UOB

In collaboration with:

J.P.Morgan ASSET MANAGEMENT

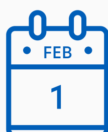
UOB Investment Insights

Market PowerBar

FEBRUARY 2023

A LOOK AT THIS MONTH

Key Topics	What Investors Should Know
1 Bonds are a bright spot	**Bonds now play an important role in generating returns across multi-asset portfolios, beyond serving as a source of diversification.** ▶ US government and Investment Grade bonds are poised to deliver promising returns amid uncertainty about economic growth. ▶ Shorter duration bonds may be more defensive should inflation stay elevated and central bank policies remain aggressive.
2 Asia ex-Japan stocks are well positioned to outperform	**Asia's economic slowdown could be much more subdued compared to developed markets, with China easing its zero-COVID stance earlier than expected.** ▶ China's re-opening should provide significant support for the region after a long period of suppressed activity. ▶ Potential weakening of the US dollar would also make Asian assets relatively more attractive.
3 What factors could result in growth stocks generating superior returns?	**Despite a significant correction in growth stocks, they are still not cheap compared to value stocks.** ▶ Economic growth momentum and inflation are important factors to monitor, to determine if growth stocks have the potential to outperform value stocks. ▶ As growth stocks have shown the ability to consistently generate superior earnings over the longer term, investors can position for an economic recovery by selecting quality growth stocks and practising dollar-cost averaging.

Upcoming Event	
 Federal Open Market Committee (FOMC) policy meeting	Keep an eye on whether the Federal Reserve announces another 50 basis point (bps) rate hike or shifts to a smaller 25 bps move. The Fed's updated rate projections will also be key.

Speak to your UOB Advisor today to find out more.

Topic 1

Bonds are a bright spot

2022 was one for the history books, with both stocks and bonds registering double-digit percentage losses. Elevated inflation in the United States and most of the developed world resulted in a highly aggressive Federal Reserve (Fed) hiking interest rates by 450 basis points (bps) in the span of a year. This in turn led to the steepest loss experienced by the US bond market since the 1970s. However, the outlook for bonds is turning more positive amid slowing economic growth and rising recession risks.

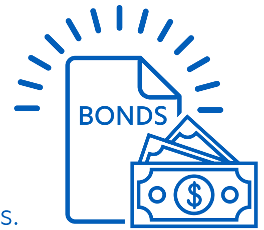
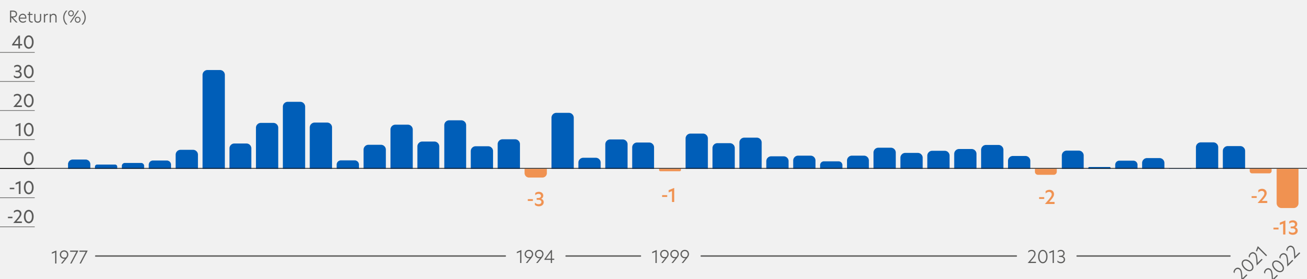


Figure 1A

The Bloomberg US Aggregate Bond Index suffered a 13% loss in 2022



Source: Bloomberg, J.P. Morgan Asset Management.
Data reflect most recently available as 31 January 2023.

