Everything Has Changed
But Nothing Has Changed
2024

DALMA GROUP
GLOBAL CIO

Ten Pointers to 2024

As we step into a new year, its crucial to understand the evolving landscape of financial markets. We look back to draw lessons and try to gauge what can be set right. We dwell on the happenings of the year gone by and try to understand what can go right – and wrong – for the markets. Below, we present ten pointers on how the markets fared and where we think we are headed.

1. 2024 – A year of modest growth and lower interest rates

Looked at purely from the point of view of simple macroeconomic outlook, asset prices in 2024 should experience some positive returns. While we do not see the Fed cutting interest rates early, the prospect of lower rates should keep the markets in a constructive frame of mind.

2. 2023 was exceptional, as much as 2022 was terrible; 2024 should be more 'normal'.

Market commentators have made a good deal out of the 'great' returns that markets experienced in 2023, but much of these were just a reversal of the misfortunes of 2022. The two years taken together do little in terms of offering an insight into trend returns from markets.

3. Emerging markets to outpace developed markets…again.

The words 'emerging markets' are evermore evidently a wrong descriptor of the high growth markets of the global economy. In 2024, the IMF forecasts emerging markets to grow 4.0% versus a not-so-impressive 1.4% expected for the developed markets. In the growth markets, interest rates should see a more rapid decline, and their currencies should perform well against the dollar. The balance sheet of many growth economies remains in relatively good shape when compared with those of the debt-fuelled Western economies.

4. Why risk underweighting the tech sector?

While we fully understand investors' concerns about the (rich) valuations of many tech stocks, we wonder if it would be wise to underweight a sector that could see its fortunes turn as the rollout of AI capabilities across the industry gathers seismic pace. Industry estimates forecast a compounded growth rate of more than 70% in generative AI solutions between 2023 and 2027.

5. Be strategic not tactical

We continue to warn investors to not spend too much time guessing or worrying about what the Fed's next move. We advise relying on strategic thinking to shape asset allocation in portfolios. It has become a mugs game to second-guess what the Fed is up to next…which even the Fed doesn't seem to know! The quite extraordinary way asset prices rallied as the year closed only underlined the risk of betting on the Fed's last statement – they reserve the right to change their mind…often!

6. Alternative assets still deserve their significant place in portfolios

After a year of good returns from equities and bonds, it is understandable and perhaps undeniable that investors will assess the merits of holding less liquid alternative investments, or those like hedge funds with less transparency around the source of their returns. However, even as we emphasise that liquid assets did well in 2023 after a very poor 2022, alternative investments provided much more consistent returns when we combine the two years together. We advise maintaining an exposure to alternative investments for their diversification benefits and less volatile returns overall.

7. Geopolitics remains a dangerously large risk

We still have two significant theatres of war, which are not improving. Indeed, many still see the risk of a significant escalation for the worse. Come spring, Russia could make more significant territorial gains in Ukraine without better support from the West for the latter. Meanwhile, should Iran become more involved in the conflict in the Middle East, it risks setting off a chain of events that no one wants to contemplate.

Half of the world population will go to polls in 2024, with the outcome of the US Presidential election having the most significant impact on the world economy and politics. For much of 2024, we will be sitting and pouring over court battles and opinion polls. The gap between the two likely presidential candidates is so stark. The consequences of a new Trump administration are frightening to many, given the perceived extremity of many of the proposed policies.

8. China – too big to ignore

China, as the second largest economy in the world, just can't be ignored even if 2023 was a real disappointment. Chinese asset markets remain a key element of some of the major indices. While some asset managers have increasingly pressed for ex-China mandates, many of the major global stocks depend for their growth on a vibrant Chinese economy, Chinese buyer or Chinese supplier. Chinese equities remain on our buy list because the 20-year low valuation over discounts much of the bad news, and things are improving with authorities incrementally providing support for the economy. The Chinese economy will likely grow 4-5% this year.

9. Inflation will remain key to market mood

It is no slam dunk that global inflation will gradually ease to what many central banks have long contemplated, but typically it will be around the 2% level. Geopolitics could still spoil the game and push commodity prices higher. Wage growth is still relatively strong, with labour seeking to cover the loss of real incomes in recent years. Climate change has the power to be a significant disruptor to crop yields. Although inflation pressure has abated, we suspect it may linger longer than the market's current price.

Chart 1: US Inflation down but not out

Source: Bloomberg

10. Buy the value or the good stories

At the end of last year, there was a sense that investors were seeking better value in markets. Indeed, it was significant that the Dow Jones 30 managed to keep pace with NASDAQ in terms of returns in the year's closing months. Beaten-up sectors such as REITs have started to perform better. There is apparent value in China, as we have already mentioned, and indeed across Asia. One story we would want to stay with and focus on is India. While some investors bemoan the high valuations, there is still such good momentum in the economy and a likely favourable outcome to the nationwide general elections this year.

Where Do US Interest Rates and Bond Yields Go in 2024?

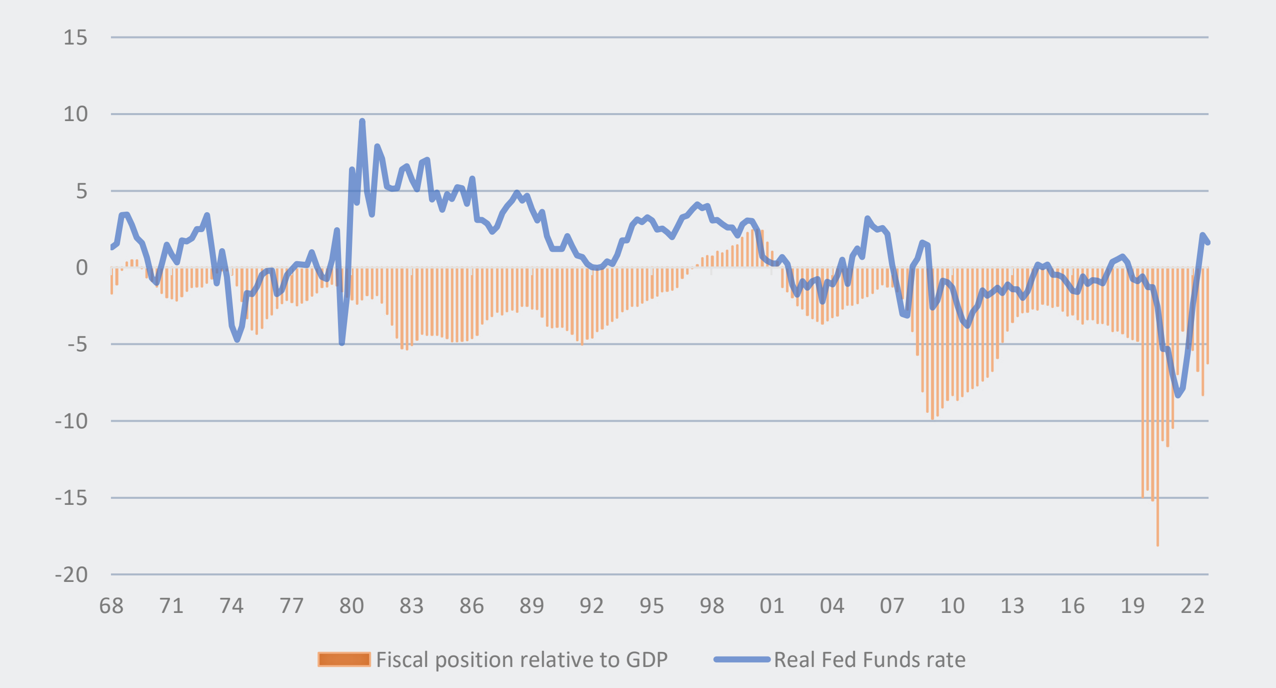
Over the past two years, commentators often complained that the Fed's increases in policy rates were about to break the US economy. However, apart from the medium-sized banks' failures in the first quarter of 2023, the economy has continued to perform well.

A large part of the robustness of growth has been generated by loose fiscal policy. Indeed, the aggregate stimulus to the economy from fiscal and monetary policy has been unprecedented in recent years. Sure, COVID hit hard, but the current year's substantial fiscal boost and negative real interest rates (Fed funds rates less inflation) helped the economy hum along...but with ever-increasing inflation.

Policy shifts by the Fed have finally brought positive real rates, restricting the economy. However, the level of real rates, as we write (1.6%), is far from the level needed in the past to bring inflation under control. Before 2007, the economy required a real rate of at least 2-3% to bring inflation under control. But these levels of real rates worked in the past because fiscal policy was also relatively restrictive.

In an election year, fiscal policy may still run around 6% of GDP. Hence, with stimulatory government policy, monetary policy has to work harder to keep bringing inflation down.

Chart 1: Loose monetary policy and loose fiscal policy



Source: Bloomberg

The consensus economists' forecast is that through 2024, inflation will drift down close to the Fed's target of 2%. If the consensus is correct real rates would be at 2.6% in Q4 should Fed policy rates remain unchanged. Such a level of a real Fed funds rate would not be exceptional in an historical context.

