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COLUMBIA THREADNEEDLE INVESTMENTS

Global Market Outlook

Is the US set to underperform Europe and the UK?

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The focus is on interest rate cuts, but the story is still about the economic soft-landing

I think the pessimism over the failure of US inflation to keep falling should reverse over the next few months. That should halt the steady decline in the scale of expected interest rate cuts across Europe, UK and US. Current expectations are 75 basis points (bp) off in Europe but only 50bp in the UK and even less in the US. That's a dramatic change compared with the optimism we saw at the start of the year.

The US economy is set to underperform current expectations as spending eases as the US consumer rebuilds depleted savings. That will take pressure off wage inflation and leave room for interest rate cuts. By contrast Europe, and especially the UK, are set to beat expectations on growth as they move onto recovery after their own soft-landings. A virtuous

downward spiral of wages and inflation will allow their consumers to ease back on precautionary savings. That doesn't mean that Europe will beat US, but the growth gap will close, in sharp contrast to current forecasts.

There are a set of elections to come. In the UK the timing is uncertain, the outcome less so. While in the US the timing is fixed, but the outcome is anything but. That is especially significant as Trump's Project 2025 represents a radical agenda, especially if the Republicans also win the Senate and retain the House.

In terms of financial markets, continued growth, albeit slower in the US, lower inflation and therefore interest rate cuts across the board makes bonds and equities both attractive. For the longer-term, valuations favour bonds and make US equities appear expensive.

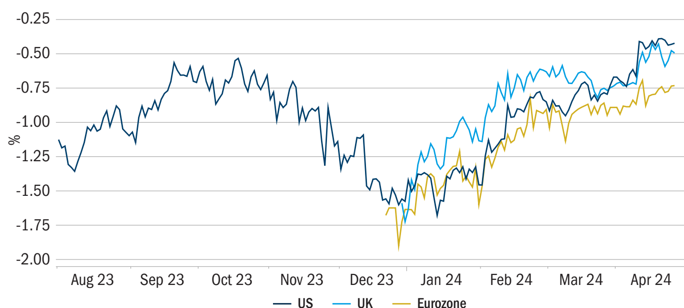
Declining wage inflation will be the key to unlocking a Fed rate cut

The improvement in inflation figures has stalled and with the economy resilient, the Fed is under no pressure to cut.

We think that the disinflationary trend remains intact. Wage inflation is set to fall further as small businesses cut back on their hiring plans, while the surge of unauthorised migrants, currently running at nearly 2.5 million a year, represents a significant addition to the US labour force[1].

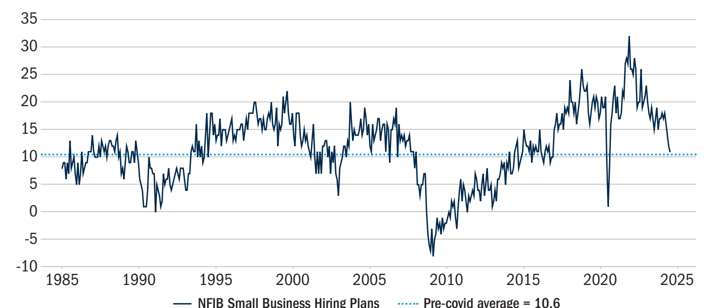
Interest rate optimism has declined steadily this year

Interest rate cuts expected by end-2024



Source: Columbia Threadneedle Investments and Bloomberg as of 25 April 2024

US business hiring plans are tumbling



Source: Columbia Threadneedle Investments, Bloomberg and Macrobond as of 25 April 2024

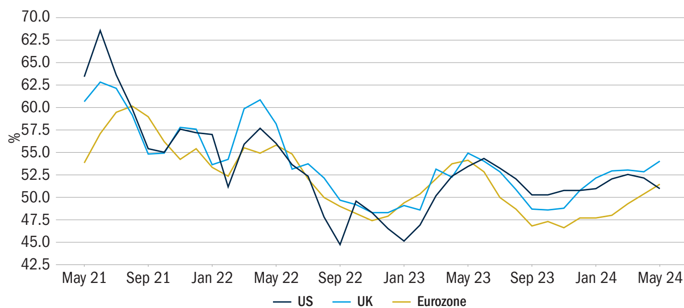
[1] Source: Columbia Threadneedle Investments and Congressional Budget Office as at 18 January 2024.

