Manulife Investment Management

Asset allocation views: balance of risks tilt to the downside

Reflecting back on the first quarter of 2024, there is no shortage of noteworthy developments and significant cross-currents. Our favorite asset class equities continue to shine, building on the robust action that we saw in the fourth quarter. This was supported by the surprising strength of the American consumer enjoying a robust job market, as well as global economies that largely avoided significant downturns. So at this stage world economies are not in sync to the extent that they typically are, and this is where we encounter our first cross-current. The U.S. remains resilient, while the UK and Japan have either flirted with recession or have actually registered two consecutive quarters of negative growth. Other G7 nations seem to be following that same trend.

Meanwhile, opportunities seem to abound in Asia, but they follow very different themes. South Korea and Japan provide access to manufacturing strength, while India's strong domestic activity is a highlight. Looking to bond markets, they were increasingly preoccupied with the stickiness of inflation. In the case of the U.S., we started 2024 discounting six cuts in the Fed funds rate starting mid-year. That has now been moved from six down to a tenuous one, and there is currently debate as to whether the Fed may very well be on hold for the rest of the year. The result is increased fixed-income volatility and higher rates across the curve.

Now to be clear, we do believe that the global hiking cycle has concluded, but this is where we encounter our second cross-current. While the Fed timeline is uncertain, the market remains convinced that the ECB and the Bank of Canada will need to move ahead of the Fed. Indeed, we've already seen that Switzerland, Mexico and Brazil have already started to ease, and this brings us to the emergence of our third cross-current. Despite a backdrop of higher rates and a stronger U.S. dollar, gold came alive in early February. It broke long-standing resistance and surged to new highs. An 8+ percent advance was attributed to higher geopolitical risk and persistent buying on the part of central banks, and this proved to be an interesting diversifier for select portfolios. So there's no shortage of opportunities to deploy capital across the globe, but this does not imply that we are not aware of risks.

Despite preferring equities to fixed income, the "higher for longer" narrative poses challenges, particularly for asset classes that would benefit from a friendly Fed. U.S. small cap would be a case in point. It's an attractive asset class that would benefit from an easing cycle, but for now, we must bide our time before witnessing the broadening out in markets. Similarly, higher valuations in the U.S. add an element of risk around earnings, and we've certainly seen some significant single-name volatility in the aftermath of hits and misses. There's plenty more insight and information on the website, so I hope you'll enjoy them.

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