2024

GLOBAL MARKET OUTLOOK

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CONTENTS

Overview: A fine balance	2
Economic Outlook	8
Key topics – What we are watching in 2024	16
Investment Strategy	22
Asset Classes	24

OVERVIEW

A FINE BALANCE

Inflation is moderating, growth is slowing, and the labour force is cooling. In 2024, we expect a shallow easing cycle to commence. For central banks, the timing and depth of rate cuts will be critical — too early, there's a risk that inflation reaccelerates; too late, and any downturn may be deeper than necessary. For investors, the year ahead will be a fine balance between chasing potential equity market gains and protecting capital should the soft-landing fail to materialise. Geopolitics, 'the election year', artificial intelligence and growing fiscal concerns mean volatility is a given. However, volatility provides opportunity, and in 2024 we expect tactical positioning to play an increasingly important role across portfolios.

THE FIRST WAVE OF FISCAL DOMINANCE

When considering the outlook for the year ahead, we typically start by reflecting on the 12 months prior — an important step in assessing the foundation for the period to come.

2023 was a year when most equity markets registered impressive gains and fixed income markets staggered through significant volatility to ultimately provide investors with solid returns. In fact, for markets, the past year might be best described as an 'everything rally' — one in which nearly every asset class registered positive gains. Remarkable, given monetary policy continued to tighten, the banking crises unfolded, war raged in Europe and conflict erupted in the Middle East.

This year, before considering the outlook for the 12 months ahead, we believe it is useful to reflect further on what has led us to this starting point in 2024, the lessons learnt from past experiences, and whether this cycle will ultimately finish differently to those before it.

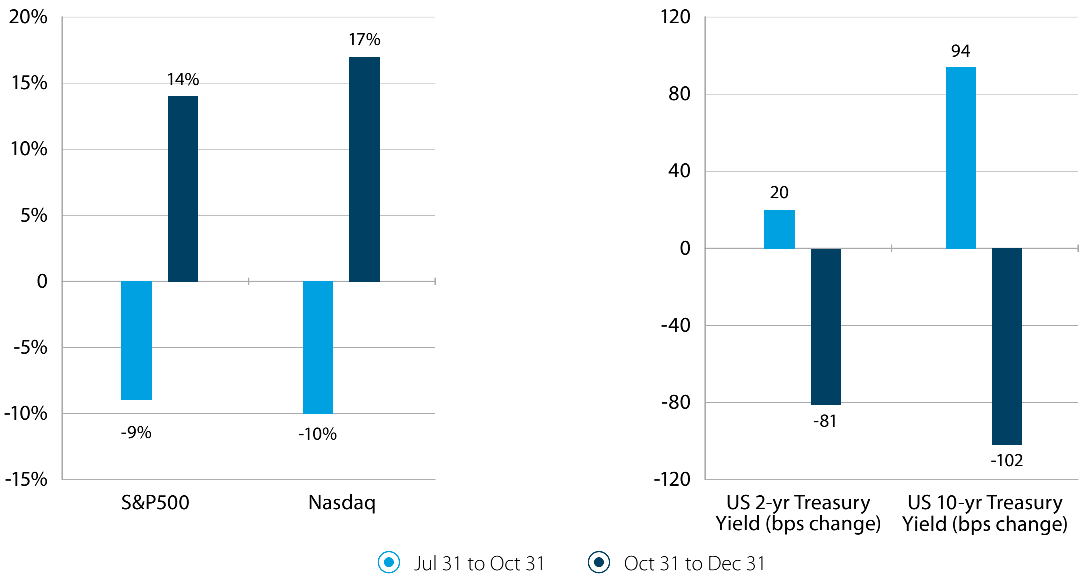
Since the 1970s, corporate profits have benefited greatly from the removal of trade barriers, favourable workforce demographics and an abundance of energy sources. Equally for consumers, following the 'Great Inflation' from 1965-82 and until the recent normalisation of rates, those disinflationary forces assisted in reducing the cost of capital and helped deliver significant asset-price appreciation.

More recently, however, and accelerated by the pandemic-period, many disinflationary tailwinds are fading. Even providing for the significant progress made by central banks in returning inflation towards target, we may be approaching a new chapter of structurally higher inflation — one that might require a 'higher for longer' rate environment.

Where a backdrop of higher rates typically leads to recession and a collapse in asset prices, so far, economies and markets have shrugged these off thanks to fiscal expansion that has supported households and corporates. Pandemic savings and tight labour markets have allowed consumers to continue spending and corporate profits to remain supported — well beyond what would normally be expected given such rapid tightening. Moreover, the onset of the first major credit event since the pandemic — the US banking crisis — was met with a liquidity bailout from the US Federal Reserve (Fed) and a government guarantee, arresting any lasting market fallout.

Where financial markets have previously been beholden to monetary policy moves, we may soon be entering a period of increasing fiscal dominance. Since the pandemic commenced, and even prior to a lesser degree, we have seen a greater willingness from governments globally to use fiscal tools to support economies. As demographics continue to evolve — driving political change and a further rise in populism — there may be a greater acceptance and

FIGURE 1: A TALE OF TWO FINANCIAL MARKET OUTCOMES FOLLOWING TREASURY QUARTERLY REFUNDING ANNOUNCEMENTS



Source: Strategas, ANZ CIO

indeed expectation of governments to run deficits and implement fiscally supportive policies. In an election year, the US government is likely to exhaust all its fiscal tools to keep the economy out of recession —a costly exercise.

Alongside the Fed's liquidity injection and government backstop during the banking crises in H1 2023, the stark difference in outcomes following US Treasury refunding decisions over the latter half of the year shows the power that non-conventional policy measures can yield. Treasury's decision to increase long-term debt issuance in August — for the first time in three years — saw bond yields jump and equities tumble. The subsequent reversal of this decision in November, alongside an increase in short-term issuance, and the market's perceived 'Powell pivot' led to a complete unwind of the moves through year-end.

Nonetheless, even if changing demographics prove more accepting of government deficits in future, successfully charting such a course against a 'higher for longer' rate environment may prove challenging. In the US, national debt tapped a new US$34 trillion high in December; and in November, net interest costs exceeded Defence spending for the first time in more than 20 years.

As we move towards a possible inflection point of more persistently elevated inflation, the nature of monetary policy may also change — being deployed less in response to growth imbalances and rather in response to managing inflation through the cycle. Here, rising rates are less likely to be reflective of a growing economy and rather a vulnerable inflationary environment. If this occurs, the negative correlation between bonds and equities that investors have become accustomed to over the past 20 years may turn positive on a more frequent basis — a phenomenon seen during the 'Great Inflation'. For investors, greater diversification and tactical asset allocation will become increasingly important.

THE GHOST THAT NEVER WAS

Since the word 'transitory' was first chosen by Fed Chair Jerome Powell to describe pandemic inflation, there has been considerable discussion regarding parallels with prior inflationary periods and the learnings policy makers must heed. The main comparison is to the 'Great Inflation' and the approaches of former Fed Chair, Paul Volcker and his predecessor, Arthur Burns.

Burns, who like Powell also inferred inflation was 'transitory' during his tenure, adopted a stop-start approach to policy — lifting the fed funds rate (FFR) as high as 13 per cent only to cut interest rates sharply due to recession, despite inflation remaining in double digits. This allowed inflation to reaccelerate to a new high until Volcker brought an end to the 'Great Inflation' by increasing the FFR to 20 per cent. In doing so, unemployment reached more than 10 per cent and twin recessions were inflicted on the US.

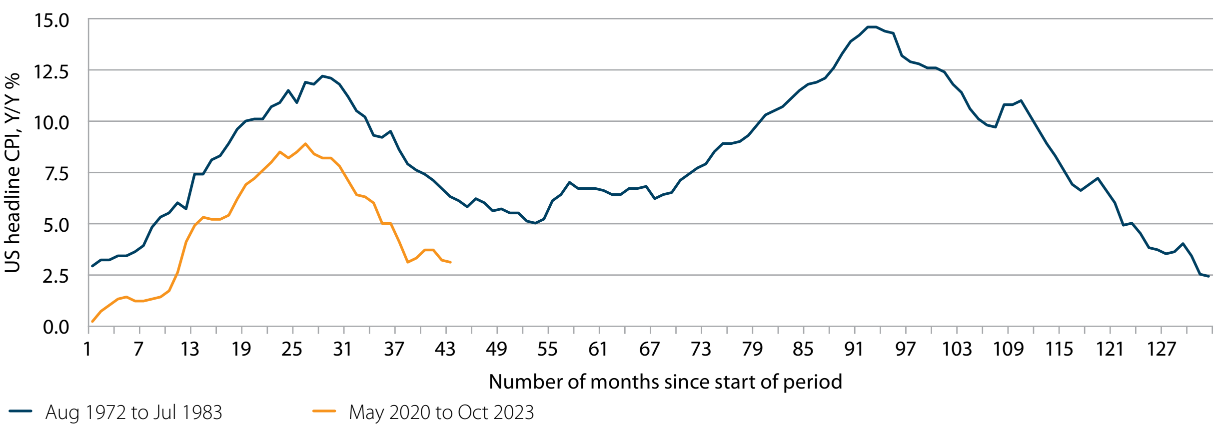
Powell has publicly stated his admiration for Volcker; meanwhile it's been suggested the 'ghost of Arthur Burns' has haunted the Powell administration from being too complacent in raising interest rates.

Burns insisted that monetary and fiscal policy must work together to arrest inflation. Using monetary policy only he suggested risked pushing the economy into a deeper recession than necessary. Interestingly, Burns' decisions were made against a social backdrop not dissimilar to today's rising populism. Burns contended with anti-Vietnam war protests, civil rights movements, significant labour strikes and a President (Richard Nixon) facing recession risks entering a re-election year.

So, while Burns is perhaps rightly villainised for his inability to slay inflation, we have no way of knowing the alternative had he persisted in increasing the FFR or maintained rates at their existing levels while recession ensued. While Jerome Powell may be haunted by the legacy of Arthur Burns, perhaps the alternative — the ghost of a Fed Chair who raised interest rates during recession – would be a far scarier proposition.

Despite a potential first wave of fiscal dominance, in 2024, with growth expected to deteriorate more meaningfully, we expect the path for inflation and the reaction function of the Fed to be the primary focal point for markets. Will Powell, in his haste to avoid being compared to Arthur Burns, simply become the Arthur Burns that never was — the version that kept policy restrictive as growth meaningfully deteriorated? Or will the much-vaunted soft landing finally be delivered?

FIGURE 2: COMPARING INFLATION ERAS



Source: BLS, Macrobond, ANZ CIO

ASSESSING THE LANDING

In 2024, investors will need to assess whether the current combination of fiscal and monetary tools is simply prolonging the cycle or fundamentally altering the standard transmission of tighter monetary policy — something that typically leads to a collapse in asset prices, a clean-out of bad debt and recession.

In recent years the challenge for central banks has been correctly calibrating monetary tightening. Now that rate cuts are finally coming into view, the appropriate timing and depth of any easing will be critical to the fortunes of the economy and markets. Should an easing cycle commence too early, or the Fed keep policy too high for too long, investors will quickly need to reassess positioning.

The market is currently pricing for Fed rate cuts from March. With inflation remaining above target and the jobs market strong, we believe this timing remains premature. Furthermore, equity markets have typically topped out ahead of an easing cycle. If equities remain well supported, yields retrace further, and credit spreads continue tightening, then financial conditions will improve — boosting sentiment and possibly economic activity. Rate cuts at this time would risk reigniting inflation pressures.

