FRANKLIN TEMPLETON | Institute

December 2023

Global Investment Outlook

Flexibility, resilience and opportunity

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About Global Investment Outlook

Global Investment Outlook allows the Franklin Templeton Institute strategists to highlight manager's views on markets across the firm. Our mission is to provide our clients with research that meets their needs and concerns. We do this by listening, understanding, and then harnessing the resources of our firm to answer the challenge. We organize around areas of exploration to develop distinct insights and their practical applications. Two related Franklin Templeton Thinks publications of note are Allocation Views, produced by Franklin Templeton Investment Solutions, which offers you our best thinking on multi-asset portfolio construction; and, Macro Perspectives, produced by the Institute, featuring economists from across the firm dissecting key macroeconomic themes driving markets.

Quality helps weather storms

> **"The oak fought the wind and was broken, the willow bent when it must and survived."**
>
> Robert Jordan

Stephen Dover, CFA
Chief Market Strategist,
Head of Franklin Templeton Institute

Trees are an appropriate metaphor for investing. When nurtured, they grow gradually but inexorably. Upon maturity they yield their bounty—shade, nuts and sweet fruit. Yet some trees withstand adversity better than others. Resilience requires flexibility, and in heavy winds, the willow's ability to bend is superior to the oak's girth. We expect markets to experience many storms in 2024. Portfolios that bend but don't break are best suited to provide the resiliency for what lies ahead.

In our recent piece, "*Quick Thoughts: Inflation—the final mile*," we discussed why the Federal Reserve's (Fed's) resolve to reduce US inflation to its target is likely to lead to weakening of both economic growth and corporate earnings in 2024. US monetary policy and credit conditions have become progressively more restrictive during 2023 as interest rates have risen, with the implication that economic activity will weaken, unemployment will rise, and a growing number of households and businesses will experience credit duress in 2024. In short, we expect an economic slowdown in 2024.

Politics may also create turbulence and uncertainty, as there are 40 upcoming national elections representing 41% of the global population in 2024 alone. Russia, India, the European Union and, of course, the United States, will hold elections that will likely re-shape the path of global affairs in the second half of the decade. The nuances of these leadership changes and potential legislative paths will alter both future fiscal spending considerations and global trade flows.

In the case of the United States, should divided government continue in Washington after the 2024 elections, partisan divides suggest little scope for legislative accomplishments. However, the history of the 1990s or the period from 2010–2016 suggests that divided government could result in greater federal government spending restraint and overall deficit reduction (as a share of gross domestic product [GDP]).

A Republican "clean sweep" would create opportunity for tax cuts or at least extensions of the expiring tax cuts under the former Trump administration beyond 2025 (somewhat limited by the size of the deficit), and even greater latitude for deregulation in sectors such as energy exploration and development, private use of public lands, as well reduced red tape in larger market capitalization (cap) sectors such as finance or health care. Meanwhile, a Democratic clean sweep would point to higher public investment in "clean technologies," infrastructure, education and health care. It might also be accompanied by higher personal and corporate income taxes and, potentially, the restoration of the inheritance tax.

Security and defense spending, both in the United States and globally, are likely to increase in almost any political outcome, given the disappearance of the "peace dividend" in Europe, the Middle East and the Far East.

Given these conditions, a bias toward ensuring the resilience of investment portfolios is warranted if not necessary. To some extent, familiar strategies are required such as a focus on higher-quality stocks and corporate credits. However, a key point of emphasis is that investors should be prepared for selective risk-taking as cash yields peak and then decline. Investing in the appropriate diversified mix of stocks, bonds and alternative investments, which we believe the market is mispricing, will be particularly important in navigating these difficult conditions.

The starting point

Our insistence on caution about the economy and markets may strike many readers as odd. After all, in the course of 2023, global equity markets have roared back from the 2022 setbacks. More recently, bond performance has also improved as interest rates fell from their peak. In both cases, a key driver of strong performance has been painless disinflation—the ability of the United States and many other economies to witness falling rates of inflation without having to endure recession.

However, prevailing assets are already pricing in the current good news as well as the expectation for more good news to follow. Stocks have zoomed ahead of earnings expectations, pushing up overall valuations. Ten-year Treasury yields have fallen some 100 basis points (bps) from their recent peaks, dragging down yields across fixed income markets. When good news is priced in, investors should take note rather than merely be swept up by the euphoria.

Investor cheer also owes to another form of resilience, namely the ability of the United States and world economies to largely shrug off monetary policy tightening and continue to grow. That growth, in turn, has made equity analysts more upbeat, as reflected in upward consensus earnings revisions into the double-digits for 2024. However, we think corporate earnings are unlikely to grow at such an aggressive rate.

Turning point

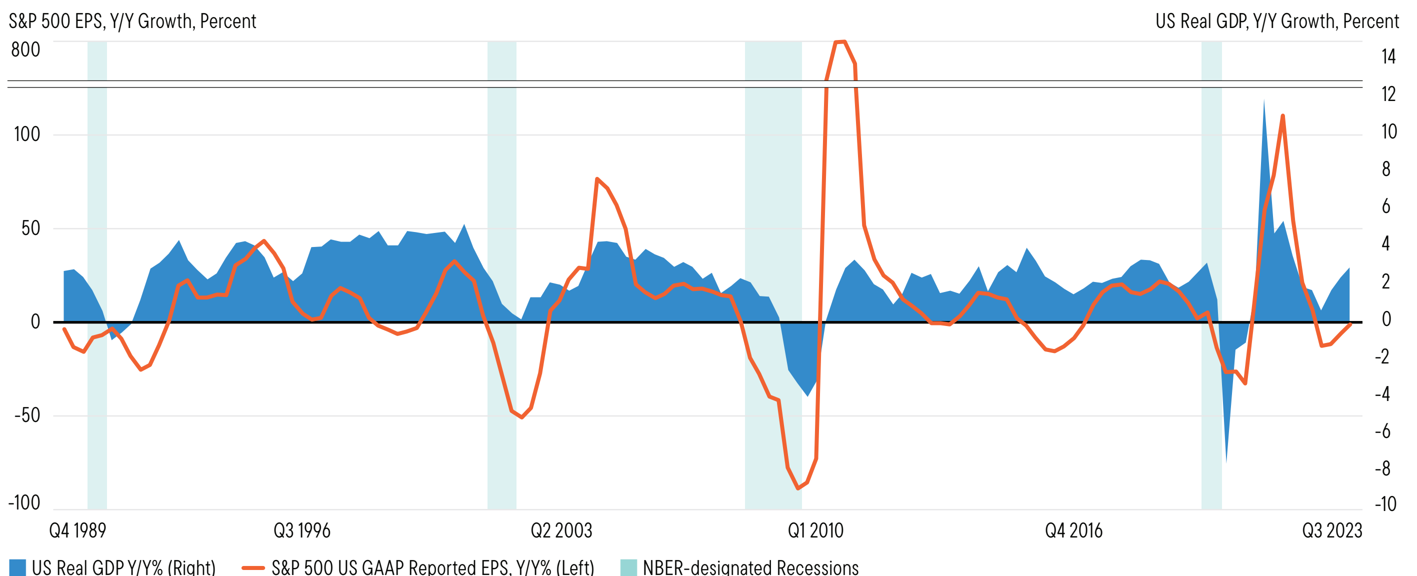
Signs of economic weakness are emerging in labor markets (e.g., slowing jobs growth), in capital spending, and in both macroeconomic and "big box" retailer reports of softer household spending. As we have noted elsewhere in "*Quick Thoughts: Quiet shifts in corporate debt may explain this year's big economic surprise*," US and global economic resilience to higher interest rates partially occurred because so many had financed at the lower, prevailing interest rates and did not need to refinance as rates rose. At some point, higher borrowing costs (now compounded by tighter lending standards of banks and others) will elicit a predictable softening of demand. The concern we have is that once that inflection point arrives, a tardy central-bank response could turn a soft landing into something much bumpier.

Investors, across all asset classes, should take note. Our trajectory of economic and earnings growth differs from what bottom-up analysts and markets presently discount. One of the most reliable indicators of corporate profits growth, after all, is real GDP growth. An earnings acceleration, whether reflected in prevailing elevated price-to-earnings (P/E) ratios or as those who follow companies have forecast, has never proven correct (Exhibit 1) when economic growth turns negative, which we believe is an increasing risk for the year ahead.

US GDP Growth and S&P 500 Earnings

Exhibit 1: US Real GDP Growth vs. S&P 500 Earnings-Per-Share Growth

Fourth Quarter 1989–Third Quarter 2023



Sources: Franklin Templeton Institute, S&P Global, BEA, Macrobond. As of November 16, 2023. GAAP = Generally Accepted Accounting Principles. Important data provider information and terms available at www.franklintempletondatasources.com. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

A small number of high-performing companies continue to lead broad US indexes. The promise of artificial intelligence (AI), among other digital transformations in the economy, continues to propel these high-performing stocks. However, we believe the best future investment opportunities are likely to come from outside this small group as the earnings power across the rest of the market is being undervalued.

But it isn't just about cyclical stocks. As growth and earnings disappointments arrive, credit spreads are likely to widen.

Bond yields, which fell rapidly in the fourth quarter of 2023, have further to fall, in our view. High US interest rates have propped up the US dollar against foreign currencies, and we think the dollar is poised to depreciate.

