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AMG National Trust

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Three-Year (2024 to 2026) Economic Outlook

A look at probable economic scenarios and asset class expected return projections

JANUARY 2024

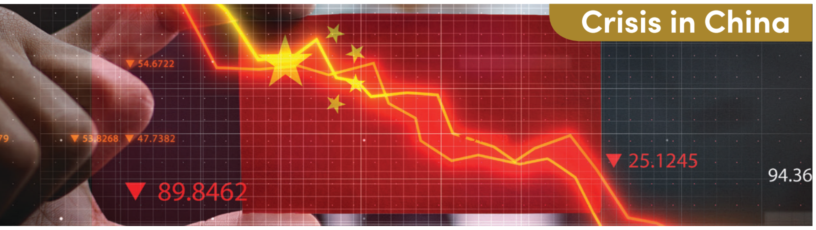
A Slow Start *(Base Case)*

Higher Productivity Growth

Inflation Reaccelerates

Stubborn Inflation

Hard Landing



Crisis in China

Low Growth Potential

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Introduction to the Scenarios

Following the unprecedented series of events of the last four years, the U.S. economy appears to be on a tenuous path to normality. However, the process remains frail and fraught with risks. Interest rates are at their highest levels in two decades. Inflation, while far down from its peak, remains elevated. The global geopolitical and economic situation is precarious at best. Such a complex environment warrants careful study, selection, and possible adjustment of investors' portfolios.

To this end, AMG has developed seven scenarios that illustrate different paths the economy may take during the 2024-26 period. AMG's Base Case, or the most likely scenario, *Slow Start*, sees a period of slower GDP growth in 2024, after which economic conditions normalize and approach their long-term equilibrium. Other scenarios illustrate the effects of potential shocks to the economic environment. While not considered the most likely, all remain distinct possibilities.

Summaries and highlights of each scenario are presented on the next few pages. Each scenario's three-year economic and two-year asset class performance projections provide the estimated expected return information required for the formulation of a client's efficient frontier.

Economic Backdrop for Scenarios

AMG systematically constructs several comprehensive economic scenarios in order to project the most likely central tendencies of investment results for various classes of assets. The multi-scenario approach permits an examination of the probable effects (both good and bad) of the most prominent foreseeable risks that may lie on the path of the economy and, by extension, investment returns.

The post-pandemic economic environment, which saw the abandoning of COVID-19-related restrictions, the lingering effects of unprecedented fiscal and monetary support deployed by governments worldwide, as well as a number of geopolitical events have all posed significant challenges to economic and financial forecasting. In the United States, the economy continued to demonstrate impressive resilience, with consumer spending, the labor market, and business investment all performing significantly better than generally expected.

Going forward, AMG expects the domestic economy to lose some of its momentum in 2024 as the effects of the previous economic stimulus measures wear off and high interest rates exert a negative impact on consumer and business spending. The slowdown in growth should prove relatively short-lived, with the economy recovering before the end of the year and eventually approaching its long-term potential GDP level and growth rate. However, since the exact effects of previous monetary tightening cannot be precisely determined, the depth of the economic slowdown remains uncertain—from lower, but still positive growth rates all the way down to a mild recession.

As every economic scenario is based on a specific starting point, it is appropriate to summarize broad economic conditions at the beginning of 2024. The economy performed very well in 2023, with real GDP growth in the last quarter of the year 3.1% above that recorded for the last quarter 2022, higher than virtually any reasonable estimate of the economy's potential growth rate. The strong growth was accompanied by an impressive performance of the labor market. While the extraordinary tightness of that market seen in 2022 has abated somewhat, the number of available job postings remains higher than the number of the unemployed. The unemployment rate stayed in the 3.4-3.8% range throughout 2023, essentially at the full employment level. Whether the economy continues to outperform expectations, or whether it slows down from the fast growth rate observed last year is likely the most important question facing the U.S. economy in 2024.

Annual consumer price index (CPI) inflation has decreased significantly from the peak levels seen in the summer of 2022. It is down from almost 9.0% to recent levels in the 3.0%-3.5% range. Core inflation, which excludes volatile food and energy prices, has also seen a decline, from over 6.0% to around 4.0% recently. Despite the significant progress, all measures of inflation remain above the Federal Reserve's (Fed) 2.0% target. The pace and timing of finally bringing inflation down to target is another significant challenge facing the economy in the current year.

