Market Forecasts
Q1 2024

Global Economic Outlook

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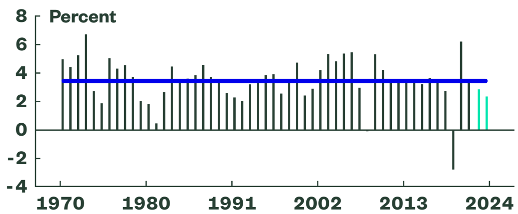
Figure 1
Slowdown Continues But Rate Cut Support On Way



World Real GDP Growth (WEO)
World, Real World GDP, State Street Global Advisors Forecast
Long Term Average Growth (3.5%)

Source: International Monetary Fund, Macrobond, State Street Global Advisors, as at December 31, 2023. The above forecast is an estimate based on certain assumptions and analysis made by the State Street Global Advisors Economics Team. There is no guarantee that the estimates will be achieved.

- The path to a soft landing seems more viable, with recession risks easing somewhat. But the effects of earlier tightening policy are still working through the system even as central banks embrace easier policy in 2024.
- Geopolitical events will be key to watch in 2024, given multiple potential flashpoints around the world and a massive election cycle globally.

Emerging Markets Outlook

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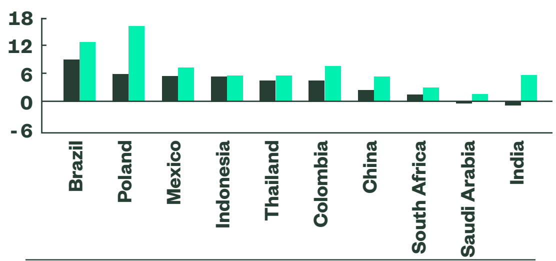
Figure 2
Consumer Price Inflation in Key Emerging Markets



Latest Value
One Year Prior

Sources: Macrobond, State Street Global Advisors Economics as of January 10, 2024.

- Inflation continues to retreat, providing room for emerging market central banks to extend the easing bias.
- A weaker US dollar and lower interest rates should offer a more helpful backdrop, not only for emerging market economies but also for EM assets.

Global Capital Markets

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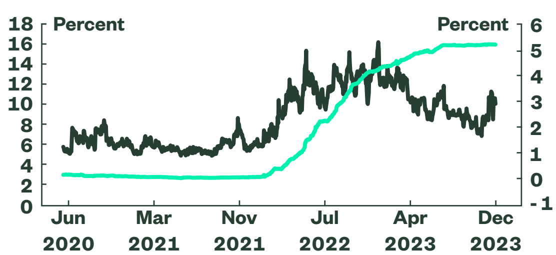
Figure 3
USD/JPY Implied Volatility and Short-Term Interest Rate Differentials



USD/JPY iVol (RHS)
Rate Differential

Source: FactSet, State Street Global Advisors as of December 27, 2023. Past performance is not a reliable indicator of future performance.

- Although some signs of complacency seem to have crept into equity markets, we continue to see a healthy outlook for global stock markets — some of which appear close to setting new all-time highs.
- The fundamental outlook for fixed income looks attractive as our expectations are for relatively subdued growth and lower short-term interest rates. However, nearer-term technical-oriented factors suggest the rally in rates may have come too far and too fast.

Global Economic Outlook

Simona Mocuta
Chief Economist, Global Macro and Research

The global economy still appears set to slow in 2024 against the backdrop of continuing disinflation, but the shift to a more dovish stance in central bank messaging lessens the chances of a recession materializing in the coming year. Focus now shifts to when rate cuts may happen.

After a very turbulent 2023, we begin the new year on a cautiously optimistic note as (with a few exceptions, such as the Bank of Japan) developed market central banks have come to the end of the tightening cycle and are now signaling that some relief on rates is not too far off. We had long argued that monetary policy nimbleness and a willingness to calibrate rates lower once progress on inflation permits was critical to maintaining a path to a soft landing. As recently as three months ago, that willingness was still in question, but no more. At their December meetings, the US Federal Reserve (Fed) and the European Central Bank (ECB) both signaled in no uncertain terms that, barring truly unexpected events, the next move in rates would be lower. While domestic conditions will dictate the pace at which other developed market (DM) central banks can join the bandwagon, the direction of travel will be the same for all. In 2023, we described the global disinflation trend as a “different speeds, same direction” phenomenon. The 2024 global monetary easing cycle can be thought of in the same way.

This will not magically solve all challenges but it helps put a floor under the ongoing global slowdown and reduce downside risks. Timing remains important and the soft landing is by no means guaranteed. However, the odds of achieving it have improved following the latest developments. Our global growth forecasts have been almost unchanged this past quarter, with global growth expected to come in a tenth better in 2023 and a tenth lower in 2024 than previously estimated. US projections have been upgraded again while eurozone estimates have been lowered incrementally. Our outlook for Chinese growth in 2024 is unchanged.

Geopolitical events will be key to watch over the course of 2024. With the US in an election year, a lot of drama seems assured. Fiscal issues are poised to be central to the debate though meaningful action is a scenario for 2025 and beyond. This is one reason why the outlook for 2025 is quite murky and not very sanguine. But that’s perhaps too far out into the future to worry about right now. For now, let’s enjoy the benefits of the long-awaited monetary policy pivot.

