# Outlook

2024 EDITION

CAPITAL GROUP®

## Long-term perspective on markets and economies

# Prepare for changes in the investing climate

**Martin Romo**
Chairman and Chief Investment Officer, Capital Group

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. climate change. While many others are concerned about the near-term weather forecast, I am looking for signs of large-scale climate 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 will 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 will that process take? In the bond market, with the federal funds rate at a 22-year high, 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 U.S. 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?

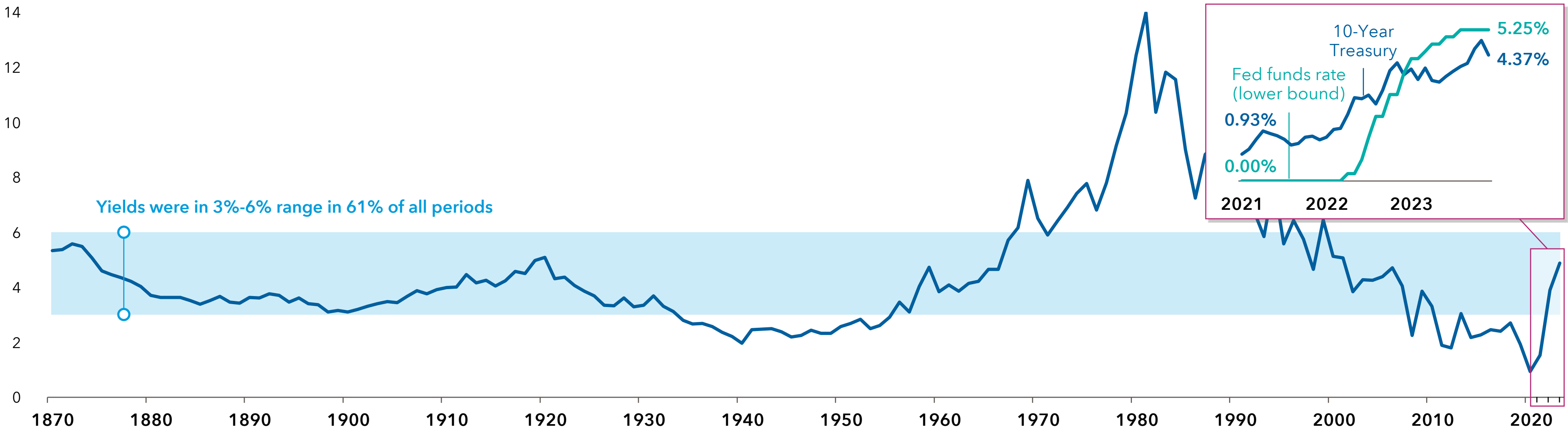
We don't pretend to have all the answers, but it's our job to explore them through exhaustive bottom-up, fundamental research. Events on the level of climate change bring a high degree of volatility, but also unprecedented opportunities. That's prime time for active investing.

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

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

## U.S. long-term rates today are within the range of historical norms

**U.S. long-term government bond yield (%)**




The Federal Reserve's mission to tame inflation without widespread economic pain just got trickier. The U.S.10-year Treasury yield, which underpins borrowing costs for much of the economy, rose sharply in 2023.

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 fixed income portfolio manager Pramod Atluri. That's partly because wages and home values remain above pre-pandemic levels, which has helped support consumer spending. 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 median annualized return since 1976 for the S&P 500 Index was 14.20%, while the Bloomberg U.S. Aggregate Index returned 6.99%.*

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

Sources: Federal Reserve, Robert Shiller. Data for 1871–1961 represents average monthly U.S. long-term government bond yields compiled by Robert Shiller. Data for 1962–2022 represents 10-year Treasury yields, as of December 31 each year within the period. Data for 2023 is as of November 30, 2023. Past results are not predictive of results in future periods.

# Rolling recessions may limit likelihood of broad downturn

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

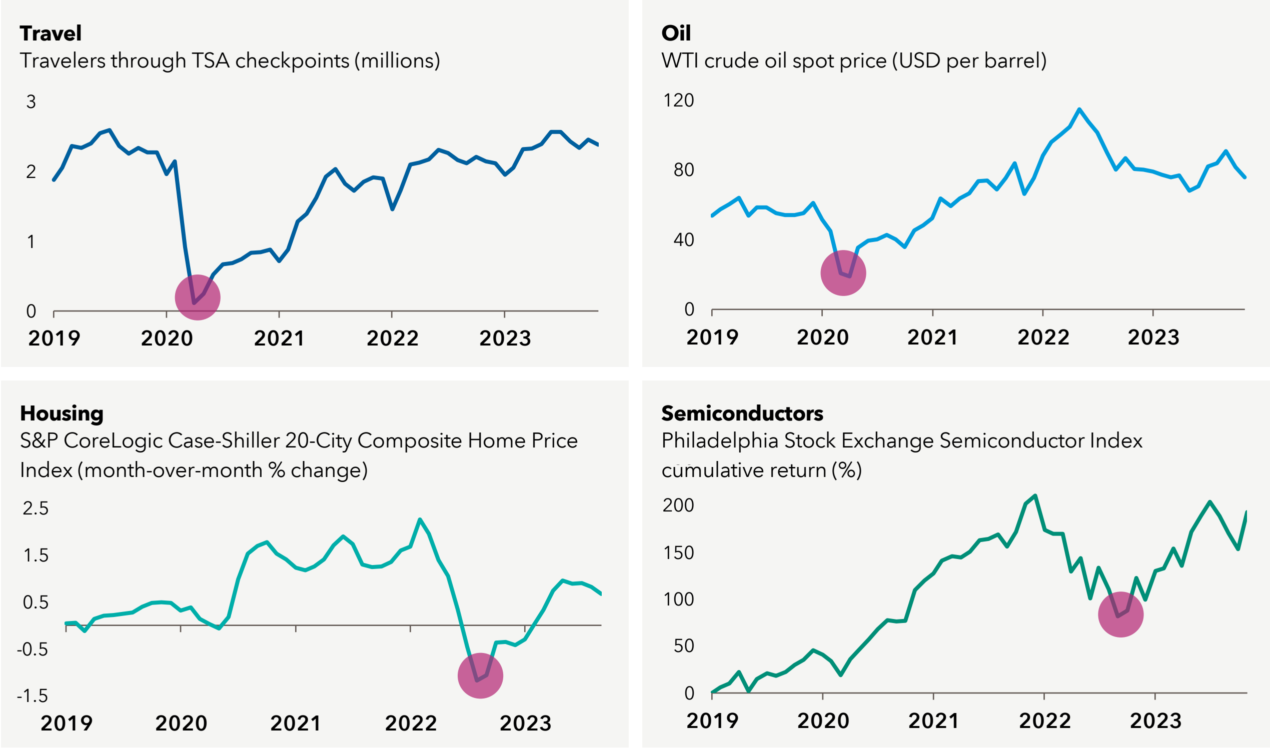
The recession did happen, just not all at once. Over the past year and a half, different economic sectors experienced downturns at different times – a phenomenon economists call a "rolling recession." Thanks to this rare event, it's possible the U.S. won't experience a traditional recession before the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

For example, 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 U.S. could avoid the most widely predicted recession in history, says Capital Group economist Jared Franz. Citing a strong labor market and resilient consumer spending, Franz believes the U.S. economy could grow at an annualized 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**

