



# New decade, new perspectives: What could 2020 offer investors?

**Presentations to Asian Clients**

January 2020

**John Greenwood.** Chief Economist



# Agenda



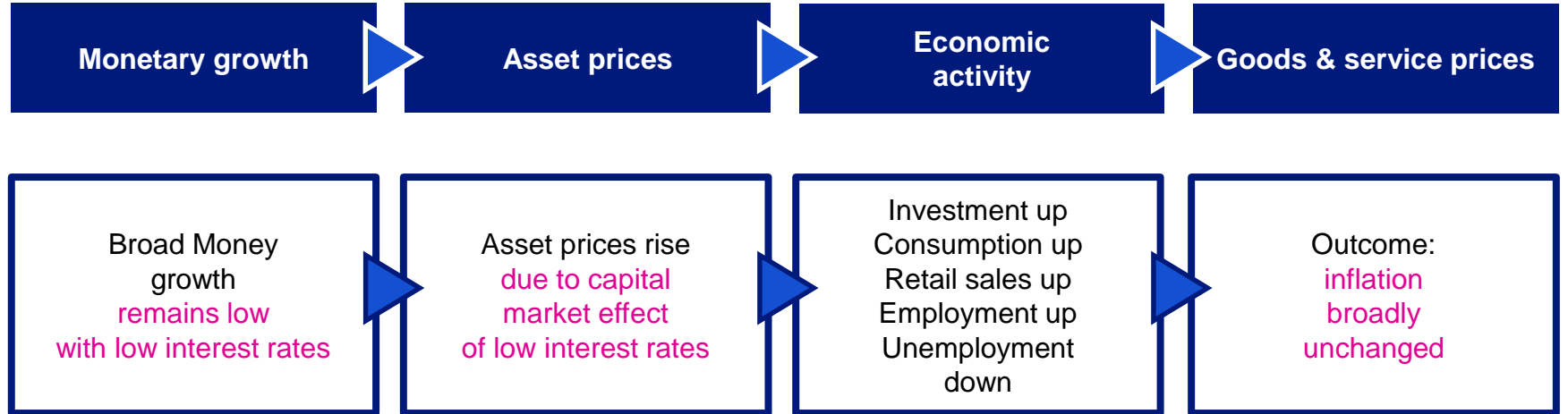
- 1 Business cycle basics**
- 2 Will the manufacturing slowdown turn into recession?**
- 3 Asian Trade Prospects**
- 4 Can fiscal stimulus help?**
- 5 Prospects for the UK under Boris Johnson**
- 6 Long-term geopolitical and geo-economic themes**
- 7 Conclusions for asset allocation**

# The Business Cycle Transmission Mechanism



Type 1: Rapid money growth, leading to higher inflation, 1960s-2000s

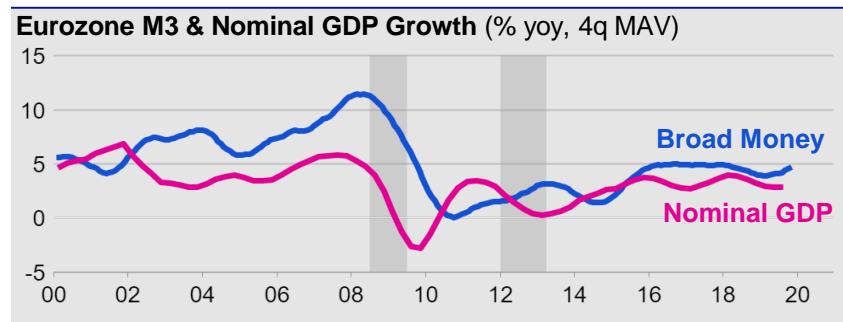
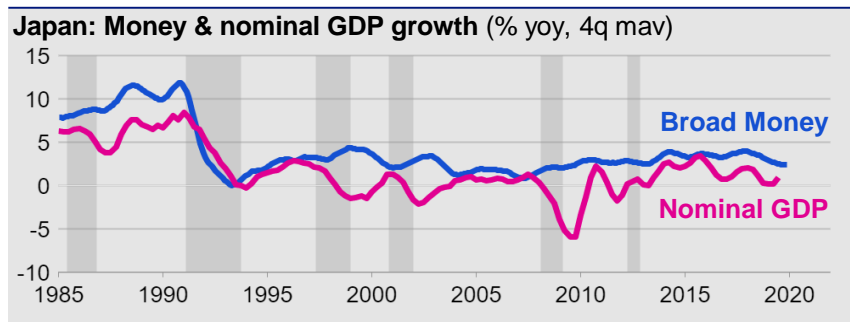
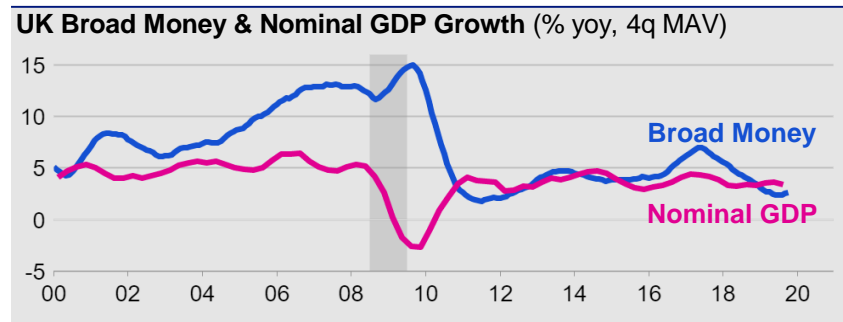
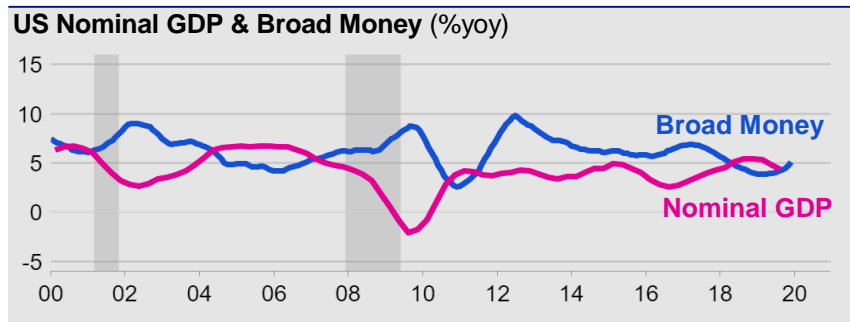
Type 2: Low money growth, with interest rates remaining low, 2010s



For illustrative purposes only.

