COLUMBIA THREADNEEDLE INVESTMENTS

2024 MACRO OUTLOOK

Balancing uncertainty and optimism

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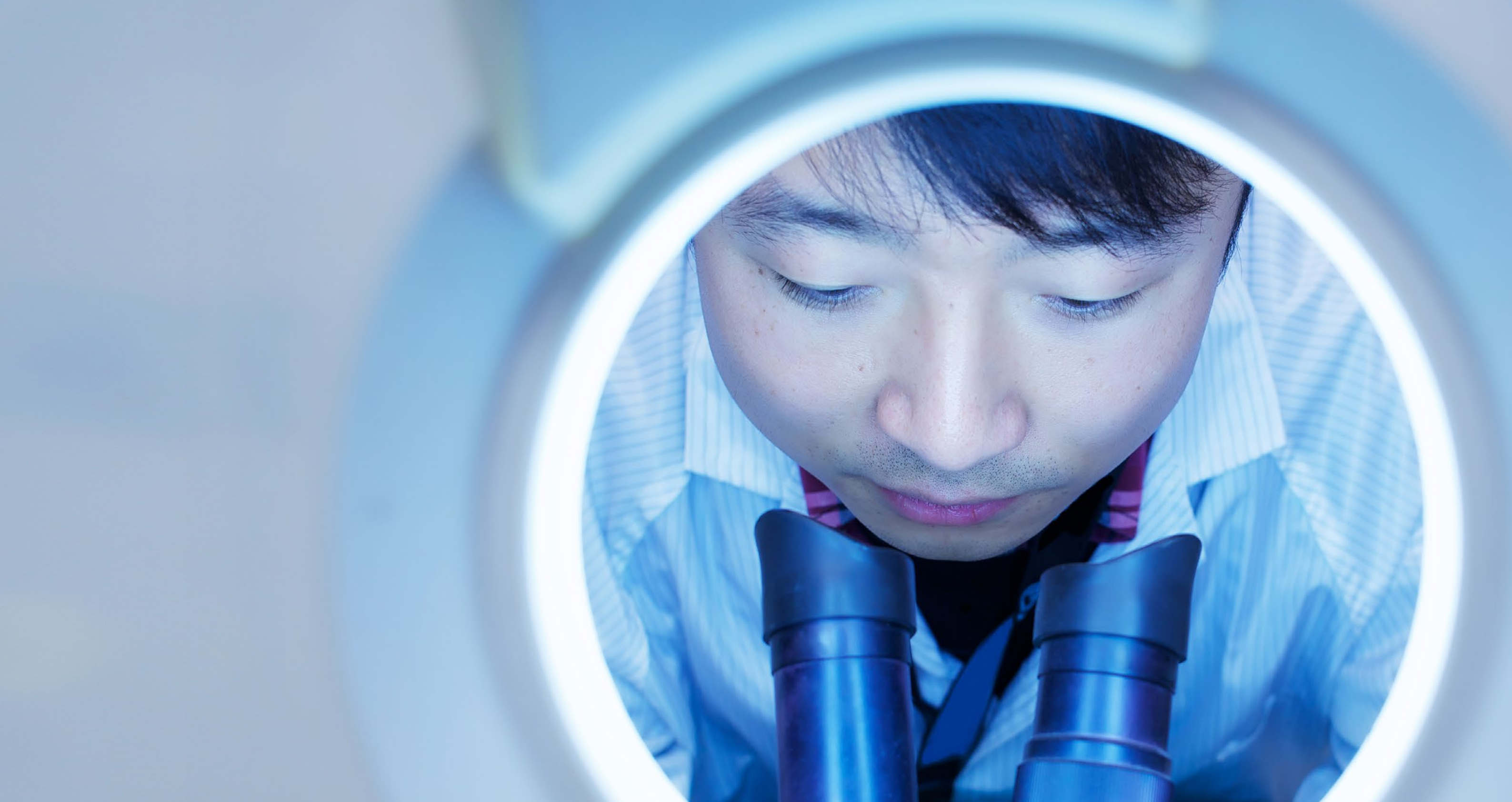
The economic data in 2023 was better than expected: inflation fell, employment remained resilient and we didn't end up in recession – in fact growth was impressively resilient.