United States: In the Nick of Time

We are becoming more hopeful again on the US macroeconomic outlook. This is a direct response to the Fed's meaningful dovish pivot at the December meeting. The hawkish September meeting had us questioning whether the soft landing scenario could survive the Fed. We wrote back then that "for our part, we continue to believe that sustained, broadening, progress on inflation, will allow the Fed to calibrate rates lower more meaningfully over the course of 2024. However, we fully acknowledge that the latest dot plot has widened the gap between what the FOMC signals it intends to do and what we believe it "should" do next year. The implicit message in the dot plot is that unless something "breaks" in the economy, the Committee is disinclined to pre-emptively calibrate policy rates lower merely on account of better inflation data. We believe that would be a mistake. Over-confidence in the soft landing scenario actually endangers the odds of the soft landing remaining soft."

We are glad to see that, despite the trials and tribulations of the intervening period, better inflation prints allowed the Federal Open Market Committee (FOMC) to forgo a December rate hike and signal three (rather than two previously) cuts in 2024. We still believe there will be more, but it will take time and additional data evidence for the Committee to align with our forecasts. The market, on the other hand, is already there, pricing 150 basis points (bps) worth of Fed cuts in 2024. As a baseline scenario, this seems the right number to us. We may get more if the economy slides into recession (a lesser likelihood now), or a little less if yet another wave of data resilience manifests.

A critically important point around any rate cuts is the rationale behind them. The 150 bps that are in our forecast are delivered because the Fed can (because of lower inflation), not because it has to (because of sharply lower growth). Better inflation allows the Fed to calibrate policy lower before something else in the economy breaks (the regional banking turmoil was an example of something breaking) and they are forced into larger cuts. It is a good and preferred pathway as it implies policymakers retain control and guide the economy to a soft landing.

US Recession Less Likely

Recession odds have diminished in the near term because the recent repricing of rates helps put a firmer bottom in residential fixed investment, alleviates credit and refinancing costs, slows the accumulation of delinquencies, and extends the labor market runway relative to a more hawkish Fed scenario. Additionally, while very fluid, ongoing budget conversations do not suggest much fiscal restraint at all in the FY2024 budget; in fact, chances are some modest tax cuts will be delivered. However, with elections out of the way and the debt ceiling back onto the scene in early 2025, it would be a mistake to interpret the more benign 2024 risk profile as signaling only blue skies ahead. A recession may be avoided in 2024, but risks are still considerable that one will arrive in 2025. Still, that's far enough out that we'll take the market's cue and ponder that worry at a later time.

As to the specifics, growth projections were upgraded again, up four and three tenths to 2.4% and 1.4%, respectively, for 2023 and 2024. Much of this reflects the puzzlingly strong third quarter GDP print (4.9% saar). A surge in consumer spending and a big inventory build-up accounted for the bulk of this, but neither are sustainable. As such, we'd view the third quarter outcome as more noise than signal vis-à-vis the future direction of the economy.

Consumer Spending Key Signal

With the personal savings rate below 4.0%, the resumption of student loan repayments, and COLA (cost of living adjustments) to social security benefits much less generous in 2024 than in the prior two years, we find it hard to believe that consumer spending can sustain its recent growth rate. Admittedly, consumers have enjoyed a powerful boost from the intense disinflation experienced since the summer of 2022; going from over 9.0% CPI inflation to slightly over 3.0% has been a boon for real incomes. However, that tailwind is already fading since the next phase in the disinflation journey will be less about magnitude and more about rotation from headline to core. For consumer spending, it is headline disinflation that matters. A slowdown in consumption therefore seems like a perfectly reasonable expectation, even in the absence of meaningful labor market deterioration. Tellingly, delinquent credit card balances have risen to multi-year highs recently, which seems to belie the strength apparent in the consumption data. This dynamic bears close watching.

On the issue of the labor market, the FOMC has maintained an impressively upbeat forecast for the unemployment rate, seeing it peak at just 4.1% in 2024 and remaining there in 2025. We suspect that it will go higher than that — and that could well be the Fed's excuse for cutting rates by more in 2024 than they are currently signaling. Our thinking rests on overwhelming evidence of slowing labor demand, seen not only in the moderating pace of hiring but also in job openings, business surveys, and consumers' own perceptions about the degree of labor market tightness. What is more of a wildcard is the behavior of labor supply. All else equal, an argument could be made that the aging of the population would be enough to continue to exert downward pressure on the participation rate and so put downward pressure on the unemployment rate even at the same level of labor demand. However, we suspect we will see some improvement in labor supply, partly as a delayed response to rising migration flows, and partly due to a return to the labor market by some workers in the older age groups. As Covid concerns fade and as COLA adjustments to social security benefits slow markedly, diminished savings may push some people back into the labor market. And so, the unemployment rate could probably be closer to 4.5% than 4.0% at the end of 2024, which also means that the Fed's dual mandate becomes dual again. After nearly two years when risk management for the FOMC meant exclusively fighting inflation, the Fed will start paying more attention to the labor market and other macro risks such as the 2025 corporate refinancing wall.

Eurozone: Walking the (Tight) Line

Having made no changes whatsoever to our eurozone forecasts in September, we tweaked them at the margin in our latest update. Growth estimates for 2023 were reduced by a tenth to 0.6%, with 2024 projections down two tenths to 0.9%.

With these changes, we remain modestly above consensus. We still do not have a formal recession in the forecast, but these projections are far from genuinely upbeat. While we retain the view that eurozone macro resilience is insufficiently appreciated by investors, the region will battle meaningful fiscal headwinds and an approaching corporate refinancing wall over the year ahead. On the plus side, the significant disinflation of recent months speaks favorably to rising real disposable incomes and the record low unemployment rate suggest an even tighter labor market than in the United States. Moreover, given the rigidities associated with European labor markets, we suspect any possible uptick in the unemployment rate will be extremely slow and shallow. With elevated excess savings and household net worth, European consumers have the money. They just don't have the confidence. Our expectation is that confidence returns as inflation gets closer to target and interest rates begin to decline. That could spur a mild pickup in consumption and lift GDP growth modestly.

