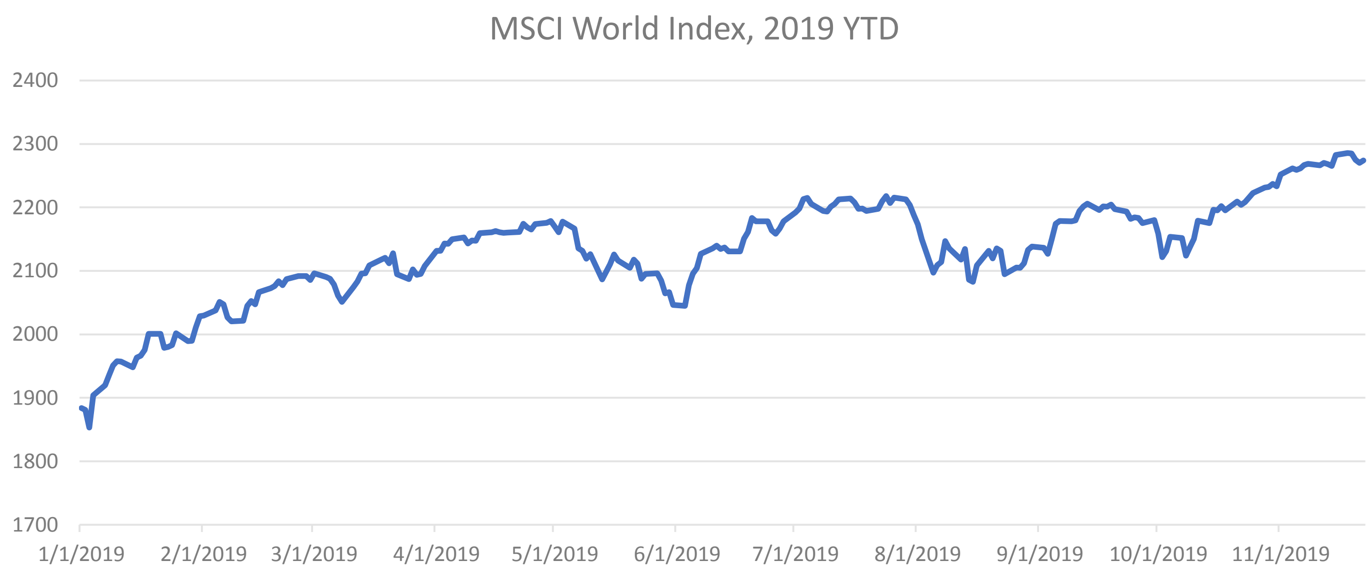
Developed Equity Markets Momentum is Alive & Kicking

Easy Money - A Continued Driver of Markets

Despite market reservations about the valuation of equities, particularly in the United States, global equity markets still look as if they have positive momentum as we move into 2020. Easy monetary policy, which likely becomes even easier in 2020, and relatively high dividend yields are two factors that could continue to support equities. Note that despite heavy selling by retail investors in 2019, equities still made good progress. Corporate buying of equities by way of share buybacks and institutional buying have supported the markets. Share buybacks were on track to be the second-highest on record in the US in 2019 at around $700bn although down on last year's record.

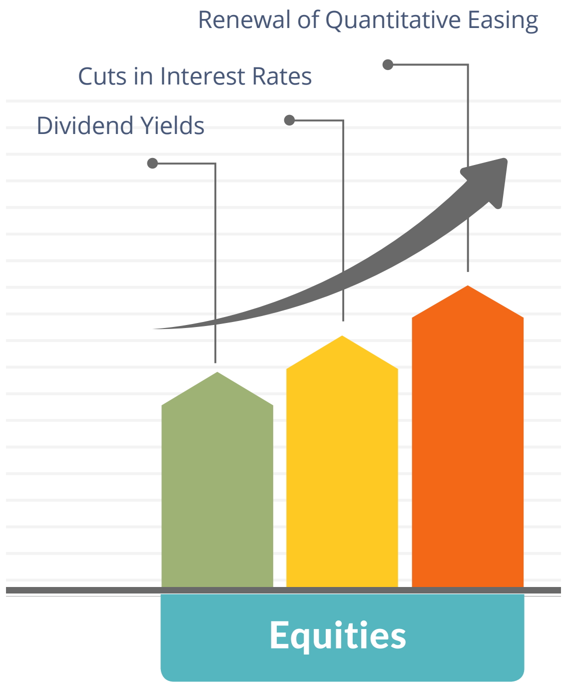
Chart 1: Global markets rally through 2019



Source: Bloomberg

A reversal of policy by the Federal Reserve when they went from monetary tightening to monetary easing was the catalyst for the sharp rebound in equities in the early part of 2019. Subsequently, the cuts in interest rates and renewal of quantitative easing by the major central banks provided the impetus for further good returns.

