



2020: Poised for a rebound?

The global economy struggled in 2019. Trade wars were the primary focus of markets, but other factors also were at play. Waning benefits from U.S. fiscal stimulus, elevated inventory levels, Brexit chaos, a stronger U.S. dollar and the lagged effects of tighter monetary policy in places like the U.S. and China coalesced to weaken the pace of global growth. We believe some of those headwinds are reversing and could provide some lift to global growth in 2020. Overall, we expect global gross domestic product (GDP) growth to average 3.4% in 2020, a slight uptick from 2019's estimated 3.0% growth rate.

Investor confidence remained consistent throughout the year with most equities posting double-digit returns. This confidence has not only sustained the record-long bull market — now in its 11th year — but also created the best performing run in history.

IVY VIEW

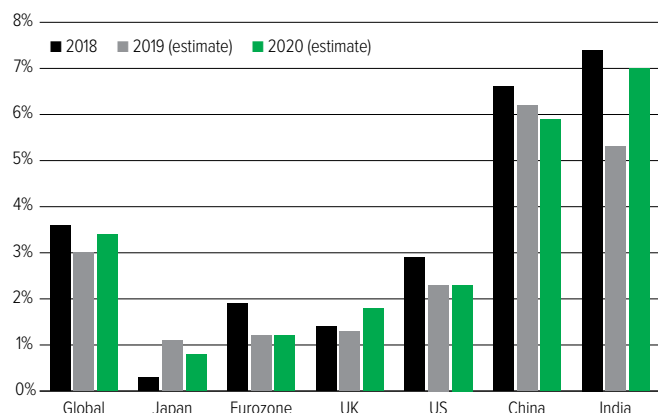


U.S. economy maintains moderate growth

The U.S. economy slowed in 2019 to an estimated 2.3%, down from 2.9% in 2018. Interest rate hikes and a shrinking balance sheet from the U.S. Federal Reserve (Fed) coupled with the diminished fiscal benefits from the 2017 tax cuts would have been enough to slow the expansion. However, President Donald Trump's

escalation of the trade war with China and tariff threats toward other major trading partners — including the European Union (EU), Canada, Mexico and Japan — further pressured the economy. Our view for some time has been that trade poses the biggest threat to both U.S. and global growth. We anticipate Trump wants to claim victory on trade to strengthen his 2020 re-election bid. The phased agreement announced in December may give him that opportunity. The deal, which still needs to go through the legal process, appears to include some tariff relief and commitments from China to purchase agricultural products.

GLOBAL GDP GROWTH MAY LIFT IN 2020



Source: Ivy Investments. Chart shows 2019, 2020 forecasts of annual gross domestic product (GDP) growth, all based on purchasing power parity. Past performance is not a guarantee of future results. The GDP growth forecasts are current through December 2019, and are subject change at any time based on market and other conditions. No forecasts can be guaranteed.

We forecast U.S. GDP growth will be unchanged in 2020 and average 2.3%. However, this masks the underlying trend in the economy. Economic growth weakened throughout 2019 because of trade uncertainty, which further hampered business confidence and caused companies to pull back on capital expenditures. The CEO Economic Outlook Index, a composite of CEO expectations for capital spending, hiring and sales over the next six months, showed declines in all three measures through fourth-quarter 2019. It marked the seventh straight quarter in which the chief executives of the nation's biggest companies downgraded their view of the U.S. economy.

The view from Main Street businesses is somewhat more upbeat. The Small Business Optimism Index rose in November, marking its biggest month-to-month gain since May 2018, according to the National Federation of Independent Business. Seven of the index's 10 components improved and small business owners said they added jobs at the highest level since the spring.

In addition, consumer spending — the key driver of the U.S. economy — continued to grow at a reasonable pace throughout 2019 and housing activity ticked up in the latter part of the year. We expect the cadence of growth to improve through much of 2020 on better business investment and housing activity and believe growth in consumer spending will continue at a solid pace.

