

# Mid-Year Investment Outlook 2024

Finding value, avoiding traps



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## In brief

- As we look to the next 12 months, we expect global growth to remain robust, although its geographical composition is changing.
- With resilient growth comes resilient inflation, but we think central bankers will be willing to tolerate some overshoot of their targets.
- Interest rates are set to move modestly lower in most major regions but are likely to remain considerably higher than pre-pandemic levels.
- In equities, we think investors need to look beyond recent winners as the shifting economic backdrop supports a broadening of returns.
- For bond investors, a higher for longer interest rate environment may change the source of fixed income returns, with healthier coupons and less reliance on capital gains.

## Economic Outlook: Resilience in growth...and inflation

We came into the year with markets expecting (1) an acceleration in global growth and corporate earnings, (2) declining inflation, and (3) massive central bank rate cuts. Adding in some artificial intelligence-related excitement, it was hoped that a new and enhanced version of ‘Goldilocks’ was back. In anticipation, bond and stock prices rallied strongly through the turn of the year.

The combination of all three of these expectations seemed to be too good to be true, and so it has proved. Growth has been resilient...but so too has inflation. This dynamic supported risk assets but challenged government bond markets as the prospect of large and imminent rate cuts has diminished.

### Growth broadening

As we look to the next 12 months, we expect global growth to be robust, although its geographical composition is changing.

The US consumer is coming off its sugar high as the scale of direct fiscal support for households and pandemic savings have dwindled. Higher interest rates are not impacting existing homeowners given they fixed their mortgages at pre-pandemic lows, but the cost of unsecured lending is slowly starting to bite.

Some moderation in growth is welcome as the US was definitively overheating last year. However, economies have an unpleasant tendency to move from too hot to too cold. Soft landings are rare. As yet, there are few signs of impending trouble. Corporate balance sheets are strong, so a modest slowing in growth is unlikely to lead to job shedding allowing the labour market to continue underpinning US consumer strength.

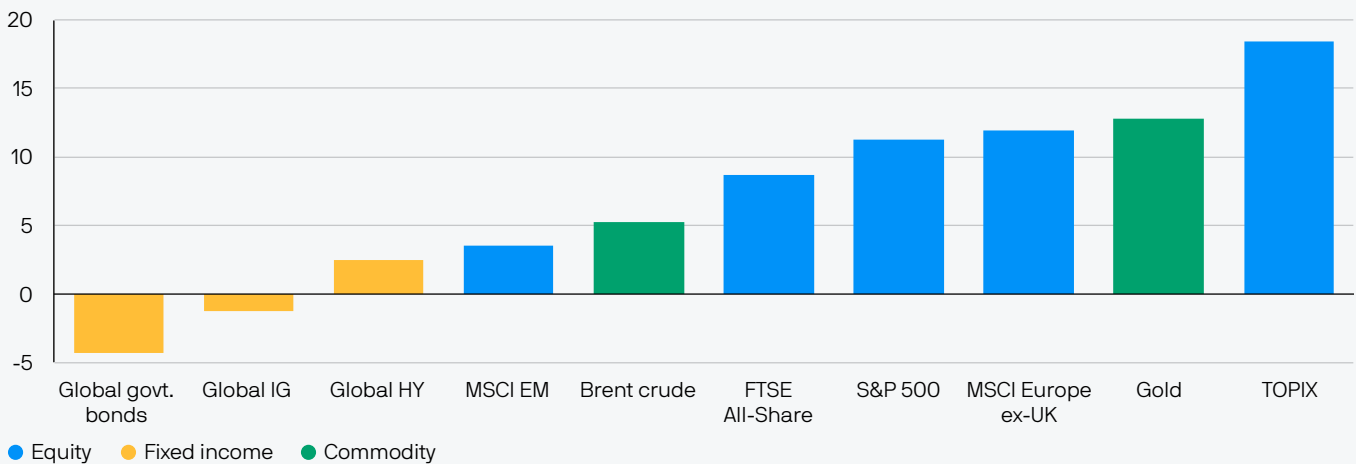
The balance sheet that looks distinctly less healthy in the US is the government’s. Indeed, part of the US economy’s resilience is surely owed to the whopping 6% government deficit, something never before seen in a period of record low unemployment.

However, reducing government spending or raising taxes to tackle this deficit is notably absent from the political discussions taking place ahead of the US election. Indeed, if anything both candidates are talking about more spending and fewer taxes. As the source of the world’s reserve currency, the US has long been described as having an ‘exorbitant privilege’, allowing it to run deficits that others cannot. It certainly seems to be pushing that privilege to the limits, which is a risk factor for the coming year (see [Scenarios and risks](#)).

Exhibit 1: Resilient growth and inflation has pleased equity markets more than fixed income

Year-to-date returns

%, total return



Source: Bloomberg, BofA, FTSE, ICE, LSEG Datastream, MSCI, S&P Global, TOPIX, J.P. Morgan Asset Management. Global government bonds: Bloomberg Global Aggregate – Government; Global IG: Bloomberg Global Aggregate – Corporate; Global HY: ICE BofA Global High Yield. Equity returns are in local currency, fixed income and commodity returns are in USD. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

As momentum is weakening in the US, the opposite is true in Europe. The cost-of-living shock is fading and the European economy is entering a more favourable environment, with growth picking up meaningfully, albeit from very low levels. As real wages and consumer confidence rise, a recovery is evident in improving retail sales and services demand. Solid labour markets, a further expansion in real wages and a significant amount of pandemic-era savings that are yet to be spent have the potential to continue to support consumption.

The slow implementation of Recovery Fund investments (especially in Italy) should see public spending contribute further to this rebound. Although the European Commission has become increasingly vocal about a need to return to fiscal prudence, we doubt this will have much impact on spending plans.

The macro outlook for more industrial countries such as Germany should also be supported by a recovery in demand for manufactured goods. Weakness in manufacturing in the past two years likely reflects the more intense impact the cost shock had on this sector of the economy, as well as an overaccumulation of goods during the pandemic. However, this overhang appears to have normalised and demand for manufactured goods globally seems to be improving.

Overall, we are not looking for Europe to overtake the US, but a convergence in activity looks likely.