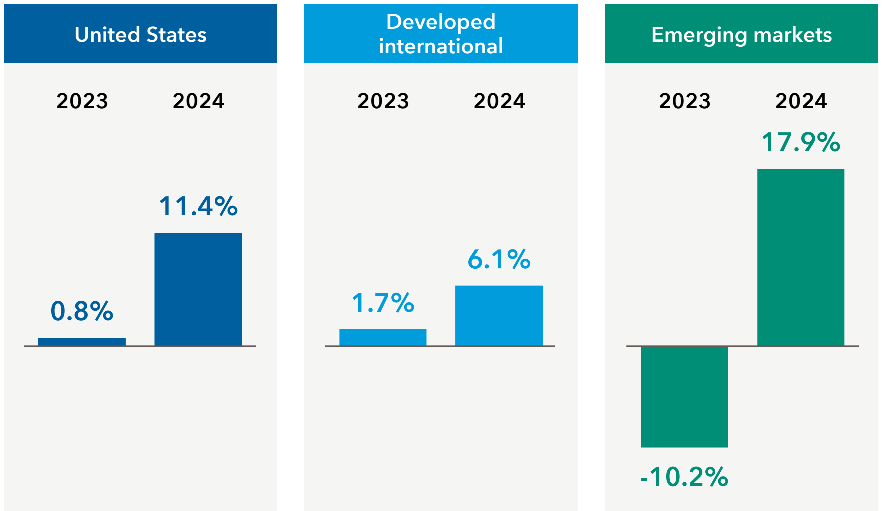



Sources: Travel: Transportation Security Agency (TSA), U.S. Department of Homeland Security. Data is a 30-day moving average. As of November 30, 2023. Oil: Refinitiv. As of November 30, 2023. Housing: Standard & Poor's. Latest available monthly data is September 2023, as of November 30, 2023. Semiconductors: Philadelphia Stock Exchange. As of November 30, 2023. Data represents cumulative price return since January 1, 2019. Past results are not predictive of results in future periods.

# Look for corporate earnings to rebound in 2024

## Solid earnings growth expected across major markets

**Estimated annual earnings growth**




## But economic indicators offer a mixed outlook

**The Conference Board Leading Economic Index®**

▲ Positive ◆ Neutral ▼ Negative

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

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

In the U.S., 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 international 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?

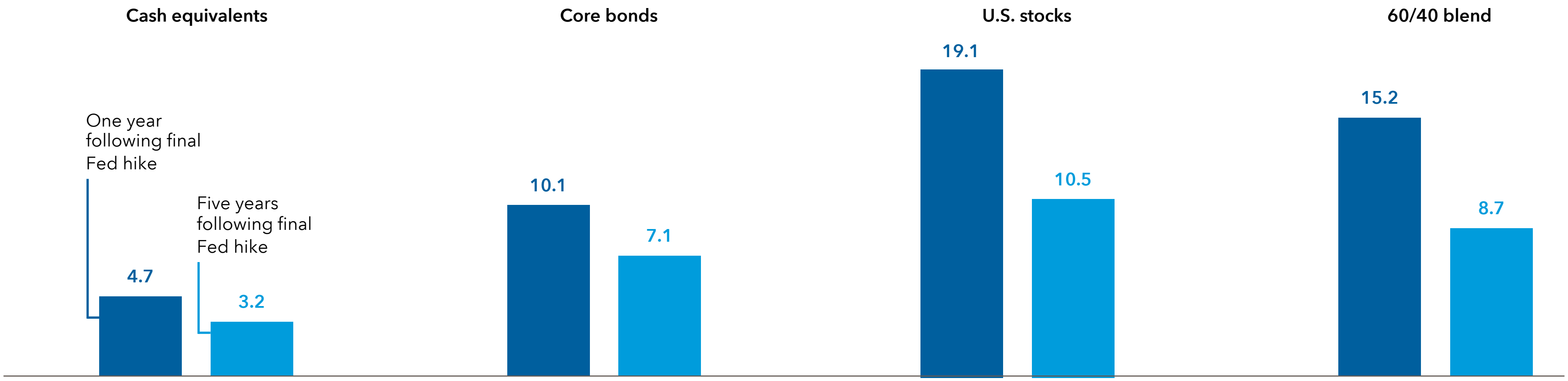
"I don't think it's going to be a terrible year for corporate earnings, but I think we're more likely to see 6% to 8% growth in the U.S.," says Capital Group economist Jared Franz, "and potentially higher in some emerging markets."

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 (U.S.), MSCI EAFE Index (developed international) and MSCI Emerging Markets Index (emerging markets). Estimates are as of November 30, 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 U.S. economic growth, based on current levels and six-month trends, as of October 31, 2023.

# A window of opportunity for moving cash off the sidelines

## After Fed hikes ended, 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. However, 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 third consecutive meeting in December, signaling the central bank may be at or near the end of its tightening cycle. Historically this has provided a favorable 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 U.S. 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.

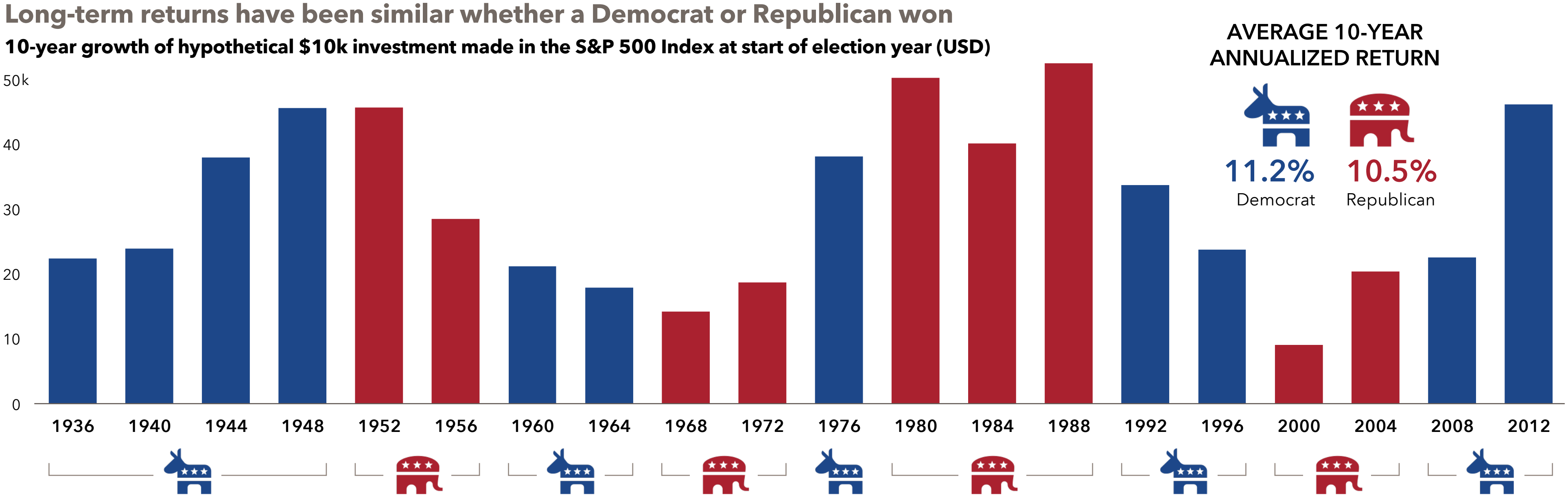
*Based on an average of the four most recent cycles, which began on March 1, 1995, June 1, 2000, July 1, 2006, and January 1, 2019, respectively.

