2020 Global Market Outlook

The market outlook for 2020 appears considerably brighter than it did at the mid-point of 2019. However, downside risks—both political and economic—remain.

T. Rowe Price®

COMFORTABLE WITH THE UNCOMFORTABLE

The "reflation trade" appears real, but risks are still elevated.

Four Key Themes in 2020

Investors will need to be "comfortable with the uncomfortable" to seek out potential opportunities in 2020. Economic uncertainty, political turmoil, and technology disruption are all risks that could challenge global markets. Attractive opportunities exist, but skillful security selection backed by in-depth fundamental research is likely to be critical to success.

Challenges to Global Growth

Key central banks appear to have put the global economy back on a growth path, but the strength of the upturn is still unclear.

Central Banks and the Search for Yield

Low or even negative yields create duration risk, but opportunities can still be found in corporate bonds and other credit sectors.

Disruption 4.0

Innovation, technological change, and automation are transforming business models across the entire global economy.

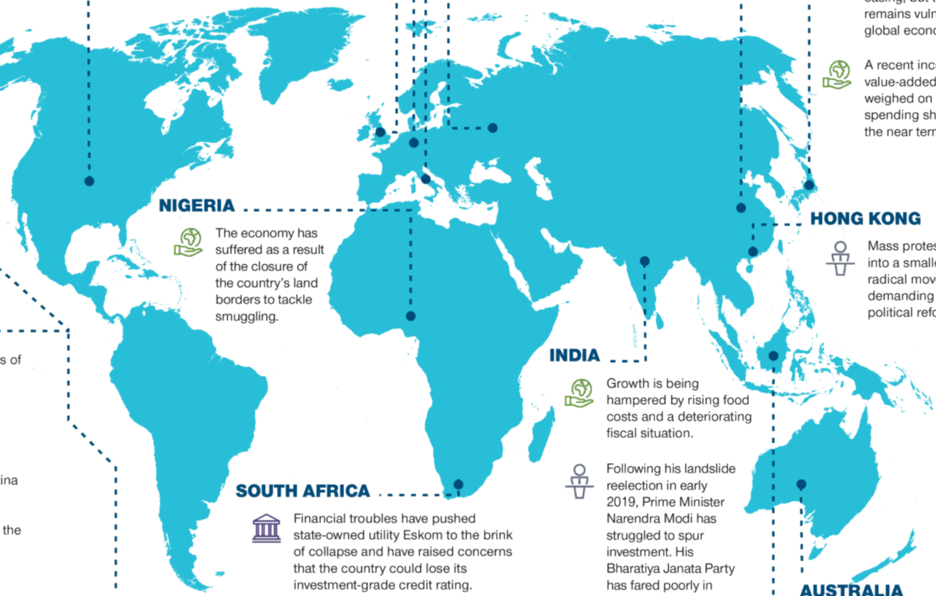
Politics, Populism, and Policy

A variety of geopolitical risks, including elections, trade, and political unrest, are likely to impact global markets.

Challenges to Global Growth

Central Banks and the Search for Yield

Politics, Populism, and Policy



UNITED STATES

Inequality is fueling populism on the right and a progressive tilt on the left—the latter may pose the more immediate risk to investors.

Consumers continue to drive growth, but sluggish capital spending could keep the brakes on earnings momentum.

GERMANY

The slowdown in global trade has badly hurt manufacturers, but a bigger problem for equity investors may be negative lending margins for banks.

Growth remains constrained, but fiscal stimulus could help. Berlin is considering cutting Germany's corporate tax rate from 32% to 25%.

UNITED KINGDOM

Completing Brexit passage might harm growth longer term, but reduced uncertainty could help UK equities and the pound.

ITALY

Support is eroding for Italy's anti-establishment Five Star Party, threatening the country's most recent coalition government.

Negative yields elsewhere in Europe have pushed Italian yields to record lows despite a worsening fiscal situation.

