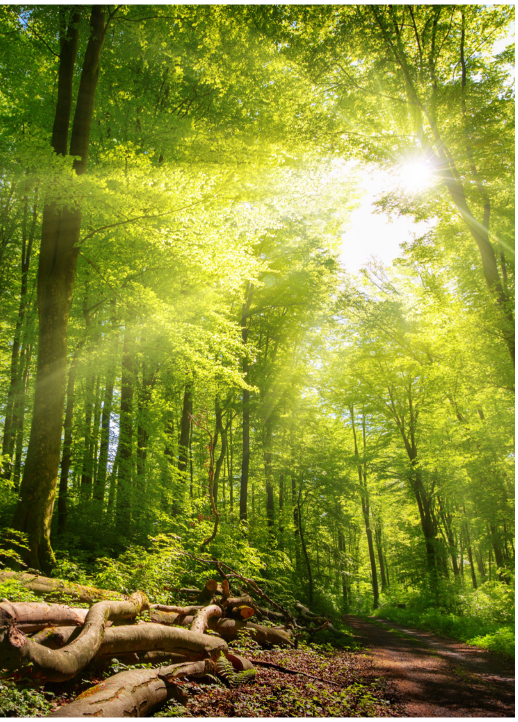
Investing under the 3i's - Innovation and Evolution continues driving our bullish outlook

Fullerton Investment Views - Quarterly report

Q4 2024

FULLERTON FUND MANAGEMENT



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Executive summary

- **Fullerton remains bullish on global risk assets, Developed Market (DM) equities, and has revised up our view from positive to bullish for Asia equities**
  - We remain bullish on DM equities, led by the US and then Japan, with Europe lagging. Asia ex-Japan equities are achieving strong earnings growth expectations, driven by Taiwan, India, and South Korea. The region can continue to benefit from robust US consumerism and the prospect of greater supply-chain demands from China.
  - Equity markets in China can deliver robust returns over our forecast horizon, and the policy stimulus to come increases our conviction. Over time this may unfold as China's 'whatever it takes' moment to finally reverse deflation, boost earnings, and lift returns for investors.
  - We maintain our positive outlook for fixed income returns as active investors can potentially secure capital gains from bonds as the Fed and the ECB cut rates. Returns from corporate credit can benefit from a 'soft-landing' for global growth (around its trend), robust profitability, and modest default rates.
  - Yields are likely to settle at levels that can provide a favourable income-stream, while providing some protection if growth unexpectedly slumps. The risk of the latter is higher, given greater geopolitical fears from the conflict in the Middle-East (as well as possible shocks from the Russia-Ukraine War or China-Taiwan relations).
  - Regardless of which party in the US takes power in 2025 we believe any policy initiatives ultimately passed may prove to be deficit and inflation neutral. We do not foresee our bullish outlook on US equities being derailed, by the actions of politicians, because the core fundamentals driving earnings are very supportive (i.e. above trend growth, robust productivity, very low real production costs, sustained consumer spending, and Fed rate cuts).

01

Risk-Asset Outlook

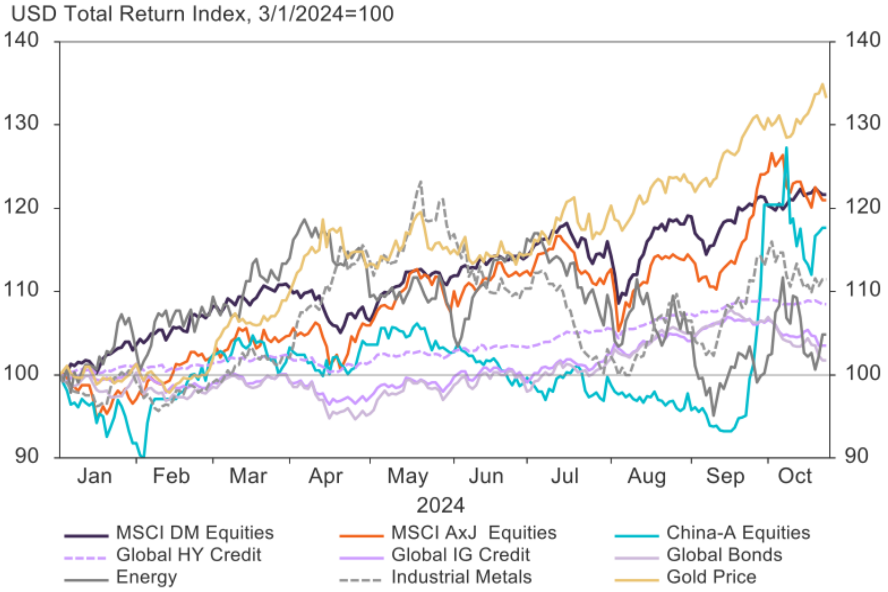
Summary of Fullerton's views (12 months ahead)

	Bearish	Negative	Positive	Bullish
Risk Assets (overall)				✓
Asia ex-Japan Equity				✓
China Equity				✓
DM Equity				✓
Asia IG Credit			✓	
Global Sovereign Bonds			✓	

Source: Fullerton Fund Management, October 2024. Views may be subject to change without prior notice

Figure 1: Risk asset performance: for the first time all key asset classes are positive (YTD)

Risk asset returns



Source: LSEG Datastream, October 2024

Fullerton believes that the robust trends in investment returns over 2024 can be sustained in 2025

The extremely high risk asset returns into Q424, dominated by over 20% (YTD) gains for equities (see Figure 1, performance of MSCI DM Equities), may ease back but still remain very positive for investors in 2025. Our investment themes, outlined in our Q3 Fullerton Investment Views[1], of Industry 5.0 and Innovation continue to underpin our bullish outlook for DM equity returns. US performance is leading DM, followed by Europe and Japan (on par with each other).

We maintain our bullish outlook for global risk assets, dominated by DM equities

We maintain our conviction that earnings growth can remain strong, driven by robust productivity growth and low unit labour costs. In addition, broad financial conditions are supportive to US equity returns and may get an added boost over 2025 from Fed rate cuts. Across US households, financial wealth is very high and this can continue to drive consumption spending. For the US corporate sector, investment growth is solid and this can reinforce productivity gains in tandem with new developments over time from technologies.

DM equity returns should also remain supported by Japan’s performance, given its robust productivity growth (second only to the US) and its very competitive real exchange rate.

Contributions to DM equity performance from Europe can also be positive as earnings growth should recover further with the benefit of robust US demand. Furthermore, Europe equity valuations are modest and as the ECB slowly cuts rates over time, easier monetary conditions can give an added boost to investor sentiment.

We have revised-up from positive to bullish our view for Asia equities, including China, as its Involution is evolving

Equities across Asia (ex-Japan) are benefiting from high earnings growth expectations, which reflects stronger competitiveness, a greater export share to the US, and improving supply-chain demands from China. Overall, Asia can continue to benefit from global demands associated with Industry 5.0, especially across new industrials, the IT/communications sector, and consumerism.

Our ‘third-i’ investment theme of ‘Involution in China’ is evolving. In our end-July Q3 Fullerton Investment Views we moved to a positive outlook for China equities, harmonising with our positive view for Asia (ex-Japan) equities (held since January), as China’s earnings growth expectations improved with the most acute deflation past.

Now into Q4 China’s policymakers have surprised markets by announcing the most significant monetary and fiscal stimulus plans since the Covid pandemic. These new initiatives are certainly the necessary conditions for China to be in a position that it may finally reverse producer-price deflation and boost corporate profitability over time.

China’s new policy stimulus plans present the best chance of success because they are multi-pronged across both the monetary and fiscal fronts, and very targeted at addressing the key areas of deflation risk (especially across the real-estate sector and consumer spending). In addition, there may now be far too much credibility at stake, from President Xi Jinping down to the province-level officials, for ‘policy failure’ to be acceptable. As a result, we now have a stronger conviction that equity markets in China can deliver robust returns over our forecast horizon, and have revised our outlook up from positive to bullish.

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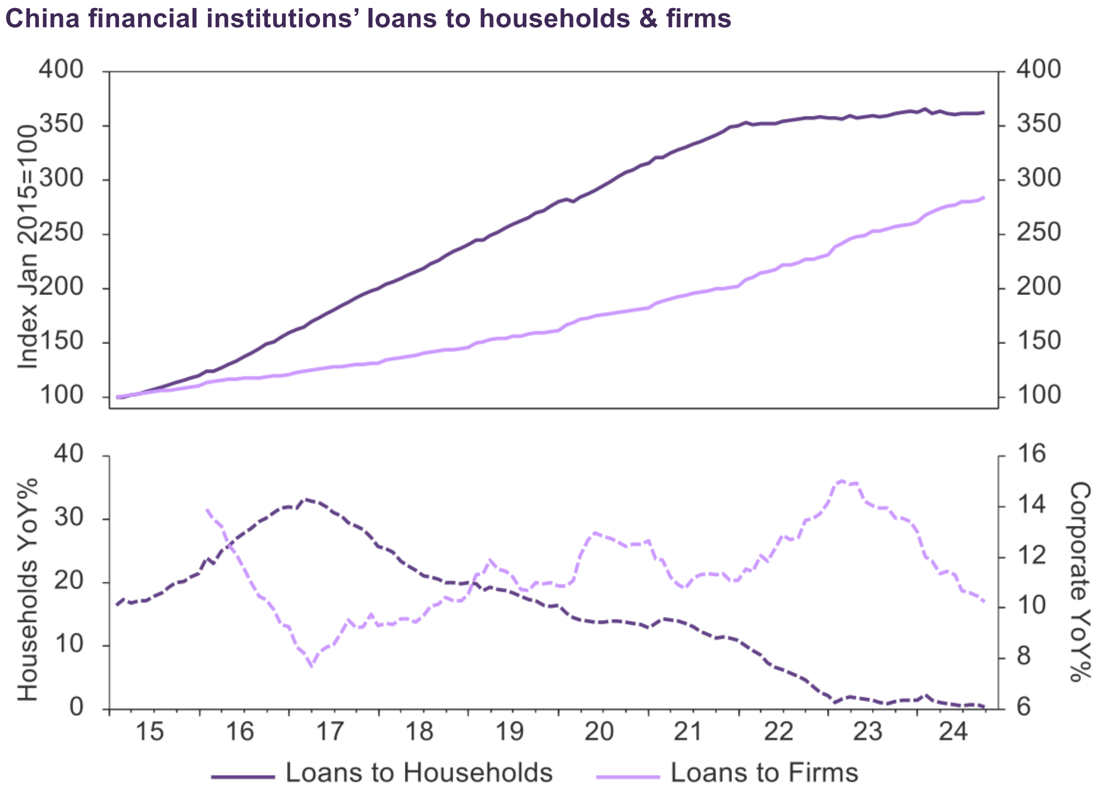
1. See https://www.fullertonfund.com/wp-content/uploads/2024/08/FIV-Q3-2024_Final-C.pdf

The People's Bank of China (PBoC) is utilising all its tools with the objective to boost liquidity (to support investor sentiment), encourage more bank lending (to households and firms), and increase housing demand. For its newly signalled fiscal policy stimulus, China has confirmed it will increase government debt significantly with spending targeted to support households (especially those on low incomes), the real-estate sector, along with the banks (to free-up capital for more lending), and with more resources channelled toward local government spending programmes. Around 2-3tn CNY in debt-raised funds should be deployed by year-end, with an (initial) issuance cap (into 2025) of up to 6tn CNY[2].

