



# 2024 Market & Economic Outlook

## Revenge of the Optimists

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January 18, 2024

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# Revisiting Our Key Themes for 2023

## Short Term Themes

1. Inflation Continues to Decline as Growth Slows
2. Fed Pauses to Assess the Effects of Their 2022 Actions
3. Expect a Soft Landing, not a Hard Landing
4. Credit Contagion from Crypto, SPACs, Speculative Tech is Contained
5. “Good News is Bad News” Mentality Persists
6. Commodity Inflation Declines as Supply Catches up to Demand, but Energy Remains a Geopolitical Wild Card
7. The Dollar Bull Market is Over, Giving Multinational Earnings a Boost
8. International Equities Benefit from a Stable (or Falling) Dollar
9. U.S. Housing is in a Recession, but Mortgage Rates Have Peaked, and Home Buyer Demographics are Favorable
10. Earnings and Margins Return to the Spotlight

## Short Term Themes

1. Deglobalization and Reshoring Boosts Domestic Capital Expenditures
2. The Era of Free Money is Over. Which Businesses Can Adapt?

# Establishing Our Key Themes for 2024

## Short Term Themes

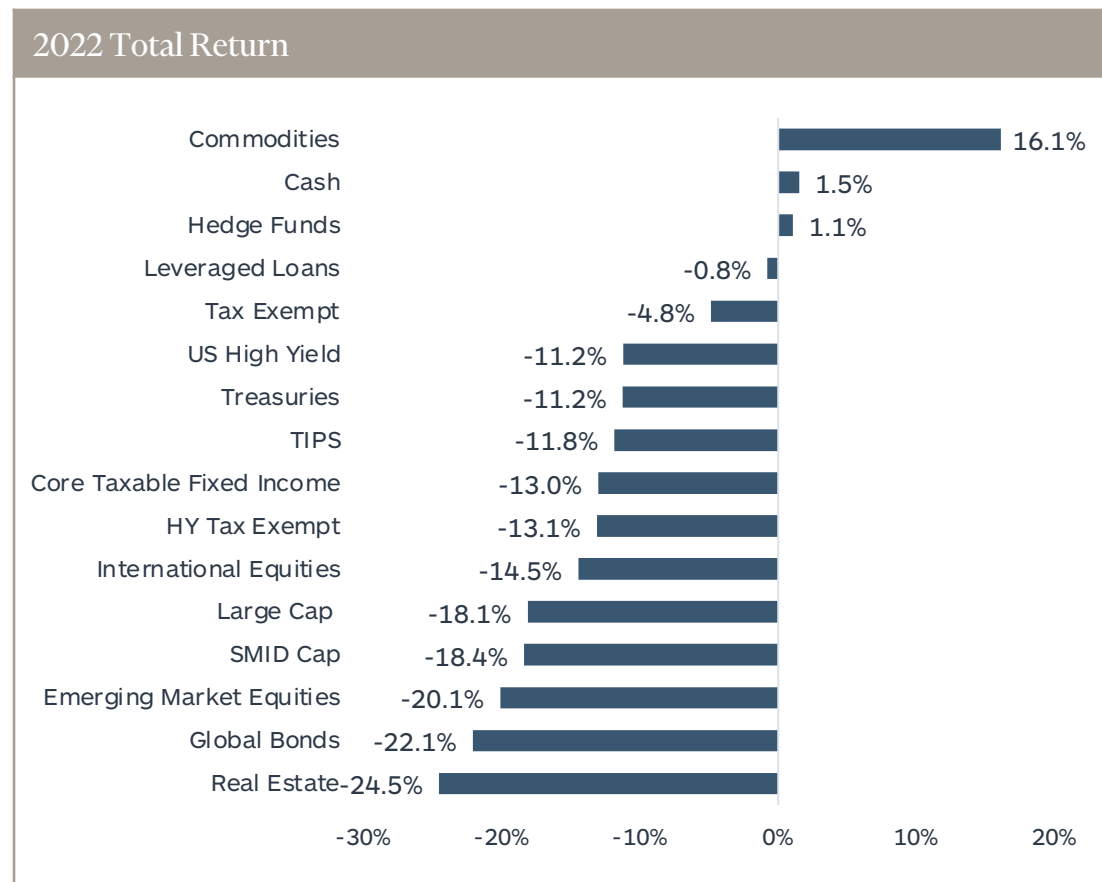
1. Slowing growth, but still no recession
2. Labor markets – cooling but not crashing
3. Inflation inches closer towards the Fed's target
4. Rate cuts in good times are rare, but we should get a few to normalize real rates
5. The yield curve moves towards normality through lower short rates and steady/higher long rates
6. Anticipating a recovery in manufacturing and housing
7. Earnings return to strong growth after a brief decline
8. Equity performance should broaden out – expecting a good year for small caps
9. Little appetite for austerity in an election year, despite the ballooning fiscal deficit

## Short Term Themes

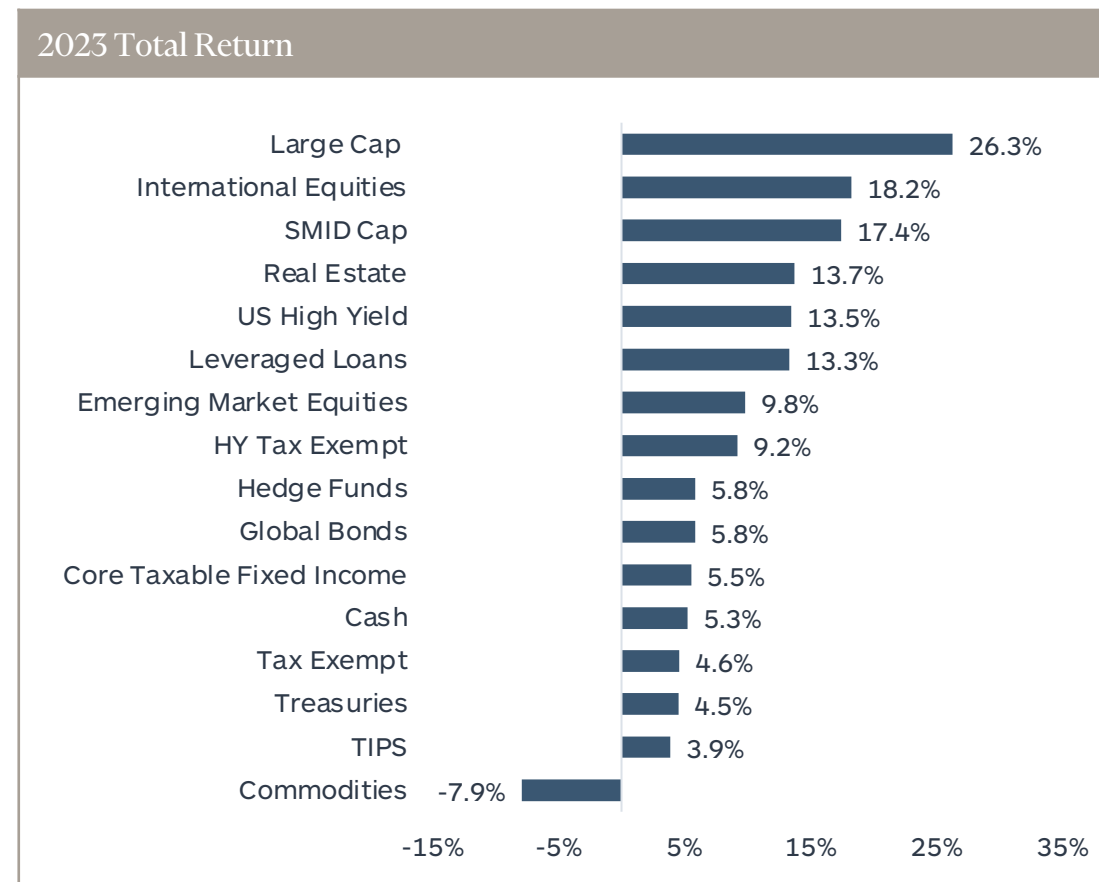
1. Baby Boomers are leaving the labor force, but they are also healthy, wealthy, and keen to consume
2. Reshoring continues to drive growth and diversify our economic model
3. AI & automation drive productivity gains and mitigate higher costs for goods and labor
4. The energy transition creates economic risks ... and opportunities

# 2023 in Review

A late-year rally helped after a historically difficult year in 2022.



Source: Morningstar Direct, 12/31/2022

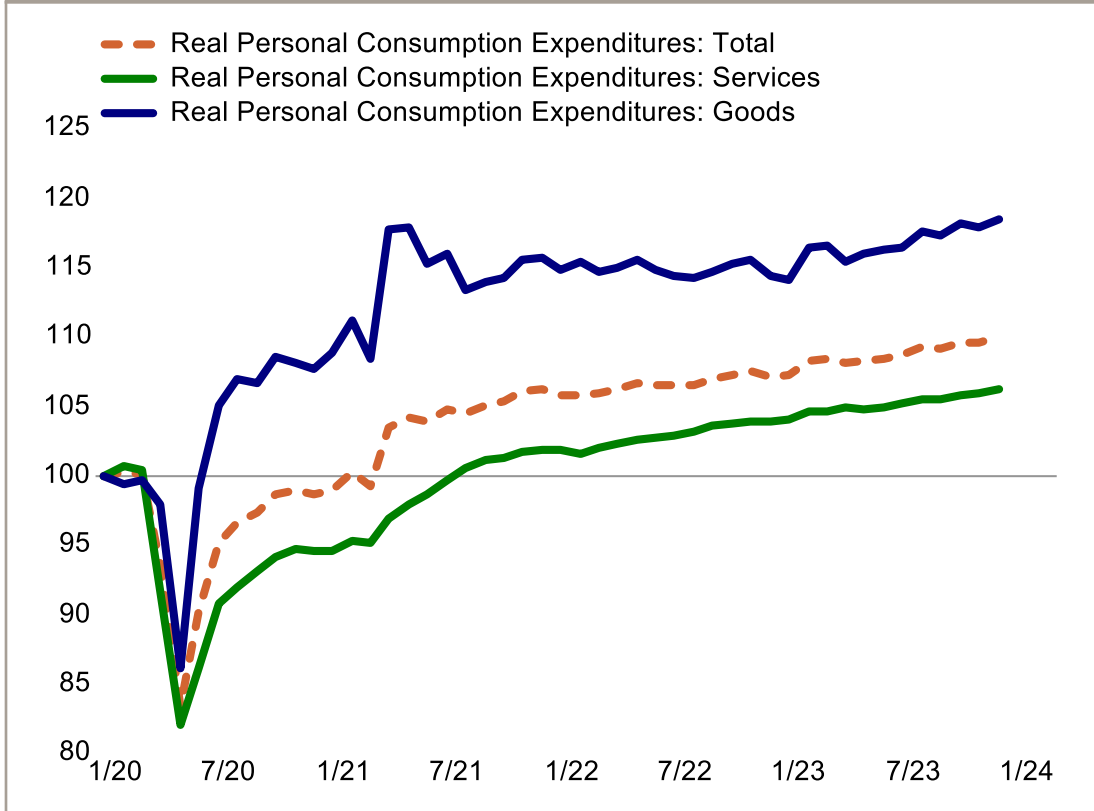


Source: Morningstar Direct, 12/31/2023

# Consumer Strength

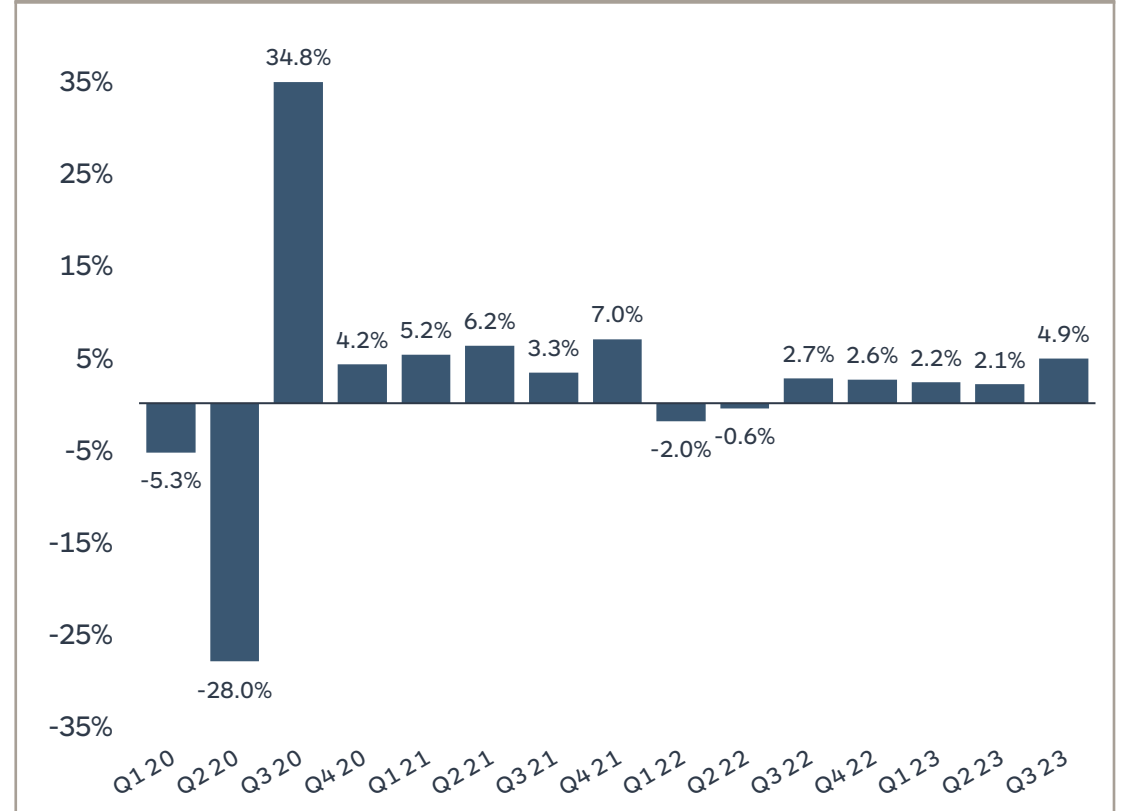
Well-employed consumers are absorbing higher prices and bolstering economic growth.

Consumer Spending (Adjusted for Inflation)



Source: FactSet, 12/31/2023

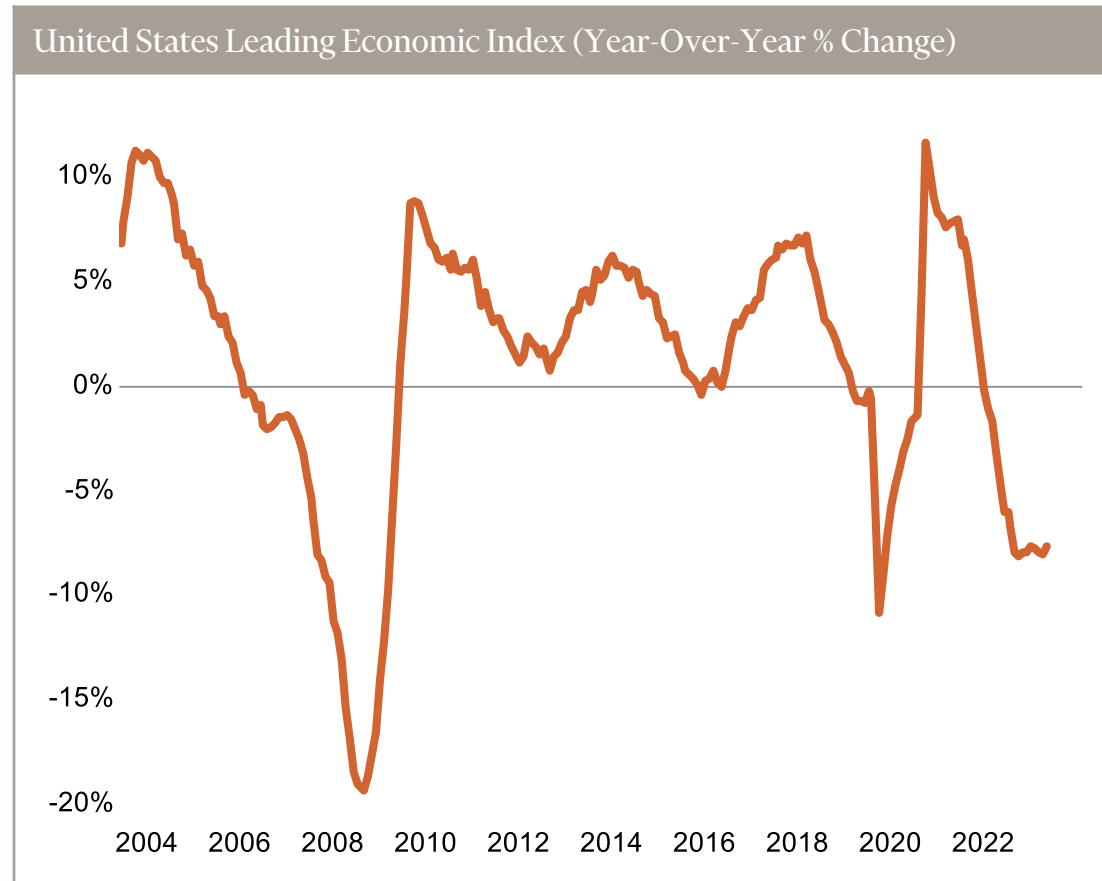
Real GDP: Annualized



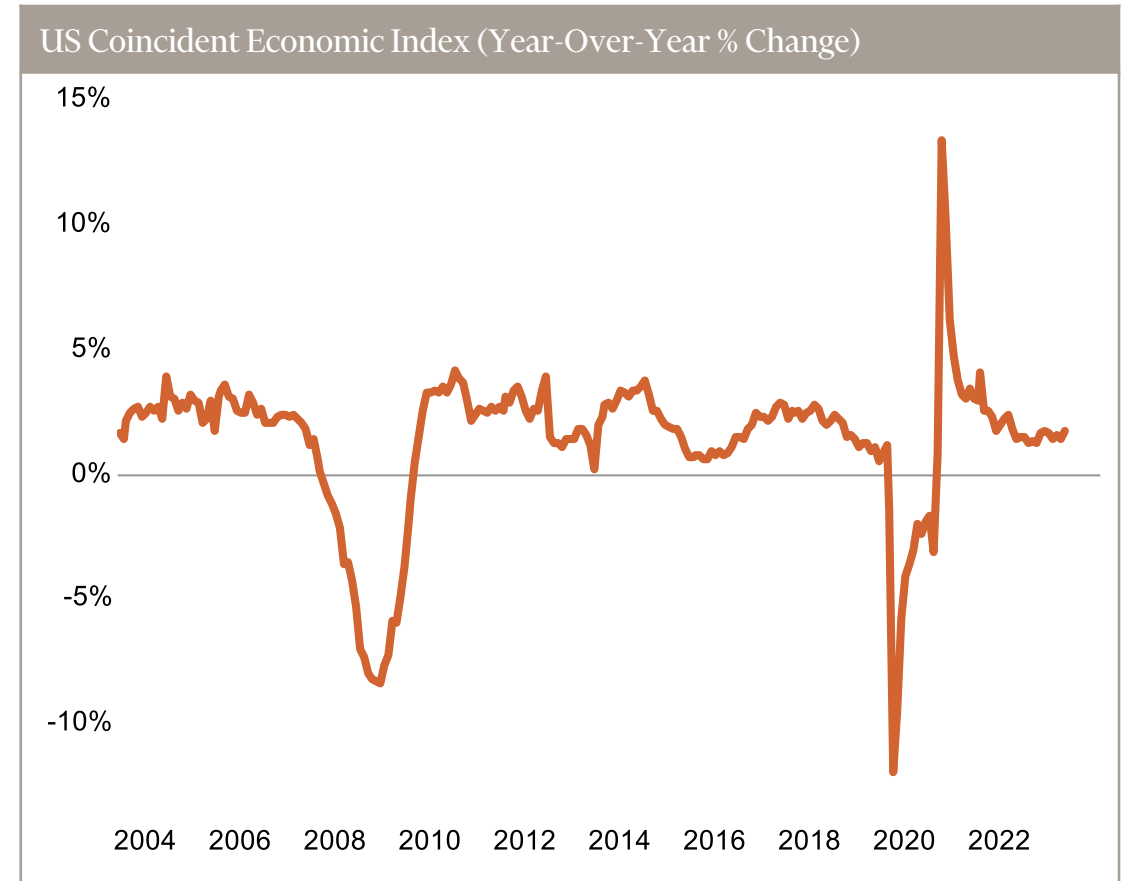
Source: FRED

# Economic Indicators

“Leading indicators” have looked bad for a while, but coincident indicators keep hanging on.



