

Macro Matters Special Edition

# Midyear Outlook 2024

## Stay on track with the Midyear Outlook

As we reach the middle of 2024, where do our experts think you should focus portfolios given shifting rate expectations, sticky inflation, and global uncertainties? Allspring shares our insight on how to focus on quality equities and structure fixed income portfolios to pursue attractive income and the best client outcomes. *Follow the insight* to find out more.

### Key takeaways for the second half of 2024

**01**

**While U.S. and international growth should slow, the slowdown will be faster internationally.** International markets are likely to progress more quickly toward inflation targets.

**02**

**Fixed income investors should expect further progress toward interest rate normalization.** We suggest considering front-end focus, multi-sector strategies, and a high-quality bias.

**03**

**We believe equity investors should stay focused on quality with volatility ahead.** Learn what this means to our investment teams and how they identify quality companies.



# Will interest rate divergence drive asset prices?

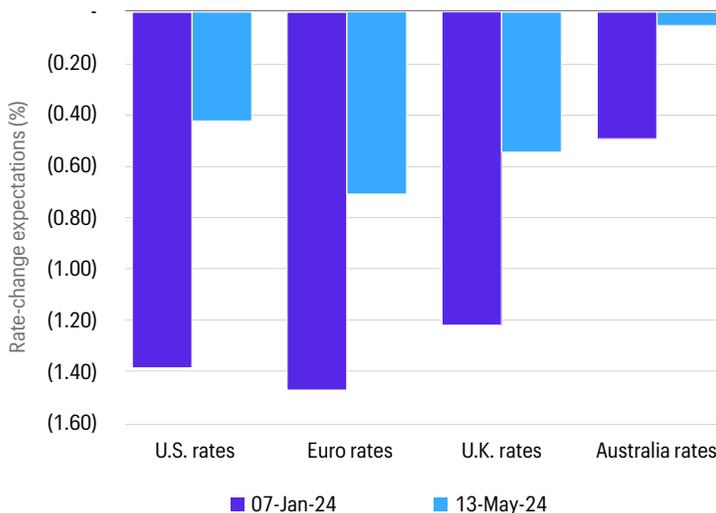


**MATTHIAS SCHEIBER, PH.D., CFA**  
Head of Systematic Multi-Asset,  
Systematic Edge

## A measured approach by each central bank means cuts in Europe and Asia with the U.S. on hold

When 2024 began, investors expected broad-based rate cuts worldwide given the flurry of weaker global data and central banks' growing comfort with inflation's trajectory. Since then, we've experienced a rather bumpy ride as larger rate cuts became priced out in the U.S. and, to a lesser degree, Europe. Figure 1 shows the overall change in rate-cut expectations since the beginning of 2024.

FIGURE 1: EXPECTATIONS HAVE SHIFTED FOR TOTAL CHANGE IN CENTRAL BANK RATES BY 31-DEC-24



Sources: Allspring and Bloomberg Finance L.P., December 2023 to April 2024

**A more cautious Federal Reserve (Fed) approach in 2024's second half seems justified** given recent U.S. growth and inflation data, and we anticipate a maximum of two U.S. rate cuts this year. In Europe, we believe the European Central Bank and the Bank of England will begin a series of rate cuts over the summer, as we expect growth will stay low, consumer sentiment will remain weak, and inflation will continue rapidly declining toward the central banks' target levels.

**The sticky U.S. inflation rate probably will end 2024 higher than anticipated when the year began.** A strong labor market and higher oil prices support higher U.S. inflation, while a stronger U.S. dollar could help offset some of the upward pressure via lower import costs. With the Fed now holding past June, higher interest rates should keep inflation uncertainty low for the rest of 2024.

**Internationally, we expect much faster progress toward inflation targets.** With headline inflation of about 2.4%, the eurozone is already quite close. The U.K., though, has some work to do with inflation still considerably above the target level of 2%. We expect to see more improvement toward the target soon. China is already undershooting on the prices side, and its consumer price indicators will likely turn negative again this summer. This will lead to monetary policy divergence (differing monetary policies adopted by the world's most systemically important central banks) for 2024's second half.

