ANZ INVESTMENTS 2020 MARKET OUTLOOK

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Looking back for a moment, 2019 was another stellar year for both equity and bond investors. In fact, it was the second best year for the S&P 500 since the financial crisis, rising 29%. And for tech investors, the NASDAQ 100 recorded its best year since 2013, rising nearly 40%, led by Microsoft and Apple, which both ended the year with market-caps greater than US$1 trillion.

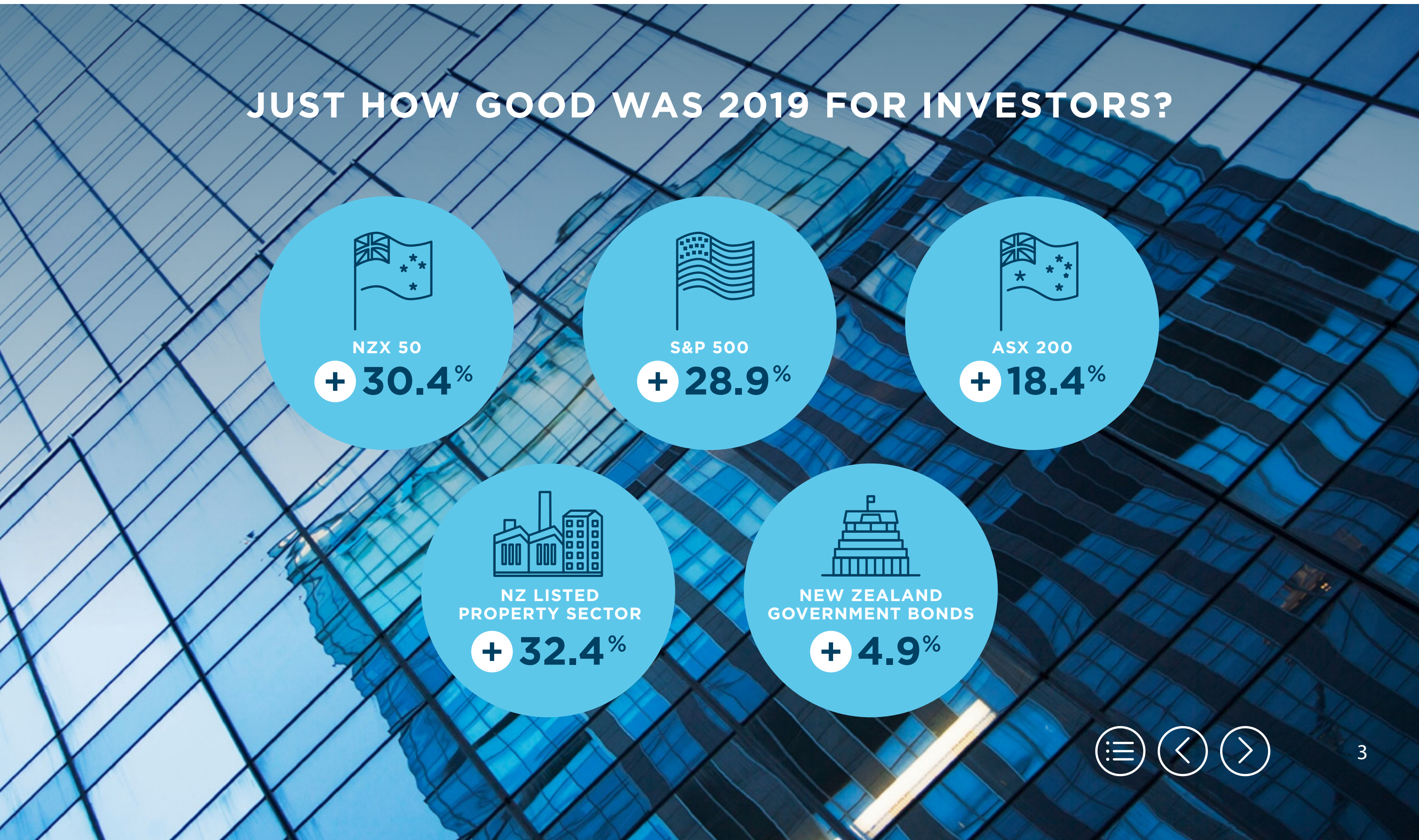
Major equity markets outside the US were also very strong and many posted double digit returns, but for the most part did not keep pace with the US. The MSCI All World ex USA was up 18.9% for the year.

