MARKET BACKDROP
A review of what's happened in markets recently

MARKET OUTLOOK
Looking ahead to the coming months

SPOTLIGHT ON
The US presidential election

The view
Winter 2019

architas

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Welcome
to The View – Winter 2019

The Winter edition of The View provides a step-by-step guide to how the political and economic environment has driven financial markets, and what this means for your investments.

While 2019 was encouraging for investors, risks are always around the corner. We believe that this highlights the importance of being 'diversified'. We delve into what this means and how it is linked to reducing the risk of your portfolio.

The race for the US presidency is one of the risks that you are likely to hear about a lot this year. Here we give you a roundup of what to expect in the run-up to the election and how this could affect your investments.

We also cast an eye over the potential for governments to wrestle back control over their economies from central banks this year. This move could spell the end of austerity as governments plan to spend large amounts of money.

Jaime Arguello
Chief Investment Officer

Market
BACKDROP

There was a healthy recovery for riskier assets which bounced back after the sometimes worrying economic backdrop over the summer.

Investor sentiment was boosted by the breakthrough in US-China trade talks and the British election in December which pointed to a smoother exit from the European Union.

As well as gains for stocks, higher-risk bonds benefited from the 'risk-on' environment as optimism returned to markets.

ECONOMIC FACTORS

The global economic outlook was given a lift. Investors took comfort from the potential for a trade resolution. The ongoing spats between China and the US and the ongoing Brexit saga took a turn for the better.

Central bank U-turns boosted risk appetite. The changes in policy by major central banks to encourage banks to lend and consumers to spend encouraged markets to rise.

RISKS

Geopolitical uncertainties reduced. This was after several quarters in which the world was gripped by protectionism, which had a heavy cost on trade and the global economy.

Inflation worries kept central banks in the spotlight. Major central banks started to concentrate on the potential for low global inflation.

FINANCIAL MARKETS

Stock markets were positive across the board. Healthy returns over the last three months were kick-started by the US's third rate cut in the year. The US was among the strongest performers having been hit hard in the previous quarter's slump.

Bond markets enjoyed nearly as much of a year-end rally as stocks. In particular, riskier bonds were boosted in December, with strong performances from corporate bonds and bonds from emerging markets.

CONCLUSION

Despite some market turbulence during the year, the last three months provided a notable end to 2019 for investors and hope of an imminent trade deal was the key driver. As a result, many equity indices, long-term bonds, oil and gold posted double-digit gains for the year.

