



According to CIO, the probabilities of a negative/bearish scenario for the economy have significantly declined. (UBS)

From a softish landing to an outright soft one

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The Fed's renewed dot-plot – in which policymakers provide quarterly forecasts - showed a median expectation of 75bps of cumulative rate cuts in 2024; more importantly, though, it clarified that no one in the FOMC was expecting further hikes this year.

From a softish landing to an outright soft one – explaining our revamped macro outlook

The past few weeks have been eventful, with the US Fed December meeting marking a clear inflection for market-watchers.

The Fed appeared more comfortable on its policy stance because inflation has fallen faster than expected. More specifically, the FOMC revised down by 50bps its 4Q23 PCE and core PCE inflation forecasts to 2.8% and 3.2%, respectively.

Additionally, core PCE – the key inflation metric monitored by the Fed – surprised to the downside after the December FOMC meeting and over the past six months has averaged a monthly print 0.15%. This implies an annualized core PCE trend of 1.9% – a figure that is actually below the Fed's 2% target.

Meanwhile, incoming data from the labor market seems to suggest that while job creation is decelerating, there are no reasons to think that it may fall off a cliff.

Policymakers' tone has also changed, with greater confidence that the current rates level is enough to accomplish inflation's convergence to the target, and a stronger focus on adjusting policy in time to avoid a recession.

So why so many were calling for a recession?

Well, the easiest way to explain it is that – from a statistical model standpoint – many variables during 2023 pointed toward a looming recession.

Historically, when the Fed tightens monetary conditions and the yield curve inverts, a recession becomes highly likely. These conditions have been present for more than a year, and while the recession alarms were being rung by financial industry experts, the economy just kept humming along.

Why were the models wrong, though?

Well, for one, because the world changes. Empirical analyses based in previous trends do not necessarily convey the present.

A key factor behind 2023's economic resilience was the accumulation of savings during the pandemic. At the beginning of 2023, our estimates suggest that there were still nearly \$1.5 trillion of excess savings, which underpinned consumption even amid high rates and elevated inflation.

Another relevant aspect was the persistent increase in government expenditures and public investment, which has expanded at an average of about 5.0% (SAAR) over the past 4 quarters, notably pushed up by defense spending.

Moreover, another long-discussed factor, is that the sensitivity of the economy to interest rates may be lower now than in the past. As the US economy has become more services-driven, the effect of high rates through the gross fixed investment channel may have become smaller.

What do we foresee in this 2024, then?

We expect the economy to accomplish a soft landing, rather than a softish one.

More specifically, when we used to say “softish” – we were trying to reflect that growth would be well below normal, with a non-negligible chance of an sequential economic contraction at some point; those concerns have largely ceased.

In our view, the probabilities of a negative/bearish scenario for the economy have significantly declined since lower inflation makes it easier for the Fed to cut rates, even in the absence of adverse economic growth data.

How to position in this milieu?

Well, in equities, we have revised up our S&P 500 June target to 4,900 (from 4,500) and our year-end target to 5,000 (from 4,700). In our base case, we think equities should display a modest upward trend in coming quarters.

However, acknowledging the possibility of an economic slowdown (which is not a contraction!), we want to reiterate to investors the importance of holding high-quality assets — as quality companies will generally have the capacity to outperform the overall market in times of macro weakness.

We also think market participants should position in such a way that they can capture further equity upside, in case the rally continues. As such, we recommend tactically adding positions in US small caps. From a sector standpoint, we remain most preferred on consumer staples, energy, and information technology.

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See the recent report, [Cooling core CPI supports the case for a soft landing.](#)

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