Meanwhile, bond investors flourished too as central banks – in the face of slowing global growth and geopolitical uncertainty – cut interest rates. In the US, the Federal Reserve cut rates for the first time since the financial crisis and the European Central Bank restarted its bond-buying programme. By the end of the year, the US 10-year government bond yield had fallen nearly 80 basis points, while in Europe, yields on German, Swiss, French and Dutch bond yields did the once-thought-impossible, falling into negative territory.

Down under, the New Zealand stock market was one of the few to keep pace with the US, with the NZX 50 rising more than 30% thanks to strong gains in defensive dividend-paying stocks. And bond investors thrived too as the Reserve Bank of New Zealand cut the Official Cash Rate to a record low 1%, citing falling demand for domestic goods and services and offshore uncertainty. Across the Tasman, the ASX 200 lagged, but still posted solid gains of 18.4%.

Of note, listed property stocks soared, benefiting in the low-interest-rate environment, making cash-flow-steady assets an attractive investment.

But, as we look ahead, 2020 is shaping up as yet-another important year in the current bull market run. Whether it's the threat to slowing global growth, all-important elections, central bank policy or the rise of environmental issues – namely climate change – the next 12 months look to be busy both here and abroad. Here's what ANZ Investments is watching heading into 2020.

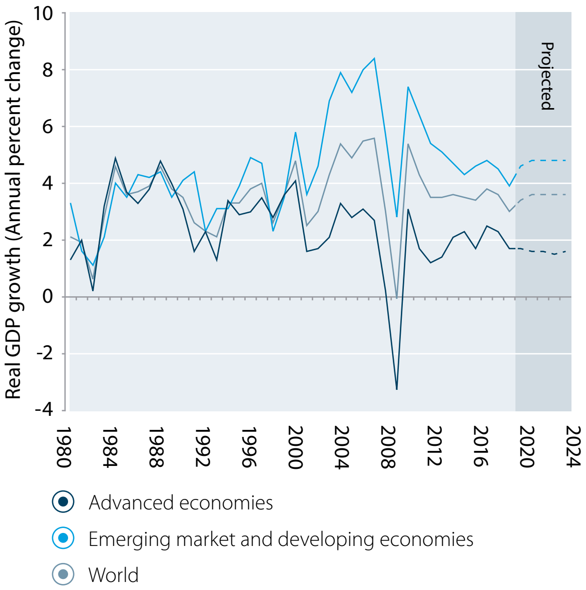


WE EXPECT A MODEST BOUNCE IN GLOBAL GROWTH

It's been more than ten years since the last global recession and as the world economy continues to expand, albeit at a moderate rate, the outlook for growth remains net-positive.

In saying this, the International Monetary Fund estimates the global economy grew at 3.0% in 2019, down from 3.6% in 2018 and the slowest pace since the financial crisis. And in Europe, both Germany and the UK just avoided a technical recession in 2019 after recording negative growth in the second quarter. Furthermore, Chinese annual GDP growth dipped to 6%, the slowest pace since 1992.

Global growth and projection



Source: IMF, 2019

The slowdown in growth over the past two years stemmed from the ongoing trade conflict between the US and China, which eased at the end of 2019 with the announcement of the 'Phase 1' deal. However, as we head into 2020, we believe the probability of a comprehensive trade deal between the two countries is low, which if correct, could temper growth expectations.

However, we are seeing the implementation of monetary policy tools to abate these concerns. Firstly, central banks are remaining accommodative, with some projected to cut rates further into 2020. And secondly, we are starting to see governments pick up some of the slack from central banks in the form of fiscal stimulus as further rate cuts are becoming less effective given the already low levels of interest rates.

The first big fiscal stimulus package came in November, when Japan announced a US$121 billion fiscal stimulus package aimed at repairing typhoon damage, investment in technology and a significant upgrade in infrastructure.

"Fiscal stimulus is looking increasingly likely as monetary policy is exhausted. A number of countries including NZ, the UK and Japan intend to increase fiscal spending, and there is also increasing pressure in the US, China, Germany and Australia to do more. Popular targets are improving infrastructure, tackling climate change and reducing inequality."

