November 2023

# Investment Navigator
## Asia Edition

# Volatility Creates Cross-Asset Opportunity?

## Summary


- Global equities and bonds continued to correct in October 2023 in a seasonally weaker period of the year. Rising yields, elevated geopolitical risk, and mixed earnings season weighed on global asset returns.
- Real yields rising, concerns over US government debt size and issuance (which has led to higher term premium*) are feeding into higher yields, albeit central bank rate hike expectations have not changed and longer-term inflation expectations also relatively anchored.
- The rise in yields provides a good entry point for quality bonds with attractive yields and a chance to even extend duration to achieve potential equity-like returns in the medium term as we expect the Federal Reserve (Fed) to cut rates from mid-2024 to mid-2025.
- US equities had corrected over the past three months. Investors should take this opportunity to monetise the volatility for better entry points in lagging sectors as the average stock is already down for the year.


*Term premium: compensation for uncertainty of holding longer maturities i.e. taking duration risk.



Given the rise in yields, elevation in geopolitical risk, and correction in equity markets, we sought to answer some of the key questions for investors at the moment.

### 1. Why are Yields Rising?

Firstly, the most interesting issue is government bond yields are rising **despite** the fact that rate hike expectations for the Fed and ECB have not changed. The market expects rates to be on hold for a long period of time, in-line with our view that the Fed and the ECB will hold rates steady until June 2024 and September 2024 respectively.

Secondly, **medium-term inflation expectations have not increased much either** with the 10-year inflation expectations rising only modestly.


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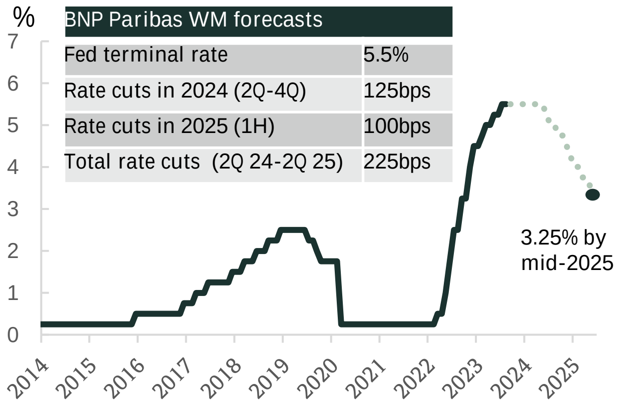
**WE EXPECT THE FED TO START CUTTING RATE FROM JUNE 2024. GRADUALLY INCREASE DURATION IN BONDS TO AVOID REINVESTMENT RISK IN CASH**




Source: Bloomberg, BNP Paribas (WM), as of 3 Nov 2023. Past performance is not indicative of current or future performance.

Hence, most of the increase in yields are in real yields (i.e. market's expected level on interest rates after adjusting for inflation), which act as a tightening of monetary policy. This brings up another crucial point - most of the rise in yields has been at the longer end of the curve. Since July 31st, the 2-year yields are up just +15 bps, while the 10-year yields are up +92 bps, leading to a bear flattening of the yield curve.

So, what are the key reasons for longer-dated yields to rise? The term premium that investors required has increased due to (1) increased issuance to fund higher budget deficits fueled by Programs including the CHIPs act and IRA which have led to reshoring boom and more resilient growth in the US, and (2) rising global yields as Japan has moderately loosened yield curve control.

On technical and positioning, yields breaking key levels and unwinding of long positions in US Treasuries by leveraged players also contributed to sharp rise in yields. That said, we have started to see some larger hedge funds covering their short positions in bonds recently and lower yields in early November.

We believe monetary policy acts with a lag. The impact of higher real yields, gradually slowing labour market illustrated by rising job claims, and early signs of slowdown in consumer spending will see the economy slowing and a peak in yields in the coming months if it has not already occurred.

While picking the exact top in yields won't be possible, the return path for investors is asymmetric with the cushioning effect of attractive coupons versus potential downside risk of further higher yields, firmly in favour of bonds. Investors can consider gradually increase duration if you are overweight cash (to reduce reinvestment risk).