The improvement in inflation has been quite remarkable. Even as recently as 3–4 months ago there was broad skepticism towards the idea that the eurozone would join the US in earnest along the disinflation path. And yet, both headline and core inflation are now lower in the eurozone than in the US.

Still, we should recognize that the speed of this improvement is somewhat artificial (linked to distortions introduced in changes to energy subsidies over time) and progress will slow markedly from here on (and likely even reverse temporarily). It is with this in mind, and also with an eye to elevated wage inflation, that we see market pricing of ECB cuts as a little too aggressive at the moment. Rather than the 150 bps worth of cuts envisioned by the market, we think 100 bps is a more reasonable expectation. It is possible that the ECB could surprise with more cuts, but given our 'no recession' baseline, we are comfortable with the more conservative profile.

United Kingdom: Tightening Policy Bites

While revised data showed the UK economy has recovered faster than previously thought, growth will remain fragile in 2024. In our latest forecasts, we downgraded the 2024 real GDP growth estimate by 0.3 percentage points (ppts) to 0.8% and slightly upgraded the 2023 inflation estimate by two tenths to 7.4%.

Third quarter GDP growth remained virtually flat following a modest expansion in the previous quarter. Higher borrowing costs continued to depress household consumption and business investment. Household consumption contracted during the quarter while weakness in the housing market led to a fourth consecutive monthly decline in residential investment. Further signs of weaker consumer spending have become more apparent. Retail sales volumes declined by 0.3% in October following a contraction of 1.1% in the previous month. According to GfK, consumer confidence rose again in December, but remained at a historically low level.

Meanwhile, the increase in the flash composite purchasing managers' index (PMI) from 50.7 in November to 51.7 in December indicated that the economy was likely to have dodged recession in the final quarter of 2023. The PMI rebound was entirely driven by a moderate upturn in services activity, with the flash reading of the services PMI registering a six-month high reading of 52.7 in December, up from 50.9 in previous month. The UK manufacturing sector downturn continued, with the manufacturing PMI posting a reading of 46.4, down from 47.2 in November. Trade remains under pressure, with both imports and exports projected to be down sharply in 2024 due to soft global demand and the continuing impact of Brexit. Given the subdued global economic outlook and slow inflation descent, we expect the economy to flatline in Q4, resulting in overall growth of 0.4% for 2023. As for 2024, downside risks have increased, but we still expect GDP growth of 0.8% in the year given the moderating inflation and strong wage growth.

Disinflation to Continue, Albeit More Gradually

Perhaps the best news since our last update was that both headline and core inflation have significantly decelerated. Headline inflation fell sharply by 2.1 ppts to 4.6% in October, below both the Bank of England (BoE) estimate of 4.8% and market expectations. The decline in core inflation was also larger than expected, dropping from 6.1% year-on-year (y/y) to 5.7%. While most of the improvement was driven by lower goods prices, services price pressures have also diminished. Going forward, we expect the disinflation trend to continue, albeit more gradually following big recent improvements. Headline inflation should average 2.9% in 2024 (from an estimated 7.4% in 2023).

Cooling Labor Market to Ease Wage Pressures

The labor market has shown further signs of cooling. Vacancies continue to trend lower while the unemployment rate picked up markedly to 4.2% during August to October, from its low at 3.5%. Given our expectations for softer growth, additional labor market softening is likely. Wage growth is also finally starting to show signs of slowing. Annual private sector regular average weekly earnings growth was 7.3% in the three months to October, compared to 8.1% in the three months to July and 7.8% in the BoE November Report. We expect that lower headline CPI and ongoing labor market conditions will reduce wage pressures further in the coming months.

A tight labor market coupled with expansionary fiscal policy means that monetary policy will need to remain restrictive for longer in order to get the inflation rate back to the BoE's 2% target. However, in their December meeting, the Bank downplayed the effect of the government's recent fiscal announcement on its policy stance. The BoE also decided to leave the Bank rate at 5.25% for the third consecutive meeting, as expected. As such, we think the current market pricing of 100 bps worth of cuts in 2024 seems reasonable. Currently, we expect the BoE will start rate cuts in August but if markets prove right with the Fed and ECB reducing rates in either Q1 or Q2 2024, we wouldn't rule out the BoE moving earlier too.

Japan: No Time Like the Present

The time has come for bold policy action in Japan, as the Bank of Japan (BoJ) vies with a narrowing window to normalize monetary policy. There is increasing evidence to suggest that not only should policy be normalized, but that the time is now ripe for it. There are a number of reasons underpinning our argument:

1. There is more confidence on wage growth and inflation
2. Households will benefit from exiting NIRP (Negative Interest Rate Policy)
3. Disinflation and wage growth will further help consumption and GDP in 2024
4. The US Fed's earlier-than-expected easing in 2024 narrows the window for the BoJ

The cost of negative or zero interest rates is perpetually-deferred household consumption. The difference between household assets and liabilities is a whopping 1.7 quadrillion yen! The 636.01 trillion yen held as 'transferable deposits' is twice the loans taken. Clearly, households will benefit from higher interest rates as they are likely to earn more income than they pay in interest. So, household consumption, which dragged growth in Q3 by -2.9% q/q saar, would benefit overall from higher interest rates.

However, the flip side of higher rates is that government borrowing could become expensive, as the cost of their capital will rise. Furthermore, it will also complicate the BoJ's profits and balance sheet management, as their Japanese government bond (JGB) holdings will lose value. So, how will government finances be managed? In a paper released after a speech by deputy governor Himino, the BoJ discussed how its balance sheet and profits could evolve if interest rates were to rise and has interesting insights. The average residual maturity of the BoJ's holdings is the lowest among major central banks at 6.6 years as of March 2023 — this compares with a maturity of 8.8 years for the US Fed's holdings.

