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INVESTMENT MANAGEMENT

Where do we go from here?

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The positive momentum in global equity markets continued in December, as the December Federal Reserve meeting added a new layer to the rally, with updates driving a more dovish interpretation of the 2024 policy path. The S&P 500 (USD) Index returned 4.5%,[1] while the MSCI Europe (EUR) Index returned 3.7%[1]. Regionally, the US has outperformed ex-US markets in local currency in both November and December. US outperformance is partially offset on a dollar basis, with the dollar weakening alongside lower US rates. While Europe has underperformed the US in 2023 and more so since May, the region has held up somewhat better than might be expected considering the macro data for Europe continues to disappoint. Support is likely coming from both falling rates and relatively undemanding valuations. Japan's equity markets have generally shown relative outperformance, offset by weaker currency through most of 2023. That said, it failed to keep up with the US rally in both November and December on both local and dollar comparisons, with the MSCI Japan Index (JPY) returning -0.5%[1]. The MSCI Emerging Markets (USD) Index posted a return of 3.9%[1]. However, China remained a notable underperformer amongst regional equities by year-end, as investors continue to recognize the headwinds from the property downturn and grow less confident in the government's ability to support growth in the near term.

The US 10-Year Treasury yield fell by 50bps from November end, ending the month at 3.87%[2]. Volatility remained range bound as the VIX ended the month at 12.5[2], slightly lower than the previous month end.

Notes:

[1] Bloomberg, 1-month returns, local currency unless otherwise stated, as of 31 December 2023.

[2] Bloomberg, 31 December 2023.

The shift to a "Goldilocks[3]" soft-landing view continued into December with rates falling, equity markets rising, sector performance once again skewing cyclical, and equity style factors skewing closer to a risk-on pattern. At the core of the Goldilocks view is rising confidence that inflation will move decidedly lower, allowing policy relief without meaningful growth disappointment – a disinflation driven policy easing story, rather than a growth driven policy easing story. While there remains much to debate about the outlook heading into 2024, recent macro data releases have supported the Goldilocks view. On the inflation front, the data has skewed softer than expected and shown disinflation progress.

The other key component of the Goldilocks story is resilient growth. Real personal spending data shows still healthy consumption. Resilient consumer spending rests primarily on a still healthy labor market, where nonfarm payroll data continues to show solid gains.

While the focus on disinflation progress and resilient growth was consistent in November and December, the December Fed Dot Plot[4] showed more cuts than consensus expected in 2023. US Federal Reserve Chairman, Jerome Powell noted both that rate cuts were discussed in the recent meeting and that these cuts were beginning "to come into view". The markets took this as a signal that the Fed was somewhat less cautious than previously expected as it pertains to success on the inflation outlook, and more focused on not letting real rates slip higher as inflation falls. This translated to another step lower in rates and another step higher in equity markets. This remains consistent with the Goldilocks focus, though we see some shifting in risk scenarios. The resultant easing in financial conditions likely serves to further reduce downside risks, but it may also increase the risk that too resilient growth results in inflation.

Investment Implications

As we have discussed in the last couple monthly updates, our base case has shifted more confidently to soft landing in the approach to 2024. From a positioning perspective the key translation of this view has been maintaining our overweight to equities. Having already added duration (moving from underweight to neutral), we maintained this in December, seeing a positive risk-reward based on where rates stood relative to our medium-term expectation for the US 10-year yield of 3.5-5.5% and believing fixed income presents a better hedge to equity risk entering 2024. While our conviction on a soft landing base case has been well supported by recent data, both equities and rates have moved considerably in the last couple months with implications for the balance of risk/reward entering 2024. The macro-outlook supports positive, but below trend earnings growth and valuations likely serve as a constraint. We continue to look for investable opportunities as we head into the new year.

We did not change any of our tactical views over December. However, for our volatility-targeting portfolios, where appropriate we have been making minor adjustments to align the equity exposure with the proxy benchmark.

Notes:

[3] A Goldilocks economy is not too hot and not too cold - where a number of factors contribute to it being "just right", such as low inflation, and where growth is not expanding or contracting by too much.

[4] Presents interest rate projections from each member of the Federal Open Market Committee. A summary of Economic Projections, December 13, 2023 is found on www.federalreserve.gov

***Diversification does not eliminate the risk of loss.**

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results. See Disclosure section for index definitions.**

Tactical Positioning

We have provided our tactical views below:

Asset Class	--	-	=	+	++
Equity					
US				■	
US Small Cap			■		
Eurozone		■			
EU Energy					■
UK			■		
Japan				■	
Asia ex Japan			■		
Emerging Markets			■		
China		■			
Global Infrastructure			■		
Global Property			■		
Commodities					
Gold			■		
Oil			■		
Copper			■		

Asset Class	--	-	=	+	++
Fixed Income					
Portfolio Duration			■		
US IG Credit		■			
European IG Credit			■		
US High Yield			■		
EU High Yield			■		
EM HC Sov Debt			■		
EM LC Sov Debt			■		
Mexican LC Sov Debt				■	
EM Corporate Debt			■		
US Treasuries				■	
EU Core Gov. Bonds			■		
EU Peripheral Gov. Bonds			■		
Greek Gov. Bonds				■	
UK Gilts			■		
JGBs		■			
Asset Backed Securities					■
Currencies					
Euro			■		
GBP			■		
JPY			■		

■ Latest view   Previous view

Source: MSIM Portfolio Solutions Group (PSG). Previous view is as of 30 November 2023 and current view is as of 31 December 2023. For informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The tactical views expressed above are a broad reflection of our team's views and implementations, expressed for client communication purposes. The information herein does not contend to address the financial objectives, situation or specific needs of any individual investor. The signals represent PSG's view on each asset class as applied to the Global Balanced Risk Control (GBaR) Strategy. A negative signal indicates a negative or underweight relative view, a positive signal indicates a positive or overweight relative view.

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MSCI Emerging Markets Index captures large and mid cap representation across 27 Emerging Markets (EM) countries. With 1,417 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Japan Index: The MSCI Japan Index is designed to measure the performance of the large and mid-cap segments of the Japanese market.

S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalisation US stocks.

VIX ©: This is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 Index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30-day period.

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