



Overview

Waning Support for Global Equities Versus Bonds

- Global data remains buoyant on the surface, but the headline numbers are masking deceleration in US activity.
- The macro backdrop has led to some rotation away from US equities while global equities outperform bonds.
- Our asset allocation favours an overweight to Rates and Commodities versus an underweight to Credit, while Equities remain neutral.
- This quarter, we adjust our intra-equity exposure, moving UK equities to underweight, and reducing the size of our Eurozone underweight.

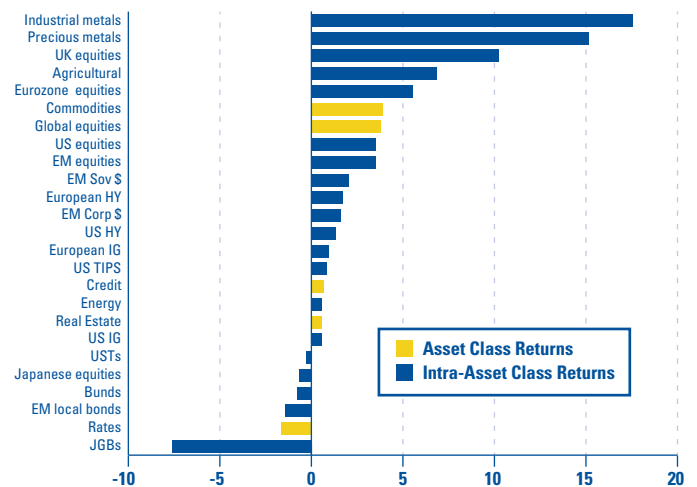
Global markets maintained some pro-cyclical flavour over recent months, with global equities outperforming fixed income. However, the March-May period (Chart 1) revealed some interesting rotations starting to occur. Commodities were the best-performing asset class, overtaking equities. Within commodities, industrial and precious metals led, while energy was a laggard despite ongoing geopolitical risks. Within equities, the US marginally underperformed the global aggregate (ACWI), while Europe and China (the largest weight in EM) outperformed.

The asset rotation reflects some shift in underlying macro fundamentals. The global composite PMI was above trend at 52.4 in May, supporting stocks. However, ex-US data has become a more significant contributor to the recent improvement, supporting international equities. The US economy remains resilient following a Fed tightening cycle last year, but there are growing signs that US strength is moderating. The Atlanta Fed’s GDPNow model estimate dropped sharply to 1.8% annualised growth this quarter, and the Citi US economic surprise index fell into negative territory. In addition, the US unemployment rate has been trending higher, which may trigger the now famous “Sahm rule” recession indicator later this year. Further softening in US data will likely limit the global manufacturing expansion, given that the US consumer is one of the primary sources of final demand.

The mixed macro backdrop suggests investors should limit their pro-cyclical exposure due to unattractive global equity and high-yield (HY) credit valuation measures. The ACWI 12-month forward P/E is still elevated at 18x, while global credit spreads have narrowed close to previous cyclical extremes. In addition, the equity earnings yield has tightened further relative to bond yields, close to its early-2000 low (see Chart 2). We favour gradually increasing government bond exposure with the US 10y Treasury yield above 4%, and the yield is likely to move lower once the Fed begins cutting rates. Our equity allocation remains neutral. Cyclical indicators support short-term equity strength; however, our bias is towards reducing equities exposure relative to bonds later this year as global macro momentum weakens.

We continue to favour some commodity exposure via industrial metals. Industrial metals are historically cyclical and have benefitted from Europe and China’s recent activity improvement. Some of this demand will likely fade if the US economy slows. However, industrial metals offer long-term value and exposure to the renewable energy transition and growing energy needs linked to Artificial Intelligence (AI). Both themes will remain relevant to our strategic allocation over the coming years.

