Macro Monthly

Economic insights and asset class views

UBS Asset Management | March 2024

For global professional / qualified / institutional clients and investors and US individual investors.
For marketing purposes

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Offense over defense as global growth broadens

Highlights

- We see increased cause for optimism on more cyclical equity regions outside the US, like Japan and Europe, as global manufacturing inflects higher
- US stocks may also continue to benefit from an elevated weighting towards technology giants bolstered by the AI theme; we prefer funding from defensive markets like Switzerland and the UK
- A potential negative side effect of a rebound in manufacturing activity is a stalling out of the disinflationary trend in goods prices
- The US dollar has utility for hedging purposes even as growth broadens if sticky inflation weighs on both stocks and bonds

The defining characteristic of the macro backdrop has been US exceptionalism: better relative economic growth, equity market performance, and a strengthening currency, to boot.

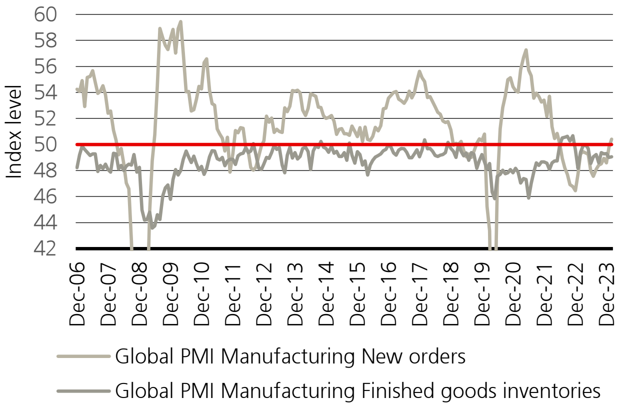
While we still anticipate US economic resilience, we now see increasing green shoots in the rest of the world. Global manufacturing is rebounding, which is positive news for economies more levered to factory activity.

However, this positive news for the goods sector may come with some potential bad news for inflation. Rebounding demand coupled with low inventories creates some upside risk for goods prices – which have played a substantial role in bringing overall inflation well down off its peak and closer to central bank targets. Some stickiness in price pressures increases the odds that central banks wait even longer before starting to lower policy rates, and become a source of bond volatility that weighs on risk assets.

US exceptionalism

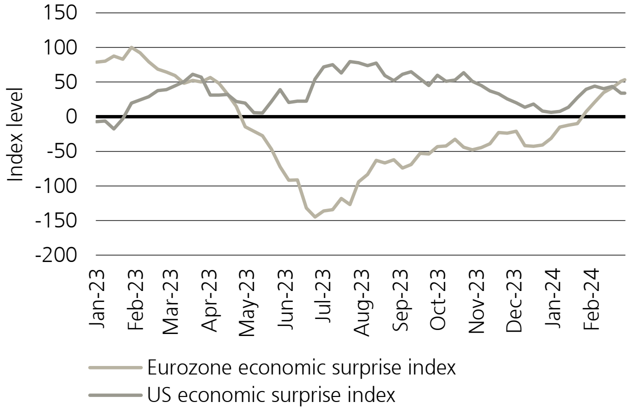
The US economy has had a long stretch of economic outperformance vs. most other major economies. The reasons have been manifold, with both one-offs and structural elements at play. US fiscal stimulus was more generous and consistent than for other countries, resulting in a long-lived boost to consumer spending and a 'crowding in' effect for business investment. Corporate dynamism is also superior, with improving productivity relative to the rest of the world, namely Europe. The US mortgage market is of a long duration, with the dominant product being a 30-year fixed rate, so higher rates have taken a smaller bite out of disposable income because they have impacted fewer households compared to other parts of the world. Even geopolitical events have had a factor in exacerbating growth differentials: Russia's invasion of Ukraine impeded the output of European industry meaningfully, while the shock to global energy markets was a positive for US terms of trade.

Exhibit 1: Global manufacturing gaining momentum



Source: UBS Asset Management, JPMorgan. Data as of February 2024.

Exhibit 2: Economic data beating expectations even more in Europe vs the US



Source: UBS Asset Management, Citi, Bloomberg. Data as of March 2024.

The outperformance of US equity markets is partially linked to US economic outperformance of other major regions. More importantly, it has been supercharged by multinational technology giants capturing outsized global market share as well as earnings linked to the development and application of artificial intelligence.

