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Investment Strategy
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Investment Directions

Q4 2024: Exposures for today's market

***Investment Directions** is designed to help navigate opportunities in equities, fixed income and portfolio diversifiers for Q4 2024, with actionable implementation ideas across index, alpha-seeking, liquid alternative and private market strategies.*

Generating Income with Rate Cuts Incoming

For the final quarter of this eventful year, we're focused on two key themes: 1) balancing US equity risk; and 2) positioning for global easing cycles – as well as the opportunity to lock in income while yields remain at elevated levels.

- **Within equities:** as US earnings growth broadens out[1], we lean into a wider set of opportunities there – positioning portfolios to stay invested in structural growth stories whilst navigating expected volatility in Q4. We continue to be selective in seeking alpha in global equities, specifically in Japan and Emerging markets-ex China.

- **Within fixed income**: Interest rates are falling[2] but remain elevated for now. We see a strong case for locking in income before that descent gathers pace. We favour the belly of the US Treasury (UST) curve and feel more comfortable with duration in Asia.

- **Portfolio diversifiers:** Macro uncertainty and less predictable asset class correlations call for a broader set of diversifiers, in our view: while bonds are regaining their role as ballast[3], there may be more volatility in correlations ahead.

EQUITY

Looking for Equity Opportunities Amidst Volatility

We see two major themes continuing to play out in global equities for Q4: navigating volatility in US equities, including ahead of the election, and the search for income and/or growth in single country and regional exposures. We advocate for complementing core portfolios with volatility management strategies, look for active income, and lean on Japan and EM ex-China for global allocations.

Playing the long game with sector conviction: While we keep one eye on slowing global growth and potential volatility inducing events like the US election, we keep the other on structural growth trends and innovation at the heart of portfolios. Combining a core of alpha seeking strategies in these areas such as healthscience and technology and blending portfolios with high-conviction but benchmark agnostic allocations, is one way to position for greater macro and market volatility in the long run.

Managing near-term volatility: For investors looking to dampen portfolio shocks in the near term, we think buffer strategies and US equity rotation models can play a significant role. These strategies allow investors to stay invested while navigating volatility and risk-off events[4].

Getting Active with Equity Income: We lean on income as a theme for Q4 as an extra source of returns in a falling rate environment and extend that view to equity allocations as global growth begins to trickle lower[5]. Dividend-focused strategies can provide defensive positioning within equities, offering steady cash flows that enhance portfolio diversification, whether in an ETF or mutual fund wrapper[6].

Playing the long game with global conviction: With the dispersion of returns across equity markets and sectors set to continue, we look to economies with longer-term structural growth stories. Despite recent volatility driven by a massive unwind of JPY net-short positions, we think Japan is moving into phase 2 of its structural bull market story and see foreign investors as underweight in allocations[7]. We like the Emerging Markets space given a recent change in direction on monetary and fiscal policy coming out of China, but advocate for investors to use a building block approach with an Emerging Markets-ex China benchmark as core, and by closing underweights to China separately via index funds.

Key

- Exchange-traded product
- Alpha- seeking fund

Our highest-conviction ideas:

- World Technology
- World Healthscience
- Global Unconstrained Equities

- Large Cap Max Buffer
- US Factor Rotation

- World High Income
- Systematic Global High Income

- Emerging Markets-ex China
- Japan Flexible Equity
- MSCI China Index

Source: Blackrock and Markit as of September 30, 2024. There is no guarantee that any forecasts made will come to pass. All figures are in US dollars, unless stated otherwise. References to specific investments are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such investments. Diversification may not fully protect you from market risk.

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FIXED INCOME

Balancing Yield vs Duration in a Falling rate Environment

As global growth cools and central banks in several economies shift into a rate cutting cycle[1], we continue to envision a favourable environment for fixed income investments. With $316B added to fixed income ETPs YTD globally, just shy of the annual record of $331B set in 2023[2]; investors are looking to lock in yields, take on some level of increased duration risk and shift away from money market mutual funds into active and index fixed income products.

