

2024 Year-Ahead Outlook

The Last Leg on the Long Road to Normal



Key takeaways

- Our outlook for the new year is “2024”: 2% growth, 0 recessions, 2% inflation and 4% unemployment. A soft landing remains in reach, particularly as disinflation looks set to continue and the Federal Reserve now appears satisfied with its progress.
- Global economic growth should be less divergent next year, but central banks more so given different journeys in the inflation battle. This should drive the U.S. dollar lower.
- Given the Fed is done with the current tightening cycle, we believe long rates peaked in October and have scope to decline further as both growth and inflation cool to trend. Moreover, interest rates should broadly stabilize and the curve should gradually steepen over the course of 2024 as markets anticipate rate cuts beginning over the next 6-12 months.
- After a strong 2023, investors should temper expectations for 2024 as earnings estimates look lofty, volatility has been unusually low, valuations could come under pressure and economic growth is likely to slow.
- International equities should continue exhibiting solid and diversified returns next year driven by still favorable valuations, positive earnings growth and improving return of capital to shareholders.
- Although the dust is still settling on valuations, alternative investments can support the outcomes investors seek in portfolios, like diversification, inflation hedging and alpha.
- Against a challenging backdrop of turning tides, investors would do well to diversify and lean on active management, stepping out of cash and into risk assets to take advantage of the anticipated changes ahead.

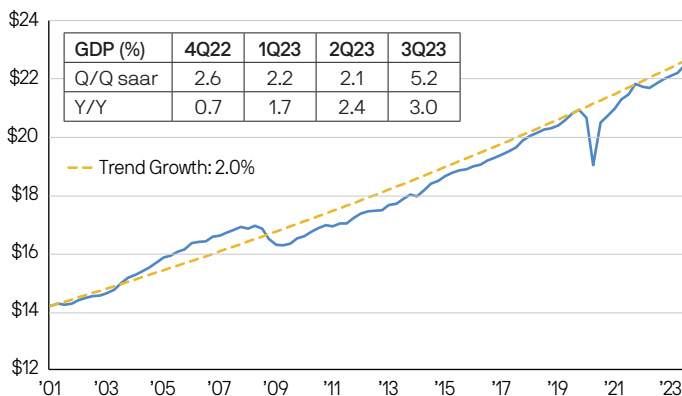
U.S. economy: Hoping for a boring 2024

Our baseline U.S. economic forecast for 2024 can be summed up by the number 2024 – 2% growth, 0 recessions, 2% inflation and unemployment staying at roughly 4%. However, there are clearly risks that could divert us from that path.

On economic growth, demand is gradually easing following a surprisingly strong 2023. Real GDP growth in 3Q23 was 3.0% year-over-year powered by strong gains in consumer and government spending, resilient investment spending, inventory restocking and improving international trade. All of these areas should see slower growth going forward.

Growth should slow following a strong 2023

Exhibit 1: Real GDP, trillions of chained (2017) dollars, seasonally adjusted at annual rates



Source: BEA, FactSet, J.P. Morgan Asset Management. Values may not sum to 100% due to rounding. Trend growth is measured as the average annual growth rate from business cycle peak 1Q01 to business cycle peak 4Q19. Data are as of December 13, 2023.

Consumer spending should grow more slowly as job gains diminish and banks gradually tighten lending standards. That being said, while younger and poorer households are showing signs of increased financial stress, on aggregate, consumer financial conditions are not nearly as dire as they were before the Great Financial Crisis, and we expect consumer spending to grow more slowly rather than shrink.

Capital spending could be more challenged as businesses react to higher interest costs and slowing revenue growth. Moreover, the longer high interest rates remain in place, the greater is the risk of a surge in small business bankruptcies. However, the outlook for capital

spending is not entirely negative, as booming spending on artificial intelligence and federal government incentives for semiconductor manufacturing should be able to offset weakness due to declines in the construction of retail and office facilities.

After improving in 2023, international trade should drag on growth in 2024, reflecting a still very-high dollar and sluggish global growth. Meanwhile, government spending growth should slow as federal spending is constrained by Washington gridlock and state and local spending is trimmed in line with a slowing U.S. economy.

All of this being said, we believe that demand growth in the U.S. should still be strong enough to support 2% real GDP growth in 2024. But how about supply?

The unemployment rate has been in a narrow band of between 3.4% and 4% since December 2021 and could stay in this range in the year ahead. If it does, then all growth in employment in 2024 would have to come from growth in the labor force. This will be challenging – just released Census projections show the population aged 18-64 rising just 0.1% in 2024, in a long-standing trend reflecting the aging of the baby boom generation. However, tight labor markets should encourage stronger immigration and some further gains in labor force participation. In addition, productivity has seen solid gains over the past year with output per worker rising by 1.1%. This could improve further in the year ahead, allowing for 2% real GDP growth without overheating the economy.

Provided the economy transitions to 2% growth and 4% unemployment, inflation should continue its steady downward trend.

One way to appreciate this is to break CPI inflation down into food, energy, shelter and everything else.

Food prices soared in the pandemic, reflecting fiscal stimulus and supply-chain disruptions – a trend that was extended by Russia's invasion of Ukraine. These effects are now fading and real food spending has declined for much of the last two years, reflecting a squeeze on lower and middle-income consumers. Restaurant spending has proven more robust, reflecting a post-pandemic bounce-back. Nevertheless, barring another supply shock, we expect these forces to continue to erode food inflation in 2024.

