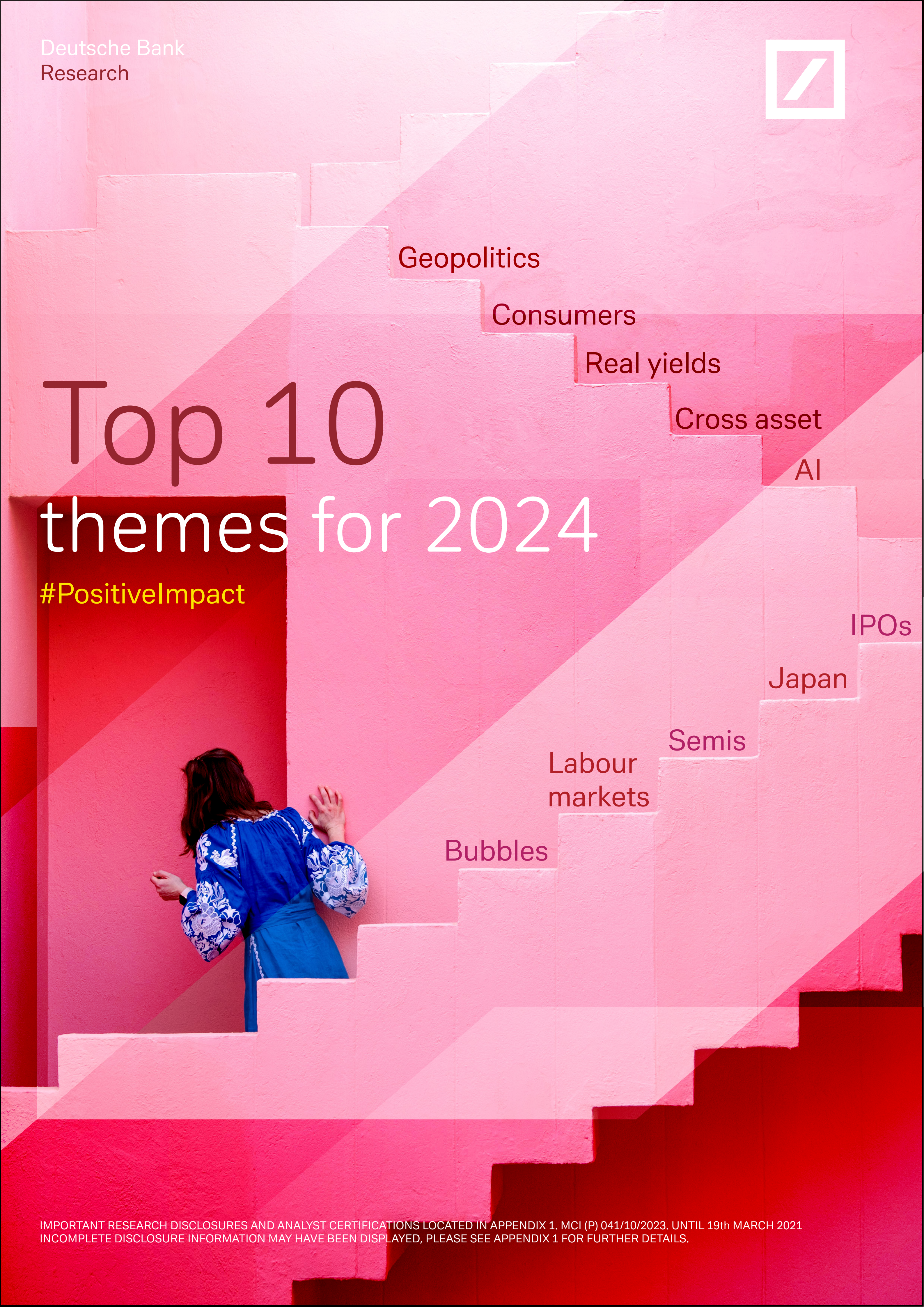
Deutsche Bank
Research



Geopolitics
Consumers
Real yields
Cross asset
AI

Top 10 themes for 2024

#PositiveImpact

IPOs
Japan
Semis
Labour markets
Bubbles

IMPORTANT RESEARCH DISCLOSURES AND ANALYST CERTIFICATIONS LOCATED IN APPENDIX 1. MCI (P) 041/10/2023. UNTIL 19th MARCH 2021 INCOMPLETE DISCLOSURE INFORMATION MAY HAVE BEEN DISPLAYED, PLEASE SEE APPENDIX 1 FOR FURTHER DETAILS.

Contents

Top ten themes for 2024 – summary

Two big ideas – geopolitics and corporate uncertainty – pervade all the key themes that we present as our top ten for 2024. We elevate these two mega-themes as they are the key drivers underlying much corporate and investment decision making in the new year.

The big focus of 2024 will be the slew of elections around the world. We expect some volatility around these, particularly if markets become nervous about fiscal spending promises. But when we take a step back, the most important aspect of the elections may be observing any increase in populist views from both sides and examining how they may realign trade relations between countries.

For corporates and markets, the key point many investors underestimated in 2023 (at times, us included) was how long corporates would remain nervous as uncertainty remained high. That fact kept a lid on things this year. In 2024, however, we expect more activity. Corporate uncertainty has dropped and there is greater visibility on the trajectory of economic and market indicators. The year may still include an economic slowdown but that may not be the key thing that drives markets.

Luke Templeman
Director, Thematic Research

Open-ended economies: Rewind to the 1980s

– Olga Cotaga

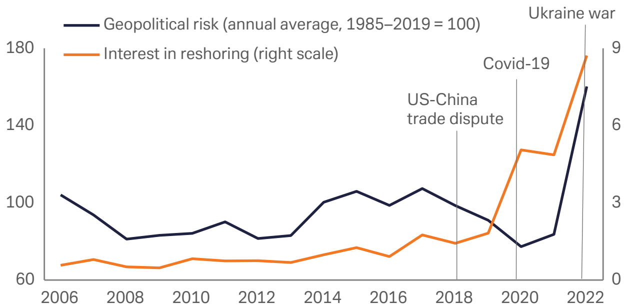
Insular trade, intrusive governments, higher fiscal spending and extreme political views. Many would argue that globally, this is how 2024 is shaping up. But it is also something of an analogy with the world four decades ago before the period of rapid economic globalisation and the improvement of relations between the US and China.

