Global Market Outlook
Q4 update
Synopsis.

Recession risks are rising as trade tensions depress global manufacturing and the inverted U.S. Treasury yield curve signals warning. While we’re cautious for now, a combination of central bank easing, a trade-war truce and China stimulus could brighten the outlook.

Key market themes

Moving into the fourth quarter, markets appear trapped in an episode of Deal or No Deal, with uncertainties surrounding the China-U.S. trade talks—and to a lesser extent, Brexit—dominating the picture. Lackluster earnings growth, waning business confidence and a lull in capital expenditures leave us waiting to see what happens with the high-level China-U.S. trade negotiations slated for early October. In the U.S., with the labor market beginning to show signs of slowing, a trade deal appears necessary to reinvigorate the fundamentals underpinning asset prices.

We believe an easing of trade tensions seems likely, if only temporary. U.S. President Donald Trump has a clear motivation to avoid a recession before next year’s election. China’s pain threshold is higher, but job losses and the threat of social instability provide an incentive to de-escalate the trade tensions and pursue domestic policy stimulus. However, it may take further equity market volatility to prod both sides into action.

On balance, we think it’s more likely that a combination of trade-war resolution and policy stimulus will see the global economy recover in 2020. The asymmetry of the different outcomes—bear market versus limited upside—keeps us cautious until there is more clarity.

We believe Europe’s outlook will improve if global trade tensions ease and China embarks on economic stimulus. Eurozone equities are close to fair value on our calculations, while core government bonds are long-term expensive. The European Central Bank (ECB) relaunch of quantitative easing and lowering of interest rates further into negative territory is unlikely to provide much economic stimulus, as we believe ECB policy has reached its effective limit.

In the UK, a much more drawn-out Brexit process on the back of another referendum has become our new base-case scenario. For large-cap UK equities, we see some short-term gains as likely, due to the downside risks of sterling. Long-term, however, we prefer to be neutral, driven by cycle concerns and sentiment that is neither positive nor negative. For UK gilts, we continue to retain a negative score, driven by valuation concerns.

As a result of the risks around trade and regional growth, central banks in the Asia-Pacific region are responding by cutting rates, which should provide some support moving forward. While easier monetary policy from the Reserve Bank of Australia has provided a boost to the Australian equity market, we think any upside is limited, given the soft fundamentals. Valuations in Emerging Asia and Japanese equities, meanwhile, continue to look reasonable to slightly attractive.

Canada’s economy has traversed well in a hostile global growth environment, but domestic stability is at risk, with the economy expected to slow sharply over the second half of 2019. This uncertainty surrounding the business cycle keeps us neutral on the outlook for Canadian equities.
Asset class views

Equities: Broadly neutral to slightly underweight
We have an underweight preference for U.S. equities, driven by expensive valuations and cycle concerns around the trade-war escalation, fading fiscal stimulus and the yield curve inversion. We’re broadly neutral on non-U.S. developed equities. We believe UK equities offer good value, as demonstrated by the 5% dividend yield. Valuations look slightly positive in Japan and neutral in Europe. We think both should benefit from eventual China policy stimulus, which will help bolster export demand. We also like the value offered by emerging markets equities.

Fixed income: Relatively neutral
We see government bonds as universally expensive, with U.S. Treasuries offering the most attractive relative value. As of mid-August, around 30% of global developed government bonds on issue were trading at a negative yield. High-yield credit is slightly expensive and at risk from slowing corporate profit growth. Investment grade credit is likewise expensive, with a slightly below-average spread to government bonds and a decline in the average rating quality.

Currencies: Preference for Japanese yen
The Japanese yen continues to be our preferred currency. It’s still undervalued, despite this year’s rally, and has safe-haven appeal if the trade war escalates. A resolution to the trade war could see the U.S. dollar weaken, given its counter-cyclical tendency.

Please visit: russellinvestments.com to read the complete 2019 Global Market Outlook – Q4 update.
IMPORTANT INFORMATION

1 Source: Refinitiv Datastream, as of September 11, 2019.

2 Source: The Bloomberg Barclays Global Aggregate Bond Index, as of mid-August 2019.

The views in this Global Market Outlook report are subject to change at any time based upon market or other conditions and are current as of September 23, 2019. While all material is deemed to be reliable, accuracy and completeness cannot be guaranteed.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Keep in mind that, like all investing, multi-asset investing does not assure a profit or protect against loss.

No model or group of models can offer a precise estimate of future returns available from capital markets. We remain cautious that rational analytical techniques cannot predict extremes in financial behavior, such as periods of financial euphoria or investor panic. Our models rest on the assumptions of normal and rational financial behavior. Forecasting models are inherently uncertain, subject to change at any time based on a variety of factors and can be inaccurate. Russell believes that the utility of this information is highest in evaluating the relative relationships of various components of a globally diversified portfolio. As such, the models may offer insights into the prudence of over or under weighting those components from time to time or under periods of extreme dislocation. The models are explicitly not intended as market timing signals.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Investment in global, international or emerging markets may be significantly affected by political or economic conditions and regulatory requirements in a particular country. Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation. Such securities may be less liquid and more volatile. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and political systems with less stability than in more developed countries.

Currency investing involves risks including fluctuations in currency values, whether the home currency or the foreign currency. They can either enhance or reduce the returns associated with foreign investments.

Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation.

Bond investors should carefully consider risks such as interest rate, credit, default and duration risks. Greater risk, such as increased volatility, limited liquidity, prepayment, non-payment and increased default risk, is inherent in portfolios that invest in high yield ("junk") bonds or mortgage-backed securities, especially mortgage-backed securities with exposure to sub-prime mortgages. Generally, when interest rates rise, prices of fixed income securities fall. Interest rates in the United States are at, or near, historic lows, which may increase a Fund’s exposure to risks associated with rising rates. Investment in non-U.S. and emerging market securities is subject to the risk of currency fluctuations and to economic and political risks associated with such foreign countries.

Performance quoted represents past performance and should not be viewed as a guarantee of future results. Indexes are unmanaged and cannot be invested in directly.

Copyright © Russell Investments 2019. All rights reserved. This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments. It is delivered on an “as is” basis without warranty.

Russell Investments’ ownership is composed of a majority stake held by funds managed by TA Associates with minority stakes held by funds managed by Reverence Capital Partners and Russell Investments’ management.

Frank Russell Company is the owner of the Russell trademarks contained in this material and all trademark rights related to the Russell trademarks, which the members of the Russell Investments group of companies are permitted to use under license from Frank Russell Company. The members of the Russell Investments group of companies are not affiliated in any manner with Frank Russell Company or any entity operating under the “FTSE RUSSELL” brand.

2019 Global Market Outlook – Q4 update

UNI-11534