March 2024 Market Insights

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Reasonably well-grounded optimism

Evaluating our 2024 Outlook

Our 2024 Outlook proposed a "base case" for the economy that achieves a soft landing – modest slowing, stabilization, and then favorable economic drivers later in the year that "shift[s] growth and profits higher in the economy." In that Outlook, we also proposed, "The most notable upside risk for the economy and equity markets is that the proliferation of artificial intelligence has potential to drive productivity gains sharply higher in 2024 and beyond."

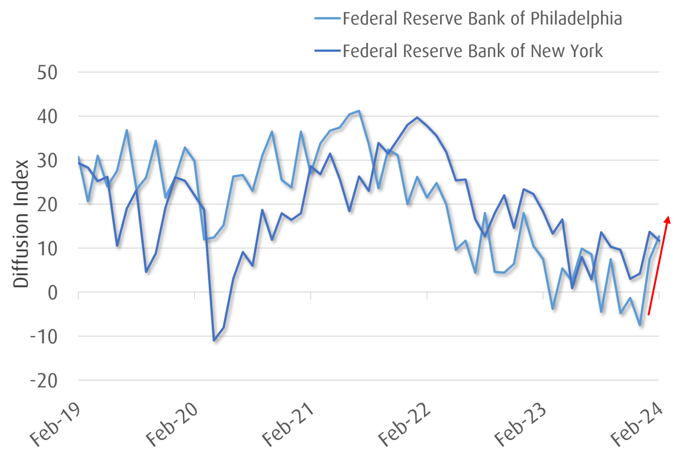
Over the first two months of this year, the labor market has indeed remained healthy. As can be expected in the latter stages of a soft landing, some recent economic data, such as consumer confidence and the ISM manufacturing survey, have been mixed. Even inflation data for January – both CPI (Consumer Price Index) and PPI (Producer Price Index) – surprised to the upside. Stickier inflation combined with strong job growth have pushed market expectations for the Fed more in line with our own expectations of rate cuts beginning in the summer and only being a few in number this year.

Favorable trends – AI, productivity, and green shoots of capital spending

Despite mixed economic data, the stock market has started strong in 2024. We believe there are two primary reasons for the continued market resilience. The first reason is enthusiasm for AI and its potential to generate strong productivity gains. Indeed, our 2024 Outlook posited an "upside scenario" in which "productivity growth kicks in more strongly." While the eventual productivity impacts of AI remain uncertain and, at least for now, largely reliant on anecdotes, market optimism is bolstered by the experience of the mid-1990s. During that time period, productivity gains from computer proliferation and the internet rollout set the stage for high growth, low inflation, and exceptional stock market gains for multiple years.

The second reason for the stock market's strong performance to start 2024, we believe, is an early indication that corporate spending could pick up over the next few quarters ***(Exhibit 1)***. In 2023, the concern about a looming recession restrained corporate spending, but once the soft landing actually "lands" in 2024 and the Fed begins cutting interest rates, corporations are likely to refocus on growth and expansion. Business spending may not be the largest component of GDP, but it can fluctuate significantly and be an important swing factor for the economy.

Exhibit 1: Future Capital Expenditures as of Feb. 2024

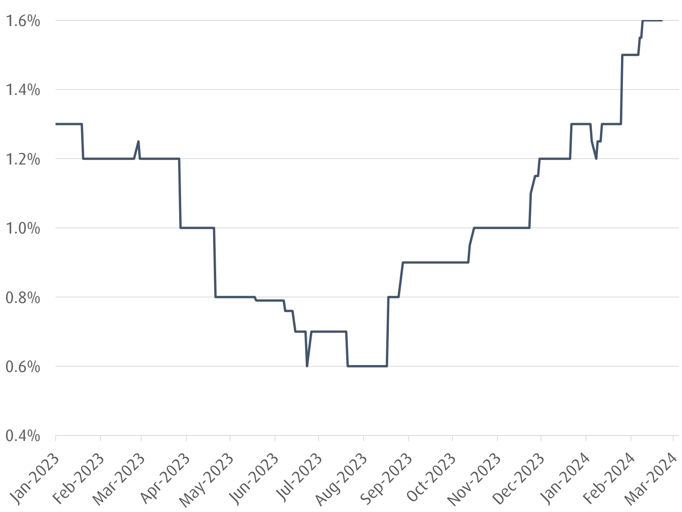


Source: Federal Reserve Bank of Philadelphia (2024), Federal Reserve Bank of New York (2024), Federal Reserve Bank of Dallas (2024); BMO Wealth Management (2024)

Looking ahead

Our 2024 Outlook recommended a balanced approach to risk. While U.S. equities remain a portfolio ballast, we also continue to emphasize high-conviction positions such as U.S. infrastructure, Japanese equities, and reinsurance/catastrophe bonds. In addition to favoring these portfolio tilts, we believe that the current AI enthusiasm increasingly lends weight to the “upside scenario” for equities that we discussed for 2024. The stock market is forward looking and expectations for growth this year have been rising ***(Exhibit 2)***.

Exhibit 2: Consensus U.S. GDP Forecast - 2024



Source: Bloomberg L.P. (2024), BMO Wealth Management (2024)
As of March 5, 2024

In just the initial two months of the year, U.S. equities have experienced almost an average year’s worth of gains. The continued upward trajectory, we believe, will be dependent upon 1) falling inflation that allows the Fed to cut rates by mid-year, 2) a stable labor market, 3) AI-driven productivity gains/anecdotes, and 4) a pick-up in business spending. Fortunately, not all of these elements have to fall perfectly into place for market gains to continue throughout the year. The equity market is priced for “pretty good,” not for “perfection.”

As our Outlook indicates, we do not believe the stock market is in a bubble. Our proprietary BMO Sentiment Metric is registering a near neutral reading, indicating neither excessive froth nor excessive fear in the equity market. Anecdotally, the market is not exhibiting 1999-like bubble behaviors. We see reasonably well-grounded optimism; not “irrational exuberance.”

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