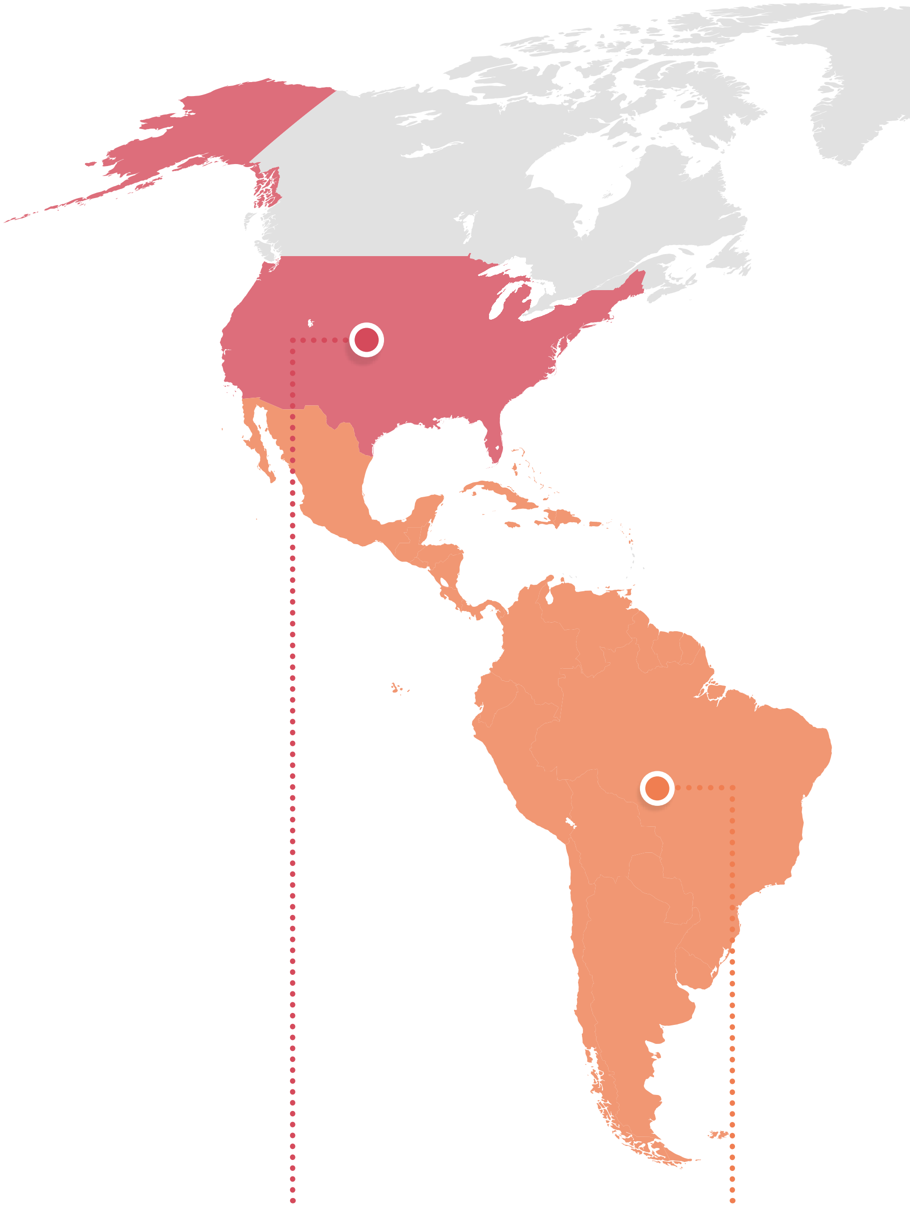
While 2019 was encouraging for investors, risks remain against an often uncertain political backdrop. This year's US election will be one of many risks that we are monitoring. We believe all this reinforces the importance of being diversified across a range of different asset classes.

Market OUTLOOK

The global economic outlook has been boosted by progress in US-China trade talks and central banks across the world maintaining their supportive stance (through monetary policies).

This combination may propel a meaningful economic rebound in 2020 defined by robust corporate and consumer spending trends. We also think that governments will increasingly offer fiscal solutions to appease voters and retrieve the 'baton' from central banks.

Among the global risks are lower than expected growth in the global economy, continued protectionism and possible fluctuations in oil prices in the context of geopolitical instability. Subdued global inflation and the upcoming US presidential election could also be potential stumbling blocks.



UNITED STATES

STOCKS (Neutral) BONDS (Neutral)

- US stocks have been on a strong run supported by a brightening economic outlook and optimism regarding company earnings growth. But we believe they look expensive with little election risk priced in.
- We're reasonably positive about US bonds. Due to the cautious optimism on global growth and the low-yield environment we cannot rule out possible bouts of bond market volatility.