A few events next year may deepen the similarities between the 'now' and 'then'. Among them is that populist parties are serious contenders in next year's spate of elections that will see countries with half the global population go to the polls. And because growing populist views often focus on domestic issues, a possible win for them next year may mean more countries may look inward or implement policies that are more aggressive towards trading partners.

The build-up of populist views across the world could result in new clusters of nations with similar interests. As a result, trade could be hampered and some ties could be jeopardised while other ties draw closer. Take Indonesia, for example, as reported in Politico, where the leading presidential candidate Prabowo Subianto said the Southeast Asian country does not "really need Europe anymore" and that it should become closer to others in the region.

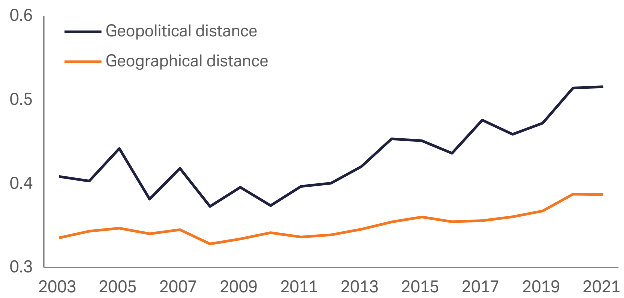
Growing military and economic clusters are continuing to build significant power. Consider that the new BRICS has overtaken the G7 in their contribution to global GDP (on a PPP basis)[1]. Additionally, the Regional Comprehensive Economic Partnership Agreement (RCEP), which now counts 14 Indo-Pacific countries including Indonesia and Korea, is the world's largest free trade deal GDP[2].

Measures of rising geopolitical tensions (indexed)



Source: IMF, Deutsche Bank

Foreign direct investment between geographically and geopolitically close countries (%)



Source: IMF, Deutsche Bank

The forming of partnerships amidst escalating tensions in the Middle East and the ongoing war in Ukraine are not too dissimilar from the period when the Soviet Union was still whole and conflict spread across Iran, Iraq, Afghanistan and the Falkland Islands. Importantly, the issue of security is now as important as it was during the Cold War. Although military spending as a share of GDP globally is smaller now than it was in the 1980s[3] , the total volume rose 3.7% as it reached a new record high of $2.24tn in 2022[4]. Also, the role of hypersonic missiles and machine-led weapons bring similar chills as during the Cuban missile crisis. And while the risk of catastrophe may be lower now than it was then, many risks are underappreciated.

Populist policies often result in the merging of public and private power. We think the merge will intensify as governments use industrial policy to ensure they are stirring they wheel of a growth recovery that results in greater self-sufficiency. In the US, a common denominator across political lines is a stronger stance on China.

Current plans to revive growth are going through a similar discussion as they did during the 1980s. This was the time of Reagan/Thatcher reforms and deregulation. We may all need to accept that buying 'Made in your own country' may not be not cheap.

1 Atlantic Council
2 UNCTAD
3 World Bank
4 Stockholm International Peace Research Institute

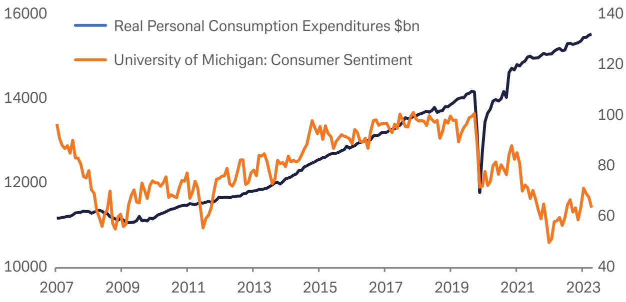
The consumer paradox

– Luke Templeman

One of the main reasons why the US managed to avoid a recession in 2023 is because consumers continued to spend. Of course, low unemployment helped but, even so, peoples' desire to spend seemed to be in opposition to what the concern they expressed in surveys.

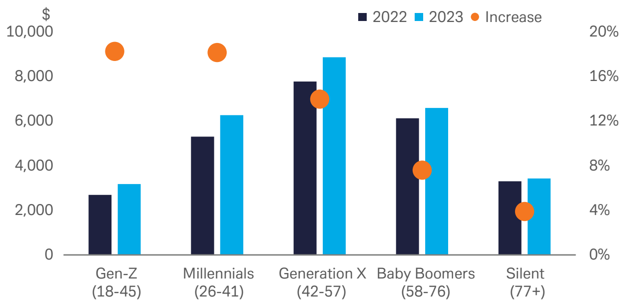
What appears odd is the large gap between spending and consumer confidence. First, spending has been unrelenting. In real terms, US personal consumption kept rising in 2023 in line with its pre- and post-covid trend. Yet, at the same time, consumer confidence is in the doldrums as people recognise the cost of living has jumped. Although it picked up a little this year, sentiment languishes at the levels last seen during serious recessions.

Americans are spending more despite being less confident (the trend is similar in Europe)



Source: AlphaSense, Deutsche Bank

Average US credit card debt by generation



Source: Federal Reserve, Deutsche Bank

So do people just think nothing can go wrong? Are they confident the government will bailout any misfortune? It is more complex than that.

One reason for this disconnect is the income and asset increases of the last few years. Those on lower incomes have (on average) been cushioned somewhat from price increases as they have been awarded larger percentage pay rises over the last few years. Meanwhile, those on higher incomes are more likely to have benefited from asset price increases, particularly in the stock market. Across the board, homeowners today generally have more equity in their house. The latter two issues may have catalysed a 'wealth effect', although studies on this come to varied conclusions.

