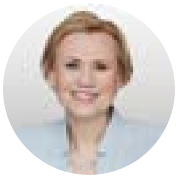
THE BALANCING ACT

# 2024 Investment Outlook



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# Executive summary

After nearly two years of policymakers fighting inflation, our 2024 outlook centers on the balance between growth durability versus the stickiness of inflation. Despite several quarters of restrictive monetary policy, the global economy — particularly in the US — has remained remarkably resilient. We think the global economy is entering a brief period of below-trend growth driven by recent monetary policy tightening, which we believe markets have already partially priced in. Questions remain over the path of inflation, however. In our view, the disinflation process will continue over our outlook horizon, and growth will slow further in H1 before starting to improve in H2, starting in the US. As inflation softens and policymakers begin to introduce rate cuts, we look for risk assets to see renewed strength.

We see inflation falling over the outlook horizon and nearing central bank targets by the end of 2024. With inflation having peaked and gradually falling and many major economies showing some signs of pressure from policy tightening, we believe monetary policymakers have now reached the end of their tightening cycles. As inflation falls, we expect real policy rates to rise and, in response, central bankers to cut rates to ease any additional pressure on growth, employment and wages. We expect this easing to begin late in the first half of 2024. We anticipate that rate cuts — combined with falling inflation — will set the stage for a recovery, putting the global economy on a path to trend growth accompanied by real wage growth in the second half of 2024.

We believe that early in 2024, markets will begin to discount an economic recovery; policy support should solidify and increase global risk appetite as the year progresses. However, we do not anticipate a significant rebound due to the shallowness of the slowdown.

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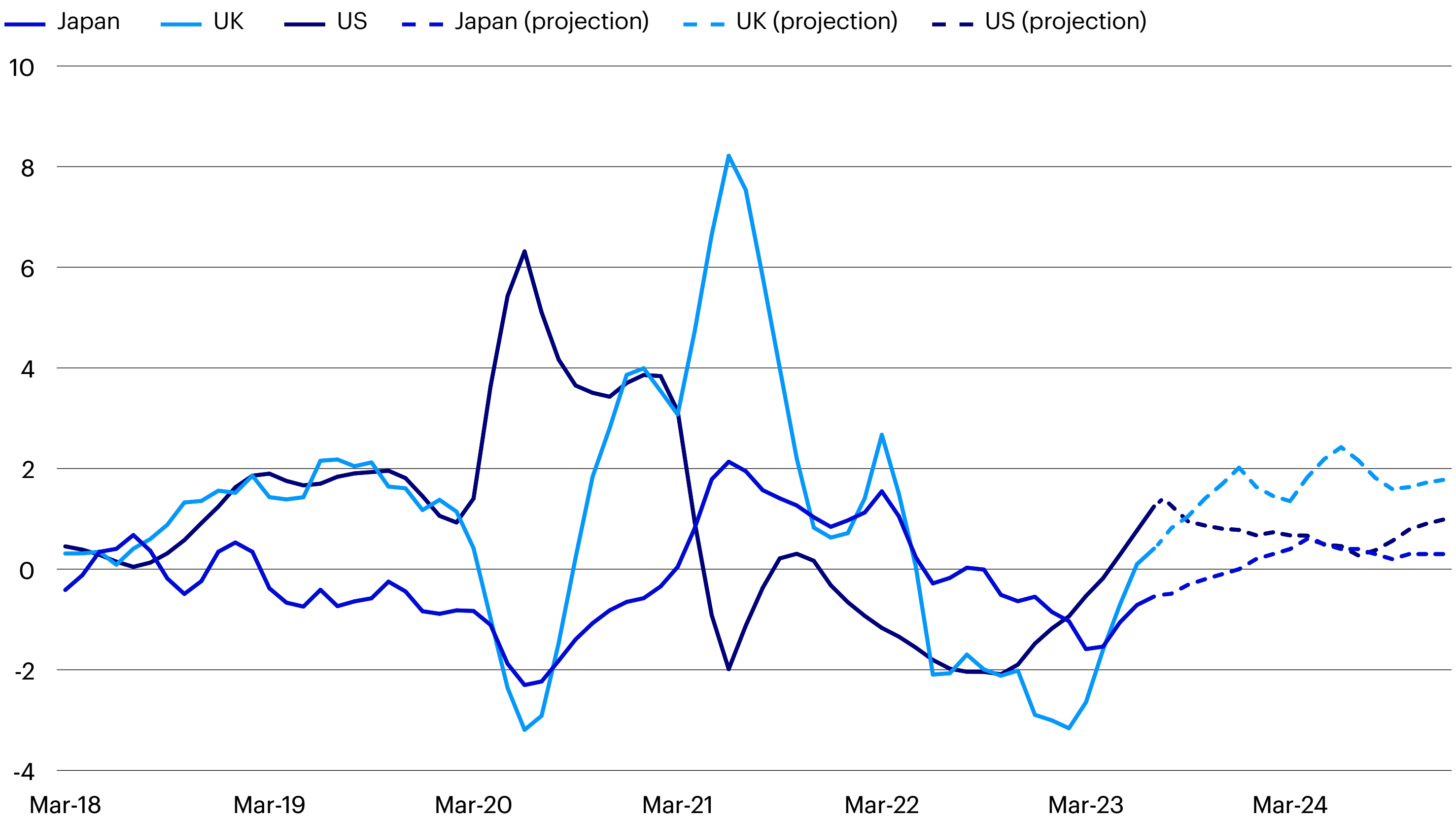
# A bumpy landing: First-half slowdown, then recovery

Despite rapid policy tightening over the course of 2022 and 2023, many developed economies have continued to grow and have only recently begun to show signs of strain. Over 2024, we expect outcomes will vary by country — the US is to be most resilient to the effects of tightening policy and financial conditions, while eurozone and United Kingdom growth is already flagging. Restrictive policy, increasingly stretched consumers, and idiosyncratic growth shocks suggest that growth is likely to continue to slow over the near term.