The surge in inflation, which began in 2021, led to the most rapid monetary tightening cycle since the 1970s. The Fed raised the federal funds rate target by a cumulative 5.25 percentage points between March 2022 and July 2023, bringing the policy rate to the highest level in over two decades. The rapid increase in the policy rate was accompanied by a similar increase in other interest rates in the economy, such as those on mortgages and on Treasurys.

The unprecedented scale of monetary tightening likely contributed to bringing inflation down, but surprisingly it has not yet produced a major fallout in the economy, except for a brief period of turmoil in the financial sector following the collapse of Silicon Valley Bank in March 2023. This fortunate combination of events has raised hopes that the Fed might achieve a nebulous "soft landing" and return inflation back to target without inflicting any serious damage to the economy. However, as the work is still in progress and inflation remains above the Fed's target, whether this feat is going to be achieved remains an open question. As inflation declines, though, it appears likely that the Fed will begin to lower its policy rate in 2024. The timing and extent of interest rate cuts, as well as their consequences for inflation, financial markets, and economic activity all constitute critical questions for the coming quarters.

Table 1

Overview of 2024-2026 Economic Scenarios

[1] H1 = First half
[2] Q4 = 4th Quarter, etc.
[3] SAAR = Seasonally Adjusted Annualized Rate

*Realized inflation is the rate of inflation that actually happens, versus forecast or projected.

