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2020 vision, or is it?

BY SAMIK MUKHERJEE
DIRECTOR, KEYSTONE CAPITAL

As a wealth advisory boutique, we primarily offer our clients advice on structuring their wealth efficiently and diversifying their investments to ensure that they remain on track to deliver their long-term objectives and minimise any shocks along the way. At the time of writing this article (mid-January 2020), the question we get asked most by our clients is our outlook for the New Year. Whilst they are keen to hear our opinion on a range of asset classes and geopolitical matters, including views on any impending tax reforms that might have an impact on their planning, the topic that is most interesting to the majority is our macro-economic view and the outlook for the stock markets this year, so have we got a 2020 vision?

2019 proved an eventful year for geopolitics and consequently financial markets experienced wide swings in sentiment from one moment to the next, but as we know it ended on a real high: progress in US-China trade discussions and a conclusive result from a December general election in the UK helped cement investor confidence and set off a 'Santa Rally' resulting in stock markets across the globe posting some of the best returns in recent times. Final scores on the door (in sterling terms): US markets up 26.4%, UK up 19.2%, Europe up 27.2%, Emerging Markets up 14.6%.

OIL

That starting point means 2020 has an extremely tough act to follow. Many of the uncertainties still remain. For most of us recovering from the festivities and still working on our New Year's resolutions, a stark reminder of how swiftly sentiment can change came as news of US air strikes in Iraq broke in the early days of the new decade. Crude prices spiked in the aftermath but thankfully this was short lived. De-escalation of tensions was anything but certain. The market seems to have taken this and the earlier drone attacks in Saudi Arabia last year in its stride. Rightly or wrongly, the fear of disruption to oil supplies from the Gulf no longer have the kind of impact it would have done a decade ago in the wake of rising US shale production. In fact, the US has become a net exporter of oil and gas for the first time in 70 years and is forecast to remain so until 2050. This has profound implications both on energy prices and the US foreign policy for the Middle East, but this additional supply of energy is also very supportive of economic growth.

CENTRAL BANKS

Despite the continuing uncertainty around US-China trade relations, the eventual outcome of Brexit negotiations, tensions in the Middle East, as yet unresolved situation with North Korea, China projecting its dominance in the South China Seas and other regional issues I have not listed, most asset managers we closely work with remain cautiously optimistic about the outlook for 2020. And there is good reason for this. All global leading indicators seems to suggest major economies will manage to dodge a recession in 2020. Monetary policy continues to remain supportive of stock markets. With interest rates at historic lows and in fact negative yields in many countries, the real question is if Central Banks are beginning to run out of firepower to provide further stimulus if and when it is needed. Is it time for them to start looking into more expansive fiscal policies? Certainly, any further loosening of the purse strings in some European countries like Germany would have a significant positive impact on the economy of Europe and therefore European equities. Will they give in? UK stock markets have been shunned by global investors through most of 2019 and have not kept pace with other developed markets, with more clarity on the direction of travel with regards to exit from the European Union we could well see UK equities in 2020 outpace their global counterparts.

ECONOMIC CYCLE

One thing to keep a close eye on is valuations. While share prices have been rising, earnings forecasts for companies have not matched these proportionately. This means equities have become more highly valued over the course of the year. This in itself is not a cause for concern as equities are still trading at around their ten-year rolling average forward price-earnings ratio. Valuations are much less stretched than they were say during the dot com crisis. But should corporate earnings start to deteriorate, and other leading economic indicators start showing signs of a slowdown then this position needs to be carefully reviewed.

	Forward P/E	10-yr Avg.
S&P 500	17.5x	15.1x
S&P Small Cap 600	18.5x	18.0x
S&P/TSX Comp	14.8x	14.7x
STOXX Europe 600	14.6x	13.2x
FTSE All-Share	12.9x	12.7x
Hang Seng	10.3x	11.1x
Shanghai Comp	10.7x	11.4x
TOPIX	13.7x	13.6x

Source: Bloomberg

Another year of growth would take the current economic expansion to an unprecedented length. It is important to remember though that this has been a shallower expansion than previous ones and expansions do not die of old age. Economic cycles usually come to an end as a result of overheating and there seems little sign of excess in the economy

US ELECTIONS

2020 is also an important year for US markets as it is election year. Earlier this week Goldman Sachs carried out a survey of its clients and found that the vast majority, 87% to be precise, expected President Donald Trump, who was recently impeached by the House of Representatives and now faces a trial in the Senate, to win a second term in office. Goldman's clients can hardly be considered a true representation of wider American voting public, the odds are not quite so strong at the bookies. Without knowing which democratic candidate will take Trump on, it is hard to make predictions in what is bound to be the most polarizing elections the US has ever seen. Americans traditionally have a habit of voting for the incumbent as long as the economy is ticking along, providing motivation for Trump to keep it propped up at all costs. Should it not play out as per current consensus and a new president is successful in rolling back Trump's tax cuts, subsequent corporate earnings could see a dip putting further pressure on US share prices.

SUSTAINABILITY

The theme that has emerged unquestionably as a frontrunner for asset managers and boardroom executives alike is climate change and sustainability. The extinction rebellion supported by personalities like Sir David Attenborough and Greta Thunberg put climate change in the spotlight. Judging by the increasing number of companies that are now talking sustainability in the same breath as profitability, the movement can already claim some successes. The recent decision by BlackRock, the world's biggest asset manager, to exit investments that "present a high sustainability-related risk" and tech giant Microsoft firstly, to become carbon negative by the year 2030 and secondly, to have removed more carbon by 2050 than it has emitted in its entire history, are early signs of asset managers and companies taking positive actions that do not have one eye on short term profitability. The mood has definitely shifted, and the next generation of consumers are acutely conscious of the impact the choices they make have on the planet. It is not surprising then that the asset managers we closely work with have all invested considerable time and effort in researching and separating companies that simply pay lip service to this important issue from those that are making a positive impact. ESG investments (Environment, Social and Governance) will be on the rise this decade and indeed ESG investments in many pockets are beginning to produce better investment performance than the market in general.

In conclusion, we remain cautiously optimistic that the major economies will largely avoid a recession in 2020 and post modest growth figures which will feed through to the stock & credit markets. It would be foolhardy though to predict a repeat of 2019. Another theme we may well see gathering momentum this year is investors recycling out of 'growth' stocks to relatively cheap 'value' stocks in companies whose fortunes are often tied to economic cycles. We always remind our clients of two key principles when it comes to investing, firstly diversification is the key to not being wrong footed but even more importantly, time is an investor's best friend.

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