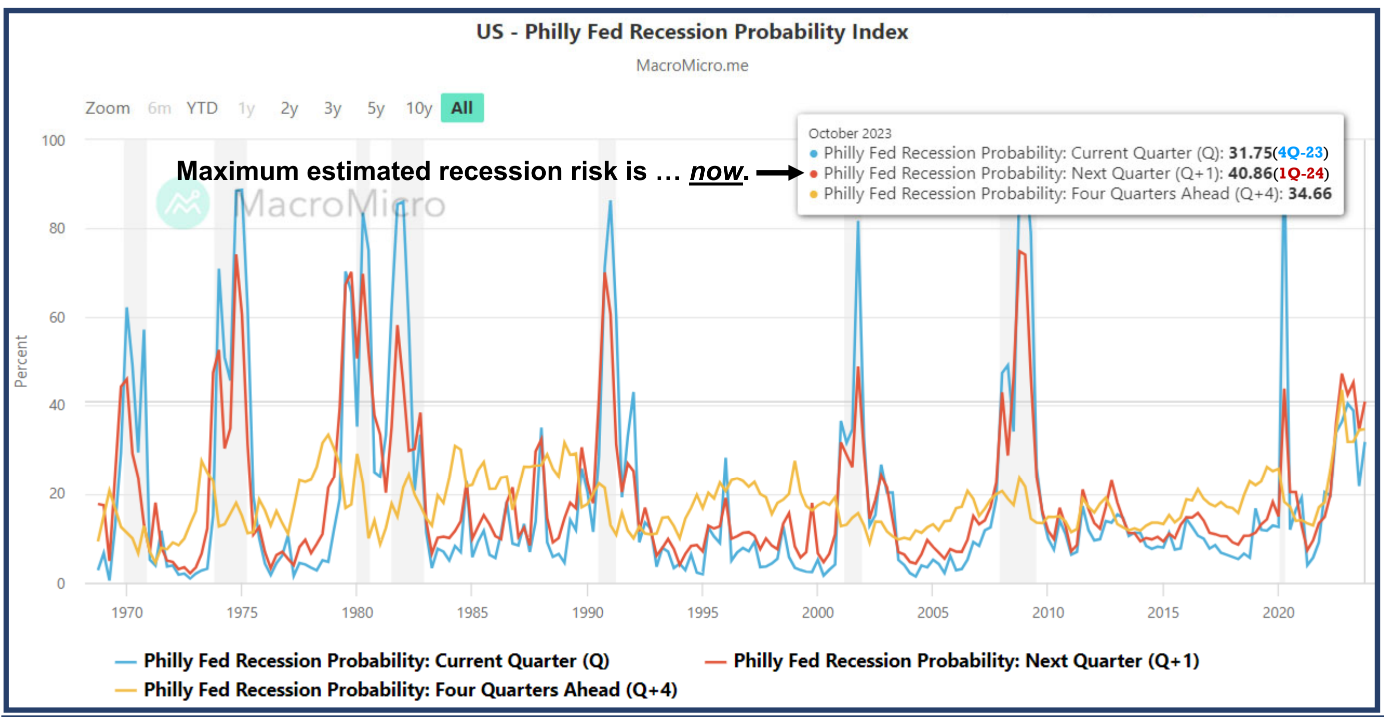
WORLD BANK: SOFT LANDING "INCREASINGLY POSSIBLE" FOR GLOBAL ECONOMY IN 2024

The U.S. economy and capital markets have been anything but normal over the past few years. They experienced a pandemic-induced recession which then resulted in trillions of dollars worth of fiscal stimulus and ultra-low rates to stimulate the economy. That was followed by supply-chain disruptions, labor imbalances, soaring inflation, a few bank failures triggered by the rapid normalization of interest rates, and persistent fears of the dreaded "hard landing" (recession) as the potential byproduct of the Fed's attempt to stem inflation by slowing the economy via the rapid normalization of interest rates.

