The Investor
Spring 2019

2019 Investment Outlook – Ireland & the World

While leading indicators of growth have deteriorated, most are still at levels which suggest global growth will remain positive in 2019. Planned increases in levels of global fiscal stimulus should aid this growth.

At a headline level global growth remained relatively strong throughout 2018, even if it was slightly lower than 2017. The global economy is estimated to have grown 3% last year compared to 3.2% in 2017. Beneath the surface however a much different story emerges. The synchronised growth across global regions which drove equity markets higher in 2017 has now been left behind.

Instead, a global growth environment which has become significantly more reliant on the US economy is evident. In addition, the positive economic momentum which was apparent throughout 2017 and the early part of 2018 has disappeared and been replaced by increasing doubts over the sustainability of the current cycle, with added fears of a possible recession in 2019.

As growth became less synchronised in 2018, the global economy and markets have become more vulnerable to shocks. This is evidenced by the sharp falls in equity markets in quarter four, following the new all time highs which were reached as recently as late September.

2018 began with optimism about the prospects for both the global economy and equity markets. This optimism was underpinned by the two large fiscal stimulus packages announced in the US in late 2017 and early 2018, which reduced corporate and income tax and increased incentives for investment. These packages were expected to boost US growth by approximately 1% over the course of 2018 and 2019 and contribute to strong growth in US earnings, aided by the reduction in corporate tax to 21%. Given the boost to growth in the world's largest economy, the risk to global growth was viewed as being to the upside. The resultant corporate earnings growth of low to mid teens was viewed as being supportive of additional upside in global equity markets.

Apart from a temporary sell off in early February, this general positive outlook played out until late September, at which point global equities had risen by over 6% over the course of the year.

Despite the generally positive backdrop a number of growing concerns arose during the course of 2018 which ultimately contributed to the significant shift in sentiment towards the global economy and equity markets in quarter four.

The trade issue which had lain dormant throughout President Trump's first year in office came to the fore in late spring as the US proposed and implemented a series of tariffs on trading partners, which in turn resulted in retaliatory measures from these countries on US exports.

Initially the expectation had been that the global trade war would not escalate to any significant degree but as it persisted and the scale and scope of proposed tariffs increased, particularly between the US and China, the negative impact on global business sentiment and activity has become more apparent.

Looking to 2019, the main issue facing investors is whether or not the global economy will experience a recession this year. Risks to growth and the risk of a recession have clearly increased. However, if central banks respond to the recent tightening of financial conditions by easing back or pausing the removal of policy accommodation, as the US Federal Reserve has hinted it would do if data warranted, then global growth and market sentiment could be supported.

World GDP Forecasts

	2017 (actual)	2018 (estimated)	2019 (forecast)	2020 (forecast)
World	3.2%	3.0%	2.9%	2.7%
Ireland	7.2%	7.5%	4.8%	3.6%
United Kingdom	1.8%	1.3%	1.5%	1.6%
Eurozone	2.6%	1.7%	1.6%	1.5%
United States	2.2%	3.0%	2.3%	1.9%
Japan	1.9%	0.8%	1.1%	0.5%
China	6.9%	6.4%	6.2%	6.0%

Source: Bloomberg 31.12.18

2019 Investment Outlook – Ireland & the World

Ireland

Despite 'Brexit' related uncertainty, the Irish economy has proven to be relatively resilient through 2018. In quarter three, GDP grew by 4.9% and personal consumption grew by 2.9%, while net government expenditure and capital investment rose by 6.1% and 43.4% respectively. Across individual sectors information and communications grew by 19.5% while construction rose by 16.8% and financial and insurance activities rose by 5.5%. Agricultural activities however declined by 13.5%.

Elsewhere, other activity measures remain strong:

- *Numbers on the Live Register continue to decline reaching 207,200 on a seasonally adjusted basis while unemployment has fallen to 5.3%.*
- *Retail sales have been consistently running at mid single digit levels of growth although the most recent headline growth slipped to 3.6% and 1.9% excluding auto sales.*
- *National residential property price gains have eased somewhat, partly in response to the Central Bank's macro prudential limits on mortgage lending, but remain strong at 8.4%.*

The positive growth backdrop of recent years is reflected in recent Exchequer returns which suggest that Ireland will have generated a budget surplus in 2018 for the first time since the financial crisis.

