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J.P.Morgan ASSET MANAGEMENT

UOB

UOB Investment Insights

Market PowerBar

AUGUST 2023

A LOOK AT THIS MONTH

Key Topics	What Investors Should Know
1 Stay cautious about the United States stock market rally	**Despite a strong year-to-date performance, there are concerns about the sustainability of the US stock market rally.** ▶ The recent rally has been driven by a small number of mega-cap tech stocks with an outsized impact on market performance and valuations. ▶ Avoid chasing the rally in these mega-cap tech stocks. Instead, build a diversified investment portfolio to meet your long-term financial goals.
2 The healthcare sector presents opportunities	**While the performance of the healthcare sector has been lagging in 2023, the sector is poised to benefit from its long-term growth story.** ▶ Earnings downgrades, lower profit margins due to high inflation and regulatory pressure on drug pricing are a drag on the earnings outlook for the sector. ▶ Nonetheless, we remain positive about the healthcare sector due to its defensive nature during economic slowdowns and contractions, as well as its potential upside during the recovery and expansionary phases.
3 Take a closer look at the diversity of the healthcare industry	**Sub-sectors within the healthcare sector offer diverse investment opportunities.** ▶ While some sub-sectors focus on manufacturing drugs, instruments and equipment, others may focus on research or the provision of care services. ▶ These sub-sectors can still perform relatively well in an economic slowdown despite their different characteristics, while they stand to benefit from various long-term tailwinds.

Upcoming Event

AUG 24-26

Jackson Hole Economic Symposium

Follow the speeches delivered by major central bank leaders for economic news and the likely direction of global interest rates in this three-day annual international conference.

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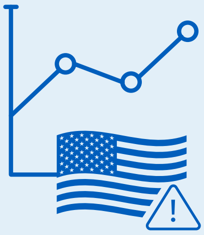
Topic 1

Stay cautious about the United States stock market rally

The US stock market has performed strongly so far this year, with the tech-heavy Nasdaq and the S&P 500 gaining 37% and 20% respectively, through the end of July. However, there are concerns about the sustainability of the rally, which has been largely driven by a small number of mega-cap tech stocks.



1. Continued strength in a number of economic data points for the US has pushed the market's recession expectations into 2024. While concerns remain over a possible recession ahead, the US stock market continues to climb higher and has been one of the better-performing markets this year.
2. Doubts about the rally are understandable as it has not been broad based. Instead, due to new developments in artificial intelligence, gains have been concentrated in a small number of mega-cap tech stocks with an outsized impact on the overall market performance and valuations.
3. The top 10 stocks in the S&P 500, which are predominantly mega-cap tech companies, have significantly higher valuations compared to the remaining stocks in the index (Figure 1A). Notably, the weightage of the top 10 stocks in the S&P 500 has jumped to 31.9%, its highest level in the past three decades, while the earnings contribution of these top 10 stocks is only around 21% (Figure 1B).
4. This combination of high valuations and relatively low earnings contribution make the best performers this year very vulnerable to volatility, as the artificial intelligence theme will take years or decades to play out, and could potentially face geopolitical and regulatory risks in the future. Recession risks have not totally disappeared as well and the lagged impact of monetary policy tightening may start to materialise over the coming months.
5. Avoid chasing the rally in US mega-cap tech stocks. Instead, build a diversified investment portfolio to meet your long-term financial goals.

Figure 1A

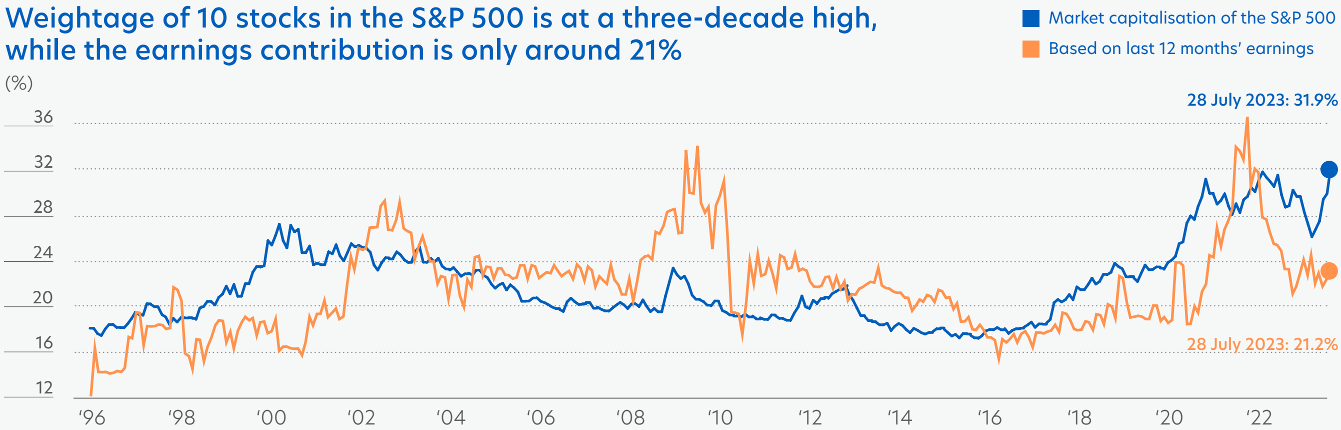
Top 10 stocks in the S&P 500 are more expensive than other stocks in the index

