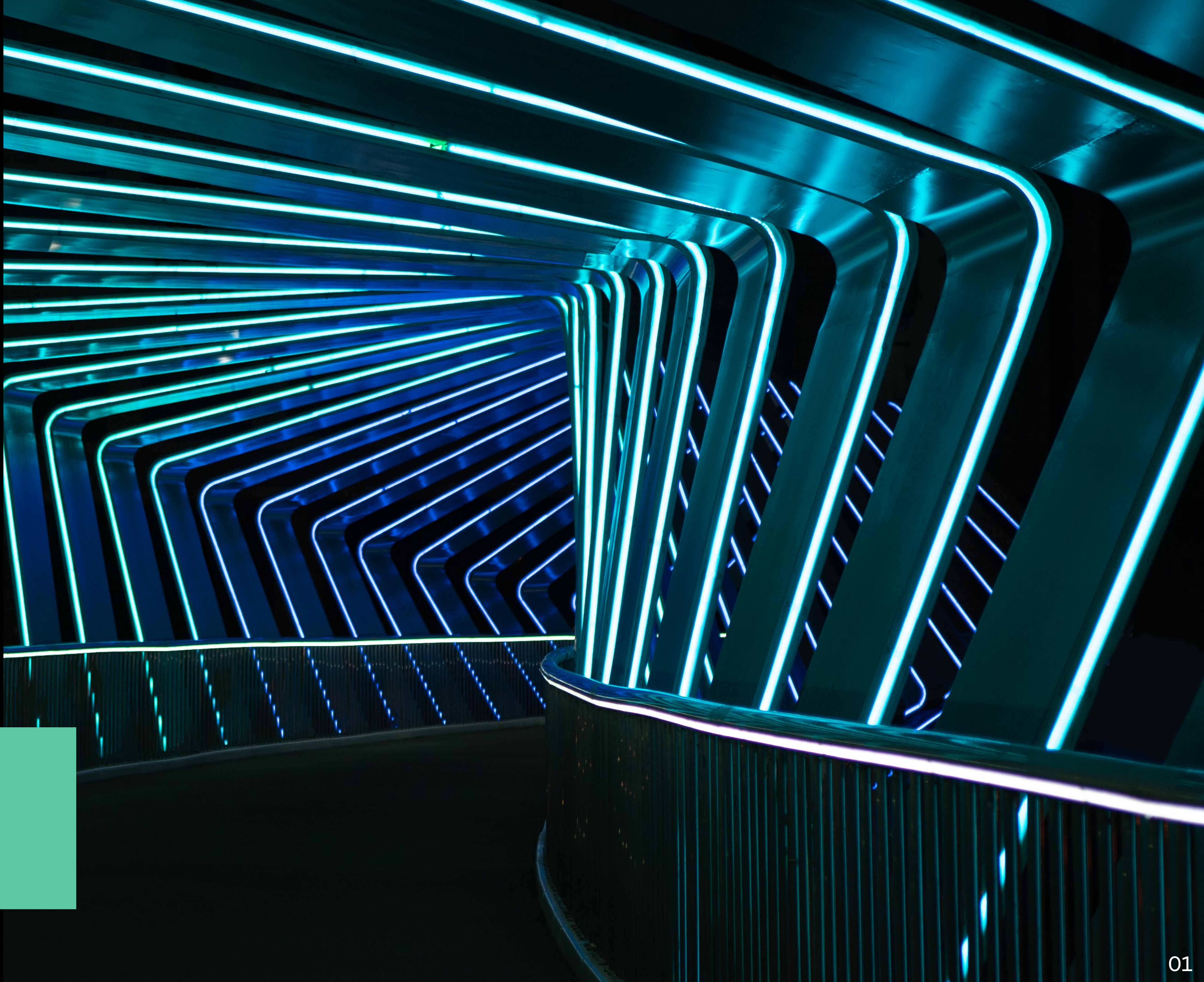
MACQUARIE ASSET MANAGEMENT

A world in transition

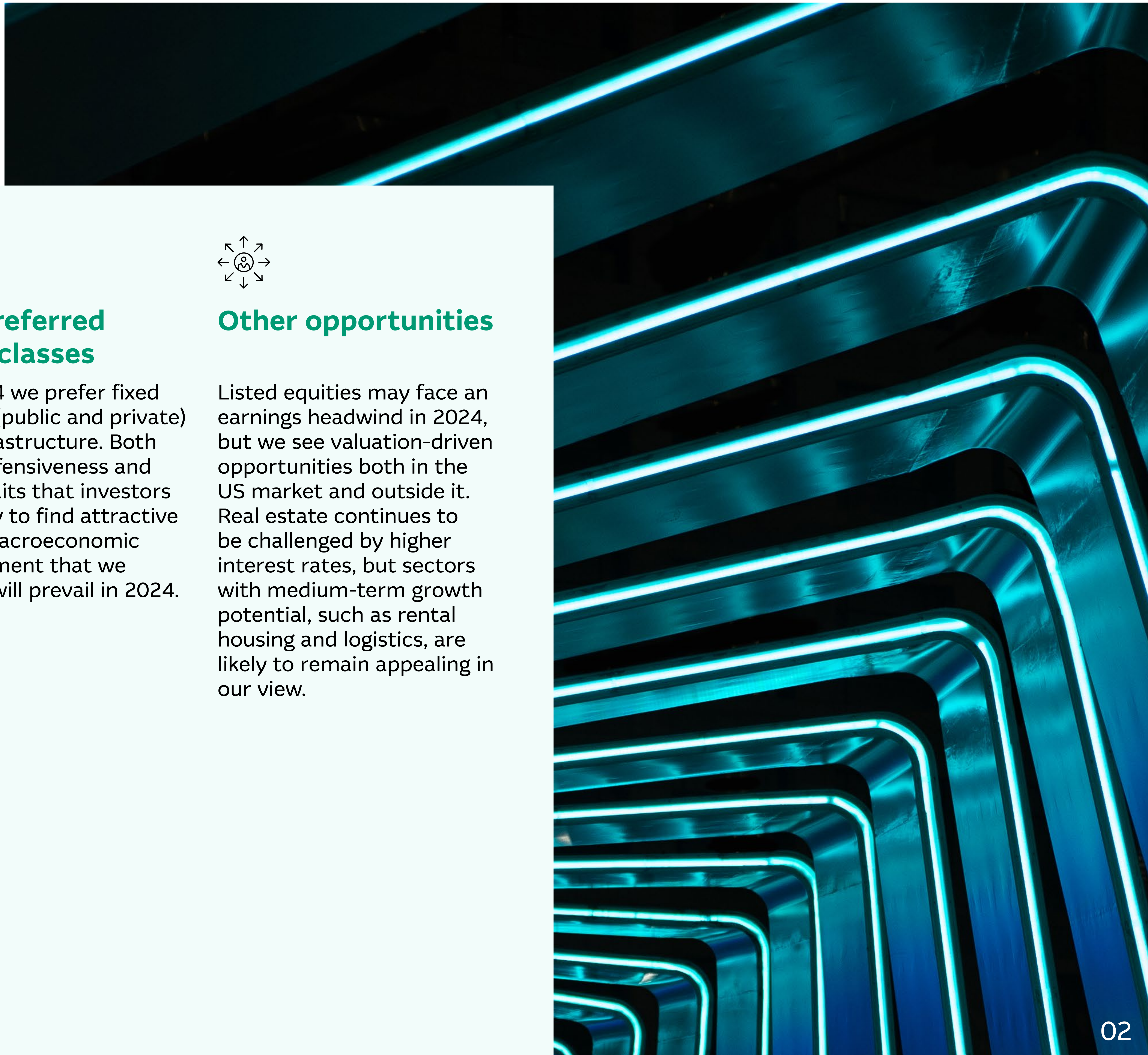
OUTLOOK 2024

MACQUARIE

Contents



Key takeaways



Global growth

The outlook for global growth remains challenging. The Euro area and UK economies are probably already in recession, while China's growth is lacklustre and likely to remain so for some time yet. The US economy has proved remarkably resilient this year, but leading indicators point to a slowdown in growth over the next 12 months.

