Global Asset Allocation Views – August 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 show signs of resiliency, 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, recession fears and declining earnings still present headwinds.
	Bonds			■				Elevated inflation rates, though declining, are potential risks to bonds. The Fed hiked rates in July and may hike again in September given the current inflation rate, especially the core inflation, is still higher than the 2% target.
	Real Assets		■					Declining inflation and economic growth concerns reduce the demand for commodities and real assets. Real estate, especially the office buildings, could present another potential risk. However, geopolitical risks may provide some short-term support to commodity prices.
	Cash						■	Cash offers attractive yields, low duration, and a good place for liquidity.
Regions and Styles	*U.S.*				■			Consumptions, labor market and overall economy still show resiliency and "soft landing" has become a more likely scenario. In addition, the AI-induced tech rally offers tailwinds. However, manufacturing continues to contract and other leading indicators like business conditions, new orders and lending conditions have shown weakness. Valuation is still expensive compared to historical average.
	International Markets (DM)					■		Valuations are attractive compared to the US. Currencies may appreciate as US dollar has peaked.
	Emerging Markets (EM)					■		Valuations are attractive relative to the US. Local currencies may appreciate further against USD. China may adopt more 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 stocks less attractive. 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 good 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 office real estates. However, geopolitical risks may provide some short-term support to commodity prices.
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	↓			■			Spreads are around historical average and default rate remains low but is expected in rise due to higher interest expenses.
	Floating Rate and Bank Loans	↓			■			Spreads are around historical average and default rate remains low but is expected in rise due to higher interest expenses.
	EM Bonds (USD)	↓			■			Yields are still attractive, but higher US dollar may make costs of the interests higher.

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2 Julex US RiskSwitch™ Model

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

		Negative	Neutral	Positive	
Overall Signal			■		Weakening manufacture sector and other leading indicators, tight monetary policies and expensive valuation are negative for risk assets; but strong market momentum, resilient labor market, personal consumptions, and AI booms may offer supports to the markets.
Economic Data					
	Manufacturing activities	■			The ISM Manufacturing Index has contracted for eight months in a row to 46.4
	Services Sector			■	The PMI Service Sector Index continues to be resilient at 52.70.
	Consumptions			■	Personal consumption expenditures rose 0.5% in June.
	Labor Market			■	US economy added 187K jobs in July and unemployment rate dropped to 3.5%.
	Housing Market		■		Case/Shiller Housing Index has edged up again after declining for 7 months.
	Leading Economic Index		■		Leading economic index improved from last month.
Liquidity					
	Monetary Policies	■			Money supplies have been declining and yield curve are strongly inverted.
	Bank Lending	■			Fed Chicago financial condition index improved a bit, 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 July.
Equity Fundamentals					
	Valuation	■			The current S&P 500 12-month forward PE is 19.2. 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 three quarters in a row, but more companies beat their estimates.

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3 *Market and Economy Review for July*

- Global stocks rose again in July amid moderating inflation and resilient economic data. US small cap and EM equities were among the best performers as investors took risky bets. Commodity prices recovered from some of the year-to-date losses, benefiting from higher oil and agricultural commodities. Oil prices rallied as OPEC+ countries cut production. US fixed income assets had moderate losses.

- Most of the U.S. economic data showed signs of resiliency despite higher interest rates. The advance estimate of second quarter GDP grew at an annual rate of 2.4%, much better than expected. While manufacturing activities continued to contract with the ISM Manufacturing Index at 46.4 in July, the consumption and labor market continued to be strong. Nonfarm payrolls rose by 187K in July, slightly lower than expected, but the unemployment rate fell to 3.5%. The personal consumption expenditures also rose by 0.5% in June. The housing market also stabilized. 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. The personal consumption expenditure price index, an inflation indicator used by the Fed, rose 3.0% in June from a year earlier, 0.8% lower than the previous reading, but the core PCE deflator rose by 4.1%. The headline CPI rose 3.0% for the 12 months through June, much lower than the previous reading. The core CPI inflation was 4.8% YOY, lower than expected.

- The Fed unanimously voted to hike rates by 25 basis points, to curb inflation. This marks the 11th time the Fed has raised rates since March 2022, the most aggressive cycle since the early 1980s. Fed chairman Jerome Powell has indicated the possibility of a further rate hike during the next meeting in September, depending on the "totality of the incoming data." Despite rate hikes, economic data continues to be resilient, and a "soft landing" is becoming a higher possibility scenario.

- Corporate earnings have been in decline though most companies beat expectations. Among 84% of S&P companies reporting Q2 earnings, 79% beat earnings estimates and 65% reported a positive revenue surprise. Blended earnings decreased by 5.2%, marking the largest year-over-year decline since Q2 2020, according to FactSet. The forward 12-month PE ratio for the S&P 500 Index rose to 19.2, which is above both the 5-year and 10-year averages.

- The European Central Bank (ECB) raised the deposit rate by 25bps to 3.75% as widely expected in July. ECB President Christine Lagarde indicated a possible pause in September. Japanese equities underperformed other developed markets as the Bank of Japan loosened its yield curve control framework in the face of higher inflation. The Chinese equities outperformed other EM countries despite its slower economic growth. Hopes for further policy easing and stimulus were behind the gains.

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