MacroResearchBoard
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Independent Investment Strategy
ASSET ALLOCATION STRATEGY
October 4, 2024

What Wall Of Worry?

- We continue to advocate a mild pro-growth investment stance, reflecting the ongoing global economic expansion and broad-based monetary easing. Thus, we favor stocks over bonds in a multi-asset portfolio on a 6-12 month horizon.
- Yet investors are overly optimistic about central bank rate cuts, particularly in the U.S., where underlying economic conditions remain solid, and inflation will ultimately prove sticky.
- DM government bond yields will rise down the road as rate-cut expectations unwind. Stay underweight government bonds in a multi-asset portfolio. High-yield corporate and emerging market local-currency bonds warrant overweight exposure in a fixed-income portfolio.
- Global equity prices will rise on a 6-12 month horizon, bolstered by steady corporate earnings growth. The relative earnings picture will shift in favor of select non-U.S. markets over the next year. We favor emerging market, Japanese and euro area equities within a global equity portfolio, with a modest underweight on the U.S.
- Commodity prices should rise alongside the global economy, but an absence of fireworks warrants only a neutral stance within a multi-asset portfolio. We expect the U.S. dollar to drift lower as growth momentum outside the U.S. gradually firms.

MRB *TradeBook Update* *p.17*

- There are several changes this week.

The economic and policy climate remains pro-risk, offsetting otherwise worrisome geopolitical developments and uncertainty about the upcoming U.S. election outcome[1]. Record or near-record global stock prices, tight credit spreads and steepening yield curves highlight that financial conditions are easy and, considering additional broad-based central bank rate cuts, likely to ease further.

Earlier fears of a potential U.S. recession continue to dissipate after solid Q3 growth solid job market data, although that has not deterred investors from pricing in (overly) aggressive Fed rate cuts in the year ahead[2].

[1] **MRB**: "*Absolute Return Strategy – Extending Goldilocks*", September 26, 2024

[2] **MRB**: "*U.S. Economy: On Firmer Ground Than You Thought*", October 2, 2024

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MRB's *Investment Recommendations* click here

Table 1 **MRB Asset Allocation Recommendations[1] (6-12 month horizon)**

Overall Asset Allocation	−	N	+
Equities		■	
Fixed Income	■		
Cash			■
Commodities		■	

Regional Equities[2]

Australia	■		
Canada	■		
EM Markets			■
Euro Area			■
Japan			■
Sweden		■	
Switzerland		■	
U.K.		■	
U.S.	■		

U.S. Equity Sectors[3]

Consumer Discretionary	■		
Communication Services		■	
Consumer Staples		■	
Energy			■
Financials			■
Health Care			■
Industrials		■	
Information Technology	■		
Materials		■	
Real Estate		■	
Utilities		■	

Emerging Market Equities[4]

Brazil			■
China		■	
India			■
Indonesia		■	
Korea			■
Mexico	■		
Saudi Arabia	■		
South Africa		■	
Taiwan			■

1 6-12 month horizon
2 Relative to common currency global equity benchmark
3 Relative to common currency U.S. equity benchmark
4 Relative to common currency emerging markets equity benchmark
5 + = Steepener and - = Flattener
6 Relative to hedged global fixed income benchmark

Note: Apart from the Asset Allocation section, recommendations are within asset classes; + = overweight, N = neutral and – = underweight

Fixed Income

Duration		■		
Government Bonds		■		
Yield Curve[5]				■
Inflation Protection				■
Corporate Bonds[6]:	Investment-Grade		■	
	High-Yield			■
EM Sovereign:	USD Debt		■	
	Local Currency Debt			■

DM Government Bonds[6] (Currency Hedged)

Australia			■
Canada			■
Euro Area	■		
Ex- Germany	■		
Germany	■		
Japan		■	
New Zealand			■
Norway			■
Sweden			■
Switzerland		■	
U.K.			■
U.S.	■		

Currencies (vs US$)

Australia	■		
Canada	■		
Euro Area			■
Japan			■
New Zealand	■		
Norway	■		
Singapore			■
Sweden		■	
Switzerland		■	
U.K.	■		
Emerging Markets			■
U.S. (DXY)	■		

Emerging Market Currencies (vs EM Basket)

Brazil			■
China	■		
India			■
Indonesia			■
Korea			■
Mexico		■	
South Africa			■
Taiwan			■
Turkey			■

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Chinese policy has reinforced the pro-risk backdrop, at least for now, via several measures intended to boost real estate and equity prices[3]. Indeed, local stock prices have surged over the past three weeks, aided by flows from foreigners. We do not expect the measures to provide any meaningful near-term boost to the economy, but they underscore that the policy bias is shifting more favorably for investors.

Table 2 **Recent Change To Our Asset Allocation**

Regional Equities*

Sweden	24-Sep-2024	→

Emerging Market Currencies (vs EM Basket)

South Africa	10-Sep-2024	→

* Relative to common currency global equity benchmark
Note: Apart from the Asset Allocation section, recommendations are within asset classes; + = overweight, N = neutral and – = underweight

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The combination of an ongoing global economic expansion and easing monetary policy underpins our mildly pro-growth tilt and bias in favor of equities versus bonds. The caveat for equities is that the U.S. market represents a huge 65% of global market capitalization and is richly priced, especially given already high profit margins, especially for the tech sector. Given our macro outlook, we believe the risk-reward trade-off is more compelling for select non-U.S. markets, including emerging markets, Japan and the euro area. Our forecast that the U.S. dollar will soften in the coming year adds to the appeal of select non-U.S. equity markets.

Economic expansion and easing monetary policy underpins our mildly pro-growth tilt

While easier monetary policy will provide near-run support for bonds, overly aggressive central bank rate cut expectations point to upward pressure on longer-dated government bond yields on a 6-12 month horizon, and perhaps sooner. It also corresponds with our continued overweight recommendation on higher-yielding cash in a multi-asset portfolio. See **table 1** for our complete asset allocation recommendations and **table 2** for changes in the past month[4].

We recognize the risks associated with the geopolitical backdrop, and the upcoming election in the U.S.[5] (see ad page 19), but believe they are consistent with our mildly pro-growth stance rather than a clear-cut defensive posture. That said, the backdrop is fluid, so stay tuned.

Stock/Bond Allocation And Investment Strategy

The going global economic expansion points to further upside for the global stock-to-bond (S/B) total return ratio on a 6-12 month horizon, consistent with solid returns for equities and middling-to-negligible returns for bonds.

[3] **MRB**: "*China: PBoC Fires Its Bazooka, Banks Will Suffer The Collateral Damage*", September 26, 2024

[4] **MRB**: "*Asset Allocation Strategy – Powell Signals Green Light For Risk*", September 6, 2024

[5] **MRB**: "*Webinar – U.S. Election 2024: Are Markets Too Complacent?*", October 2, 2024

The underlying uptrend in the global stock-to-bond (S/B) total return ratio is consistent with our expectation of an ongoing global economic expansion and contradicts the notion that G7 monetary policy has been restrictive (**chart 1**). The recent choppy performance coincides with a fresh high for equity returns and improving G7 10-year government bond returns. With both major asset classes recently producing positive returns, a 60/40 equity/bond portfolio is up sharply year-to-date (YTD), and at a new high.

U.S. and global ex-U.S. equity and bond total returns exhibit similar performance trends (**chart 2**). Equity total returns are rising strongly and at cyclical highs, while bond returns have fully recovered their 1H2024 losses, although underlying performance is unimpressive.

Global growth momentum has been patchy, but is broadly improving (**chart 3**). The global composite PMI remains in expansion territory, with solid service sector performance outweighing continued weak manufacturing. We expect the latter to firm in the coming months on the back of a restocking cycle, but it will be a bumpy process.

Global trade is gradually strengthening, with year-over-year growth having just climbed into positive territory, after a two-year downshift. A gangbusters upturn is not in the cards, but further upside is likely. Global 12-month forward earnings momentum is accelerating, which augurs well for corporate hiring and capital spending.

Among the unusual features of the current investment climate is the onset of a Fed interest rate cutting cycle even as global earnings momentum is accelerating, which is bullish

