HOUSE VIEW

2024: THE SWIFT-FOOTED CYCLE

BancaMarch

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Homer tells us in the Iliad that Achilles, the great hero of the Trojan War, was not only strong and brave, but also so fast that he was known as “the swift-footed one”.

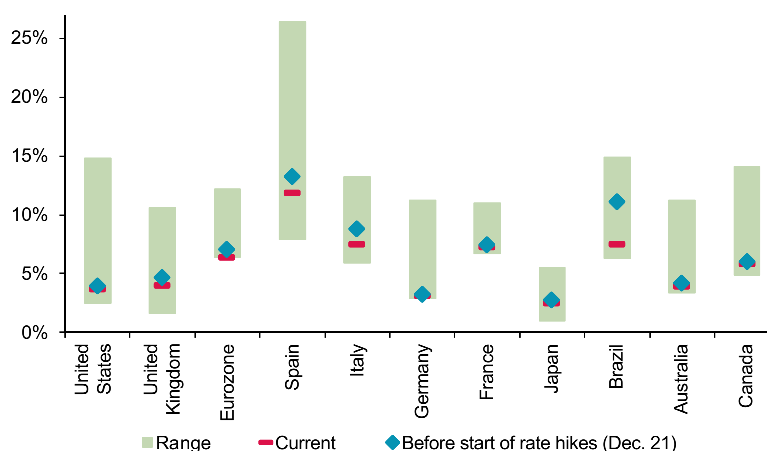
But, in spite of his deeds and gallantry, he was not invincible. No matter how much his mother, Thetis, had tried to make him invulnerable in his childhood by immersing him in the waters of the Styx, she did not achieve her goal because she forgot to wet the heel where she held him.

We are starting a new year full of optimism. This swift-footed economic cycle, which started after Covid with the greatest momentum since the 1950s, refuses to go down in defeat. Like Achilles, it looks like it’s ready to take on all comers: After experiencing the biggest interest rate hikes in more than 40 years, the economy has weathered inflation not seen since the 1970s, the invasion of Ukraine and a banking crisis. Yet it remains resilient.

A few days ago we learned that the US grew at +3.3% in the last quarter of 2023 supported by consumer spending – which totalled +2.8% – retail sales, which accelerated by +5.6% helped by a less leveraged private sector than in previous crises, and a labour market close to full employment.

UNEMPLOYMENT RATES REMAIN AT RECORD LOWS

Sources: Bloomberg and Banca March



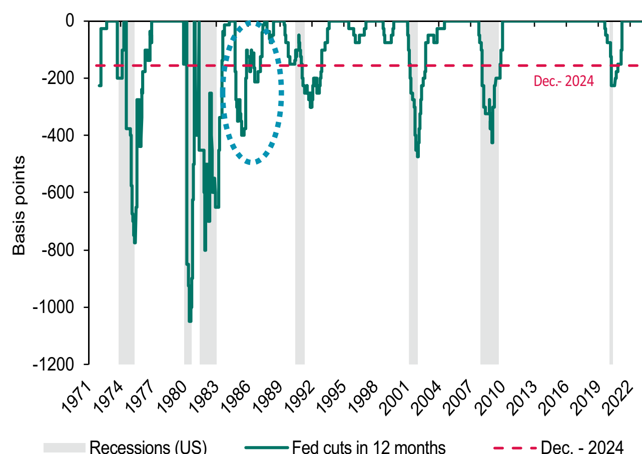
In Germany, where the situation is not so buoyant and GDP contracted by three tenths of a percentage point at the end of the year with a cumulative slowdown in industrial production of -4.9%, the unemployment rate is even lower than before the rate hikes began, as is the case in France, Australia, Canada and Japan. In the euro area, the unemployment rate of 6.4% is not only six tenths lower than when the rate hikes began, but it is also at historic lows.

In view of the strength of the data, it is surprising that the financial markets are pricing in six interest rate cuts for this year – both in Europe and in the US – something that, except in 1984, has never occurred with such intensity and speed if it has not been accompanied by a recession. This is an impossible duality: Either the cycle stretches over the next few months with the vigour of Achilles and rates do not fall as the markets expect, or Prince Paris’s arrow will strike Achilles’ heel, the indicators worsen at an unprecedented speed and the central banks have to come to the rescue.

Given the resilience of the latest figures, the first scenario seems more likely. If, as we expect, the cycle continues to live its ninth life with moderate global growth of +2.5%, rate cuts will be a long time coming. They will not arrive until well into the summer, and the Fed and ECB will simply adapt the rate cuts to the slowdown in inflation. From our point of view, they should not be too hasty: three-quarters of a point, half of what the markets expect, will be sufficient to prevent real rates from rising and try to keep the party going.

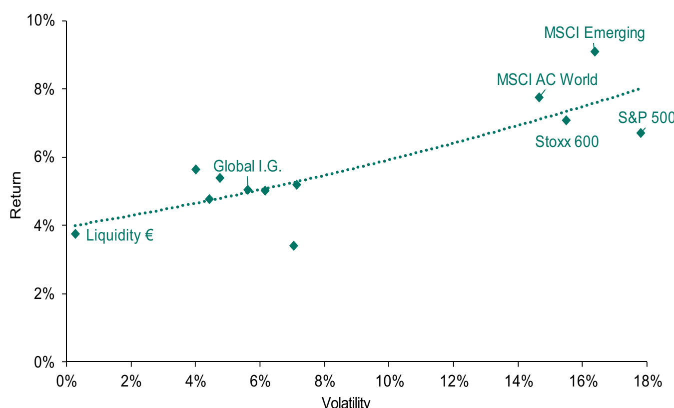
RATES DO NOT USUALLY COME DOWN IF THE ECONOMY DOES NOT WEAKEN

Sources: Bloomberg and Banca March



EXPECTED RETURNS

Source: Banca March



This situation leads us to look forward to the new year with restrained optimism. Bearing in mind that, although there is upside potential for the stock market, the equities markets will not prolong indefinitely the current "V" movement that started in October. That is why we must be demanding with equities, which will go through a year of positive but modest returns similar to those offered by other assets with less risk. Looking ahead to the coming months, we believe more in a range-bound scenario as global earnings expectations are approaching 10% and valuations are extended. In fixed income, we are certain that if we adjust the estimated returns for the risk assumed, it continues to be an asset to be overweight even if, in the short term, we have reduced exposure in duration strategies, which ended 2023 pricing in a scenario of normalised inflation and accelerated rate cuts that we think will not arrive so quickly.

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