic outlook for China in 2H24 is expected to underpin a CNY and broader Asia FX recovery. As such, our 4Q24 forecasts for USD/CNY, USD/THB, USD/VND, USD/MYR, USD/IDR and USD/SGD are 7.13, 35.8, 25,000, 4.60, 15,800 and 1.33 respectively. The risk to our positive view Asia FX recovery is a sudden and unexpected CNY devaluation. Should the PBOC decide to lift the USD/CNY CFETS fixing to 7.15

from 7.11 currently, USD/CNY could revisit last year's highs above 7.30. That would almost certainly trigger a new round of Asia FX depreciation.

Rates Strategy: Not getting any easier for the Fed to cut

In line with the much anticipated start of the Fed easing cycle later this year, our base case remains for 50bps of cuts in 2024 (25 bps each in Sep 24 and Dec 24), followed by a further 100 bps of cuts in 2025 (at an estimated pace of 25 bps per quarter) and finally for Fed Funds to reach a floor of 3.25% in mid-2026. Potential macroeconomic implications post US Presidential elections seem to present more upside risks to inflation which will hinder the Fed's ability to ease monetary policy significantly. Specifically, a second term of Trump administration may usher in material policy changes in the areas of Tax, Trade Tariffs and Immigration. These would have an impact relative to the incumbency baseline in the areas of GDP growth, inflation, as well as the Fed's monetary policy stance. The consensus take on Trump's personal and corporate tax platform suggests that the first order impact will be a mild uplift to both real GDP and inflation. This would on balance further constrain the Fed's ability to ease monetary policy. In addition, when viewed through the lens of the US fiscal deficit, there is little indication from either side that fiscal discipline resides high on their campaign agenda. The consequent spill over into monetary policy will depend on the interplay between stimulatory fiscal settings and sticky inflation dynamics.

For now, short term rates are expected to drift lower across 2024 in line with our expectations of 50 bps rate cuts from the Fed. Eventually the 3M compounded in arrears Sofr and Sora could drop to 4.97% and 3.43% respectively by 4Q24. Towards the end of 2024 as well, we have kept our long term yield forecasts unchanged with the 10Y UST and SGD yields forecasted to progressively decline and may touch 4.10% and 3.15% respectively by 4Q24. The overall forecast curve points lower across time due to our monetary policy easing cycle base case. However, we note that adjustments in the 10Y UST term premium has been modest thus far and has not demonstrated the same repricing intensity as previously seen in Oct 23's "term premium scare". This is an uneasy equilibrium and one that currently seems more likely to resolve higher. Therefore, our bias in the short term for 10Y UST price action is that the risks lie in the direction of sticky to higher yields.


















Commodities Strategy: Metals take flight amidst strong rally in both Gold and Copper in 2Q24

The two key drivers pulling gold higher have been present since late last year and have not changed at all. First is the increasing uncertainty in the global geopolitical landscape with two on-going conflicts that have ignited safe haven buying of gold. Second is the strong EM and Asian central bank reserve allocation into gold, led by strong allocation from China. The strong rally in gold this year is even more remarkable given the on-going strength in the USD with SOFR staying high above 5%. This implies that the abovementioned safe haven buying and central bank allocation have now overcome previous dampening effect from the strong USD and higher rates. Going forward, we can expect gold to be propelled higher in the months ahead by renewed ETF buying, once the Fed starts its anticipated rate cuts from Sep 2024. Overall, we maintain our positive outlook for gold and continue to raise our forecast higher to USD 2,400 / oz by 3Q24, 2,500 / oz by 4Q24 and 2,600 / oz by 1Q25 and 2,700 / oz by 2Q25.

Alongside gold, LME Copper staged a very strong rally of more than 20% year-to-date, jumping from about USD 8,500 / MT in Jan to as high as USD 10,500 / MT by mid-May. This jump in LME Copper especially in 2Q24 can be attributed to two key drivers. First is the outsized and above seasonal stockpiling of copper inventory by China. The second driver is the renewed optimism in demand from green transition, which is a difficult driver to quantify. Overall, in line with the nascent signs of growth stabilization in China, we raise our LME Copper forecast to USD 9,000 / MT for 2H24 and USD 10,000 / MT for 1H25. Concurrently, we continue to warn of near-term correction risk given recent strong rally. Over the near term, there are concerns as to whether this strong rally is sustainable? Afterall, previous attempts to trade above USD 10,000 / MT on a sustained basis were unsuccessful.

There was a recent knee jerk sell-off in Brent in early Jun to just below USD 80 / bbl. This follows the market "disappointment" after OPEC announced at its latest meeting that they will gradually phase out about 2.2 mio bpd of production cuts from Oct 2024 to Sep 2025. However, it is important to note that baseline production cuts of 3.6 mio bpd will remain till end of 2025. Furthermore, while largely unspoken, OPEC is still expected to try to keep Brent crude oil stable around the USD 80 / bbl level. More importantly, long term geopolitical risks still remain. Iran is now a key crude oil producer pumping about 40% of Saudi Arabia's crude oil production. A renewed regional conflict escalation, putting both Iran's crude oil production and exports at risk will almost certainly fire up energy risk premium yet again. Overall, we keep to our view that Brent crude oil while consolidating around the USD 80 / bbl level, needs to reflect some form of geopolitical risk premium. We therefore maintain our modest positive forecast of Brent crude oil for USD 85 / bbl for 3Q and 4Q24 and USD 90 / bbl for 1Q and 2Q25.