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 U.S. 3-month T-bill (cash), Bloomberg U.S. Aggregate Index (core bonds), S&P 500 Index (U.S. stocks) and a blend of 60% of the S&P 500 Index and 40% of the Bloomberg U.S. Aggregate Index (60/40 blend). Past results are not predictive of results in future periods.

# Red, blue and you: Investing through election uncertainty

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

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




With the U.S. 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 can provide attractive investment opportunities.

"When everyone is worried that a new government policy is going to hurt a sector, that concern is usually overblown," Lovelace says. "High-quality companies often 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, which political party takes the White House has had little impact for long-term investors. Since 1936, the 10-year annualized return of U.S. 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.

Sources: Capital Group, Standard & Poor's. Each 10-year period begins on January 1 of the first year shown and ends on December 31 of the tenth year. For example, the first period listed (1936) covers January 1, 1936 to December 31, 1945. Figures shown are past results and are not predictive of results in future periods.

# 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 identity 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

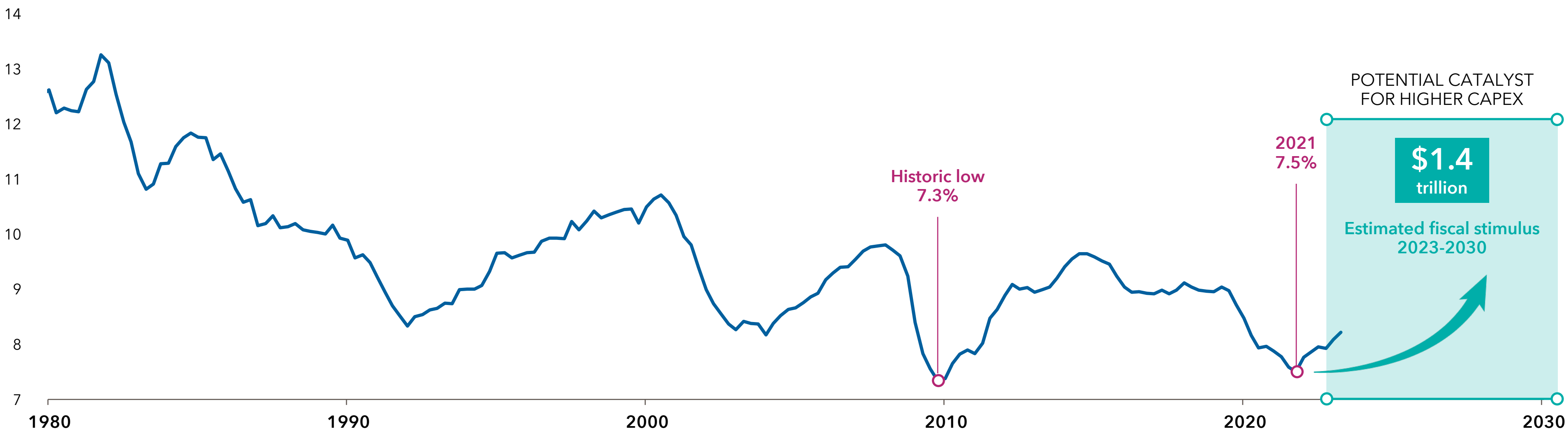
| Semiconductor chips & equipment | Cloud computing/ AI software | AI applications |
|---|---|---|
| ASML | Microsoft | Tech and telecom |
| Applied Materials | Amazon | Financial services |
| NVIDIA | Google | Health care/pharma |
| TSMC | | Legal/professional services |
| Broadcom | | Automotive and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

Source: Capital Group. TSMC refers to Taiwan Semiconductor Manufacturing Company. As of November 30, 2023.

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

## After years of underinvestment, capital spending is set to recover

**Capital expenditures as a percent of gross domestic product (%)**




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

Seeking to support local supply chains, expand clean energy and boost the U.S. semiconductor industry, the U.S. government has committed $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 U.S. 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, localizing 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 federal infrastructure spending.

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

# Out-of-favor dividend payers poised to offer diversification, income

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

With economic 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.

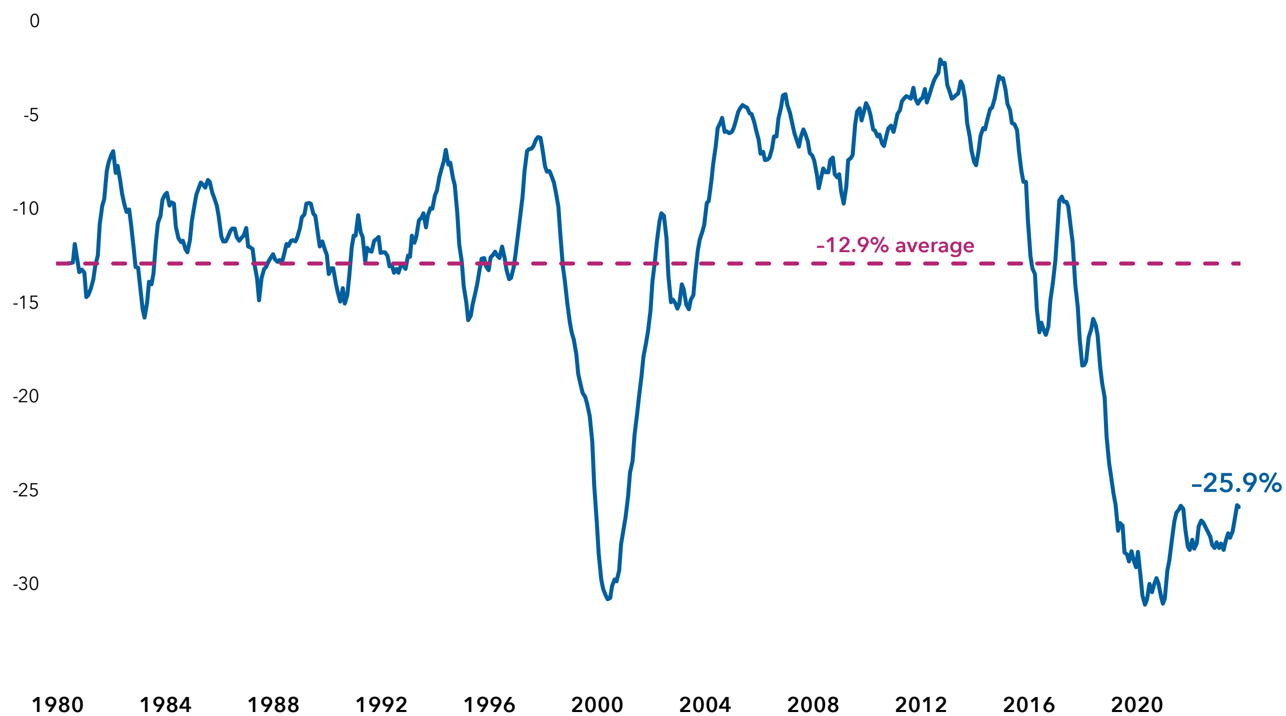
"It is difficult to know when a cycle will turn, so investors may want to look for companies with growth potential but also businesses that pay dividends, which can help mitigate market volatility," says equity portfolio manager Diana Wagner. "Valuation is important, but it is essential to distinguish 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. Beverage maker Keurig Dr Pepper has a history of relatively stable demand through business cycles for brands like Canada Dry and Snapple. Within the more challenged tobacco industry, Philip Morris International has acquired Swedish Match to tap into demand for smokeless tobacco offerings.

