

FOX WEBCAST | MARCH 6, 2024

# 2024 Global Economic Outlook



**Timothy F. McCusker,**  
FSA, CFA, CAIA  
Chief Investment Officer

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# 2024 GLOBAL ECONOMIC OUTLOOK

*FAMILY OFFICE EXCHANGE*









MARCH 6, 2024

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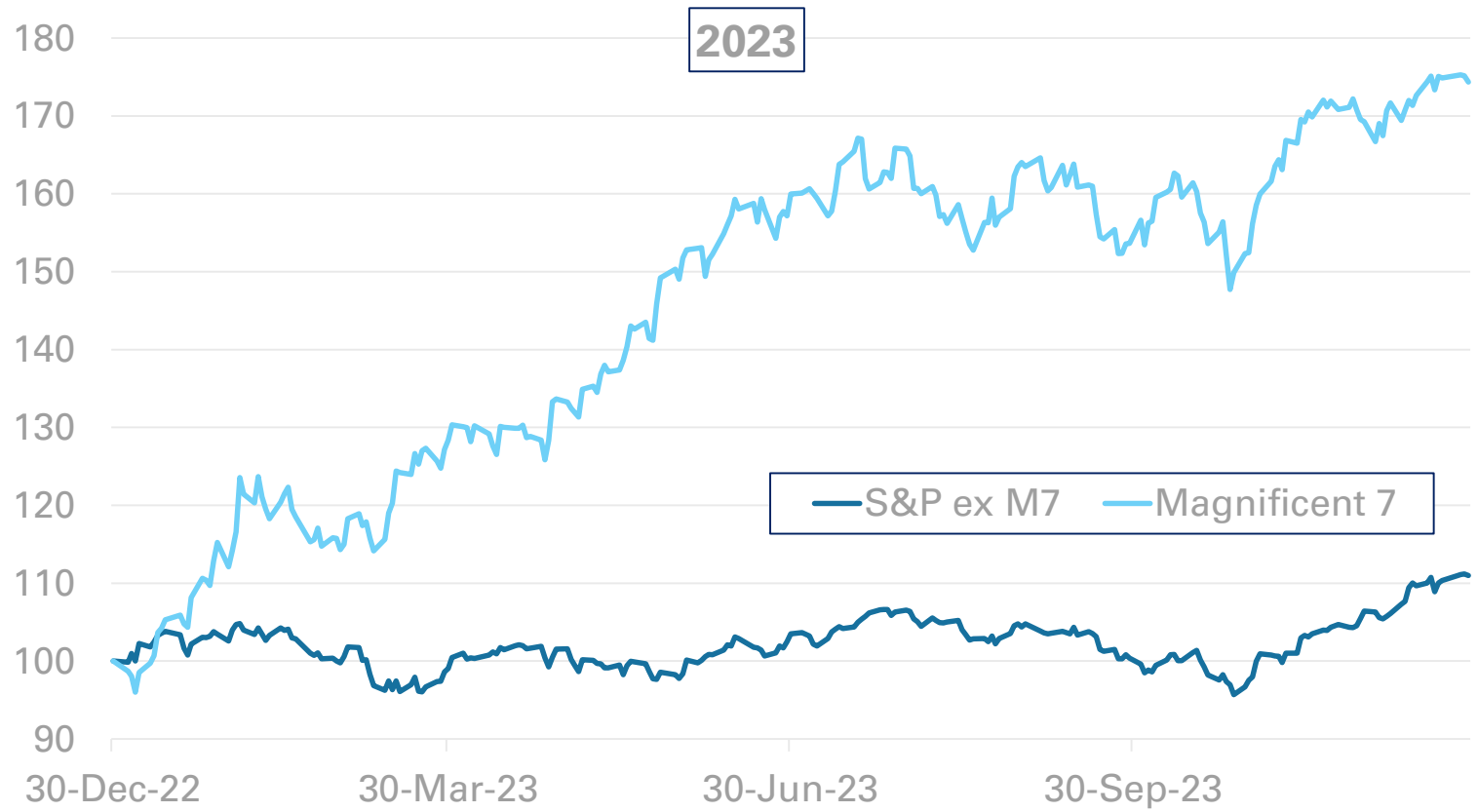
PROPRIETARY & CONFIDENTIAL

# MARKET BACKDROP

		2022	2024			2022	2024
	S&P 500	4,766	4,769		Fed Funds	0.25	5.50
	IG OAS	0.92	0.99		US 10 Year	1.51	3.88
	HY OAS	2.93	3.23		CPI	7.19	3.12
	Gold	1,895	2,072				
	Oil	75	72				

# MAGNIFICENT SEVEN

DOMINANT PERFORMANCE IN 2023



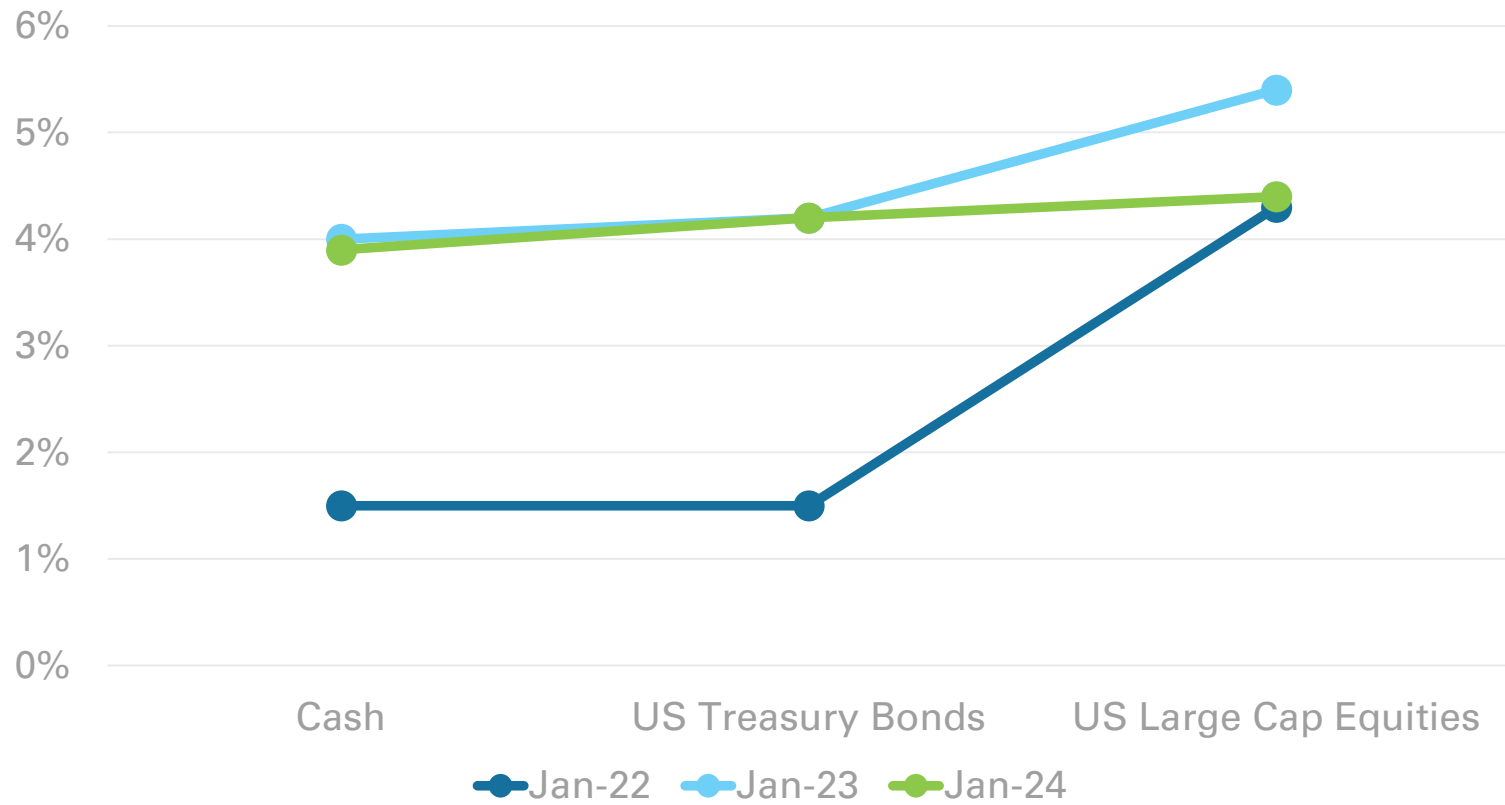
# MAGNIFICENT SEVEN

BUT REALLY JUST ANOTHER ROUNDTRIP

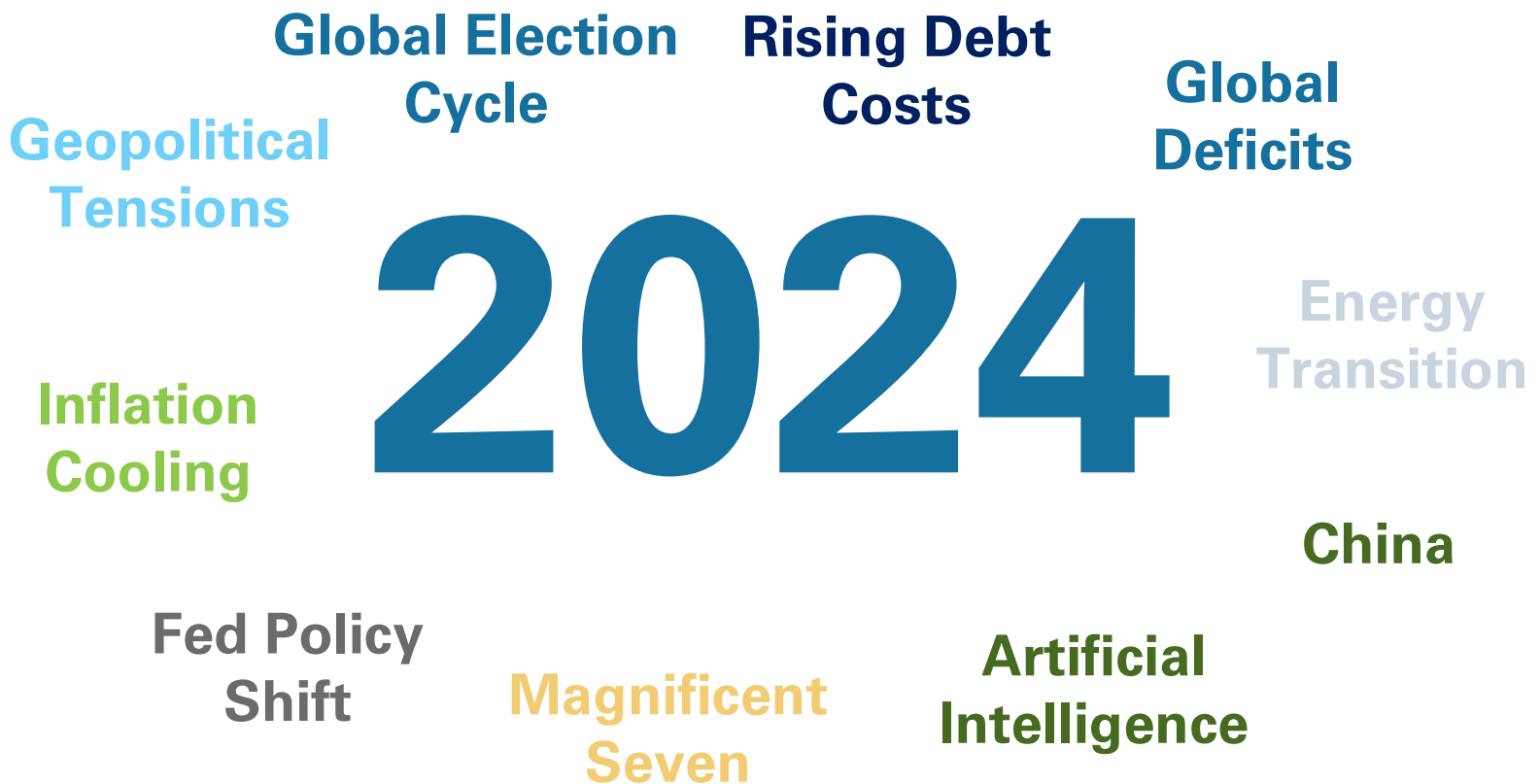


# WHY DOES THE ROUNDTRIP MATTER?

INVESTING GETS A LOT HARDER FROM HERE



# ASSESSING TODAY'S ENVIRONMENT





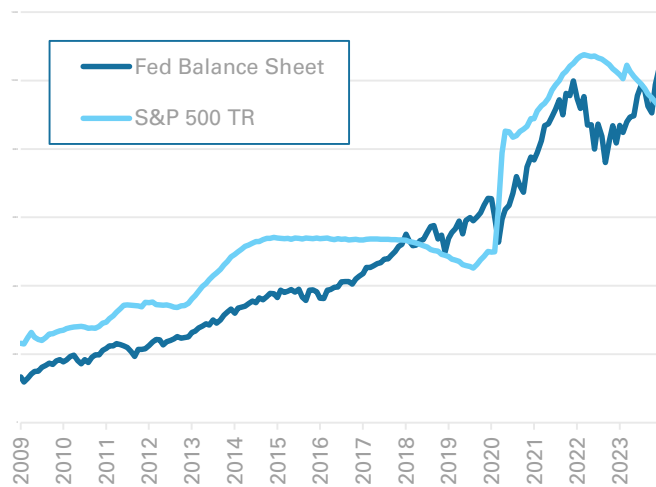
# TWO MAJOR UNDERLYING FORCES

DRIVERS OF SHORT-TERM PRICING AND VOLATILITY



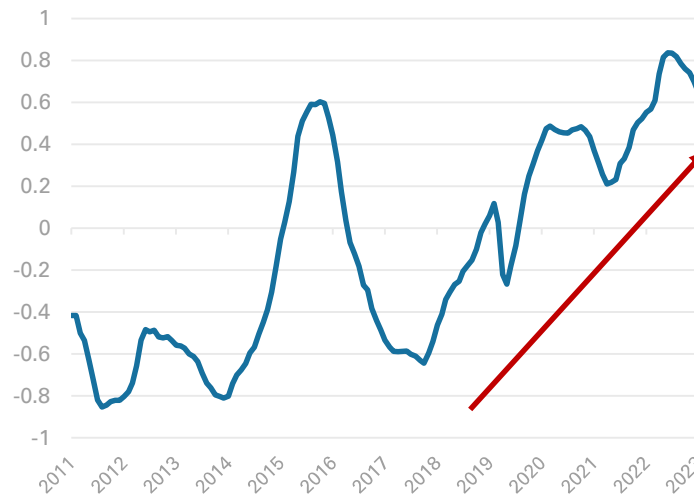
## LIQUIDITY

Fed Balance Sheet vs. S&P 500



## DURATION

S&P Earnings Yield vs. 10y Treas - 3y Correlation



# 2024 MARKET THEMES

## NEPC MARKET OUTLOOK

- **At the start of each year, we identify the Market Themes that we believe will impact the investment landscape over the next 12 months**
- **Market Themes represent essential factors for investors and are likely to exert significant influence on market pricing and investor sentiment**
- **Disruptions in these factors will reveal new investment opportunities and likely alter our understanding of market dynamics**



# ADJUSTING TO A “COST OF CAPITAL”

## 2024 MARKET THEMES



**Normalizing Higher Interest Rates**

**Economy is not acclimated to long-term interest rate environment of 4% or higher**



**Tighter Bank Lending Standards**

**Access to capital for entities needing to refinance will be a 2024 focus point**



**Benefits Accrue for Fixed Rate Borrowers**

**Fixed rate borrowers have time to adjust capital structure to the rate environment**



**Interest Income**

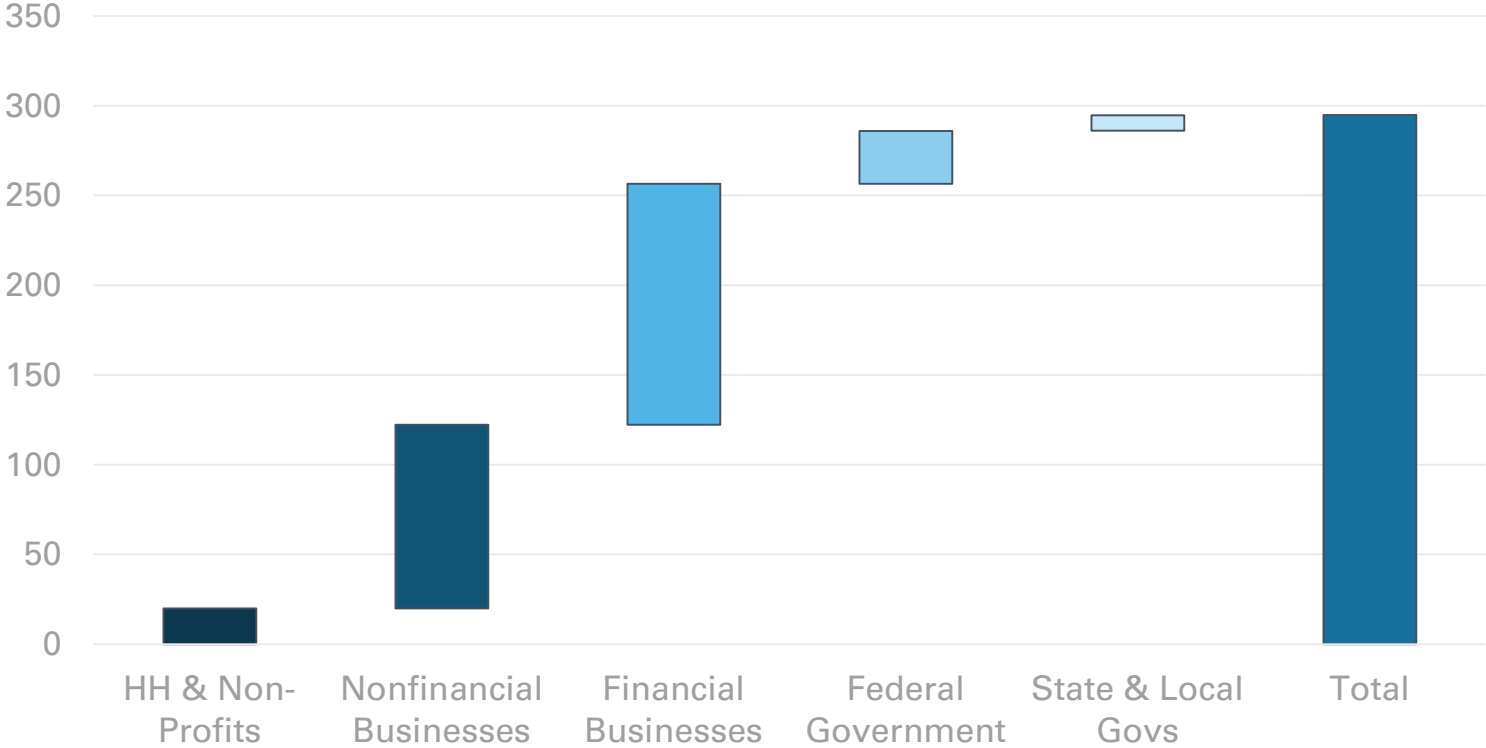
**Income flows to savers but drains availability of capital for the economy**