**The first half provided a precursor of what the second half will likely bring.** While U.S. and international growth should slow, the speed of adjustment will be much faster in international markets. In the U.S., company earnings, retail sales, and jobs have remained strong, supporting the economy, but tightening financial conditions—partly due to higher real rates and weakening external demand—could lead real U.S. growth to stabilize between 1.5–2.5%. Outside the U.S., weakness will be the trend. Cautious consumers are spending less and saving more. Manufacturing and labor have been weakening. The lack of fiscal and monetary stimuli will keep Europe's real growth rate close to 0%. Regarding China, we've observed that underneath the country's growth data, domestic weakness is being offset by cheap exports.



## We see two main risks markets face in the second half

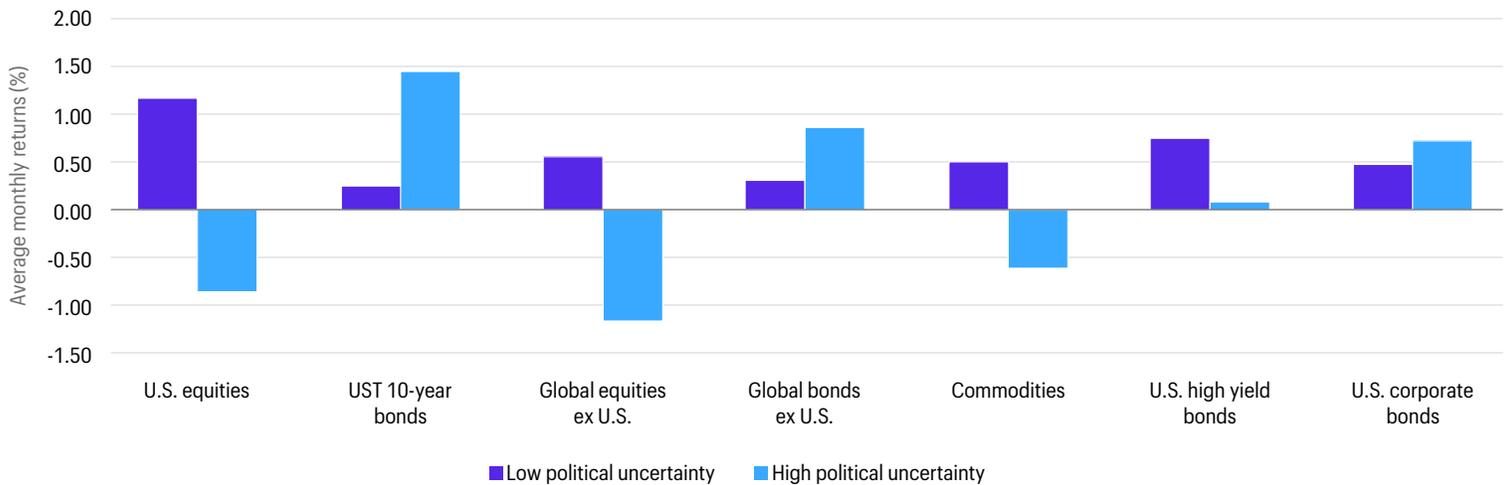
While the macro outlook looks conducive for asset prices over the coming months, there’s always a risk of uncertainties—unplanned events that might take a meaningful toll on markets. From our perspective, two main concerns in this category are the uncertain impact of November’s U.S. elections on markets and the potential for increasing geopolitical risk primarily in the Middle East.

**The U.S. presidential election is almost certain to be a pivotal event for markets.** Irrespective of the outcome, equities and commodities historically have struggled with higher political

uncertainty while higher-quality bonds, like government bonds and corporate bonds, have fared better (Figure 2). This is true for both U.S. and global asset prices as the significance of this U.S. event has the potential to affect global sentiment.

