Canaccord Genuity Wealth Management

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OUTLOOK 2020

# Happy New Year - Indeed!

# Past

For all the angst about trade wars, geopolitics and a sputtering and overly indebted global economy, 2019 might just be the best year investors have ever had. What a difference a year makes: In late 2018 we had recession fears growing as the China trade war escalated and a U.S. Federal Reserve continued to hike interest rates despite signs of slowing economic growth and a sharp stock market correction.

Fast forward to the end of 2019, and policymakers have reversed course, with a trio of Fed rate cuts and a generous dose of new asset purchases fueling stock market gains. Meanwhile Trump's China trade war has culminated in a phase-one China trade deal, avoiding tariffs on hundreds of billions of dollars in goods and turning this year's recession threat into next year's economic stimulus.

Stock market bulls are betting that business investment, corporate earnings and emerging market economies will now revive. Suddenly, the stock market rally is looking a lot like 2017. Back then, the prospect of Trump tax cuts and deregulation, helped along by a broad upturn in global growth, fueled a remarkably smooth stock market rally.

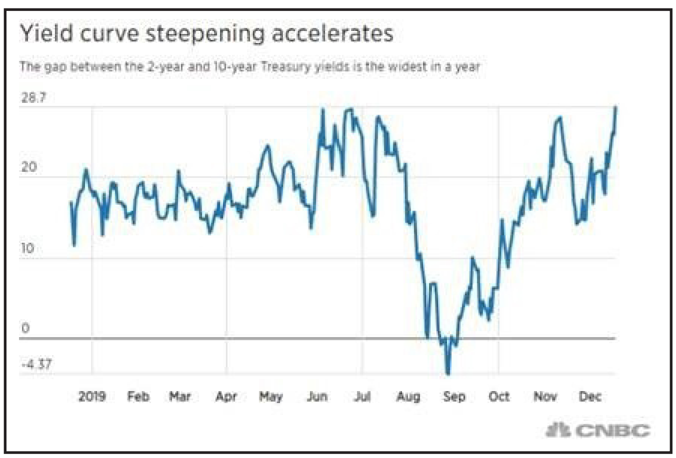
Since the stock market rally revived in early October, the major indexes have been in a strong, steady ascent, with only a modest post-Thanksgiving pause. While a tranquil bull may be hard to sustain for another 12 months, current conditions are positive for the 2020 stock market forecast. Of course there is always the risk of the unexpected. Some Wall Street firms worry that lack of clarity about China trade deal terms leaves room for disappointment in the stock market forecast for 2020.

Before we get into our outlook, here is a quick recap of some of this year's events:

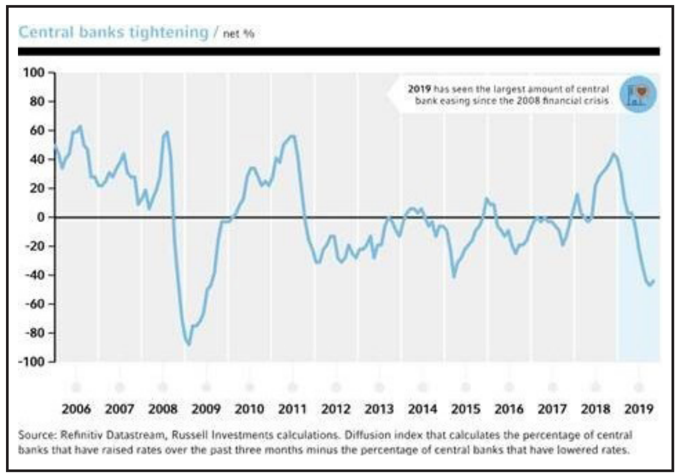
- According to FactSet, there were 17 new record highs for the TSX and 34 for the S&P 500. This remarkable feat follows a near 20% correction in December of 2018.•
- We are now in month 126 of the U.S. economic expansion. In June, the U.S. economic expansion surpassed the one in the 1990s to become the longest on record. Strategists say the slow and steady pace of economic growth has likely played a role in this expansion's longevity, with the economy avoiding the typical overheating that marks the end of the business cycle.
- Record low levels of unemployment. Despite heightened uncertainties, Canadian and U.S. consumers remained confident and continued to spend in 2019, which arguably ties back to the labour market. Despite the recent slowdown, 2019 was a solid year for hiring in Canada, with the economy adding 285,000 jobs and the unemployment rate touching a historic low before rising modestly. The U.S. economy added about 2 million jobs this year, bringing the unemployment rate down to 3.5%, which according to Bloomberg is the lowest level since the late 1960s. Rising wages, rising housing prices, and solid stock-market returns have all bolstered confidence and, importantly, continue to do so.
- Very low levels of volatility and zero 10% corrections. We always remind investors that volatility is normal. Corrections only feel natural, normal, and healthy until

