Cougar Global Viewpoints

What could go wrong in 2024?

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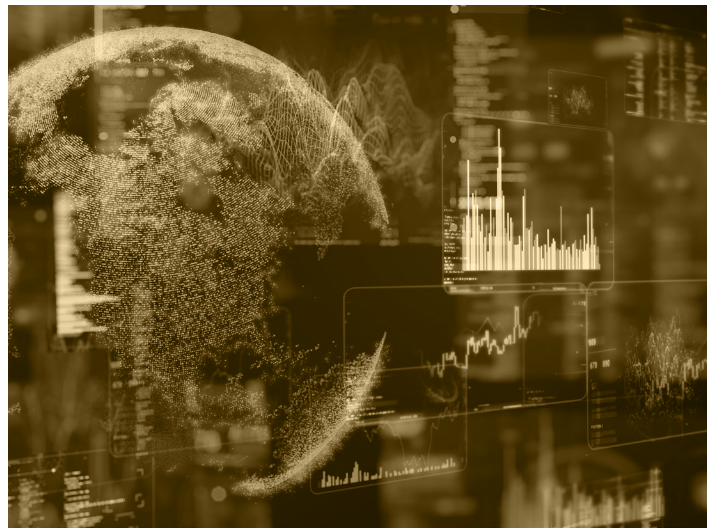

A number of factors already have been baked into asset prices in the United States, not the least of which is the anticipation of a "soft landing." Although we don't necessarily expect that a reversal is imminent, the stock market has hurdles to surmount in the coming year. We believe the largest risks to this optimistic outlook concern:

1) the paths of economic growth and inflation, and
2) the domestic political and/or geopolitical landscape.

Undoubtedly, the most important macro factors for investors and central banks to get right will be the estimates for growth and inflation. In a normal cycle, gross domestic product (GDP) and inflation tend to be positively correlated, with higher than expected GDP growth typically leading to higher than expected inflation and vice versa. Therefore, in 2022, a generally accepted belief was that central banks would need to crush their economies in order to crush inflation. This post-pandemic cycle has been unusual, with supply playing a more important role than demand this past year and with inflation declining despite solid economic growth. The virtually unprecedented nature of this business cycle and the fact that U.S. Federal Reserve (Fed) Chair Jay Powell has no historical playbook to guide his coming decisions raise the number of potential outcomes and with this, the chance that more things could go wrong. It is also very difficult for central banks to calibrate monetary policy almost perfectly when an economy reaches full employment and the bankers want to keep it there. **Hence, portfolios will need to be resilient to a wide range of outcomes, and diversification will continue to be critical.**

Consensus among investors expects a "soft landing" scenario and that the inflation danger is almost over. Our investment team believes that the U.S. economy and inflation will continue moderating in 2024, but the team doesn't exclude the possibility of a recession, or that inflation remains sticky. Pandemic-related distortions are unwinding, but the underlying core consumer price inflation is still higher than desired by the central banks and investors. **If core Personal Consumption Expenditures (PCE) Price Index inflation reaccelerates unexpectedly and remains above 2.5% in 2024**, the Fed will be more reluctant to cut interest rates, even if GDP growth disappoints on the downside. Central bank officials are prudent about reducing rates prematurely because of fear that new shocks – a run-up in oil prices, for example – could trigger a new inflationary surge, as occurred throughout the 1970s. It would be very challenging if they cut rates only to see prices take off again, forcing them to hike again later. If this scenario materializes, we'll see increased volatility in the fixed income markets, as investors will unwind the deep rate-cut expectations priced into the forward markets. If economic growth and inflation surprise to the upside, the Fed could even hike rates, which would be a big surprise for the markets. We are, however, inclined to believe that central banks have most likely finished hiking rates. Still, **there's also a risk that Powell and his colleagues** – blamed for reacting too slowly to surging inflation two years ago – **will wait too long to lower rates as they ensure inflation is fully tamed.** That mistake could suppress economic growth too much, causing a recession.

Although it appears that financial institutions have adjusted to higher interest rates, it is still possible that the lagged effects of tighter monetary policy could have a larger impact.

