

Global markets quarterly update

In the Loop
Q1 2024

Key Insights

- Stocks in most developed markets recorded solid gains in the quarter, helped in part by growing enthusiasm over generative artificial intelligence.
- Policymakers in both Europe and the U.S. signaled that rate cuts were still coming, if not in the near future, despite an uptick in inflationary pressures in the latter.
- Japan led the gains as the weakening yen boosted the competitive prospects of the country's exporters.

Highlighted regions

- U.S.
- Europe
- Japan
- China
- Other Key Markets

What we're watching next
With Sébastien Page

U.S.

Stocks recorded solid gains in the first quarter in a rally that broadened as it progressed. Early in the quarter, growth stocks outperformed handily, led by the so-called Magnificent 7¹ group of technology-oriented mega-caps—as reflected in the outperformance of communication services (including media giants Meta Platforms' Facebook and Alphabet's Google) and technology stocks. Late in the quarter, however, investors began to "pivot" to small-cap and value shares—particularly financials and energy—which had lagged since the market began its upward march in late October.

Conditions were less favorable for fixed income investors, as longer-term yields rose sharply in response to better-than-expected growth signals and diminishing expectations for Federal Reserve rate cuts. However, the same upside growth surprises helped

credit-sensitive issues, particularly high yield corporate bonds, perform better.

The quarter began with some mixed economic data and cautious words from Fed officials. While consumers appeared to be in good shape—retail sales jumped 0.6% in December, for example—the manufacturing sector remained the weak leg in the expansion. An index of manufacturing activity in the New York region reached its lowest level since early in the pandemic, and two separate gauges of nationwide factory activity indicated continuing contraction.

Signs of economic resilience amid higher rates boost sentiment

Stocks picked up momentum in February, seemingly helped by signs that the economy was continuing to defy skeptics and grow despite the highest interest rates in nearly two decades. Early in the month, the Department of

Labor reported that employers added 353,000 nonfarm jobs in January, nearly double consensus estimates, while November's and December's gains were also revised higher, due in part to an annual benchmark revision. Soon after, S&P Global and Institute for Supply Management reported solid growth in their respective indexes of service sector activity, although their manufacturing readings remained more subdued.

The better growth brought some unwelcome inflation surprises later in the quarter, however. Core (less food and energy) inflation rose by 0.4% in both January and February, while producer prices jumped 0.6% and 0.4%, respectively. The core personal expenditures price index, the Fed's preferred inflation gauge, also rose more than expected, although the year-over-year increase continued creeping toward the Fed's 2% target and ended February at 2.8%, its lowest level in roughly three years.

¹ Meta Platforms (Facebook), Alphabet (Google), Microsoft, Apple, NVIDIA, Tesla, and Amazon.com.

Fed still sees rate cuts in 2024

While hopes for a March rate cut faded early in the quarter, investors appeared pleasantly surprised by the summary of individual policymakers' rate, growth, and inflation expectations released after the Fed's mid-March meeting. The median expectation remained for three cuts in 2024, with only slightly fewer cuts in following years. Fed Chair Jerome Powell also testified before Congress that policymakers were "not far" from having the confidence that inflation's downtrend will be sustained, enabling them to begin cutting rates.

Enthusiasm over the potential of generative artificial intelligence (AI) also appeared to provide a general boost to sentiment. AI chipmaker NVIDIA handily again beat quarterly earnings estimates, helping bring its market capitalization up to nearly USD 2.4 trillion and placing it among the most valued public companies in the world. Other firms announced new AI initiatives, and reports surfaced late in the quarter that Apple was in talks with Google to embed the latter's AI assistant in future versions of the iPhone.

Europe

The STOXX Europe 600 Index and major benchmarks in Germany, France, and Italy posted strong gains for a second consecutive quarter on growing optimism about possible interest rate cuts around the middle of the year. Positive economic data and upbeat corporate earnings for the fourth quarter of 2023 also bolstered sentiment. The UK's FTSE 100 Index also advanced.

Government bond yields in France and Germany ended higher amid sharply slowing inflation and hopes that the European Central Bank (ECB) was preparing to ease policy. But Italian bond yields fell amid strong demand for high-yielding debt as traders anticipated rate cuts in the year ahead. In the UK, 10-year yields advanced as data suggested that the economy might be emerging from recession.

