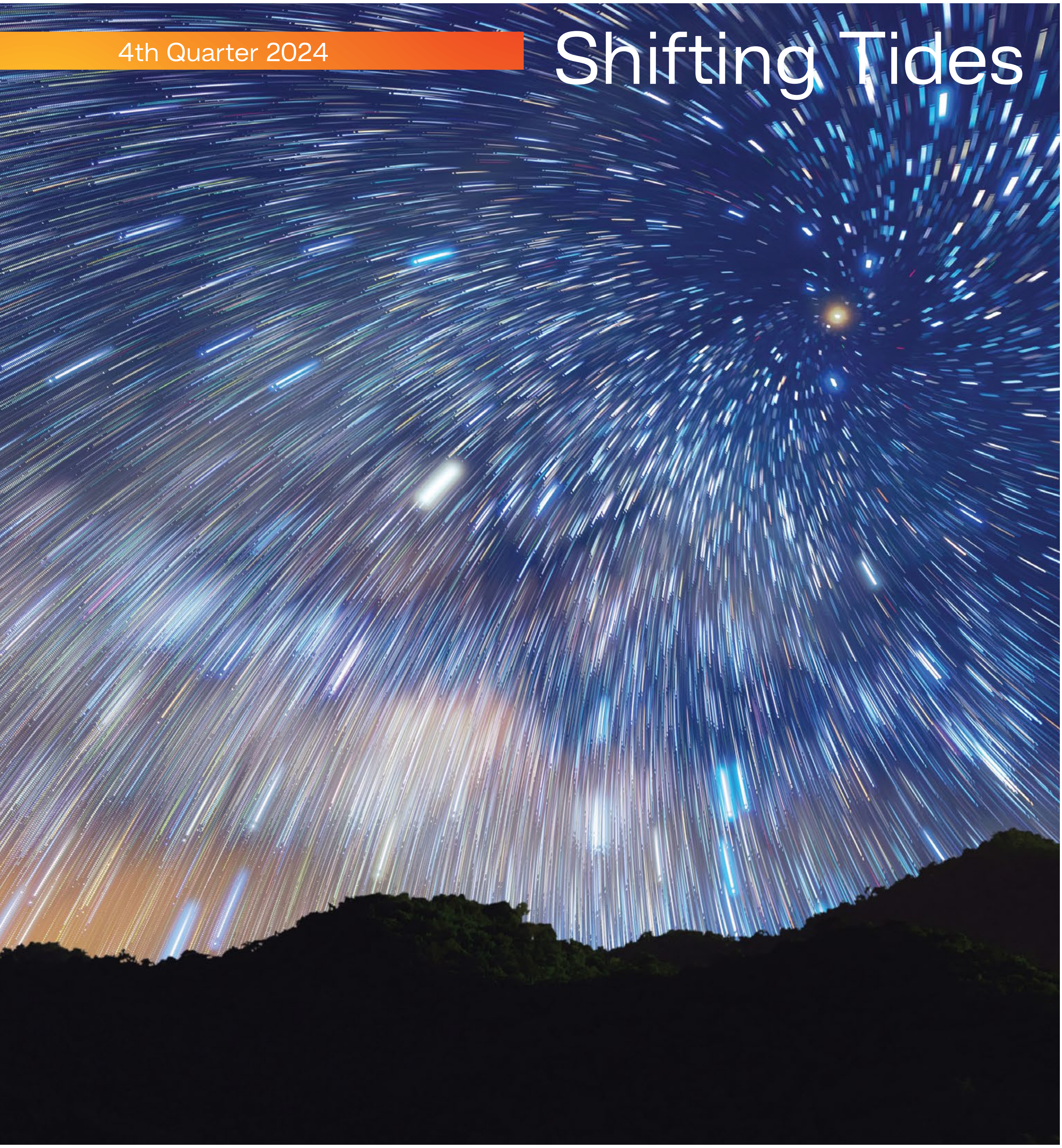
BEA 東亞銀行

BEA Wise

4th Quarter 2024

Shifting Tides



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The curtain may seem to have fallen on the US presidential election, yet it actually heralds the new chapter for the global order.

The title of the first quarter this year, "The Law of the Jungle", serves as a metaphorical reminder that history has repeatedly shown how humanity forsakes its civilization in pursuit of self-interest. A striking example lies in the documentary 20 Days in Mariupol, which documented the brutal dehumanization during the 2022 Russia-Ukraine war, through the lens of war correspondents who stayed until the bitter end. The film earned both an Academy Award and a BAFTA for Best Documentary. In contrast, the ongoing conflict between Israel and Hamas, now more than a year long, has increasingly faded from public attention, with the initial harrowing images of carnage giving way to indifference. The glorification of one side, juxtaposed with the complicity of another, is a chilling reminder of human callousness.

Contemporary Italian philosopher Giorgio Agamben, in his work "De l'Etat de droit à l'Etat de sécurité" (From a State of Law to a State of Security), argues that "national security" is not a shield to protect citizens, but rather a tool for those in power to justify their transgressions. By replacing legal authority with military power, those in power gradually strip away personal freedoms and perpetuate their reign under an indefinitely prolonged state of emergency to evade responsibility for international crimes. What holds true for a nation holds true for the world. In recent years, the Western powers have extended the concept of "national security" to encompass global trade, international finance, geopolitical affairs, and even daily life. The more those in power cling to control, the more desperate their actions become, betraying the very principles they claim to uphold.

Last year's third quarter was titled "The Spring and Autumn Annals", using the "Six Kingdoms Theory" to metaphorically describe the G7's encirclement of China and Russia. The six states were conquered by Qin due to their bribing of their lands to Qin, which led to their weakness. The echoes of that analysis still resonate today, as the G7's dominance wanes and its non-US economies within the group struggling. In the wake of ongoing geopolitical conflicts, Europe has grown more reliant on the US economically, while Japan, amid rising regional tensions, finds itself tethered to American military protection. In quiet moments of reflection, one must ask: Are these wars truly about external enemies, or are they driven by internal pressures? Will the G7 continue to follow the lead of the new US president? As the late former US Secretary of State Henry Kissinger once remarked, "It may be dangerous to be America's enemy, but to be America's friend is fatal".

It has been said many times: the more chaotic the world becomes, the more the US benefits. Despite the skepticism surrounding its credibility, the US still commands global leadership through its extraordinary economic growth. On the diplomatic front, Republican candidate Donald Trump remains as unpredictable as ever, while Democratic candidate Kamala Harris seems poised to follow in her predecessor's footsteps, offering little in the way of substantive policy change. No wonder President Biden, though physically frail during his final address to the United Nations, continued to boast, a sight that seems absurd to the oppressed.

In the film "Justice League," Steppenwolf leads parademons to invade Earth, exploiting human's fear, only to be ultimately defeated by Superman and his team of superheroes. At the moment of Steppenwolf's defeat, fear turns against him, ultimately leading to his demise. Today's G7, weakened, resorts to trade sanctions, interest rate manipulation, and geopolitical provocations in a desperate bid to crush their opponents, hoping to set an example. However, their adversaries have not surrendered; instead, organizations like BRICS are establishing new financial and trade systems. As conflicts drag on, the once easy gains are now hard to come by.

The saying from "Stories to Awaken the World" that "every drink and peck is predestined" and the prophetic " Shaobing Song " from Chinese culture seem to foretell changes in the future global order.

This quarter's title, "Shifting Tides", is inspired by Wang Bo's poem "Tengwang Pavilion": though the landscape remains, faces have changed. The sentiment not only expresses emotions but also serves as a warning to be vigilant and prepare for the future, encouraging personal perfection and national strength. In the film "Ip Man 2", after defeating the fierce opponent Tornado, the protagonist, Ip Man, offers a profound reflection: "While there are differences in status, there should be no distinction in dignity. Mutual respect is key, and in harmony, one finds strength – the art of winning without fighting" .

Even in the darkest of times, there will always be brighter days ahead.

Let us take this to heart.

Macro Strategy

Shifting Tides

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Shifting Tides

As the post-election period unfolds, a host of risk factors are poised to emerge. Investors should prioritize risk aversion and maintain flexibility in their allocations with careful deliberation

Last quarter's title was "The Final Sprint", highlighting the gradual recovery of major global economies from the mire of de-globalization. However, global funds have been charting their own course. The US's awkward position in Middle Eastern issues has eroded its international influence, and neither candidate in the presidential election is likely to resolve the US's economic challenges. Despite tariffs and sanctions, the underlying issue of declining US productivity remains. This could trigger a recession fueled by high inflation, and possibly lead to a "gray rhino" event characterized by US stagflation, which would pose significant risks to the global economy. Historically, stagflation often tied to Middle Eastern oil crises. In the run-up to the election, investors are advised to moderately increase risk exposure but should remain wary of heightened volatility. In the longer term, investors should tilt towards a balanced and defensive investment strategy. Last quarter's forecast has largely played out as expected.

The title of this quarter is "Shifting Tides", which suggests the potential for a new era in investment markets following the US presidential election. Not only will several key countries in mature markets see leadership changes, but rising egoism and right-wing movements may prompt a reversal of the aggressive, coercive measures targeted at emerging markets in recent years. Additionally, the US is expected to face deeper internal division post-election, which historically led to a progressive economic downturn. The power transition will likely leave the US in a relatively vulnerable state, which could present the BRICS with an opportune moment to push forward their "de-dollarization" agenda. With various risk factors looming, diversification across multiple assets is the optimal approach for investors.

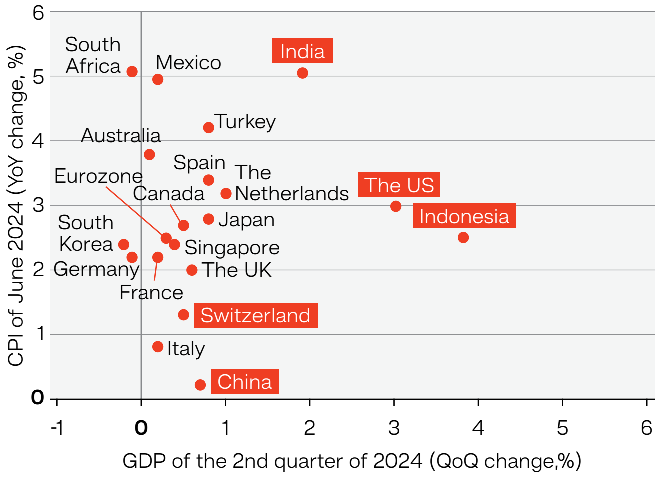
Market Review: Capital Preparing for Greater Risks Ahead

After weathering the storm of de-globalization, economies worldwide began to stabilize last quarter. This year, marked by a series of global elections, culminates with the US presidential election in November as the main event. Amidst the volatility and uncertainty, international capital has quietly positioned itself for risk aversion.

Global Economy Continues to Improve but Divergences Widen

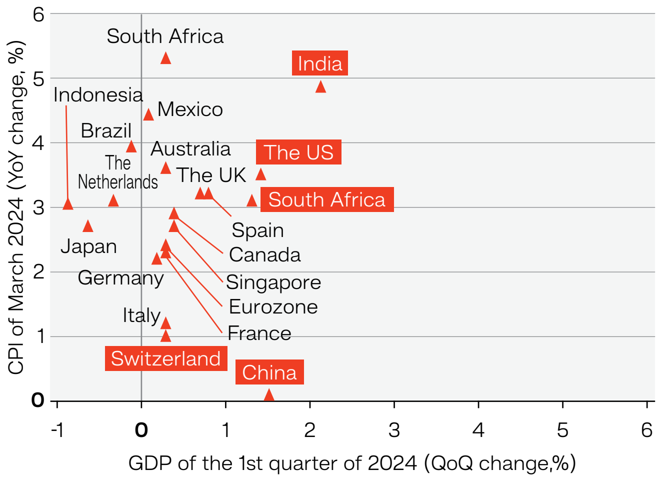
The top 20 global economies have maintained their positive momentum from last quarter. Comparing the GDP growth rates of the first and second quarters, the average growth rate increased from 0.4% to 0.8%, indicating continued overall economic improvement. The number of countries experiencing zero growth (below 0%) dropped from four to three, with the worst performer (Indonesia) improving from -0.8% to -0.2% (South Korea). This indicates that even countries in recession are showing signs of improvement. However, the gap between the highest and lowest GDP growth rates widened from 2.9% to 4.0%, highlighting the growing divergence in economic performance across countries. In light of these, a geographically diversified investment strategy is advisable.

Matrix of Countries' GDP and CPI (the 2nd quarter of 2024)



Source: Bloomberg, data as of 3 September 2024, India's GDP updated to March 2024

Matrix of Countries' GDP and CPI (the 1st quarter of 2024)



Source: Bloomberg, data as of 3 September 2024, India's GDP updated to December 2023

The Consumer Price Index (CPI) from June and March showed an average value that edged down from 2.9% to 2.8%, while the gap between the highest and lowest values narrowed from 5.2% to 4.9%. These results are broadly consistent, suggesting global inflationary pressures have not significantly abated. However, the number of countries with CPI below the average increased from nine to twelve (the proportion increased from 45% to 60%), showing a general downward trend in inflation across most countries. Still, a few countries, such as South Africa (5.1%), India (5.1%) and Mexico (5.0%), continue to post higher inflation figures, skewing the average.

In terms of GDP and CPI data, the top five countries with the highest values in the first quarter of 2024 were China, India, South Korea, the US and Switzerland. By the second quarter, the rankings shifted slightly, with China, Indonesia, the US, Switzerland and India leading the pack. The only notable change among these two groups of countries was the swap between South Korea and Indonesia, underscoring the continued economic strength of China, India, the US and Switzerland, which lead global economic growth.

While China retained its top position, its CPI remained between 0.1% and 0.2%. However, its quarterly GDP growth slipped from 1.5% to 0.7%, suggesting a potential economic decline. In contrast, the US showed remarkable resilience, with CPI falling from 3.5% to 3.0%, while GDP surged from 1.4% to 3.0%, highlighting the robustness of the US economy.

Significant Asset Volatility Highlights the Importance of Diversification

In addition to the divergence among global economies, asset performance is also highly volatile. Using widely accepted asset indices as benchmarks, the overall performance data is as follows:

Period	Performance (%)					
	MSCI World Index	Bloomberg Global Aggregate Bond Index	DXY Index	S&P GSCI Index	MSCI World REITs Index	Largest gap over the same period
During the year	15.5	1.7	0.3	0.2	9.4	15.3 percentage points (pp)
Q1	8.5	-2.1	3.1	8.7	-1.5	10.8 pp
Q2	2.2	-1.1	1.3	-0.7	-1.5	3.7 pp
Q3	4.2	5.0	-4.0	-7.2	12.7	19.9 pp
Average	7.6	0.9	0.2	0.3	4.8	12.4 pp
Largest gap	13.3	7.1	7.1	15.9	14.3	16.2 pp

Source: Bloomberg, data as of 2 September 2024

Equities emerged as the only asset class that recorded positive returns across all observed periods, indicating that stock market investments have consistently delivered solid returns, regardless of entry points. Equities also posted an average return significantly higher than other asset classes, with relatively lower volatility, reinforcing stocks as the best-performing asset class so far this year.

Bonds and the US dollar continued to exhibit their low-risk characteristics, with both showing lower average returns and return volatility. However, it is important to note the stark divergence in their performance last quarter. As of September 2, bonds, which lagged significantly in the first two quarters, surged in the third quarter with a 5.0% return YTD, outpacing equities. This was driven by market expectations of imminent rate cuts. Conversely, the US dollar recorded a -4.0% return in the third quarter, breaking its long-standing streak of strong performance, as rate cut expectations negatively impacted the US dollar.

The performance of commodities and REITs is highly volatile. Based on their average returns and volatility, their risk-adjusted returns were less attractive. However, for investors with a higher risk appetite, high volatility may better suit their investment preferences. For instance, after recording negative returns in the first two quarters, REITs rebounded sharply in the third quarter with a nearly 13% gain.

Looking at the largest gap in return, the five major asset classes delivered double-digit returns in all observed periods except for the relatively flat second quarter, reflecting effective risk diversification through asset allocation. The largest gap in return overall observed periods was approximately 16.2%, indicating that investors holding a diversified portfolio of the five major assets would experience a wider range of return volatility.

Macro Strategy

In summary, assuming no significant changes in the macroeconomic environment, investors should focus on diversification as a core strategy, adjusting their allocations based on individual risk tolerance. For detailed forecasts on different asset trends, please refer to the "Equity", "FX" and "Bond" sections.

Capital Flows Illustrate Classic Contrarian Moves

While the performance of indices fluctuates, capital flows are equally dynamic. According to data provided by the Investment Company Institute (ICI) covering the period from the first week of last quarter through to the week ending 21 August, among the four major asset classes (including equities, bonds, mixed equity and bonds and commodities), only bonds saw consistent weekly net inflows. The total inflow during the period reached $74.3 billion (USD, same below), accounting for nearly 76% of the total inflows across all asset classes. This demonstrates a strong investor preference for bonds. However, the capital flows seem at odds with the performance of aforementioned bond indices, suggesting that investors are quietly hedging their risk exposures.

The capital flows of equity funds also diverged from the trends of the related indices. Prior to the global stock market correction on July 17, the weekly equity fund inflows were subdued, even registering a $1.2 billion net outflow at one point. This indicates that while stock indices repeatedly hit new highs, long-term funds and exchange-traded funds (ETFs) were quietly reducing their positions significantly. Conversely, after the sharp decline in global stock markets, long-term funds flowed into equity funds. The mid- and late-July periods saw net inflows of $33.9 billion and $26.8 billion, respectively. Similarly, during the week ending 21 August, amid market concerns regarding US equities overextension, another $19 billion flowed into equity funds. Though total inflows into equities were far less than bonds, it still recorded a total net inflow of $40.3 billion during the period.

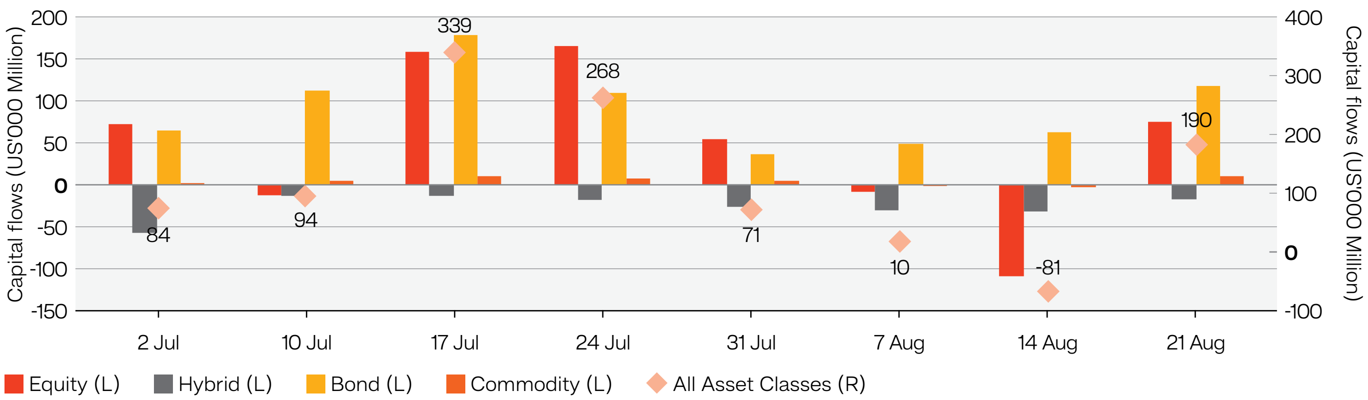
In summary, the stock market perfectly illustrates the "contrarian" operation, while the bond market shows that investors are quietly increasing their bond positions in anticipation of a first US rate cut. These findings reaffirm our long-held view: in a global election year, market noise and mixed signals will heighten volatility in investment markets. Investors should continue to diversify investment risk through asset allocation, a strategy we expect to remain effective leading up to the US presidential election.

Market Outlook: A Presidential Election Without a Clear Winner

This year stands out as a rare "global election year", with over half the world's population – representing at least 48 countries – having either completed or being in the process of conducting elections at various levels (for details, please refer to the "Macro Strategy" section of BEA Wise of the 2nd quarter 2024). Whether it is the election for leadership or parliamentary positions, widespread power transitions are occurring in regions and countries as diverse as Taiwan, Indonesia, Portugal, Iran, South Korea, Iceland, France, the UK, Japan and Thailand. On the other hand, there are countries where the original ruling regime successfully retained power, including Russia, India, the European Parliament and Mexico, as well as Ukraine and Israel, where election dates have been indefinitely postponed.

Since the 2008 financial crisis and the 2020 pandemic, mature markets have relied heavily on quantitative easing to stimulate asset appreciation, hoping to spur economic growth through the wealth effect. However, over the years, the stagnation of the real economy has exposed the declining productivity of core industries in mature markets. The widening wealth gap has eroded the middle class, forming the so-called "M-shaped society". Policy missteps have left voters in despair, and regime changes are only a matter of time.

Weekly Capital Flows of US Registered-ETFs and Long-term Funds



Source: Investment Company Institute, data as of 2 September 2024

The replacement of leaders in many countries will lead to changes in financial and economic policies, especially against the backdrop of rising egoism and right-wing ideologies. Protectionist and anti-capitalist policies may be implemented, which could disrupt the global economic order, accelerate the trend toward a multipolar world, and fundamentally alter global capital flows and long-term investment strategies.

A Ceasefire in the Middle East Could Boost Investment Appetite Ahead of US Election

In last quarter's forecast, we predicted that both US political parties would resort to extreme measures in the lead-up to the presidential election for the pursuit of votes. Unexpected and dramatic events would likely unfold. Unfortunately, this prediction came true when Republican candidate Donald Trump was shot. Although the incident was downplayed, it still has casted a shadow over the election. Following the first televised debate, Democratic candidate Joe Biden saw his approval ratings plummet, forcing the Democrats to change their candidate. Current Vice President Kamala Harris has now taken the reins, leveraging her gender and racial background, along with the anti-Trump vote, to recover Biden's lost ground. She is now slightly leading Trump in the polls[1]. However, with weeks remaining before the Election Day, investors should remain vigilant for the risk of further "unexpected" events.

It is generally believed that Harris's political achievements are mediocre, and even if elected, she would likely follow Biden's policy agenda. If she loses, the Democratic Party may still secure control of one of the chambers of Congress, which would help check a future Republican administration's policies. Therefore, even as the current administration is approaching its end, policy continuity should not be overlooked, especially in managing foreign conflicts and economic issues, both of which will heavily impact the market in the future.

In terms of foreign wars, Trump maintained "good relations" with Russian President Vladimir Putin and North Korean leader Kim Jong-un during his term, branding himself as a "war-ending" candidate in the current election cycle. He has even claimed to have a comprehensive plan to immediately halt the Russia-Ukraine conflict if elected[2]. During Trump's previous administration, there was indeed little direct or indirect involvement in geopolitical wars, giving him a "peace-seeking" image in stark contrast to Biden's "pro-war" stance.

To date, the Democratic Party finds itself in a difficult position with the Russia-Ukraine and Middle East conflicts. To shed its pro-war image and counter Trump's promises, the Democratic Party's best move would be to deliver on a ceasefire now. For the US, the Russia-Ukraine and Middle East conflicts are fundamentally different in nature and in terms of national interests: maintaining the intensity of the Russia-Ukraine conflict helps manage tensions between the US and its allies and that of the China-US- rivalry, making a ceasefire less feasible. In contrast, US economic and political interests are deeply intertwined with Israel. The US's unyielding support for Israeli military actions in the United Nations has already taken a toll on its international reputation and influence. Should the Democrats manage to broker a ceasefire in the Middle East, it would not only help attract centrist voters but also create a perception of "victory" for older, more traditional voters, further solidifying US's image as a dominant global power. As for the humanitarian toll of these conflicts, whether in terms of moral responsibility or human rights, such concerns have long been cast aside in the face of electoral gains.

If this forecast materializes, commodities will be the first to react, especially oil, natural gas and even safe-haven assets like gold, which could come under indirect pressure. This will help alleviate the potential oil crisis caused by Middle East issues, and the decline in commodity prices can also ease inflationary pressures in mature markets, paving the way for future interest rate cuts and other fiscal and monetary policies. Historically, the US used wars to drive safe-haven capital flows into the US dollar. However, with the election nearing its conclusion, the strong US-dollar strategy appears to be running out of steam, laying the groundwork for a weaker US-dollar policy post-election. Overall, a Middle East ceasefire before the election will improve investment sentiment, particularly benefiting value stocks and corporate bonds (for details, please refer to the "Equity" and "Bond" sections).

1 See Real Clear Politics website: https://www.realclearpolling.com/polls/president/general/2024/trump-vs-harris
2 See The Straits Times website: https://www.straitstimes.com/world/united-states/trump-says-witholding-surprise-plan-to-end-ukraine-war

Economic Turnaround Becomes Key Election Battleground

Beyond geopolitical maneuvering, the economic performance and fiscal and monetary policies are another arena where Democrats and Republicans are vying for dominance.

In mid-July, global stock markets experienced significant volatility. While the complex technical factors such as the unwinding of yen carry trades were cited by some analysts, the more widely accepted narrative was the looming US recession, which sparked the coining of new buzzwords like "felt recession". However, in late July, the US government announced that the second-quarter GDP surged from 1.4% to 2.8%, and by the end of August, it was further revised upward to 3.0%. As of 4 September, this economic growth rate was second only to Indonesia (3.79%) among major global economies, far outpacing India (1.9%), which ranked the third, and other mature markets. This not only debunked the narrative pushed by those disparaging the US economy, but also created a positive picture of a thriving US economy pre-election, with clear political motives behind.

Comparing the economic data from Trump's and Biden's term, it becomes evident that Harris is shouldering Biden's economic vulnerabilities as she steps into the election spotlight. The following data shows the changes in key economic indicators from Q1 2017 to Q4 2020 (Trump's term) and from Q1 2021 to 4 September 2024 (Biden's term):

Indicators	Changes during Trump's term (%)	Changes during Biden's term (%)
Quarterly GDP	2.20	-2.20
Core CPI	-0.38	1.52
Core PCE	-0.13	0.36
Unemployment rate	2.10	-1.90
Federal interest rates	-0.75	5.25

Source: Bloomberg, data as of 2 September 2024

The data reveals that Trump outperformed Biden in terms of quarterly GDP growth and inflation management. While Biden managed to improve the unemployment rate, the stark difference in interest rates highlights the challenges for his economic policies.

The economic downturn is believed to be the Achilles' heel of the Democratic Party. The Biden administration has relied on loose fiscal policies to maintain economic growth, such as approval for a total of $169 billion in loan forgiveness of nearly 4.8 million federal student debt accounts. However, this policy is now under legal challenge from Republican lawmakers. Whether or not the challenge succeeds is less important than the fact that the courts have halted the plan amid controversy, which dealt a severe blow to the Democrats' economic policies. Since March 2022, the Federal Reserve (the "Fed") has raised interest rates 11 times, totaling 5.25%. The magnitude and speed of these rate hikes are rare in recent history, and their impact on the economy has been severe. In July, the US unemployment rate rose to 4.3%. Sahm, the creator of the "Sahm rule", stated that the US is effectively in a recession, and the Fed's reluctance to cut rates is akin to "playing with fire." According to data from the bankruptcy research firm Bankruptcy Watch[5], as of August 20, Chapter 11 bankruptcy filings in the US had risen 49% year-to-date.

Currently, market views on the economic situation are divided. Whether the "Goldilocks" economy or the "felt recession" narrative prevails will depend on key upcoming data, such as the unemployment rate in September and Q3 GDP estimates, as well as how scholars and Wall Street figures present and interpret these figures. As a result, the most likely outcome seems to be an economic "soft landing", favorable for the US bond market, though cyclical stocks may face greater pressure. In contrast, defensive and value stocks are likely to benefit (for details, please refer to the "Equity" and "Bond" sections).

The Power Transition Period: The Most Dangerous Time

This year's US presidential election could potentially make history by electing the first female president of the US, or it could see the return of a former president for the first time since Grover Cleveland's non-consecutive terms (in 1885 and 1893 respectively) in the late 19th century.

[3] See CNN website, https://edition.cnn.com/2024/09/03/politics/student-loan-forgiveness-lawsuit-biden/index.html
[4] See CNBC website, https://www.cnbc.com/2024/06/18/economist-sahm-who-devised-recession-rule-says-the-fed-is-playing-with-fire-.html
[5] See Bankruptcy Watch website, https://www.bankruptcywatch.com/statistics

Assuming Kamala Harris would largely follow Biden's policy framework, the governing philosophies of Trump and Biden, while appearing diametrically opposed (favoring right or left-wing ideologies, , isolationist or alliance-based diplomacy, or monetary versus fiscal policy), ultimately converge on those same key issues including egoism, a hardline stance on China and mounting debt. However, Trump's potential return has been met with fierce criticism, including:

- actively reducing involvement or withdrawing from international commitments and organizations, reversing stances on international trade and climate policies, and accelerating global multipolarity;
- undermining transatlantic and Northeast Asian relations established during Biden's administration, potentially easing geopolitical tensions in Asia;
- advancing Middle East peace processes, solidifying Israel-centric geopolitical relations, while prolonging unresolved issues in Middle East;
- facilitating a ceasefire between Russia and Ukraine, reducing US-European cooperation, and pushing Europe toward greater military autonomy, while improving Sino-European trade relations;
- adopting an even tougher stance on China in diplomacy, military and trade, while allowing room for negotiations based on interests;
- favoring pro-business economic policies, such as increasing taxes on the wealthy while reducing corporate taxes, and adopting a more aggressive stance on rate cuts compared to the Democrats.

Since Trump's announcement of his candidacy, there has been widespread apprehension with negative sentiments such as "unpredictable," "authoritarian" and "interest-driven" which cast a global shadow. From an investment perspective, policies are neutral, and survival of the fittest remains the ultimate rule.

The key risk lies not in the election outcome but in the power transition period between Election Day (5 November) and Inauguration Day (20 January of the following year). If Trump fails to secure a decisive win over Harris, there could be a "non-cooperation movement", including delayed transitions and legal proceeding, or even incidents similar to the Capitol unrest, which could further fracture domestic unity and lead to a presidential election without a winner. On the diplomatic front, Russia may seize the opportunity to launch its own currency payment system, directly challenging the dominance of US dollar. Iran may escalate military actions against Israel post-election, dragging the US into another Middle Eastern quagmire. At this vulnerable point in the power transition, how the incoming administration handles both internal strife and external threats will be its most pressing challenge.

The risk lies in whether there will be a change in administration. Looking at the past 10 election outcomes, each party has won five times, indicating that voters see the two parties as evenly matched. This election could finally break the nearly 40-year tie, making the outcome highly significant. In terms of re-election or replacement, the data shows that both "incumbent party wins" (re-election) and "party alternation" (replacement) occurred five times each. When it comes to re-election, Republicans won three times, while Democrats won twice, giving Republicans a slight edge. If the Democrats manage to retain power this election, it would bring them level with the Republicans. A summary of the outcomes from the past 10 US presidential elections is as follows:

Year	Election outcomes		Election outcomes#
	Party	Elected candidate	
1984	The Republican Party	Reagan	R>>R
1988	The Republican Party	George HW Bush	R>>R
1992	The Democratic Party	Clinton	R>>D
1996	The Democratic Party	Clinton	D>>D
2000	The Republican Party	George HW Bush	D>>R
2004	The Republican Party	George HW Bush	R>>R
2008	The Democratic Party	Obama	R>>D
2012	The Democratic Party	Obama	D>>D
2016	The Republican Party	Trump	D>>R
2020	The Democratic Party	Biden	R>>D

Source: Bloomberg, data as of 31 August 2024
(#: "R" stands for Republican Party, "D" stands for Democratic Party; the ">>" symbol indicates the transition, with the incumbent party on the left and the winning party on the right.)