Furthermore, by 2028, 416 trillion yen or 56.6% JGB holdings will mature. In order to moderate the contraction of assets and also to minimize losses, the Bank will have to reinvest the majority of its maturing proceeds, depending on the circumstances. Hence, the Bank has enough dry powder to cater for a reasonable JGB supply. Furthermore, the BoJ too amortizes the losses on the JGB securities it holds to maturity, like the Fed. Still, if losses were to arise, the bank has provisions of 6 trillion yen.

On timing, we think the Bank of Japan should move early in 2024; it will help the BoJ to move before widespread current expectations of an easing cycle are replaced by actual cuts. We are left with the impression that in Japan, short-term interest rates will rise gradually while the long end steepens in 2024. Hence, we think the policy rate on excess savings will rise from -0.10% to +0.10% in 2024. We expect the BoJ to allow sufficient time to decipher how the economy transitions.

Inflation Remains Key

Average inflation is set to ease to 2.6% in 2024 (from 3.3% in 2023) as food and import price inflation eases. However, services inflation should gain momentum. The government recently announced tax incentives to organizations that raise wages by 7% or more by designating nearly 35% of the wage increases to be deductible from corporate taxes, provided the companies also qualify for credits related to childcare support. Hence, we expect the shunto wage negotiations to yield wage growth of 4.5% or above in 2024.

Domestic Tailwinds Drive Growth

The most crucial aspect for 2024 is that the combination of disinflation, higher wage growth, and higher interest income for households will keep the powder dry for households. Indeed, a virtuous price-wage cycle is taking shape. We also expect important tailwinds to households from interest income in the event of higher short-term interest rates. Hence, household consumption could average 1.0% y/y in 2024, just as in 2023. We expect capital expenditure (capex) to slow to 1.0%, down seven tenths from 2023. Exports may rise 3.8%, which would be below their historic average of 4.4%. The overall outcome of this could mean that GDP could rise 1.0% y/y in 2024.

As in 2023, the main risk for Japan is from outside Japan. If economic growth in the advanced economies slows sharply, it could potentially stall growth and the normalization process. Furthermore, household consumption needs some support. Nonetheless, the economic mood is quite strong, and Japan is in a great place to normalize its monetary policy in 2024.

Emerging Markets Outlook

Simona Mocuta
Chief Economist, Global Macro and Policy Research

The upcoming year for emerging markets will likely be characterized by a continuing retreat in inflation alongside central bank interest rate cuts, a shifting geopolitical landscape, and an ongoing focus on China.

There are three inter-related commonalities between developed and emerging market economies in 2024. First, inflation continues to retreat across the board — including in those countries where price pressures had previously proven more stubborn. As a result, central banks shift from the pure inflation-fighting mindset that dominated 2023 and become more attuned to potential downside growth risks. With disinflation will come interest rate cuts — the second commonality. Notably, in respect to monetary policy expectations, the biggest shift over the last couple of months has been in respect to key developed market central banks, especially the US Federal Reserve. Because of this, the seemingly unfaltering US dollar is starting to falter a little.

A weaker dollar and lower interest rates should offer a more helpful backdrop, not only for emerging market economies but also for EM assets (and generally for non-US assets). The challenge, of course, is that they are occurring against a backdrop of slowing global growth and persistent geopolitical risks. Indeed, rather than bringing the conflict in Ukraine at an end, the world is now grappling with another one in the Middle East. And there is yet another commonality between EM and DM countries: 2024 is shaping up to be a record election year, with voters in the US, Canada, Mexio, India, Indonesia, UK, and many other countries heading to the polls. Intense public debate and unexpected twists and turns should be expected; and so should volatility.

We cannot conclude an emerging markets commentary, no matter how brief, without some remarks on the largest EM economy of all: China. In regards to China's economic performance, some details may have recently changed, but the underlying story has not. Growth performance has proven a little stronger than previously anticipated, with 2023 growth estimated at 5.1%, but the medium-term trajectory remains one of slowing, sub-5.0% growth.

Global Capital Markets Outlook

Jerry Holly
Senior Portfolio Manager
Investment Solutions Group

Although some signs of complacency seem to have crept into equity markets, we continue to see a healthy outlook for global stock markets — some of which appear close to setting new all-time highs. The fundamental outlook for fixed income looks attractive as our expectations are for relatively subdued growth and lower short-term interest rates. However, nearer-term technical-oriented factors suggest the rally in rates may have come too far and too fast.

Simon Says

In the world of macroeconomics and global asset allocation, we are often trying to find ways to simplify the world. Create different categories or groups which can help us tackle complex problems in a reasonably structured way. Even in this article, our views are (mostly) separated by broad asset class categorizations such as equity, fixed income, and commodities and other real assets. But sometimes a particular theme, event, or idea just can't be wrestled into a nice and neat, orderly classification system. Is Paypal a financial firm or a tech company? Index providers have struggled with this question. How should we think about convertible bonds, which are usually more like stocks, or preferred stocks which are essentially bonds in everything but name? And how might we break down all the different countries spanning the globe to allow for ease of investment while retaining meaningful and differentiating features? For this last question, the Nobel prize winning economist Simon Kuznets offered us a compelling classification framework:

> **“there are four types of countries in the world — developed, undeveloped, Japan and Argentina”[1]**

Though Kuznets passed away nearly 40 years ago, the inductive identification of Japan and Argentina as somehow defying common classification continues to ring true in the present. In developed markets, we've noted that, generally speaking, DMs continue to enjoy a disinflationary cycle which will soon lead to monetary easing. The opposite is closer to the truth in Japan. In emerging markets, Argentina's weight may be small (if it's present at all), but its nascent policy experiments loom large. However, the market-friendly fiscal discipline that has pushed the Merval Index to all-time highs is in many ways the opposite of what markets would like to see other emerging market (EM) heavyweights pursue. The flagging performance of the CSI 300 Index in China, which ended 2023 near its lowest level since 2019, highlights the difference in market attitudes.