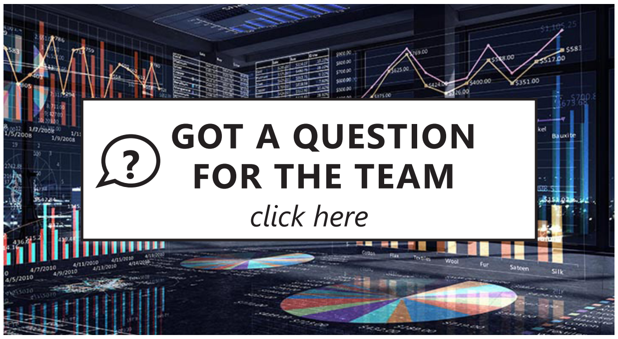
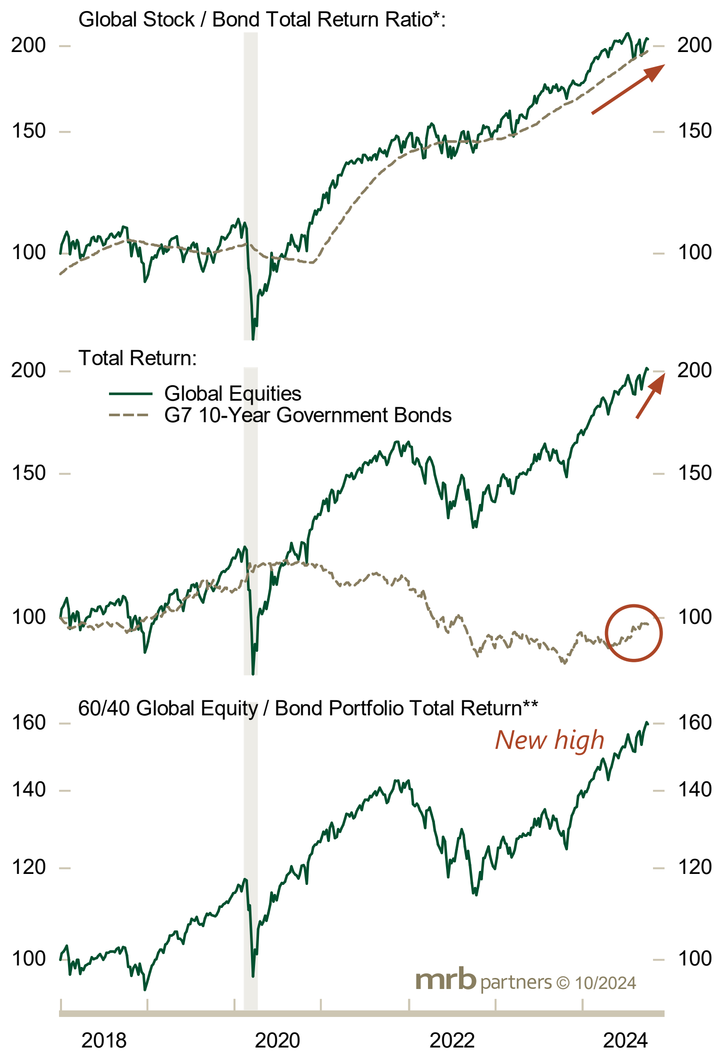
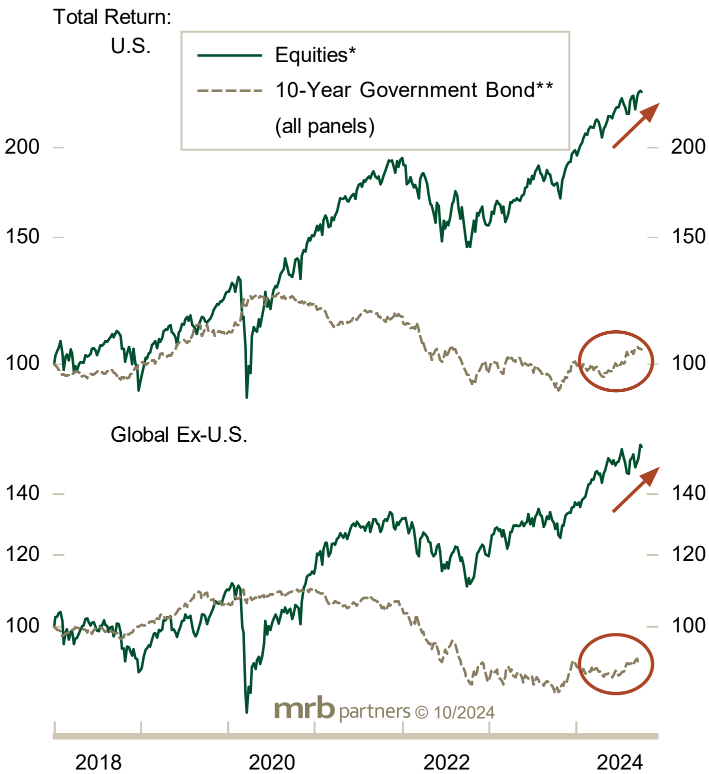


Chart 1 **Global Stock/Bond Ratio Uptrend Is Intact**



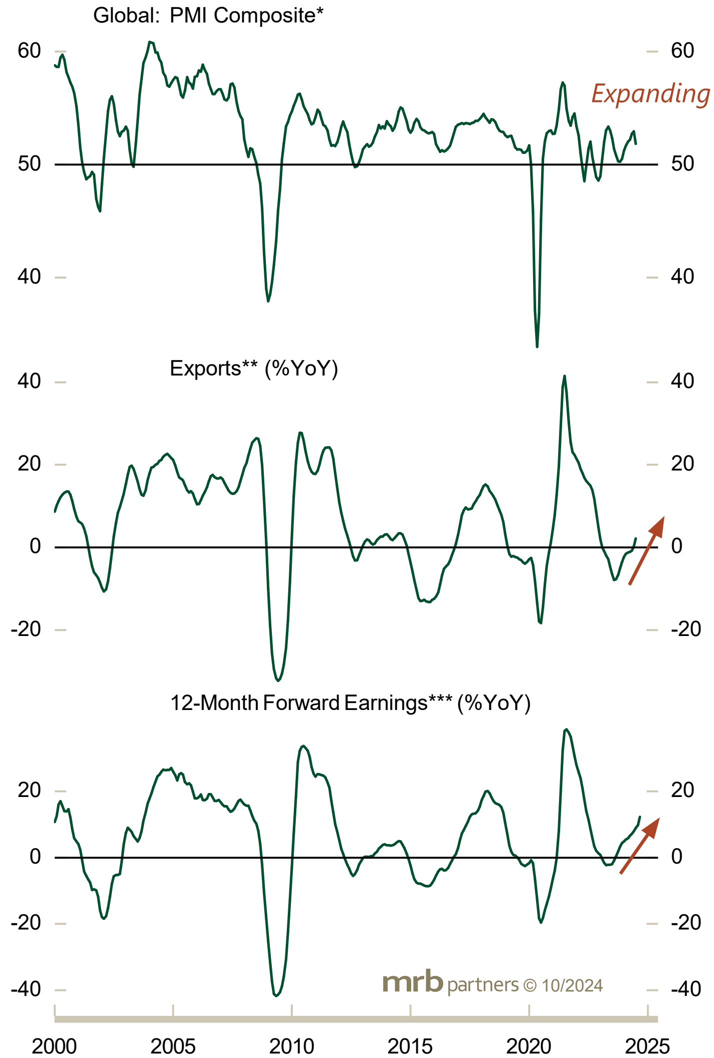
* Global MSCI stock market total return index divided by G7 10-year government Bond total return index; local currency; rebased
** 60% global equities, 40% G7 bonds; rebased
Note: Shaded for NBER-designated U.S. recessions; all panels in log scale; - - - 40-week moving average in panel 1

Chart 2 **Both Stocks And Bonds Generating Positive Returns**



* Local-currency; rebased; source: MSCI
** Local currency; rebased; source: Bloomberg and MRB calculations
Note: Both panels shown in log form

Chart 3 **Patchy, But Positive Global Growth Momentum**



* Smoothed; source: S&P Global
** U.S. dollars; smoothed; source: CPB World Trade Monitor
*** U.S. dollars; smoothed; source: MSCI

for equities and the global S/B ratio (**chart 4**). Past easing cycles have occurred when earnings growth was slowing or contracting, and the Fed was combatting economic weakness.

The Fed and other central banks are cutting interest rates while (over) confident that underlying inflation is headed toward target and "restrictive" monetary policy is no longer required. The case is much more easily made in the euro area, U.K. and Canada than in the U.S. given respective underlying economic growth and slack, but a broad-based easing cycle is underway and will persist until the threat of a rebound in inflation becomes apparent again. The latter may loom not too far down the road in the U.S. since real private sector demand growth remains well above potential GDP growth and shows no sign of slowing materially[6].

The global stock/bond ratio has a clear upward bias

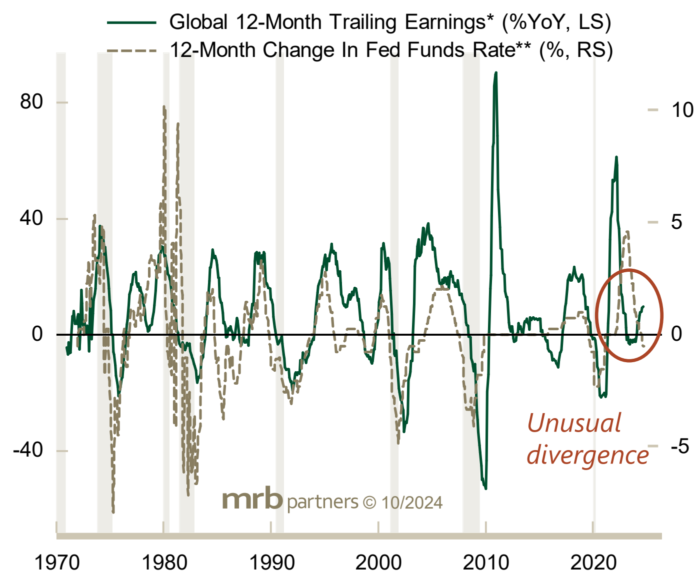
However, while central banks, and particularly the Fed, are in easing mode, the global S/B ratio and risk assets more generally, will have a clear upside bias.

6 **MRB**: "***U.S. Fed: The Makings Of Another Dovish Error***", September 19, 2024

Relative value has become decisively less favorable for equities versus bonds over the past two years, with the equity risk premium (i.e. the 12-month forward earnings yield minus the 10-year government bond yield) at its smallest in more than two decades for the global and U.S. benchmarks (**chart 5**). The equity risk premium is much greater for the global ex-U.S. index than its U.S. counterpart, with the latter having both a lower forward earnings yield and a higher government bond yield.

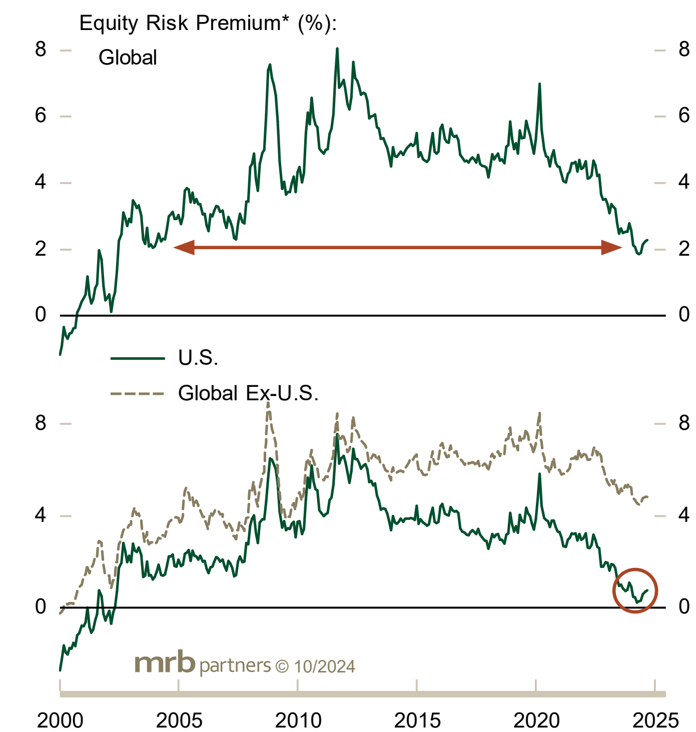
Despite lingering economic growth anxieties, current equity risk premiums imply that stocks, especially in the U.S., embed greater confidence in the earnings outlook and monetary policy effectiveness than at any time in more than two decades.