you actually get one.  Fortunately, volatility remained depressed throughout the year, with the TSX and the S&P 500 experiencing only two modest pullbacks. For historical comparison, FactSet finds corrections in the stock market – defined as a decline of 10% or more – have occurred, on average, about once a year. Also reflecting the low degree of fluctuation, the TSX did not experience any daily moves (up or down) of 2% or more in 2019, compared with an average of 14 over the past 20 years.

- $11 trillion of negative-yielding debt. With central banks in Europe and Japan setting short-term policy rates below zero, negative-yielding bonds grew to almost $17 trillion in market value ($11 trillion currently), pushing Canadian and U.S. yields lower.
- A very brief yield-curve scare. A portion of the Canadian and U.S. yield curves inverted in August as 10-year rates dipped below 2-year rates for the first time since 2007. This signal, which in the past has been a reliable, but not infallible, predictor of economic downturns triggered fears of an upcoming recession. As economic data showed a slowdown, but not a collapse, recession fears receded and the yield curve un-inverted in the U.S. The spread between the 2-year and 10-year Treasuries has now widened to the highest level since October, indicating that investors believe the global growth scare has been mitigated by rate cuts from the Fed and other central banks.




There is little doubt that the biggest change in the macroeconomic landscape in 2019 was the dovish pivot of major central banks around the world. The very cause that almost derailed the economy in 2018 is the very instrument setting the stage for the next leg higher in 2020. The U.S. Fed, the European Central Bank (ECB) and the Bank of Japan all became more accommodative to sustain the economic expansion. This synchronized policy easing was a key driver of financial markets, contributing to the fall in short- and long-term interest rates, and benefiting equities. Some of you may recall that the sell-off in 2018 was driven by concerns that the Fed was overtightening amid escalation in trade tensions and slowing global growth. Rather than continue to tighten policy as originally planned, the Fed pivoted to a pause in March and later cut rates three times as insurance against risks to the outlook. Meanwhile, the Bank of Canada (BoC) balked at the notion of cutting interest rates, as the potential benefit could be offset by a further stoking of the already frothy housing market. However, even without the BoC cutting rates, Canadian businesses and consumers benefited from the decline in interest rates, which was partly a result of the actions of other major central banks.



Source: Refinitiv Datastream, Russell Investments calculations. Diffusion index that calculates the percentage of central banks that have raised rates over the past three months minus the percentage of central banks that have lowered rates.

Implications for 2020: Financial markets are driven by Monetary Policy which, in turn, determines the availability of credit. With global central banks providing investors with a synchronized playbook on financial easing, this access to credit will likely continue to support stock prices next year. More specifically, Fed policy is driven by core inflation and a target of 2%. Steady inflation below this 2% target has given the Fed leeway to be more aggressive in getting ahead of market expectations for lower inflation. As a result, monetary policy and Financial Conditions should remain accommodative for the foreseeable future.