Aggregate supply will be constrained by very slow growth in the working age following a strong 2023

Exhibit 2A: Growth in working-age population

Percent increase in civilian non-institutional population ages 16-64

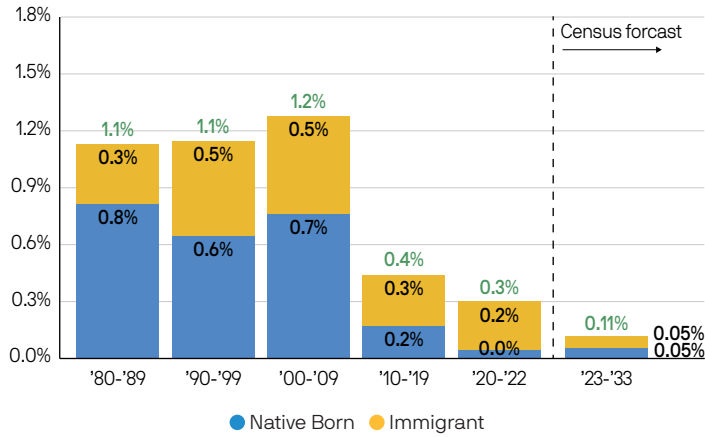


Exhibit 2B: Growth in private non-residential capital stock

Non-residential fixed assets, year-over-year % change

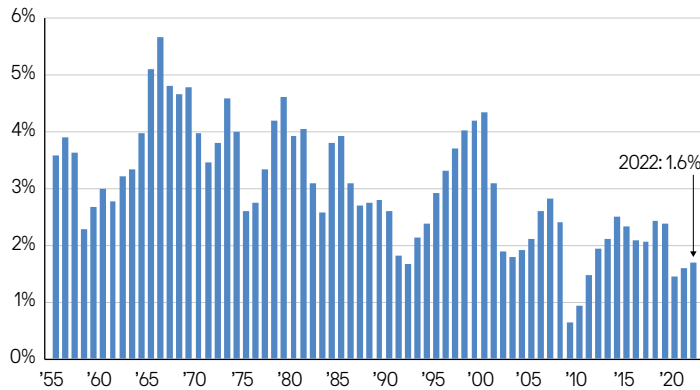
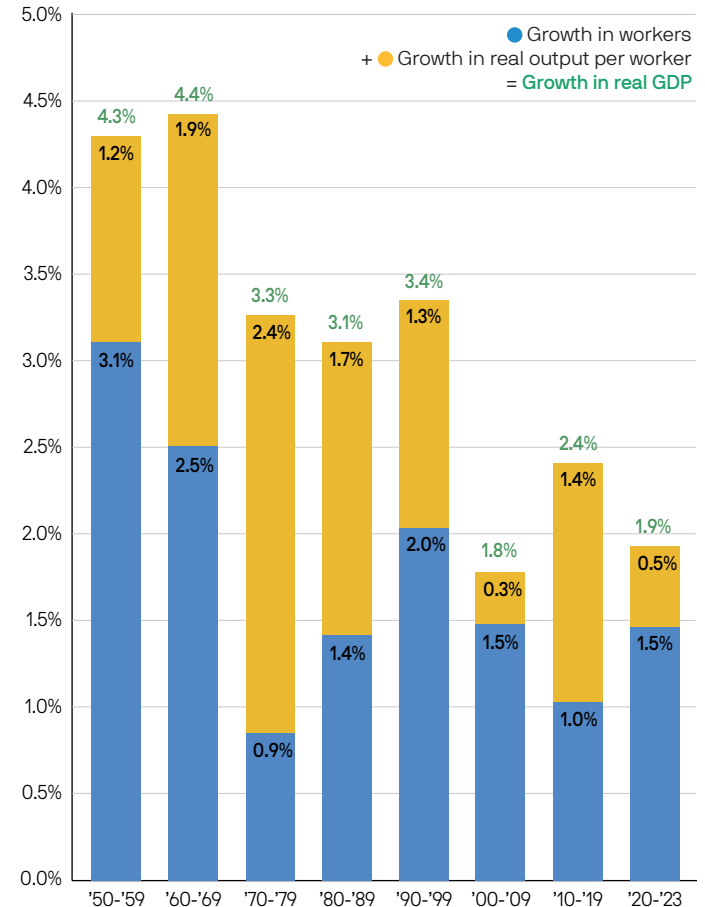


Exhibit 2C: Drivers of GDP growth

Average year-over-year % change



Source: J.P. Morgan Asset Management; (Top left) Census Bureau, DOD, DOJ; (Top left and right) BLS; (Right and bottom left) BEA. GDP drivers are calculated as the average annualized growth in the 10 years ending in the fourth quarter of each decade. *The latest period reflects 1Q20 to 3Q23. Future working-age population is calculated as the total estimated number of Americans from the Census Bureau, per the November 2023 report, controlled for military enrollment, growth in institutionalized population and demographic trends. Growth in working-age population does not include illegal immigration; DOD Troop Readiness reports used to estimate percent of population enlisted. Numbers may not sum due to rounding. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated. Guide to the Markets – U.S. Data are as of December 13, 2023.

Turning to energy, after slumping and surging in recent years, oil prices have fallen back to a more normal range of USD 80-90 per barrel of West Texas intermediate crude. Importantly, the tragic events in the Middle East have not, as yet, had a major impact on oil prices. Going forward, a combination of a sluggish global economy and increased output from the U.S. and non-OPEC nations should more than offset continued reductions in OPEC and Russian output, allowing oil prices to move sideways or down in the year ahead.

Importantly, the spread between gasoline prices and crude oil prices has narrowed significantly in recent months from very elevated levels. This has allowed gasoline prices to fall sharply and should allow for further modest declines in the year ahead. Relatively high natural gas inventories should keep natural gas prices steady or falling in the year ahead, contributing to a similar pattern for electricity prices. All told, we expect the energy component of CPI to post modest year-over-year declines throughout 2024.

Shelter comprises almost 35% of the CPI basket, of which roughly 8% is actual rent and 26% is “owners’ equivalent rent.” The government uses a complicated procedure to estimate these concepts that causes measured inflation in these areas to lag behind changes in rents negotiated in the market place. While this is hardly ideal, it does help economists predict trends in shelter inflation well in advance based on data on new leases, and given this trend, we expect shelter inflation to fall steadily throughout next year.

Finally, there is the rest of inflation, which has been boosted in recent years by a very restricted supply of new and used cars, a resurgence in airline travel following the pandemic, general supply chain issues and, to some extent, the impact of higher wage growth. However, all of these trends are easing, suggesting that this area of inflation will also moderate in the year ahead.

Pulling all of this together, and recognizing that consumption deflator inflation normally tracks a little cooler than CPI inflation, suggests that the year-over-year change in the consumption deflator is still on track to fall below 2% by the fourth quarter of 2024 – well ahead of the Fed’s current projections.

So, overall, a base case forecast of 2024 for 2024 – 2% growth, 0 recessions, 2% inflation and 4% unemployment. However, it should be recognized that there are many potential risks to this outlook, including a U.S. election, the lagged consequences of higher interest rates and very significant geopolitical tension. Any of these issues, or something else entirely, has the potential to trigger recession in a slow-growing U.S. economy, making 2024 a year for hope but not complacency.

