

Daily: Building resilience to navigate market risks

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Thought of the day

Global markets started the week on a cautiously optimistic note as oil prices declined and softer US jobs data reduced pressure on the Federal Reserve to further raise interest rates imminently. Asian equities broadly advanced on Monday, after the S&P 500 gained 0.7% on Friday and ended within 1% of its record high.

Brent crude fell 0.7% to USD 101.5/bbl at the time of writing. New data showed that crude exports from the Middle East rose above pre-war levels on four of the final seven days of September, while G7 countries agreed on Friday to release 100 million barrels of diesel and crude from emergency reserves and refrain from energy export restrictions. Meanwhile, investors scaled back their expectations for immediate Fed hikes after US payrolls in September came in well below estimates, and recent comments from Fed officials pointed to a more patient approach.

These developments support our constructive outlook for risk assets, and we believe equities have room to move higher over the next six to 12 months amid resilient economic growth and robust earnings.

But the path is unlikely to be smooth. With equity markets near record highs, managing concentration risk and strengthening portfolio resilience remain important as investors navigate geopolitical risks and elevated bond yields.

Energy markets remain vulnerable to renewed disruption. Normalizing oil flows from the Middle East are encouraging, but the risks of sudden disruptions and further damage to energy infrastructure in the region have not gone away. The Houthis said they launched ballistic missiles and drones at Saudi Aramco sites in Riyadh, while attacks on tankers in and around the Strait of Hormuz continued. Shipping intelligence firm Marisks in a weekend report said vessels transiting through the waterway face a “heightened and increasingly unpredictable kinetic threat.” We continue to believe that traffic through the Strait should resume gradually, but periodic setbacks could lead to spikes in oil prices and market volatility.

Treasury yields are likely to remain volatile. While Fed rate hike expectations declined on the back of the soft jobs report and encouraging PCE data, the 10-year US Treasury yield finished Friday higher and remained close to a 24-year high. Technical factors may partly explain the disconnect between yields and economic fundamentals and policy guidance, as investors remain concerned that yields have yet to peak and are reluctant buyers. We expect yields to ultimately stabilize, but such investor caution may persist until there is more confidence that inflation will decline at a steady pace. This means elevated yields may continue to pressure stock valuations.

Record highs may make retreating to the sidelines feel safe. In addition to valuation headwinds from higher yields, equities close to all-time highs may deter some investors. The S&P 500 is just 1% below its record high, and it currently trades at a valuation premium over its 25-year average. We have

highlighted that all-time highs are not a rare occurrence historically, and valuations have a poor record as short-term timing tools. Our analysis shows that earnings and a supportive growth backdrop matter more, and the current environment remains favorable for profit growth. We acknowledge that record highs can make investors nervous, and cash may appear safe over short horizons.

So, we think holding a resilient portfolio can help investors manage near-term volatility while staying invested for long-term gains. In addition to an equity holding that is broadly diversified across sectors and regions, we think exposure to broad commodities can provide both a structural source of return and portfolio defensiveness. Investors can also consider capital preservation strategies to manage the risk of a drawdown while retaining allocations to quality bonds for attractive portfolio income. Those willing and able to manage the risks associated with alternatives can also use hedge funds to broaden return drivers.

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