### Inflation is sticky but bearable

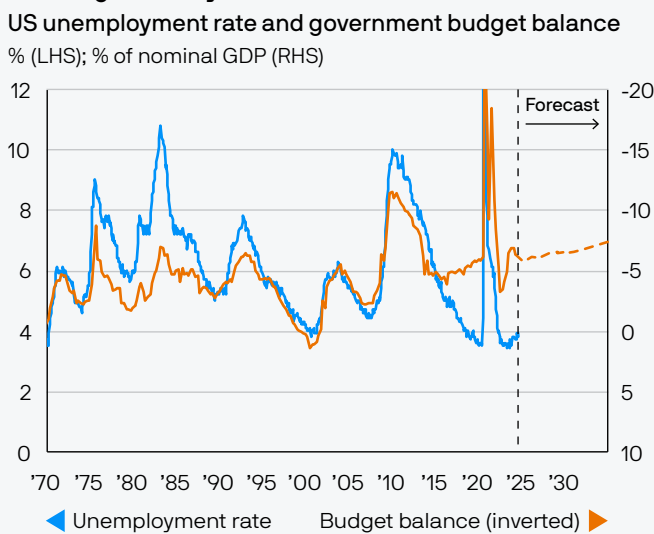
The key question today is whether growth remaining firm in the US and recovering in Europe will be consistent with inflation returning quickly and sustainably to the 2% target.

A large part of the drop in US inflation was thanks to food and energy prices stabilising. These favourable 'base effects' were slower to materialise in Europe, and are now helping headline inflation fall. But underlying inflation in the US is proving very sticky at around 3.5%. In the eurozone and UK, the underlying components, like services, also appear to be holding steady at around 4% and 6% year-on-year respectively.

In our view, this stickiness in core inflation is likely to persist. Significantly, however, so long as US growth slows and Europe's acceleration is modest, we don't see a major reacceleration in inflation on the cards. The labour market is firm, but is no longer overheating.

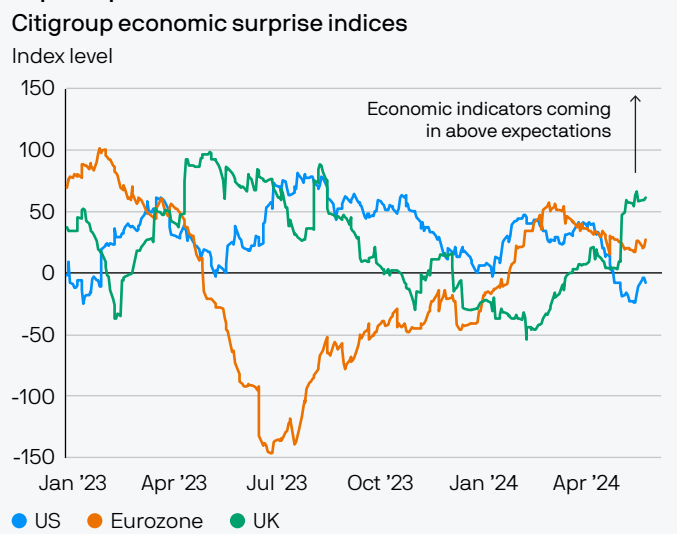
Workers are not tempted into new jobs with the promise of ever higher wages as they were a year ago. In Europe, the prevalence of indexation is likely to see lower headline inflation feed into modestly slower wage growth.

**Exhibit 2: The US fiscal deficit is uncomfortably high for a booming economy**



Source: BEA, BLS, CBO, Conference Board, LSEG Datastream, J.P. Morgan Asset Management. Budget balance forecast is CBO, assuming the provisions within the Tax Cuts and Jobs Act of 2017 that are currently due to expire at the end of 2025 are extended. Data as of 31 May 2024.

**Exhibit 3: While the US economy slows, Europe is starting to pick up**



Source: Bloomberg, Citi, J.P. Morgan Asset Management. Data as of 31 May 2024.



**Even if inflation is somewhat sticky in the region of 3% year-on-year, our judgment is that this will prove good enough for the West’s central banks.**

Crucially, even if inflation is somewhat sticky in the region of 3% year-on-year, our judgment is that this will prove good enough for the West’s central banks. Communication from these central banks over the last six months has, in our view, revealed a lot about their reaction function and the growth risks they are willing to tolerate to bring inflation back to 2%. In this heightened political environment, it seems that central banks will tolerate a continued overshoot in inflation as a price worth paying to ensure unemployment remains low.

We therefore expect all major Western central banks to begin cutting rates before the end of the year, which they will present as normalising policy from restrictive levels rather than easing. In the absence of a shock that upsets growth, we do not see much more than 100 basis points of cuts over the next 12 months, so rates will stay much higher than in the pre-pandemic era.

While the recent move from low to ‘normal’ interest rates has been a painful journey for bond investors, we should remind ourselves that the outlook now for fixed income is positive. Bonds are back doing what they should, which is providing us with decent income and diversification from growth shocks (see [Higher for longer is good for fixed income](#)). Importantly, despite interest rates staying relatively high, we think there are better places for investors to find [durable income](#) than in cash.

Resilient growth and sticky inflation is, all other things being equal, good news for corporate earnings. While overall this backdrop should provide support for risk asset valuations, we expect the earnings recovery to become more evenly spread between sectors and regions over the coming 18 months (see [Shifting gears in equity leadership](#)).

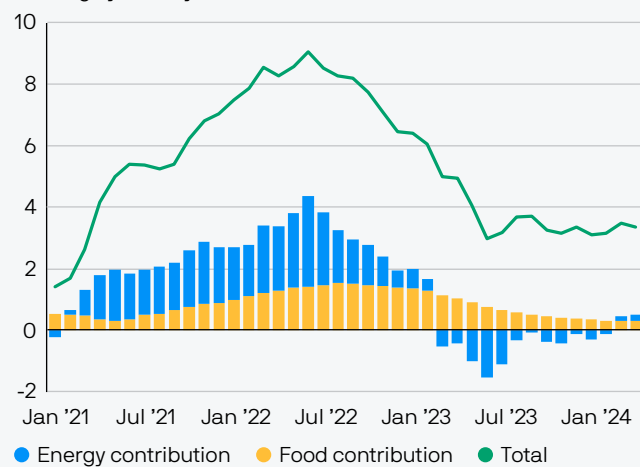
**China still lacking a growth engine, but elsewhere in emerging markets activity is improving**

