Market Forecasts
Q2 2024

Global Economic Outlook

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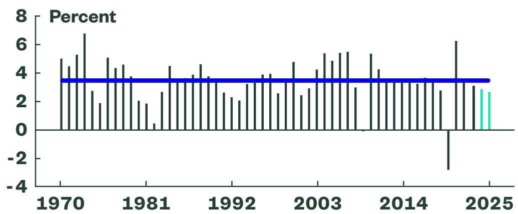
Figure 1
Gentle Step Down in Global Growth



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 March 22, 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.

- Global GDP growth is set to slow moderately from an unexpectedly robust expansion in 2023, with gentle declines to a little further below long-run averages anticipated in both 2024 and 2025.
- Non-linear progress on inflation is still progress and allows central banks to nurture the soft landing scenario via moderate rate cuts during the second half of 2024.

Emerging Markets Outlook

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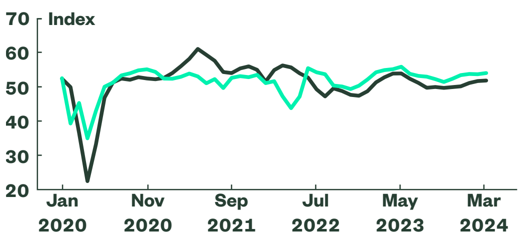
Figure 2
Purchasing Managers' Indexes Perk Up



World, Developed
World, Emerging

Sources: Macrobond, State Street Global Advisors Economics, S&P Global, as of March 31, 2024.

- For emerging markets, the more pro-growth policy backdrop in China provides support to EM economic prospects. Improving business activity in export markets such as the US and Europe is also key.
- Recent bumpy inflation readings have renewed uncertainty around the timing and magnitude of rate cuts. Until the monetary easing impetus broadens across the globe, the improvement in EM growth will likely be subdued.

Global Capital Markets

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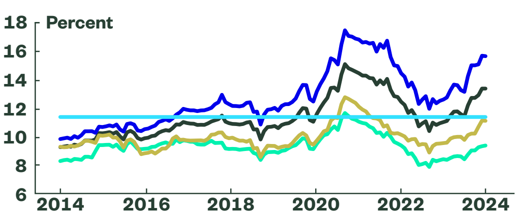
Figure 3
Market Valuation Measures on the Rise



MSCI World Index — EV to EBITDA
MSCI Europe — EV to EBITDA
MSCI USA — EV to EBITDA
MSCI Pacific — EV to EBITDA
(AVG) MSCI World Index — EV to EBITDA

Source: State Street Global Advisors, Factset as of March 31, 2024. Past performance is not a reliable indicator of future performance.

- Even as more equity markets eclipse all-time highs, we continue to see a solid foundation for them to advance amid resilient economic growth, healthy balance sheets, and supportive earnings and sales expectations.
- Over the intermediate term, bond markets also look attractive, but the economic resilience that may benefit equities (alongside stubborn inflation) presents near-term risks for fixed income investments.

Global Economic Outlook

Simona Mocuta
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The world economy is now estimated to have expanded by 3.1% last year, slower than the 3.5% advance in 2022 but much better than initially anticipated. Given elevated interest rates, this degree of resilience is notable indeed.

The three largest economies had much to do with the robust performance. Bucking earlier expectations of a slowdown, US growth actually improved to 2.5% from 1.9% the prior year amid resilient consumers, a big boost from government spending, and less drag from foreign trade. Meanwhile, on the heels of a much-delayed reopening, the Chinese economy grew 5.2%, far ahead of the 3.0% increase in 2022. In Japan, growth nearly doubled to 1.9% as much better trade and investment outcomes offset softer consumer spending. Elsewhere, the performance was much less impressive. In Europe, the delayed impact of high inflation and rising interest rates undermined both consumer spending and fixed investment and brought economies to a near standstill both in the UK and the eurozone. Outside of China, the rest of the emerging market universe had a widely varied performance. Resilience in countries like India, Mexico, and Indonesia was countered by notable deceleration in Poland, Colombia, and Malaysia, among others.

The good news is that global disinflation continued and broadened as we had been expecting. As a result, with very few exceptions (e.g., Japan, Taiwan, Turkey), the global monetary policy tide has already shifted towards careful easing. Among key developed markets, only the Swiss National Bank has actually delivered a rate cut so far, but by the middle of this year, both the ECB and the Fed look likely to have joined it. From there on, a broadening global easing cycle should help put a floor under global growth, which then drifts a little further below long-run averages, but not by much.

United States: The Best of Both Worlds?

Last December, we wrote in our quarterly commentary that the continued improvement in inflation readings had allowed the Federal Open Market Committee (FOMC) to forgo a final hike in 2023 and signal three (rather than two previously) cuts in 2024. At the time, we stated our belief that there would be more but that the FOMC would likely need additional data evidence to align with our forecasts. The market then was pricing 150 bps worth of Fed cuts in 2024, which we noted as being a reasonable baseline scenario that could skew higher if recession was to develop or lower if yet “another wave of data resilience manifests.”

What has transpired since then can be summarized as "another wave of data resilience." H2 2023 real GDP averaged 3.0% year-over-year (y/y), nearly one percentage point higher than the first-half average as consumer spending improved a little, government spending improved a little more, and investment improved a lot more. Within investment, the story remains divided. Private fixed investment is benefiting from a boom in non-residential structures and a revival in residential construction. In Q4, the latter posted its first positive y/y growth in two years. Other parts of private fixed investment are not doing nearly as well: business fixed investment in equipment has declined y/y in Q3 and in Q4. Government investment is on a tear, up 10.9% y/y during the second half of 2023. The growth benefit stemming from previously-approved fiscal packages played a key role in why the US outperformed both consensus expectations and developed market peers. Indeed, the US economy grew 2.5% last year, up from 1.9% in 2022.

