eastspring investments

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2Q24 Market Outlook

Balancing shorter-term rewards against longer-term risks

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Q1 2024: Market recap

Both equities and yields continued to rise

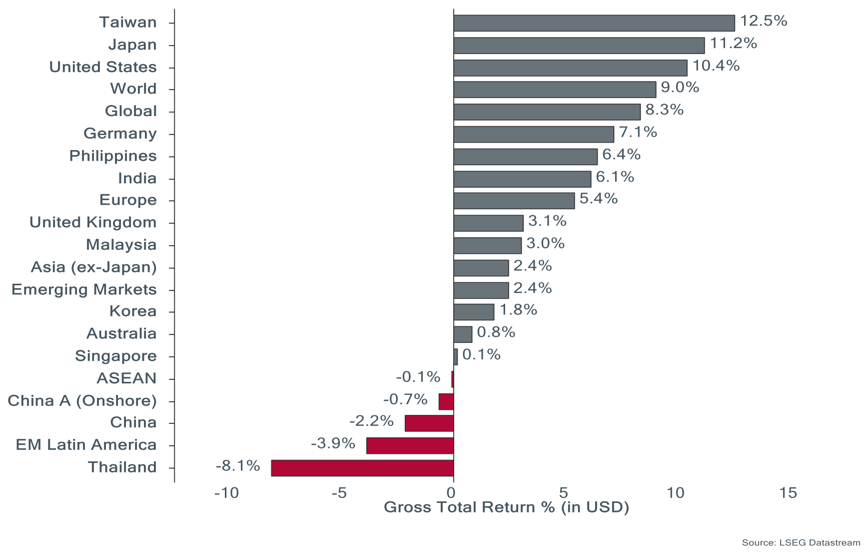
Equities

Global equities continued to rise over the first quarter of 2024 amid generally resilient economic data, bolstered by supporting sentiment, as well as the ongoing enthusiasm for Artificial Intelligence (“AI”) related stocks. Robust economic data and strong earnings from a number of US technology heavyweights further buoyed markets, with the US market generating a 10.4% return over the quarter. Asia and Emerging Markets (“EMs”) generally underperformed the developed markets over the quarter. Taiwan and Japan posted strong returns of 12.5% and 11.2%, respectively, with enthusiasm for technology and AI supporting the former and the depreciating yen and foreign investors supporting the latter. Although Chinese equities saw some improvement in sentiment over the quarter, both the onshore and investible markets posted negative returns amid continued growth concerns.

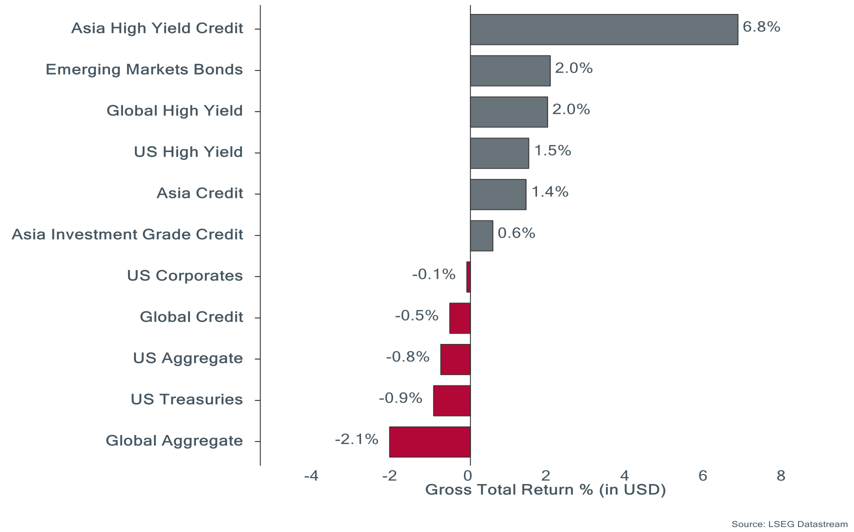
Fixed Income

In Q1 2024, the inflation and interest rate outlook underwent significant change. Initially, the market expected the Fed to take quick action to reduce interest rates, but these expectations were later moderated. This led to higher US Treasury yields, with a broad-based increase across key tenors; 10-year, 20-year, and 30-year yields were up by 0.32%, 0.25%, and 0.31% respectively, to close at 4.20%, 4.45% and 4.34%. The Barclays Global Aggregate Index fell 2.1% amid rising government bond yields, while the ICE BofA US High Yield Constrained Index outperformed investment grade bonds due to strong Q4 earnings and lower interest rate sensitivity. The JP Morgan Asia Credit Index (JACI), which proxies the Asia USD bond market, rose 1.4% supported by good returns from corporate and sovereign high yield issuers.

Global Equities: Q1 2024 Performance



Global Fixed Income: Q1 2024 Performance



Source: LSEG Datastream. For the “Global Equities” chart, each market is represented by the respective MSCI indices, in gross total return and USD terms. For the “Global Fixed Income” chart, please note the following. Asia High Yield Credit: J.P. Morgan Asia Credit Index Non-Investment Grade, Emerging Markets Bonds: J.P. Morgan EMBI Global Diversified Index, Global High Yield: ICE BofA Global High Yield Index, US High Yield: ICE BofA US High Yield Constrained Index, Asia Credit: J.P. Morgan Asia Credit Index (JACI), Asia Investment Grade Credit: J.P. Morgan Asia Credit Index Investment Grade, US Corporates: ICE BofA US Corporate Index, Global Credit: ICE BofA Global Credit Index, US Aggregate: Bloomberg Barclays U.S. Aggregate Index, US Treasuries: ICE BofA US Treasury Index, and Global Aggregate: Bloomberg Barclays Global Aggregate Index.

