AIA Investments

US Growth Remains Robust: Soft-landing or No-landing?

Quarterly Investment Insights

1st Quarter 2024

Key Takeaway

- Strong US Economy & Heightened Geopolitical Tensions: The US economy grew faster than expected, but rising tensions in the Middle East caused uncertainty and market volatility. Oil, gold, and the US dollar all saw significant price movements.

- Central Banks on Hold: Despite positive economic signs, global central banks are cautious about inflation and held off on interest rate cuts. The Fed signaled a wait-and-see approach due to persistent inflationary pressures.

- We maintain an overweight position in Global Equities. Strong fundamentals and anticipated double-digit earnings growth for US companies in 2024-2025 make equities attractive. However, a cautious approach is necessary due to potential delays in Fed rate cuts and global market volatility.

- The outlook for US bond yields is uncertain due to Fed's data-dependent approach and rising US Treasuries issuance. Tight credit spreads, especially in investment-grade bonds, offer some stability. Limited refinancing needs also help mitigate the risk of a major credit market blowup.

Market Recap

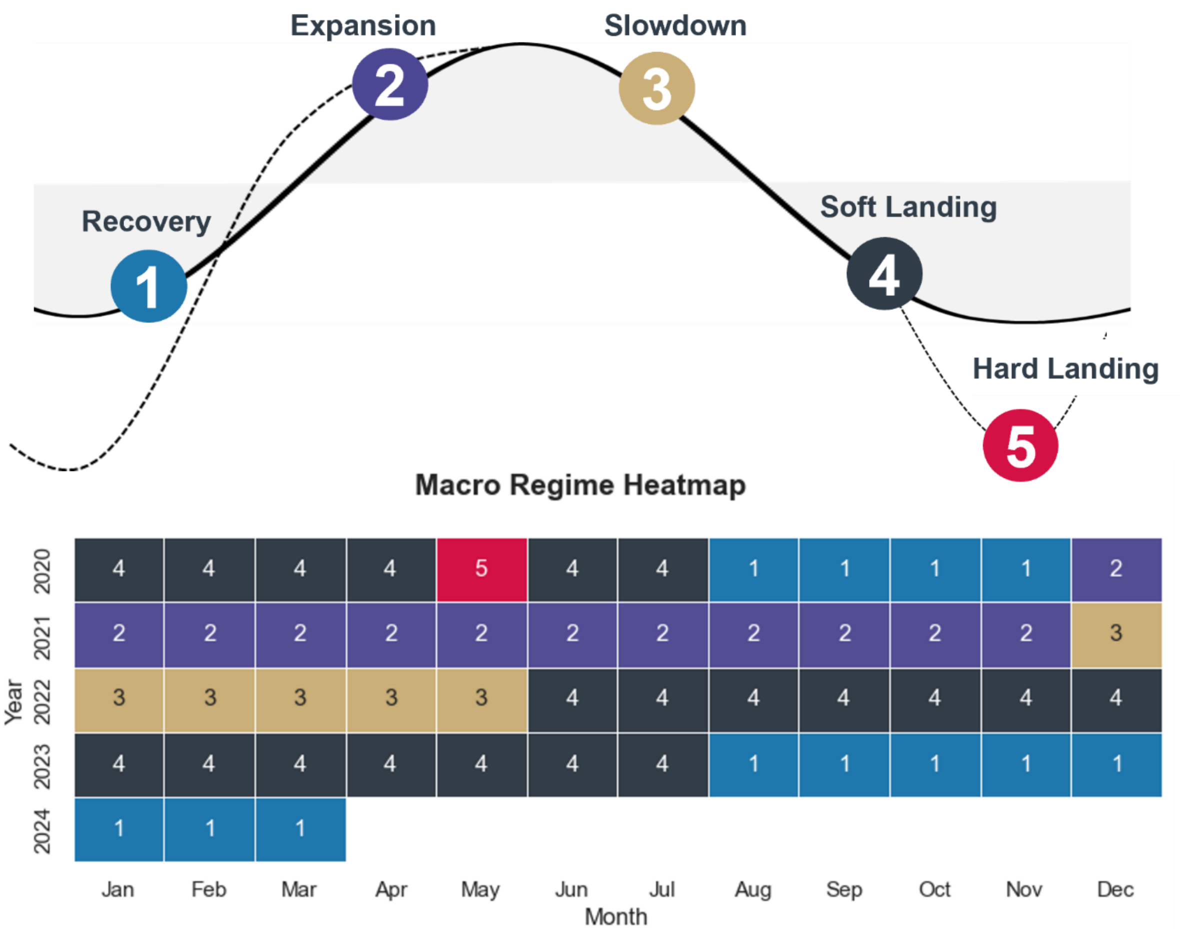
Escalated geopolitical tensions tugged at the market's heartstrings

