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A bumpy landing

As we move into 2024, we expect the global economy to slow marginally, with a bumpy landing for major developed economies in the first half.

Favored asset classes

We believe an increasing global risk appetite should favor equities, while the likelihood of falling rates could help boost fixed income.

Stabilizing growth in China

Chinese policymakers are seeking to stabilize growth after optimism around its post-COVID opening was tempered in 2023.

Investment outlook 2024: A balancing act for growth and inflation

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After nearly two years of fighting inflation across North America and Europe, we believe monetary policymakers have reached the end of their tightening cycles — but the ripple effects of past rate hikes continue to be felt. And so our 2024 investment outlook centers on the balance between the durability of growth versus the stickiness of inflation. For Western developed economies, we anticipate continued disinflation in 2024, with an economic slowdown in the first half followed by an economic recovery in the second half. Meanwhile, China and Japan are in a very different position.

North America and Europe: We expect a slowdown, then recovery

Despite rapid interest rate hikes over the course of 2022 and 2023, many developed economies continued to grow and have only recently begun to show signs of strain. As we move into 2024, we expect the global economy to slow marginally, with a bumpy landing for major developed economies materializing in the first half of the year. We expect outcomes will vary by country — the US has been the most resilient to the effects of tightening policy and credit conditions, while growth in the eurozone and United Kingdom is already flagging.

However, we expect the slowdown to be shortened by a turn in monetary policy as inflation gradually subsides. We believe monetary policymakers have now reached the ends of their tightening cycles. The next step is likely to be easing for major central banks in Western developed economies, which we expect to emerge late in the first half of 2024 as growth slows and inflation continues to move towards acceptable rates. This should help a recovery to take shape, in our view, returning the global economy toward trend growth in the second half of 2024 as real wages rise in response to lower inflation.

China: Policymakers seek to stabilize growth

Meanwhile, the Chinese economy is in a remarkably different position. Policymakers are seeking to stabilize growth after optimism around its post-COVID opening was tempered in 2023. We believe appropriate policies can improve the economic picture and expect Chinese authorities to marginally expand fiscal policy in 2024 to stabilize growth rates.

In our view, Chinese growth is likely to be subdued in the first half and improve in the second half, resulting in a year-over-year real growth rate of around 4.3% to 4.7% for the economy.

Japan: Some tightening expected in the first half

Japan is also in a very different place. We expect the Bank of Japan (BOJ) to continue to hold back on material tightening because there are significant uncertainties over the sustainability of rising inflation (after all, the BOJ has been faced with false inflation dawns in the past). However, the BOJ is likely to start tightening marginally during the first half of 2024, in our view. We also believe that the BOJ will likely tweak its yield curve management policy to prevent knock-on effects from outsized increases in volatility in global bond markets.

There is a modest risk that significantly higher inflation may force the BOJ to tighten significantly, which could drag up global bond yields and strengthen the Japanese yen.

Risks to our outlook: Geopolitics, commodity shocks, and financial accidents

Since the global pandemic, risks and uncertainty have remained elevated. The Russian invasion of Ukraine, events in the Middle East, and continued tensions over Taiwan have introduced greater uncertainty for global markets, supply chains, and prices. The ongoing conflicts could also trigger another commodity price shock that negatively impacts growth.

Political uncertainty in the US has also exacerbated concerns about the country's fiscal sustainability, the potential for further government shutdowns, and even the possibility of default. Meanwhile, the rapid tightening of credit conditions across many major economies has raised fears about potential financial accidents, such as those witnessed in the first half of 2023.

Our base case assumes no material impact from these factors, but we recognize that they do present risks to our outlook.

Two alternative scenarios for the global economy

We see the potential for two alternative outlook scenarios that focus on the balancing act between growth and inflation and resulting reactions from policymakers:

Downside scenario: Hard landing

We see two potential drivers for a “hard landing”: an already-committed policy mistake or persistent inflation that spurs more tightening.

- In the first instance, the long and variable lags of policy tightening could prove too much for Western developed economies to handle in 2024. In this event, we would expect weaker growth and faster disinflation.
- Or, more persistent inflation could require policymakers to keep rates higher for longer, resulting in a greater economic effect than we currently anticipate.

In either case, the investment implications would be similar, but near-term experience would likely differ — long duration bonds and equities would likely outperform sooner in the first scenario because we would likely see faster policy easing but underperform in the persistent inflation version.