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 (%)**




Sources: Capital Group, Goldman Sachs. As of November 28, 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. Past results are not predictive of results in future periods.

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

Think all innovation comes from U.S. tech? Think again. While U.S. 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 incentivized 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.

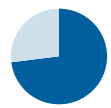
## European companies are innovating across industries

### AstraZeneca
Pharmaceuticals

Cambridge, United Kingdom

**$198.7B**
Market cap

**$280B**
Estimated TAM



73%

**Revenue outside Europe**

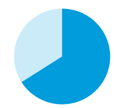
- 167 projects in current pipeline
- AI-enabled predictive tools have reduced drug manufacturing time by 50%
- Offerings span oncology, renal, cardiovascular and immunology, among others

### Sika
Chemicals

Baar, Switzerland

**$43.8B**
Market cap

**$122B**
Estimated TAM



69%

**Revenue outside Europe**

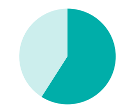
- Proprietary concrete recycling process could reduce waste by 30 million tons every year
- Expects to increase its penetration of the construction chemicals market by 2.5x-4.0x by 2050
- 30 largest competitors represent 55% of market share, presenting opportunity for consolidation

### Safran
Aerospace & Defense

Paris, France

**$75.1B**
Market cap

**$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

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 of November 30, 2023. "TAM" represents total addressable market. Data as of November 30, 2023.

# Will corporate reform in Japan unlock value for investors?

In Japan the prospect of real corporate reforms and a renewed focus on shareholders have long seemed just beyond the horizon. After many false starts, will this time be different?

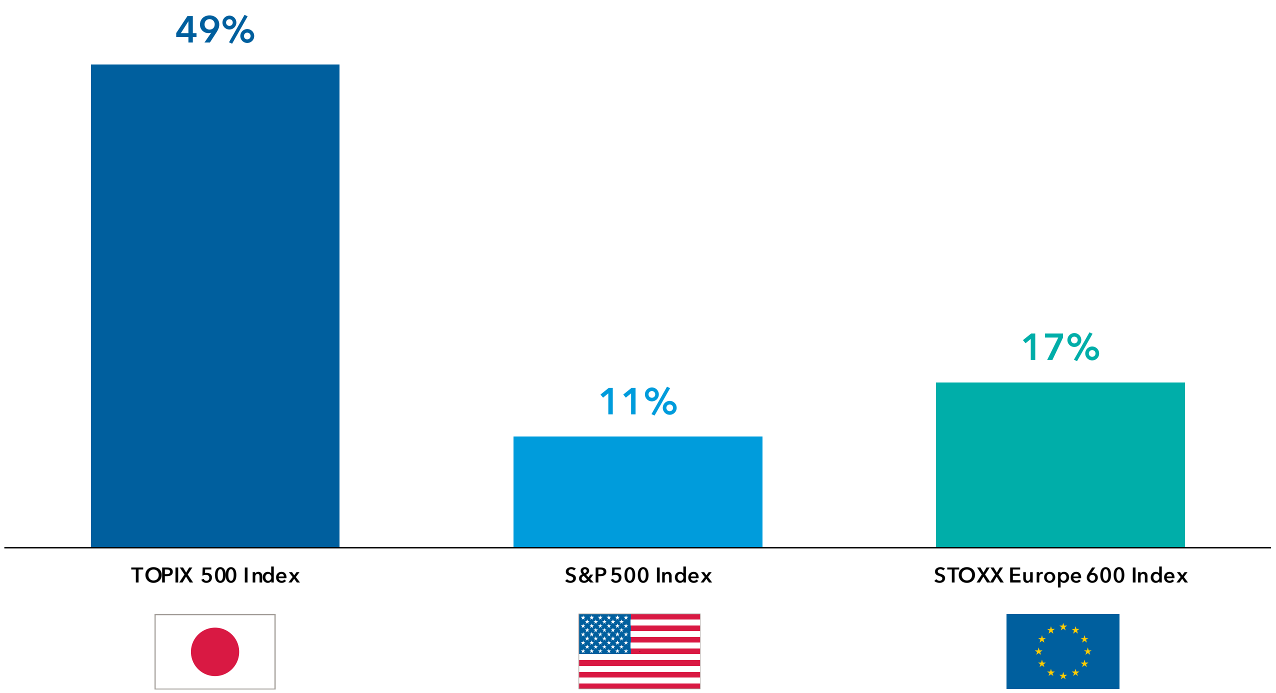
Japanese companies have been known for hoarding cash and subpar governance. To accelerate reforms, the government and Tokyo Stock Exchange are urging firms to improve profitability and boost stock valuations by reducing cash on balance sheets and shedding underperforming businesses. About half of Japanese companies have positive net cash positions, while a third have price-to-book values lower than the value of their underlying assets.

Investors have noticed. In 2023, Japanese equities rose to highs not seen since the late 1980s. "I'm more positive on Japan than I've been over the past two decades," says equity portfolio manager Eu-Gene Cheah. "I'm taking a measured approach to investing, but more aggressive steps could signal a true paradigm shift."

Many Japanese companies are prominent innovators in factory automation and niche technologies. For instance, SMC is a leader in robotic equipment components and semiconductor production, while TDK is among the largest manufacturers of high-end electric vehicle batteries. Sustained reforms could unlock opportunities across industries.

## Japan Inc. is flush with cash

**Percentage of index constituents with positive net cash positions**




Sources: Capital Group, FactSet, Standard & Poor's, STOXX, TOPIX. As of November 30, 2023. Net cash reflects the difference between the cash and short-term securities reported on a company's balance sheet and its outstanding debt. Price-to-book value is a financial metric used to compare the book value of a company with its market capitalization.

# 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 unrecognizable 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.