Shock and awe policy announcements are always tricky for markets to 'price-in' effectively – they will often overshoot in the near-term, and returns will be volatile. But so far, signals from market pricing suggest that investors are building confidence that the real-estate sector can eventually stabilise, and bank share prices are still performing well. In such an environment, value stocks and consumer-linked equities could also hold-up. The latter will be a key barometer sector because stronger household spending, and credit demand, will be critical to any sustainable recovery (see Figure 2).

Figure 2: Credit demand in China across households and firms



Source: LSEG Datastream, October 2024

2. Tax cuts have also been rumoured. We will have to wait for further details on the stimulus programs to be revealed either from the NPC (National People's Congress) meeting late Oct/early Nov or from the Politburo (early/mid Dec).

Industrial metal prices have been supported by demand growth, while gold and oil prices may rise further on geopolitical risks

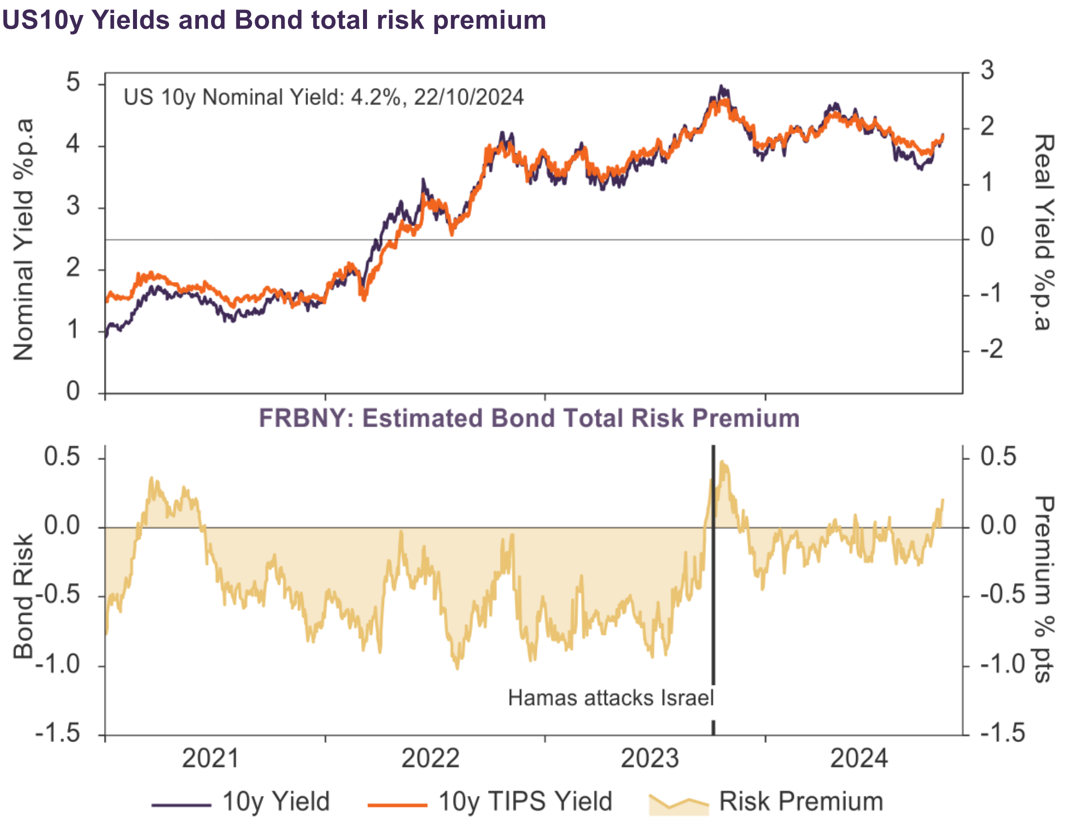
Industrial metal prices have remained solid, reflecting on-going robust US demand, especially for aluminium and copper, as well as more positive expectations that China's metal demand will increase.

Gold and oil prices have been supported by a cluster of geopolitical risks, especially fears that the Middle-East conflict will intensify (now that Iran is involved), along with potential shocks that could stem from the Russia-Ukraine War or from China-Taiwan relations. Gold prices have also been boosted by strong demand from global central banks as they increase their reserve-asset allocations to more prudent levels. Across the US bond market, the total risk premium is rising, and is now around 25bps, which is about half of the 50bps peak when the big shock of the Hamas-Israel conflict began a year ago (see Figure 3).

US election 'outcome uncertainty' may also be adding a risk premium

What has also contributed to the significant rise in the US bond risk premium during October is that the US election race may be very close. Markets would prefer a clear-cut and significant winner to avoid any possible, and prolonged, disruption-threats from vote challenges etc[3]. If the US bond risk premium reaches 50bps then US 10y nominal yields could move to around 4.6% p.a and may only fall back after clarity on the US election outcome (see Figure 3).

Figure 3: US 10y Yields (real and nominal) with the total risk premium



Source: LSEG Datastream, October 2024

3. For background see: "The presidential race won't be over on election night - it may be headed for the courts instead. A look at four scenarios in which a close election could spur trouble", the LA Times, 21 Oct 2024.

The Middle-East conflict, along with other risks across the geopolitical spectrum, are closely watched. The best defence for investors is to remain diversified and have some exposure to fixed income assets and gold. It is also important to remember that against a backdrop of strong fundamentals, any adverse reactions to geopolitical shocks can 'wash-out' and risk assets can eventually return to positive trends[4].

Fullerton remains positive on Asia IG corporate credit and global sovereign bonds

With global growth set to achieve a 'beautiful-landing' at its trend, along with strong corporate profitability growth especially across Asia, Fullerton maintains its view that returns from Asia IG corporate credit can be robust.

A key benefit of active management for bond investors is that they can secure potential capital gains, especially on DM holdings, as the Fed and the ECB cut rates. Ultimately yields are likely to settle at levels that can provide a favourable income-stream, while providing some protection if growth unexpectedly slumps (the risk of the latter is higher, given geopolitical fears).

4. See Fullerton Investment Views Q4 2023 "Speedbumps in a Goldilocks environment" for background discussion https://www.fullertonfund.com/wp-content/uploads/2023/11/FIV-Q4-2023_FINAL.pdf

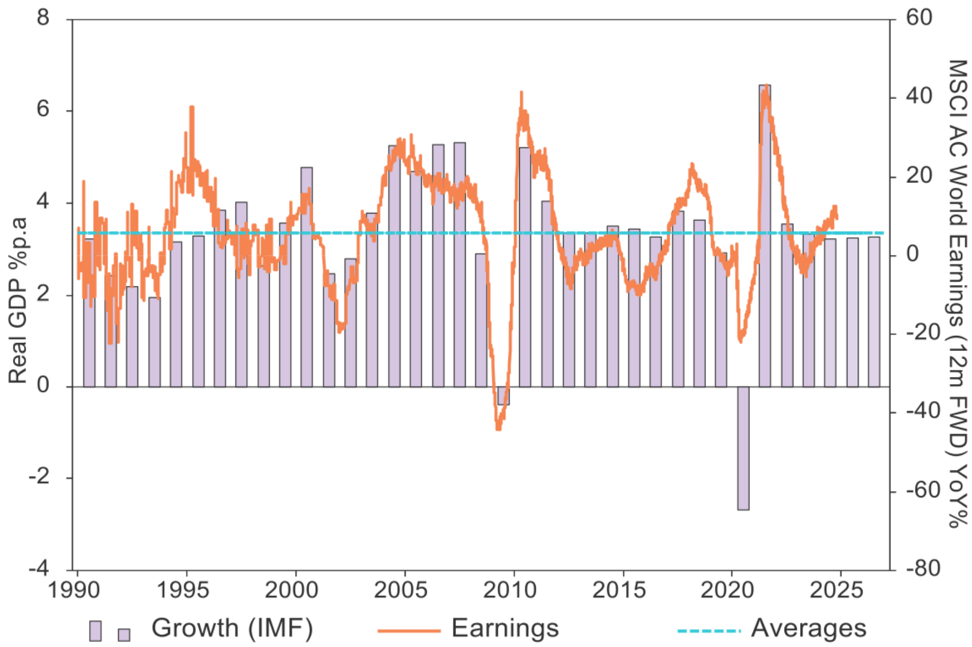
02 Investment Environment

This cycle is different: Fullerton has called it the ‘Great Decoupling’ (part of our ‘3G’ thematic). Global growth is tracking around its long-term average (3.5% p.a since 1990, see Figure 4), but there is much variation across countries. For example, US growth has been well-above the common 2% trend assumptions for six months (i.e. 3% Q2 Seasonally Adjusted Annual Rate, SAAR; 3.4% SAAR 18 Oct 2024 nowcast), Japan’s growth bounced to 2.9% (Q2 SAAR), China’s growth is 4.8% (YTD Sep), while Europe lags with just 0.8% growth (Q2 SAAR).