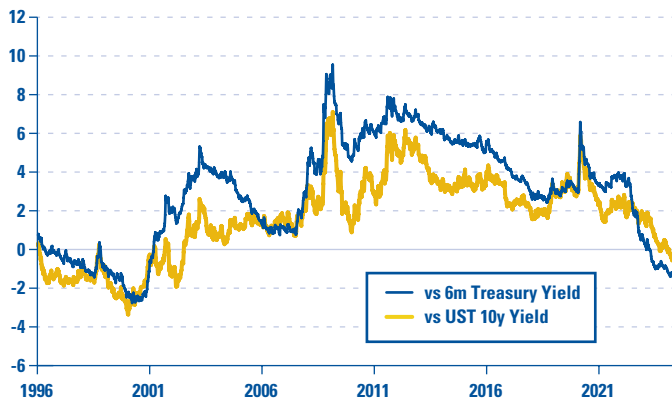
Chart 1: Asset Returns, Mar-May, %



Source: Bloomberg

*The publication reflects asset performance up to May 31, 2024, and macro events and data releases up to June 5, 2024, unless indicated otherwise.

Chart 2: S&P500 Earnings Yield Spread, % pts



Source: Bloomberg

Asset Allocation

	Chg	-3	-2	-1	0	+1	+2	+3
EQUITIES	-							
RATES	-							
CREDIT	-							
REAL ESTATE	-							
COMMODITIES	-							

	Chg	-3	-2	-1	0	+1	+2	+3
US equities	-							
Eurozone equities	↑							
UK equities	↓							
Japan equities	-							
EM equities	-							
USTs	-							
TIPS	-							
Bunds	-							
JGBs	-							
EM local bonds	-							
US IG credit	-							
US HY credit	-							
European IG credit	-							
European HY credit	-							
EM Sov \$ credit	-							
EM Corp \$ credit	-							
Energy	-							
Industrial metals	-							
Precious metals	-							
Agricultural	-							

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

Source: CLIM

Market Strategy

The data remains supportive for equity exposure, but we are staying neutral as we expect limited upside for equities at current levels. In addition, if US data continues to soften, our macro momentum indicator will likely shift to a negative equity versus bonds stance later this year. We make minor modifications to our allocations this quarter:

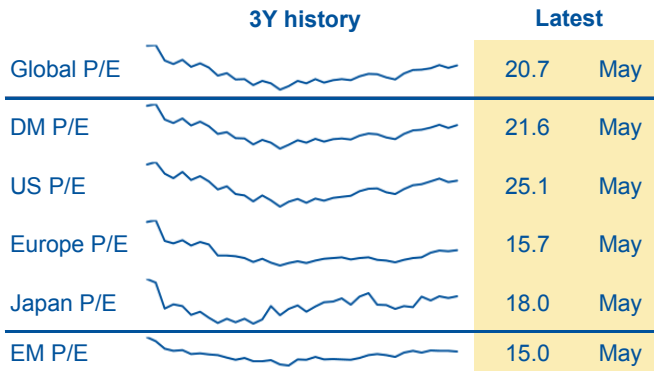
- We remain *neutral* on **equities**. Intra-equities, we move underweight UK stocks and reduce the size of our Eurozone UW. The UK has outperformed recently, but we view this strength as an opportunity to reduce exposure as we expect UK earnings growth to lag DM peers in the longer term. In the Eurozone, the manufacturing base remains weak, with German business surveys still implying a contraction. However, some improvement in Eurozone services has lifted the overall composite PMI. We do not anticipate further growth expansion, but we are diversifying our underweights to the UK. EM remains our preferred overweight based on solid earnings expectations driven by the demand for advanced semiconductors and high-band width memory to power AI.
- In **rates**, we stay *overweight*. US inflation-linked bonds is our preferred long position given compelling US real yields, and long-term inflation expectations are moderately priced. JGBs remain underweight as we expect further policy tightening from the BoJ in contrast to other major central banks.
- We remain *underweight* **credit**. This position is primarily the result of our underweight to global HY credit while we are gradually reducing our long IG exposure. IG and HY credit spreads are at unattractive levels and near previous cyclical lows. Global HY spreads are increasingly vulnerable to widening as corporate default rates continue to rise.
- Our **real estate** allocation remains *neutral*. The asset class offers long-term value, but we expect government bonds to provide better returns over the next year.
- We remain *overweight* in **commodities**, continuing to favour industrial metals. We remain neutral in energy and precious metals.

