

Anthos Annual Investment Outlook 2024-2025

A transitioning world.

Anthos Fund & Asset Management

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How to read this report

- The key messages provide the speed read of all the chapters in our outlook, for those with seconds rather than minutes to spare.
- The executive summary paints our overarching worldview. It can serve as a starting place for discussions amongst investment professionals and clients.
- The global growth and inflation outlook gives a comprehensive view of our take on the secular (5-10 years) and short-term (2024–2025) horizons.
- The investment outlook translates this macroeconomic backdrop into investments. We share the current thinking from each of our asset class teams, as well as the top-down view from our client portfolio managers.
- The views expressed in all preceding chapters inform this year’s capital market assumptions (CMAs), which give our return expectations for each asset class for the coming 5 years. Investors can use these to form their portfolio construction ideas and asset allocations for 2024 and beyond.

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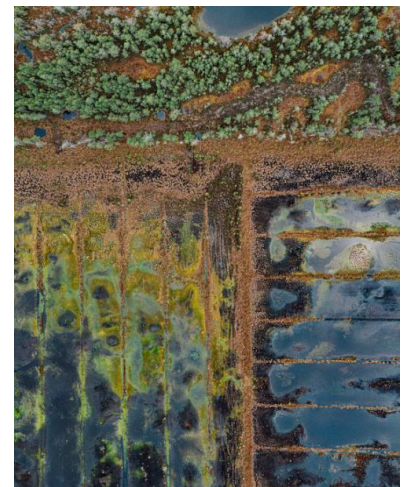
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1. Key messages

Executive summary

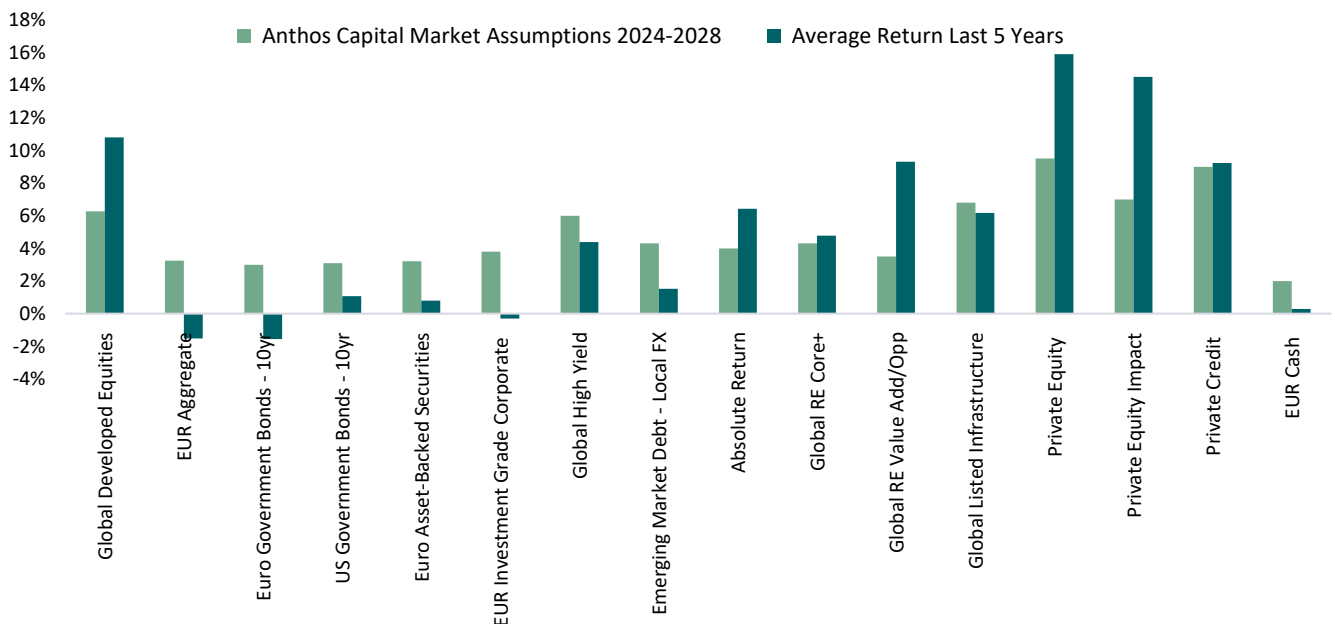
- The world is gradually shifting from secular stagnation to 'state-sponsored capitalism,' with the increasing influence of big government addressing systemic issues like inequality and climate change.
- The COVID-19 pandemic, Russia's invasion of Ukraine, inflation, and aggressive monetary and fiscal interventions have disrupted and accelerated existing global transitions, exposing vulnerabilities in interconnected systems.
- Current geopolitical tensions are heightened, with devastating humanitarian consequences. Regional conflicts in Europe and the Middle East are accompanied by the strategic decoupling of the world's two major powers, the United States and China.
- The transition to green energy is turning out to be disorderly, evidenced across prices, policies, and politics. The urgency to combat climate change requires a push from 'state-sponsored capitalism,' but a 'greenlash' amongst populist politicians is underway.
- The potential of artificial intelligence (AI) innovation is a bright spark, with expectations of multi-faceted applications boosting economic activity. However, the debate on regulation and moral questions remain open, shaping the future impact of AI.
- If the world is transitioning to state-sponsored capitalism, then responsible investments are the driving force. Along the way, many disorderly transitions must take place, creating volatility, uncertainty, and friction.
- Active investment approaches with alternative asset classes and multiple layers of diversification can help investors navigate the complexities smoothly over the long term.
- In the shorter term, our macroeconomic scenarios outlined in Chapter 5 imagine the potential roadmaps in the next 12–18 months given the long-term destination of state-sponsored capitalism.

Growth and inflation outlook

- Transitioning from secular stagnation to state-sponsored capitalism hasn't resulted in anticipated about-trend growth so far. Recent shocks, including the pandemic, war in Ukraine, and inflation surge, challenge the efforts to achieve sustainable, stable, and inclusive growth.
- In the shorter term, extraordinary fiscal stimulus, initially preventing economic contraction, is expected to give way to a contraction in 2024. The shape and size of this contraction remain uncertain, amplifying the relevance of our macroeconomic scenario framework.
- A quiet but significant setback is the persistent decline in long-term global growth prospects. Projected global growth rates are well below historical averages, driven by factors like declining demographics, deglobalisation, and a slowdown in cross-border investment.
- The 'six Ds' structurally driving inflationary pressures are demographic shifts, decarbonisation, deglobalisation, debt, digitalisation, and destruction. Notably, demographic aging and debt may have conflicting impacts, while decarbonisation and deglobalisation pose clear inflationary pressures.
- The substantial monetary tightening in 2023 raises concerns about the economic outlook. Our view is that the extraordinary fiscal stimulus supporting businesses and consumers since the pandemic has kept inflation high and certain segments of the economy afloat. As it runs its course, an economic contraction will likely follow as the full impacts of monetary tightening are felt.

Investment environment

- Optimal portfolio constructions in any setting require diversification across complementary asset classes and alternative return sources.
- Amidst persistent higher interest rates and economic contraction, fixed-income assets shine. Investors seeking higher yields may find solace in high-quality assets, eliminating the need for excessive risk. Government bonds, investment-grade credit, and selectively, emerging market and private credit, emerge as attractive options.
- In the equity landscape, caution meets optimism. Short-term stability calls for a defensive shift, focusing on the US market with robust cash flows and low leverage. Optimism arises in a ‘new’ Goldilocks scenario foreseeing higher inflation, steering focus toward energy transition and AI. The macroeconomic environment makes the case for Japan once again enticing, with all eyes on its central bank in 2024; waiting to see if monetary policy action leads to the repricing of Japanese assets that we anticipate.
- Real estate underwent a challenging year in 2023, so improved prospects are a case of when not if in 2024. The short-term trajectory hinges on macro factors, with resilience expected in European real estate. Diversified strategies, especially in the industrial and residential sectors, offer long-term opportunities whilst we are cautious about the offices sector given the shift to remote working and consequent structural challenges.
- Absolute return strategies stand resilient, providing diversified, uncorrelated returns. In the short and medium term, attractive opportunities include strategies such as specialty finance, risk transfer strategies, mortgage servicing rights, and opportunistic private credit.
- The need for impactful solutions to the world’s deep environmental and social challenges has never been greater. Nor have there been so many worthwhile solutions commercially available. Investing across a variety of asset classes provides much-needed diversification in an outlook marred by global growth and inflation challenges.
- Private equity faces significant shifts amid altered market sentiments. Mega buyouts stall with expensive financing, impacting venture and large-cap firms. The mid-market, however, displays resilience against higher rates, emphasizing operational improvements and diverse exit routes.



Source: Anthos Fund & Asset Management. Anthos Capital Market Assumptions (CMAs) for 2024-2028 assume a USD/EUR return (based on PPP valuation & USDEUR forward premium/ discount) of -1% per annum, applied to the USD sensitivity of relevant market indices.

2. Executive summary—a transitioning world

For years, we have argued that the global economy is gradually transitioning from secular stagnation to ‘state-sponsored capitalism’ where the ‘(in)visible hand of big government’ increasingly influences economies, arguing of the need to tackle systemic global issues like inequality and climate change. This shift could see opposing circumstances play out: one positive, where global cooperation achieves common goals, and one negative, seeing re-nationalisation of policies and protectionist populism leading to distrust, disputes and even destruction.