Inflation

Headline inflation has fallen sharply over the past 12 months, while core and services inflation has proved remarkably stubborn at high levels. In the near term, inflation is likely to moderate further as aggregate demand weakens and unemployment rates rise. Over the longer term, underlying inflationary pressures are likely to prove more buoyant than they have in recent decades as globalisation slows or reverses, demographics increasingly constrain supply-side growth, and productivity growth remains sluggish.

Interest rate expectations

The world's major central banks have recently paused their rate-hiking cycles, and the next move in policy rates is likely to be down. In the absence of large recessions, however, we are unlikely to see an aggressive easing cycle like we saw from central banks during the COVID-19 recession in 2020 and the global financial crisis.

Our preferred asset classes

For 2024 we prefer fixed income (public and private) and infrastructure. Both offer defensiveness and yield, traits that investors are likely to find attractive in the macroeconomic environment that we believe will prevail in 2024.

Other opportunities

Listed equities may face an earnings headwind in 2024, but we see valuation-driven opportunities both in the US market and outside it. Real estate continues to be challenged by higher interest rates, but sectors with medium-term growth potential, such as rental housing and logistics, are likely to remain appealing in our view.

Investment implications

Our view

Equities

- Listed equities are likely to be buffeted by macroeconomic uncertainty in 2024, but we see opportunities in small-caps and listed real assets.
- Outside of the US, Europe looks attractive on valuation grounds, and we may have reached the point of "peak pessimism" for Chinese equities.

Global debt and credit markets

- With cyclical risks high, inflation falling, central banks pausing, and not much priced into forward curves in terms of interest rate cuts, we are positive on fixed income and constructive on duration, particularly for very low risk sovereigns.
- Credit spreads are not reflecting recessionary conditions, in our view, so we prefer high-quality credit over low-quality credit.
- Private markets debt, including asset-based finance funds, are facing strong investor demand, and this is something we expect to continue in 2024.

Real estate

- Real estate remains challenged by high interest rates. We prefer the sectors with solid growth potential, such as rental housing and logistics.
- The office sector continues to adjust to the new work-from-home environment, but repositioning and repurposing opportunities could emerge in 2024.

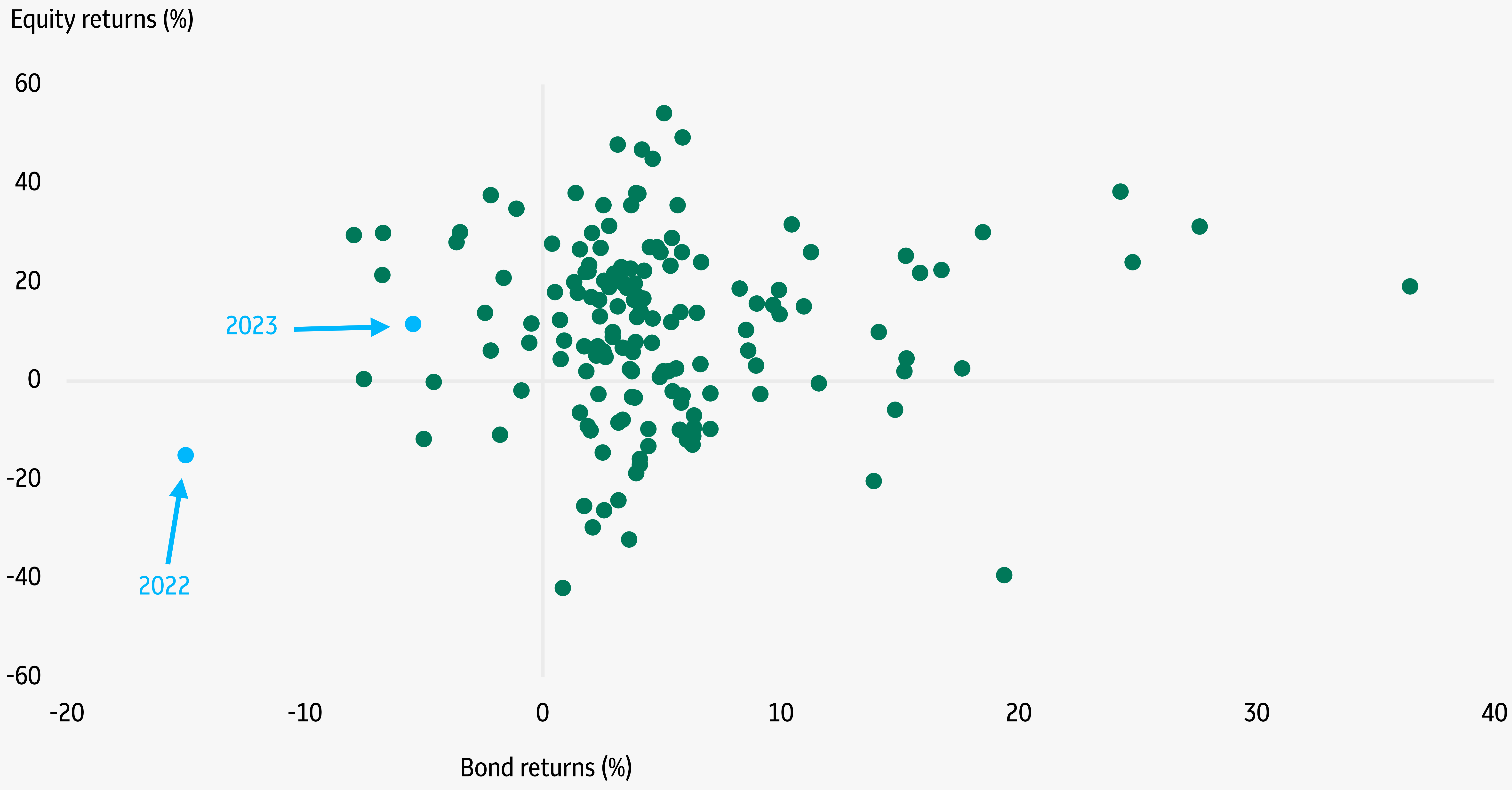
Infrastructure

- Infrastructure's defensiveness, high yield, exposure to secular growth trends (such as digitalisation and the energy transition), and the global policy tailwind should all be attractive to investors in the macroeconomic environment that we see prevailing in 2024.

It has been a difficult two years for investors

In 2022 both bonds and equities delivered negative returns. 2023 has been better as equities have recovered. But the macroeconomic backdrop remains volatile and challenging.