Table 1: US inflation

	Q1 23	Q2 23	Q3 23	Q4 23E	Q1 24F	Q2 24F	Q3 24F	Q4 24F
CPI (YoY)	5.8%	4.0%	3.5%	3.4%	3.1%	2.9%	2.6%	2.4%

Source: Consensus forecasts from Bloomberg

The fact that the US 10-year bond yield is well below the Fed funds rate is quite extraordinary, occurring on only four occasions in the last thirty years and they have typically led to stress situations in the global economy and financial markets. In essence the market appears to be betting that the Fed will eventually/soon cuts short term interest rates by two to three percentage points. In the past such rate cuts are typically a reflection of a weak global economy with some form of financial crisis underway.

Chart 2: US 10-year bond yield less the Fed funds rate

Source: Bloomberg

There appears to be a discrepancy in the market's signals. On one hand, the analysis of short rates implies the market anticipates a soft landing. On the other hand, when we model long-term bond yields, the data suggests a different story. For these yields to make sense, there must be either a notable downturn in the US economy or a drastic drop in inflation. Only such significant changes could create a more rational equilibrium between the long and short-term rates in the market.

Looking back in history, and particularly in the period 1990-2000 when the Fed was on a mission to drive down inflation, real interest rates averaged 2.1% and long rates traded on average 1.3% above the Fed's policy rates. In today's world that would equate to a US government bond 10-year yield of 6.4%!

Table 2: Historical levels of short and long-term interest rates

		Fed funds	CPI	US 10 year	Real Fed funds	Term premium
1991 to date	June 1991 to date	2.5	2.6	4.0	0.0	1.5
Driving inflation down	1991-2001	4.9	2.7	6.2	2.1	1.3
Post GFC	2008-2020	0.7	1.8	2.5	-1.1	1.8
Post Tech boom	2001-2023	4.0	3.0	4.6	1.0	0.6
Today	**Nov-23**	**5.3**	**3.7**	**4.3**	**1.7**	**-1.0**

Source: GCIO research and Bloomberg

We would accept that no period of economic history is exactly the same as it has been in the past (Table1). And there is an argument that in the 1990's, central bankers were fighting a more pronounced inflation mentality in the economy than is necessarily the case today. However, the gap between a theoretical 10-year bond yield of 6.4% is a long way from the 4.5% of today and must be building in a great deal of hope that the economy is reverting to its disinflationary best days.

So just playing with some numbers for 2024, if inflation were at 2.5% at the end of next year and real rates were say 1.0%, and a term premium of 1.0% solves for a 4.5% 10-year government bond yield. Hence for next twelve months we would assess that investors will at best clip their coupons. Today the US bond market is probably priced for perfection.

Strategic Asset Allocation over the Next 10 years – Recognising Growth over Decline

Investors often rely on portfolio optimisers when constructing a diversified portfolio designed to perform robustly over the next decade. However, simply inputting traditional asset risk and return expectations may overlook critical nuances. This method risks falling into the common pitfall of anchoring to past performance, a key investor misstep.

We stand at the precipice of significant shifts in the global economy. These changes demand a reevaluation of investment strategies, encouraging investors to approach the global opportunity set with fresh perspectives, distinct from past methodologies.

Standard Chartered Bank's projections indicate a major reshuffling of the world's top ten economies within the next 7-10 years. As shown in Table 1, 'emerging markets' are poised to dominate this list. By 2030, it's expected that only three Western economies will be among the top ten, collectively contributing a mere 22% of these nations' total GDP.

Projected Top 10 Global Economies by GDP (PPP) in 2030:				
China:	**India:**	**United States:**	**Indonesia:**	**Turkey:**
$64.2 trillion	$46.3 trillion	$31.0 trillion	$10.1 trillion	$9.1 trillion
Brazil:	**Egypt:**	**Russia:**	**Japan:**	**Germany:**
$8.6 trillion	$8.2 trillion	$7.9 trillion	$7.2 trillion	$6.9 trillion

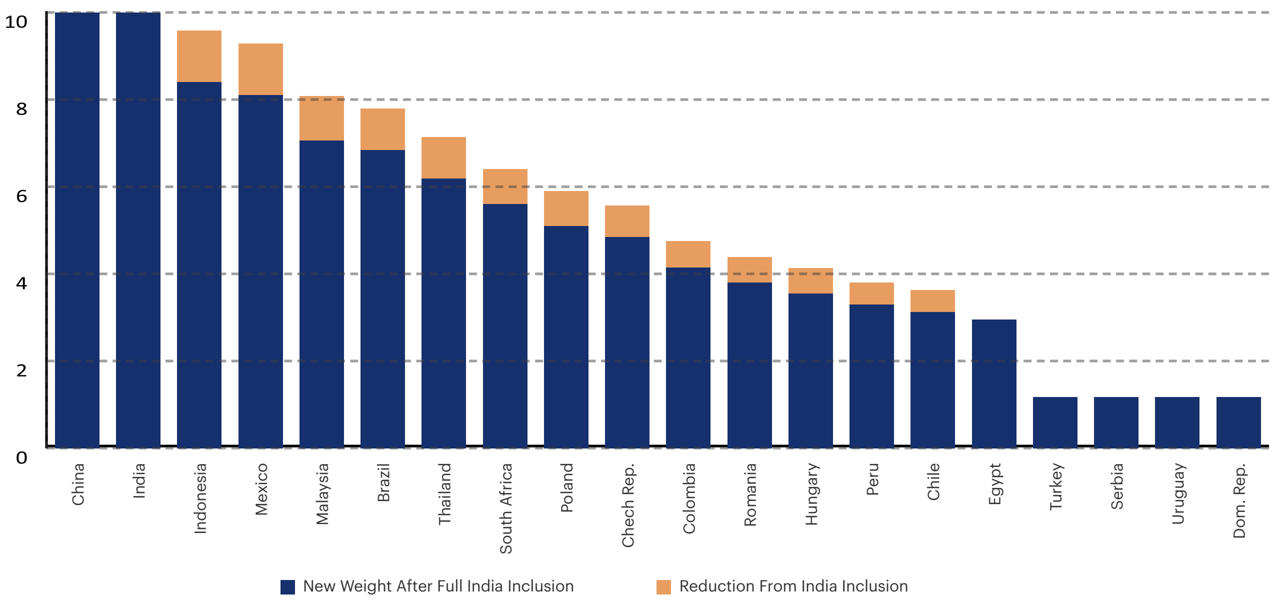
Source: Standard Chartered estimates

This upward trajectory of growth economies is likely to catalyse significant developments in their financial systems, leading to an expanded array of tradeable securities. We can anticipate substantial growth in both bond and equity markets as these nations' security markets mature, exchange controls relax, and foreign capital flows increase.

Rethinking Bond Markets:

Investors should consider shifting focus in global bond portfolios towards higher-yielding markets. This shift, however, is constrained by credit ratings' evolution. Recent moves by rating agencies, including Fitch and S&P's downgrades of U.S. debt and JPMorgan's planned inclusion of India in the JPM Morgan emerging market index, highlight this dynamic. Notably, around 60% of sovereign dollar-paying bonds in the EM index are investment-grade, with even higher percentages in corporate and local currency bonds, according to NASDAQ research.

Impact of India Inclusion



Source: J.P.Morgan. As of September 29.2023

The predominance of dollar debt may wane as growth markets like India, Indonesia, Turkey, and Brazil deepen their credit markets, leading to a surge in local bond issuance. Historically, significant issuance from emerging markets coincided with periods of financial distress, but the post-COVID era sees these nations emerging with healthier government debt-to-GDP ratios compared to developed markets.

As these countries demonstrate consistent growth, their evolving capital needs present a less risky investment opportunity in their robust nominal growth. The transition from 'emerging' to 'growth' markets will be marked by currency stability, enhancing the safety of investing in their debt markets for foreign investors."

Debt-to -GDP ratios for leading Emerging and Developed market economies

Top 10 Emerging markets	
China	83%
India	82%
Indonesia	39%
Mexico	53%
Malaysia	67%
Brazil	88%
Thailand	61%
South Africa	74%
Poland	50%
Czech Republic	45%
Simple Average	**64%**

Top 10 Developed markets	
United States	123%
Japan	255%
France	110%
UK	104%
Germany	66%
Australia	52%
Italy	144%
Spain	107%
Netherlands	50%
Ireland	43%
Simple Average	**105%**

Chart 1 is a powerful reminder of the return premium from emerging market local currency debt (measured in US dollars) over conventional bond market benchmarks. It is about more than just the timing of a tactical exposure to emerging market local debt but how much of a structural allocation an investor should make.

Chart 1: Emerging market debt outpaces the Global Aggregate index

Source: Bloomberg

Equity investing in an Evolving Global Economy

Right now, investors are trying to navigate a roller-coaster market, often switching between taking risks and playing it safe. This short-term focus can make it hard to see the bigger, long-term picture. This article takes a step back to consider what lies ahead in the financial world.

We're moving away from the strategy of boosting asset prices to drive growth. This approach, involving low interest rates and Quantitative Easing (QE), was heavily used by the U.S. Federal Reserve and other central banks to combat financial crises and prevent a deep depression. But it's not the main plan anymore.

This change has significant implications. For years, we've been in an era of "free money," which led to overly optimistic business models and some questionable decisions by Wall Street. The performance of former high-flying stocks versus traditional sectors like global energy companies tells a story of shifting fortunes.

Unfortunately, the strategies of near-zero interest rates and QE haven't spurred the expected increase in private sector investment. Instead, more government spending has been needed to prop up asset prices and keep struggling companies afloat. This approach has boosted stock prices for some companies, but it's also led to more debt, less economic growth per person, and growing income and wealth inequality.

