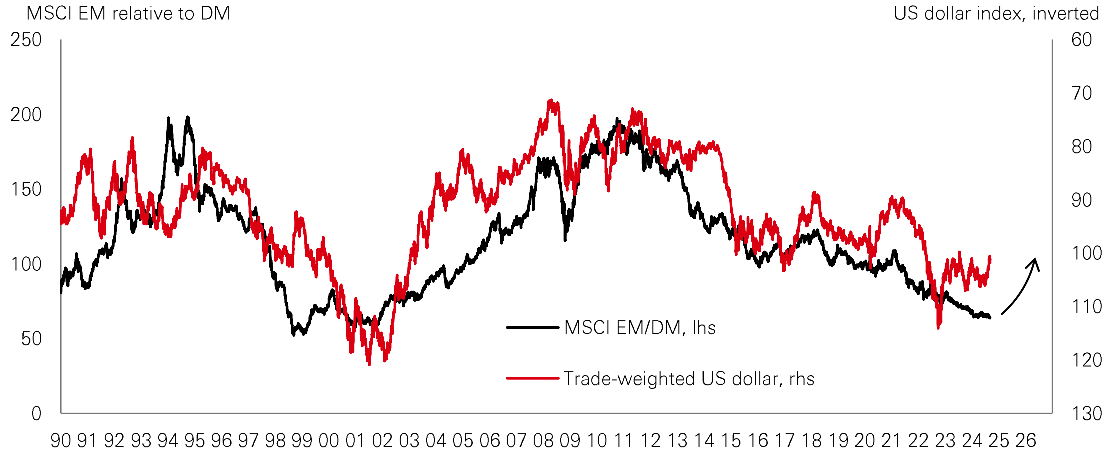
Investment Weekly

9 September 2024

Chart of the week – Emerging rotations



Risk assets have broadly recovered from August's sharp sell-off, but not all market moves have unwound. On evidence of cooling US economic activity and lower inflation, traders now expect 1.25% of Fed rate cuts by the end of 2024 – up from the one to two cuts expected in early summer – and **that is putting pressure on the US dollar**.

Dollar weakness opens the door for other central banks to ease policy, to support their domestic economies.

So far, ASEAN has been the region to watch. A weaker dollar, the region's high sensitivity to Fed policy, and ongoing disinflation, have set the scene for cuts. The Philippines central bank went first in August (reducing rates by 0.25%, and some analysts think Bank Indonesia could soon follow. While there is divergence across the region, ASEAN countries like Indonesia benefit from a resilient macro backdrop, reasonable asset valuations and structural tailwinds like favourable demographics and supportive industrial policies. They've also been shielded from the volatility in global technology stocks and resisted the impact of strong moves in the Japanese Yen.

Investors are reacting to this. **ASEAN saw one of the strongest performances in global equities in August, and quarter-to-date** – led by the Philippines, Indonesia, and Malaysia. But other EM regions are in the mix, too. Emerging Europe and Frontier regions have also done well. And while not all EMs have yet benefitted, a 'great rotation' in performance could continue to see a pick-up for the laggards.

Yield Curve →

What a dis-inverting yield curve means for economies

Private Equity →

Signs of a pick-up in deal-making activity

Global Power →

Shifting dynamics of the global economic landscape

Market Spotlight

Tech stocks boost the Hang Seng

Hong Kong's Hang Seng index (HSI) delivered a solid performance in August, rising by around 4%. With earnings season ongoing, the index's technology stocks (which include HK-listed mainland Chinese firms) have mostly beaten consensus. They are benefitting from resilient demand for tech services, overseas expansion which has boosted revenues, and recent mainland Chinese policy support for the sector – given its status as a national growth priority.

Excluding mainland Chinese tech stocks, Hong Kong's domestic firms also performed well in August. The MSCI HK index – a close gauge of the market's domestic stocks – rose 5.3%. Those firms are now seeing a pick-up in earnings estimates, helped by the prospect of imminent US rate cuts, and an improving outlook for non-cyclical sectors like utilities and consumer staples. That said, the downtrend in earnings for domestic stocks since mid-2022 has not yet reversed, with macro challenges still weighing on sectors like financials and real estate. With mainland China's largely domestic onshore stock market losing more ground in August, **some analysts think the HSI could continue to outperform this year given its appealing valuation and superior growth outlook**.