As we move into 2024, we expect the global economy to slow marginally, with a bumpy landing for major developed economies materializing in the first half of the year. However, we expect the slowdown to be shortened by a turn to easing monetary policy as inflation gradually subsides. Moving forward, we expect real wage growth in major developed economies to resume as inflation normalizes, helping to support a return to trend growth. Meanwhile, the Chinese economy is in a remarkably different position. Policymakers are seeking to stabilize growth after optimism around its post-covid opening was tempered in 2023. In developed economies, how quickly easing begins will likely hinge on the stickiness of inflation as well as how resilient growth continues to be.

**Real wage growth expected to improve in 2024**



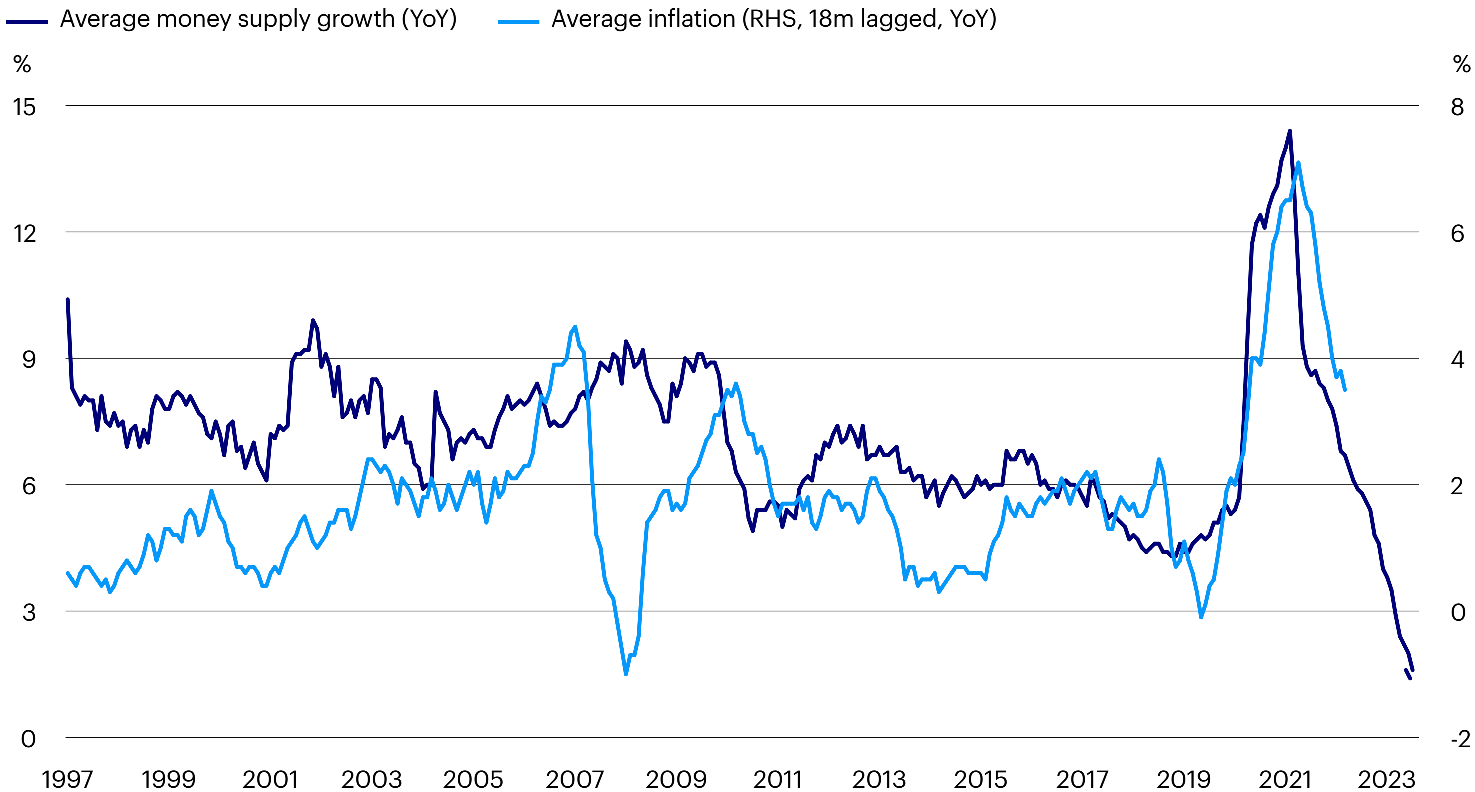

Note: There can be no assurance that any stated projections will be realized. Chart shows monthly real wage growth data for US, UK, and Japan from March 2018 to December 2024. Projections are from Invesco and are shown in dotted lines. Sources: Bloomberg L.P., OECD, and Invesco. All data is latest available as of October 31, 2023.

