Lazard Multi-Asset Team

Letter from the Manager

FEB
2024

Changes to the Market Forecast (7 February 2024)

In this letter, we discuss recent developments behind the latest changes to our team's market forecast. Our multi-asset portfolios reflect our assessment of the global economy and the investment landscape 6–12 months into the future.

Current Market Forecast (Probabilities)

Deteriorating conditions	Slow, uneven growth	Sustainable, healthy growth	Overheating conditions
15% Down 5%	44% No change	35% Up 5%	6% No change

Bear ← → Base ← → Bull

Our Market Forecast is based on an evaluation of returns and risks across four subject areas: the macro Economy, factors impacting asset Valuation, market Liquidity, and investor Sentiment. Our process assesses the future state of each area and assigns probabilities on a forward-looking 6–12 month basis to potential outcomes ranging from bearish to bullish.

Inflation, interest rates, and recession risks have dominated the outlook for a couple of years now, with market narratives shifting rapidly as incoming economic data reshapes prevailing views. However, despite frequent market whiplash, the outlook has improved. After an unprecedented and synchronized global hiking cycle, central banks are entering the "last mile" in their fight against inflation more quickly than expected, raising the probability of a soft landing for the economy. To be sure, growth is still expected to slow and many risks remain: that progress reducing inflation stalls, that central banks are slow to cut rates, or that geopolitical challenges produce new economic shocks. Nonetheless, we are adding to risk to reflect additional progress on inflation and continued stability in the economic outlook.

Economy

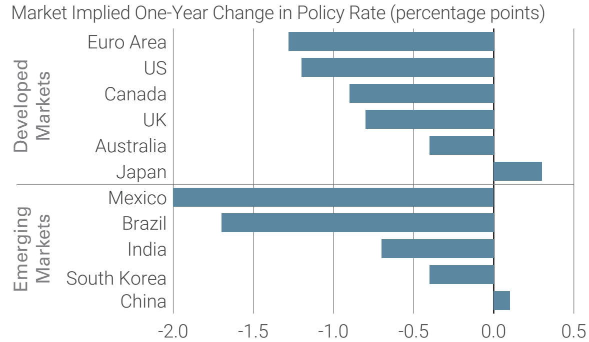
What stage of the global business cycle are we likely to be in over the next 6–12 months?

Depression/recession	Below trend	Stable growth	Overheating
16% Down 7%	45% Up 4%	34% Up 3%	5% No change

Global progress on inflation has raised expectations for central bank rate cuts, which should support activity. The US economy has slowed mildly, but strong labor markets and household consumption continue to drive growth, despite tight credit conditions. The European economy continues to stagnate but is showing tentative signs of improvement (with the notable exception of Germany). A more robust policy response has stabilized China's economy. However, generating stronger momentum will likely require more measures to lift weak demand and to address property sector challenges that pose substantial downside economic and financial risks.

Markets Imply Substantial, Synchronized Policy Rate Cuts

Market Implied One-Year Change in Policy Rate (percentage points)



As of 9 February 2024
Source: Bloomberg

Valuation

What is the outlook for business costs, profit margins, and returns over the next 6–12 months?

Poor	Moderate	Positive	Bright
12% Down 2%	42% Down 2%	39% Up 4%	7% No change

Commodity prices largely remain above prepandemic levels but are far lower than recent highs despite heightened geopolitical risks, erratic weather, and moves by OPEC+ to support oil markets. Labor markets remain tight across many developed economies, but with signs of demand and supply coming more into balance. The key to the outlook will be stabilizing employer demand at benign levels before causing higher unemployment. Equity valuations and credit spreads are unattractive if rates remain high and if the outlook is for a slowing economy; less so if rates fall and resilience continues.

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Liquidity

How are credit markets likely to be characterized over the next 6–12 months?