The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested. Past performance does not predict future returns. The level of yield is not guaranteed and may rise or fall in the future.
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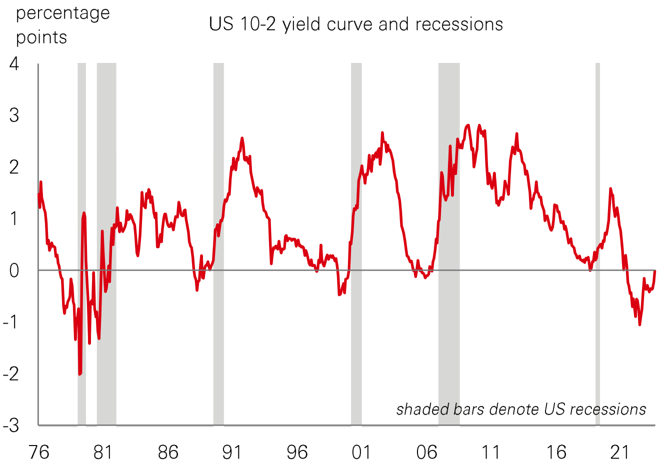
Lens on...

Back in black

What do rock legends AC/DC know about the US bond market? …they know the yield curve is 'Back in Black'.

The US yield curve – which plots the relationship between two- and 10-year Treasury yields – has been inverted since March 2022. Last week's dis-inversion – with the curve moving back into the black – shouldn't really surprise us. After all, short-term bond yields have fallen quickly over the summer, as expectations for Fed cuts have grown.

But what's concerning is that a dis-inverting yield curve, driven by 'bull steepening' (when the short end of the curve falls faster than the long end) is a robust leading indicator of recession. Even if the yield curve is just a 'mirror', reflecting the bond market's best guess about future interest rates, it looks like an important cyclical change is underway as growth and labour market data cool quickly. That should put investors on alert. The most important thing to watch now is how far – and how fast – the curve steepens. **A gradual steepening toward a normal, say +0.5% slope, would be fully consistent with a soft landing, and a broadening out pattern in stock markets**.

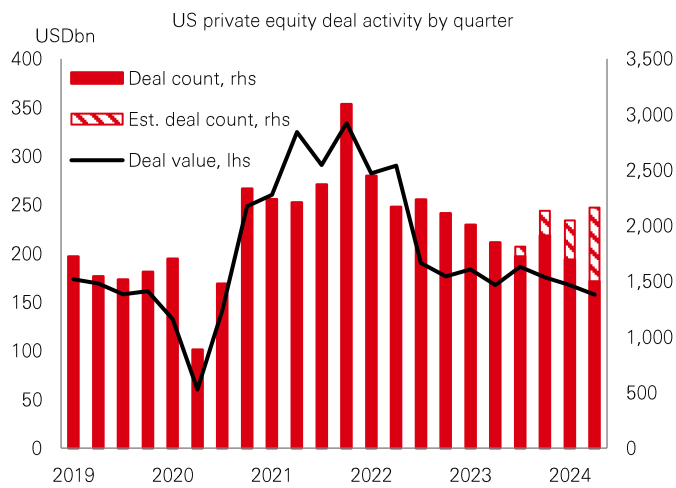


Private equity's green shoots

Private equity activity has been sluggish since mid-2022 – demanding caution on the part of investors. But green shoots of recovery and a pick-up in investment deal-making could signal a turning point.

On a like-for-like basis with other asset classes, we measure private equity expected returns in the low teens today. That reflects a sizeable equity and illiquidity premium. For an easy frame of reference, it converts to an internal rate of return (IRR) – a measure of investment profitability – of around 20%. These returns look attractive and, with valuations now lower after 2021-22 inflation burst and rapid policy tightening, we may be seeing the start of an interesting entry point for longer-term investors.

Some headwinds remain for the asset class, however. Exit markets (where investments are sold) remain mixed; data suggest that exit values are improving, but it is difficult to see a strong bounce back in sentiment or activity levels. During the last quarter, exits were just 36% of investments and suggest~~s~~ that the market has still not found its equilibrium.

