MULTI-ASSET

Global Investment Outlook PODCAST: Coping with a Changing Market Landscape in 2020

December 23, 2019

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Our senior investment leaders have a cautiously optimistic outlook for 2020. They still do not see a global recession looming and believe there are plenty of reasons to remain invested. In our latest "Talking Markets" podcast, Franklin Templeton Fixed Income Group CIO Sonal Desai, Franklin Templeton Multi-Asset Solutions CIO Ed Perks and our Head of Equities Stephen Dover share their outlook.

Some highlights of their views:

- Sonal Desai: I'm not anticipating growth is going to skyrocket in 2020, but on the other hand, I am not seeing indications from a growth perspective that would cause me a great deal of concern.
- Ed Perks: Certainly there are areas around the globe that are more vulnerable, but we would say the global economy is really experiencing more of a slowdown and not something that we think turns into a full blown global economic recession. Unfortunately, however, a lot of the uncertainty that has presented a challenge to markets, whether it be trade policy or geopolitics, is likely to remain with us for quite some time.
- Stephen Dover: When people are looking at risk, I think they have to look both at upside risk and downside risk. Over the last 10 years, not being in the market has been a risk because of the upside opportunities in equities. Going forward, we see a lot of opportunity in foreign markets, including China and some specific emerging markets where changes in trade are favorable.

Transcript

Host/Kristine Hurley: Hello and welcome to Talking Markets: exclusive and unique insights from Franklin Templeton.

I'm your host, Kristine Hurley.

Ahead on this episode: our latest Global Investment Outlook breaks down a changing market landscape in 2020. And while there are a number of uncertainties causing concern, investors also have reason to be optimistic.

Joining us is Stephen Dover, Head of Equities, Ed Perks, Chief Investment Officer, Franklin Templeton Multi-Asset Solutions and Sonal Desai, Chief Investment Officer, Franklin Templeton Fixed Income Group.

Kristine Hurley: Sonal, let's start with you and your thoughts on global growth in 2020?

Sonal Desai: You know, if I think about global growth going into 2020, the thing that I find most remarkable is the quantity of focus on the idea that something dramatic is happening globally on the growth front and the truth of the matter is it isn't. There's no drama in the sense that I'm not anticipating that growth is going to skyrocket in 2020. But on the other hand, I am not seeing indications that would cause me a great deal of concern on the growth perspective. Now if we're talking about markets, that's a slightly different issue, but from a growth perspective, I actually feel there's not very much to see.

So for the US, for example, I could see GDP [gross domestic product] growth anywhere from 2-2.5%, even 2.75% because we're looking at very easy fiscal policy, continued easy monetary policy. If I look instead at Europe, Europe has slowed. Europe has slowed substantially, but I think the key issue here is it has slowed to potential, not below potential. So again, globally, the growth picture does not look remarkable—remarkably bad or remarkably good. It essentially looks at potential.

Kristine Hurley: Ed, what's your level of concern with growth slowing?

Ed Perks: Clearly, we have experienced a slowdown in global economic activity, principally in the manufacturing sector and that's been something that's been relatively broad-based. I think what's really compounded that is some of the uncertainty that exists and the dominant role that that's playing in the economy on markets and specifically trade-related uncertainties, as well as some geopolitical, which we expect to somewhat continue. Now, I think what has been positive maybe more recently is that we have seen a pretty pronounced response to the slowdown in activity.

Now, in terms of some of the uncertainty, we unfortunately will be living with some of this policy uncertainty, whether it's trade policy or geopolitical, certainly with the elections in the UK, as well as next year in the US. Now overall though, we do think that the deceleration has moderated and is stabilizing a bit. So, as we look forward, we certainly think there are prospects for some improved economic activity.

Kristine Hurley: Earlier in 2019, the media pointed to the US Treasury yield curve inversion as a potential recession signal. The yield curve inversion has since reversed. So, Sonal and Ed, what do you make of it?

Sonal Desai: I actually stopped studying the shape of the yield curve as an indicator of future economic activity some time ago. Essentially with the massive intervention and distortionary impact coming from the Fed [US Federal Reserve], the ECB [European Central Bank], the BOJ [Bank of Japan]—essentially, central banks around the globe which have been emitting massive amounts of liquidity—the overall shape of the yield curve no longer reflects future economic activity. It's very much indicating market dynamics in terms of how much liquidity there is at different points in time. And so, when we did see that brief inversion of the yield curve earlier this year, I did not see that as the classic yield curve inversion which resulted in markets anticipating a recession.