Rising geopolitical risk overtook the spotlight on inflation and economic growth to dominate the market headlines. The Iran-Israel conflict escalated to a brief period of direct conflict between the two countries. This action intensifies the ongoing tensions between the two nations, whose historical animosity has recently heightened into open conflict. Oil, gold, and the dollar made a significant intraday movement in response to the latest strike. The US also recently introduced fresh sanctions on Iran. Besides, the unsettled situation in the Russia-Ukraine war and intensified tension between the US and China heightened market uncertainty and investor anxiety.

Economy shifts gears: soft landing to recovery

Robust economic growth in the US outpaced market expectations in the first quarter of 2024. Averting a hard landing, the US economy bounced back with impressive vigor. Key indica-

Chart 1 US Economy Cycle -Five Macro Regimes



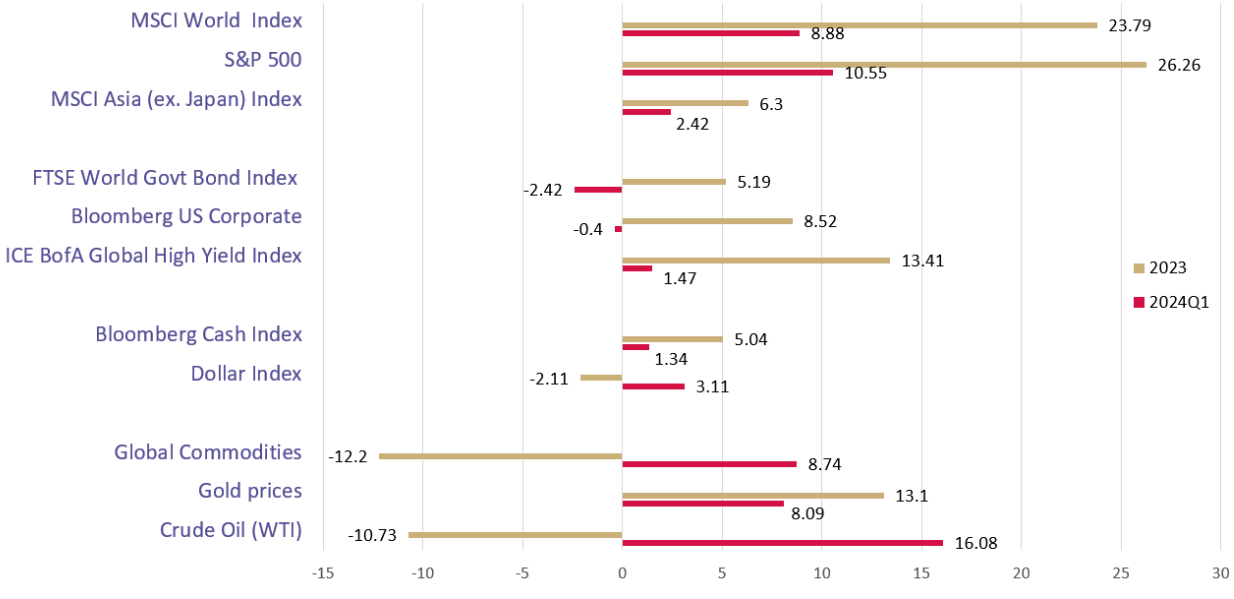
Source: AIA. Date as of March 31, 2024.

