PERSPECTIVES

Staying Nimble Amid an Uncertain Outlook

September 30, 2019

Bouts of volatility hit markets across the globe in the third quarter of 2019 amid continued uncertainties about global growth and trade. Central banks took notice, with the US Federal Reserve easing interest rates for the first time in more than a decade and the European Central Bank also cutting rates and reintroducing quantitative easing. Against this backdrop, our senior investment leaders discuss why they do not see a recession in the near term, but are taking a cautious and nimble approach.

Below are some highlights of their views. For detailed insight from our investment leaders, visit our Global Investment Outlook page.

Discussion topics within:

- Recession: Separating Fact from Fears
- The Consequences of Monetary Policy
- Geopolitical Risks Take Center Stage
- Potential Shocks

Global Macro

Michael Hasenstab, Ph.D.
Chief Investment Officer,
Templeton Global Macro

- If we were to look back 10 years ago, the thought that central banks would be cutting interest rates when wages were going up, when there is record-low unemployment and decent economic growth, would seem pretty unconventional. We just don’t know what some of the results of this policy experiment will be.
- When an economic downturn does eventually come, our question is, what policy tools are left to restart growth? Governments have already spent money and central banks have already lowered interest rates preemptively to react to a potential shock that hasn’t actually materialized, so policymakers are running out of tools.
- We need to consider whether exceptionally low interest rates are artificially pushing investors seeking better yields into riskier assets at higher valuations and perhaps less liquidity. I think it’s certainly prudent to be building a more cautious portfolio, because when we look to the horizon, it’s hard to imagine a period of geopolitical stability coming in the near term at least. We think it’s important for investors to be nimble—that means being actively positioned for greater risks ahead.
- Whether it’s stretched valuations, the lack of policy tools that central banks and ministries of finance have to fight an inevitable downdraft, or less liquidity in markets because people are buying riskier assets, we see these conditions as a mounting pile of dry kindling. We don’t know what the spark will be, but we think it’s time to buy more fire extinguishers.

Multi-Asset Solutions

Edward D. Perks, CFA
Chief Investment Officer,
Franklin Templeton Multi-Asset Solutions

- The big issue right now is trade policy uncertainty. Not just from the standpoint of the impact on the real economy, but maybe more importantly, the question of how the situation could be resolved, or how much more could it escalate. The uncertainty about trade has put a bit of a lid on the outlook for equities.
- I think we should be asking ourselves: "What are the forces that have been holding up market performance?" If uncertainty rises to a degree where corporations really start to pull back on capital expenditures, that could be a self-fulfilling mechanism that does slow growth.
- The one potential shock or variable that I think could have a real impact on financial markets would be a deterioration in consumer sentiment. The consumer has been a bastion of strength in the US and global economy. We continue to see job and wage growth. But could trade-related uncertainty weigh on consumer and business sentiment to a degree that causes big cracks?
- As multi-asset investors, when we look at negative sovereign rates around the world, and very low absolute yields in the broad range of fixed income sectors in the United States, at some point we have to ask where the alternatives are. It's a challenging time for investors.

Fixed Income

Sonal Desai, Ph.D.
Chief Investment Officer,
Franklin Templeton Fixed Income

- I don't see how it can end well when central banks—particularly the US Federal Reserve (Fed)—seem to be guarding against a perceived threat of deflation and effectively keep pushing investors towards riskier, less liquid assets. With record low US unemployment, the Fed seems to be anticipating a deflationary situation that doesn't seem to exist. If we look at wage growth combined with the impact of US-China tariffs, at some stage, we have to actually consider a rise in inflation.
- We continue to see very robust wage growth. So, while we might see an earnings recession playing out if we aren't already, I'm not so sure it's translating near term into a recession in the real economy in the United States.
- There has to be a little expectation management on the part of investors in the sense that we are in a world where fixed income rates are incredibly low, and it's difficult—and unrealistic— to expect to generate the type of returns people have become accustomed to without some risk and volatility.
- Social populism is a worry. There are what I consider to be some scary ideas out there. For example, the idea of modern monetary theory essentially says the central bank should and can keep printing money to finance deficits, and this is supposed to finance universal basic income or anything else. This approach is a really slippery slope, in my view.

Equity

Stephen H. Dover, CFA
Head of Equities

- From the equity point of view, while we see many opportunities globally in markets, we are also quite cautious. I think equities, at this point, are a yield opportunity. The yield on earnings is still much higher than the yield on fixed income.
- Absolute earnings have actually been pretty flat, but earnings per share have grown due to share buybacks, particularly in the United States. At least in the United States, buybacks have really been propelling the market.
- I'm always amazed at businesses' ability to adjust to various environments, but what businesses can't

adjust to is uncertainty. There are a lot of geopolitical risks coming up that could create even more uncertainty. That said, geopolitical risks or changes can also lead to new opportunities. For example, around Brexit and the UK market, there are some companies that have adjusted or will be able to adjust, and should do well regardless of what happens.
- If there are shocks, we believe it will manifest as shortage of market liquidity. That's something to be concerned about.

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