INVESTMENT OUTLOOK

JANUARY 2020

GREEN SHOOTS OF A GLOBAL MINI-CYCLE RECOVERY HAVE ENCOURAGED STRONGER RISK APPETITE AND A BENIGN FORWARD OUTLOOK.

Accommodative monetary policy is supporting global growth while the worldwide manufacturing-driven downturn runs its course. Valuations in many markets already reflect that favorable outlook. Economic and corporate earnings growth will have to deliver well ahead of consensus expectations to enable above-average returns in the year ahead.

MACRO & MARKET COMMENTARY

MACRO DRIVERS

The phase one trade agreement between the United States and China is a key support to global risk appetite.

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CREDIT

Emerging market credit looks relatively attractive compared to developed markets.

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GOVERNMENTS & CURRENCIES

The odds of a Federal Reserve (Fed) rate hike over the next 12 months are low, which should lead to a somewhat softer US dollar.

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EQUITIES

We expect mid-single-digit earnings growth and modest price-to-earnings multiple expansion to drive equity returns.

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POTENTIAL RISKS

US-China trade war escalation or a surprise hawkish shift in Fed rhetoric could quickly derail the global economy's positive trajectory.

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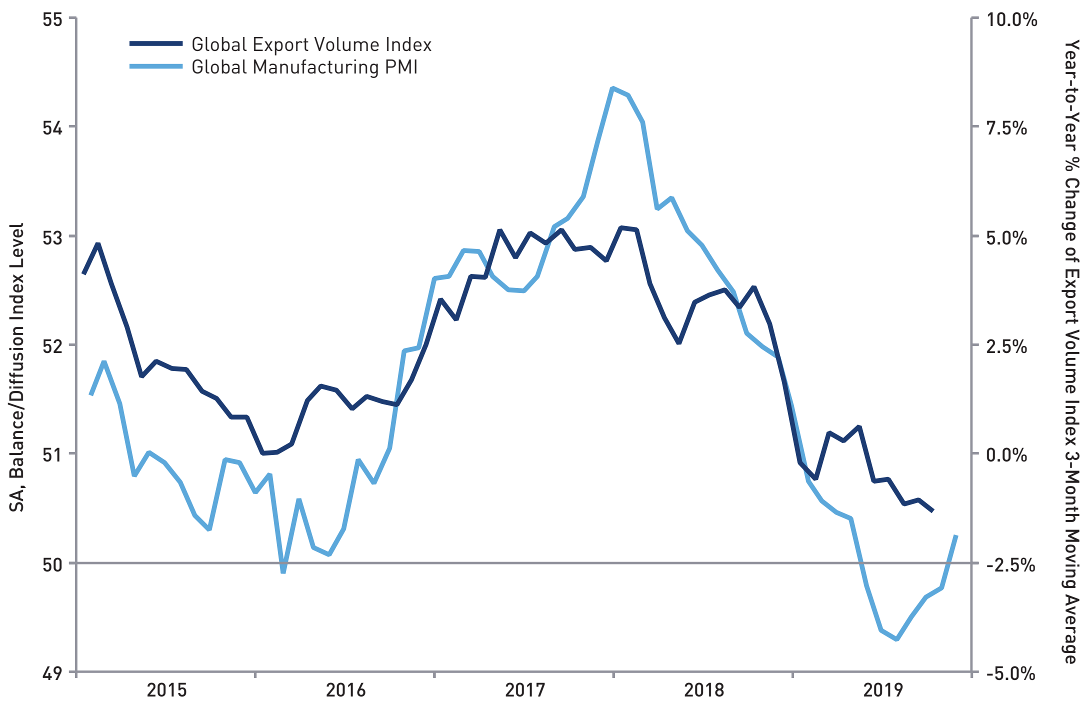
MACRO DRIVERS

The global economy looks to be gaining traction and recession fears seem largely behind us.

- The US-China phase one trade agreement is expected to have a broad positive effect on risk appetite, corporate spending and global manufacturing.
- The global manufacturing slowdown was exacerbated, not caused, by the US-China trade war. The economy appears to be exiting this slowdown, and the probability of an extended global mini-cycle recovery is now much higher.
- The US-China trade war had limited impact on overall US growth, but the uncertainty and potential for escalation represented a significant risk to corporate decision makers and investors. Now that the uncertainty has abated somewhat, a recovery in capital expenditures would be a welcome development.
- Central banks have been making a solid effort to lower interest rates to support economic growth. The Fed is unlikely to hike interest rates over the next year and is seeking to consistently reach its core inflation target of 2.0% before considering tighter monetary policy in the US.

GLOBAL EXPORT VOLUMES AND MANUFACTURING PMI

Global export volumes are likely to grow at a faster pace now that the global manufacturing PMI is indicating expansion.



Source: Refinitiv Datastream, data as of 12/30/2019.

