Investment Strategy Insights

Monthly Views From Our Diverse Global Investment Teams

PineBridge® INVESTMENTS

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How the US Election Will Drive Risks to Asian Trade

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

The lead-up to the 2024 US presidential election is shaping up to be quite a roller coaster, with recent developments returning the odds to a tossup rather than a likely Republican victory. In terms of trade policy, the outcome will have significant consequences for Asia in particular. A victory for the Democrats would likely result in a continuation of the status quo. A "Trump 2.0" scenario, on the other hand, would involve marked changes – and is therefore what we've focused on here.

Donald Trump has consistently supported tariffs since his first term and is now advocating for a broad 10% tariff globally and up to 60% tariffs on Chinese goods. While we view some of Trump's policies, such as deregulation and tax cuts, as positive for markets, tariffs are not among them. Tariffs create a negative supply-side shock, likely leading to higher inflation and lower growth. What is up for debate is only the magnitude of these effects and their broader implications, both for the global economy and for specific countries.

A 60% tariff on Chinese exports would have a significant impact on China's growth, affecting $500 billion in exports: 15% of China's total exports to the US and around 2.8% of China's GDP, based on our analysis. The result could be a potential 2.4% growth shock. However, we view such extreme measures as less likely. Trump will more likely use tariffs as a negotiation tool, with the actual growth impact falling between 0.9% and 2.4%.

To mitigate the impact of tariffs, China has the option to adjust the yuan's exchange rate to the dollar from 7.3 to a range of 7.5 to 7.7. However, the scope of such adjustments is limited due to the PBOC's aim to stabilize the yuan. China's options for retaliation are also limited due to the trade surplus imbalance, though it could target specific products for which it enjoys market dominance.

For Taiwan, potential tariffs on Chinese semiconductors could prompt international clients to shift to Taiwan to avoid higher costs, benefiting Taiwanese foundries. Additionally, the overcapacity in mature nodes resulting from China's aggressive expansion could be alleviated, improving prices and utilization for global foundries. However, Taiwanese designers and foundries that use advanced Chinese chip lines might face increased scrutiny from the US.

Sanctions on China's high-end AI semiconductor products have been in place for over two years, with recent additions tightening restrictions further. Potential future measures include closing supplier loopholes, adding more Chinese memory companies to the Entity List, and imposing additional tariffs on Chinese semiconductors. During Trump's first term, trade sanctions led many companies to relocate operations to Southeast Asia, India, Mexico, and Eastern Europe. Although these sanctions were anticipated, they still hurt China's employment and economy. Exports have been a crucial growth driver amid challenges in the property sector, soft consumption, and mixed infrastructure growth. In an extreme scenario, a ban on lagging-edge equipment (in addition to existing bans on cutting-edge tech) could disrupt global supply chains.

Overall, a potential Trump reelection presents a complex scenario for global markets, particularly in Asia. Global trade would see a negative effect overall, with China feeling the biggest impact. Taiwan will be in a difficult position both geopolitically, given Trump's ambiguity regarding the US's security stance toward Taiwan, and also in terms of markets, due to its highly prized semiconductor sector. Given the growing significance of AI (and the semiconductors that power it) over the past few quarters, any threat to this sector will pose a risk to equity markets.

The outcome of the US election has once again become "too close to call," leaving the outlook for Asia's trade highly uncertain. Active management of portfolio exposures will be critical in the months ahead to weather resulting volatility.

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst,
Global Emerging Markets
Fixed Income

CS 2.75 (unchanged)

The US economy lost momentum in the year's first half as government expenditures and export growth slowed significantly. The move was contrary to expectations as the two-speed economy converges with slowing retail sales growth and muted manufacturing production. The labor market continues to weaken, with three-month average payrolls falling to 177,000 in June from 267,000 in March, and the unemployment rate has increased to 4.1% from 3.7% in January. With the savings rate sitting below its long-term average, combined with the expectation of no immediate reacceleration in government expenditure growth, the economy is expected to continue slowing gradually. While the economy's pace is not yet at a recessionary level and immigration has provided a boost to labor supply, further weakness in labor demand will likely lead to more significant deterioration.

Upward surprises in the Consumer Price Index (CPI) appear to have been one-off noise, as insurance premiums and shelter inflation trended down in the June CPI print. Deflation in durable goods prices accelerated in in the second quarter at the fastest pace in 20 years, indicating that underlying pricing power is weak outside of services, supported by China's deflationary cycle. Against this backdrop, CPI should dip close to 2% in the first quarter of 2025.

