Outlook

2024 EDITION

CAPITAL GROUP™

Long-term perspective on markets and economies

Marketing communication

Prepare for changes in the investing climate

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Heading into 2024, it's difficult to remember another time when the outlook was so uncertain. Recession or expansion? Inflation or deflation? Higher interest rates or lower? Take your pick and you will find a pundit arguing for each scenario as if it was a foregone conclusion.

As a long-term investor, I prefer to focus on larger trends, events that may shape not just the next year, but the next decade or more. I like to use the analogy of the weather report vs. long-term weather patterns. While many others are concerned about the near-term forecast, I am looking for signs of large-scale change – events and trends that have the potential to change companies, industries, economies and the world.

Along those lines, here are some questions we are asking today: How might rapid advancements in artificial intelligence alter the way companies do business? And which companies are positioned to win the AI race? Will electricity, wind and solar power displace fossil fuels as our primary source of energy? And how long could that process take? In the bond market, with US Treasury yields near 16-year highs, are we at the start of a historic opportunity as real income returns to the fixed income universe?

On the other hand, we must be wary of gathering storm clouds. Will rising government debt levels lead to lower economic growth rates? How might worsening tensions between the US and China affect global trade? What is the risk that wars in Ukraine and Israel will spill into wider fields of conflict? And, in a pivotal election year, will market volatility keep nervous investors on the sidelines?

We don't pretend to have all the answers, but it's our job to explore them through exhaustive bottom-up, fundamental research. Large-scale change can bring a high degree of volatility, but also unprecedented opportunities. That's prime time for active investing.

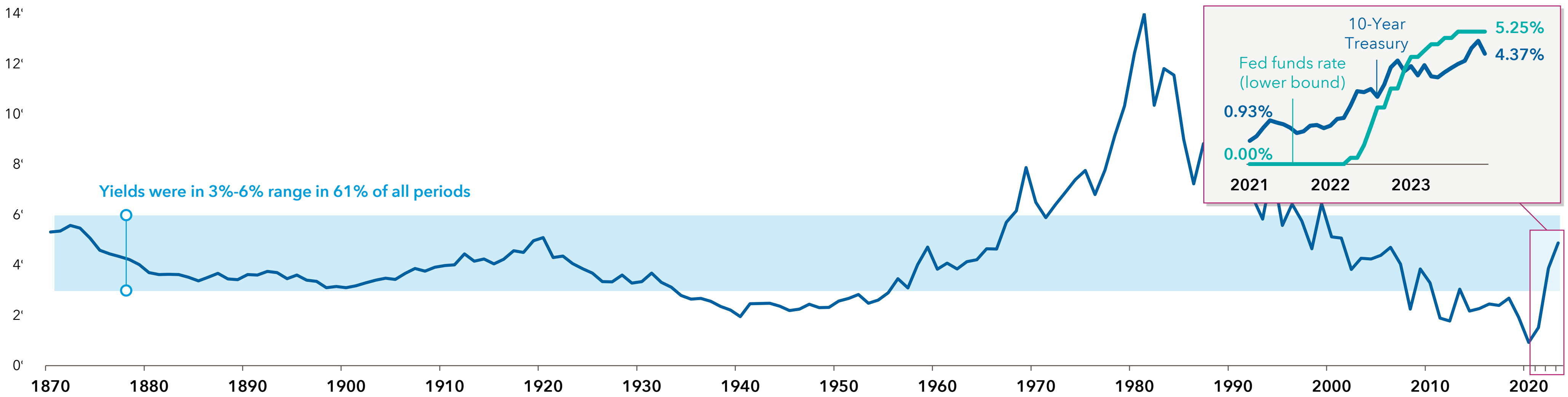
Against this backdrop, I invite you to read and share our 2024 Outlook report.

A glossary of technical terms can be found on page 17.

Back to the "old normal"? A return to higher rates

US long-term rates today are within the range of historical norms

US long-term government bond yield (%)



The US Federal Reserve's mission to tame inflation without widespread economic pain just got trickier. The US 10-year Treasury yield, which underpins borrowing costs for much of the economy, has risen sharply.

Will high rates stick around or will growth deteriorate, forcing the Fed to slash borrowing costs? "I'm optimistic that consumers will continue to carry the economy, even as rates remain higher for an extended period," says portfolio manager Pramod Atluri. That's partly because wages and home values remain above pre-pandemic levels, which has helped support consumer spending. US federal spending has also buffeted the economy, the flip side of which has been a rising deficit now close to 8% of GDP.

Looking into 2024, Atluri believes yields may remain at levels considered normal prior to the global financial crisis and hover in the range of 3.5% to 5.5%.

While the run-up in rates could weigh on markets, investors will likely adjust. When 10-year rates were 4.0% to 6.0%, the average annual return since 1976 for the S&P 500 Index was 10.38%, while the Bloomberg US Aggregate Bond Index returned 6.59%.*

Past results are not a guarantee of future results.

* Capital Group, Bloomberg Index Services Ltd., Standard & Poor's, US Federal Reserve. Returns shown from 31 December 1976 to 30 November 2023.

Sources: Federal Reserve, Robert Shiller. Data for 1870–1961 represents average monthly US long-term government bond yields compiled by Robert Shiller. Data for 1962–2022 represents 10-year Treasury yields, as at 31 December each year within the period. Data for 2023 is as at 30 November 2023. All returns in US dollar terms.

Rolling recessions may limit likelihood of broad downturn in the US

Why didn't the US fall into recession in 2023, as so many pundits predicted?

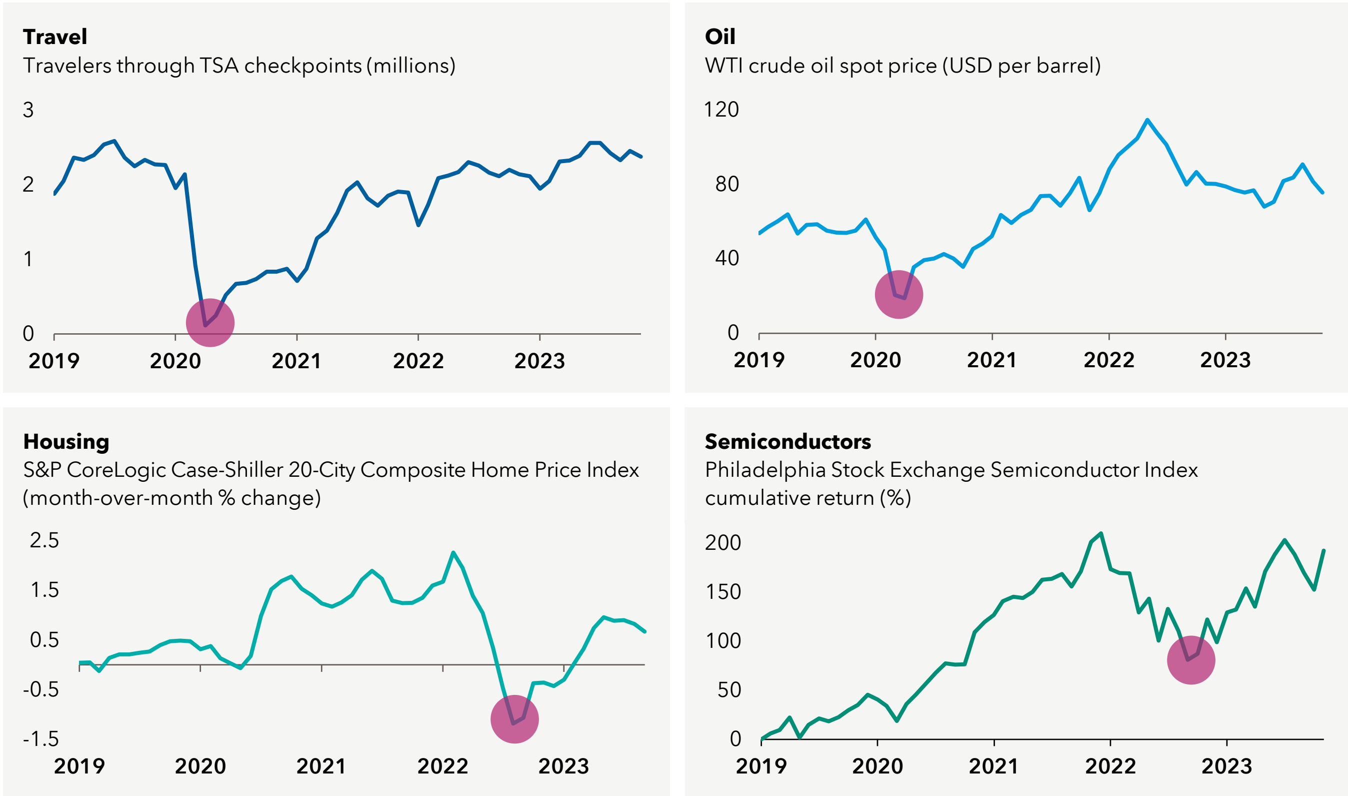
The recession did happen, just not all at once. Over the past year and a half, different economic sectors experienced downturns at different times – a phenomenon economists call a "rolling recession." Thanks to this rare event, it's possible the US won't experience a traditional recession before the end of this year or even the next, despite the burden of high inflation and rising interest rates.

