# Key investment issues in 2020

## How we're managing our clients' portfolios

**Paul Eitelman**, CFA, Senior Investment Strategist

**Sophia Wang**, Market Analyst, Non-Profit and Healthcare

2020 is getting off to a better start than originally anticipated—nearly every asset class ended 2019 with positive returns. Central bank rate cuts, trade war de-escalation, and tentative green shoots in global manufacturing have spurred risk-on sentiment in the markets, suggesting a "mini-cycle" recovery through the first half of 2020. Our investment strategists' Business Cycle Indicator (BCI) forecast pushes broad recession risks into late 2021, extending the aging economic cycle and giving equity markets modest upside potential this year.

Here is how we are managing these shifting market forces in our clients' portfolios, using our cycle, valuation, and sentiment (CVS) investment decision-making process.

## Equity markets are strengthening

We are maintaining our small underweight preference for U.S. equities, which is mostly driven by expensive valuations, but also because cycle conditions appear firmer outside the United States. We continue to fund overweights to non-U.S. developed equities. As the U.K.'s general election results have dispelled some of the uncertainty surrounding Brexit, U.K. equities offer good value, as demonstrated by the roughly 5% dividend yield. In Japan and Europe ex U.K., valuation is fair—both regions, being globally exposed, should benefit from Chinese policy stimulus, which will help bolster export demand, as well as fading trade-war concerns. We continue to favor the value offered by emerging-market equities, which should also benefit from the Chinese stimulus package, regional central-bank easing, and improving global manufacturing activity. Overall, we have become more cautiously optimistic on global equities, and are gravitating towards a negative view on government bonds.

## Most fixed income investments are expensive

With high corporate debt levels creating vulnerability to rising interest rates and slowing profit growth, as well as expensive valuations, we are maintaining our underweight positioning to high-yield credit. We also continue to uphold our underweight to investment-grade credit, which remains expensive with a slightly below-average spread to government bonds and a decline in the average rating quality. Government bonds are universally expensive, but we think U.S. Treasuries offer the most attractive relative value. We maintain our underweight to emerging-market debt hard currency, a position that contributed to our multi-asset portfolios' excess returns last quarter.

## Recession risks are looming over the horizon

Central bank easing and trade de-escalation may have temporarily prolonged the aging economic cycle, but tighter monetary policy will eventually be required—possibly around early 2021—which could push the global economy into recession. At this point, we recommend caution while continuing to emphasize the importance of managing a dynamic, globally diversified portfolio, thinking beyond the herd, and sticking to a robust investment decision-making process. For example, we maintain our preference for cyclically-oriented value stocks over their growth counterparts, due to historically cheap valuations and the fundamental drivers of return being more sustainable for value names compared to growth names. While arguments exist in favor of current valuations of growth stocks, unpacking their actual contribution to total return reveals that their earnings have not surpassed those of their value counterparts. In fact, it is the *perception* of higher growth earnings that has fueled investors' willingness to pay for them, resulting in large levels of multiple expansion. The outperformance of growth names relative to value names is, therefore, something we view as unsustainable in the long run. In our multi-asset portfolios, we maintain exposure to growth and value styles, both of which can produce alpha, at different times. We believe that diversifying our allocations, regardless of which style is leading at the moment, allows us to benefit from the best of both worlds and adjust dynamically as market conditions change. Our current portfolio positioning is a result of seeking out companies that can support levels of earnings growth, independent of the shifting macroeconomic environment and monetary policy.

Our seasoned team of investment strategists and portfolio managers will continue to monitor the markets and dynamically manage risk below long-term strategic levels. At the end of the day, our focus is on empowering our clients, and making sure we're putting your money in the right place.

## Related reading

See Russell Investments' 2020 Global Market outlook: Russellinvestments.com/us/global-market-outlook

## For more information

Call Russell Investments at **800-426-8506** or

visit **russellinvestments.com/institutional**

## Important information

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

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.



First used: January 2020 AI-28004-01-23