ECB signals midyear rate cut; BoE turns more dovish

The ECB and the Bank of England (BoE) began the period aiming to disabuse the market of expectations for an early reduction in rates, citing strong wage growth and services inflation. Policymakers were more dovish by the March policy meetings, as headline inflation decelerated and wage growth began to slow.

The ECB left its key deposit rate unchanged at a record 4.0%, while hinting that a reduction in June may be in the cards. ECB President Christine Lagarde acknowledged that "good progress" had been made toward the 2.0% inflation target but said that the Governing Council still needed to be more confident that prices were falling sustainably. "We will know a lot more in June," she said, adding that there was broad agreement on that point.

Meanwhile, the BoE in March kept its key interest rate unchanged at 5.25% for a fifth consecutive time, although the 8–1 vote that underpinned this decision appeared to send a more dovish signal. Governor Andrew Bailey said, "We are not yet at the point where we can cut interest rates, but things are moving in the right direction." Later, Bailey told the *Financial Times* that rate cuts could be "in play" at future meetings.

Inflation slows, economies perk up in eurozone and UK

Economic data turned more positive at the beginning of the year. In the eurozone, headline and core inflation, which excludes volatile food and energy prices, continued to slow in February, although by less than expected. Annual consumer price growth eased to 2.6%. The eurozone economy narrowly avoided a recession. Gross domestic product (GDP) was unchanged in the fourth quarter after shrinking 0.1% in the previous three months.

In the UK, inflation decelerated to 3.4% in February, the lowest rate in more than two years. Underlying price pressures

also moderated but remained strong. Meanwhile, the economy showed signs that it may be recovering from a recession in the second half of 2023. The National Statistics Office said GDP increased 0.2% sequentially in January, bolstered by expansion of retailing and wholesaling.

SNB unexpectedly cuts rates

The Swiss National Bank (SNB) surprised markets by lowering its main rate by a quarter of a percentage point to 1.5%—the first cut in nine years.

Japan

Japanese stocks had a very strong first quarter of 2024, with the MSCI Japan Index rising over 19% in local currency terms. These gains were largely due to yen weakness resulting from the Bank of Japan's (BoJ's) unexpectedly hawkish tilt (it raised short-term interest rates earlier than had been priced in by most market participants and for the first time since 2007). Exuberance around generative AI and solid corporate earnings also boosted sentiment.

Bank of Japan ends negative interest rate policy

The BoJ made a much-anticipated policy shift and exited its negative interest rate policy. The central bank announced that it will set a policy rate target of 0.0% to 0.1%, up from -0.1%, following reports of major companies agreeing to robust pay increases in annual wage talks. The BoJ also ended its yield curve control program. However, Governor Kazuo Ueda affirmed that financial conditions would remain accommodative as inflation expectations were still below the 2% target.

Market expectations appear to be converging around two more BoJ interest rate hikes within a one-year period. The yield on the 10-year Japanese government bond rose to 0.72% from 0.61% at the end of 2023.

Yen hovers around 34-year low, raising prospect of currency intervention

The yen depreciated to its weakest level in about 34 years over the quarter, to JPY 151.7 against the U.S. dollar, from 141 at the turn of the year. In March, the Japanese currency briefly hovered near JPY 152 against the greenback—which is perceived by many as a point that could trigger authorities to intervene in the foreign exchange markets to prop up the yen. The country's three main monetary authorities suggested toward the end of March that they could be ready to stage such an intervention, in the strongest hint to date. Japanese stock markets have been significantly boosted by historic yen weakness over the past three years, as it has provided a boost to many of Japan's large-cap exporters, which derive a significant share of their earnings from overseas.

Revised report shows Japan avoided recession

Ueda gave a relatively downcast view of the country's prospects, stating that while the economy is recovering moderately, weakness has been seen in some data. However, revised economic growth figures showed that Japan had in fact averted a technical recession (marked by two successive quarters of negative growth) in the final quarter of last year. GDP in the fourth quarter of 2023 expanded 0.1% on the quarter compared with the earlier release suggesting the economy had contracted 0.1%. On an annualized basis, this equated to a 0.4% expansion versus a prior fall of 0.4%.