Over in Asia, there are few signs yet that China is on a meaningful upswing. Consumers are reluctant to spend given the recent fall in wealth following a large equity market rout and the slow but continual decline in property prices. Beijing has announced further stimulus measures over the first half of 2024, including scrapping the floor for mortgage rates, reducing downpayment requirements and, most significantly, a new fund which will allow local governments to acquire excess

**Exhibit 4: US inflation has plateaued**

**US headline inflation breakdown**

% change year on year

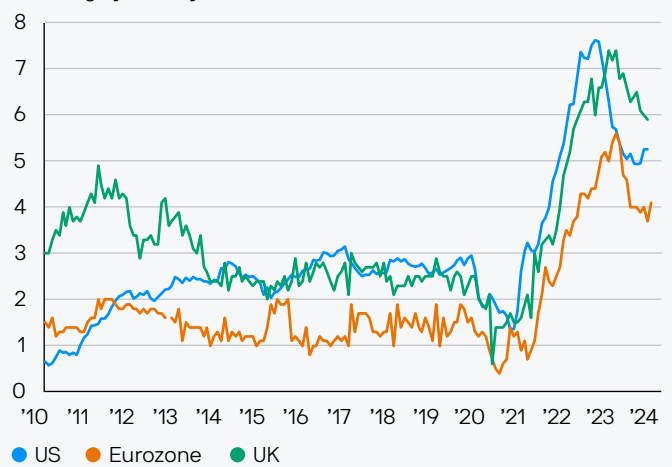


Source: BLS, LSEG Datastream, J.P. Morgan Asset Management. Data as of 31 May 2024.

**Exhibit 5: Services inflation remains stubbornly elevated**

**Services inflation**

% change year on year



Source: BLS, Eurostat, LSEG Datastream, ONS, J.P. Morgan Asset Management. Data as of 31 May 2024.

housing supply and convert it to affordable housing. Yet given the scale of the property problem, these steps look more likely to prevent the situation deteriorating further, rather than provide the catalyst for a meaningful recovery.

The difficulty for Beijing is that in the absence of a consumer upswing, there is no obvious engine for a strong growth recovery. The lack of domestic demand is leading Chinese companies to focus on exports, which had sent a disinflationary impulse through the global economy. However, this is starting to upset Western leaders and we appear to be on the cusp of a new trade war.

One of the questions we are often asked is whether broader emerging markets (EM) can perform if Chinese markets stay lacklustre. In the short term, the usual routes by which Chinese growth tends to support the broader complex – such as commodity demand and tourism – will remain challenged. But there are cyclical and structural supports that could build over time to support activity elsewhere in EM.

Many EM economies were much faster to respond to the emergence of post-pandemic price pressures, and therefore have controlled inflation with high real rates. Ahead of the game on the way up, they have scope to take rates down as soon as it is absolutely clear that the next move from the Federal Reserve is down.

In addition, some of China's woes are benefitting other EM countries. There is now compelling evidence that companies are shifting their supply chains to other economies, perhaps 'friend-shoring' to protect themselves from the potential for further geopolitical conflict. In 2015, before relations between the US and China started to deteriorate, China accounted for 21% of US imports. That has now fallen to 14%. In contrast, South Korea, Vietnam, Taiwan and ASEAN have seen their share rise from 11% to 17% of US imports. Mexico is another key beneficiary, with its share of US imports rising from 13% to 16%.

### **Political risk is prevalent but hard to position for**

Do conflicts and elections – particularly in the US – have the potential to upset this relatively benign macro backdrop?

Despite the harrowing continual loss of life from the ongoing conflicts, we do not foresee significant economic or market ramifications. Western economic links to Russia are now entirely severed, and Europe has enough liquefied natural gas storage in train for

us to stop worrying about major gas price spikes over the winter. In the Middle East, our judgment is that Saudi Arabia has both ample oil production capacity to prevent an oil price spike and the incentive to do so, even if Iranian supply were affected (see our recent [On the Minds of Investors](#) publication).

European Parliament elections resulted in a move in favour of right-wing parties, at the expense of support for the Green Party. While this is unlikely to affect any near-term policy decisions, it is reflective of the broader shift we are seeing across the West of countries both 'turning inward' – focusing on their national interests at the expense of trade and the free flow of migration – and becoming more hesitant about climate change policies as the short-term impact of internalising the cost of carbon becomes more apparent.

The UK election is unlikely to be a major global market mover. Polls point to a shift in power from the Conservatives to the Labour Party. But the Labour Party has become more centrist in recent years and both parties live in the shadow of the Liz Truss's mini-budget crisis, so are both focused on a narrative of fiscal prudence and economic stability (see our recent [On the Minds of Investors](#) publication).

With regards to the US election, we have to be very humble about our conviction on how this will affect the US and global markets. At this stage we do not know for sure who will win, or whether they will have full control of Congress and therefore the ability to enact their full agenda (see our [US election hub](#)).

If former president Trump does regain the White House we should be cautious about expecting a repeat of the policies that were supportive for the US stock market. Tax cuts, alongside measures to quickly curb migration and raise tariffs on imports, could all ignite inflation concerns and bond volatility. Tariffs and disputes about partnership in global defence could also challenge relations between the US and Europe. However, in the past we have tended to see that an external threat in fact galvanises Europe towards greater internal cooperation.

Overall, we caution against 'trading the election', aside from avoiding large overweights in positions that might be vulnerable.

## Equities Outlook: Shifting gears in equity leadership

Stock market concentration is increasingly under scrutiny. Since the start of 2023, 60% of S&P 500 returns can be attributed to just three companies and the magnificent seven stocks (Microsoft, Nvidia, Apple, Alphabet, Amazon, Meta and Tesla) now account for a mammoth 32% of the index. At a regional level, US companies now make up a near-record 64% of the global equity market.

These leadership dynamics are clearly not new: macroeconomic factors have been working in favour of the US for most of the past 15 years. While Japan battled deflation, Europe grappled with a sovereign debt crisis and subsequent austerity. Emerging markets, meanwhile, dealt first with the 2013 taper tantrum and then a series of China-related shocks. In contrast, the US economy enjoyed a long and steady expansion. With tax cuts in 2017 providing an additional tailwind, the earnings growth of US companies far outstripped their regional counterparts, thanks to both faster margin expansion and stronger revenue growth.