Macro Strategy

Based on the above forecasts, the risk during a power transition is relatively high. The changes in economic data from 31 October of the last 10 election years to 31 January of the following years are extracted and tabulated below:

Changes in economic data from 31 October of the last 10 election years to 31 January of the following years (%)				
Year	Quarterly GDP	Unemployment rate	Core PCE	Federal interest rates
1984	-0.6	-0.1	0.5	-1.75
1988	3.0	0.0	0.2	0.50
1992	0.2	0.0	0.0	0.00
1996	0.6	0.1	0.0	0.00
2000	2.0	0.3	0.2	-1.00
2004	0.3	-0.2	0.2	0.50
2008	-6.4	1.3	-0.7	-0.75
2012	-0.1	0.2	-0.3	0.00
2016	-0.7	-0.2	0.1	0.25
2020	-30.6	-0.4	0.3	0.00
Average (over all observed periods)	-3.2	0.1	0.1	-0.23
Average (excluding 2020)	-0.2	0.2	0.0	-0.25

Source: Bloomberg, data as of 31 August 2024

According to the data, quarterly GDP showed a near 3.2% drop on average over all observed periods. Excluding the 2020 pandemic-related data, the average contraction hovered around 0.2%, reflecting a gradual and orderly economic slowdown. The unemployment rate registered an average increase of 0.1% to 0.2%. The core PCE remained largely flat, while the Fed lowered interest rates by 25 basis points. These four key metrics align closely with market forecasts to date.

Further comparison of historical data with September's figures offers insights into the probability of economic changes this quarter. The analysis reveals:

Economic indicators	Quarterly GDP(%)		Unemployment rate(%)		Core PCE(%)		Federal interest rate(%)	
September this year	2.8		4.3		2.6		5.25	
Year	Value	Lower than 2.8	Average	Higher than 4.3	Average	Lower than 2.6	Average	Lower than 5.25
1984	3.3	No	7.3	Yes	4.1	No	8.50	No
1988	5.4	No	5.3	Yes	4.6	No	8.63	No
1992	4.2	No	7.4	Yes	2.8	No	3.00	Yes
1996	4.2	No	5.4	Yes	1.9	Yes	5.25	No
2000	2.4	Yes	4.0	No	1.9	Yes	6.17	No
2004	4.1	No	5.4	Yes	2.1	Yes	2.17	Yes
2008	-8.5	Yes	7.3	Yes	1.1	Yes	0.50	Yes
2012	0.5	Yes	7.9	Yes	1.7	Yes	0.25	Yes
2016	2.2	Yes	4.7	Yes	1.8	Yes	0.67	Yes
2020	4.2	No	6.6	Yes	1.6	Yes	0.25	Yes
Probability (%) (over all observed periods)	40		90		70		60	
Probability (%) (excluding 2020)	44		89		67		56	

Source: Bloomberg, data as of 31 August 2024

The above GDP figure refers to the fourth-quarter value of the observed year, while the unemployment rate, core PCE, and federal interest rate reflect the averages from November of the election year through January of the following year. The comparison of the above data with the data of September of this year indicates that the probability of GDP falling below 2.8% is roughly 40%, suggesting that a significant economic downturn before January of next year is unlikely. The unemployment rate exceeding 4.3% has a nearly 90% probability, implying that unemployment could worsen significantly. The core PCE has a 70% probability of declining, and a 60% probability of further rate cuts.

Summarizing the magnitude and probability analyses above, it is predicted that the probability of a declining GDP this quarter is low. Even if there is a decline, the magnitude is expected to be relatively moderate, which is in line with the general forecast of a 'soft landing'. It has a higher probability to record a progressive rise in unemployment rate. Core PCE may fall further, yet the magnitude is on the low side. The probability of a Fed rate cut is high, within 50bps.

Election outcomes[#]	Year	Quarterly GDP (%)			Unemployment rate (%)			Core PCE (%)			Federal interest rate (%)		
		Change	Value	Lower than 2.8	Change	Average	Higher than 4.3	Change	Average	Lower than 2.6	Change	Average	Lower than 5.25
D>>D	1996	0.6	4.2	No	0.1	5.4	Yes	0.0	1.9	Yes	0.00	5.25	No
D>>R	2000	2.0	2.2	Yes	0.3	4.0	No	0.2	1.9	Yes	-1.00	6.17	No
D>>D	2012	-0.1	0.5	Yes	0.2	7.9	Yes	-0.3	1.7	Yes	0.00	0.25	Yes
D>>R	2016	-0.7	2.4	Yes	-0.2	4.7	Yes	0.1	1.8	Yes	0.25	0.67	Yes
Average	D>>D	0.3	2.4	50	0.2	6.6	100	-0.2	1.8	100	0.00	2.75	50
	D>>R	0.7	2.3	100	0.1	4.4	50	0.1	1.9	100	-0.38	3.42	50
Gap in changes	D>>D	0.7			-0.1			0.3			0.00		
	D>R	2.7			0.5			0.1			-1.25		

Source: Bloomberg, data as of 31 August 2024
([#]: "R" stands for Republican Party, "D" stands for Democratic Party; the ">>" symbol indicates the transition, with the incumbent party on the left and the winning party on the right.)

- During Democratic administrations, data shows an equal split between "re-election" and "replacement", an alternating pattern that suggests the current Democratic administration may succeed in re-election;

- While the average quarterly GDP remains similar, "replacement" appears more favorable for the US economic growth. The change is nearly three times higher for a "replacement" than for "re-election," indicating that a Republican victory may benefit the economy but with greater volatility;

- The changes in the unemployment rate is similar, but the average for "re-election" is higher at 6.6%, with a 100% probability of exceeding the current rate. In contrast, the unemployment rate for "replacement" averages 4.4%, with a 50% probability of surpassing the present level. This suggests that a Democratic re-election may struggle with unemployment;

- Core PCE shows little difference in change, average and gap in changes, indicating election results are unlikely to have a significant impact on inflation;

- The changes in average and gap in changes of s interest rates for "re-election" are both zero, while such values are all negative for "replacement", supporting the notion that Republicans tend to favor lower interest rates.

While these findings focus on the power transition periods, they align with the conventional economic policies of both parties in various aspects, particularly in fiscal and monetary policies. For details of the market performance during power transition periods, please refer to "Equity" and "Bond" sections.

Macro Strategy

"To be America's Friend is Fatal"

Over the past four years, Biden's foreign policy has focused on strengthening alliances to encircle adversaries, primarily through the G7, and extending to second-tier allies like South Korea, Australia, the Philippines and India, creating a multi-layered regional control structure. However, if Trump returns to the White House, these alliances may disintegrate due to internal disagreements. Even if Harris wins, her lack of leadership experience raises doubts about her ability to lead the G7 and manage the second-tier alliance effectively. The unity of the Western alliance would be tested regardless of who occupies the White House.

As Biden leaves office, the G7 itself is also seeing significant upheaval. The UK has already changed leadership, Japan is following suit, and the French government has been ineffective post-election[6]. Recent regional election outcomes in Germany have signaled trouble for the ruling party ahead of next year's national election[7], while Italy is showing signs of a rightward shift[8]. In Canada, the governing coalition has fractured, potentially leading to early elections[9]. The collapse of leadership across the G7 raises serious concerns about the stability of the alliance. India, with its diplomatic agility, may continue to navigate these uncertainties, but Israel's blunders are countless, and the Philippines' fate remains uncertain. What will Ukraine ultimately gain from its aspirations to join the European Union[10]? Australia's and South Korea's nuclear ambitions are nearly shattered[11], and stepping down might be the least costly option. Misfortune comes uninvited, but the price will ultimately be paid by the public.

In the second quarter, it was predicted that shifting dynamics within the G7 would lead to a reversal of capital flows and international trade. Both Europe[12] and NATO[13] have already begun formulating post-US election diplomatic approaches. The growing discord within the alliance is becoming more apparent. Key predictions include:

- tariff disputes with China: despite expectations that the G7 will significantly increase tariffs on China, China's retaliatory measures will likely deal a heavy blow to non-US allies. Reluctant to provoke further conflict, non-US allies may adopt a more lenient stance on raising tariffs on China. With the US's growing protectionism, those countries may rekindle economic ties with China.

- friend-shoring fades: efforts to relocate complex international production lines to "friendly" countries have not been able to escape China's influence[14]. Additionally, the quality of production in these "friend-shoring" countries has raised concerns, leading to suboptimal results[15]. Right-wing policies might push for the return of production to Europe and the US, but the resulting heightened costs will inevitably be passed on to consumers.

- new direction in European energy policy: following an article by Pulitzer Prize-winning journalist Seymour Hersh on his personal website titled "How America Took Out The Nord Stream Pipeline"[16], there has been public reflection in Europe on the necessity of such actions[17]. Post-Russia-Ukraine conflict, Europe faces the dilemma of either enduring high US oil prices or purchasing processed Russian oil through India. During economic hardship, will Europe resume trade with Russia or seek alternative paths? Either way, the road ahead is fraught with challenges.

- The UK's economic struggles: the new Labour Chancellor has criticized the previous Conservative government for concealing a £20 billion public finance deficit, bluntly stating that the UK is effectively "bankrupt"[18]. Post-Brexit, the UK has struggled to finalize a free trade agreement with the US[19], and the high oil price resulting from the Russia-Ukraine war has further exacerbated the UK's economic woes. Struggling to make ends meet, the UK finds itself increasingly dependent on US policies. With limited negotiating power, how much diplomatic leverage remains?

- Canada's economic woes: since taking office in 2015, Prime Minister Trudeau has seen the highest debt-to-GDP ratio of 117.8% in Canadian history[20]. Despite no direct involvement in wars and economic or financial crises, Canada has posted a record fiscal deficit of -14.8%[21]. As of 5 September, Canada's quarterly GDP growth was

6 See Le Monde website,https://www.lemonde.fr/en/politics/article/2024/09/04/france-s-political-stalemate-seen-from-abroad-hubris-not-for-the-first-time-got-the-president-into-this-mess_6724748_5.html
7 See Deutsche Welle website, https://www.dw.com/en/german-state-elections-who-won-who-lost-results-by-the-numbers/a-70105893
8 See Reuters website, https://www.reuters.com/world/europe/italys-meloni-shows-her-arch-conservative-credentials-g7-summit-2024-06-15/
9 See CBC website, https://www.cbc.ca/news/politics/jagmeet-singh-ndp-ending-agreement-1.7312910
10 See Voice of America website, https://www.voanews.com/a/ukraine-sets-out-on-long-path-to-eu-membership/7675241.html
11 See Arms Control Association website, https://www.armscontrol.org/factsheets/nuclear-weapons-who-has-what-glance
12 See International Politik Quarterly website, https://ip-quarterly.com/en/european-plan-trump-and-harris
13 See Politico website, https://www.politico.com/news/magazine/2024/07/02/nato-second-trump-term-00164517
14 See Wilson Center website, https://www.wilsoncenter.org/article/america-talking-about-friendshoring-china-doing-it
15 See Global Times website, https://www.globaltimes.cn/page/202408/1318061.shtml
16 See the personal website of Seymour Hersh, https://seymourhersh.substack.com/p/how-america-took-out-the-nord-stream
17 See Deutsche Welle website, https://www.dw.com/en/nord-stream-gas-politics-and-war/a-69955675
18 See Reuters website, https://www.reuters.com/world/uk/britain-is-broke-broken-new-government-declares-2024-07-27/
19 See Politico Magazine website, https://www.politico.eu/article/uk-trade-deal-priority-donald-trump-election-robert-greenway/
20 See Trading Economics website, https://tradingeconomics.com/canada/government-debt-to-gdp
21 See Trading Economics website, https://tradingeconomics.com/canada/government-budget

only 0.5%, lower than Iceland, Saudi Arabia, Spain, Japan, Greece and the UK[22]. With the New Democratic Party withdrawing its support from the ruling government, citing "weakness and selfishness," early elections may be called before October next year.

- South Korea's price of its unfulfilled ambitions: South Korea, with its advanced communication and chip technology and recent global soft power, aspires to join the ranks of mature markets and become part of the G8[23]. However, under Biden's encouragement to strengthen ties with Japan against North Korean and Russian military activities[24], South Korea has paid a price. A major defeat in parliamentary elections renders the remaining term of President Yoon Suk-yeol a "lame-duck" presidency[25]. South Korea's Q2 GDP plummeted to -0.2%[26]. The South Korean presidency is often mocked as the "world's most dangerous job"[27] , similar to Japanese Prime Minister Fumio Kishida[28], with future legal troubles awaiting Yoon and his family[29].

International relations are built on interests – alliances thrive when mutual benefits exist, but quickly unravel when those benefits disappear. US Secretary of State Antony Blinken warned[30] : "If you're not at the table, you're on the menu." Once an ally has outlived its usefulness, even trusted allies can become expendable. The late US Secretary of State Henry Kissinger famously remarked[31]: "To be an enemy of America can be dangerous, but to be a friend is fatal." This sentiment echoes the words of ancient Chinese strategist Su Xun: "The ruin of the six states was not due to military defeat, but to appeasement of the Qin. Appeasement weakened their strength and led to their destruction."

Market Outlook: BRICS Sharpening Its Strategy

This year's October 1 marks the 75th anniversary of the founding of the People's Republic of China. Despite remarkable economic achievements since the reform and opening-up, the domestic economic structure has encountered bottlenecks in recent years, with slowing economic growth and innovation, posing challenges akin to the "middle-income trap" in economic theory. Concurrently, the external environment has become increasingly perilous, presenting unprecedented challenges ahead.

Wang Wen, Executive Dean of the Chongyang Institute for Financial Studies at Renmin University of China, highlighted in his article "Reigniting the Passion for China's Rise"[32] that, in the face of external challenges, China must engage in deep introspection, prepare for the worst-case scenarios, and focus on expanding the "economic pie". By returning to rationality and prioritizing economic development, China can build a stronger economic foundation to resist external containment, ultimately achieving a state of "winning without fighting". In response to aggressive diplomatic tactics, China has generally adopted the strategy of "besieging Wei to rescue Zhao," avoiding direct confrontation with powerful adversaries and instead targeting their vulnerabilities, forcing them to retreat. In the past, China countered trade conflicts like tariffs with counter-measures and, through BRICS and alliances of southern countries, formed a counter-system that strikes at the core of the US economy through "de-dollarization."

"Invincibility Lies in Ourselves, Victory Lies in the Enemy"

During the Ming Dynasty, Zheng He led an advanced and powerful fleet on his voyages to the Western seas. However, unlike the Western powers during the Age of Exploration, he did not engage in colonization or plunder the wealth of other nations. Instead, Zheng He promoted international trade through a system of "tribute and trade", which established a foundation of mutually beneficial diplomacy. It later became a precursor to modern international trade. President Xi Jinping clearly stated at the 20th National Congress of the Communist Party of China, "China will never seek hegemony or expansion," and "China will always uphold world peace," while being "committed to building a community with a shared future for mankind."[33] These principles are rooted in the same culture.

China's diplomatic approach contrasts sharply with the Western colonial and exploitative approach. Based on this foundation and as a founding member of the BRICS, China attracts countries primarily from emerging markets to join BRICS (such as Malaysia and Thailand[34]). Weak nations have no diplomacy; only through self-strengthening and unity can they gain influence on the global stage. Based on which BRICS becomes one of the leading international economic and trade organizations counterbalancing the dominance of mature markets.

[22] See Trading Economics website, https://tradingeconomics.com/country-list/gdp-growth-rate?continent=world
[23] See Global Times website, https://www.globaltimes.cn/page/202404/1311046.shtml
[24] See Nikkei Asia website, https://asia.nikkei.com/Politics/Defense/Japan-U.S.-South-Korea-start-military-drills-to-counter-North
[25] See Barron's website, https://www.barrons.com/news/yoon-suk-yeol-south-korea-s-lame-duck-president-c1defcd4
[26] See Trading Economics website, https://tradingeconomics.com/south-korea/gdp-growth
[27] See China Global Television Network website, https://news.cgtn.com/news/33636a4e326b7a6333566d54/share_p.html
[28] See Mainichi Shimbun website, https://mainichi.jp/english/articles/20240709/p2g/00m/0na/003000c
[29] See Time Magazine website, https://time.com/7013292/south-korea-kim-keon-hee-dior-bag-scandal-charges-cleared/
[30] See US Department of State website, https://www.state.gov/secretary-antony-j-blinken-german-foreign-minister-annalena-baerbock-and-indian-external-affairs-minister-subrahmanyam-jaishankar-at-the-munich-security-conference/
[31] See The Statesman website, https://www.thestatesman.com/opinion/a-man-synonymous-with-diplomacy-1503247201.html
[32] See Zhonghongwang website, https://www.zhonghongwang.com/show-278-287496-1.html
[33] See The Communist Party of China News website, http://cpc.people.com.cn/20th/BIG5/n1/2022/1016/c448334-32546318.html
[34] See China Daily (English) website, https://www.chinadaily.com.cn/a/202406/26/WS667b6f9aa31095c51c50ae4c.html

Macro Strategy

Since President Xi Jinping introduced the concept of "East rising, West declining" in 2021, it has already been realized in terms of economic scale. By 2023, the BRICS economies, measured by both purchasing power parity and nominal price index, surpassed the G7 by approximately 14% and 20%, respectively, as shown in the following data:

Country	Purchasing power parity	Nominal price index	Country	Purchasing power parity	Nominal price index
	US$(trillion)			US$(trillion)	
The US	27.36	27.36	China	34.64	17.79
Canada	2.47	4.21	India	14.54	3.55
Japan	6.25	4.46	Brazil	4.45	2.17
Germany	5.86	3.34	Russia	6.45	32.26
France	4.17	3.03	South Africa	0.96	0.38
Italy	3.45	2.14			
The UK	4.03	2.25			
Total	53.59	46.80	Total	61.05	56.15

Source: The World Bank, Bloomberg, data as of 6 September 2024

Sun Tzu's "The Art of War" states: "Those skilled in warfare establish positions that make them invincible and wait for the enemy to become vulnerable. Invincibility lies in oneself, vulnerability in the enemy" . This means that skilled strategists create conditions where they cannot be defeated, then wait for the enemy to make mistakes. BRICS, with its inherent advantages in population, resources and geographic area, has gradually built a robust economic foundation, creating initial conditions for invincibility. The next step is to harness strategic initiative, with "de-dollarization" believed to be the key breakthrough.

It has already been predicted that, following the US presidential election, internal divisions in the US are likely to worsen. Particularly in the lack of a decisive electoral victory, subsequent legal disputes or even large-scale unrest, as seen in 2021, could paralyze the US economy. This would further expose the underlying economic crises that have been brewing due to high interest rates. Therefore, the power transition period, from the Election Day to inauguration, will be a vulnerable phase for the US, and also the optimal window for advancing de-dollarization.

The Intentions of "De-dollarization" Are Clear

Recently, Saudi Arabia refused to extend the 50-year "petrodollar" agreement with the US, signaling the US dollar's loss of its anchor and the first crack in the dollar hegemony. However, some commentators quickly refuted this, claiming that the 1974 "petrodollar" agreement never existed[35] and was a market myth for 50 years by top academic institutions, international exchanges and influential figures such as academics and fund managers alike. Interestingly, neither the US nor Saudi Arabia has publicly commented on the matter, adding to the ambiguity.

In a Bloomberg's interview at the World Economic Forum in Davos in 2023, Saudi Finance Minister Mohammed al-Jadaan stated that Saudi Arabia is open to using currencies other than the US dollar for oil transactions[36]. Additionally, according to the Bank for International Settlements (BIS)[37], the Saudi central bank will officially join the "mBridge" project, a cross-border network for multiple central bank digital currencies. This system, which settles transactions in local currencies without using the US dollar, is more efficient and accurate than the current SWIFT system.

Regardless of the validity of the petrodollar agreement, other data indicate that Saudi Arabia has already begun preparations for non-dollar transactions. Certainly, de-dollarization cannot happen overnight, and it will be a long process. What is undeniable, however, is that since the 1970s oil crisis, the global demand for Middle Eastern energy has allowed the US dollar to reap monetary dividends – a trend that is now reversing. The transformation of the global monetary ecosystem has already embarked.

[35] See Nasdaq website, https://www.nasdaq.com/articles/truth-about-petrodollar-pact
[36] See Bloomberg website, https://www.bloomberg.com/news/articles/2023-01-17/saudi-arabia-open-to-talks-on-trade-in-currencies-besides-dollar
[37] See BIS website, https://www.bis.org/about/bisih/topics/cbdc/mcbdc_bridge.htm

In addition to Saudi Arabia, Russia, excluded from the SWIFT system, announced[38] that it has been discussing the establishment of an independent financial payment platform, BRICS Bridge, within the BRICS. Russia's self-developed Financial Message Transfer System (SPFS) allows unilateral settlements without using the US dollar, to which 159 countries have already connected for use when it is launched to the payment systems of BRICS members[39]. As Western financial war intensifies, sanctioned countries are seeking to collaborate with BRICS using digital currencies to circumvent sanctions. The weaponization of finance also deters other neutral countries. The more sanctions are abused, the more the US dollar's authority is undermined, prompting neutral countries to participate in alternative payment systems as a safeguard, which in turn strengthens the international recognition of these SWIFT alternatives.

It is worth noting that SPFS is not the only alternative to SWIFT. China's Cross-Border Interbank Payment System (CIPS) and India's Unified Payments Interface (UPI) are also in operation. The next step will be how to integrate these systems and expand their usage among other central banks. Technological integration may not take long, but transitioning BRICS members and even non-BRICS member countries from using these systems as "backup" to "primary" systems will be a long-term challenge. The momentum will depend on BRICS' trade developments, such as greater free trade, which would increase the demand for more efficient and secure payment systems. On the other hand, the pull factor will be determined by the extent and severity of Western financial weaponization, the impact of US interest rate volatility on emerging markets, and the potential decline of the US dollar as a result of its mounting debt.

Even without the challenge posed by alternative systems, SWIFT data tracking the internationalization of RMB shows that[40] in July, the RMB ranked fourth in international payment (behind the US dollar at 47.8%, Euro at 22.5% and British pound at 7.0%), with its share rising from 4.61% to 4.74%, marking the ninth consecutive month above 4%. Meanwhile, in the global trade finance market, RMB ranked second (6.0%), surpassing Euro (5.8%), though still far behind the US dollar (83.2%). The data reflects that after the financial weaponization, BRICS members, spearheaded by Russia, are more inclined to settle trade in their own currencies. This, coupled with violent sanctions, has made emerging markets wary of the US dollar, aiding China in promoting RMB as a viable alternative currency in international trade.

Saudi Arabia and BRICS' intentions to break through financial blockades are evident, and Western financial sanctions have also led to the self-destruction of the US dollar and Euro's dominance. The international acceptance of the RMB has been steadily rising, all of which have profound implications for the US dollar-centric global financial system. In investment markets, challenging the existing system will create market volatility and risks, while also giving rise to new and innovative investment opportunities, including the potential "return to the gold standard" (for details, please refer to the "Bond" section).

Investment Strategy: Stay Agile and Move with Caution

Summarizing the above analysis, the US presidential election is the most critical factor dominating the investment market this year. Regardless of who takes office, the internal divisions within the US and the post-election economic downturn cannot be prevented. Leadership changes within the G7 are likely to reduce internal cohesion, potentially reversing recent diplomatic policies, especially towards China. The power transition period is the time when the US national strength is at its most vulnerable, presenting the BRICS with its best opportunity to advance "de-dollarization." Investors will soon experience the true meaning of "once-in-a-decade upheaval".

Diversify Investments Amidst Turbulence

Last quarter's investment strategy recommended: "Favor safe-haven assets such as gold, short-term bonds, cash and money market funds. In equity markets, non-cyclical sectors like utilities, pharmaceuticals and consumer staples are preferred; high beta sectors such as financials, real estate and discretionary consumer sectors are less favorable." Reviewing the performance of various assets last quarter, these strategic recommendations proved to be highly accurate.

[37] See BIS website, https://www.bis.org/about/bisih/topics/cbdc/mcbdc_bridge.htm
[38] See TASS Russian News Agency website, https://tass.com/economy/1824025
[39] See Business Insider website, https://www.businessinsider.com/dedollarization-countries-national-tech-payments-systems-russia-china-india-swift-2024-8
[40] See SWIFT website, https://www.swift.com/our-solutions/compliance-and-shared-services/business-intelligence/renminbi/rmb-tracker/rmb-tracker-document-centre

Macro Strategy

The initial part of this section outlined how various asset indices and international capital flows have already been positioned to mitigate the risks of potential market turmoil. It is expected that risk aversion sentiment will further strengthen this quarter. Referencing the average monthly performance of various asset indices during the power transition periods of the past ten election years from November to January of the following year, the data is as follows:

Year	The average performance of indices during the period (%)								
	MSCI Developed Markets Index	MSCI Emerging Markets Index	FTSE World Government Bond Index	FTSE World Broad Investment-Grade Bond Index	DXY Index	S&P GSCI Energy Index	S&P GSCI Precious Metals Index	S&P GSCI Industrial Metals Index	MSCI World REITs Index
1984					1.4	-1.6	-3.5	1.5	
1988	2.5	0.0	-0.3		1.1	9.1	-1.7	7.3	
1992	0.8	0.7	0.3		1.8	-1.4	-0.6	0.0	
1996	1.7	2.9	-0.7		2.1	3.2	-2.5	3.8	
2000	-0.8	2.3	1.8	2.5	-1.8	0.8	0.4	1.7	
2004	2.3	4.6	1.3	0.9	-0.5	-3.6	-0.7	2.5	
2008	-4.0	-2.2	2.2	3.0	0.3	-16.9	8.8	-9.7	-7.6
2012	2.6	2.4	-0.8	0.3	-0.3	2.7	-1.2	2.6	1.6
2016	1.8	0.2	-1.4	-0.6	0.4	2.5	-1.5	4.5	0.0
2020	5.4	6.4	0.6	1.1	-1.2	11.4	-0.1	3.7	3.6
Average return	1.4	1.9	0.3	1.2	0.3	0.6	-0.2	1.8	-0.6
Standard deviation	2.6	2.6	1.2	1.4	1.3	7.7	3.4	4.5	4.9
The highest return	5.4	6.4	2.2	3.0	2.1	11.4	8.8	7.3	3.6
The lowest return	-4.0	-2.2	-1.4	-0.6	-1.8	-16.9	-3.5	-9.7	-7.6
The difference between the highest and lowest return figures	9.4	8.7	3.6	3.6	3.9	28.2	12.3	17.0	11.2
The no. of times ranked as top 3	1	1	2	2	2	2	1	3	1

Source: Bloomberg, data as of 7 September 2024

The performance of five conventional indicators for asset indices include: average return (higher is better), standard deviation (smaller is better), the highest return (higher is better), the lowest return (smaller is better) and difference between the highest and the lowest return (smaller is better). After analyzing these metrics, the assets that ranked in the top three most frequently were industrial metals, government bonds, investment-grade corporate bonds, energy, and the US dollar cash. On the other hand, equities, precious metals and real estate investment trusts (REITs) showed the weakest performance. The results indicate that lower-risk assets tend to perform better. However, the close distribution of rankings across asset classes highlights that asset allocation or broad diversification is the optimal strategy during the power transition period. While the analysis does not provide specific allocation percentages, investors should adjust their portfolios based on their individual risk tolerance. For detailed strategies on individual assets, please refer to "Equity", "FX" and "Bond" sections.

Investors should be mindful that the period following the US presidential election is likely to present the highest investment risks of the year. Staying agile, strategically adjusting portfolios, and prioritizing risk management will be essential.

Chapter Summary:

- The performance of various asset indices and capital flows already indicate a strong risk-averse sentiment and corresponding positioning
- The worsening of domestic divisions within the US and the declining cohesion among its allies could lead to reversals in recent foreign policies, especially those against China and emerging markets
- The BRICS may seize the opportunity to implement "de-dollarization" during the US power transition, further increasing global risks
- Following the US election, the investment market will likely lean toward risk aversion. Investors should remain flexible in adjusting their portfolios, plan thoroughly before taking action, and prioritize risk management

Macroeconomics

Justified Positioning

Economic Research Department, The Bank of East Asia

Economic Research Department, The Bank of East Asia

Economic Outlook for the Fourth Quarter of 2024

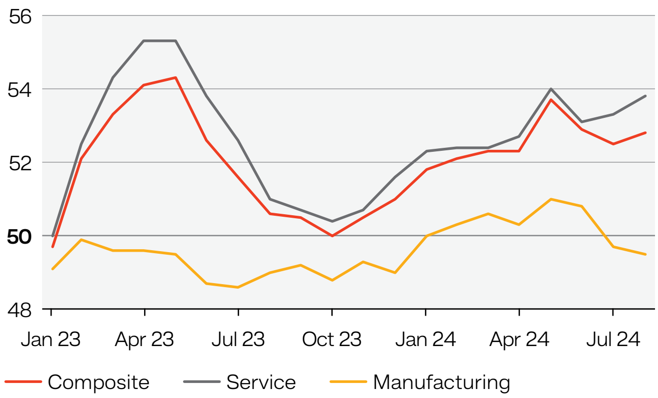
Further rate cuts by major central banks may to boost consumer and investment confidence

Global Economic Outlook

Global Economic Momentum Slows, Soft Landing Still Expected

Driven by the normalization of supply chain activities and the resurgence of the electronics cycle, merchandise trade has been the primary driver of stable global economic growth this year. This has notably benefited several Asian export hubs. However, the global manufacturing Purchasing Managers' Index (PMI) slid to near stagnation in the third quarter, with sub-indices indicating declines in production, new orders and employment, which are signals for a slight slowdown in global trade activity. In contrast, the global services PMI remained robust in the third quarter, particularly propelled by strong growth in financial and business services. Overall, the global economy has shown resilience, with recession risks staying manageable.

Global PMI



Source: Bloomberg, data as of 20 September 2024
>50 represents expansion

The global labor market has garnered heightened attention. Overall, the global labor market maintained steady expansion in the first three quarters of 2024. The US labor market remained largely stable with continued job growth despite a slight uptick in the unemployment rate, largely attributed to an increase in labor force participation. The Eurozone's labor market outperformed expectations, with further improvements in unemployment rates, supporting a recovery in domestic consumption. China's labor market remained flat, bolstered by increasingly effective policy support, which is expected to drive stronger domestic demand in the future. Other Asian labor markets also remained solid.

Inflation has further moved towards central bank targets. Attributable to the high base effect from last year, the restoration of supply-demand balance and the gradual impact of tightening monetary policies, inflation in most economies has eased progressively. Core CPI in both the US and Eurozone has fallen to around 3%. In parallel, medium-to long-term inflation expectations have aligned with central bank targets, reflecting that eased market concerns about persistently high inflation has been eased.

The good progress in curbing inflation has provided central banks with room to adjust monetary policy. With the Fed initiating rate cuts in September, global monetary policies have entered a new phase of rate normalization. Looking ahead to the fourth quarter, major central banks, including the Fed, the European Central Bank (ECB), and the Bank of England (BOE), are expected to continue rate cuts and provide more guidance on the pace of rate cuts into 2025. Other Asian central banks are likely to follow suit, while the Bank of Japan (BOJ) is expected to continue its mild rate-hiking cycle. Lower borrowing costs and the shift towards looser monetary policy are expected to stimulate both consumption and business activity, thereby mitigating the risk of economic slowdown. Nonetheless, uncertainties over global inflation outlook persists, for instance, geopolitical tensions exerting potential pressure on energy prices, supply chain activities and international shipping costs. Consequently, major central banks are likely to remain cautious and proceed with rate cuts gradually.

Overall, despite slowing growth momentum, the global economy is expected to its steady expansion into the fourth quarter, with moderate growth in trade activity and robust performance in services sector. Further rate cuts by major central banks may to boost consumer and investment confidence. Notably, the US presidential election in November could have significant implications for the medium to long-term global economic trajectory.

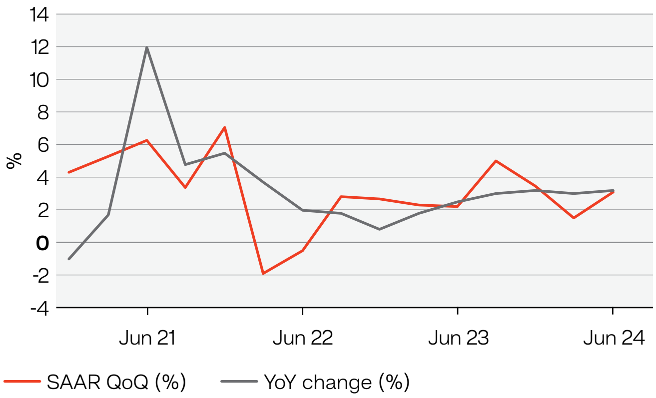
Macroeconomics

US Economic Outlook

Rate-Cutting Cycle Begins, Soft Landing in Sight

The US economy continues to grow at a brisk pace. In the second quarter of 2024, US economic growth exceeded expectations, as driven by strong consumer spending, stable government expenditure and increased investments. Despite declining personal savings and rising credit card default rates, private consumption has remained resilient. Recently, the labor market has shown signs of cooling, with job growth falling short of expectations, which has alleviated concerns of an overheating economy and prompted the Fed to adjust its monetary policy stance. Looking ahead, while the US economy may slow down in the face of persistently high interest rates, it is expected to maintain steady growth.