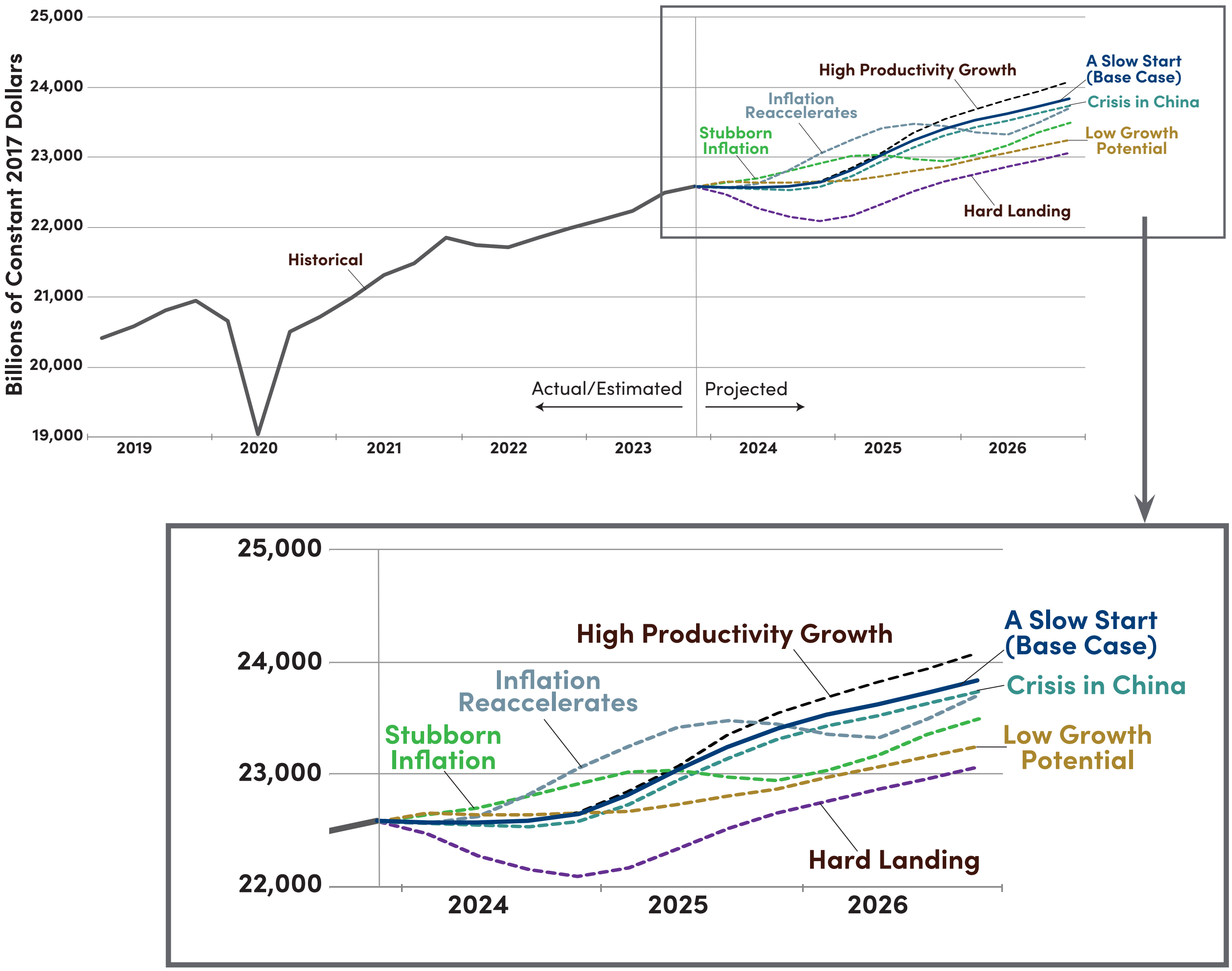
Scenario Title	Scenario Description	Duration and Severity of Domestic Recession	"Peak" Fed Funds Rate	Path of U.S. Consumer Inflation	U.S. Fiscal Policy	Economic Landscape Outside of the United States
#1 A Slow Start *(Base Case)*	The U.S. economy experiences a significant growth slowdown and possibly a mild recession in the first half of 2024. The slowdown is broad-based, with consumer spending virtually flat, and investment weak across the board. As the economy slows down, inflation approaches the Federal Reserve's (Fed) 2.0% target, allowing the central bank to ease policy in the second half of 2024. Economic growth recovers in late 2024 and returns to trend in 2025.	Possibly a shallow recession in the first half of 2024.	The Fed funds rate is currently at its maximum level. Interest rates gradually fall in the second half of 2024 and in 2025.	Inflation slows down gradually in 2024 and in 2025 and eventually stabilizes close to the Fed's 2.0% target.	No major changes. Slight fiscal tightening in line with the Fiscal Responsibility Act.	The global economic environment remains subdued through most of 2024. European economies stagnate, while China continues to muddle through its real estate sector problems. Global growth improves in late 2024 and in 2025, when Europe returns to its trend growth, at around 1.5%. China eventually resolves the problems in the property sector, but struggles with adjusting its economy from an export- to a consumption-oriented one. As a result, growth remains at around 4.0-5.0%.
#2 Higher Productivity Growth	GDP growth slows down in the first half of 2024 just like in the Base Case, with a similar path for monetary policy. However, productivity growth accelerates in late 2024 and in 2025, driven by broader implementation of artificial intelligence (AI) and favorable regulation and government policy. Increased productivity leads to faster actual and potential growth in the economy. Despite faster growth and higher aggregate demand, the efficiency gains help keep inflation under control in 2025.	Possibly a shallow recession in the first half of 2024.	Same as Base Case, but with marginally less easing in 2025.	Same as Base Case.	No major changes. Slight fiscal tightening in line with the Fiscal Responsibility Act. Faster growth improves the government's overall fiscal position.	Faster productivity growth and technology adoption are also present in the foreign economies, and their GDP growth improves accordingly.
#3 Inflation Reaccelerates	Inflation continues to fall in the first half of 2024, approaching the Fed's 2.0% target. The economy continues to perform well and the labor market remains tight. The progress on inflation leads the Fed to cut rates around mid-2024. The economic growth accelerates in the second half of 2024, but so does inflation, fueled by wage growth coming from the continuously tight labor markets. The Fed is forced to reverse course and hike rates in 2025, slowing down the economy later that year.	GDP remains close to trend in 2024. A mild recession is possible in late 2025.	The Fed cuts rates aggressively in 2024, before having to reverse course and hike again in 2025. Policy normalization happens only in 2026.	Inflation decreases in early 2024, but rebounds later that year and into 2025. Tighter monetary policy leads to an eventual decrease in inflation in late 2025 and in 2026.	Same as Base Case.	Similar to Base Case. Tighter monetary policy in the United States and possibly in Europe mean that the global recovery in 2025 is much weaker than in the Base Case.
#4 Stubborn Inflation	The equilibrium real interest rate (R*) turns out to be higher than anticipated. As a result, monetary policy is less restrictive than policymakers currently believe. After the temporary shocks wear off, inflation continues to hover around 3.0% for most of 2024. The economy slows down, but the growth rate remains positive at around 1-2%. The Fed keeps interest rates at their current level for most of the year. Stubbornly high inflation forces the central bank to raise rates in late 2024, pushing the economy into a mild recession in 2025. Inflation falls back to target in 2025 and allows the Fed to normalize policy. The recovery takes place in 2026.	Slower economic growth in 2024, followed by a mild recession in 2025.	Rates remain at their current level for most of 2024, before going up in the second half of the year. Rates stay high through most of 2025 before normalizing in 2026.	Inflation hovers around 3.0% through most of 2024. Tighter monetary policy and the resulting recession in late 2024 help bring inflation down to the 2.0% target in 2025.	No major changes. High interest rates in this scenario might raise questions about the debt sustainability in the United States.	Inflation proves sticky in Europe, limiting the scope for cuts in a similar manner to that in the United States and leading to a similar growth trajectory. No changes in China.