Asset Allocation

Asset Classes	U/W	N	O/W	Comments
Equities				Remain Overweight on supportive earnings and peak rates cycle.
United States				Remain Underweight. Cyclical bull market is intact amid moderate corrective forces.
Europe				Upgrade to Overweight from Neutral. Funded to Europe from US amid an industrial investment cycle.
Japan				Remain Overweight. Equities are supported by strong earnings and corporate reforms.
EM Asia				Remain Neutral. Cautiously optimistic on China's turnaround. Prefer South Korea, India and ASEAN.
Fixed Income				Remain Neutral amid firm Treasury yields on US economic resilience.
DM IG				Remain Overweight. Credit spreads are holding up while all-in yields remain attractive.
DM HY				Remain Underweight. Stay cautious of asymmetric risk-reward.
EM IG				Remain Overweight. Fundamentals remain resilient with coupon carry in focus.
EM HY				Remain Neutral. Avoidance of credit pitfalls will be of utmost importance.
Alternatives				Remain Overweight as less correlated alternatives offer diversification.
Hedge Funds				Remain Overweight. Selected hedge funds can outperform the public markets.
Private Markets				Remain Neutral. Selected private-market funds have well-established track records.
Crude Oil				Remain Overweight. Downside risks have largely been priced in after recent pullback.
Base Metals				Remain Neutral. China's growth stabilisation bodes well for base metals at the margin.
Precious Metals				Remain Neutral. Gold can hold up well on central bank buying but is susceptible to pullbacks.
Money Market				Remain Underweight as a benign macro backdrop is supportive of risk assets.

 Underweight
  Neutral
  Overweight
  Current quarter's position

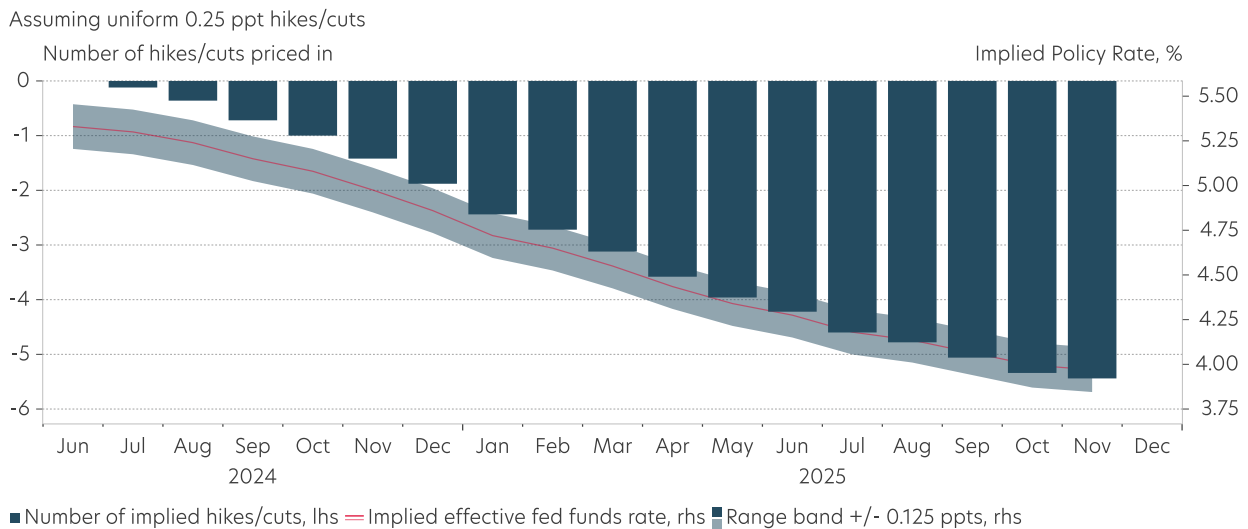
We maintain our overweight in equities given the reasonable growth outlook and expectation for lower inflation ahead. While the Fed has delayed its rate cut, it has not signaled a rate hike. This will be supportive for risk assets. We believe Japan, Asia and even Europe that are geared to the industrial sector and global manufacturing will be well-supported. China remains a valuation call and while policy stimulus remains piecemeal, the cumulative impact may become meaningful over time. Foreign investors are still lightly positioned on Chinese risk assets; their fund flows could return as growth becomes incrementally positive.

We maintain a bias to extend duration from cash and overweight credit carry, especially for financial issuers. Despite our call for the Fed to cut rates, supportive conditions do not warrant a reduction back to extremely low levels. A normalised rate environment bodes well for bank earnings. While cash rates are high, investors could be missing out on opportunities in more profitable investments. In fact, many fixed income sub-classes are yielding above cash, and will provide room for capital gains when interest rates start to decline or credit spreads tighten.

Finally, while we are positive on risk assets overall, we continue to recommend an allocation to less correlated alternative assets including hedge funds, private assets, gold, and commodities. Infrastructure buildout, general supply shortage and episodic geopolitical flashpoints are supportive factors.

