The Investor

Spring 2020

2020 Investment Outlook – Ireland & the World

2019 was a year filled with fears that were not realised. A global economic slowdown and disruptive trade wars never materialised. Equity markets rallied, supported by the US Federal Reserve's policy u-turn on interest rates.

The majority of assets experienced very strong returns in 2019 with gains evident across equities, bonds, commodities and property. The breadth of positive returns was unusual, with global equities rising almost 27% in local currency terms, representing the second best annual return in this economic cycle after the 30% gains in 2009.

Sentiment towards markets and the growth outlook became more positive early in 2019 as central banks, led by the US Federal Reserve, made a significant policy u-turn indicating previous tightening moves were being put on hold. The Federal Reserve, which had been guiding towards two further interest rate rises in 2019, effectively said it would not raise rates due to concerns over the growth backdrop, earlier tightening of financial conditions and persistent low levels of inflation.

Other central banks followed their lead and adopted more accommodative policy stances either by pushing out expectations regarding future rate rises or in some cases, beginning to cut rates and provide additional liquidity.

This policy shift by global central banks removed a significant risk, as the prospect of growth being further restrained by higher interest rates and additional policy tightening was substantially reduced. The looser monetary policy backdrop was supportive of both equities and bonds with equities benefitting from the positive support to growth, while bond yields fell as central banks committed to keeping interest rates low.

However, sentiment shifted again in May when there was a renewed rise in trade tensions as talks between the US and China surprisingly collapsed. Over the course of the summer there were a number of further escalations with new rounds of tariffs either being imposed or threatened. The associated uncertainty around trade contributed to renewed fears of recession as global sentiment and activity levels declined and traditional growth signals such as an inverted yield curve suggested that a recession was possible.

As was the case earlier in the year, global central banks again stepped forward to provide support to both the economy and markets. The Federal Reserve cut interest rates three times in the second half of the year by a total of 0.75% which helped ease growth concerns and stabilise equity markets. The European Central Bank (ECB) followed suit by cutting its deposit rate by 0.1% to -0.5%.

In early October a number of developments helped to dissipate much of the uncertainty which had been acting as a drag on markets and the global economy throughout the summer:

- *The US and China agreed to a three phased process to resolve the trade dispute.*
- *A withdrawal deal between the UK and EU was passed by the UK parliament thereby avoiding a 'no deal Brexit'.*
- *The manufacturing sector began to show signs of stabilisation.*

Looking to 2020, given the positive developments on trade, 'Brexit' and the manufacturing sector, a recession now seems very unlikely. Growth should improve from the lows in the second half of 2019 with the uncertainties and drags which were evident throughout much of last year fading. However, the expected level of improvement in 2020 will likely be limited by the length and late stage of the current economic cycle.

World GDP Forecasts

	2018	2019 (estimated)	2020 (forecast)	2021 (forecast)
World	3.2%	2.5%	2.6%	2.6%
Ireland	8.4%	6.0%	4.0%	3.5%
United Kingdom	1.3%	1.2%	1.4%	1.5%
Eurozone	1.9%	1.1%	1.2%	1.2%
United States	2.9%	2.3%	1.9%	1.8%
Japan	0.3%	0.9%	0.5%	0.8%
China	6.6%	6.1%	6.0%	6.0%

Source: Bloomberg 31.12.19

2020 Investment Outlook – Ireland & the World

Ireland

The Irish economy has continued to perform well in both absolute and relative terms despite the drag from 'Brexit' related uncertainty throughout most of the year. In quarter three, personal consumption grew 3.3% and GDP grew 1.7%.

In the year to 30 September 2019:

- *GDP grew 5%*
- *Net trade rose 7.1%*
- *Capital investment rose 1.2%*
- *Information and communications grew 22.4%*
- *Agriculture rose 15.2%*
- *Financial and insurance activities rose 9.5%*
- *Construction rose 2.3%*

Elsewhere, other activity measures remain strong. Numbers on the Live Register continue to decline reaching 185,300 on a seasonally adjusted basis while unemployment has fallen to 4.8%. Retail sales have generally been running around mid single digit levels of growth although the most recent reading shows sales excluding autos up only 1.9%. National residential property price gains remain positive although they have slowed, possibly impacted by buyer reticence given 'Brexit' related uncertainty. Most recently, national residential prices were up 0.9%.