The market has moved back to pricing between two and three rate cuts this year following weaker CPI and ISM data. The Fed will want further confirmation of the data, but September remains in play for a first rate cut. With sufficient evidence of lower inflation only to be received after the July meeting, the likely start date for the cutting cycle is later compared to what was anticipated last year.

With the European Central Bank (ECB) commencing its cutting cycle and the remaining big central banks set to ease this year (excluding the Bank of Japan), along with neutral to more stimulatory fiscal policy, growth worldwide generally has come in stronger. Global PMIs are in expansionary territory for the first time since mid-2022. European growth (except for Germany) has also bottomed and begun to trend up, albeit mildly.

Rates

Gunter Seeger
Portfolio Manager, Developed
Markets Investment Grade

CS 3.05 (-0.20)

We favor holding on to a portion of the long duration position established in late April, when the 10-year note hit 4.70%. We would view a move of over 50 basis points and a break of 4.20% as reason to exit. We currently see a 50/50 chance of a dive below 4%. Recently, a combination of 10-year notes at 4.18% and an equal portion of T-bills at 5.30% yielded 4.74%. In contrast, the five-year was yielding 4.09%.

According to Bloomberg, the US Treasury market (GVLQUSD Index) is less liquid now than it was in 2020. Our conviction is to hold a slight overweight in Treasury duration since the upcoming election coupled with wars in the Middle East and Ukraine are adding a vast amount of uncertainty to the next six months.

Credit

Steven Oh, CFA
Global Head of Credit
and Fixed Income

CS 3.50 (unchanged)

Another month of weaker economic data provided support for a Treasury rally, resulting in spread-widening across most fixed-rate credit assets. The Fed's dot plots have pulled back their easing forecast from three cuts to just one, while the market is pricing in two cuts. We continue to see a weakening yet still favorable corporate credit environment combined with less near-term monetary policy support and tight valuations. Overall, we have maintained our CS at a somewhat defensive level despite expectations that coupon yields will drive returns for the remainder of the year.

As we look across the relative value spectrum of credit, nothing stands out as being particularly cheap or expensive. As a result, we have become more neutral with respect to asset and geographic allocations. There have been some surprise election outcomes and particularly higher political risks in Europe that have the potential to introduce volatility across rates and credit markets this summer.

Currency (USD Perspective)

Anders Faergemann
Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 3.00 (unchanged)

Diminishing support for the US dollar against the euro and other G7 currencies with the exception of the Japanese yen has become increasingly evident as US/eurozone growth differentials are narrowing and US inflation moderates, signaling US monetary policy is now too restrictive. In contrast, the perception from prediction market odds that Trump is leading the presidential election race after the assassination attempt could bolster the US dollar as higher tariffs (i.e., lower economic growth and higher inflation) play a key part in Trump's election campaign.

China's authorities have become increasingly active in keeping the yuan in a narrow trading range, raising suspicions of enforced foreign exchange (FX) stability. Likewise, the euro and the US dollar have been trading in the same range (1.05-1.10) for 18 months, forcing FX volatility lower. Evidence that the US economy is cooling but not rolling over has bolstered risk sentiment twofold and is weighing on the dollar. The market is pricing in a rate cut for September and will be increasingly focused on Fed comments in the lead-up to the Jackson Hole Symposium in August. Risk markets will hold up better in a soft-landing environment. Both those factors should favor carry in emerging market (EM) currencies, including the Mexican peso and Brazilian real. Altogether, unless the rise in US unemployment triggers a Sahm Rule recession signal (when the three-month moving average of the national unemployment rate rises by 0.50 percentage points or more relative to its low during the previous 12 months), the US dollar is likely to remain unfavored ahead of the US election but still trade within a narrow range.

The Bank of Japan faces the dilemma of trying to raise interest rates at a measured pace without losing the trust of the market. Renewed intervention by Japan's finance ministry to prop up the Japanese yen shows concern over yen weakness leading up to Japan's general election, yet continued capital outflows highlight the central bank's struggle to prevent the yen from weakening further.

Emerging Markets Fixed Income

Chris Perryman
Corporate Portfolio Manager and Head of Trading, Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 3.00 (unchanged)

Local Markets (Sovereign)
CS 2.50 (unchanged)

We continue to see the macroeconomic environment for emerging markets as favorable. Domestic demand proved more robust than expected in the year's first half, preventing a slowing of growth momentum. For the remainder of the year, we see growth rates normalizing but continuing to support EM assets. The lagged effects of earlier policy easing cycles will also benefit some EM names. The prospect of Fed cuts coming sooner than thought raises the possibility of further inflows into the asset class and increases the likelihood that some lower-rated countries, which had been priced out of the market, may be able to return.