Equities

Neutral

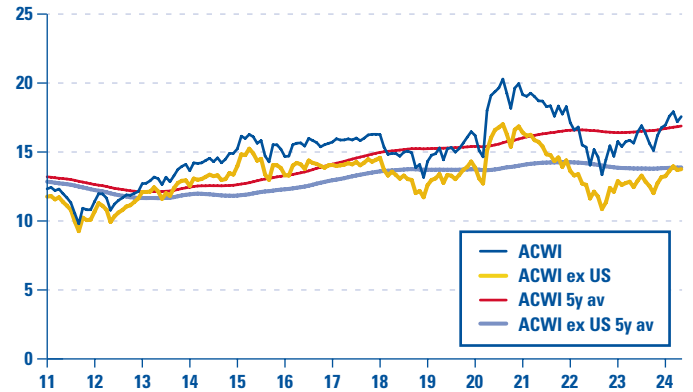
> Global equity valuations are rich, and markets are concentrated in some areas, but EM offers compelling opportunities in the AI and advanced computing space

Global Equity Indicators



Source: Bloomberg, MSCI

Chart 3: Valuations are More Attractive Outside the US, 12m Forward P/E Ratios



Source: Bloomberg

Asset	View	Chg	Commentary
Global equities	0	-	Short-term indicators are supportive for global equities, with PMIs rising into expansionary territory and macro momentum still positive. However, in the medium term, we are more cautious as valuations are elevated, especially relative to bonds, and several previously reliable indicators suggest we are late-cycle. Sentiment and positioning metrics are currently more optimistic, and the market has become more concentrated around a handful of large tech stocks.
US equities	0	-	US earnings continue to grow strongly, but these are dominated by a handful of large tech stocks. The AI-led demand has significantly increased the market concentration, a characteristic that is not historically associated with strong future index returns. US growth remains resilient, though inflation has been 'sticky', and expectations for rate cuts have been reduced accordingly.
Eurozone equities	-1	↑	We remain underweight in the Eurozone, though have reduced the size of our position since the data suggests that the economy is improving (from a low base). European equities are historically cyclical, and therefore vulnerable if the global economy begins to slow in 2H. Europe is also vulnerable to any geopolitical escalation that renews energy price pressures.
UK equities	-1	↓	We reduce our UK position to underweight following recent strength. The UK could benefit from an oil price spike, but the supply backdrop remains strong, limiting the impact of geopolitical risks. Earnings growth is expected to be weak, which typically leads to UK underperformance. There is no clear catalyst for UK outperformance despite relatively cheap valuations.
Japan equities	0	-	In Japan, corporate governance reforms remain supportive and could unlock further value. On a more cautious note, our bias towards global economic weakness and lower US rates is historically a headwind for the MSCI Japan Index. Likewise, the undervalued Yen is a risk for future local market returns, should it strengthen rapidly.
EM equities	+2	-	The MSCI EM Index has attractive earnings prospects that will benefit from growing demand for advanced semiconductors. Also, EMs offer exposure to the tech sector at more compelling valuations than the US. Finally, more meaningful stimulus from policymakers in China may lift depressed sentiment.








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Rates

Overweight

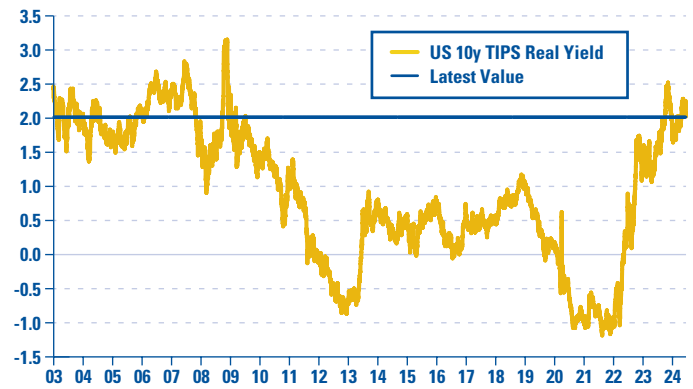
> Government bonds offer relatively attractive yields and tend to rally ahead of policy rate cuts.

