

THE OLD NEW
CYCLE



Global Market Outlook – Q4 update



Synopsis

While overheated tech stocks and U.S. election uncertainty present near-term headwinds, we believe positive vaccine developments, dovish central banks and an ongoing economic recovery should allow equity markets to push higher.

Key market themes

The global market is in the early recovery phase of the business cycle following the COVID-19 recession. This implies an extended period of low-inflation, low-interest-rate growth - an environment that usually favours equities over bonds. But after such a rapid rebound, an equity market pullback would not be surprising. Tech stock valuations are elevated, and the U.S. elections create uncertainty around tax changes, government regulation and the re-escalation of China-U.S. trade tensions. Beyond this, we believe the market looks set for a rotation away from tech/growth leadership toward cyclical/value stocks. This also implies a rotation toward non-U.S. stocks, with Europe and emerging markets likely the main beneficiaries, in our opinion.

Our cycle, value and sentiment investment decision-making process scores global equities as slightly expensive, sentiment as neutral and the cycle as supportive. This leaves us neutral on the near-term outlook, but moderately positive for the medium-term, with slightly expensive valuations offset by the positive cycle outlook.

In the U.S., the move by the Federal Reserve (the Fed) to target *average* inflation is a significant shift. It should lengthen the expansion and delay the day of reckoning for equity markets from higher interest rates. Key uncertainties include the upcoming November presidential election between Donald Trump and Joe Biden. We believe a contested election, with destabilising implications for markets, is becoming a risk. A Trump victory would likely benefit U.S. stocks (i.e., tax hikes averted, more protectionism), while a Biden victory would probably benefit non-U.S. equities (i.e., more harmonious foreign and trade relations). Another main risk is a second wave of coronavirus infections that causes renewed lockdowns. At this time, however, we expect that a second round of meaningful lockdowns will be avoided.

In Europe, economic indicators have rebounded following the easing of lockdowns. While infections have been rising, hospitalisation and death rates remain low due to the shift in infections to younger age groups as well as more effective treatments. The region's exposure to



financials and cyclically sensitive sectors such as industrials, materials and energy gives it the potential to outperform in the second phase of the recovery, when economic activity picks up and yield curves steepen.

In the UK, Brexit uncertainty dominates the outlook. There is a year-end deadline for a European Union-UK trade deal, but negotiations are at a stalemate. Our assumption is that a deal will be reached on at least a *bare bones* free trade agreement, but the risk of a hard exit is uncomfortably high. Brexit uncertainty has been reflected in the FTSE 100 Index, which as of 16 September has been the worst performer of the major developed stock indices this year. We like the value in the UK market on a longer-term basis.

The Chinese economy has seen significant improvement since the COVID-19 crisis, with many indicators now pointing to growth over the year. Fiscal policy is set to remain very supportive through the rest of the year, and we expect that credit creation will be solid.

The Japanese economy continues to lag the recovery of other major regions, with the services sector being particularly disappointing. Even with the continuation of *Abenomics* under new Prime Minister Yoshihide Suga, as well as the potential for further stimulus, we expect that Japan will remain a laggard in the recovery, due to constrained monetary policy and deflationary dynamics.

In Australia, fiscal and monetary policy should remain very supportive. The government is set to announce new measures at the October budget, and we think that the Reserve Bank of Australia will keep rates steady.

In Canada, consumer spending data, along with recent trends in housing and employment, suggests the economic recovery has commenced. We expect fiscal and monetary policies to remain stimulative for some time to come.

Economic views



FISCAL STIMULUS

While government debt levels for developed economies are likely to increase by around 15% of gross domestic product (GDP) on average, we believe that fiscal austerity and tighter monetary policy are still some years away.



FED FORECAST

We don't expect U.S. inflation overshoots (and therefore, Fed rate hikes) to become a serious risk until 2023.



EUROPEAN GROWTH

Europe's recovery should continue over the coming quarters, as the region is more exposed to global trade than the U.S. and likely to benefit more from a rebound in Chinese demand.



TRADE

Despite the escalation in trade tensions between the U.S. and China, we think the *phase one* trade deal will remain intact through the U.S. presidential election.



RECOVERY

We believe that the global recovery from the recession will lead to a long period of low-inflationary growth, supported by monetary and fiscal stimulus.

Asset class views

Equities: Preference for non-U.S. equities

We prefer non-U.S. equities to U.S. equities. We believe that the second stage of the post-coronavirus economic recovery should favour undervalued cyclical value stocks over expensive technology and growth stocks. Notably, other major markets are overweight cyclical value stocks, relative to the U.S.

We like the value in emerging markets equities. China's early exit from COVID-19 lockdowns and recent stimulus measures should benefit emerging markets more broadly.

Fixed income: Bonds universally expensive

We see government bonds as universally expensive. Low inflation and dovish central banks should limit the rise in bond yields during the economic recovery from the lockdowns. We have a neutral view on high-yield and investment-grade credit.

Currencies: U.S. dollar should weaken during recovery

Given its counter-cyclical behaviour, we expect the U.S. dollar to weaken during the recovery. The dollar typically gains during global downturns and declines in the recovery phase. The main beneficiaries should be the economically sensitive *commodity* currencies - the Australian dollar, the New Zealand dollar and the Canadian dollar. We see the euro and British sterling as undervalued.



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IMPORTANT INFORMATION

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