TAKING THE UNDER

Global equities were roughly flat over the past month against a flattish backdrop for interest rates, with non-U.S. equity markets trailing due to a strengthening of the U.S. dollar. U.S. large cap growth stocks continued to outperform, masking softness in value and small caps when looking at broader indices. Investor optimism remains on display in the U.S. for both earnings and valuations. Earnings estimates continue to edge higher – now equating to roughly 12% growth in 2024 and 2025, while the forward P/E multiple sits at an elevated 19x. We are taking the under on economic growth and earnings forecasts given accumulating global headwinds.

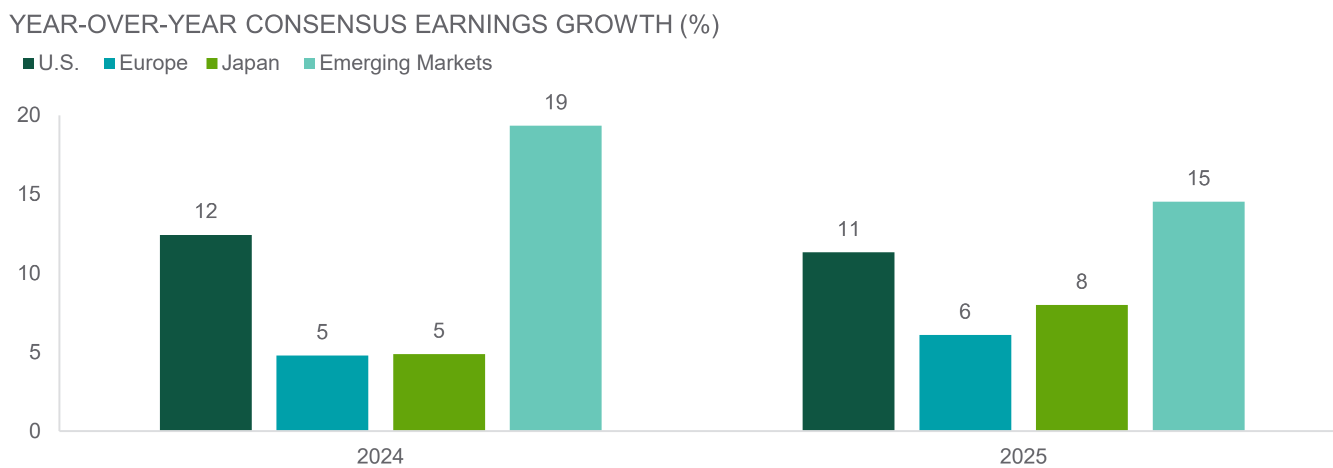
The U.S. consumer remains durable when looking at retail sales and payment network volume trends, however, depleting savings and increasing revolving debt levels have supported recent spending capacity. Going forward, we expect spending will have to slow to align with wage growth. In addition, we still expect the lagged effect of monetary policy to act as an incremental headwind – further suppressing activity.

Inflation measures ticked up this month, due in part to higher energy prices (oil prices are making new year-to-date highs). We continue to believe the market will be disappointed by the timing and pace of interest rate cuts from central banks, including the Fed. Inflation should continue its disinflationary path and the European Central Bank and the Fed are likely close to done raising rates, but we do not expect central banks to be in a hurry to remove restrictive interest rate policy via interest rate cuts.

China continues to struggle as the consumer retrenches in the wake of the property market unwind. To date, governmental support has been modest, supporting our underweight to the region. We are watching closely to see if China's woes lead to an exporting of economic weakness or further disinflationary forces – further hurting the economic growth outlook.

PERFORMANCE EQUALS REALITY MINUS EXPECTATIONS?

Elevated earnings growth expectations for the next two years leave room for disappointment.



Source: Northern Trust Asset Management, Bloomberg. Bloomberg consensus earnings per share (EPS) growth estimates for calendar years 2024 and 2025. Indexes used: S&P 500 (U.S.), MSCI Europe (Europe), MSCI Japan (Japan), and MSCI Emerging Markets (Emerging Markets). Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Indexes are the property of their respective owners, all rights reserved.

BASE CASE EXPECTATIONS

Complacency Concerns

Investors are taking too much comfort in the increased possibility of an economic soft landing (inflation returns to target without recession), not appreciating how fast long(er) monetary policy lags could materialize and the challenges China faces. We expect flattish growth with downside risk.

Don’t Count on Cuts

The U.S. economic expansion continues with the unemployment rate sitting below 4% and, yet, Fed funds futures are calling for rate cuts to begin mid-2024. We do not believe both can be true – and view it more likely that the Fed plateaus at current policy levels.

RISK CASE SCENARIOS

Reagitated Inflation

Persistent wage pressures and surging oil prices push inflation (and expectations) higher and central bank policy rates to a new level.

Continued Bull Run

A rebalancing U.S. labor market, a renewed Chinese government stimulus attempt and/or a durable AI trend cause equity markets (especially in the U.S.) to resume the year-to-date run.

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