In 2020, we expect the central banks to continue with their easy money conditions. Indeed, we assume that the Fed, ECB and Bank of Japan will all be easing monetary conditions still further as we go through the year. Equities tend to react to changes in levels of accommodation, not just the level of interest rates or quantitative easing.



Retail Selling and Earnings Downgrades are Headwinds

US retail investor net selling of equity mutual funds has shown no sign of abating. JPMorgan calculates that US retail investors have sold around $225 billion of US equities since January 2018, fully unwinding the inflows seen in 2016 and 2017.

Analysts continue to cut their corporate earnings forecasts. Global growth has continued to surprise to the downside, leading analysts to trim their corporate earnings forecasts in most parts of the world. The drop in earnings forecasts would have been more dramatic were it not for the share buyback schemes in the United States. As always, analysts are expecting double-digit corporate earnings growth in 2020, something that looks unachievable

Longer-term we have our concerns about equities. Too many commentators compare the valuations of equities with metrics for the past twenty to thirty years and conclude that equities are cheap. However, such an argument misses the rather important point that the next thirty years if not ten years will look very different from the past. Firstly, potential global GDP growth is falling. The past thirty years witnessed inflation and good growth. Demographics and lower productivity have led to lower global growth, and growth is set to fall still further. Japan is a good case in point: the thirty-year average P/E multiple of the market is close to 26.0, and the current forward P/E multiple at a lowly 14.0. Japan used to achieve growth rates of close to 5%; these days they see a sense of achievement in anything above 0.5%.

Secondly, investors are getting older and more risk-averse, and their allocations to equities in their pension funds and long-term savings are likely to continue to fall. Fidelity recently commented that more than a third of baby boomers had more than they recommend in equities. Indeed 10% of baby boomers had their entire pension plan in equities!

Equity Themes for 2020

Domestic growth over international growth

While there may yet be some agreement between the United States and China, the trade spat has put globalisation on a much rockier path if not going into reverse. Supply lines have been disrupted, and we expect international companies to find increasing challenges in accessing markets and finding suppliers that won't be caught up in the trade war.

A second factor that sways us to look more at domestic plays is that we believe that governments are primed to expand fiscal policy through tax cuts and/or spending in the coming years.

A focus on domestic growth will tend to help small and medium-sized companies over large companies.

Chart 2: Small-cap versus large-cap stock performances

MSCI Global Small total return index versus MSCI World total return index

Source: Bloomberg

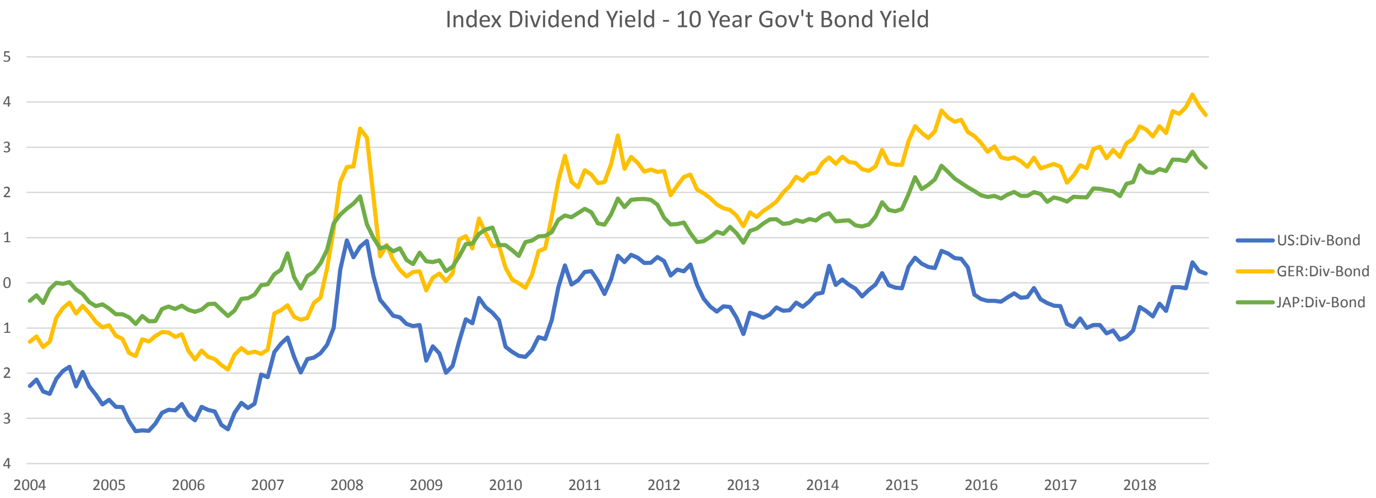
Technology – still plenty of pockets of growth

