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Market Outlook

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Collin Leggett
Director, Investment Management

www.collidr.com

hello@collidr.com

+44 (0)808 281 2900

Connect on LinkedIn

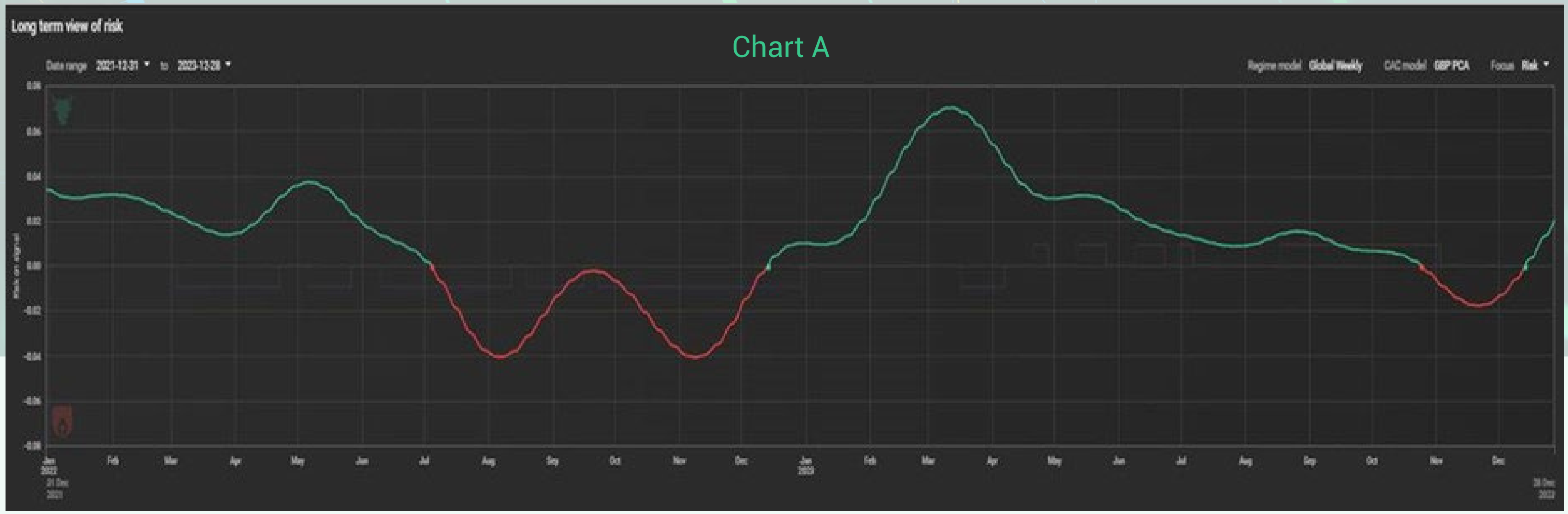
Looking back at most market analysts predictions for 2023 makes for some interesting reading. It is clear that not many forecasted the strong rally in equities (especially technology stocks), or the volatile year for bonds overall (with a notable rally going into year end).

Trying to predict the future often feels like a futile endeavour, although that doesn't stop investment strategists from trying. Our preference is to monitor the current environment and adapt to changes as the markets evolve, when, inevitably, new information comes to light. Thankfully, we have an array of tools at our disposal to help analyse the market and adapt to these on-going, never-ending changes.

Our outlook for the market in 2024 is based on these same principles, which also help show where we believe the opportunities may reside. However, we are ready to adapt and evolve as the year progresses, based on how events and conditions unfold. We do see some major themes that market participants will need to consider in 2024:

- Has the inflationary environment eased and will inflation drop back to central bank targets?
- Will central banks start to reduce interest rates and how aggressive are any rate cuts likely to be?
- Will the global economy avoid a recession and, if not, how severe will the recession be?
- How will political events, such as the US Presidential election and the wars in Ukraine and Gaza, impact markets?