What is most relevant for investors is that earnings growth cycles have been even more decoupled, with the US and Japan the strongest, closely followed by Asia (ex-Japan), China (with a wide gap between MSCI-all and China-A EPS), and Europe is the laggard.

Figure 4: Global growth and earnings expectations

Global growth and earnings

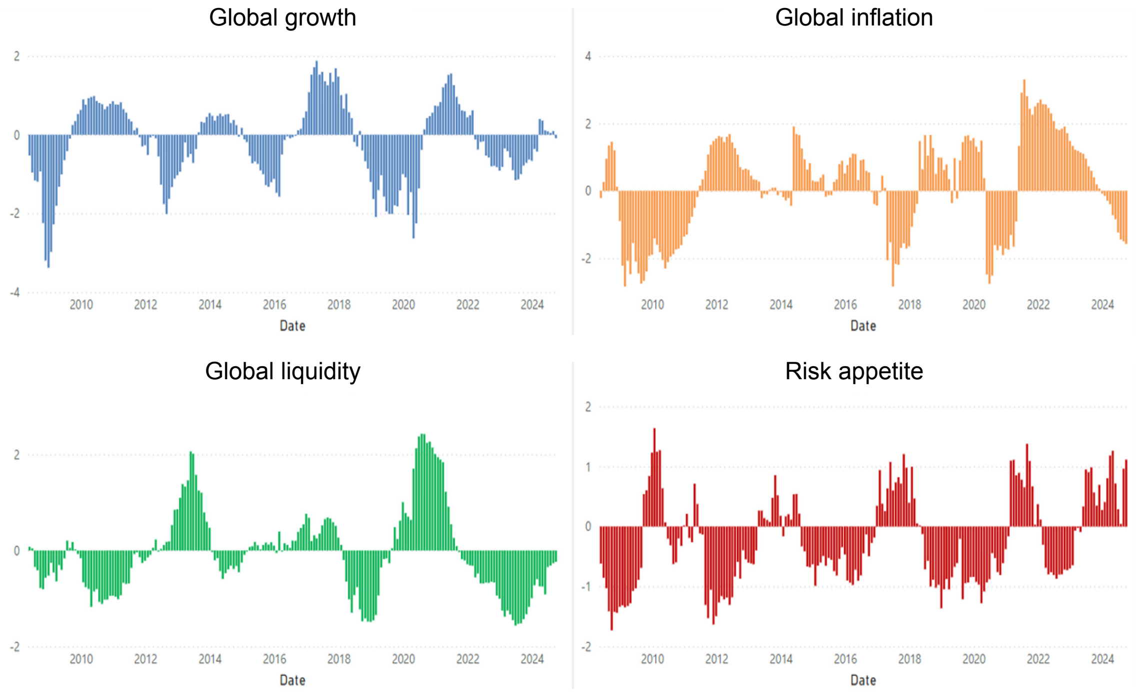


Source: LSEG Datastream, October 2024

Fullerton's Investment Environment Indicator has rebounded to 'Goldilocks' as global growth, inflation, liquidity, and risk appetite are very supportive

The signals from our four core global factors that help drive investment returns over time have become more supportive. Consistent with Figure 4, global growth is settling around its trend, inflation is low, liquidity is improving and returning toward its trend, while investor risk appetite has surged (see Figure 5). The resulting 'Goldilocks' environment can be bullish for risk asset returns into the end of the year (see Figure 6).

Figure 5: Fullerton's Global Factors that help drive investment returns over time
(expressed as z-score deviations from average or trend)



Source: Fullerton, October 2024. The information presented in the chart above is calculated based on Fullerton's internal methodology and is subject to change

Figure 6: Fullerton's Investment Environment Regime Indicator: in 'Goldilocks'

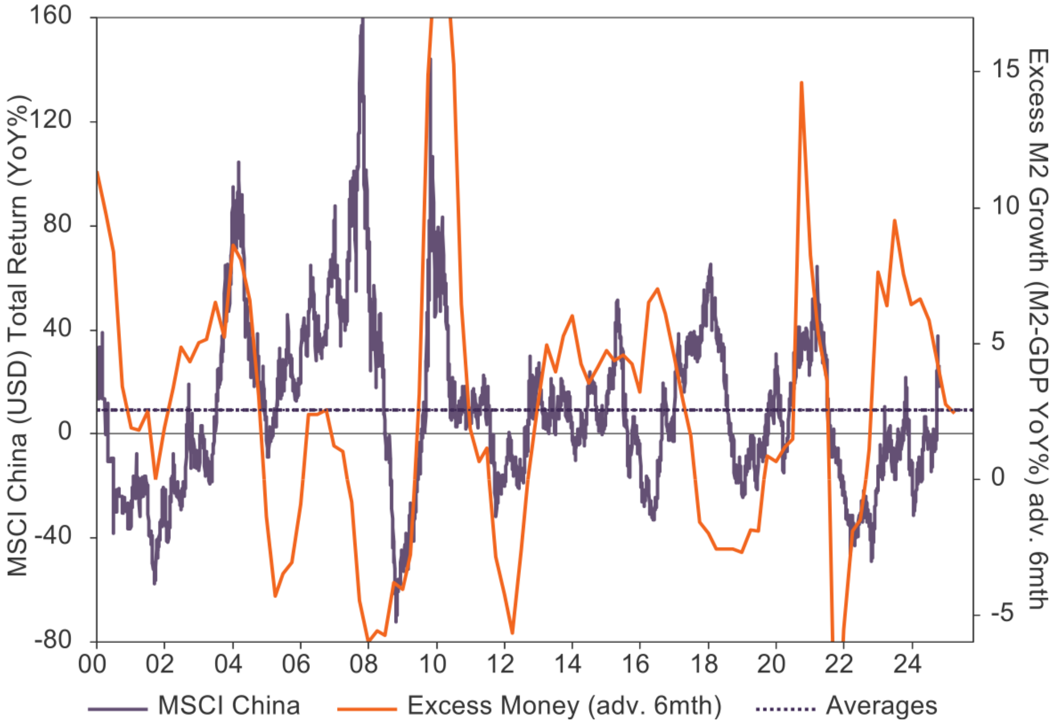
Source: Fullerton, October 2024. The information presented in the chart above is calculated based on Fullerton's internal methodology and is subject to change

What is impacting liquidity?

Global liquidity is still below its trend (see Figure 5) largely due to weakness in China and Europe. That is set to change as the ECB progresses with its rate cuts, and especially as China injects more liquidity with its new monetary policy stimulus. China's excess money growth (M2) had slowed and normalised back in-line with GDP growth (see Figure 7). So it is a very timely action that the PBoC is creating more liquidity at this juncture – because excess liquidity can have a significant positive correlation with stronger share market returns (see Figure 7).

Figure 7: More excess liquidity in China can further boost equity market returns over time

China equities and leading excess money growth



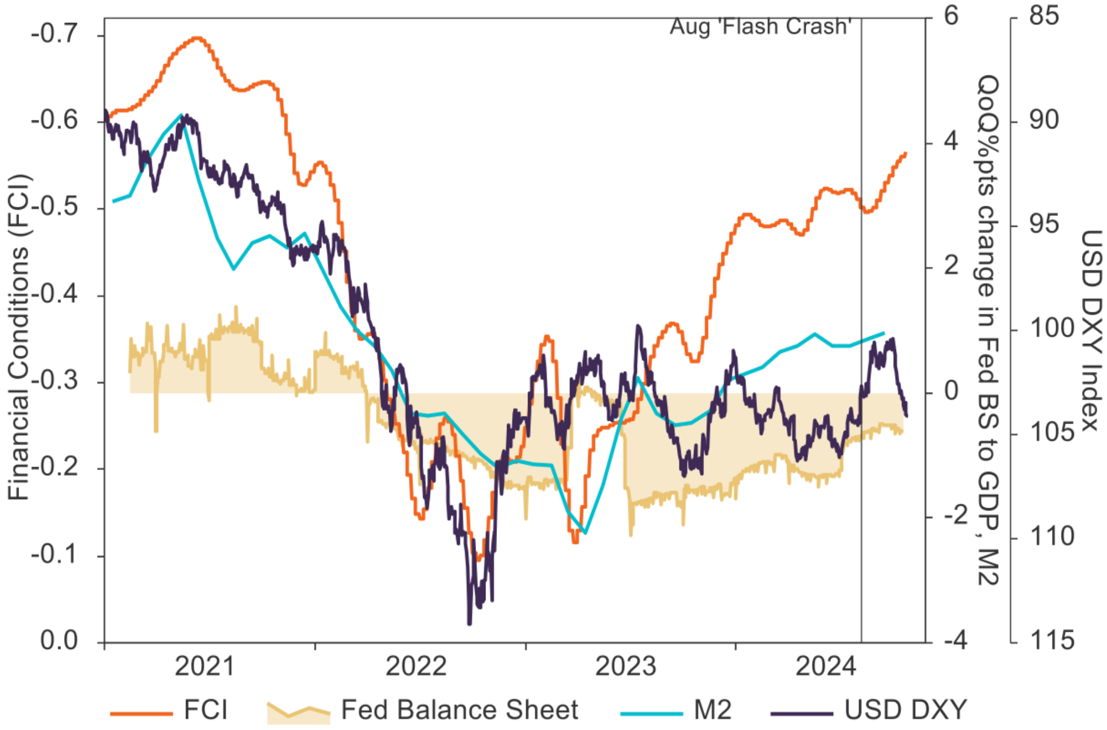
Source: LSEG Datastream, October 2024

In contrast to China, the US economy remains very well supported by easy liquidity and financial conditions (see Figure 8). That has been driven by the start of the Fed's rate cuts[5], a slower decline in the Fed's balance sheet (relative to economic activity), positive money growth, and favourable financial markets. The recent appreciation in the US dollar has not tightened financial conditions because overall the dollar has been flat since the August 'flash crash'[6].

