

REVISING FORECASTS FOR 2024 AFTER Q1

This column looks at the forecasts made for the U.S. economy at the beginning of 2024 and considers how these initial forecasts appear after the first quarter of 2024.

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In the turbulent landscape of persistent inflation and fear of a recession, at the end of 2022, there was widespread fear that 2023 was poised for a significant downturn. The global economy outlook was grim: a surge in unemployment and a drop in demand pushing the economies globally into a recession seemed highly possible.

However, defying expectations, the global economy grew in 2023, and even saw many global economies outpacing their pre-pandemic averages in terms of real GDP with most global equity markets providing significant returns to investors.

In the US, the Dow Jones Index jumped 13.7%, while the tech-heavy Nasdaq index increased 43.4%. Inflation retreated from 8.0% in 2022 to 4.1% in 2023¹, while unemployment remained below 4.0%². Consumers continued to spend, undeterred even by the Federal Reserve's interest rates reaching a 22-year peak of 5.3%.

What did the experts predict at the start 2024?

Across the board, experts are proposing caution in 2024, which is not unlike at the end of 2022. This is understandable. The last time the U.S. economy faced significant inflationary problems was in the early 1980s when the Fed (under chairman Paul Volcker) raised interest rates to over 20%, which led to two recessions and unemployment rates over 10%.

To put things in perspective, Volcker's decision happened before the Internet. Now, with supercomputers in everyone's hands and machine-learning algorithms helping to manage portfolios, the financial system has become much more complex. With all these technological advances and four decades of global monetary policy history, the question on every

investor's mind is whether Jerome Powell's Fed can tame inflation without plunging the U.S. into a recession; a balance that has been known as the "Soft Landing". More importantly, what does that mean for investors' portfolios, and how should they position themselves after the impressive market gains of 2023?

At the beginning of 2024, Lisa Shalett, CIO at Morgan Stanley Wealth Management, commented that the U.S. equity market experienced a significant rally, leading to overvalued stocks and potentially unrealistic analyst estimates for 2024 corporate earnings³. She recommended buying the equal-weighted S&P 500 Index and actively favoring value-style stocks, particularly in sectors such as financials, industrials, utilities, consumer staples, and healthcare.

Bob Michele and Kelsey Berro from JP Morgan outlined several bold possible scenarios in their article "Five Realistic Surprise Predictions for 2024"⁴. Two of their predictions were that Federal Reserve would cut rates by 250 bps, with indications that inflation is not as severe as feared, and consequently U.S. Aggregate Bonds were projected to return 10-15%,

Blackrock's global forecast for 2024⁵ recommended looking at the current situation through the eyes of a more permanent structural change related to demographic changes, geopolitical tensions, and the transition to a low-carbon economy. They predicted that an active portfolio management approach would reap greater rewards compared to previous eras where stable growth and inflation meant that a static asset allocation approach was enough.

What happened in Q1 2024?

Despite being seen by many as overvalued, the bull market charged on in Q1 2024 as the overall U.S. stock

market tracked by the MVV ETF saw 9.9% growth in the quarter⁶. Large company value stocks tracked by the VTV ETF outpaced large technology stocks tracked by the QQQ ETF 9.6% to 8.6%⁴. Still, Lisa Shalet's call to focus on value stocks has yet to bear fruits as both the VTV and QQQ underperformed the overall large company stocks tracked by the VOO ETF which returned 10.4% during the period. Blackrock's suggestion to more actively manage the portfolio appears to have thus far in 2024 proven correct as actively managed ETFs like COWZ outperformed the S&P 500, returning 12.2% for the quarter.

In the bond market, the possibility for strong returns driven by Fed interest decreases has so far proven wrong as long and intermediate term bonds experienced slight declines, while short term and inflation protected bonds saw slight gains. Treasury bills with maturities of 4-to-6 months remain a favorable low-risk option, yielding ~5.3%. However, it is still too early to rule out a comeback for bond funds. In 2023, bond funds experienced a remarkable turnaround, with the Morningstar US Core Bond Index rallying 6.6% in 4Q 2023 to conclude the year with 5.3% return⁷.

