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SOLID GLOBAL ECONOMY AND EQUITY RETURNS

Global Investment Committee Outlook

Global Growth Should Remain Solid

Our updated house view is that the G-3 and Chinese economies will continue solid through September 2019 approximately in line with consensus expectations, while we expect central banks to reduce their accommodation similarly to consensus expectations. With such as the backdrop, we expect bond yields to rise mildly, the USD to be relatively flat and equity markets to rise quite a bit further, especially as we forecast that geopolitical risks will remain under control.

MSCI World rose 1.9% from our last meeting in early-June through 14 September, vs. our 2.6% expectation (although our targets were for end-September, which could well still be met), justifying our bullish stance at the time, especially relative to bonds. The SPX rose significantly above our September-end target for 2% growth, posting very strong gains, while all other regions undershot their targets with negative returns in USD terms so far during the period, in some cases due to USD strength. U.S. and German 10-year bond yields hit our targets for end-September, while Japan's overshot slightly, with our June forecast of a -0.8% USD-based global bond return through September quite on target so far. Our Euro target was matched, while the Yen is now 112 vs. our 110 forecast.

As we expected, G-3 economic growth re-accelerated significantly from a somewhat soft 1Q, although the Eurozone slowed a bit. Looking forward, U.S. GDP, at a 2.9% Half on Half Seasonally Adjusted Annualized Rate (HoH SAAR) in 4Q18-1Q19 and a 2.3% rate in 2Q19-3Q19, should match consensus expectations. Growth should come from increased personal consumption, fixed asset investment, government spending and inventories, while net trade will likely be a negative factor. Meanwhile, the Eurozone's and Japan's GDP will likely grow at 2.0% and 1.8%, respectively, on a HoH SAAR basis in 4Q18-1Q19 and 1.9% and 1.6%, respectively, in 2Q19-3Q19, both also approximating consensus expectations. These results should re-assure risk markets and corporate profit estimates should continue to show sturdy growth through 2019. Lastly, China's official GDP should be approximately 6.4% HoH SAAR in both periods. Here too, personal consumption will likely lead the way, while fiscal stimulus will begin providing more support, as well.

As for geopolitical issues, we still believe that such will be handled without crisis due to the strong economic incentives of all major players, but there are many situations that bear close monitoring, especially Turkey, Italy, North Korea, the Middle East and BREXIT. Trade disputes between Europe, Canada and Mexico seem to have settled down, but that with China has proven quite intractable. Fortunately, even in the worst scenario of full 25% US tariffs on Chinese exports and imports to the US, we believe the global economy can withstand such without too much dislocation. The U.S. political situation is too difficult to predict, and while uncertainty and risk-volatility may rise at times, the actual effects will likely be muted in the next few quarters.

Central Banks: Normalization except only slightly so for Japan

Our Fed call for 25 bps hikes in both June and September certainly seem correct, although our forecast for a pause in December is now unlikely. We also then expected hikes in the 1Q19 and 2Q19, which overall was more aggressive than fixed income markets expected. **We now expect the pause to occur in the 1Q19, but 25 bps hikes in every other quarter.** As we expected, the ECB still intends to end QE in December, but with rate hikes starting in 3Q19 rather than the 2Q we previously expected. In June, we expected the BOJ to maintain its 10-year JGB target until a 1Q19 hike of 20 bps, but it recently widened the band to 20 bps instead. We do not expect any BOJ hikes for the next four quarters due to the proposed VAT hike in October 2019, but there will likely be some tapering of ETF purchases. As for inflation, we expect U.S. Core CPI to be 2.4% YoY in March, and as we expect the Brent oil price to be $81 then, we expect the headline CPI to be 2.6% YoY. Overall commodity prices should also move mildly upward, with oil prices rising primarily due to oil sanctions. Although global growth should keep global commodity demand quite firm, investment speculation should be reduced by higher interest rates.

Flat USD and Mildly Rising G-3 Bond Yields

Given our scenario, we expect G-3 bond yields to continue rising gradually in the next few quarters. For U.S. 10Y Treasuries, our target for end-December is 3.00%, while those for 10Y JGBs and German Bunds are 0.15% and 0.45%, respectively. In March, we expect 3.05%, 0.15% and 0.50%, respectively. This implies (coupled with our forex targets) that including coupon income, the Citigroup WGBI (index of global bonds) should produce a 0.4% unannualized return from our base date of 14 September through December in USD terms, and 0.2% through March 2019. Thus, **we continue to maintain an unenthusiastic stance on global bonds** for USD-based investors. For Yen-based investors, the WGBI index in Yen terms should be -0.5% and -0.7%, respectively, and as for JGBs, we target the 10Y to have a -0.3% total unannualized return in Yen terms through December and also through March 2019.