5. See https://www.fullertonfund.com/fullerton-insights/september-2024-fed-rate-decision/
6. See https://www.fullertonfund.com/fullerton-insights/august-2024-market-selloff-from-the-magnificent-7-to-the-magnificent-reset/

Figure 8: Indicators of US broad financial conditions (FCI)

Monetary conditions: FCI, Fed Balance Sheet, USD, and M2
(the FCI ‘rising’/more negative = more easy)

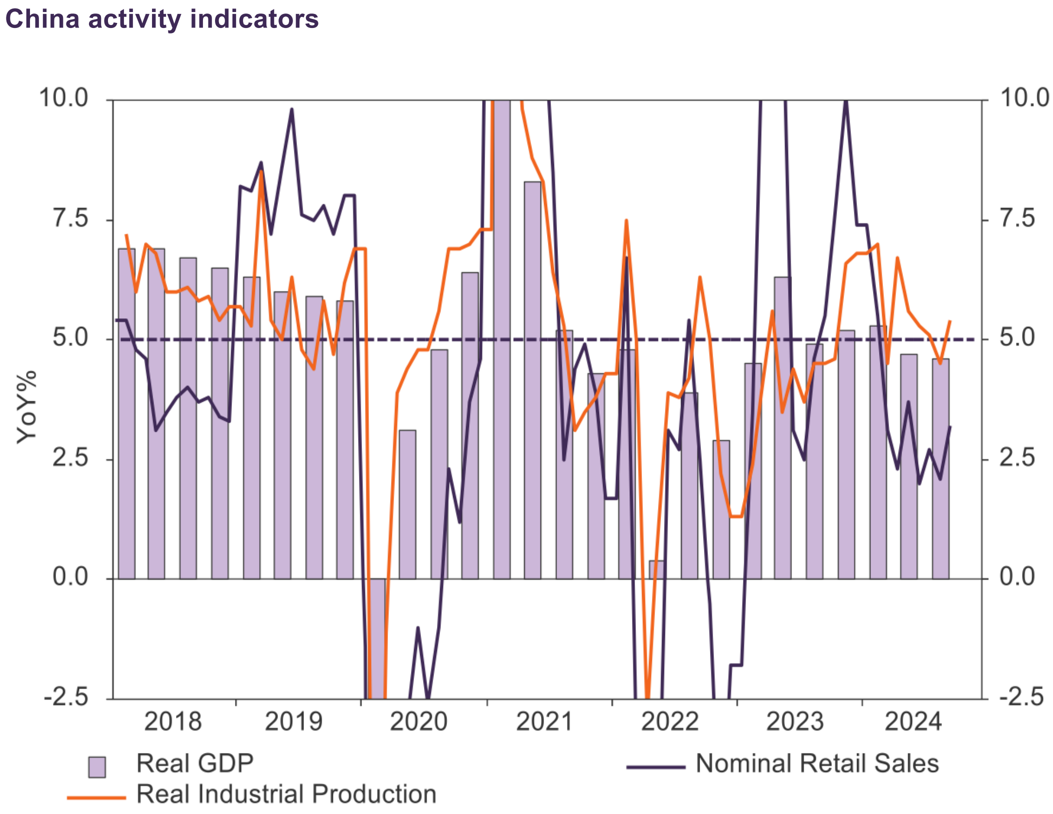


Source: LSEG Datastream, October 2024

China’s growth will almost certainly hit the 5% target this year

We have always maintained the view that China will hit its 5% GDP growth target (set by the NPC) for this year. YTD (end Sep) GDP growth was 4.8% and industrial production growth, the most significant component of the economy, has held around 5% p.a. Growth in consumer spending has slowed, but at around 3% it remains sufficient (see Figure 9). More importantly, the stimulus is too late to materially change China’s growth for 2024 – that outcome is already ‘baked in the cake’. This is an important reminder to investors that the stimulus packages are not because of any short-term weakness. Instead they are designed to resolve the longer-term problems of over-production, rebalancing more toward consumption, and ending deflation.

Figure 9: China's activity indicators: growth, industrial production, and retail sales



Source: LSEG Datastream, October 2024

DM, led by the US, is making strong contributions to global growth

As we explained in our Q3 Investment Views, 'Innovation' is a trend that has been unfolding for many years, especially across the US, Japan, and Germany. It reflects greater productivity, and lower costs - resulting in higher than otherwise earnings. No time in the past, except perhaps in the 1960s, has there been such a sustained lift in US corporate earnings (and that is across the population of around 6 mil US employer firms. As it is, strong profits on average is across 'Main Street' and not just Wall Street this time). This alone explains why many describe the environment today as one of US 'exceptionalism'. Japan has also performed well and rebounded strongly after the COVID-driven recession, while Germany is the productivity leader of Europe.

US fiscal policy outlook: many investors may be proved too pessimistic

We explained in our Q3 Investment Views that if US policy shifts toward more intense protectionism it could ultimately prove positive for US stocks (especially those with domestic centric supply-chains and revenues) and negative for foreign equities (especially for firms that rely on US demand). Surveys of reserve managers, central banks, and 'real-money' investors have suggested that if the balance of power lies with the Republicans then that may prove positive for US equities and bonds. Almost by definition then Republicans cannot be too inflationary for the US economy because that would push yields too high and become unambiguously negative for US equities (which is against the most common expectation).

The historical record suggests that Republicans tend to pursue legislation that favours US business, lowers taxes (i.e. easier fiscal policy), but also cuts social supports (i.e. tighter fiscal policy). Democrats have some bias toward more spending (i.e. easier fiscal policy) but favour higher taxes (i.e. tighter fiscal policy) for funding. Not surprisingly then, most of the time after a US election there always tends to be some offsetting forces with new government policies[7].

Do not discount the positive impact on the deficit from robust US growth

Many investors still fear that the US fiscal deficit will become worse in 2025-26 even though there is no strong evidence to support that. Firstly, the Democrats and the Republicans have proposed many off-setting policy actions that could easily prove to be deficit neutral i.e. ‘on the one hand give, while the other hand takes’. More importantly, economists are terrible at predicting deficits – even just months ahead. For example, in late 2023 almost all commentators expected the US fiscal deficit to be worse in 2024, being the last year of President Biden’s regime. In contrast, the US fiscal deficit, at 5.5% of GDP (Q2 2024[8]), has improved as spending has been stable (as a share of GDP) while revenues have surged on strong growth. Robust growth is a key swing-factor for the US fiscal deficit that many investors forget about. If US growth holds-up into 2025 as we expect then the fiscal deficit may not be concerning.

Others worry that the possibility of much higher US tariffs, especially on China, will increase US inflation and weaken US growth. However, the evidence on this is not strong either. Since the US trade war with China, where US tariffs (against China) increased by 20% on average, US goods inflation has been very low on average (it is actually deflation again: Aug 2024 at minus 0.9%YoY[9]) and US GDP growth is well-above trend. The pass-through from tariffs to US inflation is very weak and changing spending patterns gives insulation to US growth. This is because US consumers buy less of expensive imports, which is a key reason China’s export share to the US has fallen from 25% to 13%[10] (excluding the Covid period, it is a 20 year low).

Market reactions, especially rising bond yields, to potential election ‘outcome uncertainty’ should not be assumed to mean there are significant worries about the deficit or inflation

No doubt the upcoming US elections are adding to investor concerns, especially if it is a very close result, which creates the risk of votes being challenged and potentially a delayed outcome. Once decided, Fullerton believes that regardless of which party holds the balance of power the robust macro fundamentals across the US are not at significant risk. As such the fundamentals should continue to support the bullish US risk asset returns we expect[11].

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7. For further discussion on the possible impacts on the investment environment after the US elections, especially from a sector perspective, the ‘big-picture’ core issues remain largely unchanged from what we presented at the start of the year i.e. see https://www.fullertonfund.com/fullerton-insights/2024-us-elections-and-potential-investment-implications/

8, 9, 10. Source: LSEG Datastream, October 2024

11. We also showed in our research note on the US elections that there is strong evidence that the fundamentals of risk asset returns can trump the impacts of politics. See https://www.fullertonfund.com/fullerton-insights/2024-us-elections-and-potential-investment-implications/

03

Equities

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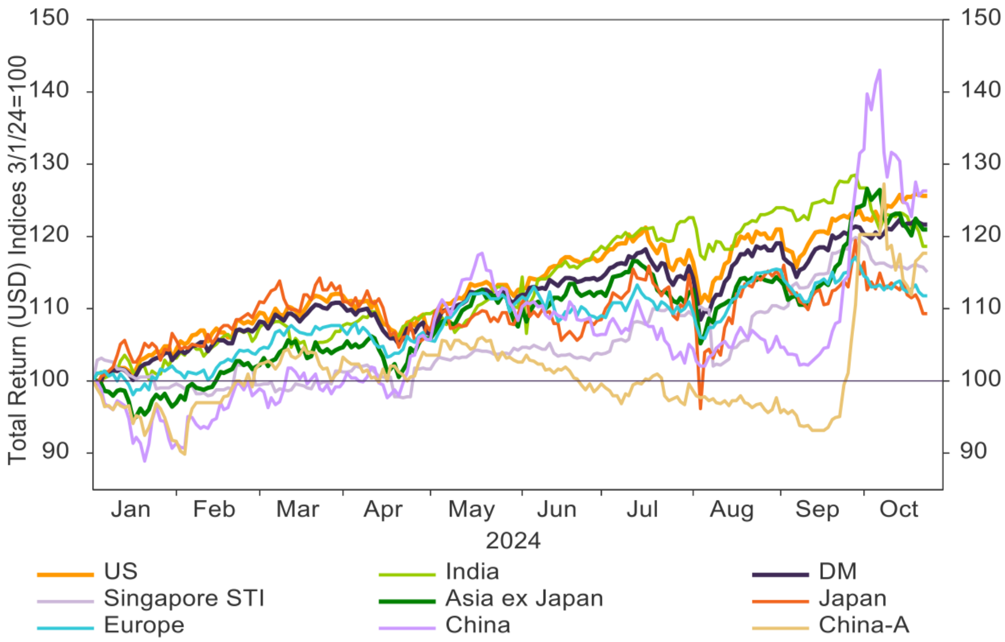
US exceptionalism continues, and not because of the Fed. If earnings growth can remain robust, because of strong US productivity and very low unit production costs, then that can be more important for positive equity returns than the Fed rate cuts[12].

