

# Capital Markets Strategy

Essential inCights for the C-Suite

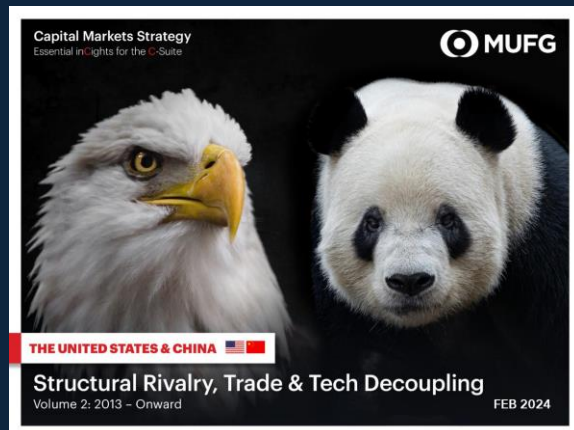


## The Art of Cartography

Maps that Matter for Markets in 2024

FEB 2024

# 2024 Outlook Publications



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## **B** — Heightened Deal Activity in 2024

# 2024: A Year of Elevated Risk & Opportunity

**“It takes a person of great care and insight to watch for any abnormality in the green grass even while it grows abundantly and healthily.”**

Kenzaburō Ōe, Nobel Prize-winning writer and major figure in contemporary Japanese literature (1935-2023)



# A. Maps that Matter for Markets in 2024

# #1 Gravity Shifting East

# The Indo-Pacific: 21st Century Geostrategic Epicenter

From both an economic and geopolitical perspective, the broader Indo-Pacific region has emerged as the geo-strategic epicenter of the great powers in the 21st Century

## The Indo-Pacific Region

- > 50% of global population
- 65% of the world's oceans
- 25% of world's land mass
- 7 of the world's largest militaries
- ~ 2/3 of global GDP
- Nearly \$2 trillion of US & Indo-Pacific trade
- ~ 3 million US jobs
- Nearly \$1 trillion of inbound US FDI
- Over \$1 trillion of outbound US FDI

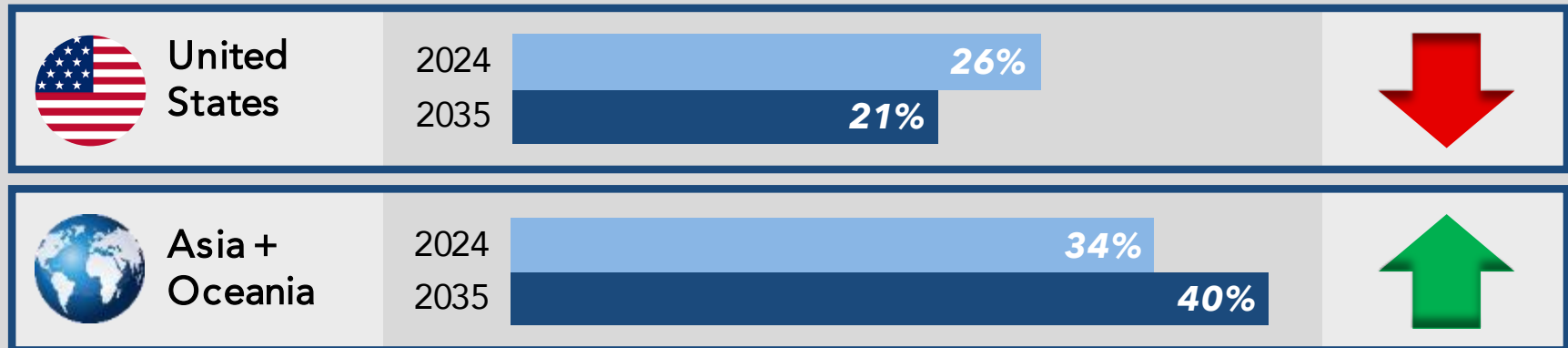




# Gravity of Global Economy Shifting East

Over the next 10 years, the Asia-Pacific region will grow to account for approximately 40% of global GDP, while the US share will decline closer to 20%.

Nominal GDP as share of global GDP








GDP, nominal, USD tn

## Top 5 economies in the world, 2024

1		US	\$28.0 tn
2		China	\$18.9 tn
3		Germany	\$4.4 tn
4		Japan	\$4.0 tn
5		India	\$3.9 tn

## Top 5 economies in the world, 2035

1		US	\$42.4 tn
2		China	\$42.4 tn
3		India	\$11.7 tn
4		Germany	\$7.2 tn
5		Japan	\$6.5 tn

Source: (1-3) Oxford Economics. Data as of December 2023.

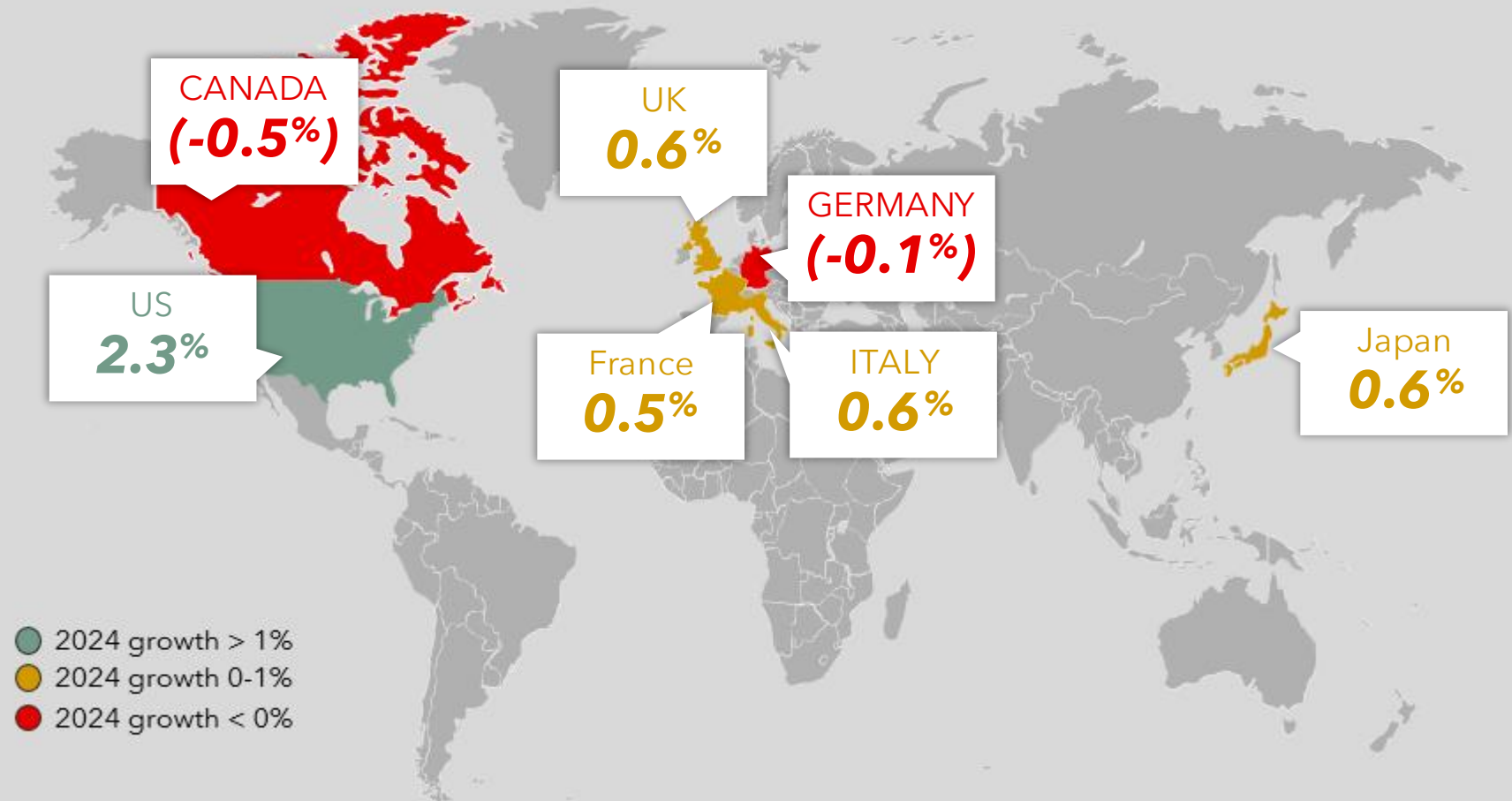


# #2 US Economic Exceptionalism

# US Economic Exceptionalism

With expected 2024 GDP growth above 2%, the United States is the only G7 economy projected to grow above 1% in 2024.

2024 GDP growth forecasts for G7 economies (y/y)



Source: (1) Oxford Economics. Data as of February 8, 2024.



# "This Time Was Different"

The US economy has been far more resilient to this accelerated Fed tightening cycle due to: (i) impact of COVID-era imbalances on US consumer; and (ii) a US economy that is structurally less rate sensitive than 30 years ago.

US adjustable rate mortgages (ARM) & floating rate notes (FRN)



## Post COVID Imbalances Supporting the US Consumer

\$10 tn	US COVID era fiscal stimulus
\$3 tn	Peak COVID era excess US consumer savings
3.7%	US unemployment near multi-decade lows
80%	Services as % of US GDP (inherently less rate sensitive)

Source: (1) Financial Times, "We are too obsessed with monetary policy." Bloomberg. Data through December 29, 2023. ARM share of mortgages is % of loan volume.

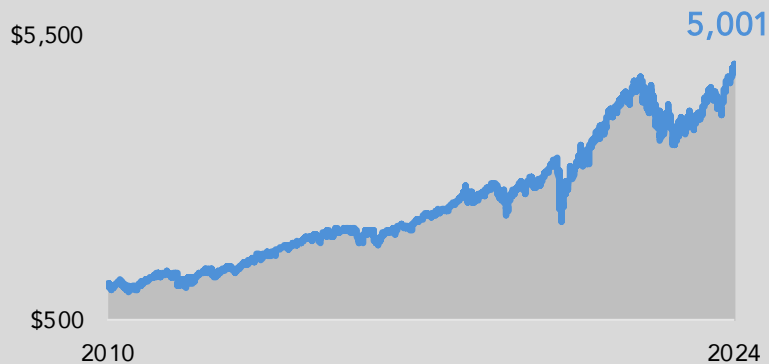


# Tightening Transition Mechanism Interrupted

Financial conditions remain easy, providing fuel for the economy and in turn disrupting the transmission mechanism between Fed tightening and US recession risk.

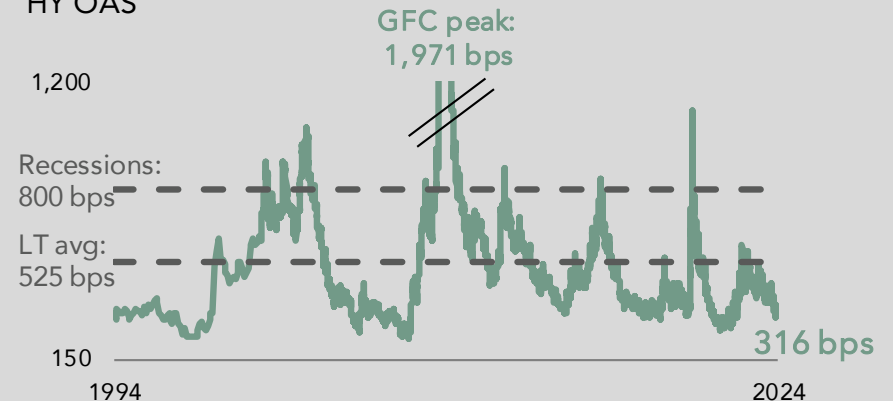
## US equities testing record highs

S&P 500



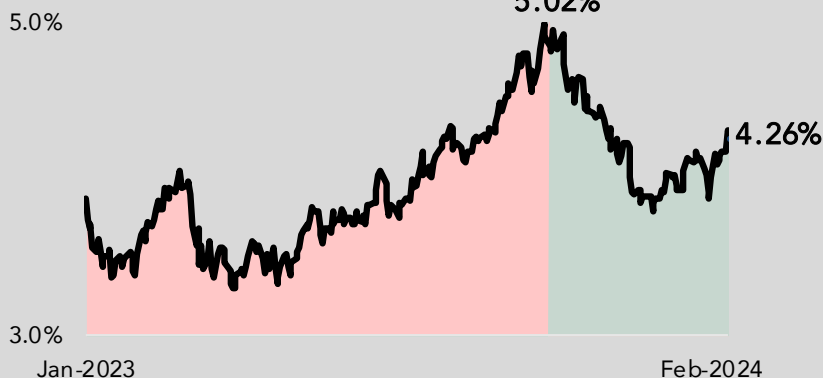
## Credit spreads well below LT averages

HY OAS



## UST rates rallying lower since Q4

10 year UST



## No geopolitical risk premium in energy prices

Brent



Source: (1-4) Bloomberg. Data as of February 14, 2024.



# **#3** The Fed is in 'No Hurry'

# The Fed is in “No Hurry”

Japan, the only major economy with a negative benchmark policy rate, is expected to normalize policy in Q2 2024. While the Fed is likely to participate in the synchronized G20 policy easing of 2024, we believe that they are “in no hurry” given resilient US economic data, tight labor markets, and financial market conditions that are currently doing the easing for them (equities, credit, energy markets).

## Monetary policy expectations for G20 economies in 2024

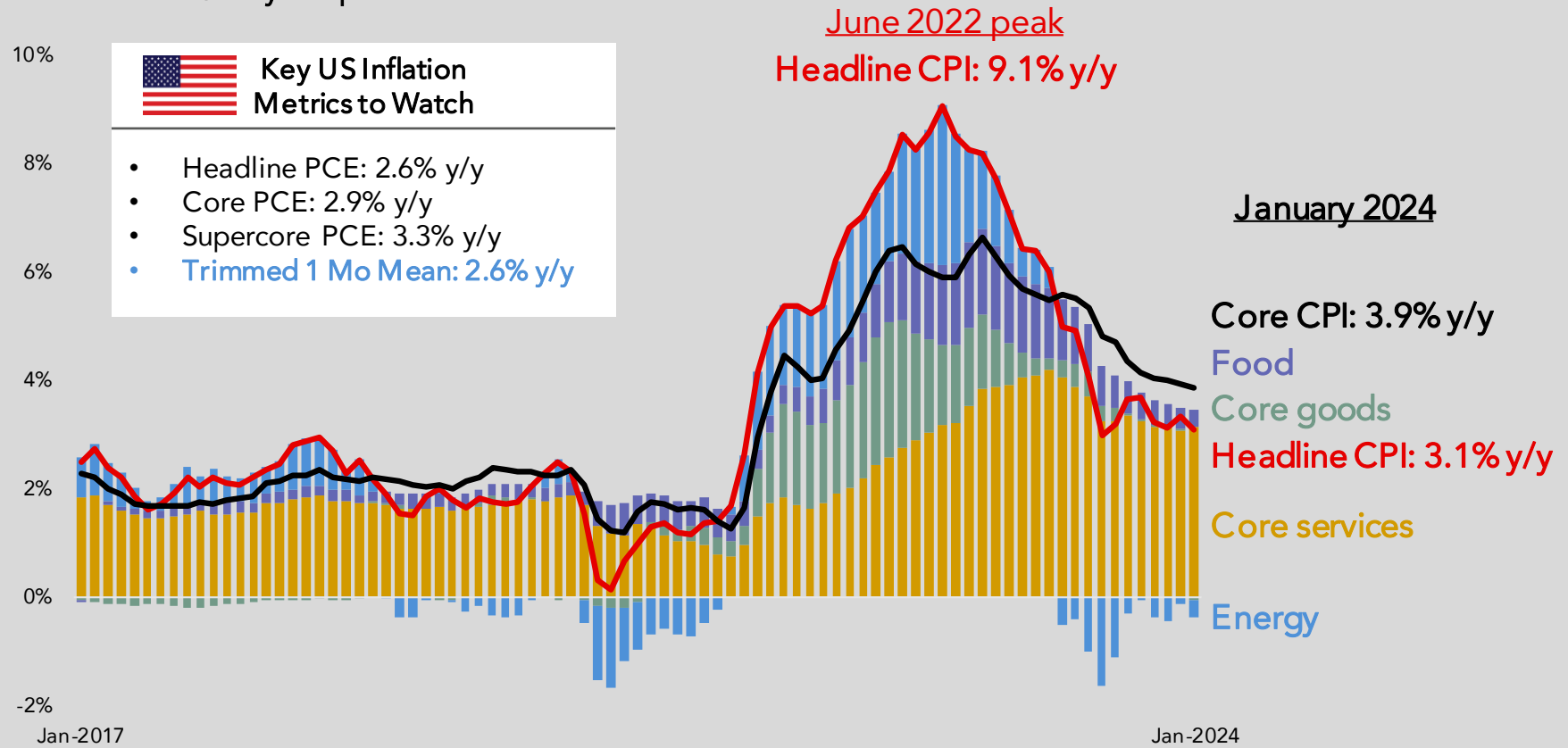


(1) Bloomberg. WIRP. Data as of February 8, 2024.