The fiscal position has continued to improve with the government generating a surplus for the second consecutive year at €647m. Given the strong levels of growth in earlier quarters, the Irish economy likely grew about 6% in 2019 with growth of approximately 4% likely in 2020 now that the risk of an imminent 'no deal Brexit' has been avoided.

The removal of the threat of a 'no deal Brexit' should contribute to a rebound in business sentiment in 2020 and support strong growth in the economy over the coming twelve months. Many business confidence readings fell to 6 or 7 year lows in the autumn as the risk of a worst case 'no deal Brexit' outcome rose with no resolution apparently in sight. A meeting between Leo Varadkar and Boris Johnson in early October in which a path to a resolution was identified ultimately proved to be the catalyst to the agreement of a new withdrawal deal between the UK and EU. The large majority won by the Conservatives in the UK general election in December enabled the deal to be passed in parliament, which allows the UK to exit the EU at the end of January with a transition period lasting until the end of 2020.

Europe

Trade accounts for a relatively large share of GDP across the Eurozone and therefore it has been one of the most sensitive regions to the global trade war over the last 15 to 18 months. Germany (with its large exposure to emerging markets and China) has been particularly badly impacted, with the economy contracting in quarter two and only just avoiding a technical recession in quarter three.

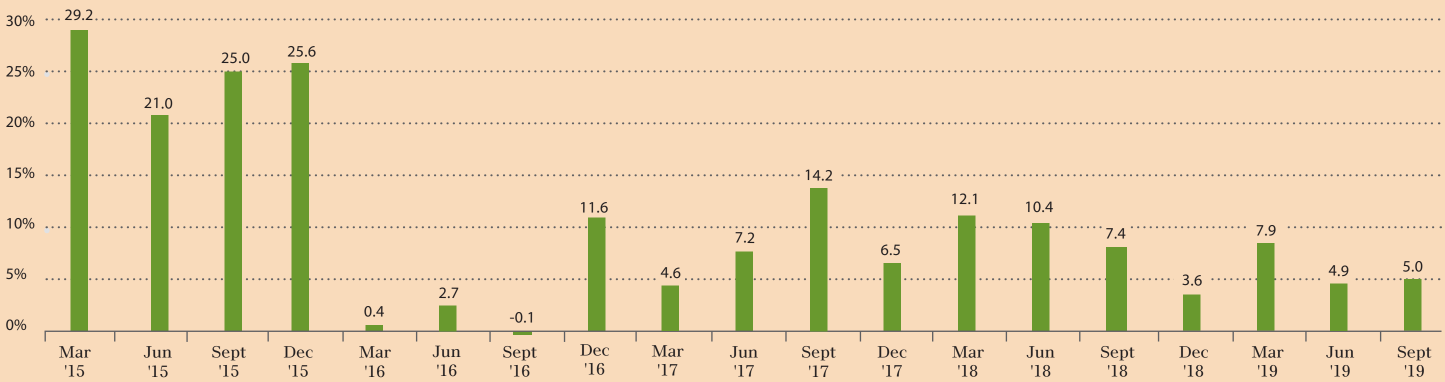
Eurozone growth slowed from 1.9% in 2018 to an estimated 1.1% in 2019 with quarterly growth halving from 0.4% in quarter one to just 0.2% in quarters two and three. In addition to the impact of the trade war and significantly slower growth in Germany, Eurozone growth and sentiment were also impacted during the year by 'Brexit' related uncertainty.

In response to the slowing growth backdrop and persistence of low inflation, the ECB increased the level of policy stimulus during the year by cutting the deposit rate by 0.1% to -0.5% and restarting asset purchases in November at a level of €20bn per month. Combined with the progress in global trade and 'Brexit', this has helped stabilise the economy and resulted in a modest improvement in sentiment surveys.

United States

The US economy has continued to perform well in a global context, benefitting from the positive albeit fading impact of the 2017 tax package, three interest rate cuts during the year and a still robust labour market which has supported consumption. Quarter three GDP grew 2.1% annualised while growth in 2019 is expected to be around 2.3%.