Figure 10: Equity returns across key markets (YTD)

MSCI Equities total return



Source: LSEG Datastream, October 2024

12. As we highlighted in our Q3 Investment Views: high US interest rates did not prove too stressful for equity market performance. It follows that rate cuts are unlikely to drive surging returns. This may be because the net interest burden on the US private sector is so low (as we explained in Q3). Furthermore, broad measures of US financial conditions have eased significantly already (see Figure 8). Fed rate cuts are positive of course – policy must normalise over time – but in our view rate normalisation is the 'icing on the investment cake' (while the core ingredients are the real fundamentals of productivity, investment, and competitiveness).

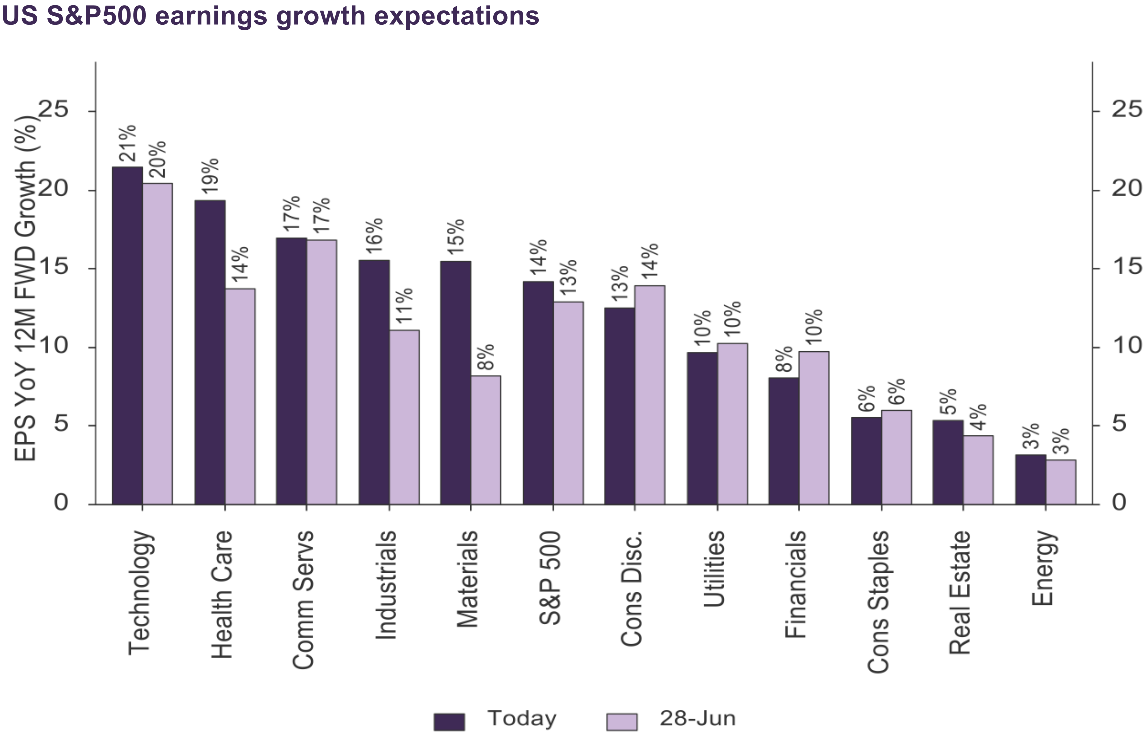
We maintain our bullish outlook on DM equities, led by the US

US activity indicators have surprise some investors on the upside, but it is what we expected and we believe the US can maintain above (2%) trend growth into 2025. The support to earnings from productivity and low unit labour costs can continue to prove very favourable for equity returns. US consumption spending is likely to remain robust given how strong household balance sheets are from the rise in wealth. On the supply-side of the economy, the rebound in investment spending by US firms is helping to enhance productivity performance.

US equity market performance remains broad

Since end-June, laggard sectors have seen upward revisions to earnings growth expectations, especially Materials, Industrials, and Healthcare (see Figure 11).

Figure 11: US S&P500 earnings growth expectations (24 Oct vs end-Q224)

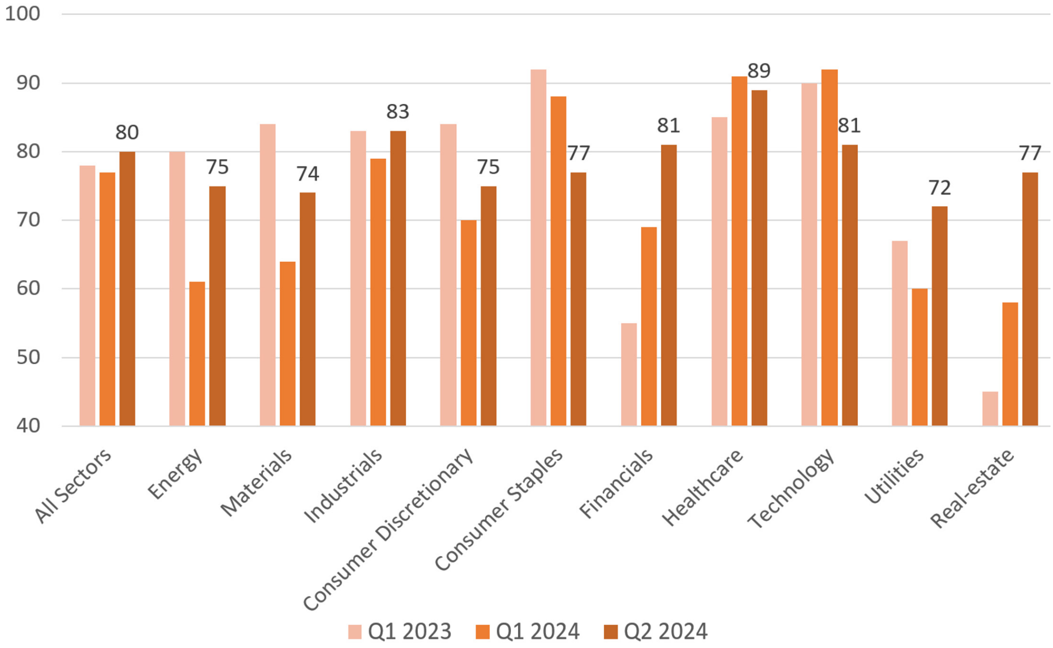


Source: LSEG Datastream, October 2024

From the Q2 reporting season across all US sectors at least 70% of firms beat expectations (see Figure 12). This reinforces how broad-based the robust US fundamentals are, and the Q3 earnings season looks set for strong performance being sustained. In part this can be because US real GDP growth was 3% in Q2, which was sustained into Q3, based on nowcasts. The US has enjoyed six consecutive months of significantly above trend growth and spending (with very low inflation and production costs).

Figure 12: US S&P500 realised earnings performance (for Q123, Q1 and Q2 2024)

US S&P500 percentage of firms beating earnings expectations



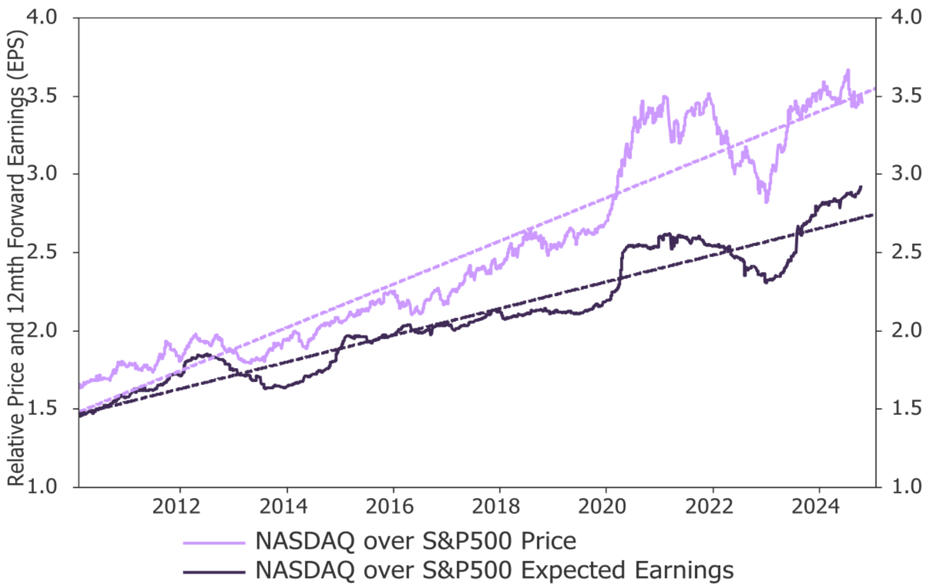
Source: LSEG Datastream (end Q2 2024)

The US IT sector can remain a leading performer, under our 3i's theme

We maintain our positive outlook on returns from the US IT sector. Granted, IT sector returns have fallen by more than the market, but IT returns have simply settled back around its historic trend of (market-wide) outperformance. The correction could prove to be 'healthy' as it may moderate some investors' over-exuberance (see Figure 13). Earnings growth expectations for the US IT sector are also slowing, and that will continue, but relative to the earnings performance across the entire US market the IT sector can defend its profitability edge (i.e. as reflected by the rising trend-line in EPS in Figure 13).