# Remarkable Progress on Inflation

Headline inflation increased 3.1% y/y in January, disappointing market expectations for CPI to fall below 3% for the first time since March 2021. On a monthly basis, headline inflation surprised to the upside, rising 0.3% m/m vs. expectations of 0.2%. Core inflation also came in above market expectations, increasing 0.4% m/m, the most in eight months, and 3.9% y/y. The market is now pricing only ~95 bps of Fed rate cuts in 2024 beginning in June, down from the ~170 bps of cuts expected in mid-January.

## Breakdown of CPI by components



Source: (1) Bloomberg. Data as of February 13, 2024.

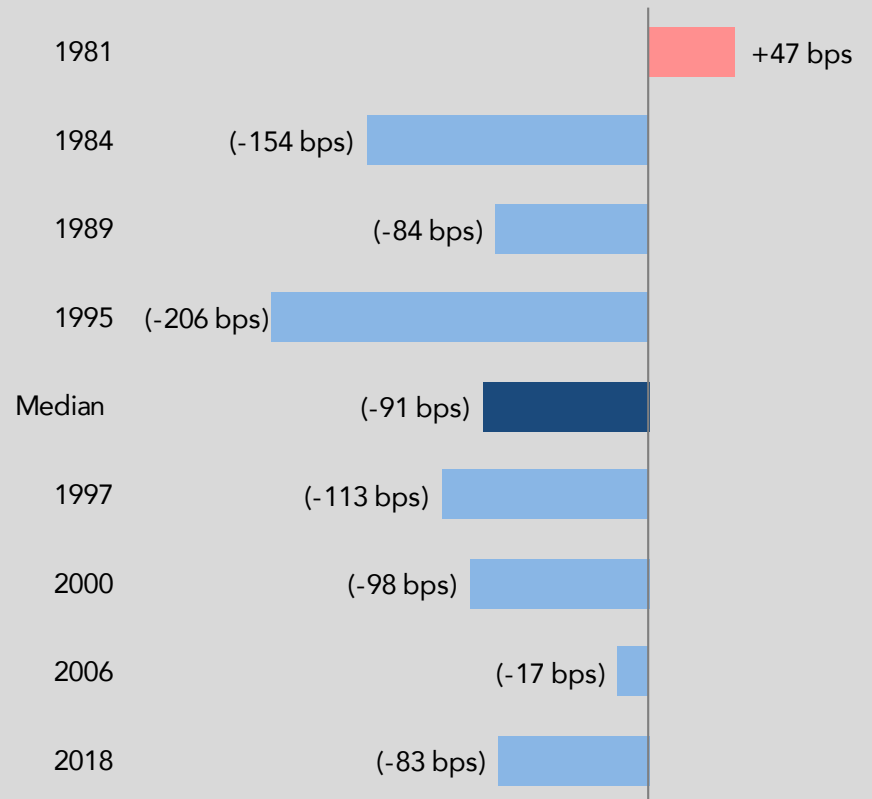
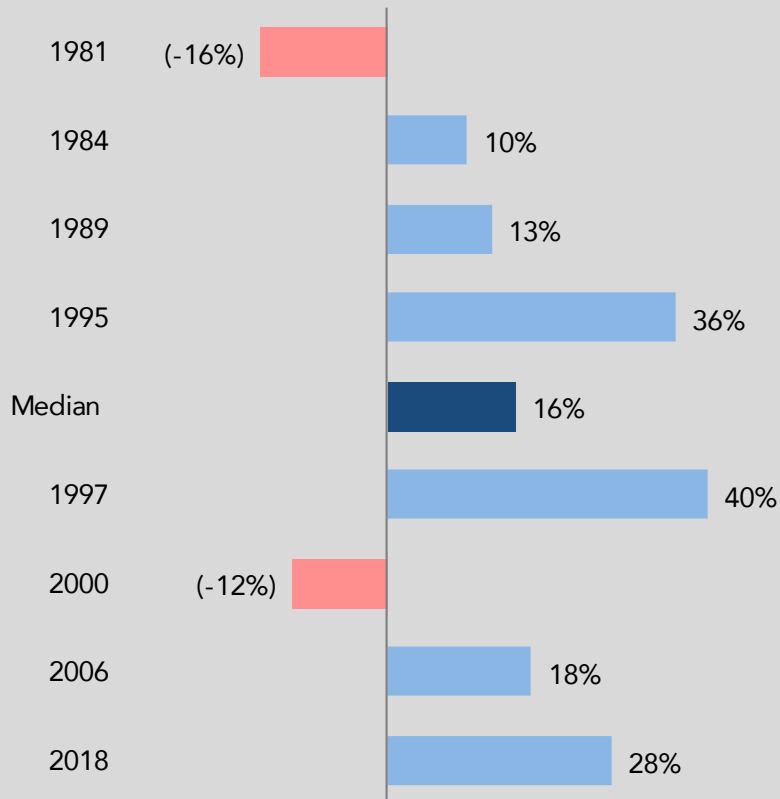


# Equities & Rates Rally During Fed Easing Cycles

While economic recessions often cause equity market “corrections”, risk assets typically perform well in Fed easing cycles.

**S&P 500 performance in the 12 months following the end of Fed tightening cycle**

**10 year UST performance in the 12 months following the end of Fed tightening cycle**



Source: (1-2) Bloomberg, Fred Economic Data St. Louis Fed. Note: Discount rate used before 1988.

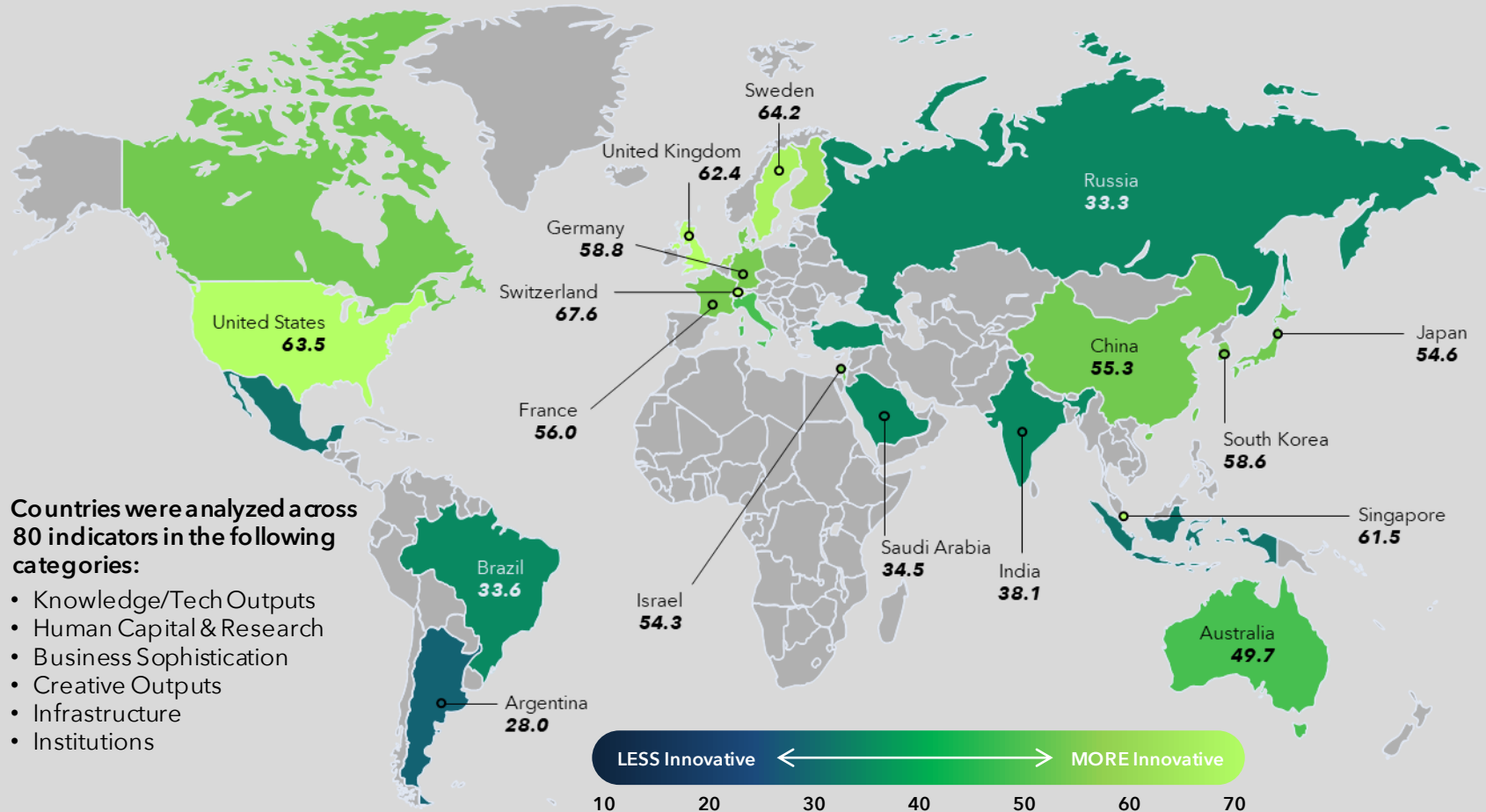
A vintage map of the world, showing continents and oceans in muted colors. A brown leather pouch with a metal clasp and a compass rose embossed on it lies diagonally across the map. The background is a dark, textured surface.

# **#4** Accelerating Innovation & Productivity

# World's Most Innovative Economies

The United States ranked #3 globally, behind Switzerland and Sweden, in the 2023 Global Innovation Index (GII) as part of a comprehensive study by the World Intellectual Property Organization (WIPO).

## 2023 Global Innovation Index

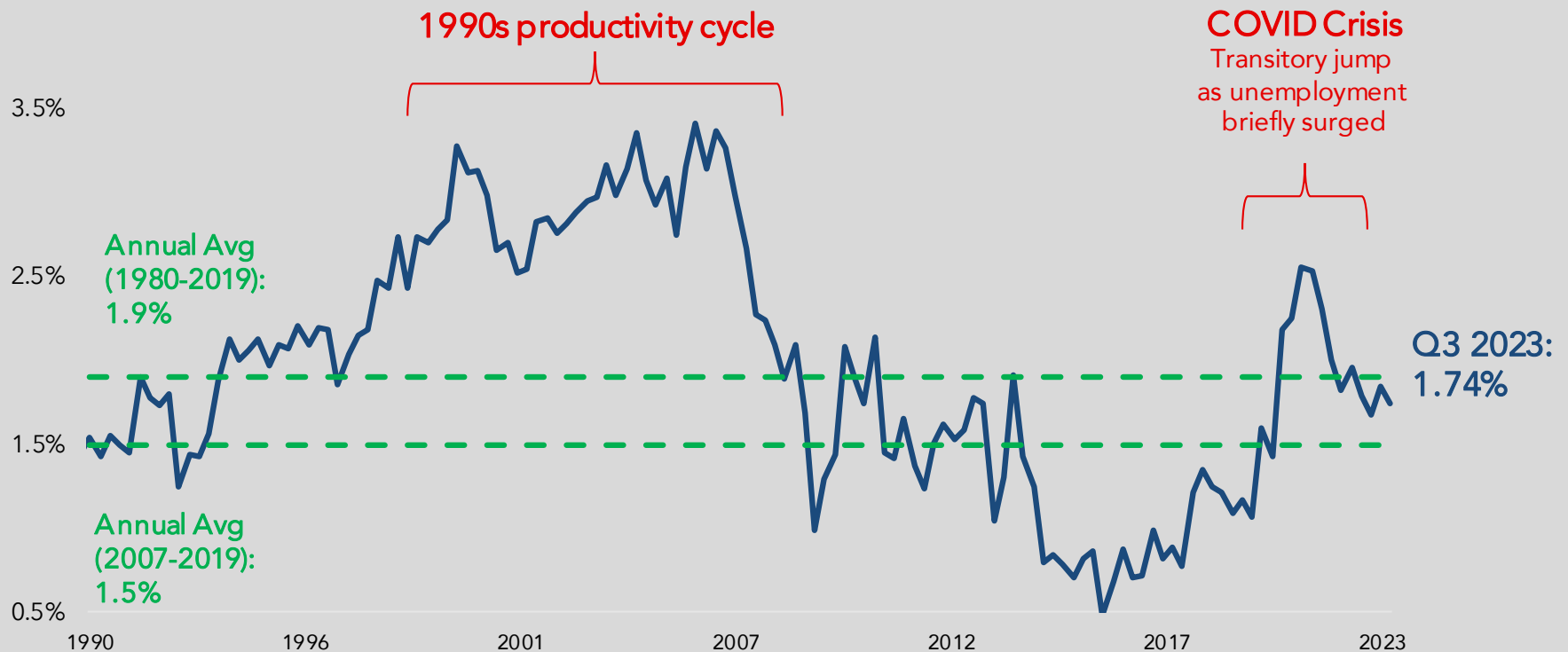


Source: (1) World Intellectual Property Organization (WIPO), "Global Innovation Index 2023".

# Productivity Cycle Optimism

The US economy has not had a sustained acceleration in productivity since the late 1990s. Following a transitory surge during COVID due to a temporary surge in unemployment, US productivity growth is poised to remain above its multi-decade 1.5% average on a multi-year basis. While an element of productivity growth is cyclical and therefore tied to growth, we believe that an acceleration in capital investment, innovation and productivity is emerging as a sustainable mega-theme in the post-COVID period.

Non-financial corporates productivity 5 year average, q/q



Source: (1) Bureau of Labor Statistics. Data as of December 6, 2023.

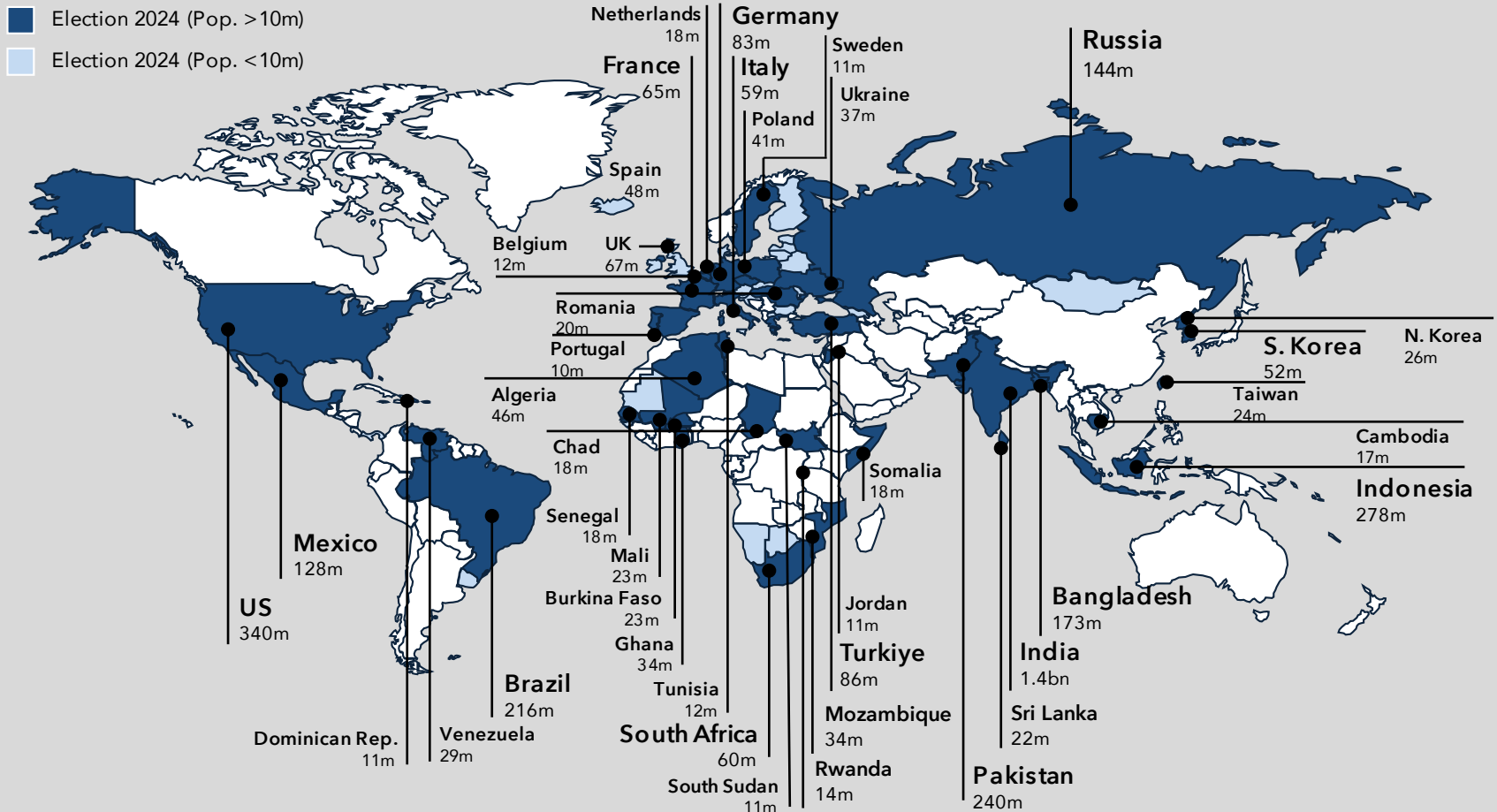


The background of the slide features a collection of antique globes. One globe in the foreground is clearly visible, showing a map of North America with labels like 'AMERIQUE DU NORD', 'CANADA', and 'LES ETATS UNIS'. Other globes are visible in the background, some showing different parts of the world. A bright, glowing blue nebula or star cluster is visible on the left side of the image. The overall lighting is warm and focused on the globes.