Irish Quarterly GDP Year/Year Growth



Source: Bloomberg 31.12.19

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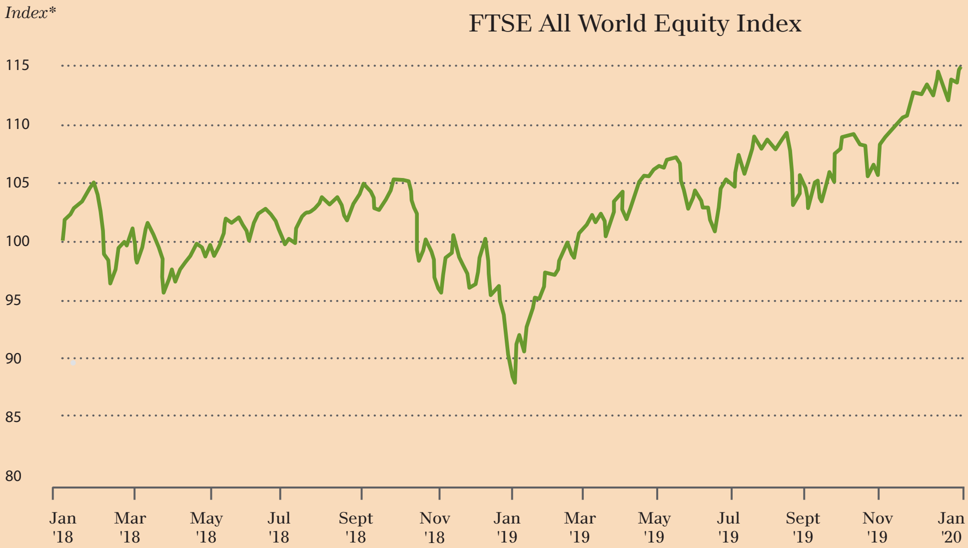

**Rebased to 100 as of 02/01/2018*

Source: Bloomberg 31.12.19

Growth is expected to ease through 2020 with the economy growing 1.9% for the year as a whole. The slowdown reflects the continued fading impact of the tax package and the more mature stage of the economic cycle in the US where the recovery has been both longer and stronger than experienced in other regions. Nevertheless, with unemployment close to 50 year lows of 3.5% and strong ongoing levels of job growth, consumption should remain well underpinned. Easing in trade tensions with China with a low probability of any further escalation should help boost business sentiment and investment levels compared to last year.

The outcome of the US Presidential election in November 2020 could have implications for the growth outlook and equity markets. If one of the more progressive Democratic candidates such as Elizabeth Warren or Bernie Sanders were to win, some of their more extreme policy proposals could contribute to slower growth. Should Donald Trump be re-elected, policy continuity should result in limited impact on the economy and markets. During the year, however, markets may be sensitive to news flow and polls relating to the election.

China

The Chinese economy continued to slow throughout 2019 with growth down from 6.6% in 2018 to an estimated 6.1% in 2019. Over the course of 2019, growth slowed from a rate of 6.4% in quarter one to just 6% in quarter three, the lowest level of growth since records began in 1992.

Growth slowed due to the negative impact of the trade war with the US and the lagged effect of tighter fiscal and monetary policies in 2018 when the authorities attempted to address the debt bubble, which has grown substantially in recent years. During 2019 China reintroduced both fiscal and monetary stimulus measures to offset the slowdown. Tax breaks were offered to boost consumption while interest rates were cut a number of times to help improve the flow of credit and increase investment.

Key activity metrics such as retail sales, fixed asset investment and industrial production eased over the first nine months of the year with growth levels in industrial production falling to their lowest rate in 17 years at one point.

In quarter four, as progress was made in the trade war with the US and earlier stimulus measures began to have an impact, business sentiment and activity levels started to improve. By year end retail sales were growing 8% from a low of 7.2%. Similarly, industrial production growth rebounded from a low of 4.7% to 6.2%. Early in quarter four Chinese authorities suggested growth of 6% might be difficult to achieve in 2020 given the pressures the economy was experiencing at the time and resulted in consensus growth forecasts falling to 5.8%. Given the improved trade outlook, business sentiment readings and activity levels since then, growth in 2020 will possibly be slightly better than this with the economy growing around 6%.