Figure 13: US IT sector performance relative to the US equity market

US NASDAQ 100 vs S&P500

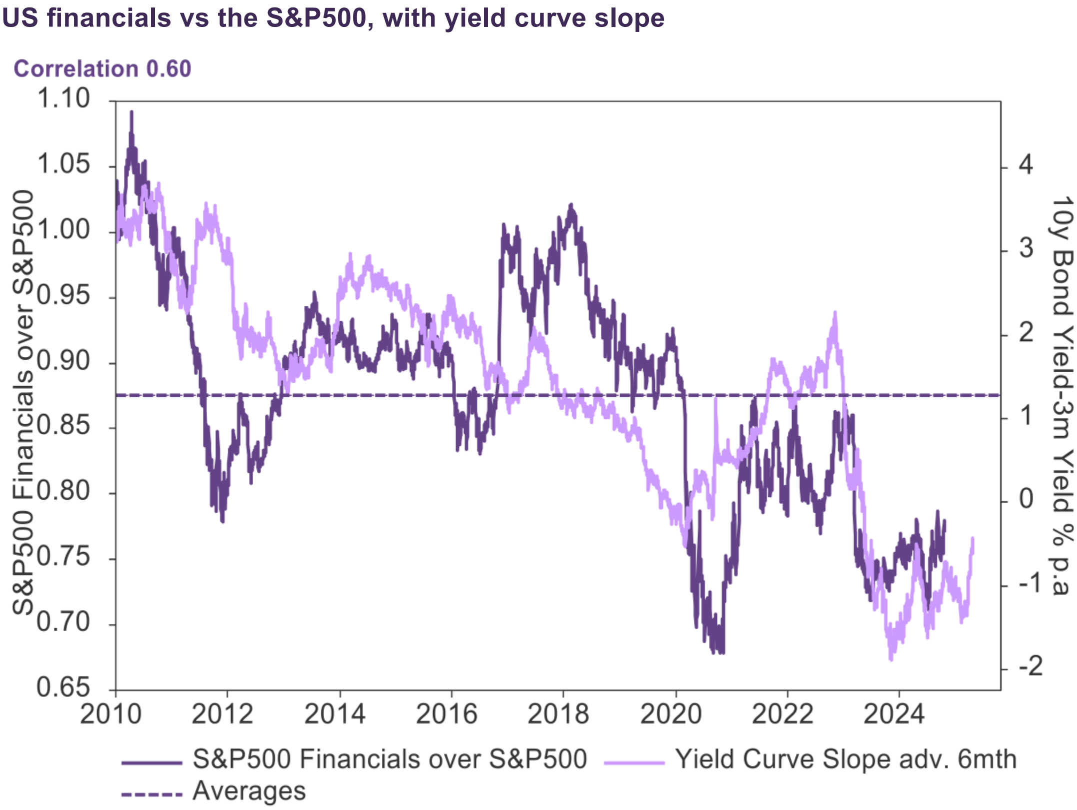


Source: LSEG Datastream, October 2024

Returns from US financials could also become stronger

Returns for US financials may improve as interest income becomes more supportive, and especially as non-interest income (from asset management etc.) continues its solid rebound. The steeper US yield curve ahead, as the forward-market seems to be 'pricing-in' (see Figure 19, in the Fixed Income section), signals higher returns can unfold for US financials (see the leading relationship in Figure 14).

Figure 14: US financial sector equities (relative to S&P500) and yield curve slope



Source: LSEG Datastream, October 2024

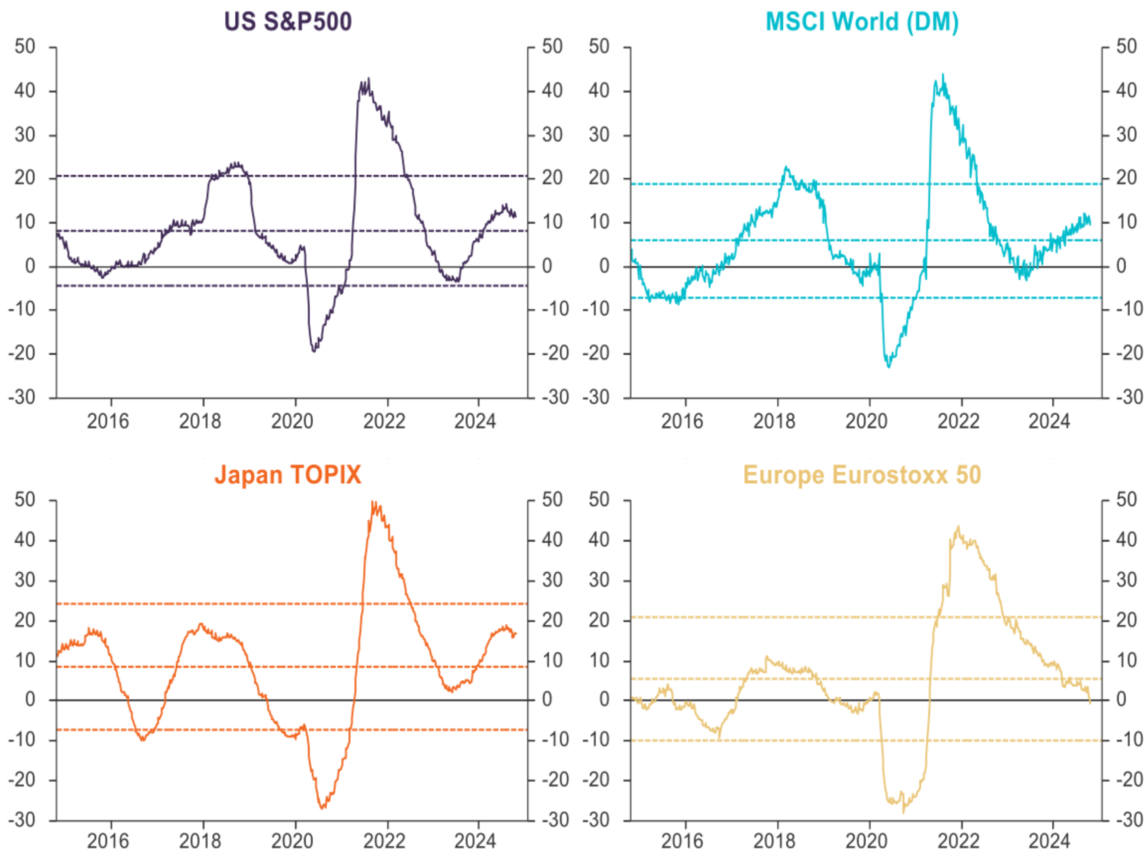
Returns from Japan equities should also remain solid, while Europe can improve over time with greater demand stemming from its stronger trade exposure to the US

We remain bullish on Japan equities as earnings performance is supported by significant productivity growth and competitiveness gains. Japan's exports, and productivity-enhancing corporate investment, are at record highs – when tracked as a percent of GDP.

It is therefore not surprising that the slowdown in Japan's' expected earnings growth should remain very gradual (see Figure 15). Separately, Europe's earnings growth expectations is continuing to try and find a bottom (see Figure 15). As activity slowly improves, especially with the benefit of Europe's higher trade share to the US, then profitability may be able to slowly grind higher.

Figure 15: Earnings growth expectations across DM markets

Earnings growth expectations (12 Mth fwd EPS YoY%)
with last 10y average and +/- 1 SD bands

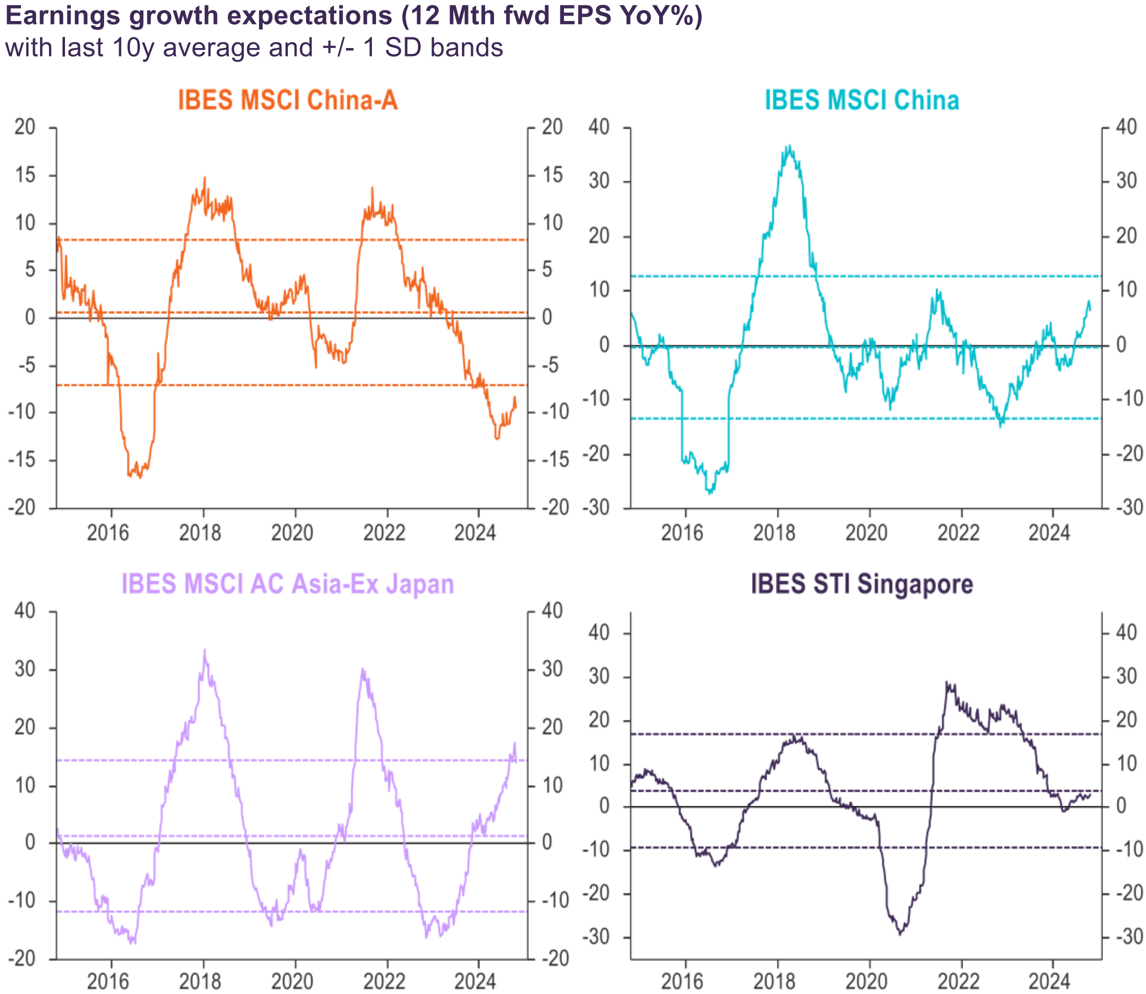


Source: LSEG Datastream, October 2024

We have revised up from positive to bullish on Asia equities, including China

Asia ex-Japan continues to enjoy a significant increase in its earnings growth expectations, which are now 1SD above average (see Figure 16). Taiwan and South Korea, as high-value added manufacturers, are benefiting from stronger global demands for new industrial outputs, IT and consumer products. Fullerton maintains its favourable outlook on India equities, as we believe its core fundamentals can remain on a solid trend. We are positive on Singapore equities, as firms are likely to benefit from stronger DM and regional demand, in particular, for higher-end capital goods.