Chart 4 **Fed Cutting Even As Earnings Momentum Is Improving**



* Local currency; source: MSCI
** Source: Federal Reserve
Note: Shaded for NBER-designated U.S. recessions

Chart 5 **Equity Investors: Least Demanding In Two Decades**



* 12-month forward earnings yield minus G7 10-year government bond yield; sources: MSCI, Bloomberg

Fixed Income

We expect G7 longer-dated government bond yields to move higher on a 6-12 month horizon as investors eventually unwind overly aggressive central bank rate cut expectations.

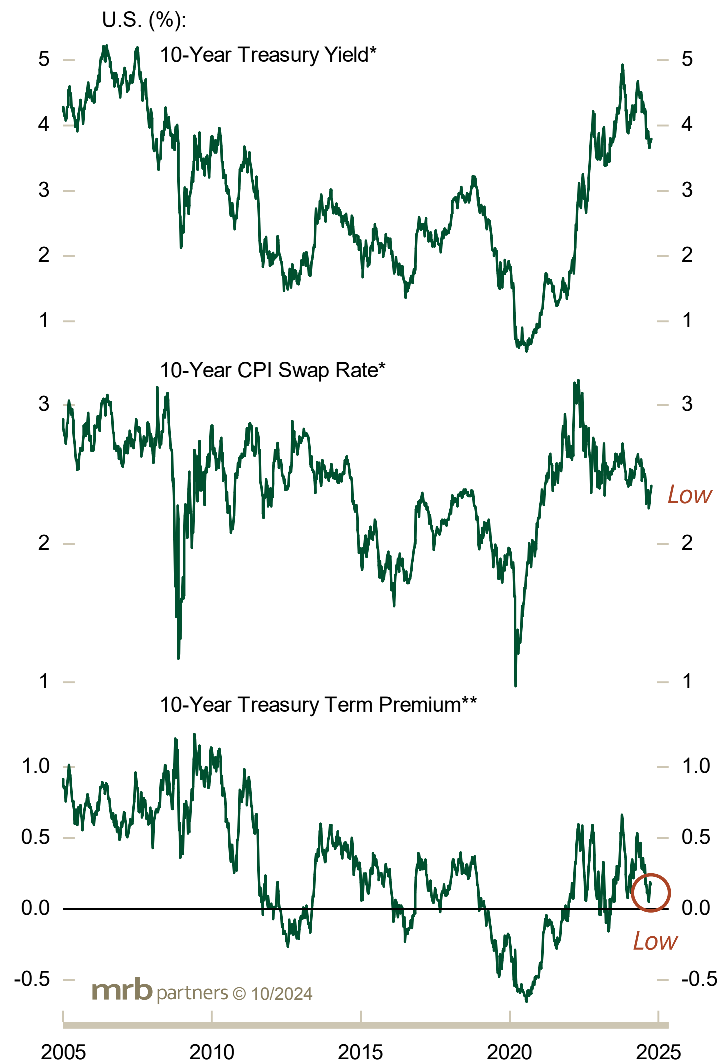
Longer-dated government bond yields have been tracking central bank policy rate expectations since the hiking cycle began in early-2022. The U.S. 10-year Treasury yield has been dragged lower over the past six months as investors have ratcheted up expectations of Fed rate cuts in the year ahead (**chart 6**). The 1-year forward fed funds rate is now consistent with the Fed's estimate of the long-run equilibrium policy rate, as published in its latest *Summary of Economic Projections*.

While a meaningful gap has opened between the U.S. 10-year Treasury yield and the 1-year forward fed funds rate, Treasury performance will continue

Chart 6 **Treasurys: Following The Fed Lead**

* Source: Bloomberg

Chart 7 **10-Year Treasury Yields Embed Little Inflation, Policy Risk**



* Source: Bloomberg
** Source: Federal Reserve

to depend on fed funds rate expectations over the next 6-12 months, at least[7].

This relationship underscores our cautious outlook for longer-dated U.S. Treasurys. Further downside for the 10-year Treasury yield is contingent on the Fed being ***compelled to reduce its policy rate to below the long-run equilibrium rate***, which would only be likely if the economy were slipping into recession. U.S. growth may ease in the months ahead from the current well-above potential pace, but a recession is not on the horizon. Instead, the Fed's projected interest rates imply sustained solid U.S. economic growth over the next year.

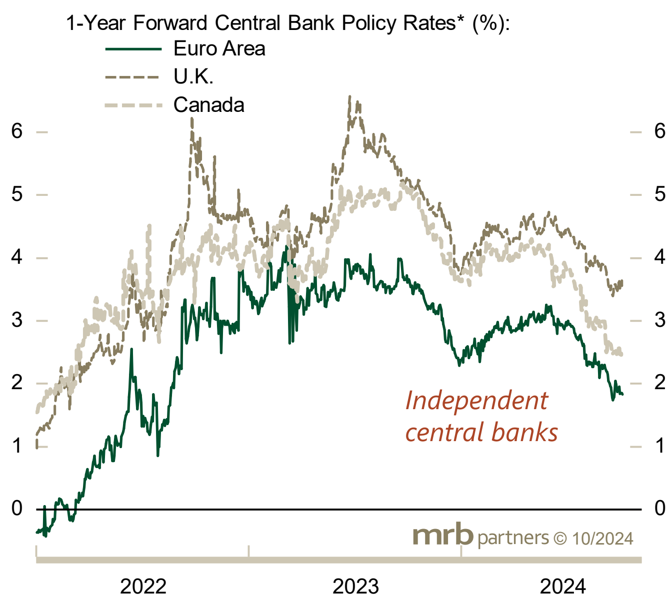
The U.S. 10-year Treasury yield will remain directionally linked to expected Fed policy, but also reflects long-term inflation compensation and a term premium (**chart 7**). Inflation compensation, as proxied by the U.S. 10-year CPI swap rate, is modestly below its average over the past two years, and assumes the Fed will deliver on its 2% inflation objective. The U.S. 10-year term premium is negligible, implying that markets expect monetary policy to be highly predictable in the long run.

Investors are overly optimistic about prospective Fed rate cuts

[7] **MRB**: "*U.S. Yield Curve: Correlation Is Not Causality*", September 17, 2024

Such optimism is misplaced in our view, given structural upside inflation risks, the poor long-run fiscal outlook, and our research indicating that the real equilibrium policy rate is higher than the Fed and markets assume. Further Fed rate cuts in the near term will provide support for Treasurys, but we expect the U.S. 10-year yield to be meaningfully higher 6-12 months down the road.

Chart 8 **DM Central Banks: Moving In Lockstep**



* Source: Bloomberg

Fed policy may be the prime driver of the global monetary cycle, but other major central banks are on a similar path (**chart 8**). The ECB and BoC are projected to reduce its policy rate by approximately 170 bps in the next year, while the BoE is projected to cut its rate by 130 bps. As we recently highlighted, the case for aggressive rate cuts by the ECB and BoC are more in-line with underlying economic fundamentals than is the case for the Fed. The BoE also has room to cut significantly in the year ahead, although recent U.K. economic data has been firmer than that in the euro area or Canada.

If global growth momentum outside the U.S. improves in the year ahead, as we expect, then an unwinding of expected Fed rate cuts and higher U.S. Treasury yields will also flow through into the policy rates and bond yields in other G7 economies, excepting Japan. We expect U.S. government bonds to underperform a basket of DM bonds on a 6-12 month horizon, but for DM 10-year bond yields to rise moderately across most individual markets. We continue to recommend an underweight stance on government bonds within a multi-asset and fixed-income portfolio.

We expect the U.S. 10-year yield to be higher in 6-12 months

Our other key 6-12 month fixed-income recommendations are:

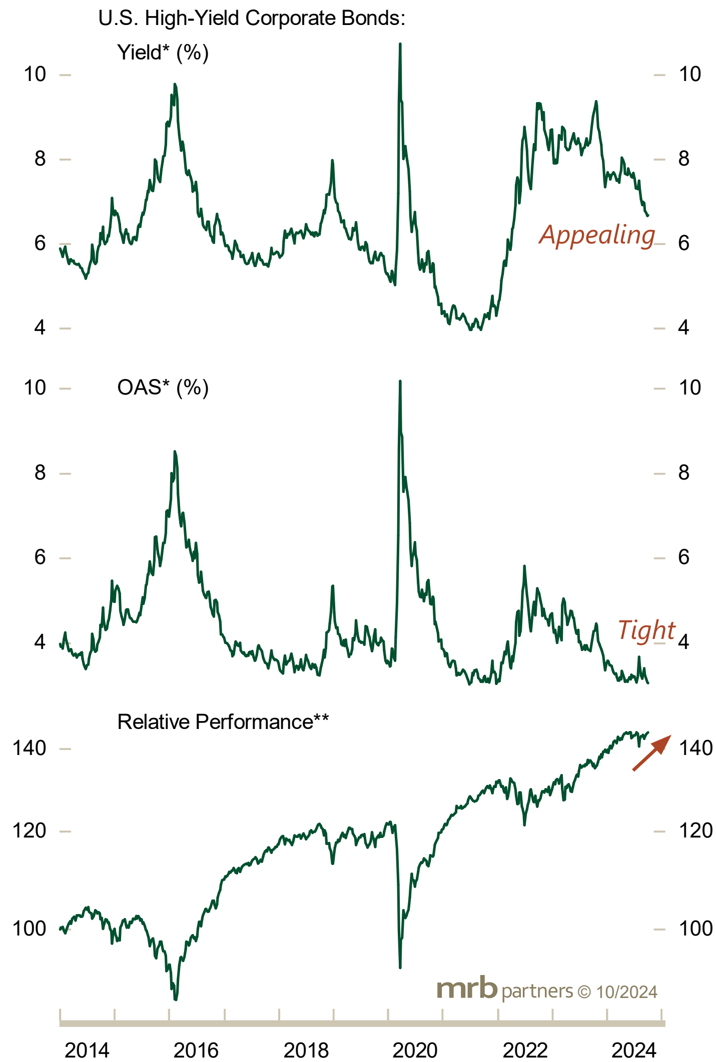
- **Duration (Underweight):** Cash and other short-term fixed-income yields will decline on a 6-12 month horizon as central banks cut policy rates, but a projected moderate rise in long-term bond yields will justify an underweight duration stance (**chart 9**). That said, short-duration outperformance is likely to be more enduring over the second half of our investment horizon.

