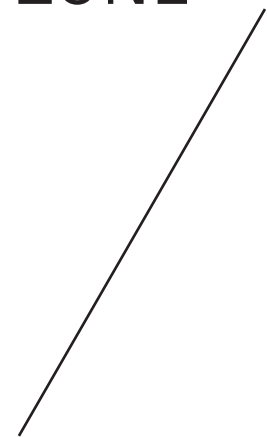


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GLOBAL
MARKET
OUTLOOK



I'm pleased to share our 2024 Global Market Outlook.

Global markets have exceeded expectations in 2023, thanks in large part to the mega-cap technology stocks known as the Magnificent Seven. Investor sentiment has shifted from “a recession is coming” to “a soft landing is around the corner.” Our market psychology index indicates high investor optimism, even though market gains have been concentrated. Too much optimism can make the markets more vulnerable to over corrections. Our outlook for 2024 is more cautious due to restrictive monetary policy, slowing growth, and geopolitical tensions.

The U.S. Federal Reserve’s “higher for longer” approach will likely strain finances in the year ahead, impacting borrowers and refinancers. Meanwhile, we expect Europe and the UK to continue contending with weak demand, high inflation, manufacturing slumps, and Brexit. Lastly, China—although stabilising—will continue to grapple with long-term issues like debt and property markets and demographics.

Despite all this, markets are pricing closer to a smooth landing in 2024. We aren’t as confident about that, but we still see opportunities in a total-portfolio context. Government bonds look valuable as yields exceed inflation and could become more appealing as a hedge against stock-market volatility. We prefer quality equities for their relative value and defensive characteristics. Real estate investment trusts and global listed infrastructure are also attractive to us and should benefit from longer demographic and technology trends.

Now, what does this mean for asset allocation? In our view, diversification and active management are more critical than ever. This goes beyond stocks and bonds and addresses broader macro factors such as inflation, growth, and trade. Next-generation diversifiers such as real assets and private credit offer additional benefits in this context. As monetary policy changes, diversification within the growth side of portfolios will become more relevant, but elevated volatility will make it critical to be selective. We see this as a ripe environment for active managers but believe that choosing the right ones and combining them will require more research and skill, especially as markets can shift quickly.

As we enter 2024, Andrew Pease, our Chief Investment Strategist, Global Head of Investment Strategy, and his team provide insights to assist investors in navigating this tricky business cycle and market events for the year ahead.

Kate El-Hillow
President & Chief Investment Officer



Over pessimism for 2023 has become over-optimism about 2024. Recession risks are elevated, creating headwinds for equity markets but a more positive environment for government bonds.



We are in a twilight zone between slowdown, possible recession and recovery, where nothing is likely to be quite what it seems.

Andrew Pease, Global Head of Investment Strategy



INTRODUCTION

“There is nothing more deceptive than an obvious fact,” according to the fictional detective Sherlock Holmes. A year ago, the industry consensus thought it obvious that the U.S. economy was on the brink of recession. The respondents to the Federal Reserve Bank of Philadelphia’s survey of professional forecasters predicted the highest probability of recession in the survey’s 45-year history. The U.S. Federal Reserve (Fed) had embarked on the most aggressive tightening since Former Fed Chairman Paul Volcker’s tenure in the early 1980s, the yield curve had inverted, sending a classic recession warning sign, and the cyclically important Institute of Supply Management (ISM) manufacturing index had fallen into contractionary territory.

The U.S. economy is on track for above-trend growth in 2023, global equities have posted double-digit returns and [government bond yields have risen](#). Having been humbled in 2023, the consensus has reversed direction. A recent survey by Bank of America found that 74% of fund managers expect a no-recession “soft landing” for the economy in 2024. This optimism is evident in bottom-up industry consensus expectations for 11% earnings growth in 2024 by S&P 500 companies, and in spreads on high yield corporate bonds that are below their long-term average.

Are U.S. recession risks still elevated?

