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02 DEC, 2023

Identifying opportunities for 2024

The Star, Malaysia

Where to put your money in 2024?

Fund managers share views on fresh opportunities in equity and bond markets amid uncertainty and volatility.

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ECONOMY

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Stay nimble and focus on quality, say fund managers

Stories by CECILIA KOK
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THE year thus far has been quite a roller-coaster ride for global financial markets.

Just a few months ago, we saw global bond yields rise to their highest levels in more than 15 years because of a massive sell-off in the global debt market. Global equity markets had also been affected throughout 2023 by heightened volatility, driven by persistent inflation, interest rate hikes, sluggish growth trends and geopolitical turmoil.

Many fund managers sum it as such: Volatility is the new normal.

On how they see the outlook for 2024, they say if 2023 was challenging, marked with unexpected headwinds in the global economy and financial markets, the year ahead would likely bring more of the same unpredictability to the investment world. This is especially so given the rising geopolitical tensions and upcoming elections in several countries, including the United States, India and Indonesia, in the year ahead.

Be that as it may, change and uncertainty also bring fresh opportunities to generate solid returns. The question is how to position oneself in such a volatile environment.

For Fidelity International global chief investment officer, Andrew McCaffery, the key is to stay nimble.

"I have never managed money on the basis that I know what's going to happen in 12 months' time. I may have a view, but good investing needs discipline, an open mind, and a preparedness to react to the facts as they change," McCaffery says in Fidelity's Outlook 2024 report.

Leung: For very long-term investors, Stashaway's long-term bond valuation model shows that the asset class has become attractive.

He points out that remarkable changes across economies and markets, combined with a year of political uncertainty, make forecasting unusually difficult in 2024.

"The world is always uncertain. But this is one of those periods when it is not an exaggeration to use the phrase 'regime change'. Investors will need to stay nimble in 2024, ready to navigate each twist and turn as the real scenario plays out," McCaffery stresses.

As it stands, global investment companies have divergent views on the market outlook for the year ahead.

While some are more cautious, such as Fidelity, whose base case for 2024 is a cyclical recession, others are more optimistic such as Goldman Sachs, which expects the global economy to outperform expectations in 2024.

> "There is growing optimism that markets have moved past some of the most challenging part of the painful adjustments in the economy."
>
> Anton Tan

Better climate

For local fund manager AHAM Asset Management Bhd (AHAM Capital), the investment climate for 2024 appears promising.

Its chief officer of product solutions and customer experience, Anton Tan, tells *StarBizWeek* there is growing optimism that markets have moved past some of the most challenging part of the painful adjustments in the economy.

"The year 2023 has a been a year of transition in many aspects, as markets adjust to a new economic cycle and a higher interest rate regime. For the most part of the year, inflation was a key concern as global central banks moved to quell price pressures," he explains.

"For 2024, there is growing optimism that markets have moved past some of the most challenging part of this painful adjustment. With inflation seen easing and the US Federal Reserve's (Fed) tightening cycle approaching its tail-end, we can see market conditions turning more conducive for risk assets," he adds.

Tan, however, cautions that there are still some risks of which investors need to take note when making investment decisions.

"Some important signposts to monitor include the strength of the US economy in weathering the Fed's cumulative interest rate hikes, which usually work with a lag effect. There is a potential risk of a rolling recession in the United States, similar to what we have witnessed this year in sectors like the US commercial real estate, automotive and banking. This might bring about implications for the outlook on interest rates, risk assets and foreign-exchange markets," he explains.

Additionally, Tan stresses, it will be vital to keep a pulse on geopolitical risks.

"While tensions between the United States and China have somewhat eased, there is a risk of tensions reigniting, especially with the US presidential elections approaching in November 2024," he points out.

He also notes that a significant number of countries, particularly emerging economies such as India, Taiwan and Indonesia, are also set to hold general elections in 2024. These could have an impact on the financial markets as well.