Consumer prices pick up, services segment continues to drive private sector growth

Inflation, as measured by the consumer price index (CPI), rose to a higher-than-anticipated 2.8%, annualized over the month of February. This was a sharp pickup from January's 2.0%

and well ahead of the BoJ's inflation target. Meanwhile, the latest Purchasing Managers' Index data showed that activity within Japan's private sector expanded at the fastest rate in seven months in March. Much of this is attributable to the strength of the services segment.

China

Stocks in China declined as concerns about the country's prolonged property downturn outweighed data pointing to a pickup in economic activity. The MSCI China Index gave up 2.19% while the China A Onshore Index lost 0.68%, both in U.S. dollar terms.

Data showed no sign of turnaround in China's property crisis. New home prices fell 0.3% in February, the eighth straight month of declines, according to the statistics bureau. A separate report showed that property investment in China fell by 9% in the combined January to February period from a year earlier, slowing from December's 24% drop.

Signs economy is gaining traction

Other readings signaled that some parts of China's economy were gaining traction. Industrial production and retail sales rose more than forecast in January and February from a year earlier as consumption surged during the weeklong Lunar New Year holiday, while fixed asset investment also grew strongly in the first two months of the year amid infrastructure growth. On the other hand, deflationary pressures continued to weigh on China's outlook. The CPI rose a higher-than-expected 0.7% in February year on year, reversing January's 0.8% decline and marking the first positive reading since August. However, the producer price index fell a bigger-than-expected 2.7% from a year ago, accelerating from January's 2.5% drop and marking the 17th monthly decline.

Beijing set an annual economic growth target of around 5% at the National People's Congress, China's parliament, in

March. The government set the budget deficit at around 3%, the same target as early last year, though it later raised it to 3.8% to accommodate more borrowing. It also said it would issue RMB 1 trillion in special ultralong central government bonds to support growth.

Central bank cuts rates to help troubled property sector

In February, the People's Bank of China cut the five-year loan prime rate, a key gauge for mortgages, by 25 basis points to 3.95%, marking the largest cut since the reference rate was introduced in 2019. Analysts said that the unexpectedly large cut will allow more cities across China to reduce minimum mortgage rates for homebuyers and signaled officials' growing focus on shoring up the troubled property sector.

China's GDP expanded 5.2% in the fourth quarter of 2023 over a year ago and rose 1.0% from the previous quarter. For the full year, China's economy grew 5.2%, in line with Beijing's official growth target of around 5%.

Other Key Markets

Türkiye (Turkey): Rates rise, central bank leadership changes, and policymakers may use lira as inflation-fighting tool

Turkish stocks, as measured by MSCI, returned 14.62% in the first quarter versus 2.44% for the MSCI Emerging Markets Index.

In late January, the central bank raised its key policy rate, the one-week repo auction rate, from 42.5% to 45.0%. Shortly thereafter, however, there was an unexpected leadership change at the central bank. Governor Hafize G     Erkan resigned following accusations of family involvement in management of the central bank, and Deputy Governor Fatih Karahan was appointed to be the new governor.

Some of Karahan's early public comments were, in the opinion of T. Rowe Price sovereign analyst Peter Botoucharov, somewhat more hawkish than expected. While confirming that policymakers were happy with the monetary policy tightening that took place from mid-2023 through the end of January, Karahan stressed that monetary policy will be kept tight for "longer than previously envisaged." He also left open the possibility that policy may be tightened further in case of "marked deterioration" in the inflation outlook. Indeed, at the central bank's policy meeting on March 21, policymakers lifted the one-week repo auction rate from 45.0% to 50.0%, noting that the underlying trend of monthly inflation in February was higher than expected, led by services inflation.

Another interesting shift at the central bank took place at its February policy meeting, when policymakers explicitly stated in their post-meeting communiqué that a "tight monetary stance will continue to contribute to Turkish lira's real appreciation process." This could be a sign that the central bank is shifting some attention from rebuilding its foreign exchange reserves to supporting

the currency as an inflation fighting tool. All other things being equal, a stronger currency can result in lower import prices, while a weaker currency usually leads to higher import prices.

