

UOB Investment Insights

Market PowerBar

MARCH 2024

TOPIC 1:

Have we missed the boat?

Recent data suggests that the United States (US) economy may be headed for a soft landing scenario where economic growth slows but avoids a recession. As investors become more optimistic that a recession can be avoided, stocks, especially those in US markets, have recently reached record highs. Is it too late for investors to invest now?

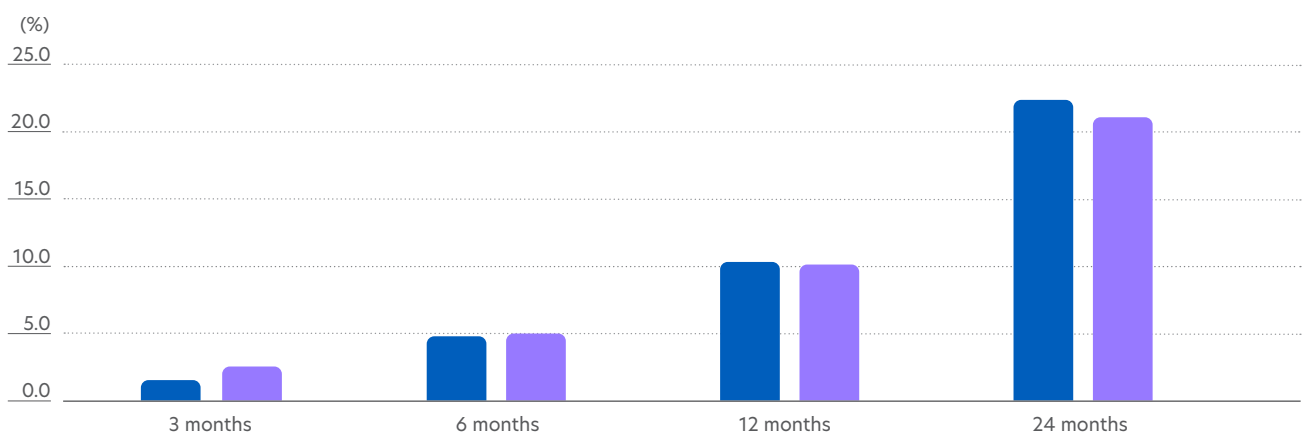
- The US economy has so far avoided a recession, with steady economic growth and employment. Meanwhile, inflation has come down from its peak. Although inflation has not reached the Federal Reserve’s (Fed) target of 2%, it is heading in the right direction.
- The Fed appears to have raised rates to control inflation without hurting growth. As inflation has declined, investors are now expecting rates to be lowered to a level where economic activity is supported while inflation is restrained.
- Since everything seems just right, the S&P500 index has reached new peaks since the last quarter of 2023. Is it too late to invest now?
- However, US stock markets often make record highs. There is no clear advantage, both in the short and long term, to invest at record highs versus waiting for markets to fall (Figure 1). Moreover, positive earnings growth as well as the possibility of central bank rate cuts when there is no recession suggest another year of stock market gains.

Figure 1:

Average returns of investing at record high days vs non record high days are not significantly different

Average S&P 500 price returns across time periods, 1980 - present

■ Average returns of investing at record high days
■ Average returns of investing on non record high days



Source: FactSet, Standard and Poor’s, J.P. Morgan Asset Management.

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Is cash still king?

In a soft landing scenario, bond yields are likely to fall, implying higher price return. This offers investors opportunities to move from cash to bonds.

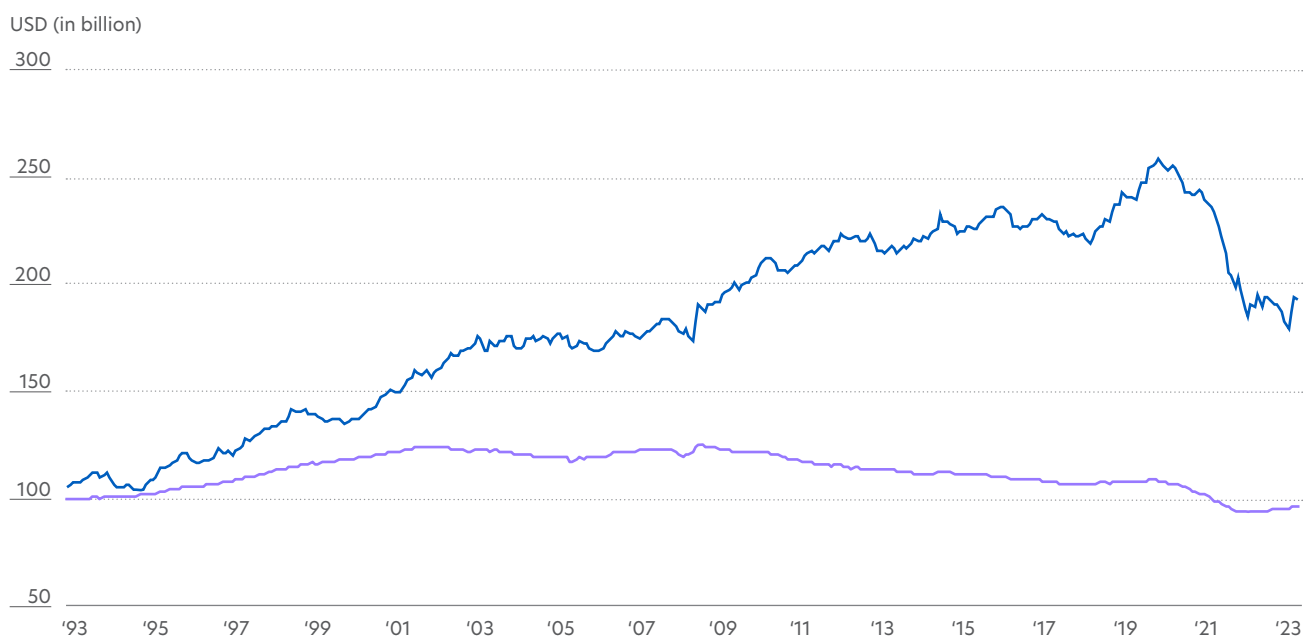
- Investors are closely watching incoming data for clues on Fed rate cuts. If inflation falls further, the probability of rate cuts will increase, driving bonds returns this year.
- In the near term, bond markets can be volatile from overly optimistic rate cuts expectations. For example, higher than expected inflation in January led to a bond sell-off in February.
- In the medium term, we expect rates to fall as the Fed gradually cuts interest rates. This means that bonds, including those with short maturity, can deliver higher returns than cash. While cash returns were over 5% last year, other asset classes have outperformed cash in most years, with the exception for 2018 and 2022 when markets experienced broad downturns.
- Looking back, holding even short duration bonds has resulted in higher returns than holding cash (Figure 2). An investor holding cash also faces reinvestment risk, where you may have to reinvest cash at lower rates in future.
- While bonds typically have lower returns than stocks, lower volatility makes bonds attractive, especially in a year likely filled with uncertainty.
- Therefore, bonds, especially high-quality ones like investment grade bonds, play an important part in your investment portfolios.

