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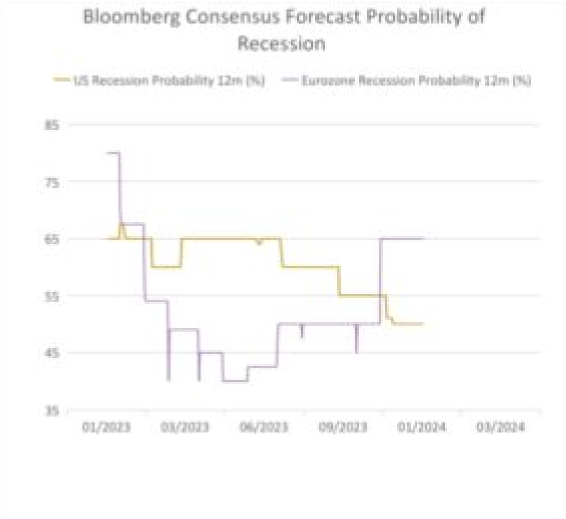
2024: A moment of truth for the global economy

2024 will usher in the Chinese year of the dragon, considered the luckiest sign of the zodiac. This, and the fact that 24 is the carat count of pure gold, might be taken as an omen of a fortuitous year ahead. However, as BIL explains in its 2024 outlook, the terrain ahead for investors is rather complex, making smooth sailing and easy gains unlikely.

Throughout 2023, market sentiment oscillated between optimism and pessimism. At the onset of the year, economists widely expected that recession was just around the corner, following some of the fastest central bank rate hiking campaigns on record. Using Bloomberg's compilation of economist expectations, we can see that in December 2022, consensus saw an 80% probability of a US recession within twelve months; 65% in the Eurozone.



Source: Bloomberg, BIL

However, thanks in a large part to strong labour markets and demand, growth and inflation turned out to be more persistent than expected, and recession probabilities were revised down meaningfully. The market adopted a "good news is bad news" mindset, assuming that continued economic strength would only serve to postpone a central bank pivot towards less restrictive policy.

It wasn't until December, when the Fed effectively closed the door on further tightening, that the market could breathe a collective sigh of relief, ending the year on optimistic shores. The subsequent "buy everything" rally pushed up stock prices and meant that most of 2024's potential capital gains on bond markets were gorged in a matter of weeks.

We believe the market might be too optimistic about how quickly central banks will begin easing policy, and by how much. Their optimism has led to a loosening in financial conditions, which risks undoing some of central banks' progress. Until we have decisive communication about the commencement of rate cuts, the tug-of-war between central banks (eager to avoid a 1970s-style reacceleration in inflation) and markets (eager for monetary easing) is likely to persist, creating market volatility.

When rate cuts do finally arrive, investors should bear in mind that they will be accompanied by slowing economic growth. 2024 will bring the moment of truth as to whether central banks have managed to control inflation without causing a hard landing for economies - something we will only know after the fact, given the 18-24 month lag with which monetary policy actions show up in the real economy. While the prospect of a soft landing is increasingly conceivable in the US, growth is still expected to be about half of what it was in 2023. In the Eurozone, the economy might have already tipped into a shallow recession, and from here, we expect only very meagre growth at best.

Macroeconomic uncertainty is compounded by geopolitical tensions and the fact that it will be the biggest election year in history. Not only will we have the highly polarised US Presidential election in November, 39 other countries will hold elections, meaning roughly 41% of the global population will take to the polls in the next twelve months. As the tectonic plates of power shift, policy uncertainty will be higher.

All of the above suggests a challenging terrain for risk assets.

For equity investors, earnings delivery will ultimately take over from policy expectations in driving returns. Slowing growth will make it more challenging for companies to deliver. We believe the US, with its sturdier macro landscape, is best-poised in this sense. Moreover, the region offers exposure to structural themes such as artificial intelligence, digitalisation and cloud computing, which we believe will continue to energize markets. An asymmetric approach is advisable, balancing exposure to aggressive corners of the market (like IT), with more defensive plays, like utilities and staples. Overall, we suggest a bottom-up approach, aimed at identifying quality companies with relative earnings stability.

In the bond space, we've spent the past twelve months gradually building up duration and yield-generating capabilities; this proved beneficial amid December's rapid repricing. Now, as expectations about the timing and magnitude of rate cuts are buffeted by cross currents of central bank communication, macro data, hope and fear, we believe it is time to actively manage duration and size opportunities to capture and lock in income. We see the most value in investment grade credit, where investors can enjoy steady income, even if directional bets have now largely played out. At the same time, corporate balance sheets in this segment appear robust enough to weather a macro slowdown.

Considering the macro context, perhaps 2024 shouldn't conjure up ideas of golden returns. Rather, we should think about the ancient wisdom of the "golden mean". The idea, which was reportedly carved at the entrance of the temple of Delphi, means "nothing in excess". In an investment context, this means staying diversified and not taking outsized bets on any one sector, idea, or region. It can also apply to investor behaviour. Investors need to find the right amount of courage to remain invested through volatile episodes, but not too much, in that they take reckless bets. Those that strike the right balance, can use 2024 to continue progressing towards their long-term investment objectives.

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