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ABERDEEN STANDARD INVESTMENTS 2019 MARKET OUTLOOK

Take risk selectively and search for diversifiers as markets brace for more volatility

Risks assets have further to run in 2019 and genuine diversification is crucial to drive returns amid heightened volatility, according to Aberdeen Standard Investments

Andrew Milligan, Head of Global Strategy, identifies five drivers that will shape the investment landscape in 2019:

Growth positive but slower
The global economy is set to grow further next year, albeit at a slower pace than in 2018, as long as core inflation remains under control and monetary policy tightening is steady. A US recession remains unlikely until the impact of the country's fiscal stimulus begins to fade – we forecast a growth slowdown in 2020/21.

Return to greater volatility
After a period of calm for markets in 2017, the recent correction has priced in the risks of a macro slowdown and political unrest. We anticipate a 5-15% correction in global equities at some point in 2019. Barring a major shock, share prices will eventually recover as the outlook for company profits remains positive, even if margins are coming under pressure.

Political tensions to roil markets
US policy after the midterm elections will be critical for the outlook for markets, while political populism could disrupt financial markets in Europe and beyond. Any major escalation in US-China trade conflicts bilateral trade war between the US and China is now our central case and, in a world of integrated supply chains, tariffs are a blunt tool that can dampen business confidence.

Monetary divergence to widen
Fiscal stimulus has ensured the US growth cycle is out of sync with the rest of the world. The divergence in the pace of monetary tightening will put some developed and emerging markets under pressure and drive currency volatility. A stronger dollar means life will get more difficult for those emerging economies that borrow heavily in dollars. Should China run out of room for policy manoeuver and allow the renminbi to depreciate sharply, this would put further pressure on many Asian countries.

China takes centre stage
As China extends its influence over the global economy and markets there are two key questions for 2019: how its relationship with the US will evolve; and the extent of its policy stimulus to support growth. If the US takes a much harsher approach to China, it will disrupt not only trade, but also technology transfer; industrial espionage; China's influence with its Asian neighbours through the 'One Belt One Road' initiative; and even the balance of power in the Pacific.

Opportunities for Investors

Andrew outlines three strategies for navigating a bumpy ride in the markets next year:

Start putting cash to work
In a world of slower growth, businesses can put cash to work via capital spending or returning it to shareholders. Investors can also use relatively high cash levels to stabilise portfolios – which also allows them to react to market sell-offs and buy solid, cheaper assets when growth triggers appear. We favour markets with attractive valuations and assets that benefit from healthy corporate cash flows.

Squeezing more juice out of risk assets
Our strategy remains pro-risk, but selectively. As long as political tensions do not deteriorate materially, valuations and profits can reassure investors in 2019. The more stretched valuations become, the greater the risk of stock markets disconnecting from earnings growth. We favour US, European, emerging market and Japanese equities. Emerging markets look reasonably priced, with some, such as China, far cheaper than last year. Japan's cyclical recovery, political stability and improving governance standards are also attractive. As dispersion between the winners and the losers heightens in a volatile market, active stock selection will become more critical.

Diversifying for less correlated returns
The current higher correlations between equity and bond markets are making a traditional balanced strategy riskier than usual. Genuine diversification across wider asset classes will smooth out volatility in a portfolio and offset some of the risks. For example, a mixture of diversified equities, emerging market debt, US Treasury Inflation Protected Securities and European real estate will provide some ballast to portfolios. Private market assets also remain attractive, offering better risk-adjusted returns and less correlation to market volatility.

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<u>Notes to editors</u>

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  *as at 30 June 2018