Progress on Inflation Merits Fed Response

Notwithstanding the impressive economic growth performance, and even though the unemployment rate was just 3.7% in December, headline CPI inflation nearly halved from 8.0% in 2022 to 4.1% last year (annual averages). Progress on core CPI inflation was more modest, declining from 6.2% to 4.8%; core PCE inflation moderated from 5.2% to 4.1%. The latter is now showing more pronounced disinflation, with the January reading down to 2.8% y/y.

Such a rare combination of trends should be celebrated. One may be reticent of using grand terms, but 2023 can be fairly described as having brought the best of both worlds for the US economy. After all, strong growth with powerful disinflation is the quintessential soft-landing scenario.

But is there too much of a good thing? We still do not believe so, but we worry there might be. That wave of renewed resilience evident in the January-February employment and inflation data is once again threatening the Fed's confidence that inflation is progressing sustainably towards the 2.0% target. We have been forced to push back our expectations for the first Fed rate cut from May to June, which makes it difficult to get all 150 basis points worth of 2024 rate cuts that we anticipated back in December. We are looking for 100-125 bps of cuts now, with comparable odds between the two outcomes.

From our standpoint, we think 125 bps worth of cuts this year would be better for two main reasons:

1. Monetary policy works with very long lags and the Fed is now making policy not for 2024 but for 2025.

2. The totality of indicators suggests labor demand is actually moderating, wage pressures are easing, and risks to the outlook are growing.

As we have argued before, we would prefer to see the Fed nurture the evolving soft landing and that means calibrating policy lower as inflation allows. Despite the upside inflation surprises in January and February, we think progress on inflation so far no longer requires the same degree of policy restrictiveness.

Fed Rates to Approach Neutral Territory

The new dot plot from the March meeting maintained three rate cuts for 2024, but removed one in 2025 (only three now expected versus four in December 2023). The FOMC has also nudged its long-term neutral rate estimate up a tenth to 2.6%. These changes suggest that the committee agrees that the economy no longer needs as much monetary policy restraint, but that restraint may have to be retained for longer than previously thought. This may well prove to be true, but it is hard to have a high conviction that this will indeed be the case. As to the uptick in the neutral rate, we agree with the move and in fact expect it to move higher still to match our own 2.75% estimate. We see this not so much as a high conviction estimate (certainly not on our part and likely not on the FOMC's part either) but more of a risk management exercise to respond to new somewhat inflationary trends like supply-chain restructuring and the green transition. Even so, a higher neutral rate (especially a change of such magnitude) should not have any bearing on 2024 rate decisions since the current level of Fed Funds is so far above that estimate.

For the time being, we pencil in another 125 bp worth of cuts for 2025. This would leave the Fed Funds upper target at 3.0% at the end of next year, close to neutral territory. It is rare that once a cutting cycle begins, the policy rate does not fall below the estimated neutral rate. However, this cutting cycle is driven by disinflation rather than economic weakness and so it can end up being shallower. Since we do not forecast a recession and as we forecast the unemployment rate to only rise to the mid-4.0% by the end of 2025, having the policy rate only approach neutral seems a reasonable expectation, especially since we also don't expect the core PCE forecast to touch 2.0% y/y until the latter part of 2025.

Regarding balance sheet policy, nothing was officially communicated in the March statement, but Chair Powell mentioned during the press conference that the time to slow balance sheet runoffs could arrive "fairly soon". Reading between the lines, we would expect a formal announcement at the May meeting. As we ourselves have done, Chair Powell highlighted the value of "slower for longer" on balance sheet: by moving more carefully, the Fed can avoid triggering undue stress and needing to end QT before it would otherwise choose to do.

There remain two-sided risks to the macro outlook, although the more time goes by, the more relevant downside risks become. As excess labor demand fades, the corporate refinancing wall approaches, and fiscal cliff risks near, the economy's performance could deteriorate faster than currently anticipated; in this scenario, the Fed has made clear that it would respond more powerfully. Similarly, the economy's resilience so far cannot be ignored; there is a possibility the lingering fiscal boost from the CHIPS Act continues to drive faster investment growth than we currently pencil in. There remain some upside risks on the inflation front as well, especially in housing, where inelastic supply is being challenged by, among others, resurgent immigration flows.

Eurozone: Some Bright Spots

2023 was far from a great year for the eurozone economy, but — with the exception of Germany — neither was it downright bad. The regional economy grew 0.5%, a tenth less than we estimated back in December but down sharply from 3.4% in 2022. We still think revisions may ultimately put that number a little higher, but for now we work with the numbers as reported.

Challenged by high inflation, consumer spending slowed drastically over the course of the year. Fixed investment held up well, but inventory accumulation slowed and was a drag on performance. Exports were surprisingly weak given the resilience of both US and Chinese growth, but this is a reminder that the eurozone also trades a lot with the UK. In other words, there was little help to be had on the growth side from either corner of the economy.