Some of the defining shocks of this decade so far—the COVID-19 pandemic, Russia’s invasion of Ukraine, inflation and aggressive monetary and fiscal intervention, as well as populist shifts in politics—have both disrupted and accelerated many of the secular transitions that were already underway before the pandemic. The globalisation that powered the phenomenal growth of the past three decades was already weakening before the pandemic showed the vulnerabilities of an interdependent and interconnected value chain. Russia’s invasion of Ukraine exposed those vulnerabilities further, forcing policymakers to quickly revise their priorities to not only tackle deep-rooted issues like climate change and social inequality, but also to ensure immediate security of resources and curbing inflation.

Power struggles have shaped the global economy for centuries, and today’s ruptures are made all the more complex by the interconnected systems and relationships presented by globalisation. The regional conflicts in Europe and the Middle East are underlined by the strategic decoupling of two great global powers: United States and China, where each is vying to form coalitions around specific conflictual issues. Tensions in Taiwan underscore the need to secure and own the value chains for commodities that will power the future. Investors must pay attention to how these complex and fluid relationships are changing to understand how this plays out in portfolios over the coming years.

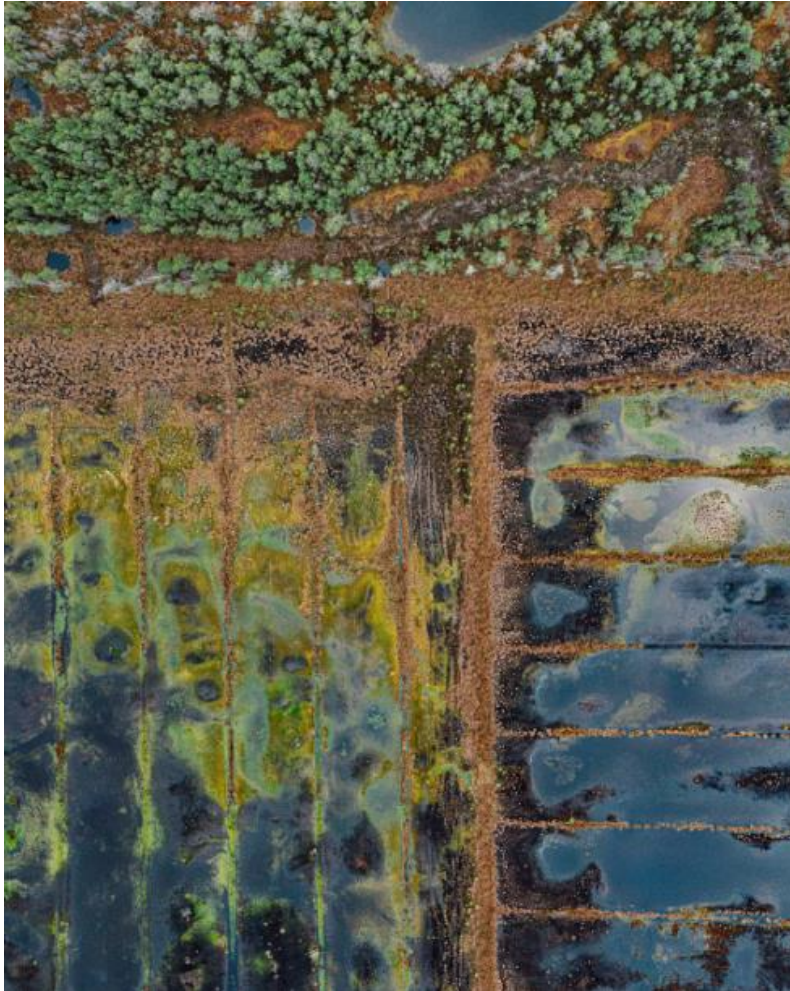
The new green energy map is a case in point, where the impacts of the energy transition are being felt. From prices, to policies, to politics, it is clear that transforming the global energy mix is turning out to be a disorderly transition. All the while, the need for such a shift is increasingly evidenced by the worsening impacts of climate change. If the number of global pledges and policies ratified to date are to be achieved, ‘state-sponsored capitalism’ must push economies harder. But these are policies that not all agree with or want: a ‘greenlash’ is underway among voters who regard climate-friendly policies as conflicting with their needs. With 2024 an election year where more than half the world’s population will vote across more than 70 countries, the climate and inequality crises will be under the spotlight.

A bright spark to watch for is the potential a new wave of artificial intelligence (AI) innovation may bring. Goldman Sachs is amongst others to revise up their growth expectations in hope for the multi-faceted and ‘horizontal’ applications to boost economic activity (meaning all industries and geographies could benefit). Of course, that takes time, investment, and culture change amongst individuals, companies, and governments, as well as investors. There’s also the existential and moral questions surrounding AI. The debate about regulation will intensify over the coming years, where certain countries will come to resolutions faster and more efficiently than others. The jury is still out on whether humanity will harness AI for the greater good, or for ill.

Across multiple pillars, these disorderly transitions are taking place. Meanwhile, the ‘older’ shifts of aging demographics and declining productivity continue to negatively impact economic activity.

This is a challenging and transformational backdrop that sets the stage for our Annual Investment Outlook 2024-2025. Last year's key message was one where we expected significantly more uncertainty for the global economy moving forward. This year's goal is to investigate why. We are delving deeper to make sense of the complexity and what this means for the economic and investment environments, asset class returns, and overall portfolio prospects.

With so much that is complex and nuanced, we are confident in three things. First, imagining and preparing for different macroeconomic environments is crucial work of the active investor—making our macroeconomic scenario framework even more relevant. Second, amidst the ever-growing challenges of climate change and inequality, responsible investment must be the way forward. Third, the profound importance of adopting an 'all-weather' investment approach with diversification by design and alternative asset classes offering different sources of return. We believe these are the portfolios that can take advantage of, and stand up to, the complexities of a transitioning world.



"The_Bog_Renatured_005", by Photography Bernhard Lang.

3. Secular outlook for growth and inflation

This chapter introduces our secular outlook for growth and inflation for the next 5-10 year period. In it, we address the drivers of growth and why some of these are faltering as well as some of the more prominent influences of inflation over the coming years. We then consider the role of monetary policy and the recent tightening regime. Finally, we include a short thematic essay on China given its role in the global economy.

Growth—sluggish, with shocks

In past years, we argued that a shift from secular stagnation to state-sponsored capitalism should result in around-trend nominal growth going forward. Whether by inflation or real GDP growth, we expected the '(in)visible hand of big government' to steer economies in the right direction and intervene when needed with the ultimate goal being sustainable, stable, and inclusive growth. Whilst this remains the widely-advertised goal, recent reality shows the difficulty in achieving it.

Major shocks have battered the global economy over the past three years—including the COVID-19 pandemic, the war in Ukraine, and the surge in inflation and consequent tightening in financial conditions. During the pandemic, as the world faced a standstill in economic activity, extraordinary levels of fiscal stimulus were injected into the economy to help keep consumers and businesses afloat. As the recovery began and economic activity picked up, inflation rose to levels that required the sharpest tightening of global monetary policy in four decades to curb it. The battle between tight monetary and loose fiscal policies has created a confusing environment to navigate, resulting in many surprises in 2023. For example, we were not alone in expecting a recession in Europe and the US, and for inflation to fall faster than it did (though we expected it to stick). What we got was surprising economic strength, very sticky inflation, and the expectation for 'higher for longer' interest rates.

This year, we conclude that the extraordinary fiscal stimulus delayed rather than diverted an economic contraction, which we expect in 2024 as the effects of monetary policy start to show after the anticipated lags diminish. Yet, the shape and size of that contraction depend on several factors with a spectrum of potential outcomes, adding uncertainty. In the short term, this makes our macroeconomic scenario framework even more relevant, which we outline in Chapter 5.

As economic growth is confronted by these short-term challenges, we recognise a longer-term setback of significant importance that has been brewing quietly: a persistent decline in long-term growth prospects.¹ Global growth has retreated from a recent high of 4.5% in 2010 to a projected 3% in 2023 and 2.9% in 2024, well below the historical (2000-19) average of 3.8%. Advanced economies are expected to slow from 2.6% in 2022 to 1.5% in 2023 and 1.4% in 2024. Emerging markets and developing economies are projected to have a modest decline in growth from 4.1% in 2022 to 4.0% in both 2023 and 2024. This deceleration in potential growth is anticipated to continue throughout the remainder of the current decade, expected to average 2.2% annually in the period spanning from 2022 to 2030, marking the most sluggish pace observed since 2000.²

¹ *Falling Long-Term Growth Prospects*, World Bank Group, June 2023.

² *World Economic Outlook*, International Monetary Fund, October 2023.

Alive, but not kicking (%)



Source: World Bank.

Note: EMDEs = emerging market and developing economies.

Projections for 2023-24. GDP-weighted averages (at 2010-19 average exchange rates and prices).

Behind this slowdown are some usual suspects: declining demographics and deglobalisation, but also a decline in cross-border investment which dents trade. Global demographic decline and its impact on working-age populations is a broad but undisputed topic. We have also written extensively in last year’s outlook on the impact of deglobalisation and the shift to a multi-polar world. As for investment, the slowdown that transpired during 2011-21 is expected to persist in this decade due to various factors, including the repercussions of the COVID-19 pandemic, Russia's invasion of Ukraine, limited policy flexibility, and stringent financial conditions.

