Omnis Investment Outlook 2019

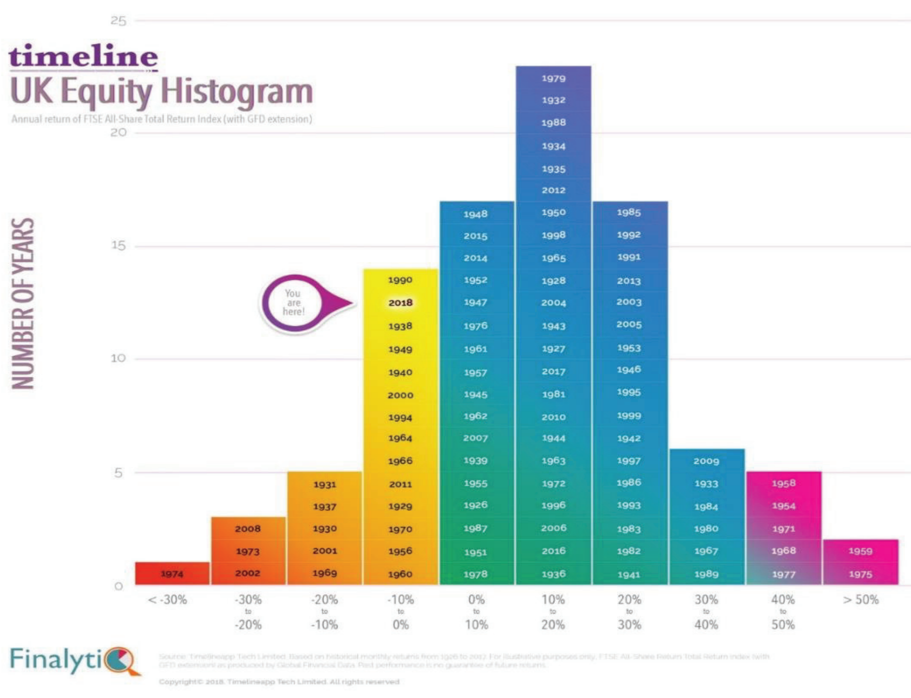
For the best part of ten years, we've enjoyed a period of steady growth across global markets. Fuelled by the sustained efforts of central banks through measures such as quantitative easing (QE) and historically low interest rates to boost the global economy in the wake of the 2007-08 financial crisis, we've enjoyed a period of sustained economic growth and comparatively low market volatility.

But 2018, and so far this year, has seen markets "wake up" to increased uncertainty on some key political and economic events that will continue to play out over the coming months. Arguably amongst the most significant of these are the US-China 'trade tensions', a change of course by central banks to reverse their economic support measures following the financial crisis of a decade ago, and closer to home, Brexit.

This uncertainty has hit market sentiment and company earnings expectations. These revised earnings expectations now broadly reflect our own views for 2019; a global economy where growth is subdued but acceptable, and an environment where market volatility is likely to remain elevated.

So, against the backdrop of most major stock market indices experiencing a negative return in 2018, its natural that this can be unsettling for those investing for their future or relying on investments for income now. But, when you consider how markets perform over the longer-term it becomes clear that the increased volatility we're experiencing is not unusual. Taking the UK equity market as an example, looking back over almost a hundred years to 1926, the market ended with a negative return in around one in four calendar years. (This is also broadly true for US and global stock markets.)

Most of these 23 years of negative return saw the equity market falling by no more than 20%. There were a few years where there were losses of more than this but, importantly, there were far more years with gains of more than 20% a year. So, the odds of an exceptionally good return are far higher than the odds of an exceptionally poor return in any one year.



So, with this historical context in mind, let's look at how we see each of the key investment markets performing in 2019.

