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Guggenheim Investments

11 Macro Themes for 2024

January 2024

Macro Themes for 2024

Quarterly Macro Themes, a quarterly publication from our Macroeconomic and Investment Research Group, spotlights critical and timely areas of research and updates our baseline views on the economy. Themes are selected from the broad range of issues we are currently analyzing, and demonstrate the type of market and economic topics we address in developing our outlook on the U.S. and global business cycle, market forecasts, and policy views. Our Macroeconomic and Investment Research Group's research is a key input in Guggenheim's investment process, which typically results in asset allocations that differ from broadly followed benchmarks.

This collection of charts presents 11 of the macroeconomic trends we believe are most likely to shape the investment environment in 2024.

1. Record Global Elections and Geopolitical Instability Will Lift Economic Uncertainty
2. Technological Innovation and Competition Will Continue to Transform the Economy
3. Massive Treasury Issuance Will Continue to Weigh on Rates and Crowd Out Other Issuers
4. The End of the 'Free Money' Era Will Burst Lingering Asset Price Bubbles
5. Commercial Real Estate Stress Will Intensify and Spill Over to Small Banks
6. Private Credit Will Cannibalize Banks' Role in Leveraged Credit Further
7. Resilience Gives Way to Bifurcation
8. Negative Money Supply Growth and Draining of RRP Are Key Risks and May Usher in Deflation
9. Soft Landing Hopes Will Give Way to (Mild) Recession
10. Fed Easing Cycle Will Drive Long-End Rates Lower Than Anticipated
11. Out of Chaos Comes Opportunity in Fixed Income

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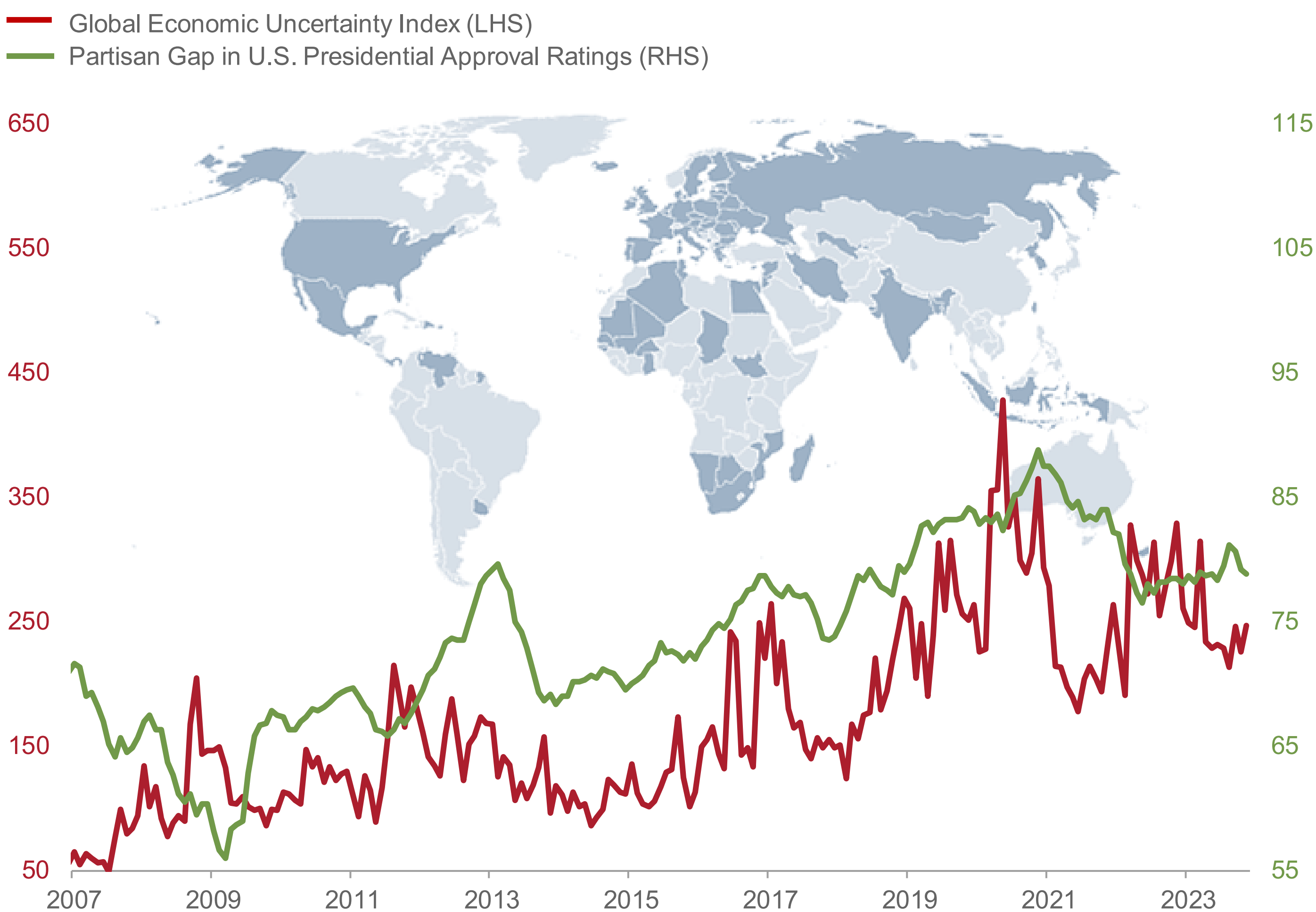
Record Global Elections and Geopolitical Instability Will Lift Economic Uncertainty

Global Economic Uncertainty, U.S. Partisanship, and a Map of 2024 Elections

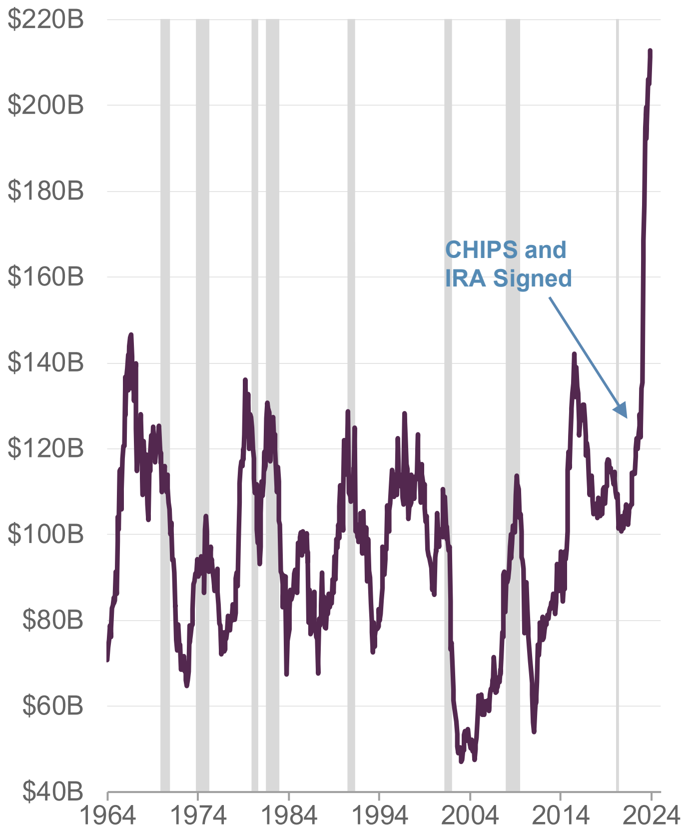


- A historic surge in global elections in 2024 encompassing over 50 percent of global gross domestic product (GDP) will amplify economic uncertainty. Among the most consequential will be elections in the United States, Taiwan, Russia, and the European Union.
- Already heightened geopolitical risks are set to intensify given ambiguity surrounding the profile of political leadership and their economic agendas.
- In the United States, the presidential election will be contentious. President Biden faces unfavorable conditions including the highest disapproval rating for a president going into an election year since 1980 and heightened recession risks. Uncertainty is compounded by former President Trump's legal challenges that will ramp up during campaign season.
- Events abroad will add to the volatility, with ongoing conflicts in Ukraine and the Middle East, tensions with China likely to ramp up with Taiwanese elections, and new hotspots undoubtedly emerging.

