In collaboration with: J.P.Morgan ASSET MANAGEMENT

UOB Investment Insights

Market PowerBar

OCTOBER 2024

TOPIC 1:

Investing in an election year

Ahead of the US Presidential Election on 5 November, investment decisions should focus on macroeconomic conditions rather than fiscal policy expectations, as sector performance is typically driven more by macro forces than political outcomes.

- The US presidential election remains too close to call. Beyond the presidential contest, the tight battle for control of both chambers of Congress, the House of Representatives and the Senate, is also crucial. A divided Congress means passing new policies is not assured as it requires bipartisan support (Figure 1a).
- This uncertainty may cause investors to adjust their strategies to position defensively for any volatility, seek opportunities for potential market rallies, or wait for more clarity on government policies.
- In addition, sector performance often does not align with political intentions. For example, despite the Trump administration's support for traditional energy, the S&P 500 Energy index fell 40% during his term. Under the Biden administration, the energy index nearly doubled (Figure 1b) despite the focus on renewables. Therefore, it is difficult to identify winning sectors solely based on political results.
- More broadly, pre-election volatility is common, but staying invested is key. Sitting on the sidelines, investors risk missing out on compounding returns. Historically, long-term investors who remain active during downturns often see positive returns.
- In the near term, investors should focus on the broader economic environment, particularly growth and interest rates, which will have a greater impact on sector performance than policies.

Figure 1a:

Seats in United States Senate and House of Representatives by party

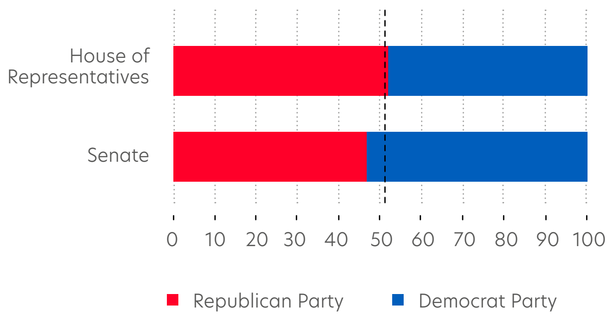
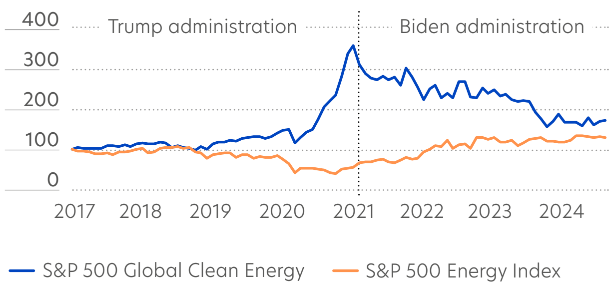


Figure 1b:

S&P 500 Energy and S&P 500 Global Clean Energy performance during Trump and Biden administration

Price return, indexed to 100 on 1/20/2017



Source: (Left) 270towin, J.P. Morgan Asset Management. The Senate currently consists of 48 Democrats, 49 Republicans, and 3 Independents that vote with the Democrats. Currently, the House of Representatives consists of 218 Republicans, 213 Democrats, and 4 vacant seats due to retirement. Data are as of 31 August, 2024. (Right) Factset, J.P. Morgan Asset Management

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What you can do

- While the US election may create some short-term volatility, expectations of more rate cuts and no recession will provide support to the stock market. Stay invested and buy quality stocks on dips.

Speak to your UOB Advisor today to find out more.

