QUARTERLY ECONOMIC OUTLOOK | FOURTH QUARTER 2023

The year ahead: Soft landing or hard slog?

By: James R. Solloway, CFA, Chief Market Strategist and Senior Portfolio Manager

SEI recently released its fourth-quarter Economic Outlook. Here is summary of our key perspectives.

- 2023 saw a sharp reversal of winners of losers compared to the prior year. In 2022, bonds and equities were punished while commodities were rewarded. Conversely, 2023 has been relatively kinder to investors: U.S. large-cap stocks put in a stellar return of 26.5%, while fixed-income markets saw mixed performance. Commodities were the worst performing asset—down 8.4% after being up nearly 19% in 2022[1]. Altogether, it's been quite the reversal from the previous year's performance.
- The U.S. avoided a recession in 2023, managing to advance at an above-average pace through the first three quarters of the year, continuing a streak of superior performance relative to other major advanced economies. That noted, we expect more subdued growth in 2024, perhaps deteriorating into a stagnant/mildly recessionary environment along the lines of what is currently being seen in much of Europe.
- Within emerging markets, China was a particular disappointment. Household spending on restaurants and travel within the country rebounded from last year's COVID-19 lockdowns, but property markets are moribund and both consumer and business confidence are low following a series of detentions and corruption probes of dozens of business leaders.
- What inflation continues to move lower, the rate of increase has decelerated more dramatically in recent months than we expected. Both the U.S. and the eurozone have enjoyed a year-over-year decrease in inflation. We still don't think central banks can declare mission accomplished on the inflation control front. We believe Europe is more likely than the U.S. to see core inflation get closer to the 2% area by the end of 2024, owing to a relatively weaker regional economy, while the U.S. sees a stabilization of inflation closer to the 3% mark. As was the case at the end of 2022, we maintain our view that inflation will not fall all the way back to target on a sustainable without some economic pain.
- In its mid-December meeting, the U.S. Federal Reserve clearly signaled its expectation that the U.S. economy will experience a soft landing and forecast federal-funds rate decreases in 2024, followed by reductions in 2025 and 2026. While futures markets appear to be pricing in 150 basis points of cuts before the end of next year, we lean much closer to the Fed's view. Indeed, we question whether any rate cuts are really needed, as financial conditions have been easing since October 2022, reflecting the strength of the equity market and the tightening of credit spreads.
- Other central banks appear to be taking a more conservative tack; both the Bank of England (BOE) and the European Central Bank insist that the job of vanquishing inflation is not done. Not surprisingly, given the U.K.'s higher inflation rate, the BOE's rhetoric is more aggressive and the central bank seems to be preparing the ground for a hard landing. Meanwhile, Japan has the opposite problem. Despite intense speculation over the timing of a move away from negative policy rates and yield-curve control, the Bank of Japan has maintained the status quo, rising inflation notwithstanding. Like many other observers, we expect the BOJ to begin the normalization of interest rates in 2024.
- Investor sentiment is currently enthusiastic over the prospect of a soft economic landing and a return to 2% inflation. Both bonds and stocks appear overbought on a near-term basis, so some kind of price consolidation would not be surprising. The extent of any correction in risk assets will, of course, depend on changing perceptions on economic growth, the corporate-profits outlook, the path of inflation and central-bank responses.

A full-length paper is available if you wish to learn more about these timely topics.

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[1]Source: FactSet.

Glossary

A **basis point** is one hundredth of one percent, typically used when expressing differences in interest rates.

The **federal-funds rate** is the interest rate charged to lending institutions on unsecured overnight loans. It is set by the U.S. Federal Reserve's Federal Open Market Committee. The rate is increased when the Federal Reserve wants to discourage borrowing and slow the economy and decreased when the Federal Reserve wants to spur economic growth.

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