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Key Takeaways

- Global inflation will bottom in 2024. The secular stagnation era of the 2010s — defined by disinflation and low rates and driven by underinvestment and excess savings — is not coming back.
- The largest trend of 2023 was the rush into cash and longer-dated bonds to hedge recession risks and front-run rate cuts. That positioning is now both crowded and vulnerable to a sharp reversal.
- A new risk cycle is unfolding led by productive assets in the real economy with pricing power, and high and sustainable yields.

Ask Forstrong: Is the inflation threat over?

Welcome back to the pages of *Ask Forstrong* dear readers. The gluttonous blur that was this author's late December has now given way to the tyranny of January — that jarring month of reset, resolution, and the relentless pressure to be thinner, smarter, and happier versions of ourselves. Middle age is fun right? Meanwhile, money managers are busily positioning for the year ahead. 2024 already promises explosive fireworks. As we wrote in [our recent "Super Trends" annual outlook](#), global economic conditions are now, in many ways, similar to those experienced after World War II: lingering distortions with deep labour shortages, chronic government deficits and a fragmenting world.

Hot wars are also raging in Europe and the Middle East. Both threaten to explode into wider conflicts. And, of course, this is a massive year for democracy. The congested electoral calendar includes the most divided (America), most disgruntled (Britain), most populous (India), not to mention those front lines of the free world (Taiwan and conceivably even Ukraine). Adding it all up, 46% of planet earth's population can exercise their right to decide who leads them, the largest share since 1800 when the records began (hat tip to Deutsche Bank). The potential for big policy changes is enormous.

Yet no trend is more important for investors than the pathway for inflation and interest rates. This has been the epicenter of all global macro volatility over the last year. It will continue to be in 2024.

Looking back, the largest trend of 2023 was the rush into cash, with a colossal \$1.3 trillion poured into global money market funds. Lured in part by higher rates, record cash levels were also put in place to hedge recession risks (that clearly never materialized). Then, in late October, Fed Chair Powell hinted rates could fall in 2024. Markets latched onto that view and promptly spent the last few torrid months of 2023 scrambling to position for aggressive rate cuts. Asset prices dramatically re-priced. Take the ten-year government bond in America. It slumped by 100 bps since late October, creating a deeply inverted yield curve. Bond markets all around the world showed a similar trend.

Forward markets are now discounting nearly 150 basis points of Fed rate cuts this year with more to come in 2025. Bank of America's Global Fund Manager survey also tells us that investors are not only positioned with the biggest overweight to bonds since March 2009 but also view bonds as the most favoured asset class for 2024. Markets are now all-in on a deep rate cutting cycle.

But how likely will this positioning be rewarded? Everything hinges on the inflation outlook. Here, one cannot deny that progress has been made. Since peaking at 9.1% in June 2022, the annualized consumer price index in the US now sits at 3.1% (and increased just 0.1% in November). In the Eurozone, inflation spiked to

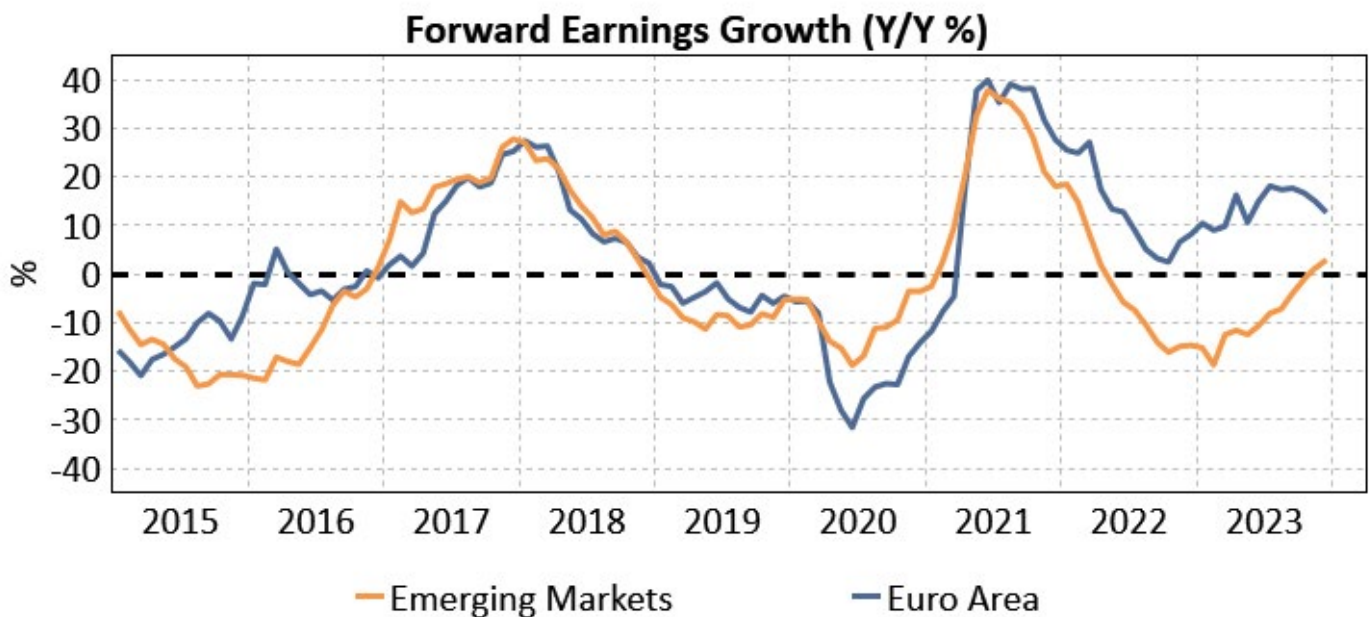
10.6% in October 2022, with the latest reading in December at just 2.9%. But consider what has driven this disinflation: the unwinding of pandemic price spikes caused by bottlenecks, steep energy price rises and the big shift in consumption from services to goods. These issues have now largely been resolved and are all related to the supply side of the economy.

