

# Broadening equity horizons



Global equity markets are likely to remain challenged in 2024 as the world transitions to a regime of higher trend inflation and interest rates. This transition could generate shifts in earnings growth expectations, triggering volatility. Close attention to risk management will be needed.

On the plus side, broader, less concentrated market leadership is likely to provide more varied sources of returns for investors who maintain a sharp focus on valuation fundamentals.

Although U.S. equity valuations appear more reasonable, they continue to face stiff competition from attractive yields on money market and short-term fixed income assets. This suggests a need to look for pockets of attractive relative valuation.

Global equity performance in 2023 was predominantly driven by the so-called

“Magnificent Seven” mega-cap U.S. technology stocks (Figure 6), propelled by their above average earnings performance and rising expectations for artificial intelligence (AI) applications. Through November, the Magnificent Seven stocks collectively were up over 70% for the year to date on a capitalization-weighted basis. The remaining 493 stocks in the S&P 500, on the other hand, rose less than 9.5% (Figure 6). Such highly concentrated markets increase risk, particularly for investment strategies measured against benchmarks that require them to maintain exposure to these oversized positions.

Stretched valuations, produced by their strong performance, leave the U.S. tech giants vulnerable to mean reversion—the historical tendency for periods of above-average performance to be followed by subpar returns. Accordingly, we believe mega-cap tech leadership is likely to fade in 2024 as the opportunity set broadens.

## U.S. equity performance has been top-heavy, but that could change in 2024

(Fig. 6) Cumulative returns through the first 10 months of 2023.



As of November 30, 2023.

\* The Magnificent 7 are Apple, Alphabet, Amazon, Meta, Microsoft, NVIDIA, and Tesla. Performance results shown are capitalization-weighted averages. The specific securities identified and described are for informational purposes only and do not represent recommendations.

Source: Standard & Poor's (see Additional Disclosures). T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Past performance is not a reliable indicator of future performance.

## The world in equities 2024

### US Equities

Mega-cap tailwind expected to fade, but health care and energy are bright spots

### European Equities

Economic woes to weigh on markets, at least for first half

### EM Equities

Attractive valuations combine with fiscal and monetary stimulus



### Japan Equities

Regulatory reform, governance, valuations, and macro trends all supportive

### China Equities

Subdued recovery a problem but select opportunities in high-tech industrials

## Regional opportunities

We continue to favor EM equities over developed equities as relatively attractive valuations (Figure 7), upside earnings potential, and the possibility of incremental fiscal and monetary stimulus generally are more supportive for the EMs. A shift away from highly centralized global supply chains also could favor the EMs.

Potential beneficiaries include Malaysia, Indonesia, Brazil, and Chile.

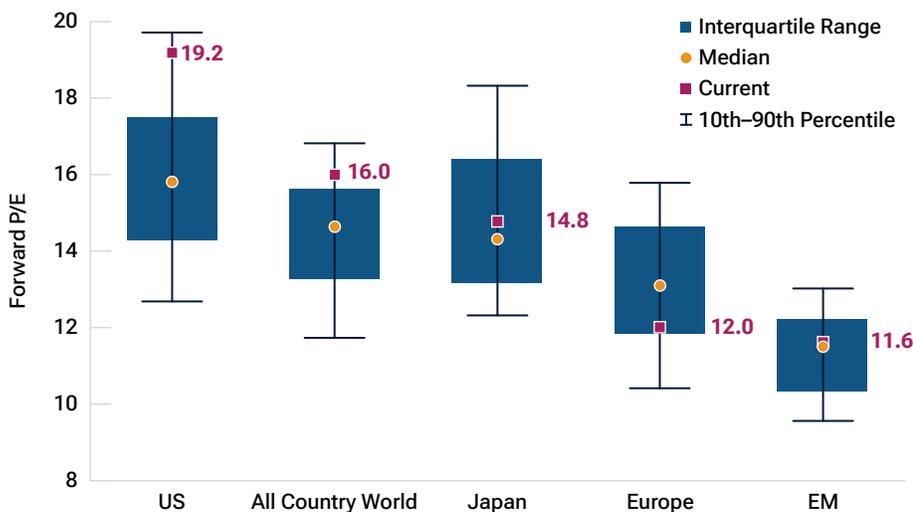
Within the developed markets, near-term prospects for European equities look less attractive relative both to other developed markets and to the EMs. As the business cycle rolls over, demand is likely to weaken and profit margins could come under pressure. Companies with more

robust margins are likely to navigate this environment more effectively but also will sell at higher valuations.

