



Overview

A Late-Cycle Balancing Act

Recent activity data is consistent with our base case for a ‘muddle-through’ scenario of trend growth and ‘sticky’ inflation. However, ex-US activity has been stronger than anticipated since our last quarterly update. Overall, the backdrop is consistent with some profit growth and lower interest rates. Still, various leading indicators argue against complacency. Valuations remain elevated for the All Country World Index (ACWI), while the US unemployment rate is rising – a historically ominous signal. Our country allocation consists of a balance between cyclical and defensive beta. This quarter we added to our EM overweight and reduced the UK allocation to underweight.

The ACWI came under pressure in April but is still 24% higher than its October 2023 low. Global equities remain supported by profits, with a concentration of large-cap firms driving this trend. ACWI earnings growth expectations for this year are still a solid 11%. Our cyclical indicators do not signal an imminent directional change to earnings, while the global composite PMI rose 0.6 points over the past three months to 52.4 in April. Interestingly, ex-US surveys are pushing the global composite index higher, while US surveys have started to fall. This trend partly explains why the ACWI ex-US slightly outperformed the MSCI USA Index over the past three months. Overall, earnings trends support global equities, but we may be witnessing some early signs of a rotation away from the US.

While global profit growth remains positive, our scenario analysis justifies some caution against an aggressive pro-cyclical view. ACWI earnings multiples have expanded, bringing the forward P/E for ACWI above historical averages, at around 18x. Rates volatility is one pressure point that could derail stocks if rates reprice higher again. ‘Sticky’ inflation has slowed the projected pace and timing of US rate cuts, but our bias remains towards moderating service inflation and rate cuts (rather than hikes) this year. Still, the slower pace of easing leaves the economy and equities vulnerable if the US unemployment rate continues to rise, which has historically been followed by a recession.

Market Strategy: Our base case this year is a ‘muddle-through’ or ‘no-landing’ scenario where global growth remains closer to trend and inflation is elevated but not rising. The recent uptick in activity adds to further evidence of our base case at the expense of a ‘soft-landing’ scenario (requiring lower inflation) and an imminent recession (requiring weaker growth). Our forward-looking indicators do not anticipate a sharp acceleration in growth or inflation at this current juncture. Overall, our asset allocation favours a balance between cyclical and defensive beta. However, we prefer positions that benefit from a decline in global rates as we assume

the US 10-year yield will not rise to a new peak above its 5% level in October 2023. Since the last Quarterly Outlook, we made the following changes to our country allocation:

- Increase the *overweight* allocation to **EM**. We have favoured exposure to EM given the significant index weighting to advanced semiconductors and high-bandwidth memory (HBM). Both are vital inputs for Artificial Intelligence (AI) computing and offer investors a strategic growth opportunity. In addition, attractive valuations and policy support have started to feed into better China performance. Given the improvement in EM sentiment, we favour adding to our existing EM overweight.
- Downgrade the **UK** to *underweight*. UK stock performance has improved in recent months. However, the underlying drivers are unlikely to support further medium-term outperformance. UK earnings growth has historically lagged DM peers, which correlates closely with stock underperformance. We do not forecast a period of sustained earnings strength for the UK. Valuations remain cheap relative to the ACWI, but this discount has shrunk following recent UK strength, providing an opportunity to downgrade.
- The **Eurozone** remains *underweight*, but we are reducing the size of our position. Europe’s manufacturing base remains weak, with German business surveys still implying a recession. However, some improvement in Eurozone services has lifted the overall composite PMI. We do not anticipate further growth expansion. Still, we are diversifying our underweights to the UK and Australia, given some risk that Eurozone equities could rally due to recent improvements and potential ECB rate cuts.