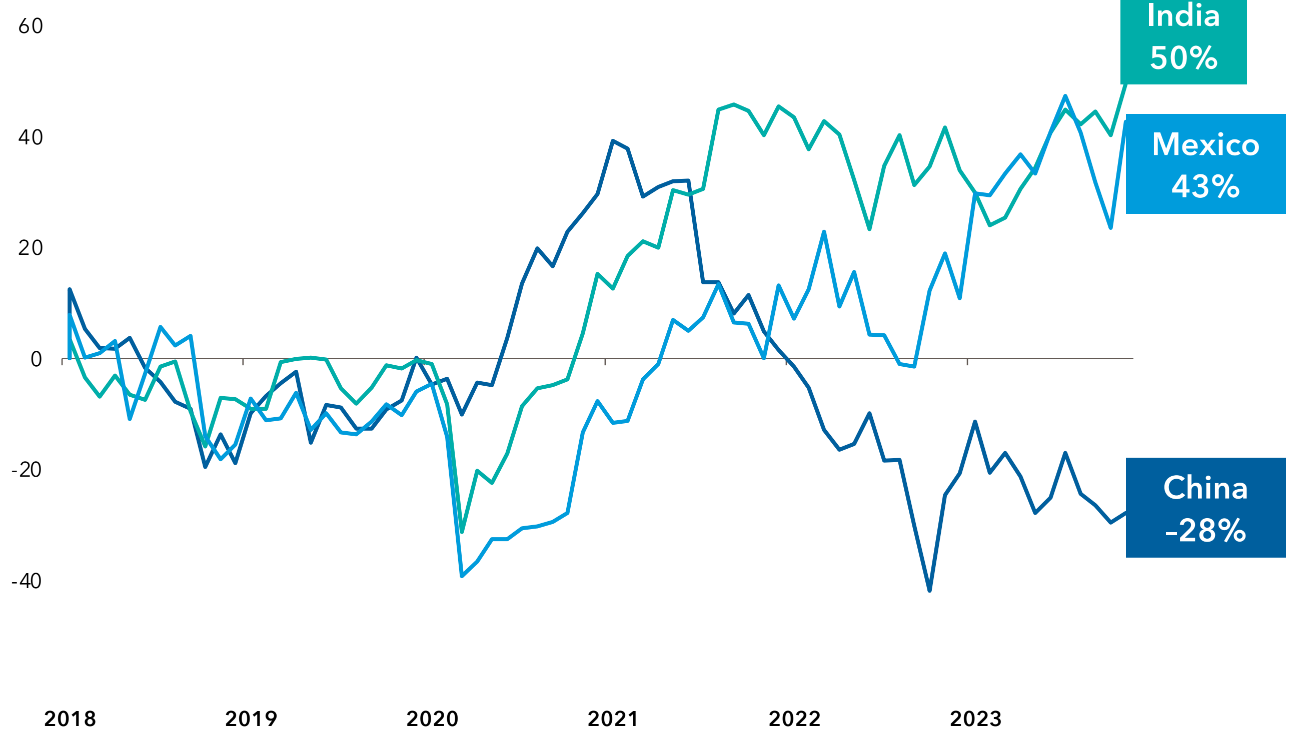
"Despite China's slowing economy, I think durable trends – such as the reconstruction of supply chains, demographic shifts and the energy transition – could add more depth to emerging markets than we have seen in the past," says portfolio manager Brad Freer.

Investment opportunities range from banks to airplane 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 selloff 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 (%)**




Sources: MSCI, RIMES. Returns reflect MSCI India Index, MSCI Mexico Index and MSCI China Index in U.S. dollars. Five-year time period shown to reflect returns pre- and post-COVID. Data as of November 30, 2023. Past results are not predictive of results in future periods.

# 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).

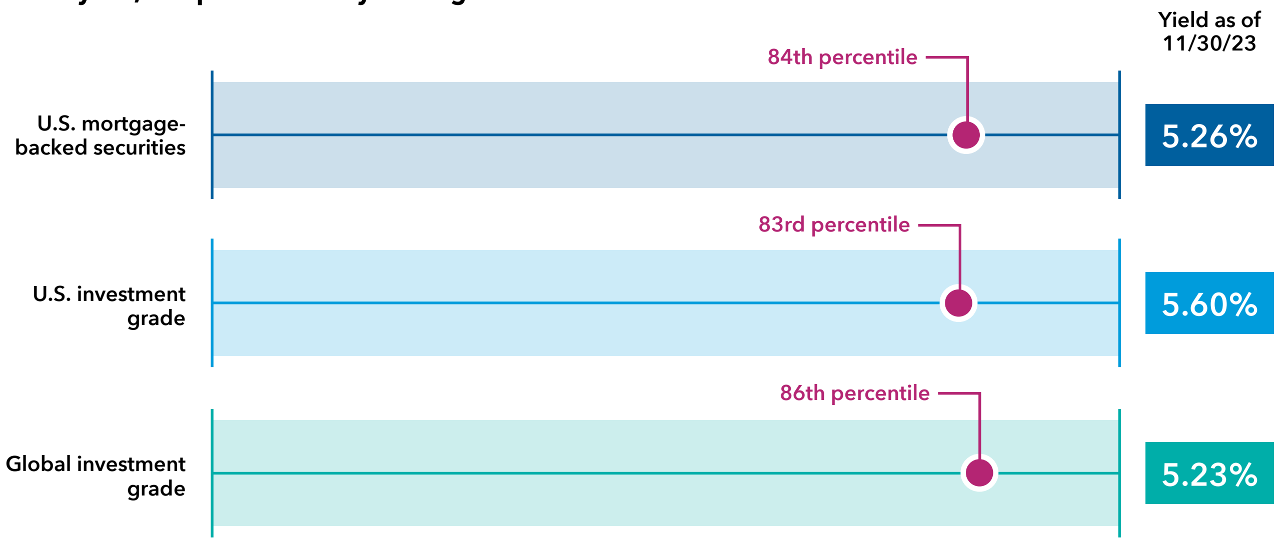
Higher coupon MBS look appealing as the expected conclusion of the Fed's hiking cycle looms. Volatility is likely to decline, and valuations today are near levels not seen since April 2020. Housing inventory and affordability are approaching all-time lows, which should dampen MBS supply and support near-term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

"As securities that carry an implicit government guarantee, agency MBS can be an outstanding 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. In a modest growth environment, investors could earn the coupon without too much downside risk. If the economy slows and Treasury yields decline, the sector's longer duration would mean potential price appreciation, which could offset any widening in spreads.

## Yields are near 20-year highs

**Latest yield, as a percent of 20-year range**




Sources: Capital Group, Bloomberg Index Services Ltd. Indexes used are the Bloomberg U.S. MBS: Agency Fixed Rate MBS Index (U.S. mortgage-backed securities), Bloomberg U.S. Corporate Investment Grade Index (U.S. investment grade) and the Bloomberg Global Aggregate Corporate Index (global investment grade). Includes daily yields for the 20-year period ending November 30, 2023. Past results are not predictive of results in future periods.