We are not as confident that the all-clear can be sounded on recession risks. Corporations and households built strong defenses against Fed tightening following the pandemic, accumulating large cash reserves and locking in low interest rates on 30-year mortgages and longer-term corporate bonds. These defenses, however, are beginning to crumble. Households will soon exhaust their excess savings, while significantly higher interest rates—which have become a constraint on new borrowing—will create refinancing issues. We think this 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 U.S. economy. Recession in 2024 might be avoided, but the risks are elevated.

Slowing jobs growth and declining inflation are [signs the economy has begun to cool](#). The good news is that the Fed has [probably finished lifting interest rates](#) and may contemplate easing during the first half of the year. It also means, however, that we are entering a period of heightened uncertainty as investors debate whether recession can be avoided. It may appear for a time that the U.S. economy has achieved a soft landing, but this could be a waypoint on the path to a mild recession later in 2024.

Is the UK at a greater risk of a recession? What about Europe?

The other developed economies are also under stress from aggressive tightening. Europe has been hard hit by the global manufacturing downturn and demand weakness from China.

The UK economy has had a larger inflation shock than others and is still battling the fallout from Brexit. Both are likely to underperform the U.S. economy in 2024.

Japan remains an outlier with accommodative monetary policy and above-trend gross domestic product (GDP) growth. This should continue through 2024, allowing the Bank of Japan to progressively [step away from its yield-curve control policy](#).

China’s economy appears to be stabilising in response to [piecemeal stimulus policies](#). The debt and property market problems will continue to be a headwind and growth is likely to remain lackluster.

What’s the outlook for equities in 2024? What about bonds?

Slower economic growth and the threat of recession provide a cautious equity market backdrop. The S&P 500 Index is expensive with a forward price-to-earnings ratio of 18 times as of November 2023 and has priced a soft-landing cycle view based on double-digit earnings growth expectations. Asymmetry seems the best description of the outlook, with significant upside only if both the economy and earnings beat already optimistic expectations. Our concerns about [elevated recessions risks](#) make us worried about downside potential. The likelihood, however, of rapid Fed easing in the face of recession fears should limit the magnitude of market declines and set the stage for an eventual rebound.

10-year U.S. treasury yields around 4.5% offer good value and recession risks should provide cycle support for bond returns.

We expect that 2024 will be the transition year that the consensus anticipated for 2023. The over-pessimism about 2023 has become over-optimism for 2024. We are in a twilight zone between slowdown, possible recession, and recovery where nothing is likely to be quite what it seems.

Our key asset-class views for 2024:

- Government bonds offer attractive value as yields trade well above expected inflation. Yields should decline as

recession risk looms. Our target is 3.5% for the U.S. 10-year Treasury yield by the end of 2024.

- Equities have limited upside with expensive valuation and recession risk on the horizon.
- The Quality factor is our preferred exposure within the equity market.
- The U.S. dollar could weaken early in the year on soft-landing hopes but strengthen later in the year if recession fears take hold.

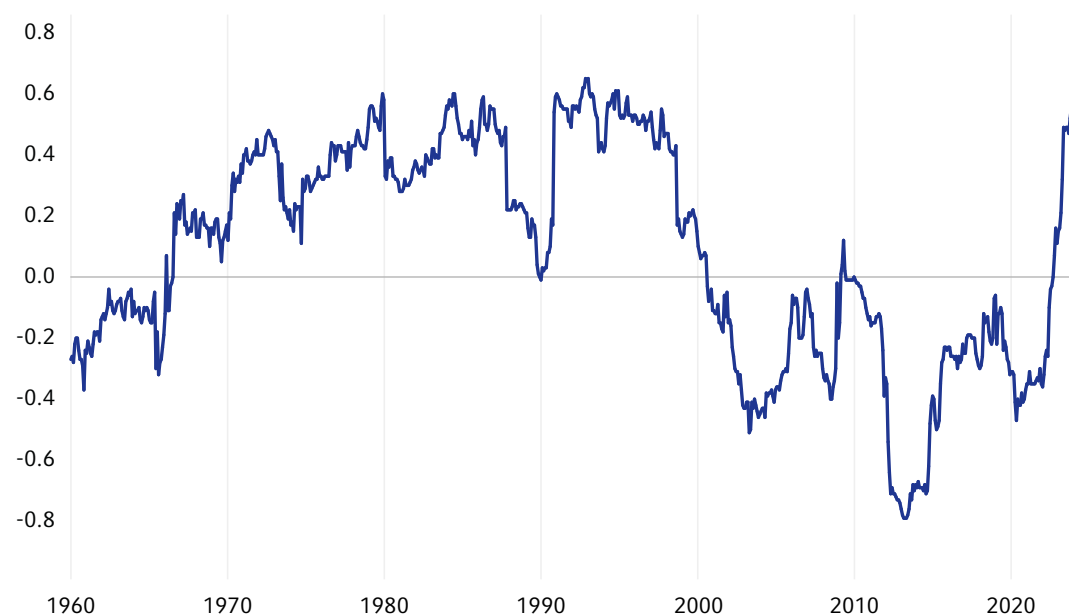
- High yield and investment grade spreads are uncomfortably tight for an environment of elevated economic uncertainty, leading us to dampen our typical strategic overweight to corporate credit.
- We are neutral on emerging markets despite their relative cheapness due to negative sentiment. The structural changes facing China's economy mean we need to see extremely oversold conditions before overweighting.