# “Monetary policy is about the growth of broad money”

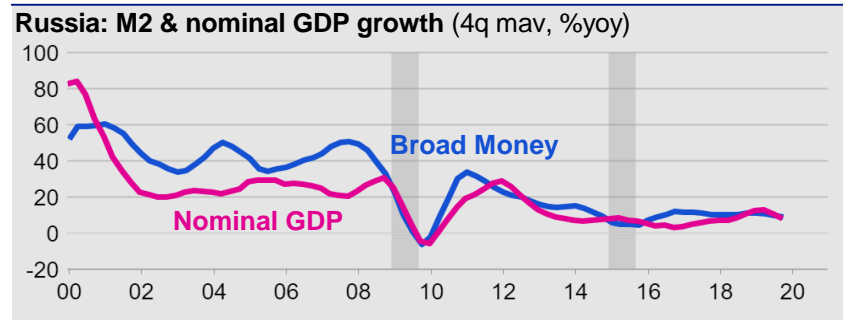
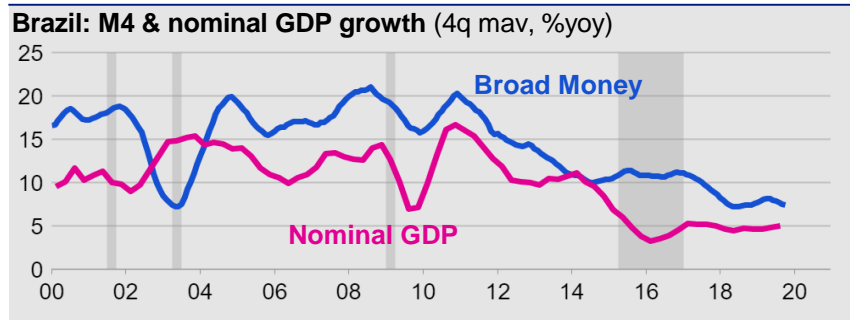
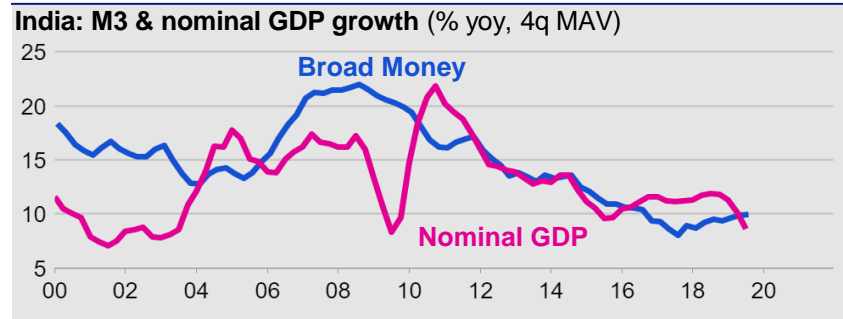
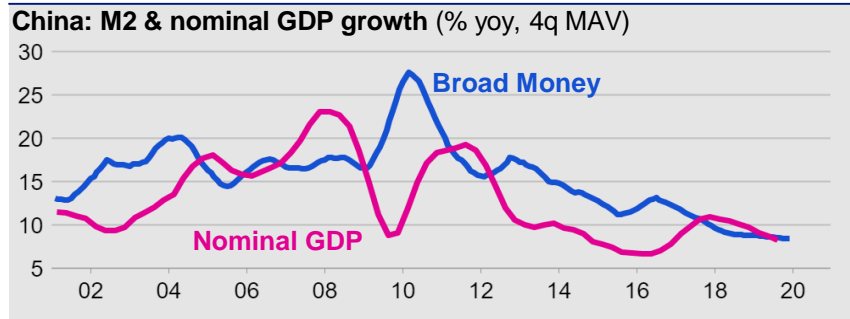
Broad money growth imposes ceiling on nominal GDP in US, UK, Japan & Eurozone



Source: Refinitiv as at 17 December 2019. Grey bars = recession. Broad money is M3 in US, M4 & M4x in UK, M2 in Japan, and M3 in Eurozone. For illustrative purpose only.

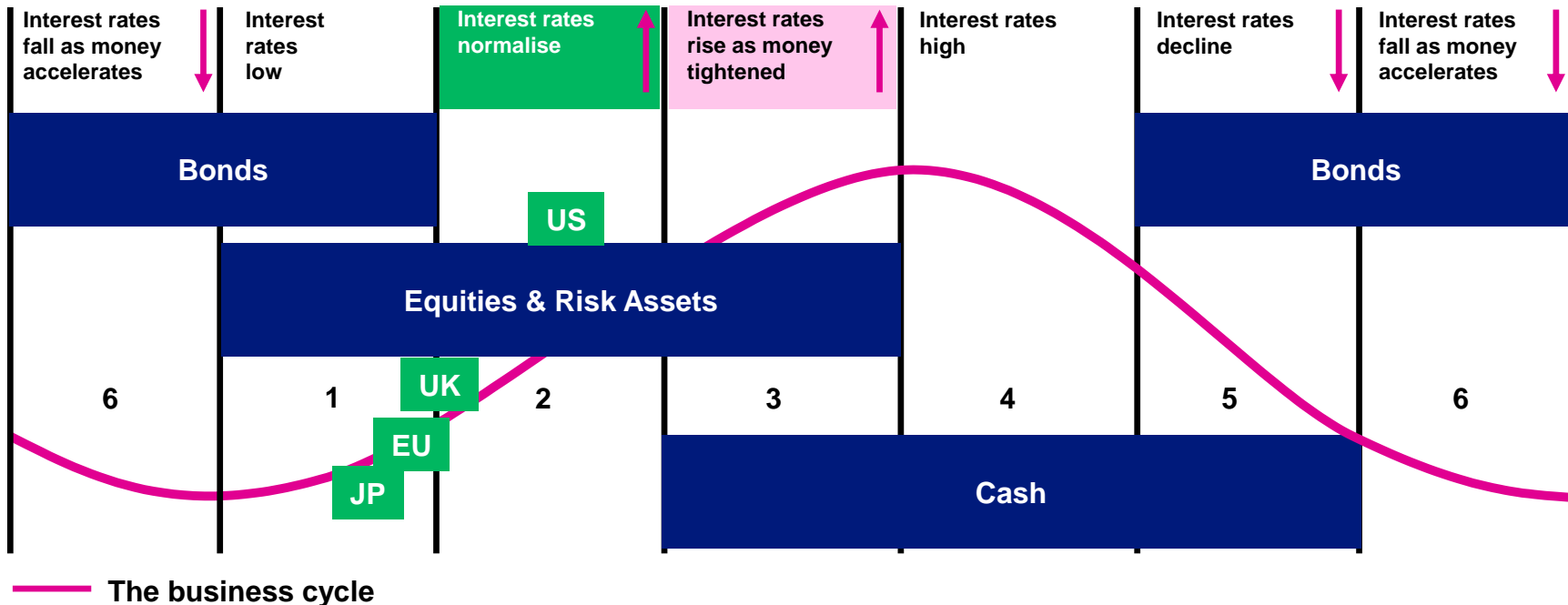
# “Monetary policy is about the growth of broad money”

