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Global Trends, Countertrends and Portfolio Blends

- As we enter 2024, equities are outperforming bonds and US equities are outperforming global shares, both in line with our asset allocation. US equities have returned +2.5% in the year to date, US fixed income -1.2% vs 0.9% for global equity and -2.3% for global fixed income[1].
- The normalization of the world economy is underway. But the global economy is not growing uniformly and the potential opportunities in equity markets reflect this. The "return to normal" has many features as we outline herein.
- Even as corporate profits are rebounding, we expect US employment growth in 2024 to moderate. This reverses the unusual pattern of 2022-2023 where we saw strong employment growth and declining earnings. This suggests an improvement in labor/capital productivity in 2024 and 2025.
- Our favored equities - quality growth shares in small and mid-caps, as well as equal-weighted S&P 500 have been rising, with small cap growth outperforming the S&P 500 since November 2023. We continue to see opportunity in global equities markets through broadening earnings and equity performance beyond large cap US tech.
- Current drags on economic activity will not endure indefinitely. We see a reversal in monetary policy tightening unfolding across the globe at different times and rates. More importantly, in our view, will be the end of inventory corrections that will sustain a global trade recovery. We believe this is likely to begin before the end of 2024. The US was harmed least and will benefit less from the improvement in global trade.
- In In terms of risks, global supply shocks remain our largest concern. Recent news that the Red Sea has become practically impassable fits that narrative (see our January 21, 2024 Strategy CIO Bulletin). As we discussed in our Wealth Outlook 2024, this keeps us disposed to allocate slightly less aggressively toward equities and within equities, toward sectors such as energy.
- We recently published our Global Investment Committee January 2024 report, which left the allocation unchanged in Equities at +2% with global Fixed Income and Cash -2%. During the coming year, we expect the world economic expansion to regain strength and several regions to commence recovery. If market yields drop modestly further while cash returns are driven lower by the Fed, we would likely further shift up our global equity exposures at the expense of certain fixed income instruments.

[1] Source: Bloomberg as of January 26, 2024. MSCI USA is used as a proxy for US Equities. Bloomberg US Aggregate is used as a proxy for US Fixed Income. MSCI ACWI is used as a proxy for Global Equities. Bloomberg Global Aggregate is used as a proxy for Global Fixed Income. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

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Global Trends, Countertrends and Portfolio Blends

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The normalization of the world economy is underway. But the global economy is not growing uniformly and the potential opportunities in equity markets reflect this. The "return to normal" has many features. Here are some critical elements:

From Rates to Earnings

After two years of powerful interest-rate driven valuation improvements, we see corporate earnings as the decisive factor to drive further equity returns in 2024.

Until such time as we have visibility on estimated Earnings Per Share (EPS) gains in 2025, realized corporate earnings will be a main mover of markets in 2024.

A complex "dance" between management, analysts and investors is taking place. In the US, 4Q23 EPS estimates are far weaker than any deterioration reported for the US economy. Even with lingering areas of weakness in the US economy, this bodes well for future realization of 2024 profit estimates.

US Equities

Corporate earnings expectations look to be too conservative over the near term, very much in conflict with fears that 2024 will be disappointing. Historic data suggest that companies take more restructuring and other one-time charges in fourth quarters. We believe both the 4Q23 and 1Q24 periods should show positive earnings surprises vs consensus in the US. Cyclical industries appear poised to bottom within 2024. Our estimates for mid-single digit EPS gains in 2024 could prove too cautious, as many industry pressures lift (please see our January 2024 Quadrant for further detail).

Even as corporate profits are rebounding, we expect US employment growth in 2024 to moderate. This reverses the unusual pattern of 2022-2023 where we saw strong employment growth and declining earnings. This suggests an improvement in labor/capital productivity in 2024 and 2025.