Global equities

How, then, should investors adjust portfolio holdings to the shifting fundamentals? We begin with global equities.

Macro-driven growth and earnings disappointments will likely be global, and we suggest that investors should reduce risk to more cyclical sectors, styles and, to some extent, regions. A weaker dollar will also have implications for regional allocations.

A small number of high-performing companies continue to lead broad US indexes. The promise of artificial intelligence (AI), among other digital transformations in the economy, continues to propel these high-performing stocks. However, we believe the best future investment opportunities are likely to come from outside this small group as the earnings power across the rest of the market is being undervalued.

Across markets, we prefer stocks with sustainable growth and dividends. Note that our preference is not for mere dividend yield. After all, high dividend-yielding stocks include many cyclical or over-leveraged companies whose prices become fundamentally depressed during periods of earnings weakness, eventually resulting in dividend cuts. Our preference is for dividend quality. Quality companies—ones that consistently grow dividends based on sustainable and less volatile sources of profitability—can provide better stability and downside protection in challenging markets. To provide stability through the ups and downs in the economy, quality companies often have less cyclical exposure and are exposed to attractive secular themes, which can in turn provide growth participation throughout the expansion phase of a market cycle.

Focusing on opportunities outside the United States, the regionalization of trade will become an even more powerful force in 2024. The increase in the global geopolitical temperature with wars in Ukraine and Gaza is one reason for the acceleration of this trend. A desire for each country to create strategic stability after the experiences around COVID-19 and the Russia-Ukraine war has driven reshoring. The uncertainty of these conflicts will not slow down this path. This will allow for the potential incremental growth in manufacturing and consumer spending across a wider group of countries, particularly those with either access to or expertise in processing critical minerals that are becoming increasingly important to the global economy.

At a regional level, our greatest concerns reside in Europe. European companies have already recorded weaker margins and overall profitability than their global peer group, despite the tailwind of positive translation gains that accrue from the euro's weakness. It is difficult to imagine much enthusiasm for European companies as global growth slows and the US dollar weakens.

Japan, on the other hand, offers a more resilient earnings story, girded by secular gains in operating margins. Moreover, for now, the yen remains weak in global currency markets, given the Bank of Japan's continued policy of (relative) monetary policy easing.

China is also of interest. Recent domestic and foreign policy moves (including President Xi Jinping's positively received summit with US President Joe Biden) suggest that China is shifting toward a more pragmatic approach to domestic and international economic priorities, which should support its economy and earnings. Recently, for example, the International Monetary Fund upgraded its 2024 growth forecasts for China. The (mainland) Chinese equity market trades on historically low valuations (relative to its own history and to global peer markets) and given various anecdotal evidence that investors have shunned Chinese equity plays, there may be opportunities for contrarians.

Lastly, India warrants attention. Traditionally, the Indian equity market has been considered a defensive play within emerging markets, given its less-cyclical composition of holdings relative to China or other Asian markets. We believe India also warrants another look for longer-term reasons. Corporate governance and transparency have improved relative to other emerging market countries. India will also benefit from greater investor flows, as India's weight in the MSCI Emerging Market Index was increased on November 30.[1]

Fixed income

Notwithstanding the sharp declines in long-term government bond yields through the middle of the fourth quarter of 2023, we continue to believe that overweighting high-quality fixed income within portfolios makes sense.

The primary reason we favor fixed income is our concern about weaker growth in 2024. Weak growth, rising unemployment and falling inflation will prompt the Fed (and other central banks) to cut interest rates. Given these factors, rates have peaked and therefore should come down. US 10-year Treasuries recently dipped below 4%, and we can readily envisage more rate cuts in 2024 than the roughly 50 bps the interest-rate swap market currently implies.

Growth and earnings disappointments will expose flawed business models underpinned by excessive borrowing, and both the corporate and household sectors will bear the effects. Accordingly, within areas of credit, we prefer higher-quality securities more senior in a company's capital structure and credit instruments. US government sponsored mortgage-backed securities, investment-grade corporate bonds, and high-quality private credit allocations are preferable to subordinated debt or covenant-light structures, in our view. We are also cautious that there is not enough risk implied in the valuations of lower-credit-quality securities across both public and private credit. We would especially focus on higher-credit-quality securities within the high-yield space. Some might consider high-yield fixed income as a bridge between fixed income and equity investments.

Real estate

As a general proposition, cyclical weakness and high (real) interest rates are negatives for real estate. Yet, investors must also pay attention to market pricing and what has already been discounted. Over the course of the past year, negative headlines have strongly pushed down valuations in areas of commercial real estate, particularly office space. We believe investors should begin searching for opportunities only where pricing reaches distressed levels. Patience is the byword, as weaker economic and financial fundamentals are likely to depress prices further.

Shifting dynamics including demographics, technology, deglobalization, housing affordability/shortages and climate change all influence where the best opportunities in commercial real estate can be found. While factors, such as working from home, are challenging commercial office spaces, low vacancies and higher demand make sectors such as industrial warehouses, life sciences, self-storage and multi-family real estate more appealing.

Portfolio construction

For many investors, the painful memories of combined equity and fixed income disappointments in 2022 remain fresh. That year, portfolios took a once-in-a-generation hit from simultaneous large setbacks in stocks and bonds.

The good news is that the experience was, indeed, a rarity. But it was also a useful teaching moment about how and when balanced portfolios work and when they don't.

The key takeaway from 2022 is that an inflation shock and the need for central banks to hike short-term interest rates rapidly undermined stocks and bonds. In that environment, neither asset class can offer refuge and, as a result, diversification via a blend of stocks and bonds proved impossible.

But that is not the scenario we envisage for the coming year. Instead, weaker growth, or even a recession, will cause inflation to retreat. If so, earnings disappointments may drag many stocks and corporate bonds lower. However, rising bond prices will act as an offset as yields decline in anticipation of central bank easing.

In short, 2024 is likely to be a year in which balance and diversification are rewarded.

Risks to the view

No outlook is complete without some consideration about how things could turn out differently and what that could mean in terms of investment strategy and portfolio construction.

Should the current wars widen, energy supplies could be jeopardized and risk premiums would jump. Higher energy prices could then put central banks in a quandary, insofar as they would blunt or reverse progress toward disinflation. If central banks were then slow to ease, stock markets will be

US Treasury 10-Year Real Yield (Nominal Yield Minus Inflation Expectations)

Exhibit 2: US Interest Rates and the Business Cycle

January 1, 1997–October 31, 2023

Sources: Franklin Templeton Institute, Bloomberg, Macrobond. Important data provider notices and terms available at www.franklintempletondatasources.com. **Past performance is not an indicator or a guarantee of future results.**

even more vulnerable than we anticipate, and bond yields might not fall much either. Diversification via balanced portfolios could once again fail. Similarly, an outbreak of hostilities elsewhere could disrupt supply chains for other raw materials or industrial goods, with similar adverse consequences for investor portfolios.

In the realm of more knowable factors, many observers fret that large government budget deficits and debts, coupled with political constraints to common sense compromises, might force up bond yields, undermining the diversification benefits of Treasuries or other fixed income securities considered low risk. While recognizing that potential pitfall, we would also note that if the economy is slowing (as is our base case), private sector credit demand will ebb, offsetting the impact on economy-wide borrowing costs of large government budget deficits. Indeed, the norm is for real and nominal interest rates to move with the business cycle, not fiscal borrowing (Exhibit 2).

The exception, of course, is if a significant credit risk premium were to emerge for the US government. While impossible to exclude as a possibility, that outcome still strikes us as fundamentally remote, given the unique qualities of the US Treasury market (liquidity, reserve asset, rule of law, etc.).

Conclusions

Ending where we began, the storms that are brewing require a great deal of flexibility when considering how to allocate assets within a portfolio. With interest rates at current levels, fixed income opportunities are widespread, and we believe they will provide a better total return option over high-yielding cash equivalents going forward as slowing inflation continues to pull interest rates downwards. Equity allocations should tilt toward sectors and regions that are being overlooked due to the heavy concentration toward the singular theme of AI. And lastly, alternatives like private real estate may have pockets of weakness, but also provide exposure to areas of the market that have secular growth stories consistent with larger themes that are expected to drive the economy in the future.

Navigating the year ahead through multiple lenses

Franklin Templeton Institute and our independent investment teams provide a diversity of thinking. This diversity is reflected in wide-ranging views on macro topics such as the growth, inflation and interest-rate outlook, as well as where they believe the best investment opportunities can be found in 2024. Given this, we have summarized the key themes from Franklin Templeton Institute and our independent investment teams to help better understand how they compare to one another. Because we believe an investor's portfolio should be distributed across the broad range of asset classes and regions in a way that optimizes the balance of risk and reward across various economic outcomes, we hope this provides context as to where our independent managers might fit into a broad allocation.

The macro outlook

The Franklin Templeton Institute view

We expect the global economy will slow in 2024 but avoid a recession, with inflation moderating. This will prompt the Federal Reserve (and other central banks) to cut interest rates over the next year.

What do our investment teams think?

