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2019 Global Market Outlook – Q2 update

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The pause that refreshes.

Synopsis

Global central banks have turned dovish, China stimulus is stronger than expected and trade-war tensions are easing. The cycle is becoming slightly more supportive for equities, but we believe it's late in the game and upside potential is limited.

Key market themes

Markets are caught between incoming data pointing to slower global growth and forward-looking factors that suggest improvement later in the year. We think global cycle conditions will moderately improve as we head deeper into 2019, but we see the window of opportunity for equity markets as limited. We have an underweight preference for U.S. equities, mostly driven by expensive valuations. The U.S. Federal Reserve (the Fed)'s pause on interest-rate hikes has helped push markets up, but wage growth is already threatening corporate profit margins. We believe it will eventually find its way into inflation and bring the Fed back into action. We expect a Fed rate hike late in the year, followed by another two hikes in 2020.

Europe has suffered from several one-off events that have depressed growth, but we view most of these as temporary, and expect to see growth in the region improve through the year. Fiscal easing is likely to provide a decent tailwind, with the European Commission expecting that eurozone fiscal thrust will be 0.4% of GDP (gross domestic product) this year. In addition, the European Central Bank (ECB) has become more dovish, pushing out its guidance on the timing of the first funds rate rise to the end of 2019. Overall, we're neutral on eurozone equity valuations, while we see core government bonds as long-term expensive.

The ongoing Brexit uncertainty has been detrimental to the British economy. Corporate confidence is low, which prevents businesses from investing. The consumer is pessimistic, slowing demand for durables such as houses and cars. UK bonds remain very expensive, with yields well below fair-value.

The Asia-Pacific region is set to benefit from the increased focus on policy stimulus from the Chinese government. We think emerging Asian equities should be able to deliver around 10% earnings growth for 2019. Japanese economic activity has been disappointing, but we think the big downgrade to industry consensus earnings expectations is too pessimistic. In Australia, the market is currently pricing in one central bank rate cut by the end of the year, which in our view is slightly aggressive, given the labor market should remain fairly solid.

We have business cycle concerns in Canada, as the economy is clearly vulnerable to downside shocks. We are neutral toward Canadian equities in an absolute sense, but continue to emphasize a preference for those domestic equities over the U.S.

Economic indicators

We think a modest improvement in global cycle conditions is likely, led by the Fed's shift to a more dovish outlook and China's moves toward policy stimulus.

U.S. GDP GROWTH

We expect a slowdown in U.S. GDP growth to around 2.2% this year—a rate that is still well above the trend 1.8% growth rate.

EUROPEAN GDP GROWTH

The economic cycle should improve in Europe over the coming months as the impacts of one-off events subside. The survey of forecasters by Consensus Economics expects 2019 European GDP growth of 1.3%. This is above-trend growth of around 1%, but is a significant downgrade from a year ago, when the consensus was predicting 1.8% growth in 2019.

CHINA'S ECONOMY

China's economy continues to slow, pushing authorities toward more aggressive policy stimulus measures. This should provide support to both China and the global economy in the coming months

TRADE TENSIONS

It seems likely that U.S./China trade tensions are heading for a form of détente, which will lift a constraint on global trade and business confidence.

Asset class views

Equities: Broadly neutral

Our cycle, value and sentiment investment process points to a broadly neutral view on global equities. We have an underweight preference for U.S. equities due to expensive valuations, but we're more positive on non-U.S. developed equities. We see valuations in Japan and Europe as reasonable. We like the value offered by emerging-markets equities, as the asset class is a beneficiary of the Fed rate-hike pause, China stimulus and a potential thaw in the trade war.

Fixed income: Fair value at 2.7% in the U.S.

We believe U.S. Treasuries offer reasonable value. Our models give a fair-value yield of 2.7% for the 10-year bond. We see German, Japanese and UK bonds as very expensive with yields well below fair-value. The cycle is a headwind for all bond markets as inflation pressures slowly build. High-yield credit is expensive and losing cycle support, which is typical late in the cycle, when profit growth slows and there are concerns about defaults.

Currencies: Preference for Japanese yen

The yen is our preferred currency as we look toward the second quarter. It's significantly undervalued, can get cycle support as over-pessimistic growth expectations are revised higher and has contrarian sentiment support from extreme market-short positions.

We believe that pessimism around the U.S. economy is overdone and we expect another leg up in the U.S. Dollar Index (DXY) that could take it to 98, possibly to 100, before its bull run ends for this cycle.

The euro and British sterling appear undervalued. The recovery in European economic indicators should support the euro. Sterling will be volatile around the Brexit negotiations, but should rebound if a deal is agreed with Europe. Overall, we believe it has more upside potential than the euro.

2.7%

Our models give a fair-value yield of 2.7% for the 10-year U.S. government bond

Please visit:

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IMPORTANT INFORMATION

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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.

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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.

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

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