For our part, the asset allocation outlook for early 2024 may not fit all that nicely into a bullish or bearish dichotomy either. To be sure, we're bullish with respect to our equity allocations (where we are overweight). But there are some pockets of equity markets where we hold underweight positions and we also see a constructive outlook for fixed income (despite holding a net underweight allocation). Furthermore, that bullish outlook does not extend to the more growth-sensitive real asset space, with the caveat that we continue to see firm trends in gold.

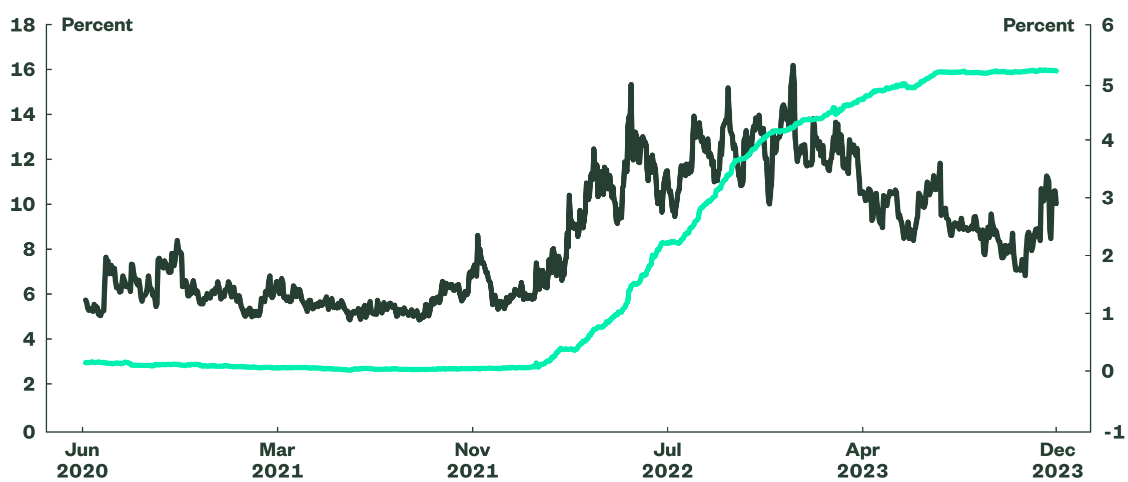
Watch out for USD/JPY

Since late October when markets were fearing super-sized Treasury issuances and the risk of sticky inflation prints, risk-seeking sentiment has lifted equity markets while sending bond yields sharply lower. Viewed through the lens of our Market Regime Indicator (MRI), these dynamics have once again pushed up against levels that suggest a degree of complacency has entered into market psychology. While this doesn't suggest that 'risk-off' allocations are the right answer, more moderate risk budgeting is effective in this type of environment and we enter 2024 with a meaningful, but less aggressive, equity stance.

The MRI is a composite of indicators that span equity, credit, and foreign exchange markets. And just as all countries don't cleanly fit into easy classifications, so too do we see disparity across some of the MRI's individual factors. In particular, currency volatility between the US dollar and Japanese yen stands out as one outlier in the mix. Figure 4 plots the implied volatility between these two currencies alongside the differential between short-term interest rates in the United States and Japan for the post-Covid era. It can clearly be seen that as the Federal Reserve (Fed) began increasing interest rates and the rate differential widened, USD/JPY implied volatility rose in tandem. And as that interest rate differential leveled off, implied volatility subsided. Even though this measure of volatility remains well below levels that held in late 2022, we can see signs that it is beginning to perk up as markets anticipate convergence in interest rate differentials. Will it rise enough to upset carry traders or alter the current ebullience in markets? We're not there yet but this will be a key indicator to watch as the calendar turns.

Figure 4
USD/JPY Implied Volatility and Short-Term Interest Rate Differentials

USD/JPY IVol (RHS)
Rate Differential



Source: Factset, State Street Global Advisors as of December 27, 2023. Past performance is not a reliable indicator of future performance.