Chart A

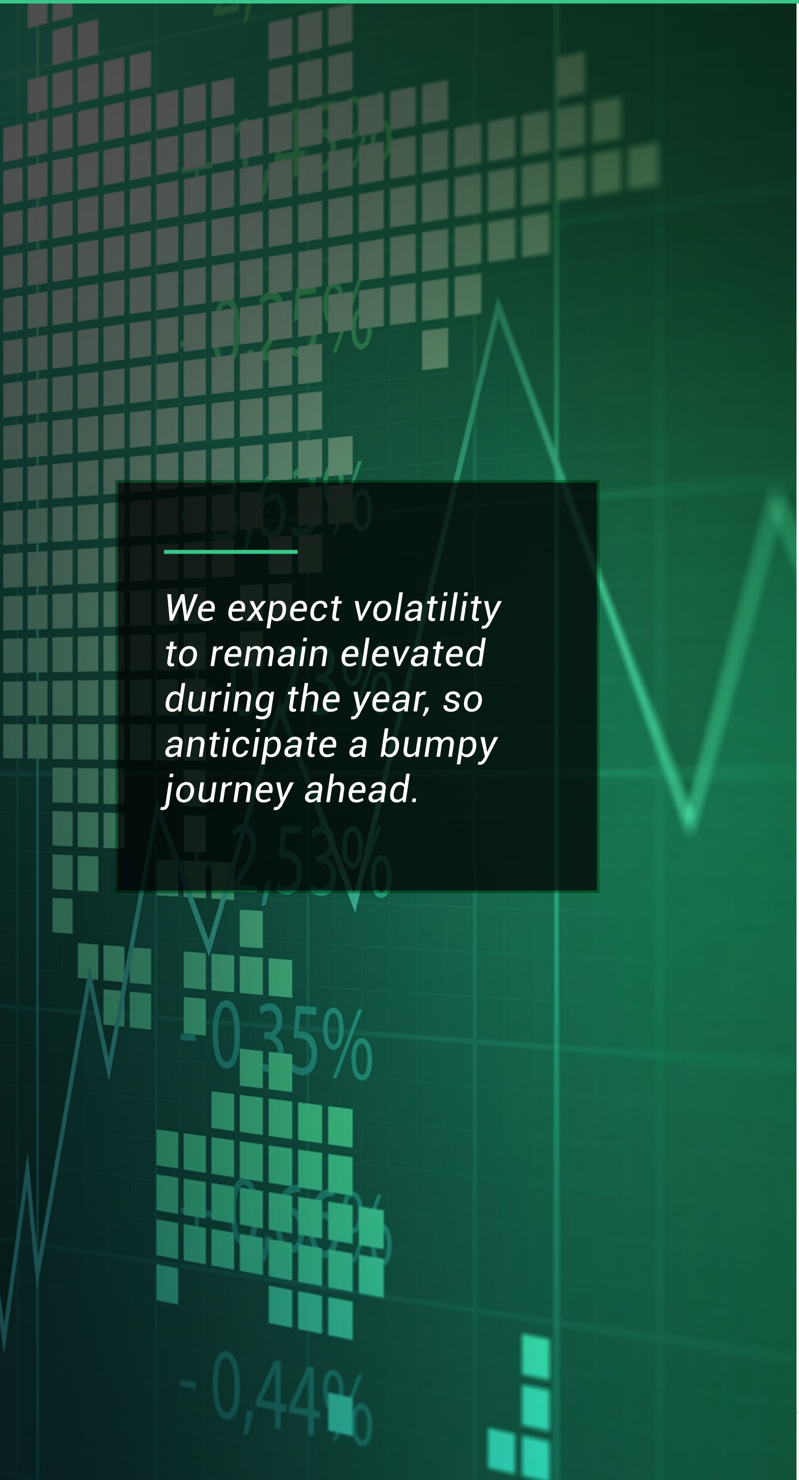


Source: Collidr.