THE RETURN OF 60/40

The past couple of years have been tough for investors with diversified portfolios. The classic portfolio model of 60% equities and 40% fixed income suffered one of its worst years in 2022 and has managed only a hesitant recovery in 2023. Equity and bond returns have become positively correlated, which means that declines in equity markets have not been offset by gains in government bonds.

The *renormalisation* of interest rates is at least partly to blame. This has seen the 10-year U.S. Treasury yield rise from 1.5% at the beginning of 2022 to near 4.5% at the end of 2023. As a result, bonds have not helped stabilise portfolio returns during periods of equity market volatility and have been a drag on overall returns. In addition, the diminished diversification value of bonds likely contributed to the rise in long-term yields.

Stock-bond correlation, 3-year rolling window



Source: LSEG DataStream, Ibbotson Associates. Monthly returns as of October 2023.

Stocks represented by the 500 Index. Bonds represented by the Bloomberg Long-Term U.S. Treasury Index.

Could the stock-bond correlation become negative in 2024?

The stock-bond correlation tends to be positive when there is an unexpected surge in inflation. If discount rates (i.e., Treasury yields) rise significantly without a commensurate rise in earnings expectations, the valuation of both stocks and bonds will decline. This is most likely to occur when inflation expectations are unanchored or when the economy suffers an adverse supply shock as it did in 1973, 1980 and 2021.

Going forward, our baseline is that supply-chain healing, the Fed's commitment to bring inflation back to target, and the potential for a recession should collectively flip the [stock-bond correlation](#) back toward the negative levels that prevailed for most of the 2000s.

The bottom line is government bonds are likely to re-establish their role as effective diversifiers for multi-asset portfolios, and as a result we expect the 60/40 portfolio is set for a comeback.



Government bonds are likely to re-establish their role as effective diversifiers for multi-asset portfolios.

Paul Eitelman, Chief Investment Strategist, North America

THE END OF EXPANSIONARY FISCAL POLICY

Former U.S. president Bill Clinton's chief adviser, James Carville, mused in 1994 that he would like to be reincarnated as the bond market because he would then be able to intimidate everybody. After three quiet decades, the bond market has its menacing mojo back.