Shifts in secular growth trends have an impact on inflation prospects. As do adverse economic shocks like the ones we’ve experienced in the past three years. The question is ‘how’ and ‘to what extent’ which, as events of 2023 demonstrate, there is little agreement on. In the next section, we strive to give broader assessments as to the forces behind inflation.

Inflation—‘the six Ds’

Last year, we highlighted the sustained impact of fiscal stimulus measures on labour and consumer markets, anticipating a structural rise in inflation. Our foresight proved accurate this time. However, as inflation remains worryingly persistent even despite aggressive monetary tightening, it raises crucial questions about other underlying factors propelling structurally higher inflation. These factors, which we term ‘the six Ds,’ encompass demographic shifts, decarbonisation, deglobalisation, debt, digitalisation, and destruction.³

Demographics

There are (at least) two schools of thought when it comes to the inflationary force of aging populations. The positive one states that the retirement of the baby boomer generation, coupled with fewer new entrants into the job market, creates a dual impact: a growing number of elderly consumers without active employment and a shift towards domestically-produced services.

The second school challenges the assumption suggesting that aging societies, being less innovative and adaptive, might dampen inflation due to a lack of dynamic growth and fewer price adjustments. Japan is a prime case study. With demographics having such a clear and accelerating impact, Japan’s economy has undergone ‘shrinkonomics’ for a number

³ Variations of the ‘four/five/even six Ds’ of structurally higher inflation have been recognised by many market participants besides us. Morgan Stanley, Allianz, DWS, Yardeni Research, as just some examples.

of years—where the impact of an aging and shrinking population is already visible in everything from economic and financial performance to the shape of cities and public policy priorities (such as long-term solvency of public pension, healthcare, and long-term care systems).

However, the global surge in inflation has also touched Japan where wage and price inflation is coinciding with an exciting corporate renewal. Where wages and prices are both largely driven by global supply shocks, they converge with gradual institutional and generational shifts changing Japan's prospects from the inside. This combination of external shocks and internal evolution represents a turning point for Japan's economic prospects.

Decarbonisation

Climate change and efforts to combat it are unequivocally pushing up various prices. Adaptations due to climate change force companies to adjust production, passing associated costs to customers, and resulting in price hikes. For instance, an extended drought in France in the summer of 2022 led to decreased river levels, forcing several nuclear power plants to halt electricity production. The price of carbon in the European Union (EU) has surged more than tenfold in the last five years. Achieving a climate-neutral economy will unavoidably raise the costs of carbon emissions, making them economically unviable. Bans on carbon emissions will further prompt price increases.

Cost of polluting Europe (Price €/tonne)



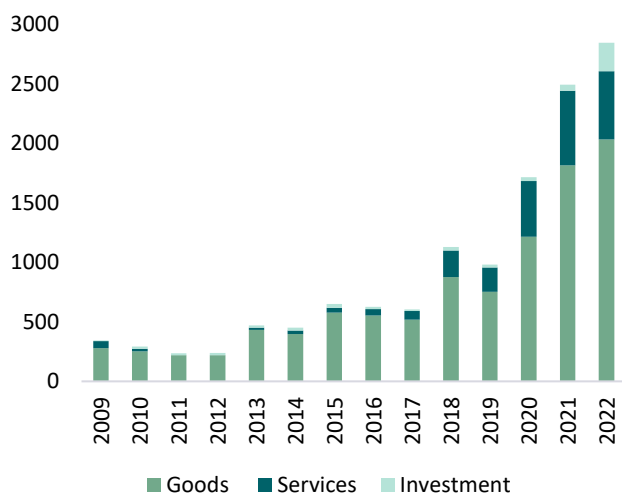
Source: Bloomberg, Anthos Fund & Asset Management research.

Deglobalisation:

The impact of deglobalisation on inflation is complex and often tied to the supply chain 'shocks' post-pandemic. However, the trend of deglobalisation is evident through various global events indicating a retreat from free trade, making this a structural trend. Take a look at the number of trade policies inking long-term contracts which are restrictive in nature and it hints that this trend will only accelerate, with geopolitical tensions slicking the wheels.

The recent semiconductor shortage exemplifies how deglobalisation can drive inflation. As countries pivot towards securing domestic production and reshaping supply chains, the disruption in the global flow of semiconductors due to reduced interdependence has led to soaring prices. This scarcity has significantly impacted industries like automotive and electronics, raising manufacturing costs and subsequently increasing prices for consumers, highlighting how deglobalisation can create supply constraints and inflationary pressures.

Rising restrictions in global trade



Source: IMF, World Bank, Global Trade Alert (2022), and Anthos Fund & Asset Management research. The figures show exports only.

Debt

The possibility of central banks reaching their low inflation goals amid growing government debt raises concerns about ‘fiscal dominance’ and ‘financial dominance.’ Fiscal dominance questions whether government debt levels hinder central banks from raising interest rates to avoid national insolvency. Financial dominance suggests that the precarious state of banks might restrict central banks' monetary policy actions. While debt levels may dampen the effect of interest rate hikes on demand, both fiscal and financial dominance might play a role in central banks' decisions but won't solely determine outcomes.

Argentina is an extreme case where this becomes a problem. Since 2001, Argentina has defaulted thrice, leading to severe inflation and radical populist policies culminating in the election of a far-right outsider who promises to destroy the currency and central bank. Politics aside, these policies if enacted will reduce financial stability and credibility, and could set Argentina back decades with grave implications for its people. Closer to home, the recent example of Germany’s attempt to siphon funds from emergency COVID stimulus towards energy transition investment was ruled out by its supreme court in an act considered unconstitutional.

With higher borrowing costs as a result of higher interest rates, indebtedness across the world will only worsen. Our view is that governments will strive for fiscal dominance and apply more pressure on central banks to be flexible. These two examples from very different economies show the range of approaches to do that.

Digitalisation:

The surge in a new wave of digital technology, notably AI, introduces both inflationary and deflationary pressures. AI investments may drive up costs as demand for skilled labour and resources rises, potentially causing inflation. Rapid technological advances could prompt frequent upgrades, contributing to inflationary pressures. Integration of AI in sectors like healthcare may lead to productivity gains, but if cost savings aren't passed on, it may inflate prices.

Conversely, AI adoption can create deflationary forces. Automation reduces operational costs, possibly causing technological unemployment and impacting consumer purchasing power. Intense competition driven by technological

evolution may induce price wars, and AI's pricing optimisation can lower overall prices, fostering deflation. Digital products, often featuring decreasing marginal costs, reinforce deflationary trends.

Destruction

The triad of 'distrust, disputes, and destruction,' manifested in the multifaceted nature of warfare, not only poses a threat to economic stability but also casts a long, somber shadow on the humanitarian landscape. This stark reality is vividly exemplified by tragic events such as the Ukraine conflict, the US-China trade tensions resembling a technological cold war, and the recent heart-wrenching devastation in Gaza. In the tapestry of war's impact, it is crucial to recognize not just the economic toll but also the profound humanitarian consequences that echo through the affected regions.

Wars, whether waged through traditional means or the virtual battleground of cyberspace, have historically left indelible marks on both economies and, more significantly, the lives of countless individuals. Reflecting on the historical perspective, World War II stands as a poignant reminder, with an estimated €3.6 trillion cost that reverberated through the fabric of societies.

The lens through which we view contemporary conflicts, such as the ongoing strife in Ukraine, the tense dynamics between the US and China, and the recent tragedy in Israel-Gaza, should extend beyond economic disruptions. These conflicts serve as stark reminders of the intertwined fates of economies and human lives. From the Cold War's arms races to the current technological rivalries, the economic consequences of ideological confrontations remain palpable. The advent of technological warfare, marked by cyber-attacks, only deepens the complexity of these conflicts.

In addition to the economic repercussions, conflicts unleash inflationary pressures that ripple through capital markets. The resultant unpredictability undermines investor confidence, triggering capital flight and currency depreciation. Yet, the impact extends far beyond the immediate economic fallout. Post-war reconstruction efforts not only require substantial resources but also reshape entire production landscapes, affecting the lives of those involved.

In navigating this intricate web of economic, geopolitical, and technological factors, a nuanced and globally aware approach to investment decisions becomes imperative. However, this awareness must transcend mere economic considerations. Responsible investment demands a compassionate acknowledgment of the humanitarian impacts of conflicts. In this uncertain world, where wars threaten not only economic stability but the very essence of human dignity, a call for responsible investment rings louder than ever. It beckons us to consider the broader implications of our financial choices, urging a commitment to investments that uphold and prioritize human rights, fostering a world where economic stability coexists with empathy and compassion.

Another inflationary force that has played a prominent role in this current regime change is the significant role of monetary and fiscal policy.

Policy—rates & money

Policy

The significant monetary tightening witnessed in 2023, both in scope and speed, stands out historically. Over the past century, almost every instance of monetary tightening has been trailed by a recession. Despite this, persistently high inflation rates during central banks' tightening indicated underlying economic strength, especially fuelled by tight labour and consumer markets.

Our current perspective suggests that the fiscal stimulus supporting businesses and consumers since the pandemic is reaching its limits. Drawing on the theory that it takes time for monetary policy to impact an economy, this leaves us with the essential questions of 'how long' and 'to what extent.' For both answers, we use our macroeconomic framework and scenario planning outlined in Chapter 4.