Certain viewpoints also indicate debt levels are relatively manageable. In the US, real credit card debt is roughly in line with the average since 2000. In the UK, household debt (excluding student debt) is at its lowest level relative to income in two decades.

The willingness to spend also appears to be a generational issue. This year, Gen-Z and Millennials (roughly speaking adults up to 41 years old) increased their credit card debt by about 18%. That was well about the 14% growth of Gex-X and 8% growth of Baby Boomers[5]. Some argue that younger generations are more willing to spend as they believe saving for a house is too hard. If this is true, it indicates serious problems in the medium term. However in the short term, their spending may help prop up economies in 2024.

Will people keep spending freely in 2024? There are a couple factors working against consumers. The first is that savings buffers have been exhausted in the US. Meanwhile in Europe, they are being depleted but people have been reluctant to use them. The second factor is a likely rise in unemployment. Still, our current forecast is that the US unemployment will rise from 3.7% to 4.5% in 2024; in the euro area, we expect it to rise from 6.5% to 6.8%. Joblessness is, of course, deeply concerning, however, these forecasts are much lower than the rates seen in previous recessions. That means consumers may not retrench as much as they have done in the past. Although they may tighten their belts somewhat during a potential 2024 recession, we do not expect them to stop completely.

5 Wallethub

The danger of high real yields is underappreciated

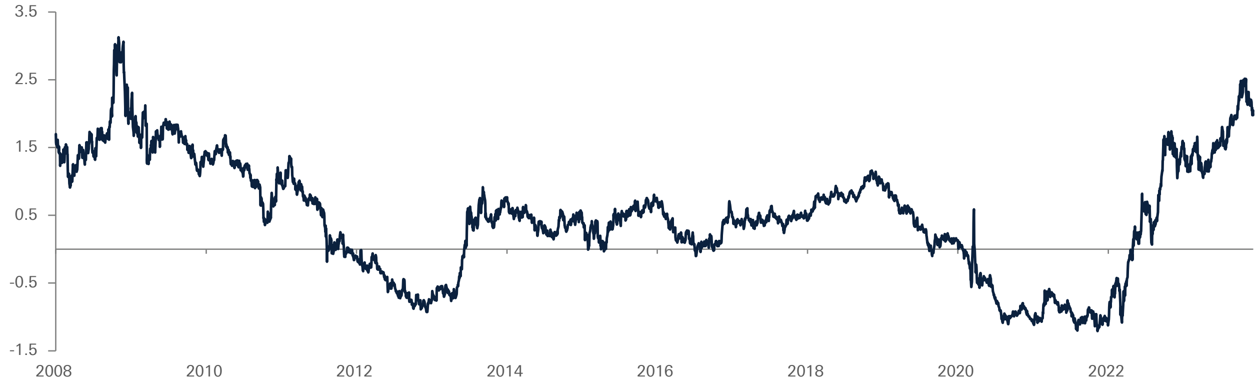
– Henry Allen

The cost to borrow money in real terms is around the highest it's been since the financial crisis, and the effects of this increase are still widely underappreciated.

First, the greater cost of taking on more debt will constrain governments that want to stimulate their economies. It will make debt dynamics much less favourable, raising the chance that countries may not be able to borrow their way out of a fresh shock without putting their debt on an unsustainable path. Given financial markets have become more concerned about this issue over the last two years, it means policymakers are likely to place a much greater weight on maintaining market confidence. In other words, there may be a bias against large stimulus during the next shock.

On both sides of the Atlantic, real yields have risen substantially over the last couple of years. For instance, the US government now pays around 2% in real terms to borrow at a ten-year horizon, up from -1% at the end of 2021. Nor is that confined to long-term borrowing, since real yields are now around or above 2% at all maturity lengths. Similarly in Germany, ten-year real borrowing costs are now in positive territory, having been less than -2% at the end of 2021. And because this increase is in yields that adjust for inflation, this will not mechanically reverse once inflation returns to target levels.

US 10yr Real Yield (%)



Source: Bloomberg Finance LP, Deutsche Bank

Second, one of the most important relationships for debt sustainability is the difference between a country's real yield and its growth rate. For much of the period after 2008, growth exceeded real yields. That meant, in general, any country could roll over its debt sustainably, so long as it did not run a primary deficit that was too big. After all, national income was growing faster than national debt. But if that difference between growth and real yields narrows or even switches around, then it would require a smaller primary deficit or even a consistent surplus to prevent the national debt from moving to a trajectory where it spirals ever higher.

The beginning of debt sustainability being questioned may be closer than many investors think. None of the G7 countries are set to run a primary surplus in 2023, according to the IMF's latest Fiscal Monitor forecasts. Even in 2028, primary deficits are still forecast in the US, UK, France and Japan. And this comes at a time when there are still several long-term pressures to spend money. For example, ageing populations require greater spending on health services and public pensions.

What is more concerning is how governments will deal with the next economic shock. Policymakers no longer have the advantage of historically low real interest rates, along with inflation that was broadly stable for many years. And following the pandemic, debt-to-GDP ratios also stand at their highest level in decades. That means next time, the economic backdrop is likely to prove much more constraining. That, itself, will be a surprise for those who have seen big bailouts in the past.

A year of cross-asset mean reversion

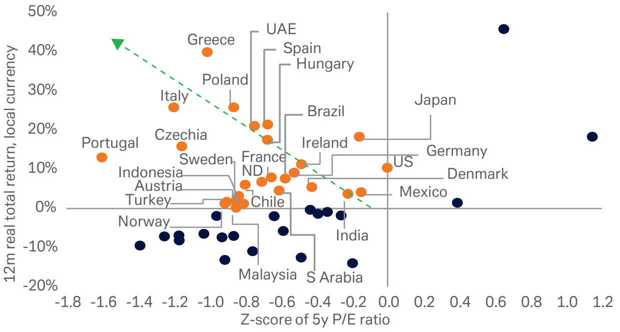
– Galina Pozdnyakova

The thing about this year's rally in equity markets is that it has been so narrow. In the US, particularly, just a few key stocks drove the bulk of index returns. However, if the current positive sentiment continues in 2024, then a broader rally is likely. And that will open opportunities for subdued valuations to mean revert. The opportunity set is especially promising, on these metrics, in various emerging markets and some European countries, although momentum is strong across many assets.