## Broad money growth imposes ceiling on nominal GDP growth in China, India, Brazil & Russia



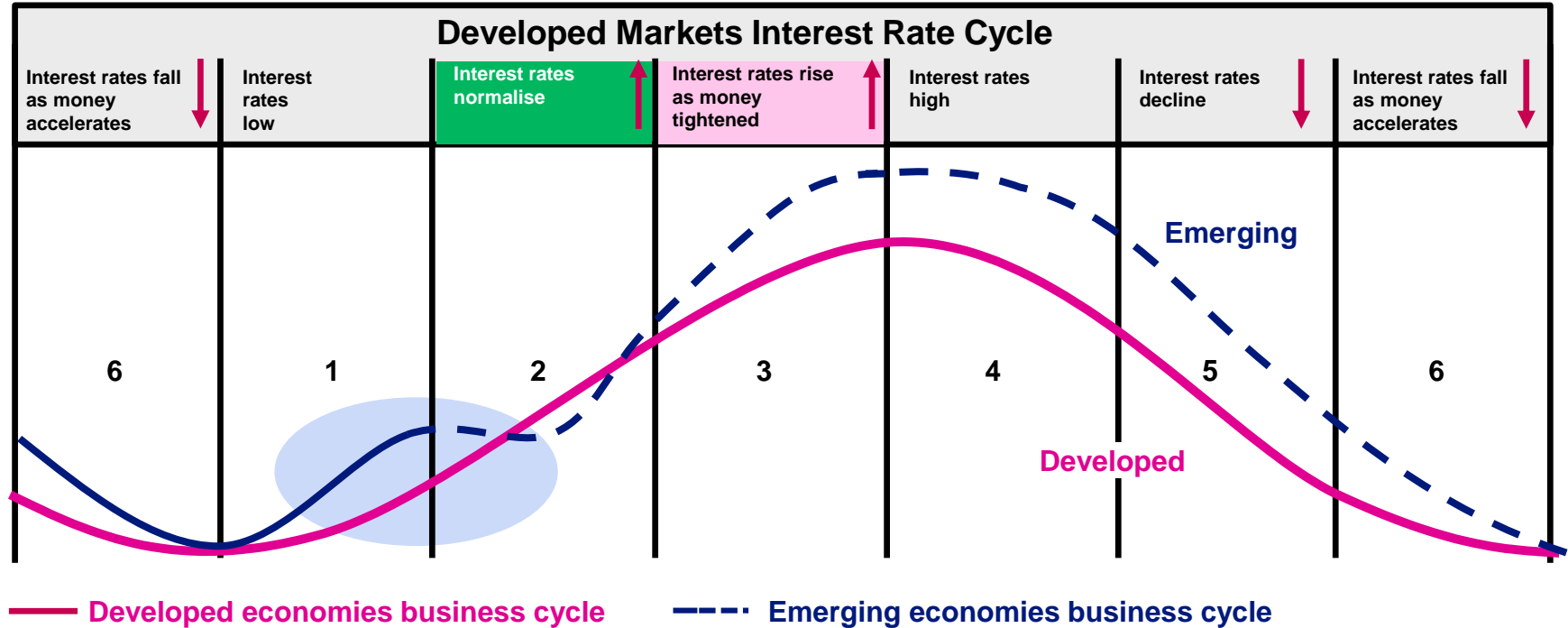
Source: Refinitiv as at 17 December 2019. Grey areas = recession. For illustrative purpose only.

# The US is still only mid-cycle; other developed economies are further behind. This implies risk assets have further to run



Source: Invesco. For illustrative purposes only.

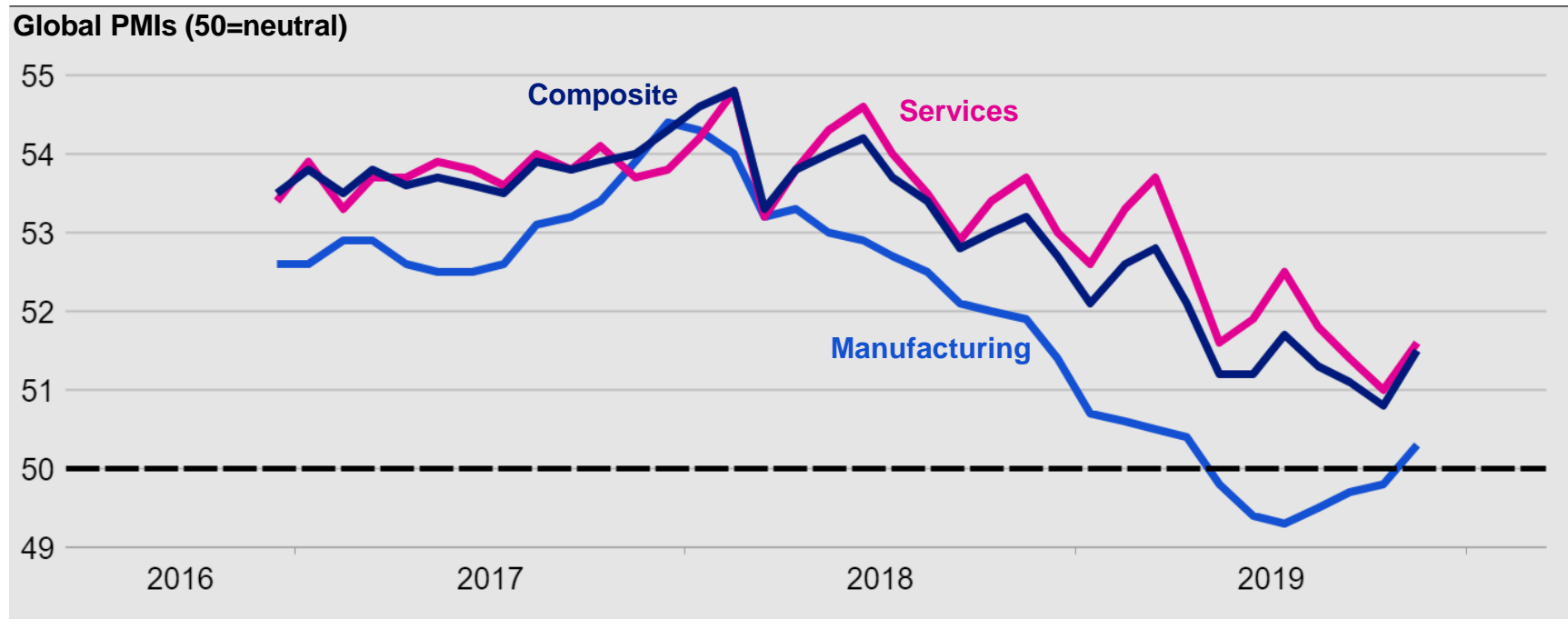
# Emerging markets business cycle superimposed on developed markets



Source: Invesco. For illustrative purposes only.

# Will the recent manufacturing slowdown result in recession?

## Weakness confined to the manufacturing sector; services buoyant



Source: Refinitiv as at 17 December 2019.



# Four key signals for a US recession:



## A. Tightening of monetary policy

- Slowdown of broad money growth or credit crunch?

## B. Excess private debt growth

- Household, financial, non-financial corporate sector over-indebted?