# Uneven but continued disinflation in US and eurozone throughout 2024

Despite earlier widespread fears of enduring inflationary forces, we believe we are in the middle of a bumpy disinflationary trend that will continue to play out over the coming quarters. In our view, recent inflation spikes have largely been a byproduct of pandemic-induced imbalances rather than core economic forces. Indeed, many of these disruptive elements have meaningfully stabilized, including large-scale direct fiscal stimulus (facilitated by central banks), supply chain dislocations, and pandemic-driven changes in consumption.

We believe we are on the path to normalization, allowing inflation rates to decline without a corresponding significant reduction in output. By year-end 2024, we expect year-over-year US inflation to be appreciably below 3%, with eurozone and UK inflation also coming considerably closer to target rates.

**Normalizing money growth suggests more benign inflation environment ahead**



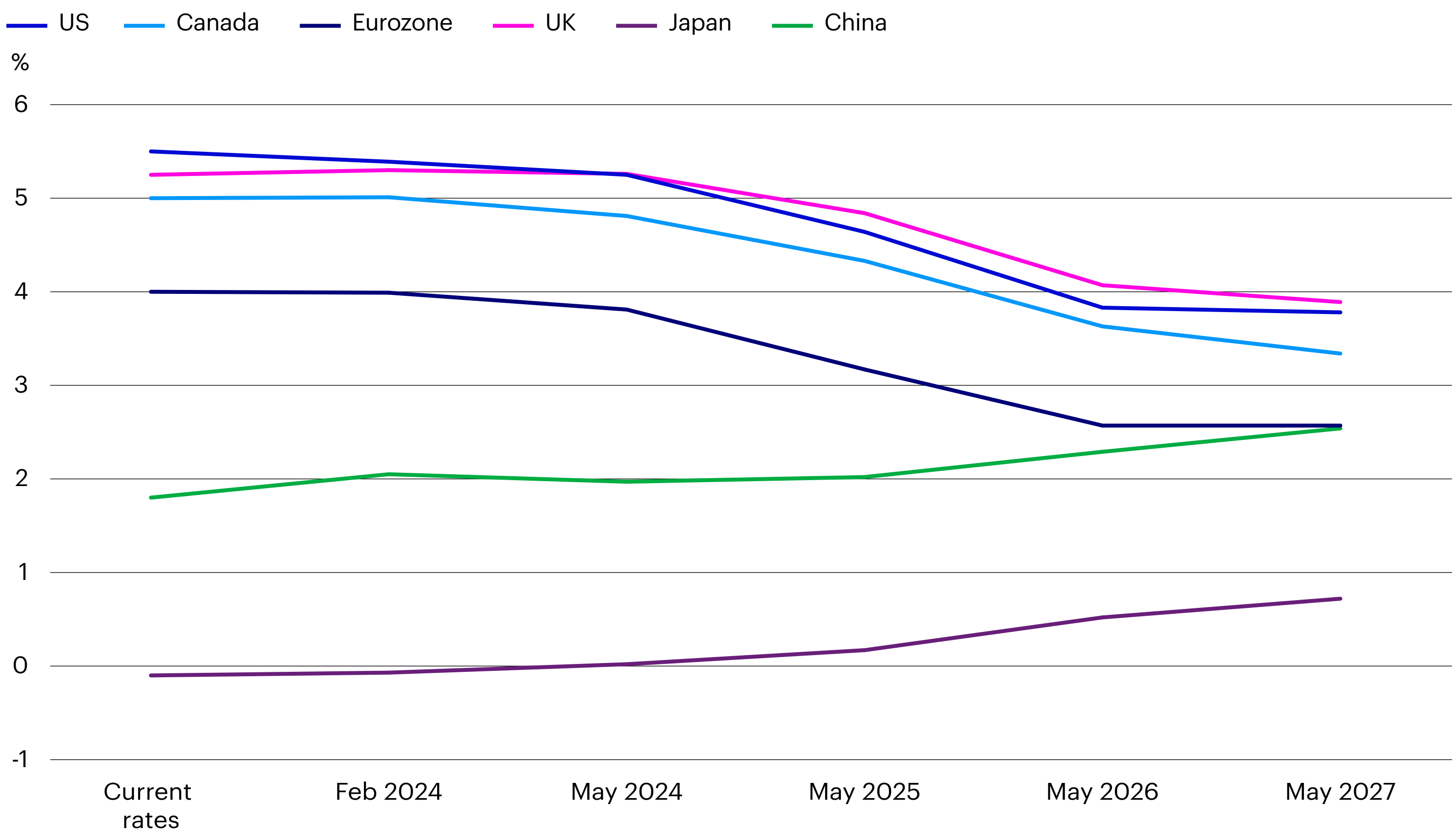

Note: Global average money supply growth and average inflation include figures from the US, China, eurozone, Japan, and United Kingdom. Both money supply and Consumer Price Index (CPI) measures show the average year-on-year growth across the countries covered since January 1997 (18-month lagged). Sources: Datastream and Invesco, as of October 31, 2023, using monthly data.

# Peak policy now, marginal easing to begin late in first half

We believe monetary policymakers have now reached the end of their tightening cycles. The next step is likely to be easing, which we expect to emerge late in the first half of 2024 as growth slows and inflation continues to move towards acceptable rates. This should help a recovery to take shape, returning the global economy toward trend growth in the second half of 2024 as real wages rise in response to lower inflation.

Policy stances are likely to vary across regions in the period ahead. In our view, easing is most likely to emerge in Europe first, given the poorer growth outlook, followed by the US. Meanwhile, we expect the Bank of Japan to embark on monetary policy tightening, even though it continues to hold an accommodative policy stance. Chinese policy, on the other hand, is already firmly in accommodative mode as policymakers look to stabilize growth.

