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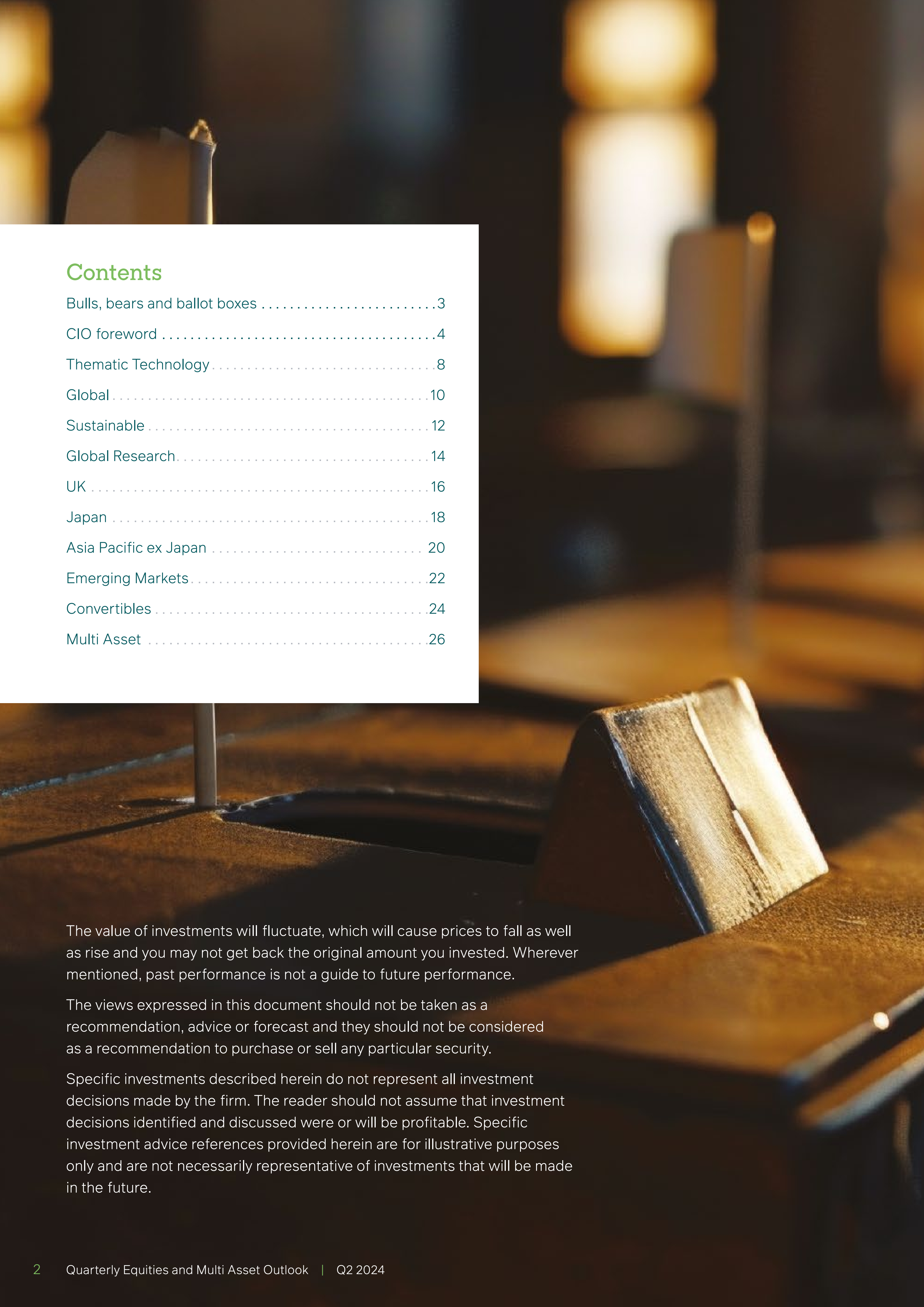
M&G Investments

Quarterly Equities and Multi Asset Outlook

Bulls, bears and ballot boxes

Q2 2024



Contents

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Bulls, bears and ballot boxes

In 2024, more voters than ever in history are expected to head to the polls. While the media and industry pundits have much discussed the ensuing 'heightened' geopolitical risk, we don't believe this is the case everywhere, and certainly not uniformly.

To affect financial markets, geopolitical events have to have a meaningful implication on the economy or economies that drive those markets. Otherwise, any resulting volatility becomes an opportunity for active investors to buy at a better price.

Meaningful policy changes following elections may have a much longer-lasting impact, although the market performance may not be as straightforward and depend on more circumstances than just domestic policy. In India, the S&P BSE Sensex has performed strongly in the ten years since Modi's government, but not as well as in the prior ten years when India's policies were less market friendly.

As always, the devil is in the detail: some of the elections could impact specific areas of the market and be less meaningful for others. In the US, the most exciting opportunities to emerge are likely to be in areas that neither presidential candidate seems to be talking about.

CIO foreword

In 2024, more voters than ever in history are expected to head to the polls in national (or transnational, in the case of the EU Parliament) elections. A total of 91 countries and close to half of the world's population.

There has been a lot of talk in the media and among industry pundits about the ensuing 'heightened' geopolitical risk. Geopolitical risks have indeed increased, but not everywhere, and certainly not uniformly. Let's not forget that not all geopolitical events affect financial markets. To do so, they have to have a meaningful implication on the economy or economies that drive those markets. Otherwise, any resulting volatility becomes an opportunity for active investors to buy at a better price. Take the initial negative equity market reactions to the Brexit referendum or Trump's victory in 2016 – which led to shorter-term, tactical investment opportunities. In the US, historical data shows that elections have hardly altered the medium-term direction of travel for domestic financial assets.

Meaningful policy changes following elections may have a much longer-lasting impact, although the market performance may not be as straightforward and depend on more circumstances than just domestic policy. For example, the election of Narendra Modi to Prime Minister in May 2014 was arguably the trigger for a series of unprecedented policies that enhanced India's longer-term economic prospects. The country's equity market has performed strongly since then and yet not as strongly as in the ten years prior, when policies were considered far less business and economy friendly. India's Sensex was up 14% annualised in the 10 years preceding Modi's election, versus 8% in the almost ten years following Modi's first election, outperforming the MSCI All Country World Index by 8% and 2% respectively[1].

And as always, the devil is in the detail: some of the elections could impact specific areas of the market and be less meaningful for others. One area that has been much discussed and seen as a clear loser from a Trump victory in the US, is sustainability and investments in a low-carbon future. Current valuations of many companies in this area reflect such uncertainty.

[1] Source: Bloomberg, April 2024. Returns in USD currency terms, Pre-Modi period (16 May 2004 – 15 May 2014), Post-Modi period (15 May 2014 – 9 April 2024).

President Biden has embraced government intervention and the Paris Climate Agreement with the Inflation Reduction Act (IRA) providing c.$400 billion in clean energy and climate financing. On the other hand, Donald Trump has stated he will roll back the IRA if he wins. It is worth noting, the IRA was written into the US tax code over a 10-year period. In order to reverse the law, it will require both Houses of Congress and the President to be on side. And even within the IRA, there is one area of bipartisan support, which is improvements to the US grid infrastructure.

The other area that is often debated in connection with the US elections is healthcare. After an *annus horribilis* in 2023, healthcare has seen somewhat better performance so far in 2024 – unusually for an election year. This is, in part, because the Democratic Party has already acted. The IRA includes a provision that over time will limit drug price rises, reduce patient out-of-pocket spend and cut prices for Medicare pharmaceuticals over a 9-13 year period.

This is not to say that something else could not come out of left field when it comes to healthcare reform. Biden has suggested that Medicare could ultimately see prices negotiated for 50 drugs per year, rather than only the 20 provided for in current legislation, and apply further caps on out-of-pocket spend.

At his end, Trump has mentioned the reissuing of an Executive Order regarding 'Most Favoured Nation' drug pricing. That is, the US pays the same price as major trading partners. This would be bad news for the sector as net European Union prices are currently 50% of those realised by manufacturers selling into the US.

While the policies above are far from certain, they all bring risks that we need to consider when making our portfolio choices, and measure against the valuations and earnings growth prospects of healthcare companies.

As one of our portfolio managers points out, the most exciting opportunities to emerge in the US are likely to be in areas that neither candidate seems to be talking about, such as the healthcare insurance sector.

“We could look back in 18 months’ time and point to the UK elections as a catalyst for change in investor sentiment, precisely because it means limited change”

An election that appears to bring a very different potential outcome for markets is the UK General Election. A Labour win, which is currently the most expected scenario, appears to be met by market participants and the business community with a dose of optimism. The opposition Labour Party has presented itself as more business friendly than in the past, providing investors with the hope of a period of stability in UK politics that has been missing since 2016.