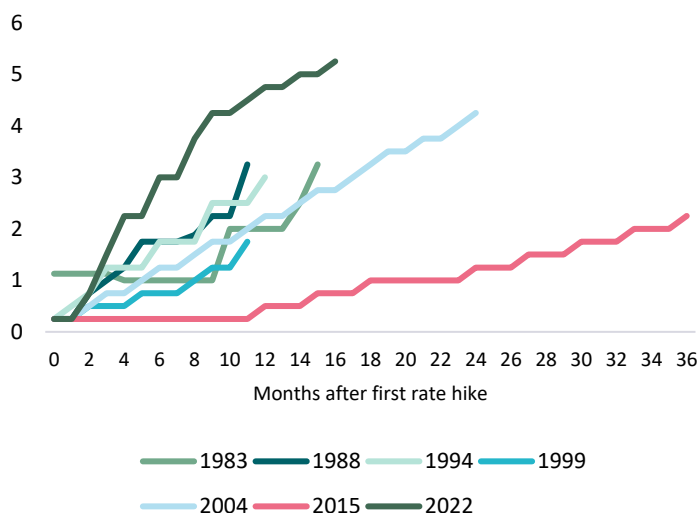
Rates

Regarding interest rates, the US Federal Reserve Bank (Fed) and the European Central Bank (ECB), among others, have been explicit in stating that rates will need to stay 'higher for longer.' The associated credit tightening, supported by fiscal stimulus, is expected to hurt economic growth. The long-term outlook for interest rates hinges on growth and inflation.

Ideally, nominal interest rates should align with nominal economic growth. If rates persistently outpace economic growth, an ensuing economic contraction becomes a deflationary force, pushing rates back down, and vice versa.

Monetary policy tightening through history

Changes in the federal funds target rate in past tightening cycles (%)



Source: Federal Reserve, Anthos Fund & Asset Management research, 31 December 1079 to 30 November 2023.

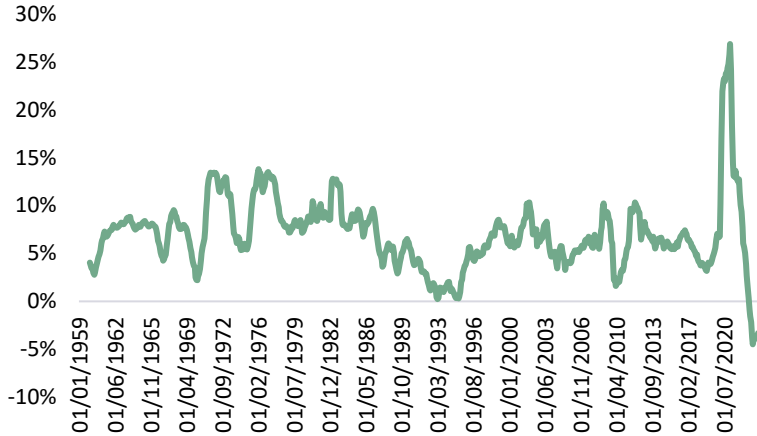
Money

Last year, we highlighted that the surplus savings from consumers and corporations implied an excess supply of money available for investment, with limited demand for capital. The quantitative theory of money asserts a direct link between the money supply and price levels. If a government or central bank increases the money supply at a rate surpassing real output (GDP) growth, it could lead to inflation. According to this theory, controlling the money supply growth is crucial for

inflation control. A stable and predictable money supply growth rate is needed to maintain price stability and avoid excessive inflation. However, the combination of fiscal spending post-pandemic followed by aggressive tightening has been anything but stable and predictable; prompting concerns that the shrinkage of the US money supply could be seen as a leading indicator for a recession.

US money supply is shrinking

M2 Money Supply, percent change from one year ago



Source: Federal Reserve, Anthos Fund & Asset Management research, 1 January 1959 to 31 October 2023.

Summary

Slowing global growth prospects, structurally higher inflation, and sharper shocks are all characteristics of a world that is in transition on multiple fronts—from energy to technological, to geopolitical, to policy. All the while, a macroeconomic shift is underway as we move from secular stagnation to a future of state-sponsored capitalism. Along the way, we are realising that transitions are difficult and uncomfortable, so we should expect more frequent shocks, volatility, and state intervention in the coming years. The need for active management and diversified investment strategies is warranted to weather these complexities.

China's economic slowdown

"Just as polishing makes jade finer, adversity makes one stronger"

China's emergence from the COVID-19 lockdowns had initially sparked optimism that it would propel the global economy. However, a series of disappointing economic data points and a couple of poor quarters of performance took many investors by surprise. Here, we investigate two key reasons behind China's less-than-anticipated recovery.

Firstly, it is essential to recognise that China faced imbalances in its economy even before the pandemic. Trade tensions and regulatory tightening in previous years had already strained its economic growth. Secondly, China's response to the COVID-19 crisis differed significantly from other countries. While most nations focused on supporting households with cash handouts, China concentrated on maintaining production and exports, neglecting direct cash support to citizens. Simultaneously, the government intensified its regulatory measures, particularly in the tech and housing sectors. The economic outlook is shaped by three key factors: the strength of consumption recovery, government policy responses, and the external economic environment. While China's external demand is expected to remain relatively stable, the prospects for a robust domestic recovery hinge on government policy decisions. The Chinese government's approach to stimulating the economy is expected to be moderate, which might not be sufficient to restore confidence fully.

China's economic landscape is multifaceted, with different sectors experiencing varying levels of success. State-owned enterprises have seen stronger investment growth, while private companies have struggled. Sectors like services and restaurants, initially impacted by COVID-19, are gradually recovering, but the property sector continues to face challenges.

One alarming issue is the high youth unemployment rate, which is 20% particularly among those aged 16 to 24 (double 2019's rate). This is driven by cyclical and structural factors, such as young people typically being employed in services (cyclical) and changes in educational focus and a mismatch between graduates' skills and labour market demands (graduates want to go into new-age tech; not semiconductor engineering and property – structural).

The property sector, being the largest in the Chinese economy, plays a pivotal role. Its decline, if not properly managed, can significantly impact the broader economy. Although the sector is expected to continue to drag on GDP growth, it may not be as severe as in the previous year.

Investor sentiment varies between onshore and offshore investors. While onshore investors are cautiously optimistic, offshore investors have become increasingly bearish. This divergence reflects the uncertainty surrounding China's economic recovery. When it comes to policy responses, monetary policy is expected to lead the way with further interest rate cuts. Fiscal policy faces more significant hurdles, with limited fiscal resources available. The property sector's focus is risk management, and other sector-specific regulations might continue to evolve.

While China's growth prospects look uncertain, government priorities have shifted towards security, which may necessitate slower economic growth. China's policymakers are now facing trade-offs between achieving their longer-term policy goals and sustaining short-term economic growth. Security in various aspects, including food, energy, and data, has taken precedence over rapid economic expansion.

Ultimately, the Chinese government's choice to prioritise security over growth will shape China's medium-term outlook. The shift in policy objectives requires investors to reassess their expectations and adapt to a new framework for understanding China's economic trajectory.

4. Secular investment outlook

This chapter introduces our investment outlook for 2024–2025, whilst touching on longer-term secular themes we are enthused about. We provide the top-down view from our client portfolio managers before delving into the current thinking from each of our asset class teams. We consider the outlook, including risks and opportunities, implementation strategies, and investment ideas.

All-weather portfolios for a world in transition

In an environment marked by prolonged higher interest rates and economic contraction, we anticipate favourable performance from various fixed-income categories. Investors are inclined to secure higher rates, a feat achievable through high-quality assets. Furthermore, with Europe already experiencing a recession and through its revaluation cycle, private real estate emerges as an appealing asset class. The prospect of higher income, coupled with lower valuations, adds to its allure. Absolute return strategies provide investors with an avenue for diversification and uncorrelated return streams across niche strategies in this economic environment. Maintaining a cautious yet optimistic stance, private equity remains on our radar, especially when investments exhibit low leverage and are part of mid-market buyouts, steering clear of venture and higher-risk strategies.

Notably, growth markets may face challenges in a contractionary setting. Listed equities and infrastructure are susceptible to higher interest rates and increased borrowing costs, making project finance more expensive. Investors in these sectors should consider hedging and seek managers with robust defensive strategies. Looking ahead, a mild contraction could create attractive entry points for longer-term growth opportunities as a new cycle begins.

Equities—Eyes on the long-term prize

Looking back at 2023, equity markets were carried by a small and mighty set of companies called ‘the Magnificent Seven’ (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla). If and when the market enjoys a more dovish interest rate environment, the expectation is that market breadth will return beyond these seven stocks.

Looking forward to 2024, we approach the challenges with a blend of caution and optimism. The imminent impact of aggressive monetary tightening raises concerns about the impact it may have on economic growth and consumer spending. Capex plans are impacted by higher financing and input costs. The economic headwinds may lead to a potential recession, and forecasts are not in agreement on either a soft landing or a hard landing. The uncertainty is palpable, especially against the backdrop of geopolitical risks and an impending election year.

China's positive turn in sentiment thanks to reopening after Covid proved to be short-lived. Policymakers have to deal with several challenges such as a fragile property market, rise of geopolitical tensions (especially China–US), and youth unemployment. We believe that the ensuing vacuum presents opportunities for other Asian countries. The deglobalisation trend, including discussions around re-shoring and friend-shoring, suggests a potential shift in manufacturing capacities. The next factory for tech giants like Apple might not be in China but in India, Vietnam, Mexico, or Japan. Globally, infrastructure development, particularly in the energy transition and sustainable real estate, technological innovation and adoption including significant growth in AI, emerges as a beacon of opportunity.

