



Authored by:

Morgane Delledonne
Head of Investment
Strategy, Europe

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GLOBAL X ETFs INVESTMENT STRATEGY

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The market started the year on a bumpy note, revealing investor bearishness about the global economic outlook. The slowdown in U.S. economic growth coupled with the missed estimate for Institute for Supply Management (ISM) manufacturing and consumption slowdowns in China and India had boosted expectations of a dovish turn. However, the minutes from the Federal Reserve's (Fed) meeting in December signalled a neutral stance from Federal Open Market Committee (FOMC) members rather than a dovish pivot on interest rates, which led to a pullback in the December rally. The mismatch between the Fed and the markets on the rate outlook could persist well into Q1 as both await data that confirm, or contradict, their views. Despite these market uncertainties, more upside potential in U.S. equities is expected compared to their European counterparts, as well as in several key themes including those relating to the clean energy transition.

Investment strategies highlighted this month:

- **The Fed and the market are at odds** – Mismatched expectations for interest rates will likely keep market volatility high in Q1 as investors wait for economic data, namely inflation. Prospects for lower rates and a weaker USD set the stage for a global soft landing, leaving U.S. equities with more upside potential than their European counterparts this year.
- **Oil prices appear more susceptible to economic risks** – Tensions are rising in the Red Sea, but it is believed that oil prices have more downside potential than upside potential amid deteriorating macroeconomic data and increased influence from the non-OPEC countries.
- **Clean energy could bounce back in 2024** – After a rough 2023, attractive valuations, the bearish outlook for oil prices, prospects for lower interest rates, and government investment could be catalysts for the Solar, Wind Energy, and Lithium & Battery Technology themes.

The Fed or the Market: Who Gets It Right About the U.S. Economy?

Better-than-expected U.S. job growth and wage gains in December triggered the early January selloff in stock markets. If economic data continue to show more strength than what the market anticipates, stocks could be prone to another selloff towards the end of Q1. With the 10-year Treasury yield hovering around 4% in January, the U.S. Dollar Index and the major U.S. equity indices continue to fluctuate with no clear direction either way.¹

For December, nonfarm payrolls increased by 216,000 after downward revisions to payrolls for October and November.² The unemployment rate held at 3.7%, while average hourly earnings rose 0.4% from November.³ Fed Chair Jerome Powell noted that wage gains had been "gradually cooling off."⁴ U.S. Consumer Price Index (CPI) numbers were mixed for December with a slowdown in core inflation to 3.9% year-over-year (yoy) from 4.0% yoy in November and a pickup in headline figures to 3.4% yoy from 3.2% yoy, which left the status quo intact.⁵

Overall, the U.S. job market remains tight and the economy might require less monetary easing than the market expects. Based on fed funds futures, market participants now expect about 140 basis points (bps) of cuts to the fed funds rate this year.⁶ That expectation means almost 6 rate cuts of 25bps this year, or double what the FOMC projected in December.⁷



The next two inflation prints are critical to the Fed's path. A 25bp rate cut in March still looks possible given that Fed policy remains so restrictive, at levels last seen in 2000 and 2007 when looking at the real fed funds rate based on PCE inflation.⁸ When the time comes, the Fed is likely to rapidly turn more neutral. However, the current pace of the economic slowdown doesn't suggest a more pronounced dovish pivot just yet. It is viewed that the December jobs and inflation data are not enough to materially impact the Fed's view. The Fed is likely to wait for more marked deteriorations in the economy before shifting its policy from neutral to accommodative.

Europe's economic resilience and the emerging market soft landing counterbalance the rising U.S. domestic weaknesses. Expectations for the Bank of England (BoE) and the European Central Bank (ECB) to turn more dovish faded due to better-than-expected employment data and rising wage inflation. The economic conditions and the low level of real rates limit the central banks' maneuvers, at least in the first half of the year. Also, it seems highly unlikely that either the BoE or the ECB would cut rates prior to the Fed, given that the U.S. slowdown is more marked than Europe's.

Similar to the U.S. situation, markets interpreted the BOE's statements from its December meeting as more dovish than they were, which resulted in an equity rally across the board. In fact, the BoE was rather cautious in calling recent softer inflation data a trend and warned inflation was largely due to fading external cost pressures, but services inflation remained elevated, without any indication of rate cuts.⁹ The ECB hasn't signalled an imminent rate cut either. So while markets price a first rate cut as soon as April in Europe, the risks are largely skewed towards the first cut in the second half.

