January 2020
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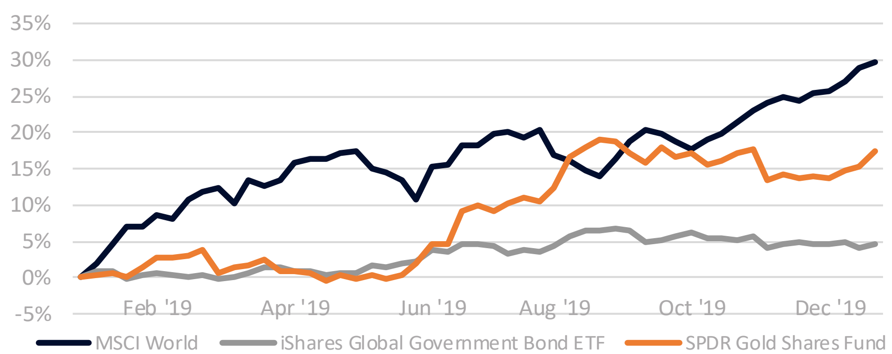
HOTTINGER GROUP

GLOBAL INSIGHT

Overview

- After 18 months of a globally synchronized deceleration in economic activity in which over 40 central banks cut rates and QE reduction plans were reversed many forecasters are looking for global growth at the end of 2020 to be approx. 3%, thus avoiding recession.
- In our **feature article,** Tim Sharp, Managing Director at Hottinger Investment Management, explores the outlook for global investors in 2020.
- Despite central bank intervention in 2019 conditions remain tight and central banks reactionary rather than proactive meaning that any future action may well be too late to ward off negative growth should the environment continue to slow.
- In our **Macro View**, we cover the effect of the trade dispute between the United States and China and how this has put the brakes on global activity.
- We are not convinced that we are seeing benign mid-cycle events but a number of economies in late-cycle with falling rates of capital expenditure, growth and inflation.
- In our **Investment Outlook**, we assess activity in the fourth quarter and the potential for this to be repeated in 2020.
- Equity valuations have experienced a sharp expansion in recent months as investors have already priced-in future growth. US and European equities are a case in point where the rally over the past year has been largely due to earnings multiple expansion rather than earnings growth, which was barely above standstill.
- The value within the UK equity market has not gone unnoticed by overseas companies in recent months as demonstrated by numerous takeover approaches.

2019 was another year of positive returns for all the major asset classes



Source: *Bloomberg*

Inside this issue

Economic Highlights

- UK final services PMI was revised up to 50.0 from 49.3 in November..
- US December ISM Manufacturing index fell to 47.2 from 48.1, its lowest level since 2009.
- Third quarter 2019 eurozone GDP was the same as the second quarter at 0.2%

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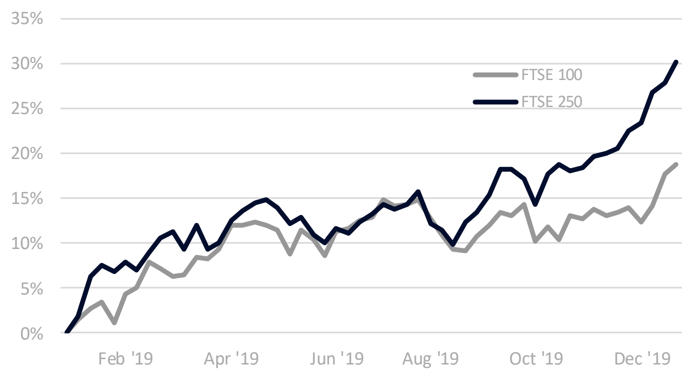
Based upon information available up to and including 15th January 2020

Key Issues in Charts

UK FTSE 250 outperformed the FTSE 100 FY2019 as investors returned to the UK

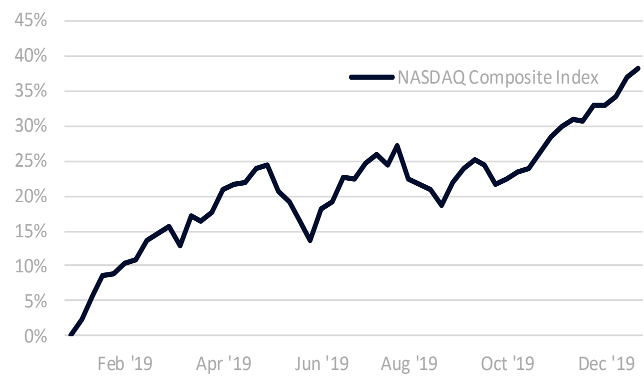


Source: *Bloomberg*

- UK Mid Cap stocks have rallied strongly since October, to be joined by the FTSE 100 stocks since the General Election.
- Following the General Election result the cheaper relative valuation of UK assets has come to the attention of international investors with the expectation for an increase in inward investment into the UK economy from corporate, private and retail sources in the short to medium term.

