

# POLICY AND POLITICS

Focus remains on monetary policy with investors parsing Fed minutes and statements. Rate cut hopes drove much of the Santa Claus rally, but the Fed has not committed to investors' full wish list. Politics will battle monetary policy for mindshare; ~40% of the planet can cast a vote this year, including the U.S. and Taiwan (which just reelected its nationalist party). We expect a U.S. soft landing, areas of global economic weakness and hesitant central banks. When joined by elevated U.S. equity valuations and geopolitical risks, the macro backdrop endorses a small underweight to risk and a preference for high yield over equities.

## Interest rates will likely show less volatility this year.

The 10-year U.S. Treasury (UST) yield ended 2023 at 3.88% – the same level as it ended 2022, but with a rise to a high of 4.99% along the way. Given our call for a U.S. soft landing and modest Fed accommodation, it's reasonable to expect the 10-year UST yield to end 2024 around 4% again, and without last year's detour higher. We side with the Fed's forecast calling for three 0.25% rate cuts this year (versus market calls for roughly six) with the first cut occurring at the June Fed meeting (versus market expectations for March). Such an outcome would likely remove the inversion from most of the yield curve by bringing down the front end more than the back end – presenting a reasonable backdrop for risk-control assets.

## Comparing Powell's soft landing to Greenspan's.

The last time the Fed achieved a soft landing – in 1995 – the S&P 500 gained 38%, kicking off the dotcom era and a five-year period of 29% annualized returns. Could AI elicit a similar market reaction as the internet revolution? Perhaps. But starting-point equity valuations today are much higher – 24.9 on a price-to-trailing-earnings (P/E) basis (versus 16.9 heading into 1995, ultimately reaching 30.7 at the end of the five-year period). Today's 4.0% S&P 500 earnings yield compares unfavorably to the 7.6% yield on high yield bonds – especially given the ~1.5% real growth environment we expect (versus the 4.2% annual growth from '95-'99). Also, profit margins will be pressured as companies roll over debt at rates around double what was secured post-pandemic (~8% from ~4% in high yield and ~5% from ~2% in investment grade).

## Getting paid upfront in a risky, modest-growth world.

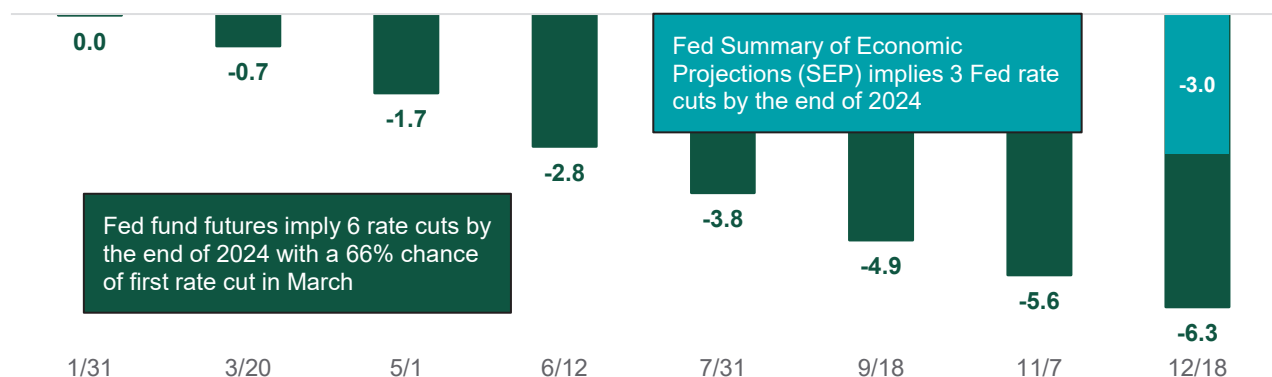
We like high yield's income generation over the potential price appreciation in developed market equities, wherein U.S. valuations are rich and European growth is at risk. Emerging market equities are looking more attractive but we seek more clarity on the contours of Fed policy and the implications of Taiwan's election before going overweight. We are strategically allocated across all real assets.