The recent upward momentum in equities has created a favourable backdrop for risk assets. Most of key DM and EM markets globally are either already rebounding or showing such signs on a real basis, especially in Europe and Latin America. Such trends may also help European credit relative to the US, with $IG credit still trading especially tight.

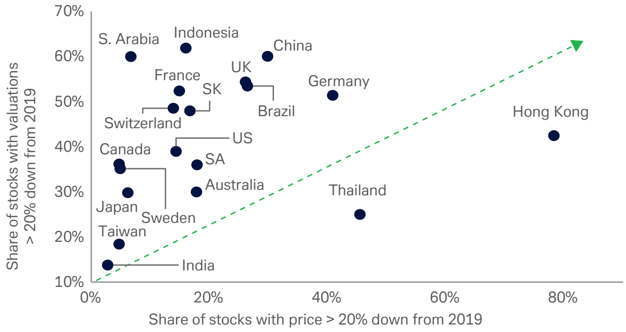
Meanwhile, the still subdued equity valuations may provide a good cushion for entry points. Looking back at the last five years, the trailing P/E ratio in several European and Asian countries (roughly half the markets we analysed) was 0.75 standard deviations below the mean. Even in the US and Japan, multiples are only now reaching their average level.

European equity markets rank well on both valuations and momentum



Source: Bloomberg Finance LP, Deutsche Bank

Despite the recent rally there are still valuation opportunities



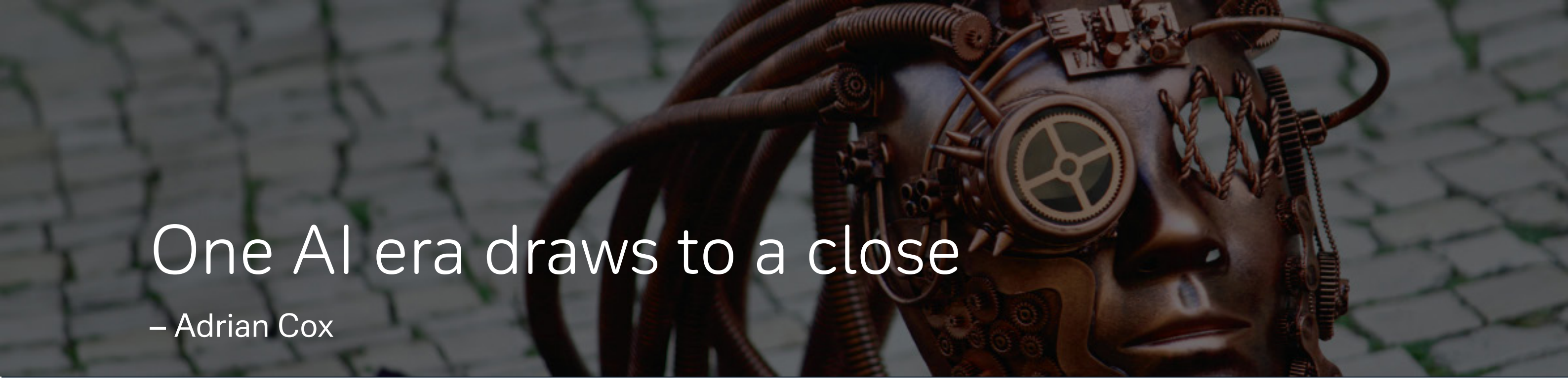
Source: Bloomberg Finance LP, Deutsche Bank

Across many markets, the rally in 10y yields is also under way and has positive momentum. In roughly half of our sample countries, the change in nominal yield levels is one standard deviation above the five-year average. And positive momentum is emerging for many EM and Western European countries. In the US, there appears to be further room for yields to fall based on CFTC data which shows that despite the recent drops, traders are still very negatively positioned across the Treasury curve, at roughly 1.7 and 3.2 standard deviations below the five-year average. As this mean reverts, it will put further downwards pressure on yields. That will be helped by a less uncertain economic backdrop in 2024 as well as further progress on inflation.

Beyond aggregate valuations, variation within stock indices is also providing a good backdrop for stock picking. Roughly a third or more of securities in the UK, Germany and key Asian markets that are included in the Bloomberg World Large and Mid cap index are still down 20% or more from their levels at the end of 2019. Consumer and high-yielding industries have been particularly hard hit.

As investors rebalance from the gains in a limited number of stocks this year, diversification into the broader market will assist those relatively cheap stocks. Moreover, over the past five years, emerging markets in Asia and the Americas, together with several European countries, saw negative correlations between 10y bonds and stock indices of more than 20%.

So if the risk-on mode in markets carries on in 2024 amidst a more certain macroeconomic backdrop, it will likely support assets that are cheap relative to the past few volatile years. Many of these are outside of the US and have momentum on their side. They can provide both valuable diversification benefits and, just maybe, we will finally see the return of stock pickers.