Price-to-Earnings (P/E) Ratio

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Figure 1B

Weightage of 10 stocks in the S&P 500 is at a three-decade high, while the earnings contribution is only around 21%



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Topic 2

The healthcare sector presents opportunities

While healthcare has lagged behind other sectors in terms of performance so far this year, it has the opportunity to outperform given its long-term growth story as well as positive drivers beyond the world's ageing demographics.

1. Healthcare is usually considered a defensive sector that is less affected by market volatility as demand for health-related goods and services is inelastic. This means that demand for healthcare is less affected by the economic cycle, an important characteristic at a time when the economy is slowing and a contraction is looming.

2. However, the year-to-date performance for the sector has been lagging despite the economic slowdown. Earnings downgrades are the key reasons for the underperformance as the strong revenues seen during the COVID-19 years have faded.

3. Meanwhile, inflation is also starting to erode profit margins, as healthcare companies' capital expenditure as well as research and development (R&D) expenses are heavily impacted as interest rates rise. Other factors such as increased labour costs and regulatory pressure to lower the prices of drugs for consumers have also been a drag on the earnings outlook.

   Nonetheless, we remain positive about the sector, especially given uncertainties in the economy. Figure 2A shows that the healthcare sector has one of the highest risk-adjusted returns across all sectors over the past 10 years. On an annualised basis, healthcare ranks second in terms of returns, while exhibiting the second-lowest volatility.

4. The healthcare sector can outperform the broader market in periods of slowdown and contraction due to its defensive nature (Figure 2B). During the recovery and expansionary phases of the economic cycle, the sector is still driven by the need for healthcare, as well as an increase in capital expenditure and business expansion. Looking at the historical trend, this typically allows the healthcare sector to deliver positive returns in every stage of the economic cycle.

Figure 2A

Healthcare sector has one of the highest risk-adjusted returns across all sectors over the past 10 years

10 years (2013 – 2023)

Annualised Return	Annualised Volatility	Sharpe Ratio*
Info. Tech. 17.4%	Energy 25.4%	Info. Tech. 0.96
Healthcare 11.2%	Materials 18.7	Healthcare 0.84
Cons. Disc. 0.6%	Info. Tech. 18.1%	MSCI World 0.64
MSCI World 9.4%	Financials 18.1%	Cons. Staples 0.62
Industries 8.9%	Cons. Disc. 18.0%	Cons. Disc. 0.59
Financials 8.1%	Industries 16.5%	Utilities 0.55
Utilities 7.4%	Comm. Svcs. 15.9%	Industries 0.54
Cons. Staples 7.3%	MSCI World 14.6%	Financials 0.45
Materials 6.3%	Utilities 13.5%	Comm. Svcs. 0.34
Comm. Svcs. 5.4%	Healthcare 13.3%	Materials 0.34
Energy 3.8%	Cons. Staples 11.7%	Energy 0.15

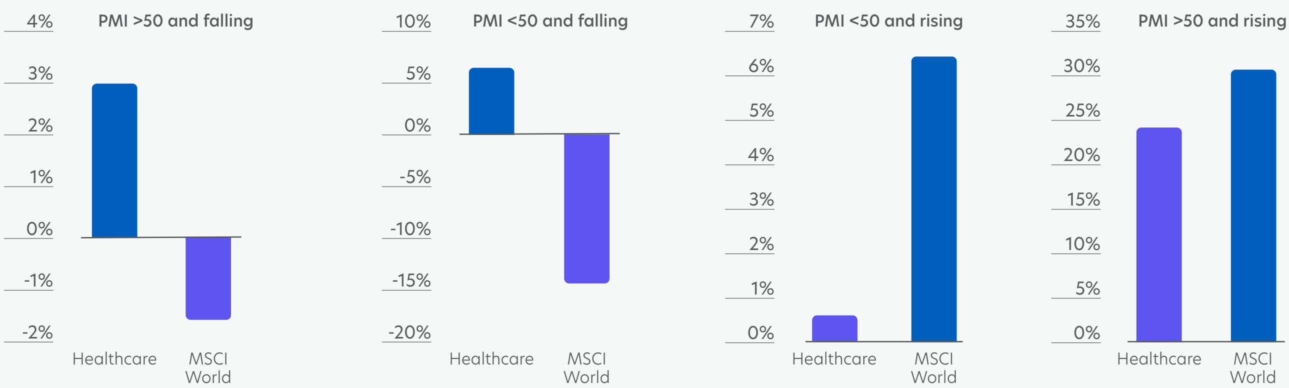
*Sharpe ratio is a measure used to assess the risk-adjusted return of an investment by comparing its return to its volatility.