The market response was also dramatic, with a sharp stock market downdraft in 2020, a subsequent boom in 2021, a 10-month-long bear market during 2022, and another strong advance in equity values during 2023 while annual economic (GDP) growth trudged along in the low 2% range during the first half of 2023 before surging to 4.9% during the third quarter.

Despite the recent surge in the annual pace of GDP, the Federal Reserve Bank of Philadelphia has continued to suggest an elevated risk of recession since the summer of 2022, as shown in the image below. The elevated probability of recession is corroborated by the Conference Board's Leading Economic Index®. **Press-Time Newsflash**: Newly released GDP and inflation data (included later in this letter) supports the World Bank's view and conjecture contained in the first four pages of this letter that the probability of recession within the U.S. is, in fact, waning.



WANING RECESSION RISK AS PER LEADING ECONOMIC INDEX®

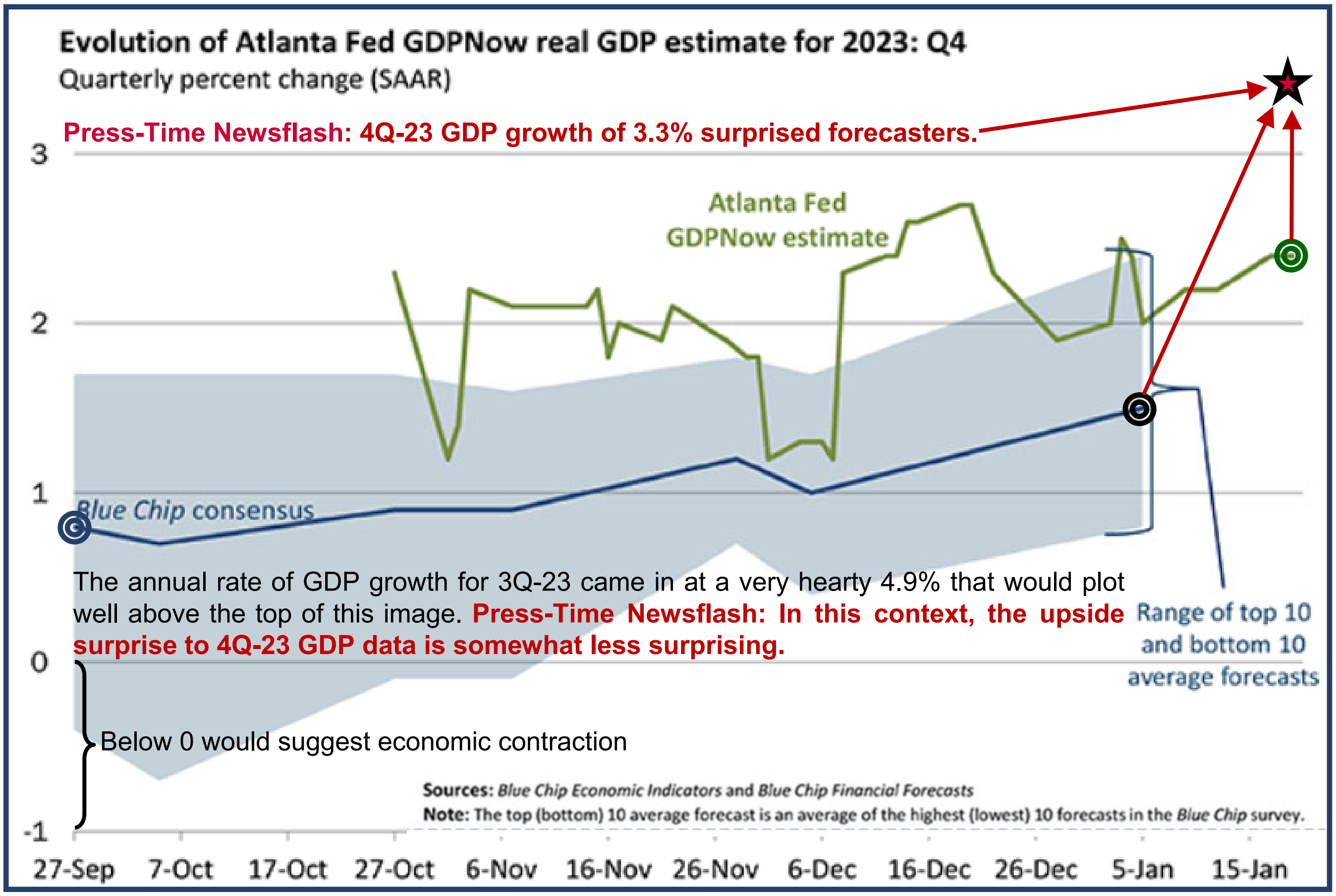
The Leading Economic Index (LEI) considers the duration, depth, and diffusion (the 3Ds) of any index deterioration. Duration refers to how long-lasting a decline in the index is, depth denotes the magnitude of the decline in the index and both measures are gauged in terms of their change over the previous six months. And, finally, diffusion is a measure of how widespread the decline is across the various indicators that comprise the Leading Economic Index.