Maaike van Tol, Head of Asset Allocation, Investment Strategy & Portfolio Management at ANZ Investments

In the US, as President Donald Trump heads into an election year we could see him push for a second income tax cut. After his 2017 tax cut garnered criticism from some who argued it was the top income earners that benefited the most, a more direct cut to middle-class taxes may be a strategy to increase his popularity less than a year out from the election.

In Europe, governments are weighing up an increase in subsidies paid to electric car sales to help production capacity. And in Germany, policymakers are debating whether or not to bring forward the end of the solidarity surcharge (an additional income tax) which some argue would free up consumer spending.

Elsewhere, in New Zealand the government announced a NZ$12 billion infrastructure package with the majority of the funds earmarked for transport projects, schools, district health boards and regional investment.

INTEREST RATES TO REMAIN LOW

This time last year, some central banks – namely the US Federal Reserve – were in the midst of raising interest rates and the prospect was for further hikes. However, 12 months on and with geopolitical uncertainty on the rise and a lacklustre bounce in growth, we saw central banks reverse trend and cut rates.

However, we feel interest rates are now near or at neutral levels and we see the prospect of future rate cuts in 2020 slowing, if not ending.

Nevertheless, we expect central banks to remain accommodative, supporting global economies where necessary. This should see short-term interest rates remain at current levels or lower in the major regions we track, although if the global economy does improve, long-term rates should gradually drift higher.

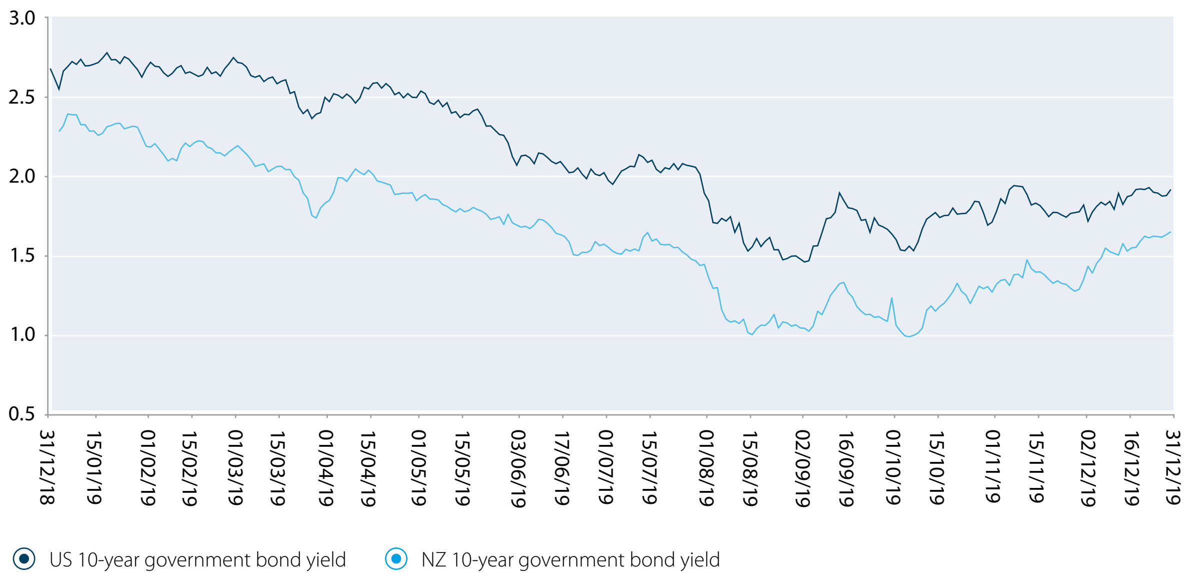
Regionally, we see Australia most likely to cut rates, while in the US, the Federal Reserve is likely to remain accommodative, but the likelihood of a cut has decreased given the mild improvement in trade relations between the US and China.

In New Zealand, we have seen a substantial bounce in business confidence and with the recent fiscal stimulus package we see the likelihood of lower rates to be limited, especially compared to other parts of the world. In saying this, we see little sign of the Reserve Bank of New Zealand lifting rates over the short to medium term.

"Globally, fundamentals, growth and inflation, look mixed. Domestically we are reasonably confident that the pickup in business and consumer confidence, along with a more active government fiscal approach in an election year, will aid growth. However, conditions in Australia look more challenging, exacerbated by the terrible natural disasters. In the US, the consumer and housing sectors look reasonable, which are helping offset weaker manufacturing as a result of trade conflicts."

