

VARIATIONS ON THE BALANCE THEME

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With the global economy on the wane, the US and China will be more inclined to be cautious about confrontation

From our current vantage point halfway through 2019, we still see no valid reason to alter our basic view of financial markets: there is a rough balance between a weakening global economy and monetary policy stimulus from central banks. Despite the many dramatic political and geopolitical developments unfolding, the major stock markets have all recovered to their end-March levels.

In this late-cycle period, it is important to maintain our disciplined market analysis so that we can continue to distinguish between noise and signal.

The routine cliffhangers in this year's serial drama

The key takeaway from the talks at the G20 summit is that neither China nor the United States is particularly keen on throwing the world economy into a deep slump. Given the US election timetable and a global economy on the wane, both governments will most likely be cautious about confrontation in the coming months.

Meanwhile, the economy is sputtering

Wherever you look today, you see a lacklustre economic backdrop, with industrial production stuck in the doghouse – even if the traditionally less cyclical service sector is still resilient.

In China, for example, the leading indicators for manufacturing confirm the downward trend. Nor does Beijing appear to be in the mood for a new stimulus programme at this juncture. In the United States, the growth rate for private non-residential fixed investment has continued to fall, no doubt as a result of uncertainty over

trade war.

Oddly enough, this basically downbeat climate is good news for markets in the short term. The outlook for low but relatively steady GDP growth ensures that central banks will hew to an accommodating stance towards markets, without lapsing into panic mode for the time being.



In the medium term, the need to resort to greater fiscal spending is increasingly acknowledged

Is central-bank power on the way out?

It's tricky business attaching relative weights to the various drivers of deceleration in the global economy:

- 1/ The slowdown deliberately engineered by Beijing in 2018.
- 2/ The detrimental impact of the US-China trade war on capital spending.
- 3/ The untimely monetary policy tightening carried out last year.

This cocktail invites a key question. Will a return to dovish monetary policies – a prospect made more likely by Christine Lagarde's nomination to the position of ECB President – be enough to counteract all the causes of the economic slowdown?

This shouldn't matter much in the short run, as the financial markets will probably feel comfortable with central bankers' renewed interventionism in what looks for now like a settled economic and political climate.

But in the medium term, the issue will be crucial: the need to resort to greater fiscal spending is increasingly acknowledged. A further question is how this major shift will impact bond and equity markets that have seen nothing other than financial repression and fiscal austerity for the past ten years.

What investment strategy at this stage of the cycle?

The most sensible one still has the same three basic components:

- 1/ A core equity portfolio focused on carefully selected growth stocks, given that they now constitute a pricy market segment.
- 2/ Sufficient agility to be able to capture the upside potential of the intermediate market movements inherent in such phases.
- 3/ Positioning along the yield curve to exploit the greater clarity today on policy easing by central banks.

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