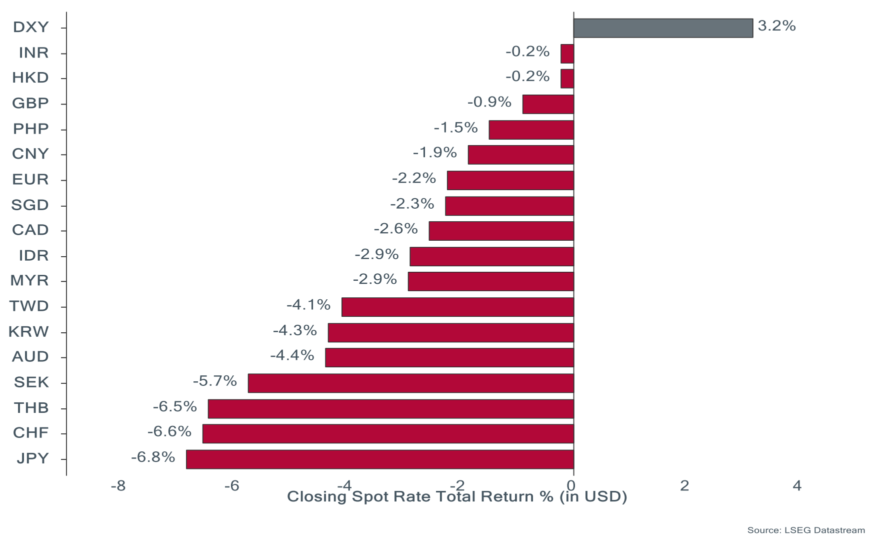
Currencies

The US dollar, as represented by US Dollar Index (DXY), outperformed all major currencies during the quarter, mostly benefitting from a combination of strong US economic data, higher US yields, and inflows into US risk assets. Despite the Bank of Japan's symbolic exit from its negative interest rate regime, the Japanese yen declined almost 7% against the dollar, the biggest laggard amongst the major currencies. Amongst its G8 peers, the Swiss franc experienced a notable decline of -6.6%, as the Swiss National Bank unexpectedly cut its interest rates by 0.25% to 1.5%, opposite to market expectations of no policy change.

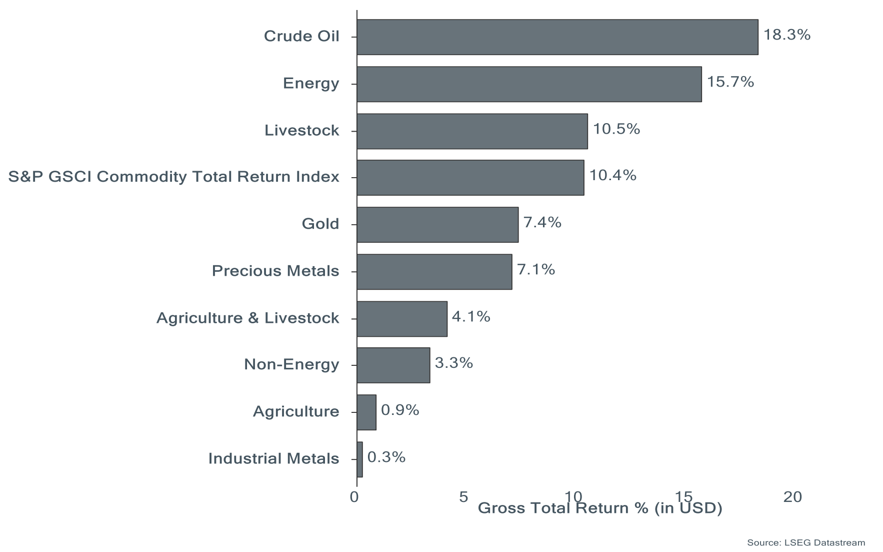
Commodities

The broad commodity sector, represented by the S&P GSCI Commodity index, posted a strong gain of 10.4% during the quarter. The strong performers included crude oil and energy at 18.3% and 15.7%, respectively. The rise in crude oil prices is due to OPEC's commitment to production cuts and the rise in geopolitical risks in two major oil-exporting regions, the Middle East and Russia/Ukraine. The precious metals sector also posted a strong gain of 7.1%, with gold going past its previous all-time highs. This was due to ongoing purchases by central banks and growing concerns about potential global conflicts. Within agriculture, cocoa price rose significantly due to both strong demand and shortages.

Currencies (vs. USD): Q1 2024 Performance



Commodities: Q1 2024 Performance



Source: LSEG Datastream. For the "Currencies (vs. USD)" chart, with the exception of the U.S. Dollar Index (DXY), the returns for the other respective currencies (against the USD) are based on the closing spot rates calculated by Refinitiv. For the "Commodities" chart, please note the following. Crude Oil: S&P GSCI Crude Oil Index, Energy: S&P GSCI Energy Index, Livestock: S&P GSCI Livestock Index, Gold: S&P GSCI Gold Index, Precious Metals: S&P GSCI Precious Metals Index, Agriculture & Livestock: S&P GSCI Agriculture and Livestock Index, Non-Energy: S&P GSCI Non-Energy Index, Agriculture: S&P GSCI Agriculture Index, and Industrial Metals: S&P GSCI Industrial Metals Index.

Macro outlook

Resilient US economy and "sticky" core inflation to delay Fed's pivot

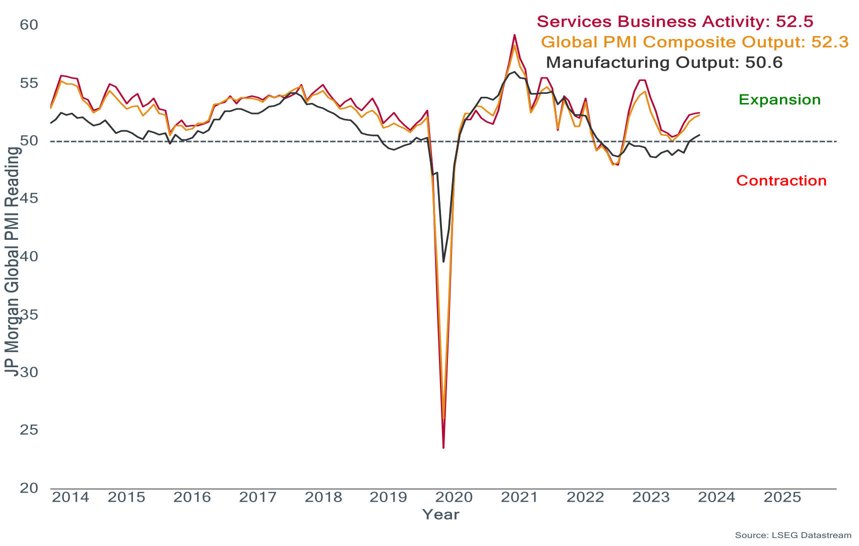
Global growth

The global economy steadily expanded with strong momentum, as indicated by recent PMI surveys. PMI data is considered a reliable leading indicator of economic growth, providing an accurate snapshot of the current state of the economy and useful insights into the pace and direction of global economic growth. The J.P. Morgan Global Composite PMI, which covers manufacturing and services across 40 economies, increased to 52.3 in March from 52.1 in February, its highest reading since mid-2023. Notably, the expansion in manufacturing output was widespread across various countries and sectors. Emerging markets, led by India, showed strong growth while Europe remains a drag on the overall growth. The negative impact has however reduced to some extent. The service sector, which constitutes the largest portion of the global economy's business activity, continues to lead the increase in global output.