Key takeaways

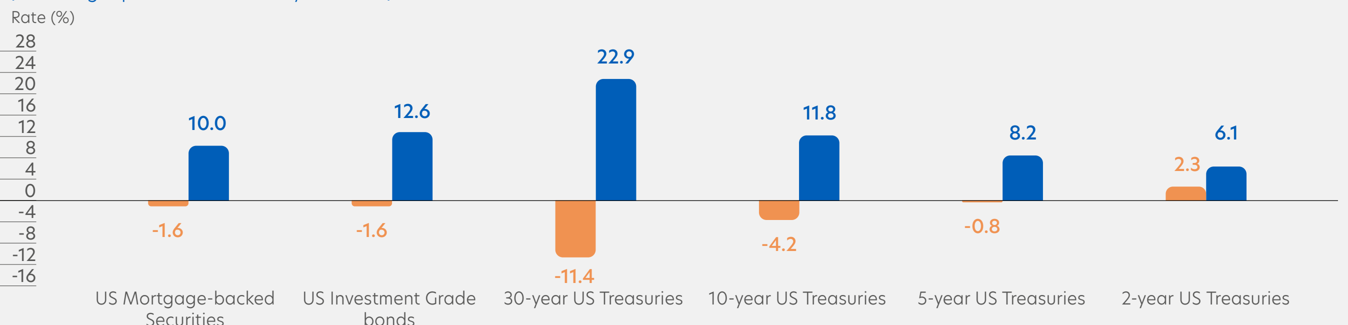
1. The US bond market fell by 13% last year (Figure 1A). Since the inception of the Bloomberg US Aggregate Bond Index in the 1970s, there have only been five instances of negative annual returns, and in the other four years, the index fell by less than 3%. With this large sell-down behind us, we think bonds can now play a larger role in generating returns across multi-asset portfolios, beyond serving as a source of diversification.
2. High-quality bonds are a reasonable place for investors to focus on in 2023. As inflation trends lower and economic growth continues to slow down, central banks may gradually pause or eventually reverse their interest rate hikes, which would provide support for bonds.
3. We think US government bonds, together with high-quality assets such as Investment Grade bonds and agency mortgage-backed securities, are poised to deliver promising returns amid an uncertain environment.

Figure 1B

Impact of a 1% rise or fall in interest rates on returns

(assuming a parallel shift in the yield curve)

Rise of 1% Fall of 1%



Source: Bloomberg, J.P. Morgan Asset Management. Data reflect most recently available as 31 January 2023.

In summary

- Figure 1B compares the total returns of US Treasuries (UST) and selected credit sectors when interest rates rise or fall by 1% (assuming a parallel shift in the yield curve).
- Due to the yield curve currently being inverted*, higher yields are available for shorter-term assets. Furthermore, these shorter-term assets such as 2-year UST are likely to deliver positive total returns even if central banks continue to hike interest rates.
- While risks surrounding persistent inflation and aggressive central bank policies are still very real, we think a lot of those risks have been reflected by the sell-down in 2022. Even if these risks continue, staying with shorter duration bonds can help investors stay defensive.

**A yield curve is inverted when shorter-term rates are higher than longer-term rates.*

Topic 2

Asia ex-Japan stocks are well positioned to outperform

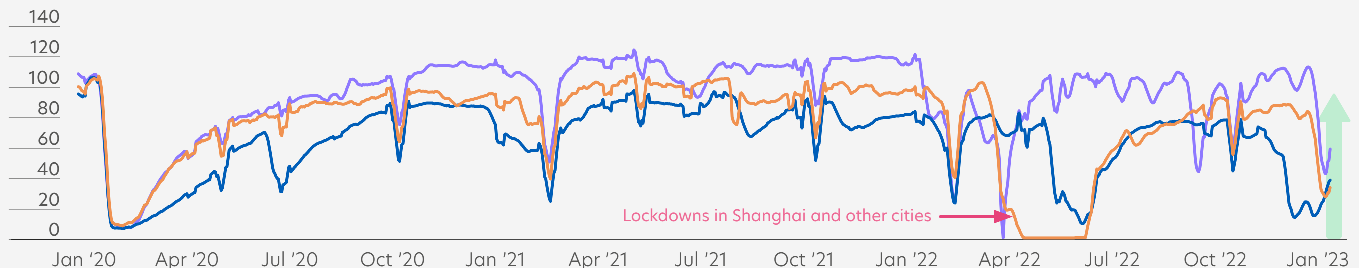
The outlook for Asia ex-Japan stocks may appear shaky in the eyes of the public. Negative developments related to China's re-opening and the resulting surge in COVID cases have been dominating headlines. However, we maintain our view that Asia ex-Japan stocks have the potential to outperform in 2023.