There were two bright spots in this otherwise underwhelming picture, and they are important as they carry the seeds of future improvement. One is the resilience of the labor market, with the unemployment rate touching new lows. The other is the deep disinflation trend seen over the course of last year; headline inflation was down from an average of 8.4% in 2022 to 5.5% in 2023. On a December-to-December basis, the improvement was even starker: from 9.2% y/y in December 2022 to 2.9% y/y in December 2023.

Growth in 2024, But Modest

The combination of steady employment, strong nominal wage gains, and material disinflation, speaks to a delayed yet powerful boost to real consumer incomes in 2024. It is quite likely that a conservative predisposition — especially among German consumers — will limit the positive impact of this on consumer spending. But we doubt it would entirely offset it. So, we still look for above consensus growth of 0.8% this year (down a tenth from December), followed by 1.3% in 2025.

Despite the region's weak growth and steep disinflation, the European Central Bank (ECB) has been so far reluctant to initiate an easing cycle due to latent inflationary pressures stemming from the labor market. The ECB indicator of negotiated wages has only recently peaked and remains historically very elevated. The ECB decision to wait was warranted, but we think the door is open to start dialing back policy restriction and we look for a total of 100 basis points worth of cuts this year. Both the timing and the magnitude are the same as in our December forecasts. There is a chance the ECB may be able to do a little more, but the labor market would have to show a more meaningful pullback in wage inflation for that to happen.

United Kingdom: Brightening Growth Outlook

Following a shallow technical recession in the second half of 2023, the UK economy should improve a little this year. We have maintained our 0.8% real GDP growth forecast for 2024 and expect 1.5% growth in 2025 as business investment and household consumption pick up.

GDP growth in Q4 slightly undershot expectations as large declines in trade and household spending offset investment gains. But, given lower inflation and real income gains, we anticipate that consumer spending will pick up firmly in coming quarters. Business investment and housing activity (which saw large declines last year) should also recover, albeit at a more muted pace. Meanwhile, UK purchasing managers' indices (PMI) point to a brighter outlook. Manufacturing production ended a twelve-month period of contraction, supported by strong new orders. Services experienced another robust expansion in March, driven by rising business and consumer spending.

Inflation and Employment Market Pressures Ease

Inflation surprised to the downside again in February, with the headline rate down six tenths to 3.4% y/y. The deceleration was broad-based. Importantly, core inflation took a big step down, easing from 5.1% to 4.5%. Given the improved outlook for inflation, we downgraded this year's forecast by two tenths to 2.5% and expect 1.7% CPI inflation in 2025.

The latest data revealed further easing in the labor market, albeit at a marginal pace. The growth in average total pay (including bonuses) for the three months to January eased two tenths to 5.6% y/y, with growth in regular pay (excluding bonuses) also edging down to 6.1%. However, private sector pay growth remains above Bank of England (BoE) forecasts. Meanwhile, labor demand continues to ease with vacancies down for the twentieth consecutive period to 908k. The unemployment rate inched up to 3.9% but with the usual caveat that there is "increased volatility of Labour Force Survey (LFS) estimates." We expect wage pressures to ease further in the next few months.

As expected, the BoE's Monetary Policy Committee (MPC) left the Bank rate of 5.25% unchanged at the March meeting, with no votes favoring a hike for the first time since September 2021. The MPC kept their hawkish guidance but seem to be gaining confidence that inflation is moving back to the 2% target. The data will decide when rates are cut, but given the improved inflation outlook, we now expect 100-125 basis points of cuts this year (up from 100bps previously) and think that a June rate cut is possible.

Japan: The Great Normalization

In March 2024, the Bank of Japan (BoJ) finally ended its Negative Interest Rate Policy (NIRP) and Yield Curve Control (YCC) and began normalizing monetary policy. They also formally ended ETF and J-REIT purchases. The target range for the uncollateralized overnight call rate will now be 0.0%-0.1%, and there will be a uniform +0.1% interest rate on all Current Account Balances (reserves/CABs).

These moves may seem deceivingly small, but they mark the beginning of a great normalization process. If inflation continues to hover near the 2% target and wages continue to trend higher, we expect the BoJ to raise the policy rate to 0.25% by December 2024 and then to 0.75% next year. The balance sheet may expand at a smaller pace, or even decline slightly over the medium term, as the BoJ reduces JGB purchases, while the government borrows less.

The economy will benefit from this normalization on higher interest rates, which could add additional interest income, as households are net creditors. This could only improve as the new NISA rules led Japanese investors to already move their savings into higher yielding assets.

Potential Tailwinds Emerge

Real consumption may get a shot in the arm from wages in the second half of 2024. The record shunto initial outcome of a 5.28% wage increase at large firms was above expectations. This number may decline as the results for the 84% non-unionized Japanese unfold; still, we expect the final outcome to be above 4.0%, higher than in 2023. Furthermore, we think price effects that had depressed real consumption will fade this year as inflation eases.

As such, the dispersion between nominal and real consumption has risen to an all-time high. So consumption will benefit from high wage growth, declining price effects, and higher interest income.

Capital expenditures and exports — key pillars of growth — are robust. Capex plans tracked by the Japan Construction Research Institute showed record growth for Q2; this is a good leading indicator of investment in the GDP accounts. Net real exports will also offer some resiliency; in the first two months of this year, real exports averaged 9.7% y/y, while imports declined 5.0%. We hence expect GDP growth to average 1.0% in 2024 and then rise to 1.3% in 2025.