**Market-implied policy rates for major central banks**



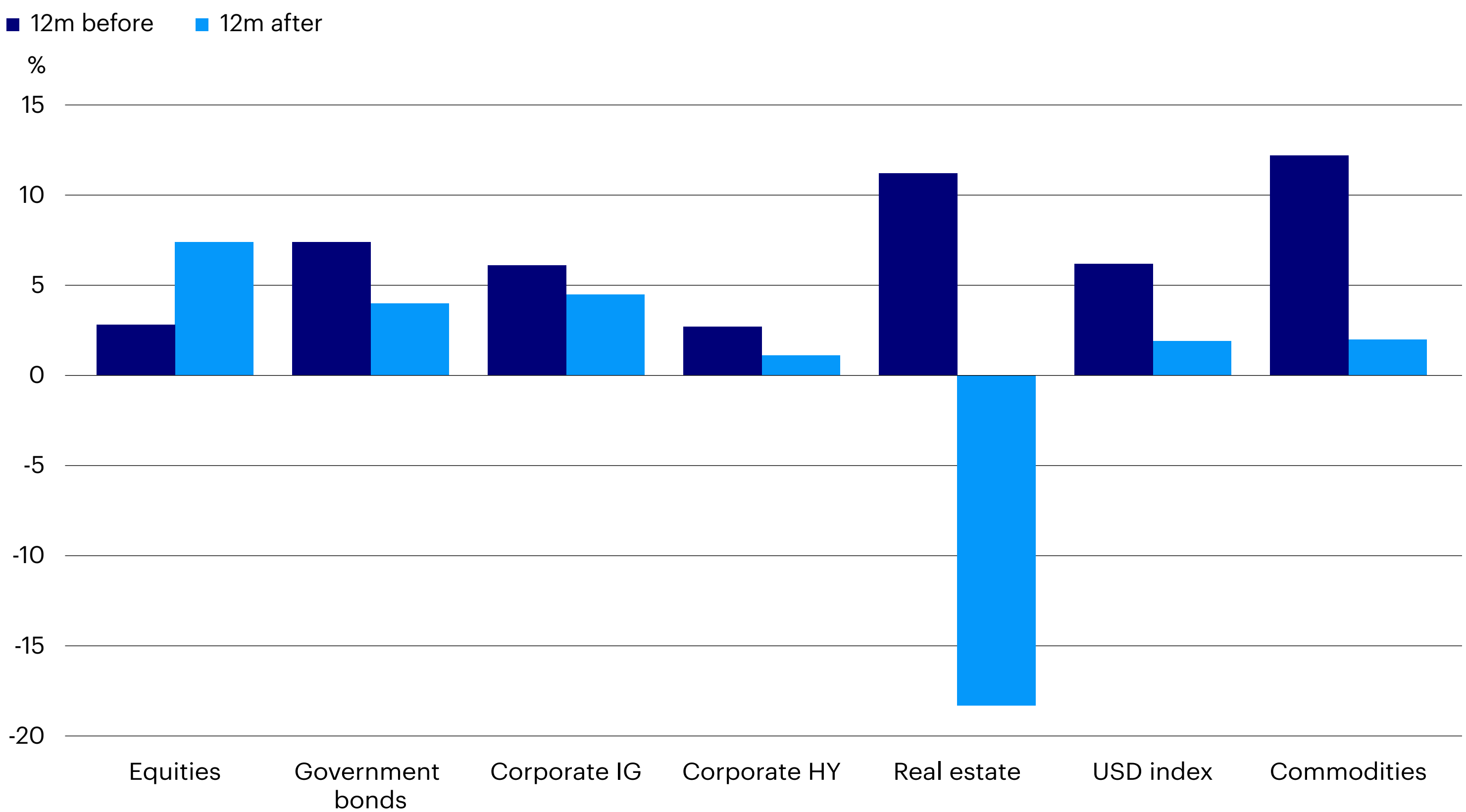

Note: There can be no assurance that any forward-looking figures will be realized. Chart shows market-implied policy rate paths for the central banks of the respective countries shown. Market-implied policy rate is based on overnight index swaps pricing available for the term structure shown.
Source: Bloomberg L.P., as of November 3, 2023.

# After first-half slowdown, risk appetite likely to improve

In the near term, we expect yields to peak as the tightening cycle draws to a close, as we have seen in past tightening episodes. During this period, risk appetite should start to improve, but given that some policy uncertainty will remain around the timing of when rate cuts begin, there could be some volatility early in the year (a pattern of "bad macro news is good news for markets" and vice versa). We expect this environment will present opportunities for pursuing long-duration fixed income exposure.

As growth and inflation cool, we expect bull steepening to prevail as the slowdown is realized. We expect risk assets to benefit when policy support emerges. Later in 2024, a global easing cycle should increase risk appetite, but we do not expect this to have long legs due to the anticipated shallowness of the slowdown.