As another one of our portfolio managers puts it, we could look back in 18 months' time and point to the elections as a catalyst for change in investor sentiment, precisely because it means limited change. Importantly, we are likely to see policy agreement between both sides of the UK political spectrum on continued spending on the electricity grid, critical infrastructure and national defence.

Of course, with 75% of revenues of the UK equity market coming from overseas, the outcome of US elections and their policy implications are just as important for UK Plc.

Asia will also have its share of elections. Between 19 April and 1 June this year, India will hold General Elections. Prime Minister Modi's incumbent ruling Bharatiya Janata Party (BJP) is widely expected to win and Modi to be re-elected for a third term. The victory is largely discounted by markets and a different outcome would potentially trigger very poor market performance. While political stability looks likely, the policy direction is likely to take a different turn. India has doubled its deficit through the COVID years and is now looking to remove such stimulus. The Minister of Finance, Nirmala Sitharaman, has already announced a fiscal consolidation. This could affect the growth trajectory and valuation upside of some Indian corporates that have benefited from the fiscal largesse.

A less discussed set of elections will take place in Japan in late April. Prime Minister Kishida's administration's approval-rating is significantly low at around 20%–25%. If Kishida's party loses the Lower House by-elections in late April, we expect to see calls for his resignation emerging. While there is uncertainty, we don't believe this will derail the positive momentum in the Japanese equity market, which is underpinned by corporate reform, balance-sheet improvement, productivity growth and earnings upside.

For Asia, and China in particular, market volatility is likely to come from the US elections. Some of Donald Trump's pledges on increased tariffs on Chinese imports will mean that Chinese companies will be vulnerable to headlines tied to a Trump victory. Arguably, some of this is already discounted in the depressed valuations of the Chinese market, and the dependency of China Inc. on the US has been on a downward trend – with the US accounting for 17.6% of Chinese exports in 2023 versus 19.3% five years ago[2]. As always, we will need to follow the news flow and make a clear distinction between companies that may be affected and companies that should not.

And, while all of the above looks at the short- to medium-term impact of elections, one longer-term effect is looming. Biden and Trump both seem inclined to keep the US on a path of fiscal largesse and elevated debt issuance. While in the near term this is unlikely to challenge the US dollar's status as the international reserve currency, and the US market as the 'haven' of last resort – allowing it to enjoy lower debt servicing costs than it would have to incur otherwise – markets are increasingly asking questions about the sustainability of the country's fiscal trajectory. Until now, historical data shows no clear relationship between public debt levels and yields on US treasuries but, as we have learned from history, nothing should ever be taken for granted.

In the following pages, our Equities and Multi Asset teams will each discuss the implications of the 2024 elections on markets and within their areas of expertise.

We wish you an enjoyable and – hopefully – interesting read.

Fabiana Fedeli
Chief Investment Officer
Equities, Multi Asset and Sustainability

[2] Source: CEIC Data, China Total Exports to USA, 1981 – 2024 | CEIC Data. World Integrated Trade Solution (WITS), April 2024. China Exports by country and region 2018 | WITS Data (worldbank.org)

Thematic Technology

Jeffrey Lin
Head of Thematic Technology Equities

Supporting semiconductor industry growth

Semiconductors have been a strong source of return in the first quarter of 2024 – up nearly 19%[3] year to date. The performance of the broader semiconductor group has been driven by secular growth for Artificial Intelligence (AI) as well as cyclical recovery in other end markets for semiconductors.

This has buoyed stocks such as Nvidia, given the strength in demand for processers, along with advanced manufacturing companies like Applied Materials, Tokyo Electron and LAM Research that make equipment used to manufacture semiconductors.

Notably, during the quarter, the EU passed the Artificial Intelligence Act. The regulations aim to protect fundamental rights, democracy, the rule of law and environmental sustainability from high-risk AI – establishing obligations for (the use of) AI based on its potential risks and level of impact. We believe the regulations are validation of the potential impact AI will have on the global economy. In our opinion, proactive regulation is a positive for the broad adoption for AI.

While the forthcoming Federal elections in the US are looming large for many, we do not believe the outcome of the Presidential Election will have a major impact on current policy with regards to the semiconductor industry, for a number of reasons:

Firstly, the US government restricted access to semiconductor technology to China under both the Trump and Biden administrations. So in terms of future actions, we would expect limitations on exports to China to continue regardless of administration.

Secondly, the CHIPS and Science Act – passed by Congress and signed into law by President Joe Biden in August 2022, which provides subsidies for semiconductor manufacturing in the US – received bi-partisan support. As such, we would expect either a Trump-led or Biden-led administration to support the manufacturing of semiconductors in the US, both in the interests of national security and to mitigate supply-chain risks.

> “...we expect [continued] support [for] the manufacturing of semiconductors in the US”

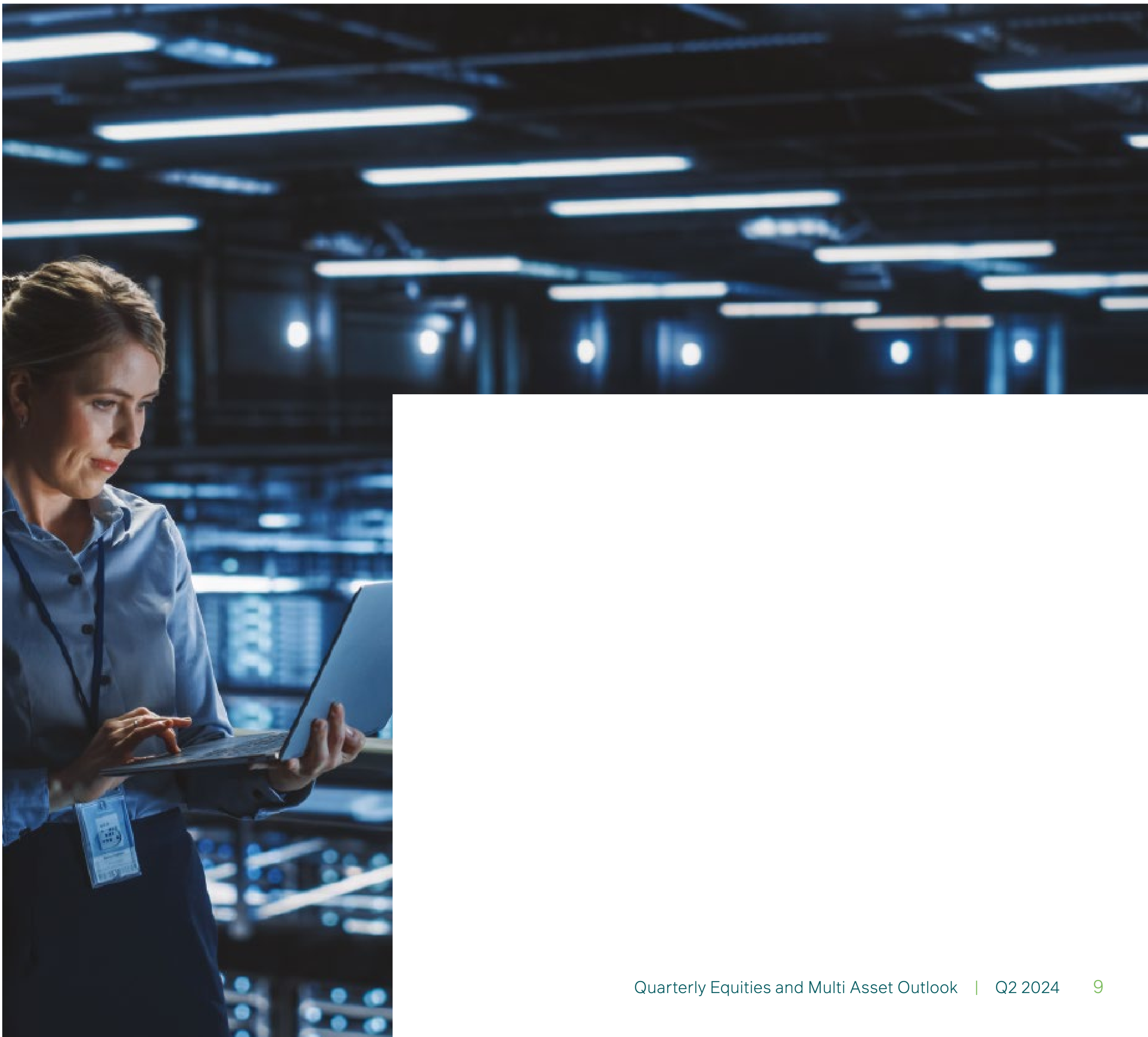
For this reason, we believe our portfolio is neutrally positioned when it comes to the political landscape in the US, regardless of the outcomes of the US Federal elections. At the margins, some of our industrials and holdings related to managed healthcare could be exposed to tailwinds and headwinds respectively. For the former, our holdings (c.10% of the portfolio) are well-placed to benefit from increased capital spending on infrastructure and any moves to upgrade the electricity grid, for example. For our healthcare names, universal healthcare could change the landscape for managed care companies, particularly the introduction of a ‘single payer’ system. Historically, some Democrats such as Senator Bernie Sanders have pushed for universal healthcare, in the form of ‘Medicare For All’. However, this concept has not featured in Biden’s (or Trump’s) plans for 2024, rather Biden is looking to expand healthcare provisions in the IRA should he win.

