凱基亞洲
KGI ASIA

2024 Q2 Global Market Outlook

Embracing Steady Growth

Macroeconomic Analysis

Global economic momentum improves, but the U.S. economy might slow down

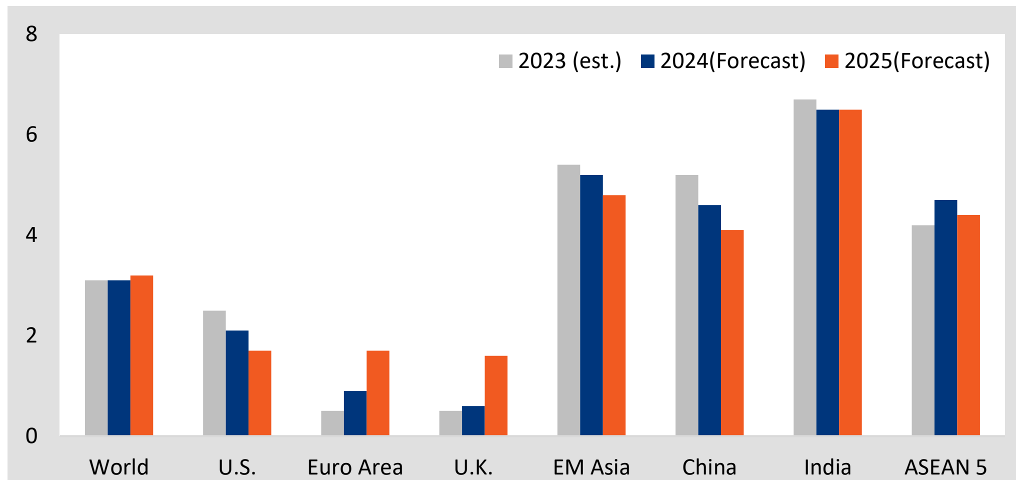
In February, the JP Morgan Global Purchasing Managers Index (PMI) Composite increased by 0.3 percentage points to 52.1, reaching its highest level since August 2023. This improvement reflects an uptick in global economic growth momentum. According to relevant data, the global economic growth rate is expected to reach 2.9%, surpassing market expectations. A detailed analysis of the February data reveals improvements in both the manufacturing and service industry indices. However, the rise in the manufacturing PMI outweighs the other, indicating a more significant improvement and becoming the focal point for promoting the overall PMI increase.

The Managing Director of the International Monetary Fund (IMF), Georgieva, recently announced that a soft landing for the global economy is anticipated. The projected economic growth rate for this year stands at 3.1%, consistent with last year's figure, but an upward revision of 0.2 percentage points from the previous forecast. This suggests a steady expansion of the global economy in the current year. However, it is noteworthy that a 3.1% growth rate is relatively modest, considering that in the decade prior to the COVID-19 pandemic, the global economy experienced an average growth rate of 3.8%.

Investors should take into consideration that certain regions and countries may encounter a notable economic deceleration this year. For instance, the growth rate of the United States is projected to slow down in the first quarter of this year, subsequent to growth rates of 4.9% and 3.2 % in the third and fourth quarters of last year. In addition, the recent U.S. ISM manufacturing and service industry employment data have fallen below 50, indicating a gradual cooling of the labor market. But given the fact that the overall U.S. economy remains robust, a significant growth slowdown is improbable in the first half of the year.

According to the IMF forecast, the local economic growth rate this year will decelerate to 2.1% from 2.5% last year, while other institutions' projections are more conservative.

Graph 1: Global GDP Growth (%)



Source: IMF, Prepared by KGI Asia

Inflation falls, Europe and the United States may start to cut interest rates in June

In the context of economic growth, investor focus has shifted towards the inflation and monetary policies of major countries. According to the latest IMF forecast, the global inflation rate is expected to be 5.8% this year and followed by 4.4% next year. As disinflationary progress continued, it provides more leeway for central banks in major mature markets (excluding Japan) to reduce interest rates. Federal Reserve Chairman Jerome Powell stated during his semiannual monetary policy testimony before the House Financial Services Committee on March 6 that it would be suitable to commence cutting interest rates later this year. We uphold our previous assessment that the United States will initiate its interest rate reduction cycle in June this year. There is potential for three interest rate reductions amounting to 75 basis points this year, which is not as drastic as earlier market anticipations.