Global Equity Allocation Breakdown

	Chg	-2	-1	0	+1	+2
US	-					
Canada	-					
Eurozone	-					
Switzerland	-					
UK	↓					
Japan	-					
Australia	-					
EM	↑					

International Equity Allocation Breakdown

	Chg	-2	-1	0	+1	+2
Canada	-					
Eurozone	-					
Switzerland	-					
UK	↓					
Japan	-					
Australia	-					
EM	↑					

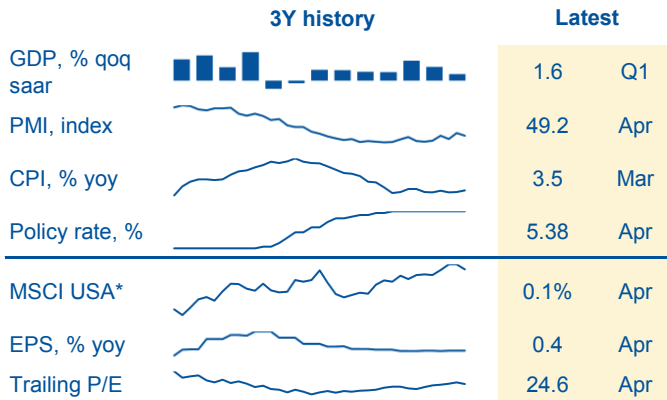
Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarter. A dash indicates no change. Source: CLIM

*This publication reflects asset performance up to 30 April, 2024, and macro events and data releases up to 8 May, 2024, unless indicated otherwise.

United States

NW (Global Index)

Earnings are expected to grow, though valuations remain high.



*US\$ total return relative to MSCI ACWI. Latest is three-month return.

Source: Bloomberg

The US equity market has seen a correction in recent weeks, falling by over 5% at one point during April before strengthening later in the month. Despite this, MSCI USA still rose 4.1% over the three-month period, leaving the index richly valued. MSCI USA is trading at a forward P/E ratio over 20x, significantly above its five-year average and ahead of its peers.

Earnings continue to grow – an 11% rise is expected in 2024 – helped by the hugely profitable Megacap technology firms. The market leadership remains narrow, and current market concentration levels do not historically bode well for long-term returns. However, the US stock valuations are not as stretched as the Nifty 50 era (1970s), Japanese bubble (1980s), or US tech bubble (2000s). Also, some measures of profitability and balance sheet strength indicate that the current US leaders (e.g., Mag-7) are more dominant than US leaders in the early 2000s.

US growth forecast revisions have been revised higher despite recent PMI data surprising to the downside. Excess savings accumulated by households during the pandemic are often cited as one factor for the continued strength of the US economy, but these now seem close to being exhausted. The labour market remains tight, but there are some signs of loosening, which will weigh on consumption.

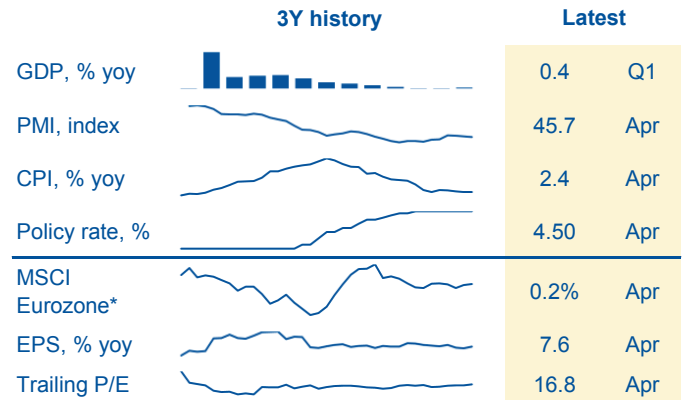
Furthermore, inflation is not returning to target as smoothly as hoped, with headline CPI climbing 30bp to 3.5% yoy in the latest data. Expectations for Fed rate cuts this year have been markedly scaled back, with only one cut priced in for before the end of the year now.

Market Strategy: We remain *neutral* on the US. Although it has been the stand-out market of recent years, valuations are unappealing.

Eurozone

UW (Global and Global ex-US index)

European economic data has improved in recent months.



*US\$ total return relative to MSCI ACWI. Latest is three-month return.

Source: Bloomberg

The European economy has improved since the beginning of the year, with the composite PMI reaching 51.4 in the April data. The manufacturing data remains weak though, with the PMI having remained below 50 since the summer of 2022. Q1 GDP data also saw a return to growth, as the data came in stronger than expected. The expected path for the ECB has detached from that of the Fed, with cuts expected earlier in the Eurozone, thanks to their inflation falling faster towards target.

Historically, Europe has been more pro-cyclical, benefiting from higher global growth and rates. Therefore, although European manufacturing remains relatively weak, signs of a global improvement should support the European market. If Chinese consumption strengthens, this tends to increase demand for European luxury goods, although it should impact Emerging Market stocks more directly. Earnings for the Eurozone are expected to grow 5.9% in 2024.