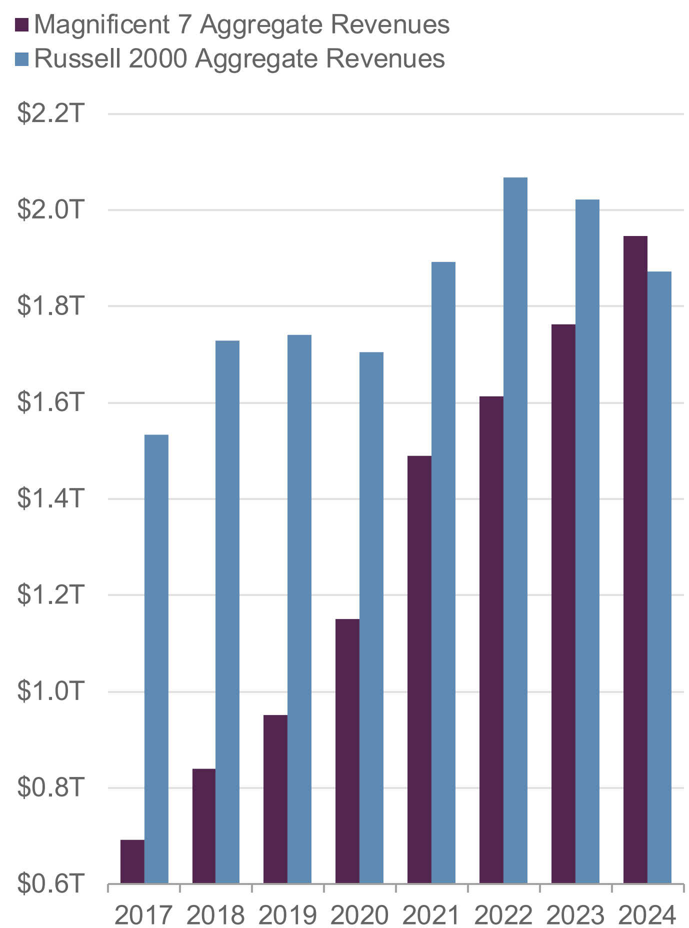
Source: Guggenheim Investments, Bloomberg, Caldara, Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk," American Economic Review, April, 112(4), pp.1194-1225.

Technological Innovation and Competition Will Continue to Transform the Economy

Construction Spending on Private Industrial/Manufacturing Facilities, Inflation Adjusted



Annual Revenues and Projections Russell 2000 vs "Magnificent 7"

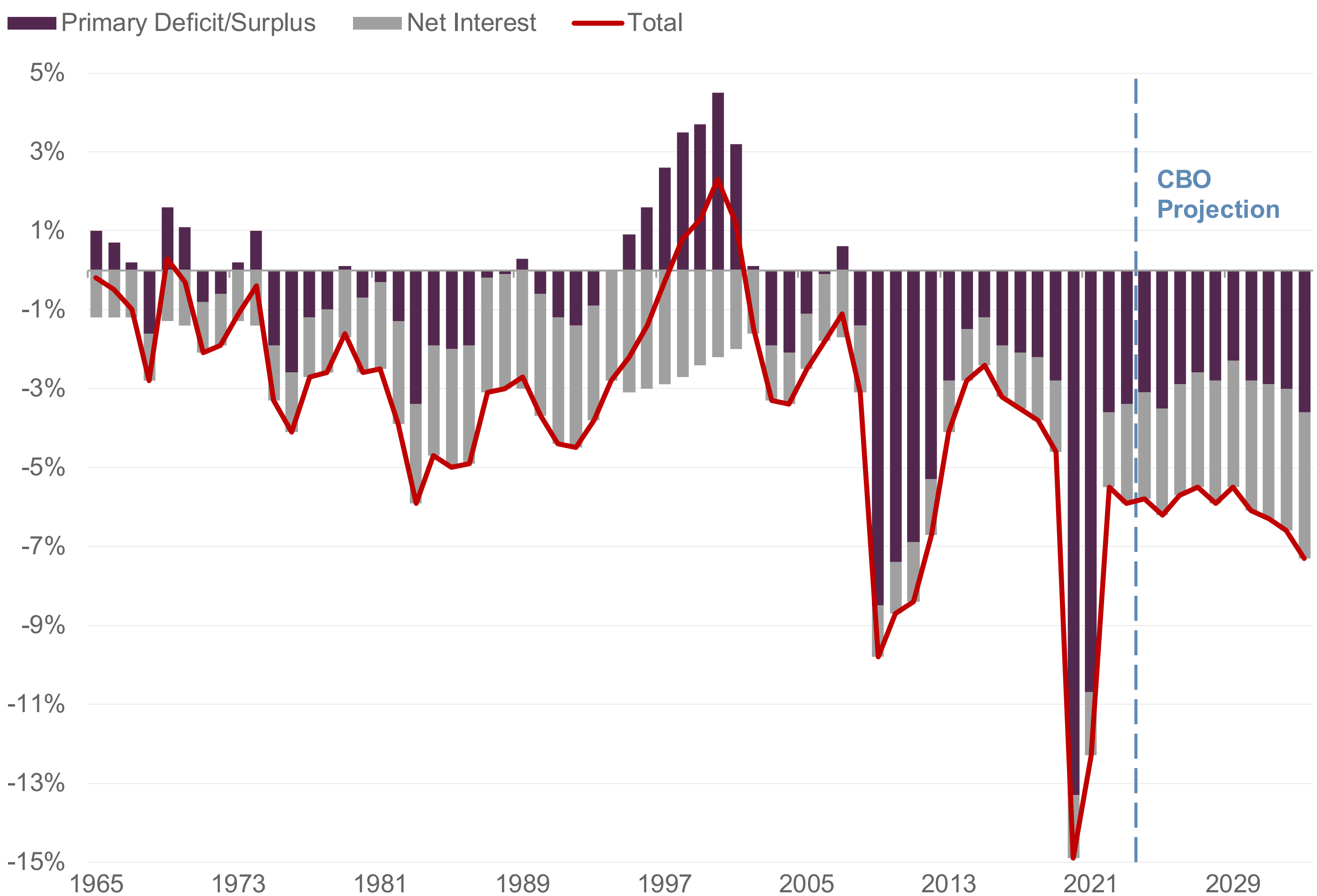


- Tech innovation, spurred on by artificial intelligence hype and geopolitical risks that accentuate the need for U.S. manufacturing independence, should continue to buttress investment in manufacturing plants, advanced technology, and research and development.
- The passage of tech and infrastructure-related legislation in 2022 drove a boom in the construction of new manufacturing facilities to a record high.
- The strong focus on tech innovation also supported the "Magnificent Seven" stocks–a group of mega cap companies capitalizing on tech growth trends. Further AI progress will lead the tech sector to siphon more revenues from other industries and drive an increasingly bifurcated world.
- We expect revenues of the magnificent seven to exceed that of the Russell 2000 index in 2024, reinforcing mega cap tech's dominance.