Japan

The Japanese economy continued to lag other developed markets in 2019 with expected growth of only 0.9%. This however does represent an improvement from the 0.3% experienced in 2018.

In 2019 the economy was again buffeted by a number of factors including a 2% VAT increase in October and severe weather related disruptions in quarter four, which will have resulted in the economy contracting in the last quarter of the year. Japan is relatively sensitive to Asian trade and the trade war was an overhang on the economy over the course of the year.

Despite the relatively soft economic backdrop the Bank of Japan left policy unchanged throughout the year, even though it suggested on a few occasions that it was ready to increase the level of stimulus. Concerns over its already high ownership level of the bond market combined with worries over the impact of negative interest rates on the banking sector prevented the Bank from loosening policy further.

Environmental, Social & Governance in the Spotlight

2019 saw the continuation of Environmental, Social & Governance (ESG) discussions which have been propelled further into the spotlight by notable environmental crises and social activism including the emergence of environmental activist Greta Thunberg.

The increasing focus on ESG more generally has seen corporate bodies lead the charge amidst reluctance from global governments to address these multi-layered issues head on. Concerns surrounding electorate dissatisfaction with potential changes, cost implications arising from enforcement and general apathy at senior government levels have seen the subject pushed down the priority order. The recent wildfires in Australia are testament to the dangers government officials expose themselves to by ignoring climate concerns, with the Australian Prime Minister facing the vitriol of the public for not engaging with efforts to contain the fires more quickly.

Greenwashing

The corporate view of ESG has evolved from attempting to appease a small cohort of activists to a more fundamental conversation around the drivers of corporate profitability. Whilst there is a range of engagement amongst companies on ESG factors, clever marketing material with unsubstantiated claims, referred to as 'greenwashing', has led to a demand for action rather than mere commentary. With ESG not being taken seriously across all political circles, companies are well aware of how changes in consumer sentiment can impact their balance sheets. Implementing a full ESG approach to their business model may ultimately prove the better opportunity cost to a company's viability in the long run.

"Environmental, Social, and Governance (ESG) refers to the three central factors in measuring the sustainability and societal impact of an investment in a company or business."

Embracing ESG

Within the corporate world, improvements in the reporting of respective attitudes to ESG, including a corporate's carbon footprint, has helped raise the bar. Yet, there is a significant journey ahead. The current lack of a standardised set of metrics and consistent terminology has added to the confusion within the public sphere as to which factors need to be measured and how the data is represented. On attaining consistency on reporting, it will be far easier for individuals and investors alike to reward those corporate entities whom embrace ESG and in turn coerce other corporates who are still slow to adopt the principle. Whilst a common ESG taxonomy is in development, the coming months and probably years will see increased emphasis on ESG participation through not just social pressures but also from within by corporate employees.

Will ESG succeed?

ESG will only succeed on a level when there is appropriate engagement across all stakeholders. The regulatory environment has seen a change in attitude to ESG of late. Until such time as political force backs up any regulatory discussions, however, it will be difficult for meaningful enforcement of breaches in policy to be investigated and prosecuted.

Voice of a Generation

From a generational point of view, older age groups risk feeling the ire from younger generations, including Generation Z and Generation Alpha, due to their lack of engagement and general apathy to the cause. Greta Thunberg has been pedestalled as the poster child for change, drawing both strong commendation and harsh criticism from vested individuals for her environmental stance.

Leave no Trace

When on a walk in the park or your local woodland area you are encouraged to leave no trace. Whilst it is a bit late for such a request on planet earth, environmental protagonists fear if we continue in our current fashion, we will ultimately leave no planet at all. This may seem extreme, in particular in Ireland where we benefit from a temperate climate but the reality is far different in countries which are at the forefront of climate change.

Meaningful Changes

More generally, a change in attitude to ESG appears inevitable but support by the majority is needed to deliver meaningful improvements. Whilst there will always be those who do not adhere to guidelines or rules, there needs to be critical mass committed to making the changes necessary.

In summary, the acronym ESG is no longer a meaningless footnote but rather a central topic for discussion.

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