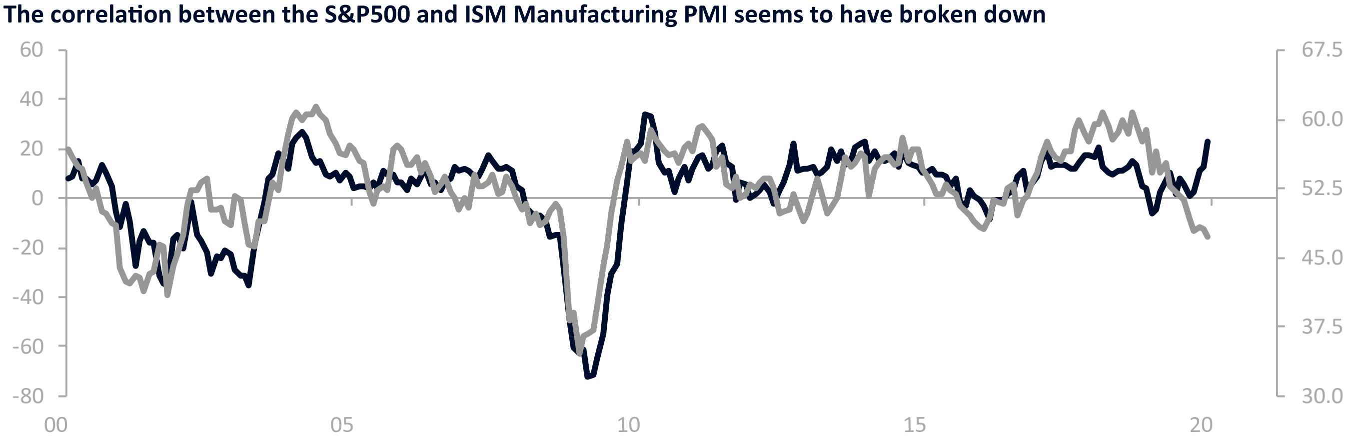
The NASDAQ Composite Index benefitted from exposure to technology

- Big tech stock prices rallied in the 2nd half of the year on the back of favourable reports detailing their ability to adapt and improved investor sentiment.
- Apple, Microsoft and Facebook shares returned 89%, 58% and 57% in 2019 respectively.
- Technology is the largest sector in the S&P500 representing 23.2% of the index as at the end of 2019.



Source: *Bloomberg*

The correlation between the S&P500 and ISM Manufacturing PMI seems to have broken down



Source: *Bloomberg*

- The current negative correlation between US Stocks and fundamentals is an unusual occurrence in recent history.
- Many companies are operating at peak margins and valuations in the US are stretched by historical standards.
- Price-earnings ration (P/E) of the S&P500 stands at approximately 21x according to Bloomberg while its long term average is nearer 15x

Big Picture for 2020

By Tim Sharp, *Managing Director at* ***Hottinger Investment Management***

Following a torrid December 2018, financial markets bounced back in January 2019 embarking on one of the strongest equity rallies for many years with global equities returning 25% over 2019. Fed Chair Jerome Powell announced a “flip flop” in Fed policy that the central bank remains neutral on interest rates, which meant that the next move could be a rate rise or a rate cut in line with most investor expectations. This early decision formed the basis for the weak dollar / strong emerging market recommendation from most investment banks for 2019. By the summer, as we argued at the time, this strategy had been reversed and emerging markets were among the worst performers of the year.

Forecasts for 2020 are very similar to 2019 where a weak US dollar creates a good environment for EM.

Fast forward to December 2019 when the majority of investment banks and independent market strategists announce their forecasts for 2020. Generally speaking, the forecasts seen by us are once more suggesting that an expected weak dollar should create a good environment for emerging market assets that from a valuation perspective are less stretched on a relative and historic basis than the main developed markets. While this may be true the question is whether these economies have the combined strength to lead the global economy when its major markets are forecast to underperform?

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Do these economies have the combined strength to lead the global economy when major markets underperform.

In October, China released its Gross Domestic Product (GDP) data for the third quarter, disappointing analysts with a 30-year low figure of 6.0%. It is apparent that China is unlikely to use levels of stimulus seen in the past to reinvigorate the economy preferring to concentrate on defusing financial risks during the transition to a consumer-led economy.

