Markets Anti-Predictions For 2019

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"You must always be able to predict what's next and then have the flexibility to evolve."

Marc Benioff

Each half, as part of our outlook for the coming six months, we provide a series of "anti-forecasts" for what will **NOT** happen over this period. This is a light-hearted way to approach the vagaries of forecasting to look at things from the opposite perspective. But on a deeper level, it serves the purpose of helping to narrow our investment horizon by ruling out things that we think are unlikely to happen to allow us to better understand things that may happen.

Here are some of the things we do not think will happen between now and June 30th, 2019.

BACK CHECK

But first, we must reflect on the performance of our last set of "anti-forecasts" over the half that just ended.

US 10-YEAR BOND YIELDS WILL NOT BREAK ABOVE 3.50%

Hit! Emphatic win here with US bond yields finishing the year at 2.68%, well below the level most people were forecasting at the middle of the year. The curve continued to flatten, though at lower levels as the market took out future hikes.

US EQUITY MARKETS (MSCI USA) WILL NOT FINISH LOWER

Miss! As they say in sport "played well for 3 quarters, but unfortunately the game is 4 quarters". As recently as the end of November, this prediction was looking good. The worst December since the 1930s for the USA put an end to that. Lower yields and better EPS did nothing to save the savage de-rating.

US INVESTMENT GRADE CREDIT WILL NOT GO BELOW THEIR 2018 LOWS (JP MORGAN GLOBAL AGGREGATE IG CREDIT INDEX SPREAD)

Hit! Higher interest rates and panic in the equity markets proved to be a toxic mix for credit spreads.

AUSTRALIAN SHARES WILL NOT OUTPERFORM GLOBAL SHARES

Hit! Despite global markets falling, the Australian dollar falling plus the bank-heavy local index suffering from the Royal Commission fallout and housing fears led to global shares slightly outperforming Australian shares in common currency over the half.

TRUMP'S RATINGS WILL NOT COLLAPSE

Hit! 41.8% approved of Trump (using 538 website aggregation data) at June 30th, with this number finishing at 41.5% at December 31st. Loyal supporters remain unphased about tariffs, government shutdowns and criminal investigations. Equity investors turned out to be less impressed.

A paradox: 4 out of 5 is one of our best outcomes, coupled with one of the poorest performances of the Funds. The divergence relates to the fact that as an equity firm, the second prediction is of out-sized importance and the other predictions mostly help inform that prediction.

NEW VIEWS

We conclude this blog by looking at our predictions of what WILL NOT happen by June 30th, 2019.

EMERGING MARKETS WILL NOT UNDERPERFORM DEVELOPED MARKETS

If January 2018 was all "sweetness and light" for Emerging Markets (EM) on the belief that 2017 would carry on, by October it had turned to darkness and despair. Then something remarkable happened: the US market collapsed in December and Emerging Markets outperformed. There is a saying in the market that strong price action into weak backdrops shows you the future leader. With the Federal Reserve likely on hold, or maybe with one hike left, EM earnings revisions at lows; positioning now lighter; and valuations good if not compelling, barring an escalation of the trade wars, EM outperformance should continue.

SHORT-TERM INTEREST (2-YEAR YIELDS) RATES WILL NOT BE LOWER

2019 will see a strange dichotomy – a Federal Reserve that walks back on their rate hikes, but a bond market that went too far in pricing cuts. Hence an odd outcome: economists revise down expectations of Federal Reserve hikes, yet bond yields do not fall.

US MARKET WILL NOT FINISH BELOW THE DECEMBER 2018 LOWS

The first half of 2019 will likely see the US equity market climbing a wall of worry. Economic data will likely continue to soften but with the Federal Reserve easing off the brakes, equity markets will likely breathe a sigh of relief and push above 2018 lows – with some wobbles along the way no doubt.

EUROPE WILL NOT OUTPERFORM JAPAN

One has to feel a little sorry for Japanese corporates: having been hectored by Westerners for failing to run to maximise shareholder value, after improving returns, buying back shares and increasing dividends, they have been rewarded for this with… a large de-rating. At 11x forward earnings and vastly improved corporate balance sheets with somewhat improved capital management, 2019 could see the sunrise on forgotten Japan. Europe, on the other hand, is about to discover Brexit woes do not end at the English Channel, and is likely to face inappropriately tighter monetary policies, and continuing political stress caused by slow growth.

AUSTRALIA WILL NOT AVOID POLITICAL VOLATILITY, MEANING ANOTHER HALF OF UNDERPERFORMANCE

Globally politics have become a more significant driver of market performance. Locally despite numerous Prime Ministers and changes of parties in power, Australia has largely avoided its politics having any impact on either its stock market or currency over the last decade. This year we expect to be different. The Australian Labor Party enters the year strong favorites which will mean financial markets will have to start moving to factor in potential changes to franking credits, capital gains taxes and changes to negative gearing tax rules.

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