Source: Guggenheim Investments, Bloomberg, Factset. Data as of 11.30.2023 and shown in May 2023 dollars for construction spending. Magnificent 7 represent Apple, Amazon, Microsoft, Meta, Nvidia, Tesla, and Google. Revenues in 2024 are based on Guggenheim's views.

Massive Treasury Issuance Will Continue to Weigh on Rates and Crowd Out Other Issuers

Federal Deficit/Surplus, % of GDP

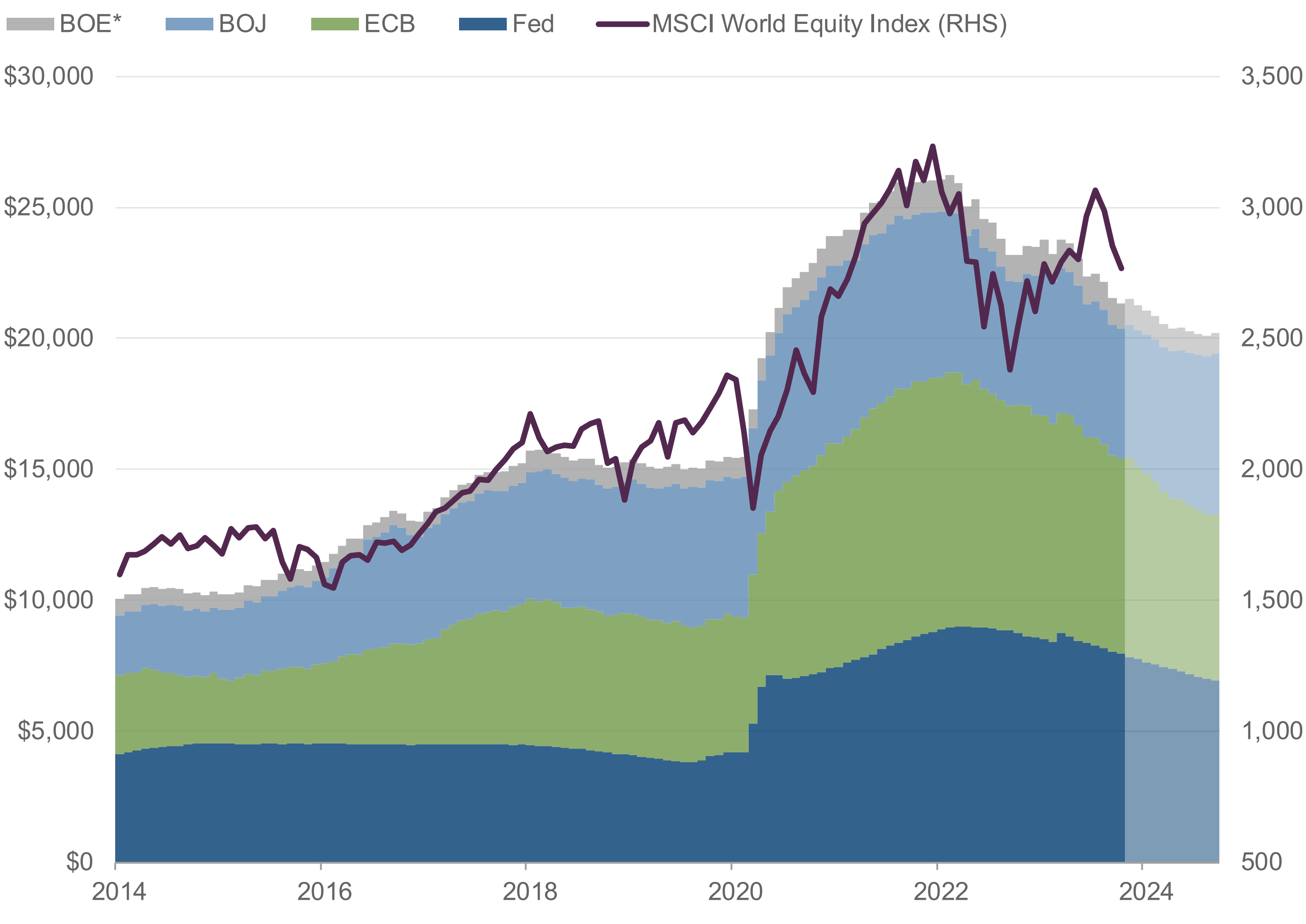


- After a significant expansion of the budget deficit throughout 2023, concerns about the U.S. government's fiscal outlook were spurred by the Treasury's debt issuance plans across various tenors. This led to another spike in interest rates, impacting borrowing costs broadly.
- High interest rates caused a substantial decline in issuance of mortgage-backed securities and credit instruments compared to a record year in 2021. Meanwhile, Treasury issuance surged amid increased government borrowing.
- The Congressional Budget Office's (CBO) projects a further increase in the deficit to 7.3 percent of GDP by 2033. We expect that these dynamics will further crowd out non-Treasury fixed-income supply and could exert downward pressure on private investment.
- There appears to be no appetite from either party to address fiscal challenges. Pressures from geopolitical competition, aging societies, and climate change further serve to increase spending pressure.

Source: Guggenheim Investments, CBO, Haver Analytics.