**M&A Dealmaking Complexity**

**Deal volume is more limited and pathway to finalize transactions are tighter**

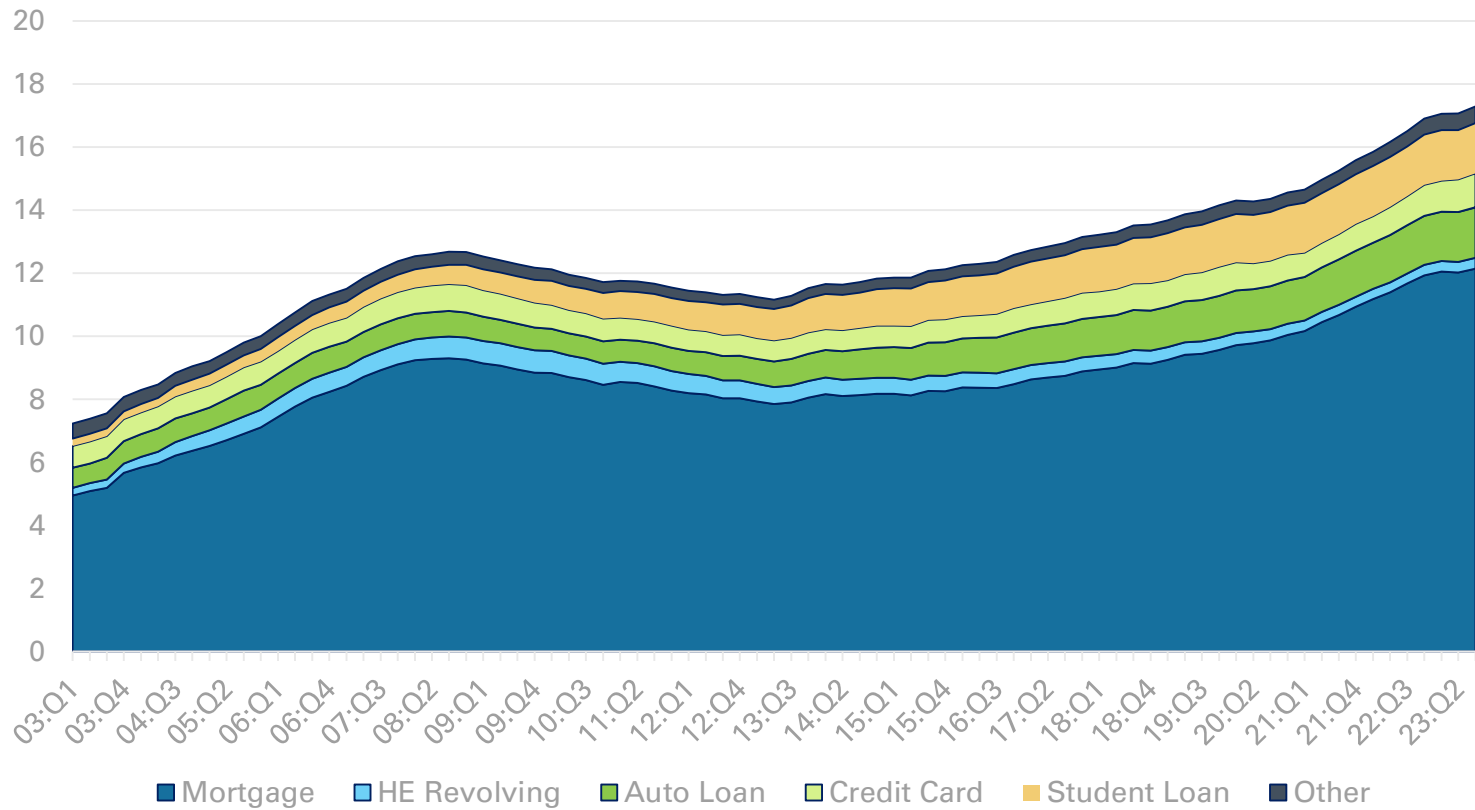
# TOTAL DEBT ACROSS UNITED STATES



Source: Federal Reserve

# HOUSEHOLD DEBT COMPOSITION

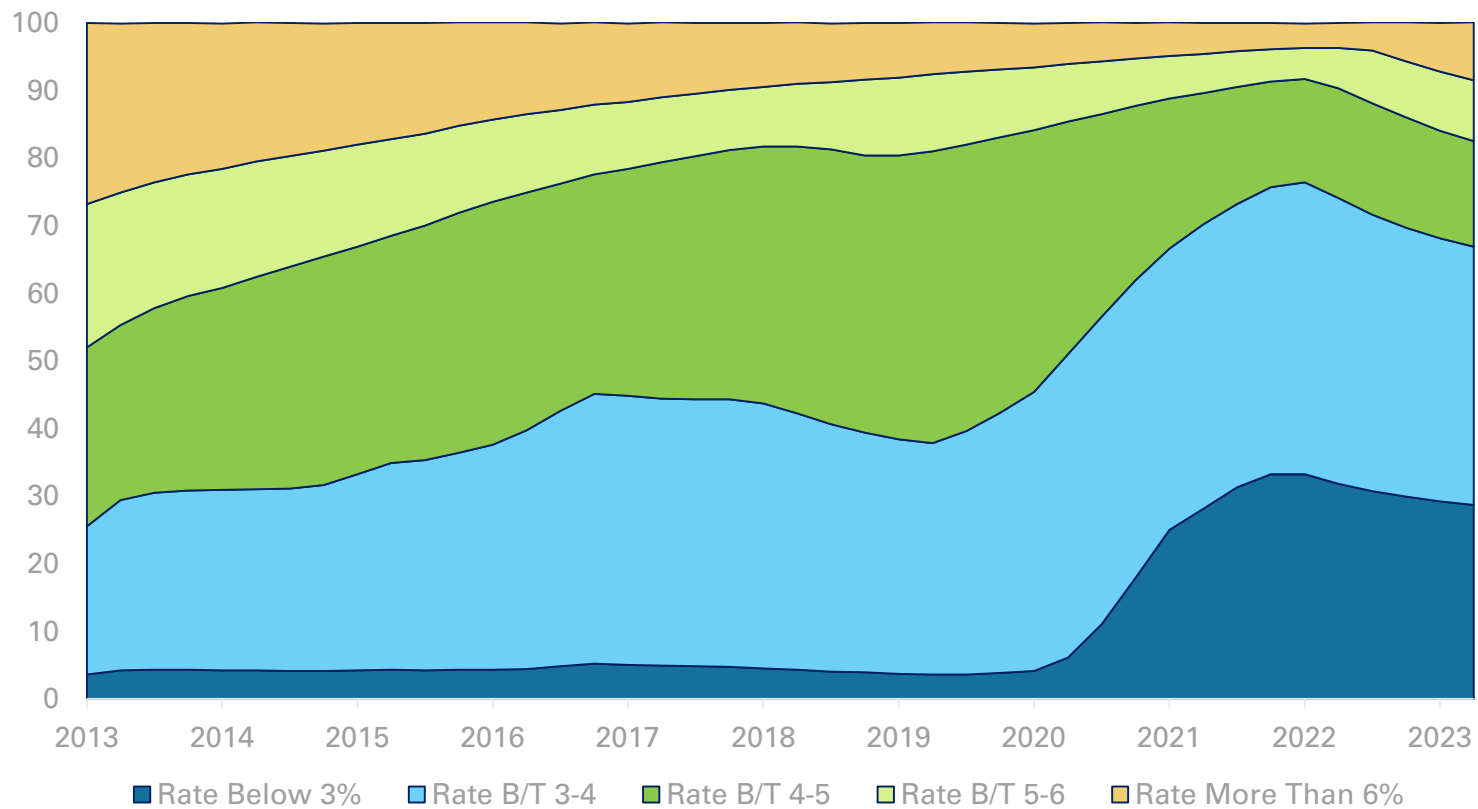
## 70% MORTGAGES



Source: New York Federal Reserve Bank

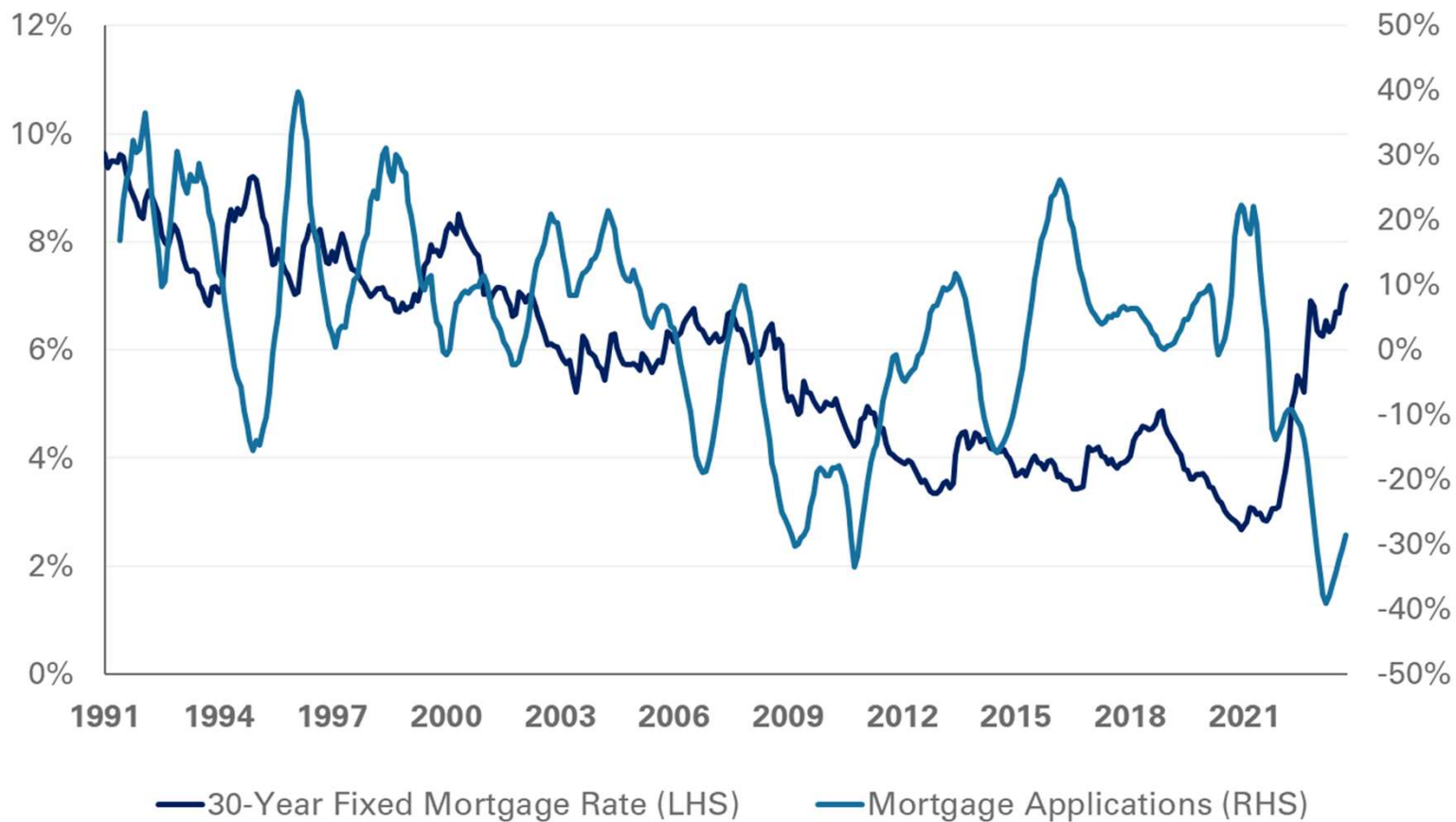
# VALUE OF US MORTGAGES BY RATE

90% OF MORTGAGES LESS THAN 6%



Source: National Mortgage Database

# INTEREST RATES WEIGH ON MORTGAGE VOLUMES

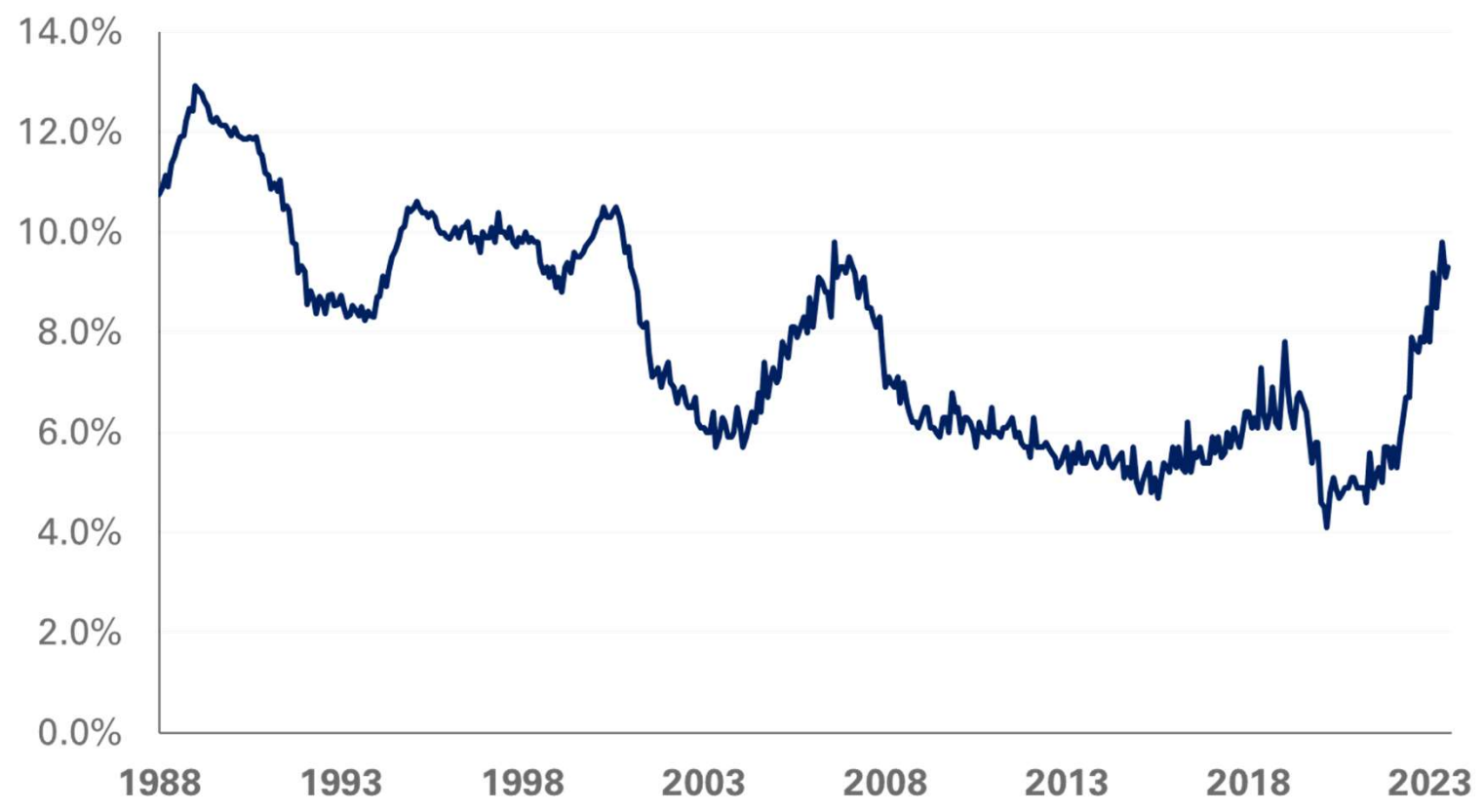


Notes: Mortgage applications data series reflects a six-month moving average of annual changes in application volumes  
Sources: Freddie Mac, FactSet