# **#5** Markets, the Fed & Election Cycles

# Largest Global Election Year in History

2024 will be the largest election year in human history. More than 75 countries, and over 4.2 billion of the world's 8.1 billion people, will hold national or major regional elections.



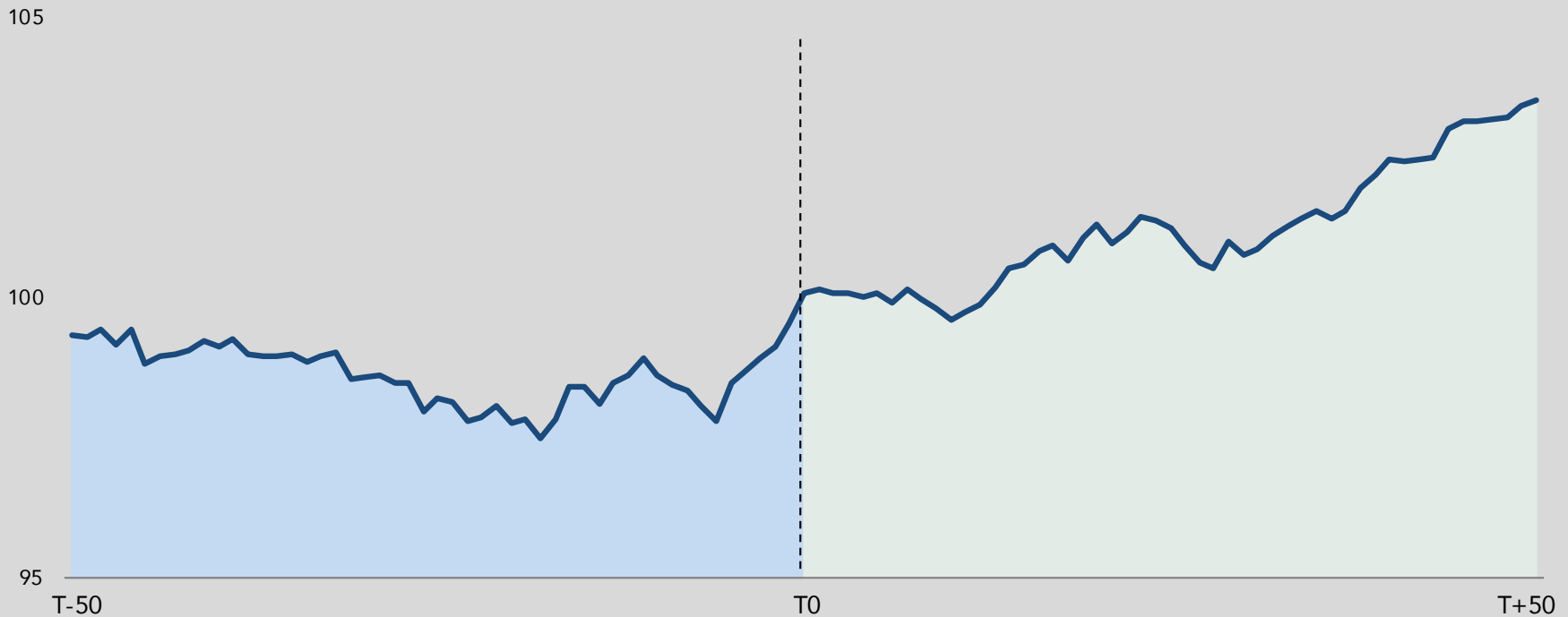
Source: (1) Economist Intelligence Unit. United Nations. V-Dem 4. European countries included because of EU Parliamentary elections. UK general election could take place as late as January 2025, though 5-year Parliamentary term will end in 2024.

# Markets During US Election Years



Historically, markets have tended to underperform during the period of pre-election uncertainty, with the post election rallies on higher certainty often beginning in the days immediately preceding the actual election (regardless of political party gaining or losing control).

## S&P 500
















While elections are critically important, their ability to have sustained influence over the trajectory of economies and markets tends to be overstated, as the private sector becomes the more important variable over time

Source: (1) Bloomberg. US elections includes presidential elections only. Election data since 1960. Election day = 100 for S&P 500.

# Fed Policy During US Election Years

Historical data suggests that the Fed has been very willing to increase or cut policy rates in a US election year, though perhaps marginally more reticent in the two months prior to the election. Fed Chair Alan Greenspan's decision in 1992 to cut policy rates in September, but not in October one month before the election (when many believed the economy needed it), could prove to be a relevant historical precedent for 2024.

		Fed Policy Action in Election Years			
Election Year	Incumbent	Hike in election year	Cut in election year	Hike 2 months ahead of election	Cut 2 months ahead of election
1972		-	-	-	-
1976		-	Yes	-	Yes
1980		Yes	Yes	Yes	-
1984		Yes	Yes	-	Yes
1988		Yes	-	-	-
1992		-	Yes	-	Yes
1996		-	Yes	-	-
2000		Yes	-	-	-
2004		Yes	-	Yes	-
2008		-	Yes	-	Yes
2012		-	QE3	-	QE3
2016		Yes	-	-	-
2020		-	Yes	-	-

Rate Hikes less common

Source: (1) The GailFosler Group, "The Federal Reserve and the Presidential Election Cycle" (Bernadette Kilroy Martin). "Is the Fed Politically Biased? Look at its Interest-Rate Decisions as Elections Near" (Puzzanghera and Lee). "Election Year Unlikely to Sway Fed on Interest Rates" (Richard Berger). Bloomberg. Fed Economic Data St. Louis Fed. Note: Discount rate used before 1988. Fed Fund based on upper bound.





# **#6** No Risk Premium for US Deficits (Yet)

# Unsustainable US Trade Deficits

The US had trade deficits with 103 countries in 2021, up from approximately 80 countries in 1990. While our largest trade deficits are with China, the sheer number of counterparty deficits suggest that the origins of our weakness in this regard may also have roots in our own structural domestic shortcomings.



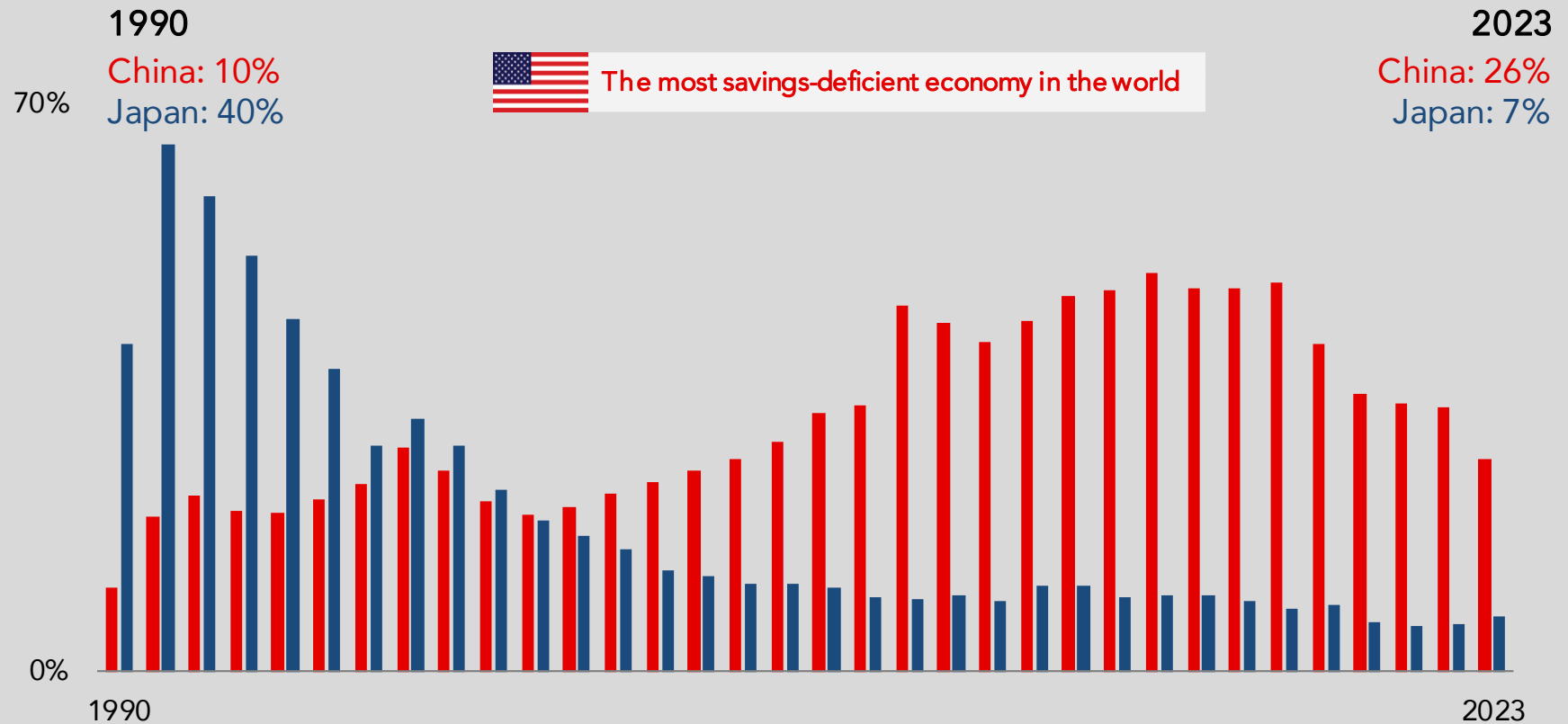
Source: (1) World Integrate Trade Solution. Full year data as of 2021.

# Unsustainable US Trade Deficits



Just three decades ago, the United States was looking East toward another strategic competitor, Japan, as the primary source of its unsustainable annual trade deficits.

## Composition of US trade deficit



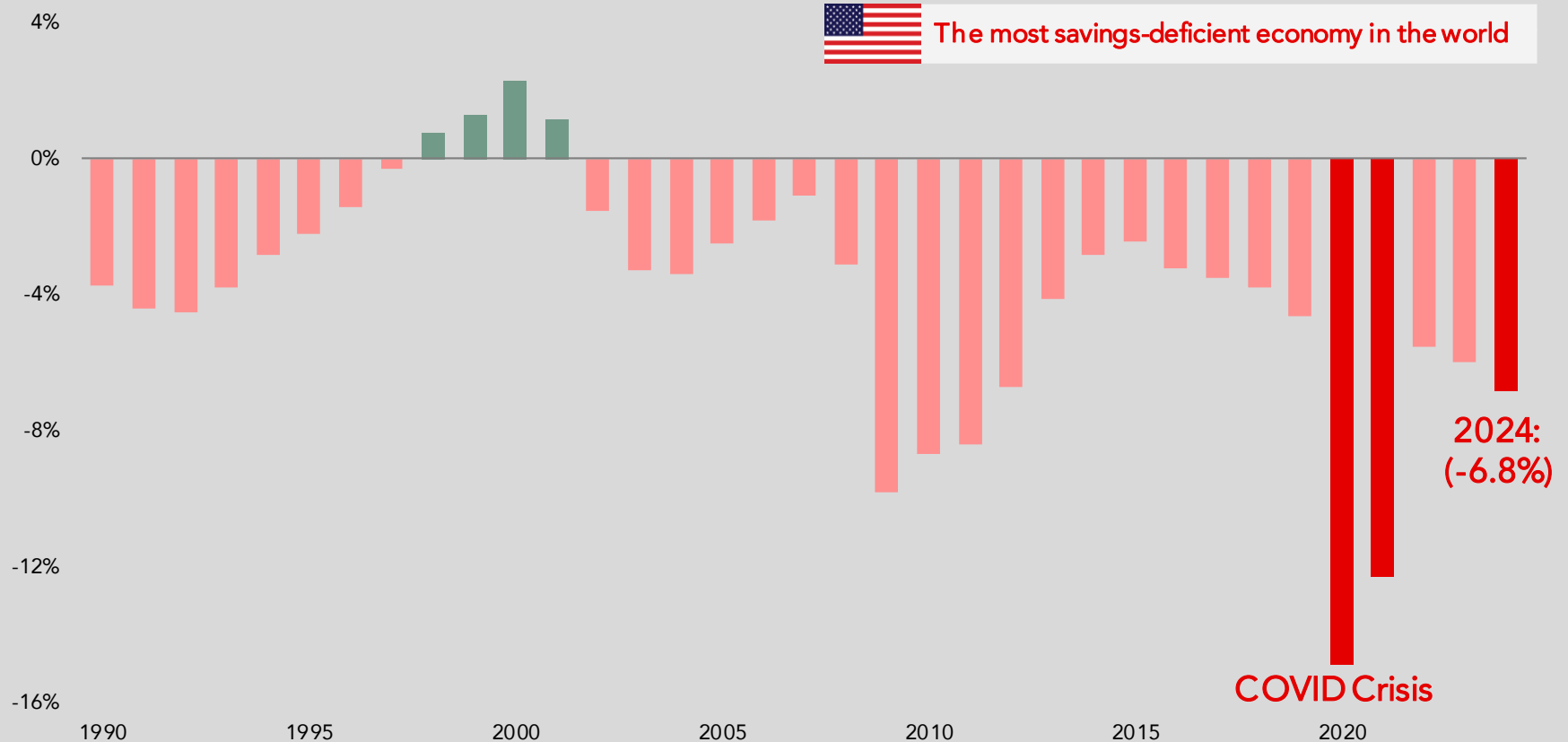
Source: (1) US Census Bureau. 2023 data through November 2023.

# Unsustainable US Fiscal Deficits



Since the decline of Bretton Woods in the early 1970s, a US dollar dominated global financial system has been a "national treasure," providing the US both low cost debt and a powerful toolkit in foreign affairs. However, many experts have warned that excessive use of this toolkit and unsustainable debt and deficits have weakened US competitive advantages.

## US Federal budget deficit, % of GDP



Source: (1) Bloomberg. Data as of January 31, 2024. US Treasury.

# No Risk Premium for US Deficits (Yet)

MUFG's US Rates Strategist, George Goncalves is forecasting 10 year UST yields below consensus forecasts for much of 2024. Following a sell-off in Q1, MUFG expects rates to resume their rally to new cycle lows by Q3 2024.



Source: (1) Bloomberg. Data as of February 14, 2024. MUFG (George Goncalves).