Inflation

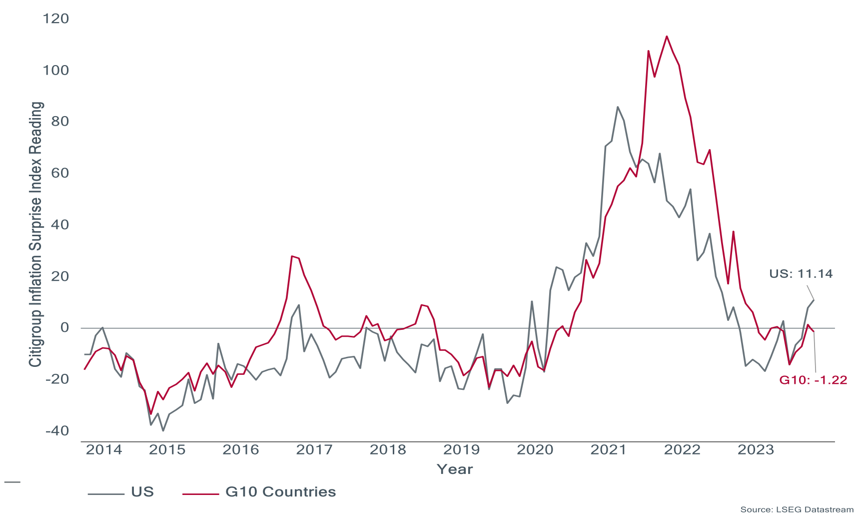
US core inflation, as measured by the Consumer Price Index for All Urban Consumers: All Items Less Food and Energy, remained firm over the quarter due to higher shelter inflation, which makes up roughly 33% of the overall US CPI basket. Despite expectations for a downturn in shelter inflation, it remained elevated due to a rise in both the rent of primary residence and owners' equivalent rent (OER). From a global perspective, inflationary trends in the US and G10 countries are seemingly diverging with inflation surprises in Europe decreasing lately and those in the US increasing. While recent US inflation readings have been above expectations, the multi asset team anticipates that the overall US inflation should decrease if there is a significant decline in labour market demand and consumer spending momentum; the latter is expected to be hit sooner or later by the still high rates and decreasing pandemic savings.

Global PMI, March 2024



Source: J.P. Morgan, LSEG Datastream. 15 March 2024

Citi Inflation Surprise Index (US, G10)



Source: LSEG Datastream, Citigroup, 29 March 2024.

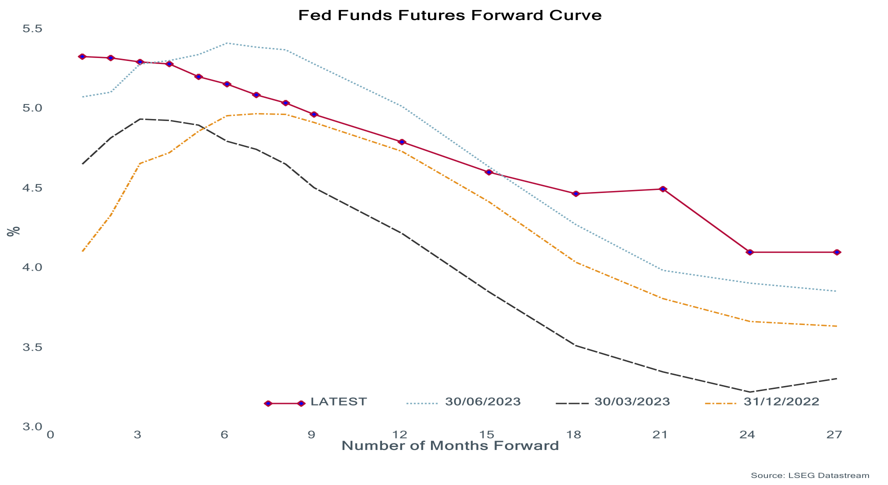
Interest rates

Since the beginning of the year, US Treasury yields have gone back up significantly due to two main reasons. The first is the three consecutive months of stubborn US inflation data, which put upward pressure on yields. The second reason is the markets' reduced expectations for Fed rate cuts in 2024. The expectations for the number of rate cuts in 2024 have changed significantly, from initially five rate cuts starting in March, to now currently two rate cuts to end the year on a target range of 4.75%-5.00%. Given the recent resilient US economic data, the Fed will likely not cut rates too early but will base their decision after seeing a few more months of data. The multi asset team expects the data-dependent Fed to begin pivoting on clear signs of a threatening recession, a meaningful breakdown in labour market demand, and/or a clear easing of core inflation in a lasting manner toward its target inflation rate of 2%.

