2020 outlook: An optimistic view of capital markets

Weekly Market Compass: We detail our forecasts for each region and asset class

Dec 2, 2019 | Kristina Hooper, Chief Global Market Strategist

Welcome to December – just one more month until a new year begins (and, depending on how you do the math, a new decade as well). Naturally, this is the time when market-watchers issue their forecasts for what may lie ahead, and my team is no exception. Simply put, we expect continued monetary policy accommodation with little fiscal stimulus. Therefore, we are more optimistic about capital markets than we are about the overall economy, and we favor risk assets over non-risk assets for 2020. Below, I highlight some of the reasons why.

Global outlook: Central banks expected to drive growth

As we look ahead to 2020, it's clear that central banks are still shouldering the burden for stimulating the economy via monetary policy. That should bode well for 2020, in our view. However, we believe such monetary easing should be more positively impactful for asset prices than the overall economy. Economic uncertainty is likely to continue to depress capital spending, in our view, and we must watch vigilantly to ensure it doesn't spill over into diminished hiring plans.

Bottom line: We expect overall economic growth of about 3% for the globe.

US outlook: We expect accelerated growth as next year progresses

Our view is that growth bottoms early in the year at approximately 1%, and then accelerates as the year progresses. Cycles tend to end with policy mistakes, and the risks have risen. However, it is our base case that the policy mix will continue to get modestly better. We believe the Federal Reserve and central banks globally will deliver more accommodation if necessary to support the economic expansion. And so we do not expect a recession in 2020.

Bottom line: We expect an environment of modest growth of approximately 2% for the US in 2020, which exceeds consensus expectations.

Canada outlook: A chance of rising rates doesn't dampen our growth expectations

We believe the Bank of Canada could be one of the few central banks to raise rates in 2020 (most likely in the second half). However, we do not believe this will create headwinds – the Canadian economy and stock market tend to do best in an environment of quickening global growth, rising commodity prices, and an appreciating Canadian dollar, which would be consistent with interest rate hikes.

Bottom line: We expect Canadian gross domestic product (GDP) growth to exceed expectations at approximately 2% for 2020.

Eurozone outlook: Policy responses to sluggish growth may remain elusive

We believe the weakness in the manufacturing sector may bleed over into the services sector to a greater extent next year. In response, we expect the European Central Bank (ECB) to remain accommodative in 2020, continuing quantitative easing purchases and possibly even cutting rates again. Furthermore, if governments, especially Germany, appear unwilling to provide fiscal stimulus, we could see the ECB explore more experimental monetary tools. However, we're mindful that this isn't an easy task. Therefore, further monetary easing may not be possible in the absence of a deeper downturn or outright recession.

Bottom line: We expect economic growth of about 1% or less for the eurozone in 2020.

UK outlook: Dec. 12 election to set the tone for next year

The economic policy uncertainty created by Brexit has depressed business investment and business confidence. Much of what happens to the UK economy in 2020 will depend on the outcome of this month's Parliamentary election and the ensuing Brexit outcome.

Bottom line: We expect the UK economy will grow at less than 1% in 2020.

Japan outlook: We expect tax-related headwinds to subside

We expect the Japanese economy to stabilize in early 2020 after a fourth-quarter 2019 deceleration caused by the effects of the new consumption tax. We then expect the economy to modestly re-accelerate. We believe the increased tax burden should slow consumption demand, although the impact should be much smaller than what we saw with the 2014 consumption tax increase. We believe the Japanese government is likely to initiate accommodative fiscal policy to help counter tax-related headwinds, and we also believe the Tokyo Olympic Games will increase tourism and help boost economic growth. We don't expect the Bank of Japan (BOJ) to ease policy unless the yen strengthens significantly – in which case we would expect the BOJ to consider a variety of policy tools.

Bottom line: Our base case expectation for Japan's GDP growth in 2020 is approximately 0.4%.

China outlook: We see positive catalysts on the horizon

Chinese economic growth has modestly decelerated, but we believe the fundamentals remain solid as the transition continues to a consumption, services-led economy. China's property market continues to be buoyant and is likely to see continued robust investment growth, in our view. We expect further softening of the renminbi – but at a measured clip, which should also be supportive of economic growth. Other positive catalysts include fiscal stimulus measures that should boost fixed asset investments, and our expectation that there will be a stabilization in the tariff wars. But regardless of whether the US-China trade conflict is resumed quickly, we believe China will utilize the fiscal and monetary tools necessary to support its economy through the headwinds.

Bottom line: We expect Chinese GDP growth in 2020 to be approximately 5.8% to 6%, which is around consensus expectations.

Asset class outlooks: We favor risk assets over non-risk assets

As noted earlier, we expect continued monetary policy accommodation with little fiscal stimulus. Therefore, we are more optimistic about capital markets than we are about the overall economy, and we favor risk assets over non-risk assets for 2020.

