Monthly Newsletter Savings and Investments

Extremely strong stock markets in 2019, what to expect this year?

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Market overview

Despite decelerating world economic growth, slowing manufacturing sector, downward revisions in corporate earnings forecasts, tensions related to Brexit, US-Chinese trade dispute, stock markets were extremely strong in 2019. Tensions in 2019 led central banks to take stimulus actions that resulted in reduced fears in markets. Also by the end of the year trade tensions have reduced and there have been tentative signs that economic data has bottomed. The recession risk also decreased. All of this fueled markets with more optimism. The problem is that the equity market already has discounted a recovery in growth. The question is whether a growth rebound will be a confirmation of the returns of 2019 or whether it will be enough to propel equities even higher. In our view, the latter looks likely. The lack of viable alternatives exists and central bank stimulus will continue to filter in over 2020. As a combination of this and the still strong domestic US economy, we expect accelerating growth over the first half of 2020. Note that we expect it but have not yet fully seen it. We are a little cautious by the still weak manufacturing sector and the return of negative macro surprises. And there still is a lot of skepticism to the sustainability of the economic cycle and the financial gains of late. With that being said, we remain neutral in risk utilization. Yes, a recovery in growth is our base case scenario but following the multiple driven rally of 2019 we want to actually see it materialize before we allocate into it. With valuations at close to the highest levels since 2002 we require an economic upswing and unfortunately we are not there yet in our view. So for now we stay neutral despite a stronger outlook and fading recession risks.

Stock market indexes' performance (until 31 December 2019)

Region	Index	Currency	Performance							
			2019 Dec	2019 YTD	12 Months	2014	2015	2016	2017	2018
USA	S&P 500	USD	2,9%	28,9%	28,9%	11,4%	-0,7%	9,5%	19,4%	-6,2%
Europe	MSCI EURO	EUR	1,1%	22,0%	22,0%	2,3%	6,1%	1,7%	8,7%	-14,2%
Eastern Europe	MSCI EM Eastern Europe	USD	6,6%	26,9%	26,9%	-40,0%	-8,1%	33,0%	12,9%	-8,3%
Asia	MSCI EM Asia	USD	6,9%	16,6%	16,6%	2,5%	-11,8%	3,8%	40,1%	-17,3%
Latin America	MSCI EM Latin America	USD	9,8%	13,7%	13,7%	-14,8%	-32,9%	27,9%	20,8%	-9,3%

Major events and expectations

Trade conflicts. In our view the main reason behind the slowdown of 2019 was the trade war related uncertainty which hampered investments. And during the last quarter of 2019 two significant political risks were avoided, at least for now. Firstly, US tariffs on China were scheduled to increase on 15 December but a so-called phase one trade deal avoided that outcome and provided a significant relief for equity markets. Secondly, the fact that the US also didn't impose tariffs on European Union auto exports also helped support equities. While the trade war is not fully solved, and while we are sure that it is going to be a source of uncertainty also during 2020, we do think that we have passed the peak in terms of trade related uncertainty. So-called phase 1 of a bilateral trade agreement is set to be signed on 15 January.

Iran-US situation. On the Iran-US situation we are not overly concerned. Normally geopolitical risks in the Middle East creates uncertainty through either fear for higher inflation growth (because of potential oil price increase), or a pure sentiment shock. But given that the FED in our, and their own, view will not hike interest rates during 2020 and given that the US is now an oil exporter we see the risk of higher inflation growth as unlikely. And for the sentiment effect the escalation comes at the same time as we are about to see a signing of the phase 1 trade deal and the Q4 earnings season. Those two events will in our view dominate the Iran related uncertainty. Naturally this is outside of some risk, but for now we are largely looking past it.

Brexit. The risk related to Brexit uncertainty decreased after UK Prime Minister B. Johnson's party has won British parliamentary election in December and secured the mandate to leave the EU by 31 January this year. The UK will enter the transition period and negotiations on a trade deal for the future relationship with EU. The combination of these election implications helped lift UK stocks and British pound over the quarter. However, initial rally after the election result soon faded when it was announced that it would be made law that there would be no extension to the transition period beyond the end of 2020, giving the UK government a very short period of time to agree a free trade deal that avoids a hard Brexit. We see a risk if upcoming negotiations in 2020 turn out to be difficult. The reason is that the new withdrawal deal no longer prevents a hard Brexit if negotiations with EU would fail.