Looking ahead

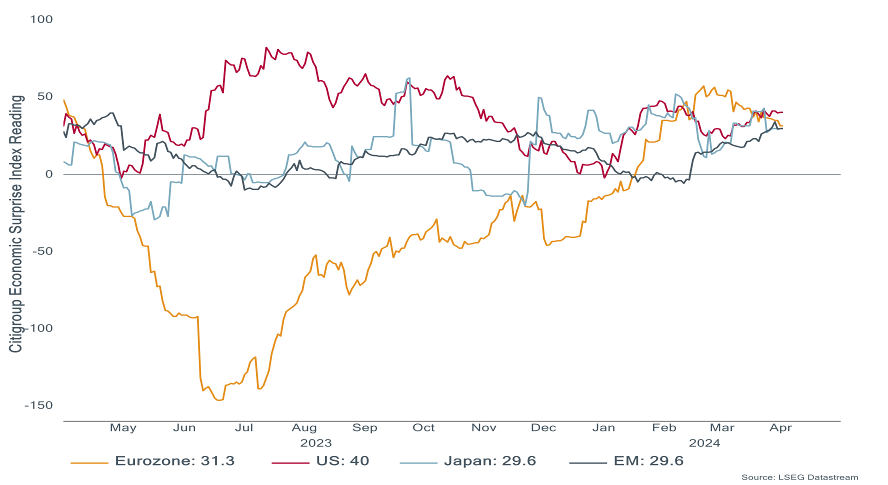
Global economic activity in 2024 has been stronger than expected, driven by strong US growth and an improvement in the global manufacturing output. US consumer spending, a key driver of US growth, continues to be robust. The US labour market remains relatively strong while the US manufacturing sector seems on the mend. On the monetary policy front, most global central banks, especially in developed markets, appear to have reached the end of their rate hiking cycles. All things considered, on the back of the recent resilience of US economic data, the team believes that the final stage of the inflation battle could be the toughest. If the US economy continues to perform well, it is possible that the 'higher-for-longer' narrative could persist, which suggests the "goldilocks" scenario plays out for longer than expected. But over the medium term, the team does not expect a substantial increase in inflation as manufacturing capacity utilisation remains low and labour market data shows moderation. The disinflation trend will occur once the labour market conditions meaningfully slow down and US consumer spending loses momentum amid dwindling pandemic savings.

Fed Funds Futures Forward Curve



Source: LSEG Datastream. 15 April 2024.

Citigroup Economic Surprise Index



Source: LSEG Datastream. Citigroup 16 April 2024.

Global Heatmap - Key Economic Indicators

Source: Eastspring Investments. LSEG Datastream. 29 March 2024.

Assessment of Key Risks – Inflation and Geopolitics Remain Key Risks

Areas of concern	Likelihood	Negative Impact
Middle East tensions The recent Iran–Israel and Gaza-Israel conflicts, and any further broadening of Middle East tensions, may cause further energy-related (oil) inflation and increase global trade costs in the event of supply disruptions.	Medium	High
Stubbornly strong US growth could see the Fed keeping interest rates at restrictive levels for longer than expected, challenging our medium term base case view of defensive positioning.	Medium	High
Inflation persisting while the forward-looking indicators suggest a general downward trend will result in uncertainty about the pace at which inflation will moderate. US labour market conditions and the US wages trajectory are the key watchpoints.	Low	Medium
2024 US presidential election cycle will feature prominently in the headlines and present a source of potential volatility over the 12-month horizon.	Medium	Medium
Limited impact (and untimely implementation) of meaningful stimulus measures from China pose a risk that China's continued disinflationary environment may spill over and drag global growth.	Low	Medium

Source: Eastspring Investments (Singapore) Limited, April 2024

Asset Allocation

Stay "risk-on" for now

The market backdrop continues to be driven by positive US economic data pointing to a robust environment. Risk assets have remained on a path of solid gains. A key watchpoint is the US labour market: forward-looking market expectations and the trend of indicators such as average hourly earnings data, hiring rates and temporary employment will determine the strength going forward.

The team's base case is for a shallow downturn in the 6-12 months horizon. This pushes out the window of our expectations somewhat, as we made a similar call in our previous quarterly outlook. However, over the 3-month horizon, the team is maintaining its "risk-on" positioning, given the strong fundamental data and that the potential for short-term upside is likely if fundamental data continues to be positive.

Asset allocation views

Underweight | Neutral | Overweight

Asset	Rationale
Global Equities 3m 12m	As US equities forms 64% of global equities, the team maintains its positive outlook on global equities for now based on the near-term strength of the US economic data, such as strong employment and a potential revival of the US manufacturing sector. The new record highs achieved by the S&P 500 and Nasdaq make equities susceptible to future sell-offs, especially if corporate profits get squeezed; however, the short-term upside potential remains on continued positive fundamental data. Over the 12-month horizon, dwindling US pandemic savings and weakening labour market demand are likely to slow US economic growth, and hence, drive equity valuations lower.
10Y Govt Bonds 3m 12m	The team maintains a short-term neutral stance on government bonds i.e., US, Europe. While US yields have risen higher year to date on reduced expectations of Fed rate cuts in 2024, US yields are likely to remain range-bound for now. In line with the team's more risk-off or defensive positioning over the next 12-month horizon, US duration stands to benefit from a backdrop of slowing growth and disinflationary trends, in addition to the typical "flight-to-safety" moves.
Credit 3m 12m	US credit spreads remain tight following the strong late-2023 rally and increased market expectations of a potential "soft landing" scenario. To this end, over the one-to-three-month horizon, the short-term overweights in risk assets (e.g., global equities, US high yield bonds, EM bonds) across the team's multi asset portfolios are typically being funded out of US investment grade bonds. However, over the 12-month horizon, the team is more positive on US investment grade bonds, relative to its less interest rate sensitive US high yield bond counterpart, as the asset class can benefit from potential price appreciation as US yields decline over the 12-month horizon.
Cash 3m 12m	The team's cash positioning remains neutral over the short-term given the risk-on short-term positioning but overweight in the medium term based on the defensive, risk-off positioning over the 12-month horizon.

Source: Multi Asset Portfolio Solutions team. Asset class views are as of the team's most recent monthly meeting in April 2024 and should not be taken as a recommendation. 3m = 3-month view. 12m = 12-month view. The information provided here is subject to change at the discretion of the Investment Manager without prior notice.

Asset Allocation (cont.)