IVY VIEW



The Fed will hold the line on rates in 2020

Uncertainty around trade and the weakening of the global economy pressured the Fed to reverse its policy during 2019. After projecting two rate hikes at the start of the year, the Fed cut interest rates three times in 2019 and bringing the federal funds rate target range to 1.50-1.75%. We believe this reversal could further boost the housing market. In addition, the tightness in short-term lending markets caused the Fed to allow its balance sheet to grow again, which should remove the stealth tightening that was taking place by leaving the balance sheet unchanged.

Overall, we expect the Fed to leave rates unchanged throughout 2020. Fed Chairman Jerome Powell has indicated the U.S. central bank will raise interest rates only when inflation moves higher in a “significant” and “persistent” manner. If the Fed does decide to make a change, we believe a rate cut is more likely than a rate hike as inflation is likely to remain relatively muted.

IVY VIEW



Global trade continues to pressure China and eurozone

China's economy weakened throughout much of 2019 as policymakers attempted to find the right balance between reducing the pace of debt accumulation and preventing much weaker economic growth. The pace of credit growth continued to be lackluster, putting pressure on the domestic economy. At the same time, the Chinese government cut taxes further.

We believe that 2020 will bring more of the same and some additional stimulus will follow. As the benefits from prior tax cuts fade, China's consumer spending is likely to come under pressure. Investment growth has been weak, especially for infrastructure and manufacturing. Housing investment has held up well, but we think it could come under pressure in 2020. We do expect some improvement in credit growth as the flow of credit remains insufficient to sustain an acceptable

pace of economic growth. This credit is likely to be funneled into stimulating infrastructure projects, as we believe stimulus via further significant tax cuts will be difficult.

CHINA'S INFRASTRUCTURE SPENDING AND SHADOW BANK LENDING ON THE RISE

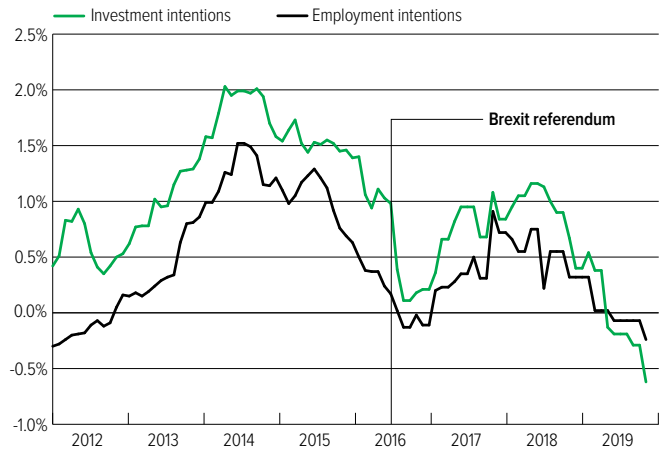


Source: Ivy Investments analysis of the correlation between China infrastructure spending and shadow bank lending. Data show % change year to year for infrastructure spending, 1-year moving average of the monthly flow of shadow bank credit.

We think a pause in the trade spat between the U.S. and China is likely to boost domestic Chinese manufacturing. We believe China's leadership would welcome that boost because further weakness could bring a problematic rise in unemployment. Overall, we expect Chinese GDP growth to stabilize around 6% in 2020, slightly below 2019's growth rate.

External risks contributed to weakness in other economies for the year. **The eurozone is an open economy**, so swings in global trade have an outsized impact relative to other economies. The uncertainty about the future of global trade created a significant slowing in the eurozone, especially in Germany. In addition, uncertainty about the U.K.'s potential exit from the EU triggered a further reduction in business confidence. The European Central Bank (ECB) announced additional easing in September, pushing interest rates further into negative territory and introducing another round of quantitative easing via bond purchases. While we believe average GDP growth in 2020 will be similar to the estimated 1.2% average in 2019, we expect the pace of eurozone growth to improve throughout 2020 on the back of a better global economy and reduced risks around trade and Brexit.

U.K. BUSINESS SENTIMENT FALLS AS BREXIT DRAGS ON



Source: Ivy Investments analysis of the correlation between U.K. business investment and employment surveys. Data show % change year to year of capital spending hiring intentions.

