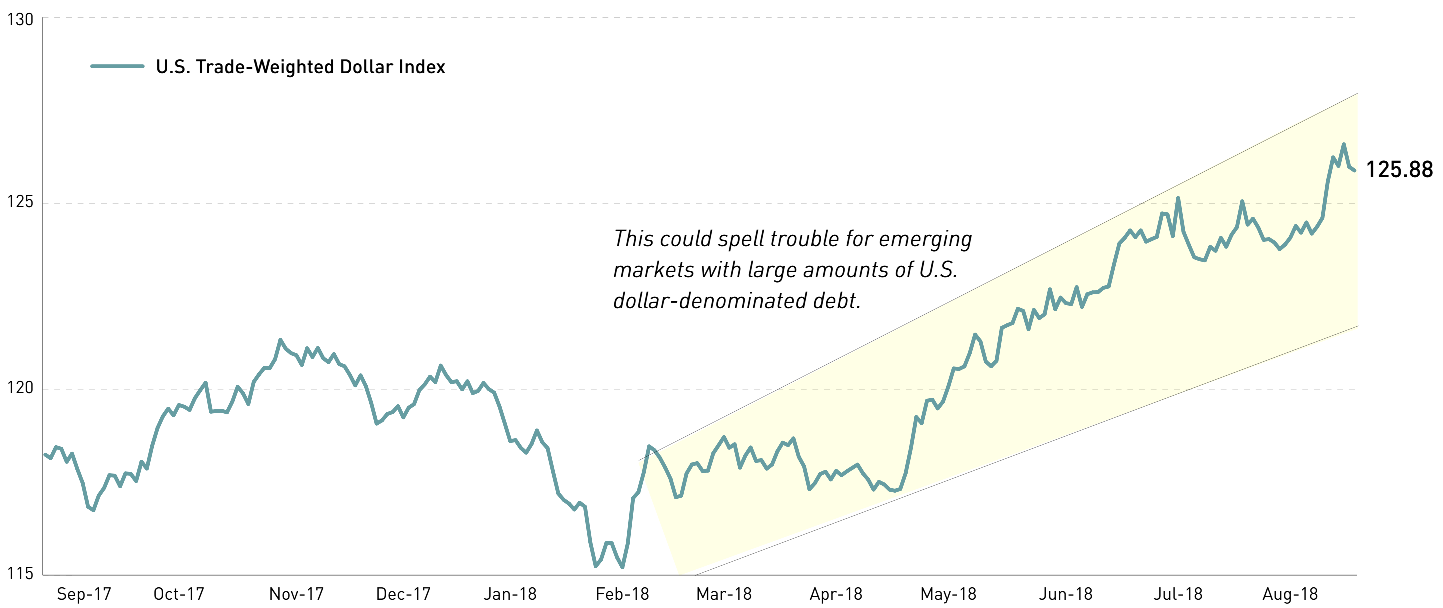
LORD ABBETT

MARKET VIEW

GLOBAL OUTLOOK: SCOPING A POTENTIAL "SEPTEMBER TO REMEMBER"

While we believe the overall backdrop for investments remains constructive, our experts will be keeping an eye on these economic and geopolitical uncertainties.

CHART 1. THE U.S. DOLLAR RALLY HAS ACCELERATED THIS YEAR

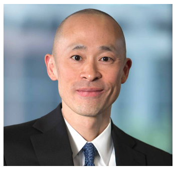


Source: Federal Reserve. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

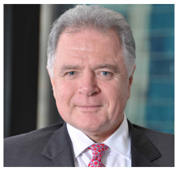
IN BRIEF

- The confluence of a stronger U.S. dollar, higher U.S. interest rates, and trade wars could dampen the global economic expansion.
- Following the longest U.S. bull market in equities ever, investors will have to factor in the potential impact of political upheaval in Washington as well as increasing geopolitical tensions—both of which could increase market volatility.
- While we remain sanguine about many of these risks, there is no doubt that such an environment underscores the need for active risk management of investor portfolios.

CONTRIBUTING STRATEGISTS



Robert Lee
Partner & Chief Investment Officer



Giulio Martini
Partner, Director of Strategic Asset Allocation

September historically has been a challenging month for investors. But no matter what happens to stocks in the longest bull market in U.S. history (with the Nasdaq Composite Index recently topping the 8,000 level for the first time), this month could be "a September to remember," in the words of Giulio Martini, Lord Abbett partner and director of strategic asset allocation.

Indeed, with a laundry list of global developments that could weigh on financial markets worldwide in the coming month, we thought it would be useful to review some of the most important items—and offer some needed context.