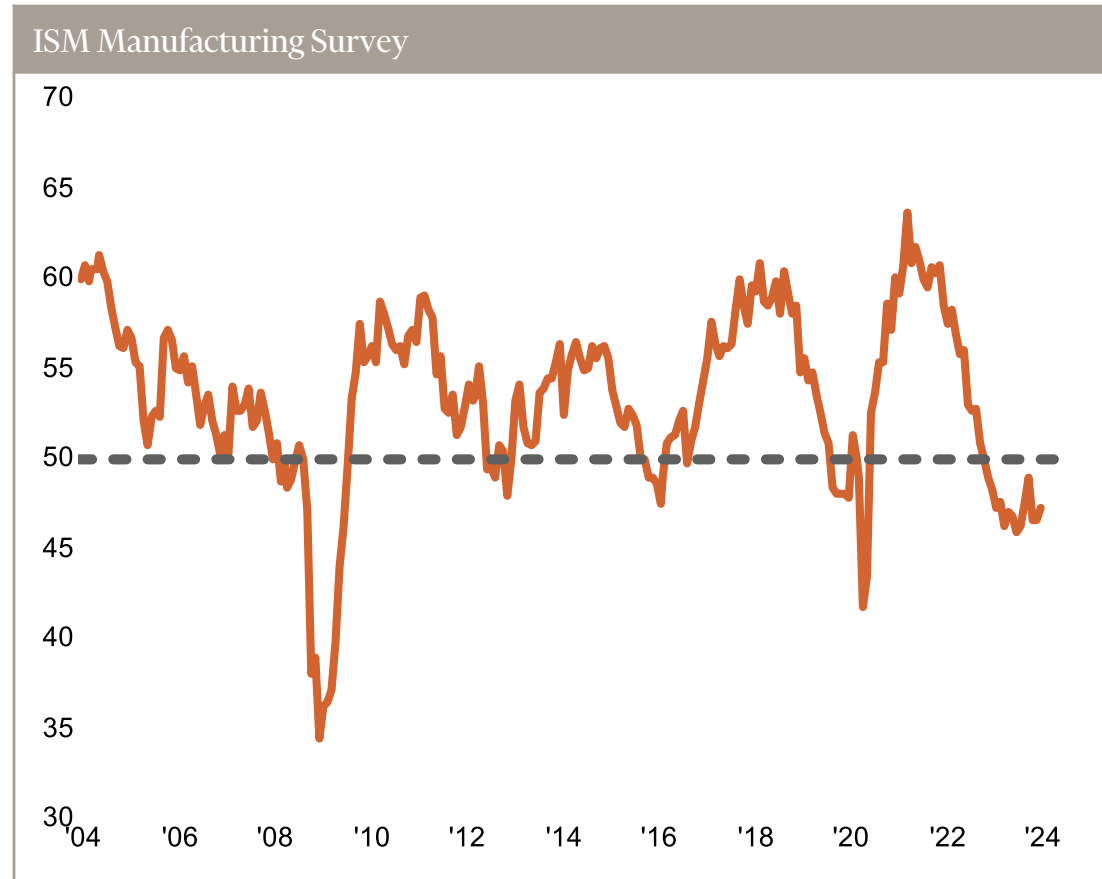
Source: FactSet, Conference Board, 12/31/2023



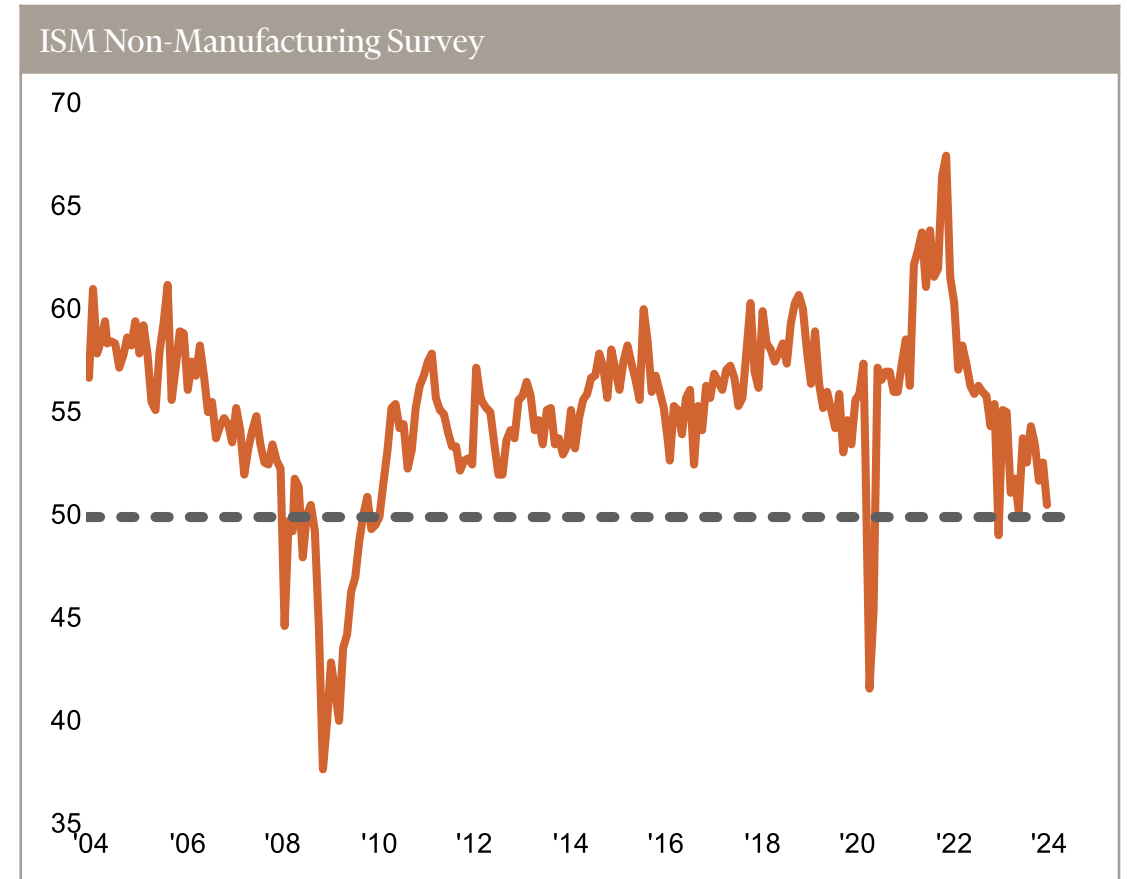
Source: FactSet, Conference Board, 12/31/2023

# Manufacturing vs. Services

Looking for a bottom in manufacturing, while keeping an eye on services.



Source: FactSet, ISM, 12/31/2023

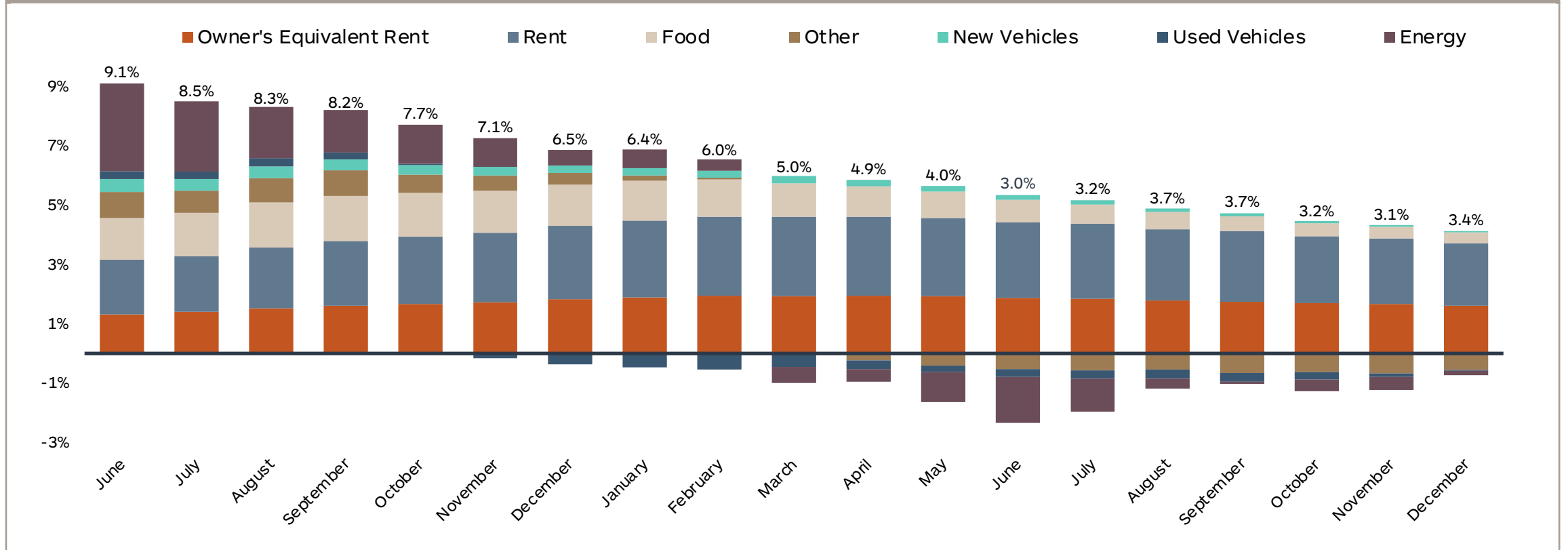


Source: FactSet, ISM, 12/31/2023

# Inflation

Shelter is still the biggest holdout.

Contributions to Year-Over-Year CPI Inflation

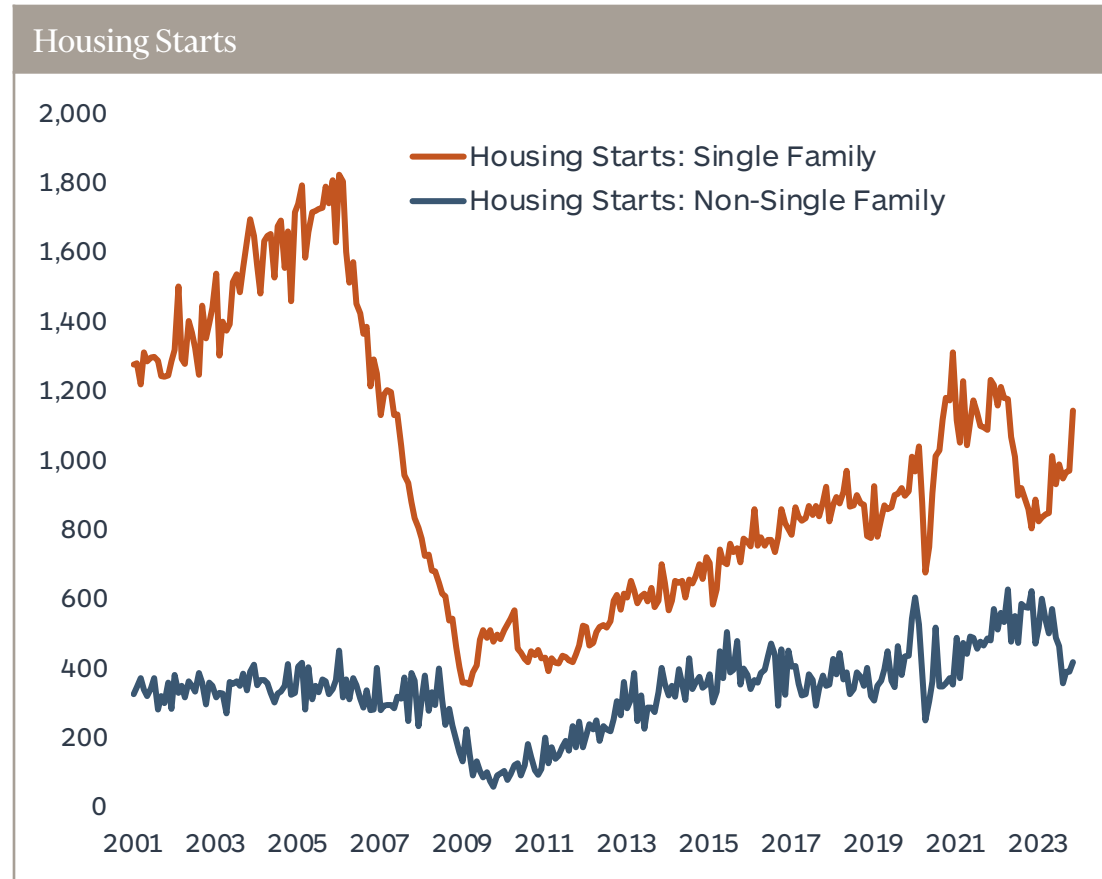


Source: BLS

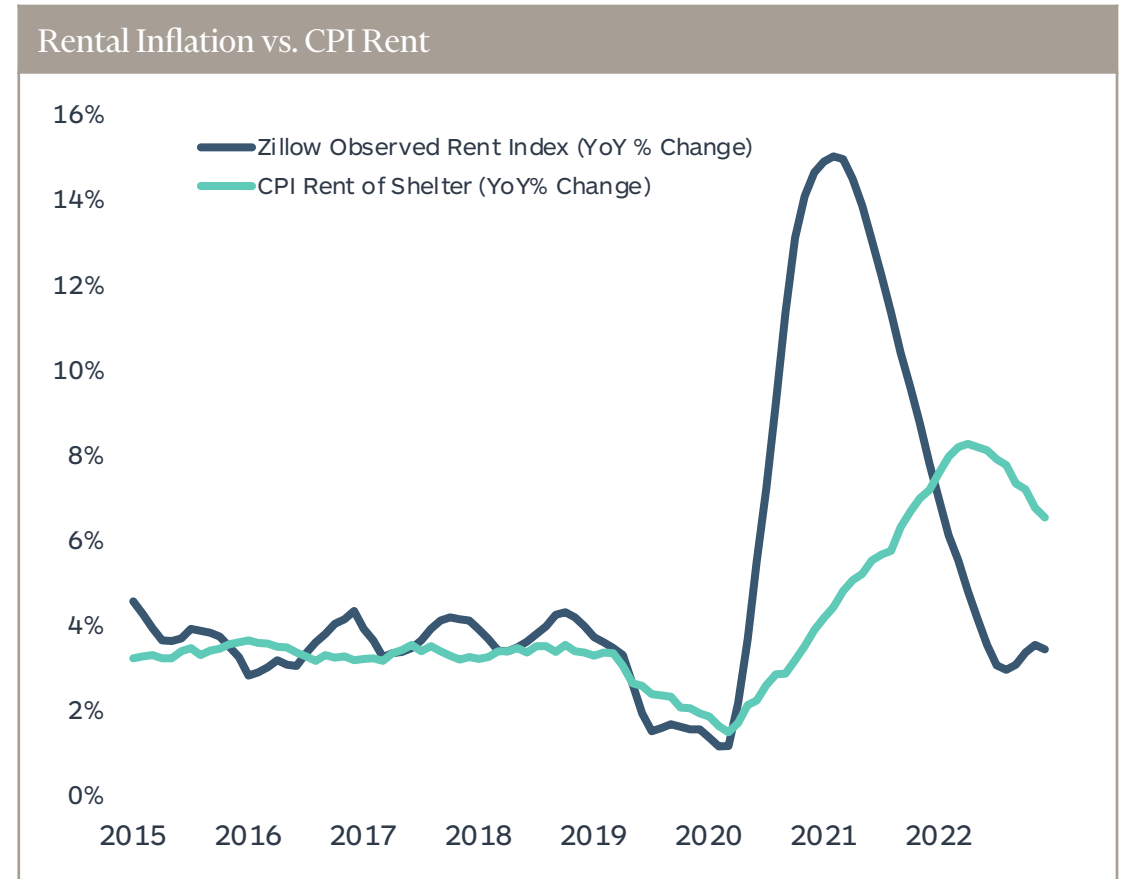


# Housing

Activity may be beginning to recover, while recent cooling in rents will help shelter inflation.