tors like GDP growth and job creation exceeded forecasts, suggesting a shift from a cautious soft-landing mode to a no-landing scenario or recovery regime (Chart 1). This positive momentum has instilled optimism in consumers and businesses alike, fuelling hopes for a sustained period of growth.

Inflation Rebound Risk Looms

The Federal Reserve held interest rates steady on March 20. However, policymakers indicated they still expect to reduce them by three-quarters of a percentage point by the end of 2024. While recent data points to an optimistic recovery, policymakers remain vigilant about the potential for inflation to rebound, typically amid oil and commodity price hikes triggered by elevated geopolitical tensions. This risk stems from several factors, including lingering supply chain issues, volatile energy prices, and rising wages. Inflation could surge again if these factors combine to push up production costs or consumer demand excessively. This could force the Fed to delay interest rate cuts even further, potentially dampening economic growth.

Chart 2 Major Asset Class Performance



Source: Bloomberg, AIA. All figures are total return in percentages and represent data as of March 31, 2024.

Market Performance Review

Global stock markets surged in the first quarter, delivering their best first-quarter performance in five years (Chart 2). This rally was fuelled by optimism for a soft economic landing in the US and continued excitement surrounding artificial intelligence. US equities led the charge, with the S&P 500 and NASDAQ exceeding 10% returns thanks to ongoing tech strength. Gains were more modest in other regions, and some emerging markets even saw declines. Despite the strong start, the year remains cautiously optimistic, with potential risks like geopolitical tensions and rising real interest rates.

Asia ex-Japan stocks lagged developed markets

(DM) due to worries about China's growth, reflected in the modest gains (2.42%) of the MSCI Asia ex-Japan Index. However, the MSCI China defied the regional trend, experiencing a 12.3% rebound since January. This upswing was fuelled by positive economic data during the Lunar New Year and the Chinese central bank's easing measures, such as lowering the key 5-year loan prime rate (LPR). By March 12, the Chinese market had surged 20% from its lows. That is a potential market bottom in our view.

Global fixed income experienced a rocky Q1 2024. Unexpectedly strong economic data, particularly in the US, triggered rising real interest rates, surprising investors who anticipated cuts. These shifted expectations caused bond prices to fall, leading to losses in most portfolios. Additionally, a strengthening US dollar pressured international bond returns.

However, the performance between rates and credit wasn't uniform. Corporate bonds, especially high-yield issues, outperformed as the market discounted default fears. Despite the challenges, some investors remain optimistic, viewing higher rates as signs of a strong economy and believing future cuts could benefit bond prices.

The first quarter saw the US dollar dominate global markets. A strong US economy, rising bond yields, and geopolitical tensions bolstered its safe-haven status. The Chinese yuan depreciated on China's slowdown fears, while the Japanese yen hit a 30-year low against the USD. Japanese officials are monitoring the situation closely and may intervene if needed.

