January Market Reflection

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Following a year of bumper returns in 2019, equity markets looked set fair to extend their gains into 2020, helped by the signing of the first phase of a trade deal between the US and China. Locally, sentiment was buoyed by the Conservative Party's resounding election victory, lifting the threat of a Labour government and providing at least some clarity on Brexit, in that it would now actually happen. However, two unexpected developments stopped markets in their tracks in January. The first, currently de-escalated to the market's satisfaction, although far from resolved, was the exchange of missiles between the US and Iran, and the killing of a key Iranian military figure. Just as investors were regaining their confidence after that incident, news began to emerge from China of a novel coronavirus. At the time of writing it remains difficult to assess the full impact. Comparisons are being made to the outbreak of SARS in 2003, although there are initial differences in, for example, the incubation period (longer), risk of contagion (higher) and fatality rate (lower for now). The uncertainty will weigh on investor sentiment until the picture becomes clearer, but it is already evident that this outbreak will have a depressing effect on economic activity. The bulk of the pressure will be felt in China, but the fear is that increased global connectivity will spread the pain far wider than in previous cases. The positive corollary to such a potential slowdown is that monetary and fiscal authorities will be more inclined to provide support, which is expected to limit the downside for equity and credit markets. With austerity being gradually consigned to history, governments are being encouraged to loosen the purse strings, especially in pursuit of remedies to climate change. The winning asset classes so far this year have been safe havens such as government bonds and gold.

- Global growth decelerated in 2019, with consensus forecasts now pitched at around 3% for the year versus 3.8% in 2018. A small acceleration in the pace of growth is currently expected in 2020 driven by a recovery in global trade and the lagged influence of looser monetary policy. However, that is before the effects of the coronavirus have been accounted for, suggesting downgrades ahead.

- Central banks are committed to continuing to provide liquidity support, which provides a degree of comfort to investors.

- Fiscal stimulus is being more widely accepted as a policy lever to encourage higher rates of growth. Extremely low government bond yields mean that cheap capital can be provided for projects that have the potential to boost productivity and to combat climate change.

- We continue to see little evidence of the excesses associated with cyclical peaks (of either economies or stock markets), and equity valuations remain fair to cheap when inflation levels and bond yields are taken into account, especially for investors seeking income.

- The strong equity returns of 2019 were driven primarily by re-rating following a very poor 2018, and we would caution against expecting another year of similar performance.

- Donald Trump remains the favourite in the US presidential race, despite the impeachment proceedings. The outcome of the Democratic leadership contest will become clearer in the next few weeks, with investors focused on how far to the left the party is willing to swing.

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