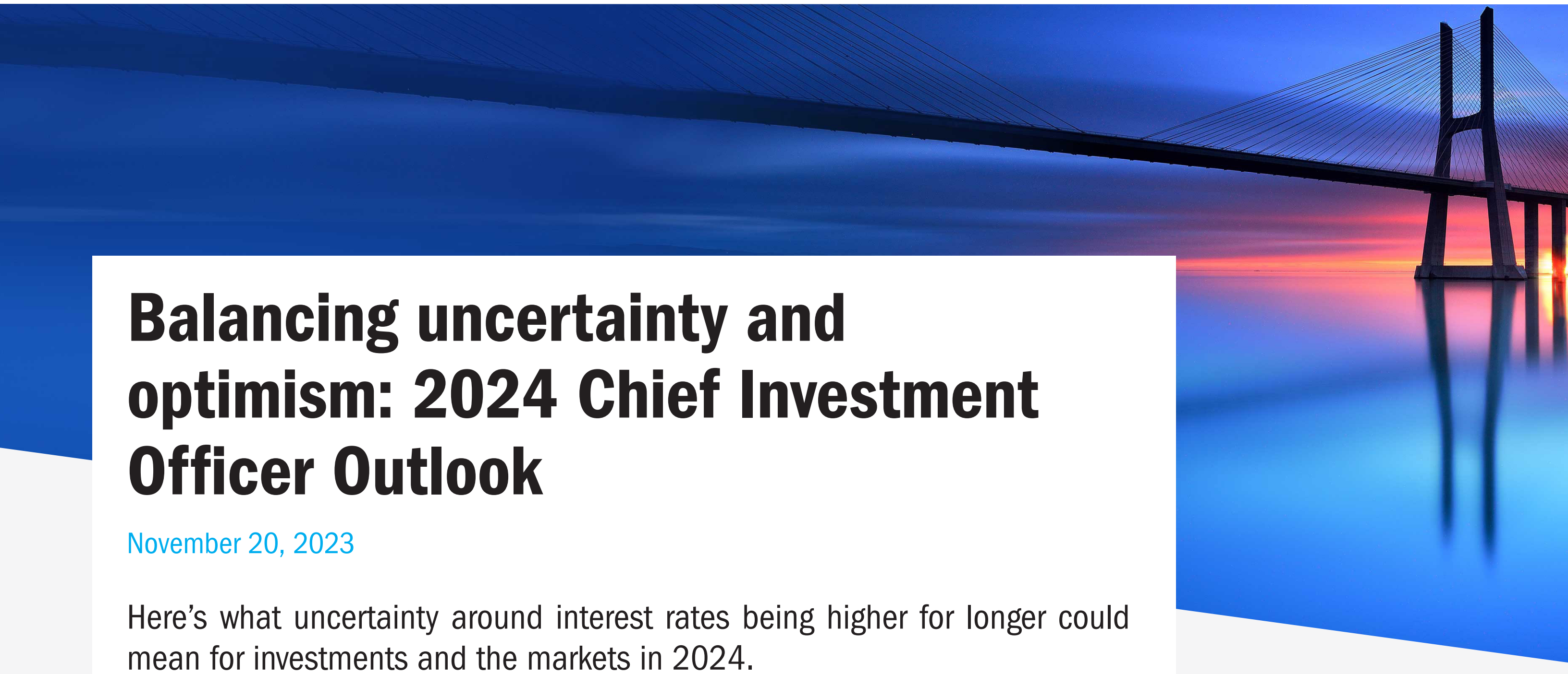

Balancing uncertainty and optimism: 2024 Chief Investment Officer Outlook

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Here's what uncertainty around interest rates being higher for longer could mean for investments and the markets in 2024.

The economic data in 2023 was better than expected: inflation fell, employment remained resilient and we didn't end up in recession — in fact, growth was impressively resilient. All of this "good news" forced the Fed and other central banks to keep rates higher for longer. Now we're seeing uncertainty around the timing of rate cuts, and of the scale and timing of an economic slowdown introducing some fear into the market. Here are my thoughts as we head into 2024:

William Davies
Global CIO

Geopolitical risks may outweigh economic risks
The slowdown we're all expecting keeps being put off, but I don't expect it to be overly severe when it occurs. And from a market perspective, the relative risks of incrementally higher or lower inflation or a milder or deeper recession are known risks.

I think the bigger risks in 2024 are geopolitical, which have more potential to throw expectations off track. This includes escalation in the Middle East and continuation of the war in Ukraine — which carry a tragic human toll — and tensions between the U.S. and China. These events introduce volatility in the short term and inflationary pressures in the long term. These pressures affect companies directly, as finding alternative energy supplies or building new supply chains will be costly.

Another wildcard is the U.S. elections. It's hard to predict the effect, if any, it will have on the markets. And it's that very unpredictability that's the problem: The markets hate uncertainty.

Opportunities amid uncertainty
Investing as we head into 2024 will involve balancing one's optimism for the global economy with the many uncertainties that we face. For bonds it means that one could consider mid- to- long-term U.S. Treasuries and investment-grade corporate bonds, which are offering solid rates of return. If you're willing to accept the risk, you could also consider high-yield bonds, where we're seeing nearly double-digit yields that are tempting. The choice is really tied to your view on the economic path from here and appetite for risk.

If you look at stocks, I think that you need to look beyond the narrow grouping of companies that led the market in 2023. I think performance will widen from here, and areas that haven't experienced the rallies we've seen in the strongest sectors could be more attractive.

Differentiation is returning to the markets

Through COVID and its immediate aftermath, we saw central banks and fiscal policy working toward the same effect: stabilizing economies. Their tactics may have differed, but the intent was largely consistent. Through 2023, we started to see some differentiation in policy and economic outcome return, and we think that may increase as we go through 2024.

The Fed may keep rates higher for longer than the Bank of England, for example, as the UK economy, with its shorter term mortgage lending structure and greater overall vulnerability to higher rates, weakens sooner. Europe successfully forestalled recession in 2023 thanks in part to a mild winter, which allowed them to keep energy costs down even with the loss of Russian supply. It's possible that we'll see that again in 2024.

The point is, we're starting to see gaps open up, and we're seeing that in valuations, too. At 18x forward earnings, U.S. stocks are quite a bit more expensive than European stocks at 12x and Japanese stocks at 14x. I don't think valuation alone is the right reason to make a regional bet now, but it's another example of growing differentiation across markets, which could lead to opportunities.

Bottom line: There are opportunities ahead of a slowdown

The economy appears to be traveling on a path guided by low or even slowing growth, falling inflation and high interest rates. There are those who believe a deeper recession is possible because of lingering high interest rates, and those who expect inflation to go up because of continuing economic strengthening, an OPEC production cut or the impacts of war. Investors should prepare for that middle road between those outcomes, which I think is the most likely scenario over the next six months.

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