2020 Investment Outlook: A Global Focus

Our investment experts ponder the U.S. central bank's new policy focus and discuss the circumstances that might alter global economic performance for the better in 2020. This is the first of three parts.

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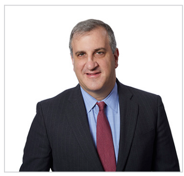

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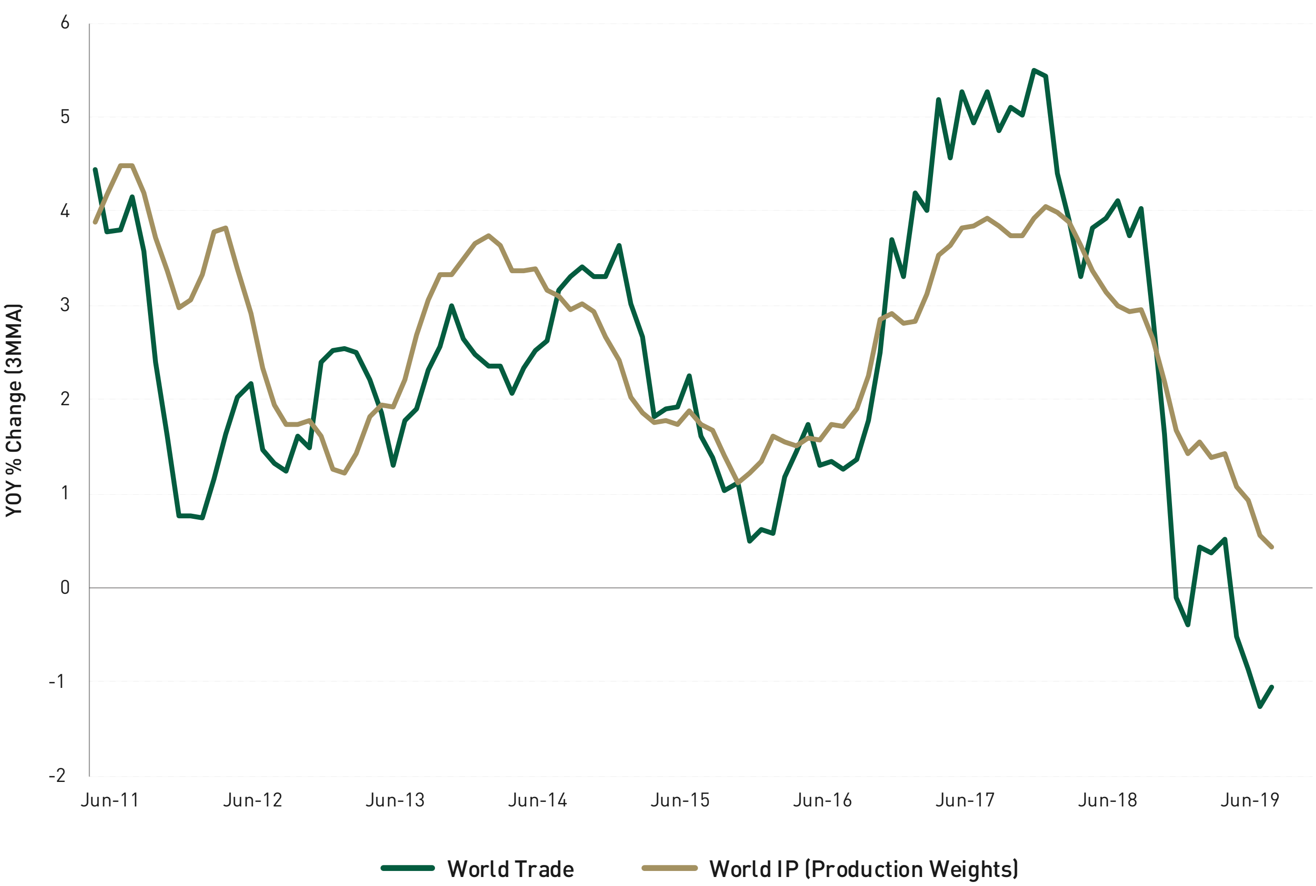
Chart 1. For Now, the Global Economy Has Weathered a Very Severe Storm from Global Trade Contraction

World trade volume and industrial production (June 2011–June 2019)



Source: Bloomberg and Lord Abbett. Most recent data available.

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In Brief

- In 2019, the U.S. central bank focused on risk and uncertainty rather than on the central tendency of U.S. economic growth, and much of that uncertainty was derived from a slowdown in growth outside of the United States.
- In 2020, we believe the biggest impact on asset valuations will likely be driven by events outside the United States — and chief among those events will be what happens with trade and tariffs at the end of 2019.
- We're seeing a resurgence in global liquidity which, in our opinion, could have a positive impact on global economies, including emerging markets.
- In our view, there is meaningful opportunity for those that have been hurt the most by the trade dispute and tariffs to actually benefit the most when a trade deal gets done, even though the deal may not be as meaningful as some would wish.