This exceptionality extends to the foreign exchange market. Flows into US dollar assets are robust, as US Treasuries are among the highest 'risk-free' yields available in fixed income, and equities are expected to deliver better earnings growth than their global peers, in aggregate.

Catching up

The US may still be a relative leader among developed markets in terms of economic growth, but we believe a period of catch-up and more broadly based global growth could be at hand.

Global factory activity is improving. In February, the JPMorgan global manufacturing purchasing managers' index rose above 50 (which separates expansion from contraction) for the first time since August 2022. The internals of this survey are also improving, with new orders improving and inventories contracting – a positive indicator for future production. As the US is more services-oriented than other economies, this rebound in manufacturing is more positive for economies outside the US.

Leading indicators suggest the European economy is turning up on aggregate, even with sluggish performance from Germany (its largest component). Europe's economic surprise index recently moved above its US counterpart for the first time in nearly a year. And the Asia ex-China region should be well-supported by the continued strength in the technology goods cycle.

As for China, we expect continued efforts to stabilize the economy amid what is likely to be a long period of readjustment in the property sector. Economic conditions in China becoming less negative can help on the margin. But we believe there is a low likelihood of the type of stimulus packages delivered following the global financial crisis of 2007-08 and again in 2016-17, both of which contributed to higher domestic growth and also produced material positive spillovers for global growth.

The big-picture view is that an environment in which nominal activity stays relatively robust as the rest of the world picks up steam is a far better scenario for financial markets, on net, than one in which the expansion is in jeopardy.

Lingering inflation risk

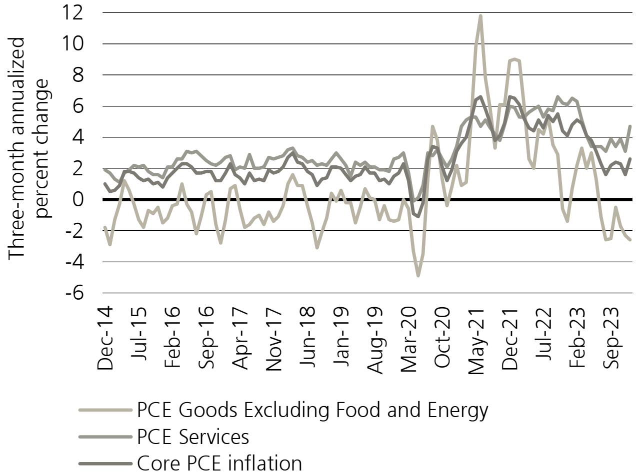
A critical reason inflation has been able to decelerate so much over the past year and a half is the stark change in pricing trends in the goods sector. After soaring during pandemic-induced supply shortages, goods prices have been moving sideways-to-lower since mid-2022. This drop-off in inflationary pressures was due in part to healing supply chains, but soft demand in the rest of the world, and excess capacity in China, also contributed. Rising shipping costs and geopolitical maritime risks coupled with a recovery in goods sector demand suggest less disinflationary help going forward.

January inflation data was hotter than anticipated across the board in the US. One month's worth of information on price pressures does not derail the overall disinflationary trend. Granted, residual seasonality appears to have contributed to this elevated print, but it cannot be totally dismissed. There is the risk that some of the strength, particularly in non-housing services inflation, continues to bleed into February. And in Europe, inflation slowed less than expected in February with price pressures in services appearing to be sticky, with recent readings of around 4% year-on-year.

The growth and inflation data so far this year have forced a resetting of expectations in which both the start date for the easing cycle from developed-market central banks is being pushed back and its depth reduced. We believe the path of least resistance is for this trend to continue. In the near term, higher frequency measures of inflation are unlikely to give the Federal Reserve the "greater confidence" it requires that price pressures are heading durably back to its 2% target.