Poland: Policymakers hold rates steady amid "substantial uncertainty" about future inflation

Polish stocks, as measured by MSCI, returned 3.54% in the first quarter versus 2.44% for the MSCI Emerging Markets Index.

The Polish central bank kept its key interest rate, the reference rate, at 5.75% throughout the first quarter. The reference rate has remained at 5.75% since early October 2023.

According to the most recent post-meeting statement issued on Wednesday, March 6, policymakers acknowledged that "the process of disinflation" in the Polish economy is continuing, with inflation being "driven down by the reduction of cost pressures reflected in falling producer prices, and by the weak growth

in economic activity." They also noted that fourth-quarter GDP growth measured at 1.0% was "relatively low" but that incoming data "indicate an increase in economic activity growth" in the first quarter of 2024. While policymakers projected that annual CPI growth "will run at the level consistent with" the central bank's inflation target, they anticipate that "the decline in core inflation will be slower and core inflation will remain above CPI inflation." As a result, policymakers decided to keep interest rates unchanged.

Central bank officials justified their decision by noting that inflation developments in future quarters are "associated with substantial uncertainty, related in particular to the impact of fiscal and regulatory policies on price developments, as well as the pace of economic recovery...and labor market conditions." They also cited other factors, such as the potential for higher value-added taxes on food products, higher energy costs, and "medium-term demand pressure in the economy...stimulated by wage growth."

The specific securities identified and described are for informational purposes only and do not represent recommendations to buy or sell.

Major index returns

Total returns unless noted

As of 3/31/24

Figures shown in U.S. dollars

1Q24

U.S. Equity Indexes

S&P 500 Index	10.56%
Dow Jones Industrial Average	6.14
Nasdaq Composite Index	9.11
Russell Midcap Index	8.60
Russell 2000 Index	5.18

Global/International Equity Indexes

MSCI Europe Index	5.39
MSCI Japan Index	11.16
MSCI China Index	-2.19
MSCI Emerging Markets Index	2.44
MSCI All Country World Index	8.32

Bond Indexes

Bloomberg U.S. Aggregate Bond Index	-0.78
Bloomberg Global Aggregate ex USD Bond Index	-3.21
Credit Suisse High Yield Index	1.73
J.P. Morgan Emerging Markets Bond Index Global	1.40

Past performance is not a reliable indicator of future performance.

Note: Returns are for the periods ended March 31, 2024. The returns include dividends and interest income based on data supplied by third-party provider RIMES and compiled by T. Rowe Price, except for the Nasdaq Composite Index, whose return is principal only.

Sources: Standard & Poor's, LSE Group, Bloomberg Index Services Limited, MSCI, Credit Suisse, Dow Jones, and J.P. Morgan (see Additional Disclosure).

What we're watching next



**Sébastien Page, CIO,
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The magnitude of Fed cuts in 2024 is likely to be less than expected at the start of the year, as economic growth has been resilient and inflation has continued its downward trajectory, laying the groundwork for a soft landing. The end of the quarter brought growing hopes that the market's strong advance since late October may be broadening on the back of robust earnings and continued economic momentum.

Valuations in some of the growthier parts of the equity market are elevated, though areas like value stocks and small-caps remain relatively attractive. Should economic growth remain stable, and inflation continue its downward trend, we expect that those areas, and equities more broadly, will see upside.

While the Asset Allocation Committee isn't explicitly negative on growth stocks, the category is expensive with narrow leadership. Moreover, we have witnessed recently the vulnerability of growth stocks to higher interest rate expectations, which implies a greater discount on future earnings. Positive sentiment from AI is a tailwind, however, and the mega-cap technology-related companies have seen earnings increase alongside valuations—a

far different situation than during the dot-com boom years of the late 1990s.

In international markets, the sector mix between growth and value is less clearly defined than in the U.S.—in particular, markets are not as heavily bifurcated between “big tech” and financials. That said, international value is poised to benefit from a number of cyclical factors—higher yield levels at the long end of the curve, potential for falling short rates, and rebounding consumption trends. Earnings appear to have bottomed, valuations are cheap, and with macro catalysts poised to deliver tailwinds over the next 12 months, we are leaning into the opportunity.

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