



Danske Bank Asset Management  
Quarterly House View Winter 2019  
INSTITUTIONAL

## *2020 – no fireworks, but less could also be enough*

Despite the presence of several potential showstoppers in the global economy, we still see a reasonable return potential for equities in the coming year.



Industrial production has been a sore point in the global economy in 2019, but has shown signs of improvement in the US, for example. Here we see the Boeing factory in Renton near Seattle.



# Potential and risks for investors in the new year

Economic and political progress in recent months supports our expectation that equities will retain a reasonable return potential in 2020, though this progress could prove to be based on a rather fragile foundation. We review the global economy and assess what could push equity prices even higher following this year's substantial increases.

A few months can really make a difference in the financial markets - in recent months for the better.

**MARKET SENTIMENT WAS BLEAK IN AUGUST:** The US-China trade war was escalating, signs of weakness in the global economy were becoming more pronounced, and the risk of a chaotic no-deal Brexit was rising. In the US, the

yield curve inverted - in other words, long yields dipped below short yields - and that reinforced market jitters, as historically this has been one of the most robust signals that a recession is imminent. Investors sought sanctuary in bonds, yields in Europe hit new lows and equity prices fell.

**BUT OPTIMISM HAS NOW GAINED A SIGNIFICANTLY FIRMER FOOTING:** Political risk has eased following US-China negotiations on a partial deal in the trade dispute, while a no-deal Brexit has been averted for now. Central banks have worked hard to bolster sentiment in recent months by easing monetary policy, while a number of economic key figures have printed positively and provided a slightly brighter outlook. Recession fears have faded and investor risk appetite has increased, which since August has sent equity prices and long yields, in particular, higher.

**Overweight maintained in equities**  
Recent trends generally support ►►



By Danske Bank's chief strategist Henrik Drusebjerg



*In brief, we are in the late phase of an economic upswing that in the US has lasted more than 10 years, making it the longest upswing since World War 2.*

Expected return from global equities of

# 4-8%

over the coming 12 months in local currency.

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↑ Overweight in equities

↓ Underweight in bonds

our expectation that equities have a reasonable return potential in the coming year. Therefore we are maintaining a slight overweight in equities in our portfolios and a matching underweight in bonds. More specifically, we expect a return from global equities of 4-8% over the coming 12 months.

That being said, we are being careful not to get carried away by this renewed optimism, as a new wave of market turmoil and falling equity prices is in reality no further away than a negative tweet about the trade war from Donald Trump or a few disappointing economic key figures. Moreover, we estimate that the political and economic progress of the past few months has largely been priced into equities by now, and that this progress may be based on a fragile foundation.

So what is needed to push equity markets higher, and what could derail further price increases? We consider these factors below.

**Driving forces behind further equity price rises**

In brief, we are in the late phase of an economic upswing that in the US has lasted more than 10 years, making it the longest upswing since World War 2. The years of highest economic growth are behind us, and for some time now the manufacturing sector, in particular, has been slowing, with declining key figures across Europe, the US and China. Lately, however, we have seen some signs of a stabilisation across a number of key figures, which at best could indicate a turnaround, though we have problems envisaging a marked increase in growth in this late phase of the cycle.

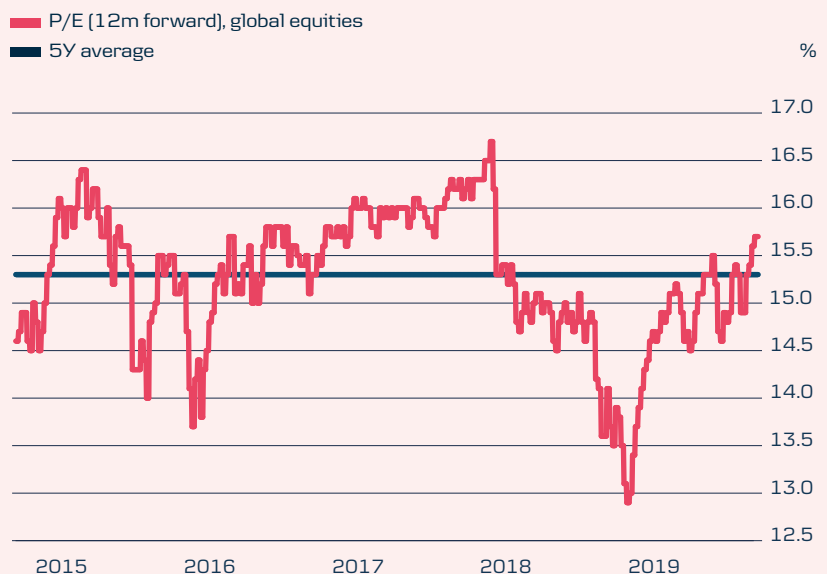
Yet, less could also be enough. If the economic key figures remain stable and continue to confirm for us and other investors that a recession is not just around the corner, more modest growth could be enough to keep equity markets on track. And while global manufacturing is limping along, the picture is more positive for the service sector, which fortunately accounts