RUSSIA

Spending on President Vladimir Putin's 13 "national projects" could boost growth, but sanctions are likely to continue and may even become tougher.

CHINA

Growth is likely to continue decelerating in 2020, only partially due to the trade war. High debt levels and aging demographics also weigh.

Curbing excess debt in the financial system is likely to take priority over stimulating credit and spending.

JAPAN

The Bank of Japan is likely to continue quantitative easing, but the economy remains vulnerable to the global economic cycle.

A recent increase in the value-added tax has weighed on consumers, but spending should stabilize in the near term.

HONG KONG

Mass protests have evolved into a smaller and more radical movement demanding democratic political reforms.

NIGERIA

The economy has suffered as a result of the closure of the country's land borders to tackle smuggling.

LATIN AMERICA

Populists from opposite sides of the political spectrum have taken power in Mexico, Argentina, and Brazil, while protests in Chile have forced increased pension benefits.

The currency crisis in Argentina (and in Turkey) has failed to spread to other emerging markets, demonstrating how the asset class has matured.

SOUTH AFRICA

Financial troubles have pushed state-owned utility Eskom to the brink of collapse and have raised concerns that the country could lose its investment-grade credit rating.

INDIA

Growth is being hampered by rising food costs and a deteriorating fiscal situation.

Following his landslide reelection in early 2019, Prime Minister Narendra Modi has struggled to spur investment. His Bharatiya Janata Party has fared poorly in regional elections.

INDONESIA

President Joko Widodo is seeking to boost foreign investment and curb a slowdown in growth through economic reforms, including cutting corporate taxes and easing labor restrictions.

Critics complain that Widodo is prioritizing his economic agenda over democratic reforms and fighting corruption.

AUSTRALIA

The worst housing crash in over a century was partly to blame for Australia's slowest growth in nearly three decades in 2019, but home prices have begun to recover in major cities.

The Reserve Bank of Australia cut rates to record lows in 2019, but the bank expects tax cuts and infrastructure spending to support growth in 2020.

Disruption 4.0

Innovators are increasingly taking market share from legacy companies.

Key Industries at Risk

CHALLENGES TO GLOBAL GROWTH

U.S.-China tensions are impeding growth in both countries, while the Eurozone is continuing to show vulnerability to trade risks. Are central banks in a position to respond?

Questions to Consider

- As the tailwind from past fiscal stimulus fades, what is the ability for Central Banks to respond?
- Will unresolved Brexit negotiations and the looming threat of additional U.S. tariffs pose potential headwinds?
- Will central bank policy, a negotiated end to the trade war, or other positive developments be enough to avoid recession?

Global manufacturing and trade indicators appeared to have bottomed in late 2019. However, in the U.S. corporate fundamentals, such as per share earnings growth, have deteriorated. Equity returns in 2020 will depend heavily on whether an expected reacceleration in global economic growth actually materializes.

Renewed efforts by the U.S. Federal Reserve and other key central banks to support the global economy appeared to be working as 2019 drew toward a close. But the balance of economic risks is still tilted to the down side.

In China, we expect the current slowdown in growth to be prolonged, even without a trade war, as the country's urbanization process continues to mature. We think Beijing's efforts to stimulate growth will be constrained by the need to limit debt growth among overly leveraged financial institutions and local governments.

Global Trade and Manufacturing Appear to Be Stabilizing

(Fig. 1) World Exports[1] and Global Manufacturing Purchasing Managers' Indexes (PMIs)[2]
Through September 30, 2019

Sources: J.P. Morgan Chase/Haver Analytics (see Additional Disclosures); all data analysis by T. Rowe Price.
[1] YoY = year-over-year. Includes the U.S., China, South Korea, Japan, European Union, Canada, and Mexico.
[2] PMI readings below and above 50 typically indicate contraction or expansion, respectively.