The purchasing managers' index (PMI) is a measure of the prevailing direction of economic trends in manufacturing.

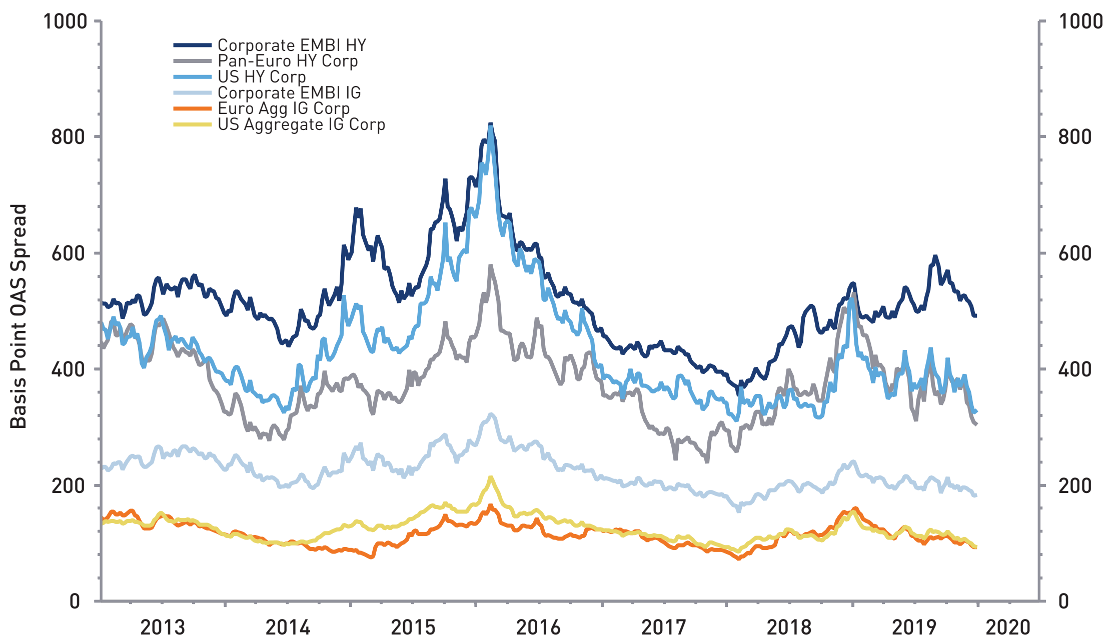
CREDIT

The global search for yield continues to drive credit spreads lower.

- We expect the operating environment for most corporations to improve at the margin over the course of 2020. We anticipate mid-single-digit profit growth in many regions of the world.
- Investors appear to have an insatiable demand for high-grade income as credit spreads ratchet tighter. High yield spreads in the US, Europe and emerging markets are also tightening on expectations for stable to improving growth.
- The lowest-quality segments of the credit market have been under a bit of pressure as leverage has built up and the probability of defaults has risen. However, broadly speaking, we think corporate health still looks decent.
- Accommodative monetary policy has been a key factor in extending this expansion. Corporations around the world have been taking advantage of low interest rates by borrowing or refinancing existing debt.
- Debt service ratios look manageable in aggregate. That said, we are concerned that valuations within certain sectors of the credit market look stretched based on our debt-to-profit indicators.

GLOBAL CREDIT SPREADS

Emerging market high yield spreads look attractive compared to global peer indices.



Source: Refinitiv Datastream, Bloomberg Barclays, JP Morgan, data as of 1/1/2020.