In December, the Indian central bank cut its 2020 growth forecast to 5%, it’s slowest pace for 5 years. Indian factory growth hit a two year low in October and power demand fell in December for the fourth consecutive month. Corporate tax cuts and infrastructure projects have failed to lift prospects for the Indian economy.

Our recent dollar article outlined a scenario for a stronger dollar again in 2020, although many forecasters are using the Fed‘s decision to hold rates as a signal for a weaker dollar. The article agrees that there is less room for dollar appreciation against developed currencies, but unless there are clear signs of recovery in global growth outside the US, a broad dollar decline is unlikely, painting a less favourable back drop for Emerging Market investment.

Unless there are clear signs of a recovery in global growth outside the US, a broader dollar decline is unlikely painting a less favourable picture for EM investment.

Following the assassination of General Soleimani the oil price spiked 5% suggesting that ongoing geopolitical risk in the Middle East has the potential to create an oil shock. During the 1970’s, tensions in the Middle East used to have significant consequences for the US economy resulting in stagflation and high unemployment. However, economies in the developed world now have a much lower percentage in manufacturing following the expansion of the services sectors that are far less sensitive to the oil price. Furthermore, the US is now a net exporter of oil thanks to the development of oil sands and any oil shock is more likely to affect net importers and economies with higher percentages in manufacturing, which would point once more to the developing economies.

After 18 months of a globally synchronized deceleration in economic activity in which over 40 central banks cut rates and QE reduction plans were reversed many forecasters are looking for global growth at the end of 2020 to be approx. 3%, thus avoiding recession. Fed Chair Powell has characterized this slow down as a mid-cycle adjustment believing that the swift reaction from central banks has added enough stimulus to prevent a global recession occurring in 2020. It is possible that financial markets could continue avoiding a significant drawdown in equities, despite stretched valuations, in a low volatility, low return scenario over a longer period of low interest rates.

We have maintained that the global economy is in late cycle and prone to a recession in the medium term.

However, in line with the beliefs of our independent research provider, Absolute Strategy Research, we have maintained that the global economy is in late cycle and prone to a recession in the medium term. Indeed, the inversion of the US Treasury yield curve in August is considered a leading indicator for recession and is usually bad for equities. On previous occasions during which the US Treasury yield curve inverted, it took anything between six months and two years for a recession to actually materialise. In that time, equity markets can continue to rally until falling earnings take valuations to unsustainable levels. In this scenario the downturn in corporate profits leads firms to cut costs, and unemployment to rise, causing a US recession. In this scenario equity markets would re-rate as earnings forecasts and forward guidance are adjusted.

August's inversion of the US Treasury yield curve is considered a leading indicator to a recession normally within 6 to 18 months.

Turning to the UK, it is clear that many UK investors are relieved by the general election result awarding PM Boris Johnson an 80 seat Conservative majority in the House of Commons and the expectation is for an almost immediate increase in inward investment into the UK economy from corporate, private and retail sources. However, Brexit uncertainty is set to linger in 2020, affecting the potential for UK assets, long term investment and the path of interest rates. We expect the withdrawal agreement to be passed by January 31 but Prime Minister Johnson's desire to have the final deal date enshrined in law could affect long-term plans. The upside potential comes with a trade agreement being reached by the December deadline and uncertainty dissipates. The downside risk comes with PM Johnson fulfilling his threat to leave the EU without a deal and the UK and EU trading under WTO rules. Therefore, there is still a level of uncertainty as to the type of trade deal that can be agreed that will affect UK financial and business investment. Nevertheless, there is enough momentum from the likely passing of the withdrawal agreement and the fiscal policies announced in the Conservative manifesto should provide opportunity to close this valuation gap.

Many UK investors relieved by the Conservative's 80 seat majority but Brexit uncertainty is set to linger in 2020. Nevertheless, there should be enough momentum to provide an opportunity to close the valuation gap.

The positive momentum from the US-China trade deal has boosted risk assets going into 2020 and while guidance suggests that earnings will grow then valuations may still be justifiable. We remain cautious of a possible drawdown if earnings disappoint and believe that if a recession were to materialise in the second half of 2020 then equity markets may well start to react around Easter. Should central bank action prevent a recession from occurring then the forecasts of even the most optimistic see equities returning less than 6%.

We remain cautious of a possible drawdown in equities if earnings disappoint and believe that if a recession was to materialise in the 2nd half of 2020 then equities will start to react around Easter.

Regionally, the technology sector is the largest sector in the US equity markets and the reason why US equities performed so well in 2019. Many forecasters suggest that the country most likely to experience a recession is the US due to its cyclical nature, therefore, reducing the cyclical nature of a portfolio would probably involve reducing US equities or moving into more defensive sectors. Historically, in times of strife, the US equity market has been viewed as a safe haven due to its diversity and if there is a significant sell off in US equities then it is highly likely that other equity markets will not be immune. During the fourth year of a presidency, equity performance has tended to be positive but the election remains an unknown particularly when confronted with a divisive incumbent and a number of Democratic candidates from the left of the party.

