Green Shoots Mark Modest Improvement for 2020

EXECUTIVE SUMMARY

glc asset management

2020 Capital Market Outlook

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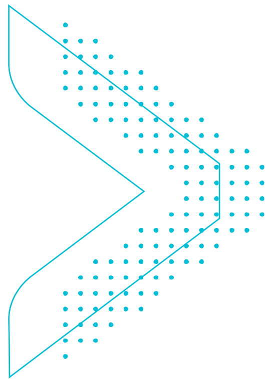
Data as of Nov. 30, 2019 unless otherwise stated.

Green Shoots Mark Modest Improvement for 2020

The current economic slowdown should come to an end in 2020. **The global economy is showing signs (the so-called ‘green shoots’) that growth in 2020 should pick-up modestly, aided by a détente in global trade frictions and stimulative central bank policies.** We see an economic environment where corporate earnings growth will be sufficient to support equity market gains. We expect that bond yields will remain low but have a modest upward trend, commodity prices will improve, and the U.S. dollar will weaken.



“My sun sets to rise again.”

~ Robert Browning, English poet and playwright, 1812-1889.

Global equity markets have moved sideways for 22 months (January 2018 through to October 2019) and are now breaking out to the upside. Equities are moving up in anticipation of improvement in the macro-economic environment into 2020. In contrast to 2019, where many indictors were slowing, these same metrics are starting to turn the corner, pointing to growth in 2020. The growth won't be robust, but it will at least be moving from a downward trend to a stable or upward trend. **In short, what were headwinds in 2019 will turn benign or become tailwinds in 2020.**

Equity markets have already moved to price in a rosy scenario for trade, supportive global central banks and the expectation that the earnings recession will come to an end in 2020. While our full-year return scenarios leave room for further growth, equities likely require more time to consolidate recent gains (a 5 to 7% correction in equities would pique our interest) and greater evidence (versus just hope) that the clouds are indeed going to part in 2020.

2019's headwinds set to become 2020's tailwinds

Conversely, **bond yields appear to reflect a degree of pessimism inconsistent with our base-case scenario of modest improvement.** While yields have been in an uptrend since their 2019 lows back in August (making higher highs and higher lows), their attraction is more muted than if yields were currently moving toward the upper-end of their trading range (a 35 to 40 basis point move higher from November 30 levels for Canadian sovereign bond yields would whet our appetite for more fixed income).

Bottom line: Our current tilt to the defensive side of neutral (i.e., slight underweight in equities and slight overweight to fixed income) continues to offer exposure to participate in equity market growth without overreaching for risk.

- Our 2020 Capital Market Outlook calls for high single-digit equity price gains, with select markets (Canada and Emerging Markets) capable of going slightly higher. Trade-, political- and geopolitical-related volatility is to be expected, with uncertain outcomes requiring a meaningful allocation to fixed income as a safe-haven investment.
- Within equities, we recommend broad, diversified geographic and sector allocations. We recommend neutral exposure to Canadian, U.S. and International (EAFE) equities and an underweight to Emerging Markets.
- For fixed-income investors, we recommend a neutral weight to sovereign bonds, offset by an overweight to investment-grade corporate bonds and underweight in high-yield bonds. Overall, we forecast a 1.5% total Canadian fixed-income return for the next twelve months. Importantly, fixed income remains positioned to deliver on its role as a risk-mitigation tool during bouts of risk-off sentiment or an outright deteriorating macro-economic environment.

GLC Outlook Summary

[1] From June 2019. **Change in view[1]** **Under** **Neutral** **Over**

Fixed income

Bond yields have begun to rise, but we do not see bond yield increases being sufficient to negate a positive total return in 2020. Fixed income remains attractive as a risk-mitigation tool. We recommend a high-neutral weight. Our base-case scenario calls for a total bond market return of 1.5% over the next twelve months.

Government bonds

Government bonds are attractive for their superior risk-mitigation qualities. Yields have shifted to a lower trading range. We will opportunistically take advantage of relative-duration opportunities depending on where yields are within this new range.

Investment grade corporate bonds

We see investment-grade corporate bonds as most attractive given their mix of yield pickup and modest safety. On an absolute basis, investment-grade corporate bond spreads remain narrow, moderating any significant price appreciation.

High-yield corporate bonds

High-yield spreads remain low and narrow. When coupled with a lack of risk-mitigation characteristics, we see the risk/reward trade-off in high-yield bonds as unattractive. Our active fixed-income managers continue to uncover selected unique opportunities through individual security selection where the risk/return trade-offs are appealing.

Equity

We believe the global economy is showing signs that global growth should pick up in 2020, aided by a détente in global trade frictions and stimulative central bank policies. Corporate earnings growth supports equities, keeping our outlook constructive. However, valuations are elevated and risks remain so we see a low-neutral stance as appropriate.

Canada

Canadian equities continue to look attractive. Sentiment has improved and valuations remain attractive against earnings growth of 7%. The sector composition (favouring cyclicals and value) is poised to outperform in a scenario of modestly improving global growth and waning trade uncertainty. With a 3% dividend yield, we see a total return of 10% in 2020.

U.S.

U.S. equities are home to some of the best secular growth opportunities and are capable of delivering decent earnings growth. However, current elevated valuations drive muted return prospects. With a modest dividend yield of 2%, we forecast a 6% total return for 2020, leading to our neutral recommendation.

International

We hold a neutral view toward EAFE equities. Weighed against Europe and Japan's longer-term structural issues, heavily export-oriented EAFE corporations have an opportunity to benefit from a pick-up in growth and a trade détente. The group offers reasonable valuations and decent earnings growth potential, along with a high dividend yield.

Emerging markets

EM equities are the most sensitive to trade and policy uncertainty, making their risk/reward trade-off stark. EM equities remain a riskier, high-beta asset class most appropriate for those with higher risk tolerance and longer time horizons.

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