Global Rates Indicators

	3Y history	Latest	
Global Govt Yield		3.4	May
UST 10Y Yield		4.5	May
TIPS 10Y Real		2.2	May
Bund 10Y Yield		2.7	May
Italy 10Y Yield		4.0	May
JGB 10Y Yield		1.1	May
EM Local Yield		4.1	May

Source: Bloomberg Barclays Indices, US Federal Reserve. Yield in %.

Chart 4: TIPS Real Yields Are Attractive



Source: FRED, St Louis Federal Reserve

Asset	View	Chg	Commentary
USTs	+1	-	US Treasury yields are attractive above 4%, and policy rate cuts will likely provide price appreciation going into the next recession. Since the late 1970s, when the Fed pauses rate hikes, US yields have consistently fallen over the subsequent year. Disinflation has been frustratingly slow in the services sector, but there is limited evidence of a sharp reacceleration in inflation that would shift the Fed back into tightening mode. Concerns about the US fiscal deficit and the growing interest costs will remain, though this is not exclusive to the US and may not affect UST auctions for some years.
US TIPS	+2	-	US TIPS currently offer an attractive real yield and they are likely to appreciate if the Fed cut rates or if there are clearer signs of a US slowdown. TIPS will underperform US nominal bonds if inflation smoothly returns to target. However, if inflation proves more stubborn or geopolitical tensions push up oil prices, then inflation-linked bonds should outperform. While not our baseline view, the credibility of the Fed's long-run inflation target could be tested under a second Trump presidency, and TIPS should offer some protection from this tail risk.
Bunds	0	-	The ECB is expected to cut rates faster by year-end than their US counterparts, as inflation is closer to target. Yields would typically fall as policy rates are cut, though the Bund-US spread is already tight, suggesting limited value. European economic data has improved since the beginning of the year, making a more aggressive tightening cycle (than current market pricing) less likely.
JGBs	-1	-	Japan is the outlier among developed market central banks as they seek to raise rates and end their ultra-loose monetary policy – an unattractive backdrop for fixed income. In addition to future policy rate hikes, the BoJ will also likely reduce JGB purchases and the size of their balance sheet. The speed of exit will be determined by inflation and wage growth trends.
EM local bonds	0	-	EM central banks were earlier than DM to hike rates and were also quicker to embark on rate cutting cycles last year. These factors have setup a favourable backdrop for EM local bonds. As a result, the EM spread relative to US Treasuries has tightened, leaving limited value to extract at current levels. EMs are also vulnerable to outflows if economic conditions weaken. The long-term trend in the USD is likely weaker given the current rich valuations, which historically support EM local assets, but the path will likely be gradual.

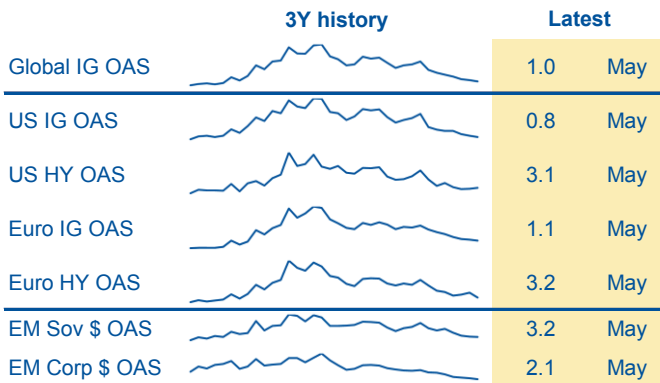
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Credit

Underweight

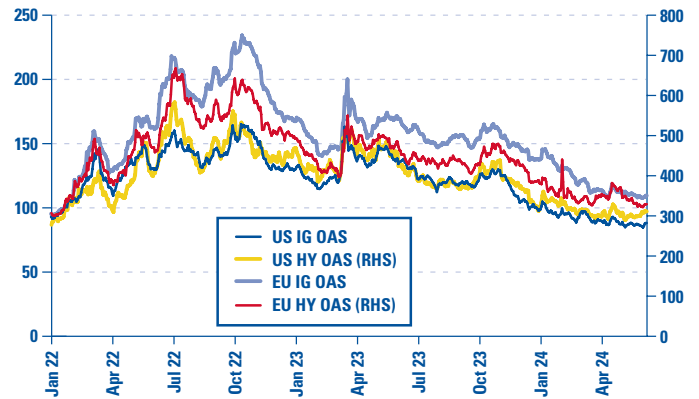
Global credit spreads are unusually tight, leaving lower-quality debt vulnerable should HY defaults continue to rise.