ClearBridge Investments	"Currently the markets are discounting a soft landing; however, our base case remains recession as the pre-conditions we track persist."
Martin Currie	"Rising risks of recession given rapid rate hikes in 2022–2023, even if still not our central scenario for the United States."
Franklin Templeton Fixed Income	"We do not feel the US economy will fall into a technical recession over the course of 2024 and 2025; however, even in a 'soft landing' scenario, there will be some pain as the economy slows."
Royce Investment Partners	"While we don't predict when or if the economy will fall into recession, we do believe the small-cap market has already priced in a recession and many companies have been preparing for the possibility of one for some time."
Templeton Global Macro	"While risks to growth remain and global growth is more pedestrian than sparkling, the actual outcomes over the past year have been somewhat better than projections made this time last year, and have certainly defied the worst-case predictions of global recession."
Franklin Equity Group	"We see recession risks moderating in the United States and a period of stabilization in economic indicators as inflation cools and the Fed likely nears the end of the tightening cycle."
Franklin Income Investors	"The US economy is expected to experience a slowdown, though perhaps not at the level that market participants expected."
Brandywine Global	"Our base case has been that a recession is not needed for normalization to occur, providing the Fed reacts to lower inflation with timely rate cuts."
Western Asset	"In the United States, we do see positive growth and expect we'll avoid a recession but the headwinds cannot be underestimated."
Templeton Global Investments	"Both the United States and China are likely to avoid a recession in 2024. In our view, policymakers have considerable monetary policy flexibility to stimulate growth."

Equity market catalysts

The Franklin Templeton Institute view

Resilient economic growth has made equity analysts more upbeat, with consensus expectations for earnings growth in the low double-digits for 2024. We think corporate earnings are not likely to grow at such an aggressive rate given the expected slowdown in the broad economy.

What do our investment teams think?

ClearBridge Investments	"Investors will continue to react to company profit revisions, as well as any significant changes in interest rates."
Franklin Equity Group	"We believe 2024 may present an inflection point in revenue and earnings growth for many companies."
Franklin Mutual Series	"Value stocks trade at historically attractive valuations which we believe may be advantageous to investors in what could be a more uncertain 2024."
Martin Currie	"...the pivot in central banks and the potential for synchronized rate cuts across major central banks could be supportive for equity markets and for the quality growth style leadership in 2024."
Royce Investment Partners	"We see an array of potential triggers that would jump-start small-cap performance, which include the end of the rate hiking cycle, inflation moderating, a labor market that remains strong and consumer spending steady."
Templeton Global Investments	"US interest rate cuts and a weaker US dollar as well as signs of slowing growth in the United States are catalysts we believe will be positive for global ex-US and emerging market equities."

Fixed income market catalysts

The Franklin Templeton Institute view

With slower growth and earnings disappointments, credit spreads are likely to widen. Bond yields, which fell rapidly in the fourth quarter of 2023, will likely fall further. High interest rates have buoyed the US dollar, which we think is poised to depreciate.

What do our investment teams think?

Franklin Templeton Fixed Income	"We do not see a lot of opportunity for significant capital appreciation next year. Returns will be driven by the substantial income provided by holding fixed income assets, as yields remain attractive across many sectors."
Templeton Global Macro	"In our view, both cyclical factors (particularly the end of the US rising rate cycle) and structural factors (the US's twin current account and budget deficits) will result in US dollar weakness. We expect select emerging markets as well as Japan to benefit from this."
Brandywine Global	"After nearly three years of disappointing long-term Treasury total returns, mean reversion and normalization argue for a meaningful rebound. A major slump in nominal economic activity will likely be the main catalyst for a rebound in fixed income."
Western Asset	"With bonds offering the most attractive yields in nearly 15 years and an improving backdrop of lower inflation and peaking interest-rate cycles, we see strong tailwinds for fixed income."
Franklin Income Investors	"Within fixed income, there is strong potential for attractive total returns as monetary policy shifts from restrictive to either neutral or one of accommodation if the economy were to experience sluggish growth or recessionary conditions."

Greatest potential investment opportunities

The Franklin Templeton Institute view

Global equities

- We favor reduced exposure to more cyclical sectors and to regions going through cyclical downturn
- We prefer stocks with sustainable/ quality dividends
- US equities: Focus on undervalued stocks outside the "Magnificent Seven"
- Non-US equities: Focus on Japan, China and India

Fixed income

- Preference for high-quality duration on the back of concern about weaker growth in 2024
- Preference for higher-quality, more senior securities such as agency mortgage-backed securities, investment-grade corporates and high-quality private credit

Alternatives

- We see opportunities in commercial real estate benefiting from longer-term economic trends outside of the traditional office sector, including industrial warehousing and multi-family residential

Global equities: What do our investment teams think?

ClearBridge Investments	"We believe defensive stocks broadly defined are set to rebound as the economy slows. 2023's narrow advance has created extreme divergences in small- and mid-cap stocks vs. large caps, making them more attractive on a relative basis."
Franklin Equity Group	"We believe investors should expand their horizons beyond the 'Magnificent Seven' to include attractively valued, quality mid- and small-cap growth businesses throughout the broader market."
Martin Currie	"Equity valuations remain more supportive in Europe and Asia versus the United States, although a selective approach remains key… Thematic opportunities still abound, notably in the areas of energy transition, aging population and AI."
Franklin Mutual Series	"…seeking out value stocks can give investors more diversified global exposure and potentially more consistent returns over time, in our view. In Europe, we see big globally competitive companies trading at compelling valuations and providing the potential chance for attractive future returns."
Royce Investment Partners	"While the near-term view is as cloudy as any we've seen, there are enough positives for us to have a very constructive long-term view for small-cap returns going forward. Valuations for small-cap stocks are looking more attractive in aggregate and look even cheaper compared to large caps."
Templeton Global Investments	"The most attractive equity investment opportunities in 2024 center on emerging markets, global equities ex-US and small-cap stocks."

Fixed income: What do our investment teams think?

Franklin Templeton Fixed Income	"We remain focused on high-quality, lower duration assets that provide significant levels of income. In corporate credit, we are wary of sectors and issuers that will be disproportionately affected by a slowing economy. Within the securitized market, we look to selectively add to agency mortgage-backed securities as spread volatility has provided better entry points."
Templeton Global Macro	"We believe some countries in Latin America are benefiting from having been early movers, while certain emerging Asian countries have solid fundamentals, while both cyclical factors like interest-rate differentials and structural factors like reshoring are expected to further bolster their currencies."
Brandywine Global	"We believe 2024 could be a strong year for investors in general. From a valuation perspective, the bond market looks more attractive than the cap-weighted equity market, although there are clearly sectors trading at steep discounts to intrinsic value that also stand to benefit."
Western Asset	"Investment-grade credit offers opportunities, with fundamentals and technicals providing support. Agency mortgage-backed securities offer attractive spreads and high-quality carry. Emerging market debt stands out as an attractive opportunity given depressed valuations, prospects of policy easing, and potential to benefit from ongoing global economic growth."
Franklin Income Investors	"Our preferred asset exposures within fixed income heading into 2024 include US Treasury securities across the yield curve and investment-grade corporate bonds where refinancing risk is muted and balance sheets remain strong."

Investment perspectives: Opportunities for 2024

In the following, our investment teams share their perspectives on the outlook for 2024 through their responses to the following questions:

1. Do you expect a soft or hard landing in the major economies?
2. How will the path of interest rates and inflation develop in the major economies?
3. What catalyst could drive a significant shift in your asset-class focus?
4. Where do you see the best investment opportunities?
5. What are the main areas of risk?
6. What could be a major surprise to markets in 2024?

Multi-asset income perspective

Contributor

Ed Perks, CFA
Chief Investment Officer
Franklin Income Investors

Higher Yields Have Expanded the Opportunity Set for Income Investors

Fixed Income Yields

June 1, 2020–November 30, 2023

Source: Bloomberg. US Investment-Grade Corporates YTW is represented by Bloomberg US Corporate Bond Index, which measures the performance of the investment-grade, fixed-rate, taxable corporate bond market. It includes US dollar-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. US High-Yield Corporates YTW is represented by Bloomberg US Corporate High Yield Bond Index, which measures the performance of the US dollar-denominated, high-yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and Standard & Poor's is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets (EM) country of risk, based on Bloomberg EM country definition, are excluded. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Soft landing

While the Fed pursued a policy to move rates into restrictive territory, economists have long believed that monetary policy tightening acts with a long and variable lag. The broader impact that influences both consumer and corporate spending behavior may just be upon us now as we enter 2024. The US economy is expected to experience a slowdown, though perhaps not at the level that was previously expected by market participants.

Interest rates and inflation

We believe interest rates could remain higher for longer as inflation remains above the Fed's target. The remaining path toward the Fed's 2% target could also prove to be more challenging.

Catalyst

Within fixed income, there is strong potential for attractive total returns as monetary policy shifts from restrictive to either neutral or one of accommodation if the economy were to experience sluggish growth or recessionary conditions.

Opportunities

Our preferred asset exposures within fixed income heading into 2024 include US Treasury securities across the yield curve and investment-grade corporate bonds where refinancing risk is muted and balance sheets remain strong.

While we currently have a meaningful underweight to equities, we remain diligent by looking for opportunities where valuations more appropriately discount the potential slowdown in growth that we believe will characterize markets in 2024.

Risks

Total return prospects for equities could be challenged in 2024. With the higher-for-longer environment and lagged effect of monetary policy, we expect revenues and earnings growth to be far more challenged in the coming quarters.