Figure 2:

Long-term returns of cash vs bonds

Growth of a USD 100 investment

Based on inflation-adjusted monthly return from 31 December 1991



Source: Bloomberg, J.P. Morgan Asset Management. US Agg: US Aggregate bonds is based on Bloomberg US aggregate Index, US Cash: US short term Treasuries based on Bloomberg Short-term Treasury Total Return Index.



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Will inflation make a comeback?

Our main scenario is that the economy will slow down gradually without crashing. One of the main challenges to this scenario is inflation. Look out for these three potential risks.

- The first risk is related to wage costs, probably the result of a strong US labour market. If companies pass high wage costs onto their products instead of absorbing them, prices of goods will go up.
- The second risk comes from sticky shelter costs. Looking at a breakdown of the drivers of inflation, a big component is made up of shelter costs. These should drop in the coming months as they are lagging indicators (Figure 3a). For core services prices (excluding shelter costs) to fall, wage growth also needs to come down (Figure 3b).
- The third risk could come from a commodity shock from geopolitical tensions. Not only could this push energy prices up, as we have seen with events in the Middle East, a commodity shock can also disrupt shipping and cause new problems for supply chains.
- Considering these risks, the last mile for inflation to fall to 2% is not a smooth one, and reminds us of the importance of portfolio diversification. A diversified portfolio can capture opportunities across different market cycles and deliver consistent returns over time with lower volatility.

Figure 3A:

Shelter is a large part of US inflation

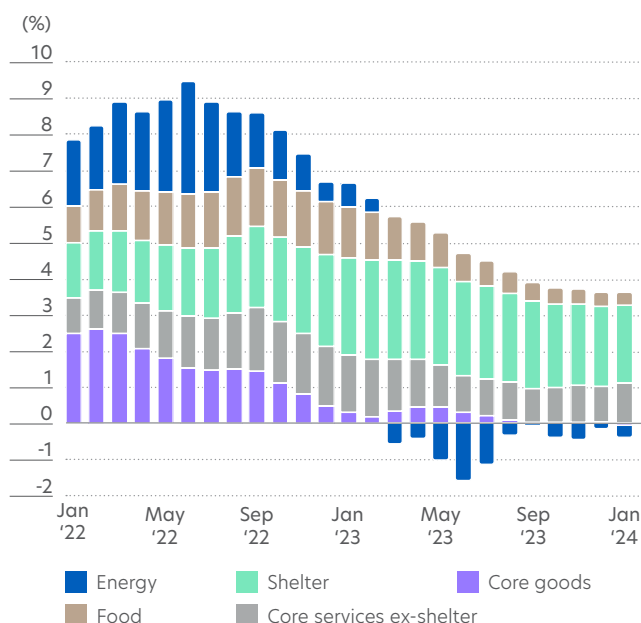
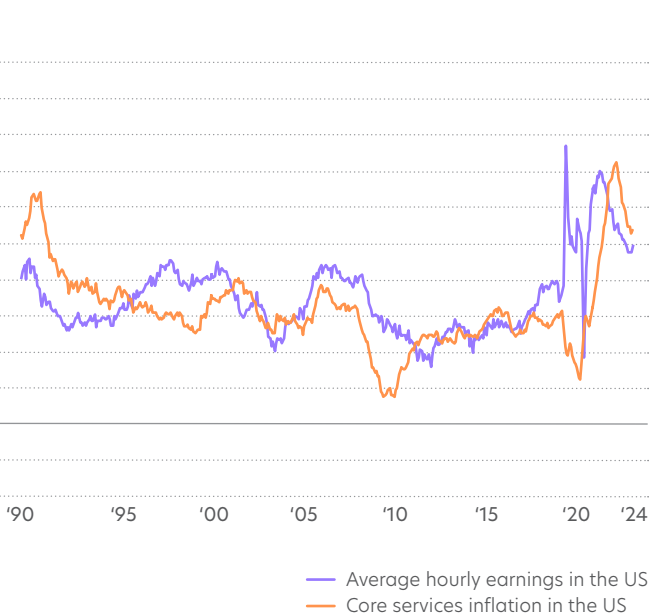


Figure 3B:

Strong wage growth keeps core services inflation high



Source: FactSet, US Department of Labor Statistics, J.P. Morgan Asset Management.



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