Lazard Asset Management Multi-Asset Team

Letter from the Manager

MAY
2024

Changes to the Market Forecast (10 May 2024)

In this letter, we discuss recent developments behind the latest changes to our team's market forecast. Our multi-asset portfolios reflect our assessment of the global economy and the investment landscape 6–12 months into the future.

Current Market Forecast (Probabilities)

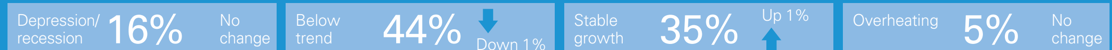
Bear ← → Base ← → Bull

Our Market Forecast is based on an evaluation of returns and risks across four subject areas: the macro Economy, factors impacting asset Valuation, market Liquidity, and investor Sentiment. Our process assesses the future state of each area and assigns probabilities on a forward-looking 6–12 month basis to potential outcomes ranging from bearish to bullish.

Inflation, interest rates, and recession risks continue to dominate the outlook, with market narratives shifting rapidly as incoming economic data reshape prevailing views. While the global economic outlook remains resilient, rapid disinflation in the second half of 2023 stalled in the first quarter of 2024 in some major economies, most notably in the United States. Is this just a "bump in the road," or is it a "hard last mile?" At best, rate cuts may be delayed given new uncertainty about the underlying pace of inflation. At worst, "higher for much longer" rates and a slower economy may be necessary. We remain optimistic that disinflation may continue and are making only minor changes to our forecast. However, confidence is lower and upcoming inflation reports will be important.

Economy

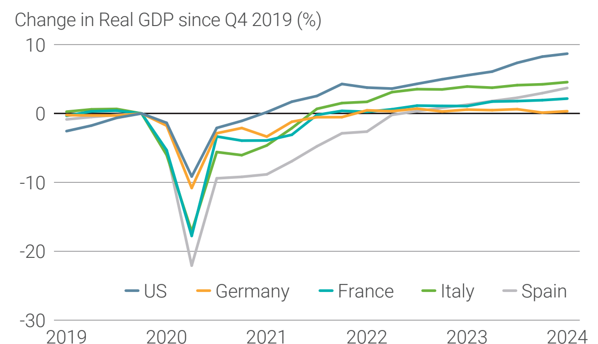
What stage of the global business cycle are we likely to be in over the next 6–12 months?



The resilient US economy raises questions about whether robust business conditions and labor markets need to weaken to reduce sticky services inflation. We believe labor markets are already gradually slowing and are hopeful that disinflation can resume. The European economy remains weak, but with signs of improvement—including in Germany, a laggard. Labor markets appear resilient and imminent rate cuts are expected. Incoming data continue to suggest stabilization in the Chinese economy, but with fragility and downside risks. Momentum is strongest in the manufacturing and export sectors, with hopes that additional policy support may address property sector challenges and lift household demand.

Germany's Economy Has Lagged

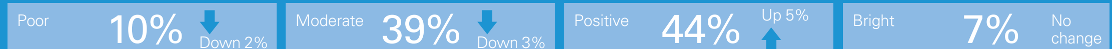
Change in Real GDP since Q4 2019 (%)



As of March 2024
Source: Haver Analytics, National Sources

Valuation

What is the outlook for business costs, profit margins, and returns over the next 6–12 months?



Commodity prices largely remain above prepandemic levels, but are lower than recent highs despite geopolitical risks, erratic weather, and moves by OPEC+ to support oil markets. Labor markets remain tight across many developed economies, but with signs that demand and supply are more balanced. Recent market whiplash highlights that equity valuations and bond yields are unattractive if the outlook is for higher rates and a slowing economy; less so if rates fall and resilience continues.

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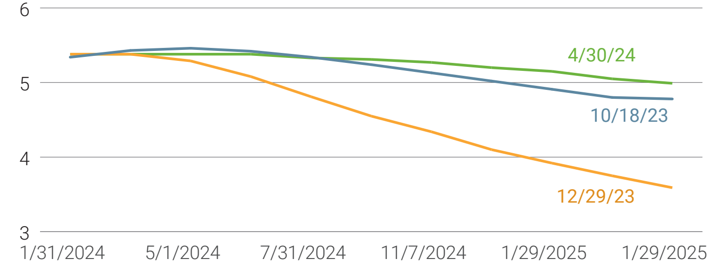
Liquidity

How are credit markets likely to be characterized over the next 6–12 months?

Financial conditions have tightened due to stalling progress on inflation in some major economies, especially the United States where rate cut expectations have been pushed out and yields have risen. Restrictive monetary policy continues to contribute to stringent lending standards and weakening credit demand, with delinquencies and defaults rising for more vulnerable borrowers. However, if—and when—rate cuts begin, financial conditions should loosen and credit availability and demand should improve, but within limits, given that the outlook remains for a slowing economy and for gradual cuts, at best. The risk remains that "higher for longer" rates prove necessary.

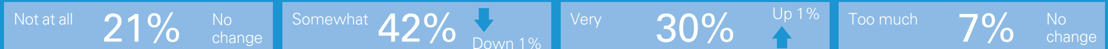
US Rate Cut Expectations Have Shifted



As of 30 April 2024
Source: Bloomberg

Sentiment

How supportive will politics and/or public opinion be to capital markets over the next 6–12 months?



Implied equity market and interest rate volatility rose as rate cut expectations were pared back—both should decline with rate cuts and a soft landing, and rise without them. The geopolitical landscape remains highly challenging, including two wars. Despite some thawing in relations, trade tensions with China are increasing amid concerns about overcapacity in export-oriented sectors. Fiscal policy will likely tighten in both the United States and Europe and remain supportive in China. Expect the run-up to US elections to increase focus on potential market impacts.

Outlook

First-quarter inflation data has raised difficult questions about the outlook. Much like the Federal Reserve, we maintain hope that this proves to be a "bump in the road," but with lower confidence. Over the medium term, we think the three scenarios Fed Chair Jerome Powell laid out in his latest press conference offer a good roadmap for expectations:

- Recent months are a bump in the road and inflation resumes its decline. Once confidence in disinflation is regained, so is the rates trajectory anticipated entering the year, only delayed. Bonds and equities reflect relief.
- Recent months prove symptomatic of sticky "last mile" services inflation. Rates stay where they are for even longer than currently anticipated, and the ultimate cutting cycle is both slower and possibly to a higher terminal rate. Bonds and equities suffer.
- Labor markets weaken in an unexpected manner. Rate cuts come sooner and are faster than anticipated. Safe bonds benefit, equities suffer.

Hanging over all of this are a number of additional risks, including: a difficult geopolitical landscape, the potential for new financial stress, and a polarized US election. We are maintaining a similar outlook but with more uncertainty, while adjusting our forecast and positioning to reflect recent market moves and these risks.

Favor

- US equities
- Sovereign fixed income
- Small cap equities

Avoid

- Low-quality equities
- Riskier credit
- US election exposure

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Important Information

Published on 15 May 2024.

All probabilities reflect rounding.

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