- **Yield Curve (Steepener):** The 2/10 curve has steepened with the start of the Fed's rate-cutting cycle, but with approximately 200 bps of further rate cuts discounted over the next two years, there is comparatively limited further steepening to come if our macro scenario is correct. Still, it is too early to remove the steepening bias.

Chart 9 U.S. Treasury Curve Steepening

* Rebased; source: Bloomberg, MRB calculations
** Source: Bloomberg

Chart 10 Credit Is Expensive, But Still Poised To Outperform



* Source: ICE Data Indices, LLC
** Rebased; versus U.S. 5-year Treasury; source: ICE Data Indices, LLC

❍ **Inflation Protection (Overweight):** Inflation expectations have lifted modestly since early-September, but remain sufficiently low to warrant an overweight stance on inflation-protected bonds, especially since the U.S. and global economies are more likely to surprise on the upside than downside in the year ahead. Moreover, inflation expectations tend to move with oil prices, which we believe are biased upward in the next year from depressed levels.

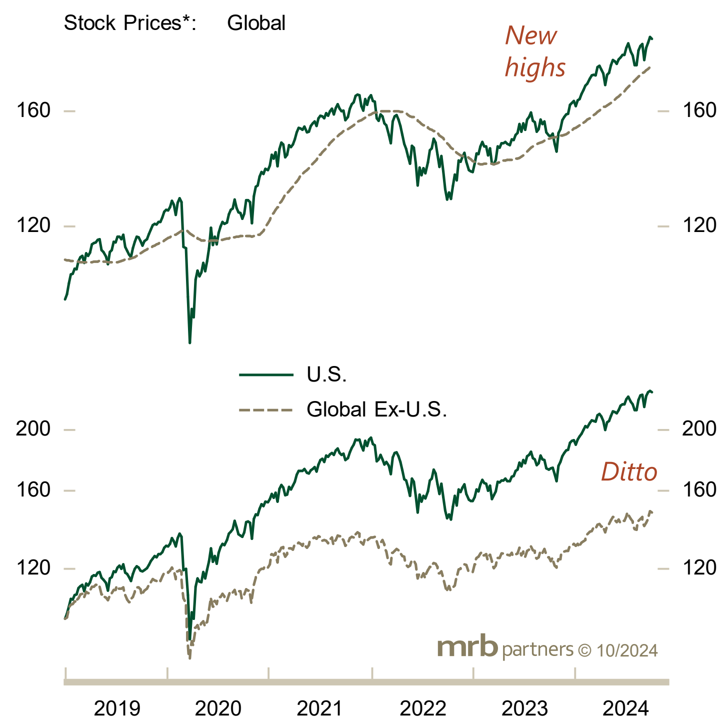
❍ **Corporate Bonds (Overweight):** Corporate bond spreads have come in smartly since mid-September and are historically tight, but default/downgrade risk is abating (**chart 10**). There is limited scope for further sustainable spread compression, which will temper nominal returns, but real yields are decidedly positive, especially for high-yield issues. Favor high-yield over investment-grade corporate bonds, but we expect both to outperform similar duration government bonds.

Stay overweight corporate bonds

❍ **EM Bonds (Overweight):** The investment climate for EM bonds remains favorable, with global growth sturdy, trade improving, and the U.S. dollar softening[8]. EM central banks will cut less than their DM counterparts given their head start this cycle, but positive carry and improving credit risk will support relative returns. Local-currency debt is more appealing than hard-currency debt given easing EM policy rates and expected modest EM currency appreciation versus the U.S. dollar.

Final Word: *Fixed-income assets will be well supported in the near term, but G7 government bond yields will eventually move meaningfully higher in response to an unwinding of overly aggressive rate cut expectations. On a 6-12 month horizon, stay underweight government bonds and duration and overweight corporate and EM bonds within a fixed-income portfolio.*

Chart 11 **Equities Remain In Uptrends**



* Local currency; rebased; shown in log scale; source: MSCI
Note: - - - 40-week moving average in panel 1

Equities

The economic and policy outlooks remain positive for equities, with broad-based gains expected in the year ahead, along with a gradual shift away from U.S. mega-cap growth stocks toward other sectors and select non-U.S. markets[9].

Equities continue their march upward, with the global, U.S. and global ex-U.S. benchmarks recently hitting multi-year or all-time highs, despite significant choppiness (**chart 11**). U.S. stocks are still leading the global pack (China's 3-week surge notwithstanding), but most major markets are perky. Japan is a notable exception, although that partly reflects the abrupt appreciation of the yen since mid-July. Japanese stocks hit a fresh high in U.S. dollar terms last week.

The economic and policy outlooks remain positive for equities

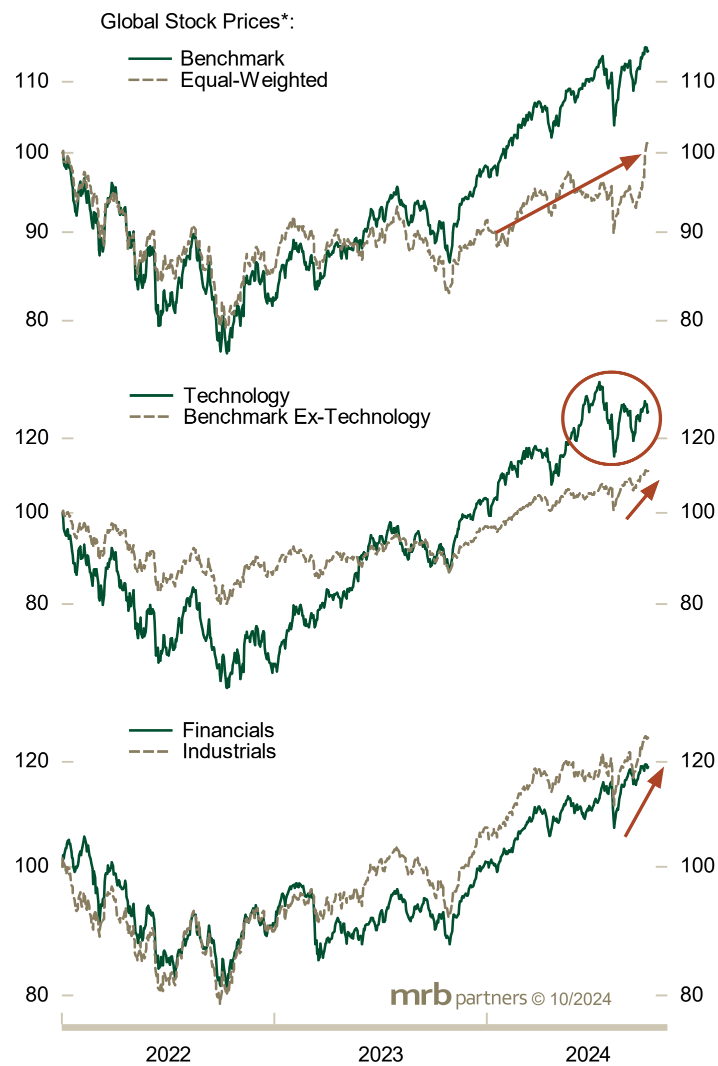
Other trends confirm the underlying positive equity market trend (**chart 12**). Partly buoyed by the recent surge in Chinese stocks, the global equal-weighted stock price index has broken out of an earlier soft spot. The U.S. equal-weighted index is powering ahead, dispelling the notion that the U.S. market is just a tech/A.I. play.

[8] **MRB**: "***EM Fixed Income – EM Debt: Stick With High Yielders***", July 25, 2024

[9] **MRB**: "***Regional Equities – Policy Tailwinds For A Gradual Rotation***", September 24, 2024

Global tech stocks are struggling to regain upward momentum, although the modest correction in recent weeks pales next to the huge advance in the first 6+ months of the year (which was on the back of very strong gains in 2023 as well). Encouragingly for equity investors, global stocks excluding technology have reinforced their underlying uptrend over the past month. A more balanced global equity market that is less reliant on U.S. or global tech stocks is a sign of improving health.

Chart 12 **Encouraging Signs Beneath The Equity Headlines**



* Local currency; rebased; source: MSCI
Note: All panels shown in log scale

Key pro-cyclical sectors also exhibit positive momentum. Both global financials and industrials are at/near new highs and in solid uptrends. The two are the largest pro-cyclical sectors outside tech, and the two largest sectors in the global ex-U.S. benchmark and hence are bellwethers for global equities in general. Investor jitters about the global economy may periodically flare, but the underlying market tendencies paint an encouraging picture for equity investors.

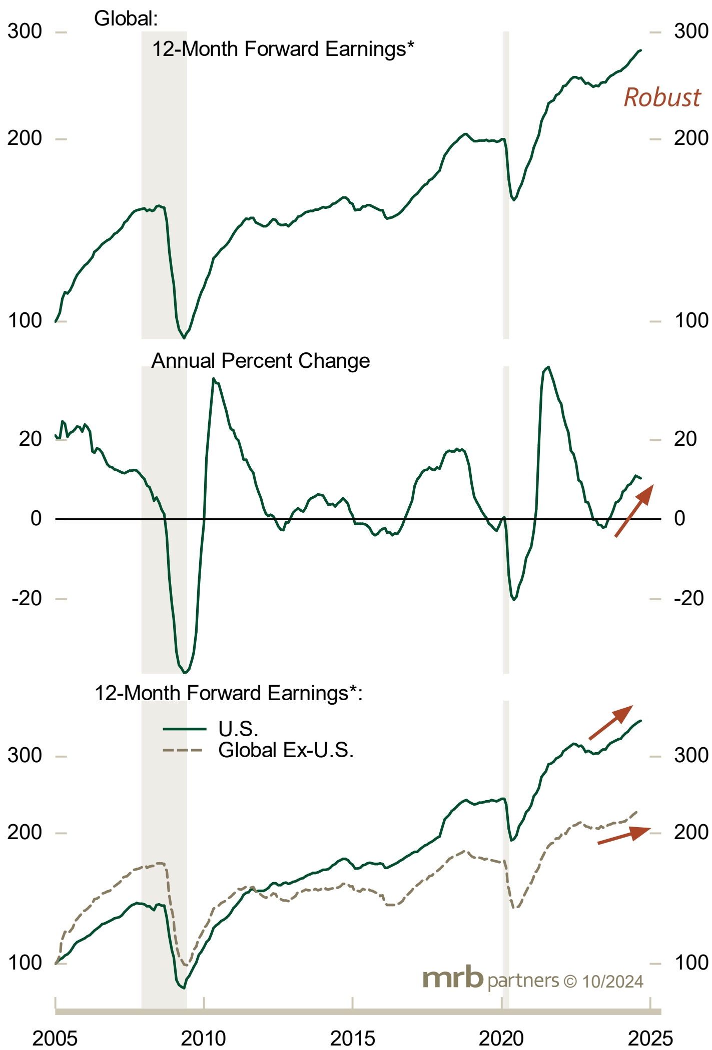
Global equity prices are being powered by rising earnings. Global forward earnings are in a strong uptrend and momentum (i.e. the year-over-year growth of forward earnings) is accelerating (**chart 13**). These trends should persist if the global economic expansion persists, as we expect. As with stock prices, U.S. forward earnings are outpacing those of the rest of the world, but the latter are also gaining steam.