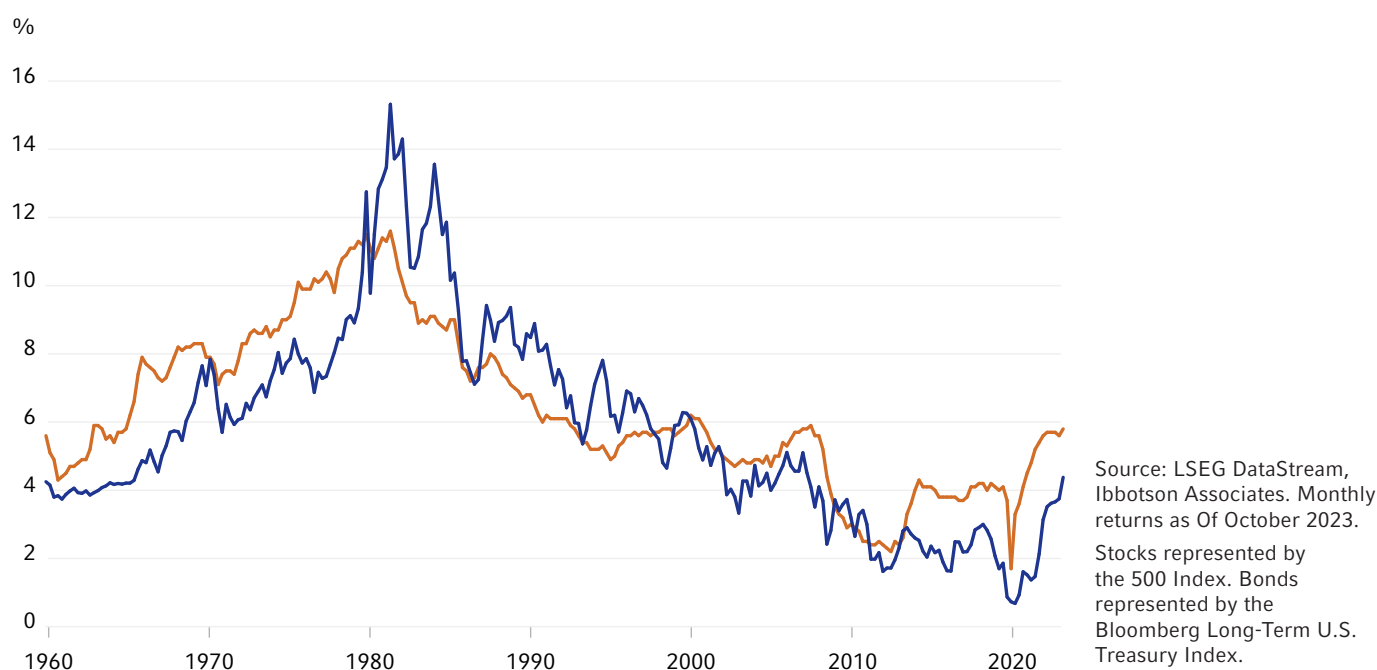
U.S. debt-to-GDP ratio is on the rise

The problems are that government debt shot up in response to the pandemic, and aging populations make it hard to wind back deficits. The International Monetary Fund (IMF) forecasts that based on current fiscal deficit projections, the U.S. debt-to-GDP (gross domestic product) ratio will rise from 123% currently to 137% by 2028. Debt was just 53% of GDP back in 2001.

Higher bond yields mean that interest payments are going to be a larger part of fiscal deficits. The IMF thinks that by 2028, interest payments on government debt will equal nearly 4% of GDP.

The arithmetic of government debt sustainability hinges on the difference between the interest rate paid on government debt and the growth rate of the economy. An interest rate greater than GDP growth means that the government will need to run a primary fiscal surplus (excluding interest costs) to prevent the debt-to-GDP ratio from rising. The chart below shows how the past decade has been an unusual period in which the government bond yield has been consistently below economic growth. This gap has recently closed and could turn negative if nominal GDP growth returns to its recent trend near 4% and the bond yield remains near current levels.

Nominal U.S. GDP Growth & 10-Year Yield



The U.S. primary fiscal deficit is currently around 5.5% of GDP. The last surplus was in 2001 and the deficit has averaged 4% of GDP over the past decade. The Congressional Budget Office predicts that the primary deficit will average 2.9% over the next decade. The yield on government debt would need to fall below 2% to prevent the debt-to-GDP ratio from rising further. The problem, of course, is that ongoing deficits will keep upward pressure on Treasury yields.

What steps can governments take to reduce deficits?

There are only two available choices for governments. One is to undertake the politically painful process of reducing spending and increasing taxes. The other is to allow higher inflation to boost nominal GDP growth and reduce debt in real terms.

Former Prime Minister Liz Truss' short-lived government in the United Kingdom discovered the intimidatory power of the bond market last year when it tried to boost the economy with unfunded tax cuts. Bond investors saw there was no plan to reduce the fiscal deficit and control inflation. The yield on 10-year gilts rose by over 100 basis points in three days, Sterling plunged, and Truss was forced to resign.