# SMALL BUSINESSES FEELING RATES PRESSURE

ACTUAL INT. RATE PAID ON SHORT-TERM LOANS

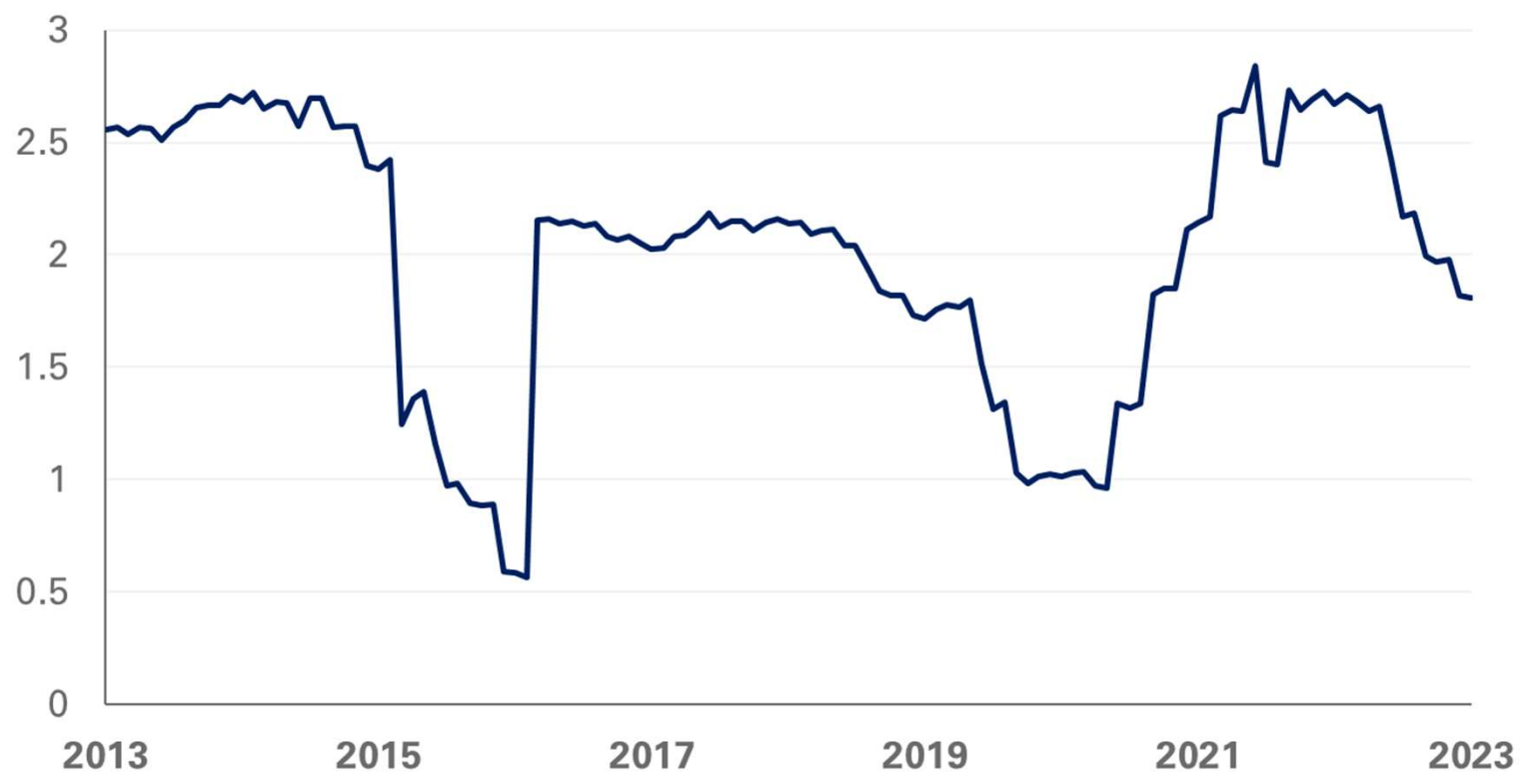


Source: National Federation of Independent Business, FactSet



# INTEREST COVERAGE RATIO FOR SMALL-CAPS

RUSSELL 2000 LTM EBIT/INTEREST EXPENSE ON DEBT



Source: Russell, FactSet

# LENDING STANDARDS ARE TIGHTENING

## LOAN OFFICER SURVEY: TIGHTENING STANDARDS FOR LOANS

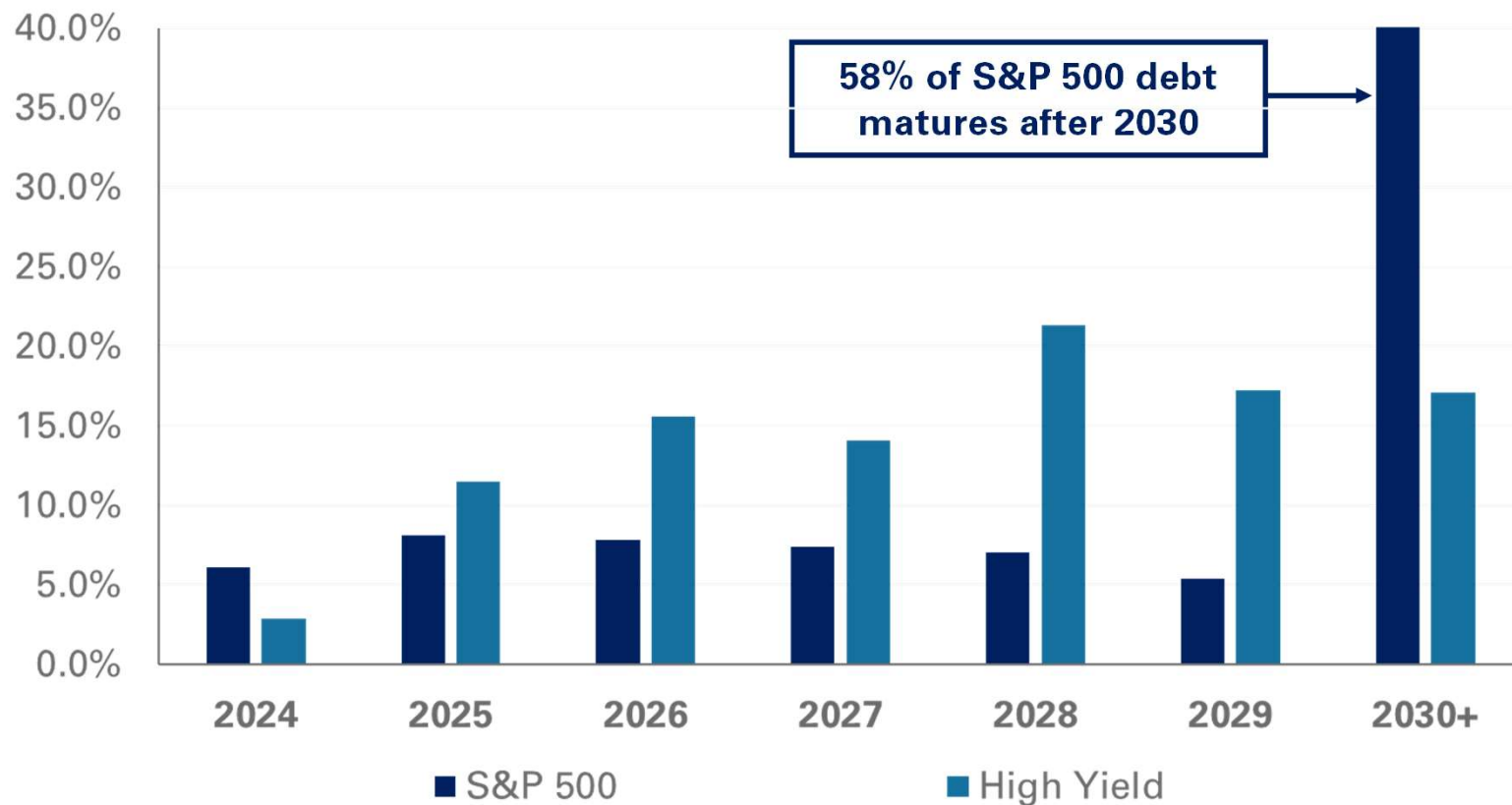


Notes: Gray shading reflects recessions as defined by the NBER  
Sources: Federal Reserve System, FactSet



# FIXED RATE DEBT REFLECTS QUALITY PROFILE

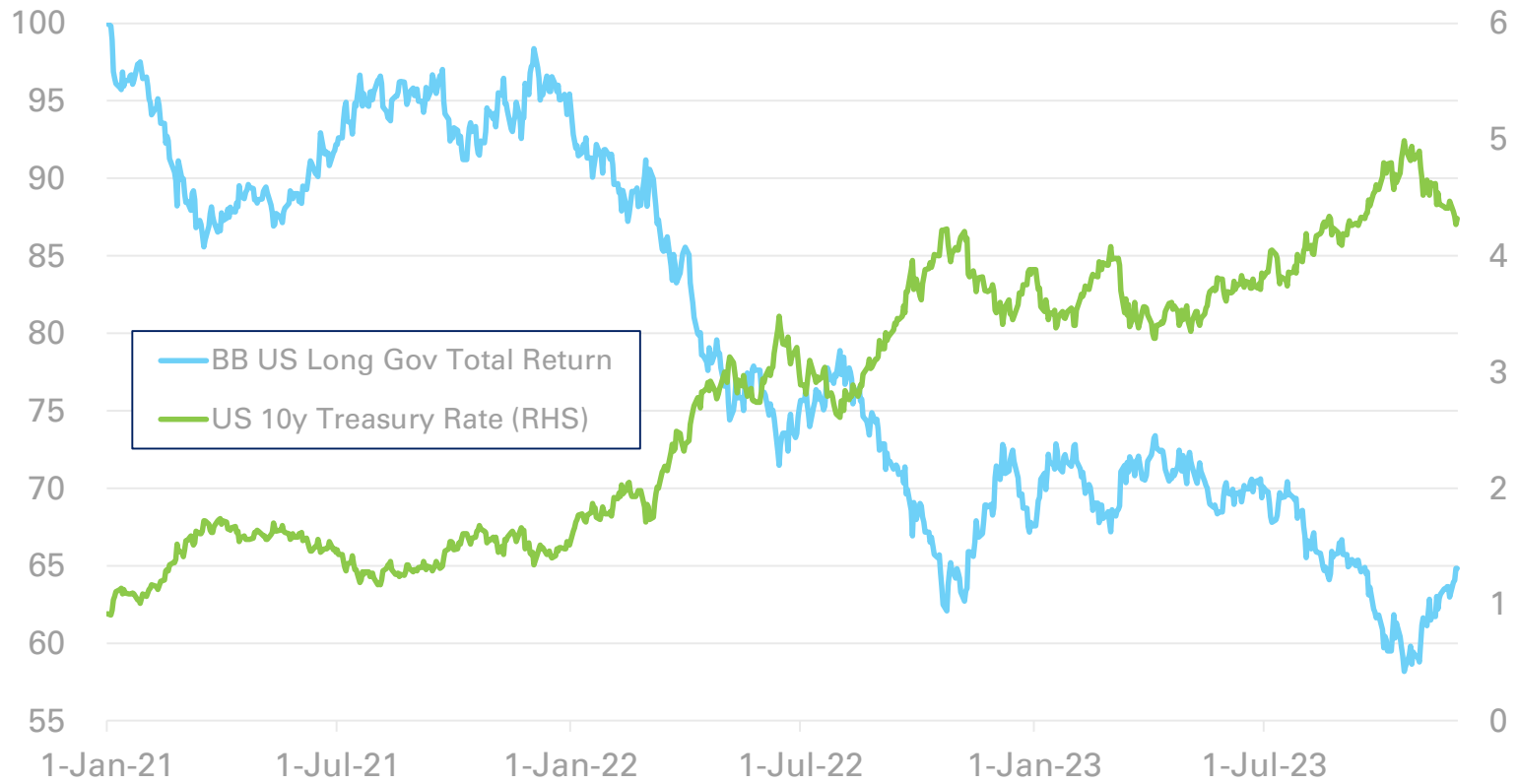
## DEBT MATURITIES OF HIGH YIELD AND S&P 500 EX-FINANCIALS



Source: S&P, Strategas

# MAJOR ADJUSTMENT IN RATES IN PROGRESS

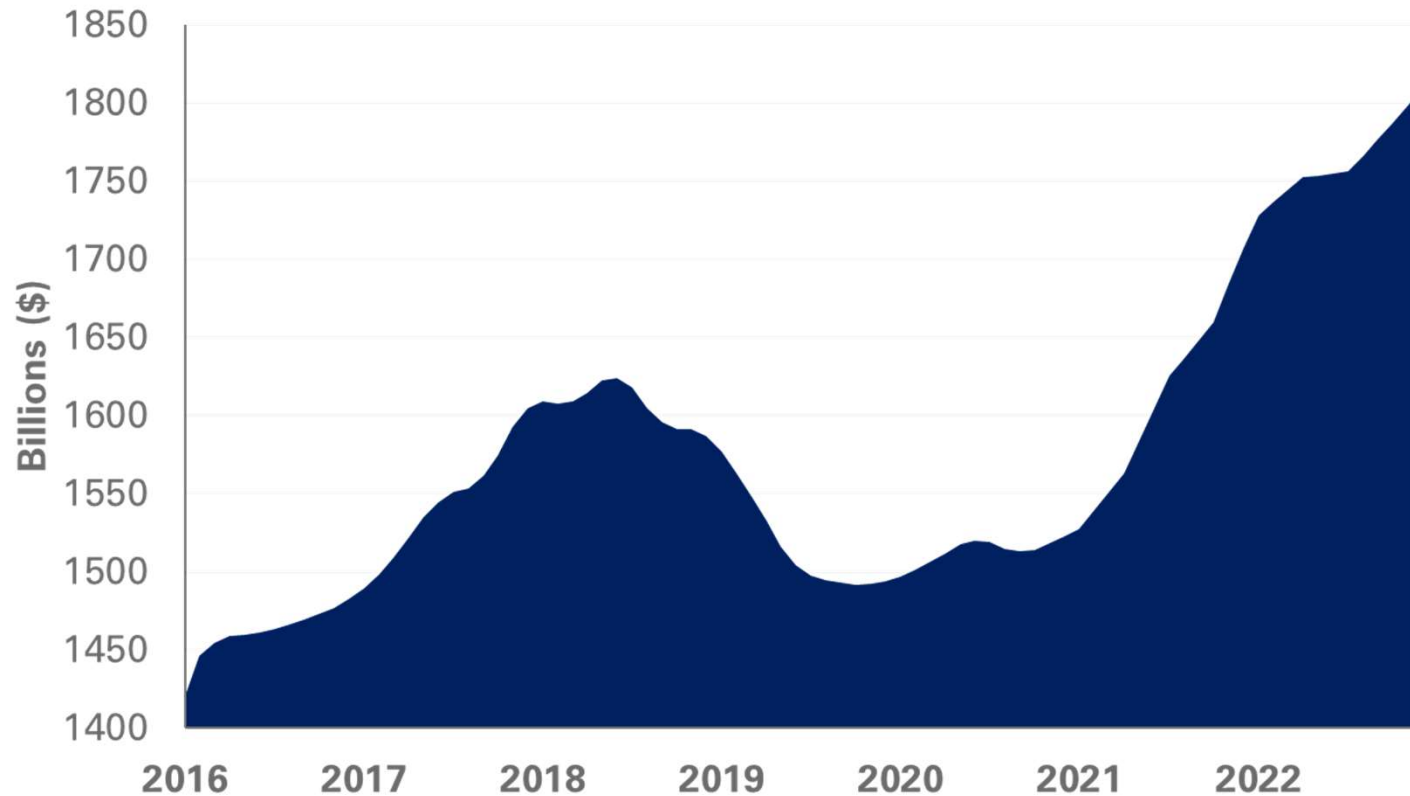
US LONG GOV-CREDIT INDEX DOWN ~40% OVER 3 YEARS