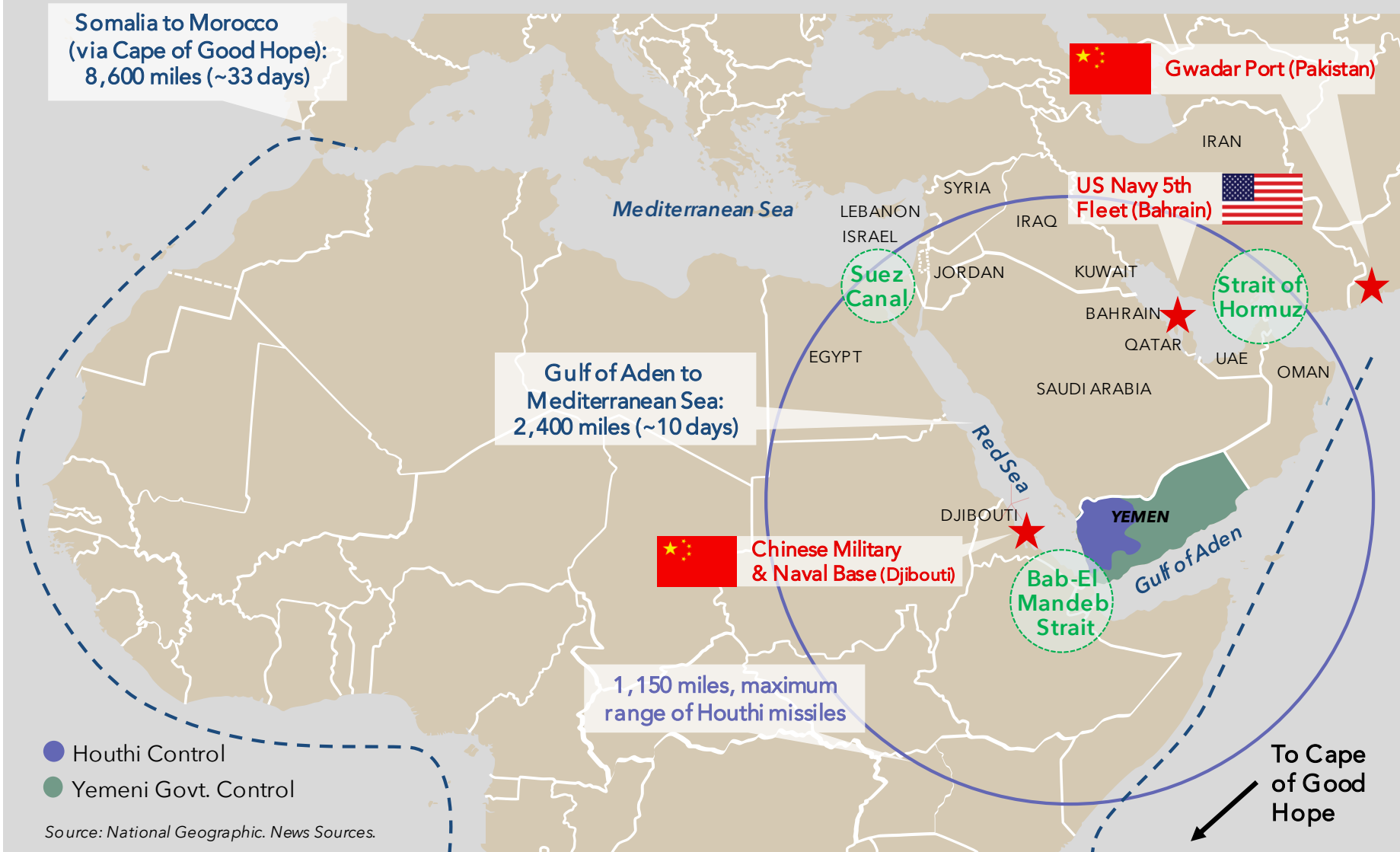




# **#7** No Risk Premium in Energy Markets

# No Geopolitical Risk Premium on Oil

As the world's largest oil importer, energy security is a key strategic priority for China. Owned by Pakistan and operated by China, the Gwadar port allows China to circumvent Strait of Malacca & South China Sea risk.

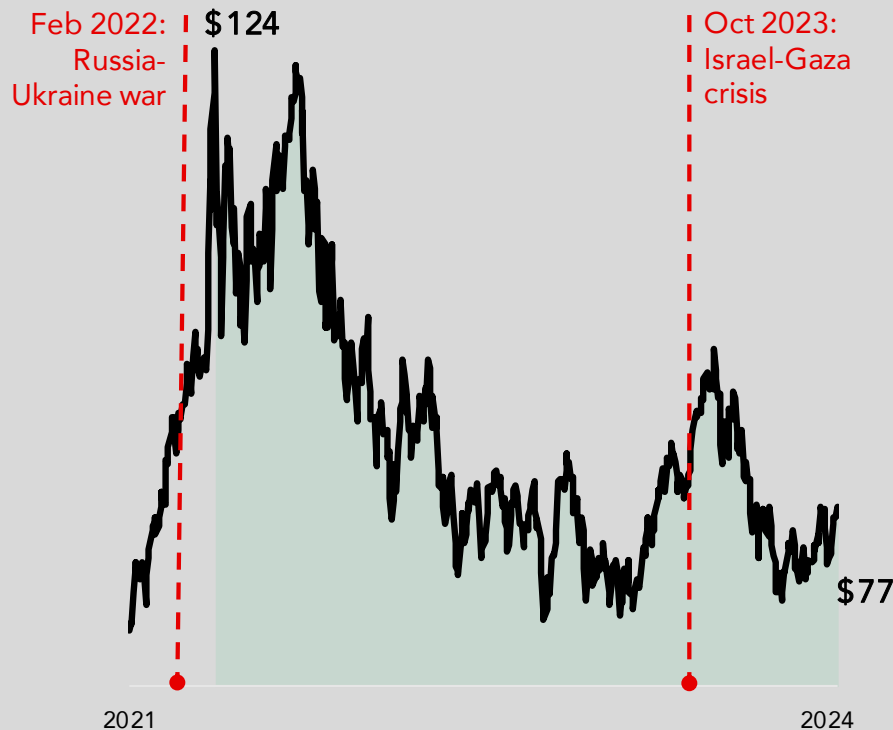


# No Geopolitical Risk Premium in Energy Markets

Unlike the Yom Kippur War 50 years ago, Arab states have NOT imposed an oil embargo against the US and allies in the current crisis as more than 75% of GCC oil today flows to Asia. In addition, although the critical geostrategic Strait of Hormuz chokepoint is well within the missile range of Houthi rebels, they have been notably reticent to disrupt any flow of oil out of the Gulf given the importance of oil revenue to Iran.

Energy prices since December 2021

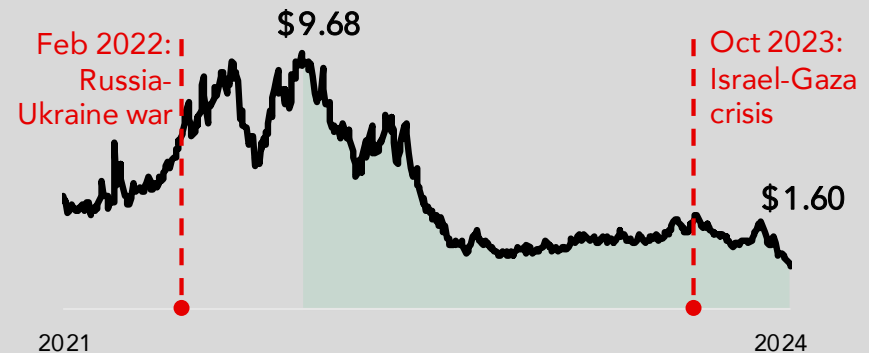
WTI



EU nat gas (TTF)



US nat gas

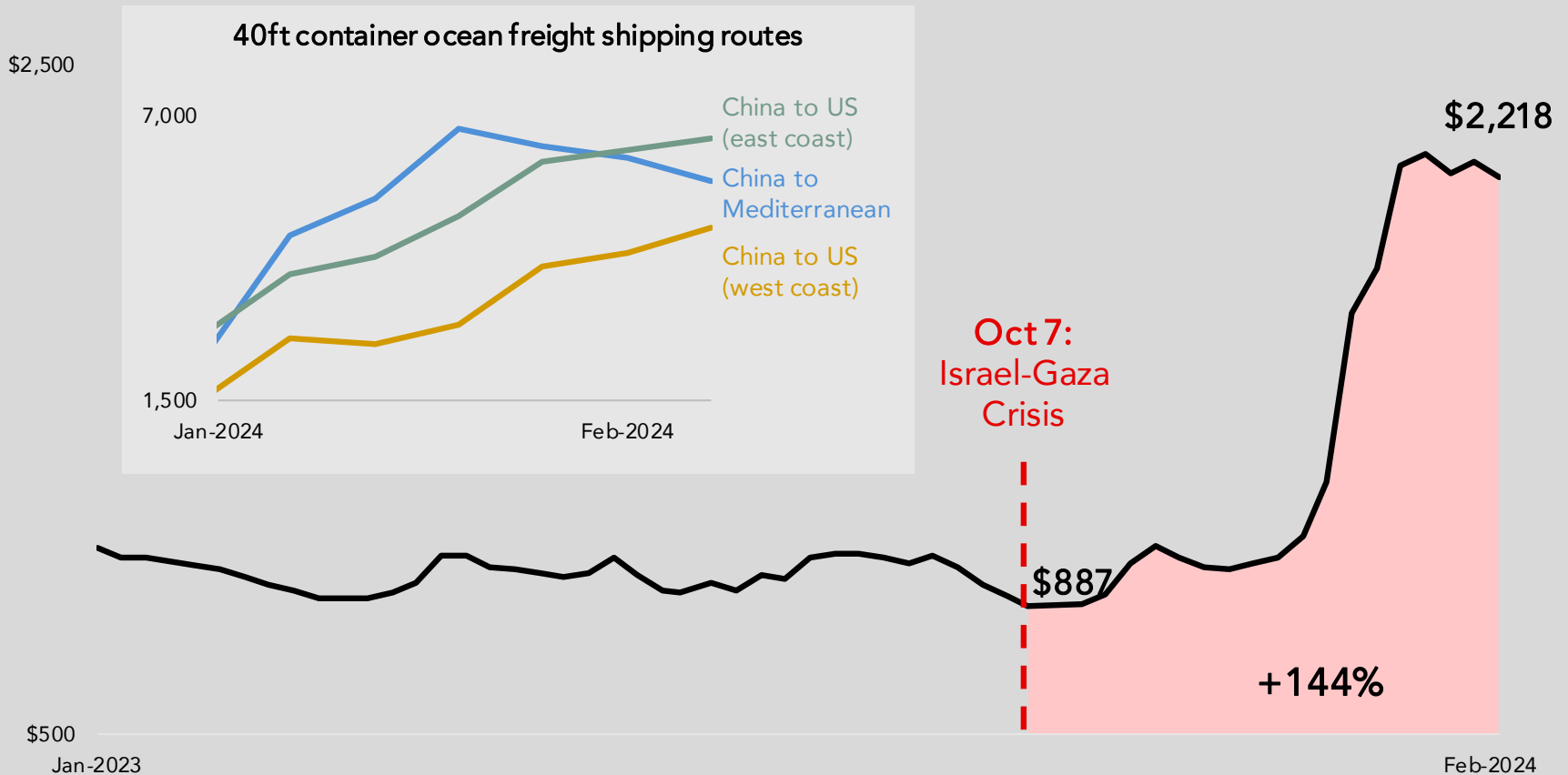


Source: (1-3) Bloomberg. Data as of February 14, 2024.

# Geopolitical Risk Premium in Container Ship Prices

While the Houthi rebels have not disrupted outbound Strait of Hormuz oil flow, their missiles have been highly disruptive to inbound Bab-el Mandeb shipping routes, as evidenced by the sharp rise in Asia-to-Europe container shipping prices in recent weeks.

Shanghai Shipping Exchange Index, cost of moving 40ft container



Source: (1-2) Bloomberg. Data as of February 14, 2024. Shipping routes are Freightos Baltic Indices.



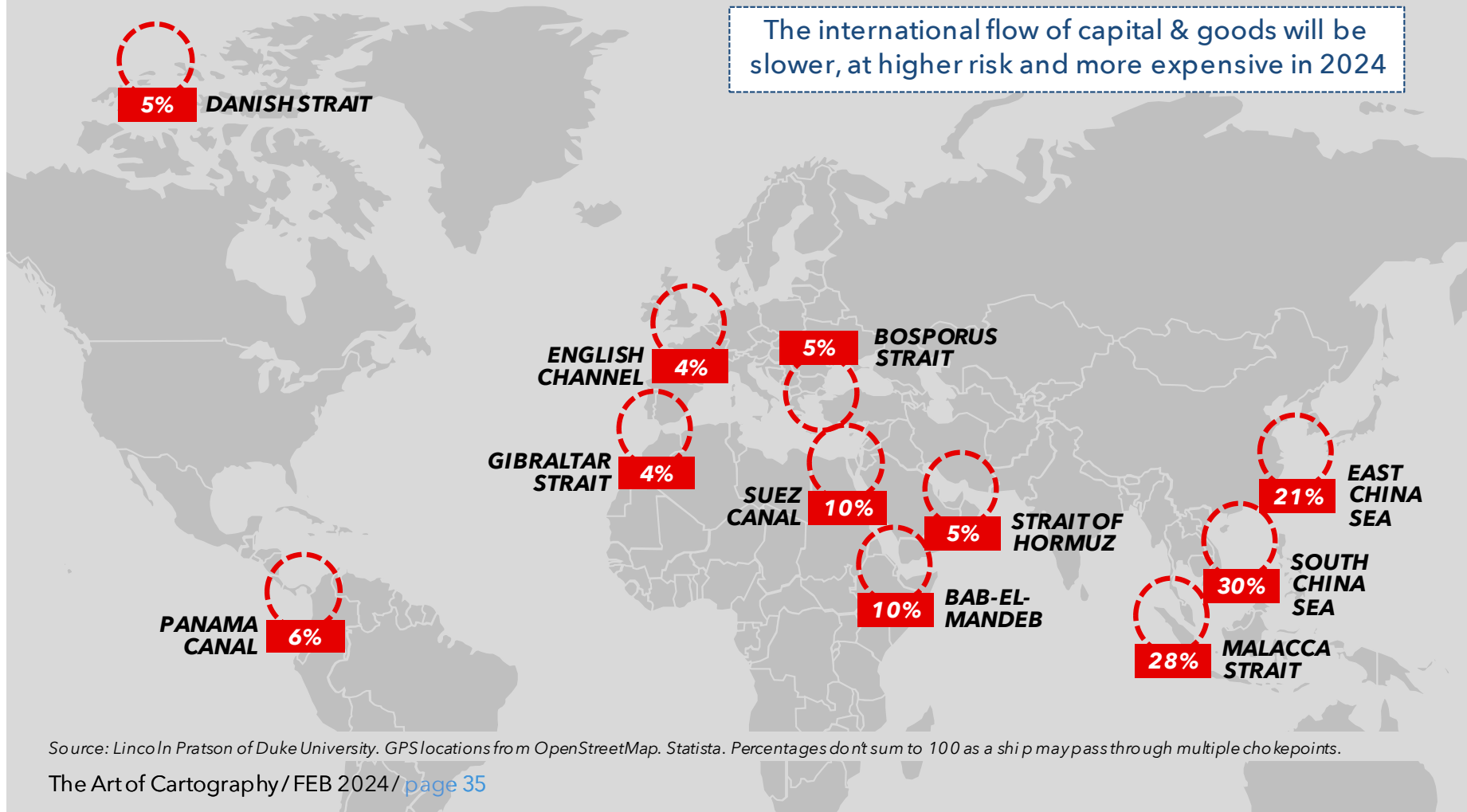
A vintage map of Alaska is the background, showing various geographical features and place names like 'Alaska', 'Gulf of Alaska', 'Cook Inlet', 'Katmai Vol.', and 'Hicmna'. A brass compass is in the upper left, and a pair of dividers is in the center. A small brass cup is in the lower right. The text is overlaid on the map.

# #8 Geopolitical Risk Shifts to Maritime Theaters

# Global Maritime Chokepoints at Risk in Decade Ahead

Military conflict in the 21st Century is quickly shifting to maritime theaters, and critically vulnerable geo-strategic chokepoints. Notably, over 90% of global trade (95% for the US) and 60% of global oil, is transported by sea. Over 6 billion of the world's population also lives within 200 miles of the sea.