**Geopolitical risk in the Middle East rose markedly in the first half of 2024**, raising the prospect that Iran could engage militarily with Israel or another country at the same time that Russia continues its war in Ukraine. We expect this risk to remain high throughout 2024—we see no signs that the rising tensions will abate soon. While the potential for any negative impact is highest in commodity markets, it’s also possible the Western world could experience higher inflation as a result.

FIGURE 2: WHEN POLITICAL UNCERTAINTY IS HIGH, HIGH-QUALITY BONDS HISTORICALLY HAVE OUTPERFORMED EQUITIES



Sources: Allspring and Bloomberg Finance L.P., December 1989 to March 2024

U.S. equities = Bloomberg U.S. Large Cap Total Return Index

UST 10-year bonds = Bloomberg 10-Year U.S. Treasury Bellwethers Index

Global equities ex U.S. = MSCI World ex USA Index

Global bonds ex U.S. = Bloomberg Global Aggregate Bond ex-U.S. Dollar Total Return Index

Commodities = Bloomberg Commodity Total Return Index

U.S. high yield bonds = Bloomberg U.S. Corporate High Yield Total Return Index

U.S. corporate bonds = Bloomberg U.S. Corporate Bond Total Return Index

In this environment of lower inflation and growth along with political uncertainty, **the outlook for medium-term bonds remains favorable. This environment also should support equities**, especially in markets with lower interest rates and weaker currencies. **However, higher starting valuations warrant an active approach to managing risk**—to move past the U.S.’s “Magnificent 7” into high-quality companies in better-priced areas of the market like small caps, mid caps, and international equities.





# Can income *still* drive outcomes?



**GEORGE BORY, CFA**  
Chief Investment Strategist,  
Fixed Income

Bond investors can continue managing risk by using the three basic principles we identified at the start of 2024:

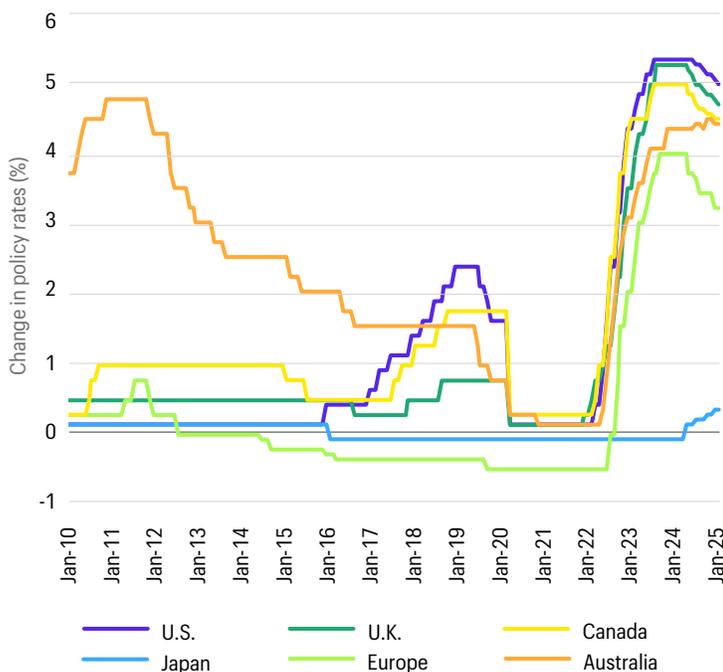
**Diversify duration.** Spread duration across different yield curves in an effort to maximize income and capture return potential.

**Prioritize flexibility.** Diversify across sectors and securities to remain nimble.

**Be intentional with risk.** Use high nominal and real yields to pursue durable, inflation-beating cash flows over multiple years.