Central banks. Financial markets currently expect the US Federal Reserve (the Fed) to continue with its recent supportive stance, keeping interest rates low with a higher likelihood of further rate cuts as opposed to rate increases. This expectation was reinforced after latest US jobs report for 2019 December. It showed that the economy continued adding jobs with limited wage inflation, which eliminates incentive for the Fed to raise interest rates due to inflationary concerns. Other central banks have also been supportive across major economies via numerous interest rate cuts throughout 2019. We expect this supportive stance to continue in 2020 as economic growth remains sluggish while political risk remains elevated.

Manufacturing and service sectors. The US and Eurozone manufacturing business surveys picked up slightly from September, although they remain weak. The service sector business surveys in the US and Europe also picked up. This pick-up in the service sectors, and the resilience of overall employment to the weakness in manufacturing, has helped restore market confidence that a recession is not imminent.

Q4 earnings season. The Q4 earnings season has started. This earnings season is not expected to change the market's earnings view in any meaningful way. We have seen already that growth was constrained in the first three quarters of the year and 2019 Q4 results are not expected to be any different. For 2019 Q4, total earnings for the largest US companies (S&P 500 index) are expected to be down around -3% from the same period last year on +3.2%. Growth is expected to resume in 2020 and continue the following year, after the modest decline in 2019. However, the way 2020 Q1 and full-year 2020 expectations evolve in the will depend to a large extent on management guidance and commentary as 2019 Q4 results come out

Overall, the power of the stock market rally late in 2019 created a positive momentum that may persist for another while. Continued extremely low interest rates and bond yields led to the acronym TINA (There Is No Alternative), which is considered to be one driver behind the rally. A closely related acronym is FOMO (Fear of Missing Out) – few investors want to be left with low-yielding bonds in their portfolios as the stock market continues to rise.

Towards year-end there were also positive signs from the economic and political scene: a stabilization in macroeconomic statistics, progress towards a phase 1 agreement in the US-Chinese trade dispute and greater clarity on the Brexit issue. Provided that these developments persist, which is our main scenario at the moment, there are many indications that stock markets may continue upward for another while.

But there is no shortage of threats to this positive scenario. Today's stock market valuations are high in a historical perspective. Meanwhile the subdued economic growth outlook suggests that corporate earnings will show only modest increases and that they risk coming in below the expectations of market analysts. This will become especially clear if the macroeconomic stabilization that we foresee does not materialize.

Since most investors already assume that corporate earnings may end up below analysts' forecasts, and considering the lack of alternatives to equities, this stock market year may also begin on an optimistic note. Economic developments will then determine the stock market mood during 2020, probably seasoned with political surprises that can move the markets, especially in the short term. We anticipate plenty of fluctuations, and we expect returns to be below those of 2019, though slightly positive.

Glossary

Terms used	Explanation
Fiscal policy	Fiscal policy relates to government spending and tax collection. Fiscal policy refers to the use of the government budget to influence economic activity. For example, when economic growth is slowing down, the government can step in and increase its spending to stimulate demand and economic growth. Or it can lower taxes to increase disposable income for people and businesses.
Gross Domestic Product (GDP)	The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.
Monetary policy	Monetary policy is the process by which the monetary authority (usually the central bank) of a country controls the supply of money (the size and rate of growth of the money supply), for the purpose of promoting economic growth and stability. For example, if the money supply grows too fast, the rate of inflation will increase and the economy will "overheat". If the growth of the money supply is slowed too much, then economic growth may also slow. The main tools to control money supply include open market operations (buying or selling assets), changing interest rates and changing reserve requirements for commercial banks.

Purchasing managers' indexes (PMIs)	An indicator of the economic health of the manufacturing sector. The PMI indexes are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A PMI of more than 50 represents expansion of the manufacturing sector, compared to the previous month. A reading under 50 represents a contraction, while a reading at 50 indicates no change.
Yield	The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.