Outlook 2024:

A year of hard choices

BARCLAYS | Private Bank

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Foreword

Welcome to our "Outlook 2024" report, the signature investment strategy update from Barclays Private Bank.

Strong economic headwinds will likely persist in 2024, amid an increasingly fraught geopolitical backdrop, and diverging fortunes in the key regions. Investors should brace both for uncertainty, and for market volatility that often accompanies it.

Despite the obvious challenges, our report offers context on why it's not all doom-and-gloom for investors. In addition to our macro and asset class analysis, you'll find fresh insights on the fast-evolving sustainability space, as well as our latest perspectives from the field of behavioural finance.

The world is changing at pace, but for long-term investors the core message remains consistent: stay invested and stay diversified.

Jean-Damien Marie
Global Head of Investments, Private Bank and Wealth Management

What lies ahead for the global economy and financial markets in 2024?

As we look ahead to 2024, the temptation was high to just repeat the investment strategy we laid out back in our June Mid-Year Outlook. The world is as uncertain, if not more, as it was then and anticipating what will happen next is an ever more challenging task.

RECESSION 2.0

The most anticipated recession in history is still nowhere to be seen. Simply because it didn't happen in 2023, many investors are now expecting it in 2024. While each day passing brings us closer to the next economic contraction, we continue to believe that the whole "recession debate" is misplaced.

First, there's the misconception in most people's mind that a recession is what we experienced in 2008 and brings a near collapse of developed economies. If this is what a recession looks like, then we can convincingly say that we still do not expect one in 2024.

Second, it's worth remembering that we, as investors, are in the business of selecting the optimal combinations of assets that could deliver the most attractive risk-adjusted returns over the medium term. We do not go long or short the GDP of a country or a region. This is why, recession or not, what really matters is how stocks, bonds, commodities, and real assets will react to the future macro and micro-economic developments.

LOWER GROWTH AND LOWER INFLATION

What we do expect is a world where economic growth trends lower, sometimes flirting with contraction. With that, we also expect inflationary pressures to recede, albeit gradually from here. With main central banks having been extremely aggressive in their pursuit of higher interest rates, we would expect them to change tack as the year progresses (given expectations of falling inflation). However, investors should be careful what they wish for: monetary policy may not turn accommodative unless the outlook meaningfully deteriorates.

This environment may not seem conducive to attractive investment opportunities, but we see plenty. Of course, the road ahead won't be plain sailing and setbacks are likely. In addition, risks appear tilted to the downside as the "long and variable" lags of tighter monetary policies have yet to filter through. This is why, in 2024, investors' resolve will likely be tested once again.

LOOKING IN AND LOOKING OUT

While the main risks that come to mind when thinking about the next 12 months are macroeconomic or geopolitical, investors often underestimate two other sources of possibly even greater risk. The first is the risk from within and how detrimental investor psychology can be. The second is the risk staring us in the face: climate change. The successful investor will have to consider both of these risks in 2024 and beyond.

PLAYING DEFENCE

Cash is now a comforting and arguably rewarding alternative. However, it's unlikely to be the long-term answer to meeting one's investing goals. Instead, a well-planned and appropriately diversified portfolio should allow both the dampening of short-term volatility, and the maximising of potential risk-adjusted returns. While this message may sound familiar to our readers, the make-up of said portfolio should be adjusted to reflect the current backdrop.

While 2023 was about locking in yields, 2024 could be about extending (fixed income) duration to capture more than just coupons until maturity. Similarly, equity investors would need to tweak their allocation to favour sectors and regions that can respond well when growth slows and rates start falling. Beyond stocks and bonds, investors will also need to be creative and tactical. Option strategies could be a very useful tool for improving the risk-reward profiles of investment in 2024. Finally, private markets and hedge funds could allow portfolios to benefit from sources of returns that are less directional and less correlated than traditional asset classes.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

Global economy shines rays of hope

Leading economies, bar China, have been more resilient than had been expected this year. Leaving aside bulging government deficits and geopolitical risks, the prospect of inflation plunging closer to the target rate, healthy company balance sheets and the potential impact of artificial intelligence on economies all point to reasons for some optimism.

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

ECONOMIC FORECASTS, YEAR-ON-YEAR (%, F=FORECAST)

	GDP			CPI		
	2022	2023F	2024F	2022	2023F	2024F
Global	3.3	3.0	2.4	6.3	3.9	2.7
Advanced	2.6	1.5	0.8	7.6	4.7	2.7
Emerging	3.8	4.0	3.6	4.6	2.8	2.7
US	1.9	2.4	1.0	8.0	4.1	2.6
Eurozone	3.4	0.4	0.3	8.4	5.6	2.8
UK	4.3	0.5	0.4	9.1	7.3	3.0
China	3.0	5.1	4.0	1.9	0.5	1.6
Japan	1.0	2.2	1.3	2.5	3.2	2.8
Brazil	2.9	3.0	1.9	9.3	4.6	3.8
India	6.8	6.3	6.4	6.7	5.5	5.0
Russia	-1.9	1.7	1.0	13.7	5.6	5.5

Source: Barclays Investment Bank, Barclays Private Bank, November 2023

A year ago, the consensus pointed to a median global growth forecast of around 2% for 2023. Fast forward to today, and this number has nudged up to 2.8%. While this may seem negligible, it also means that the world's economy has grown almost 50% faster than was expected a year ago.

This unexpected resilience can be explained by many factors. First and foremost, consumers have been able to rely on excess savings and wage growth to offset the challenges caused by elevated inflation. Second, businesses have been able to maintain profitability levels thanks to strong pricing power and appropriate balance sheet management. Finally, governments have often taken the baton from central banks, providing fiscal support when monetary conditions were tightening quickly.

The only significant disappointment came from China, where the anticipated post-lockdown boom quickly gave way to investors wondering if the economy could actually achieve just 5% growth this year.

LOWER GROWTH AHEAD

With a stronger base to start from, 2024 is likely to be a year of lower economic growth. The current median forecast is for global gross domestic product (GDP) to expand by 2.6%. That said, we forecast that expansion will be a more conservative 2.4%.

However, this number masks significant disparities. Advanced economies are expected to struggle more (with 0.8% growth, less than half the pace seen in 2023) while the momentum in emerging markets could remain largely unchanged (3.6% versus 4.0% in 2023). This is the result of India's strong contribution, where GDP expansion is forecast to accelerate next year (6.4% versus 6.3%), likely the result of ongoing reforms, companies reallocating capital from China to the country and access to lower-priced energy (especially oil).

It seems reasonable to expect that the developed world will find growth more difficult to achieve. Higher interest rates and tighter credit conditions should take their toll, eventually. Furthermore, the US Federal Reserve, the European Central Bank and the Bank of England have all been clear that they want to slow their respective economies in order to tame inflation.

WEAKER INFLATION TOO

The base case is for central banks to succeed in reining in price pressures. Indeed, inflation in most large economies is forecast to dip below 3% by the end of 2024. Even emerging markets, excluding China, should see their aggregate inflation rate drop from 5.1% to 3.8%.

However, deflationary forces won't be the same everywhere, or for everybody. Some services prices should fall significantly in the coming twelve months. In particular, it seems that the post-pandemic 'revenge' travel boom is now over, as consumers turn more cautious. On the other hand, strong wage pressures might keep other parts of the services inflation basket higher for longer. Meanwhile, goods prices are likely to remain subdued as demand wanes, inventories are full and, in many cases, pricing power fades. That said, commodity prices remain a wild card.

Supply-demand dynamics and geopolitical risk premium should underpin fuel prices, which will also remain vulnerable to the threat of a weaker macroeconomic backdrop. Meanwhile, the cost of agricultural commodities remains hostage to an ever more capricious climate.

POLITICS TO KEEP MARKETS GUESSING

In addition to an uncertain growth-inflation mix, investors may have to contend with several other risks. Among the knowns for 2024 are two major elections in the US and the UK. At this stage, it is too early to speculate as to which party will be elected and on what platform. One thing is clear though, the political uncertainty in these countries will ramp up as we close in on the final quarter of the year.

Turning to Asia, investors will also have to account for a potentially contentious presidential vote in Taiwan.

Irrespective of their political inclinations, governments around the world will come under more pressure to address ballooning debt burdens and excessive deficits. Financial markets could morph into fiscal referees, arbitrating the appropriateness of any new spending plans.

REASONS FOR HOPE

While it's difficult to get excited about the macroeconomic outlook for 2024, it is important not to underestimate the private sector's ability to adjust and navigate uncertain times. On that front, there appear to be rays of hope. First, corporate balance sheets are, for the most part, still healthy. Indeed, firms took advantage of the pandemic-related decline in interest rates to extend the lower cost of their debt while increasing average maturity.

Second, innovation continues unabated. In particular, the exponential adoption of artificial intelligence (AI) could pave the way for one of the fastest technological revolutions. Indeed, the tangible first impacts of AI could be felt next year already, be it on employment (negative), productivity or profitability (both potentially positive).

Finally, and unlike twelve months ago, many investors and forecasters are somewhat downbeat about what lies ahead. While this in itself is not enough to prevent a slowdown, it leaves plenty of room for positive surprises if the data turn out to be better than expected, even if only marginally.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

What could go wrong, or right?

While the base-case scenario is for global growth to chug along and for inflation to weaken, what might be the main risks to the scenario in 2024?

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

The base-case scenario is for the global economy to muddle through in 2024, with some regions only narrowly avoiding a recession. But an unprecedented interest rate hiking cycle, a tense geopolitical backdrop and the lagged effect of the COVID-19 pandemic make forecasting the next twelve months particularly challenging. This article explores what could go wrong compared with the baseline, but also what could go right.

SOMETHING BREAKS

As highlighted by the banking stress of March 2023, which saw US bank runs and the demise of Credit Suisse, the rapid increase in interest rates around the developed world is unlikely to go unnoticed. So far, whether on the consumer or the corporate side, events have been encouraging. However, this may not last for much longer.

Consumers are running out of excess savings, especially those in the lower income quartile. In fact, credit card delinquencies in the US have already started to pick up. Meanwhile, companies with upcoming refinancing needs might struggle to find the money they need to stay in business. As such, worsening credit quality is a major risk for 2024.

SOVEREIGN DEBT CRISIS REDUX

Business and consumer finances are not the only ones that could come under pressure in coming months. Governments are also being watched like hawks by financial markets after years of fiscal largesse. The global debt-to-GDP ratio currently stands at 99%, a sharp jump from the 91% recorded before the pandemic in 2020.

With the cost of borrowing increasing, some countries could find it difficult, if not impossible, to roll down their debt. And this time around it's not just the usual suspects, such as Greece or Italy, that are worth keeping an eye on. In fact, with an extremely polarised and divided government, the US might find itself in the eye of the storm.

ANOTHER INFLATIONARY SHOCK

It may be easy to blame central banks for getting inflation forecasts wrong in the last two years. The reality is that the Ukrainian war threw a spanner in the works of the "transitory" narrative. While this conflict was not the sole source of surging prices, its contribution has been real and reminds us that shocks can easily upend any forecast.

With geopolitical tensions running high, another major conflict (Taiwan comes to mind) could erupt in 2024. Should it have global repercussions, all bets could be off.

A CURVE BALL

Most of the previously mentioned risks, as remote as they might be, can be anticipated by investors. The real danger comes in the form of a curve ball that nobody saw coming. Because it hasn't been priced in, this surprise can be hugely disruptive. The COVID-19 pandemic, or the war in Ukraine, were two recent 'unknown unknowns' that weren't on most investors' radars even a week before they started.

There is no reason to believe that 2024 won't have its own shocks in store for us. Here are some "out of the box" hazards one may want to think about: a major US earthquake, an AI-generated securities sell-off, or worldwide cyber disruption. The only way to account for these risks is through appropriate diversification and a strong commitment to one's investment goals. As we've learned from these two episodes of uncertainty and market stress, the recovery can be as unpredictable as the initial shock.

IT'S NOT ALL DOOM AND GLOOM

While we've focused on negative shocks so far, positive surprises could pop up in 2024. Whether it's in the form of a much resilient global economy, a faster-than-expected cooling of inflationary pressures, a geopolitical détente in the Middle East or another momentous technological leap, the coming year could be much stronger than expected.

It's also important not to underestimate the ability of societies, companies and financial markets to innovate and adapt to changes in their environments. This is why, despite all the risks discussed, staying invested in financial markets will likely be the most appropriate strategy for anyone who has a time horizon of longer than a few months.

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Can the US economy keep defying gravity?

America continues to resist the downward pull of sky-high inflation and zooming interest rates. It is coming at a cost, notably in the form of stratospheric government spending. In the run-up to the next presidential election, the risks of a recession of sorts will likely grow.

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

US ECONOMIC FORECASTS, YEAR ON YEAR (%, F=FORECAST)

	2022	2023F	2024F
GDP growth	1.9	2.4	1.0
CPI inflation	8.0	4.1	2.6
Unemployment rate	3.6	3.6	4.2
Gross public debt (% of GDP)	122.0	123.2	126.2
Private consumption	2.5	2.2	1.1

Source: Barclays Investment Bank, Barclays Private Bank, November 2023

The main economic surprise of 2023 was the resilience of the US economy, driven primarily by the government's fiscal largesse, as highlighted in It's a mIRAcle. While growth was much stronger than expected, it has come at a cost.

The US debt pile surpassed $33 trillion in 2023, up more than $3 trillion during the year and $10 trillion since 2019, the last calendar year before the COVID-19 pandemic. Meanwhile, the latest Congressional Budget Office (CBO) projections point to a budget deficit that will be above 5% of gross domestic product (GDP) for the next ten years. Ouch.

At this rate, the amount of US government debt could surpass $50 trillion by 2033. This, at a time of higher interest rates (at least for now), could mean that, by 2031, the country spends more on interest payments than it does on non-defence discretionary expenditure (such as funding for transport, education, health, international affairs, natural resources and the environment, and science and technology). This is unsustainable.

CHALLENGING US EXCEPTIONALISM

Without a large, price-insensitive buyer like the US Federal Reserve (Fed), and with the apparent desire of foreign central banks to diversify away from US-linked currency or debt holdings, the government can't afford to spend in a totally reckless fashion.

This issue will likely be a key point of debate among White House hopefuls in the run-up to the presidential election in 2024. Especially at a time when tensions around the debt ceiling and government funding are such hot potatoes.

Despite the dangers facing the nation's economy or assets, there is still no credible substitute to the perceived safety offered by the country's government bonds. Furthermore, many locally based companies still dominate their respective industries globally, in terms of both market share and profitability.

Yet, with the above headwinds in mind, the US economy is unlikely to generate significant growth in 2024, with real GDP forecast to slow to 1.0% during that year, down from the 2.4% anticipated this year. While hardly exciting, such performance stacks up well compared to European nations.

INFLATION TO MODERATE AND PUT A LID ON RATES?

With consumers running out of the excess savings built up during the pandemic, partly via government spending initiatives, as well as limited real wage growth and the soaring cost of financing debt, consumption will likely falter in 2024. In turn, this would probably limit companies' ability to hike prices, in turn helping to tame inflationary pressures. At least, that's the theory.

In addition, shelter costs should gradually normalise in 2024, pressured by higher interest rates, according to the Federal Reserve Bank of San Francisco[1]. As a result, barring a major economic shock, domestic inflation should continue to trend lower and possibly dip below 3% in the next 12 months.

Should inflation return to within touching distance of the central bank's 2% target, this would offer some welcome respite for the Fed; perhaps enough for policymakers to consider cutting rates in the second half of 2024. Of course, this is dependent on a relatively "soft landing" for the economy and a somewhat limited increase in the unemployment rate (forecast to tick up towards 4.5%).

That said, if the macroeconomic picture worsens faster than anticipated, then the central bank could be forced to act more forcefully. On the other hand, there seems to be little risk of significantly higher domestic interest rates in coming months.

> "The US economy is unlikely to generate significant growth in 2024, with real GDP forecast to slow to 1.0%. While hardly exciting, such performance stacks up well compared to European nations"

JOBS, HOUSING AND CREDIT

Looking to the coming year, there appear to be three main risks around the base case. These largely relate to pandemic-related discrepancies that have yet to be resolved.

The first is the local job market, which has remained incredibly tight in 2023. The persisting strength of the local economy, in the face of several signals of a pending recession, accounts for some of this performance. Another factor might be linked to "labour hoarding", as companies retain staff by fear of not being able to hire them back when economic prospects turn for the better.

The second risk relates to the impact of higher rates on the domestic housing market. Outside of new builds, activity has been anaemic in the face of soaring mortgage costs and people preferring to stay put rather than move house. While this is technically sustainable, it likely restricts job mobility and with it, potential economic growth. As such, house prices may have to adjust lower, eventually.

Finally, with the surge in interest rates seen in the last 18 months still working its way through the economy, the credit market is a source of potential concern. Whether it's more companies defaulting or an uptick in credit card delinquencies, the extent of the hit to the economy is still unclear. However, on balance, credit measures are most likely to deteriorate further in coming months.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

[1] Where is shelter inflation headed? The Federal Reserve Bank of San Francisco, 7 August 2023

Can it get any tougher for Europe?

With the eurozone's largest economy spluttering and increased fears of higher energy prices, the bloc will struggle to grow much in 2024.

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

EUROPE ECONOMIC FORECASTS, YEAR ON YEAR (%, F=FORECAST)

	2022	2023F	2024F
GDP growth	3.4	0.5	0.3
CPI inflation	8.4	5.6	2.8
Unemployment rate	6.7	6.5	6.7
Gross public debt (% of GDP)	93.2	92.0	93.6
Private consumption	4.2	0.3	0.5

Source: Barclays Investment Bank, Barclays Private Bank, November 2023

The last twelve months have been another challenging year for the eurozone. While, on aggregate, the bloc avoided a recession, growth was muted. Germany was caught in the eye of the storm and, after being the engine of growth for the region, has become its sick man.

Indeed, the country's business model in recent decades has relied on access to cheap Russian energy and exports to the Far East, both of which are being challenged on both sides with the Ukrainian war and the lack of a recovery in China.

While the energy crisis has abated in 2023, other challenges remain. First, the region's dependence on international trade is suffering as the rest of the world hasn't been immune from the macroeconomic slowdown, in particular on the manufacturing side. Second, with financial markets increasingly focused on government deficits and national debt levels, worrying memories of the 2010 sovereign debt crisis have started to resurface.

With inflation still problematic, the risk of stagflation can't be ignored. The silver lining could come in the form of increased spending from the €800 billion Next Generation EU (NGEU) recovery package, which, after a slow start, could finally pick up in 2024.

FLIRTING WITH RECESSION

With monetary policy likely to remain restrictive for most of 2024, the bloc's gross domestic product (GDP) is forecast to expand by just 0.3%, roughly in line with the pace seen in 2023. With growth so weak, and the economy being close to stagnation, there is the risk that a small accident tips the eurozone into recession. However, should this occur, any contraction would likely be relatively mild.

Within the eurozone, most major countries appear on course to grow by less than 1% in the next twelve months. Even after contracting in 2023, the recovery in Germany should be minimal, with the country's GDP set to expand by just 0.2% next year. On the other hand, the Spanish economy should continue to outgrow its peers. That said, the main driver of this performance should shift from the recent tourism boost to the benefits of having been the main user of the NGEU grants so far.

INFLATION TO STAY ABOVE TARGET

One of the challenges facing the European Central Bank (ECB) is the wide disparity of inflationary pressures evident among EU members. While the Netherlands saw prices drop year on year (Y/Y) in October (-0.4%), France's harmonised index of consumer prices was still running at 3.9% Y/Y. This makes it difficult to fine-tune monetary policy and increases the risk of the authorities getting policy wrong.

