

24 ANNUAL

THE
TWILIGHT
ZONE



GLOBAL
MARKET
OUTLOOK

SYNOPSIS

We believe markets may be overly optimistic about a *soft-landing* scenario in 2024 and that recession risks remain elevated for most developed economies in the year ahead. While this is likely to create headwinds for equity markets, we expect a more positive environment for government bonds.

KEY MARKET THEMES

A recent survey by Bank of America found that 74% of fund managers expect a *soft landing*—where economic growth slows but a recession is avoided—for the global economy in 2024. This optimism is evident in bottom-up consensus expectations for 11% earnings growth by S&P 500® companies in 2024, and in spreads on high-yield corporate bonds that are below their long-term average.

We're not as confident that the all-clear can be sounded on recession risks, however, as households will soon exhaust their excess savings from the pandemic. Up until now, these savings have acted as a strong defense against U.S. Federal Reserve (Fed) tightening. In addition, significantly higher interest rates have become a constraint on new borrowing, which will create refinancing issues.

All told, this business cycle may be a case of *this time is longer* rather than *this time is different* with regards to the lagged impact of aggressive Fed tightening on the economy. While a recession in 2024 might be avoided, we see the risks as elevated. The world will likely enter the new year in a twilight zone between slowdown, possible recession, and recovery—where nothing is likely to be quite what it seems.

In the U.S., slower economic growth and the threat of a recession provide a cautious equity market backdrop. We think 10-year Treasury yields around 4.5% offer good value and expect recession risks to provide cycle support for bond returns.

Europe has been hard hit by the global manufacturing downturn and demand weakness from China. Although eurozone equities have been strong performers in 2023, they'll likely battle tight monetary policy and recession risks in 2024.



We believe the UK has the most challenging outlook of the major economies—and the greatest risk of recession in 2024. With inflation declining more slowly than elsewhere, the Bank of England will likely be slower to start easing than other central banks.

In China, fiscal policy is likely to be a dominant factor through 2024 as the government continues with incremental new policies to support the economy. Chinese equities look cheap across most metrics, but we remain cautious for now, looking for clearer signs of a commitment to policy measures that will resolve the debt issues in the property market and meaningfully boost the economy.

We expect economic growth in Japan to slow next year as reopening dynamics fade. A key focus for Bank of Japan (BoJ) policy is whether there are further improvements in wage growth. We expect more incremental tightening from the BoJ, with yield-curve control likely to be removed through 2024.

In Australia, we anticipate the economy will slow through 2024, but that a recession will be avoided due to strong population growth and less restrictive policy relative to other developed markets.

We expect the Bank of Canada to resist further tightening amid significant inflation declines and rising uncertainty over the economic outlook. We see rate cuts as likely in Canada next year as recession risks intensify.

ECONOMIC VIEWS



FED POLICY

Amid slowing U.S. jobs growth and declining inflation, we believe the Fed has probably finished lifting interest rates and may contemplate rate cuts during the first half of 2024.



CHINA GROWTH OUTLOOK

We expect growth of around 4.5% in China next year, underpinned by government spending and some improvement in consumer standing.



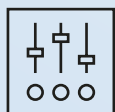
EUROPEAN ECONOMY

We believe the eurozone is on track for another year of below-trend growth in 2024, with elevated recession risks.



U.S. FISCAL POLICY

With the U.S. debt-to-GDP (gross domestic product) ratio on the rise, we think the era of big fiscal expansions is over. Going forward, politicians will likely be constrained by the realities of debt burdens and interest costs.



BANK OF ENGLAND (BoE) EASING

In the UK, fixed income markets have 75 basis points (bps) of BoE easing priced for next year. This seems like an underestimate to us, given the underlying weakness of the nation's economy.

ASSET CLASS VIEWS

Equities: Limited upside

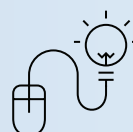
Equities offer limited upside as valuation multiples are expensive amid elevated recession risks. From our viewpoint, the quality factor is a preferred exposure within the equity market. It trades at a reasonable relative valuation to the market, and the style's emphasis on profitable companies with strong balance sheets can offer useful defense if the economy slows and interest rates decline.

Fixed income: Government bonds offer attractive value

With yields trading well in excess of expected inflation, we see government bond valuations as attractive in the U.S., the UK, Canada, Germany, and Australia. U.S. Treasuries are a preferred overweight exposure for us. Our fixed income strategy team sees particularly good value in the five-year segment of the yield curve, and the potential for the curve to re-steepen if more aggressive rate cuts are delivered in 2024 and 2025.

Currencies: Neutral stance on U.S. dollar

The U.S. dollar is expensive on a purchasing-power-parity basis, which suggests potential for the greenback to depreciate over the medium-term. However, the potential for a global recession in 2024 could result in further upside for the dollar in the short-term as investors flock to the relative safety of U.S. assets. From our vantage point, these two-sided risks warrant a neutral stance.



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