International economy: Another year of divergence? Consumers will decide

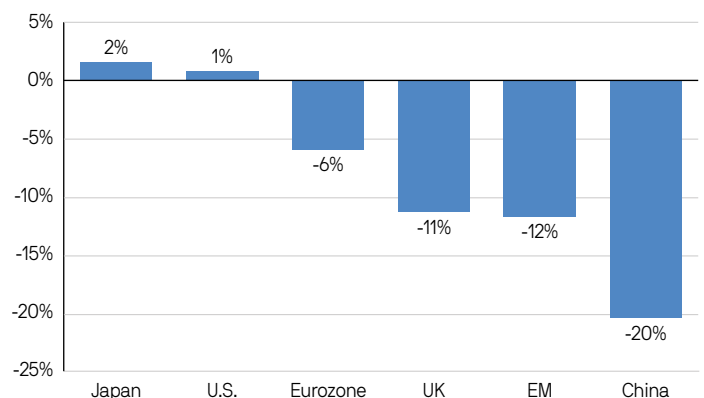
Despite the negative headlines, the global economy has grown 2.8% so far this year, in line with its 15-year average pace. Beneath the surface, however, a lot of divergence is on display – albeit not the divergence investors expected going into the year. The eurozone, UK, Canada and China ended up disappointing, while the U.S., Japan and emerging markets ex-China ended up surprising positively. In Europe, energy rationing did not occur, but neither did falling energy prices deliver an uplift, as consumers remained cautious and higher

rates weighed on manufacturing. In China, the end of “zero COVID policy” did not prove disruptive, but still low confidence led to a subdued recovery in investing, hiring and spending despite normalized mobility levels.

In 2024, the key question for the global economy is: will this divergence persist, and if not, will it close in the positive or negative direction? Central to this question is consumer spending (**Exhibit 3**). Japanese and U.S. consumer goods spending has been robust and is now above pre-pandemic trends, but consumers in the eurozone, UK and China have been cautious, with spending still 6%, 11% and 20% below trend, respectively. The good news is this is where excess pandemic savings persist. There is hope for some modest reacceleration in Europe, as inflation continues to fall (boosting real incomes) and the sticker shock of 2022’s energy price spike fades. In China, consumers may remain cautious for a bit longer given a weak housing market, but policy makers are now in pro-growth mode, providing a floor to growth at this year’s 5% pace. Meanwhile, like the U.S., growth in Japan and emerging markets ex-China should downshift from this year’s pace given used up savings. This should leave global growth less divergent, albeit a bit slower than its long-run average. A heavy calendar of elections next year may be consequential, especially the one in Taiwan (given geopolitical tensions with China) and India (given the positive reform momentum under the Modi government).

Consumer spending has room to catch up in Europe and China

Exhibit 3: Consumer goods spending, deviation of current spending vs. 2014–2019 trend growth



Source: national sources, J.P. Morgan Economic Research, J.P. Morgan Asset Management. Retail sales data is as of September 2023 except for the U.S. and China, which have data as of December 13, 2023.

Central bank action has been more uniform since 2022 (with notable exceptions of easy policy in Japan and China), as central banks hiked rates aggressively to combat globally elevated inflation. Next year, more divergence may creep in: as the year ends, U.S. and Eurozone core inflation has already retraced about half of its pandemic surge, the UK only a third, and Japan's is still hovering at its peak (**Exhibit 4**). The key to these differences is wages, with sticky wage growth in Europe and (finally) accelerating wages in Japan. This gives European central banks less breathing room to start cutting rates as soon or as quickly as the Fed and pressures the Bank of Japan to finally get going on exiting negative rates. The lone exception to stimulative policy should remain China, given below-target inflation and modest growth.

Next year should bring some continuation of the U.S. dollar downward trend that began in October 2022 due to narrowing growth and interest rate differentials, as well as flows returning to non-U.S. markets (as they began to in 2023). The risk to this thesis is U.S. recession fears returning, which would dampen investor sentiment again. Stronger international currencies should provide a relief for central bankers' fights against inflation and for U.S. dollar-based investors' international returns from this year's very small currency drag.

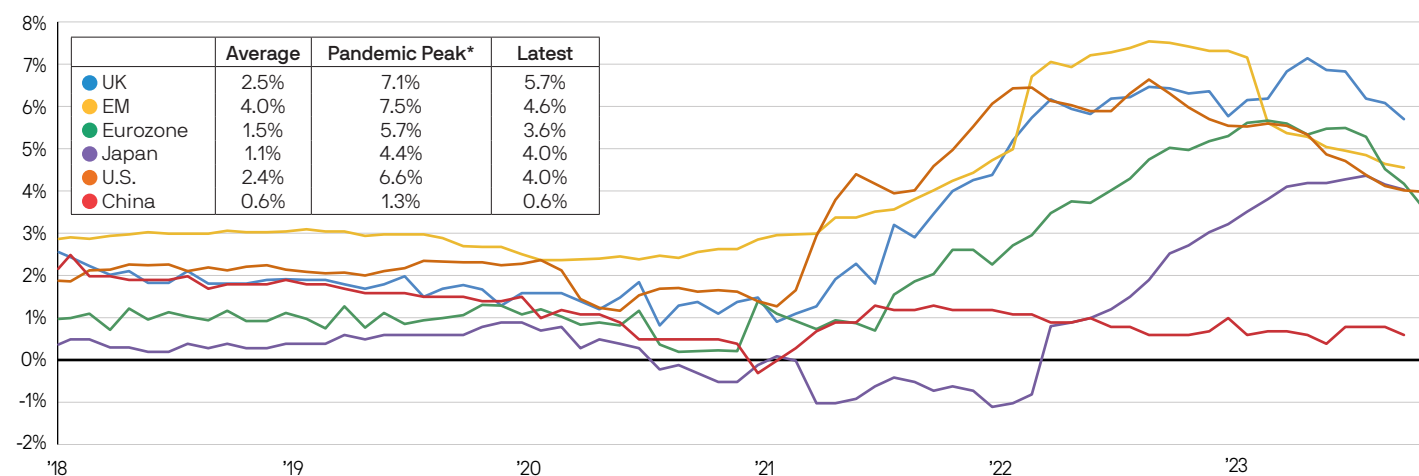
Fixed income: Prolonged pause or cautious cuts?