Very weak 10% Down 5%	Weak 45% Down 5%	Normal 40% Up 10%	Very strong 5% No change

Restrictive monetary policy continues to contribute to more stringent lending standards and weakening credit demand. Delinquencies and defaults are rising, especially for more vulnerable borrowers. However, increasing prospects for rate cuts and a soft landing are leading to slower deterioration in both credit availability and demand. Trends could improve further, but within limits, given that the outlook remains for a slowing economy—which impacts confidence in borrowing and lending—and for tighter financial conditions than before the pandemic.

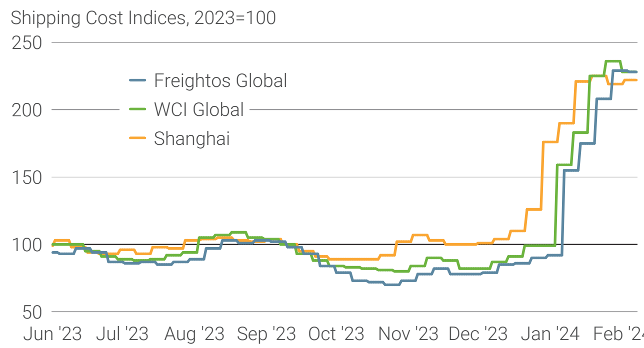
Sentiment

How supportive will politics and/or public opinion be to capital markets over the next 6–12 months?

Not at all 21% Down 5%	Somewhat 43% Up 1%	Very 29% Up 4%	Too much 7% No change

Implied equity market volatility remains near post-pandemic lows, amid rising expectations for lower rates and a soft landing. Implied interest rate volatility remains high, amid ongoing uncertainty about the timing and pace of rate cuts. The geopolitical landscape remains highly challenging. Disruptions to shipping should have more limited implications than during the pandemic but demonstrate the potential for spillovers from regional conflicts. US budget negotiations have been smoother than anticipated and new proposals could add to expenditures if passed. However, fiscal policy will likely tighten in both the United States and Europe and remain supportive in China and Japan. As US primaries give way to the general election, we believe domestic and international policy implications will receive greater market attention.

Red Sea Trade Disruptions Are Raising Shipping Costs



As of 7 February 2024

Source: Bloomberg, OECD

Outlook

Our first forecast change of 2024 leans further in the direction of prior ones. We continue to expect global growth to slow in response to tight credit conditions. However, the recent decline in inflation has been more rapid than anticipated, raising prospects for imminent relief from central bank rate cuts.

The median MSCI World country saw core consumer price inflation (excluding food and energy) peak in March 2023 at 6.6% year on year, before falling to 3.7% by the end of 2023—nearly two-thirds of the decline required to bring inflation back to target. Shorter-term trends have been especially encouraging, particularly in the United States where the month-on-month pace of core personal consumption expenditure inflation has been at or below target for six of the past seven months.

As a result, a lot of commentary is now focused on when different central banks will begin cutting rates and at what pace. These are important questions in the short term but ultimately we expect the more important question to be where cuts end up. The more rapid the progress on moderating inflation, the more likely that cuts will be deeper over time. The deeper the cuts, the better for both bonds and equities, all else being equal.

We expect uncertainty to continue amid a number of risks to the outlook. Among these risks are that: services inflation could prove stickier than expected, making the “last mile” in reducing inflation the hardest; central banks could be overly cautious in responding to falling inflation, causing unnecessary economic pain; and very high geopolitical challenges could cause new shocks to global inflation or activity. Nonetheless, we believe current trends can continue, which is reflected in growing optimism in our outlook.

Favor

- US equities
- Sovereign fixed income
- Market laggards

Avoid

- Low-quality equities
- Riskier credit
- Crowded trades

This content represents the views of the author(s), and its conclusions may vary from those held elsewhere within Lazard Asset Management. Lazard is committed to giving our investment professionals the autonomy to develop their own investment views, which are informed by a robust exchange of ideas throughout the firm.

Important Information

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