TOPIC 2:

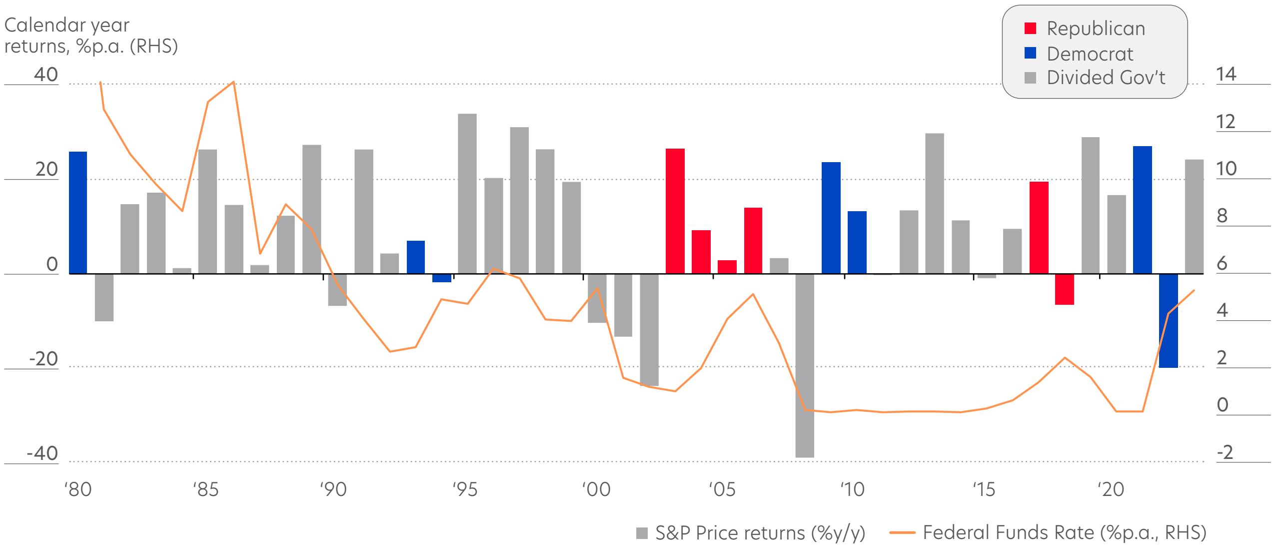
Fed cuts interest rate by 50bps, what comes next?

The US Federal Reserve's (Fed) widely anticipated rate cut is now behind us, and more easing looks likely ahead.

- Last month, the Fed reduced interest rates by 50 basis points (bps), exceeding analysts' forecast of 25bps. Chairman Powell emphasised confidence in the Fed and noted that the big rate cut was a recalibration of interest rates to more neutral levels and to support the labour market. Powell signalled that rate cuts may continue but the pace of reduction will depend on economic data.
- Currently, cyclical economic indicators show no significant imbalances that could signal recession risks. Unless a major shock occurs, the gradual cooling of economic momentum supports expectations for further 25bps rate cuts at each of the remaining two policy meetings this year.
- Despite concerns the Fed may be reluctant to adjust interest rates in an election year, history shows the Fed setting monetary policy solely on its dual mandate of price stability and maximum employment.
- Since the 1980s, the Fed has adjusted rates (both upwards and downwards) during every election year except 2012, when the economy was recovering from the Global Financial Crisis and the Fed maintained a zero interest rate policy (ZIRP). Instead, stock market returns depend on expectations of economic growth and interest rate policy (Figure 2).
- More importantly, the reason behind the Fed's rate cut matters more than the size of the cuts themselves (read more in Topic 3). The cuts this time likely reflect adjustments to ensure the extension of the current economic cycle.

Figure 2:

S&P 500 performance under Republican/Democrat control or divided government



Source: BEA, CBO, Treasury Department, J.P. Morgan Asset Management. Blue bars denote a Democrat-majority government, red bars a Republican-majority government and grey bars a divided government.

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What you can do

- While stocks may continue to rally with the prospect of more rate cuts, bonds could provide portfolio stability if growth slows faster than expected.