In Europe, the tight labor markets have prompted the European Central Bank to shift its focus towards wage growth. The decision to maintain current interest rates level in January was made by the European Central Bank. While President Christine Lagarde

mentioned that it was too early to discuss an interest rate cut and hinted that the central bank might refrain from cutting interest rates until the summer, her remarks indicated a more dovish stance when compared to the previous meeting. It is our assessment that the Eurozone is experiencing a rise in wages but weak productivity, its economy was not as robust as the United States. Also, there is a high likelihood of Germany, a major industrial country, falling into a recession. If inflation in the Eurozone cooled as expected, authorities may initiate an interest rate cut cycle in June.

In summary, we anticipate that the United States, the Eurozone, and the United Kingdom may all have the opportunities to commence interest rate cuts in June.

Potential risk

Investors should remain caution of the following four potential risks:

- If inflation falls, but not as much as expected, the rate cut schedule might be postponed.
- Prolonged high-interest rates could elevate financial market risks.
- Global economic growth may fall short of expectations, potentially due to a more rapid slowdown in the U.S. economy or an extended period of economic recovery for China.
- The U.S. presidential election, Chinese-U.S. relations, and geopolitical risks in the Middle East and other regions also warrant attention.

Global Strategies

Global stock markets have recorded decent gains so far this year. Global economic growth beats forecasts, and we expect the optimism to continue. Q1 strategies will still stay relevant in Q2.

U.S. Large Cap still has an edge

Over the last year, the increase in AI applications has driven demand for semiconductors and driven up the U.S. stock market. This year, U.S. economic data continues to beat estimates, which has also become a catalyst for performance. We expect the economic downturn to be delayed, and the strength of U.S. stocks may continue in Q2.

The Fed kept fed funds rates unchanged in the March FOMC meeting and expects three cuts this year. However, the median of Fed Funds Rate projections for 2025 and 2026 has increased, and rates are expected to stay elevated for longer.

The Fed's latest Economic Projections are pointing toward a more robust economy. The significant changes in the Projections are as follows: Real GDP growth is revised upward and above longer-run figures, core inflation is also revised upward, and the unemployment rate is revised downward slightly. In other words, the Fed does not expect the economy to slow down this year. However, the Fed may still proactively lower rates to avoid real rates being too restrictive. It is positive for the stock market if such "precaution" is taken.

In Q1, our investment focus was on U.S. Large Cap. Compared with small-cap, we expect that the advantage of large-cap stocks may be maintained until we are in the rate-cut cycle, and "large-cap dominance" is likely to continue this year. Small-cap stocks are relatively sensitive to interest rates, so maintaining higher interest rates will have a greater impact on small-cap stocks, and it is difficult for small-cap to outperform large-cap before rate cuts. In addition, since the triggering of interest rate cuts is likely to be an expected economic slowdown, small stocks are still in a relatively unfavorable environment even in the early stages of interest rate cuts. After rate cuts begin and the economy starts to improve, small stocks will be better off.

Therefore, even if small-cap stocks have lagged behind large-cap stocks in the past year, it is quite difficult to "catch up". "Large-cap dominance" also applies to different industries.

Since the beginning of the year, U.S. stocks have repeatedly hit new highs, and valuations have also risen. At the same time, the companies with the largest market capitalization account for a very high proportion of the U.S. stock index. Investors need to pay attention to related risks. Investing in multiple tranches and avoiding concentrating on an industry is preferable.

IG bonds are more favorable before and after rate cuts

The Fed kept interest rates unchanged in March and still expected 75bps cut throughout the year. Despite a stronger-than-expected economy, it did not significantly delay the timing or reduce the number of interest rate cuts. In the past rate cut cycles, the period after rate hikes and before rate cuts was the best time to buy IG bonds. In addition, current yields are at multi-year highs, issuers of IG bonds are generally larger companies, and the rationale of "large-cap dominance" is also applicable to bonds.

