Macro Monthly

Economic insights and asset class views

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For global professional / qualified / institutional clients and investors and US individual investors.
For marketing purposes

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Flash update: Pressing pause

Our highest-conviction view for 2024 was that global stocks would rise to fresh all-time highs without any meaningful decline in government bond yields. That has now come to pass – faster than we anticipated – and for good reasons: Growth is solid, labor markets are strong and disinflation is well underway.

But what now?

A soft landing for the US and global economy is still our base case. However, this optimistic economic view has been increasingly embedded in markets for more than three months with little interruption. A mix of technical and fundamental factors lead us to believe that this narrative could become somewhat challenged on a tactical basis.

We have held an overweight to global equities since early June 2023 but are now turning neutral. Simply, our modal economic scenario has firmly become the consensus view, so the risk-reward proposition for equities is no longer as attractive as it has been. We suspect faith in the soft-landing consensus may come under some pressure in coming months, leaving opportunities to reengage on weakness in equity markets.

Short-term doubt in soft landing
Core PCE inflation ended 2023 below the Federal Reserve's target at 1.9% on a six-month annualized basis, and Q4 GDP growth came in stronger than expected at 3.3%. This scenario, in our view, is close to 'as good as it gets.' Indeed, we project three-month and six-month annualized readings of inflation to accelerate temporarily in the coming months before resuming their disinflationary trend. A modest pickup in price pressures may complicate the Fed's ability to gain greater confidence that inflation is heading durably back to target. While we still expect a few rate cuts this year, a Fed that drags its feet on easing could unsettle markets for a period, if investors start to question the soft landing narrative.

Meanwhile, our leading indicator for earnings revisions has become more neutral recently – even amid surprisingly strong US growth. The renewed rally in the US dollar so far this year is poised to weigh somewhat on US multinationals' earnings power. And the failure of bond volatility to decisively fall out of the elevated range it has been stuck in since the Fed's tightening cycle began may crimp what have become rather rich valuations.

Technical difficulties
The internals of the equity market may be starting to 'sniff out' some of these headwinds. Despite major equity indexes hitting all-time highs, market breadth has been narrowing with the share of S&P 500 constituents trading above their 50-day moving averages falling sharply.

With the S&P 500 trading around 5,000, we expect some 'round number fatigue.' The S&P 500 stalled or weakened when first surpassing two of its last three 1000-point milestones. In 2014 and 2019, US stocks traded sideways for at least three months after breaching 2000 and 3000, respectively. The path above 4000 did not follow this pattern in 2021. But while we agree that the earnings backdrop is solid now, it is not nearly as robust as in 2021 – a unique year in which calendar year profit estimates were persistently revised to the upside by an unusually large degree.

Some positioning metrics, like the AAII investor survey and CFTC asset manager futures positioning, are stretched to the upside. The implied correlation of the top S&P 500 constituents is at extremely low levels vs. history. This means equity investors are ill-prepared for any perceived change in the macro backdrop that could cause stocks to move lower in unison.

Asset allocation

We retain an optimistic view on the global economy and for global stocks in the medium term. But tactically, we believe it is time to press pause on what has been a historically strong equity rally.

Returns of 15.8% for the three months ending January rank in the 97th percentile for the MSCI World Index over its history. Over the past 30 years, the only periods of better performance occurred during the dot-com bubble, the end of recession-induced bear markets, and the successful breakthrough on vaccinations that allowed for the start of a return to normal from the COVID-19 pandemic.

A neutral view on equities is not an outright bearish call, and there are pockets of risk assets we still embrace. In particular, we continue to favor Japanese equities, which are highly levered to the post-pandemic improved nominal growth environment, have more shareholder-friendly corporate governance, and accommodative monetary policy even as the BoJ embarks on a slow tightening cycle. We fund this position out of Swiss equities, where our leading indicators point to significant earnings weakness relative to other regions.

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Americas

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