Recent data on inflation and labor markets and signals from the December Federal Open Market Committee (FOMC) meeting reinforce the assumption that the Federal Reserve is finished hiking rates this cycle. To be clear, economic activity indicate a decelerating economy, not an economy destined for a near-term recession, and while the Fed may not need to tighten further, it does suggest the central bank can keep rates higher for longer. Given the Fed is likely done tightening policy but will be in no rush to ease, investors are curious on how long-term rates may behave over the next year after spiking in the third quarter before settling down to ~3.9% at time of writing.

While it's not unreasonable to assume rates could move higher from here given quantitative tightening, softening demand for U.S. Treasury debt from foreigners and commercial banks, political uncertainty in Washington and increased Treasury supply due to higher deficit spending, history suggests (**Exhibit 5A**) that the timing of the last hike normally coincides with the peak in the U.S. 10-year Treasury yield. As highlighted, on average over the previous five tightening cycles, the U.S. 10-year has historically peaked 3 months prior to the last hike. Given the hawkish tilt in Fed commentary and firm economic data since its last hike in July, it's not surprising yields may have peaked 3 months after in October this year.

Progress on core inflation is less far along in Europe and Japan

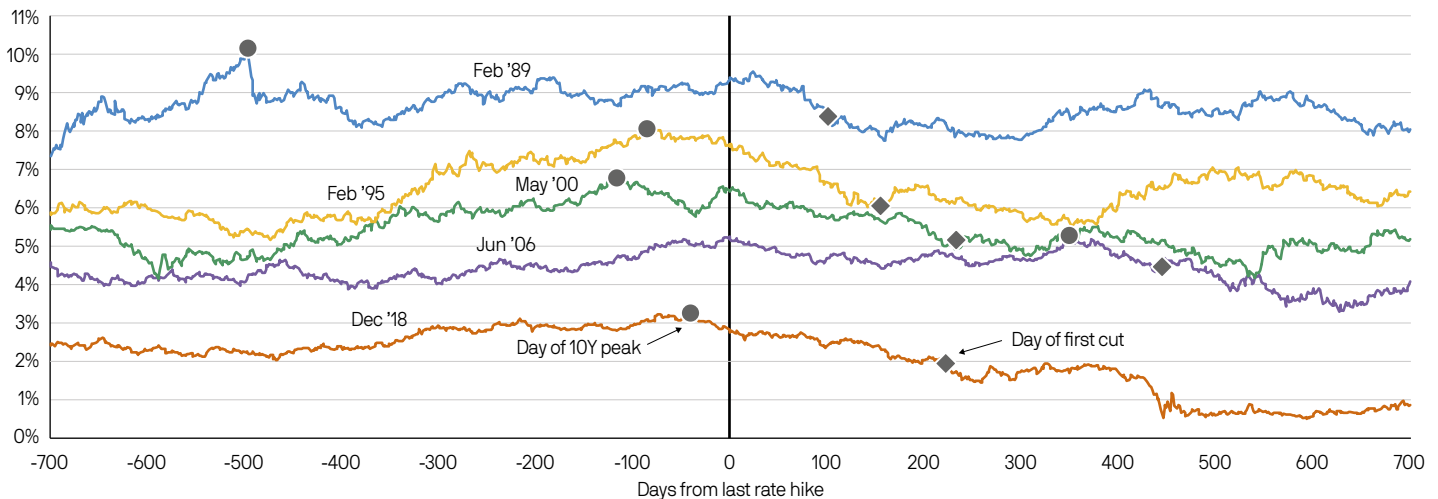
Exhibit 4: Core inflation, year-over-year, seasonally adjusted



Source: FactSet, national sources, J.P. Morgan Economic Research, J.P. Morgan Asset Management. Shows 15-year averages. "Latest" is as of October 2023 except for the Eurozone and U.S., which are as of November 2023. *The pandemic peaks for each country are as follows: UK - May 2023, EM - October 2022, Eurozone - March 2023, Japan - August 2023, U.S. - September 2022, and China - October 2021. Data are as of December 13, 2023.

Peak in U.S. 10-year Treasury yield tends to coincide around the last Fed rate hike

Exhibit 5A: Percent, 0 = day of last rate hike



Source: Bloomberg, J.P. Morgan Asset Management. Label represents the month in which the last rate hike occurred. Data are as of December 13, 2023.

Exhibit 5B: Rate hiking cycles and the U.S. 10-year

Month of last hike	Month of 10Y peak around last hike	Peak 10Y relative to last hike (months)	Month of first cut	Change in 10Y from last hike to first cut
Feb '89	Oct '87	-16	Jun '89	-0.95%
Feb '95	Nov '94	-3	Jul '95	-1.48%
May '00	Jan '00	-4	Jan '01	-1.51%
Jun '06	Jun '07	11	Sep '07	-0.73%
Dec '18	Nov '18	-1	Jul '19	-0.70%
Average		-3		-1.07%

Notably, not only do long rates tend to peak near the final rate increase, but long rates have also consistently declined following the end of a tightening cycle. On average, the U.S. 10-year has fallen by 107 basis points during the period between the last rate hike and the first rate cut (**Exhibit 5B**). Moreover, yields tend to fall further once the Fed begins cutting rates by an additional 46 basis points on average, six months after the first cut.

Since peaking at 5% in mid-October, the 10-year has already fallen by 1%, but we believe there is room for long-term rates to fall even further while Fed remains on hold, particularly if growth and inflation continue to trend lower. This suggests that investors should consider stepping out of cash and extending duration as falling yields could generate strong price appreciation in longer maturity bonds.

Lower rates, lower volatility

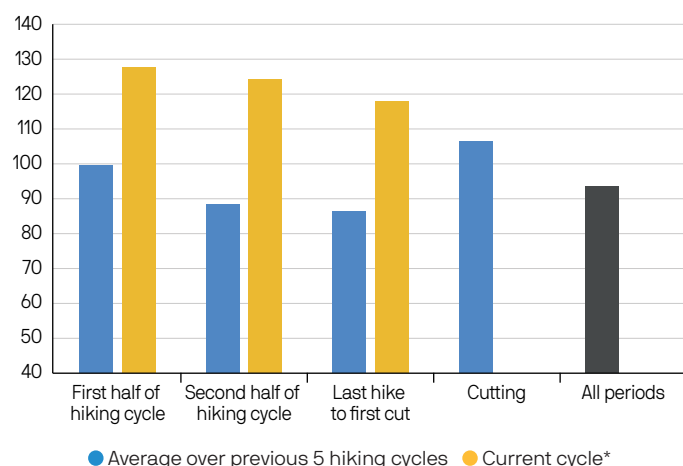
Over the past two years, aggressive tightening from the Federal Reserve, resilient data relative to expectations and technical factors have caused elevated interest rate volatility. Historically, as evidenced in **Exhibit 6**, interest rate volatility tends to be highest when the Fed first begins raising interest rates and when the Fed is cutting interest rates. This makes intuitive sense; when the Fed first begins hiking rates it is often unclear how high rates will go before economic activity begins to come under pressure, leading to uncertainty around the path forward for rates. Similarly, when the Fed is cutting interest rates, it is often in response to a recession leading to a quick shift in the outlook.