## C. High cyclical spending

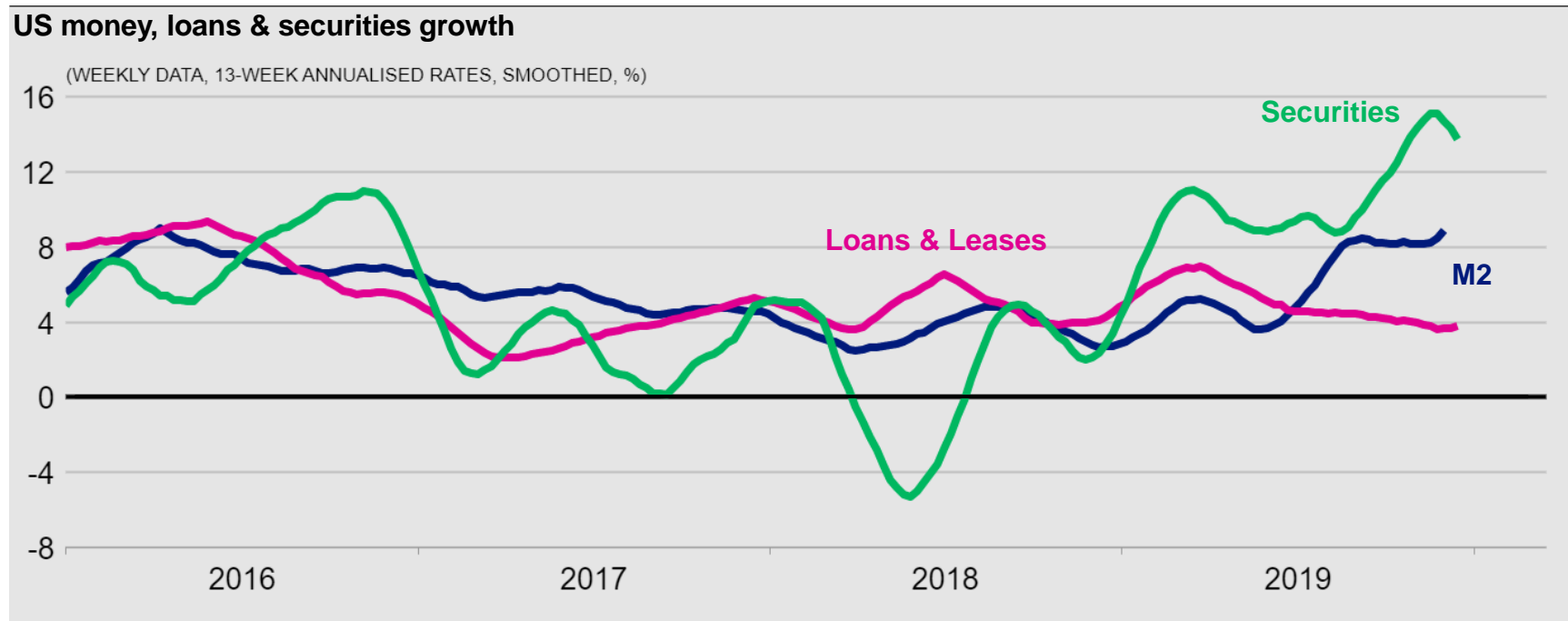
- Any sign of overheating?

## D. Rising inflation

- Any threat of inflation?

**But currently none of these problems exist in the US/UK/Eurozone/Japanese economy**

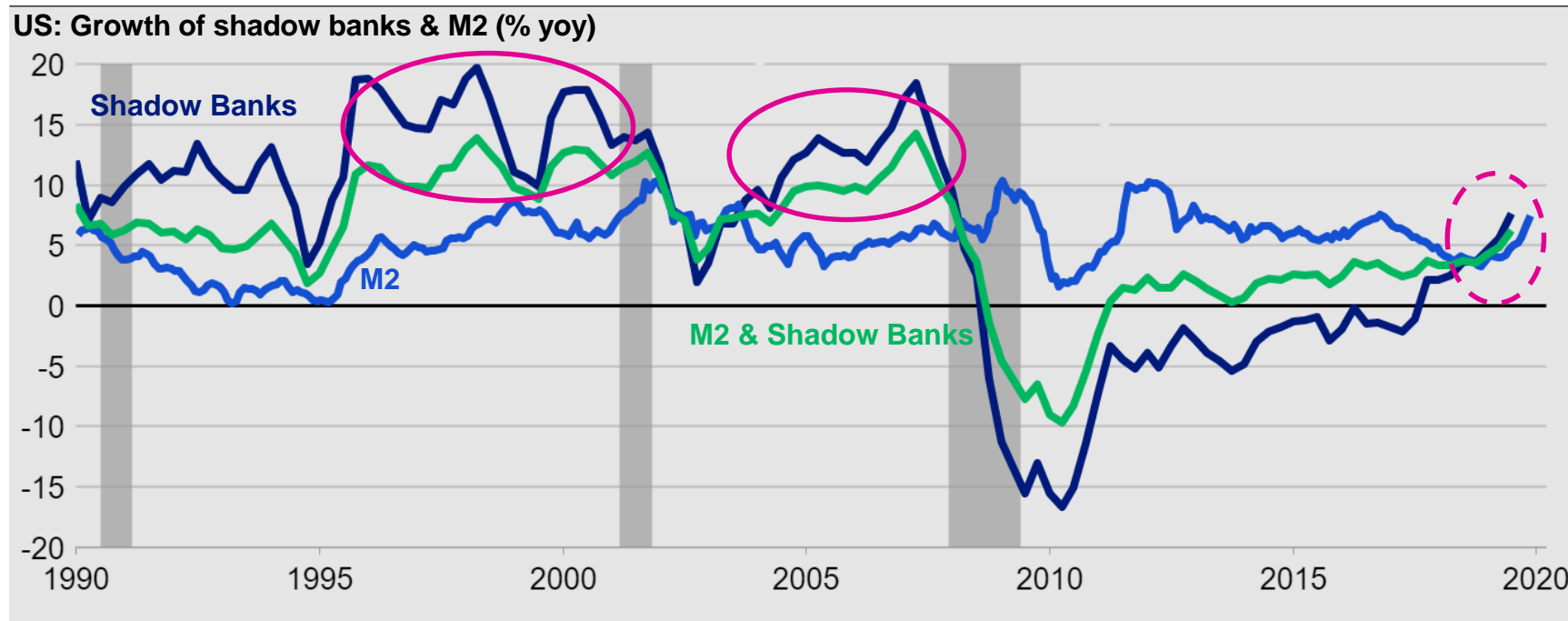
# A. Money & credit growth were low, but recently accelerating



Source: Refinitiv as at 17 December 2019.