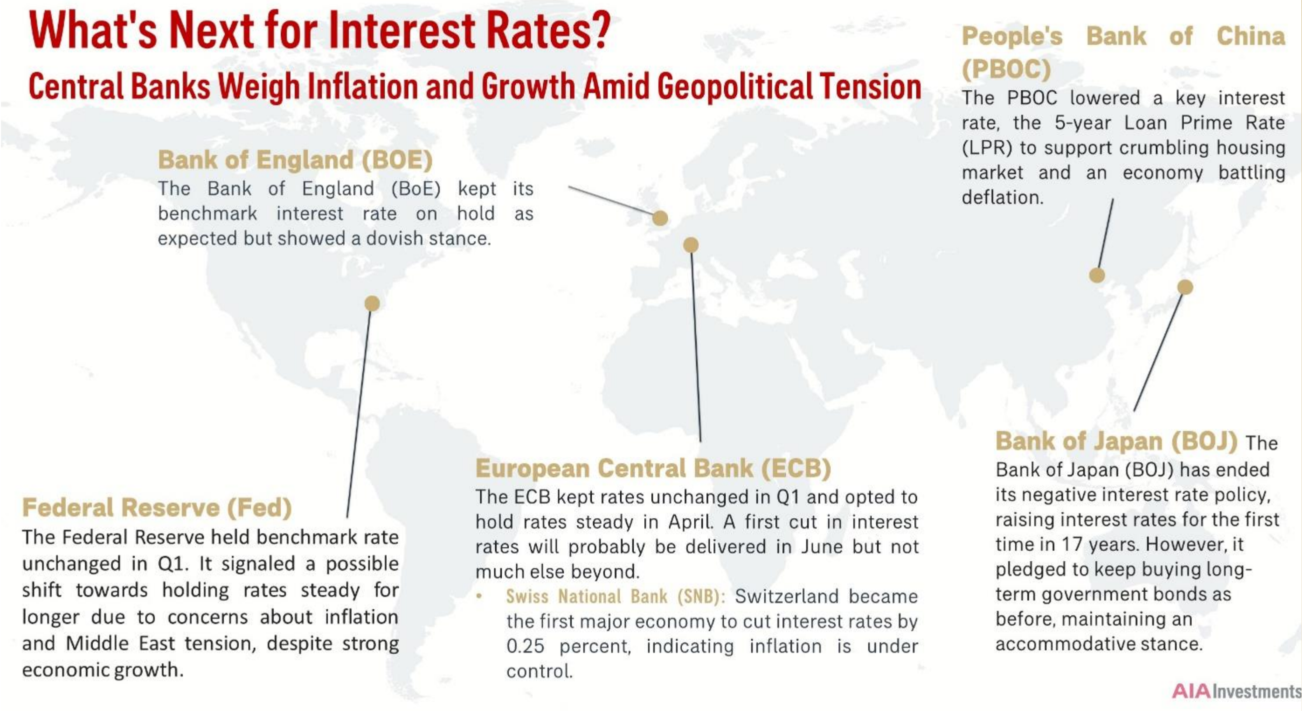
Benchmark crude oil prices continued their upward climb in the first quarter and early April. This trend was fuelled by two key factors: heightened geopolitical tensions and a potential supply shortage in the coming months due to sustained output curbs by the OPEC+. Solid global demand and a more optimistic global economic outlook further supported prices. However, the ongoing escalation in the Middle East is likely to exacerbate oil price volatility.

Similarly, gold prices rose significantly in the first quarter of 2024 despite lingering inflation and a strengthening economy. This trend persisted from the high prices seen in December 2023. As geopolitical tensions continue to rise, more investors might turn to gold as a safe investment option, reinforcing its status as a haven asset.

Central Banks Hit Pause: China Eases, Japan Normalizes, Geopolitical Jitters Delay Rate Cuts

Despite positive economic growth in the first quarter of 2024, global central banks remained cautious about a potential rebound in inflation and held off on immediate rate cuts.

This wait-and-see approach reflects a desire for more evidence that inflation is under control before cutting borrowing costs. The goal is to maintain economic momentum without reigniting inflationary pressures. Considering the new uncertainty of the geopolitical complex, the decisions in front of central banks will be even tougher.



Thinking Ahead

The US economy continues to show resilience, with signs of increasing inflationary risk amid geopolitical tensions. There's a growing consensus that the economy is poised to perform even better than initially thought, suggesting a potential 'no-landing scenario.' In this scenario, the economy avoids recession and experiences higher price levels, which could lead to increased investment opportunities and economic stability. Meanwhile, the Federal Reserve is expected to scrutinize more carefully before making any policy changes, hinting at a potential decrease in rate cuts this year.