Major surprise

A major surprise for 2024 would be an end to regional conflicts, namely the war between Russia-Ukraine and Israel-Hamas. This could provide a more favorable economic backdrop than is currently discounted in markets.

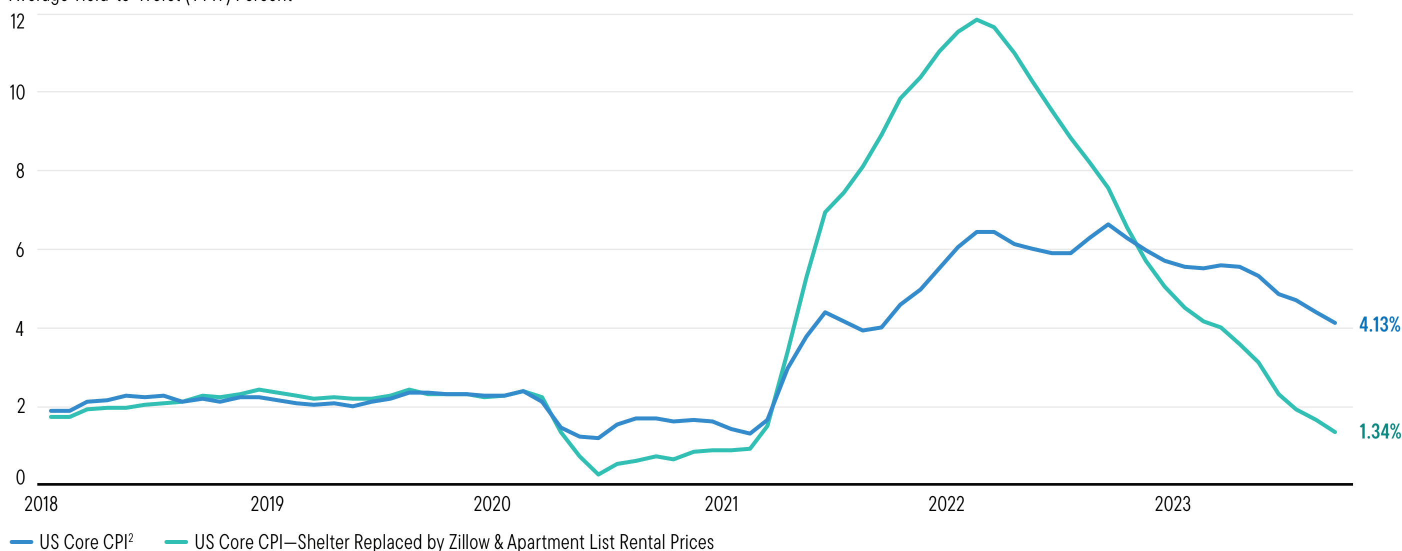
Global fixed income perspective

Contributor
Francis A. Scotland
Director of Global Macro Research
Brandywine Global

Adjusting the US Core Consumer Price Index (CPI) with Current Rents Shows a Different Inflation Picture

US Core CPI Inflation: Year-Over-Year Percent Change

As of September 1, 2023



Sources: Brandywine Global, Macrobond, Bureau of Labor Statistics, Apartment List, Zillow.

Soft landing

Our base case has been that a recession is not needed for normalization to occur, providing the Fed reacts to lower inflation with timely interest-rate cuts. The longer the Fed ignores the retreat in inflation, the longer the Treasury curve will remain inverted, and the higher the probability of a recession or some discontinuous event that increases recession risk. The odds of recession are not trivial. However, it is not the most likely scenario given our constructive view on inflation.

Interest rates and inflation

Price inflation has been in full retreat. US core CPI may already be below the Fed's 2% target after adjusting for shelter, which the CPI methodology does not capture well. With the lagged effects of monetary tightening yet to be realized, the risks point in the direction of an undershoot on inflation targets. This material drop in inflation removes any need for the Fed to keep raising rates and increases the probability it will cut rates, which would be very stabilizing. There is no macro inflationary pressure coming from China, and Europe may be even more disinflationary. In the United States, the remarkable resilience of the dollar and these external deflationary forces are helping suppress domestic inflation.

Catalyst

After nearly three years of disappointing long-term Treasury total returns, mean reversion and normalization argue for a meaningful rebound. A major slump in nominal economic activity will likely be the main catalyst for a rebound in fixed income. That slowdown should primarily come through inflation, but the Fed, if it stays too heavy-handed, could also play a role. If the Fed behaves according to our script, we will be looking for rate cuts sooner and faster than the market is currently pricing.

Best opportunities

We believe 2024 could be a strong year for investors in general. From a valuation perspective, we believe the bond market looks more attractive than the capitalization (cap)-weighted equity market, although there are clearly sectors trading at steep discounts to intrinsic value that also stand to benefit.

Risks

Risks include geopolitical upheaval, recession, and US fiscal policy and the upcoming election. The US budget deficit is unsustainable given the level of interest rates relative to economic growth, yet political discord will likely make any significant fiscal consolidation difficult.

Major surprise

The biggest surprise could be how low inflation gets. If the Fed leans into that inflation story and normalizes the Treasury curve, 2024 may go out with strong growth and low inflation.

US fixed income perspective

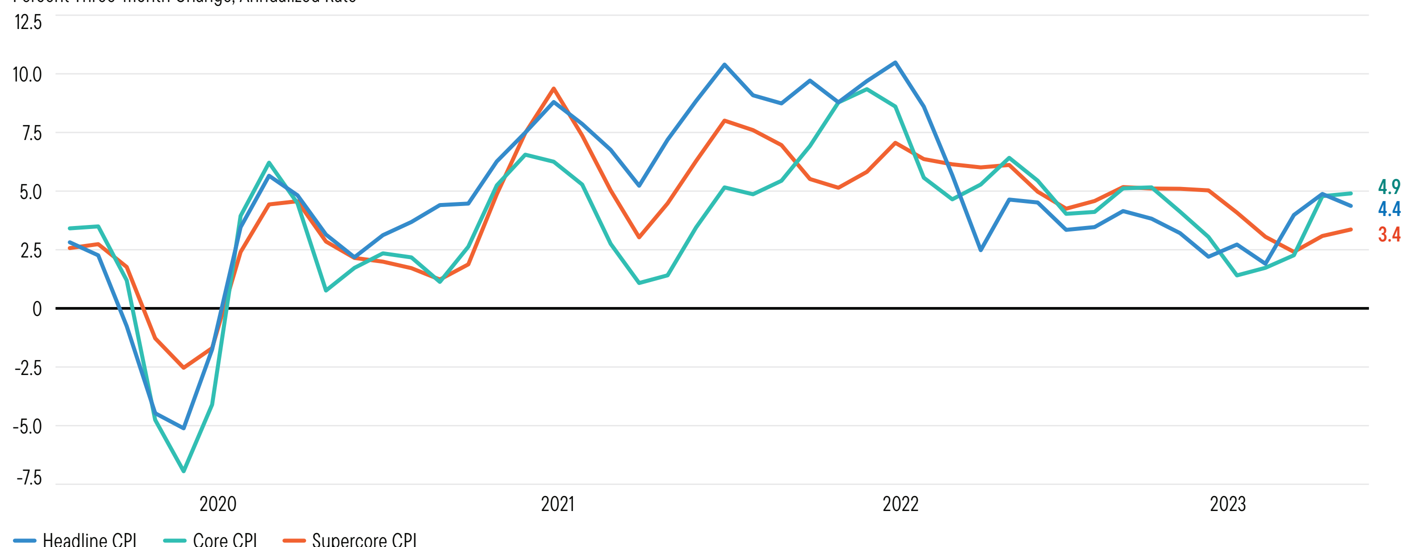
Contributor

Franklin Templeton Fixed Income

Inflation Is Not Quite Under Control Yet

US CPI Inflation

Annual Return 2020–2023



Sources: Franklin Templeton Fixed Income Research, US Bureau of Labor Statistics, US Bureau of Economic Analysis, Macrobond. As of November 15, 2023.

Soft landing

We do not feel the US economy will fall into a technical recession over the course of 2024 and 2025, however, even in a "soft landing" scenario, there will be some pain as the economy slows. We currently project the unemployment rate will move higher, peaking around 4.5% in the third quarter of 2024.

Interest rates and inflation

Compared to a year ago, US inflation is now closer to target—and yet still too far away. We have seen the effects of Fed tightening in more interest-rate sensitive markets such as housing and business investment. However, a tight labor market fueling real wage growth, robust consumer activity and increasing US fiscal government spending are further complicating the Fed's mission to reduce overall inflation, and we still see core CPI exceeding the Fed's 2.0% target level through 2025.

Catalyst

We do not see a lot of opportunity for significant capital appreciation next year. The substantial income provided by holding fixed income assets should drive returns, as yields remain attractive across many sectors.

Best opportunities

We remain focused on high-quality, lower-duration assets that provide significant levels of income. In corporate credit, we are wary of sectors and issuers that will be disproportionately affected by a slowing economy. Within the securitized market, we look to selectively add to agency mortgage-backed securities as spread volatility has provided better entry points. Prudent downside risk management remains a core tenet in our portfolio construction to limit exposure to widening spreads or increasing US Treasury yield scenarios.