> It is a concern that we may be sitting at an inflection point, where some sort of catalyst or crisis could tip the world economy into recession. The central banks are coming in, hopefully, to sustain the expansion.

Mark Vaselkiv
CIO, Fixed Income
Head of Global High Yield

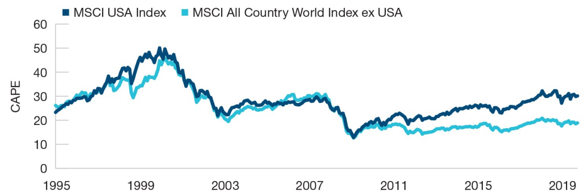
Despite these factors, we believe a near term pickup in global growth may be on the horizon as trade concerns ease somewhat and manufacturing economies stabilize.

Inflation is broadly low around the world relative to central bank targets, although pockets of wage pressure are emerging. It is also notable that the U.S. Treasury yield curve, which briefly inverted across the 2- to 10-year segment in August, returned to a positive slope.

While economic headwinds were strongest in non-U.S. markets in 2019, signs of stabilization are visible. On a cyclically adjusted basis, relative valuations appear to favor non-U.S. equities.

U.S. Equity Valuations Appear High Relative to Rest of World

(Fig. 2) Cyclically Adjusted Price/Earnings Ratios (CAPE)
Through September 30, 2019



Sources: MSCI (see Additional Disclosures) and Citigroup. Copyright Citigroup 2005–2019. All Rights Reserved.

CENTRAL BANKS AND THE SEARCH FOR YIELD

Investors are piling into bonds amid concerns that markets are nearing the end of the global growth cycle. But in a low-yield environment, what does this mean for investors who have an increasing need for income?

Questions to Consider

- With low yields, do investors stretch for yield by going down in credit or extending out in duration? Or, this late in the cycle, do investors hunker down in higher-quality but lower-yielding government bonds?

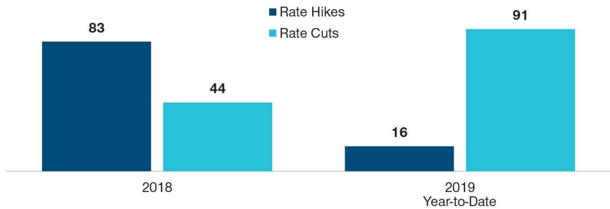
- If there is a negotiated resolution to the US-China trade war and an orderly Brexit, combined with easier global monetary policy, will interest rates actually rise from the current low levels as the economy improves?

Alarmed by spreading signs of global economic weakness, key central banks changed direction in 2019—reviving or expanding quantitative easing programs. As a result, the search for yield has intensified. Duration remains a key risk. Although we don't expect rates to go meaningfully higher in 2020, at current levels even slight increases would significantly reduce bond returns.

For bond investors, the shift to monetary accommodation in 2019 produced an unanticipated windfall, with virtually all global fixed income sectors delivering strongly positive returns, pushing yields on many bonds into negative territory. The pool of negative-yielding debt shrank somewhat as bond markets recovered from a late summer flight to quality, it still accounted for over $13 trillion in bonds outstanding—24% of total global market value—as of the end of October 2019.

Global Central Banks Have Returned to Accommodation

(Fig. 3) Monetary Policy Actions[1]
Through September 30, 2019



Sources: International Monetary Fund and CBRates.com; data analysis by T. Rowe Price.

[1] Total number of rate cuts and rate hikes made by central banks globally. For a full list of the central banks or monetary authorities included in the survey, please see Bank for International Settlements, Central Bank Hub, on the web at: https://www.bis.org/cbanks.htm?m=2%7C9

Lingering concerns about the global economy have led many high yield investors to remain cautious about troubled companies and industries. However, if global reflation strengthens in 2020, investors may want to consider selected opportunities in some disfavored sectors, such as energy and autos, where credit spreads remain relatively high. Likewise, despite widespread concerns about a deterioration in credit quality and lender protections, attractive opportunities can still be found in floating rate bank loans.