Global Credit Indicators



Source: Bloomberg Barclays Indices. Option-adjusted spreads in %.

Chart 5: US and EU Corporate OAS (bps)



Source: Bloomberg

Asset	View	Chg	Commentary
US IG	+1	-	US corporate spreads have narrowed following resilient US economic growth, disinflation (from elevated levels), low volatility (as proxied by VIX), and relatively low issuance. At current levels, IG offers a limited spread cushion relative to Treasuries, and we are gradually reducing our IG exposure in favour of government bonds. However, we still favour IG relative to HY, given that the higher-duration IG index should benefit from a broader rebound in fixed income assets. Higher-quality corporate debt should perform well in a US slowdown.
US HY	-3	-	HY spreads are close to cyclical lows and are not priced for a rising trend in default rates. If economic conditions deteriorate or companies are forced to refinance at higher rates, default rates should rise further. Current spreads do not offer sufficient cushion for this scenario. However, default rates did moderate in recent months, which may delay the timing of HY underperformance. Historically, a mid-cycle slowdown or a mild recession implies a material widening in HY spreads from current levels.
European IG	+1	-	European IG has benefitted from an improvement in Eurozone data and a shift to policy easing from the ECB. This optimism is reflected in tighter spreads. We expect higher-quality fixed income to outperform if global growth softens in 2H and, therefore, maintain some exposure to EU IG. However, we are gradually reducing our exposure in favour of government debt given less attractive spreads.
European HY	-1	-	EU HY spreads have narrowed suggesting limited value over the medium-term. The economic data has been improving in Europe, albeit from a low base. Despite some economic improvement, EU HY default rates have continued to rise. We see more asymmetric risks for wider spreads.
EM Sov \$ credit	0	-	Spreads remain tight relative to history due to lower market volatility and a presumed end to the Fed's tightening cycle. A more stable US dollar (which directly impacts the cost of EM dollar debt) also has limited stress. We do not view current spread levels as attractive.
EM Corp \$ credit	0	-	The EM Corporate USD yield remains attractive, but spreads are narrow and do not currently offer an appealing entry point. New issuance activity has picked up from 2023, but well below the pre-2022 levels. Default rates are tracking lower in 2024 than 2021-23.

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Real Estate

Neutral

>> *Valuations are stretched compared to Treasuries, and softness in the direct market favours a neutral stance.*

Asset	View	Chg	Commentary
Global Real Estate	0	-	Valuations for global real estate stocks remain unattractive, with the dividend yield spread to US bond yields significantly below historical averages, while the spread to global equities has been stable. The narrowing but wide bid-ask gap in the direct market suggests investor caution and subdued transaction activity. REIT valuations are set to improve once the Fed embarks on its easing cycle.

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Commodities

Overweight

>> *We favour copper due to growing demand linked to electrification, while the US election and geopolitical risks could support gold and oil prices.*

Asset	View	Chg	Commentary
Energy	0	-	The global oil market looks set to shift into a small deficit over the coming months during peak travel season and the extension of OPEC+ supply cuts. However, the flattening of the backwardation structure in the Brent futures market suggests concerns of oversupply. Moreover, non-OPEC+ supply has been robust. The US election in late 2024 could bring geopolitical risks back to the fore, supporting oil prices.
Industrial Metals	+1	-	The recent consolidation in copper prices has further to run as positioning is stretched and demand indicators from China have been weak. Beyond the short-term, we are still positive on copper as the global decarbonisation transition drives prices higher amid a tight market. For aluminium, prices should be supported by copper substitution and constrained supply beyond this year.
Precious Metals	0	-	As a proxy for duration, the eventual easing in monetary policy should support gold prices. Nevertheless, gold screens as rich as central bank buying has propped up prices, weakening the correlation with traditional drivers like the US dollar and real rates. Therefore, we currently prefer fixed income. Closer to the US election, the risk of a widening US fiscal deficit could see our preference switch from bonds to gold.
Agriculture	0	-	The expected transition to the La Niña phase in H2 means that weather risks will be prevalent, but global supply for soybean and wheat does not appear tight.