I am actually not very concerned about a major recession in the US or in the euro area. And if I look instead to China, there has been a slowdown. There's been a lot of concern about that slowdown, but that slowdown is still within the parameters that the authorities can address using policy actions. So, I'm not actually anticipating a major growth slowdown in any individual area. Certainly, there are going to be idiosyncratic recessions. Germany is going through a fairly powerful, idiosyncratic slowdown. But more broad-based recession, no, not at this point.

Ed Perks: I think as we look at the probability of recession, it clearly rose through 2019, but we also think that that was overly impacted by sentiment, which certainly deteriorated quite a bit during the year, because of the economic statistics, leading economic indicators clearly showing some weakness as well as just that policy uncertainty that's really gripped markets. So while we think recession overall remains pretty low in the US, I think we do have to look more broadly, look at global economies and realize that in portions of the global economy that have been maybe chronically a little bit more anemic growth, the challenges that this global slowdown has presented is very weak growth.

Two areas that really jump out at me would be Japan and Germany of the eurozone more broadly, where maybe we haven't fallen into negative GDP, but we are right on the cusp of that. So, you know, certainly there are areas around the globe that are certainly more vulnerable to some of the weakness that we have seen, you know, but at this point we would say the global economy is really experiencing more of a slowdown and not something that we think turns into a full blown global economic recession.

Kristine Hurley: Stephen, let's bring you in here. What are your thoughts on a possible global recession in 2020?

Stephen Dover: Well, there's always a risk of recession. But the outlook for recession, we don't see over the course of the next year or two, particularly, in the United States or China which are the primary drivers of the global economies. What we do see is perhaps a rolling recession in that parts of the economy may be in recession, and that's particularly the manufacturing sector, which probably is in a recession right now.

Kristine Hurley: Fair enough. So with that said, Stephen, where do you see opportunities with equities?

Stephen Dover: Globally, we see a lot of opportunity. What's happened over the course of the last 10 years is that the United States, which 10 years ago was probably about 42% of the market cap of the global indexes is now over 55%, meaning the United States has dramatically outperformed foreign equity markets. So, at this point we see a lot of opportunity in some of those foreign markets. We strongly advise looking at China, which is continuing to grow at a slower rate, that Chinese market is not fully included in many of the benchmarks and will expand and we think that there's a lot of opportunity there.

In general, there's opportunity in some specific emerging markets due to changes in trade doing to some markets doing better than others.

Europe has significantly underperformed, and we think that in specific cases with companies there, there's also opportunity.

And finally, of course there still are opportunities in the United States. We think those opportunities are particularly in very innovative companies that are going to likely to continue to have good growth.

Kristine Hurley: So, a lot of potential opportunities to consider globally. Ed, what's your perspective on US equities versus non-US equities?

Ed Perks: We do like US equities relative to non-US equities still and there are reasons for that. We do think in a slowdown, the US economy has proven its resilience more so than other regions and many companies in the US do show leadership around the world and profitability metrics that really standout. So, we think there are real reasons to own US equities, even with the strong performance that's been realized. You know, other areas of the world, we do think the UK equities are actually quite interesting and we are often confronted with the Brexit overhang that's existed for quite some time. And we do think that is possibly quite priced into UK equities and the profile that UK equities have, particularly if the backdrop is a stabilization and gradual improvement in global economic activity, we do think that will benefit UK equities. In terms of fixed income, clearly very low rates around the world, very little interest or attraction to owning negative yielding sovereign assets, so we are a bit more focused to US fixed income assets, principally in the shorter end of the yield curve. And we do think we will get that opportunity to redeploy or take advantage of opportunities that present themselves in fixed income markets in 2020.

Kristine Hurley: Sonal, Ed briefly touched on fixed income—where do you see opportunities?

Sonal Desai: I think that, globally, we still do continue to see some opportunities in global yield curves and developed markets. Not in the US but we do think there's some values in some other countries including in the euro area, very specific emerging market hard currency bonds offer some value right now. I think that's something we're looking at very carefully. I would just note, you know, the words very carefully, I think I could repeat them with any particular asset class right now because I think the most dangerous thing we could do at this point of the credit cycle, not the economic cycle, but the credit cycle would be to just jump in and buy an entire index. At these types of valuations, the urgency to find true value has never been greater. So I think that this would be a reason to remain very active, you know, to be really looking at those bottom up fundamentals, be it for credit, be it for a country, and managing portfolios to that.