Figure 1 - Implied number of the Fed rate hikes/cuts: No rate hike being priced in so far

Source: Macrobond, UOB Private Bank, CME Group



Equities

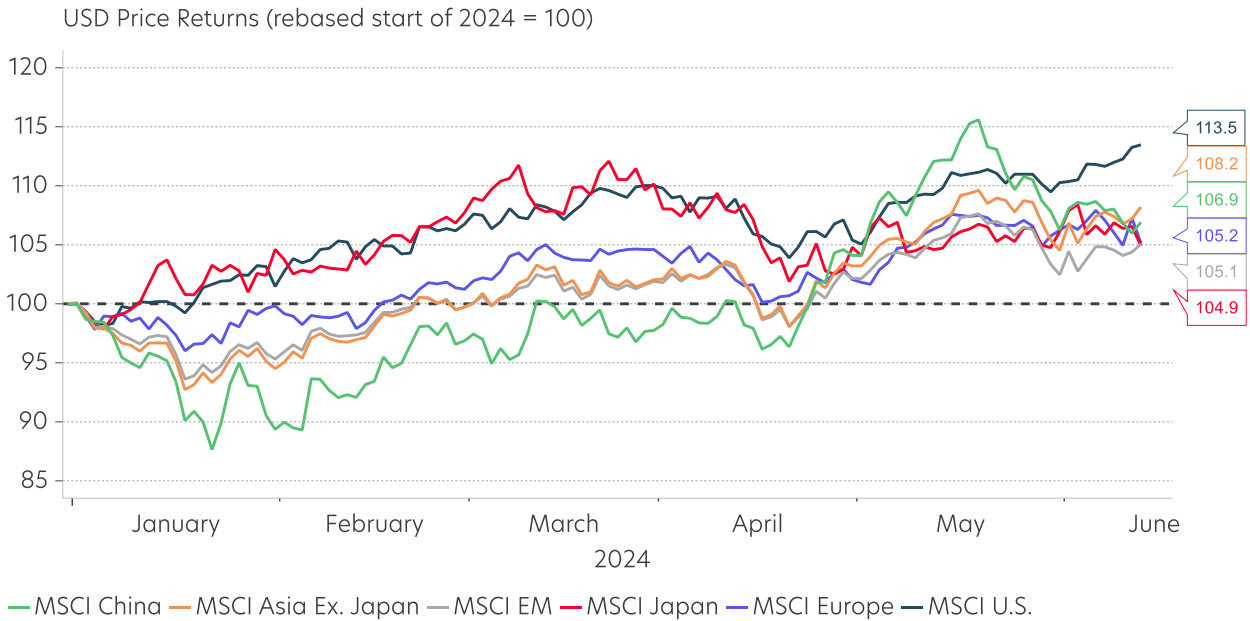
MSCI USA (+13.5% in USD terms) outperformed all other regional markets year-to-date (as of 13 June 2024). Out of the ~3,000 US companies which have reported their latest quarterly results, close to 65% saw positive earnings surprise. It is noteworthy that more than 70% of those in Technology (highest across the sectors) beat their earnings estimates. Stocks leveraged to the Momentum factor continued to outperform, led by the AI boom.

On economy, the impacts of the Fed's tightening cycle have so far been offset by expansionary fiscal policies, limiting vulnerabilities and lending support to the US growth resilience. Yet, the rising interest burden on public debt could constrain fiscal policy going forward. Consumer data remained healthy for consumers and small businesses. While consumer cash buffers are substantially lower than at the peak of the pandemic, they are still higher than pre-pandemic. Meanwhile, household wealth effect still dominates. Having said that, the ISM manufacturing PMI rebound has stalled, suggesting that demand could be weakening.

Looking ahead, forthcoming bad economic news could be tantamount to good news for the markets. Continued growth slowdown and disinflation, albeit with speedbumps along the way, will lay the groundwork for the Fed to cut interest rates later this year. It is noteworthy that markets have not priced in any Fed rate hikes; rate-cut expectations have simply been delayed. Barring a recession or financial crisis, anticipated rate cuts will likely spur the next up-leg in risk assets.

Equity Performances

Source: Macrobond, UOB Private Bank



While inflation has been stubborn for the last two years, it is projected to decline. Indeed, the US super core services inflation has been stickier than expected, with the services sector still generating solid labour demand. Yet, the underlying trend points to a softening US labour market, with the current job openings to unemployed ratio falling back to pre-pandemic levels. At the headline level, an upside surprise in the labour market strength or inflation could periodically lead to Fed Funds Futures pricing in a less/no-cut scenario for this year. Nonetheless, policy rates are biased downwards.

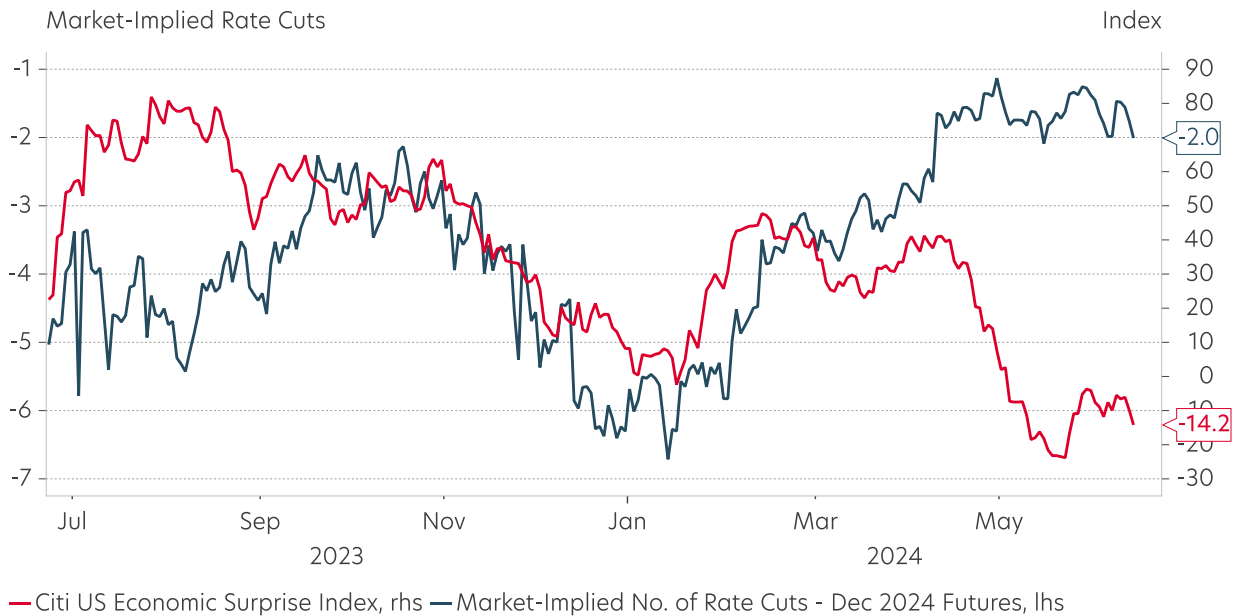
On markets, a consolidation or pullback can be expected following an overextended equity rally. Having said that, the corrective forces for the equity market will likely be moderated due to several factors. First, a dovish Fed rhetoric and an encouraging earnings outlook (with the latest earnings season tilting to positive surprises) should lend support to risk sentiment. Second, the "Magnificent 7" continue to generate resilient sales growth and robust operating margins in aggregate. Third, the recent string of downside economic surprises could bring forward rate cuts.