We recently gathered six Lord Abbett investment leaders for a wide-ranging discussion of the current market and economic environment and to elicit their views on key investment themes for 2020.

Register now for our January 8, 2019, webinar to hear our investment leaders discuss these investment themes live!

In this first of a special three-part Market View, *our experts discuss global markets and consider what may be a new approach to monetary policy on the part of the U.S. Federal Reserve.*

Our panel featured Lord Abbett Partners Thomas O'Halloran, Portfolio Manager for micro-, small-, and large-cap growth strategies; Giulio Martini, Director of Strategic Asset Allocation; Daniel Solender, Director of Tax-Free Fixed Income; Leah Traub, a currency expert and Portfolio Manager for Taxable Fixed Income; and Kewjin Yuoh, Portfolio Manager for Taxable Fixed Income. Tim Paulson, Investment Strategist, moderated the discussion.

When our panel of investment experts last met in May 2019 for a Midyear Outlook, one of the issues they were eager to address was the decade-long U.S. economic expansion and how much longer it might last. Was there a recession around the corner? Martini had steadfastly held throughout the year that there was neither a Fed-induced nor a bubble-led recession in sight – an observation that proved correct – and that the U.S. economic expansion, although it may be poised to slow a bit, showed few signs of coming to an end over the short term.

Under those circumstances, it would seem that the U.S. Federal Reserve (Fed) would have no reason to lower rates, but rather might continue to "normalize" or move them higher from their historically low levels. That was the panel's opinion at the midpoint in 2019.

Instead, the Fed lowered its benchmark interest rate three times—in July, September, and October.

From Martini's perspective, this was the Fed focusing on risk and uncertainty rather than on the central tendency of U.S. economic growth, and much of that uncertainty was derived from a slowdown in growth outside of the United States.

"Usually what's important to the Fed," Martini said, "is its dual mandate [related to the U.S. economy], which is to achieve maximum employment with inflation close to 2%, its target. And the Fed is very close to achieving that dual mandate. But despite that, the Fed was willing to cut a key U.S. rate, even as the U.S. economy continued on its growth trend – probably because a potentially growing trade war could slow down global economic growth enough to take them away from those targets."

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"What surprised me," he continued "was how preemptive the Fed was in the face of those global uncertainties. The Fed was willing to cut rates aggressively sooner than it usually does."

"While we didn't anticipate those rate cuts," Yuoh observed, "and one could argue they were perhaps not necessary, they were nonetheless greatly beneficial for risk valuations."

According to Martini, the Fed has come to the conclusion that when short-term rates are close to zero – the point at which monetary policy becomes much less effective –there is a much greater cost to waiting too long before cutting rates than raising them later than usual. "The research showing this has been very persuasive in the central banking community and is having an immediate effect on policy, perhaps around the globe," Martini said.

The Global Equation

"It's easy to fall into a bit of a trap here," Martini opined. "We tend to talk about the world as if all that matters is the United States and what happens in the United States. But what 2019 showed us was the importance of economic growth outside of the United States."

Yuoh agreed. "In this kind of environment," he said, "the global equation matters even more than the domestic outlook. When you look at valuations in the U.S. fixed-income markets, they're already priced for a kind of domestic nirvana in the sense that you have a 10-year Treasury note with a yield between 1.5–2%, a Fed that's on hold, and markets probably returning to historically low volatilities. The biggest impact on valuations will likely be driven by global events, not domestic – and chief among those events will be what happens with trade and tariffs at the end of 2019."

In fact, over the last decade, the biggest driver of global economic growth (accounting for nearly 40% of it) has been China, added Martini, who also believes that China's enormous economic influence will continue just by virtue of its sheer size and determination to succeed in world markets.

"Credit growth in China has started to pick up from a very low point in June," Martini said. "If that momentum sustains itself into early 2020, it will be a signal that the Chinese economy is coming back. And that's something that will reverberate globally."

O'Halloran agreed. "We're seeing some of that confirmed in the price action of leading internet stocks of Chinese companies listed in the United States" O'Halloran said. "They look very good right now."

O'Halloran believes that China will improve economically and that the United States and China will reach a "Phase 1" trade deal before the end of 2019, which will provide a positive influence on global GDP growth in 2020.