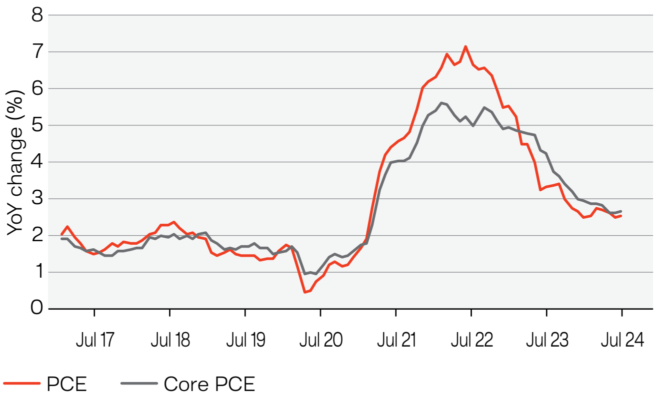
The US's GDP Growth Rate



Source: Bloomberg, data as of 20 September 2024

Progress in curbing inflation continues. Since the second quarter this year, US inflation has further decelerated, gradually approaching the Fed's 2% policy target. However, housing prices and other core service costs remain sticky, indicating that underlying inflationary pressures persist. Looking forward, inflationary pressures are expected to ease further, albeit at a moderate pace, with short-term inflation likely to hover above the policy target. Additionally, recent developments in the labor market show signs of weakening. Despite growth in the number of new jobs, the unemployment rate has edged higher, largely due to an increase in labor force participation rate. Wage growth has also moderated, alleviating concerns that a tight labor market could keep inflation elevated.

The US's PCE Price Index



Source: Bloomberg, data as of 20 September 2024

In its September meeting, the Fed has initiated its rate-cutting cycle, shifting towards a more balanced policy stance. The Fed cut rates by 50 basis points to a range of 4.75% to 5.00%, and signaled orderly rate cuts ahead. The post-meeting statement shifted from solely focusing on reducing inflation to emphasizing the dual mandate of promoting full employment and maintaining price stability. This indicates a shift towards a more balanced policy to ensure further ease of inflation while supporting steady economic expansion. According to the median forecast from the Fed's September dot plot, there is room for a further 50 basis points of rate cuts this year, with an additional 100 basis points of cuts expected in 2025, bringing the rate down to 3.25%–3.50%. We anticipate that the Fed's rate-cutting cycle will lower borrowing costs for households and businesses, boost overall investment sentiment, support stable consumption growth and extend the US economic expansion cycle.

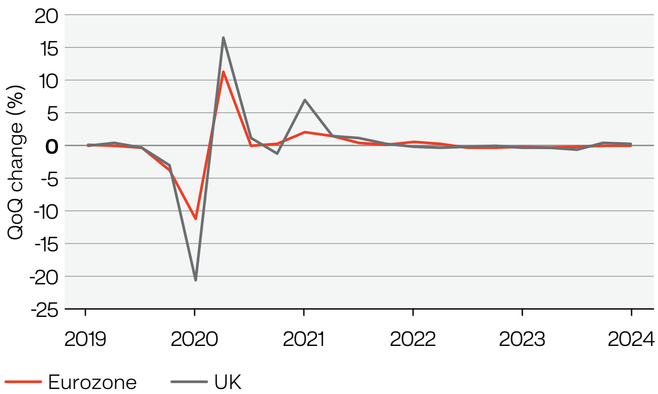
Overall, the US economy is poised for a soft landing. As interest rates decline, the monetary environment will gradually shift from restrictive to neutral. We forecast that the US's economic annual growth rate this year will drop from 2.5% in 2023 to around 2.0%, achieving a soft landing. Furthermore, the upcoming US presidential election in November will have a significant impact on the economic outlook, particularly the policy differences between the two candidates on taxes, welfare, government debt, tariffs, diplomatic relations and energy could have far-reaching effects on both the market and the economy.

European Economic Outlook

Europe Continues Its Moderate Recovery

The Eurozone economy recorded moderate growth. Supported by rising foreign trade and increased government expenditure, the Eurozone economy maintained its growth trajectory. In the second quarter of 2024, the Eurozone's economy grew by 0.2% quarter-on-quarter, 0.1 percentage point lower than the growth in the first quarter, but still the second-highest increase in the past seven quarters. Economic performance varied among major economies in the region. Germany, the largest economy in the Eurozone, slipped back into contraction territory in the second quarter, weighed down by weak private spending and investment. In contrast, France, Italy and Spain posted stronger growth, providing major momentum for the Eurozone. The UK also performed well in the second quarter, driven by robust growth in the services sector. Recent data shows that the composite Purchasing Managers' Index (PMI) for both the Eurozone and the UK has remained in expansion territory for several consecutive months, suggesting that both economies will continue on their moderate growth trajectories.

Eurozone and the UK's Economic Growth

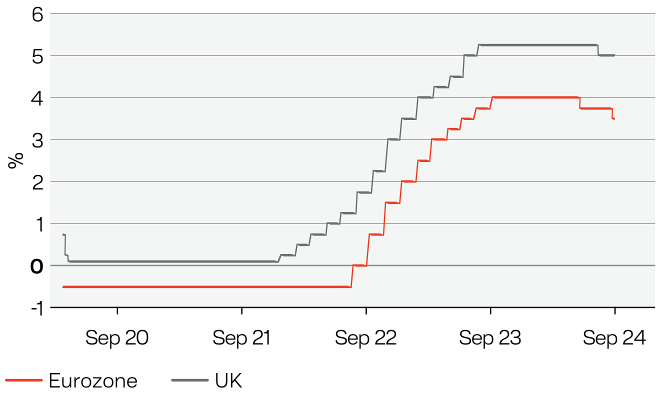


Source: Bloomberg, data as of 20 September 2024

Inflation across Europe and the UK continues to decelerate. Due to last year's high base and tight monetary policies, inflation in both the Eurozone and the UK has fallen to around 2% in the third quarter this year. Additionally, a significant drop in energy prices contributed to the slowdown in headline inflation. However, labor markets in both the Eurozone and the UK remain tight, leading to faster wage growth, which has put upward pressure on service prices. With core goods prices having already stayed low for some time, the future trajectory of inflation will largely depend on the service prices. As a result, inflation in Europe and the UK may take longer to cool and stabilize near central banks' policy targets.

The European Central Bank (ECB) and the Bank of England (BoE) are gradually easing their tight monetary policies. As inflation gradually eases, the ECB cut rates in June and again in September, emphasizing that future policy decisions will remain data-dependent. In the UK, the BoE also lowered its policy rate by 25 basis points in August, officially starting a rate-cutting cycle. Given the lingering inflationary pressures in Europe, we expect both the ECB and BoE to proceed with gradual and orderly rate cuts.

Eurozone and the UK's Policy Rates



Source: Bloomberg, data as of 20 September 2024

Looking ahead, lower policy rates are expected to improve investment, consumption, business confidence and asset market activity across Europe and the UK. Gradual easing of inflation and wage growth is expected to boost real incomes, further promoting consumption and investment. Additionally, the conclusion of the European Parliament, the UK and French elections in 2024 has reduced political uncertainty in major economies within the region, providing a stable policy and business environment for regional economic growth.

In summary, we expect Europe and the UK to maintain their moderate growth momentum. However, geopolitical risks still loom over Europe. If tensions in the Middle East or the Russia-Ukraine conflict escalate, European supply chains could face severe disruptions, pushing up costs and even a resurgence of inflation.

Macroeconomics

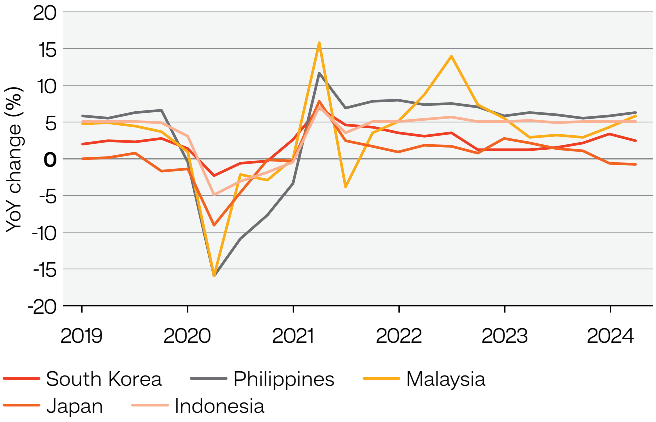
Asian Economic Outlook

Sustained Growth in Asia Backed by Domestic Demand

Asia's economic growth momentum remains robust. In the first half of 2024, the overall economy in Asia maintained incremental growth. Japan's economy has gradually recovered from the impact of the major earthquake and temporary disruption in automobile production earlier this year, with domestic demand improving and real wage growth boosting private consumption. Additionally, corporate demand for digital transformation has spurred related investment growth. South Korea's economy continued its moderate expansion, with emerging technologies such as artificial intelligence supporting export performance, offsetting weaker investment. Furthermore, Taiwan's economy grew rapidly, benefiting from strong private consumption and a rebound in corporate investment.

Emerging Asian economies have generally seen faster growth. ASEAN economies such as Malaysia, Thailand, the Philippines and Vietnam recorded a pick-up in quarterly economic growth in the second quarter, while Singapore and Indonesia maintained steady growth. In addition to export growth spurred by external demand, stable labor markets across the region have further supported the momentum in private consumption. With rising expectations for central banks to ease monetary policy, corporate investment demand has further strengthened.

GDP of Asian Economies

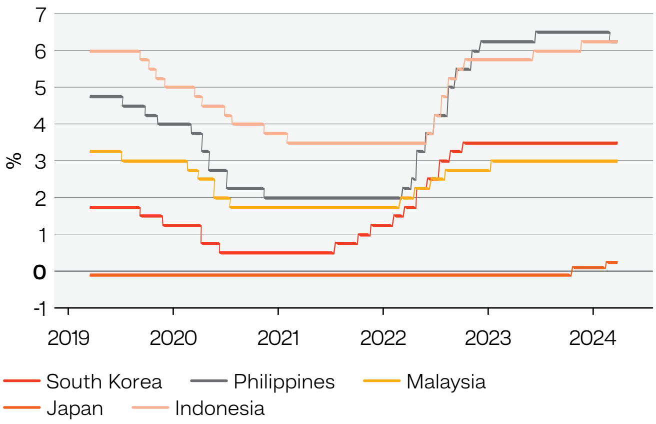


Source: Bloomberg, data as of 20 September 2024

Inflationary pressures in Asia remain flat. Consumer price inflation in Japan, South Korea and Taiwan has stayed within a range of 2% to 3%, indicating that inflationary pressures are largely under control. Meanwhile, inflation in Indonesia and Singapore has continued to ease, while inflation in Thailand and Malaysia remains stable at low levels. Although Vietnam and the Philippines face higher price pressures, inflation remains near to their respective policy target ranges and are expected to moderate further in the future.

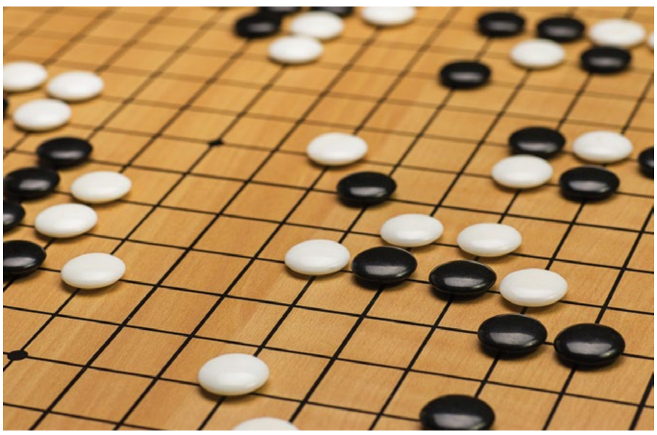
The BOJ continues its monetary policy normalization, while other Asian central banks are expected to have room for rate cuts. The BOJ raised rates in March and again in July by 15 basis points to 0.25%, while also announced trim sin bond purchases. If Japan's economic growth and inflation trends meet expectations, the BOJ may proceed with further rate hikes. The Bank of Korea has expressed greater confidence that inflation returning to its target range and will consider the appropriate timing for rate cuts. The Philippine central bank took the lead in August by cutting its policy rate by 25 basis points. Overall, as inflation pressures moderate and major global central banks such as the Fed and the ECB begin rate cuts, most Asian central banks are expected to gradually ease monetary policy.

Policy Rates of Asian Economies



Source: Bloomberg, data as of 20 September 2024

Looking ahead, the economic outlook for Asia remains positive. Recent survey data suggests that manufacturing activity in Asia continues to expand, which will sustain stable wages and income and reinforce corporate confidence in business growth. Nonetheless, ongoing geopolitical tensions and rising trade protectionism, among others, will continue to weigh on global supply chain activities and commodity price. In addition, changes in the Prime Minister of Japan and the Prime Minister of Thailand may also add uncertainty to the economic outlook for Asia.

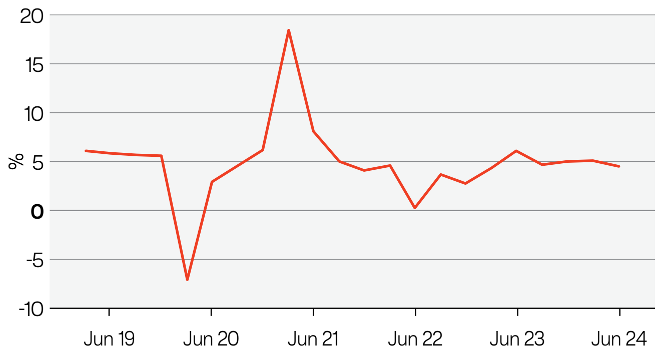


Chinese Mainland Economic Outlook

Policy Support Needs to Be Strengthened to Stabilize Growth Momentum

In the first half of 2024, Chinese Mainland's economy expanded steadily by 5.0%. Consumption remained the primary driver of growth, followed by investment and net exports. On a quarterly basis, the economy's year-on-year growth slowed from 5.3% in the first quarter to 4.7% in the second quarter.

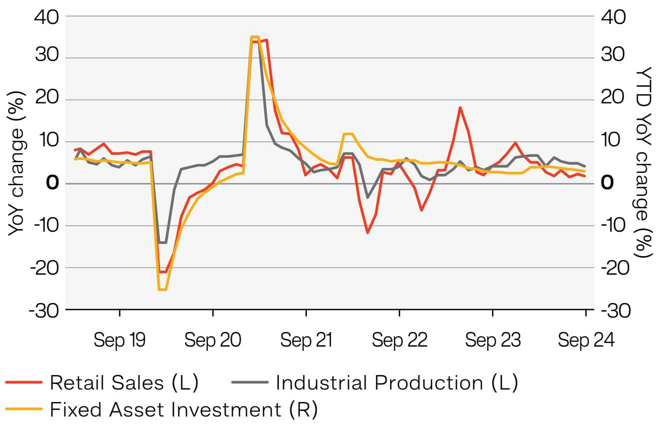
Chinese Mainland's Economic Growth



Source: Bloomberg, data as of 20 September 2024

Entering the third quarter, the economic growth momentum slightly slows. Solid external demand has driven industrial production, outperforming consumption and investment. Meanwhile, the manufacturing sector is accelerating its transition towards intelligence, greening and digitalization, which has driven rapid growth in equipment manufacturing and high-tech manufacturing in July and August. The services sector remained resilient, with resilient retail sales supported by robust summer tourism and promotional activities in the cultural and entertainment sectors. However, retail sales of consumer goods only saw a modest recovery, reflecting the need for stronger policy support. Additionally, fixed asset investment growth slightly weakened due to extreme weather, with infrastructure investment slowing and property development investment continuing to contract. Nevertheless, the accelerated issuance of local government special bonds in August is expected to support public project investments, particularly in projects related to national strategic priorities and key security infrastructure capabilities. Furthermore, strong corporate demand for advanced equipment and green technology has kept manufacturing investment growing rapidly.

Chinese Mainland's Retail Sales, Industrial Production & Fixed Asset Investment



Source: Bloomberg, data as of 20 September 2024

Policy effects gradually emerge with property market showing signs of stabilization. Since the introduction of a new round of property policy support in May, the decline in the key indicators of the property market has slightly narrowed, such as the sales of commercial residential properties and the funds available to property developers. At the end of July, the Politburo emphasized the need to actively support the acquisition of commercial housing for the use as affordable housing, while stepping-up efforts to ensure the delivery of pre-sold homes and promote the stable and healthy development of the property market. Future policies are likely to focus on reducing housing inventories, improving the financial conditions of property developers, and lowering home purchase and mortgage costs through adjustments to housing loan policies, with the aim to gradually boost demand in the property market. Overall, Chinese Mainland authorities are expected to maintain a supportive policy environment for the stable development of the property market.

The Third Plenary Session has approved further comprehensive and deepening reforms to promote Chinese modernization. Such decision outlines the mid- and long-term direction for Chinese Mainland's development and introduces a series of reform tasks, including unwavering support for both public and private economies, developing new quality productivity, building a unified national market, deepening supply-side structural reforms, improving high-level openness, advancing fiscal and tax reforms and accelerating the establishment of a housing system that integrates both renting and purchasing.

Macroeconomics

The ample macroeconomic policy space is expected to boost domestic demand and stabilize growth. The Politburo meeting at the end of July called for stronger counter-cyclical adjustments, highlighting the need to boost consumption as a key priority. The focus will be on increasing household incomes, expanding the social safety net and supporting service consumption in sectors such as culture, tourism, elderly care, childcare and domestic services. Subsequently, the Ministry of Commerce, in cooperation with multiple ministries, has reinforced the support for large-scale equipment upgrades and trade-in of consumer goods, including higher subsidies for cars and home appliances. Additionally, the Ministry of Finance has pledged to urge local governments to accelerate the issuance of special bonds and make full use of funds from ultra-long-term special government bonds to promote effective investment. On the monetary policy front, the People's Bank of China (PBoC) has actively pushed forward reforms in its monetary policy framework, gradually shifting from quantitative control to price-based control. In July, the PBoC cut several key interest rates, including the 7-day reverse repo rate, by 10 to 20 basis points, signaling further room for additional rate cuts and reserve requirement reductions in the future. Looking ahead, it is believed that Chinese Mainland authorities will intensify policy efforts to revive domestic demand, solidify growth momentum and strive to achieve the full-year economic and social development goals.

Hong Kong Economic Outlook

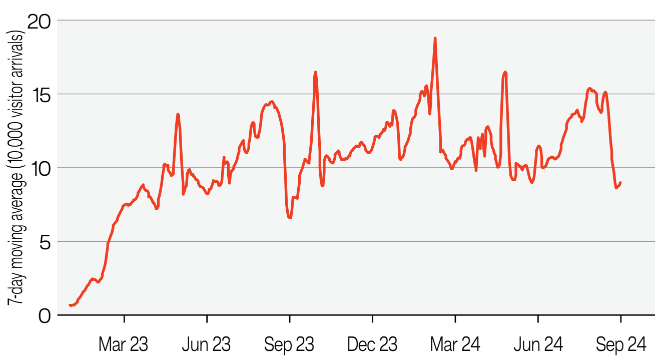
Hong Kong's Economy Continues Moderate Expansion

Hong Kong's post-pandemic recovery remains on track, continuing its expansion cycle. Following a 2.8% growth in the first quarter of 2024, the economy accelerated to 3.3% year-on-year growth in the second quarter, fueling first-half growth to around 3.0%. This momentum was primarily ignited by strong merchandise trade amid a rebound in external demand. Private consumption has registered relatively weak performance due to the high base effect and elevated interest rates. While visitor arrivals continues to grow, surged outbound travel demand has partially offset gains in inbound tourism recovery. Additionally, government spending has gradually normalized as post-pandemic recovery sets in. Looking ahead, proactive economic stabilization policies and measures benefitting Hong Kong introduced by Chinese Mainland authorities and the Hong Kong Special Administrative Region (HKSAR) government are expected to sustain moderate economic growth.

Merchandise trade has emerged as a key growth driver. Underpinned by rising external demand, Hong Kong's merchandise trade has recorded solid growth. Both exports and imports have posted significant gains year-to-date. With export growth outpacing imports, the trade deficit has narrowed substantially, becoming one of the main engines of Hong Kong's economic expansion. On the services trade front, inbound tourism continues to recover, with passenger airline capacity further restored. The expansion of the Individual Visit Scheme, higher duty-free allowances for Chinese Mainland tourists, and the hosting of various large-scale events are set to support the continued economic recovery of Hong Kong.

Number of Visitors Arrivals of Hong Kong

Daily visitor arrivals

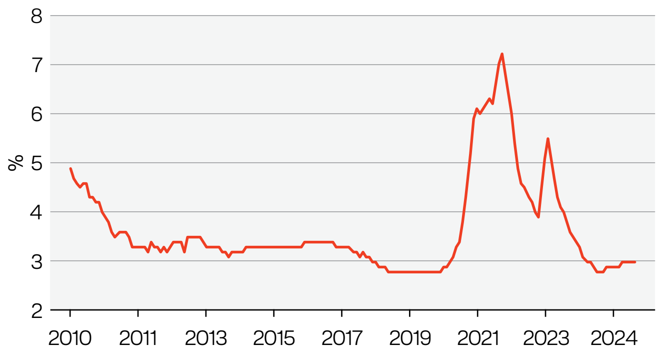


Source: Bloomberg, data as of 20 September 2024

The retail sector, however, continues to face near-term challenges. Retail sales have remained under pressure throughout the year due to last year's high base, changes in tourist consumption patterns, asset market volatility, and a significant increase in outbound travel demand among Hong Kong residents. Despite these headwinds, the labor market remains resilient, with the unemployment rate hovering around 3%, near full employment levels, providing some support for the retail sector.

Additionally, Chinese Mainland authorities have actively introduced policies to benefit Hong Kong and strengthen its economic competitiveness. The expansion of the "ETF Connect" under Stock Connect mechanism in July has gradually improved market liquidity, while enhancements to mutual recognition of funds measures are expected to be implemented soon, which will further invigorate Hong Kong's financial market.

Unemployment Rate of Hong Kong



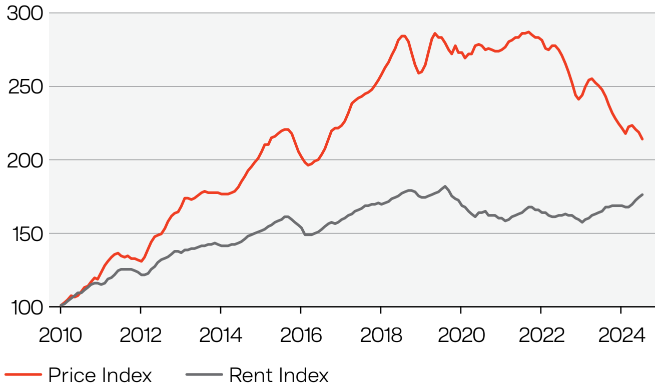
Source: Hong Kong Census and Statistics Department, data as of 20 September 2024

Hong Kong's property market continues to adjust amid persistently high interest rates. Although the official residential property price index began to subdue in the second quarter, transaction volumes have continue to slow from the highs seen after the full withdrawal of demand-side management cooling measures. However, the official rental index has climbed steadily, reflecting sustained housing demand, with some potential buyers opting to rent due to high interest rates. As the global economy enters a new rate-cutting cycle, sentiment in the property market is expected to improve, which will gradually attract more buyers and drive a steady recovery in the property market.

Macroeconomics

Housing Price & Rent Indices of Hong Kong

Base figure is 100 as of January 2010



Source: Rating and Valuation Department, data as of 20 September 2024

Looking ahead, the drop in global interest rates will provide the shot in the arm for Hong Kong's asset markets, while also bolstering consumer and investment confidence, leading to steady economic growth. Considering these factors, the full-year economic growth is expected to fall within the Hong Kong SAR government's forecast range of 2.5% to 3.5%.

Chapter Summary:

- While global economic momentum is slowing, recession risks remain manageable. Inflation is progressively aligning with central bank targets, providing more room for monetary policy adjustments. The global economy is expected to continue its steady expansion in the fourth quarter of 2024
- The Fed officially begins rate-cutting cycle, with policy focus shifting from solely controlling inflation to dual mandates, being supporting full employment and maintaining price stability. Further orderly rate cuts are expected to ensure a soft landing for the US economy
- Europe's economy continues moderate growth. The ECB and BoE are poised to gradually ease tight monetary policies. The economies of both Europe and the UK are projected to maintain a moderate expansion trajectory
- Consumer and investment demand in Asia is on the rise, with inflation largely under control. Aside from the BoJ, most central banks in Asia are expected to cut rates, supporting robust economic growth across the region
- While Chinese Mainland's economic momentum has cooled, ample policy space remains. Authorities are likely to stabilize economic growth outlook by stimulating consumer demand and promoting effective investment
- Hong Kong's property market has been under pressure since the second quarter, while the retail sector is still facing near-term challenges. However, strong merchandise trade has been the significant driver for economic growth, with Hong Kong's economy expected to expand steadily throughout the year

Equity

All Roads Lead to Rome

Chief Investment Strategist, Wealth Management Division, The Bank of East Asia | **Frank Lee**
Senior Investment Strategist, Wealth Management Division, The Bank of East Asia | **Jason Chan**
BEA Union Investment – Investment Teams

Equity

Chief Investment Strategist, Wealth Management Division,
The Bank of East Asia **Frank Lee**

All Roads Lead to Rome

Election Results and Rate Cut Trends Weight On US Equities; European Equities under Pressure Amid Continued Rate Cuts; Japanese Equities Still at Risk Amid Carry Trade Storm

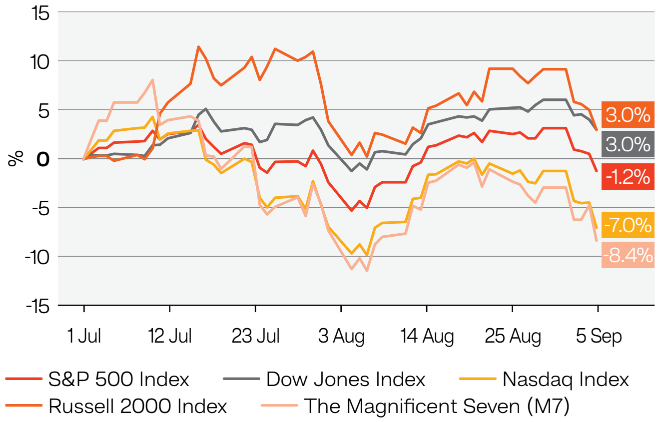
Last quarter's title was "Primed for Action". We forecasted that the first US rate cut would be triggered by economic downturn rather than the Federal Reserve (the "Fed")'s obsession with inflation. Supported by technical analysis, we predicted an imminent market correction. Historically, US equities tended to perform well in the run-up to a presidential election. However, the expected gains are likely to slow compared to the first half of the year. The extremely crowded trades in tech stocks are alarming, with profit-taking at the tipping point, rendering defensive and value stocks more attractive. Considering earnings expectations, the first rate cut and the election-year dynamics, sector rotation will become a core investment strategy. While European equities generally benefit from the spillover effect of the US election, the weak European economy may drag down future market performance. The widening USD-YEN interest rate spread is expected to cause a yen rebound, which could negatively impact Japanese equities. As a result, a "stock-picking over market" investment strategy is more appropriate for Japanese equities. In fact, past predictions have largely aligned with current results.

The title of this quarter is "All Roads Lead to Rome". US equities will face three major risk factors: First, the stark contrast of the fiscal and financial policies between the presidential candidates from the Democratic and Republican parties. Whoever wins the White House will determine the future trajectory of various industry indices. Second, the post-election power transition period, when the US is at its most vulnerable, could expose the market to potential post-election aftershocks and multiple external challenges, casting a shadow over mature markets. Therefore, diversifying investments regionally to mitigate investment risks is advisable. Third, following the Fed's first rate cut, stock market performance has diverged, with low-volatility stocks outperforming. Earnings forecasts for various European sector indices have weakened, likely derailing the current uptrend, with prolonged rate cuts being the "fatal blow" for the future market. Japanese equities, facing both domestic and international economic headwinds, have seen corporate earnings forecasts fluctuate wildly, making them more suitable for risk-tolerant investors.

Market Review: Rebalancing Tech-Heavy Portfolios

Last quarter, the Bank of Japan (BOJ) raised interest rates to 0.25%, which triggered a massive global carry trade unwinding and significant corrections across global equity markets. This, coupled with speculation over a US economic recession, resulted in maximum declines of the four major US indices: 6.1% for the Dow Jones Index, 8.5% for the S&P 500 Index, 10.1% for the Russell 2000 Index and 13.6% for the Nasdaq Index. The "Magnificent Seven" (M7) stocks, which had been soaring in the first half of the year, fell by 18.1%, with profit-taking becoming more evident. Subsequently, except for the Dow Jones Index, which briefly surpassed its annual high, the other indices showed weakness, with declines continuing wave after wave. As of 6 September, the Dow Jones and Russell 2000 indices rose by 3%, while the other indices recorded losses ranging from 1.2% to 8.4%, in line with our last quarter's forecasts.

Performance of the Four Major US Equity Indices and the 'M7' in Q3



Source: Bloomberg, data as of 6 September 2024

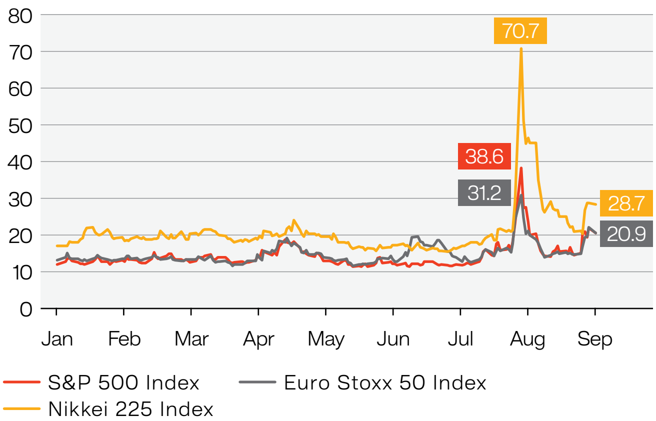
US equities weaken as non-US markets also falter. As of 6 September, regional MSCI indices all posted declines for the quarter. Japanese equities fell by 9% in a single quarter, underscoring their position at the epicenter of carry trades unwinding. This aligns with our last quarter's forecast of a correction in Japanese equities. The performance of the key MSCI indices is summarized below:

MSCI Indices	Quarterly Return (%)
Emerging Markets	-1.1
United States	-1.2
Asia ex-Japan	-1.4
Europe	-1.5
Japan	-9.0

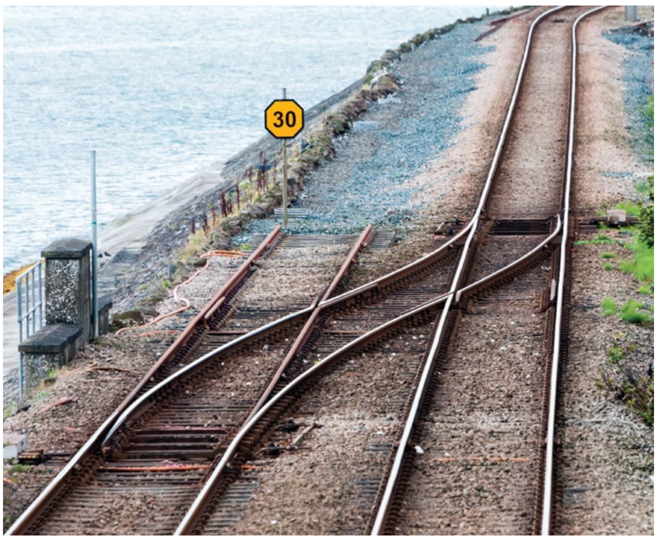
Source: Bloomberg, the third-quarter data as of 6 September 2024

Mature markets have been struggling, with multiple attempts made to reach new highs but failed. Volatility indices further confirm market instability. According to data from the Chicago Board Options Exchange (CBOE), as of 6 September, the volatility indices for the S&P 500, Euro Stoxx 50 and Nikkei 225 indices all plummeted from their yearly highs but rebounded in tandem following the release of the latest US employment data at the end of August. These volatility indices now stand nearly 40% above their yearly averages (14.8 for US equities, 15.3 for European equities and 21.2 for Japanese equities), indicating investors' lingering fear over the earlier significant market correction. Several potential risks loom on the horizon, including a potential rate hike by the BOJ, a downturn in the US economy, escalating geopolitical conflicts and an unexpected outcome of the US presidential election. These factors could prompt investors to reduce their stock holdings or rebalance their tech-heavy portfolios.