We're likely to see a shift in economic policies, returning to strategies focused on national interests and government-led investment in specific industries and social goals. Think of the 1950s and 1960s, but with modern twists like environmental and social governance. The government will likely play a bigger role in directing where money goes.

The approach will probably include more government spending in strategic areas, like the tech industry and inflation control, as seen in recent U.S. laws. Politicians are also aiming to balance wages and profits better, especially for lower-income workers.

Internationally, countries like Japan, China, and India have always focused on national interests in their economic policies. As Western countries return to similar approaches, expect changes like reduced global trade, stricter immigration policies, less technology sharing, more government control, and potential hidden inflation.

Regarding U.S. debt, it's a growing concern. The national debt is over $30 trillion, more than 120% of the country's GDP. The cost of managing this debt is huge and could rival defence spending soon. If current trends continue, we might see policies from the past, like strict government controls on financial activities, re-emerge.

To manage these challenges, the U.S. might need to cut government spending, boost economic growth, or control financial markets more tightly. This situation will have a significant impact on investment strategies.

For investors, this means focusing on:

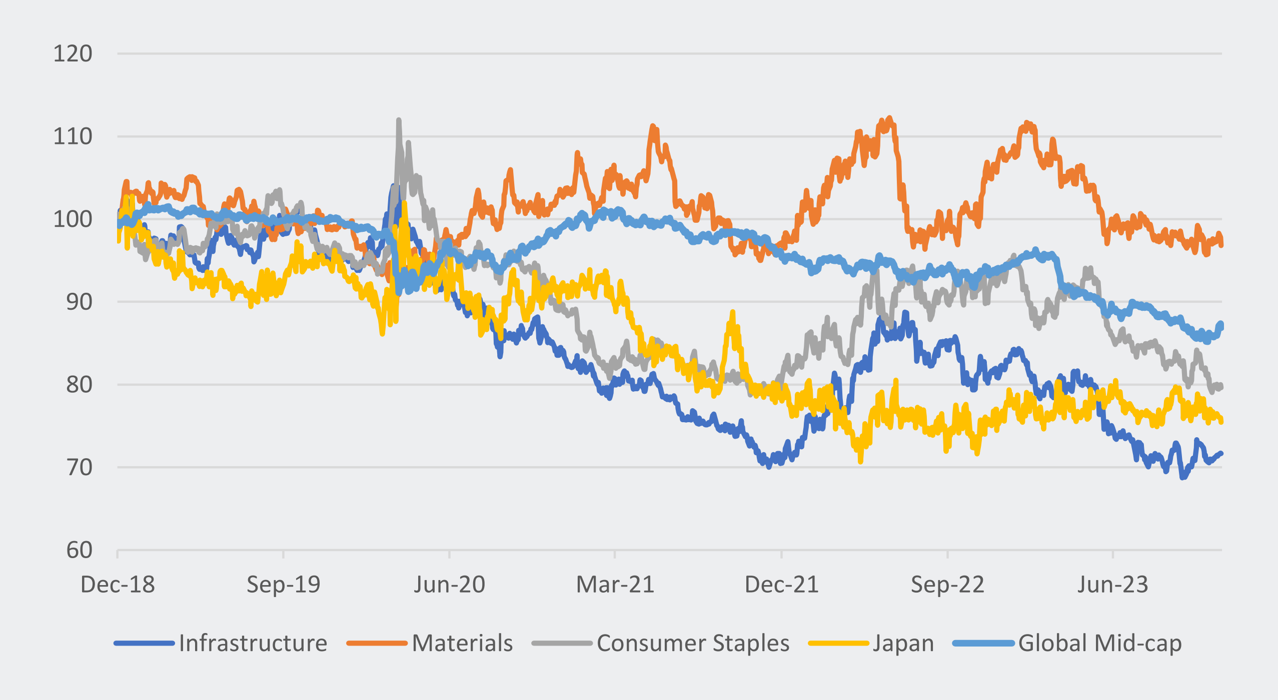
- **Mid-cap companies that are profitable and sustainable**. Quality/Profitable mid cap firms. The Russell 2000 in the USA, excluding the loss-making firms, is an optimal choice. The loss-making companies in that index account for an astonishing 25% of companies (based on the last 3 years) and thus the profitable ones are on a significant P/E discount (the P/E is 12.5x) to the S&P 500 which is dominated by "The Magnificent 7" at high P/Es. Equal weighted indices have already begun to perform better relative to the capitalisation weighted ones. If one seeks equity risk then it's highly unlikely that the mega caps outperform the mid-caps from here as much as they have done? If the whole equity market is de-rated then there is less to lose from a P/E of 12.5?

- **Firms that meet essential needs**, which are less likely to face additional taxes or regulations. They will also provide an inflation hedge in that any product price rises will be harder to avoid by switching consumption preferences. In this area we still like Infrastructure companies, energy providers and Basic Materials businesses.

- **Investing in Japan, where corporate changes are benefiting shareholders**. Japan – much is changing at the corporate level with share buy backs rewarding shareholders. Companies are keen to enter the Nikkei 400 index which is weighted based on how well a company is managed for shareholders. In a world where bureaucrats will have more say on how a company can operate with respect to 'national interest', one might as well invest in a country where the bureaucrats are well trained and have done an effective job, rather than one where they are unproven!

In conclusion, while the future is uncertain, investors can still find opportunities for good returns by adjusting their strategies to these changing times.

Chart 1: Recent Relative Performance of Next Year's Potential Winners



Source: Bloomberg

China - Uninvestable?
or just different?

The "China is uninvestable" narrative among Western investors and commentators emerged after the education sector crackdown and last-minute cancellation of the Ant Financial IPO in 2020. However, the issues and risks involved with investing in China predated this by quite some margin.

Despite extensive debate on the issue (mostly from people who took their positions or sides a long time ago), no side has scored a unanimous victory, resulting in a position where "price is truth" is countered by "US dollar hegemony is doomed" and sensible discussion remains elusive.

Some of the key arguments from each side are listed below.

China is uninvestable because;	China shouldn't be ignored because;
Demographics (ageing population)	Government has shown fiscal and monetary restraint
Real estate bubble	Scale of the economy
Debt is unsustainably high	Substantial trade surplus
Over reliance on FAI for GDP growth	Influence in the EM/global south (via BRI)
Government interference stifles entrepreneurs	Lack of colonizing impulse
Lack of genuine technological innovation	Superior GDP growth even after real estate issues
High youth unemployment	Position in energy transition industries, (rare earths, solar, batteries, EV & supply chain)
Energy and food insecurity	The risks are adequately priced

We would note that very few of the arguments on the "uninvestable" side (save for youth unemployment, which is a more recent development) are new, and most have been evident for some time. Jim Chanos famously called out overbuilding in the real estate sector in 2010 (65m empty apartments), while others pointed to problems even earlier.

Conversely, we could argue that China has demonstrated fiscal and monetary restraint in stark contrast with Western governments (US & Europe in particular). The argument follows that China has a greater capacity to stimulate its economy, especially through an expansion of fiscal spending, but is choosing not to. The principal reason for this is that much of the GFC stimulus ("the bazooka") led to the creation of unproductive assets (empty residential apartments and roads to nowhere) and elevated debt levels within the property sector. This ultimately led to the collapse or default of many private real estate developers, including Evergrande and Country Garden.

Absent a "bazooka" stimulus (which we believe is unlikely), fixed asset investment (FAI – infrastructure and real estate construction) will be a drag rather than a contributor to GDP growth. At peak, this represented almost 45% of GDP, leaving a substantial gap and presenting a risk to headline growth figures.

At peak activity in 2018, Chinese developers were building approximately 18m apartments per year when the underlying demand was estimated to be closer to 11m. This resulted in many empty and unsold apartments in places (tier 3 & 4 cities) where people did not want to live. The collapse of Evergrande is the most obvious result of this.

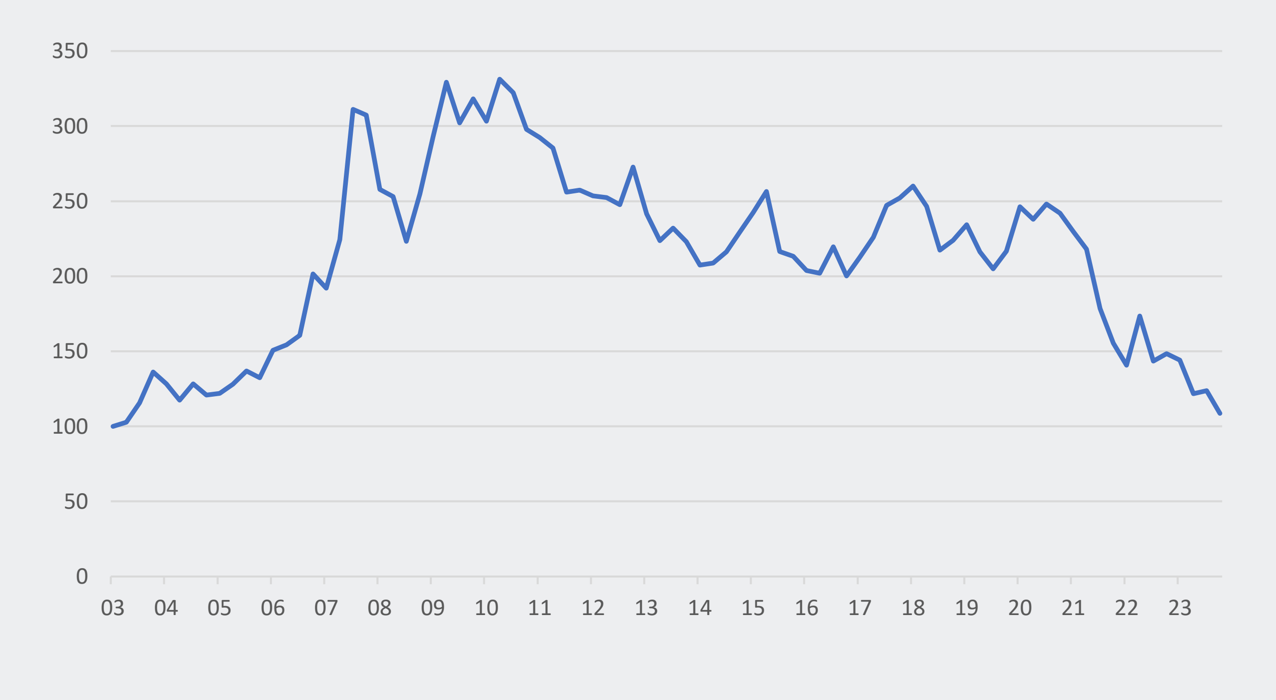
Part of the problem stems from a structural flaw in China's real estate market whereby developers receive full payment upfront from buyers of apartments and can use these proceeds however they wish (such as to finance the growth of their operations by buying more land). This worked well while prices, pre-sales, and construction activity were rising but caused significant problems in reverse.