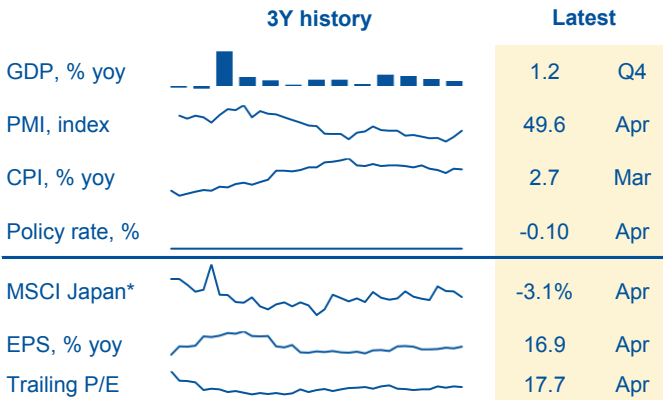
European equities returned 4.2% in the three months to end-April. MSCI EMU is trading at a forward P/E ratio of 13x, below its five-year average, and at a greater discount to ACWI than normal. Europe remains exposed to flare ups in both the Middle East and the Russia/Ukraine war, as well as being vulnerable should the US (under a second Trump term) introduce tariffs with the aim of reducing the trade deficit.

Market Strategy: We stay *underweight* the Eurozone, though less than before. The economy has shown signs of improvement but is not strong. Valuations are cheap, but the discount has narrowed.

Japan

NW (Global and Global ex-US index)

Japanese corporate reforms offer longer-term value.



*US\$ total return relative to MSCI ACWI. Latest is three-month return.

Source: Bloomberg

After a strong performance at the start of the year due to a weaker yen, the rally in MSCI Japan lost steam in April. Earnings are expected to grow 11% during the year. However, volatility in the yen has become an issue in recent weeks, with the currency reaching a multi-decade low against the dollar. The yen's weakness has benefited Japanese exporters, but recent interventions by the central bank suggest that there may be a limit to the amount of depreciation that they will allow.

The Bank of Japan is an outlier among its peers as it gradually increases rates and tightens policy. Japan's efforts to boost inflation are contrary to the rest of the world, but there are some signs that it is working. Inflation was 2.7% yoy in March. Further rate hikes may support the yen, but global rates ex-Japan will likely remain the primary driver of Yen FX rates. In particular, a decline in US rates would likely weigh on USD/JPY, given its historically close linkage to interest rate differentials.

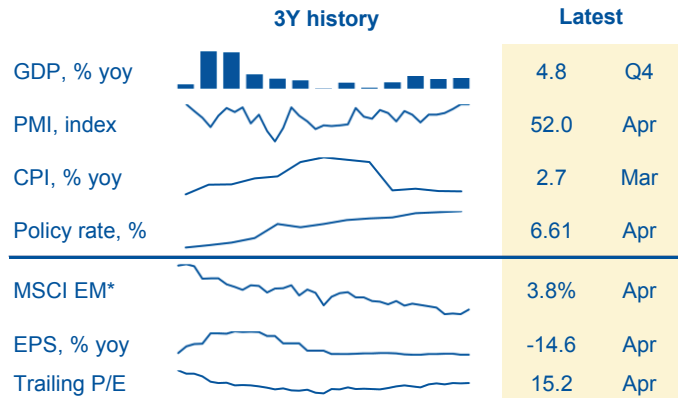
Most valuation measures are slightly above recent averages, with the forward P/E ratio at 16x, but they remain below a longer-term average, including the 1990s. The ongoing corporate governance reforms seek to improve efficiency, and if they continue to be successful, then a higher multiple may be justified. There are promising signs, with the number of companies that have published their initiatives rising, and the market rewarding those that have done so.

Market Strategy: We maintain a *neutral* allocation to Japan. Corporate reforms are a potential longer-term tailwind, and improving global growth would also support Japanese exporters. However, the undervalued yen is a risk for future local market returns should it start to strengthen rapidly.

Emerging Markets

OW (Global and Global ex-US index) ↑

The market is well-positioned to meet growing semiconductor demand.



*US\$ total return relative to MSCI ACWI. Latest is three-month return. Economic indicators are GDP-weighted with the exception of PMI, which is value-added-weighted.