Regarding forex, although Fed policy will tighten faster than the BOJ and ECB, global worries about U.S. budget and trade deficits, coupled with an uncertain U.S. political situation, should restrain USD enthusiasm, so we expect the Yen and Euro to be basically flat through September 2019, with the Yen at 111:USD from end-December onward. Meanwhile, our call for the AUD:USD is for 0.71 at end-December and 0.70 onward.

Still Positive on Global Equities

Our new scenario continues to be bullish on equities (as it has for virtually the entire period since the Global Financial Crisis), as economic growth should propel earnings growth, while mildly rising interest rates should not curtail valuations much. Aggregating our national forecasts from our base date of 14 September, we forecast that the **MSCI World Total Return Index will increase 5.7% (unannualized) through December in USD terms and 6.3% through March 2019. Clearly, this suggests a positive stance on global equities for USD-based investors (and Yen-based investors, as well).**

In the U.S., strong global economic growth and tax cuts, coupled with deregulation and accelerated share buybacks should easily offset the headwinds from mildly higher interest rates and political uncertainty, so the equity backdrop is quite strong, especially as the SPX CY18 EPS estimate has risen by another 2% since our June meeting and the PER based on 12-month forward EPS is at a fairly reasonable 16.8 times. Given all of this, we expect the SPX to hit 3075 (6.4% total unannualized return from our base date) at end-December, then correct to 2053 in March (6.4% return), clearly very high returns on an annualized basis.

European equities have been quite disappointing for the last two quarters, especially in USD terms. Some European macro economic data, especially exports, are still showing signs of deceleration, but GDP should be reasonably solid going forward, especially by mature-country standards. Political risk continues to haunt the markets, as does the credit quality for major parts of the region's banking system. Fears of ECB tapering and global trade disputes are also harming sentiment. Continued low interest rates and strong earnings growth from global economic growth, however, should help its equity market rebound. Notably, mildly rising commodity prices, to which UK and European corporations are highly geared via multinational companies, should also boost corporate earnings. Furthermore, the European PER on next-12-months EPS is quite reasonable at 13.6 and will likely rise somewhat, so we see the Euro Stoxx index rising to 388 and the FTSE to 7550 at end-December, and to 395 and 7700 through March, which translates to 4.2% and 6.9% unannualized MSCI Europe returns in USD terms for those periods. On the political front, fears of an Italian crisis have greatly decreased in recent days, but this issue and BREXIT will likely remain headwinds to sentiment.

Japanese equities have also disappointed, falling significantly in USD terms during the reporting period (although they have rallied since then) despite a good 2Q EPS performance, very low valuations and EPS growth still looking positive ahead. Global trade disputes likely have played a key factor in reducing investor sentiment regarding the country, but its domestic economy is strong and companies have high operational gearing to continued global economic growth. Meanwhile corporate governance continues to improve (despite a few hiccups), so we expect TOPIX at end-December to be 1773 with 1811 through March for total returns of 4.1% and 6.8% in USD terms, respectively (and about 1% less in Yen terms, but clearly still high). The very low equity valuation, at 12.9 times next 12-month EPS, is also factor in our positive outlook. The one question mark is how volatile economic sentiment will be in the lead up to the proposed VAT hike in October 2019.

As for the Developed Pacific-ex Japan MSCI, it too has been very disappointing due to trade fears, but we expect Hong Kong and Australian equities to perform well ahead, leading to a 3.5% unannualized return in USD terms through December and 6.5% through March. Strong global growth, reasonable equity valuations, decent earnings growth and continued low global interest rates all play major roles in these expected returns. Once again, the major risk is trade disputes, particularly between the U.S. and China, but that risk is greatly priced into the markets by now. Key also, particularly for Asian markets, is how the North Korean denuclearization effort proceeds.

Investment Strategy Concluding View

There is no doubt that geopolitical tail risks remain quite large, but the Global Investment Committee remains upbeat because the net impulses for global economic growth and corporate profits continue to improve. Thus, similar to our meetings of the last many years, this justifies a **positive stance on global equities, with expectations for the US market being the highest through year-end**. Meanwhile, global bond yields should rise somewhat, so we **maintain an unenthusiastic stance on global bond returns**, especially compared to US short term fixed income rates.

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