# Present

Meanwhile, the next biggest uncertainty for global economic growth in 2019 was President Donald Trump's trade war with China. Indeed, trade war headlines dominated the financial news throughout most of the year with trade tensions triggering the two most sizable pullbacks in global stocks this year. Accompanied by a series of tweets in May, President Trump raised tariffs to 25% from 10% on $200 billion in imports from China. China responded by increasing tariffs on $60 billion worth of U.S. exports. In another episode of the trade saga in August, the U.S. announced 10% tariffs on an additional $300 billion worth of Chinese imports. China responded with $75 billion in new tariffs. The direct impact of the trade escalation was a drop (but not a collapse) in global trade volumes. The indirect impact, which potentially carries more economic significance, in our view, was the deterioration in business confidence and investment hesitation because of the uncertainty. As a result, U.S. manufacturing data sent out warning signs as activity in the U.S. contracted for the fourth straight month in November. On the other hand, the non-manufacturing index continues to expand, meaning the service sector is still running strong. It seemed whatever negative turns the economic data took in 2019, it was always offset by strong consumer spending and a historically low unemployment rate - currently 3.5%. The emergence of the "Phase One" trade deal between the U.S. and China, which includes agricultural purchases and some tariff relief, should ameliorate manufacturing data and ease fears of further trade escalation.

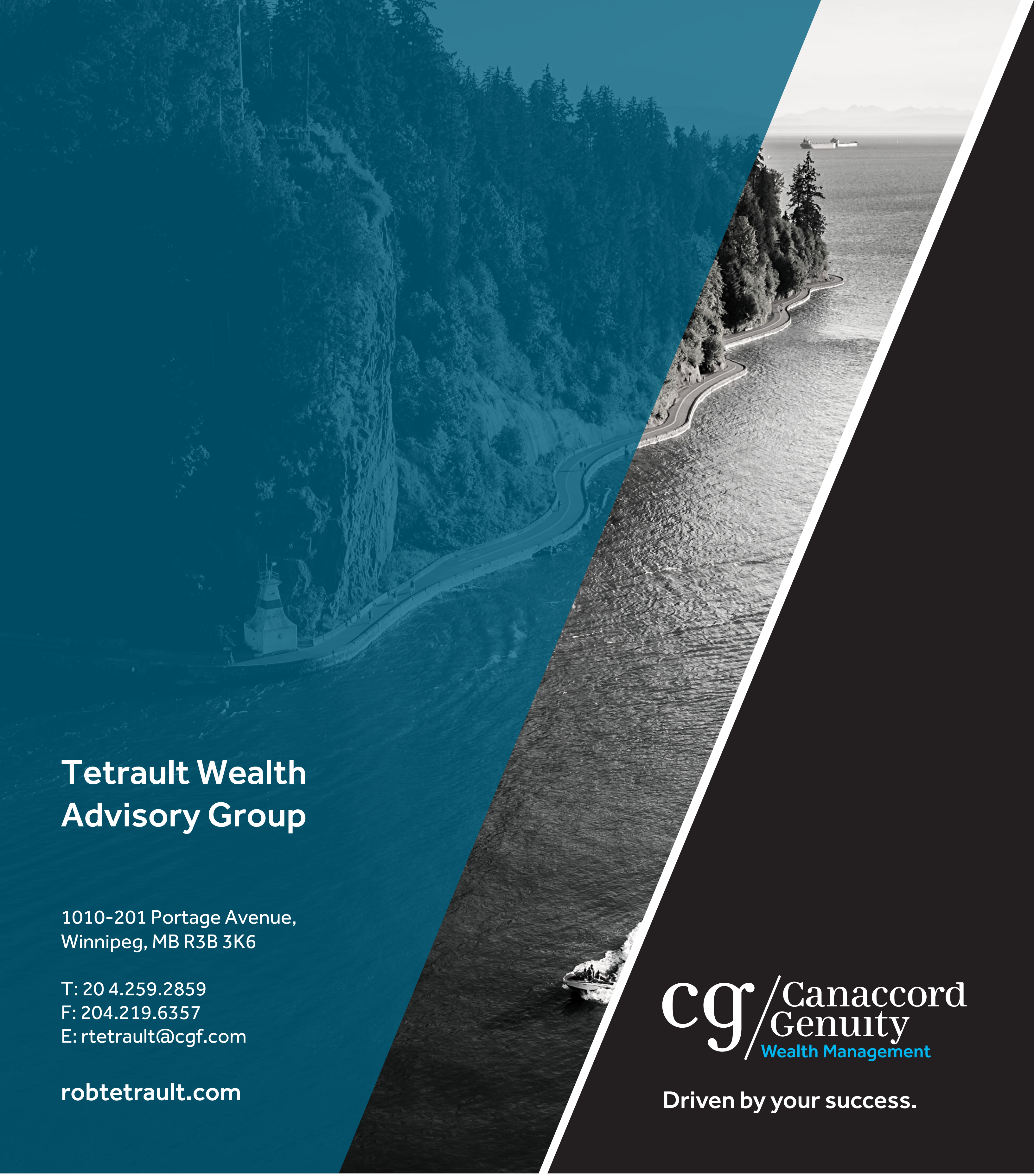
- Implications for 2020: We believe that the recent trade truce signals that both countries are incentivized to compromise to avoid more economic harm. The Phase One agreement could help ease uncertainty and act as a catalyst for a modest rebound in global manufacturing activity. However, we would caution that there could be further setbacks that stoke market volatility. Trump said on New Year's eve that he would travel to Beijing to discuss a "Phase Two" trade deal after signing the Phase One agreement in two weeks. A comprehensive deal including the more-sensitive issues of intellectual property rights protection and enforcement will likely not happen before the 2020 U.S. elections. When U.S. and China officials sign the deal in the coming weeks, it hardly means an end to what are sure to be difficult negotiations, and investors should expect continued volatility on headlines, but the initial agreement has marked a pause in trade war escalation, and that has sharply boosted markets.

