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Asian portfolio responses to potential trade tensions

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Financial markets have been fairly sanguine about the policy disruption that the incoming Trump administration might bring. The potential rise in trade tensions in particular—especially with its likely focus on China—suggests that investors should maintain portfolio discipline and look to bolster the resilience of portfolio returns. Asian investors in particular should take note of these opportunities: Asia ex-Japan equities and Asia IG bonds remain appealing in our view. Both the USDJPY and USDSGD might be candidates to be sold on excessive rises; and the case for gold as a hedge against event risks remains very much intact.

As we come up to a week since Donald Trump's presidential election win, markets appear to be remaining sanguine about the overall macro outlook. The S&P 500 is up around 5%, with the VIX volatility index down from 22 to under 15—levels last seen in mid-August. Additionally, gold is still down around 4.5% as speculators switched from the market's favorite hedge to equities. It appears that the markets have decided to focus almost entirely on the purported equity-positive aspects of the Trump policy platform. This also seems to be accompanied by the assumption that the more-disruptive elements of his policy rhetoric might be a feint.

But amid all the exuberance, investors would do well to remember that there is still much uncertainty surrounding the incoming Trump administration's policy agenda, its ability to execute, and the amount of resistance it is likely to face. China's decision to hold off on a stimulus burst (likely an effort to keep its ammunition for when they have greater clarity on the tariff picture) provides a timely reminder of the opacity surrounding trade and diplomatic relations with the new Trump administration.

Investors would be best placed to navigate this uncertain environment via a well-diversified and balanced portfolio, especially with the inclusion of key Asian components that might be fairly insulated against the key tariff risks.

Asia ex-Japan (AxJ) key to resilience in equity portfolios. Although the MSCI Asia ex-Japan (MXASJ) has underperformed the S&P 500 folllowing the election, we believe it remains Attractive. The region as a whole should benefit from continued easing by the US Federal Reserve, as well further incremental policy easing out of China. Within AxJ, South Korea and Taiwan afford investors exposure to the structural AI trend, while India and Southeast Asia offer robust domestically-driven economic growth. While we continue to view equities overall as Attractive—and the US as the other Attractive region—investors should not forget AxJ's appeal regardless of the US's outperformance.

Asia IG remains attractive. We remain neutral on bonds in portfolios, but after the recent sharp increase in US Treasury (UST) yields, we see positive returns for bonds ahead. Investors with high cash balances should use currently elevated yields to lock in yields for the year ahead. In the same vein, we think investors should continue to position in Asia investment grade (IG) bonds, where yields are looking attractive at around 5.4%, a level which should garner strong demand from yield-focused investors. Asia IG bonds are a good avenue to lock in stable carry, and we expect healthy total returns in the next 12 months, given a robust fundamental and demand/supply backdrop. We see limited potential for Asia IG spread widening even if protectionist US policies materialize as most USD bond issuers in Asia are domestically oriented.

Asia Pacific currencies are likely to see divergent impacts. Although the region is broadly dependent on trade, the level of exposure to trade tensions with the US – even within the more liquid and widely traded ones – varies quite a bit. Most impacted will undoubtedly be the CNY given that China has been the focus of Mr. Trump's trade-related animosity; the USDCNY has already risen 1.5% post-election, compared to 1.3% for the USD index (DXY). We have raised our USDCNY forecasts to 7.3 (Dec 24), 7.4 (Mar 25), 7.5 (Jun 25), 7.5 (Sep 25); from 7.2, 7.0, 7.0, 7.0 previously. While the PBoC could contain the rise at around 7.5, we would refrain from seeing this level as a hard cap. The risk for the USDCNY will likely be skewed toward the upside over the medium term, even though this might well manifest in a staggered, stepwise fashion as it did in 2018/19.

For the USDJPY and USDSGD, we would see the upside as more limited, and there is the potential to sell if either experiences an excessive spike. For the USDJPY, we believe a USDJPY spike toward 158-160 would be unsustainable and see such levels as opportunities to tactically sell either the USDJPY outright or the upside risk for yield pickup. For the USDSGD, we regard levels above 1.35 as attractive to tactically sell USDSGD or sell the upside price risk for yield pickup. We believe the medium-term erosion of the USD's carry premium (as the Fed continues to cut) limits the sustainability of extreme levels of USD strength, while the SGD should be further bolstered by the Monetary Authority of Singapore's policy of maintaining gradual currency appreciation.

It is also important to note that the fundamental supports for gold demand—especially as a hedge against event risks—remain very much intact. We maintain our 12-month target at 2,900/oz and continue to recommend a 5% allocation to gold in USD-denominated balanced portfolios.

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