In the corporate space, the fundamental picture remains resilient. On balance, first-quarter earnings were better than expected, and we expect second-quarter earnings to outperform as well. The supply-side technical picture remains solid for the remainder of the year.

In the fall, investor attention should shift toward the US elections and their effect on macro risk. While EM valuations remain balanced, high carry and robust fundamentals should offer support. We remain positive on India's fundamentals and neutral on China.

Multi-Asset

Peter Hu
Portfolio Manager, Global Multi-Asset

CS 2.50 (unchanged)

Soft landings, while idealized, present challenges of their own. We are currently experiencing slower growth and inflation, affecting company earnings and exposing weaker firms. We have confidence that inflation will keep grinding lower, driven by supply-led growth trends in goods and US labor supply, giving the Fed enough evidence to start cutting rates in September and keep the soft landing on track.

Political uncertainty in France and the US could meaningfully impact policies and fundamentals. A hung parliament in France might lead to increased fiscal spending, while a Democratic victory in the US may maintain the status quo. A Trump victory could reintroduce aggressive policies like tax cuts, reduced immigration, and increased tariffs. The US economy, currently cooling from an overheated state, may respond differently based on the election outcome and economic conditions. For now, we maintain our more constructive CS of 2.50 in a soft-landing scenario, favoring equities over credit and credit over rates.

Global Equity

Rob Hinchliffe, CFA
Portfolio Manager and Head of Global Sector Cluster Research, Global Equities

CS 3.00 (unchanged)

Market uncertainty is fueling volatility, rotation, and investment opportunities. The timing and number of interest rate cuts are the market's primary driver, followed closely by the health of the US consumer and valuations of the Magnificent Seven stocks (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta Platforms, and Tesla), along with developments in China, the US elections, and AI.

From our perspective, companies in developed markets (DM) continue to sound generally positive. Yes, mega-cap tech continues to lead, but we see decent growth elsewhere too, and valuations are supportive. The US consumer seems to be steady, although the market is searching hard for cracks. The Mag 7 have led a narrow market, driven by earnings and visibility, and we don't think valuations are out of bounds. The recovery in China is still a waiting game, and perhaps a weaker US dollar will help EM. US elections seem like an exercise in risk management for now. AI has tons of potential, and we're looking for opportunities beyond the obvious beneficiaries.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager, Global Equities

CS 2.50 (unchanged)

In China, overall loan growth has continued to slow. As of mid-June, banks are not seeing demand pick up. A few leading automation companies saw good order book growth from traditional industry, with some expecting policy support to be rolled out soon. Companies producing lower-end products saw relatively better growth. China's July plenum meeting has not produced tangible positive outcomes for the market or the economy.

In India, reporting so far from IT companies shows that the contraction in employee headcount seems to be ending and revenue growth may have bottomed out for the near term. In Taiwan and Korea, all eyes are on earnings reports and guidance by chip manufacturers as the markets weigh whether AI stocks have run too far. Thus far, a leading Taiwan semiconductor firm has released strong earnings with an upbeat outlook. Investors are trying to understand and interpret the impact of potential new chip sales restriction to China on key companies in the segment.

In Latin America, quarterly results from corporates have been better than expected, but we have not seen strong beats. In EMEA, earnings reporting has not yet begun. As we await first-half results, the big debates in the market are AI's peak, the potential impact of a second Trump administration, and China's slowing economy. We try to look as much as possible past such factors and focus on companies with strong and improving business models, quality management, sound financial structure, and proper adherence to ESG values.

Quantitative Research

Haibo Chen, PhD
Portfolio Manager and Head of Fixed Income Quantitative Strategies

We have become slightly more bearish as the curve steepened by three basis points but not enough to offset credit spread widening of 8 bps.

Our global credit forecasts are negative, and our model favors EM over DM. In DM, favored industries are banking, insurance, and industrials. The model dislikes utilities and transportation. In EM, the model likes infrastructure, consumer goods, pulp and paper, and mining. It dislikes transportation, real estate, and diversified companies.

The global rates model forecasts lower yields except for Australia, Japan, Norway, Switzerland, and Sweden, and a steeper curve globally except for Japan and Greece. The rates view expressed in our G10 model portfolio is overweight global duration. It is overweight Italy, Belgium, New Zealand, Canada, and Japan, while underweight the US and core EU countries. Along the curve, it is overweight the six-month, 10-year, 20-year, and 30-year and underweight the two-year and five-year.

All market data, spreads, and index returns are sourced from Bloomberg as of 22 July 2024.

About PineBridge Investments

pinebridge.com

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 30 June 2024, the firm managed US$169.7 billion across global asset classes for sophisticated investors around the world.

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