In collaboration with:

UOB Investment Insights

# Market PowerBar

AUGUST 2024

TOPIC 1:

## European stocks attractive despite political uncertainty

The inconclusive result of France's recent election introduces uncertainty to European markets. However, this situation could present opportunities for investors.

- The recent French election has introduced uncertainty into Europe's political landscape. The surprise outcome of a hung parliament means a coalition government must be formed, which could take considerable time. This coalition comprising of political parties with conflicting policy objectives may prove unstable and hinder legislative progress. As a result, France's near-term economic outlook and European Union (EU) collaboration could be negatively impacted.
- However, it is important to note that no major French political party is pushing for an exit from the Eurozone currency union or the EU, making a breakup of the EU unlikely.
- Signs of uncertainty have spread to other European countries as shown by rising spreads of 10-year bond yields of some European nations against 10-year German bond yields (Figure 1a). However, these spreads remain within historical levels, suggesting that the situation is not dire.
- In the coming months, European financial markets may experience some volatility. Nonetheless, investors should focus on economic fundamentals like corporate earnings. Historically, stock prices have moved in line with future earnings expectations (Figure 1b). Given the improving earnings outlook for the next few quarters, European stocks are expected to find support.

Figure 1a:

### European bond yield spreads rising but within historical levels

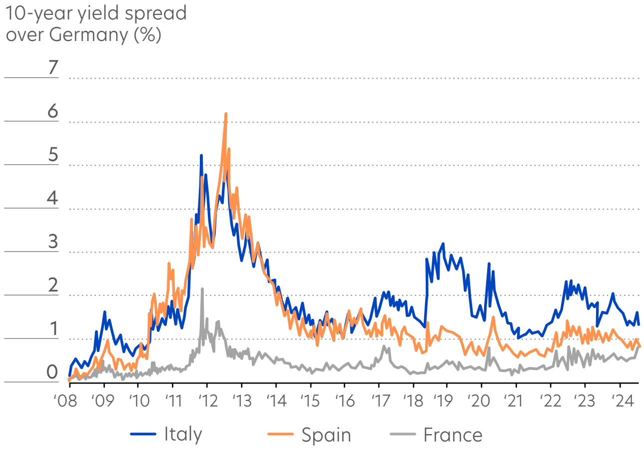
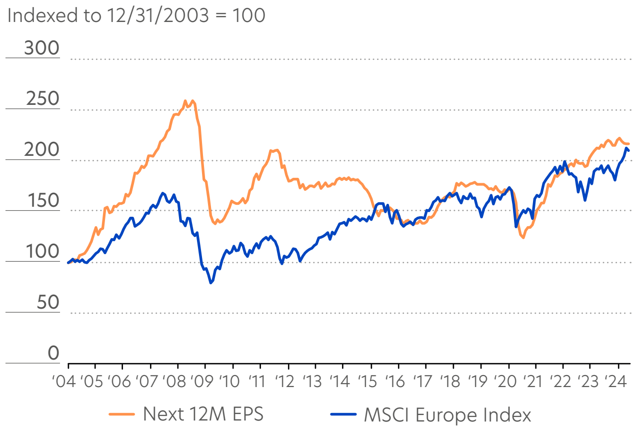



Figure 1b:

### European equities earnings expectations and returns




**Source:** Factset, J.P. Morgan Asset Management.

### What you can do

- Europe currently presents an attractive opportunity due to an improving economic backdrop, attractive valuations and favourable earnings prospects, together with support from EU institutions and the European Central Bank (ECB). Any market volatility resulting from the French election could potentially create buying opportunities. Additionally, the possibility of further ECB interest rate cuts provide additional benefits to both businesses and households, further enhancing the investment landscape.

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TOPIC 2:

# Quality stocks beyond the United States (US) can provide opportunities

## Investors can find valuable opportunities outside of the US. Other stock markets offer strong potential for long-term earnings growth.