We expect inflation to ease this year but remain around the 2% BoJ target over the medium term. CPI inflation is already moderating on base-effects in goods prices, and on declining commodity prices. However, higher services prices offer crucial support in maintaining price pressures; services prices rose sequentially for eight consecutive months through February, the longest in 15 years. Furthermore, inflation could benefit from a weak yen as well. All in all, we expect the CPI to average 2.2% y/y in 2024 and then ease to 1.8% in 2025.

Emerging Markets Outlook

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For emerging markets, much attention will be focused on finding clarity for the timing of monetary easing in the United States and other key export markets, given its implications for EM growth prospects.

There is growing evidence that global manufacturing is trying to put in a bottom. Interestingly, this is mostly a reflection of activity nearing a break-even point in developed markets, as emerging markets had been leading the recovery on this front. Indeed, the S&P Global manufacturing purchasing managers' index for emerging markets had held above the neutral 50 mark consistently since February 2023, whereas the developed market (DM) counterpart had last exceeded 50 back in September 2022.

A somewhat similar dynamic has been playing out in services as well, resulting in an overall narrative of DM recovery and EM reacceleration. Given the intra-EM dispersion in growth performance, it would be a mistake to overlink this reacceleration to an earlier monetary policy easing cycle, but there is some truth to this as the rate-cutting cycle has already selectively begun in emerging markets. The more pro-growth policy backdrop in China also helps. A bottoming out of commodity prices lifts EM export earnings and budget revenues, reinforcing a gradual improvement.

Still, the next few months are more likely to mark a "holding" period rather than a genuine break higher. Recent bumpy inflation readings have driven renewed uncertainty around the timing and magnitude of rate cuts in the US and other key export markets. Until the monetary easing impetus broadens across the globe, the improvement in EM growth will likely be subdued.

Global Capital Markets Outlook

Jerry Holly
Senior Portfolio Manager
Investment Solutions Group

Even with more equity markets eclipsing all-time highs and some relatively stretched sentiment measures, we continue to see a solid foundation for them to advance amid resilient economic growth, healthy balance sheets and supportive earnings and sales expectations. Over the intermediate term, bond markets also look attractive, but the same economic resilience that may benefit equities (alongside stubborn inflation) leads to more prominent near-term risks for fixed income investments.

Strange Bedfellows

It's not often that we look for capital market inspiration from Sesame Street characters and French grocery chains. But Cookie Monster and Carrefour might be onto something. Cookie Monster, the venerable and voracious Muppet, is also a high-profile opposition figure against surreptitious product down-sizing. In a tweet from early March, the character exclaimed: "Me hate shrinkflation! Me cookies are getting smaller." For its part, Carrefour, whose forward price-to-earnings ratio is not too far above its current dividend yield, has sought to defend consumers (and its own margins) by placing "shrinkflation labels on products that had shrunk in volume but maintained or increased in price on its shelves."[1] Kudos to both Sesame Street and Carrefour for fighting the good fight in this regard. And while we may not have to worry too much about shrinkflation impacting common consumer price indexes such as the CPI, due to its focus on unit costs, it is encouraging to see a light shined on those practices that exploit the ongoing inflation wave.

How to exploit mis-pricings that may have arisen as the inflationary wave has evolved is a different question altogether. Resilient economic activity and earnings may provide some comfort to equity market investors. But sticky inflation trends and concerns about prolonged levitation in interest rates have already dented forward progress in bond markets and may eventually cause equities to hesitate. That same economic resilience, alongside geopolitical risks, has supported commodities early in 2024. However, it's hard to envision either equity or bond markets staying afloat if a continued commodity rally leads to upward pressure on inflation expectations.

Our view of how best to navigate this environment is one which also joins some strange cross-asset bedfellows in our portfolio construction. A meaningful overweight to global equities is the most prominent risk allocation in our portfolios at the moment. But it is paired with sizable overweight positions in cash and gold — both of which are normally viewed as so-called safe havens. So how do we square this circle of seemingly conflicting ideas? A deeper dive into our analysis and market drivers will help to explain.

Risk Sentiment a Little Stretched

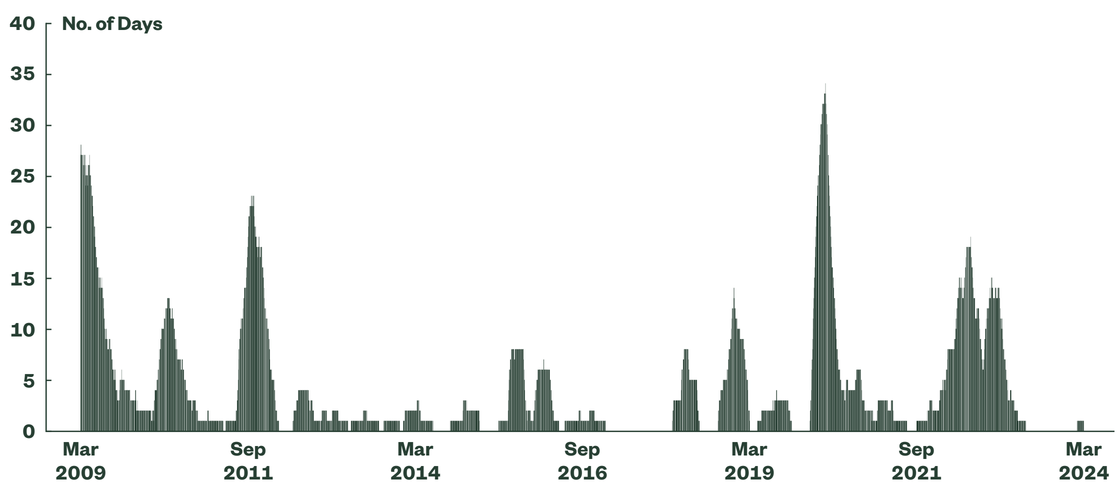
From a risk environment perspective, 2024 has been characterized by relatively benign risk regimes according to analysis using our Market Regime Indicator (MRI). Although equity volatility has started to establish a pattern of perking up around key inflation prints, implied volatility in currency markets and spreads for emerging market bonds remained firmly anchored. Some signs of normalization with respect to central bank policy have contributed to the relatively rosy risk outlook as the Bank of Japan exited negative interest rate policy and the Swiss National Bank reduced its own policy interest rate. While these developments continue to point towards a constructive environment for risk assets, risk aversion may have come too far and too fast.