An overhaul of this structure, bringing it into line with other countries, is a logical path; however, it will require significant support from the central government and its proxies (banks, AMCs, and local governments). DSG Asia recently estimated that a complete cleanup of the property sector & recapitalization of the financial system could run to 35-40% of China's GDP.

The bottom line is that when the dust settles, activity in China's property sector is expected to be significantly (25-30%) below its 2018 peak. While this means that China's real estate complex (private developers and banks) should be avoided, it only renders the entire market uninvestable.

The other most often cited argument is that government intervention stifles innovation and crimps the economy's potential (and, therefore, the potential valuation of companies). The counter is that there is a price for everything, and an investor's job is to determine whether risks have been appropriately priced. Does a forward PE discount of 52% (MSCI PE of 9.3x vs S&P500 at 19.5x) accurately capture these risks? Many scenarios could see these figures converge or mean revert, which would quickly make the "China is uninvestable" go away.

Chart 1: China's marked underperformance of Global equities in recent years



Source: Bloomberg

Sustainable Finance: Unlocking a Trillion-Dollar Opportunity in the Gulf

The Gulf Cooperation Council (GCC) nations stand at the precipice of an extraordinary opportunity – a transformative shift towards sustainable finance that holds the potential to reshape the region's economic landscape and propel it to the forefront of global sustainability. As the world transitions towards a low-carbon economy, the GCC, with its abundant and low-cost renewable energy resources, is uniquely positioned to capitalize on this burgeoning realm of investment.

Sustainable finance, a practice that directs capital towards environmentally and socially responsible projects, is experiencing explosive growth. Investors worldwide increasingly seek ESG-aligned investments, recognizing the long-term benefits of sustainable practices for both the environment and their portfolios.

With their strong economic fundamentals, well-developed capital markets, and supportive regulatory environments, the GCC nations are ideally suited to embrace sustainable finance. By seizing this opportunity, the region can unlock a staggering US$2 trillion in cumulative GDP contribution, create over 1 million jobs, and attract foreign direct investment on an unprecedented scale.

To fully capture this momentous opportunity, GCC governments must adopt a strategic four-pronged approach:

01

Fostering Environmental Sustainability: Enacting policies that promote environmental responsibility across all industries, including incentives, market mechanisms, and stringent environmental standards.

02

Establishing a Green Sovereign Wealth Fund: Creating a dedicated green sovereign wealth fund in each GCC nation to attract and engage international investors, fostering innovation and propelling environmentally conscious projects.

03

Bolstering Capital Markets: Continuing to open up and strengthen capital markets, enhancing market liquidity, facilitating seamless exits for investors, and providing access to GCC funds held by high-net-worth individuals and families.

04

Embracing Standardized and Transparent Reporting: Implementing comprehensive, standardized, and transparent reporting frameworks for green finance to attract investors and ensure the integrity of sustainable investments.

Beyond the overarching economic benefits, sustainable finance presents a compelling opportunity for six key non-oil sectors in the GCC:

Food & Agriculture:

The agriculture and food sector in the GCC is poised for significant growth and transformation as the region embraces sustainable finance. Key areas of focus include:

Restructuring supply chains: Enhancing supply chain efficiency and resilience to reduce food losses and waste while ensuring fair and equitable practices for farmers and distributors and adopting sustainable farming techniques

Safeguarding imports: Implementing sustainable agricultural practices and technologies to reduce reliance on food imports and promote self-sufficiency.

Construction:

The construction sector in the GCC is embracing sustainable finance to reduce its environmental footprint and promote resource efficiency. Key initiatives include:

Utilizing low-environmental-impact hydrocarbon resources: Implementing carbon capture and storage (CCS) technologies to mitigate emissions from hydrocarbon-based construction materials.

Harnessing low-cost renewables: Integrating renewable energy sources into construction processes, reducing reliance on fossil fuels and lowering energy costs.

Power:

The power sector in the GCC is undergoing a rapid transition towards sustainable energy sources, driven by sustainable finance and the need to reduce carbon emissions. Key areas of focus include:

Transitioning to renewable energy sources: Investing in renewable energy projects, such as solar and wind farms, to diversify the energy mix and reduce reliance on fossil fuels.

Reducing reliance on fossil fuels: Implementing energy efficiency measures and adopting cleaner fossil fuel technologies to minimize environmental impacts.

Transport:

The transport sector in the GCC is transforming towards sustainable mobility solutions supported by sustainable finance. Key initiatives include:

Developing smart charging infrastructure for electric vehicles (EVs): Expanding the availability of EV charging stations to facilitate the adoption of EVs and reduce emissions from road transport.

Integrating renewables into the energy mix: Utilizing renewable energy sources to power transportation infrastructure, such as electric rail systems and public transportation.

Water:

The water sector in the GCC is facing water scarcity challenges, which sustainable finance is helping to address through innovative solutions. Key initiatives include:

Establishing the world's first low-carbon urban water utility: Developing a water utility that utilizes renewable energy, reduces water losses, and promotes water conservation.

Reducing wastewater discharge: Implementing wastewater treatment technologies to reuse and recycle wastewater, minimizing environmental impacts and enhancing water security. And adopting energy-efficient treatment technologies.

Waste Management:

The waste management sector in the GCC is embracing sustainable practices to reduce waste generation and promote resource recovery. Key initiatives include:

Increasing recycling rates: Implementing comprehensive recycling programs to divert waste from landfills and increase the use of recycled materials.

Creating jobs in the waste recycling sector: Investing in waste recycling infrastructure and training programs to create employment opportunities in the circular economy.

These sectors, with their potential for significant growth and job creation, stand to benefit immensely from the influx of sustainable finance.

The GCC nations have made significant strides towards sustainability, but now is the time to accelerate their efforts and capture the lion's share of this economic windfall. By embracing sustainable finance, the GCC can transform its economies, create a more resilient and equitable future, and establish itself as a global leader in environmental stewardship.

For market watchers and investors, the GCC presents a compelling investment destination. The region's commitment to sustainability, strong economic fundamentals, and well-developed capital markets offer a unique opportunity to participate in the transformative power of sustainable finance. As the GCC transitions towards a more sustainable future, it is poised to generate significant returns for investors aligned with ESG principles.

The time for action is now. The GCC nations, with their visionary leadership and abundant resources, have the potential to become global pioneers in sustainable finance, unlocking a trillion-dollar opportunity and shaping a brighter, more sustainable future for generations to come.

References:

Nakhooda, S. (2022). Sustainable Finance and Climate Finance in the Arab Region. UN Environment Programme (UNEP).

World Bank, 2022; FAO, 2023; IRENA, 2022

BloombergNEF, 2023

The Global CCS Institute, 2023; IEA, 2022; United Nations Environment Programme, 2022

PwC. (2023). Middle East green finance: A US$2 trillion opportunity. PwC.