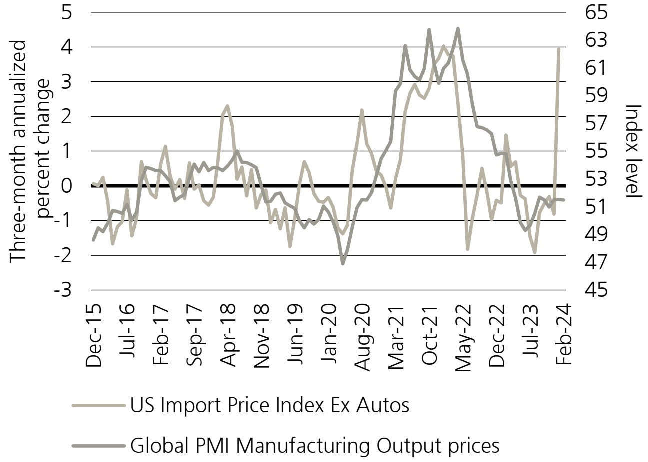
Within the strong performance for risk assets in recent months, we are seeing some signs of speculation in markets. Not all of this easing of financial conditions may be warranted or wanted in the eyes of monetary policymakers as it may contribute to leaving inflation somewhat sticky above-target.

Exhibit 3: Still stickiness in US services inflation



Source: UBS Asset Management, Bloomberg. As of January 2024.

Exhibit 4: Less goods deflation could change inflation pictures



Source: UBS Asset Management, BLS, JPMorgan, Macrobond. As of January 2024.

Asset allocation

The improvement in global activity has room to run, in our view. Within equities, we prefer exposure to regions levered to strong nominal global growth and the nascent recovery in manufacturing, like Japan and Europe, respectively.

An element of US exceptionalism still exists amid this global rebound – a higher concentration of AI-beneficiaries are poised to grow earnings at a rate well above the market average. In our view, better funding markets for our preferred equity longs include more defensive, acyclical markets like Switzerland and the UK.

Global sovereign bond yields have meaningfully re-adjusted to reflect the better nominal growth outlook. Short-term interest rate markets have moved much closer to our own outlook and become more consistent with forward guidance from central banks. With risks to the outlook becoming more two-sided as confidence on the economic outlook has increased in recent months, we maintain a neutral stance on government bonds.

Typically, the US dollar tends to weaken on positive inflections in global growth. That being said, we believe exposure to the US dollar is attractive as a hedge. The US dollar is among the only major sources of portfolio protection in the event investors price in a 'no landing' that involves both stocks and bonds selling off. This scenario would include an increase in US interest rate differentials relative to the rest of the world.

Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 1 March 2024. The colored squares on the left provide our overall signal for global equities, rates, and credit. The rest of the ratings pertain to the relative attractiveness of certain regions within the asset classes of equities, rates, credit and currencies. Because the Asset Class Views table does not include all asset classes, the net overall signal may be somewhat negative or positive.

	Underweight			Overweight		
Global Equities			●			Profits growing, but rich valuations, more elevated positioning mean risk-reward is more balanced.
US				●		Still some room to advance as earnings continue to grow.
Europe				●		Cheap valuations and leading indicators turning up.
Japan				●		Earnings outperforming, ongoing corporate reform, and still not expensive after recent gains.
Emerging Markets			●			EM outperformance requires USD weakness, more evidence of China strength. Asia ex China supported by tech goods rebound.
Global Government Bonds			●			Market pricing in line with central bank guidance. Bonds = recession hedge.
US Treasuries			●			Growth is solid, inflation roughly in line with Fed expectations.
Bunds			●			Inflation is cooling, but labor market is tight and wages remain elevated.
Gilts			●			Inflation to follow global trend lower; growth not as bad as Bank of England has feared.
Global Credit			●			Attractive all-in yields amid decent growth and disinflation, but limited room for spread compression.
Investment Grade Credit			●			Spreads relatively narrow, so risk-reward confined to carry.
High Yield Credit			●			Slight preference for IG versus HY; more potential negative convexity in riskier bonds.
EMD Hard Currency			●			Valuations and macro data have become less supportive relative to DM credit.
FX						
USD				●		Bullish against G10 as US economy remains relative outperformer.
EUR		●				Core inflation slowing quickly, along with weak growth. Expect rate differentials to stay in USD's favor.
JPY			●			Bank of Japan is moving towards tightening at slow, methodical pace. Better currencies to be long.
EM FX			●			Bullish high carry LatAm FX, cautious on Asia ex Japan on China, geopolitical risks.
Commodities			●			Prefer oil to industrial metals on China property weakness, Middle East risks.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 1 March 2024. Views are provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

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Americas

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