[3] Source: Bloomberg, MSCI ACWI IMI Semiconductors & Semiconductor Equipment, price returns, year to date through 29 March 2024.

Regulation more broadly does pose a tail risk for the wider technology sector, but we believe regulation can co-exist with the secular growth of technology and AI. We think the leading technology companies can make adjustments to appease regulators that are not overly burdensome. For example, we expect Microsoft to separate Teams from Office, to create two separate products and alleviate anti-trust concerns.

Infrastructure build-out for AI could come also under some pressure. Nvidia has discussed that AI datacentres are different to historical datacentres, and sees next generation datacentres as 'AI Factories'. Building out these new datacentres will require power and cooling that could create bottlenecks to the build-out and unpopular environmental impact.

There has also been discussion around manufacturing capacity for semiconductors as demand growth continues. Semiconductors for AI are manufactured using leading-edge foundries, and we believe the industry will need to continue to increase capacity long term, but this risk is mitigated by planned geographic supply diversification.



Global

John Weavers
Fund Manager, North American Dividend

US Equities: Entrepreneurship trumps politics

The investment world can be a strange place. There's nothing inherently special about the first of January, yet often times the turn of the year can coincide with sharp reversals in momentum and market leadership, as if we throw out the prior year's winners with the Christmas wrapping paper. In 2022, coming off a red hot 2021, the S&P 500 Index (S&P) peaked on the first trading day of the year before settling into a miserable, Tech-led pullback as the Federal Reserve (Fed) kicked off an inflation-driven rate hike cycle. In 2023, the Magnificent Seven managed to get to the third trading day before bottoming and starting a 12-month surge that would drive the S&P to new highs.

Investors could be forgiven, therefore, for being cautious in that the early parts of 2024 might see a bit of a reversal from the Generative AI-driven market of the last 12 months. Not so. Of the nearly 10% return generated by the market year to date, over 60% has come from the top six best performers, all with an AI angle to their investment case[4]. And many companies are seeing growth driven by AI in their earnings right now. Tens of billions of dollars in capital is being poured into the Generative AI space, a large percentage of which has gone to Generative AI posterchild Nvidia.[5]

Although we can debate the returns that this spend will deliver and the pace of development from here, it seems clear that Generative AI is here to stay in a more meaningful way than prior Tech hype cycles such as the Metaverse.

If you'd told me 12 months ago that 2024 would see the release of Gladiator 2, I'd have assumed that the award for 'Least Wanted Sequel' of the year would be straightforward. But post Super Tuesday, it seems like that accolade is instead slated to go to the Presidential Election match up of Donald Trump versus Joe Biden in November.

Despite their respective primary victories, US voters seem remarkably unenthused with their options this year. In a recent Reuters poll[6], 70% of respondents – including about half of Democrats – agreed with a statement that Biden should not seek re-election. 56% of people responding to the poll said Trump should not run, including about a third of Republicans.

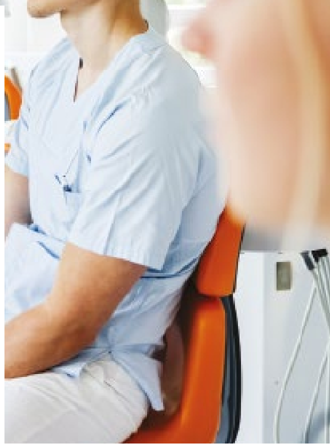
Despite these being two candidates running for a second term, the 2024 election has so far been a 'vibes' election, with actual policy platform details remarkably sparse, especially in the economic sphere. Contrast this to 2016 when Donald Trump was proposing the largest tax cut in a generation, or 2020 when Joe Biden was campaigning for an historically-large stimulus package.

> "…some of the most exciting opportunities… are in areas that neither candidate seems to be talking about"

[4] Source: Bloomberg, 29 March 2024.

[5] Source: Pitchbook (online), 14 June 2023, The most active investors in generative AI – PitchBook; Macrotrends (online), 4 April 2024. NVIDIA Market Cap 2010-2024 | NVDA | MacroTrends

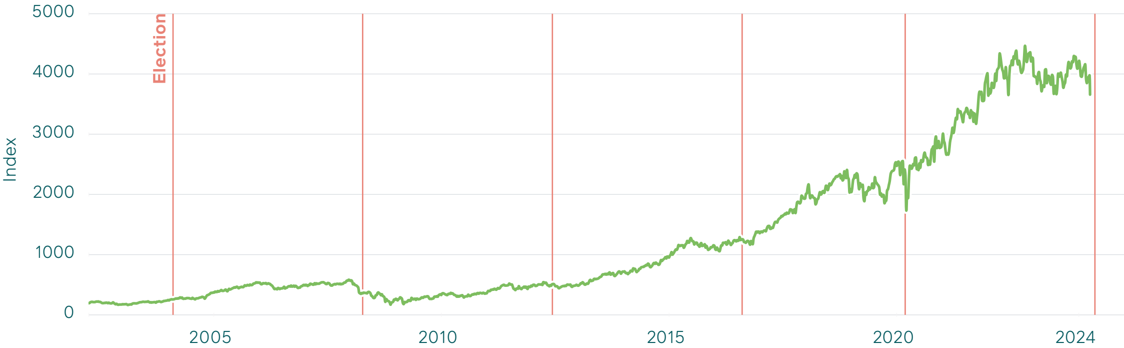
[6] Source: Reuters, 25 January 2024, Trump vs Biden: The rematch many Americans don't want

At this point, we are still waiting for the official manifesto launches of both major parties. Within that context, perhaps some of the most exciting opportunities starting to emerge are in areas that neither candidate seems to be talking about. The Healthcare Insurance sector has historically been weak into election cycles as changes of party have raised risks of systemic change. This time around has proven no different so far, but with two candidates who mostly seem to favour the status quo, this seems like a decent opportunity to invest at prices that historically tended to recover nicely once the election dust has settled.

Figure 1. S&P 500 Managed Care sector

Past performance is not a guide to future performance



Source: Bloomberg, 2 April 2024.

The good news for investors in general is that election results have rarely impacted the ability of the US stock market to provide attractive returns in aggregate.

Situation	Number of years	S&P 500 Index Annual Average Return
Unified Republican	13	14.52%
Unified Democrat	36	14.01%
Divided with Republican President	34	7.33%
Divided with Democratic President	15	16.63%

Source: Bob French, Retirement Researcher, 2023. Data from 1926 through 2023. Unified government means that the Presidency, the House of Representatives and the Senate are all controlled by a single party. Divided government means that at least one houses of Congress or the Presidency is controlled by the other party. Indexes are not available for direct investment. For educational purposes only.

Although there will undoubtedly be opportunities thrown up by the upcoming political cycle, our philosophy will be to focus on high-quality, high-returning businesses with long-run opportunities to grow their earnings regardless of the political weather, rather than try to get too cute about timing voting volatility. To quote Benjamin Franklin – “The bitterness of poor quality remains long after the sweetness of low price is forgotten”.

Since the end of the Second World War, the US has proved to be a fantastic market for long-term investors to put their money to work in. That wealth creation function is underpinned by an entrepreneurial culture that persists and thrives regardless of who sits in the White House. I firmly expect that dynamic to continue into the future.

Sustainable

Randeep Somel
Co-Deputy Fund Manager,
Global Sustain Paris Aligned

The power of politics to influence the Paris Climate deal

As the world's largest economy and the world's most populous country head to the polls in 2024 – what are the implications for the Paris Climate deal?

The second half of 2023 was a challenging period for renewable energy companies. Concerns increased with regard to the inflation implications for long-term project economics and also how 2024 elections may weigh on supportive government policies across the world.

In the first quarter of 2024, we have seen inflation levels come under control and renewable energy companies begin to manage contracts better for the risks of inflation. Governments across the world so far continue to be supportive of green investments as they have targets to reach for their national decarbonisation goals.

On the Sustain Paris Aligned strategies we took this opportunity to add our first renewable energy companies on the portfolios as we believe the valuations have fallen to compelling levels. The additions include companies with exposure to offshore wind and the solar energy supply chain. We have identified companies that are better placed to manage inflationary risks, that hold intellectual property, and have a differentiated asset base for growth.

