Economic & Market Update

March 2024 Outlook

Global Economy

- Midway through the first quarter, the U.S. economy is slowing only slightly, as jobs and wage growth both remain robust despite the numerous company layoff announcements delivered in the first two months of the year. There are early indications that consumers may be dialing back somewhat on big-ticket purchases. Business spending has been flat over the past few months, as the manufacturing recession has been short, shallow and generally offset by continued spending on productivity-enhancing technology. Housing, a sector that has also been in recession due to the sharp increase in mortgage rates, is showing signs of a sustained recovery that should add to growth domestic product (GDP) growth throughout the year. With government fiscal spending in an election year also expected to add to economic growth, the U.S. economy appears poised to grow at a rate close to the longer-term trend of 2% through the remainder of 2024.
- As it had in the summer of 2023, progress on disinflation stalled somewhat in early 2024 as services and housing price increases continue at a stubbornly high rate. With goods price inflation having fallen close to zero and shelter prices set to decline, wage inflation in the services economy needs to show more tangible signs of slowing for the overall inflation rate to approach the 2% Federal Reserve (Fed) target. This should begin to occur over the coming months with the target expected to be achieved by year-end or the first quarter of 2025.
- European economies are collectively teetering on the brink of recession, but they're still slightly positive as lower energy prices over the last year have taken some pressure off consumers while the surprisingly strong U.S. economy has helped boost the export sectors. With monetary and fiscal policies remaining as headwinds, it will be difficult for the eurozone economy to break out to higher growth rates, and it is likely to remain flat for the full year.
- The Japanese economy is technically in recession as fourth quarter GDP surprised to the downside following a negative third quarter. Restrained wage growth and disappointingly slow consumer spending have offset the salutary effects of a weak currency on trade growth. Continued fiscal and monetary stimulus will be needed and should be forthcoming to prevent any further deepening of the length and magnitude of recession.
- Chinese economic growth estimates should fall short of the government's 5% target, as the cyclical and secular constraints of a property crisis, continued trade wars with the West and a poor demographic landscape will prove challenging. Government support in the way of expansive fiscal and monetary policies has been rather sporadic but should help prevent more pronounced deterioration of economic growth.

Monetary Policy

- The recent stall in the progress on fighting inflation along with continued above-trend economic growth have pushed out the timing and magnitude of federal funds rate cuts with investors now expecting the first 25-basis-point reduction in rates to occur at the end of the second quarter. The number of cuts is still likely to be only three for the full year. Discussions around adjusting the balance sheet reduction program should begin at this month's Federal Open Market Committee meeting, although no change is expected until midyear.
- The European Central Bank and Bank of England will be more pressured to lower their target rates ahead of the Fed given very weak economic growth outlooks, although both central banks have only a single mandate to ensure price stability. The currency effects of an early move will also be considered, as a resulting weakening of the currencies could be inflationary.
- With Japanese inflation at the target level of roughly 2%, the Bank of Japan is likely to finally abandon its negative interest rate policy as it stands in stark contrast to the rest of the developed world, which has implemented a greater normalization of rates over the past few years. The current policy will also be increasingly characterized by trading partners as mercantilist in providing an unfair currency advantage to Japanese exporters.
- The People's Bank of China should continue gradual ease to help offset declining GDP growth rates while being careful not to cause any sharp decline in the currency and increased flight of capital out of the country.

Bond Markets

- Stronger-than-anticipated economic growth is expected to keep some upward pressure on intermediate- to longer-term Treasury bond yields as well as the government's need to issue incrementally more debt to finance ever-growing budget deficits.
- Continued improvement in the inflation outlook should eventually lead to Fed ease and a decline in short-term yields, which will help move the Treasury yield curve back to its normal upward slope after nearly two years of inversion. Any stall in the disinflation trajectory will reinforce the inverted curve and increase the risk that restrictive monetary policy causes a recession.
- With little to no default risk on the near-term horizon, yield spreads in the below-investment-grade bond market have narrowed to levels not seen in over 15 years. The high-yield debt space appears expensive given the refinance risk many issuers will confront over the coming years as relatively low coupon debt will need to be replaced upon maturity.

Equity Markets

- Fourth quarter earnings growth exceeded expectations due primarily to the strength of the large technology, communication services and consumer discretionary industry champions. Equity prices rose in February to record levels in the U.S. large-cap sector, as greater confidence in the earnings outlook offset the backup in bond yields amid concern around a delay in Fed ease. Small- and mid-sized companies have also advanced early in the year but not at the same magnitude and remain cheap on a valuation basis. This equity asset class will need better earnings growth in the coming quarters to unlock the value inherent in the share prices.
- The expected increase in the overall breadth of participation in the market advance should support relatively cheap European equities, although these markets will likely need easier monetary policies to compensate for slower earnings growth.
- Aggressive monetary policies that have weakened the Japanese yen have helped support the stock prices of the large Japanese multinational exporters. Japanese equity markets have finally gotten back to the highs set over 33 years ago, but they may have gotten a bit ahead of themselves given the prospect of some monetary tightening and continued weakness in the domestic demand-driven sectors.

- Chinese equities perked up a bit in February, but confidence in the market among global investors continues to wane due to trade wars, a bursting property bubble and a government that appears to be overtly favoring state-owned enterprises over publicly traded corporations. Investors likely need to see greater policy support as well as a more welcoming attitude to invest more confidently in both the mainland and Hong Kong markets.

Commodities and Currencies

- Oil prices are likely to remain in a trading range through the summer, as the risk of geopolitical events contracting supply is currently offset by ample production from both the United States and the OPEC cartel. Continued weak demand from China is another factor that reduces the probability of an upside breakout in price.
- The state of global economic growth should be the prime determinant of price movements in the industrial metals space, although the geographic distribution of that growth is important. U.S. growth is expected to be relatively strong over the coming quarters, but China is a much more manufacturing-centric economy and the expectation of slowing growth will likely cap any metals price increases.
- The recent pushback of prospective Fed ease to the summer has caused some choppiness in the price of gold, as the currently high short-term yields are headwinds to any advance. The forecast of only three 25-basis-point cuts in the federal funds rate should keep gold trading in a rather narrow range as the real federal funds rate remains high in a declining inflation environment.
- Better relative economic growth rates and higher relative interest rates have driven further U.S. dollar appreciation at the beginning of the year. With other central banks poised to ease before the Fed to combat slower growth, the U.S. dollar will be biased toward higher prices—at least until the Fed begins its easing cycle.

What This Means For Investors

- As the U.S. economy appears to be currently running a little too hot, there is no rush on the part of the Fed to ease rates despite the continued progress on inflation. Equity markets appear rather relaxed about this delay as economic growth is boosting corporate revenues and earnings. However, any increase in intermediate-term rates due to economic strength could challenge valuations and lead to heightened volatility in an equity market that has already largely achieved year-end price targets. Greater workforce productivity should continue to be the key to reaffirming investor confidence that any price declines we may see over the coming months should be viewed as buying opportunities.

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