# UPSIDE SURPRISES

U.S. economic growth continues to surprise to the upside and the consensus expectation for full-year 2024 growth is now over 2%. During the March Federal Open Market Committee (FOMC), the Fed also raised its expectations for growth this year from 1.4% to 2.1%. Inflation has also been surprising to the upside. January, February and March inflation data was stronger than expected. Despite raising its year-end core inflation projection from 2.4% to 2.6%, the FOMC continued to project that its target policy rate will come down by 75 basis points by the end of 2024.

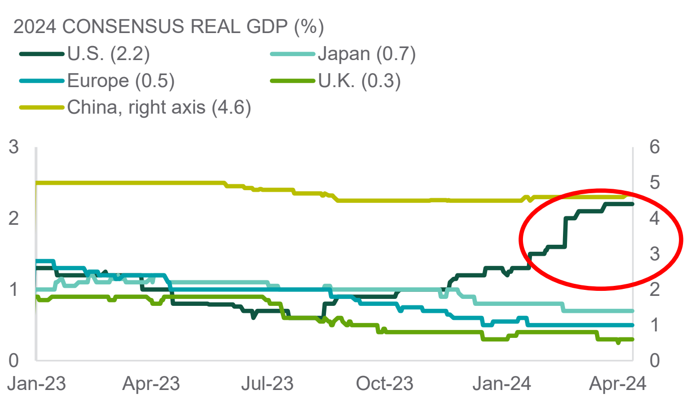
Our base case is that inflation will moderate by the end of this year, but near-term 3-month and 6-month momentum has been on an upward trend (see below chart). One source of concern is the stalling of the quits rate, which typically is a good indicator of wage inflation. A declining quits rate is associated with lower wage growth. Labor supply, via immigration, has had a positive effect on wage dynamics, but there is no clarity on whether this will persist after the U.S. Presidential Election. Meanwhile, goods prices are on an uptrend and housing-related inflation relief is yet to show up in the official statistics. This has led to some market uncertainty about the Fed's willingness to ease monetary conditions. So far this year, this has manifested itself in rates and currency markets. Higher for longer has meant a backup in Treasury yields and a stronger dollar. But stocks have mostly shrugged off these interest rate dynamics. Equity markets have been following the improving growth trend.

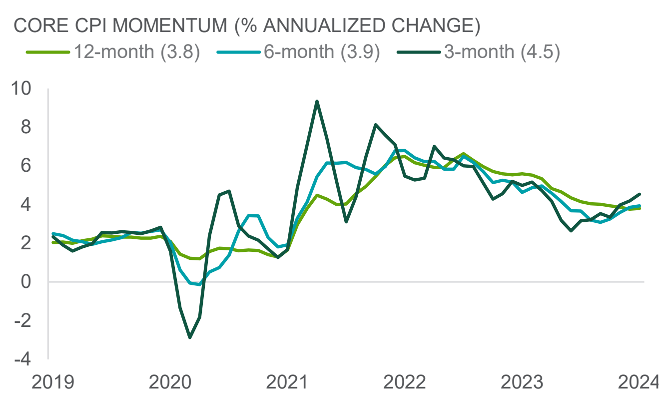
Global economic developments have been positive on balance. The biggest improvement has been in the manufacturing segment, where Purchasing Managers' Indexes (PMIs) have moved into expansionary territory (above 50) for several major economies. The global manufacturing PMI has now been in expansion for a full quarter. Aside from Japan, global central bankers are looking to cut rates later this year.

We made no changes to our asset allocation positions this month. Earnings should support global equities, but potentially higher bond yields could weigh on already high valuations, underpinning our neutral stance within a multi-asset portfolio. We are neutral across the regions within global equities. Spreads are tight for high yield bonds, but they should outperform investment grade (IG) bonds as we expect improving growth momentum to benefit riskier bonds, likely via reduced default risk. The higher yield on these bonds also provides some cushion against a backup in rates. We are underweight IG bonds, inflation-protected bonds and cash. We continue to maintain benchmark exposure to alternative assets such as natural resources, real estate and infrastructure given their role in the portfolio as diversifiers.

## TOPPING EXPECTATIONS

U.S. economic growth continues to surprise to the upside, but so has inflation with momentum trending upwards.




Source: Northern Trust Asset Management, Bloomberg. Left chart: Bloomberg consensus data. Consensus Gross Domestic Product (GDP) is the average level of the y/y change during the year (i.e., it uses 8 quarters of data). Data from 12/31/2022 through 4/15/2024. Core CPI data from 3/31/2019 through 3/31/2024.

## **BASE CASE** EXPECTATIONS

### Sticking the Landing

Global growth will move below trend but remain positive, supported by ongoing U.S. economic strength as labor market/consumer momentum has continued. Inflation will remain above target but continue to proceed toward 2%. Despite the constructive economic backdrop, sentiment and high valuations temper risk-taking appetite.

### Central Bank Transitions

We expect U.S. and European central banks to transition to rate cuts this year. Economic resilience may afford monetary policymakers more time to confirm that inflation is moving down sustainably.

## **RISK CASE** SCENARIOS

### Stubborn Inflation

Inflation does not move lower as a result of several potential factors: economic resurgence, tight labor markets keeping pressure on services, and/or goods and commodity disruptions from conflict in the Middle East.

### Lagged Impacts

The market's enthusiasm for a soft landing proves to be misplaced as the cumulative effect of 5%+ rate hikes in two years starts showing up in economic functioning. TAA is not underweight risk enough in this scenario.



ViewPoints reflects data as of 4/17/24.