HSBC Global Management

2019 Macro & Multi-Asset Outlook

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2018 has been a tricky year for investors. Performance is either flat or negative across most traditional and alternative asset classes with only a few exceptions such as US equities and the US dollar. And some assets classes like emerging markets have performed really poorly although there's been quite a lot of variation in performance within this group. What's been really challenging for multi-asset investors alongside poor overall returns are the poor returns on traditional diversifying asset classes such as treasury bonds and gold.

There's been a lot of noise in financial markets in 2018 and that's created episodic waves of volatility even if overall levels of market volatility for the year as a whole have remained relatively low. And it's hard for investors because much of the news are just developments in the narrative rather than decisive shifts in the facts about the macro economy.

For us, the really important fundamental change in 2018 is US interest rates. This year the economic background has been of cyclical divergence. Strong economic growth in the US versus a slowdown in other economies of the world. And this has forced market participants to reprice the outlook for US interest rates. The two-year US government bonds, for example, has doubled in interest rates versus this time last year. This move in interest rates has caused the dollar to appreciate significantly so and quite abruptly versus emerging market currencies. And it's the emerging markets with the weakest macro fundamentals that have fared the worst while those with stronger macro characteristics have fared a little better. So, for us, it's this combination of factors that have really mattered for investment markets in 2018, higher US interest rates, a stronger US dollar and weaker than expected growth in the rest of the world.

We're moving away from 2018's regime of cyclical divergence where the US economy has been leading the world. Today global economic momentum has slowed. We think the global economy is now expanding at a trend-like pace. It feels a bit different and it's a clear contrast versus the synchronized growth, the so-called Goldilocks economy of 2017 but it's certainly no disaster. The main reason for this change in pace of growth is due to our second theme, our second economic theme is that policy is moving back to neutral. The US fiscal stimulus has been an important driver of US growth in 2018 but it is now set to fade as we go into 2019. Fed policy is moving back into neutral gear too and other central banks are further behind the process but the direction of travel is clear and in China, policy stimulus should feed through into stronger economic activity in 2019. Meanwhile, global inflation is creeping higher but remains contained overall. Again, there are a few exceptions in emerging economies but overall, we expect price pressures to build only gradually in 2019.

Our final economic theme as we move away from the regime of cyclical divergence is that the global economy is running on two engines, China and the US and it's the outlook for these two engines of growth that will be really important for determining the path that the economy takes in 2019.

Growth at a reasonable price. We think the global economy is in pretty good shape and worries about a growth slowdown or recession are overplayed. There is unwarranted pessimism about the economic cycle, especially when we think about the good continued trends in corporate profits. A number of growth-sensitive asset classes, however, have become significantly cheaper during the course of the last year and we think that they now offer good value on a tactical basis. We think this is particularly the case for Asian equities and also for emerging market equities where the currencies and equity markets have cheapened materially.

We think the big event of 2018 was the repricing of US interest rates. Since the Brexit vote in 2016, bond yields have been on a rising trend and been poor diversifiers for multi-asset portfolios. Now, for the first time since then, yields have increased in parts of the US Treasury curve such that they look a lot more interesting as effective portfolio diversifiers for multi-asset investors. Bond yields could still move higher if inflation trends build or if a market psychology around inflation develops. For now, in multi-asset portfolios, we think there is value in parts of the US treasury curve and especially on a relative basis versus European government bonds.

The improvement in US fixed income valuations during 2018 also means that investors have the opportunity to buy more defensive asset classes at better prices. This is attractive because we can add portfolio resilience versus more adverse scenarios developing in the macro economy. So, again we would focus on US fixed income, particularly short duration parts of the treasury curve and also some short duration higher quality credits in the US. The biggest impact risk is US inflation. The labor market is already tight and faster than expected US inflation would force bond yields higher in the US and also undermine asset class valuations. So far, inflation trends look to be subdued and inflation normally builds only very slowly but we do need to be vigilant about this risk. The second key risk for us is China and the impact of high global policy uncertainty. A further escalation of the trade war could impact China, other Asia economies and the global system. The good news is that this risk is already well known to the market and financial market pricing is already quite fearful about this. As always, there are a number of other important risks around too, especially politically uncertainty in Europe which needs to be monitored closely. And there are some things that could go right for the world economy also such as corporates doing more capex or stronger consumer spending particularly in the US. Given the macro backdrop today, it's really important to be diversified, to be willing to ride out phases of volatility and also be adaptive to any changes in the environment.