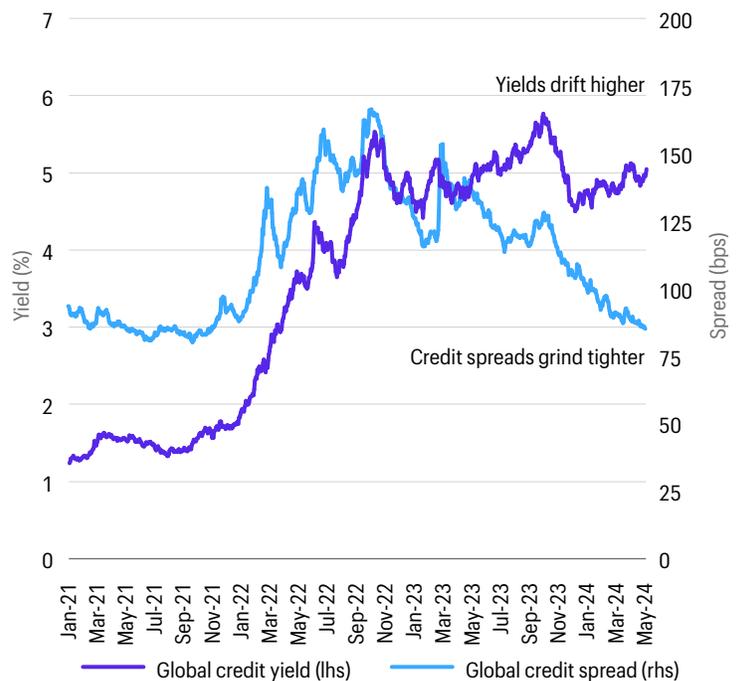
These principles are just as relevant in June as they were six months ago, and they're likely to remain so over the rest of 2024 and into 2025. The global macroeconomic backdrop as of mid-2024 is a mix of diverging front-end interest rates, uneven growth, and sticky inflation across many jurisdictions (Figure 1). Elevated yields and tight credit spreads should persist in these conditions (Figure 2). Big policy shifts in the second half will likely include broader central bank inflation targets and political volatility.

FIGURE 1: CENTRAL BANK POLICY RATES AND FORWARD EXPECTATIONS



Allspring and Bloomberg Finance L.P. Each country's policy rate is represented by Bloomberg's pricing. Data is as of 30-May-24.

FIGURE 2: GLOBAL CREDIT: HIGHER YIELDS, TIGHTER SPREADS



Sources: Allspring and Bloomberg Finance L.P. Each sector is part of the Bloomberg Global Aggregate Bond Index. Data is as of 30-May-24.

100 basis points (bps) equal 1.00%.

Fixed income investors should expect further progress in 2024 along the path of interest rate normalization as policymakers worldwide navigate the shifting landscape. Prudently financed public- and private-sector borrowers possess considerable advantages in this environment. Highly indebted entities will face real pressure—or even solvency issues—due to higher borrowing costs and tighter financial conditions. Identifying the winners and losers will be paramount to capture attractive absolute and relative returns in bond portfolios over the coming years.



In this environment, consider the following actions we believe will benefit fixed income portfolios over the coming months:

#### FOCUS ON THE FRONT END

Adding duration at the front end of yield curves will likely steepen and/or “twist” as yield curves normalize in the second half of 2024.

We favor duration in Europe and emerging economies, neutral positioning in the U.S., and underweighting Japan.

Ultrashort and short-duration strategies coupled with a high-income yield advantage should perform for taxable, tax-exempt, and global bond investors.

#### EMPLOY MULTI-SECTOR STRATEGIES

Multi-sector debt strategies that include the *plus* parts of the bond market should allow investors to capture positive *real yield* while also layering in some protection against unexpected bouts of volatility and/or an economic hard landing.

Incremental yield at the front end of yield curves—by going down the rating spectrum, up to and including high yield, coupled with high-quality duration at the long end and structured products and mortgage-backed securities (MBS) in the intermediate part of the curve—provides an attractive blend of *diversified duration*.

#### MAINTAIN A HIGH-QUALITY BIAS

Bond strategies tracking the core of the taxable and tax-exempt bond markets offer a high-quality bias and mid-market duration that should provide stable cash flows and protection against an economic hard landing.