Asset Allocation Views

Global Equities	
US 3m 12m	In March, US equities continued to rise, with a more diverse group of companies participating in the S&P 500 rally. Despite the potential for continued gains over the one-to-three-month horizon, especially if US economic data and AI sentiment remain firm, the upside may be more limited. The team's view for the next 12 months is that growth will slow, and the cumulative impact of previous rate hikes will eventually lead to a decline in equity valuations, which are already at historically high levels (e.g., S&P 500, Nasdaq). Therefore, we maintain an underweight stance on US equities over the 12-month horizon.
Europe 3m 12m	The team maintains a neutral short-term view on Europe equities given no major changes in our model's key indicators. Over the 12-month horizon, European equities are expected to face headwinds due to their high sensitivity to the global business cycle; generally weaker economic growth, driven by a combination of a decline in manufacturing activity and lower German exports, is likely to negatively impact the performance of European equities.
Emerging Markets 3m 12m	The team maintains a less positive outlook on EM equities over the 3-month horizon, especially as China's stimulus policies continue to disappoint. Over the 12-month horizon, EM earnings growth has the potential to outpace that of the developed markets (DM) economies; this is especially the case if a global recession transpires and is concentrated in the DM economies i.e., US, Europe).
Asia Pacific ex-Japan 3m 12m	As Asia Pacific ex-Japan (APxJ) region makes up about 73% of EM equities, the team's short-term underweight in EMs will by default result in an underweight in APxJ. Over the 12-month horizon, Asian equities are likely to trade range bound as the global recession will likely be concentrated in DM countries. Furthermore, Asian valuations are relatively more attractive than the US.

Government Bonds	
US 3m 12m	The team believes that US yields are likely to remain range bound for now, and hence remains neutral over the short-term. Over the 12-month horizon, we expect yields to move downwards, especially as wage inflation meaningfully deteriorates; US duration stands to benefit from a backdrop of slowing growth and disinflationary trends, in addition to the typical "flight-to-safety" moves.
Europe 3m 12m	The team maintains its neutral short-term stance. Though there is a possibility of an ECB rate cut starting in June 2024, the ECB will remain cautious. Over the 12-month horizon, a combination of relatively weak economic growth and the lagged effects of rate hikes make Europe government bonds relatively attractive in a potential risk-off market scenario.
Singapore 3m 12m	As Singapore's economic growth tends to closely follow that of DM countries, please refer to our comments on US government bonds above.

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Asset Allocation (cont.)

Asset Allocation Views

Corporate Bonds	
US High Yield 3m 12m	The still positive fundamental indicators showing up in team's model and the near-term resilience of US economic data can continue to support the asset class in the short-term. That said, the asset class' current valuations (i.e., spread levels) will be subject to volatility over the 12-month horizon. The "maturity wall" will likely start to kick in from 2Q25 onwards; the currently tight spreads will widen over the 12-month horizon if clear signs of a recession or a growth slowdown start to emerge.
US Investment Grade 3m 12m	Given the current extremely tight US investment grade spreads, the team maintains a short-term underweight position. Over the medium term, the view is neutral given the team's defensive preference for government bonds and cash.
Emerging Markets 3m 12m	The team upgraded its tactical outlook on EM USD bonds, from neutral to now marginally positive, primarily on the back of improvements in economic surprise data. EM USD debt is less sensitive to EM monetary policies (i.e., more sensitive to changes to US rates), and hence less sensitive to local currency movements. Over the 12-month horizon, the team is neutral as higher quality, safe haven assets tend to outperform towards the end of the business cycle, especially as global growth slows down.
Asian Credit 3m 12m	Asian bond yields have come off their highs but given the lower chances of a severe recession and reduced expectations of rate cuts, the current conditions are still ideal for Asian USD debt. But we are mindful that sentiment can change quickly and over the next 12 months, will look into the strength of balance sheets. Nevertheless, corporate bond yields in Asia are likely to be better behaved than DM countries.

FX	
USD 3m 12m	The team recently the upgraded the short-term outlook on USD (broad) to slightly positive from a neutral stance on improvements in our model's technical indicators (e.g., trading sentiment). Strong US growth and high real rates should continue to support USD in the near term, but other catalysts are needed to support the upward momentum. Over the 12-month horizon, the USD, given its counter-cyclical nature, stands to benefit in a slowing global growth environment.
EUR 3m 12m	Over the shorter horizon, the team is more positive on the USD versus the EUR, as per the above rationale. Over the 12-month horizon, the EUR, given its pro-cyclical characteristic, will be weighed down amid a slowdown in the Euro area later in the year.
SGD 3m 12m	The SGD should remain relatively range bound at current levels as the Monetary Authority of Singapore would likely keep its FX policy status quo for now.

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Equities

US equity valuations appear stretched, but maybe not yet at a breaking point

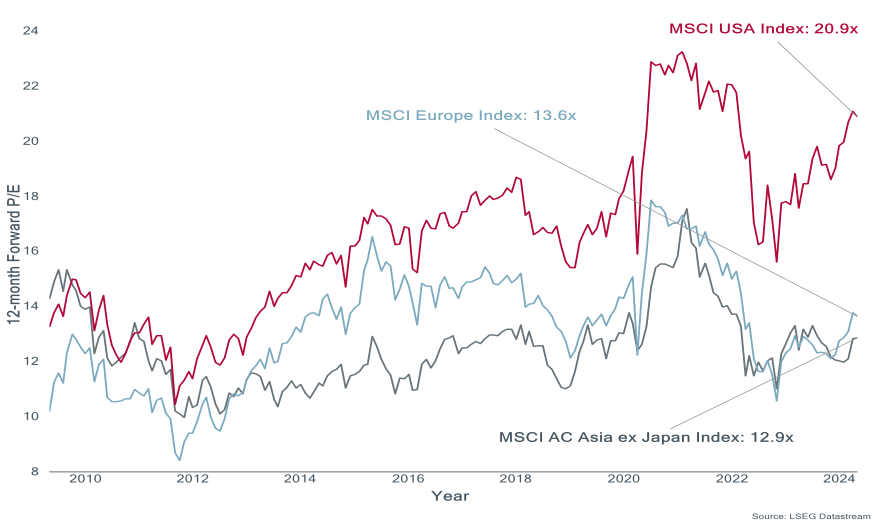
There has been no shortage of drama in the markets in recent times and this has led to narratives such as 2023's "Immaculate Disinflation" and 2024's "Goldilocks Forever" scenario and the "Magnificent 7" technology-related names' rally.

