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Habib Investment Limited

Views from the desk

Monthly Global Market Overview and Outlook

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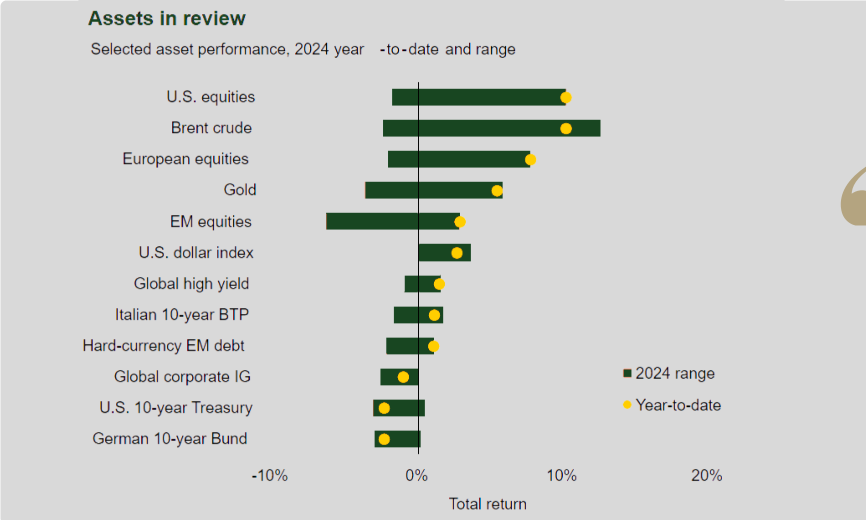
The Race to Rate Cuts

The norm that still prevails is Higher for Longer



Macro Overview

> *"The $VIX has average 13.7 thus far in 2024, on pace for the lowest volatility since 2017. Historical average $VIX is 19.5. However, Sentiment remains in "greed" territory."*
>
> **— Sandeep Jadwani | ACSI, CIB**
> **Head of Investment Advisory**

Macro Overview

In the month of March, global equities demonstrated resilience amid key developments in monetary policy and economic indicators. US equities surged as the Federal Reserve maintained interest rates for the fifth consecutive meeting. The S&P 500 closed 2.31% higher, fueled by the Fed's reiterated prospect for three cuts in 2024. Similarly, the STOXX 600 and FTSE 100 ended the month 1.04% and 2.72% higher, respectively, with the latter bolstered by a decline in UK inflation to its lowest level in over two years.

Commodity prices experienced downward pressure in March, attributed to rising US crude inventories and discussions within OPEC+ regarding production cuts. WTI and Brent crude closed lower at $80.63 and $85.43/bbl, respectively, amid reports of a potential ceasefire in the Middle East. Conversely, gold closed higher at $2181.60 troy/oz.(at the time of writing)

Fixed income markets saw US sovereign yields decline as investors evaluated the Fed's policy path for 2024. The 2-Year and 10-Year US Treasury yields ended lower at 4.60% and 4.22%, respectively, despite the latter reaching a new 2024 high earlier in the month. Meanwhile, the 10-Year UK Gilt yield fell below 4% for the first time since May 2023 following the Bank of England's decision to maintain rates, ultimately ending the month at 3.93%.

In the foreign exchange market, the US dollar strengthened against a basket of currencies amidst a flurry of central bank decisions.

The US dollar index rose to a one-month high, climbing 0.91%, while the Japanese yen weakened to ¥151.43, its lowest level since November 2023, despite the Bank of Japan raising its policy rate for the first time in 17 years and exiting its negative interest rate policy.

The economic summary for March highlighted significant developments in monetary policy, economic activity, housing, and labor markets. Notably, central banks made historic moves, with the Swiss National Bank (SNB) becoming the first in the G10 to cut interest rates, and the Bank of Japan ending negative rates, marking a return to more normalized monetary conditions. This shift indicates gradual economic normalization, addressing various challenges such as the pandemic and years of stagnation. Looking ahead, global borrowing costs are expected to decrease, with the SNB likely to make two more cuts in June and September, totalling a 50 basis point reduction by year-end.