Structured cash flows in asset-backed securities, MBS, and other structured products can help investors diversify cyclical risk that’s inherent in single-issuer corporate credit and provide precise risk exposure.

Tax-exempt municipal debt in the U.S. also allows bond investors to move up in quality and de-emphasize cyclical exposure.

Global climate transition strategies could also perform well while pursuing carbon-reduction strategies at the same time.

## Income can drive desirable outcomes

**With nominal yields still close to multidecade highs, bonds have continued to deliver value.** Further, breakeven inflation rates imply attractive real yields across several jurisdictions and sectors.

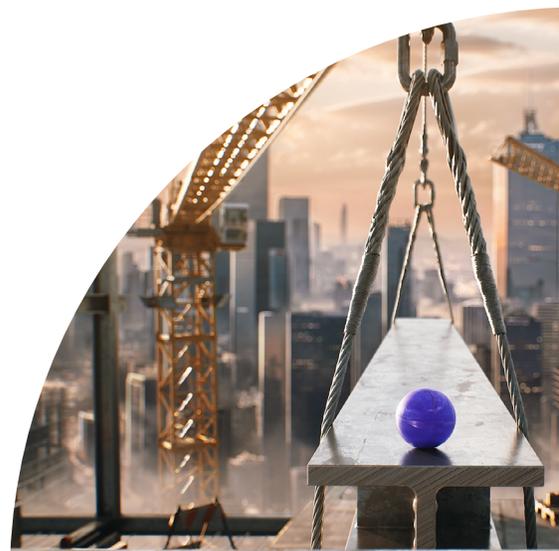
**Within sectors, price/yield/spread dispersions across sectors, issuers, and securities remain wide,** which we believe should benefit investors who can monetize security selection and reduce dependence on large macro or directional positions.

#### What are the major risks to this bond-friendly environment?

We’ve identified the following: possible central bank policy errors, U.S. elections in November 2024, and potential military escalations in the Middle East and/or Eastern Europe.

**In today’s market, most bonds are doing exactly what they’re designed to do: generating consistent, predictable cash flows that we believe should beat inflation over time.**

These cash flows can anchor a well-diversified investment portfolio. Furthermore, the prospect of political upheaval only strengthens the argument. Opportunities to capture these investments can be built into a wide array of fixed income portfolios across different maturities, sectors, regions, tax statuses, and currencies.





# Are you taking stock of quality and valuations?



ANN MILETTI

Head of Active Equity &  
Chief Diversity Officer

At the start of 2024, we said investors should consider owning quality stocks given the ongoing paradigm shift of monetary policy and lack of tailwinds supporting lower-quality businesses. So far, the market has largely agreed, and we remain steadfast in supporting this approach for the balance of 2024.

However, let's step outside the shadow of an intangible concept—*quality*—and bring some sunshine in by providing several concrete examples of how quality can be perceived and applied in this industry.

A company's value is based on the cash flow it produces, and the stock market represents investors' expectations for the company's future cash flows. These seem irrefutable, but what

an investor *believes* affects these future cash flows has a material impact on how that investor *defines what to look for* in a quality business. The definition may change as investors move through an economic cycle, digest different regional opportunities, or reflect on the characteristics of the specific investable universe(s) in which they've focused their investments.

Importantly, as asset owners, investors should make the effort to learn what different investment teams *specifically mean* when they say they own quality businesses. To illustrate this concept, we've compiled the table below, which shows how three Allspring teams that invest in different equity categories define what a quality business means to their team.

