Latest Asset Allocation View

October 2024[1]

Multi-Asset Solutions Team

[1]The latest Asset allocation views publication schedule is January, April, July and October. The last update was issued in July 2024.

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Key Global Themes

1. Monetary policy is easing, but how far and fast it goes is the question

- The US Federal Reserve (Fed) has definitively shifted from its sole focus on inflation to also supporting full employment. As such, with jobs and economic growth cooling, we expect a faster pace of easing than what the Fed has telegraphed. We see a Fed funds rate of 4.25% at the end of 2024 and 3.00% at the close of 2025.
- This clearer policy path could result in a more synchronous global easing cycle as a weaker US dollar prompts rate cuts from central banks—particularly in emerging markets (EM) —that have been somewhat constrained from easing by recent US dollar strength.
- That said, specific factors are still at play for many policymakers. The European Central Bank and Bank of England are contending with stubborn inflation, while the Bank of Canada faces sluggish domestic demand and the possibility of weak inflation. The Bank of Japan has actually raised rates twice this year, and Brazil Central Bank has increased rates due to inflation. Among other emerging markets, Bank Indonesia has begun cutting rates as the Rupiah stabilizes against the US dollar.

Source: Multi-Asset Solutions Team (MAST), as of 30 September 2024. Projections or other forward-looking statements regarding future events, targets, management discipline or other expectations are only current as of the date indicated. There is no assurance that such events will occur, and if they were to occur, the result may be significantly different than that shown here.

Key Global Themes

2. United States: regardless of the landing, we're likely to experience turbulence on the way down

- For months, there has been a debate about whether the US economy would experience a hard landing, a soft landing, or no landing at all. We've maintained that no slowdown is highly unlikely given the massive monetary policy tightening of the past two years. Recent US data has however broadly shown strength, which has seen yields rise and dollar strength. This move in yields is partly to reflect the market's view of less aggressive cuts to come than previously thought, or anticipation of a Trump election win which could be seen as policy being more inflationary
- Outside of household consumption, most sectors of the US economy have slowed, including housing, business investment, and international trade. We also see limited upside potential for consumption: With labour demand slowing, we expect a moderate hit to income and consumer confidence, which would ultimately weigh on households' ability to spend.
- The question now is whether the US slowdown will be limited to a modest deceleration or a more pronounced deterioration. So far, the data has moderated at a reasonable pace. If a more benign business environment unfolds, easier monetary policy should ultimately be a positive for risk assets. There is, however, an important caveat: We DO expect volatility around disappointing macroeconomic data as markets adjust to the odds of a weak growth environment. Furthermore, should inflation come back, this would complicate the current Fed guidance to markets.

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Key Global Themes

3. Global economies have already softened; the global trade cycle will become an important theme

- While the discussion around whether or not the United States can stick the landing is alive and well, we would note that large parts of Europe, the United Kingdom, Japan, Canada, and China have all experienced underwhelming, and comparatively weaker, growth at various points over the last six quarters.
- With the United States slowing, we expect global trade volumes will continue to slow–an outcome already reflected in business surveys such as global PMIs. This is especially the case given the limited scope from China for improved domestic demand compounding any global slowdown. Consequently, any country-level assessment should include careful consideration of its exposure to the global trade impulse.
- Given the divergence in policy and macroeconomic data across economies, it's essential to maintain vigilance and carefully review portfolio positioning on a regular basis.

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Asset Class Overview

Broad Asset Class Outlook

Current outlook • Represents previous view		Underweight	Neutral	Overweight
Broad Asset Classes	Equities			•
	Fixed Income	•		

- While plenty of opportunities remain in both equities and fixed income, we've shifted to a neutral stance. This is due to elevated equity valuations and weakening macroeconomic conditions in business, trade, and the labour market, and despite resilient yet slowing corporate earnings growth.
- Volatility remains amid a complex macroeconomic landscape where geopolitical risks and a global growth slowdown are potential headwinds for riskier assets going into Q4 2024.