The biggest risk to the Irish economy and the positive consensus growth forecasts for 2019 is the outcome of 'Brexit'. The Irish economy remains dependent on and sensitive to developments in the UK economy with 14% of Irish goods exports going to the UK and 24% of goods imports sourced from the UK. Risks in the event of a 'hard Brexit' with no deal at the end of March relate to the expected slowdown in the UK economy, the expected weakness in sterling, the potential for the UK to move to World Trade Organisation (WTO) tariffs, the possibility of new regulations and customs procedures for trade between the EU and the UK and the risk of blockages at ports which could restrict the flow of goods between Ireland and the UK.

The outcome of 'Brexit' negotiations will be a key determinant of the outlook for the Irish economy in 2019 and beyond. While there is still a significant amount of uncertainty and lack of clarity around the final outcome, the sense is that a 'hard Brexit' with the UK crashing out of the EU in March will be avoided. As a result, it is widely believed the Irish economy will likely grow in line with current consensus forecasts of 4.5/5% in 2019.

Europe

Among the major economic regions the Eurozone has experienced one of the most significant slowdowns in growth in 2018. In 2017 the region grew 2.6% but growth slowed by approximately half over the first half of the year and declined even further to less than 1% annualised in quarter three. While unemployment across the region has fallen to 8.1%, the decline has stalled in recent months and the pace of job growth has halved to approximately 0.8%.

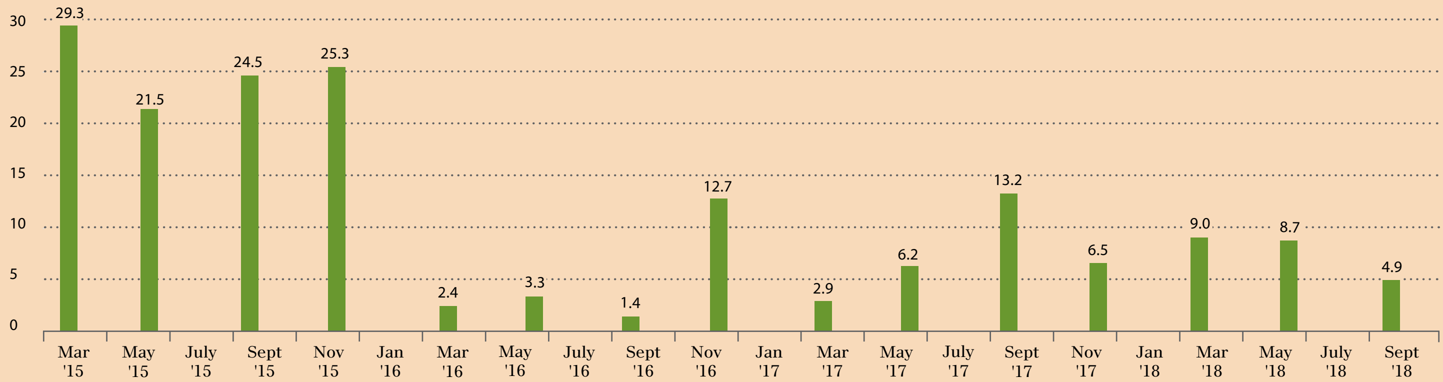
The Eurozone is particularly sensitive to trade with emerging markets and China in particular, and has therefore been especially negatively impacted by the escalation in the trade war during the year. Political tensions in Italy and those related to 'Brexit' have also acted as drags on sentiment and general activity.

The specific weakness in quarter three was partly down to temporary factors due to disruptions in auto production across the region related to changes in emission standards. Germany in particular has been badly impacted by this issue with auto production falling almost 40% on a seasonally adjusted basis in that quarter. As this temporary impact fades, growth should have improved in quarter four and into early 2019 but even excluding this issue, Eurozone growth has generally been soft.

Italian GDP also contracted by -0.1% in quarter three due to the tighter financial conditions caused by the Italian government's standoff with the EU over its fiscal proposals. The compromise deal reached with the EU at year end should however begin to ease some of the recent pressures on the Italian economy.

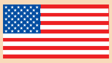
Eurozone growth is expected to pick up in 2019 with growth of approximately 1.6% anticipated for the year. While the European Central Bank (ECB) has reduced the level of policy accommodation by ending asset purchases under its quantitative easing (QE) programme, policy still remains relatively loose. Investors are not expecting the ECB to raise rates for the first time until June 2020 and this policy stance should be supportive of growth. Additional fiscal stimulus in France and Italy in 2019 and possibly Germany would also be supportive.