Kristine Hurley: Let's get more specific with possible risks in 2020…Stephen, what's top of mind for you?

Stephen Dover: There always are a lot of risks in the markets, but there are two areas that I would be concerned about which I think both create downside risk, but also upside opportunity. The first being geopolitical risk and changes in governments. Changes in elections in Europe as well as the United States. Those could affect the markets and by definition, those are very difficult to predict.

The second area of risks that I'm concerned about is the massive inflows into private investments, both debt and equity and very high valuations. Globally, there are over 270 companies that are privately held that have valuations over $1 billion that have absolutely no profits at this point, so that would be an area I'm concerned about. In terms of opportunities, I think that when people are looking at risk, they have to look both at upside risk and downside risk and certainly over the course of the last 10 years not being in the market has been a risk because people haven't had that great upside opportunity of being in equities.

Kristine Hurley: Ed, your thoughts on risks?

Ed Perks: I think as we think about the major risks maybe that investors will face in 2020, I fall back on two things. One would be that mixed message that markets have sent us. Equity markets looking a bit forward, performing very strongly, the economy slowing and the bond market kind of endorsing that with a significant decline in longer-term rates. That mixed message at some point may need to be reconciled a bit as we move forward. Now if growth does show that stabilization and improvement, that certainly will benefit equities but may present a challenge to fixed income markets and that's something that I think we are focusing, you know, very closely on as it relates to the fundamentals that we see in economies and markets.

Now unfortunately, a lot of the uncertainty that has really hurt sentiment and presented a challenge to markets, whether it be trade policy or geopolitics, those unfortunately are likely to remain with us for quite some time. And that's something that I think investors will have to deal with a bit as we look forward into 2020.

Kristine Hurley: Sonal, what potential risks or shocks have your attention?

Sonal Desai: I think sectorally, there are many areas within the credit spectrum which could be very negatively impacted from anything ranging from an intensification and re-intensification of trade tensions. These are sectoral impacts. I don't think that the trade tensions for the US have had a broad-based impact on the economy. We did not expect it. And I wrote about this earlier in the year in 2019 and I don't think we have seen them. However, sector by sector, you could certainly have an impact for clear reasons, you know, for particular sectors hit with massive tariffs, there's going to be a lot of disruption coming to that sector.

Similarly, if you have presidential candidates who are very clearly targeting specific sectors of the economy for wholesale changes and be it health care, be it energy, be it big tech, this is going to have a very real impact on the performance of those individual sectors, largely because we won't have visibility on actual policies for a very long time. The market hates being in a vacuum, especially if there is uncertainty as to which direction prices and assets are going to move. I think that these are definite concerns that I have.

Politically, here in the US of course we are very obsessed with what's happening with the presidential election and I think that will offer us plenty to sit and look at and go through, but more globally there are some very significant changes happening in country after country, countries where we have not seen populist uprisings are seeing them, be it a Chile or a Taiwan. Needless to say, Hong Kong is front and center here, but it's not just Brexit, it's not just a populist government in Italy, it's not just populist policies coming from the US, it just seems to be a much broader-based element of populism which is running through the global economy. Will this result in something in 2020 itself? It's not clear, but somewhere along the way, I do think that we are probably going to see an impact coming from all of these populist uprisings that are occurring.

Kristine Hurley: A lot to think about and consider. Ed, we'll leave the final word with you: bottom line 2020 for us.

Ed Perks: I think as we look at 2020, we certainly enter the year with more modest return expectations from financial assets. But that said, we do think that being nimble, being active manager of assets will give you that opportunity to find attractive investments. And, you know, we are certainly approaching the year that way and think that in many respects that can play out.

Host/Kristine Hurley: Ed Perks, Sonal Desai and Stephen Dover—thank you for your insights, and thank you for listening to this episode of Talking Markets with Franklin Templeton. If you'd like to hear more, visit our archive of previous episodes and subscribe on iTunes, Google Play, or just about any other major podcast provider. And we hope you'll join us next time, when we uncover more insights from our on the ground investment professionals.

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