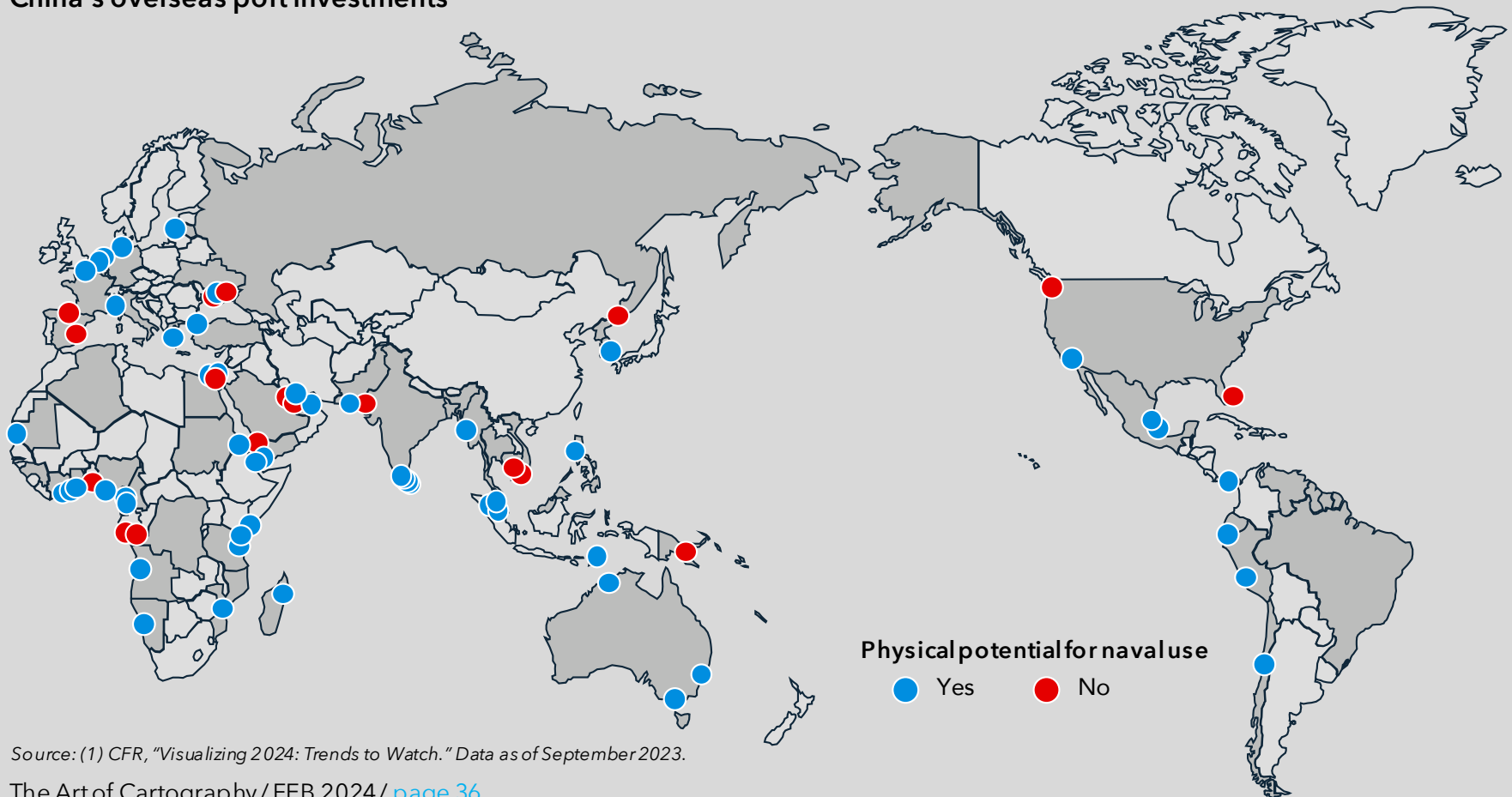
Share of global trade by 2019 value



# China's Expanding Global Naval & Port Infrastructure

As measured by number of ships, China became the world's largest navy in 2020, though is not yet on par with the United States as a global naval power. According to the CFR, China currently has more than 90 port projects underway, part of its strategic plan to dominate global port infrastructure and support its position as the world's largest trading economy. More than half of these development projects have physical potential for naval use (and more than a dozen are China majority-owned).

## China's overseas port investments



Source: (1) CFR, "Visualizing 2024: Trends to Watch." Data as of September 2023.

# The World's Most Contested Sea










# Timing Considerations for Potential China-Taiwan Conflict




Taiwan has been the centerpiece of the CCP's political priorities for decades, and a source of discord between Washington and Beijing. A defining feature of President Xi Jinping's foreign policy has been his assertiveness regionally, and this includes an abandonment of China's decades-long gradualist approach to absorbing Taiwan. It appears increasingly likely that President Xi, age 70, will seek to secure his place in Chinese history by resolving the "Taiwan question" during his political lifetime.

## Timing Considerations for a Potential China-Taiwan Conflict

-  **President Xi's political lifetime** (age 70, health considerations)
-  **Resolution of China's key strategic vulnerabilities** (oil, semiconductors, military)
-  **Preparedness of China's military** (corruption, technology, relative strength)
-  **Complexity of a Taiwan invasion** (cyber, ballistic missiles, critical infrastructure, amphibious, special ops, response assessment, propaganda narrative)
-  **Political leadership in the West** (US President, strength of regional alliances)

2027 will mark the 100th Anniversary of the People's Liberation Army (PLA) and the end of President Xi's 3rd term. While a milestone to be watched closely, many China experts believe this may still be too soon for a China-Taiwan military event.

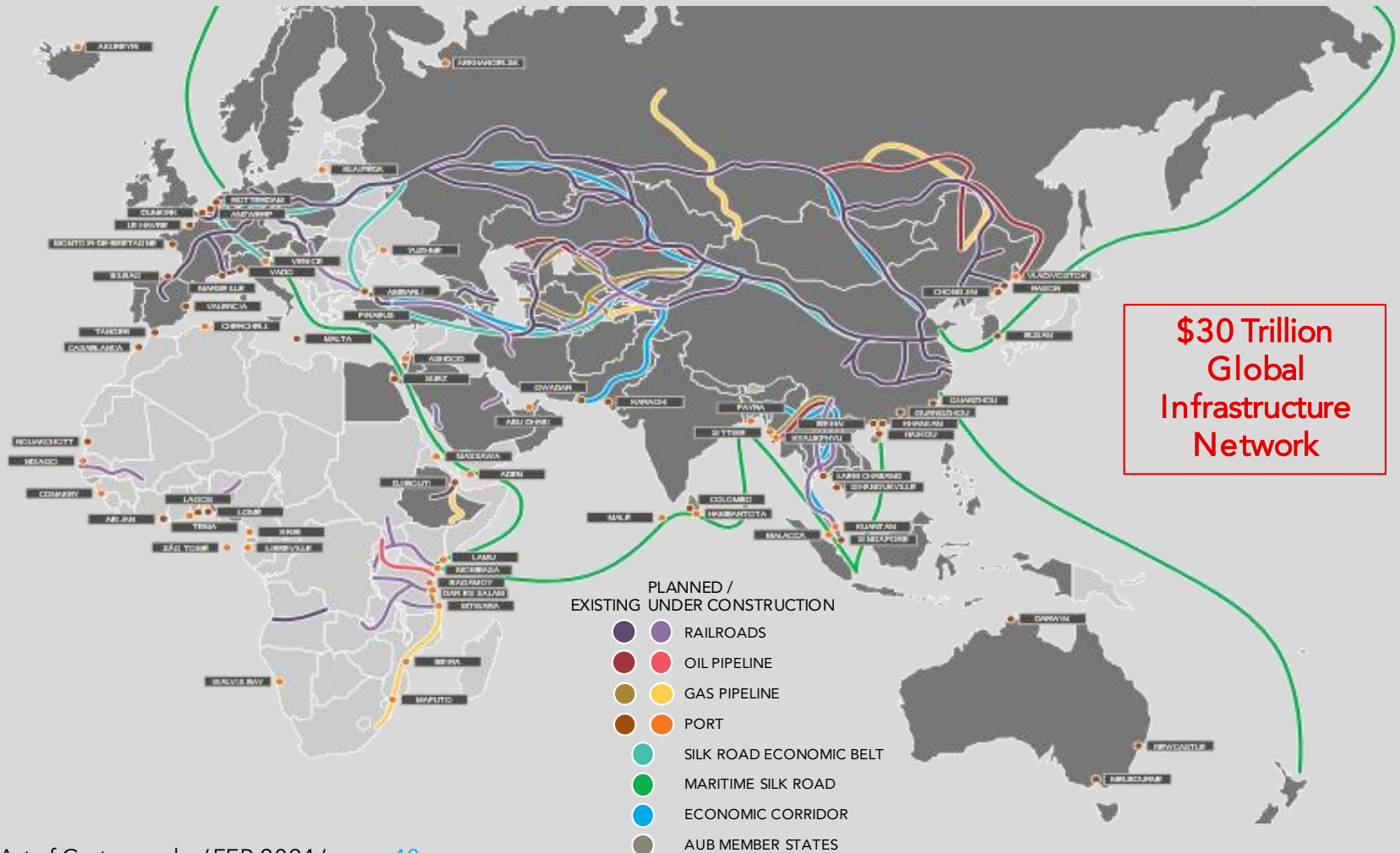
A vintage map with a compass and a notebook. The map is spread out on a dark surface, showing a coastline with green dots. A small, round, black compass with a blue cord is placed on the map. A blue fountain pen lies diagonally across the map. A notebook with handwritten text in cursive is open on the map. The background is a dark, textured surface.

# #9 US-China Structural Rivalry & Decoupling

# China's Pivot Away From Western Dependencies

President Xi announced his signature foreign policy initiative, the landmark Belt & Road Initiative (BRI), in Kazakhstan in September 2013. Ten years later, the BRI has become a \$30 trillion global infrastructure project across land, maritime and digital theaters.

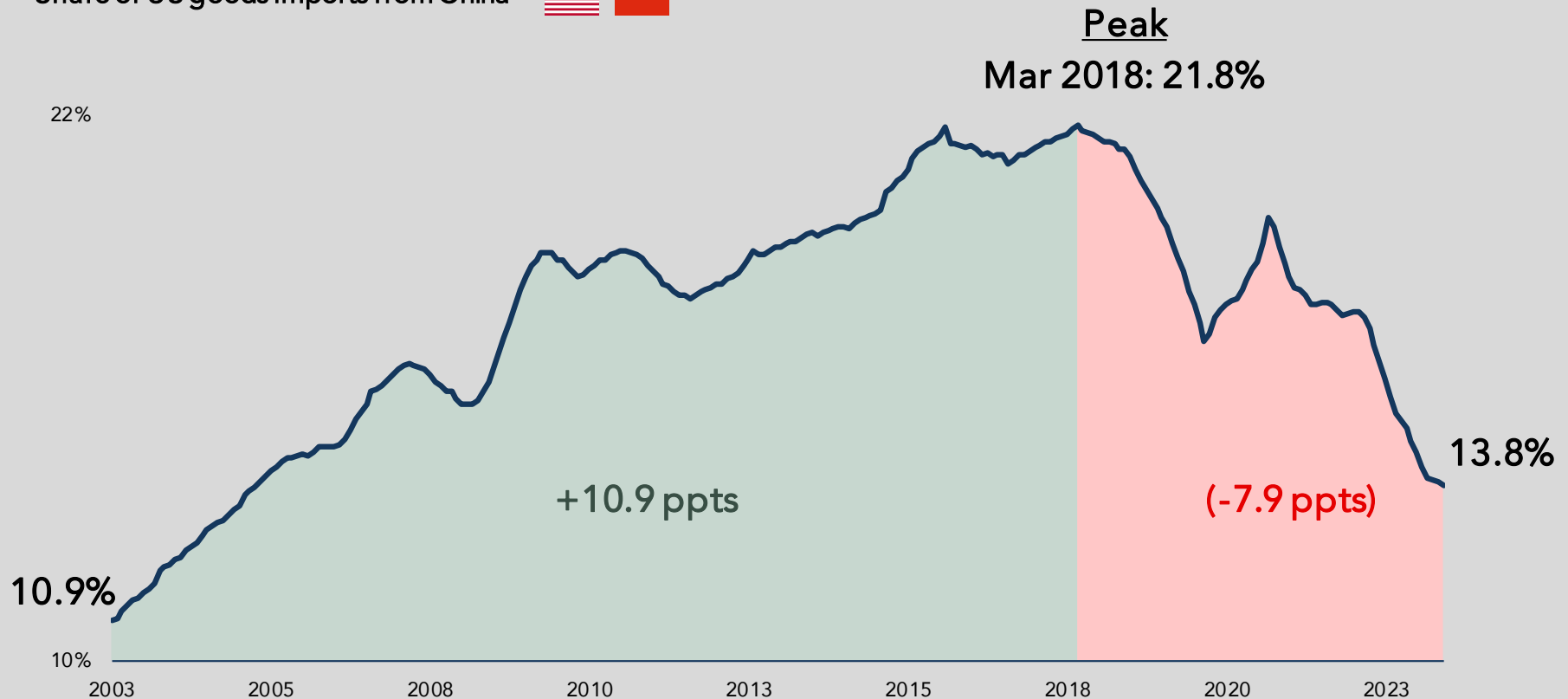
## China's Belt & Road Initiative



# US Diversifying Away from China

Following their accession into the WTO in Dec 2001, China's market share of US imports more than doubled from about 10% to nearly 22% in just 15 years. Since the peak of the trade wars in 2018, China's market share of US imports has declined from approximately 22% to 14% in just 5 years as US MNCs restructure supply chains and diversify production into Mexico, Europe and Asia.

Share of US goods imports from China



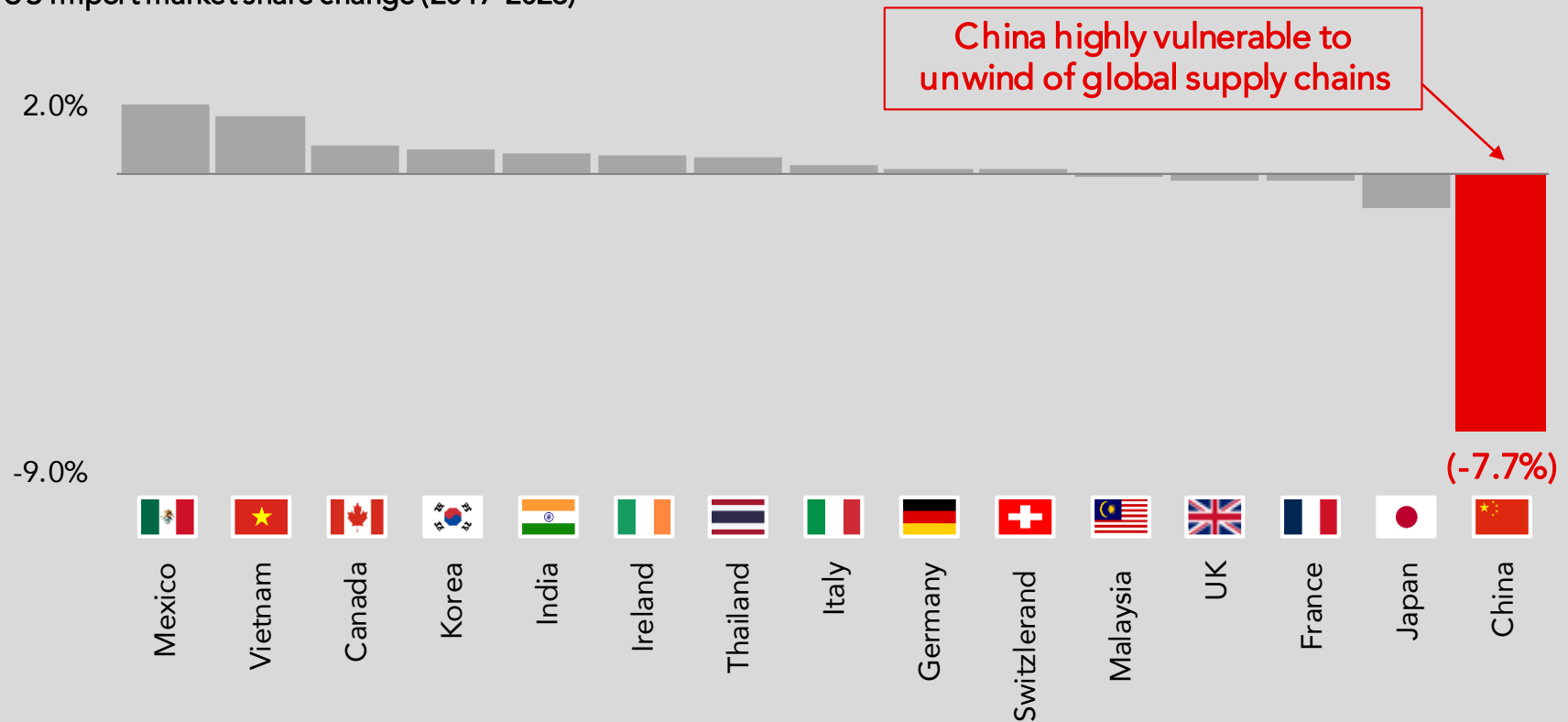
Source: (1) US Census Bureau. Data is rolling 12-month average through December 2023.