A more resilient economy and cooling inflation undoubtedly contributed to the good performance of HY bonds in Q1, especially as HY bonds have a higher correlation with the stock market. As time goes by, more companies have refinancing needs. If the economy slows down in the future, credit risks are expected to increase, spreads will widen, and default rates are more likely to rise. The impact is more severe with HY than IG bonds. As with Small Cap, a better time to add to HY bonds is when we are in the middle of a rate-cut cycle. This strategy is more critical for conservative investors.

In the last five rate cut cycles, two experienced hard-landing recessions, and two did not. COVID-19 broke shortly after the most recent cut in 2019, so it was not easy to determine the relationship between recession and rate cut. However, the commonality of all five cut cycles is that the medium and long-term bond yields all fell 3 to 6 months before the first rate cut. Six months after the cut began, the extent of the decline in bond yields depends on whether there is a recession: in a recession, the 10-year U.S. Treasury bond yield can fall below 3.0%; in the absence of a recession, the bond yield may fall to 3.5% (Currently, 10-year Treasury yield is roughly 4.2%).

In addition, U.S. Treasury and IG Corporate bonds generally have longer maturities, providing greater flexibility of maturities to investors. The longer the tenor, the higher the potential price return, and investors can lock in potential return for a more extended period. However, the interest rate risk of long-term bonds is higher, and bond prices can be more volatile. Investors can choose according to their risk tolerance and investment horizon. Fed has stopped raising rates, limiting the room for further increases in mid and long-term yield. Investors can gradually add mid and long-term IG bonds to their portfolios.

In recent months, U.S. inflation has risen higher than market expectations. If inflationary pressure is not receding as expected, the Fed may become hawkish, increasing the volatility of bond prices.

Asian markets are worth looking forward to

Different Asian markets have their advantages, and investors may consider diversifying into various Asian markets as satellite holdings in their portfolios.

After the March meeting, the Bank of Japan (BOJ) ended the negative interest rate policy (NIRP) and yield curve control (YCC) and stopped purchasing additional ETFs and J-REITs. The "extreme" easing environment has ended, and monetary policies are gradually returning to normal. Japan's overall inflation rose by 2.8% yoy in February. Inflation has exceeded the central bank's target of 2% for nearly two years. This spring, Japanese companies' employee salary increases were satisfactory, which has become a catalyst for ending the "extremely" loose policies. Although some Japanese companies had good salary increases last year, real wages did not increase due to higher inflation. This year, inflation has fallen, and salary is expected to have a "real" increase. Increasing purchasing power is expected to stimulate local consumption.

Although BOJ has tightened the financial environment, the actual extent of tightening is limited. On one hand, short-term rates have only increased by 0.1%. BOJ will also maintain a similar amount of bond purchases to maintain liquidity in the market. If necessary, it can also purchase more to tackle the surge in long-term bond rates. BOJ remains supportive of the economy, which is beneficial to Japanese companies. As the U.S. is more likely to cut and Japan is more likely to raise rates, the rate differential is expected to narrow, and yen can strengthen in the mid to long term.

India is one of the fastest-growing regions in Asia. The 2023/2024 fiscal year ending in March this year is expected to grow by 7.6%, higher than the long-term average of 6.3%. The manufacturing and service PMIs in March were 59.2 and 60.3, respectively, indicating growth in both sectors. It is worth mentioning that India's service industry's share of the world is rising, while the manufacturing industry is flat. India's overall inflation rose by 5.09% yoy in February, with rising food prices (8.66%) still being the major driver of inflation, core inflation is slowing. Although the inflation rate is still within the central bank's mid-term target of 2-6%, the bank is committed to bringing inflation down to 4%. However, it decided to keep the policy rate unchanged at 6.5% in February. Policies remain supportive, and India's overall growth potential is worth looking forward to.