**Global asset average total returns (in USD) around the first cut in a Fed loosening cycle**




Sources: ICE, ICE BofA, FTSE Russell, MSCI, S&P GSCI, Refinitiv Datastream and Invesco. **Past performance is not a guarantee of future results.** An investment cannot be made directly in an index. IG = Investment Grade. HY = High Yield. Data as of August 31, 2023, covering the period from July 31, 1973, through July 31, 2020. The chart shows the total return on global assets in the 12 months before and after the first Fed rate cut in easing cycles since 1974. Data doesn't exist for all assets for every easing cycle. **Government bonds:** ICE BofA Global Government Bond Total Return Index, data starting Dec. 31, 1985. **Corporate investment grade (IG) bonds:** ICE BofA Global Corporate Bond Total Return Index, data starting Dec. 31, 1996. **Corporate high-yield (HY) bonds:** ICE BofA Global High Yield Bond Total Return Index, data starting Dec. 31, 1997. **Equities:** MSCI World Total Return Index, data starting July 31, 1973. **Real estate:** FTSE EPRA Nareit Global Total Return Index, data starting Feb. 18, 2005. **Commodities:** S&P GSCI Commodity Total Return Index, data starting July 31, 1973. **US dollar:** DXY Dollar Index, data starting July 31, 1973.

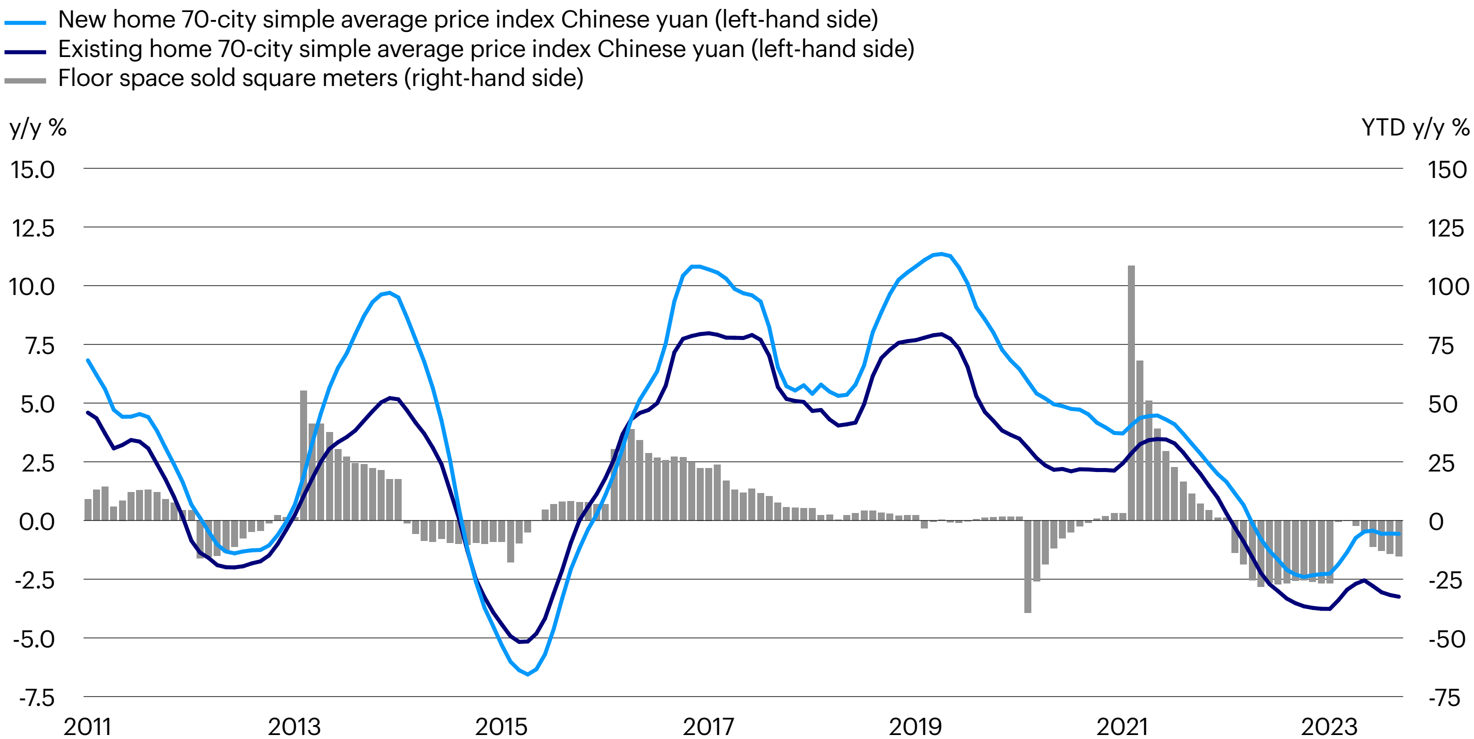
# China to stabilize in 2024

The world's second-largest economy stands at a critical juncture as we head into 2024. In contrast with many major developed market economies, China is in a markedly different place in its cycle. The relaxation of COVID-19 restrictions has driven a meaningful but incomplete recovery in growth, curtailed in part by a slowing global growth environment, less fiscal policy support than expected, continued household saving, and persistent weakness in the local property sector.

In our view, Chinese growth in the first half of 2024 is likely to be subdued, though likely to improve in the second half, resulting in a year-over-year real growth of around 4.3 to 4.7%. Property investments are likely to decline further in the first half of the year as lagged effects of a sharp decline in housing starts have not yet fully materialized. Still, we expect the beleaguered property market to stabilize, albeit  at weak levels, over the course of the year. We also anticipate that China's exports will remain weak in the first half of 2024, although exports are likely to rebound in H2 2024 as we expect a recovery in advanced economies.