Against a backdrop of imminent US elections, markets could see higher volatility in the coming months. With a view that the cyclical bull market remains intact, investors could consider buying on pullbacks or engaging defensively via structured products. We advocate diversifying some exposure away from the "Magnificent 7" to the value-oriented sectors like Energy, Commodities, Industrials and Utilities. Some of these stocks can hedge against higher inflation expectations and/or benefit from a manufacturing rebound as well as the AI investment cycle.

Overall, we remain Underweight on US equities.

Huge divergence in the Fed rate-cut expectations vs. US economic surprise

Source: Macrobond, UOB Private Bank



MSCI Europe (+5.2% in USD terms) underperformed several regional markets year-to-date (as of 13 June 2024). The positive price returns thus far can be attributed to valuation rerating amid a lackluster earnings growth, offset mostly by the EUR depreciation. For 2Q 2024, European growth stocks fared better than their Value peers. French President Macron's decision to hold snap elections (on 30 Jun and 7 Jul) led to a surge in political uncertainties as well as risk premium, culminating in the latest drawdown which accounted for Europe's regional underperformance.

On the economy, European growth had a reset last year and is looking sequentially better this year. While Euro area core services inflation has been sticky of late due to strong wage growth, the European Central Bank (ECB) has been optimistic that inflation is on track to fall to its 2% target next year. This optimism is driven by a relief in supply-side pressures. A rebound in productivity growth and moderating wage gains should culminate in lower unit labor costs. Overall, the process of disinflation remains firmly on track for the eurozone economies.

Following the ECB's latest 25 bps rate cut in June which was in line with our expectations, markets are set to focus on the timing of future moves. The ECB President Christine Lagarde did not provide firm guidance on further easing in her typical adherence to a data-dependent approach. However, further slowdown in wage growth amid fewer upside risks to prices, as well as the slump in commercial real estate, would render it difficult for the ECB to justify a restrictive policy stance.

On markets, Europe's relative earnings growth momentum could be bottoming out amid undemanding valuations. Notably, the European banks, especially those in the peripheral regions like Italy and Greece, have rallied on the back of much reduced systemic stress. Overall, the risk-reward for European equities has improved, especially with the ECB beginning its policy pivot ahead of the US Federal Reserve.

Looking ahead, Europe's industrial exports growth are poised to rebound amid nascent signs of growth stabilisation in China. Eurozone's manufacturing PMI has already bottomed alongside the global peers. Importantly, continued "friend-shoring" and re-shoring trends will favour selected industrial players which are leveraged to the infrastructure buildout. Structural capex growth in the areas of transmissions, renewables and datacenters will benefit some of these names. Concurrently, given the mounting geopolitical tensions and policy uncertainties, rising military defense spending across sovereign states will feature as a big macro theme.

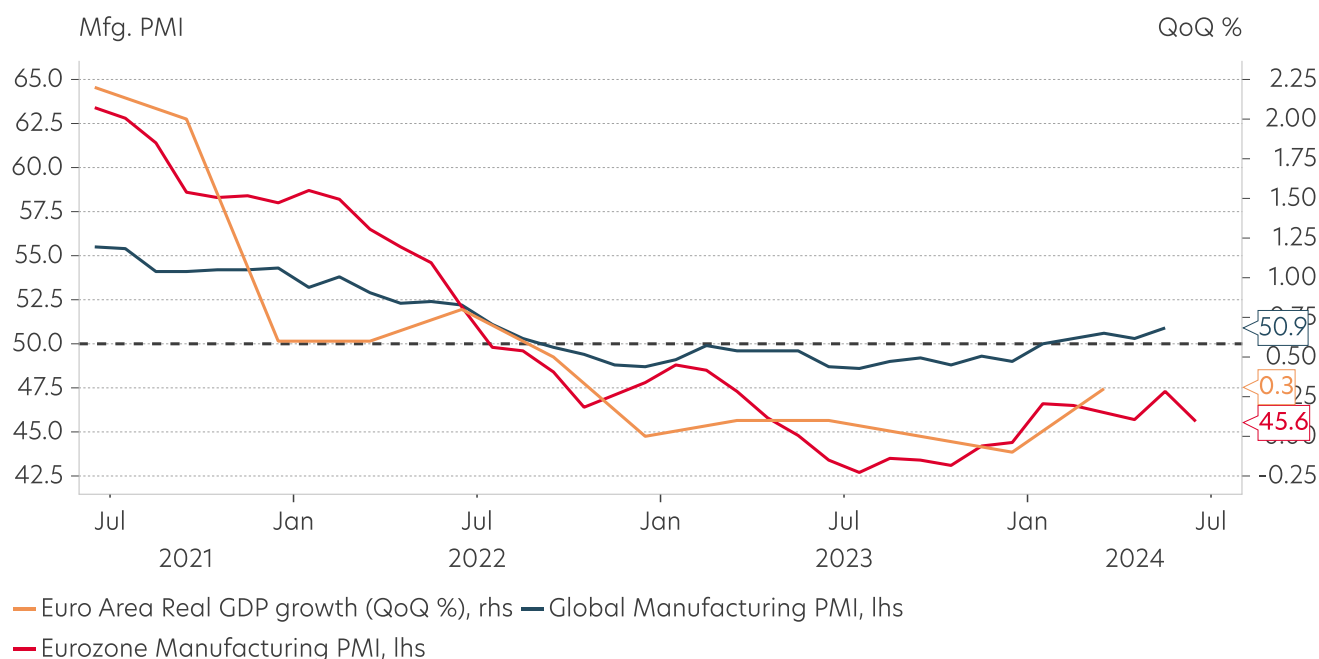
While growth prospects for eurozone economies are brightening, it is imperative for investors to stay selective. We remain on watch for China's growth trajectory and manufacturing activity levels, which have huge implications for the eurozone