Oil Outlook: Slowing Global Growth Outweighs Geopolitical Risk in the Red Sea

Oil prices began 2024 lower than their average for 2023 despite heightened geopolitical risks in the Red Sea. Currently, the slowdown in the global economy, especially the recession risk in the United States and the consumption slowdowns in China and India, outweigh the risk of supply disruptions. The strong non-OPEC supply could continue to counter OPEC's efforts to tighten the market, leaving markets with ample supply and reducing OPEC's influences on prices. The possibility of OPEC members not meeting their lower quota could also hurt oil prices.

The tensions in the Red Sea, including the recent U.S. and UK airstrikes on Houthi targets, appear to be causing a prolonged redirection in oil flow. Events like these add a geopolitical risk premium to oil prices and prevent a more marked decline for now. Outside of a geopolitical tail risk that materially disrupts the market, such as a more direct engagement from Iran, oil prices have limited upside.

The Red Sea is more critical for Russian oil barrels heading to Asia after European buyers shunned them following the Ukraine invasion. Iran's oil assets and ability to block trade via the Strait of Hormuz make its potential direct engagement in the war a substantial danger to the regional energy supply. On average, 15 million barrels a day of OPEC+ petroleum went through the Strait of Hormuz in 2023, compared to 3 million through the Suez Canal and the Red Sea.¹⁰

Clean Energy Catalysts: Valuations, Oil, Interest Rates, Government Support

Clean energy themes largely underperformed in 2023, driven by a repricing from high valuations at the start of last year, the significant rise in oil prices at the end of the summer, and aggressive monetary policies in the United States and Europe. It can be a different story in 2024, though, as clean energy valuations look increasingly attractive compared to the broader tech benchmarks.¹¹ Also boosting clean energy's outlook is the bearish outlook for oil prices and prospects for lower interest rates. Given the risk for market volatility this year, it is believed that the more mature and profitable markets within the clean energy themes could perform, including those in Solar, Wind Energy, and Lithium & Battery Tech.

In addition, these themes continue to benefit from large private and public investments in Europe and the United States. Ahead of the COP28 climate conference, the United States and China announced an



agreement to work towards tripling global renewable energy capacity by 2030.¹² In November 2023, the U.S. Department of Energy announced an additional US\$3.5 billion from the Infrastructure Investment and Jobs Act (IIJA) to boost domestic production of advanced batteries and battery materials.¹³

The United Kingdom announced a five-year funding package of £960 million (US\$1.19 billion) aimed at increasing domestic clean energy manufacturing, including for offshore wind, electric vehicles, batteries, carbon capture, and hydrogen.¹⁴ Also in Europe, the North Seas Energy Cooperation (NSEC) countries announced plans to launch a joint offshore wind tender initiative and coordinated offshore infrastructure planning.¹⁵

Footnotes

1. Bloomberg data as of 16 January 2024.
2. U.S. Bureau of Labor Statistics. Current Employment Statistics. Payroll employment increases by 216,000 in December; unemployment rate unchanged at 3.7%. 05 January 2024.
3. Ibid.
4. Federal Reserve. Summary of Economic Projections. 13 December 2023.
5. U.S. Bureau of Labor Statistics. Consumer Price Index. CPI for all items rose 0.3% in December; shelter up. 11 January 2024.
6. Bloomberg data as of 17 January 2024.
7. Federal Reserve. Summary of Economic Projections. 13 December 2023.
8. Bloomberg data as of 17 January 2024.
9. Bank of England. Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 13 December 2023. 14 December 2024.
10. MarketWatch. Red Sea crisis highlights 'clear and present danger' of wider war involving Iran. 3 January 2024.
11. Bloomberg data as of 17 January 2024.
12. Reuters. COP28 chief, groups, urge tripling renewable capacity by 2030. October 30, 2023
13. Department of Energy. Department of Energy Celebrates Two Years of President Biden's Historic Investment in America's Clean Energy Future. 15 November 2023.
14. Department for Energy Security and Net Zero and The Rt Hon Claire Coutinho MP. Huge boost for UK green industries with £960 million government investment and major reform of power network. 23 November 2023
15. European Commission. North Seas conference in The Hague: from national goals to joint action for offshore wind energy. 20 November 2023



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