Firstly, we use an important tool that evaluates the longer-view of risk from a high level, top-down approach (CHART A). For most of 2023 this tool remained in bullish territory, suggesting that the prevailing market sentiment would be positive. In November, the tool dipped into more bearish conditions until, to close out December, the year-end rally pushed it back into positive territory.

Going into 2024 we have a positive mind-set but remain wary of some feasible inflection points, a few possible escalation events, for example, which may move the markets into a more defensive stance. We expect volatility to remain elevated during the year, so anticipate a bumpy journey ahead. However, looking through the short-term noise in the markets, we believe that risk levels should be maintained, while remaining vigilant to the risks that these possible inflection points may bring.

We have an array of tools at our disposal to help analyse the market and adapt to these on-going, never-ending changes.



We expect volatility to remain elevated during the year, so anticipate a bumpy journey ahead.

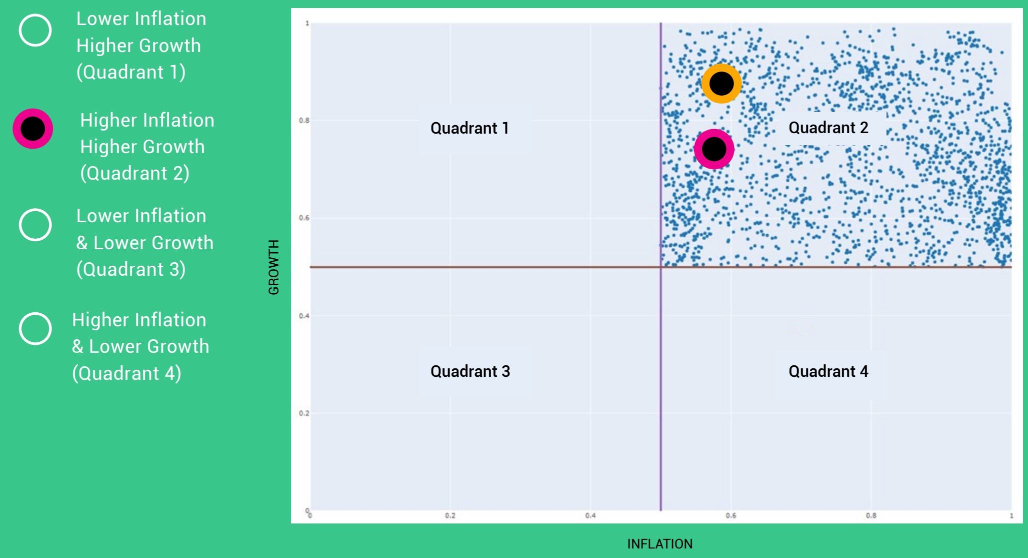
Secondly, we use macro economic quadrants to assist in analysing the current market condition set, and the asset classes most appropriate for these type of conditions. Charts Y, Z reflect this analysis. Given the market reaction to the change in US Federal Reserve ("the Fed") rhetoric towards the end of 2023, we have moved to a "Loosening Monetary Policy" environment using this analysis. However, despite inflation falling to close out 2023, we still remain in a "Higher Inflationary" environment, although with "Improving Credit Risk Appetite" and "Higher Growth expectations". This analysis is purely data driven, so it reflects the current market conditions rather than any subjective view.

