Investment outlook

A monthly round-up of global markets and trends
January 2020

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Investment outlook

Clearing macro clouds provide 2020 vision for equities

To get some perspective for the 2020 investment outlook, it is worth reviewing how markets fared in 2019 and over the past decade. Global equities (including dividends) returned 27% in 2019, the best performance since 2009 and almost all regional markets have made gains – see the market highlights page opposite. Markets were driven higher, as central banks cut interest rates to kick-start the economic recovery in the last few months of the year. This accommodative policy more than offset the drag from tit-for-tat US-China trade tariffs, which led to slower company earnings growth over the course of 2019. On a longer-term horizon, the US equity bull market is now into a record 10th year and has outperformed all other major stock markets and assets classes. That raises the bar for US stocks to continue to outperform on a relative basis.

Looking forward to 2020, we see clearing macro clouds, with an outline US-China trade agreement now possible. It probably doesn't make sense for President Trump to escalate the US-China trade spat to hinder output/jobs growth and risk his re-election bid. Moreover, globally, monetary and fiscal policy is increasingly being used to support economic growth. Our base-case scenario of faster global growth in 2020 increases the probability that companies can deliver on earnings expectations. Not only should this raise risk appetite, but it also adds clarity on the market outlook.

Given that the US has not experienced a recession in 2010-2019 (the first time the economy didn't contract at some point in a single decade since the data began in 1850), tail-risk late cycle vulnerabilities persist. Nevertheless, US recession risk has been mitigated by what looks like a recovery in the manufacturing sector, healthy non-farm payrolls and stronger consumer confidence that continue to provide uplift for the US (and thus the global) economy.

Rising opportunities for non-US equities

If the global business cycle is to be extended (our base case scenario), we see better investment opportunities outside of the US. This view is broadly predicated on the rest of the world catching up with the growth rate of the US. The IMF forecasts that nominal GDP in Advanced Economies ex-US will expand +0.1% point faster than the US in the years 2020-2024, a stark contrast to a -1.7% growth deficit against the States in the previous decade. Translating this macro backdrop into company earnings, the consensus forecasts that World ex-US 2020 Earnings Per Share (EPS) growth at 10.3% versus 9.4% for the US. Consequently, faster relative earnings growth should favour non-US equities. Moreover, US-centred risks have grown, with valuation headwinds from the tech sector, which trades on 7.7 times its book value (the highest level since the tech boom in 2000) and accounts for nearly a quarter of market cap. Tech stocks may also face potential break-up risk and greater regulation over data privacy should a progressive left Democratic candidate win the presidency in November 2020.

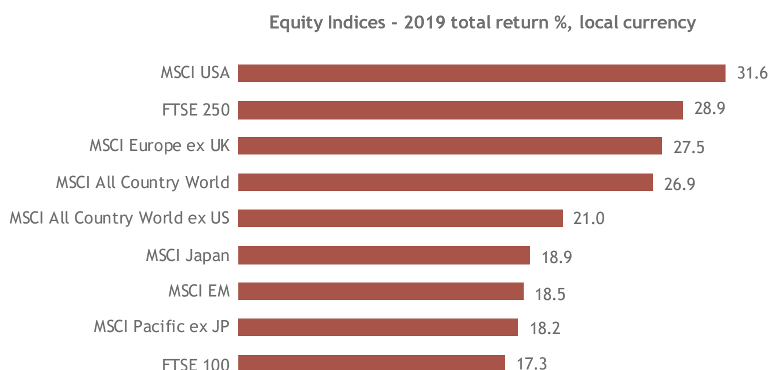
Out of non-US markets, the UK is perhaps the standout opportunity for 2020. Following an election that delivered a Tory majority government, the political risk of a left-wing Labour government has likely been averted for the next 5 years. The government will now be free to concentrate on "Borisnomics" (see our September 2019 Investment Outlook) of low tax rates and deregulation to provide a business-friendly environment for companies to operate. Over time, we expect current cheap UK equity valuations (and particularly domestically focused stocks) to mean revert and drive up equity prices in the process. Though the government has introduced legislation that prohibits an extension to the transition period beyond 2020, we believe the risk of a "no deal" Brexit deal with the EU is probably contained. That's largely because; i) it is in the interest of both the EU and UK negotiators to work out an economically beneficial Canada-style Free Trade Agreement (FTA); ii) PM Johnson has a sizeable majority in the House enabling him leeway to agree terms of any potential FTA; and iii) after being part of the EU for over 40 years, the UK is already aligned to EU regulations and product standards, which should make negotiations easier than for a non-EU country.