Navigating through these dynamics requires a keen eye on macro trends and potential upcoming changes in monetary and fiscal policies. While risks persist, we maintain a confident stance that companies with strong sustainability credentials aligned with long-term priorities will outperform. Our strategic approach involves rigorous manager selection and due diligence, focusing on strategies that not only promise ambitious financial returns but also align with the transformative trends in manufacturing, energy transition, and AI.

Our strategy in the short term is grounded in practical considerations. We expect the US monetary cycle is close to its peak but the outlook beyond that peak is far from clear. We expect interest rates to drop in 2024 but are conservative on the magnitude of this decline. In this uncertain environment, where the risk of a (severe) recession is still present, companies with a high-quality profile that command low leverage should prove more resilient.

We advocate for a shift towards the stability of developed markets, prioritising companies with solid cashflows, EPS protection, and a low leverage profile. This defensive stance aligns with our acknowledgment of the heightened risks in the current environment.

As we look further into the future, we see opportunities for a more optimistic turn. Potentially, a new 'Goldilocks scenario' could emerge, characterised by higher inflation and interest rates but that are lower than today. We believe this backdrop will shape a compelling narrative for global equities, especially for the types of companies we tend to invest in. High-quality sustainable companies, with a strong moat, should be able to grow their revenues (and dividends) alongside the real growth of the economy. The risk to this more benign scenario is more persistent or even higher inflation that could keep central banks on the hook for much longer.

As most central banks in the world are at or close to the peak of a hiking cycle, there's one country which hasn't even started: Japan. After three decades of very low-interest rates and absent inflation, the Japanese economy was confronted with significant price increases in 2023. This has triggered many market participants, including us to revisit the Japan case. In 2024, all eyes will be on the Bank of Japan. Will they exit their extremely dovish monetary policy? If and when they do, this could have far-reaching consequences for the Japanese economy and may lead to a repricing of Japanese assets.

Bonds—Back in the game

Nominal yields have surged to pre-2008 levels, offering real yields at decade highs. Our 2024 outlook anticipates a potential recession and interest rate movements, favouring longer duration positions. Foreseeing falling interest rates, we expect longer-duration bonds to rally more, allowing investors to capitalise on immediate capital gains.

Caution is warranted with spreads due to already rich valuations. The current level of valuations suggests that the potential return for taking on credit risk may be limited, given the current pricing levels. While high yield spreads offer a nice carry over the long-term, the current richness may limit their ability to serve as an additional driver of price appreciation.. This caution is especially relevant in the face of possible economic downturns, which could lead to increased volatility and impact the performance of fixed-income assets. Therefore, we are adopting a vigilant approach to assessing spread valuations in 2024.

While we prioritise time in the markets over timing the markets, we anticipate tactical opportunities to adjust allocations should the macro environment take a turn for the worse. In such scenarios, high-quality credit becomes increasingly attractive. Our recent selection process has focused on identifying managers and strategies best positioned to capitalise on the conditions we expect in 2024.

We are particularly enthused by the growing number of strategies and managers incorporating responsible investment into their approach in sophisticated ways. For instance, in Europe, the constructive regulatory backdrop, including initiatives linked to the Green New Deal, Paris Agreement, and more, has paved the way for fixed-income solutions that meaningfully factor in environmental, social, and governance (ESG) considerations. . Should the next market cycle begin in 2024 and a deep recession is avoided, we expect revitalised demand for responsible solutions such as these, supporting related fixed-income assets.

Caution and active selection should be exercised when considering emerging market debt instruments in the short term. China's structural problems, coupled with exceedingly high debt levels amid higher-for-longer interest rate expectations, could challenge the space. Longer-term, however, we believe the fundamentals are strong for emerging markets and expect positive returns for investors who include sovereign debt in their strategic asset allocations.

Actively managing such allocations can provide much-needed stability in portfolios for 2024 and beyond. In conclusion, bonds are increasingly becoming an attractive addition to portfolios – they are back in the game.

Real estate—New cycle incoming

In the realm of global real estate, the past five quarters have marked a challenging correction period. European real estate has felt the pain, having started its revaluations earlier than the US for example. As we navigate through this phase, the question is not whether sentiment will improve, but when.

The Asian landscape exhibits a clear and robust dichotomy. On one front, we witness persistent and impressive strides, particularly in Japan, South Korea, and Singapore, where market performance continues to shine. Conversely, a recalibration is underway in China and Hong Kong, as markets undergo a reassessment. Ongoing uncertainties within the domestic economy, exacerbated by an impending housing crisis, pose hurdles to consumer spending. This, coupled with the outward flow of international capital, compounds the complexities of the real estate investment market, presenting formidable challenges. Our overall stance on the Asia Pacific region remains optimistic, albeit discerningly so, focusing our positivity on selectively mature markets with proven resilience and stability.

In the short term, the trajectory hinges on macroeconomic factors. If growth persists and interest rates remain around 4%, real estate could display resilience, thanks to robust underlying cashflows and income growth. Conversely, a weakened macroeconomic backdrop and falling inflation could lead to lower interest rates, potentially enhancing the attractiveness of quality real estate. Despite potential refinancing challenges, our outlook for the asset class anticipates improvement from the first half of 2024.

Dynamics in the global real estate market vary across regions. Europe sees stabilized logistics sector cap rates, contrasting with expanding residential cap rates. Housing shortages in key cities underscore a persistent demand for

residential properties. The residential sector, driven by demographics, and the industrial sector, driven by the ongoing effects of digitalisation, remain high-conviction strategies, given these supply and demand dynamics.

On the flip side, the office sector confronts uncertainties linked to remote work and outdated spaces, particularly those lacking green credentials. Repricing continues, especially in offices, raising global concerns, particularly in regions with low return-to-office numbers like the US, Europe, and Australia.

Implementation strategies to consider include:

- **Sectors:** Investors might consider a cautious stance in the repricing office sector, particularly in regions with low return-to-office rates. Conversely, the residential and industrial sectors present long-term opportunities, buoyed by housing shortages and demographics-led demand.
- **Refinancing challenges and market dynamics:** Anticipated refinancing challenges may impact high-risk funds, necessitating additional securities. Simultaneously, expectations for further cap rate movements underscore the need for a balanced approach to cap rates and financing rates.
- **Global variations:** The real estate market unfolds as a dynamic landscape with varied trends in Europe, the US, and APAC. Sensitivity to interest rate shifts and economic stability demands nuanced strategies across regions.
- **Alternatives and nuances:** Real estate credit strategies have opened up as a significant opportunity in the current climate of high rates and tighter lending standards pushing alternative financing into the limelight. We suggest exploring uncorrelated alternatives, such as medical offices, senior housing, and self-storage, particularly in the US. Meanwhile, caution prevails regarding offices and retail due to structural oversupply, with nuanced considerations for the ongoing strength in Asia.

Absolute return strategies—Harnessing alternative sources of return

In the pursuit of absolute return strategies, the focus remains on harnessing alternative sources of return irrespective of the direction of risk markets. The overarching goal is to achieve steady positive absolute returns over the long term with limited volatility and without correlation to equity and fixed income markets. This commitment leads to a diversified investment portfolio spanning unique strategies across a multitude of asset classes, sectors, regions, and securities.

In 2023, traditional investments in equities and fixed-income markets offered rewards, but they also brought significant volatility. In contrast, absolute return strategies continued to showcase low-risk return profile with low correlation to other asset classes resulting in a more balanced overall portfolio for clients.

Looking ahead to 2024, the macro environment is anticipated to feature structurally higher inflation and challenged economic growth. Factors such as deglobalisation, climate policies, tight labour markets, restricted energy supply, and geopolitical tensions contribute to the ongoing spectre of inflation. This presents an opportunity for absolute return strategies to demonstrate their advantages to long-term investors. In addition, the portfolio is directly benefitting from the higher-yielding environment through innovative and niche means, showcasing the resilience of this strategy in navigating diverse market dynamics.

In the short and medium term, attractive opportunities include strategies such as specialty finance, risk transfer strategies, mortgage servicing rights, and opportunistic private credit which exhibit low sensitivity to equity markets and represent

strong idiosyncratic, yield-oriented returns. Other areas of focus include discretionary global macro where the opportunity set appears broad and diverse. For the longer term, a focus on value centres around the energy transition and the digital asset ecosystem (DAE) appears promising as the global landscape continues to evolve.

A distinctive feature of the absolute return strategy is the intentional effort to mitigate the portfolio's vulnerability to fluctuations in risk markets and interest rates. Strategic positioning is fundamental to expecting sustained performance across diverse economic scenarios, reinforcing the commitment to delivering reliable returns. Risk management and unique avenues for investment are guided by a pursuit of uncorrelated opportunities with low market beta. Viewing this as grounds to take caution, we believe that unique investment avenues, characterised by minimal cross-correlations, are strategically positioned to withstand market volatility and consistently deliver returns.

As we prepare to navigate the complexities of the market environment leading into 2024, absolute return strategies position themselves to adapt to evolving market conditions. The focus remains steadfast on delivering steady growth with limited volatility, drawing on a diverse range of strategies, supported by a deep understanding of market dynamics. The emphasis on uncorrelated opportunities and risk management reflects our dedication to providing reliable returns for investors.

Multi-asset impact—Moving the needle

Impact investing is imperative, especially in the tumultuous environment of 2023, marked by the return of conflict in the Middle East, humanitarian devastation, heightened geopolitical tensions, and the escalating impacts of climate change. In this challenging landscape, moving the needle of impact investment demands prudent management. As portfolio managers, our current approach involves a thorough assessment of emerging vulnerabilities amid the ongoing impacts of interest rate hikes.

