

CYCLE, INTERRUPTED

2020 Global Market Outlook



Synopsis

Central bank easing and the cooling in the China-U.S. trade war have set the scene for a global economic rebound in 2020. Our forecast pushes the risk of recession into late 2021, giving equity markets modest upside potential for 2020.

Key market themes

Hold the epitaphs—this aging cycle seems likely to last beyond 2020. Central bank easing, the de-escalation in the trade war and tentative green shoots in global manufacturing suggest we might be on the cusp of another *mini-cycle* recovery through the first half of 2020.

We believe that both China and the U.S. have incentives to reach a *phase one* deal on trade soon. U.S. President Donald Trump would like to declare victory in the trade war ahead of his 2020 re-election bid. Chinese President Xi Jinping, on the other hand, would like to limit the risk of a further trade shock as he strives to balance the short-term requirement for economic stimulus against a medium-term need to reduce debt levels in the Chinese economy.

Low inflation should keep the U.S. Federal Reserve (the Fed) on hold during 2020, although it may move to a tightening bias by year-end if bond market inflation expectations rise toward 2.2%, from their current levels of 1.7%. The November presidential election is likely to be a major source of uncertainty. Low unemployment and trend economic growth favor President Trump's re-election. The Democratic frontrunners in the primary race all favor at least a partial repeal of the 2017 corporate tax cuts, which would have negative implications for corporate earnings growth in 2021.

We believe the eurozone should benefit in 2020 from easier monetary conditions, the recovery in global manufacturing, the lifting of trade-war uncertainty and Chinese policy stimulus that increases import demand from emerging markets. Overall, we look for a gradual pick-up in growth across the eurozone during 2020. The absence of inflation pressure means the European Central Bank is unlikely to consider lifting interest rates.

The lifting of Brexit uncertainty and increased fiscal stimulus should support the UK economy in 2020. Both major parties in the Dec. 12 general election are proposing pathways to Brexit resolution and the end of fiscal austerity. A significant boost from fiscal policy is likely regardless of the election outcome, which would reverse a decade of deficit-reducing *austerity*.

We believe that Chinese stimulus will likely be modest—enough to stabilize or provide a small boost to the Chinese economy, but smaller than the previous stimulus episodes in 2016 and 2012. Japan should also benefit from this stimulus, as it will help bolster export demand.

In Australia, potential income tax cuts could provide a boost, but a sluggish economy will likely have the Reserve Bank of Australia considering another interest rate cut. We expect further rate cuts from the Reserve Bank of New Zealand, as business confidence in the country is at the lowest levels since the 2008 financial crisis.

The Bank of Canada (BoC) has been an outlier when it comes to central bank easing. It has the highest policy rate in the G7¹ and has resisted cutting rates despite softening global and domestic economic conditions. The hesitation is in part due to fears of stoking household debt. Although the Canadian housing market has reaccelerated, lackluster consumer and investment trends should eventually force the BoC to consider rate cuts.

Economic indicators



ECONOMIC SLACK

Economic slack² is limited at this advanced stage of the cycle. Nowhere is this more apparent than in the U.S., where an unemployment rate of 3.5% in late 2019 is causing wage pressures to build.



UNEMPLOYMENT

We expect U.S. non-farm payrolls growth to remain above 100,000 per month in 2020, which should lower the unemployment rate further—to levels not seen since the Korean war in the early 1950s.



GLOBAL ECONOMY

A Fed on hold and an improving U.S. economy should lead to higher Treasury yields and a steeper yield curve. The 10-year U.S. Treasury yield could rise to around 2.25%.



FINANCIAL CONDITIONS

Italian 10-year government bond (BTP) yields are under 1.2% in late 2019, mirroring declines across Southern Europe and supporting stronger financial conditions across the region.



INFRASTRUCTURE SPENDING

While China is likely to increase local government bond issuance to boost infrastructure spending, we believe that GDP (gross domestic product) growth is unlikely to rebound and should remain near 6%.

Asset class views

Equities: More optimistic

We have a small underweight preference for U.S. equities, driven mostly by expensive valuation, but also because the cycle conditions appear firmer outside of the U.S. We favor non-U.S. developed equities. UK equities offer good value, as demonstrated by the 5% dividend yield.³

In Japan and Europe, valuation is neutral. We think both markets will benefit from fading trade-war concerns. We also like the value offered by emerging markets (EM) equities, as the asset class should benefit from regional central-bank easing and China stimulus. The smaller scale of the China stimulus, however, limits the upside for EM.

Fixed income: Shifting toward a negative view

High-yield credit is slightly expensive and at risk from slowing corporate profit growth. Investment-grade credit is expensive, with a slightly below-average spread to government bonds and a decline in the average rating quality. Government bonds are also universally expensive. We think U.S. Treasuries offer the most attractive relative value.

Currencies: Preference for Japanese yen

The Japanese yen remains our preferred currency. It's still undervalued despite this year's rally and has safe-haven appeal if the trade war escalates. A mini-cycle recovery as the trade war is resolved, at least temporarily, could see the U.S. dollar weaken, given its counter-cyclical tendency. British sterling is very undervalued, but it has upside on most scenarios following the UK's Dec. 12 election.

¹ The Group of Seven (G7) is an international intergovernmental economic organization consisting of the following seven advanced economies: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

² Economic slack refers to the amount of resources in the economy that are not used. Machines left idle in a factory or people who cannot find a job represent slack to an economist. The reason slack exists is usually due to insufficient demand relative to what the economy is capable of producing.

³ Source: The Bloomberg Barclays Global Aggregate Bond Index, as of mid-November 2019.



5%

dividend yield means UK equities offer good value.



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IMPORTANT INFORMATION

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 December 9, 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.

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