Global equities are being powered by rising earnings

Relative stock price performance has been very choppy in recent weeks, owing in part to the decline in the U.S. dollar, as well to volatility in several major markets (**chart 14**). The U.S. market, which still looks strongest in absolute terms, has slightly underperformed since mid-July versus the global ex-U.S. benchmark, when measured in U.S. dollar terms. As gauged by the 40-week moving average, the U.S. relative performance uptrend is still intact, but shows tentative signs of rolling over.

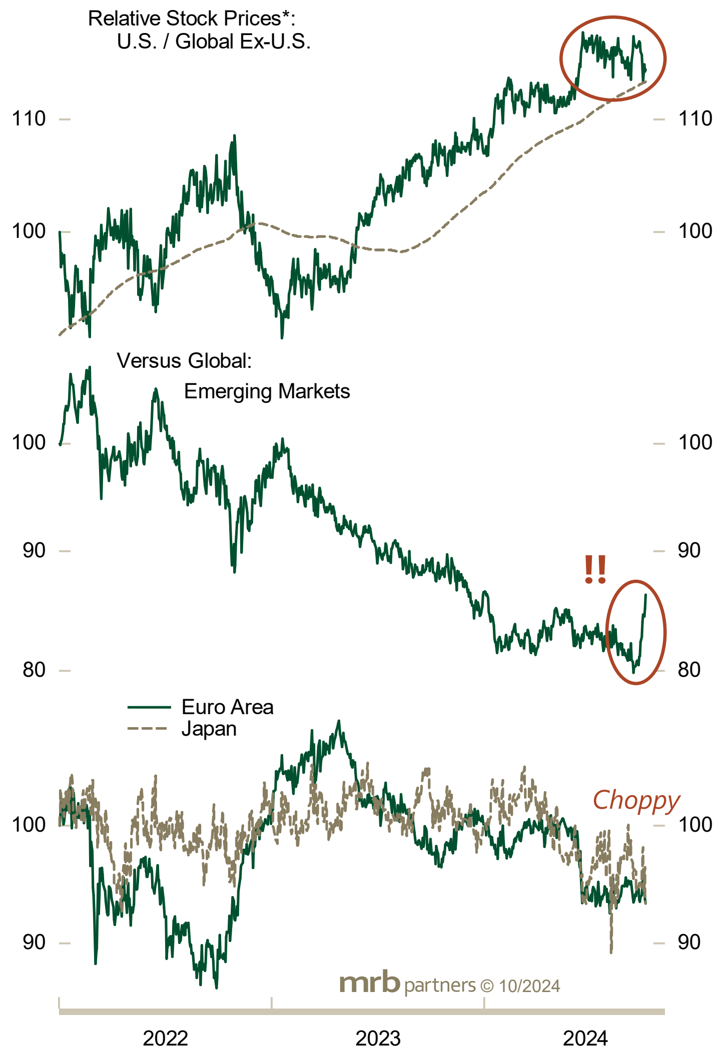
EM stocks have jumped sharply relative to the global benchmark over the past three weeks, albeit driven entirely by the policy-driven surge in China. Euro area and

Chart 13 Strong Earnings Support For Stocks



* Local currency; rebased; source: MSCI
Note: Panels 1 & 3 are shown in log scale; shaded for NBER-designated U.S. recessions

Chart 14 Murky Relative Performance Signs



* U.S. dollars; rebased; source: MSCI
Note: - - - 40-week moving average in panel 1; all panels are in log scale

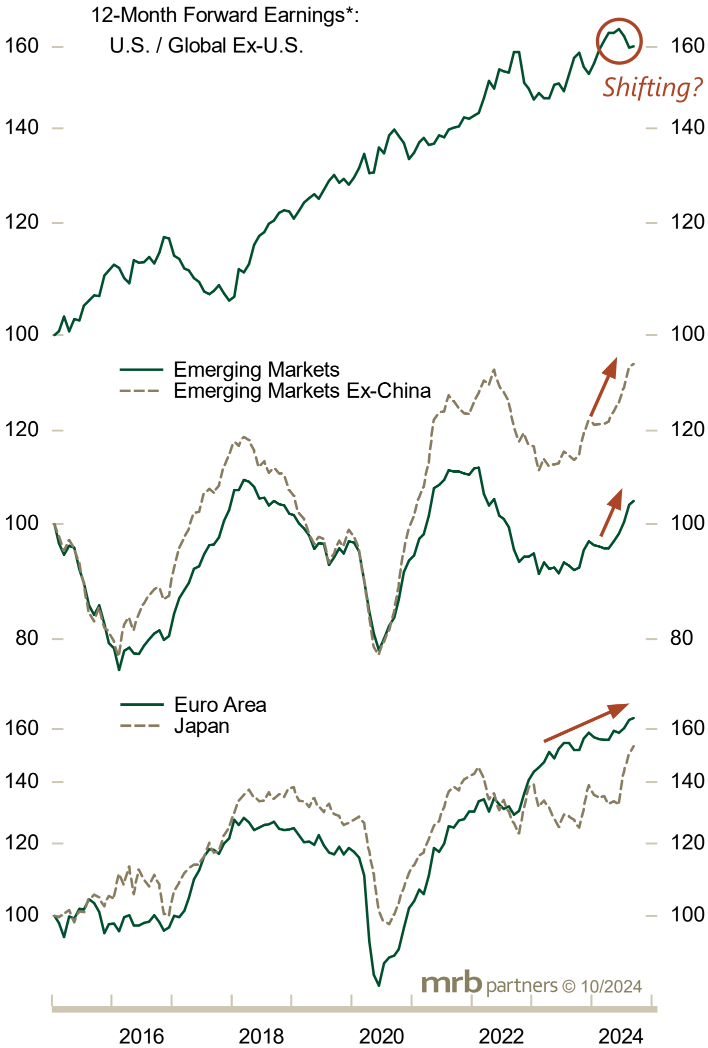
Japanese stock prices versus the global benchmark in U.S. dollars show no discernable recent trend and significant volatility. There is more noise than signal.

U.S. forward earnings are in a strong uptrend, but have recently dipped relative to those of the global ex-U.S. index (**chart 15**). It is premature to conclude that a relative fundamental shift is underway, but the strength of earnings in other key markets is occurring even against a backdrop of still sluggish growth in the euro area, China and Japan, and global trade. If economic growth perks up outside the U.S. and coincides with a further pick-up in global trade, which is our base-case scenario, then the relative earnings shift from the U.S. to the rest of the world would gain traction.

The outlook for tech earnings is core to our regional equity view

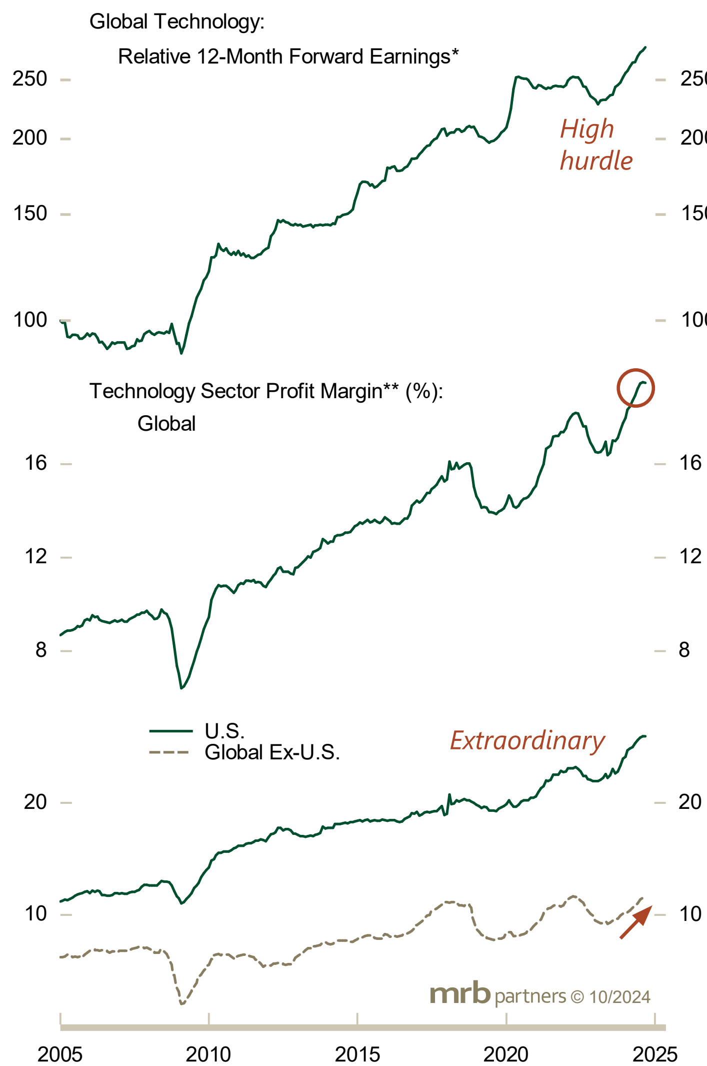
The outlook for tech earnings is core to our view. Global and U.S. forward earnings for tech are still outpacing their respective aggregates, but the bar to continued

Chart 15 Favorable Global Ex-U.S. Earnings Trends



* U.S. dollars; rebased; source: MSCI
Note: All panels are in log scale

Chart 16 Can Tech Meet Optimistic Earnings Expectations?



