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2019 Outlook: 5 Key Themes for Plan Sponsors

What are the trends to watch over the coming year and how can sponsors prepare?

The past year saw sharp turns toward market uncertainty and volatility as investors grappled with questions about global growth, protectionism, interest rates and profit potential. Looking ahead, the heads of our investment platforms—Joseph Amato, President and CIO – Equities; Erik Knutzen, CIO – Multi-Asset Class; Brad Tank, CIO – Fixed Income; and Anthony Tutrone, Global Head of Alternatives—have identified the key themes they anticipate will guide investment decisions in 2019.

Listed below are those themes with particular implications for plan sponsors. We hope they prove useful as you look ahead to 2019.

1 A Soft Landing for the U.S., and the Wider World

We believe that U.S. GDP growth will slow from 3.5% to around 2.0–2.5% in 2019, and that some of the tail risks associated with the U.S.–China trade dispute will dissipate. In our view, U.S. wages will continue to rise, squeezing corporate earnings, but the inflationary effect will be partly offset by lower commodity prices. This could help to dampen the past year's dollar rally and ease liquidity conditions worldwide, supporting a re-convergence of the rest of the world's growth rates with those of the U.S.

Implications for Plan Sponsors: A slowing U.S. economy may lead to heightened volatility and tighter asset correlations. As you review your plan lineups for 2019, ensure that your menu offerings—from the core plan menu to the underlying investments in your target date funds—provide the diversification and volatility mitigation options that retirement plan participants need. Consider adding alternative investments, reducing U.S. bias, diversifying fixed income solutions and introducing personalized asset allocation products for near-retirees and retirees.

2 Credit Drivers Begin to Change (Again)

Last year, we forecasted that continued low default rates would lead to credit spreads being impacted less by fundamentals and more by technical developments; and that was the case until October and November of 2018. At that point, we saw the market become more discerning with respect to both sector and individual issuer creditworthiness, and we expect that to be a key theme throughout 2019 as U.S. growth slows. We see particular opportunity in medium-quality credits in the short and intermediate parts of the curve.

Implications for Plan Sponsors: A flexible multi-sector fixed income investment option that has access to an expansive fixed income universe without limitations in terms of sector, quality, currency or geography puts the responsibility for opportunistic allocations in a changing environment on a portfolio manager rather than the plan participant. Because of this expanded opportunity set, multi-sector funds may also offer more income potential than a core or core-plus fund, and can be an attractive option to offer participants at or near retirement in your plan's "retirement tier"—or the portion of your plan menu that may be appropriate for participants planning to remain in the plan after retiring.

3 U.S. Equity Returns Will Be Determined Primarily by Multiple Expansion

If U.S. equities in 2018 were about strong earnings growth balanced with shrinking valuation multiples, we think that 2019 will flip that around. As the current market cycle matures, the range of possibilities widens, but the base case is for top lines to be under pressure from slowing U.S. growth while margins are squeezed by wage inflation, offset by some multiple expansion from what is now a modest base. The result, positive or negative, will be determined primarily by changes in valuation multiples: we think mid-single-digit total returns are possible for appropriately cautious portfolios.

Implications for Plan Sponsors: Even in the unique market environment of the past 10 years, active management has added value versus passive management in certain less-efficient asset classes, such as small-cap equities, fixed income and international and ESG investments. We expect research-based stock picking to become even more important as U.S. growth slows, and should be a key consideration in selecting investments that may help participants effectively grow and protect their savings, even in today's increasingly fee-sensitive environment.

4 The Real Value Will Be ex-U.S., Especially in Emerging Markets

Late-cycle dynamics with moderate multiples could help the U.S. perform better than expected, but even lower multiples and mid-cycle dynamics in Europe, China and the emerging world arguably make them a more certain source of value. Given our views on heightened political and policy risk in Europe, we think emerging markets are the most attractive place to be if you are not forecasting a major global slowdown for 2019.

Implications for Plan Sponsors: Consider your participant demographics. If the participants using your core menu are generally more knowledgeable about investments, or tend to rely on outside advisors for asset allocation expertise, then a standalone emerging markets option might make sense. Defined contribution investors are typically under-allocated to emerging markets. A standalone emerging markets investment option may help their retirement portfolios become more diversified and could provide more opportunity for portfolio growth in 2019.

5 A Recovery Beyond U.S. Shores

We expected the U.S. to diverge from the rest of the world in 2018, but were perhaps surprised at how early, how severe and how long-lasting that divergence has been. As the U.S.–China trade dispute cools and China's fiscal stimulus takes hold, however, we believe the signs of recovery we already see in Japan, Europe and the emerging world will grow and enable some re-convergence, confirming our view that these economies are still mid-cycle, relative to the late-cycle position of the U.S.

Implications for Plan Sponsors: Plan sponsors who aren't currently offering a standalone emerging markets option may want to consider adding flexible, all-cap approaches to international investing that include allocations to emerging markets via a single manager who employs an opportunistic approach or through a multi-manager white label structure. This structure allows participants to "set and forget" their international exposure without having to worry about concentration risk in emerging markets, because the portfolio manager will take care of making the difficult asset allocation decisions for them.

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