

Global Outlook

In July 2024, global capital markets at the margin appreciated. Asian equity markets outperformed developed markets. Top gainers were Singapore, India & Jakarta at 3.7%, 3.4% and 2.7% respectively. Note that the S&P 500 & Stoxx 600 rose 1.1% and 1.3% respectively. The losers were Taiwan and H-shares at -3.6% and -3.5% respectively. Bonds rose 1.3% to 2.8%.¹

The Fed maintained the Fed Fund rate at 5.50% during the July FOMC meeting. The minutes of the FOMC indicated that interest rate cuts could take place in 2H2024. The ECB cut interest rate by 0.25% to 4.25% based on weak economic fundamentals and better-behaved inflation.

We have a positive view on Asian equities given attractive investment themes and corporates have the potential to post better earnings growth in 2024 than developed markets. We remained neutral on global developed market fixed income.³

Global Outlook of the two capital markets: Fixed Income & Equity

Region: Developed economies

Fixed income

- Our view – neutral.
- The US in 2Q2024 grew 2.8% y-o-y compared with 1.4% in 1Q2024. The healthy expansion reflected steady consumer spending, export & government spending.⁴
- Switch out of shorter tenure UST into longer tenure & higher yielding bonds. Prefer new credit issuances offering wider spreads. We have a risk-on, carry-positive bias on the markets.⁵

Equity

- Our view – positive.
- The US in 2Q2024 grew 2.8% y-o-y compared with 1.4% in 1Q2024. The healthy expansion reflected steady consumer spending, export & government spending.⁴
- Tactically cut US to Neutral from Overweight. Maintain Underweight on EU and Overweight Japan. The move on EU is on cheap valuation, stabilizing PMIs and investors looking to diversify outside US and technology.⁵

Region: Regional (Asia-Pacific ex-Japan)

Fixed income

- Our view – neutral.
- Pockets of opportunity in local currency Asian and Chinese credits as yields remained relatively attractive.⁶
- We expect investment grade Asian bonds to provide a gross yield of 4.50% to 5.50% in 2024.⁶

Equity

- Our view – positive.
- We remained positive on Asian equities underpinned by cheap valuation & China's continued execution of more friendly policies.⁷
- We are positioned for a) tech hardware cycle driven by AI, b) broad-based growth across India, c) selected global names with resilient demand in industrials and technology.³

Region: China

Fixed income

- Our view – neutral.
- Net supply of bond in May 2024 rose 36% mom to RM329bn owing to higher net financial issuances. Non-financial issuances dropped 77% mom to RM43bn over the same period.⁸
- Default rate for May 2024 edged lower to 0.14% from 0.16% previously. The property sector default rate dropped to 3.9% from 4.5% over the same period.⁸

Equity

- Our view – positive.
- China in 2Q2024 reported GDP growth of 4.7% compared with 5.3% in 1Q2024. Weaker domestic demand underpinned the slower economic number.¹
- Manufacturing PMI for July 2024 slipped to 49.4 from 49.5 previously. The Services PMI dropped further to 50.2 from 50.5 over the same period.⁹

Region: Domestic (Malaysia)

Fixed income

- Our view – positive.
- BNM maintained the OPR at 3.00% during the July 2024 MPC meeting. The move was well anticipated.¹⁰
- We capitalized on the recent government bond rally to shift focus to corporate bonds, prioritizing them over government securities due to the stable domestic interest rate outlook.³

Equity

- Our view – positive.
- The National Energy Transition Roadmap (NETR) and the Industrial MasterPlan 2030 would revitalize domestic investment and buoy consumption.³
- We continue to lock in gains but maintain our positive view and deploy cash to quality laggard names. Favour Construction, Property and Utilities as beneficiaries from the NETR. Also, we like selected Oil&Gas, Technology and Financial names.³