Iain Cox, Head of Fixed Interest and Cash at ANZ Investments

US and NZ 10-year government bond chart 2019



Source: Bloomberg

GEOPOLITICAL RISKS TO KEEP MARKET VOLATILITY ELEVATED

While our base case is for a mild rebound in global growth, one of the material threats to this is the rising geopolitical unrest across the globe. This uncertainty was a bellwether for market volatility in 2019 and, as we head into 2020, we see little sign of this theme abating.

In Asia, the pro-democracy protests in Hong Kong, which began in June 2019, plunged the local economy into recession as tourists stay away amid the unrest. Moreover, the conflict threw a wrinkle in the US-China trade situation after the US Congress passed a human rights bill aimed at protecting the protestors, something Chinese authorities did not appreciate.

Should the US get dragged further into the conflict, we see this weighing on trade relations between the two countries.

Meanwhile, across Europe, we continue to note social unrest as protestors march in the streets against rising inequality and climate issues. Beginning in France, the "yellow vest" movement fought against rising taxes, which became a symbol of the economic hurdles middle-to-lower-class citizens face. In Germany and the UK, the Extinction Rebellion – an environment movement demanding governments do more to address climate concerns – continues to highlight the civil tension between citizens and governments. While direct economic impact from the unrest may be minimal, the heightening conflict is something to watch.

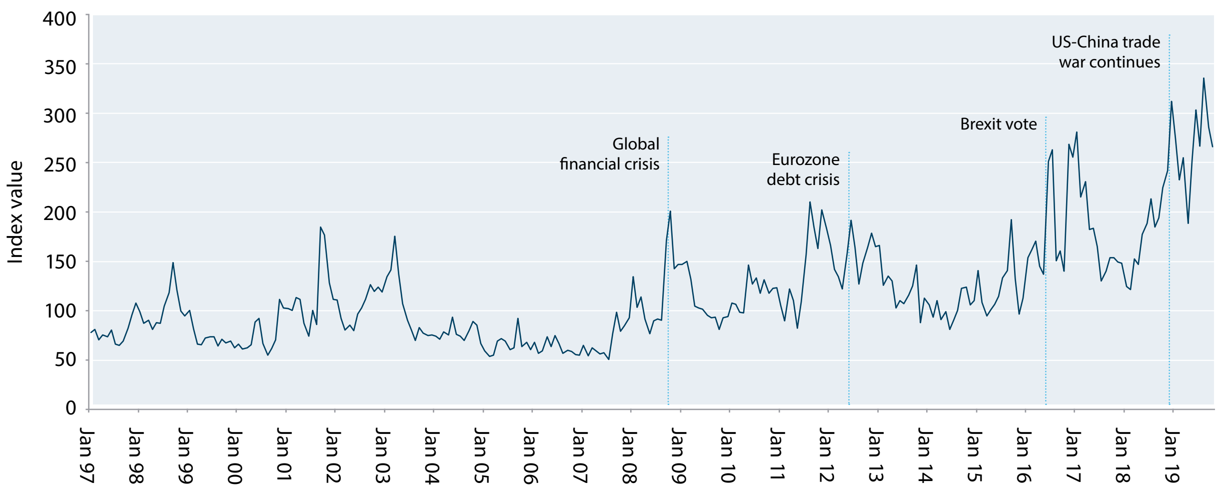
Furthermore, another substantial geopolitical risk out of Europe, at least from an economic perspective, is Brexit. On 12 December 2019, The Conservative Party comfortably won a general election, winning 365 seats in parliament, enough for UK Prime Minister Boris Johnson to likely push through his Brexit deal by the 31 January 2020 deadline.

However, this is just the beginning of the UK's breakup with the EU, with a raft of economic and political uncertainty ahead. While a trade deal with the EU could be relatively straight forward, given its alignment to the EU, negotiations could be lengthy if the UK wishes to have freedom to diverge from EU rules to broker deals with other individual countries, which could make negotiations complicated.

Given all this, we expect ongoing volatility in UK assets as the country navigates its way to a smooth exit from the EU.