#5 Hard Landing	High interest rates push the economy into a full-blown recession in 2024. The commercial real estate (CRE) financing issues turn out to be larger than presently estimated. High interest rates and the CRE crisis dry up financing by both banks and private lenders. The activity in CRE markets comes to a near halt, with few properties changing hands outside of foreclosures and bankruptcy reorganizations. This results in a relatively severe recession and a financial crisis, with typical impacts on economic output, asset values, and broad financial market activity. As demand and inflation fall rapidly, the Fed lowers rates aggressively in 2024 to stimulate the economy. The economy recovers slowly in 2025 but remains below potential for an extended period of time.	A stronger-than-average recession through virtually all of 2024.	Fed cuts rates aggressively in 2024 and in early 2025 to fight the recession. Due to the problems in the financial sector, rates stay low for an extended period of time.	Inflation falls fast and goes below target as the economy enters a recession in early 2024. After the recession is over, inflation reaccelerates to values around the Fed's target in 2025 and beyond.	Severe recession leads to a resumption of expansionary fiscal policy.	Europe goes from stagnation into recession in 2024 as the housing market continues to deteriorate and unemployment increases, limiting consumer spending. The recovery takes hold in 2025. China is similar to the Base Case, but with a more pronounced slowdown caused by low demand for exports in its trading partners.
#6 Crisis in China	Despite government measures, problems in China's massive property sector get out of control. The decline in property values leads to a wave of developer insolvencies, which then spills into the financial sector. As a result, financing dries up in the economy and consumer spending declines rapidly, sending China into a severe recession. A recession in China creates shockwaves around the world, heavily affecting commodity exporters as well as capital goods producers (Europe). The United States is also affected through lower global demand and the fallout into the U.S. companies with exposure to China.	Mild recession in the United States in 2024. Severe recession in China.	Similar to Base Case. The Fed cuts rates more aggressively to prevent the economic fallout from China.	Crisis in China and the resulting fall in commodity prices lead to inflation falling faster and to a lower level than in the Base Case.	Same as Base Case.	China experiences a severe recession. Countries with exposure to China, like commodity exporters and capital goods producers (Europe) are also significantly affected and see their growth rates fall significantly.
#7 Low Growth Potential	The economy is currently operating above its potential. As high interest rates affect the economy, inflation slows down and economic activity stagnates in the first half of 2024. Thus, the Fed embarks on rate cuts. However, easier monetary policy fails to boost the economy, and economic growth remains anemic. Inflation falls below 2% in late 2024 and fails to accelerate despite continuous monetary policy easing. Going into 2025, the economy reverts to the post-Global Financial Crisis low-growth, low-inflation environment.	Slow growth in 2024 and 2025.	Similar to Base Case. The Fed continues to cut rates through 2025 and 2026 to try to boost anemic growth.	Inflation remains above the target for most of 2024. It falls back to target toward the end of 2024 and remains close to it for the rest of the projection.	Same as Base Case.	The recovery in the global economy in late 2024 and in 2025 is milder than in the Base Case.

Calculating Expected Total Return Estimates

Estimates of expected returns for the 19 asset classes used by AMG to develop clients' strategic investment plans are provided for each economic scenario. These estimates for the aggregate of investment in each asset class were obtained using the following procedure.

- Identify key economic indicators—the most prominent of which are growth in real GDP, the rate of consumer price inflation, paths of long-term interest rates (10-year Treasury bond yields), short-term interest rates (90-day Treasury bill rates), oil prices, and changes in the foreign-exchange value of the dollar (trade-weighted index).
- Develop projections for the numerical values of the various economic indicators that are consistent with each scenario.
- Enter the projected indicator values, together with certain other data, in AMG's proprietary statistical tools for investment-return projections.
- Apply the extensive judgment and experience of AMG's research staff to analyze and adjust the results obtained from the investment-return projections to calculate expected return estimates.

U.S. Real GDP



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