Rather, we look to Q3 as a potential starting point for the Fed to commence easing. We expect rate cuts to materialise in Europe from Q2, and Australia over the latter part of the year.

In our view, an earlier and more aggressive easing cycle would be reflective of a harder landing, where growth capitulates rapidly, the Fed is forced to intervene, and markets suffer. A shallow easing cycle, commencing over the latter half of the year, seems more consistent with a soft landing and an outcome that might be more supportive for markets.

Even so, growth is expected to weaken over the course of 2024. In the US, while GDP growth is expected to be 1.1%, a period of mild contraction or worse cannot be ruled out. Growth in Australia and Japan is slated to be 1.2%. For the euro area, expectations are for a more modest 0.4% increase. While in China, where growth remains robust relative to developed markets, GDP growth is forecast to ease to 4.2%.

While a soft-landing is plausible and could be supportive for markets in the year ahead, risks remain.

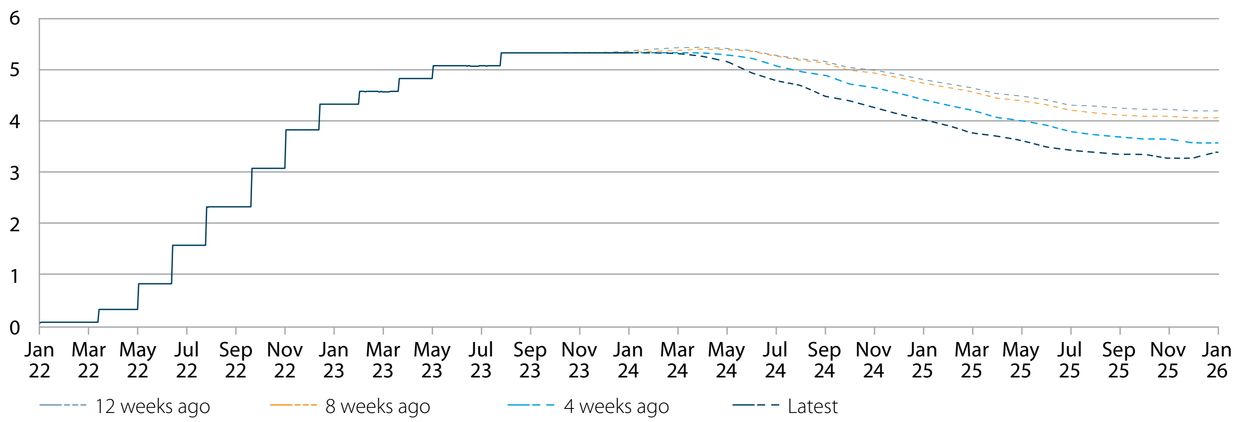
Among those is the presence of global elections. According to The Economist, "76 countries are scheduled to hold elections in which all voters have the chance to cast a ballot in 2024."

We expect geopolitics to again figure prominently and be a continued source of volatility for markets, an ongoing threat to supply-chains and an inflation risk.

This year, US pandemic savings are expected to run dry and unemployment is forecast to rise. US credit card balances have ballooned since the start of 2021, and delinquencies have climbed solidly. Consumer strength that has supported corporate profits during recent years appears to finally be weakening. With the US consumer weaker and growth forecast to be meagre, analyst expectations for double-digit EPS growth currently appear stretched.

And while central banks and governments have shown a willingness to intervene if financial conditions deteriorate rapidly, we cannot rule out a market dislocation should they fail to act in an appropriate timeframe.

FIGURE 3: THE STARTING POINT FOR FED CUTS STILL SEEMS PREMATURE



Source: New York Fed, CME Group, Macrobond, ANZ CIO as at 14 January

TACTICAL THROUGHOUT

This year, perhaps more so than previously, we believe tactical positioning will play an increasingly important role in managing client capital.

In 2024, we see scope for equities to rise further. However, even if a soft landing can be delivered, given the magnitude of challenges facing markets, a lot will need to go right for this to occur. Following the strong gains over 2023, we believe this probability remains low relative to the potential upside in risk assets. Irrespective, market performance across regions and sectors is likely to be uneven throughout.

One key aspect may be where and when to position for any global easing cycle — emerging markets, cyclicals, real estate, small caps, and the value sector could be among the beneficiaries. While we see the potential for mid-single digit upside across equity markets, there remains the possibility of greater downside too.

Balancing this possibility of equity gains against the potential for risk-adjusted returns from fixed income informs our positioning as we start the year.

Across portfolios we hold a preference for high quality fixed income assets, including Australian and global sovereign bonds, and investment grade credit. While we don't forecast a sharp fall in yields over 2024, as the starting point for rate cuts becomes clearer, we believe the US yield curve is likely to bull steepen. Alongside the current yield embedded in these assets, bonds should provide an opportunity to deliver solid risk-adjusted returns to portfolios.

Conversely, we start the year with an underweight to high-yield credit. Here, spreads remain tight and inconsistent with the prevailing recession risks.

If the economic downturn becomes more severe and central banks are forced to cut rates more aggressively, we expect high-quality fixed income to offer outsized returns to equities and solid diversification to portfolios also.

We are modestly underweight equities overall, with a current preference for developed market equities and European shares in particular. In Europe, equity valuations are relatively attractive, profit growth is likely to match the US, and an easing cycle should commence earlier.

In 2024, this theme of investing in previously underperforming and cheaper segments of the market is likely to be a feature of portfolios — providing the opportunity to participate in rallies while potentially limiting the downside in the event of a broader market pullback. Although we currently hold a modest underweight to Australian and emerging market equities, given recent underperformance and relatively cheap valuations, we look for opportunities to increase our positioning over the year.

Of course, valuations and past performance will not dictate positioning entirely. In the US, the 'Magnificent Seven' are expected to drive EPS growth. If a broader market pullback eventuates, we may use this as an opportunity to increase exposure to higher beta segments such as this.

For investors, 2024 appears delicately poised. A soft landing may allow equities to continue climbing; a misstep from the Fed could prove otherwise. So, while we commence the year positioned defensively overall, we will seek to actively exploit opportunities across risk assets as we navigate what is likely to be another volatile year for markets.

On behalf of ANZ, I'd like to take this opportunity to thank you for your ongoing support. We trust our Global Market Outlook will provide you with an understanding of what we expect for the year ahead.

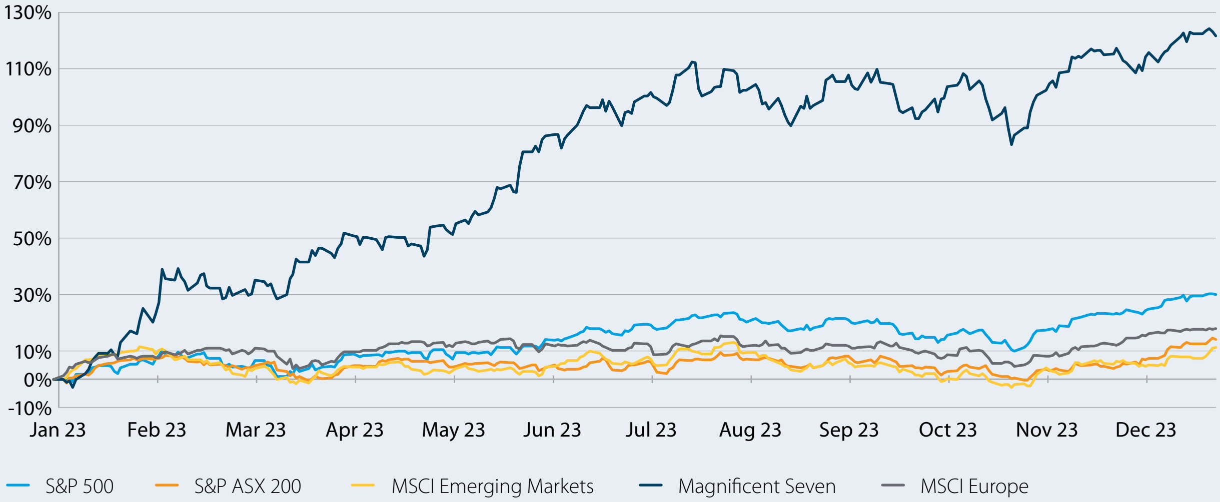
I look forward to meeting with many of you again this year as we continue to assist you with your investment needs and seek to provide further investment insights and opportunities over 2024.

As always, the team and I will be watching markets with interest.

Lakshman Anantakrishnan
Chief Investment Officer, ANZ Private

FIGURE 4: PERFORMANCE DIFFERENTIALS ARE EXPECTED TO FEATURE ONCE MORE IN 2024

2023 Calendar Year Performance: S&P 500 vs. S&P ASX 200 vs. MSCI Emerging Markets vs. MCSI Europe vs. Magnificent Seven



Source: Bloomberg, ANZ CIO as at 31 December 2023

FIGURE 5: ASSET CLASS RETURNS

Asset class	2014-2023 annualised returns	2023 returns	2023-2033 forecast annualised returns*
Australian shares	7.9%	12.1%	8.9%
International shares (unhedged)	11.7%	23.2%	9.5%
International shares (hedged)	9.5%	21.7%	9.7%
Emerging market shares	5.5%	9.2%	11.1%
International property (hedged)	5.0%	7.5%	8.5%
Infrastructure (hedged)	7.1%	-2.1%	9.0%
High Yield (hedged)	N/A	11.0%	7.4%
Australian fixed income	2.6%	5.1%	4.8%
International fixed income (hedged)	2.6%	5.3%	5.3%
Cash	1.8%	3.9%	4.5%

Index information: To 31 December 2023. Australian Shares – S&P/ASX 300 Accumulation | International shares unhedged – MSCI World ex Australia (Net) | International shares hedged – MSCI World ex Australia Net Index (hedged to AUD) | Emerging market shares – MSCI Emerging Markets (Net) in AUD | International property – FTSE EPRA/NAREIT Developed Rental Index ex Australia (hedged) | Infrastructure – FTSE Developed Core Infrastructure Net Hedged to AUD | Australian fixed income – Bloomberg AusBond Composite (0+Y) | International fixed income – Bloomberg Barclays Global Aggregate (AUD Hedged) | Cash – Bloomberg AusBond Bank Bill.

Source: FactSet, ANZ CIO.

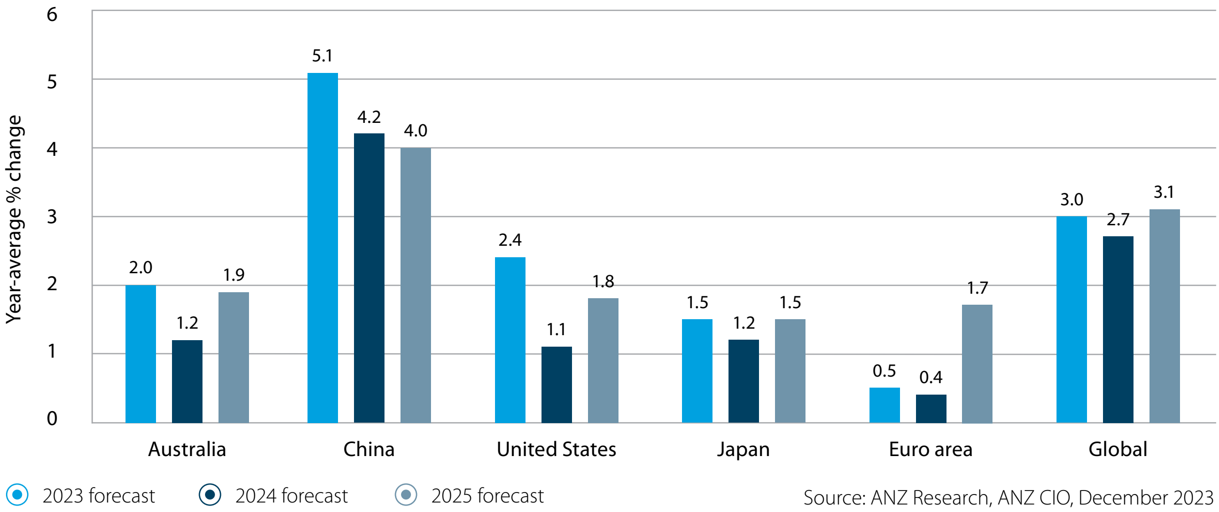
*Annualised returns are forecast through to September 2033 using Willis Towers Watson (WTW) capital market assumptions (CMA) from September 2023. CMAs are gross of fees and taxes unless otherwise stated.