## 2. How Long Will the Equity Correction Last?

The S&P 500 broke its 200-day moving average at the end of October with a drop of 10%, entering correction territory and finally joining other global markets. Three factors drove the decline: (1) rising yields, (2) mixed earnings season with normal level of earnings beats for 3Q but modest downgrades for 4Q, and (3) an increase in geopolitical risk.

We believe yields are at or near a peak, and will be lower 12 months from now. However, earnings estimates are elevated for 2024 with earnings growth of 11%, which are vulnerable to downside revisions given the slowing US economy. Hence, we expect choppy markets in the short-term.

That said, we only have a moderate US recession projected for next year. The S&P 500 cap-weighted index has outperformed its equal-weighted peer by 13% YTD, the widest margin of outperformance in 30+ years, as the rally had been largely driven by the "Magnificent 7" stocks, which were the last to correct, while the S&P 500 equal-weighted index is actually down -3% YTD. Many sectors, such as energy, healthcare, materials and financials, have been left behind and already pricing in an economic slowdown.

Furthermore, non-US equity markets, including Japan, Europe, UK and Latin America, trade on low valuations with many stocks offering attractive dividend yields. We recommend gradually accumulating stocks on weaknesses. Normally, we are entering a traditionally stronger period of equity returns in terms of seasonality in November and December though volatility will likely remain.

### 3. What About the Conflict in the Middle-East?

In absence of a broadening of the Middle East conflicts, we expect Brent oil to trade in the $85-95 range. Geopolitical risks and OPEC+ production cuts

are putting a floor for oil prices. However, the key risk is stronger sanctions on Iran could cut exports by 1 mb/d and push Brent prices up to $110, a level that would lead to demand destruction.

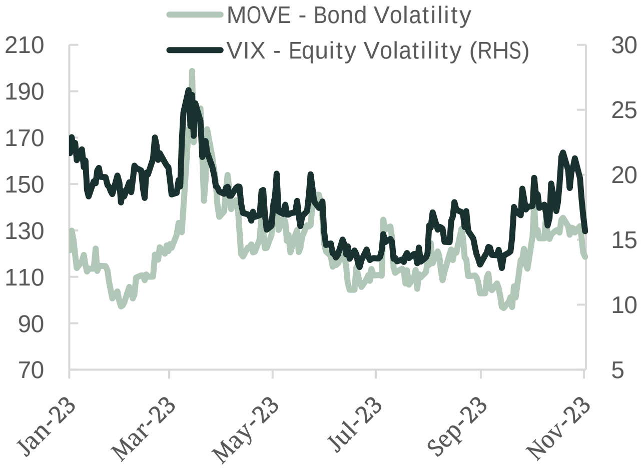
Keep in mind that most geopolitical events do not have lasting impacts on the global economy. We make no changes to our views based on this situation. We will continue to monitor the fluid situation.

### 4. Let Volatility Create Cross-Asset Opportunity?

The recent rise in yields, questions over how long the central banks will remain on hold, and the increase in geopolitical risk, mean volatility has increased. Both the VIX index (implied volatility of the S&P 500 index) and the MOVE index (measure of US treasury bond volatility) were higher than previous months. The recent correction in global equities and increase in bond yields represent tactical opportunities to build strategic positions in bonds and equities.

Structured solutions allow customised entry points, offering better risk/rewards and more defensive strategies in this environment. Don't forget always focus first on your strategic asset allocation and then take advantage of volatility to build longer-term positions.

**MONETISE THE VOLATILITY VIA STRUCTURED SOLUTIONS TO GET BOND & EQUITY EXPOSURE WITH BETTER ENTRY POINTS**




Source: Bloomberg, BNP Paribas (WM), as of 3 Nov 2023.
Past performance is not indicative of current or future performance.

## CONCLUSION

The increase in bond yields, rising geopolitical risk and mixed earnings season led equities to enter correction mode in October. Yields have risen since July not because of market worries over additional rate hikes nor increased longer-term inflation expectations. The rise in yields was due to increase in real yields and increase in risk premium investors asked for holding longer-dated bonds.

