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2024 will be a challenging year for investors with the backdrop of war and geopolitical uncertainty. (UBS)

Asset Allocation: Looking ahead to 2024

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Market sentiment has improved into year-end, with the S&P 500 now up over 15% in 2023 and US 10-year yields back below 4.5%, down from 5% just a few weeks ago. While the positive market moves are a welcome holiday gift for investors, we think we are entering "a new world" in 2024.

On the economic front, we expect global growth to slow. US consumption should decline, but avoid a deep contraction. This should allow the Fed to start cutting rates starting in the middle of next year, putting further downward pressure on Treasury yields. Meanwhile, we expect politics to play an outsized role, with the US presidential election, Israel-Hamas and Russia-Ukraine wars, and the US-China rivalry all having the potential to shake up markets.

Against this backdrop we maintain our overall preference for bonds over equities, though we recommend investors **buy quality** in both asset classes. Quality bonds offer attractive yields today and we expect capital appreciation as growth slows and yields fall. Specifically, we like US TIPS, investment grade corporate bonds, Agency MBS, and sustainable bonds.

While we are neutral on global and US equities overall, we focus on quality names. Stocks with strong balance sheets and high returns on invested capital, including those in the technology sector, should be best positioned to generate earnings despite weaker growth. Within US equity sectors we upgraded information technology to most preferred, as higher-quality companies that have good secular growth should benefit in the late-cycle environment that we expect. Elsewhere, we remain most preferred on consumer staples and energy. We are least preferred on materials, utilities and real estate.

With interest rates set to fall next year amid slowing growth, the return on cash will be diminished, while reinvestment risks will grow. We recommend that investors actively manage liquidity and prioritize minimizing cash balances and optimizing yields.

While the outlook for both stocks and bonds is positive heading into 2024, we recommend that investors focus on **diversifying with alternative credit** and look to **capture growth from private markets**. Certain strategies like credit arbitrage and distressed debt have a supportive backdrop today. High debt balances, slowing growth, and refinancing needs could contribute to elevated price and spread volatility, creating opportunities for skillful managers. In the private space, managers with the ability to provide equity or debt capital to companies across lifecycle stages have a key role to play supporting companies that offer innovative solutions across industries.

Thematically, we see opportunities to **pick leaders from disruption** in industries across technology, energy and healthcare. AI beneficiaries should broaden to software and internet firms, the renewable energy transition still needs substantial private investment, and drug innovation in diabetes and weight-loss fields is driving strong industry growth, while addressing growing medical issues.

Lastly, 2024 will be a challenging year for investors with the backdrop of war and geopolitical uncertainty. That means investors need to consider ways to **hedge market risks**. Aside from diversification, we see value in capital preservation strategies, alternative investments, or positions in oil and gold.

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