exports. We reiterate preference for quality large-cap stocks which are leveraged to the industrial theme, and stocks with resilient fundamentals and a solid track record of dividend payouts. Healthcare stocks are also favoured for their growth characteristics with defensive tilts.

Overall, **we upgrade Europe's equities to Overweight from Neutral.**

A manufacturing activity rebound and growth improvement in the Euro area

Source: Bloomberg, UOB Private Bank



MSCI Asia ex-Japan (+8.2% in USD terms) staged a strong comeback in mid-April, outperforming China (+6.9% in USD terms) but trailing behind the US year-to-date (as of 13 June 2024). China broadly remains a valuation call. Latest fund managers' surveys suggest that sentiments towards China have turned incrementally less pessimistic, as some institutional investors seek to reduce their heavy underweight on allocation to China's equities. It is noteworthy that while China's policy stimulus remains piecemeal, the cumulative impact may become meaningful over time.

On economy, there have been nascent signs of growth stabilisation in China. Exports growth has been resilient amid a global tech upswing, firm external demand and competitive pricing. Meanwhile, the supply-side of the economy has been recovering amid strong industrial production and easing deflationary pressures (seen in producer prices). Having said that, China's manufacturing PMI surprisingly slipped into contraction in May, sparking concerns that weak demand could short-circuit China's growth recovery. Expansion in services also slowed. Retail sales growth has been lackluster amid domestic consumption downgrade.

For now, the Chinese government continues to provide drip-feed stimulus to the economy despite excess household savings. The government's property loosening measures could provide some support, but the slump in housing market requires more policy efforts to be effectively reinvigorated. Looking ahead, downward pressures in the economy could force President Xi to pivot to pro-growth policies. On markets, Chinese equities have tended to rebound from a wide earnings yield relative to bond yield gap. As the yield gap narrows from a record high, there is still further upside potential in Chinese equities from current levels.

It is also noteworthy that a golden cross, where the 50-day moving average cuts above the 200-day moving average, has been established in both the Hang Seng Index (HSI) and the CSI 300 Index. This is a bullish technical set-up that typically signals further share price gains. Importantly, based on several indicators, China's current market conditions resemble those of 2016 (which saw a sustained market recovery) as opposed to those of 2015 (which saw a temporary bounce).

Finally, any positive catalyst could drive Chinese equities higher from here given low expectations and their deep valuation discount relative to global and EM peers.

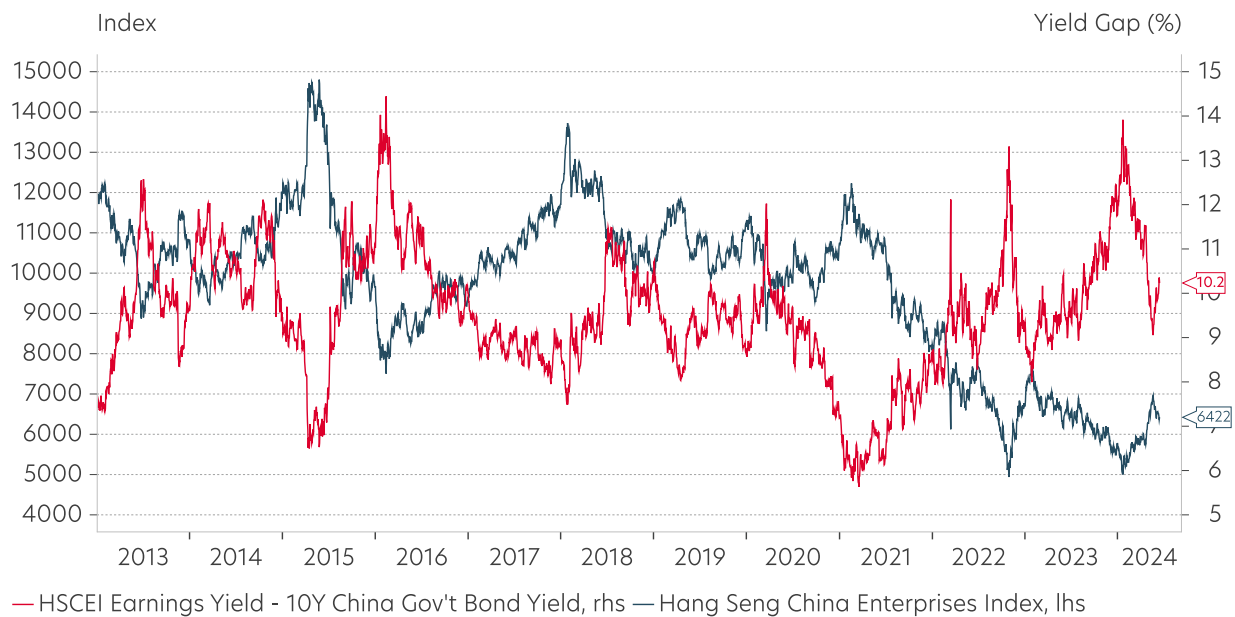
In terms of positioning, investors could consider a barbell strategy with high-dividend names on one end, and selected beta options (e.g., China Internet) on the other end. High dividend-yielding stocks could benefit from a potential dividend tax waiver which is under consideration for Hong Kong-listed stocks via Stock Connect. Meanwhile, foreign inflows are expected to return to selected Internet names which have seen strong growth in their latest earnings results.