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TOPIC 3:

Positioning your portfolio for a soft landing

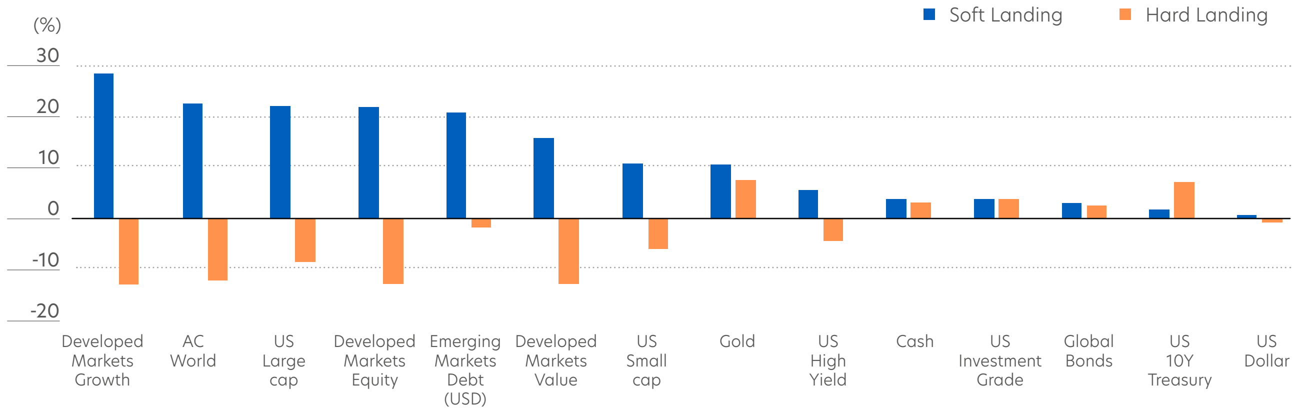
The Fed has initiated a new rate-cutting cycle, prompting investors to reassess their positioning in a declining rate environment.

- Now that the first cut is done, many investors are asking how quickly rates will fall. In our view, the more important question is why rates are cut since asset performance varies based on the reason. Risk assets typically perform well during "soft landings" but struggle in "hard landings".
- Investors should evaluate whether their portfolios are positioned for the rate cutting cycle ahead. History offers some guidance, but not all rate-cutting cycles are the same as the drivers of rate movements significantly affect outcomes.
- During "soft landings" (e.g. 1995, 1998, and 2019), when inflation cools and economic growth slows moderately without entering a recession, risk assets like large-cap stocks and emerging market debt performed well (Figure 3). Large-cap stocks outperformed small-caps, suggesting investors should focus on quality.
- Growth and value equity returns were similar, indicating the need to rebalance portfolios. US Treasuries also outperformed cash.
- In "hard landings" (e.g. 1989, 2001, and 2007), where the economy and labour market suffers a severe downturn that leads to recession, risk assets suffered, with non-US stocks hit hardest. High-yield bonds and emerging market debt saw negative returns, while US Treasuries provided strong returns.
- Our base case is a "soft landing," where growth stocks typically outperforms value stocks. However, investors should not abandon other assets. If the economy shifts into a "hard landing," quality bonds like US Treasuries will offer crucial defense.

Figure 3:

Asset class returns following the start of rate cuts

12 month returns* after the first rate cut following the past five rate hike cycles



Source: FactSet, US Federal Reserve, J.P. Morgan Asset Management. Based on MSCI AC World Index (AC World), MSCI World Index (DM Equity), MSCI Emerging Markets Index (EM Equity), MSCI Asia Pacific ex-Japan Index (AxJ Equity), MSCI Asia Pacific ex-Japan High Dividend Yield Index (AxJ Equity High Div. Equity), MSCI World Growth Index (DM Growth), MSCI World Value Index (DM Value), S&P 500 Index (US Large Cap), Russell 2000 Index (US Small Cap), Bloomberg Global Aggregate (Global Bonds), Bloomberg US Treasury Bellwethers 10Y (US 10Y Treasury), Bloomberg US Corporate Investment Grade Index (US IG), Bloomberg US Credit Corporate High Yield (US HY), J.P. Morgan EMBI Global (EM Debt USD), Bloomberg US Treasury Bills 1-3M (Cash), Gold New York Spot price (Gold), US dollar index (US dollar). The first rate cuts occurred in Jun '89, Jul '95, Jan '01, Sep '07, Aug '19. *Total returns in local currency are used, unless otherwise specified. **GFC stands for global financial crisis. Past performance is not indicative of current or future results

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What you can do

- Investors should maintain a diversified portfolio across global stocks and bonds, with an emphasis on quality and income.

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