Figure 2A

China's traffic returning to normal as activity rebounds in post-Covid recovery

Shenzhen — Beijing — Shanghai

Subway passenger flow index, 2019 average = 100, 7-day moving average



Source: Wind, J.P. Morgan Asset Management
Data reflects most recently available as of 30 January 2023.

Key takeaways

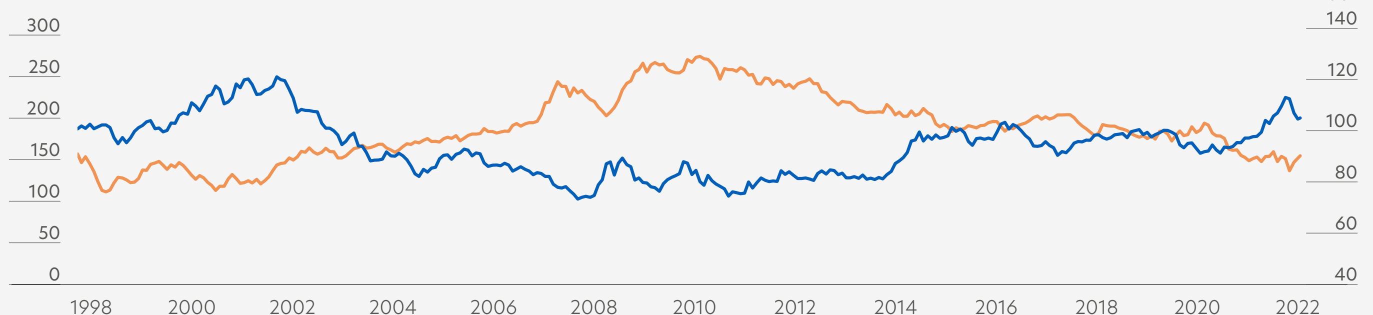
1. The US and Europe may experience a recession in 2023, but Asia's slowdown could be much more subdued with China easing its COVID controls earlier than expected.
2. After a long period of suppressed activity, China's local passenger traffic is rising quickly (Figure 2A). The return of Chinese demand and tourist activity should lead to improved revenue growth across Asia.
3. The strength of the US dollar (USD) has also been a drag on Asian stocks. Figure 2B shows that USD strength and Asian stocks outperforming that of developed markets are negatively correlated. In other words, USD strength tends to result in developed market stocks outperforming Asian stocks, and the reverse is true when the USD weakens. After appreciating significantly, the USD should peak sometime in 2023, especially with the Fed poised to slow down its interest rate hikes. A weakening USD would make Asian assets relatively more attractive.

Figure 2B

Asia ex-Japan stocks tend to outperform developed market stocks when the USD weakens, and vice versa

USD Index — MSCI APAC ex-JP / MSCI DM

Relative index level, December 1997 = 100 Index



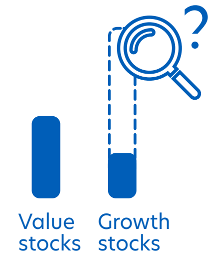
Source: Bloomberg.
Data analysis period from 30 November 1989 – 31 January 2023. Note that for Real Estate sector the returns start from 31 December 2001.

In summary

- Despite global uncertainty, our main scenario is for Asia to outperform developed markets this year. China is rebuilding and recovering, putting Asia in a good spot to benefit. Teething issues in China's abrupt COVID re-opening journey should eventually fade.
- Factors that have been a drag on Asia ex-Japan stocks in 2022, such as USD strength, should also dissipate.

Topic 3

What factors could result in growth stocks generating superior returns?