But an examination of inflation needs to include the other main cause of rising prices: excess demand. The big surprise over the last year has been the persistence of high demand and economic resilience, despite higher rates. It should be clear that the global economy is now in new territory. The secular stagnation era of the 2010s — defined by disinflation and low rates and driven by underinvestment and excess savings (i.e. low aggregate demand) — is not coming back.

Instead, higher aggregate demand will continue. Why? Start with government deficits. Western policymakers, no matter the election results, are not returning to the fiscal austerity of the last decade. In fact, [a global race to reindustrialize](#) — driven by decarbonization, reglobalization and remilitarization — is now firmly underway. Public and private money is flooding into capital projects of all kinds, creating an investment boom in all corners of the world. Deeply oversold commodity markets will perk up in the months ahead.

Next, turn to businesses. Global corporate earnings growth is still positive. And, now, key measures of world trade and manufacturing are improving. And while the US has led earnings

momentum over the last year, participation has broadened out: Euro area forward earnings are now in a strong uptrend and emerging markets forward earnings have hooked up sharply.



Sources: Macrobond, MSCI, Forstrong Global Asset Management

Lastly, look at the consumer. Despite predictions that the consumer is “out of gas”, most regions in the world still have strong employment trends and wages rising in the 3% - 4% range (Canada is a notable laggard). In the US, real incomes are rising at roughly 3%. All of this supports robust household consumption.

Does any of this paint a picture of disinflation and deep rate cuts? Hardly. It's far too early to

declare “mission accomplished” on the inflation front. The big risk factor facing investors in 2024 is not recession but sticky inflation. Investors should view the central bank 2% targets, even if they are reached in 2024 in some countries, as a floor for inflation rather than the ceiling as it was from 2009 to 2020 (and not even the average as it was from 1994 – 2008).

Investment Implications

Markets have rightly recognized that historically once central bank policy turns, it turns in a big way. Most Fed rate cutting cycles have seen meaningful declines in interest rates. But most cycles have also coincided with a typical boom and bust cycle, where cuts were implemented to counter economic downturns. Those are not today's conditions. Resilience, rather than recession, continues to be the operative word. And while central banks may cut rates modestly in 2024, this will be more of a policy recalibration than a sustained series of deep cuts.

More broadly, markets are missing a key point: inflation will not return to the aberrational sub-2% level of the 2010s. We are in a new world. Longer-dated developed market government bonds, which have already priced in a meaningful rate cutting cycle (whether to hedge recession risks or front-run

disinflation), face downside risks. Yield curves will steepen in 2024.

And, while many have spent the last year braced for recession and, now, for much lower interest rates, our investment team has a thesis that may stretch minds: we are entering a new risk-taking cycle based on an entirely different set of macroeconomic conditions and investment leadership. As 2024 progresses, recession fears will again recede and aggressive rate cut expectations will be unwound. Shifts at the margin away from cash and bonds will lead to a big rotation into the cheap, cyclically-sensitive and inflation-hedging assets: financials, industrials, gold, international value stocks and especially commodity-oriented emerging market equities. Investors should not miss this setup.

Tyler Mordy, January 2024