Overall, eurozone inflation should ease in 2024, averaging 2.8%, nearly half of that seen in 2023. While this is still above the ECB's 2% target, the central bank may be willing to tolerate this overshoot in the context of a bleak growth outlook and weak consumption, despite historically strong wage growth.

"With growth so weak... there is the risk that a small accident tips the eurozone into recession"

POTENTIAL FLASHPOINTS

With the ECB aiming to keep interest rates elevated for as long as needed in the fight against inflation, escaping stagflation will require fiscal support. On that front, disparities among the growth dynamics of EU members will cloud policy again, and we would expect financial markets to police governments that spend more than they can afford. As a result, increased spread volatility on sovereign bonds seems to be a real risk in coming months.

Energy prices will be another key factor to consider when assessing economic prospects for the eurozone. While gas storage is 98% full and in a much better shape than it was this time last year, geopolitical tensions and a colder-than-expected winter could revive the inflationary impulse and weigh on the bloc's growth prospects.

Finally, part of the region's weakness of late can be attributed to a global slump in manufacturing activity. This could just be the payback from a pandemic-related boom and, if so, a rebound may be on the cards for 2024. However, if this rebound does not materialise, at a time when services activity is likely to slow, the bloc could find itself gasping for air.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

Stormy weather ahead for the UK

With weak growth, elevated inflation and bulging government debt, the UK's economic prospects for the next twelve months seems tough enough. Add in a probable general election and investors should strap in for a roller-coaster ride.

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

UK ECONOMIC FORECASTS, YEAR ON YEAR (%, F=FORECAST)

	2022	2023F	2024F
GDP growth	4.3	0.5	0.4
CPI inflation	9.1	7.3	3.0
Unemployment rate	3.7	4.2	4.6
Gross public debt (% of GDP)	97.7	103.9	103.7
Private consumption	5.2	0.6	0.3

Source: Barclays Investment Bank, Barclays Private Bank, November 2023

It's hard to look at the UK and not to feel concerned. While each region and country faces its own challenges, the UK seems to be accumulating them.

Indeed, domestic inflation remains stickier despite the continued surge in interest rates seen in the last twelve months. With labour supply still constrained, the job market's tightness is still problematic and raises the prospects of a wage-price spiral embedding higher inflation expectations. In one word, the UK economy exhibits all the trademarks of stagflation.

That said, just like the rest of the world, the economy has been much more resilient than expected a year ago. But here again the positive surprise could be attributed to overly pessimistic assumptions about 2023 made back then, rather than stronger economic momentum.

NO RECOVERY IN SIGHT

The UK economy is on track to deliver growth of 0.5% in 2023. Without any signs of improvement in leading indicators, it's hard to envisage a stronger showing in 2024. In fact, we would expect gross domestic product (GDP) to expand by just 0.4% . While a UK recession will probably be avoided in the coming months, just like its eurozone neighbour, the margin for error is small.

On the positive side, consumption should remain supported by wage growth and a long normalisation process for the job market from the effects of the COVID-19 pandemic. On the negative side, this will likely keep inflation elevated for longer than the Bank of England would like. As a result, the "plateau" of higher interest rates may extend until well into the later parts of 2024 before dropping significantly.

STICKY PRICES

After peaking at above 11% twelve months ago, headline inflation has been on a steep downtrend in 2023, rapidly approaching 6%. Meanwhile, core prices (or those excluding volatile items like food and fuel) have been stuck close to these levels for the best part of a year.

There are good reasons to believe that inflation will ease more quickly. First, with economic growth stalling for a second year, companies' ability to pass on higher prices to shoppers should be much tougher. Second, some cracks are starting to appear in the job market: the unemployment rate has risen to 4.3% in the three months to July, from the 3.8% seen in the previous three-month period. Furthermore, vacancies dipped below one million in the summer, after peaking at 1.3 million in May 2023. This should encourage lower wage growth and help to bring the consumer prices index below 3% in 2024.

> "While a UK recession will probably be avoided in coming months, just like its eurozone neighbour, the margin for error is small"

POLITICS TO THE FORE

Consumers, businesses and investors face the difficulty of judging the likely outcome of a general election seemingly pencilled in to take place in the fourth quarter of 2024 (unless snap elections are called before). The opposition Labour party is well ahead in the opinion polls and appears to be on course for a victory.

A possible change in the administration can be a source of both hope and uncertainty and electoral campaigns are often rich in headline-grabbing promises, whether or not these translate into law. But, elections also breed uncertainty at a tough time for the country, economically speaking.

Whoever comes to power will face the harsh reality of public borrowing fast approaching 100% of GDP, having doubled in the last 15 years. Any incremental public spending is unlikely to be financed through hiking the deficit further. In other words, higher taxes might be on the cards.

Given the limited certainty over what the political landscape will look like a year from now, the risk is that businesses and consumers alike turn cautious, adopting a "wait and see" attitude. This could hamper spending at a time when the UK economy is already failing to generate meaningful growth.

With so many unknowns and with risks tilted to the downside, the outlook for the domestic economy is far from exciting. That said, as seen in the last twelve months, it's much easier to surprise positively when expectations are so low.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

Is the worst now behind China?

After hopes of a strong bounce in Chinese growth following the ending of COVID-19 restrictions were dashed, is the gloom surrounding the country's prospects now really justified?

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

CHINA ECONOMIC FORECASTS, YEAR ON YEAR (%, F=FORECAST)

	2022	2023F	2024F
GDP growth	3.0	5.1	4.0
CPI inflation	2.0	0.5	1.6
Unemployment rate	5.4	5.3	5.2
Consumption	1.0	4.2	3.0

Source: Barclays Investment Bank, Barclays Private Bank, November 2023

The Chinese economy is on track to grow by just 5.1% in 2023. While this is still better than last year's 3.0% expansion, it is lower than the bounce most economists expected after the country ended its "zero COVID" policies around 12 months ago.

The country faces headwinds. First, as an exports-driven economy, the combination of slow growth in the developed world along with trade tensions in some of its largest markets, have been a drag on the manufacturing sector. Second, the domestic real estate sector is still struggling to recover from its recent troubles and is in dire need of a profound restructuring. Finally, Chinese consumers are suffering a typical "balance sheet recession", as their main focus is to reduce debt rather than to take on more of it.

In this context, the government's limited stimulus measures offered during 2023 have been of little help to lift growth. A much larger fiscal boost would be required to significantly increase output. That said, every initiative helps, and although a sharp reacceleration in the economy remains unlikely, China's weak economic momentum appears to have troughed.

ANOTHER CHALLENGING YEAR AHEAD?

With so much relying on central and local governments' willingness and ability to support the economy, visibility remains limited. With no clear plans to unleash a large fiscal package and the persisting drag on growth from the deleveraging process, Chinese economic growth will likely remain subdued in 2024, at around 4%.

However, the same way that the nation disappointed in 2023, it could surprise positively next year. After such optimism twelve months ago, the almost-unanimous cautiousness among economists over the outlook for China is perhaps the main factor playing in favour of such a scenario.

Whether it is from a cyclical (such as the real estate hangover, elevated public debt levels or subdued consumption) or structural (such as the ageing population, more disconnected world) stand point, almost everybody appears pessimistic about the country's prospects.

INFLATION TO REBOUND GRADUALLY

At least the nation doesn't have to worry about inflation. Unlike most of the developed world, domestic price pressures have been minimal in 2023. In fact, the country briefly experienced headline deflation in July, as shown in the article Chinese deflation may be a blessing in disguise.

With food representing about a third of the Chinese headline consumer price index (CPI) basket, items like pork prices tend to be key drivers of inflation. Similarly, housing costs (30% weighting) have been muted in 2023, although they have started to pick up recently. Lastly, with plenty of slack in the labour market, wage pressures have been largely non-existent.

With this year's weak inflation data coming into play as base effects through 2024, headline CPI is likely to pick up and could average 1.6% next year. Importantly, there doesn't seem to be an impediment to further fiscal and/or monetary stimulus.

CHAOS CREATES OPPORTUNITIES

China's recovery will likely be uneven and the short-term outlook remains as challenging as it is uncertain. Similarly, geopolitical developments remain a wild card and can explode into life quickly, as seen with recent events in the Middle East. Furthermore, there is no reason to expect a significant improvement in Sino-American relations.

However, the lack of inflationary pressures should allow the People's Bank of China to keep monetary policy accommodative in 2024. Additionally, domestic authorities remain laser-focused on their long-term objective of "Common Prosperity", the Chinese Communist Party's goal to raise incomes for the worst off, promote fairness, make regional development more balanced and focus on people-centred growth.

As such, we believe the stars are aligned for the country to accelerate the structural reforms needed to address drags on growth, helping the economy to rebalance and in turn opening up fresh opportunities for investors.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

Tuning to the macro beat

A sudden pandemic, invasion or election result can throw markets into a tailspin in days, and seemingly turn an investor's strategy upside down. Can the relationships between different aspects of macroeconomics and financial market indices help investors to allocate assets more robustly at such times?

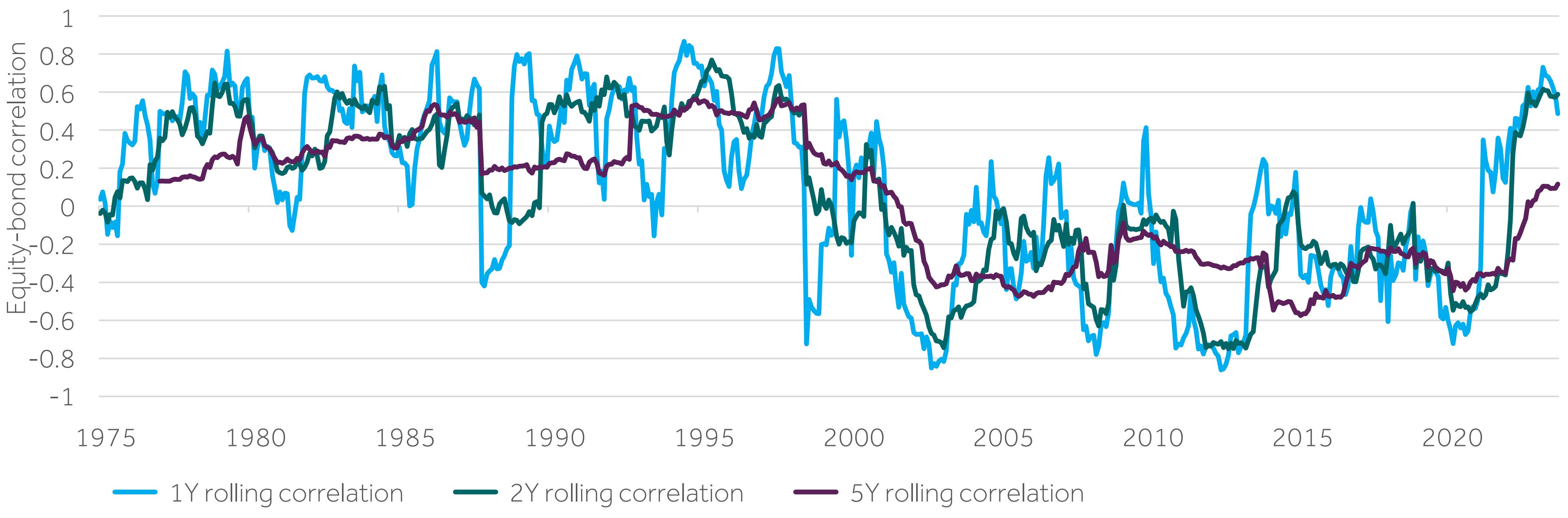
Please note: This article is more technical in nature than our typical articles, and may require some background knowledge and experience in investing to understand the themes that we explore below.

The wealth advisory world is at a crossroads, it seems. Investors are coming to terms with whether the COVID-19 pandemic and the current geopolitical uncertainty will ultimately lead to a world of persistent higher inflation, excessively higher rates and ever increasing government debt; or if the economic effects of the virus will unwind soon and return the economy to an era of slow growth and structurally weak inflation.

In addition, the financial community is coming to terms with an altered equity-bond correlation, a key measure for asset allocation strategies, that has shot up to levels last seen twenty years ago (see chart). This has implications for the roles of equities and bonds in a portfolio. At current levels of correlation, bonds do not act as the shock absorbers to equities as they have done over the last twenty years.

EQUITIES AND BONDS MOVE IN TANDEM

The correlation of monthly returns for US equities and US government bonds over one-, two- and five-year rolling windows since 1975 (where 1 or -1 implies a perfect correlation between the assets, and zero implies no correlation)



Source: Bloomberg, Barclays Private Bank, October 2023

THE RULES HAVE NOT CHANGED

The health of the economy will ultimately drive the course of financial markets, the former determining the supply and demand for raw materials and financing, the pricing of finished goods and the creditworthiness of businesses and governments.

The course an economy takes may change, but the effects that different parts of it have on the pricing of financial instruments, evolve only slowly. For example, the intensity of oil production might change and affect the sensitivity of oil prices to different levels of activity, but these shifts usually occur at a snail's pace. Therefore, understanding the economy can help to make sense of financial markets.

LISTENING TO THE HEARTBEAT

Economic data can be difficult to interpret. For every data release, there is a story that could involve revisions of past data, that shines fresh light on current data, an unexpected political effect, a seasonal distortion or just the statistical noise of a bustling nation.

Hence, it can pay to listen closely and ignore the noise by looking at various indicators and cross-checking them, as well as smoothing the regular data beats by studying the momentum built up over many months, rather than every snapshot on its own.

IDENTIFYING THE DIFFERENT MOMENTUM BEATS

To help get to the bottom of macroeconomic data more, many readily available monthly or weekly data prints[1] have been collected for leading economies. They have been classified to show the different aspects of an economy: hard activity (output measurements), soft activity (survey-derived), consumption, labour, housing, monetary policy and prices.

Within each aspect, momentum gauges comparing data released in the last three months, versus those published in the last six months, have been assembled and then boiled down to one single momentum indicator[2].

MACROECONOMIC MOMENTUM INDICATORS

Heatmap of aggregated momentum indicators for the US and Chinese economies. Green (red) colours indicate acceleration (deceleration) in momentum

	2023	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
USA	Activity Hard	-1.0	-0.3	1.6	0.9	0.6	-0.5	-0.2	0.1	1.0	
	Activity Soft	-0.9	-0.9	-0.2	0.0	-0.5	0.0	0.1	1.1	0.6	0.5
	Consumption	-0.3	0.9	0.8	-0.9	-1.0	-0.3	0.8	0.7	0.5	0.0
	Housing	-0.7	2.4	3.0	3.3	0.2	-0.2	-0.4	0.0	0.1	-0.9
	Labour (market strength)	-0.2	-0.5	-0.5	-1.1	-0.8	-0.6	0.0	0.0	0.4	0.6
	Monetary Policy (stimulus)	-0.3	-0.6	-1.8	-1.6	0.0	2.1	3.1	1.2	-0.4	-0.2
	Prices	-0.5	-0.4	-0.1	-0.3	-0.6	-0.3	-0.1	1.0	1.3	

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
China	Activity Hard	-1.0	0.6	2.1	0.6	0.1	-0.8	0.4	0.0	-0.2	
	Activity Soft	-1.1	1.1	4.3	3.7	1.7	-1.1	-1.7	-1.4	-0.6	
	Consumption	0.7	17.6	28.2	24.8	-6.9	-14.7	-17.4	-4.5	-4.7	
	Housing	-1.0	-0.1	2.1	3.2	2.3	-0.5	-3.1	-3.6	-2.3	
	Labour (market strength)	-0.1	2.0	4.1	0.8	-2.0	-2.9	-0.8	0.6	0.6	
	Monetary Policy (stimulus)	10.8	6.5	-0.1	-7.3	-4.4	-5.8	-0.6	0.3	4.8	2.0
	Prices	0.2	-0.1	0.0	-0.5	-0.4	-0.4	0.1	0.4	0.8	

Source : Barclays Private Bank, October 2023

[1] For the US models referenced in the article, the following series are used. Activity hard: Industrial Production, Industrial Production Survey Surprise, Factory Orders, Capacity Utilisation. Activity soft: ISM New Orders, ISM Services New Orders, ISM Manufacturing, ISM Services, Empire Manufacturing, Philadelphia Fed Business Outlook, Small Business Optimism. Consumption: Personal spending, Retail sales advance, Durable goods orders, Michigan Sentiment. Housing: Housing starts, New home sales, Existing home sales, Building permits, FHFA house price index, NAHB housing market index. Labour: Nonfarm payrolls, Unemployment rate, Job openings, ISM Employment, personal income, initial jobless claims, Continuing claims, ADP Employment. Monetary policy: Fed funds Rate, M2. Prices: Producer price index final demand, ISM Prices paid, Citi Inflation Surprise Index, CPI index, CPI index survey surprise.

[2] Principal component analysis is used to condense information contained within many input series to one resulting output series.

INTERPRETING THE SIGNS

Negative (red) readings show the aspects of the economy that are slowing, while positive (green) readings highlight those aspects that are quickening in pace. This means that even though an economy may still be expanding, if it does so more slowly than six months ago, the activity momentum reading will be negative.

The momentum in US prices has re-accelerated recently. However, consumption and housing have tipped over into deceleration, while activity indicators have gained momentum. For China, on the other hand, activity indicators imply a stagnating economy while the housing and consumption gauges suggest deceleration.

TAKING THE MACRO TO THE MARKETS

The usefulness of short-term momentum snapshots for asset allocation, which tends to be a long-term game, lies in the reaction of market participants to new data. A series of odd tunes may alter the key that financial markets are humming to.

As seen recently, it is not always the same parts of the music score that carry the melody. Inflation, which was more a background noise for decades, has taken centre stage since 2022. As such, analysis has been carried out into how different parts of financial markets react to each aspect of economic momentum separately[3].

The table shows that for the US economy and its effect on global financial markets, positive momentum in survey data and consumption are the most conducive aspects to positive returns in risky assets such as high yielding bonds, equities and equity-like hedge funds.

In something of a surprise, hard activity data like industrial production is less of a driver for risky assets, but instead acts more as confirmation of conditions that drive the returns of safer bonds. Quickening US prices have had a positive effect on the returns of commodity indices while hurting the returns of (global) government bonds.

RETURN SENSITIVITY TO MACROECONOMIC MOMENTUM INDICATORS

Partial correlations of three-month-ahead returns of broad financial market indices to the three-month over six-month momentum indicators for the US economy

	Hard economic data	Soft economic data	Consumption	Labour market (strength)	Monetary policy (stimulus)	Price pressure
Cash & Short Maturity Bonds	0.0	-0.1	-0.1	-0.3	0.1	0.0
Developed Government Bonds	0.2	0.0	0.0	-0.1	0.3	-0.1
Investment Grade Bonds	0.2	0.1	0.1	0.0	0.2	0.0
US High Yield	0.2	0.2	0.3	0.0	-0.1	0.1
Developed Market Equities	0.0	0.3	0.2	0.2	-0.1	0.0
Emerging Market Equities	0.1	0.3	0.2	0.0	0.0	0.0
Real Estate	0.1	0.2	0.2	0.2	0.0	0.0
Hedge Funds	0.0	0.3	0.3	0.1	0.0	0.0
Commodities	0.1	-0.1	0.1	0.3	0.0	0.4
Industrial Metals	0.1	0.1	0.1	0.2	-0.1	0.2
Energy	0.0	-0.1	0.0	0.2	-0.1	0.3
Agriculture	0.1	-0.2	0.0	0.2	0.0	0.1
Precious Metals	0.1	0.0	0.1	0.0	0.2	0.1

Source: Barclays Private Bank, October 2023

[3] To this end, partial correlations are computed, which represent the correlation of one macroeconomic aspect of momentum to the returns of a financial market index in three-months' time, while cancelling out the interference from all of the other macroeconomic aspects.