Furthermore, the resurgent manufacturing activity in developed markets indicates a sustainable economic expansion. Meanwhile, weaker inflation in non-US developed markets paints a different picture. Their central banks can now consider potential rate cuts, which could further stimulate global growth.

We continue to maintain an overweight position in Global Equities. Equity fundamentals remain supportive, with earnings growth poised to become the primary driver, taking over the previous focus on interest rate cuts. Market consensus anticipates a return to double-digit earnings growth for US companies in most quarters in 2024 and 2025.

We shift to a marginally constructive stance on Asia ex-Japan (AxJ) equities due to the promising developments in China. Signs of stabilization, including rising portfolio inflows, and the Chinese government's consideration of market reforms, offer a beacon of hope for future growth. However, potential catalysts like Fed rate cuts and a weaker US dollar are likely delayed, introducing near-term uncertainty. This, coupled with ongoing global market volatility, necessitates a cautious approach.

Risks for US bond yields appear balanced and data-dependent in the near term. Uncertainties surrounding inflation and the timing and extent of Fed rate cuts keep the direction unclear. Although credit spreads remain tight in the corporate bond market, especially in investment-grade bonds, we are cautious about potential underperformance compared to rising yields. On the silver lining, limited refinancing needs make a significant credit market blowup unlikely.

Navigating the investment landscape can be challenging in today's dynamic and ever-changing economic climate. AIA Stewardship recognizes this complexity. Our philosophy emphasizes professional guidance, a long-term vision, and global expertise to help you achieve your financial goals.

We go beyond just maximizing returns. We strive to make a positive and sustainable impact on society and the environment, ensuring your investments contribute to a better future. Together with our partners, our team of experts possesses the global reach and experience to identify opportunities and navigate market complexities, building resilience within your portfolio for long-term growth.

AIA STEWARDSHIP – ELITE FUNDS

Portfolio Performance

Our investment approach focuses on long-term opportunities and application of bi-directional risk management. For Elite Funds, we combine AIA stewardship with best-in-class managers to seek long term opportunities. For 1Q 2024, Elite Funds continued to build on the performance of 2023, and delivered positive absolute returns for all the Elite Funds. For example, on a gross basis, Elite Adventurous SGD and USD funds delivered high single digit returns for 1Q 2024 and around 9% annualized since inception. This is a clear testament to the benefits of staying the course and having a disciplined approach to investing.

A summary of absolute portfolio performances is set out below.

Absolute Performance		Q1 - 24	1 Year	2 Year	3 Year	Since Inception*
SGD Funds	AIA Elite Adventurous Fund [1]	9.37%	19.90%	2.32%	2.24%	8.94%
	AIA Elite Balanced Fund [2]	6.86%	14.84%	0.57%	0.35%	4.80%
	AIA Elite Conservative Fund [3]	4.35%	9.64%	-1.32%	-1.70%	1.66%
USD Funds	AIA Elite Adventurous Fund [4]	6.87%	18.41%	3.16%	2.24%	9.38%
	AIA Elite Balanced Fund [5]	4.33%	13.26%	1.36%	0.52%	6.64%
	AIA Elite Conservative Fund [6]	1.85%	8.28%	-0.59%	-1.73%	2.23%

Source: AIA Investment Management
Performance figures for a period greater than a year are annualised
Performance of the funds are on a bid-to-bid basis with net dividends reinvested, without taking into consideration the fees and charges payable through deduction of premium or cancellation of units
*Fund inception date: [1] 24/7/2019; [2] 25/7/2019; [3] 1/8/2019; [4] 20/7/2019; [5] 31/7/2019; [6] 20/12/2019

