2019 Outlook_Market Themes

Richard Edgar: [00:07]

Hello, markets in 2018 were in many ways dominated by the US - its stocks, its earnings and its economy. But how will that dominance play out as central banks unwind their balance sheets and volatility darts onto the scene.

Where might the opportunities lie?

What else should we be watching for in markets across the world in 2019?

Well, with me to discuss the themes of 2019, our portfolio manager, **Eugene Philalithis**, and investment director, **Kasia Kiladis**.

Welcome to you both.

Kasia, now you focus on the US and of course it has led the way in 2018. How much do you expect that to continue in 2019?

Kasia Kiladis: [00:41]

Well, I think most people expect a slower pace of growth, so I think that's already embedded in, but I think people are far too negative about the risks and the slowdown because we still have plenty of fiscal policy to take us through.

And of course, we'll also have the consumer tax cuts coming in early 2019, and what that'll do is that'll increase consumer spending, and we know in the US that consumer consumption is the key to growth in the economy.

Richard Edgar: [01:08]

What about Eugene, how do you feel about the US in 2019?

Eugene Philalithis: [01:16]

Well I think that 2018, until the fourth quarter, really was a continuation of the themes we saw in 2017, with very strong growth, very strong performance from US markets.

But I think we've seen quite a lot of volatility, especially in the fourth quarter and especially in the tech sector, which I think has been a bit of a wakeup call for investors - in the sense that very strong, low volatility growth and strong momentum from those stocks might be called into question.

This will, I think, have broader implications for how investors are positioned within markets overall, and how they view the US, relative to the rest of the world.

Richard Edgar:	01:58	We will come to those tech stocks in just a moment. But thinking about volatility, because it has been a spike towards the end of 2018, how will that play out in the coming year?
Eugene Philalithis:	02:07	Well, I think when we look more broadly at asset classes, we think that valuations are quite extended in some areas and returns from markets in general, so the market return that you would expect over the next few years is likely to be lower than what we've seen over the previous years. So in an environment where we expect lower returns and central banks are continuing to normalize policy - the Federal Reserve will continue to raise rates and even the ECB is likely to raise rates at some point in 2019 - we think that will lead to a pickup in volatility. With low returns and high volatility, market returns will be a lesser driver of total return, and so that volatility pickup will continue. In that sense, it makes sense to be quite diversified, look for opportunities across the world, but also look at how you can position your portfolio with a full toolkit of hedges, your currency exposure, and allocating to uncorrelated assets like alternatives or even defensive assets, such as US treasuries or US investment grade.
Richard Edgar:	03:24	It's not just as simple as it used to be because the FAANGs, the tech stocks, they really did dominate everything in 2018. What would the picture be, do you think, as we go into next year?
Kasia Kiladis:	03:35	So I think with the FAANGS it's really interesting because we knew that they drove the market in 2017 and really up until 2018, when we saw that spike in volatility. We were always mindful of those risks because can that growth be sustainable? And there certainly are a lot of risks on the horizon, from regulation to data privacy, and what started in Europe in terms of taxes and data privacy, has now seeped into the US. Even the US administration has become a little bit more, I guess, sour on Silicon Valley.

		So we're starting to see those risks grow and the market is saying that. And I think that's good because we will have a broadening out of the opportunity set, but I think we have had a period of low volatility, an extended period of growth. So I think investors are kind of on tenterhooks right now in terms of whether there are risks and are those risks multiplying? What's going to happen to the FAANGs? What's going to happen with the Fed? And in October, the Fed also accelerated its balance sheet reduction. So again, you know, all these risks are in play and that's going to see volatility come back, which shouldn't be unique because I think 2017 was really the aberration in terms of low volatility. I think we'll have a return to normal and that broadens the opportunity set for investors.
Richard Edgar:	04:56	It's a healthier situation perhaps for the world to be?
Eugene Philalithis:	05:00	In addition, when you look at the makeup of volatility in the US market, you had the FAANGs, the tech stocks which were particularly exhibiting low volatility that continued the ramp up in prices. This meant that they were, because of the size that they represent in the US market, they were dragging the overall index down. So if there's a reappraisal of their dominance, or the outlook for their profitability and their earnings, that should result in overall market volatility rising as well, even though the rest of the market was maybe exhibiting more normal levels of volatility, when you exclude the FAANGS and the tech stocks.
Richard Edgar:	05:47	Let's move away from the US, where do you see opportunities in the months ahead?
Eugene Philalithis:	05:50	I think many of the opportunities will be when we look at 2018, some of the areas that were beaten up because of the withdrawal of capital or because of a repricing of risk premia, they look to be some of the areas that we favour in 2019. So emerging markets stands out as one, Asia high yield as well, which is an asset class that’s really suffered in the first half of 2018 and is now exhibiting better valuations and attractive

fundamentals, in terms of corporate balance sheets and leverage data.

And so in 2019, we think that this asset class could deliver attractive returns, as it's offering a very attractive yield at the moment which, relative to other parts of the fixed income market, is quite appealing for us.

Richard Edgar:	06:44	Kasia, back to you finally. What would be the surprising things for you in 2019? Where would investors find interesting returns?
Eugene Philalithis:	06:50	Well, I think the US market has been very polarized in the past with, as we spoke, the FAANG names monopolizing the majority of the market returns in 2017, and 2018 until recently. So I think the biggest surprise will be a continuation of US growth, but also in those unloved sectors that we haven't seen really grow to the same extent - that maybe now with the fiscal policy still intact, we could see those opportunities begin to rise. And I think any type of positive surprises in terms of the outlook for trade. So if the Trump administration starts to maybe normalize some of those trade disputes, then we should still see some positive upside from that.