IT TAKES MANY PARTS TO WRITE A SYMPHONY

Temporary macro tunes will not in themselves determine the long-term success of an investment strategy. While it takes more than a single melody to write a symphony, the sensitivities to momentum don't change quickly. So, a long-term investment arch is nothing more than a series of shorter momentum melodies.

This brings us back to the recent momentous changes seen in equity-bond correlations, highlighted at the top of the article. Just why have such correlations bounced back into positive territory, as seen for large parts of the 70s, early 80s and early 90s?

The answer pertains to economic indicators that are back in the macro headlines, as was the case a few decades ago: inflation is the main worry for investors and it comes at a time when economic activity is anaemic at best. This drives equities and bonds in the same direction.

GETTING TECHNICAL WITH TACTICAL TUNING

To explore the usefulness of the momentum indicators for tactical portfolio overlays, the US Macroeconomic Momentum Indicators (MMIs) were tested as inputs to a 'random forest classifier' model. The goal was to determine whether the respective financial market indices would decline, remain stable or increase over the following three-month period after the release of the respective macro data.

Looking at the most important MMI for each asset class suggests that the classifier model has built an understanding of various economic cycles. As such, activity indicators are preferred for signals on corporate bond prices and metals, while labour appears to be more important for equities.

In the out-of-sample tests, MMIs were most useful at producing signals for developed market equities, US dollar (USD) cash and real estate, and performed worst for hedge funds and commodities. This discrepancy could be due to the overall commodity index being composed of more diverse components than, for example, the developed market equity index.

MMI	**...is the most important signal for**
Activity indicators (hard and soft)	Investment grade bonds, US high yield, Precious metals, Industrial metals
Monetary policy	USD cash, Emerging market equities
Prices	Energy, Developed government bonds
Labour	Developed market equities

With the current set of US momentum data shown in the heatmap above, the classifier model sees the highest probability of capital gains over the upcoming three months to be in developed market equities, emerging market equities and direct real estate indices. Less probability for capital gain is seen in commodity indices and developed government bonds.

LESSONS FOR THE LONG-TERM INVESTOR

The outlook for growth can be summarised as elevated, if softening inflation, a slowdown in growth, a weakening labour market and somewhat restrictive monetary policy are likely to persist as headwinds.

In such a stagflationary backdrop, one would expect equity-bond correlations to remain elevated and that bonds will act more as a substitute to equities, rather than as a complement to them, in a portfolio well into 2024.

This calls for different sources of portfolio diversification. Simply diversifying is unlikely to be enough, without identifying what it is against. Some commodity exposure can help to shield against bouts of inflation, but at the cost of additional risk when activity weakens.

A well-diversified portfolio needs to be constructed with different macroeconomic risks in mind. Understanding the way that markets react to different macro tunes does not help to forecast the future. However, it means that investors can be better prepared for whatever the future holds in store.

Authors: Lukas Gehrig, Zurich Switzerland, Quantitative Strategist; Nikola Vasiljevic, Ph.D, Zurich Switzerland, Head of Quantitative Strategy

The journey to a new rate regime

Interest rates have sold off sharply in the second half of 2023 and volatility is likely to remain for now. The good news is that inflation is retreating. The two key remaining questions are therefore: How long will the journey to the new normal be? And what will this new normal look like? Be prepared and embrace change.

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

ANATOMY OF A SELL-OFF: A RECAP

After subdued performance in 2021, and clearly disappointing performance in 2022 (with almost every segment showing double digit losses), 2023 was meant to be a more rewarding year for bond investors. Unfortunately, as things stand, most bond indices remain on a downward trend spurred by higher rates.

As we published our Outlook a year ago, global rates re-priced sharply on the back of fiscal uncertainty in the UK. As a result, UK 10-year gilts rose from 1.9% to 4.5% in a matter of two months. Interestingly, 10-year gilt yields are at similar levels today.

Five months later, the US financial system was rocked as several US regional banks succumbed to higher yields and a mismatch between their asset and liability duration. Then, fears of spill-over caused yields to retreat again.

The conclusion is that the negative repercussions associated with a spike in rates tend to limit the extent to how high rates can go.

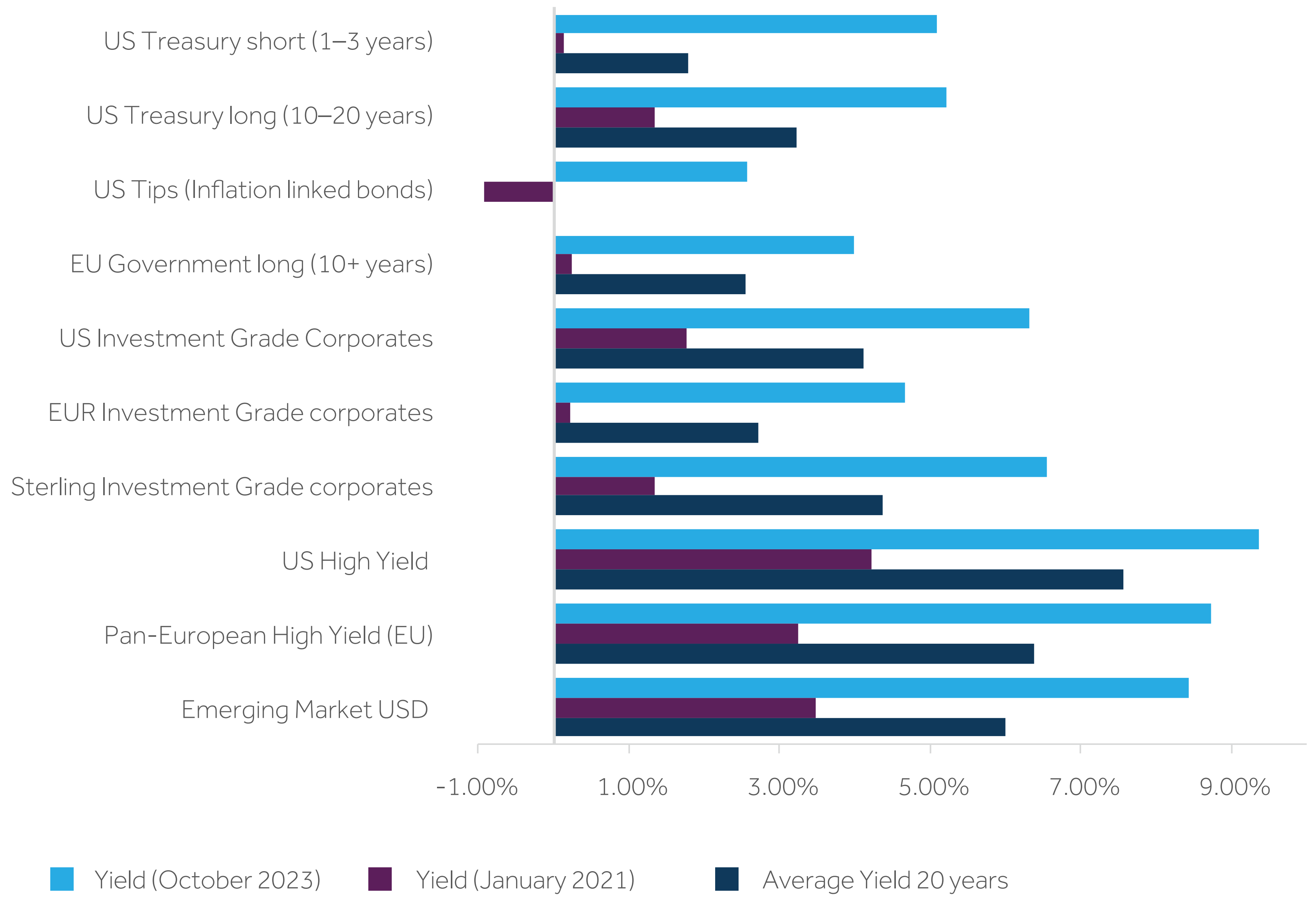
FIXED INCOME MARKETS' PERFORMANCE AND YIELDS

The recent performance and evolution of yields for various fixed income segments.

BOND INDEX PERFORMANCE

Bond segment	Total return 2022	Total return 2023 YTD
US Treasury short (1–3y)	-3.8	2.0
US Treasury long (10–20y)	-25.2	-10.4
US Tips (Inflation linked bonds)	-12.6	-1.6
EU Government long (10+ y)	-32.3	-3.6
US Investment Grade Corporates	-15.8	-1.7
EUR Investment Grade corporates	-13.6	2.1
Sterling Investment Grade corporates	-19.3	-0.1
US High Yield	-11.2	4.1
Pan-European High Yield (EU)	-10.6	5.1
Emerging Market USD	-15.3	-1.1

BOND YIELDS



Source: Bloomberg, Barclays Private Bank, October 2023

FROM SHORT END TO LONG END

The surge in yields during this cycle was first driven by higher short-end yields, something which coincides with historical patterns. This part of the yield curve had to acknowledge during 2023 (as previously) that the US Federal Reserve's (Fed) hiking exercise wasn't over yet, as inflation remained sticky and the job market tight. Instead of early rate cuts, as priced in back in March (150 basis points (bp) to 4% by end of December 2024), the Fed called for policy rates to stay "higher for longer". We have pointed to this complacent market pricing many times during the last 12 months.

In the second half of the year, the long end of the curve started moving, driven by three main factors. The first culprit was the significant imbalance between demand and supply of US government debt. Indeed, as the US treasury signalled that supply was going to increase meaningfully over the coming quarters, the Fed and foreign buyers were both reducing bond purchases. The situation was made worse by the rating downgrade of US debt from AAA to AA+.

The second driver behind the rise in yields was the re-evaluation of the so-called neutral rate. In other words, the policy rate the central bank is trying to navigate to once the Fed can call victory over the fight of inflation. Also known as "r-star", this neutral rate represents an equilibrium state with near-to-full employment but no overheating of the economy.

If this holy grail rate (anchor) ends up being higher than previously expected, the long end of the curve has no choice but to reflect that higher anchor point in today's rate level. The third and last factor is evidence of a more resilient US economy.

GLASS HALF FULL

Although one may be tempted to get carried away after the bond market has witnessed its largest sell-off in recent history (Bloomberg US Treasury +20 year index has lost over 45% since July 2020), investors should look ahead. After this great re-pricing (as illustrated in the table on the previous page) most bond segments now offer their highest yields in 15 years.

For buy and hold (to maturity) investors, this is certainly good news. Admittedly, high yields do not prevent yields from going higher still. But, over the medium to long term, an increased probability of lower rates could drive returns beyond what current yields suggest.

In the subsequent sections, we look at potential drivers for the short and long end of the curve.

ASSESSING THE SHORT END PATH

The short end of the curve is usually determined by the central bank's policy path and the expectation of the respective path. At this stage, the forward rate market is not fully pricing in a further hike and implies almost 100bp worth of cuts by the end of 2024. As highlighted previously, history shows that, on average, the Fed holds its policy rates at the terminal peak for around six months, although it has varied between cycles. Should the Fed initiate its easing cycle in the third quarter 2024, as many expect, this would imply a roughly 12-month long plateau.

This may seem a long time but, in reality, the current economic cycle is somewhat unique and could justify such a long, or even longer, pause. Indeed, the unprecedented monetary and fiscal support has led US households to build significant excess savings while the unemployment rate remains historically low and higher mortgage rates have yet to filter through to the housing market. As a result, US consumption has and could remain healthy for longer than expected.

This is probably why, as illustrated by the gradual rise in the 5-year forward breakeven inflation rate (from 2.2% in June 2023 to 2.4% today), the rate market increasingly believes that the Fed may need to do more in order to bring down inflation towards its 2% target.

BEND IT WITHOUT BREAKING

While any further increase in rates may compromise an economic soft landing, history shows that inflation can be tamed only when the economy has cooled off significantly. In fact, in the last 50 years, only once has the Fed managed to quell inflation without breaking the economy. This was in 1994. Back then however, the Fed acted quickly and did not hesitate as long as it did during the current cycle.

Consequently, some repricing potential at the short-to-medium part of the curve persists.

Although it has been delayed, a loss of economic momentum is still expected to materialise. Indeed, tighter financial conditions should ultimately curb consumer spending and slow credit growth. As such, while the Fed may not reach its inflation target by the end of 2024, PCE core inflation is likely to settle not far above it either, according to our estimates.

THE PREMIUM IN THE LONG END

Meanwhile, bond yields at the long end are likely to remain subject to the factors we mentioned previously, including the absence of price insensitive buyers such as the Fed or foreign institutions.

As a result, the premium that investors require for holding longer-dated bonds, the so-called term premium, has increased since the summer and is likely to prevent a deeper inversion of the curve. In fact, it could lead to a more pronounced steepening once the Fed starts its easing cycle.

That said, and in the absence of another crisis, the US debt pile is unlikely to jump again as much as it did in response to the pandemic. As such, the risk of a significant increase of the premium demanded, seems to be contained.

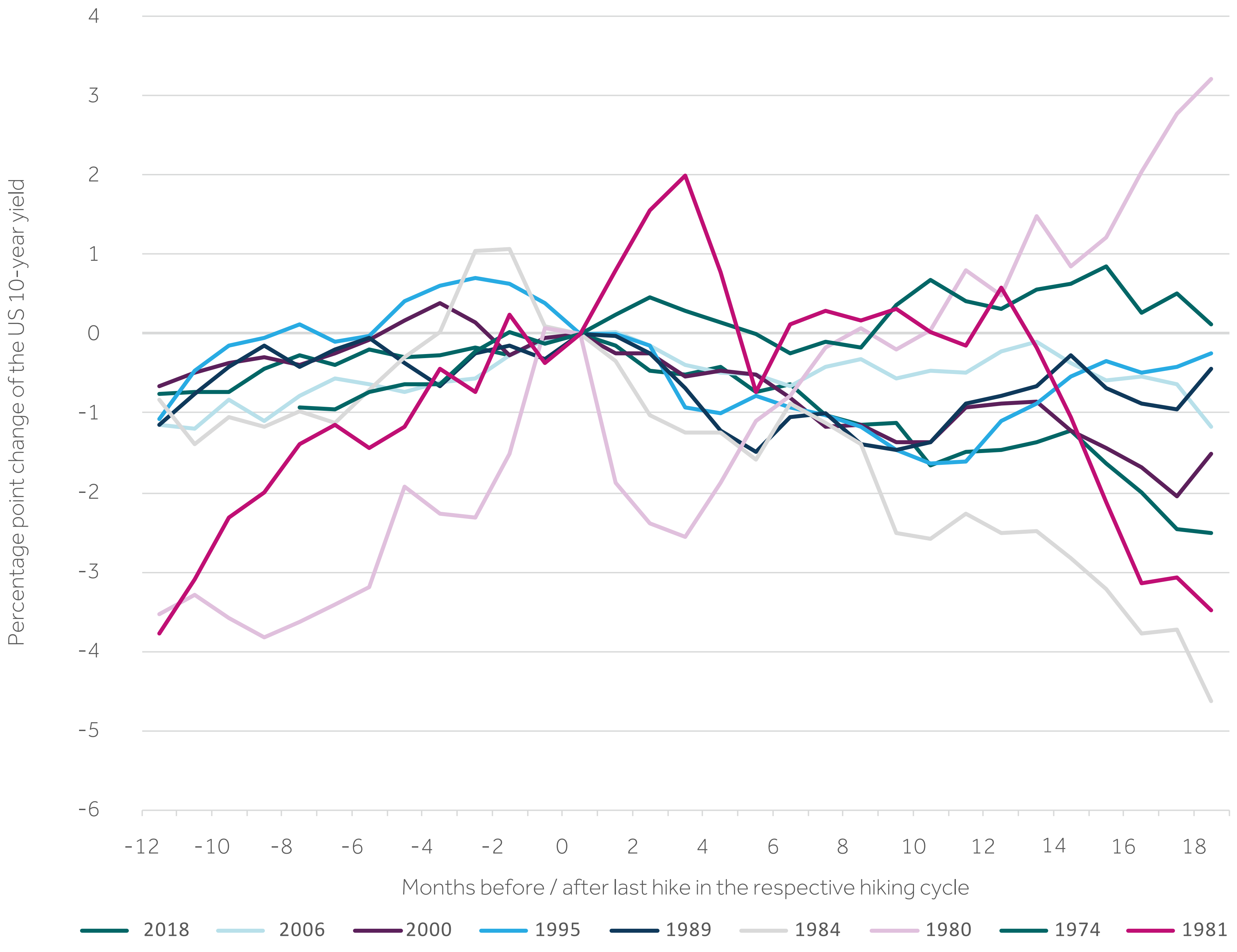
WHAT TO EXPECT FROM LONG END YIELDS

Overall, long-end yields have some more room to re-price higher, driven by both a potentially higher policy rate, as well as a greater term premium. Importantly, long-end yields have not yet been close to the peak policy rate level, something we've often seen in previous cycles. However, a US 10-year yield close to 5.5%, or even 5.75% (the potential policy rate peak), seems unlikely as markets would likely start pricing in an increased risk of recession.

Rate volatility has the potential to push 10-year yields towards levels witnessed during the rate hiking cycle in 2006 of around 5.25%, but at this level, longer-dated bonds would start to look attractive to many long-term investors. Such a scenario would be supported by historical patterns: with the exception of 1980 when another hiking cycle followed, in the last nine hiking cycles, 10-year yields retreated in the following 18 months after the Fed's last hike (albeit historic performance is never a guarantee of future performance).