Volatility Indices of Various Equity Indices



Source: Bloomberg, data as of 9 September 2024



Capital flow trends align with the above analysis. According to weekly data from the Investment Company Institute (ICI) for the third quarter, as of the last week of August, most US-registered long-term mutual funds and exchange-traded funds (ETFs) flowed into the "US Domestic" category, totaling $53 billion(USD, same below). In contrast, the "World" category saw net outflows of $19 billion, highlighting a stark divergence in capital flow trends. During the nine weeks of net outflows, the "World" category experienced outflows in seven weeks, while the "US Domestic" category only had three weeks of outflows. This suggests that investors' withdrawal from non-US markets is not a short-term impulsive behavior.

The largest weekly inflows into the "US Domestic" category occurred during the weeks of 17 July and 24 July, coinciding with sharp corrections in global equity markets. This surge in capital inflows into US equities further supports our last quarter's analysis of US equities dominance in the lead-up to the presidential election. The data does not show sector-specific capital flows, but given the broader analysis, it is likely that much of the capital inflows into US equities are for hedging purposes, rather than a renewed appetite for tech stocks. The overall capital flow data is as follows:

Week	Total	US Domestic	World
	(USD 100 Millions)		
2 July 2024	73	49	24
10 July 2024	-12	-20	8
17 July 2024	161	238	-77
24 July 2024	168	198	-30
31 July 2024	55	92	-37
7 August 2024	-8	8	-16
14 August 2024	-110	-82	-28
21 August 2024	77	84	-07
28 August 2024	-63	-37	-26
Total	340	530	-190

Source: Bloomberg, data as of 6 September 2024

US Equity Market Outlook: Investment Diversification amid Risks

This quarter's key risks to US equities include the US presidential election, the power transition period and the Fed's rate cut. In the following analysis, we use the S&P 500 index and its 11 sector indices as benchmarks to evaluate how these risk factors may impact the indices. We will then outline appropriate strategies to derive a comprehensive investment approach.

US Presidential Election: Election Outcome to Shape Future Market Performance

If Democratic candidate Kamala Harris wins, her fiscal and financial policies are expected to continue the incumbent President Biden's direction with limited changes. In contrast, if Republican candidate Donald

Equity

We analyzed 45 datasets from Biden's term (January 2021 to 9 September 2024) and compared with 48 datasets from Trump's term (January 2017 to December 2020). Despite a slight difference in the number of datasets, the impact is minimal. Using the monthly annualized average returns and standard deviations of the indices, the overall findings are as follows:

	Term	S&P 500	Info Tech	Utilities	Energy	Health Care	Consumer Staples
Average Return (Annualized, %)	Trump	15.3	32.0	7.6	-9.9	14.7	7.9
	Biden	12.0	19.3	7.0	29.7	9.6	7.9
	Gap	3.3	**12.7**	0.6	**-39.6**	5.1	0.0
	Term	Consumer Discretionary	Financials	Industrials	Communications Services	Real Estate	Materials
	Trump	21.4	8.6	11.0	7.6	5.7	11.8
	Biden	6.2	13.9	12.1	9.3	7.6	8.4
	Gap	**15.2**	-5.3	-1.1	-1.7	-1.9	3.4
Standard Deviation (Annualized, %)	Term	S&P 500	Info Tech	Utilities	Energy	Health Care	Consumer Staples
	Trump	16.3	19.1	13.3	34.5	14.7	13.0
	Biden	16.4	22.5	17.9	28.2	13.9	13.6
	Gap	-0.1	-3.4	**-4.6**	**6.3**	0.8	-0.6
	Term	Consumer Discretionary	Financials	Industrials	Communications Services	Real Estate	Materials
	Trump	20.0	21.3	20.5	18.3	14.6	18.7
	Biden	23.2	19.6	19.0	21.0	21.1	20.7
	Gap	-3.2	1.7	1.5	-2.7	**-6.5**	-2.0

Source: Bloomberg, data as of 10 September 2024

During Trump's term, the S&P 500 Index averaged an approximately 3.3% higher return compared to Biden's term, while the standard deviation was marginally lower by 0.1%. Trump's edge in return and volatility suggests that if Trump wins the election, US equities may benefit more than if Harris were to win.

In terms of the return gap between sector indices, Trump administration has a slight edge in 5 out of 11 sectors, with the largest absolute return gap in Energy, Consumer Discretionary and Information Technology, all with double-digit gaps. The result highlights the respective policy bias of the two administrations, with Trump administration's GDP growth outperforming Biden administration (for details, please refer to the "Macro Strategy" section), which favored cyclical and high growth sectors like Consumer Discretionary and Information Technology. The Biden administration, with its geo-warfare implications, fueled a nearly two-fold rise in New York oil future price from a low of around US$45 to a peak of US$124. Although oil price has recently slipped below $70, it is still about 50% higher than when Biden took office, resulting in strong returns for the Energy sector during Biden's term.

However, the analysis of standard deviation paints a different picture. Trump administration outperformed in 7 of the 11 sectors (with lower standard deviation being preferable), indicating that a Trump victory could lead to reduced market volatility. The largest absolute gap in standard deviation are found in Energy, Utilities and Real Estate sectors, reflecting the continued decline in interest rates under Trump administration, which benefited the Utilities and Real Estate sectors. The Energy sector's volatility, on the other hand, is closely tied to Biden's involvement in geopolitical conflicts.

Finally, when calculating the ratio of average return to standard deviation (the higher ratio being preferable) of various sector indices, the results show that during Trump's term, the top three sector indices are Information Technology, Consumer Discretionary and Health Care. If Harris wins the election, the advisable sectors for investment would be Energy, Information Technology and Financials. Notably, only Information Technology appears in both lists, suggesting that regardless of who wins the White House, the current tech boom is likely to continue. The analysis result is as follows:

Ratio of Average Return to Standard Deviation (%)						
Trump	S&P 500	Info Tech	Utilities	Energy	Health Care	Consumer Staples
	0.94	1.68	0.57	-0.29	1.00	0.60
	Consumer Discretionary	Financials	Industrials	Communications Services	Real Estate	Materials
	1.07	0.40	0.53	0.42	0.39	0.63
Biden	S&P 500	Info Tech	Utilities	Energy	Health Care	Consumer Staples
	0.73	0.86	0.39	1.05	0.69	0.58
	Consumer Discretionary	Financials	Industrials	Communications Services	Real Estate	Materials
	0.27	0.71	0.64	0.44	0.36	0.41

Source: Bloomberg, data as of 10 September 2024

Power Transition Period: Regional Diversification Investment Strategy is Advisable

As indicated in the "Macro Strategy" section, it is noted that the period from the US presidential election day (5 November) to the inauguration (20 January of the following year) is the power transition period, a time when the US government is relatively vulnerable. Especially if the election results are close, the losing side may file lawsuits or even incite unrest, similar to the previous Capitol Hill incident. On the diplomatic front, the BRICS members may seize this opportunity to launch an alternative international payment system to replace the current SWIFT system, undermining the US dollar during vulnerability. Additionally, the Middle East situation could escalate further due to Iran's potential retaliation against Israel.[1]

For investment strategies during the power transition period, we analyzed the monthly average returns of the four major US equity indices and the main indices representing European and Japanese equity markets from November to January of the following year during the past 10 US election years. The overall results are as follows:

Year	Election Outcomes			Indices Performance (%)					
	Winning Party	Elected Candidate	Election Outcomes	S&P 500	Nasdaq Composite	Dow Jones	Russell 2000	Euro Stoxx 50	TOPIX
1984	Republican	Regan	R>>R	2.7	N/A	2.2	3.9	N/A	2.7
1988	Republican	George HW Bush	R>>R	2.2	2.3	3.0	1.5	1.7	4.6
1992	Democratic	Clinton	R>>D	1.6	4.0	0.9	4.7	2.0	0.5
1996	Democratic	Clinton	D>>D	3.8	7.2	4.2	2.8	5.5	-3.9
2000	Republican	George W. Bush	D>>R	-1.4	-6.5	-0.2	1.1	-1.8	-1.9
2004	Republican	George W. Bush	R>>R	1.5	0.9	1.6	2.4	2.5	1.9
2008	Democratic	Obama	R>>D	-5.1	-3.9	-4.9	-5.9	-4.4	-2.8
2012	Democratic	Obama	D>>D	2.0	1.1	1.9	3.3	2.7	8.2
2016	Republican	Trump	D>>R	2.3	2.2	3.1	4.7	1.8	3.0
2020	Democratic	Biden	R>>D	4.5	5.4	4.4	10.6	5.8	4.7
Average Return				1.4	1.4	1.6	2.9	1.8	1.7
Standard Deviation				2.8	4.3	2.7	4.1	3.2	3.8
Gap between the Highest & Lowest Return				9.5	13.7	9.3	16.5	10.3	12.1

Source: Bloomberg, data as of 10 September 2024

[1] See BBC website, https://www.bbc.com/news/articles/cvgewyx7pn5o

Equity

The results show that the Russell 2000, Euro Stoxx 50 and TOPIX indices had relatively better returns. Indices with lower standard deviation and return gap included the S&P 500, Dow Jones and Euro Stoxx 50 indices. Considering both return and risk, Euro Stoxx 50 stands out, indicating that during the US government power transition period, capital tends to flow into European equity market for diversification or risk aversion.

Historical data shows that negative returns for most of the equity indices occurred during election years only in 2000 and 2008, primarily due to the dot-com bubble burst and the financial crisis at the time, rather than election itself. Overall, the probability of achieving positive returns when investing in the aforementioned equity indices during the power transition period is as high as 77%. Therefore, investors should adopt a regional diversification investment strategy during this period. Finally, focusing on elections held during Democratic administrations, only 2000 saw poor indices performance due to the dot-com bubble burst. This serves as a reminder to investors that if the current artificial intelligence (AI) investment boom were to falter, the risks in mature markets could be very high.

US Rate Cuts: Easing Cannot Reverse Downward Cycle

In September, the Fed announced a 50-basis-point rate cut, marking the end of over two years of high-interest rates. The Fed's dot plot forecasts suggest that rate cuts will continue this year and next (for details, please refer to the "Macroeconomic" section). While the market generally views rate cuts as beneficial to equity markets, based on the Fed's interest rate data for the past 40 years, we define a "rate-hiking cycle" or "rate-cutting cycle" as a period with more than three consecutive rate hikes or cuts. To eliminate sporadic rate changes, we select the turning point from a rate-hiking cycle to a rate-cutting cycle (i.e., the first rate cut) as the anchor for our analysis, and calculate the market performance for 3-month, 6 –month and 9-month periods after the first rate cut. There have been seven such instances that meet the above criteria over the past 40 years, and we analyze the correlation between these cases and the performance of the S&P 500 index. The results are as follows:

Average of correlation coefficients			
Dates	3-month period	6-month period	9-month period
31 October 1984	-0.28	-0.40	-0.50
30 October 1987	0.34	0.36	0.29
30 June 1989	0.76	0.66	0.50
31 July 1995	0.65	0.62	0.47
31 January 2001	0.52	0.59	0.67
28 September 2007	-0.11	-0.02	0.16
31 July 2019	0.18	-0.10	-0.16
Total Average	0.29	0.24	0.21

Source: Bloomberg, data as of 10 September 2024

- The average correlation coefficients for the 3-month and 9-month periods after the first rate cut ranges between 0.21 to 0.29, indicating a positive correlation between interest rates and equity market trends. This shows that, following the first rate cut, the index generally falls rather than rises;

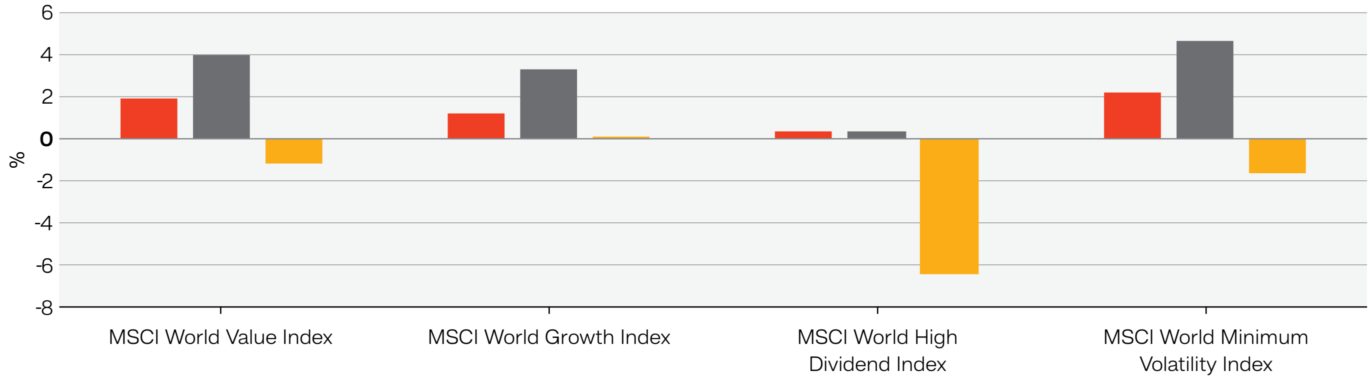
- The correlation is only about 20-30%, and it decreases over time. This suggests that the impact of rate cuts on equity markets is minor and gradually diminishes;

- The risk is higher in the first 3 months after the first rate cut. Notably, two of the top three correlation coefficients occurred in 1989, which has limited relevance to modern-day impacts;

- There were seven instances of negative correlation coefficients, accounting for about one-third of the total. In other words, the theory that "rate cuts are favorable to equity markets" lacks empirical support. Caution is advised as the market may retreat after the first rate cut.

Based on the above analysis logic and timeframe, we further analyze the impact of the first rate cut on various equity indices, using the MSCI World Value, Growth, High Dividend and Minimum Volatility indices as the subjects of analysis.

Average Returns of Various Equity Indices Over Various Periods After the First Rate Cut



Source: Bloomberg, data as of 10 September 2024

The results indicate that, in the early stages after the first rate cut, all indices recorded slight positive returns, reflecting the neutral impact of rate cuts on equity markets. The best performer 3 months after the first rate cut was the Minimum Votatility Index, while surprisingly, the worst performer was the High Dividend Index, likely due to capital deployment in advance of the rate cut, rather than action afterwards. For the 6 months after the first rate cut, the best performer remained the Minimum Volatility Index, with significantly higher return than in the early stages of the rate cut. This trend was also seen in the Value Index and Growth Index, suggesting that the positive effects of the rate cut often take time to materialize. The only index that continued to underperform was the High Dividend Index, indicating that dividends were not the top priority for investors post-rate cuts.

For the 9 months after the first rate cut, the result showed a sharp decline across all indices, with the High Dividend Index dropping by 6.4%, while only the Growth Index managed to maintain a slight gain. Historical data shows that, except for 1984 and 1995, the MSCI World Index experienced significant declines within 9 months after the first rate cut: -21% in 1987, -16% in 1989, -27% in 2001, -55% in 2007 and -21% in 2019. Most of these years involved force majeure events including natural disasters and human-induced crisis, indicating that rate cuts can only alleviate short-term economic pressure, but not a panacea for reversing economic cycles. We focus on the volatility of each index, using the standard deviation and the average gap between the highest and lowest returns as the metrics. The results are as follows:

Average Standard Deviation Over Various Periods (%)				
Periods after the first rate cut	Value Index	Growth Index	High Dividend Index	Minimum Volatility Index
3-month	5.9	8.0	4.1	5.5
6-month	11.8	12.9	11.7	10.6
9-month	18.1	15.3	15.6	10.3
Total Average	**11.9**	**12.1**	**10.5**	**8.8**
Average Gap between the Highest and Lowest Returns Over Various Periods (%)				
Periods after the first rate cut	Value Index	Growth Index	High Dividend Index	Minimum Volatility Index
3-month	15.5	25.7	7.6	13.8
6-month	32.6	36.0	26.5	25.9
9-month	40.9	47.6	35.5	23.5
Total Average	**29.7**	**36.4**	**23.2**	**21.1**

Source: data as of 10 September 2024

The red numbers in the above table indicate the lowest values for the same period. The results of both indicators are consistent: the High Dividend Index performed best in the 3-month period, while the Minimum Volatility Index outshone the other indices for the 6-month and 9-month periods. This suggests that, aside from returns and in terms of reducing portfolio volatility during a downturn cycle, these two indices are the top choices.

Equity

Considering return and volatility analysis, the Minimum Volatility Index led, with the highest returns for the 3-month and 6-month periods and the lowest volatility for the 6-month and 9-month periods. Based on such finding, investors should gradually increase their holdings of those types of equities after the first rate cut. In addition, the High Dividend Index exhibited low returns and volatility for the 6-month periods but saw a sharp decline in returns and a surge in volatility for the 9-month periods, warranting caution. The Value and Growth Indices maintained their high-risk, high-return characteristics, unaffected by rate changes.

After considering the three major factors affecting the market outlook, being the US presidential election, the power transition period and the Fed's first rate cut, the overall results are as follows:

- If Trump wins, it is expected to be beneficial for US equities in terms of returns and volatility. Sector-wise, Technology, Health Care and Consumer Discretionary are expected to deliver better performance; if Harris wins, it would be more favorable for Technology, Energy and Financials, with tech stocks expected to outperform regardless of the winner.

- During power transition periods, US equities performance across different indices varies. In terms of returns and volatility, European equities surpass US equities, reflecting a tendency for capital inflows into Europe equities for risk diversification. Mature markets have a higher probability of positive returns, making regional diversification strategy advisable.

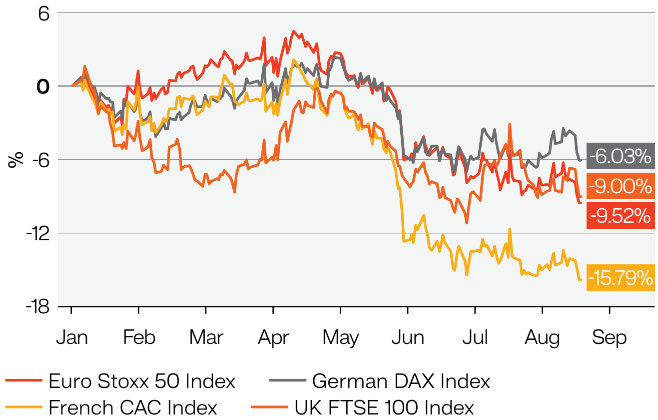
- The theoretical basis that rate cuts are favorable for equity markets is insufficient. Among stock types, the Minimum Volatility Index stands out in terms of returns and risk. Within the 9-month period after the first rate cut, global equity markets generally saw significant corrections, indicating that rate cuts are not a panacea for reversing downward cycles.

Based on the above analysis, under the base case scenario, we maintain a year-end target of 5,886 points for the S&P 500 index.

Non-US Equity Markets Outlook: Powerless to Defend Oneself

The above analysis indicates that a US election year is generally more supportive for European equities, while Japanese equities are expected to deliver moderate performance. As of 12 September, the Euro Stoxx 50 index has risen by 5.4% year-to-date, with the German DAX index and the UK FTSE 100 index recording gains of 9.4% and 6.0%, respectively. In contrast, the French CAC index has slumped -1.9% during the year, following the ruling party's defeat in local elections.

Percentage of Various European Equity Indices Against the S&P 500 Index



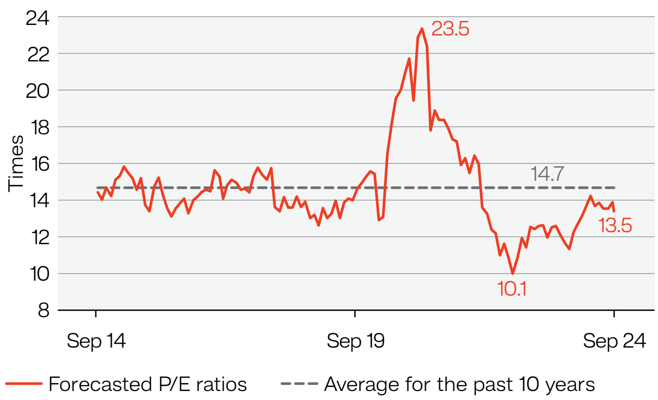
Source: Bloomberg, data as of 12 September 2024

Although European equities have excelled many major stock markets during the year, they still lag behind US equities. When comparing the performance of various European indices to the S&P 500 in percentage, French equity market is the worst performer, while Germany's equity market leads, yet still trails the US equities by about 6%. This aligns with our last quarter's forecasts: during US election years, US equities tend to outshine global equity markets.

European Equities: Weakening Earnings Forecasts

The ultimate determinant of stock investment is earnings performance. As of 12 September, the Euro Stoxx 50's P/E ratio is approximately 13.5 times, rebounding from historical lows to levels comparable to its pre-pandemic level, but still about 8.5% below the average. This suggests that while valuations are not expensive, they are no longer cheap, and the room for further upside may be limited.

Euro Stoxx 50's Forecasted P/E Ratios and Its Averages for Past 10 Years



Source: Bloomberg, data as of 12 September 2024

The forecasted P/E ratios for the German DAX, French CAC and UK FTSE 100 indices at current prices are approximately 3.4%, 10.2% and 14.5% lower than their respective 10-year averages. These differences are also reflected in their GDP growth figures (Germany at -0.6%, France at 0.2% and the UK at 0.6%), yet the ranking order of GDP growth is inverse to equity markets' valuations.

Does this divergence imply higher risk for German's equity market? According to the Buffett Indicator (market capitalization of an equity market to GDP ratio, where a higher ratio indicates greater market risk), Germany's Buffett Indicator is actually the lowest, while France appears to be the riskiest market. The overall data is as follows:

Country	Total Market Capitalisation	GDP	Ratio
	(USD Trillions)		
Germany	4.46	2.45	0.55
France	3.03	3.41	1.12
The UK	3.34	3.26	0.98

Source: Bloomberg, MacroMicro, CEIC; data as of 12 September 2024

In terms of sector earnings, based on the Euro Stoxx 50 index and its 11 industry sub-indices, the earnings forecasts for the next three quarters and their averages are as follows:

Index	Earnings Forecast (%)			
	Q3 for the year	Q4 for the year	Q1 for next year	Average
Real Estate	-3.92	23.31	3.76	7.72
Technology	-16.15	2.80	36.19	7.61
Industrials	11.46	-8.04	11.39	4.94
Financials	5.54	2.41	4.09	4.01
Consumer Staples	1.99	1.29	8.53	3.94
Health Care	7.27	-3.53	7.96	3.90
Euro Stoxx 50	-2.85	0.01	5.55	0.90
Communication	-28.92	7.33	-4.94	-8.84
Consumer Discretionary	-18.80	-6.91	-6.90	-10.87
Utilities	-18.45	4.79	-19.79	-11.15
Energy	-19.41	-12.03	-3.44	-11.63
Average	-7.48	1.04	3.85	-0.86
Materials	N/A	485.27	28.66	256.97

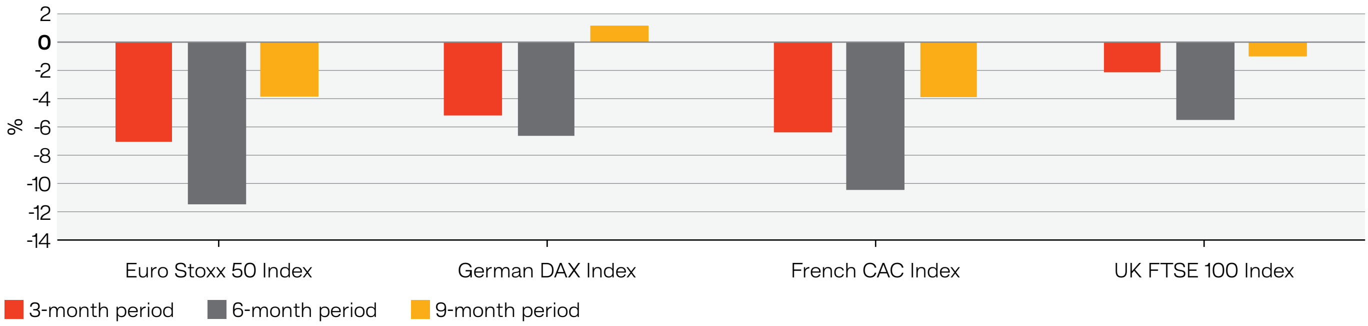
Source: Bloomberg, data as of 12 September 2024

Excluding the Materials sector due to incomplete data, the result shows that the ratio of average earnings forecast above the composite index to those below the composite index is 6 to 4. This suggests that while the performance of some sectors may continue to support European equities, the overall growth momentum has clearly been diminishing. This aligns with the quarterly average trends: negative in the third quarter, with slight rebounds to positives values over the next two quarters, but insufficient to sustain the current strength. Investors should be wary of potential profit-taking.

The analysis reveals that sectors outperforming the composite index account for 83%, while underperforming sectors represent only 13%, reflecting a significant earnings disparity between sectors. Specifically, the Financials and Consumer Staples sectors are forecasted to register positive, albeit modest single-digit, growth throughout the period, making them relatively stable choices in turbulent times. Conversely, the Consumer Discretionary and Energy sectors are in the eye of the storm, with negative growth forecasts throughout the period and double-digit average declines in average values. Risks are more pronounced this quarter, and investors should steer clear.

Equity

Average Returns of European Equity Indices Over Various Periods After the First Rate Cut



Source: Bloomberg, data as of 12 September 2024

European Equities: Rate Cuts May Trigger Market Corrections within the Region

In September, the European Central Bank (ECB) cut interest rates by 25 basis points once again. Applying the same logic used in the US equities analysis to European equities, a rate-cutting cycle may trigger a correction in regional stock markets. Based on data from January 1999 (The Eurozone came into existence) to August 31 this year, and defining a "rate-hiking cycle" and a "rate-cutting cycle" as a period with more than two consecutive rate hikes or cuts, we use the first rate cut as the anchor to analyze the average returns of the Euro Stoxx 50, German DAX, French CAC, and UK FTSE 100 indices for the 3-month, 6-month and 9-month periods after the first rate cut.

Since 1999, the Eurozone has experienced three major interest rate cycles, in 2001, 2008 and 2011 respectively. The average returns of the indices for the 3 to 9 months after the first rate cut were disappointing. Apart from the German DAX, which posted a single positive return during the observed periods, all other indices exhibited declines over all observed periods. In the 3-month period following the first rate cut, all indices experienced noticeable drops. For the 6-month period after the first rate cut, losses intensified, with both the Euro Stoxx 50 and French CAC indices falling by more than 10%. The downward momentum started to ease after 9 months, but the indices still posted single-digit losses.

To measure volatility, we reference the average standard deviation and the average gap between the highest and lowest returns of each index over various periods, with smaller values being preferable. The UK FTSE 100 showed the best performance across all metrics, with relatively stable trend. On the other hand, the German DAX was more volatile, with both metrics exceeding those of the UK's equity market by more than double, suggesting higher risks for the German's equity market as the rate-cutting cycle resumes. The overall data is as follows:

Average Standard Deviation Over Various Periods (%)				
Periods after the first rate cut	Euro Stoxx 50	German DAX	French CAC	UK FTSE 100
3-month	12.9	15.5	13.8	7.7
6-month	5.0	10.9	6.9	4.1
9-month	12.4	16.8	13.3	9.6
Total Average	10.1	14.4	11.3	7.1
Average Gap between the Highest and Lowest Returns Over Various Periods (%)				
Periods after the first rate cut	Euro Stoxx 50	German DAX	French CAC	UK FTSE 100
3-month	23.2	27.9	24.2	14.4
6-month	9.0	21.4	13.6	7.2
9-month	22.8	32.2	26.4	17.3
Total Average	18.4	27.2	21.4	13.0

Source: Bloomberg, data as of 12 September 2024

Japanese Equities: Persistent Rate Hikes to Exacerbate Domestic and External Challenges

Last quarter, this section's forecast stood out, stating: "Even if Japanese bond yields remain unchanged, the interest rate spread as of early June could pull the USD/JPY exchange rate from near 160 to around 140. If this happens, it will place significant pressure on high-flying Japanese equities, making it difficult to replicate last year's strong momentum." As predicted, Japanese equities experienced a wave of carry trade unwinding, aligning closely with our forecast.

Additionally, last quarter raised several key questions: "Will Warren Buffett continue to increase his holdings in Japanese equities? Will tech giants keep their investment promises? Is the return of inflation a blessing or a curse?" It also noted, "Today's investors face economic and investment considerations spanning a 30-year cycle. Beyond short-term speculation, stronger mid- to long-term arguments are needed to justify current equity valuations or to push Japanese equities beyond their 35-year highs." So far, there has been no news of Buffett increasing his holdings. The promises made by Western leaders to invest in Japan's technology during the Hiroshima G7 summit last year have faded into obscurity. Prime Minister Fumio Kishida stepped down, with past commitments now seem like distant memories[2]. According to Bloomberg's data, Japan's inflation rate has held steady at 2.8% for three consecutive months, but personal consumption expenditure forecasts have dropped significantly – from 3.7% in the second quarter to 1.7% in the third quarter and 1.0% in the fourth quarter. The resurgence of inflation has shown its harms before its benefits.

Overcoming historical economic challenges requires more drastic reforms, but political infighting among parties is hindering economic reforms. Unfortunately, Japan continues to be plagued by economic scandals, such as multiple Japanese automobile manufacturers falsifying data[3], a well-known pharmaceutical company's supplement products allegedly causing illness and even death[4], and a national railway freight company being involved in data falsification during train assembly[5]. These issues, often concealed for decades, are shaking global confidence in "Made in Japan," impacting the foundation of Japan's economy and making it even harder to overcome economic challenges.

The most critical issue may be the BOJ's insistence on rate hikes. BOJ Governor Kazuo Ueda has stated that further rate hikes are only a matter of time, contingent on economic conditions[6]. The market predicts that Japan will raise rates to at least 1% by the second half of the next fiscal year[7], signaling a potential resurgence of yen carry trade unwinding. While the impact may not be as severe as the one in early August, the narrowing interest rate spread between the US and Japan could have lasting effects. With two BOJ's policy meetings remaining this year (31 October and 19 December), any rate hike in Japan coupled with a US rate cut could drive the yen closer to 140 against the US dollar, triggering another wave of carry trade unwinding, which will cause significant volatility for Japanese equities.

The unwinding also pressures Japan's financial system. Recently, Norinchukin Bank, a major agricultural financier, announced plans to sell approximately 10 trillion yen (USD 63 billion) of US and European government bonds to mitigate losses from incorrect interest rate bets. This situation is reminiscent of last year's US regional banking incidents, where significant short-term interest rate fluctuations severely devalued the financial instruments held by banks, causing deteriorating balance sheet, a liquidity crunch and triggering major bank runs. Consequently, the systemic risk within Japan's financial system driven by interest rate spread should not be overlooked.

