

BITESIZE

PORTFOLIO ADVISORY INSIGHTS

Why revisiting scenarios now is important for investors.

We have built three scenarios that are plausible:

Scenario	Recession	Extended Cycle	Productivity Boom
GDP	Recession that lasts for most of 2024	The Fed achieves a soft landing as inflation slows back to trend in 2024	AI boosts productivity, allowing trend GDP growth to move higher
Inflation	Disinflationary pressures with a medium-term recovery	Disinflationary pressures give way to within target inflation over the medium term	Productivity boom allows wages to grow without a meaningful increase in inflation
Monetary Policy	Rates are cut abruptly by up to 5% and left at lower levels for up to 1 year	Rates remain elevated for most of 2024 then are cut back to neutral	Rates remain elevated for 2024 before being cut back to neutral
Medium-term market impact			
Equity Markets	Average annual returns are very low relative to history	Returns are in line with historical outcomes over the medium term	Average annual returns are higher relative to history as earnings growth is boosted by margin compression and sales
Sovereign debt	US Treasury yields fall sharply offering solid returns	US Treasury yields remain elevated compared to recent history before normalising in 2025	US Treasury yields remain elevated compared to recent history before normalising in 2025
Corporate Credit	Credit defaults spike in lower credit grades, before credit spreads narrow gradually	Credit spreads remain near tight as defaults are manageable and low	Credit spreads narrow to historic tight.

We do not know with any confidence the probability of each scenario being the right scenario. So rather than assign probabilities, we have focused on a series of data that can help gauge which scenario is relatively more likely.

Key economic indicators to gauge the likelihood of each scenario:

Data	What matters?	Assessment
US PMIs	Is the economy close to recession – i.e below 45	The PMI is below 50 but above 45 – this suggests below trend growth but no recession yet
US Jobless Claims	Is jobless claims rapidly increasing above 250k-300k	Jobless claims have been low at around 200k – indicating recession remains some time away.
US Treasury Yield Curve	Is the yield curve normalising back towards zero from deeply negative	The yield curve has normalised to -0.72% from -1.08%. This is concerning but not indicating recession yet.
Oil prices	Are production cuts pushing prices higher or is weaker demand limiting price increases	Oil prices have climbed steadily back to USD90/bbl as production has been cut. Demand is holding up.
Corporate defaults and downgrades	Are defaults and downgrades on the rise	Defaults and downgrades are trending higher, which is a worrying development.

The outlook is uncertain. We are potentially near the end of the cycle. Scenarios are a useful way to manage portfolios and to understand investment risk and market vulnerabilities. We suggest reviewing these scenarios or considering other scenarios as a sensible portfolio management tool in this environment.



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Isaac is the Global Chief Investment Officer and Portfolio Manager for Oreana Financial Services. With experience across investment strategy, portfolio and risk management, research and central banking in Asia, the UK and Australia, he leads the team in monitoring economic and market outlooks.