The End of the ‘Free Money’ Era Will Burst Lingering Asset Price Bubbles

Fed, ECB, BOJ, BOE Total Assets (U.S. $bn) & MSCI World Equity Index

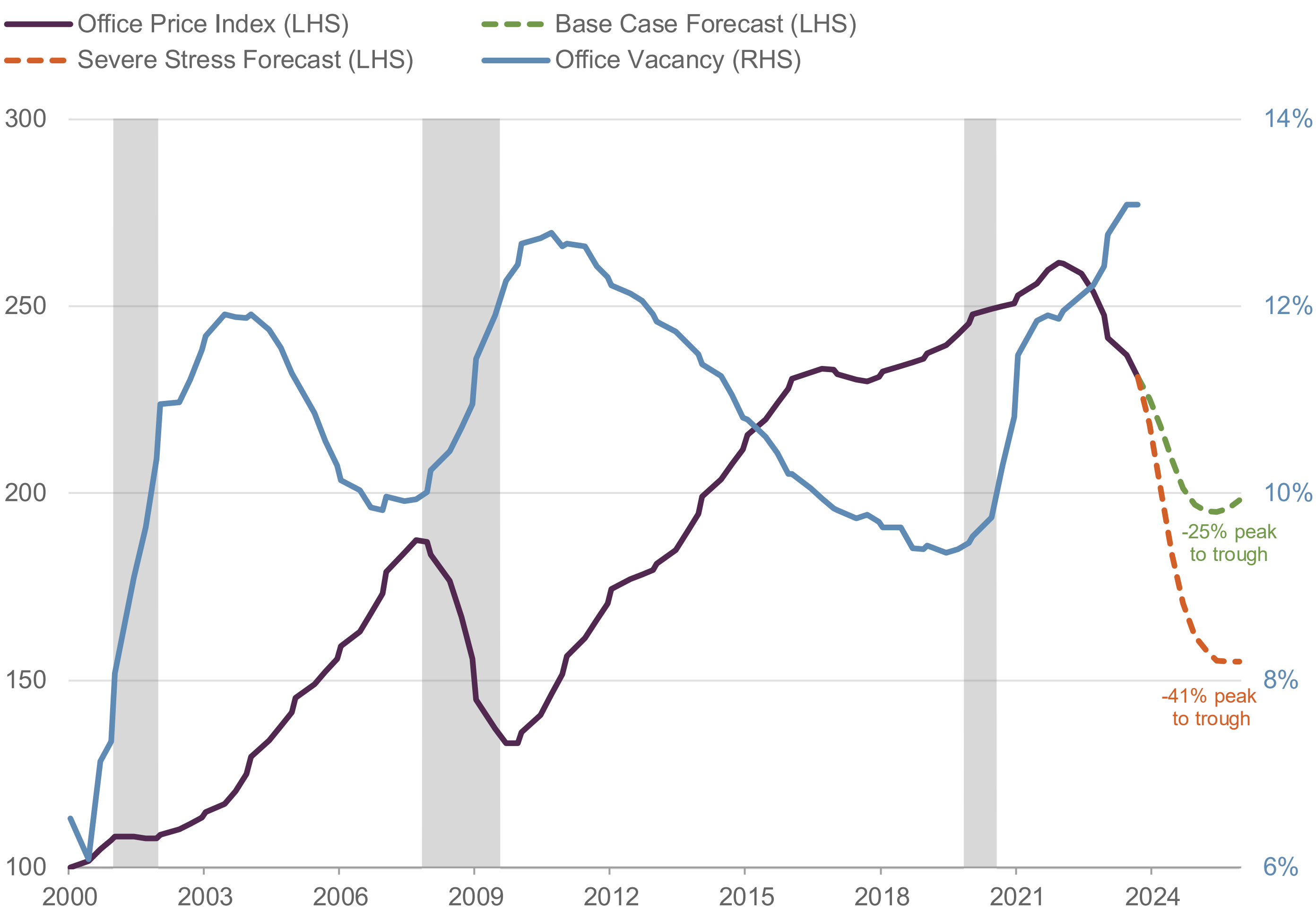


- It is widely acknowledged that global central bank balance sheet expansion played a pivotal role in uplifting risk assets, particularly equities, over the last 15 years. But the tide that once propelled risk assets through years of easy money and expansive balance sheets is reversing, as the size of the largest developed market central banks have shrunk by nearly $5 trillion since their peak in 2021.
- We expect global central bank balance sheets to continue to shrink well into 2024 as they seek a more normalized level. The “free money” era, characterized by ultra-low interest rates and central bank asset purchases, inflated asset price bubbles.
- Signs point to potential vulnerabilities within the global equity market, which has yet to fully adjust to global liquidity withdrawal, unlike the fixed-income market.
- We speculate that the proliferation and survival of “zombie” companies may reach its end in 2024.

Source: Guggenheim Investments, Haver Analytics. Data as of 11.30.2023. *BOE balance sheet derived from truncated monthly data.

Commercial Real Estate Stress Will Intensify and Spill Over to Small Banks

Commercial Real Estate Office Price Index and Vacancy Levels

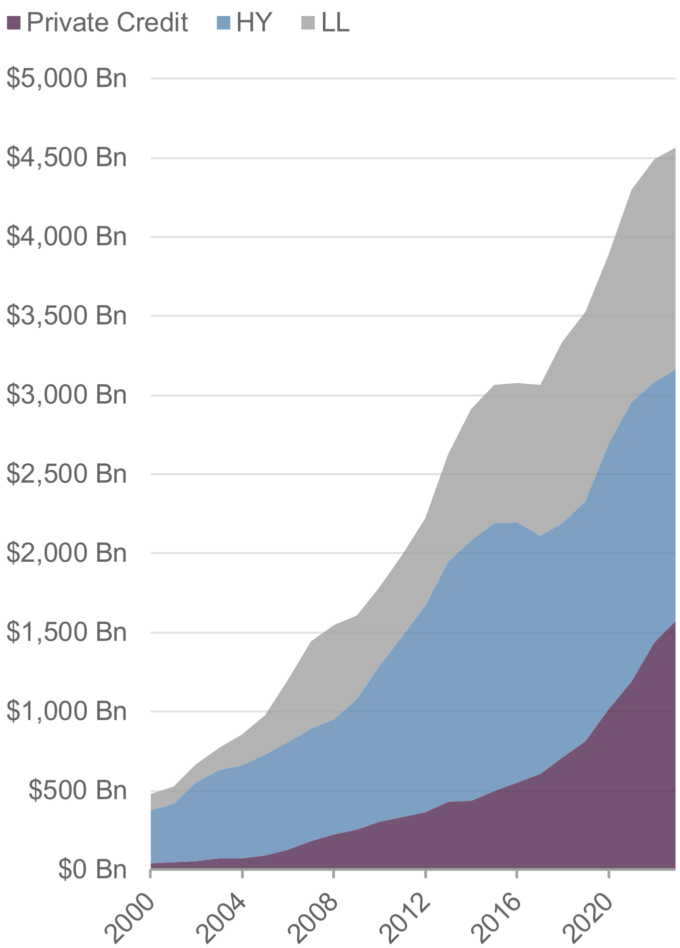


Source: Guggenheim Investments, CoStar. Data as of 10.30.2023.

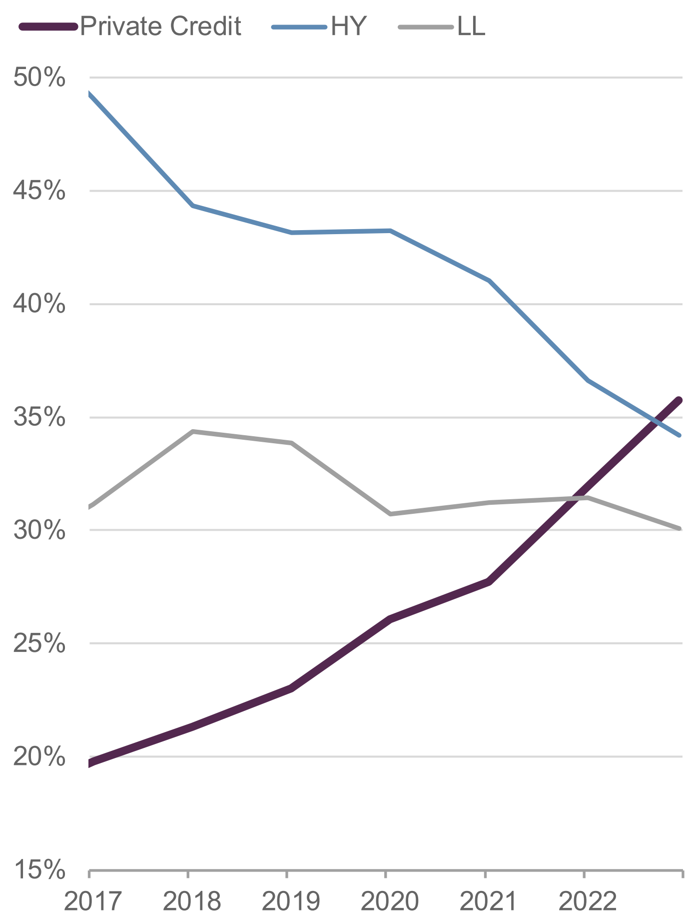
- Commercial real estate (CRE) prices are under pressure due to high interest rates, rising costs and tighter credit conditions, with the oversupplied office market presenting acute challenges.
- National office vacancy rates rose from 9.5 percent in 2019 to 13 percent most recently, and prices have fallen 12 percent from their 2021 peak. Due to weak demand, transaction volumes have been very thin and if there were more sales, prices would be much lower. We believe more downside risks remain.
- Our base case and severe stress forecasts, shown on the chart, undoubtedly carry additional consequences for property, banks, and investors.
- Small banks play a key lending role in this market, with CRE loans representing 44 percent of their total loans and leases. By contrast, CRE loans represent just 13 percent of total loans and leases among large banks. This dynamic threatens a downward spiral where CRE losses impair small bank lending, in turn further damaging the CRE market.
- As the fundamental situation in the CRE market sours further, small banks will remain at risk.