Risks

Although not our base case, the overall tightening of monetary policy could overshoot and lead the country into a recession. Alternatively, the Fed could prematurely begin the process of reducing the fed funds rate, that would potentially stoke the economy and lead to a resurgence of inflation. Geopolitical risk remains heightened as global conflicts threaten to potentially raise commodity prices.

Major surprise

We feel the Fed will have to keep rates at current levels for the better part of 2024 in order to sustainably reduce inflation to its 2% target, forcing the markets to readjust their short- and long-term yield expectations, currently implying steep rate cuts throughout 2024.

Global fixed income perspective

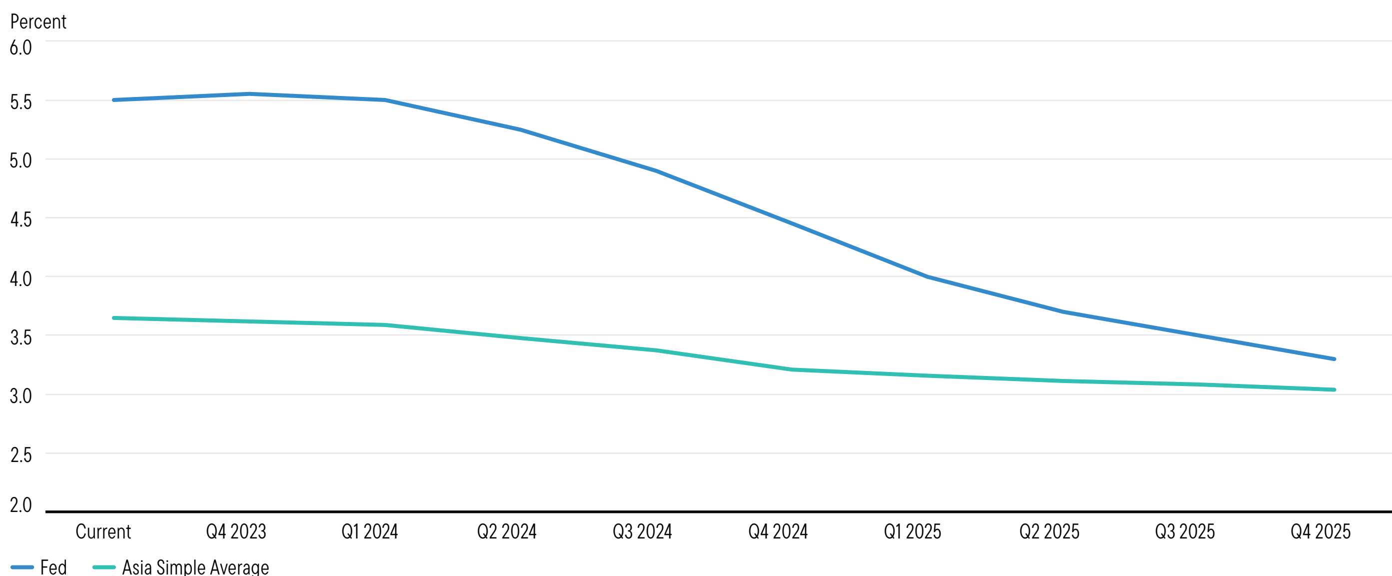
Contributor

Templeton Global Macro

Interest-Rate Differentials: Fed vs. Asian Central Banks Expected to Support Asian Currencies

Policy Rate Paths for Fed and Asian Central Banks by Market Consensus

As of October 31, 2023



Source: Bloomberg. Data as of October 31, 2023. Note: Asia indicates the simple averages of seven Asian economies (Australia, Japan, Korea, India, Indonesia, Malaysia and Thailand). Rate projections are from Bloomberg consensus. There is no assurance that any estimate, forecast or projection will be realized.

Soft landing

While risks to growth remain and global growth is more pedestrian than sparkling, the actual outcomes over the past year have been somewhat better than projections made this time last year and have certainly defied the worst-case predictions of global recession. The International Monetary Fund now projects global growth at 2.9% in 2024, while emerging Asia is projected to grow at 4.8%.[3]

Interest rates and inflation

The global monetary policy cycle has peaked. Inflation has declined—in many cases, very sharply—from its peaks. This has enabled most central banks across the globe to decelerate from prior tightening. In 2024, easing global monetary policy likely will gradually look more synchronized than it does now. A singular exception is likely to be Japan. We think that as reflation takes hold more structurally, the Bank of Japan will begin to normalize policy from its current still ultra-accommodative stance.

Catalyst and opportunities

In our view, both cyclical factors (particularly the end of the US rising rate cycle) and structural factors (the US' twin current account and budget deficits) will result in US dollar weakness. We expect select emerging markets as well as Japan to benefit from this. We believe some countries in Latin America are benefiting from having been early movers, while certain emerging Asian countries have solid fundamentals (current account surpluses, low fiscal deficits and low debt levels), while both cyclical factors like interest-rate differentials and structural factors like reshoring are expected to further bolster their currencies. We think Japan stands out from a significantly improving structural perspective, and we expect the Japanese yen to benefit.

Risks

If the world anticipated some kind of return to normal once the COVID-19 pandemic receded, it has become a new normal characterized by the constant shadow of various geopolitical factors. US-China relations have been significantly tense since even before the pandemic, though more recently there have been some efforts at alleviating tensions. As the Russia-Ukraine war continues, potential risks arising from it remain. Events in Israel and Gaza have also kept geopolitics at the fore.

Major surprise

Any unanticipated events that shock the market, we believe, would be most likely to arise from geopolitical factors.

Global fixed income perspective

Contributor
Western Asset

US Treasury Yields Defy Economic Data and Our Own Expectations

Long-Run Market Rates and Federal Open Market Committee (FOMC) estimates
As of September 29, 2023

Source: Bloomberg. **Past performance is not an indicator or a guarantee of future results.** There is no assurance that any estimate, forecast or projection will be realized.

Soft landing
We believe growth is set to slow from current levels as headwinds like tighter monetary policy take hold. In the United States, we do see positive growth and expect the economy will avoid a recession, but the headwinds cannot be underestimated. In Europe, we see growth risks tilted to the downside on tightening credit conditions. In China, additional policy support should keep the official growth target on track.

Interest rates and inflation
Disinflationary trends are firmly in place globally, with substantial progress on bringing inflation down already achieved. US disinflationary trends should continue, though it's uncertain whether inflation can get all the way back to the Fed's 2% target. In Europe, inflation should continue to decline steadily, especially as service sector inflation starts coming off its highs. Against a backdrop of moderating growth, China is a source of mild global deflation.

Catalyst
With bonds offering the most attractive yields in nearly 15 years and an improving backdrop of lower inflation and peaking interest-rate cycles, we see strong tailwinds for fixed income. Historically, following a Fed pause after a series of rate increases, bonds have delivered positive returns. What's more, one of the most important qualities of fixed-income—the diversification benefit—appears to be functioning again. This is especially important as bonds offer compelling income in both nominal and real terms, which is well above recent equity yields.

Opportunities
Emerging market debt stands out as an attractive opportunity given depressed valuations, prospects of policy easing, and the potential to benefit from ongoing global economic growth. High-yield valuations appear quite compelling, considering current fundamental metrics. Investment-grade credit offers opportunities, with fundamentals and technicals providing support. We believe agency mortgage-backed securities offer attractive spreads and high-quality carry.

Risks
Unanticipated shifts in macro-related sentiment, geopolitical developments and the ongoing risk of central bank overtightening are the risks we see.

Major surprise
Should headwinds intensify for US and global growth, a hard-landing scenario could materialize. Refinancing and default risks could rise among various sovereign and corporate issuers. If this happens, we would expect the Fed and other central banks to cut rates ahead of what is currently priced into markets.

Conversely, if we see global growth accelerate, led by the United States, then we would expect inflation to reaccelerate and remain stickier for longer. In this case, the Fed and other central banks are likely to resume a hawkish stance and telegraph further rate hikes.

US equity perspective

Contributor

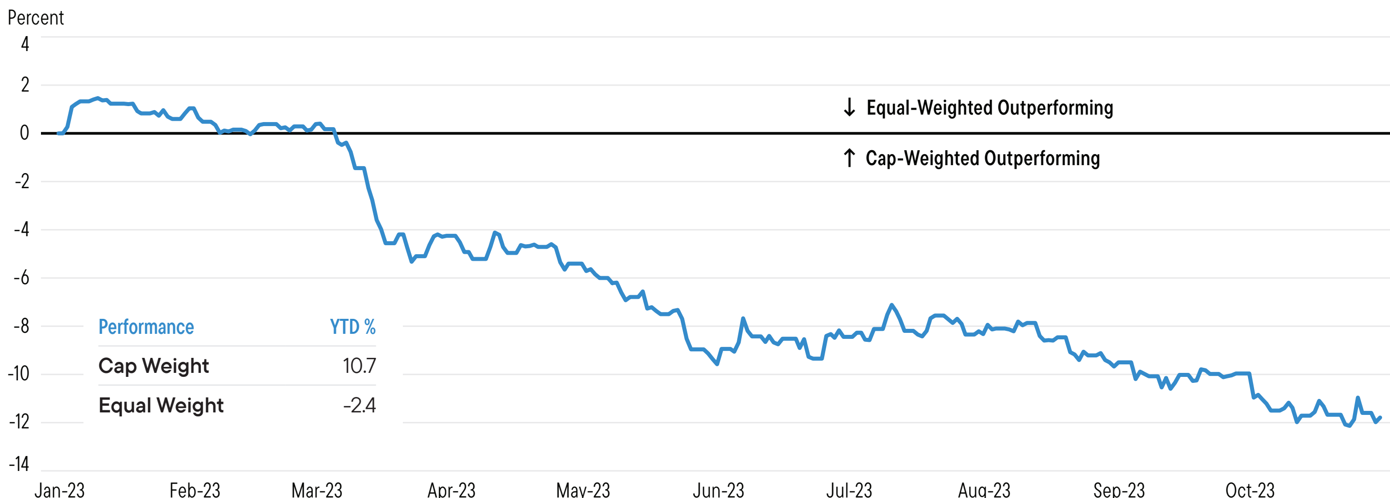
Scott Glasser
Chief Investment Officer and Portfolio Manager

