ClearBridge Investments

2020 Outlook for Global Equities

December 12, 2019

Key Takeaways

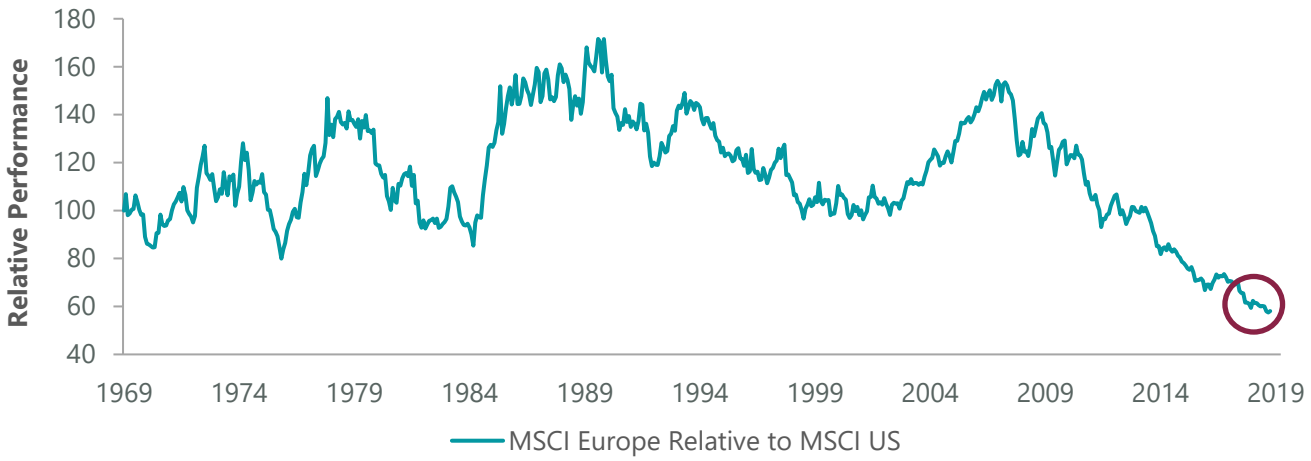
- Accommodative policy moves by global central banks give us an optimistic view of equities heading into 2020.
- European stocks, most notably in financials, could be boosted by better earnings growth and the potential for accretive merger & acquisition activity that should help close the valuation gap with U.S. equities.
- Emerging markets stand to benefit from progress on the U.S.-China trade dispute and the prospects for a weakening U.S. dollar.

European, Emerging Markets Stocks Positioned to Surpass Low Expectations

Economic sentiment in most regions worsened over the course of 2019, which we believe sets a low bar for global equities heading into 2020. Manufacturing data continued to weaken, yet consumers held up relatively well. We see reasons for optimism that are underpinned by policy moves. The European Central Bank has resumed a measured program of quantitative easing, the U.S. Federal Reserve has lowered interest rates while China and Japan continue to provide ample liquidity to their economies. In past cycles, increasing money supply has supported stock values after a several month lag, with the manufacturing sector picking up soon after. If we do not see a hardening of the U.S.-China trade war, this could be the case again.

Valuations in the United Kingdom and Europe are attractive, particularly compared with U.S. equities (Exhibit 1). European stocks are at 50-year lows vs the U.S., which has represented a good entry point the last two times performance dispersions became this extreme. Near-term risks in Italy are contained for now with a new moderate government in place. Fiscal stimulus is being discussed within the EU, which would be a clear positive. Brexit remains a wild card with Prime Minister Boris Johnson awaiting the results of December elections after his initial Brexit deal was rejected by Parliament and the EU granting an extension for a deal until the end of January.

Exhibit 1: European Stocks Historically Cheap vs. U.S.



Data as of Sept. 30, 2019. Source: FactSet.

Earnings growth has not been particularly robust in developed markets but there is good opportunity for that to improve in 2020. Earnings were quite good in Japan last year, but not so in Europe. Equities have done well on the Continent more due to forward looking expectations and multiple revisions. We are looking for earnings growth next year in the eurozone, with consensus numbers between eight and ten percent. Better earnings, however, will be dependent on what happens with manufacturing and the U.S. dollar (USD). A weaker USD would be beneficial for European, emerging markets and any export-driven businesses.

Japan, China and emerging markets are very dependent on progress in trade talks. A positive trade resolution should cause the USD to decline against other currencies. How Beijing deals with the protests in Hong Kong and the ongoing trade standoff will provide important signs of where the global economy and equity markets are headed. Geopolitical risks are a constant and we can take advantage in positioning our portfolios.

Emerging markets underperformed relative to developed markets this past year, which we believe is a good setup going forward. We have seen some good performance out of small cap emerging market stocks recently and continue to find interesting ideas in the space.

Other drivers of global equity performance in 2020 where we are constructive include merger & acquisition activity, especially in Europe where company balance sheets are in very good shape. We also see potential in selective cyclical sectors such as European banks, which should benefit from higher loan growth and eventually better yields. We gained exposure to large cap pharmaceuticals in 2019 at very attractive rates and we expect our positive thesis on the industry and other positions in health care across developed and emerging markets will continue to play through in the year ahead.

About the Author

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- 34 years of investment industry experience
- Joined predecessor in 2008
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