Past performance is not necessarily indicative of future performance

Investment Strategy

The focus for the Elite Funds is to construct a well-diversified portfolio. Fundamentals continue to hold up with both macro growth and earnings growth poised to continue their positive trajectory. The outlook for equities over the medium term remains constructive. On the technical front, there are pockets of exuberance as a small number of stocks have risen sharply since the start of the year. In addition, in terms of cross asset price action, bond yields have increased alongside dollar strength – a sign that liquidity conditions could be less favourable. As such, equities allocation for the Elite Funds has decreased. The intention of this action is to create greater capacity for the Elite Funds to add risk subsequently when conditions are more favourable. On the intra asset level, the equity strategy of the Elite Funds is anchored by AIA Global Select Equity Fund and AIA New Multinationals Fund which offer a blend of investment styles to help capture opportunities while balancing risk-taking. We actively monitor the markets and will risk manage the Elite funds accordingly.

Fund Allocation as of 31 March 2024

SGD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Global Multi-Factor Equity Fund	8.72%	5.53%	2.86%
	AIA Global Quality Growth Fund	8.49%	5.36%	2.61%
	AIA Global Select Equity Fund	32.93%	21.50%	11.89%
	AIA New Multinationals Fund	31.47%	20.46%	10.95%
	Amundi Funds Index MSCI-IU-C	0.07%	0.11%	0.19%
	iShares Core MSCI AC AXJ-USD	0.40%	0.41%	0.13%
	iShares Core MSCI World UCIT SWDA	1.96%	2.17%	0.71%
	Vanguard Global STK-A INS $ GBL STOCK	7.08%	6.41%	2.61%
Fixed Income	AIA Diversified Fixed Income Fund	8.07%	36.91%	67.62%
Money Market Fund & Cash	AIA SGD Money Market Fund (AAMM)	0.24%	0.47%	0.14%
	JPM SG Dollar Liquidity-INS	0.28%	0.40%	0.04%
	Cash	0.29%	0.27%	0.25%
	TOTAL		100%	

USD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Global Multi-Factor Equity Fund	9.40%	5.72%	2.80%
	AIA Global Quality Growth Fund	8.69%	5.28%	2.41%
	AIA Global Select Equity Fund	32.34%	21.46%	11.15%
	AIA New Multinationals Fund	31.56%	19.99%	11.11%
	Amundi Funds Index MSCI-IU-C	0.10%	0.06%	0.22%
	iShares Core MSCI World UCIT SWDA	2.02%	3.55%	1.41%
	Vanguard Global STK-A INS $ GBL STOCK	6.92%	5.77%	3.15%
	iShares Core MSCI AC AXJ-USD	0.25%	0.17%	0.19%
Fixed Income	AIA Diversified Fixed Income Fund	8.22%	37.42%	66.84%
Money Market Fund & Cash	JPM LIQ-USD LIQUIDITY-INSD JPM LIQ-USD L	0.24%	0.23%	0.15%
	Morgan Stanley Liquidity Fund-USD LIQ-INST	0.11%	0.22%	0.35%
	Cash	0.15%	0.13%	0.22%
	TOTAL		100%	

Note:
Fund Allocation Total may not sum up to 100% due to rounding.