Within emerging Asia, we prefer stocks in South Korea, India and ASEAN region. Selectivity is key in Chinese equities. Investors can consider engaging them defensively via structured products.

Overall, **we remain Neutral on EM Asia's equities.**

Yield gap is narrowing from record high; risk-reward for equities is still attractive

Source: Macrobond, UOB Private Bank



MSCI Japan (+4.9% in USD terms) underperformed all other regional markets except their EM peers (as of 13 June 2024). This can be largely attributed to the yen's continued depreciation against the US dollar given their wide interest rate differential for carry trades. The rise in Japan's long-term bond yields also posed as a drag to semiconductor names and other growth stocks. While bearish guidance for FY2024 was perceived as a near-term setback in the fiscal year results reporting season which ended in mid-May, the acceleration of corporate governance reforms remains supportive of Japanese equities in the longer term.

On the economy, revised real GDP growth for 1Q 2024 showed a narrower annualised contraction of 1.8%, suggesting domestic demand is weak and the economy lacks vigor. Notably, net exports dragged alongside private consumption and capital expenditure. Household spending has been retreating as wage growth has not been able to keep up with the broad inflation. These could temper expectations for the Bank of Japan (BOJ) to hike policy rates in the near term.

Despite a worsening economic environment, the BOJ is cognisant of the effects of a weaker currency on inflation and the broader economy. Domestic consumers lament the higher costs of living, which are passed through from imported energy and materials. Given BOJ's expectations for a pickup in demand-led inflation, markets expect the BOJ to hike rates towards the end of this year. Coupled with the Fed rate cuts, the weak yen pressure could peak out in the coming months.

On the markets, FY2023 results confirmed that corporate reforms are accelerating. The total value of share buybacks rose ~60% y/y, while raising return on equity (ROE) targets and shareholder returns has become a focal point. Looking ahead, there is still potential for Japanese companies to put large sums of the excess cash on their balance sheets to more efficient use. i.e., further share buybacks and higher growth investments. A reduction to net cash positions by increasing leverage could also culminate in further uplift to the share prices.

While MSCI Japan's valuation has pulled back slightly to 16x 12-month forward P/E in 2Q 2024, the structural rerating is well-sustained. At the same time, the earnings momentum has remained favourable. In this vein, companies could look to raise guidance as FY2024 progresses. Strong corporate earnings as well as corporate actions aimed at improving capital efficiency are expected to drive a recovery in Japanese equity performance and support shareholder returns.

We reiterate preference for investors to keep the yen unhedged to defend against any abrupt shifts in BOJ's policy. Selected Consumer Discretionary names should continue to hold up well on firm inbound consumption. Meanwhile, upward pressure on Japan's interest rates typically bodes well for the Financials sector. Finally, companies tapping into strong AI and semiconductor demand remain well-positioned for long-term outperformance. Investors can consider engaging them defensively via structured products. Overall, **we remain Overweight on Japan's equities**.

A sustained structural re-rating amid strong earnings momentum for Japanese equities

Source: Macrobond, UOB Private Bank



Fixed Income

Developed Markets Investment Grade Credits

DM Investment-Grade (IG), proxied by the US Corporate IG Index (Bloomberg US Corporate Bond Index), delivered a total USD return of +0.4% year-to-date (as of 13 June 2024). This was driven by a trio of offsetting effects: marginal credit spread tightening, coupon carry and negative US treasury ("UST") returns. UST yields rose to a year-to-date high in end-Apr before paring back on softer manufacturing data.