## RATE CUT RECONCILIATION NEEDED

Markets are hoping for a March start to rate cuts and a total of roughly six in 2024; the Fed is only offering three so far.

### 2024 FEDERAL OPEN MARKET COMMITTEE (FOMC) MEETING DATES

■ # of hikes/cuts (market expectations) ■ # of hikes/cuts (SEP projection)



Source: Northern Trust Asset Management, Bloomberg. Summary of Economic Projections (SEP) as of 12/13/2023. Market expectations implied by futures. Data as of 1/16/2024.

## BASE CASE EXPECTATIONS

### Sticking the Landing

Global growth will move below trend but remain positive, supported by a U.S. economic soft landing underpinned by a solid labor market and healthy consumer. Inflation will remain above target but continue to proceed toward 2%. Despite the constructive economic backdrop, high valuations temper risk-taking appetite.

### The Fed's Transition

The Fed is very likely done raising rates, but market expectations for a probable rate cut in March, two cuts by June and a total of five-to-six rate cuts in 2024 are too aggressive. More realistic would be three cuts, starting in June and followed by cuts in September and December.

## RISK CASE SCENARIOS

### Lagged Impacts

The market's enthusiasm for a soft landing proves to be misplaced as the cumulative effect of 5%+ rate hikes in two years starts showing up in economic functioning. TAA is not underweight risk enough in this scenario.

### A Bad Goods Environment

Geopolitical tensions in the Red Sea (currently causing significant but manageable goods trade disruptions) intensify or broaden to the Persian Gulf (impacting oil supplies) – potentially causing stagflation.

Prepared by Northern Trust Asset Management for United Bank.

**UNLESS NOTED OTHERWISE, DATA IN THIS PIECE IS SOURCED FROM BLOOMBERG AS OF JANUARY 2024.**

FOR ASIA-PACIFIC MARKETS, THIS INFORMATION IS DIRECTED TO INSTITUTIONAL, PROFESSIONAL AND WHOLESALE CLIENTS OR INVESTORS ONLY AND SHOULD NOT BE RELIED UPON BY RETAIL CLIENTS OR INVESTORS.

© 2024 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A. The information is not intended for distribution or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. This information is obtained from sources believed to be reliable, and its accuracy and completeness are not guaranteed. Information does not constitute a recommendation of any investment strategy, is not intended as investment advice and does not take into account all the circumstances of each investor. Forward-looking statements and assumptions are Northern Trust's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information. Investments can go down as well as up.

This report is provided for informational purposes only and is not intended to be, and should not be construed as, an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Recipients should not rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors. References to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. Indices and trademarks are the property of their respective owners. Information is subject to change based on market or other conditions.

All securities investing and trading activities risk the loss of capital. Each portfolio is subject to substantial risks including market risks, strategy risks, advisor risk, and risks with respect to its investment in other structures. There can be no assurance that any portfolio investment objectives will be achieved, or that any investment will achieve profits or avoid incurring substantial losses. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Risk controls and models do not promise any level of performance or guarantee against loss of principal. Any discussion of risk management is intended to describe NTAM's efforts to monitor and manage risk but does not imply low risk.

**Past performance is not a guarantee of future results.** Performance returns and the principal value of an investment will fluctuate. Performance returns contained herein are subject to revision by NTAM. Comparative indices shown are provided as an indication of the performance of a particular segment of the capital markets and/or alternative strategies in general. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Net performance returns are reduced by investment management fees and other expenses relating to the management of the account. Gross performance returns contained herein include reinvestment of dividends and other earnings, transaction costs, and all fees and expenses other than investment management fees, unless indicated otherwise. For additional information on fees, please refer to Part 2a of the Form ADV or consult an NTI representative.

Forward-looking statements and assumptions are NTAM's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information.

Northern Trust Asset Management is composed of Northern Trust Investments, Inc. Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K., NT Global Advisors, Inc., 50 South Capital Advisors, LLC, Northern Trust Asset Management Australia Pty Ltd, and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

**NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE.**

ViewPoints reflects data as of 1/17/24.

Powered by



©2024. All Rights Reserved.