For example, US residential housing contracted sharply after the Federal Reserve started aggressively raising interest rates. At one point in 2022, existing home sales tumbled nearly 40%. Now there are signs that the housing market is recovering. The chart illustrates several sector-based examples.

If these contractions and recoveries continue, the US could avoid the most widely predicted recession in history, says Capital Group economist Jared Franz. Citing a strong labour market and resilient consumer spending, Franz believes the US economy could grow at an annualised rate of roughly 2% in 2024.

"This has been Godot's recession – we've all been waiting for it*," adds portfolio manager Chris Buchbinder. "But in my view, the probability of a severe downturn is now well below 50%."

Mini-recessions, and recoveries, have rolled across different industries and sectors

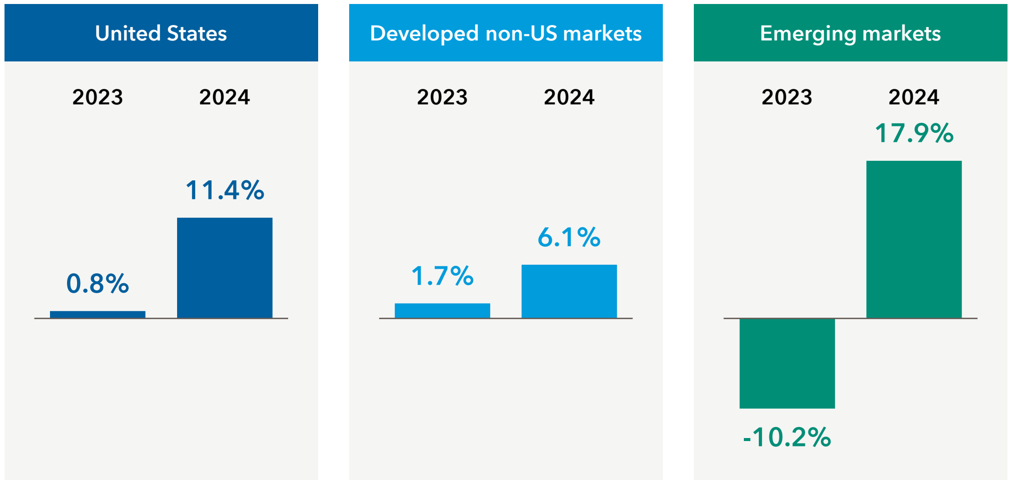


Past results are not a guarantee of future results.
As at 30 November 2023. Data represents cumulative price return since 1 January 2019. Returns in US dollar terms.
Sources: Travel: Transportation Security Agency (TSA), US Department of Homeland Security. Data is a 30-day moving average. WTI - West Texas Intermediate oil: Refinitiv. Housing: Standard & Poor's. Latest available monthly data is September 2023. Semiconductors: Philadelphia Stock Exchange.
* Refers to 'Waiting for Godot', a play by Samuel Beckett.

Look for corporate earnings to rebound in 2024

Solid earnings growth anticipated across major markets...

Estimated annual earnings growth (in US dollars)



...but economic indicators offer a mixed outlook

The Conference Board Leading Economic Index®

New unemployment claims	▲ Positive
Average manufacturing hours worked	◆ Neutral
Manufacturers' new orders (consumer goods)	▲ Positive
Manufacturers' new orders (producers)	◆ Neutral
ISM New Orders Index (from customers)	▼ Negative
New residential building permits	▲ Positive
S&P 500 Index	▲ Positive
Leading Credit Index	▼ Negative
Interest rate spread	▼ Negative
Consumer expectations	▼ Negative

▲ Positive ◆ Neutral ▼ Negative

Investors are getting mixed signals about the direction of the economy. But when it comes to stock prices, one metric matters most: corporate earnings.

In the US, Wall Street analysts expect earnings for companies in the S&P 500 Index to rise more than 11% in 2024, based on consensus data compiled by FactSet. That's along with an expected 6.1% earnings boost in non-US markets and a robust 18% gain in emerging markets.

Given that 2023 was a difficult year, it's logical to expect an earnings rebound in 2024, which could provide a runway for stocks to head higher. But there are several risks that could result in substantial earnings revisions, including sluggish consumer spending in the face of persistent inflation, slowing economic growth in Europe and China, and rising geopolitical risk from the wars in Ukraine and Israel.

What's the risk that earnings expectations are too high?

"I don't think it's going to be a terrible year for corporate earnings, but I think we're more likely to see 6% to 8% growth in the US," says Capital Group economist Jared Franz, "and potentially higher in some emerging markets."

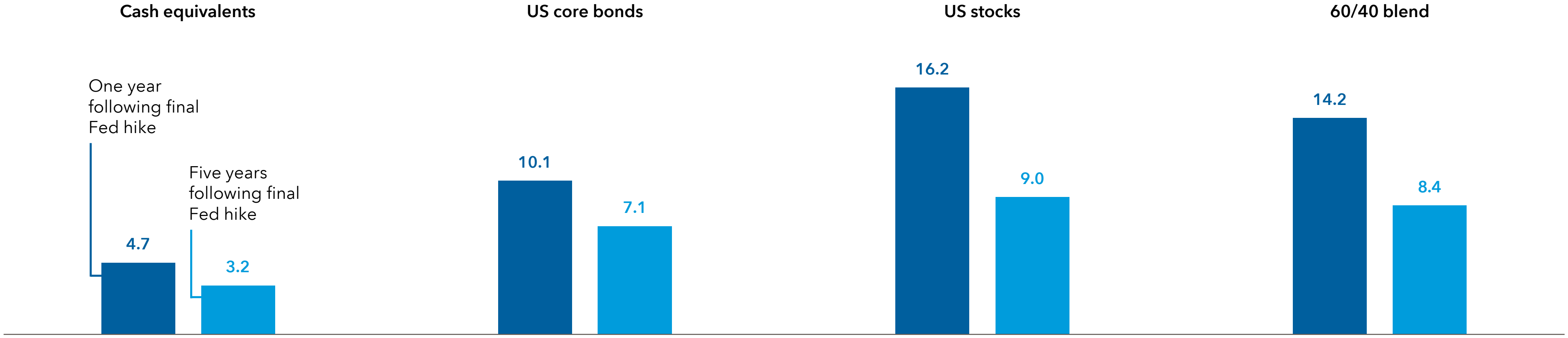
Past results are not a guarantee of future results. Forecasts are for illustrative purposes only.