International Renewable Energy Agency, 2022; World Energy Council, 2023; Hydrogen Council, 2022

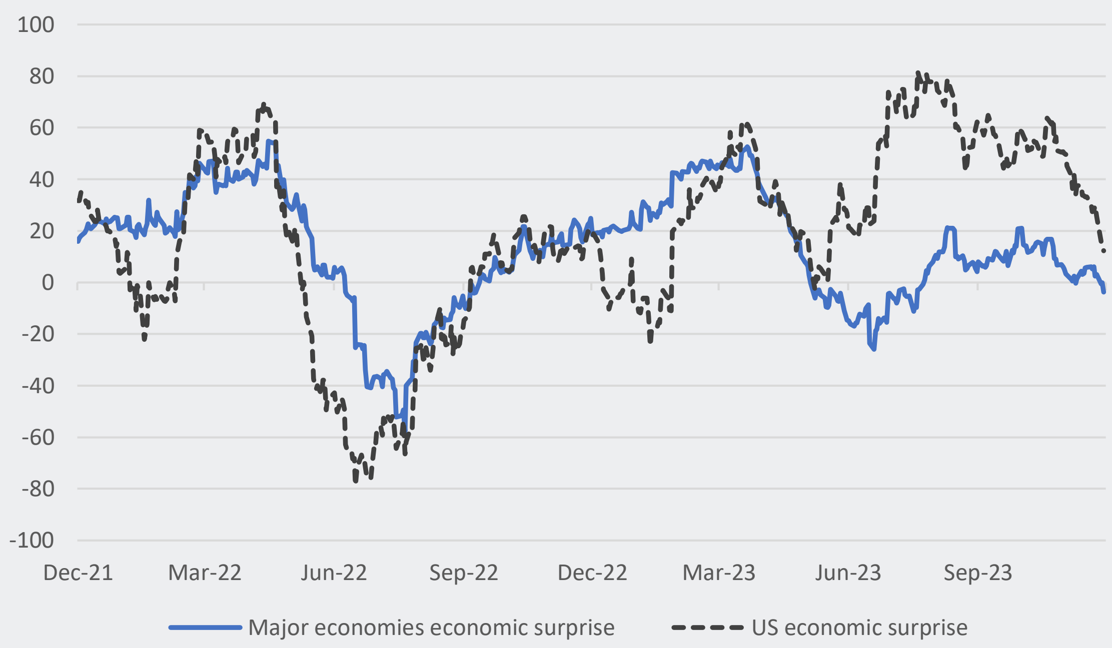
UNEPFI. (2021). Promoting Sustainable Finance and Climate Finance

World Economic Forum, 2022; International Labour Organization, 2023; Inter-American Development Bank, 2023

The Global Economy in 2024

As we turn the year, it is evident that the global economy is slowing down, led by recent weak data in the United States. Economic surprise indices that measure the degree to which economic growth data is coming in above, or below expectations have weakened, the US economy most sharply.

Chart 1: Economic surprise indices show a loss of growth momentum



Source: Bloomberg

In the West, a return to a (weak) Normal

We sense that after all the distortions of COVID and the wars in Ukraine and the Middle East, we will see the global economy revert to some form of normalcy. For the developed world, we expect growth in the US and Europe to revert to potential—1.5% in the case of the United States and 1.0% in the case of Europe.

Ongoing high interest rates and generally tight credit conditions are likely to hamper the drivers of growth. On this point, Europe and the United States may diverge. European household income growth is benefiting from still strong wage growth that is running ahead of inflation, while in the US, there is a fear that wage growth will shortly moderate. US consumers are already showing a pivot to heavier use of credit cards after savings were run down. Europe will likely look much healthier with real income growth of 2%.

US corporate spending, a key driver of growth in 2023, is expected to moderate in 2024. US corporate spending growth has proven quite resilient due to higher interest rates. In good part, this has been due to the high levels of investment in structures. The Onshoring of manufacturing led to a widespread increase in investment in warehouse and production facilities. US companies have also benefitted from an unprecedented rise in business income tax refunds from an average monthly level of $4-6b up to $27bn. The government shut the programme down in the summer.

On government policy, the US is likely to carry some momentum into 2024 and, hence, may look strong to start with before tapering off. In the eurozone, the ongoing fiscal consolidation (particularly noteworthy in Germany) will likely be a significant headwind in 2024.

Japan- slow motion normalization

Wage growth should finally move above the inflation rate, boosting growth and giving the Bank of Japan the scope to exit its long-term 'extraordinary' hostile interest rates regime. There is a general hope among commentators that 2024 will prove to be that seminal year when the country starts to look as if it is normalizing. A persistence in inflation and favourable nominal interest rates will present new challenges, particularly to the corporate sector. We already have signs of the corporate restructuring that is needed. As long as it continues to be seen as necessary and not just a nice-to-have, the country should continue progressing. Of course, more fundamentally, a declining population remains a significant headwind to aggregate GDP growth. At this stage, economists forecast around 1.0% GDP growth in 2024, which, in the circumstances, would be seen as a positive outcome.

China's slow move to post-COVID normalcy

The Chinese economy's performance is expected to show a better profile to growth in 2024 with an acceleration through the first half. The approval of 1 trillion yuan ($139.3 billion) in government bonds in the fourth quarter of 2023 should effectively expand demand. Economists expect fixed investment to grow significantly and be an essential growth driver. A renewal of confidence in stabilizing the property market will be necessary to revive consumption. The market is expecting some very specific shifts in policy to encourage consumption potentially in certain areas, such as durables goods and renewal of confidence in the pace of income growth so that Chinese households run down their savings rate, which has seen little by way of a significant post COVID reduction (it remains around 31%).

EM - With sense and sensibility

EM ex-China shone through as a region of general solidity in 2023. Through 2024, we should get much the same and a bonus from a likely trend of lower policy rates. Latin America has been an absolute star, with fiscal and monetary prudence encouraging more robust domestic demand. EM has managed its disinflation path well, allowing for early and consistent rate cuts.

A strong showing by the B.J.P. in the State election in India in late November has allayed fears of potential mixed outcomes from national elections in 2024. Investors will be more confident that the policy and direction from the centre will remain unchallenged. A general feeling that the future is assured by consistency in leadership and policies should help India build on the solid base of significant structural change seen in recent years. Inflation remains well controlled in the near term despite very sharp increases in government capital investment. RBI policy has remained prudent, and recently moved to control the strong growth of shadow banking lending.

Table 1: IMF GDP growth forecasts

Region	2022	2023E	2024E
Global	3.5%	3.0%	2.9%
Advanced	2.6%	1.5%	1.4%
US	2.1%	2.1%	1.5%
Euro Area	3.3%	0.7%	1.2%
Japan	1.0%	2.0%	1.0%
UK	4.1%	0.5%	0.6%
EM and developing	4.1%	4.0%	4.0%
China	3.0%	5.0%	4.2%
India	7.2%	6.3%	6.3%
Saudi Arabia	8.7%	0.8%	4.0%

Source: IMF

Emerging Trends and Investment Opportunities in AI for 2024

In the realm of artificial intelligence (AI), 2023 has been a year of remarkable advancements and **growing adoption across** industries. As we look ahead to 2024, several key trends are poised to shape the future of AI and present exciting opportunities for investors.

Generative AI: Unleashing the Power of Creation

Generative AI, the ability of AI systems to create new content, is poised to revolutionize various industries. Generative AI models, such as large language models (LLMs), can generate realistic text, translate languages, create images, and even design products. This transformative technology is expected to have a profound impact on fields like marketing, design, and entertainment.

AI-Powered Drug Discovery: Accelerating Medical Breakthroughs

The healthcare industry is rapidly embracing AI to accelerate drug discovery and development. AI algorithms can analyze vast amounts of data to identify potential drug candidates, predict their efficacy, and design more effective therapies. This has the potential to significantly reduce the time and cost of drug development, leading to faster breakthroughs and improved patient outcomes.

AI-Driven Automation: Redefining Work and Productivity

AI-driven automation is transforming workplaces across industries, automating repetitive tasks, and augmenting human capabilities. AI-powered robots are increasingly taking over tasks in manufacturing, logistics, and even customer service. This automation is freeing up human workers to focus on higher-value tasks, increase productivity, and streamlining operations.

AI-Enhanced Cybersecurity: Fortifying Defenses in a Digital World

Cybersecurity is paramount in today's increasingly interconnected world. AI is playing a crucial role in enhancing cybersecurity by detecting and responding to threats in real-time. AI algorithms can analyze vast amounts of data, identify anomalies, and predict potential attacks before they occur. This advanced protection is essential for safeguarding sensitive data and critical infrastructure.

AI-Powered Personalization: Tailored Experiences for Consumers

AI is revolutionizing the way businesses interact with consumers by enabling personalized experiences. AI algorithms can analyze customer data to understand preferences, predict behavior, and deliver tailored recommendations. This personalized approach is enhancing customer satisfaction, increasing retention, and driving business growth.

- **Automation of tasks:** AI can automate routine and repetitive tasks, freeing up workers for more creative and strategic endeavors. For instance, AI-powered chatbots can handle customer service inquiries, while AI-driven algorithms can optimize logistics and supply chain management.

- **Improved efficiency:** AI can optimize processes, streamline workflows, and enhance supply chains, leading to reduced costs and increased production. AI-powered predictive maintenance can prevent equipment failures and downtime, while AI-driven demand forecasting can optimize inventory management and reduce waste.

- **Innovation and growth:** AI can drive innovation by facilitating new product development, personalized services, and data-driven insights, fostering economic growth. AI-powered drug discovery can accelerate the development of new treatments, while AI-driven personalized marketing can enhance customer experiences and boost sales.

AI is anticipated to have a significant impact on global productivity, potentially adding around $13 trillion by 2030, or about 1.2 percent additional GDP growth per year.

Investment Implications: Navigating the AI Landscape

Given the transformative potential of AI, investors should carefully consider the impact of these trends on their investment portfolios. Key sectors to consider include:

- **Technology Companies:** Investing in companies that are developing and deploying AI technologies can provide exposure to the growth of this sector.

- **Healthcare Companies:** Companies leveraging AI for drug discovery, medical diagnosis, and treatment personalization offer promising investment opportunities.

- **Industrial Automation Companies:** Investing in companies developing AI-powered robotics and automation solutions can tap into the growing demand for enhanced productivity.

- **Cybersecurity Companies:** Companies providing AI-driven cybersecurity solutions are well-positioned to benefit from the increasing need for robust cyber defenses.

