Planting the Seeds of a Productivity Boom

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After a long period of underinvestment following the global financial crisis, US productivity growth was subdued at a run rate of 1%. An era of free money and the availability of inexpensive labor led firms to grow earnings per share simply through hiring and financial engineering (read: buybacks) rather than through the harder work and risks of investing to enhance their productivity. Yet the post-Covid era is shaping up to be fundamentally different: capital expenditures are outpacing the rate in the previous regime, and US productivity has rebounded and is now surpassing pre-pandemic levels, with nonfarm business sector output per hour increasing by 2.7% in 2023.

Historically, productivity growth has been supported by three main pillars: 1) full employment, which leads to better job matches and boosts labor income and consumer demand; 2) strong investment, particularly in technology, driven by consumer demand and bolstered by fiscal support; and 3) stable inflation and access to essentials like food, commodities, and energy, which allows for more discretionary spending. The current environment exhibits these ingredients, the most important being tight labor markets. Faced with daunting wage growth, productivity enhancement is no longer a nice-to-have; thus, we believe necessity will once again be the mother of invention.

The recent boost in productivity can be linked to progress in two of the three areas noted above, including a boom in manufacturing investment and more balanced supply and demand for essentials. Additionally, the work-from-home trend post-Covid has boosted productivity through reduced office costs, lower attrition rates, and shortened commuting times, though this is partly counterbalanced by attracting less-productive workers and a decline in individual output. Moreover, there has been a spike in new High-Propensity Business Applications (those which are likely to turn into a business with a payroll), which could increase overall growth through enhanced job creation and productivity. Private business formation is another powerful ingredient for productivity growth.

The cherry on top is that businesses are increasing their investments, particularly in generative AI, which is significantly boosting productivity. The Fourth Industrial Revolution is now fully underway, with AI and robotics spurring a capital expenditure cycle that boosts productivity, prolongs economic growth, and fosters rapid, disruptive growth without commensurate inflation. After a decade of minimal spending, businesses are now making significant investments in technologies like cloud computing, software-as-a-service (SaaS), and cybersecurity to enhance efficiency and profit margins, despite rising costs. This investment focus is now a priority in IT budgets, aimed at protecting margins and countering disruption in several industries.

Elsewhere, emerging markets (EM) have experienced increased productivity growth, underpinned by structural trends like reshoring in Mexico and India, which boosts business investment and productivity. This comes at the expense of China as global firms diversify their supply chains. In contrast, Europe's productivity remains sluggish, hindered by the energy crisis and structural challenges like trade restrictions and supply chain reconfigurations.

The extent to which the new regime will differ from the previous one hinges on a race between these productivity growth drivers and entrenched structural constraints on potential growth, such as demographics and high debt levels. If sustained, productivity-driven supply-side growth could be a real game changer, presenting opportunities for growth in specific countries, industries, and themes that can be leveraged through a combination of active beta and security selection.

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Ilke Pienaar
Head of Sovereign Research, Global Emerging Markets Fixed Income

CS 2.75 (-0.25)

Supported by government expenditures and a renewed acceleration in residential real estate loans, the US economy shows no signs of slowing in the year's first half. Adding to the buoyancy are looser financial conditions, the wealth effects of a rising stock market, and immigration, which added 1% to the population over the last 12 months. Nevertheless, we still foresee a slowdown in the second half as the Federal Reserve halts its term lending program and liquidity falls alongside slower employment growth, which is only a meagre 0.6% year over year, with net creation coming only in part-time jobs. Similarly, all job growth since mid-2023 has come from foreign-born nationals, raising concerns over the sustainability of the productivity growth.

Against this backdrop, inflation as measured by the Consumer Price Index (CPI) should continue trending lower toward 2% in early 2025 despite the upward surprises in both January and February 2024. Import prices are still in deflation, the US dollar is still appreciating on a year-on-year basis, and credit is still contracting, notwithstanding the most recent bounce.

Given the upward surprises in CPI, market expectations of the timing of the Federal Reserve's first rate cut have been pushed out to June/July (with the total remaining between three or four for the year). Given the heavy political calendar, the likely start of the cycle is set to be June, followed by possible cuts in September and December.

As a result of expectations of easing by all major central banks, with the exception of the Bank of Japan (BOJ), and stimulatory fiscal policy, global growth has generally come in stronger than it did at the end of 2023. Currently, global PMI is in expansionary territory for the first time since mid-2022.

Rates

Gunter Seeger
Portfolio Manager, Developed Markets Investment Grade

CS 3.20 (+0.20)

It now appears that the market is desperate to catch what has been perceived as the next big macro trade, namely easing by developed market (DM) central banks, with the exception of the BOJ. The scope of the rally since the October 2023 highs in yields has matched that expected global synchronicity of actions. This setup looks identical to the experience of the last 18 months, in which there has been a persistent hope (or fear) that the economy is about to roll over. We have had two decades of easy money fueling "irrational exuberance" and a market addiction to lower rates. But we have entered a new era of structurally higher rates in the US and, to some extent, everywhere else. There is no going back.