* Versus global benchmark; U.S. dollars; rebased; shown in log scale; source: MSCI
** Source: Refinitiv I/B/E/S Global Aggregates

outperformance is high, especially for the U.S. sector, where profit margins are already extremely elevated. The upturn in the global semiconductor cycle offers upside for non-U.S. technology earnings, especially in emerging markets[10].

Relative earnings momentum will gradually shift from the U.S. to other markets

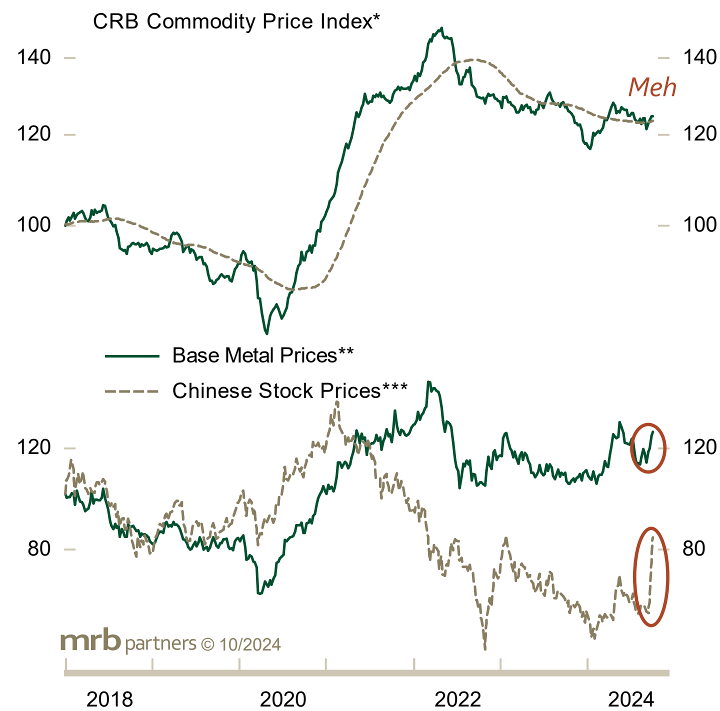
Our 6-12 month regional equity market recommendations reflect our expectations that the global economic expansion will persist and broaden and that relative earnings momentum will gradually shift from the U.S. and U.S. tech to global ex-U.S. in general and select other markets with significant exposure to financials and non-resource cyclical sectors. The latter includes EM, Japan and the euro area specifically.

[10] **MRB**: "*Why We Prefer EM Over U.S. Semiconductor Stocks*", October 3, 2024

The near-record high weight of the U.S. in the global benchmark and elevated U.S. earnings/margins and relative valuations skew the risk-reward trade-off in favor of a mild underweight stance on the U.S. within a global equity portfolio, with overweight exposure to EM[11], Japan[12] and the euro area that offer catch-up earnings potential and comparatively attractive valuations.

Final Word: *Global equities should continue to appreciate on a broad basis over the next 6-12 months, underpinned by rising corporate earnings and supportive monetary policy. An expected shift in relative earnings and a better risk-reward profile underpin our recommended overweight exposure to emerging markets, Japan and the euro area within a global equity portfolio, and a mild underweight on the U.S.*

Chart 17 **Commodity Prices: China Relief, For Now**



* - - - 40-week moving average; rebased; source: Bloomberg
** Rebased; source: London Metal Exchange
*** U.S. dollars; rebased; source: MSCI
Note: All panels are in log form

Commodities & Currencies

Commodities

Commodity prices have rallied strongly in recent weeks, but have not broken out of the trading range that has prevailed over the past two years (**chart 17**). The recent rebound has been broad-based, with industrial and agricultural commodities participating, energy belatedly bouncing, and precious metals continuing their bull run. The gains partly reflect the latest policy easing in China, but also the resilience of the global economy and the start of the Fed's rate cutting cycle, as well as easing financial conditions.

The policy stimulus from China is a welcome sign for commodities

The policy stimulus from China is a welcome sign for commodities, particularly base metals, which have popped alongside Chinese stock prices (aside from the 2021 pandemic-induced commodity price surge, base metal and Chinese equity price movements have been correlated for years). However, as we noted above, the stimulus is unlikely to boost Chinese economic growth or commodity-intensive industrial activity materially. Hence, any improvement in China's demand for copper,

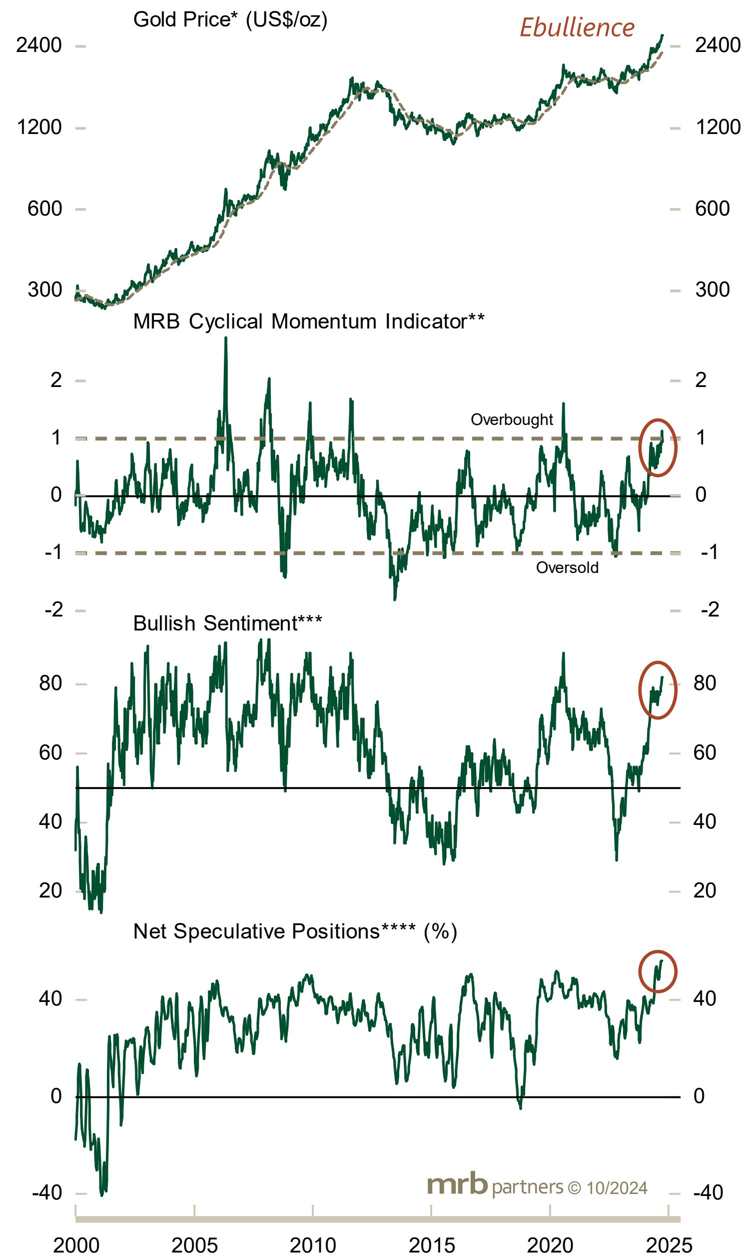
[11] **MRB**: "*EM Equities: Earnings Are Outperforming, Prices Will Follow*", September 10, 2024
[12] **MRB**: "*The Case For Japanese Equities*", August 21, 2024

iron ore and oil is unlikely to be significant. The overall global growth backdrop is directionally positive for industrial commodity prices, but a boom is not in store.

The demand case for oil prices is more straightforward given our constructive economic outlook, but gauging the supply side is more challenging. Escalating military activity in the Middle East may have boosted oil prices in recent days, but the rebound still leaves them below the average that has prevailed for most of the year. Robust non-OPEC oil production and recent signals that the Saudis want to increase output to take back global market share (Saudi Arabia has significant spare capacity) will limit gains for oil prices. Risks to oil prices are tilted to the upside on a 6-12 month horizon, but volatility will likely remain high.

A global monetary easing cycle is inherently positive for gold prices, which are up sharply YTD. There is no clear near-term catalyst for a reversal, but markets have already discounted overly aggressive Fed rate cuts, and gold prices are overbought, based on the *MRB Cyclical Momentum Indicator* (**chart 18**). Sentiment is also highly bullish, and speculators have accumulated large net long positions. The gist is that a lot of good news is priced into bullion and a pause or pullback is increasingly likely in the near term. Despite the favorable macro backdrop, we would not accumulate gold at current prices, and expect to be sellers of gold down the road as bond yields rise.

Chart 18 **Gold: Overbought, Overloved, Overowned**

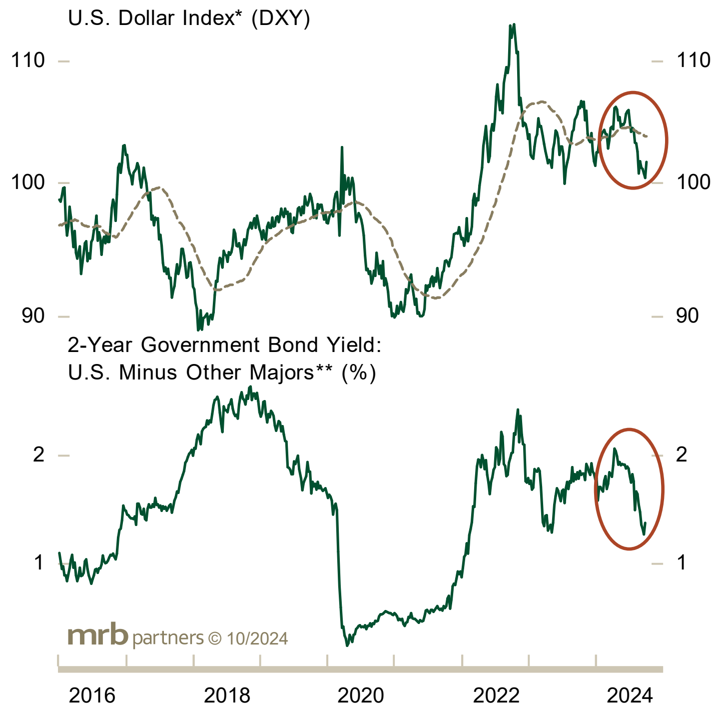


* - - - 40-week moving average; shown in log scale; source: Bloomberg
** Standardized
*** Smoothed; source: Marketvane
**** Net long positions as a percent of open interest, smoothed; source: Commitment of Traders Report

Overall, we are mildly constructive on commodity prices, but do not expect them to outperform other risk assets, and thus recommend a neutral stance within a multi-asset portfolio.

