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Market Outlook

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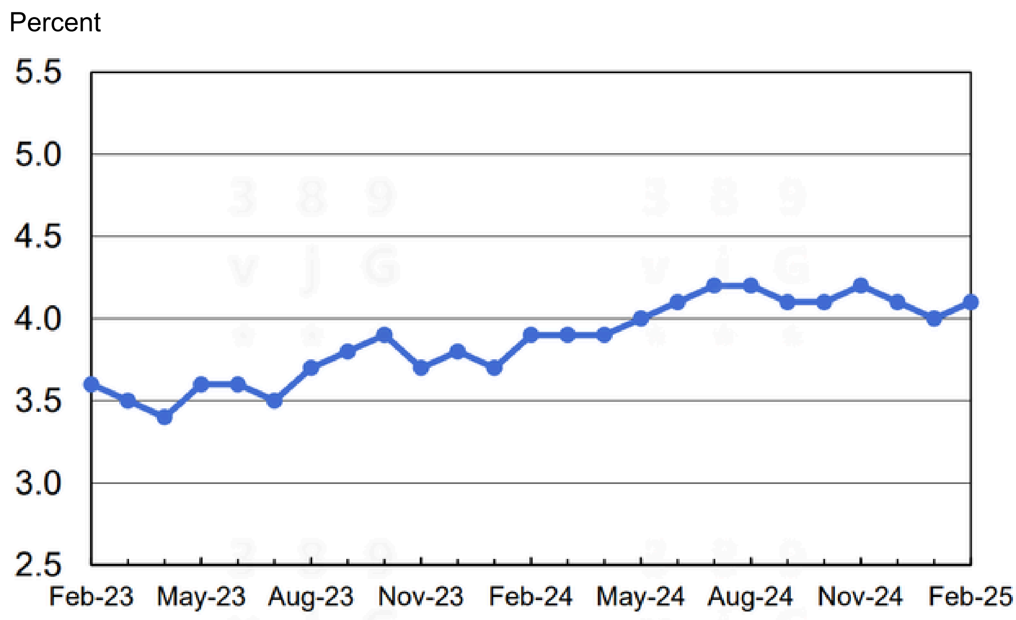
Equity market volatility has risen across many markets, as witnessed by a significant correction in the US equities market from February. US policy uncertainty has increased to a multiyear high with fears that the US tariff uncertainties could further weigh on US economic growth. Valuations of global equities are more attractive after the recent pullback. The ensuing volatility will likely be negative for equity markets in the near term, while the impact on fixed income is less clear. Regionally, we prefer Asia equities to US and European equities. We are positive, particularly on Singapore, Korea, and India equities. We are slightly cautious on Asian credit bonds, though the all-in yield remains attractive.

MACRO OUTLOOK

1. Equity market volatility has risen across many markets, as witnessed by a significant correction in the US equities market from February. US policy uncertainty has risen to a multiyear high, with fears that the US tariff uncertainties could further weigh on US economic growth. President Trump's tariffs could lead to retaliation by affected countries and expansionary fiscal policies to offset the impact of tariffs on their economies.

2. Business activities are off to a rough start in the US. Business investments, consumer spending, and homebuilding were notably weak in January and February as Trump's policies raised concerns about the broader economy. Most economists do not see an imminent US recession risk. ISM manufacturing (also known as Purchasing Manager's Index (PMI)) remains in modest expansion with a retreat of new orders and higher input costs. Consumer confidence has waned recently with rising inflation expectations over the impact of tariff increases. The labor market is cooling gradually as the unemployment rate increased slightly to 4.1% in February. Elon Musk's efforts at DOGE to slim down the federal bureaucracy also add to unemployment risk.

Figure 1: Unemployment rate, seasonally adjusted, February 2023 – February 2025



Source: Bureau of Labor Statistics News Release, February 2025

3. The historic change in German fiscal policy and the European Union (EU) proposal of a ReArm Europe Plan are game changer. It raises the prospects for higher potential growth in the region. The likely new German government coalition has called for reform of the current debt brake to exempt defense spending above 1% of GDP (Gross Domestic Product) from the fiscal rule, creation of an off-budget infrastructure fund of €500 billion over 10 years, and loosening of the debt brake for Germany's federal states to allow for deficits of 0.35% of GDP. The seismic shift in Germany's fiscal policy should boost the struggling economy. This policy change has also prompted the EU to look at plans to activate a mechanism allowing EU members to use their national budgets to spend an additional €650 billion on defense over 4 years without hitting budgetary constraints.

4. In China, consumption and industrial production grew faster at the start of the year, which can be attributed to front-loading of shipments and government subsidies, which boosted consumer spending and investment. Policymakers are planning a record budget deficit and setting a target of 5% real GDP growth in 2025. It will adopt a proactive fiscal policy and speed up the implementation of pro-growth measures. Government expenditure will help encourage consumption and fund infrastructure projects to drive domestic demand, as exports may face higher US tariffs from the incoming US administration. The emergence of DeepSeek as a credible global competitor to US-based Artificial Intelligence leaders suggests a faster adoption rate and a more significant economic upside for China with increased productivity.