Choppy process

According to Stephanie Leung, chief investment officer of digital wealth management platform Stashaway, 2023 has clearly been favourable to equities over bonds, which had been subject to the worst drawdown in 40 years.

"This reflects the market's outlook for a higher-for-longer regime and we would expect a similar environment during early parts of 2024 until there are clearer signs of US labour market slowdown, which should bring down both inflation and growth," she says.

Nevertheless, she points out that for "very long-term investors", Stashaway's long-term bond valuation model shows that the asset class has become attractive.

"However, the bottoming process may still remain quite choppy, as the market still remains concerned about a sticky inflation due to supply-side constraints, in particular the labour and energy markets in the case of military conflicts," Leung adds.

In general, she notes that as the US economy has proved to be more resilient in 2023 than most had expected and it has managed to avoid a recession, the major risks to the global economy now are the ripple effects from an interest rate regime of "higher for longer".

In particular, non-US economies with weaker fundamentals, and/or are more sensitive to interest-rate moves, run a higher risk of recessions and declines in asset prices, Leung says.

60:40 strategy

So, how should one invest in the year ahead?

While the 60:40 portfolio strategy, which allocates 60% to stocks and 40% to bonds, did poorly in 2022, when both stocks and bonds suffered greatly amid record inflation and aggressive interest rate hikes, the traditional approach now appears viable, according to Morgan Stanley chief cross asset strategist Serena Tang.

In a recent podcast, Tang says it's understandable why some investors may be sceptical of fixed-income assets given the recent spike in global yields. However, today's higher yields are a strong reason to buy bonds because they can better cushion fixed-income returns, she points out.

"In fact, looking across assets, fixed income stands as being particularly cheap to equities relative to history," she explains.

As such, the traditional 60:40 allocation between stocks and bonds looks viable once again despite the strategy's poor performance in 2022. Traditionally, bonds and equities often move in opposite directions, offering portfolio diversification, but in recent years, both assets have moved in the somewhat same direction due to elevated inflation and rising interest rates.

"From where we sit now, the high long-run expected returns across most assets mean that a traditional 60:40 equity-to-bond-dollar portfolio would see about 8% per year over the next decade," Tang says.

"The last time it was this high was in 2013 and surely a 60:40 equity-to-bond-euro portfolio could see 7.7% per year over the next 10 years, the most elevated since 2011," she adds.

Similarly, Vanguard Group states the case for the 60:40 portfolio is stronger than in recent memory, pointing out that long-term investors in balanced portfolios have seen a dramatic rise in the probability of achieving a 10-year annualised return of at least 7%, the post-1990 average, from an 8% likelihood in 2021 to 40% today.

The investment company says global bond markets have repriced significantly over the last

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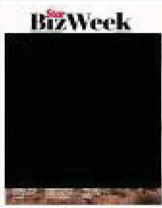

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Bright outlook: The Bursa Malaysia building in Kuala Lumpur. Equities will be of interest, while in fixed income the focus will remain on short-dated, high-quality credits, says Fidelity.

two years because of the transition to the new era of higher rates. Hence, its view is that bond valuations are now close to fair, and its bond return expectations have increased substantially.

Conversely, Vanguard sees global equity markets as overvalued, particularly in the United States where equities have outperformed international peers. This is due to the higher interest rate environment having depressed asset price valuations and squeezing profit margins of corporations.

Vanguard estimates that the spread between global equity and global bond returns would be around zero to two basis points annualised over the next 10 years. In contrast to the last decade, it expects return outcomes for diversified investors to be more balanced.

"For those with an appropriate risk tolerance, a more defensive risk posture may be appropriate given higher expected fixed-income returns and an equity market that is yet to fully reflect the implications of the return to sound money," Vanguard says.

Risk assets

According to AHAM Capital's Tan, inflection points in markets are currently pointing towards a more favourable environment for risk assets such as equities.

"While timing market opportunities precisely can be challenging, a global portfolio that is diversified across different asset classes, sectors and region can help investors reap an attractive risk-adjusted return," he argues.