Sector performance has also played a part. Declining bond yields and weaker commodity prices helped global growth stocks outperform their value counterparts by 160% points from 2010 to 2023, creating challenges for regional indices, such as Europe, where sector composition results in a value tilt.

This combination of macroeconomic outperformance and growth sector leadership has made it hard for investors to look past recent winners. The magnificent seven — and many US stocks, more generally — boast strong margins and impressive returns on equity. Yet while these structural factors are unlikely to change any time soon, we see several reasons why stock market returns are likely to broaden out going forward.

First, valuation dispersion in today's stock markets appears extreme. In the S&P 500, the top 10 stocks trade on a 12-month forward earnings multiple of 28x, compared to 19x for the rest of the market. Yet if the US megacap 'AI architects' are going to continually benefit from strong demand, a growing number of 'AI consumers' elsewhere in the index will need to be identifying AI-related benefits — suggesting earnings upgrades should be in order for other sectors. If AI-related hype instead turns out to be unfounded, a "catch down" scenario for the megacaps relative to other names is more likely. Either way, we expect US equity returns to become far less dependent on just a handful of names.

**Exhibit 6: Corporate earnings growth has been stronger in the US than other regions**

12-month trailing earnings  
Index level, rebased to 100 in 2010



Source: LSEG Datastream, MSCI, J.P. Morgan Asset Management. US: MSCI USA, Global ex-US: MSCI ACWI ex-US. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

**Exhibit 7: Valuation dispersion appears extreme**

12-month forward P/E ratios  
x, multiple



Source: FactSet, MSCI, S&P Global, J.P. Morgan Asset Management. The top 10 S&P 500 stocks are based on the 10 largest S&P 500 index constituents at the start of each month. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

At a regional level, the supportive economic outlook we anticipate is much less obviously priced into equity markets outside of the US. Valuation discounts for the UK and Europe ex-UK relative to the US now stand close to multi-decade record levels, and cannot be explained by index composition alone, with larger than average discounts vs. US counterparts present in almost every sector.

With economic momentum now turning in Europe’s favour, valuation gaps appear too wide. This is particularly true in European small caps, which stand to benefit disproportionately from earlier European Central Bank (ECB) rate cuts given their dependency on floating rate debt and where the usual valuation premium vs. large caps has been eroded. Any euro weakness stemming from a relatively more dovish ECB is another potential catalyst for European exporters. We are a little more cautious on the prospects for outperformance of Asian markets, with China’s economy still sluggish, Indian markets looking expensive, and Japanese stocks already having re-rated substantially, as we explain in our recent [On the Minds of Investors](#) publication.

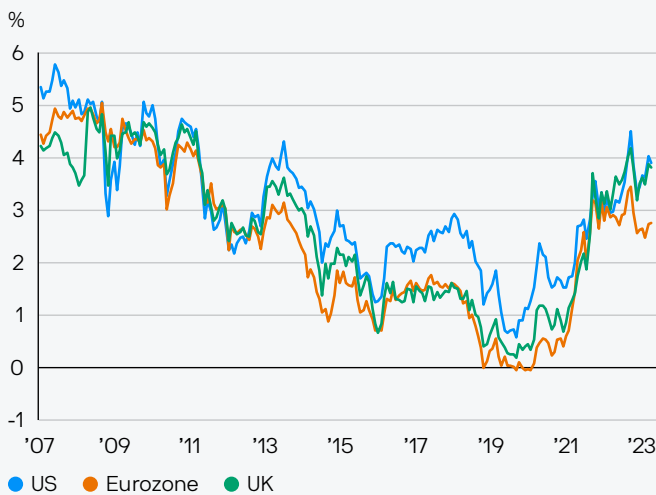
The global interest rate environment is also likely to support broadening returns across sectors. Negative rates hurt European bank profitability during the 2010s, with European financial sector earnings growing by just 68% from 2010 to 2023, compared to 680% in the US.



**With economic momentum now turning in Europe’s favour, valuation gaps appear too wide.**

**Exhibit 8: Interest rates are expected to stay higher in the medium term**

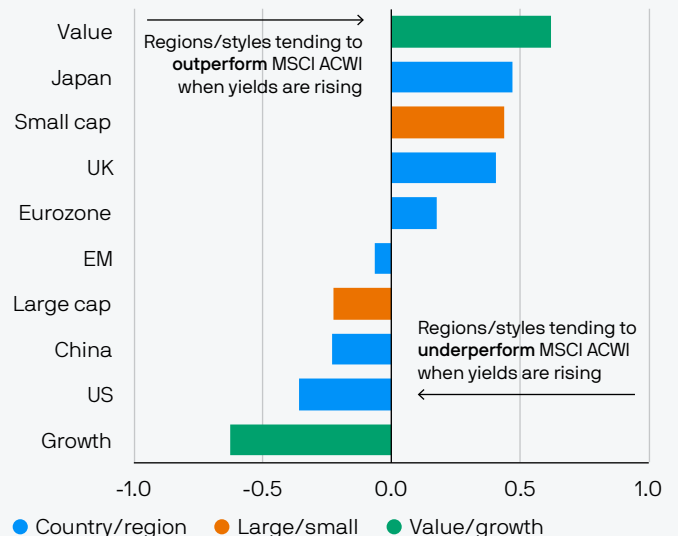
Nominal 5y5y interest rate swap rates



Source: Bloomberg, J.P. Morgan Asset Management. Nominal 5y5y interest rate swaps represent the market’s expectation of five-year average interest rates, starting in five years’ time. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

**Exhibit 9: Historically, reflation and higher interest rates have coincided with value sectors outperforming**

Correlation of regions and styles to US bond yields



Source: LSEG Datastream, MSCI, J.P. Morgan Asset Management. Correlations are calculated between the six-month change in US 10-year Treasury yields and the six-month relative performance of each region and style to MSCI All-Country World Index. All indices used are MSCI. Value, Growth and size indices are for the MSCI All-Country World universe. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

A return to ultra-low interest rates appears highly unlikely, even if rates are set to drift lower over the coming year. Market participants appear to agree with this view as medium-term rate expectations have shifted upwards everywhere, especially in Europe. While higher interest rates boost net interest margins, this benefit can sometimes be offset by larger loss provisions if households prove unable to meet repayments. In today's environment, however, economic and labour market resilience in the face of higher interest rates reduces the risk of losses, implying that higher-for-longer rates should support the earnings outlook for global financials.

