2019 Economic & Equity Outlook

Having a top-down portfolio building approach (meaning we take a look at the world from a macro-economic perspective before identifying allocation and underlying investments), we as a firm have spent a lot of time this past month meeting with various business partners, being on calls with economists, and attending events put on by asset management strategists to discuss not only their 2019 market & economic outlook, but their updated medium to long term assumptions as well. This includes analysis & commentary from Vanguard, JP Morgan, MFS, Goldman Sachs, and FlexShares. We subsequently discuss this internally and voice our opinions before deciding on any portfolio changes that we should be looking at. Here are some of the comments, numbers, and projections of note that we have come across.

From an economic perspective, the biggest talking point is the imminent recession in the United States. Fears over this were well documented in 2018. However, the broad sentiment is that a recession in 2018 is unlikely, but growth will slow down. Vanguard writes that "current fundamentals such as consumer demand, household balance sheets, price inflation, and the present stance of monetary policy suggest that the U.S. recovery could persist at least through 2020." They add that "The US consumer has been the key engine of growth during the recovery from the global financial crisis." With the consumer set to get a bigger tax refund in April, this growth should continue through the summer. JP Morgan echoes this sentiment and believes that the earliest we'll see a recession is in late 2019. Blackrock does foresee a low probability of a recession in 2019, but the forecast gradually escalates to 54% likelihood of a recession in 2021. From an investment perspective, we must begin being cautious about something like this now, as the markets will begin to price in any change in probability of a recession. Much like towards the end of last year, and the beginning of this, investors will be looking closely at all economic numbers and will monitor what the Federal Reserve does. This will almost certainly result in continued volatility. Lastly, a recession in the U.S. will drive down global equities as a well, which adds extra significance to the economic numbers and the Fed commentary. That is why Vanguard's largest single risk to forecasts is an overly aggressive Federal Reserve. After the Fed reassured investors in early 2019 that it would be careful and pull back on the tightening, the stock market bounced back in a big way. This is something to be mindful of going forward.

The other big worry among investors is the worsening of China – U.S. trade relations. Chinese growth is slowing down, and the weight of the tariffs will start to impact their GDP growth this year. While China is set to grow the most among all EM economies, they are ahead of the U.S. in their economic cycle. Vanguard's projections give a probability of 80% of a slowdown in China in 2019.

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That said, we'll look to see what economic reform the Chinese leadership undertakes. Because of that, alongside valuations and earnings growth, BlackRock and Goldman Sachs both remain very positive on Emerging Markets as a whole. If the trade discussions between the U.S. and China resolve positively, EM equity is set for a major bounce back.

Looking out at mid to long term projections: Vanguard has U.S. equities returning an annualized 4-6% over the next 10 years, with developed international returning 6.5-8.5%. This is in line with general sentiment, including our own. However, we don't know what the path will look like to get there. As we enter this period of uncertainty, we are not bearish on the equity market in 2019. We remain bullish on the global economy, but will strive to minimize drawdowns in a more volatile environment.

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