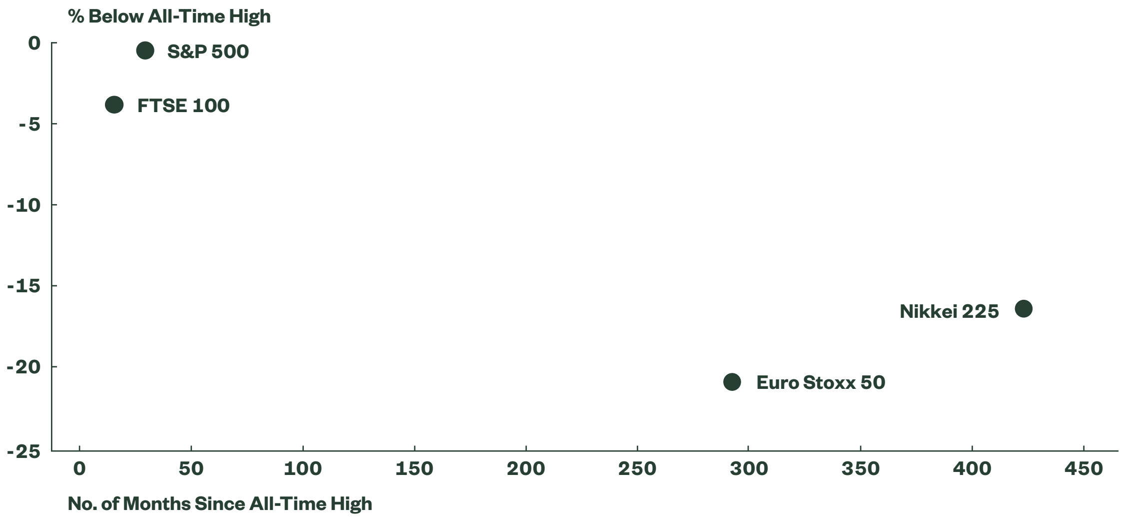
Differentiate Across Equity Markets

With the fourth quarter surge in equities, many major stock markets look ripe for breaking through prior all-time highs in the not too distant future. In the United States, the S&P 500 Index ended the year less than 1% south of the prior peak reached in the first trading session of 2022. UK large cap companies were only about 3% off highs established in February 2023. In Europe, the Eurostoxx 50 has more ground to cover (~20%) in order to surpass its all-time high from early 2000. And while Japanese equities (using the Nikkei 225) have experienced the longest duration without reclaiming an all-time high, that index was only 16% shy of its 1989 record at the end of 2023. On the one hand, putting in record highs might sound the alarm bells — especially if those records are breached in conditions of relatively stretched valuations. But our equity research continues to point to a reasonably healthy backdrop for equity markets broadly. Comparatively low debt loads, still strong operating results and a handful of valuation metrics that showcase fair valuations all point to further equity strength. Of the signals that offer up a less auspicious outlook, we are again reminded of the possibility of complacency creeping into market sentiment as the most negative factor in our modeling relates to the low level of dispersion between individual stock returns.

Although our equity modeling does not explicitly account for breakout patterns that push through new all-time highs, our evaluation of regional and country-level equity markets favors those that are closer to this psychological threshold. The US equity market maintains the top spot in our research and is supported by a host of macroeconomic, sentiment and quality drivers. From a macro and market internals perspective, relatively strong revisions to projected GDP growth alongside steady fund flows prop up US equities compared with other markets. Though the lack of dispersion, in part evidenced by the fact that seven stocks accounted for nearly two-thirds of the S&P 500's 2023 advance, does weigh on domestic shares, healthy profitability ratios and relatively low debt levels remain foundations for a sizable US overweight as we move into 2024. In the UK, the concentration of stock market gains may have been even more pronounced than in the United States with the top 10 stocks accounting for nearly all of the 2023 return achieved by the FTSE 100. But with the FTSE advancing a more modest +8% in local terms, market internals appear healthier and valuations are attractive — particularly if encouraging inflation trends continue to catch up with other developed markets.

Over the intermediate term, Japanese equities look to be establishing a sturdy foundation. Low oil prices, a cheap yen, and an uptick in management buyout activity are all good signs for Japanese equities and may even pave the way for new record highs in the Nikkei 225. But in the nearer term, those governance reforms have not yet translated into improved quality metrics and the looming exit from negative interest rate policy may have unanticipated side-effects — much like the UK experienced with the LDI crisis in the fall of 2022 and with the US regional banking crisis in early 2023. We currently hold a slight underweight in Japan. And while continental Europe sports decent relative valuations, not dissimilar to the UK, without a more meaningful improvement in earnings expectations we think it will be challenging for the Eurostoxx Index to outpace other markets, never mind the 20 percentage point gain needed to eclipse its 2000 high.

Figure 5
US and UK Markets Near Record Highs, Europe, Japan Further to Go



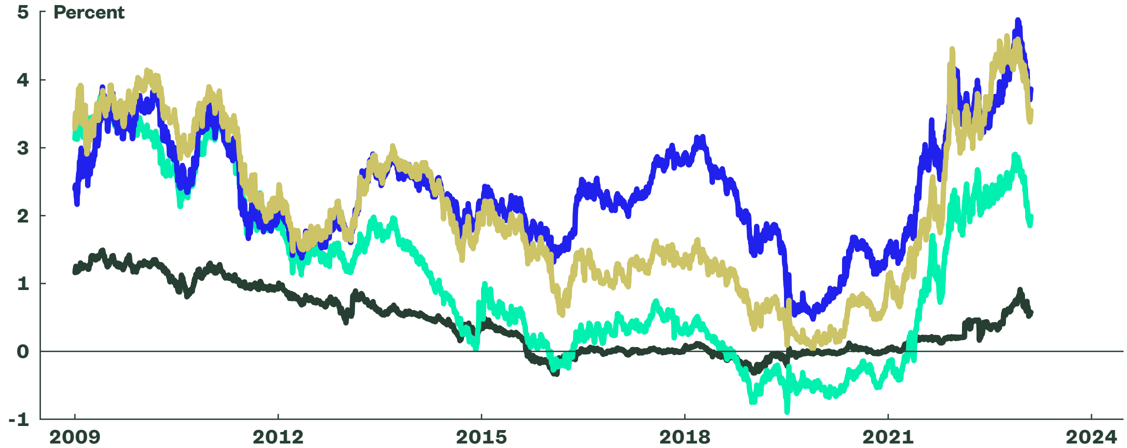
Source: FactSet as of December 31, 2023.

