Fullerton Investment Views

Risk Assets to Stay Buoyant in 2020

1st Quarter 2020

Key Takeaways

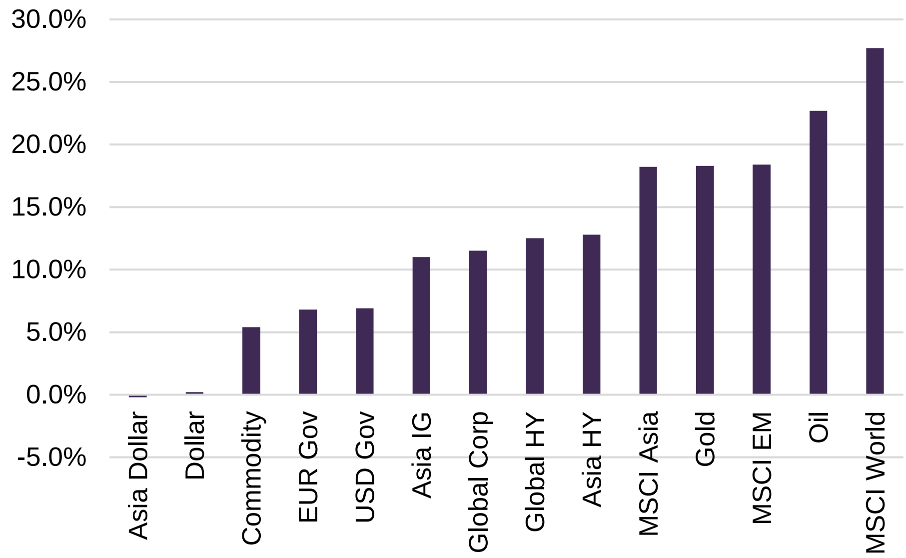
- We believe risk assets can remain buoyant in 2020, against a backdrop of stabilising global growth, as US-China trade tensions de-escalate.
- The lagged effects from global central bank easing will continue to support liquidity, growth and risk assets, even in the event of lesser rate cuts in 2020.
- Key risks to our positive outlook include rising geopolitical tensions in the Middle East, and weakening global growth, resulting from depressed manufacturing and trade.
- Asia's equity earnings should continue to improve in 2020. IT and Financials sectors are expected to lead the outperformance. 2020 is likely to be a key inflection point for Technology sector, with the roll out of 5G.
- In the Asian local currency bonds space, India and Indonesia remain markets where real yields are attractive relative to history and curves are steep. Asian corporate credit spreads can narrow further as growth stabilises and earnings improve.

Risk Assets Performed Strongly in 2019, Despite Weaker Growth

2019's global GDP growth, estimated at 3%yoy by the Bloomberg Consensus, was the weakest since the Global Financial Crisis (GFC) of 2008-09. The global economy is suffering a manufacturing slump where global trade, PMIs, and industrial production growth are very weak. Key economies driving the 2019 slowdown were Europe, the US, India and China. ASEAN countries have also suffered, with weak demand from Europe, China, and Japan, coupled with uncertainties from the US-China trade war.

Despite very weak manufacturing, global recession risk has remained low because performance across the services sector has held up, with robust employment and wage growth supporting consumption. In addition, given low inflation, policymakers, especially across Developed Markets (DM), have become much more dovish with significant monetary policy support. Households and firms continue to draw significant benefit from low debt servicing costs, keeping financial imbalances contained. While global growth last year was the weakest in more than a decade, risk asset returns have been stellar.

Risk assets register double digit returns in 2019



Source: Fullerton, Bloomberg, as at end Dec 2019

We believe that risk assets can remain buoyant in 2020. Firstly, there are signs in the latest indicators that global growth is stabilising. While equities have 'priced-in' some of that we believe it is still early in this phase with more gains to come. Secondly, the lagged impacts of monetary policy actions from last year continue to flow-through. As a result, liquidity growth is very strong and this will remain a key driver of higher risk asset returns. Thirdly, market positioning data is defensive. Recession fears have abated but investors are not fully committed to the prospect that global growth is stabilising and the worst of the weakness has passed.

Asia's Equity Earnings Should Continue to Improve

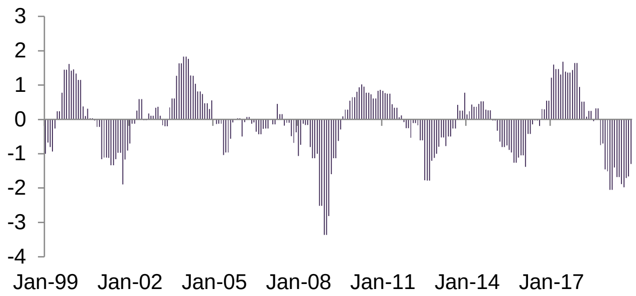
The latest indicators for 2020 suggest that global growth is stabilising as US-China trade tensions de-escalate. The US capital-investment cycle is showing signs of recovery and global capex indicators are bottoming. Across Asia, leading indicators of export demand have improved and as a result very weak trade growth should stabilise and eventually rebound. Given this backdrop, Asia's equity earnings performance should continue to improve. The Technology and Financials sector are likely to continue to lead performance and 2020 is likely to be a key inflection point for Technology sector performance with the roll out of 5G.