Private Credit Will Cannibalize Banks' Role in Leveraged Credit Further

The Leveraged Finance Market Is Increasingly Comprised of Private Credit



Private Credit Closed the Market Share Gap with Syndicated High-Yield Bonds and Loans

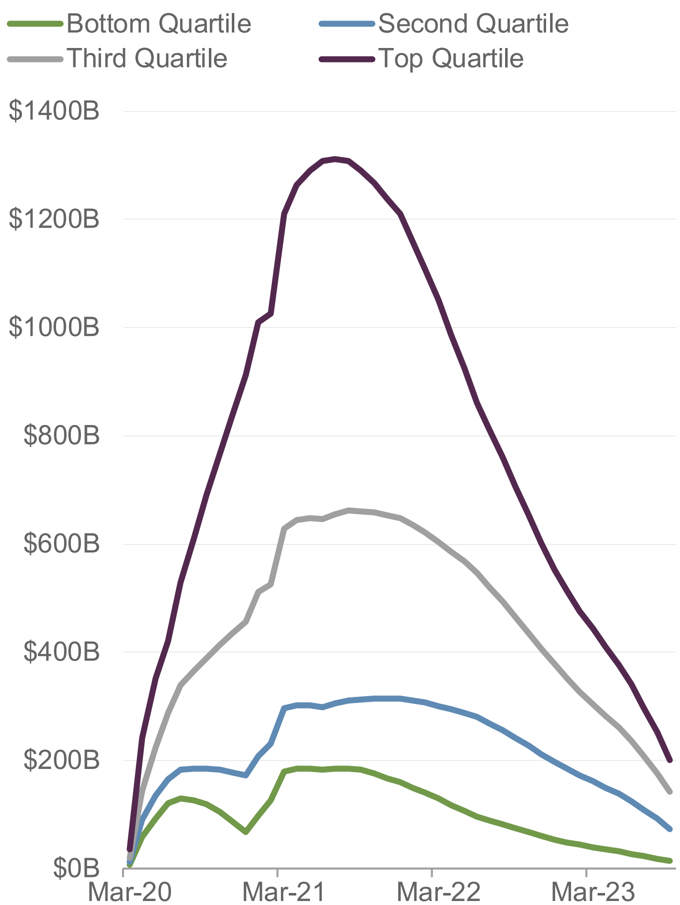


- The combination of elevated interest rates and stricter lending standards by banks created a challenging environment for accessing credit in 2023. Syndicated high yield bond and institutional loan issuance collectively amounted to only $401 billion, marking another year that pales in comparison to 2021's $1.1 trillion total.
- Despite the stagnation in leveraged credit growth, a noteworthy counterpoint emerged with the surge of private credit. Reports indicate that private credit managed to increase its market share of debt encompassing private credit, high-yield bonds and institutional leveraged loans by almost 10 percentage points in five years, with amounts outstanding now over $1.5 trillion. This underscores the resilience and prominence of private credit in the evolving financial landscape.
- Private credit is unlikely to pose macro risks for now. However, with ongoing flows in 2024, there's a possibility that the year could lay the groundwork for future bubbles and shape the next default cycle.

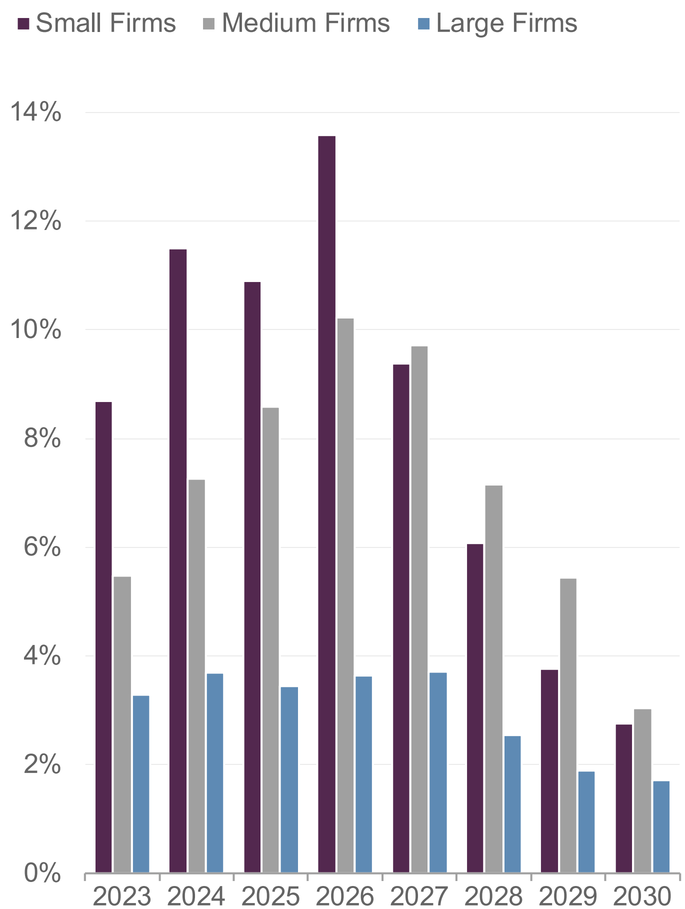
Source: Guggenheim Investments, Federal Reserve, Pitchbook/LCD, Preqin. Data as of 11.30.2023 for high yield and leveraged loans, 6.30.2023 for private credit.