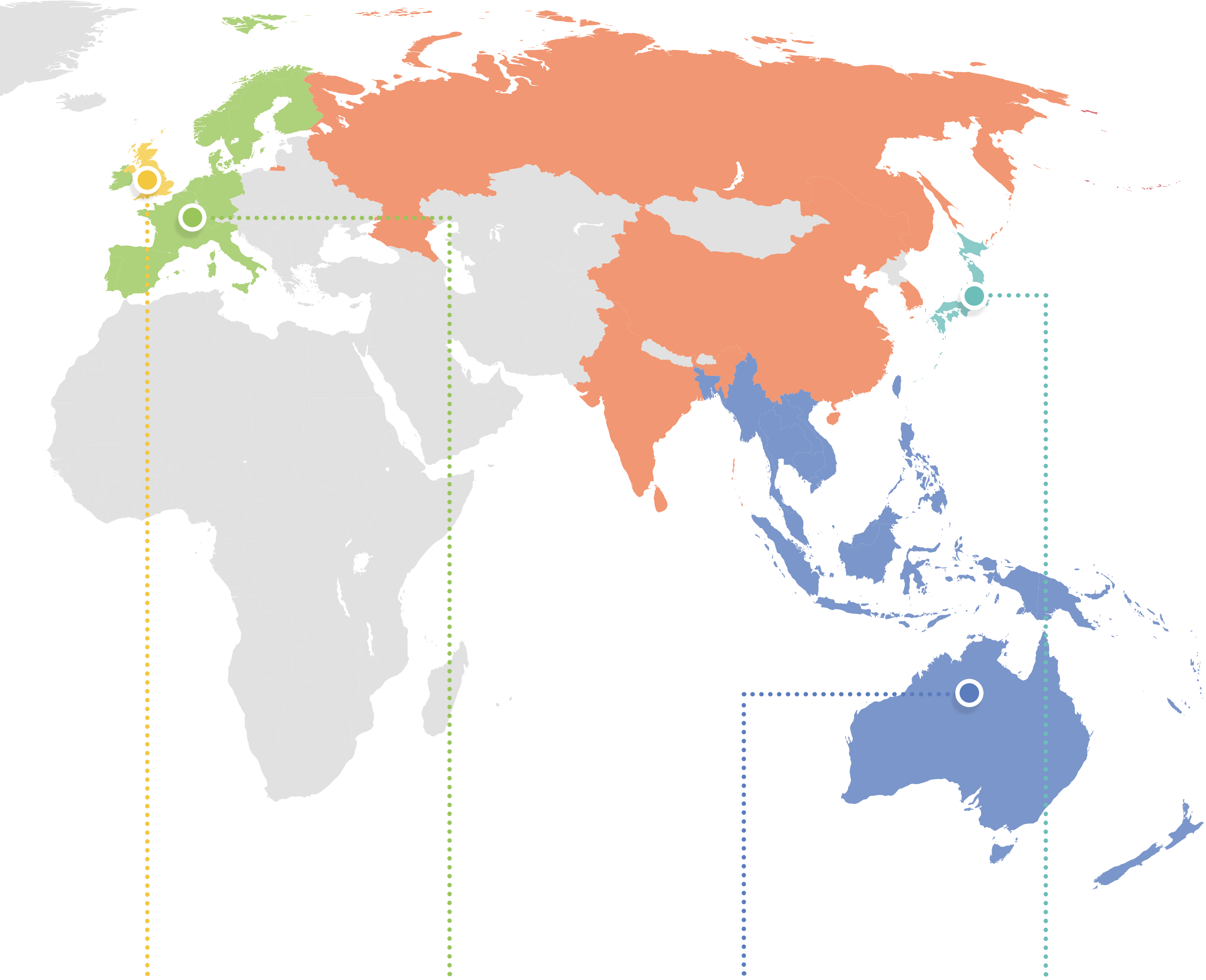
EMERGING MARKETS

STOCKS (Neutral) BONDS (Positive)

- Having endured a difficult time due to factors such as the US-China trade spat, emerging market stocks are starting to look like good value relative to peers.
- Emerging market fixed income still offers value. And the easing of trade tensions coupled with the US rate cuts should benefit the region.

KEY

- Positive
- Negative
- Neutral



UNITED KINGDOM

STOCKS BONDS

- Assuming Brexit happens, it removes a lot of uncertainty in the short term. This is very positive for UK shares that were under-owned by international investors. Even so, the unresolved trade deals with the rest of the world pose risks.
- Lower-risk assets such as government bonds are likely to reduce in popularity over coming months after the Conservative election victory reinstated investors' faith in riskier assets.

EUROPE

STOCKS BONDS

- In Europe, economic data is fairly promising. The after-effects of the phase one US-China trade agreement and an encouraging pan-European political outlook should boost demand for European stocks.
- Regionally, fixed income assets in Europe look the riskiest. Many have 'negative yields' meaning investors may get back less than they paid for them after the bond's end date.

ASIA PACIFIC

STOCKS

- The de-escalation of the trade war and its positive consequences on the real economy will almost certainly be the most important market driver in the early part of 2020.
- There is the risk that Asian currency markets have already priced in the recovery in exports; idiosyncratic factors including the often irrational actions of Trump have a greater risk in this region than elsewhere.

JAPAN

STOCKS

- Japanese stocks have room to perform positively as investors seek cheaper regions now that political headwinds of the US/China trade war have eased.
- However, growth in Japan remains challenged with less positive good news on the horizon economically than peers as Japan's third decade of monetary loosening and recent tax rise puts a strain on the economy.

SPOTLIGHT **ON...**

The US presidential election

The race for the US presidency is gaining attention across the globe. After all, the President of the United States has the power to influence stock markets, trade and politics on an international scale. Here we give you a roundup of what to expect in the run-up to the election and how this could affect your investments.