The Eurozone is another equity market that looks increasingly attractive. Lead indictors of growth, such as money supply, point to upside in economic activity. Given that European equity funds have seen heavy net outflows worth 12% of assets under management since the start of 2018, even a modest increase in the region's growth prospects should improve the market outlook.

Finally, after lagging global markets in 2019, Emerging Markets (EM) at current undemanding valuations are an opportunity for investors. EMs typically perform in the up-phase of a global recovery cycle. Fundamentally, the consensus forecasts EM EPS growth of 15% in 2020, the highest out of all the major regions, backed by growth-friendly policy support from China (see our December Investment Outlook). A key risk for EMs is the direction of the US dollar, which has typically depressed relative performance, but with the Fed easing monetary policy, the risk of Greenback upside seems contained to us.

Equities

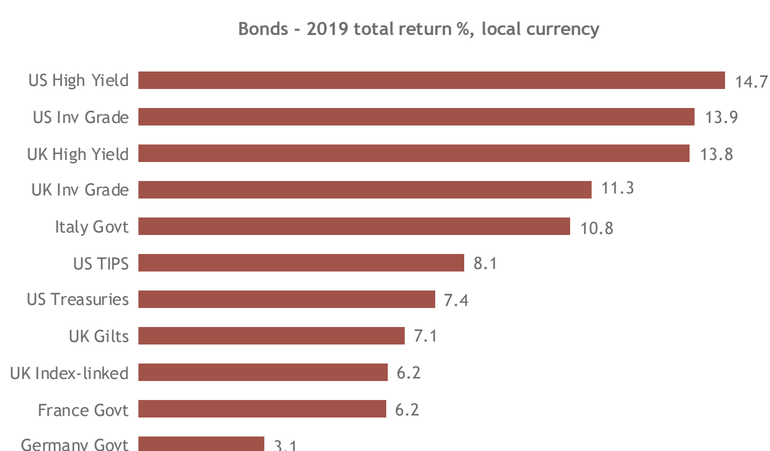
Global equities rallied in 2019 despite numerous geopolitical risks, with central bank easing being a key driver of market returns. Over the longer term, the US equity bull market has entered its 10th year outperforming other major stock markets. In Europe, despite economic stagnation and an industrial recession gripping Germany, MSCI Europe ex UK delivered total returns of 27.5% for the year. Although faced with domestic uncertainty, the FTSE 100 also generated an 17.3% return, buoyed most of the year by a weak pound and recently by a rerating of cheaper, domestic stocks.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 31/12/2019

Fixed income

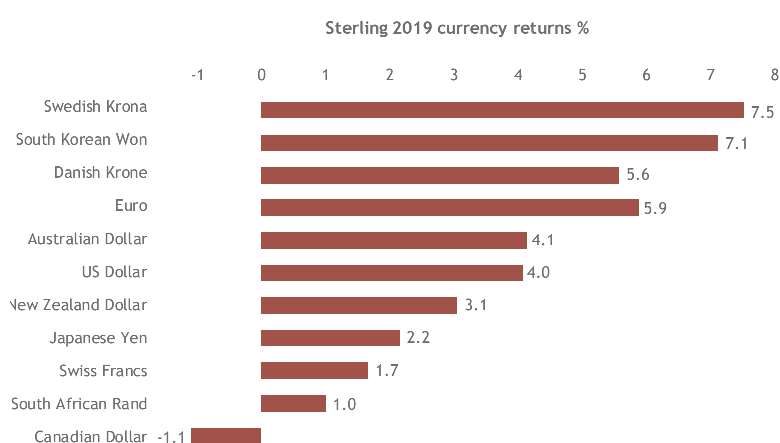
2019 has been a good year for fixed income broadly, driven by monetary policy easing and investors' search for yield at the lower quality end of the market. US Treasuries returned 7.4% over the year, spurred on by three Federal Reserve rate cuts that helped to push 10-year Treasury yields briefly below 1.5%. Lower quality high-yield US corporate bonds which yielded, on average, nearly 4% more than government bonds looked attractive to investors and went on to return 14.7%. In the UK, gilts provided a return of 7.1%. The Conservative victory in the UK general election had little impact on the market, given the new government's constrained fiscal expansion plans, relative to that proposed by the Labour party.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 31/12/2019