Overall, the global economy and markets in March indicated a complex and evolving landscape for investors and were influenced by:

1. **Central bank policies,**
2. **Geopolitical developments, and**
3. **Economic data releases,**

Navigating Dynamic Markets: A Strategic Outlook for Q2 2024

Embracing Opportunities Amidst Shifting Economic Landscape

Global Outlook

As we embark on the second quarter, we maintain a steadfast belief in the conducive environment for risk-taking. Notably, U.S. inflation has moderated from its pandemic-induced peaks while economic growth remains robust. Revised projections for S&P 500 earnings growth in 2024, indicating an approximately 11% increase according to LSEG data, underscore the positive trajectory. Of particular interest are the elevated earnings expectations for tech firms leveraging artificial intelligence (AI), as depicted by the orange line in our analysis. Moreover, broader market earnings are showing signs of recovery, excluding commodities and healthcare sectors.

The Federal Reserve's commitment to three quarter-point rate cuts this year, coupled with its upward revisions to growth and inflation forecasts, further bolsters our confidence. In light of these developments, we maintain our overweight position in U.S. stocks. We anticipate that the upbeat risk appetite will extend beyond the tech sector as AI adoption proliferates across various industries. Despite soaring valuations in some tech names, we remain committed to the AI theme due to improving earnings. This sentiment is supported by Bloomberg data, highlighting the tech sector's anticipated contribution of half of this year's S&P 500 earnings. Notably, unlike the dot-com bubble era, current valuations show a decrease in price-to-earnings ratios for select companies.

While our outlook remains optimistic, we acknowledge potential disruptions to our stance. Factors such as inflation dynamics and macroeconomic news sensitivity could challenge our risk-on approach. Looking ahead, Japanese equities emerge as our highest-conviction tactical view for the quarter. Solid corporate earnings and shareholder-friendly reforms continue to drive our overweight position in Japanese equities, supported by a favorable Bank of Japan policy stance. Additionally, we adjust our stance on euro area inflation-linked bonds to neutral, reflecting eased market expectations for persistent inflation.

In the broader market context, U.S. stocks reached all-time highs recently, while U.S. 10-year Treasury yields experienced a slight decline following the Fed's reaffirmation of its policy direction. Japan's Nikkei stock index also hit record highs after the Bank of Japan's policy adjustments.

Looking ahead, we anticipate continued resilience in China's economy supported by stimulus measures, while other Asian markets benefit from robust U.S. demand.

Looking ahead, we anticipate the market to broaden in the coming quarters, providing a wider range of opportunities for stock pickers. While tech stocks have been driving market returns and exceeded expectations in Q4, we believe their momentum may slow down as comparisons become tougher and earnings decelerate. On the other hand, we expect earnings growth to pick up in other sectors of the S&P 500 as they continue to recover from the impacts of the COVID-19 pandemic.

Moreover, in Europe, the investment narrative centers on the industrial application of AI technology, reflecting a growing emphasis on innovation. Despite challenges, such as ECB rate cuts, European equities are expected to benefit. Meanwhile, in China, positive sentiment signals potential growth, though sustained expansion depends on consumer confidence.

These developments reaffirm the attractiveness of exposure to the U.S. market amidst global uncertainties. While the Eurozone's growth outlook remains subdued, opportunities for recovery persist, particularly in diversified exposure to the U.S. market across sectors.

In conclusion, while global uncertainties persist, the U.S. market remains resilient. We advise investors to consider diversified exposure to the U.S. market across various sectors, including small and mid-cap companies. The combination of lower interest rates and potential fiscal stimulus in the U.S. could lead to a stabilization or slight increase in 10-year yields.

In summary,

1. We see a supportive environment for risk-taking, driven by falling inflation and reinforced by the Fed's positive sentiment
2. We maintain our overweight position in U.S. stocks and the AI theme.
3. Accumulating quality credits to lock in yields by adding more duration.
4. Private credit also appears attractive in the current environment subject to investors understanding of the businesses

Market Definitions 101

MSCI World Index

A broad global equity index that represents large and mid-cap equity performance across 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country

J.P. Morgan Emerging Markets Bond Index (EMBI Global Index)

An unmanaged market capitalization Index that tracks total returns for USD-denominated debt instruments issued by emerging market sovereign and quasi- sovereign issuers

S&P GSCI Commodity Index

A composite index of commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities

Asset Class Views

Asset Class	Sub-Class	View (FY '24)	View (Apr '24)
Main Asset Class	Equities	=	=
	Fixed Income	=▲	▲
	Commodities	=▲	=▲
	Currencies	=▲	=▲
Equities	USA	=▲	=
	EU (Ex UK)	=	=
	Japan	▲	▲
	UK	=	=
	EM (Ex MENA)	▲	▲
	MENA	=	=▲

Asset Class Views

Asset Class	Sub-Class	View (FY '24)	View (Apr '24)
Fixed Income	US Treasuries	=▲	=
	Euro (Bunds)	▼	▼
	UK Gilts	▼	▼
	US IG	=▲	▲
	US HY	=▲	=
	Europe IG	▼	▼
	EM	=▲	=
Commodities	Oil	=	=
	Precious Metals	=▲	=▲
Currencies	USD	=▲	=▲
	EUR	=	=
	GBP	=	=
	EM	=	=

▲ overweight = neutral weight ▼ underweight ■ negative tilt ■ positive tilt

Critical Future Events

Apr 11: ECB Meeting

Apr 26: BoJ Meeting

Japan's Economic Resurgence: Investor Interest Surges Amidst Changing Monetary Policy

Exploring the Impact of Japan's Stock Market Rally and the BOJ's Recent Rate Hike Decision

The surge in Japan's stock market has captured the attention of international investors, but the recent decision by the country's central bank to implement its first rate hike since 2007 could potentially temper this upward trend.

After grappling with a sluggish economy for years, Japan seems to be regaining its footing towards sustainable growth, driven by increases in wages and exports. This resurgence has attracted foreign investors who are pouring funds into Japanese assets, propelling the Nikkei 225—a key benchmark for Japan's stock market—beyond its previous record set three decades ago. Notably, even renowned investor Warren Buffett has increased his investments in Japanese companies.

However, amidst this positive momentum, the Bank of Japan (BOJ) has concluded its experiment with negative interest rates, signaling confidence in the country's economic outlook. While this move is viewed as a positive development, the subsequent rate hike could impact investors' strategies.

So, what has been unfolding in Japan? Since the burst of Japan's asset bubble in the early 1990s, the country has faced a prolonged period of economic challenges, including deflation and stagnant growth. In response, the BOJ implemented various policies, including negative interest rates in 2016, aimed at spurring economic activity. While these measures helped weaken the yen and prevent deeper deflation, it wasn't until external factors like the COVID-19 pandemic and geopolitical tensions triggered supply shocks that inflation exceeded 2%. Consequently, Japan's gross domestic product (GDP) showed modest growth in the fourth quarter of the previous year.

This positive economic backdrop has fuelled a notable resurgence in the Japanese stock market, with the Nikkei 225 outperforming major indices like the S&P 500 this year. Foreign investors have been drawn to Japan's more shareholder-friendly corporate culture, particularly in the wake of uncertainties in China's markets.

In tandem with these developments, the Japanese yen has depreciated significantly against the US dollar, largely due to the BOJ's prolonged low-rate policy compared to other countries nearing the end of their monetary tightening cycles.

Winners	Channel	Losers	Channel
Megabanks	Higher interest rates	Government	Higher interest rates
Regional banks	Higher interest rates	Bank of Japan	Losses on bonds
Importers	Stronger yen	Regional banks	Losses on bonds
Power-intensive firms	Stronger yen	Global Firms, Exporters	Stronger yen
Life insurers	Higher interest rates	Real-estate firms, property owners	Cooler property market
Investment Banks	Higher interest rates	Zombie firms	Higher interest rates
Wealth managers	Higher interest rates	Mortgage holders, renters	Higher rates, rents
Consumers	Stronger yen	Bondholders	Losses on bonds
Foreign holders of Japan stocks	Stronger yen	Japanese holders of foreign stocks	Stronger yen
Bank deposit holders	Higher interest rates	Households with consumer loans	Higher interest rates
Japanese tourists abroad	Stronger yen	Inbound tourists, hospitality sector	Stronger yen

In terms of recent actions, the BOJ has raised borrowing costs for the first time since 2007, signaling confidence in the economy's health and the end of negative interest rates. Additionally, the central bank announced the cessation of its purchases of exchange-traded funds (ETFs) as part of its efforts to support economic growth.