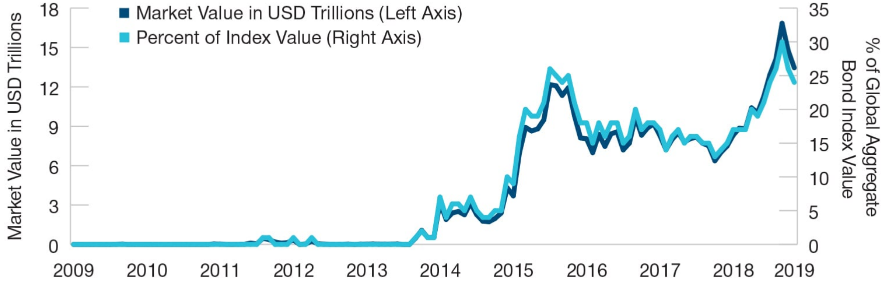
Regardless, the race to the bottom on interest rates has caused significant challenges for fixed income investors as we look ahead to 2020. At the same time, aging populations and demographic shifts mean investors have increasing need for income. Navigating this environment will require careful security selection and thoughtful implementation of global macroeconomic views.

> "Right now, you have an opportunity to earn more attractive yields in loans than you do in high yield bonds."

Mark Vaselkiv
CIO, Fixed Income
Head of Global High Yield

The Stock of Negative-Yielding Debt Has Soared Globally

(Fig. 4) Negative-Yielding Debt in the Bloomberg Barclays Global Aggregate Bond Index
Through October 31, 2019



Source: Bloomberg Finance L.P.

DISRUPTION 4.0

The pace of innovation is breathless.
The next stage of disruption is transforming business models across global markets.

Questions to Consider

- Established firms are not sitting still and many incumbents are beginning to fight back. How will these shifts impact disruption in 2020?
- Disruption reaches beyond equity investing. How will it impact credit markets over the next few years, given that investors have more flexibility to invest in companies that may ultimately face disruptive challenges?
- With machine learning and artificial intelligence (AI) identified as key themes for the coming decade, how will the race for global dominance in this space impact markets?

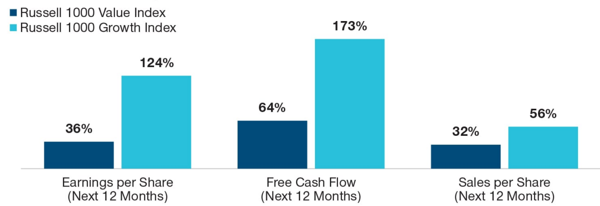
The secular forces powering technological disruption are robust and here to stay. Innovation and automation continue to disrupt global industries, including health care, media, energy, and utilities. We believe this dynamic is likely to persist in 2020.

The next stage of disruption, which we call "Disruption 4.0" is not a discrete phenomenon limited to specific standalone sectors, but is transforming business models across almost every sector of the global market. As a consequence, we believe investors need to think about disruption in a more diverse way.

Disruption has created a strong fundamental backdrop for its beneficiaries—such as the major technology platform companies—while curbing earnings growth for many incumbent firms trading at lower multiples.

Disruption Has Created a Strong Fundamental Backdrop for Growth

(Fig. 5) Changes in Forward Revenue and Earnings Measures
June 1, 2007, Through October 31, 2019[1]



Source: Russell via FactSet (see Additional Disclosures). T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved.

[1] Difference between forward revenue and earnings measures as of October 2019 and forward measures as of June 2007.

However, disruption is also improving the growth characteristics of some traditional sectors. Utilities, for example, typically have been viewed as defensive yield plays. But the sector has evolved in recent years, demonstrating newfound growth potential that may not have been fully rewarded by the market.