MARCH
Tuesday 3rd

Super Tuesday

Super Tuesday sees 15 states vote for party presidential nominees on the same day. Because these 15 states encompass a wide range of demographics and political persuasions, Super Tuesday gives the first clue of which candidates are likely to go head to head for the presidency. It's estimated that we could see the US stock market move by up to 1.5% on the day.

JULY
Monday 13th – Thursday 16th

Democratic National Convention

The Democratic presidential nominee will be announced at the party's convention in Wisconsin. Attitudes towards tax, regulation, international trade and public spending vary greatly between the candidates – with some seen as more market-friendly than others – so the global stock markets could react when the winner is revealed.

AUGUST
Monday 24th – Thursday 27th

Republican National Convention

Donald Trump should be announced as the official Republican presidential nominee at the party convention in North Carolina. This continuity, along with Trump's pro-business policies, is likely to be seen positively by investors. In fact, Trump will likely do everything he can to keep the stock market ticking up before the election – starting with the signing of the US/China trade deal that we saw in January.

SEPTEMBER – OCTOBER

Thursday 29th September – Thursday 22nd October

Presidential debates

A trio of televised debates in Indiana, Michigan and Tennessee will give the presidential nominees the chance to go head to head on policies and current issues. Trade relations with the likes of Asia and Europe have been high on the political agenda in recent years, so these could receive some airtime. In previous years we have seen spikes in US stock market volatility around these dates, depending on which candidate appears to win the debates.

NOVEMBER

Tuesday 3rd

The big day

On 3 November the American public will take to the booths to decide who will be sworn into the Oval office. It's estimated that the US stock market could move by up to 3% when the dust settles, sending ripples across global markets too. But the direction and magnitude of any movement will depend on who wins and what their policies are like.

A Trump victory is likely to be well-received by the stock markets, as global investors anticipate more of the same after 2019's stellar returns. On the other hand, many expect a Democrat victory to cause a market downturn – although the same was said about Trump in 2016!

What does it mean for your investments?

It's difficult to say how the US election might affect the stock markets as we don't yet know which names will be on the ballot sheet. Historically the US stock market has performed well in election years, but this isn't guaranteed in 2020 and there remain unresolved global geopolitical issues. We also expect there to be some volatility along the way, but don't believe that this should be a concern for long-term investors.

At Architas, we design multi-asset funds with the goal of withstanding political uncertainty, without being overly tied to the fortunes of a particular country or type of investment. We do this by spreading our clients' money across a diverse mix of high-quality investments from all over the globe.

AN INTRODUCTION TO **DIVERSIFICATION**

From year to year, it is difficult to predict which asset classes will be the best performers. Most investment specialists agree about the benefits of spreading your money across different investments. This diversification can reduce volatility, smooth out highs and lows in returns and help avoid unnecessary risk.

Selecting the right mix

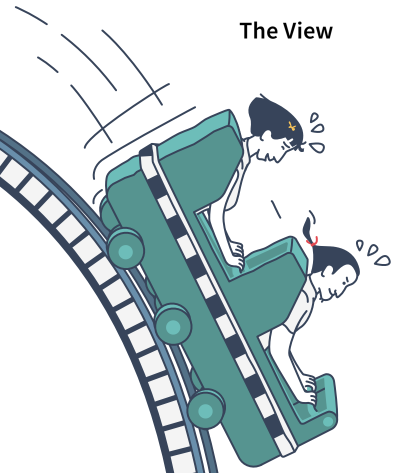
One of the major aims of diversification is to construct a portfolio of investments that don't all behave in exactly the same way. So while one part of your investment portfolio could be falling in value, the others may be flat or rising to balance it out. This difference in potential returns could offer some protection against all assets falling in value at the same time. Selecting the right mix can help to even out the damage inflicted by downturns, recessions or just routine fluctuations in specific markets.

Market bumps are normal

Markets are unpredictable and it will always be difficult to foresee what will happen in the future. It may be wise not to take a short-term outlook, and avoid overreacting to immediate stock market moves. Taking a multi-asset approach could help to smooth out your returns. A well-constructed investment portfolio, designed around your time frame and keeping your portfolio diversified could be a prudent way to weather market uncertainty.