One AI era draws to a close

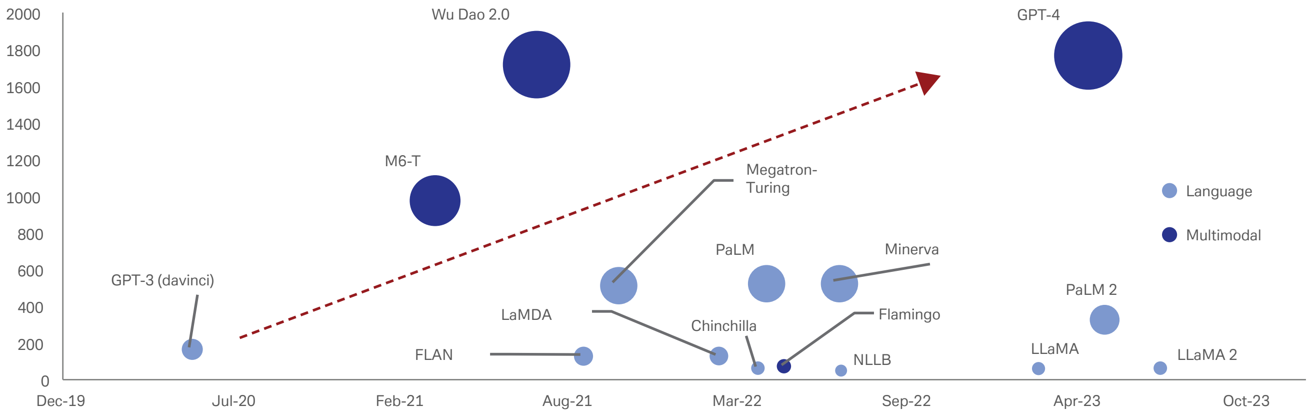
– Adrian Cox

Just as the largest dinosaurs were wiped out at the end of the Cretaceous period, mostly superseded by smaller, nimbler mammals in the face of a meteor strike and rapid environmental change, large AI models may be giving way to smaller versions that are simpler, more tailored and cheaper to train and run.

Sam Altman, ringmaster of what is probably the largest large language models (LLM) of all, GPT-4, (with an estimated 1.8tn parameters) acknowledged that the time of "giant models" may be ending and "we'll make them better in other ways".

This matters because in the five years or so since LLMs burst onto the scene in their current form, parameter size has been a proxy for capabilities. These AI systems are loosely modelled on human brains, with parameters representing simulated connections between artificial neurons. The number of parameters in the largest models has increased by 10 times or more in each of the past few years, each time leading to a rich expansion in unexpected powers, from coding to translation. The cost of training larger models has increased even faster – along with the cost of using them.

Selected multimodal and language AI systems with more than 50bn parameters, n parameters in bn



Source: Our World in Data, Deutsche Bank

The resistance against bigger forms of LLMs is seen in recent regulatory frameworks. Indeed, the US Executive Order on safe, secure and trustworthy AI published by the White House in late October explicitly imposes transparency requirements on the makers of "dual-use" foundation models, identifiable in part because they have "tens of billions of parameters". But critics say that parameter numbers are a crude measure of capabilities or risks and that the authorities should instead focus on uses.

It certainly now seems that there are different ways to extract value from LLMs. Models can be made more efficient by cutting the number of parameters, but including more data in a longer training process. As an example, Google's Chinchilla model outperformed OpenAI's GPT-3 even though GPT-3 was more than twice the size of Chinchilla. That is because Chinchilla was trained on a bit more than 1tn words and GPT on a quarter of that.

Other promising ways to improve performance without bulking up computing power are: 1) having multiple models working together, 2) rounding off the decimal places on training data, 3) and fine-tuning the model on specific tasks, 4) adapting the code to suit the chip it runs on, 5) developing more specialised chips.

The advantages of smaller models are legion. Perhaps most importantly, they can sit on a user's computer or even smartphone instead of requiring a data connection with a faraway data centre. This makes them faster, more personalised and secure.

There are already examples. Meta's open-source Llama 2, which is freely available to be downloaded and adapted by users, was launched in July in three versions ranging from just 7bn parameters to a still paltry 70bn. BloombergGPT, purpose-built for finance applications, has just 50bn. Yet, both outperform similar models on a range of tasks.

As the hardware and software environment evolves though, it is safe to assume "small language models" will not stay too small for long.

Green shoots in the IPO market

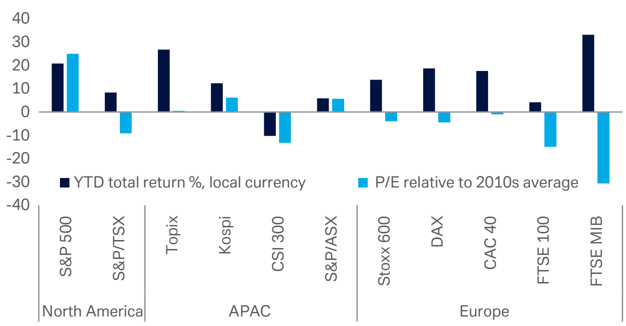
– Galina Pozdnyakova

A few high-profile IPOs in 2023, such as ARM, Maplebear and Klaviyo, failed to ignite a wave of public offerings. Instead, this year saw a rising share of smaller IPOs and highlighted the growing importance of the Middle East and Asian markets amidst a drought of deals in the US and Western Europe. Technology debuts also took a backseat to consumer and industrial firms.

One concern that is hindering the IPO market is uncertainty around a US recession. We forecast this will strike mid-2024 so there may be a window of opportunity for IPOs ahead of this. Most likely to take advantage would be non-venture capital (VC)-backed firms that are not waiting for exuberant multiples to return. And they would probably only sell a small portion of their business to the public. In Europe, we expect the backdrop to remain a little more challenging but, Asia may benefit from some recent momentum.

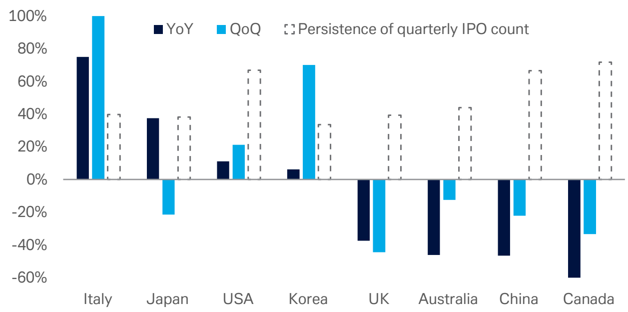
One catalyst for an IPO rebound next year is the recent rebound in risk assets. A number of high-profile stock market debuts have already been reported in recent weeks as global markets have rallied. In the US, there is certainly pent-up demand for, and supply of, IPOs. Plenty of potentially good deals have been shelved because of the last two years of challenging equity markets and volatility in bond yields. Furthermore, the underwhelming performance of Russell 3000 firms that have gone public since 2020 (a median decline from peak price of nearly 70%) is also likely weighing on investors' minds.