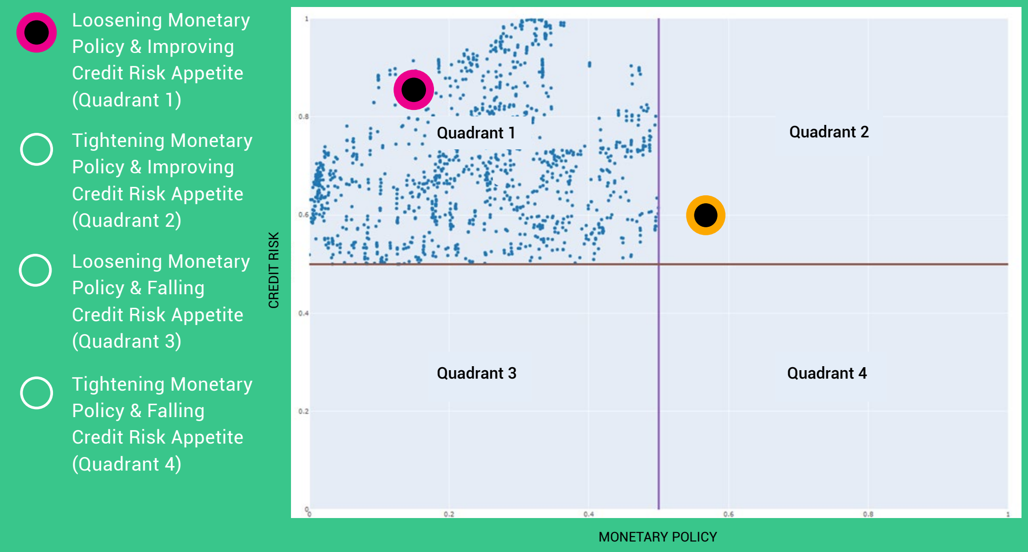
This allows us to make the following conclusions about the market at present.

2024 Expectations
» Markets expect central banks to start reducing interest rates in 2024, and are actually pricing in the first reduction to take place in March for the US.
» Markets expect inflation to continue to fall but remain at higher levels than previous years.
» Markets believe that 'credit risk' conditions have improved and that the outlook is more positive.
» Market expectations of economic growth remain positive.

Moving this into a more practical context:

- Central banks had tightened monetary conditions in 2023, pausing this towards the end of the year. Markets expect, and have priced in, interest rate reductions in 2024. However, central banks have re-iterated that any reduction will be dependant on economic data.
- The expected economic recession, as a result of the increased interest rate environment, has not yet occurred. There is typically a lag effect between when a change in monetary policy is implemented and the impact to the economy. Markets are still debating whether a recession is coming and, if so, whether it will be a hard or soft landing.
- Across developed markets inflation has fallen. However, inflation figures still remain above most central bank targets.
- Employment data remains strong, especially in the US, which may possibly keep inflation expectations elevated. Increases in geopolitical tensions (e.g. Ukraine/Russia, Israel/Gaza, attacks to shipping in the Red Sea) may also contribute to inflationary pressures.
- Political issues will be at the fore in 2024, with major elections being held in many countries – most notably the US Presidential election, the general election in India, the Taiwanese Presidential election, and a likely general election in the UK. These elections will create uncertainty, both in terms of the outcome, as well as the anticipation leading up to election day.





KEY: Current - Jan 2024 | Previous - Jan 2023

Asset Classes

So what does this mean for the different asset classes and strategies available to investors?

Equities

These are the main themes that we see for the year ahead:

Overall - We favour a balanced approach to equity allocation. While the markets may evaluate every economic data point and central bank messaging, there remains the prospect of heightened volatility ahead. In this respect, a balanced investment across different equity markets and sectors, ones that are likely to benefit in different market outcomes, offers the most prudent approach.

- Despite the recent rally, we think an allocation to large cap technology stocks is sensible. Should interest rates be reduced aggressively, tech and growth stocks may benefit. Consumers, especially in the US, are still spending, which could keep demand, and therefore revenues, strong for these companies. In addition, with continuing developments in AI, technology stocks may continue to be re-rated and offer additional returns, as the continued use of AI creates productivity enhancements and cost reductions for these firms.
- On the opposite side of the coin, should any forthcoming recession be harder than expected, more defensive stocks, such as quality, dividend-paying, low-debt, and high-earning stocks, may benefit. In a recessionary environment, good quality companies should continue to survive and thrive.
- Similarly, small cap companies may be a beneficiary if a recession does not materialise, and inflows start moving back into the smaller cap space. However, in the event of a recession, particularly a hard recession, small cap companies will likely suffer.