The positive real yields will slow the economy as monetary policy acts with a lag of 12-24 months. There are early signs of slowing consumer, rising job claims in the US, and more cautious outlook by companies.

Any stabilization in bond yields would provide good entry points for quality bonds given attractive yields (16-year high) and chance to achieve potential equity-like returns (taking duration risks) in the medium term in the rate cuts environment in 2024 and 2025.

**S&P 500 cap-weighted index has outperformed its equal-weighted peer by 13% YTD, the widest margin of outperfomance in 30+ years, as the rally had been largely driven by the "Magnificent 7" stocks, while the S&P equal-weighted index is actually down -3% YTD. Many sectors, such as energy, healthcare, materials and financials, have been left behind and already pricing in some economic slowdown. Furthermore, non-US equity markets, including Japan, Europe, UK and Latin America, trade on low valuations with many stocks offering attractive dividend yields. Investors should monetise the volatility via structured solutions for better entry points.**

# Overview of our CIO Asset Allocation for November 2023

| | Views Current | Views Prior | Constituents | We like | Comments |
|---|---|---|---|---|---|
| EQUITIES | + | + | Markets | Eurozone, UK, Japan, Latin America (selective), China, South Korea, Singapore & Indonesia | ■ **We maintain our positive view on non-US equities.** Historically, there have been several instances of (geo)political turmoil and war. None of them managed to derail equities in the long run. |
| | | | Sectors | Energy, Healthcare, Materials | ■ We also like EU utilities and financials. We **upgrade EU technology from neutral to positive.** |
| | | | Styles/ Themes | Megatrend themes | ■ **Security, circular economy, electrification and income themes.** |
| BONDS | = | = | Govies | US government bonds (prefer 3-5 year maturities) US inflation-indexed bonds | ■ Bond yields are currently overshooting. **Our 12-month target for the US 10-year Treasury yield remains at 3.75%.** |
| | + | + | Segments | Investment grade, Emerging markets (EM) bonds (USD + local currency) | ■ **We are positive on US (short to intermediate maturities) and Euro (short maturities) investment grade corporate bonds.** |
| CASH | - | - | | | |
| COMMO-DITIES | + | + | | Gold Oil Battery metals | ■ **Gold - positive**: target range $1950-2150.<br>■ **Oil - positive**: Brent's target range $85-95.<br>■ **Base metals – positive.** |
| FOREX | | | USDJPY | | ■ USDJPY 3- and 12-month targets at 145 and 134 respectively. |
| ALTER-NATIVE | + | + | | Hedge funds (macro, long-short equities, relative value); | ■ We **upgrade global macro strategy from neutral to positive.**<br>■ Neutral on event driven |

Note: + Positve / = Neutral / - Negative

## GDP & CPI Forecasts

| | | GDP (YoY%) | | | CPI (YoY%) | | |
|---|---|---|---|---|---|---|---|
| | | 2022 | 2023f | 2024f | 2022 | 2023f | 2024f |
| Developed | US | 1.9 | 2.4 | 0.7 | 8.0 | 4.2 | 2.4 |
| | Japan | 1.0 | 2.0 | 1.0 | 2.5 | 3.2 | 2.6 |
| | Eurozone | 3.4 | 0.5 | 0.9 | 8.4 | 5.6 | 2.8 |
| | UK | 4.1 | 0.6 | 0.0 | 9.1 | 7.4 | 3.0 |
| North Asia | China | 3.0 | 5.1 | 4.5 | 2.0 | 0.5 | 2.0 |
| | Hong Kong* | -3.5 | 4.4 | 2.9 | 1.9 | 2.2 | 2.3 |
| | South Korea | 2.6 | 1.2 | 1.8 | 5.1 | 3.4 | 2.3 |
| | Taiwan* | 2.4 | 0.8 | 3.0 | 2.9 | 2.1 | 1.5 |
| South Asia | India | 7.2 | 6.1 | 6.0 | 6.7 | 5.9 | 5.0 |
| | Indonesia | 5.3 | 5.0 | 5.0 | 4.2 | 3.4 | 2.7 |
| | Malaysia | 8.7 | 3.7 | 4.0 | 3.4 | 2.8 | 2.9 |
| | Philippines* | 7.6 | 6.0 | 5.8 | 5.8 | 6.3 | 3.2 |
| | Singapore* | 3.6 | 1.0 | 2.1 | 6.1 | 5.5 | 3.5 |
| | Thailand | 2.6 | 2.5 | 3.5 | 6.1 | 1.6 | 2.3 |