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Asset Allocation View

Active Asset Allocation Views

• Represents previous view

	Underweight	Neutral	Overweight
Asset class: Equities			
United States			■ •
Canada	•	■	
Developed markets excluding North America		■ •	
Europe ex U.K.		■ •	
Emerging Markets		■ •	
US small cap			■ •
United Kingdom		■ •	
Japan			■ •
Emerging Latin America		■ •	
APAC ex-Japan		•	■
Mainland China		■ •	
Hong Kong		■ •	
Real estate investment trusts		■ •	
Infrastructure			■ •
Commodities		■	•
Asset class: Fixed Income			
US investment grade		■ •	
Canadian investment grade		■ •	
Asia investment grade		■ •	
US high yield	■ •		
Asia high yield		■ •	
Leveraged loans		■ •	
Emerging-market debt			■ •

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Equity View

Broad Equity:

- We've **shifted from an underweight to a neutral position in Canadian equities** due to improving earnings growth and attractive valuations compared to other developed markets. The Bank of Canada's dovish stance on rate cuts could be the potential catalyst for these benefits.
- While we remain overweight in US equities—supported by positive earnings growth and an easier Fed policy—the magnitude of this overweight position has moderated compared to our stance last quarter, as growth has slowed relative to other developed markets.
- While equities outside North America benefit from attractive valuations, well-contained inflation and gradual growth recovery, their weak earnings outlooks, alongside international and domestic political headwinds, warrant a neutral stance.

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Equity View

Regional/Sector-specific Equity:

- Our view on U.K. equities remains neutral but is leaning more positive due to historically low valuations, attractive yields, and improving growth. Despite structural post-Brexit challenges and policy uncertainty, the economic recovery appears more resilient compared to the euro area, and recent capital flows have turned positive.
- We maintain our overweight stance in Japanese equities given their improving fundamental outlook, reasonable valuations, and positive corporate governance reforms. Over the short term, we believe yen appreciation will temper some outperformance of the asset class and add to volatility.
- Our view in Chinese equities remains neutral, as we acknowledge their compelling valuations and intensified policy efforts to thwart ongoing deflationary forces. However, weakness in real estate and domestic consumption alongside a lack of substantial fiscal stimulus are headwinds for Chinese equities. As such, much of our positioning is biased to the downside.
- We've **upgraded Asia-Pacific ex-Japan to overweight** as we see relative investment opportunities in select countries, which are likely to benefit from a manufacturing recovery and accelerated rate cuts following the Fed's easing path.
- Despite improved valuations, we've shifted our view from overweight to neutral in commodities, as concerns from both the demand and supply sides present near-term risks.

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Fixed Income View

Fixed Income:

- We remain neutral in investment-grade debt as we believe the tightness of current spread levels doesn't provide ample cushion in the face of a credit risk event.
- We favour leveraged loans over US high yield as they can offer more attractive spread and yield carry, providing a better risk/reward balance. Leveraged loans issuers have adjusted to higher short-term rates compared with bond issuers.
- Within Asia, we prefer high-yield credits over investment-grade credits due to their more attractive valuations and favourable spreads compared to historical averages. Additionally, default rates are likely to normalize following years of credit stress. Non-China high-yield credits present resilient and solid credit fundamentals.
- We still maintain an overweight stance in emerging-market debt due to the potential for EM currencies to appreciate if the Fed delivers on cuts. That said, spreads have tightened, and future downward revisions could be possible.

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Building a little defense into portfolios

- While global monetary easing should provide continued growth opportunities across equities and fixed income, current valuations and continued geopolitical uncertainty are burnishing the appeal of defensive plays.

- At a time when we're seeing peak-level U.S. equity valuations, tight credit spreads, continued uncertainty in the geopolitical environment, and wider dispersion in markets, there is value in taking a more cautious approach. That said, we believe opportunities still exist across both equities and fixed income.

- Within the United States, there is an opportunity for healthcare and financials, and we still feel the large-cap growth story has some legs. Japan is enjoying improving fundamentals and reasonable valuations, and it stands to benefit from positive corporate governance reforms. Outside of Japan, Asia-Pacific is well-positioned as a defensive play within a slower growth, manufacturing-led world.