The warning signal, the flat, black line that appears below, is plotted at some threshold where deterioration across the various subcomponents of the index would be considered to be widespread (diffuse) enough to suggest the possibility of recession. That black warning line is then overwritten with an actual recession signal (the flat red line that also appears below) anytime the depth and duration of the LEI deteriorate to some threshold level *after* there has already been widespread deterioration in the subcomponents of the index.

As shown in the circled area below, the LEI is currently signaling the onset of recession, but the index has recently inflected upward to suggest that the recession signal this indicator is currently flashing may soon morph into a more benign reading before a recession actually comes to fruition. **Press-Time Newsflash:** Surprisingly good GDP data has been released for 4Q-23. (Refer to image on next page.)

GDP ESTIMATE SUPPORTS IMPROVEMENT IN LEADING INDEX

Last September, the consensus estimate from "Blue Chip" forecasters for Gross Domestic Product (economic output) within the U.S. economy for the first quarter of 2024 stood at an annual rate of slightly less than 1% (blue bullseye). That weak forecast has given way to a somewhat more sanguine forecast of about 1.5% (black bullseye). Notably, the range of Blue Chip forecasts no longer includes any expectation of economic contraction.



WORLD BANK'S TAKE ON ECONOMIC GROWTH DURING 2024

According to a summary of the World Bank's Global Economic Prospects report, "Global economic activity continues to soften amid the effects of tight monetary policies, restrictive financial conditions, and weak global trade growth. After a sharp slowdown in 2022 and another decline last year, global output growth is set to edge down in 2024, marking the third consecutive year of deceleration. The recent conflict in the Middle East has heightened geopolitical risks and raised uncertainty in commodity markets, with potential adverse implications for global growth. This comes while the world economy is continuing to cope with the lingering effects of the overlapping shocks of the past four years—the COVID-19 pandemic, the Russian Federation's invasion of Ukraine, and the rise in inflation and subsequent sharp tightening of global monetary conditions."

2024 MAY BE AN INFLECTION FOR SLOWING GLOBAL GROWTH

As captured in the table below, the World Bank estimates that final data for 2023 will have resulted in worldwide economic (GDP) growth of 2.6%. Despite the previously cited risks, it nonetheless forecasts worldwide growth to barely relax (to 2.4%) this year, before drifting higher again during 2025. While growth within the U.S. and other advanced economies is expected to be on the anemic side over the next couple of years, note that forecasted GDP growth of 1.6% within the U.S. during 2024 is now twice as high as it was in June of 2023 (three circles).