2 See The Economic Times website, https://economictimes.indiatimes.com/small-biz/trade/exports/insights/ahead-of-g7-japan-pm-welcomes-more-investment-from-global-chipmakers/articleshow/100347041.cms?from=mdr
3 See Japan's National Daily website, https://mainichi.jp/english/articles/20240606/p2a/00m/0op/015000c
4 See Reuters website, https://www.reuters.com/world/asia-pacific/second-kobayashi-pharma-japan-factory-inspected-over-deaths-2024-03-31/
5 See The Japantimes website, https://www.japantimes.co.jp/business/2024/09/11/jr-freight-suspended/
6 See Reuters website, https://www.reuters.com/markets/asia/boj-will-remain-vigilant-unstable-market-moves-says-governor-ueda-2024-08-23/
7 See Reuters website, https://www.reuters.com/markets/rates-bonds/bojs-tamura-calls-raising-rates-least-1-2024-09-12/
8 See Nikkei Asia website, https://asia.nikkei.com/Business/Finance/Japan-s-Norinchukin-Bank-to-sell-63bn-of-U.S.-and-European-bonds

Equity

Japanese Equities: Finding Bright Spots in Sector Earnings Amidst Turbulence

Despite the headwinds facing Japanese equities, are Japanese stocks unsuitable for investment? Not necessarily. By analyzing the earnings forecasts and their averages across the 11 sector sub-indices within the TOPIX over the next three quarters, the overall data is as follows:

Index	Earnings Forecast (%)			
	Q3 for the year	Q4 for the year	Q1 for next year	Average
Health Care	20.8	18.1	180.4	73.1
Financials	25.4	53.9	89.2	56.2
Consumer Staples	8.0	15.0	33.3	18.7
Technology	12.4	28.5	8.6	16.5
TOPIX	11.1	5.1	21.5	12.6
Materials	-5.7	10.6	31.6	12.1
Industrials	-1.2	-3.9	32.6	9.2
Real Estate	-14.6	16.1	6.9	2.8
Consumer Discretionary	-13.0	2.2	-5.4	-5.4
Energy	8.2	-8.6	-39.8	-13.4
Average	5.1	13.7	35.9	18.2
Communication	15,072.1	-39.4	-19.0	5,004.6
Utility	-62.2	-22.4	NA	NA

Source: Bloomberg, data as of 12 September 2024

Communication and Utilities sectors have been excluded due to incomplete data or extreme reasons. Among the remaining sectors, four outperform the composite index in terms of the average value of earnings forecasts, which is slightly down from five last quarter. This shrinking earnings advantage is not an encouraging sign.

Among the sectors that outperformed the Composite Index, the Health Care and Financials sectors grew by an average of 50% to 70%, with impressive earnings growth expected to boost the underlying equities. The Consumer Staples and Technology sectors both saw double-digit growth in average. These sectors are expected to perform well in the next three quarters, with positive earnings forecasts.

For sectors underperforming the composite index, there is a nearly equal split between positive and negative earnings forecasts. However, the average gains and loss are 11.1% and 13.2%, respectively, with a slight tilt toward the positive values. Among these, Materials, Industrials and Real Estate sectors are expected to perform better in the coming quarter. Conversely, only Consumer Discretionary and Energy sectors show negative average earnings growth forecasts, warranting caution from investors.

Looking at quarterly averages, while the third quarter of 2024 shows low single-digit growth, the forecasts jump quarter-on-quarter by multiples in subsequent quarters. By the first quarter of 2025, earnings are projected to surge by a remarkable 34%, which should provide a strong tailwind for the TOPIX index. However, compared to the US and European equity markets, Japanese equities' earnings forecasts are notably volatile across both sectors and quarters. This reflects the unique investment environment in Japan, where a mix of bearish risks and bullish opportunities create a landscape suitable for investors willing to take on higher risk and ride market momentums.

Chapter Summary:

- The US presidential election outcome will drive sector-specific performance. During the power transition period, investments should be diversified, and rate cuts are not a panacea for reversing the downward cycle
- Base case scenario maintains a year-end target of 5,886 points
- European equities' earnings forecasts support their upward trend, but prolonged rate cuts could become a "fatal flaw" for the future market
- Japanese equities face internal and external challenges with volatile earnings forecasts, making them more suitable for investors who can tolerate higher risks

Senior Investment Strategist, Wealth Management Division,
The Bank of East Asia **Jason Chan**

Hong Kong and Chinese Mainland Equity Markets Outlook: Vigilance Amid Stability

Last quarter's title was "Reaping the Rewards," suggesting the continued recovery in Chinese Mainland's macroeconomic data and corporate earnings, and a potential sustained rally in the Chinese Mainland and Hong Kong equity markets. Looking back at the overall market trend, the forecast was largely on point.

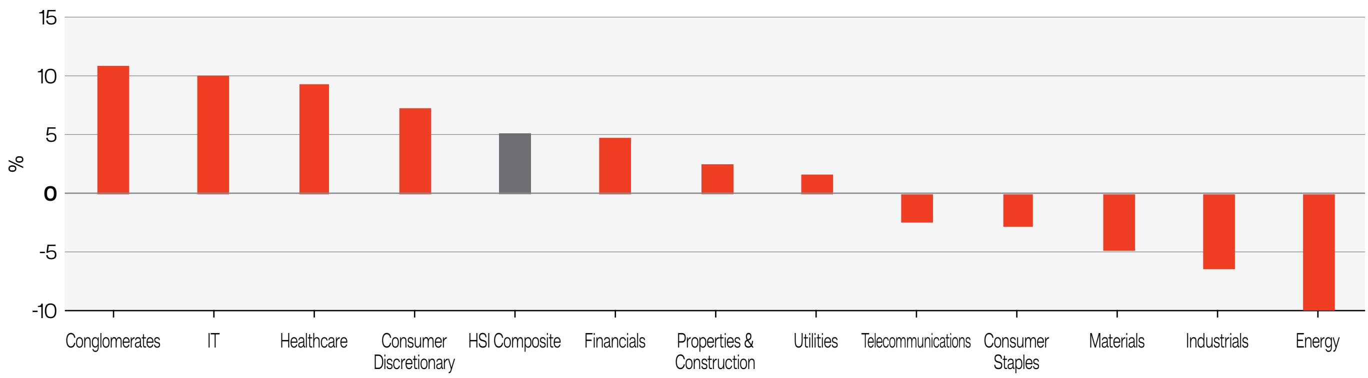
From July to early August, Chinese Mainland's economic data, including Gross Domestic Product (GDP), Purchasing Managers' Index (PMI), real estate investment and retail sales, generally weakened. Despite the People's Bank of China (PBoC) decisively lowering policy indicator rates including reverse repo rate and the Loan Prime Rate (LPR), market concerns about the downward pressure on the Chinese Mainland's economy persisted. During the same period, the Third Plenary Session proposed several medium- to long-term economic reform directions but lacked short-term stimulus measures, further inflating market risk aversion. Externally, Donald Trump, the Republican presidential candidate, gained a decisive advantage in the first presidential debate, fueling the "Trump Trade" narrative. Concerns over aggressive tariffs on China led to continued global capital outflows from Chinese stocks. Additionally, the sharp rise in the Japanese yen triggered the unwinding of high-risk asset carry trades, causing volatility in Hong Kong equities. The Hang Seng Index repeatedly declined during this period, once hitting a low of 16,441 points – a drop of over 10% from its July peak and the lowest level since April.

Entering mid-August, as US employment data sharply deteriorated, the market began to bet on more aggressive rate cuts by the Fed. With significant declines in the US dollar exchange rate and US Treasury yields, the Renminbi (RMB) strengthened again, acting as a booster for the Hong Kong equity market. Additionally, the Democratic Party's replacement of Biden with Kamala Harris for the presidential candidacy, whose popularity rating is ahead of Trump's has slightly raised the visibility of China-US- relations, supporting a strong market rebound. Positive news continued to flow in. Hong Kong equity market's earnings season in mid- to late August showed impressive results. Several major Chinese tech stocks, being the constituents of the Hang Seng Index reported second-quarter earnings far exceeding market expectations, prompting an approximately 2.7% upward revision in the Hang Seng Index's earnings forecast from its low point during the period, laying the foundation for a market recovery.

By September, the Fed finally commenced the long-awaited rate-cutting cycle, with an unexpectedly aggressive rate cut of 50 basis points. The Fed's dot plot also indicated a faster pace of rate cuts over the next year, reigniting market enthusiasm. Additionally, a surprise joint press conference by the PBoC, the National Financial Regulatory Administration and the China Securities Regulatory Commission suddenly announced a policy combination of rate cuts, reserve requirement ratio reductions and downward adjustments to mortgage rates, alongside new monetary tools to support the equity markets. This further fueled investors' risk appetite. During this period (up to 24 September), the Hang Seng Index surged to a high of 19,002 points, rebounding more than 15% from its intra-quarter low. However, despite the sharp rebound in Hong Kong equities, Chinese Mainland A-shares remained weak, with the CSI 300 Index falling 2.6%.

As of 24 September, the Hang Seng Index and CSI 300 Index posted quarter-to-date returns of 7.2% and -3.2%, respectively, highlighting that US rate cuts had a much more positive impact on Hong Kong equities than A-shares. Sector-wise, conglomerates, information technology, healthcare and consumer discretionary stocks all outperformed the broader market. Conversely, energy and industrial sectors underperformed, falling 11% and 6% respectively. Among the sectors we recommended last quarter, Chinese insurance stocks, rated as "outperform", outpaced the market due to strong earnings and dividend hikes. Similarly, local high-dividend equities, also rated "outperform", were in demand, benefiting from the sharp drop in US Treasury yields. Several local utilities, telecommunications and international banking stocks hit 52-week highs. In contrast, the Chinese telecom and power sectors, rated "cautiously optimistic," saw mixed performance: the former tracked the market, while the latter underperformed.

Performance of the Hang Seng Composite Industry Indices for Q3 2024



Source: Bloomberg, data as of 24 September 2024

Equity

This quarter's theme "Staying Vigilant" suggests that the Hong Kong equity market may continue to be supported by US rate cuts, Chinese Mainland's stimulus policies and improved corporate earnings. Major indices are expected to challenge their yearly highs. However, after two consecutive quarters of gains, entering the market now seems less appealing. Investors should remain cautious about potential risks such as a downturn in the US economy and escalating China-US tensions to safeguard against future uncertainties.

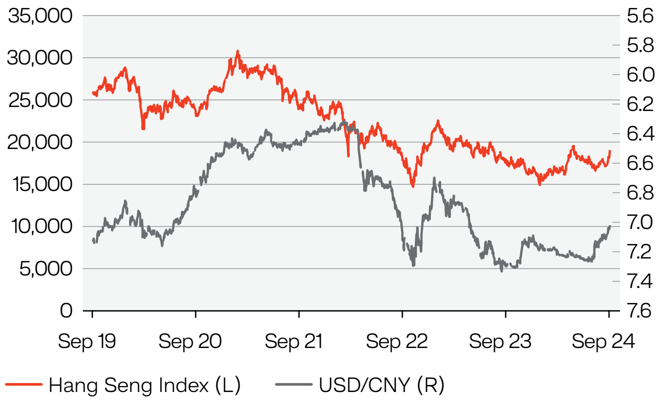
US Rate Cuts Could Lift Hong Kong Stocks, But Be Cautious for External Economic Downside Risks

The Fed's rate cut in September marked the beginning of a new easing cycle of the US. According to the Fed's latest dot plot, rate cuts could total 150 basis points from the fourth quarter this year to the end of next year. Conventional investment wisdom links rate cuts with a bullish equity market, especially as a weaker US dollar and falling Treasury yields tend to drive capital into emerging markets, benefiting both Chinese Mainland and Hong Kong equity markets. However, historical data from the last five US rate-cutting cycles since 1995 suggests a more nuanced picture. During the period from the Fed's first rate cut to its third, the Hang Seng Index has risen three times and fallen twice, with an average return of 10.2%. This indicates that while Hong Kong equities may perform well at the start of a US rate-cutting cycle, the advantage is not overwhelming. Notably, in the three instances where the Hang Seng Index posted positive returns, the US economy maintained positive quarterly growth. Conversely, in the first quarter of 2001, despite the Fed's three rate cuts by a cumulative 150 basis points (the largest reduction in any of these five rate-cutting cycles), the US economy plunged into contraction, leading to an 11% drop in the Hang Seng Index. This suggests that while further rate cuts by the Fed this quarter could benefit Chinese Mainland and Hong Kong equities, their overall impact will hinge largely on whether the US economy can achieve a soft landing.

On the other hand, should the Fed pursue more aggressive rate-cuts, the China-US interest rate spread could gradually narrow, providing some relief for the pressured RMB which has been persistently pressured for the past 2 years. In fact, since July, as markets began pricing in the Fed's impending rate cuts, the yield spread between US and Chinese 10-year government bonds has shrunk by 480 basis points, triggering a 3.3% surge in the RMB against the US dollar during the period.

As the weighting of Chinese stocks in Hong Kong's major indexes continues to grow, the performance of the Hong Kong stocks has become more closely tied to the RMB's exchange rate. According to regression analysis over the past decade, the weekly movements of the Hang Seng Index and the RMB/USD exchange rate exhibit a correlation of 0.4, with an adjusted beta from Linear Regression of 1.65. This means that for every 1% appreciation in the RMB against the USD, the Hang Seng Index could theoretically rise by 1.65%. This is one of the direct benefits that US rate cuts could bring to Hong Kong stocks. Of course, if the PBoC cut rates further to stimulate the economy, the RMB may not appreciate significantly. However, with US Treasury yields continuing to fall, at the very least, the pressure of capital outflows from Chinese Mainland could ease, allowing the PBoC more flexibility to implement accommodative monetary policies. In this sense, US rate cuts could serve as an indirect catalyst for Chinese and Hong Kong equities.

Trend of Hang Seng Index and CNY



Source: Bloomberg, data as of 24 September 2024

Date	Cumulative Rate Cuts (First 3 Cuts)	Hang Seng Index level at the beginning of the period	Hang Seng Index level at the end of the period	Return
July 1995 to January 1996	75 bps	9,407 points	11,359 points	+20.8%
September 1998 to November 1998	75 bps	7,946 points	10,148 points	+27.7%
January 2001 to March 2001	150 bps	14,869 points	13,223 points	-11.1%
September 2007 to December 2007	100 bps	24,599 points	29,226 points	+18.8%
July 2019 to October 2019	75 bps	28,146 points	26,667 points	-5.3%
Average return:				+10.2%

For investors looking to capitalize on opportunities from the US's rate-cutting cycle may consider the following sectors:

(i) Equities with high proportions of USD- or HKD-denominated debts and high financing costs. These includes local property rental equities , local conglomerates equities, Macau gaming equities and airline operations and leasing equities;

(ii) High-yield value sectors. These include local utility equities, local telecommunications equities and local real estate investment trusts (REITs);

(iii) Gold-related equities or ETFs.

However, it's worth noting that since mid-July, market expectations for Fed rate cuts have become increasingly aggressive. As of 23 September, the interest rate futures market has been pricing in US interest rates at 4.0% to 4.25% by the end of 2024 and 2.75% to 3.0% by the end of 2025, 25 and 50 basis points lower, respectively, than that as indicated by the Fed's latest dot plot. If the Fed's rate cut pace in the coming months is less aggressive than the market expects, coupled with the significant gains in the aforementioned sectors in recent months, there could be short-term profit-taking. As such, a phased, buy-on-dips strategy is advisable.

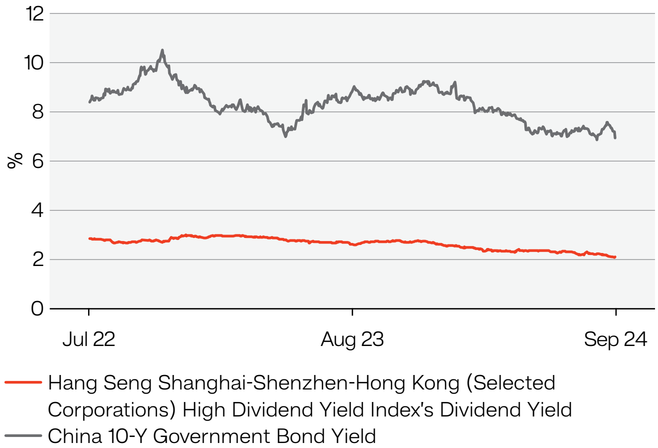
Chinese Mainland's Economic Recovery Faces Challenges, More Fiscal and Monetary Support Expected

Chinese Mainland's macroeconomic data for the third quarter has been volatile. While exports and manufacturing fixed investment remained relatively stable, other areas such as consumption, real estate and fixed investments in infrastructure significantly lagged behind market expectations, dampening the recovery of Chinese cyclical equities. For instance, in August, China's official manufacturing PMI, retail sales growth, industrial output growth and year-to-date fixed asset investment growth registered 49.1%, 2.1%, 4.5% and 3.4%, respectively, all lower than July's 49.4, 2.7%, 5.1% and 3.6%. Regarding inflation, although the CPI year-on-year increase expanded to 0.6% in August (July: 0.5%), this was mainly due to rising food prices, while core CPI growth fell to 0.3%, slowing for the second consecutive month. The Producer Price Index (PPI) also reversed its improving trend over the past six months, with the contraction widening to -1.8% in August (June and July: -0.8%). Overall, unless September's economic data shows a significant rebound, third-quarter GDP, set to be released in October, could face further downside risks. This could trigger negative sentiment, leading to downgrades in GDP targets for 2024 and 2025, which would in turn weigh on earnings forecasts for Chinese companies. Investors should be cautious of potential volatility in the Chinese Mainland and Hong Kong equity markets during this period.

If Chinese Mainland's macroeconomic data fails to improve in the short term, the pressure to meet the full-year GDP growth target of around 5% will increase, likely prompting more aggressive stimulus and easing measures. In terms of monetary policy, the PBOC indicated in mid-September that it would maintain a supportive monetary policy stance, stating that it would "accelerate the implementation of existing financial policy measures, introduce some incremental policy measures, and reduce corporate financing and household credit costs". At the end of September, the PBOC announced a 50 basis point reserve requirement ratio (RRR) reduction, a 20 basis point reduction in the 7-day reverse repo rate and the Loan Prime Rate (LPR), with the easing measures slightly exceeding expectations. Additionally, the PBOC continued to guide the reduction of existing residential mortgage rates to levels close to new mortgage rates, with an average reduction of 50 basis points, potentially saving households nationwide RMB 150 billion in annual mortgage interest expenses, which will in turn release more consumption capacity. Most notably, the PBOC unprecedentedly introduced structural monetary policy tools to support the capital market, including providing swap facilities to securities and fund companies and offering low-interest loans to listed companies and major shareholders for stock purchases or buybacks. For equity assets, lower risk-free rates will help sustain valuations, particularly benefiting high-yield value state-owned enterprises (SOEs). After a moderate price correction in the third quarter, the forecast dividend yield of the Hang Seng China Enterprises High Dividend Yield Index/ Hang Seng China Enterprises High Dividend Index (HSCEI Select) has risen to above 7.0%, with the spread over the 10-year Chinese government bond yield widening to 550 basis points, restoring valuation attractiveness. Additionally, low-cost refinancing tools may prompt some highly leveraged SOEs to initiate stock buyback plans. As a result, we maintain a positive outlook on sectors such as Chinese energy, insurance, telecommunication, power and non-ferrous metals. Additionally, the reduction in existing residential mortgage rates is expected to boost consumer confidence, and undervalued Chinese consumer stocks could gradually recover lost ground. While Chinese Mainland banks' net interest margins will remain under pressure, they are likely to benefit from potential RRR cuts and accelerated deposit rate reductions, mitigating the impact on the industry's profitability. Therefore, the overall earnings hit to the banking sector should be manageable.

Equity

Trend of Hang Seng Shanghai-Shenzhen-Hong Kong (Selected Corporations) High Dividend Yield Index's Dividend Yield and China 10-Y Government Bond Yield



Source: Bloomberg, data as of 24 September 2024

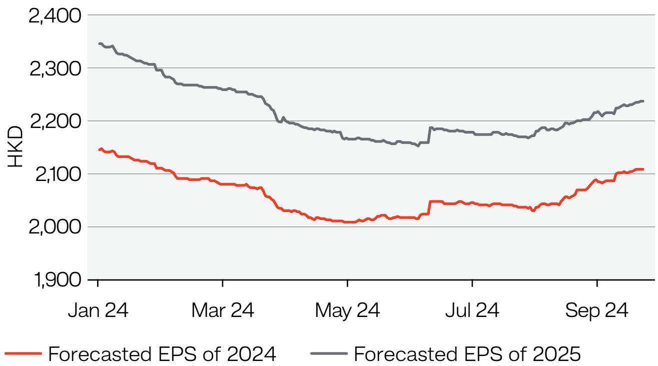
Another critical indicator for the market's direction this quarter is whether the central government will ramp up its fiscal policy. Observing central government's fiscal expenditure from January to July this year, which stands at only 54.5% of the annual target (compared to 55.1% in the same period in 2023), it reflects a slower pace of fiscal expenditure. This is partly due to the slower issuance of local special bonds compared to last year and the year-on-year decline in public fiscal revenue. Therefore, referencing last year's experience, there is a possibility that the national fiscal budget deficit target could be moderately adjusted upward from the initial 3% set at the beginning of the year, with the October Politburo meeting being an ideal opportunity for such adjustment. Should this materialize, it could trigger a revaluation rally for Chinese equities. Additionally, the Ministry of Finance announced last quarter the issuance of RMB 1 trillion in ultra-long-term special government bonds, with RMB 300 billion allocated to support nationwide consumer goods trade-in and equipment renewal programs. This not only significantly increases the subsidy amounts for related products but also is expected to markedly enhance the efficiency of the program's implementation. It remains to be seen whether the issuance scale of these ultra-long-term special government bonds will increase and whether the use of funds can be expanded to cover areas such as technology and new infrastructure (such as renewable energy, water conservation and computing power). Finally, the Central Economic Work Conference in December will also be another crucial event for investors this quarter. Given the slowdown in export growth and the lackluster recovery in the property market, the policy focus of the conference is expected to shift towards revitalizing household consumption. This is likely to benefit sectors such as home appliances, new energy vehicles, smartphones, food and beverages, sports goods, as well as e-commerce platforms for food delivery and travel booking.

Hong Kong Corporate Earnings Show Improvement, Tech Sector Shines

Beyond the influence of external interest rates and Chinese Mainland's policies, corporate earnings and shareholder returns are increasingly critical drivers for Hong Kong equities. During the last earnings season (15 July to 4 September), the 2024 earnings forecast for constituents of the Hang Seng Composite Index was revised upwards by about 1.6%, reversing several quarters of downward revisions of earnings forecast during the earning season. This reflects a gradual improvement in corporate earnings, particularly in the first half or second quarter of this year. Additionally, several large central state-owned enterprises (SOEs) in banking, insurance and resources sectors announced increased interim dividends, while certain major international banks, Chinese consumer and internet companies also ramped up stock buybacks, marking highlights of this earnings season. However, the interim earnings performance varied significantly across sectors, with mixed stock price reactions. The standout performer was information technology, where several major Chinese internet platform companies reported substantial year-on-year growth in adjusted net profits for the second quarter. Consequently, the 2024 earnings forecast for the Hang Seng Information Technology Industry Composite Index was significantly raised by nearly 5.4%, the largest upward revision among all sectors. As a result, the Hang Seng Information Technology Industry Composite Index delivered a return of 10% in the third quarter, leading all sectors. In contrast, the real estate and construction, consumer staples and utilities (mainly Chinese Mainland power and gas stocks) sectors underperformed, with significant downward revisions in earnings forecasts post-results, causing these sector indices to lag the broader market.

Looking ahead to the second half of the year, we expect the third-quarter earnings growth of Chinese companies to remain challenging due to the slower-than-expected recovery in Chinese Mainland's macroeconomic data from July to August. However, with the recent intensive issuance of ultra-long-term government bonds and local special bonds, combined with the rollout of various growth-stabilizing measures, there is hope for a final push in corporate earnings in the fourth quarter. We forecast the Hang Seng Index's full-year net profit growth for 2024 to reach 10%, slightly up from the 8.6% estimated at the end of June. Earnings performance across sectors is expected to continue diverging in the coming half-year. The information technology sector is likely to maintain high growth rates, with a positive outlook for key players in gaming, food delivery and community services platforms, online travel platforms, and smartphones. Traditional e-commerce platform companies are expected to boost earnings per share through improved fee models, reduced subsidies, lowered new business losses and increased stock buybacks. However, gross merchandise volume (GMV) and revenue growth may remain subdued, potentially limiting stock price recovery.

YTD Trend of Hang Seng Index Earnings Forecasts

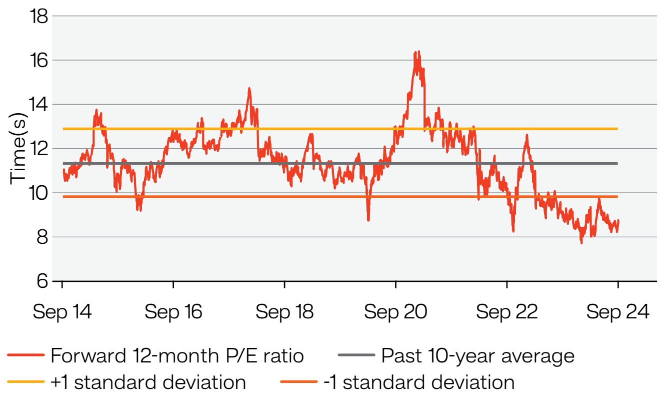


Source: Bloomberg, data as of 24 September 2024

Revise Year-End Target for Hang Seng Index upward to 19,900 points

Given the Chinese Mainland government's signals of stable economic growth and support for capital markets, we anticipate more favorable policies to be rolled out this quarter. In parallel, further rate cuts by the Fed seem inevitable, which could help sustain the valuation recovery in the Hong Kong and Chinese Mainland equity markets. However, the impact of the US presidential election could continue to unfold. There is a risk that the newly elected president could immediately impose higher tariffs on Chinese imports or introduce new rounds of sanctions against China's technology or financial sectors. The limited visibility of China-US relations remains a significant risk for Hong Kong equities this quarter, potentially limiting the room for valuation multiples to rise. Regarding corporate earnings, we expect a modest improvement in the second half year, with recovery momentum in the fourth quarter likely to outpace the third quarter.

Forward 12-month P/E ratio of Hang Seng Index



Source: Bloomberg, data as of 24 September 2024

Overall, we are revising our 2024 forecasted earnings per share (EPS) of the Hang Seng Index to HK$2,150, up from HK$2,075 in the previous quarter, slightly above the Bloomberg consensus of HK$2,110 as of 24 September. For valuation, despite the Hang Seng Index's gain of over 7% last quarter, the market has significantly raised its earnings forecast, causing the forward 12-month P/E ratio to decline to 8.7x, still below the 10-year average by one standard deviation. We are adjusting our 2024 forward P/E ratio target from 9.6x to 9.8x, while revising the Hang Seng Index's year-end target upward to 21,100 points (The year-end target was set at 19,900 points in the third quarter).

Equity

Key sectors to watch in the fourth quarter of 2024:

Sector/Thematic sectors	Key investment rationale	Bullishness#
Chinese Consumer & Tourism	1. The Politburo has indicated that boosting consumption will be key to expanding domestic demand. Measures such as increasing subsidies for home appliance and vehicle trade-ins, lowering mortgage rates of existing residential mortgages to enhance disposable income, and more fiscal stimulus policies are expected.	***
	2. During this year's National Day holidays, the number of Chinese Mainland residents traveling and tourism spending are expected to see solid growth, especially with the notable decline in airfares and hotel prices. Demand for long-haul and outbound travel is likely to rise, benefiting sectors such as online travel platforms and Macau gaming.	
	3. Priority should be given to industry leaders with strong interim earnings performance. Additionally, companies with a significant P/E discount, dividend hikes, or new share buyback programs also present attractive opportunities.	
Chinese Insurance	1. Regulatory tightening on bancassurance sales channels and commission structures, coupled with a reduction in the pre-determined interest rate for life insurance products and product structure improvements, have significantly boosted the new business value (NBV) margins of Chinese Mainland major insurers in the first half year, supporting NBV growth.	****
	2. The State Council's "Ten National Guidelines" for the insurance industry prioritizes mitigating interest rate spread risk, supports protection-type products, and encourages diversified investments, favoring the growth of large insurers.	
	3. The PBoC has introduced several measures to support the economy and capital markets, which should help A-shares and Hong Kong equities recover steadily, lifting insurers' investment returns.	
	4. Improved liquidity for domestic property developers has reduced default risks, aiding valuation recovery for insurers with significant exposure to domestic property assets.	
	5. Chinese insurance equities are significantly undervalued compared to their historical averages. Most major insurance stocks have price-to-book (P/B) ratios below 1x, and dividend yields ranging from 4% to 7%, making them attractive for medium- and long-term domestic capital.	
Chinese Gas	1. Since June this year, multiple Chinese Mainland cities have announced increases in residential natural gas prices, with some areas seeing double-digit hikes, improving the unit profit margins of gas distribution companies.	***
	2. Recent accommodative measures and economic stimulus policies from the central government should help accelerate the recovery of manufacturing activities. Additionally, the utilization rate of natural gas power plants has seen strong growth so far this year, further supporting stable natural gas sales growth.	
	3. Leading Chinese gas companies boast strong balance sheets, positioning them to increase dividend payout ratios and initiate share buybacks in the future. Current dividend yields are attractive, ranging from 4% to 7%.	
Hong Kong Property, Rental and REITs	1. The Fed's rate cut pace may be more aggressive than the market expects. Over the next year, Hong Kong banks may continue to lower prime rates (P), potentially reducing new residential mortgage rates from the current 3.85% to below 3.3%. When mortgage costs fall below rental costs, this could boost housing demand, benefiting developers' new sales.	****
	2. The continued decline in HIBOR (Hong Kong Interbank Offered Rate) helps property companies reduce interest expenses, particularly benefiting firms with high net leverage ratios and large floating-rate debt in HKD borrowings. This improves EPS and dividend payouts	
	3. The current share prices of Hong Kong property developers and rental businesses are still at an average discount of over 60% to their net asset value (NAV). The next 12 months' dividend yields are close to 6% and 7%, respectively, offering an attractive valuation compared to the US 10-year Treasury yield, which is 220 bps and 320 bps higher.	

The degree of bullishness is denoted by the number of asterisks, with 5 being the highest level of bullishness and 1* being the lowest. The rankings of 5/4/3/2/1 asterisks represent views of very bullish/bullish/cautiously optimistic/neutral/bearish, respectively.

Chapter Summary:

- Positive factors for Hong Kong equities this quarter include US rate cuts, Chinese Mainland's stimulus policies and improving corporate earnings. However, downside risks stem from a potential US economic slowdown and escalating China-US tensions
- Corporate earnings are expected to show moderate improvement, with recovery momentum this quarter likely to outpace the third quarter
- We have raised our forecasted EPS of the Hang Seng Index this year to HKD 2,150, with a slight increment in the forward P/E ratio to 9.8x, revising the year-end target for the Hang Seng Index upward to 21,100 points
- Key sectors to watch this quarter include Chinese consumer and tourism, Chinese insurance, Chinese gas, and Hong Kong property, rental and REITs

BEA Union Investment – Investment Teams

Rate Cuts to Stimulate Economy, Stocks Outperform Cash

Rate cuts help stimulate personal consumption and corporate investment, driving business growth and investor sentiment

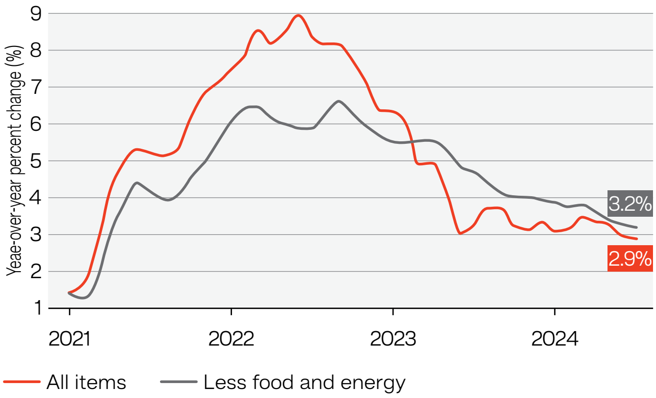
Market Volatility Expected to Increase Ahead of US Election

In early September, weak US manufacturing data reignited investor concerns about the economic outlook, causing global stock markets to tumble. However, investors swiftly took advantage of the dip, and markets stabilized within days. BEA Union Investment anticipates that uncertainties including the US presidential election and the trajectory of the yen may continue to fuel market volatility. However, we believe the US economy remains resilient, with a low likelihood of a hard landing. In a reflationary cycle, rate cuts help stimulate the economy, while equity risk premiums will support long-term stock valuations. As a result, we maintain a positive outlook on the global economy and risk assets, favoring equities over cash holdings.