Building a strong core in duration: Against a moderating growth backdrop and increasingly benign inflation, the Fed kicked off its cutting cycle in September[3]. Whilst a US recession is not our base case: we expect a gradual building of labor market slack, consistent with a still solid, but cooling, US economy. This sets up a favorable environment for fixed income investments centered around the belly of the US Treasury (UST) curve, with the front end subject to rate repricing and near-term volatility. We try to stick to quality in global allocations and go active in corporate bonds and sustainable bond income to mitigate interim volatility in rates.

USD 3-7yr Treasury Bond

Global Corporate Bond

Sustainable Global Bond Income

Getting selective with Indian government bonds: We look to keep exposure to the Indian structural growth story in the fixed income space. Whilst the index inclusion story is well flagged, we still see foreign investors as underweight relative to projected benchmark weights and see room for continued inflows[4]. The attractive yield in the space has led to an upsize in positioning across our fixed income Asian Active platform.

India Government Bond

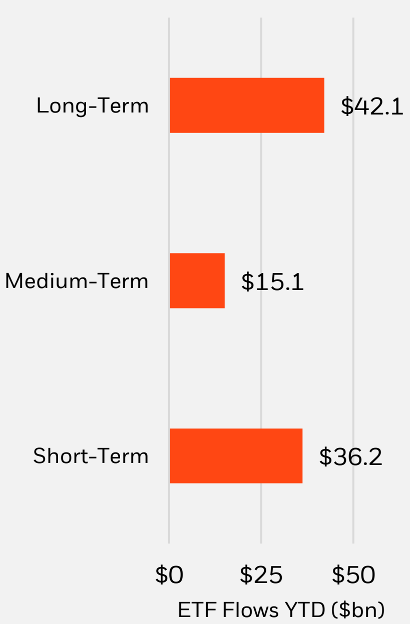
Seeking relative value in Asian Credit: We like Asia due to the supportive growth and inflation dynamics in the region, coupled with the potential for local central banks to cut rates following recent Fed actions[5]. Globally we've turned more positive on high yield due to positive technicals (lower net supply) and falling leverage across the space. In Asia, that dynamic is even more pronounced- the negative net supply has been well-flagged for the past 2 years. With the fall in US rates and the preemptive move in certain Asian central banks and more to come (notwithstanding already low China yields), financing costs are likely to fall[6].