The dispersion of valuation within US equities, across market capitalization and sectors, remains near historic extremes in many cases. The S&P 500 Equal Weight index lagged the market cap weighted index return last year by 12.4%. the largest shortfall since 1998 (see **FIGURE 1**). The fast growing, profitable small and mid-cap US shares are still trading at historical discounts compared to their large cap peers, worthy of an overweight (see **FIGURE 2**). We believe there are opportunities for outperformance, even as we expect single-digit gains for large cap US equities in 2023.

FIGURE 1: S&P 500 Equal Weight Underperformance the largest since 1998

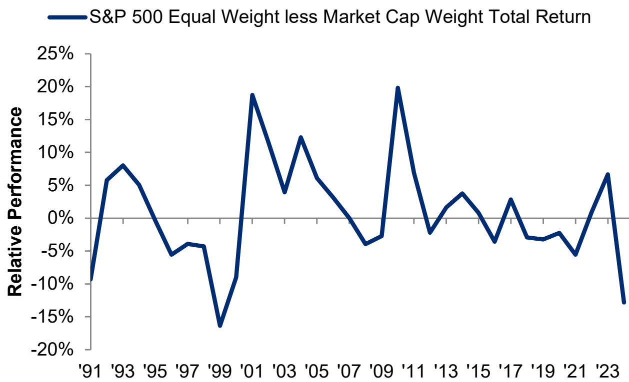

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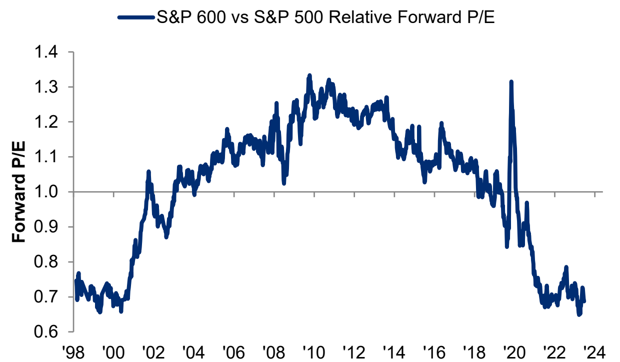
FIGURE 2: Small cap US shares are trading at historical lows compared to large caps



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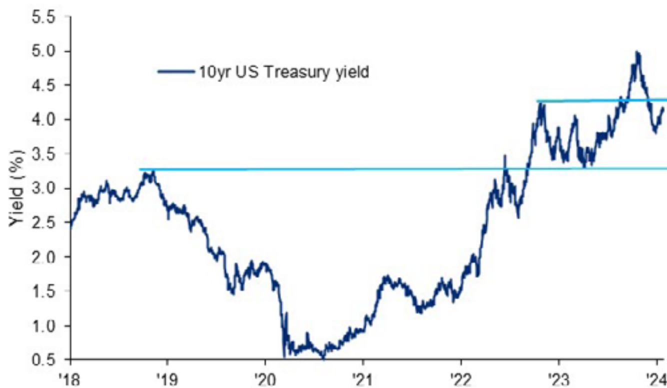
US Fixed Income

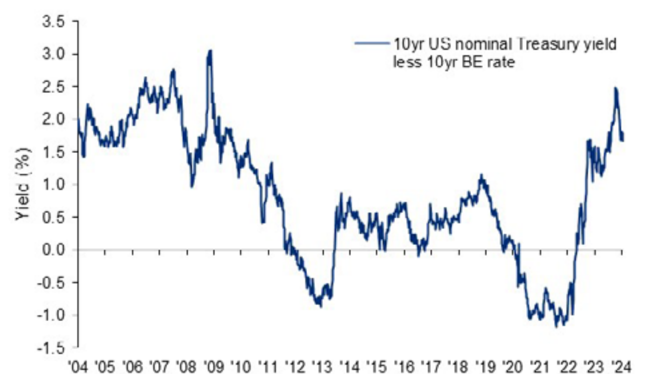
At 4.15%, 10yr US Treasury yields are roughly 100bps below the peak rate from 2023, however, are still 100bps above the peak rate seen in the 2018 tightening cycle **(FIGURE 3)**. In 2018 inflation dynamics were much different as inflation then had already peaked just below 3%. Despite that, current 10yr nominal US yields relative to market breakeven inflation rates are the highest levels seen in the last 15 years **(FIGURE 4)**. A possible delay in Fed timing on rate cuts could keep rates rangebound near-term, we see extending duration as an attractive relative yield opportunity in fixed income in 2024.

