T.RowePrice

2024 Global Market Outlook
Midyear Update

Market resilience is uncovering investment opportunities

Key Insights

- A surprisingly resilient economy may keep rates higher for longer, but there is still potential for one or two Fed rate cuts later this year.
- The dominance of the “Magnificent Seven” may be waning, potentially offering investors a broader set of opportunities in areas that have lagged.
- Periods of change highlight the value of research and active portfolio management.

An economic surprise

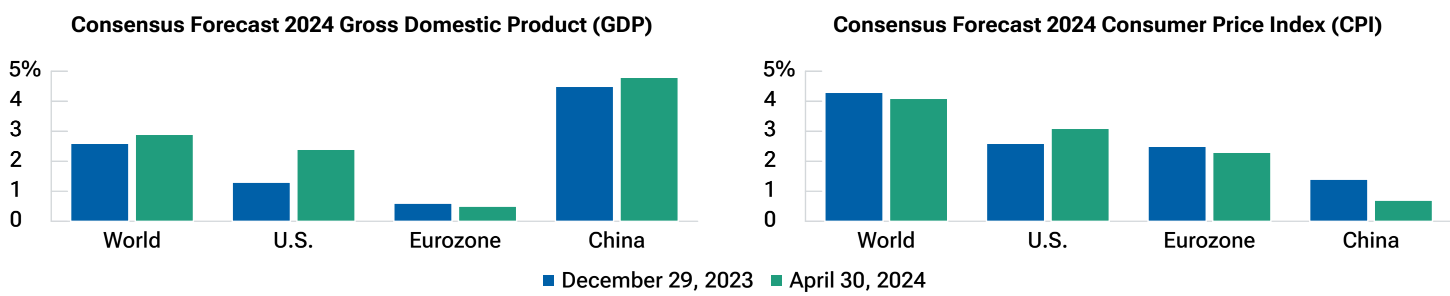
2024 has surprised economic forecasters. Six months ago, the consensus expectation for the global economy included steadily falling inflation and a slide toward recession. This had investors eagerly hoping for aggressive central bank rate cuts to combat a weakening economy.

What a difference a few months can make. As shown in Figure 1, over the course of this year, forecasters have slowly revised their expectations for global economic growth upward as the economy has shown unexpected resilience. At the same time, inflation expectations and interest rates have remained stubbornly elevated. These developments have unsettled many investors, who have been holding back on moving out of cash given the uncertain environment.

What does this backdrop mean for markets and asset classes? We expect a broadening in U.S. equity market

More growth, more U.S. inflation

(Fig. 1) How consensus forecasts have shifted since the end of last year



As of April 30, 2024.
Source: Bloomberg Finance L.P.
There is no guarantee that any forecasts made will come to pass.
The consensus forecasts are for full-year 2024 GDP and CPI figures, taken at the end of December and the end of April, respectively.

performance, meaning that a wider range of previously lagging stocks and sectors have a chance to rally. We are also seeing attractive value in some international stock markets. Investors seeking to move out of cash may find good opportunities in shorter-term bonds as well as stocks.

Most importantly, we believe the ongoing transition from the low rate environment under COVID to one characterized by persistently higher interest rates will present favorable conditions for active managers to outperform.

Interest rates caught in a tug of war

As investors plan for the rest of the year, it would help to know where interest rates are headed. Interest rates offer a window into the health of the overall economy and the environment that companies will be operating in.

With inflation remaining elevated and the economy uncertain, the Federal Reserve should carve a careful path as it makes decisions about rates. Like most global central banks, it appears that the Fed would like to cut rates to avoid recession—but not if the price is a renewed surge in inflation.

In our view, there's good reason to think the Fed will cut rates near the beginning of the second half of the year, perhaps by 25 basis points (equivalent to 0.25 percentage points). The Fed will likely want to avoid any sign that it is influenced or motivated by politics, so it will probably not take action in September or November.

The Fed believes that monetary policy is tight, and many observers believe the Fed can provide some benefit to the economy without amping up inflation. We think it would only take modest softening in the labor market to convince the Fed to cut.

On the other hand, if the Fed struggles to get core inflation to 2%, it may choose to keep rates steady for an extended period. It's also possible that the Fed will raise rates if inflation surges again. This is not our base outlook, but we believe investors should be prepared to hedge against this risk.

Tactical considerations for investors:

- While inflation is generally not considered positive for stocks, energy sector stocks have tended to perform well during periods of high inflation. If inflation remains elevated, a good option for investors to consider may be tilting their portfolio toward stocks, with an emphasis on the energy sector and other commodity-oriented equities.

- Bonds have tended not to benefit from inflation. However, inflation protected government bonds may help hedge inflation risk because they have held up well in inflationary environments.

- Regardless of what interest rates and inflation do, shorter-term bonds are a good risk/reward option. In our view, they offer modest risk, attractive yield levels, and the potential for price appreciation if yields move lower.

A wider range of opportunities

One of the challenges for investors with a surplus of uninvested cash has been identifying areas of opportunity in the U.S. stock market. In recent years, the market has been dominated by the "Magnificent Seven" tech stocks (Nvidia, Meta, Microsoft, Amazon, Apple, Alphabet, and Tesla), but there are signs this once-monolithic group of large-cap growth firms is beginning to fragment.

Meanwhile, value stocks and small-cap stocks could be primed for a comeback, as many investors are looking to control their risk by diversifying outside of high-valuation large-cap growth stocks.