While this may sound like we are suggesting that investors should own everything, in reality, the markets are potentially at a major inflection point and there are many metrics at play. Our preferred option is to maintain a balanced approach, maintain market participation at present, while ensuring there is sufficient protection in portfolios, until such time as the economic outlook becomes much clearer.

Movements in the US dollar may also impact markets

- If the Fed were to cuts interest rates, this may make the dollar weaker due to interest rate parity metrics. Consequently, this could boost emerging markets, for example. Yet, in the event of a hard recession, any move to safety is likely to strengthen the dollar.
- This may provide a boost for asset classes that benefit when their own currency weakens – for example, UK equities when sterling weakens.

Chinese equities had a difficult time in 2023 and the outlook continues to look bleak

- On the other hand, China is the world's second largest economy and they can implement an economic boost at any time, based on political rather than economic requirements.
- Therefore, the Chinese government could stimulate the Chinese economy at any time… and without warning. So China is always a consideration.

Fixed Income

Fixed income also had a difficult time in 2023. The elevated level of correlation between equities and fixed income has continued, so diversification can often seem difficult at times. Despite a strong recovery towards the end of the year, fixed income still has its challenges, especially in this environment. However, we see pockets of optimism and believe that a balanced approach, once more, is a sensible one.

Investment Grade

- In the investment grade space, we see opportunities in debt issued by ‘quality names’, for example, strong established companies with substantial and stable cash flows. Whether there is a recession or not, quality names should continue to repay their debt, so there will be less default risk for these firms. For even more protection, one might consider the short-duration section of the market.

Yields

- Yields within the fixed income space have increased as bond prices fell. This has created pockets of opportunities. Money market funds have seen substantial inflows in 2023, as the yields provided by these products increased. They continue to provide a decent yield for low volatility, whilst being mindful of the other risks present in this sub-asset class. Equally, we anticipate outflows to this part of the market in 2024, as investors start putting their money back to work in higher yielding, riskier assets.

Interest Rates

- Should interest rates come down in 2024, we would expect longer duration assets to benefit. Yet, if inflation should start to pick up again (for example, if geopolitical events push up oil and gas prices, which could have a knock on effect to inflation), then the longer duration part of the curve could remain vulnerable.

Therefore, we believe a balanced approach remains appropriate, seeking out pockets of opportunity but remaining mindful of the risks ahead. We expect volatility to remain elevated in the fixed income market over the course of the year. A balanced approach to fixed income exposure allows investors to capture upside opportunities, where they exist, but also have appropriate levels of protection, where possible.

Other Asset Classes

In an era of higher correlations between equities and fixed income, alternatives and commodities continue to help portfolio diversification. We expect the benefits to remain high from these asset classes in 2024, adding improved risk and return sources, as well as the potential to perform should conditions deteriorate.

Given there remain risks ahead as conditions evolve, we continue to see alternatives as a way to help stabilise returns in a correction, or highly volatile environment.

- In situations where volatility remains elevated - we think that Commodity Trading Advisor (CTAs) or trend following funds are a useful tool, as they add low to negative correlation to the main asset classes. Although position sizing becomes important, so that CTA's do not dominate returns
- Long/short equity and bond funds, run by good managers – can help provide positive/low volatile returns in these type of market environments, adding positive performance and limiting downside volatility.
- Commodities – can provide additional diversification, particularly metals and energy in an economic recovery, and gold in a "risk off" environment.
- Property - Given the impact of increasing interest rates, property has proven to be a difficult asset class. If interest rates start to fall, this is one area that could benefit. To reduce liquidity risk, we prefer an allocation to REITS.
- Currencies – Finally, there may be opportunities in currency markets. The US dollar could weaken if interest rates fall, or increase in a risk-off environment. The result of which is an increase in currency volatility. In this type of environment, there may be opportunities for currency strategies. As well, there will be look-through benefits to other asset classes, such as emerging markets, should the US dollar weaken against other major currencies.