We believe appropriate policies can improve the economic picture. Moving forward, we expect Chinese authorities to marginally expand fiscal policy in 2024 to stabilize growth rates. The authorities' plan to increase infrastructure spending by issuing government bonds worth 1 trillion yuan sends a strong signal to the market and should support the economy in the first half of 2024. It is possible that the government may opt to stimulate the economy with significant fiscal support, which poses an upside risk to growth as it could provide a powerful boost to consumer and business confidence. Instead, we expect more targeted measures to support the property sector, additional infrastructure stimulus and debt swaps between the local and central government to be the favored approach. These efforts are likely to lead to a more convincing growth profile that markets have been seeking and provide a boost to sentiment in the coming year.

**China's housing market remains weak, but we expect stabilization**




Source: China National Bureau of Statistics (NBS). Data as of September 2023.

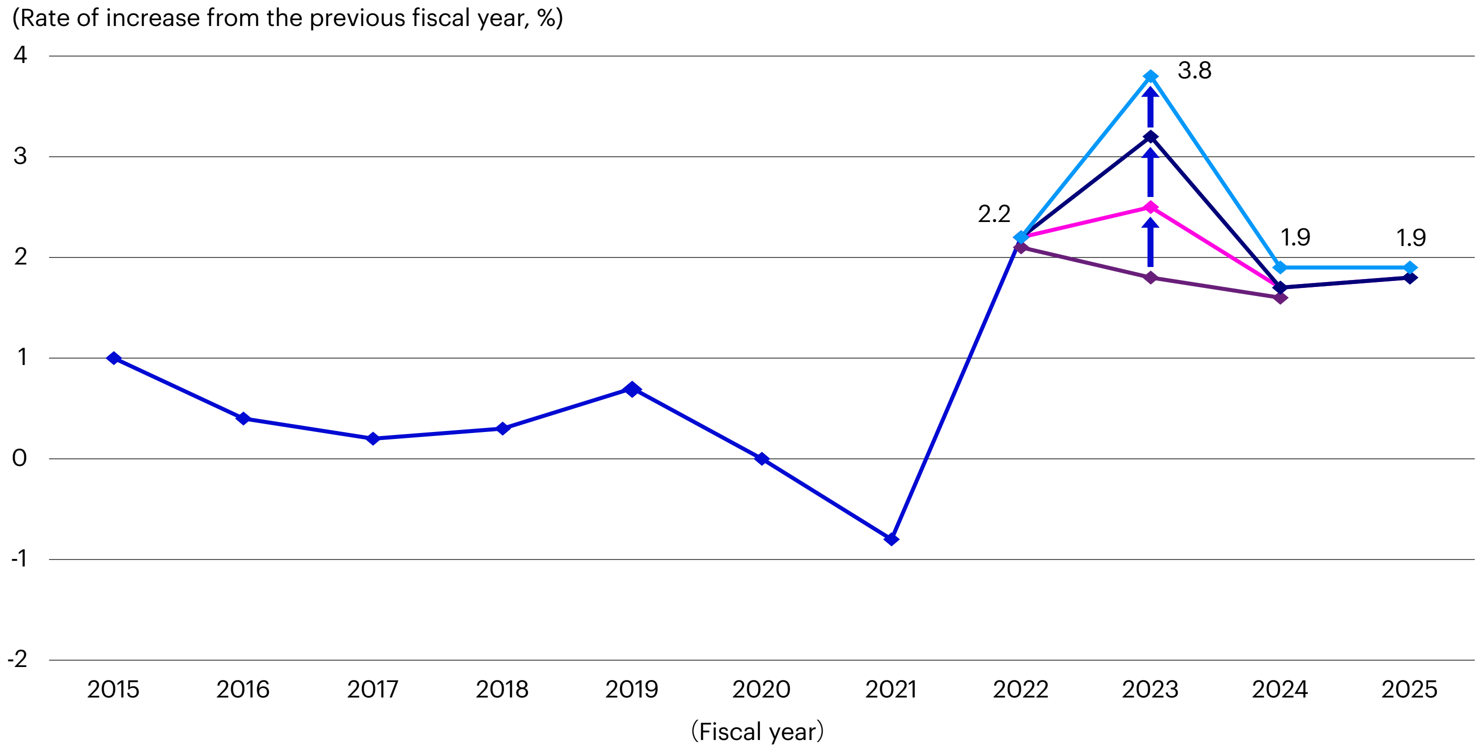
# Modest policy tightening in Japan starting in the first half

For the first time in decades, Japan is facing higher and more sustained inflation. A tight labor market has continued to generate wage pressures while growth has remained resilient, with spring 2024 Shunto wage negotiations likely to yield further considerable wage increases.

Nevertheless, we expect the Bank of Japan (BOJ) to continue to hold back on material tightening because there are significant uncertainties over the sustainability of rising inflation (after all, the BOJ has been faced with false inflation dawns in the past). In the West, most price categories were rising faster than the target by the time central banks became hawkish, which is not the case for Japan. Nonetheless, as underlying inflation appears to be rising gradually, with meaningful changes in corporate price-setting behavior under resilient economic growth, the BOJ is likely to start tightening monetary policy marginally during the first half of 2024, in our view. We also believe that the BOJ will likely tweak its yield curve management policy to prevent knock-on effects from outsized increases in volatility in global bond markets.  A modest left-tail risk of significantly higher inflation may force the BOJ to tighten significantly, which could drag up global bond yields and strengthen the Japanese yen.