Tech has supported the strong rally in US equities, and it continues to surprise expectations on the upside. Within Asia, India has been one of the few bright spots that has benefitted from a relatively high growth environment compared to its peers in the Emerging Markets. From a valuation standpoint, Asian equity valuations remain cheap relative to other regional markets.

The common thread that ties US equities and India equities is the question of valuations. As both markets have run up significantly, valuations look relatively high. Positive economic data and election year dynamics suggests that in the near term, the higher price for these markets is worth paying. Still remain cautious and be prepared to reallocate once sentiment becomes negative.

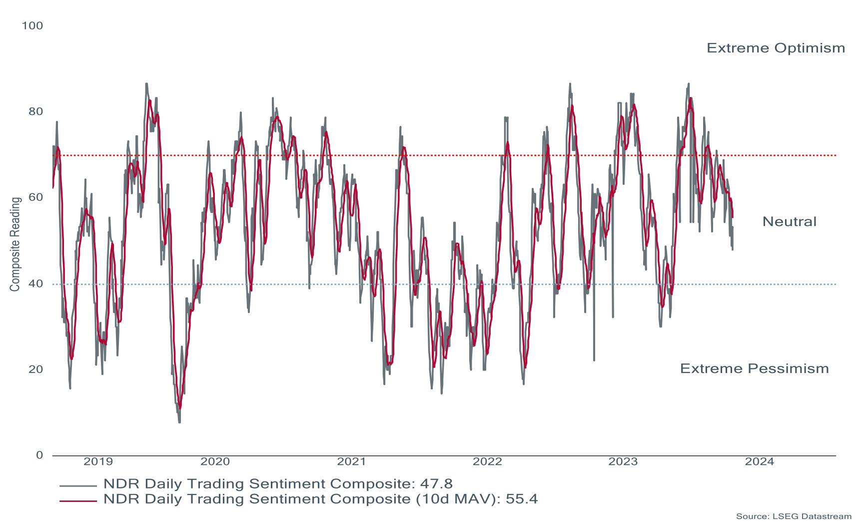
Per the recent AAII Sentiment Survey, as of 11 April 2024, the bullish sentiment (e.g., expectations that equities will rise over the next six months) remained above its historical average of 37.5%, though optimism amongst investors has seemingly decreased amid high valuations. However, the Ned Davis Research (NDR) Daily Trading Sentiment Composite reading show that trading sentiment is currently neutral territory. The "Sentiment" sub-section on the following page further explains our usage and interpretations of sentiment indicators

IBES MSCI 12 forward P/E: US vs. Asia ex-Japan



Source: LSEG Datastream, 17 April 2024.

NDR Daily Trading Sentiment



Source: LSEG Datastream, 15 April 2024.

Valuations

Forward P/E multiples for US equities are just short of 21x now and well above average levels. While the asset class is looking 'rich', historically US equities, as proxied by the S&P 500 index, have tended to peak about six months before the start of an economic slowdown. Given our expectations of a potential (shallow) recession towards the end of 2024 or into 2025, there is a short runway for equities to continue its run higher, at least for now.

Asia ex Japan valuations at 12.9x and Europe at about 13.6x look more attractive from a relative perspective. However, given our base case slowdown scenario, the USD's safe haven nature along with the cyclical nature of other regional markets, we favour US equities in the short term despite their stretched valuation.

Sentiment

Sentiment indicators have been a useful contrarian data point for us, as part of our tactical decision-making toolkit. Typically, forward equity returns are highest when sentiment is pessimistic but improving, and lowest, when sentiment is optimistic, but deteriorating.

Investor sentiment for the shorter-term outlook for equities, as represented by Ned Davis Research (NDR) Daily Trading Sentiment is painting a neutral picture but coming off the highs of overly optimistic levels. This is supportive of our view that in the near term equities are likely to rise as sentiment bottoms out.

Positioning

Given our expectations of a potential (shallow recession) towards the end of 2024 or into 2025 we are positive on equities broadly on a three-month view. While Emerging Markets (and Asia) seem relatively more attractively valued than the US, and Europe to some extent, China remains a significant near-term consideration.

The Chinese fiscal stimulus efforts have yet to make a significant positive mark on the economy and the housing market in China remains an overhang on the market. While China's market does look attractive, we remain cautious and prefer to see concrete signs of an upturn before allocating meaningfully to China.

Consequently, we maintain a relatively more favourable stance on US equities in the near term but we expect our overall positioning to tilt in favour of fixed income over the longer term. Within equities, the tilt will be from US equities to EM / Asia as slowdown concerns play out beyond 2025.

Bonds

Why US Treasuries remain a valuable asset

In the Q124, the fixed income markets were dominated by the recurring theme of "higher-for-longer" rates that had prevailed throughout much of 2023 but reversed for a short period in Q423 on increased market expectations of a Fed pivot. Near-term resilient US economic data and the unwinding of aggressive rate cut expectations during the Q124 led to sell-offs in global government bonds, led by US Treasuries. As a result, 10-year, 20-year, and 30- year US treasury yields rose by 0.32%, 0.25%, and 0.31% respectively, to end at 4.20%, 4.45%, and 4.34%, respectively.

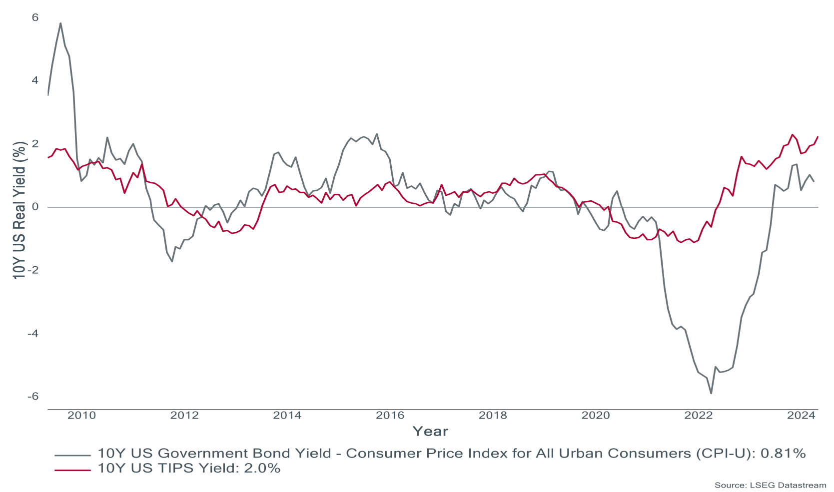
In the US credit market, high yield performed better than investment grade due to its lower sensitivity to interest rates as well as limited impact on profitability despite high rates. In the EMs external debt space, high yield bonds also performed well, buoyed by strong performances from issuers in this segment.

