

SOLVING FOR 2019

CONFERENCE SUMMARY



JOSEPH V. AMATO
PRESIDENT AND CIO—EQUITIES

KEY POINTS

- Synchronized growth has given way to synchronized slowdown
- Can the U.S. achieve a soft landing, and can China's stimulus gain traction?
- Subdued inflation is giving central banks much needed flexibility
- Corporate earnings can grow modestly—as long as the soft landing is achieved
- Political risk remains high, especially around U.S. – China trade

THE YEAR AHEAD: OUTLOOK AND CHALLENGES

“What we are seeing, globally, is a late-cycle slowdown.”

The synchronized global economic growth of 2017 turned into a synchronized slowdown during 2018, Joe observed. One by one, asset markets followed. Europe, Japan and the emerging markets suffered poor performance in the first half of the year, but the U.S. gave up much of its outperformance in a violent sell-off in the fourth quarter. In late September, investors were still worrying about the U.S. overheating and the Fed tightening too quickly. Just 10 weeks later, markets were pricing in rate cuts and signaling that the economy might fall off a cliff. By year-end, 2018 saw the most asset classes with negative real returns for decades, indicating higher correlations as well as poor performance.

Against that background, Joe asked: Will the economy achieve a soft landing? Will central banks make or break 2019? Will corporate earnings grow? Is corporate leverage too high? And will politicians mess things up?

Our central view is that the U.S. can achieve a soft landing. Joe surveyed a range of traditional forward indicators of recession and found very few warning of either an overheating or a stuttering economy. Among the causes of past recessions, he argued that the only one that looks like a current risk is the presence of financial imbalances and the threat of a bursting credit bubble. However, he cautioned that the most worrisome credit bubble is currently to be found in one of the world's most important economies: China. While our view is that, ultimately, China has the means to stimulate its economy without exacerbating this problem, it remains the most substantial risk to our soft-landing scenario.

When it comes to central banks, Joe acknowledged that the shift from quantitative easing to quantitative tightening is affecting market liquidity, but overall he observed that the recent slackening in inflation worldwide was giving policymakers more flexibility in their efforts to avoid over-tightening and inverting yield curves. The marked slowdown in euro zone PMI data suggests that the ECB might have missed an opportunity to make a start on policy normalization during 2017, however.

Joe noted that current analysts' expectations were for 8% growth in S&P 500 earnings this year, and while he anticipates realized growth to be slightly lower than that as margins are

squeezed by slower nominal growth and rising wages, he does not regard them as overly vulnerable outside the technology sector. Ultimately, however, these views depend upon the central soft-landing scenario coming to pass: in the event of a more serious slowdown, earnings could contract and equities could sell off to reflect that.

Turning to the topic of leverage, Joe observed that government debt had climbed by 73% and corporate debt by 62% since 2008. Asking whether this might be the catalyst for a turn in the current cycle, he noted that, while gross leverage among investment grade borrowers is as high as it was before the two previous recessions, net leverage remains lower given the amount of cash that companies have on their balance sheets. Among high yield borrowers, issuance has moved from bonds to loans, and in doing so, a lot of the covenant protection normally associated with loans has deteriorated or disappeared altogether. Set against this worrisome trend, however, Joe noted that there was little immediate risk from borrowers having to refinance a large wall of maturities.

Joe wrapped up by addressing some of the political risks stalking markets. He acknowledged that the rising proportion of the populations in the developed world who feel disenfranchised by globalization and by technological disruption is a deep challenge that we will all face for the foreseeable future. The most immediate risk, however, comes from the U.S. – China trade dispute. Joe argued that, while the “transactional question”—what China will buy from the U.S. to help balance the trade deficit—is easy enough to resolve, the “transformational” change on questions such as protection for intellectual property and subsidies for industry, while a reasonable requirement, will be far more difficult.

This document is addressed to professional clients only.

This document is a financial promotion and is issued by Neuberger Berman Europe Limited, which is authorised and regulated by the Financial Conduct Authority and is registered in England and Wales at Lansdowne House, 57 Berkeley Square, London, W1J 6ER, and is also a Registered Investment Adviser with the Securities and Exchange Commission in the U.S. and regulated by the Dubai Financial Services Authority.

This document is presented solely for information purposes and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. We do not represent that this information, including any third party information, is complete and it should not be relied upon as such. No recommendation or advice is being given as to whether any investment or strategy is suitable for a particular investor. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of any investment, and should consult its own legal counsel and financial, actuarial, accounting, regulatory and tax advisers to evaluate any such investment. It should not be assumed that any investments in securities, companies, sectors or markets identified and described were or will be profitable. Any views or opinions expressed may not reflect those of the firm as a whole. All information is current as of the date of this material and is subject to change without notice. The product described in this document may only be offered for sale or sold in jurisdictions in which or to persons to which such an offer or sale is permitted. The product can only be promoted if such promotion is made in compliance with the applicable jurisdictional rules and regulations. Indices are unmanaged and not available for direct investment. An investment in this product involves risks, with the potential for above-average risk, and is only suitable for people who are in a position to take such risks. **Past performance is not a reliable indicator of current or future results.** The value of investments may go down as well as up and investors may not get back any of the amount invested. The performance data does not take account of the commissions and costs incurred on the issue and redemption of units. The value of investments designated in another currency may rise and fall due to exchange rate fluctuations in respect of the relevant currencies. Adverse movements in currency exchange rates can result in a decrease in return and a loss of capital. Tax treatment depends on the individual circumstances of each investor and may be subject to change, investors are therefore recommended to seek independent tax advice. Investment in this strategy should not constitute a substantial proportion of an investor's portfolio and may not be appropriate for all investors. Diversification and asset class allocation do not guarantee profit or protect against loss. No part of this document may be reproduced in any manner without prior written permission of Neuberger Berman Europe Limited. The “Neuberger Berman” name and logo are registered service marks of Neuberger Berman Group LLC.

NEUBERGER	BERMAN
-----------	--------

Neuberger Berman
Lansdowne House
57 Berkeley Square
London W1J 6ER
United Kingdom

www.nb.com