# Global Asset Allocation Views -- June 2023

## 1 *Global Asset Allocation*

(SUW – strong underweight, UW - underweight, N – Neutral, OW-overweight, SOW – strong overweight)

| | | SUW | UW | N | OW | SOW | |
|---|---|---|---|---|---|---|---|
| **Asset Class** | ***Equities*** | | | ■ | | | Economic data are mixed, inflation rates are trending down, and central bank rate hikes are close to the end. However, valuations, especially in the US, are not cheap compared to fixed income assets. Tight monetary policies and recession fears still present headwinds. |
| | ***Bonds*** | | ■ | | | | Elevated inflation rates, though declining, are potential risks to bonds. |
| | ***Real Assets*** | ■ | | | | | Declining inflation and slowing economic growth (potential recession) decrease the demand for commodities and real assets. |
| | ***Cash*** | | | | | ■ | Cash offers attractive yields, low duration, and a good place for liquidity. |
| **Regions and Styles** | ***U.S.*** | | | ■ | | | Despite the resilient labor market and consumer spendings, manufacturing and housing sectors have shown weakness. Valuation is still expensive compared to historical average. AI-induced tech rally offers tailwinds. |
| | ***International Markets (DM)*** | | | | ■ | | Valuations are attractive compared to the US. Currencies may appreciate as the US dollar has peaked. |
| | ***Emerging Markets (EM)*** | | | | ■ | | Valuations are attractive relative to the US. Local currencies may appreciate further against the USD. China may adopt new stimulus measures as its economic recovery stalled. |
| | ***U.S. Growth vs. Value*** | | ■ | | | | Value stocks are cheap compared to historical average and slowing economic growth and higher interest rates also makes the growth stock unattractive. However, the AI boom may offer tailwind to tech sectors. |
| | ***U.S. Small vs. Large-Cap*** | | | | | ■ | Small caps offer the cheapest valuation in decades. High quality small cap stocks should provide tremendous upside potential. |
| | ***Real Asset Equities*** | ■ | | | | | Declining inflation and economic growth concerns should put pressure on commodity prices. Higher interest rates and reduced demands for office space are unfavorable for commercial real estate. |
| **Bonds** | ***U.S. Investment Grade*** | | ■ | | | | Corporate balance sheets remain solid, but the elevated inflation rate may last longer, and the FED may keep interest rates high longer than expected. |
| | ***International Bonds*** | | ■ | | | | International bond yields stay volatile as central banks continue hiking rates to combat inflation. |
| | ***U.S. Long-Term Treasury*** | | ■ | | | | Elevated inflation may last longer than what most investors had expected. |
| | ***Inflation-Linked*** | | ■ | | | | Declining inflation rates may make TIPs unattractive. |
| | ***High Yield*** | | | | ■ | | Credit fundamentals remain supportive, and spreads are around historical average. |
| | ***Floating Rate and Bank Loans*** | | | | ■ | | Spreads are attractive and short-term rates are high. |
| | ***EM Bonds (USD)*** | | | | ■ | | Yields are still attractive and EM country fundamentals remain solid. |



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## 2 *Julex US RiskSwitch™ Model*

(Negative – Reducing Risk, Neutral – Balancing Risk, Positive – Increasing Risk)

| | | Negative | Neutral | Positive | |
|---|---|---|---|---|---|
| **Overall Signal** | | | ■ | | Weakening manufacturing sector and housing markets, tight monetary policies and high interest rates are negative for risk assets; but strong market momentum, solid labor market and consumptions and AI booms offer tailwinds. |
| **Economic Data** | | | | | |
| | ***Manufacturing activities*** | ■ | | | The ISM Manufacturing Index has contracted for seven months in a row. |
| | ***Services Sector*** | | ■ | | The PMI Service Sector Index is marginally positive. |
| | ***Consumptions*** | | | ■ | Personal Consumption Expenditure still had positive growth in April. |
| | ***Labor Market*** | | | ■ | The US economy added 339K jobs in May and the unemployment rate edged up to 3.7%. |
| | ***Housing Market*** | ■ | | | The Case/Shiller Housing Index stabilized after declining for 6 months. |
| | ***Leading Economic Index*** | ■ | | | The leading economic index continues to deteriorate. |
| **Liquidity** | | | | | |
| | ***Monetary Policies*** | ■ | | | Money supplies have been declining and yield curve is strongly inverted. |
| | ***Bank Lending*** | ■ | | | Fed Chicago financial condition index improved a bit recently, but the leverage subindex continues to indicate tightening lending condition after SVB crisis |
| **Market Technical** | | | | | |
| | ***Long-term Trend*** | | | ■ | Equity markets are trading above their long-term averages. |
| | ***Volatility*** | | | ■ | Market volatility falls below its long-term average. |
| | ***Short-term Reversal*** | ■ | | | Short-term reversal signal indicates the probability of short-term correction increase a bit. |
| **Equity Fundamentals** | | | | | |
| | ***Valuation*** | | ■ | | The current S&P 500 12-month forward PE is 18.5. It is below the five-year average, but above the 10-year average. |
| | ***Relative Valuation vs. Bonds/cash*** | ■ | | | Higher interest rates make equities less attractive. |
| | ***Earnings*** | ■ | | | Corporate earnings have declined two quarters in a row, but more companies beat their estimates. |


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## 3 *Market and Economy Review*

- Most asset classes had negative performance in May with US large stocks being the only exception. Technology stocks jumped amid strong earnings numbers, but overall, the S&P 500 Index moved only slightly higher. Commodities continued their slide with declining oil prices. Fixed income assets lost ground as interest rates moved higher when investors adjusted their rate cut expectations. As a result, the US dollar became stronger.

- U.S. economic data remained mixed. The Case/Shiller House Price Index edged up again after declining for seven months in a row. The Institute for Supply Management (ISM) said national factory activities contracted again in May. Personal consumption expenditure climbed by 0.8% in April. Nonfarm payrolls rose by 339K while the unemployment rate rose to 3.7% in May.

- The inflation rate continues to trend down, but the pace of decline slowed. The personal consumption expenditure price index, an inflation indicator used by the Fed, rose 4.4% in April from a year earlier, 0.1% higher than expected. The headline CPI rose 4.9% for the 12 months through April, lower than the previous reading. The core CPI inflation was 5.5% YOY, in line with expectation.

- In its May meeting, the Fed approved its 10th interest rate increase in just a little over a year and dropped a tentative hint that the current tightening cycle is at an end. The widely expected decision took the fed funds rate to a target range of 5%-5.25%. The meeting statement looked less hawkish by omitting a sentence that said, "the Committee anticipates that some additional policy firming may be appropriate".

- Corporate earnings have been in decline though most companies beat expectations. Among 97% of S&P companies reporting Q1 earnings, 78% beat earnings estimates and 76% reported a positive revenue surprise but blended earnings decreased by 2.1%, marking the second straight quarter of a year-over-year decline, according to FactSet. Tech giants like Microsoft, Meta Platform, Nvidia and Alphabet all reported better-than-expected earnings and revenue numbers.

- Internationally, the Eurozone inflation rate has been trending down as well. The Eurozone Harmonized CPI rose by 6.1% YOY in May, much lower than the April number of 7.0%. The Eurozone GDP grew by 1.1% YOY in the first quarter. In China, the manufacturing activities contracted further in May with the PMI Manufacturing Index dropped to 48.8.


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