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Monthly letter: Key questions for 2024

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The rally in equities and bonds has stalled at the start of 2024, but with rate cuts in prospect we see scope for further gains this year. We retain a positive stance on quality fixed income, and in equities we focus on quality stocks that should be well placed in an environment of slower economic growth.

After a strong final two months of 2023, both equities and bonds have faltered in January as markets have reassessed the prospects for rate cuts this year by the Federal Reserve.

The yield on 10-year US Treasuries has risen to 4.1% from 3.88% at the end of December and market expectations for the chances of a March rate cut have dropped to 63% from 84%, according to Bloomberg data. Upward progress for the S&P 500 has stalled, with the index 0.6% lower year to date at 4,739 as of 17 January.

After these moves, the questions investors are asking us are focused on three themes: Can equity and bond markets rise in 2024? How should we navigate portfolios through the coming turn in the rate cycle? And how should we think about the geopolitical and political risks we face in the months ahead?

In short:

- **We think there is more upside for both equity and bond markets.** Our base case scenario is for a soft landing. Lower interest rates, positive (albeit slowing) economic growth, and growing corporate earnings should support modest further upside for equities. We also think long-term bond yields have room to fall further, given long-term real rates are still higher than the Fed's estimate of the real neutral rate, in our view. We favor bonds on a risk-adjusted basis.

- **Lower interest rates will reduce returns and increase reinvestment risks for cash and money market investors.** We think now is the time for investors to get portfolios back in balance. We see both tactical and strategic benefits to shifting portfolios away from cash and toward bonds and equities.
- **Geopolitics are likely to remain prominent, but we think it is important to disassociate broad investment decisions from politics.** We do not expect the recent escalation in the Middle East to have a major impact on global inflation, though it may add market volatility in the near term. We also note that US elections have not historically had a decisive impact on broad markets, though the presence of the November election is contributing to investor speculation that the Fed may start the rate-cutting cycle sooner.

In this environment, we retain a positive stance on quality fixed income. In equities, we focus on quality stocks that should be well-placed in an environment of slower economic growth thanks to their strong balance sheets, high profitability, and resilient earnings profile. We like the US tech sector, which aligns with our quality tilt and offers exposure to compelling disruptive trends like artificial intelligence.

We also see tactical opportunities in areas of the equity market that we would expect to capture more upside in a “Goldilocks” scenario of faster growth, lower inflation, and preemptive Fed rate cuts, while also faring well in our base case. For example, emerging market equities, and small-cap stocks in the US and Europe, would likely fare well in both scenarios.

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