- While US stocks remain strong due to healthy corporate earnings, there are opportunities in other markets when considering long-term earnings potential. Recent data show upward revisions in analyst earnings expectations, particularly for Europe and Asia ex-Japan (Figure 2a).
- Central banks are either on the verge of or have already begun cutting interest rates. This change in monetary policy could further support stocks, particularly growth stocks. As yields decline, the discounted future cash flows[1] of growth-oriented companies become more attractive, potentially improving their valuations.
- Investors typically use price-to-earnings (P/E) ratio to value stocks. However, adjusting for the long-term earnings per share (EPS) can provide a better picture of a company's earnings growth potential. This adjusted measure is known as the price/earnings to growth ratio (PEG)[2]. If a stock's current PEG ratio is higher than its long-term average, it is considered relatively expensive, and vice versa.
- Declining PEG ratios suggest that stock markets are becoming increasingly attractive, particularly in Asia ex-Japan. Some markets in this region are benefitting from ongoing supply chain reorientation and Artificial Intelligence (AI) trends (Figure 2b).
- Even in Japan, where the PEG ratio appears higher than in other regions, it has been steadily declining. This reflects factors such as ongoing corporate governance reforms and stabilising consumer sentiment.

[1] Discounted cash flow is a valuation method that uses expected future cash flows to estimate the value of an investment.
[2] Price/earnings to growth (PEG) ratio is calculated as a stock's P/E ratio divided by the growth rate of its long-term EPS growth.

Figure 2a:

### Upward revisions in earnings expectations for Europe and Asia ex-Japan

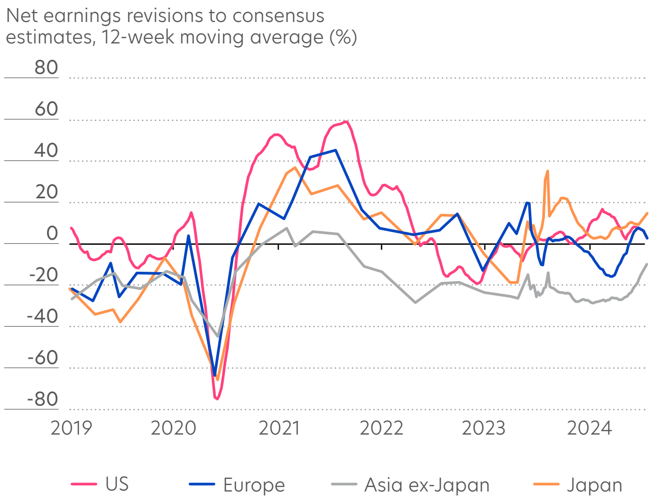
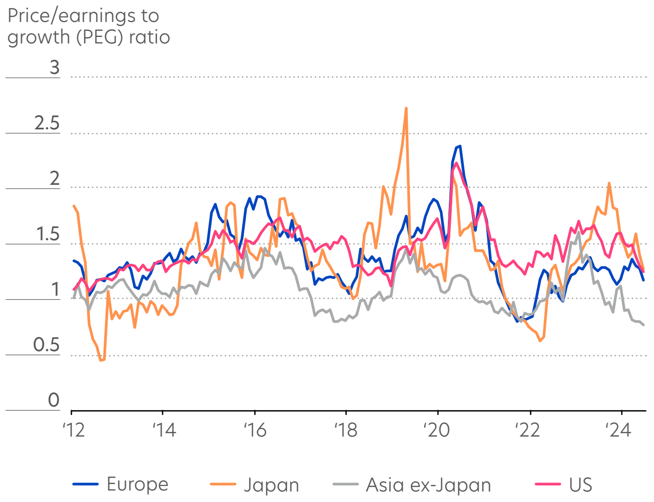



Figure 2b:

### Price/earnings to growth ratio suggest valuations are increasingly attractive




**Source:** FactSet, MSCI, J.P Morgan Asset Management. Asia ex-Japan, Japan, Europe and US equity indices used are the MSCI AC Asia Pacific ex-Japan, MSCI Japan, MSCI Europe and S&P 500, respectively.

### What you can do

- While the US stock market remains attractive, consider diversifying your portfolio to capture long-term earnings potential in other regions. The coming months may bring political and geopolitical uncertainties, further emphasising the need for diversified allocation across different asset classes, regions, and sectors.