- **Consumer Data and Analytics Companies:** Investing in companies that collect, analyze, and utilize consumer data to provide AI-powered personalization can capture the value of data-driven marketing.

Embracing the AI Revolution

AI is rapidly transforming our world, and the trends outlined above represent just a glimpse of the transformative potential that lies ahead. Investors who embrace the AI revolution and carefully position their portfolios to capture the opportunities presented by these trends are well-positioned for long-term success.

How to invest:	
iShares Automation & Robotics UCITS ETF	Global X Robotics & Artificial Intelligence UCITS ETF
L&G Artificial Intelligence UCITS ETF	Xtrackers Artificial Intelligence & Big Data UCITS ETF

Sources:

- McKinsey Global Institute, “The Future of AI and Its Impact on Industries” (2022)
- World Economic Forum, “The Global AI Readiness Index 2023”
- Center for a New American Security, “The Taiwan Strait: A Critical Corridor for Global Trade and Security” (2023)
- Council on Foreign Relations, “The Future of Taiwan” (2023)

Indian Equity Market Outlook 2024

In 2022, Indian equities stood out as one of the best-performing global equity markets. Despite most markets closing the year in the red, the Nifty, which represents the top 50 market cap companies in India, concluded the year positively. Given the divergence in performance, we predicted that Indian equities would likely lag behind global peers in 2023. This has played out as expected, with the Nifty underperformed global equity markets such as the US, Europe, and Japan. Notably, India outperformed Emerging markets, which were bogged down due to the underperformance of Chinese equities. However, this doesn't highlight the full picture. If we look at the broader market, mid and smallcap Indian equities had a tough 2022, and bounced back sharply in 2023.

Performance as of 30 November 2023	CYTD 2023	CY 2022
Nifty 50 Index	11.2%	4.3%
Nifty Midcap 100 Index	36.2%	3.5%
Nifty Smallcap 100 Index	45.6%	-13.8%
S&P 500 Index	19.0%	-19.4%
Nasdaq 100 Index	45.8%	-33.1%
Nikkei 225 Index	28.3%	-15.1%
Shanghai Composite	-4.9%	-9.4%
MSCI ACWI Index	14.7%	-19.8%
MSCI EM Index	3.2%	-22.4%

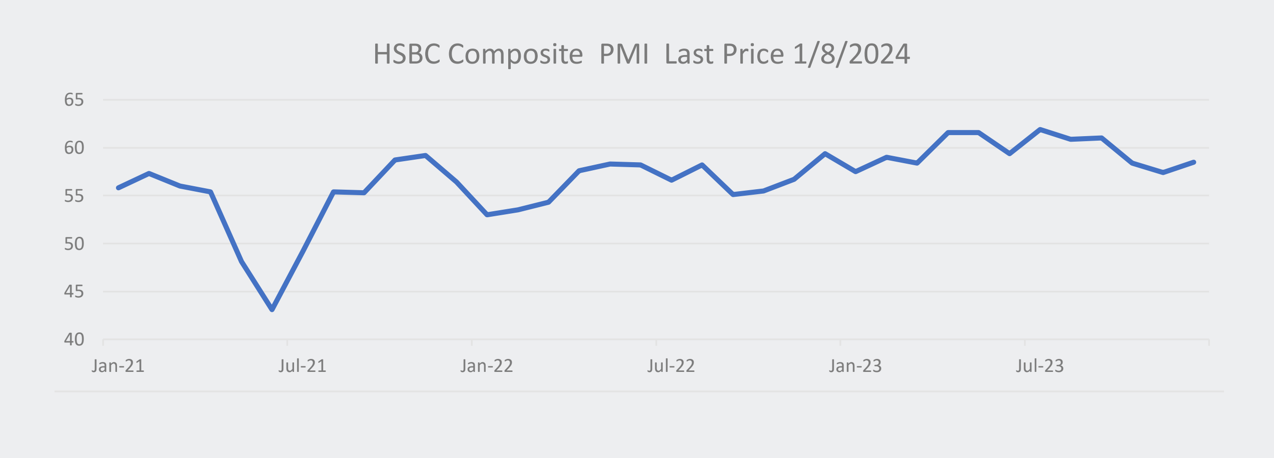
Source: Bloomberg, Sanctum Wealth
All data is in local currency and represents price returns.

As we look ahead into 2024, Indian macroeconomic fundamentals appear robust. The foundation of India's stable macroeconomic fundamentals lies in the structural reforms implemented by successive governments in recent years. Initiatives such as the unified tax structure (GST), the insolvency and bankruptcy code, real estate reform through RERA, a comprehensive digitalization agenda, and a dedicated focus on infrastructure development have collectively fostered a favourable economic environment. Although the country experienced some challenges during the implementation of these reforms, we are now reaping rich dividends from the same.

Although the upcoming general elections in 2024 may introduce volatility to the equity markets, current predictions suggest that the incumbent is likely to retain power. Even in the event of a change in leadership, we anticipate that the structural reforms in place are unlikely to be reversed.

As global growth seems to be moderating, India's GDP growth and key high-frequency indicators such as PMI, GST collections, and industrial output continue to underscore sustained strength. Moreover, throughout the Covid period, India's fiscal and monetary policies were more measured, avoiding unnecessary excesses. Consequently, the RBI did not have to implement extensive corrective measures, further contributing to India's relative stability. Additionally, India's external fundamentals remain robust, characterized by built-up of FX reserves, under control current account deficit and balance of payments, and a relatively stable INR.

Chart 1: PMI data shows strength



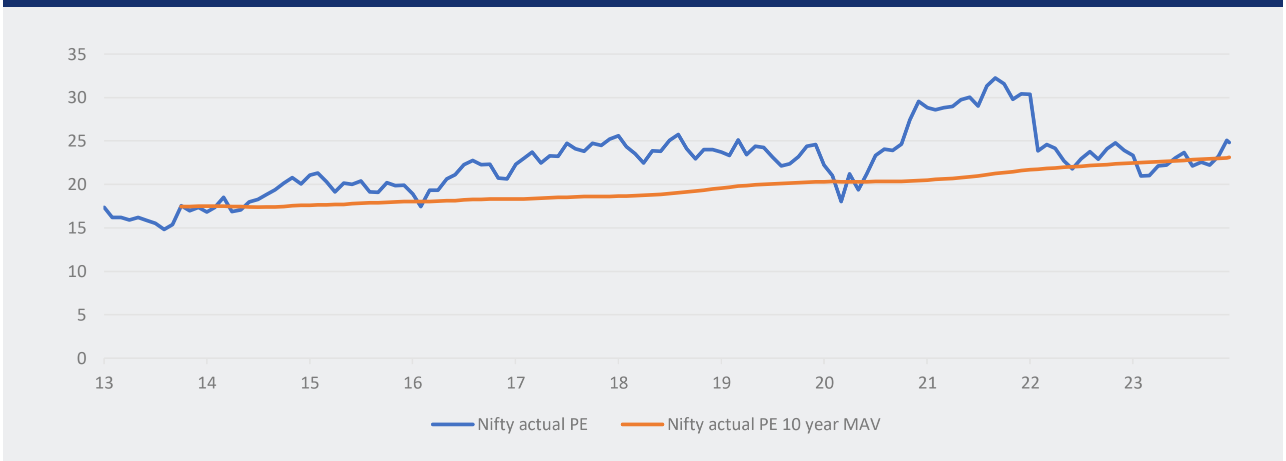
Source: Bloomberg, Sanctum Wealth

Reinforcing the argument for Indian equities is the robust growth in the corporate earnings. Earnings for the current fiscal year have beaten estimates across the board primarily driven by lower commodity prices that have boosted margins. The only point of concern is the muted revenue growth. Sustaining earnings momentum requires an uptick in revenue growth, as further gains from margin expansion are unlikely.

Historically, Indian equities have heavily relied on foreign inflows. Nevertheless, in recent years, domestic institutional investors (DIIs), propelled by robust mutual fund flows, have assumed a more prominent role. This trend was noticeable in the current year, as DIIs consistently intervened whenever foreign investors withdrew from Indian equities. Despite intermittent outflows by foreign investors, cumulative flows into Indian equities year to date for Foreign Institutional Investors (FIIs) stood at USD 14.4bn, while DIIs have invested more than USD 20.8bn into the markets.

Finally, lets look at valuations. Indian equities are currently trading close to their 10-year historic averages in terms of P/E. However, in comparison to EM equities, they appear relatively expensive. EM equities, led by China, are trading at a discount to their historic averages. Thus, his is partly attributed to the superior macroeconomic fundamentals of India compared to its emerging market peers.