Sources (left chart): Capital Group, FactSet, MSCI, Standard & Poor's. Estimated annual earnings growth is represented by the mean consensus earnings per share estimates for the years ending December 2023 and December 2024, respectively, across the S&P 500 Index (US), MSCI EAFE Index (developed non-US) and MSCI Emerging Markets Index (emerging markets). Estimates are as at 30 November 2023. Source (right chart): The Conference Board. The table shows the 10 components of The Conference Board Leading Economic Index and indicates if each is expected to have a positive, neutral, or negative impact on US economic growth, based on current levels and six-month trends, as at 31 October 2023. Returns in US dollar terms.

A window of opportunity for moving cash off the sidelines

After US Fed hikes end, stocks and bonds have historically outpaced cash

Average annual return (%)



The investor exodus from stock and bond markets into cash over the last few years is understandable, but investors who are still on the sidelines may miss out on a historic window of opportunity to position portfolios for long-term success.

With the Federal Reserve in the midst of an aggressive rate-hiking cycle, yields on money market funds and cash equivalents rose to attractive levels. What's more, the speed of the rate increases at times rattled stock and bond markets.

But with inflation easing more quickly than anticipated, the Fed paused further hikes for the second consecutive meeting in October, signalling the central bank may be near the end of its tightening cycle. Historically this has provided a favourable time for investors to redeploy cash into stock and bond investments.

Following the last four tightening cycles, stocks, bonds and a blended hypothetical 60/40 portfolio (60% stocks, 40% bonds) sharply outpaced US 3-month Treasury bill returns in the first year after the last Fed hike. Conversely, the 3-month Treasury yield, widely regarded as a proxy for cash-equivalent investments, rapidly declined an average 2.5% in the 18 months* after the last Fed hike.

"I believe we're on the cusp of a major transition where long-term investors can find attractive investment opportunities in stocks and bonds," says Mike Gitlin, president and chief executive officer of Capital Group.

Past results are not a guarantee of future results. Hypothetical data for illustrative purposes only. Investors cannot invest directly in the index.

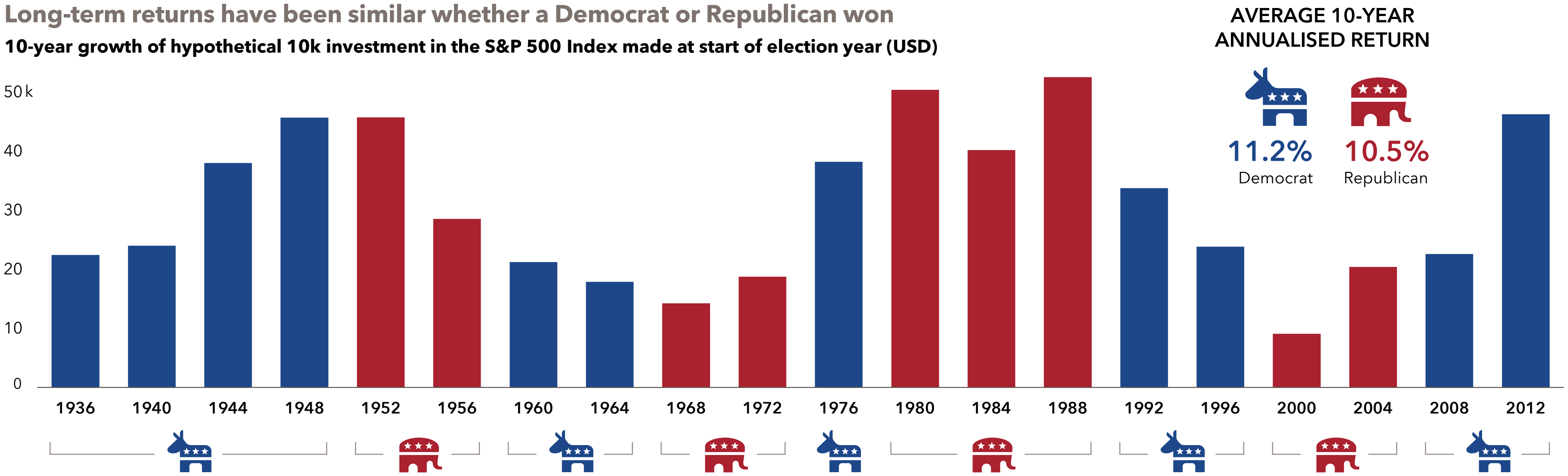
* Based on an average of the four most recent cycles, which began on 1 March 1995, 1 June 2000, 1 July 2006, and 1 January 2019, respectively. Returns in US dollar terms.

Sources: Capital Group, Morningstar. Chart represents the average returns across respective sector proxies in a forward extending window starting in the month of the last Fed hike in the last four transition cycles from 1995 to 2018 with data through June 30, 2023. Benchmarks represent US 3-month T-bill (cash), Bloomberg US Aggregate Index (core bonds), S&P 500 Index (US stocks) and a blend of 60% of the S&P 500 Index and 40% of the Bloomberg US Aggregate Index (60/40 blend).

Red or blue? Investing through US election uncertainty

Long-term returns have been similar whether a Democrat or Republican won

10-year growth of hypothetical 10k investment in the S&P 500 Index made at start of election year (USD)



With the US presidential election less than a year away, investors are feeling anxious about how markets will react.

"Several key issues will certainly be top of mind for voters, including international policy, the impact of inflation and numerous important social issues," says political economist Matt Miller. "But a lot can change between now and November."

Equity portfolio manager Rob Lovelace, who has invested through many election cycles in his 37-year career, believes the added uncertainty may provide attractive investment opportunities.

"When everyone is worried that a new government policy is going to hurt a sector, that concern is often overblown," Lovelace says. "High-quality companies can sometimes get caught in political crosshairs, which can create a buying opportunity.

But I typically try to look beyond the election cycle and aim for an average holding period in my portfolios of around eight years – essentially two presidential terms."

While markets can be volatile in election years, for long-term investors, which political party takes the White House has had little impact. Since 1936, the 10-year annualised return of US stocks (as measured by the S&P 500 Index) made at the start of an election year was 11.2% when a Democrat won and 10.5% in years a Republican prevailed.

Past results are not a guarantee of future results.

Sources: Capital Group, Standard & Poor's. Each 10-year period begins on 1 January of the first year shown and ends on 31 December of the tenth year. For example, the first period listed (1936) covers 1 January 1936 to 31 December 1945. Returns in US dollar terms.

With artificial intelligence, separate hype from real opportunity

Major advancements in artificial intelligence (AI) captured the market's attention in 2023, driving up stock prices for a handful of Big Tech companies. But the beneficiaries of AI's ascent aren't only to be found in the tech world.

AI-driven applications are spawning innovation across many industries, including pharmaceuticals, banking and even fast food. McDonald's is using AI to make its drive-through order systems faster. Pfizer is employing AI to accelerate the development of new drugs. And JPMorgan Chase is unleashing AI bots to detect identify theft.

These companies join more obvious beneficiaries, such as NVIDIA, which designs powerful computer chips needed to run AI applications, and Microsoft, co-owner of the popular AI app ChatGPT.

The challenge for investors will be to separate the hype from reality amid the expected exponential growth of AI systems over the next decade.

"When I think about investing in AI, I do have a degree of caution," says portfolio manager Don O'Neal. "The hype reminds me of internet stocks in the late 1990s, although I don't think it's that pervasive in AI. I think AI is going to have a huge impact on society, but we're still trying to identify the profit pools. There's a lot of work yet to be done."