A fiscal crisis in the United States or other major developed economies seems unlikely anytime soon (aside from Italy, which has made improvements). The UK example stands as a salutary lesson to other politicians. Our main conclusion is that the era of big fiscal expansions is over, and politicians are going to be constrained by the realities of debt burdens and interest costs. There will be less ability to respond to the next economic downturn with fiscal support. There is a risk that central banks will be forced to accommodate inflation above their targets, but as we learned in 2023, inflation is unpopular with voters. The bond market bullies are back.

The era of big fiscal expansions is over, and politicians are going to be constrained by the realities of debt burdens and interest costs.

Andrew Pease

REGIONAL SNAPSHOTS

United States

The U.S. economy was [more resilient than expected in the third quarter of 2023](#), but important headwinds remain. Monetary policy is restrictive as evidenced by the deeply inverted Treasury yield curve. The labour market needs to soften further to put the nail in the coffin of the inflation overshoot. Meanwhile, the consumer—which was a source of strength in Q3—is depleting its excess savings, delinquency rates are rising, and budgets are being stretched with a mix-shift in spending toward necessities and discounted brands.

We estimate that recession risks and macro uncertainty remain elevated in 2024.

Markets by contrast are priced for a more favourable, soft-landing scenario. This creates an attractive risk-reward for investors in Treasury markets, for example, where we expect the Fed will [cut interest rates much more aggressively than priced if a recession materialises](#).



Eurozone

The eurozone is on track for another year of below-trend growth in 2024, with elevated recession risks. Restrictive monetary policy, sluggish growth in China and weak global trade will be headwinds. The positives are that consumer purchasing power is being lifted by robust wage growth and falling inflation. There also may be at least a temporary rebound in manufacturing activity as low global inventory levels are rebuilt, given Europe's larger exposure to manufacturing than other developed economies.

The region has been flirting with recession for the past year and it will be hard to avoid if

the U.S. falls into recession. The other risk is that the European Central Bank (ECB) is slow to cut interest rates, as it is over-focused on backward-looking measures of inflation risk, such as wages growth.

Eurozone inflation is falling at a brisk pace, declining to 2.9% in October. Interest rate markets have priced just 100 basis points of ECB tightening in 2024. We expect that falling inflation and weak growth will see more easing than priced. Eurozone equities have been strong performers in 2023 but will battle tight monetary policy and recession risk in 2024.



United Kingdom

The UK has the most challenging outlook of the major economies, and we believe it has the greatest risk of recession in 2024. Inflation is declining more slowly than elsewhere, which means the Bank of England (BoE) will be slower to start easing than other central banks.

The economy is [showing signs of slowing](#) with job vacancies falling and unemployment rising. House prices are declining and the full impact of the substantial rise in 2-to-5-year fixed-rate mortgage interest rates is still to be felt.

A general election is likely in 2024 and current UK opinion polls point to a strong lead for the opposition Labour Party led by Keir Starmer. The incumbent Conservative Party government has cut some taxes to boost its poll ratings, but as these are pushing in the opposite direction to monetary policy, we expect the main impact will be to delay easing by the BoE.

Fixed income markets have 75 basis points of BoE easing priced for next year, which seems an underestimate given the underlying weakness of the economy. UK gilts are attractive with the 10-year yield at 4.25%.



Japan

Economic growth should slow in Japan next year, as reopening dynamics fade. A key focus for Bank of Japan (BoJ) policy is whether we see further improvement in wage growth. We expect that more incremental tightening from the BoJ, with [yield-curve control likely to be removed through 2024](#). However, they may not get the chance to increase the policy rate before the U.S. and Europe go into recession.

Japanese equities have been boosted by the Tokyo Stock Exchange's focus on corporate governance and return on equity. The low-hanging fruit has been picked this year in terms of stock buybacks, and the focus will now turn to sustainable corporate changes.

The Japanese yen has been one of our favoured currencies—we continue to think it is very cheap but unlikely to meaningfully appreciate until U.S. interest rates start to decline.



