

2020

20 **QUESTIONS** FOR 2020 **OUR CONVICTIONS.
YOUR RESOLUTIONS.**

2020 OUTLOOK
HAS CALM BEEN RESTORED?



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IN BRIEF

- 2019 was marked by a significant slowdown in global growth.
- Our scenario for 2020: no recession, despite a slowdown in economic activity in the US and in China and sluggish growth in Europe.
- Although there are still grounds for uncertainty, their nature is likely to change: the election year in the US will be watched particularly closely.
- Against this backdrop, our core convictions for our portfolios are as follows:
 - Overweight equities vs bonds;
 - Profitable investment themes over the coming months: value and cyclical stocks, certain emerging debt segments and gold as a core portfolio holding;
 - Mega trends should continue to outperform over the long term.
- Selectivity, conviction and flexibility will be our watchwords throughout the year during 2020.

2020 OUTLOOK

2019 was marked by a significant slowdown in global economic activity. The growth rate fell to 3% (vs 3.6% in 2018) which is the lowest level observed since the financial crisis. The widespread slowdown, which affected almost three quarters of the global economy, was chiefly attributable to the escalating trade war between the US and China. However, local economic crises among emerging economies, including Argentina, Turkey and Venezuela, along with difficulties in the European automotive sector and Brexit uncertainties also played a significant role in the slowdown.

Is China resigned?

Bogged down by the trade war and confronted with a slowdown in domestic economic activity, the Chinese authorities have adopted a particularly cautious policy. Although borrowing terms for smaller businesses have been relaxed, along with the implementation of measures to support the real estate and automotive sectors and infrastructures investments, unlike during 2015-16, these latest stimulus measures have been calibrated less towards boosting growth and more towards avoiding an economic hard landing. Faced with ongoing trade tensions, the authorities will maintain their moderate stance, with growth slowing further in 2020 to slightly below 6%. Among the other emerging economies, despite their contrasting individual situations, overall economic activity should accelerate slightly once again in 2020. In most regions, the central banks have reacted to the persistent trade tensions and the slowdown in global growth by loosening their monetary policy.

The trade war will continue to weigh on growth

By creating a huge shift in the economic rules of play and reducing corporate visibility, the trade war contributed significantly towards the slowdown in global commerce and corporate investments. The IMF estimates that the trade war had an impact of 0.4 GDP points on global growth in 2019. Although China was logically the hardest hit, the US was also impacted. US exports slowed and there was a downturn in capex. The trade war was therefore neither “good” nor “easy to win” for the US, as Donald Trump would have us believe. Furthermore, even if a truce were to be declared tomorrow between the US president and Xi Jinping, such a move would be unlikely to fully dissipate the prevailing uncertainty.

The US: a slowdown... without tipping into recession

The US economy is no longer proving to be an exception. Like the other major economies, growth in the US has now also slowed. Although consumer spending remains dynamic, exports have been weighed down by the deteriorating global situation and the strength of the dollar. Above all, there has been a sharp downturn in capex as companies have postponed their projects due to low visibility. Faced with these headwinds, the Federal Reserve had no real choice but to reverse its interest rate policy after hiking rates until the end of 2018 in order to prevent the economy from overheating in reaction

to Donald Trump's budgetary policy. This monetary easing has stimulated residential investments and, combined with the persistent increase in the wage bill, should enable the economy to avoid a recession, although growth will continue to slow during 2020. Over the longer term however, the current policy mix is absurd. With a high federal budget deficit and base rates once again at rock bottom, the US authorities will have no room for manoeuvre when the US does tip into recession. It will then be even harder to kick start the economy.

Zone euro: looking for a second wind

Over the past few quarters, growth has slowed down sharply in Europe. After reaching 3% at the end of 2017, the European growth rate fell to only slightly above 1% during the autumn of 2019, weighed down by a combination of economic and structural factors, including trade tensions, doubts over Brexit and difficulties in the automotive sector. The sharpest downturn however, particularly in Germany, was triggered by external factors, while domestic demand proved relatively resilient. Although outlook for 2020 is hardly more favourable, a recession should be avoided, with growth in the region likely to remain at around 1%. With reduced monetary leeway, any boost

to European growth supposes a shift in budgetary policy. Hopes for this type of move lie mainly with the European Commission and the ambitious agenda proposed by its new president. Ursula Von der Leyen has promised to deliver a green deal in her first 100 days in office and make Europe "the first continent to achieve climate neutrality" by 2050. Although commendable, this project is nonetheless less ambitious than it appears. The plan is set out on a very long term timeframe and the rigid framework of European policies means that Europe will probably struggle to rapidly implement a genuine growth strategy under this type of scheme.