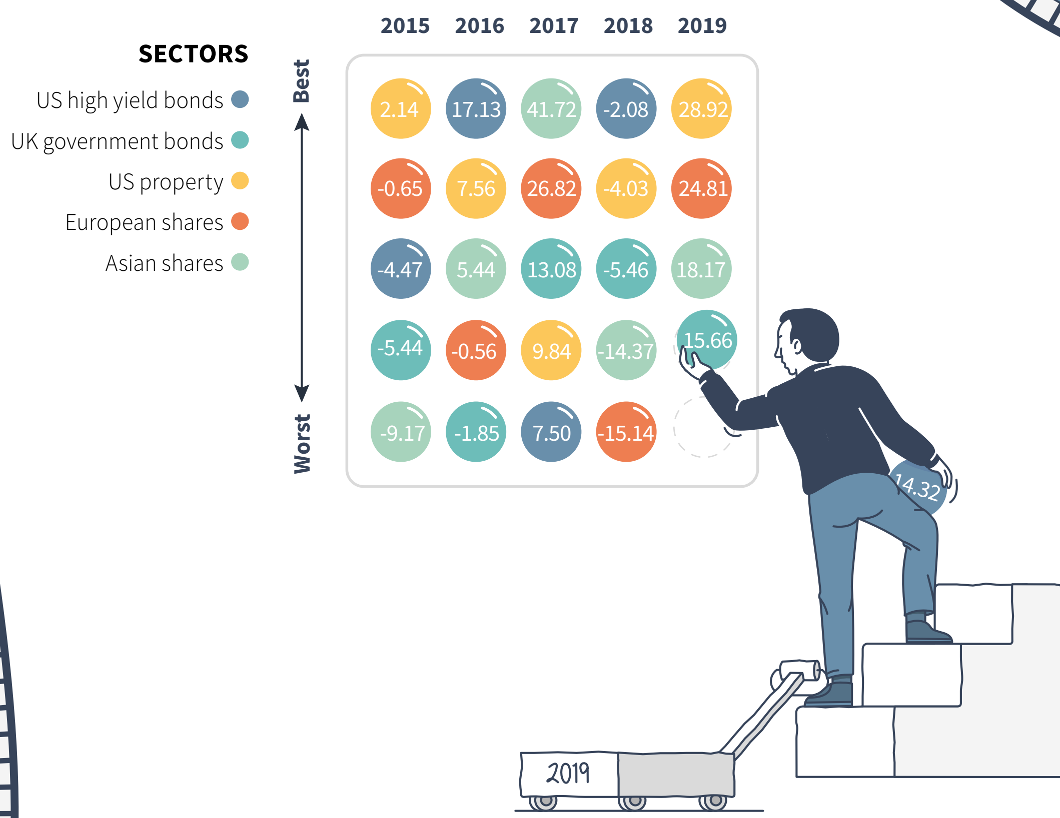
Risky versus safe assets

If you need to protect yourself from the possibility of a short-term decline in the value of your portfolio, you are likely to follow the conventional wisdom of putting some of your capital into bonds rather than stocks. Over time this might well cost you money. Over the long run, stocks consistently outperform bonds. Although it's important to note past performance is not a reliable guide to future performance. However, investing some of your money in bonds is likely to reduce the short-term ups and downs of your investment portfolio, which may allow you to sleep better at night.



The importance of diversification

The chart below shows why it is so important to make sure your investments are diversified. As you can see, over time no single asset class or region is a consistent top performer. Spreading your investments across a range of asset classes and regions could help smooth the impact of ups and downs in the market. One investment may perform badly in any particular year but this negative performance could be offset by the positive performance of another investment.



Source: Morningstar as at 31.12.2019. Returns as a percentage rebased to US dollars. Past performance is not a guide to future performance.

Asset allocation is king

Asset allocation refers to the decision of how much capital to invest and where, such as for example in stocks vs. bonds, in US vs. European stocks, how much to keep in cash and everything in between. Having the right balance – the optimal asset allocation – is what keeps you diversified in the market. Diversifying your investment portfolio across a range of asset classes, geographies and fund managers could help to reduce your overall risk.

Fiscal stimulus

WHAT'S THE BIG STORY?

Interest rates tumbled in the years following the global financial crisis in 2008, as central banks attempted to kick-start economic growth using monetary stimulus. But has that game now played out? In recent months there has been a rising chorus of demands for governments to forget about austerity and take up the baton. This could happen by cutting taxes or spending large sums of money on big infrastructure projects. And that's what is meant by fiscal stimulus. Let's look at some examples.