Central Banks on Auto Pilot

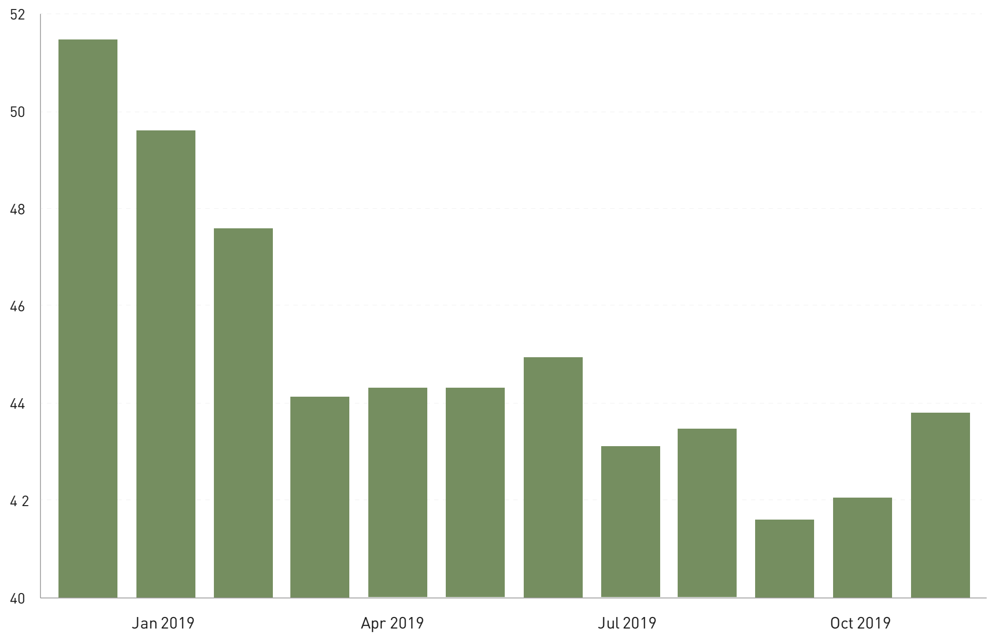
With warnings of a global economic slowdown reflecting trade disputes, it wasn't just the Fed that lowered rates in 2019. According to Traub, about 60% of all global central banks eased in 2019 after tightening in 2018. "Some of them are also re-expanding their balance sheets, such as the Fed [has done] by purchasing low risk U.S. Treasury bills," she said. "We're seeing a resurgence in global liquidity which we believe could have a positive impact on global economies, including emerging markets."

"At this point, global central banks are pretty much on autopilot," Traub said, "I don't think central bank policy will be our focus in 2020. When we look at opportunities outside the United States," Traub noted "we're focusing on an improvement in trade and a reduction in the threat of tariffs." All of Europe and many emerging markets have been affected by the trade war between China and the United States, Traub said.

"That's one of the many ironies of this trade dispute," Martini added. "The United States declared a trade war on China. And the first shot it fired hit Germany! Europe really suffered because the German economy is heavily dependent on manufacturing. They are large producers of capital equipment. As global trade tensions rose and businesses started to delay capital spending, that hit Germany hard and the slowdown radiated out into the rest of Europe. The primary beneficiary of a trade deal will be Europe, because that's where the impact was felt the greatest."

Chart 2: The German Manufacturing Sector Has Declined for 11 Straight Months

IHS Markit Germany Manufacturing Purchasing Managers Index (PMI) (January-November 22, 2019)



Source: Trading Economics. The Markit Germany Manufacturing PMI measures the performance of the manufacturing sector and is derived from a survey of 500 industrial companies.

The picture was complicated, Martini said, "by the fact that many central banks in the eurozone and elsewhere are dealing with negative interest rates, which greatly limits the ability of monetary policy to stimulate the economy."

"I agree with Giulio," O'Halloran said. "Looking at the year ahead, there is a big opportunity for those that have been hurt the most by the trade dispute and tariffs to actually benefit the most when a deal gets done, even though the deal may not be as meaningful as some would wish."

"The issue of tension between the United States and China," added Martini, "won't go away regardless of whether we have a trade deal. China is challenging the United States more and more as a global leader on many different fronts."

Political Turmoil

Looking back at 2019, several of our panelists commented on the political turmoil around the globe.

"We've certainly seen a very big pickup in political unrest," Traub observed. "We saw it in the Yellow Vest protests in France, which started at the end of 2018. Certainly unrest in Hong Kong has been going on for months. And I don't think Chile was on anyone's radar as an economic or political trouble spot, but the economic inequality that's been very obvious there for some time has become a key factor behind recent protests in that once stable part of South America."

When you consider emerging markets, according to Traub, you have to be cognizant of the potential for significant changes in economic policies that can result from a single election in a period of political transition. "Unlike in the United States," she said, "institutions and the rule of law in emerging markets can be less stable and result in significant market volatility."

Traub is confident, however, that should trade tensions ease, improving global growth will have a positive impact on emerging markets in 2020.

Next: Lord Abbett investment professionals focus on the United States, with discussions on the outlook for recession, inflation, and consumer confidence.

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