10 Predictions for 2024

Theme: Goldilocks Remains a Fairytale

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2023 Review – THEME: The Fed Calls the Shots

The U.S. economy avoided a much-anticipated recession in 2023 and made significant progress toward a soft landing. The key surprise was much stronger-than-expected economic growth as the labor market continued to rebalance and inflation continued to fall. In the U.S. and across many parts of the world, inflation declined, approaching but not reaching central bank targets, while importantly (and amazingly) avoiding a major slowing of growth or a pickup in unemployment. As we exit 2023, the risks are more symmetric: the risk of inflation remaining sticky and above target, and the risk of weaker economic activity exists as well.

2023 was a year of valuation expansion, which is unusual for the late stages of an economic cycle. Market optimism was related to above-expected economic growth, fiscal stimulus, consumer spending, expected Fed rate cuts, and AI. Earnings actually fell somewhat short of expectations, so P/E expansion led by mega cap stocks (especially the Magnificent Seven) was the story. The average stock trailed the major averages by more than 1,000 basis points despite market broadening toward the end of the year. August to October recorded a slightly above 10% correction that was followed by a 15% rally into mid-December. Overseas, India passed China as the world's most populated country and the Indian economy trounced China.

The key economic question for 2024 is whether central banks can continue the "landing of the plane" (soft landing) without a crash (recession). The consensus view of 2024 is a "Goldilocks" environment; i.e., not too hot and not too cold. Expectations include a soft economic landing, a continued decline in inflation towards targets, and double-digit earnings growth. We think that fairy tale is unlikely, meaning either 1) the economy weakens enough for a bumpy ride (perhaps a recession) and earnings fall short (most likely), or 2) the economy remains strong enough to support double-digit earnings growth at the risk of little progress on inflation and Fed rate cuts. It is with this backdrop that we proceed as usual with fear and trepidation (and hopefully some good educated guesses) to unveil our prognostications for 2024 in the form of the Ten Predictions.

2024 10 Predictions

Theme: Goldilocks Remains a Fairytale

1 The U.S. economy experiences a mild recession as the unemployment rate rises above 4.5%.

2 The 2-3% inflation ceiling of the 2010s becomes the 2-3% inflation floor of the 2020s.

3 The Fed cuts rates fewer than the six times suggested by the Fed funds futures curve.

4 Credit spreads widen as interest rates decline.

5 Earnings growth falls short of the double-digit percentage consensus expectation.

6 Stocks record a new all-time high early in the year, but then experience a fade.

7 Energy, Financials and Consumer Staples outperform Utilities, Healthcare and Real Estate.

8 Faith-based share of industry AUM rises for the eighth year in a row.

9 Geopolitical crosscurrents multiply but have little impact on markets.

10 The White House, Senate and House all switch parties in November.

Conclusion

As noted in the introduction, the main focal point for 2024 is likely to be whether or not investors can enjoy a Goldilocks (or Nirvana) environment; namely, further significant progress on inflation, decent economic growth and double-digit earnings growth. As explained in the Ten Predictions, we are skeptical. Either 1) we get a noticeable slowdown/recession and earnings fall short, or 2) double-digit earnings growth materializes, probably requiring stronger economic growth, less progress (if any) on inflation and a Fed that is boxed in.

The long-predicted recession will likely materialize in 2024, although it most likely will be brief and shallow. The main arguments for a recession are the lagged effects of monetary tightening both via the Fed and long-term interest rates. While the absence of a recession thus far has increased market expectations for a soft landing, historical comparisons point out that a recession prior to this point would have been on the early side compared to history. Also, after the largest growth in the money supply since WWII (due to COVID), we are now experiencing the biggest decline since the 1930s. Can a productivity boom rescue the U.S. via AI, automation and robotics? Only time will tell.

We expect a more challenging backdrop for stocks in 2024, with softening consumer spending at a time when investor sentiment has turned bullish. Equities are richly valued, with volatility near historic lows, even as geopolitical and domestic political risks remain elevated. We expect the 2023 momentum and Fed cut euphoria to fade early in the new year, resulting in lackluster earnings growth and downside risk to equities as 2024 unfolds.

At some point, the political dysfunction in Washington, D.C., and record non-recession, non-war deficits will pile up even as interest expense takes an even larger share of governmental spending. As such, we believe markets are excessively focused on monetary policy and are almost ignoring fiscal policy.