ClearBridge Investments

Equal-Cap Weighted Dispersion Favors Active Managers

S&P 500 Equal-Cap Weighted: Year-to-Date (YTD) Performance

January 1, 2023–October 31, 2023



Performance	YTD %
Cap Weight	10.7
Equal Weight	-2.4

Source: FactSet. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Soft landing

This is the most-debated topic in investing. Currently, the markets are discounting a soft landing; however, our base case remains recession as the pre-conditions we track persist. The leading economic indicators (LEIs) have declined sharply over the last two years and are showing a disconnect right now with GDP growth, but there are often lags in the impact of the LEIs. The Treasury yield curve has been inverted for over a year and could now serve as a recession trigger. The US economy is softening, and while we don't expect a hard landing, we believe investors remain too complacent.

Interest rates and inflation

We think the Fed is done raising rates. We are seeing disinflationary trends in the US economy, but the last mile will be the hardest. Services inflation remains stubborn and we believe the fed funds rate will remain higher for longer as compared to bond market expectations.

Catalyst

Investors will likely continue to react to company profit revisions, as well as any significant changes in interest rates. In the shorter term, investor sentiment, geopolitics and domestic politics could dictate market direction. We expect both AI and GLP-1 therapeutics to play an important, but lesser role than the past year in driving sector-specific returns.

Opportunities

We see three major, interrelated divergences in the stock market with the potential to reverse in 2024. First, the historically wide dispersion between market-weighted and equal-weighted performance of the S&P 500 signals an opportunity for active managers with diversified portfolios. Second, we believe defensive stocks broadly defined are set to rebound as the economy slows. Finally, 2023's narrow advance has created extreme divergences in small- and mid-cap stocks vs. large caps, making them more attractive on a relative basis.

Risks

The biggest long-term equity risk would be a repeat of last year's very narrow market where a handful of large-cap tech stocks continue to drive returns, market cap weighted indexes become even more concentrated, and market breadth remains weak or even deteriorates.

Major surprise

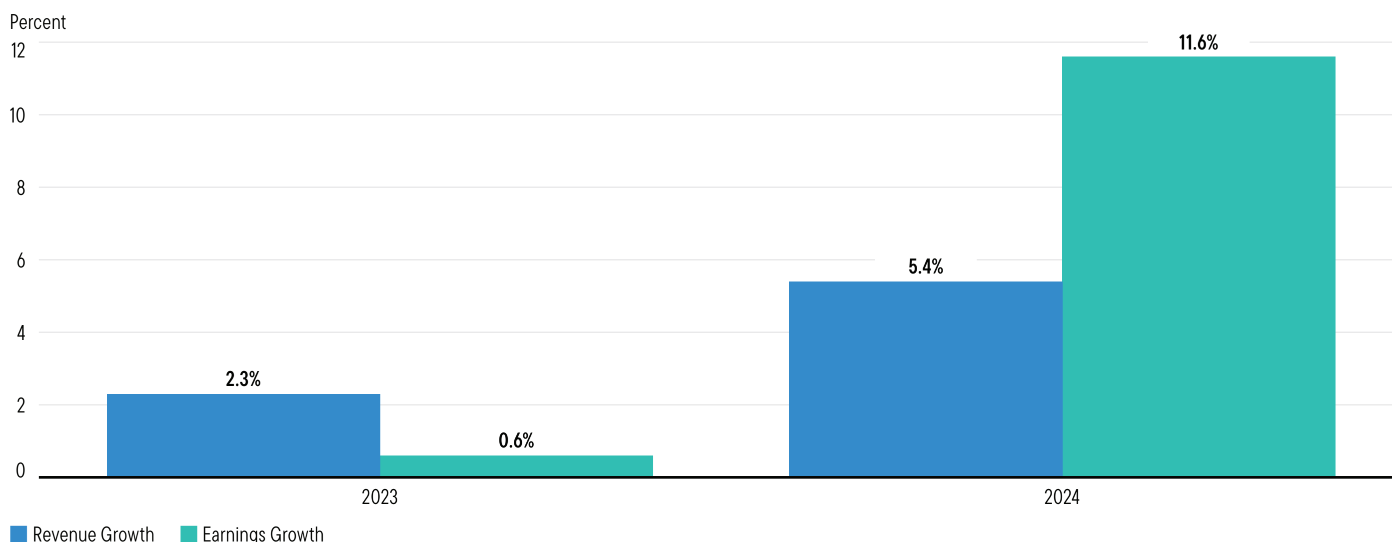
Perhaps the biggest surprise would be a scenario where the labor markets, and by extension the consumer and economy, continue to exceed expectations to the upside, inflation flares back up and yields climb back to highs.

Growth equity perspective

Contributor
Franklin Equity Group

US Equities: S&P 500 Index Revenue and Earnings Growth Poised to Accelerate in 2024

S&P 500 Index Revenue and Earnings Growth
As of November 17, 2023



Source: Factset. There is no assurance any forecast, projection or estimate will be realized. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Soft landing
We see recession risks moderating in the United States and a period of stabilization in economic indicators as inflation cools and the Fed likely nears the end of the tightening cycle.

Interest rates and inflation
Inflation has generally slowed, but economic headwinds persist, including the lagged effects of tighter monetary policy and bank lending standards. As we head into 2024, we expect US economic growth to slow and see the potential for the Fed to reduce rates as inflation continues to wane.

Catalyst
We believe evidence is mounting that the US economy is in relatively good shape and that the market is entering a new phase of recovery and growth. Longer-term equity fundamentals remain constructive, in our analysis, with the prospects for AI potentially supporting US equities. Earnings expectations have largely been reset, and largely reflect flat growth in 2023. We believe 2024 may present an inflection point in revenue and earnings growth for many companies; a more stable, or potentially declining, interest-rate environment could also bring cash off the sidelines to longer-duration equity securities with compelling total return prospects.

Opportunities
To capitalize on this opportunity, we believe investors should expand their horizons beyond the "Magnificent Seven" to include attractively valued, quality mid- and small-cap growth businesses throughout the broader market. Mid-cap and small-cap businesses offer potential for innovation and disruption that can affect entire value-chains for the better. Many of the investments we focus on involve secular growth themes, such as digital transformation, that we believe can potentially deliver consistent long-term performance.

Risks
Key risks, in our view, are largely macroeconomic in nature. If inflation metrics remain stubborn, or reaccelerate, it likely changes the market's view of future Fed decisions. We are also mindful of potential volatility related to strife around the world, and, more locally, the effects of a possible US government shutdown and future policy expectations as the 2024 US presidential election nears. Lastly, we are watching consumer spending, which has been resilient in a period of healthy personal balance sheets, strong employment and rising wages; a downward shift could pose a risk to overall economic growth.

Major surprise
After a multi-year pandemic, unexpected geopolitical events leading to significant conflict in many parts of the world, and ongoing economic uncertainty, a major surprise would be nothing "major" happening.

Small-cap equity perspective

Contributor

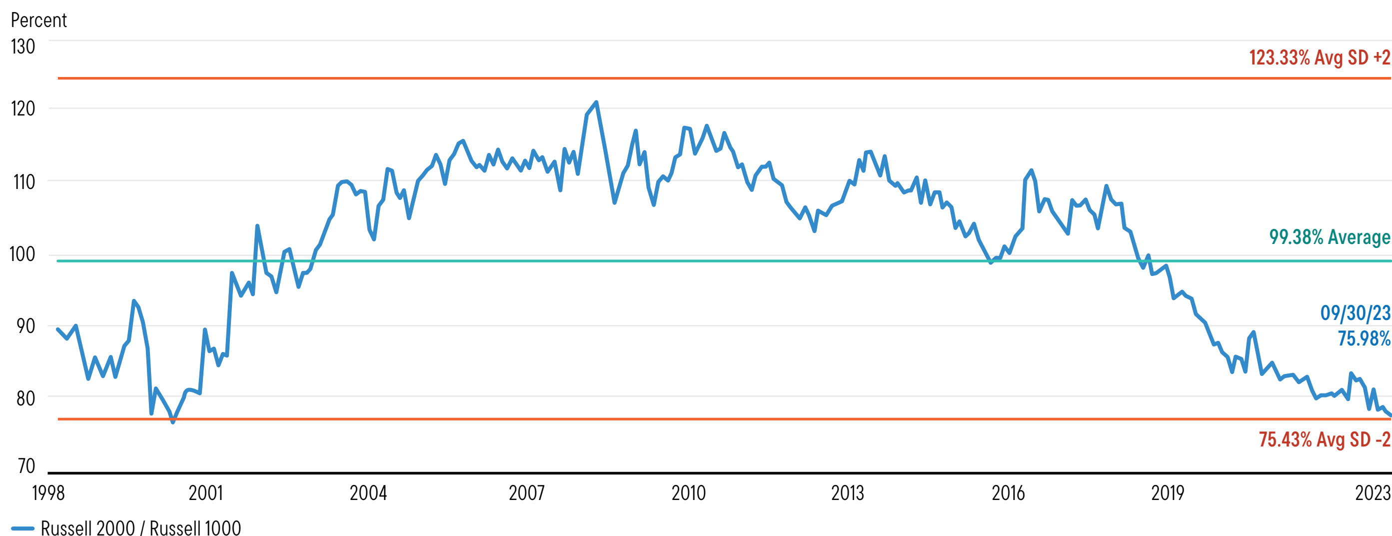
Francis Gannon
Co-Chief Investment Officer, Managing Director

Royce Investment Partners

Relative Valuations for Small Caps vs. Large Caps are Near 25-Year Low

Russell 2000 vs. Russell 1000 Index Median LTM EV/EBIT (ex. Negative EBIT Companies)

September 30, 1998–September, 30 2023



Add chart note: EBIT= Earnings Before Interest and Taxes. LTM EV= Last 12 Months Enterprise Value.