# Restructuring of Global Supply Chains



Following the US-China trade wars in 2018 - 2019, China's share of US imports began a steady decline as US Government policy and the COVID crisis encouraged US companies to reallocate sourcing patterns across partner countries. While the total volume of Chinese imports into the US has increased over this period, China's market share has experienced a sharp 8% decline in just 6 years.

US import market share change (2017-2023)



Source: (1) "Global Supply Chains: The Looming Great Reallocation" (Alfaro, Chor). Prepared for the Jackson Hole Symposium, Aug 24-26, 2023 organized by the Federal Reserve Bank of Kansas City. UNComtrade. Data as of February 12, 2024. 2023 import data is through December 2023.



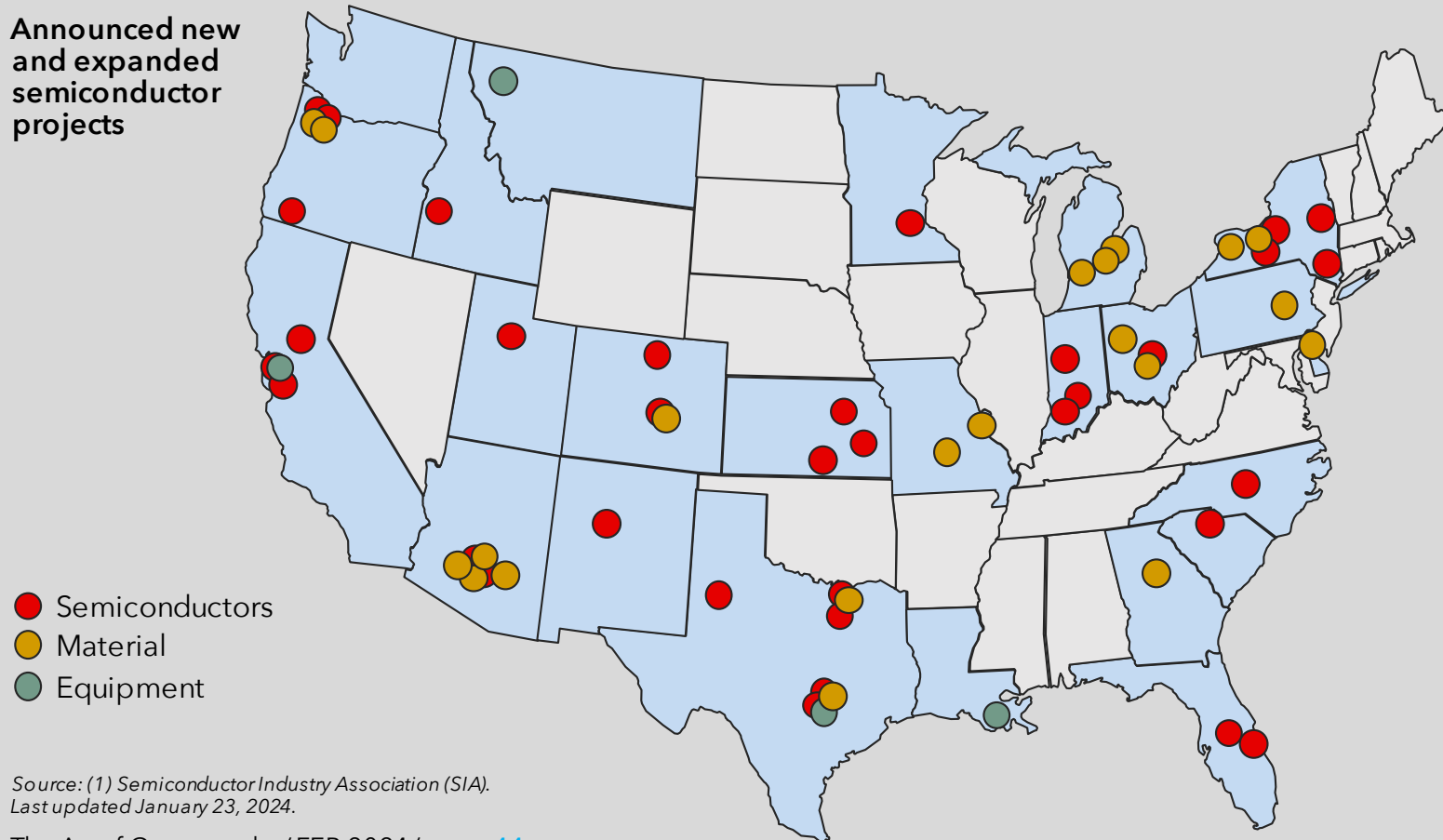


# #10 Semiconductor Showdown

# US Investment in Semiconductor Fabrication Plants

Since the CHIPS Act was originally introduced in summer 2020, semiconductor companies have announced dozens of new manufacturing, equipment and materials projects. According to the Semiconductor Industry Association, there are over 40 new chip projects underway to expand domestic manufacturing capabilities. The projects underway represent over \$180 billion in company investments and could create over 200,000 jobs.

**Announced new and expanded semiconductor projects**



Source: (1) Semiconductor Industry Association (SIA).  
Last updated January 23, 2024.

# Chips as the New Oil for the 21st Century



Gas-Combustion Vehicle  
~ **1,000 Microchips**



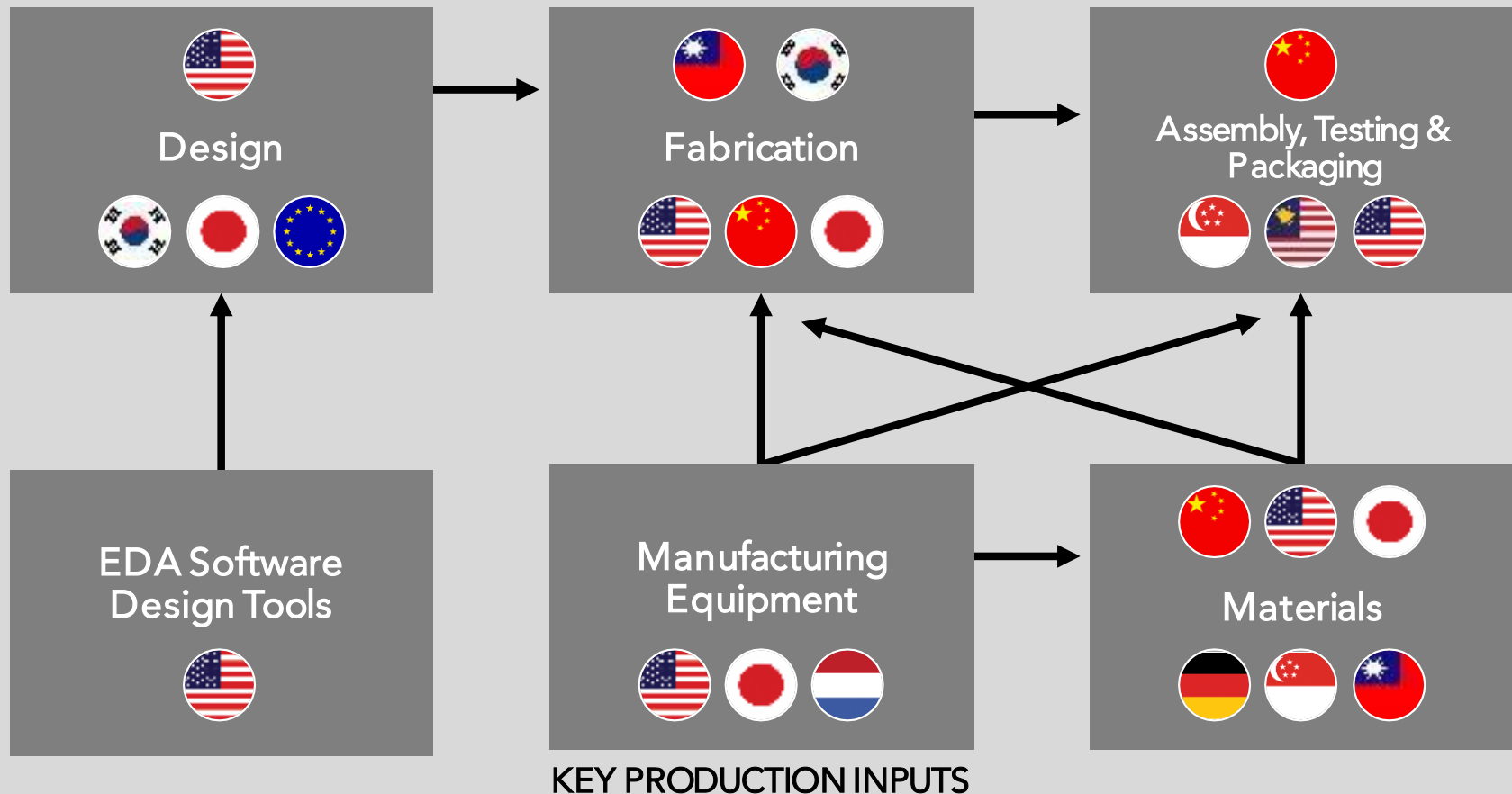
Tesla Electric Vehicle  
~ **3,500 Microchips**

# Globally Extended Semi Supply Chain

While closing the “technology gap” has become a primary strategic focus, China remains particularly vulnerable to the impact of restrictive US public policy (and that of our allies) on the exceptionally complex and globally extended semiconductor supply chain.

Leadership in the global semiconductor supply chain

## CHIP PRODUCTION



Source: Center for Security and Emerging Technology “The Semiconductor Supply Chain: Assessing National Competitiveness”. January 2021.

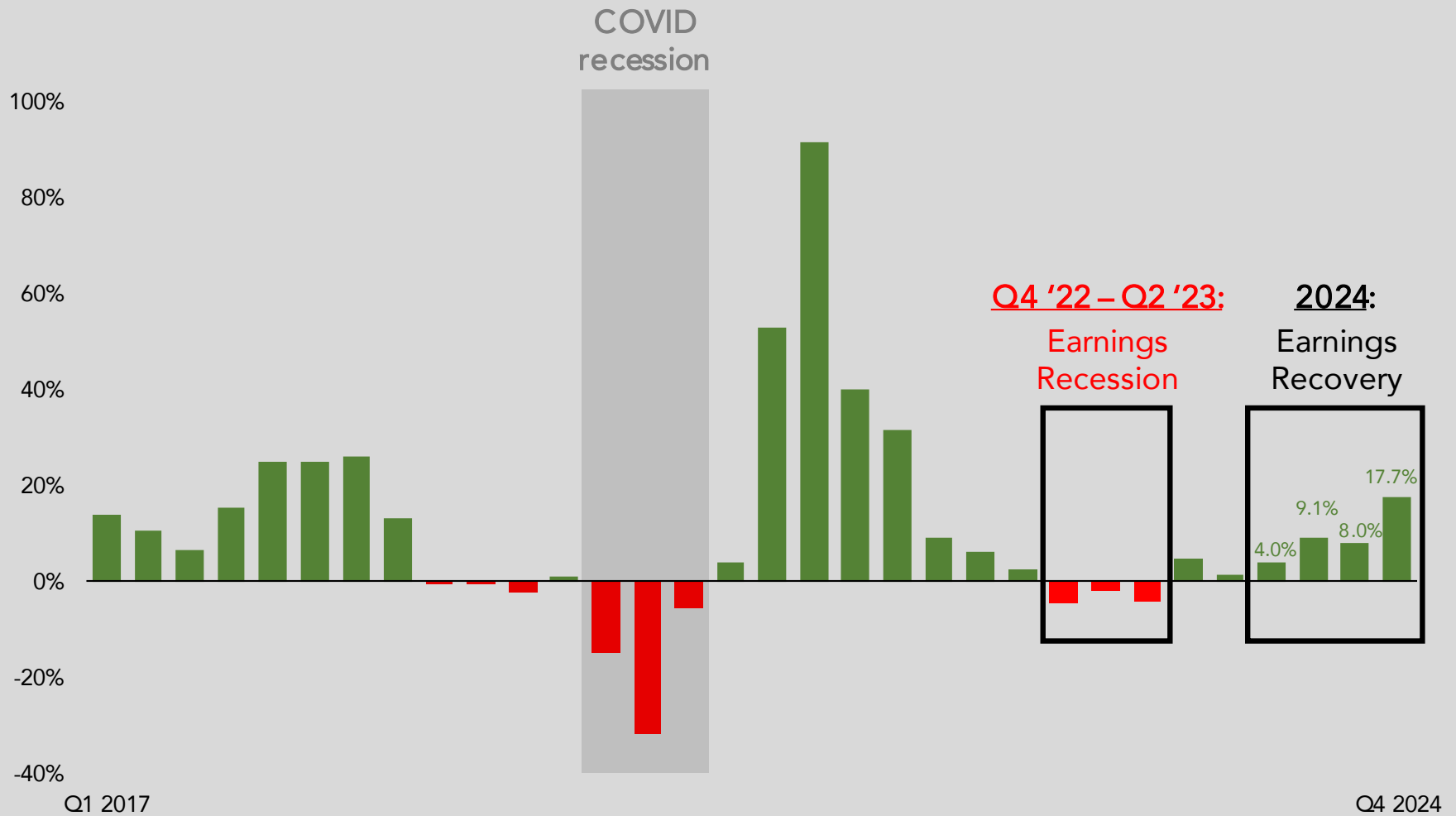


# **B.** Heightened Deal Activity in 2024



# Corporate Earnings Recovery in 2024

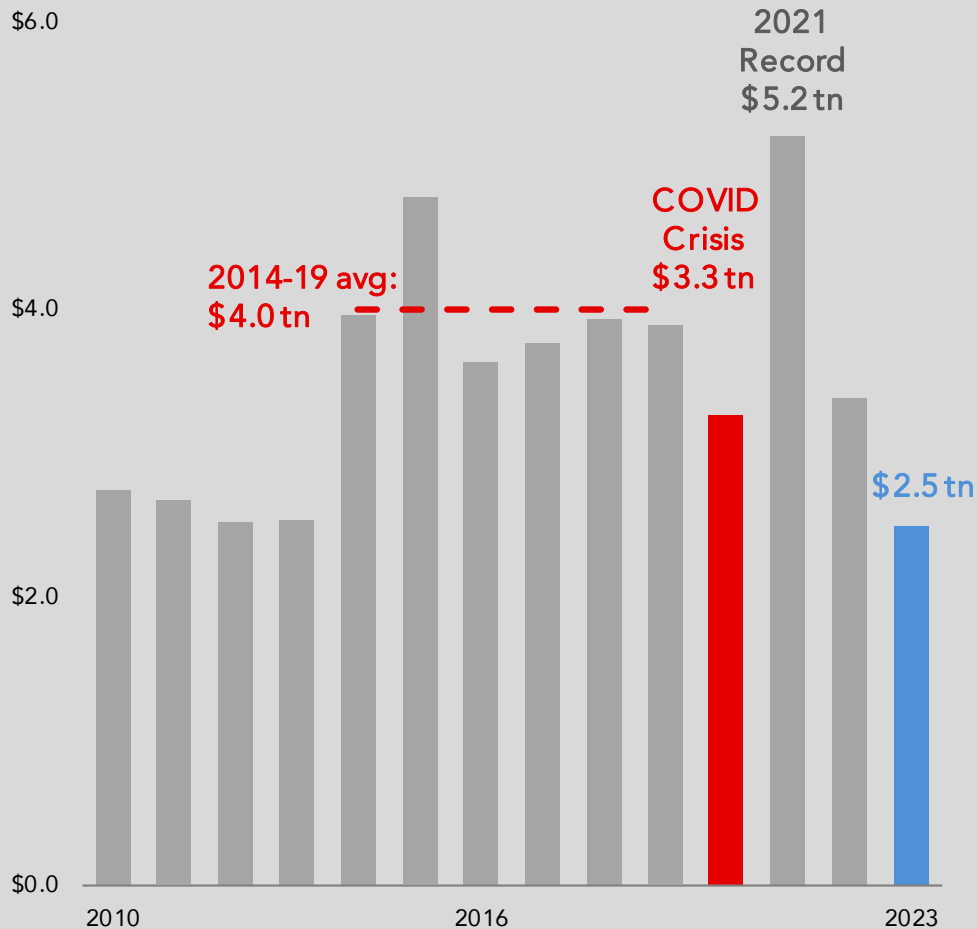
S&P 500 quarterly earnings growth, y/y



Source: (1) FactSet, Earnings Insight Report (February 9, 2024). Q4 2023 is January 5, 2024 FactSet forecast. KKR ("Glass Half Full: Outlook for 2024". Henry McVey).