In other signs that investors may be a touch over-exuberant we could look to recent activity in cryptocurrency and convertible bond markets. It has been less than two years since much of the cryptocurrency ecosystem imploded, yet billions of dollars have been flowing into the nascent bitcoin ETF market. The convertible bond market also seems to be stepping towards questionable practices last seen in 2020 and 2021 when the likes of Beyond Meat and Peloton were able to issue convertible debt with zero coupons. Super Micro Computer has taken the baton in the latest boom of convertible debt issuance and will need to add over $20 billion to its market capitalization for the securities to eclipse their conversion price.

A simpler way to visualize the low volatility environment can be found in Figure 4, where we can see the number of 2% (up or down) trading days in the S&P 500. To put the peaks and valleys into context, when the chart ticks up to around 30 that means that the S&P 500 experiences 2% moves (up or down) on roughly half of the trading days in that particular window. And we can see that since the fall of 2023, large moves in the market have been virtually non-existent. A sign of complacency? Perhaps. But is it a sign of imminent market drawdowns? Not necessarily. But for us it does mean that we have pared back our overall equity exposure — even if we remain overweight on balance.

Figure 4
No. of 2% Up/Down Days in S&P 500 (Mar 2009 — Mar 2024)

60-Day Moving Window

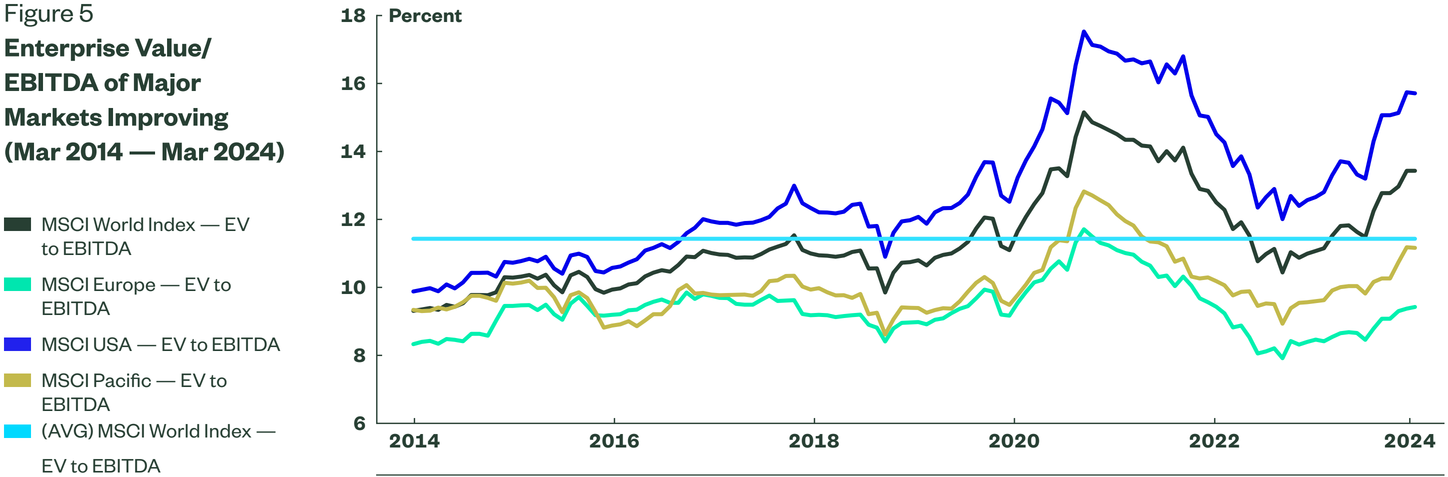


Source: State Street Global Advisors, Factset as of March 31, 2024. Past performance is not a reliable indicator of future performance.

Equity Markets: All-Time Highs and Then Some

In the prior edition of Market Forecasts, we assessed key global stock markets in relation to their all-time highs as certain markets were already on the cusp of eclipsing past peaks (S&P 500), while for others the achievement appeared more of a stretch (Nikkei, Eurostoxx). To quote: "On the one hand, putting in all-time 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." That assessment continues to ring true today, notwithstanding the strong Q1 markets where the Nikkei managed to post fresh all-time highs and the Eurostoxx Index put in a meaningful march towards besting the prior highs notched over two decades ago. While our outlook on stock markets remains constructive, our expected returns have been steadily compressing on a lookback basis the past six-to-twelve months. The grind higher in equity markets has been met with a similarly consistent downturn in valuation metrics, including dividend and free cash flow yields. Of course, multiples also point to a market that has become more expensive — whether looking at price-to-earnings multiples or more capital structure agnostic measures such enterprise value in relation to earnings before interest, taxes, depreciation and amortization (EBITDA) (see Figure 5). But with still solid expectations for earnings and sales growth, high quality balance sheets, and improving momentum, we continue to see a better near-term outlook for equities than most other assets.

