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2020 MARKET OUTLOOK

AN INTERVIEW WITH OOI BOON PENG

Ooi Boon Peng, Head of Investment Fund Strategies at Eastspring Investments, Singapore, shares why recession fears are not warranted and where the key opportunities are for investors in the new year.

1 What is your outlook for the global economy for 2020?

I continue to believe that we are in an extended global growth cycle, and the US will enjoy its longest post-war expansion. That said, the IMF's projection of global growth strengthening from 3.0% in 2019 to 3.4% in 2020 appears a bit optimistic.

Without significant new fiscal stimulus and given the overhang from the upcoming US Presidential Election, US growth will likely slow towards trend levels of about 1.8% in 2020. The IMF is counting on Latin America and the other emerging economies to produce a stronger global GDP print. Note, however, the US, China, Japan and the Eurozone are slowing. China's growth rate is decelerating despite the fiscal and monetary measures undertaken. Fixed asset investments which historically have been a key contributor to China's growth has not rebounded meaningfully. Without a reacceleration in the major large economies, global growth would range between 3-3.2% and may even dip below 3%.

2 Are recession fears warranted?

The Global Financial Crisis (GFC) and the significant reforms (e.g. Dodd-Frank Act) to date had ensured that the US and European economies grow without significant increases in leverage. Household and corporate debt in aggregate is under control in the developed markets and there is no risk of an asset bubble bursting which would cause the onset of a recession. While the marked global growth slowdown in 2019 raised recession fears among many investors as we move into 2020, I am, however, less concerned. The very presence of such worries makes a recession unlikely. A sharp downshift of the economy into a recession generally occurs in the presence of excesses (such as high debt levels or overvalued stock markets) and complacency. This is currently not the case as confidence amongst investors and corporate leaders has been eroded by the uncertain economic and political backdrop.

That said, the risk of recession is not immaterial. Further escalation in trade tensions and growing protectionism in the current climate of marked economic slowing can still push the world into a deeper downturn. With 2020 being an election year in the US, President Trump is likely to act to ensure a steady economy and a strong stock market. Some form of a US-China trade deal by early 2020 will help achieve these goals and allow him to focus on campaigning. For the year ahead at least, investors and corporate CEOs can rest more easily.

3 What will be the key drivers for the global economy?

Consumer spending will continue to support the US and global economies. Consumption is being underpinned by significant job creation since the end of GFC. The International Labour Organisation reported that the world's unemployment rate has dropped to 5% as at end-2018, the lowest level since the GFC. In the US, we are seeing low unemployment rates (3.6% as at Oct 2019), steady wage growth (circa 3%) and stable household debt levels. US home prices have also appreciated over the years, albeit slowing from the highs of over 6% in early 2018 to +2% in Aug 2019. This explains why US consumer confidence held up relatively well even at the peak of US-China trade hostilities. At the point of writing, many political watchers are expecting a mini US-China trade deal by Dec 2019, with both sides conceding some ground. Stock markets had gained ground on the back of these expectations in October/November which bodes well for US consumption in 2020. Given that consumer spending makes up almost 70% of US GDP, recessions in the US must necessarily be a result of a sharp downturn in consumer spending.

Policy uncertainties, on the other hand, will likely to continue to weigh on corporate spending. Surveys of corporate sentiment similar to those conducted by the US National Federation of Independent Business show that companies generally shy away from major capex decisions or hiring in an election year because of policy uncertainties. The impeachment proceedings against President Trump, Brexit-related maneuverings and the unfolding of Middle East tensions could add to these uncertainties.
In addition, even with a mini US-China trade deal, a comprehensive and long-lasting resolution would be challenging given the structural nature of the US-China competition.

4 What about the prospects for monetary and fiscal easing?

In a slow growth environment, where political uncertainty is an overhang, the Federal Reserve (Fed) would ensure that monetary conditions remain accommodative. This is despite Chairman Powell expressing a high hurdle to move rates either way at the Oct 2019 FOMC meeting.
I see the possibility of 1-2 insurance rate cuts of 25 bp in 2020, either driven by negative episodes or by further softening economic momentum.

Obviously, with interest rates near historic lows, and in the negative territory for Europe and Japan, the effectiveness of further monetary easing is questionable. Fiscal policy will have to do more of the heavy lifting.

China has already eased both fiscal and monetary policies over 2018 to 2019. More of such policy actions will yield diminishing results. China's growth could fall below 6% in 2020. Meanwhile, Japan's consumption tax hike from 8% to 10% in Oct 2019 will impact household spending in 2020. However, the stimulus from the 2020 Tokyo Olympics as well as targeted budgetary measures to support spending should help mitigate.

In the US, fiscal stimulus largely from the Tax Cuts & Jobs Act 2017, has waned over 2018 and 2019. The Republicans could move to introduce fresh budgetary measures – already President Trump had declared that he would give "very, very inspirational" tax cuts for the middle class, but these would probably meet with Democrat resistance. Overall, we will likely see limited fiscal expansion in the US. The optics of the US fiscal balance is also not great. The Congressional Budget Office is already projecting a USD 890 billion deficit for the new financial year (Sep 2019 to Sep 2020), which widens the budget deficit to 4.6% of GDP. Introducing any election year giveaways would quite easily push the deficit back above USD1 trillion or 5% of GDP.

Over in the Eurozone where fiscal discipline ranks highly, we may see member countries push for more fiscal measures. This is particularly so in Italy, and even in Germany given its recession-like economy. Any significant pump-priming, however, would be a surprise.

5 Where are the opportunities for investors?

I expect global equity markets to be underpinned by continued earnings growth and major equity indices to see further gains in 2020 on the back of benign inflation and easy monetary conditions. The extent of the gains may however be capped. Equity market valuations (e.g. price-to-earnings ratio) tend to be compressed during periods where there are major political events. This is particularly so for the S&P 500 which is currently trading at a forward price-to-earnings ratio of 18 times, which is on the high side by historical standards.

Within equities, the sweet spot for investors appears to be in large capitalisation stocks in the developed markets where there is relative safety given slower global growth and overhanging political concerns. Emerging Markets are better valued versus Developed Markets. Value stocks in Asia are also very attractively priced and may outperform going forward as investors shy away from growth and momentum-driven stocks whose valuations are stretched. Many investors have been enamoured by the glamorous, faster-growing companies in the technology sector which now appears to be a crowded space.

As for fixed income, G3 government bond markets are likely to stay range bound given the steady to easier policy of the respective central banks. Investment grade credits are also in a sweet spot, supported by accommodative central bank policy and sounder corporate fundamentals. They can potentially give investors more stable incremental returns in a less robust economic climate. While the attractive carry in Asian high yield credit should help to underpin bond returns on the back of supportive liquidity and interest rate conditions, investors should stay selective.

Sources: [1]11 November 2019. Please refer to www.eastspring.com/reference-index-list for more details on the indices.

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