# US Shadow Bank activity only just starting to recover

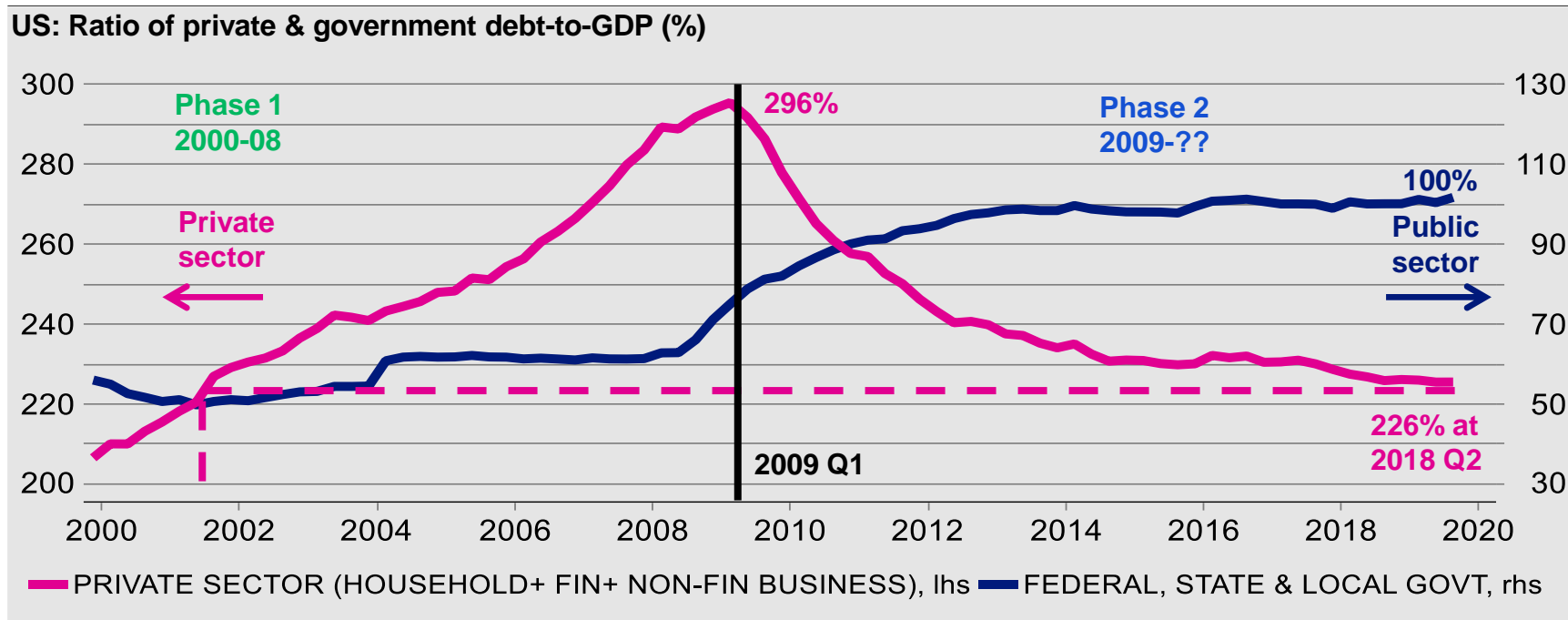
## Broad money & credit starting to grow more rapidly



Source: Refinitiv as at 17 December 2019.

## B. No excess private sector debt

US private sector balance sheets healthy; public sector debt high

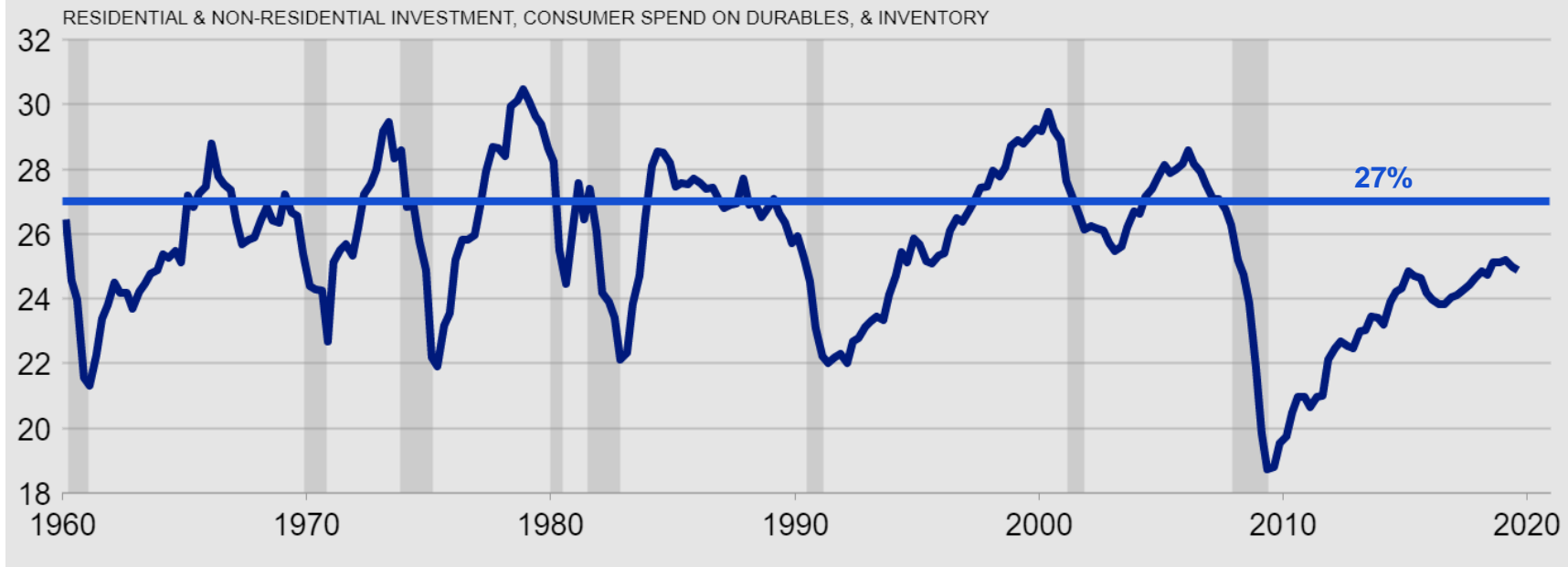


Source: Macrobond as at 17 December 2019.