Recognizing potential challenges, we strategically adjust our exposure by reducing public equity and diversifying fixed-income exposure as well as through private credit. In equities, we note weakness in earnings, anticipating more challenges as rates remain high. Meanwhile, fixed-income assets benefit from higher yields and increased demand for alternative credit options due to tightened bank lending. These strategic asset allocation decisions are pivotal in our recession-prepared strategy.

For the foreseeable future, we step back from venture capital, having reached our maximum allocation for impactful funds. In the short term, capital vintages in this space navigate the J curve, poised for success as the market turns positive. Other risk mitigation measures include private debt funds exploring alternative exit strategies and debt restructuring to extend cash runways.

Our commitment extends beyond risk mitigation; we strategically position our portfolio to navigate challenges and seize opportunities. Aligning investments with impactful themes and regions, our aim transcends financial returns to effect positive changes where solutions are most needed. Amid these considerations, the focus on African infrastructure emerges as a pivotal opportunity for socio-economic progress, addressing challenges of limited access to services and environmental concerns. This includes robust infrastructure in renewable energy, digital infrastructure, and logistics, fostering sustainable inclusive growth—all while earning a market-rate return that differs from investing in listed markets, adding diversification benefits.

Looking ahead, our secular outlook aligns with structurally higher inflation, current peaked interest rates, and cautious optimism for muted global growth. With the negative interest rate environment behind us, fundamental analysis regains prominence in investment selection. Emerging markets, particularly in Asia, are viewed as better positioned for growth than developed markets, with recent due diligence trips reinforcing our confidence.

India, with its advantageous position in trade and as an open democracy, stands to gain from global dynamics. Our strong conviction in India's growth prospects is reflected in our deliberate exposure, grounded in fundamentals. In India, we have our sole single-country fund investment, and our commitment is exemplified by a private debt fund fully hedged to USD, focusing on SMEs, agriculture, vehicle, and microcredit finance to foster access to finance. This strategic approach ensures our portfolio remains resilient, impactful, and well-positioned in the face of evolving global challenges.

Private equity—Steady in the middle

Private equity is in the midst of significant changes influenced by altered market sentiments, financial shifts, and revised outlooks, deeply impacting investment strategies and portfolio management.

Expensive financing has halted the mega buyout rally, affecting venture companies and large-cap buyers due to increased interest rates. Complications arise in finding IPO-reliant buyers in a constricted market, especially impacting mid-market companies in software, retail, and consumer products facing challenges in refinancing, pricing, supply chain disruptions, and valuation comparability.

The mid-market, however, displays more resilience against higher interest rates, emphasizing value addition through operational improvements, mergers and acquisitions, and professionalization. Diversification of exit routes beyond IPOs showcases adaptability within this segment.

Extended holding periods are expected, underscoring the significance of manager selection, amidst a potentially slower investment pace due to limited low-cost capital. The distinction between top-quartile managers and others might impact the Internal Rate of Return (IRR) due to extended holding periods and potential losses on secondary transactions. Private equity strategies are evolving, focusing on mid-market growth, sustainable trends, restrained leverage, and hands-on value creation. Buyout strategies concentrate on operational improvements, distressed debt investment provides opportunities during downturns, while special situations seek above-average returns through complex opportunities.

5. Macroeconomic scenarios

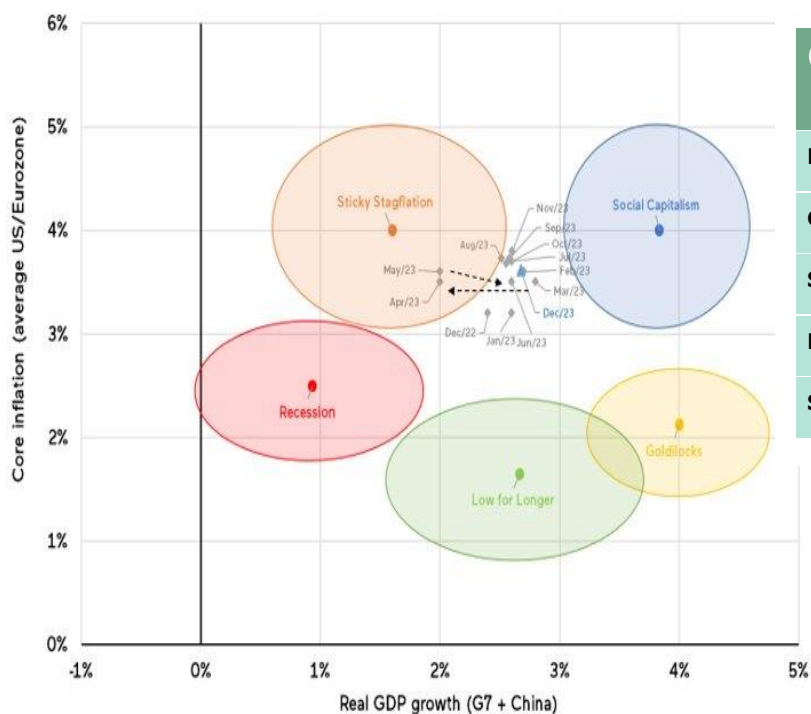
While the previous sections focused on the secular 5-10-year horizon, this section looks at the shorter-term cyclical horizon (2024-2025) and introduces our macroeconomic scenario framework.

After two decades of below-target inflation, it will be structurally higher in the coming years. The speed with which this economic regime change will take place will determine where we are in the context of our macroeconomic scenario framework. Also, within any fundamental regime change, the room for policy errors is large, and such potential errors are important swing factors for moving from one macro scenario to the other.

Given the level of monetary policy tightening in 2023, we expect inflation to continue declining from its peak and for economic growth to weaken in both the US and Europe in 2024 (Recession, 40%). If central banks begin their cutting cycles too early before inflation comes under control, this could result in sticker inflation driven by the six Ds we outlined above (Sticky Stagflation, 30%). Should the Fed achieve a soft landing, or there is only a mild and short-lived contraction, this could quickly give way to a new cycle characterised by capex cycles related to the energy transition and AI (New Goldilocks, 15%). We note that the aggregate probability for these three scenarios: Recession, Sticky Stagflation, and New Goldilocks is significant at 85%. With 2024 an election year, we expect fiscal policies and state intervention to be less prominent though the rhetoric will be loud and will give signals as to what to expect in the coming years (Social capitalism, 15%). Finally, amidst stickier inflation and the expectation that interest rates will be 'higher for longer,' we have assigned a low probability to the 'Low for Longer' scenario (5%). We have removed this low category from our capital market assumptions (CMAs) due to the low probability, however we do not take it off the table completely. Should central banks have tightened too aggressively, and a recession ensues or we see a considerable trend toward disinflation, we could return to such an environment. We therefore keep it as part of our macroeconomic scenario framework for 2024-2025.

Below we outline our macroeconomic scenario framework and describe the individual scenarios in more detail. We also provide our estimates of their likelihood of occurring over the next two years: 2024-2025.

Macroeconomic scenario framework for 2024-2025



(%)	AIO 2024	AIO 2023	AIO 2022
Low for longer	5	15	30
Goldilocks	15	5	30
Social capitalism	10	20	20
Recession	40	30	25
Sticky stagflation	30	30	5

Source: Anthos Fund & Asset Management, Coloured dots show scenario outcomes for 2024-2025. Grey diamond shows the latest realized outcomes. Dark blue triangle shows the Bloomberg Consensus forecast for growth & inflation over the next two years (2023-2024).

Recession (40% likelihood)

- Historically, 8/9 times the Fed triggered a recession while trying to fix inflation through monetary tightening regimes. The only soft landing recorded was in 1994, and those conditions were far milder than today’s.⁴
- The historic speed at which the Fed raised interest rates (from 0 to 5.5% in 12 months) sends the economy into recession with an approximate 12-month lag time.
- The worst-case scenario sees a deep and broad global recession, where GDP declines, with an escalation in geopolitical tensions from any number of plausible places—Ukraine/Russia, Israel/Palestine, China/Taiwan/US causing restrictive trade and disruptions in food and energy supplies. This results in a fresh wave of inflation spikes, consumer and business sentiment are marred by high costs, rising unemployment levels, and the credit cycle contracts meaningfully leading to higher default levels and bankruptcies reaching 8-10% (like they did in the financial crisis).
- The best-case scenario sees a technical recession with a ‘spring clean’ of defaults and bankruptcies (4-5%), inflation comes under control, geopolitical tensions contained, and positive centralist election news across the board suggesting a renewed sense of state-sponsored capitalism as the way forward.
- Amidst a plethora of contrasting challenges, the room for policy error is great. Both with the pandemic and when Russia invaded Ukraine, we saw how “quickly and completely” policymakers change their priorities in times of stress, so the same should be expected should there be significant geopolitical escalations.