AI's impact will be felt across sectors and industries

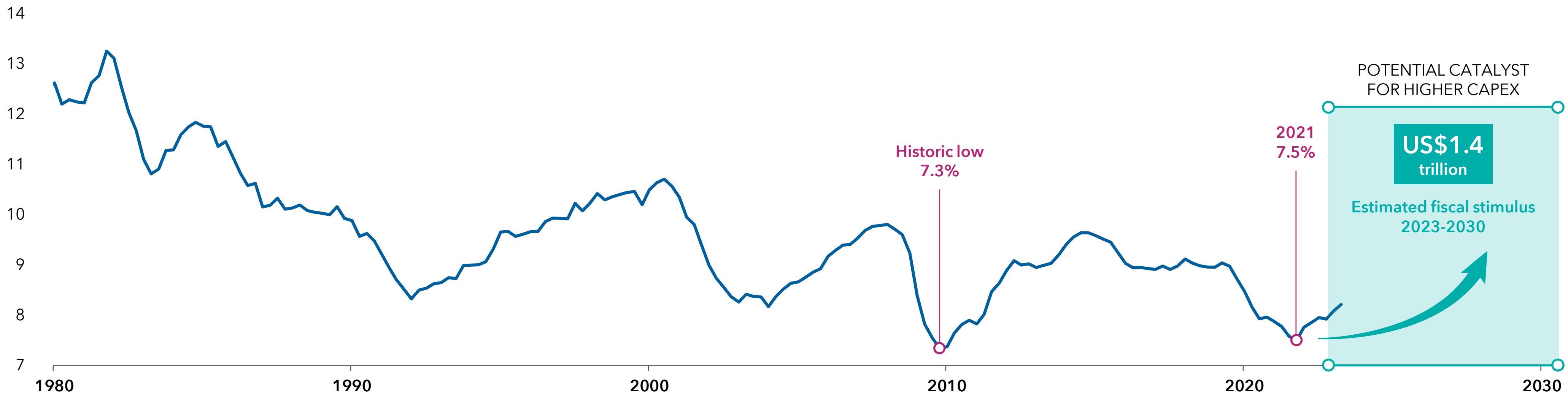
Semiconductor chips & equipment	Cloud computing/ AI software	AI applications
ASML	Microsoft	Tech and telecom
Applied Materials	Amazon	Financial services
NVIDIA	Google	Health care/pharma
TSMC		Legal/professional services
Broadcom		Automotive and assembly

Examples are for illustrative purposes only.
Source: Capital Group. TSMC refers to Taiwan Semiconductor Manufacturing Company. As at 30 November 2023.

Made in America: Capital spending boom could spark a manufacturing revival

After years of underinvestment, capital spending looks set to recover

Capital expenditures as a percentage of gross domestic product (%)



A tidal wave of cash is headed directly at American industry, with the potential to galvanise the capital investment cycle and reshape US manufacturing and energy industries.

Seeking to support local supply chains, expand clean energy and boost the US semiconductor industry, the US government has committed US$1.4 trillion over the next seven years for capital projects.

This investment translates into revenue and earnings growth potential for companies with the capacity and flexibility to undertake these expansive projects, including upgrading the US power grid and building manufacturing facilities, says equity portfolio manager Anne-Marie Peterson. "Many industrial firms have been in a figurative desert for years," Peterson explains. "This level of investment can potentially transform them from sleepy cyclicals to growth businesses."

The stimulus will also likely have a multiplier effect throughout the economy as new facilities will create job prospects and other potential benefits. While much of the money has yet to be spent, the trend toward energy efficiency, localising supply chains and infrastructure improvements is already generating opportunity. Air conditioning maker Carrier Global saw demand for its energy efficient systems surge in 2023 as many countries experienced periods of record-high temperatures.

Among capital equipment companies, Caterpillar reported robust orders in the second quarter of 2023 for its construction equipment, partly driven by US federal infrastructure spending.

Forecasts are for illustrative purposes only.

Sources: Capital Group, St. Louis Federal Reserve. Data from 1 January 1980 to 30 June 2023. Capital expenditures include private non-residential equipment and structures and excludes energy.

Out-of-favour dividend payers poised to offer diversification, income

With investors swept up in the artificial intelligence fervour, valuations for dividend-paying stocks have quietly drifted toward multi-decade lows compared to the broader market.

With growth expected to moderate in 2024, and the potential for recession lingering, dividends may take a more prominent role in driving total returns for investors.

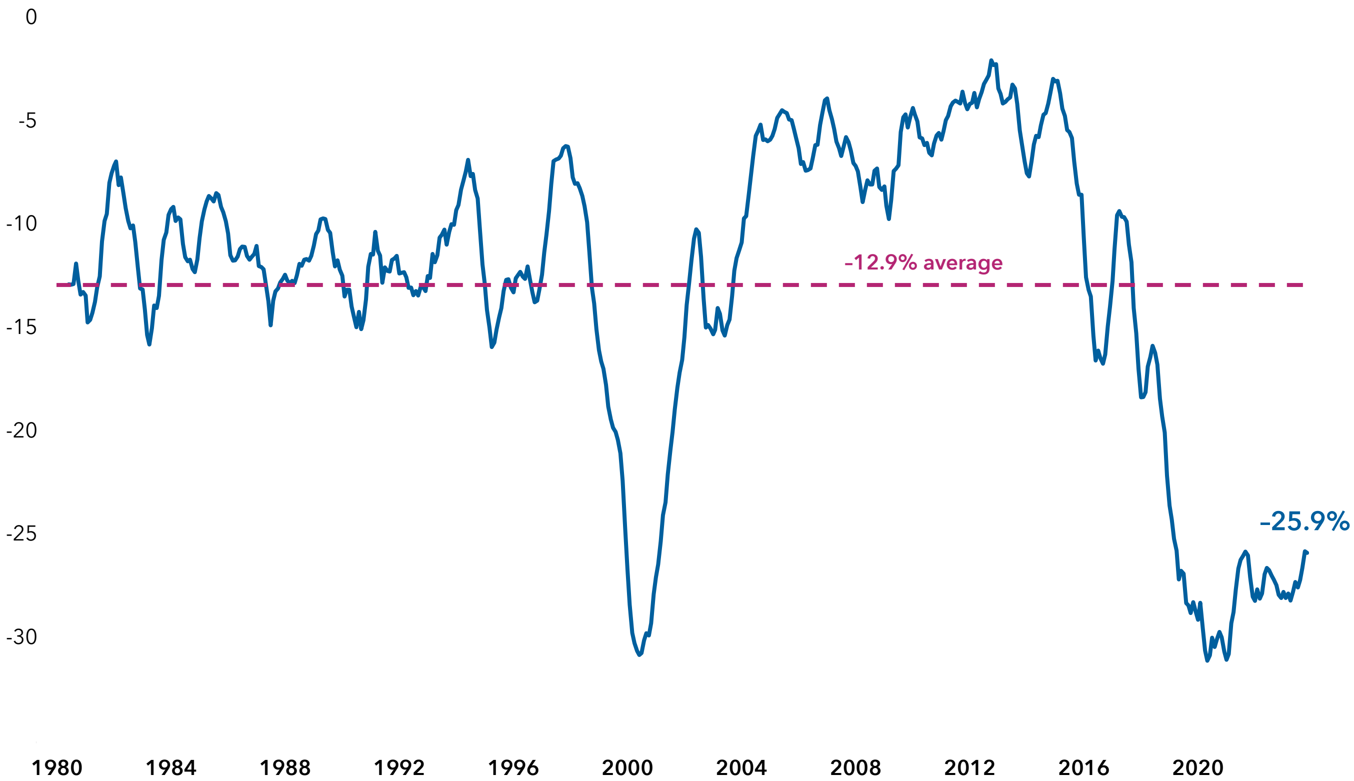
"It is difficult to know when a cycle will turn, so investors may want to look for companies with growth potential but also businesses that pay dividends, which can help mitigate market volatility," says equity portfolio manager Diana Wagner. "Valuation is important, but it is essential to distinguish between real values and companies with deteriorating business prospects."