Valuations: US Treasuries

The US Treasury 10-year nominal yield has risen considerably since the beginning of 2024, starting the year at around 3.9% to close to 4.7% in mid-April, at time of writing. Inflation-adjusted US Treasury yields, or US Treasury Inflation-Protected Securities (TIPS) yields have also trended higher since December 2023, and now closer to 2%.

The left-hand chart shows two measures of real yields: one is based on actual changes in prices, which takes the US government 10-year nominal yield and is deflated by Consumer Price Index for All Urban Consumers (CPI-U). The other measure represents the actual US TIPS 10-year yield (i.e., real yield). Currently, the US 10-year real yields adjusted by both CPI and inflation expectations are both positive, indicating a positive real return on US government 10-year bonds.

10-Year US Real Yield (%)



Source: LSEG Datastream, 15 March 2024.

US Investment Grade and High Yield ICE BoFA Option Adjusted Spread (in basis points)

Source: LSEG Datastream, 16 April 2024.

Positioning: US Treasuries

Over the three-month horizon, the team is cautious on US Treasury bonds given that continued near-term resilient US data is likely to make the Fed cautious about cutting rates too early. That said, current yield levels likely already reflect much of the recent inflation upside surprise, which may limit the upside for yields and in our view keeps US yields range-bound for now. On the 12-month horizon we anticipate that US yields will move down as the disinflationary trend materializes, making US duration an attractive asset over the longer horizon.

Our analysis indicates that US Treasuries are the most effective hedge for a potential growth slowdown scenario. The team remains encouraged that the disinflationary trend will continue to play out over the 12-month horizon, as we anticipate a continuing easing of shelter inflation and core wages to eventually prompt the Fed to pivot. Ultimately, this will lead to a decrease in US yields, resulting in increased total returns for US duration (via price appreciation).

Valuations: Credit

As illustrated in the right-hand side chart on the previous page, the option-adjusted credit spreads ("OAS") for both investment grade and high yield have reached their narrowest levels in recent years, with the OAS for investment grade bonds at 95 basis points and the OAS for high yield at 336 basis points, as of mid April.

Positioning: Credit

As US high yield bonds offer 8% yield and continue to boast strong corporate balance sheets and interest coverage ratios, the team has a strong short-term preference for US high yield over its more interest-rate sensitive US investment grade counterpart. Recent US economic data has shown remarkable resilience and could potentially lead to continued outperformance of risk assets, such as equities and US high yield bonds, over the next three months. However, over the longer-term 12-month horizon, the team has a more defensive stance, with a preference for US investment grade bonds (versus US high yield bonds).

Currencies

The USD continues to be supported by resilient US growth

The USD, as represented US Dollar Index (DXY), returned 3.2% in the Q124, outperforming all major currencies and benefitting from a combination of strong US economic data, higher US yields, and inflows into US risk assets.

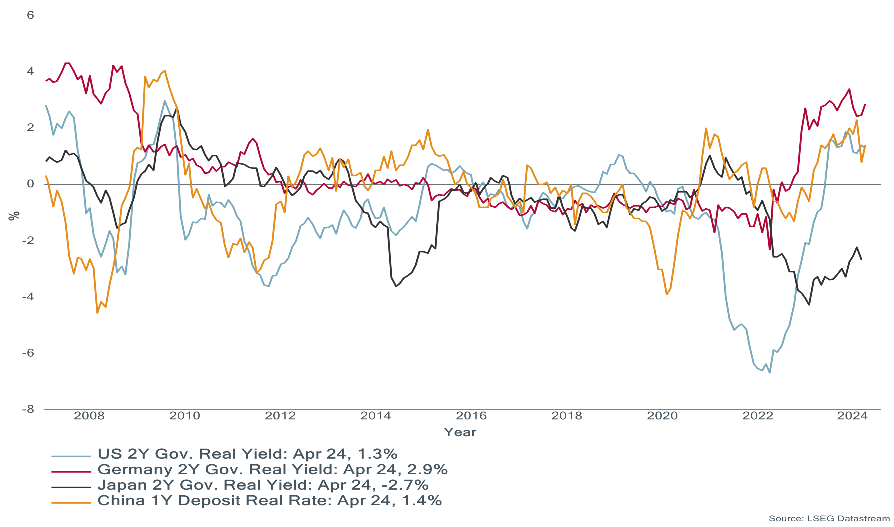
Valuations

Based on a real effective exchange rate (REER) basis, the USD's valuation appears rich (i.e., overbought) as it is currently almost two standard deviations above its historical REER average. Nonetheless the still positive real short-term US interest rate can still support demand for the USD.

Positioning

Resilient US growth has contributed to positive momentum and strength for the USD, at least for the short term. Acknowledging the stellar Q124 performance, the team's key technical indicators suggest that peak levels have not been reached yet. Hence the team remains marginally positive over the short-term horizon. Over the medium term, the USD will likely weaken as the Fed ramps up its rate cutting cycle, but we acknowledge that a recession outcome may see the USD rally in a classic "flight to safety" scenario, given its counter-cyclical nature and in consideration of the late-stage cycle.

Global Short-Duration Real Interest Rates (%)



Source: LSEG Datastream, April 2024.

JP Morgan US Dollar REER

Source: LSEG Datastream, 7 April 2024.

India: Why the future looks bright

India's annual GDP averaged 6.21% from 2006 – 2023, higher than many developed and emerging markets. This trend is expected to continue. According to IMF projections, GDP growth will be 6.7% in FY24 and 6.5% in FY25. India's fast-growing economy is too big to ignore and presents a 10–15-year investment opportunity.