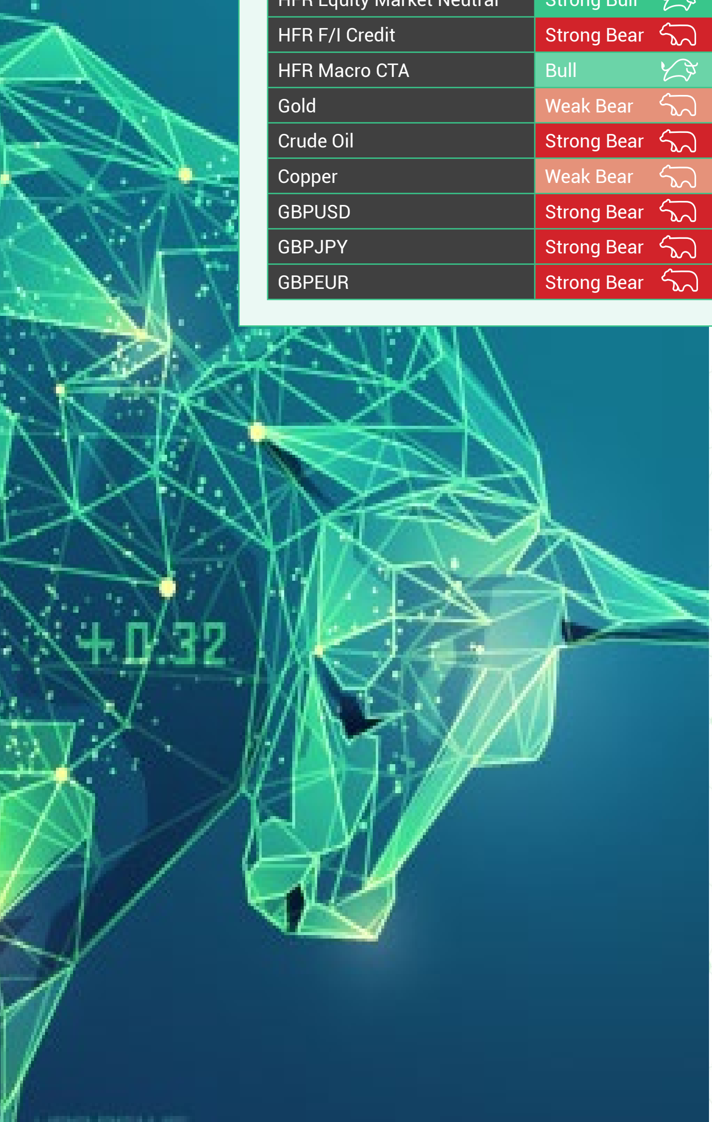
Appendix 1 – Asset Class Outlook

The following chart is an extract from some of the quantitative signals that we use in our market analysis. The metrics shown are Volatility Regime, and Trend and Sentiment, which are combined to produce an overall view of each asset class as at the end of December 2023. The chart shows the comparison of each of these metrics, and the overall view, against how they were evaluated at the end of December 2022. This allows for an understanding of whether the condition set for each asset is improving or deteriorating, and which underlying metric is driving that change.