FIGURE 3: 10yr US Treasury yields



Source: Bloomberg as of January 26, 2024

FIGURE 4: Treasury yield less breakeven inflation rate



Source: Bloomberg as of January 26, 2024

Global Growth

The world economy is enduring drags in cyclical industries including trade, manufacturing and property. Asia, Europe and Latin America are more trade dependent than the US. The impact of real estate and manufacturing activity declines are 2-3x larger for China than for the US.

Current drags on economic activity will not endure indefinitely. We see a reversal in monetary policy tightening unfolding across the globe at different times and rates. More importantly, in our view, will be the end of inventory corrections that will sustain a global trade recovery. We believe this is likely to begin before the end of 2024. The US was harmed least and will benefit less from the improvement in global trade.

China

The CSI 300 index remains near its five-year lows. China continues to report weak growth and deflationary pressures. While the central government has undertaken numerous fiscal and monetary actions, none have been focused or large enough to change economic or market behaviors decisively. Most recently, we have seen an announcement of 2 trillion yuan ($278.53 billion[2]) to stabilize the stock market. On its face, this would appear to be good news, but it does not address root causes. In prior cycles, infrastructure and property investments have been used in a countercyclical fashion to offset economic weakness. China appears to be steering clear of large measures in these areas in the hopes of avoiding a future repeat of its housing debt woes. A rise in private consumption, driving aggregate demand, will require more fiscal easing, not government purchases of equities.

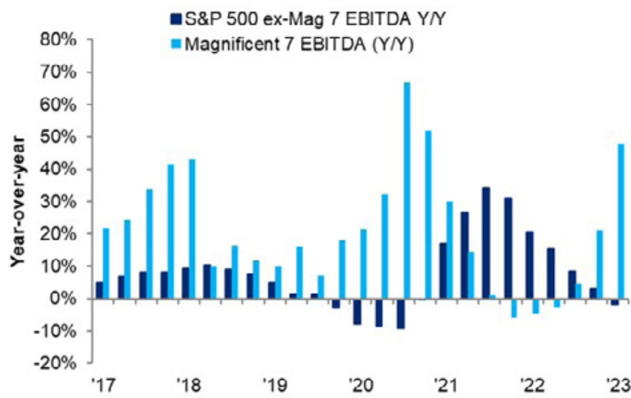
Broadening as a Theme

Equity markets have been riding momentum over the last three months. The S&P 500 has surged by 19% from the low levels in October, when a premature Fed pivot has been aggressively pricing in by the markets. The bulk of that performance still came from the so-called “Magnificent 7”[3] US tech giants **(FIGURE 5)**. These firms have historically fast-growing profits despite their mega cap valuation (two are worth about $3 trillion). But we have seen signs of improving market breadth as our tactical calls played out. Our favored equities - quality growth shares in small and mid-caps, as well as equal-weighted S&P 500 have been rising **(FIGURE 6)**, with small cap growth outperforming the S&P 500 since November 2023. We continue to see opportunity in global equities markets through broadening earnings and equity performance beyond large cap US tech.

[2] Source: Bloomberg as of January 24, 2024

[3] The Magnificent 7 stocks include Amazon.com (AMZN), Apple (AAPL), Google parent Alphabet (GOOGL), Meta Platforms (META), Microsoft (MSFT), Nvidia (NVDA) and Tesla (TSLA). The securities or company names included herein are for illustrative purposes only and do not constitute a recommendation of or solicitation to purchase or sell any security.