The market in 2024 has remained cautious on renewable energy names, but we believe the valuations now provide a good margin of safety, with little long-term growth priced in.

Sentiment for the sector may remain volatile in 2024 as major economies head to the polls, but valuations are favourable, and while the speed of the transition may be impacted by elections this year, the long-term trajectory remains intact.

> "Sentiment for the sector may remain volatile in 2024 as major economies head to the polls, but valuations are favourable and...the long-term trajectory remains intact"

Since becoming Prime Minister of India in 2014, Narendra Modi has introduced ambitious market friendly reforms, including liberalising foreign direct investment rules and providing more flexibility to India's labour laws. India, now the world's largest country by population, has grown to be the world's fifth largest economy from tenth place over the decade[7]. Due to India's size and growth its ability to grow sustainably will be crucial in reaching the targets of the Paris Climate deal.

At COP21 (held in Paris, 2015), India, under newly-elected Prime Minister Modi, put forward an ambitious target that it would reach 40% of its power generation from renewable sources by 2030. That target was met in 2022. India has updated its aim to 50% power generation from renewable sources by 2030.

India's total power generation capacity is c.434GW (of which, c.183GW is renewable sources today)[8]. It has targeted to reach 500GW of renewable capacity alone by 2030[9]. Prime Minister Modi

[7] Source: Goldman Sachs Intelligence, 6 July 2023 How India could rise to the world's second-biggest economy (goldmansachs.com)

[8] Source: Government of India, Ministry of Power, Central Electricity Authority (CEA). Data as at February 2024.
Dashboard – Central Electricity Authority (cea.nic.in)

[9] Source: Government of India, Ministry of Power, Central Electricity Authority (CEA). Approved_CEA_Annual_Report_2022_23.pdf

has requested that India host COP33 in 2028. India heads to the polls through April to June 2024, GDP growth is running at 8% and polls look to favour Modi for a third term – this bodes well for India's green ambitions.

The most consequential election of 2024 for the Paris Climate deal will likely come in November when US citizens head to the ballot box to decide whether to give President Biden or former President Trump a second term in office. The polls show the election is likely to be close.

There are clear policy differences between the two candidates: President Biden has embraced government intervention and the Paris Climate Agreement with the Inflation Reduction Act (IRA) providing c.$400 billion in clean energy and climate financing, whereas Donald Trump has stated he would roll back the IRA. It is worth noting, the IRA was written into the US tax code over a 10-year period. In order to reverse the law, it will require both Houses of Congress and the President to be on side.

While the Republicans may have full control post the November elections, a majority of the IRA funding (58%) goes to firm Republicans states, and the largest single recipient is deep-red Texas. Swing states account for a further 10% of spending[10], and Trump will need their support for victory in 2024. It will be difficult for Republican lawmakers to rescind legislation that is clearly working and provides a benefit to their states for both employment and investment. An area that has bipartisan support is improvements to the US grid infrastructure, and the most contentious area for support is for electric vehicles.

As the US is at an earlier stage in certain areas such as offshore wind farms, it has yet to build its first, government incentives remain very important.

As the election nears, President Biden, in order to highlight his first-term achievements, will likely tie low unemployment, falling inflation, and strong GDP growth to his infrastructure and green finance spending bills.

With Trump ahead in some polls, the markets are already cautious about the implications for green investments in the US and therefore valuations are not pricing in strong growth. Election rhetoric doesn't always translate into firm policy and while we believe private enterprise investment in this area will continue in the US regardless of who is in the White House, it would grow much faster with government support.

We would be remiss if we didn't mention the UK elections. As the Conservative Party comes to the end of its fourth successive parliamentary term, we will likely see an election in the Autumn of 2024. While elections can provide uncertainty to markets, there are no significant policy differences on net zero ambitions between the current government and the opposition Labour Party.

In November 2023, the UK government increased the guaranteed price offer for offshore wind projects by 66% (£73 per MW hour from £44 per MW hour) and aims to have 50GW of offshore wind capacity by 2030 from 14GW today. The UK has the second largest offshore wind capacity currently, after China. The opposition Labour Party, which has a commanding lead in the polls, is as ambitious, if not more so, than the incumbent government in reaching net zero GHG emissions.

[10] Source: Net Zero Investor, 1 January 2024. Can Trump ruin Biden's Inflation Reduction Act? | Netzeroinvestor

Global Research

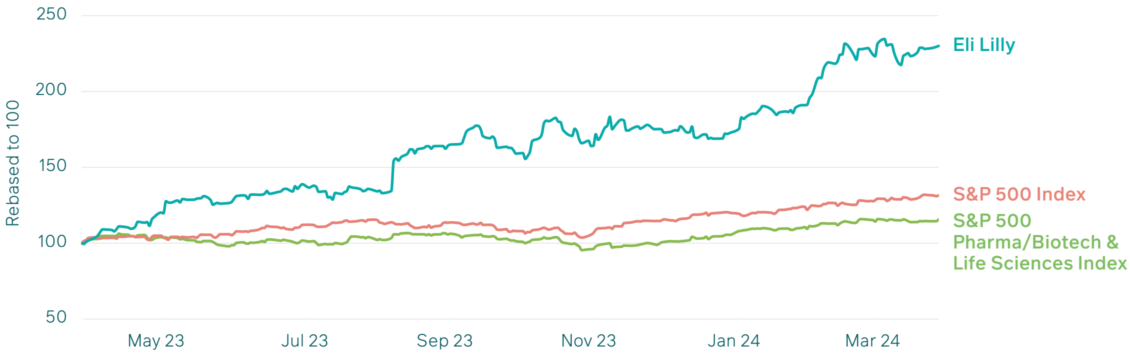
Martin Wales
Head of Equity Research,
Global Pharmaceuticals/ Healthcare Senior Analyst

The dog that hasn't barked yet...the 2024 US presidential election and potential for further US healthcare reform

Other than the obesity drug manufacturers which sucked the life out of investing in the rest of the sector, the pharmaceutical/biotechnology (pharma/biotech) sector underperformed significantly in 2023, but 2024 to date has seen somewhat better performance, unusually for an election year.

Figure 2. Pharma/biotech sector stabilising after losing out to narrow rally from obesity drug manufacturers

Past performance is not a guide to future performance



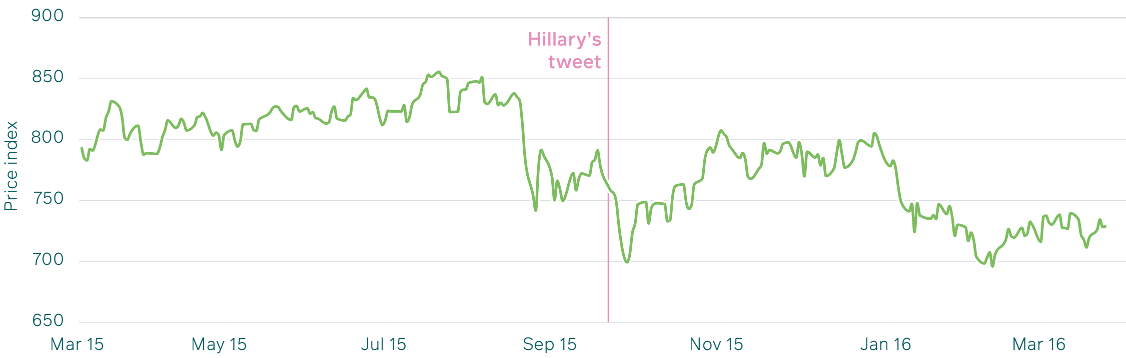
Source: Bloomberg, 27 March 2024.

Typically in a US Presidential election cycle, healthcare reform (particularly drug pricing fears), often dominates sentiment towards the pharma/biotech sector. In our **1Q 2023 Equities and Multi Asset Outlook**, my colleague Dan White, Head of Global Equities, highlighted that this time it could be different.

This is, in part, because the Democrats (who often lead the debate in this area and remember the hit the sector took following 'Hillary's tweet' in September 2015 about drug price reform) have already acted.

Figure 3. S&P 500 Pharmaceuticals, Biotechnology and Life Sciences Index

Past performance is not a guide to future performance



Source: Bloomberg, 2 April 2024.

Biden passed the Inflation Reduction Act (IRA) in 2022 which included provision to limit drug price rises (from 2023), reduce patient out-of-pocket spend (2024-25) and (from 2026) start to cut prices for Medicare Part D (self-administered) and (from 2028) Part B (physician administered) pharmaceuticals after nine years on the market for small molecules, 13 years for biologics.