## C. High levels of cyclical spending often associated with excesses, but not evident currently

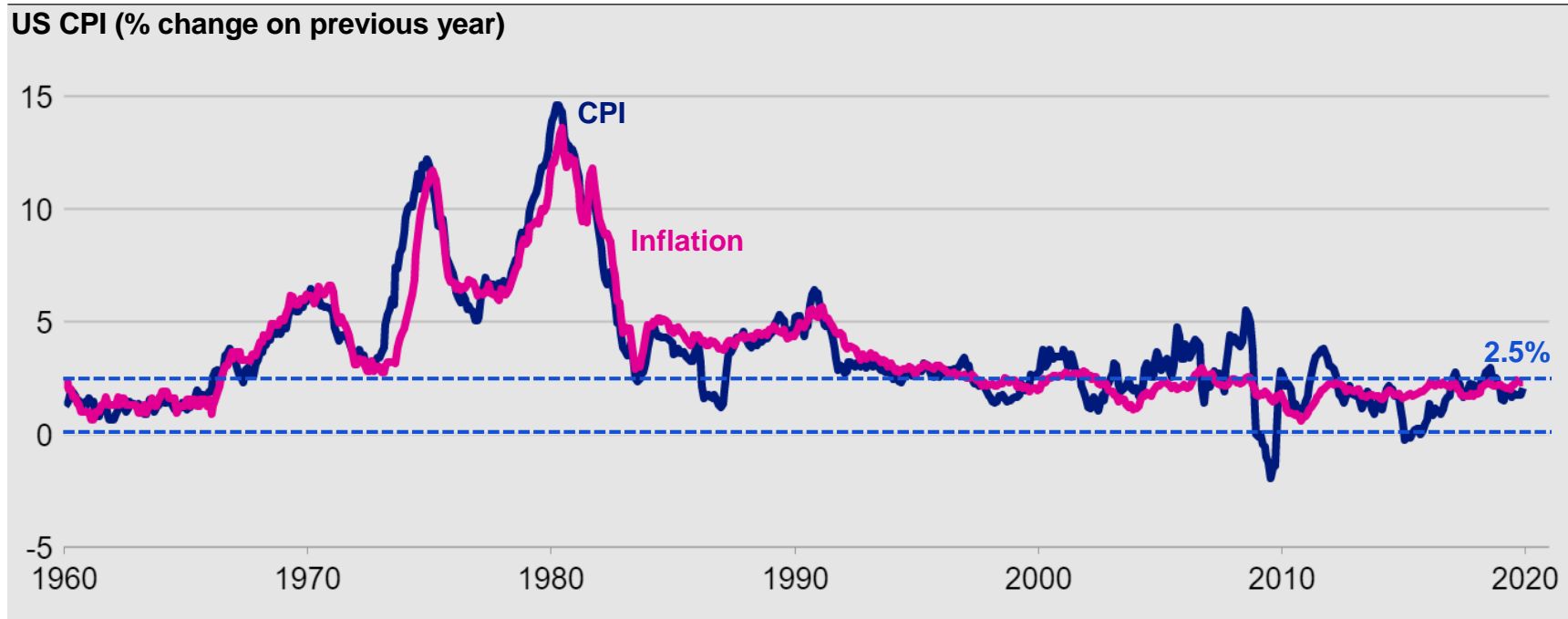


### US cyclical spending (% of potential GDP)



Source: Refinitiv as at 17 December 2019. Latest datapoint = 2019 Q2. Grey areas = recession. Cyclical spending includes personal consumption expenditures of durable goods, residential investment, non-residential fixed investment, and business inventories.

## D. When inflation rises rapidly, monetary tightening tends to follow; but currently inflation is below target



Source: Refinitiv as at 17 December 2019.

# Summary: Episodes of significant economic slowdown and S&P 500 real total return

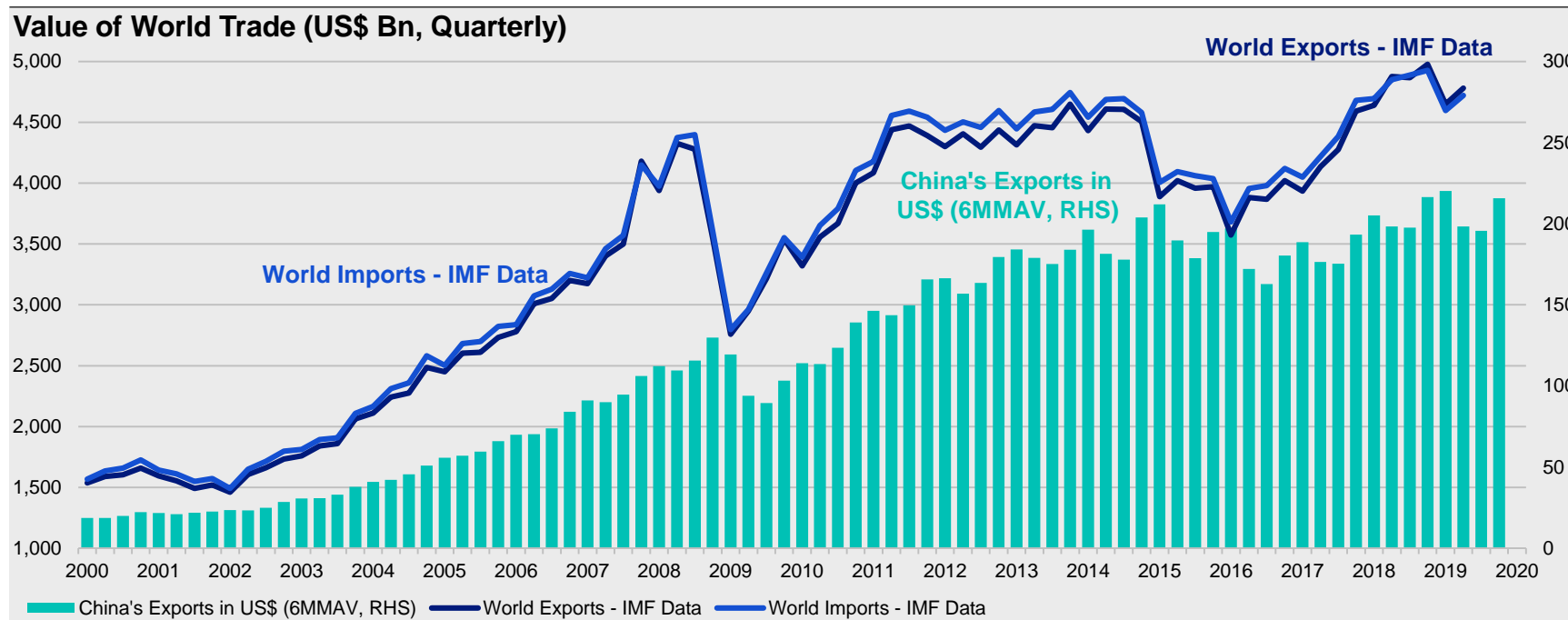


|            | Slowdown that turned into a recession | Private debt growth | Cyclical spending | Inflation | No. of imbalances | S&P 500 real total return in USD, next 12 months |
|------------|---------------------------------------|---------------------|-------------------|-----------|-------------------|--|
| May 62     | No                                    |                     |                   |           | 0                 | 21.8   |
| Nov 66     | No                                    |                     | ✓                 | ✓         | 2                 | 17.3   |
| Feb 70     | Yes                                   |                     | ✓                 | ✓         | 2                 | 7.0  |
| Jul 73     | Yes                                   |                     | ✓                 | ✓         | 2                 | -31.7  |
| Jul 79     | Yes                                   |                     | ✓                 | ✓         | 2                 | 9.3  |
| Jul 81     | Yes                                   |                     | ✓                 | ✓         | 2                 | -18.4  |
| Mar 84     | No                                    |                     | ✓                 | ✓         | 2                 | 14.5   |
| May 89     | Yes                                   | ✓                   | ✓                 | ✓         | 3                 | 11.7   |
| May 95     | No                                    |                     |                   |           | 0                 | 24.7   |
| Dec 98     | No                                    |                     | ✓                 |           | 1                 | 17.9   |
| Dec 00     | Yes                                   | ✓                   | ✓                 |           | 2                 | -13.2  |
| May 05     | No                                    | ✓                   | ✓                 |           | 2                 | 4.3  |
| Oct 08     | Yes                                   | ✓                   | ✓                 |           | 2                 | 9.9  |
| Nov 12     | No                                    |                     |                   |           | 0                 | 28.6   |
| Jan 16     | No                                    |                     |                   |           | 0                 | 17.0   |
| May-Oct 19 | ?                                     |                     |                   |           | 0                 | ?  |

Source: Bank Credit Analyst & Invesco, 20 December 2019. Past performance is not a guide to future returns.