What are experts saying after Q1 2024?

Lisa Shalett maintained her position about the challenge of achieving the necessary earnings growth to sustain current market valuations⁸, and particularly mentioned the valuations among the top-performing "Magnificent 7", Nvidia (NVDA), Meta Platforms (META), Tesla (TSLA), Amazon (AMZN), Alphabet (GOOG), Microsoft (MSFT), and Apple (AAPL). However, she cautioned against trying to time the market, and to keep an eye on the VIX ETF which tracks market volatility. Its recent price below USD 15 may suggest investors have become complacent, so investors should remain cognizant of how quickly things could change should financial conditions tighten.

Following the wonderful performance of the U.S. market in 2023 amid continuous decreases in inflation, Bob Michele and Kelsey Berro's suggestion that the Fed may have interest rate cuts of up to 250 bps in 2024 seemed quite possible. But, after Q1 saw hotter-than-expected inflation and job numbers, the chance that this bold bet materializes has diminished considerably.

In its Q2 2024 outlook⁹, Blackrock raised its expectations for the S&P 500 earnings, with the tech sector expected to account for half of this year's S&P 500 earnings. They also remain confident in overweighting U.S. stocks as they believe more sectors will adopt AI, an area where the U.S. is a powerhouse, while inflation will continue remain stickier than the market currently anticipates.

What does this mean for my portfolio?

With so much uncertainty, it is difficult to predict an individual sector that will outperform others. It is even more difficult to try and time the market. This suggests that a more active approach to stock and fixed-income selection could help outperform the indexes. There are also several key catalysts investors should continue to monitor.

Disinflation: Q4 2023 in the U.S. showed significant slowing of inflation, with month-over-month increases of 0.1-0.2%. This has increased in Q1 2024 to 0.3-0.4%. Although it is not an alarming increase (as Q1 2024 YoY inflation was 3.2% compared to 5.8% in Q1 2023), it suggests that inflation may remain higher than the Fed's 2% inflation target for longer than expected. This means that the Fed will likely keep interest rates higher than expected if unemployment and other signs of a recession do not require fiscal support. If core inflation remains stubbornly high due to ongoing supply chain disruptions or labor market tightness, it could necessitate tighter monetary policies. This could increase financial instability and hinder global growth.

Fiscal Support: Major economies may prolong fiscal policy support, leading to higher-than-expected growth in the short term. However, this could exacerbate inflation and debt-related concerns, potentially resulting in a future disruptive policy adjustment. Excessive austerity measures in response to rising debt levels could stifle economic growth, especially in low-income countries and emerging markets, where debt distress risks remain elevated.

China: Reforms in China's property sector or increased fiscal support could stimulate consumer confidence and private demand, generating growth spillovers globally. On the other hand, without comprehensive restructuring of China's property sector, reduced investment and

household consumption could dampen domestic and global growth.

Commodity Price Spikes: Escalating geopolitical conflicts, such as in the Middle East or Ukraine, could lead to spikes in commodity prices, particularly food and energy. Extreme weather events may exacerbate food insecurity, disrupting the global recovery.

Footnotes

1. Bureau of Labor Statistics. "Historical Consumer Price Index for All Urban Consumers (CPI-U).
2. Bureau of Labor Statistics. "The Employment Situation"
3. <https://www.morganstanley.com/ideas/us-stock-market-outlook-2024>
4. <https://am.jpmorgan.com/us/en/asset-management/adv/insights/portfolio-insights/fixed-income/five-realistic-surprise-predictions-for-2024/>
5. <https://www.blackrock.com/sg/en/insights/outlook-package>
6. https://rgimllc.com/2024/03/30/first-quarter-2024-market-update/?utm_source=linkedin&utm_medium=social&utm_campaign=tweepsmap-Basic-Pipeline
7. <https://www.morningstar.com/funds/how-bond-funds-fared-2023>
8. <https://www.investmentnews.com/investing/news/us-stock-valuations-rich-japan-a-better-bet-says-morgan-stanleys-shalett-251737>
9. <https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/outlook#global-investment-outlook>