# Modest Global M&A Recovery in 2024

Global M&A volumes, USD tn



## Catalysts for 2024 Deal Activity

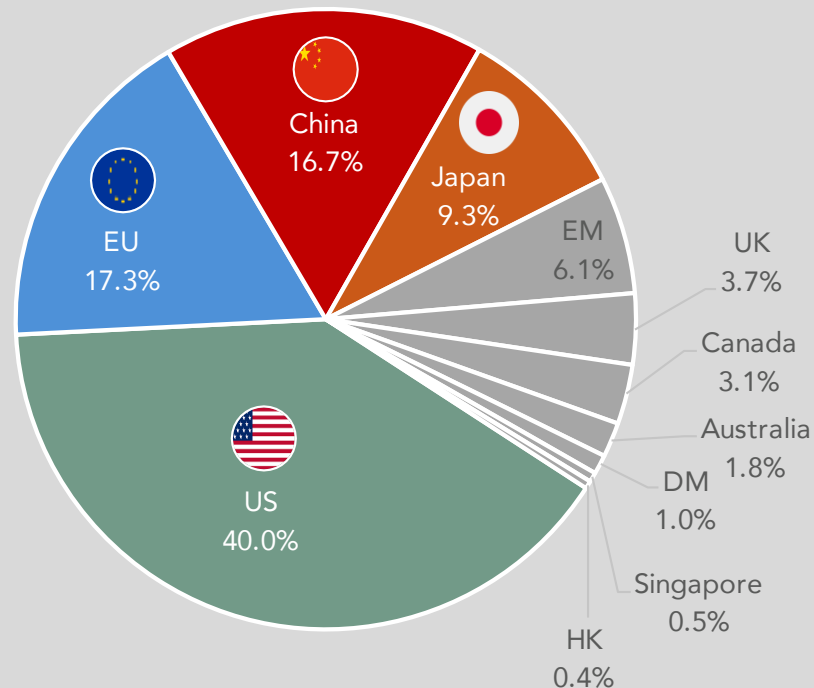
- Moderating inflation; lower rates
- Earnings recovery; equity market strength
- Resilience & depth of IG financing markets
- Generate growth > organic alternatives
- Strong, cash-rich balance sheets
- Record PE dry powder (\$2.5 trillion)
- Converging buyer / seller price expectations
- Access to technology, innovation (digital, AI, fintech)
- Higher energy prices; energy transition; infrastructure
- Pent up demand following low 2023 M&A

Source: (1) Bloomberg. Data as December 31, 2023. Institute for Mergers, Acquisitions & Alliances. SP Global "End of rate hikes can trigger M&A turnaround". PWC "US Deals 2024 Outlook".

# Largest, Most Liquid Capital Markets in the World

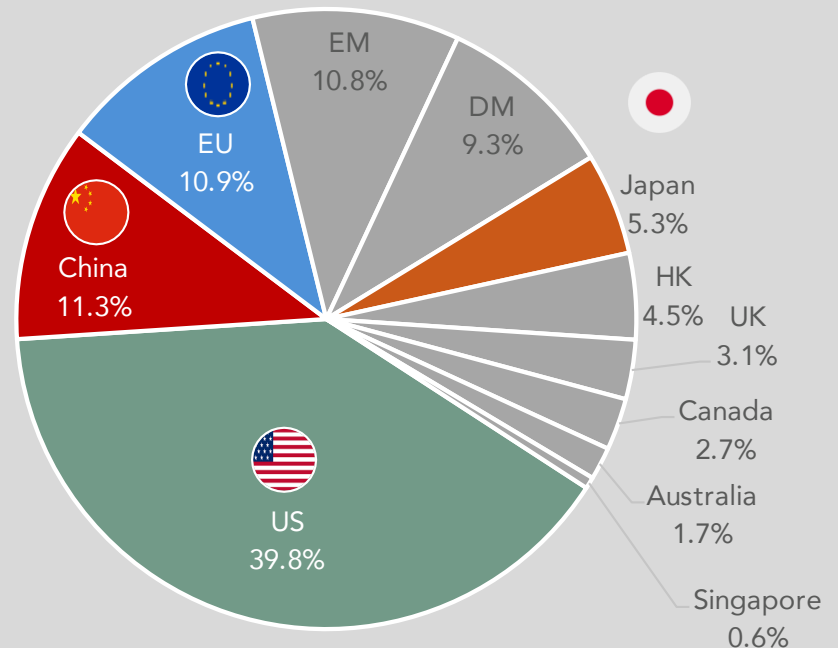
The US fixed income markets account for approximately 40% of the more than \$130 trillion debt securities outstanding globally, which is over 2x the next largest market, the EU.

Global fixed income securities outstanding



The US equity markets also represent approximately 40% of more than \$100 trillion in total global equity market capitalization, which is 3.5x the next largest market, China.

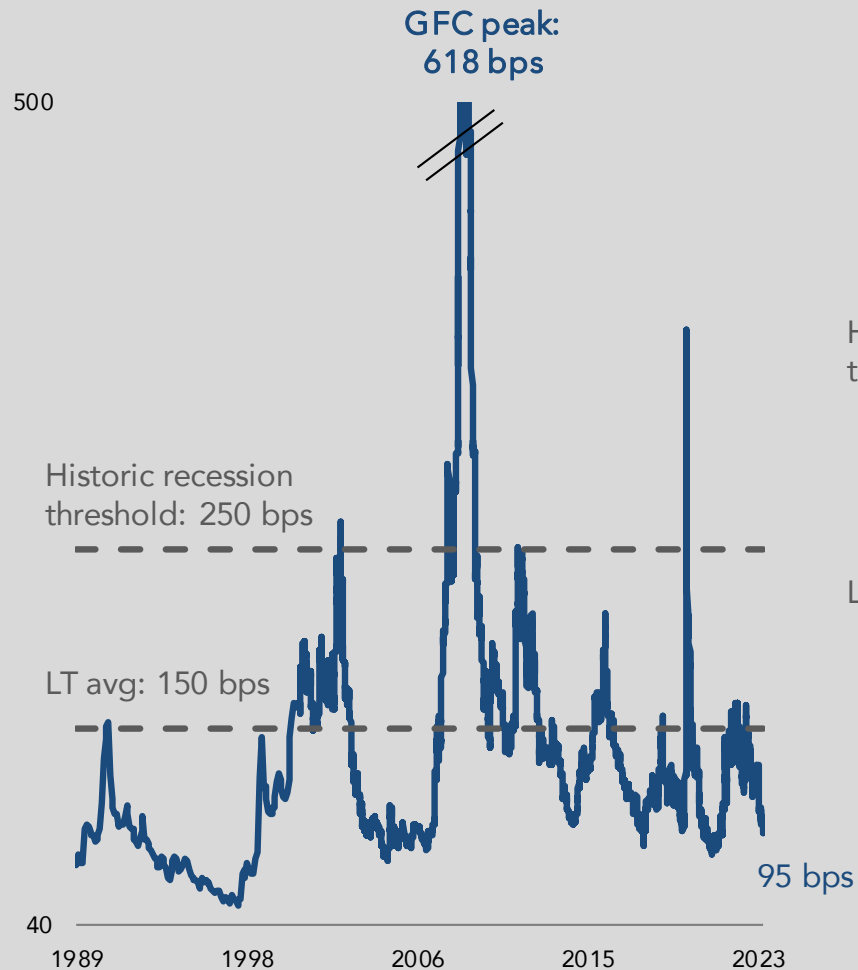
Global equity market cap



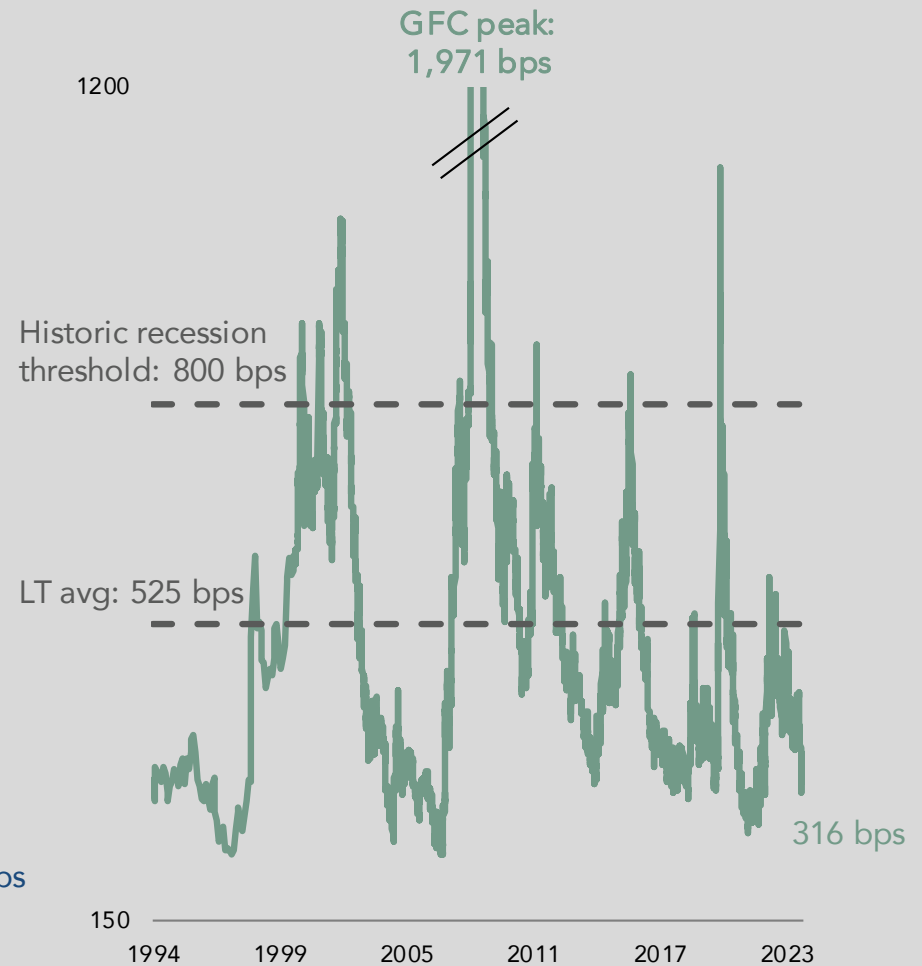
Source: (1-2) SIFMA Research (2023 Capital Markets Fact Book, July 2023). Data is full year 2022.

# Resilient Credit Markets Trading Well Inside LT Avg

USD IG OAS



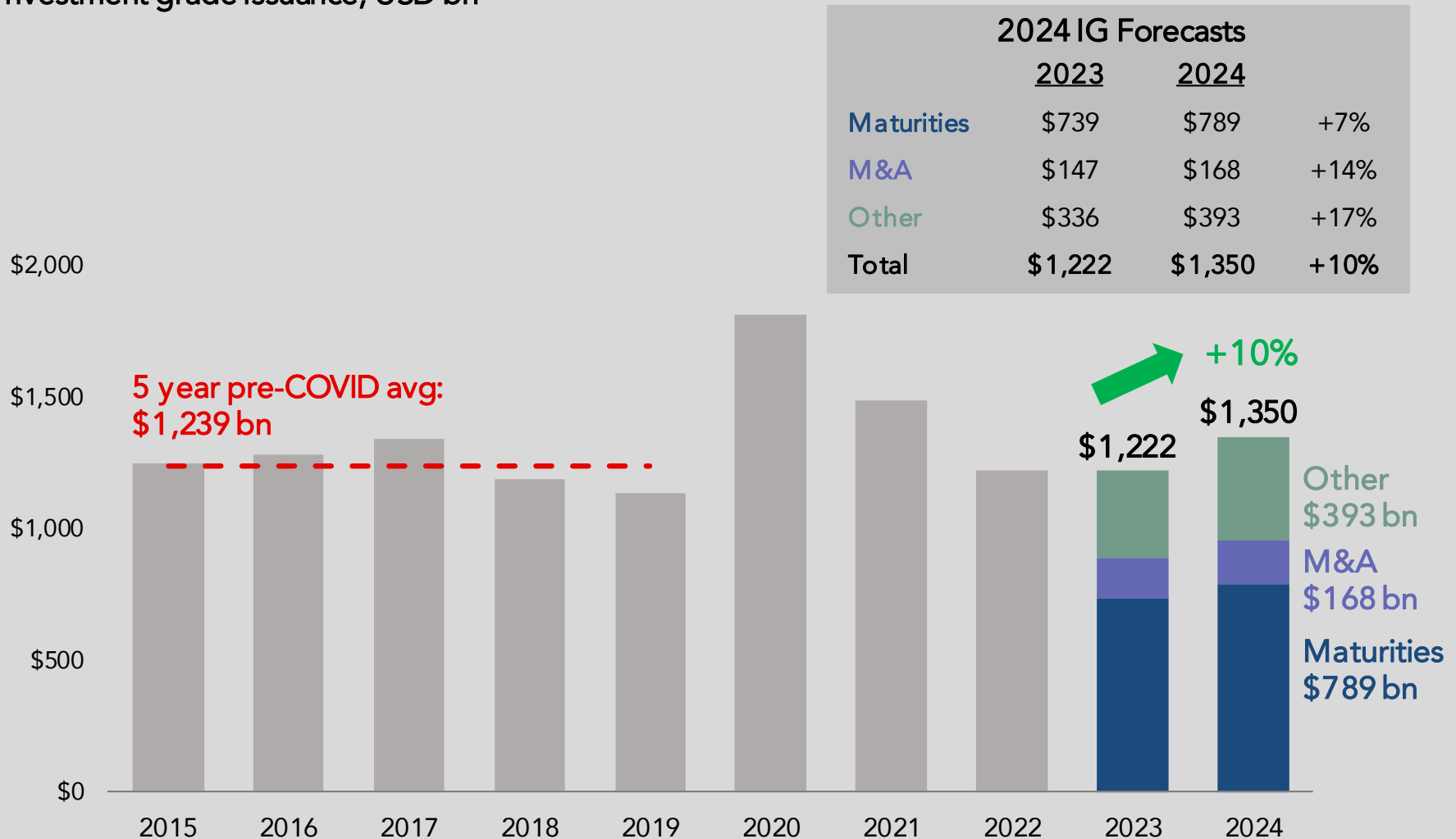
USD HY OAS



Source: (1-2) Bloomberg. Data as of February 14, 2024.

# 2024 IG Issuance Should Increase 10%

Investment grade issuance, USD bn



Source: (1) Bloomberg. Data as of January 31, 2024. MUFG.



# Largest January US Dollar IG Issuance on Record

Driven by strong market fundamentals and technicals, January 2024 investment grade issuance of \$195 billion was the largest January on record, surpassing the two and five year average for January of \$150bn and \$137 bn, respectively.