Sources: FactSet. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Soft landing

While we don't predict when or if the US economy will fall into recession, we do believe the small-cap market has already priced in a recession and many companies have been preparing for the possibility of one for some time.

Interest rates and inflation

Using history as our guide, we know that small-cap returns in the first year of fed funds tightening have usually been good. Surprisingly, in the 12 months that followed the first Fed rate hike in March of 2022, the Russell 2000 Index was down. At the same time, following the final rate hike, the average one-year return for the Russell 2000 Index has been quite strong, averaging 18.4% going back to the mid-1990s.[4]

Catalyst

Small caps remain mired in a classic bear market, down close to 25% from their peak in late 2021. We see an array of potential triggers that would jump-start small-cap performance, which include the end of the rate-hiking cycle, a moderation in inflation, a labor market that remains strong, and steady consumer spending. The strength of capital spending, the reshoring phenomenon, the effects of the CHIPS and Science Act, and AI applications are all highly promising elements whose benefits haven't yet registered fully, if at all.

Opportunities

While the near-term view is as cloudy as any we've seen, there are enough positives for us to have a very constructive long-term view for small-cap returns going forward. The majority of corporate management teams we have spoken with remain cautiously optimistic over the long run. Valuations for small-cap stocks are looking more attractive to us in aggregate and look even cheaper compared to large caps. In fact, based on EV/EBIT, small caps remained close to 20-year lows relative to large caps at the end of September (see Exhibit above). We focus on quality and active management throughout the small-cap universe. Given the dramatic change in access to capital, stronger companies should continue to outperform in these uncertain times. We remain focused on industrials, financials and information technology.

Risks

Geopolitics, the US presidential election, or a crack in the financial system are the main risks we see.

Major surprise

Our confidence is that small caps are poised for recovery. The lower-than-average annualized five-year returns for the Russell 2000 Index have historically led to higher-than-average returns over the next five years.

Value equity perspective

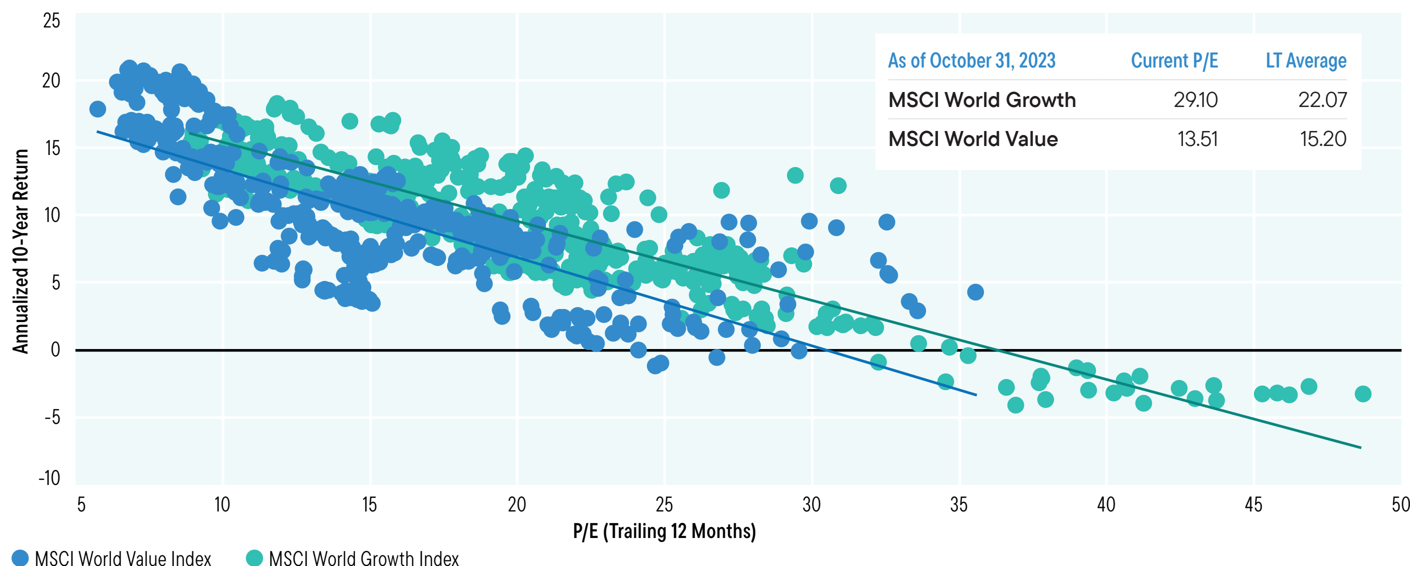
Contributor

Christian Correa, CFA
Chief Investment Officer
Franklin Mutual Series

Valuations Matter for Long-Term Returns

MSCI World Value and Growth Indexes, Starting P/E & Subsequent 10-Year Returns (Annualized)

P/E Trailing 12 Months (TTM) and Subsequent 10-year Annualized Returns, Since December 31, 1974



Sources: FactSet, MSCI. The MSCI World Growth Index captures large- and mid-cap securities exhibiting overall growth style characteristics across 23 developed market countries. The MSCI World Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across 23 developed market countries. MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Catalyst

Value stocks trade at historically attractive valuations, which we believe may be advantageous to investors in what could be a more uncertain 2024. Based on our analysis, starting valuations historically have been a strong indicator of long-term future returns (see Exhibit above), and the current valuation of the MSCI World Value Index suggests to us many opportunities to find compelling investments with significant future return potential.

Opportunities

With 2023 global market returns concentrated in a handful of US stocks, seeking out value stocks can give investors more diversified global exposure and potentially more consistent returns over time, in our view. In Europe, we see big globally competitive companies trading at compelling valuations and providing the potential chance for attractive future returns. We also believe Japan is an increasingly dynamic market worth investors' attention. More and more Japanese companies are focused on improving returns on capital, raising prices amid higher inflation and are willing to take more risks to pursue faster growth—a marked change from the past few decades. Government infrastructure spending and the long-term energy transition are also geared toward sectors that trade at value multiples, and may be compelling long-term opportunities.

Interest rates and inflation

Global monetary policy normalization should further positively impact certain value-oriented sectors. Higher interest rates have lured capital away from dividend-paying industries toward fixed income over the past year. For value investors, the recent drop in valuations in the consumer staples, utilities and real estate sectors can create greater prospects of finding stocks unfairly trading below their fundamental value.

Risks

The labor market has so far remained resilient with increased participation, rising wages and persistently low unemployment supported by continued business and government infrastructure spending. However, if wages, employment, consumer spending or the promised infrastructure spending falter, we could potentially see an economic slowdown.

Global equity perspective

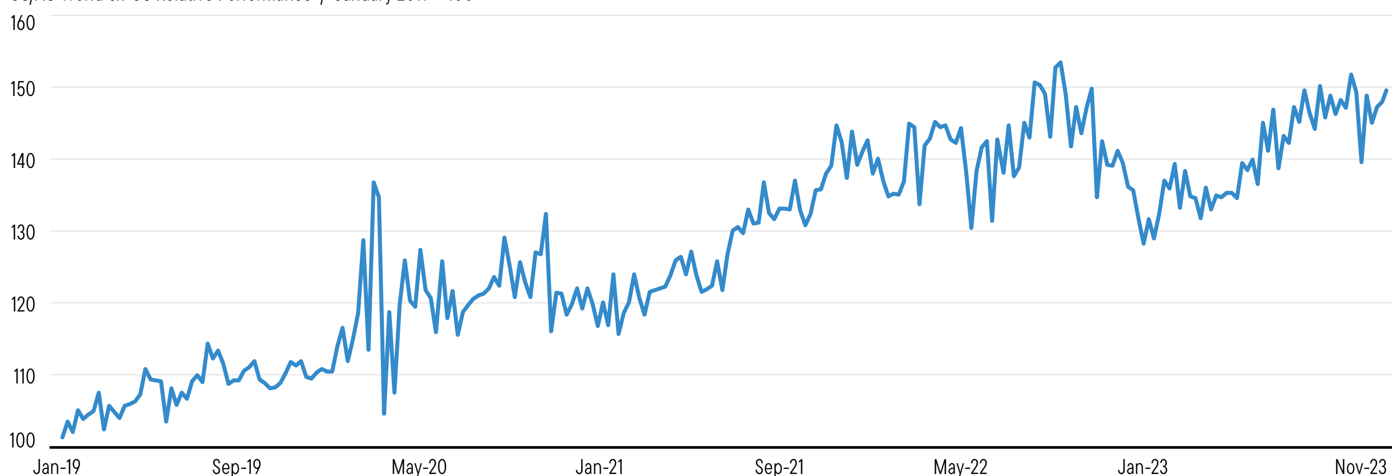
Contributor

Manraj Sekhon
Chief Investment Officer
Templeton Global Investments

US Equities Outperformed Global ex-US Over the Past Five Years, a Trend That Could Change in 2024