Market returns and valuations



Source: Bloomberg Finance LP, Deutsche Bank

IPO growth rate by country (Q3 2023 data)



Source: Dealogic, Deutsche Bank

Therefore, companies with public aspirations will likely try to jump ahead of a US recession and take advantage of recently-declining long-term yields and the equity market recovery that have both led to a rebound in investor sentiment.

We do not expect an immediate flood of IPOs, however. Investors will remain picky as rates remain historically elevated, and public market multiples are still well down on the levels seen in 2021. As a consequence, those companies most likely to IPO will be those with robust business models and predictable cash flow.

Companies backed by private equity may be disappointed. As IPO markets initially favour businesses with strong financials, many private firms will be left to continue their search for exit options, or may flounder into lower returns. That comes as private markets hold an abundance of growthy but money-losing firms as a result of frenetic dealmaking during the low-rate years. There are increasing signs of pressure in the venture market meaning many private companies will need to accept large discounts to their latest funding rounds if they are to IPO.

Yet, IPO timing beyond the first several months of 2024 will be harder as US growth slowdown worries resurface and investors become more cautious. Those companies with public aspirations will need to move quickly in 2024 or accept that their public debut may be delayed once again.

The winners and losers from higher Japanese inflation

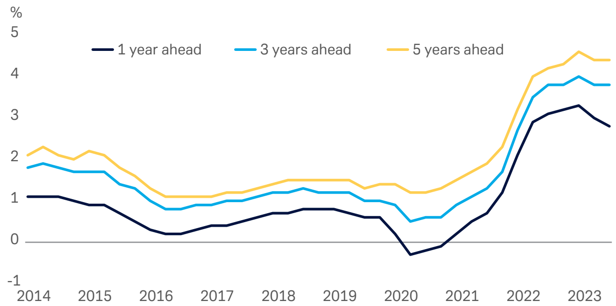
– Cassidy Ainsworth-Grace

Japan's current economic backdrop exhibits plenty of contradictions. Headline annual inflation has been above the Bank of Japan's (BoJ) target for 19 straight months and earlier this year expectations mounted that the BoJ would soon end its unconventional, ultra-accommodative monetary policy after two decades. Markets appeared excited by these developments, with the Nikkei 225 up 28.9 per cent YTD. Now in December, BoJ policy normalisation has fallen short of initial expectations and the most recent Tokyo CPI surprised to the downside at 2.6 per cent YoY, versus 3.0 per cent expected, lessening the pressure on the BoJ to act.

But the inflation story is not over. Short-term inflation momentum is strong, the household and corporate sectors' long-term inflation expectations remain elevated, and our economists expect an additional 4 per cent wage hike in the 2024 shunto spring wage negotiations after an already record-breaking 2023 increase of 3.6 per cent, the highest in 30 years. Also, our economists now expect the BoJ to terminate its negative interest rate policy, end yield curve control and set its policy rate at 0.1 per cent in January. Recent messaging from the BoJ Deputy Himino in December hinted that the end to negative rates may indeed be closer than market expectations back in April.

And if inflation persists above 2 per cent, combined with a further depreciation of the yen, monetary policy may have to turn even more hawkish, with major consequences for the Japanese economy.

Expectations for output price inflation for all Japanese enterprises (%)



Source: Bloomberg Finance LP, Deutsche Bank

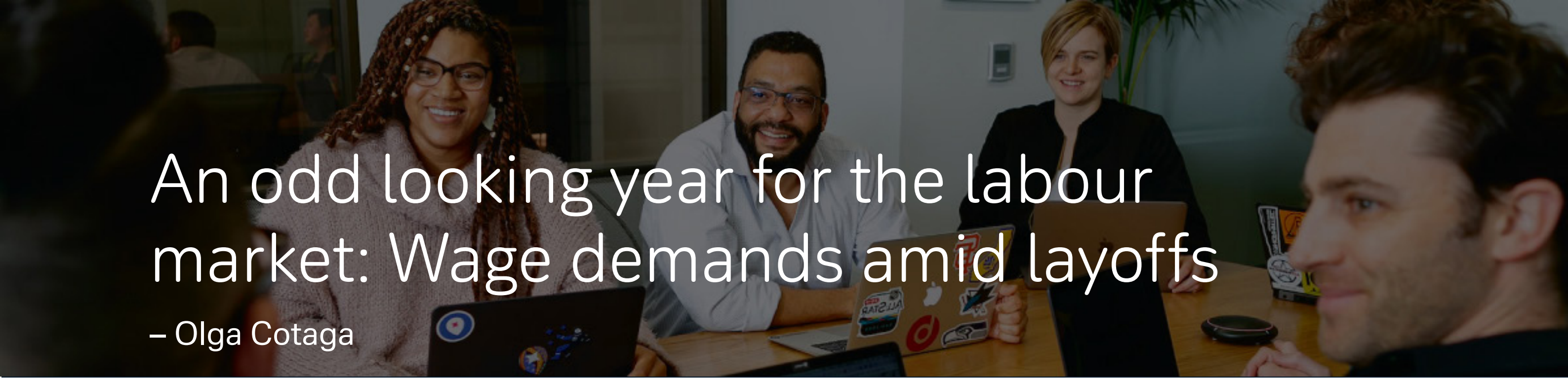
Japan Real Wage Income of Employees Index, 1995=100

Source: OECD, Deutsche Bank

The Japanese general government currently funds spending by borrowing from Japanese households via the banking sector at floating rates. It then invests in foreign and domestic assets of higher duration, using the profits from the trade to subsidise fiscal spending. To finance this borrowing, the government issues government bonds (JGBs), largely bought up by the BoJ.

