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INVESTMENT MANAGEMENT

Jon Cunliffe, Chief Investment Officer, Charles Stanley:

Eight market predictions for 2020

The Cabot range sub investment manager Charles Stanley takes a look at what lies in store for investors in 2020.

One

Investment returns are likely to be lower than in 2019. This year has been characterised by broad-based asset price performance, with all the major asset classes generating significantly above-average returns. As we head into next year, markets are anticipating another year of strong equity market performance. This is predicated on better economic and corporate earnings growth, supported by reduced political risk now that we have a "phase-one" trade deal between the US and China and a resolution of UK parliamentary deadlock.

However, above-trend economic growth and corporate earnings growing in the mid-teens are baked into consensus expectations, so there is ample room for disappointment if the business cycle remains sluggish and downward pressure on profit margins persists. Against this background expect mid-to-high single-digit returns at best.

Two

However, low bond yields will remain a tailwind for equities so don't be outright bearish on stocks. With most developed and emerging market central banks keeping monetary policy highly accommodative, global growth struggling to move above trend and inflation remaining subdued; we expect bond yields to stay low. As a result, the discount rate applied to the returns of risk assets will remain low and present values (price/earnings ratios in the case of equities) should be well supported. In short – expensive bonds, expensive equities.

Three

Ignore ESG if you want to lose money. A combination of upcoming regulatory change, a rising green agenda in Europe and increasing investor sensitivity to the corporate sector's impact on the environment will generate a snowballing of interest in following the principles of Environmental, Social and Governance. Many investments (both direct and collective) which score poorly on ESG factors may begin to trade at a discount. (For a more in-depth look at the growing importance of ESG investing click here.)

Four

Expect the Bank of England to cut rates. Of all the key central banks, the Old Lady has had by far the quietest year. The UK economy ends 2019 on a weak footing, with financial conditions having tightened in recent months. Whilst there is fiscal stimulus in the pipeline, we expect that the Bank's incoming Governor will feel minded to build a consensus in the Monetary Policy Committee around the need for a modest cut in interest rates in 2020.

Five

UK equities will perform relatively well on valuation grounds. The dividend yield gap between the FTSE 100 and ten-year gilts has never been wider. In addition, UK equities are trading at a generous valuation discount to their European neighbours. Finally, although Sterling has recovered some lost ground, it remains cheap on a trade-weighted basis and this is likely to be a draw card for overseas investors.

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Six

Domestic value plays within the UK equity market will have more appeal after the general election. Quality/growth stocks – both globally and in the UK – have been the standout performers in recent years. Muddle-through growth and low bond yields have encouraged investors to pay a premium for sustainable and above-average earnings growth, leaving cheaper, so-called value plays behind. However, now

that UK domestic political risk is somewhat lower and the economy is poised to benefit from upcoming fiscal stimulus, investors are revisiting some of the cheaper sectors – notably, housebuilders, banks and utilities. Whilst this approach has some merit, it is important to hedge domestic exposure with international earners given 2020's Brexit uncertainty.

Seven

Donald Trump is not done with tariffs. The self-styled "tariff man" is obviously pleased with the "phase one" trade deal with China. The key element of this agreement was to rescind the planned tariffs on US consumer goods scheduled for 15 December and roll back some of the earlier tariffs. All this is in return for Chinese purchases of US agricultural goods. This trade deal is, however, light years away from a comprehensive agreement which deals with technology transfer and intellectual property rights and a betting man should not rule out the opportunistic use of further tariffs on Chinese imports in an election year where the polling is likely to be tight.

Eight

Don't expect significant Eurozone fiscal stimulus. Northern European countries, notably Germany, Austria and Holland, consistently run balanced budgets despite weak domestic and regional growth. This is not to burden future generations with rising debt. However, with monetary policy flying at the edge of the envelope, and pressure from incoming ECB President Christine Lagarde to loosen the purse strings, surely some fiscal reflation is overdue? Don't bank on it – aside from some modest fiscal loosening linked to the incoming President of the European Commission's green agenda, we feel that fiscal conservatism is so ingrained in the German psyche that it will take a full-blown recession for the purse strings to be loosened in any meaningful way over the next twelve months.

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