# Healthy income potential in high yield

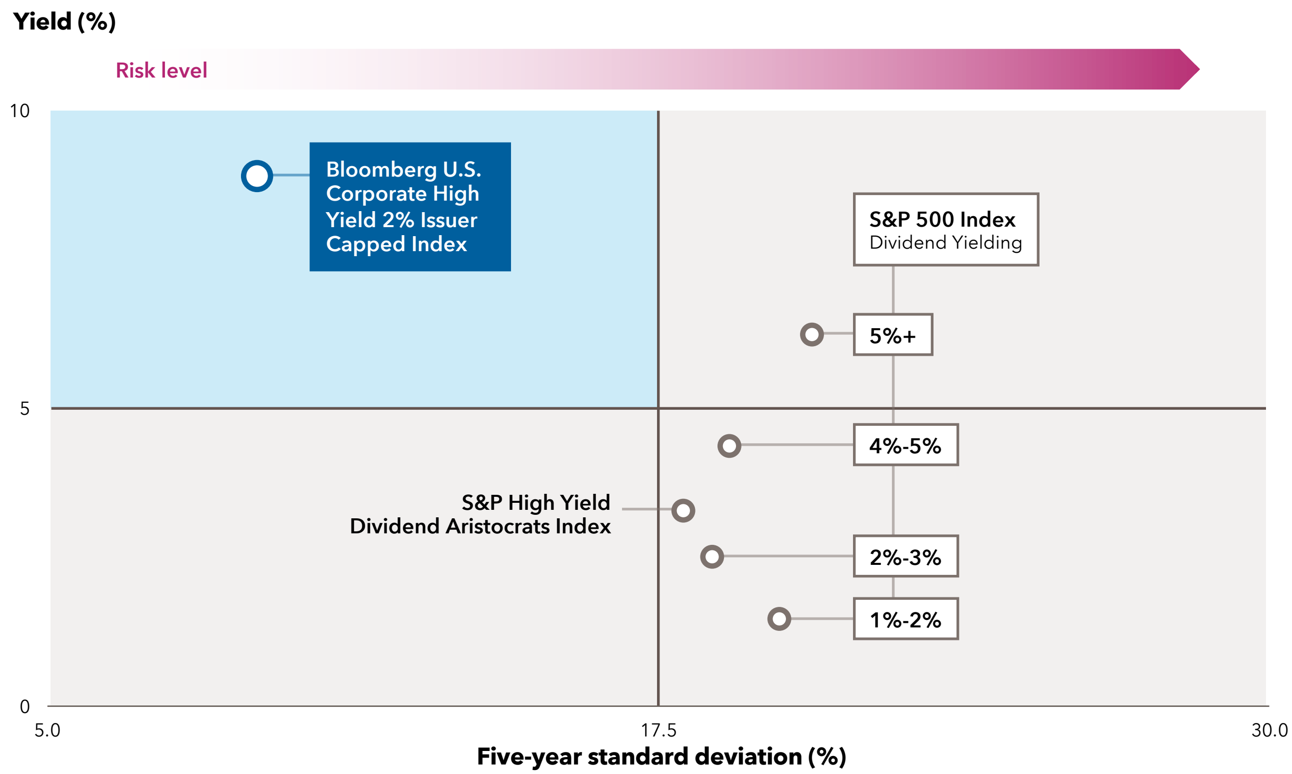
Amid the fuss about where rates are going, you could have easily missed the healthy returns that high-yield bonds posted in 2023. The lesson: High-yield bonds (BB/Ba rated and below) can offer powerful income potential.

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 can 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 and large equity cushions are attractive while issuers rated CCC-and-below require a more selective approach.

## High yield offers income with less volatility than stocks

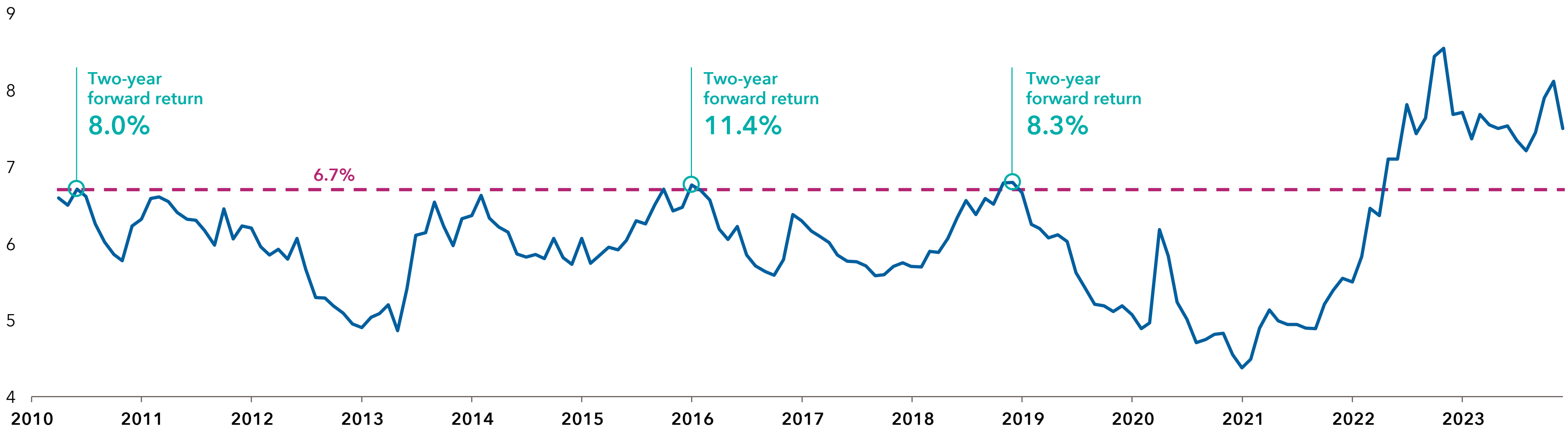



Sources: Bloomberg Index Services Ltd., Morningstar, Standard & Poor's. As of October 31, 2023. Yields are yield to worst for bond index and dividend yields for stock indexes. Yield to worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms 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. Past results are not predictive of results in future periods.

# 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, U.S. 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 favors 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.

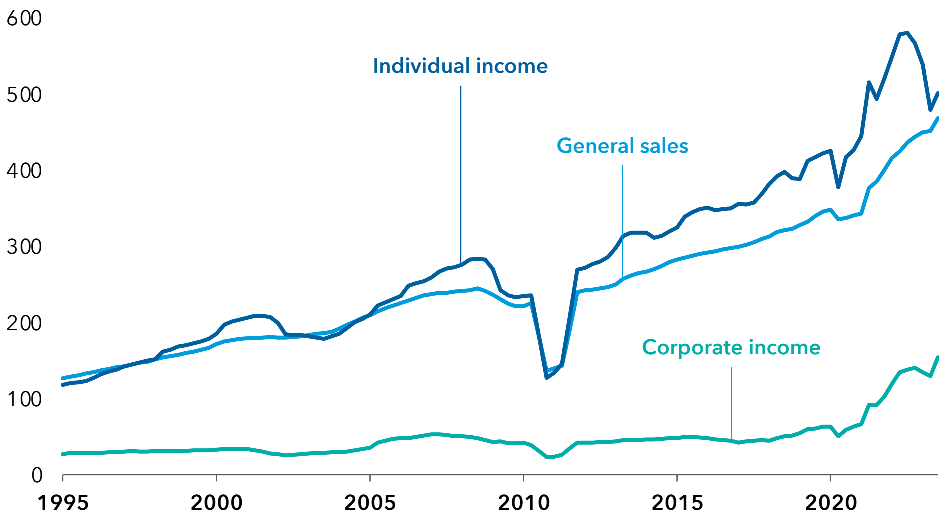
Historically, two-year forward returns have been positive when yields reach 6.7% or higher. High starting yields offer a buffer against any volatility that the global macroeconomic and geopolitical environment might bring in 2024.

Sources: Bloomberg, JP Morgan, Morningstar. Data as of November 30, 2023. Yield-to-worst and forward return callouts shown are for 50% JP Morgan EMBI Global Diversified Index/50% JP Morgan 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 annualized two-year total return (in USD) of the benchmark starting on May 31, 2010, December 31, 2015, and November 30, 2018, respectively, which were the three dates that yields peaked above 6.7%. Past results are not predictive of results in future periods.