Global Liquidity and Central Bank Easing Provide Support for Risk Assets

The surge in global liquidity growth since last year has been driven mostly by DM central banks – the Federal Reserve (Fed) has eased significantly and the European Central Bank (ECB) and the Bank of Japan (BOJ) have become more dovish on their respective balance sheet expansions. After 75bps of mid-cycle 'insurance' interest rate cuts in the US, the Fed is likely to remain on hold in 2020 unless US inflation and growth have another leg down. Across Asia, monetary policy is likely to remain supportive, especially across India, Indonesia, China, and the Philippines. China has already shown a willingness to step-up its liquidity provision but the authorities are also conscious of balancing support for economic activity with the need to contain any possible risks across the domestic financial system.

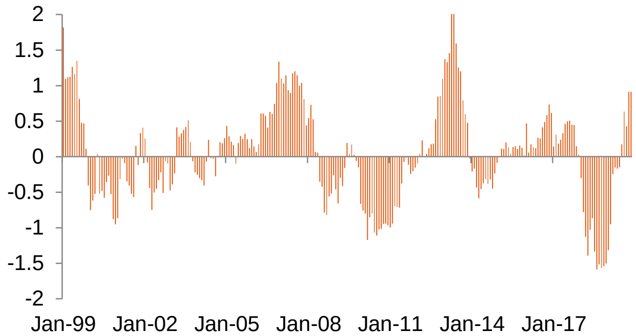
It is worth noting that the lagged effects from global central bank easing will continue to support liquidity, growth and risk asset performance, even if there are lesser interest rate cuts in 2020.

Global growth indicator showing further signs of stabilisation



Source: Fullerton, Bloomberg, Dec 2019. Please refer to the disclaimer on the use of internal methodology.

Liquidity growth should continue to support risk assets



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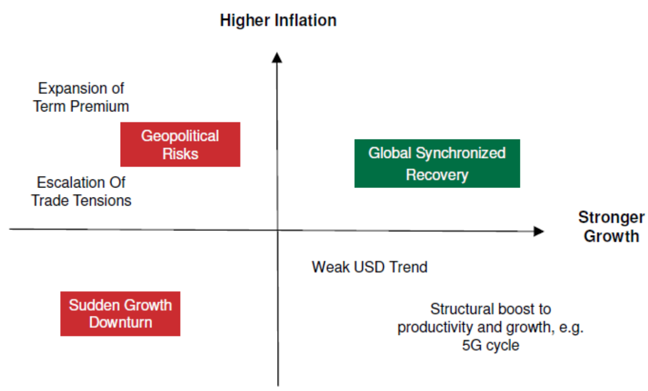
Upside and Downside Risks to our Positive Outlook



Source: Fullerton, Dec 2019

Trade tensions fall but other geopolitical risks remain

Investor sentiment has improved as trade uncertainties have eased with the US and China finalising a 'Phase One' agreement this month on the trade war. This Phase One deal is most likely to result in China buying more US goods in exchange for the US suspending any further tariff hikes. Any further positive outcomes from the US-China trade deal in 2020 remain difficult to predict as President Trump is likely to focus more on supporting the US economy and getting re-elected, while China will remain sensitive to negotiating intellectual-property and technology transfer issues. But even just the absence of new tariff increases will help to restore stronger global trade growth this year.

Looking longer-term, beyond the January 2020 Phase One trade deal, it remains unlikely that the US and China will completely resolve their differences. We have entered an era where globalisation may take a step down as the US pursues more unilateral policies. There are similar forces at play across Europe as the UK's strong Conservative Party victory has set the stage for a smoother Brexit.

While US-China trade tensions have eased, other adverse geopolitical events have disrupted financial markets and pose significant downside risks to our positive outlook on risk assets. For example, a sustained military conflict in the Middle-East would cause oil prices to spike well beyond current levels and cause global equities to fall significantly (with bonds and safe haven currencies rallying). Another downside risk to our positive outlook is that global growth does not stabilise, and instead has another leg down this year, as employment growth and household consumption fall under the weight of depressed manufacturing and trade.

New Environment Supportive for Risk Assets but Distorts Valuation

With the strong rallies we have seen last year, some traditional valuation metrics are stretched – especially for equities. However, we believe it is premature to conclude prices are moving toward bubbly territory given such low real interest rates globally. The global economy seems to have moved into a low inflation and low interest rate regime which is more bullish for investors and valuations typically judged as excessive can remain higher for longer. There is room for further rotation in risk assets from bonds back into equities. With lower neutral real interest rates, this new environment may also mean that when the next growth downturn hits, monetary policy ammunition will be much less effective. That is why some economies are already signalling a policy rotation toward fiscal stimulus, for example:

- Japan launched more fiscal stimulus in December last year;
- South Korea and the Philippines also announced new government spending packages in Q319 and Q419;
- The ECB highlighted the importance of fiscal policy in helping support growth at its Q3 meeting;
- With the US presidential election happening this year, we may see more government spending;
- China's policymakers have also emphasised before that if growth is weaker than expected, then fiscal policy could be used to help support domestic demand and infrastructure.

In Fixed Income, we remain cautious on DM government bond duration as yields are very low and if GDP growth is stabilising then a turning point may be reached this year where downward pressures fade. For Asian local bonds, we still expect central banks to remain dovish but with rate cuts front-loaded, there is likely less easing impetus this year. There have been more upward pressures on headline CPI inflation, especially in China and India, exacerbated by the jump in oil prices. However, core inflation remains well contained. As a result, Asian central banks may not hike rates any time soon but they will be more cautious on how much more easing they undertake (especially if higher oil prices are sustained). India and Indonesia remain markets where real yields are attractive relative to history and curves are steep.

Asian corporate credit is attractive as growth stabilises, and as earnings improve, spreads can narrow further. Gold is likely to stay supported with low real interest rates, a greater incidence of adverse geopolitical shocks, and the prospect of a weaker USD.