Resilience Gives Way to Bifurcation

Consumer Excess Savings by Income Quartile



Nonfinancial Business Debt Maturities as % of Revenues by Year

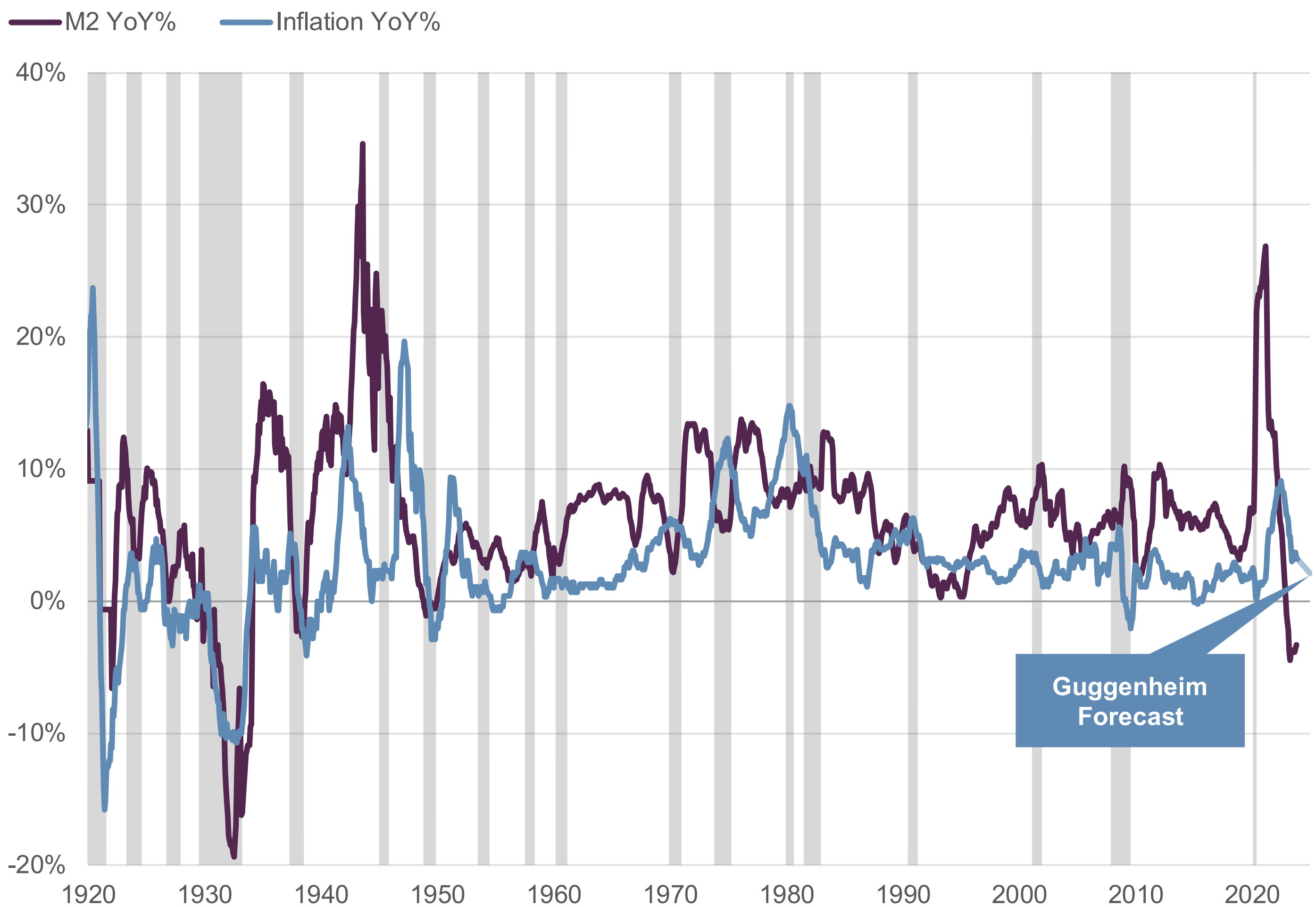


- The presence of excess liquidity on consumer and corporate balance sheets aided resilient economic growth in 2023 and helped the economy avoid a recession.
- Various measures of excess liquidity are normalizing, including estimates of consumer excess savings and corporate cash holdings.
- The distribution is showing a bifurcation in the way different sectors of the economy are experiencing this normalization.
- Consumers in the bottom quintile of income have fully exhausted the excess savings buffer. Small firms face a large maturity wall in the coming year, needing to refinance at substantially higher rates.
- Without these buffers to support spending across consumer and corporate cohorts, we think this bifurcation will contribute to recessionary risks in 2024.

Source: Guggenheim Investments, Federal Reserve, Haver Bloomberg, BIS. Data as of 9.30.2023 for excess savings. Nonfinancial business universe is from a BIS sample of 18,000 firms in 53 countries. Firm size is determined by the tercile of 2022 revenues in the respective country.

Negative Money Supply Growth and Draining of RRP Are Key Risks and May Usher in Deflation