Source: FactSet

# INTEREST INCOME CAN SUPPORT CONSUMPTION

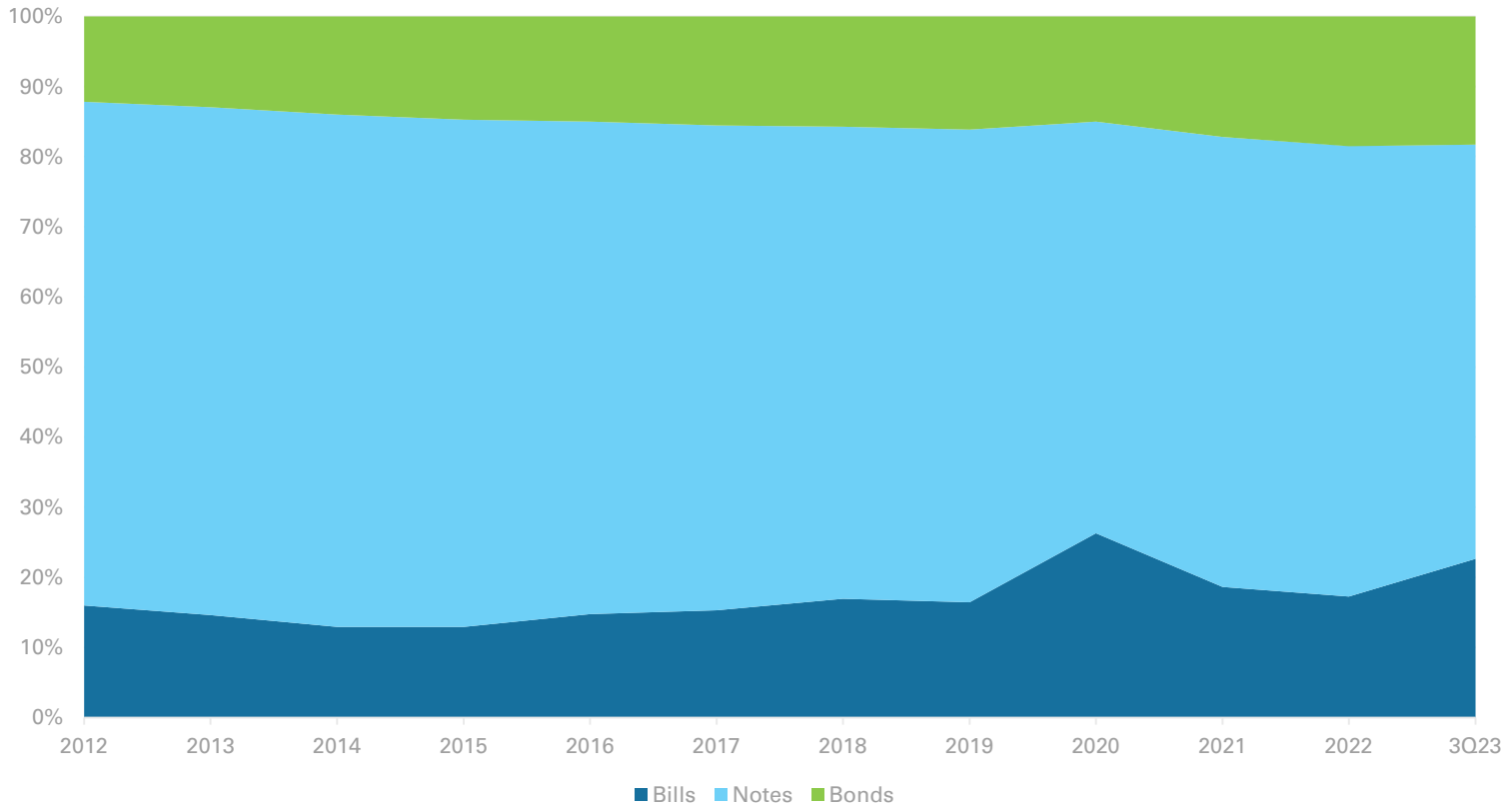
## PERSONAL INTEREST INCOME FROM ASSETS



Sources: Bureau of Economic Analysis

# US NATIONAL DEBT

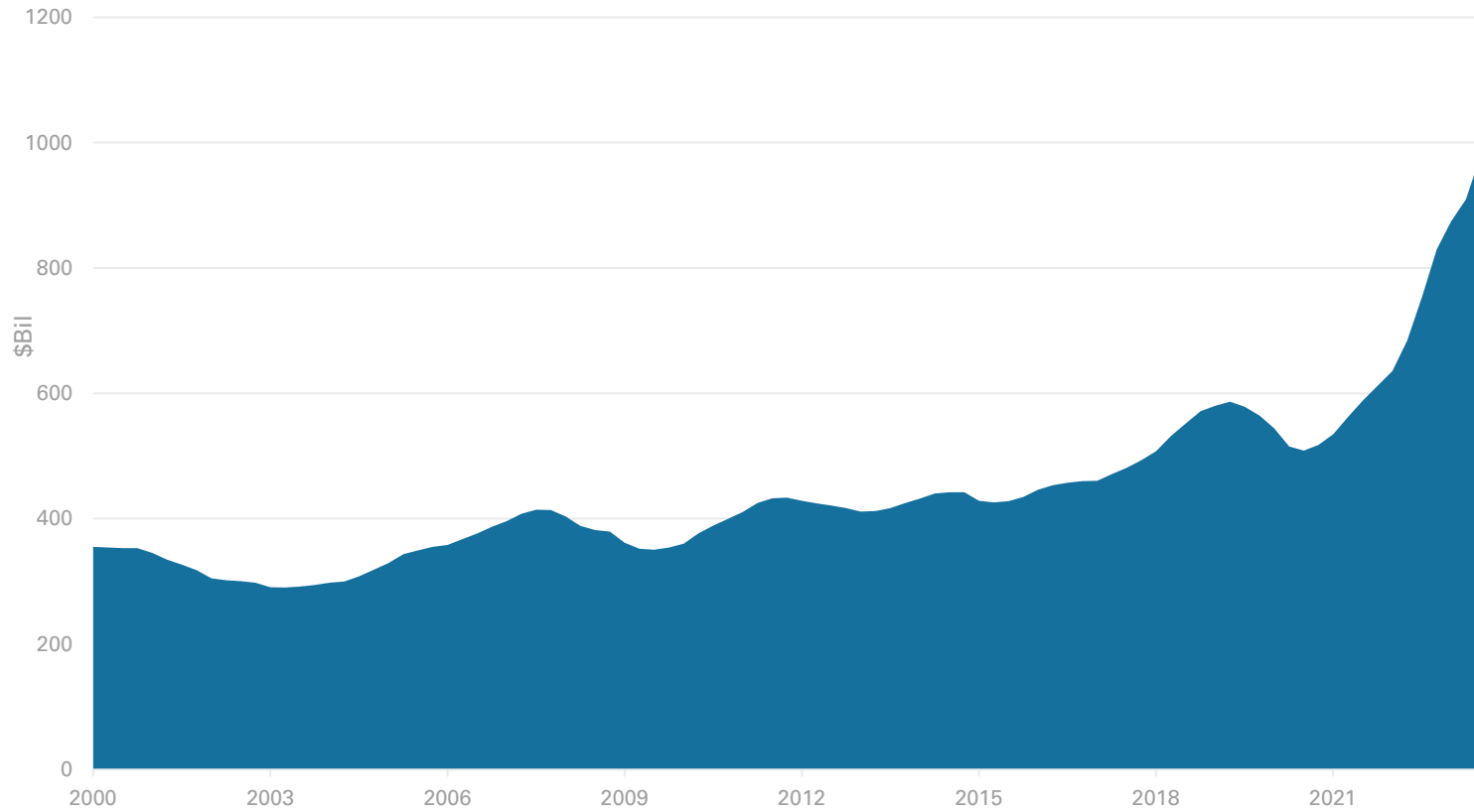
## COMPOSITION BY MATURITY



Source: US Treasury

# US GOVERNMENT – NET INTEREST PAID

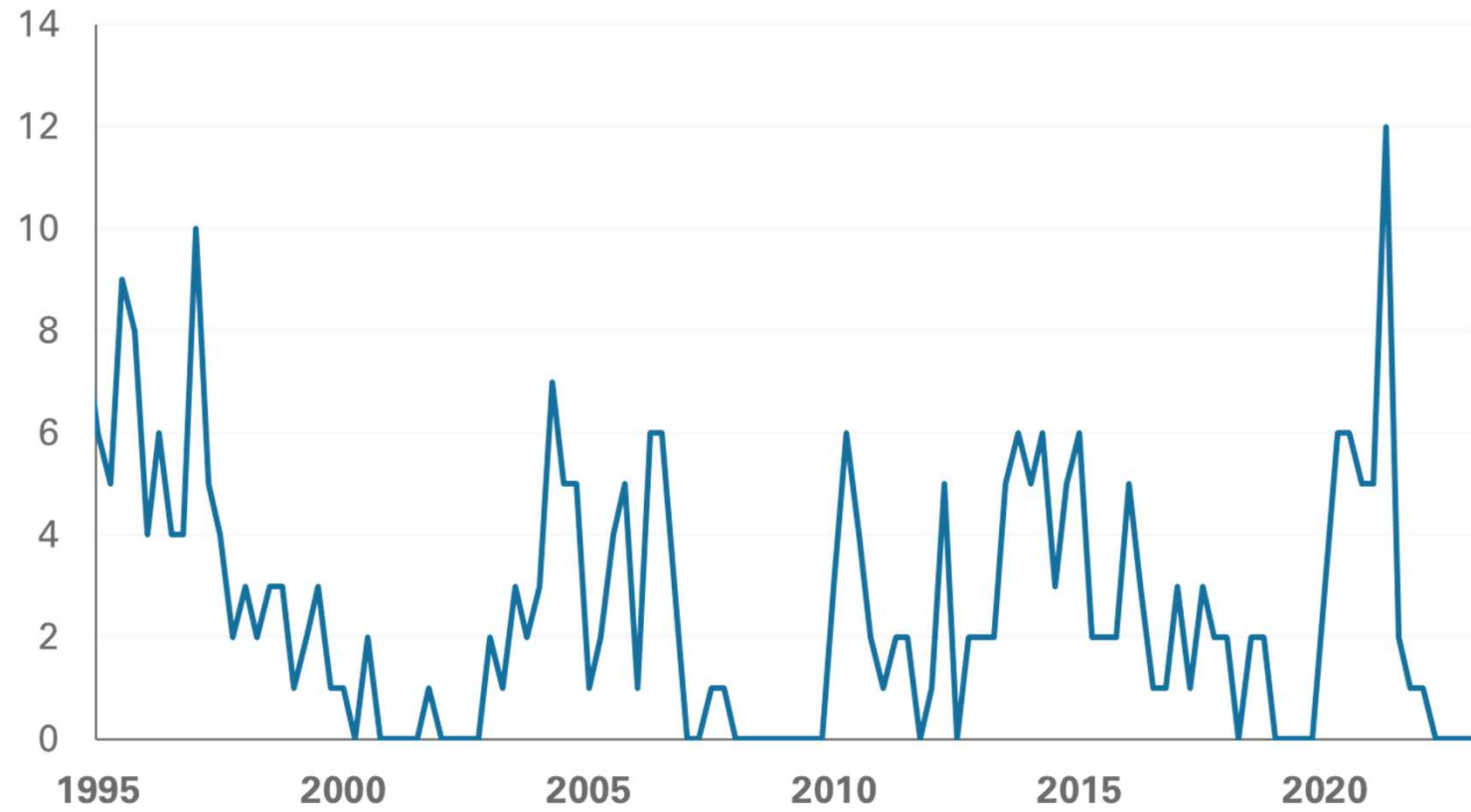
ACCELERATING SINCE 2021



Source: St. Louis Federal Reserve

# INTEREST RATES SUPPRESSING M&A ACTIVITY

BANKS REPORTING LOAN DEMAND DUE TO M&A FINANCING



Notes: Gray shading reflects recessions as defined by the NBER  
Sources: Federal Reserve System, FactSet





# PORTFOLIO CONSIDERATIONS

## 2024 MARKET THEMES

**Economic impact from cost of capital increases has been mitigated due to termed-out debt for many economic participants**

**Benefits of fixed rate mortgages and higher interest income flowing through to higher income and consumer spending**

**Public markets are framed by fixed rate vs floating rate borrowers and the spectrum of a delayed reaction function to higher interest rates**

**Premium is placed on free cash flow generators and stable EBITDA companies that are not exposed to debt markets**



# MAGNIFICENT SEVEN

## 2024 MARKET THEMES



### Unprecedented Size

**Massive Scale; Just 7 companies account for 28% of the S&P 500 Index**



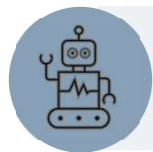
### Priced For Perfection

**Sky-high earnings growth expectations offer limited upside at current valuations**



### Free Cash Flow Cows

**Operating cash flows and revenue quality insulated names from higher rates**



### Tech Dominance

**Pioneers of tech in their own right, but new tech advances can usurp them**



### Nifty Fifty Vibes

**Historically, growth at this size becomes harder and darling stocks tend to fade**



## WHO ARE THE MAG 7 AND WHAT DO THEY DO?

Alphabet  
Google

amazon.com<sup>®</sup>



Meta

Microsoft

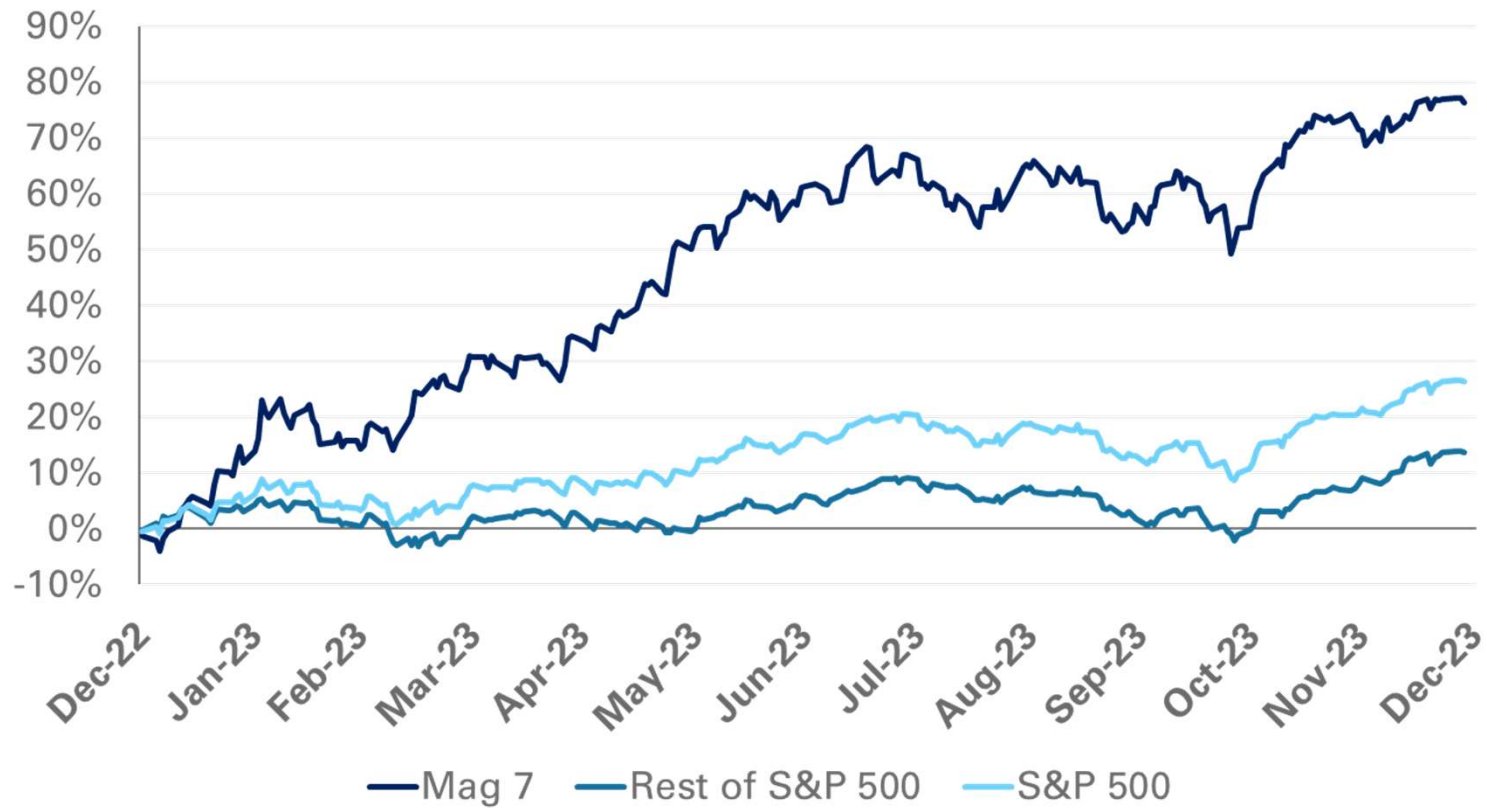
nVIDIA<sup>®</sup>

TESLA

1. Large-Cap Growth Stocks
2. Innovative Tech Companies
3. Strong Growth, Free Cash Flow
4. Monopolistic & Wide-Moats
5. Stellar Outperformance
6. Most did not exist 30 years ago
7. Strong BS's and Low Leverage
8. Focused on Organic Growth and Building Market Share
9. Platform Companies Built for Global Scale
10. All U.S. companies and Largest in the World

# ...AND WHAT HAVE THEY DONE IN 2023?

## 2023 MARGINAL PERFORMANCE



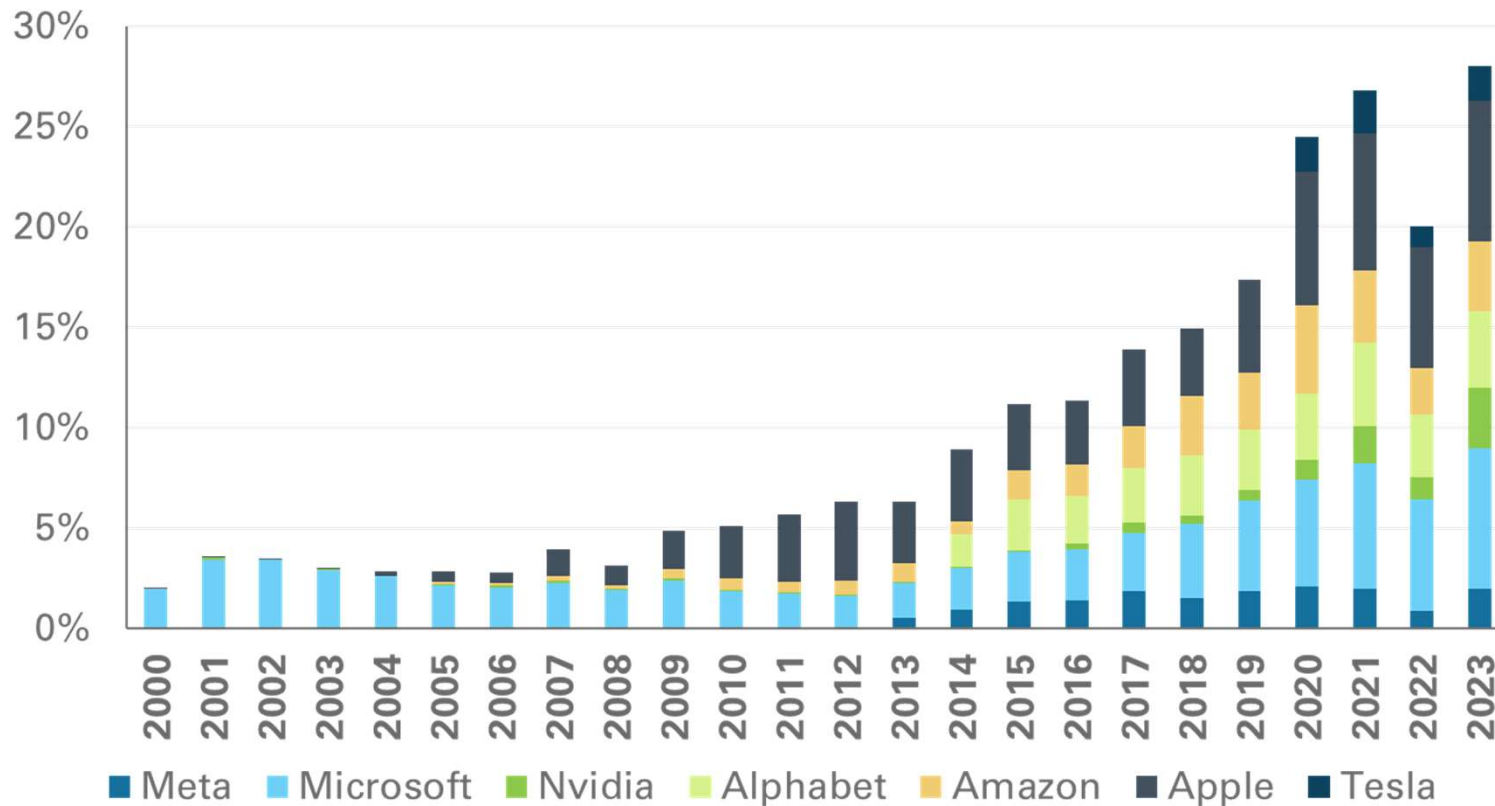
Source: FactSet, NEPC

Performance is based on marginal portfolios of each subset of the index based on daily performance and weights



