## Market Outlook – Asset Class 2Q 2023



## **Equities**



- The global economy has exhibited resilience, yet developed countries remain vulnerable to mounting recessionary pressures, as the effects of tighter policies and financial conditions continue to filter through.
- Despite a fall in headline inflation, core inflation in the U.S. has remained stubbornly high. Credit conditions for households and businesses are expected to tighten, which may help ease inflation together with a weaker labour market later this year.
- The banking crisis that emerged in mid-March poses a significant challenge to the Fed's rate policy by adding an additional consideration to the pressure on financial stability. The Fed may opt to hike rates one or two more times and pause.
- The tighter lending standards of banks may further exacerbate the already-heightened funding costs faced by firms, potentially placing a damper on growth and investment. A deteriorating economic outlook will likely weigh on corporate profitability and lead to downward revisions in earnings.





- Market expectations on rate hikes by the Fed have cooled due to concerns about the contagion risks, resulting in a sharp drop in bond yields. This trend may signal a halt to the rising yields seen over the past year as we approach the end of the hiking cycle.
- Given the looming global recession risks and potential deterioration of corporate fundamentals, risk assets performance may remain volatile. There may be growing appetites for safer assets, with defensive sovereign bonds with longer durations offering a more attractive total return potential.
- The recent banking crisis may lead to a credit crunch and, together with the effects of the tightening policies coming through, that may result in spread widening and higher default risks on corporate credits, particularly for high-yield bonds.











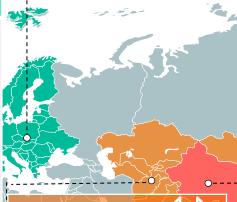
# Market Outlook - Equities 2Q 2023

- The current inflationary environment, combined with slowing economic activity and diminishing consumer savings, will likely present significant challenges to corporate profitability, resulting in an earnings contraction.
- Tighter financial and macro environment could trigger a correction in the equity market again, particularly given that the valuation of US equities has yet to reflect the potential downward revision in earnings.
- The Fed may remain relatively cautious and more data-dependent regarding its rate policy. The March dot plot indicated that the peak rate may settle at 5.1%, suggesting that the Fed could be near the end of its hiking cycle.

### Eurozone



- The European Central Bank is holding on to its hawkish stance in the face of recession as inflation - though easing remains elevated.
- A mix of evolving factors, including recession risks, financial system stability and the energy market disruption caused by the OPEC+ oil production cut, could continue to weigh on the economy.
- There is no resolution in sight to the war in Ukraine that began more than a year ago. The deteriorating economic outlook could result in a deceleration in earnings growth and a weigh on equity returns. However, valuation of European equity markets remain cheap even after the rebound in the first quarter.



### Asia ex-Japan

- The reopening of the Chinese economy could continue to boost trade and tourism in the region. This may offset part of the negative impacts from weakening exports to the developed markets.
- Against the backdrop of recession concerns in developed markets, Asia appears to be better positioned in earnings outlook. Overall valuations of the region remain reasonable.
- A pause in rate hikes from the Fed may favour Asian currencies and attract capital inflows into the region. Yet, equity markets in the region could stay volatile given the rise in uncertainties globally.



- The Bank of Japan is likely to keep the interest rate at ultra-low levels given Japan's subdued economic growth, but the continuation of yield curve control turns uncertain amid rising inflation and the consideration of improving bond market functioning.
- External demand may remain sluggish due to the mounting recessionary pressures in the developed economies and stronger yen. This could drag earning prospects for the exportoriented companies in Japan.
- The service sector may receive a boost from the lifting of Covid restrictions in other Asian countries, which may spur inbound tourism to Japan.



### China



- The Chinese economy is expected to continue its rebound driven by the release of pent-up consumption demand, a stabilized housing market, and the supportive fiscal and monetary policies.
- The full reopening of the Hong Kong economy sets the stage for a broadbased recovery and will continue to bolster consumer and business sentiment. Inbound mainland visitors are expected to drive demand in the service sector.
- Valuations in the Chinese and Hong Kong equity markets remain reasonable. Due to low base effects and fast economic recovery, earnings growth in 2023 is likely to be strong.





Slightly Overweight



Neutral



Slightly Underweight



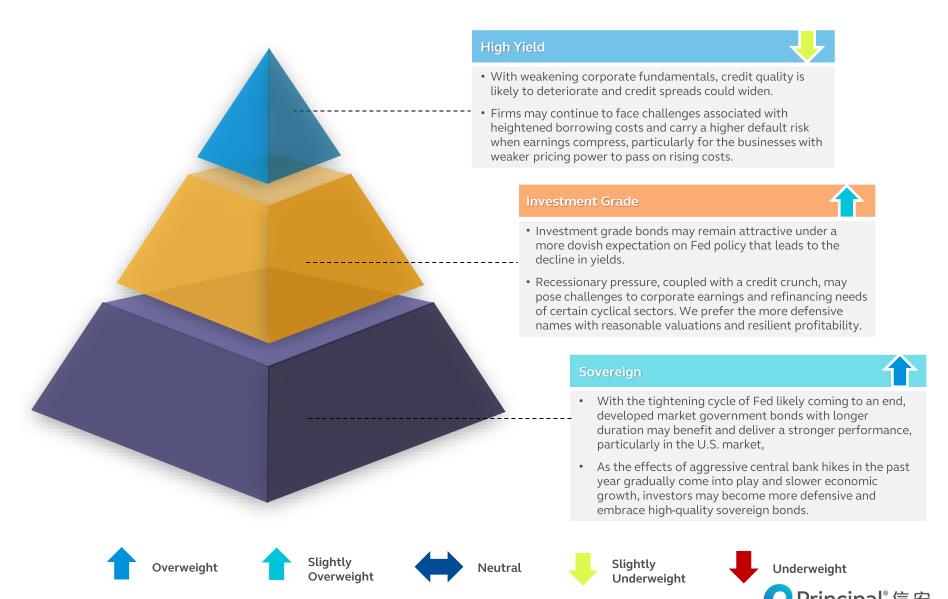
Underweight



Source: Principal Asset Management Company (Asia) Ltd.

The geographical classification of above listed equity markets is based on MSCI 2021 annual market classification review. For more information, please refer to https://www.msci.com/market-classification

## Market Outlook - Fixed Income 2Q 2023



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