China

Fiscal policy is likely to be a dominant factor through 2024 as the Chinese government continues with [incremental new policies to support the economy](#). We expect growth of around 4.5% next year, underpinned by government spending and some improvement in consumer standing. The property market will continue to be a watchpoint, and the potential for a global recession will weigh on exports. Inflation is likely to increase through the year but will remain below the target of 3%.

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.



Canada

The Canadian economy is skating on thin ice, evident in the -1.6% contraction in GDP per-capita over the year ending the second quarter of 2023. An official recession has only been avoided due to immigration providing support for spending and growth. However, the per-capita decline indicates spending habits are souring largely due to escalating costs of home ownership.

Small businesses lack confidence, citing insufficient demand as a significant concern. We expect the Bank of Canada (BoC) to resist further tightening amid significant inflation declines and rising uncertainty over the economic outlook. Rate cuts are likely in 2024 as recession risks intensify.

The cyclical nature of Canadian equities keeps us cautious. Core fixed income, however, is attractive as market pricing for the BoC does not adequately reflect the economy's underlying vulnerabilities.



Australia/New Zealand

We expect the Australian economy will slow through 2024 but should avoid recession due to two key factors. First, [population growth is likely to remain strong](#), which provides a buffer to aggregate demand. Second, the Reserve Bank of Australia (RBA) has not made policy as restrictive as other regions. Australian equities look attractively valued relative to global peers and should benefit from China stimulus. We think the RBA is at or near the end of its rate-hiking cycle, and Australian government bonds are attractively valued.

The New Zealand outlook is more mixed. Monetary policy is tight and is likely to remain that way for some time. However, aggregate demand should be supported through 2024 by a notable pickup in population growth. The recent change in government from October election results will likely see fiscal policy become less supportive over the second half of 2024, but there is still uncertainty given the National/ACT coalition of political parties did not get a majority. New Zealand bonds look slightly cheap.



Eurozone equities will battle tight monetary policy and recession risk in 2024.

Andrew Pease

ASSET-CLASS PREFERENCES

Our cycle, value, and sentiment (CVS) decision making process is slightly cautious on the outlook for 2024. Equity valuation multiples are expensive and credit spreads are tight, which constrains the upside potential for risk assets. Meanwhile, government bonds are attractively priced with U.S. Treasury yields trading two to three percentage points above expected inflation. There are real alternatives (TARA¹) for investors as fixed income offers a competitive expected return for multi asset portfolios.

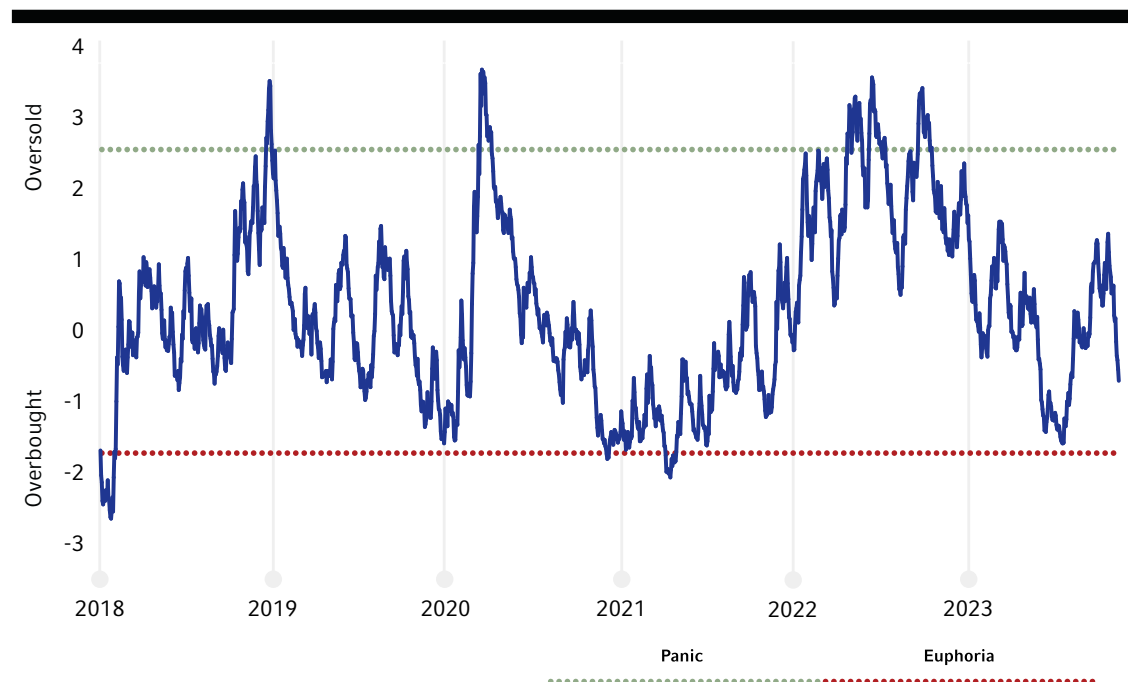
Is investor sentiment shifting toward more optimistic levels?

