Active is: Anticipating what's ahead

# In our mid-year outlook, trade and politics are top challenges

by Neil Dwane | 10/06/2019


## Summary

After a strong start to 2019, the markets abruptly turned volatile. The global economy looks increasingly fragmented, and our mid-year outlook calls for more unease over trade tensions and politics. While there are no easy answers, we suggest investors focus on ESG, hunt for income and invest actively.


**Key takeaways**

- US-China tensions could hurt the stocks of large American tech firms that were already under fire for privacy issues, but cyber-security and defence stocks may benefit from rising geopolitical hostilities
- With political uncertainty high, investors might consider pivoting towards income-generating investments – but with low to negative yields on many bonds and cash, the biggest risk is still to take no risk
- Use ESG factors to help manage risk and drive performance potential; sustainability is becoming increasingly mainstream for a reason
- Take an active approach to investing: watch out for high-priced assets and take contrarian positions when attractive valuations can be found

## At the halfway mark, volatility persists amid fragile global growth

Investors began 2019 cheering the global rally in risk assets that followed a dramatic late-2018 market plunge. The tough fourth quarter caused the US Federal Reserve (Fed) to stop raising interest rates despite a relatively strong US economy, aligning the Fed more closely with other major central banks that are still keeping rates low.

However, as 2019 progressed, the markets turned volatile in the face of a fragmented economic environment with multiple pain points:

- Investors are caught in the disruptive fire of the US-China trade war, which is turning into a "tech cold war" that threatens to disrupt global supply chains.
- Europe is still vulnerable to Brexit uncertainty, and recent parliamentary election results may slow the European Union's ability to make critical decisions.
- The US is continuing along its late-cycle path with growth stuck at less than 2% and rising expectations of a recession in 2020. Moreover, policy uncertainty related to the upcoming presidential election could create market headwinds.

Against this backdrop, we are closely watching the themes that will likely drive markets, regions and investors' decisions throughout the remainder of 2019.

## Key investment themes at the halfway point of 2019

### With the Fed on hold, will the dollar slide if the debt ceiling lifts?

The Fed made a surprise U-turn to its monetary policy at the end of January. Instead of hiking rates further, as expected, the central bank put future rate hikes on hold. The market is even pricing in two rate cuts by the end of 2019 and four by the end of 2020. This shift in US monetary policy may ultimately weigh on the US dollar, especially if the US debt ceiling is increased this autumn against a backdrop of looser monetary policy. But general political uncertainty and ongoing easing by non-US central banks will likely prevent the dollar from falling further.

Takeaways for investors

- Interest rates now seem likely to remain lower for longer. With the market already pricing in several rate cuts, investors should expect continued low returns for traditional bonds – though they may be an attractive defensive option if recession risks rise.
- We believe the US dollar is likely to peak in value sometime during the second half of 2019; this may offer some relief to emerging-market assets in particular.

## Polarised politics could mean higher volatility

Political incumbents around the world are feeling pressure to move away from the political centre on issues such as economic inequality and immigration. Yet markets have largely stayed calmer than expected about politics because of the difficulty of anticipating policy changes. That said, some geopolitical shifts are having direct effects on markets – for example, US pressure on Iran is raising oil prices, which is hurting consumer spending. This supports our view that all investors, particularly those focused on emerging markets, can benefit from an active asset-management approach and considered analysis of political risks.

Takeaways for investors

- With political uncertainty high, investors might consider pivoting towards income-generating investments and away from "riskier", more volatile asset classes.
- Political events are hard to anticipate, but populism has been rising and politics are getting more polarised; an active approach may help make investment risks more clear.

## A "tech cold war" could rage for years

Amid heightened trade tensions between the US and China, President Donald Trump has fired the first volleys in a tech cold war by targeting Chinese corporations for trade practices that many describe as unfair. Supply chains could be disrupted if countries are forced to choose between Chinese and American tech ecosystems while the two superpowers vie for leadership in big data and artificial intelligence.

Takeaways for investors

- The tech cold war could undo the globalised low-cost, high-margin supply chains of many US and Asian tech companies.
- With large American tech firms already under fire for privacy issues, new US-China tensions could cause their valuations and expected returns to decline.
- Cyber-security and defence stocks may benefit from rising geopolitical hostilities.
- With nearly every industry attempting to use technology to its advantage, investors will need to employ active, rigorous research as they aim to separate winners from losers.

