M&G Investments

# M&G Asset Allocation Team

## Asset Allocation Perspectives – January 2024

The value and income from a fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise and you may get back less than you originally invested. The views expressed in this document should not be taken as a recommendation, advice or forecast. Past performance is not a guide to future performance.

## Market assessment

### Asset price behaviour

January 2024 saw divergent performance across and within asset classes. Broadly speaking, aggregate equity markets delivered modest positive returns, and broad-based fixed income markets delivered small negative returns. This negative correlation was even more profound within asset classes,  where markets like Japan were up 8%, whilst Chinese equities were down nearly 10%. Interest rate cut expectations were pushed back modestly, which led to weakness in fixed income assets and USD strength during January.

### Macro developments

Recent macroeconomic data continued to show broadly robust economic growth, with labour markets in particular remaining highly resilient. Whilst the global manufacturing outlook has continued to look weak, there have been modest signs of improvement, alongside still resilient service sector data. Headline and core inflation have broadly continued to fall, albeit in some cases at a slower pace than desired by central bankers. The combination of these two factors has led to some pushback on the expectations of rate cuts in the very short term.

The earnings season to date has broadly been favourable and suggests further signs of resilience and reacceleration of the global economy. Persistently slower activity in China may pose a risk to global growth – and yet could potentially also help contain global inflation.

### Investors' beliefs

Market expectations around a soft landing or no landing are now firmly entrenched. Market participants continue to price in a very benign economic environment going forwards, of robust growth and declining inflation, which will allow central banks to begin cutting interest rates. There has been some pushback around the timing of rate cuts, but this has only shifted expectations around when they would be implemented, rather than their extent.

To date, the market is showing little evidence of pricing in a number of observable threats to the global economy, ranging from the still-elevated interest rates and the impact they could have on corporate and consumer balance sheets, to the elevated threat from geopolitics given current geopolitical tensions and significant elections taking place throughout 2024.

On a more granular level, market participants are becoming very optimistic once again towards the prospects around artificial intelligence (AI) and mega-cap tech, whilst at the same time negative sentiment and aversion towards China-related assets is highly observable in their relative pricing behaviour.

Source of data: Bloomberg, as at 31 January 2024.

## Asset allocation views

### Equities (=)

- Aggregate valuations don't seem particularly stretched to us given the prevailing economic environment, however vulnerabilities persist to any shift away from the current soft-landing/no-landing environment – which until now has been highly favourable for equities.
- Within our equity exposure, we find selective opportunities in more attractively priced markets like Europe and Asia – whilst US equities currently at all-time highs look significantly more expensive from a valuation perspective, and highly concentrated in terms of market composition.

- Post significant price weakness and incredibly negative sentiment, we believe Chinese equities currently look like a compelling opportunity in the months to come should we see any improvement in sentiment or fundamentals.

### Fixed income (+)

- DM government bonds continue to offer reasonable compensation in the medium term, and have begun to exhibit negative correlation with other parts of the portfolio, which can be valuable from a portfolio construction perspective. We continue to favour USD duration, but also find value in GBP and EUR bonds.
- EM local currency bonds continue to offer attractive real and nominal yields, in our view, and might continue to benefit from more accommodative monetary policy going forward.
- Credit spreads continue to price in benign economic outcomes and have rallied to what we think are fair value levels – thus no longer offering excess compensation. We continue to prefer other parts of the fixed income market to credit.

### Cash and other (+)

- Cash remains attractive given elevated cash rates, and continues to be uncorrelated to other parts of the portfolio. Should we see increased volatility leading to tactical opportunities in other asset classes, the cash is ready to be deployed.
- After some price weakness attributed to the interest rate sensitivity of some listed infrastructure assets, we currently observe compelling valuations across a number of exposures that can provide a stable and growing income coming from real assets.

## Our approach

Our aim is to develop and leverage global asset allocation views to build portfolios that deliver attractive investment returns, aligned with the financial objectives of our clients in line with their preferred outcomes (such as sustainability, income, or enhanced flexibility). Our approach integrates behavioural analysis with an assessment of macro and fundamental drivers to gain insight into valuations, market dynamics and volatility. This allows us to identify the most suitable strategic investment prospects as well as to exploit phases of heightened volatility to capture tactical opportunities.

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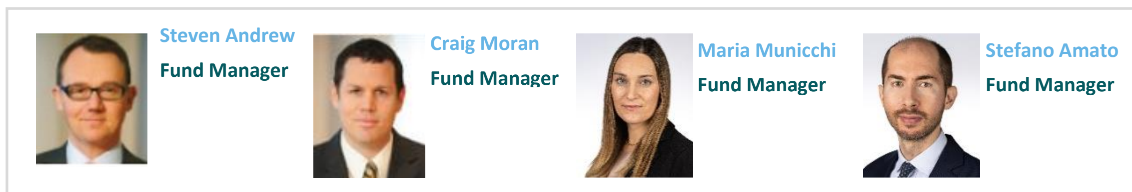


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