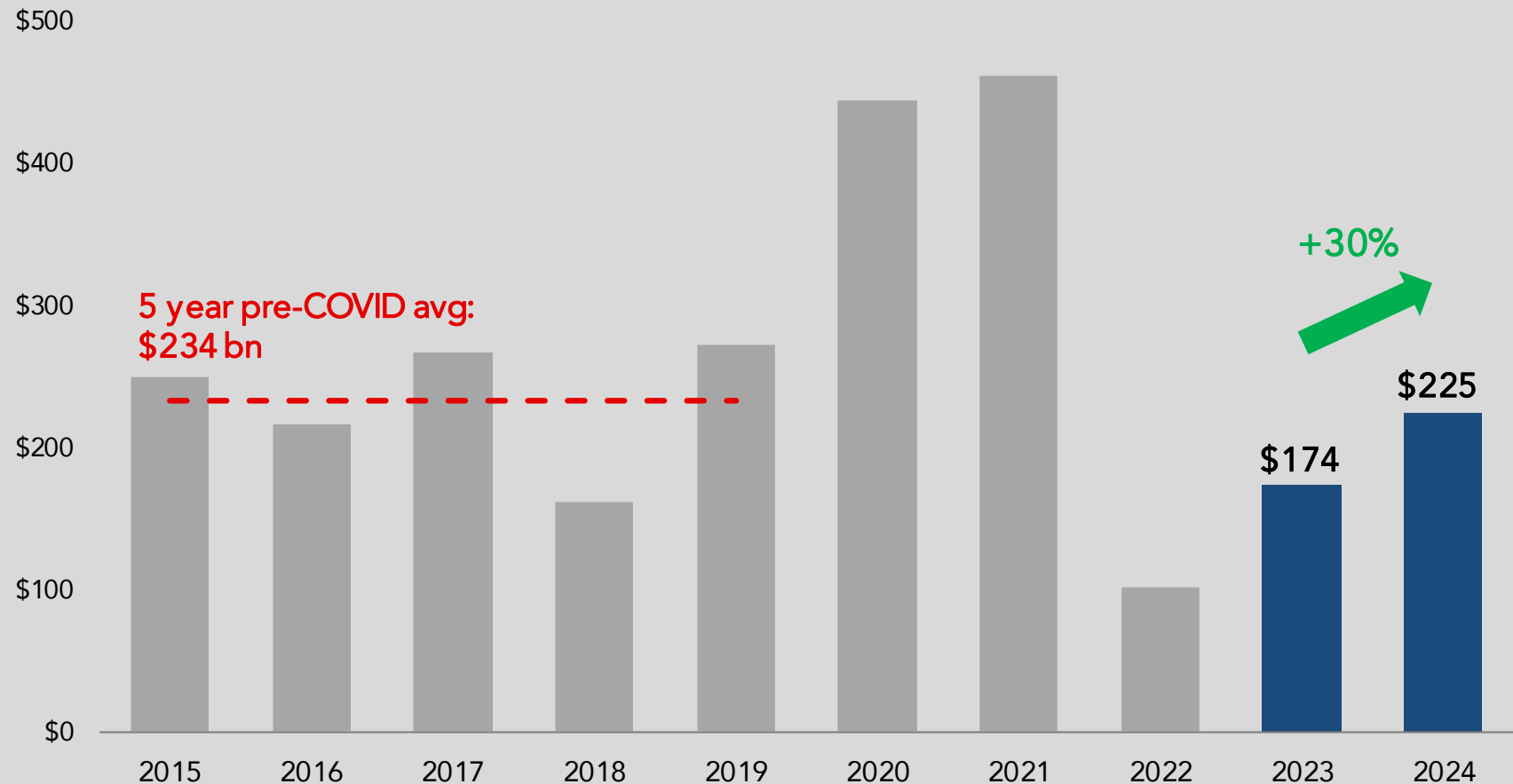
All time largest January USD IG issuance, bn



Source: (1) CFR. Data as of January 31, 2024.

# 2024 HY Issuance Should Increase 30%

High yield issuance, USD bn

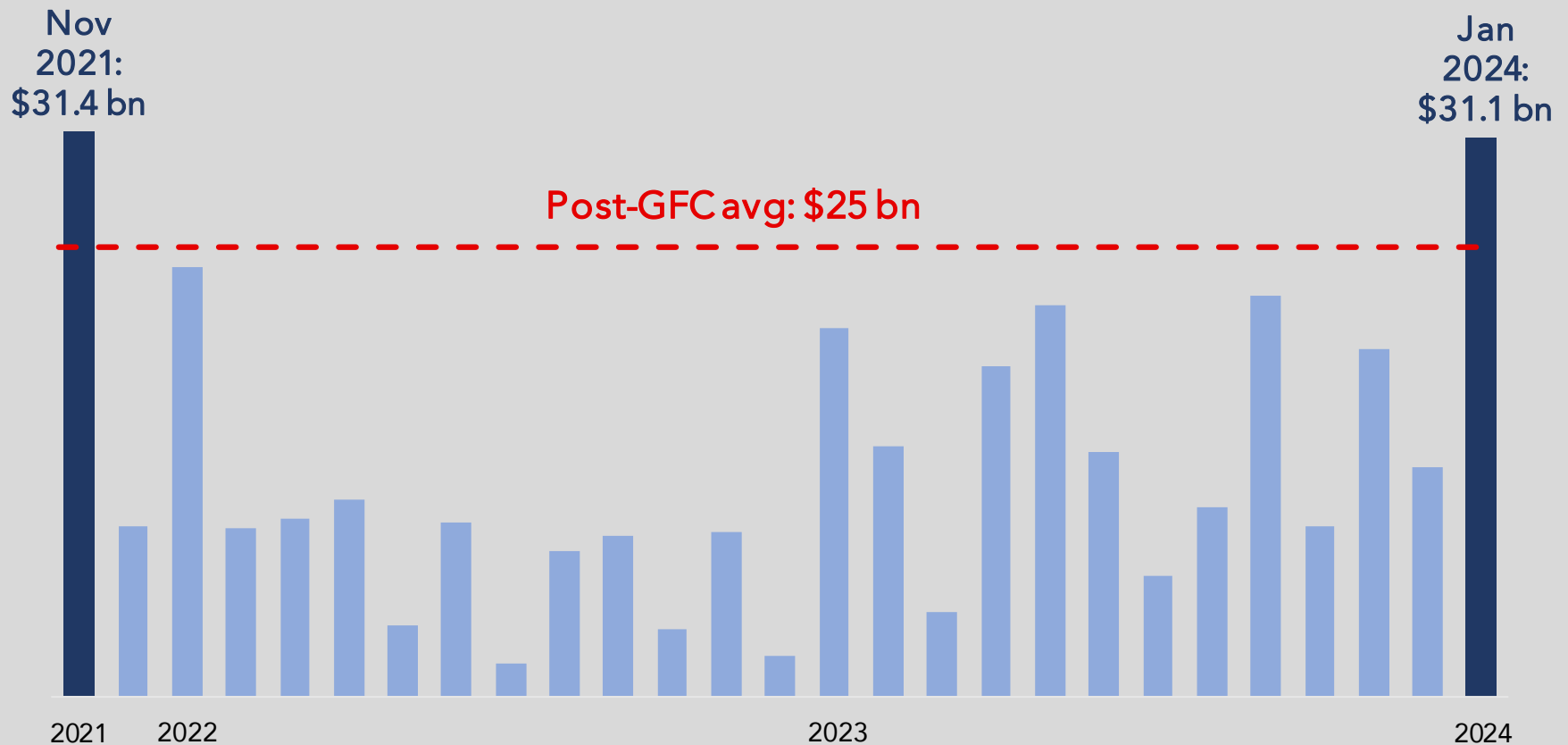


Source: (1) Bloomberg. Data as of January 31, 2024. MUFG.

# Largest HY Issuance Month in Over 2 Years

After a slower start to the year, late January USD high yield issuance surged to make monthly issuance the largest since November 2021. Total monthly volume of \$31 bn well surpassed consensus expectations of \$20 - 25 bn.

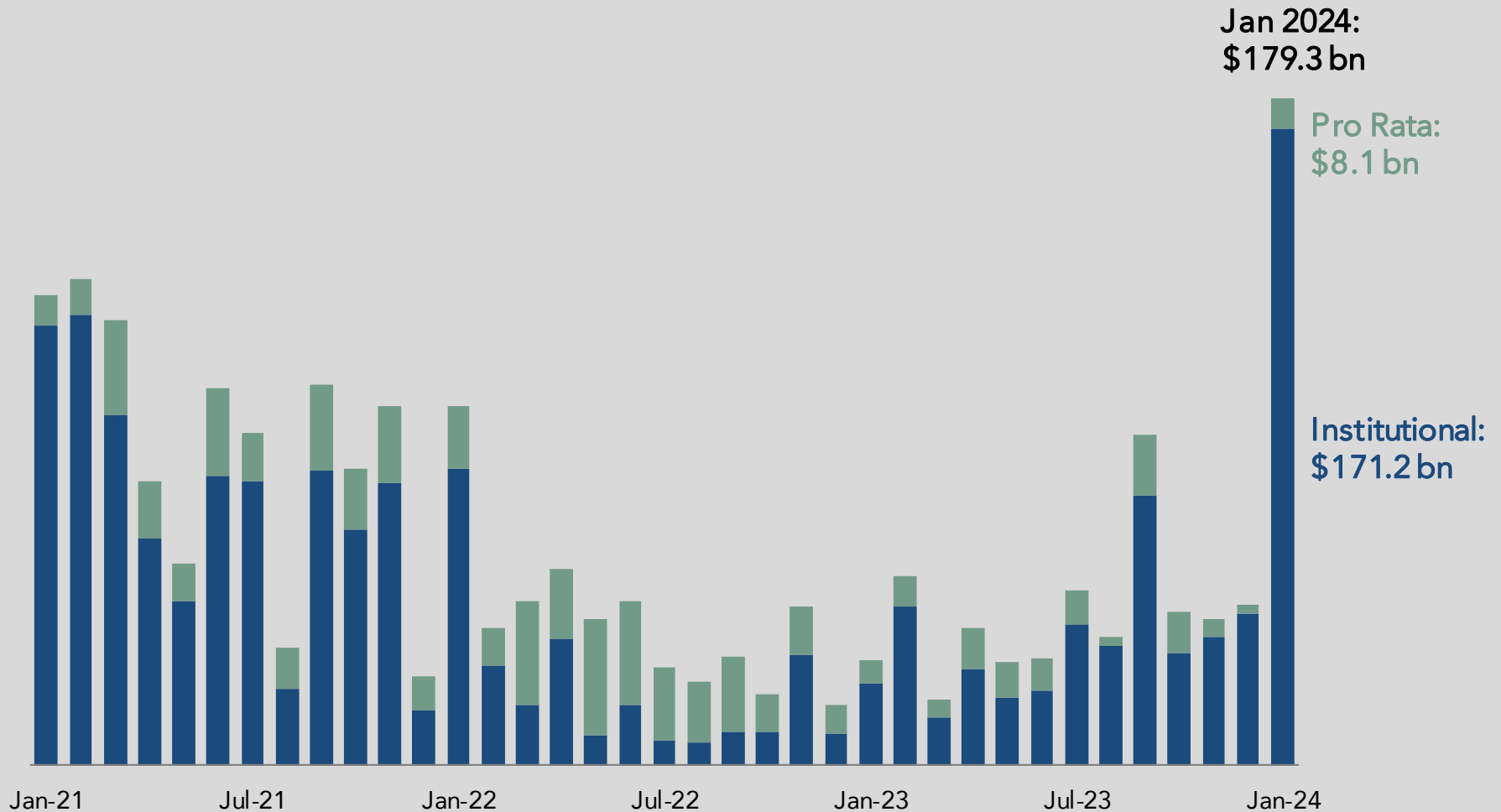
Monthly HY USD issuance, bn



Source: (1) CFR. Data as of February 1, 2024.

# Repricings Drive Higher Loan Volume

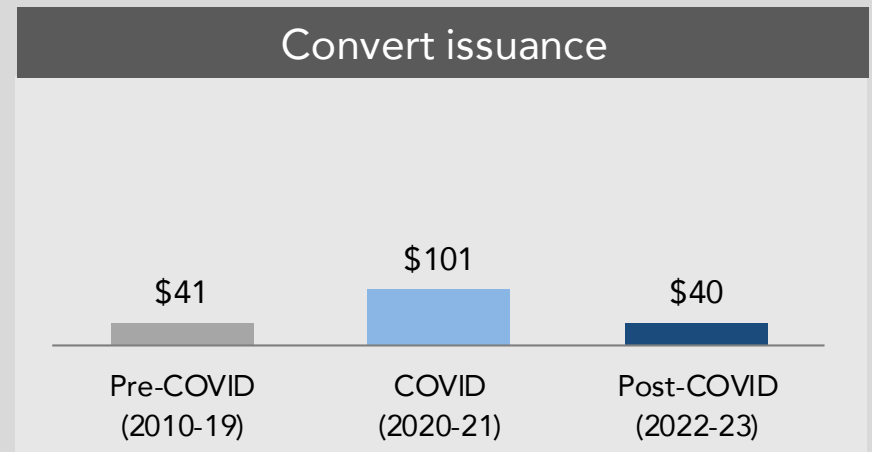
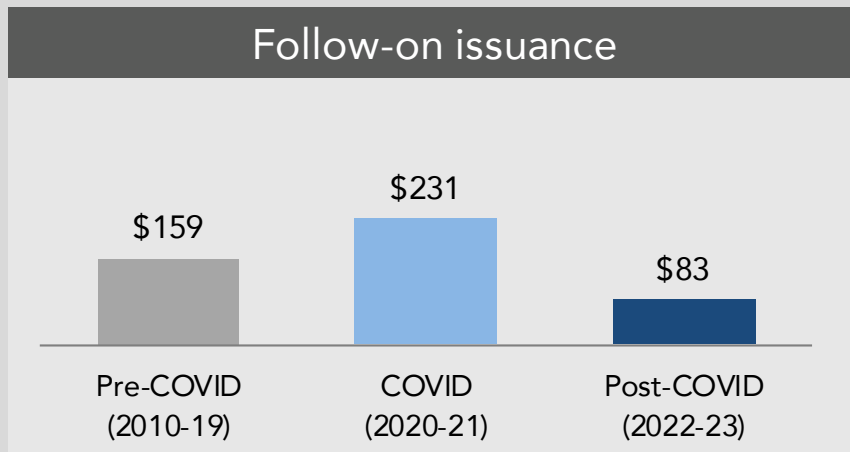
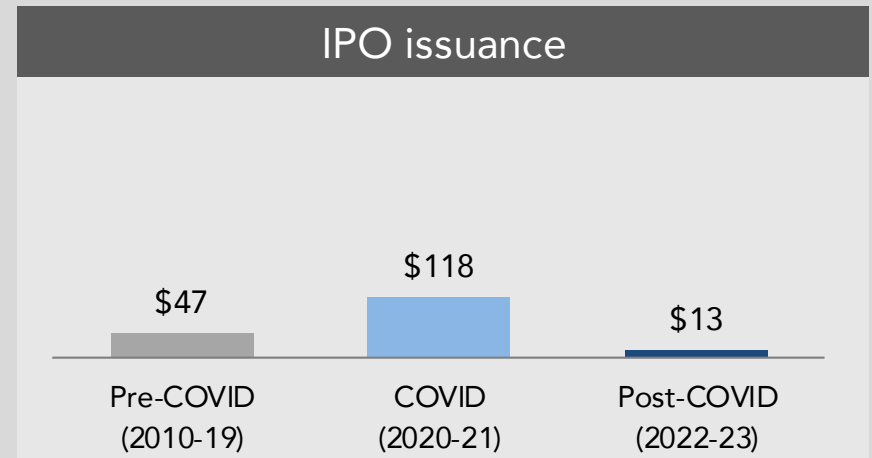
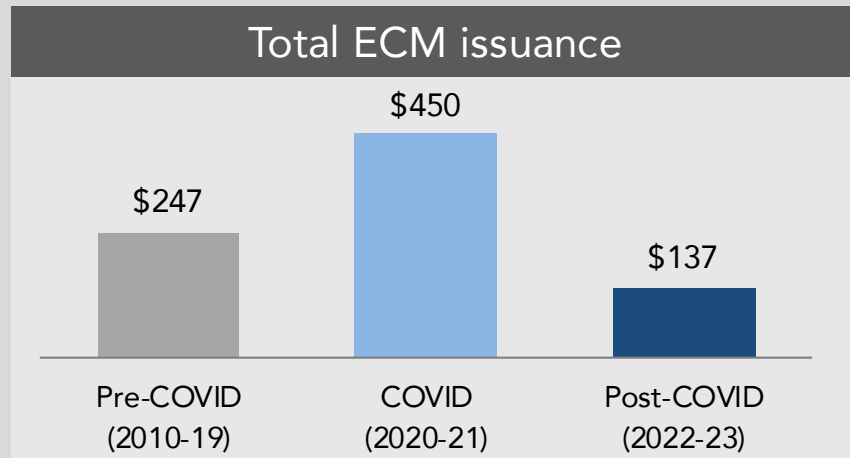
Monthly USD leveraged loan issuance USD volumes, bn



Source: (1) Pitchbook. Data as of January 31, 2024. Institutional volume represents new money, repricings, and extensions.

# Equity Issuance Should Bounce Back in 2024

Annual average volume, USD bn



Source: (1) MUFG Equity Capital Markets Team (Geoffrey Paul), Dealogic, Bloomberg and MUFG Equity Capital Markets as of 12/13 /23. Includes US-listed offerings priced with deal value greater than or equal to \$50 million. Excludes SPACs and CEFs. Includes marketed follow-on offerings and registered block trades.



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