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FINANCIAL PLANNING

Review of 2019, outlook for 2020

– *The beat goes on*

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Key points

- 2019 saw growth slow, recession fears increase and the US trade wars ramp up, but solid investment returns as monetary policy eased, bond yields fell and demand for unlisted assets remained strong.
- 2020 is likely to see global growth pick up with monetary policy remaining easy. Expect the RBA to cut the cash rate to 0.25% and to undertake quantitative easing.
- Against this backdrop, share markets are likely to see reasonable but more constrained & volatile returns, and bond yields are likely to back up resulting in good but more modest returns from a diversified mix of assets.
- The main things to keep an eye on are: the trade wars; the US election; global growth; Chinese growth; and fiscal versus monetary stimulus in Australia.

2019 – growth down, returns up

Christmas 2018 was not a great one for many investors with an almost 20% slump in US shares from their high in September to their low on Christmas Eve, capping off a year of bad returns from share markets and leading to much trepidation as to what 2019 would hold. But 2019 has turned out to be a good year for investors, defying the gloom of a year ago. In fact, some might see it as perverse – given all the bad news around and the hand wringing about recession, high debt levels, inequality and the rise of populist leaders. Then again that's often the way markets work – bottoming when everyone is gloomy then climbing a wall of worry. The big global negatives of 2019 were:

- **The trade war** and escalating US-China tensions generally. A trade truce and talks collapsed several times leading to a new ratcheting up of tariffs before new talks into year end.

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- **Middle East tensions** flared periodically but without a lasting global impact & the Brexit saga dragged on although a near-term hard Brexit looks to have been avoided.
- **Slowing growth in China to 6%.** This largely reflected an earlier credit tightening, but the trade war also impacted.
- **Slowing global growth** as the trade war depressed investment & combined with an inventory downturn and tougher auto emissions to weigh on manufacturing & profits.
- **Recession obsession with "inverted yield curves"** – many saw the growth slowdown as turning into a recession.

But it wasn't all negative as the growth slowdown & low inflation saw central banks ease, with the Fed cutting three times and the ECB reinstating quantitative easing. This was the big difference with 2018 which saw monetary tightening.

Australia also saw growth slow – to below 2% - as the housing construction downturn, weak consumer spending and investment and the drought all weighed. This in turn saw unemployment and underemployment drift up, wages growth remain weak and inflation remain below target. As a result, the RBA was forced to change course and cut interest rates three times from June and to contemplate quantitative easing. The two big surprises in Australia were the re-election of the Coalition Government which provided policy continuity and the rebound in the housing market from mid-year.

While much of the news was bad, monetary easing and the prospect it provided for stronger growth ahead combined with the low starting point resulted in strong returns for investors.

Investment returns for major asset classes

Total return %, pre fees and tax	2018 actual	2019 actual	2020 forecast
Global shares (in Aust dollars)	1.5	29.1	9.5
Global shares (in local currency)	-7.5	24.5	9.5
Asian shares (in local currency)	-13.7	11.9	12.0
Emerging mkt shares (local currency)	-10.1	11.7	12.0
Australian shares	-2.8	26.1	9.0
Global bonds (hedged into $A)	1.7	7.5	0.5
Australian bonds	4.5	9.1	1.0
Global listed property securities	-4.0	22.7	6.0
Aust listed property trusts	2.9	24.9	6.0
Unlisted non-res property, estimate	10.0	6.5	6.0
Unlisted infrastructure, estimate	9.0	9.0	9.0
Aust residential property, estimate	-5.5	4.5	11.0
Cash	1.9	1.4	0.6
Avg balanced super fund, ex fees & tax	**-0.3**	**15.5**	**6.5**

* Yr to date to Nov. Source: Thomson Reuters, Morningstar, REIA, AMP Capital

- Global shares saw strong gains as markets recovered from their 2018 slump, bond yields fell making shares very cheap and monetary conditions eased. This was despite several trade related setbacks along the way. Global share returns were boosted on an unhedged basis because the $A fell.
- Emerging market shares did well but lagged given their greater exposure to trade and manufacturing and a still rising $US along with political problems in some countries.
- Australian share prices finally surpassed their 2007 record high thanks to the strong global lead, monetary easing and support for yield sensitive sectors from low bond yields.
- Government bonds had strong returns as bond yields fell as inflation and growth slowed, central banks cut rates and quantitative easing returned.
- Real estate investment trusts were strong on the back of lower bonds yields and monetary easing.
- Unlisted commercial property and infrastructure continued to do well as investors sought their still

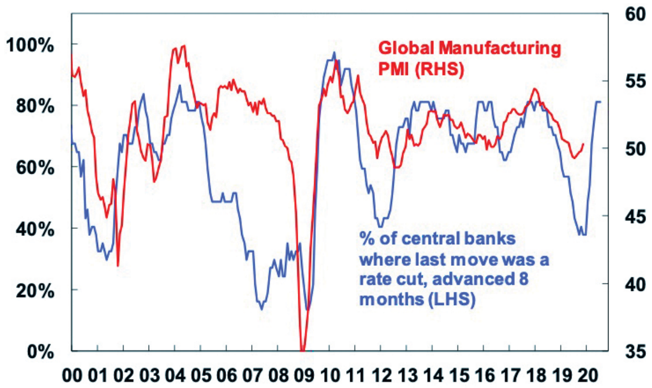
relatively high yields. However, Australian retail property suffered a correction.