Tailoring one's portfolio to align with individual risk profiles is paramount, he stresses.

"The exact composition will vary based on an investor's tolerance for risk and overall financial goals. Whether an investor leans towards a more conservative or aggressive stance, a well-diversified portfolio provides a strong foundation for navigating a changing market landscape," Tan explains.

He says equity markets will benefit in the year ahead from a stable interest rate outlook.

"Post-2022 market correction, we have not seen valuations return to levels seen in 2020-2021. While there is potential for a re-rating in valuations, we believe that corporate earnings would be the main factor driving a sustainable equity market performance," Tan says.

In terms of region, he points out, the US market capitalisation has grown significantly over the past decade, noting that the average weight of the United States in the MSCI World Index has increased from 40.6% (2000-2010) to 51.5% (2011-November 2023).

"Thus, as a single market, the United States has become more important as part of any diversified portfolio," Tan argues.

He also voices optimism on emerging markets (EMs), including those in Asia.

"A stable US interest rate outlook, alleviation of inflationary pressures, and the avoidance of a hard landing in the United States could serve as catalysts for strong performance in EMs and Asian equities," Tan says.

"Given their relatively lower valuations, investors should also look to building exposure in EMs to seize opportunities in this fast-growing and dynamic region," he adds.

As for fixed-income securities, Tan says, the asset class continues to play an integral role as part of any well-rounded investment portfolio.

"While this asset class has faced challenges in an era characterised by near-zero interest rates, we believe bonds are poised to reassume a pivotal role as we move towards a new normal environment," he explains.

"Its diversification benefits and defensive attributes are expected to reassert themselves again, providing a buttress to an investor's portfolio," he adds.

In general, Tan says his team has turned increasingly constructive on the outlook for bonds, given the significant rise of yields over the last two years.

"With the US interest rate hike cycle likely at its tail-end, we think bonds are in a sweet spot for investors seeking attractive returns in terms of income generation and potential capital gains," he points out.

"This favourable backdrop becomes even more pronounced as we enter the next rate cut cycle in 2024 and beyond," he adds.

Buy quality

In its strategy report for 2024, titled "A New World", UBS Global Wealth Management says it expects both equities and bonds to generate positive returns in the year ahead. But the key is "focus on quality".

"We think it will pay to focus on quality in 2024," the investment company's president, Iqbal Khan, says in the foreword of the report.

"As interest rates fall, we expect quality bonds to deliver both attractive income and capital appreciation. And we believe it will be quality stocks, including many in the technology sector, that will be best positioned to grow earnings in a slowing global economy," he adds.

In general, UBS expects a moderate rally in global equity indexes in 2024 as earnings grow, and as interest rates and bond yields fall.

In its base case, the fund management company sees the S&P 500 rising to 4,700 by December 2024. It expects a 9% increase in the earnings per share for S&P 500 companies next year after a flat outcome in 2023. It also projects a 3% growth for European companies and 16% from EMs.

UBS says investors can find quality stocks within the US technology sector; stable quality-income and high-quality cyclical stocks in Europe; and in select names in Asia.

As for fixed income, it expects government bond yields to fall in 2024 and this should support positive returns for the asset class. It notes weaker growth should contribute to lower interest rate expectations in the year ahead.

UBS argues that this is an opportune time to add to high-quality bonds – specifically high grade (government) and investment grade paper. It explains current yields should provide attractive returns, with positive returns possible across a range of scenarios, and particularly in downside economic scenarios.

Importantly, UBS chief investment officer Mark Haefele says investors should have a proper investment plan, get a balanced portfolio, and stay "disciplined, yet agile".

"In this new world, data has become more available but not necessarily more informative. The pervasiveness of social media means each data point is amplified more than ever before," Haefele says in the UBS report.

"A clear plan, linking strategies with goals and values, can help investors stay focused on the bigger picture in an increasingly noisy world," he explains.