Currencies

Chart 19 U.S. Dollar: Just A Fed Watcher



* Source: Bloomberg
** Other majors based on the DXY weights
Note: - - - 40-week moving average in panel 1

The U.S. dollar has bounced in recent days as Fed rate cut expectations have been slightly scaled back following sturdy U.S. economic data (**chart 19**). The bounce is timely as the dollar was at risk of testing a crucial support level last week, a breach of which could have triggered a wave of selling pressure.

The dollar has been driven by relative interest rate differentials in recent years, although most of the swings in the rate differential have been driven by Fed expectations. As highlighted above, there is a clearer case for aggressive rate cuts by the ECB (and other DM central banks except the BoJ) than the Fed in the year ahead, which would widen the U.S.' rate advantage and provide support for the dollar.

However, relative economic growth momentum is likely to act as a constraint for the dollar on a 6-12 month horizon as the U.S. cools modestly and the euro area, Japan and much of the rest of the world gradually strengthen.

On balance, we expect the shift in relative growth to outweigh any widening of interest rate differentials such that the U.S. dollar drifts lower over the next year[13]. While a weaker dollar would benefit most other major currencies (i.e. relative to the dollar), we caution that various DM economies have structural vulnerabilities that will limit sustainable appreciation potential and could trigger significant downside if macro conditions deteriorate. We favor the euro, yen, Swiss franc, Singapore dollar and an EM currency basket, and would underweight the Australian, Canadian and New Zealand dollars, as well as the Norwegian krone.

We expect the U.S. dollar to drift lower over the next year

interesting! many of these are opposite views to AM

Final Word: *The macro backdrop should allow commodity prices to rise in the year ahead, but only in-line with risk assets in general, warranting a neutral commodity stance within a multi-asset portfolio. A gradually firming of economic growth outside the U.S. points to a further softening of the U.S. dollar on a trade-weighted basis over the next 6-12 months, despite a partial unwinding of Fed rate-cut expectations down the road.*

[13] **MRB**: "*Global Foreign Exchange:Fed-Induced U.S. Dollar Weakness For Now*", September 5, 2024

MRB *TradeBook* Update

Changes To Positioning This Week

There are several changes to positioning in the ***MRB TradeBook*** this week (**chart 20**):

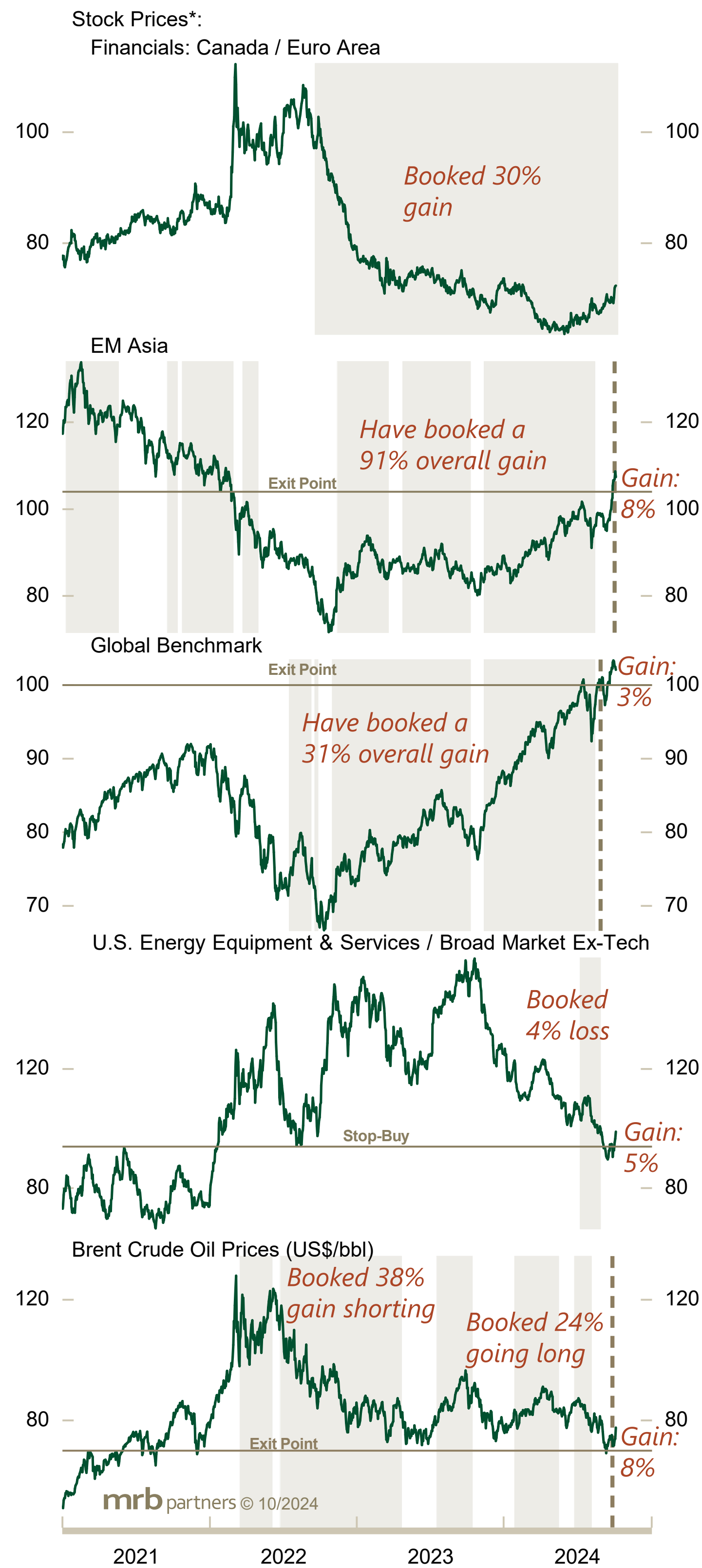
Closed Positions:

❍ **Financials: Short Canada / Long Euro Area:** After material outperformance euro area financials have underperformed versus Canadian financials which triggered our 30% gain on this position. While we see a reversal on this pair trade as euro area financial institutions have much stronger structural backdrop compared to their Canadian counterparts, we will stand aside for now. Our view is that the euro area economy can withstand elevated interest rates, and this should ultimately benefit the domestic financial sector as investors realize its resiliency[14].

Tighten Stops:

❍ **Long EM Asian Equities:** This position has gained further traction on the back of China's monetary reflation[15] (up 8%). We expect that several factors will combine and contribute to the outperformance of EM equities[16]. Chief among these is the acceleration of EM earnings which, driven by stronger domestic growth momentum and recovering export demand, are now modestly outperforming their DM counterparts. With Chinese policymakers now providing monetary

Chart 20 MRB *TradeBook*: Equity Positioning Changes



* U.S. dollars; source: MSCI
Note: Total return rebased to 100 at initiation of trade; vertical line denote when MRB initiated trade; shaded denotes when MRB previously held trade

[14] **MRB**: "*Absolute Return Strategy: Extending Goldilocks*", September 26, 2024

[15] **MRB**: "*China:PBoC Fires Its Bazooka, Banks Will Suffer The Collateral Damage*", September 27, 2024

[16] **MRB**: "*EM Equities: Why We Prefer EM Over U.S. Semiconductor Stocks*", October 3, 2024

reflation and promoting risk-taking, global investors may be more inclined to add exposure to EM assets. We will take this opportunity to tighten the exit point to secure 4% of the current gain.

- **Long Global Equities:** This position has gained further traction in recent weeks in line with our view that central banks in the developed markets (excluding Japan) are providing monetary reflation to stimulate their economies. Indeed, global equities and other risk assets should hold up well for as long as bond yields remain low, but we warn that the trend in yields could reverse on the back of sticky inflation and resilient growth. For now, we will tighten stops to its entry level on this position protect against market volatility.

- **Long Energy Positions:** The stop-buy on long U.S. energy equipment and services versus the broad U.S. market was triggered this week (up 5%). The outlook for energy prices over the next 6-12 months remains modestly positive on the back of resilient global growth. This pair trade has considerable upside potential. We will set the stop on this position at its entry level to protect against market volatility. Note that we also have a long crude oil position (currently up 7%), and will take this opportunity to tighten its stop to protect 2% of the current gain.

Peter Perkins
Partner, Global Strategy

Please see the following pages for the highlights of this week's research

This Week's Research

Watch *Webinar*

U.S. Election 2024: Are Markets Too Complacent?

The U.S. elections are just a month away and bring the prospect of significant changes to policy depending upon the outcome. In recent months, investors have been focused primarily on the Fed and U.S. employment data, raising the risk that they are overlooking the potential consequences of the elections.

In today's ***Webinar***, Peter Perkins and Salvatore Ruscitti discuss the U.S. policy outlook under different election outcomes and the implications for the capital markets and sectors.

Key issues addressed include:

What are the polls and swing states indicating about the election outcome?

How will the election and the U.S. fiscal situation shape tax policy in 2025?

What are the main implications under a Harris or Trump victory?

How important is the election outcome to the outlook for capital markets?

What are the policy platforms of the two candidates at the sector level, and what can they actually do if elected?

Which sectors are most potentially impacted under different election outcomes?

Fixed Income

Divergence Re-Emergence: Opportunities In Regional Bond Markets

Chart 21 Early Signs Of Divergence In Forward Markets?

* Source: Bloomberg

Fixed-income markets are being too aggressive in expecting a prolonged period of deep Fed rate cuts. Instead, there is a better economic case for the ECB and BoC doing so, setting the stage for some cross-market fixed-income spread trades, as we highlighted in this report.

