**The three biggest threats facing investors in 2020**

**By Guy Monson, chief investment officer at Sarasin & Partners**

2019 was a year of astonishing contrasts. For financial markets, it was a ‘vintage’ year, with almost all investable assets generating returns above inflation. Meanwhile, in the real world, economic conditions worsened. The IMF forecasted global growth of just 3% – the lowest in a decade.

So what of the future? The fragile ‘Goldilocks’ scenario, which was so rewarding for markets in 2019, will not easily be repeated in 2020. Below, we outline the macroeconomic assumptions which guide our assessment of the biggest investment risks and opportunities ahead.

**Supportive backdrop**

Our first broad assumption is US President Donald Trump will need to maintain economic momentum well into the 2020 election – even more so since his actions in Iraq. This will require de-escalating international trade disputes. Already it appears a ‘Phase One’ trade agreement with China is largely complete, and the White House has succeeded in getting the US-Mexico-Canada Agreement (USMCA) signed by all parties.

We also believe global monetary conditions will likely remain generous in 2020. The Federal Reserve’s Jerome Powell stated it would take a material reassessment in the outlook to warrant a shift in the Fed’s accommodative policy, and Christine Lagarde, the new ECB chair, announced no change to the current bond purchasing programme. The People’s Bank of China will continue to support liquidity in the local banking system, and we expect other emerging world banks to continue to loosen.

As governments look to mitigate populist pressures and buttress domestic growth, we also foresee continued fiscal expansion. The Trump administration is already running a massive 4.6% of GDP deficit, Japan ran a 2.9% deficit in 2019, and the UK’s new government has committed up to £80bn for regional infrastructure spending. European fiscal spending continues to creep higher, with further funding likely under the banner of ‘green budgets’.

**Shifting dynamics**

In principle, these trade, monetary and fiscal policies should act together to support a fragile world economy in 2020. If we are right, this should trigger a modest firming of manufacturing data, a recovery in global trade volumes and, in time, a gradual rise in bond yields.

To some extent this already began last quarter. The inversion of the US yield curve seen over the summer has reversed, the mountain of negative-yielding government bonds has fallen from a staggering $17trn to about $11trn today[[1]](#footnote-2), while the US 10-year yield has risen by 35bps from summer lows.

Even modest rises in bond yields will likely alter equity market leadership, and if the moves are significant, this could trigger a rise in financial market volatility. There is already some evidence of the former – high valuation Silicon Valley IPOs have suffered recently, global value indices have rallied since the summer, while bank stocks have climbed strongly as the yield curve has steepened.

There has also been a catch up in non-US equity indices versus their US equivalents, notably in Japan, Germany and France over the last quarter of 2019. These trends are likely to continue and suggest a less US-growth-dominated backdrop for global equity investors.

**Guarding against risks**

Military and security threats are a rising risk to financial markets. The US drone strike that killed the Iranian Quds Force commander Qasem Soleimani marks a pivot towards direct confrontation with Iran. A more belligerent North Korea has also left defence officials across the Pacific prepared for the worst. Finally, US-Soviet relations continue to deteriorate, with a series of military and nuclear arms control agreements void or soon to expire. In this context, we continue to hold gold, higher than normal cash positions and rolling programmes of portfolio insurance.

Another concern relates to the continued build-up of global debt and the steady deterioration in the quality of corporate bond issuance. Both the World Bank and the IMF issued warnings last year highlighting the rise in private sector debt, particularly in the emerging world. We have acted by reducing almost all our exposure to high yield, emerging world debt and leveraged loans or related products. Overall debt quality averages A to A+ across our balanced funds.

Finally, we see additional ESG challenges coming into focus this year in the area of Extended Producer Responsibility – where producers are held liable for the treatment or disposal of post-consumer products. Fast fashion could become the next plastic ocean, as the industry is forced to confront the disposal of about 70% of all clothing produced today[[2]](#footnote-3). We will be looking across supply chains, scrutinising commitments to recycle and re-use, and watching for new liabilities, particularly in the retail, food, fashion and clothing industries.

1. Bloomberg Barclays Global Negative Yielding Debt Aggregate – Jan 2020 [↑](#footnote-ref-2)
2. Circular Fibros Initiative analysis [↑](#footnote-ref-3)