# Municipal bond fundamentals appear solid in an uncertain environment

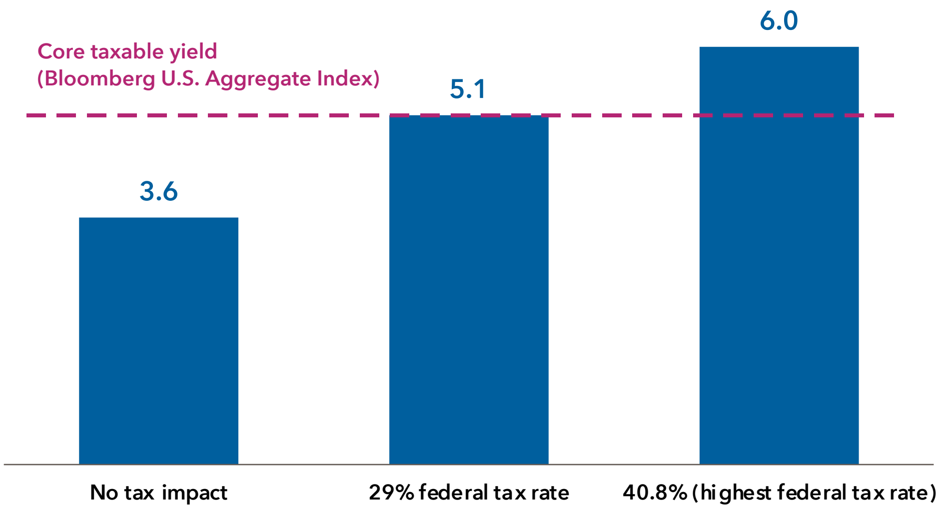
## Munis can benefit from historically strong state tax revenues

**Tax collection, rolling four quarters ($B)**




## Muni income could surpass taxable bonds

**Bloomberg Municipal Bond Index – Tax-equivalent yield (%)**




Rising yields have dampened municipal bond returns over the past few years, but there is a silver lining – solid income opportunity. As of November 30, 2023, the Bloomberg Municipal Bond Index ("Muni Index") was yielding 3.6%. Investors may also benefit from munis' tax-exempt status. That advantage over taxable bonds starts at federal tax rates as low as 29%.

Robust state coffers suggest strong fundamentals. Corporate income and general sales tax receipts continue to climb. Household income remains near historic highs, despite some layoffs and cooling wage growth.

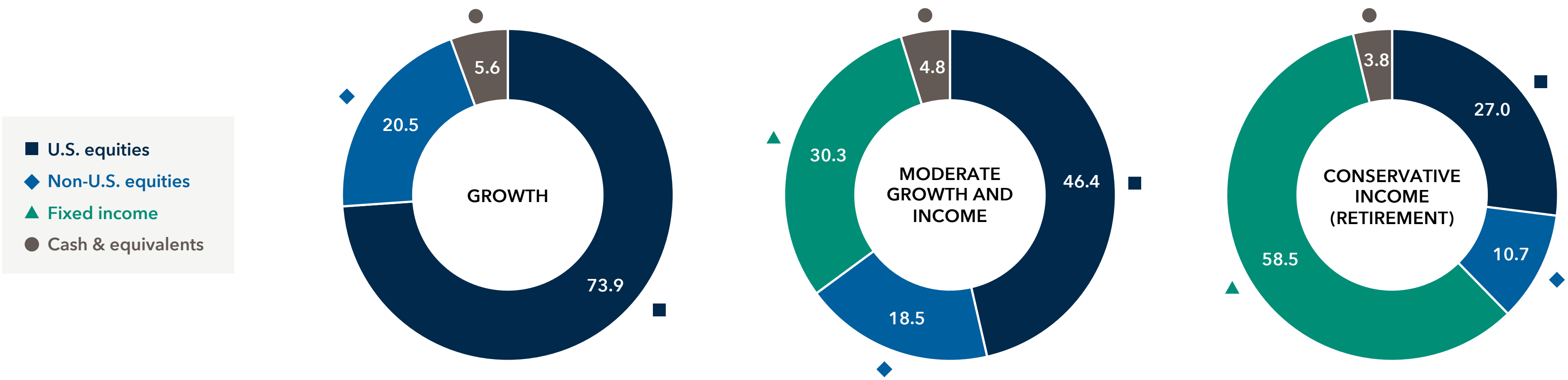
While munis have shown resilience during periods of economic turmoil, a defensive stance may be warranted. "I've positioned the portfolios I manage to benefit should the inverted muni yield curve – a historic anomaly where short-term yields are higher than longer term yields – normalize," says portfolio manager Vikas Malhotra. Companies providing essential services, such as electrical utilities, are also attractive in a slow growth environment.

Other compelling opportunities include planned amortization class (PAC) bonds, which are pooled single-family mortgage loans backed by the federal government. PAC bonds contained in the Muni Index yielded 4.3%, compared to 3.1% for the index's broader five-year subset (a similar maturity profile), as of November 30, 2023. Given rising wage pressures, some managers are more cautious on hospitals.

Sources (left chart): Capital Group, Bloomberg, U.S. Census Bureau. Data as of September 30, 2023. Sources (right chart): Capital Group, Bloomberg Index Services Ltd. As of November 30, 2023. The after-tax (or tax-equivalent) yield of a municipal bond investment is the yield a taxable bond would have to offer to equal the same amount as the tax-exempt bond. Highest tax rate assumes the 3.8% Medicare tax and the top federal marginal tax rate for 2023 of 37%, for a total federal tax rate of 40.8%.

# Portfolio positioning for a range of objectives

### Allocation weights by investor objective (%)




Inflation, Fed policy and equity market concentration created uncertainty for investors in 2023. But over the long term, returns are driven by fundamentals and not the latest "noise." How can investors see past these ongoing concerns while maintaining diversified portfolios?

That depends on their goals. "Asset allocation starts with objectives and long-term expectations for asset class returns," says Samir Mathur, chairman of Capital Group's Portfolio Solutions Committee. Given the decade-long run for U.S. growth stocks and a broad international opportunity set, investors might look to non-U.S. equities in 2024. "Whether it's the prevalence of dividend payers, currency shifts, or simply identifying market leaders, international equities can play a role in portfolio diversification," adds senior portfolio consultant Casey Dregits.

In income-oriented portfolios, investors comfortable with the increased associated risks may want to balance core fixed income exposure with flexible bond allocations that target higher yielding sectors with strong prospects, such as emerging markets debt. Meanwhile, mortgage-backed securities currently offer attractive valuations. Explains Mathur, "Flexible strategies, in general, can pivot across a range of sectors as market conditions shift and help investors stay focused on their long-term goals through market unpredictability."

Source: Capital Group. As of September 30, 2023. Allocations are examples of what an investor with the identified investment objective might consider and are for illustrative purposes only.

As nondiversified funds, Capital Group ETFs have the ability to invest a larger percentage of assets in securities of individual issuers than a diversified fund. As a result, a single issuer could adversely affect a fund's results more than if the fund invested a smaller percentage of assets in securities of that issuer. See the applicable prospectus for details.

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For **CGCP, CGMU, CGMS:** The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. For **CGCP, CGMS, CGMU:** Lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds. For **CGMU:** Income from municipal bonds may be subject to state or local income taxes and/or the federal alternative minimum tax. Certain other income, as well as capital gain distributions, may be taxable. For **CGCP, CGMS:** The use of derivatives involves a variety of risks, which may be different from, or greater than, the risks associated with investing in traditional securities, such as stocks and bonds. For **CGCP, CGMS:** Investments in mortgage-related securities involve additional risks, such as prepayment risk, as more fully described in the prospectus.

