Global Asset Allocation Views – July 2023

1 *Global Asset Allocation*

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

		CHANGE	SUW	UW	N	OW	SOW	
Asset Class	***Equities***				■			Economic data are mixed, inflation rates are trending lower, 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. Real estate, especially office buildings, could present another potential risk.
	Cash						■	Cash offers attractive yields, low duration and good place for liquidity.
Regions and Styles	***U.S.***				■			Despite a resilient labor market and strong consumer spending, manufacturing and other leading indicators like business conditions, new orders, and lending conditions have shown weakness. Valuation is still expensive compared to the 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 averages. Slowing economic growth and higher interest rates also makes growth stocks unattractive. However, the AI boom may offer a 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 continue raising rates and 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.

2 *Julex US RiskSwitch™ Model*

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

		Negative	Neutral	Positive	
Overall Signal			■		Weakening manufacturing sector and other leading indicators, tight monetary policies, and expensive valuations are negative for risk assets; but strong market momentum, resilient labor market and personal 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 improved in June.
	Consumptions			■	Personal Consumption Expenditure still increased in May.
	Labor Market			■	The US economy added 209K jobs in June and the unemployment rate dropped to 3.6%.
	Housing Market		■		The Case/Shiller Housing Index has edged up again after declining for 7 months.
	Leading Economic Index	■			The leading economic index continues to deteriorate.
Liquidity					
	Monetary Policies	■			Money supplies have been declining and yield curve are 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 Activities					
	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 after the market rallied in June.
Equity Fundamentals					
	Valuation	■			The current S&P 500 12-month forward PE is 18.9. It is above both the five-year and the 10-year averages.
	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 for Q2*

- Global stocks rallied in the second quarter amid moderating inflation, mixed economic data, and AI-induced optimism. US stocks led the charge as the S&P 500 Index finished the first half of 2023 up 16%, and the Nasdaq posted the best start to a year in four decades. Eurozone shares posted gains as well with advances led by the financial and technology sectors. Japanese stocks had a huge gain as the TOPIX Index rose by 14% in local currency for Q2. Emerging markets delivered a moderate gain, underperforming the developed markets.

- U.S. economic data remained mixed but was more resilient than expected. A revision to Q1 GDP growth indicated expansion of 2% (annualized), substantially more than the previous estimate of 1.3% growth. While manufacturing activities continued to contract with the ISM Manufacturing Index falling to 46 in June, the consumption and labor market remained resilient. Nonfarm payrolls rose by 209K in June, and personal consumption expenditures rose by 0.1% in May. The housing market also showed signs of stabilization. The Case/Shiller House Price Index edged up again after declining for seven months in a row.

- The headline inflation rate continues to trend down, but core inflation remains stubbornly high. The personal consumption expenditure price index, an inflation indicator used by the Fed, rose 3.8% in May from a year earlier, 0.5% lower than the previous reading, but the core PCE deflator rose by 4.6%. The headline CPI rose 4.0% for the 12 months through May, much lower than the previous reading. The core CPI inflation was 5.3% YOY.

- In its May meeting, the Fed approved its 10th interest rate increase in just a little over a year. However, it did not hike rates again in June, taking a position of "hawkish pause". Many economists expect two further rate rises in 2023.

- 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. Blended earnings decreased by 2.1%, marking the second straight quarter of a year-over-year decline, according to FactSet. The forward 12-month PE ratio for the S&P 500 Index is 18.9, which is above both the 5-year and 10-year averages.

- Internationally, central banks' policies diverged as each country managed its own economic issues. The European Central Bank (ECB) raised interest rates twice in the quarter, taking the main refinancing rate to 4.0%. Headline inflation declined during the period, with annual inflation estimated at 5.5% in June, down from 6.1% in May. The Bank of Japan (BoJ) held their first two policy meetings under new governor Kazuo Ueda in April and June. There was no change to policy, which suggested their dovish stance will continue. The Chinese central bank cut its seven-day reverse repo rate from 2% to 1.9% to stimulate the slowing economy.

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