It is not just banks that should benefit from higher-for-longer rates. If interest rates are higher due to stronger levels of nominal growth, cyclical sectors – such as industrials and materials, which are more closely connected to the performance of the economy – should also fare better.

Another issue well worthy of attention is the likelihood of a less reliably negative stock-bond correlation. If economic shocks are more often caused by inflation spikes and not just growth slumps going forward, the case for a less interest-rate sensitive portfolio becomes stronger to avoid both stock and bond allocations being hit hard simultaneously. Take 2022 as an example, when commodity-heavy UK equities were one of the few assets to deliver positive total returns.

The potential impact of the US election is one key uncertainty. The 2017 tax cuts were cheered by equity investors, with S&P 500 earnings upgraded by 10% in the three months after the bill was passed into law. We do not believe that the experience of 2017–18 is the right template this time round. The US fiscal situation is far weaker today, and, while it's possible that news of further stimulus could initially be taken positively, the potential for a disorderly bond market reaction that puts broad pressure on risk assets should not be dismissed lightly.

With valuations having risen across all markets over recent quarters, investors need to be humble about the outlook for medium-term returns. The US growth rally has been built on firm foundations, but valuations, interest rates and stock-bond correlations all support a rotation in leadership. Now is a good time to revisit equity allocations to ensure they are suitably set up to thrive in the conditions of the future, not the past.



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## Bonds Outlook: Higher for longer is good for fixed income

Our central expectation is that growth will be relatively resilient but inflation somewhat sticky, curtailing the ability of central banks to slash rates in the way that markets had hoped at the start of the year. While this has caused another bout of volatility in fixed income, we fundamentally believe that ‘higher for longer’ will prove good for fixed income investors.

### Back to basics

Multi-asset investors have traditionally looked to fixed income for two things: a reliable income stream, and diversification in the case of growth shocks. In the decade prior to the pandemic, bonds largely lost their ability to do either as inflation, central bank policy rates and long-term government bond yields crept ever lower. Investors had to hope for even lower rates and measly capital gains to eke out any return in core bonds.

The shift from low inflation and low interest rates to what 20 years ago might have been perceived to be ‘normal’ rates has undoubtedly been painful. But now that we’re here, we think the prospects for fixed income investment returns are good.

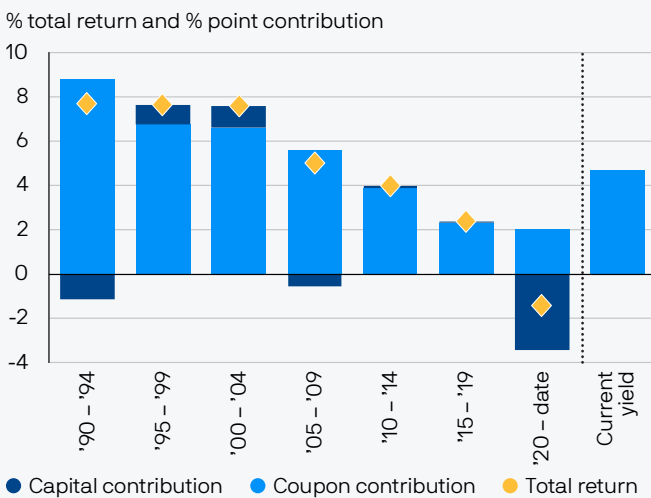
In ‘normal’ interest rate times prior to the Global Financial Crisis, strong coupon payments formed a sizeable part of the returns investors enjoyed from their bonds. A higher-for-longer interest rate environment should change the source of fixed income returns, rather than necessarily hurt them. Falling yields would deliver attractive short-term capital returns, but these would be achieved at the cost of cannibalising future coupon payments.



**A higher-for-longer interest rate environment should change the source of fixed income returns, rather than necessarily hurt them.**

**Exhibit 10: Fixed income should provide income**

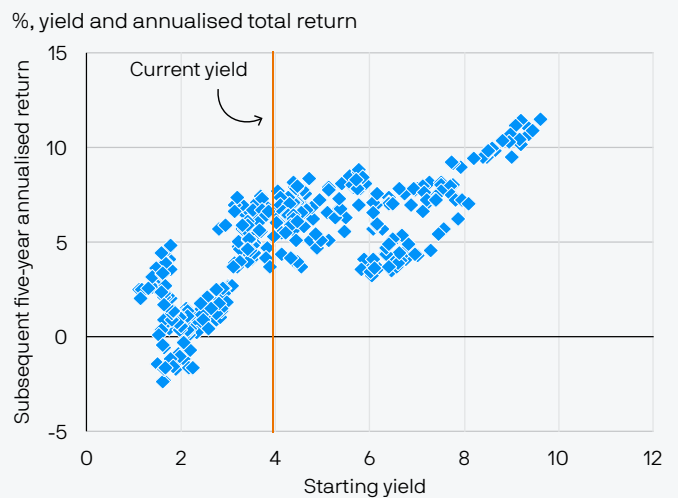
#### Average contribution to US Treasury annual returns



Source: Bloomberg, LSEG Datastream, J.P. Morgan Asset Management. US Treasuries are represented by the Bloomberg US Treasury index. Returns from 2020 on include 2024 year to date annualised returns. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

**Exhibit 11: High starting yields have historically led to positive returns, even when yields rise**

#### Global fixed income starting yield and subsequent five-year annualised returns



Source: Bloomberg, LSEG Datastream, J.P. Morgan Asset Management. Global fixed income is represented by the Bloomberg Global Aggregate index. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

For long-term investors, we believe core fixed income is compelling. While history is never a perfect guide to the future, from the current yield level, global aggregate bonds have historically delivered annualised returns in the region of 6.5% over the subsequent five years and have always delivered positive returns. This is because even in periods of rising yields, the higher starting point delivers a healthy cushion against any capital depreciation. For today’s investors, global aggregate bond yields would need to rise from 4% today to 7% over the next five years for investments to lose money over the same period.