Bond ratings, which typically range from AAA/Aaa (highest) to D (lowest), are assigned by credit rating agencies such as Standard & Poor's, Moody's and/or Fitch, as an indication of an issuer's creditworthiness. If agency ratings differ, the security will be considered to have received the highest of those ratings, consistent with the fund's investment policies. Small-company stocks entail additional risks, and they can fluctuate in price more than larger company stocks.

The market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

**Bloomberg U.S. Aggregate Index** represents the U.S. investment-grade fixed-rate bond market. **Bloomberg U.S. Corporate Investment Grade Index** represents the universe of investment-grade, publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specific maturity, liquidity and quality requirements. **Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index** covers the universe of fixed-rate, non-investment-grade debt. The index limits the maximum exposure of any one issuer to 2%. **Bloomberg Global Aggregate Corporate Index** is a flagship measure of global investment-grade, fixed-rate corporate debt. **Bloomberg U.S. Mortgage Backed Securities Index** is a market value-weighted index that covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). **Bloomberg Municipal Bond Index** is a market value-weighted index designed to represent the long-term investment-grade tax-exempt bond market. **JP Morgan Emerging Markets Bond Index (EMBI) Global Diversified** is a uniquely weighted emerging market debt benchmark that tracks total returns for U.S. dollar-denominated bonds issued by emerging market sovereign and quasi-sovereign entities. **JP Morgan Government Bond Index – Emerging Markets Global Diversified** covers the universe of regularly traded, liquid fixed-rate, domestic currency emerging market government bonds to which international investors can gain exposure. The **50% EMBI Global Diversified/50% JP Morgan GBI-EM Global Diversified** blend weighs the indexes cumulative total returns at 50% each. This assumes the blend is rebalanced monthly. **MSCI China Index** captures large- and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs). **MSCI EAFE (Europe, Australasia, Far East) Index** is a free float-adjusted market capitalization-weighted index designed to measure developed equity market results, excluding the United States and Canada. **MSCI Emerging Markets Index** captures large- and mid-cap representation across 27 emerging markets (EM) countries. **MSCI Europe Index** is designed to measure developed equity market results across 15 developed countries in Europe. **MSCI India Index** is designed to measure the performance of the large- and mid-cap segments of the Indian market. **MSCI Mexico Index** measures the performance of the large- and mid-cap segments of the Mexican market. **S&P 500 Index** is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks. **S&P Global Broad Market Index (BMI)** is a market capitalization-weighted index maintained by Standard and Poor's (S&P) providing a broad measure of global equities markets. **S&P CoreLogic Case-Shiller 20-City Composite Home Price Index** seeks to measure the value of residential real estate in 20 major U.S. metropolitan areas. **The Conference Board Leading Economic Index** is an American economic leading indicator intended to forecast future economic activity. The **ISM New Orders Index** shows the number of new orders for manufacturing firms as reported by survey respondents. **The Leading Credit Index** consists of six forward-looking financial indicators related to credit and tends to lead economic activities. **Philadelphia Stock Exchange Semiconductor Index** is a Philadelphia Stock Exchange capitalization-weighted index composed of the 30 largest U.S. companies primarily involved in the design, distribution, manufacture and sale of semiconductors. **STOXX Europe 600 Index** is a market capitalization-weighted index consisting of 600 fixed components spanning large-, medium- and small-cap companies, and covers roughly 90% of the investable European stock market. **TOPIX 500 Index** is a market capitalization-weighted index consisting of the 500 largest and most liquid components of the Tokyo Stock Price Index (TOPIX).



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# 2024 Outlook

## Investment implications and strategies to consider

CAPITAL GROUP®

| Themes | U.S. equity opportunities | Global/International equity opportunities | Core bond opportunities | Credit opportunities |
|---|---|---|---|---|
| | **Diversify stock allocations with dividends, select growth opportunities** | **Europe's trailblazers prove there's no monopoly on innovation** | **Bonds should again provide ballast amid economic uncertainty** | **Income is back in fixed income** |
| **Investment implications** | As artificial intelligence rapidly advances, it's essential to separate hype from opportunity. And with uncertainty looming, look for dividends to play a greater role in portfolios. | U.S. tech giants may be garnering all the headlines, but Europe is home to many innovative companies making advancements across industries. | High-quality bonds typically offer strong income opportunities and a measure of protection from equity market swings. | Better economic outlook and higher yields set the stage for strong income and return potential. |
| **Mutual funds** | **Washington Mutual Investors Fund**<br>A – AWSHX; F-2 – WMFFX;<br>F-3 – FWMIX; R-6 – RWMGX<br>**American Mutual Fund®**<br>A – AMRMX; F-2 – AMRFX;<br>F-3 – AFMFX; R-6 – RMFGX<br>**The Growth Fund of America®**<br>A – AGTHX; F-2 – GFFFX;<br>F-3 – GAFFX; R-6 – RGAGX | **American Funds® International Vantage Fund**<br>A – AIVBX; F-2 – AIVFX;<br>F-3 – AIVGX; R-6 – RIVGX<br>**New World Fund®**<br>A – NEWFX; F-2 – NFFFX;<br>F-3 – FNWFX; R-6 – RNWGX<br>**New Perspective Fund®**<br>A – ANWPX; F-2 – ANWFX;<br>F-3 – FNPFX; R-6 – RNPGX | **The Bond Fund of America®**<br>A – ABNDX; F-2 – ABNFX;<br>F-3 – BFFAX; R-6 – RBFGX<br>**American Funds® Strategic Bond Fund**<br>A – ANBAX; F-2 – ANBFX;<br>F-3 – ANBGX; R-6 – RANGX<br>**The Tax-Exempt Bond Fund of America®**<br>A – AFTEX; F-2 – TEAFX;<br>F-3 – TFEBX | **American Funds® Multi-Sector Income Fund**<br>A – MIAQX; F-2 – MIAYX;<br>F-3 – MIAZX; R-6 – RMDUX<br>**American High-Income Trust®**<br>A – AHITX; F-2 – AHIFX;<br>F-3 – HIGFX; R-6 – RITGX<br>**American High-Income Municipal Bond Fund®**<br>A – AMHIX; F-2 – AHMFX;<br>F-3 – HIMFX |
| **Separately managed accounts (SMAs)** | **Capital Group U.S. Income and Growth**<br>**Capital Group World Dividend Growers** | **Capital Group International Equity**<br>**Capital Group International Growth** | **Capital Group Core**<br>**Capital Group Long Municipal** | |
| **Exchange traded funds (ETFs)** | **Capital Group Dividend Value ETF**<br>CGDV<br>**Capital Group Growth ETF**<br>CGGR | **Capital Group International Focus Equity ETF**<br>CGXU | **Capital Group Core Plus Income ETF**<br>CGCP<br>**Capital Group Municipal Income ETF**<br>CGMU | **Capital Group U.S. Multi-Sector Income ETF**<br>CGMS |

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*Source: Marketing Support: The Advisor View, May 2023, July 2021, June 2020; Fund Intelligence, February 2020. FUSE Research surveys of 500-1,000 advisors identifying the "most-read thought leaders." Survey was not conducted in 2022.

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