# ...AND HOW HAS THAT CHANGED THE INDEX?

## S&P 500 INDEX WEIGHTS OF MAGNIFICENT 7 STOCKS

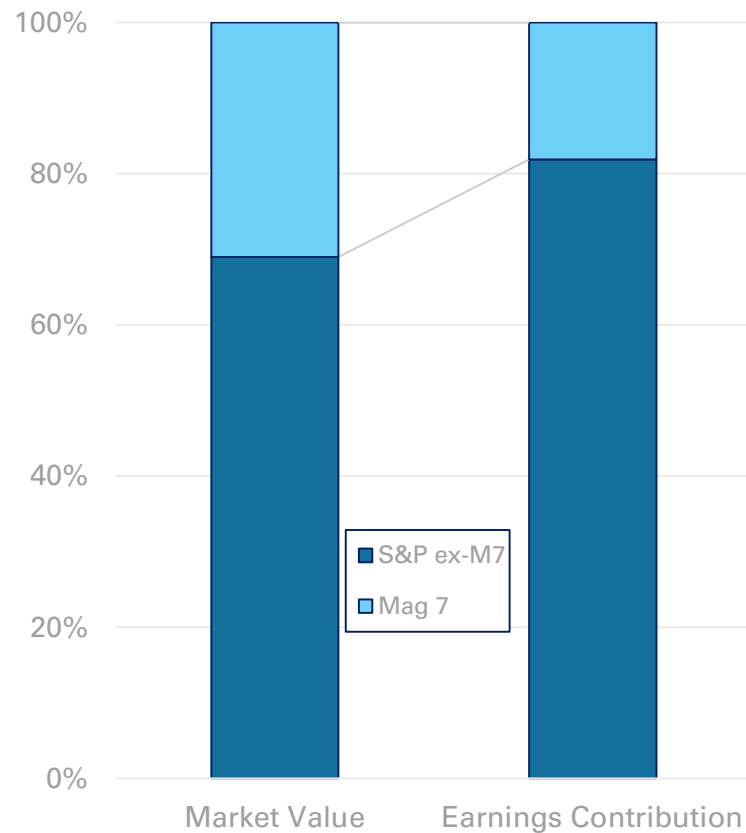
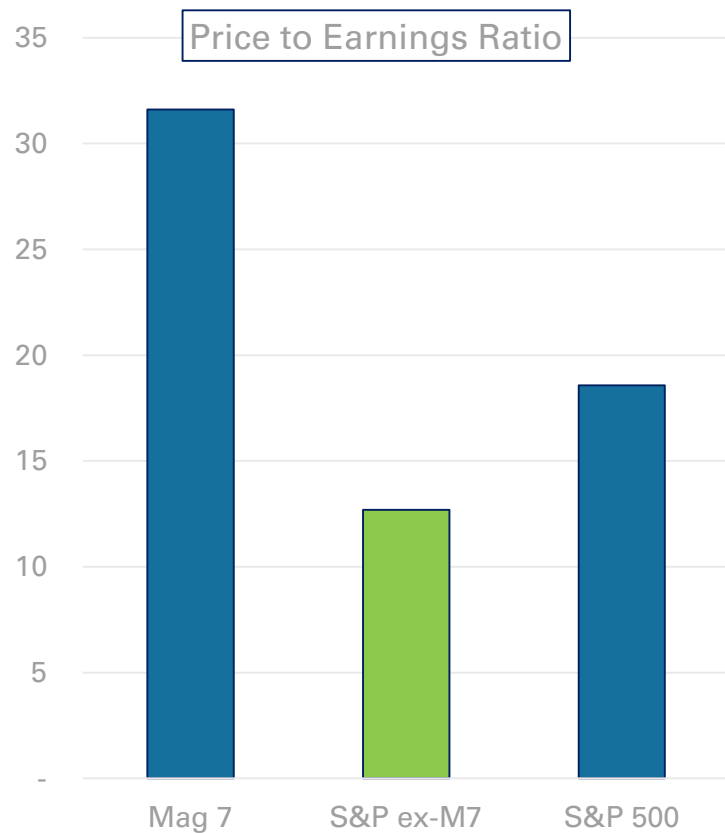


Source: FactSet, NEPC  
Based on index weights on December 31 each year



# DRASTICALLY DIFFERENT CHARACTERISTICS

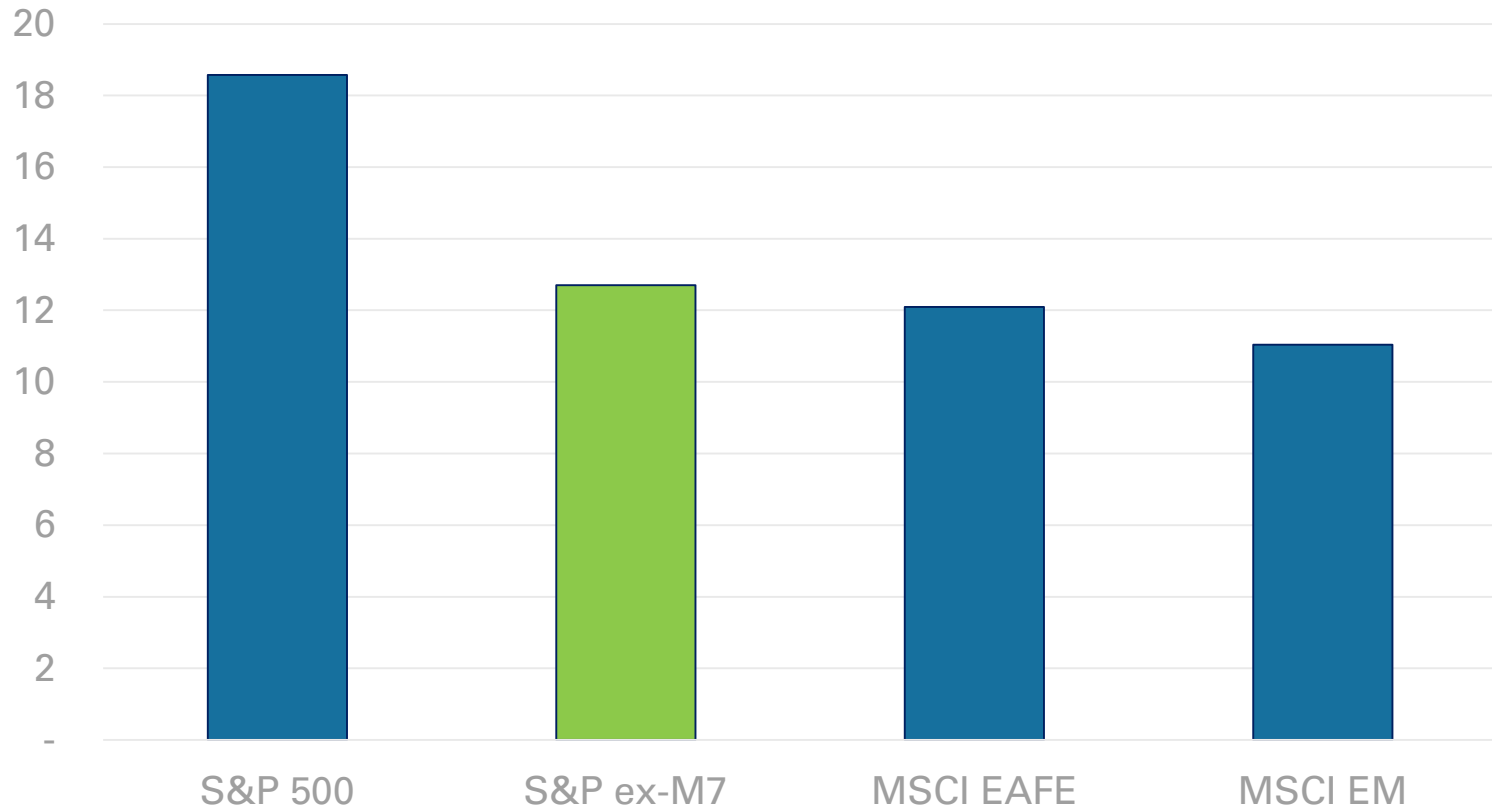
## MAGNIFICENT SEVEN WITH LOFTY VALUATIONS



Source: FactSet

# GLOBAL VALUATIONS (P-E RATIO)

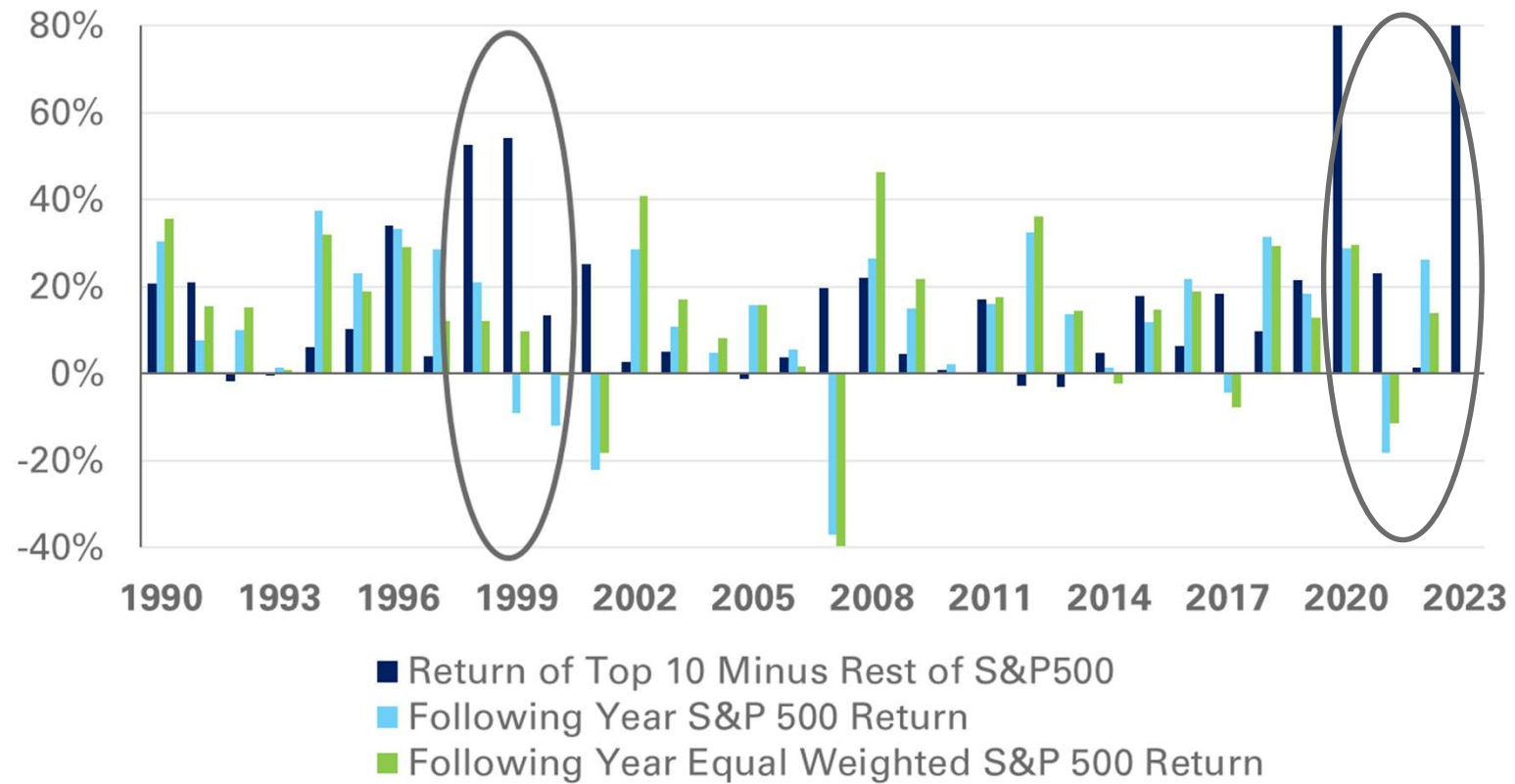
MOST OF US VALUATION PREMIUM EXPLAINED BY MEGA-TECH



Source: FactSet

# WHAT HAPPENS WHEN THE MARKET BIFURCATES?

YEARLY PERFORMANCE OF TOP 10 STOCKS VS REST OF S&P 500



Source: FactSet, NEPC



# PORTFOLIO CONSIDERATIONS

## 2024 MARKET THEMES

**The Magnificent Seven face their own unique risks; Regulatory scrutiny, Antitrust actions, China revenue exposure, “Priced for Perfection”**

**History shows high company concentration in equity markets reverts to a more balanced landscape (e.g. 1970’s Nifty Fifty, 1990’s Dot-Com)**

**We expect the S&P 500 ex Magnificent 7 to outperform in the coming years and prefer a fundamental value exposure for implementation**



# U.S. FISCAL DEBT PROFILE

## 2024 MARKET THEMES



### Interest Rate Implications

Fundamentals suggest perpetual deficit cycle requires higher interest rates



### Inflation Pressure

Money supply can absorb the debt but stoke demand and inflation



### Dollar Impact

The dollar still has no competitor for global reserve currency status



### Crowding Out Effect

Increasing supply of Treasuries will compete for credit vs. other investments



### Nominal Growth Needed

To maintain a healthy debt-to-GDP ratio, higher nominal GDP growth is needed

# AN UNSUSTAINABLE PATH

FEDERAL DEBT HELD BY THE PUBLIC AS PERCENTAGE OF GDP



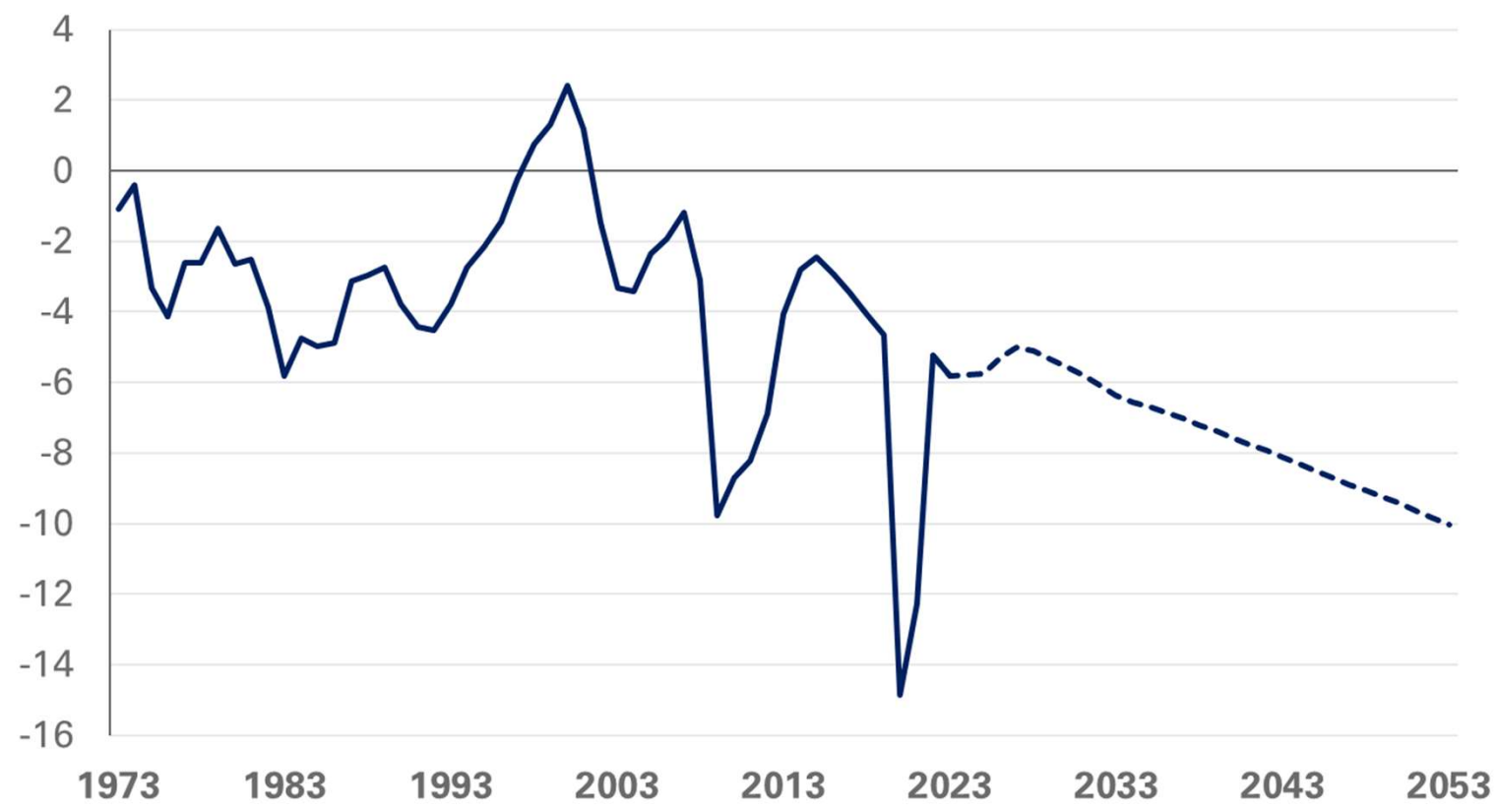
Source: Congressional Budget Office, NEPC