**BOJ's outlook on Japan's core inflation (CPI excluding fresh food and energy)**

Actual CPI excl. fresh food and energy | As of October 2023 | As of July 2023 | As of April 2023 | As of January 2023

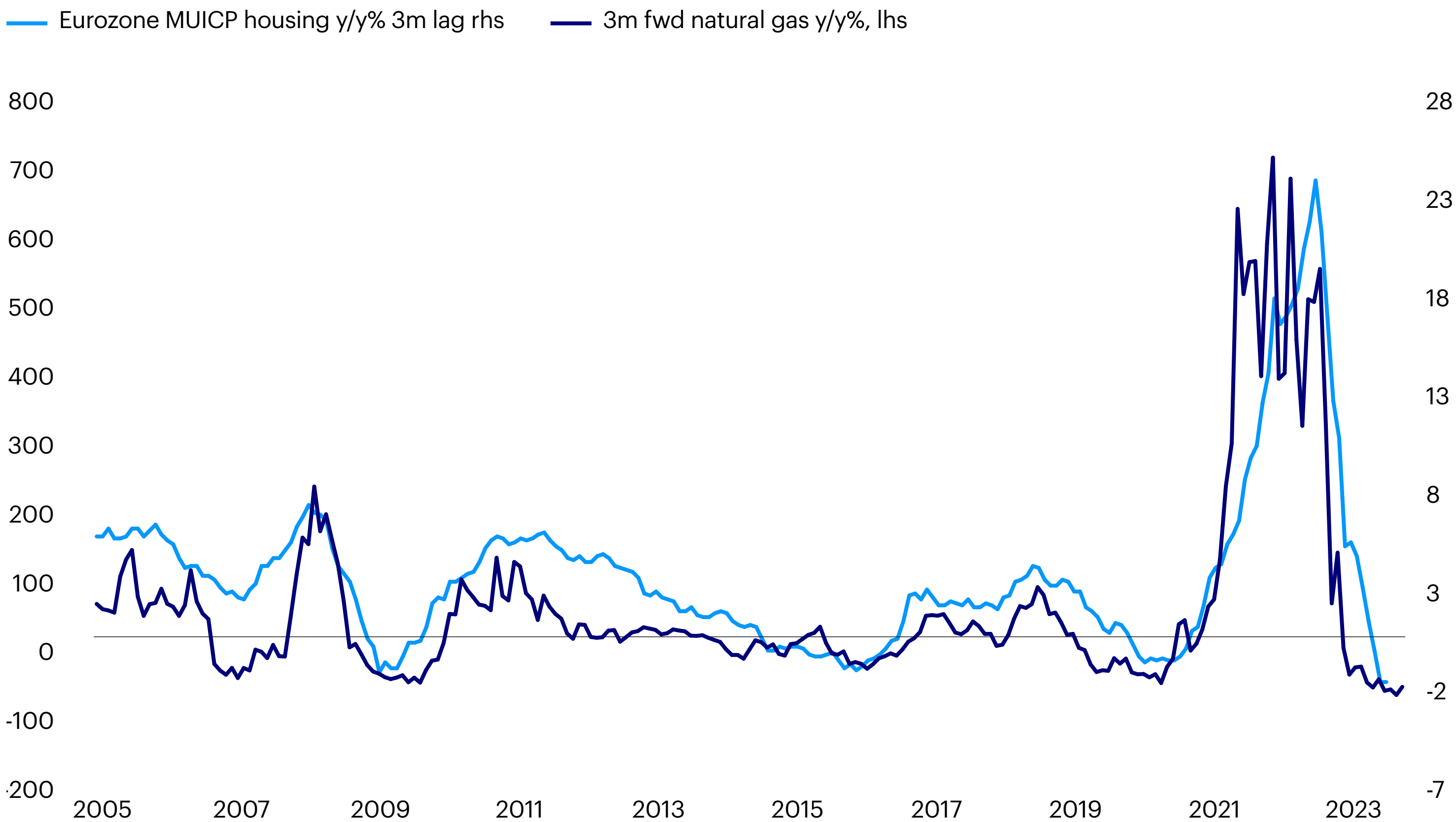



Note: Japan's fiscal year starts in April and ends in March. Median outlook by BOJ's Policy Board members. Sources: The Bank of Japan and CEIC. There can be no assurance that any forward-looking figures will be realized.

# Risks to our outlook: Geopolitics, commodity shocks, and financial accidents

Since the global pandemic, risks and uncertainty have remained elevated. Recent geopolitical events, including the Russian invasion of Ukraine, events in the Middle East, and continued tensions over Taiwan, have introduced greater uncertainty for global markets, supply chains and prices, and their effects on consumption and trade. The ongoing conflicts could also trigger another commodity price shock, with a concomitant negative impact on growth. Domestic political uncertainty in the US has also exacerbated concerns about the fiscal sustainability of the US, the potential for further government shutdowns and even the possibility of default. Meanwhile, the rapid tightening of financial conditions across many major economies has raised fears about potential financial accidents, such as those witnessed in the first half of 2023. Our base case assumes no impact from these factors, but we recognize that they do present risks to our outlook.

**Geopolitics have recently shown up in key energy prices — and if persistently higher, could seep into core inflation**




Sources: Invesco, Bloomberg L.P., and Macrobond, as of October 3, 2023. Note: Chart shows eurozone housing-related inflation, which includes energy, and natural gas futures. MUICP = Monetary Union Index of Consumer Prices.