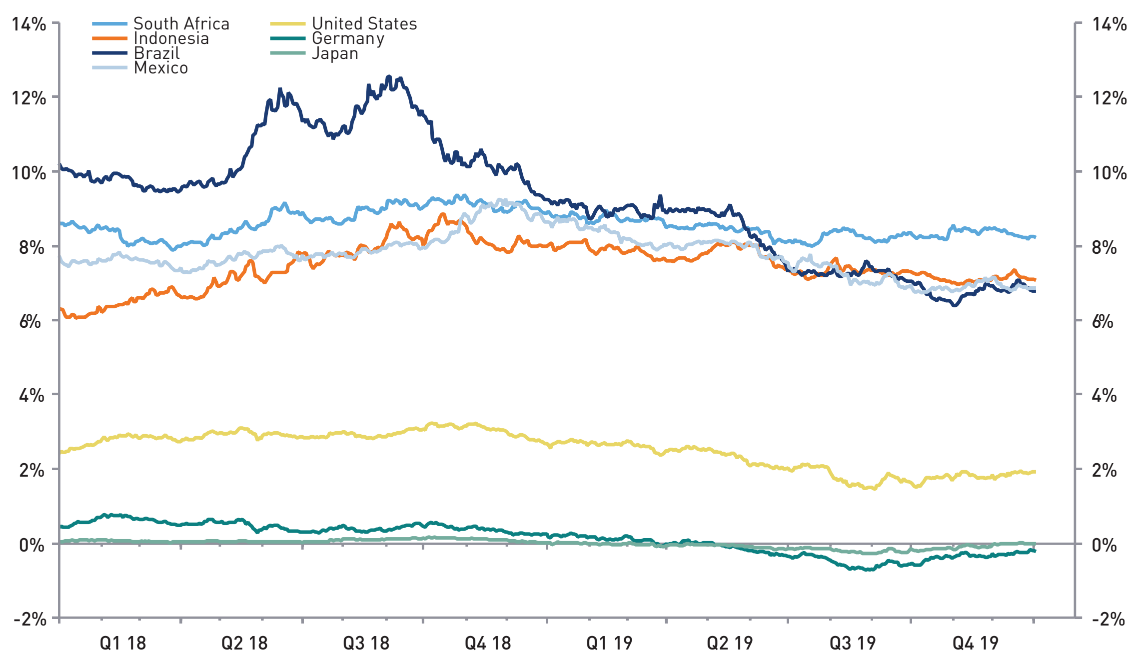
GOVERNMENTS & CURRENCIES

Fed insurance cuts and a steepening US yield curve are easing recession fears.

- Inflation pressure in the US remains nonthreatening and the global growth outlook does not suggest boom times are ahead. Global central banks are likely to stay on the sidelines or ease policy in 2020.
- In this environment, it seems unlikely that global government bond yields will gain much traction. We expect developed market rates to trade in a tight range, with a modest bias higher over the long term.
- An inflation spike would be a big surprise to the bond market. We anticipate moderately higher inflation ahead, but not to a level that would put Fed hikes back on the table.
- Emerging market local-currency debt could be an opportunity for investors looking for income greater than what the US, Europe or Japan will likely offer.
- The US dollar could weaken a bit, especially if growth outside the US starts to accelerate at a relatively faster pace.

LOCAL-CURRENCY GOVERNMENT BOND 10-YEAR YIELDS

EM local-currency government bonds have offered relatively high yields and tend to deliver strong returns when the US dollar weakens.



Source: Refinitiv Datastream, data as of 1/1/2020.

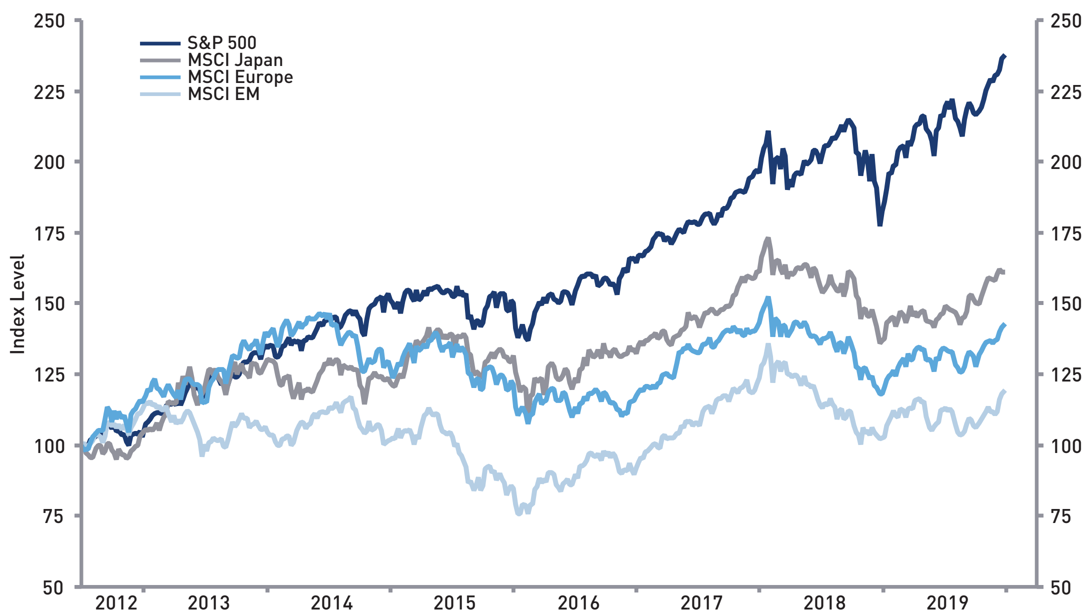
EQUITIES

Earnings growth likely to play a greater role in total return generation in 2020.