Select dividend payers across a variety of industries are adopting strategies to drive demand for their offerings. For example, retail pharmacy CVS Health is launching a new division that will work with drugmakers to produce biosimilar versions of leading therapies that will make them more affordable. And beverage maker Keurig Dr Pepper has a history of relatively stable demand through business cycles for brands like Canada Dry and Snapple.

For investors concerned about the risks of concentrating their portfolios in a handful of tech giants with similar businesses, dividend payers can offer diversification as well as income.

Valuations for high dividend payers are far below the market average

P/E of high dividend stocks vs. S&P 500 Index (%)



Past results are not a guarantee of future results.

Sources: Capital Group, Goldman Sachs. As at 28 November 2023. High dividend stocks refer to the cohort of stocks in the S&P 500 Index with the highest quintile dividend yield (sector-neutral) within the index. Line represents smoothed six-month average. P/E ratio = price-to-earnings ratio.

Europe's trailblazers prove there's no monopoly on innovation

Think all innovation comes from US tech? Think again. While US technology giants may be dominating the headlines with their breakthroughs in artificial intelligence, Europe is home to many businesses making advancements across a range of industries.

AstraZeneca, the British-Swedish COVID vaccine developer and maker of lung cancer treatment Tagrisso, has invested aggressively in research and development, resulting in a deep pipeline of oncological and rare disease therapies in late-stage development.

Swiss multinational specialty chemical company Sika appears poised to benefit from more stringent emissions regulations and higher infrastructure investment in developed economies with its energy-efficient, durable construction materials.

Innovation will also be key in solving sustainability challenges in the aerospace industry, according to equity portfolio manager Michael Cohen. "Stricter requirements on emissions means airlines are incentivised to order the newest, most efficient planes, creating a tailwind for manufacturers employing leading-edge technology," he says.

France's Safran, the world's top producer of narrow-body aircraft engines, through its partnership with General Electric, is developing engines that could reduce emissions by 20%.

While America remains an important engine for innovation, investors should look to Europe and beyond for investment opportunities that can provide diversification to portfolios.

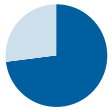
European companies are innovating across industries

AstraZeneca
Pharmaceuticals

Cambridge, United Kingdom

US$198.7B
Market cap

US$280B
Estimated TAM



73%

Revenue outside Europe

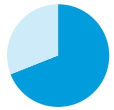
- 167 therapies in current pipeline
- AI-enabled predictive tools have reduced drug manufacturing time by 50%
- Offerings span oncology, renal, cardiovascular and immunology, among others

Sika
Chemicals

Baar, Switzerland

US$43.8B
Market cap

US$122B
Estimated TAM



69%

Revenue outside Europe

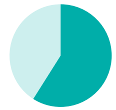
- Proprietary concrete recycling process could reduce waste by 30 million tons every year
- Expects to increase its penetration of the construction chemicals market by 2.5x - 4.0x by 2050
- 30 largest competitors represent 55% of market share, presenting opportunity for consolidation

Safran
Aerospace & Defense

Paris, France

US$75.1B
Market cap

US$748B
Estimated TAM



59%

Revenue outside Europe

- Top supplier of narrow-body plane engines, helicopter engines and aircraft cabin interiors
- Global flight hours are projected to increase by 60% between 2023-2032
- Developing jet engines projected to be 20% more fuel efficient than current models by 2035

Estimates and examples are for illustrative purposes only.
Sources: Capital Group, Aviation Week Intelligence Network, company reports, FactSet, Global Market Insights, MSCI. Companies above serve as examples of European companies across selected industries with geographically diversified revenue bases; each of the selected companies is among the top 10 largest companies by market value for their respective industries within the MSCI Europe Index. Geographic revenue percentages represent estimates from FactSet based on most recently reported company figures, as at 30 November 2023. "TAM" represents total addressable market. Data as at 30 November 2023.

Revitalising an undervalued market: is this time different for Japan?

Japan is taking major steps to modernise its corporate landscape and prioritise shareholders. Since the 'Abenomics[1]' reform programme began, Japan has attempted to improve its corporate governance but progress has been slow; today, however, there is growing urgency to address cash-heavy balance sheets and inefficient business lines.

In March, the Tokyo Stock Exchange asked companies to improve profitability, returns, and valuations – focusing on raising price to book (P/B) ratios above one[2]. If a business generates return on equity above cost of capital, its P/B should improve and ways to achieve this include reducing excess cash and shedding underperforming subsidiaries.

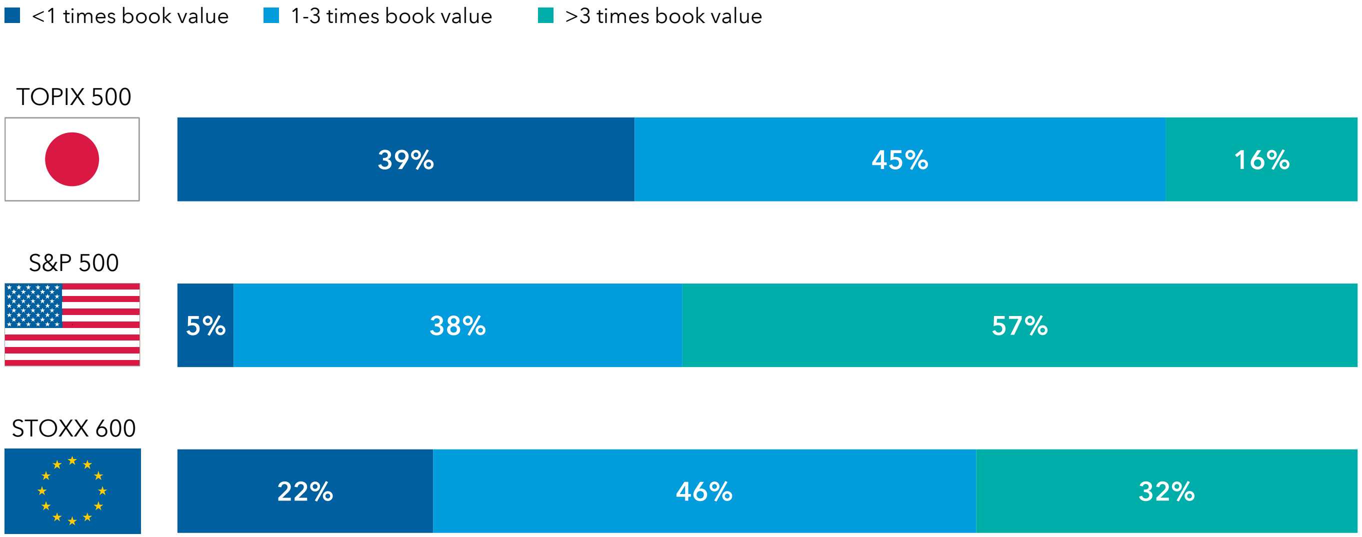
In the short term, this backdrop has boosted Japanese equities to highs not seen since the late 1980s, largely driven by value stocks. But after so many false dawns, is this time different?

