Summary of Indosuez Wealth Management webinar on 14 December 2023

In search of a new inflation regime

In 2024, the deceleration in inflation will lead to a normalisation of monetary policies. The bond markets will continue to offer attractive yields, while the trend should also remain positive for equities. While the climate transition is a major opportunity for investors, the risks of "greenflation" should not be overlooked in the short term.

The era of low inflation and low or even negative interest rates is now a thing of the past. The abrupt adjustment following the Covid-19 pandemic led to a surge in inflation, taking central banks by surprise, which hugely increased their rates. *"For the third year in a row, the main victim of this movement is the bond market. However, this is a great investment opportunity, with bonds offering the attractive yields that the market is looking for,"* notes Alexandre Drabowicz, Chief Investment Officer.

Against this backdrop of a normalisation of major post-pandemic imbalances, the global economy is heading towards a soft landing. *"Although the disinflation movement is already well advanced, it should continue in 2024. Our scenario is based on the following assumptions: developed economies will grow below their potential, but without going into recession, while inflation in the US and the eurozone will end the year just above central banks' targets,"* says Lucas Méric, Investment Strategist.

The ECB faces a dilemma in 2024

In the meantime, the new inflationary environment has changed the framework in which investors operate. *"The fact that cash and bonds are once again becoming an asset class offering a positive return, but also potentially higher than inflation, could change investors' long-term allocations for some time to come. At current yield levels, bonds offer a solid hedge against an economic slowdown or recession that would force central banks to lower their key rates,"* says Nicolas Mougeot, Head of Investment Strategy & Sustainability.

In 2024, however, the decline in core inflation will allow the Federal Reserve (Fed) to lower its key rates. *"As it is unlikely that the Fed will maintain real key rates above 2%, we expect three or four rate cuts in 2024. Conversely, the European Central Bank (ECB) is facing a dilemma: inflation is decelerating but remains above its 2% target, while growth remains sluggish and some countries are close to recession. As such, we believe that normalisation could begin in 2024, but at a slower pace than in the US,"* explains Delphine Di Pizio Tiger, Global Head of Asset Management.

On the equity markets, the trend is expected to remain positive in 2024. Three key themes should continue to dominate the trend: artificial intelligence (AI) led by the "Magnificent 7" and their resistance to rising rates, the energy transition and deglobalisation. Geographically, the dominance of the US is likely to be strengthened, as the key players in AI and, more broadly, growth companies are located in the US. *"However, the eurozone, which is home to many companies in the value segment, could benefit from global activity. In emerging markets, we favour a broader approach, focusing in particular on Asia,"* says Laura Corrieras, global equity manager.

On the foreign exchange market, the Fed's rate cut could lead to a slight depreciation of the dollar in 2024, which could help strengthen the European currency if the eurozone manages to avoid a recession. While the rise in real rates is penalising gold, the precious metal should continue to be supported by the normalisation of the Fed's monetary policy and strong demand from central banks.

The transition to carbon neutrality could produce $17 trillion in investment by 2035

As 2023 proved to be the hottest year on record, some investors are tending to abandon ESG approaches in a context of declining returns. However, by 2070, the price of climate inaction would be twice as high as the necessary investments, put at $75 trillion by 2050, to achieve the transition to carbon neutrality. In this context, the energy transition represents a major opportunity for investors, who are aware of the challenges and long-term benefits, even if risks exist in the shorter term. *"As a crucial response to climate change, the climate and energy transition is reshaping the global economy and creating a new phenomenon: greenflation. Indeed, the growing demand for green technologies is putting pressure on commodities, leading to high volatility in commodity prices,"* says Fabrice De Sousa, ESG equities manager.

In alternative asset classes, 2024 should be full of opportunities in the private equity universe, as the downward adjustment in valuations could accelerate during the year and offer particularly attractive entry prices. In this buyer's market, there is a large pool of small and medium-sized enterprises. Distressed credit and structured capital strategies can be favoured to take a position in the private credit market, which should benefit from the current environment. On the private debt market, investors should remain cautious and selective after a strong acceleration in capital raised over the last 18 months amid rising rates.

Lastly, corrections of 10% to 20% on average have been under way for more than a year in the real estate market and this downward trend could continue until mid-2024, opening up opportunities for investors. As interest rates approach their peak, some segments such as logistics warehouses and the best office assets could benefit from a gradual recovery as early as next year.