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*Equities no longer cheap*

Following recent equity price rises, global equities are now valued above the average for the past 5 years in terms of P/E (12m forward) - in other words, the price investors pay for expected corporate earnings over the coming 12 months. Hence, equities are not cheap, though in our view they remain an attractive alternative to the very low expected returns from bonds. All else being equal, higher valuations increase equity vulnerability in the event of negative events in the global economy, which just serves to reinforce the importance of being selective in your choice of equities, including your choice of regions and sectors, and also of continuing to have bonds in your portfolio as a stabiliser.



Source: Refinitiv Datastream, 25.11.2014-25.11.2019.





*Christine Lagarde took over the reins as head of the European Central Bank at the beginning of November, so the interesting question in 2020 will be which course she sets for monetary policy in Europe - will she ease further?*

for a larger share of the global economy. Here, confidence indicators (PMI) continue to point towards growth, while consumers are generally still doing well, as low unemployment and low interest rates - and thus low housing costs - are helping to keep consumption buoyant, and we expect interest rates to remain low in 2020 too.

Hence, there are several different factors still pulling in the right direction for the economy. Our overall assessment is that the current upswing still has some way to run - at least 12 months and potentially longer - before a downturn materialises. We thus expect a solid enough foundation remains for corporate earnings to grow, which in the end is what justifies rising equity prices.

**Several potential showstoppers**  
Nevertheless, there is good reason

to maintain a cautious approach to investing and not assume too high a risk in your portfolio. We see the following risks as being among the most important threats that could dampen the increased optimism among investors:

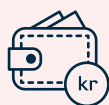
**WE HAVE BEEN CHEATED BEFORE:** Manufacturing is the sorest point in the global economy. Industrial production is suffering from the trade war, as it causes companies to hold back on major investments. Yet, confidence indicators (PMI) for the manufacturing industry are among the figures that have recently shown modest signs of stabilising after an extended period of ever declining numbers. However, we should be cautious about over-interpreting these, as we have previously seen signs of a turnaround in the PMI figures only to see a further deterioration later. This



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### 3 topical numbers



**68.1%**

Share of US GDP accounted for by personal consumption in Q3 2019 (source: fred.stlouisfed.org). The US is a consumption-driven economy, and low unemployment and rising wages are currently providing a solid foundation under US growth. Moreover, consumption has historically been a more stable contributor to growth than, for example, corporate investment.



**9.8%**

Average rise in corporate earnings per share (EPS) expected by analysts in 2020 for global equities (source: Reuters IBES as of 14.11.2019). This is a very high figure compared to 2019, where expectations average around 0.5%, and it could well prove unduly optimistic. Corporate earnings can come under pressure from rising wages, among other things, during this late phase of the upswing, while the economy slowing more, or more sharply, than expected could mean expectations quickly losing their foothold in reality. Expected growth in the price-to-sales ratio is 4.5%.



**2%**

Level of inflation that central banks in the euro area (ECB) and the US (Fed) target, but central banks on both sides of the Atlantic are having difficulty creating inflation in the economy. This is one reason why we continue to expect a very accommodative monetary policy, with central banks very wary of tightening during this fragile phase of the economy and also given the considerable political uncertainty currently prevailing.