5. Inflation remains sticky and is expected to settle in the 2% to 3% range for most major economies. However, growth scares from escalating trade wars have increased the probability of more rate cuts than less. The European Central Bank (ECB) cut interest rates by 25 basis points again in February, bringing the deposit rate to 2.5%. The economic risks from possible US tariffs suggest that the ECB could further lower its deposit rate to 2.0% by summer this year. Bucking the trend, the Bank of Japan (BoJ) raised its overnight call rates by 25 basis points to 0.5% in January. BoJ governor has hinted at higher terminal interest rates given the stronger wages and higher household spending data.

INVESTMENT OUTLOOK

6. Valuations of global equities are more attractive after the recent pullback. While the “Trump put” has been called into question, the “Federal Reserve put” remains intact. President Trump is expected to remain firm on his economic policies, and market views are dispersed as to how he may carry through on his threat to impose sweeping reciprocal tariffs. The ensuing volatility will likely be negative for equity markets in the near term, while the impact on fixed income is less clear. While the inflationary impact of tariffs may be dismissed as transitory, a potential growth slowdown could see yields declining further. Despite increased uncertainty around the economic outlook, the Federal Reserve's dot plot showed that officials still see two more rate cuts this year, suggesting a bias to cut interest rates on growth concerns.

7. Regionally, we prefer Asia equities to US and European equities. A weakening dollar is expected to be positive for Asian equities. In addition, the Artificial Intelligence capital expenditure cycle is still at its nascent stage of development in Asia, suggesting that it could be a significant growth driver, especially for China. China's policymakers appear prepared to unleash stimulus to mitigate the impact of tariffs, and thus, the economy may be better positioned to weather the headwinds from external uncertainty. The US may continue to underperform in the near term as President Trump proceeds to enact his agenda.

8. Nevertheless, valuations have come off, creating opportunities to add on weakness for select US technology stocks. The rally in European equities could take a breather after pricing in the positive news of additional fiscal spending. In contrast, the risk of additional tariffs by the US and retaliation from Europe remains.

9. Back home in Singapore, Prime Minister Lawrence Wong delivered a comprehensive and market-friendly Budget Statement on 18 February 2025. The Budget included various support measures for households and businesses, including vouchers, worker skills upgrading initiatives, and tax rebates. Market-friendly programs such as a S$5 billion equity market development fund were also announced. We are positive on Singapore equities because of the abovementioned positive developments, undemanding valuations, and attractive dividend yields.

10. We are also positive on Korea equities as per previous newsletters. Korea's defense industry would benefit from increasing defense spending globally. Europe will likely see the sharpest growth in defense budgets even after a potential ceasefire between Russia and Ukraine.

11. In recent months, we have turned more positive on India equities after healthy corrections. Reasons to be positive includes improving key leading data such as government orders, power consumption, freight volumes and the RBI (Reserve Bank of India) clearly moving to an easing cycle. Lower global interest rates and potentially a weaker dollar could also be supportive of the India equities market.

12. The Japan equities market is subjected to the same policy risks from the incoming US administration, and it remains to be seen if the current political leaders could strike a similar rapport with the incoming Trump administration. However, Japan equities are still supported by structural growth themes such as factory automation, digitalisation, and the continuing inbound consumption trend. Corporate restructuring driving better shareholders' returns is also a positive domestic catalyst for the Japan equities market.

13. We see greater volatility for ASEAN equities, which may be affected by potential tariffs on trade, the evolution of the AI (Artificial Intelligence) complex, the US Fed's interest rates direction, and geopolitics. However, ASEAN's economic growth could be resilient from increased fiscal policies, spillover from China's stimulus and diversification of the global supply chain. We are positive on beneficiaries, particularly in the Consumer, Technology, Utilities, and Industrials sectors.

14. Given tariff uncertainties and a China economic slowdown, we are slightly cautious on the Asia credit market for 2025. While strong technical factors and attractive yields provide some support, the tight credit spreads in investment-grade credit offer limited compensation for the risks. As a result, a defensive positioning is preferred, focusing on the front end of Investment Grade (IG) credit and defensive sectors.

15. The credit spread component of credit bonds are trading near historical tight levels which is considered in unattractive zone. A decompression of credit spreads in reaction to a fall in interest rates is possible. Nonetheless, bond markets are currently driven more by the focus on all-in bond yield, which is considered attractive by historical standards. In the expected soft-landing scenario, we expect company fundamentals and credit trends to remain supported. In the near term, credit spreads are expected to move sideways to wider, though modestly so, riding on support from supply technicals. The trajectory for central bank policy rates easing has ratcheted down globally. What is uncertain for the Fed is the frequency and magnitude beyond the initial insurance rate cuts in 2024. The risk for longer-dated bonds would be a resurgence of inflationary pressures in the US, partially resulting from tariffs.

*All data are sourced from Lion Global Investors and Bloomberg as at 1 April 2025 unless otherwise stated.

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