Source: Bloomberg

Emerging Markets (EM) offer exposure to advanced manufacturing and AI-related technologies at more appealing valuations than their DM counterparts. Taiwan and Korea are integral to manufacturing cutting-edge semiconductors and high bandwidth memory (HBM) and are well-positioned to benefit from a rebound in the semiconductor cycle.

The dollar is richly priced on some standard valuation measures such as PPP. While FX valuations are not typically a reliable short-term predictor of FX moves, they do signal that the risks are more asymmetrically to the downside for the USD over the long run. Should the dollar weaken, history suggests that EM equities and currencies will be significant beneficiaries.

China was a drag on EM performance last year, and there are still areas of weakness, such as the property market and ongoing geopolitical risks. In recent months, sentiment has improved, likely reflecting the growing index value and more direct policy support for the domestic stock market. The MSCI EM Index outperformed in the past three months, returning 7.8%. Relative to other markets, expected earnings for EM are strong (+20% in 2024). Despite solid earnings expectations, the current 12m forward P/E ratio for the MSCI EM Index is only 12x, below its five-year average. The combination of robust earnings growth and attractive value suggests that the market may be due for a re-rating.

Market Strategy: We remain *overweight* EM as there are several factors that provide a tailwind for EM, namely the exposure to the growing semiconductor demand.

United Kingdom

UW (Global and Global ex-US index) ↓

Weak earnings growth will limit further outperformance.

The UK remains cheaply valued, with a forward P/E ratio of 12x, but the discount to ACWI has narrowed in recent months due to stronger UK equity performance. The rise in energy prices has helped the commodity-heavy UK index, while higher global rates have historically favoured the more value-oriented UK large-cap stocks. Should global rates peak, as we expect, this trend will not support UK stocks.

UK earnings growth expectations (3.0% in 2024) are trending down and are closely correlated with UK stock market underperformance historically. We do not anticipate a meaningful upgrade to UK earnings over the medium term. Risks to the oil price are expected to be reasonably balanced given Saudi excess capacity. GBP weakness has helped cushion UK earnings, which are predominantly generated overseas, but an expensive USD will likely limit further GBP/USD weakness.

Market Strategy: We downgrade the UK to *underweight*. Recent strength is unlikely to be sustained without a meaningful upgrade to future earnings growth. We prefer to add to strategic opportunities in places such as EM, and we maintain some Energy exposure via Canada.

Australia

UW (Global and Global ex-US index)

Earnings expectations are poor and the P/E multiple relatively high.

The MSCI Australia Index is richly valued compared to its peers without material upward revisions to earnings. Earnings are forecast to grow just 0.3% during 2024, and the market is trading at a 16x forward P/E ratio. The market has significant exposure to iron ore, which has performed poorly this year and looks likely to remain one of the weaker commodities without a recovery in China's property sector.

Australia is typically a beneficiary of positive sentiment towards China. However, Chinese economic growth and demand for Australia's primary exports (i.e., industrial commodities) have historically propelled the Australian commodity and financial sectors. At the moment, China's economic growth is expected to remain steady at "around 5%" and shrink over time, while the Chinese equity market is benefitting from factors that are less directly tied to the traditional economic engines (e.g., compelling valuations and direct policy support for domestic equities). Given this dynamic, EM should benefit more directly.

Market Strategy: We remain *underweight* Australia. The market is at risk for de-rating when its elevated P/E multiple is compared to its low earnings growth expectations. Mining stocks are also vulnerable to weakness in iron ore prices.

Canada

OW (Global and Global ex-US index)

Canada offers oil exposure and a well-capitalised financial sector.

Oil prices are likely to be stable due to OPEC spare capacity, however geopolitical risks emanating from the Middle East and Russia suggests some upside risks. Canadian equities are exposed to the Energy sector and offer some protection against this tail risk.

Financials also have a high weight in the Canadian index, and the sector continues to screen cheap. Although higher interest rates tend to bolster net interest margins, falling rates may reduce the default risk for household mortgages that the banks are exposed to. The Bank of Canada is expected to begin its rate-cutting cycle this year, which should help reduce some of this risk.

Canadian equities are trading in line with their five-year average discount to ACWI, at a 12-month forward P/E ratio of 14x. Earnings growth is expected to be 4.8% in 2024, which appears consistent with its discount to ACWI. Upwards revisions would likely result from energy price strength or improvement in the domestic bank profitability.

