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J.P.Morgan ASSET MANAGEMENT

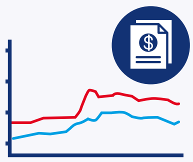
UOB

UOB Investment Insights
Market PowerBar

AUGUST 2022

A LOOK AT THIS MONTH

Key developments to watch	What investors should know
1 Stock and bond prices have concurrently fallen recently, resulting in heightened portfolio volatility for investors.	**Stock and bond prices should return to having an inverse correlation as inflation subsides.** ▶ Stock and bond markets have experienced a sell-off at the same time as a direct result of aggressive central bank policy to fight high inflation. ▶ As supply constraints ease and demand cools, inflation in the developed world should moderate and bond yields should stabilise.
2 Bond yields are peaking as growth and inflation are expected to slow.	**As uncertainty persists, seek refuge in investment grade corporate bonds.** ▶ Intermediate-duration investment grade bond yields are now more attractive than a year ago. ▶ Such bonds can be held to maturity or can benefit from potential capital appreciation as economic growth slows.
3 Despite higher volatility in stock markets, prospects for Asia ex-Japan stocks remain positive.	**Asia ex-Japan stocks still present attractive opportunities.** ▶ Asia ex-Japan stocks have the potential to surpass low earnings growth expectations and deliver an upside surprise to the market. ▶ Economic re-opening is a possible catalyst for fresh earnings growth momentum, which could in turn be accompanied by dividend growth.



Upcoming Event

AUGUST 18

Federal Open Market Committee (FOMC) Meeting Minutes

Minutes from the FOMC's latest meeting are poised to provide in-depth insights into economic and financial conditions influencing the committee's vote on where to set interest rates.

Speak to your UOB Advisor today to find out more.

Topic 1:

Stock and bond prices should return to having an inverse correlation as inflation subsides

Over the past two decades, stocks and bonds have consistently had a negative correlation – in other words, stock prices tended to rise when bond prices fell and vice versa. This has played a crucial role in helping investors build resilient multi-asset portfolios. However, it is interesting to note that this relationship was not as consistent prior to the 2000s, when inflation and growth uncertainties were more dominant.

Figure 1A:

US stock and bond prices have had a negative correlation for the past two decades – until recently

Correlation

Source: Bloomberg. Stock-bond correlations calculated on a rolling 24 months basis using the following: S&P500 and Bloomberg US Aggregate Treasury Total Return Indices. Data reflect most recently available as of 30 June 2022.

