2024 Investment Outlook: Midyear Update

Here is why we have a favorable view on the financial markets in the second half of 2024.

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Key Points

- We think strong employment and consumer spending, as well as innovation propelled by generative artificial intelligence (AI) and genomics, are potent trends that will support economic growth.
- There are risks, such as geopolitical uncertainty, deficit spending, and higher-for-longer interest rates. While important, these risks have been well telegraphed.
- When optimism is prevalent, we think an actively managed approach is crucial for finding relative value and providing downside protection.

The theme of our 2024 Midyear Investment Outlook is “A Strengthening Case for Optimism.” Why do we have that view? At Lord Abbett, we pride ourselves on independent, non-consensus thinking. And we understand that optimism is not currently a non-consensus view; signs of optimism can be seen in nearly every market. Equity multiples are elevated (though not extreme) relative to history, and that is on top of strong operating margins. Credit spreads are generally at post-COVID-19 tights and, in some cases, not far from all-time tights. Yield curves remain inverted, and term risk is not garnering much premium, despite looming debt and continued deficit spending.

So why the optimism? Because, in our view, the sanguine state of the market will likely be supported by a strong economy, fueled by an employed and productive labor force with attendant consumer spending, supportive monetary and fiscal policy, and real innovation occurring among equity market leaders in AI and genomics. The case for elevated nominal growth seems overwhelming. The question will be whether that nominal growth will be accompanied by high inflation—labeled “reflation”—or whether the U.S. Federal Reserve (Fed) will be able to get inflation down to its stated target and achieve a soft landing.

A possible third outcome: The risk of a shock to growth delivered by higher interest rates grows less pertinent with every quarter of strong U.S. Gross Domestic Product (GDP) growth and robust labor numbers. Clearly, this is an economy less sensitive to higher rates than in the past. The prospects of sliding into a negative real growth malaise have been further reduced by a Fed that is predisposed to lowering real interest rates to more neutral levels. A close inspection of the twelve recessions since World War Two (WWII) shows that the last four have come from shocks to growth rather than a Fed that was overzealous in tightening.

Figure 1. Past Recessions and Proximate Causes

Post-WW II U.S. Recessions	Decline in GDP (%)	Duration in Quarters	Cause
1949Q1-1949Q4	-1.4	4	?
1953Q3-1954Q2	-2.4	4	Fed
1957Q4-1958Q2	-3.0	3	Fed
1960Q3-1961Q1	-0.1	3	Fed
1970Q1-1970Q4	-0.2	4	Fed
1974Q1-1975Q1	-3.1	5	Fed/Oil
1980Q2-1980Q3	-2.2	2	Fed/Oil
1981Q4-1982Q4	-2.5	5	Fed
1990Q4-1991Q1	-1.4	2	Oil/CRE
2001Q2-2001Q4	0.4	6	Oil/Tech Bubble
2008Q1-2009Q2	-4.0	6	Oil/Lehman
2021Q1-2021Q2	-10.1	2	COVID-19

Source: National Bureau of Economic Research and Lord Abbett. Data as of April 30, 2024. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment

Pundits looking at the Fed as a possible cause of negative growth are best served looking elsewhere. Where could the shock come from, then? Geopolitical risk is one area. Growing impatience with fiscal deficits and accompanying Treasury issuance could be another. A loss of confidence in the Fed's ability to achieve price stability is a third. But, on balance, these risks are much appreciated and much discussed, striking us as a wall of worry to climb rather than true unknowns.

For us, a stronger case for optimism doesn't mean go long market beta and take the summer off. Rather, we find the need for active management to be particularly crucial during times when optimism reigns. In addition to monitoring markets for early signs of weakness, and adjusting liquidity, quality, and other positioning accordingly, active managers can find relative value trades that can isolate a differentiated view on competitive dynamics, enhance total return, and provide downside protection.

Specific themes we favor that you will find in our Midyear Outlooks for fixed income and equities:

- Continued appreciation of the growth potential in AI and genomics.
- Increasing market breadth and participation in an earnings-driven rally, with select international markets poised to potentially outperform.
- High nominal economic growth and strong margins supporting credit and keeping rates higher for longer.
- A continued possibility for enhanced carry and mitigation of rate risk at the short end of the fixed-income curve, particularly in credit.

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Glossary & Index Definitions

A **soft landing** is the process of an economy shifting from growth to slow growth to potentially flat, as it approaches but avoids a recession. It is usually caused by government attempts to slow down inflation. A hard landing is an economy rapidly shifting from growth to slow growth to flat as it approaches a recession, usually caused by government attempts to slow down inflation.

Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates.

The Federal Reserve (Fed) is the central bank of the United States. The federal funds (fed funds) rate is the target interest rate set by the Fed at which commercial banks borrow and lend their excess reserves to each other overnight.

Beta is a statistic that measures the expected increase or decrease of an individual stock price in proportion to movements of the stock market as a whole. Market beta refers to the expected increase or decrease of the stock market.

The **federal funds rate** is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight on an uncollateralized basis.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury

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