Will it continue? Q&A: Outlook 2020 – update
Global Asset Allocation Strategy
January 2020
Will it continue?
Outlook 2020 Q&A – update

WILL 2020 BE ANOTHER GOOD YEAR?

• We think the chances are good. Our main scenario is an economic stabilisation, which will underpin a decent earnings development. Valuation continues to be attractive relative to fixed income, where opportunities are few.

• While central bank stimulus has been key to 2019, they have less ammunition going forward. But the accommodative stance will act as support for risky assets going into 2020.

• A recession and/or (geo)political turbulence poses the greatest risk to the outlook. Elevated sentiment increases the risk of a short-term pullback, but we think that will be a buying opportunity. Keep the overweight in equities.

EQUITY STRATEGY: which region(s) will be the winner(s)?

• We recommend moving to a neutral stance across regions as risks have turned increasingly two-sided. Specifically, Europe is helped by flows and political clarity and hurt by wobbly macro and auto tariffs. EM may benefit from a reinvigorated global economy and trade truce, or lose out on slower Chinese growth.

• We end the year in the sector strategy with a balanced cyclical stance, with overweights in Energy and Healthcare, and underweights in Utilities and IT.

FIXED INCOME STRATEGY: is there any value, anywhere?

• Generally, risk-taking is needed if any return is to be had in this space, where most government yields still are very low. Riskier credits yield more, and among them we prefer EM debt. OW EM Debt, UW government bonds.

• We expect modest returns from fixed income during 2020 as yields are low and probably will not head lower.
Market performance & recommendations

A very strong year for most assets, especially equities

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<th>ASSET ALLOCATION</th>
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Source: Refinitiv Datastream / Nordea
2019 | Positive returns across asset classes

Returns 2019, EUR (unless otherwise stated)

Source: Refinitiv Datastream / Nordea
2019 – A very good year!

S&P500 total return (USD) 1871-2019

Source: Refinitiv Datastream / Nordea
Political noise has so far failed to stop the long rally

Source: Refinitiv Datastream / Nordea
What are the scenarios for 2020?

**Scenarios for stocks in 2020**

- **Expansion**: Moderate growth. Stabilization in manufacturing and capex rebounding moderately. Consumers solid. Rates slightly higher (5-10%).
- **Melt-up**: Geopolitical risks evaporate while financial conditions are still easy. Steeper yield curves and TINA on speed (25%).
- **2020 recession**: Geopolitics escalates significantly and pessimism spreads to corporates and consumers. CBs reacts but pessimism persist (-40%).

**Scenarios for bonds in 2020**

- **Expansion**
- **Melt-up**
- **2020 recession**

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65% Expansion: Moderate growth. Stabilization in manufacturing and capex rebounding moderately. Consumers solid. Rates slightly higher (5-10%).

25% Melt-up: Geopolitical risks evaporate while financial conditions are still easy. Steeper yield curves and TINA on speed (25%).

10% 2020 recession: Geopolitics escalates significantly and pessimism spreads to corporates and consumers. CBs reacts but pessimism persist (-40%).
Where is the world economy headed?

Manufacturing could be rebounding which bodes well for services

- Slowly to a better place. Growth in the near term might be sluggish, but the pace may already be improving.
- Importantly for investors, global manufacturing seems to have bottomed out. While growth could still be negative, it should pick up going forward.
- Services are showing signs of following manufacturing down, but as the situation in the latter improves, so too should the outlook for the former.
Continued economic uncertainty is keeping the important DM central banks in easing mode. EM central banks are following with more room to ease.
Fed insuring sufficient liquidity (mini-QE), has removed some tail risk. The responsiveness is a positive signal that fed is ahead of the curve.
Financial conditions are still easy and already feeding into the real economy. We expect the central bank put will lift markets further going forward.
How deep will the earnings recession be?

- Not deep. Leading indicators for earnings including PMI:s, global trade and commodity prices point to a stabilization in the earnings outlook.
- Earnings will continue to be weak, but if the cyclical outlook stabilizes as indicated by leading indicators, they should bottom out during the first half of 2020.
- However, we are concerned about the longer term outlook for margins and earnings as tailwinds from lower interest rates, taxes and wages fade or reverse.
Will TINA continue to support equities?