Starting in June this year, Indian government bonds will be included in the JPM Emerging Market Bond Index. Government bonds are expected to account for 10% of the index, with an inflow of approximately US$20-25 billion. Being included in the index is undoubtedly beneficial, and it will also draw funds into other Indian bonds. However, investors still need to pay attention to how the Indian government uses funds.

In Q1, Mainland China launched several policies to support the economy and the stock market, but the rebounds across various sectors were inconsistent. Investors still need to carefully select industries to capture the rebound. For details, please refer to this report's "China macroeconomic" section.

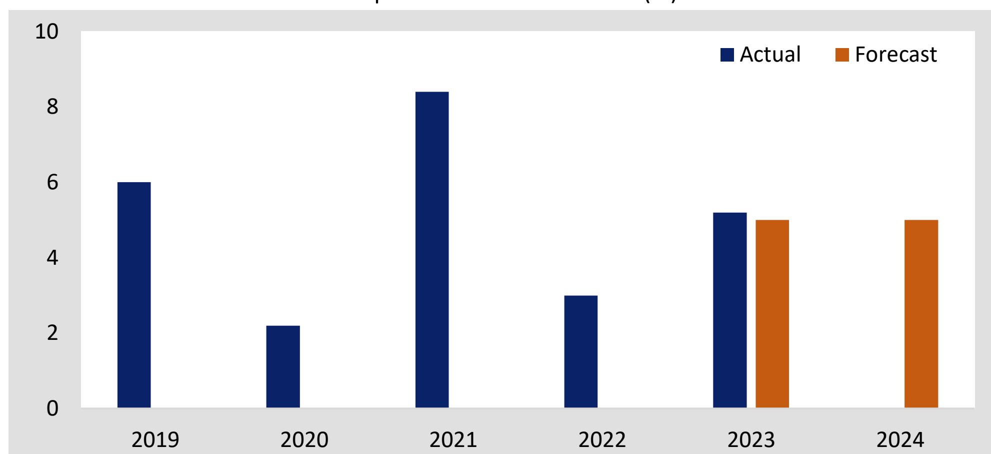
China Macroeconomic

In early March, the Chinese central government convened the "Two Sessions." Premier Li Qiang of the State Council delivered the government work report during the 14th National People's Congress, outlining the objectives and developmental trajectory of China's economy in 2024. The address encompassed targets for gross domestic product (GDP), consumer price index (CPI), unemployment rate, and deficit rate etc.

Gross Domestic Product

Looking back, the GDP growth rate in 2023 reached 5.2%, slightly surpassing the 5% target set at the beginning of 2023. During the meeting, Premier announced the GDP growth target would be maintained at 5%, aligning with our 2024 outlook range of 4.5% - 5%. However, he emphasized that attaining this target maybe challenging. Also, he suggested that a set of measures would need to be implemented to ensure the realization of the growth target. We believed it is necessary for China to rely on the expansion of fiscal policy, monetary policy, and gradual control of the real estate crisis to restore citizens' confidence and drive economic growth.

Graph 2: China GDP Growth (%)