Interest rate paths are relative to CBO Baseline and based on an effective interest rate paid on debt



# DEFICITS HAVE TO BE FINANCED

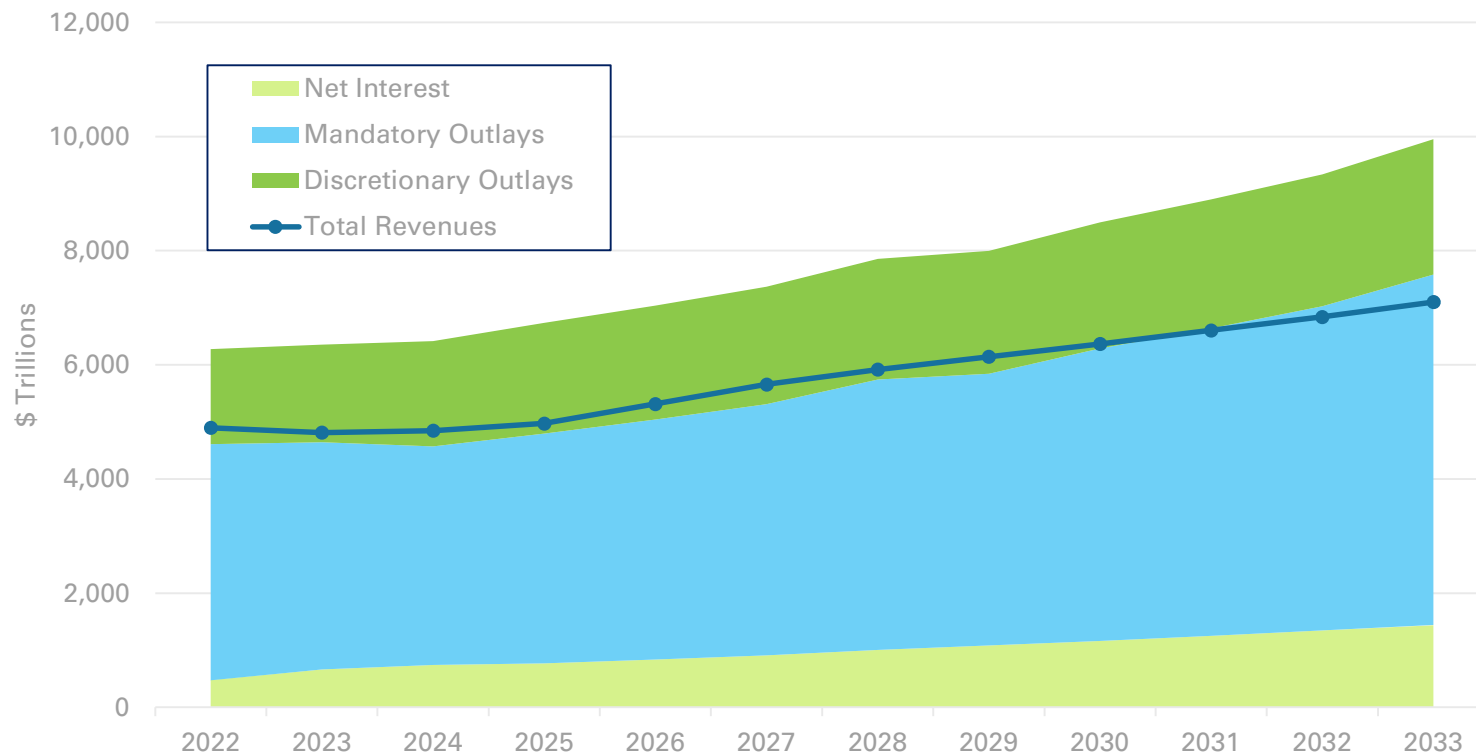
TOTAL DEFICITS AS PERCENTAGE OF GDP



Source: Congressional Budget Office

# TOTAL US GOV BUDGET VS. REVENUE

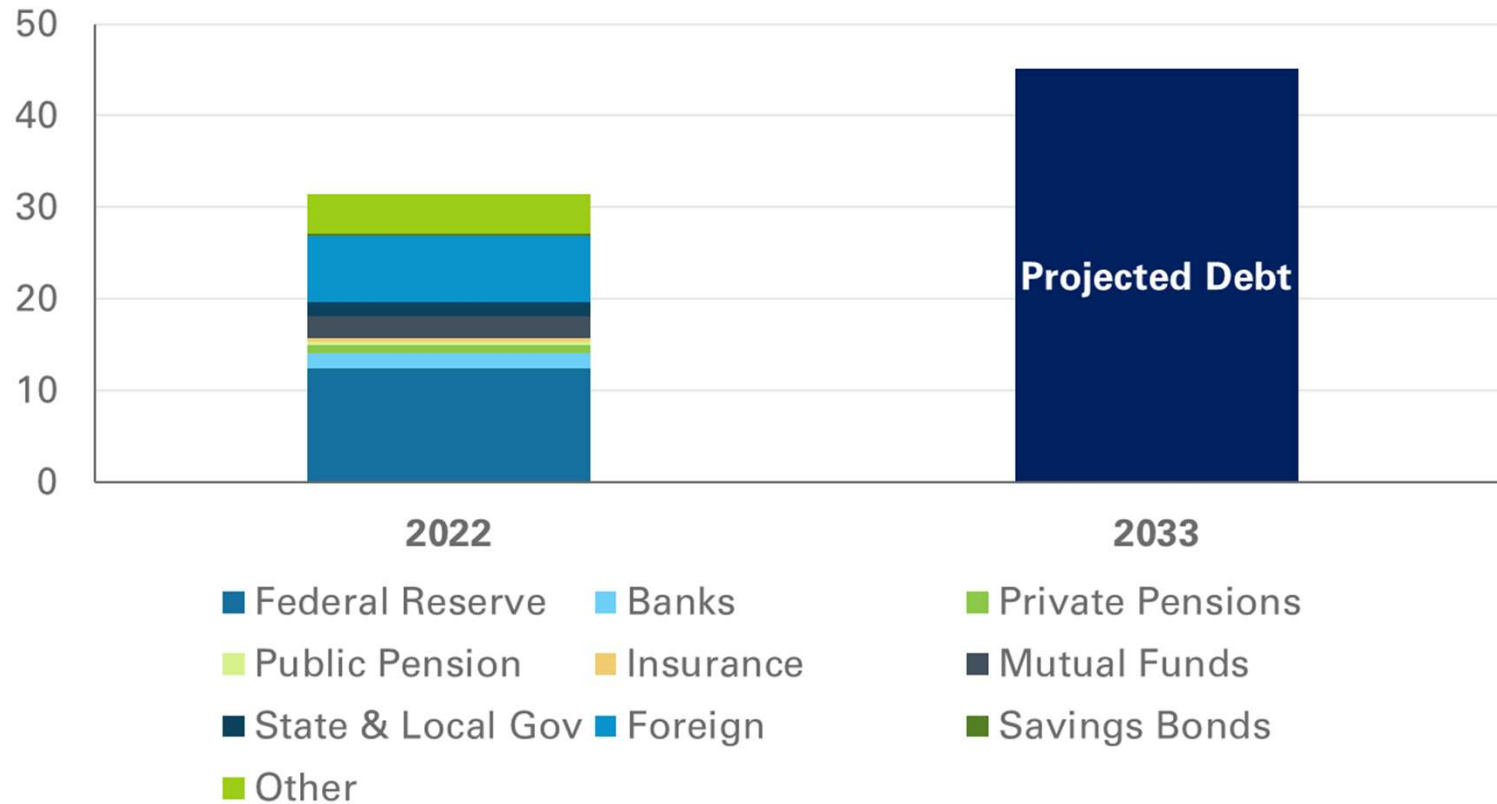
NOT A LOT OF WIGGLE ROOM ON DISCRETIONARY SPEND



Source: Congressional Budget Office

# WHO'S GOING TO BUY ALL THIS DEBT?

OWNERSHIP OF U.S. TREASURY SECURITIES IN TRILLIONS

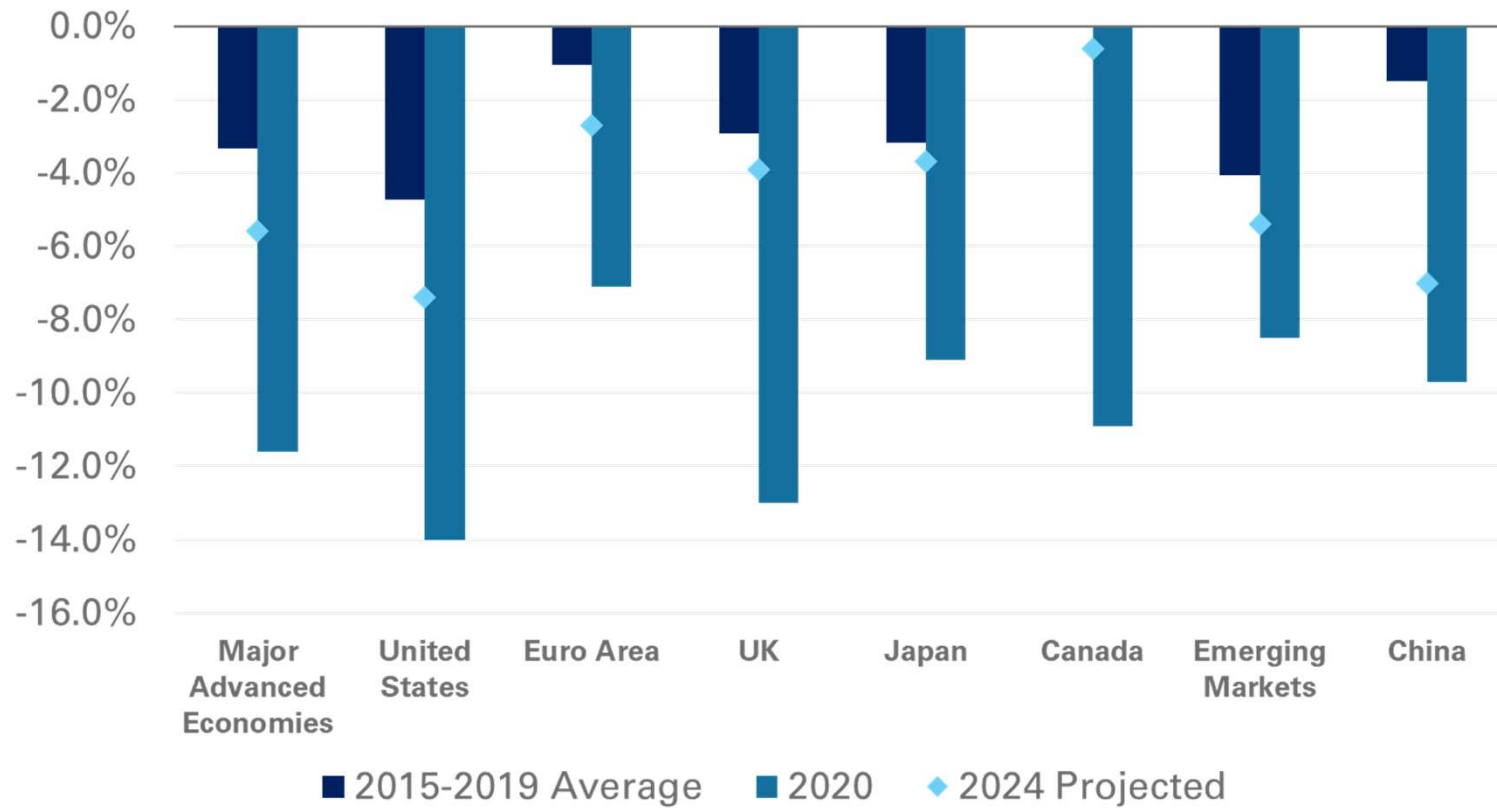


Source: U.S. Treasury, Congressional Budget Office  
As of December 31



# THE U.S. IS NOT ALONE

## GENERAL GOVERNMENT NET BORROWING AS PERCENT OF GDP



Source: International Monetary Fund October 2023 World Economic Outlook

# PORTFOLIO CONSIDERATIONS

## 2024 MARKET THEMES: U.S. FISCAL DEBT PROFILE

**Developed markets have been unable to unwind excess government spending post-COVID and the path forward appears unsustainable**

**Perpetual deficits require outsized Treasury issuance which will put upward pressure on interest rates and potentially inflation**

**There are explicit ways to deal with the debt (higher taxes, lower spending) and implicit ways (higher nominal growth)**

**We expect higher for longer interest rate levels and rate volatility to be challenged due to higher Treasury issuance**





# ARTIFICIAL INTELLIGENCE

## 2024 MARKET THEMES



### AI as a Tool

Artificial Intelligence will be used with humans rather than replace humans



### Productivity Gains

Adoption of AI may boost real economic growth and enhance productivity



### Impact is Beyond Tech Sector

Current market has favored tech sector, broader industry effects remain unknown



### AI Proof Statement

Novel products and successful AI adoption will test valuations in 2024



### Geopolitics May Alter Adoption

Costs for semiconductors, data, regulation could slow adoption

# WHERE IS ARTIFICIAL INTELLIGENCE TODAY?



ChatGPT

## ChatGPT

Freelance writing job listings have fallen 2.0% and freelance writing earnings have declined 5.2%<sup>1</sup>



## Aitana Lopez

“We did it so that we [would] not be dependent on other people who have egos” – The Clueless Agency

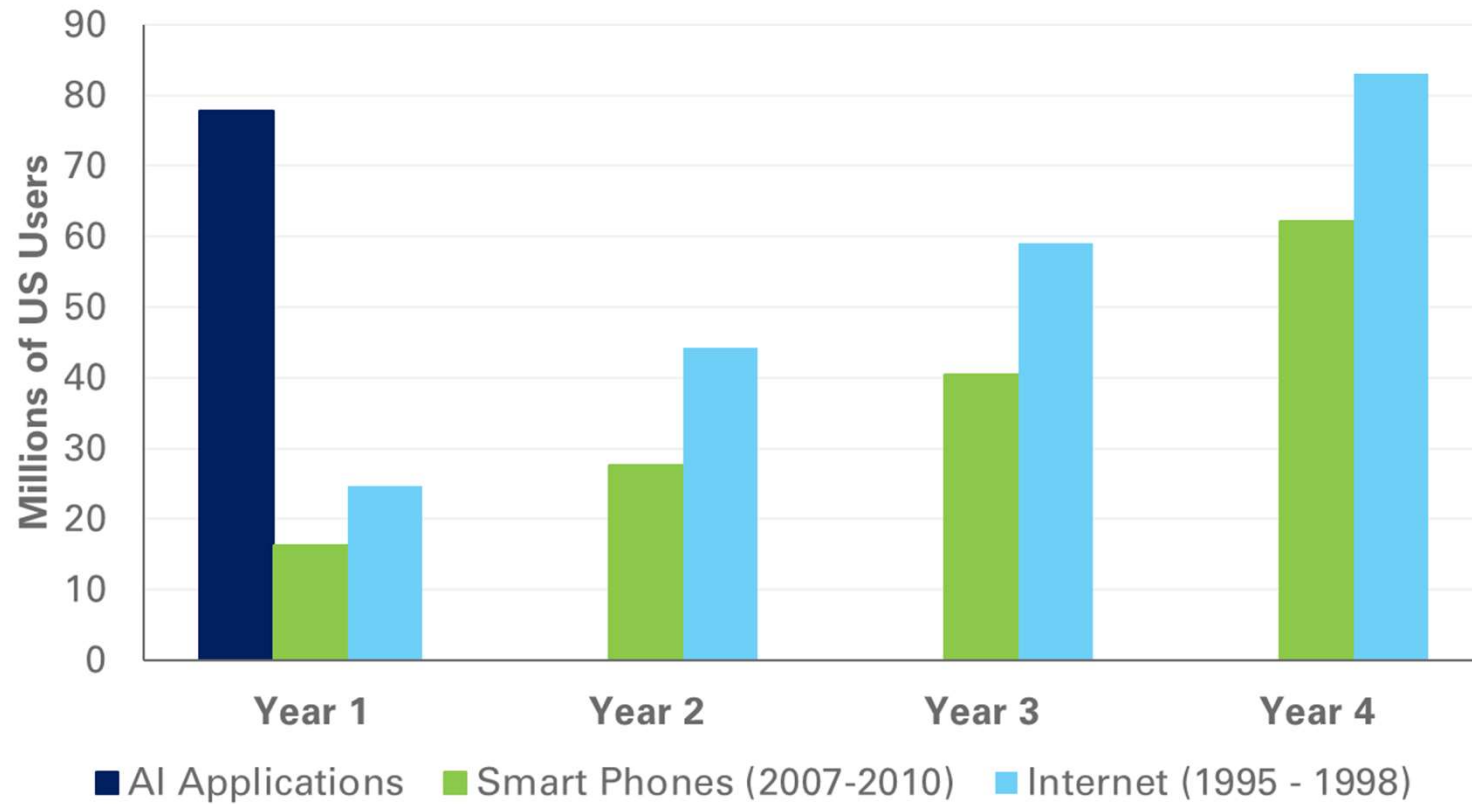


## Flawless AI

Video editor that automates and removes tedious aspects of the filmmaking process