This cycle has experienced higher rate volatility than in any of the previous five rate-hiking cycles, and while volatility has come down slightly since July, it is still elevated relative to history. That said, we believe rate volatility should fall for two reasons. First, a decelerating economy should keep the Fed firmly on hold through the first half of 2024. Second, assuming the economy avoids a recession next year, we expect the Fed to reduce policy rates gradually and avoid a knee-jerk pivot to aggressive rate cuts.

Given this, rate volatility should continue to drift lower next year providing some much-desired stability in rates and helping support spread products. All things considered, bond investors should prepare for brighter days from both an income and capital appreciation perspective.

While current interest rate volatility remains elevated relative to history, volatility tends to decline later in rate hiking cycle and when the Fed is on hold

Exhibit 6: Average daily level of MOVE index during previous five rate hiking cycles and current cycle



Source: Haver Analytics, J.P. Morgan Asset Management. Averages are based on the last five hiking/cutting cycles beginning with the hiking cycle in March 1988. Interest rate volatility is measured by the Merrill Lynch Option Volatility Expectations or MOVE index. The MOVE is an index measure of Treasury yield volatility and is based on one-month over the counter implied yield volatility (normalized) weighted as follows: 20% 2-year tail, 20% 5-year tail, 40% 10-year tail, 20% 30-year tail. A higher reading indicates higher interest rate volatility. *The MOVE index for the current cycle assumes the first hike was in March 2022 and the last hike was on July 2023. The last hike to first cut volatility for the current cycle is the average level of the MOVE index from July 2023 to present. Data are as of December 13, 2023.

U.S. equities: Tempering expectations

2023 has turned out to be a surprisingly strong year for equity markets, with the S&P 500 boasting double-digit returns. However, investors should temper expectations for 2024 as estimates for profit growth look lofty, volatility has been unusually low, valuations could come under further pressure and economic growth is likely to slow.

Analysts' expectations show earnings growing by 11% next year, double the long-term average, while our models are estimating 5-6% growth. Dissecting the sources of earnings growth, margins could maintain stability, but revenues are likely to slow. On margins, pricing power is waning, but input costs and wages are decelerating. Interest costs remain high, but 49% of S&P 500 debt is fixed beyond 2030, with no more than 7% maturing in any calendar year until then. Many S&P 500 companies also maintain ample cash balances, which are earning meaningful interest. Therefore, interest costs as a share of profits are falling. However, disinflation, slowing economic growth and headwinds to the consumer are likely to constrain revenues. If the U.S. economy goes into recession, profit growth would likely contract, weighing on stocks.

In addition, unusually low equity volatility in 2023 could be difficult to sustain in 2024. The VIX was at 16.8 on average this year, compared to 19.5 over the last 15 years, while interest rate volatility has been elevated to early pandemic levels since the Fed began raising rates. If the U.S. economy falters, interest rate volatility could pass the baton to equities.

Finally, on valuations, valuation dispersion deepened this year, with the top 10 stocks 38% more expensive relative to 25-year averages vs. 14% for the rest of the S&P 500. The S&P 500 overall is about 17% expensive; however, valuations since the Great Financial Crisis have been unencumbered by high rates. Looking at forward P/E ratios over the last 25 years, today's real interest rate implies that stocks are 30% overvalued. We don't expect a massive imminent correction while profits are still growing, but valuations may need to reset over time in a higher-for-longer rate environment.

Therefore, from an allocation perspective, we continue to favor quality exhibited in large caps. Small caps have seen a significant valuation reset, but are levered to domestic growth, which could slow. Furthermore, margin pressures could be particularly acute even if input and wage costs are slowing, as 38% of outstanding debt for small caps is floating rate, raising concerns that higher rates could result in more immediate pressure. Within large caps, it's less about growth vs. value, as we have seen significant divergence even within sectors and industries, and more about stock selection, gearing toward companies with resilient profits, solid balance sheets and favorable relative valuations (**Exhibit 7**).

2024 estimates have declined, but still look lofty

Exhibit 7: 2024 S&P 500 consensus EPS estimates, 12/31/2022 = 100, daily



Source: FactSet, J.P. Morgan Asset Management. Data are as of December 13, 2023.

International equities: A lot more than meets the eye

Despite divergent economic growth and some disappointment in parts of the world, international equity performance has been strong: up 10% year-to-date (in U.S. dollar terms). Beneath the surface, even stronger performance has occurred as Europe ex-UK and Japanese equities are both up 15%. In emerging markets (EM), there is more strength underlying the 5% return this year, as China is substantially dragging on performance and EM ex-China is up 12% this year. Style differences have also been significant, with international value outperforming international developed value outperforming international developed growth by 3 percentage points. Lastly, time frames also matter: the rebound in international performance began in October

2022, and on a rolling one-year timeframe, international developed markets have kept pace with the U.S., especially international value which has outperformed U.S. value by 2 percentage points (**Exhibit 8**).