Our Strategy:³

Despite some softness in consumers and the labor market, economic growth is slowing only modestly, maintaining the overall resilience narrative. This economic strength, even if slightly downshifting, supports a positive backdrop for corporate earnings. Expectations of Fed rate cuts, easing inflation and valuation dispersions support a broadening out of risk appetite and earnings growth. **We have temporarily brought US to Neutral** while increasing allocation to cash and off-benchmark exposure that we expect to outperform during US equity sell-off. As sector rotation continues, sectors that have performed well, such as large-cap technology stocks, are likely to underperform. We are assessing opportunities to reposition the portfolio. We are assessing opportunities to reposition the portfolio. **Maintain Underweight in Europe and Overweight in Japan.** Despite incremental positive economic surprises in Europe, both economic and earnings growth expectations fall short of those in the US. In Japan, the fundamental themes of reflation and ongoing corporate governance reforms remain intact. Valuations for MSCI Japan have become very attractive after a sharp sell-off exacerbated by technical dynamics and margin calls. According to our internal valuation metrics, MSCI Japan is trading at a mid-cycle P/E of a 21% discount versus a 1.3% premium in June. P/B-ROE valuation is at a 21% discount compared to a historical average of a 5.6% premium. We maintain the view that policy normalization in Japan will be gradual, with monetary policy remaining accommodative as real interest rates stay negative, barring a hard landing in US economy.

We have a positive view on Asian equities, given the attractive investment themes. Current market correction is likely to present investment opportunities as valuations become more attractive. We will continue to diversify and position the portfolio in areas where they are likely to print strong earnings growth such as the semiconductor industry, beneficiaries of AI spend, and Korea value up program, rising consumer discretionary spent or rising capex. We will also be selective in our investments in China, especially for those companies who have shown signs of turnaround or have high dividend yields.

We believe the Lifetime Bond Fund and Lifetime Sukuk Fund would benefit significantly from the commitment of the Malaysia government to lower the budget deficit to 3.2% by 2025. The projected improvement in fiscal position over the medium term would enhance the attractiveness of the domestic bond market.

Additionally, the improvement in sentiment and the launch of data centre projects, along with the implementation of the New Energy Transition Roadmap (NETR) and the New Industrial Master Plan 2030, have further reinforced Malaysia's economic growth and corporate earnings outlook. In light of this, we recommend considering equity exposure in Principal's small-cap funds and Principal's Malaysia growth and income-focused funds. These funds have the potential to capitalize on the opportunities presented by the current economic landscape and provide favourable returns for investors.

For diversification and long-term growth trend, we recommend investors to consider the Asia Pacific Renewable Fund and Global Sustainable Growth Fund that focusses on ESG related investments for long term exposure.

The overall supportive economic conditions and the prospects of lower rates is supportive for a diversified strategy. We continue to emphasize quality growth and income attributes.

- ✓ **Quality Income:** quality bonds can help to protect against market volatility and to sustain performance in a range-bound market.
- ✓ **Quality Growth:** an investment style which has historically outperformed as whole, but with the highest relative returns during recessions.

Glossary

FOMC: *Federal Open Market Committee*

ECB: *European Central Bank*

MoM: *Month-over-Month*

YoY: *Year-over-Year*

UST: *United States Treasury*

PMI: *Purchasing Managers Index*

BNM: *Bank Negara Malaysia*

UW: *Underweight*

OW: *Overweight*

Disclaimer

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Sources:

- 1 Bloomberg, 31 July 2024
- 2 Federal Reserve Board, 31 July 2024
- 3 Principal, 31 July 2024
- 4 European Central Bank, 31 July 2024
- 5 Federal Open Market Committee (FOMC), 31 July 2024
- 6 JP Morgan Research, 31 July 2024
- 7 Bloomberg, 31 July 2024
- 8 BofA Securities, 31 July 2024
- 9 National Bureau of Statistics of China, 31 July 2024
- 10 Bank Negara Malaysia, 31 July 2024