Source: FRED, 11/30/2023

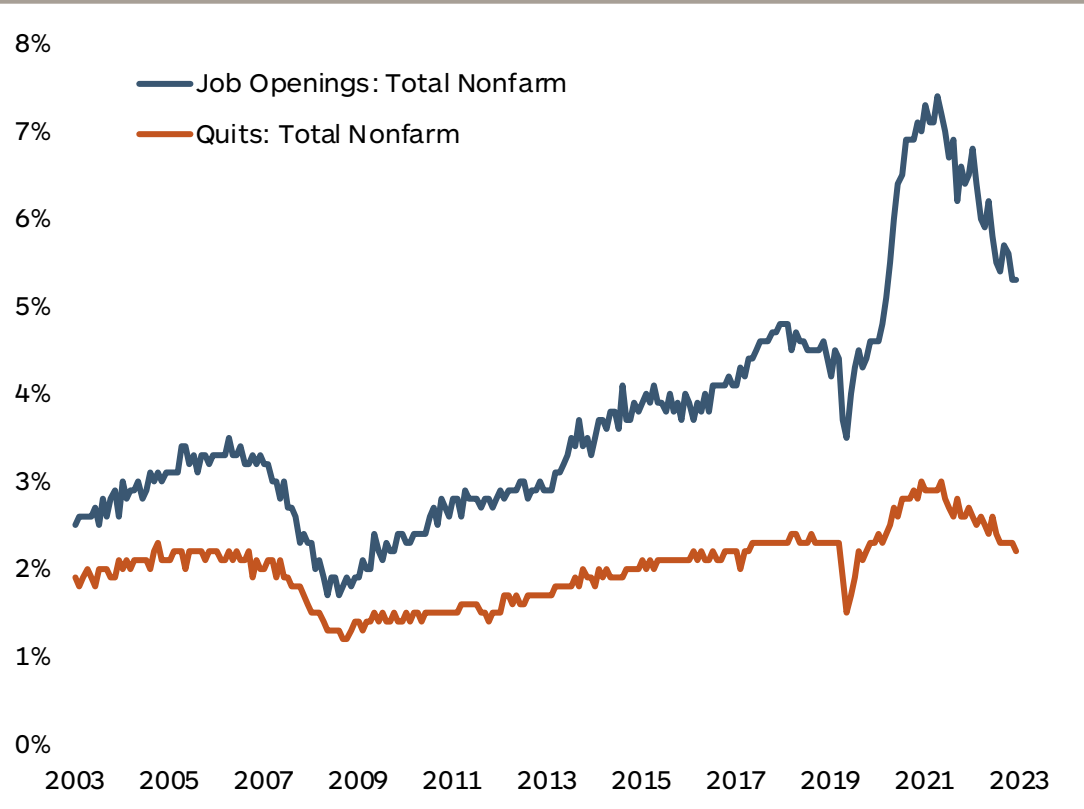


Source: Zillow, 11/30/2023

# The Labor Market

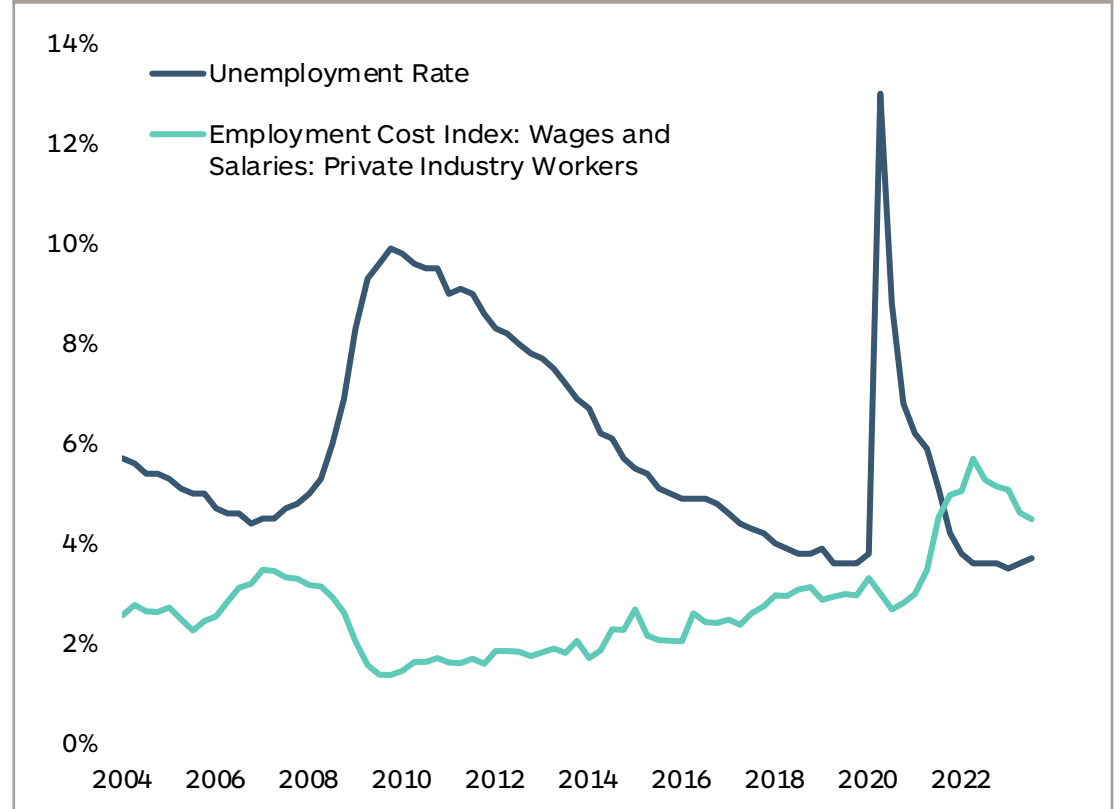
Loosening labor markets should limit wage growth and help services inflation.

## Job Openings & Quits



Source: FRED, 11/30/2023

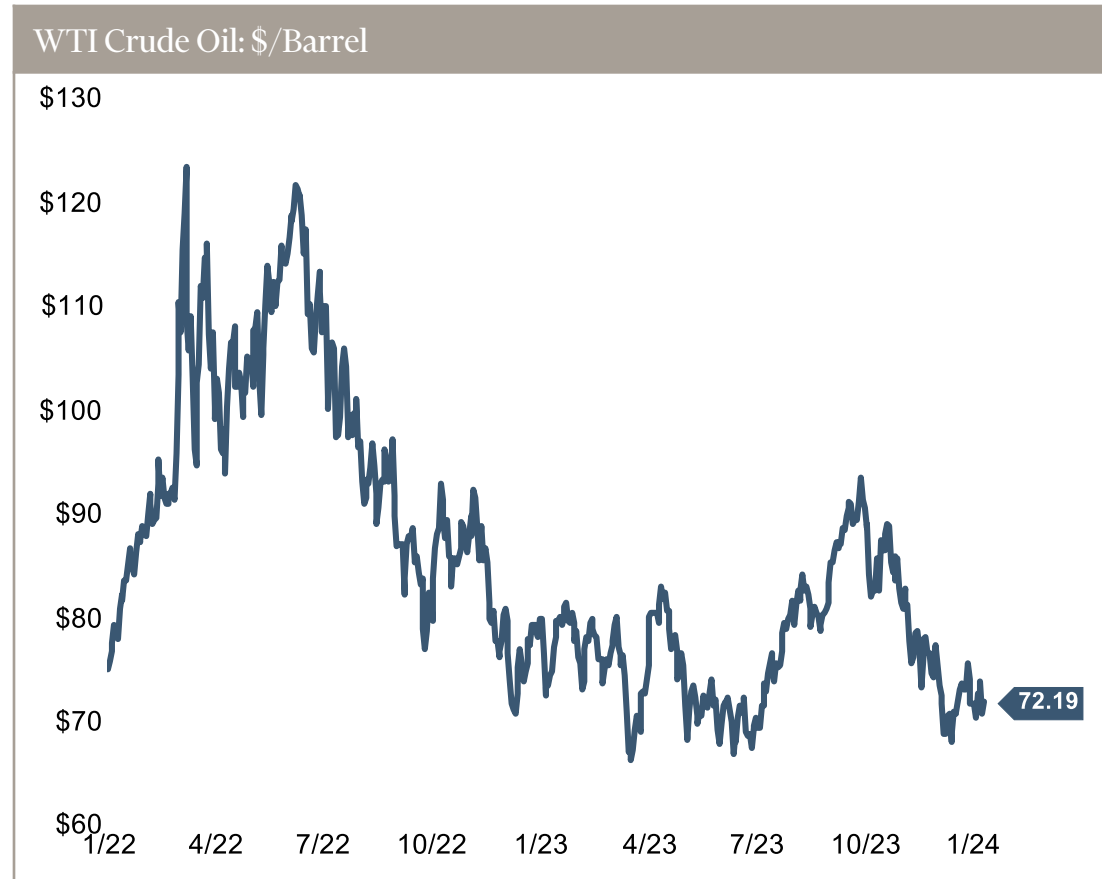
## Unemployment Rate vs. Wage Growth



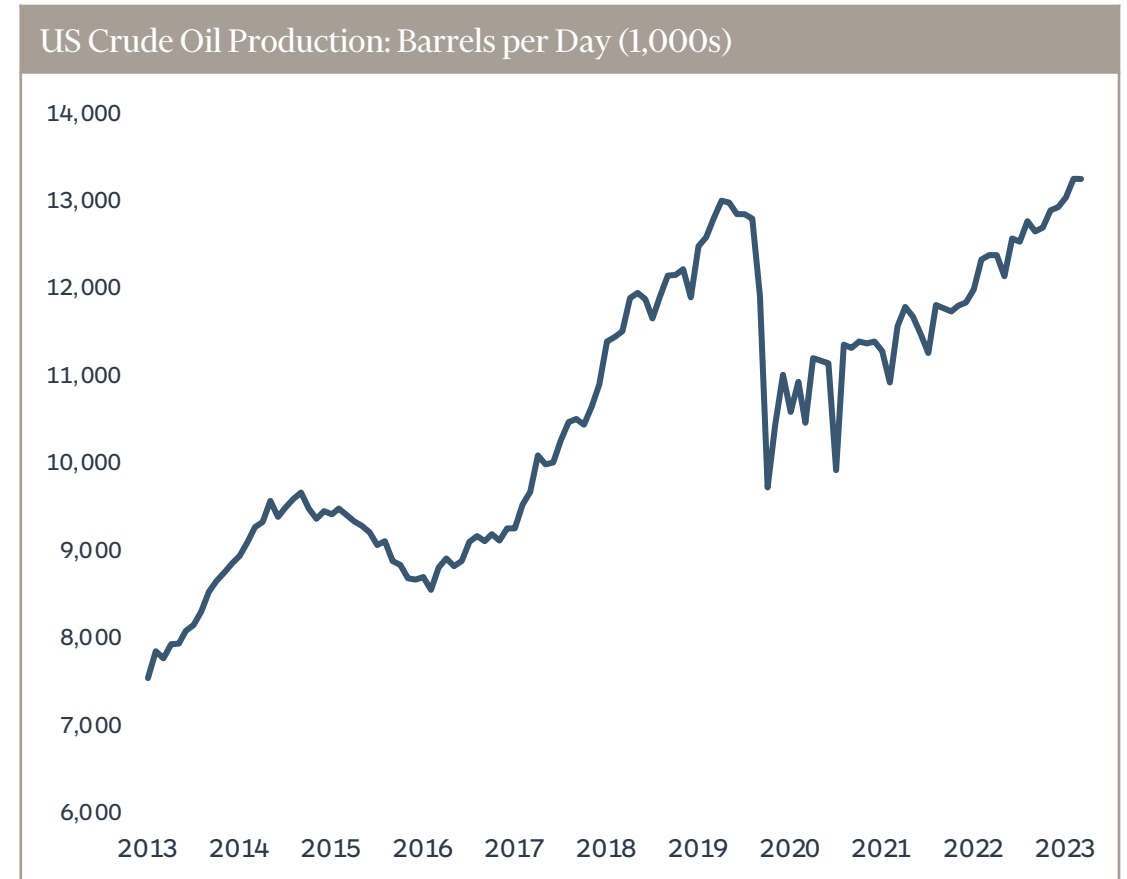
Source: FRED, 10/31/2023

# Energy

U.S. hits record production to fight back against OPEC+ supply cuts, to the surprise of many.



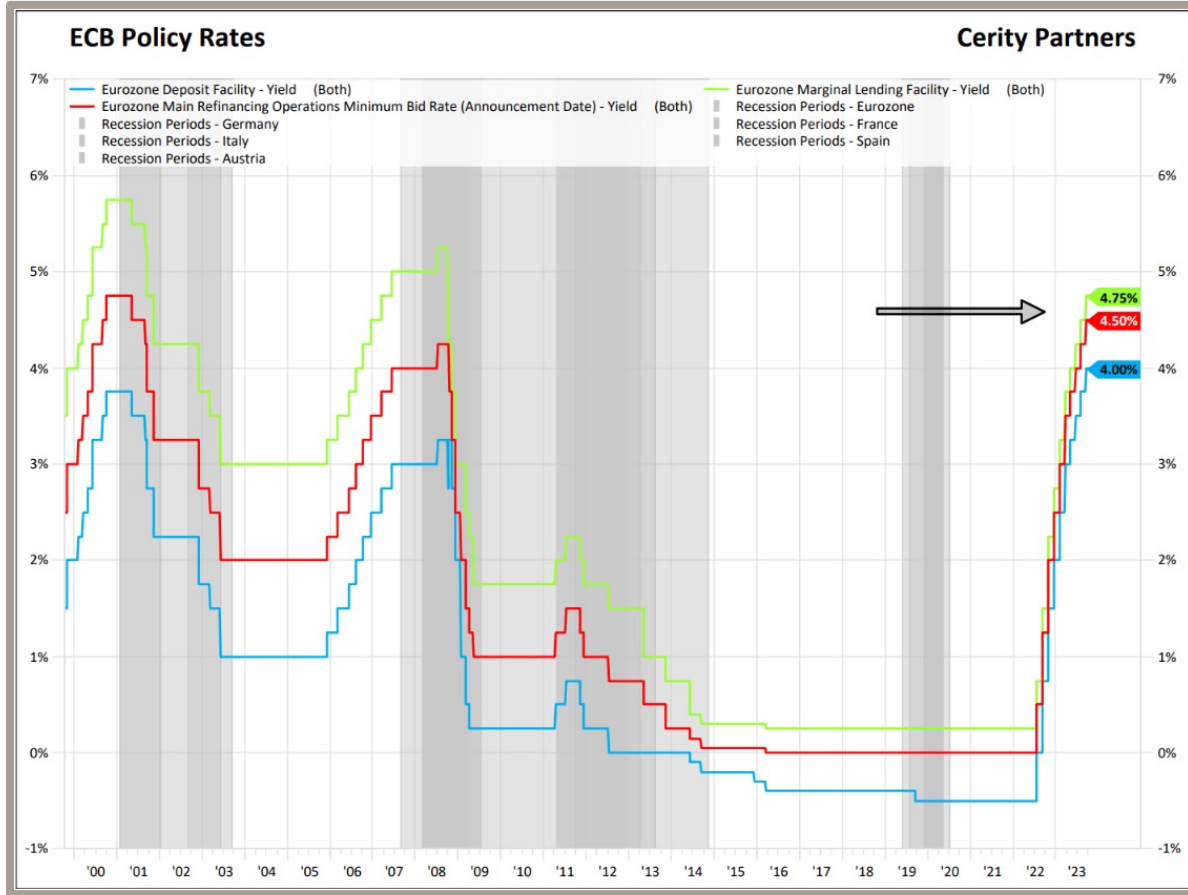
Source: FactSet, 12/31/2023



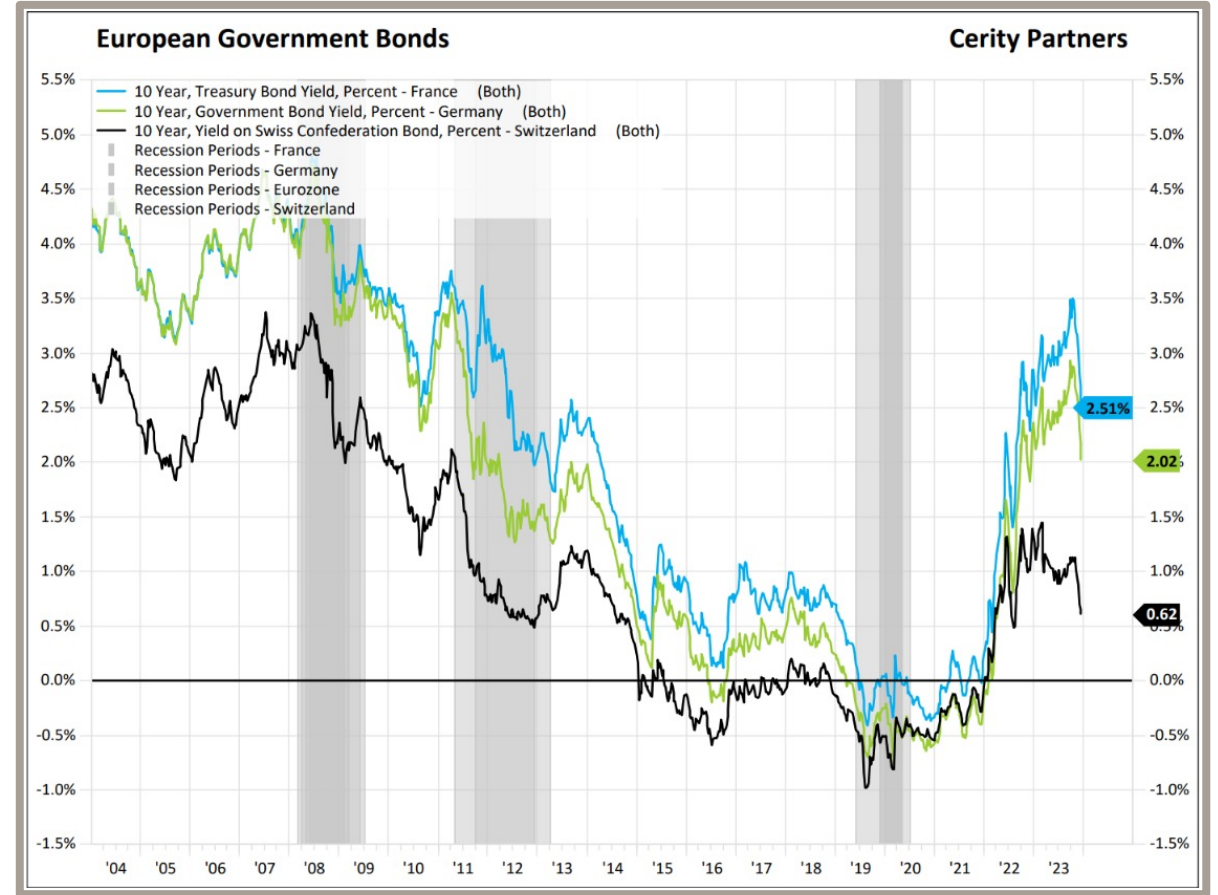
Source: U.S. Energy Information Administration, 11/30/2023

# Europe

The ECB has its hands full in the growth vs inflation trade-off.