TABLE 1.1 Real GDP[1] GLOBAL ECONOMIC PROSPECTS | JANUARY 2024

(Percent change from previous year unless indicated otherwise)

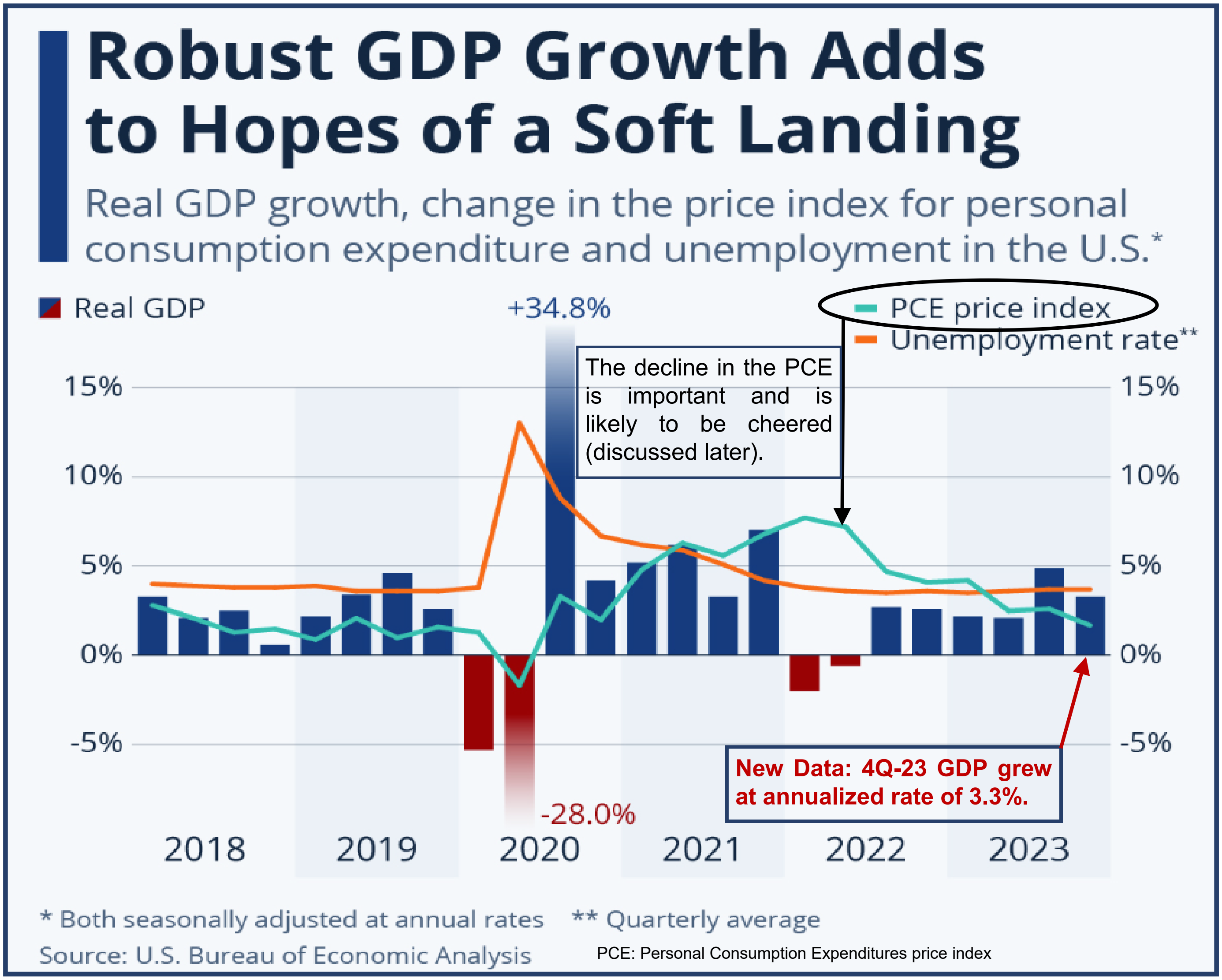
e = estimate f = forecast

						Percentage point differences from June 2023 projections		
	2021	2022	2023e	2024f	2025f	2023e	2024f	2025f
World	**6.2**	**3.0**	**2.6**	**2.4**	**2.7**	**0.5**	**0.0**	**-0.3**
Advanced economies	**5.5**	**2.5**	**1.5**	**1.2**	**1.6**	**0.8**	**0.0**	**-0.6**
United States	5.8	1.9	2.5	1.6	1.7	1.4	0.8	-0.6
Euro area	5.9	3.4	0.4	0.7	1.6	0.0	-0.6	-0.7
Japan	2.6	1.0	1.8	0.9	0.8	1.0	0.2	0.2
Emerging market and developing economies	**7.0**	**3.7**	**4.0**	**3.9**	**4.0**	**0.0**	**0.0**	**0.0**
East Asia and Pacific	7.5	3.4	5.1	4.5	4.4	-0.4	-0.1	-0.1
China	8.4	3.0	5.2	4.5	4.3	-0.4	-0.1	-0.1
Indonesia	3.7	5.3	5.0	4.9	4.9	0.1	0.0	-0.1
Thailand	1.5	2.6	2.5	3.2	3.1	-1.4	-0.4	-0.3
Europe and Central Asia	7.1	1.2	2.7	2.4	2.7	1.3	-0.3	0.0
Russian Federation	5.6	-2.1	2.6	1.3	0.9	2.8	0.1	0.1
Türkiye	11.4	5.5	4.2	3.1	3.9	1.0	-1.2	-0.2
Poland	6.9	5.1	0.5	2.6	3.4	-0.2	0.0	0.2
Latin America and the Caribbean	7.2	3.9	2.2	2.3	2.5	0.7	0.3	-0.1
Brazil	5.0	2.9	3.1	1.5	2.2	1.9	0.1	-0.2
Mexico	5.8	3.9	3.6	2.6	2.1	1.1	0.7	0.1
Argentina	10.7	5.0	-2.5	2.7	3.2	-0.5	0.4	1.2