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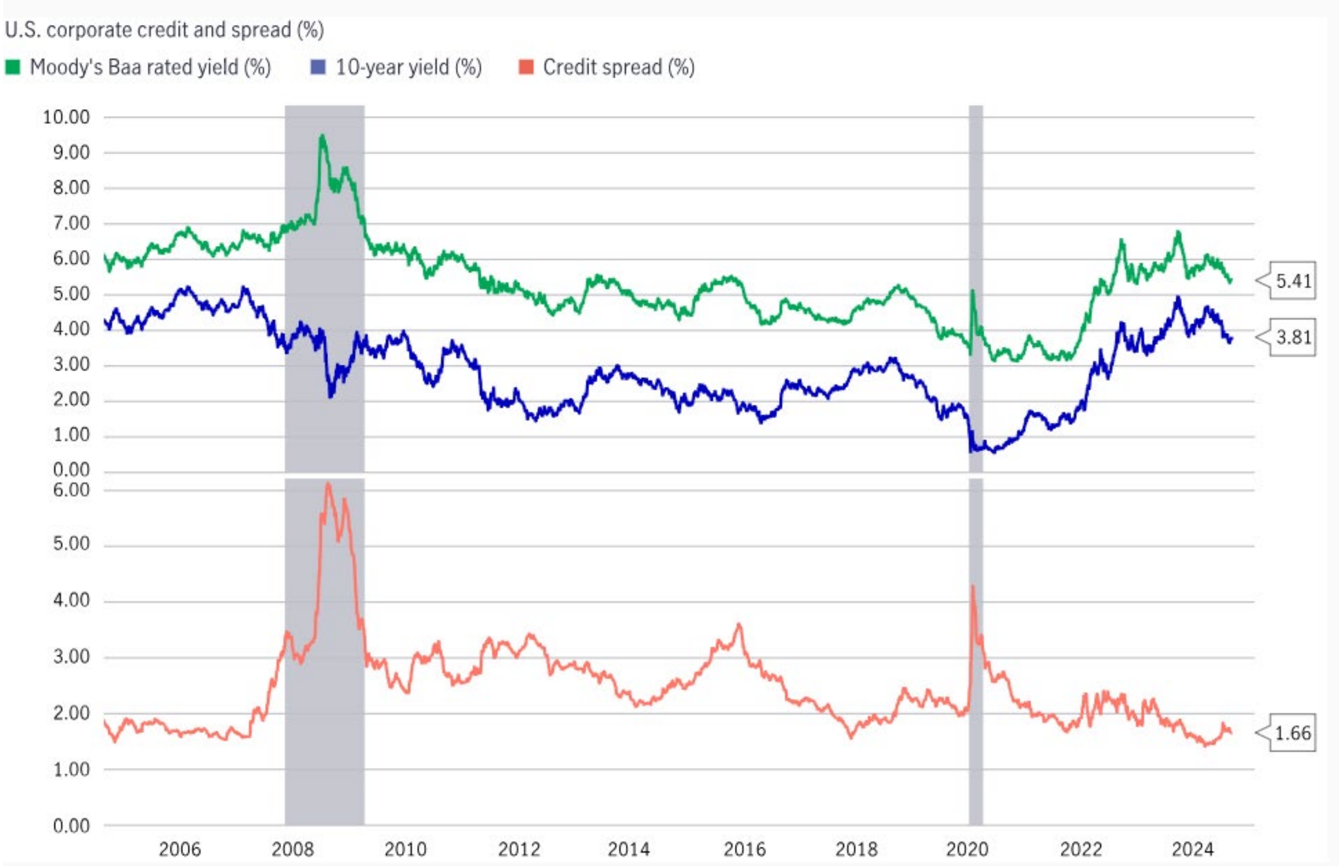
Building a little defense into portfolios

- In fixed income, we continue to shift our preference toward high-quality investment-grade credit, and we see the appeal floating-rate fixed income over high-yield bonds. Lastly, while we've cooled somewhat on broader commodities, exposure to gold remains appealing due to geopolitical uncertainty and favourable supply-demand dynamics.

Credit spread tightness



Source: U.S. Federal Reserve, Macrobond, Manulife Investment Management, as of September 10, 2024. The gray areas represent recession.

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