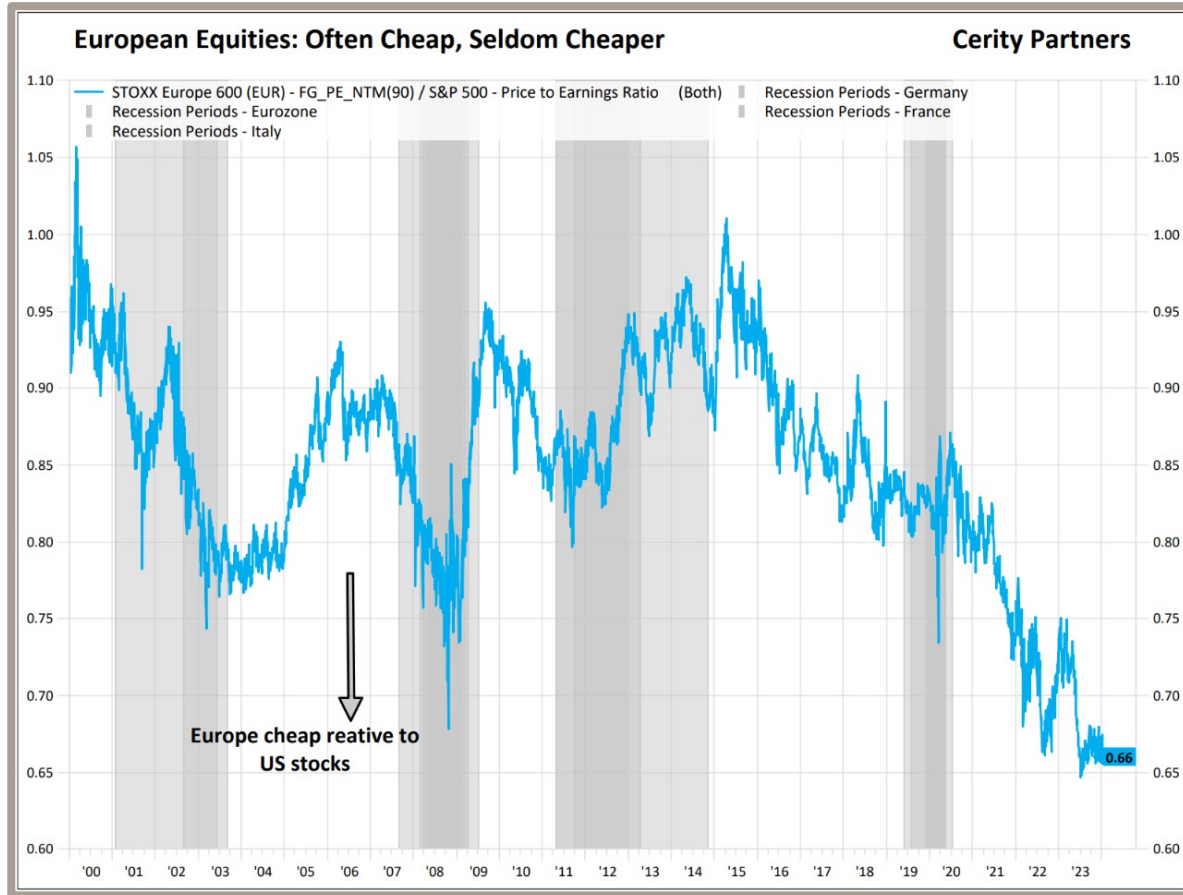
Source: FactSet, 1/11/2024



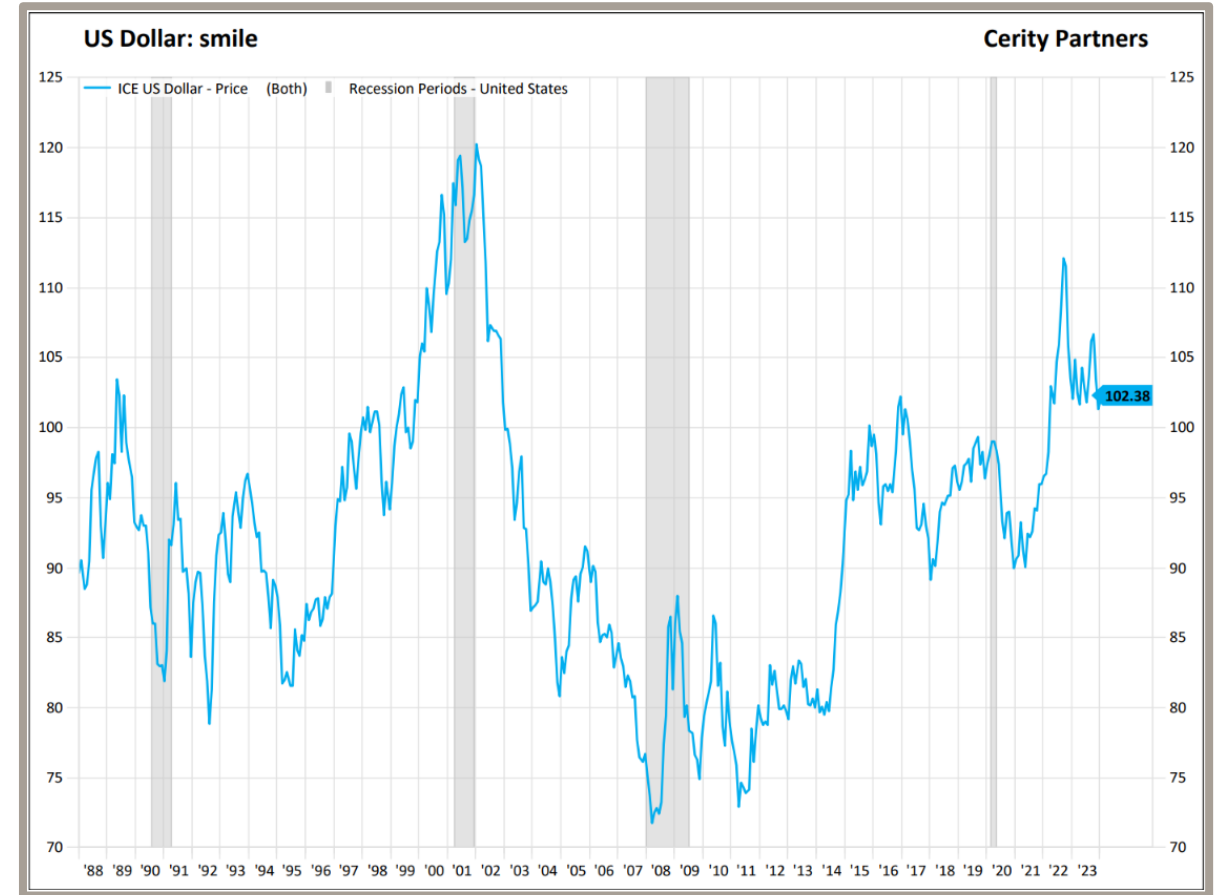
Source: FactSet, 1/11/2024

# Europe

What are the new drivers of growth?



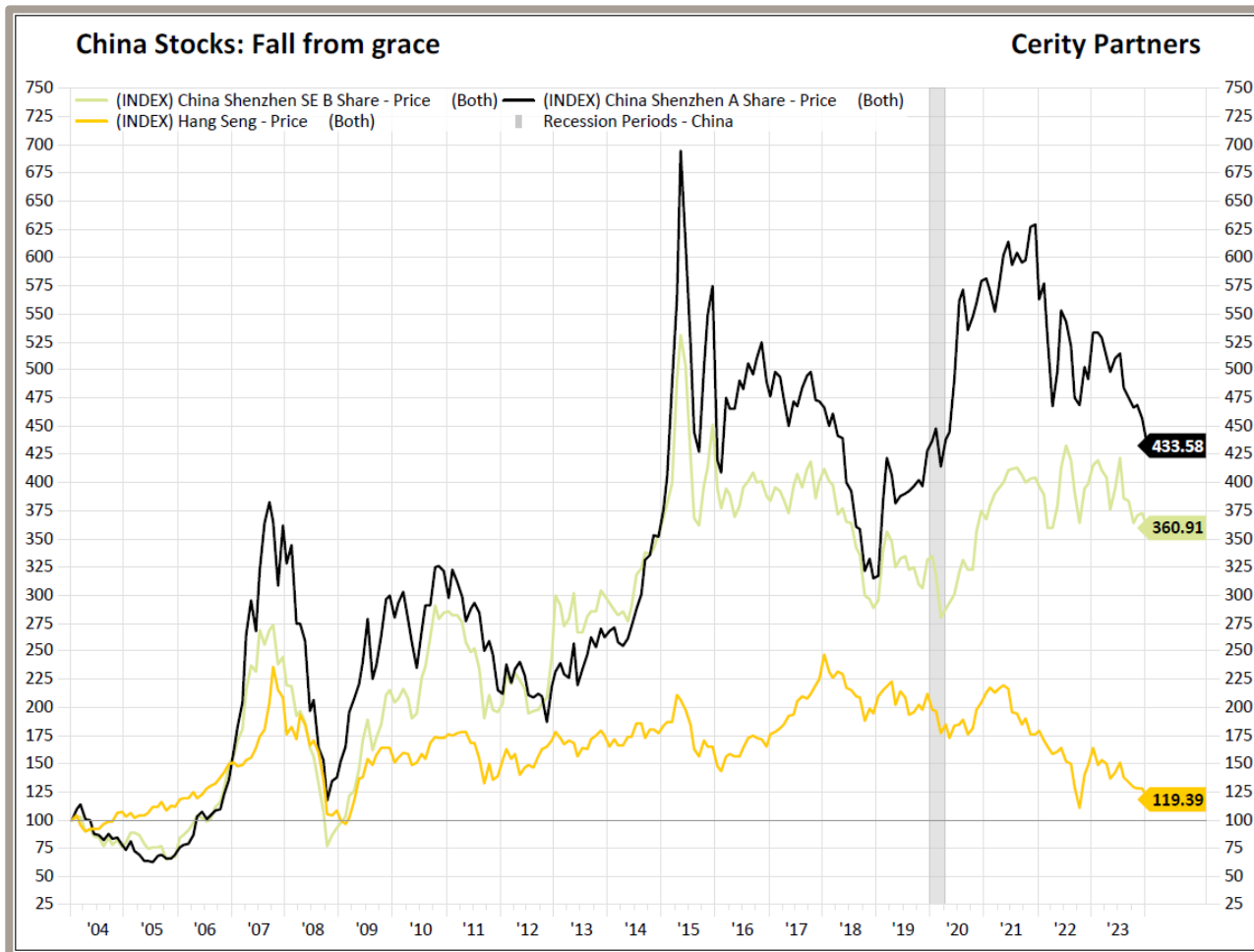
Source: FactSet, 1/11/2024



Source: FactSet, 1/11/2024

# China

Another tough year is making investors question the country's "investability"



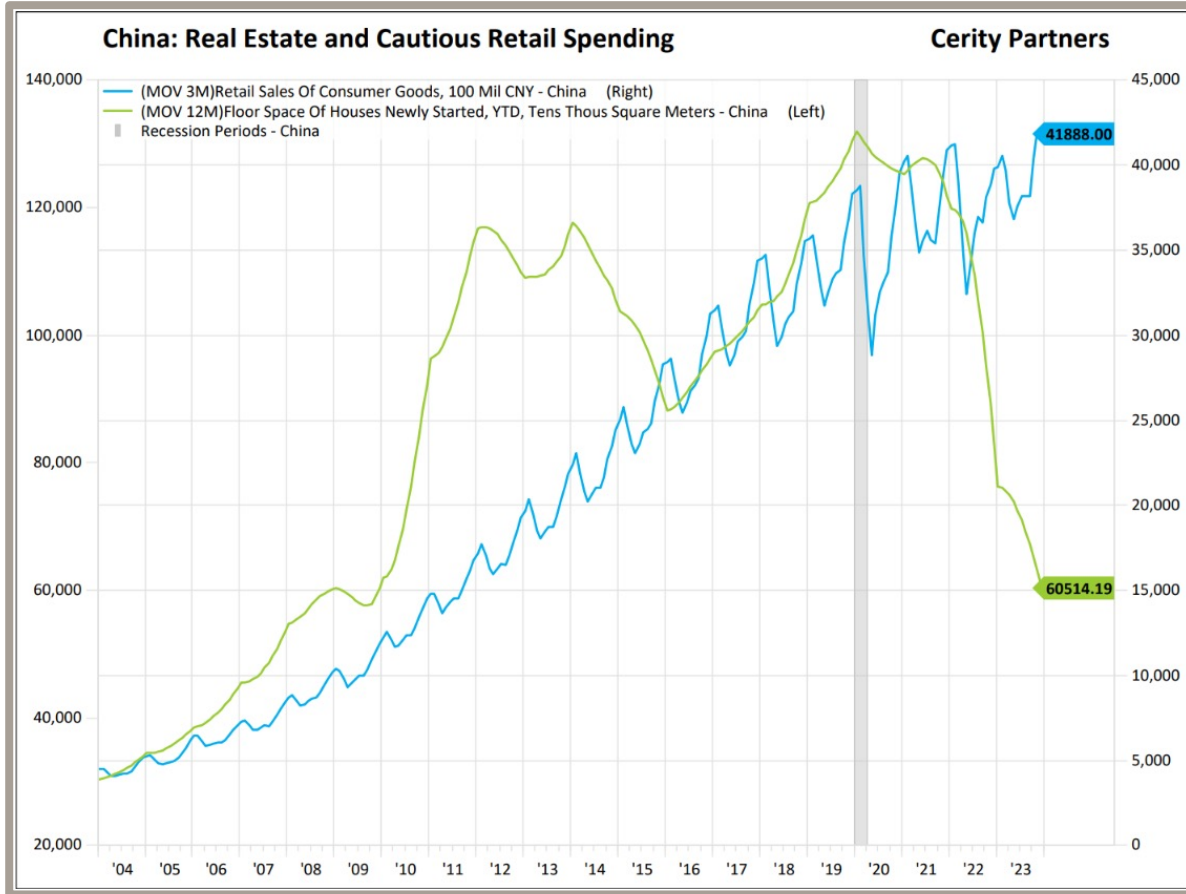
- Chinese equities are down **55% from their peak...**
  - and **21% over 6-months...**
  - and another **4% YTD**
- China **bond yields are 2.5%** (lower than during Covid-19)
- And there's **deflation at -2.6%**

Is China the new Japan?