Higher for longer due to resilient growth should support credit. It’s worth remembering that if policy rates remain relatively high, it will be because growth is proving resilient. If this is the case, then moderately riskier parts of fixed income such as high-quality corporate credit or peripheral European bonds will likely outperform their steadier counter parts.

Since 2000, the average default rate of US high yield in a year of increasing profits has been 1.6% compared to 4.6% in times of earnings contraction. Current default rates are 1.25%. If company earnings do not deteriorate substantially from here, we expect a continuation of the outperformance of credit versus government bonds, despite low spreads. However, in a higher-for-longer scenario, companies with relatively high and stable profitability and not overly extended balance sheets seem more attractive to us.

From a regional perspective, investors can take advantage of higher spreads in European high yield as the growth convergence (see **Resilience in growth...and inflation**) between the US and Europe should benefit the region.

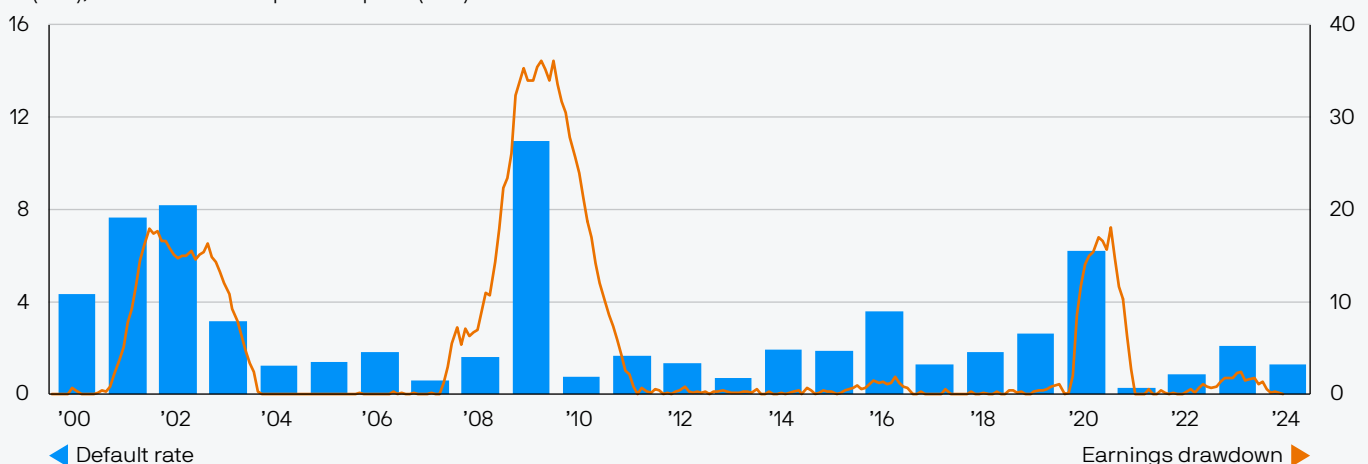
Government bonds in the European periphery also look attractive as falling ECB interest rates have historically been a key pre-condition for periphery bonds in Europe to outperform. Spreads have remained tight this cycle, but justifiably so. The stronger growth outlook, the introduction of the European Central Bank’s Transmission Protection Instrument (TPI) and the EU Recovery Fund’s financial transfers should all be supportive for the fiscal stability of Italy and Spain, particularly relative to core Europe.

France’s debt has increased significantly in the last five years, and the upcoming election is, in part, a test of whether the French population supports President Macron’s reforms that have sought to put France on a more sustainable path. Germany’s position as a role model of fiscal prudence is also undermined by the circumvention of the debt brake with special funding vehicles and by the non-consideration of EU liabilities. These factors have all contributed to a level reset in spreads and mean that spreads could remain sustainably tight despite higher overall yields, allowing the periphery to continue to outperform with potentially further tightening on the back of moderately falling rates.

**Exhibit 12: Default rates tend to be low when earnings are growing**

**US HY default rates and S&P 500 earnings drawdowns**

% (LHS); % drawdown from previous peak (RHS)



Source: IBES, J.P. Morgan Securities Research, LSEG Datastream, S&P Global, J.P. Morgan Asset Management. 2024 default rate is last 12 months. Past performance is not a reliable indicator of current and future returns. Data as of 31 May 2024.



## Higher for longer due to resilient growth should support credit.

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While our base case is a rosy one for fixed income, we remain cognisant of the risks. Yield curves are inverted across the western world, and we would expect them to normalise primarily through short-dated yields falling as central banks gradually ease monetary policy. However, with so many cuts priced into rates markets, expansionary fiscal policy and sticky inflation have the potential to upset the long end of the curve.

In our view, the path to interest normalisation is not as broad or smooth as current low market volatility suggests and taking large duration risk doesn't look attractive with the middle of the curve providing a better risk-return outlook for the next 6–12 months. While the absolute yield level favours US Treasuries over European sovereigns or UK Gilts, the greater possibility of a fiscal misstep in the US creates higher risks around our base case there. We do not expect European or UK bond markets to completely decouple from US yield movements, but our higher conviction in the path for central banks on this side of the Atlantic means we prefer European and UK duration on a relative basis.

After a painful two years, bond holders are understandably nervous about delays to the long-awaited central bank cuts. But even if the peak in rates is morphing into more of a plateau, we believe that the view from here is an attractive one for fixed income investors.

## Alternatives Outlook: Alternative, and essential

There are four ways in which the world is changing that, in our view, challenge the risk-adjusted returns investors might achieve by allocating solely to public market assets. These changes are modestly higher unanticipated inflation, bouts of cost-push inflation, the changing structure of capital markets and the energy transition.

### Protecting against inflation

The first two themes relate to the outlook for inflation.

On average we expect inflation to be moderately higher than it was pre-pandemic. Demand is expected to be modestly firmer, with austerity being less of a prominent political narrative, while trade fragmentation and re-shoring are likely to result in modest goods inflation, in contrast to the 20-plus years of goods disinflation that western economies enjoyed before the pandemic.

We would generally classify modestly higher inflation caused by firmer demand as “good inflation”, and corporate earnings would be a beneficiary. However, any inflation that is unanticipated erodes the real return on bonds. By contrast, real assets, such as real estate, have tended to provide long-term protection from modestly higher inflation.