- Commodity prices rose with oil & iron up but metals down.
- Australian house prices fell further into mid-year before rebounding as the Federal election removed the threat to negative gearing & the capital gains tax discount, the RBA cut interest rates and the 7% mortgage test was relaxed.
- Cash and bank term deposit returns were poor reflecting new record low RBA interest rates.
- The $A fell with a lower interest rates and a strong $US.
- Reflecting strong gains in most assets, balanced superannuation funds look to have seen strong returns.

2020 vision – growth up, returns still good

The global slowdown still looks like the mini slowdowns around 2012 and 2015-16. Business conditions indicators have slowed but remain far from GFC levels. See next chart.

Global Manufacturing PMI v central bank policy direction



Source: Bloomberg, IMF, AMP Capital

While the slowdown has persisted for longer than we expected – mostly due to President Trump's escalating trade wars – a global recession remains unlikely, barring a major external shock. The normal excesses that precede recessions like high inflation, rapid growth in debt or excessive investment have not been present in the US and globally. While global monetary conditions tightened in 2018, they remained far from tight and the associated "inversion" in yield curves has been very shallow and brief. And monetary conditions have now turned very easy again with a significant proportion of central banks easing this year. See chart. The big global themes for 2020 are likely to be:

- **A pause in the trade war but geopolitical risk to remain high.** The risks remain high on the trade front - with President Trump still ramping up mini tariffs on various countries to sound tough to his base and uncertainty about a deal with China, but he is likely to tone it down through much of 2020 to reduce the risk to the US economy knowing that if he lets it slide into recession and/or unemployment rise he likely won't get re-elected. A "hard Brexit" is also unlikely albeit risks remain. That said geopolitical risks will remain high given the rise of populism and continuing tensions between the US & China. In particular, the US election will be an increasing focus if a hard-left candidate wins the Democrat nomination.
- **Global growth to stabilise and turn up.** Global business conditions PMIs have actually increased over the last few months suggesting that monetary easing may be getting traction. Global growth is likely to average around 3.3% in 2020, up from around 3% in 2019. Overall, this should support reasonable global profit growth.
- **Continuing low inflation and low interest rates.** While global growth is likely to pick up it won't be overly strong and so spare capacity will remain. Which means that inflationary pressure will remain low. In turn this points to continuing easy monetary conditions globally, with some risk that the Fed may have a fourth rate cut.
- **The US dollar is expected to peak and head down.**

  During times of uncertainty and slowing global growth like over the last two years the $US tends to strengthen partly reflecting the lower exposure of the US economy to cyclical sectors like manufacturing and materials. This is likely to reverse in the year ahead as cyclical sectors improve.

In Australia, strength in infrastructure spending and exports will help keep the economy growing but it's likely to remain constrained to around 2% by the housing construction downturn, subdued consumer spending and the drought. This is likely to see unemployment drift up, wages growth remain weak and underlying inflation remain below 2%. With the economy remaining well below full employment and the inflation target, the RBA is expected to cut the official cash rate to 0.25% by March, & undertake quantitative easing by mid-year, unless the May budget sees significant fiscal stimulus. Some uptick in growth is likely later in the year as housing construction bottoms, stimulus impacts and stronger global growth helps.

Implications for investors

Improved global growth and still easy monetary conditions should drive reasonable investment returns through 2020 but they are likely to be more modest than the double-digit gains of 2019 as the starting point of higher valuations and geopolitical risks are likely to constrain gains & create some volatility:

- Global shares are expected to see returns around 9.5% helped by better growth and easy monetary policy.
- Cyclical, non-US and emerging market shares are likely to outperform, particularly if the US dollar declines and the trade threat recedes as we expect.
- Australian shares are likely to do okay but with returns also constrained to around 9% given sub-par economic & profit growth. Expect the ASX 200 to reach 7000 by end 2019.
- Low starting point yields and a slight rise in yields through the year are likely to result in low returns from bonds.

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- Unlisted commercial property and infrastructure are likely to continue benefitting from the search for yield but the decline in retail property values will still weigh on property returns.
- National capital city house prices are expected to see continued strong gains into early 2020 on the back of pent up demand, rate cuts and the fear of missing out. However, poor affordability, the weak economy and still tight lending standards are expected to see the pace of gains slow, leaving property prices up 10% for the year as a whole.
- Cash & bank deposits are likely to provide very poor returns.
- The $A is likely to fall to around $US0.65 as the RBA eases further but then drift up a bit as global growth improves to end 2019 little changed

What to watch?

The main things to keep an eye on in 2020 are as follows:

- The US trade wars – we are assuming some sort of de-escalation in the run up to the presidential election, but Trump is Trump and often can't help but throw grenades.
- US politics: the Senate is unlikely to remove Trump from office if the House votes to impeach and another shutdown is also unlikely but both could cause volatility as could the US election if a hard-left Democrat gets up (albeit unlikely).
- A hard Brexit looks like being avoided but watch UK/EU free trade negotiations through the year.
- Global growth indicators – like the PMI shown in the chart above need to keep rising.
- Chinese growth – a continued slowing in China would be a major concern for global growth.
- Monetary v fiscal stimulus in Australia – significant fiscal stimulus could head off further RBA rate cuts and quantitative easing.

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