India is in its demographic prime. The world's most populous country also has a growing middle class (31% of the population) and its abundant lower cost labour pool offers a long runway for growth. As India's population and workforce dynamics continue to improve, consumption-savings patterns and preferences will change. When Indians get richer, national savings will grow. This is an important source of investment capital. At the same time, the shift away from physical assets (such as gold) towards stock and bond markets will also be a driver for the country's financial markets.

On the economic front, foreign direct investments are increasing as businesses look to India to reshore outside of China. It helps that the US regards India as an emerging global power and vital partner. This is critical considering the daunting challenges posed by climate change, artificial intelligence, supply chain resilience etc. Consumer price inflation is also on a secular downtrend, giving the Reserve Bank of India the wherewithal to cut rates to boost investors' confidence and keep growth strong. On the political front, the ruling Bharatiya Janata Party is expected to win the upcoming April national elections. This suggests the reforms that have made a huge difference to India will continue to support the economy going forward.

India's weight in the MSCI Emerging Markets' index has been steadily increasing; from under 10% in 2020, it is currently almost 18%[1]. Indian stocks rallied strongly in 2023; the MSCI India posted a 22% return, underpinned by consistent flows from domestic institutional investors and steady foreign portfolio investor participation. Strong growth is expected this year too. The NIFTY 50's earnings per share growth is expected to be 18% CAGR between FY 20-25. Indian equities mostly derive their revenues within India, making it less sensitive to global macro headwinds.

India Equities vs. Global Equities (Performance rebased to 100 starting in January 2006)

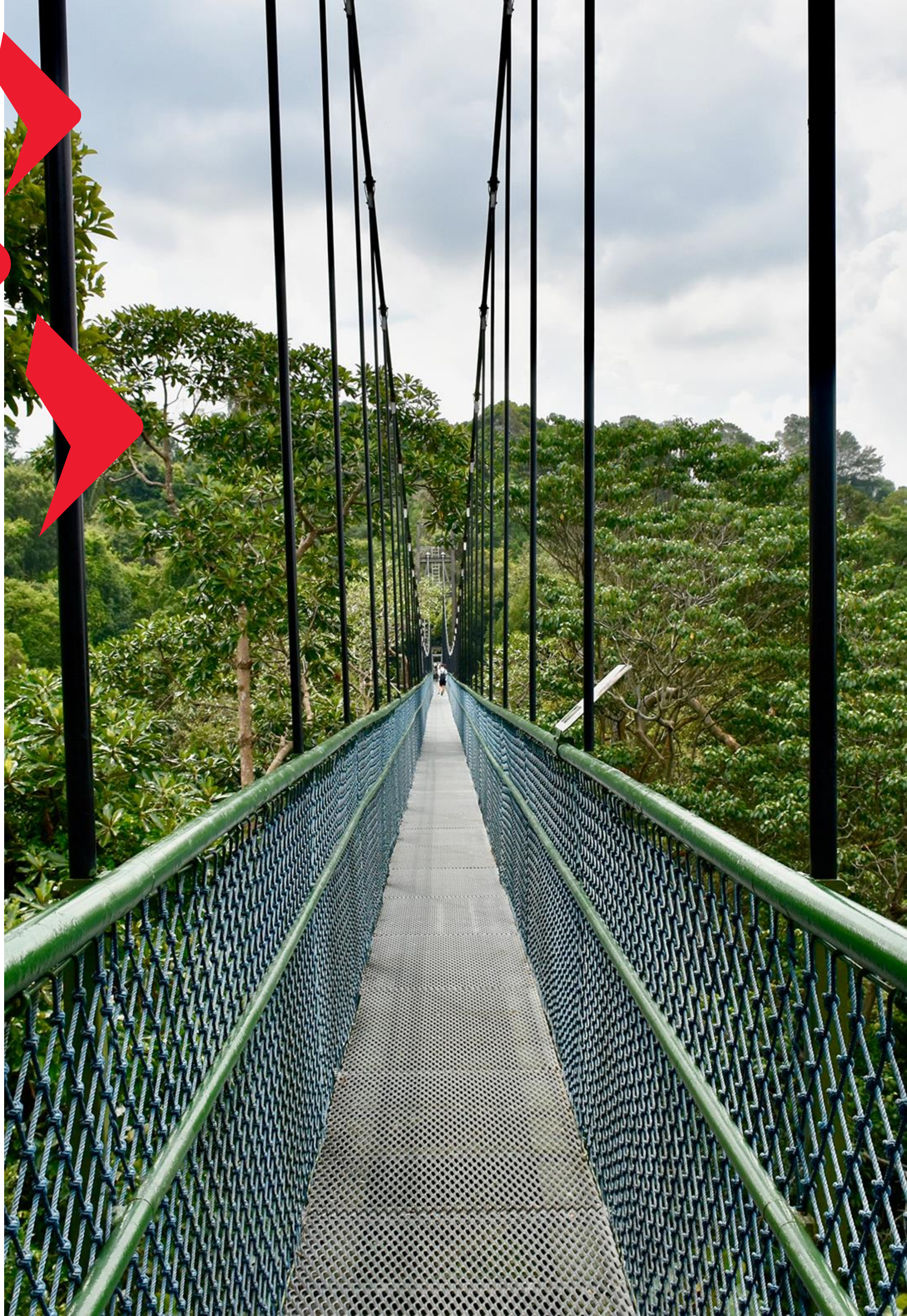
Source: LSEG Datastream

That said, there are areas to watch. Firstly, Indian stocks look expensive by any metric; MSCI India's price to book (p/b) ratio is 4 and price to earnings (p/e) is 22.2 versus MSCI Emerging Markets' p/b of 1.7 and p/e of 11.8[2]. However, one could argue that if investors see India entering a new growth phase, this could lead to higher earnings and better returns. As a result, they might be willing to pay higher for Indian equities, which will lead to a re-rating of Indian stocks.

But incidents such as the Reserve Bank of India's recent move to curb activities of a bank with unhealthy loan growth may dent confidence in the short term. Nonetheless such a move should be considered as better structurally for India in the long run. Lastly geopolitics i.e., tensions with China and Pakistan and Islamic extremists, could flare up at any moment, potentially driving geopolitical risk premia.

[1] MSCI Emerging Markets index (USD), March 2024.
[2] As of February 2024.

A Prudential plc company



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