YIELDS TEND TO FALL ONCE THE FED IS DONE HIKING

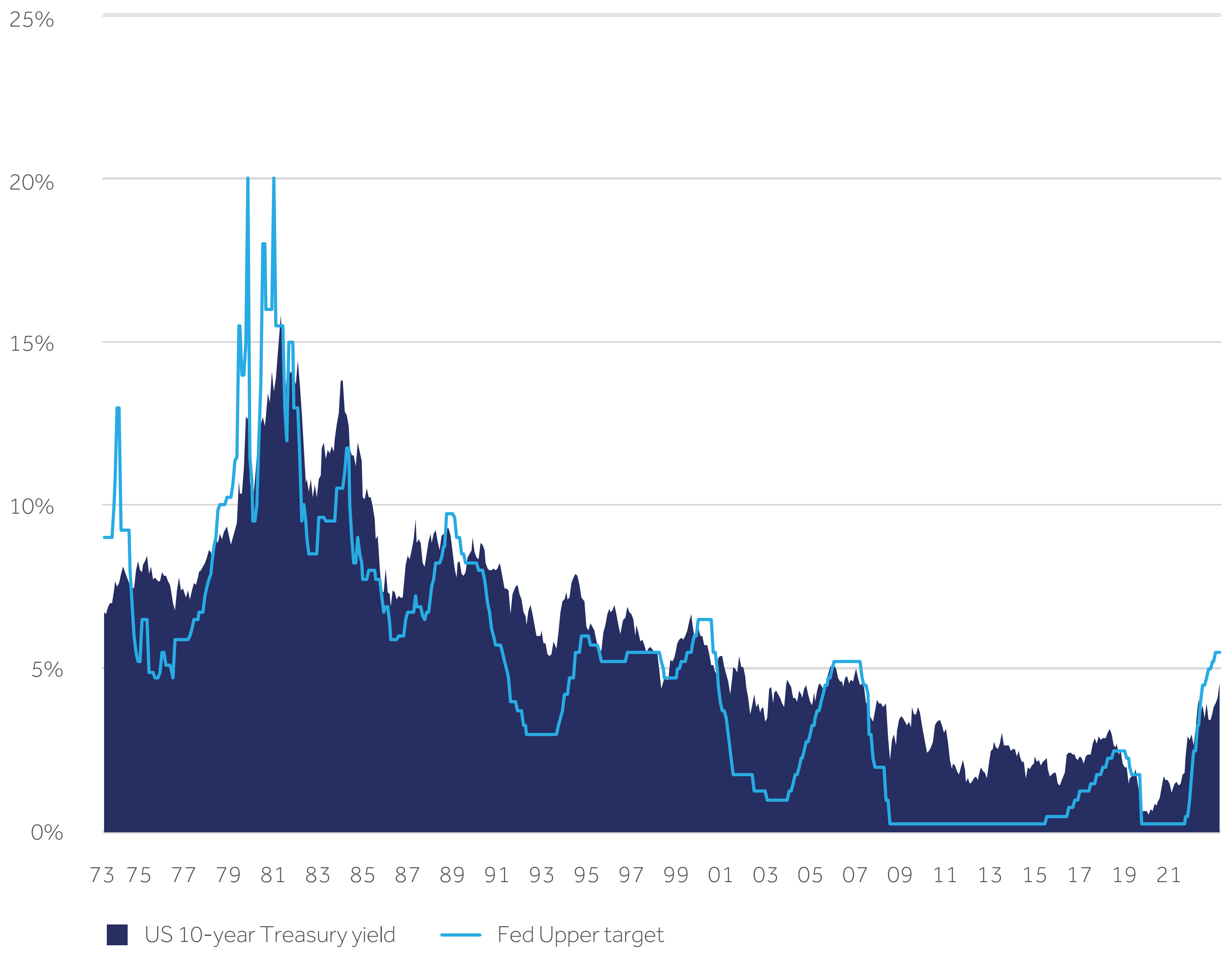
The evolution of the 10-year US movement bond yield 12 months before, and 18 months after, the peak of various Fed hiking cycles



Sources: Bloomberg, Barclays Private Bank, October 2023.

LONG-END RATES MAY NOT MATCH THE POLICY RATE THIS TIME

US 10-year government bond yields and the upper target for the Federal Funds rate across ten hiking cycles.



Sources: Bloomberg, US Federal Reserve, Barclays Private Bank, October 2023.

EMBRACE VOLATILITY

While uncertainty remains, the end of the hiking cycle seems very close. Rather than hiding away from volatility, investors may want to embrace it. In other words, while maintaining a core position in medium-term duration to "lock in" yields, periods of dislocations should give investors opportunities to selectively extend duration and unlock further value.

Admittedly, higher duration brings higher price risk, but at this stage of the cycle, the scope for a large upward move in yields seems more contained. On the flip side, should the economy weaken significantly more than expected, long-end yields may adjust quickly and reward investors. In the context of a diversified portfolio, this may prove a valuable hedge against downside risks.

UK AND EUROPEAN RATES

Moving on to Europe, higher central bank policy rates in the eurozone appear less likely after the surprise hike by the European Central Bank (ECB) back in September. While inflation may heat up due to increased energy prices, financial conditions are markedly tight. The ECB must take into account the risk of recession, as well as the challenges posed by higher rates to highly indebted countries such as Italy. In fact, we see a significant risk of elevated volatility in the Italian debt market should monetary conditions tighten further.

Meanwhile, UK bond yields might not seem cheap on a real basis given the persistently high inflation. However, just like the ECB, the Bank of England (BoE) must find a balance between fighting inflation and not pushing the UK economy into a deeper recession. A further hike still seems possible but the threshold for this to happen appears very high at this stage. As a result, yields appear somewhat capped. That said, the long end remains exposed to bouts of volatility given the BoE's need to sell outright gilts in order to normalise its balance sheet.

BEWARE OF VALUE TRAPS

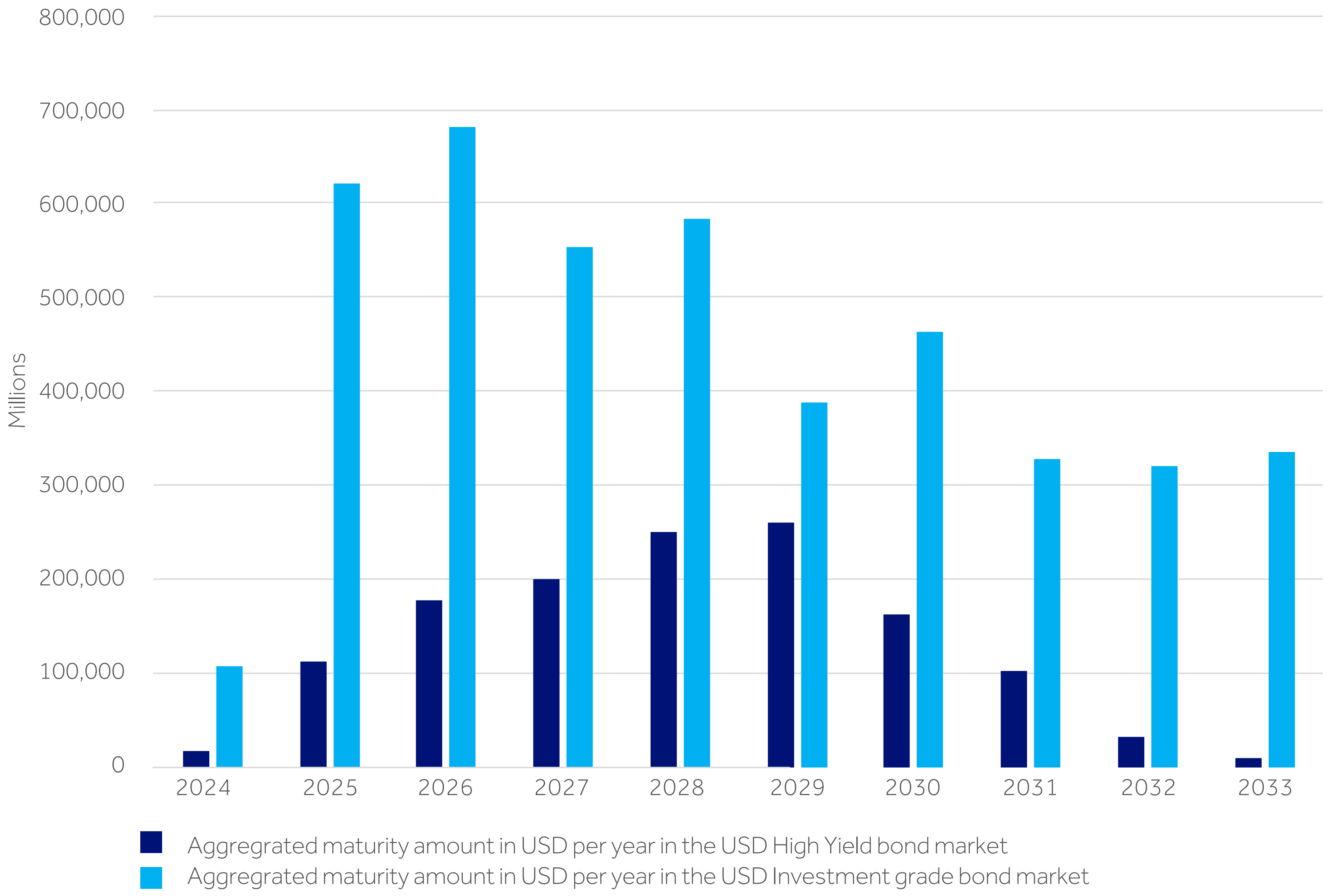
With higher bond yields on offer, investors should watch out for value traps. These appear to be concentrated primarily within the high yield segment. While US high yield bonds offer an average yield of 9.3% (8.6% in Europe), spreads have remained relatively contained throughout 2023 - although they have started to show signs of life recently.

Within the highest beta part of the market, spreads are prone to continue to widen in 2024. According to Moody's rating agency, US speculative-grade companies have $1.87 trillion of rated debt maturing between 2024 and 2028, up a significant 27% from the previous record of $1.47 trillion (2023-27). Although, the maturity wall of 2025 and 2026 may seem distant, markets tend to look ahead and many of the most leveraged companies will have to absorb a much higher interest burden from then. Default rates in the US may not spike as a result but a gradual rise well over 5.5% (from 2.9% currently) could be sufficient to cause spreads to widen notably.

Focusing on higher quality issuers within the investment grade segment remains a more prudent strategy. This is even more relevant when, in the US, investment grade bonds are offering yields (6.3%) not too dissimilar from the long-term average returns seen in public equity markets. In addition, and unlike their high yield peers, investment grade issuers were able to term out funding needs to much longer maturities, and can consequently better withstand the recent rise in rates.

THE MATURITY WALL IN HIGH YIELD AND INVESTMENT GRADE

The maturity distribution for both high yield and investment grade issuers over the next 10 years



Sources: Bloomberg, Barclays Private Bank, October 2023

LOOK OUT FOR ALPHA

This is not to say that investors should avoid the high yield segment altogether. It's about being aware of value traps and being selective. US Dollar BB-rated bonds, for example, still yield over 8% on average, and these bonds often stand on more solid credit metrics and a better funding profile compared to lower quality issuers within the segment.

Similar yields can also be found in financial subordinated debt instruments which, due to their complexity and inherent risks, are often overlooked. Being selective and using strategies and solutions to explore alpha would appear to be a reasonable approach. This is also true for emerging market bonds where value can be found selectively, as we highlighted in our Market Perspectives publication in October. (See, "How might emerging market bonds cope with higher rates?")

OUR VERDICT

Uncertainty is unlikely to disappear in 2024. Investors should be prepared to experience further volatility and ultimately, be ready to embrace it. Next year, income opportunities could morph into price (i.e. capital gain) opportunities, also providing hedging benefits. As always, diversification will be essential. Meanwhile, investors will need to avoid value traps and look out for alpha within high yield and emerging markets.

Author: Michel Vernier, CFA, London UK, Head of Fixed Income Strategy

Time for more defensive equity positioning?

Equity markets have been surprisingly resilient this year, given the weak macro backdrop and the widely held view that a recession would hit in 2023. This strong market performance has not been achieved in a straight line and has been characterised by a number of pull-backs and sharp rallies.

Please note: All data referenced in this article is sourced from Refinitiv Datastream unless otherwise stated, and is accurate at the time of writing.

Global equities soared by 28% from their October 2022 lows to their July 2023 highs, but subsequently reversed some of those gains. At the time of writing, they are up 6% year-to-date, or 17% from their October 2022 lows.

EQUITY MARKETS FACE A NUMBER OF CHALLENGES

It is clear that going into 2024, equity markets face a challenging environment, characterised by a deteriorating growth outlook, elevated yields, higher oil prices, and heightened geopolitical uncertainty.

Growth slowing down

While growth has been more resilient than expected in 2023, it is expected to slow down in the coming months.

The implications for risk assets in general will depend on the shape and severity of the downturn. Encouragingly, our economists do not anticipate a severe downturn, due to the absence of major imbalances in the system at present.

Yields expected to stay 'high for longer'

While inflation has convincingly moved past its peak in most economies, it remains above central banks' targets. As long as this remains the case, central banks will be reluctant to ease their monetary policy stance, unless we see a significant deterioration in the economy or the financial system.

In addition, concerns over swelling budget deficits and associated bond issuance could still push long-term yields higher. Therefore, rates are likely to remain elevated for an extended period of time, which will put pressure on equity market valuations.

Higher oil prices and geopolitical risks

If sustained, the significant rise in the oil price seen in recent months poses an additional threat to global growth, and could derail the disinflationary path. Oil prices initially jumped by close to 35% between the middle of June and late September, following production cuts by Saudi Arabia and Russia, before paring back some of those gains on expectations of a decline in global demand. However, following the rise in geopolitical tensions in the Middle East, the oil price has started to move up again.

History shows that sharp and sustained increases in the oil price have often led to significant equity market sell-offs, especially when driven by supply factors. For more details on the implications for equity markets, please refer to our October article, 'Should investors worry about surging energy prices?'.

While it is impossible to predict how the conflicts in the Middle East and Ukraine will evolve, they do raise the level of uncertainty and the equity risk premium (i.e: the excess return equity investors would expect to receive, compared with a risk-free rate).

IN THE NEAR TERM, A MORE SELECTIVE INVESTMENT APPROACH APPEARS WARRANTED

Despite the recent pull-back, broad equity markets seem to have run ahead of macro fundamentals, with valuations looking stretched given the weak macro backdrop, and earnings likely to disappoint overly optimistic expectations.

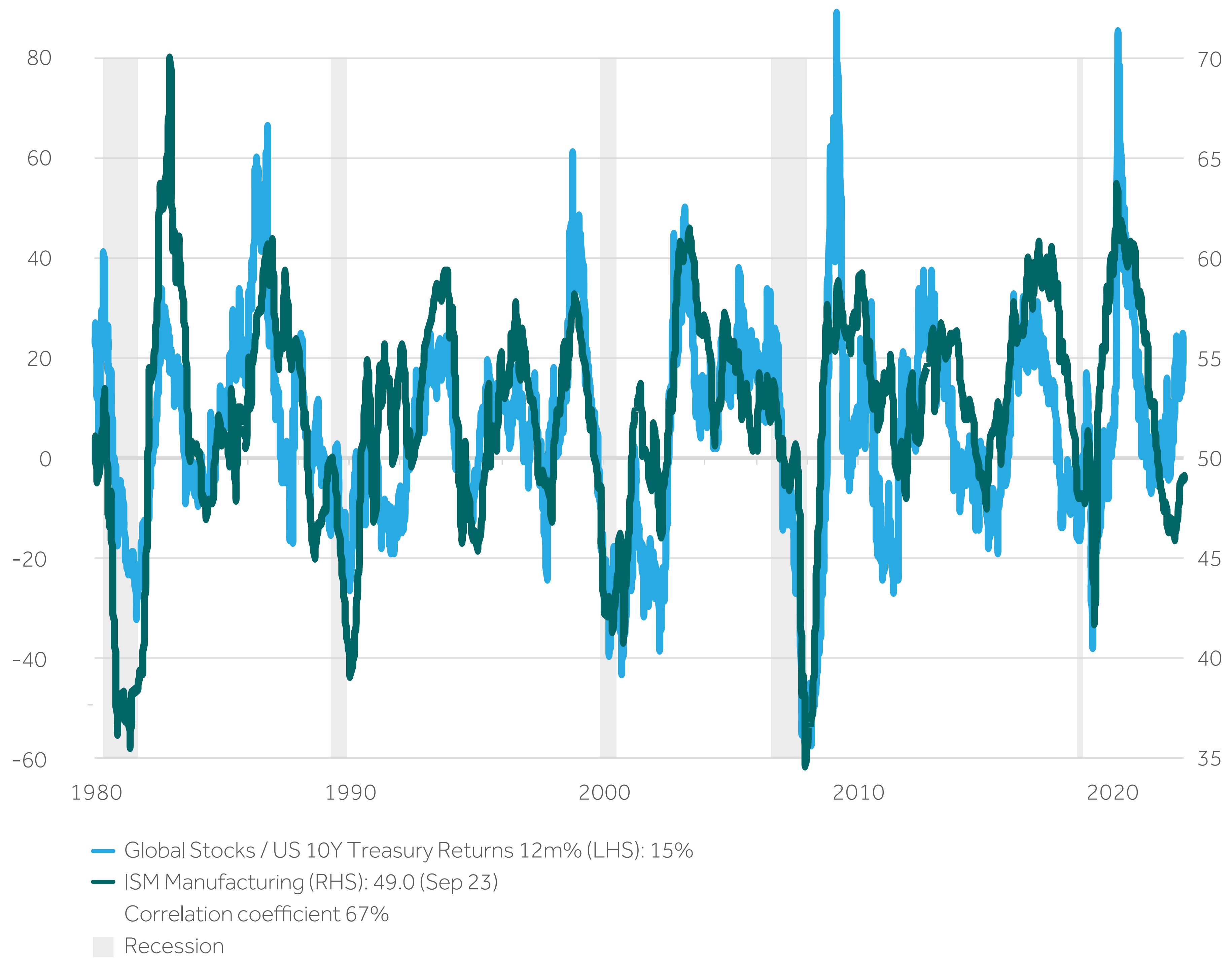
Equities' recent performance is consistent with a 'no landing' of the economy

Based on their historical relationship with the ISM Manufacturing index and corporate profits, global equity prices appear to be discounting a significant improvement in economic activity, and double-digit growth in global earnings over the next six months.

This would be consistent with a 'no landing' scenario, and implies a sharp reacceleration of the economy from current readings. This scenario is possible but unlikely. Other indicators, which tend to lead earnings growth, suggest that global earnings are more likely to contract in the coming months. US bank lending standards are consistent with a double-digit decline in global earnings over the next six months, while the new orders component of the US ISM Manufacturing index implies a mid-single digit decline in the next nine months.

GLOBAL EQUITIES APPEAR TO BE DISCOUNTING A REACCELERATION OF ECONOMIC ACTIVITY

12-month change in global equity prices vs. US 10-year Treasuries, against the ISM Manufacturing Index



Source: Refinitiv Datastream, Barclays Private Bank, October 2023

Valuation disconnect

Similarly, equity valuations appear extended relative to real yields. Equity markets typically de-rate in periods of rising real yields. However, the opposite trend has been observed since October last year, which coincides with the equity market trough. Over this period, US 10-year real yields have surged to 2.6% from 1.8%, while the global equities' forward price-to-earnings ratio has jumped to 15.5x from 13.4x. Similarly, global equities are currently trading 7% above their 20-year average. This looks stretched given the deteriorating macro backdrop and the risks highlighted previously.

Having said that, the recent volatility has created a lot of dispersion in returns, with some sectors and regions trading on more reasonable valuations. This has opened up attractive investment opportunities on a selective basis, which we discuss later in this article.

Earnings could also be challenged

At the index level, earnings expectations for next year remain optimistic. Based on an International Brokers' Estimate System (IBES) consensus, bottom-up analysts expect corporate profits to grow by 11% globally in 2024, vs. 0% in 2023. However, here again significant differences exist at the regional level, with earnings projected to grow by 12% in the US, 7% in Europe, 6% in the UK, 8% in Japan, and 19% in emerging markets.

In that sense, upcoming reporting seasons will be closely watched, with investors paying particular attention to trading outlooks and management guidance for the year ahead. Key areas of focus include any signs of weakening demand, pricing power, the impact of higher rates on borrowing costs and delinquency rates, the availability of credit, as well as the impact of a potential oil shock on earnings.