Higher Interest Rates and a Stronger Dollar

While inflation is well under control and employment is strong, the U.S Federal Reserve (Fed) is likely to raise interest rates again during its meeting on September 26 (for the third time this year). Many market observers are concerned that this could lead to recession, further dampening an already slowing housing market and consumer spending. The effects also may be felt elsewhere, as a strengthening U.S. dollar (see Chart 1) makes it harder for debtors in Turkey and other emerging markets to repay loans denominated in greenbacks. So, investors should not get complacent, cautions Robert Lee, Lord Abbett partner and chief investment officer.

U.S. Fiscal and Political Developments

Meantime, the Congressional Budget Office reports that gross federal debt has risen to a whopping $21.2 trillion. As a percentage of GDP, that debt burden amounts to 105.4% (according to Trading Economics), the third highest in the world, behind only Japan and Italy, and is expected to grow significantly. (See Chart 2.) Of course, some economists have pointed out that, while the debt level is high, the U.S. economy is improving, and further economic growth may lessen the debt burden as a percentage of GDP. But others ask whether the U.S. government will address the debt now while the economy is on solid footing and before the economy hits a downturn.

"Congress will eventually have to increase the debt ceiling," Martini opined at a recent wide-ranging roundtable with investment professionals. "There could be another government shutdown or a very tough negotiation around that. That doesn't necessarily mean there would be a default on U.S. debt," but congressional negotiations on addressing the issue could be difficult in the run-up to what are shaping up to be contentious U.S. midterm elections.

Meanwhile, the Fed reports that total U.S. corporate debt was 45.2% of GDP at the end of the first quarter, matching the highest level it hit during the financial crisis of 2008–09, and, according to Bloomberg, the share of risky debt is rising. It should be noted, however, that default rates are low—a reflection of stronger U.S. economic growth.