Returns on US equities and bonds since 1872

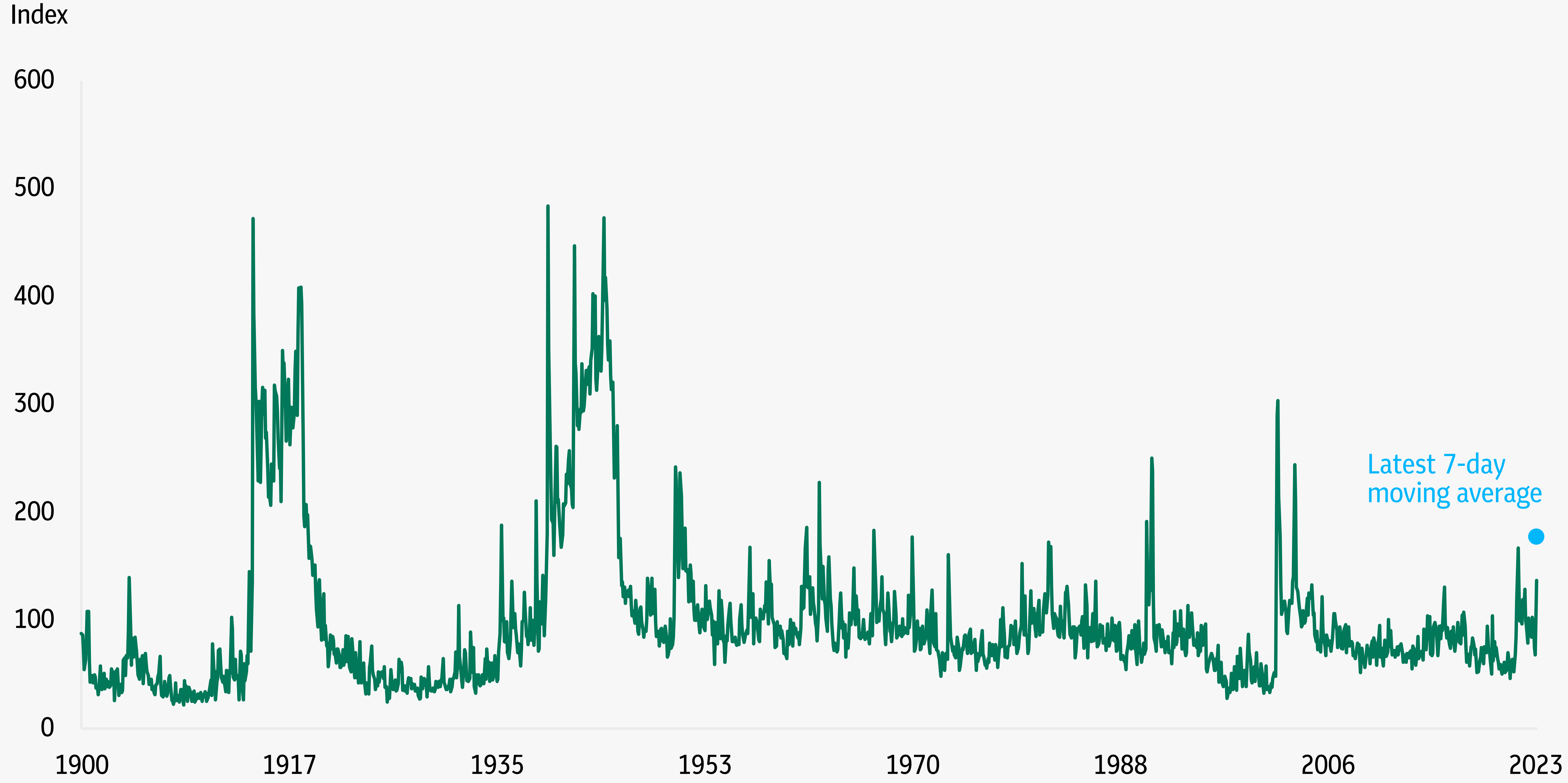


Sources: Robert Shiller online data, Yale Department of Economics, accessed 15 November 2023; Macrobond (November 2023). Equities are represented by the S&P 500® Index. Bonds are represented by 10-year US Treasuries.

Geopolitical risk is back

We are now entering a period of great-power rivalry, with knock-on effects for trade, investment, and risk premiums.

Measuring geopolitical risk

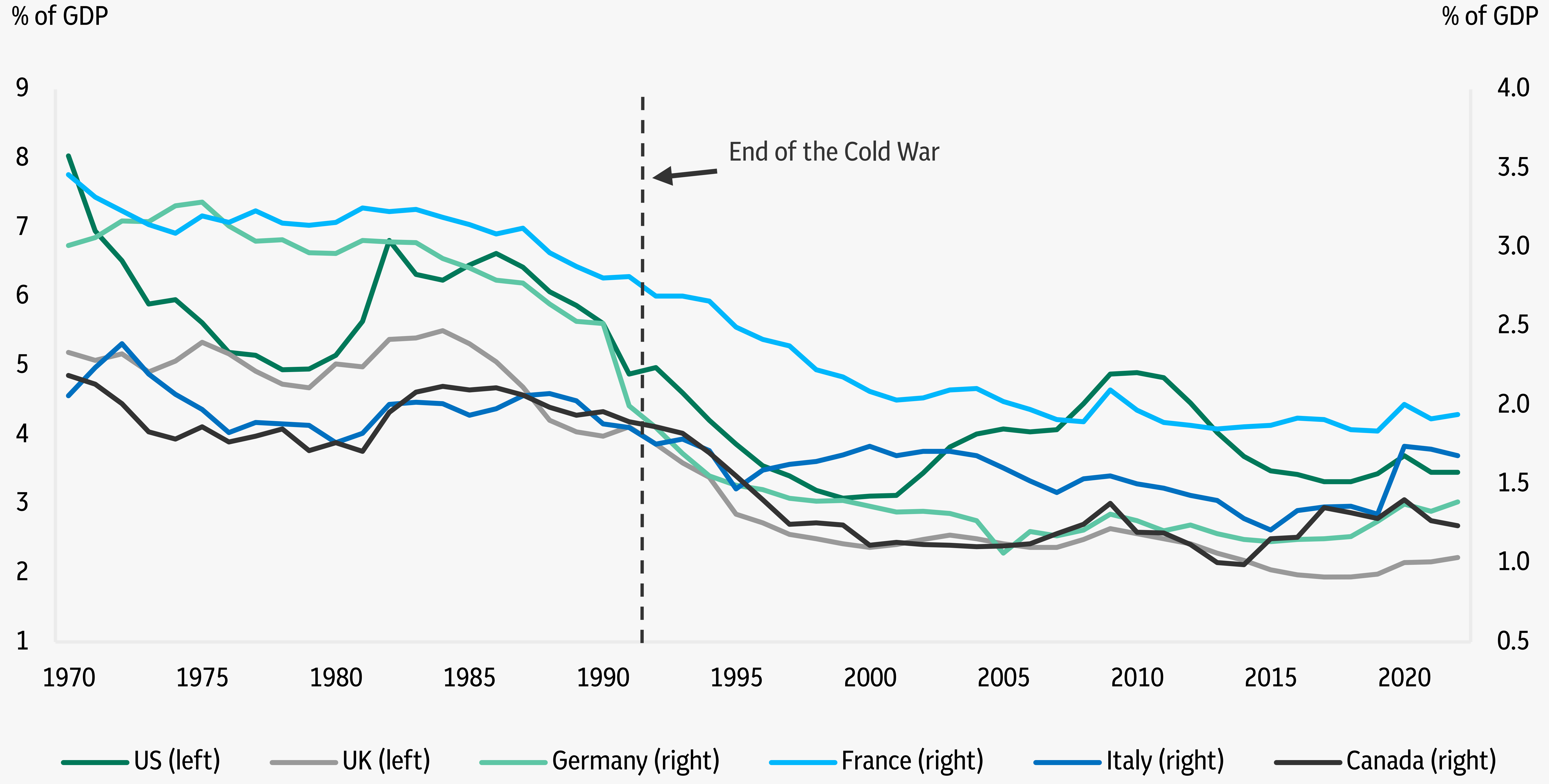


Source: Data downloaded from Matteo Iacoviello Geopolitical Risk (GPR) Index on 15 November 2023.

The peace dividend is now reversing

This will weigh on fiscal positions just as ageing starts to exert its inexorable effect on government spending and higher interest rates push up governments' interest costs.

G7 ex Japan military spending



Source: Stockholm International Peace Research Institute (SIPRI) Military Expenditure Database 2023, 30 October 2023.

Leading indicators still signal concern

In the US, yield curve inversions have often preceded recessions. The current lag between inversion and recession onset is longer than average, but not outside the historical range.