Delays related to the expected Brexit conclusion hindered U.K. growth through much of 2019. Confidence suffered from the inability of the U.K. Parliament to rule out a hard Brexit, in which the U.K. would leave the EU without any agreement, and that kept recession fears at the forefront. Those risks were amplified in July when Boris Johnson took control of the Conservative Party and was named prime minister. Johnson struck a deal with the EU on Brexit and, while Parliament was amenable to that deal, it would not agree to the timetable Johnson demanded. This led Johnson to call for early elections in an attempt to garner a Parliamentary majority and ultimately gain approval of the Brexit deal.

We think the fact that a staunch Brexit supporter like Johnson is seeking a deal with the EU indicates the risk of a hard Brexit may be off the table for the U.K.



Reforms taking hold in emerging markets

Emerging markets felt the effects of weak global trade in 2019, which led to disappointing economic growth overall. Turkey and Argentina had major recessions because of what we believe were self-induced problems. We think most emerging market economies could improve as global demand strengthens, the U.S. dollar potentially weakens and lower interest rates feed through the system.

India's economy struggled in 2019, due in part to declining credit. A funding crisis among several non-bank financial companies — a key source of funding for India's economy — triggered a significant slowdown in the country's GDP growth. The Reserve Bank of India slashed interest rates and the government announced a reduction in the corporate tax rate, among other measures. We believe economic growth will find a bottom in early 2020 as the Indian government continues to stimulate the economy.

Policymakers in Brazil took steps in 2019 to help the economy continue to recover. This included critical pension reform, which could help stabilize government debt, as well as more accommodative policy from the central bank, which cut interest rates to a record low 5%. Brazil's government would like to push forward additional reforms in 2020, including tax reform and changes to fiscal spending rules.



Wildcards to watch

Fears of a global recession were heightened at mid-2019 after the U.S. Treasury yield curve inverted, leaving long-term rates below short term. We do not think a recession is likely in 2020. Our biggest fear continues to be related to trade. If the trade agreement between U.S. and China breaks down at some point, our confidence in a continuation of economic growth will fall and recession risks would likely rise.

We also have concerns related to 2020 U.S. presidential election. The Trump administration's policies have been decidedly pro-business, including deregulation and tax cuts. If an anti-business nominee emerges from the U.S. Democrat Party and demonstrates a strong chance to become president, we believe companies could again begin to reduce spending, which could lead to another economic slowdown.

Finally, there are geopolitical hotspots around the world that have potential impacts on the global economy. If Iran continues to be a disruptive force on Middle East oil production and shipment, a spike in energy prices could be damaging, given already weak global demand. In addition, the global rise in the popularity of parties espousing nationalism could further escalate tensions between countries.

Market and sector view

Despite the prevailing headwinds of lingering trade turmoil and slowing global growth, strong underlying fundamentals and a “Goldilocks” economy that is not too hot/not too cold have combined to support overall investor confidence. This confidence has not only sustained the record-long bull market – now in its 11th year – but also created the best performing run in history. The S&P 500 Index has returned nearly 475% since March 2009, surpassing the long boom of the 1990s.

Perhaps the best word to describe the performance of **equities** in 2019 is resilient. In a year marked by unrelenting volatility and a tentative rotation in market leadership from growth to value in September, equity markets delivered strong returns across the board.

In domestic equities, large-cap stocks bested small caps and growth outperformed value for the year. Sector performance overall was cyclical in nature, with information technology and industrials continuing to be key catalysts for market gains. Tech giants Facebook, Amazon and Alphabet faced greater scrutiny from consumers and lawmakers alike for much of the year, but these mega-cap companies were supported by solid business models and superior brand loyalty to again deliver strong returns. We believe the underlying reason these companies have been successful is because they create products and services people demand. While the noise may increase, we believe the long-term secular opportunities created by these companies continue to be attractive.

The information technology sector led 2019’s resurgence in equities and we believe the backdrop for the broader tech space sets up well going into 2020. We think a wave of powerful trends is likely to provide a tailwind for the sector: 5G, artificial intelligence, machine learning, financial technology, data centers, cloud storage and the “internet of things” are all likely to play a significant role. Some of these growth drivers have been boosting tech for years, while others are just starting. In our view, there is significant opportunity from these trends, especially within software and semiconductors.