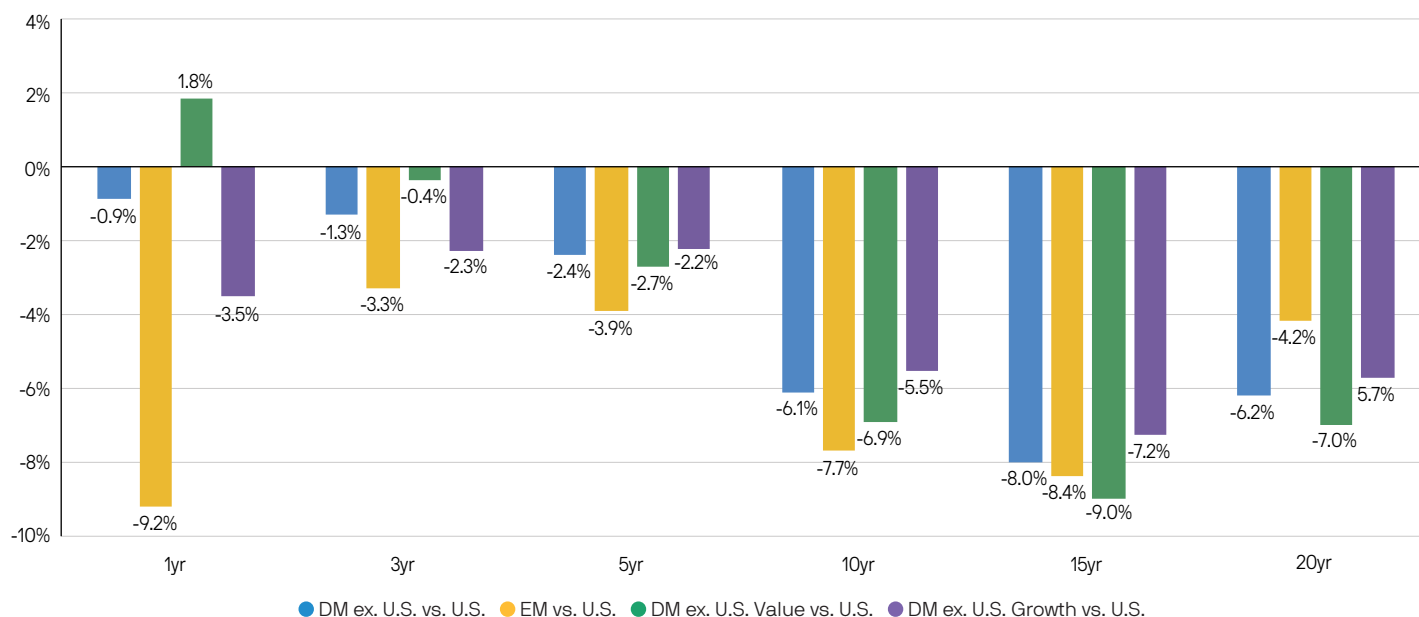
In addition to strong overall performance, international returns have seen a healthy breadth, driven by less concentration than U.S. performance: the spread in year-to-date returns between the top ten stocks and the remaining ones is only 7 percentage points in developed markets excluding the U.S. versus 53 percentage points in the U.S. In addition, performance has been driven by an equal contribution from multiple expansion, earnings growth and dividends. Investors have taken notice of the turnaround in international performance: international equities have been the fifth strongest category for net new flows so far this year.

Despite this year's strong performance, the starting point for international equities next year is favorable, as multiples are still sitting 5% below the 10-year average (and at double the normal discount to the U.S. at 33%). The improved long-term international outlook for stronger nominal growth and positive interest rates (vs. last decade's weak and negative outlook), combined with a turnaround in sentiment toward China from this year's very depressed levels, can lead to further multiple expansion. On earnings, Europe and Japan should see somewhat slower earnings growth than this year at low single digits, as nominal growth decelerates from this year's boomy pace. However, the new focus on increasing shareholder returns through buybacks should continue to provide a boost. EM should see much better earnings growth next year at high double digits, as commodity earnings swing from a big drag to a big support given year-over-year comparisons and as Chinese earnings estimates should improve given more policy support to the economy. Lastly, international equities should continue to provide a steady income boost, with dividend yields sitting at 3% (nearly double those in the U.S.).

Style leadership may vary by region, with value continuing to lead the way in Europe and Japan (as it often does in developed ex-U.S. led outperformance). Growth may take over the baton in EM given a better outlook for the semiconductor cycle, combined with more confidence in China's private sector growth, which should fuel technology and consumer-related sectors. As always with international, there will be a lot more than meets the eye beneath the surface, and with valuation spreads near record highs, active managers have a chance to uncover it.

International relative performance may be changed, led by Value outperformance

Exhibit 8: Relative returns vs. the U.S., USD, total return, annualized



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. "DM ex. U.S." is represented by the MSCI EAFE Index, "U.S." is represented by the S&P 500 Index, "DM ex. U.S. Value" is represented by the MSCI EAFE Value Index, and "DM ex. U.S. Growth" is represented by the MSCI EAFE Growth Index. The 1yr return shown is a cumulative return. Data are as of December 13, 2023.

Alternatives: As the dust settles

Public markets repriced significantly in 2022; 2023 was supposed to be the year when private markets followed suit. Repricing has begun and is still in various stages. It is still underway in real estate. It has been somewhat more benign thus far than expected in private equity as profits and economic growth have been resilient. It is likely yet to come in private credit once the economy slows, higher-for-longer interest rates apply pressure to floating rate loans and defaults pick up. Because transaction volumes have been lighter, it can be difficult to get a firm gauge on valuations as assets simply aren't trading frequently enough to give a clear barometer.

Still, although the dust is still settling on valuations, alternative investments can support the outcomes investors seek in portfolios. Some of the most pressing concerns for 2024 will likely be diversification, inflation hedging and alpha.

Diversification proved elusive in 2023. Bonds are tracking to narrowly avoid a third consecutive annual decline and interest rate volatility has been severe. Assets like gold and the U.S. dollar are expensive and produce no income. If diversification proves to be evasive again in 2024, infrastructure investments have provided low or