# AI ADOPTION RATES HAVE BEEN FAST

## TECHNOLOGY ADOPTION RATES

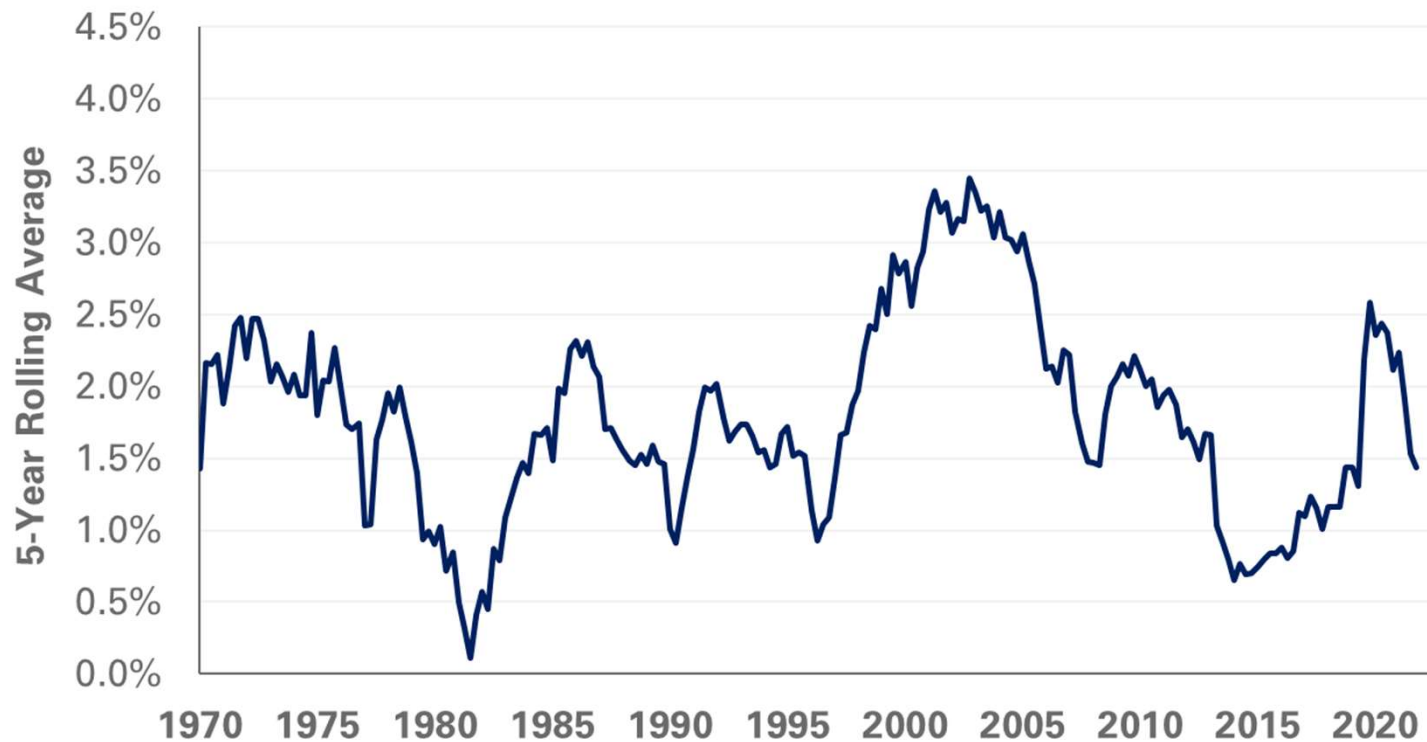


AI Applications represents users who enter a prompt to ChatGPT or another Generative AI system at least once per month and if as of June 2023  
Source: Insider Intelligence, World Bank, US Bureau of Economic Analysis FactSet,



# MACROECONOMIC IMPACTS FROM AI ADOPTION

## 5-YEAR ROLLING AVERAGE OF LABOR PRODUCTIVITY



Source: U.S. Department of Labor, FactSet

# INTEREST IN AI EXTENDS PAST TECH COMPANIES

AI MENTIONED ON EARNINGS REPORT IN RUSSELL 3000



Source: Russell, FactSet

# PORTFOLIO CONSIDERATIONS

## 2024 MARKET THEMES: ARTIFICIAL INTELLIGENCE

**If AI is the next technological revolution, we could see higher real growth, greater economic productivity, and lower inflation levels**

**The U.S. is best positioned to benefit from AI due to a friendly regulatory environment and accessibility to key technology inputs**

**Ongoing demand for semiconductors and companies' ability to adopt AI into their operating models will test equity valuations**

**Downstream impacts from AI have yet to be seen and proof of adoption outside of the technology sector is a key test**



# HEIGHTENED GEOPOLITICAL RISK

## 2024 MARKET THEMES



**Instant Transmission of (Mis)Information**

**The speed of information amplifies tail risks and introduces uncertainty**



**Market Impact of Geopolitics**

**Historically, geopolitics have a short-lived market impact following a flash point**



**The Balance of Power**

**Geopolitical alignments must be chosen by countries caught in the middle**



**2024 Global Election "Supercycle"**

**Elections increase the likelihood of geopolitical surprises for the market**

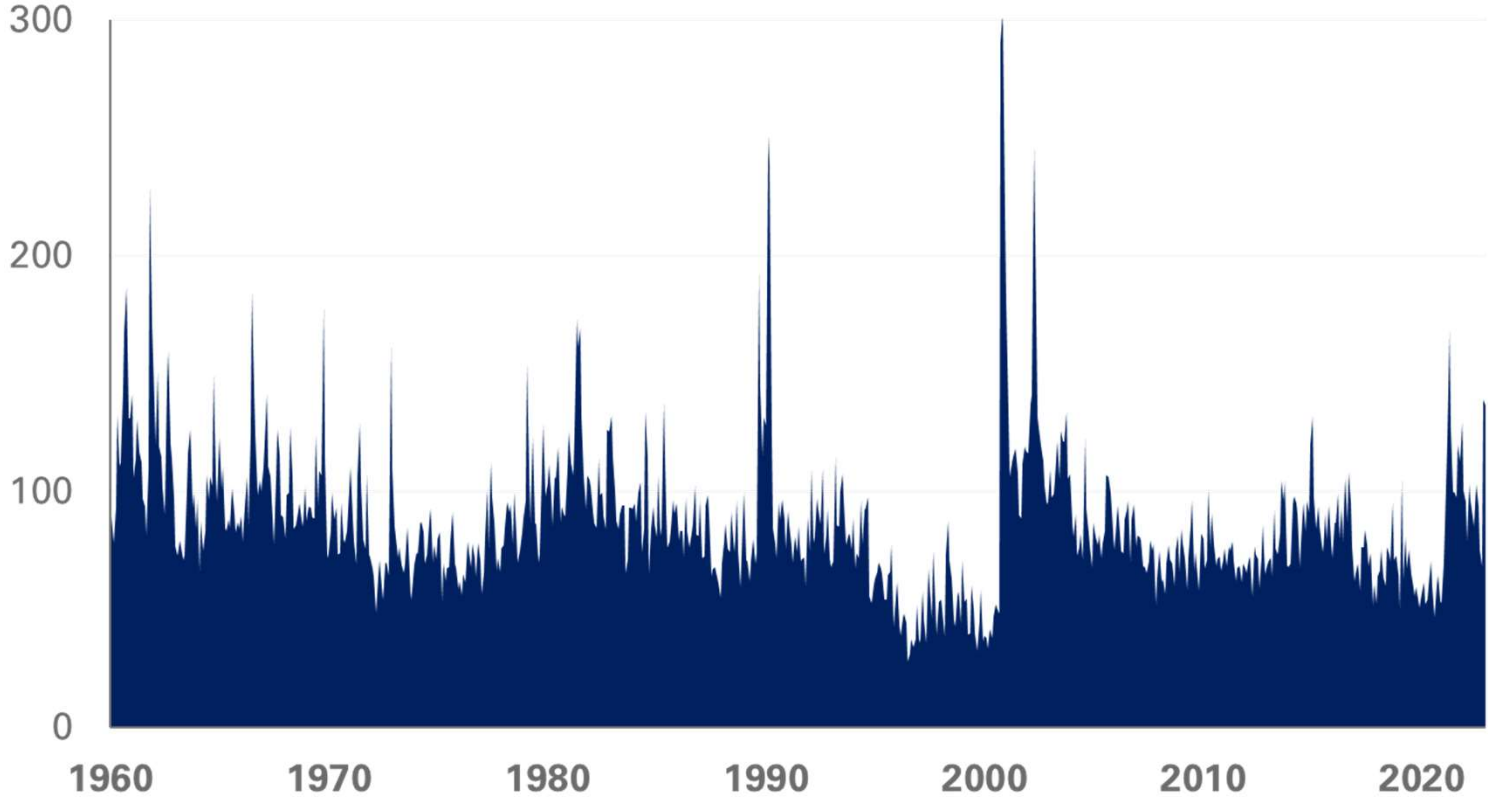


**Rebalance Opportunities**

**Find opportunities amid volatility around geopolitical events and election outcomes**

# A TRANSITION AWAY FROM RELATIVE STABILITY

## HISTORICAL GEOPOLITICAL RISK INDEX

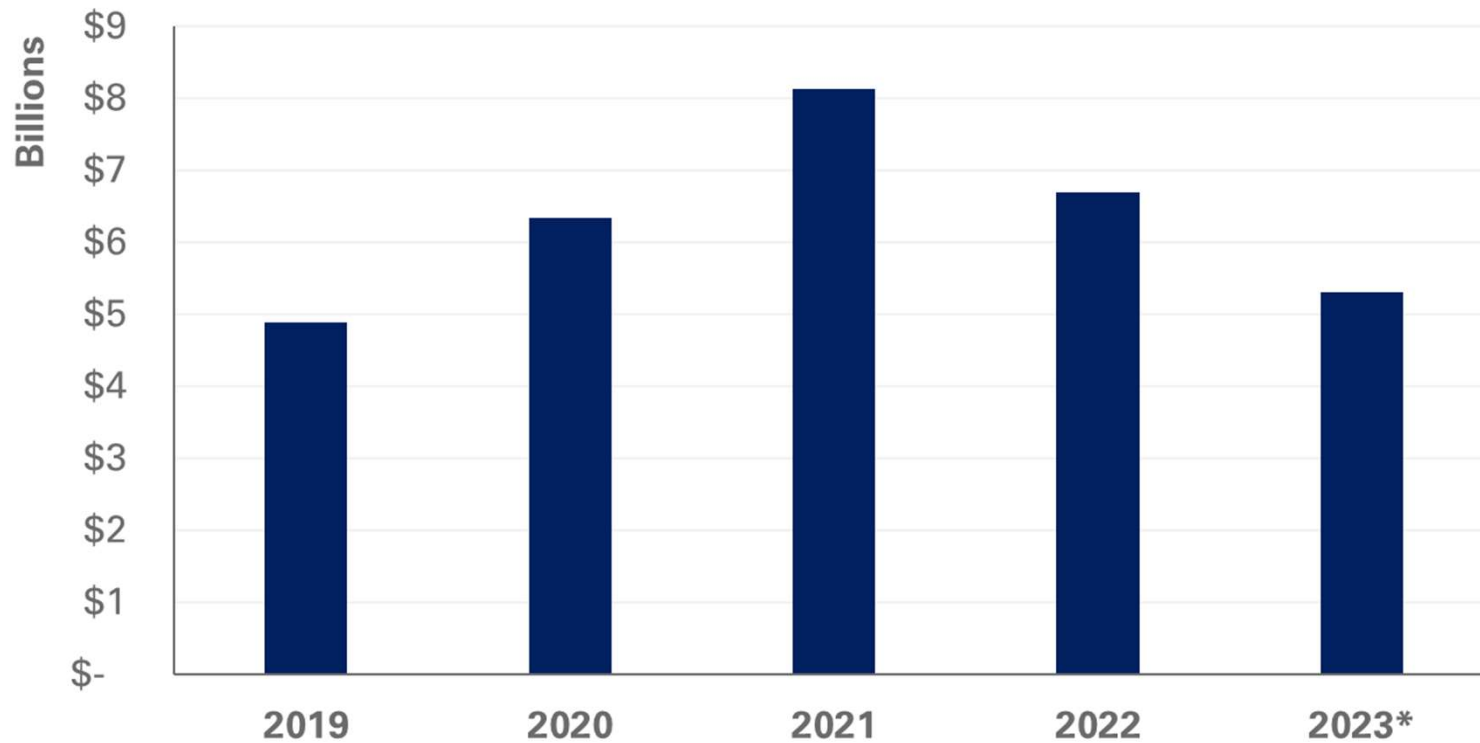


Source: <https://www.matteiacoviello.com/gpr.htm>



# U.S.-CHINA RELATIONS ARE EVER-PRESENT

## SEMICONDUCTOR-RELATED EXPORTS FROM THE U.S. TO CHINA

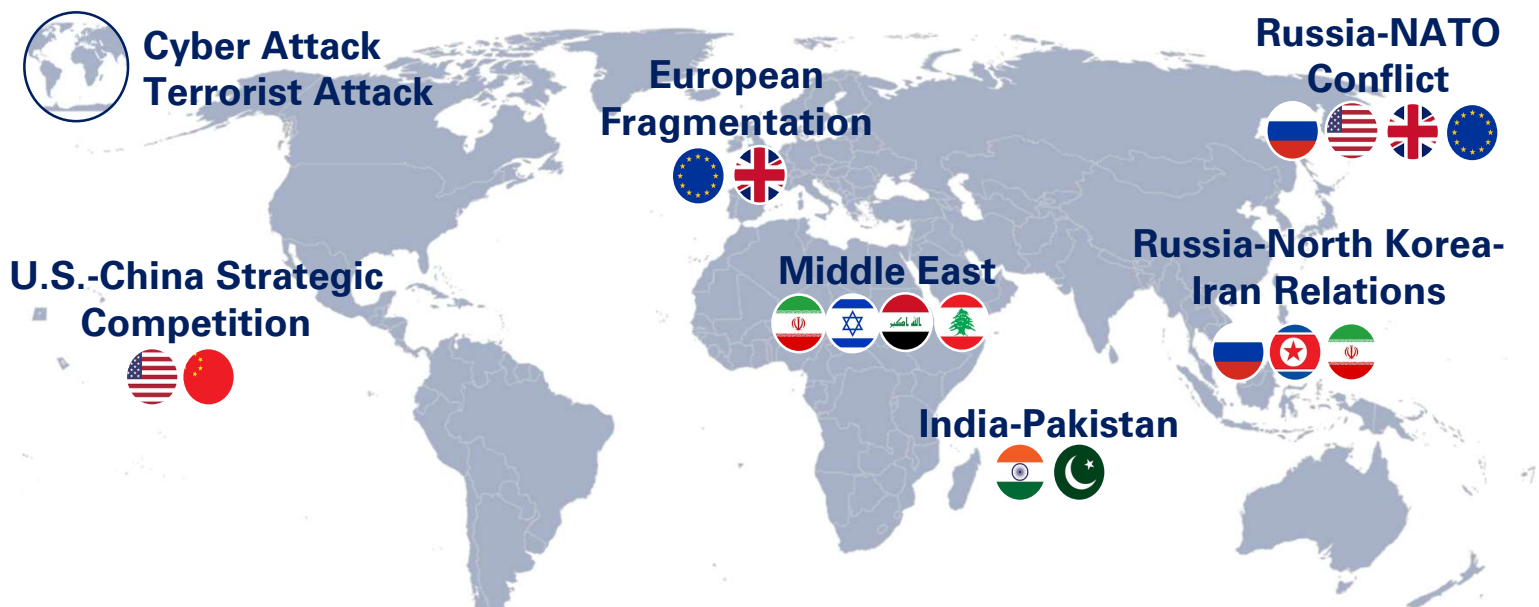


Notes: 2023 assumes fourth quarter exports is an average of the first three quarters of 2023  
Semiconductor is based on FAS value for HTS Codes: 8541, 9030.92.00, 9031.41, 8480.71.40.00, and 8486  
Source: U.S. International Trade Commission