Middle East and North Africa	3.8	5.8	1.9	3.5	3.5	-0.3	0.2	0.5
Saudi Arabia	3.9	8.7	-0.5	4.1	4.2	-2.7	0.8	1.7
Iran, Islamic Rep.[2]	4.7	3.8	4.2	3.7	3.2	2.0	1.7	1.3
Egypt, Arab Rep.[2]	3.3	6.6	3.8	3.5	3.9	-0.2	-0.5	-0.8
South Asia	8.3	5.9	5.7	5.6	5.9	-0.2	0.5	-0.5
India[2]	9.1	7.2	6.3	6.4	6.5	0.0	0.0	0.0
Bangladesh[2]	6.9	7.1	6.0	5.6	5.8	0.8	-0.6	-0.6
Pakistan[2]	5.8	6.2	-0.2	1.7	2.4	-0.6	-0.3	-0.6
Sub-Saharan Africa	4.4	3.7	2.9	3.8	4.1	-0.3	-0.1	0.1
Nigeria	3.6	3.3	2.9	3.3	3.7	0.1	0.3	0.6
South Africa	4.7	1.9	0.7	1.3	1.5	0.4	-0.2	-0.1
Angola	1.2	3.0	0.5	2.8	3.1	-2.1	-0.5	0.0
Memorandum items:								
Real GDP[1] Boxed: No recession forecasted for *any* economy!								
High-income countries	5.5	2.8	1.5	1.3	1.8	0.7	0.0	-0.5
Middle-income countries	7.2	3.4	4.3	4.0	4.0	0.1	0.0	-0.1
Low-income countries	4.2	4.8	3.5	5.5	5.6	-1.7	-0.5	-0.4
EMDEs excluding China	6.0	4.2	3.2	3.5	3.8	0.3	0.1	0.0
Commodity-exporting EMDEs	5.2	3.2	2.5	2.9	3.1	0.6	0.1	0.2
Commodity-importing EMDEs	7.9	3.9	4.8	4.4	4.4	-0.2	0.0	-0.1
Commodity-importing EMDEs excluding China	7.2	5.3	4.2	4.2	4.5	0.0	0.0	-0.3
EM7	7.8	3.3	4.9	4.1	4.1	0.2	0.0	-0.1
World (PPP weights)[3]	6.4	3.3	3.0	2.9	3.1	0.3	0.0	-0.3
World trade volume[4]	**11.1**	**5.6**	**0.2**	**2.3**	**3.1**	**-1.5**	**-0.5**	**0.1**

