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R&R Weekly Column
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The Year Ahead: In Spite of An Improved Outlook, Beware of Cracks

Last week we published our Global Outlook and Strategic Asset Allocation for 2020. We discussed our growth, inflation, policy and market forecasts for the year that is about to begin, with baseline, downside and upside scenarios. We also discussed the main macroeconomic and market themes for 2020, with their implications for market and asset allocation.

In our global overview, we mentioned how 2019 was characterised by a synchronized global economic slowdown, but with a strong rally of risky assets, such as US and global equities. The slowdown was driven by a number of geopolitical risks, such as the escalating trade and tech war between the US and China, the risks of a hard Brexit, and increasing tensions in the Middle East. These helped lead to a recession in the manufacturing sector. Now, in our baseline scenario for 2020, we expect this slowdown and stagnation of the major developed market economies to continue. We are less convinced however by the global reflation story that other research houses, especially in the sell-side of the financial industry, are pushing these days.

Equally, we consider a global recession in 2020 to be a risk scenario, at this stage. In a series of articles published in the second half of 2018 we discussed the possibility of a severe market correction and a global recession occurring as early as in 2020, and we outlined the ten factors that could lead to such an outcome. At the same time, in a more in-depth analysis, we discussed the ten reasons why a milder scenario could materialise, in spite of those threats. Chief among these ten reasons were an accommodation in the global monetary policy stance and a containment of the geopolitical risks, both of which have occurred since then, thereby reducing the probability of a global recession in 2020. Nevertheless, geopolitical and domestic political tensions, an increase in trade wars, disruption of global supply chains, tighter financial conditions, and market valuations disconnected from underlying macro fundamentals could still cause sudden market corrections: investors need to remain aware of these risks in the year ahead.

Given this background, the current environment calls for a moderately 'risk-on' position in 2020. There is a high probability that trade and political tensions will de-escalate. A more balanced policy mix is expected to emerge. Variants of "helicopter money" policies could eventually be introduced when the next economic recession and severe market downturn finally occur. From an asset allocation perspective, over the next few years, the investment environment remains challenging, because central bank liquidity and geopolitical risks are likely to matter more than fundamentals and market volatility is likely to rise, hampering portfolio performances and increasing the likelihood of corrections and, eventually, bear markets. As a result, "expected returns" are likely to be lower than in the pre-2008 crisis period. Investors, over a multi-year horizon, will therefore have to accept lower expected returns in exchange for lower volatility, and while riding the liquidity wave remain aware of the risks mentioned above.

Our Recent Publications

- Flash Review: Riksbank Brings The Repo Rate Back To Zero, And Signals A Long Pause, *by Brunello Rosa and Karmen Meneses, 19 December 2019*
- 2020 GLOBAL OUTLOOK AND ASSET ALLOCATION - Despite The Improved Outlook, Beware of The Cracks, *by Nouriel Roubini, Brunello Rosa, Alessandro Magnoli Bocchi, 16 December 2019*
- Central Bank Reviews: BoJ, BoE and Norges Bank Stay On Hold In December And Signal Caution Ahead, *By Brunello Rosa, Fawaz Al Mughrabi and Farah Aladsani, 19 December 2019*
- MONETARY AFFAIRS - BOJ PREVIEW: Bank of Japan to Stay on Hold, as Global Headwinds Are Lessened, *by Nouriel Roubini and Brunello Rosa, 16 December 2019*
- **GEOPOLITICAL CORNER** - *Macron Rolls The Dice Over French Economic Reform And The Leadership Of Europe, by John C. Hulsman, 17 December 2019*

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Looking Ahead

The Week Ahead: US Durable Goods Expected To Rise, Japanese Retail Sales' Fall To Soften

In the US, durable goods orders are expected to rise (Nov., c: 1.4% m-o-m; p: 0.6).

In Japan, the recent contraction in retail sales and IP is expected to soften (Retail sales; c: -1.7% y-o-y; p: -7.1; IP, c: -1.4% y-o-y; p: -4.5), as the country recovers from typhoon-related damages.

The Quarter Ahead: Breakthroughs On Trade, US Budget, And Brexit Can Reduce Uncertainty

On the US-China trade front, President Trump stated that "a formal signing of the US-China first-phase trade agreement is being arranged". Meanwhile, China has started large-scale purchases of US agricultural products and Trump has suspended plans for new import taxes on Chinese goods. The agreement hinges on commitments to: *i)* protect IP rights; and *ii)* refrain from competitive currency devaluations.