Despite some impressive returns in recent years for global payment companies, experts still believe there are excellent prospects ahead. MarketResearchNest.com thinks that the industry will grow revenues by a compound growth rate of 18% in the coming five years. Such growth is most apparent in the emerging world. Cashless payments increased by 55% in India last year compared to 48% in China and 23% in Indonesia. KPMG expects 299% annual growth in developing markets through to 2024. There is still much room for growth to remain exponential. Consider that there were only 18 cashless payments per inhabitant in India in 2018 compared to 142 in China and 529 in Sweden, according to the BIS.

Dividend yield plus growth

The search for yield is likely to continue to focus on the equity markets, given that most equity markets yield more than their respective bond markets. However, we would be very careful not to buy yield blindly as you might do when buying a high dividend yield ETF.

Chart 3: Equity dividend yields way above respective bond yields



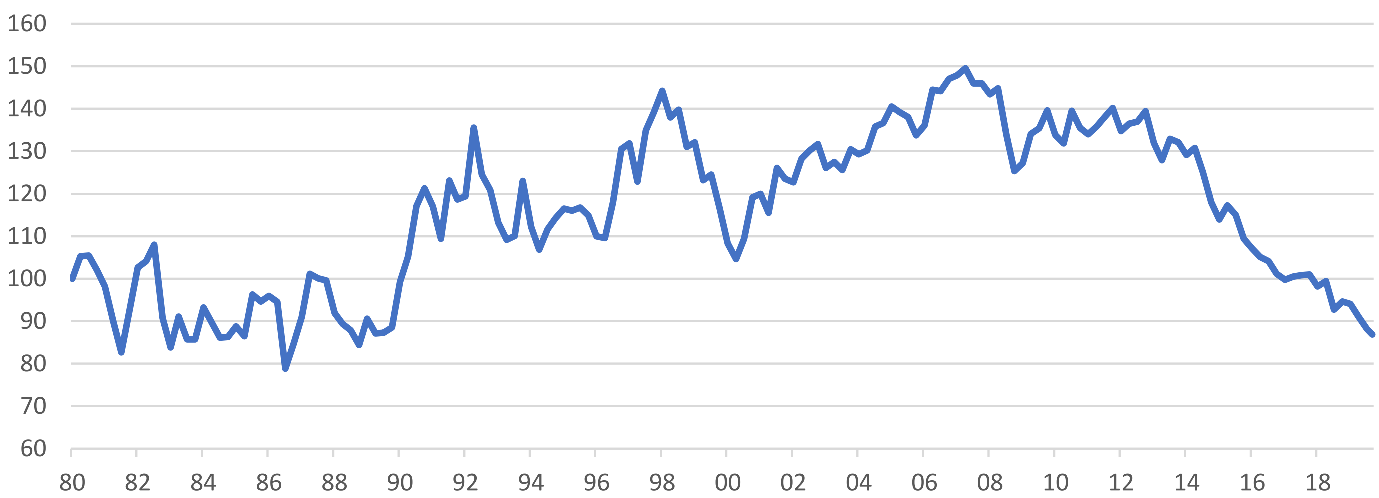
Source: Bloomberg

Laggard countries – Has the UK's time come?

If the UK can get beyond Brexit, investors will have to find other excuses for not buying back into a market that has been a serial underperformer against global markets in recent years (chart 4). We expect the catalyst for better performance to come from some certainty about Brexit and a pending significant boost to the economy from an easing of fiscal policy through a combination of spending increases and tax cuts.

Chart 4: UK equity market markedly underperformed the global index

MSCI UK total return index versus the MSCI World index ex UK total return



Source: Bloomberg

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