We have been looking at the correlation between equity markets to investigate the possibility of reducing drawdown through diversification and China and Japan seem to show low levels of correlation to US and European markets. Furthermore, Japanese equities have been among the best performers since the summer recession scare, which Morgan Stanley are attributing to the possibility of the next phase in global reflation, however, it could just be cautious investors looking to diversify away from cyclical growth orientated stock markets.

China and Japanese equity markets seem to show a low correlation to US and European equity markets.

More interestingly, government bonds have no recession risk built in to yields following a strong performance with equities in 2019. Relative asset valuations mean that any rally in prices from here will require anxiety over growth prospects, but central bank action and subdued inflation should support longer dated bonds. Furthermore, interest rate differentials between developed countries will also prevent any major bond market sell-off when there are natural buyers. From a multi-asset perspective government bonds normally provide a hedge against equity exposure so should continue to hold an important place in portfolios with the preference to adjust through duration to the changing landscape.

Government bonds have no recession risk built into yields.

In conclusion, we would argue that despite central bank intervention in 2019 monetary conditions remain relatively tight and central banks are reactionary rather than proactive meaning that any future action may well be too late to ward off negative growth should the environment continue to slow. Previous brushes with global recession have been averted by significant Chinese stimulus boosting global trade that looks unlikely to materialise in 2020 meaning that the global economy is relying on the actions of developed nations and smaller developing countries. We remain engaged but cautious of the valuations of developed equities and the guidance for forward earnings preferring to err on the defensive side. We continue to believe in the merits of a traditional multi-asset portfolio approach using medium duration developed country government bonds even though many do not provide a real return from income alone. As with 2019 the direction of the dollar continues to have an effect on the wider economy as the world's reserve currency affecting the ability of areas of the global economy where growth expectations are more positive to show their potential.

Despite central bank intervention in 2019 conditions remain tight and central banks reactionary.

While we continue to believe in the merits of a traditional multi-asset portfolio, we remain engaged but cautious of the valuations of developed equities and the effect of the direction of the dollar on the wider economy.

Macro View

The fourth quarter of this year saw the Fed finish it's "mid-cycle adjustment" and the ECB re-start QE in response to the rapid slowdown in global growth expectations experienced in the third quarter. Many market commentators expected this to represent the bottom of the economic slowdown and so started the debate between mid-cycle and late-cycle advocates that continues into 2020.

In some respects, it is difficult to argue against the positive financial market sentiment that has seen US equities hit new high after new high in December while US 10 year government bond yields move back above 1.90% despite the lack of any obvious catalyst to kick start global growth in a significant way.

Risk of recession seems to have receded slightly since the summer, activity remains weak going into 2020.

United States

While it seems true that the risk of recession has receded slightly since the summer, data reports would suggest that activity remains weak going into 2020 with final 2019 US GDP expected to be below 2% as growth in the fourth quarter falls to close to 1.5% annualised.

December ISM Manufacturing index fell to

47.2

The December ISM manufacturing index fell to 47.2 from 48.1, its lowest level since 2009, continuing to suggest that the US is falling into recession as companies adjust to slower global activity and fading fiscal policy support.

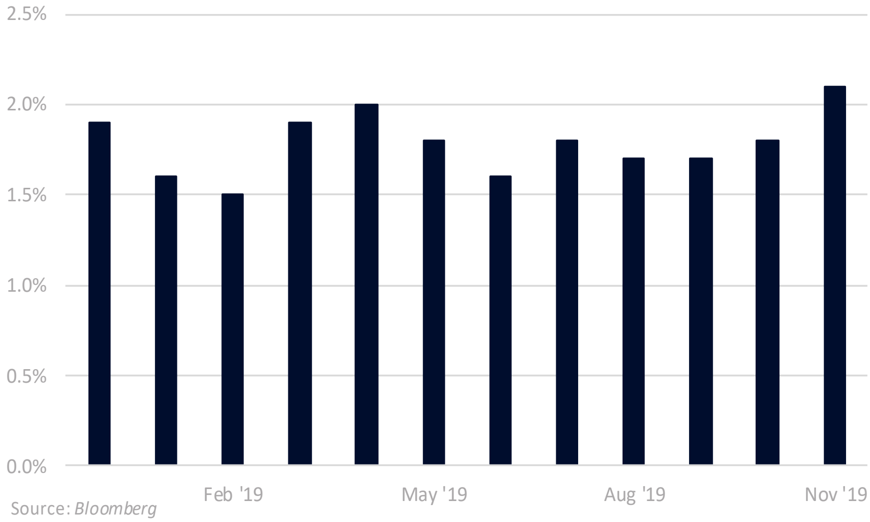
The strength of the American consumer has helped buoy the economy as indicated by the lowest unemployment rate since 1969 of 3.5%. The labour market has averaged 184,000 new jobs per month during the quarter with wage inflation steady at 3.1%p.a. although real consumption growth seems to have weakened during the fourth quarter despite this underlying strength.