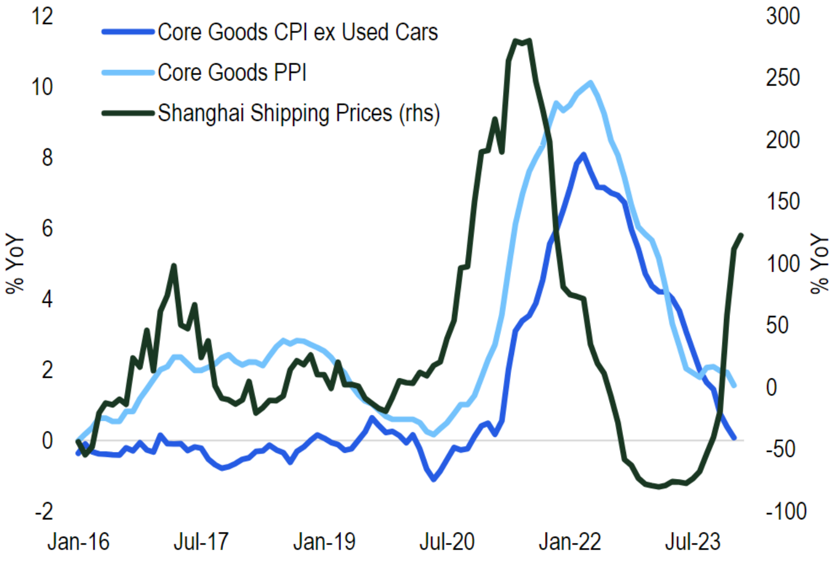
Stewardship Insights:

Exploring Investment Excellence with BlackRock

Uncertainties around the timing and magnitude of the Fed rate cut are rising on the back of better-than-expected economic data and stickier inflation; what is Blackrock's outlook on inflation and interest rate path?

BlackRock: Inflation data thus far in 2024 has confirmed our view that the "last mile" of disinflation^ toward the Fed's 2% target was going to be difficult to achieve. Strong employment growth, and higher asset prices are supportive for consumer spending, and there is still a substantial amount of lagged government spending and stimulus that is just hitting the real economy. It will be difficult for inflation to cool meaningfully while there is still so much liquidity coursing through both financial markets and the real economy.

The challenge of meeting core inflation targets was already a concern before tensions began rising in the Middle East. The unpredictable conflict that has emerged is likely to place continued upward pressure on inflationary data through 2024, as oil prices will remain above trend, and the dangers of shipping good through the Red Sea disrupts global shipping prices. Goods deflation has been a key offset to the sticky Services inflation in the last 12 months –



Source：Citi Research, as of April 04, 2024

Notes:
^: Disinflation is a decrease in the rate of inflation – a slowdown in the rate of increase of the general price level of goods and services in a nation's gross domestic product over time.

per the chart above, to the extent that the lagged impact energy and shipping costs cause goods prices to inflect higher later in 2024, it will potentially not only pause the dis-inflationary trend, but potentially be re-inflationary.

We see core inflation to struggle to break through 3% in 2024, with a tail risk that we actually re-accelerate up near 4% if the bear-case plays out with the geopolitical risks.

On the interest rate side, the strength of growth, employment, and inflation leaves the Federal Open Market Committee (FOMC) and global central bankers more broadly, stuck in a tough position after largely pre-committing to monetary policy easing in 2024. We thought the market was irrational when pricing in 6 cuts earlier this year. With current pricing reflecting 1.5-2 cuts, we think that is more reasonable. However, we believe there is a greater chance of the potential for zero cuts, or potentially even further hikes, than what the market is currently anticipating. While we do think the Fed is willing to tolerate a slower path towards its inflation goal, a re-acceleration of inflation would cause significant concern about a repeat of the 1970s, and likely cause the Fed to look to hike rates further. Globally, while inflation and growth is not as strong in Europe or the UK, significant cuts in the face of a restrictive Fed would be highly inflationary and impactful for the currency.

We think that the “average” Fed Funds futures pricing of 2 cuts is a relatively low probability outcome – either the Fed is forced to remain very restrictive by higher inflation or is forced to cut aggressively to combat an unfolding economic slowdown. We think the path for gradual easing is relatively unlikely.

That puts longer term interest rates at largely fair levels today. We would put the range for the 10-year at 3% to 5.25% this year, with a strong likelihood that we oscillate here between 4-4.75% for much of the year, as the market gets consistently conflicting signals about the durability of growth and the path of inflation.

Looking ahead, how should investors position their fixed income strategy from the short, medium, and long-term perspectives?