FIGURE 5: EBITDA growth of Magnificent 7 reached 47% y/y in 2023



Source: Bloomberg as of January 26, 2023. The Magnificent 7 stocks include Amazon.com (AMZN), Apple (AAPL), Google parent Alphabet (GOOGL), Meta Platforms (META), Microsoft (MSFT), Nvidia (NVDA) and Tesla (TSLA). The securities or company names included herein are for illustrative purposes only and do not constitute a recommendation of or solicitation to purchase or sell any security. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. **Past performance is no guarantee of future results**. Real results may vary.

FIGURE 6: Equal weight S&P 500 (6-month lead) vs EPS Y/Y%

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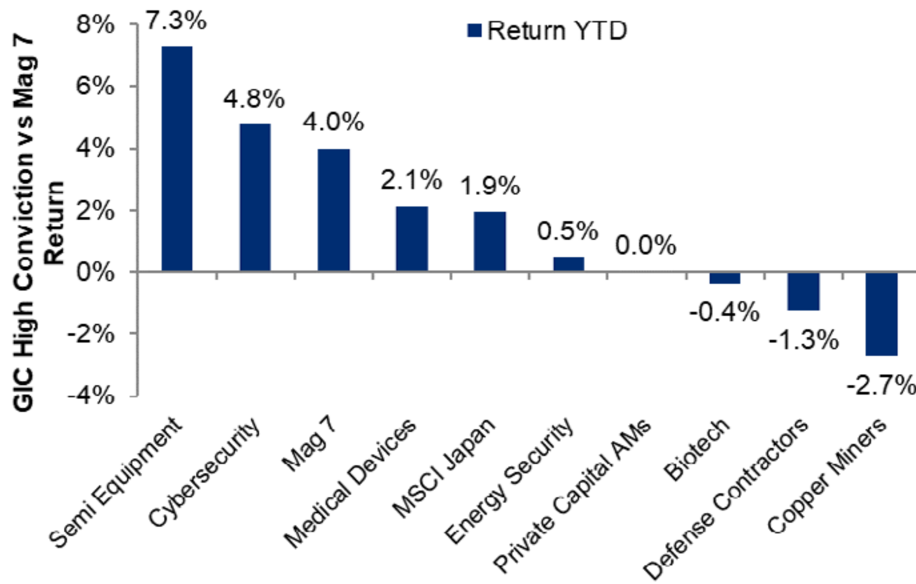
Sector Specificity as a Theme

Our stock and industry selections as outlined in our Wealth Outlook 2024 and favor thematic investing over regional investing. As the peak of earnings season starts to kick in in the following days, some of our high conviction thematic investments, including semiconductor equipment and cyber security, have outperformed the Magnificent 7 ("Mag 7") YTD as companies realized turnaround in earnings reports and guidance **(FIGURE 7)**. We see potential opportunities in broadening healthcare investments to include equipment and biotech. We continue to see cyber security and semiconductor equipment as particularly strong niches.

FIGURE 7: Our high conviction investments, semi equipment and cybersecurity, have outperformed Mag 7 YTD



Source: Citi Global Wealth CIO, Bloomberg, as of January 26, 2024. First Trust NASDAQ Cybersecurity ETF used as a proxy for Cybersecurity. Bloomberg Magnificent 7 Price Return Index used as a proxy for Mag 7. iShares U.S. Medical Devices ETF used as a proxy for Medical Devices. Energy Select Sector SPDR Fund used as a proxy for Energy Security. Invesco Global Listed Private Equity ETF used as a proxy for Private Capital Markets. iShares Biotechnology ETF used as a proxy for Biotech. Invesco Aerospace & Defense ETF used as a proxy for Defense Contractors. Global X Copper Miners ETF used as a proxy for Copper Miners. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. **Past performance is no guarantee of future results.** Real results may vary.

Risks Remain

In terms of risks, global supply shocks remain our largest concern. Recent news that the Red Sea has become practically impassable fits that narrative (see our January 21, 2024 Strategy CIO Bulletin). As we discussed in our Wealth Outlook 2024, this keeps us disposed to allocate slightly less aggressively toward equities and within equities, toward sectors such as energy.

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Medium grade	Baa	BBB	BBB
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Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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