US trade policy has been the biggest cause of the negative change in business sentiment this year.

US trade policy has been the biggest cause of the negative change in business sentiment this year with the deadweight of new tariffs and growing uncertainty over the international trading environment impacting global growth. However, the year ended with the announcement of a "Phase One" trade deal agreed with China that will defer further tariffs and rollback existing tariffs. Financial market sentiment was significantly boosted by this announcement although, in reality, it is unlikely to give more than a modest boost to the US economy. This is because the reduction to tariffs is unlikely to provide much of an initial boost and the deal is unlikely to change materially the trajectory of Chinese growth prospects. However, the announcement does add to the near-term positive momentum by reducing uncertainties in markets although the announcements surrounding intellectual property protection will probably need further rounds of negotiation.

The last of the Fed's three 25bp rate cuts came after the October meeting with clarity provided that the current stance remained "appropriate". Without a

US Inflation Rate
(CPI Urban Consumers YOY NSA)



Source: *Bloomberg*

Without a significant rise in inflation it is unlikely that the Fed would risk tightening rates too early.

Having hiked rates 4 times in 2018 it could be argued that the Fed is yet to unwind that cycle fully.

significant rise in inflation it is unlikely that the Fed would risk tightening rates too early as in 2018 and further rate cuts would need to see a major deterioration in the US economy not aligned with the mid-cycle beliefs held by the committee. However, having hiked rates four times in 2018 it could be argued that the Fed is yet to unwind that cycle fully, perhaps underestimating the tightness of current policy and hindering US recovery potential.

UK

Although short and medium term investment plans could now be executed following the Conservative party's 80 seat majority in the December 12 General Election, Prime minister Johnson's decision to have the final deal date enshrined in law means that the Brexit drama will continue to hold back GDP in 2020. The prospect of extensive spending plans and looser fiscal policy as laid down in the election mandate should create the prospect of some GDP growth. The final estimate for third quarter GDP was 0.4% qoq with a slowdown in household consumption outweighing a slight increase in investment spending. Expected growth of 0.2% qoq in the fourth quarter will leave GDP growth estimation for 2019 challenging 1%.

The final services PMI for December rose to 50.0 from 49.3 in November and when combined with November's manufacturing and construction final figures continue to paint a very weak picture with risks that final GDP is weaker than expected.

Although November's inflation rate remained at 1.5%, the October employment figures were stronger than expected and the potential increase in sentiment in December left the BOE Monetary Policy Committee on hold at year end awaiting more favourable economic data.

Europe

0.2%

Evidence would suggest that the economic environment has taken its toll on the eurozone. Third quarter 2019 eurozone GDP was the same as the second quarter at 0.2% with the outlook for the fourth looking little different.

Composite December PMIs rose slightly from November's 50.6 although there are significant differences at country level. The manufacturing recession in Germany and Italy seems to be offset by better numbers in France and Spain. The Manufacturing PMI confirms that the industrial recession shows little sign of recovery, falling to a seven year low, while the services sector index increased to a four month high of 52.8 in December as all nations saw an increase in activity. Domestic demand has been consistent while export markets have been badly affected by the global slowdown and the new orders index continues to forecast contraction.

In its September meeting, the European Central Bank (ECB) cut interest rates and pledged to resume bond buying.

In September under President Draghi, the ECB cut interest rates and pledged to resume bond buying, but it also did something more unexpected. By raising the deposit rate on excess reserves to 0% while lending reserves under TLTRO III at -0.5% under certain conditions, the ECB effectively offered to subsidise European banks, if they increase lending to non-financial companies. However, the first auction had a very low take up, which might suggest that the access to cheap money is not the main problem for European companies.

Mr Draghi's replacement, Christine Lagarde, echoed the call for countries to consider collaborative fiscal policy measures in a further sign that many central bankers will be looking for government spending to take the pressure off themselves having to find more alternative QE measures in the future. Policy remained on hold as Lagarde called a strategic review that will be wide ranging and likely to take a couple of months to conclude.

Japan

Both Mr Draghi and Ms Lagarde have called for countries to consider fiscal policy measures rather more alternative QE measures.