US yield curve and recessions

Source: Macrobond (November 2023).

For institutional investors and investment professionals only.

Impact of tighter monetary policy

In Europe, the impact of the energy price shock is fading. But higher interest rates are really starting to bite.

The housing market has turned

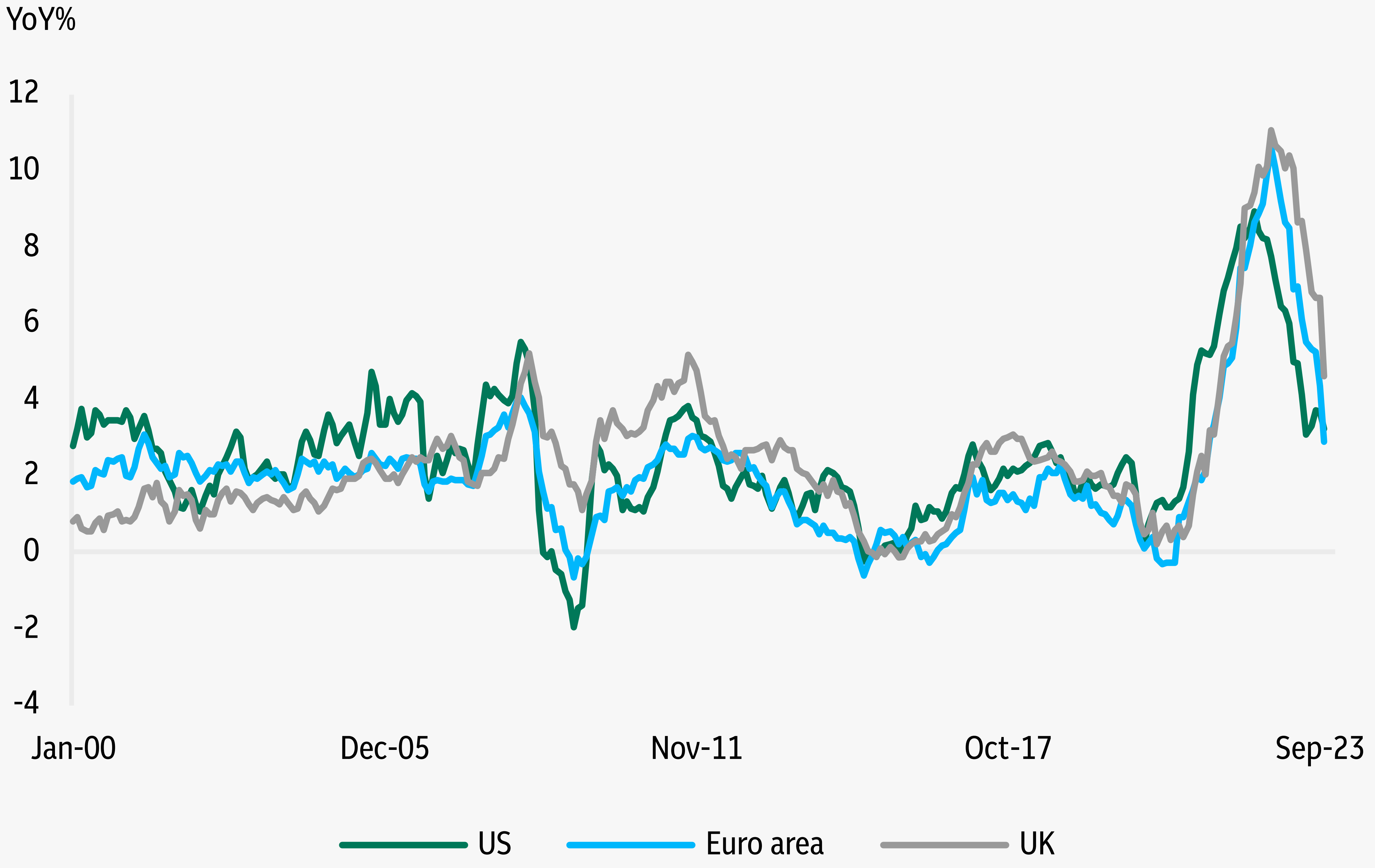
Credit demand has collapsed

Source: Macrobond (November 2023).

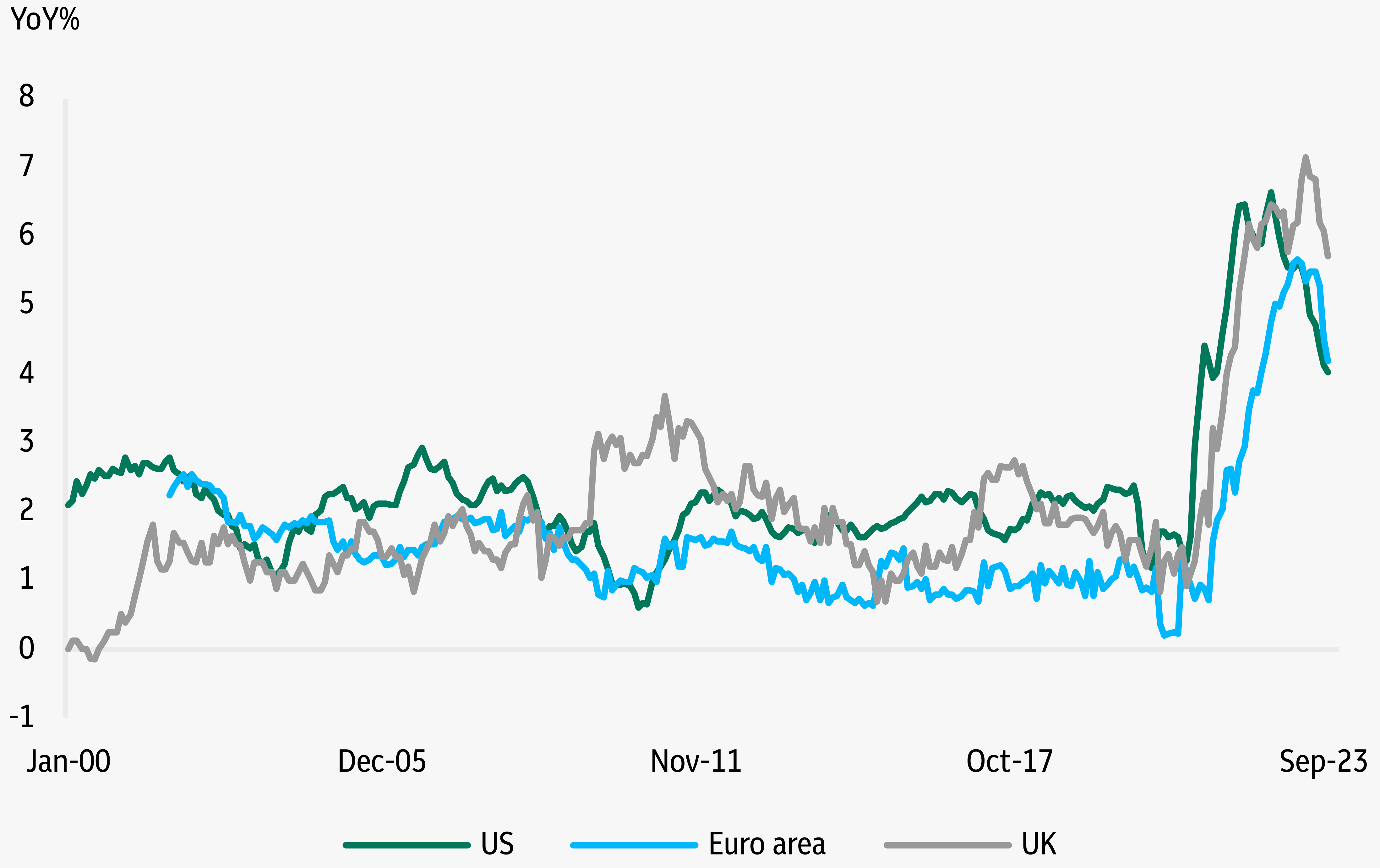
Sticky core inflation

Inflation is likely to continue to fall in the near term due to weak aggregate demand and rising unemployment rates. Over the medium term, we remain concerned it could come back quickly once global growth bottoms.