AI Applications to Enhance Corporate Operations and Valuations, Seize Opportunities in US and Asian Tech Stocks

The US job market and wage growth are beginning to normalize, which is expected to help ease inflationary pressures. Consumer prices in the US have gradually declined, but the current real interest rate remain elevated, a readjustment of monetary policy by the Federal Reserve (the "Fed") has started. Rate cuts help drive consumption and corporate spending, further reinforced by the strong corporate earnings recently reported. Consequently, our team remains bullish on US stocks, particularly companies at the forefront of artificial intelligence (AI) and technology. While tech stocks have already seen significant gains this year, there is a possibility of a market correction, especially as the US presidential election is approaching where volatility is expected to increase. Should the market undergo a correction, it could present an opportunity for investors to buy on the dip.

U.S. consumer price index



Source: US Bureau of Labor Statistics, data as of 14 August 2024

AI technology is increasingly being applied across various sectors, including retail, healthcare and finance. Companies that successfully apply AI stand to improve operational efficiency, thereby boosting profitability and valuations. The broadening application of AI is one of the factors behind our positive view of the sector, as it is expected to benefit business across the AI supply chain. The computing of AI relies heavily on data processing, therefore, the development of AI will spur demand for data centers, semiconductors and power grids. Many of the companies involved in these sectors are based in the US, with a significant number also located in Asia. In addition to chipmakers in South Korea and Taiwan, firms from Japan and Australia are also expected to be benefitted. Furthermore, the growing demand for AI infrastructure is likely to bolster industrial stocks in emerging markets. India, for instance, has recently launched several initiatives for AI infrastructure, including AI infrastructure equipped with 10,000 graphics processing units (GPUs)[1] and the approval of a large-scale chip manufacturing plant[2]. The rise of the middle class, growing labor force and infrastructure spending all support our positive outlook on structurally promising Indian stocks.

[1] See Data Center Dynamics website, https://www.datacenterdynamics.com/en/news/indian-government-launches-12bn-indiaai-mission-plans-10000-gpu-supercomputer

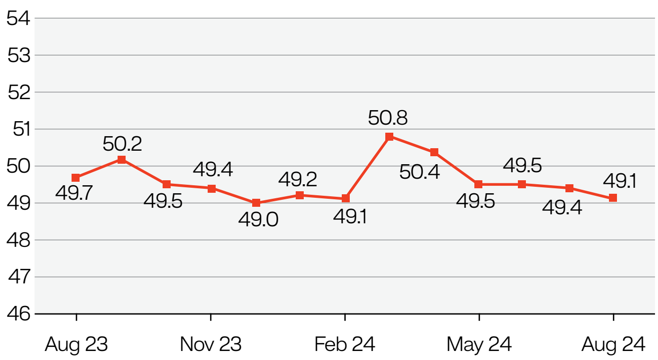
[2] See Reuters website, https://www.reuters.com/technology/india-approves-three-chipmaking-units-worth-152-bln-2024-02-29/

Equity

China's Economy Still in Transition, Eye on Japan's Monetary Policy for Economic Impact

China remains in the midst of an economic transition. Despite a series of stimulus measures, economic data remains mixed. China's August exports growth exceeded expectations, but import growth fell short of estimates[3]. The August's manufacturing Purchasing Managers' Index (PMI) dropped to a six-month low of 49.1[4], remaining in contraction territory. The Caixin services PMI stayed in expansion in August, but slowed compared to July. Our team believes that the pace of China's economic recovery warrants close monitoring, as such we maintain a cautious stance on Chinese Mainland and Hong Kong stocks. We currently focus on high-dividend and value stocks in Chinese Mainland and Hong Kong stock markets, such as state-owned oil and gas companies. With interest rates likely having peaked, stocks consistently offer dividend are relatively defensive, while energy stocks provide a hedge against escalating geopolitical tensions. We will continue to watch for additional stimulus measures in the fourth quarter.

China's Manufacturing PMI



Source: National Bureau of Statistics, data as of August 2024

The Bank of Japan's rate hike in July triggered a wave of yen carry trade unwinding, causing significant market volatility. However, the central bank subsequently softened its stance, indicating it would refrain from further rate hikes if market stability is threatened. Japan's second-quarter economic growth was robust, with expanded corporate capital expenditure[1]. While Japan's economy continues to improve, uncertainty concerning the yen's potential fluctuations and monetary policy keeps our outlook on Japanese stocks neutral. Additionally, with Japan set to appoint a new prime minister, we will continue to monitor market reactions to the successor.

Maintaining a Positive Outlook on Risk Assets

BEA Union Investment believes that rate cuts will stimulate personal consumption and corporate investment, driving business growth and boosting investor sentiment. Coupled with the growing application of AI, these factors are favorable for long-term stock valuations. Despite potential short-term volatility caused by the US election and yen fluctuations, our team maintains an overall positive outlook on the global economy and risk assets.

Chapter Summary:

- Market volatility may intensify due to uncertainties including the U.S. election and yen fluctuations, warranting close monitoring of market developments
- In a reflationary cycle, equities are more favourable than cash
- We remain optimistic on US and high-quality Asian tech stocks, with opportunities to buy on dips
- Watch for potential additional stimulus measures from China, while also keeping an eye on Japan's monetary policy adjustments and the market's reaction to the new prime minister

[3] See CNBC website, https://www.cnbc.com/2024/09/10/china-trade-data-august-2024-exports-imports.html
[4] See CNBC website, https://www.cnbc.com/2024/09/02/asia-stock-markets-set-for-mixed-open-as-investors-await-china-pmi-s-korea cpi.html#:~:text=China%20released%20its%20official%20purchasing,the%2049.4%20seen%20in%20July

FX

New Chapter Unfolds

Senior Investment Strategist, Wealth Management Division, The Bank of East Asia | **Angela Wong**

FX US Dollar Index

Senior Investment Strategist, Wealth Management Division,
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US Economy Achieves Soft Landing as Inflation Eases and Overall Economic Growth Remains Steady

Expected trading range of US Dollar Index in Q4	98.00 to 103.00

One-year chart of the US Dollar Index

Source: Reuters, data as of September 2024

Key economic indicators in the US	Time period	Value (%)
Gross Domestic Product (GDP)	Q2 2024 (Preliminary)	3.0 (YoY)
Unemployment Rate	August 2024	4.2
Retail Sales	August 2024	2.1 (YoY)
Consumer Price Index (CPI)	August 2024	2.5 (YoY)

Source: Reuters, data as of September 2024

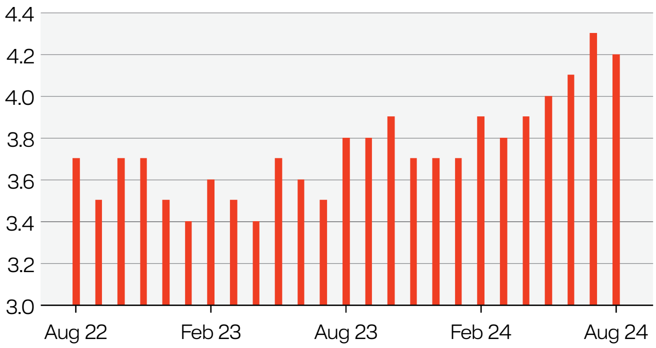
Fed's Significant Rate Cuts Not a Response to Economic Weakness, More Cuts Expected by Year-End

The Fed finally kicked off its long-anticipated rate-cutting cycle in September, reducing the benchmark interest rate by 50 basis points to a range of 4.75% to 5.00%, the first cut in over four years. According to the latest dot plot, Fed policymakers are likely to implement two more 25-basis-point cuts by the end of the year, with each cut expected to be 25 basis points, followed by further cuts of 1% next year. However, markets remain more dovish than the Fed after FOMC, pricing in over 70 basis points of rate cuts by year-end and projecting a neutral rate of 2.85% by the end of next year. In its policy statement, the Fed expressed greater confidence in inflation returning to target levels, projecting the unemployment rate to rise to 4.4% by year-end. Overall, the Fed clarified that the significant rate cut is aimed at protecting the economy's resilience rather than immediate response to recent economic weakness, which led to a rise in both the US dollar and US Treasury yields following the announcement.

US Recession Risk Remains Low, but Job Market Warrants Attention

Fed Chair Jerome Powell has repeatedly hinted at the Jackson Hole Economic Symposium the shift in the Fed's policy focus from curbing inflation to preventing deterioration in the job market. While the number of job openings has reduced, there are no corporate layoffs. The US labor market has shown a steady slowdown in recent months. Non-farm payrolls increased by 142,000 in August and 114,000 in July, the smallest gains this year. Despite signs of a slowdown, the risk of the US economy slipping into a recession remains low based on the US's overall economic data. This warrants close attention to local employment trends.

Unemployment Rate of United States



Source: Reuters, data as of September 2024

US Inflationary Pressures Gradually Easing, Likely to Fade from Monetary Policy Focus

In August, the CPI rose 0.2% month-on-month and 2.5% year-on-year, marking the smallest annual increase since February 2021. Core CPI grew by 3.2% year-on-year. While both CPI and PPI inflation growth rates have been gradually declining, core inflation data shows that housing costs and services prices remain relatively sticky. Fed Chair Powell has also stressed the importance of maintaining low unemployment rate as inflation subsides. With US inflationary pressures easing, it is expected that inflation will gradually move away from being the Fed's monetary policy focus.

FX EUR to USD exchange rate

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ECB's Rate Cuts Expected to Lag Behind Fed for the Year, Supporting Euro

Expected trading range of EUR/USD in Q4	1.0900 to 1.1400

One-year chart of EUR to USD exchange rate

Source: Reuters, data as of September 2024

Key economic indicators in the Eurozone	Time period	Value (%)
Gross Domestic Product (GDP) (Preliminary)	Q2 2024	0.6 (YoY)
Unemployment Rate	July 2024	6.4
Retail Sales	July 2024	-0.1 (YoY)
Consumer Price Index (CPI)	August 2024	2.2 (YoY)

Source: Reuters, data as of September 2024

ECB's Rate Cuts Expected to Lag Behind Fed for the Year

The European Central Bank (ECB) cut rates by 25 basis points to 3.50% in September. ECB President Christine Lagarde indicated that borrowing costs will continue to decline in the coming months, citing slowing inflation and weak economic growth. However, her remarks dampened market expectations for another rate cut in October, with the market now anticipating that the ECB may wait until its December meeting, pending more economic data and forecasts for further rate cuts. Consequently, the Fed's rate cuts are expected to outpace those of the ECB this year, leading to a weaker US dollar and supporting the euro.

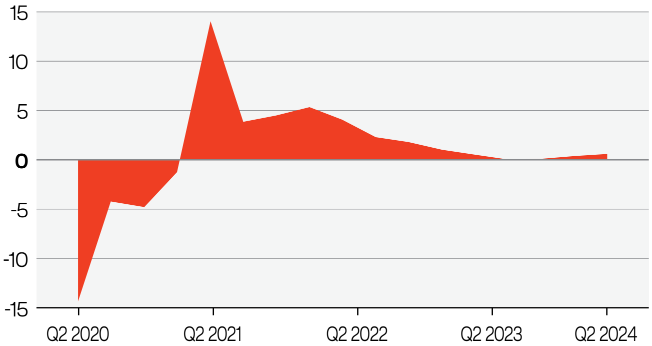
Volatile Wage Growth Expected, ECB's Caution against Resurgence of Inflation

In the second quarter of 2024, negotiated wage growth in the Eurozone fell significantly to 3.55% from 4.69% in the first quarter. While the slowdown in negotiated wage growth alleviates ECB policymakers' concerns about rising labor costs fueling inflation, the ECB noted that some countries in the Eurozone will see one-off payments this year, suggesting that wage growth may remain elevated and volatile. This indicates that inflation concerns have not fully subsided within the ECB. The central bank is expected to carefully balance rate cuts with the inflationary pressures and economic growth considerations, rather than follow Fed's rate-cutting pace.

Eurozone Economic Recovery Still Sluggish, Further Rate Cuts May Stimulate Economic Growth

The Eurozone's composite Purchasing Managers' Index (PMI) rebounded to 51.2 in August from 50.2 in July, driven by a notable recovery in the services sector, despite a slowdown in manufacturing activity. The services PMI rose to 53.3, offsetting the ongoing contraction in manufacturing, where the manufacturing PMI fell to an eight-month low of 45.6. In August, France saw its strongest expansion in its services PMI over two years, benefiting from hosting the Olympic Games. Germany's services PMI contracted for the third consecutive month, reflecting a loss of economic momentum. Overall demand in the Eurozone remains weak, and a significant recovery is expected to take longer.

Eurozone's GDP



Source: Reuters, data as of September 2024

FX GBP to USD exchange rate

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UK Economy Gaining Momentum, BOE Unlikely to Rush into Rate Cuts

Expected trading range of GBP/USD in Q4	1.300 to 1.3500

One-year chart of GBP to USD exchange rate

Source: Reuters, data as of September 2024

Key economic indicators in the UK	Time period	Value (%)
Gross Domestic Product (GDP) (Preliminary)	Q2 2024	0.9 (YoY)
Unemployment Rate	July 2024	4.1
Retail Sales	August 2024	2.5 (YoY)
Consumer Price Index (CPI)	August 2024	2.2 (YoY)

Source: Reuters, data as of September 2024

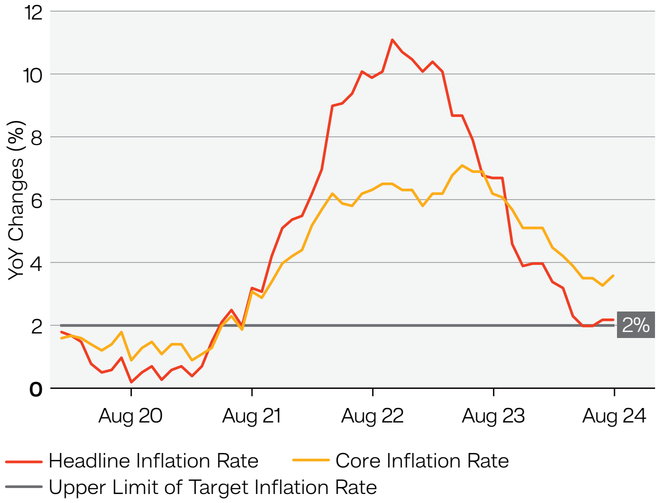
BOE's Hawkish Rate Cut in August Signals Potential for Further Rate Cuts by November

Following a rate cut in August by the Bank of England (BOE) from a 16-year high of 5.25% to 5%, Governor Andrew Bailey indicated that there is no rush for further cuts, as BOE remains unconvinced that inflation has been fully tamed. After the hawkish rate cut, interest rate future market has priced in the possibility of another rate cut as early as November, with a further rate cut likely in December, which may bring the year-end rate to 4.50%. Given the slow wage growth and declining inflation in the services sector, the BOE is expected to cut rates more cautiously compared to the Fed by year-end. With the UK's economy showing signs of gradual improvement, this could provide support for the pound.

UK's Inflation Rebounds Moderately, No Urgency for BOE to Cut Rates Aggressively

Domestic service price inflation remains a key focus for the BOE. In July, service inflation rose modestly, leading to a slight rebound in the headline inflation rate. The Consumer Price Index (CPI) rose 2.2% year-on-year in July, marking the first rise this year, though it came in below the expected 2.3%. Average weekly wage (excluding bonuses) grew by 5.1% in the three months ended July, the smallest increase since the three months ended June 2022. Overall, UK's inflation has now slowed to near the BOE's 2% target. However, with service prices remaining elevated and wages still rising, the market anticipates that the BOE will not rush into cutting rates aggressively in the short term.

UK's Headline Inflation Rate



Source: Reuters, data as of September 2024

UK Economy Stagnant but Showing Signs of Growth Momentum

The UK's GDP has maintained its growth momentum year-on-year despite zero growth in June and July, with year-on-year growth at 1.2%, which was more rapid than June. However, despite the sluggish domestic economic activity, rising domestic demand has offset declining exports. In August, UK factories posted their strongest monthly performance in over two years, adding momentum to the economic growth. The labor market added 265,000 jobs in the three months ended July, significantly exceeding the forecast of 123,000 newly added jobs. Overall, the UK economy is improving and showing growth momentum, suggesting the BOE will adopt a cautious approach to monetary policy.

FX USD to JPY exchange rate

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Amid Expected Narrowing of US-Japan Interest Rate Spread, Yen Likely to Strength

Expected trading range of USD/JPY in Q4	138.00 to 146.00

One-year chart of USD to JPY exchange rate

Source: Reuters, data as of September 2024

Key economic indicators in Japan	Time period	Value (%)
Gross Domestic Product (GDP)	Q2 2024	2.9 (QoQ annualized)
Unemployment Rate	July 2024	2.7
Retail Sales	July 2024	2.6 (YoY)
Consumer Price Index (CPI)	August 2024	3.0 (YoY)

Source: Reuters, data as of September 2024

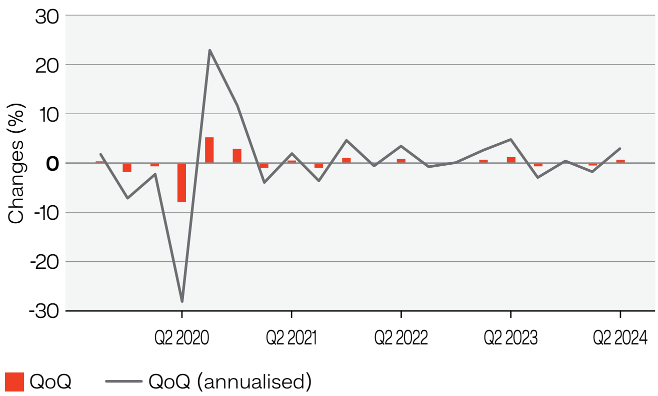
BOJ Maintains Stance on Phasing Out Large-Scale Stimulus Gradually

The Bank of Japan (BOJ)'s unexpected rate hike at the monetary policy meeting in August provides a boost to the yen. This, coupled with weak US non-farm payroll data announced subsequently, further spurred safe-haven demand for the yen, leading to massive unwinding of carry trades. As a result, the yen surged significantly, with USD/JPY pair dropping to 141.67, its lowest level since January 2. The market's reaction also reverberated across other asset classes. Following this rate hike, BOJ Governor Kazuo Ueda and other policymakers reiterated in various occasions that the central bank remains committed to its gradual exit from large-scale stimulus, signaling that further rate hikes could be on the table if inflation continues to progress toward the 2% target. The expected narrowing of US-Japan interest rate spread is expected to support yen in the medium to long term, as well as the overall performance of the yen.

Japan's Economic Performance Lacks Sustainability, BOJ Likely to Slow Rate Hikes

Japan's economy saw rebound in the second quarter of 2024 from the sluggish start of the year, primarily driven by robust domestic consumption, with a year-on-year growth of 3.1% in GDP, far exceeding market expectation of 2.1%, which later revised to 2.9%. Despite the economic fundamentals are gradually improving and inflation is showing some stickiness, the BOJ is likely to proceed with further rate hikes. However, the economy's ongoing instability and lack of sustained momentum could limit BOJ's room for rate hikes in the short term. Additionally, with the Fed now entering a rate-cutting cycle, the BOJ is expected to continue monitoring domestic economic performance without rushing into aggressive rate hikes.

Japan's Quarterly GDP



Source: Reuters, data as of September 2024

Core Inflation Slows, Easing Immediate Pressure on BOJ to Hike Rates

Japan's year-on-year core inflation rate in August accelerated for the forth consecutive month to 2.8%. However, excluding fresh food and energy prices, core inflation rate rose by only 2% year-on-year, reflected that the growth momentum remains soft. . As demand-driven price increases has slowed and the yen has gain strength recently, along with the government's reintroduction of energy subsidies, inflationary pressure is expected to ease in the near term. This should alleviate some of the BOJ's concerns over rapidly rising inflation. Based on such, BOJ has no urgency for immediate rate hikes. Interest rate futures prices suggest that the BOJ may wait until December this year or early next year before another rate hike.

FX AUD to USD exchange rate

Senior Investment Strategist, Wealth Management Division,
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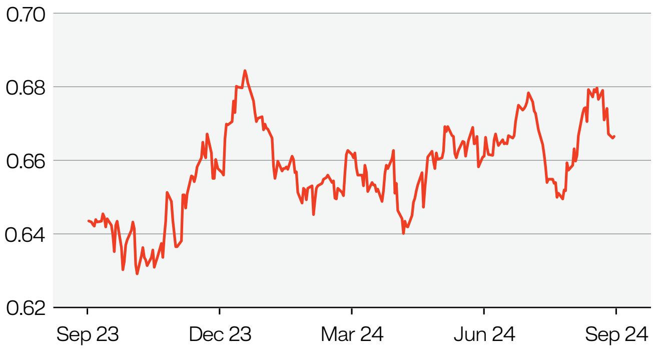
RBA's Hawkish Stance Differentiates It from Major Central Banks, Bolstering AUD's Interest Rate Spread Advantage

Expected trading range of AUD/USD in Q4	0.6600 to 0.7100

One-year chart of AUD to USD exchange rate



Source: Reuters, Data as of September 2024

Key economic indicators in Australia	Time period	Value (%)
Gross Domestic Product (GDP)	Q2 2024	1.0 (QoQ-annualized)
Unemployment Rate	July 2024	4.2
Retail Sales (preliminary)	July 2024	0.0 (YoY)
Consumer Price Index (CPI)	Q2 2024	3.8 (YoY)

Source: Reuters, Data as of September 2024

RBA's Hawkish Currency Policy to Reinforce AUD's Interest Rate Spread Advantage

While most major central banks pivot towards rate cuts, the Reserve Bank of Australia (RBA) maintains its hawkish stance. RBA Governor Bullock stated that with local inflation still elevated, bringing the inflation rate down to the target range of 2-3% remains the central bank's top priority. She noted that any short-term rate cuts would be premature. With Australia's headline inflation (CPI) still above 3%, the RBA is concerned about upward price pressures. Based on which, the timing of any rate cuts will depend on inflation trends in the coming months. The RBA has kept its interest rate policy unchanged since November 2023, and the market widely anticipates that the first rate cut may be postponed to the end of this year. This suggests that Australian rates will remain at a peak of 4.35% in the short term, providing an interest rate spread advantage that supports the Australian Dollar (AUD)'s strength.

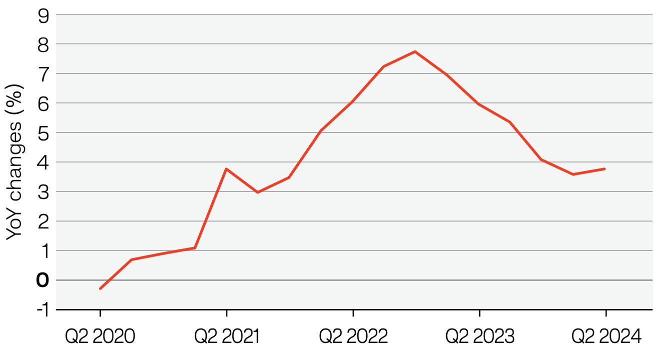
RBA Remains Vigilant on Rising Inflation with Diminished Rate Cut Prospects

Driven by rising housing and food costs, Australia's second-quarter CPI rose by 3.8% YoY, marking the first inflation increase since the fourth quarter of 2022, while the core inflation rate eased to 3.9%, a sixth consecutive quarter of slowdown. Despite the gradual easing of core inflation, the headline inflation is still heating up, giving the RBA reason to delay the first rate cut. Governor Bullock has stated that the central bank will remain vigilant against further inflationary pressures. She also stated that if the economy develops as expected, there will be no rate cuts in the short term. This again rules out the possibility of the RBA easing policy in the near future. Therefore, compared to most global central banks that have already started their rate-cutting cycles, the RBA's delayed rate cuts will provide an interest rate spread advantage for the AUD, benefiting its short- and medium-term performance.

Iron Ore Prices Hit New Year-Low, Yet Medium- to Long-Term Outlook Remains Positive

Recently, disappointing economic data from China and the US has dampened market expectations for commodity demand, putting significant pressure on prices across the board, including iron ore, which has fallen to its lowest level of the year. However, from a medium to long-term perspective, the Fed and other major central banks have begun cutting rates this year, which is expected to stimulate economic activity globally. This, in turn, will likely increase demand for various major commodities, ultimately bolstering iron ore prices. This will boost Australia's economy as the world's largest iron ore exporter and support the medium- to long-term performance of the AUD.

Australia's Quarterly CPI



Source: Reuters, data as of September 2024

FX NZD to USD exchange rate

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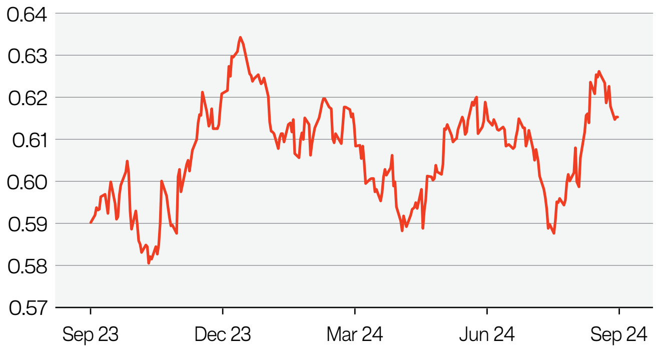
Economic Growth Resurfaces, Potential Contraction Could Prompt RBNZ to Accelerate Rate Cuts

Expected trading range of NZD/USD in Q4	0.6000 to 0.6500

One-year chart of NZD to USD exchange rate



Source: Reuters, data as of September 2024

Key economic indicators in New Zealand	Time period	Value (%)
Gross Domestic Product (GDP)	Q2 2024	-0.5 (YoY)
Unemployment Rate	Q2 2024	4.6
Retail Sales	Q2 2024	-3.6 (YoY)
Consumer Price Index (CPI)	Q2 2024	3.3 (YoY)

Source: Reuters, data as of September 2024

Central Bank Initiates Rate Cut Cycle, Signals Further Rate Cuts

In August, Reserve Bank of New Zealand (RBNZ) Governor Adrian Orr initiated a rate cut, laying the groundwork for future policy easing. He expected the local inflation to return to the 1-3% target range and planned an additional 50 basis points cut by year-end. Currently, New Zealand's inflation rate further eased to 3.3% in the second quarter, which is near the RBNZ's target. This alleviates RBNZ's concerns over persistently high inflation. Should local inflation continue to decline, it would bolster the RBNZ's momentum for further rate cuts.

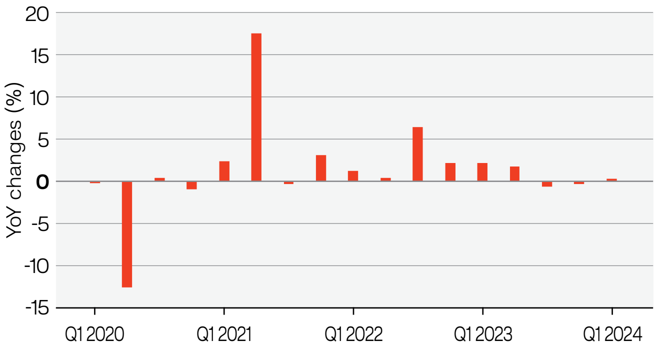
Limited Impact on NZD from Interest Rate Spread in Early Period of Rate Cuts

The RBNZ's initial rate cut in August since March 2020 lowered the Official Cash Rate (OCR) by 25 basis points to 5.25%. As the easing cycle begins, the RBNZ Governor has indicated that more accommodative measures will be implemented this year. The latest futures prices reflect market expectations of an additional 80 basis points cut by year-end. With New Zealand's OCR still at 5.25%, it remains higher than other countries. Even if the RBNZ continues to cut rates in tandem with other central banks, the impact of changing interest rate spread on the NZD is expected to be limited in the early period of rate cuts.

A return to economic contraction in Q2 may prompt accelerated rate cuts by the RBNZ

New Zealand's saw modest GDP growth in the first quarter of this year, but the economy slipped back into contraction in the second quarter. The latest GDP figures show a 0.5% year-on-year decline, while the economy shrank 0.2% on a quarterly basis. The high-interest environment, driven by sustained rate hikes last year, suppressed consumer spending and business investment, which potentially stalled the local economy. Even if the economy contracts again following the RBNZ's rate cuts, it is expected to be temporary, potentially prompting the RBNZ to continue its rate cut policy to stimulate economic recovery.

New Zealand's Quarterly GDP



Source: Reuters, data as of September 2024

FX USD to CAD exchange rate

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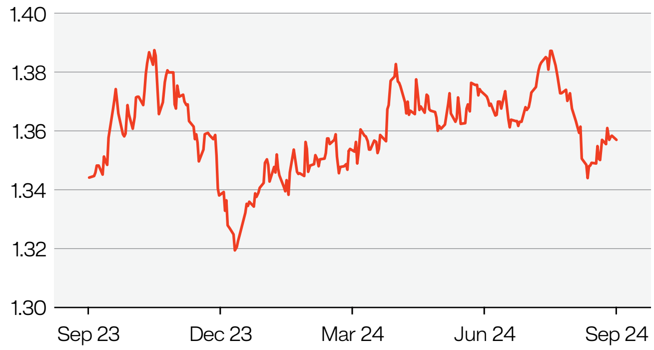
The Bank of East Asia **Angela Wong**

Bank of Canada Expected to Cut Rate In Tandem with the Fed, CAD Neutral

Expected trading range of USD/CAD in Q4	1.3200 to 1.3700

One-year chart of USD to CAD exchange rate



Source: Reuters, data as of September 2024

Key economic indicators in Canada	Time period	Value (%)
Gross Domestic Product (GDP)	Q2 2024	2.1 (QoQ-annualized)
Unemployment Rate	August 2024	6.6
Retail Sales	July 2024	0.9% (MoM)
Consumer Price Index (CPI)	August 2024	2.0 (YoY)

Source: Reuters, data as of September 2024

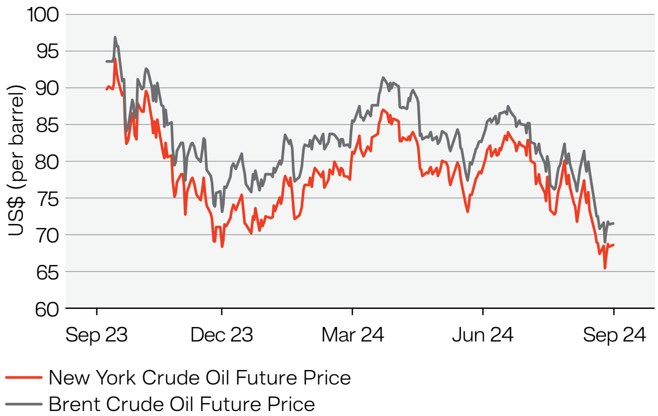
Short-term Rate Cut Likely to Remain Despite Economic Concerns

The Bank of Canada ("BOC") cut its key policy rate by 25 basis points in early September to 4.25%. The central bank highlighted the rising concerns over economic weakness and the risk of inflation undershooting the target, as the inflation rate approaches the target. While the BOC has signaled caution against the economic impact caused by rapid rate cuts, it is expected to follow the Fed's lead in rate cuts in the short term, given the close economic ties between the two countries. The interest-rate futures market has priced in two more rate cuts of 25 basis points each, likely in October and December, following the September cut.

OPEC Cuts Oil Demand Forecast with Neutral to Bearish Outlook

Oil price has been pressured by expectations of declining demand from China, which led to a particular weak oil demand in overall. Coupled with a significant buildup in inventories, oil price has been dragged down to a more than two-and-a-half year low, with London Brent crude oil future price falling below US$70 per barrel for the first time since December 2021. While the Organisation of Petroleum Exporting Countries (OPEC) and its allies (OPEC+) have delayed their original plan to increase production by two months starting in October, which is favorable to oil prices in the short term, the organization has also expressed concerns over weak demand and further revised down its global oil demand forecasts for this year and the next year. Consequently, the short-term outlook for oil prices remains neutral to bearish amidst demand-side headwinds, with limited impact on the Canadian dollar.