Capital Group engaged with over 100 Japanese companies on capital allocation this year and several show improving shareholder return policies. But portfolio manager Akira Horiguchi says that even if companies with a lower book value reach the target, he estimates the index would only rise around another 15% (in JPY terms) because most stocks involved are smaller constituents.

"We believe changes should not stop with companies below 1x book but evolve to become more broad-based," he says. "Many Japanese companies above 1x book do not earn high enough return on equity due to cash hoarding or insufficient portfolio management. If we see meaningful change here, there may exist a true opportunity for paradigm shift."

Targeting 39% of TOPIX[3] trading below the value of their assets

Percentage of index constituents whose price-to-book ratios are:



1. Started under former prime minister Shinzo Abe in 2012, Abenomics involved enacting reforms to make the economy more competitive.
2. A P/B ratio below one means the market is valuing a company at less than its assets are worth.
3. TOPIX - Tokyo Stock Price Index

Sources: Capital Group, FactSet, Refinitiv Datastream, Standard & Poor's, STOXX, TOPIX. As at 18 August 2023. The price-to-book ratio is the ratio of a company's publicly traded share price to its equity value per share.

Emerging markets: Coming out of China's shadow

Is it time for emerging markets other than China to grab more of the spotlight? The setup looks attractive, and opportunities are growing in countries such as India, Indonesia and Mexico. Why? Infrastructure growth is accelerating, government balance sheets are stronger, and supply chain shifts are boosting regional economies.

Take India. New roads, housing developments and industrial parks have left parts of the country unrecognisable from just a few years ago. Indonesia is attracting foreign investment to build out the electric vehicle supply chain. And Mexico is becoming a reshoring hub.

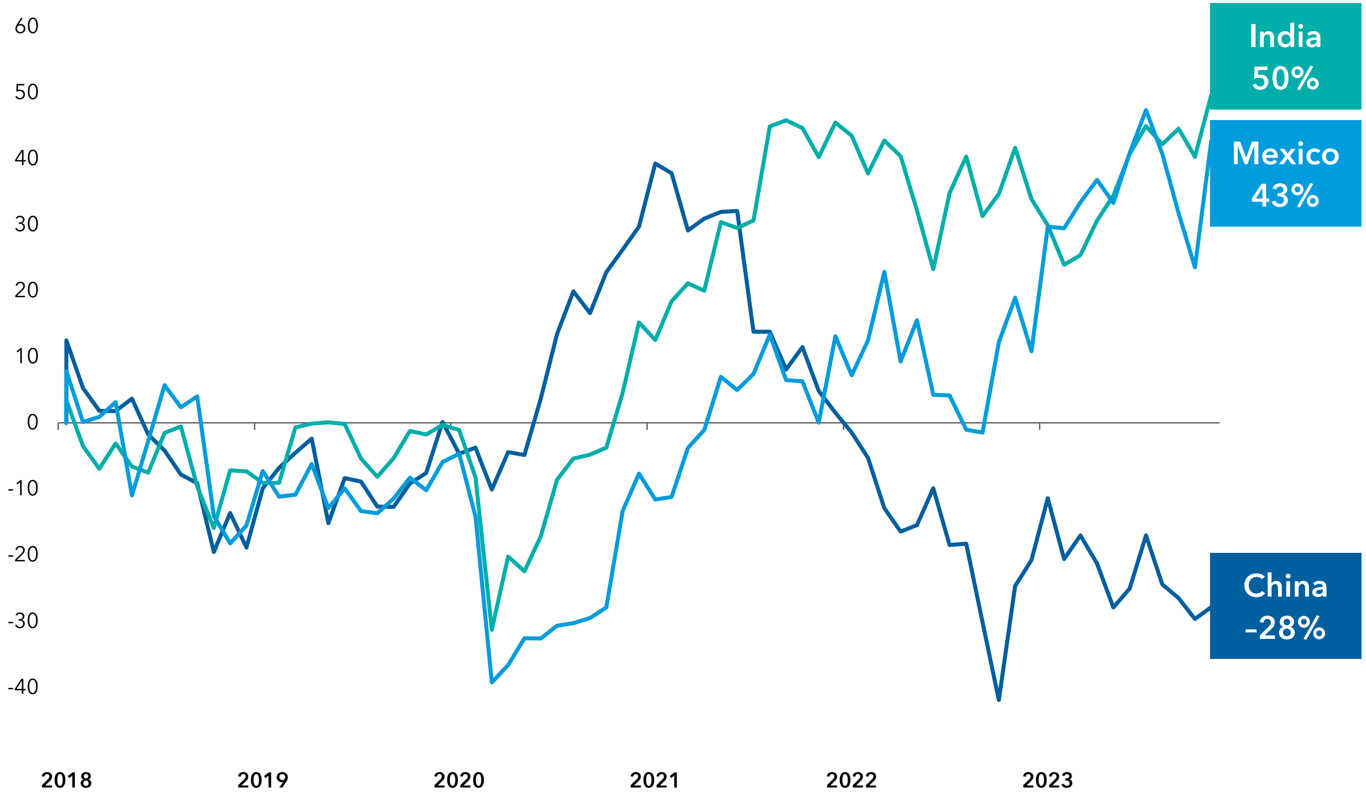
"Despite China's slowing economy, I think durable trends – such as the reconstruction of supply chains, demographic shifts and the energy transition – could add more depth to emerging markets than we have seen in the past," says portfolio manager Brad Freer.

Investment opportunities range from banks to aircraft component makers to real estate developers to mining and consumer-related companies. Meanwhile, the rapid expansion of mobile-based technology platforms is tapping into demand for consumer services.

And don't discount China as a whole. A deep sell-off has created select opportunities to invest in innovative companies that have dominant market share in their home country, generate copious cash flows and trade at appealing valuations.

Returns among large EMs have diverged post-COVID

Cumulative total return (%)



Past results are not a guarantee of future results.
Sources: MSCI, RIMES. Returns reflect MSCI India Index, MSCI Mexico Index and MSCI China Index in US dollars. Five-year time period shown to reflect returns pre- and post-COVID. Data as at 30 November 2023. Returns in US dollar terms.

Corporate and mortgage bonds offer compelling income opportunities

Despite an uncertain economic outlook creating potential headwinds, high starting yields combined with a confluence of supportive factors currently underpin agency mortgage-backed securities (MBS) and investment-grade corporate bonds (rated BBB/Baa and above).

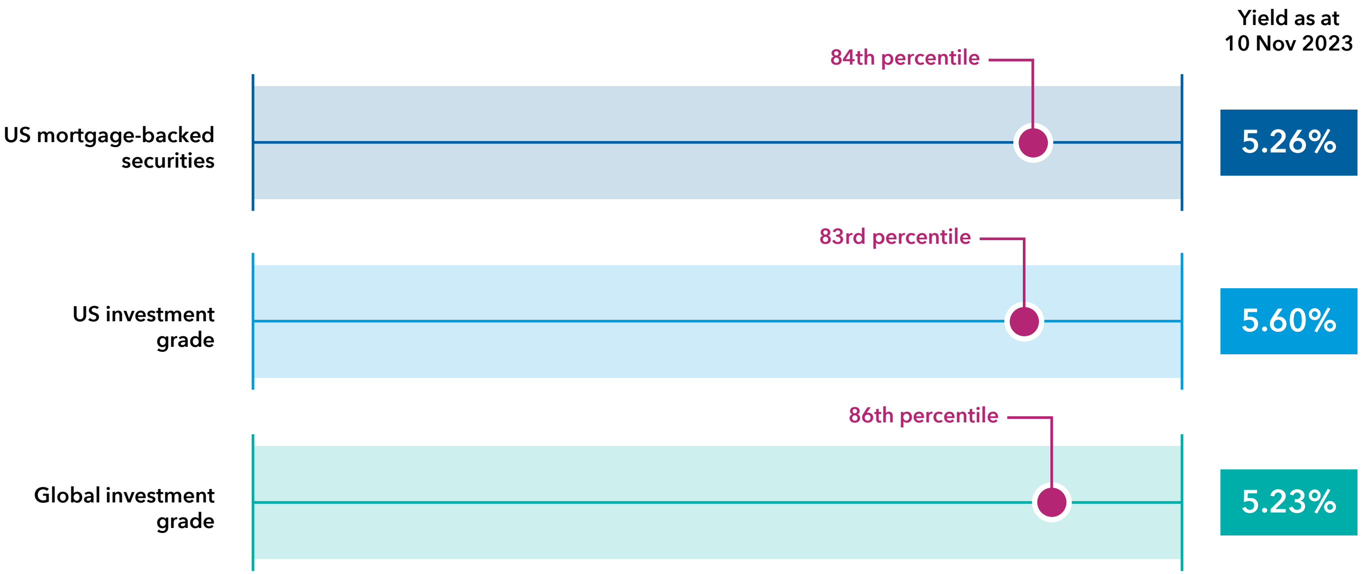
Higher coupon MBS look appealing as the expected conclusion of the Fed's hiking cycle looms. Volatility is likely to decline, and valuations today are at levels not seen since April 2020. Housing inventory and affordability are approaching all-time lows, which should dampen MBS supply and support near-term valuations.