Asset classes	Overall State Dec 2022	Overall State Dec 2023	Volatility Regime Dec 2022	Volatility Regime Dec 2023	Trend Following Dec 2022	Trend Following Dec 2023	Sentiment Dec 2022	Sentiment Dec 2023
Equities								
Equity Global	Strong Bear	Bull	High	Low	Out	Long	Neutral	Positive
Global Growth	Strong Bear	Strong Bull	High	Low	Out	Long	Negative	Positive
Global Small Cap	Strong Bear	Weak Bull	High	Medium	Long	Long	Neutral	Positive
Global Value	Weak Bear	Weak Bull	Medium	Low	Out	Long	Neutral	Positive
Equity US	Strong Bear	Bull	High	Low	Long	Long	Negative	Positive
S&P 500	Strong Bear	Bull	High	Low	Out	Long	Negative	Positive
Russell 2500	Strong Bear	Weak Bear	High	Medium	Long	Long	Negative	Positive
Nasdaq 100	Strong Bear	Bull	High	Low	Out	Long	Negative	Neutral
S&P Growth	Strong Bear	Bull	High	Low	Out	Long	Negative	Positive
S&P Value	Weak Bull	Bull	Medium	Low	Long	Long	Neutral	Positive
Equity UK	Weak Bear	Weak Bull	Medium	Low	Long	Long	Neutral	Neutral
FTSE Small Cap	Strong Bear	Weak Bull	High	Medium	Long	Long	Negative	Positive
FTSE 250	Strong Bear	Bull	High	Low	Long	Long	Neutral	Positive
FTSE 100	Bull	Weak Bull	Low	Low	Long	Long	Neutral	Positive
Equity EU	Weak Bear	Weak Bull	Medium	Low	Long	Long	Neutral	Positive
Euro Stoxx Mid Cap	Weak Bear	Bull	Medium	Low	Long	Long	Neutral	Positive
Euro Stoxx Large Cap	Weak Bear	Bull	Medium	Low	Long	Long	Neutral	Positive
Equity Japan	Weak Bear	Bull	Medium	Medium	Long	Long	Negative	Neutral
Japan Small Cap	Weak Bear	Weak Bull	Medium	Medium	Long	Long	Negative	Neutral
Equity Emerging	Strong Bear	Strong Bull	High	Low	Out	Long	Neutral	Positive
Brazil	Weak Bear	Weak Bull	Medium	Low	Out	Out	Negative	Neutral
South Africa	Weak Bear	Weak Bear	Medium	Medium	Long	Long	Neutral	Neutral
Russia	Bear	Bull	Medium	Low	Out	Long	Negative	Negative
India	Weak Bear	Bull	Low	Low	Out	Long	Neutral	Positive
China Composite	Weak Bull	Weak Bear	Low	Low	Long	Out	Negative	Negative
Equity APEX	Strong Bear	Strong Bull	High	Low	Long	Long	Neutral	Positive
South Korea	Bear	Weak Bull	Medium	Low	Out	Out	Negative	Positive
Natural Resources	Weak Bear	Weak Bull	Medium	Low	Long	Long	Neutral	Neutral

Asset classes	Overall State Dec 2022	Overall State Dec 2023	Volatility Regime Dec 2022	Volatility Regime Dec 2023	Trend Following Dec 2022	Trend Following Dec 2023	Sentiment Dec 2022	Sentiment Dec 2023
Infrastructure	Strong Bear	Weak Bull	High	Low	Out	Long	Neutral	Neutral
Gold Mines	Bear	Bull	Medium	Low	Out	Out	Neutral	Positive
Global Utilities	Strong Bear	Weak Bull	High	Medium	Long	Long	Neutral	Neutral
Global REIT	Strong Bear	Strong Bull	High	Low	Out	Long	Negative	Positive
Global Information Technology	Strong Bear	Strong Bull	High	Low	Out	Long	Negative	Neutral
Global Financials	Weak Bull	Strong Bull	Medium	Low	Long	Long	Neutral	Positive
Global Clean Energy	Bear	Weak Bull	Medium	Medium	Out	Long	Negative	Negative
Biotech	Weak Bull	Strong Bull	Medium	Low	Long	Long	Neutral	Neutral
Global Healthcare	Strong Bear	Weak Bull	High	Low	Out	Long	Neutral	Neutral
Fixed Income								
Global Fixed Income	Strong Bear	Weak Bear	High	High	Long	Long	Negative	Neutral
Bond Government	Strong Bear	Weak Bear	High	High	Out	Long	Negative	Neutral
Treasuries All Maturities	Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
US Treasury 7-15 Years	Bear	Bull	High	Medium	Long	Long	Negative	Neutral
US Treasury 5-7 Years	Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
US Treasury 3-5 Years	Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
US Treasury 1-3 Years	Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
Gilts All Maturities	Strong Bear	Bull	High	Medium	Long	Long	Negative	Positive
UK Gilt 5-10 Years	Bear	Bull	High	Medium	Long	Long	Negative	Neutral
UK Gilt 3-5 Years	Bear	Bull	High	Medium	Long	Long	Negative	Neutral
UK Gilt 10-15 Years	Strong Bear	Weak Bear	High	High	Long	Long	Negative	Positive
UK Gilt 0-3 Years	Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
EU Gov Bond All Maturities	Strong Bear	Weak Bear	High	High	Out	Long	Negative	Positive
Japan Gov Bond All Maturities	Strong Bear	Bear	High	High	Long	Long	Negative	Neutral
EM Gov Bond Generic Local Currency	Weak Bear	Bull	Medium	Low	Long	Long	Neutral	Positive
EM Gov Bond Generic USD	Weak Bull	Strong Bull	Medium	Low	Long	Long	Neutral	Neutral
Bond Inflation Linked	Strong Bear	Bear	High	High	Out	Long	Negative	Positive
US Inflation Linked	Strong Bear	Bear	High	High	Long	Long	Negative	Positive
UK Inflation Linked	Strong Bear	Bear	High	High	Out	Long	Negative	Positive
Bond Corporate Short Duration	Weak Bull	Strong Bull	Medium	Low	Long	Long	Neutral	Neutral
Sterling Corporate 1-5 Years	Bear	Bull	High	Medium	Out	Long	Neutral	Neutral
US Corporate 1-5 Years	Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
Bond Corporate	Strong Bear	Bull	High	Medium	Out	Long	Neutral	Neutral
UK Corporate	Strong Bear	Strong Bull	High	Low	Out	Long	Negative	Neutral
US Corporate	Bear	Weak Bear	High	High	Long	Long	Neutral	Neutral
Japan Corporate	Bear	Strong Bear	High	High	Long	Long	Negative	Positive
EU Corporate	Strong Bear	Bull	High	Medium	Out	Long	Negative	Neutral