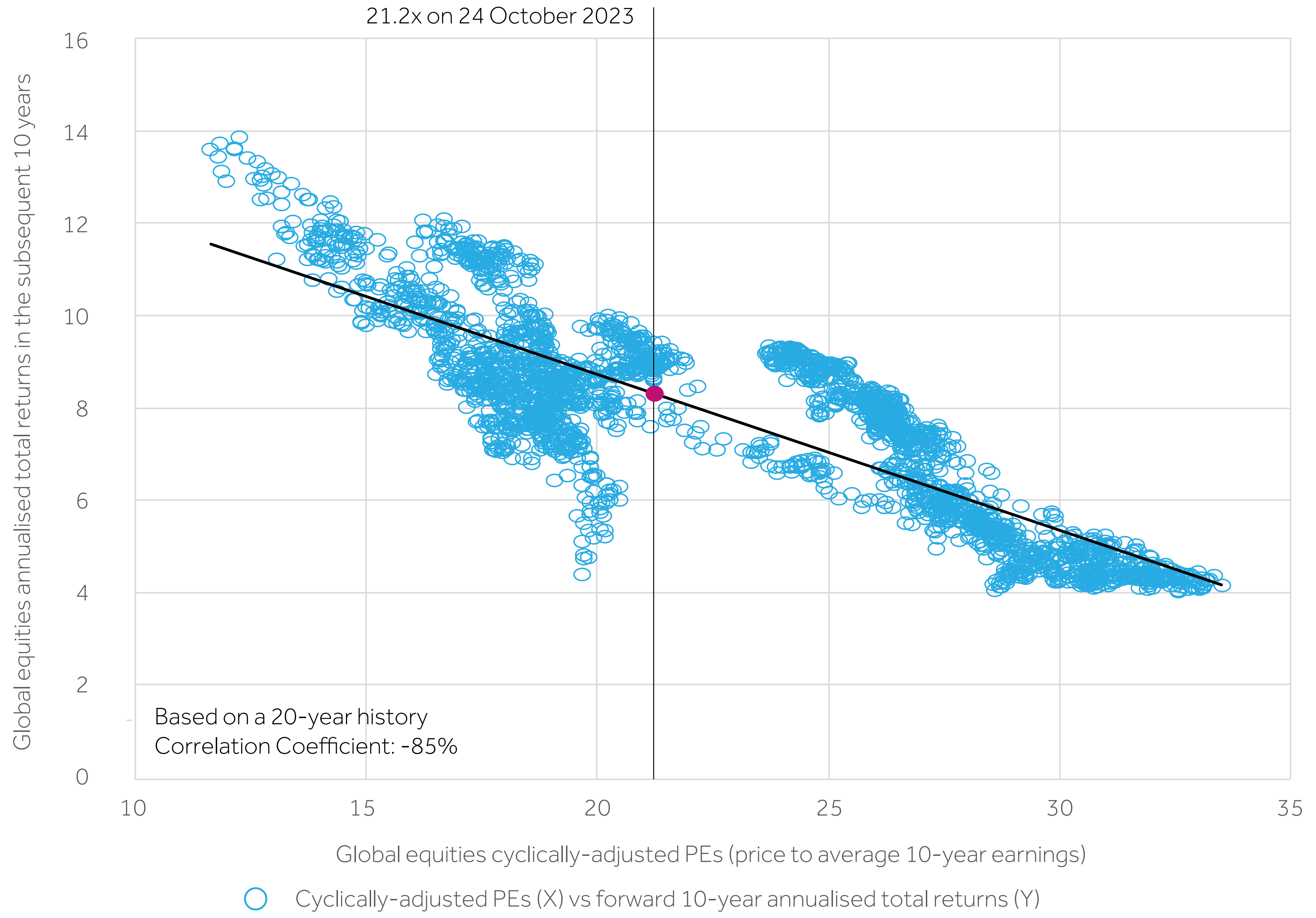
HOWEVER, OVER THE MEDIUM TO LONG TERM, EQUITIES STILL OFFER ATTRACTIVE RETURN PROSPECTS

While the risk / reward proposition for equity markets looks challenging in the near term, the longer-term picture is more encouraging, with stocks likely to outperform bonds meaningfully over a 10-year investment horizon.

Historically, cyclically-adjusted price-to-earnings (CAPE) ratios have been reliable indicators of long-term expected returns. At current levels, CAPE ratios suggest that global equities could generate annualised returns of 8% in the next 10 years, including dividends. These returns are essentially in line with the returns posted in the past two decades, and well above US 10-year Treasury yields of 4.8% at present.

CYCLICALLY-ADJUSTED PRICE-TO-EARNINGS RATIOS SUGGEST THAT GLOBAL EQUITIES COULD GENERATE ANNUALISED RETURNS OF 8% IN THE NEXT 10 YEARS INCLUDING DIVIDENDS

Comparing global equities' cyclically-adjusted price-to-earnings ratios and annualised returns over the subsequent 10 years, including dividends



Source: Refinitiv Datastream, Barclays Private Bank, October 2023

WHAT DOES THIS MEAN FOR INVESTOR POSITIONING?

Staying invested:

With that in mind, and given the difficulty in timing markets, staying invested remains preferable, but investors would do well to consider downside protection and a more defensive positioning. Indeed, with many risks on the horizon, capital preservation should be the number one focus. To that end, option strategies may be particularly useful in the current environment, allowing to both mitigate downside risk in portfolios and enhance risk-adjusted returns.

Diversification to the rescue:

In addition, diversification within and across asset classes is more important than ever. In particular, investors could consider adding exposure to alternative asset classes (subject to personal circumstances), including private markets and hedge funds, as they can bring uncorrelated sources of returns and less directional exposure to equity markets, respectively.

A defensive but balanced positioning:

Within the equity market, a more defensive but balanced positioning appears warranted, at least in the short term. Indeed, some areas of the market remain attractive for investors who can tolerate short-term volatility.

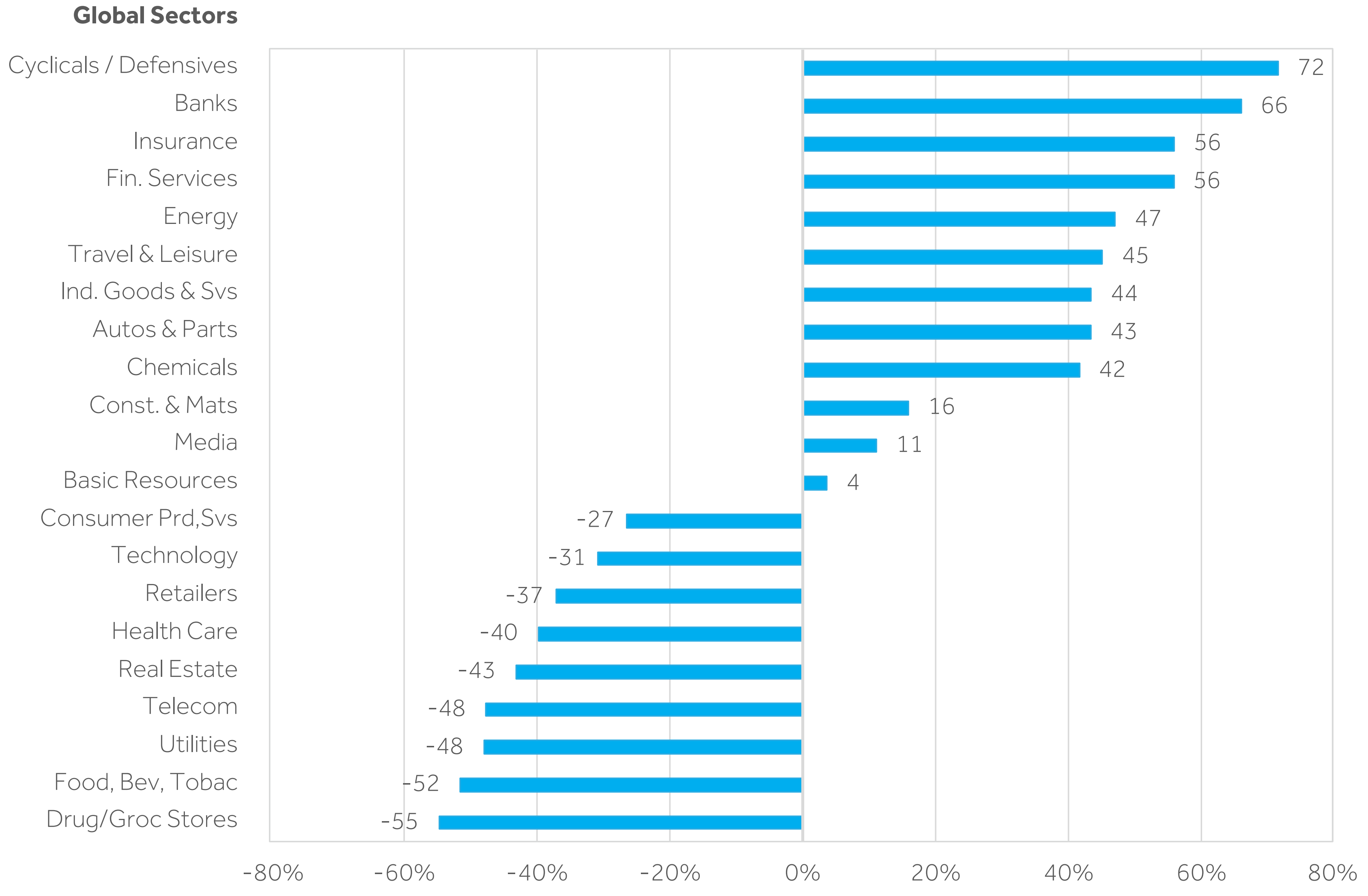
With global growth expected to slow and yields expected to normalise over the course of next year, some sectors appear better positioned than others, namely the defensives and bond proxies.

The chart ranks global sectors' relative performance according to their correlation with US 10-year Treasury yields as of March 2022, i.e. before the start of the aggressive monetary policy tightening cycle by the US Federal Reserve. We have excluded the past 18 months from our analysis, as the correlation between equities and bond yields has substantially weakened over this period (from positive to negative). But as inflation moderates, we expect the typical relationships of the 2000–2022 period to re-establish themselves.

At the bottom of the chart, utilities, consumer staples, telecom and healthcare sectors rank as the most negatively correlated with yields globally. In other words, they tend to outperform the market, as yields decline. These sectors also rank as some of the most defensive ones, as they generally outperform the market in periods of weaker economic activity.

THE SECTORS MOST NEGATIVELY CORRELATED WITH YIELDS LOOK BEST POSITIONED TO OUTPERFORM, AS YIELDS DECLINE

Correlation of global sectors' relative performance vs US 10-year Treasury yields as of 1 March 2022 (6-month changes over 10 years)



Source: Refinitiv Datastream, Barclays Private Bank, October 2023

Utilities, consumer staples and energy look well positioned

Taking valuations into account, out of those four sectors, we favour utilities and consumer staples, which have substantially de-rated in recent months, as interest rates have surged. Based on MSCI All Country World indices and forward price-to-earnings multiples, utilities and consumer staples trade at a significant discount to their 10-year average (2.2x and 1.7x standard deviations below 10-year average, respectively), near historical lows. They offer a superior forward dividend yield (4.5% for utilities and 3.0% for consumer staples, versus the market on 2.3%). Their earnings expectations for 2024 also look more conservative and less prone to disappointment.

Within the more cyclical sectors, we remain positive on the global energy sector, despite a 14% outperformance since mid-July. The sector is still lagging its relationship with earnings, and it is well positioned to benefit from higher oil prices. The sector continues to look cheap, trading at a significant discount to history (0.9 standard deviations below its 10-year average), with a superior forward dividend yield of 4.1%. It also represents an attractive hedge against an oil shock, inflation more generally, and geopolitical risk.

UK equities remain attractive

At the regional level, we also favour the more defensive markets, which trade at a discount to history. On that basis, we continue to like large-cap UK equities, which have a defensive tilt and are overweight consumer staples and utilities amongst others, and tend to outperform global equities in a down market. UK equities currently trade at 10.4 times forward earnings, a 26% discount to their 10-year average, and offer one of the highest dividend yields amongst major markets (4.5% forward dividend yield).

Other markets, such as the Eurozone and China, also screen cheap. However, they are more cyclical and appear more vulnerable to a growth slowdown. In the absence of a catalyst, they are unlikely to re-rate in our view.

THE BOTTOM LINE

2024 is likely to be another challenging year for equity investors. While the long-term picture remains bright, the short-term outlook is clouded by elevated uncertainty and demanding valuations. Opportunities are much more likely to materialise at the sector and stock levels rather than at the index level. To best navigate this uncertain backdrop, investors will need to be creative while remaining laser-focused on their long-term goals.

Author: Dorothée Deck, London UK, Cross Asset Strategist

Beyond the hourglass: Spotlight on private assets

While central banks are still combating the post-pandemic inflation wave, investors are wondering how to position their portfolios amid elevated economic and geopolitical uncertainty. Can private markets offer a ray of hope, and help investors navigate the turbulent tides by making their portfolios more robust?

Please note: This article is more technical in nature than our typical articles, and may require some background knowledge and experience in investing to understand the themes that we explore below. All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

Persistent macroeconomic volatility remains one of the main worries, and one of the key performance drivers for all asset classes. As a result, investors are increasingly concerned about the implications of a more fragmented, precarious world.

WHISPERS OF TIME: UNDERSTANDING MACRO DRIVERS

Knowing this and acknowledging investors' aversion to risk and ambiguity, we turn our attention to two burning questions that we aim to address in this article:

1. What can we learn from past economic cycles regarding the performance of different asset classes?

2. How can private markets help investors to effectively diversify their portfolios and boost returns?

We consider six traditional, liquid asset classes: cash, developed government bonds, developed investment grade bonds, global high yield bonds, developed equities and commodities. These asset classes are the essential building blocks of any multi-asset class portfolio. They cover a broad range of investment opportunities and allow investors to tap into different sources of return in the form of income and/or capital gain.

In addition to these "core" asset classes, we consider illiquid alternatives such as private markets (i.e., private debt, private equity and private real estate) and hedge funds. We note that – due to the lack of liquidity – these "satellite" asset classes are less transparent than public market investments. Therefore, any estimation procedure is subject to uncertainty and should not be taken at face value.

MONETARY POLICY REGIMES IN THE SPOTLIGHT

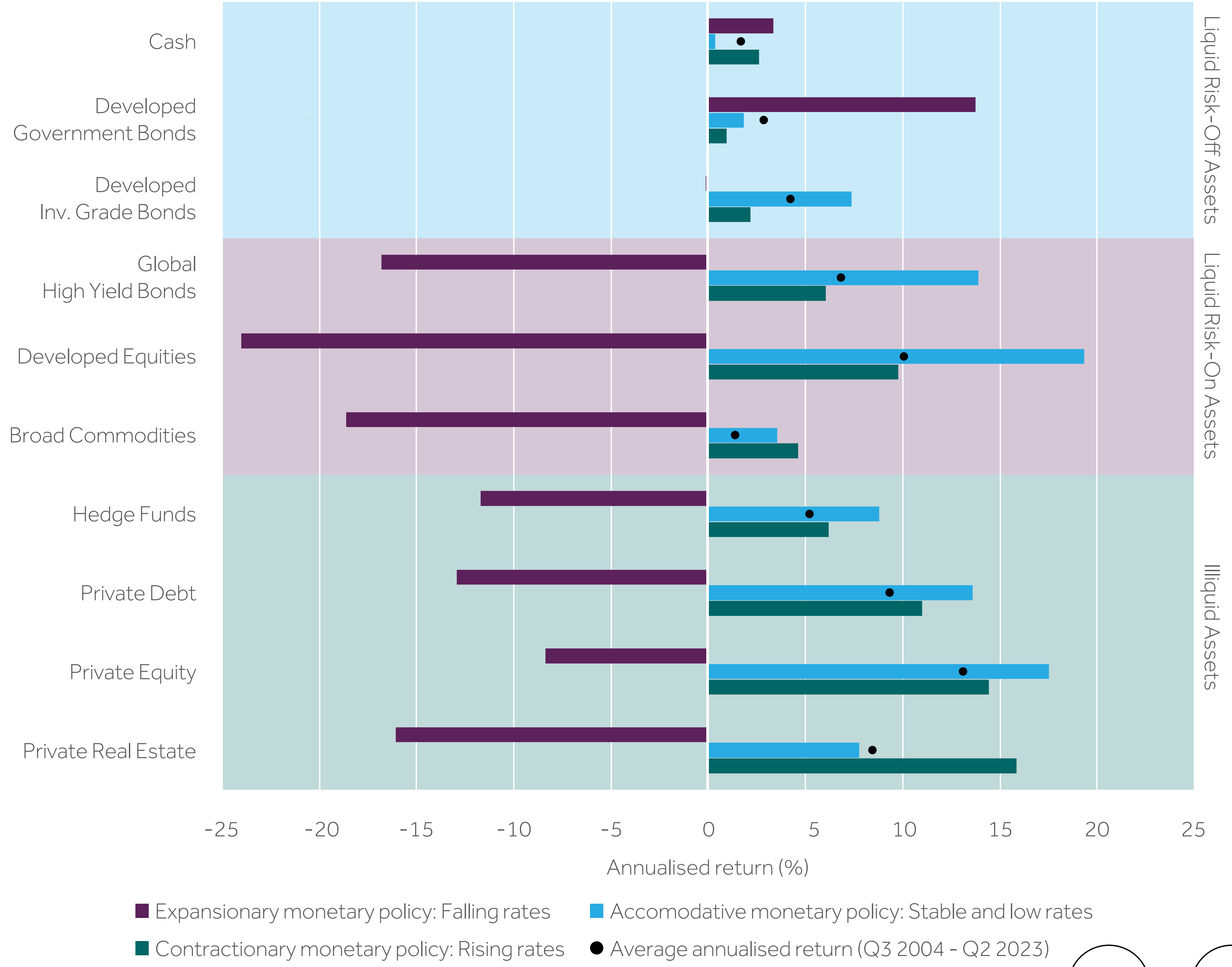
We calculated the annualised nominal quarterly performance for liquid and illiquid investments in different monetary policy regimes between Q3 2004 and Q2 2023. This sample period is determined by balancing data availability and the macroeconomic cycle dynamics. We considered three US monetary policy regimes:

- Expansionary monetary policy: characterised by rate cuts, covering the periods Q3 2007–Q4 2008 (deflationary bust and a major recession caused by the Global Financial Crisis) and Q3 2019–Q1 2020 (disinflationary bust and a brief sharp recession caused by the COVID-19 pandemic),
- Accommodative monetary policy: characterised by stable and low interest rates, spanning the periods Q1 2009–Q3 2015 (disinflationary growth) and Q2 2020–Q4 2021 (pandemic-induced economic stimulus),
- Contractionary monetary policy: characterised by rate hikes, covering the periods Q3 2004–Q2 2007 (inflationary boom), Q4 2015–Q2 2019 (interest rate normalisation on the back of near full employment and reflation) and Q1 2022–Q2 2023 (stagflation).

In the chart, the performance of each asset class in different regimes is represented by horizontal bars.

MONETARY POLICY REGIMES IMPACT ALL ASSET CLASSES

Annualised average quarterly performance of selected liquid and illiquid asset classes over the whole period and in different US monetary policy regimes from Q3 2004 to Q2 2023.



Sources: Bloomberg, Preqin, Barclays Private Bank. Data accessed in October 2023, last observation point June 2023

FALLING RATES

Our first finding is that – over the last two decades – only cash and liquid high-quality bonds have posted positive average returns during monetary easing episodes (which typically coincide with recessions). Historically, developed government bonds have significantly outperformed other asset classes in the "falling rates" regime, validating their "risk-off" or "safe-haven" status.

As one might expect, the riskier assets such as equities and credit performed the worst during "risk off" episodes. Commodities and illiquid assets have also lagged, albeit to a lesser extent on average. Among the latter, the least negatively affected asset classes were private equity and private debt.

RISING RATES

A very different outcome is observed during periods of monetary tightening. In this scenario, liquid risk-on assets, hedge funds, and private markets in particular, have exhibited relatively strong performance.