MSCI USA Index and MSCI AC World ex-USA Index

January 11, 2019–November 29, 2023



Source: Bloomberg. The MSCI USA Index is designed to measure the performance of the large and mid-cap segments of the US market.The MSCI All Country World Index (ACWI) ex-USA Index is a free float-adjusted, market capitalization-weighted index designed to measure the equity market performance of global developed and emerging markets, excluding the United States. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Soft landing

Both the United States and China are likely to avoid a recession in 2024. In our view, policymakers have considerable monetary policy flexibility to stimulate growth. Based on currently available data, a soft landing is expected in the US economy. China's economy has already slowed. Sectors such as real estate have witnessed a rapid deceleration, but other industries including green energy and those related to the electrification of transportation are witnessing high growth.

Interest rates and inflation

Inflation in the United States is likely to continue trending lower. In China, inflation should remain subdued, given the spare capacity in the economy. US interest rates are likely to be cut from current elevated levels. China will continue easing monetary policy via a combination of reserve requirement and interest-rate cuts to stimulate growth in the year ahead.

Catalyst

US interest-rate cuts and a weaker US dollar as well as signs of slowing growth in the United States are catalysts we believe will be positive for global ex-US and emerging market equities.

Best opportunities

The most attractive equity investment opportunities in 2024, in our view, center on emerging markets, global equities ex-US and small-cap stocks.

Risks

Voters in the United States, India and Indonesia, which account for 25% of the global population, will go to the polls in the year ahead. We view the period in the run up to and potentially post these elections, and those in Taiwan, as a source of risk for equity markets. In addition, we are monitoring geopolitical uncertainty, as we view this as an ongoing source of risk.

Major surprise

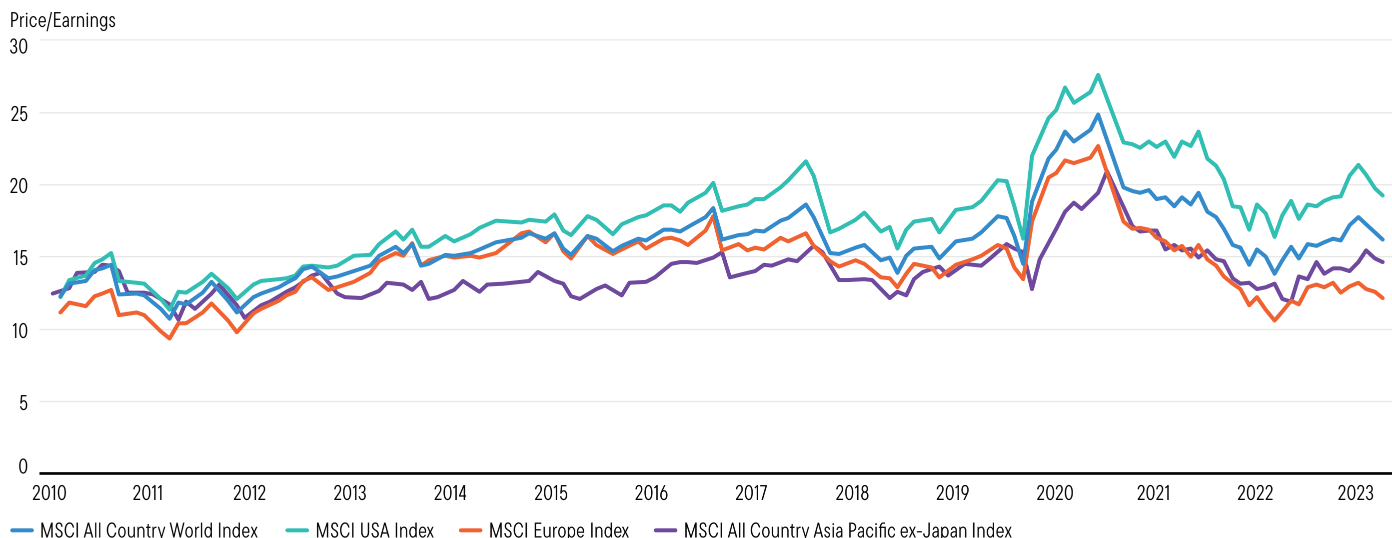
A major source of surprise to markets in the year ahead includes a resurgence of inflation, and a hard landing in the United States or euro-area economies. A further deterioration in geopolitical risk from its current elevated levels would also be a surprise to markets.

Global equity perspective

Contributor
Martin Currie

Equity Valuations Remain More Supportive in Europe and Asia

Forward P/E (FY1) of Given Equity Markets
As of October 31, 2023



Source: FactSet. The MSCI All Country World Index captures large- and mid-cap representation across 23 developed markets and 24 emerging markets countries. The MSCI USA Index is designed to measure the performance of the large and mid-cap segments of the US market. The MSCI Europe Index captures large- and mid-cap representation across 15 developed markets countries in Europe. The MSCI AC Asia Pacific ex-Japan Index captures large and mid-cap representation across 4 of 5 developed markets (excluding Japan) and nine emerging markets in the Asia Pacific region. There is no assurance any forecast, projection or estimate will be realized. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Soft landing
Macroeconomic momentum is at risk of weakening, leading to ongoing stagflation in Europe and the United Kingdom in 2024, and a slowdown in the economies of the United States and China. We see rising risks of recession given rapid rate hikes in 2022–2023, even if still not our central scenario for the United States.

Interest rates and Inflation
Inflation could end up being more elevated and longer lasting in 2024, despite general easing in pressures coming through. Wage inflation remains the key focal point. Monetary policies have peaked or are close to peaking, but we do not expect any pivot toward cuts in Western central bank rates until the second half of 2024.

Catalyst
Despite our muted growth outlook, the pivot in central banks and the potential for synchronized rate cuts across major central banks has the potential to be supportive for equity markets and for the quality growth style leadership in 2024.

Opportunities
Equity valuations remain more supportive in Europe and Asia versus the United States, although a selective approach remains key. We remain focused on companies with resilient earnings growth, exposed to long-term structural growth themes, and that have pricing power and solid balance sheets, given the uncertain macro and inflation environment and the low growth prospects. Thematic opportunities still abound, notably in the areas of energy transition, aging populations and AI.

Risks
Ongoing fiscal and monetary policies, the still uncertain inflationary backdrop, style leadership and equity markets volatility, margin pressures, higher tax rates, low structural growth and geopolitical tensions represent risks we see.

Major surprise
An ever-more disruptive decade is likely to go into overdrive in 2024 and beyond, which will bring both opportunities and challenges for companies and for investors alike. With the focus on investing for a transitioning world toward net-zero and the seismic shift brought on by AI. Innovation rates and disruption are likely to continue to increase. We continue to focus our three mega-trends of Demographic Changes, Future of Technology and Resource Scarcity.

Contributors

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Franklin Mutual Series

Manraj Sekhon
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Templeton Global Investments

Endnotes

1. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges.
2. The CPI measures the cost of spending made directly by households for the items in its basket, with the notable exception that it also includes a measure of the rents that homeowners implicitly pay instead of renting their home. The core CPI excludes food and energy prices from the CPI.
3. There is no assurance that any estimate, forecast or projection will be realized.
4. Source: Factset. Indexes are unmanaged and one cannot directly invest in them. **Past performance is not an indicator or a guarantee of future results.**

WHAT ARE THE RISKS?
All investments involve risks, including possible loss of principal.

Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. Low-rated, high-yield bonds are subject to greater price volatility, illiquidity and possibility of default.

Equity securities are subject to price fluctuation and possible loss of principal. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks.

Special risks are associated with investing in **foreign securities**, including risks associated with political and economic developments, trading practices, availability of information, limited markets and currency exchange rate fluctuations and policies; investments in emerging markets involve heightened risks related to the same factors. Sovereign debt securities are subject to various risks in addition to those relating to debt securities and foreign securities generally, including, but not limited to, the risk that a governmental entity may be unwilling or unable to pay interest and repay principal on its sovereign debt. To the extent a strategy focuses on particular countries, regions, industries, sectors or types of investment from time to time, it may be subject to greater risks of adverse developments in such areas of focus than a strategy that invests in a wider variety of countries, regions, industries, sectors or investments. **China** may be subject to considerable degrees of economic, political and social instability. Investments in securities of Chinese issuers involve risks that are specific to China, including certain legal, regulatory, political and economic risks.

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Investments in **alternative strategies**, may be exposed to potentially significant fluctuations in value.

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