Drug pricing rhetoric has been much more limited ahead of the likely Biden versus Trump rematch in 2024. The drug pricing ramifications of the original legislation are already being rolled out with ongoing negotiations for cutting Medicare price paid for the first 10 drugs identified, ahead of the 1 August 2024 deadline (prices due to be announced on 1 September 2024). Pharma industry litigation against the US government is slowly progressing through the courts with any final decision unlikely before it reaches the Supreme Court in 2025-26.

There still is, however, some potential for further policy headwinds.

First, in March 2024, Biden suggested that Medicare could ultimately negotiate prices for 50 drugs per year, not the 20 (from 2028) provided for in current legislation. He would also like to expand the $2,000 cap on out-of-pocket (o-o-p) spend to private insurance, and cap generic drug o-o-p costs to $2.

Second, while Trump has few formal proposals as yet beyond onshoring generic drug manufacture, he has made noises around reissuing an Executive Order (EO) re ‘Most Favoured Nation’ drug pricing. That is, the US pays the same price as major trading partners. This would be bad news for the sector. Net European Union prices are 50% of those realised by manufacturers selling into the US. However, it isn’t being discussed given his 2017 EO along these lines had no impact and would need both houses of Congress to change the law for it to have any ‘bite’.

All that said, given that the IRA only got passed via budget reconciliation when the Democrats controlled the House and Senate, any further meaningful reform to the IRA or any new provision, absent one party having a majority in both houses of Congress, seems unlikely. As Dan highlighted last year, US drug price reform is ‘the dog that didn’t bark’ or at least it hasn’t yet in 2024.

> “Any further meaningful reform to the IRA…seems unlikely”

UK

Michael Stiasny
Head of UK Equities

Stability as a catalyst for change

In the first quarter, UK equity indices climbed c.3%[11], but on many valuation metrics they remain at a significant discount to other developed markets. The UK reporting season was generally positive and merger & acquisition (M&A) activity has picked up significantly with a number of bid approaches. The fall in inflation we are seeing in the UK lags the rest of the world – but almost entirely because of the energy cap we have in place. The focus of investors for the remainder of 2024 will be on events that could derail the economy, and the growing expectation of moderating inflation and falling interest rates.

General elections can bring volatility and uncertainty for stock markets. This year however, we expect the reaction of the market to the UK general election to be one of cautious optimism. The opposition Labour Party has made much of its intention to provide an environment in which business can thrive and this has been welcomed by much of the UK business establishment. The foundation that this provides is important because it allows investors to anticipate a period of stability in UK politics that has been missing since 2016. The level of uncertainty and instability that has been projected internationally has been one of the factors that we believe has led to a 'buyers strike'.

This isn't necessarily rational given that 75-80% of the revenues of the FTSE All Share come from countries outside the UK[12] – but we consistently hear from investors that the UK is seen as having been unstable and, therefore, worth giving a reasonably-wide berth. However, with the discount that the market is now trading on, the level of M&A we are seeing (suggesting that there are many players who would also agree with the proposition that the market is cheap) and the fact that of all the elections in the world this year the outcome of the UK's is one of the most predictable (at the time of writing), we believe the general election itself could be an inflection point. We could look back in 18 months' time and point to the elections as a catalyst for change in investor sentiment, precisely *because* it means limited change, and stability for investors. Furthermore, if economic forecasts are to be believed, the election will also coincide with a period of lower inflation and modestly rising growth, again helping to erase the 'UK as the sick man of Europe' narrative and improve investor sentiment.

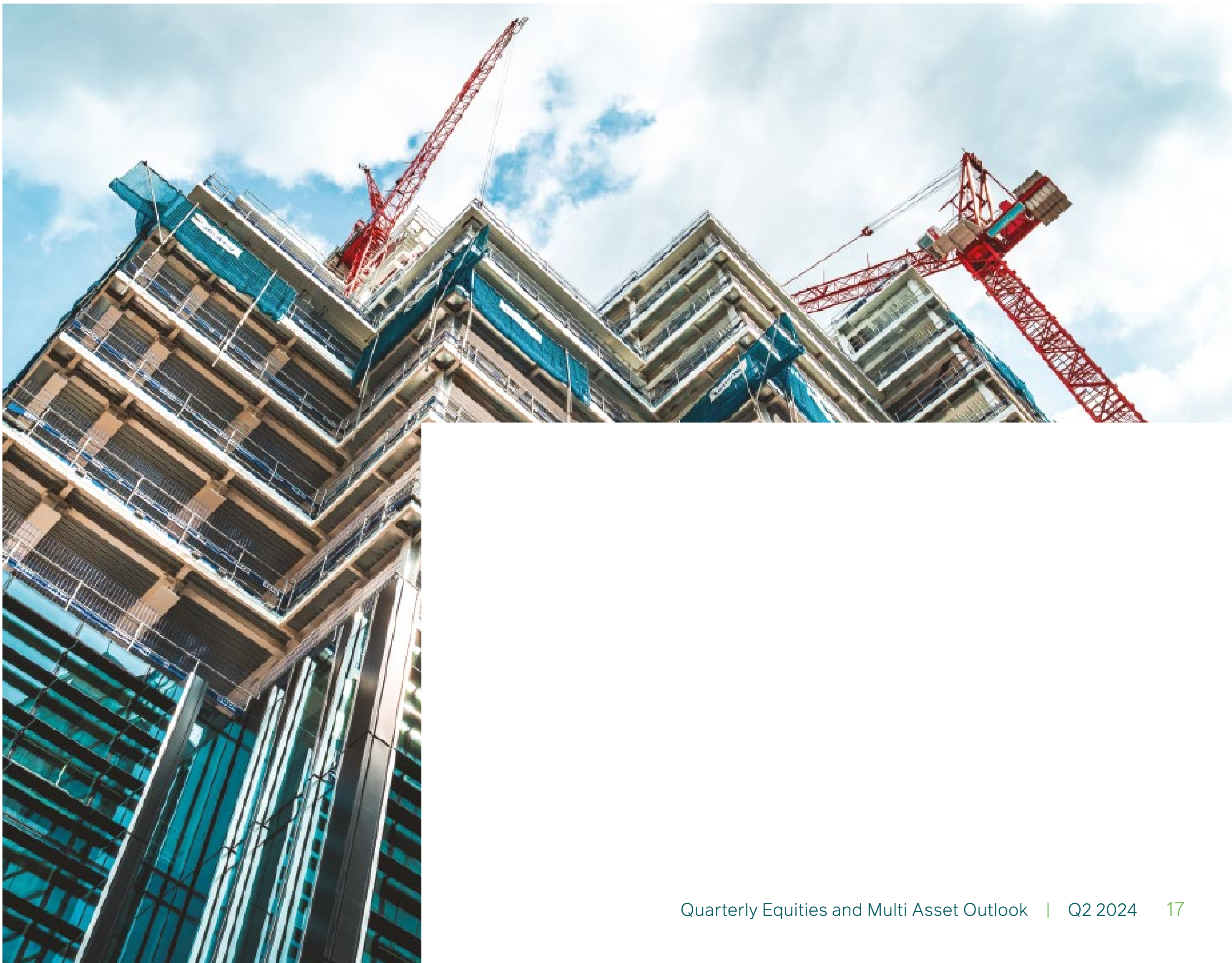
> **"...the elections [may be] a catalyst for change in investor sentiment, precisely *because* it means limited change, and stability for investors"**

[11] Source: LSEG DataStream, April 2024. FTSE All Share and FTSE 100 (price) indices in local currency terms through 29 March 2024.

[12] Factset, M&G Investments, March 2024.

Despite the suggestion of stability, there will be practical implications from new policies that could be implemented. We are yet to see the manifestos of the two main parties, but one can guess that there will be commitments to maintaining strict fiscal rules. As a consequence, money for new initiatives will be limited so a new government may look to further partner with the private sector and/or push greater responsibility on to individuals. For example, contribution rates to workplace pensions/auto-enrolment schemes are likely to increase – that will be good news for pensions and savings companies like Phoenix and Abrdn. We are also likely to see policies from both sides that promote continued spending on the electricity grid, critical infrastructure and national defence. The companies that will assist in these processes – the contracting and construction sectors and companies such as Kier and Balfour Beatty – are positioned to do well in our opinion. In addition, it's clear the UK is suffering from a new housing shortage, so any policies (such as planning reform) that accelerate housing output could benefit the housebuilders and building products companies.

Still, whatever one thinks about the politics of a UK general election, the truth of the matter is that the bigger driver of volatility for the UK market is likely to be the election taking place at a similar time on the other side of the Atlantic! With 75% of revenues of the UK market coming from overseas, the geopolitical (and domestic US) implications of a Trump presidency or a second term for President Biden are likely to increasingly dominate the discourse of investors in the UK, as markets try to discern the implications for companies, the macroeconomic backdrop and geopolitical context in which businesses operate.