1

United States

When President Trump came to office in 2017 he promised an 'America First' budget. Spending plans included a boost to the US military, as well as the infamous wall along the border with Mexico. Progress has been slow with this particular project and yet US government debt keeps on rising. For 2019 the budget was in deficit to an eyewatering $1 trillion.

2

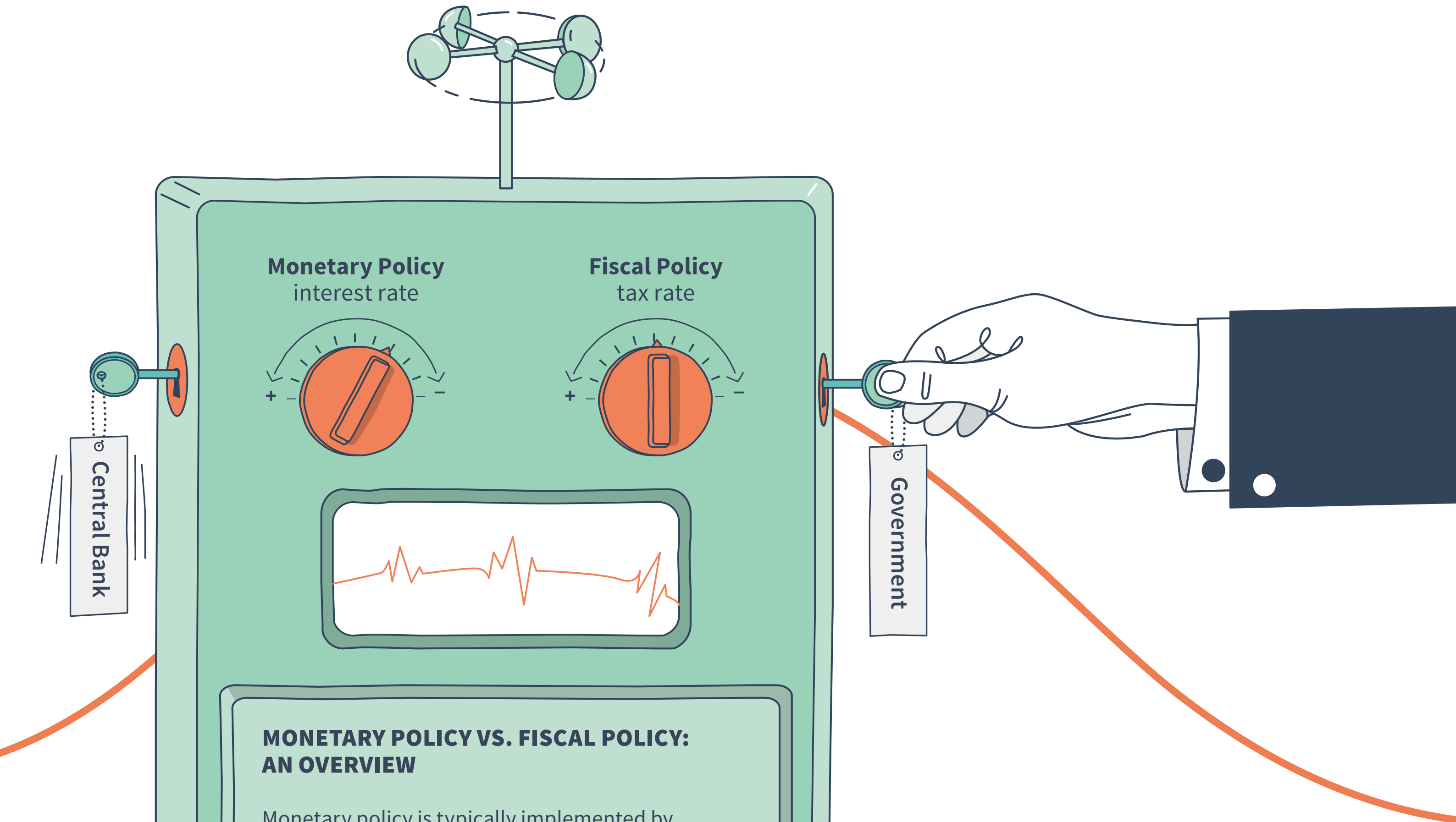
Germany

Germany, a more naturally prudent economy, has attempted to achieve a 'schwarze Null' or black zero. That means a perfectly balanced budget. In fact, government spending has been so tightly controlled that the country is now running a budget surplus close to 2% of GDP. The influential Green Party is looking to unlock spending via environmental initiatives over the next few years.