BlackRock: It is a very interesting time for fixed income – there are cross currents that make the investment outlook across these three different horizons very varied.

In the short term (3-6 months) we would expect a relatively benign outlook for fixed income, particularly credit spreads, as the strength of domestic growth continues to be viewed positively by markets. While inflation is the key risk to this outlook, base effects should keep the rise in core inflation from being overly disruptive. We may see more cuts priced out, but probably not yet fearing hikes within this time frame. With all-in yields near 6%,
carry* is a powerful ally for fixed income investors over the short term.

Notes:
*: “Carry" refers to the total return a fixed-income investor can expect to earn in the short term (3-6 months) due to coupon payments.

In the medium term (6-18 months) the ride likely gets pretty bumpy for fixed income investors. The election is almost sure to bring increased volatility and risk premiums given the wide range of potential outcomes for various sectors of the economy. Regardless of which party prevails, we expect the fiscal narrative to turn to one of increased deficit spending for 2025, which will likely be viewed negatively by rates markets. The potential for disappointment from the Fed will also likely be at its peak during this period. The ongoing strength of the US economy, in part driven by government spending, is likely to keep the Fed funds rate higher for longer, disappointing those that had hoped for multiple rate cuts in 2024. Additionally, as we enter into the end of the year, risks to financial market liquidity are likely to be on the rise. The reverse repo facility is likely to have been fully drained, and the FOMC will be trying to navigate the correct size of the balance sheet in an already volatile market period. This brings the risk of a financial market/funding seizure, similar to 2019, to the forefront. As the large amount of liquidity in the financial system had been a driver of financial asset price rises. With the liquidity position turning to net removal of liquidity from the system, it will put pressure on asset prices. Lastly, we should be seeing the impact of higher real rates start to impact corporate earnings, and the potential for an actual recession rising more materially. As a result, we are relatively bearish on credit spreads and overall fixed income performance over the medium term.

In the long term, carry and yield will dominate the return profile for fixed income investors. With all-in yields well above the 75th percentile over the last 30 years, we think fixed income is quite an attractive long-term investment, particularly when viewed through a volatility adjusted lens as compared to equities or other financial assets. Structural trends like AI should provide a tailwind to many parts of Corporate credits and should in the long term bring down inflationary pressures. This would create meaningfully positive real return expectations for corporate credit based on today's yield and coupons.

Government bonds are yielding over 4%. Given the high cash rate, is there additional value in taking risks by investing in corporate bonds at this stage?

BlackRock: The competition of cash and treasuries is one of the key reasons why we see corporate credit spreads as relatively fully valued at these levels. Some key sectors/cohorts of the market that are still relatively wide, such as front-end# and banks, will be somewhat constrained from tightening further by both the level of interest rates and the shape of the curve.

That said, because of the relative durability of corporate credit fundamentals, and the carry/yield focus of the current market narrative, demand is still quite strong for corporate credit, and this will place a lid on the amount of widening that is possible, at least in the short term. These very positive supply demand technicals are what lead us to the view
that corporate credit still provides value at this stage.

Notes:
#: The "front-end" refers to short-term securities that will mature in the near term, usually in one year or less.

Amid an increased in volatility in fixed income markets, correlation between equity and fixed income has turned increasingly positive. Does Fixed Income still provide good diversification in a portfolio?

BlackRock: The yield and carry profile of fixed income is the key driver of diversification against equities. While we do expect a continuation in the near term of the positive correlation between the price performance of equities and fixed income, it is important to consider the offsetting impact of carry when yields are at these levels. With yields of 6% on corporate credit, it takes almost +100 basic points (bps) of yield/spread widening to eliminate the annual carry return. That is up almost 5 times from the lows of 3 years ago. With the implied dividend yield of stocks so far below UST yields, we feel much more comfortable with the medium to long term diversification benefit of fixed income in the current market environment.

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