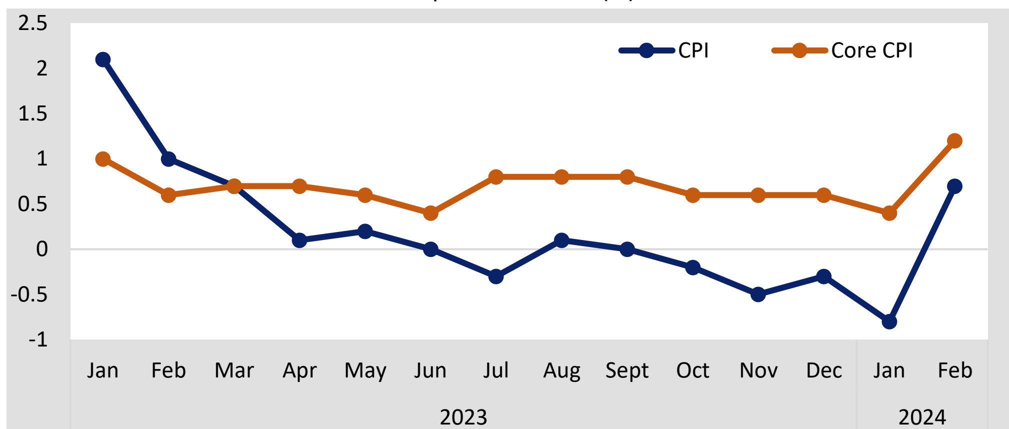
Source: Bloomberg, Prepared by KGI Asia

Consumer price index

The consumer price index target, aside from GDP, has been set at 3%. In 2023, China saw a minimal inflation of 0.2%, with core inflation rose by 0.7%. This figure fell below the central government's 2% inflation target. The primary reasons were the decrease in food prices, particularly for fresh vegetables and hog. Additionally, sluggish resident consumption and an excess supply negatively impacted the price level. Despite the overall inflation remain low, service prices displayed resilience, increased by 1% annually.

It is noteworthy that the high base of hog prices had subsided and the Ministry of Agriculture has announced plans to enhance control over pork production in the future. This measure is expected to mitigate the negative impact on inflation. Therefore, the primary concern regarding rising inflation this year should focus on the potential recovery of consumer confidence. Factors influencing this confidence are closely tied to employment issues. The target for this year remains consistent with previous years, aiming to generate over 12 million new jobs while sustaining a surveyed unemployment rate of approximately 5.5%. These efforts are crucial for stimulating consumption.

Graph 3: China CPI (%)



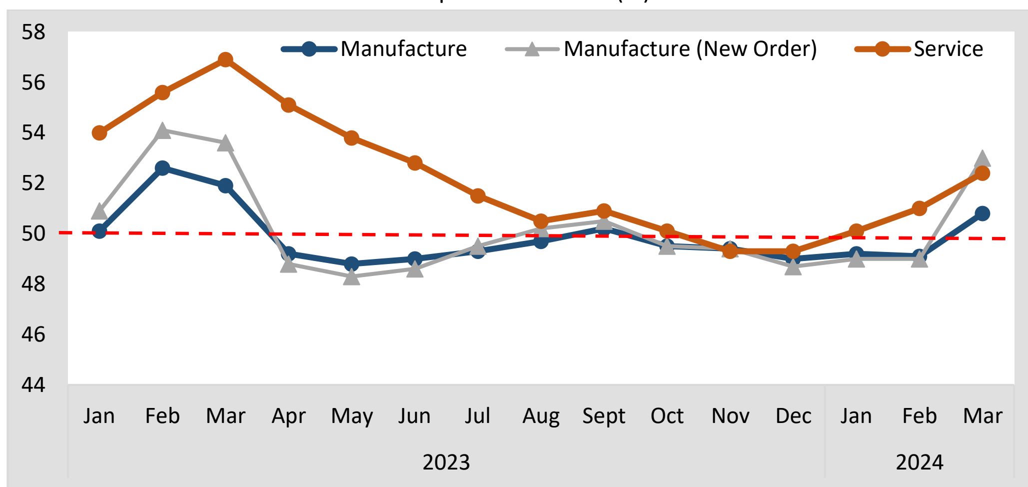
Source: National Bureau of Statistics, Prepared by KGI Asia

Purchasing manager index

Based on the PMI index movement, the service industry has demonstrated rapid growth in the past year following the relaxation of COVID-19 prevention and control measures. Till now, the service PMI has stabilized. However, the manufacturing PMI has raised concerns in the market.

Since April of last year, it has mostly remained below the boom-bust line, indicating industry pressure and market contraction. A recently proposed action plan of promoting the equipment renewal and trade-in of consumer goods may potentially reignite recovery momentum in the manufacturing industry, although it takes time to see the result.