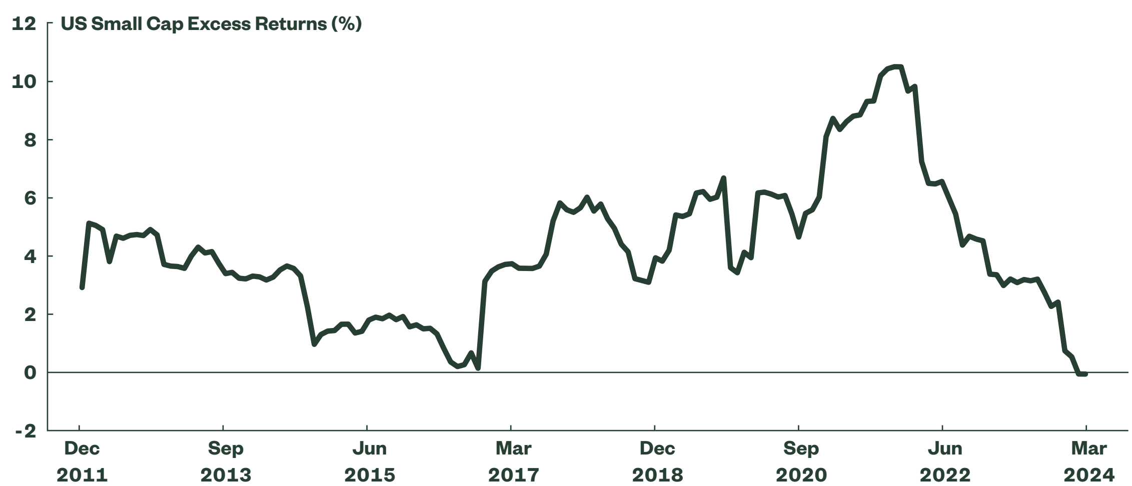
Figure 5
Enterprise Value/EBITDA of Major Markets Improving (Mar 2014 — Mar 2024)



Source: State Street Global Advisors, Factset as of March 31, 2024. Past performance is not a reliable indicator of future performance.

As a preview to our evaluation of bond markets, we continue to see some modest upside pressure on interest rates even if our intermediate horizon view sees short-term policy rates lower at year end 2024. Extrapolating that view into equity markets might cause some consternation with our optimistic outlook for areas like US small caps — at least given recent market moves where higher rates have seemingly cut small caps down to size. But there are competing schools of thought in terms of judging the sensitivity of small cap equities to interest rates. One perspective sees higher interest rates as favorable for small caps as the higher interest rate environment usually coincides with periods of improving economic growth. However, others think that higher rates subject small caps to additional financing burdens — especially as they have less capacity to fund themselves from internal cash flows. Over the long-term, the data would suggest that the former interpretation is right more often than not. Figure 6 plots the regression slope coefficient for US small cap equity excess returns relative to changes in the 10-year Treasury yield.[2] The average coefficient has been around 4.0 — which means that if the 10-year US Treasury yield were to rise by 20 basis points in a month, we'd expect small caps to deliver excess returns (vs large cap) on the order of 80 basis points. However, one can see why market participants might gravitate toward the interpretation that small cap stocks get tripped up due to higher financing costs as that has been the direction of travel for the past two years. But historically that relationship doesn't persist for too long and with other comparative advantages including relatively cheaper valuations, a benign risk environment, and better stock market internal characteristics (like dispersion), we think small caps can stabilize and turn the corner.

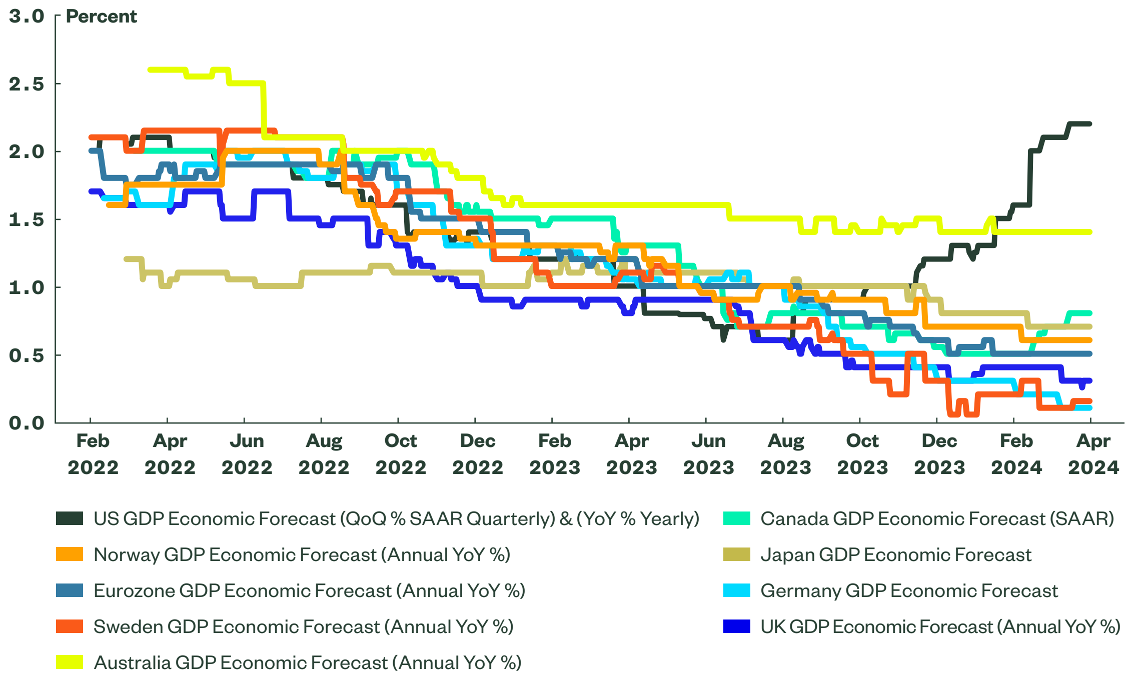
Figure 6
US Small Cap Excess Returns and Interest Rates (2011–2024)