Japan

Carl Vine
Co-Head of Asia Pacific Equities

Japan: delivering

During the first quarter of this year, the Japanese equity market put in its strongest quarterly performance in a decade, in local currency terms. The broad TOPIX index rose by close to 17%[13] over the quarter as optimism around the asset class continued to deepen.

Unlike the US equity market, which saw roughly half of its first quarter gains concentrated around the Artificial Intelligence (AI) thematic, gains in Japan were relatively broad based. The biggest contribution came from auto stocks, thanks to a 46% rally from Toyota Motor. Beyond autos, trading companies, financials and real estate were all strong contributors. Whilst pockets of notable AI-linked enthusiasm pervaded in the quarter in Japan, the dominant driver of market performance was company earnings combined with growing confidence in the 'capital improvement' thematic.

A few notables from Japan over the first quarter would include the following:

Firstly, observers have been keen to see whether or not retail investors have been using the increased tax-free savings limits for stock market investing since the NISA scheme was revised on 1 January 2024[14]. We only have data for January and February but, so far, inflows into NISA accounts have roughly tripled year-on-year to approximately 1.7 trillion yen with almost half of that inflow going to domestic stocks. The NISA regime change was never going to unleash a 'financial tsunami' of inflows, but it has clearly increased household interest and participation in the domestic stock market, a helpful and healthy development for the market.

Secondly, the yen exchange rate has been a hot topic so far in 2024. The currency continues to confound the pundits. Most observers believe that the yen is currently too cheap and will strengthen from here thanks to rising rates in Japan versus peak rates in western economies. However, following the Bank of Japan finally announcing a well anticipated, if modest, increase in interest rates in March, the currency went on to weaken further.

We believe that corporate reform is driving productivity growth in Japan. This, along with a narrowing of interest rate differentials, leaves us sympathetic to the consensus view that yen is too cheap. That said, we also acknowledge we have no edge in currency forecasting, and so continue to build a portfolio that is designed to be broadly unimpacted by currency outcomes.

Wages have also been a KPI that Japan observers are paying attention to. Signalling not just improved consumption prospects, higher wages have also been seen as a signal of rising 'animal spirits' and a dismantling of the old state-led economic model. On this front, it's notable that in March, the Japanese Trade Union Confederation announced that large-sized companies have agreed to an average wage hike of 5.25%, the largest increase in 33 years. Furthermore, Prime Minister Kishida stated publicly in late March that he is dedicated to maintaining wage increases beyond 2025. This was taken positively by the market.

[13] Source: LSEG DataStream, April 2024. TOPIX, price indices in local currency terms through 29 March 2024.

[14] Nippon Individual Savings Accounts (NISA). The new NISA was introduced in January 2024, with changes to the system including making the system permanent, making the tax-free holding period indefinite, and increasing the annual investment limit and the tax-free holding limit.

Although the Kishida administration has worked hard to support higher wages, the administration's approval-rating remains alarmingly low at around 20%–25%. Public trust has been eroded by the political-funding scandal that emerged in 2023. The Kishida administration now faces a critical few months ahead. If Kishida's party loses the Lower House by-elections in late April, calls for his resignation will emerge. Like other major economies, the election dynamics in Japan this year offers ample scope for surprises.

Looking ahead, we need to acknowledge the valuation expansion in Japan in the past year or so. At the start of 2023, the Japanese market was simply too cheap versus the existing earnings power, irrespective of the corporate reform dynamic which we believe will help drive strong long-term compounding gains from Japan equities. Today, more than a year on, the excessive undervaluation has been removed for many large-cap stocks. That said, the long-term opportunity from corporate restructuring and balance-sheet reform remains firmly intact and the pace of reform continues to accelerate.

> **"If Kishida's party loses the Lower House by-elections in late April, calls for his resignation will likely emerge"**

Asia Pacific ex Japan

Dave Perrett
Co-Head of Asia Pacific Equities

Driving ‘Value Up’ and Asian resilience

Despite considerable intra-quarter volatility Asian markets ended the first quarter modestly higher. For context, in late January, Chinese markets were down over 10% from levels seen at the beginning of the year, but ended the quarter down just 2% as economic policy easing and measures to improve investor sentiment – like encouraging higher dividend payouts – helped stabilise markets. The best performing market was Taiwan, which rallied more than 12%. Artificial Intelligence (AI) was the key driver, with index heavyweight TSMC rallying more than 30% after strong earnings and guidance. Korea rallied a little more than 3% but, within the market, the divergence of performance was huge. The Korean government, having seen the success of Abenomics in lifting Japan’s Nikkei index, launched a ‘Value Up’ campaign with the intended goal of boosting equity valuations and eradicating the historic Korean ‘discount’. The government floated the idea of tax changes to encourage higher dividends and simplified corporate structures, as well as using the National Pension Fund and other vehicles to reward reforming companies and exclude corporate governance laggards. A number of ‘Value Up’ names – including holdings such as KB Financial, Samsung Life and Hyundai preferred shares – all returned near 30%[15].

An initial test of the popularity of ‘Value Up’ was the 10 April 2024 legislative elections in Korea for the National Assembly. The President’s right-of-centre People Power Party has pitched the programme as an effort to share corporate wealth with individual shareholders, while opposing parties have criticised some of the policies as favouring the wealthiest in society, including the families that control the Chaebol[16]. This election result saw the leading opposition party maintain their majority in the legislature, but not secure a super majority which would have allowed the party to override a Presidential veto. Korea’s KOSPI Index was down c.1.6% on opening, but subsequently rallied to close the day up. Although the electoral setback could reduce momentum for ‘Value Up’ at the margin, it will not lead to widespread repudiation of the programme at this stage. With President Yoon still in power until 2027, the policy will remain in place for the foreseeable future.

India’s impending election is very important for the Asian market. The incumbent ruling Bharatiya Janata Party (BJP) is widely expected to win, and their victory is largely discounted. We have no reason to quarrel with the consensus in this regard, but we would note that, in the unlikely event the BJP does not win, the market could perform very poorly.

Arguably, the greatest source of political uncertainty for the region in 2023 comes from, you guessed it, the US. The US Presidential election is discussed in detail elsewhere in this note. Certainly, some of Donald Trump’s comments on trade and China will mean Asian markets will be vulnerable to headlines tied to a Trump victory and related trade policies. Importantly, this is 2024 not 2016. Since the last Trump victory and associated tariff policies, regional trade practices and operations have evolved and companies have been pursuing China Plus One (C+1) strategies[17] in their production plans. This does not mean that the Asia region will be immune from renewed trade friction, but it does mean it should be more resilient. Indeed, the exporters we own in the portfolio have been carefully picked so that they are less vulnerable to new or higher tariffs on their operations.

[15] Source: LSEG DataStream. MSCI (Price) indices in US dollar currency terms through 29 March 2024. Same source for KOSPI.

[16] System of large family-owned business conglomerates in South Korea.

[17] Supply chain strategies that encourage companies to diversify their supply chain and manufacturing activities away from China to mitigate risk.

> "Asian markets will be vulnerable to headlines tied to a Trump victory and related trade policies"

Emerging Markets

Michael Bourke
Head of Emerging Market Equities

Emerging markets: at the intersect of investment and politics

After a precipitous drop in January, largely driven by China, Emerging Markets (EM) stabilised over the quarter to close in positive territory by quarter end. China is the biggest source of volatility within the asset class right now. Technology-heavy markets such as Korea and Taiwan have delivered handsome returns, driven by continued Artificial Intelligence (AI) fervour. Korea, in particular, as our largest country overweight has also benefited from the 'Value Up' strategy. Elsewhere, markets in Latin America have given back some of the late fourth quarter 2023 excitement on the back of the 'Fed pivot' in messaging towards lower rates, with Brazil down 4-5% year-to-date in US dollar terms. The Middle East and Africa saw positive returns in Saudi Arabia (c.4%) and Turkey (c.25%); offset by continued weakness in South Africa (down c.7%)[18]. We continue to see a route to better returns in China with vigorous corporate activity driving payout ratios and buybacks, while expecting some stabilisation of the China macroeconomic concerns this year on the back of greater policy efforts.

Unstable political environments routinely lead to volatility in EM assets. We increasingly find our own clients have geopolitics, rather than returns on capital, top of mind. To allay fears, we firstly point towards our long history of investing in countries which have elevated geopolitical risk premia and, secondly, we highlight that astute EM investors often use these episodes as advantageous entry points. We would also highlight that volatility does not always reflect downside risk. The truth is, elections and geopolitical risks are very hard to price.

