BREAKING BREADTH

Despite solid returns for most asset classes last year, you wouldn't know it by peering into the average investor's mind. The temptation to liquidate risk assets and run into the safety of cash proved too strong for many in 2023, as evidenced by the $USD 1.3 trillion stampede into money market funds. Continued central bank interest rate hikes and solvency issues at a few smaller US banks added to fears of an imminent recession. The outbreak of a new war in the Middle East and a soft real estate market for office space certainly didn't help matters either. All of this to say that the market's collective risk appetite has languished. But is the tide starting to turn?

Bull markets are often described as climbing a wall of worry. An "all clear" signal simply doesn't exist; investors will always find new and innovative things to fret over even in the best of times. With the US Federal Reserve talking down the possibility of further rate hikes and opening the door to rate cuts, recession fears have cooled sharply. But staunch holdouts in the hard landing camp (worried about the lagged impact of monetary tightening and the still-inverted yield curve) remain. Commercial real estate (CRE) woes have stayed in focus, particularly after smaller banks with elevated CRE balance sheet exposure in the US and Japan recently reported financial troubles.

But with so much money sitting on the sidelines, it is important to closely monitor shifts in behaviour, as the re-deployment of cash and other defensive positionings can provide a powerful tailwind to riskier assets. Leading indicators and anecdotal evidence are beginning to mount in favour of a positive shift in sentiment. While economic circumstances remain quite varied across regions, per the chart below, incoming data is beginning to surprise on the upside in most major economies. In the US, banks are reporting an easing of lending standards (after tightening sharply following the Silicon Valley Bank collapse) and bottoming commercial, industrial and household loan demand. Speculative corporate and emerging markets debt issuance has surged recently, after having been largely frozen out by weak demand. Remarkably, Japanese stocks have finally taken out the highs previously set in 1989 (for a deeper dive on Japan, please see Hot Topix)! The list goes on.

If we're correct that animal spirits are indeed returning to financial markets, the next logical question is where does the money go? While a rising tide can lift all ships, there will be winners and losers, at least on a relative basis. One major catalyst to follow is market breadth; something that was severely lacking in 2023, as only a handful of mega-cap US stocks accounted for the lion's share of stock market performance. Accordingly, we're looking for performance to broaden out to other more economically-sensitive sectors in the US and for capital to flow to international markets; both developed and emerging. A move up the "risk curve" in fixed income already appears to be underway, as evidenced by the resurrection of the new issue market noted above.

Of course, risk appetite is not a binary concept. Investment climates don't move from risk-off to risk-on overnight; changes happen in fits and starts. In the near-term, volatility remains elevated as investors attempt to gauge the timing and magnitude of central bank rate cuts. But with positioning already at extreme levels in cash, government bonds and US mega-caps, we believe the time is right to orient portfolios for a broadening risk cycle.

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GLOBAL STRATEGY OVERVIEW

CASH

Most major central banks are likely at or very near peak interest rates. Historically, long-term returns for stocks and bonds are strongly positive in the years following terminal rate hikes. We remain near fully invested with cash at neutral levels in client portfolios.

BONDS

Bonds have become a consensus overweight, as financial markets expect aggressive rate cuts in 2024. While the outlook has improved, we believe markets are getting ahead of themselves, as inflation is likely to prove "sticky" and central banks will need to proceed with caution. Fixed income exposure has been kept underweight this quarter.

EQUITIES

Industrially-oriented Japanese equity indices are highly competitive with the yen at depressed levels. Add that valuations are undemanding, monetary policy remains highly accommodative (an anomaly amongst major global central banks) and shareholder-friendly reforms are being forcefully promoted by policymakers, and the bull case for Japanese stocks is compelling. We have increased exposure to dividend-paying Japanese small cap equities in balanced and growth-oriented strategies.

OPPORTUNITIES

We continue to expect the largest opportunity in Chinese equity markets to be in the consumer sector, as the historically high savings of households supports spending as confidence slowly begins to rebuild. Chinese internet companies should thrive, given their direct exposure to domestic consumer demand, already strong earnings momentum, fading regulatory hostilities and attractive valuation multiples. We have sold Chinese onshore (A share) equities and added to Chinese internet equities in balanced and growth-oriented strategies.

FORSTRONG STRATEGIES	INCEPTION DATE	1 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEARS	SINCE INCEPTION
BALANCED								
Global Income	30/06/08	1.19%	1.05%	6.35%	1.86%	3.41%	5.40%	7.00%
Global Balanced	30/06/03	2.79%	1.92%	7.44%	2.28%	5.45%	6.65%	6.83%
Global Growth	30/06/03	3.36%	2.32%	9.08%	3.97%	7.18%	8.04%	7.99%
Core Income	30/06/08	0.73%	0.26%	5.04%	2.01%	3.58%	4.61%	5.96%
Core Balanced	30/06/03	2.23%	1.08%	6.25%	3.15%	5.72%	6.13%	6.88%
Core Growth	30/06/03	2.57%	1.26%	6.78%	4.52%	6.99%	7.09%	7.79%
GLOBAL EQUITY								
Emerging Markets Equity Focus	31/01/19	5.45%	1.40%	2.70%	-2.14%	1.79%	-	1.96%
Global Ex-North America Equity Focus	31/12/19	4.33%	2.32%	7.69%	1.84%	-	-	4.29%
ALTERNATIVE INCOME								
High Income Opportunities	30/06/22	2.31%	0.54%	6.83%	-	-	-	11.93%

* Performance as of February 29th, 2024

Performance statistics for ETF Managed Portfolios are calculated from documented actual investment strategies as set by Forstrong's Investment Committee and applied to its portfolios mandates, and are intended to provide an approximation of composite results for separately managed accounts. Actual performance of individual separate accounts may vary with average gross "composite" performance statistics presented here due to client-specific portfolio differences with respect to size, inflow/outflow history, and inception dates, as well as intra-day market volatilities versus daily closing prices. Performance numbers are net of total ETF expense ratios and custody fees, but before withholding taxes, transaction costs and other investment management and advisor fees. Past investment results provide no indication of future performance. Future returns are dependent on the general investment environment, the nature of the investment mandate and specific portfolio risks. A rate of return for one year or less is not annualized.

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