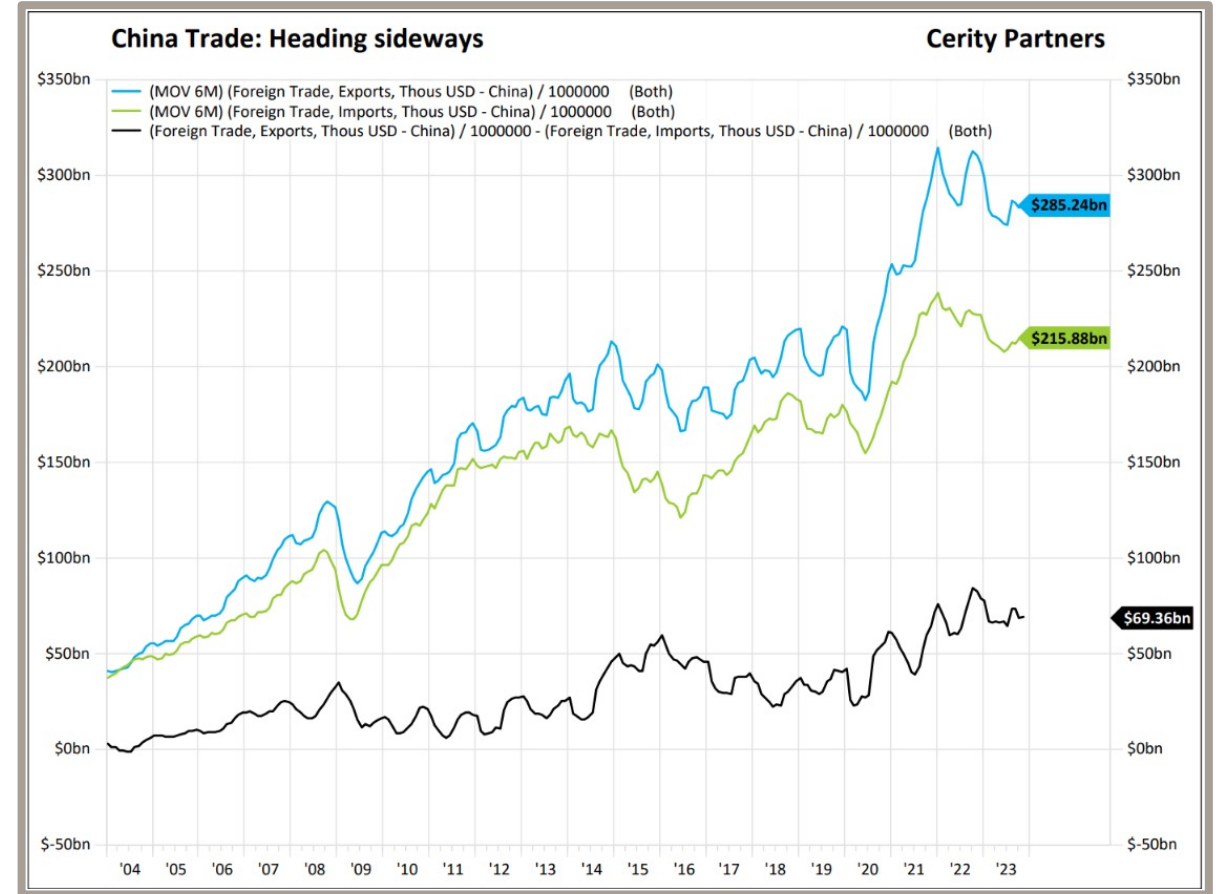


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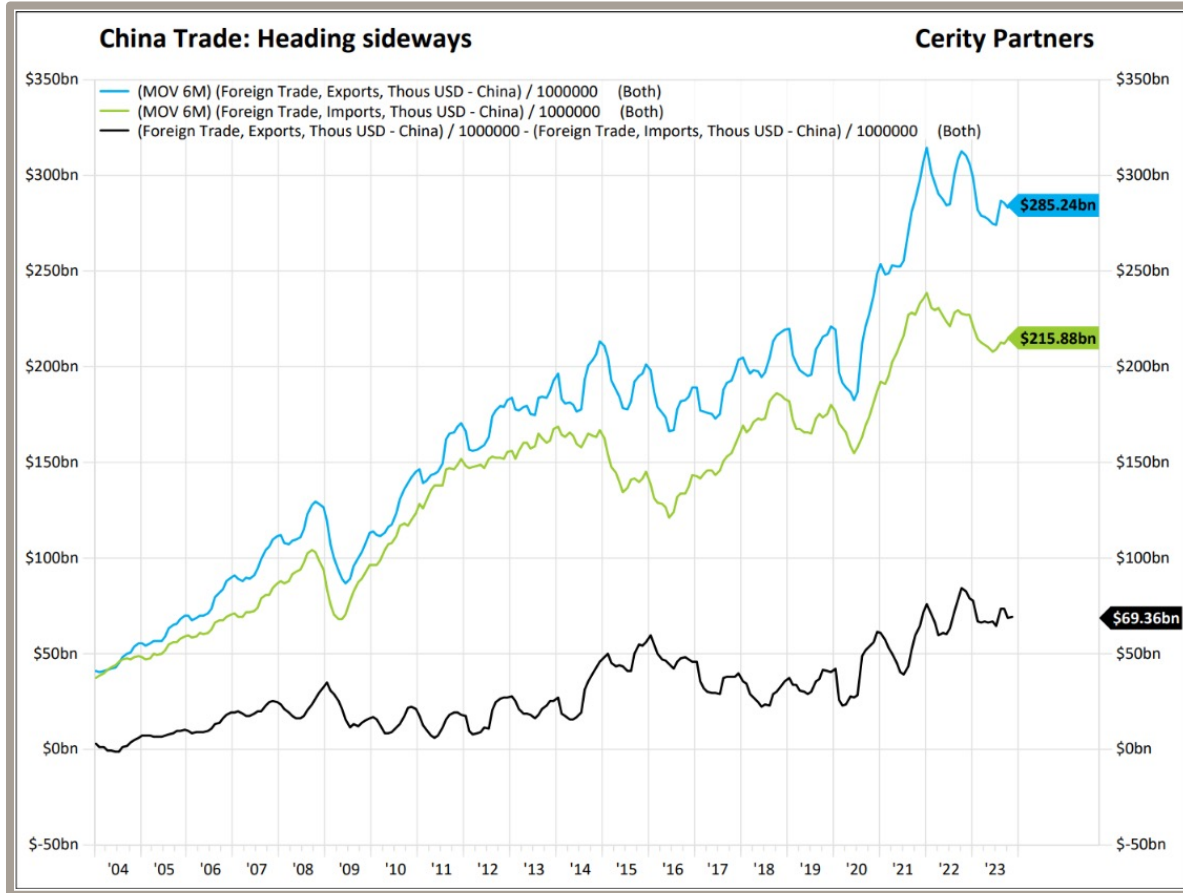
Source: FactSet, 1/11/2024



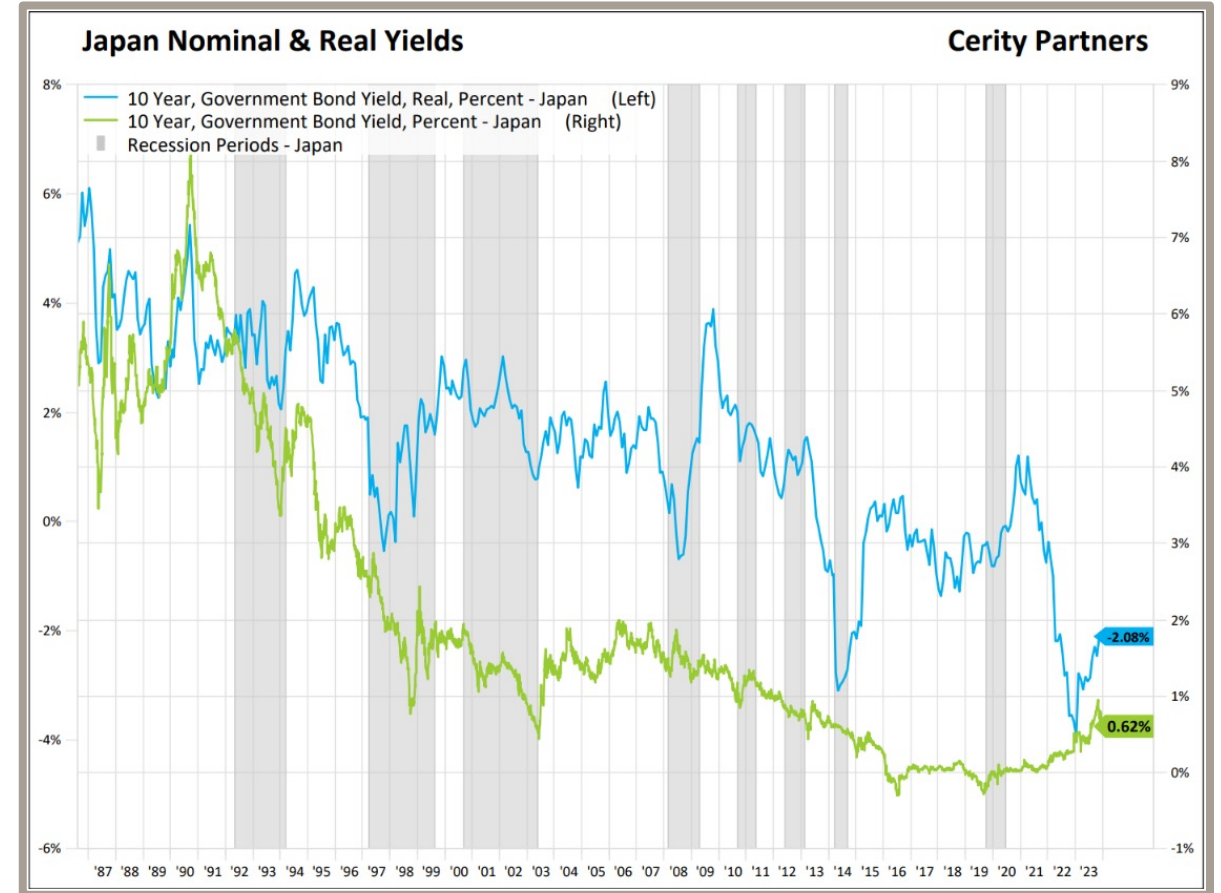
Source: FactSet, 1/11/2024

# Japan

Sticky inflation is good when you're stuck in a deflationary doom loop.



Source: FactSet, 1/11/2024

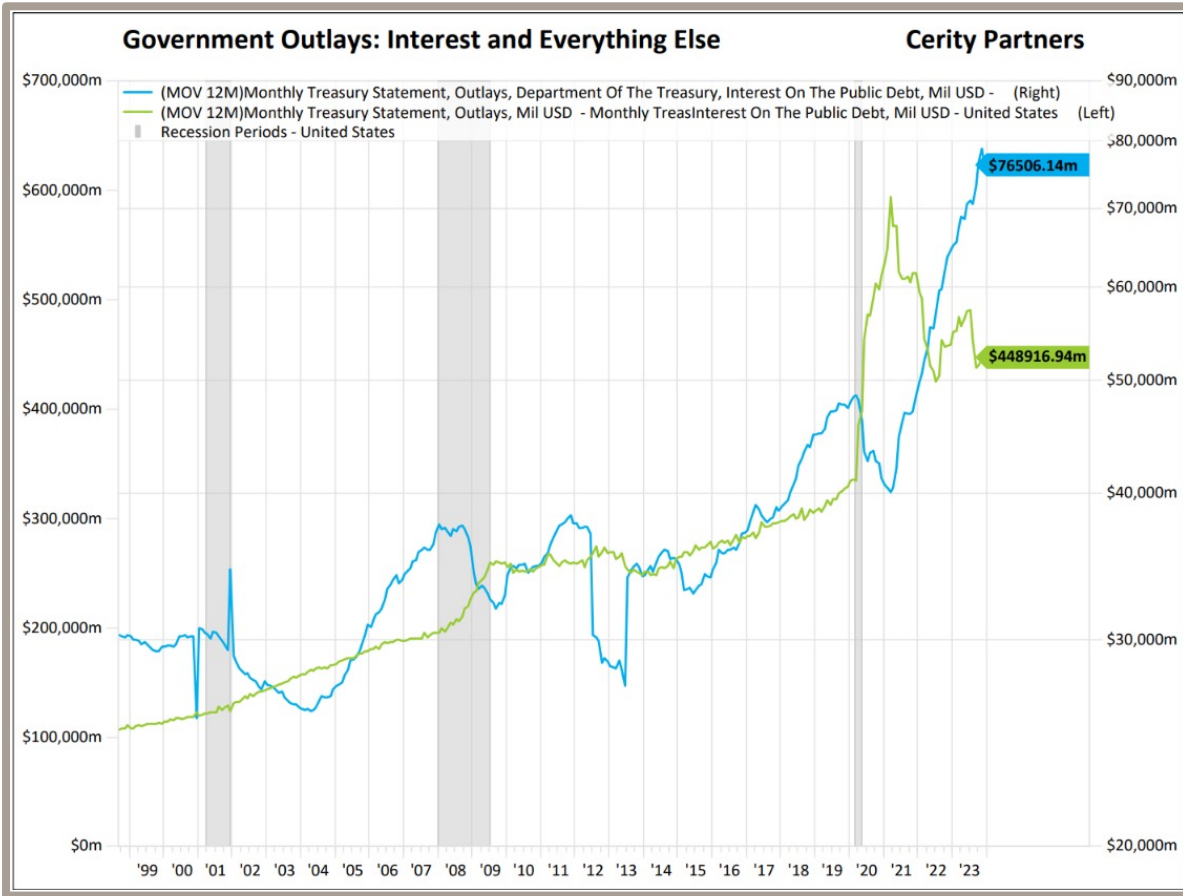


Source: FactSet, 1/11/2024

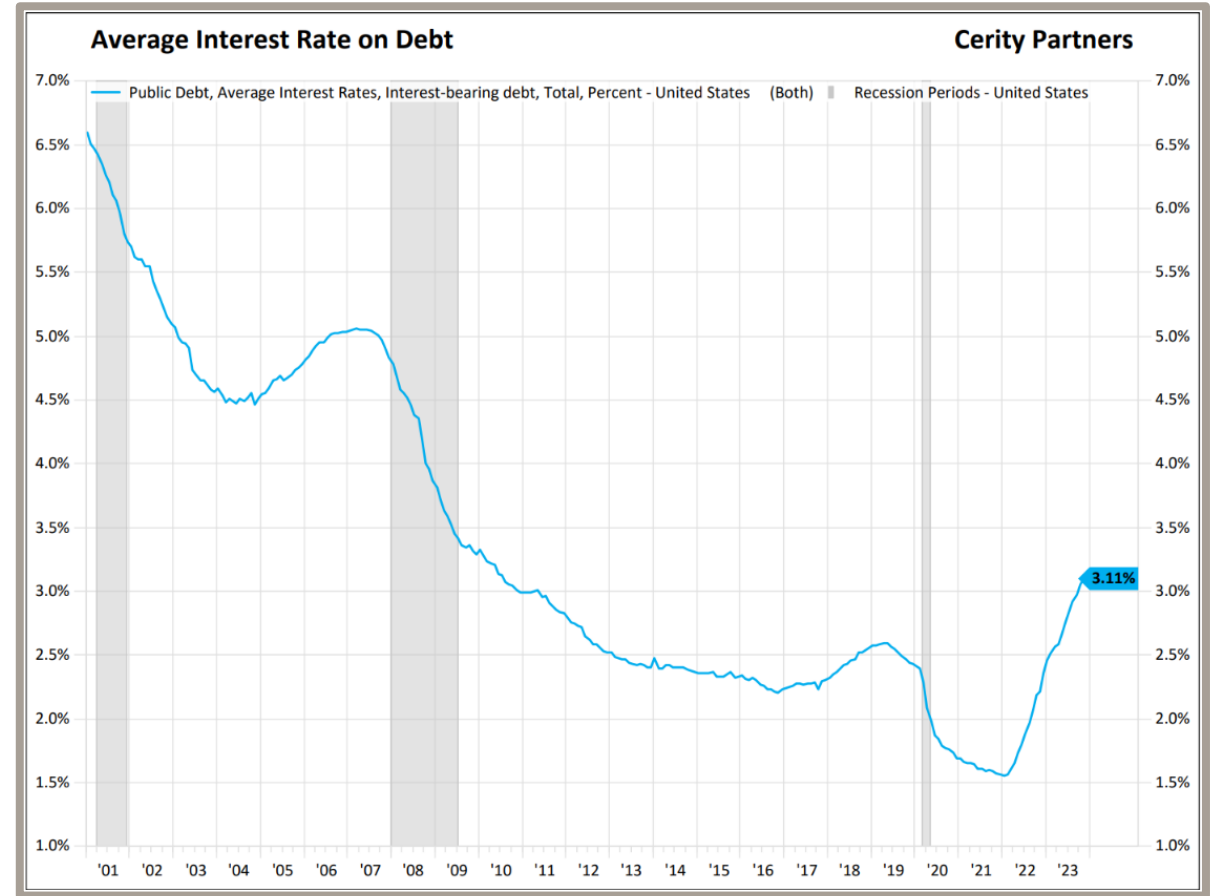


# The Fiscal Situation

Federal interest outlays are skyrocketing. But does it matter?