UK economic recovery is my highest-conviction, non-consensus, view

Over in the UK, we ended 2023 with an economic contraction. But all that is changing, and I expect firm growth in the year ahead. This is my highest-conviction, non-consensus view and I'm pleased to say it's going my way as other forecasters start hiking their expectations for the UK economy.

UK inflation should be at or below the Bank of England's 2% target for the next 12 months. Wage inflation is falling fast assisted by a marked increase in immigration, with 1.1million National Insurance Numbers issued to adults from overseas in 2022 and another 1.1million were issued last year[2]. I think the Bank of England will cut rates by 0.25% in June and begin a slow process of reducing rates further.

UK ahead on economic surveys
Composite Purchasing Managers' Indices



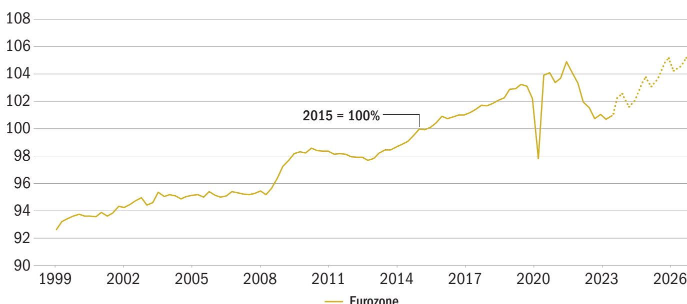
Source: Columbia Threadneedle Investments and Bloomberg as of 25 April 2024

European growth to recover slowly in 2024, but still faster than expected

Real wages are rising in Europe as the wage-price spiral operates in reverse, with falling inflation driving up real incomes. Although real wages won't get back to the pre-Ukraine peak until the end of next year, a big turnaround is already underway. European consumers are likely spend ahead of their income growth as confidence improves with lower inflation and lower interest rates.

The ECB have come as close as they ever get to promising to start cutting rates in June and slow steady cuts are likely to follow.

Real wages set to recover in Eurozone
Eurozone real compensation per employee



Source: Columbia Threadneedle Investments and Societe Generale as at 14/01/2024. Estimates and forecasts are provided for illustrative purposes only. They are not a guarantee of future performance and should not be relied upon for any investment decision. Estimates are based on assumptions and subject to change without notice.

Lower interest rates will make bonds and equities attractive. Gold to shine

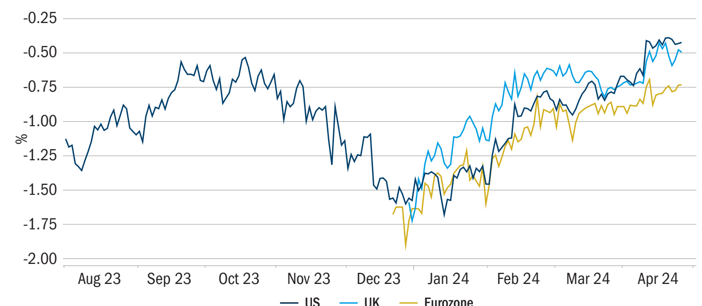
The shift from -1% to plus 2% in real returns for US TIPS might not sound much, but for long-term secure returns that's huge. To deliver $100 in real terms in 30-years' time would have required $135 at a yield of -1%, today, you need just $50. That's a much healthier investment proposition and, at its simplest, it's why we regard bonds as attractive.

Higher bond yields typically mean lower stock prices. But this has not been the case over the last 18 months or so, meaning equities, particularly in the US, are expensive on this measure. But this metric is only useful in the longer-term, and experience suggests that equities can get more expensive before they peak. Therefore, given the positive short-term fundamentals, we remain overweight equities, but only modestly.

The reason US equities have kept on getting more expensive this year is the 'Magnificent 7' of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. They have done this on the back of superior profit margins in over the last year. Note that the rest of the S&P 500, the remaining 493, saw a decline in margins in 2023.

One market that I have liked all year is gold. Gold has also bucked its trend of falling as interest rates rise since the invasion of Ukraine. It was not just Russian FX Reserves that were frozen, but no less than 2,000 entities and wealthy Russians. That has driven a safe-haven demand for gold, and I think prices have further to go.

Magnificent 7 have magnificent margins
US Net Income Margins



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The mention of stocks is not a recommendation to deal

[2] Source: Columbia Threadneedle Investments, ONS and Macrobond as at 25 April 2024.

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