The October hike in sales tax had a limited impact on consumer spending compared to the reaction in 2014 and many are forecasting a bounce back in retail sales in November when the data is released. Industrial production, however, tells a different story with Capital Economics estimating a sharp fall in manufacturing output in the fourth quarter, increasing the likelihood that GDP also contracted

The fiscal stimulus announced at the beginning of December will amount to approximately Yen9.4tn despite the inflated headline figures, according to Capital Economics, and is projected by the government to boost real GDP by 1.4%. However, stimulus packages do not always translate into increased public demand and Capital Economics reiterate their forecast for GDP to drop 0.2% in 2020.

The sluggish end to the year has seen the unemployment rate move higher although still within the Bank of Japan's tight range adding to weak disposable income levels experienced after the sales tax hike. The Bank of Japan left major policy settings unchanged after its December Policy Board meeting.

Emerging Markets and China

Despite a sluggish end to the year the Bank of Japan left major policy settings unchanged in December.

That many emerging market central banks sought to cut rates over the third and fourth quarters shows that the slowdown in trade growth has been truly global. India cut rates by 135bp in 2019 in order to stimulate their economy and the signs are that headline inflation will exceed central bank targets. As with many economies it is likely that price pressures will be left to run rather than see the early results stall. Many emerging economies are suffering relatively low inflation, Brazil, Mexico and Russia are examples, with many policy-makers likely to continue with easing policies.

Chinese growth has decelerated to an estimated 6.1% in 2019 as the economy transitions to be more consumer-led rather than stimulated by capital expenditure. The China / US trade conflict has had a major effect on exports and when combined with the global manufacturing slowdown has created a structured slowdown that may dip below 6%.

Monetary easing by EM central banks shows that the slowdown in trade growth has been truly global.

More recently the prolonged trade negotiation has seen the central bank look to reduce lending rates through its medium term lending facility but seems reluctant to start easing rates when property investment remains reasonably strong. The authorities have also allowed the currency to depreciate, cut taxes on incomes and consumption, expanded loan availability to private firms and allowed local governments to issue more special infrastructure bonds over the course of the year. However, there are concerns that these actions are not enough in comparison to previous cycles to provide the main boost to stimulate the global economy.

6.1%

Chinese growth has decelerated to an estimated 6.1% in 2019.

Conclusion

Despite central bank actions and positive financial market sentiment, we are not convinced that we are seeing benign mid-cycle events but a number of economies in late-cycle with falling rates of capital expenditure, growth and inflation. We still believe central banks are being reactive and will struggle to forestall further deceleration. The rhetoric emanating from many major central bankers supports a concerted move towards expansive fiscal policy in places other than the United States.

We are not convinced that we are seeing benign mid-cycle events but a number of economies in late-cycle.

Investment Outlook

Global economic growth may have slowed in 2019 but markets posted strong gains, albeit following a severe correction at the end of the previous year.

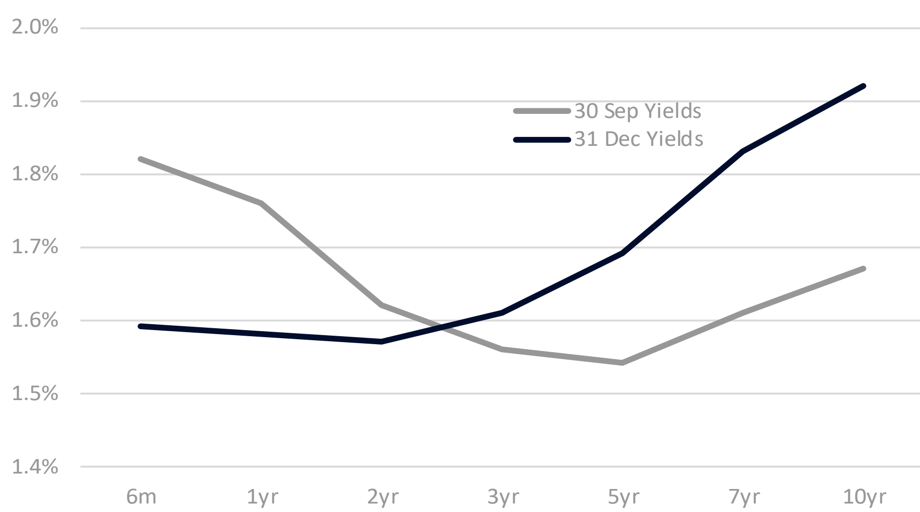
Global economic growth may have slowed in 2019 but markets posted strong gains, albeit following a severe correction at the end of the previous year. Rising bond yields in 2018 caused equity valuations to de-rate sharply, but a U-turn in policy by the US Federal Reserve (Fed) and additional stimulus from the European Central Bank (ECB) in 2019 was instrumental in equity markets rebounding as bond yields fell to historic low levels.