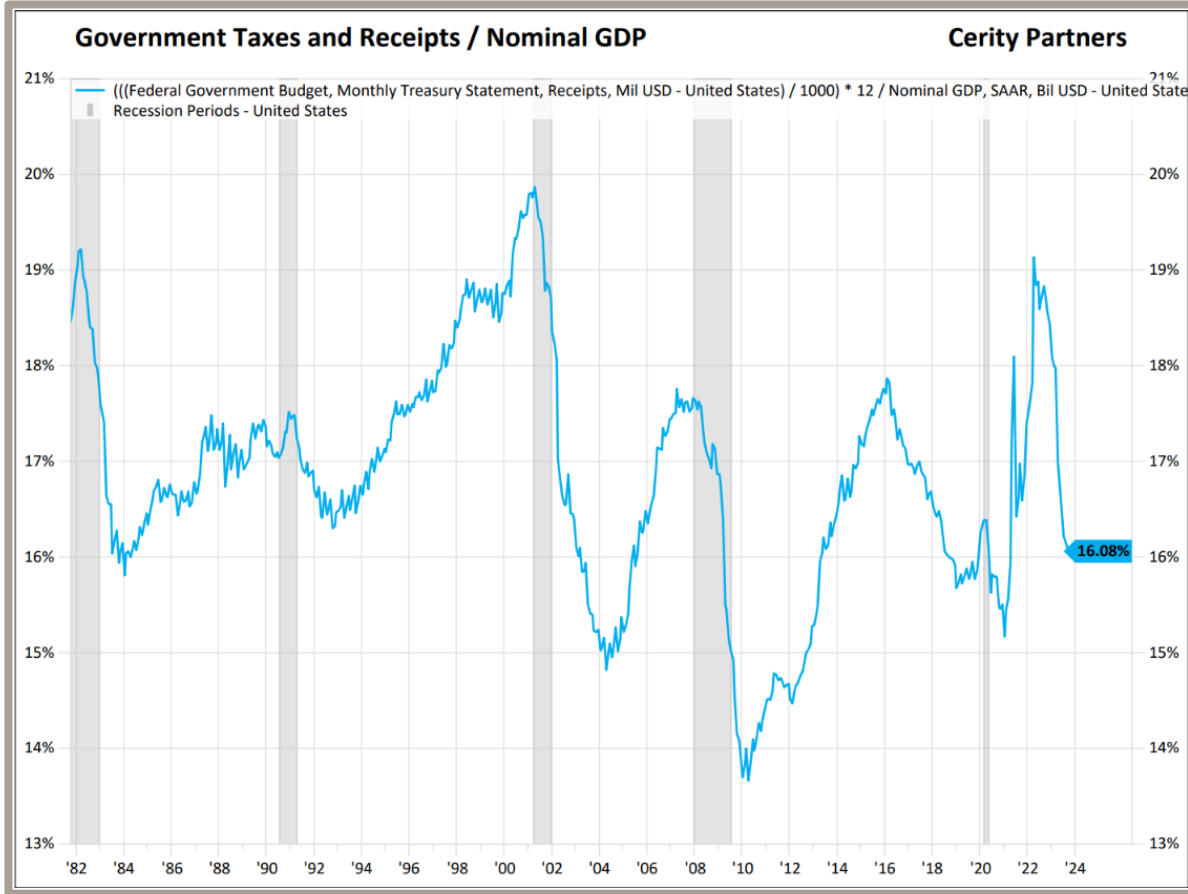
Source: FactSet, 1/11/2024



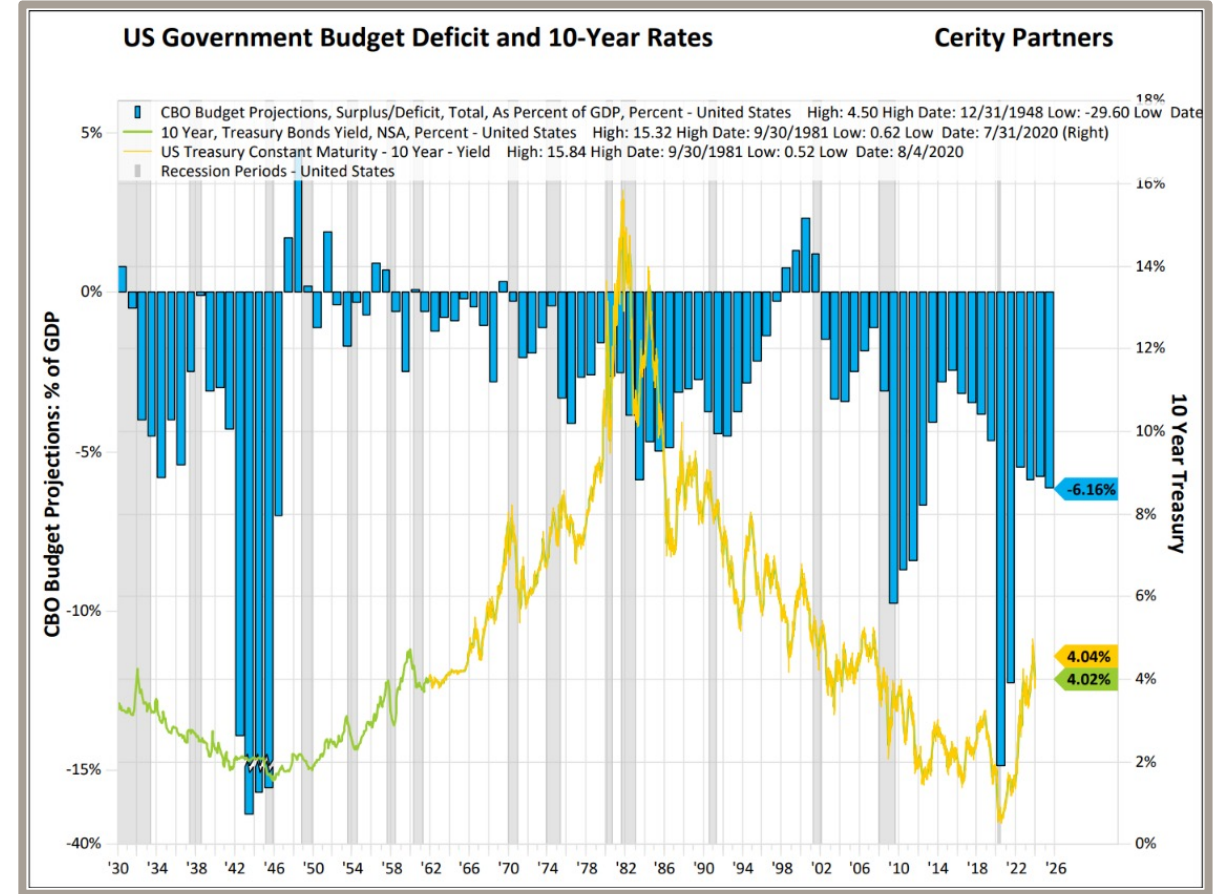
Source: FactSet, 1/2024/2023

# The Fiscal Situation

The relationship between fiscal deficits and rates isn't simple



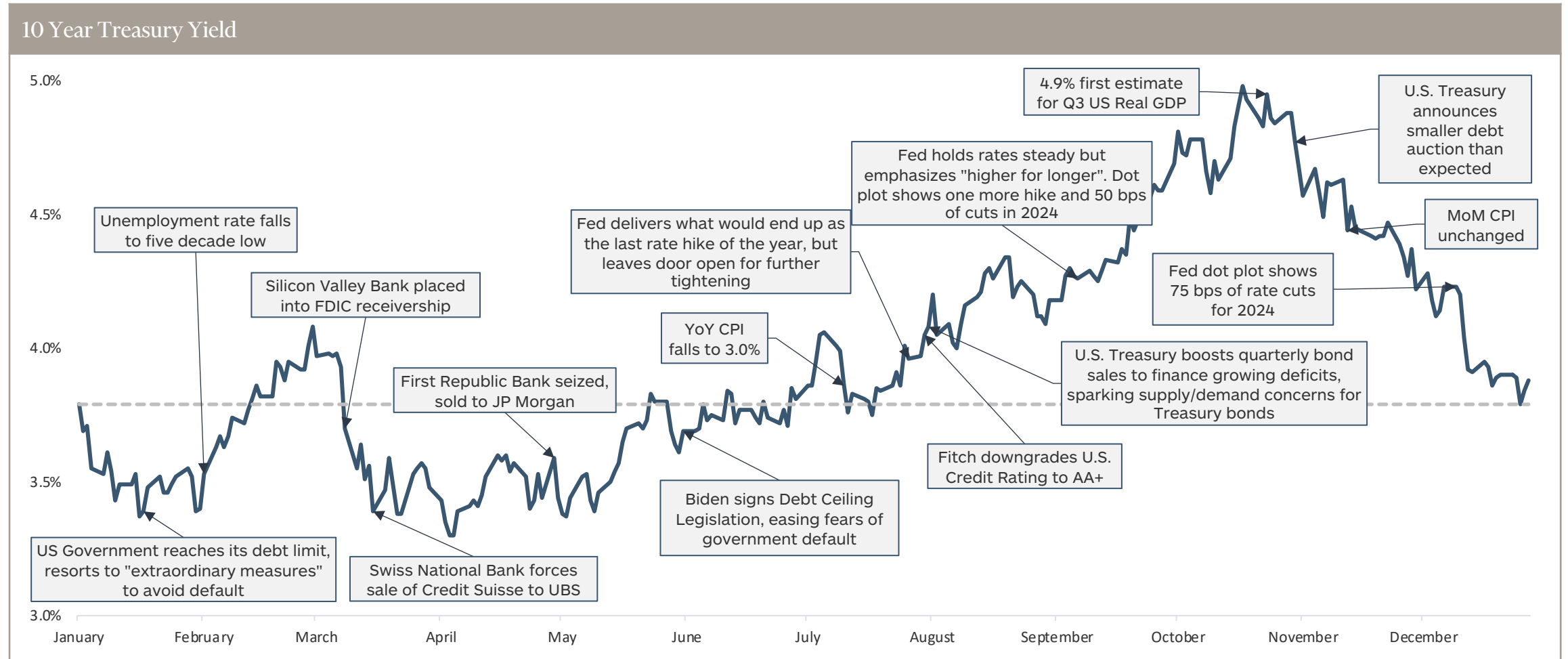
Source: FactSet, 1/11/2024



Source: FactSet, 1/11/2024

# A Round Trip for the 10-Year

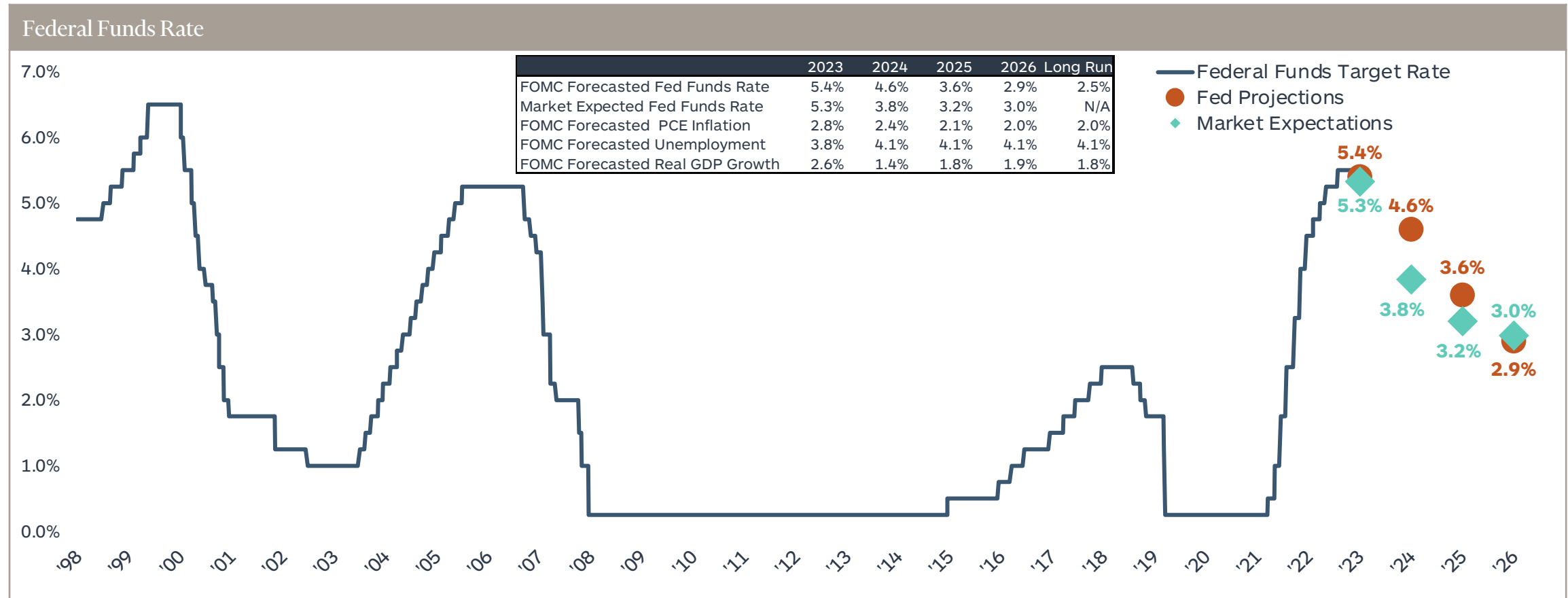
After a volatile year, Treasury yields wound up right where they started



Source: FRED

# The Path for Interest Rates

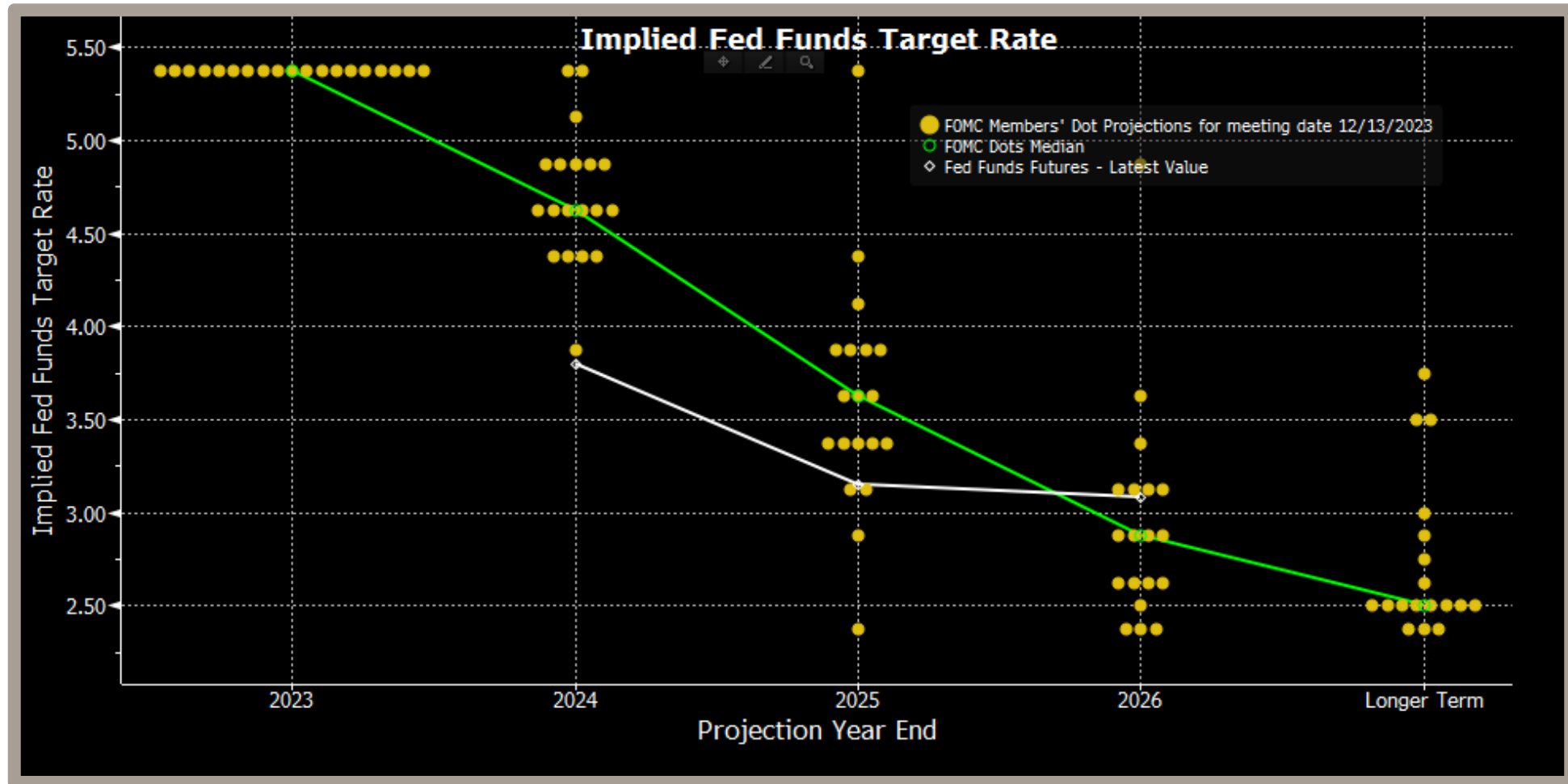
It appears rate hikes are behind us. Now, attention turns to the timing and magnitude of cuts.



Source: FactSet, FOMC, 12/31/2023. Market expectations derived from Fed Funds Futures

# Market Pricing vs. Fed Guidance

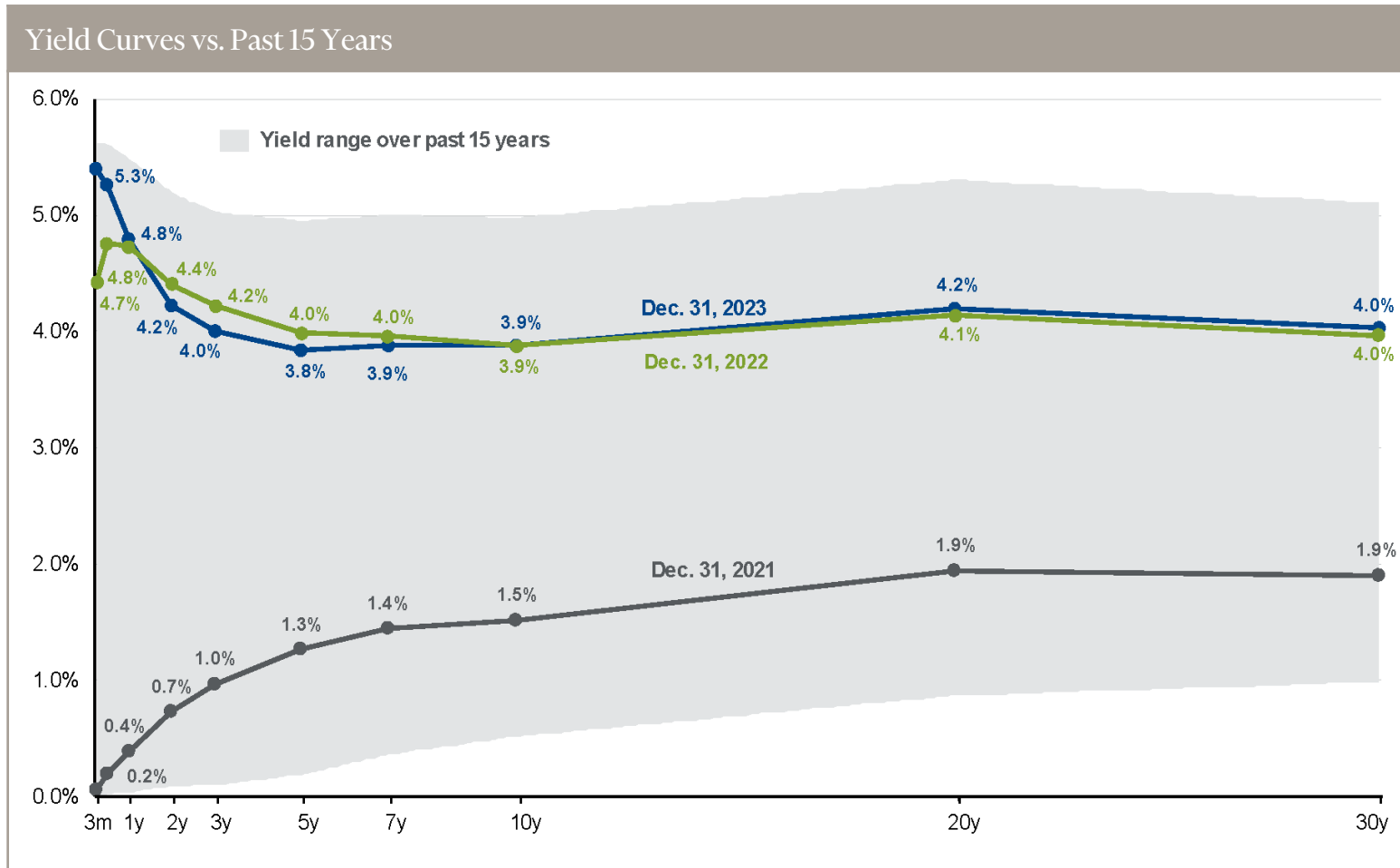
Markets are pricing in more rate cuts in 2024 than the Fed is currently communicating.



