INVESTMENT OUTLOOK
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2020 Market Forecast and Outlook

Review of 2019:

As predicted in my 2019 Outlook newsletter, 2019 was a strong year in the markets and the recession risks that drove global markets down towards the end of 2018 dissipated as evidence of a US-China trade deal became more realistic.

It was interesting that during this period of time, many financial institutions published reports/indexes designed to track US recessionary risk. RBC Wealth Management was no exception to this trend. In fact, the most recent scorecard points to a no-recession scenario so far in 2020.

As a point of reference, the "RBC US Recession Scorecard" measures 6 major economic indicators to gauge recession risk. They include the Yield Curve (1 yr to 10 year Treasuries), Unemployment Claims, Unemployment Rate, Conference Board Leading Index, ISM New Orders Minus Inventories, and Fed Funds Rate vs. Nominal GDP Growth.

In 2019, only one (Yield Curve) pointed to a potential recession, while the other 5 were either Neutral or Expansionary in indication. Even then, the inversion was somewhat reversed by the Fed lowering rates last year. All said, when these measures do point to a recession, the actual recession does not transpire for up to 6 months further down the road.

Outlook for 2020:

Global economies appeared to have navigated through the tariff and other structural challenges in 2019. In addition, there remains accommodative monetary policies in major developed central banks across the globe. This coupled with general strong consumer confidence and no immediate signs of a US recession suggests that Global Markets in 2020 should show a net positive gain for the year, with Emerging Markets likely leading the way.

It would be understandable to consider that significant growth for 2020 would be overly optimistic given the growth experienced in 2019. That said, we have had 12 such instances of the S&P 500 prior to last year since 1950. The average rate of return over those 12 periods in the year following a significant return of the S&P 500 was + 15.2% and only 2 were negative years (1980 – 4.7% and 1989 -3.1%) according to LPL Research. As such, history would in fact suggest a good year in the markets for 2020.

My readings of several dozen 2020 market outlook materials produced by several financial services companies seem to support this view across the board. Although it should be noted that the general view is a more muted growth for 2020 vs 2019. Within equity, there also appears to be a continued bias towards technology, but there is a notable shift generally away from growth stocks and more of a value approach + towards cyclicals (energy, financials and materials). This makes Emerging Markets and energy/material heavy economies like Canada and Australia as preferred markets to invest. By comparison, US economic growth (GDP) is projected by RBC to grow at 1.75% (vs 2.5% - 3% in prior) & Europe is similarly showing signs of economic flattening. As such, we would anticipated those markets will not be as positive on a relative basis.

World According to Joe:

Although it is unlikely that we will be seeing a recession in 2020, it is important to note that bull markets typically peak well before a recession starts, sometimes as much as a year in advance.

In addition, as much as most US Recession indicators, including the aforementioned "RBC US Recession Scorecard", cracks are appearing even in the measures that are currently showing US economic expansion. Given that virtually all bear markets have also been associated with US recessions, it would be prudent to use growth in 2020 as an opportunity to trim equity exposure and begin the process of adjusting client asset allocations towards a more conservative level.

If there is one area where I differed strongly from our RBC Capital Markets people it is in the area of projected value of the Canadian Dollar in 2020. That is to say, until very recently (where they seemed to have seen the error in their ways.. :o)..). Up until November 2019, the general view of my colleagues in RBC Capital Markets (Note: They were not alone in this position) was that the Canadian Dollar was to decline (roughly to USD $0.73) in 2020. The rationale at the time was that there was significant consumer debt in Canada + the US-China trade conflict + muted global growth expectations.

Since then, Canadian GDP growth has surprised to the upside + the US-China trade dispute seems to be working out to the positive. The net result has been a revised forecast showing a short term appreciation of the Can$ in 2020 to the current roughly USD $0.77 level. All said, I believe that the Cdn$ has the potential to break through the $0.80 level in 2020 if the anticipated shift in equity allocation to cyclicals occurs (note: keeping in mind that current Purchasing Power Parity to the USD is set at $ 1.2436, or USD $0.804).

In addition, I believe that Canadian Consumer Debt levels is an overblown concern as much of that debt has been incurred for the purpose of investment in Real Estate. Much of which is designed to create income cash flow, or at least be sufficient for debt servicing. As such, unless there is an anticipated real estate correction planned (especially in high urban centres like the GTA, Vancouver or Montreal) , I suspect that these elevated Consumer Debt levels will not have the feared impact on Consumer spending as has been in many forecasts.

Conclusions:

In conclusion, I have in the past used the term cautious optimism when describing my view on upcoming markets. Although I remain optimistic, I can simply say that I am becoming increasingly cautious and will apply that approach to portfolio rebalancing in the coming months.

QUOTE

"If you are not embarrassed by the first version of your product, you've launched too late."

Reid Hoffman, co-founder of LinkedIn

KEY FORECASTS

USA	Curr	Q1/20	Q2/20	Q3/20	Q4/20
Fed Rate	1.63	1.63	1.63	1.63	1.63
2 Yr Try	1.65	1.70	1.75	1.75	1.75
10 yr Try	1.90	2.00	2.10	2.10	2.10
(2-10)	0.25	0.30	0.35	0.35	0.35
Canada	**Curr**	**Q1/20**	**Q2/20**	**Q3/20**	**Q4/20**
Overnight	1.75	1.50	1.50	1.50	1.50
2 Yr GoC	1.68	1.50	1.40	1.50	1.55
10Yr GoC	1.65	1.70	1.70	1.75	1.80
(2-10)	-0.03	0.20	0.30	0.25	0.25
$ vs. $	**Curr**	**Q1/20**	**Q2/20**	**Q3/20**	**Q4/20**
U$ > C$	1.305	1.30	1.31	1.32	1.33
C$ > U$	0.758	0.741	0.746	0.7519	0.7519
U$ > EU	0.898	0.901	0.926	0.901	0.893
U$> JPY	110	111	108	108	111
U$> BP	0.769	0.719	0.729	0.735	0.741
U$ > AU	1.448	1.448	1.448	1.515	1.515
U$ > SF	0.971	1.02	1.04	1.03	1.01

Source: RBC Capital Markets