DW headline inflation has fallen sharply



DW core inflation has proved remarkably stubborn

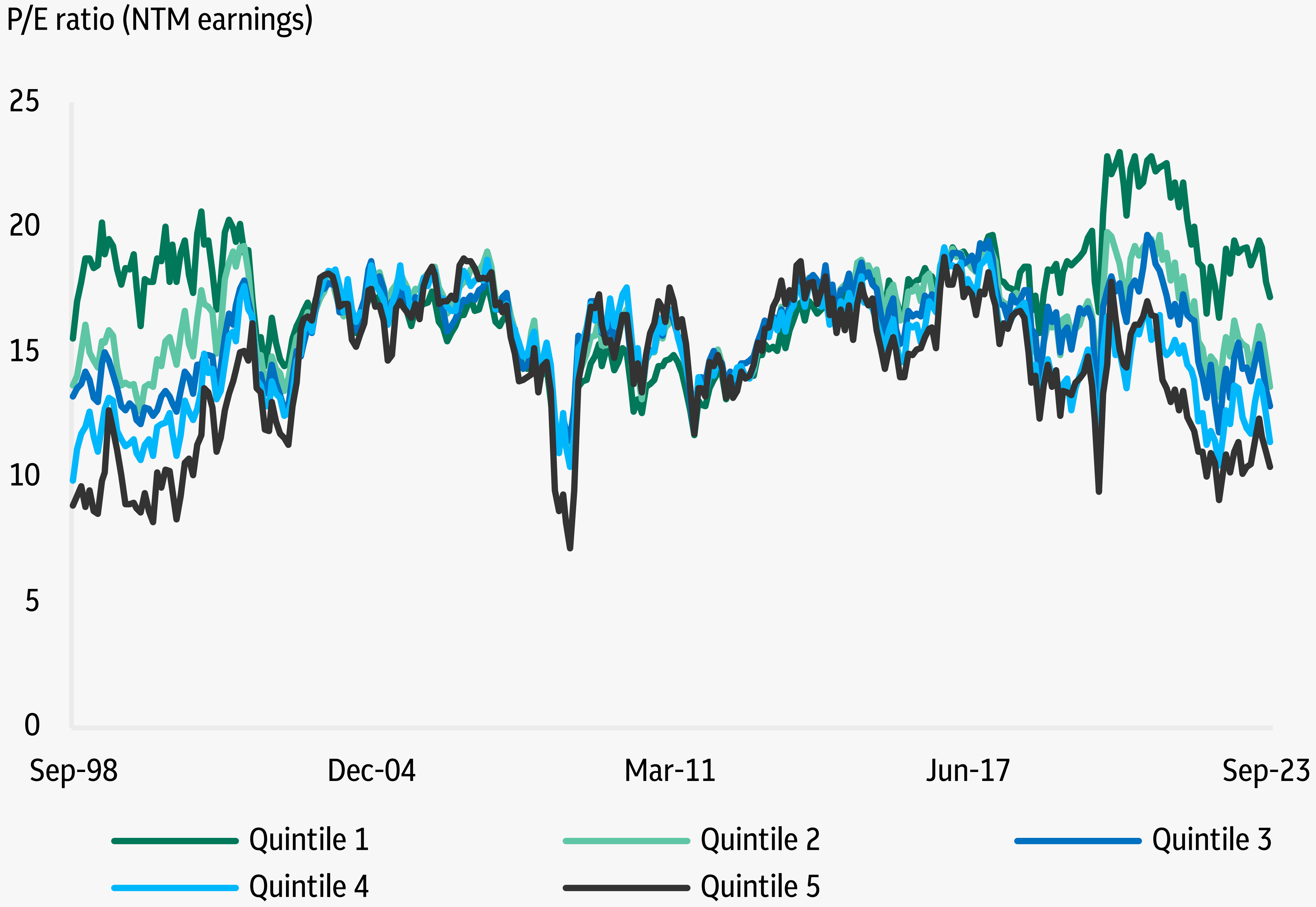


Source: Macrobond (November 2023). DW = developed world.

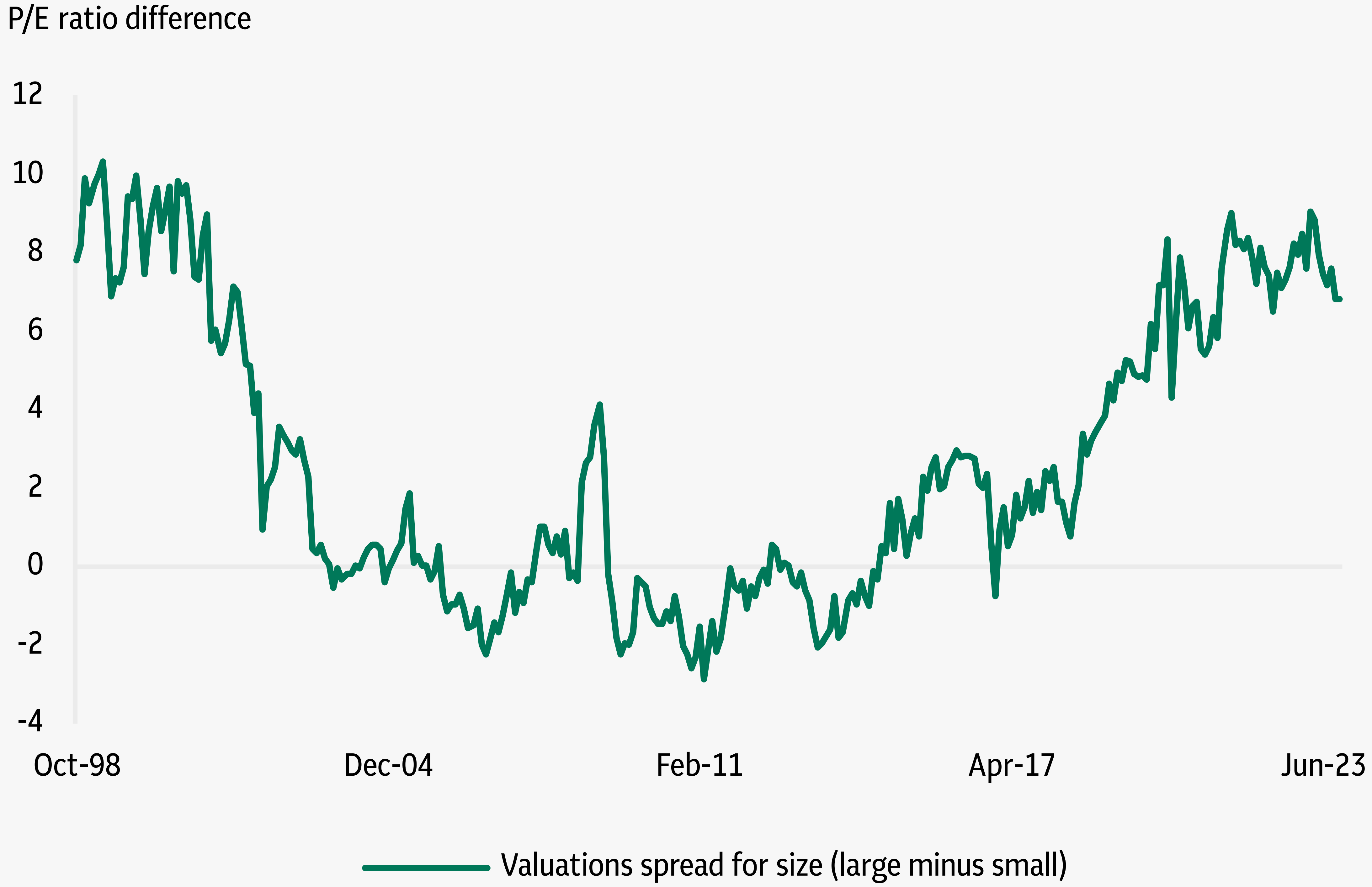
Searching for value amid market volatility

A large valuation gap has opened between large-cap and small-cap stocks. Small-caps appear to be more fully pricing in the cyclical risks.