In its base-case scenario, UBS says balanced portfolios should provide positive returns in 2024, and its scenario analysis suggests multi-asset diversification would be effective at hedging risk scenarios.

"Over the longer term, we believe that investors who keep a diversified multi-asset portfolio – traditional or sustainable – as a "core" investment strategy are most likely to successfully protect and grow real wealth over time," Haefele says.

Further, he stresses investors should regularly review their plans for strategic allocations, tactical allocations, and "satellite" investment ideas, as markets evolve and need change.

Lower rates

Meanwhile, BNP Paribas Asset Management says for 2024, it favours government bonds over equities in anticipation of lower bond yields, as central banks cut interest rates to support growth; and lower equity prices, as expected earnings fail to materialise.

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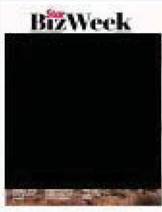

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Consider alternative investments like hedge funds, private equity

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"Market valuations are strikingly disconnected, with elevated bond premia and comparatively low equity risk premia," BNP Paribas global head of multi-asset, Maya Bhandari, says in the investment firm's 2024 outlook report.

"As a result, combining our assessment of fundamentals and market valuations or risk premia, our highest conviction asset allocation view for 2024 is being long duration alongside caution on developed market equities," she adds.

BNP Paribas is cautious on equities, chiefly in Europe, noting that European equity valuations appear unattractive, not only relative to the region's own history, but also compared to European high-grade, high-yield and government bonds.

Similarly, BNP Paribas also regards EM local debt as more attractive than EM equities given the increasingly opaque outlook for China, particularly on macroeconomic policy, which has an outsized impact on equity indices.

As for Fidelity, in its base case for a cyclical recession in 2024, a mild risk-off situation is to be expected. Nevertheless, there will still be good opportunities for investors who are discerning about sectors and geographies, it says, adding that investors shouldn't be scared of holding select equity investments because markets anticipate an economic recovery later in the year.

Equities of interest

"A cyclical recession would bring lower economic growth that could be a worry for small-caps or companies with discretionary sales.

"Equities (away from low-quality or small names) would be of interest, while in fixed income the focus would remain on short-dated, high-quality credits," Fidelity shares.

"We would take long positions in certain EMs in any scenario, given attractive valuations and idiosyncratic economic cycles, but our preferences change depending on which scenario emerges," it reveals, adding that in a recession, India and Indonesia are markets with good defensive qualities that are less tied to the global cycle.

On its fixed-income outlook, Fidelity argues that in a cyclical recession scenario, which starts with a period of above-consensus inflation in the first half of 2024, one can expect an outperformance for inflation-linked bonds, driven by a series of upside inflation surprises.

In the later part of 2024, there could be faster-than-expected interest rate cuts by the Fed. This is expected to be a strong period for nominal bonds.

General consensus

There is a consensus that geopolitical tensions will remain a risk in the year ahead.

As such, as UBS puts it, investors need to prepare for volatility ahead by considering alternative investments such as hedge funds, private equity, real estate and even commodities.

"In addition to diversification, investors can further help insulate portfolios against specific risks through capital preservation strategies, using alternatives, or with positions in oil and gold," the investment firm asserts.

It estimates that allocating a 20% exposure to alternatives in a balanced portfolio could increase expected returns by about 50 basis points a year over the long term, for an equivalent level of portfolio volatility.

"An environment of higher rates and attractive returns for traditional assets bodes well for hedge funds, which we think will remain an important portfolio diversifier in the years to come," UBS explains.

"We also see attractive opportunities in entering private markets today, where secondaries are trading at a compelling 16% discount to net asset value, while new private loans are yielding 12.5%," it adds.

Nevertheless, it cautions that investors should be aware of the added risks borne in alternatives, including illiquidity, the use of gearing and less transparency than in public market investments.

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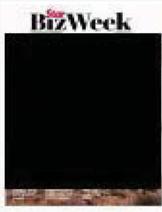

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