Irish Quarterly GDP Year/Year Growth



Source: Bloomberg 31.12.18

2019 Investment Outlook – Ireland & the World



United States

In contrast to all other major regions the US saw a significant pick up in growth of over 3% expected for 2018 compared to 2.2% in 2017. This improvement was mainly driven by President Trump's tax package which was announced in December 2017 and a supplementary fiscal package in early 2018 which boosted spending by $300bn. The resultant reduction in corporate and income taxes have helped support consumption and investment while the repatriation of overseas profits enabled US corporates to announce a record level of share buybacks in 2018. The US labour market has been extremely strong with unemployment reaching a 39 year low in 2018. With wages beginning to experience some upward pressure, household incomes have grown strongly and supported consumption.

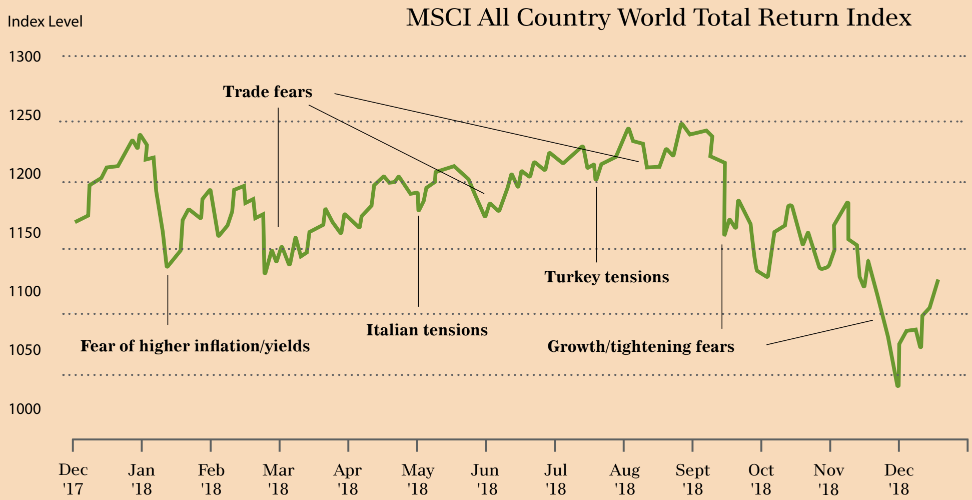
Growth in the middle of the year was particularly strong, but began to ease through the second half of the year, with growth of 2.5% expected in quarter four. The slowdown reflects the fading of the initial impulse from the fiscal stimulus measures and weaker growth in the housing market, as rising rates have slowed activity. Similarly, investment activity has been negatively impacted by both the rising interest rate environment and the uncertainty caused by the trade war.

Although growth has since slowed and will continue to do so in 2019, it is still expected to remain positive at around 2.3% in 2019. A strong labour market should continue to boost consumption as should the recent sharp fall in oil prices. A positive bank lending backdrop, positive rates of house price inflation, a possible pause in Federal Reserve tightening and a possible resolution to the trade war with China would all be supportive of growth in 2019 if they come to pass.

China

Chinese growth slowed from a rate of 6.9% in 2017 to around 6% in quarter three of 2018. Growth had begun to ease even prior to the outbreak of the trade war. The Chinese authorities tightened both fiscal and monetary policy from the end of 2017 in an effort to address the debt bubble which has grown substantially in recent years. As a result, greater restrictions and regulations in the lending and property markets had already begun to reduce the level of credit growth and general activity levels in the economy through the early part of 2018.

The initiation of the trade war with the US in the middle of 2018 however came at a sensitive time for the economy. It posed significant risks not only in relation to trade but also with regard to the demands being made by the US for China to make changes to its main industrial growth policy called 'Made in China 2025.' Two separate rounds of new tariffs announced by the US together with the threat of ultimately imposing tariffs on all Chinese exports to the US have taken their toll as evidenced by the significant slowing in retail sales, industrial production and fixed asset investment growth. In response to the slowdown, the Chinese authorities have begun to loosen fiscal and monetary policy again in an effort to boost growth. Corporate and personal tax breaks have been introduced while improved access to lending for private enterprises has also been facilitated. The impact of these stimulus measures should soon begin to stabilise growth. Consensus forecasts suggest growth of 6.2% in 2019.