# Future

What does all this mean for 2020? Well, momentum heading into 2020 is positive. The economy appears to have emerged from the third mini-recession of the current economic cycle driven by the lagged effect of lower interest rates, a solid domestic economy, and a positive inflection in the outlook for global manufacturing. The bull story for 2020 is continued domestic growth based on credit, confidence, employment, and demographics. There will be many twists and turns in the economy and financial markets, though ultimately, not recessionary. While bullish signals are not unequivocally flashing green, some consolidation may be necessary considering strong returns earned in 2019. U.S. election uncertainties, trade setbacks and occasionally underwhelming economic reports will likely stoke higher volatility than investors have been accustomed to in recent years.

We believe economic data will be more balanced and stock-market gains will moderate as we progress through next year and the next decade. Valuations are higher exiting 2019 compared with year-ago levels, yet they are still at reasonable levels given the economic and interest rate backdrop. With limited opportunities for further multiple expansion, the pace of market gains will be set by the pace of earnings growth, which we think will rise at a mid-single-digit rate. We expect the labour market to remain a bright spot in the North American economy, even as the pace of job growth likely moderates in 2020. Wages should continue to grow faster than consumer prices, increasing real household incomes. While U.S. large-cap stocks have consistently generated the best returns this decade, asset-class leadership often rotates. As the cycle advances, we think global, well-diversified portfolios will be better positioned to navigate the swings.

The Fed has undergone a generational change in how they view inflation risk. We are 11 years into an economic cycle without a consumer led recession with the unemployment rate at a 50-year low, yet there is no sign of inflation. The U.S. Federal Reserve has literally told us they are going to remain on the sidelines for the foreseeable future, which gives us an offensive playbook. The two major mini-recessions this cycle began with the fear of the Fed tightening financial conditions to combat potential inflation that had already shown up in the higher 10-year U.S. Treasury Bond yield. The 2011 and 2018 bear markets were preceded by fear of Fed rate hikes. They have clearly stated they are keeping rates low until there is a meaningful ramp in inflation vs. a fear of one. As a result, we believe any market weakness should prove limited and temporary and provide a more attractive entry point for a move toward new and prolonged highs in 2020.



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