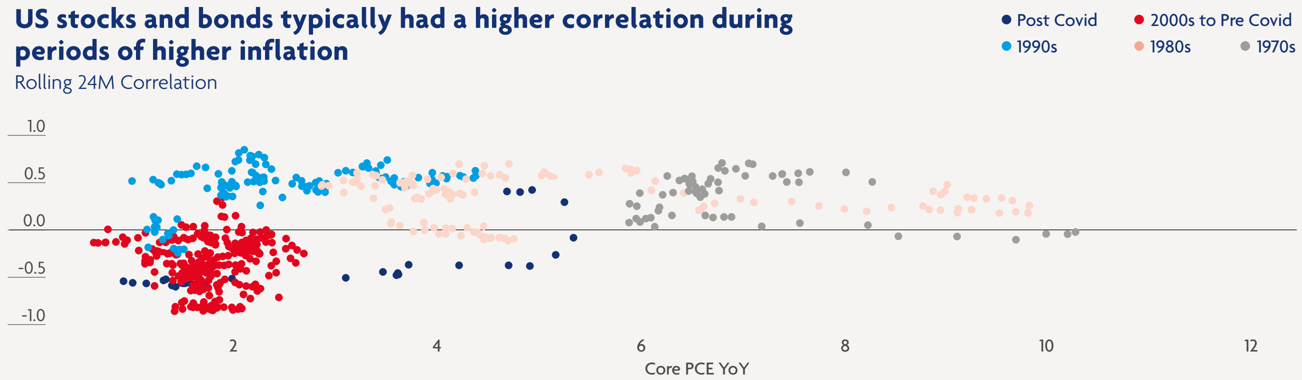
Key takeaways

1. Barring a couple of episodes when stock and bond prices fell concurrently during the Federal Reserve's 2018 rate hike cycle and 2013 taper tantrum, the inverse relationship between stocks and bonds has largely held until recently (Figure 1A).
2. As it turns out, it is inflation that matters in this relationship. During the higher inflation regimes of the '70s, '80s and part of the '90s, stock and bond prices tended to have a direct correlation as well (Figure 1B).
3. Today's concurrent sell-off in both bonds and stocks is a direct result of the most aggressive policies that developed market central banks have introduced in the past decade to fight inflation.
4. Our view is that inflation in the developed world should moderate as supply constraints ease and demand cools. High energy and food prices inherently reduce inflationary pressures as consumers start to feel the pinch and cut back on consumption.

Figure 1B:

US stocks and bonds typically had a higher correlation during periods of higher inflation

Rolling 24M Correlation



Source: Bloomberg. Stock-bond correlations calculated on a rolling 24 months basis using the following: S&P500 and Bloomberg US Aggregate Treasury Total Return Indices. Data reflect most recently available as of 30 June 2022.

In summary

- ▶ The correlation between stock and bond prices matters to your portfolio risk and returns. If both asset classes move in the same direction, your portfolio volatility also increases, and you would need to adjust your asset allocation, assuming your risk tolerance remains constant.
- ▶ As inflation subsides and bond yields stabilise, this should help stock-bond correlations normalise from their current elevated levels.

Topic 2:

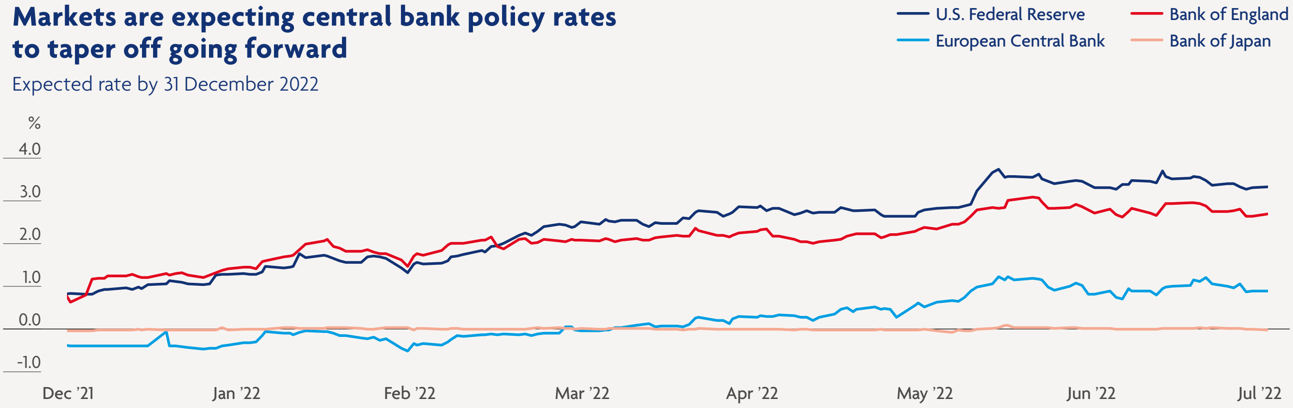
Seek refuge in investment grade corporate bonds as uncertainty persists

We believe government bond yields are closer to peaking for two reasons: 1) Both growth and inflation are expected to slow, and 2) Markets are already pricing in an aggressive rate hike trajectory for developed market central banks, except for the Bank of Japan, and policy rates are expected to peak and taper off going forward (Figure 2A).

Figure 2A:

Markets are expecting central bank policy rates to taper off going forward

Expected rate by 31 December 2022



Source: Bank of England, Bloomberg L.P., Federal Reserve, J.P. Morgan Asset Management . *Expectations are derived from the World Interest Rate Probability (WIRP) estimated forward rates. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Asia*. Data reflect most recently available as of 29 July 2022.