The impact on earnings has been dramatic. The utility sector saw virtually zero earnings growth from 1986 through 1998, while S&P 500 earnings rose 159% over that same period. But the gap has narrowed substantially over the past two decades.

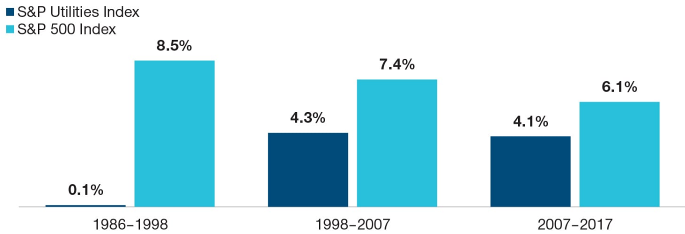
Continued declines in renewable costs and improvements in storage capacity could fuel a sustained, multi-decade period of above-trend earnings growth for utilities. Yet, valuations today reflect only a small premium over the broad U.S. market.

> “You just see this time and time again where companies are making poor capital allocation decisions, which makes it hard for the secularly challenged companies to win over a long period of time—almost regardless of their valuations.”

David Giroux, CFA
CIO, Equity and Multi-Asset

Earnings Growth Has Improved for U.S. Utilities

(Fig. 6) Earnings per Share (EPS) Compound Annual Growth Rates Through 2017[1]



Source: S&P via FactSet (see Additional Disclosures). T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved.

[1] Earnings data is shown through December 31, 2017, to avoid distortions caused by the 2017 U.S. tax reform law, which included major cuts in corporate income tax rates. These changes greatly increased per share earnings for both the S&P Utilities index and the S&P 500 Index. However, because utilities as a sector generate large amounts of taxable income, they benefited disproportionately from the law. Thus, including 2018 earnings here would have created an unfair comparison to the broader S&P 500 Index.

POLITICS, POPULISM, AND POLICY

We can expect geopolitical uncertainty on a number of fronts, as major elections, rising populism, and trade tension could impact macroeconomic conditions worldwide.

Questions to Consider

- Will key emerging and frontier markets continue on their paths toward market-friendly reforms in 2020?
- What will be the impact of regulatory scrutiny of the dominant tech platforms?
- Will an altered political landscape around the globe lead to increased regulations, wealth redistribution, and higher taxes?

Starting with the elections in Taiwan in January and extending to the U.S. presidential election at the end of the year, politics promise to be a significant factor in markets in 2020. The U.S. election is the main event looming, but we can expect geopolitical uncertainty from Brexit, the trade war, U.S.-China strategic rivalry, unrest in Hong Kong, tensions in the Middle East, debates over climate change, and more.

Importantly, support for populist parties and rising political tensions across the world continue to climb on the back of increasing inequality and concerns about the impact of globalization. This has already manifested itself in Brexit, recent global election results, the U.S.-China trade conflict, rising labor actions, and the threat or promise of new regulations in the policy platforms of some 2020 U.S. presidential hopefuls.

The Trade War

The U.S.-China trade dispute was a key driver of market volatility in 2019, as seen in the fluctuating fortunes of the companies most directly exposed to the Chinese market.

After stumbling sharply in August, following a U.S. announcement that it would raise tariffs on an additional $300 billion in imports, China-related stocks subsequently rallied along with the broader market as hopes rose for an interim trade agreement.

While there are signs that the U.S. and China could finalize a short-term deal—in essence, a truce—that boosts sales of U.S. agricultural goods and rolls back some tariffs, the underlying conflict is unlikely to be resolved in 2020. On some core issues, such as technology subsidies, compromise may not be possible at all.

The U.S.-China Trade War Has Contributed to Market Volatility

(Fig. 7) Performance of S&P 500 Companies With Highest Exposure to China[1]
Relative to the S&P 500 Index, Through October 31, 2019

Past performance is not a reliable indicator of future performance.

Sources: S&P (see Additional Disclosures), Strategas Research Partners, and T. Rowe Price.