> “Unstable political environments [create] volatility in EM assets [but] volatility does not always reflect downside risk”

Much has been made of the 'world of elections' in 2024 but we would also point out elections that have just happened. Noteworthy recent examples include Taiwan, Indonesia, Turkey and Argentina. A diverse spread of countries that have had equally diverse election outcomes and ensuing impacts on asset prices.

In January, we saw the pro-democracy party returned in Taiwan, a result that fanned regional tensions but was perhaps expected by global markets. We have been underweight Taiwan in our portfolios due to valuation concerns posed by frothiness in the global AI trade, rather than the optical geopolitical risk premia. In Indonesia, President-elect Prabowo Subianto represents a continuum of the status quo, albeit with a potentially different policy bias; he had previously been banned from the US due to purported human rights violations and, policy-wise, may be seen as more pro-China than his predecessor, Joko Widodo. For both of these Asian economies, the interpretation of their respective political outcomes and the impact on their economies sits squarely between two giants: the US and China.

[18] Source: LSEG DataStream, April 2024. Price indices in US dollar currency terms through 29 March 2024.

Markets in Turkey have warmed to President Erdogan's apparent return to monetary policy orthodoxy with the Finance Minister and Central Bank raising rates aggressively to staunch the chronic inflation picture. Erdogan's power appears to be ebbing, as he signals this is his last term and the AKP party have lost further ground in local elections, with both Ankara and Istanbul now run by the opposition CHP party. Erdogan has subsequently made his maiden voyage to the White House, purportedly to consult on tensions between Israel and Hamas. Again, the lens of perception for Turkey is led by relative closeness to the US. Argentina is more anomalous to the rest; years of economic malaise and lowly regard from international investors has received a veritable fiscal shot in the arm from populist right winger, Javier Milei. The country has huge economic problems to fix, but the radical policies espoused by the new government has certainly brought Argentinian companies back on the radar.

Yet to come are elections in notable EM heavyweights South Africa, Mexico and India. We have moderate overweight positions to both South Africa and Mexico and will remain watchful in the buildup to both events. The election in South Africa could be a moment of peril or real opportunity, depending on whether or not the ANC lose the majority they have enjoyed since the end of Apartheid and, if so, which party may provide coalition support. A coalition with the Democratic Alliance, who have provided a degree of stability since they took power in Cape Town in 2006, could increase the chances of market-friendly reforms. Both Mexico and India are not expected to provide fireworks. In India, Prime Minister Modi looks certain to win re-election for a third term, sufficiently so that the Minister of Finance Nirmala Sitharaman feels confident enough to have already announced a fiscal consolidation, targeting a less than 4% deficit by the end of fiscal year 2026. India has doubled its deficit through the COVID years and is now looking to remove such stimulus as the country's overall debt-to-GDP looks high at close to 82%. Time will tell what effect such moves have on India's growth and elevated market valuations. Finally, in Mexico, incumbent party Morena is expected to regain power via AMLO's protégée Claudia Sheinbaum. Little is known about her likely policy direction with the New York Times calling her 'an enigma'; the race, thus far, has been very low-key.

The US election in November is of course hugely consequential for the globe. Meanwhile, key geopolitical issues (Russia-Ukraine, Middle East and China-Taiwan) remain unresolved and the US elections are not helping to ease the uncertainty on this front. As mentioned though, the truth is that elections and geopolitical risks are very hard to price. It is why, rather than focus on the events in-and-of themselves, we spend our time diligently analysing companies from a bottom-up perspective and seek to take advantage of any market dislocation in valuations.

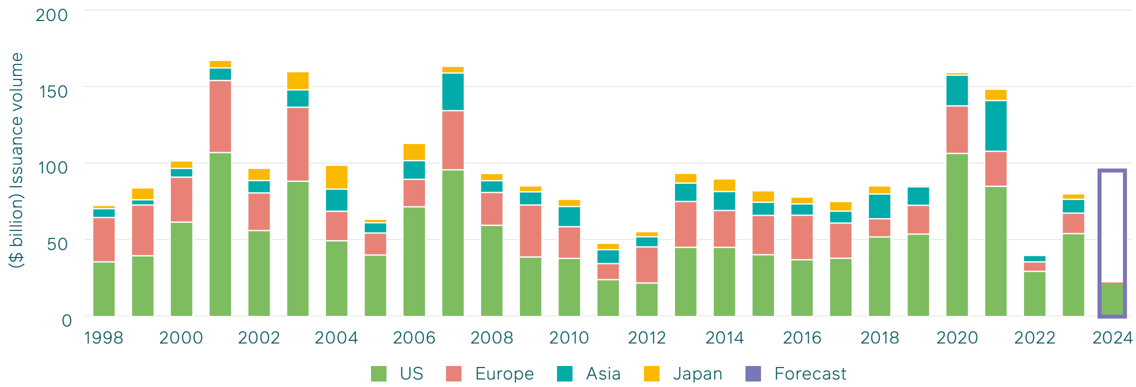
Convertibles

David Romani
Deputy Fund Manager, Convertibles

Politics turns and turns but it does not make the (investment) world go round

Global convertibles saw a strong bout of new issuance during the first quarter of 2024, with $24 billion of new paper coming to market, of which c.80% was from US issuers. The pace of new issuance exceeded that of 2022 and 2023 and is on track for an annualised $90-100 billion in 2024, surpassing pre-COVID levels[19].

Figure 4. Global convertible bond new issuance volumes



Source: BofA Global Research, 25 March 2024.

Several factors contributed to this – not least, the higher interest rates at a time of refinancing needs[20], a recovery in stock prices and renewed enthusiasm for 'hot' themes such as Artificial Intelligence (AI) and bitcoin. We have previously discussed AI in our **Q3 2023 Equities and Multi Asset Outlook – Beyond Nvidia**[21]. Since then, we have seen three direct AI plays issue converts, with the poster child being Super Micro Computer's $1.7 billion bond in February. Additional excitement came from crypto names. MicroStrategy continues to trade at a very significant premium to the value of its bitcoin holdings. It capitalised on its meteoric rise in March by issuing two convertibles in rapid succession within two weeks of each other. The stock price has been rising so fast (c.67% in March), that the first bond entered the FTSE Global Focus Convertible Bond Index[22] and is likely to come out after just one month as it is deeply in the money already.

In a year in which politics will increasingly be in focus, it's worth noting that any volatility caused by geopolitical events can, in our view, affect positively the pricing of convertible options – supporting their valuation and mitigating (but not completely offsetting) the negative effects of any volatility on equity and credit values. This can help convertibles produce better risk-adjusted returns than other asset classes in times of political upheaval.

[19] Source: Bank of America Global Research, Data as of 25 March 2024.

[20] We talked about maturity walls in the Q4 2023 Quarterly Equities and Multi Asset Outlook – Landing in the dark, in our section entitled: Soft, hard or no landing, debt falls due.

[21] We discussed AI in the Q3 2023 Equities and Multi Asset Outlook – Beyond Nvidia, in our section entitled: Expect a wave of AI-related issuance, but beware the lagging productivity boost

[22] Source: LSEG DataStream, April 2024. Monthly return data through 29 March 2024. The Global Focus Sub-Index is an index derived from the Global Index using Regional Market Capitalisation, Percentage Price, and Premium criteria.

Geopolitical events are notoriously unpredictable and, as such, it is a challenge to position a portfolio for the whole gamut of political risks. Therefore, our focus remains on having a well-diversified portfolio with strong equity and credit fundamentals, attractive valuations and favourable risk-reward characteristics that can withstand such uncertainties. It is also important not to be unduly exposed to themes or areas of the market that may have greater sensitivity to political or policy uncertainty. For example, three areas that would be influenced by the US Presidential election, as mentioned by my colleagues elsewhere in this outlook, are protectionism and the technology export restrictions to China, potential healthcare reform, and energy transition.

In our portfolios, our largest technology exposure is in software, an area that has attracted less political attention, rather than semiconductors and hardware. That said many semiconductor and hardware stocks are likely to weather the storms thanks to their strong intellectual property and innovation capabilities, and we have actually taken advantage of price volatility around political and regulatory risk to add exposure to a Korean memory chip manufacturer at depressed equity valuation and favourable convertible terms.