Figure 16: Earnings growth expectations across Asia

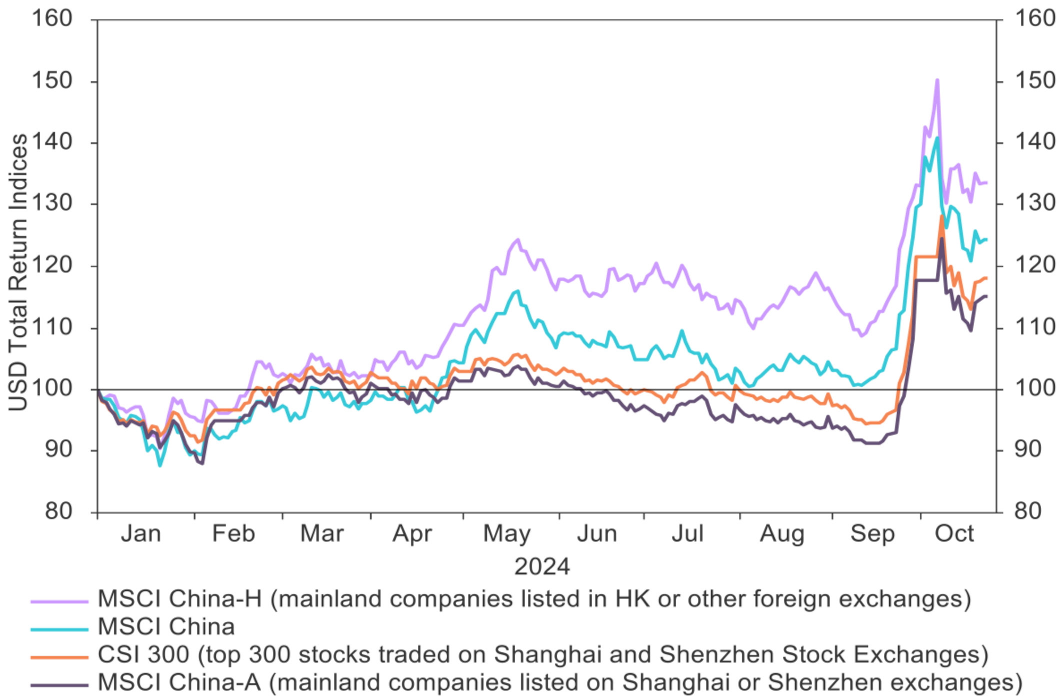


Source: LSEG Datastream, October 2024

Our bullish outlook for China equities reflects the on-going improvement in earnings growth expectations, and as China's new stimulus packages appear to meet the 'necessary conditions' to eventually reverse deflation and boost corporate profitability. So far, relative equity performance has not changed too much across the various China exchange listings (see Figure 17) which fits with the relative earnings expectations (i.e. China-A is still the weakest vs MSCI China, and China-H). Furthermore, across the domestic (China-A) sectors, relative performance has also been largely preserved (see Figure 18). Not surprisingly, all returns (across all exchanges) surged, 'overshot' on the upside (given the big shock the stimulus announcements proved to be), and have corrected back - but are holding-up, which should be positive for investor confidence (as time passes).

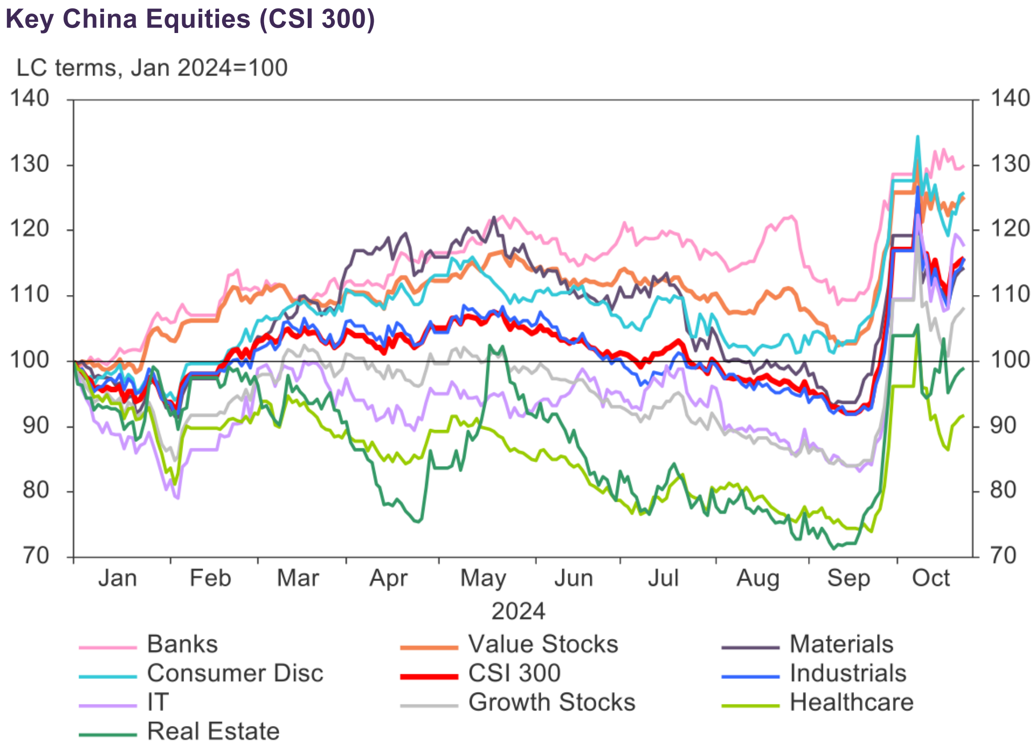
Figure 17: China equity performance by stock exchange

MSCI China, China-A and H-Shares



Source: LSEG Datastream, October 2024

Figure 18: China-A equity sector performance



Source: LSEG Datastream, October 2024

We continue to favour IT, consumerism, new industrials, and ESG-linked stocks

The global equity sectors we like have not changed materially from what we discussed in detail in our Q3 Investment Views. We generally prefer growth over value, and sectors linked to consumerism, IT, new industrials, (select) healthcare names, financials, and ESG-leaders. These sectors are favoured, as overall they are experiencing rising market share coupled with productivity gains containing costs. Financials can benefit from steeper yield curves, and stronger non-interest income, into next year.

As we also highlighted in our Q3 update, potential rotations are likely to remain on the radar as earnings growth expectations continue to converge between the strongest (slowing down) sectors and the laggards (rising). That said, relative performance orderings may not change dramatically i.e. US tech, IT, and communications will likely maintain the strongest earnings growth expectations, while the energy sector may hold the lowest ranking (refer back to Figure 11).

04 Fixed Income

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Our baseline view has always been that the rate cuts signalled by the Fed seem consistent with the US macro outlook. During October, US forward-market pricing aligned back to the Fed's outlook (as presented in September), and a key takeaway is the (market) view that the yield curve will return toward a more normal (positive) slope next year (see Figure 19).

Figure 19: US Interest Rate Outlook from the Fed and the Forward-Market

%p.a.	2023 (Actuals)	2024	2025	2026
Fed's Projection for its Policy Rate	5.4	4.4	3.4	2.9
Forward-Market Pricing for the Policy Rate	5.4	4.4	3.4	-
Forward-Market Pricing for the US 10y Yield	3.9	4.1	4.2	4.3
Implied Yield-Curve Slope (10y-Policy Rate)	-1.5	-0.3	0.8	1.4

Source: FOMC September 2024. Forward-market pricing: as at 21 Oct 2024, from Bloomberg

The Fed has forecast its policy rate to hit 3.4%[13]) during 2025, which is not too far (only 50bps) above its assumed long-term neutral policy rate of 2.9%. The Fed's easing reflects[14]:

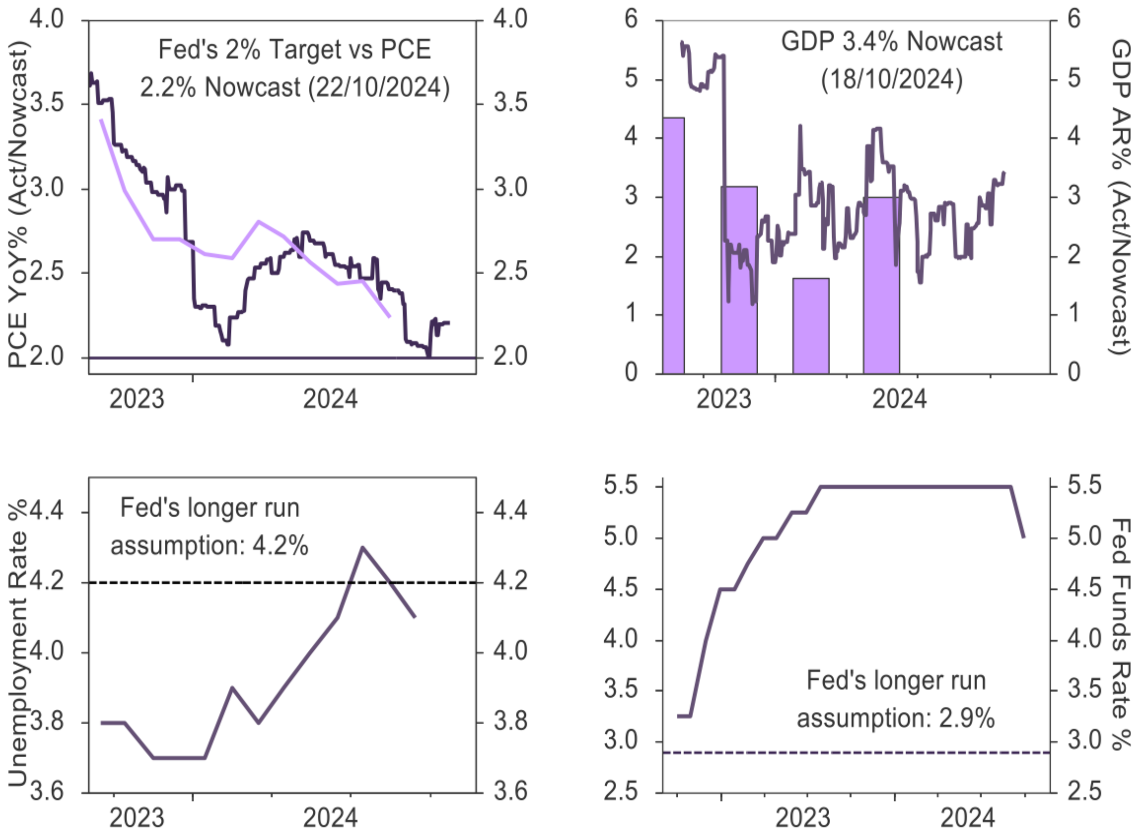
- US PCE inflation already being around the neighbourhood of the Fed's 2% target (with no expected tangible inflation upside in 2025), and
- the rise in unemployment to a more sustainable rate. The Fed expects the US unemployment rate to hit 4.4% by year-end, and hold at that level in 2025 – which is marginally above the assumed 4.2% natural-rate.

13. FOMC's projection, 18 September 2024
14. For further discussion see: September 2024 Fed rate decision - Fullerton Fund Management

Even though US growth continues to track very strongly (at over 3%, see Figure 20), and it may well hold above common trend assumptions of 2% in 2025, the Fed still needs to ease as it has presented in September. This is because a key part of its dual mandate is to avoid unemployment being too high (i.e. above the Fed's long-term natural rate assumption, which would break its 'full-employment' objective. See Figure 20).

Figure 20: Key US indicators that the Fed is watching

US PCE inflation, growth, unemployment, and fed policy rate



Source: LSEG Datastream, October 2024

We remain positive on Asia local currency bonds and IG corporate credit

Our positive view is supported by regional central bank easing and favourable global monetary dynamics. As the Fed's rate cuts unfold further in 2025 the tailwinds for Asian currencies and bond markets may improve further. The prospect of USD weakness can create a favourable environment for Asian local currency investors.

However, the extent of USD depreciation could be tempered by the ECB also easing significantly as EMU inflation is close to target and the growth outlook is weak. That said, even if the USD remains range-bound against DM it could slip versus Asia which will open-up room for central banks across the region to potentially ease faster. Therefore, more front-loading of monetary easing across the region is possible, in particular from countries like Indonesia and South Korea, as inflation is well-contained.

Overall, we remain constructive on Asian local currency bonds, supported by ongoing easing cycles and favourable market technicals. That said, we are mindful of potential risks, including the outcome uncertainty surrounding the US elections contributing to market volatility.

After the US elections, fears of any escalation of trade tensions could negatively impact Asian currency sentiment. On the other hand, the prospect of higher US tariffs on imports from China could lead to larger than otherwise stimulus actions from China's policymakers.

With China unveiling its new monetary and fiscal stimulus packages, the spillover effect has been most pronounced in China high-yield credits, particularly in the property sector. This shock and awe announcement caught most investors underweight and short on China assets by surprise. Accordingly, positioning is likely to shift significantly if the policy actions push China yields sustainably higher over time.

For Asia corporate credit we do not expect significant changes in the supply dynamics, but we see potential for demand to start picking-up. This could provide an additional technical boost, especially if investor sentiment towards China becomes more positive.

We believe investors should adjust exposures toward sectors that are linked to consumerism, select industrials, and real-estate. This is because they may benefit the most from the robust rise in earnings growth underway, easier monetary conditions, and from China's stimulus. There is also likely to be selected opportunities over time across EM credits, where technicals are less crowded, but we would remain cautious and avoid regions with geopolitical sensitivities.

The US dollar may be range-bound, but still with some bias toward depreciation, especially once the US election is past

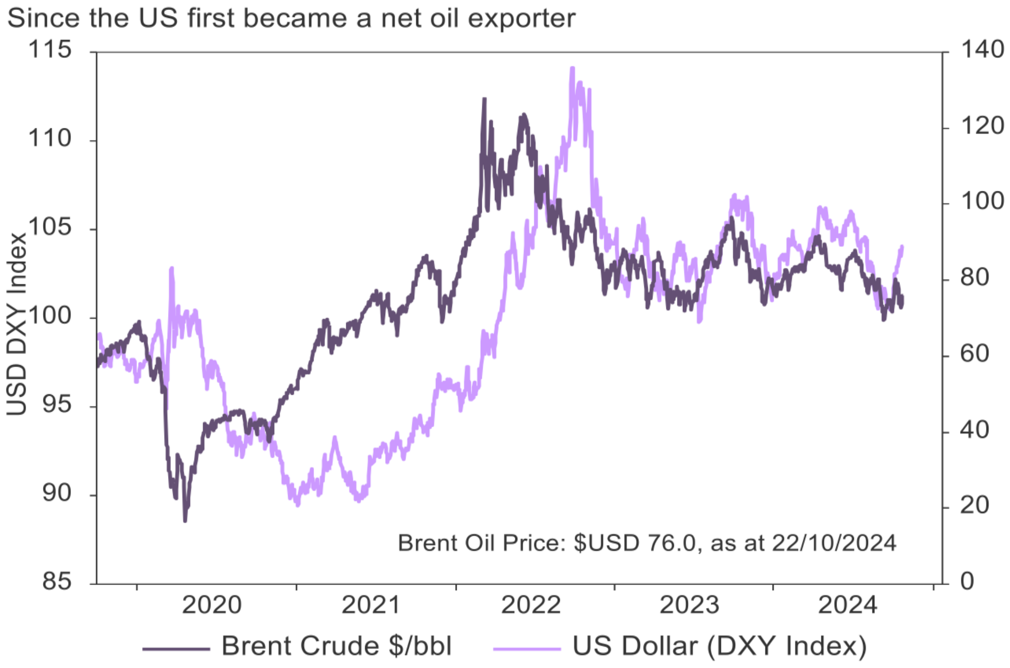
The US interest rate differential (against DM) has created some depreciation force on the US dollar as the Fed has outlined a significant easing path. However, the downside for the USD-DXY Index may be limited to the degree that the ECB also cuts its policy rate.

So far, the US dollar has remained significantly positively-correlated with oil prices (see Figure 21). Oil prices have been volatile, jumping on Middle-East concerns, but also falling by relatively more, reflecting concerns that global crude demand will surprise further on the downside.

More recently the US bond risk premium has increased significantly, in part perhaps reflecting the US election being too close to call - which has pulled-up US yields and the dollar. Furthermore, investor positioning was significantly short the US dollar, but has since corrected back sharply to neutral, which has helped the USD rise (even as oil prices have slipped. See Figure 22).

Figure 21: USD-DXY Index with oil prices

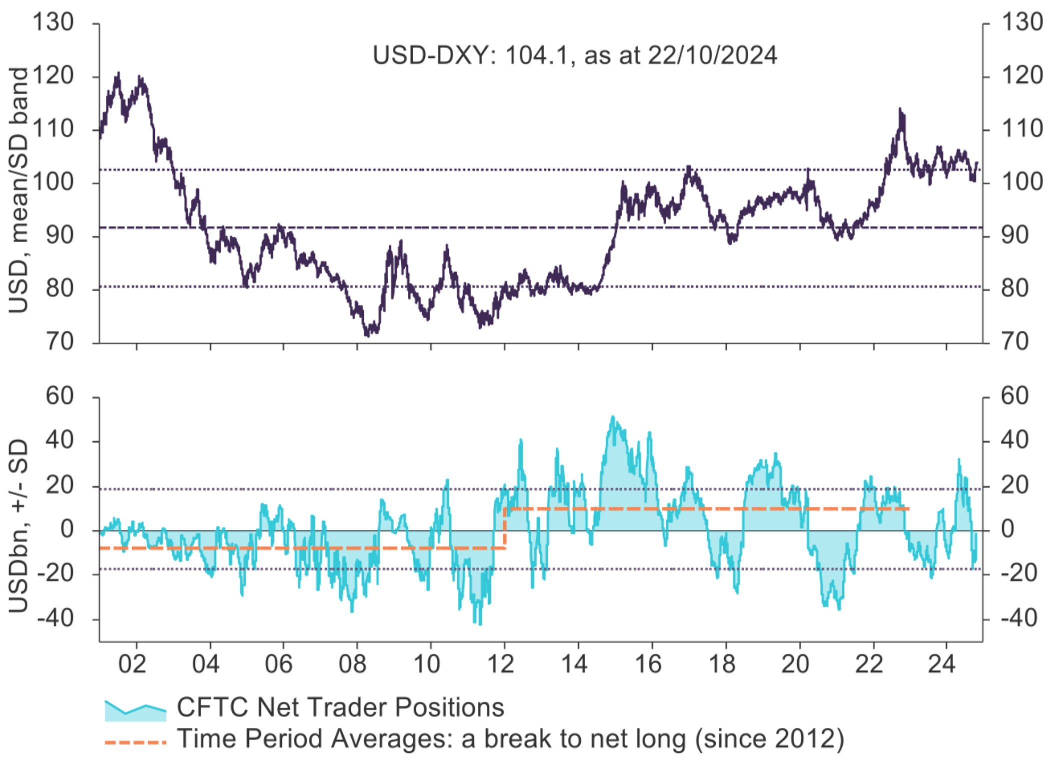
USD DXY and oil prices



Source: LSEG Datastream, October 2024

Figure 22: USD-DXY Index and investor positioning

USD DXY and investor positioning



Source: LSEG Datastream, October 2024