ECONOMIC OUTLOOK

PREPARING TO LAND

In 2024, central banks are expected to finally engineer the long-awaited soft landing. Still, the prevailing conditions in which to achieve this will be no less challenging than last year. An expected rise in unemployment, stubborn services inflation, and the biggest year in election history suggest any outcomes remain far from certain.

FIGURE 6: GLOBAL GDP FORECASTS



Source: ANZ Research, ANZ CIO, December 2023

In 2023, the challenge for central banks was assessing the required level of monetary tightening. Strong employment, and the continued impact of pandemic fiscal measures saw demand remain resilient and inflation more stubborn than initially expected. However, over the latter stages of the year, we saw signs that labour market strength was weakening and economic activity easing. Central banks have confirmed the global interest rate cycle has turned, and in 2024 their challenge will be the appropriate calibration of monetary easing.

In the US, growth was incredibly strong over Q3 2023, and this momentum is expected to have carried into Q4. Nonetheless, we believe monetary policy is now sufficiently restrictive – and owing to the lagged effects of policy, growth should slow meaningfully over the year ahead.

ANZ Research forecasts annual GDP growth for the US of 1.1% but cannot rule out a period of mild contraction. Alongside reduced labour market demand and dwindling pandemic savings, we expect US consumer strength to weaken over the course of the year and for broader macro conditions to allow the Fed to commence easing from Q3. This is likely to be preceded by cuts from the European Central Bank (ECB) in Q2 and followed by the Reserve Bank of Australia (RBA) in Q4.

These easing cycles are expected to be relatively shallow by historical standards. The Fed's latest dot plot suggests 75 basis points of easing this year. ANZ Research expects 100 basis points of rate cuts in 2024 followed by a further 100 basis points in 2025.

In Australia, while continuing to moderate over 2024, inflation isn't expected to return to target until 2025. Still, the possibility that quarterly inflation annualises just within the band over the latter half of the year, combined with modest economic growth, provides scope for the RBA to begin cutting rates late this year.

Where the central banks of Australia, the US and Europe are all expected to ease policy, economic conditions in Japan may finally allow the Bank of Japan (BoJ) to commence normalising monetary policy.

The above outcomes would be consistent with a soft landing. But there also remains the possibility that inflation doesn't recede as expected or even worse there is a resurgence in price pressures. It also reflects an expectation that growth declines modestly, assumes central banks have correctly calibrated the tightening to date and the same is done with any easing over 2024.

In China, while growth should continue to outpace each of the major developed market economies, its slowdown appears structural and its recovery from 'zero-covid' remains fragile. Risks of a spill over to the global economy cannot be completely discounted.

Bond markets are currently pricing seven rate cuts from the Fed in 2024, starting as early as Q1, suggestive of a more material downturn than currently expected. Meanwhile, equity markets are near all-time highs indicating a soft landing is all but given. This mismatch comes in a year when countries responsible for more than half the world's population will head to the polls to vote, and when fiscal and geopolitical brinkmanship are likely to remain a constant threat to markets.

Central bank assumptions and expectations have proven incorrect repeatedly since the pandemic. Given the strong rally in markets last year, investing with a prevailing certainty that the soft landing will be delivered could prove risky.

Disclaimer: Components of the 'Economic Outlook' section, associated charts and content relating to the Australian dollar on page 31 have been derived from the ANZ Research Quarterly, December 2023.

AUSTRALIA

In 2024, GDP is forecast to grow modestly by 1.2%. First half growth is expected to be primarily led by public sector and private business investment. Over the second half, the advent of Stage 3 tax cuts, the potential for discretionary fiscal easing, and a continued moderation in inflation should provide households with a pick-up in real incomes and a platform to increase consumer spending over H2. Nonetheless, real income growth will come from a soft base — potentially limiting consumption growth — and some households will likely use the increase to boost savings.

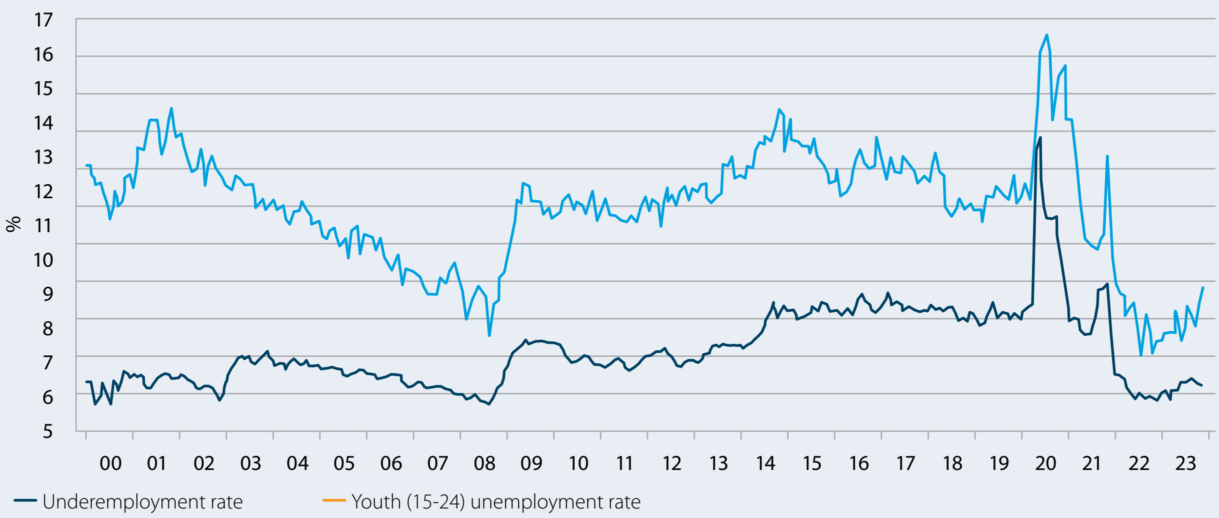
Despite the sharp rise in interest rates, strong population growth and tight supply has helped support property prices over 2023. These factors are again expected to assist housing markets over 2024, with ANZ Research forecasting further growth of 6%.

Strong population growth is also expected to influence the unemployment rate this year. As population growth exceeds employment growth it should assist in pushing the unemployment rate to somewhere near 4.25% by the end of 2024. There have already been initial signs of labour market easing, including a slowdown in growth in hours worked, a pick-up in the youth unemployment rate and a modest increase in underemployment.

Of course, inflation and the reaction function of the RBA will once again be a major focal point in 2024. We expect inflation to moderate over 2024, but the pathway to be far from linear. With growth in domestic demand remaining reasonable, the RBA will likely want to wait to assess the impact of tax cuts on the household sector (particularly if inflation remains above target) before considering any easing. On this basis, the cash rate is expected to remain at 4.35% for much of 2024.

While annual inflation will likely still be above the RBA's 2-3% target band in H2 2024, ANZ Research expects quarterly inflation to annualise just within the band. Combined with modest growth, this should open the door for the RBA to consider the commencement of a shallow easing cycle late in 2024.

FIGURE 7: EARLY SIGNS OF LABOUR MARKET EASING



Source: ABS, Macrobond, ANZ Research, as at December 2023

UNITED STATES

Last year, the US economy displayed incredible resilience, outperforming most expectations. Q3 real GDP growth increased 4.9% on an annualised basis and this momentum is expected to have continued into Q4.

However, with the real policy rate restrictive, growth is expected to wane over the coming quarters as the lagged effects of Fed tightening weigh on economic activity and the jobs market. Alongside dwindling pandemic savings, this should see demand ease.

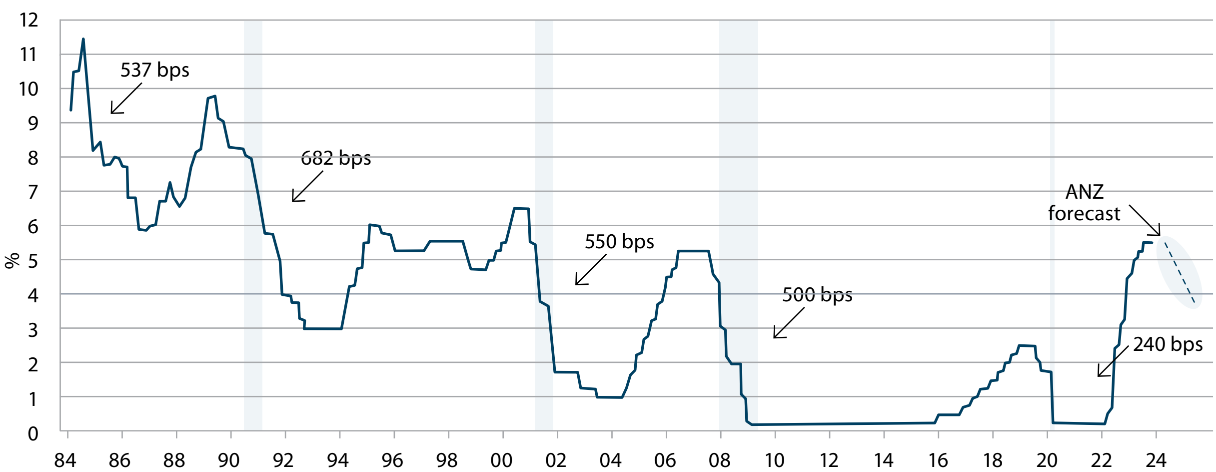
Typically a reliable indicator of recession, the US yield curve (10y less 3m Treasury bonds) entered its 15th month of inversion in December — the longest period since the early 1980s. ANZ Research forecasts annual average GDP growth of 1.1% in 2024 but cannot rule out a period of mild contraction. If this transpires, it is expected to be short-lived with no hard landing currently forecast. Consumption has remained strong, boosted by tight labour markets, pent-up services demand, pandemic savings and a recovery in real wage growth. It has typically taken around 16-18 months for private consumption to start weakening following curve inversion — suggesting Q2 2024 will be an important period to observe consumer strength.

Alongside pandemic savings, labour market strength has been a key catalyst in shielding the economy from the Fed's tightening. However, labour market indicators have begun to ease more recently. While not suggesting recession is imminent, they intimate a recession remains plausible if the current deterioration continues. The quits rate has fallen to 2.3% — a dip below 2.25% has been an accurate signal for recession this millennium. Another, Sahm's Rule, argues recessions normally occur when the three-month average of the unemployment rate has risen 0.5% above its recent low — it is currently 0.3% above its nadir. Although typically this needs to be accompanied by an absolute fall in payroll employment — which is yet to materialise.