International stocks also appear to be attractively valued. Many non-U.S. companies (particularly in Japan, South Korea, and Vietnam) have seen their fundamentals rebound dramatically in the post-COVID environment, as demonstrated by strong earnings growth in recent

years. In contrast to the U.S. market's heavy exposure to growth stocks, the international market is more weighted toward value-oriented sectors such as financials, materials, industrials, and energy—all areas that we believe will advance in the coming quarters.

Tactical considerations for investors:

- Assuming the market broadens, it's our view that value stocks may be positioned for success. Value stocks have lagged large-cap growth firms and, we believe, are more attractively priced. Value companies are often cash-rich and historically fared better when interest rates remained higher for longer.

- In our view, small-cap stocks are another effective way to diversify a portfolio that is concentrated in large-cap growth stocks. Small-caps are trading at a major discount to larger companies, and their earnings will likely improve if rates stabilize or decline.

- Diversifying into international stocks may help an investor's portfolio manage risk in the U.S. market.

Getting active

Early in 2024, concerned investors held a vast amount of cash in money market funds and other short-term, liquid instruments. (See Figure 2, U.S. investors are flush with liquidity.) But with the economy holding up better than expected, it's becoming increasingly costly for investors to stay on the sidelines.

The uncertain and surprising nature of economic developments in recent quarters suggests that active portfolio oversight and consistent risk management will become increasingly necessary. Higher interest rates will, we believe, lead to greater dispersion of returns and heightened volatility in both stock and bond markets.

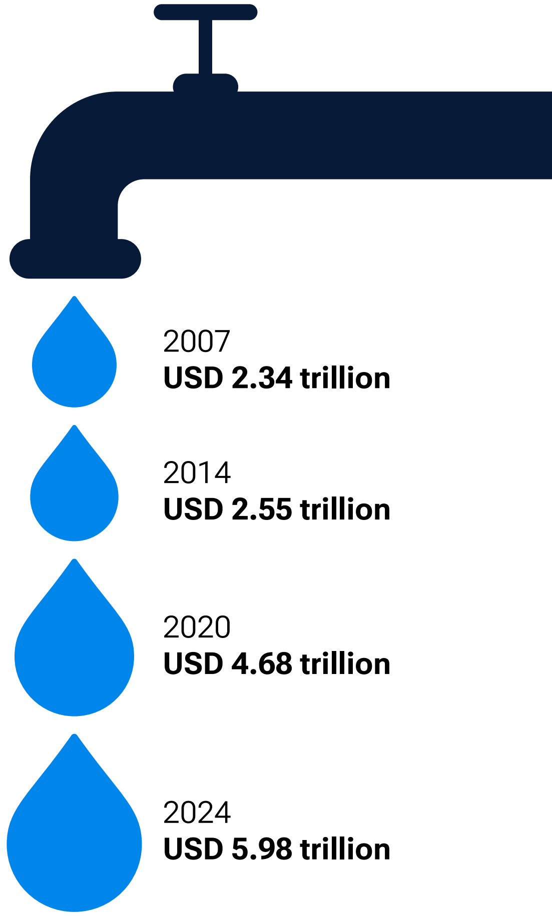
Active management offers a flexible and proactive approach to managing risk and pursuing gains. If market trends are changing or the economic outlook is unclear, active portfolio managers can act on behalf of investors to monitor the fundamentals, macroeconomic developments, and valuations that have the potential to provide investors with better risk-adjusted return opportunities.

These developments do not mean we expect passive investing to undergo a major retreat. However, we believe that active management will be the better option for the period ahead, as it has the potential to offer better outcomes during periods of greater volatility and dispersion.

Navigating today's market requires a proactive approach to investments. With the economy showing resilience, high interest rates proving sticky, and market dynamics constantly shifting, it appears to be a great time for investors to rethink their portfolio for potential gains. Focusing on value stocks, small-cap stocks, and international equities, along with shorter-term bonds, can help investors manage risk and be prepared to seize new opportunities. Active management is especially valuable now because it offers the flexibility and insight to adapt to rapid changes. By staying informed and making strategic adjustments, investors have the opportunity to enhance their financial outlook.

U.S. investors are flush with liquidity

(Fig. 2) Money market assets are highly elevated



As of April 1, 2024.
Source: Investment Company Institute.

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Investment risks: Past performance is not a reliable indicator of future performance. Active investing may have higher costs than passive investing and may underperform the broad market or passive peers with similar objectives. Each person's investing situation and circumstances differ. Investors should take all considerations into account before investing.

International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. The risks of international investing are heightened for investments in emerging market and frontier market countries. Emerging and frontier market countries tend to have economic structures that are less diverse and mature, and political systems that are less stable, than those of developed market countries.

Commodities are subject to increased risks such as higher price volatility, and geopolitical and other risks. Commodity prices can be subject to extreme volatility and significant price swings.

The **value approach** to investing carries the risk that the market will not recognize a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced.

Small-cap stocks have generally been more volatile in price than the large-cap stocks.

Diversification cannot assure a profit or protect against loss in a declining market.

Because of the cyclical nature of **natural resource companies**, their stock prices and rates of earnings growth may follow an irregular path.

Fixed income securities are subject to credit risk, liquidity risk, call risk, and interest rate risk. As interest rates rise, bond prices generally fall. Short duration bonds have more risk than cash/cash equivalents such as money markets. Equities have higher risk and are subject to possible loss of principal.

Investments in **high yield bonds** involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities.

Investments in **bank loans** may at times become difficult to value and highly illiquid; they are subject to credit risk, such as nonpayment of principal or interest, and risks of bankruptcy and insolvency.

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