EQUITY TEAM CATEGORY	TEAM'S CRITERIA FOR IDENTIFYING QUALITY	COMPANY EXAMPLES WE BELIEVE ARE HIGH QUALITY*
Global Value	<p><b>Company must offer:</b></p> <ul style="list-style-type: none"> <li>• <b>High visibility of demand</b></li> <li>• <b>Cash flow stability</b> from limited drawdown risk</li> <li>• <b>Financial freedom</b> due to excess balance sheet capacity</li> <li>• <b>A skilled management team</b>, especially in capital allocation</li> </ul>	<p>Carlisle Companies Inc. AerCap Holdings N.V. Walmart Inc. J&amp;J Snack Foods Corp. Mueller Industries, Inc.</p>
U.S. Growth	<p><b>Company must demonstrate:</b></p> <ul style="list-style-type: none"> <li>• <b>Clear competitive advantages</b></li> <li>• <b>A value proposition</b> to customers</li> <li>• <b>A resilient and predictable business model</b> that's highly cash generative</li> <li>• <b>A skilled management team</b> at execution and investing capital</li> </ul>	<p>Progressive Corp. Visa, Inc. Chipotle Mexican Grill, Inc. Trade Desk, Inc. Health Equity, Inc.</p>
Emerging Markets	<p><b>Company must generate:</b></p> <ul style="list-style-type: none"> <li>• <b>A return on capital that's higher than its cost of capital</b> over an extended period</li> <li>• <b>Pricing power or scale of production</b> that drives cost advantages</li> </ul>	<p>Taiwan Semiconductor Manufacturing Company Ltd. Li-Ning Company Ltd. Shoprite Holdings Ltd. Fomento Económico Mexicano, S.A.B. de C.V. InPost sp.z o.o</p>

\*The securities listed should not be considered a recommendation to purchase or sell any particular security. The securities may or may not be in an Allspring portfolio.



## Look for quality and attractive pricing in small and mid caps

Notice that none of the teams' quality criteria mention a business's size, as there's no need to sacrifice quality when moving down in market cap. That's especially beneficial in an environment like today's, where, relative to large caps, small caps are undervalued. Their attractive valuations mean investors are being compensated to move down in market cap.

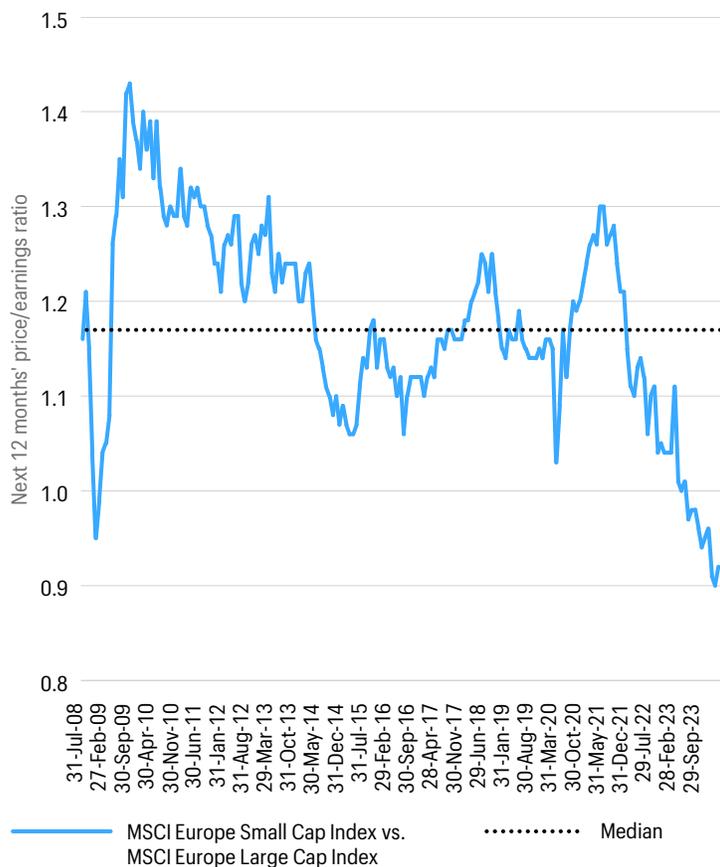
While it's challenging to predict when small caps could revert back toward their average longer-term prices, we think the fading exuberance around the large-cap artificial intelligence theme is as good a catalyst as any to point out the current valuation dispersion, as seen in Figures 1 and 2.