Chart 2: Nifty forward PE close to historic averages



Source: Bloomberg, Sanctum Wealth

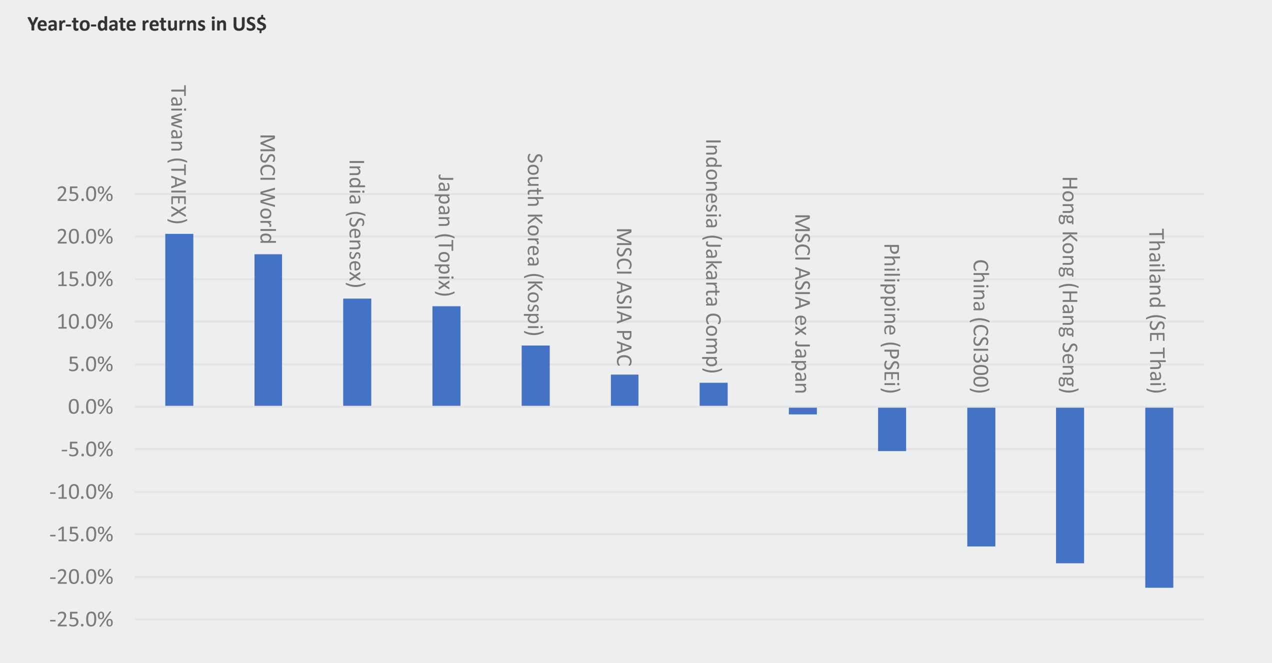
In summary, the fundamentals of Indian equities remain robust. Although valuations are not cheap, they also do not appear expensive when compared to their own historical averages. However, the persistent global uncertainty and the upcoming 2024 general election in India are potential sources of volatility. While predicting the absolute path for Indian equities is challenging in this environment, in relative terms, Indian equities might demonstrate greater resilience than other global markets, particularly if there is a correction in 2024.

The case for Asian equities 2024 – more than China

Asia is more than just a bet on China – 2023 is a testament to this.

After a solid start to the year driven by excitement around China's reopening from COVID lockdowns, Asian equities faded to underperform US and Global equities (again!). While the YTD returns of broad Asian equities (MXAP +6.5% & MXAPJ +2.7%) have fallen well short of US and global equities, this masks strong underlying performance from some of the component markets, including Japan 27.5%, Korea 26.5%, India 16% & Korea 14% (all in $US terms) which were dragged down by HK -11% & China MSCI China -9%. While Asia is home to some of the worst-performing markets this year, it also contains some of the best. There is nothing better than price action to underscore the thesis that investing in Asia is more than a bet on China.

Chart 1: Asia is more than China – no more apparent than 2023



Source: Bloomberg

Will equity returns in Japan endure or fade

So far, in 2023, Japanese equities have turned in one of their best performances in over a decade. YTD returns from Japanese equities have been beaten only by the Nasdaq. While the Nikkei 225 is yet to take out its (January 1990) all-time high, it remains supported by reasonable valuations (PE of 14x vs 19.5x for the S&P500) and corporate governance reforms that have seen shareholder returns in the form of dividends and share buybacks increase significantly. The dividend yield on the Japanese market is now above that of the US and many other developed markets.

The YTD performance is also notable in that it happened against the backdrop of a substantially weakening currency (the JPY USD is down 11%). Any reversal of the yield curve control policies of the BOJ (anticipated for some time) would change the interest rate relative equation and likely lead to the repatriation of substantial offshore assets by Japanese investors and reverse the course of the JPY vis a vis the USD.

Taiwan and Korea – Tech exposure drives returns

Taiwan and Korean stocks were beneficiaries of several themes in the technology sector during 2023, including AI and US "friendshoring" (which also benefited semi and semi-equipment stocks in Japan).

Taiwan is home to some key suppliers to Nvidia, the leading AI chip designer, including TSMC, Wistron and Quanta. Wistron and Quanta stock prices were up 2-3x between January and July before giving back some gains after their valuations became stretched.

TSMC is also a key supplier to Nvidia and critical to the AI supply chain however, the direct revenue contribution from AI remains low (low single-digit per cent), and the upside there was not enough to counter the impact of the regular semi-cycle (EPS estimates were downgraded 14% through the year).

While valuations in some pockets of the Taiwan market became stretched on the AI theme, it was also a flashpoint for trade tensions between the US and China regarding access to advanced semiconductors and equipment. The January 2024 election in Taiwan will be closely watched and set the tone for the year on many fronts.

Valuations in Korea are more reasonable, and US "friendshoring", which, along with the upside AI should provide a tailwind. However, closing the valuation gap with the rest of the region (15-20%) will likely require genuine corporate governance reforms (similar to those underway in Japan for the past ten years).

Equity income remains our core approach to Asian equities.

Our preferred approach to investing in Asia is to use an equity income portfolio as the core investment supplemented by tactical investments in opportunities providing country and regional exposures. This approach has served us well, with our Asia Dividend Champions strategy outperforming broader Asian equities (MXAP) by 11% in 2023.

We focus on an equity income strategy because:

- Average dividend yields in Asia are higher than in most other regions.
- The outperformance of high dividend stocks is more pronounced in Asia than in any other region.
- Dividends have been a more critical component of overall equity returns in Asia, making up 69% of returns from the MXAP but only 17% for the S&P500 and 26% for MSCI World (ACWI) over the past ten years.
- A high dividend strategy focusing on sustainability self-selects for value and corporate governance over the long term. Corporate governance reforms in Japan have significantly increased shareholder yield (dividend yield and buybacks) and enhanced Japanese stocks' presence in dividend yield portfolios.

A Tactical Perspective of 2024

We see 2024 as a year of elevated risk. In the context of the recent past of COVID and military conflict, this level of risk might not be extraordinary. However, it reminds investors to take tactical positions of significant conviction and sufficient potential payoff.

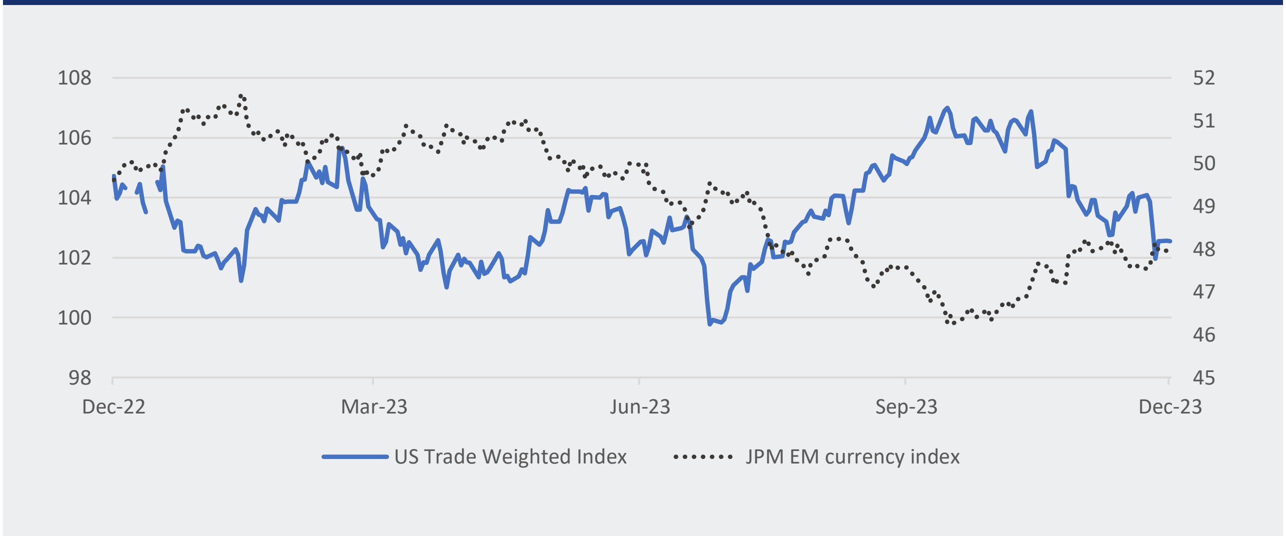
Given high valuations in the US equity market, **there is no obvious reason to be overweight global equities in 2024**. Cash and short-dated government bonds give investors relatively attractive real returns at the start of the year. Such returns are relatively secure and contrast with equity markets that might face a recession with a downside risk on corporate profit forecasts.

Chart 1: Marked underperformance of MSCI World ex US versus MSCI World Index

Source: MSCI

Underweight the dollar – we expect more of the weakness witnessed at the end of 2023 as the Fed moves on a path of loosening policy, the Bank of Japan start to normalise policy and the emerging markets attract more capital flows.