Inflation was a major story in 2023, and developments across the key inflation buckets of goods, shelter, and services ex-shelter, continue to be promising. The normalisation in supply-chains and re-orientation of spending to services is contributing to aggregate goods price deflation. Shelter cost inflation has eased, with the three-month average to November being 0.4% m/m down from 0.7% m/m in Q1 2023. Core services ex-shelter inflation is also moderating.

Against a backdrop of weakening labour markets, slower growth and moderating inflation, ANZ Research expects the FOMC to commence a 200bp easing cycle later this year — likely starting in Q3 and extending into the first half of 2025. That said, the timing and level of any cuts will be driven by the speed that data continues to moderate.

FIGURE 8: FED FUNDS RATE



Source: Fed, Macrobond, ANZ Research

JAPAN

Most developed market central banks have begun thinking about policy easing. In 2024, Japan could again be the outlier, as economic conditions may finally allow the BoJ to raise rates. Other aspects of BoJ policy, including yield curve control, continue to remain open to change at any time.

Japan's GDP shrank by 0.7% q/q in Q3 2023, with private demand shrinking for the second successive quarter. Despite this, both the BoJ and Cabinet Office estimate Japan does not have an output gap — something evidenced by the jobs market, which is at its tightest point since the early 1990s.

Even with household spending more subdued recently, the outlook for Japan is encouraging, with positive signs for workers and unions. The Japan Trade Union Confederation is pushing for a wage increase in fiscal year 2024 of 5% or more, including a base-pay rise of at least 3%. Pay rates for non-union workers are also rising, albeit by smaller margins.

Moreover, the government announced economic stimulus measures in November that should further support household consumption. These included cash handouts, tax rebates and extended subsidies for gasoline, natural gas and power.

Elsewhere, businesses are thriving as margins increase amidst improved pricing power and greater productivity. This is leading to further business investment, including labour-saving technology that is designed to address the severe worker shortage.

Price and wage setting behaviour appears to be shifting alongside the rising longer-run inflation expectations of households and corporations. Sticky service-based inflation is rising in response to higher wages growth — the latter increasing partly because of elevated inflation. Where other central banks are actively trying to stop wage price spirals, the BoJ is eager to see this continue.

Services inflation has just lifted above 2%, and although it will likely need to push a little higher before overall inflation can be sustained at 2% (as long-run goods-based inflation isn't far from zero), given labour markets are so tight, there is a decent chance wages growth and therefore services inflation will rise also.

In 2024, ANZ Research forecasts GDP of 1.2%. However, with GDP growth likely to be above trend over the next couple of years, persistent 2% inflation might finally be within reach.

FIGURE 9: JAPAN'S LABOUR MARKET CAPACITY

Source: BoJ, SBJ, Macrobond, ANZ Research, as at December 2023

EUROPE

Growth in the euro area is stagnant. In 2024, ANZ Research expects real GDP to increase by only 0.4%. The weakness in economic activity is attributable to both cyclical and structural factors. The former relates to record policy rates, easing fiscal stimulus and softer labour markets. The latter is partly a result of climate transition affecting output in key industries, and energy costs that are still double (or more) their long run average.

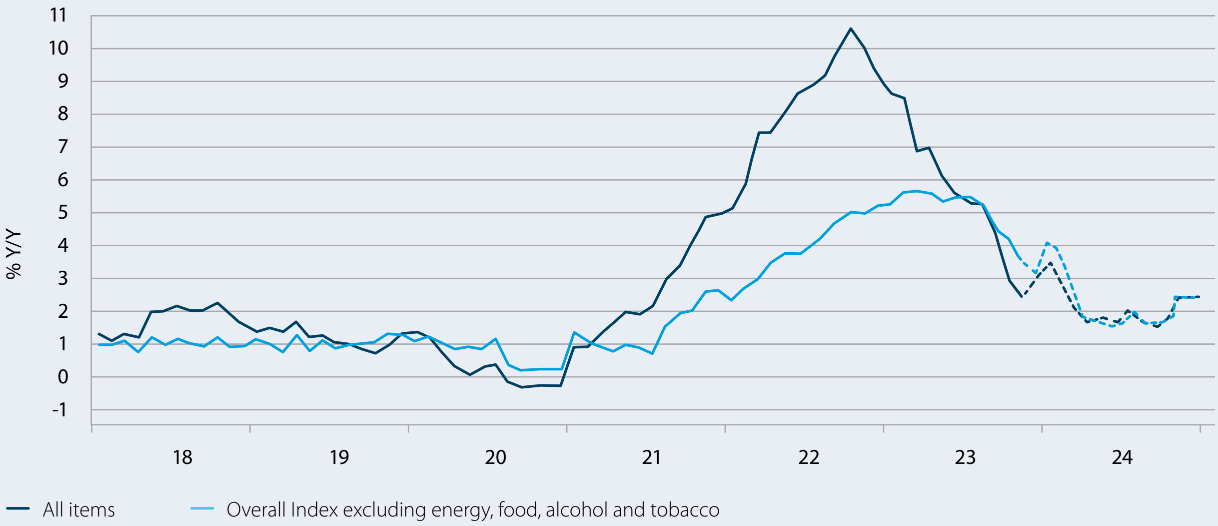
Fiscal policy will likely tighten further in 2024 as energy support measures are phased out. Moreover, restrictive monetary policy is expected to keep private consumption weak. The ECB's record level of tightening has quickly impacted the real economy. The three-month average of M3 — the broadest measure of an economy's money supply — was -1.1% y/y in December, while credit growth to non-financial corporates contracted 0.3% y/y in October.

Despite this, consumer and business sentiment should improve as 2024 progresses. Moderating headline and core inflation are having a positive impact on growth expectations. The current six-month average of core inflation is 0.1% m/m. Assuming a conservative forecast path of 0.2% m/m, core inflation should fall below target in April, allowing the ECB to consider rate cuts from Q2.

ANZ Research anticipates 150 basis points of rate cuts this year. Lower interest rates should provide a catalyst for a modest recovery in private demand, and cheaper credit could boost private sector demand for money too. Sustainably lower inflation should also support real wage growth and private consumption accordingly.

While the economic environment in Europe currently appears bleak, we expect gradual improvement over the course of 2024.

FIGURE 10: EA HICP FORECAST TO CONVERGE ON TARGET



Source: Eurostat, Macrobond, ANZ Research as at December 2023

CHINA

China's recent PMI figures suggest a bumpy road to recovery. In 2024, ANZ Research forecasts GDP growth of 4.2%, down from an expected 5.1% in 2023.

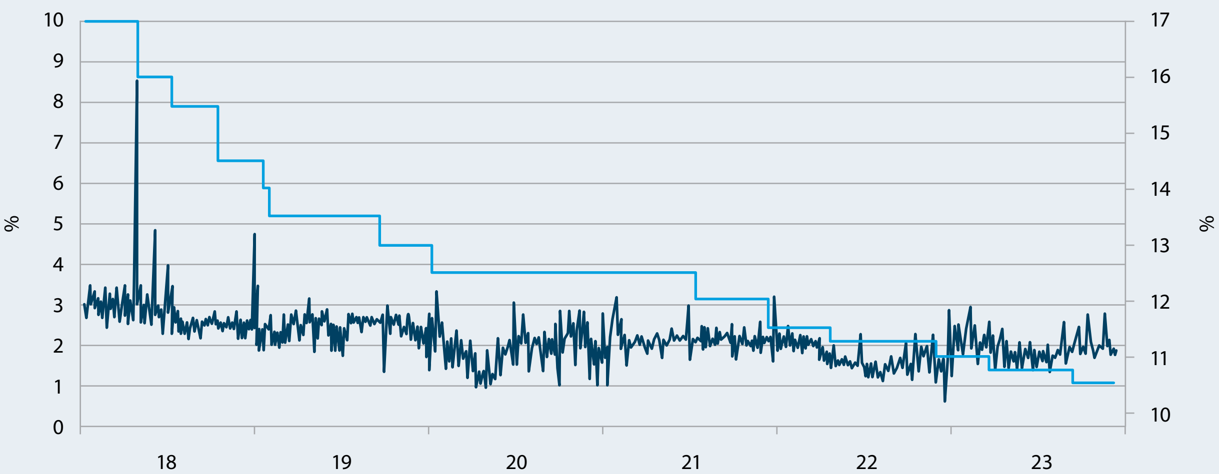
In 2024, Chinese consumption is expected to grow modestly. Retail sales are forecast to rise to 4-6% on a nominal basis, with issues amongst the property sector possibly resulting in a negative wealth effect on household spending. Moreover, with unemployment expected to remain problematic, households are likely to spend cautiously.

More positively, holiday spending and domestic tourism should be more robust in 2024. There is a policy to support the development of 'domestic circulation'. ANZ Research expect the government will relax outbound travel arrangements with other countries gradually, however, do not expect outbound tourism to return to pre-pandemic levels — meaning households are more likely to holiday domestically.

China's property woes were one of the prominent stories of 2023. According to ANZ research, the central government's housing policy — notably, common prosperity – has likely caused a permanent shift in buyers' appetite. Given the declining population, inventory levels are expected to continue growing. Unlike the sharp cyclical adjustment in 2012-2015, the excess supply condition could last much longer. That said, recent policy developments support the view that the central government will bail out or possibly nationalise the housing market — ensuring there is not a significant collapse.

China's output gap remains negative and as such monetary policy is expected to be prudently accommodative in 2024. ANZ Research expects a modest reduction of policy rates (7-day reverse repo, Medium-term Lending Facility). Chinese authorities have a scorecard that focuses on overall economic development and the general wellbeing of households. Monetary policy easing is considered a potential cause of asset price bubbles that could extend the wealth gap — and therefore runs contrary to the common prosperity policy objective.

FIGURE 11: CHINA SHOULD MAINTAIN A LOW RATE REGIME



China InterBank repo rate 7 days, LHS — China required deposit reserve for major banks, RHS

Sources: Bloomberg, Macrobond, ANZ Research as at December 2023

KEY TOPICS

WHAT WE ARE WATCHING IN 2024

The economic cycle has been extended and equity markets have advanced. This year, several competing factors could prolong or end the cycle. The implications for markets and opportunities for investors will be varied. Irrespective, in 2024 we expect fixed income to continue to present compelling value for investors.

THE US CONSUMER

In the US, consumer spending accounts for approximately 70% of the nation's GDP.

Despite the sharp rise in interest rates over the past two years, the balance sheet of the US consumer has been supported by the swathe of fiscal measures unleashed at the height of the pandemic, America's 'Great Resignation' and the subsequent labour hoarding by corporates.

