THE GREAT
REOPENING

Russell Investments

Global Market Outlook – Q3 update

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Synopsis

Markets have rallied on hopes for an economic recovery as coronavirus-imposed lockdowns are eased across the globe. The rebound has been helped by oversold investor sentiment, but with sentiment back to neutral, so too is our strategists' market outlook.

Key market themes

The market rebound means that value is no longer compelling for global equities or credit. On the other hand, the cycle outlook has improved amid vast fiscal and monetary stimulus and economic reopenings. Sentiment, unsurprisingly, is no longer as supportive. Our composite contrarian indicator, as of mid-June, is providing a neutral signal. This means that the support from oversold conditions is waning, and markets are at greater risk of pulling back on negative news.

Neutral value, neutral sentiment and a supportive cycle give us a more balanced view on the investment outlook. Looking near-term, markets are vulnerable to negative headlines after rebounding approximately 40% from their March lows, with sentiment on the verge of triggering our indicator's overbought signal. Over the medium-term, we believe the supportive cycle outlook should allow equities to outperform bonds.

In the U.S., the recent historic economic slowdown has been met with an equally extraordinary fiscal and monetary response. Unprecedented stimulus and the potential for a few years of non-inflationary growth suggest investors may earn a larger-than-normal equity risk premium going forward. However, the U.S. still has relatively high coronavirus infection rates, so a second wave is an obvious downside risk to monitor. Meanwhile, the country's upcoming November federal elections appear too close to call. They will become a bigger focus for markets if the Democratic nominee for president, Joe Biden, takes a decisive lead.

Europe's disadvantage heading into the COVID-19 crisis was its lack of policy ammunition, but the region's policy response has surprised to the upside. The European Central Bank, for instance, has increased its asset-purchase program by over 12% of GDP (gross domestic product). Europe'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, economic uncertainty caused by the coronavirus has been compounded by Brexit negotiations. This has been reflected in the FTSE 100 Index, which has been the worst performer of the major developed stock indices. In the short-term, Brexit uncertainty and the slow decline in virus cases may continue to hold the UK market back, but we like the value in the market on a longer-term basis.

China's recovery from the COVID-19 crisis has continued through the second quarter of 2020, with the services sector starting to catch up to the manufacturing sector. The Chinese government has also announced further stimulus measures, including coupons to households to encourage spending, while the People's Bank of China is making monetary policy more accommodative.

In Japan, fiscal policy has become supportive, with the government recently approving a second stimulus package worth close to 117 trillion yen ($1 trillion U.S. dollars). However, the country's structural weaknesses in terms of monetary policy and persistent deflation mean it will likely remain an economic laggard relative to other developed economies.

Australia has been successful in containing the coronavirus through a combination of stringent border controls and lockdowns. High household debt levels and a slow growth in wages, however, translate to a cautious consumer—a headwind to the nation's recovery.

In Canada, high-frequency data, such as credit card transactions, suggests that April marked the cycle trough. Although a full jobs recovery will take time, May's employment report suggests a gradual recovery is unfolding.

Economic views

FISCAL STIMULUS

The U.S. fiscal stimulus packages passed since March provide the nation's economy with its most significant fiscal thrust since World War II. With the potential for more stimulus on the way, we are positive on the U.S. economic outlook.

FORECAST

The Organization for Economic Co-operation and Development (OECD) forecasts a 9.1% decline in eurozone GDP this year, followed by a 6.5% rebound in 2021. In the UK, the OECD predicts an 11.5% decrease in GDP in 2020, followed by a 9% rebound in 2021.

GEOPOLITICAL RISKS

While geopolitical risks are rising between the U.S. and China, we don't believe the increased rhetoric will lead to a dissolution of the *phase one* trade deal signed earlier this year.

GLOBAL ECONOMY

China appears well-positioned for a strong rebound through the second half of 2020 and into 2021, as stimulus kicks in and the global economy recovers.

RECOVERY

We believe the 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 have a preference for non-U.S. equities over U.S. equities. This is partly driven by expensive relative valuations, but is also reflective of the likelihood that the second stage of the post-coronavirus recovery will see corporate profits improve. This should favor cyclical and value stocks over defensive and growth stocks—and the rest of the world is overweight these stocks, relative to the U.S.

We also like the value in emerging markets (EM) equities. China's early exit from the lockdown, coupled with additional stimulus measures, should benefit EM 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 recovery from lockdowns. We have a neutral view on high-yield and investment-grade credit.

Currencies: U.S. dollar should weaken during recovery

The dollar typically gains during global downturns and declines in the recovery phase. The main beneficiaries during the recovery should be the economically sensitive *commodity currencies*—the Australian dollar, New Zealand dollar and Canadian dollar. The euro and British sterling are undervalued at mid-year 2020.

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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 June 22, 2020. 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.

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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.

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.

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The FTSE 100 Index is a market-capitalization weighted index of UK-listed blue chip companies.

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