BREAKING (GOOD) NEWS

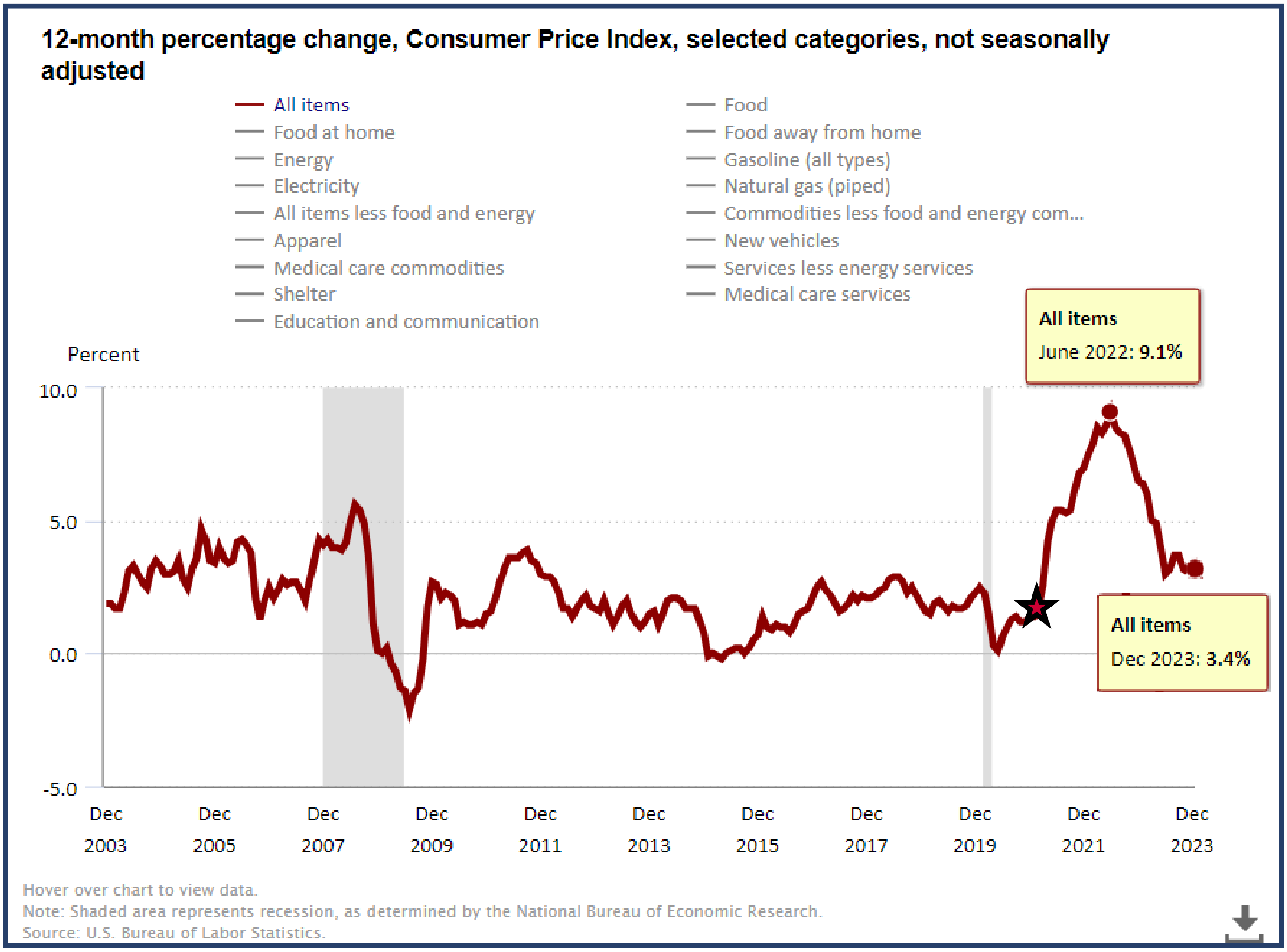
As of January 26th, the formation of the most anticipated recession in my memory seems to be anything but imminent. After spending the previous four pages handicapping the odds of the onset of another economic downdraft, **news just broke of an advance estimate that the U.S. economy grew at a surprisingly robust annual rate of 3.3% during the final quarter of 2023** (as noted in the image on page 3).