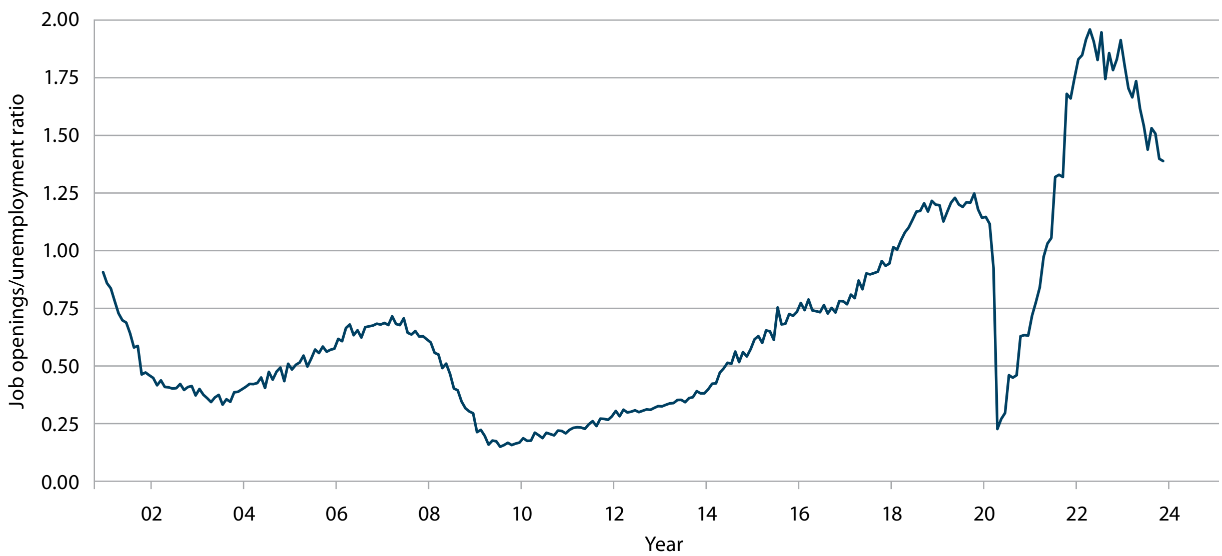
These factors have assisted households to absorb rising costs from corporates, while helping bulging profit margins as consumer demand has held up in the face of cost push inflation and rising debt servicing costs. Nonetheless, over the latter stages of 2023 we began to see signs that the strength of the US consumer could be tested in the early part of this year.

Firstly, temporary employment — often a precursor to broader labour market direction — has turned lower in recent months. Moreover, while still at a level that is inconsistent with recession, the ratio of job openings to unemployed persons has turned sharply lower. And after bottoming out in the first quarter of 2021, US credit card balances have skyrocketed over the past two and a half years — coinciding with a sharp fall in the savings rate of US households as a percentage of disposable income. The fact these are occurring at the same time as a solid rise in credit card delinquencies is unlikely to be a coincidence.

With the Fed eager to see further cooling in the jobs market and with an expectation that pandemic savings will finally be exhausted in 2024, a significant part of the corporate outlook will hinge on how far US consumers are willing to stretch themselves. If unemployment rises further as expected, many consumers may not have a choice. And with the market expecting double digit earnings growth in 2024, any downside surprise in US consumer spending could have a negative impact for the share market too.

Despite the potential headwinds, investors should remember that wealth creation is achieved through the compounding of returns over the long term. As such, our investment approach focuses on managing portfolio risk so an investor can remain invested throughout the changing conditions of a full market cycle. We believe a long-term diversified investment strategy is the best way to achieve this. Additionally, in 2024, tactical positioning is likely to play an increasingly important role across portfolios as investors position for a potential easing cycle.

FIGURE 12: DEMAND FOR LABOUR IS COOLING



Source: BLS, Macrobond, ANZ CIO as at December 2023

RISING CREDIT RISKS

In 2024, the story of rising delinquencies is unlikely to be confined to consumers. Indeed, rising credit risks amongst corporates could also be a major headline as the lagged impact of policy tightening has a more marked effect.

So far, corporates — both private and public — have largely withstood higher borrowing costs. Nonetheless, even if interest rates commence their decline later this year, owing to numerous drivers of structurally higher inflation, we believe the period of easy money since the global financial crisis (GFC) has likely finished.

Structurally higher interest rates may prove problematic for governments also. In November last year, the US government's net interest costs exceeded Defense spending — something that had not occurred in more than 20 years. Indeed, interest costs hit almost 16% of tax revenue in November. According to research from Strategas, when net interest costs have historically moved above a 14% threshold, financial markets impose austerity on policymakers. In an election year, austerity measures might prove difficult to enact, so the government will also be eager to see rate cuts materialise.

The concern for borrowers across the corporate spectrum is multi-faceted. The risks facing small banks with large exposure to commercial property books was well documented post the collapse of Silicon Valley Bank. The latest findings from the National Bureau of Economic Research (NBER) suggest commercial real estate (CRE) loans account for US$2.7 trillion of bank assets or roughly a quarter of assets for the average US bank. Following the decline in property valuations since the pandemic, NBER believes some 14% of all loans and 44% of office loans could be in negative equity. Moreover, more than US$1 trillion of CRE loans are expected to require refinancing prior to the end of 2025.

However, it extends further. Like consumers, many corporates became accustomed to the period of declining interest rates following the GFC. Additionally, a significant amount of debt was issued as 'free money' during the pandemic period. This is particularly pronounced across the junk debt market where, according to Bloomberg, more than 40% of maturing high yield debt that will require refinancing between 2024 and 2026 was taken out during the pandemic period. These companies face the very real prospect of refinancing debt at twice the level it was initially issued. And while not extreme, Fitch expects high yield default rates to peak in 2024 at between 5-5.5%, up from 2023 default forecasts of 3.0-3.5%. S&P Global expects defaults to reach 4.5% by the middle of the year.

It's not just that interest rates have risen strongly and are likely to remain elevated for some period that is concerning. According to the Fed's senior loan officers' opinion survey — that seeks to understand how US banks are considering lending to consumers and businesses — credit conditions have tightened materially since mid-2022. For some businesses, this might mean turning away from banks and public market issuance towards private credit markets for funding — where repayment terms are less favourable, and the cost of funding is generally higher.

The refinancing issue also extends to private equity (PE). For some of these PE consortiums that borrowed extensively at uber low rates to purchase businesses, the next year may prove to be a litmus test, as initial company valuations (and their subsequent equity holding) reset at much lower prices against the spectre of higher interest rates.

Many of these companies require capital injections, and with investors remaining cautious, some PE firms are needing to consider less traditional approaches to keep companies with large liabilities afloat. These include borrowing against other fund assets to pay investor distributions, or making 'payments in kind' against the existing debt obligations of underlying firms.

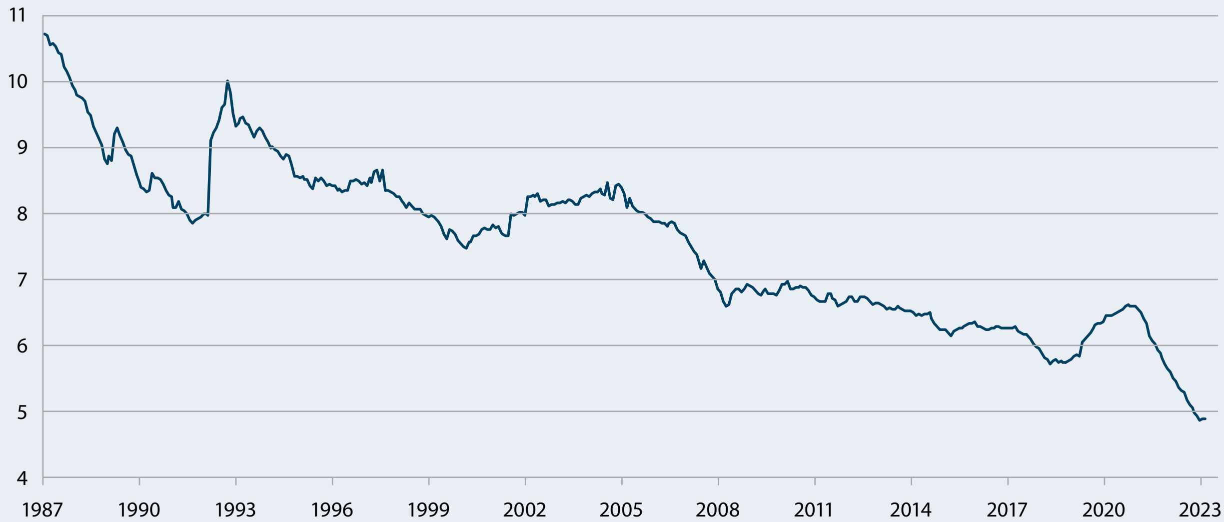
A more positive spin on this approach is that PE firms are conserving liquidity for future opportunities; conversely, it could be argued they are simply 'kicking the can down the road' by keeping companies afloat in the hope that a sharp reversal in interest rates allows the eventual refinancing to be undertaken at a lower cost.

In a world where initial public offerings are well below the peak seen in 2021, and merger and acquisition activity remains subdued, there is also potentially less opportunity to exit some of these underperforming and over-levered businesses.

When there is the possibility of market distress, there is also generally an opportunity for those investors with a stronger risk appetite. Globally diversified managers, with a proven track record of navigating these environments, may be able to take advantage of such market dislocations should they transpire — often at the expense of those investment managers that lack the experience of managing capital through a full credit cycle. When considering investment across high yield and private credit, we utilise experienced investment managers with proven credentials who run globally diversified portfolios. After all, remaining invested throughout the full market cycle is one of the most important factors in long-term wealth creation.

FIGURE 13: US HIGH YIELD DEBT HAS SHORTEST MATURITIES ON RECORD

Bloomberg US Corporate High Yield Statistics Index – Index Time to Maturity (Years)



Source: Bloomberg, ANZ CIO as at December 2023

GEOPOLITICS AMIDST THE ELECTION YEAR

One of our four structural thematics is people and demographics — centred on ageing populations, growing wealth inequality, an increasing scarcity of trust between and within regions, and rising populism as new generations ascend to power.

Since 2022, we have witnessed two significant hot wars and growing cold war tensions. While we are not suggesting there will be further kinetic conflicts in 2024, we do believe this year could be a microcosm of the challenges investors will face in the decade ahead.

This year, investors will see no less than 40 national elections. According to The Economist, "76 countries are scheduled to hold elections in which all voters have the chance to cast a ballot." All up, these countries are believed to account for more than half the world's population.

Amongst these, the outcomes of the US and Taiwan elections will be closely scrutinised and could lay the foundation for the next chapter in US-Sino tensions.

Moreover, the US election could play a significant role in portfolio sector biases with some investors already positioning for potential outcomes. A win for Biden is most closely correlated with outperformance from Communication Services, Consumer Discretionary and Tech. Conversely, a Republican title is more closely correlated with gains for Financials and Industrials — although infrastructure within the Industrials sector would be a likely beneficiary from a Biden salute given the Inflation Reduction Act (IRA), and the CHIPS and Science Act.

While the first quarter of presidential election years are historically weak for stocks, perhaps positively for markets, the S&P 500 has not declined in a presidential re-election year (when an incumbent is running) since 1948. The theory is sitting presidents have numerous tools at their disposal to keep the economy afloat — possibly a double-edged sword in a year when the Fed is desperately attempting to return inflation to target.