The US 10-year Treasury yield ended the year at 1.92%, down from 2.68% at the start of the year. Meanwhile, global equity markets gained 25.2% in US dollar terms led by the US and European indices, and in particular the technology-heavy Nasdaq. Emerging markets underperformed but still posted double-digit returns. In the UK, the FTSE All-Share index lagged for much of 2019 but closed the year on the front foot following a decisive General Election result which removed some of the uncertainty surrounding Brexit.

The final quarter was certainly risk-on buoyed by hopes that an interim trade deal between Beijing and Washington was imminent. Global equity markets posted positive returns and strongly outperformed bonds.

The final quarter was certainly risk-on buoyed by hopes that an interim trade deal between Beijing and Washington was imminent. Global equity markets posted positive returns and strongly outperformed bonds. Within the fixed income sector credit outperformed government bonds. The inverted US yield curve of the summer months, which has historically forewarned of a looming recession seemed a distant memory as the yield curve steepened. Elsewhere, the Japanese 10-year yield moved above zero for the first time since March and German bund yields with maturities beyond 20 years also moved into positive territory. The market moves globally have seen the value of negative yielding debt shrink from a peak of US$17tn during the summer to US$11tn by year-end.

Q3-Q4 2019 Change in US Yield Curve



Source: *Bloomberg*

At present, rates would appear to be on hold among the major central banks.

Markets are pricing-in a

50%

chance of a UK rate cut in 2020.

At present, rates would appear to be on hold among the major central banks. In the US, despite coming under intense pressure from President Trump to cut rates, Fed Chair Jerome Powell has indicated that the central bank is unlikely to loosen policy any further unless a "material reassessment" is required. The Fed would also likely tolerate persistently higher inflation before tightening and is currently considering a policy amendment to allow itself greater flexibility. In Europe, ECB President, Christine Lagarde continued Mario Draghi's theme of a coordinated eurozone fiscal policy, with monetary policy having very few tools to implement. The Bank of Japan is confronted with deteriorating household confidence and risks of falling inflation expectations, which suggests it should loosen monetary policy. However, it seems reluctant to extend negative rates as further cuts could prove counter-productive.

We do not foresee a major move in US Treasuries for several reasons. Investors have already pared back expectations of Fed easing.

The path of interest rates in the UK is more difficult to call. The Bank of England continues to forecast a rebound in growth next year, but markets are pricing-in a 50% chance of a rate cut in 2020. The newly elected Conservative government has pledged billions of pounds to upgrade the country's infrastructure. Should this fiscal boost effectively stimulate the economy the Bank of England may find itself in tightening mode. A loosening of the purse strings could also see the 10-year gilt yield head towards 1% in the coming months as investors digest the increased issuance to fund the government's spending plans and a potentially stronger economy. That said, yields should be capped by demand from institutional buyers who are hungry for long-duration assets to match their liabilities. Gilts should also provide portfolios with protection in the event a failure to achieve a trade deal with the EU reduces the UK's growth potential.

Companies with triple-B rated debt, the lowest credit quality of investment grade paper, account for almost

60%

of the sector.

Similarly, we do not foresee a major move in US Treasuries for several reasons. Investors have already pared back expectations of Fed easing, and aggressive tightening is unlikely given how inflation has remained contained over the past decade, even in the face of record low unemployment. In addition, should the 10-year yield break above 2%, overseas investors should become attracted given the lack of yield available in their own markets.

In Europe, bunds yields are unlikely to return to the lows of the summer given the less dovish remarks from the ECB and the stabilisation of data. The introduction of fiscal stimulus has been a popular topic, which should push yields higher, but only Germany has the necessary capacity and is unlikely to consider such a path during the next twelve months. Nevertheless, political movements are worth monitoring as any break in the CDU/SPD coalition could shift the balance towards a looser fiscal stance in Germany, with other EU countries potentially following suit.

Earnings are forecast to rise by just shy of

10%

over the calendar year.

Corporate bonds performed well in 2019 buoyed by accommodative central bank policy and a tightening of spreads. In Europe, the renewed buying of corporate bonds by the ECB should ensure spreads remain relatively tight. Stateside, if the cut in US interest rates at the end of October proves to be the last in the current cycle then historic precedent would suggest that spreads could narrow further in 2020, according to research by Axa. The study also concluded that US high yield would outperform US investment grade under this scenario. Nevertheless, there are concerns surrounding the quality of the investment grade market. Companies

$30bn

has been withdrawn from UK equities by investors since the 2016 referendum.