Emerging market funds may not have benefited from the late-2023 magic in the Merval[2] but there has been no shortage of encouraging stock market progress across developing countries. In 2023, nine EM countries generated gains in excess of the S&P 500 Index and there were only a handful of markets that finished in the red. That China happened to be one of them curtailed the overall emerging market performance. But moving forward the macro environment looks to be less threatening to emerging markets compared with recent history. Lower interest rates in the United States and other developed markets, alongside signs that the US dollar is topping versus many emerging currencies (whose valuations look quite cheap), suggests we could see some resilience across EM equity in 2024. To be sure, challenges remain even on the macro front as the pace of global growth is set to decelerate and trade volumes ease. And the idiosyncratic risks within the China market could send ripples (or waves) across global markets. But China is also relatively cheap, and with the exception of India, the same goes for most EM country stock markets.

Fixed Income Fundamentals Battle Technicals

Strong fundamental drivers in global bond markets and relatively constrained risk premia available in equities would seem to make a good case for boosting bond allocations in early 2024. High interest rates, decelerating inflation, and some signs that central bankers will start to normalize short-term interest rates all provide a healthy backdrop for bond markets. But a mixed technical picture and the sharp decline in yields that has transpired since October create concern that markets may have moved too fast in embracing a more benign rates backdrop for early 2024. Some markets, such as the UK and German bond markets, have seen yields drop so fast as to change their directional trend.[3] That's not yet the case for US yields, and it doesn't look like 10-Year Japanese government bond yields are likely to breach that threshold anytime soon.

Figure 6
Global Bond Yields Change Direction in Late 2023

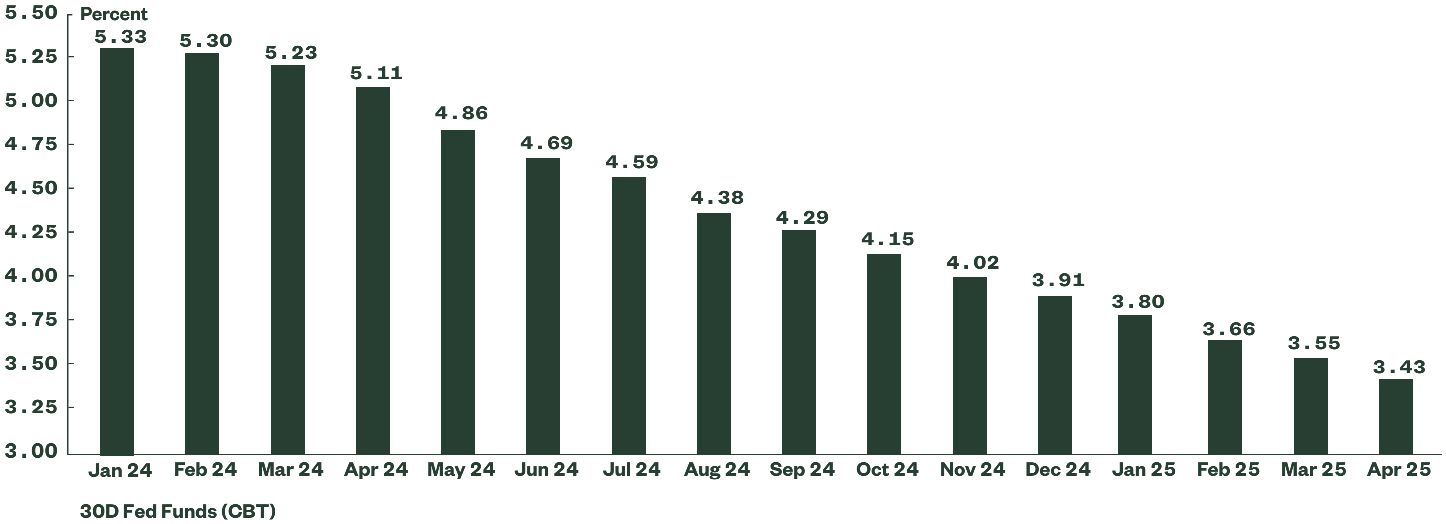


Source: FactSet as of January 2, 2024. Past performance is not a reliable indicator of future performance.

Coming back to the fundamentals — which we'll attempt to classify under the auspices of economic, monetary and fiscal — one can see that these drivers are largely supportive for developed market fixed income. On the economic front, and as reported in the preceding section of Forecasts, we anticipate advanced economy growth to decelerate to +1.2% in 2024, with average inflation almost halving from 5.1% in 2023 to 2.8% in 2024. From a monetary policy perspective, though the commentary has tilted more hawkish in Europe than in the United States, markets are still braced for bankers to push on the brakes less forcefully throughout 2024. Borrower fundamentals and fiscal positions may not be as supportive, as evidenced by the ratings (or outlook) downgrades issued by Fitch and others for US government debt. But just as markets started to ponder whether 2023 was the time that fiscal discipline might be more thoroughly enforced by bond markets, some encouraging inflation prints and the dovish December meeting of the Federal Open Market Committee (FOMC) once again relegated fiscal concerns to the back burner.

However, fundamental forces do not operate in a vacuum – and here is where other momentum and technical indicators can help play a role over shorter-term horizons. Lower policy rates may well flatter fixed income performance, but what if the six rate cuts priced into Fed Funds futures markets do not materialize (see Figure 7)? The same question stands for Europe, where a dovish December pivot was unequivocally denounced — yet the market points to a comparable amount of easing as in the United States. And while establishing new trends from a moving average perspective is a development not to be overlooked unless European bond markets are sniffing out something more sinister in the economic environment, the rally seems a bit overdone. For context, the most recent rally in German bunds was the sharpest since 2011 when Europe was in the throes of the Greek debt crisis and the US debt ceiling debacle also drove investors to higher-quality bonds. With this much interest rate volatility, our momentum indicators have faded such that bond markets may be more susceptible to some mean reversion in early 2024.