Real assets such as commodities and private real estate have posted their highest average returns in this monetary regime. As interest rates tend to rise in sync with inflation, real assets are often included in a well-diversified portfolio as inflation hedges.

On the other hand, liquid high-quality bonds lagged significantly in this monetary policy regime.

STABLE AND LOW RATES

When monetary policy is accommodative most asset classes tend to do well. This regime is typically characterised by stable growth and inflation that is either in line with, or slightly below, the central bank's target. Equities, credit, hedge funds and private markets particularly shine in such an environment.

LONG-TERM PERSPECTIVE: ILLIQUIDITY PREMIUM

Additionally, we calculated the annualised average return over the full sample (represented by black circles in the chart).

Only cash and developed government bonds exhibited positive average performance in all three monetary policy regimes. However, safety and below-market risk come as the cost of below-market returns. Over the full sample, cash is actually the worst performing asset class. Moreover, the average real cash rate (i.e., adjusted for inflation) was -0.8%. This means that staying on the sideline would have significantly eroded wealth over the past two decades.

The best performing asset classes were public and private equities. Private debt (private equity) delivered an illiquidity premium over global high yield bonds (developed equities) of 2.4% (3.0%) per annum.

However, it is important to highlight that private market investments tend to be longer-term. Therefore, market and funding liquidity risk management is an additional element that needs to be considered when investing in private assets. Indeed, investors who were willing and able to accept longer lock-up periods benefited the most from 2004 to 2023.

CHARTING NEW PATHS WITH PRIVATE ASSETS

Our analysis above indicates that each asset class has a specific role in a portfolio, depending on its sensitivity to inflation and growth.

In particular, the past two decades show that there are pockets of value within private markets irrespective of the monetary policy regime. As such, private markets appear to be a particularly valuable building block in a multi-asset class portfolio.

Although the evidence of strong private markets performance in the accommodative and contractionary regime is convincing, one could question the role of private markets during expansionary monetary policy episodes.

In reality, as private markets are genuine long-term investments, economic cycles cannot be avoided. This seems to be the price that investors must accept to harvest the illiquidity premium.

TAMING ECONOMIC CYCLES WITH TIME DIVERSIFICATION

To gain further insights into the investment dynamics in private markets, it is necessary to consider the performance of different private markets over time and across a sufficiently large set of private market funds.

To this end, we explored the performance of different funds within four important private market segments: buyouts, venture capital, private debt and private real estate (see the charts on the following page). We calculated the median net internal rate of return (IRR) and the performance dispersion across funds (as the interquartile range) for vintages 2004–2021.[1]

The median net IRR varied substantially over time; however, it was positive for almost all vintage years across the four asset classes. Averaged over the considered vintage years, the median net IRR is 8–15%, depending on the private market segment.

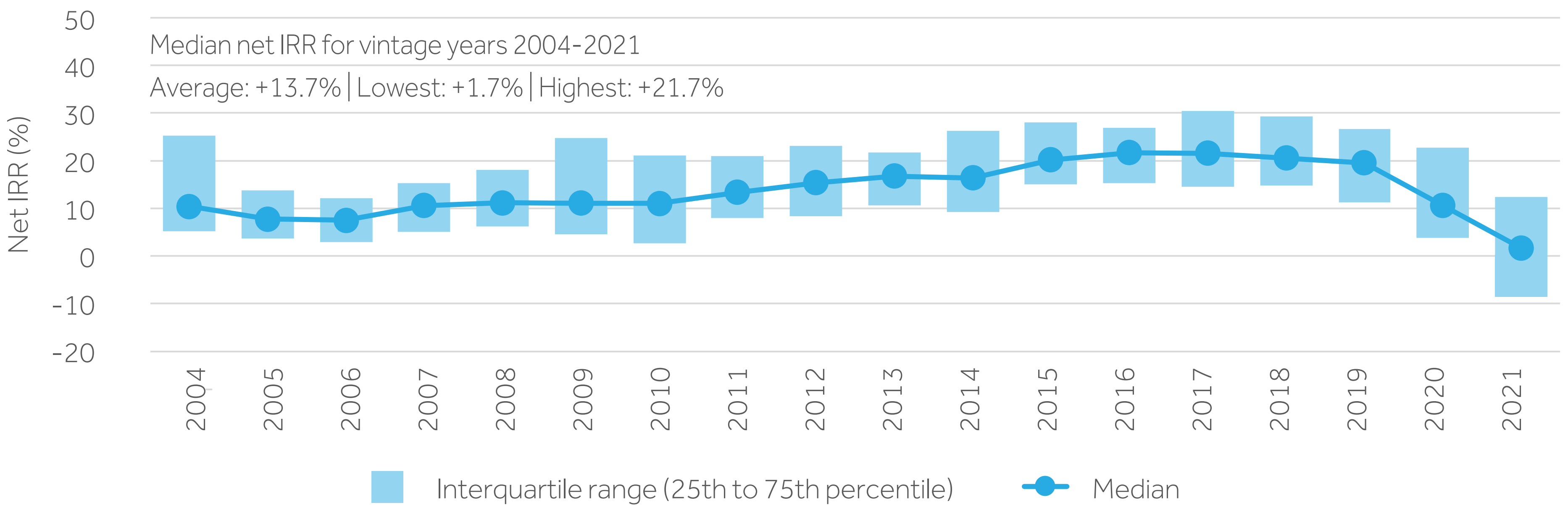
The net IRR dispersion also exhibited some variation over time, typically being higher during crisis periods. In other words, performance in any monetary policy regime can look significantly different from the numbers presented above in this article, depending on the fund selection. Choosing the right private markets segment and selecting the above-average funds (e.g., in the first or second quartile) is essential for investment success (albeit nothing is ever guaranteed).

[1] More recent vintages are not available due to the lack of data since the vast majority of funds launched this year, and the previous year, have not yet started to return capital. Additionally, private equity and private real estate funds typically require capital deployment over the period of 4–5 years before distributions become significant. These private market mechanics are reflected in the decreasing net IRR from 2018 to 2021 vintage. We note that this effect is not observed for private debt due to shorter deployment phase on average.

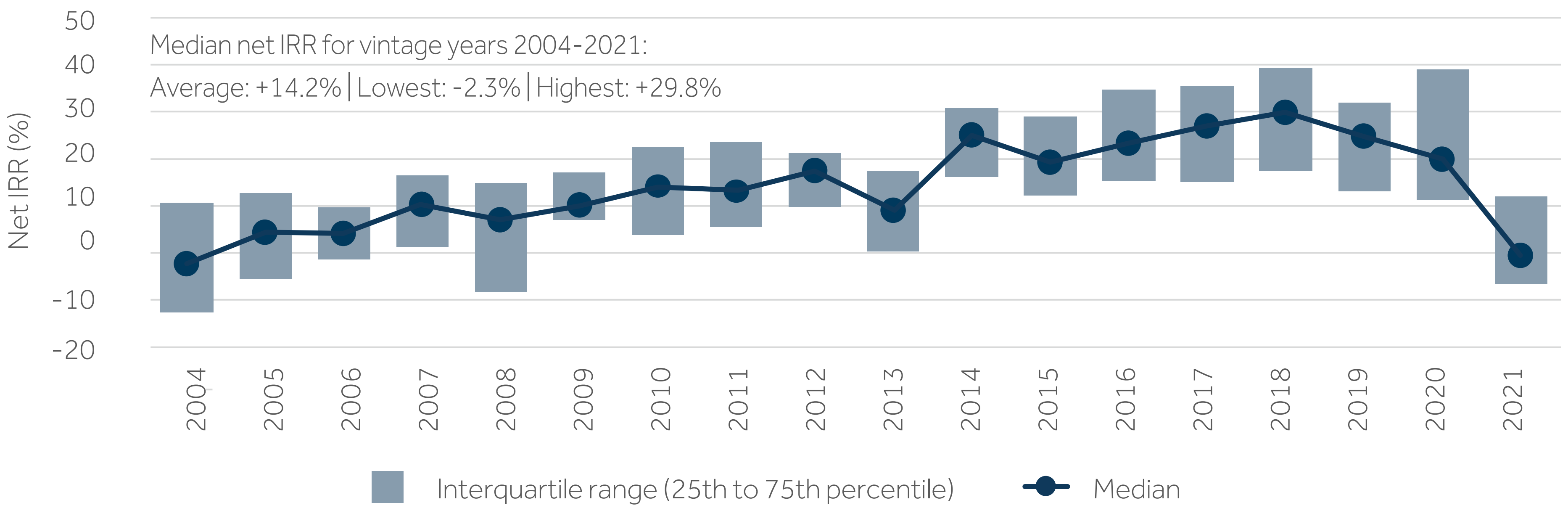
PRIVATE MARKETS PERFORMANCE VARIES SUBSTANTIALLY OVER TIME AND ACROSS FUNDS

The median net IRR shows the overall trend, whereas the interquartile range provides a robust statistical measure of the cross-sectional performance dispersion for selected private markets from 2004 until 2021. The interquartile range is a robust statistic that captures the middle part of the return distribution (i.e., the range between the 25th and 75th percentile), measured over more than 100 funds.

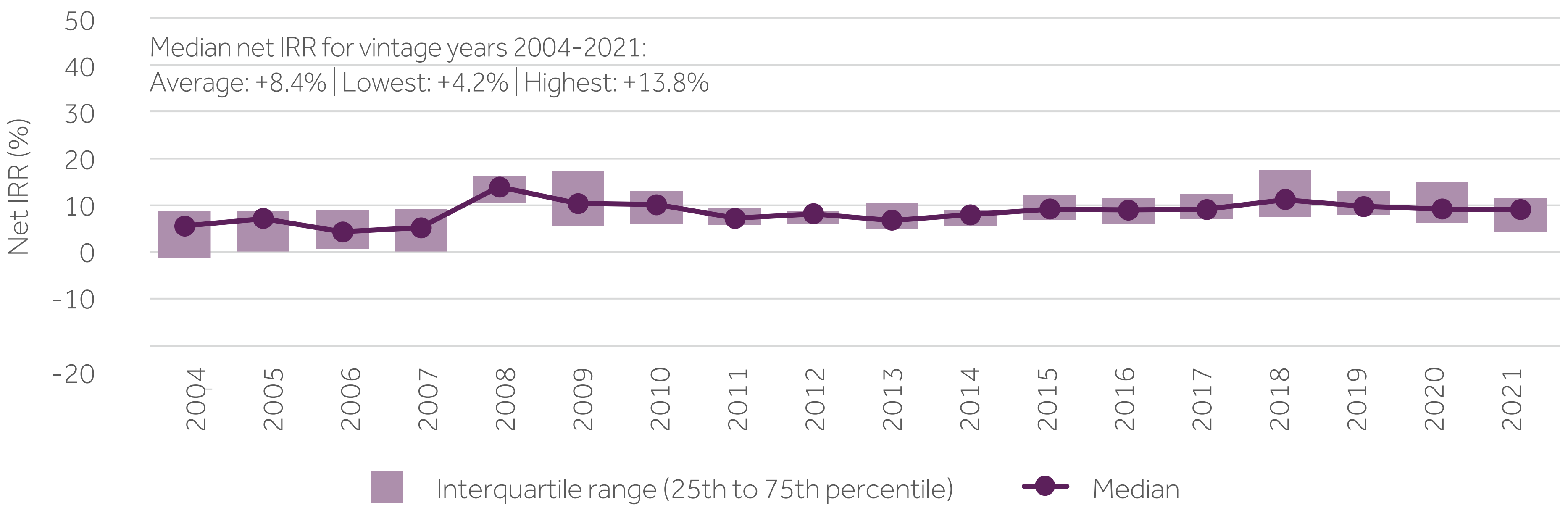
PRIVATE EQUITY: BUYOUT



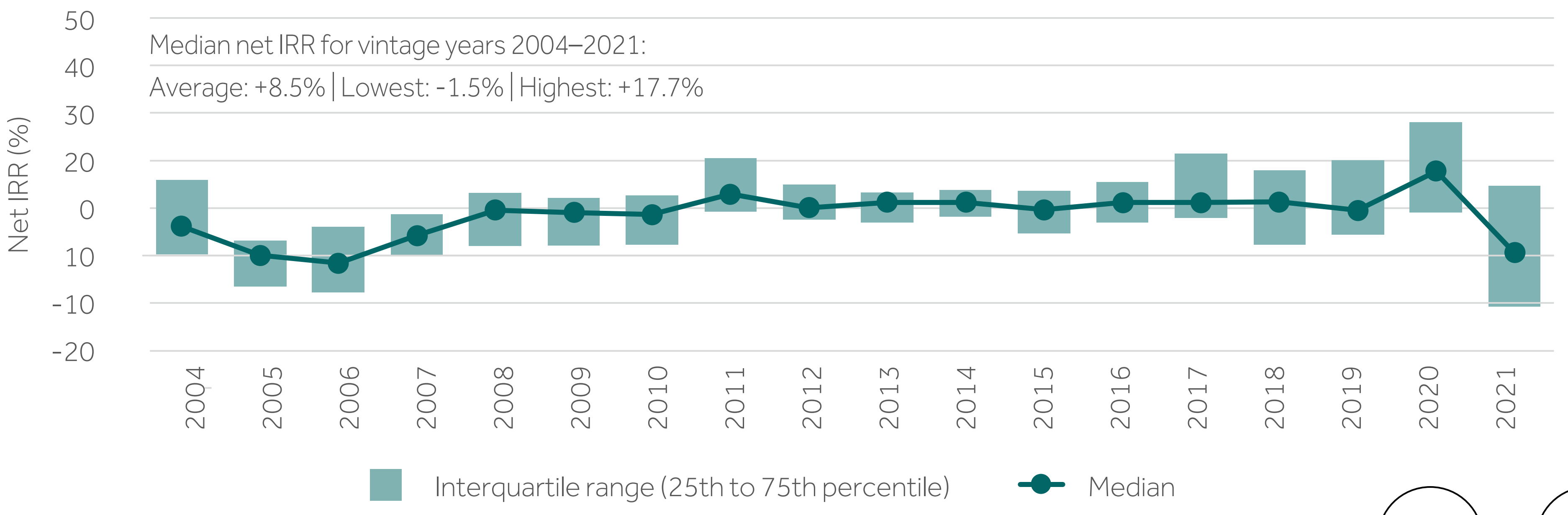
PRIVATE EQUITY: VENTURE CAPITAL



PRIVATE DEBT



PRIVATE REAL ESTATE



Sources: Bloomberg, Barclays Private Bank. Data accessed in October 2023, last reported vintage year 2021

SELECTING THREADS AND WEAVING A PRIVATE MARKETS TAPESTRY

The final element in our analysis is to break down private debt, private equity and private real assets into sub-asset classes. The private markets universe offers a very wide set of opportunities, and putting each asset class under the microscope can bring valuable insights.

We calculated the average annualised return, autocorrelation-adjusted annualised volatility[2] and worst historical loss for 18 sub-asset classes split between the three aforementioned categories. In contrast to the previous section – where we worked with funds data – here we consider Preqin's quarterly benchmark indices and measure performance as total return.

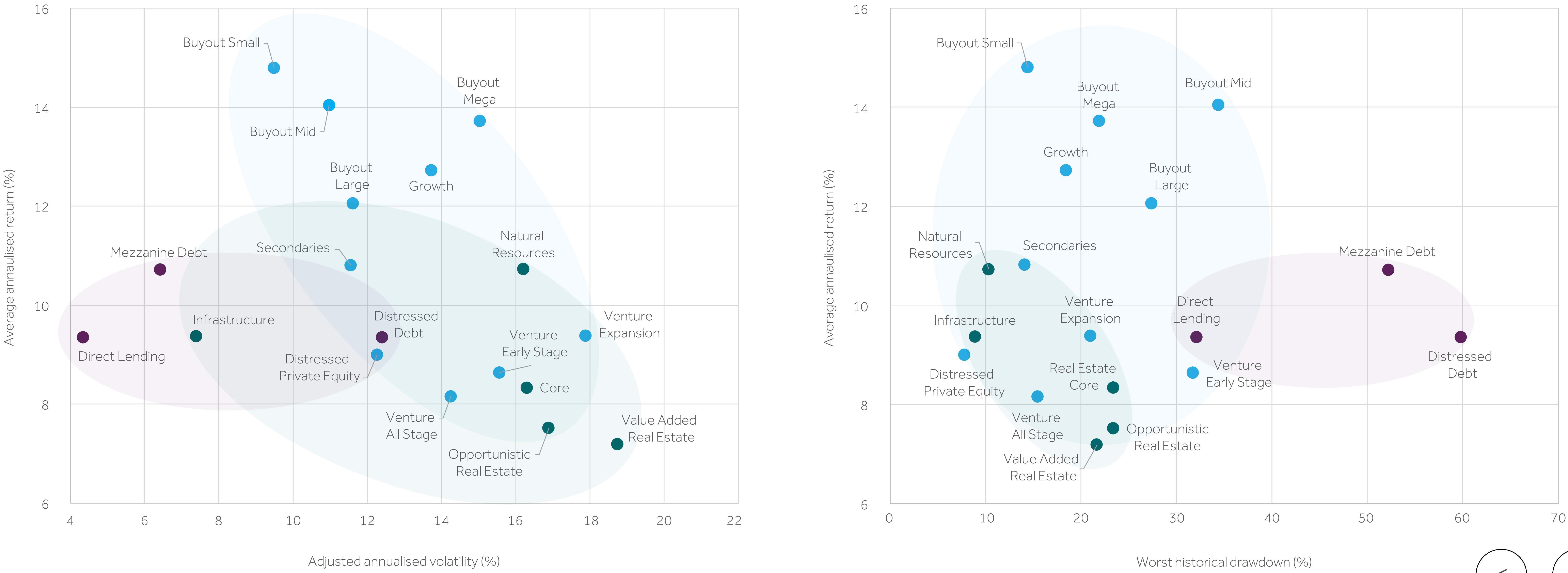
Our analysis indicates that private debt strategies have had the most stable return and lowest volatility (see the left panel in the chart on the previous page). However, they also suffered the largest drawdowns in 2008 (albeit they were quick to recover thereafter). This example also illustrates that investors should think carefully about the risk measure they use when analysing investment opportunities.

Private equity strategies span a wide range of risks and returns, and therefore offer most selection opportunities. A similar conclusion holds true for private real assets. This is not surprising since these two broad asset classes have by far the most assets under management of any private markets.

[2] The autocorrelation-adjusted volatility accounts for the fact that private assets data is not mark-to-market, but rather based on appraisals and therefore exhibits a high degree of autocorrelation. We correct for the often-overlooked issue of underestimation of volatility. If returns are not independently distributed – which is indeed the case with private markets – then temporal aggregation of volatility does not follow the well-known "square-root-of-time" scaling. In the presence of positive autocorrelation, annualised volatility calculated using this simple scaling is a downward biased estimator.

PRIVATE MARKETS OFFER A RICH SPECTRUM OR RETURN AND RISK

The average annualised total return versus autocorrelation-adjusted annualised volatility (worst historical loss) for selected private market strategies from Q3 2004 until Q2 2023 are presented in the left (right) panel. The span of risk-return trade-offs for various private equity, private debt and private real assets strategies is captured by the shaded cyan, purple and teal areas, respectively.



Sources: Bloomberg, Preqin, Barclays Private Bank. Data accessed in October 2023, last observation point June 2023

TURNING TODAY'S ANXIETIES INTO TOMORROW'S HOPES

Uncertainty is unsettling and can keep investors away from markets for too long. However, considering potential macro scenarios and taking measured risk often benefits investors in the form of higher long-term returns.