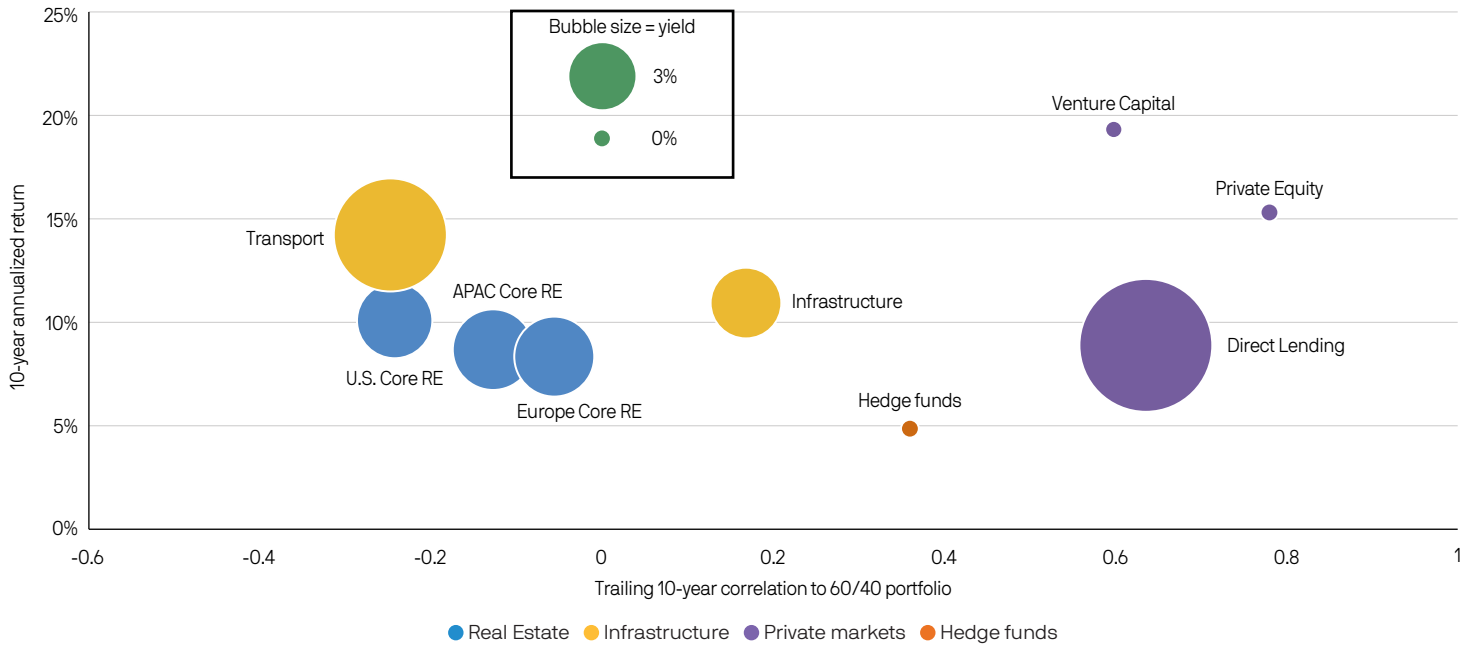
negative correlation to the public markets and stable income with minimal volatility over time. With industrial policy back in vogue across the U.S., Japan, India and Europe, the structural tailwinds are robust.

U.S. inflation saw significant declines in 2023 and could reach the Fed's 2% goal sooner than anticipated in 2024. However, as we note in our *Long-Term Capital Market Assumptions*, U.S. inflation could be closer to 2.5% over the next decade. If that is the case, real estate has proven to be an effective inflation hedge over time as higher costs can be passed on via higher rents. Public REITs have already repriced notably and could be the first place to deploy capital.

Unexpectedly buoyant public equity markets lavished investors with double-digit returns in 2023. However, higher-for-longer rates may pose a challenge to beta but allow alpha producers like stock pickers and private equity managers to shine in a less navigable environment going forward. In fact, history shows that performance from vintage years (the year when a private equity fund first deploys capital) that are economically challenging have tended to produce higher median returns. Still, quality and selectivity will be critical in both public and private equity (**Exhibit 9**).

Alternatives can provide alpha, income and diversification

Exhibit 9: 10-year correlations and 10-year annualized total returns, quarterly, 2013-2022



Source: Burgiss, Cliffwater, Gilberto-Levy, HFRI, MSCI, NCREIF, FactSet, J.P. Morgan Asset Management. Correlations are based on quarterly returns over the past 10 years through 2022. A 60/40 portfolio is comprised of 60% stocks and 40% bonds. Stocks are represented by the S&P 500 Total Return Index. Bonds are represented by the Bloomberg U.S. Aggregate Total Return Index. 10-year annualized returns are calculated from 2013 – 2022. Indices and data used for alternative asset class returns and yields are as described on pages 8, 9, and 11 of the Guide to Alternatives. Yields are based on latest available data as described on page 8 of the Guide to Alternatives. December 13, 2023.

Asset allocation in 2024: Expect the unexpected

Investors looking back at 2023 face a slew of contradictions. Inflation eased, the labor market cooled, a war broke out and banks failed, yet the Fed pushed rates higher; despite lower confidence and higher borrowing costs, the U.S. consumer kept consuming; growth equities outperformed value, though stretched valuations and rising rates should have encouraged the opposite; and the international recovery has been fragmented despite China finally emerging from the pandemic.

As a result, when investors look forward to 2024, asset allocation must reflect a hard-learned mantra: “expect the unexpected.”

The health of the U.S. economy remains top of mind, and investors are likely confounded by its remarkable resilience. While tighter lending standards, weaker job gains and lower savings should result in some “belt tightening,” a recession may once again be avoided.

Some of this economic optimism can be attributed to growing confidence that the U.S. has already pushed through peak rates, with the Fed likely finished hiking. A lower Federal Funds Rate should translate into lower borrowing costs more broadly, providing a reprieve to indebted Americans. Meanwhile, the international economic laggards of 2023, like China and Europe, should accelerate through 2024 as other economies gradually lose steam, resulting in less divergence across global growth. Still, politics at home and abroad have the potential to temporarily sour this outlook.

In other words, investing remains a challenge, and asset allocation must reflect the inherent uncertainty of a world very clearly in flux.

Assuming that rates fall in 2024, bond investors should embrace intermediate-duration instruments while having confidence that attractive coupons will act as a “cushion” in portfolios if the rate view unexpectedly changes. They should also shore up quality to account for tighter-than-expected spreads and protect against unpredicted economic risk.

From an equity perspective, stretched valuations and overly optimistic earnings projections, coupled with a slowing economy, mean U.S. stock investors should look toward profitability in large cap names. This favors an allocation to quality regardless of sector and underscores the importance of security selection. Outside the U.S., favorable valuations and an improved growth outlook, including positive interest rates, should translate to further multiple expansion, benefiting most regions around the world and emerging markets in particular. Moreover, a declining dollar should provide an extra tailwind to local currency performance.