Economies may also be subject, however, to more bouts of “bad inflation” (cost shocks) as a result of a more fragmented geopolitical, trade and energy system. As 2022 taught us, neither bonds nor stocks like cost-push inflation. Alternative assets, such as transport, timber and private core infrastructure can provide genuine inflation protection, at times when there are few places to hide. While core bonds will still insulate a portfolio from growth shocks, these alternative assets can help insulate a portfolio from cost shocks.

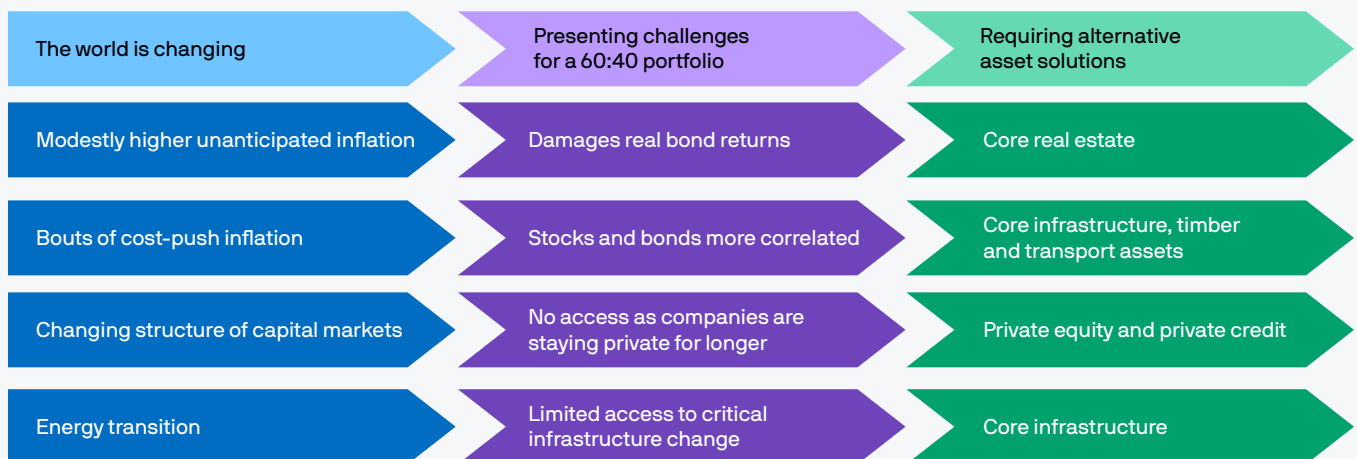
### Changing capital markets and an infrastructure overhaul

The next way in which the world is changing relates less to the macroeconomic backdrop, and more to the structure of capital markets. More companies are either choosing to stay private, or are entering the public markets at a much more mature age. Investors in the small cap equity space are therefore missing out on some of the early stage returns that they might once have enjoyed, which makes private equity and private credit important allocation decisions. Many of the exciting new developments in artificial intelligence and healthcare, for example, are gestating in private markets.

Finally, while climate ambitions were already going to necessitate a dramatic overhaul of our domestic infrastructure, the current focus on energy security has injected a new sense of urgency to the energy transition. As many governments have limited fiscal space, there is likely to be plenty of regulation and subsidies to support private solutions, presenting numerous opportunities for investment in core infrastructure.

There is no doubt that alternative asset classes come with additional complexity and illiquidity. But in our view, alternatives are essential when building portfolios that are fit for this changing world.

Exhibit 13: Alternatives are required for a changing world



Source: J.P. Morgan Asset Management, June 2024.

Look beyond cash to sustain income

The higher interest rates delivered by the Bank of England (BoE) and the European Central Bank (ECB), coupled with the apparent safety provided by cash, is luring European investors towards cash-like instruments, such as money markets funds and cash deposits.<sup>1</sup>

However, investors are missing out on potentially better opportunities to generate attractive long-term income. Although other instruments beyond cash come with capital risk, in our view combining stocks and bonds can balance these risks and provide an income that can be sustained at a higher level over time, along with the potential for capital gains.



**Investors sat in cash are missing out on potentially better opportunities to generate attractive long-term income.**

**Comparing coupons**

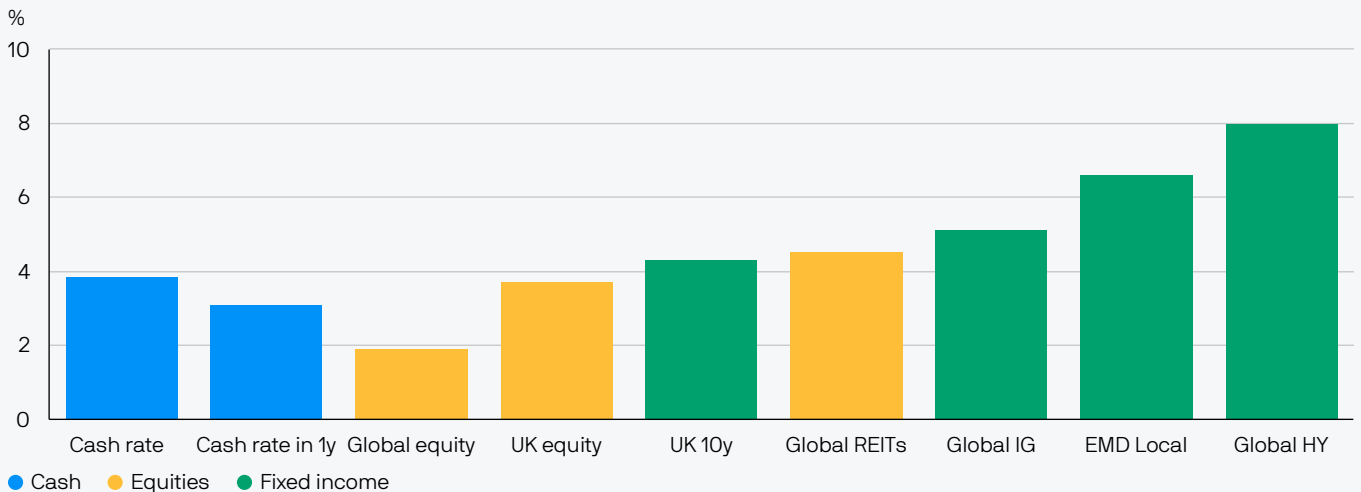
The roughly 3% income on cash deposits in the eurozone and 4% available in the UK is optically appealing when one considers the interest rates that have been available for much of the last decade. However, these cash rates are unlikely to stay this high. By the start of 2026, the market expects policy rates in both the eurozone and the UK to have fallen by around 100 basis points.