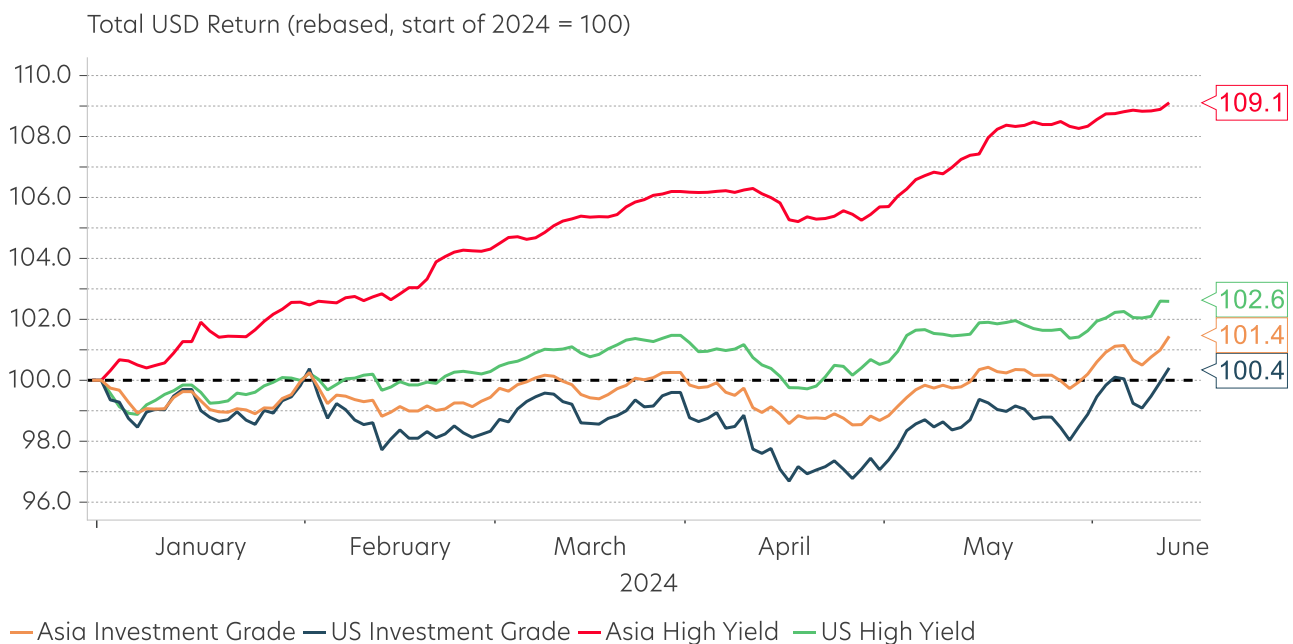
Expectations for eventual Fed rate cuts and a soft landing in the US economy provide an accommodating backdrop for credit spreads to stabilise. At current juncture, spread differentials are pricing in consensual likelihood of about 2 rate cuts over the next 6 months.

Credit valuations appear stretched but all-in yields remain attractive from a historical perspective. Excess returns for the rest of 2024 will likely be driven by credit selection; avoiding adverse credit events will prove paramount. We continue to advocate a bottom-up approach in selecting fundamentally robust credits to secure income over a longer horizon.

Overall, **we remain Overweight on DM IG.**

Fixed Income Year-to-date Performances

Source: Macrobond, UOB Private Bank



Developed Markets High Yield Credits

DM High Yield (HY) continued its outperformance over IG, with the US Corporate HY index (Bloomberg US Corporate High Yield Index) posting a total USD return of +2.6% year-to-date (as of 13 June 2024). The performance is largely idiosyncratic in nature, with selected distressed names leading overall returns on improved risk sentiments.

HY credit spreads outperformed by tightening ~25 bps year-to-date. Elevated credit carry at 312 bps average option-adjusted spread (OAS) on index level (as of 13 June 2024) remains a source of excess return, with systematic risks stay well-contained.

Having said that, default rates are projected to edge higher amid the elevated interest-rate environment. Overall, the material credit spread compression between IG and HY, as well as rising tail risks from a potential acceleration in defaults, lead us to be cautious of the asymmetric risk-reward.

Therefore, **we remain Underweight on DM USD HY.**

Asymmetric risk-reward following material spread tightening in High Yield

Source: Macrobond, UOB Private Bank



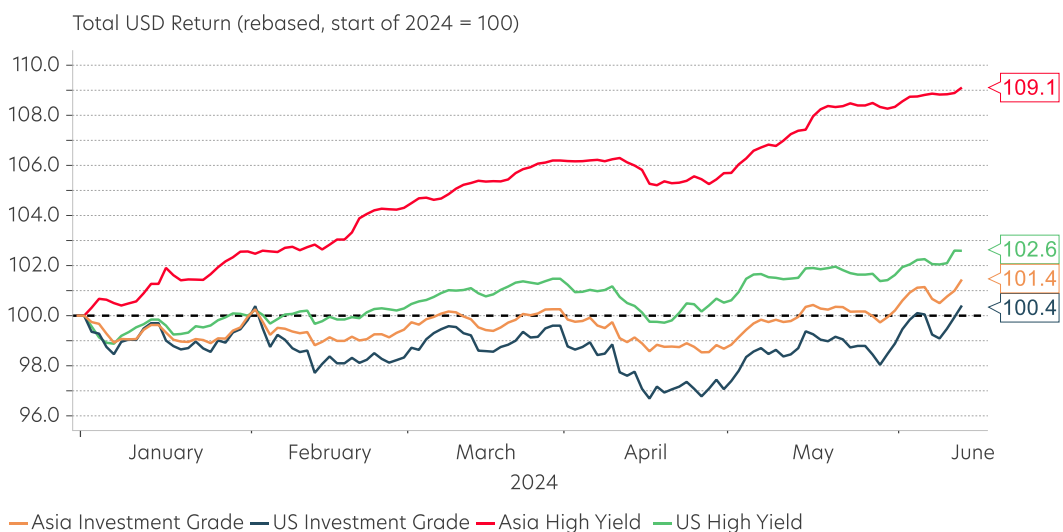
Emerging Markets Investment Grade Credits

EM Asia Investment-Grade (IG) delivered a total USD return of +1.4% year-to-date (as of 13 June 2024) at the index level (Bloomberg EM Asia USD Credit High Grade Index). Notably, IG credit spreads were ~30 bps tighter year-to-date. EM credits have been a beneficiary of a supportive macro backdrop and favourable demand-supply dynamics. Apart from coupon carry, treasury performance under the scenario of eventual Fed rate cuts will be an important contributor to total returns for 2024.