FX

2019 was a volatile year for sterling, as investors grappled with the UK's Brexit outlook as well as its general election in December. Over the year the currency appreciated by 4.0% relative to the US dollar, but this masks the scale of the moves along the way. From its peak of around $1.33 in March, GBP declined by 9.8% over the period to August, as a 'no-deal' Brexit outcome looked more likely, only to reverse this move entirely over the remainder of the year, as the Article 50 process was extended. Following the general election, initial optimism that the new government would end Brexit uncertainty quickly gave way as Boris Johnson ruled out an extension to the transition agreement beyond the end of 2020, making a 'no-deal' outcome possible again, given the limited time available to deliver a trade agreement. GBP remains cheap relative to most major currencies, but political developments will likely continue to be the driving force for the currency in 2020.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 31/12/2019

Market highlights

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	1.1	1.5	22.4	81.1
FTSE 100	2.8	2.7	17.3	40.8
FTSE 250	5.4	10.4	28.9	56.2
S&P 500	0.6	1.5	26.4	104.6
MSCI Europe ex UK	1.0	0.9	21.0	62.7
MSCI Japan	-0.3	0.2	15.4	73.5
MSCI Pacific ex Japan	0.1	-1.6	13.9	56.3
MSCI Emerging Markets	5.0	4.1	14.3	57.6
Bonds				
iBoxx GBP Gilts	-1.5	-4.2	7.1	22.0
iBoxx USD Treasuries	-3.2	-8.2	2.8	32.3
iBoxx GBP Corporate	0.1	-0.2	11.0	28.2
Commodities and trade-weighted FX				
Oil Brent Crude ($/barrel)	5.9	8.9	24.8	18.8
Gold ($/ounce)	4.0	3.2	18.7	28.2
GBP/USD	2.4	7.5	4.0	-15.0
GBP/EUR	0.6	4.4	5.9	-8.4
EUR/USD	1.8	3.0	-1.8	-7.2
USD/JPY	-0.8	0.6	-0.9	-9.4

Glossary of terms

Bonds – The relationship between price and yield. Yield is the return you get on a bond. When the price of a bond changes prior to maturity due to supply and demand pressures, so does its yield. When the price of a bond goes up due to demand, the yield goes down to compensate. This is so the bond's fixed rate of return (coupon) remains relatively constant – and vice versa. A bond's price and its yield are inversely related. A key factor which influences a bond is the prevailing interest rate. When interest rates rise, the prices of bonds fall, thereby raising yields. This is because the older bonds are sold in order to buy new higher yielding bonds.

Equities – A stock or any other security representing an ownership interest.

GDP – Gross Domestic Product.

Monetary policy – Actions of a central bank or other agencies that determine the size and rate of growth of the money supply which will affect interest rates.

Key macro data	Latest	2020 Consensus forecast	Spot rates	31-Dec	Yields (%)	31-Dec
UK GDP (YoY%)	1.1	1.10	GBP/USD	1.32	FTSE 100	4.36
UK CPI Inflation (YoY%)	1.5	1.80	GBP/EUR	1.18	FTSE 250	2.95
Bank of England Base	0.75	0.75	EUR/USD	1.12	10 Year Gilt	0.83

All values and charts as at 31 December 2019. Total returns in sterling.
Returns are shown on a total return (TR) basis i.e. including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Thomson Reuters Datastream and Bloomberg

Important information

Please remember the value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested. Past performance is not a guide to future performance.

Sources

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