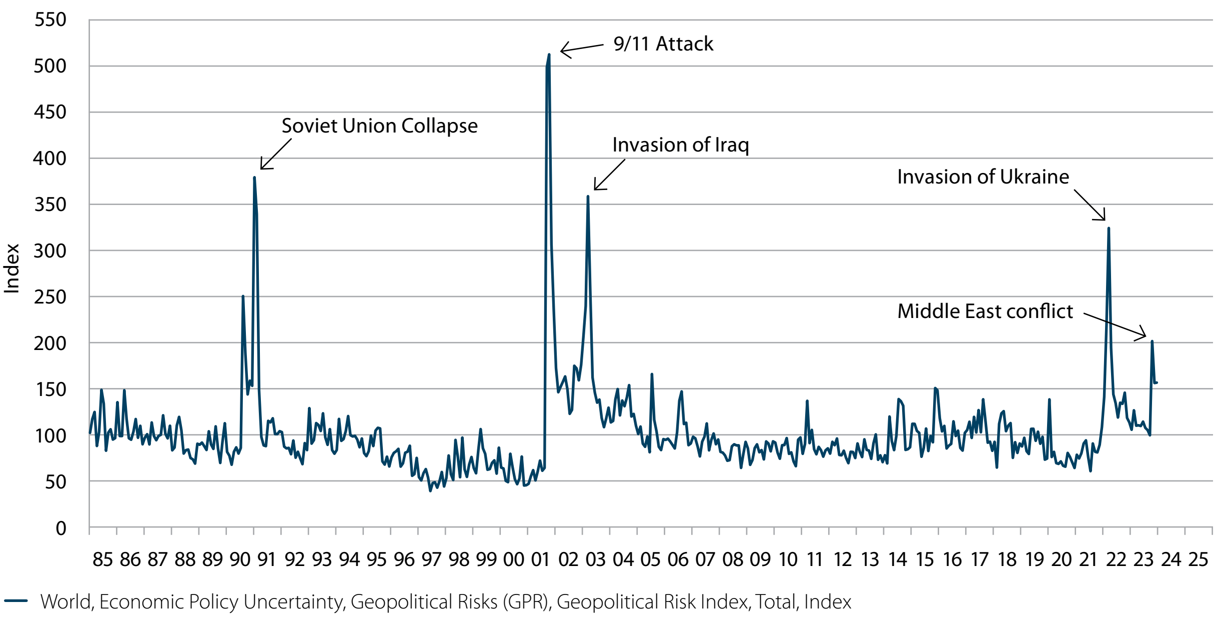
Geopolitics typically has a short-lived impact on markets and resulting spike in volatility. Indeed, markets have performed admirably over the past two years given the geopolitical headwinds.

As the chart below shows, although geopolitical risks spiked following the onset of the Middle East conflict, they have remained relatively elevated since the invasion of Ukraine.

While the outcome of many elections remains unclear, an expectation of volatility from geopolitical tensions in the year ahead is perhaps more predictable and investors will need to ensure portfolios are positioned to navigate this.

In 2024, we will be adjusting the strategic asset allocation of our core portfolios to prepare for the period ahead. The changes will include a strategic allocation to gold and an increase in alternative assets, incorporating hedge funds. For investors, we will also discuss how some global macro strategies may complement core portfolios.

FIGURE 14: GEOPOLITICAL RISKS ARE RISING



Source: Economic Policy Uncertainty, Macrobond, ANZ CIO as at December 2023

FIXED INCOME — OPPORTUNITY ONCE MORE

The first three topics may have a hint of pessimism attached to them. However, we expect they should also provide tactical opportunities for investors this year. That aside, our final theme is undoubtedly a good news story for investors — the end of the bond bear market.

Long the anchor and defensive ballast for diversified multi-asset portfolios, bond markets were pummelled over 2021 and 2022 as rising inflation — followed by hawkish policy moves — battered a once reliable asset class. With central banks increasingly appearing to have finished tightening policy and with the market looking towards rate cuts in 2024, the outlook for some fixed income assets appears constructive once more.

Despite the bond rally into the end of 2023, yields remain relatively attractive from an outright and historical perspective. Our analysis suggests with yields at current levels, longer-term bond returns should be favourable for multi-asset investors.

Modelling indicates that 10-year government bond yields are a strong precursor to longer-term bond returns. The yield on the US 10-year Treasury note hit a 16-year peak last year, and Australian 10-year government bond yields reached their highest point in more than a decade.

This starting point for yields is important. Our analysis suggests that since the late 1970s, future three-year returns have been positive for investors when starting yields were above 2%.

Moreover, while periods of yield curve inversion may seem unfavourable for adding bonds to portfolios, the counterfactual is often true. The recession that typically follows such inversions provides an environment where not only do bonds markedly outperform relative to periods of upward sloping curves, but they also tend to provide excess returns to cash and equities. The US 2-/10-year yield curve, typically a harbinger for recession, has been inverted since July 2022 — the longest period since 1980.

We cannot rule out better investment returns from equities this year, particularly given the strong momentum seen over the latter part of 2023. However, we are confident that bonds should provide better risk-adjusted returns for investors as we enter an increasingly volatile period.

Furthermore, for investors that have enjoyed solid returns from cash and shorter duration investments since central banks began tightening policy in 2022, the prospect of rate cuts brings the need to consider rollover risk. That is, the potential for reinvestment to occur at lower rates should central banks be loosening policy or approaching this point.

In 2024, we commence the year with a tactical preference for investment grade and sovereign bonds across portfolios — both global and domestic. As we enter a period of expected vulnerability, and with yields at elevated levels, investors have a unique opportunity to build more resilient portfolios by increasing their allocations to fixed income.

Of course, as with all investment decisions these should be made in conjunction with an advisor, and any potential allocations to longer-duration fixed income assets should consider liquidity requirements, risk tolerance and be made within the context of an investor's entire multi-asset portfolio.

FIGURE 15: YIELDS HOLD A STRONG CORRELATION WITH LONG-TERM BOND RETURNS

Source: Bloomberg, ANZ CIO as at December 2023

INVESTMENT STRATEGY

REMAINING DEFENSIVE WITH TACTICAL OPPORTUNITIES THROUGHOUT

Last year, markets pressed higher against the spectre of rising interest rates, the banking crises and two hot wars. This year, while we see scope for this momentum to continue — even if rates decline as expected, there remains no shortage of challenges for equities to overcome. For investors, we believe tactical positioning will play an increasingly important role in managing risk and taking advantage of opportunities.

2023 was punctuated by three distinct periods. An early year rally was abruptly ended following the collapse of Silicon Valley Bank and Credit Suisse's takeover by UBS. However, the correction was short lived as the Fed and US treasury provided a 'put' of financial market liquidity.

This provided a platform for equities, led by the 'Magnificent Seven' to rise sharply through mid-year before bond yields rose to near 16-year highs, as traders pared bets on the timing of rate cuts, driven by strong US economic data suggesting the Fed would remain patient in its quest to tame inflation.

The correction appeared a healthy one for markets, until seasonality, growing expectations of a peak in interest rates, and a US Treasury refunding decision ignited a final push for equities and a sharp decline in yields to year-end.

Looking ahead to 2024, we expect markets to again be susceptible to significant swings. Last year, where bond markets were hit with increased volatility, this year it may be equities that are forced to navigate greater uncertainty.

The equity market rally over the first part of 2023 followed the sharp sell-off the year prior. In 2024, the starting point for equities is vastly different. The MSCI World ex-Australia index rose more than 20 per cent last year, with almost half this gain registered in the final quarter.

Equity market valuations are rich on an outright basis, and particularly relative to fixed income where yields remain elevated from a historical perspective.

Markets are currently pricing for the global easing cycle to commence from the first quarter of 2024 — with as many as seven rate cuts from the Fed over the course of the year. We are more circumspect and point to Q3 as a potential starting point for Fed easing. This is contingent on further labour market cooling, inflation continuing to moderate and economic activity declining. Moreover, we currently expect any easing to be less aggressive than current market consensus.

In our view, a shallower easing cycle would be more consistent with the soft-landing narrative that equities appear positioned for.

The alternative, where meaningful rate cuts materialise, is suggestive of a harder landing and one where growth capitulates to such an extent that the Fed is forced to intervene to stimulate activity. If this were to occur, we would expect corporate earnings to suffer, equities to decline and fixed income markets to provide outsized returns for investors.

Against analyst expectations of double-digit EPS growth, this leaves plenty of room for disappointment; particularly when considering that markets will need to navigate what has been touted as the biggest year in election history, with national elections taking place in countries that represent some 80% of the globe's stock market capitalisation. As a result, further geopolitical brinkmanship is likely to be a headwind for markets and any increase in armed conflict or tit-for-tat sanctions threatens to disrupt supply-chains — presenting a risk for inflation and monetary easing. If rates are forced to remain higher for longer than forecast, markets would be expected to reprice accordingly.

This is not to suggest equities can't climb further, but after significant gains in 2023, the possibility of additional upside appears limited relative to the potential risks. Furthermore, any gains are unlikely to be linear, with the potential for sizeable performance variations across regions and sectors. Indeed, tactical equity positioning ahead of, and throughout, the global easing cycle may prove critical for investors over 2024 and well into 2025.

As a result, we commence the year with portfolios positioned modestly below benchmark to equities. Within equities, we maintain a preference for developed market shares, where we favour the relative outlook for European equities.

The European market is trading at a sizeable valuation discount to the US, and we find it difficult to reconcile how this can widen further. Especially given cuts are expected to come earlier from the ECB, profit growth should be similar on either side of the Atlantic, and more consistent across European sectors.

In the US, we believe EPS growth is likely to be driven by the 'Magnificent Seven'. Artificial Intelligence (AI) and Disruptive Technology — one of our four structural investment themes — are once again expected to capture market attention in 2024. We look for broader market pullbacks throughout the year as a potential opportunity to increase our discrete exposure to those market segments positively exposed to this theme.

Although we currently hold a very mild underweight to Australian shares and are modestly below benchmark to emerging markets, throughout 2024 we will closely assess opportunities to increase exposure to both. Valuations are appealing on a relative basis, providing the potential for portfolios to benefit during broader risk-on environments while offering some downside protection given the significant underperformance over 2023. Moreover, earnings expectations remain subdued relative to global developed markets.

In the case of emerging markets, should the Fed begin easing in the second half of the year, the strong correlation between emerging markets and a weaker US dollar may also benefit investors.

Conversely, the outlook for bonds appears more stable over 2024. Even after the decline in yields over the latter part of 2023, for US Treasury yields to finish the year higher we would probably need to see a reacceleration in inflation and further Fed tightening. While this could be somewhat unpleasant for bonds, we would expect the outcome to be far worse for equities.

As central banks move closer to an easing cycle, greater clarity on the timing of rate cuts should provide an attractive backdrop for fixed income assets to provide investors with solid risk-adjusted returns.

As a result, we commence the year positioned defensively overall, with overweights to sovereign bonds and investment grade credit — both global and domestic. We are modestly underweight equities and will likely seek to take tactical positions across underperforming segments, and potentially higher beta sectors if markets rally over the course of 2024.

FIGURE 16: ASSET CLASS PREFERENCES

	Current
Growth assets	U
Developed market shares	B
Australian shares	MU
Emerging market shares	B
Real assets	B
High yield	U
AUD	MU
Defensive assets	O
Australian fixed income	MO
International fixed income	O
Cash	B

U Underweight MU Mild underweight B Benchmark
MO Mild overweight O Overweight

ANZ CIO, as at 14 January 2024

ASSET CLASSES

CURRENT STRATEGY AND OUTLOOK

AUSTRALIAN EQUITIES

MU Current

Our current preference is to be **mildly underweight Australian equities**.

The Australian economy is expected to experience a very shallow growth environment over 2024. Against this backdrop, unemployment is expected to lift to 4.25% by year-end, and inflation should continue to ease — although it is unlikely to return to target until 2025. And while an easing cycle is expected to commence in the latter stages of 2024, there remains potential for a further interest rate increase in the early part of the year.

The Australian market is titled heavily towards value, with more than 50% of the ASX 300 comprising Materials and Financials stocks. In a year where value trailed growth by a wide margin, it's unsurprising that the domestic market broadly tracked the weak performance of global value stocks in 2023. Given sectors of the Australian market are closely tied to China's fortunes, this underperformance was possibly exacerbated by troubles there also.