Market Strategy: We keep our *overweight* to Canadian equities. The tail risk of an oil price shock makes the market attractive. Household leverage remains a risk for the banking sector, but the financial stocks are already trading at depressed multiples and Canadian banks are relatively well capitalised.

Switzerland

NW (Global and Global ex-US index)

The Swiss franc has come under pressure, but equity valuations are approaching attractive levels.

Swiss equities performed poorly in the past three months, falling 5.6%. To a large degree this was because the franc weakened significantly during the period, partly weighed down by a surprise rate cut by the SNB in March. Similar to Japan, an eventual decline in global and US rates would tend to favour lower yielding currencies such as CHF.

Earnings growth expectations for the year are strong at 12%. The MSCI Switzerland Index has a large weighting to defensive sectors such as Consumer Staples and Healthcare, which have not benefited from the recent upturn in global activity. The recent poor performance has cheapened valuations to more compelling levels.

Market Strategy: We remain *neutral* Switzerland. CHF depreciation and underperformance of Switzerland's two largest sectors (Consumer Staples and Healthcare) hurt the equity market in USD terms. If global growth weakens later this year, Switzerland is an attractive upgrade candidate.

The information contained herein is obtained from sources believed by CLIM to be accurate and reliable. No responsibility can be accepted under any circumstances for errors of fact or omission. Any forward looking statements or forecasts are based on assumptions and actual results may vary from any such statements or forecasts.

GLOBAL EQUITY - KEY ECONOMIC AND FINANCIAL INDICATORS

Developed Market	Macroeconomic Data										Market Performance				Forecast†					
	% change on year ago					Latest 12 months					Foreign Reserves 2024 Latest	Foreign Reserves 2023 Year Ago	Currency vs \$ 2024 Latest	Short-Term Interest Rates %	Sovereign Rating S&P	% MSCI ACWI Net***	Stock Market Index (MSCI ACWI Net) Apr. 30, 2024	Change since 12/31/23 US\$	Change since 12/31/23 Local	3 month Currency vs \$ +/-
	Annual GDP Growth %	Quarterly GDP Growth %	Industrial Production Growth %	Consumer Price Index %	Budget Balance % of GDP 2024F**	Trade Balance \$ Bns	Current Account Balance \$ Bns	Foreign Reserves 2024 Latest	Foreign Reserves 2023 Year Ago	Currency vs \$ 2024 Latest										
EM****	4.8	n.a.	1.7	7.9	-4.3	723.2	484.1	7787.35	7605.91	1725.95	1696.06	6.61	n.a.	10.36	549.92	2.83	5.96	12.7	n.a.	
CANADA	0.8	1.0	0.6	2.9	-1.3	-3.7	-13.3	93.63	86.30	1.37	1.34	4.85	AAA	2.75	7832.88	0.43	4.64	14.6	+	
DENMARK	3.5	10.8	2.9	0.9	1.9	9.0	43.3	96.87	89.06	6.94	6.75	3.60	AAA	0.88	69899.67	14.51	18.36	31.5	-	
HONG KONG	2.7	9.5	4.1	2.0	-1.7	-55.7	115.5	425.02	429.00	7.82	7.85	4.49	AA+	0.46	52441.48	-7.09	-6.94	12.6	+	
ISRAEL	-4.1	-21.1	-26.8	2.7	-5.9	-29.1	66.2	209.29	195.95	3.71	3.63	4.45	A+	0.17	155.00	4.02	6.06	11.1	+	
JAPAN	1.2	0.4	-6.7	2.7	-4.1	-40.7	168.7	1163.52	1134.01	155.38	134.71	0.03	A+	5.43	8404.39	5.61	17.89	16.7	+	
NEW ZEALAND	-0.3	-0.4	-6.9	4.0	-2.5	-6.0	-17.1	12.89	11.36	0.60	0.64	5.35	AA+	0.05	584.48	-3.35	3.41	38.2	-	
NORWAY	1.0	0.8	5.7	3.9	14.4	71.4	87.0	73.68	70.30	10.93	10.48	4.71	AAA	0.14	9513.38	-6.72	1.72	9.8	+	
SINGAPORE	2.7	4.8	-9.2	2.7	0.1	187.5	99.2	343.13	281.31	1.36	1.32	3.95	AAA	0.33	1195.50	4.12	7.28	12.3	+	
SWEDEN	-0.2	-0.4	-2.4	4.1	-0.6	4.9	40.6	41.63	44.45	10.90	10.14	3.85	AAA	0.72	31812.02	-1.30	7.50	16.9	+	
SWITZERLAND	0.6	1.2	-0.4	1.4	0.3	53.2	68.4	793.17	813.08	0.91	0.89	-0.75	AAA	2.15	17039.28	-5.89	2.56	18.0	-	
UNITED STATES	3.0	1.6	0.0	3.5	-6.0	-786.3	-818.8	35.99	37.57	1.00	1.00	5.46	AA+	63.32	14260.03	5.72	5.72	21.0	uc	
AUSTRALIA	1.5	0.8	0.5	3.6	-0.5	69.6	21.5	34.21	36.38	0.66	0.68	3.50	AAA	1.69	5287.92	-3.00	1.94	16.7	+	
EUROZONE	0.4	1.2	-6.4	2.4	-3.0	-1.0	1.5	300.33	302.57	1.08	1.10	0.74	n.a.	8.02	450.44	4.67	8.12	13.6	-	
UK	-0.2	-1.2	1.4	3.2	-3.6	-38.9	-111.0	100.11	107.72	1.25	1.26	5.20	AA	3.59	8307.91	5.05	6.95	11.9	+	