Asset Classes	Overall State Dec 2022	Overall State Dec 2023	Volatility Regime Dec 2022	Volatility Regime Dec 2023	Trend Following Dec 2022	Trend Following Dec 2023	Sentiment Dec 2022	Sentiment Dec 2023
Bond High Yield	Strong Bear	Strong Bull	High	Low	Out	Long	Neutral	Neutral
US High Yield 1-5 Years	Strong Bear	Bull	High	Medium	Out	Long	Neutral	Neutral
Euro High Yield	Strong Bear	Bull	High	Low	Long	Long	Neutral	Neutral
Sterling High Yield	Strong Bear	Strong Bull	High	Low	Out	Long	Neutral	Neutral
US High Yield	Strong Bear	Bull	High	Medium	Out	Long	Neutral	Neutral
Other Asset Classes								
Alternatives	Weak Bull	Weak Bear	Low	Low	Long	Out	Negative	Negative
HFR Absolute Return	Weak Bull	Weak Bear	Low	Low	Long	Out	Neutral	Negative
HFR Equity Market Neutral	Strong Bull	Weak Bear	Low	Low	Long	Out	Neutral	Negative
HFR F/I Credit	Strong Bear	Bull	High	Low	Long	Long	Neutral	Negative
HFR Macro CTA	Bull	Weak Bear	Low	Low	Long	Out	Negative	Negative
Gold	Weak Bear	Strong Bull	Medium	Low	Long	Long	Neutral	Positive
Crude Oil	Strong Bear	Bear	High	High	Long	Long	Negative	Negative
Copper	Weak Bear	Bull	Medium	Low	Long	Long	Neutral	Positive
GBPUSD	Strong Bear	Bull	High	Medium	Long	Long	Neutral	Neutral
GBPJPY	Strong Bear	Bear	High	High	Out	Out	Negative	Negative
GBPEUR	Strong Bear	Weak Bull	High	Low	Out	Out	Negative	Neutral



Going into 2024 we have a positive mind-set but remain wary of some feasible inflection points, a few possible escalation events, for example, which may move the markets into a more defensive stance.

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+44 (0)808 281 2900

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