3

Elsewhere

Japan has recently announced a stimulus package of $121bn, aimed at typhoon repairs and investment in infrastructure and new technology. And the UK has been promised a 'Brexit bonus', boosting an economy held back by the uncertainties of leaving the EU. Over the next five years spending of up to £100bn ($130bn), including on roads, rail links and hospitals, is due to be unleashed.



MONETARY POLICY VS. FISCAL POLICY: AN OVERVIEW

Monetary policy is typically implemented by a central bank. It involves changing interest rates, and the supply of money and credit, which can influence the economy.

Fiscal policy decisions are set by the national government. They include changing tax rates and levels of government spending, which can also influence demand in the economy.

Monetary and fiscal policy can be used in tandem to shape economic performance. In general terms, stimulative monetary policy is designed to improve an economy's rate of output growth (measured by Gross Domestic Product or GDP); tight or restrictive monetary policy is designed to put a brake on the economy, generally to offset inflationary pressures. In a similar way, stimulative fiscal policies such as tax cuts and spending increases are normally expected to boost economic growth in the short run, while tax increases and spending cuts tend to slow the rate of future economic expansion.

So, governments' views on fiscal stimulus range from reluctance in some quarters to big promises in others. Always remember that the cost ultimately falls to the taxpayer. Or, if funded by government borrowing, to the taxpayers of the future. Nonetheless, global growth and inflation are still sluggish, and the world is waiting to see how this challenge will now be met.

Facts & Figures

QUARTERLY DATA

UK stocks	Emerging market stocks	US stocks	European (but not UK) stocks	Japanese stocks	Asian (but not Japanese) stocks
12.0	**11.9**	**9.1**	**8.5**	**7.8**	**5.8**
FTSE All-Share Index	MSCI Emerging Market Index	S&P 500 Composite Index	FTSE All World Developed Europe ex UK Index	TOPIX Index	MSCI Pacific ex. Japan Index

UK corporate bonds	Global high yield bonds	European corporate bonds	Emerging market bonds	US corporate bonds	Global government bonds
4.2	**3.4**	**2.4**	**2.1**	**1.2**	**-0.6**
Bloomberg Barclays Sterling Aggregate Bond Index	ICE Bank of America ML Global High Yield Bond Index	Bloomberg Barclays European Corporate Bond Index	JP Morgan Global Emerging Market Bond Index	Bloomberg Barclays US Corporate Bond Index	FTSE G7 Index

To highlight the unpredictability of markets, the table below details the performance of global equity and fixed income indices over the past five years (in US dollar terms).

This table demonstrates how volatile markets can be, and shows the benefits of diversifying your investment, or in other words, not putting all your eggs in one basket.

Index percentage growth (%)	1 Jan 2019 to 31 Dec 2019	1 Jan 2018 to 31 Dec 2018	1 Jan 2017 to 31 Dec 2017	1 Jan 2016 to 31 Dec 2016	1 Jan 2015 to 31 Dec 2015
US stocks	31.5	-4.4	21.8	12.0	1.4
European (but not UK) stocks	25.3	-14.4	28.3	0.3	0.2
UK stocks	24.0	-14.8	23.8	-2.1	-4.5
Japanese stocks	16.3	-15.6	23.9	1.2	9.6
Asian (but not Japanese) stocks	18.5	-10.2	26.0	8.0	-8.4
Emerging market stocks	18.9	-14.2	37.8	11.6	-14.6
Global government bonds	5.8	-0.4	6.3	1.8	-2.4
Global high yield bonds	13.7	-3.3	10.2	14.8	-4.2
US corporate bonds	14.5	-2.5	6.4	6.1	-0.7
European corporate bonds	4.3	-6.0	16.6	1.7	-10.7
Emerging market bonds	14.4	-4.6	9.3	10.2	1.2
UK corporate bonds	12.2	-6.0	12.4	-7.1	-5.0

Past performance is not a guide to future performance. Rebased in US dollars where appropriate, i.e. all index returns are recalculated based on exchange rates to give returns for a US dollar investor. Source: Morningstar Direct, January 2020.

Important INFORMATION

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