Equities: An overall bullish view, with some regional exceptions

- **US stocks.** We believe the monetary policy environment will remain supportive of equities in 2020. However, we believe investors will need to be more discerning in this environment. Valuations appear stretched for US equities, in our view, but we recognize that valuations have not often been a good predictor of equity performance in the shorter term. In addition, we believe lower interest rates and low inflation make US equities more attractive. Also, the dollar has weakened recently because of "quantitative easing lite" policies that are expected to be ongoing. That should be positive for US equities. Therefore, we are bullish on US stocks, with the caveat that investors should expect more volatility in the coming year.
- **Canadian stocks.** We are modestly bullish on Canadian equities. We believe long-term Canadian equity underperformance could be coming to an end as Canadian stocks enjoy some advantages that may be underappreciated by investors. The United States-Mexico-Canada trade agreement (USMCA) appears poised to be ratified, which would benefit Canadian stocks. In addition, the Canadian manufacturing outlook remains positive, suggesting business sentiment is positive, which should bode well for equity returns. Also, Canadian stocks could benefit from a weaker US dollar and the potential for higher commodity prices.

- **European and UK stocks.** We are neutral on European (ex UK) equities. Valuations are very attractive (based on an analysis of dividend yield and cyclically adjusted price-earnings ratios), but we have not yet seen signs that the eurozone economy has reached an inflection point. We are bearish on UK equities. We believe it is reasonable to expect earnings declines and slower dividend growth, especially since a large portion of the UK market is exposed to either commodities or banks.
- **Japanese stocks.** We are modestly bullish on Japanese equities given that we envision a moderately brighter economic picture for Asia and expect limited downside to US long-term yield in our base case, which will likely result in either more stable or even weaker yen. (It has often been the case that stronger yen worked negatively for Japan equities, including this year.)
- **Emerging market stocks.** Overall, we are bullish on emerging market equities. Catalysts include a more accommodative Fed as well as investors' search for yield, which may drive them to emerging market equities. Asian emerging equities should benefit from fiscal stimulus in China and India. Chinese stocks in particular should benefit from Chinese financial liberalization and the increased weighting of Chinese A share stocks in MSCI indexes. We are bearish on Latin American equities, many of which are too closely tied to the fortunes of commodities prices and some of which we expect to suffer from policy uncertainty. We have a neutral view of emerging Europe equities given decelerating growth in the euro area.

Fixed income: We favor higher-yielding bonds in this environment

- We believe that higher-yielding investments will outperform given the low rate environment. Therefore, we are bearish to developed government bonds with the exception of UK gilts, whose returns should be driven by declining yields.
- We prefer investment grade credit to developed sovereign credit, given the former's higher yields and better total return potential.
- We are positive on high yield bonds, although we prefer US high yield to eurozone high yield. Even allowing for a widening of spreads and a rise in default rates, we expect returns to be better than that of lower-yielding fixed income asset classes.
- We are also positive on emerging market debt, also given higher yields and greater total return potential.

Alternatives: Real estate's yield potential may be beneficial

- **Real estate.** Among alternative asset classes, we are most positive on real estate, given its relatively high yields and potential for outperformance in what we expect to be a relatively low return environment. We favor eurozone and emerging market real estate but favor avoiding UK real estate until Brexit is resolved.
- **Gold.** We are bearish on gold. While we recognize the diversification benefits of gold as well as a lower opportunity cost given lower rates globally, we expect low returns for gold in the coming year given the rally it experienced this year. In addition, gold typically performs best in recessionary or stagflationary environments, neither of which we expect for next year.
- **Commodities.** We are bearish on commodities, as we believe valuations are much higher than historical norms for commodities in real terms. In addition, our historical analysis suggests that industrial commodities have performed poorly when the Fed is cutting rates.

Cash: Having 'dry powder' on hand may be beneficial during volatile periods

- We have a slightly bullish view of cash-like instruments, preferring ultra-short-duration instruments. Our rationale is that such investments can offer a "safe haven" alternative to gold and are currently more attractive than gold given the latter's stretched valuations.
- In addition, given the volatility markets are experiencing, having adequate cash on hand enables investors to take advantage of opportunities created by downward volatility.

Source

[1]Source: Bloomberg, L.P., "China Lenders Trim Borrowing Costs, Following Central Bank," Nov. 19, 2019

Important information

Blog header image: Greg Rakozy/Unsplash

Brexit refers to the scheduled exit of the UK from the European Union.

UK gilts are bonds issued by the British government.

Stagflation is an economic condition marked by a combination of slow economic growth and rising prices.

Quantitative easing (QE) is a monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective.

Gross domestic product is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

Risk assets are generally described as any financial security or instrument, such as equities, high-yield bonds, and other financial products that carry risk and are likely to fluctuate in price.

All investing involves risk, including the risk of loss

Past performance cannot guarantee future results. Diversification does not guarantee a profit or eliminate the risk of loss.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

Stock and other equity securities' values fluctuate in response to activities specific to the company as well as general market, economic and political conditions.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate.

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