⁴ <https://www.vox.com/policy-and-politics/2022/12/15/23508155/federal-reserve-inflation-recession-soft-landing>

- Should the worst-case recession scenario materialise, the Fed, and other ally central banks, may decide to slash interest rates to enable cheaper borrowing to finance capex for defence, and to keep economies from falling into a deep and long-lived recession. They would do this at the risk of allowing inflation to 'run hot,' which it likely would in times when interconnected global supply chains are disrupted by tensions.⁵ What's more, countries in conflict do not trade with each other, so inflation spikes could spill over from energy and food to other sectors—leading to more entrenched inflation.
- The landscape in which fiscal policy operates shifts abruptly in this worst-case scenario. Fiscal policy needs to tackle the effects of the war while navigating an environment of rising inflation and interest rates, slower economic growth, and high debt and borrowing costs that make budget constraints increasingly binding. If monetary policy loosens, governments may decide to do what they did during the pandemic and allow their debt to surge to incredible levels. The lower interest rates in advanced economies may positively impact emerging economies that borrow from the US and that are not involved in the conflict in the short term. This bright spot may be short-lived, however, if energy and food inflation become untenable for net-import emerging economies. The long-term outcome will be yet deeper divergence between advanced and emerging economies with significant implications for tackling longer-term systemic issues like poverty reduction and averting climate change.
- A rosier outcome in this scenario sees no need for central banks to reverse their scheduled and data-driven monetary policy campaigns. With geopolitical tensions taught, but reined in, the Fed and others keep rates higher for longer before starting to cut rates mid-way through 2024 as planned. With plenty of forewarning, growth declines modestly which results in some defaults and bankruptcies (see capital markets section below). Inflation comes down to the target range of 2%, which has a net positive impact on the economy as it sends a signal of credibility that monetary policy is effective at doing its job.
- In this scenario, fiscal policy exercises restraint so as not to induce inflation again. Policies focus on the most vulnerable, helping them cope with covering costs, but support is across the board dialled back as governments focus on reducing debt deficits, working in step with monetary policy to avoid further risks to financial stability. As the recession is mild, fiscal planning and promises form a key part of political election campaign rhetoric with populists advocating for loose and liberals for disciplined regimes moving forward.
- Whether it be the worst, or best-case recession scenario that materialises, the underpinning themes coming into this scenario are the same. Namely, the impact of higher for longer interest rates, companies' ability to finance debt, and the resultant impact on economic sentiment.
- Higher for longer interest rates and debt financing: With interest rates to stay higher for longer, the cost of debt becomes untenable for companies that borrowed at low, fixed interest rates during the pandemic, but that now must re-finance maturing debt or have borrowed at floating rates of interest. UBS estimates the value of outstanding US leveraged loans at around \$1.4trn and the assets managed by private credit lenders at more than \$1.5trn. According to the Fitch ratings agency, defaults rose to 3% in the 12 months to July, up from 1% a year ago, and expects they could rise to 4.5% in 2024—restructurings and bankruptcies on this scale are more of a spring cleaning than the debt distress during the financial crisis when loan defaults exceeded 10%. However, if rates stay higher for longer, or if our worst-case recession scenario evolves, the tally of troubled firms could grow. To what extent depends on the depth and breadth of the recession.
- Although all companies with unhedged floating-rate debt balances are vulnerable, those loaded with debt in private-equity buy-outs at high valuations during the recent deal boom are especially at risk.

⁵ Yardeni Research, *Fed Watching for Fun & Profit*, 2020.

- As the recession slows profit growth, borrowers can't afford their floating-rate debt. Those companies that tapped high-yield bond markets rather than solely relying on leveraged loans fare better than those that did not. Private debt markets also suffer from default rates, with opacity in the market dampening investor sentiment resulting in spillover into the leveraged-loan market.
- The relevance of the role of private markets in the impending credit crunch can be seen in the increased scrutiny from regulators in 2023: in August America's Securities and Exchange Commission announced rules to increase transparency, including demanding quarterly financial statements. The following month, the International Organisation of Securities Commissions, a global regulatory body, warned about the risks of leverage and the opacity of private debt markets.⁶
 - Flight to 'safe-haven' assets sees US Treasuries, the US dollar, and gold outperform risk assets which decline in line with the level of exposure to conflicts. European and Asian currencies suffer due to the vulnerability of oil markets should the Middle East crisis become regional, for example. Over-leveraged companies and assets face defaults, then again if monetary policy loosens then re-financing debt sees a brief respite for these assets. Investments linked to real, high-quality assets and non-cyclical sectors outperform and can even provide an income-based buffer during hard times. Strategic sectors like defence, energy, and technology outperform.

Stagflation (30% likelihood)

- Amid continued tighter monetary conditions to rein in inflation, 2024 sees a tepid recovery in economic growth. Tighter financial conditions and lack of external demand weigh on emerging and developing markets. Inflation is persistent but is projected to decline gradually as demand weakens and commodity prices moderate, provided longer-term inflation expectations remain anchored.⁷
- Sticky supply-side issues continue to keep the longer-term drivers of inflation in place, despite the more transient drivers coming down as a result of tight monetary policy. There are three areas of continued supply constraints: wages (mostly in the US), housing (mostly in the US, but also in other parts of the world), and commodities (with oil & gas supply constraints mostly in Europe). Also, the new economic world order described above adds to the inflationary pressures in this scenario (deglobalisation).
- US labour market/wage growth is the main driver of core inflation. Unemployment will need to rise a lot (to 6.5%) to slow down wage growth and, historically, the average lead time from a decline in labour markets to lower wage growth is about two years. However, vacancies/job openings will need to be removed before unemployment starts increasing. This means that the labour market will remain tight for longer.
- Consumer sentiment suffers from higher unemployment, prices, and real estate assets. Households experience reduced purchasing power and uncertainty about the future. Student loan refinancing and life insurance claims become painful realities. Politicians take advantage of the pain in their election campaigns, leading to a rise in populist sentiment.
- Geopolitical tensions and OPEC policy lead to a firming of commodity prices. Depending on the extent to which OPEC countries get involved in any conflict, the price of oil could rise to significant heights in a worst-case scenario which would cause greater economic disruption and send the economy into a recession scenario (see above). If contained, then higher oil prices could keep inflation elevated for longer, leading policymakers in a difficult balancing act as the economy stumbles along.

⁶ <https://www.economist.com/finance-and-economics/2023/10/12/corporate-america-faces-a-trillion-dollar-debt-reckoning>

⁷ World Bank Group, June 2023.

- As Fed Reserve Bank of St. Louis's James Bullard assesses, monetary policy has not been sufficiently restrictive to bring down record levels of inflation; the Fed and ECB have been behind the curve throughout their campaigns—aggressive as they were deemed to be.⁸
- Last year, we wrote: *Initially, the Fed pauses (or even reverses) their current tightening cycle while the ECB remains well behind the curve (too little too late). This causes stagflation to be sustained for longer and requires a second tightening cycle to bring inflation back into their tolerance zone. This second tightening cycle is not priced in financial markets, so both bonds and risky assets will struggle in this scenario (repeat of H1 2022)*". If it is true that monetary policy has not been restrictive enough, then we could see a second tightening cycle described in the above.
- Governments try to use fiscal stimulus to assuage the damage in certain consumer and business segments, whilst central banks keep rates higher for longer to counteract the high inflation.
- Due to political instability, food & energy supply/demand imbalances, and the risk of policy errors, financial market volatility and liquidity continue to create a challenging market environment in this Sticky Stagflation scenario. Risk premia should be structurally higher than the pre-pandemic period.
- Asset allocation: with core inflation at 4% and US nominal bond yields at or above 5%, the stock-bond correlation is likely to continue rising into positive territory: equities and bonds sell-off at the same time, and government bonds are not (yet) a reliable hedge for exposure to risky assets. Diversification will increasingly need to manage risk and choose strategies that don't rely on broad market performance to generate returns.

'New' Goldilocks (15% likelihood)

- If there's one think that the 'New' Goldilocks scenario has that the old one doesn't, it's structurally higher inflation and interest rates (though lower than levels seen in 2023).
- Bucking its record (see Recession scenario), the Fed achieves a soft landing: bringing inflation under control without causing a recession. If one of the main reasons why inflation remained sticky in 2023 had to do with the strength of the labour market, then the logic follows that a weaker labour market helps subdue inflationary pressures. Despite cooling, the US labour market remains strong, with employment at ultra-low levels.
- Moderate growth in the US, more subdued growth in the eurozone where the ECB remains behind the curve.
- Europe has made substantial progress in improving efficiency and reducing energy demand since the first days of the Russia/Ukraine war (World Bank 2023). This helps Europe meet its energy demands this winter, taking away one of the downside risks to growth. Last year, warmer weather and lower natural gas prices helped Europe grow on the back of strong labour markets and robust wage growth. This pushes Europe to grow in 2024, thanks to the downgrade in energy price projections and better-than-expected data. After bottoming in 2023, Europe achieved X% growth, supported by reforms and investments funded by the Recovery and Resilience Facility.
- China posts better-than-expected growth, helped by the considerable policy space enjoyed by its government. The recovery driven by services is largely disinflationary in nature, prompting positive spillover effects to other regions as trade policies become less restrictive and more open and connected.
- Geopolitical risks are contained, with the US and China reaching a high-level agreement, a new communiqué, in which Washington reiterates its longstanding political neutrality and China commits to dialling back its military threats.