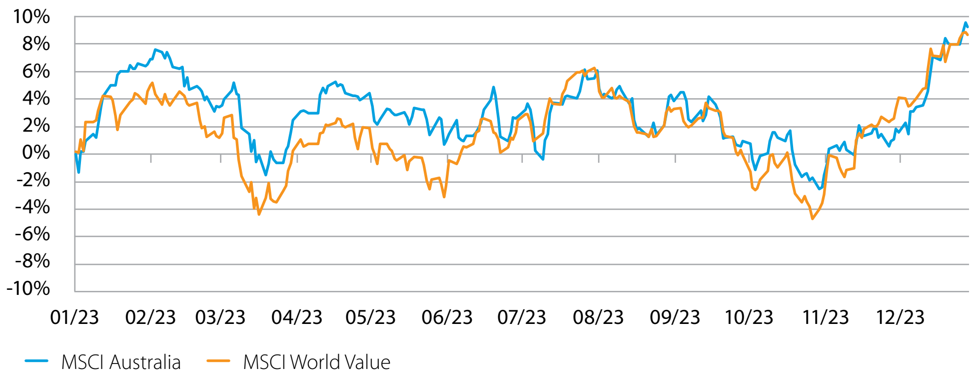
Looking ahead, and just as the forecast for the Australian economy in 2024 remains uncertain, so too does the outlook for the domestic share market. At this stage we are expecting miserly EPS growth over the next 12 months, with index returns in the mid-single digits — although risks remain skewed to the downside.

Positively, the fact that earnings growth was flat for 2023 and analysts are expecting very low EPS growth in 2024 signals that a reasonable amount of pessimism is already priced in. Furthermore, where rate cuts can be a precursor to share market declines across the US equity market, in Australia, key cyclical sectors have historically bottomed three months before the first RBA cut.

Moreover, just as the Australian market was partially impacted by negative investor sentiment towards China over 2023, this year, the domestic market could equally benefit from a reversal in Chinese fortunes — should stimulus become broader and investor sentiment recover.

Nonetheless, with the RBA expected to be a laggard in easing monetary policy, and with the argument that Australia trades like a 'more expensive' value market, we currently assess Australian shares as fairly valued and commence 2024 mildly underweight.

FIGURE 17: MSCI AUSTRALIA VS. MSCI WORLD VALUE INDEX



Past performance is not indicative of future returns.
Source: Bloomberg, ANZ CIO as at 31 December 2023.

DEVELOPED MARKET EQUITIES

B Current

Our current preference is to be at **benchmark** to **developed market equities**.

Global equities staged a stunning and largely unexpected rally over the first half and then latter part of 2023. The first-half gains followed an injection of liquidity during the banking crises, and year-end gains relied heavily on the notion that a 'soft landing' was achievable and indeed probable. Pushing these catalysts aside, investors can continue to point to superior inflation protection and long-term mid-single digit EPS growth as being partly attributable to the performance.

Nonetheless, market gains, particularly in the US, were led by a narrow group of stocks for the most part of the year and came as the market disconnected from underlying fundamentals. While the rally did broaden over the second half, the performance contribution of the 10 largest stocks in the S&P 500 remained close to 70% by year-end.

While we forecast further EPS growth over 2024, we also expect negative earnings revisions to continue as higher interest rates remain a drag on the economy and corporate profits. Our EPS growth expectations remain some 5% below market consensus and are rather meagre — within the range of 4% to 7% across Europe, Japan and the US. Hardly inspiring, but not as bleak as some might have thought only a few months ago.

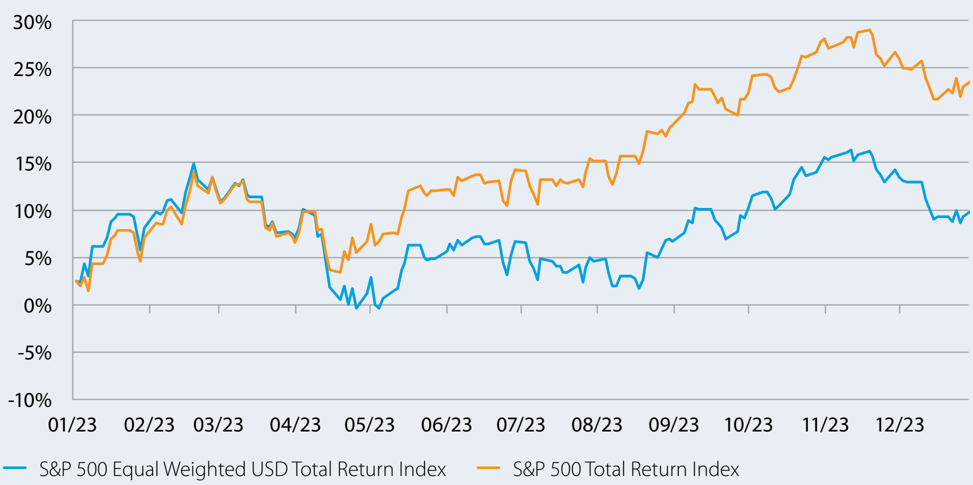
We see the possibility of mid-single digit performance across developed markets over 2024, but caution this potential comes against a backdrop of significant risks and the prospect of greater downside also. We are entering an election year in the US, with factors such as geopolitical brinkmanship, and talk of austerity measures once again expected to dominate headlines and drive volatility. Moreover, while the Fed is expected to have finished its tightening cycle, stubborn core inflation, and the lagged impact of monetary tightening means there is potential for a harder landing.

One of the major challenges for investors this year will be when and where to position for the global easing cycle. This could commence ahead of what we anticipate will be the Fed's first rate cut in Q3 2024. Beneficiaries may include emerging markets, cyclicals, real estate, small caps, and the value sector.

With respect to regions, we prefer the outlook for European equities. Rate cuts are expected to materialise ahead of the US, profit growth should be close to the US, and it is currently difficult to see why an already record valuation discount to the US should widen further. In the US, we believe EPS growth is likely to be driven by the 'Magnificent Seven' while European growth should be more evenly distributed amongst sectors.

For investors, tactical equity positioning is likely to play a greater role across portfolios in 2024.

FIGURE 18: SPX V SPX EQUAL-WEIGHT



Past performance is not indicative of future returns.
Source: Bloomberg, ANZ CIO as at 31 December 2023

EMERGING MARKET EQUITIES

B Current

Our current preference is to be at **benchmark** to **emerging markets equities**.

Emerging market equities trailed developed market peers by a wide margin over 2023. A significant driver of emerging markets performance was, as usual, China. The covid-zero reopening failed to gather momentum and although the number of stimulus measures introduced over 2023 was significant, the lack of a 'bazooka' style package failed to stem the confidence crisis that plagued many Chinese equity investors. While growth in China is not expected to recover to pre-pandemic levels this year, sentiment remains downtrodden and does provide scope for upside surprises should the economy stabilise over 2024.

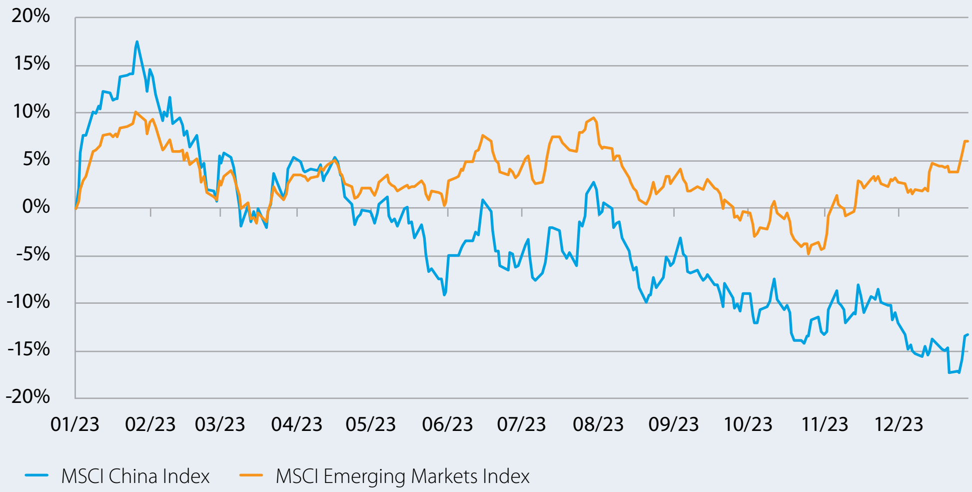
Even so, if China is removed from the equation, the broader emerging market index still trailed global shares. As a result, looking ahead to 2024, the MSCI Emerging Market index is trading at a discount to developed markets — meaning there could be better entry points over the course of 2024.

Positive emerging market performance tends to correlate strongly with a weaker US dollar (USD). With the Fed expected to begin easing over the second half of the year, this could also increase the relative attractiveness of emerging markets versus developed markets. Moreover, earnings revisions continue to be negative relative to developed markets.

Conversely, in 2024 geopolitical headwinds are again expected to buffet investors. Taiwan has already held its presidential election, and India is among a host of other countries set to vote in 2024. Furthermore, in a US election year we expect China to once again be a major political pawn for presidential candidates.

We continue to look for opportunities to increase exposure to emerging markets on both a structural and tactical basis in 2024. A more favourable growth outlook and demographic tailwinds are expected to benefit the sector in the years ahead.

FIGURE 19: EMERGING MARKET PERFORMANCE 2023 — MSCI EM VS MCSI CHINA



Past performance is not indicative of future returns.
Source: Bloomberg, ANZ CIO as at 31 December 2023

LISTED REAL ASSETS – GREITS & INFRASTRUCTURE

B Current

Our current preference is to be **benchmark listed real assets**.

Over 2023, Global Real Estate Investment Trusts (GREITs) and listed infrastructure trailed global share markets by 14% and 24% respectively.

The underperformance came against the backdrop of rising bond yields. However, late in 2023, with expectations that a peak in policy rates had been reached, both segments stabilised and began to show some outperformance.

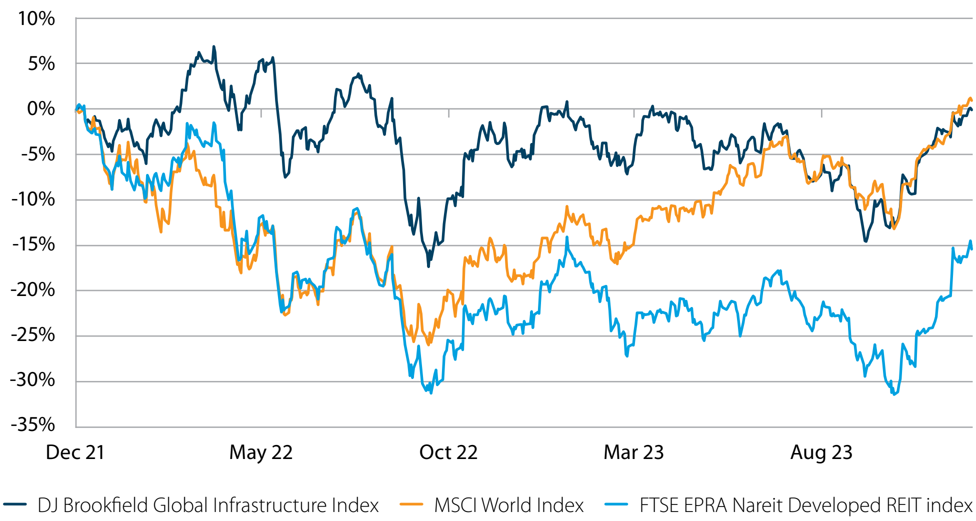
Looking ahead to this year, while inflation may remain sticky and a subsequent reversal in bond yields could derail a recovery, a combination of rent growth, market repricing, peak interest rates and weak supply should provide some support for GREITs. These forces will have to contend with slowing global growth and higher costs of capital.

