Investment Perspective

Investment perspective | Time to stop ignoring global equities?

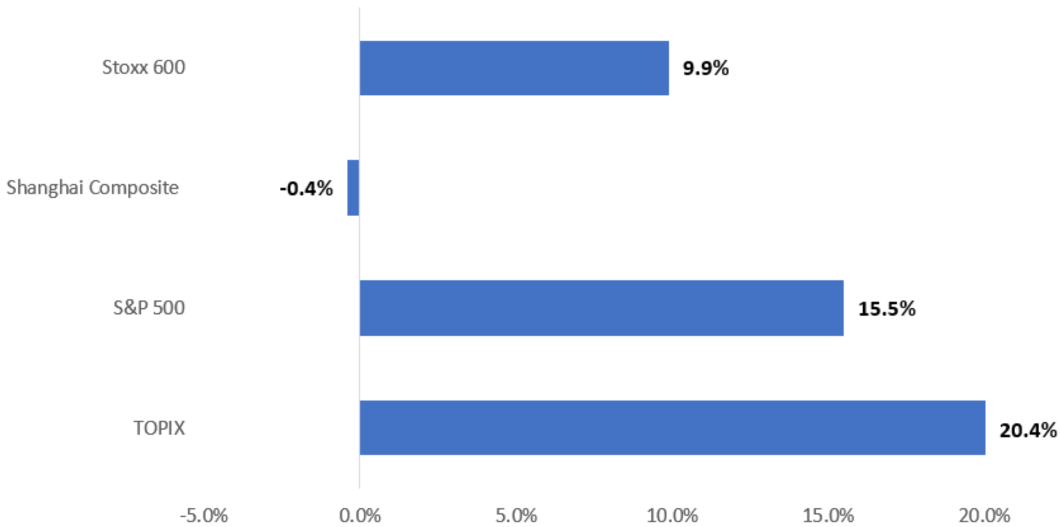
Investors' appetite for global equities is returning as the macroeconomic outlook improves

Global equities are up nearly 12 percent so far this year, a stark contrast to 2022 when the MSCI All-Country World Index (MSCI ACWI) dropped more than 20 percent after being hit by high inflation and high interest rates.

US equities have been a key contributor to this rise, having gained 16 percent year to date. The US is home to the world's largest stock market, and accounts for about 60 percent of global equity indices.

Japan, the next largest, is one of the best performing markets globally with the TOPIX up by 20 percent so far this year in local currency terms.

Fig 1: Performance of key market indices, year to date



Source: Bloomberg, as at 23 August 2023, in local currency terms

Why take the equities plunge?

Global equities appear poised to maintain this momentum, supported by four key drivers:

1. Unexpectedly resilient growth

In its latest World Economic Outlook, the International Monetary Fund (IMF) raised its projection for global real gross domestic product (GDP) growth to 3 percent in 2023, up 0.2 percent from its April forecast.

The IMF say economic activity across the world has proved more resilient than expected. Despite several warnings at the start of the year, forecasts of a severe global recession have not come to pass. The global Purchasing Managers' Index (PMI) remains above 50[1], the threshold between contraction and growth.

2. Services-driven expansion

Much of the US's current economic activity is being driven by services. Meanwhile manufacturing and trade is lagging given China's slugging growth.

Traditionally, a manufacturing downturn would be expected to spill over to other parts of the economy. However, in the current cycle, it appears that many service sectors have yet to return to their pre-COVID levels of employment.

This lends strength to UOB Asset Management's view that a deep recession is unlikely. Instead, service sectors have room to keep growing, enabling them to compensate for the drop in goods demand and crucially, help support strong employment levels.

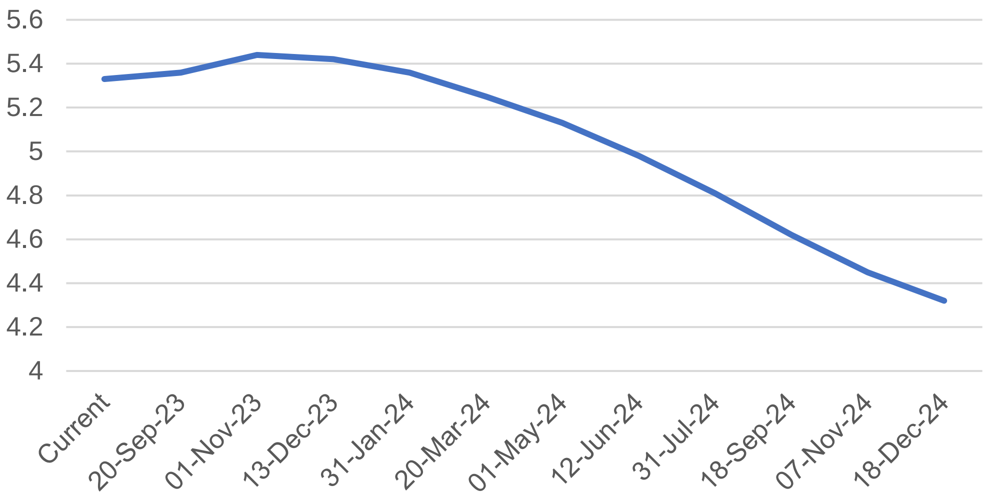
3. **Inflation easing not a one-off**

While in major economies, inflation is still above the 2.0 percent target, prices have shown signs of cooling for several consecutive months. In the US for example, July's core inflation rate – which excludes the prices of food and energy – is the lowest since October 2021.

As such, reasons for the US Fed to keep hiking interest rates are dissipating. Looking ahead, it is unlikely that interest rates will rise much further in the US. As more parts of the CPI data improve, the Fed to looks set to pause, then possibly cut rates. We don't expect this to be a quick process, but it is nevertheless positive for global equity markets.

[1] Source: Global IHS Markit, Bloomberg, 31 July 2023

Fig 2: Implied Fed policy rate (%)



Source: Bloomberg, 17 August 2023

4. Equities now more on-trend

Global fund managers have significantly pared back their net underweight positions in global equities from 24 percent in July to 11 percent in August[2]. Not only are risk appetites increasing, but there is also a greater demand for real returns (i.e. returns net of inflation).

If, as we suspect, inflation stays structurally higher, over time a bond's income payments will generally lag in terms of real returns because bonds pay a fixed income that does not change.

On the other hand, companies have the ability to grow their earnings above the inflation rate. As such, the combination of capital gains and dividends offered by equities have the potential to keep pace with high prices.

Risks

- The biggest tail risk for global equity markets is if inflation pressures pick up again, forcing central banks to keep up their rate hikes.
- China's faltering economy could also weigh on global growth. For instance, weaker consumer spending in China could impact exporters to China as demand cools.

Ultimately, sustained equity market performance would depend on whether the economy can continue to weather high interest rates and defy recession expectations. Based on our economic analysis, we expect this to be the case and as such, have a slight equities overweight within our multi-asset portfolios.

[2] Bank of America's global fund manager survey, August 2023

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