"As securities that carry an implicit government guarantee, agency MBS can be an effective way of adding income to a portfolio without taking credit risk, that correlates with equities and other assets," says portfolio manager David Betanzos.

Investment-grade corporate bonds are supported by strong balance sheets and low refinancing needs. Investment-grade spreads did not tighten as much as high yield in 2023, and now look more attractively priced on a relative basis. In a modest growth environment, investors could earn the coupon without too much downside risk. If the economy slows and Treasury yields rally, the sector's longer duration would mean potential price appreciation, which may offset any widening in spreads.

Yields are near 20-year highs

Latest yield, as a percent of 20-year range



Past results are not a guarantee of future results.

Sources: Bloomberg Index Services Ltd. Indexes represented are Bloomberg US Mortgage Backed Securities Index, Bloomberg US Corporate Investment Grade Index and Bloomberg Global Aggregate Corporate Index. Includes daily yields for the 20-year period ending 30 November 2023.

Healthy income potential in high yield

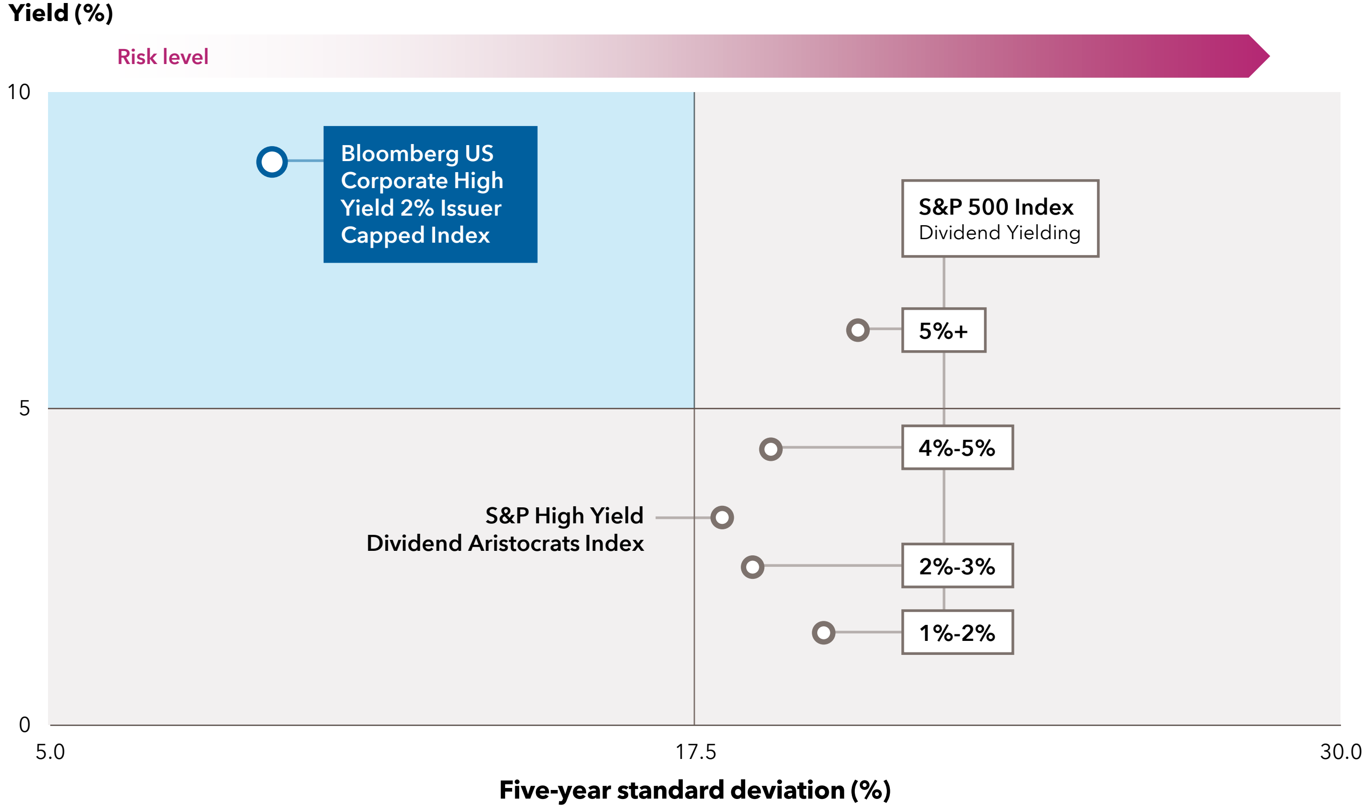
Amid the fuss about where rates may be going, you could have easily missed the healthy returns that high-yield bonds posted in 2023. The lesson: Under the right conditions, high-yield bonds (BB/Ba rated and below) may offer powerful income potential.

Despite the risk of a decline in earnings growth and lower cash flows for many companies in 2024 – especially those with leveraged balance sheets – high-yield bonds have historically done well as long as economic growth remains positive. Even if spreads to Treasuries widen, with yields around 9%, the income component could support positive returns. The asset class can be used as part of an equity or bond allocation, since it shares characteristics of both.

The refinancing needs of many companies rated high yield have caught the attention of markets, but most don't hit a "maturity wall" until 2026, says portfolio manager Tom Chow. Moreover, the overall credit profile of the sector has improved as riskier companies have turned to private credit for funding.

"Investors have priced in an uptick in default rates to be in the 4% to 5% range in 2024," says Chow. "It really is about credit selection," he adds, noting technology companies with high recurring revenues are attractive, while issuers rated CCC and below require a more selective approach.