Source: Bloomberg 31.12.18

Japan

Japanese growth was extremely volatile in 2018, with the economy contracting by -2.5% in quarter three. This was due to distortions caused by severe weather events including a major earthquake and hurricanes which caused major disruptions in activity levels. Growth is expected to have rebounded strongly in quarter four to 3% as business sentiment and investment plans have remained strong and production levels have recovered.

The Bank of Japan is the only major central bank still undertaking an active asset purchase programme. With the bank targeting 10 year bond yields in a range of 0% to 0.2% and maintaining a negative base rate, monetary policy remains extremely loose and should be supportive of growth. The government has announced its intention to implement another increase in the VAT rate from 8% to 10% in October 2019. It has also already indicated it will implement a fiscal package of up to Y5trn between both temporary and permanent measures to offset the negative impact of the VAT increase, while the Bank of Japan has indicated it will maintain the current loose monetary conditions to support growth.

Emerging Markets

Investors are seeking access to emerging markets for reasons including diversification, cheap relative valuations and the belief that as these economies develop their investments will bear fruit. There is currently an extensive offering of both active and passive funds available within the emerging market space.

Economies which are termed 'Emerging Markets' have received increasing attention over recent years. As the market appetite has increased for exposure to these economies so has the proliferation of emerging market funds, with an increasing focus on investments in the fixed income space, or more commonly known as debt, alongside equities.

What are Emerging Markets and why is there a focus on these economies?

'Emerging Markets' is a term for those countries which are deemed by various agencies to exhibit characteristics below that of their developed counterparts (including the United States, Germany and the UK). These countries, whilst similar to their developed counterparts, are exemplified by offering investors higher growth opportunities. Typically, emerging market countries have a lower relative cost of living and low overheads such as cheaper labour which are seen as being conducive to value creation. This is countered, however, by lower regulatory standards and more general monetary and political uncertainty which can lead to price instability.

Despite this uncertainty, the additional payoff or reward potential is seen as an enticing reason to invest in emerging markets. The view is that as emerging market countries develop, they will build trade surpluses, strengthening their own economies and reducing reliance on foreign imports. This in turn helps to strengthen their domestic currency. From a Euro investor's perspective, the potential for capital appreciation through an emerging market country's development in addition to a stronger domestic currency provides a two-pronged return opportunity. At present, the commonly recognised emerging markets investments available to investors include allocations to both equities and debt.

Emerging Market Equities

Emerging market equities currently represent exposure to approximately 1,150 stocks across 24 emerging market countries. Since the inception of the Euro in December 1998, emerging market equities have delivered an annualised return of 9%, eclipsing traditional global equities which have returned 5.1% over the same time period.

It must be noted that emerging market equities as an asset class tend to exhibit periods of volatility which can typically be in excess of wider global equities. However, when taking into account the differential in performance in conjunction with the investment risk to which both are exposed, over the long term emerging markets have demonstrated enhanced risk adjusted returns versus global equities.

Emerging Market Debt

Emerging market debt refers to government bonds issued by emerging market countries. As you would expect with investing in emerging markets, the yield attainable is considerably higher than other traditional highly rated government bonds.

Growth Outlook

Emerging Markets are increasingly becoming a standard allocation within investment strategies. The nature of these assets whilst exhibiting greater risk than traditional developed economies offer the opportunity to earn enticing growth returns, particularly when compared to the types of yield available on more secure government bonds. Fundamentally the growth outlook for emerging markets is favourable when compared to developed economies. The International Monetary Fund (IMF) has predicted that developed economies will grow at a rate of 2.1% in 2019 and 1.7% in 2020. This compares to emerging economies which the IMF predicts will grow at a rate of 4.7% in 2019 and 4.9% in 2020, making a compelling argument for investment in these regions.

* For further information please contact Richard White (rwhite@invesco.ie) or Paddy Swan (pswan@invesco.ie)

Dublin 2 Sandyford Business Centre, Burtonhall Road, Sandyford, Dublin 18, Ireland.
tel +353 1 294 7600 fax +353 1 294 7633

Cork No. 6 Lapp's Quay, Cork, Ireland.
tel +353 21 480 8041 fax +353 21 431 0530

web www.invesco.ie email info@invesco.ie