Figure 7
Implied Federal Funds Rate in 2024



Source: FactSet as of January 2, 2024.

Gold Finds Support from Technicals and Fundamentals

Although the slower growth environment is one that may create challenging conditions for commodity performance, particularly when momentum has been sluggish and broadening contango increasingly chips away at returns, we continue to see a strong setup for gold. Unlike the major equity indices covered earlier, gold did not have to wait until 2024 to set new nominal highs. The strong performance in December that saw gold push up toward $2,100 per ounce was enough to vault past prior highs made in the aftermath of the Russia invasion of Ukraine in 2022 and during the regional bank crisis in the spring of 2023. That new all-time high lifted the last of our technical indicators to embrace the idea that gold is firmly in a positive trend — a very strong reading at present. Couple that with some reinforcing macro conditions, including a weaker US dollar and easing policy rates, and the rally in gold looks to be in good shape at the onset of 2024.

Simon Says Simplify, But Not Too Much

If we return to our inspiration for classification and were able to converse with Simon Kuznets about the state of global economies and markets today, several observations stand to reason. For one, it is quite unlikely that he'd be stunned to find that Japan and Argentina continue to play the role of outliers in both economics and policy. And, as a Nobel prize winning economist of the 1970s he would probably not be terribly surprised to see the world dealing with the ramifications of another inflation shock. More sadly, as someone who studied in Kharkiv around the time of the Russian Civil War, present geopolitical conflicts might not seem to be much of an outlier either. But, if we take his tongue-in-cheek taxonomy as a lesson in avoiding oversimplification — at least as it relates to capital market analysis — then hopefully our differentiated views across and within asset classes will prove profitable in the year ahead.

Sources: Bloomberg, FactSet, J.P. Morgan, Barclays, MSCI, Morgan Stanley and The Economist as of December 31, 2023.

Endnotes

1 Simon Kuznets via The Economist March 28, 2019 "How Argentina and Japan continue to confound macroeconomists."

2 Argentina was removed from the MSCI Emerging Markets Index in 2021.

3 Trend measured by comparing the 50 day moving average (DMA) in yield to the 200 day moving average. When the 50 DMA moves below the 200 DMA it is suggestive of a declining trend and vice versa.

State Street Global Advisors Forecasts as of December 31, 2023

	2023 (%)	2024 (%)
Real GDP Growth		
Global	2.9	2.4
US	2.4	1.4
Australia	2.1	1.6
Canada	1.1	1.0
Eurozone	0.6	0.9
France	0.8	1.0
Germany	-0.2	0.8
Italy	0.9	0.9
UK	0.4	0.8
Japan	1.9	1.0
Brazil	3.0	1.9
China	5.1	4.4
India	6.3	6.0
Mexico	2.0	1.3
South Africa	0.6	1.2
South Korea	1.2	1.4
Taiwan	1.0	2.8
Inflation		
Developed Economies	5.1	2.8
US	4.1	2.5
Australia	5.7	3.7
Canada	3.5	2.5
Eurozone	5.4	2.4
France	4.9	2.5
Germany	6.0	2.0
Italy	5.8	2.3
UK	7.4	2.9
Japan	3.3	2.6
China	0.2	1.0

	December 31, 2023 (%)	December 31, 2024 (%)
Central Bank Rates		
US (upper bound)	5.50	4.00
Australia	4.35	4.00
Canada	5.00	4.00
Euro	4.50	3.50
UK	5.25	4.25
Japan	-0.10	0.10
Brazil	11.75	8.00
China	4.35	4.25
India	6.50	5.50
Mexico	11.25	8.00
South Africa	8.25	7.00
South Korea	3.50	2.75
10-Year Bond Yields		
US	3.88	3.29
Australia	3.96	3.84
Canada	3.10	2.60
Germany	2.00	1.61
UK	3.53	3.03
Japan	0.61	0.83
Exchange Rates		
Australian Dollar (A$/$)	0.68	0.75
British Pound (£/$)	1.27	1.35
Canadian Dollar ($/C$)	1.32	1.22
Euro (€/$)	1.10	1.15
Japanese Yen ($/¥)	140.98	127.00
Swiss Franc ($/SFr)	0.84	0.91
Chinese Yuan ($/¥)	7.09	6.85

One-Year Return Forecasts	USD (%)	EUR (%)	GBP (%)	JPY (%)	AUD (%)	CAD (%)
S&P 500	6.5	2.3	0.6	-4.1	-3.1	-1.5
Russell 2000	6.7	2.5	0.8	-3.9	-2.9	-1.3
MSCI EAFE	5.9	1.7	0.0	-4.6	-3.7	-2.0
MSCI EM	8.2	3.9	2.2	-2.5	-1.6	0.1
Barclays Capital Aggregate Bond Index	4.8	0.7	-1.0	-5.6	-4.7	-3.0
Citigroup World Government Bond Index	3.0	-1.1	-2.7	-7.2	-6.3	-4.7
Goldman Sachs Commodities Index	0.8	-3.2	-4.8	-9.2	-8.3	-6.7
Dow Jones US Select REIT Index	5.6	1.4	-0.3	-4.9	-3.9	-2.3

State Street Global Advisors Forecasts, as o December 31, 2023.
The above estimates based on certain assumptions and analysis made by State Street Global Advisors. There is no guarantee that the estimates will be achieved.

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- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

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* Pensions & Investments Research Center, as of December 31, 2022.
† This figure is presented as of September 30, 2023 and includes approximately $58.13 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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