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 31 October 2023
* IMF data and forecasts as of 31 October 2023

### GROWTH

- Despite stronger than expected 3Q US GDP numbers, we expect a consumer downshift in 4Q and into 2024, taking into account a rapid rise in consumer debt serving costs amid gradually slowing wage growth. We still expect a mild US recession in 1H 2024.
- While Eurozone's 3Q GDP slightly contracted by a mild 0.1% qoq against our expectation of a flat print, the data beneath the surface appear more resilient. We still characterize the current environment as stagnation.

### INFLATION

- In the US, while core CPI rose in line with expectations in Sep, the details reaffirmed our view that a softer labour market will be required to move inflation back to the Fed's 2% target.
- In Eurozone, headline inflation (+2.9% in Oct vs 4.3% in Sep) showed more improvement than expected (+3.1%), while core pressures eased in line with our forecast (+4.2% in Oct vs 4.5% in Sep).
- Disinflation trend remains intact, but inflation risks remain skewed to the upside.

## Equities

POSITIVE NEUTRAL NEGATIVE

| OVERALL GLOBAL: POSITIVE | | |
|---|---|---|
| Positive | Neutral | Negative |
| **COUNTRY** | | |
| UK<br>Japan<br>Emerging Mkt<br>Eurozone | US | - |
| **SECTOR** | | |
| Energy<br>Healthcare<br>Materials | Comms., Industrials<br>Utilities, Real Estate<br>Technology<br>Consu. Discre.<br>Financials | Consumer Staples |

| OVERALL ASIA: POSITIVE | | |
|---|---|---|
| Positive | Neutral | Negative |
| **COUNTRY** | | |
| China<br>Singapore<br>South Korea<br>Indonesia | Taiwan<br>India, Thailand<br>Malaysia<br>Philippines | - |
| **SECTOR** | | |
| Comms.<br>Consu. Discre.<br>Consumer Staples<br>Technology | Energy<br>Materials<br>Real Estate<br>Financials<br>Industrials<br>Healthcare | Utilities |

- Historically, there have been several instances of (geo)political turmoil and war. None of them managed to derail equities in the long run.
- We remain positive on non-US equities. We are cautious/selective with expensive market segments, such as Consumer Staples, some large-cap US tech stocks and some Consumer Cyclicals as pricing power is weakening and operating profits are under pressure from rising costs. Some very high P/E ratios are difficult to justify.
- We **upgrade the Europe technology sector from neutral to positive**. The majority of European software companies are active in the application layer of the AI value chain. We expect a growing demand as AI enables users to overcome traditional software limitations when it comes down to process automatization. This potential seems not to ben fully appreciated by the market yet.