# President Trump's Tariff War & Asian Trade Prospects

## Trade recovery has stalled



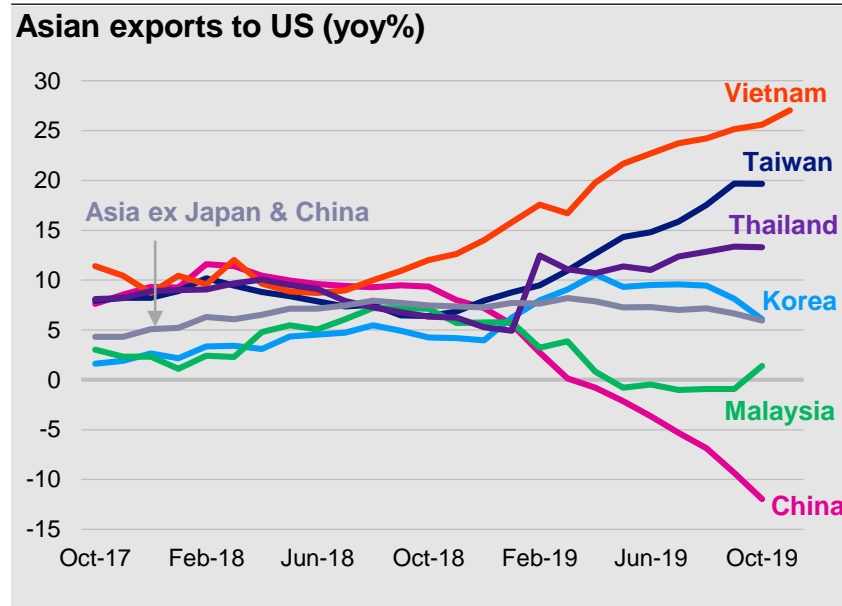
Source: Refinitiv Datastream, 20 December 2019. For illustrative purpose only.



# Tariff War Causing Trade & Investment Diversion

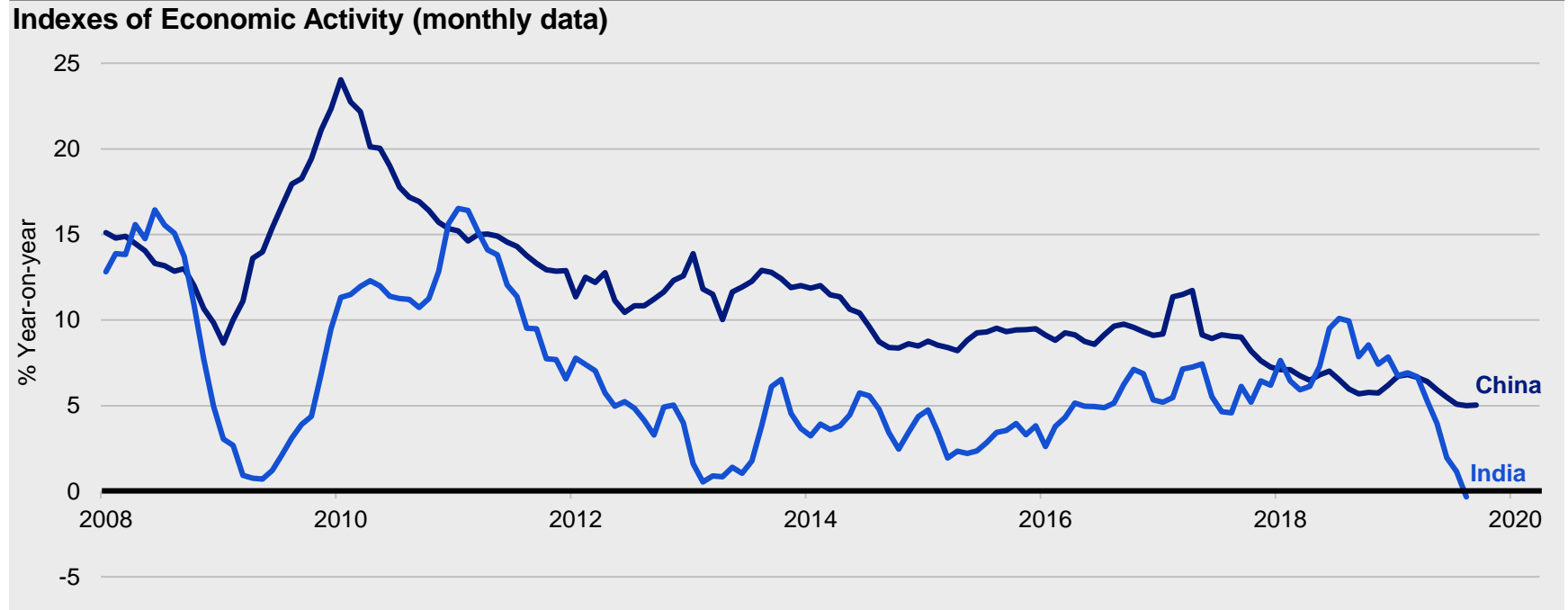
Exposure to US/China trade tensions varies significantly...

Effects showing up in both trade and investment diversion



Source: LHC: Source: HSBC as at 27 July 2019. Note that Mexico, Canada and Hong Kong figures have been adjusted to appear in the scatter chart – actual numbers are shown in parentheses). RHC Source: Refinitiv Datastream, 20 December 2019.