P/E ratio by size quintile for the Russell 3000® Index



Valuation spread of size factor for Russell 3000 Index

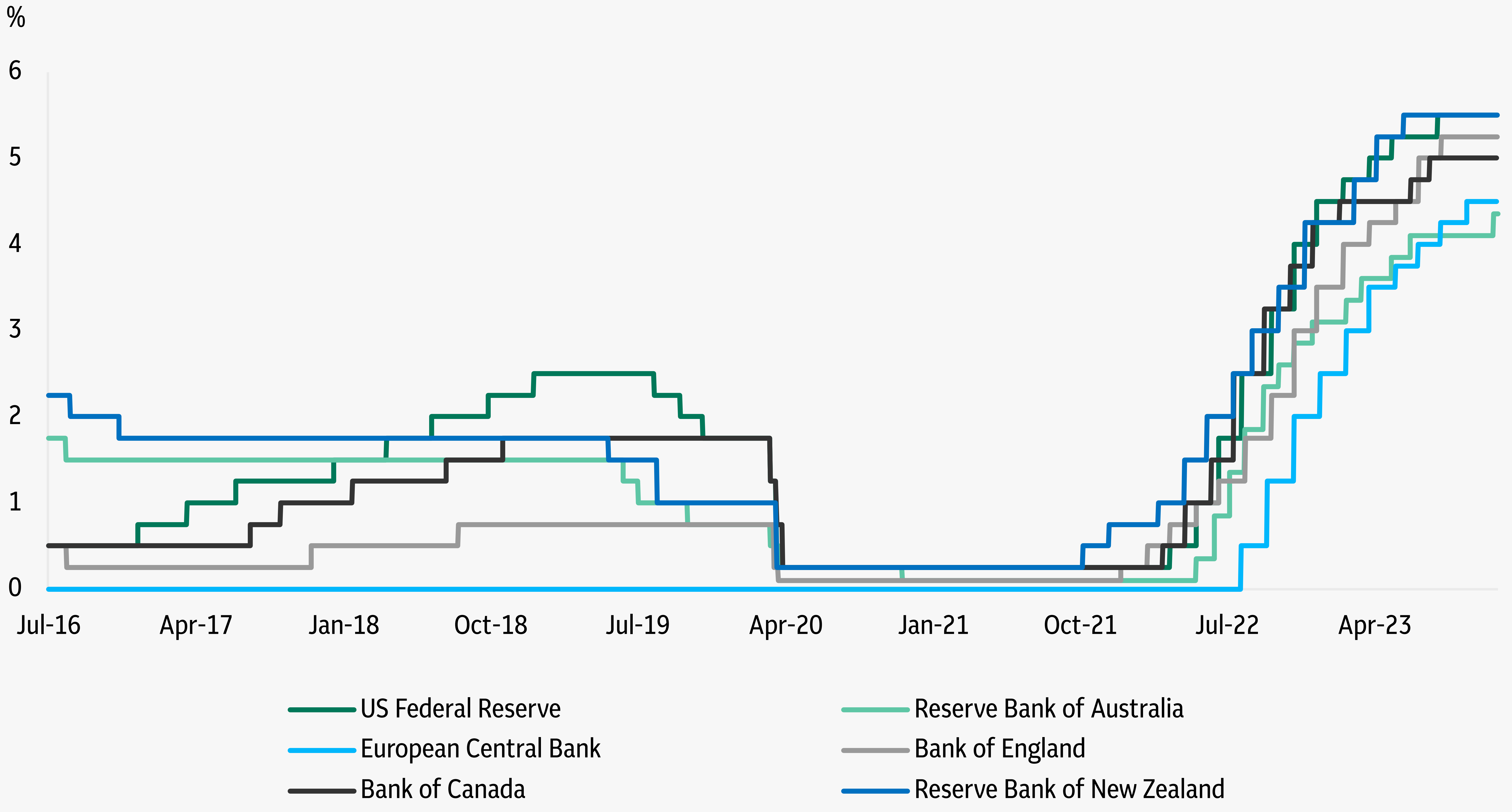


Sources: FactSet, MSCI Barra, Macquarie. Monthly data from 30 September 1998 to 29 September 2023. P/E = price-to-earnings. NTM = next 12 months.

DW central banks are changing tack

With global growth slowing and central banks pausing, we see fixed income as attractive in 2024. We are constructive on duration and prefer very low risk sovereigns and high-quality credits.