If sustained inflation above 2% materialises, and the BoJ hikes, younger households tend to benefit as the return on current and future deposits rises. At the same time, the government's interest servicing costs would dramatically increase, affecting fiscal sustainability. The subsequent decline in the value of JGBs would also hit the general government balance sheet. As a result, the wealth of older households would decline as fiscal capacity to fund pensions deteriorates and asset prices drop. The BoJ is aware of this, with BoJ Deputy Himino outlining them in his recent speech in Oita.

But, if the BoJ chooses to delay raising rates, younger households, who have long suffered from the BoJ's unconventional policy, would see future real incomes fall. Whatever the road BoJ takes, there will be clear 'losers' and 'winners' to the Japanese inflation story and will likely determine the trajectory of Japan's economy in 2024 and beyond. Already, the corporate sector is encouraging proactive wage hikes. The Japan Business Federation and the Japan Association of Corporate Executives have expressed desire for the 2024 shunto wage hike to exceed the record-breaking 2023 increase. Next year, in our view, will be a pivotal year for Japan.



An odd looking year for the labour market: Wage demands amid layoffs

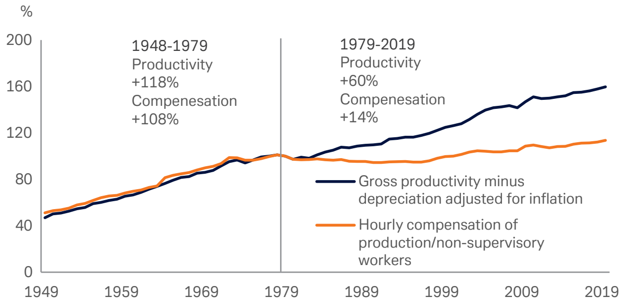
– Olga Cotaga

Just as President Biden's appearance on the UAW picket lines brought forward the 2024 US election campaign, the recent jump in corporate discussions about layoffs may make the issue a key feature of next year.

After years of tight labour markets, things are beginning to turn. In the US, the most recent Jolts report showed that job openings fell to 8.7m in October, well below the 9.3m expected. This was the lowest level in over two years and it follows our forecast that US unemployment is set to rise to 4.5% in 2024 from 3.7% this year. In the euro area, we expect unemployment to rise to 6.8% from 6.5%.

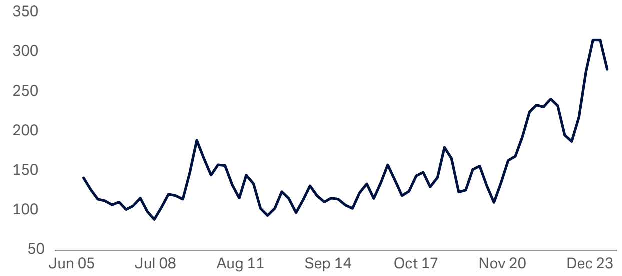
As the labour market slack increases, corporates have begun discussing layoffs. The following chart shows that the instances of layoff-related phrases in corporate documents have jumped in both the US and Europe. Words have started to translate into actions. Words have started to translate into actions. Firms such as Google, Spotify and Condé Nast are among those to recently announce layoffs. More broadly, a survey of global firms shows that employers think about a quarter of jobs will be changed hands in the medium term[6].

Effective productivity v hourly compensation growth - US. Cummulative change since 1948 (index 1979=100)



Source: Bloomberg Finance LP, Deutsche Bank

Mentions of layoff-related phrases in corporate documents US & Europe. (Sum of 6m rolling averages)



*Phrases include "reduction in force and costs", "reallocate and costs" and "round of layoffs"

Source: OECD, Deutsche Bank

Yet, while there may be more layoffs in 2024, employees are not shirking from their wage demands. Indeed, the net change in the number of workers on strike has spiked recently even as the job 'quality' has improved[7]. That contrasts with the last two decades where strikes have only coincided with periods of lower pay.

One explanation for continued worker discontent is that for the first time in a long time, workers have sensed they can attempt to close the wage gap (based on wages and productivity – see chart above) that has widened over the years. Staff, and their representatives are also aware they have more power now than during a recession which we expect next year in the US, and may already be happening in Europe.

Yet, while fears of the effects of recession on jobs are real and serious, layoff rates may not hit levels that wipe out staff demands. Indeed, our forecasts for unemployment in both the US and Europe in 2024 would see rates peak well below those during the financial crisis.

So as economies recover from a downturn in late 2024, companies risk, once again, finding it difficult to rehire staff they may be thinking of letting go now. Indeed, a skills shortage is currently upon us. In October, there were still only 68 workers for every 100 open jobs in the US. That was the smallest number over the last two decades[8]. In Europe, an ECB helicopter view of the euro area labour market since 2005 mentions 'skills mismatch' as one of the worst outcomes[9].

Therefore, worker power looks set to be a feature of 2024 even if industrial action does soften somewhat as economies cool. Companies with large workforces, and low profit per employee metrics are particularly susceptible. Managers should become used to displaying those 'help wanted' signs in the window.

6 World Economic Forum
7 Haver Analytics
8 US Chamber of Commerce
9 ECB

Tech cold war: The US-China race for semiconductor dominance

– Marion Laboure

As one of the world's top-five most traded products by value, semiconductors are core components in devices from smartphones to automobiles.

Chips are also core to the 'tech cold war' that has escalated over the last two years. Among other measures, the US imposed broader restrictions in October 2022, curbing Chinese access to advanced semiconductor technology. Last October, the US further intensified its stance by imposing new restrictions on Nvidia's 'Made for China' AI semiconductors, including the A800 and H800 AI graphic chips. However, shortly after the announcement, Nvidia released versions of its top-of-the-line A100 and H100 AI chips to continue catering to the Chinese market.