Japan's Economic Resurgence: Investor Interest Surges Amidst Changing Monetary Policy

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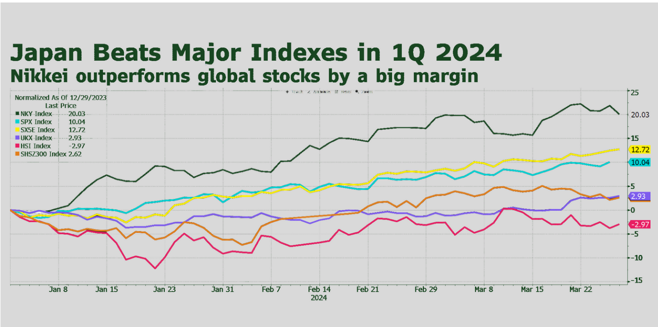
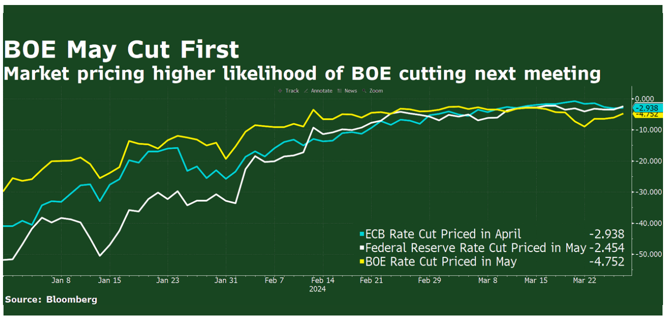
Despite these changes, the BOJ has reiterated its commitment to maintaining accommodative financial conditions, suggesting that the rate hike is not indicative of an aggressive tightening cycle.



For investors seeking exposure to Japan's resurgence, investing in exchange-traded funds (ETFs) offers a convenient option. The largest ETF for Japan, Blackrock's iShares MSCI Japan ETF (EWJ), provides exposure to large- and mid-cap stocks and has experienced significant inflows this year. Other options such as the JPMorgan BetaBuilders Japan ETF (BBJP) and sector-specific ETFs offer additional avenues for investment.

However, it's essential to consider the potential risks associated with higher interest rates, which could dampen economic growth and impact stock market performance. Growth-oriented companies, in particular, may face challenges if a stronger yen makes their exports more expensive abroad. As such, investors may consider equity investments in companies poised to benefit from a stronger yen.

Moreover, currency fluctuations pose a significant risk for overseas investors, impacting returns when converting currencies. To mitigate this risk, currency-hedged ETFs like the WisdomTree Japan Hedged Equity Fund (DXJ) offer protection against changes in currency values.



Now the BOJ has ended the negative rate with its first interest rate hike since 2007, the next question will be how high the BOJ will take its policy rate. BOJ Governor Kazuo Ueda has already indicated the bank's overall monetary settings will stay accommodative for a while, meaning he won't be conducting a series of rate hikes of the sort seen in the US and elsewhere in recent years. Weakness in consumption in Japan will warrant caution as the BOJ navigates its policy path in the new era.

In conclusion, while Japan's economic resurgence presents promising opportunities for investors, careful consideration of potential risks and appropriate investment strategies is crucial in navigating the evolving landscape.

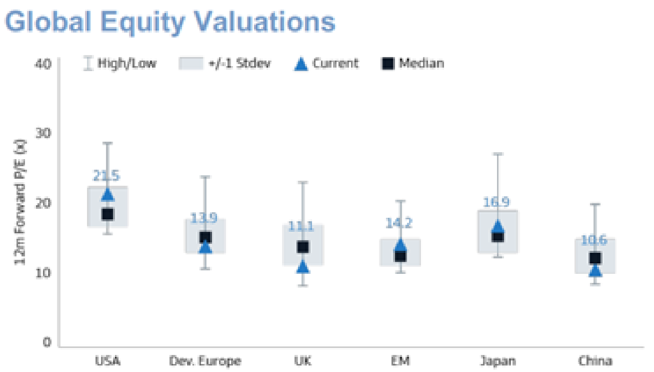


Chart Source: Goldman Sachs Asset Management and Bloomberg as of close of trading on February 29, 2024. Chart data shows next 12-month P/E ratio from March 2014 to the current period. 12m forward P/E(x) refers to price-to-earnings ratio for the next 12 months, which is a valuation measure applied to respective broad equity indices. Please see additional disclosures at the end of this presentation.

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