⁸ Has monetary policy been sufficiently restrictive? Fed Reserve Bank of St. Louis's James Bullard uses the "Taylor" monetary policy rule to show current monetary policy is at the low end of what is arguably restrictive given current macroeconomic conditions (as at June 2023). <https://www.stlouisfed.org/publications/regional-economist/2023/june/is-monetary-policy-sufficiently-restrictive>

- Positive election results prompt governments to switch rhetoric from protection to collaboration to stoke mutually beneficial sustainable growth, and to tackle systemic issues of poverty reduction and climate change now that inflation is brought within the target range (shifting priorities amidst shifting regimes; see Social Capitalism scenario).
- Monetary policy and fiscal policies are data-dependant, benign, and disciplined. The Fed continues to loosen rates, while governments dial back support as the economy removes its stabilisers. New announcements and promises to re-focus budgets on longer-term sustainable growth now that the primary remit of keeping inflation on target, and the labour market strong are successfully met.
- The US economy sees better-than-expected growth, with the Fed embarking on its monetary loosening regime, prompting positive sentiment in corporate America and a rise in M&A action and consumer sentiment. Many of the deals on the sidelines materialise as uncertainty is removed.
- Particular hunger for AI and technology sectors spurs acceleration in capex towards R&D, and a fresh wave of private capital towards innovative businesses and ideas, like the venture capital surge post-second world war.
- Growth expectations rise, prompting a selloff in T-bills and a broad-based market recovery in stock markets and other assets. The resilience of economic activity in the face of substantial headwinds thus far point to the risks that prospects for major economies may be stronger than currently estimated.
- Non-USD risk assets such as EM and European equities can outperform the US, and global risk premia (credit spreads) narrow further. Market volatility remains low on average but with occasional spikes driven by investor sentiment.

Social capitalism (10% likelihood)

- For years, we have argued that the global economy is gradually transitioning from secular stagnation to 'state-sponsored capitalism' where the '(in)visible hand of big government' increasingly influences economies, arguing of the need to tackle systemic global issues like inequality and climate change. This shift could see opposing circumstances play out: one positive, where global cooperation achieves common goals, and one negative, seeing re-nationalisation of policies and protectionist populism leading to distrust, disputes and even destruction. Our social capitalism scenario includes elements of both these opposing circumstances, with the focus on the role of greater fiscal dominance and how that plays out in markets.
- Politicians become more aggressive in fiscal/income policies, tax policies, financial regulation, and environmental regulation. While fiscal stimulus promotes growth in the short run, income redistribution policies ultimately depress economic growth, capital spending, and corporate aggression.
- It is arguable that the fiscal stimulus measures post-pandemic in Western economies masked the true state of the economy. Continuation of this scenario means further delays, and further asset price inflation, but no inflation in the real economy.
- Populism provokes fiscal policy stimulus: nationalist agendas promote inward-looking strategies. Governments keen to demonstrate economic growth, yet unable to use monetary tools to stimulate the economy, continue to engage in aggressive fiscal spending, among others to support the energy transition to counter climate change. Austerity is out, larger deficits are in, and more payments are likely to be direct.
- This scenario combines higher short-term economic growth with high inflation from fiscal spending to support real consumer incomes. Another driver of this fiscal spending is the West dealing with the new economic world order described above: investment is required in three areas: defence, commodities (food & energy), and energy

transition. One common denominator in all these domains (commodity intensity) makes the spending especially inflationary.

- Productivity fails to counterbalance inflation: without the benefits of a positive supply-side shock (more capex leading to higher labour productivity – see ‘Goldilocks’ scenario), labour markets continue to tighten putting further pressure on wages. Combined with higher commodity prices, this leads to higher inflation, staying well above the central bank’s targets.
- Core inflation will settle around 4% in this scenario, which is higher than the current 2022-2023 Social Capitalism scenario because we start at a higher level and tighter product & labour markets. The main difference with the Stagflation scenario is higher economic growth from fiscal stimulus.
- House price boom. Given the tight housing supply, low-interest rates, and the shift to working from home are fuelling housing demand and creating a house price boom in Western economies (more than 7% per year, since the 2008 GFC – BIS data). This adds to both core inflationary pressures (especially in the US where shelter inflation contributes about 30% to core inflation and 40% to headline inflation), as well as a further increase in financial imbalances in the household sector.
- Profit decline puts pressure on balance sheets: Given highly leveraged corporate balance sheets, credit markets start discounting higher corporate defaults and credit spreads widen. This raises the real cost of capital closer to the return on invested capital which, in turn, hurts business investment activity. Although sales growth remains strong on the back of strong nominal GDP growth, rising interest rates, higher wage growth, and higher taxes put pressure on corporate profit margins. Nominal GDP grows faster than nominal profits, which means that the corporate profit share of GDP declines (and employees/wages take a bigger share of the economic pie).
- Corporate & financial market risk appetite declines. Following an initial boom in M&A, share buybacks, and other financial engineering activities, markets started anticipating higher interest rates. This tightens financial conditions and puts pressure on asset valuations.

Low for longer (5%)

- Though implausible, a return to an environment of ‘low for longer’ interest rates could be triggered by an event such as a deep recession or inflation coming back to below trend.
- Despite central banks' best efforts to stimulate economic growth through low interest rates and monetary policy tools, the global economy remains mired in disinflation. A key driver of this phenomenon is the entrance of India into global markets, which unleashes a positive supply shock. India's vast labour force and resources lead to increased production, intensifying competition, and reducing production costs. As a result, consumer prices remain stable or even decline in some regions, causing central banks to struggle to achieve their inflation targets.
- The prolonged disinflationary environment contributes to sluggish economic growth. Reduced consumer demand, stemming from both the aging populations in developed countries and the competition from Indian goods, hampers GDP expansion. Furthermore, demographic trends lead to an older and potentially less productive workforce, further impeding growth prospects.
- The prolonged period of low interest rates and demand for safe assets exacerbates income inequality. Wealthier individuals, who are more likely to hold assets, benefit from the demand for safe assets, while the average wage earner faces stagnant wage growth. This inequality can have social and political implications.
- Central banks are compelled to maintain historically low interest rates for an extended period to combat the disinflationary pressures. The prolonged low-interest-rate environment raises concerns about the effectiveness of

monetary policy. Central banks may explore unconventional policies, such as negative interest rates or more aggressive quantitative easing, to stimulate demand.

- Governments must address the economic consequences of demographic shifts, including increased healthcare and pension costs. This might necessitate changes in fiscal policies, including raising taxes or implementing cost-saving measures. Policymakers may need to work on long-term strategies to ensure sustainability and equity in the face of these challenges.
- The persistent demand for safe assets, driven by investor risk aversion, leads to higher prices and lower yields on government bonds and other low-risk investments. Investors continue to flock to these safe-haven assets as they seek to preserve capital in uncertain economic times.
- The prolonged low-interest-rate environment and heightened demand for safe assets can create potential asset bubbles in certain market segments. Real estate, technology stocks, and other high-yield assets may see valuations soar, potentially leading to concerns about financial stability.
- Investors become increasingly risk-averse due to the uncertainty surrounding the global economic landscape. Traditional investment strategies, which rely on predictable yields from bonds and certain stocks, may no longer perform as expected in this low-inflation, low-interest-rate environment.
- Traditional asset allocation strategies may need to be reevaluated. Investors might explore alternative investments, such as cryptocurrencies, commodities, or emerging markets, to find yield and diversification in this environment. Portfolio managers and financial advisors must adapt to these shifting preferences.
- The scenario presents opportunities for innovation in financial products and investment strategies. New financial instruments designed to navigate the unique challenges of this scenario may emerge. Additionally, businesses may find new avenues for growth by tapping into emerging markets like India, capitalizing on the supply shock.

6. Capital market assumptions

The table below shows our expected returns for the various asset classes that we monitor. We show our capital market assumptions for the 5-year period from 2024-2028, as well as the shorter-term expected return per asset class in each of our macroeconomic scenarios.

Asset Class	Anthos Capital Market Assumptions 2024-2028	Expected Returns in Scenarios EUR unhedged			
		Goldilocks	Social Capitalism	Recession	Sticky Stagflation
Global Developed Equities	6,3%	9,0%	4,5%	-8,0%	-3,0%
EUR Aggregate	3,2%	4,1%	-8,2%	9,5%	-15,7%
Euro Government Bonds - 10yr	3,0%	2,5%	-11,0%	10,1%	-19,2%
US Government Bonds - 10yr	3,1%	-8,4%	-7,2%	18,3%	-9,5%
Euro Asset-Backed Securities	3,2%	4,6%	4,9%	4,6%	5,0%
EUR Investment Grade Corporate	3,8%	7,7%	-1,8%	8,2%	-7,5%
Global High Yield	6,0%	6,7%	1,5%	8,7%	-5,3%
Emerging Market Debt - Local FX	4,3%	4,1%	-1,3%	8,0%	-10,9%
Absolute Return	4,0%	5,0%	6,0%	3,0%	4,0%
Global RE Core+	4,3%	8,8%	2,9%	3,3%	0,2%
Global RE Value Add/Opp	3,5%	10,6%	1,4%	2,4%	-3,5%
Global Listed Infrastructure	6,8%	15,0%	6,0%	-5,0%	2,0%
Private Equity	9,5%	20,0%	10,0%	-7,0%	5,0%
Private Equity Impact	7,0%	17,0%	8,0%	-10,0%	4,0%
Private Credit	9,0%	15,0%	8,0%	2,0%	5,0%
EUR Cash	2,0%	1,5%	1,7%	2,3%	1,3%

Source: Anthos Fund & Asset Management. Anthos Capital Market Assumptions (CMAs) for 2024-2028 assume a USD/EUR return (based on PPP valuation & USDEUR forward premium/ discount) of -1% per annum, applied to the USD sensitivity of relevant market indices. Given the low likelihood of the 'Low for Longer' scenario over the relevant period, we have removed this scenario from our CMA calculations.

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