Uncertainty around the global business cycle is high as developed market economies face a stiff test from restrictive monetary policy, and China navigates structural challenges. Meanwhile, markets appear priced for a soft-landing of the global economy in 2024, characterised by double-digit earnings growth, record dividend payouts, and a gradual pace of rate cuts by central that would [leave interest rates at restrictive levels for years](#). This optimistic market pricing

creates downside asymmetry for risk markets, which means we see greater downside potential for equities if the economy slips from slowdown to recession than upside potential if a recession is avoided.

Our proprietary index of market psychology also shows that investors transitioned toward a more optimistic outlook as of mid-November. Current sentiment readings reinforce the earlier evidence for downside asymmetry in markets, but sentiment has not moved to an unsustainable extreme that would warrant a significant risk-off posture in portfolios.

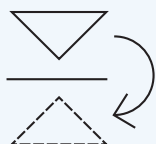
Composite contrarian indicator: Investor sentiment is somewhat overbought, though not yet euphoric.



Source: Russell Investments. Last observation is -0.8 Standard Deviations, as of 20 November 2023. The Composite Contrarian Indicator for investor sentiment is measured in standard deviations above or below a neutral level. Positive numeric scores correspond to signs of investor pessimism, while negative numeric scores correspond to signs of investor optimism. The chart shows sentiment as somewhat overbought, though not yet euphoric.

¹ TARA, or "There Are Reasonable Alternatives," is a term used to describe the current state of global markets and suggest there may be more attractive alternatives to the traditional investment options, such as stocks. For example, investors can access higher savings rates and alternative investments that offer some inflation protection.

Instead, as we look toward 2024, we see select opportunities within asset classes to build a slightly cautious stance in portfolios:



Equities offer limited upside as valuation multiples are expensive given elevated recession risks.

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.

Our portfolio strategies are **neutral across major equity regions**. **Non-U.S. developed equities** trade at a steep discount to U.S. equities but lack cycle support, particularly in Europe, where economies are flirting with recession and earnings trends have been weaker in recent quarters.

Chinese equities have sharply underperformed the S&P 500 Index in 2023, lagging by almost 30 percentage points. Given the structural challenges facing China's economy, we need evidence that the market is extremely oversold before overweighting the region. Our sentiment indicators show pessimism—but not a panic extreme—leaving us neutral on **China** and broader **Emerging Markets**.



Emerging market equities

Emerging market equities have underperformed developed markets so far this year. Concerns about China's economy have been a headwind and these worries seem unlikely to lift over the near-term. For now, a neutral stance is warranted. Emerging markets usually deliver stronger returns when the U.S. dollar is declining. This may be delayed until 2024 when investors start anticipating the Fed will lower interest rates and the dollar declines in response.

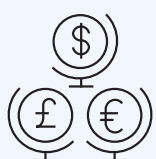


High yield and **investment grade** spreads are uncomfortably tight into an environment of elevated economic uncertainty, leading us to dampen our normal strategic overweight to corporate credit.



Government bonds offer attractive value as yields trade well in excess of expected inflation. If developed market economies slip into recession, we expect central banks to [cut interest rates more aggressively than currently priced into forward curves](#). **U.S. Treasuries** are a preferred overweight exposure. Our fixed income strategy team sees particularly good value in the five-year segment of the yield curve and potential for the curve to re-steepen if more aggressive rate cuts are delivered in 2024 and 2025.