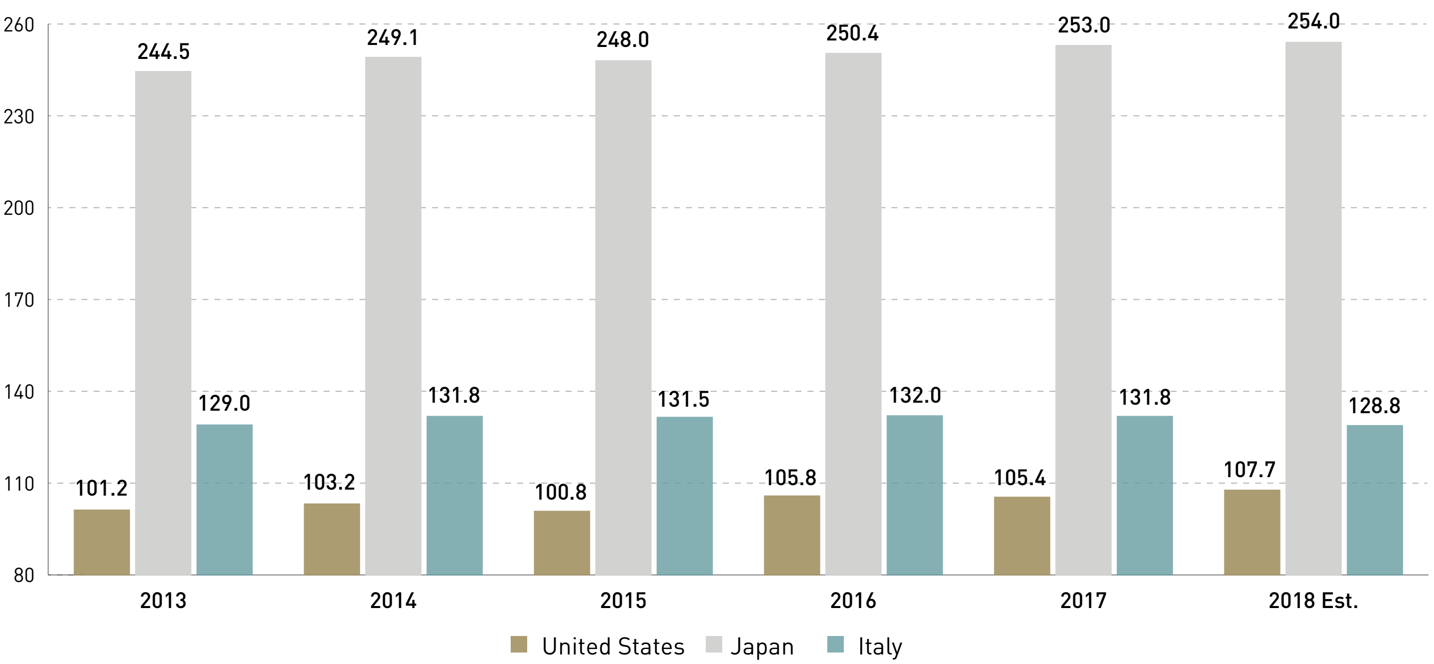
Brexit and the European Union

Another potential stress on the markets could be Brexit negotiations, which are now in their final stages. According to a recent study by the International Monetary Fund, the United Kingdom's departure from the European Union (EU)—a so-called "hard Brexit"—will hurt income and employment in the EU.

"If the U.K. and the EU settle on a standard free trade agreement whereby tariffs on goods traded are low, but with higher non-tariff barriers, we estimate that EU [excluding the United Kingdom] real output will be lower by 0.8%, and employment by 0.3%, in the long run than in a no-Brexit ["soft Brexit"] scenario," the IMF report said.

CHART 2. U.S. DEBT AS A PERCENTAGE OF GDP NOW RIVALS ITALY

U.S. GROSS FEDERAL DEBT TO GDP VERSUS JAPAN AND ITALY, 2013-18E



Source: TradingEconomics.com and U.S. Bureau of Public Debt For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

"A 'hard Brexit' scenario is not our base case," said Lee. The 28-nation European Union not only hopes to strengthen its role in the world but also to cooperate with the United Kingdom as a close partner. Once negotiations are completed, a 21-month transition period would give businesses and administrations time to adapt, as the U.K. would stay in the EU's Single Market and Customs Union until December 31, 2020.

But the EU has other issues to contend with, including considerable friction between Italy and the rest of the bloc over budgetary rules and procedures concerning the processing of refugees. Following the deadly collapse of a bridge in Genoa, Italian officials urged some easing of EU budget limits in order to upgrade the country's aging infrastructure, seemingly assigning blame for the tragedy on the fiscal austerity measures resulting from EU strictures. Meanwhile, the refusal of the government to allow migrants to disembark in Italy without a burden-sharing agreement with the rest of the EU opened another front for conflicts.

Geopolitical Risks

At any given time, Lee can enumerate a number of geopolitical risks that may be difficult to assess, but require constant due diligence. For instance:

- *North Korea*—One big question on Lee's mind is whether current diplomatic efforts will be able to defuse tensions on the Korean peninsula. Will North Korean leader Kim Jong Un live up to his pledge to abandon his nuclear arsenal? Unlikely—as a recent report by the International Atomic Energy Agency (IAEA) raised considerable doubts to that issue. All of which helps to explain why President Trump recently decided to delay talks, given a lack of "sufficient progress." Trump suggested talks could resume in the near future once the United States' trading relationship with China is resolved.
- *Iran*—While the U.S.-China trade dispute helped control international oil prices, increased diplomatic and economic pressure against Iran, including economic sanctions imposed by the United States, have hampered the global oil supply outlook. For its part, the EU appears committed to maintaining economic ties to Iran (especially in regard to oil supplies), despite President Trump's threats of "severe consequences" of retribution. Iran has asked a U.N. court to lift the crippling U.S. sanctions. Meanwhile, escalating clashes between Israeli and Iranian forces in Syria have led observers to believe that the risks of a new, large-scale regional conflict have increased.
- *Russia*—The Trump administration recently imposed new sanctions on Russia, as U.S. lawmakers weighed tougher measures, despite the need for cooperation on North Korea, Iran, and Syria, among other hotspots. One U.S. State Department official told a Senate committee that the Russian economy is under considerable strain. Foreign direct investment in Russia has fallen by 80% since 2013, and its major exports, oil and natural gas, are facing increasing competition from the United States.

No one can say with certainty how any of these risks will evolve. But, in summing up the geopolitical outlook, Lee remains sanguine. "I don't think the picture is particularly dire on any one of these situations," he says, "but some of the risks have increased, which underscores the important role that Lord Abbett's risk management team plays in evaluating the impact on our portfolios."

Suffice it to say, Lord Abbett investment professionals will be constantly monitoring key trends and developments that could affect portfolios, and while the overall outlook on the state of the global economy remains constructive, our highly collaborative approach to active management will allow us to adapt to changing market conditions as warranted.

"We expect risk markets to go up," said Martini. "These concerns on the part of investors show they have more to overcome than usual." ■

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