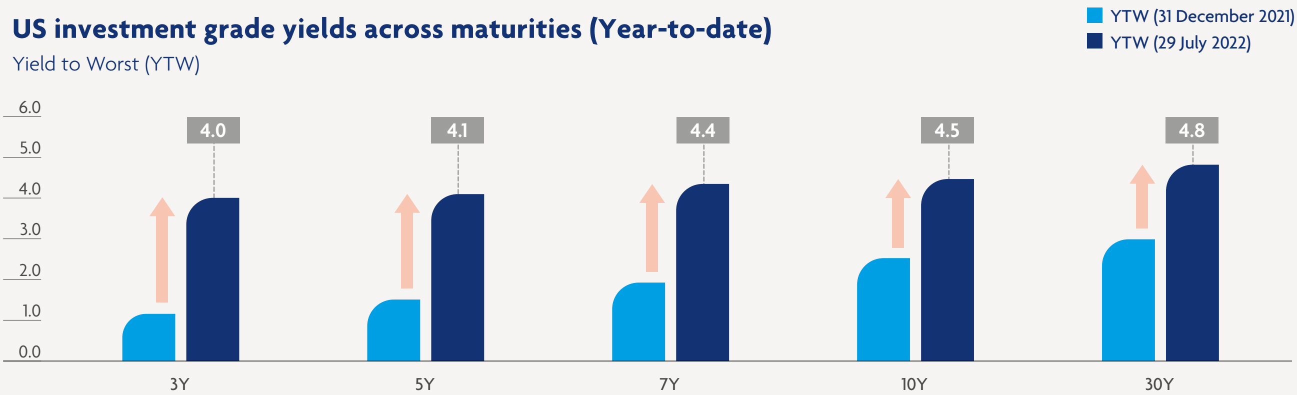
Key takeaways

1. Bond prices have fallen recently, equating to higher bond yields. With government bond yields closer to peaking, there is now relatively greater value in adding longer-duration bonds to one's portfolio to capitalise on the higher yields. This is especially since growth risks could cause a shift in the interest rate environment moving forward.
2. As uncertainty remains high, investors can get paid to wait while seeking shelter under the fixed income umbrella. Focusing on high-quality bonds like investment grade corporate bonds makes sense for protection against a dimmer economic outlook. Corporate fundamentals remain strong, which should keep their bond yields stable.

Figure 2B:

US investment grade yields across maturities (Year-to-date)

Yield to Worst (YTW)



Source: J.P. Morgan US High Grade Index (JULI).

In summary

- Within the investment grade space, although yields across maturities are more attractive now compared to a year ago, Figure 2B shows intermediate-duration (3 to 7 years maturity) yields widening the most.
- With intermediate-duration yields ranging from 4.0% (3 years) to 4.4% (7 years), you can either hold these bonds to maturity or benefit from potential capital appreciation if rates go lower in the event of a recession, making this a practical strategy.

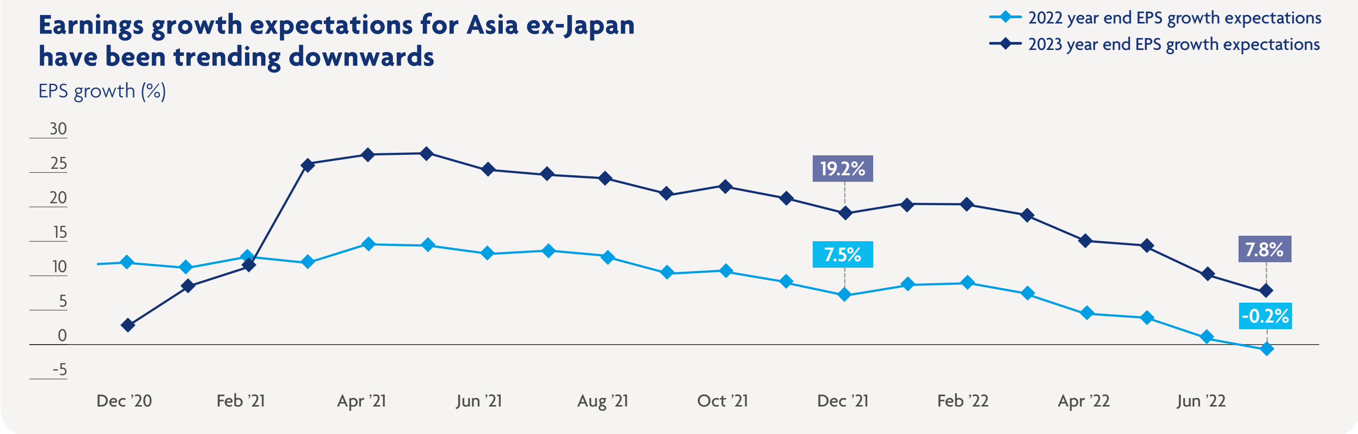
Topic 3:

Asia ex-Japan stocks still present attractive opportunities

Stock markets are expected to remain volatile as the world grapples with inflation and growth worries. While latest economic releases suggest that recession risks are rising, we are still positive on prospects for Asian stocks in particular.

Figure 3A:

Earnings growth expectations for Asia ex-Japan have been trending downwards



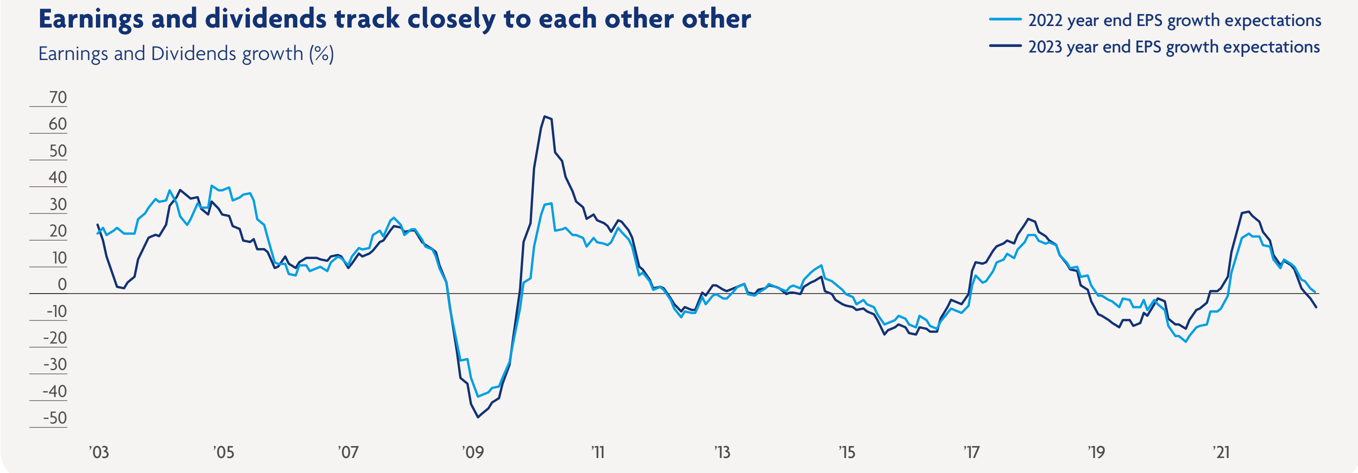
Source: FactSet, MSCI, J.P. Morgan Asset Management.
Data reflects most recently available as of 31 July 2022.

Key takeaways

1. The Asia ex-Japan stock market still offers compelling opportunities. Earnings growth expectations have been trending downwards (Figure 3A). At such a low level, we believe that expectations can be easily surpassed, which would deliver an upside surprise to the market. The re-opening theme should provide fresh earnings growth momentum, despite concerns about higher food and energy prices.
2. Earnings and dividend prospects track each other closely. As we expect an earnings growth recovery, dividend growth should also follow, providing investors with an additional buffer in the form of an extra income source that can be deployed or re-invested (Figure 3B).

Figure 3B:

Earnings and dividends track closely to each other other



Source: Source: FactSet, MSCI, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – Asia. Data reflect most recently available as of 29 July 2022.

In summary

- While economies are at risk of recession and the United States appears to be heading towards a late stage in the business cycle, Asia ex-Japan stocks can still provide valuable returns.
- The market correction over the last few months has improved valuations, and low expectations mean we could easily see upside surprises to overly pessimistic estimates.

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