Companies might struggle to refinance their long-term loans once they come due, and this may trigger a round of insolvencies. These risks are probably the greatest for commercial property companies.

A number of geopolitical and domestic political outcomes in 2024 could yet undermine economic confidence and trigger a worse growth outcome than the consensus envisioned by investors. This year's presidential election could end up being a key driver of markets in 2024, as they look ahead to what policies the winner might introduce. Foreign conflicts can affect U.S. politics via the energy channel, as conflicts with Iran or Russia could cause an energy shock and economic slowdown ahead of the elections, which would reduce the chance for the incumbent to be re-elected. The war in Ukraine likely will remain deadlocked, unless Donald Trump is re-elected U.S. president, then threatens to curtail funding for Ukraine and challenges U.S. membership in the North Atlantic Treaty Organization (NATO). A re-elected Joe Biden would maintain the current policy and support for Ukraine and opposition to Russian President Vladimir Putin.

Global fracturing concerns might escalate. Relations between the United States and China could deteriorate, due either to the election in Taiwan or the election in the U.S. This could result in sanctions, tariffs and limits on technology and capital. As a result, financial markets could react negatively.

Final word: The consensus among investors is that the danger of inflation is over and that the Fed will achieve a soft landing. Given the unprecedented specifics of this business cycle, there is a wider range of things that could go wrong. Asset prices will remain sensitive to interest rate expectations. The political and/or geopolitical landscape will trigger periodic volatility, especially the developments surrounding the U.S. presidential election. The impact of any shock will depend on the nature of the shock. In addition, the risks are not independent of each other. The realization of one may increase the probability of others, such as higher interest rates prompting fiscal concerns and financial strains.

Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful. Small-capitalization companies are subject to higher volatility than those of large-capitalized companies. International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be appropriate for all investors. Stock investing involves risk, including the risk of loss. Investments in emerging market issuers are subject to a greater risk of loss than investments in issuers located or operating in more developed markets. This is due to, among other things, the potential for greater market volatility, lower trading volume, higher levels of inflation, political and economic instability, greater risk of a market shutdown and more governmental limitations on foreign investments in emerging market countries. High Yield/Junk Bonds are not investment grade securities, involve substantial risks and generally should be part of the diversified portfolio of sophisticated investors. Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity and redemption features. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Mortgage-Backed Securities are subject to credit, default risk, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extensions risk, the opposite of prepayment risk, and interest rate risk. Investing in IAU involves additional risks. The market price of the Shares will be as unpredictable as the price of gold has historically been and the price received upon the sale of Shares may be less than the value of the gold represented by them. Government bonds and Treasury bills are guaranteed by the U.S. Government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. The fund's concentrated holding will subject it to greater volatility than a fund that invests more broadly. The fast price swings of commodities will result in significant volatility in an investor's holdings. Precious metal investing is subject to substantial fluctuation and potential for loss. All indexes mentioned are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. The indexes don't reflect charges, expenses, fees and is not indicative of any particular investment. Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, disease, and regulatory developments.

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DEFINITIONS

Core inflation is measured by the Personal Consumption Expenditures (PCE) excluding Food and Energy, Price Index, also known as the core PCE price index, is a measure of the prices that U.S. consumers pay for goods and services, not including two categories – food and energy – where prices tend to swing up and down more dramatically and more often than other prices. The core PCE price index, released monthly by the U.S. Department of Commerce Bureau of Economic Analysis, measures inflation trends and is watched closely by the U.S. Federal Reserve as it conducts monetary policy.

Correlation is a statistic that measures the degree to which two securities move in relation to each other.

A forward market is an over-the-counter market that sets the price of an asset or financial instrument, which can include currencies, securities, and commodities, for future delivery. Forward market prices are based on interest rates, and terms of forward contracts can be customized.

A soft landing is a cyclical slowdown in economic growth that avoids a recession.

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Cougar Global Investments is a global macroeconomic asset allocation manager that believes the goal of investing is to achieve compound annualized returns for clients. We use a disciplined portfolio construction methodology combining post-modern portfolio theory and risk management to pursue our clients' objectives.

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