As Europe approaches a business cycle recovery that is likely later in 2024, further opportunities should arise in those markets, where valuations overall are likely to still be reasonable.

## EM equity valuations appear relatively cheap

(Fig. 7) Forward 12-month price/earnings (P/E) ratios.\*



As of November 20, 2023.

\*Based on consensus earnings forecasts. Ranges and medians are for the 20 years ended November 2023 using monthly P/Es. U.S. = MSCI USA Index; All Country World = MSCI All Country World Index; Japan = MSCI Japan Index; Europe = MSCI Europe Index; EM = MSCI Emerging Markets Index.

Source: Goldman Sachs Investment Research.

## Sectors in the spotlight 2024



### Technology

Semiconductors with leading chip technology and companies supporting AI scaling



### Health Care

Biomedical devices and obesity treatments, which could have knock-on effects for food, retail, and hospitality



### Energy

Higher energy prices and decarbonization initiatives supportive of both old and new energy

Japanese equities continue to look relatively attractive. The Japanese yen appears undervalued and will likely appreciate should the BoJ change its monetary policy. While a stronger yen historically has been seen as a negative for the export-driven Japanese economy, its potential impact going forward is unclear given the positive momentum and potential for repatriated flows by domestic investors. For foreign investors, however, Japan has the triple merits of reasonable valuations, a cheap currency, and structural reform.

whether policymakers will go further. This uncertainty is reflected in relatively low valuations in China's equity markets.

While the direction of economic growth in China is uncertain, excessively negative sentiment could produce selective equity opportunities in 2024 in sectors benefiting from the technological upgrade of China's industrial base, including electric vehicles, semiconductors, and higher-value industrial products.

### Key sector themes

**Technology/AI:** The extent to which richly valued U.S. tech giants can demonstrate clear benefits from AI may influence how much pressure they come under in 2024, as these firms race to acquire new capabilities and refine existing ones. But, in contrast to the internet boom of the 1990s, when a relatively small number of firms reaped the bulk of the benefits, we believe AI has the potential to enhance productivity across a wide range of sectors and companies.

Attractive opportunities could include semiconductor companies that are developing leading-edge chips, tech service firms that help companies scale and enhance their AI capabilities, and data centers that benefit from increased demand.

**Health Care:** Innovation—from bioprocessing to medical devices to new treatments for obesity—also could

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The growth outlook for China is less positive, as efforts to stimulate demand so far have been relatively ineffective. Beijing's decision to allow its 2024 budget deficit to exceed 3% of GDP was a step in the right direction, but it's not clear

generate significant equity opportunities in 2024. The U.S. Food and Drug Administration's approval of a class of diabetes medications for use as weight-control drugs has the potential not only to change patient outcomes, but to remake health care economics, given that obesity is a contributing factor to many other conditions. These advances also could have longer-term implications for the food, retail, and hospitality sectors as structural patterns adapt.

**Energy and Commodities:** Energy and other commodity-related stocks could prove to be attractive hedges in 2024 if inflation is stickier than expected and/or if geopolitical factors trigger another energy price shock. These sectors also could be a major focus for investors as

countries and firms push ahead with decarbonization programs. Many EMs are heavily concentrated in energy and commodity-related sectors, so these markets should benefit if renewable energy projects fuel a capital spending boom.

The longer-term outlook for commodity producers could improve as prices adjust upward due to peaking productivity and higher production costs. Geopolitical risks also are likely to keep energy prices high even as supply expands—with positive implications for industry profitability.

These factors do not necessarily mean that global commodities are entering a new bull market, but do imply that we may be past the trough of the long-term cycle.

## Broadening equity horizons

Investment Idea	Rationale	Examples
Expect a broadening in market leadership and more varied sources of return.	Despite near-term economic uncertainty, some sectors are benefiting from innovation and the need to transition to renewable energy sources.	<ul style="list-style-type: none"> <li>— Technology stocks</li> <li>— Health care stocks</li> <li>— Energy stocks</li> </ul>
Focus on attractively valued regions with structural tailwinds.	Key drivers of Japan's market recovery—regulatory reform, improved corporate governance, better capital allocation, and closer attention to shareholder returns—remain positives. EMs could benefit from fiscal and monetary stimulus.	<ul style="list-style-type: none"> <li>— Japanese stocks</li> <li>— EM stocks</li> </ul>

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