Chart 2: EM Currencies improve as the dollar falls away



Source: Bloomberg

Overweight global ex-US assets for currency appreciation, and some re-rating. We particularly favour emerging market equities and bonds. The weak dollar is giving greater scope for monetary policy easing and providing a welcome boost to growth. While China is not everyone's cup of tea, the marked underperformance of the market offers an opportunity for access to a huge economy that is still growing at around 4-5% per annum. Despite the recent strong performance, we see no reason not to continue being enthusiastic about India. The likely electoral success of Modi's government will add to the positive news.

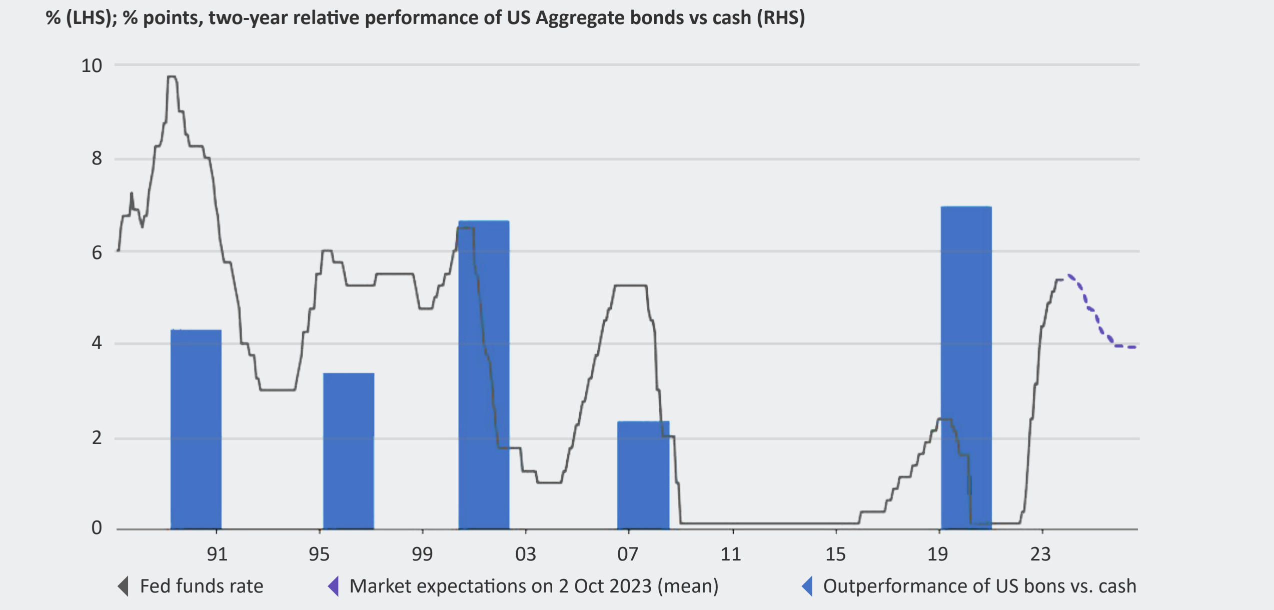
The European equity markets have the potential to spring some positive surprises. Within the economy, consumers have instead hoarded their excess savings through the COVID crisis. A modicum of greater household confidence helped by a likely cut in interest rates from the ECB could lend itself to higher-than-expected consumer spending and a good boost to GDP growth. The European economy has its problems, but European companies only derive 40% of their earnings domestically.

Don't bet against tech. The 45% rise in the Nasdaq composite index through to late December showed the risk of being short of a fundamental part of the rise in the US equity market for the year. The seeming revenue and profit opportunity from developing and embedding AI in technology adds a further unknown potential upside to the industry. It won't just be about technology companies. The degree to which companies embrace AI will provide new sources of growth and competitive advantage that share prices have barely started to discount.

Higher-yielding equities offer some defensiveness from market volatility and upside potential if central banks cut interest rates faster than expected. As the year closed out, we advocated an overweighting of REITs, given their marked underperformance and a substantial discount to NAV. Active management is critical here, given the commercial real estate market challenges.

Don't hold onto your cash for too long. History tells us that bonds tend to outperform some money beyond the peak in rates. Indeed, the latter months of the year saw a strong performance from all bond markets as investors believed that US rates had peaked.

Chart 3: Relative performance of US bond vs. cash after interest rate peaks



Source: Bloomberg

Our overweights in fixed income include positive views of EMD and the yield pick up on investment grade versus government.

UK Turning Left in 2024 – UK equities not obviously outperforming

14 years of Tory political drama to end but challenging public finances tie the hands of the incoming government as pressure builds for radical reforms

The United Kingdom is poised for a potential general election in 2024, ahead of the parliament's term ending in January 2025. The UK electorate is likely to follow the global trend where electorates have been moving away from incumbent governments post-pandemic. The UK's electorate appears to be leaning leftward, signalling a significant shift in political dynamics.

A 'More in Common' think-tank survey in September revealed that 75% of respondents favoured a change in government. However, only 32% saw the Labour Party as a better alternative. Nonetheless, opinion polls show Labour leading the Conservatives by 20%, a margin that has narrowed since Liz Truss's tenure but still indicates lukewarm support for Prime Minister Rishi Sunak. Recent by-elections have demonstrated significant swings away from the Conservatives, a decline in support for the Scottish National Party, and growing acceptance of Labour Leader Sir Keir Starmer as Sunak's successor. Therefore, a majority Labour government is anticipated after 14 years of Conservative rule, a stark contrast to the Conservative majority gained in 2019.

There are implications to consider If Labour needs to collaborate with the Liberal Democrats (LDs) to form a government. On economic policy, the parties are aligned, but fiscal constraints are significant. The key areas of contention could be electoral reform and the stance on the European Union, issues critical for the LDs.

The incoming government will face a challenging fiscal environment, marked by sluggish growth, rising debt service costs, healthcare crises, and economic impacts from the Covid pandemic and the Ukrainian war. The Labour Chancellor will aim to establish credibility, possibly advocating for a more significant role for the Office of Budget Responsibility in overseeing fiscal projections. With the overall tax burden projected to be at a historically high level, tax policy changes might be minimal, focusing on specific areas like non-resident stamp duty. The Treasury could see a revenue boost due to frozen tax bands until 2026. Adherence to fiscal rules will likely necessitate spending limits or cuts in areas other than healthcare and overseas aid.

Labour plans to foster a strong relationship with the Bank of England, will be crucial after recent inflation spikes and monetary policy adjustments. A Labour government is unlikely to revise the Bank's inflation target, focusing on financial stability to support the sterling currency.

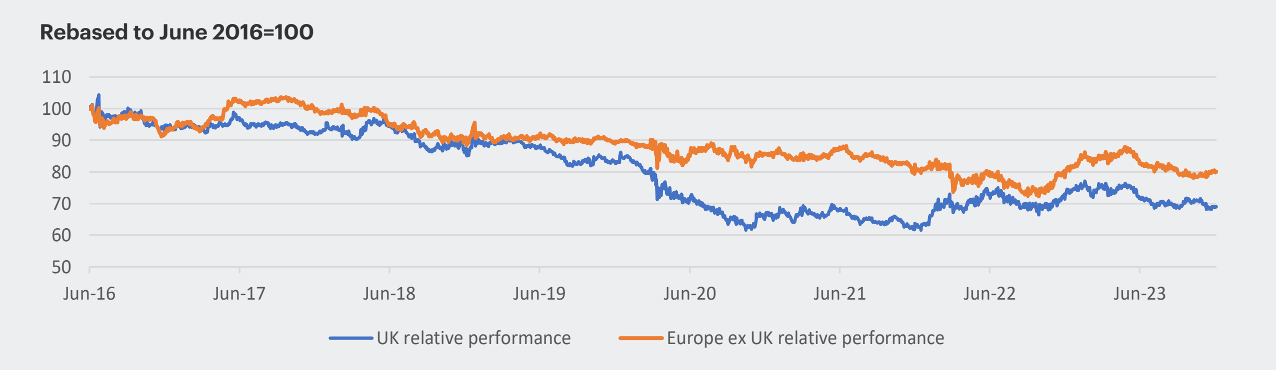
With limited room for demand management policies, Labour is expected to emphasize supply-side reforms, inspired by the Biden Administration. This includes deregulation, infrastructure spending, and initiatives targeting the green economy.

Labour's economic strategy, termed 'securenomics,' might encompass:

- A Housing Recovery Plan to speed up planning approvals and establish new towns, granting more authority to local mayors.
- Revised commercial investment planning and approvals.
- A Green Prosperity Plan focused on net-zero targets by 2050, involving spending and private sector incentives.
- A review of corporate taxation to encourage higher capital investment, particularly from offshore sources.

These policies, alongside encouraging domestic pension funds to invest in illiquid equity, have generated interest in the mid and small-cap sectors of the UK equity market, particularly in the context of the UK equity market's perceived low valuation in the wake of post-Brexit.

Chart 1: Since Brexit UK equities have underperformed global equities and EU equities



Source: Bloomberg

Authors:

- Gary Dugan
- Chadi Farah
- Michael Chu
- Bill O'Neill
- Adam Upton AOP Capital – Asia/China
- Robert Swift Delft Partners – Global Equities
- Sanctum Wealth – India

Disclaimer

Designed by
MarzArts
marzarts.com

GLOBAL CIO

Dalma Capital Management Limited
ICD Brookfield Place, Level 11
Dubai International Financial Centre
Dubai, UAE, 9361