Express Insights

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Can the 'bull with momentum' leap over the 'bear with short tails'?

Bottom line: while the momentum is strong and is indicating further gains in equities, there are reasons to turn cautious on the asset class tactically; however, on our assessment, the left tails risks are contained.

- **History suggests more gains for equities in 2024 after the 20% return during 2023.**
- **Technicals, sentiment, valuations, and earnings are all indicating a weak start to 2024.**
- **Overall, we expect global equities to post mid-single digit gains over the next 12 months…**
- **…but a flat-to-weak H1'24 followed by a strong recovery in H2'24.**

- History suggests more gains for equities during 2024 after the 20% return during 2023. Looking at the data since 1988, MSCI All Country World Index (ACWI) gained more than 20% in nine different years (including 2023). Keeping up the momentum, ACWI also posted smaller gains the following year – c4% on average over those eight instances (i.e. excluding 2023).
  - In two instances of the eight, ACWI posted losses of more than 10% – these coincided with the dot-com bubble and the 2018 market sell-off triggered by the Fed raising interest rates, The Trump administration's tariffs driving uncertainty, big-tech coming under scrutiny, and elevated equity valuations.
  - In the other six instances, ACWI rose c10% on average.
  - This begins to suggest that in absence of a major recession, Fed's policy misstep, and or rise of political and policy risks, global equities could post small but positive returns during 2024.
  - However, looking at all the eight instances, the first half of the year that followed a year of 20%+ returns were largely flat to negative.
- Of course, there are certain aspects that warrant caution in the first half of the year. However, none of them would account for a fat left tail risk.
  - Equities look technically overbought. Particularly US stocks have rallied strongly through Q4'23 and now look overbought on technical parameters.
  - Just over the last two months, investor sentiment has gone from extremely bearish to extremely bullish. We use this as a contrarian indicator.
  - Implied volatility (VIX) is low and this calls for a reality-check on market complacency.
  - Any pause in disinflation in the US could be treated by markets as a negative. In this context, the US December inflation print is due on January 11 and The Cleveland Fed's inflation now cast has core CPI rising more than 0.3% in December. If this proves accurate, it would be the hottest inflation reading since May.
  - Q4'23 corporate earnings season is set to begin in about two weeks. While the earnings are likely to beat expectations for the quarter, markets might worry about the lofty earnings growth expectations for 2024 (I/B/E/S Consensus expects MSCI ACWI EPS to grow 10.4% in 2024). Any evidence that such growth expectations might not be met will likely be met with elevated price volatility.
- Taking all these together, we expect the following:
  - Global equities post mid-single digit gains over the next 12 months.
  - However, the asset class is likely to experience a flat to weak H1'24 followed by a strong recovery in H2'24.
  - While US stocks are rich in quality and our preferred way to play equities in the medium to long-term, we are beginning to see better value in Emerging and European equity markets tactically.
  - We expect the market breadth to improve during 2024 from the extremely narrow market leadership observed during 2023.
  - Thematically, we prefer clean energy segments which have lagged the broader markets in the past couple of years.
  - By sector, we prefer health care (a defensive proposition) during H1 but would position into more cyclical industrials sector during H2.
  - Small caps could also benefit from the cyclical bounce in equities which we expect to happen in the later part of the year.

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