Private markets represent the ultimate frontier (depending on an investor's personal circumstances) when it comes to long-term investing. To achieve a desired stable level of strategic asset allocation in private markets, investors need to commit capital every year. In other words, they need to diversify not only across different (sub-) asset classes, but also across vintages.

Moreover, our historical analysis of the performance dispersion among funds indicates that tactical views can be addressed by a diligent and skilful fund selection.

By combining all these elements, investors could harvest the illiquidity premium over the long term, and open the door to additional returns, without necessarily having to worry too much about the macroeconomic environment.

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In conversation with David Rubenstein

Shenal Kakad, our Head of Private Markets, spoke to David Rubenstein, Co-Founder and Co-Chairman of The Carlyle Group, about investor opportunities at a time of global friction and flux. He also reflected on his career, offering his unique insights to any investors at the start of their career.

Please note: Barclays Private Bank does not endorse any of the companies or individuals referenced in this article.

This article is intended for readers with a solid understanding of investments. Investing in private markets is often complex, illiquid and brings higher idiosyncratic risks than public markets, and so is only suitable for experienced investors. This communication is also general in nature and provided for information/educational purposes only. It does not take into account any specific investment objectives, the financial situation or particular needs of any particular person. The value of investments can fall as well as rise and you may get back less than you invested.

Shenal Kakad (SK): How do you assess the current state of the global economy, given recent events and longer-term trends?

David Rubenstein (DR): The global economy seems to be in reasonable shape, despite the challenges of inflation, high interest rates, and several ongoing wars. At the moment, the United States seems likely to avoid a recession in the near term. Some European countries are not that fortunate, and China's economic growth is clearly lagging, though the word "recession" is probably not appropriate right now.

(SK): What's your investment perspective of the looming elections in the UK and US? Do you envisage significant market reactions to either?

(DR): Both the US and UK elections are more than six months away, and therefore it is probably unwise to say right now what the impact will be, in large part because the likely winners and their policies are not known. As a general rule, there is a tendency for new governments—that is to say, a different party running the government—to make, or at least announce, changes that markets tend to overreact to a bit, for the new policies rarely get implemented as proposed.

(SK): In light of the US Federal Reserve's (Fed) efforts to tame inflation in 2023, what do you make of the higher-for-longer climate? Both from a risk and opportunity perspective?

(DR): Of course, higher interest rates tend to produce lower returns in equity-kinds of investments, particularly in real estate, but debt investments tend to do better, in part because the higher yields attract a good deal of investor interest. The industry is already seeing enhanced investor interest in public and private credit instruments.

< >

(SK): How does the Private Markets landscape look for investors right now?

(DR): The best investors generally recognise that the best investments tend to occur during times when investment outlooks appear riskier, so the lower prices in many kinds of equity investments might well yield attractive returns over time.

(SK): Are there regional, and/or sector trends, that excite you more than others?

(DR): Absolutely, there are exciting—but not risk-free—opportunities in new technology areas such as artificial intelligence, fintech, biotech, quantum computing, cyber, and space. Less risky opportunities might be in the growing healthcare and wellness areas, and the somewhat-related industries of healthy food and drinks as well. Investments in sports teams, travel and tourism, and entertainment-related areas should also do well as consumers increasingly seem interested in living longer and healthier, and with entertaining themselves in ways that were harder to do in the COVID-period.

(SK): And conversely, where do you envisage the headwinds coming from in 2024?

(DR): Headwinds always seem to emerge at times and in places not anticipated by experts. Thus, the most likely headwinds over the next year or so may not be foreseeable today. Who would have foreseen a Russian invasion of Ukraine, or the breakout of war in the Middle East? With that caveat, the areas that investors should at least think about over the next year or so are: a possible recession in the West or China, pressure on the US dollar due to continued, and more expensive, US government borrowing, tensions that go beyond words in some parts of Asia, the continued effects of climate change on corporate spending and earnings, and the effects of prolonged gridlock in the operations of the US government.

(SK): What are some of the experiences and decisions that helped you succeed in a volatile and uncertain environment?

(DR): Doing as much research as possible, knowing the details of what you are pursuing as investments, having realistic return objectives, not getting over leveraged, not panicking if an adverse occurrence appears, remembering that the world is never as troubled as a few days of bad headlines might suggest, and not engaging in practices which will cause nights of sleeplessness.

(SK): What lesson learned would you share with any investors about to start their career today?

(DR): Those starting a career in investing should do so because they believe smart investing will yield results that are beneficial for society, not just to enrich oneself. If you do not enjoy the challenges and vicissitudes of investing, or in being in parts of the financial world, find something you do enjoy. No one ever accomplished anything great or enduring if he or she did not enjoy what they were doing day-to-day. Life is too short to hate what you do for a living, if you have any realistic choice in the matter. But investing can be quite enjoyable and rewarding if one puts in the time and effort into really learning the skills and practices needed in the profession.

The psychology of investing

Psychology can play a significant role in an investment journey. We provide a guide for investors to understand and navigate it.

When Harry Markowitz, the pioneer of modern portfolio theory, was asked about his own investment allocation, he said, "My intention was to minimise my future regret, so I split my contributions 50/50 between bonds and equities." Psychology drove his behaviour.

Despite creating an optimal investment strategy and portfolio being a financial optimisation problem, psychology can play a significant role in the success of an investment journey.

WHY IS PSYCHOLOGY CRITICAL?

Whilst finance is built on models of 'rational agents' that seek to maximise utility, daily decisions are influenced by emotions like fear or greed. In fact, history is littered with episodes where non-financial factors, or 'animal spirits' drove markets.

By taking into account psychology, we can better understand investor behaviour to improve one's own investment approach. As human beings, we are prone to behavioural biases – systematic deviations from rationality – which can impair decision-making and potentially drag on returns.

WHAT DOES THIS MEAN FOR THE INDIVIDUAL INVESTOR?

Any investment plan should be tailored to the investor. In practice, this means identifying investors' behavioural proclivities, and putting things in place to maximise the chance of sticking to the plan, particularly in challenging times.

Below are three examples of behavioural tendencies and their investment implications. Through specific solutions, ad hoc strategies to enter the market whilst providing comfort (e.g. phasing in), or clearly identified triggers for action, an adviser can help find ways to mitigate the impact of these biases.

INVESTOR BEHAVIOUR TENDENCIES AND THEIR INVESTMENT IMPLICATIONS

Investor	Behavioural tendency	Investment impact / implication	Behavioural bias
Investor A	Becomes overly excited when markets are rising and increases risk exposure significantly, but panics when markets fall and crystalises losses at the bottom.	Lower returns versus if they had held a portfolio through ups and downs.	Loss aversion
Investor B	Doesn't want to get into markets when they perceive a risk to returns from an impending but uncertain event	Misses investment opportunities whilst holding cash.	Regret aversion
Investor C	When holding a view about a market event, will only seek information which confirms it to justify taking a particular action.	Asset allocation decisions taken without adequately considering the longer term.	Confirmation bias

SHOULD I WAIT FOR THE UNCERTAINTY TO PASS?

Investors such as 'Investor B' (see chart 1) are often tempted to wait for clarity before investing. Unfortunately, there are always reasons to hesitate. The availability heuristic, a mental rule of thumb which leads to placing greater weight on events and data that are more dramatic and thus more readily available in one's mind, is a key influence here. As investors overly focus on certain headlines, uncertainty and hesitancy increase, overshadowing the longer-term data and trends which drive markets in the long run.

This is why waiting for the 'perfect time' can often lead to sitting on the sidelines for longer than anticipated, potentially missing rallies while inflation erodes wealth.

HOW DO YOU PREPARE FOR THE RISKS?

Investors concerned about risks may consider putting hedges in place. A core-satellite approach, where a satellite portfolio of hedges complements a core portfolio, can make it easier to stay invested. This may be preferable to the binary situation of being in the market when optimistic, and out of it when pessimistic.

However, the market impact of risk events can be unpredictable. There is also the potential for risks that have not been considered - unknown unknowns.

One pre-emptive action an investor can take in this case is to hold a well-diversified portfolio. Owning a mix of asset classes, sectors, and regions can provide one of the few ways to both protect and capitalise on unexpected events.

Finally, diversification can help dampen volatility and, as a result, protect the investor from the emotions that it can induce. This provides the building blocks for clear and rational decision-making.

WHY INVEST AGAINST A WORSENING BACKDROP?

As outlined in the macroeconomic chapters, we are getting closer to the next economic contraction. But this doesn't necessarily have to be a cause for concern for long-term investors. After all, a slowdown isn't necessarily synonymous with the near collapse of developed economies we experienced in 2008. But why risk capital when so-called risk-free returns from cash are so attractive?

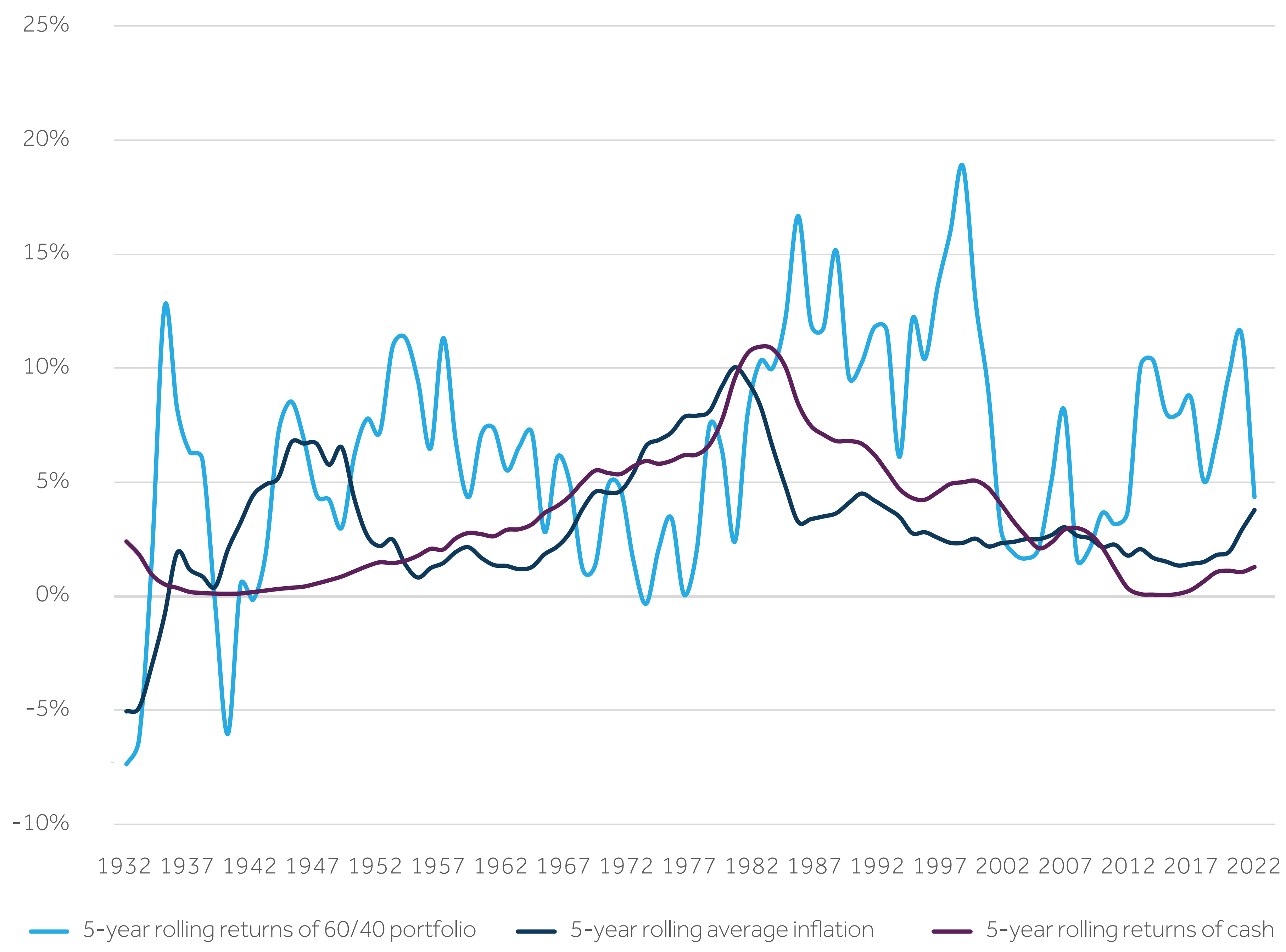
Cash can certainly provide short-term comfort, but in the long term, the costs of foregone investment returns and the erosion from inflation also need to be taken into consideration.

The Barclays Equity-Gilt study, which examines UK asset class returns from 1899–2022, shows that over two years the probability of equities outperforming cash was 70%, and over ten years, this rose to 91%. However, past performance is never a guarantee of future performance.

The figure below shows a similar picture with five-year rolling returns for a hypothetical 60/40 US equity-bond portfolio against cash and inflation from 1927 to end 2022. The probability of the portfolio outperforming cash on a 1-year basis was 62.7%, and for 10 and 20-years was 78.8% and 78.7%, respectively.

5-YEAR ROLLING RETURNS OF A 60/40 US EQUITY-BOND PORTFOLIO VS. CASH AND INFLATION, 1927–2022

Cash index: 3-month T.Bill. 60/40 portfolio: 60% SPX Index and 40% US T.Bond. All data from 1927–2022.



Source: Bloomberg, NYU Stern School of Business, Barclays Private Bank, October 2023.

WHERE ARE THE INVESTMENT OPPORTUNITIES?

As investors, we aim to select the combination of assets that will deliver the most appropriate risk-adjusted returns over the medium term. This is why, recession or not, what matters most is how stocks, bonds, commodities, and other asset classes will react to future macro- and micro-economic developments. Indeed, investing isn't just about 'the market'; it's also about companies. Quality, well-run companies do not necessarily stop being so because of a gloomy macro environment.

In the same way, much market news may simply be noise and investors should think about market events within the context of their own portfolios and goals.

Investors should also remember their time horizon as this can both open up new opportunities, and also prevent irrational decisions. For example, those investing with the intention to pass on wealth to the next generation may be able to capitalise on the illiquidity premium offered by some Private Assets.

WHAT TO DO WHEN INVESTING FEELS UNCOMFORTABLE?

Investors earn returns on their invested capital for taking risk, and higher risks typically yield higher expected returns (and potentially higher losses). Therefore, to earn returns over and above the risk-free rate, it is necessary to accept the discomfort that comes with volatility and uncertainty.

Investors can:

a. Accept this cost and earn the long-term returns that will typically be associated with the returns profile of the assets they are holding.

b. Hold assets with lower volatility and accept lower expected returns. This may reduce discomfort but can affect an investor's ability to reach their long-term goals.

c. Try to earn the return while avoiding paying the price, by attempting to time the market. However, this is a difficult sport, which can prove costly. In investing, just like in life, humility is essential.

IS HISTORY RELEVANT IN THIS NEW ENVIRONMENT?

Whilst history does not repeat itself exactly, it can rhyme. Markets move in cycles, with periods of expansion followed by periods of contraction. Similarly, market sentiment often swings between euphoria and panic.

The further back one looks, the more general historical takeaways should be. A key lesson is that throughout history, in spite of disruptions, the long-term drivers of the growth of markets – human ingenuity and technological advancement – continue in the background. We do not believe there is reason for this to change.

From an emotional standpoint, investors will often find it easier to get and stay invested in the good times, and find it more challenging in the bad times. But it's when the herd's thinking is extreme that real opportunities generally arise.

HOW CAN I GAIN AN EDGE IN 2024?

In what looks to be a year which will test the resolve of investors, timeless investing principles, combined with strong behavioural resolve, could improve the odds of success.

A robust investment process, leading to a well-diversified portfolio of quality companies, should provide solid foundations on which to generate appropriate returns over the medium term. But, for this to happen, an investor must be able to hold that portfolio during challenging times.

The key to doing so is to have an awareness of one's own behavioural proclivities. Putting a plan in place to limit their impact can make it easier to stay the course.

Strong foundations for clear and rational decision-making improve the chances of being able to mitigate risks and capitalise on opportunities. This should give investors an edge in 2024 and beyond.

Author: Alexander Joshi, London UK, Head of Behavioural Finance

Five sectors for long-term green growth in 2024

With an uncertain near-term, investors can look beyond current markets to spot growth opportunities in sectors that will have to be transformed to achieve net zero.

Please note: This article is designed to be thought leadership content, to offer big picture views and analysis of interesting issues and trends that matter to our clients and the world in which we live. It is not designed to be taken as expert advice, investment advice or a recommendation, and any reference to specific companies is therefore not an opinion as to their present or future value or broader ESG credentials. Reliance upon any of the information in this article is at the sole discretion of the reader. Some of the views and issues discussed in this article may derive from third-party research or data which is relied upon by Barclays Private Bank and may not have been validated. Such research and data are made available as additional information for the reader where appropriate.

Navigating the markets in 2024 may be challenging. Contradictory geopolitical, economic and inflation pressures are creating uncertain and choppy waters.

Beneath the surface, though, there are deeper currents of social and environmental problems. Issues such as climate breakdown and biodiversity loss will be critical, global challenges, not just in 2024; but for decades to come.

Such structural trends can act as a longer-term beacon to inform your investment decisions today. This shifts the question from simply "To which asset classes do I allocate today for potential returns?" to "How can I protect and grow my family's portfolio while trying to influence tomorrow?".

This article looks to the world as it might be in 2030. Five key sectors are highlighted below with reasons why they may need to grow substantially over the next seven years to address the environmental challenges being faced now.

CHARTING THE WORLD IN 2030

Investors wanting to plot a course of potential sustainable investments might first want to contemplate what the world might look like in 2030.

Climate scenarios can provide diverse narratives of key milestones in coming years and show the path a net-zero transition might take. The Task Force for Climate-related Financial Disclosures explains climate scenarios as "a plausible description of how the future may develop based on a coherent and internally consistent set of assumptions about key driving forces (such as the rate of technological change and prices) and relationships"[1].

While imperfect and approximate, scenarios can help to inform investment decisions and strategies. Importantly, they do not predict what will happen, but what would need to happen to reach a particular moment in time.

[1] Task Force on Climate-related Financial Disclosures, Guidance on Scenario Analysis for Non-Financial Companies, October 2020

In this case, potential queries might be: In 2030, what would our world need to look like for the 1.5C ambition of the Paris Agreement to be within reach? By then, how could global emissions be cut by 45%[2]? What milestones of growth or reduction would be needed? For key industries and sectors, what achievements are needed?

Reviewing the climate scenarios across various specialist organisations[3] helps to provide answers to these questions as well as to identify the key areas of consensus. While specific figures or calculations might vary, overall, they present a collective narrative of the world at 2030 on a 1.5 degree pathway. From there, investors can plot back to the present day to identify where opportunities could lie.

Five trends from the analysis, with various entry points for investors, are worth highlighting. Given the scale of the challenges that lie ahead, the underlying story is consistent – long-term growth markets are emerging for well-run companies with effective solutions to the global challenge of climate change.

1. SCALING RENEWABLES CAPACITY

Producing energy without creating any destructive greenhouse gas emissions is critical to mitigate climate change successfully. Complicating the outlook is that attempts to cut greenhouse gases will occur at a time when global energy demand will continue to grow[4]. To be on course to limit temperature rise to a 1.5C increase above pre-industrial levels, between 65-92% of electricity generation should be from zero-carbon sources by 2030[5].