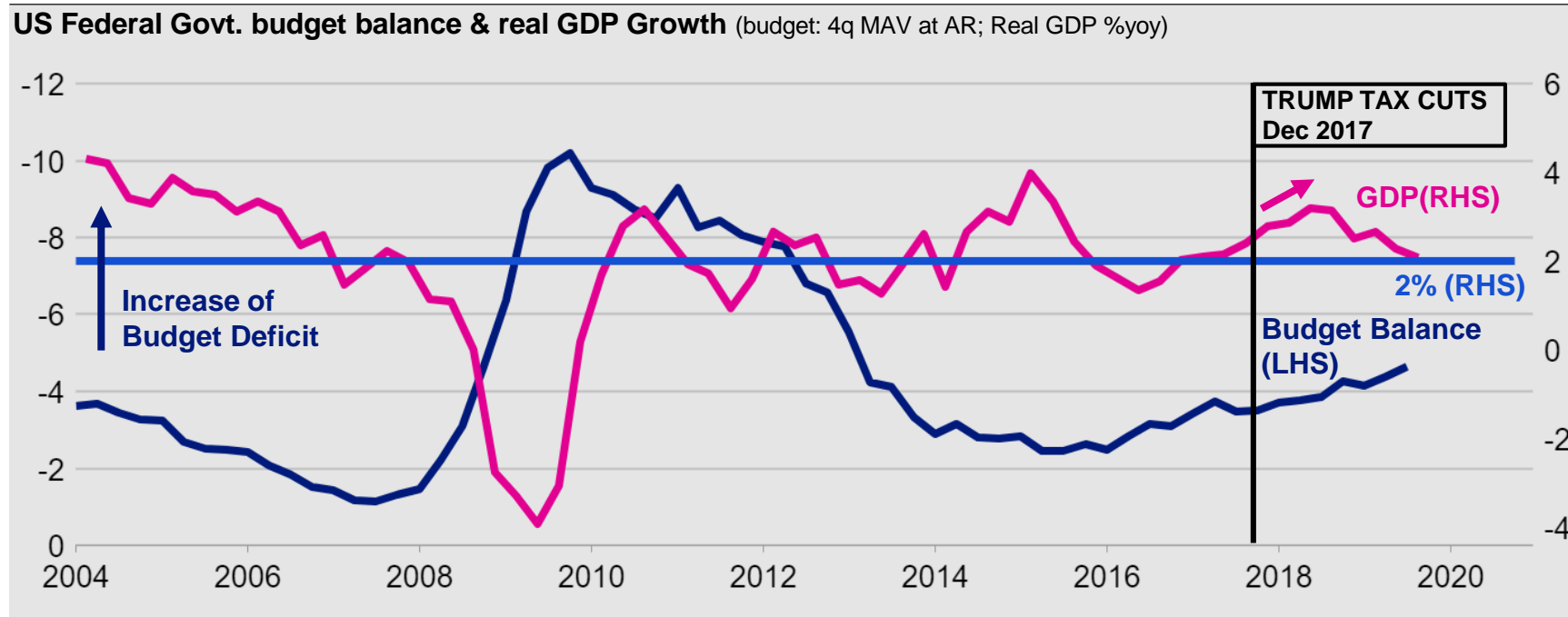
# China & India both Suffering Shadow Banking Crisis



Source: Refinitiv Datastream and Invesco calculations, 20 December 2019.

# Can fiscal stimulus help?

## Short-lived effect of the Trump tax cuts



Source: Refinitiv as at 17 December 2019.

# The interaction of fiscal and monetary policy:

Trump's Tax Cuts: fiscal policy expansionary, but monetary policy was tight. **However, monetary growth much faster since April 2019**



|               |                | MONETARY POLICY |  |
|---------------|----------------|-----------------|--|
|               |                | Easy            | Tight  |
| FISCAL POLICY | Expansionary   | Case A          | Case B<br>President Trump's TCJA<br>Federal Deficit: 3% → 5%<br>Money growth: 4% → 8%<br>with Fed funds <b>falling</b> |
|               | Contractionary | Case C          | Case D   |

Source: Invesco Research, 28 September 2018.

# Why is fiscal policy not inflationary?

Only three ways to finance government spending:



- 1. Taxation** Crowds out private sector spending
- 2. Borrowing** Crowds out private sector borrowing and investment
- 3. Printing Money** Boosts total spending including govt. spending

Source: Invesco Research, 17 December 2019.

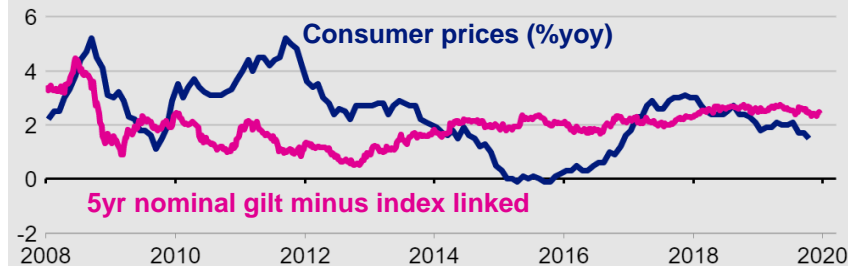
# UK prospects after the election: End of regime uncertainty, but inflation & yields to stay low



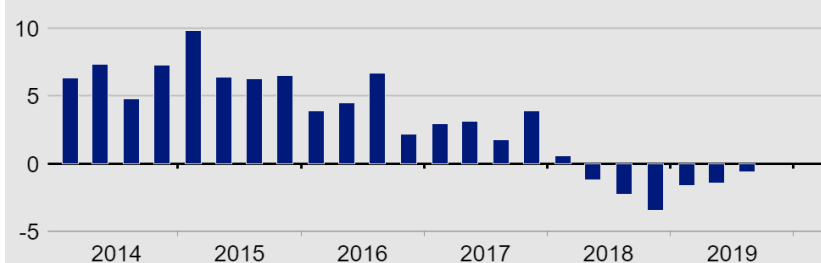
US\$/£ EXCHANGE RATE, 2008-20



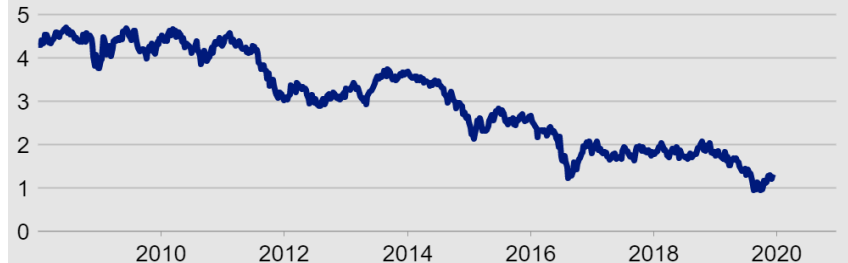
CPI & BREAK-EVEN EXPECTATIONS, 2008-20



UK BUSINESS INVESTMENT, 2008-20 (%yoy)



30-YEAR GILT YIELD, 2008-20



Source: Refinitive as at 17 December 2019.

# Geopolitical/geo-economic themes to influence potential growth, strategic asset allocation, capital markets assumptions



- 1. US-China Rivalry** Election year reprieve; uncertainty may resume in 2021
- 2. Tech Disruption** Fast evolving technological frontier poses policy challenges
- 3. UK & Brexit** Tory landslide; single market exit/customs union alignment?
- 4. Future of the EU** Incremental but incomplete banking, capital markets union
- 5. Future of EM** Trade/investment barriers in major economies a challenge

Source: Invesco Research, 17 December 2019.

# Conclusions for asset allocation



- **US BUSINESS CYCLE EXPANSION TO CONTINUE** – Recent acceleration in US broad money implies that US nominal spending will improve in 2020. The current record-long business cycle expansion will continue through 2020 and probably beyond. Recession risks are overstated. US continued growth will benefit the Eurozone, the UK & EM economies
- **G7 INFLATION TO REMAIN SUBDUED** – Overheating not inevitable; it depends on money and credit growth which still remained subdued and therefore not threatening inflation
- **ASSET ALLOCATION**
  1. Maintain substantial exposure to risk assets (equities, real estate)
  2. Hold corporate debt (low default rates, compressed spreads to continue)
  3. Hold EM \$-denominated debt
  4. Hold minimal cash
- **INVESTMENT OPPORTUNITIES** – Monitor EM economies for signs of turnaround – in either business cycles or commodity prices

Source: Invesco as at 17 December 2019.



# Risk warnings



The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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