*Negotiations on a phase 1 trade deal breaking down would be a major disappointment, and even if we get a deal, it may not be as good as expected.*

was the case in early 2019, for example. Furthermore, should the manufacturing sector begin to seriously shed jobs, this would also impact consumers and the service sector. We need to see a slightly longer period of stabilisation – and at the very least no deterioration.

**LESS POWDER IN RESERVE:** 2019 has been defined by the trade war and political uncertainty, but while these have put a damper on growth, we have avoided a recession and enjoyed high returns from equity markets. Monetary policy easing by the central banks has

been a major factor in mitigating the negative effects of the slowdown and keeping investor sentiment positive. Our assessment, however, is that the global economy will have less of a cushion in 2020, and so will find it harder to absorb new shocks. The central banks have less powder at their disposal and the economy is growing at a slower rate, closer to the cusp of a recession.

**Trade war could flare up again**  
**THE TRADE WAR LIVES ON:** A third serious reservation we have is the trade war between the US and China. The ►►

### Risk of recession has eased

The Federal Reserve Bank of New York (regional division of the US central bank) regularly estimates the risk of a recession in the US in the coming 12 months based on the difference between short and long US yields (3-month and 10-year, respectively). Historically, movements in the spread between these yields have been one of the most reliable indicators of an imminent recession.

The risk of a recession has eased in recent months, but remains at a high level. If the economic data continue to point towards a stabilisation of the economy, this could further reduce fears of a recession and support equity prices.



Source: Macrobond.

Presidential elections and the potential impeachment of Donald Trump will make US politics one of the dominating themes in 2020.

Brendan Smialowski/AFP/Ritzau Scanpix



financial markets have naturally reacted positively to the recent rapprochement between the partners that is expected to initially result in a partial agreement – a so-called phase 1 agreement – though we still have to see the agreement materialise so Donald Trump and Xi Jinping can be lauded as the great negotiators. Negotiations on a phase 1 deal breaking down would be a major disappointment, and even if we get a deal, it may not be as good as expected when it is finally announced, as the daily flow of rumours and speculation about the negotiations points in all directions, and in our view investors have already largely priced in the good news.



*Both the US and China are suffering due to the trade war – and Donald Trump probably has a need to demonstrate some form or other of progress ahead of the presidential election in 2020.*

Furthermore, the phase 1 agreement will only be the first step on the road to unanimity on the more fundamental terms and conditions for trade between the US and China going forward. While the political risk has faded for now, the trade war could quickly flare up again. But make no mistake, both the US and China are suffering due to the trade war – and Donald Trump probably has a need to demonstrate some form or other of progress ahead of the presidential election in 2020, as growth and equities suffering too much

would have a negative impact on his chances.

**Summary**

All in all then, our conclusion is that while we are now in a better place than a few months ago, the outlook is not completely rosy when looking ahead to 2020. Nevertheless, we are sufficiently

confident to maintain our slight overweight in equities, where we continue to see value in the new year, also compared to bonds. That being said, investors will also have to cope with periods of significant volatility in the coming year and should not be hoping for a repeat of the handsome returns from equities seen this year.

*3 critical factors for 2020*



**US politics**

How might the potential impeachment case turn out for Donald Trump, and will he be re-elected? The election campaign will be a huge theme in which investors will also be very focused on who wins the Democrats' nomination for president at the November 2020 election, and what he or she stands for politically and economically. The US election will only grow in importance as the year progresses.



**Trade policy:**

What next for the trade war between the US and China, and will trade tensions between the US and Europe flare up? The US-China trade war has proved to be the most important geopolitical factor for the financial markets in years and a key piece in the rivalry between the world's two superpowers, with China gnawing away at the US's global dominance.



**Recession signals:**

The financial markets will again in 2020 be very vulnerable to signs of the economic upswing nearing its expiry date. Economic data will therefore be closely scrutinised, and anything that stokes recession fears may produce periods of significant market volatility and price falls.

*The further unfolding of the Brexit drama will naturally also draw attention, though this is more of regional significance for Europe than of global importance.*

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**Always remember your risk as an investor:**

This publication is based on Danske Bank's macroeconomic and financial market expectations. Deviations from our expectations could potentially affect the return on any investments negatively and result in a loss.

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