The rewards of deciding to invest more in small-cap stocks could likely be amplified by choosing active managers who've proven themselves adept at exploiting the inefficiencies of the small-/mid-cap universe. But for over 15 years, many investors have chosen instead to buy broad market exposure through passive indexes. Passive indexes, though, hold the good, the bad, and the ugly—which means significant portions of those purchases were in low-quality stocks.

In a perfect investing world—where all economies regularly fire on all cylinders and central banks consistently pump just the right amount of liquidity into their systems—passive investing could be a winning approach. But we know this isn't the case at all times, and certainly not today.

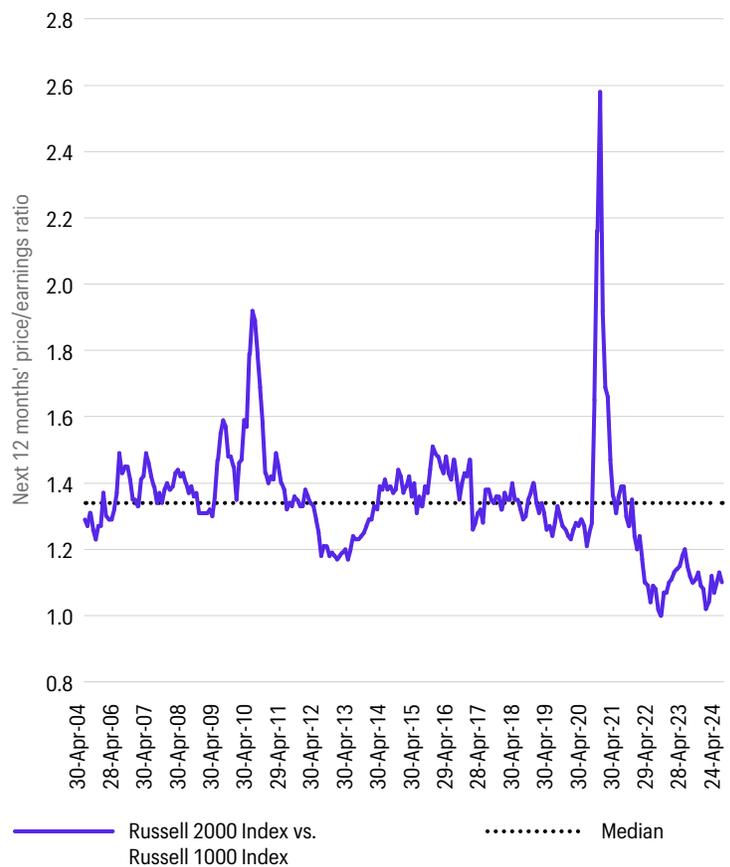
EUROPEAN SMALL CAPS ARE CURRENTLY ATTRACTIVE RELATIVE TO LARGE CAPS (FIGURE 1), AND THE SAME IS TRUE FOR U.S. SMALL CAPS RELATIVE TO LARGE CAPS (FIGURE 2)

FIGURE 1



Sources: Maestro and Allspring, from July 2008–March 2024. Past performance is no guarantee of future results.

FIGURE 2



Sources: Maestro and Allspring, from June 2004–April 2024. Past performance is no guarantee of future results.