Source: State Street Global Advisors, Factset as of March 31, 2024. Past performance is not a reliable indicator of future performance. Small cap excess return represented by the return of the S&P 600 Small Cap Index less the return of the S&P 500 Index. The rolling slope coefficient uses a 36-month window.

So if we can maintain a bullish stance on US small cap equities in the face of potential interest rate headwinds, what is the outlook for other equity markets? Overall, the US equity market remains our favorite and we hold overweight allocations to both small and large cap stocks. For the large cap position, strong momentum, healthy balance sheets, superior sentiment and significantly stronger growth expectations (see Figure 7) all support that market. But we also see some green shoots in emerging market equities which have started to stabilize on a relative basis when compared with US equities. Here the drivers are different as momentum across emerging markets has been weak and the asset class is supported by relatively attractive valuations. But it's not just a valuation story for EM in our opinion — improving fund flows to the EM regional equity markets and a stronger-than-expected overall growth outlook contribute to our optimistic stance. And while that relatively firm economic backdrop should benefit developed and emerging markets broadly, we remain more cautious on non-US developed markets, particularly in Europe.

Figure 7
GDP Revisions Across Select Developed Markets (Feb 2022–Apr 2024)



Source: State Street Global Advisors, Bloomberg, Macrobond as of April 10, 2024.

Although European equities have made progress in tracking down all-time highs, the last bout of meaningful outperformance came at the tail end of 2022 when the US dollar started to lose its safe haven bid and appreciation in the euro accounted for roughly half of the total return of European shares. Today we see a set of equities that, in relative terms, ranks poorly across all metrics with the exception of valuations. And while we do see room for the euro to advance versus the dollar over the long term, we see little in the way of near-term catalysts to unlock that potential value and so we'll bide our time with European equities.

Tough Timing in Fixed Income

While on the topic of seeking to unlock value, there should be no clearer catalyst to prop up bond prices than the start of a central bank easing cycle. Lower short-term policy rates which cascade through easing real interest rates and render a somewhat steeper yield curve would be the typical pattern in this scenario. And we do think that path of outcomes will eventually be realized, but the timing here is the tricky bit and our research suggests that it is not yet time to position for that eventuality.

That same economic resilience that we see providing some support to equities serves as the primary hurdle to near-term progress for bond markets. With nominal GDP in the United States running at close to 6% and purchasing manager indexes pointing to expansionary conditions in the US and globally, the extent of bond price appreciation at the moment appears constrained — even if central bank policymakers effectively separate their inflation fighting objectives relative to other mandates pertaining to labor markets, economic growth or financial stability. There are other good reasons to question the degree to which interest rates are likely to fall throughout the remainder of the year — notably the fiscal deficit and debt position of the United States where the Congressional Budget Office (CBO) projects ever-increasing budget deficits.[3] This may be particularly important in an election year where efforts to rein in the deficit will likely be few and far between. But any contest between potential bond vigilantes enforcing fiscal discipline and central bankers recalibrating real interest rates is more likely in the back half of the year.

In credit markets, we see some more interesting opportunities, particularly in high yield bonds. Although valuations in spread terms are quite tight relative to history for both investment grade and high yield bonds, the present low volatility and firm growth backdrop should be supportive of credit spreads. Additionally, the decline in interest rates that has occurred since last October coupled with consistent tightening of credit spreads has provided an environment where high yield issuers have continued to refinance debt and reduce the severity of the maturity wall that had been looming towards year-end 2024 and into 2025. Add in some favorable seasonality for high yield bonds and still elevated all-in yields at close to 8% and we think demand can remain solid for lower quality credits.

We also maintain a favorable outlook for assets at the other end of the fixed income risk spectrum in the sense that we hold a good amount of excess cash. Given the still inverted yield curve, on a yield basis alone there are not many other fixed income assets that sport better yields than Treasury bills. Add in our expectation of near-term pressure on interest rates and the cash advantage becomes even more pronounced.

Precious Metals over Broad Commodities

As mentioned earlier, our overall bullish outlook on the (stock) market is coupled with some more defensive postures. In addition to cash, we continue to like gold in this environment — something which the broader market has seemingly come around to as well. From a price standpoint, it doesn't take an expert in technical analysis to come to the conclusion that gold is in a strong uptrend. Whether we look at the current gold price relative to a moving average, a price channel, or a regression trendline, the signal is clear — gold benefits from a firm price trend. From a fundamental perspective, the outlook is more mixed. The continuing resilience of the US dollar, all else equal, could be a headwind for further progress in gold prices. And if real rates are slightly more delayed in their deceleration that too could complicate matters for gold. But with deficits still wide and Chinese demand supported by a lack of alternative savings vehicles, the overall outlook for gold continues to look good. And the increasingly uncorrelated performance of gold relative to equity markets also adds support for the metal, particularly given our overweight to equity markets.