DW policy rates – The tightening cycle is coming to an end

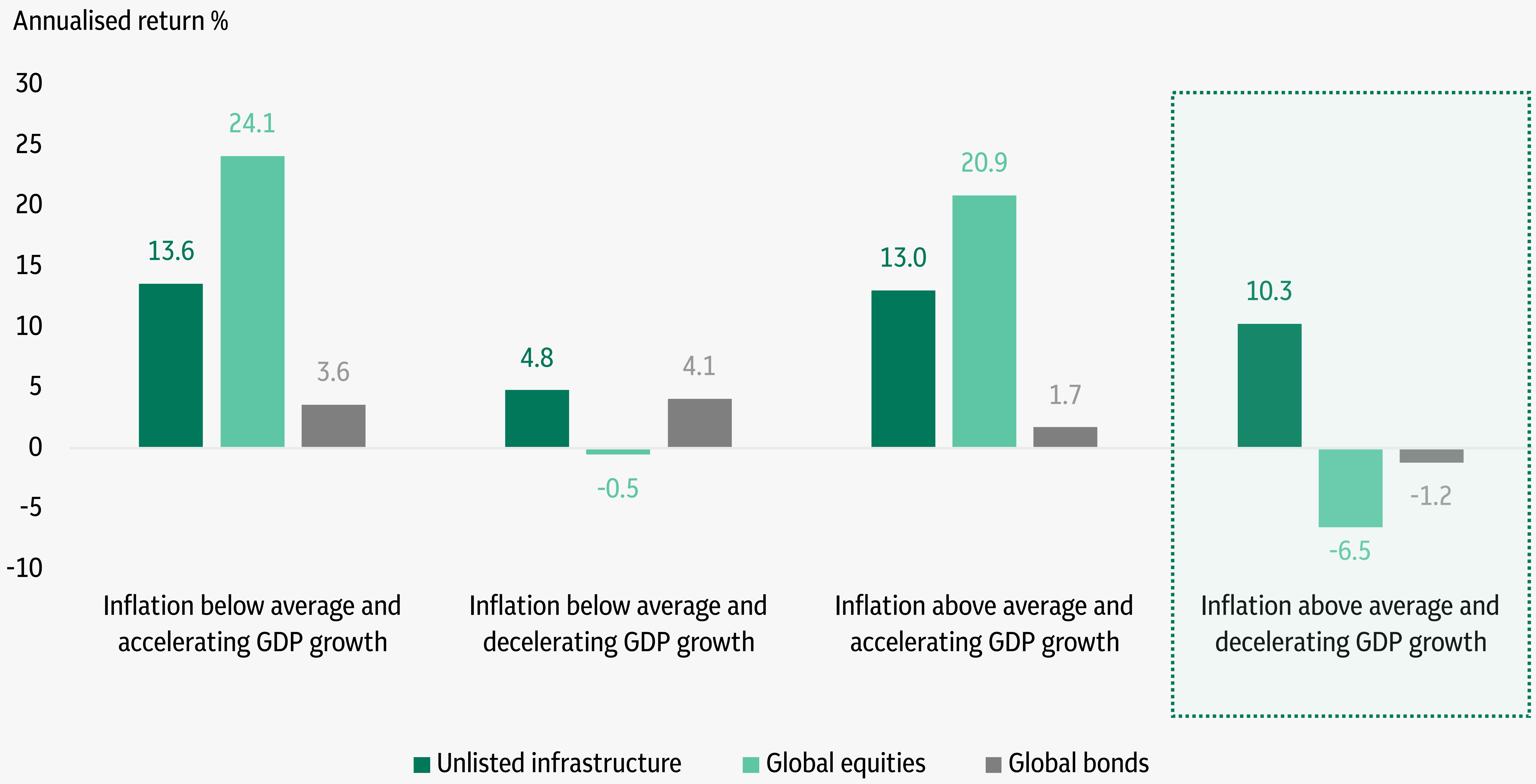


Source: Macrobond (November 2023).

Real asset returns expected to stay resilient

Infrastructure is defensive, with a high yield and exposure to secular growth trends. These traits should hold it in good stead in the macroeconomic environment that is likely to prevail in 2024 and beyond.

Infrastructure's stable return profile relative to other asset classes

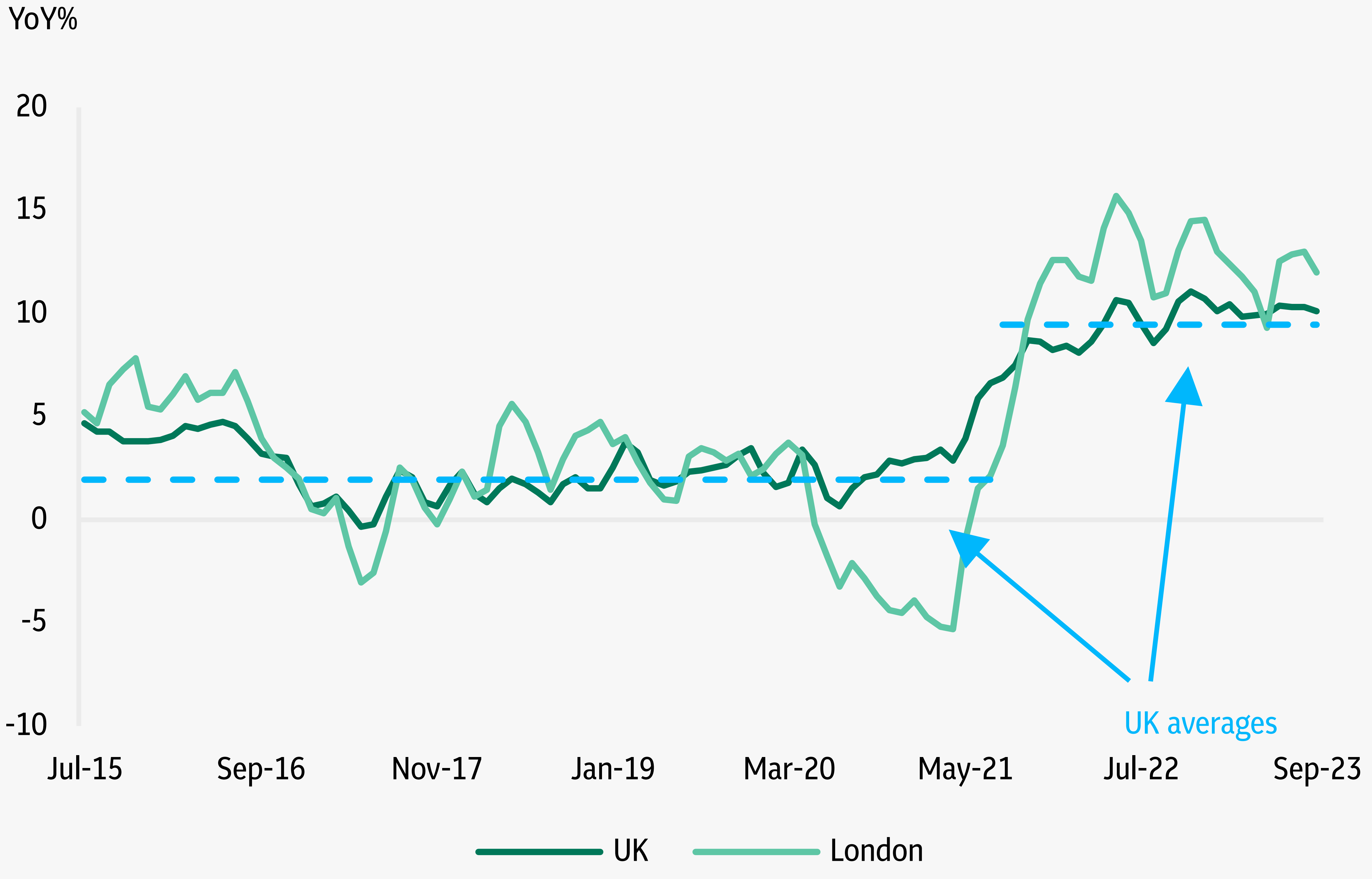


Sources: Macrobond, Cambridge Associates (June 2023). Infrastructure: Cambridge Associates Infrastructure Index; global equities: MSCI World Index; global bonds: Bloomberg Global Aggregate Index. Analysis conducted from 4Q03 to 2Q23.