Graph 4: China PMI (%)



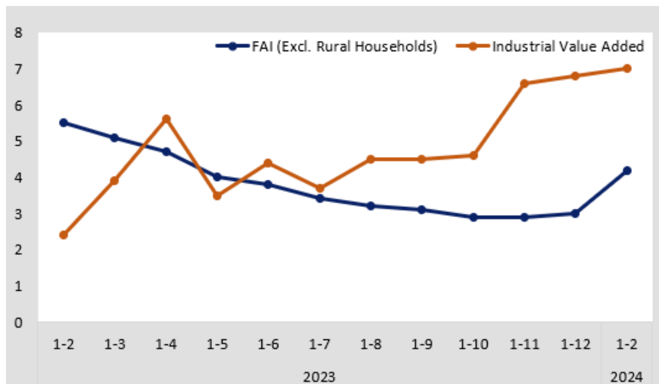
Source: National Bureau of Statistics, Prepared by KGI Asia

Fixed asset investment, industrial value added and retail sales performance

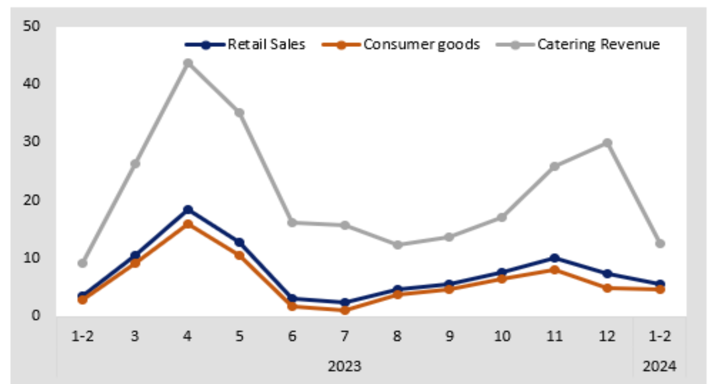
In mid-March, the National Bureau of Statistics published economic data for the initial two months of the year. The data indicated that fixed asset investment and industrial value added surpassed market expectations. Fixed asset investment experienced a 4.2% increase, outperforming the anticipated 3.2%. Similarly, industrial value added exceeded expectations, escalating by 7% as opposed to the projected 5.3%. State-owned enterprises continued to significantly contribute to fixed asset investments, marking a 7.3% year-on-year rise. Private investment displayed positive growth, increasing by 0.4% year-on-year. Additionally, retail sales experienced a 5.5% rise, marginally below the projected 5.6%. Although the growth rate of catering revenue regressed to 12.5%, consumer goods exhibited steady growth at 4.6%.

Overall, the signals of improvement in the manufacturing industry, substantial infrastructure investment, and a modest rebound in consumption collectively bolstered the economic aggregate and fostered a more favorable trajectory for economic structural growth.

Graph 5: FAI & Industrial Value Added (%)



Graph 6: Retail Sales (%)



Source: National Bureau of Statistics, Prepared by KGI Asia

As mentioned, the central government promoted a large-scale equipment replacement could help drive the performance of manufacturing investment and become the most important engine of economic growth this year. However, investors should remain vigilant regarding the development of mainland property sector. Currently, both property FAI and property sales remain weak.

HSI Forecast For 2024

The market bottomed out after the launch of rescue package

Reviewing the Hang Seng Index's (HSI) performance in the first quarter, the index broke below the 17,000-point level at the start of 2024, falling to a bottom of 14,794 points in mid-January. Subsequently, after the purchase of A-shares ETFs by the Central Huijin Investment and the introduction of SOEs' market cap management, the index rebounded from its lows. Meanwhile, performance among sectors and individual stocks were diverge in the first quarter, with the SOEs and traditional resources stocks outperformed the market, while the tech sector underperformed the HSI. Since 2024, the YTD return of the HSI was -2.5%, compared to the negative 7.6% of the Hang Seng Tech Index (as of 28 March).