# 2024 GEOPOLITICAL FLASHPOINTS

ESCALATION RISK IS KEY FOR CAPITAL MARKETS



## Potential Economic and Market Impact:



Food Supply



Global Trade



Global Inflation



Energy Supply

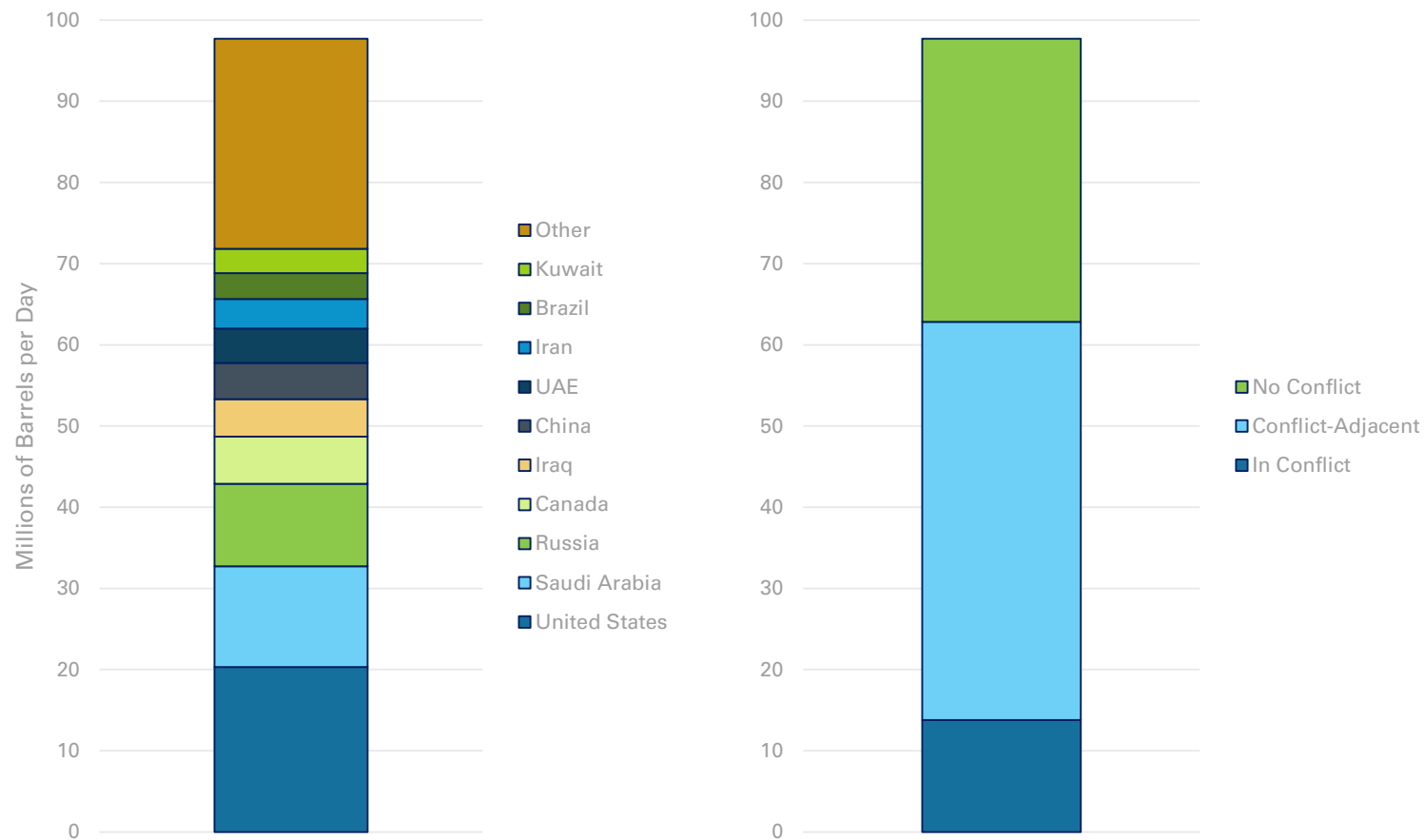


Economic Growth



Currency Volatility

# OIL PRODUCTION FACING CONFLICT



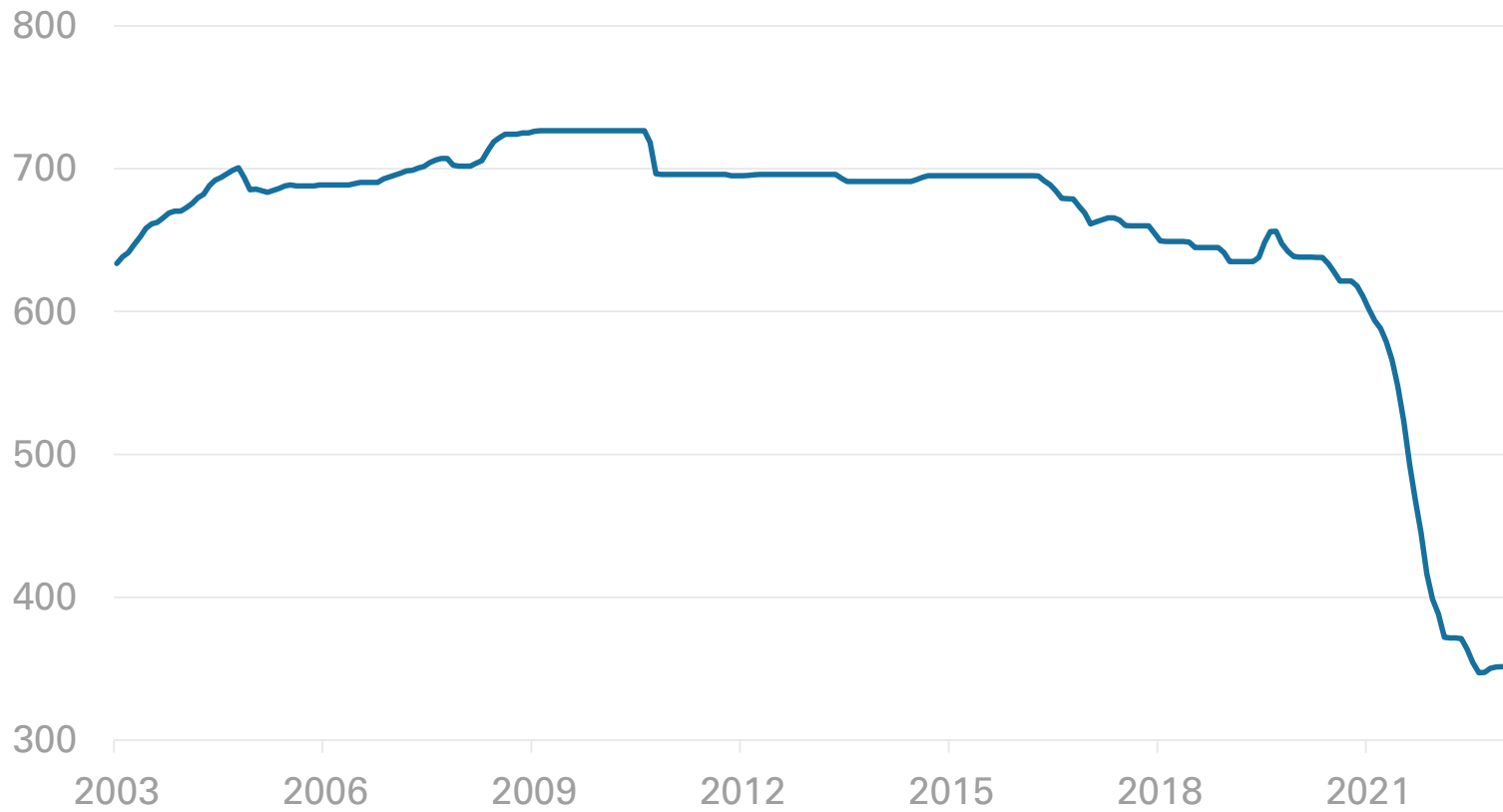
Source: Energy Information Agency, NEPC

Note: In Conflict – Russia, Iran; Conflict Adjacent – US, Saudi, Iraq, China, UAE, Kuwait; No Conflict: Canada, Brazil, Other



# UNITED STATE STRATEGIC PETROLEUM RESERVE

HALF OF HISTORICAL LEVELS



# HISTORICAL MARKET IMPLICATIONS

- This backdrop can fuel near-term volatility in markets, but history suggests long-term returns will be driven by the economic regime

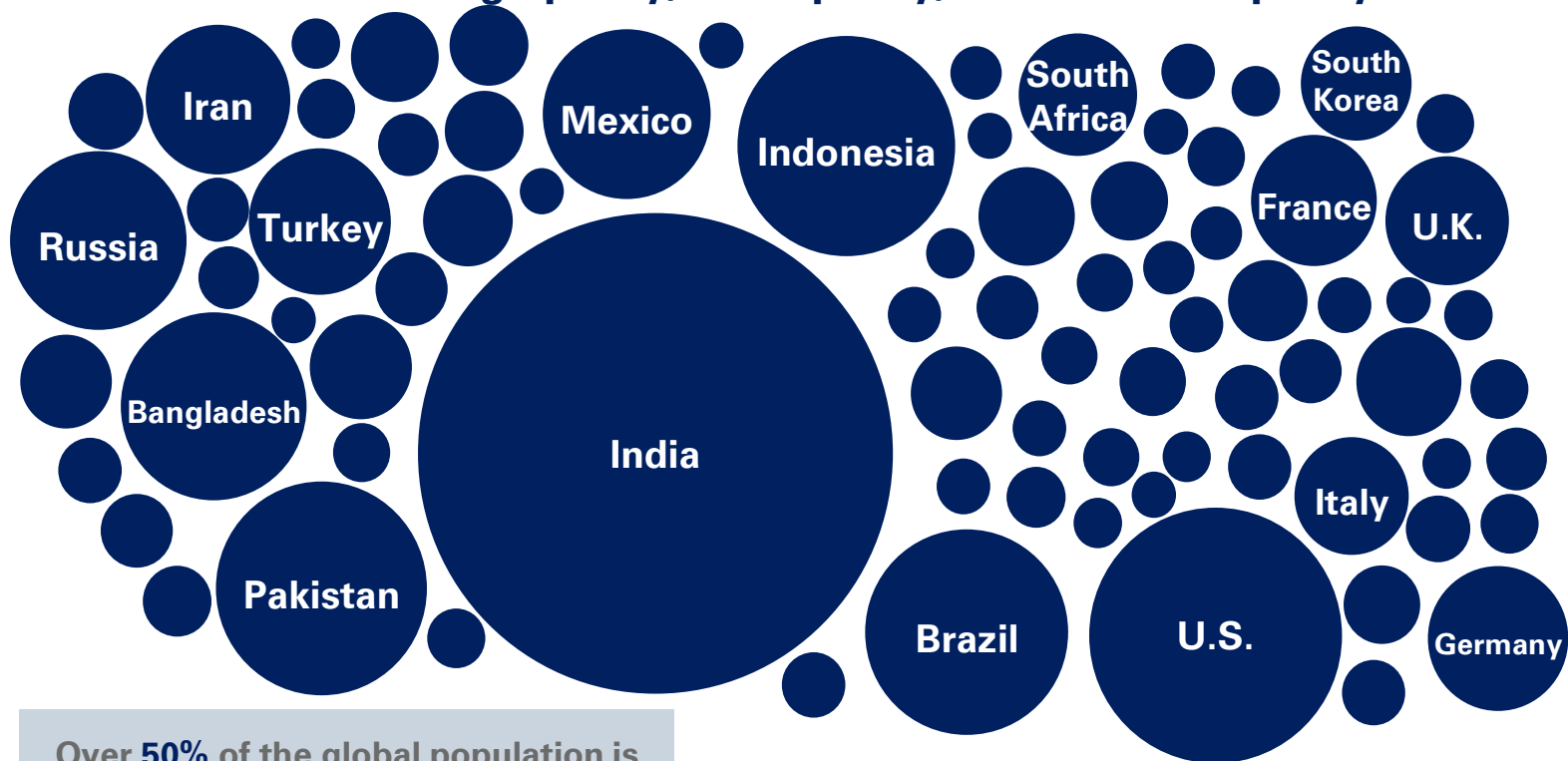
Date	Events	S&P 500 1-Day Return	S&P 500 1-Month Return	S&P 500 1-Year Return	Trading Days to Recoup
October 26, 1973	Yom Kippur War & Oil Embargo	-0.2%	-10.7%	<b>-37.0%</b>	1574
November 2, 1979	Iranian Hostage Crisis	-0.7%	3.6%	<b>24.3%</b>	7
December 13, 1989	U.S. Invasion of Panama	-0.5%	-3.4%	<b>-3.2%</b>	12
August 2, 1990	Invasion of Kuwait by Iraq	-1.9%	-7.8%	<b>14.1%</b>	129
September 11, 2001	9/11 Terrorist Attack	-4.9%	0.6%	<b>-15.5%</b>	20
February 20, 2011	Arab Spring Reaches Libya	-2.1%	-3.5%	<b>3.5%</b>	46
January 31, 2014	Annexation of Crimea by Russia	-2.3%	4.6%	<b>14.2%</b>	6
June 23, 2016	BREXIT	-3.6%	3.1%	<b>17.8%</b>	11
February 24, 2022	Invasion of Ukraine by Russia	2.2%	6.1%	<b>-5.9%</b>	-
October 7, 2023	Israel Attacked by Hamas	0.6%	1.4%	<b>11.2%</b>	-



Sources: S&P, FactSet

# A GLOBAL ELECTION CYCLE COMPLICATES THINGS

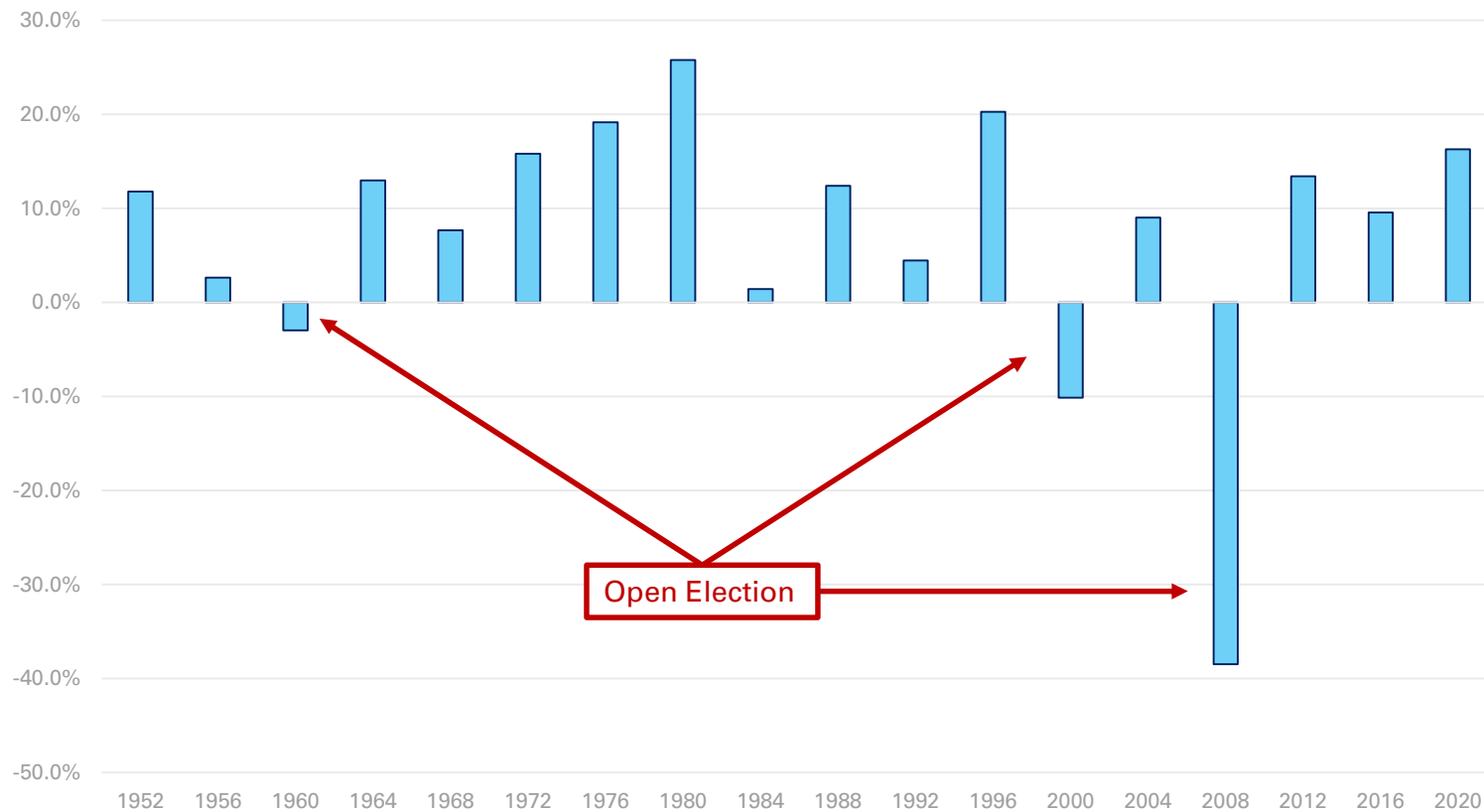
- An election “supercycle” in 2024 widens the range of outcomes associated with foreign policy, trade policy, and domestic policy



Notes: Includes the European Union member states that will elect the next Parliament in June 2024. Size of bubble denotes size of population for voting country. Source: FactSet

# US PRESIDENTIAL ELECTION YEARS

USUALLY POSITIVE FOR S&P 500 (ESPECIALLY RE-ELECTIONS)



Source: Strategas, FactSet

## **US PRESIDENTIAL POLICY TOOLS...**

- **Short-end debt borrowing**
- **Fed/Treasury easing financial conditions**
- **US-China relationship healing**
- **Fiscal spending for Congressional approved Infrastructure**
- **Student Loan Cuts for qualified borrowers**
  - July 1, 2024
  - SAVE Program





# PORTFOLIO CONSIDERATIONS

## 2024 MARKET THEMES

**We do not expect geopolitical events or elections will warrant an investment action;** brace for market volatility should tensions escalate

**Embrace portfolio diversification** as elevated geopolitical uncertainty introduces the potential for market surprises

**Elevated tensions are intensifying geopolitical alliances;** “swing states” represent a catalyst for geopolitical tensions

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Past performance is no guarantee of future results.

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Information on market indices was provided by sources external to NEPC. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.

All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.

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# Upcoming Events

**FOX TECHNOLOGY  
RESOURCE PARTNER  
FOCUS GROUP:  
DEVIATE CONSULTING** | Mar. 7, 2024  
Virtual Event

**FOX  
Rising Gen  
Leadership  
Program** | April 12-13, 2024  
Denver, CO

**FOX Premier  
Technology and  
Risk Management  
Days** | April 17-18, 2024  
Virtual

**FOX  
Family Advisor  
Training  
Program** | **In-person**  
May 15-16, 2024, Chicago, IL  
**Virtual modules**  
April 24, May 8, and June 26

Please visit our website for more information [familyoffice.com/learning-programs](https://familyoffice.com/learning-programs)