- The outlook for corporate earnings and global growth remain critical factors helping to drive equity market performance. We expect mid-single-digit earnings growth across many regions of the world and very modest multiple expansion.
- S&P 500 bottom-up consensus earnings estimates for 2020 are likely too high at 10%, though these estimates are typically revised lower as the year progresses. We believe the S&P is more likely to deliver earnings growth near 6.0% in 2020.
- While uncertainty about US trade policy has diminished, the risk still lingers for corporate decision-makers and investors. A signed phase one deal looks built into market valuations; therefore, re-escalating tension represents a downside risk.
- We believe global equities will be among the best-performing asset classes in 2020 across growth and value styles. We prefer US large-cap equities over global peers in Japan, Europe and emerging markets.

GLOBAL EQUITY RELATIVE PERFORMANCE

A large technology weight helped drive the S&P 500's outperformance relative to global peers.



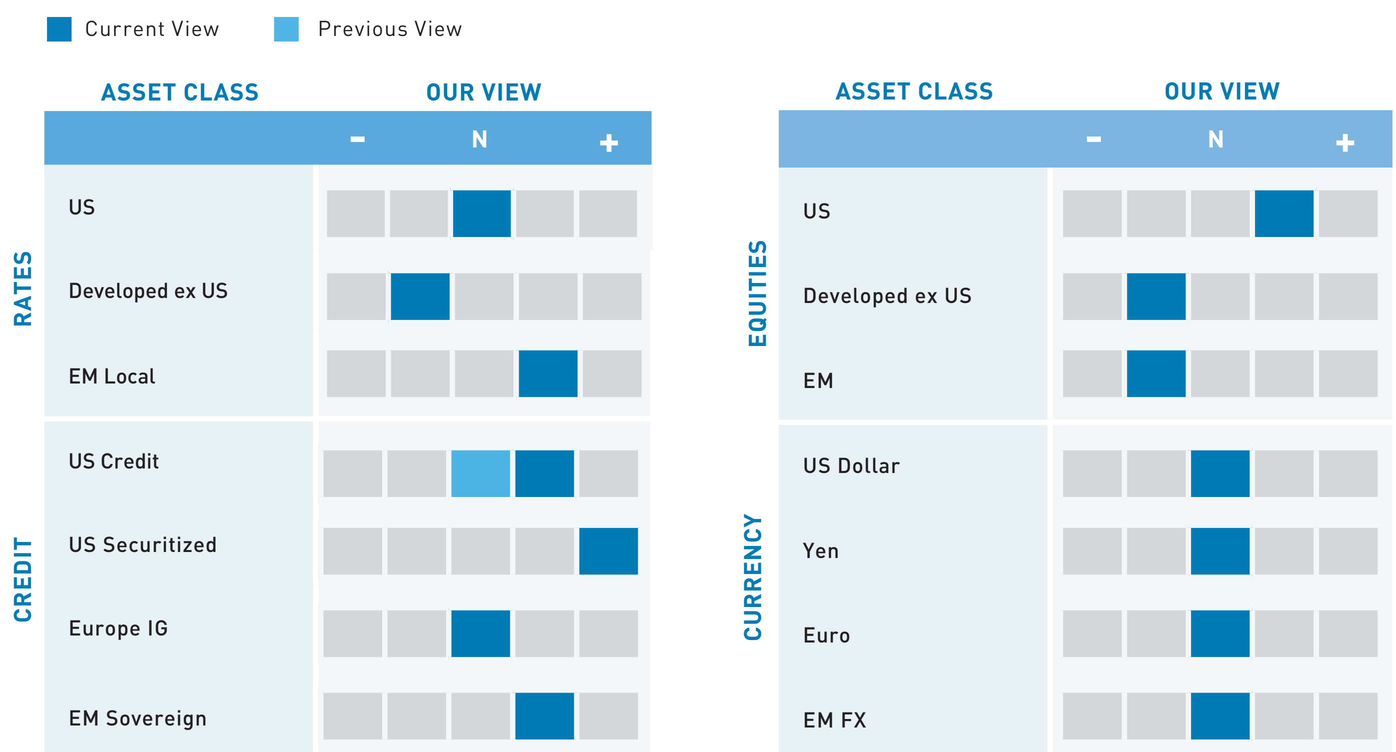
Source: Refinitiv Datastream, data as of 12/31/2019. June 2012=100.

POTENTIAL RISKS

We have green shoots, not deep roots.

- Early signs of a cyclical pickup in the global economy are popping up all over. However, global manufacturing PMI readings still remain at somewhat depressed levels, especially in Europe. We need further progress in the months ahead before the mini-cycle recovery can fully take root.
- Any deterioration in US-China trade relations would be detrimental to our cautiously optimistic view on credit and equity markets.
- The Fed's lower-for-longer messaging is anchoring bond yields in the US, which is, in turn, supporting risk asset valuations. A surprise change in the Fed's tone could derail the economy and financial markets.
- At times, investor exuberance itself has been an indicator that risk markets were near a peak. That does not seem to be the case now, given that a degree of investor skepticism is still evident.

ASSET CLASS OUTLOOK



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