Upside scenario: Soft landing

We also consider an upside scenario for the United States in which supply-side shocks dissipate or are already gone, and mild cooling on the demand-side enables inflation to ease. In this “soft landing” scenario, we are already in (or even in the process of exiting) a mid-cycle slowdown, from which we reaccelerate in the first half of 2024.

In this case, we would expect core inflation to fall with more certainty and at a smoother trajectory versus the base case, enabling the Fed to ease sooner. Outside the US, we would expect surplus economies like the eurozone, Japan and China — as well as twin-deficit emerging markets — to benefit more robustly in this scenario, as US disinflation and growth boosts the world economy, helping offset recent softness in China and the eurozone.

Favored asset classes

Given our base case scenario, we anticipate global risk appetite increasing as 2024 begins, with markets experiencing some volatility as they start to price in a recovery later in the year. We believe this environment should favor equities, although fixed income is also poised to perform well given the likelihood of falling rates.

Equities

- We see the greatest potential in emerging markets, although developed market equities outside the US also appear attractive.
- We anticipate that value, cyclical, and small-cap stocks will outperform.
- In terms of sectors, we prefer consumer discretionary and technology. Consumer discretionary is closely correlated with the economic cycle, and so an economic recovery would likely be positive for this sector, especially since consumers are benefiting from low unemployment. We believe that as rates come down, earnings multiples for technology stocks may see a boost.

Bottom line: We prefer cyclicals and value in the first half as markets price in a second half recovery, but in the second half of the year, a return to trend growth rates and falling interest rates could benefit technology and growth stocks.

Fixed income and currencies

- We favor high quality credit given short-term concerns about decelerating economies, along with the prospect of falling rates.
- We favor long duration and believe this is an attractive time to lock in rates on the long end of the curve.
- We anticipate nominal bonds will perform well as disinflation continues.
- We favor emerging market local currency debt in this scenario, as it should benefit from a weakening US dollar.
- We believe the US dollar will ease as markets anticipate rate cuts by the Fed.

Alternatives

- Within private assets, direct lending has been attractive given the asset's high yields¹, floating-rate nature, and favorable lender terms and protections.

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- The potential for modest default rates next year could also set the stage for distressed lending to outperform.
 - We favor commercial real estate lending as a way to access real asset markets, which could fill a gap for financing left after recent regional banking failures. Higher interest rates may continue to pressure real estate assets, however we find fundamentals improving as there are pockets of strength in various sectors and markets.
 - When considering private equity, we prefer assets that focus on cash transactions because we see opportunities for growth equity firms to provide capital to private companies that would historically have looked to access the initial public offering market.
 - We recognize that, given the increase in geopolitical risks, gold could have periods of strong performance.

Notes

'As of 6/30/23, the Cliffwater Direct Lending Index yield was 11.6%. The Cliffwater Direct Lending Index is an asset-weighted index of more than 13,000 directly originated middle market loans. **Past performance is no guarantee of future results.** An investment cannot be made directly in an index.

Important information

Investors should consult a financial professional before making any investment decisions. This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

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Should this contain any forward looking statements, understand they are not guarantees of future results. They involve risks, uncertainties, and assumptions. There can be no assurance that actual results will not differ materially from expectations.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

A value style of investing is subject to the risk that the valuations never improve or that the returns will trail other styles of investing or the overall stock markets.

Growth stocks tend to be more sensitive to changes in their earnings and can be more volatile.

Stocks of small and mid-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

Fluctuations in the price of gold and precious metals may affect the profitability of companies in the gold and precious metals sector. Changes in the political or economic conditions of countries where companies in the gold and precious metals sector are located may have a direct effect on the price of gold and precious metals.

Real growth is an inflation-adjusted measure of gross domestic product, which is the value of all goods and services produced by an economy in a given year.

The Bank of Japan's yield curve management policy seeks to fix yields on 10-year Japanese government bonds at a desired level.

Tightening monetary policy includes actions by a central bank to curb inflation.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates to project future interest rate changes and economic activity. The front end of the yield curve refers to bonds with shorter maturity dates. An inverted yield curve is one in which shorter-term bonds have a higher yield than longer-term bonds of the same credit quality. In a normal yield curve, longer-term bonds have a higher yield. A steepening yield curve means that the difference between short term and long term is increasing.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates. Duration is expressed as a number of years.

A cyclical stock is an equity security whose price is affected by ups and downs in the overall economy.

A multiple is any ratio that uses the share price of a company along with some specific per-share financial metric to measure value. Generally speaking, the higher the multiple, the more expensive the stock.

The opinions referenced above are those of the author as of Nov. 30, 2023. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.