| | | 1-month (%) | YTD (%) | 2022 (%) | Forward PE (x) | Trailing PB (x) | Dividend Yield (%) 2023f | EPS Growth (%) 2023f | EPS Growth (%) 2024f | ROE (%) 2023f |
|---|---|---|---|---|---|---|---|---|---|---|
| Developed | US | -2.4 | 9.5 | -20.8 | 17.8 | 4.0 | 2.1 | 1.4 | 11.8 | 18.2 |
| | Japan | -3.1 | 19.5 | -6.6 | 13.8 | 1.4 | 2.3 | 3.5 | 8.4 | 8.8 |
| | Eurozone | -3.3 | 4.3 | -14.5 | 11.1 | 1.6 | 3.4 | 3.6 | 6.4 | 0.0 |
| | UK | -3.7 | -2.1 | 3.0 | 10.0 | 1.6 | 4.0 | -11.9 | 5.2 | 15.0 |
| | Asia Ex-Japan | -3.9 | -6.2 | -21.5 | 11.9 | 1.5 | 3.1 | 0.3 | 21.3 | 9.8 |
| North Asia | China | -4.2 | -12.1 | -22.4 | 9.2 | 1.2 | 3.8 | 14.8 | 15.8 | 10.6 |
| | China A-shares | -3.2 | -7.7 | -21.6 | 11.4 | 1.8 | 3.2 | 14.9 | 13.8 | 12.1 |
| | Hong Kong | -2.2 | -21.7 | -7.8 | 11.5 | 0.9 | 4.4 | 3.3 | 12.3 | 6.6 |
| | South Korea | -7.0 | 5.3 | -26.4 | 11.1 | 1.0 | 2.3 | -36.3 | 72.4 | 5.7 |
| | Taiwan | -1.2 | 12.4 | -24.7 | 14.7 | 2.3 | 3.6 | -20.3 | 20.0 | 13.6 |
| South Asia | India | -2.8 | 4.5 | 1.6 | 19.7 | 3.7 | 1.3 | 21.9 | 14.4 | 14.6 |
| | Indonesia | -5.9 | -5.0 | 10.4 | 13.1 | 2.2 | 4.9 | 35.0 | 9.2 | 14.7 |
| | Malaysia | 1.3 | -3.8 | -4.3 | 13.4 | 1.4 | 4.0 | 8.4 | 8.3 | 9.1 |
| | Philippines | -5.4 | -8.0 | -7.3 | 11.3 | 1.7 | 2.2 | 23.5 | 9.2 | 13.0 |
| | Singapore | -4.1 | -5.6 | 4.4 | 11.2 | 1.3 | 5.2 | 41.7 | 2.2 | 10.0 |
| | Thailand | -4.6 | -15.4 | 6.3 | 15.6 | 1.7 | 2.8 | -13.6 | 16.2 | 8.9 |

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 31 October 2023

## Fixed Income

POSITIVE NEUTRAL NEGATIVE

| OVERALL GLOBAL: NEUTRAL | | |
|---|---|---|
| POSITIVE | NEUTRAL | NEGATIVE |
| EMD (LC)<br>EMD (HC)<br>IG<br>UST | High Yield | - |

| OVERALL ASIA (USD): NEUTRAL | | |
|---|---|---|
| POSITIVE | NEUTRAL | NEGATIVE |
| | India<br>Philippines<br>Singapore<br>Indonesia | ▼ Hong Kong<br>▼ China |

| | | Total Return (%) | | | Yield-to-Worst (%) |
|---|---|---|---|---|---|
| | | 1-Month | YTD | 2022 | |
| Asia | Asia USD Bond | -0.9 | 0.1 | -11.7 | 6.7 |
| | Asia Local Currency Bond | -1.9 | -2.7 | -8.6 | 4.8 |
| | China | -0.7 | -0.7 | -10.9 | 6.9 |
| | Hong Kong | -0.9 | 0.8 | -10.5 | 6.5 |
| | India | -1.1 | 1.9 | -9.7 | 8.0 |
| | Indonesia | -1.6 | -1.9 | -12.9 | 6.4 |
| | Singapore | -0.9 | 0.4 | -11.0 | 5.8 |
| | South Korea | -0.2 | 2.2 | -8.6 | 5.9 |
| | Philippines | -1.7 | -2.3 | -14.2 | 6.6 |
| Other Regions | US 10-year Treasuries | -1.3 | -2.9 | -12.1 | 4.9 |
| | US Investment Grades (IG) | -1.6 | -2.8 | -13.0 | 5.6 |
| | US High Yield (HY) | -1.2 | 4.6 | -11.2 | 9.5 |
| | Emerging Market USD Bond | -0.8 | 0.0 | -12.1 | 7.5 |

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 31 October 2023

| US Treasury 12-month Yield Targets (%) | 2Y | 5Y | 10Y | 30Y |
|---|---|---|---|---|
| | 3.50 | 3.70 | 3.75 | 4.00 |

- Main central banks will likely stay on hold for several quarters, with a hawkish bias until they see signs of the economic slowdown. We expect 125bp of rate cuts in 2024 from the Fed from June, and 50bp from September from the ECB.