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KEY ASSET ALLOCATION INDICATORS (All data shown are as at end-May 2024 unless otherwise stated)

	ASSET ALLOCATION						PERFORMANCE						BENCHMARK INDEX & WEIGHTS		
	-3	-2	-1	0	+1	+2	+3	5Y	3Y	1Y	2023	Ytd	End Feb- End May		
EQUITIES															
US								73.7	16.2	23.6	22.2	8.9	3.8	MSCI ACWI	50%
Eurozone								102.6	27.2	27.8	26.5	10.7	3.5	MSCI USA	25%
UK								54.1	9.8	21.0	22.9	9.2	5.6	MSCI EMU	7%
Japan								41.1	21.4	18.9	14.1	8.8	10.3	MSCI UK	3%
EM								43.9	7.5	18.6	20.3	7.0	-0.7	MSCI Japan	5%
RATES								19.0	-17.5	12.4	9.8	3.4	3.5	MSCI EM	10%
USTs								-13.9	-20.8	-1.6	4.2	-4.7	-1.6	Bloomberg Barclays Global Treasury Total Return Index Value Unhedged	27%
US TIPS								-3.3	-9.8	-0.2	4.1	-1.9	-0.3	Bloomberg Barclays US Treasury Total Return Unhedged USD	10%
Bunds								10.9	-4.1	1.6	3.9	-0.1	0.8	Bloomberg Barclays US Treasury Inflation-Linked Bond Index	3%
JGBs								-18.2	-25.1	1.5	9.3	-5.1	-0.8	Bloomberg Barclays Euro Aggregate Treasury Germany TR Index Unhedged USD	3%
EM Local								-37.3	-36.1	-15.8	-5.9	-13.4	-7.6	Bloomberg Barclays Asian-Pacific Japan Treasury TR Index Unhedged USD	5%
CREDIT								1.9	-8.7	3.5	11.3	-3.5	-1.4	Bloomberg Barclays EM Local Currency Liquid Govt TR Index Unhedged USD	6%
US IG								2.3	-10.8	5.4	9.6	-1.2	0.7	Bloomberg Barclays Global Aggregate Credit Total Return Index Value Unhedged USD	13%
US HY								5.0	-7.9	4.4	8.5	-1.1	0.6	Bloomberg Barclays US Corporate Statistics Index	4%
European IG								22.8	5.4	11.2	13.4	1.6	1.3	Bloomberg Barclays US Corporate High Yield Statistics Index	3%
European HY								-5.3	-17.3	7.2	12.0	-1.8	1.0	Bloomberg Barclays EuroAgg Corporate Statistics Index USD	2%
EM Sov \$								12.0	-8.0	12.6	16.1	0.7	1.7	Bloomberg Barclays Pan-European High Yield (Euro) Index Statistics USD	1%
EM Corp \$								1.5	-7.1	10.9	11.0	1.4	2.0	Bloomberg Barclays Emerging Markets Sovereign TR Index Value Unhedged USD	2%
REAL ESTATE								4.0	-9.8	7.7	6.7	2.7	1.6	Bloomberg Barclays Emerging Markets Corporates TR Index Value Unhedged USD	1%
COMMODITIES								-5.3	-15.0	7.0	8.7	-4.0	0.6	FTSE EPRA/NAREIT Global Index Net TRI USD	5%
Energy								53.3	47.1	18.4	-4.3	9.5	3.9	S&P GSCI Total Return Index	5%
Industrial metals								44.4	76.3	25.1	-5.2	10.1	0.6	S&P GSCI Energy Total Return Index	2%
Precious metals								55.6	5.5	19.9	-4.5	14.3	17.6	S&P GSCI Industrial Metals Total Return Index	1%
Agricultural								71.5	19.0	18.7	11.5	13.7	15.2	S&P GSCI Precious Metals Index Total Return Index	1%
								49.8	11.5	0.1	-8.3	3.3	6.9	S&P GSCI Agriculture Index Total Return Index	1%

Source: Bloomberg, CLIM



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