M2 Money Supply YoY % and Consumer Price Index YoY %

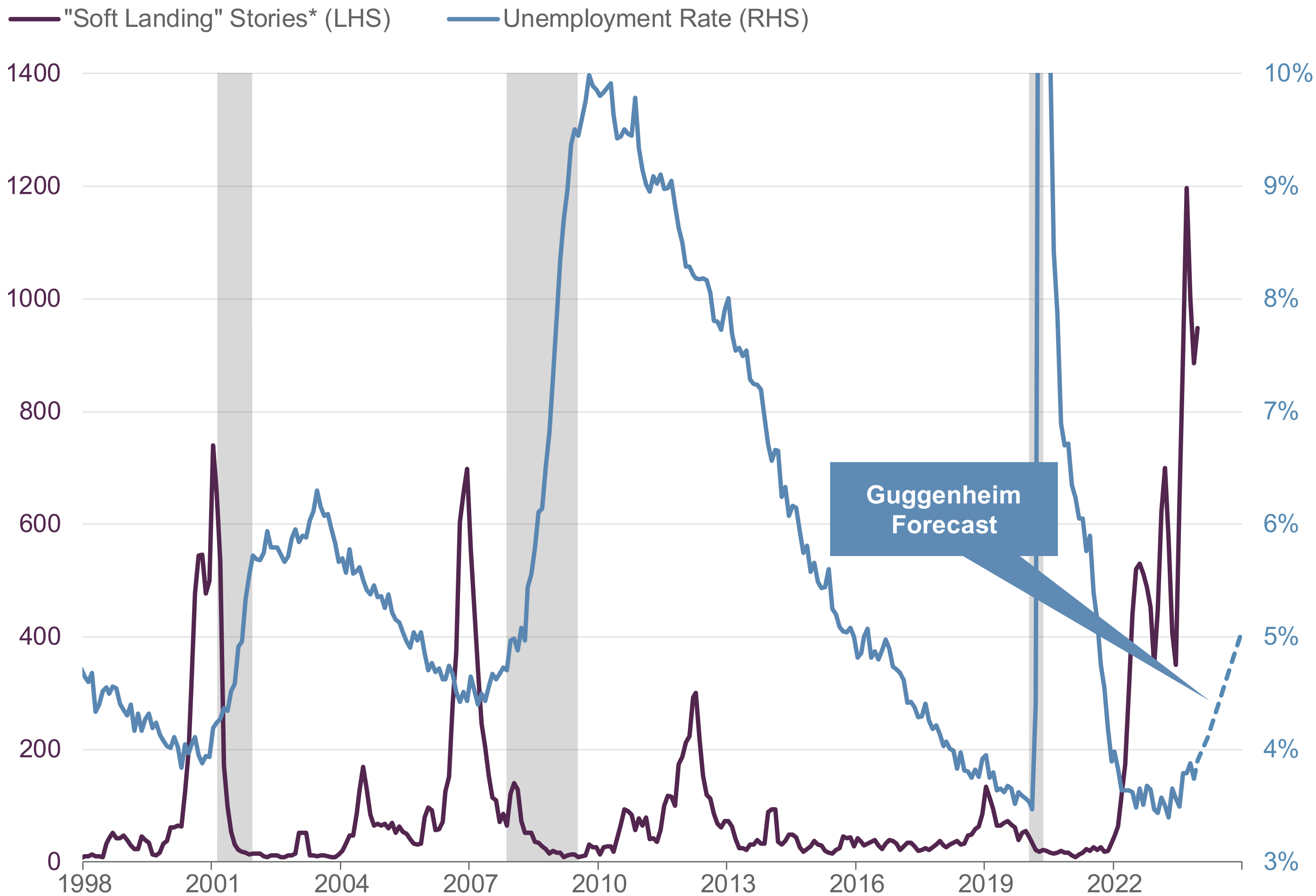


- Inflation has come down strongly, with core personal consumption expenditures (PCE) inflation cooling from 5.5 percent in September 2022 to 3.2 percent in November on a year-over-year basis, and 1.9 percent on a six-month annualized basis.
- Progress is likely to continue toward the Fed's 2 percent target in 2024 with goods prices already falling, rental inflation set to catch up to market trends, and services sector inflation easing more with labor costs coming down.
- As inflation progress continues, participants will turn to deflation indicators. Money supply is one such indicator, especially as the draining of the reverse repo facility signals that excess liquidity is evaporating.
- Money supply contracted by 4 percent in 2023. Contractions in the money supply are rare and have historically been followed by some degree of deflation, even if short-lived. While this is not our base case, we believe it will enter the market discourse and could incite brief periods of volatility.

Source: Guggenheim Investments, Bloomberg, Haver Analytics. Data as of 10.31.2023. Prior to 1930, inflation is based on Cost of Living Index by Albert Rees as published by the Federal Reserve Bank of Minneapolis.

Soft Landing Hopes Will Give Way to (Mild) Recession

Bloomberg Stories Mentioning "Soft Landing" and the Unemployment Rate

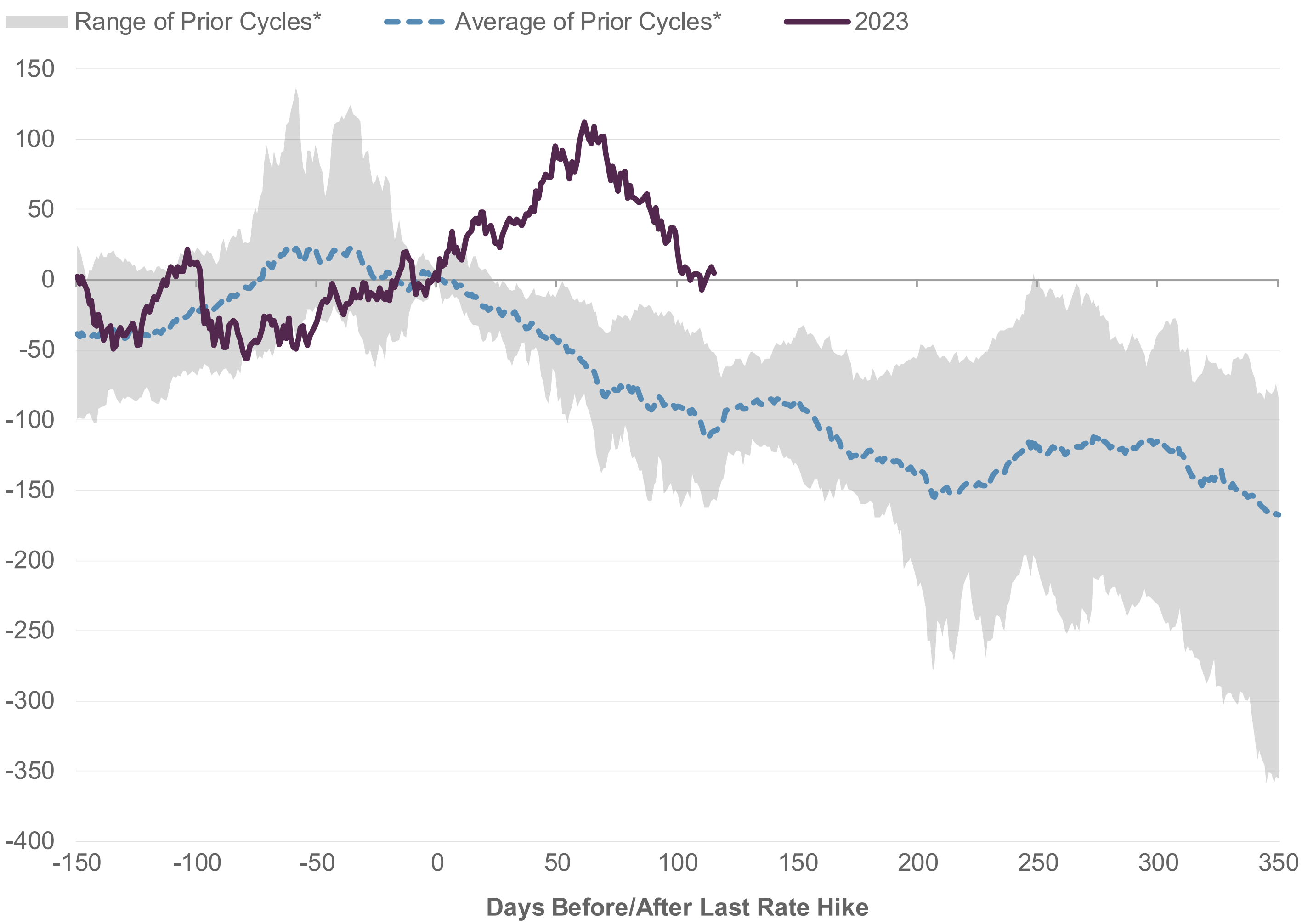


- A cooling economy and lower inflation have increased expectations of a soft landing for the U.S. economy. These hopes are typical near the end of economic cycles, in part because recessions look like soft landings in their early stages.
- We remain concerned about steady deterioration in the labor market, with rising unemployment, falling average hours worked, and narrowing of industries seeing job gains. We see no compelling reason to expect the slowing should stop in the near term, leading to a rise in unemployment sufficient to cause a recession.
- On a positive note, we expect a mild recession as aggregate fundamentals for households and the business sector are relatively healthy, and some industries like housing and autos have already gone through downturns, which likely limits the depth of the 2024 recession (a "rolling recession").
- Bifurcation among weak vs. strong consumers, businesses, and industries will intensify, highlighting the importance of active credit selection.

Source: Guggenheim Investments, Bloomberg. Data as of 10.31.2023. *Note: Soft landing story count is three-month moving average.