Broader commodity markets have enjoyed a relatively orderly rally since mid-February when natural gas prices stopped sliding and solid momentum in other hallmark commodity markets such as crude oil and copper continued. And given the geopolitical risks in the Middle East and in Russia/Ukraine there are observable potential catalysts for sharper upside price action. But the orderly rally has not yet translated into attractive price trends, at least when compared to other growth-exposed asset classes. And while the geopolitical risks are real, our baseline market outlook does not call for another energy shock — however it is derived. With non-OPEC oil supply holding firm and negative roll yields increasingly prevalent within individual commodity markets, we prefer to take our active risk elsewhere.

On Avoiding Investment Shrinkflation

Although a bullish stance in a multi-asset portfolio may not often be paired with meaningful investments in safe haven assets such as gold and cash, we think the balance makes sense in the current environment. There is, of course, a diversification benefit to be had by blending investments that will respond in uncorrelated ways to various market scenarios. But even in a baseline where growth holds up and questions related to progress on inflation persist, ongoing progress in equity markets is not inconsistent with ample returns from safe haven hedging assets like gold and cash. And, in our view, this mix might just be the best way to avoid shrinkflation in portfolio values as we move into the middle of 2024.

Sources: Bloomberg, FactSet, J.P. Morgan, Barclays, MSCI, Morgan Stanley and The Economist as of March 31, 2024.

Endnotes

1 Klasa, Adrienne and Madeleine Speed. “French retailer Carrefour drops PepsiCo products over high prices.” Financial Times. January 4, 2024.

2 Small cap excess return represented by the return of the S&P 600 Small Cap Index less the return of the S&P 500 Index. The rolling slope coefficient uses a 36-month window.

3 Congressional Budget Office. *The Long-Term Budget Outlook: 2024–2054*. March 2024.

State Street Global Advisors Forecasts as of March 31, 2024

	2024 (%)	2025 (%)
Real GDP Growth		
Global	2.9	2.7
US	1.9	1.4
Australia	1.7	2.3
Canada	1.0	1.4
Eurozone	0.9	1.3
France	1.0	1.2
Germany	0.6	1.1
Italy	0.9	1.2
UK	0.8	1.5
Japan	1.0	1.3
Brazil	0.9	1.8
China	4.6	4.2
India	7.0	6.5
Mexico	1.9	2.1
South Africa	0.7	1.4
South Korea	1.8	1.9
Taiwan	2.8	2.5
Inflation		
Developed Economies	2.9	2.3
US	2.9	2.3
Australia	3.3	2.7
Canada	2.5	2.2
Eurozone	2.4	1.8
France	2.6	1.5
Germany	2.0	1.9
Italy	2.2	1.8
UK	2.5	1.7
Japan	2.2	1.8
China	0.4	1.6

	March 31, 2024 (%)	March 31, 2025 (%)
Central Bank Rates		
US (upper bound)	5.50	4.00
Australia	4.35	3.75
Canada	5.00	3.75
Euro	4.50	3.00
UK	5.25	3.75
Japan	0.10	0.25
Brazil	10.75	7.75
China	2.50	2.30
India	6.50	5.75
Mexico	11.00	8.25
South Africa	8.25	7.50
South Korea	3.50	2.75
10-Year Bond Yields		
US	4.20	3.68
Australia	3.97	3.74
Canada	3.47	3.09
Germany	2.29	1.75
UK	3.92	3.32
Japan	0.70	0.90
Exchange Rates		
Australian Dollar (A$/$)	0.65	0.70
British Pound (£/$)	1.26	1.31
Canadian Dollar ($/C$)	1.35	1.29
Euro (€/$)	1.08	1.12
Japanese Yen ($/¥)	151.35	133.00
Swiss Franc ($/SFr)	0.90	0.95
Chinese Yuan ($/¥)	7.23	6.90

One-Year Return Forecasts	USD (%)	EUR (%)	GBP (%)	JPY (%)	AUD (%)	CAD (%)
S&P 500	6.3	2.5	2.2	-6.6	-1.3	1.6
Russell 2000	6.4	2.6	2.3	-6.5	-1.2	1.7
MSCI EAFE	5.8	2.0	1.8	-7.0	-1.8	1.1
MSCI EM	8.1	4.2	4.0	-5.0	0.4	3.3
Barclays Capital Aggregate Bond Index	4.6	0.9	0.6	-8.1	-2.9	0.0
Citigroup World Government Bond Index	2.2	-1.5	-1.7	-10.2	-5.1	-2.3
Goldman Sachs Commodities Index	0.8	-2.8	-3.0	-11.4	-6.4	-3.7
Dow Jones US Select REIT Index	5.3	1.5	1.3	-7.5	-2.2	0.6

State Street Global Advisors Forecasts as of March 31, 2024.
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

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $4.13 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2022.
† This figure is presented as of December 31, 2023 and includes approximately $64.44 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.

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Investments in small-sized companies may involve greater risks than in those of larger, better known companies.

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Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Government bonds and corporate bonds generally have more moderate short-term price fluctuations than stocks, but provide lower potential long-term returns.

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Investing in foreign domiciled securities may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations.

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