Source: Bloomberg

# The Yield Curve

Even after a strong December rally, the curve is still sitting at the high end of its recent historical range

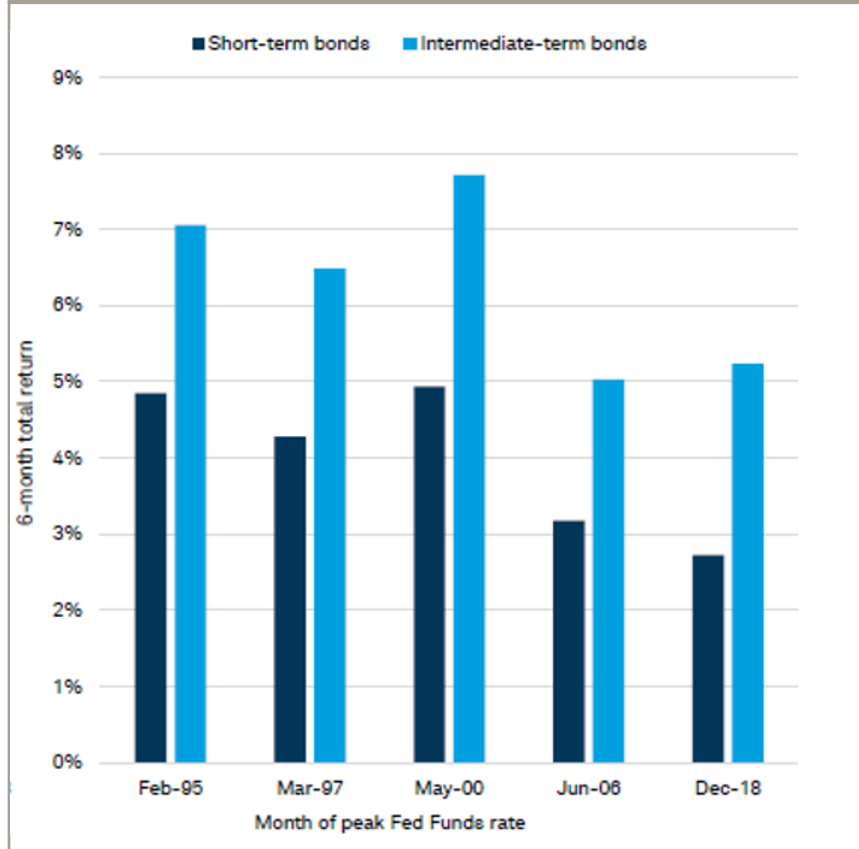


Source: FactSet, Federal Reserve, JP Morgan Asset Management, 12/31/2023

# The Duration Dilemma

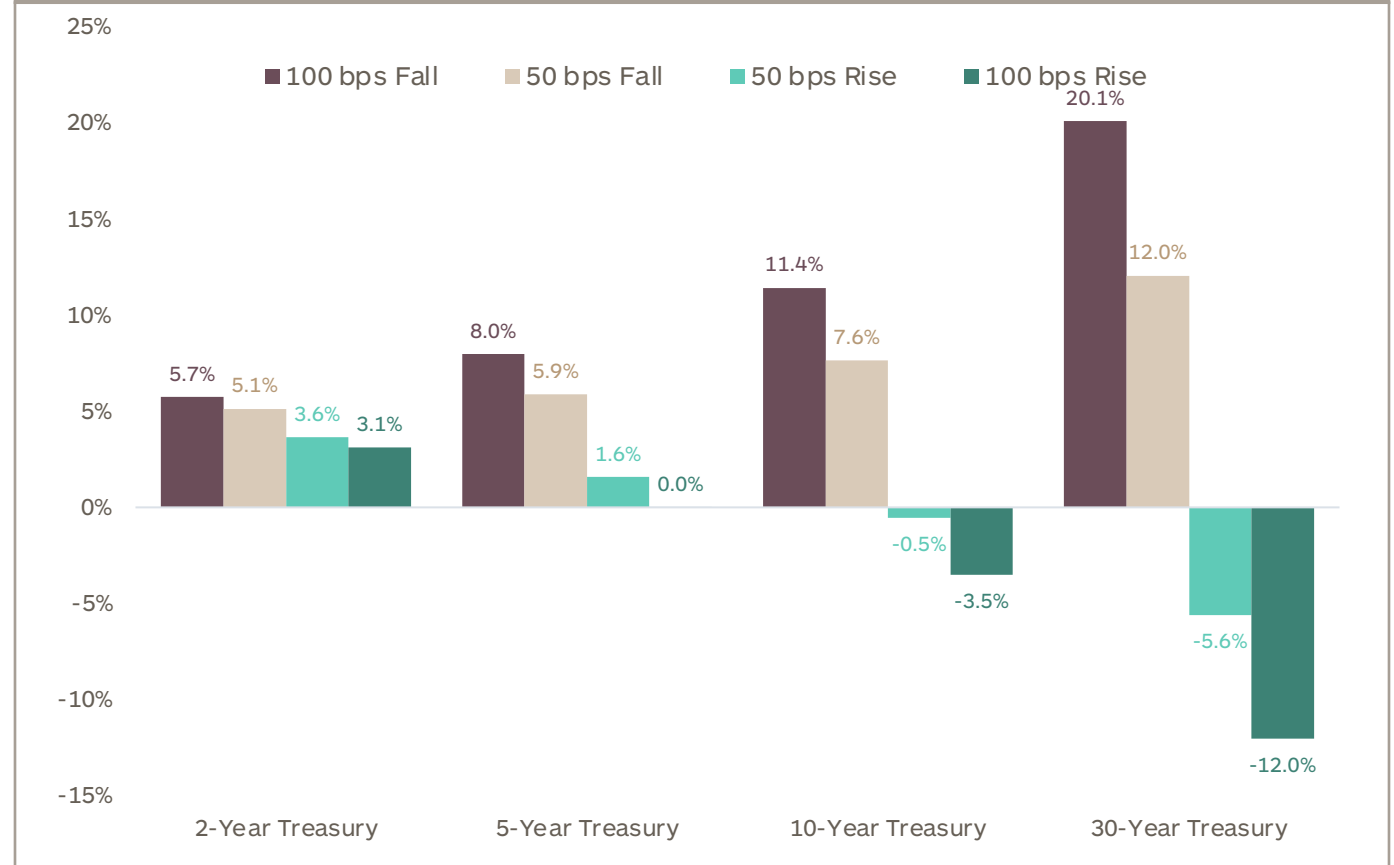
Sitting in cash feels good for now, but attractive risk/reward exists further out on the curve.

### Bond Performance Around Last 5 Terminal Rate Hikes



As represented by the Bloomberg US Agg 1-3 Year and 5-7 Year indices.  
**Source:** Charles Schwab, Bloomberg,

### Total Return Impacts From Moves in Rates

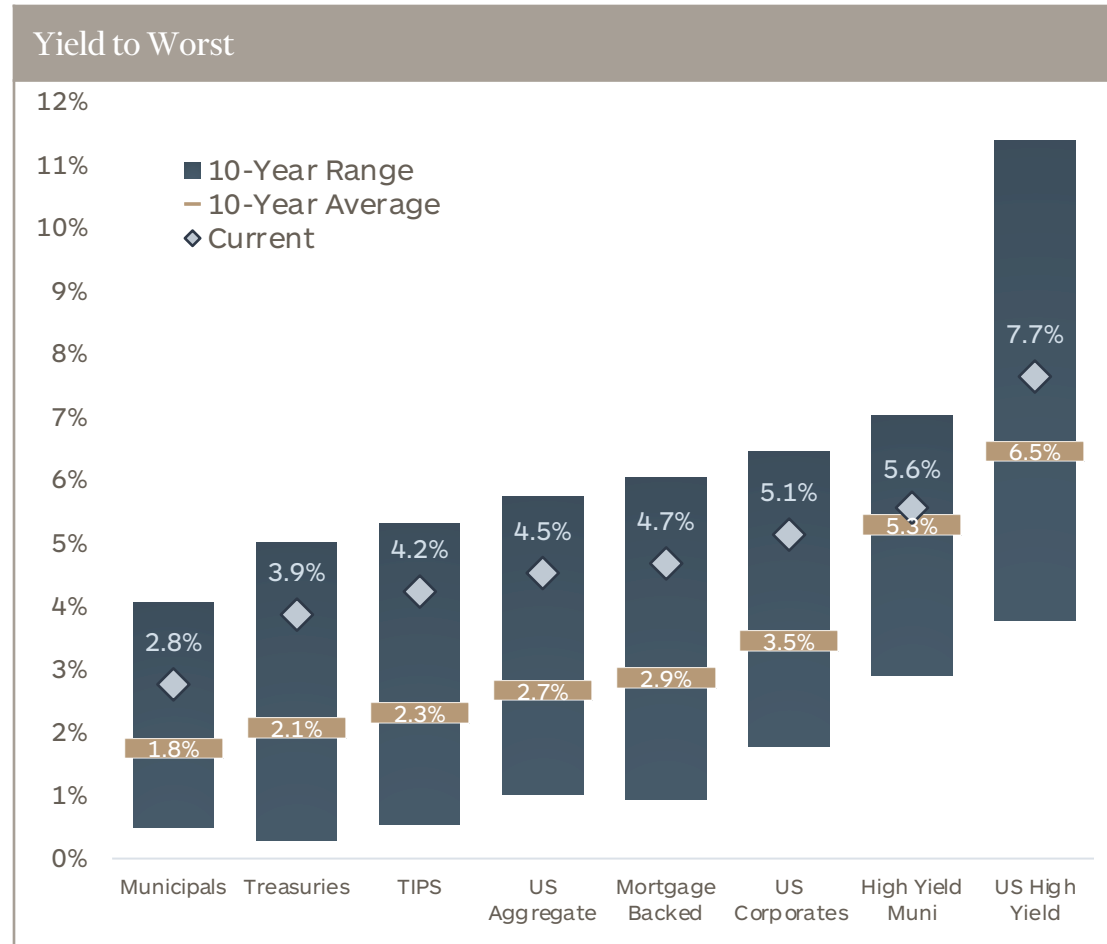


**Source:** FactSet, 12/31/2023

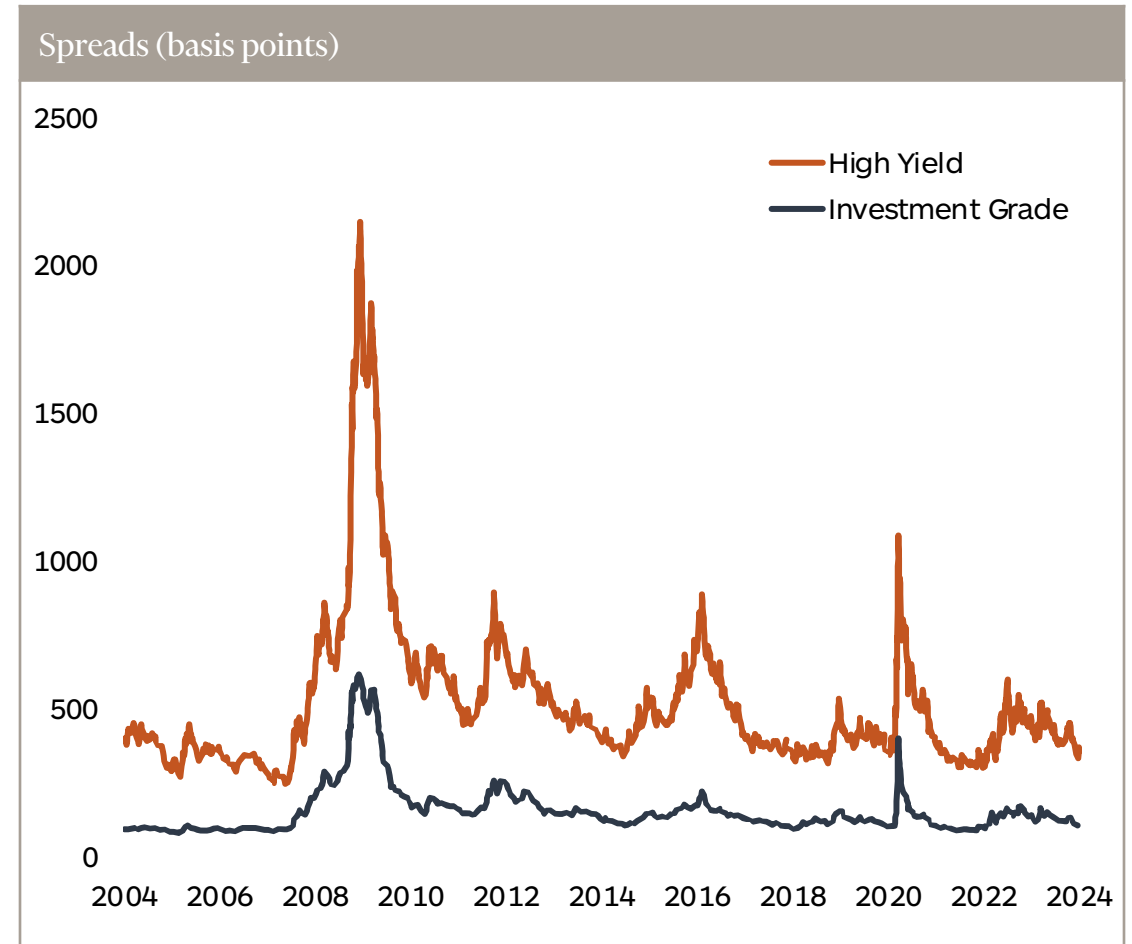


# Yields and Spreads

Spreads are relatively tight, but all-in yields are attractive.



Source: FactSet, 12/31/2023



Source: FactSet, 12/31/2023



# Municipal Bond Yields are at Attractive Levels

Munis are offering yields not seen for almost two decades.

Municipal Bonds: Yield to Worst

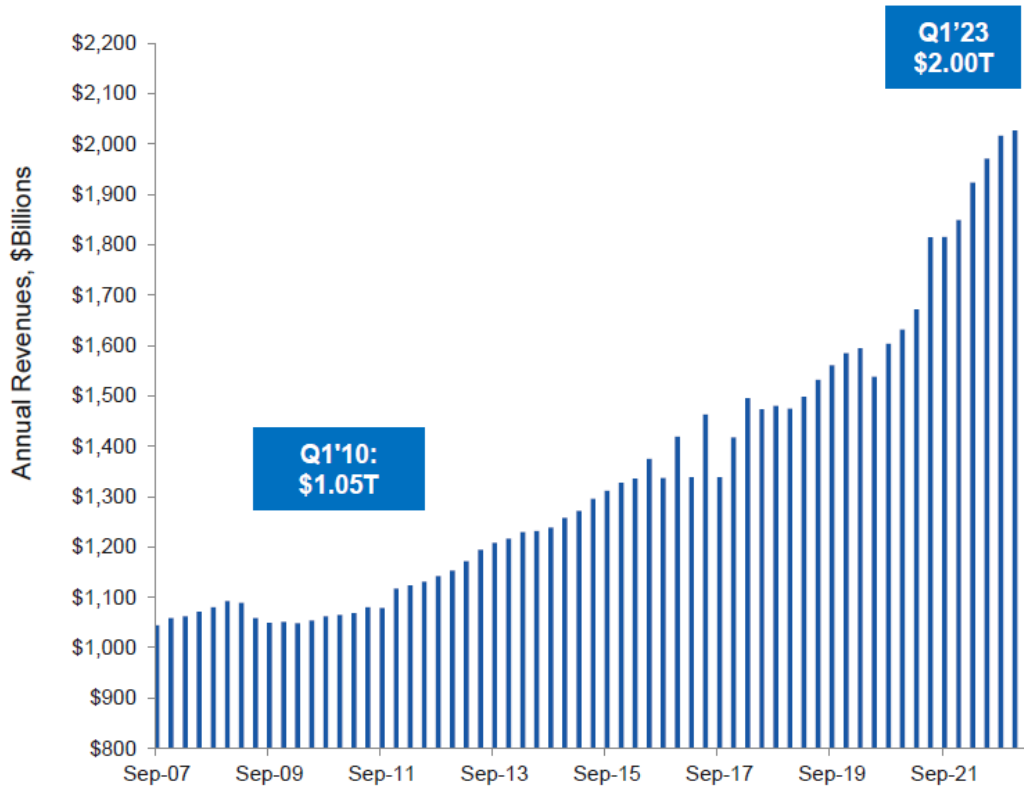


As represented by the Bloomberg Municipal Bond Blend 1-10 Year (1-12Y) index. Source: FactSet. 12/31/2023

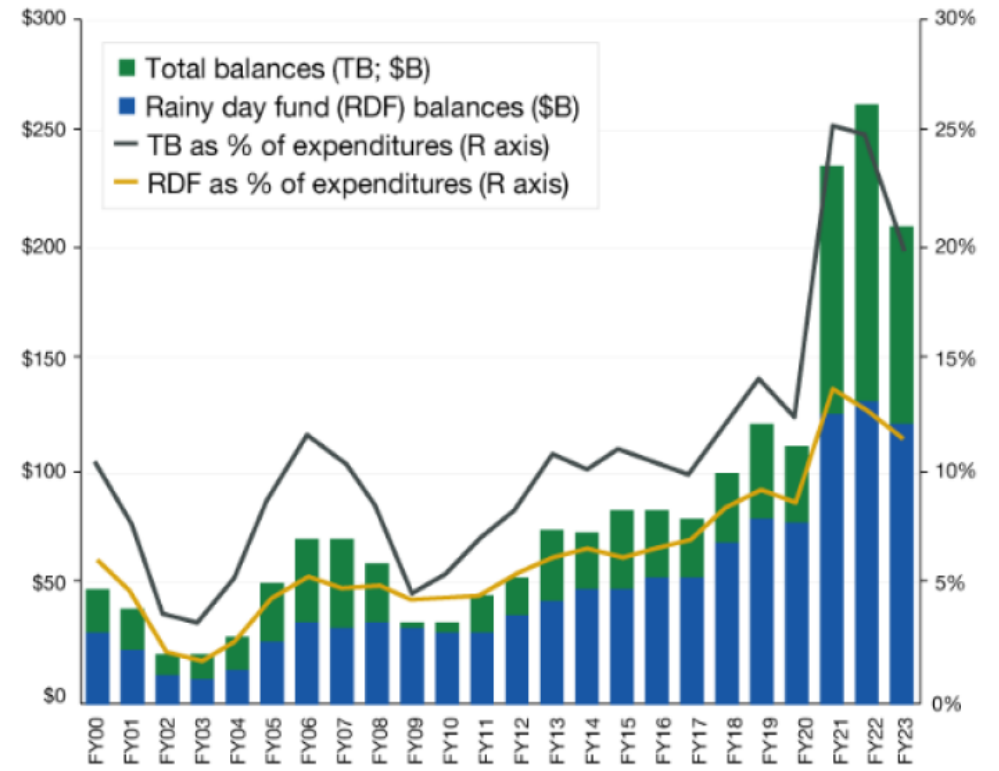
# Municipal Credit Fundamentals Remain Sound

State government issuers are generally in a strong position to weather an economic downturn

## State and Local Tax Revenues are at Record Highs



## States have built up significant Rainy-Day Funds

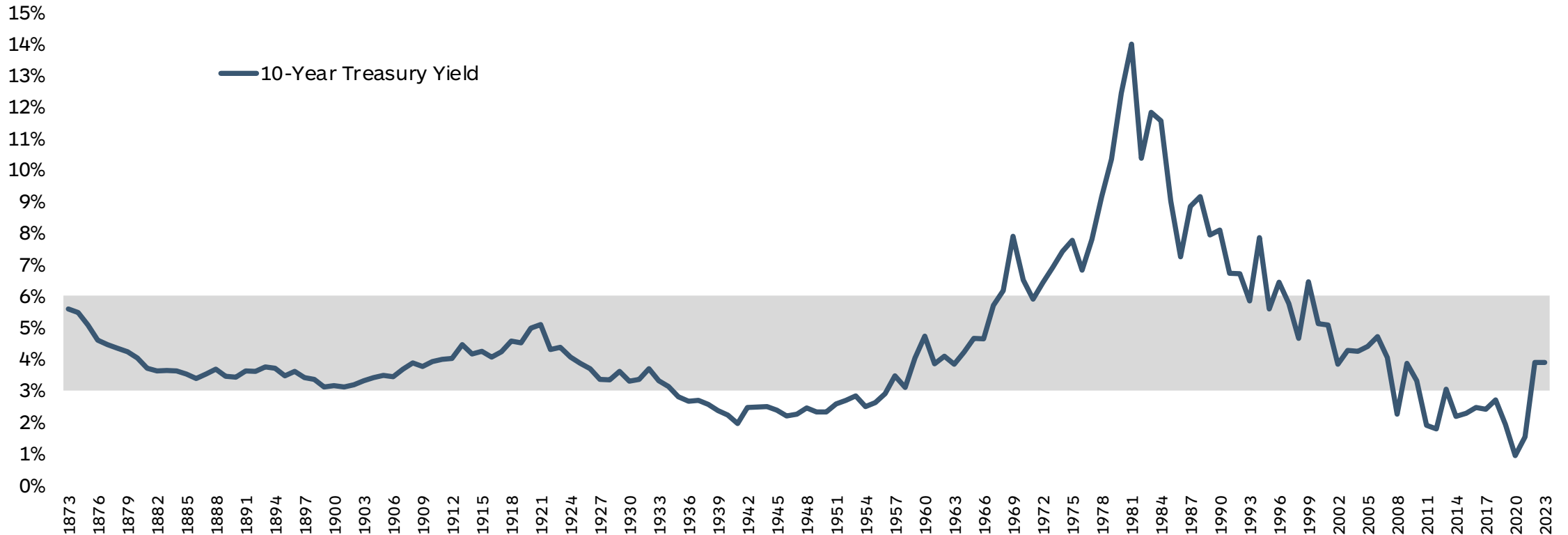


Source: National Assn. of State Budget Officers (NASBO) (left) and the U.S. Census Bureau. Rainy-day fund and total balances as a percentage of general fund expenditures, fiscal 2000–fiscal 2023 (fiscal 2022 estimated; fiscal 2023 projected). Rainy-day funds, also known as budget stabilization funds, allow states to set aside surplus revenue for use during unexpected deficits. Quarterly state government tax revenue data as of 03/31/2023, most recent data available. The historical data are for illustrative purposes only, and do not represent any specific portfolio managed by Lord Abbett or any particular investment.