Within the US, the impeachment process of President Trump is in full swing as the Democrats seek to remove the President from office. While we think it unlikely President Trump will be removed from office, given the Republicans hold a comfortable majority in the Senate, the process could impede his work in brokering trade agreements and handing the conflict in the Middle East.

Economic Policy Uncertainty Index



Source and methodology: http://www.policyuncertainty.com

THE US ELECTION – A SIGNIFICANT GEOPOLITICAL RISK OF 2020

Against the backdrop of growing partisanship in the US, the 2020 US Presidential election is shaping up as a significant risk to global markets.

President Donald Trump's victory in 2016 caught most pundits by surprise, but his pro-business policies and corporate tax cut aided – to some degree at least – the stock market rally. Since he won the election on 8 November 2016, the S&P 500 has risen more than 50% to the end of 2019.

However, President Trump is a polarising figure. His hard-line views on immigration and trade relations, to name a few, have torn the Democrats and Republicans further apart. In doing so, the base of the Democratic Party is being tested with a rise in popularity of far-left figures – two of whom are running to face President Trump in the 2020 general election: Vermont Senator Bernie Sanders and Massachusetts Senator Elizabeth Warren.

With these two candidates climbing up the polls, some commentators have been vocal about what a far-left Democrat president would mean for the US economy and global equity markets, especially given both have promised significant tax increases on the wealthy and stringent regulation on the private sector, with the healthcare sector seemingly a big risk as both candidates advocate for medical coverage for all with a single-payer system.

"As a general rule, [President] Trump is seen as more pro-business than his Democratic rivals, but [we note] some challengers (Sanders and Warren) are less market friendly than others. President Trump's first term successes include market-friendly initiatives such as the 2017 tax reform bill as well as a wide-reaching regulatory rollback… If markets perceive the Democratic nominee to be in favour of dramatically higher taxes and a significantly greater regulatory burden, market confidence could be undermined, if that Democrat is elected."

MFS, global equity manager and an ANZ Investments international equity manager

THE US ELECTION – A SIGNIFICANT GEOPOLITICAL RISK OF 2020 (CONTINUED)

While a number of candidates are still on the Democratic ballot, four candidates are dominating the polls – the two far-left candidates in Sanders and Warren and two more moderate Democrats in former vice president Joe Biden and South Bend, Indiana, Mayor, Pete Buttigieg. Heading into the primaries, here's a look at some policy initiatives each facet of the Democratic Party is promising.

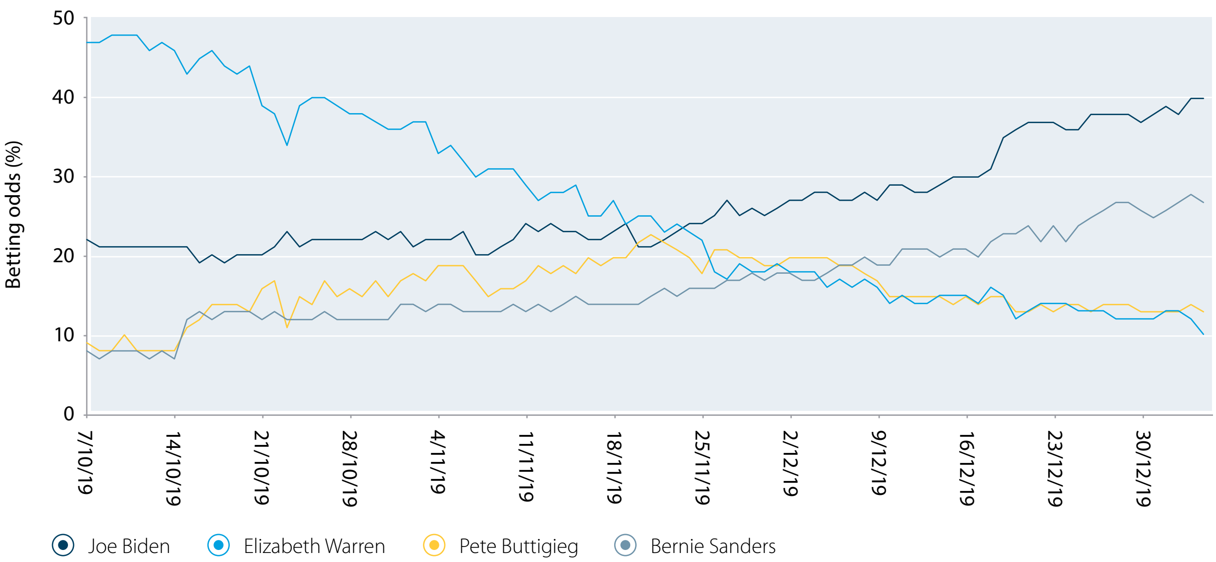
Far-left Liberal Democrats in Sanders and Warren:

- Medicare-for-all, with Sanders even proposing to abolish private insurers.
- The break-up of big tech firms such as Google and Facebook.
- The repeal of the corporate tax cut introduced by President Trump in 2017.
- Tax hikes on the wealthy: Elizabeth Warren has proposed a Wealth Tax, a 2% tax on household net worth above $50 million.

And closer to the Democratic centre, Biden and Buttigieg have promised the following:

- Both oppose Medicare-for-All, but would expand healthcare coverage.
- Biden plans to raise corporate taxes, but not to the levels before the 2017 corporate tax cut.
- Both plan to raise the minimum wage to US$15 per hour and raise the top individual tax rate.

Who will win the 2020 Democratic Presidential nomination?



Source: PredictIt

CLIMATE CHANGE CONVERSATION TO GROW LOUDER

Perhaps one of the biggest movements of 2019 was the mounting pressure on countries to address their climate change commitments, made under the Paris Agreement, amid growing evidence of the damning effect climate change is having on the planet, and economies.

The social impact and recognition of these issues across the globe will continue to grow in 2020 putting pressure on governments to pursue greater efforts, requiring an adequate budget to fund climate adaptation and mitigation strategies.

We have seen some countries pushing back on trade agreements with countries whose climate change targets fall short of international (Paris Accord) goals. Most notably, Australia received an ultimatum from France that any free trade deal it wishes to strike with the European Union would require "highly ambitious" action on climate change targets.

From an investment perspective, we are seeing destruction from climate change in the form of wildfires, floods and rising sea levels, losses of physical assets weighing on capital expenditure to mitigate some of these risks. In fact, a 2019 report from The Economist Intelligence Unit, a forecasting and advisory group within The Economist, estimated that the effects of climate change will have a material impact on global growth in the coming decades.

In this context ANZ Investments' staff have contributed to the Interim Report of the Aotearoa Circle's Sustainable Finance Forum and responded to Government and NZ regulators on policy development discussion papers.

An ongoing challenge for investors as we head into 2020 will be sourcing accurate data on portfolio exposure to higher emitting companies and encouraging more companies to disclose their emissions profile.

For ANZ Investments, the emissions intensity in our international equity fund has been consistently at around half that of the benchmark investment. This signals how seriously our selected external managers take these issues and the need to protect our client's portfolios from climate-related risks.

In 2020 we will continue to show our commitment to the Principles of Responsible Investment, www.unpri.org, of which we are a signatory and continue to engage with, and exclude companies identified as abusing environmental, human rights and related issues.

"In 2020 ANZ Investments will be focussing closely on climate-change issues as litigation, regulation and shareholder resolutions increase within our investment universe potentially affecting valuations. Domestically, the Climate Change Commission begins its work, we also expect to hear more on modern slavery issues as Australian legislation begins to come onto the radar of both Australian companies and foreign companies operating in Australia."

Peter Jones, Senior Manager Responsible Investment at ANZ Investments

STILL A LOT TO BE OPTIMISTIC ABOUT

There is no doubt that 2020 will offer up periods of uncertainty and market volatility, both around themes discussed and the always unexpected.

However, there is still a lot to be optimistic about both home and abroad. In a year where the word 'recession' was atop of many conversations, the global economy staved off these concerns. And although global growth is trending lower, we feel it is bottoming thanks to central bank accommodative policy and a pick-up in government spending.

We are particularly encouraged by the strength in global labour markets with unemployment rates near record lows and wage inflation trending upwards. Furthermore, in a globally consumer-driven economy, we are seeing no slowdown in consumer spending.

Still, we recognise economies work in cycles and asset prices are susceptible to volatility through periods of uncertainty. With that being said, economic cycles can provide opportunities through mispriced assets, and with ANZ's active management approach and long-term focus, we are confident this philosophy will deliver reliable returns for our investors over the long term.

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