A 3.3% annualized rate of GDP growth may pale in comparison to the 4.9% posted in the 3rd quarter of 2023, but it's a hearty figure nonetheless. This 3.3% figure throws more water on the notion that the U.S. is on the cusp of the hard landing (recession) that has been so feared for so long, it supports the inflection captured by the Leading Economic Index (page 2), it supports the Atlanta Fed's persistent relative optimism (page 3), and it lends credence to the World Bank's view that the U.S. is not on the cusp of recession (page 4).



CONSUMER PRICE INDEX NEARS THE FED'S 2% TARGET

In February of 2021, the year-over-year change of the Consumer Price Index (CPI) stood at a benign 1.7% (star). By June of 2022, inflation was on fire with the CPI advancing at a rate of 9.1% per year which caused the Fed to institute a set of historically fast interest rate hikes in response. After a year and a half of elevated interest rates, the CPI has now declined to a point where the most recent 3.4% figure is nearing the Fed's inflation 2% target.



PCE IS THE FED'S PREFERRED INFLATION MEASURE

Although the Fed certainly considers the Consumer Price Index as a measure of inflation, the Fed's preferred measure of inflation is the Core Personal Consumption Expenditures (Core PCE) index where the "core" qualifier indicates that the price changes for food and energy have been excluded due to their tendency to distort the index through their inherent volatility.