## Sustainability is a driver of long-term returns

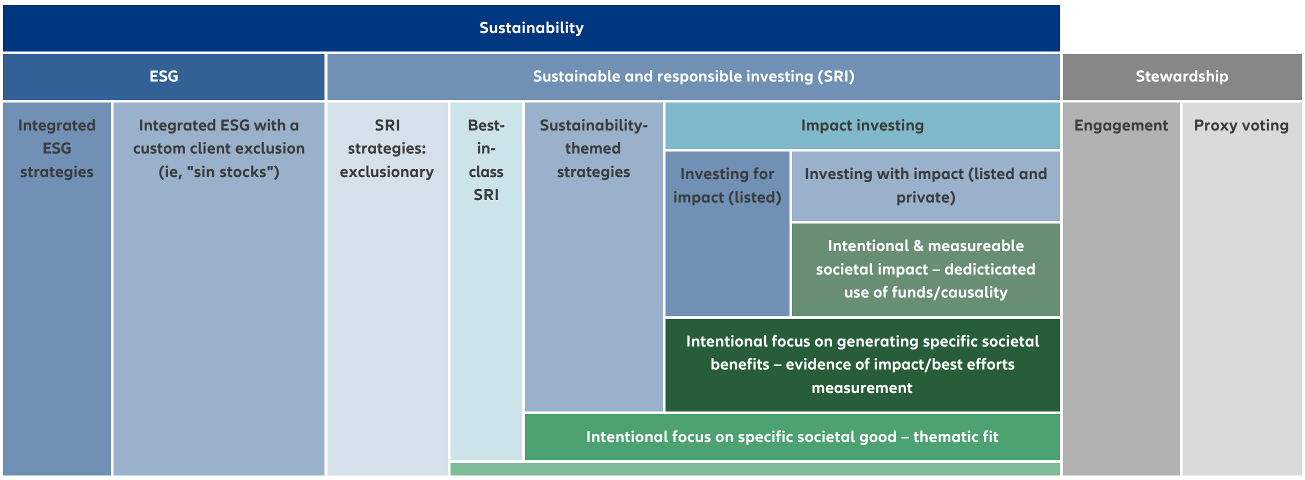
Sustainability has quickly become a key area of focus for investors – and for good reason. In the light of increasing pressure from activists and investors, boardroom agendas are increasingly reflecting topics such as climate change, higher governance standards and board diversity. Companies that manage these environmental, social and governance (ESG) factors well are better able to strengthen their competitive positions. We believe investors should examine ESG factors for a critical layer of insight, aiming to identify key risks and opportunities that are not yet fully reflected in prices. This can have a direct effect on risk-adjusted returns.

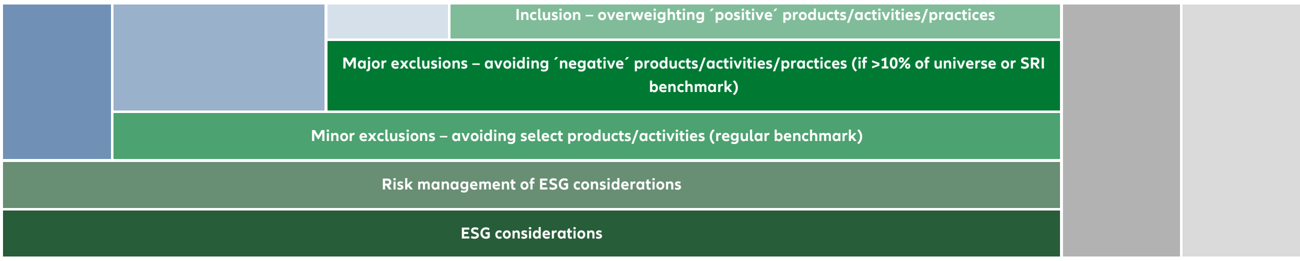
Takeaways for investors

- Done well, sustainable investing is about managing risks and improving performance. This is what drives our "integrated ESG" approach. In a systematic and disciplined way, we incorporate ESG factors into our existing investment processes, using our proprietary ESG research and the deep knowledge of our portfolio managers and analysts.
- We are also active stewards of the companies we own. We engage with companies with low ratings to help improve performance rather than exclude them outright.

## Sustainability can mean many things – clarity is key

Investors can pursue sustainable investments in multiple ways, from integrating ESG factors into all investment decisions to investing with a specific societal impact in mind. This graphic shows how our offerings sit across the spectrum of sustainable investing capabilities.






Source: Allianz Global Investors.

## Mid-year 2019 regional outlooks

### US

### EU

### UK

### China

### Asia

## Investment implications

1. "Riskier" assets may hold up as long as recession risks – or trade threats and retaliation – are contained. But if economic data start to deteriorate, government bonds may be an attractive option, despite low yields.
2. Take an active approach to investing: watch out for high-priced assets and take contrarian positions when attractive valuations can be found.
3. "Use ESG factors to help manage risk and drive performance; sustainability is becoming increasingly mainstream for a reason.
4. With returns on "safe" cash assets stuck at low or even negative levels, the biggest risk is still to take no risk.

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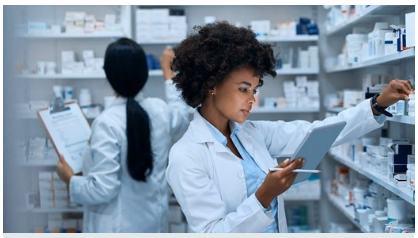

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## About the author

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Neil Dwane is a portfolio manager and the Global Strategist with Allianz Global Investors, which he joined in 2001. He coordinates and chairs the Global Policy Committee, which formulates the firm's house view, leads the firm's bi-annual Investment Forums and communicates the firm's investment outlook through articles and press appearances. Neil is a member of AllianzGI's Equity Investment Management Group. He previously worked at JP Morgan Investment Management as a UK and European specialist portfolio manager; at Fleming Investment Management; and at Kleinwort Benson Investment Management as an analyst and a fund manager. He has a B.A. in classics from Durham University and is a member of the Institute of Chartered Accountants.

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2019 Mid-year Outlook

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