Note: All data shown are as at May 7, 2024 unless otherwise stated. S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate. ** Bloomberg consensus forecast. *** MSCI All Country World ex USA Index Daily Total Return Net. **** IP data from CPB; Currency level from MSCI EM Currency Index; GDP, CPI, budget and interest rate data from Bloomberg. † Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results. Source: Bloomberg, CLIM



CITY OF LONDON
Investment Management Company Limited

Contacts

Macroeconomic Analysis

Justin Kariya, London Office
Phone: 011 44 207 711 1558
E-Mail: justin.kariya@citlon.co.uk

Tom Traill, London Office
Phone: 011 44 207 860 8316
E-Mail: tom.traill@citlon.co.uk

Yasemin Engin, London Office
Phone: 011 44 207 711 1551
E-Mail: yasemin.engin@citlon.co.uk

London Office

77 Gracechurch Street
London EC3V 0AS
United Kingdom
Phone: 011 44 20 7711 0771
Fax: 011 44 20 7711 0774
E-Mail: info@citlon.co.uk

Philadelphia Office

17 East Market Street
West Chester, PA 19382
United States
Phone: 610 380 2110
Fax: 610 380 2116
E-Mail: info@citlon.com

Singapore Office

20 Collyer Quay
10-04
Singapore 049319
Phone: 011 65 6236 9136
Fax: 011 65 6532 3997

Website

www.citlon.com
www.citlon.co.uk

Disclosures

City of London Investment Management Company Limited (CLIM) is authorised and regulated by the Financial Conduct Authority (FCA) and registered as an Investment Advisor with the Securities and Exchange Commission (SEC). CLIM (registered in England and Wales No. 2851236) is a wholly owned subsidiary of City of London Investment Group plc. (CLIG) (registered in England and Wales No. 2685257). Both CLIM and CLIG have their registered office at 77 Gracechurch Street, London, EC3V 0AS, United Kingdom.

While CLIM has used reasonable care to obtain information from reliable sources, no representations or warranties are made as to the accuracy, reliability or completeness of third party information presented herein. No responsibility can be accepted under any circumstances for errors of fact or omission. Some of the information in this document may contain projections or other forward looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions as of the date of this document which could change without notice and actual events or results may differ.

This document does not constitute an offer to sell or the solicitation of an offer to buy any securities. Nothing herein should be construed as investment advice to buy or sell any securities. Past performance is not a guide to future results. The value of an investment and any income from it can go down as well as up and investors may not get back the original amount invested.

The MSCI ACWI Index is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 24 emerging markets.

The Bloomberg Terminal service and data products are owned and distributed by Bloomberg Finance L.P. ("BFLP"). BFLP believes the information herein came from reliable sources, but does not guarantee its accuracy. No information or opinions herein constitutes a solicitation of the purchase or sale of securities or commodities.