Performance of Oil Prices in the Past Year



Source: Reuters, data as of September 2024

FX USD to CNH exchange rate

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Anticipation of Further Stimulus Boosts Economic Recovery; Greater Room for Reserve Requirement Cuts than Rate Cuts

Expected trading range of USD/CNH in Q4	6.9500 to 7.1000

One-year chart of USD to CNH exchange rate

Source: Reuters, data as of September 2024

Key economic indicators in China	Time period	Value (%)
Gross Domestic Product (GDP)	Q2 2024	4.7 (YoY)
Unemployment Rate	August 2024	5.3
Retail Sales	August 2024	2.1 (YoY)
Consumer Price Index (CPI)	August 2024	0.6 (YoY)

Source: Reuters, data as of September 2024

External Environment Changes Support Chinese Yuan's Recent Rally

China's recent macroeconomic data suggests a slight economic deceleration in the second half of the year. The recent rally in Chinese Yuan has largely been driven by changes in the external economic environment. As global central banks have commenced rate cuts and the market has priced in Fed's potential rate cuts commencing September, demand of Chinese Yuan settlement has surged, bolstering the currency's exchange rate. While the pace of China's economic recovery remains uncertain, the Chinese Yuan is expected to show increased flexibility, with a tendency for two-way fluctuations in the near term.

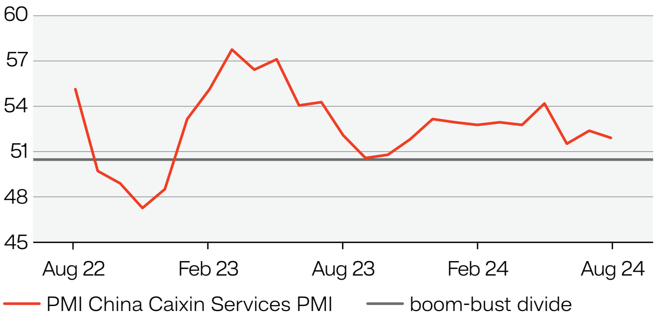
Reserve Requirement Ratio Cuts Expected to Support Moderate Economic Recovery; Limited Space for Rate Cuts

Thanks to supportive economic policies, China's economy maintained an average growth rate of 5% in the first half of the year. However, recent data has been mixed, signaling the need for additional macroeconomic policy measures to sustain a moderate recovery in the second half year and achieve the full-year economic growth target of 5%. Zou Lan, head of the Monetary Policy Department at the People's Bank of China (PBOC), noted that with the average reserve requirement ratio (RRR) for financial institutions currently at around 7%, there is still room for further RRR cuts. On the other hand, further reductions in deposit and lending rates may face certain limitations. Meanwhile, PBOC Governor Pan Gongsheng reaffirmed the central bank's commitment to maintaining supportive monetary policies to stabilize economic rebound. Consequently, it is expected that following the Fed's aggressive rate cuts, the PBOC will continue to implement stimulus monetary policies, with a greater likelihood of RRR cuts rather than substantial rate cuts.

Mixed Economic Data Leaves Markets Waiting for More Solid Growth Signals

China's recent economic data has fallen short of expectations, suggesting the need for more solid growth signals to sustain the momentum for economic growth throughout the year. China's industrial output growth slowed to its lowest level in five months in August, reflecting continued weakness in consumer demand. Fixed asset investment growth also hit a year-to-date low, with private investment once again posting negative growth, indicating a further slowdown in economic growth in August. Additionally, the Caixin China Services PMI fell to 51.6 in August, marking the second-lowest reading this year and signaling a slowdown in expansion. Overall, there are signs of cooling in China's economic growth, exacerbated by continued weakness in the domestic property market. As a result, the market is waiting further stimulus policies to bolster economic growth.

China Caixin Services PMI



Source: Reuters, data as of September 2024

Chapter Summary:

- The Fed cuts rates to safeguard US economic resilience. With US inflation easing and the overall economic growth remaining robust, a soft landing is still within reach
- UK's services sector prices remain strong amid rising wages. The overall economy is gradually gaining momentum, suggest the Bank of England has no immediate need for substantial rate cuts
- Australia's inflationary pressures delay rate cuts. RBA's divergence from most global central banks in monetary policy is expected to provide interest rate spread advantage for AUD
- China's economy continues slow recovery. The market anticipates further stimulus measures to boost economic activity, with the Chinese Yuan expected to exhibit two-way fluctuations

Diversified Investment Opportunities for Every Investor

Chief Investment Strategist, Wealth Management Division, The Bank of East Asia | **Frank Lee**
BEA Union Investment – Investment Teams

Chief Investment Strategist, Wealth Management Division,
The Bank of East Asia **Frank Lee**

Diversified Investment Opportunities for Every Investor

Rate Cuts Setting-in while Yield Curve Normalizes; Non-US Bond Markets Present Diversified Investment Opportunities

Last quarter's title was "Precision in Caution". At that time, we underscored that the Fed's first rate cut would come in response to economic downturns, not merely cooling inflation. While policymakers painted a "Goldilocks economy" narrative, Fed Chair Powell and FOMC's members have repeatedly misled the market with their linguistic artistry. Their decision to raise the median fed funds rate forecast seemed out of touch, potentially damaging their credibility in the long run. Most US Treasury yields had already priced in the expected rate cuts before the first rate cut, meaning the prime window for entering the bond market had passed. The yield spread between long- and short-term Treasuries is unlikely to flatten before the first rate cut, suggesting that corporate bonds are expected to be more appealing than government bonds, in particular the high-yield ones are expected to outperform investment-grade(IG) corporate bonds. As the US election approaches, large cumulative bonds in Europe and the US should see improved performance, whereas non-US dollar bond markets may lag behind. Overall, these predictions largely align with the current outcomes.

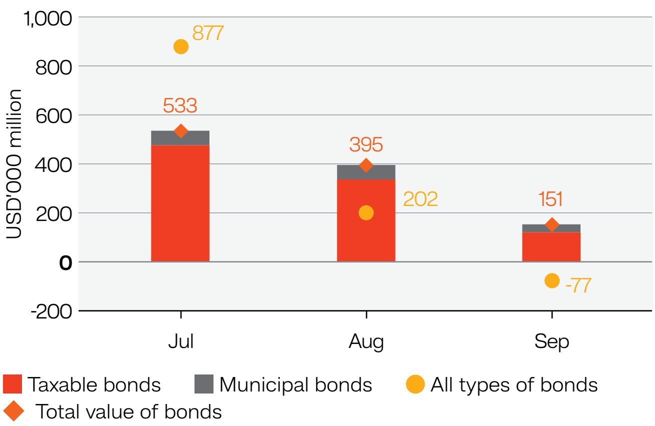
The title of this quarter is "Diversified Investment Opportunities for Every Investor". The global bond market has cooled compared to the first half of the year, as capital has already positioned itself ahead of the first rate cut. While the Fed continues to deploy its verbal tactics to steer the market, over-reliance on these signals may cloud judgment. Only a broader, macro view will frame the right investment strategies. Yield forecasts indicate that the room for a substantial drop in long-term rates is limited, while future short-term rate cuts warrant more focus. From an investment strategy perspective, investors can capitalize on the normalization of the yield curve by locking in short-duration bonds or extending durations to capture volatility-driven gains. Additionally, the expected rise in yield volatility during rate cuts presents opportunities to tactically exploit yield spreads. The focus of corporate bonds is likely to shift from high-yield bonds to IG corporate bonds following the first rate cut. Meanwhile, non-US bond markets should not be overlooked, as they offer diversified investment opportunities worth close attention.

Market Review: A Gradual Cooling in Bond Markets

While mature equity markets continued their upward momentum this year, we repeatedly emphasized the need for bonds in portfolios, especially to hedge against potential pullbacks in overvalued equity markets. The market widely expects the Fed, along with other central banks, to begin a rate-cutting cycle in the second half of the year, with bonds typically performing well ahead of the first cut. Hence, increasing bond exposure was the optimal strategy at that time. For instance, the US 10-year Treasury yield fell from its yearly high of around 5.0% to approximately 3.7% by the end of September, a 130-basis point drop that aligns with the Fed's dot plot forecast for median rate cuts, validating last quarter's predictions.

As of 19 September, data from the Investment Company Institute (ICI) shows that from July to September, total capital inflows into long-term US-registered funds and exchange-traded funds (ETFs) across all type of funds(covering all asset types such as equities) amounted to USD100.2 billion, with bond funds recording a near-total capital inflow of USD107.9 billion. This reflects the overwhelming capital influx into the bond market during this period. On a monthly basis, aside from July when global equities underwent adjustments, net inflows into all types al funds exceeded those into bond funds. However, bond funds saw net inflows surpassing all types of funds in both August and September. Notably, in September, while all types of funds saw a net outflow of USD7.7 billion, bond funds recorded an USD15.1 billion net inflow, reflecting investors' preference for bonds ahead of the Fed's first rate cut as they shed other asset classes to double down on bond holdings.

Monthly Captial Flows of US-registered ETFs & Long-term Funds



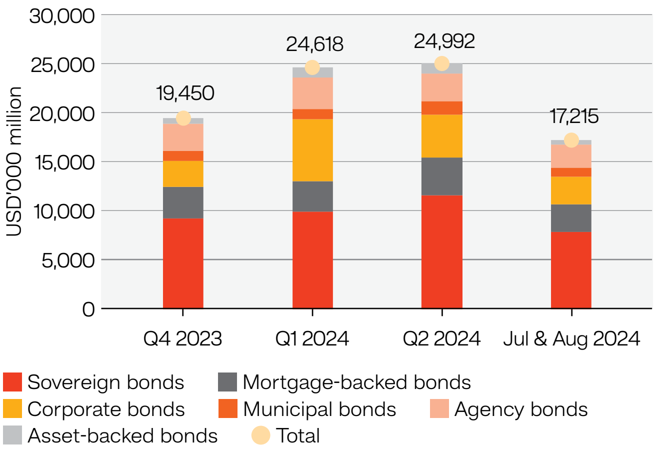
Source: Investment Company Institute, data as of 19 September 2024

Breaking down capital flows of bonds by category, corporate bonds ("taxable bonds") and government or municipal bonds ("munis") saw net inflows of USD92.9 billion and USD15.1 billion, respectively, accounting for approximately 86% and 14% of total value of bonds. Monthly data consistently showed positive figures, signaling a continuous global capital inflows into the bond market last quarter. This aligns with our analyses last quarter, which forecasts that corporate bonds would generally outperform government bonds ahead of the first rate cut – an outlook that has proven accurate.

Bond

To meet the robust demand for fixed-income products, bond issuers have actively ramped up supply throughout the year. According to data from the Securities Industry and Financial Markets Association (SIFMA), as of 20 September, the total issuance across all bond types in the first quarter this year reached around USD2.5 trillion, marking an approximately 27% quarter-on-quarter increase. The second quarter saw a similar issuance total of USD2.5 trillion. However, the issuance volumes in July and August dropped to just USD1.7 trillion, a nearly 31% decline compared to the second quarter. Even with the addition of September figures, it is unlikely that total issuance will match the previous quarter's total, reflecting issuers' orderly reduction in bond issuance in response to evolving demand conditions.

The Total and Individual Issuance Volume of US Bonds



Source: Securities Industry and Financial Markets Association (SIFMA); data as of 20 September 2024

An examination of bond issuance between public issuers (comprising sovereign bonds, municipal bonds, and agency bonds) and private issuers (comprising corporate bonds, mortgage-backed bonds and asset-backed bonds) reveals that public issuers consistently accounted for around two-thirds of total supply throughout various periods. This reflects the market's preference for highly rated public bonds. The overall data is as follows:

Periods	Proportion to Public Issuance (%)				Proportion to Private Issuance (%)			
	Sovereign bonds	Municipal bonds	Agency bonds	Total	Sovereign bonds	Mortgage-backed bonds	Asset-backed bonds	Total
Q4 2023	48	5	14	67	14	16	3	33
Q1 2024	40	4	13	58	26	13	4	42
Q2 2024	46	6	11	63	17	15	4	37
July & August 2024	46	5	14	65	16	16	3	35

Source: Securities Industry and Financial Markets Association (SIFMA); data as of 20 September 2024

Focusing on corporate bond issuance data, the first quarter of this year saw a near 1.4x surge in the issuance volume of compared to the previous quarter. However, the following two quarters experienced sharp declines of 31% and 36%, respectively, highlighting a significant reduction in corporate bond supply. By bond type, investment-grade corporate bonds remained the primary issuance, consistently representing over 80% of total corporate bond issuance, while convertible bonds had only sporadic issuance. This trend aligns with investor preferences, reflecting a broader strategy to use corporate bonds as a risk-balancing tool in portfolios. The overall data is as follows:

Periods	Investment-grade	High-yield	Convertible	Total
	USD'000 million			
Q4 2023	2,191	468	2	2,662
Q1 2024	5,371	889	31	6,290
Q2 2024	3,515	830	0	4,346
July & August 2024	2,389	400	2	2,791

Source: Securities Industry and Financial Markets Association (SIFMA); data as of 20 September 2024

Interest Rate Forecast: A Decision That Could Jeopardize the Future

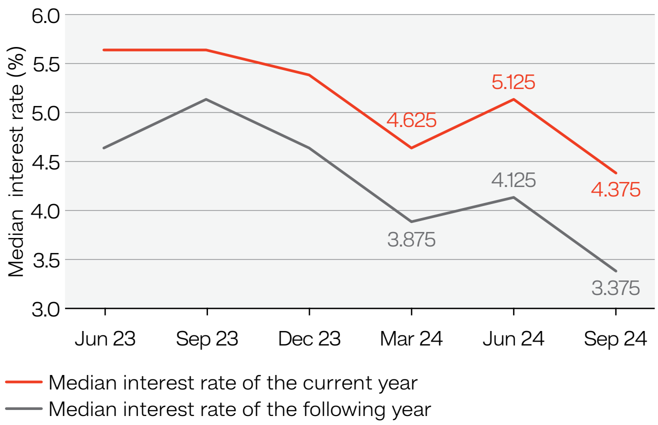
After nearly 14 months of a high-interest-rate environment, the Fed has finally announced a 50-basis-point rate cut. While asset prices reacted positively in the short term, market sentiment remains divided on the magnitude of the rate cut. Rather than delve into the arguments on either side, it's crucial to focus on the rationale behind Fed Chair Powell's decision and the implications of the Fed's dot plot for future market trends.

Looking back to late 2021, Powell publicly stated that high inflation was "transitory"[1], justifying the Fed's commitment to ultra-low interest rate policy. However, within months, the Fed suddenly initiated a rate-hiking cycle in March 2022. In May of the same year, Powell claimed that there was no active consideration of a 75-basis-point hike[2], yet in June, the Fed raised rates by 75 basis points. Subsequently, the Fed's post-meeting statements indicated that the 75-basis-point hike was not the norm[3] – only to follow up with three consecutive 75-basis-point increases. The Fed's rate maneuvers have left the market reeling, with many investors caught off guard.

As we have repeatedly emphasized in this section, historically, the Fed's rate cuts are driven by economic weakness, not simply a decline in inflation. This prediction has proven accurate once again. Powell and his committee members, have fixated on "data dependency", using the words of academics and pundits to shift the focus of rate cut decisions to inflation data. However, current inflation data cannot justify rate cuts, leaving Powell in a difficult position and undermining his own credibility.

Reviewing economic data from June to August, particularly the Fed's preferred inflation gauge, raises further questions. The core personal consumption expenditures (PCE) remained flat month-over-month, and core consumer price index (CPI) even rebounded. However, the Fed's updated inflation projections were essentially unchanged. What is the logic behind this? Additionally, GDP surged from 1.4% in the first quarter to 3% in the second quarter, hardly a sign of a weakening economy that would traditionally prompt a rate cut. Is the rate cut now out of the concern for inflation's resurgence, or to mask a sharp economic downturn? Powell has already admitted that the Fed should have cut rates earlier, before the labor market deteriorated following July's jobs report. This aggressive 50-basis-point cut may be an attempt to "catch up." What is puzzling, however, is that the Fed with earlier access to economic data, consistently lags in action. Even more perplexing is that, despite rising unemployment, the Fed raised its median interest rate forecasts for this year and next in the second quarter, only to backtrack now. In 2022, the Fed lagged behind inflation with its rate hikes; this time, it seems to be lagging behind unemployment with its rate cuts. The consistent lag is hard to ignore.

Median Interest Rates of the Current and Following Years in Fed's Dot Plot



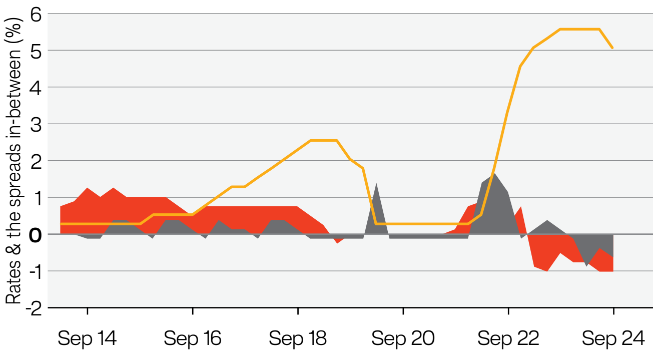
Source: Bloomberg, data as of 20 September 2024

A comparison of the Fed's dot plot median forecast with the actual fed funds rate and the following year's median forecast reveals a striking pattern. Since Jerome Powell took over as the Fed Chair in February 2018 through September this year – a span of 27 quarters – not once has the median forecast matched the then prevailing interest rate. The average discrepancy stood at 0.13%, with a standard deviation of approximately 0.60%, the probability of forecasts being lower than the then prevailing interest rate was as high as 63%. In contrast, during former Chair Yellen's term (2014 to February 2018), the average discrepancy was 0.11%, with a standard deviation of about 0.21%, and probability of forecasts being lower than the then prevailing interest rate was only 31%. This indicates that under Powell's leadership, the Fed has been more inclined to create rate cut expectations, often to no avail. The standard deviation (volatility of the discrepancy) during Powell's term was about three times higher than during Yellen's term, especially when interest rates were at their peak, with the discrepancy between forecasts and actual rates reaching the highest level in nearly a decade. How can businesses and investors make commercial decisions on such an unpredictable interest rate path? Where does that leave the notion of stable economic growth?

[1] See Reuters website, https://www.reuters.com/business/why-fed-chair-powell-still-thinks-high-inflation-is-temporary-2021-08-27/
[2] See Reuters website,https://www.reuters.com/world/us/feds-powell-75-basis-point-rate-hike-not-being-actively-considered-2022-05-04/
[3] See CNBC website, https://www.cnbc.com/2022/06/15/fed-hikes-its-benchmark-interest-rate-by-three-quarters-of-a-point-the-biggest-increase-since-1994.html
[4] See Reuters website,https://www.reuters.com/markets/rates-bonds/fed-might-have-cut-rates-july-meeting-powell-says-2024-09-18/

Bond

Spread Between Fed Funds Rates and Interest Rates Medians



Spread between median interest rates of the current and the following year
Spread between medians and fed funds rate of the current year
Fed funds rate

Source: Bloomberg, data as of 20 September 2024

Recently, Powell remarked that he sees no signs of an economic recession, emphasizing the strength of the US economy. He downplayed the significance of the 50-basis-point rate cut, claiming it "not a new rhythm". However, as the world's most influential central bank, the Fed's continuous missteps and abrupt decisions have left investors increasingly unsettled. Parsing Powell's statements for reassurance seems futile. The larger risk is that if the economy weakens while inflation rebounds due to continued aggressive rate cuts, stagflation could become a looming threat. Historically, US stagflation has often been triggered by geopolitical turmoil, such as conflicts in the Middle East (for details, please refer to last quarter's "Macro Strategy" section).

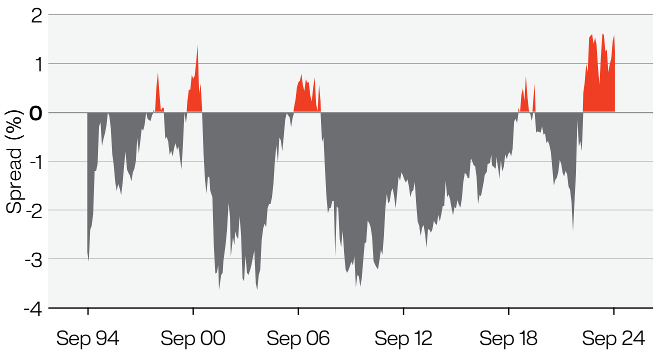
Ultimately, the Fed's erratic behavior appears to be suppressing market expectations and eroding confidence, making the public easier to manipulate. With the US presidential election and the ongoing China-US rivalry on the horizon, the challenges facing markets could be unprecedented, and focusing too much on the immediate picture may cloud judgment. Investors would be wise to adopt a broader, long-term perspective when devising their investment strategies.

We predicts that the Fed will cut rates by another 25 basis points each at both the November and December meetings this year. Additionally, we expect four more cuts of 25 basis points each in the first half of next year at the January, March, April and June meetings, totaling an additional 100 basis points (for more details, please refer to this quarter's "Macroeconomics" section). Certainly, this forecast is subject to change depending on how events unfold, and we will adjust our outlook accordingly.

Yield Forecast: Unemployment May Affect Trajectory

Historical monthly data from the past 30 years shows that the fed funds rate has remained below the US 10-year Treasury yield over 80% of the time, with a correlation coefficient of approximately 82% between the two. This suggests that changes in the fed funds rate will predominantly influence US Treasury yields, suggesting that bond yields are likely to remain higher than interest rates.

Fed Funds Rate Minus US 10-Y Treasury Yield Spread



Source: Bloomberg, data as of 21 September 2024

[5] See CNBC website, https://www.cnbc.com/2024/09/18/fed-meeting-live-updates-traders-await-september-interest-rate-cut.html

According to the Fed's latest dot plot, the median interest rate forecast for this year has been revised down from 5.125% to 4.375%. In line with this significant 75-basis-point quarterly drop, the extrapolated yields for the US 10-year and 2-year Treasuries using last quarter's investment models have been adjusted. As before, the model assumes US quarterly GDP growth will range between 0.5% and 2.0%, core PCE inflation between 2.3% and 2.6%, and the fed funds rate between 4.0% and 4.5%, based on the latest dot plot. The following matrix shows the extrapolated US 10-year Treasury yields:

		Core PCE (%)						
	GDP: 2.0%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Rate (%)	4.50	3.93	3.92	3.92	3.91	3.91	3.91	3.90
	4.25	3.80	3.79	3.79	3.79	3.78	3.78	3.78
	4.00	3.67	3.67	3.66	3.66	3.66	3.65	3.65
	GDP: 1.0%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Rate (%)	4.50	3.91	3.91	3.90	3.90	3.89	3.89	3.89
	4.25	3.78	3.78	3.77	3.77	3.77	3.76	3.76
	4.00	3.65	3.65	3.65	3.64	3.64	3.64	3.63
		Core PCE (%)						
	GDP: 1.5%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Rate (%)	4.50	3.92	3.91	3.91	3.91	3.90	3.90	3.90
	4.25	3.79	3.79	3.78	3.78	3.78	3.77	3.77
	4.00	3.66	3.66	3.66	3.65	3.65	3.64	3.64
	GDP: 0.5%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Ratea (%)	4.50	3.90	3.90	3.89	3.89	3.89	3.88	3.88
	4.25	3.77	3.77	3.77	3.76	3.76	3.76	3.75
	4.00	3.65	3.64	3.64	3.64	3.63	3.63	3.62

Source: Bloomberg, data as of 20 September 2024

The model's R-squared value is 0.84, and the F-statistic is 1.11, indicating a high level of reliability. The average US 10-year Treasury yield calculated from the above four matrices is 3.77%, with a standard deviation of 0.11% and a peak-to-trough range of 0.28%. Based on current trend of yield, we expect the US 10-year Treasury yield to hover between 3.50% and 3.67% this quarter. Applying the same analysis to the US 2-year Treasury yield, the corresponding matrices show:

		Core PCE (%)						
	GDP: 2.0%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Ratea (%)	4.50	3.33	3.33	3.33	3.33	3.32	3.32	3.32
	4.25	3.17	3.17	3.17	3.17	3.17	3.16	3.16
	4.00	3.01	3.01	3.01	3.01	3.01	3.00	3.00
	GDP: 1.0%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Ratea (%)	4.50	3.32	3.32	3.32	3.31	3.31	3.31	3.31
	4.25	3.16	3.16	3.16	3.15	3.15	3.15	3.15
	4.00	3.00	3.00	3.00	2.99	2.99	2.99	2.99
		Core PCE (%)						
	GDP: 1.5%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Ratea (%)	4.50	3.32	3.32	3.32	3.32	3.32	3.32	3.32
	4.25	3.16	3.16	3.16	3.16	3.16	3.16	3.16
	4.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
	GDP: 0.5%	2.60	2.55	2.50	2.45	2.40	2.35	2.30
Fed Funds Ratea (%)	4.50	3.31	3.31	3.31	3.31	3.31	3.31	3.31
	4.25	3.15	3.15	3.15	3.15	3.15	3.15	3.15
	4.00	2.99	2.99	2.99	2.99	2.99	2.99	2.99

Source: Bloomberg, data as of 20 September 2024

Bond

The model's R-squared and F-statistic values are 0.94 and 7.42, respectively, indicating a high level of reliability of the results and further suggesting that rate cuts have a more significant impact on short-term yields. The average US 2-year Treasury yield extrapolated form the above four matrices is 3.16%, with a standard deviation of 0.13% and a peak-to-trough range of 0.32%. Aligning with the current yield trend, the forecast of the 2-year US Treasury yield this quarter is expected to hover between 3.16% and 3.48%.

Additionally, Fed Chair Powell mentioned in his post-meeting statement that the Fed will place greater focus on unemployment rate and its impact. According to the economic forecasts from the Fed and Bloomberg for the fourth quarter this year and next, the overall data is as follows:

Indicators	2024 Q4 Forecast (%)		Indicators	2025 Q4 Forecast (%)	
	The Fed	Bloomberg		The Fed	Bloomberg
Fed Funds Rate	4.38	4.70	Fed Fund Rate	3.38	3.60
Core PCE	2.60	2.70	Core PCE	2.20	2.20
GDP YoY	2.00	1.80	GDP YoY	2.00	1.90
Unemployment Rate	4.40	4.40	Unemployment Rate	4.40	4.30

Source: Bloomberg, data as of 21 September 2024

Including the unemployment factor into the model, we recalculated the average and upper/lower bounds (set at a 95% confidence interval) of US 2-year and 10-year Treasury yields. The overall results are:

Extrapolated 10-Y US Treasury Yield for Q4 2024 and 2025 (%)			
2024	Lower Bound	Average	Upper Bound
The Fed	2.02	3.22	4.42
Bloomberg	2.15	3.36	4.57
2025	Lower Bound	Average	Upper Bound
The Fed	1.58	2.70	3.83
Bloomberg	1.65	2.77	3.90
Extrapolated 2-Y US Treasury Yield for Q4 2024 and 2025 (%)			
2024	Lower Bound	Average	Upper Bound
The Fed	1.95	2.97	3.98
Bloomberg	2.13	3.15	4.18
2025	Lower Bound	Average	Upper Bound
The Fed	1.38	2.33	3.29
Bloomberg	1.51	2.46	3.40

Source: Bloomberg, data as of 21 September 2024

Excluding the unemployment factor, the average of the US 10-year and 2-year Treasury yields this year are 3.77% and 3.16%, respectively. Including the unemployment factor, the Fed's forecast suggests that US 10-year and 2-year Treasury yields will drop to 3.22% and 2.97%, down by 0.55% and 0.19% respectively. Under Bloomberg's composite market forecast, the US 10-year and 2-year US Treasury yields are 3.36% and 3.15% respectively, down by 0.41% and 0.01% respectively. Including the unemployment factor, the R-squared and F-statistic values for the US 10-year and 2-year Treasury yield models are 0.90 and 2.17, and 0.94 and 1.83, respectively. These slight declines in test statistics do not undermine the analysis's reliability.

Overall, including the unemployment factor, the lower extrapolated yields of both the US 2-year and 10-year Treasuries suggest that rising unemployment could increase both the likelihood and magnitude of future rate cuts, with a greater impact on the Fed's forecast. The yield range for the US 10-year Treasury is about 2.4%, compared to 2.0% for the US 2-year Treasury, suggesting the greater impact of unemployment on long-term yield. Additionally, comparing the extrapolated yields of this year with the next year, the average yields for the US 10-year and 2-year Treasuries fall by approximately 0.37% and 0.31% respectively including the unemployment factor. We believe such fall is driven by downward revisions in the fed funds rate and core PCE forecast rather than the unemployment rate. Finally, both the Fed's and Bloomberg's forecasts show that the upper and lower bounds for Treasury yields narrow by around 0.15% in this year and the next, indicating a similar impact of each forecast on yield volatility.

Based on the yield extrapolation mentioned above, excluding the unemployment factor, the 10-year minus 2-year yield spread is expected to be positive by 19 to 34 basis points, marking the first positive forecast within the year. As of 20 September, this spread has already turned positive at 12 basis points, indicating the near end of the 27-month-long yield curve inversion.

The 10-year Minus 2-year US Treasuries Yield Spread

Source: Bloomberg, data as of 22 September 2024

As this section analyzed in the second quarter of this year, the 10-year minus 2-year yield spread would turn positive 3 to 6 months after the Fed's first rate cut, ultimately extending across the entire yield curve. This normalization of the yield curve will mark the completion of the process. For a detailed analysis, please refer to prior discussions in this section. Here, we turn our focus to investment strategies in light of this development.

Investment Strategy: Yield Curve Normalization Offers Prime Investment Opportunities

Since the Fed began its 16-month rate-hiking cycle in March 2022 with 11 rate hikes totaling 525 basis points, the US Treasury yield curve has been distorted, with its typical upward slope inverted. The inversion, which started on 5 July 2022, when the 10-year minus 2-year yield spread turned negative, theoretically signaled potential economic concerns and disrupted capital flows across personal and commercial loans, as well as currency markets.

Just as interest rates move in cycles, so does the yield curve. The reversion of the yield curve from inversion to a positive slope (known as "curve normalization") follows certain patterns. In the first and second quarters of this year, we highlighted that investors should increase their holdings of long-duration bonds (with maturities of 10 years more) when yields were still above 5%. This marked the first phase of positioning. As capital flowed into long-duration bonds and pushed yields lower, the "yield-seeking" strategy then shifted to short-duration bonds (with maturities under 10 years), where mid-term yields were expected to fall more sharply than long-term ones. This marked the second phase, creating a partial normalization.

With mid- and long-term yields already reflecting most of the anticipated rate cuts, short-term yields (typically under 2 years) remain more sensitive to actual rate cuts. Before the Fed officially announces rate cuts, short-term yields are anchored at relatively high levels, marking the third phase. During these first three phases, the yield curve takes on a "U" shape. In the final phase when the Fed officially starts cutting rates and continues doing so, short-term yields will fall in tandem with policy rates. The drop in short-term yields will be faster and more pronounced than in mid- and long-term yields, completing the normalization process as short-term yields fall below long-term yields.

The bond market is now in the final phase. As a result, investors should increase holdings of short-term fixed-income instruments to lock in the rare high yields return seen in the past 20 years. This aligns with the recent Wall Street trend of the "T-bill & chill" strategy, where significant capital is being allocated to money market funds and short-term interest rate instruments like Treasury bills[6].