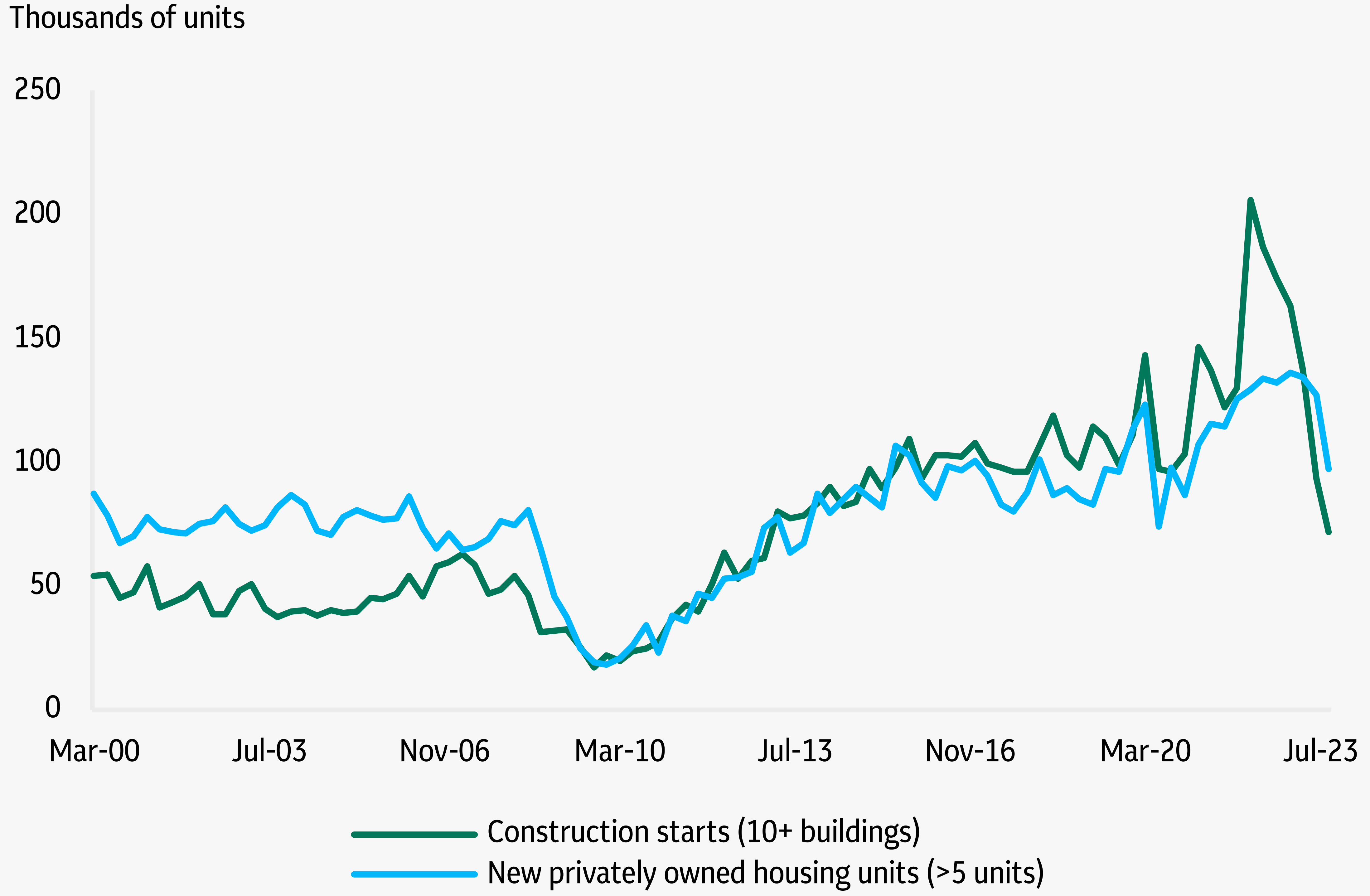
Property: Divergence by sector

Rental housing across the developed world is benefitting from strong rental growth and tightening supply, as higher interest rates and elevated costs weigh on construction activity.

UK rents have been growing strongly



US construction starts – Supply is tightening



Sources: Macrobond, CoStar, US Federal Reserve Economic Data (FRED) database (October 2023).

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Diversification may not protect against market risk.

Fixed income securities and bond funds can lose value, and investors can lose principal, as interest rates rise. They also may be affected by economic conditions that hinder an issuer’s ability to make interest and principal payments on its debt. This includes prepayment risk, the risk that the principal of a bond that is held by a portfolio will be prepaid prior to maturity at the time when interest rates are lower than what the bond was paying. A portfolio may then have to reinvest that money at a lower interest rate.

Market risk is the risk that all or a majority of the securities in a certain market – like the stock market or bond market – will decline in value because of factors such as adverse political or economic conditions, future expectations, investor confidence, or heavy institutional selling.

Natural or environmental disasters, such as earthquakes, fires, floods, hurricanes, tsunamis, and other severe weather-related phenomena generally, and widespread disease, including pandemics and epidemics, have been and can be highly disruptive to economies and markets, adversely impacting individual companies, sectors, industries, markets, currencies, interest and inflation rates, credit ratings, investor sentiment, and other factors affecting the value of the Strategy’s investments. Given the increasing interdependence among global economies and markets, conditions in one country, market, or region are increasingly likely to adversely affect markets, issuers, and/or foreign exchange rates in other countries. These disruptions could prevent the Strategy from executing advantageous investment decisions in a timely manner and could negatively impact the Strategy’s ability to achieve its investment objective. Any such event(s) could have a significant adverse impact on the value and risk profile of the Strategy.

International investments entail risks including fluctuation in currency values, differences in accounting principles, or economic or political instability. Investing in emerging markets can be riskier than investing in established foreign markets due to increased volatility, lower trading volume, and higher risk of market closures. In many emerging markets, there is substantially less publicly available information and the available information may be incomplete or misleading. Legal claims are generally more difficult to pursue.

Currency risk is the risk that fluctuations in exchange rates between the US dollar and foreign currencies and between various foreign currencies may cause the value of an investment to decline. The market for some (or all) currencies may from time to time have low trading volume and become illiquid, which may prevent an investment from effecting positions or from promptly liquidating unfavourable positions in such markets, thus subjecting the investment to substantial losses.

Credit risk is the risk of loss of principal or loss of a financial reward stemming from a borrower’s failure to repay a loan or otherwise meet a contractual obligation. Credit risk arises whenever a borrower expects to use future cash flows to pay a current debt. Investors are compensated for assuming credit risk by way of interest payments from the borrower or issuer of a debt obligation. Credit risk is closely tied to the potential return of an investment, the most notable being that the yields on bonds correlate strongly to their perceived credit risk.

IBOR risk is the risk that changes related to the use of the London interbank offered rate (LIBOR) or similar rates (such as EONIA) could have adverse impacts on financial instruments that reference these rates. The abandonment of these rates and transition to alternative rates could affect the value and liquidity of instruments that reference them and could affect investment strategy performance.

Deglobalisation is the process of diminishing interdependence and integration between certain units around the world, typically nation-states.

Important information and disclosure

Gross domestic product (GDP) is a measure of all goods and services produced by a nation in a year. It is a measure of economic activity.

Inflation is the rate at which the general level of prices for goods and services is rising, and, subsequently, purchasing power is falling. Central banks attempt to stop severe inflation, along with severe deflation, in an attempt to keep the excessive growth of prices to a minimum.

The price-to-earnings (P/E) ratio is the ratio for valuing a company that measures its current share price relative to its per-share earnings.

Valuation spread is the difference between the median next 12-month price-to-earnings ratio of the highest quintile of size factor exposure minus the lowest quintile of size factor exposure of stocks in the Russell 3000 Index, sector neutral.

The yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the 3-month, 2-year, 5-year, and 30-year US Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. It is also used to predict changes in economic output and growth.

The shape of the yield curve is closely scrutinized because it helps to give an idea of future interest rate change and economic activity. There are three main types of yield curve shapes: normal, inverted and flat (or humped). A normal yield curve is one in which longer maturity bonds have a higher yield compared to shorter-term bonds due to the risks associated with time. An inverted yield curve is one in which the shorter-term yields are higher than the longer-term yields, which can be a sign of upcoming recession. A flat (or humped) yield curve is one in which the shorter- and longer-term yields are very close to each other, which is also a predictor of an economic transition. The slope of the yield curve is also seen as important: the greater the slope, the greater the gap between short- and long-term rates.

Yield curve inversion is when coupon payments on shorter-term Treasury bonds exceed the interest paid on longer-term bonds.

The Bloomberg Global Aggregate Index provides a broad-based measure of the global investment grade fixed-rate debt markets.

The Caldara and Iacoviello Geopolitical Risk (GPR) Index reflects automated text-search results of the electronic archives of 10 newspapers: Chicago Tribune, the Daily Telegraph, Financial Times, The Globe and Mail, The Guardian, the Los Angeles Times, The New York Times, USA Today, The Wall Street Journal, and The Washington Post. Caldara and Iacoviello calculate the index by counting the number of articles related to adverse geopolitical events in each newspaper for each month (as a share of the total number of news articles).

The Cambridge Associates LLC Infrastructure Index is a horizon calculation based on data compiled from 93 infrastructure funds, including fully liquidated partnerships, formed between 1993 and 2015. Private indexes are pooled horizon internal rate of return (IRR) calculations, net of fees, expenses, and carried interest.

The MSCI World Index represents large- and mid-cap stocks across 23 developed market countries worldwide. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Russell 3000 Index measures the performance of the largest 3,000 US companies, representing approximately 98% of the investable US equity market.

The S&P 500 Index measures the performance of 500 mostly large-cap stocks weighted by market value and is often used to represent performance of the US stock market.

Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Economic trend information is sourced from Bloomberg unless otherwise noted.

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