USD Asia High Yield Bond

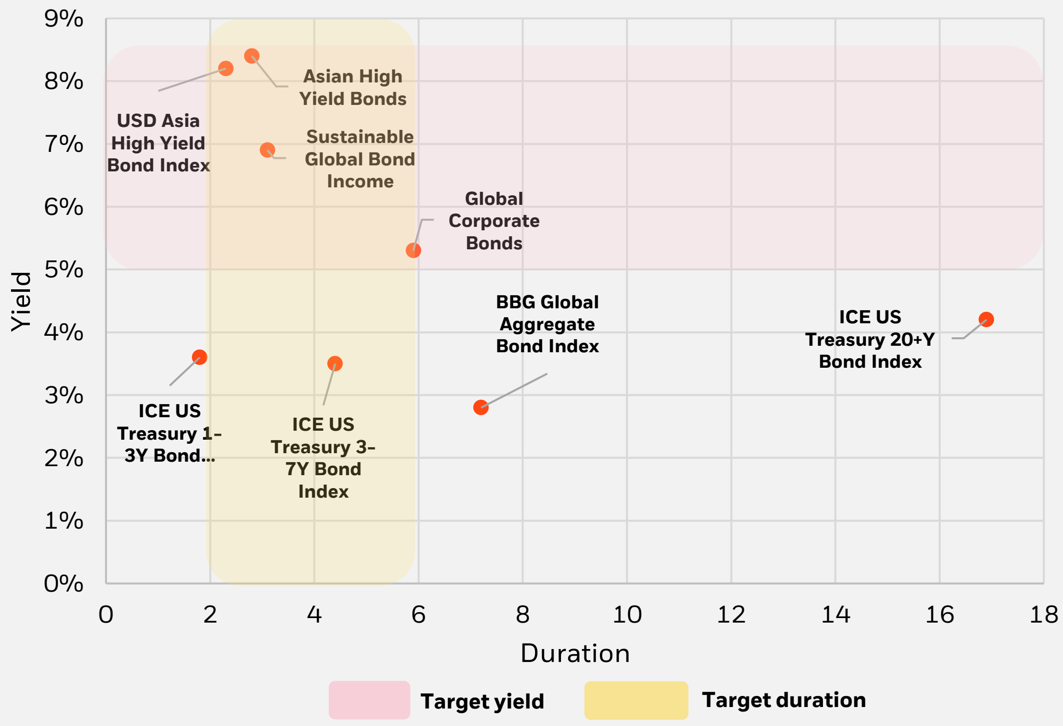
Asian High Yield Bond

Finding the right mix of yield and duration is difficult. Although we believe this is a favorable environment for the belly of the curve, we also see investors turning towards long-duration U.S. Treasuries to add duration to their portfolios.

U.S. Treasury Flows



Finding the right mix of yield and duration



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PORTFOLIO DIVERSIFIERS

Building a portfolio for the new regime

In an environment of dispersive global returns and potential bouts of volatility akin to the episode witnessed in August[1], we see room to dial up exposure to alternative assets to bolster portfolio diversification and resilience beyond traditional asset classes. Stock-bond correlations have adjusted recently but remain less predictable than in the past as ballasts to one another[2], leading investors to look for ways to reduce broad equity beta through systematic and absolute return strategies.

Getting Systematic: We look to systematic strategies for better risk-adjusted returns, given their idiosyncratic return profile and potential to mitigate volatility while delivering consistent alpha. Strategies targeting precise market segments are well-positioned to achieve superior risk-adjusted returns by leveraging big and alternative data, forms of AI including machine learning and natural language processing while systematic equity income strategies benefit from income generation even in periods of market weakness. Finally, sustainable income and growth funds benefit from their multi-asset makeup that also allow for increased capital protection[3].

Systematic Asia Pacific Absolute Return

Systematic Global Sustainable Income and Growth

Multi-asset risk management: In this climate of heightened dispersion and valuation expansion, many investors are turning to high-conviction and/or flexible, multi-asset strategies to navigate market complexities. By blending a dynamic mix of carefully selected equities with a diversified bond allocation, these funds are strategically positioned to benefit from key macro trends, including inflationary pressures and interest rate volatility.[4]

Global Allocation

Dynamic High Income

Hedging for geopolitical risk via gold: Despite prices hitting all-time highs in 2024[5], we stay positive on gold and its role as a potential hedge against political risk. Investors are taking notice. Following 11 months of consecutive outflows to May, Gold ETPs have racked up $7.5b of inflows since[6]. In our view, this reflects growing investor appetite for defensive assets, as growth risks and geopolitics drive potential for further volatility.

Physical Gold

Fund correlation matrix

	S&P 500	Syst. APAC Absolute Return	Syst. Sustainable Income /Growth	Global Allocation	Dynamic High Income	Physical Gold
S&P 500	1	-0.053	0.758	0.921	0.799	0.176
Syst. APAC Absolute Return	-0.053	1	-0.053	-0.039	-0.016	-0.182
Syst. Sustain. Income/Growth	0.758	-0.053	1	0.808	0.926	0.322
Global Allocation	0.79	-0.039	0.808	1	0.850	0.312
Dynamic High Income	0.799	-0.016	0.926	0.850	1	0.308
Physical Gold	0.176	-0.182	0.322	0.312	0.308	1

Uncorrelated	Low	Moderate	High	Very High
-0.2	0.2	0.6	0.85	0.95

Source: Blackrock and Markit as of October 02, 2024. There is no guarantee that any forecasts made will come to pass. All figures are in US dollars, unless stated otherwise. References to specific investments are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such investments.

Sourcing

Equities
1,2,3,5,7 Source: Bloomberg, as of 25 September 2024.
4,6 Source: BlackRock and Markit, as of 25 September 2024
8 Source: LSEG Datastream, MSCI , as of 31 May 2024.

Fixed Income:
1 Source: Bloomberg, June 2024.
2,5,6 Source: BlackRock and Markit, as of 28 June 2024.
3 Source: Bloomberg, as of 25 September 2024.
4 Source: LSEG Datastream, MSCI , as of 31 May 2024.

Portfolio Diversifiers
1,2,5 Source: Bloomberg, as of 25 September 2024.
3,4,6 Source: BlackRock and Markit, as of 28 June 2024.

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