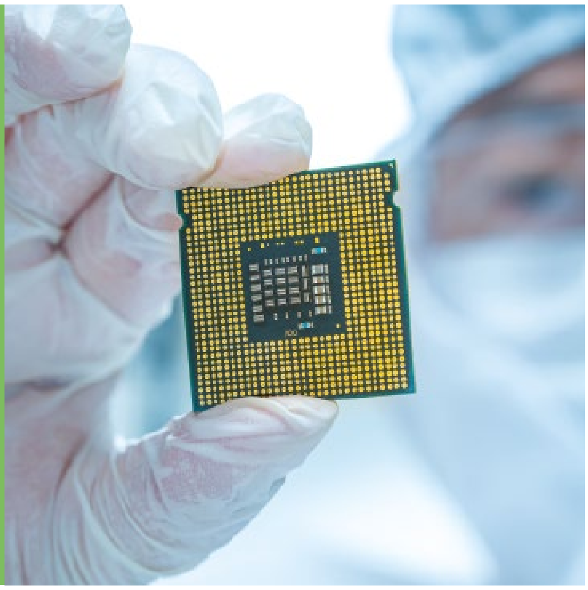
Similarly, we believe diversification and intellectual property are the best defence to counter any volatility in the healthcare sector driven by drug pricing concern. We focus on companies with the ability to extend patent life, improve cancer detection, those offering novel, differentiated treatments, and those expanding the availability of difficult-to-manufacture new formulations.

In energy transition, we also prefer firms with idiosyncratic, company-specific drivers, rather than those relying on external developments or government incentives. Hence, whatever political zigzags the US election may bring, we attempt to steer clear of the names that may be unduly swayed (positively or negatively) by the political winds.

Last but not least, when it comes to protectionism and trade restrictions, while we are cognisant of government actions that may be detrimental (or favourable) to individual sectors or companies, we focus much more on fundamentals and valuation. Our large overweight position in China/Hong Kong names focuses primarily in out-of-the-money cheap, high-yielding convertibles with very limited equity sensitivity, and issued by domestic consumption businesses – dominant in, for example, food and parcel delivery – along with hotels and real estate businesses.

Globally, politics turns and turns but it does not make the (investment) world go round. At its core, the key to generating consistent investment performance, in our view, is a steadfast focus on fundamentals, valuations, risk management and diversification – whatever the prevailing political backdrop.

“...we have taken advantage of price volatility around political risk to add exposure to Korea”



Multi Asset

Stefano Amato
Fund Manager, Multi Asset

Political volatility can lead to opportunities

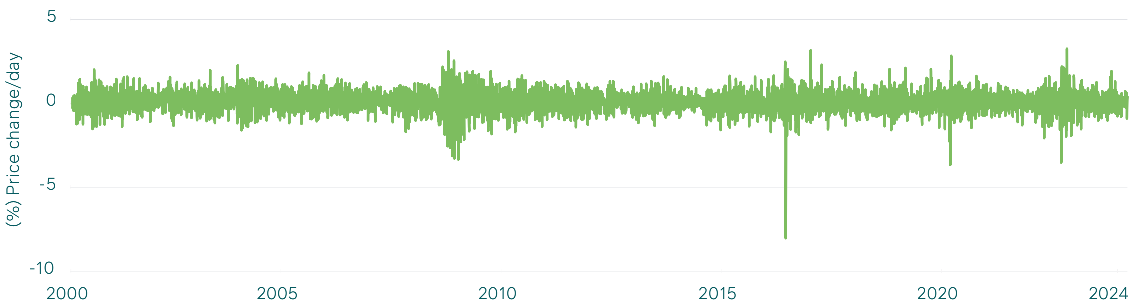
Through the first quarter, we remained constructive on both equities and bonds and, therefore, implicitly positioned for a continuation of the 'relief rally' witnessed over the final two months of 2023. While equities performed well – the MSCI World Net Total Return USD Index was up c.9% and logged its best first quarter since 2019 – bonds, as measured by the Bloomberg Global Aggregate Index, actually lost c.1% amid lingering inflation pressures[23] – yet we still see value in government debt securities given attractive real yields in our view, and the increased potential to provide portfolio insurance.

Going forward – as we survey the packed 2024 election calendar – we are reminded that elections historically have rarely altered the medium-term direction of travel for financial assets. That said, there have been meaningful recent exceptions.

> **Markets are increasingly asking questions about the sustainability of [the US'] fiscal trajectory**

For example, markets reacted very dramatically to the surprises of both the Brexit referendum and Trump's victory in 2016 – leading to shorter-term, tactical investment opportunities.

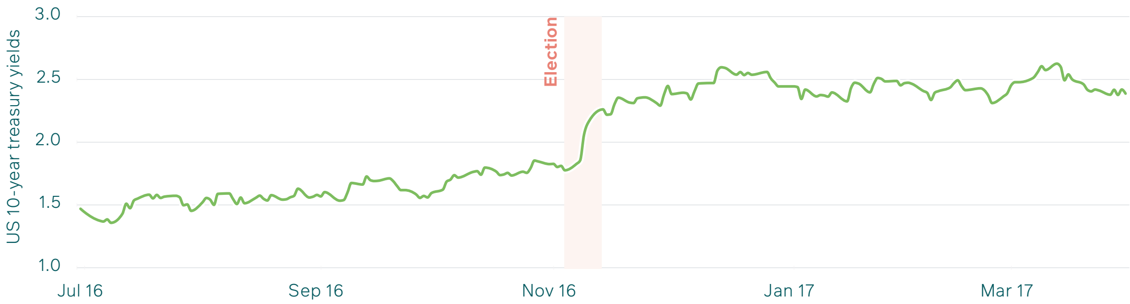
Figure 5. Brexit referendum: UK sterling short-term reaction to result



Source: Bloomberg, 25 March 2024.

Figure 6. Trump election victory: after an initial 2016 election night dip, yields resumed their upward journey at pace

Past performance is not a guide to future performance



Source: Bloomberg, March 2024.

[23] Source: LSEG DataStream. All returns in US dollar terms through 29 March 2024.

Political known unknowns are of course not all created equal, and for 2024 the obvious elephant in the room is the US election in November which we fully expect to dominate headlines from the summer onwards at the latest.

As investors, one of the most interesting features is that – despite the two candidates having very little in common in terms of political platforms – Biden and Trump both seem inclined to keep the US on a path of fiscal largesse and elevated debt issuance.

This is all the more relevant as – while there are no apparent challengers to the US dollar status as the international reserve currency, which is granting the US its exorbitant privilege to enjoy lower debt service costs than it would have to incur otherwise – markets are increasingly asking questions about the sustainability of its fiscal trajectory.

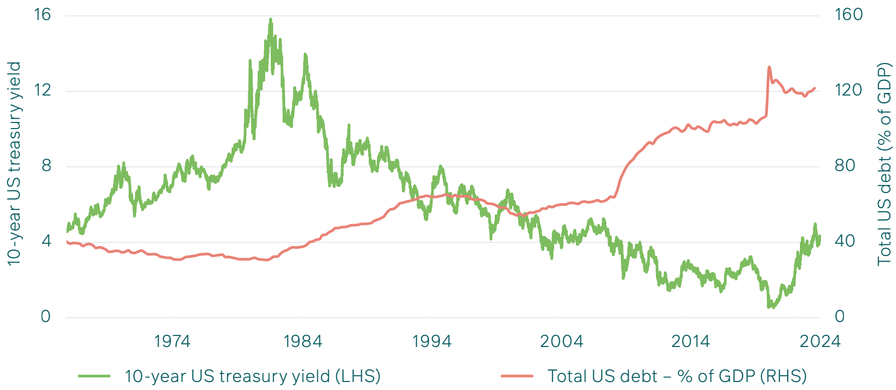
Until now, data shows no clear relationship between public debt levels and yields on US treasuries over the long run.

Nonetheless, we have entered a markedly-different environment after the historic fiscal and monetary policy response to COVID, with interest rates having conclusively exited the c.40-year downward trend that started with the Volcker-led Federal Reserve interest rate hike peak of 20% in 1981.

While this change, in our opinion, demands increased vigilance and creates potential vulnerabilities for the US debt profile – a theme which markets already explored in 2023 as US 10-year yields briefly touched 5% – any meaningful impact to the attractiveness of US treasuries is likely to potentially only play out over the long run, or it would at least require a large and US-focused shock to push investors away from the ultimate safe haven.

Figure 7. No clear relationship between public debt levels and US treasury yields

Past performance is not a guide to future performance



Source: Federal Reserve Economic Data (FRED). US treasury securities at 10-year constant maturity, quoted on an investment basis, percent, daily, not seasonally adjusted; Federal debt: total public debt, percent of GDP, quarterly, seasonally adjusted. As at 21 March 2024.

On balance we remain constructive on US treasuries. We also think that 2024 might bring about potentially more conducive conditions for short-term spikes in US yields – and likely therefore in other government bonds as well – which could present us with investment opportunities to purchase these assets and increase our holdings at potentially attractive levels. Indeed, we maintain conviction that US treasuries should still provide portfolio insurance in most scenarios, despite the potential for politics-led volatility in the US.

As usual, we expect that keeping things in perspective and exercising judgement will once again be key to successfully manage our portfolios through periods of high volatility.

M&G Investments