Therefore, an increasing proportion of renewables will be at the core of this transition, with installed capacity of solar and wind power needing to triple by 2030[6]. Despite persisting issues around permitting, supply-chain difficulties and grid integration, these "traditional" renewables are cost-effective already and rapidly deployable[7].

This economic argument is why scenarios show, for example, the solar industry is preparing for over 1,000 gigawatt (GW) of sales by 2030, which would exceed most scenario stretch targets for the necessary net-zero trajectory[8].

Renewables are one sector with both mature and emerging opportunities for investors. Both public and private companies, as well as infrastructure funds, are developing and managing wind and solar installations at scale. At the same time, businesses within supply chains continue to make key efficiency improvements in components. Beyond these, new alternative renewables are popping up, such as wave, geothermal and hydrogen power which are shifting from prototype phases to commercialisation.

2. REVITALISING THE GRID

Energy grids around the world will need to transform profoundly to enable the shift to zero-carbon energy sources.

Grids will need more flexibility to adapt to changing nature and sources of production, to manage inherent variability, and to match demand and supply across different timeframes. Upgrading transmission and distribution systems would require more than tripling the recent annual investment – from $260bn in 2020 to $820bn in 2030[9].

Initiating this work is urgent, given the long lead times for modernising and extending grids. Also, the scale of the challenge is immense. Over 80 million kilometres of power lines – equivalent to the existing global grid network – will need to be added or replaced by 2040 to meet current climate aims[10].

The growth and disruption of electricity grids creates an unusual 'barbell' of traditional and innovation entry points. First, companies operating, upgrading and servicing, as well as key component manufacturers, will be supported by core market growth. At the same time, companies with new technologies for smart-grids, energy-trading or demand-response systems will enable grids to be more flexible and resilient as underlying supply and demand changes.

3. GENERATING NEW ENERGY STORAGE

Energy storage will be needed to meet the shift in the nature of energy demand and supply. It can take different forms, sizes, and technologies – from providing grid flexibility and resilience to powering vehicles such as bicycles, cars or airplanes.

At the level of a grid, storage provides the needed flexibility and security when renewables are not producing energy or for peaks in demand. For instance, 2023 will be another record year for energy storage capacity, with an expected 42GW added[11]. In the following seven years, to 2030, new storage added each year is expected to grow at a 27% compound annual growth rate, meaning 110GW of fresh storage each year[12].

In other key sectors being electrified, such as transport or industry, batteries will be a critical component. For example, to meet needs solely for electric vehicles in 2030, annual battery production would need to grow from around 160 GWh in 2020 to 6,000 GWh in 2030[13].

Investors seeking to support this transition can find opportunities across the value chain. This could be in companies that provide critical input materials and metals, those that manufacture the storage systems, those which integrate and operate these systems, or those which look at end-of-use services such as component recycling.

[2] Compared with 2010 levels, Emissions Gap Report 2022, United Nations Environmental Programme, 27 October 2022
[3] A non-exhaustive list includes: Rocky Mountain Institute (RMI), RethinkX, Bloomberg New Energy Finance (BNEF), International Energy Agency (IEA), Intergovernmental Panel on Climate Change (IPCC), United Nations Environmental Program (UNEP), Network of Central Banks and Supervisors for Greening the Financial System (NGFS), International Renewable Energy Agency (IRENA) and International Union for Conservation of Nature (IUCN)
[4] Emissions Gap Report 2022: The Closing Window, United Nations Environmental Programme, 27 October 2022
[5] Net Zero Roadmap: A Global Pathway to Keep the 1.5 °C Goal in Reach, International Energy Agency, September 2023
[6] The Renewable Revolution, Rocky Mountain Institute , June 2023
[7] Net Zero by 2050: A Roadmap for the Global Energy Sector, International Energy Agency, 2021
[8] Electricity Grids and Secure Energy Transitions, International Energy Agency, October 2023
[9] 2H 2023 Energy Storage Market Outlook, BloombergNEF, October 2023
[10] Net Zero by 2050: A Roadmap for the Global Energy Sector, International Energy Agency, 2021
[11] Buildings: a source of enormous untapped efficiency potential, International Energy Agency, October 2021
[12] Net Zero Roadmap: A Global Pathway to Keep the 1.5 °C Goal in Reach, International Energy Agency, 2023
[13] Net Zero Roadmap: A Global Pathway to Keep the 1.5 °C Goal in Reach, International Energy Agency, 2023

4. RENOVATING OUR BUILDINGS

Buildings will need to be run more efficiently with a different approach for how they are powered, heated and cooled. Based on recent estimates, buildings and building construction sectors produce over one-third of global final energy consumption, and nearly 40% of total direct and indirect CO_2 emissions[14].

To meet net zero ambitions, buildings construction and retrofit will need new materials, techniques and technologies to be zero-carbon ready. By 2030, this would mean 100% of new builds being zero-carbon ready, from less than 1% in 2022; and retrofitting 20% of existing buildings, compared with under 5% in 2022[15].

Perhaps most notably, space heating will need to be driven by heat pumps. Capacity of this form of heating will need to triple to 3000 GW[16], with roughly 90 million such pumps sold this decade[17]. This will require developing new manufacturing and installation capacity at significant scale supported by governmental policy, regulations and financial support.

For investors, the net-zero journey for buildings has various entry points of physical and digital elements, as well as servicing. Sub-sectors, such as energy generation and storage, construction techniques and building materials, especially insulation, steel and cement, will be particularly relevant for new builds. Simultaneously, with increasingly digital reliance, software for building management, energy efficiency/carbon management and construction will be required to manage decarbonisation.

5. NATURE-BASED SOLUTIONS

Managing, preserving and restoring nature and biodiversity has intrinsic benefits while also playing a critical role in mitigating climate change. Nature already serves as a carbon-sink, absorbing roughly 50% of carbon emissions[18]. Supporting these natural processes can help to protect existing systems and sequester more.

Funding nature-based solutions (NbS) is a nascent but rapidly growing field, being used to deliver climate mitigation, as explained previously in How to invest "in" our planet. NbS are "actions to protect, sustainably manage, and restore natural or modified ecosystems, that address societal challenges effectively and adaptively, simultaneously providing human well-being and biodiversity benefits"[19].

Implementing NbS across various land and water ecosystems by 2030 could reduce and/or remove between 5–12 gigatons of additional greenhouse gases per year[20]. For context, this would close nearly half of the current 2030 emissions gap (the difference between the amount of greenhouse gases that should be emitted in 2030 to meet the Paris Agreement goals and the amount of emissions currently projected to be emitted)[21].

For investors, opportunities exist across three broad response options: 1) protecting existing ecosystems from loss and degradation, 2) managing working ecosystems more sustainably, and 3) restoring areas that have been degraded. Moreover, they exist around the world in ecosystems ranging from forests, grasslands and agricultural lands, wetlands and peatlands, or coasts and oceans.

START TODAY FOR BENEFITS TOMORROW

A common theme emerges when reviewing the sectors that are likely to be most affected – they will need significant disruption and growth to arrive at a 2030 milestone on a 1.5C pathway.

In fact, addressing climate change requires a substantial systems-wide transformation across the economy. The five sectors covered are just a starting point for such opportunities. Others, such as cement, steel, ammonia, transport, shipping, aviation, hydrogen, plastics, waste and energy efficiency will also need to be changed. Using energy transition as a beacon can help short-term volatility and uncertainty, and point to potential upside in longer-term opportunities.

However, while this transition is a structural trend, not every boat will be carried equally forward by these currents. Countries, and industries, will shift at different rates, in part dictated by political, regulatory, fiscal and societal circumstances.

In considering how to boost a portfolio's contribution to a future sustainable world, investors still have to select high-quality, well-run companies, highlighting the importance of incorporating environmental, social and governance (ESG) considerations into financial analysis. In the end, asset class allocation and selection remain critical.

But the potential and urgency exist. Unfortunately, as the United Nation's global stocktake points out, continuing on our current course suggests that global warming would exceed the 1.5C target[22].

Being well into the current decade already, 2030 will arrive sooner than we likely expect. Looking at 2024, positioning portfolios to protect and grow a family's wealth while hoping to influence tomorrow has rarely seemed so vital.

Author: Damian Payiatakis, London UK, Head of Sustainable & Impact Investing

[14] IRENA, World Energy Transitions Outlook 2022, March 2022
[15] Global Carbon Budget 2020, Earth Science Systems Data, December 2020
[16] Nature-based Solutions to address global societal challenges, International Union for Conservation of Nature, 2016
[17] Nature-based solutions for climate change mitigation, International Energy Agency, International Union for Conservation of Nature, 2021
[18] Emissions Gap Report 2022: The Closing Window, United Nations Environmental Programme, 27 October 2022
[19] United Nations, Technical dialogue of the first global stocktake, 8 September 2023
[20] Nature-based solutions for climate change mitigation, International Energy Agency, International Union for Conservation of Nature, 2021
[21] Emissions Gap Report 2022: The Closing Window, United Nations Environmental Programme, 27 October 2022
[22] United Nations, Technical dialogue of the first global stocktake, 8 September 2023

Multi-asset portfolio allocation

Barclays Private Bank discusses asset allocation views within the context of a multi-asset class portfolio. Our views elsewhere in the publication are absolute and within the context of each asset class.

	-		=		+
Cash and short duration bonds				■	
Fixed income			■		
Developed market government bonds			■		
Investment grade bonds				■	
High yield bonds		■			
Emerging market bonds		■			
Equities				■	
Developed market equities				■	
Emerging market equities			■		
Other assets		■			
Alternative trading strategies		■			
Commodities			■		

- denotes a cautious view = denotes a neutral view + denotes a positive view

CASH AND SHORT DURATION BONDS

- Given the heightened level of uncertainty in financial markets, and to manage portfolio risks, we prefer higher-quality and liquid opportunities.

FIXED INCOME

- More opportunities are popping up in fixed income
- We see value in developed market government bonds and as a hedge against macro volatility
- In credit, the higher-quality segment is preferred driven by what we consider to be better relative value
- In high yield, where selection is key, our exposure is relatively low, as spreads have room to widen in an adverse scenario
- We are cautious on the emerging market segment.

EQUITIES

- Equities still appear relatively more appealing than bonds for long-term investors
- Yet, we are highly selective in allocations
- In line with our long-term investment philosophy, portfolios remain geared towards high-quality, cash-generative and conservatively capitalised businesses
- As a function of bottom-up selection, more opportunities are seen in developed market equities compared to emerging market ones.

ALTERNATIVE TRADING STRATEGIES (ATS)

- There are a limited number of opportunities in the ATS universe, as the cost/benefit trade-off can be challenging
- Our focus is on strategies that offer diversification benefits due to their low correlation to equity markets.

COMMODITIES

- As a risk-mitigating asset, gold remains the only direct commodity exposure held in portfolios
- From a portfolio management perspective, we believe that our risk budget is better spent outside of the asset class.

Author: Julien Lafargue, CFA, London UK, Chief Market Strategist

Can India's growth sustain?

The growing interest from international investors in, and coverage of, the Indian investments landscape, are not surprising. In the current VUCA (Volatility, Uncertainty, Complexity, and Ambiguity) world, no other major economy has, over the coming years, the potential to deliver north of 6 per cent real economic growth with a high degree of macroeconomic stability (albeit nothing is ever guaranteed).

Please note: All data referenced in this article is sourced from Bloomberg unless otherwise stated, and is accurate at the time of publishing.

India's growth story remains resilient and broad-based across industry, services and agriculture. Exports, while dependent on global growth, should comparably do well. Goods exports, in particular, should benefit from global supply chain diversification, stronger domestic balance sheets and the government's policy support. A relatively stable currency, and productivity gains aided by massive infrastructure spends, should also continue to support this progress.

With investment in traditional sectors being typically government-led, we believe more public investment will be needed to drive the structural shift upwards in overall investment, and push the gross domestic product (GDP) growth rate above 6.5%. Encouragingly, fiscal capex has increased over the past year, with the government planning investment of more than INR 150 trillion (trn) over the next five years. That said, massive capital injections such as the INR 10trn planned in the FY24 budget cannot keep rising at the same pace, and the need for fiscal consolidation means that the private sector will need to step up if the economic momentum is to be sustained.

Strong corporate profitability, high capacity utilisation levels, and a twin balance-sheet advantage suggest that conditions are ripe for private investment to pick up. Early signs indicate a more considerate and gradual private capex plan, which is healthy. The challenge then becomes the financing of such a massive investment spree by both the government and the private sector. We think a 4-5 percentage points increase in the investment-to-GDP ratio over the coming years will have to be financed largely by domestic national savings, in order to retain India's hard-earned macro stability.

A steady increase in employment is key to harnessing the power of one of the world's largest working age populations. While IT jobs (and wage growth) are witnessing some (healthy) correction, job growth across financial services, construction, and retail is picking up. Private investments pick-up, especially in manufacturing, should also help. Rural income should make some progress too, benefiting from the upcoming elections. Domestic household savings, disposable income, consumption and investments should therefore remain healthy, although their growth may moderate.

Importantly, the increased global (IGB's global bond index inclusion being just a case in point) and domestic investment flows, coupled with overall healthy balance sheets, should gradually bring down the cost of capital in the country.

The two key risks to the Indian story in the coming year are sustained high oil prices and the central elections mid-2024.

If oil prices remain above $90 a barrel, the current account deficit will probably be higher than expected. That said, financing requirements are unlikely to be a concern, given the positive effects of India's impending inclusion in some of the global bond indexes in 2024, likely prompting some front-loading of debt investment inflows in the first half of 2024. Meanwhile, the government may continue to somewhat dampen the effect of high energy costs by reversing the hikes in excise duty and price cuts to stabilise fuel prices.

EQUITY OUTLOOK 2024

Among emerging markets, the Indian equity market has been standing tall post pandemic, thanks to strong domestic retail flows and foreign flows, as well as wider participation from institutional players. We expect the domestic flows to continue in 2024, complementing foreign flows and providing a cushion against any global risk-off events.

Amidst a strong macroeconomic backdrop, estimated earnings growth for Nifty50 companies for fiscal year 2025 is in the range of 12–13% (1–2% higher than the expected nominal GDP growth), which is reasonable. In terms of valuation, markets may trade at slightly higher price-to-earnings multiples than the long-term averages, reflecting a more sustainable high earnings growth.

Central elections in mid-2024 do bring their own set of anxiety amongst investors, but while cautioning against historical performance not repeating itself, we would highlight the following interesting data.

PERFORMANCE OF THE NIFTY50 INDEX BEFORE AND AFTER CENTRAL ELECTION RESULTS

Election year	-6M	-3M	-1M	Prior Election result Day	1M	3M	6M
2019	10.7%	9.3%	1.2%	22 May	0.8%	-7.0%	2.2%
2014	18.9%	18.7%	5.8%	15 May	5.9%	8.7%	17.3%
2009	30.6%	24.5%	5.4%	15 May	22.1%	24.7%	36.1%
2004	6.7%	-9.5%	-6.9%	15 May	-9.7%	-5.2%	9.6%
1999	34.6%	10.8%	-0.9%	5 Oct	-3.8%	18.9%	3.6%

Source: Bloomberg, Barclays Private Bank, October 2023.

As can be seen above, since the central elections in 1999, Nifty50 index returns have been positive in the six months prior to the date of election results announcement, as well as in the six months following. While never a guarantee, history therefore suggests that it pays to stay invested through such events.

Investors may do well to maintain their strategic allocation to equities, while keeping some dry powder available to capture any potential market corrections.

However, with much of the positive macroeconomic developments already priced in to some degree, and following a solid performance in 2023, investors may need to be more selective in 2024. Rotations across factors, sectors, and themes could be faster and picking out companies that may continue to gain market share, protect profit margins, demonstrate sustainable earnings growth and that are available at reasonable valuations, will be key.

From a sectoral or thematic perspective, domestic cyclicals such as infrastructure, capital goods, financials, and consumer discretionary appear well-positioned, as they should be the main contributors to earnings growth going forward. Meanwhile, global cyclicals like metals and technology seem more challenged.

FIXED INCOME OUTLOOK 2024

Cash is now a comforting and arguably rewarding alternative. Yet, it's unlikely to be the long-term answer to meet anyone's investing goals. While 2023 was about locking in yields, 2024 could be about extending duration to capture more than just coupons until maturity.

As India goes to polls in 2024, bond market participants may be worried about sovereign debt. However, this arguably remains a marginal risk since the present government has demonstrated in the past two election years its propensity to present a sober and pragmatic budget. With fiscal issues likely manageable, the key source of risk for Indian debt in 2024 remains inflation.

On that front, and bar the risk of sustained and elevated oil prices, inflation in India should trend lower and remain within the central bank's (RBI) comfort zone. However, with economic growth momentum likely to remain relatively strong, the RBI is unlikely to cut rates. In fact, in the past 20 years, interest rate cuts have always been linked to quarter-on-quarter contraction in GDP growth.

For now, the RBI may consider rate cuts towards the second half of 2024, but the pace of cuts may be slow and considerate, thereby presenting a 'higher for longer' rates environment. Our analysis shows that historically in India, bond markets usually price in the rate cuts 2-6 months prior to the first rate cut announcement.

Bond markets (especially sovereign bonds) are likely to see a boost in demand in 2024 as Indian bonds find inclusion in the global bond indices, triggering flows from Foreign Portfolio Investors and potentially providing an additional nudge to lower yields in domestic markets. Once again, the RBI may use various tools at its disposal for an orderly evolution of the yield curve, while keeping liquidity at adequate levels.

As a result, and broadly speaking, there is a compelling case to be overweight on Indian bonds and to add duration to the portfolio with a medium-to-long-term investment horizon (18–24 months).

ALTERNATIVE ASSETS AS DIVERSIFIER

With much uncertainty on the outlook for inflation, interest rates and global growth, diversification is particularly important in managing portfolio risk levels. Among alternative assets, and even if cross-asset correlations globally have recently diverged from their long-term historical trends, gold remains an useful diversifier. In addition, the yellow metal is likely to benefit as real yields start to weaken, especially in the US. For Indian investors, any rupee weakness against the US dollar should add to the attraction of holding this commodity.

For discerning investors, private credit could provide a good risk premium. Indeed, the asset class tends to perform well at times of improving macroeconomic and balance-sheet cycles, as is currently the case in India.

Similarly, with price and time corrections seen across venture capital and private equity investments, as well as deeper scrutiny on business models through the ongoing funding winter, 2024 could be a good vintage to add to one's portfolio.

Author: Narayan Schroff, Mumbai India, Director, Private Clients India

Key dates

JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
13 Taiwan presidential election	1 BoE Meeting	7 ECB Meeting	11 ECB Meeting	1 Fed Meeting	6 ECB Meeting	18 ECB Meeting	1 BoE Meeting	12 ECB Meeting	17 ECB Meeting	5 US presidential election	12 ECB Meeting
15–19 2024 World Economic Annual Forum		20 Fed Meeting	19–21 Spring meeting of IMF and World Bank	2 UK local elections	6–9 European Parliament election	31 Fed Meeting	TBC Jackson Hole Symposium	18 Fed Meeting	25–27 Annual Meeting of IMF and World Bank	7 Fed Meeting, BoE Meeting	18 Fed Meeting
25 ECB Meeting		21 BoE Meeting		9 BoE Meeting	12 Fed Meeting			19 BoE Meeting			19 BoE Meeting
31 Fed Meeting					20 BoE Meeting						

Central banks | Geopolitical events | International bodies privatebank.barclays.com

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