Emerging market equities underperformed their developed market peers by

15%

in US dollar terms during 2019.

with triple-B rated debt, the lowest credit quality of investment grade paper, account for almost 60% of the sector, up from one third in 2008. Moody's, the ratings agency, has warned that the high-yield sector is outright expensive as the strong price gains in 2019 have not been backed up by either business sales or corporate earnings.

In a similar vein, equity valuations have experienced a sharp expansion in recent month as investors have already priced-in future growth. US and European equities are a case in point where the rally over the past year has been largely due to earnings multiple expansion rather than earnings growth, which was barely above standstill, according to FactSet. Further, Morgan Stanley has noted that more than a third of US companies reported a reduction in year-on-year earnings; profit declines of this breadth in 2002 and 2009 coincided with broader economic recessions. However, earnings are forecast to rise by just shy of 10% over the calendar year, according to FactSet. We believe there is room for disappointment with companies already operating at peak margins and GDP growth likely to be pedestrian.

The outlook for European equities should be slightly more favourable. According to Barclays, price/earnings (p/e) multiples are only at their long-term average and have room to expand over the coming year. With more than half of European companies' earnings sourced from overseas, the marginally brighter outlook for global trade and a potential détente between the US and China should prove supportive. European equities are also relatively attractive compared to government debt from a yield perspective; the 12-month forward dividend yield of the MSCI Europe Index is 3.8% compared to the benchmark bund yield of –0.37%.

One equity market that is not expensive is the UK as almost US$30bn has been withdrawn by investors since the 2016 referendum, leading to a material de-rating. The combination of several valuation measures including p/e ratio, price-to-book and the dividend yield of 4.1% shows the UK to be trading at a 16% discount to its 30-year average, according to Panmure Gordon. By comparison, the rest of the world is trading at a 5% premium. The value within the UK equity market has not gone unnoticed by overseas companies in recent months as demonstrated by numerous takeover approaches, including those for Cobham, Greene King and Merlin Entertainments. It is true that mid-cap stocks have appreciated strongly since October, to be joined by the FTSE100 stocks since the General Election, but any reallocation to the UK could have more legs.

Emerging market equities underperformed their developed market peers by 15% in US dollar terms during 2019 and suffered large outflows. Much of the relative weakness could be attributable to the strong dollar as the two tend to move in opposite directions. Whilst we do not expect the dollar to weaken, investors might take a more constructive view in 2020 as emerging market valuations have de-rated to the point where they have become attractively valued on a relative basis.

In summary, we are somewhat cautious for 2020 as a whole and do not expect the returns of last year to be repeated. Bond yields are close to historically low levels and equity market valuations are more expensive than twelve months ago, particularly in the US and Europe. Political events will likely become more prevalent as the year progresses. The US election will take place in November and, on a positive note, the S&P500 has appreciated in 19 of the 23 election years since 1928. During his tenure, President Trump has often linked any rise in the stock market to his leadership and therefore will probably not wish to upset the apple cart before the poll. However, were he to win a second term, there is a risk he might renew trade tensions with China or Europe, which could prompt a fall in business sentiment. Meanwhile, a victory for a progressive democratic candidate such as Elizabeth Warren could prove testing for certain sectors; a ban on fracking would hurt the oil sector, more robust anti-trust enforcement could see large technology companies broken-up and banks could face tighter regulation. The UK is also likely to face periods of volatility during the year as it enters testing negotiations with the EU around a free trade agreement.

The recent rally in equity markets leaves very few investors positioned for a recession, meaning that such a scenario will have a notable effect on risk assets should it materialise.

Meanwhile, corporate profits and margins are under pressure, balance sheets remain levered and the recent rally in equity markets leaves very few investors positioned for a recession, meaning that such a scenario will have a notable effect on risk assets should it materialise. Further, the recession warning from the summer's inverted yield curve could yet come back to bite as it usually precedes the downturn by 12-18 months. That is not to say we are outright bearish. The recent détente between the US and China, as well as the greater certainty surrounding Brexit should support equities, especially during the early part of the year.

In terms of asset allocation, we retain our conviction that late-cycle investing bears heightened risk. Whilst the valuations of risk-free assets are unattractive at current levels we would invest in longer-dated gilts and US Treasuries on any significant back-up in yields. We are also looking at the correlation between equity markets to investigate the possibility of reducing any drawdown through diversification. Our investigations suggest that China and Japan show low levels of correlation to US and European markets. In the light of the recent general election result, we would increase the allocation to UK assets, particularly for UK investors, in view of the expected increased optimism for the UK to start to close the valuation gap that has opened since the 2016 referendum.

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