US

The tax cuts that provided a sugar rush in 2018 will begin to fade, slowing US growth closer to its long-term average by the end of the year. Originally, the tax cuts provided a significant boost to business investment, however, many businesses are now pausing further investment as geopolitical uncertainty intensifies. The US has always been a driving force in the global economy, but with business investment slowing, growth and productivity could struggle. With weaker oil prices of late, wage growth unlikely to rise drastically, and global demand for other commodities to be somewhat softer in 2019, US inflation is expected to remain subdued. Consequently, the Federal Reserve (the US central bank commonly referred to as “the Fed”) will likely pause interest rate rises over the coming months and possibly slow the pace at which it unwinds QE, known as quantitative tightening (QT). This change in attitude from the Fed will be welcomed by investors who fear that higher interest rates and QT could force a faster slowdown in US economic activity. We would be surprised if the Fed hiked interest rates more than twice in 2019.

Having lost control of the House of Representatives in November, the Trump administration will likely face continued gridlock in Congress (as evidenced by the long-lasting government shutdown at the start of the year). Despite this split there is still the possibility of minor additional government spending in 2019 in the form of infrastructure investment - mainly because both parties would be in favour.

The reorganisation in Congress did not stop Trump in his other “America First” ambitions, as he continues to play to his base in the runup to the 2020 Presidential elections. Trump continues to threaten China with an increase in US tariffs to 25% on a full range of Chinese goods if a trade agreement cannot be made. Ultimately, we believe that some trade concessions will be reached between the US and China in the nearer term, however the two sides may struggle to make progress on more entrenched economic issues over the longer term.

ASIA & EMERGING MARKETS

In addition to trying to solve the impasse with the US, China is grappling with a slowing domestic economy. A fine balance to strike in 2019 will be stimulating their economy to prevent it from slowing down too sharply, whilst sticking to a programme of reform and reigning in unsustainable levels of debt. We expect the government to inject liquidity (cash) into the banking system to encourage lending, but not to the same extent as we have seen in previous years. An increase in government spending from China could bode well for Emerging Markets and the Asia Pacific region, where the strength of the Chinese economy will continue to drive performance.

UK

Brexit continues, and will continue, to dominate the prospects for the UK economy and UK asset prices. We continue to expect a soft Brexit, either by parliament eventually voting through Prime Minister May’s deal in some form or with a postponement of the exit date – a second referendum remains a possibility – rather than a hard Brexit. Heightening volatility, especially for sterling, is likely to continue. Assuming our base case for a softer Brexit, the Bank of England could start raising interest rates sooner than expected, which would negatively affect bond yields. We view UK bonds, in particular government bonds (gilts), as unattractively valued. Currently, the market predicts less than a 50% chance of a single interest rate hike in 2019. The uncertainty surrounding Brexit has weighed on domestic share prices, and they now appear attractively valued.

EUROPE

Aside from Brexit, there remain significant challenges for the European authorities in 2019. A battle between centrist and populist politicians looks to be the biggest threat to the EU. Many Eurosceptic supporters could conform to influence the European elections in May. If lacklustre growth and political uncertainty arises, the European Central Bank (ECB) may struggle to raise interest rates in line with its forecasts. Consequently, negative interest rates will continue to limit the options available to the ECB if faced with a downturn. Expectations in Europe have been persistently lowered – leaving room for upside surprises if corporate earnings and economic growth come through stronger. We view equity valuations as cheap relative to the US, reflecting the region's poorer economic prospects. Most bond valuations remain unattractive.

JAPAN

Japan is one of the few regions where the central bank is keeping interest rates low and continuing with quantitative easing. We expect inflation to remain low, which will alleviate any pressures to change course. October 2019 will see Japan's consumption tax increase from 8% to 10%. A previous increase, from 5% to 8% in April 2014, resulted in an immediate decline in Japan's economy. This time around we expect the government to provide more significant short-term measures to mitigate against a repeat scenario.

CONCLUSION

We expect global growth to moderate in 2019. If the current economic cycle is to extend significantly further, increased business investment and productivity gains will be required. Corporate earnings growth will slow this year, but valuations are such that we see room for equities to rise. With unemployment continuing to fall, and wage growth rising, the backdrop for many fixed income assets is likely to be a challenging one. Uncertainty and volatility are expected to remain elevated as the world deals with political developments such as trade relations, Brexit and populism.

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