Market View

Update from 21.01.2020

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- Global synchronized monetary easing, fiscal stimulus mainly in the US and China, continuous growth in services and consumption, anticipated “First Phase Trade US China Deal” and prospects of orderly BREXIT after clear majority for Conservative Party in UK elections have stabilized the global economy and delivered exceptionally strong returns for investors in 2019. Turnaround in global leading indicators, manufacturing PMI and even stabilization in international trade point to recovery in global business cycle in 2020. In particular, export-oriented regions such as Europe and Asia are set to benefit the most from global recovery in industrial cycle. However, we expect only moderate global recovery because most output gaps are already closed with very low unemployment rates, especially in the US.
- In our view the US president Donald Trump will restrain from significant trade escalations in 2020 in order to maximize his chances for the re-election. For this reason, we also don’t expect a full-scale war with Iran in 2020. In addition, the U.S. as the largest oil producer in 2019 (19.4% of the world production), can mitigate any large increase in oil prices. Furthermore, independent from the outcome of US elections on November 3rd, we don’t expect the more radical policies been enacted into legislation because of most likely missing control of both the House of Representatives and the Senate.
- As a conclusion, we estimate the probability of a recession in 2020 as very low for the following reasons, strong financial position of households and businesses across most advanced economies with high savings rates and wage growth, high liquidity and very loose financial conditions with central banks on hold due to well anchored low inflation expectations. In addition, global leading indicators and manufacturing PMIs are pointing to a recovery in global industrial cycle. Finally, the absence of exaggerated economic and financial imbalances is another sign of low recession probability over the next 12 months.

- **Watch:**
  - US-China and UK-EU trade negotiations
  - High risk of real estate bubbles in Canada, Sweden, Australia and Hong Kong
  - Inflation signs in US, Germany and other countries from recovery in wage growth
  - Oil price developments especially related to geopolitical risks in Iran, Libya and Venezuela
  - Continuation of America First policy and new trade dispute with European Union
  - Corporate debt overhang and securitization in wealth management products in China

- Yield curve has much lower predictive power today than in the past due to QE influence on long-term interest rates. On average, it took 22 months from curve inversion to recession.
- Focus on companies with relative stable earnings und low leverage is a key at the current late stage of the cycle.
- For 2020 we expect moderate global economic recovery with slightly increasing yields for long-term fixed assets and positive returns from equities, especially in Europe and Emerging Markets.

- **End of 2020 key economic forecast by Linvo:**
  - USD/CHF - 0.94
  - EUR/USD - 1.17
  - USD/JPY - 103
  - GBP/USD - 1.35
  - XAU/USD - 1550 USD
  - WTI - 65 USD
  - US 10y T - 2.0%

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GO positive, buy/increase CAUTION neutral, monitor closely STOP negative, sell/reduce position

Market View	USA	EUROPE	CHINA	Emerging Markets
Macro CAUTION	The US economic growth is set to moderate further to 1.8% in 2020 from 2.3% in 2019, due to closed output gap and fading fiscal stimulus. Improving manufacturing sector with 52.4 PMI in December, supportive financial conditions from Fed on hold, low unemployment and strong wage growth together with very prudent household debt levels continue to support the consumption and housing market.	Eurozone growth is expected to stabilize at 1% due to continuous strength of consumers with low unemployment, solid wage growth and low inflation, remaining extraordinary loose financial conditions. In addition, Europe is set to benefit from recovery in global industrial cycle and exports following accelerating growth in Asia from China credit impulse. Government debt especially in Italy, Portugal and Greece is very high but manageable for now due to very low interest rates and long maturities. Negative interest rates and slow growth will encourage countries like Germany to provide some fiscal stimulus.	Government monetary and fiscal stimulus helped manufacturing (Dez. PMI 51.5) to recover at the end of 2019. Continuous credit impulse, strong consumption, first phase US-China trade deal and recovery in global business cycle and trade will keep China growing at around 6% in 2020. If needed, government still has enough room for additional stimulus. The risks from corporate debt overhang are under control for now.	Emerging markets are benefiting from recovery in global business cycle, first phase US-China trade deal, eased global financial conditions, expected US dollar softening and long-term higher structural growth drivers. Especially, countries that disappointed in 2019 like Brazil, Mexico, India, South Africa and Turkey are expected to gain more growth momentum in 2020.
Equities CAUTION	The US equity market is very expensive by looking at historical averages for forward and Shiller P/E, and shows signs of exuberance. First Phase US China Trade Deal, low long-term interest rates, share buybacks, return of retail investors and global recovery are already priced in. Because of very high investors' expectations and valuation, election uncertainties, expectations of some steepening of the yield curve and compression of corporate profits from higher labour costs, we expect more volatility and only moderate returns in 2020. Onl[illegible]h care, energy and financials are not overval[illegible]ive to historical averages. STOP	European equity market is currently fairly valued by looking at historical averages for forward, Shiller P/E and P/B ratios. Expected solid growth in earnings and abundant liquidity plus acceleration in share buybacks will support European equity market in 2020. In addition, lower valuations relative to the US equity market together with prospects of softer USD may encourage further inflows from abroad. Communication Services, Energy and Financials are most undervalued relative to the history and offer very attractive dividend yields. GO	The valuations in China are currently attractive and will benefit from stabilization in China over the short-term as well as from structural consumption growth. However, the Chinese equity market is very cyclical and exposed to strong imbalances in corporate debt. Therefore, we prefer mainly Chinese technology and consumer-oriented companies with low leverage. CAUTION	Emerging Market equity markets are still undervalued in comparison to the long-term average P/B and forward P/E ratios and offer higher earnings growth than developed markets in 2020. In addition, EM tend to outperform advanced markets during the recovery of the global business cycle. We prefer especially technology and consumer-oriented companies, that benefit from fast growing middle class. GO
Bonds CAUTION	As a result of global search for yield, yields and credit spreads have decreased to historical lows. With expectation of some steepening of the yield curve to the level of positive real yields, we prefer very selective high-yield bonds only with attractive risk return reward and medium-term maturity. US IG bonds are very unattractive with historically tight spread to the US treasuries and very high net leverage together with very low interest coverage. Especially BBB-bonds carry high risk of fire sale from downgrade in case of recession, because [illegible] share of BBB-bonds in IG universe has increase[illegible] 35% in 2008 to 50% in 2019. CAUTION	Due to very loose ECB monetary policy, the Eurozone bonds don't offer any risk premium. STOP	Bond yields in China are currently attractive but require very careful selection due to very high corporate leverage and governance issues. CAUTION	Sovereign and corporate EM bonds both in hard and in local currency offer currently more attractive risk return reward than fixed income from advanced economies. Government and corporate debt levels remain low in the most EM. In addition, EM currencies are more than one standard deviation cheaper relative to USD and are expected to strengthen in 2020. On duration, EM still have room for more monetary policy easing in 2020. Especially sovereign and corporate bonds from India, Indonesia, South Africa, Mexico, C[illegible]mbia and Middle East offer attractive spreads[illegible]ir 3-year range. GO

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