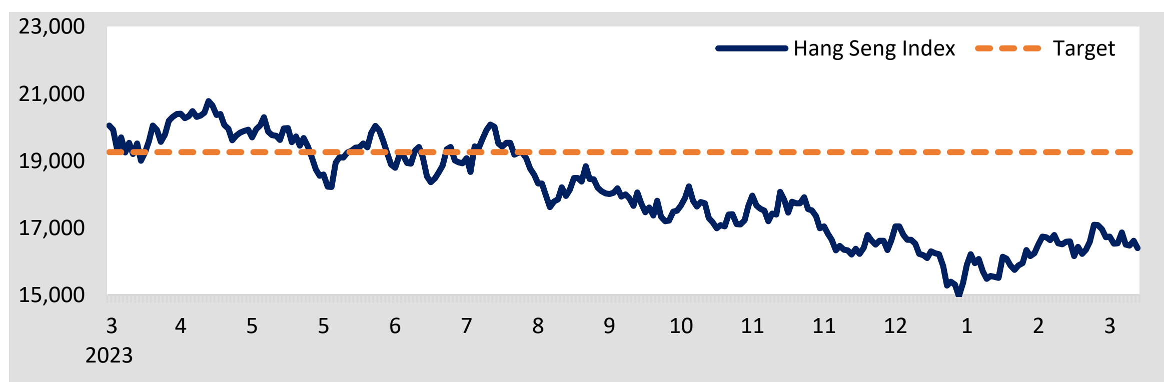
Mixed factors affecting FY24 market outlook

Positive factors for the HK equity market include: (i) the higher flexibility of the monetary policy of China due to the end of the U.S. rate cut, (ii) USD weakness driving capital inflows into non-U.S. markets, and (iii) the improvement of shareholder returns from SOEs. While the negative factors include (iv) weakness in domestic property sales and (v) the potential worsening of China-U.S. relations during the U.S. presidential year.

HSI Target at FY24-end maintained at 19,260

The market estimates the blended 2024 EPS of HSI to be at HK$2,018, broadly in line with our previous forecast. We maintain our HSI target at 19,260 corresponding to a 9.5x forward P/E ratio. However, we would like to raise the HSI's bear-case scenario to 14,794, which is the market low in January.

Graph 7: Hang Seng Index



Source: Bloomberg, Prepared by KGI Asia, As of 28 March 2024

5 Stock Picks

Tencent (700): Tencent 4Q23 net profit comes at RMB42.6bn, matched market expectation. GPM increased by 7 percentage points yoy to 50%, thanks to more contribution from higher- margin revenue stream, alongside its effective cost control. We think Tencent's economic moat remains. TP: $370

China Unicom (762): China Unicom's full year dividend grew by 22.8% to RMB0.33. The annual dividend payout ratio was 55%, an increase of 5 percentage points year-on-year, reaching a record high. The capital expenditure target for 2024 is RMB65bn, representing a yoy decrease of 12%. The market expects China Unicom's dividend payout ratio still has room to increase, with an increase of 5 percentage points in both FY24 and FY25. Market expects its dividend yield to be at 9% in 2025, the highest among the three Chinese telecommunications companies. TP: $6.5

Trip.com (9961): Trip.com recorded RMB10.3bn net revenue, grew by 105% yoy in 4Q23, consistent with market expectations. The adjusted EBITDA amounted to RMB2.85bn, better than market expectation. Domestic and international businesses continued to show robust recovery. The company has a leading position in the mid-to-high-end market and outbound travel market, therefore can benefit from the recovery trend of China's outbound travel. TP: $420

CNOOC (883): The Company maintain strong growth in oil and gas production. The Company's net production for 2024 is targeted at 700 to 720 million BOE. Upside for CNOOC remains due to the favorable oil price, increasing reserves and stably increasing production. TP: $21

Weichai Power (2338): The market is leaning towards LNG heavy-duty trucks. At the same time, the current layout of domestic LNG filling stations in China has been greatly improved. The network density has increased, allowing the refueling of LNG heavy trucks to be more convenient. Weichai has more than 60% market share in the LNG engine market. It is well positioned to seize the structural growth opportunities of the heavy truck industry. TP: $19

Table 1：Top Picks

Name	Target Price
Tencent (700)	370
China Unicom (762)	6.5
Trip.com (9961)	420
CNOOC (883)	21
Weichai Power (2338)	19

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