Within EM Asia IG, we maintain our preference for Asia financials, select Asia-focused insurers, quasi-sovereigns/strategic state-owned enterprises, as well as defensive consumer names. We emphasise the importance of adopting a diversified approach in managing duration risk, with an average modified duration target of 5-8 years. **We continue to advocate buying on dips whenever such opportunities present themselves and reiterate our Overweight on EM Asia IG.**

Fixed Income Year-to-date Performances

Source: Macrobond, UOB Private Bank



Source: Macrobond, UOB Private Bank

Emerging Markets High Yield Credits

EM Asia High Yield (HY) maintained its standout performance with the reference index (Bloomberg Asia USD High Yield Bond Index) delivering a total USD return of +9.1% year-to-date (as of 13 June 2024). Apart from the removal of defaulted China property developer bonds which contributed to base effects at the index level, the profound recovery of idiosyncratic dollar curves (i.e., Sri Lanka, Pakistan and select mainland China/HK SAR developers) pulled returns higher.

We continue to maintain a cautious stance on the China property space given the lack of meaningful, direct policy support for developers. Moreover, positive restructuring outcomes have faced significant headwinds as liquidation possibilities remain an overhang. In this regard, caution and high selectivity remains our modus operandi within the EM Asia HY sector. We favour select ASEAN infrastructure, Indonesian utility and Indonesian property development credits.

Overall, **we remain Neutral on EM Asia HY.**

Emphasize selectivity after material spread tightening

Source: Macrobond, UOB Private Bank



FX, Interest Rate & Commodities Forecasts

FX	06 Jun	3Q24F	4Q24F	1Q25F	2Q25F	POLICY RATES	21 Jun	3Q24F	4Q24F	1Q25F	2Q25F
USD/JPY	156	152	149	147	145	US Fed Funds Rate	5.50	5.25	5.00	4.75	4.50
EUR/USD	1.09	1.10	1.12	1.14	1.15	JPY Policy Rate	0.10	0.10	0.25	0.25	0.25
GBP/USD	1.28	1.30	1.32	1.34	1.36	EUR Refinancing Rate	4.25	4.00	3.75	3.50	3.25
AUD/USD	0.67	0.68	0.69	0.70	0.71	GBP Repo Rate	5.25	5.00	4.75	4.50	4.25
NZD/USD	0.62	0.63	0.64	0.65	0.65	AUD Official Cash Rate	4.35	4.35	4.00	3.75	3.50
DXY	104.12	103.19	101.56	99.95	99.02	NZD Official Cash Rate	5.50	5.50	5.25	5.00	4.75
USD/CNY	7.25	7.20	7.13	7.06	7.00	CNY 1Y Loan Prime Rate	3.45	3.20	3.20	3.20	3.20
USD/HKD	7.81	7.80	7.80	7.80	7.80	HKD Base Rate	5.75	5.50	5.25	5.00	4.75
USD/TWD	32.29	32.00	31.50	31.00	30.50	TWD Official Discount Rate	2.00	2.00	2.00	2.00	2.00
USD/KRW	1,363	1,350	1,330	1,310	1,290	KRW Base Rate	3.50	3.25	3.00	2.75	2.50
USD/PHP	58.54	58.00	57.50	57.00	56.50	PHP O/N Reverse Repo	6.50	6.50	6.25	6.00	5.75
USD/MYR	4.69	4.65	4.60	4.55	4.50	MYR O/N Policy Rate	3.00	3.00	3.00	3.00	3.00
USD/IDR	16,260	16,000	15,800	15,600	15,400	IDR 7D Reverse Repo	6.25	6.25	6.25	5.75	5.50
USD/THB	36.38	36.20	35.80	35.40	35.00	THB 1D Repo*	2.50	2.50	2.50	2.50	2.50
USD/VND	25,433	25,200	25,000	24,800	24,600	VND Refinancing Rate	4.50	4.50	4.50	4.50	4.50
USD/INR	83.48	83.00	82.00	81.00	80.50	INR Repo Rate	6.50	6.50	6.25	6.00	5.75
USD/SGD	1.35	1.34	1.33	1.32	1.31	INTEREST RATES	06 Jun	3Q24F	4Q24F	1Q25F	2Q25F
EUR/SGD	1.47	1.47	1.49	1.50	1.51	USD 3M SOFR (compounded)	5.35	5.22	4.97	4.72	4.47
GBP/SGD	1.72	1.74	1.76	1.77	1.78	SGD 3M SORA (compounded)	3.67	3.60	3.43	3.28	3.08
AUD/SGD	0.90	0.91	0.92	0.92	0.93	10Y US Treasuries Yield	4.29	4.20	4.10	4.00	3.90
SGD/MYR	3.49	3.47	3.46	3.45	3.44	SGD 10Y SGS	3.21	3.20	3.15	3.10	3.00
SGD/CNY	5.39	5.37	5.36	5.35	5.34	COMMODITIES	06 Jun	3Q24F	4Q24F	1Q25F	2Q25F
JPY/SGDx100	0.86	0.88	0.89	0.90	0.90	Gold (USD/oz)	2,372	2,400	2,500	2,600	2,700
						Brent Crude Oil (USD/bbl)	80	85	85	90	90
						Copper (USD/mt)	10,149	9,000	9,000	10,000	10,000

Updated on 24 June 2024

* Forecasts updated as compared to previous report on 07 Jun 2024
Source: UOB Global Economics & Markets Research

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