

Q4

2024

DEFINITELY
MAYBE



GLOBAL
MARKET
OUTLOOK

SYNOPSIS

The latest data suggests the U.S. economy is headed toward a soft landing rather than a recession. With Federal Reserve (Fed) rate cuts underway, markets are backing this view, creating risks for portfolios if a recession does materialise. We believe weekly U.S. jobless claims may provide investors with the best guide to which scenario is playing out.

KEY MARKET THEMES

1990s nostalgia is back with the announcement of a reunion tour by Britpop band Oasis. Investors are hoping for another 1990s throwback in the shape of an economic soft landing, since the last time the U.S. economy avoided a recession after aggressive Fed tightening was in the mid-1990s.

The economic data indicates a soft landing is likely, but as Oasis declared in the title of their 1994 debut album, it's Definitely Maybe. This is because although inflation is declining, wage growth is moderating, and labour market pressures are cooling, recession risks still appear more elevated than normal due to potential lags in the impacts of the Fed's 2022-23 rate-hiking campaign.

Importantly, the Fed has started easing before clear signs of economic stress have emerged, and our base-case scenario is that the U.S. economy will achieve a soft landing. But we do think there's a lesser chance that the slowdown could overshoot into a recession if U.S. consumers rein in their spending due to a weaker job market. This could cause companies to pull back on spending or hiring, which in turn could trigger further consumer caution.

Whether or not the Fed can lower rates back to normal levels while stabilising the economy is likely to be the final post-pandemic test for the central bank—and the health of the labour market will be a key watchpoint as this challenge plays out. U.S. employment growth today has slowed to a point where it's become increasingly difficult for new workforce entrants like college graduates and immigrants to find jobs. The unemployment rate is rising as a result, although importantly, without the layoffs that usually accompany an economic recession.

The U.S. elections are also nearing, with very competitive races for the presidency and control of Congress. It's important to note that the democratic system of government

in the U.S. features checks and balances across the executive, legislative, and judicial branches, which makes it hard for individuals and parties to enact sweeping change. As a result, the impact of politics on U.S. markets is typically limited.

In Europe, economic prospects are brightening as growth picks up and inflation moderates. The decline in inflation has allowed the European Central Bank to lower rates twice since June, with one more cut likely by the end of the year. We view European stocks as attractively valued and think they'll perform well if earnings recover in line with the economy.

Meanwhile, the improvement in the UK economy is becoming more sustained, with consumer and business confidence on the rise and house prices beginning to recover. However, the cautious tone from the Bank of England suggests it will cut rates at a slower pace than most of its developed-market counterparts. We see the FTSE 100 Index of UK stocks as relatively attractive, with a 12-month-ahead price-to-earnings ratio of 11.5 times and a 3.7% dividend yield as of mid-September.

China's outlook has taken a turn for the worse as property market problems remain unresolved, credit growth slows, and consumer confidence hovers near record lows. Chinese equities are attractively valued and, despite the soft backdrop, we believe the outlook for earnings growth among Chinese companies is reasonable.

Japan looks to be on steady footing, with reasonable growth and inflation returning to target. Our confidence on the direction of monetary policy has dropped following the surprise rate hike in July, but we expect that the Bank of Japan (BoJ) will be patient and not take policy to a restrictive stance.

In Australia, consumers are under pressure from higher interest rates, while the mining sector is facing softer commodities prices given China's slowdown. Despite this, we think Australia should be able to narrowly dodge a recession.

The New Zealand economy is set for some respite now that the Reserve Bank of New Zealand has begun its rate cutting cycle. We expect that the RBNZ are on a path of steady 0.25% rate cuts but will preserve the option to do larger cuts if the economy deteriorates further. New Zealand government bonds are close to fair value in our opinion and should provide some return upside if the economic outlook deteriorates further.

The business cycle outlook is challenging in Canada amid a fall in GDP (gross domestic product) per capita and a rise in the unemployment rate. Although Canadian equities still look favourably priced compared to U.S. equities, macro concerns also keep us cautious if economic conditions in the country weaken further.

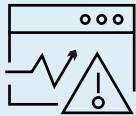


ECONOMIC VIEWS



U.S. LABOUR MARKET

We think weekly jobless claims could provide valuable clues on where the economy is heading. Initial jobless claims sustained above 260,000 per week would be an indicator that a recession may be close, while a sustained weekly number less than this would indicate a soft landing is more likely.



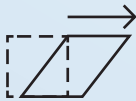
BANK OF JAPAN POLICY

The BoJ seems determined to swim against the global central bank trend and raise interest rates further. In our view, this risks a repeat of the policy mistakes made over the past 30 years, where the bank tightened monetary policy before long-term expectations for sustained 2% inflation were entrenched.



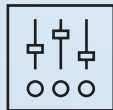
EUROPEAN ECONOMY

The gradual pickup in bank lending and rising household incomes are providing a tailwind for eurozone economies. We think the recovery will continue in 2025, barring a sharper downturn in the U.S. economy.



RATE CUTS IN CANADA

We think the Bank of Canada may have to ease more aggressively than its current measured pace if the growth outlook deteriorates further or unemployment increases.



CHINA STIMULUS

We think China will probably only announce substantive policy measures, such as large-scale stimulus, if economic data worsens.

ASSET CLASS VIEWS

Equities: Neutral

From our vantage point, the tactical opportunity set in equity regions, sectors, and styles is muted. Across global equities, the value and momentum factors appear relatively cheap but are accompanied by higher economic beta and poor sentiment, respectively. We prefer to maintain a balanced exposure and allow stock selection to be the key driver.

Fixed income: Government bonds are fairly valued

We believe that government bonds are fairly valued and offer positive asymmetry if economic growth declines further. That said, some of the tactical opportunity has dissipated given the rally in bond prices. We expect the U.S. Treasury yield curve to steepen from here, which means the gap between the 10-year government bond and the 2-year government bond will increase. Credit spreads are pricing in a significantly lower recession risk than our own, making them unappealing, in our opinion.

Currencies: Expensive U.S. dollar

The U.S. dollar continues to look expensive, and we expect it will likely depreciate in a soft landing. The oversold reading on the Japanese yen has unwound since August given the unraveling of the yen carry trade.



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