Credit

Steven Oh, CFA
Global Head of Credit and Fixed Income

Credit 3.50 (-0.50)

Despite the lack of change in tight valuations, we have greater conviction in the base case fundamental outlook for a stable economic environment. Our view is further underpinned by the Fed's affirmation of maintaining its rate cut outlook for 2024 despite an upward revision of inflation expectations and overall economic strength. The greater economic confidence is also resulting in stronger technical support, with investors continuing to seek credit based on attractive overall yields rather than tight spreads. Therefore, despite rich spread valuations, which would call for higher caution, there isn't a need to be overly cautious as downside probabilities decline further.

At current BB-BBB valuations of only 75 basis points (bps), we prefer the investment grade (IG) component. However, the additional pickup at lower ratings tiers results in base expectations of single-B high yield (HY) outperforming. The material yield advantage of floating-rate credit over fixed rate from both the base rate and spread elements results in expectations of outperformance for floating rate for the year. While spreads in Europe have tightened as well, the differential screens well for European credit in both IG and HY relative to the US. Finally, emerging market (EM) credit spreads have also rallied and the differential is now fair to DM.

Currency (USD Perspective)

Dmitri Savin
Risk and Solutions Strategist, Emerging Markets Fixed Income

CS 2.75 (unchanged)

FX market volatility has declined, and trading ranges have narrowed as investors' thoughts on the future path of central bank policy have moved to the forefront. We expect moderate US dollar strength from here, with our 12-month target unchanged at 1.05 versus the euro. We continue to argue for measured, synchronized rate cuts by the Fed and the European Central Bank (ECB), whose path to cutting rates remains clear, with inflation proving less sticky. On the euro growth side, manufacturing PMIs have started to turn, indicating that we may be reaching a bottom in growth. An improved outlook is most clearly the case in Spain, Portugal, and Italy, but Germany and France continue to lag, which is the more significant driver of negative sentiment. This also leaves the growth differential in the dollar's favor.

The BOJ became the last major central bank to exit negative rates as a monetary policy tool, lifting its overnight interest rate to between 0% and 0.1%. The BOJ also sought to abolish yield curve control and discontinue ETF and J-REIT purchases. Importantly, however, it committed to continuing its government bond purchases at "broadly the same amount." Combined with an emphasis on gradualism on future policy moves, that commitment left a dovish wrapper on the meeting. The bank's end to ultra-accommodative policy appeared fully baked into market expectations, so the dovish overlay may explain why the Japanese yen has traded weaker. In the future, we expect a reduction in the rate differential versus the US dollar to support the yen's appreciation. This reduction, however, will only be moderate; we need to see further action from the Fed for a more significant move. This will leave the yen in the hands of the global macro environment.

Improving structural forces in emerging markets seen through rising trade and current-account surpluses provide support for EM foreign exchange even in a mildly stronger US dollar environment. High real yields linked with rapid disinflation have created a decent yield buffer in EM currencies, which further enhances their ability to withstand US dollar appreciation.

Emerging Markets Fixed Income

Chris Perryman
Corporate Portfolio Manager and Head of Trading, Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 3.00 (unchanged)

Local Markets (Sovereign)
CS 2.50 (unchanged)

We maintain our base-case expectation of GDP growth of 4.5% for China in 2024, the challenge being policy execution by the government, as the continuation of its wait-and-see approach, with a tolerance for slightly lower growth, is making investors more bearish. Asian high-yield sovereigns have improved, with good recovery in non-distressed names and with restructuring and IMF support giving good near-term momentum in distressed names. In Central and Eastern Europe, the Middle East and Africa, the story is a little more mixed, with recovering growth but fiscal support remaining weak for most. In Turkey and Egypt, the outlook is positive. In Egypt, support is coming from an IMF program with other funding being put in place. Turkey's positive outlook comes from a steady economic rebalancing, inflation peaking, and central bank credibility improving.

In Latin America, Brazil is likely to see growth slowing to 1.5% amid continuing cuts in local rates and a negative long-term fiscal outlook as more companies are nationalized and market-friendly reforms are rolled back. The corporate sector is doing well, and we are constructive on financials, consumer goods, and industrials but see business managers being cautious in technology, media, and telecommunications (TMT). Imports are pressuring metals and mining companies, which also are seeing depressed domestic sales. In Colombia, we see a mild rise in growth to 1.5% this year and local rates being cut. The long-term outlook is improving as negative reforms are either being watered down or are failing to pass in the legislature. Corporates on the whole are benefiting from lower inflation, with the financials, TMT, and utilities sectors to benefit most. In oil and gas, the story is more mixed. We maintain our weights in the global macro scenarios, favoring the "Stabilization" scenario (60%) with a slight skew toward "Recession" as a risk (25%).

