MULTI ASSET
ACCUMULATOR RANGE

January 2020

2020 Global Investment Outlook

1st quarter insights

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After the trauma of the financial crisis, the 2010's saw markets rise sharply with both bonds and equities enjoying strong gains. As we usher in a new decade, we will review the winners and losers of the last ten years and contemplate what might be in store for the next ten.

A decade both kind and cruel

Looking back, the last decade was mostly kind to investors and cruel to cash savers. An uninterrupted period of economic growth has seen equity markets outperform all other liquid asset classes, having come last in the asset class race in the previous decade.

The US is enjoying the longest economic expansionary period since the American Civil War. Whilst the upswing is now more than twice as long as average, the rate of GDP growth has been half the average of the last 75 years. Equities typically outperform other asset classes; equities without a recession are pretty much unbeatable.

THE WINNER OF LAST DECADE: The US Equity Market

There has been a huge spread between the winning and losing regions; hindsight makes this game easy, so let's start by looking at the clear winner: the US equity market.

American equities have enjoyed significant tailwinds: falling tax rates, declining interest costs, reduced competition, record share buybacks and increased valuation multiples. These have provided the ingredients for the US to return 12.9% per annum in US Dollars without ever suffering a 20% correction, only the second decade on record. Other regions have been less fortunate.

The rest of the developed world rose at just 5.3% per annum, whilst this decade's wooden spoon goes to emerging market equities returning just 4% per annum.

Equity market returns from 31 Dec 2009 to 31 Dec 2019

Source: Bloomberg

Past performance is not necessarily a guide to future performance.
US = MSCI World US Total Rtn; World ex US = MSCI World ex USA Total Rtn; Emerging Markets = MSCI EM Total Rtn

1850 2010s was the first decade since 1850 that the US didn't experience a single recession

200 New all-time highs on the S&P 500

128 No of months of current US expansion
Longest economic expansion in US history

But remember, in the previous decade EM equities generated 10% a year whilst US equities fell by 1% a year. Markets have a tendency to revert to the mean.

Fixed income has also seen dispersion of returns, even as developed government bond yields have continued to move lower everywhere. Gilts have been one of the winners of the developed world, returning 5.6% as yields fell from 3.5% to less than one. Coincidentally, that's roughly where Japanese bonds started this decade. Japanese government bonds duly paid their 1% coupon a year, with returns boosted to 2% pa with the further tailwind of yields falling to 0% by the end of the decade. In the context of a multi-asset fund, most developed market government bonds don't have the role to play that they did 10 years ago, given the low prospective return, but they can still be shock absorbers in an economic downturn.

Now for the real losers of the last decade. Firstly, commodities suffered a decade of neglect. Most commodities are poorly equipped to serve a useful purpose for long term investors as they differ from most other assets in that they cost money to hold rather than paying a dividend or a coupon. Gold, however, is different. It eked out a positive return last decade and has a record stretching back millennia of preserving the purchasing power of savers.

SAVERS: A decade of waiting

Finally, we have the weakest link: CASH.

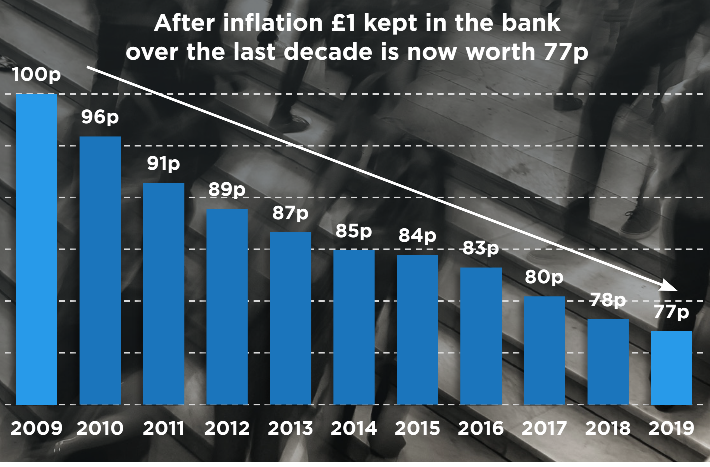
Savers in the UK who have spent the last decade waiting for interest rates to rise back to levels above inflation are still waiting.

Cash has lost money in real terms (after inflation) every year since 2009.

Individual years don't look that painful, but cumulatively £1 kept in the bank over the last decade is now worth 77p.

Source: Bloomberg and Pacific Asset Management

Calculated using Overnight GBP Cash and UK RPI from 31 Dec 2009 to 31 Dec 2019.



So, what might the next decade bring?

We think 2020 will be a decade where diversification is critical. Whilst we still expect equities to outperform other asset classes, we anticipate another decisive change of leadership. We doubt that US equities can maintain their lead over the rest of the world. Over the last 60 years, whenever the US has been one of the top three performing countries in a decade, it has always underperformed the average of the world in the next decade. This time that looks likely again as it has benefitted from a series of unrepeatable benefits. More than half of the gains of the last decade have come from higher valuations and increased margins. Both are likely to be reversed over the coming years.

Our strongest candidate for the next decade is emerging market equities, which have actually got cheaper over the last ten years, as earnings have grown faster than share prices, and unlike the US, their margins don't look unsustainably high.

Fixed income returns are pretty much certain to be lower in the next decade than the last and although developed market bond yields look unappealing, bonds are a broad church, offering a range of risk and return characteristics. Whilst being riskier than developed government bonds, we expect bonds issued by developing countries will likely to generate much stronger returns given their higher yields, both in nominal and real terms.

It will be particularly important to include diversifiers in a portfolio over the next decade.

1 Firstly, we expect gold to play an important role as central banks use more extreme measures to combat the next downturn, including a combination of ultra-low interest rates, QE accompanied by governments engaging in fiscal stimulus. This will be a powerful backdrop for gold.

2 Secondly, with government bonds diversification benefits being limited by their low yields, we think that other diversifying strategies such as alternative risk premia and macro funds will play an important role.

Unfortunately, there is one asset class where we don't expect mean reversion to occur and that is cash. For those savers waiting to be able to simply leave their cash in the bank and beat inflation, unfortunately it may be another long decade. Only the US briefly managed to move cash rates above inflation, only to have to reverse course last year. In the UK, the market's view (using pricing from real rate forward curves) is that savers will lose around 2% a year in real terms for the next 10 years. It's going to be necessary to be invested but diversified to grow wealth in real terms over the next decade.

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