High yield could offer income with less volatility than stocks



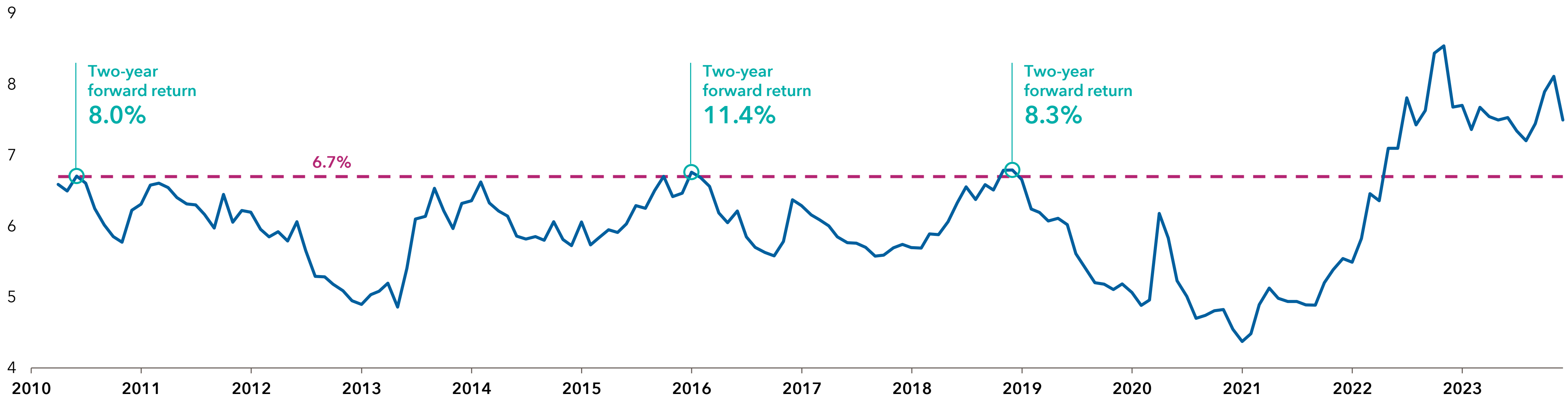
Past results are not a guarantee of future results.

Sources: Bloomberg Index Services Ltd., Morningstar, Standard & Poor's. As at 31 October 2023. Yields are yield-to-worst for bond index and dividend yields for stock indexes. Yield-to-worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting. S&P High Yield Dividend Aristocrats Index is designed to measure the performance of companies within the S&P Composite 1500® (which includes all the stocks in the S&P 500, S&P 400 and S&P 600) that have followed a managed-dividends policy of consistently increasing dividends every year for at least 20 years. Standard deviation (based on monthly returns) is a common measure of absolute volatility that tells how returns over time have varied from the mean. A lower number signifies lower volatility.

High starting yields, better fundamentals and falling rates should support EM debt

Current yields may indicate an attractive entry point

Emerging markets sovereign debt – Yield to worst (%)



Emerging market (EM) local currency bonds are less vulnerable to higher developed market rates than they once were. Many EM economies have seen improving economic trends. "On balance, the fiscal deficits of several EM countries have narrowed to or below pre-pandemic levels," portfolio manager Kirstie Spence says. Meanwhile, as inflation has been declining, EM central banks are starting to cut interest rates. Falling EM rates alongside decent fundamentals should support EM local currency bonds in 2024.

The hard currency, US dollar-denominated bond market is divided between issuers rated investment grade (rated BBB/Baa and above) and high yield (rated BB/Ba and below). Spreads on some higher yielding, lower credit quality EM bonds have trended wider, but are being driven by factors specific to each credit, requiring case-by-case analysis. Investment-grade credits offer lower income but are supported by relatively strong fundamentals.

Spence favours a balanced approach to owning both hard and local currency issuers: A blended portfolio can benefit from the differentiated risk profiles and return drivers for each segment of the market.

Historically, two-year forward returns have been positive when yields reach 6.7% or higher. High starting yields offer a buffer against any volatility that the global macroeconomic and geopolitical environment might bring in 2024.

Past results are not a guarantee of future results.

Source: Bloomberg, JP Morgan, Morningstar. Data as at 30 November 2023. Yield-to-worst and forward return callouts shown are for 50% JP Morgan EMBI Global Diversified Index/50% JPMorgan GBI-EM Global Diversified Index. Yield-to-worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting. The forward returns in the chart refer to the average annualised two-year total return (in USD) of the benchmark starting on 31 May 2010, 31 December 2015, and 30 November 2018, respectively, which were the three dates that yields peaked above 6.7%.

Glossary

Agency Mortgage-Backed Securities (MBS) – These are pools of securitised residential mortgage loans that are issued and guaranteed by US government agencies.

Coupon – The regular interest payment on a bond. It is usually expressed as a percentage of the face value and it is paid from issue date until maturity.

Credit rating – Typically ranging from AAA/Aaa (highest) to D (lowest), these are assigned by credit rating agencies such as Standard & Poor's, Moody's and/or Fitch, as an indication of an issuer's creditworthiness.

Credit spreads – The difference between the yield (return) of two different debt instruments with the same maturity but different credit ratings.

Default rate – A bond is considered in default if the issuer misses a coupon interest payment or cannot repay the principal amount at maturity. The default rate measures the percentage of issuers in each fixed income asset class that failed to make either of these payments in the prior 12 months.

Cumulative price return – The accumulated gain or loss of a stock (excluding dividends) over time, independent of the amount of time involved.

Deflation – A decrease in the prices of goods and services in an economy.

Duration – A measure of the approximate sensitivity of a bond portfolio's value to interest rate changes.

Federal (Fed) Funds Rate – The target rate reflects the upper bound of the Federal Open Markets Committee's (FOMC) target range for overnight lending among US banks.

Fundamental analysis / research – A method of evaluating a security to get a measure of its intrinsic value by examining related economic, financial and other qualitative and quantitative factors.

Gross domestic product (GDP) – Measures the monetary value of final goods and services – that is, those that are bought by the final user, produced in a country in a given period (for example over a quarter or a year). Real GDP takes inflation into account.

Hard currency bonds – Government or corporate debt that is issued in the currency of a nation that is seen as politically and economically stable, usually US dollars, euro, British pound sterling, Japanese yen, Swiss franc.

Investment-grade bonds – These bonds are considered higher quality bonds. They have a credit rating of BBB/Baa and above.

Leveraged balance sheets – Leverage is the amount of debt a company has in its mix of debt and equity (its capital structure). A company with more debt than is average for its industry is considered highly leveraged.

Local currency bonds – Government or corporate debt that is issued in the local currency of the country of the participating organisations.

Macroeconomic analysis – The study of trends that affect the whole economy, rather than the different companies, industries, consumers and so on that make up the economy.

Market capitalisation/cap – Value of a company as determined by the market price of its outstanding common stocks.

Maturity – The date when the principal of a fixed income security is due to be repaid.

Mean consensus earnings – The average of the combined projected earnings based on estimates from professional analysts that cover the stock.

Monetary policy – A set of tools used by a central bank to manage the country's money supply and promote economic growth. In an economic slowdown, a central bank may adopt an accommodative (expansionary) policy, also known as quantitative easing, to boost the economy by measures such as lowering interest rate and purchasing securities. When inflation is high, a central bank may adopt a contractionary policy, also known as quantitative tightening, by increasing interest rate to slow growth and decrease inflation.

Money market – The market for trading short-term debt investments.

Mortgage-backed securities (MBS) – An investment similar to a bond that consists of a bundle of loans (usually home loans) bought from the banks that issued them.

Multiplier effect – Where a change in a particular input has the impact of causing a greater change in output.

Price-to-earnings (P/E/) – The ratio for valuing a company that measures its current share price relative to its earnings per share (EPS).

Private credit – Investments in private, non-publicly traded debt instruments.

Recession – A significant decline in economic activity, usually defined as when GDP falls for two consecutive quarters.

Sovereign bonds – A debt security issued by a national government to raise money for financing government programmes, paying interest on current debt and any other government spending needs.

US Treasury – Debt instruments (bonds) issued by the US government.

Value stock – A stock that trades at a lower price compared to its value based on its fundamentals (such as cashflows, dividends, earnings, or sales).

Yield – The income returned on an investment, such as the interest or dividends received from holding an asset. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market.

Yield-to-worst – The lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.

All data as at 30 November 2023 and attributed to Capital Group unless otherwise specified.

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