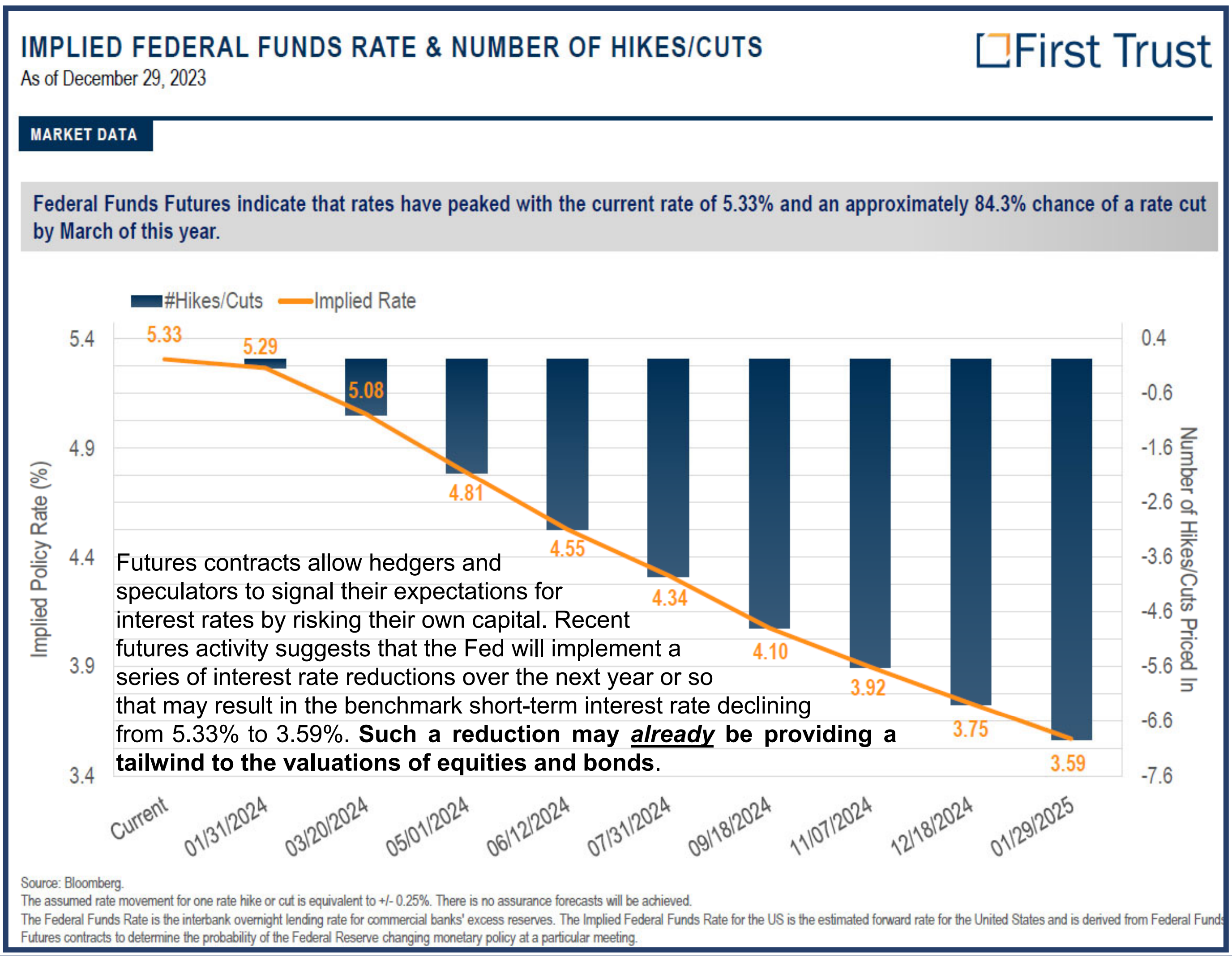
The Fed wishes for the Core PCE to eventually to show that the typical household is experiencing inflation at a rate of around 2% per year.

BREAKING NEWS — CORE PCE LIKELY FELL TO 3%

A preview of data from the Commerce Department suggests that the Core Personal Consumption Expenditures (Core PCE) index, rose at an annual rate of 3% during December. This would be an improvement versus the 3.2%, year-over-year increase that was reported for November. The Core PCE is expected to have risen only .2% during December which is roughly in line with November's monthly increase of only .1%. This is good news.

BREAKING NEWS — CORE PCE TO FALL FURTHER DURING 2024

If advance data from the Commerce Department is accurate, the Core PCE price index is now expected to rise by only 2.6% during 2024 (versus the 3% annual rate calculated for December). If this is the actual estimate, the continued relaxation of inflation is likely to allow the Fed to begin reducing interest rates sooner rather than later to help ensure it does not accidentally overshoot its 2% inflation target and unwittingly push the U.S. economy toward recession. **I expect investors to welcome this news of subsiding inflation.**



CORPORATE EARNINGS EXPECTED TO REACCELERATE

I was hoping to not need to include any blurry graphs for once, but I feel compelled to note that analysts as a whole expect the 500 companies that comprise the S&P 500 to earn 11.3% more this year than they did last year. I imagine that **an investor would look forward to rising corporate earnings in an environment of declining interest rates**. I would.

INGREDIENTS MAY BE IN PLACE FOR A DECENT 2024

Unemployment remains 3.7% and stable (see page 5), recent GDP and inflation data suggests an increased likelihood that the Fed may actually engineer a soft economic landing after all, and earnings estimates for 2024 look pretty good.

Let's presume that the rate hike the Fed implemented last July will turn out to be the last hike associated with the Fed's effort to control the recent surge in inflation. If the Fed's next move were to reduce interest rates, the image to the right might then be instructive to any investor who wished to understand how asset classes have performed during previous periods of Fed transition.

— Glenn Wessel