- Yes. Global equities seem stretched on some valuation measures like price/sales, which are currently high relative to p/e-ratios due to high margins.
- However, relative to bonds most equity regions still seem very attractive and will stay so without a major contraction in earnings and/or higher yields.
- 2019 has demonstrated the power of monetary policy and TINA (“There Is No Alternative”) as equity markets have risen despite falling earnings.
Will sentiment stay volatile?

- With all likelihood, yes. We are 10+ years into the current cycle, which usually means more skittish investor/market behaviour.
- However, should we see an economic stabilisation (our main scenario), chances are that sentiment will be a less forceful driver relative to 2019.
- The year-end rally poses short term correction risks though, as both sentiment and technical indicators are presently stretched.
Will geopolitics still be left, right and center for markets?

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<th>2020 Presidential Election</th>
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<td>• Will Trump be re-elected? Or impeached? The biggest political event in 2020 will create a lot of headlines.</td>
<td>• Hong Kong/EM protests is a risk, especially if an economic stabilisation don’t materialise.</td>
<td>• Europe will, with all likelihood, continue to be impacted by political risks.</td>
<td>• Middle East tensions remain a risk, especially after the US airstrike on Iranian general Qassem Soleimani.</td>
<td>• Chile protests (Transport fares), Catalonia Independence protests, France (Yellow Vests), etc.</td>
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The trade conflict

• The strategic conflict will not disappear during 2020, if even during Trump’s presidency. The "Phase 1"-deal has been agreed (not signed), but details are scarce and uncertainties still linger.

• Expect market mood swings along with the news flow, roughly like the conflict has played out since it began in earnest during 2018.

Brexit

• With the landslide victory for Tories in the parliamentary election, Boris Johnson got a strong mandate to “get Brexit done”. Uncertainties have resurfaced as Johnson wants Brexit by the end of 2020, opening up for a “semi-hard” Brexit.

• We see continued noise from this issue also during next year.
The good, the bad & the ugly – risks & opportunities going into 2020

### The good

- Central bank stimulus, and possible fiscal stimulus, lifts global demand and capex. Growth rebounds.
- Earnings growth recovers while input costs remain low, high margins are maintained.
- Reluctant investors return to the market (FOMO), reversing the outflows from equities since early 2018.
- (Geo)political fears lessens further, risks from trade and/or Brexit fade.
- A moderate in the White House lift market sentiment.

### The bad

- Trade talks and/or Brexit goes awry.
- The manufacturing malaise deepens and spreads to the service sector. Growth slows towards recession
- Capex heads into a deeper recession - weakness spreads
- Margin contraction leads to a deeper earnings recession
- Unexpected inflation pick up spooking the markets
- Consumers pull back spending despite low rates
- Rising inequality questions corporate tax levels
- US 2020 election turns ugly

### The ugly

- China cracks down hard on HK.
- Late cycle dynamics trigger shocks due to excessive positioning.
- Oil/war in the Middle east.
- Russia succeeds in dividing western opinion.
- Inequality moves centre stage increasing extreme populism.
- EM turmoil deepens, e.g. Venezuela.
- North Korea continues to act up.
Which equity region has the best potential?

- We prefer a neutral stance across the regions as downside risks for potential winners and upside risks for potential losers have increased.
- Specifically, Europe might benefit from political clarity and stabilising macro, but positioning is less of a support and US tariffs a risk. Reduce to neutral.
- Emerging markets, on the other hand, might be hurt by sluggish Chinese data, but trade truce and improving global macro will support. Lift to neutral.

Source: Refinitiv Datastream / Nordea
Credits | Will bonds repeat their outstanding performance in 2020?

- Hardly. The great bond performance in 2019 was possible with the help of sinking government yields. We are not assuming yields to repeat this dive.
- Current economic environment is moderately supportive for growth in 2020. We assume that major central banks are done with grand share of easing.
- EM central banks have room for further monetary easing. We keep our overweight recommendation for emerging market hard currency bonds.
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