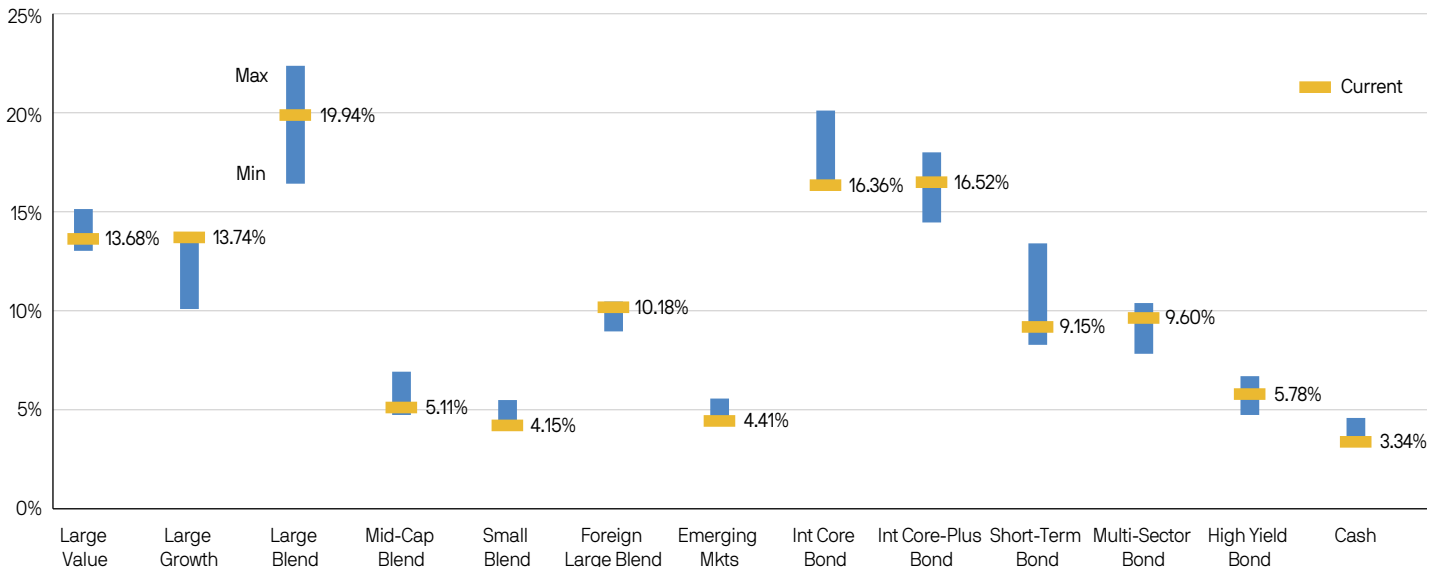
This backdrop is also supportive of alternative assets. Infrastructure investments can dampen portfolio volatility, particularly with a renewed interest in expansive industrial policy; real estate can protect against structurally higher inflation; and private equity and hedge funds can thrive if the beta trade weakens. Against this backdrop, however, investors should recognize that a repricing in some private markets is possible, underscoring the need for a long-term view.

Looking at the current portfolio positioning of individual investors, this outlook has only partially been implemented (**Exhibit 10**). Within fixed income, appetite for higher-quality, extended-duration bonds has increased since the start of the year. Within equities, growth investing is back in vogue, likely a reflection of investors chasing momentum given this year's surprise rally; this has somewhat unwound the shift toward value that had occurred earlier in 2023 and has driven up duration in stock allocations. Meanwhile, interest in non-U.S. stocks has increased since the beginning of the year, albeit mostly through passive vehicles, with investor allocations trending higher than the historical average despite a hazy geopolitical horizon. Finally, investors are still broadly overweight cash, weighing on returns in 2023 and positioning portfolios poorly relative to the opportunity set in 2024.

All told, the investing landscape is challenged, and predicting the winners and losers in periods of uncertainty is nearly impossible. Instead, investors would do well to expect the unexpected, diversify and lean on active management, stepping out of cash and into risk assets to take advantage of the anticipated changes ahead.

Investors are fairly well positioned to take advantage of market opportunities

Exhibit 10: Average allocations in moderate portfolios, last 12 months



Source: J.P. Morgan Asset Management. Data as of December 13, 2023.

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Index Definitions

All indexes are unmanaged and an individual cannot invest directly in an index. Index returns do not include fees or expenses.

The **Composite PMI future output index** is a gauge of economic growth and can provide valuable insights into GDP, service sector growth and industrial production trends well ahead of official data.

The **Bloomberg Euro Aggregate Corporate Index** is a benchmark that measures the corporate component of the Euro Aggregate Index. It includes investment grade, euro-denominated, fixed-rate securities.

The **Bloomberg Pan-European High Yield Index** measures the market of non-investment grade, fixed-rate corporate bonds denominated in the following currencies: euro, pounds sterling, Danish krone, Norwegian krone, Swedish krona, and Swiss franc. Inclusion is based on the currency of issue, and not the domicile of the issuer. The index excludes emerging market debt.

The **Bloomberg U.S. Aggregate Treasury Bond Index** is a broad-based benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market. This includes Treasuries, government-related and corporate securities, mortgage-backed securities, asset-backed securities and collateralized mortgage-backed securities.

The **ICE BofA MOVE Index** tracks fixed income market volatility.

The **J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)** is an expansion of the J.P. Morgan Corporate Emerging Markets Bond Index (CEMBI). The CEMBI is a market capitalization weighted index consisting of U.S. dollar denominated emerging market corporate bonds.

The **J.P. Morgan Emerging Markets Bond Index Global Diversified (EMBI Global Diversified)** tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, Eurobonds. The index limits the exposure of some of the larger countries.

The **J.P. Morgan GBI EM Global Diversified** tracks the performance of local currency debt issued by emerging market governments, whose debt is accessible by most of the international investor base.

The **J.P. Morgan Leveraged Loan Index** is designed to mirror the investable universe of U.S. leveraged loans.

The **MSCI ACWI (All Country World Index)** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

The **MSCI Europe Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe.

The **MSCI Pacific Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the Pacific region.

The **MSCI World with USA Gross Index** measures the performance of the large and mid-cap segments across 23 Developed Markets (DM) countries. With 1,540 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The **Russell 1000 Index**[®] measures the performance of the 1,000 largest companies in the Russell 3000.

The **Russell 1000 Value Index**[®] measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The **S&P 500 Index** is widely regarded as the best single gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The **S&P 500 Index** focuses on the large-cap segment of the market; however, since it includes a significant portion of the total value of the market, it also represents the market.

The **U.S. Treasury Index** is a component of the U.S. Government index.

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