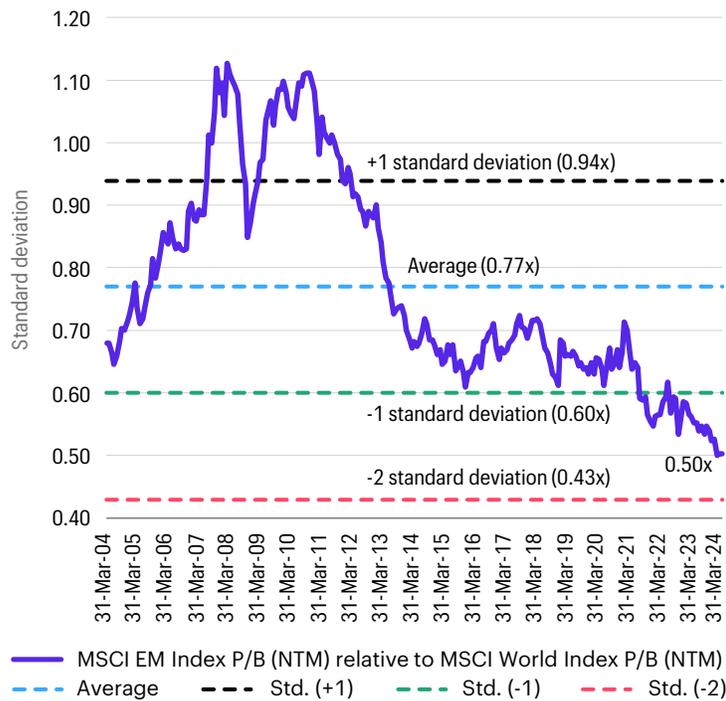
## Emerging markets offer opportunities for discerning investors

The emerging market category has long underperformed developed markets, resulting in some investor fatigue for the category. However, perhaps the tide is beginning to turn—and those who consider investing in emerging markets will see that the category currently is significantly discounted relative to developed markets, as shown in Figure 3. Also, they'll likely find that having to grapple with the geopolitical, economic, currency, and fiscal variables within emerging markets underscores the value a quality investment manager can deliver through constant monitoring and risk management.

We understand that uncertainty and volatility frequently appear—and critical investment decisions must be made with the goal of maximizing risk-adjusted returns in the face of shifting environments.

This is today's environment. In the U.S., for example, the Federal Reserve has been confronting a lukewarm economy and stubbornly high inflation. Consumers have shown tremendous resilience, but their stamina has been fading. This type of fluctuation is the norm, and it's why active investment managers recognize the need to dig into the fundamentals of each business they're considering. Active managers want to understand where each company resides within their team's definition of quality and how the company may successfully navigate today's environment and the possible shifts ahead.

FIGURE 3: EMERGING MARKETS ARE CURRENTLY TRADING AT A 50% DISCOUNT TO DEVELOPED MARKETS



Sources: Allspring and FactSet, as of 31-March-24

The P/B ratio (NTM) compares a stock's projected market value with its projected book value 12 months forward from the date of the comparison. It is calculated by dividing the stock's projected closing price by the projected book value per share 12 months forward from the calculation date. Standard deviation is the square root of the sum of squared deviations from the mean. It is often used as a measure of volatility, variability, or risk.

**Past performance is no guarantee of future results.**

We believe the back half of 2024 looks ripe for volatility. It's a good idea to stay focused on **quality**—we suggest you ask your investment managers what that word means to them.



## For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains. Visit our website at [www.allspringglobal.com](http://www.allspringglobal.com).



## Contact details

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The Bloomberg Global Aggregate Bond Index is a measure of global investment-grade debt performance. This multicurrency benchmark includes Treasury, government-related, corporate, and securitized fixed-rate bonds from both developed and emerging market issuers. You cannot invest directly in an index.

The Bloomberg 10-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments. You cannot invest directly in an index.

The MSCI Emerging Markets Investable Market Index (IMI) captures large, mid and small cap representation across 24 Emerging Markets (EM) countries. With 2,669 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in each country. You cannot invest directly in an index.

The MSCI World Index captures large and mid-cap representation across 23 Developed Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country. You cannot invest directly in an index.

The MSCI Europe Small Cap Index captures small cap representation across the 15 Developed Markets (DM) countries in Europe. (DM countries in Europe include: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the U.K.) With 903 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in the European equity universe. You cannot invest directly in an index.

The MSCI Europe Large Cap Index captures large cap representation across the 15 DM countries in Europe. You cannot invest directly in an index.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. You cannot invest directly in an index.

The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index. You cannot invest directly in an index.

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