Vanguard®

# Quarterly economic and market update

December quarter 2019


## Quarter in review

The December quarter of 2019 capped off a strong year in terms of investment returns, which was contrary to most expectations at the end of 2018 after the Australian share market closed at a two-year low.

At that time, many central banks had foreshadowed they would be raising interest rates during 2019. Instead, they moved in the opposite direction by cutting rates to stimulate economic growth, and this spurred a wave of investment into share markets as investors sought out higher-yielding assets.

This spurred a rally across financial markets globally, with the Australian and US share markets—among others—reaching record highs during the year.

The December 2019 quarter was no exception to this rally, with investor spirits continuing to soar as global manufacturing data showed some stabilisation, and as a result of more positive news around Brexit and the protracted US-China trade negotiations.

By the end of the fourth quarter, major equity markets including Australia's had recorded average gains of around 20 per cent higher and even the returns from fixed interest neared double digits following a surge in bond prices.

Many investors have seen this as an "opportunity" to pile into risky assets, but there is a risk that financial markets are getting ahead of themselves and are pricing in too much optimism for what remains largely uncertain outcomes.

## Economic outlook

At the start of 2020, weakening economic conditions around the world, the unresolved trade negotiations between the US and China, the yet-to-be-completed Brexit program, and rising global geopolitical tensions, all paint an uncertain outlook for financial markets.

Vanguard's recently published 2020 economic and markets outlook highlights these risks, including unpredictable policymaking, and points to stretched valuations, weak earnings growth and late-cycle risks.

They are unlikely to be allies of the market momentum seen in 2019, nor will they be supportive of global demand in 2020.

Investors should therefore expect a deterioration in the prevailing economic conditions over time, which will ultimately flow though to investment markets.

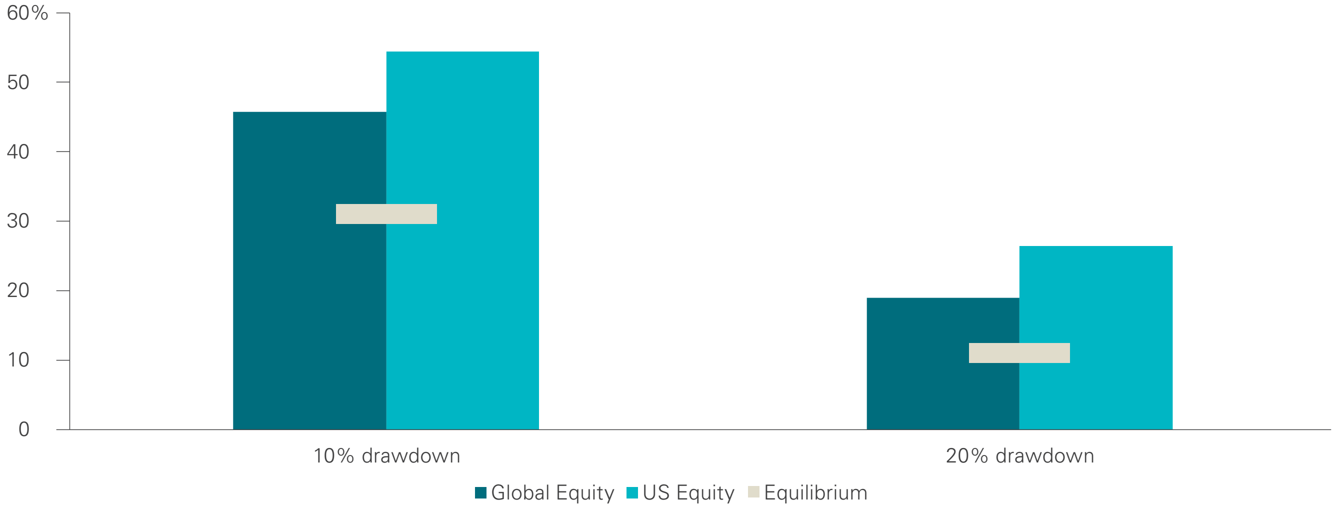
Our near-term outlook for global equity markets remains guarded, and the chance of a large drawdown for equities and other correlated assets remains elevated and significantly higher than it would be in a normal market environment.

High-quality fixed income assets, whose expected returns are positive only in nominal terms, remain a key diversifier in a portfolio.

The chart below illustrates Vanguard's expectations for global and US equity market corrections over the next three years.

**Figure 1.** Downside risks and volatility likely to stay elevated in risk assets

Probability of global correction over the next three years seems elevated




**Notes:** Probability corresponds to the percentage of global equity in USD VCMM simulations that declines over the next three years.
**Source:** Vanguard.

## How should investors respond?

The general uncertainty overhanging investment conditions globally, particularly the prospect of heightened volatility on financial markets and lower returns, is understandably disconcerting.

Yet, there is an inherent danger in trying to pre-empt what markets may or may not do, as we saw in 2019 when markets defied earlier expectations and rallied.

Those that may have exited their investment positions in late 2018 in the belief that markets would deteriorate in 2019 will have missed out on very strong returns.

So, rather than trying to "time the markets" by predicting what may happen in 2020 and beyond, the tried and well tested strategy of staying on your chosen investment course is always the most sensible strategy.

Asset class returns will vary, as they always do, depending on economic, political and other catalysts.

Taking a long-term perspective, setting measured investment goals, and spreading your capital across a range of assets, are the best ways to reduce your exposure to market risk.

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