Fed Easing Cycle Will Drive Long-End Rates Lower Than Anticipated

10-Year Treasury Yield, Change Relative to Day of Last Fed Hike

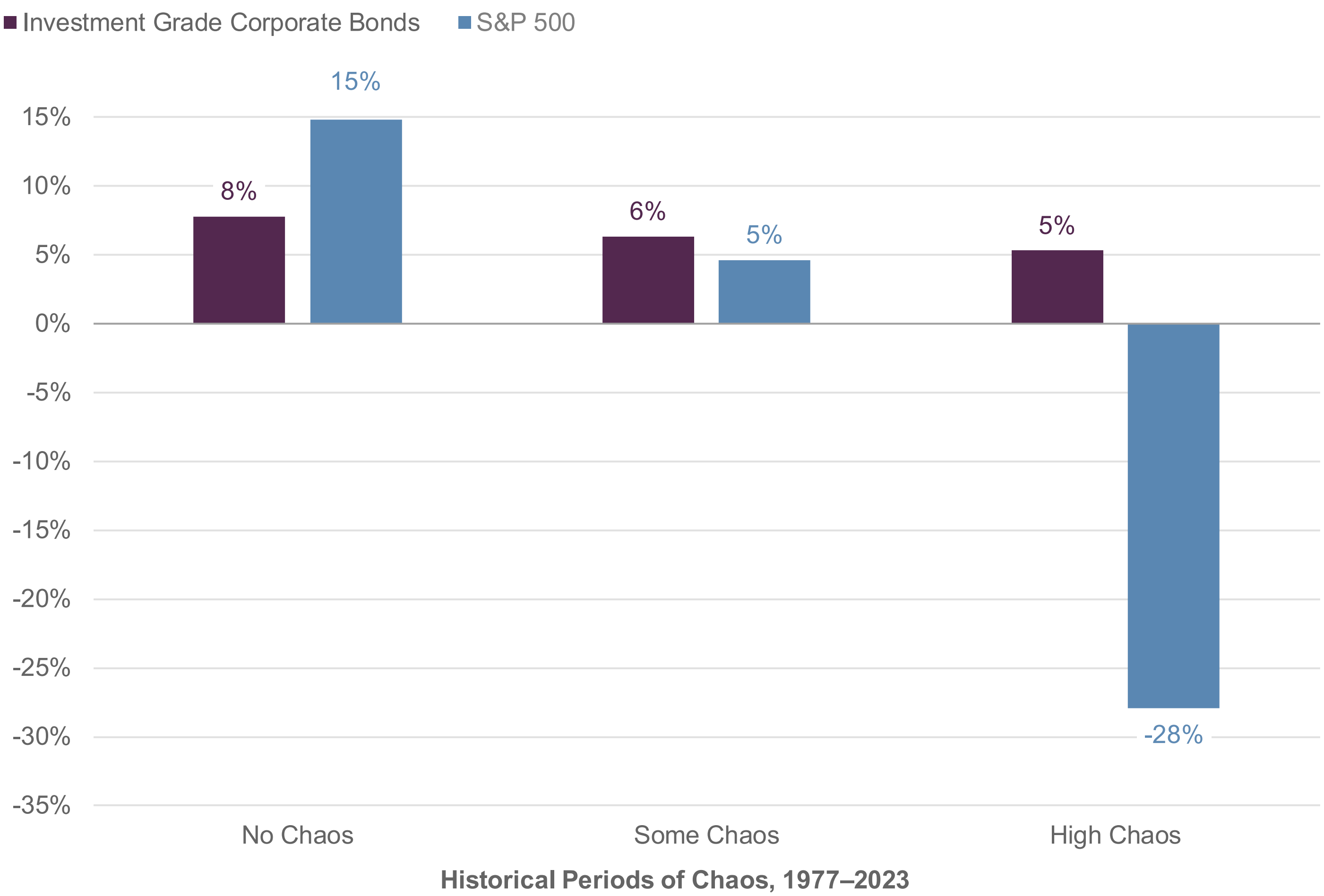


- Even with the recent rally in the Treasury market, expectations for Fed cuts are still underpriced. The Fed is increasingly abandoning any pretense of hawkishness as inflation data continue to surprise lower and the labor market softens.
- For all the technical debate about neutral rates, real rates, and financial conditions, history shows the Fed tends to follow where the economic data—and anecdotal reports like those contained in the Beige Book—lead them.
- The historical relationship between unemployment, inflation, and rate cuts would suggest >300 basis points of rate cuts in 2024 based on our economic forecasts. We think they'll act more conservatively, cutting around 175 basis points. But that 175 basis points of cuts is more than the Fed's dot plot or market pricing show.
- In the last six easing cycles, the 10-year Treasury yield has fallen by more than 150 basis points in the first year and a half after the Fed stopped hiking rates, on average.

Source: Guggenheim Investments, Bloomberg. Data as of 1.3.2024.

Out of Chaos Comes Opportunity in Fixed Income

Risk Asset Returns During Periods of No Chaos, Some Chaos and High Chaos



- We combined various measures of chaos, spanning credit, equity, rates, geopolitics, and growth uncertainty to define no chaos, some chaos, and high chaos periods since 1977. Our work shows that equity returns are typically weakest during high chaos periods, while high quality credit offers stable performance.
- As we enter another year that could be marked by high chaos, we think high quality fixed income will outperform the historical 5 percent average return given very attractive yields and the start of a Fed easing cycle. But the chaos may be reflected in equity market valuations this year, which is currently priced for a very smooth outcome in 2024.
- Heighted volatility and uncertainty will present attractive entry points for strategic investments in riskier assets next year. Until then, the stability and predictability provided by high quality fixed income assets looks attractive.

Source: Guggenheim Investments, Bloomberg, International Monetary Fund, Caldara, Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk," American Economic Review, April, 112(4), pp.1194-1225. The determination of chaos periods are based on a Guggenheim constructed index that takes an average z-score of indexes that measure U.S. economic uncertainty, geopolitical risk, interest rate volatility, equity market volatility, and credit spreads since 1977. Periods of no chaos are when the index is below 0 (which means that the average z-score of the underlying indexes is less than 0). Periods of some chaos are when the index is between 0 and 1.1. Periods of high chaos are when the index is above 1.1. Each month since February 1977 are assigned to no chaos, some chaos, or high chaos based on these criteria, and the returns on the chart are average six-month trailing annualized returns during these periods.

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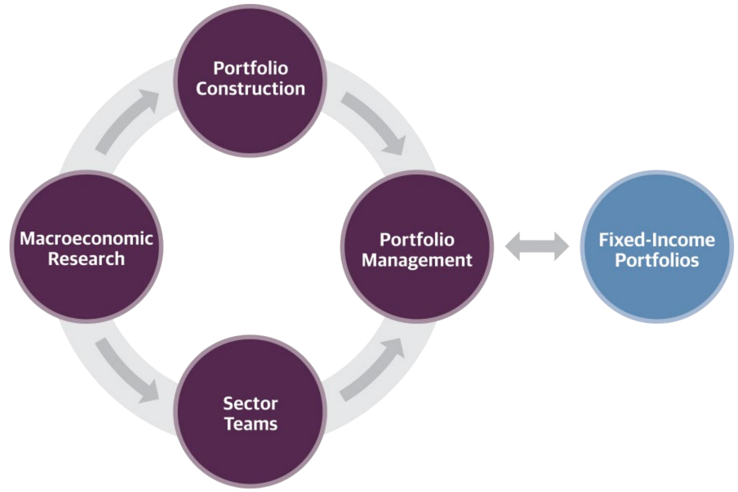

Guggenheim Investments

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Guggenheim Partners

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