Income-focused investors should consider looking for more durable sources of cash flow. With yield curves currently inverted, on coupons alone, there appears little incentive to extend into longer-duration government bonds. In corporate credit and equities, however, income is meaningfully higher. Moreover, our expectation is that this income can be sustained. Certainly, in investment grade credit the risk of default, and therefore not receiving your coupon, looks low (see [Higher for longer is good for fixed income.](#))

In equity markets, our expectation is that dividends are more likely to grow than be cut in the coming months as payout ratios are still below their pre-Covid levels. Dividends have historically been a stable part of equity returns.

**Exhibit 14: Cash rates today look optically appealing**

Asset class yields



Source: Bank of England, Bloomberg, FTSE, ICE BofA, J.P. Morgan Economic Research, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Indices used are as follows: Global IG: Bloomberg Global Aggregate – Corporate; Global HY: ICE BofA Global High Yield Index; EMD local: J.P. Morgan GBI-EM Global Diversified; UK equity: FTSE 100; Global equity: MSCI ACWI; Global REITs: FTSE NAREIT. Cash rate in 1 year calculated using market expectations for policy rates using OIS forwards. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

<sup>1</sup> Source: BoE, ECB and the European Fund and Asset Management Association.

Finally, while public markets offer plenty of income opportunities, investors without immediate liquidity needs can consider alternative asset classes, such as transportation or real estate. These assets generally operate under long-term contracts, which provide predictable income streams over extended periods. The income generated by alternative asset classes is also often explicitly linked to inflation, thus protecting real income, unlike cash returns, which can be eroded by unexpected inflation.

### What about the capital at risk?

Of course, even if the income from this range of asset classes looks compelling, capital is at risk. One source of capital risk that often holds investors back today is geopolitical risk and the residual chance of recession. However, if such a risk were to materialise, cash rates would be cut quickly as central banks responded to support growth, sending longer-term bond prices substantially higher. Investors worried about this risk would therefore likely be better prepared by holding a basket of high-quality core bonds than cash.

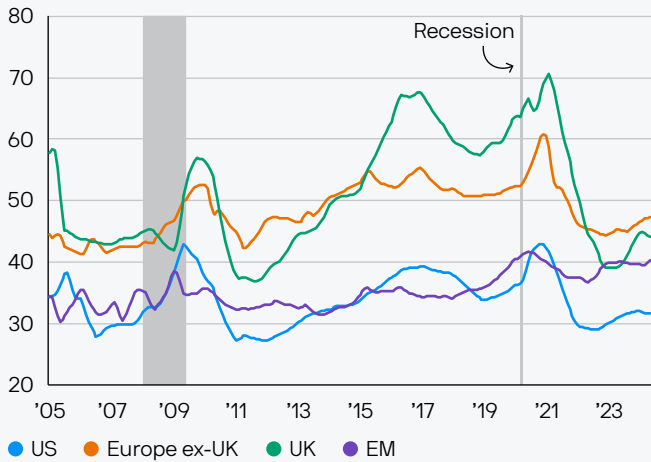
Alternatively, investors may be concerned about high valuations in risk markets. However, our central expectation is that corporate earnings are on a modest upturn (see **Shifting gears in equity leadership**) which will broaden across geographies. We don't therefore anticipate a significant leg down in stock markets. An income focus would historically have led to a bias towards Europe, value stocks and defensive sectors, but today dividend opportunities can be found globally and across sectors, so investors can diversify against country-specific risk.

Pairing stocks and bonds therefore provides the opportunity to build a portfolio that offers an attractive income and better protects investors from the range of upside and downside risks that we face today.

**Exhibit 15: With payout ratios low, dividends are more likely to increase than fall**

#### Dividend payout ratios

%, three-month moving average



**Dividends are more likely to grow than be cut in the coming months as payout ratios are still below their pre-Covid levels.**

Source: FTSE, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. US: S&P 500; Europe ex-UK: MSCI Europe ex-UK; UK: FTSE 100; EM: MSCI EM. Dividend payout ratio shows 12-month trailing dividend per share divided by 12-month trailing earnings per share. Periods of recession are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

## Macro and market scenarios and risks

Our macro base case over the next 18 months is resilient global growth and sticky inflation. An increasingly narrow path to meet this central global economic scenario comes with two-sided risks. This environment is a reminder to investors of the importance of well-diversified portfolios across equities, fixed income and alternatives.

### Solid growth, sticky inflation (base case)

**Macro:** Growth remains resilient globally, with a shift in regional strength. The US economy slows slightly while European economies accelerate. Inflation remains sticky but a reacceleration is unlikely. Interest rates are lowered moderately but more substantial rate cuts are not required.

**Markets:** This scenario supports a valuation catch-up in leftover segments of the equity market, particularly Europe. Bonds are important, offering income in a higher-for-longer interest rate world. More conviction in European vs. US duration, given US inflation and fiscal risks.

### Recession

**Macro:** Developed market economies slip into mild recessions as long and variable lags of monetary tightening take hold and/or political uncertainty damages confidence. Interest rates are cut by considerably more than currently priced to support the economy.

**Markets:** Moderate downside for stocks. Higher quality and income strategies outperform. Positive environment for core fixed income.

### Overheating

**Macro:** US growth does not slow and a broader global growth acceleration causes an acceleration in inflation. The US election could exacerbate inflationary pressures if tough protectionist and anti-immigration policies are pursued. Interest rates move even higher to squeeze out inflationary pressures.

**Markets:** Negative environment for stocks. Rising yields on core fixed income lead to losses as stock-bond correlations remain positive. Real assets and commodity strategies outperform cash while hedge funds that can benefit from higher volatility also perform well.

### Productivity boom

**Macro:** Growth accelerates driven by an AI-induced productivity boom. Inflation simultaneously falls back towards 2%, allowing interest rates to fall gradually despite strong growth.

**Markets:** Very positive environment for stocks, particularly in the US. Catch-up in US stocks outside of the magnificent seven. Decent environment for fixed income as central bank interest rates move gradually lower but credit spreads remain tight.

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