# Taking a Step Back

In reality, yields have spent much of history in the 3-6% range

10-Year Treasury: A Long-Term View



Source: Before 1964: Robert Schiller website; After 1964: FactSet, 12/31/2023

# Key Themes for Equity Markets in 2024

## Opportunities

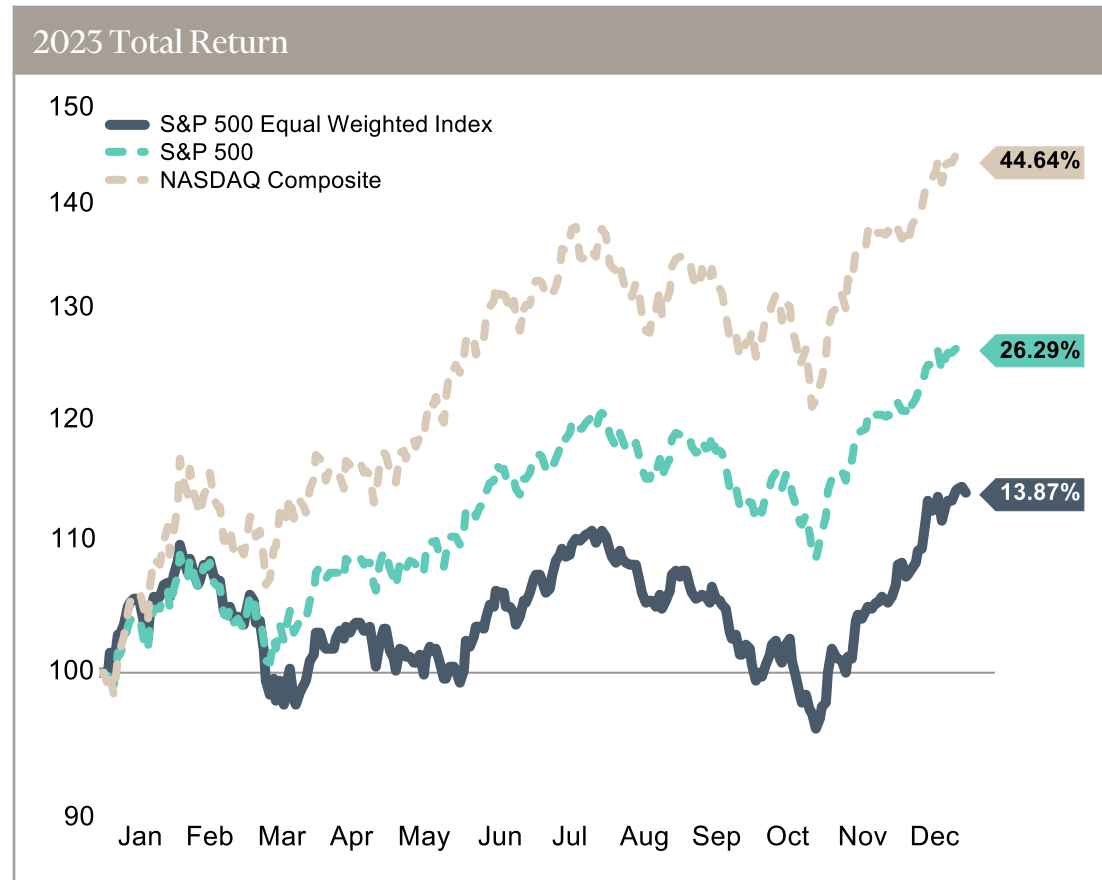
1. U. S. economy stays strong, inflation continues to decline
2. U.S. Federal Reserve lowers interest rates, tapers QT
3. China stimulates its economy, Europe recovers
4. Strong labor markets fuel consumption & confidence
5. Supply chain onshoring promotes industrial production
6. Infrastructure bills ramp up spending
7. Election year spending stimulates U.S. economy
8. AI boosts productivity
9. Corporate profits grow again

## Risks

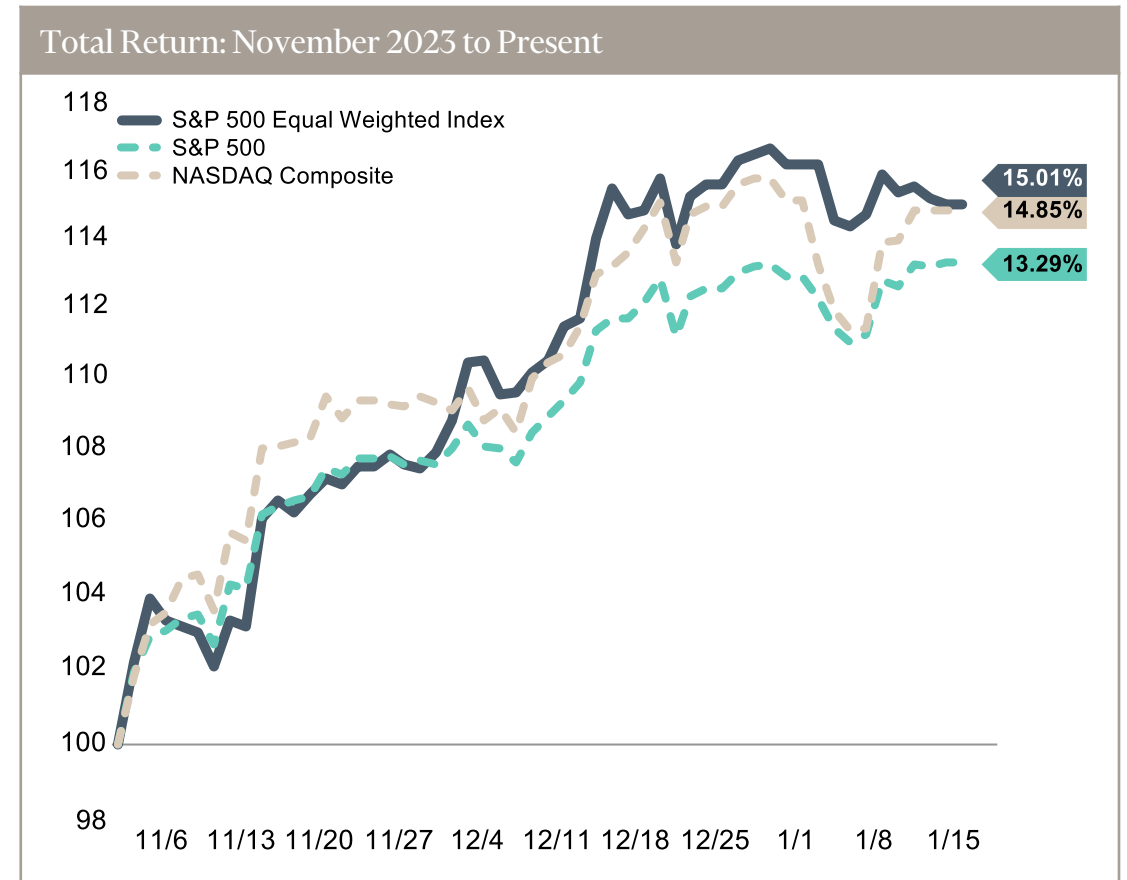
1. Military conflict around the world
2. Domestic politics
3. International elections
4. Sovereign deficits and debt levels
5. Lagged effects of central bank tightening
6. Inflation and interest rates

# Equity Market Breadth

Looking for signs of a sustainable change in leadership.



Source: FactSet, 12/31/2023

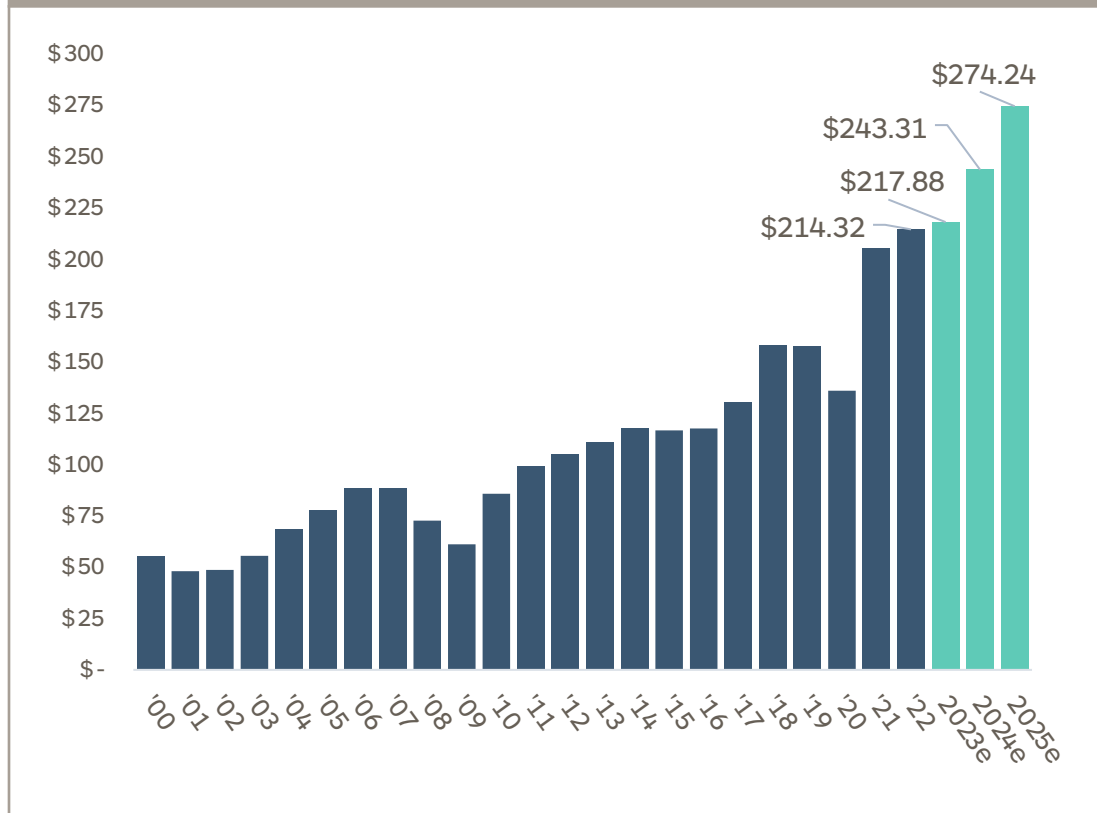


Source: FactSet, 1/12/2024

# The Earnings Picture

Looking ahead to solid growth after a choppy year.

### S&P 500 EPS Estimates



Source: FactSet, 12/31/2023

### S&P 500 EPS Estimate History



Source: FactSet, 1/10/2024

# Valuations

Are they stretched? Depends where you look.

## Large Cap Valuations



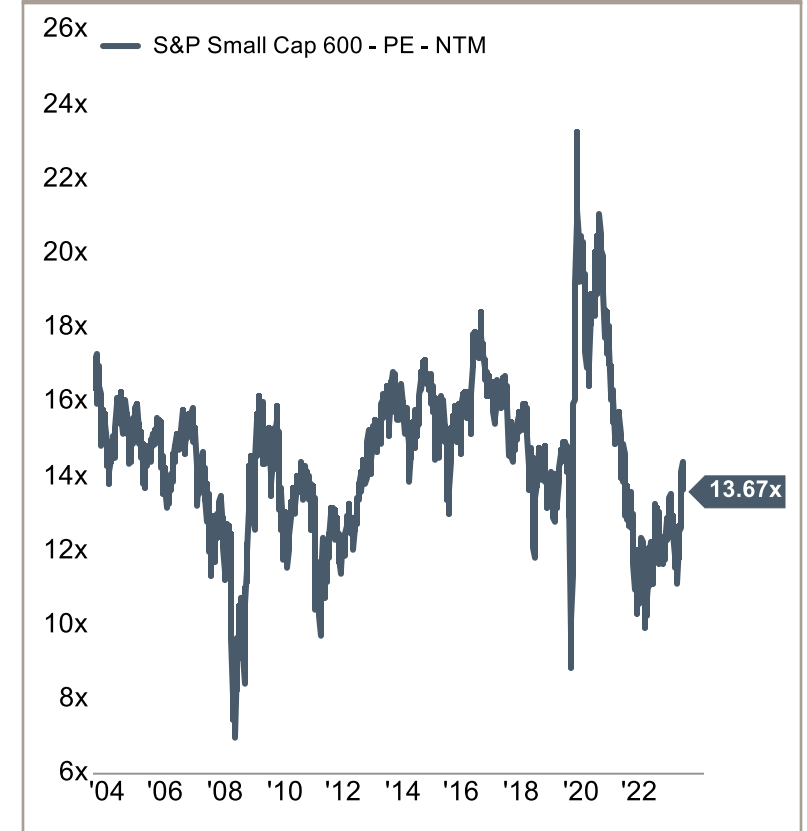
Source: FactSet, 1/12/2024

## Mid Cap Valuations



Source: FactSet, 1/12/2024

## Small Cap Valuations



Source: FactSet, 1/12/2024

# 2024 Year-End Price Targets

US Large Cap

S&P 500						
Current Price	4,719.19					
2023 EPS (E)	\$219.14					
y/y EPS Growth	0%					
	2024	2025	P/E	Target	Projected Return	Probability
<b>Bull</b>	<b>\$252.01</b>	<b>\$287.29</b>	<b>20.50x</b>	<b>5,889</b>	<b>24.80%</b>	<b>30%</b>
y/y EPS Growth	15%	14%				
<b>Base</b>	<b>\$244.87</b>	<b>\$274.65</b>	<b>18.50x</b>	<b>5,081</b>	<b>7.67%</b>	<b>40%</b>
y/y EPS Growth	12%	12%				
<b>Bear</b>	<b>\$238.86</b>	<b>\$262.75</b>	<b>16.50x</b>	<b>4,335</b>	<b>-8.13%</b>	<b>30%</b>
y/y EPS Growth	9%	10%				
<b>Target Price</b>	<b>5,100</b>			<b>Return to Year End Target</b>	<b>8.07%</b>	

## Bull Case

Multiple factors can lead to the bull case including easing geopolitical tensions, continuing inflation moderation, smooth electoral politics, and increasing economic confidence.

## Base Case

In the base case the U.S. economy slows while inflation abates. The Fed takes little action beyond a small number of prophylactic rate cuts, while continuing Quantitative Tightening. The U.S. economy avoids recession.

## Bear Case

Exogenous events cause a sharper than expected economic slowdown that tips the U.S. into recession. These could include ratcheting up in global military conflict, election of a radical U.S. president, a banking crisis, or increased concerns about the U.S. debt/deficit level.



# 2024 Year-End Price Targets

US Small Caps

S&P 600						
Current Price	1,290.88					
2023 EPS (E)	\$86.24					
y/y EPS Growth	-14%					
	2024	2025	P/E	Target	Projected Return	Probability
<b>Bull</b>	<b>\$96.59</b>	<b>\$112.04</b>	<b>18.00x</b>	<b>2,017</b>	<b>56.23%</b>	<b>30%</b>
y/y EPS Growth	12%	16%				
<b>Base</b>	<b>\$92.89</b>	<b>\$105.97</b>	<b>14.00x</b>	<b>1,484</b>	<b>14.93%</b>	<b>40%</b>
y/y EPS Growth	8%	14%				
<b>Bear</b>	<b>\$89.69</b>	<b>\$100.45</b>	<b>10.00x</b>	<b>1,005</b>	<b>-22.18%</b>	<b>30%</b>
y/y EPS Growth	4%	12%				
<b>Target Price</b>	<b>1,500</b>			<b>Return to Year End Target</b>	<b>16.19%</b>	

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# The Importance of Staying Invested

Market timing can be tempting, but the cost of missing out can be substantial.

S&P 500: Compounded Growth of \$10,000 (Last 25 Years)



Source: YCharts. Date range is 12/31/1998–12/31/2023. The chart on the right shows annualized averages of daily returns, assuming 252 days per year.



THANK YOU

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