# Potential alternative paths for the global economy

**Alongside our risks, we have considered two alternative outlook scenarios that focus on the balancing act between growth and inflation and the resulting reactions from policymakers:**

### Downside scenario: Hard landing

We see two potential drivers for a "hard landing:" an already-committed policy mistake or persistent inflation that spurs more tightening. In the first instance, the long and variable lags of policy tightening take effect over 2024 and prove to be too much for the economy to handle. In this event, we expect weaker growth and faster disinflation, enabling faster policy easing. The other hard landing possibility contemplates more persistent inflation that requires policymakers to keep rates higher for longer, resulting in a greater economic effect than we currently anticipate. In either case, the investment implications would be similar, but the near-term experience would likely differ — long-duration bonds and equities would likely outperform sooner in the early hard-landing scenario but underperform in the persistent inflation version.

### Upside scenario: Soft landing

We also consider an upside scenario for the United States in which supply-side shocks dissipate or are already gone, and mild cooling on the demand side enables inflation to ease. In this "soft landing" scenario, we are already in (or even in the process of exiting) a mid-cycle slowdown, from which we reaccelerate in the first half of 2024. In this case, we expect core inflation to fall with more certainty and at a smoother trajectory versus the base case, enabling the Fed to ease sooner. Outside the US, we expect surplus economies like the eurozone, Japan, and China, as well as twin-deficit emerging markets, to benefit more strongly in this scenario, as US disinflation and growth boost the world economy, helping offset recent domestic softness in China and the eurozone.

# Global Market Strategy Office: Favored assets in the period ahead

**Equities**

- Emerging markets
- Ex-US developed markets
- Value
- Cyclicals
- Small cap
- Consumer discretionary
- Technology

**Fixed income and currencies**

- High quality credit
- Longer duration
- Nominal bonds
- EM local currency debt
- US dollar

**Alternatives**

- Private credit
  - Direct lending
  - Distressed and special situations
- Real assets
  - Commercial real estate debt
- Growth equity and expansion capital

Given our base case scenario, we anticipate global risk appetite increasing as 2024 begins, with markets experiencing some volatility as they start to discount a recovery later in the year. In our view, this environment should favor equities, although fixed income is also poised to perform well, given the likelihood of falling rates.

**Equities**

Within equities, we see the greatest potential in emerging markets, although developed market equities outside the US also appear attractive, and we anticipate that value, cyclical and small-cap stocks will potentially outperform. In terms of sectors, we prefer consumer discretionary and technology. Consumer discretionary is closely correlated with the economic cycle, and so an economic recovery would benefit this sector, especially since consumers are benefiting from low unemployment. We believe that as rates come down, earnings multiples for technology stocks may see a boost. We prefer cyclicals and value in the first half as markets price in a second half recovery, but in the second-half of the year, a return to trend growth rates and falling interest rates could benefit technology and growth stocks.

**Fixed income and currencies**

Within fixed income, we favor high quality credit given short-term concerns about decelerating economies, along with the prospect of falling rates. We favor long duration; based on historical precedent, this is an attractive time to lock in rates on the long end of the curve. We anticipate nominal bonds will potentially perform well as disinflation continues. We favor emerging market local currency debt in this scenario, as it should benefit from a weakening US dollar. We believe the US dollar will ease as markets anticipate rate cuts by the Fed.

**Alternatives**

Within private assets, direct lending is currently attractive given the asset's floating-rate nature and favorable lender terms and protections. The potential for modest default rates next year should also set the stage for distressed lending to potentially outperform. We favor commercial real estate lending as a way to access real asset markets, which could fill a gap for financing left after recent regional banking failures. Higher interest rates may continue to pressure real estate assets; however, we find fundamentals improving as there are pockets of strength in various sectors and markets. When focused on private equity, we prefer assets that focus on cash transactions because we see opportunities for growth equity firms to provide capital to private companies that historically would have looked to access the initial public offering market. We recognize that, given the increase in geopolitical risks, gold could have periods of strong performance potential.

**Important information**

The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.

All data as of October 31, 2023, unless otherwise stated. All data is USD, unless otherwise stated.

The document contains general information only and does not take into account individual objectives, taxation position or financial needs. Nor does this constitute a recommendation of the suitability of any investment strategy for a particular investor. Investors should consult a financial professional before making any investment decisions. Past performance is not indicative of future results.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

**Definitions:**

- MSCI World Total Return Index is an unmanaged index considered representative of stocks of developed countries.
- ICE BofA Global Government Bond Total Return Index measures the performance of the global government bond market.
- ICE BofA Global Corporate Bond Total Return Index measures the performance of the global investment grade corporate bond market.
- ICE BofA Global High Yield Bond Total Return Index measures the performance of the global high yield bond market.
- FTSE EPRA Nareit Global Total Return Index tracks the performance of listed real estate companies in developed and emerging countries worldwide.
- DXY Dollar Index measures the value of the US dollar relative to a basket of foreign currencies.
- S&P GSCI Commodity Total Return Index tracks the performance of the global commodities market.
- Tightening monetary policy includes actions by a central bank to curb inflation.
- Easing monetary policy refers to the lowering of interest rates and deposit ratios by central banks.
- The Consumer Price Index (CPI) measures change in consumer prices. Core CPI excludes food and energy prices while headline CPI includes them.
- Bull steepening is when short-term interest rates fall faster than long-term interest rates.
- The 70-city simple average price index measures changes in the prices of residential buildings in 70 medium and large cities across China.
- The Monetary Union Index of Consumer Prices measures consumer inflation for all countries in the eurozone.
- Shunto refers to the annual wage negotiations between enterprise unions and employers in Japan.
- The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates to project future interest rate changes and economic activity.