LGT Snapshot

17th April 2024

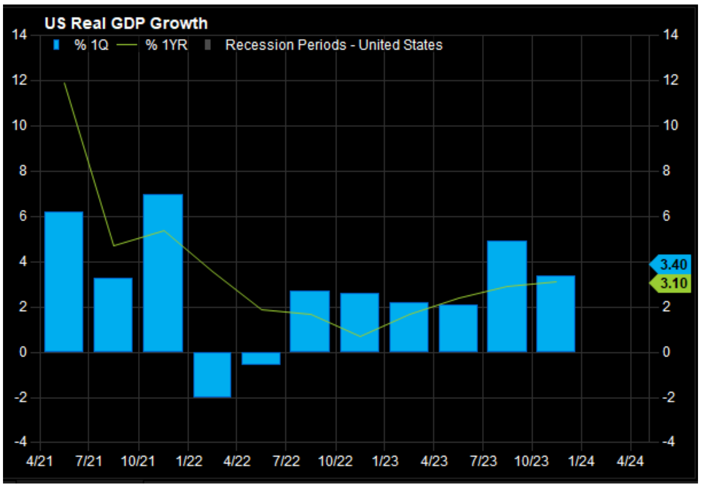
# The rise of the 'no landing'

**After a string of positive inflation prints towards the end of 2023 and the Federal Reserve (Fed) pivot in December, very few economic forecasters anticipated that the US would experience a 'no landing' scenario[1] in 2024. Indeed, coming into 2024, market consensus was that central banks had orchestrated a 'soft landing'[2].**

At one stage the market was predicting more than six interest rate cuts in the US. However, recently, as sovereign bonds have come under pressure and energy stocks have risen, the number of expected rate cuts has fallen to circa two. Markets oscillate, rarely operating as 'a one-way bet', often quickly re-pricing in new scenarios. This serves as a useful reminder to be aware that consensus opinion is just that; opinion. It is therefore vital we have conviction in our own views and are willing to adapt to new economic data as the outlook changes. Below we examine the causes of the recent resurgence in inflationary pressures and discuss potential solutions for asset allocators.

**Resilience of US economy and sticky CPI**

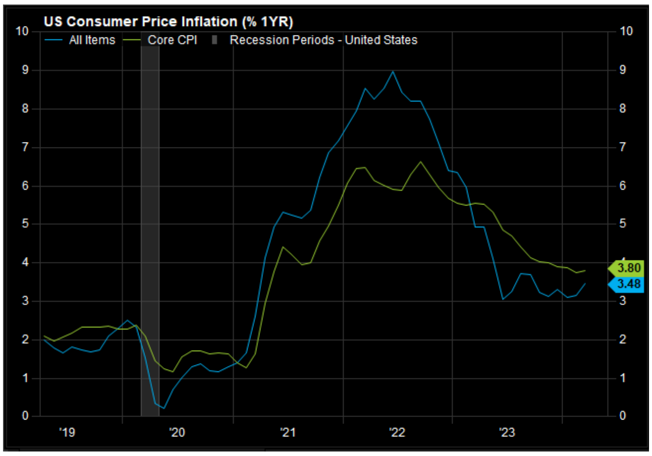
The US economy is more resilient than many people realised, despite the very aggressive rate hiking cycle that we witnessed last year. Instead of slowing down or 'landing', the US economy is still expanding at a steady pace. Leading economic data is looking increasingly encouraging, in addition to a continually robust job market. On top of this, a notable deviation from the past downward trend is the slowdown in progress on inflation, with three successive recent CPI data prints coming in higher than expected. Despite earlier signs of abatement, 'all-items' US CPI data seems to have bottomed, indicating that the economy may not be experiencing the anticipated 'landing.' This presents a dilemma for Fed policymakers. Whilst seeking to achieve price stability and promote full employment, they may need to grapple with a scenario where strong growth and persistent inflation intersect, complicating their objectives.




*Source: Factset*

1 When the economy continues to grow and inflation remains above target levels (2%) despite monetary policy tightening/interest rates rising.
2 A soft landing is when central banks seek to raise interest rates just enough to stop an economy from overheating and experiencing high inflation, without causing a severe downturn or mass unemployment.

**Energy prices**
On the other side of the coin, energy prices have increased year-to-date. Whether these moves have been caused by OPEC cuts, green shoots of growth in China, big fiscal deficits, Middle Eastern geopolitics, excess global demand or some other factor, is unclear. That said, the longer energy prices remain elevated, the greater the chance these price increases feed into inflation. This would further complicate the picture for the Fed given that energy price moves are mostly out of their control. A muddled inflationary picture for the Fed could lead to uncertainty in bond markets, which could also beget volatility within equities.



*Source: Factset*

In summary, the developments of 2024 present a new set of challenges, which have several implications from an asset class perspective, despite our base case still being for a 'soft-landing'. The implications of a possible 'no-landing' scenario would, most likely, be bullish for short-dated bonds relative to longer-dated bonds. Treasury Inflation Protected Securities may also outperform nominal bonds without inflation protection. In equities, one could expect cyclical sectors, such as financials, to outperform, and equities sensitive to duration, such as utilities and property, to struggle, as interest rates would arguably stay higher for longer than expected.

We anticipate such a scenario would also be fruitful for alternative assets, such as absolute return and real asset funds, especially on a relative basis to longer-dated government bonds. Unlike stocks and bonds, alternatives tend to perform independently and are not strongly correlated with traditional assets. These funds can access a variety of different assets and have specific, dynamic investment styles. This makes them valuable portfolio diversifiers, and is one of the key reasons why we continue to favour funds like Cohen and Steers Diversified Real Assets and Troy Trojan, despite the relatively attractive yields that bonds offer. While inflation and interest rate cut expectations will likely oscillate over the coming months, we have strong conviction in our approach of balancing traditional assets with nontraditional assets and recognising the folly of trying to precisely predict the path of markets.