Advancements in chips manufacturing lay bare countries' efforts to build tech security. China, for instance, has made progress within a year, with Huawei and its top chipmaker, SMIC, successfully manufacturing an advanced 7nm chip now integrated into the latest Huawei smartphone. While China will continue heavy investment (semiconductors' research costs second only to pharmaceuticals), it might take around five years to achieve parity with the US. The US, with its established leadership position, might emerge as the decisive winner throughout the remaining decade, solidifying its global leadership.

Timeline of the semiconductor industry since October 2022

Source: Deutsche Bank, Bloomberg Finance LP, Financial Times, Reuters.

Achieving self-sufficiency, however, will be difficult due to reliance on rare materials and complex production processes. Also, although countries are now imposing more trade restrictions to protect technologies (the Global Trade Alert found restrictions surged nearly tenfold from 2009 to 2022), globally, the semiconductor industry is highly integrated, with regions specialising in different production stages. This led to over 50 points where a single region held over 65% market share.

Self-sufficiency in semiconductors will be defined by two events next year. Firstly, Taiwan's presidential election on January 13 will determine the next phase of the country's foreign policy. The incumbent party, DPP, which favours closer ties with the US, had been leading until mid-November. However, Taiwan's two main opposition parties, pledging to renew talks with China, recently agreed to form a joint presidential ticket, injecting uncertainty into the situation. Remember that Taiwan finds itself at the centre of US-China tensions and relies on strategic partnerships. The country produces over 60% of the world's semiconductors and more than 90% of the most advanced ones. Secondly, the US election in 2024 could catalyse foreign policy shifts depending on the outcome.

As political stakes over semiconductors intensify, 2024 may prove decisive in the unfolding "Tech Cold War" between the US and China for dominance over strategically vital semiconductor supply chains.

The next asset bubble

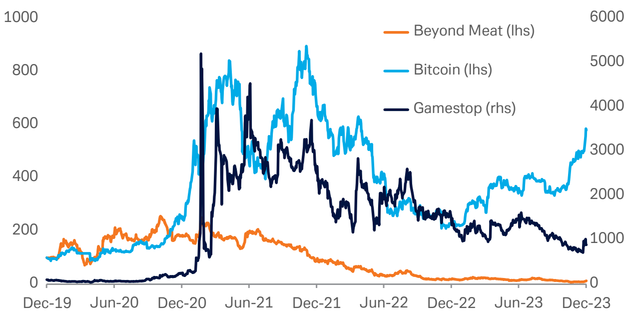
– Luke Templeman

Predictions of the 'Roaring 20s' were common in many decade-ahead forecasts … in 2019. Of course, any analogies with the post-WWI wealth and excess of the 1920s have completely dried up following the pandemic, inflation, rising rates, and market sell-offs. Even conversations in a taxi – the usual way to identify asset bubbles – now revolve more around yields in excess of cash.

So it is easy to think that asset markets are done with bubbles. After all, many of the recent bubbles have popped: alt-foods, cryptocurrencies, spacs, NFTs, meme stocks, the TINA trade. Even real estate is wobbling in many countries, particularly China, while the 'Magnificent-7' AI beneficiaries have paused for breath. It seems investors have become hard-nosed now that money is not free anymore.

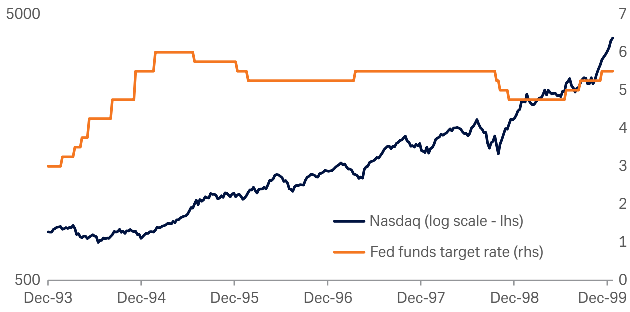
When we look around markets now, it is hard to identify a specific major asset of consequence that may be in a bubble where investors are desperately trying to justify value. Bubbles, of course, are not tail risks (that are unusual) or black swan events (that are completely unexpected). Bubbles occur in full sight and are inflated as investors dream up justifications. For example, in 1999, technology investors pointed to theoretical future revenues. In 2007, commercial real estate investors argued they could repay their debts once they increased rents on 'redeveloped' properties. In 2017, Bitcoin promised to become something people would use.

Share prices of companies affected by market bubbles



Source: Bloomberg Finance LP, Deutsche Bank

Bubbles can form as rates rise and stay high



Source: OECD, Deutsche Bank

Sure, there are conversations to be had about weight loss drugs, olive oil, uranium, and bitcoin after their 2023 rallies. Yet, from a wider market standpoint, they are either niche assets or mere curiosities. Meanwhile, other major asset classes, such as certain equity indices, may have valuations that are 'high' by historic standards, but a 'high' valuation and a bubble valuation are two very different things.

There are some more serious arguments for a bubble in private credit. But systemic issues are unlikely in the near term. The $1.6tn of private credit assets represents barely 12% of the private capital market and barely scrapes the surface of the approximately $500tn in global financial assets. Of course, contagion can start in small places but any near-term private credit losses will almost certainly be cushioned by the large amounts of fundraising done over the last two years. Managers have plenty of cash and are keen to deploy it.

So, can nothing go wrong? Hardly. In fact, the conditions we have today are akin to those in prior periods where asset bubbles formed. Consider the setup in the 1990s, 2000s, and early 2020s – each had a period where bond yields fell after a period of economic turmoil. All three periods ended with a painful bubble burst.

As the 2020s approaches its second half, we see the conditions forming for the next asset bubble. Bond yields are falling and many aspects of the global economy are still in a post-covid rebuilding phase. That sets the scene for products or services to emerge that create hype and then an asset bubble. Expect more quips about the 'Roaring 20s' before the decade is done.

Appendix 1
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Top 10 themes for 2024

December 2023