Multi-Asset

Amien Johaadien
Research Analyst,
Global Multi-Asset

CS 2.80 (-0.40)

January's hot CPI print reignited concern that the last mile for disinflation might be the stickiest. While restrictive policies by the Fed as it awaits more data increase the odds of a recession, we suspect its foot-dragging will only delay the onset of rate cuts from May to June or July, which is not enough to change the outlook for 2024-2025. Growth should soon slow, with the stickiest areas of domestically generated inflation (Chair Powell's "super core" metrics) resuming their impressive second-half 2023 disinflationary trend after the January bounce. While the onset of policy rate cycles resulting from recession favors bonds over stocks, policy rate-cutting cycles triggered by soft landings have witnessed stocks outperforming bonds.

Though the slope of our Capital Market Line is still not signaling outright caution, nor that investors are being paid particularly well for taking on risk, our nine- to 18-month outlook for the direction of fundamentals (our second criterion for dialing risk up or down) has improved. With odds falling for a recession and continuing to rise for a soft landing, cash flows are now expected to inflect higher.

We also now expect quantitative tightening (QT) to end sooner, leaving markets still flush with supersized pandemic-injected liquidity. Previously, we had expected QT to continue until markets were at least facing neutral liquidity conditions. As a result, we shifted our Risk Dial Score (RDS) from a slightly conservative 3.2 to a modestly constructive 2.8.

Global Equity

Chris Pettine
Research Analyst,
Equities Fundamental

CS 3.00 (unchanged)

Fed Chair Powell's confidence in continued disinflation coupled with strong economic and labor market conditions have pushed DM equity markets higher. Notably, the Fed is "not far from" a level of confidence from which it would be appropriate to dial back the level of restriction. The earnings outlook is improved following strong fourth quarter earnings and stable 2024 outlooks. Earnings upside has been driven by US tech and AI-driven spending. Forward earnings estimates have been revised higher as the soft-landing scenario appears more certain. Outperformance at the sector level is broadening beyond tech and communication services, with six sectors now in line with or better than the MSCI ACWI. Geopolitics, election-related policy uncertainty, and valuations are potential offsets.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 2.50 (unchanged)

Fourth-quarter earnings reports showed more misses than in previous quarters, resulting in negative market reactions when a miss was due to one-off factors but no positive response when a surprise came on the upside. Thus far this year, a "glass half empty" has been the way markets have treated the slightest disappointments.

In China, earnings from the automotive and travel sectors have been strong, while industrials and financials were mixed, but with some signs of improvement from select companies. The property market remains weak. Results were better than expected for several internet platforms. In Taiwan and Korea, tech companies with exposure to the AI chain see continued profit upgrades, with stock prices responding accordingly.

In Latin America, investors have been negative on Brazil, with the market a year-to-date laggard. Some of this is due to a few disappointing earnings results and some to delays in US rate cuts. In Mexico, financials remain attractive while consumer stocks have been struggling after reporting their results. In EMEA, Polish and Greek banks and consumer stocks have been exceeding expectations and performed well.

Investors continue to exhibit a lack of conviction in bottom-up fundamentals, albeit with wide sector and country variation. Unpredictable geopolitical and top-down factors continue to have a disproportionate impact on the markets. As the views on US rate cuts have been pushed out, a tendency to take profits remains. In our investment decisions, we try to look as much as possible past such factors and continue to focus on companies with strong and improving business models, quality management, sound financial structure, and proper adherence to ESG values.

Quantitative Research

Qian Yang
Quantitative Strategist,
Fixed Income
Quantitative Strategies

Our US Conviction Score weakened slightly, driven by curve flattening of 11 bps. Global credit forecasts are negative, and our relative model favors EM over DM. In DM, the industries model favors brokerage, technology, and consumer goods; it dislikes electric and energy and natural gas. Among EM industries, the model likes consumer goods and financials; it dislikes transportation, real estate, and pulp and paper. Our global rates model forecasts lower yields and a steeper curve globally.

The rates view expressed in our G10 model portfolio is overweight global duration but divided within regions. In North America it is overweight Canada but underweight the US. In Europe it is overweight Belgium, Italy, and France. It is underweight the UK and Germany. In Asia and Oceania it is overweight Japan and New Zealand, while underweight Australia. Along the curve, it is overweight in 10- and 20-year durations and underweight in two-, five-, and 30-year durations.

All market data, spreads, and index returns are sourced from Bloomberg as of 25 March 2024.

About PineBridge Investments

pinebridge.com

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 December 2023, the firm managed US$157.1 billion across global asset classes for sophisticated investors around the world.

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