- The Fed delivered a 50bp rate cut to begin its easing cycle, and kept the emphasis on its employment mandate. Chair Powell is determined to prevent the labor market from softening further, which has encouraged the bond market to price in deep interest rate cuts though the end of next year. That said, our research suggests that monetary conditions were not as restrictive as feared, and that the U.S. economy will prove resilient and will not justify the amount of easing currently priced in.

- Conversely, current rate expectations are justified in the euro area and Canada, due to their relatively weaker economic conditions. In fact, there is a case for both bond markets to front-load easing. This sets up for an opportunity to play a divergence within regional fixed income markets (**chart 21**).

- Specifically, we believe U.S. Treasurys are set to underperform their euro area and Canadian counterparts. We recently added a spread trade favoring 5-year German Bunds versus U.S. Treasurys to the **MRB *TradeBook***. We believe this can roll up the curve as well in the 10-year segment as expectations for U.S. economic growth and monetary repricing are at extremes. We also expect more front-loaded easing in Canada by Q1 of next year.

Economy

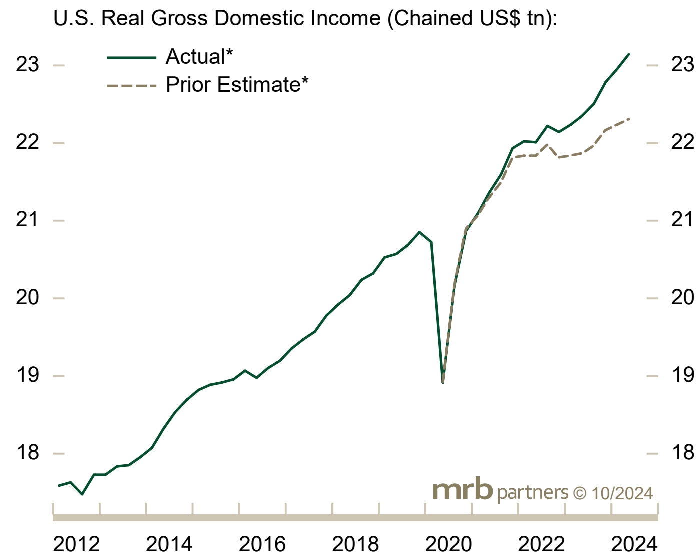
U.S. Economy: On Firmer Ground Than You Thought

This U.S. economy has seen more than one unwarranted bout of heightened recession fears, only to be firmly quashed by cyclical resilience. Recent data revisions now indicate that economic growth over the last three years was stronger than initially reported, and the expansion has been more resilient than was previously estimated. The revisions validate MRB's view that the persistent undercurrent of consensus bearishness in this economic cycle has been badly misplaced. Monetary policy has clearly not been very restrictive to-date and is now becoming easier. This fact and the economy's strong fundamentals imply that the expansion will continue to run at a solid pace.

The main takeaways included:

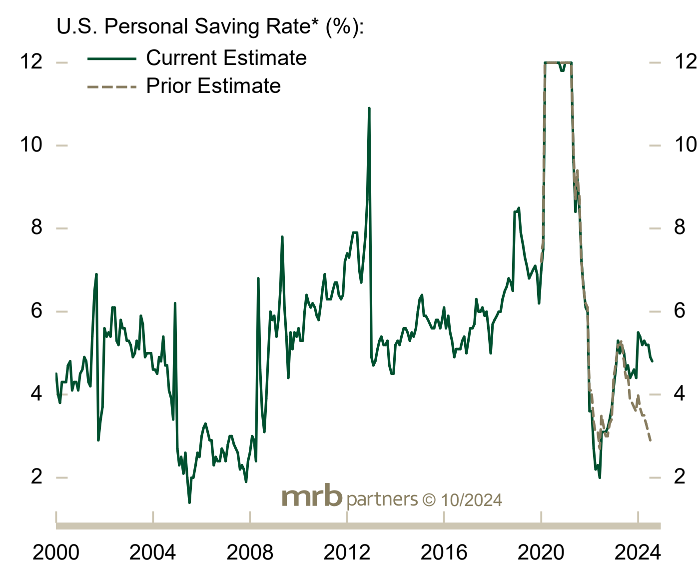
- ❍ Strong upward revisions to real GDP growth highlight that the economy has been expanding well above its potential rate in recent years and has been nowhere close to tipping into a recession.
- ❍ Economic bears had previously highlighted weak real Gross Domestic Income (GDI) as a major macro vulnerability. However, GDI was also revised up significantly, quashing this pessimistic narrative (**chart 22**).
- ❍ Wages and interest income were revised up meaningfully, resulting in a two percentage point increase in the recent trend of the savings rate (**chart 23**).
- ❍ Consumers have been much less reliant on savings this year than was previously estimated. Doubts about the sustainability of solid consumer spending have been overblown.

Chart 22 **Real GDI Saw A Major Upward Revision**



* Source: U.S. Bureau of Economic Analysis

Chart 23 **The Savings Rate Is Much Higher Than Was Earlier Believed**



* Source: U.S. Bureau of Economic Analysis
Note: Truncated above 12%

- Overall, the data validates MRB's view that the consensus' persistent bearishness in this cycle has been misplaced.
- The improved assessment of the economy's underlying fundamentals further raises the odds that economic growth will remain resilient over the foreseeable future (which has consistently been MRB's view).
- We expect that ongoing solid economic data will force the Fed to rein-in its easing plans.

Emerging Market Equities

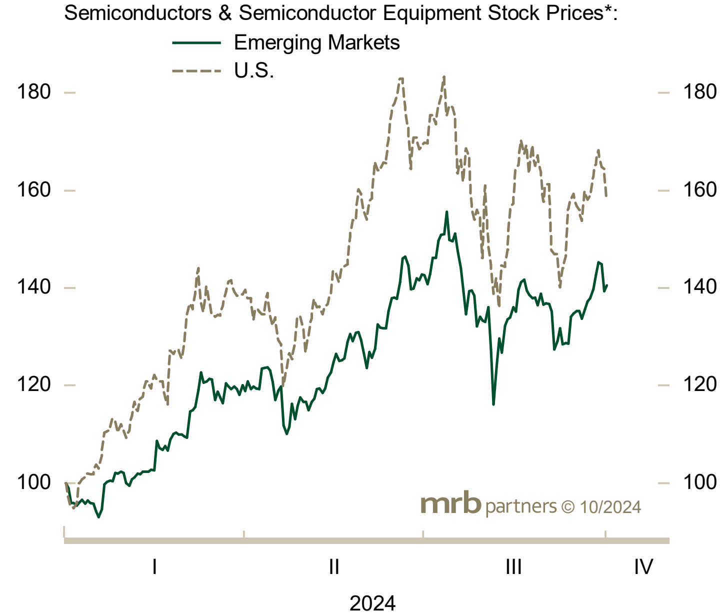
Why We Prefer EM Over U.S. Semiconductor Stocks

The close correlation between the performance of EM and U.S. semiconductor stocks during July's sell-off in U.S. tech shares (**chart 24**) has raised questions about the vulnerability of EM chip stocks to a correction in their U.S. brethren, should doubts about the pace and timing of A.I. monetarization grow in the coming months.

Yesterday's report, we compared the EM semiconductor sub-group with its U.S. counterpart and conclude that EM chip stocks offer a more diversified revenue and earnings base at significantly more attractive valuation multiples. This should insulate them (relative to the U.S.) from A.I. or other sector-specific risks.

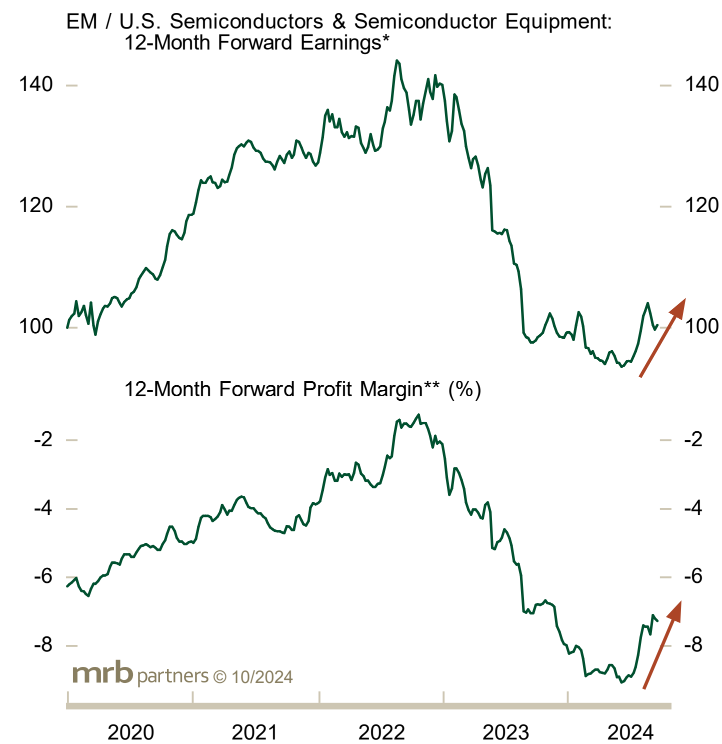
The boom in A.I. spending over the last year has disproportionately benefited a small handful of listed chip companies in the U.S. and driven the outperformance of the broader semiconductor sub-group versus its EM counterpart. However,

Chart 24 Close Correlation Between EM And U.S. Semiconductor Stock Prices



* U.S. dollars; rebased; source: MSCI

Chart 25 EM Semiconductor Earnings Are Now Outperformed



* U.S. dollars; rebased; source: I/B/E/S Global Aggregatres
** EM minus U.S.; 12-month forward earnings divided by 12-month forward sales; source: I/B/E/S Global Aggregatres

there are signs that relative performance drivers are shifting in favor of EM semiconductor stocks as earnings of the EM semiconductor group are starting to outperform (**chart 25**). This improvement will likely continue as global growth and trade firm, and the expansion of semiconductor sales broadens across end-markets.

Highlights included:

- EM semiconductor stocks offer a diversified revenue base and attractive multiples.
- The semiconductor space in the U.S. has become highly concentrated and dependent on A.I. plays, with significantly more demanding multiples compared to EM peers.
- The A.I. investment boom has led to the outperformance of the U.S. semiconductor sub-group so far this cycle, but EM semiconductor stock prices and earnings are now outperforming their U.S. counterparts and will continue to do so as the expansion of semiconductor sales broadens.

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