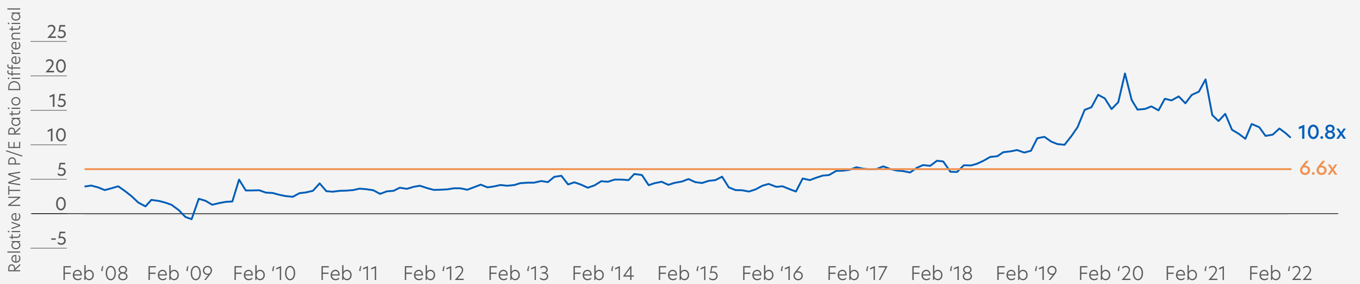


The rapid rise in interest rates in 2022 caused growth stocks to underperform value stocks disproportionately. The MSCI World Growth index delivered -29% returns for the year, underperforming the MSCI World Value Index by 23%. There are a few indicators to watch before investors should turn more positive on growth stocks in general.

Figure 3A

Valuations for growth stocks compared to value stocks are still higher than the 15-year historical average

MSCI World Growth – MSCI World Value



Source: Bloomberg, J.P. Morgan Asset Management.
Data reflect most recently available as 1 February 2023.

Key takeaways

1. Despite significant correction in growth stocks recently, they are still not cheap compared to value stocks. In fact, the difference in the current relative Next Twelve Months (NTM) Price-to-Earnings ratio between growth stocks and value stocks is 10.8x, which is still above the 15-year historical average of 6.6x.
2. Economic growth momentum and inflation are important factors to monitor, to determine if growth stocks can outperform value stocks. The Purchasing Managers' Index (PMI) New Orders data, which serves as a forward-looking indicator of economic growth, indicates that we are in a contractionary phase of the economic cycle. Meanwhile, inflation has started to slow, but the most recent inflation reading of 6.5% is at the top end of the historical range (75th – 100th percentile).
3. A contractionary growth environment can be positive for growth stocks to outperform value stocks only if inflation moderates to below the 50th percentile (Figure 3B). Hence, we need to see inflation continue to ease meaningfully for growth stocks to outperform.

Figure 3B

Growth tends to outperform value when inflation falls

Percentile analysis period: 31 January 1975 – most recent month end

Average Next Twelve Months (NTM) Relative Performance of MSCI Growth Index vs. MSCI Value Index

		US PMI New Orders (3-month moving average)				
		Percentile	0-25th	25th-50th	50th-75th	75th-100th
	Percentile	Level	27.3 to 50.9 (Contraction)	50.9 to 56.2 (Recovery)	56.2 to 60.2 (Expansion)	60.2 to 71.2 (Slowdown)
US Headline Inflation (3mma)	0-25th	-1.7% to 1.9%	5.2%	4.1%	6.1%	(0.1%)
	25th-50th	1.9% to 3.0%	3.2%	(1.2%)	1.7%	0.5%
	50th-75th	3.0% to 4.6%	(2.2%)	(2.6%)	(4.2%)	(4.3%)
	75th-100th	4.6% to 14.6%	(0.1%)	(0.3%)	(2.7%)	(9.5%)

Current environment

Source: Bloomberg, J.P. Morgan Asset Management. 3mma = 3 month moving average
Data reflect most recently available as 31 January 2023. Most recent percentile for US PMI New Orders / US Headline inflation 3mma is 11.3% and 89.38%, respectively.

In summary

- Once economic growth has reached the recovery stage, inflation must remain low for growth stocks to continue to outperform. The key is how the Fed reacts to inflation data. It is only when we see a meaningful deceleration in both inflation and economic activity that the Fed will ease off on rate hikes and cut rates. We are not there yet.
- As growth stocks have shown the ability to consistently generate superior earnings over the longer term, investors can position for recovery by selecting quality growth stocks and practising dollar-cost averaging.

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