- We stay **Positive on IG corporate bonds** given the risk/return upside and low volatility of return. The current level of spreads compensate for the long-term average default rates and even for the worst historical default. We prefer short maturities in the Eurozone, and short to intermediate maturities in the US.

- We **tactically downgrade China and Hong Kong credit from neutral to negative in the short term**. We turn more cautious as China IG and SOEs are expensive while HY or high-beta companies are still facing huge headwinds. Hong Kong companies are facing different levels of challenges given the "rates stay higher for longer" scenario, further weakness in the economy and tightening of lending standards from commercial banks.

## Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

| 12-MONTH FOREX VIEW | | |
|---|---|---|
| POSITIVE | NEUTRAL | NEGATIVE |
| JPY EUR GBP AUD NZD CNY KRW TWD IDR MYR PHP SGD THB | CAD INR | USD |

| COMMODITIES | | |
|---|---|---|
| POSITIVE | NEUTRAL | NEGATIVE |
| Gold<br>Oil<br>Base metal | | - |

**JPY:** The Japanese Yen has weakened to its 32-year lows against the US dollar. We expect the BoJ to revise its forward guidance in January and exit from its negative interest rate policy and yield curve control in March 2024. The JPY will likely benefit from rate cuts by most other central banks in 2H 2024. We maintain our USDJPY 3-month target at 145 and our 12-month target at 134.

**EUR:** We believe the ECB has reached its terminal rate at 4% and the Fed is also done on rate hike. The yield differential should be more favourable for Euro. We lower our EUR/USD 3-month target from 1.08 to 1.06 given the recent market movements and the lack of drivers in the short-term. In the medium-term, we maintain our 12-month target at 1.15.

**GOLD** has proved once again to be a good hedge against geopolitical risks. EM central banks purchases, diversification needs, lower expected real yields and weaker dollar should help gold to trade in the **$1950-2050** range.

**OIL:** In absence of a broadening of the Middle East conflict, we expect Brent to trade in the **$85-95** range. Geopolitical risks and OPEC+ production cuts are putting a floor for oil prices.

**BASE METALS:** Short term demand outlook is bleak, but a sharp recovery is expected due to necessary restocking. We keep our medium-term positive stance because of the huge needs of the energy transition and the supply inelasticity. **Copper is our preferred base metal.**

## Forex Forecasts

| | | Spot | 3-month | | 12-month | |
|---|---|---|---|---|---|---|
| | | As of 31 Oct 2023 | View | Target | View | Target |
| Developed | USD Index* | 106.66 | = | 105.0 | - | 97.4 |
| | Japan | 151.4 | + | 145 | + | 134 |
| | Eurozone | 1.057 | = | 1.06 | + | 1.15 |
| | UK | 1.213 | = | 1.23 | + | 1.34 |
| | Australia | 0.633 | + | 0.68 | + | 0.70 |
| | New Zealand | 0.584 | + | 0.60 | + | 0.63 |
| | Canada | 1.388 | + | 1.32 | + | 1.30 |
| Asia Ex-Japan | China | 7.318 | = | 7.20 | + | 6.80 |
| | South Korea* | 1,351 | = | 1,310 | + | 1,270 |
| | Taiwan* | 32.44 | = | 32.0 | = | 31.3 |
| | India | 83.26 | = | 82.0 | = | 82.0 |
| | Indonesia* | 15,885 | = | 15,500 | + | 15,200 |
| | Malaysia* | 4.765 | = | 4.68 | + | 4.53 |
| | Philippines* | 56.74 | = | 58.0 | = | 58.3 |
| | Singapore* | 1.370 | = | 1.37 | + | 1.29 |
| | Thailand* | 35.94 | = | 35.00 | + | 33.00 |

Source: BNP Paribas (WM) as of 31 October 2023
*BNP Paribas Global Markets forecast as of 31 October 2023

Note: + Positve / = Neutral / - Negative

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