INVESTORS WILL CONTINUE SEEKING ATTRACTIVE RISK PREMIUMS

Understanding 2019 in order to anticipate 2020

Among financial markets, returns in 2019 were ultimately much stronger than expected across all asset classes. This result may seem paradoxical given the disappointing economic indicators and political tensions which could have tipped the markets into the red on several occasions. How is it that certain equity markets are currently posting year to date returns of over 20%? It should be highlighted that during the final quarter of 2018, equities had fallen 15 - 20%, pricing in a high risk of recession in 2019. Investors had therefore mostly anticipated the sharp economic slowdown which has occurred. The Fed operated an extremely rapid U-turn in its monetary policy, switching back from a tightening cycle to a fresh loosening phase in just a few months. The other central banks followed suit, recreating a favourable context for risky assets, involving lower interest rates, a limited risk of a recession and inflation outlook anchored below their target level.

What is the market outlook for 2020?

From an economic point of view, the currently favourable context may endure. Global growth remains moderate but is no longer slowing down. A Brexit deal is now more likely, along with a truce in the trade war between China and the US, which would restore confidence among companies and consumers. Against this backdrop, growth in Europe

and among emerging markets could even beat forecasts. Although the central banks will maintain an accommodating stance and keep a close watch on trends among leading economic indicators, monetary easing is now mainly behind us. Budgetary stimulus measures will be required to take over from monetary policies as a growth relay.

Equities offer the most attractive risk premiums

We are therefore expecting interest rates to stabilise at around their current levels. In our fixed-income allocation, we remain underweight in sovereign bonds and continue focusing on seeking yield through local currency denominated emerging debt. Although the credit market could be more volatile than during 2019, as spreads have tightened sharply this year, we still prefer credit securities over sovereign debt. Gold continues to provide protection against portfolio volatility. As interest rates are negative or close to zero, investing in gold no longer represents an opportunity cost. Exposure to gold plays a similar role to the fixed-income segment of a diversified portfolio, i.e. it increases in value as real interest rates ease.

Global yields are likely to remain low across all asset classes in 2020. Equities nonetheless still offer an attractive risk premium and we are therefore still privileging equity weightings over bonds or cash. Although corporate earnings are likely to post sluggish growth and fall far short of current analyst forecasts, equity prices will be underpinned by the low interest rate environment and a context of greater global economic stability. Non-US equities could be buoyed by a potential rerating due to an improvement in economic indicators in Europe and among emerging markets. Non-US equities are trading on a 2020 price earnings multiple of 14 times vs 17 for US equities.

“These political events could trigger periods of volatility among the markets, incurring both upside and downside risk and providing potential investment opportunities.”

Key dates in 2020

Equity upside potential will obviously depend on how certain identified risks develop. This includes a potential truce in the trade war between the US and China and rescinding customs rights, with the US presidential election setting the tempo this year. There will be two particularly important electoral periods during 2020. The first half of the year will be marked by Super Tuesday on 3 March and the Democrat convention in mid-July to nominate the party's candidate. Later in the year, there will be 3 presidential debates in October. In Europe, a Brexit deal should be concluded, which will open negotiations over the future relations between the UK and the European Union. These political events could trigger periods of volatility among the markets, incurring both upside and downside risk and providing potential investment opportunities.

Thematic & responsible investing

Our thematic convictions for next year draw on short term opportunities for the next few months and specific trends identified over the longer term, focusing on the next few years. During the first half of 2020, we believe that an improvement in economic indicators should continue to drive value stocks and global cyclicals. Certain stocks, particularly in Europe, which have been neglected by investors over several years, were trading at all time discounts in 2019. These stocks harbour significant rebound potential and a high dividend yield. Financials and automotive stocks could benefit for example.

Over the longer term, infrastructure investment should also gather momentum, underpinned by government budgetary measures. Infrastructure investments could boost the digital sector associated with the fight against global warming. Similarly, companies involved in energy transition, automation, healthcare equipment and biotechs should further benefit from dynamic underlying momentum compared to sluggish growth in the global economy.

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