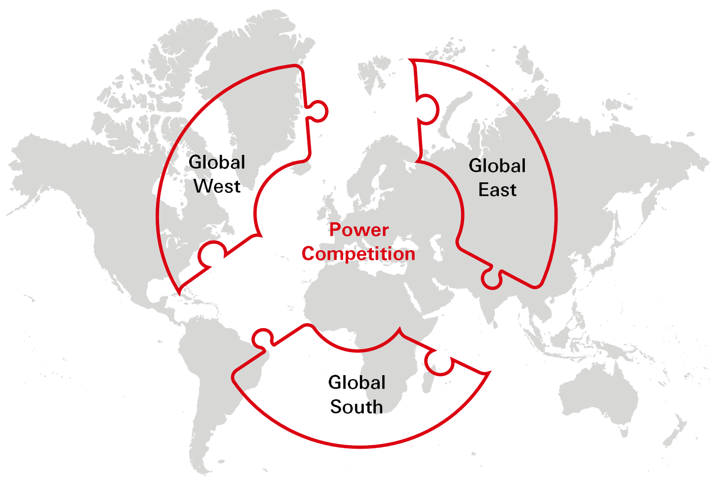


Power competition and its opportunities

The world is undergoing profound change as globalisation decelerates. It's useful to examine this shift through three power clusters: the global West, the global East, and the global South. In simple terms, the West wants to preserve the current world order, the East aims to take the lead by presenting an alternative to the West's hegemonic order, and the South operates as a collective system or 'swing cluster' capable of 'swinging' to the West or East depending on its interests.

Amid this power competition, new opportunities arise for investors in frontier and emerging markets. Moves by the West and East to reduce their economic interdependence imply a realignment of supply chains via 'friendshoring' and 'nearshoring'. **This benefits many economies in the South, such as Mexico, India, and Southeast Asia**.

And by sector, capital equipment, semiconductors and electric vehicle batteries are well positioned to grow rapidly as East-West tensions persist. India's nascent semiconductor industry – with a total of USD15bn of investment in chipmaking plants announced earlier this year – is a good example. So as these shifting dynamics continue to reshape the global economic landscape, it'll be key for investors to stay attuned.



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Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Mon. 02 September	BR	S&P Global Manufacturing PMI	Aug	50.4	54.0
	MX	S&P Global Manufacturing PMI	Aug	48.5	49.6
	ID	CPI (y-o-y)	Aug	2.1%	2.1%
	CN	Caixin Manufacturing PMI	Aug	50.4	49.8
Tue. 03 September	KO	CPI (y-o-y)	Aug	2.0%	2.6%
	US	ISM Manufacturing Index	Aug	47.2	46.8
	BR	GDP (q-o-q)	Q2	1.4%	1.0%
	CH	Banco Central de Chile Policy Rate	Sep	5.50%	5.75%
Wed. 04 September	US	JOLTS Job Openings	Jul	7.67mn	7.91mn
	CN	Caixin Services PMI	Aug	51.6	52.1
	CA	BoC Policy Rate	Sep	4.25%	4.50%
Thu. 05 September	US	ISM Services Index	Aug	51.5	51.4
Fri. 06 September	US	Change in Non-Farm Payrolls	Aug	-	114.0k

Q – Quarter BR – Brazil, MX – Mexico, ID – Indonesia, CN – China, KO – South Korea, US – United States, CH – Chile, CA – Canada

The week ahead

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 09 September	MX	CPI (y-o-y)	Aug	5.1%	5.6%
	CN	CPI (y-o-y)	Aug	0.7%	0.5%
Tue. 10 September	US	Presidential debate	Sep		
	US	NFIB Index of Small Business Optimism	Aug	93.6	93.7
	BR	CPI (y-o-y)	Aug	-	4.5%
	UK	Unemployment Rate, ILO	Jul	-	4.2%
	CN	Trade Balance (USD)	Aug	81.5bn	84.7bn
Wed. 11 September	US	CPI (y-o-y)	Aug	2.6%	2.9%
Thu. 12 September	EZ	ECB Deposit Rate	Sep	3.50%	3.75%
	IN	CPI (y-o-y)	Aug	3.7%	3.5%
	IN	Industrial Production (y-o-y)	Jul	4.4%	4.2%
Sat. 14 September	CN	Industrial Production (y-o-y)	Aug	4.7%	5.1%
	CN	Retail Sales (y-o-y)	Aug	2.5%	2.7%

MX – Mexico, CN – China, US – United States, BR – Brazil, UK – United Kingdom, EZ – Eurozone, IN – India

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Market review

Mounting fears of a possible US hard landing cast a pall over risk markets. Core government bonds rallied, with the US yield curve dis-inverting for the first time since 2022 amid a re-pricing of US rate expectations. The Bank of Canada cut rates by 0.25% for the third consecutive meeting, with attention now turning to the European Central Bank’s Council meeting this week. Elsewhere, the US DXY dollar index resumed its downward trend, and there was continued weakness in US technology equities, with cautious sentiment spilling into European and Japanese stock markets. EM equities largely weakened, led by Korea’s tech-dominant Kospi index. Mainland China’s Shanghai composite index fell amid continued macro concerns, while Thailand’s SE index rallied. In commodities, demand worries drove oil prices to 2024 lows, and copper also weakened. Gold consolidated after recent gains.

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