From a long-term perspective, we believe the performance of GREITs will ultimately be driven by the pricing and fundamentals of their underlying assets.

To infrastructure, we expect cash flow stability to be important given the global backdrop in 2024. Volatility is expected to continue, and in an environment where inflation could remain sticky and economic growth weak, infrastructure could benefit given its ability to act as an inflation hedge and the necessity-based traits of the asset class.

As 2024 commences we are positioned at benchmark to both GREITs and listed infrastructure. In a late-cycle environment, both strategies should provide diversification benefits, income to portfolios and a hedge against inflation if it remains stickier than expected.

FIGURE 20: GLOBAL REITS VS. INFRASTRUCTURE VS. MSCI WORLD



Past performance is not indicative of future returns.
Source: Bloomberg, ANZ CIO as at 31 December 2023.

HIGH YIELD

U Current

Our current preference is to be **underweight high yield**.

Late last year, US high yield spreads narrowed to their tightest level since 2022 — reflecting the broader market view that a soft landing was becoming more likely. Despite this expectation of a soft landing for the global economy, there remains potential for a sharper downturn. On this basis, we start the year positioned cautiously towards the asset class and prefer to take exposure to higher quality assets — specifically developed market equities in risk assets and investment grade credit and sovereign bonds across the defensive part of portfolios.

We believe the Fed will keep rates elevated through the first half of next year and possibly beyond. If this coincides with softer labour markets, deteriorating economic growth and a US consumer that comes under further duress, then corporate pressures are likely to build.

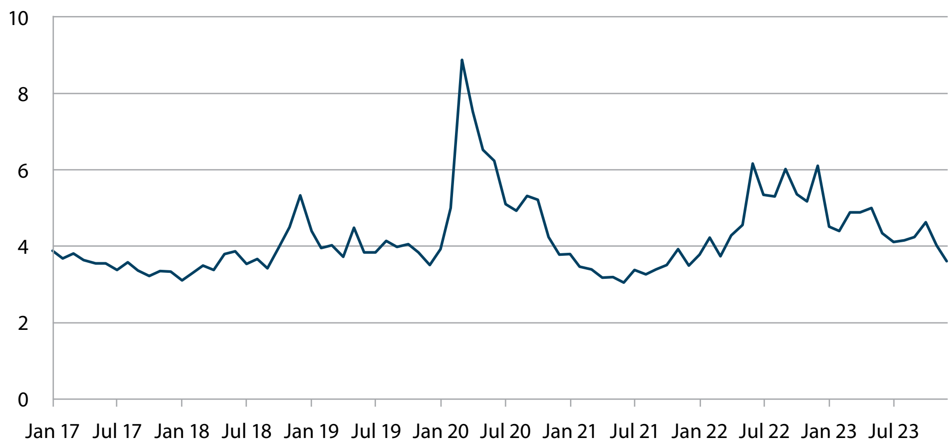
High yield default rates are forecast to climb to 4-5% in 2024, although at this stage are not expected to become extreme. In part, this can be attributed to the higher quality credits seen across the market. The growth in private credit and bank loan markets has meant that overall, the quality of company balance sheets, particularly at the upper end of the high yield market, are much better this cycle compared to those prior.

Still, with a significant amount of debt needing to be reissued out of the high yield market over the coming 24 months, there remains a reasonable amount of refinancing risk — particularly given the generally shorter duration of high yield versus investment grade credit. Moreover, the market remains susceptible to contagion risk if a broader credit event occurs.

Positively, new issue volume has modestly recovered for both the US and Europe as more issuers seek to address this looming maturity wall across 2024 and 2025. We anticipate new issue supply will stay limited and this could support demand this year, particularly if recession risks are downgraded further.

The main risks for the asset class, like almost every other in 2024, are persistent inflation, geopolitics and a more severe recession. We look for opportunities to tactically close our underweight as the year progresses or should spreads widen to more constructive levels.

FIGURE 21: GLOBAL HIGH YIELD – OPTION ADJUSTED SPREAD TO TREASURY



Past performance is not indicative of future returns.
Source: Bloomberg, ANZ CIO as at 31 December 2023

AUSTRALIAN FIXED INCOME

MO Current

Our current preference is to be **mildly overweight Australian fixed income**.

Despite 425 basis points of tightening from the RBA, the Australian economy has been incredibly resilient. Unemployment remains low, wage growth strong and inflation appears on a slow path back to target. At this stage we expect the RBA to have delivered its final interest rate increase for the cycle.

Nonetheless, the RBA remains more hawkish than many peers. Just as it was a late mover in tightening policy, so too is it likely to be one of the last developed markets to ease — we currently expect the first rate cut to materialise in the latter stages of 2024.

GDP growth is forecast to print at 1.2% in 2024. While weak, in the context of the tightening delivered and jobs maintained, this could be considered a positive outcome. Conversely, stickier than expected inflation, fiscal measures (including stage 3 tax cuts) and annual wages growth remaining strong, due to the lagged effect of new enterprise bargaining agreements, could keep the RBA in tightening mode for longer than currently expected. Like the US, the longer that policy is held restrictive, the greater the potential for a sharper downturn.

To the outlook for fixed income, Australian yields have fallen sharply from their peak at the start of November, leaving room for them to push higher once more — particularly if economic data surprises to the upside and the market is forced to remove cuts that are currently priced in.

Although we expect some spread tightening between 10-year US Treasury and Australian Government bond yields over 2024, we largely expect yields to move in a similar manner. However, with the RBA likely to undertake a later and shallower easing cycle than the Fed, any rally at the short end is expected to be less aggressive than in US Treasuries. This is likely to result in a flatter curve relative to the US.

For multi-asset investors, when considering fundamentals and current valuations, we continue to weigh up the risk of owning equities versus bonds at this stage of the cycle. Although yields moved materially lower over the final part of 2023, they remain elevated, and some corporate and government bonds continue to offer yields commensurate with the ASX 200.

With potential remaining for a stronger economic downturn than currently expected, and with equities forecast to provide mid-single digit returns over 2024, on a risk-adjusted basis we favour Australian fixed income across portfolios as the year commences.

FIGURE 22: ACGB CURVE TO FLATTEN RELATIVE TO UST

Source: Bloomberg, Macrobond, ANZ Research as at December 2023

INTERNATIONAL FIXED INCOME

Current

Our current preference is to be **overweight international fixed income**.

Despite the sharp retracement in yields from mid-October, US 10-year Treasury yields finished higher for the third straight year — the first time since 1981. Even with an anticipation of structurally higher rates in future, we now expect the bond bear market to have finished.

For investors, the US yield curve is likely to bull steepen over 2024 as the Fed's first rate cut draws nearer. However, the pathway to steepening is unlikely to be linear. The market is currently pricing in seven rate cuts for 2024, starting in H1 — in our view this seems aggressive. At this stage we don't expect the Fed to commence easing until Q3, although conditions could begin to materialise before mid-year that bring this timing forward.

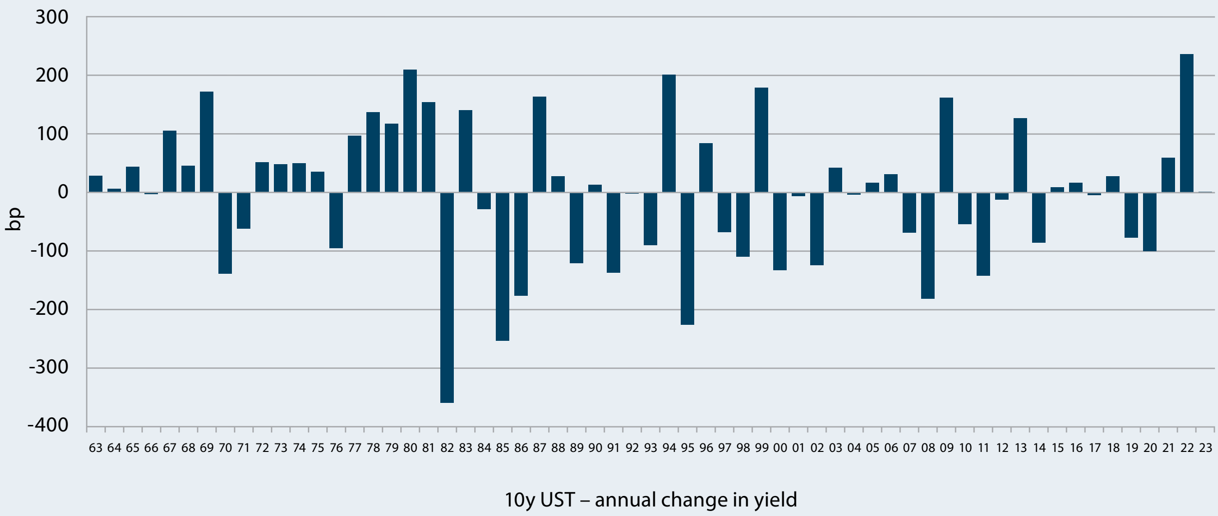
We expect the Fed to resist easing until it can be confident that inflation is on a sustained path back to target. The current mismatch in job openings to unemployed remains inconsistent with the Fed's inflation target, disinflation doesn't appear strong enough nor growth weak enough to warrant an early pivot. Nonetheless, as witnessed over the latter part of last year, in 2024 the bond market should react favourably if it receives more dovish rhetoric from central banks and the timing of initial rate cuts become clearer.

We expect this environment to be accommodative for government and investment grade credit where we currently hold overweights across fixed income. In the case of the latter, many companies have used the pandemic recovery to stabilise balance sheets and the higher for longer rate environment is attracting investment in the asset class which should be supportive of credit spreads.

While there are more obvious risks further down the credit spectrum, a backdrop of solid corporate fundamentals amongst high quality issuers alongside a structurally higher rate environment, should compensate for a modest recession if it eventuates — particularly given investment grade yields remain attractive relative to equities.

And while our base case remains for a soft landing, if investors become concerned about a hard landing, and risky assets become more vulnerable, then global bonds should offer solid diversification to portfolios too.

FIGURE 23: ANNUAL CHANGE IN US 10-YEAR TREASURY YIELD



Past performance is not indicative of future returns.

Source: Macrobond, ANZ CIO as at 31 December 2023.

AUSTRALIAN DOLLAR

MU Current

Our current preference is to be **mildly underweight** the **Australian dollar (AUD)**.

The AUD was largely beholden to two forces over 2023, and this year we expect these to again play a major factor in its direction — namely USD strength and developments in China. Furthermore, with the RBA expected to lag most major central banks in easing policy, the domestic currency may benefit from carry versus those currencies where easing has commenced earlier and at a more rapid pace.

On the China front, if data does improve over 2024 then this could provide support for the AUD and other major commodity exporters.

Looking at the USD, we expect fading USD exceptionalism that commenced over the backend of 2023 to continue — albeit at a more modest pace.

While we expect the USD to finish the year lower, the pathway there is unlikely to be a straight line. With global risks remaining elevated, particularly on the geopolitical front, the greenback is likely to benefit from its 'safe haven' status at various points throughout the year.

Despite the potential for modest AUD upside in 2024, we commence the year mildly underweight. Given the AUD's status as a premier risk currency, this should provide portfolios with some downside protection in the event of a risk-off market environment.

FIGURE 24: DXY FADED OVER THE LATTER STAGES OF 2023

Past performance is not indicative of future returns.
Source: Bloomberg, ANZ CIO as at 31 December 2023

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