Source: FactSet, MSCI, J.P. Morgan Asset Management.

Figure 2B

Healthcare sector delivered consistent positive returns in different stages of the business cycle

Annualised average monthly returns, May 2006 to July 2023



Source: FactSet, MSCI, J.P. Morgan Asset Management.

Topic 3

Take a closer look at the diversity of the healthcare sector

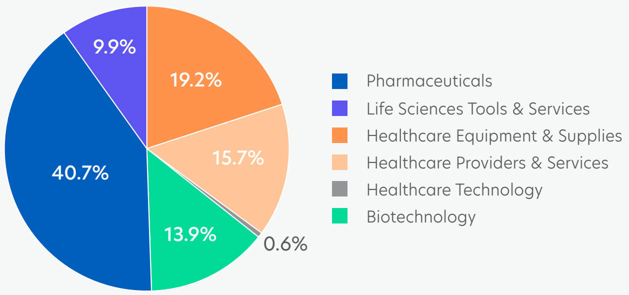
As a whole, the healthcare sector is valued by investors for its defensive nature. However, the sector has many other positive attributes, and its different sub-sectors offer various investment opportunities.

1. The healthcare sector is diverse, comprising different sub-sectors such as pharmaceuticals, biotechnology, healthcare technology and healthcare providers and services. Each sub-sector presents varying growth opportunities that have different drivers of returns.
2. While some sub-sectors focus on manufacturing drugs, instruments and equipment, others may focus on research or the provision of care services. Pharmaceutical companies currently make up around 40% of the market capitalisation in the broader healthcare sector within the MSCI World Index (Figure 3A). Some of these are major drug manufacturing firms with steady or stable prospects. Other sub-sectors such as biotech and healthcare technology have companies that are heavily involved in research and development, and they can possibly offer much higher growth margins and earnings potential. Life sciences, tools and services, as well as healthcare equipment and supplies are heavily intertwined with technological advancement and the adoption of new technology.
3. Despite their different characteristics, these sub-sectors can still perform relatively well in an economic slowdown (Figure 3B), as demand for these goods and services tend to remain stable regardless of where we are in the economic cycle.

Figure 3A

Healthcare sector within the MSCI World Index comprises of various sub-sectors

Share of healthcare



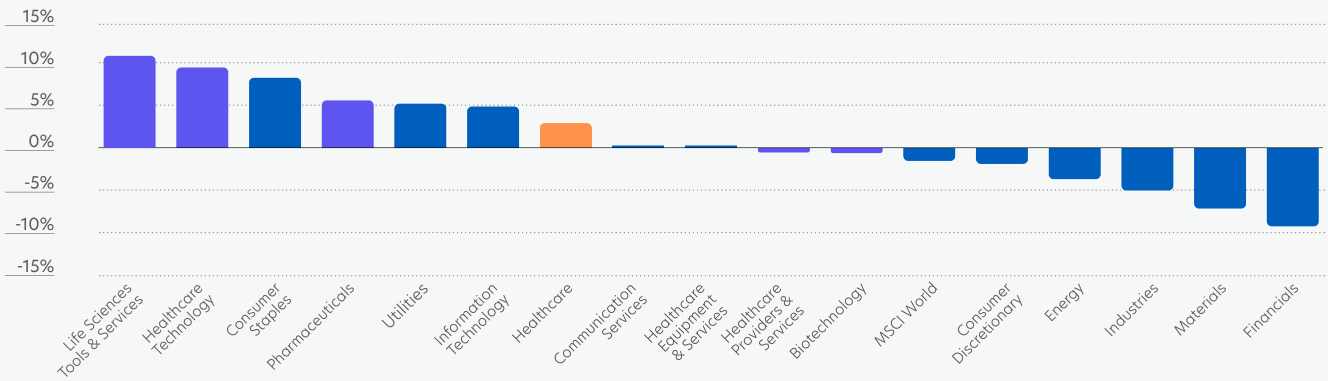
Source: FactSet, MSCI, J.P. Morgan Asset Management.

4. With increasing demand for healthcare services along with digitalisation to improve efficiency and convenience, interesting investment opportunities could emerge within the sector.
5. In the long term, the backdrop for the healthcare sector remains positive, supported by tailwinds such as technological advancements in health and science, a global ageing population and rising market demand.

Figure 3B

Healthcare sub-sectors perform well during late cycle slowdown

Annualised average monthly returns when PMI>50 and falling, May 2006 to July 2023



Source: FactSet, MSCI, J.P. Morgan Asset Management.

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