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TOPIC 3:

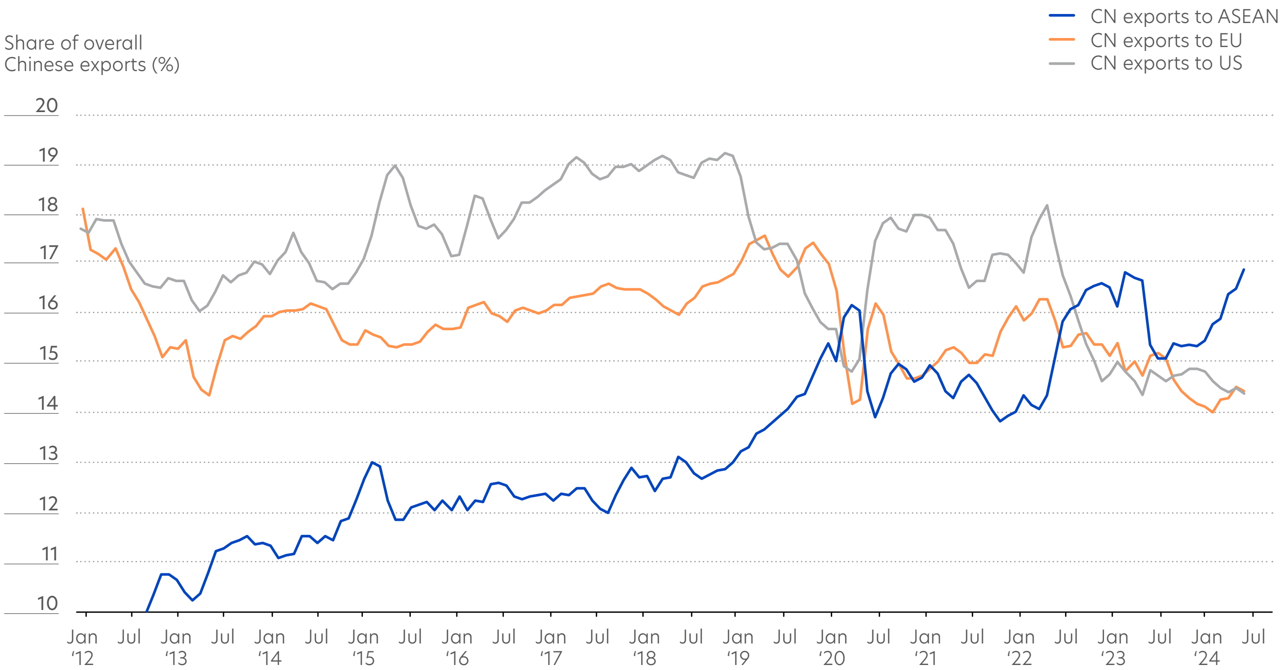
# Trade tensions may not be as damaging as feared

## Trade tensions exist between major economies, but their impact could be less damaging than feared.

- Since early 2018, trade tensions have fluctuated, with both the US and EU recently announcing higher tariffs on Chinese products. The outcome of the US presidential election could lead to further tariff adjustments, potentially affecting global supply chains, particularly those involving China.
- In response, China has begun shifting its export focus away from the US and EU towards key markets like ASEAN (Figure 3). Despite this reorientation, China's overall share of global exports has risen modestly, highlighting its dominance as a global manufacturing hub.
- The restructuring of global supply chains may mitigate the impact of renewed tariffs. However, there is risk that if the US imposes universal tariffs on all imports, it could lead to retaliatory tariffs from other countries.

Figure 3:

### Chinese exports increasingly shifting towards ASEAN




**Source:** CEIC, J.P. Morgan Asset Management.

### What you can do

- Remain invested despite potential volatility. Focus on quality assets in markets that stand to benefit from the ongoing reorientation of supply chains, particularly in ASEAN. This strategy could make it easier to take advantage of opportunities arising from geopolitical tensions.

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