**Outlook**
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# Omnis Investment Outlook 2019

## Introduction

Equities and fixed income markets faced strong headwinds during a turbulent 2018. A range of factors contributed to higher market volatility – the Fed tightened US monetary policy, a brewing trade war between China and the US intensified, and political uncertainty in Europe increased. Uncertainty now looks to have reached a peak, suggesting that when these events begin to unravel, markets will become clearer. Meanwhile, central banks across the world have reversed monetary stimulus in the hope of preventing the global economy from overheating.

Such uncertainty has hit market sentiment and company earnings expectations. These revised earnings expectations now broadly reflect our own views for 2019; a global economy where growth is uninspiring, but acceptable, and an environment where volatility is likely to remain elevated.

**Year-on-year % change in estimated earnings growth over the next 12 months (as at January 2019)**


*Source: Financial Times, Bloomberg & IIF*

## US

The fiscal stimulus that provided a sugar rush in 2018 will begin to fade, slowing US growth closer to its long-term trend growth rate by the end of the year. Originally, the tax cuts provided a significant boost to business investment, however, many businesses are now pausing further investment as geopolitical uncertainty intensifies. The US has always been a driving force in the global economy, but with capital investment slowing, growth and productivity could struggle. With weaker oil prices of late, wage growth unlikely to spike drastically higher, and global demand for commodities to be somewhat softer in 2019, US inflation is expected to remain muted. Consequently, the Fed will likely pause interest rate rises over the coming months and possibly change focus on the speed at which it reduces its balance sheet, known as quantitative tightening. This change in attitude from the Fed will be welcomed by investors who fear that tightening monetary conditions could force a faster slowdown in US economic activity. We would be surprised if the Fed hiked interest rates more than twice in 2019.

Having lost control of the House of Representatives in November, the Trump administration will likely face continued gridlock in Congress (as evidenced by the current government shutdown). In spite of this split there is still the possibility of minor additional fiscal stimulus this year in the form of infrastructure spending. Mainly because both parties would be in favour.

The reorganisation in Congress did not stop Trump in his other "America First" ambitions, as he continues to play to his base in the runup to the 2020 Presidential elections. As the trade war continues into 2019, Trump continues to threaten China with an increase in US tariffs to 25% on a full range of Chinese goods if a trade agreement cannot be made. Ultimately, we believe that some trade concessions will be reached between the US and China in the nearer term, however longer term underlying structural oppositions will remain.

## Asia & Emerging Markets

In addition to trying to solve the impasse with the US, China is grappling with a slowing domestic economy. A fine balance to strike in 2019 will be stimulating their economy to prevent it from slowing down too sharply, whilst sticking to a programme of reform and reigning in an unsustainable credit expansion. We expect more fiscal stimulus, and further cuts to reserve requirement ratios in 2019 to inject liquidity and aid capital formation, but not to the same extent as we have seen in previous years. An increase in government spending from China could bode well for Emerging Markets and the Asia Pacific region, where the strength of the Chinese economy will continue to drive performance.

## UK

Brexit continues, and will continue, to dominate the prospects for the UK economy and UK asset prices. We continue to expect a soft Brexit resolution, either by parliament eventually voting through Prime Minister May's deal (possibly at the second or third attempt) or with a postponement of the exit date – a second referendum remains a possibility. Heightening volatility, especially for sterling, is likely to continue. Assuming our base case for a softer Brexit, the Bank of England could create a more aggressive interest rate hike cycle, which would negatively affect bond yields. We view UK bonds, in particular gilts, as unattractively valued. Currently, the market is pricing in less than a 50% chance of a single rate hike in 2019. The uncertainty surrounding Brexit has led to domestic stocks being attractively valued.

## Europe

Aside from Brexit, there remain significant challenges for the European authorities in 2019. A battle between centrist and populist politicians looks to be the biggest threat to the EU. Many Eurosceptic supporters could conform to influence the European elections in May. If lacklustre growth and political uncertainty arises, the ECB's ability to raise interest rates in line with forward guidance could become restricted. Consequently, negative interest rates will continue to limit the flexibility of monetary policy in Europe. Expectations in Europe have been persistently downgraded – leaving room for upside surprises if earnings and growth come through stronger. We view equity valuations as cheap relative to the US, reflecting the regions poorer economic prospects. Most fixed income valuations remain unattractive.

## Japan

Japan is one of the few regions where policy will remain loose. We expect inflation to remain subdued, which will alleviate any pressures to tighten. October 2019 will see Japan's consumption tax increase from 8% to 10%. A previous increase, from 5% to 8% in April 2014, resulted in an immediate decline in Japan's economy. This time around we expect the government to provide more significant short-term measures to mitigate against a repeat scenario.

## Conclusion

We expect global growth to moderate in 2019. If the current economic cycle is to extend significantly further, increased capital spending and productivity gains will be required. Corporate earnings growth will slow this year but valuations are such that we see room for equities to rise. With labour markets continuing to tighten, and wage growth rising, the backdrop for many fixed income assets is likely to be a challenging one. Uncertainty and volatility are expected to remain elevated as the world deals with political developments such as trade relations, Brexit and populism.