In the US, the House has impeached President Trump along partisan lines, on charges of: 1) an 'abuse of power'; and 2) 'obstruction of Congress'. In January 2020, the process will move to a vote in the Republican-controlled Senate, where President Trump will unlikely be removed from office. The House also approved two spending bills with bipartisan support, to provide the government with USD 1.4 tn of spending through Fiscal Year 2019/2020. President Trump is expected to sign the bills, thereby preventing a repeat of last year's 35-day government shutdown. The market expectations of a Fed rate cut in 2020 fell to 54.7% (p: 45.3%).

In the UK, after the Tory's electoral win, PM Johnson's 'Withdrawal Agreement Bill' passed the House of Commons by 358-234. The new bill makes a softer Brexit less likely, as it prohibits the UK from extending the transition period beyond 2020.

In Argentina, amid wider restructuring talks, the new government asked bondholders to "show good faith" and delayed payments on USD9bn in USD-denominated debt.

Last Week's Review

Real Economy: Low Growth, Low Inflation – Central Banks Hold Accommodative Stance

In the EZ, the slowdown in industrial activity continues, while the services sector remains resilient. Weaker-than expected manufacturing PMIs (EZ, a: 45.9; c: 47.3; p: 46.9; Germany, a: 43.4; c: 44.5; p: 44.1) were compensated by a resilient services sector (EZ Serv. PMI, a: 52.4; c: 52.0; p: 51.9; Germany, a: 52.0; c: 52.0; p: 51.7).

In the US, both PMIs remained in expansion (US Markit Manuf. PMI Dec.; a: 52.5; c: 52.5; p: 52.6 - US Serv. PMI, a: 52.2; c: 51.9; p: 51.6). After a 40-day strike at General Motors ended, IP expanded (IP Nov., a: 1.1% m-o-m; c: -0.8; p: -0.9). Consumer spending – which accounts for two-thirds of US GDP – rose by 0.4% in November (c: 0.4; p: 0.3). Core inflation remains below target (core-PCE Nov., a: 1.6% y-o-y; c: 1.6; p: 1.7), while headline inflation rose (PCE, a: 1.5% y-o-y; p: 1.4), lifted by energy prices.

In the UK, the composite PMI displayed the deepest contraction since the Brexit vote in 2016, with both the services and manufacturing sub-components below-50 (Markit Comp. PMI, a: 48.5; c: 49.6; p: 49.3).

In China, growth in the industrial (IP; a: 6.2% y-o-y; c: 5.0; p: 4.7) and retail (Retail sales; a: 8.0% y-o-y; c: 7.6; p: 7.2) sectors was faster-than-expected, as government spending and lower borrowing costs propped up demand.

In DMs, BoJ, BoE, and Norges Bank kept their key policy rates unchanged at -0.10%; 0.75%; and 1.50% respectively.

In Sweden, Riksbank hiked by 25bps, to 0%, as a prolonged sub-zero rates could lead to negative effects.

In China, the PBoC kept its interest rate on hold (Loan Prime Rate 1y. a: 4.15%; p: 4.15).

Financial Markets: US Consumer, Chinese Data, And Eased Uncertainty Stirred Risk Appetite

Market drivers: global stocks rallied on strong data from the US and China.

Stocks: w-o-w, global equity indices rose (MSCI ACWI, +1.4% to 563), led by DMs – where the S&P500 hit fresh record highs (S&P 500, +1.7% to 3, 221) – and EM stocks (MSCI EMs, +1.9% to 1,108).

Bonds: w-o-w, returns fell (BAML Global, -0.3% to 284.5). European bond yields rallied (German 10y bund, +5 bps to 0.25%; Italian 10y bond, + 16bps to 1.42%) after Sweden's exit from negative interest rates prompted speculations that other CBs may be deterred from dropping borrowing costs below zero.

FX: w-o-w, the USD strengthened against a basket of currencies (DXY, +0.5% to 97.690). The EUR and GBP weakened (EUR/USD, -0.4% to 1.108; GBP/USD, -2.4% to 1.300), following concerns that the UK might leave the EU without a trading agreement in place by the 2020 deadline. After the 'phase-one' deal, the Yuan firmed at around USD/CNY 7.000.

Commodities: Oil prices continue to rise (Brent, +1.4% to 66.1 USD/b) on the back of lower oil stockpiles and trade optimism. Despite risk-on market sentiment, gold maintains its safe-haven appeal (Gold, +0.2% to 1,478 USD/Oz.).

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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*