[1] The S&P 500 companies with the highest exposure to China are composed of the 30 companies within the S&P 500 Index that have the highest China revenues and/or the largest China trade lobbying efforts according to Strategas Research Partners. The basket of companies was created in March 2019, and its performance was calculated back to December 31, 2017. The basket was reconstituted on June 19, 2019 and again on August 24, 2019. All performance results were based on the companies in the basket following each reconstitution, i.e., historical performance was not rerun to reflect the changes in the basket.

"As China tries to deleverage, they've got to find ways to increase productivity in terms of capital and labor, and this is really what's at the heart of the trade dispute."

Justin Thomson
CIO, International Equity

U.S. Elections

Equity markets may be underestimating the potential impact of the 2020 presidential race on tax rates, regulation, and companies in the health care, energy, and financial services sectors. Part of the political backdrop to the election is the debate over the rise in income inequality that has accompanied the free market reforms of the past four decades. Although these structural changes have boosted growth and lowered inflation, the benefits have not always translated into rising wages and living standards. While economic anxiety has helped fuel populism, the political appeal of candidates promoting tighter regulation and income and wealth redistribution poses the more immediate risk to markets.

Brexit

The uncertainty generated by the U.K.'s divorce from the EU appears likely to continue into 2020. Repeatedly extended, the Brexit deadline was set for January 31, 2020; however, that date could be moved again depending on whether the British parliament approved the necessary exit legislation after the country's December general election.

Hong Kong

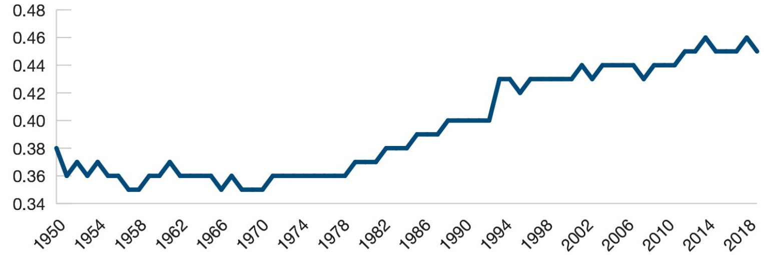
The mass protests in China's special administrative region began in reaction to a proposed extradition law allowing residents to be tried on the mainland but have evolved into a movement demanding democratic political reforms. While the disturbances have had a negative effect on Hong Kong's economy, the impact on China as a whole has been difficult to distinguish from the trade-related and structural issues slowing growth. It also remains unclear what steps, if any, Beijing might take to restore order.

> It's fascinating to me that the market is not more concerned about the U.S. election. We think it has the potential to be very disruptive for many sectors.

David Giroux, CFA
CIO, Equity and Multi-Asset

Increasing Income Inequality Has Helped Fuel Economic Anxiety

(Fig. 8) Gini Coefficient for the United States[1]
As of December 31, 2018



Sources: Strategas Research Partners and U.S. Census Bureau.

[1] The Gini coefficient is a summary measure of income inequality that indicates the dispersion of income across the entire income distribution. The coefficient ranges from 0, indicating perfect equality, to 1, perfect inequality. A higher coefficient indicates higher-income individuals are receiving larger percentages of total national income. It is not an absolute measure of income or wealth.

ADDITIONAL INFORMATION

2020 Global Market Outlook

COMFORTABLE WITH THE UNCOMFORTABLE

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ADDITIONAL RESOURCES

2020 Global Market Outlook Webcast **Access Replay**

2020 Global Market Outlook Narrative **View Now**

Fixed Income Insights: *Looking Beyond Negative Yields* **View Now**

U.S. Equity Insights: *Utilities: A Potential New Growth Sector* **View Now**

International Equity Insights: *As Japan Looks to the Future, Productivity Is the Key* **View Now**

IMPORTANT INFORMATION

For additional disclosures, **click here**.

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