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INVESTMENT MANAGERS

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Pulse

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IN SHORT

- Data has remained relatively solid ahead of the coronavirus's expected impact
- Accommodative central banks and better than expected earnings releases have continued to fuel equity markets, with some added volatility due to the outbreak
- We expect risk assets to grind higher over the medium and we maintain our exposure

Macroeconomic overview

- Recent macro data has been somewhat mixed – **stronger than expected in the US, weaker in the Eurozone and disappointing in Japan**. But, although disruptions from the coronavirus outbreak are likely to impact incoming data, particularly in Asia, we believe that the global backdrop remains supportive. US consumer sentiment has improved, the labor market added 225k new jobs in January and the ISM manufacturing PMI for January jumped back into expansionary territory. Japan's GDP shrank an annualized 6.3% following the VAT hike, and could see a technical recession as the impact of the outbreak poses an added risk to the economy. Growth in the Eurozone remains sluggish as the Area grew 0.1% in the fourth quarter – the slowest pace since the crisis seven years ago. Germany's economic sentiment dropped sharply due to expected consequences of the outbreak on exporters. Factory orders and manufacturing production were also weaker in both Germany and France, which might only be exacerbated by the outbreak and slower Chinese growth.
- The recent **coronavirus outbreak** is likely to have a significant impact on Q1 Chinese data. In an effort to cushion the blow, China has halved tariffs on USD75 billion of US goods, the People's Bank of China cut by 10bps its reverse repos rates as well as its medium-term lending facility rate and injected liquidity – and more stimulus is expected.
- **German domestic politics** got messier as Merkel's chose successor, Annegret Kramp-Karrenbauer, announced she was stepping down from the CDU flowing a regional alliance with far-right anti-immigration AfD party. While early elections are not expected, questions are likely to continue to surround Merkel's succession plan in the coming months. This could also limit the potential for fiscal support, though slightly more expansionary policies are expected.
- The beginning of **negotiations between the UK and the EU** are off to a rocky start as the UK is showing signs of wanting a 'harder' Brexit than hoped by the Europeans. We expect tensions to remain over the coming months, but believe the worst case no deal will be averted. The change in the Chancellor in the UK suggests fiscal stimulus will be announced at the 11 March budget to help support a fragile UK economy.
- **Italian regional elections** resulted in a blow for Mr. Salvini, who did much worse than expected, suggesting the fragile coalition can continue to hold for some time. This lead to a strong rally in equities and Italian government bonds.
- The **US dollar** is up more than 2.5% in the first six weeks of 2020, benefiting from safe haven demand, better growth and high demand for US Treasuries. We believe that recent strength is likely to continue as concerns surrounding the outbreak's effects persist.

(Continued on page 2)

Market outlook

- **Equity markets have continued to advance** despite the coronavirus outbreak, helped by stronger than expected earnings and abundant liquidity. Major central banks stand ready to ease policy further, but we do not expect further rate cuts in 2020. Given this backdrop, we expect equities to continue to advance in 2020, though rich valuations could eventually cap returns.
- **EM equities** have bounced back from their selloff at the beginning of the year, boosted by the Chinese market recovery and they are on track to consolidate their 2019 advance. However, a stronger dollar remains a headwind and idiosyncratic stories suggest selectivity remains key.
- With over 75% of the **Q4 earnings season** completed, profit growth has so far beaten expectations. Earnings have increased 1.2% YoY, prompting analysts to expect robust profit growth from US companies in 2020, despite the potential impact of the coronavirus. We believe that earnings growth can show upside surprises in the coming quarters, helping markets higher.
- **Sovereign yields** remain at very low levels, as concerns about the outbreak's impact on global growth and inflation expectations linger. Indeed, recent flows into bond funds were very large, suggesting investors do not expect price pressures to pick up. US 10-year yields are around 1.55%, Bunds are at -0.4%, and Italian and Greek 10-year yields are both below 1%. We believe yields will take time before drifting higher given still weak growth and low inflation, as well as accommodative central banks. While we believe yields should be somewhat higher in 2020, we maintain some exposure to core segments as protection. We maintain our **preference for credit**, both in the US and Europe, over sovereign debt, as sovereigns remain overvalued.
- **Credit spreads** in the investment grade space have continued to tighten, and, after widening at the beginning of the month, HY spreads have followed. We expect spreads to remain broadly range bound for now, and even absorb some higher yields, and still see little systemic risk. We continue to see opportunities in HY, though the further along we move in the cycle, the more likely we are to see demand for IG rise. We continue to see attractive opportunities in EM hard currency debt, where spreads have continued to tighten as well.
- Without a clear view yet on the effects of the coronavirus outbreak, we expect a **challenging road ahead with higher short-term volatility**, though we continue to expect risk assets to grind higher over time. We nonetheless continue to add absolute return, flexible strategies such as liquid alternatives for diversification.

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