All of this "good news" forced the US Federal Reserve and other global central banks to keep rates higher for longer. Now, we are seeing uncertainty around the timing of rate cuts and of the scale and timing of an economic slowdown, introducing some fear into the market. Here are my thoughts as we head into 2024:

Geopolitical risks may outweigh economic risks

The slowdown we are all expecting keeps being put off, but I don't expect it to be overly severe when it finally occurs. The relative risks of incrementally higher or lower inflation, or a milder or deeper recession, are at least known risks. We think the bigger dangers in 2024 will be geopolitical, which have



more potential to throw expectations off track. This includes escalation in the Middle East and increasing tensions between the US and China.

Outside of the tragic human toll of the former, these events introduce volatility in the short term and inflationary pressures in the long term. These pressures impact companies directly, as finding alternative energy supplies or building new supply chains will be costly. Another wildcard is the US elections. It is hard to predict the effect, if any, it will have on the markets – and it is that very unpredictability that is the problem. Markets hate uncertainty.

Opportunities amid uncertainty

As we head into the new year investing will involve balancing one's optimism for the global economy with the many uncertainties we face. For bonds it means that one could consider mid- to long-term US Treasuries and investment grade corporate bonds, which are offering solid rates of return. You could also consider high yield bonds where we are seeing nearly double-digit yields that are tempting.

The choice is really tied to your view on the economic path from here and appetite for risk. In terms of stocks, I think you need to look beyond the narrow grouping of companies that led the market in 2023. I think performance will widen from here, and areas that haven't experienced the rallies we have seen in the strongest sectors could be more attractive.

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Differentiation is returning to markets

Through the Covid-19 pandemic and its immediate aftermath we saw central banks and fiscal policy working towards the same effect: stabilising economies. Their tactics may have differed but the intent was largely consistent. Through 2023 we started to see some differentiation in policy and economic outcome return, and we think that may increase as we go through 2024 (Figure 1).

So the Fed may well keep rates higher for longer than the Bank of England, for example, as the UK economy, with its shorter-term mortgage lending structure and greater overall vulnerability to higher rates, weakens sooner. Europe successfully forestalled recession in 2023 thanks in part to a mild winter, which allowed it to keep energy costs down even with the loss of Russian supply. It is possible we will see that again in 2024.

Figure 1: a little less in sync?

2024 consensus expectations

	Year-on-year GDP growth	Year-on-year headline inflation
US	↑	↑
Japan	–	–
Germany	↓	–
France	↓	–
Italy	–	–
Spain	↓	↑
UK	–	–
China	↓	↓

Source: Bloomberg/Columbia Threadneedle Investments, 25 October 2023

The point is, we are starting to see gaps open up, and we are seeing that in valuations, too. At 18x forward earnings, US stocks are quite a bit more expensive than European stocks at 12x, and Japanese stocks at 14x. I don't think valuation alone is the right reason to make a regional bet right now, but it is another example of growing differentiation across markets, which could lead to opportunities going forward.

A longer timeline for the energy transition

In an environment of slowing economic growth, we may see the implementation of energy transition programs slow down, or a pullback on some commitments, as we have seen in the UK. That is not to say that we won't hit those commitments, but in a weaker economic environment this effort is likely going to have to be balanced with other economic and spending priorities.

Bottom line: there are opportunities ahead of a slowdown

The economy appears to be traveling on a path guided by low or even slowing growth, falling inflation and high interest rates. There are those who believe a deeper recession is possible because of lingering high interest rates, and those who expect inflation to go up because of continuing economic strengthening, an OPEC production cut, or even the impacts of war. Investors should prepare for that middle road between those outcomes, which I think is the most likely scenario over the next six months.

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