Our favourable outlook for government bonds extends across most major sovereigns, including Canada, Germany, Australia and the UK. The only notable outlier is Japan, where yields are depressed and out-of-synch with the rest of the world.



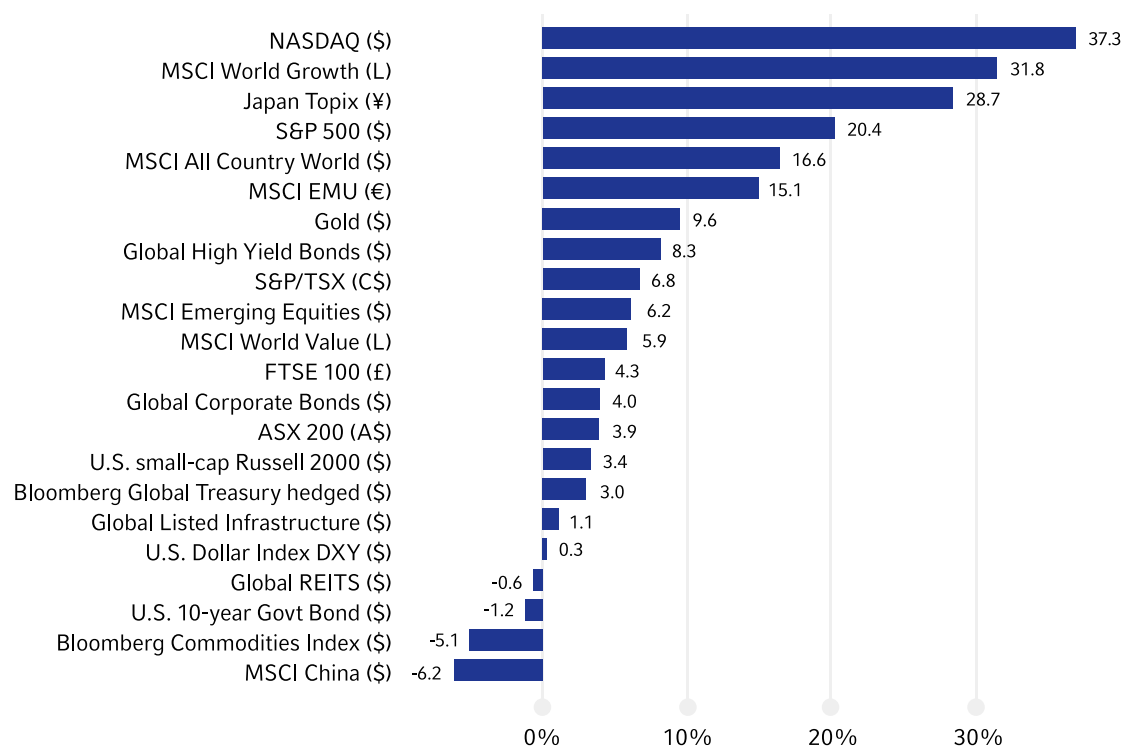
Real Estate Investment Trusts (REITs) and **Global Listed Infrastructure** look attractively valued relative to global equities. Our business cycle outlook is more positive for REITs than infrastructure, as REITs are more interest-rate sensitive and could benefit from lower yields in the year ahead. **Oil** is likely to be volatile in 2024 given the potential for further supply cuts from OPEC², geopolitical risk in the Middle East and slowing global demand. **Industrial metals** should benefit from increased construction, infrastructure and capital expenditure in China.



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. These two-sided risks warrant a neutral stance.

² The Organization of the Petroleum Exporting Countries (OPEC), which comprises the leading oil-producing countries, was formed in 1960 to collectively influence the global oil market. OPEC+ refers to additional members that joined in 2016.

Asset performance since the beginning of 2023.



Source: LSEG DataStream, as of 23 November 2023. EMU refers to the European Economic & Monetary Union.

We see greater downside potential for equities if the economy slips from slowdown to recession than upside potential if a recession is avoided.

Andrew Pease

IMPORTANT INFORMATION

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2024 Global Market Outlook