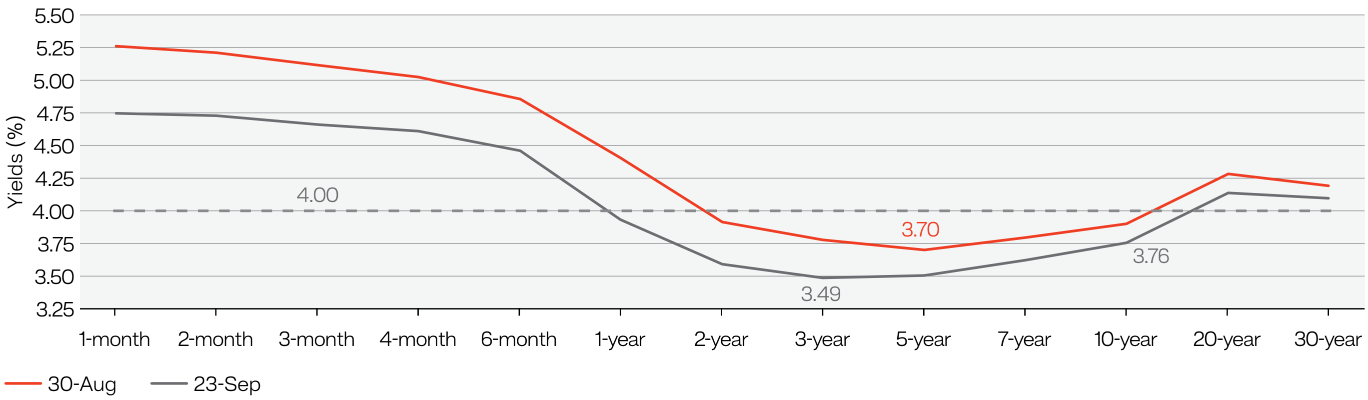
Duration Strategies: Tailoring to Fit

As discussed earlier, there is a strong positive correlation between the fed funds rate and US Treasury yields, and since bond prices move inversely to yields, the relationship is straightforward. Duration reflects the sensitivity of a bond's price to changes in yields, theoretically longer duration means greater volatility in bond prices. Taken the above analyses as a whole, we have emphasized that bond yields tend to decline ahead of the Fed's first rate cut, with the drop accounting for roughly 60% of the expected future rate cuts. Investors typically anticipate policy moves and position themselves accordingly. The Fed's September dot plot indicates a total of 200 basis points of rate cuts over the next two years (100 basis points each year). The US 10-year Treasury yield has already fallen from its peak of nearly 5% to around 3.7% by the end of September, a 130-basis-point drop that aligns with this historical pattern of capturing 60% of the anticipated rate cuts. In other words, unless the Fed significantly revises its dot plot downward in December, the downside potential for the US 10-year Treasury yield is now limited.

[6] See Bloomberg website, https://www.bloomberg.com/news/articles/2024-08-27/-t-bill-and-chill-is-a-hard-habit-for-investors-to-break

Bond

US Treasuries Yield Curve



Source: Bloomberg, data as of 23 September 2024

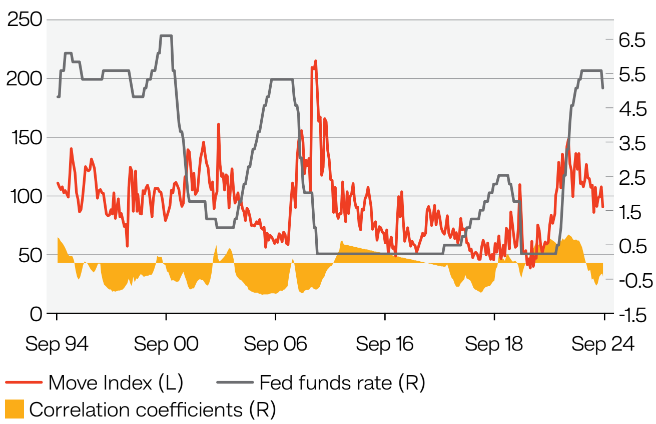
As of 23 September, the 2-year US Treasury yield stood at approximately 3.60%. Based on our earlier analysis, the 2-year US Treasury yield is expected to range between 3.16% and 3.48% for the rest of the year, suggesting there is still up to 44 basis points of downside potential, more than double the estimated 20-basis-point drop for the US 10-year Treasury yield, which is favourable for the performance of short-duration bonds. Moreover, with yield curve normalization still underway, the curve's trough has shifted from the 5-year maturity to the 3-year maturity. If normalization continues, the 2-year or shorter maturities could eventually become the new trough, suggesting that the sooner investors invest in shorter-duration bonds, the more they stand to benefit. Short-duration bonds also carry lower risk, making them a safer choice for conservative investors in the wake of the first rate cut.

Normalization also presents higher-risk investment opportunities. Investors could increase exposure to bonds with maturities over 10 years. Long-term yields are traditionally more sensitive to changes in inflation. As the Fed expects, inflation is likely to decline in an orderly manner, providing a path for long-term yields to decline further. Although the decline in yields may not be as steep as in short-term yields, the effect of duration means that bond prices will rise by a factor greater than 10 times. Conversely, if the Fed reduces the magnitude of rate cuts or inflation rebounds, yields could climb instead of fall, and the longer the duration of the bond, the greater the potential losses, highlighting that duration is indeed a double-edged sword. While the entire yield curve is expected to gradually decline, the process will likely be uneven and irregular. Long-duration bonds are more volatile and therefore may appeal to investors who are adept at timing market moves or are willing to take on higher risk.

A more sophisticated strategy involves creating a self-made long-short position without principal, primarily by going long on short-duration bonds and shorting long-duration bonds, and adjusting the portfolio's allocations regularly based on volatility to capture the spread. The greater the yield volatility, the higher the potential profits. Historically, turning points in interest rates are rare and present a prime opportunity for seasoned investors to capitalize. However, such a strategy demands more advanced analysis and trading expertise, which will not be covered here.

Looking at the monthly data over the past 30 years, the trends in the fed funds rate and the MOVE Index appear to be inversely correlated. Of the 31 rate-cutting months we analyzed, approximately 84% showed a negative correlation, suggesting that yields tend to experience significant volatility during rate cuts, benefitting momentum-driven investors.

MOVE Index, Fed Funds Rate and the Correlation Coeffeficents In-between



Source: Bloomberg, data as of 23 September 2024

In summary, yield curve normalization offers various investment opportunities, such as increasing short-duration bond holdings to lock in high yields, and speculations on the price volatility of long-term bonds. Alternatively, as the yield curve is shifting towards an upward slope, investors can exploit the spread between long-term and short-term yields to generate returns. These investment opportunities, rare in many years, offer strategies suited to different risk profiles.

Other Strategies: Opportunities in Corporate Bonds and Non-US Bond Markets

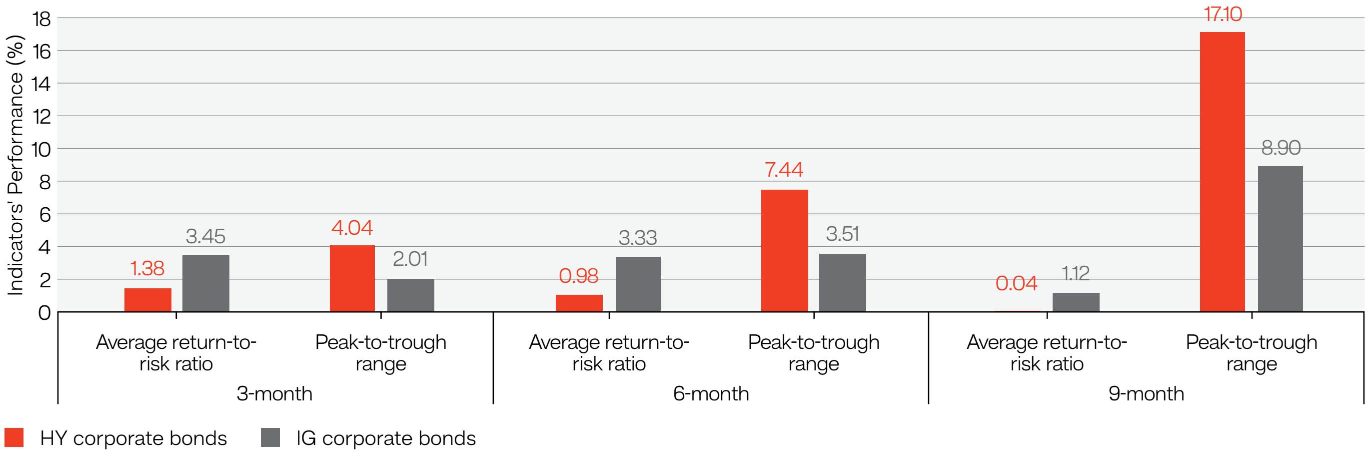
Data indicates that interest rate cycles typically last several years, with a decade or more between cycles, making the current yield curve normalization a rare occurrence. Investors should seize this opportunity, but there are also attractive investment prospects in other bond markets.

Corporate Bonds: Investment-Grade Bonds More Attractive Post-Rate Cut

In our previous analysis of last quarter before the first rate cut, we noted that high-yield (HY) corporate bonds generally outshine investment-grade (IG) bonds. But what happens after the first rate cut? Drawing on the monthly data over the past 30 years, we analyzed the impact by defining a "rate-hiking cycle" and a "rate-cutting cycle" as periods with at least three consecutive rate hikes or cuts, anchoring the first rate cut as the pivotal event. Instances where the above conditions were met occurred in 1995, 2001, 2007 and 2019. We then compared the performance of HY and IG bonds over 3, 6 and 9 months after the first rate cut, using the average return divided by standard deviation ("ratio") and the peak-to-trough range ("maximum volatility") over these four instances. This approach emphasizes not just returns but also higher-level risk-adjusted investment strategies.

The results show that in the first 3 months after the first rate cut, IG bonds outperformed. The average return-to-risk ratio for IG was 3.45%, more than double the HY's 1.38%, and the maximum volatility for IG was only half that of HY. After 6 months, the gap widened further, with IG bonds delivering an average return-to-risk ratio nearly 3.4 times higher than HY, and their maximum volatility was just 47% of that of HY. After 9 months, IG continued to hold a similar volatility advantage, with an average return-to-risk ratio nearly 28 times higher than that of HY. Notably, the main driver was the 9 months post-July 2019 when the global pandemic caused capital to flee HY markets, resulting in an average return of negative 9.21%. In short, while HY bonds tend to outperform before the first rate cut, IG bonds dominate afterward.

Indicators' Performance of the Bloomberg USD HY and IG Corporate Bond Indices Across Various Periods



Source: Bloomberg, data as of 21 September 2024

Bond

We also analyzed the impact of the magnitude of the first rate cut. Among the four instances, only September 2007 saw a 50-basis-point cut. The overall data is as follows:

Instances qualifying for first rate cuts (%)		
Month in which the first rate cut occurred	The then prevailing interest rate	Magnitude of rate cut
July 1995	5.75	-0.25
January 2001	5.50	-1.00
September 2007	4.75	-0.50
July 2019	2.25	-0.25
Rate of return across various period after the first rate cut in 2007 (%)		
Periods after the first rate cut	HY Corporate Bonds	IG Corporate Bonds
3 months	0.99	2.59
6 months	-1.43	3.91
9 months	2.84	2.54

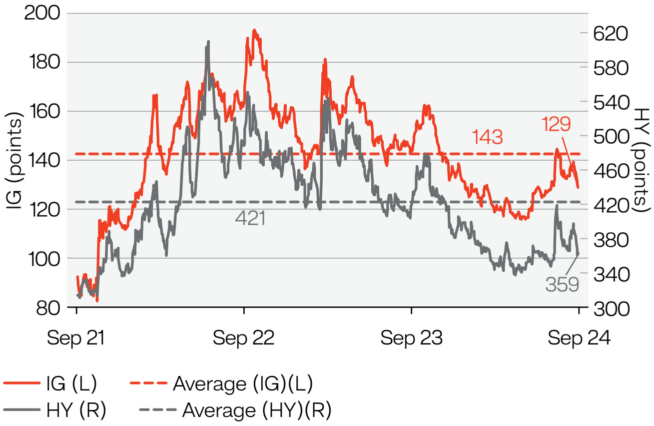
Source: Bloomberg, data as of 21 September 2024

Further analysis of the 2007 instance shows that in the 3, 6 and 9 months after the first rate cut, 5 out of 6 datasets recorded positive values, with the exception of HY corporate bonds which saw a slight decline of negative 1.43% after 6 months. From a return perspective, a 50-basis-point rate cut generally results in positive returns for both IG and HY corporate bonds. However, considering the average and standard deviation of the 6 datasets (1.91% and 1.88% respectively), the ratio is only 1.01, indicating that risk-adjusted returns were not particularly compelling. Therefore, investors should not focus solely on the magnitude of the first rate cut when considering corporate bond investments, but should also account for timing and credit ratings in their overall strategy.

Additionally, this section previously analyzed how a prolonged period of high interest rates in the US could lead to a larger global financial crisis (for details, please refer to our analysis published in the second quarter). Over the past 50 years, there have been only two instances where high-rate environments persisted for more than 12 months: 1998 (17 months) and 2007 (14 months). After the Fed's 50-basis-point rate cut in September 2007, the global financial crisis erupted in September 2008 – exactly one year later. Coincidentally, the current high-rate environment has also lasted 14 months. Although the Fed continues to express optimism about the economic outlook, experienced investors may read between the lines.

Comparing the credit spreads of US dollar-denominated IG and HY bonds, as of 20 September, IG spreads stood at 129 points and HY spreads at 359 points, both below their 3-year averages of 143 and 421 points, respectively, representing a spread of about 10% (IG) and 15% (HY) respectively. This suggests that IG bonds have more upside potential.

USD IG & HY Credit Spreads and Their Averages



Source: Bloomberg, data as of 21 Sep 2024

US equity market volatility also influences the performance of USD-denominated corporate bonds. Referencing to the correlation coefficients analysis between credit spreads and the S&P 500 Volatility Index (VIX) over the past five years, we find that the proportion of instances recording positive correlations exceeds 80% for both IG and HY bonds. This indicates that a rising stock market (declining VIX) tends to boost bond prices (compressing credit spreads), and vice versa. The average correlation coefficients are 0.4 for IG and 0.5 for HY, reflecting moderate influence (generally, a coefficient above 0.7 indicates a "significant impact"). This also implies that adding bonds to a portfolio helps diversify risk. The maximum and minimum correlation values for both IG and HY are the same, with the maximum at 1 (indicating a perfect positive correlation) and the minimum at -0.7 (indicating a strong negative correlation), highlighting that in extreme scenarios, US equities can have a substantial impact on bond markets. The overall data is as follows:

Correlation coefficients with VIX (%)		
Proportion of instances recording positive values	IG	HY
	80.0	84.4
Other indicators		
Average	0.4	0.5
Maximum	1.0	1.0
Minimum	-0.7	-0.7

Source: Bloomberg, data as of 23 September 2024

Non-US Bond Markets: Top Performers Are Rightfully So

The US dollar interest rate remains the primary driver of global capital flows. When the turning point of interest rates is reached, the spillover effect will undoubtedly ripple through the sovereign bonds of non-US countries. The largest risk is a deterioration in default rates, which is measured by Credit Default Swaps (CDS), as commonly used by the market as a key indicator. Below is a table summarizing the 1-year CDS levels of major global sovereign bonds as of 21 September, along with their gap from peak, average, and trough levels over the past one and three years:

G7 (Non-US)							
Countries	Current level (points)	1 year: Gap between the current level and indicators (%)			3 years: Gap between the current level and indicators (%)		
		Peak	Average	Trough	Peak	Average	Trough
Canada	10.6	-46.9	-14.6	15.1	-54.2	-26.6	26.7
The UK	10.2	-50.2	-19.3	37.8	-50.2	-18.8	48.3
France	13.2	-16.7	38.7	99.6	-16.7	52.0	173.3
Germany	5.1	-51.3	-15.2	68.0	-73.0	-18.4	109.5
Italy	17.6	-29.7	9.0	31.1	-29.7	9.0	31.1
Japan	6.5	-41.1	6.5	85.9	-54.7	4.1	85.9
Averages	10.5	-39.3	0.8	56.3	-46.4	0.2	79.1
Europe							
Countries	Current level (points)	1 year: Gap between the current level and indicators (%)			3 years: Gap between the current level and indicators (%)		
		Peak	Average	Trough	Peak	Average	Trough
The UK	10.2	-50.2	-19.3	37.8	-50.2	-18.8	48.3
France	13.2	-16.7	38.7	99.6	-16.7	52.0	173.3
Germany	5.1	-51.3	-15.2	68.0	-73.0	-18.4	109.5
Portugal	11.4	-17.9	15.7	43.2	-17.9	15.7	43.2
Italy	17.6	-29.7	9.0	31.1	-29.7	9.0	31.1
Ireland	8.2	-35.8	-1.8	92.8	-44.4	-5.7	92.8
Greece	20.5	-8.8	28.4	55.2	-8.8	28.4	55.2
Spain	10.4	-9.8	21.1	58.9	-9.8	21.1	58.9
Average	12.1	-27.5	9.6	60.8	-31.3	10.4	76.5
Asia-Pacific							
Countries/ regions	Current level (points)	1 year: Gap between the current level and indicators (%)			3 years: Gap between the current level and indicators (%)		
		Peak	Average	Trough	Peak	Average	Trough
Australia	6.2	-36.3	-0.1	30.0	-57.7	-13.9	39.5
New Zealand	8.5	-28.2	23.8	50.3	-48.1	0.7	50.3
South Korea	24.0	-31.0	-6.4	24.5	-47.7	-4.1	132.1
Chinese Mainland	30.5	-26.6	1.2	37.8	-39.8	11.6	193.4
Hong Kong	18.1	-47.7	-11.1	35.3	-47.7	8.2	105.7
Average	17.4	-34.0	1.5	35.6	-48.2	0.5	104.2
South Asia							
Countries	Current level (points)	1 year: Gap between the current level and indicators (%)			3 years: Gap between the current level and indicators (%)		
		Peak	Average	Trough	Peak	Average	Trough
India	20.6	-41.5	-4.3	65.9	-64.8	-37.0	65.9
Indonesia	26.4	-23.3	7.9	36.1	-56.4	-5.1	38.9
Malaysia	17.3	-47.3	-17.0	9.9	-59.9	-23.1	47.6
Vietnam	46.2	-39.6	-18.8	13.0	-41.1	-9.3	56.0
Thailand	12.0	-55.1	-4.6	33.0	-66.9	-19.1	93.2
Average	24.5	-41.4	-7.3	31.6	-57.8	-18.7	60.3

Source: Bloomberg, data as of 21 September 2024

Bond

The evaluation criteria is that the lower the current level, the better; and the smaller the gap between the current level and all indicators of each period, the better. The data shows that in terms of current level, the G7 countries perform best, which comes as no surprise. In terms of the gap between the current level and all indicators, all South Asian countries stand out, indicating that while default rates in the region remain higher, they have improved significantly in recent years, offering favorable conditions for higher-risk investments. Among the G7, Canada ranks highest, followed by the UK, Germany and Italy in Europe. In the Asia-Pacific and South Asian regions, Australia and Thailand stand out, reflecting their relatively attractive risk profiles.

After considering risk, the next question is about returns. The market commonly uses the yield spread between 10-year sovereign bonds and either US Treasuries or German Bunds as a benchmark. The performance is as follows:

G7(Non-US)		
Countries	Yields (%)	Yield Spread with US Treasuries (points)
The UK	3.9	15.7
Italy	3.6	-19.3
France	3.0	-78.3
Canada	2.9	-79.5
Germany	2.2	-154.0
Japan	0.8	-291.5
Average	2.7	-101.2

Europe		
Countries	Yields (%)	Yield Spread with German Bunds (points)
The UK	3.9	169.3
Italy	3.6	134.2
Greece	3.2	97.5
Spain	3.0	78.5
France	3.0	75.2
Portugal	2.8	55.4
Ireland	2.6	35.2
Average	3.1	92.2

South-east Asia		
Countries	Yields (%)	Yield Spread with US Treasuries (points)
India		301.6
Indonesia	6.4	268.5
Malaysia	3.7	-5.5
Singapore	2.5	-127.3
Thailand	2.4	-129.8
Average	4.4	61.5

Asia-Pacific		
Countries/ regions	Yields (%)	Yield Spread with US Treasuries (points)
New Zealand	4.2	41.4
Australia	3.9	17.1
South Korea	3.0	-75.1
China	2.0	-171.6
Average	3.3	-47.1

Source: Bloomberg, data as of 21 September 2024

The evaluation criterion is straightforward – the higher, the better. On a regional basis, South Asia leads, followed by the Asia-Pacific region. Among the G7 and Europe, the UK outperforms, while New Zealand and India are the best performers in the Asia-Pacific and South Asia, respectively. Overall, ranking countries purely by yield spreads, India, Indonesia and the UK take the top three spots, mirroring the earlier CDS analysis. This consistency underscores that top performers are rightfully so.

Chapter Summary:

- Bond market cooled notably in the last quarter compared to the first half of the year, with a clearer capital allocation expected in the future
- Interest rate forecasts should rely on real data rather than the Fed's words and actions, with at least another 50 basis points of rate cuts during the year
- Short-term yields are likely to fall faster than long-term yields, and the long-standing yield curve inversion is expected to disappear
- Yield curve normalization offers various investment opportunities for different risk profiles, with both corporate bonds and non-US bond markets presenting viable options

BEA Union Investment – Investment Teams

Outlook for China and Asian Bond Markets

Rate Cuts Favor Asian Bonds, but US Election Could Bring Market Volatility – Watch High-Yield Bonds in the Short Term

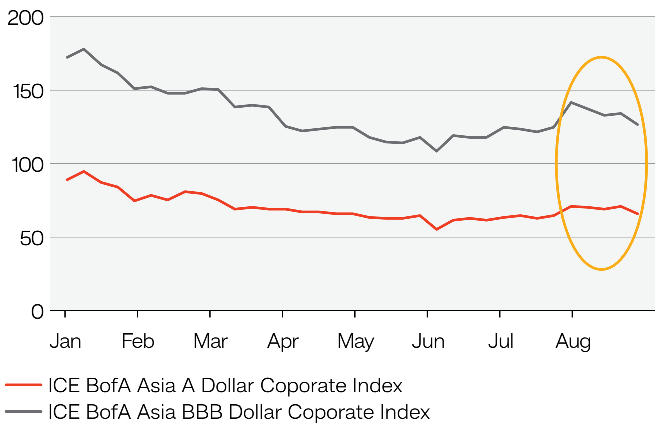
The Fed's monetary policy focus has shifted from solely combating inflation to fulfilling its dual mandate: stabilizing prices while promoting employment. With inflation cooling and the labor market showing signs of weakness, it is expected to cut rates faster than the market currently anticipates. BEA Union Investment predicts that interest rates could fall to around 3% within the next two years, implying a potential 200 basis points of rate cuts. Given the inverse relationship between interest rates and bond prices, rate cuts will likely support a rise in bond prices. Based on which, our team is seeking moderate extension of portfolio duration, as longer-duration bonds have greater potential for price appreciation during a rate-cutting cycle.

In respect to Asian investment-grade bonds, we hold a positive view on South Korean and selected Chinese bonds. Despite the solid fundamentals of Asian high-yield bonds, short-term performance may be hindered by market volatility. Therefore, our team maintains a cautious stance for the short-term outlook but remains optimistic about their long-term prospects.

Volatile Markets Present Credit Spread Opportunities in Investment-Grade Bonds

In a volatile market environment, there is a noticeable credit spread disparity between Asian investment-grade bonds with difference credit ratings across various sectors, offering numerous investment opportunities. For instance, A-rated bonds have seen their credit spreads narrow significantly, while BBB-rated bonds still offer relatively wide spreads, rendering them particularly attractive.

Credit Spreads in Asian Investment-Grade Bonds This Year



Source: Bloomberg, data as of 31 August 2024

Among various regions, we are particularly bullish on South Korean financial-related bonds due to their solid and defensive nature. South Korean banks, supported by stringent regulatory frameworks, boast strong balance sheets and liquidity. Coupled with a robust local financial system, banks are well-equipped to withstand risks. South Korea is the largest issuer of USD-denominated investment-grade bonds in Asia, with recent issuances primarily from quasi-sovereign entities, banks and securities brokerages, all of which generally have high credit ratings and are well-received by investors. For instance, in July, a major South Korean bank issued Additional Tier 1 bonds, which saw strong investor demand, prompting the bank to increase the issuance size to US$550 million, while successfully lowering the coupon rate to 6.375%[1]. This demonstrated the market's confidence in South Korea's financial sector.

In August, many Chinese bonds, including those from the technology, media, and telecommunications (TMT) sectors as well as state-owned enterprises, experienced profit-taking. However, we remain optimistic about China's investment-grade TMT bonds. While some e-commerce giants posted second-quarter results below market expectations, from a bond investment perspective, a company's leverage ratio and financial health are more critical than its growth prospects. Currently, Chinese TMT companies have solid credit profiles and generate stable, long-term cash flows. If the market correction occurs, we will consider adding high-quality Chinese bonds at attractive valuations.

[1] See The Korea Economic Daily website, https://www.kedglobal.com/banking-finance/newsView/ked202407180017

Bond

Asian High-Yield Bonds: Low Default Risk but Watch for Short-Term Volatility

Inflationary pressures in Asia are relatively mild compared to other mature markets, while the central banks within the region have adopted a more moderate pace of rate hikes. Many companies have been refinancing through local currency bond markets or bank loans, leading to early redemption of USD-denominated bonds. This has led to a decrease in the supply of USD-denominated Asian high-yield bonds, coupled with limited new issuance, which is favorable for bond performance. Currently, about 70% of Asian high-yield bonds are rated BB, higher than the 50% in the US. Additionally, excluding Chinese high-yield real estate bonds, the default rate for Asian high-yield bonds is below 1%, compared to 2% in the US.

BEA Union Investment is particularly attentive to the short-term volatility that may arise from the upcoming US presidential election concerning Asian high-yield bonds. However, from a long-term perspective, we remain optimistic given the stable fundamentals and ample investment opportunities of Asian high-yield bonds across regions and sectors. Many Indonesian and Indian high-yield bond issuers exhibit strong credit profiles and robust cash flows.

In Indonesia, for example, many corporate bonds are set to mature within the next two years. Issuers with sound financials are well-positioned to refinance through various channels or to redeem existing bonds early. We are particularly interested in the real estate and energy sectors. India is currently a major issuer of high-yield bonds in the region, offering investment opportunities across diverse sectors, including clean energy, airports, toll roads, and non-bank financial institutions, all of which generate stable cash flows.

In China, the property market continues to struggle. In August, the top 100 developers' home sales fell by nearly 27% year-on-year, a sharper decline than the 19.7% drop in July . Despite such figure, many private companies are still able to service their USD-denominated debt, and numerous SOEs have been able to secure refinancing from banks. We are particularly bullish on developers that have successfully refinanced and those with commercial properties, as the latter have better access to financing. Additionally, high-quality short-term Chinese real estate bonds are worth noting.

The investment philosophy of "cash is king" will likely conclude as the rate-cutting cycle begins. Rate cuts will support Asian bond prices, narrowing spreads for investment-grade bonds and alleviating interest expenses for high-yield bonds. However, the market may experience volatility leading up to the US presidential election, and high-yield bonds could be relatively susceptible to fluctuations, necessitating caution.

Chapter Summary:

- Monetary easing is expected to drive bond prices higher
- Credit spread disparity in Asian investment-grade bonds creates investment opportunities
- Watch for the impact on high-yield bonds from market volatility caused by the US presidential election
- Market corrections may present opportunities to accumulate high-quality Asian bonds at more attractive valuations

BEA Asset Navigator

Investment Themes

Investors should be aware of the spillover risks stemming from the US presidential election after positive factors are priced in.

- The Republican and Democratic presidential candidates have significantly different stances on the future US economic and foreign policies. Investment strategies must remain flexible and adjust in response to the election outcome.
- Potential risks during post-election power transition period include intensified internal divisions within the US, escalation of geopolitical conflicts and accelerated "de-dollarization".
- Given the economic downturn, the rate-cutting cycle and geopolitical risks, investors may consider increasing positions in European and US bonds, as well as value, defensive and dividend-paying equities in mature markets.

Rate cuts by European and the US central banks are expected to provide only a temporary lift to local equity markets.

- Market sentiment is expected to surge ahead of the US presidential election, benefiting high-beta stocks, but these stocks are likely to face heightened selling pressure post-election.
- The next US president will have a profound impact on US foreign policy. A managed economic decline in Europe and the US would favor value and defensive equities.
- Asian equities are likely to benefit from global rate cuts, but the negative effects of geopolitical tensions and Western sanctions on China are expected to spill over into the region's economy.

The global rate-cutting cycle is favorable for various bond markets.

- US yield curve normalization: a widening decline in short-term rates is expected to push bond prices higher, while fluctuations in long-term rates could present opportunities for duration-based speculation
- Credit spread trends indicate that corporate bonds still have upside potential. After the first rate cut, investment-grade corporate bonds are expected to outperform high-yield corporate bonds.
- Default rates in non-US bond markets have generally improved compared to pre-pandemic levels. When factoring in returns, the bond markets of Indonesia, India, and the UK appear more attractive.

Asset Class Overview

↑ Outperform → Neutral ↓ Underperform

Asset Class	Quarterly View	Commentary
		Equities
United States	↑	Fed signals aggressive rate cuts over next two year, boosting investors' sentiment amid stable economic outlook
Europe	↑	Historical data shows European equities poised to benefit ahead of US Election; ECB & other central banks expected to follow Fed's lead on rate cuts
Asian ex-Japan	→	China's economy faces potential weakness despite global rate cuts, dampening regional investment sentiment
Chinese Mainland	→	RMB stabilization and eased fiscal and monetary policies to aid Chinese corporate earnings recovery, yet US presidential election poses greater uncertainty
Hong Kong	↑	Hong Kong's property sector to rebound as HIBOR follows fed rate cuts; high-yield sectors such as utilities, telecom and conglomerates also set to benefit
		Bonds
US Government	↑	Yield curve normalization favors US Treasuries; short-term rate cuts support prices, long-term rate volatility offers trading opportunities in relation to duration
USD Investment-grade	↑	Data shows strong performance 3-6 months after initial rate cut; gradual economic slowdown in the US could attract safe-haven flows
Global High-yield	→	Equity rally likely to moderate ahead of initial rate cut, yet credit spreads to support bond prices in the short term
USD High-yield	↑	US economy not heading for recession, "yield-seeking" capital with high risk tolerance to continue supporting bond prices, albeit with weakened momentum
Asian Pacific Investment-grade	↑	Data shows Fed rate cuts benefit emerging market bonds, with Asian default risks improve significantly post-pandemic
		FX
AUD	↑	RBA's hawkish stance differentiate it from global central banks, strengthening AUD's rate spread advantage
NZD	↑	New Zealand's economic growth resumes, but any contraction could prompt RBNZ to accelerate rate cuts
EUR	↑	ECB expected to have less aggressive rate cut than Fed, likely boasting EUR
GBP	↑	UK economy shows signs of growth, suggesting no rush for BOE to cut rates
JPY	↑	Narrowed rate spread between Yen & USD points to Yen strength with limited downside risks
RMB	→	Market expects further stimulus to bolster economic recovery; RRR cuts offer more room than rate cuts

Important Note:

Quarterly view of each asset class is benchmarked against a corresponding proxy index

Asset Class	Benchmark	Asset Class	Proxy Index	Threshold*	Asset Class	Proxy Index	Threshold*
Equities	MSCI World	US	S&P500	1.1%	China	CSI300	4.3%
		Europe	STOXX Europe 600	1.6%	Hong Kong	Hang Seng	3.3%
		Asian ex-Japan	MSCI Asia ex Japan	2.8%			
Bonds	Bloomberg Global Aggregate Bond	US Government	US Gov't/Credit	0.8%	USD Investment-grade	US Corporate High-yield	1.5%
		USD Investment-grade	US Corporate	0.8%	Asian-Pacific Investment-grade	Asian-Pacific Aggregate	0.9%
		Global High-yield	Global High-yield	1.8%			
FX	US Fed Trade Weighted Advanced Foreign Economies	AUD	AUD/USD	2.8%	GBP	GBP/USD	2.7%
		NZD	NZD/USD	3.2%	JPY	JPY/USD	3.1%
		EUR	EUR/USD	4.0%	CNH	CNH/USD	2.2%

* Outperform: Quarterly performance of proxy index is higher than the positive threshold percentage of corresponding benchmark; Neutral: Quarterly performance of proxy index within the positive and negative threshold percentages of corresponding benchmark; Underperform: Quarterly performance of proxy index is lower than the negative threshold percentage of corresponding benchmark.

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