Sectors like materials and transportation dealt with multiple headwinds during 2019, including the cost of tariffs, higher production prices and supply chain breakdowns. We believe many companies and industries would likely benefit from an easing of the trade tensions with China and think there are likely to be opportunities within these sectors in 2020.

Certain health care industries with exposure to research and manufacturing in China, particularly pharmaceutical and biotechnology companies also have been impacted by the trade war. We believe health care could face additional challenges in 2020 if the focus on drug pricing and access to care become platform issues in the upcoming presidential election.

Consumer discretionary companies were negatively impacted when the Trump administration announced in September it would impose 15% tariffs on consumer goods in two phases. In addition, investor concerns about China’s weakening economy and growing anti-U.S. sentiment among Chinese consumers hampered the performance of some consumer goods, particularly luxury goods. Overall, we think performance in the consumer discretionary sector could be muted through early 2020 as “on again, off again” trade negotiations drag on.

Other sectors were less impacted in 2019 by the trade tumult, especially areas offering the perceived comfort of near-term safety and long-term stability.

- Industrials persevered through the initial salvos of tariffs and improved performance throughout 2019.
- Real estate and financials were buoyed by the wave of monetary easing among global central banks. Investors tend to see real estate as a relative “safe haven” in today’s environment because of persistently low interest rates, continued favorable operating conditions and dependable cash flows.
- Financials, which had lagged in performance during the year, ultimately delivered strong returns as concerns about the mid-year yield curve inversion appeared to have dissipated.

In addition, we think the aerospace sector appears well positioned for growth in 2020 as the pace of global travel is expected to double over the next couple of years. We think an abundance of oil supply and the growing adoption of green sustainability technology among companies and countries will likely keep prices in the energy sector stable in 2020. However, downstream benefactors for raw petroleum materials, such as coatings industry, view the supply issue as a tailwind and could see positive trajectory in 2020.

International equities also performed well in 2019, with both developed and emerging markets poised to deliver double-digit growth for the year. Europe's economy and business activity thrives off global trade. As signs point to a bottoming in industrial production and a trade war resolution, the eurozone could be a key beneficiary. Businesses could have confidence to deploy capital and we think there may be a recovery from a slowdown in big-ticket purchases by Chinese consumers. This could provide a growth tailwind to the eurozone's core industries, including machinery and autos. In addition, continued strides toward a Brexit resolution could help the U.K. to further regain its footing.

A growing consumer population with increasing wealth across many emerging countries, improving economic and corporate fundamentals and an explosion of new industries offer potential investment in a wide range of tech companies, particularly those involved in mobile technology, memory chips, semiconductors and mobile payment platforms.

Because the underlying structural factors driving emerging market growth remain solid, we believe the valuation gap between companies in emerging markets and the U.S. is likely to narrow in 2020. Emerging market valuations were at a discount to the U.S. as 2019 came to a close. But valuation alone will not support price appreciation in emerging market equity. We also expect earnings-per-share growth to reaccelerate. Earnings growth in emerging markets trailed the U.S. over the past two years, but there are market expectations for it to regain a higher rate of growth in 2020.

Our view on **fixed income markets** continues to trend toward higher quality U.S. Treasuries and investment grade credits. We believe credit spreads could widen again in 2020, especially in the investment grade corporate bond market where fundamentals remain stretched with corporate balance sheets at their most levered levels since the financial crisis. Additionally, duration in the investment grade marketplace continues to rise, which could lead to higher price volatility for a given change in spreads.

We think the technical factors look favorable as net supply in 2020 is likely to be lower than 2019 because of lower merger and acquisition volume and tax law changes, reducing the incentive to issue debt. However, we expect a higher amount of total fixed income issuance principally to fund the U.S. deficit. On the demand side, we see spreads modestly supported by inflows into mutual funds, as well as foreign investors searching for additional yield.

Being that we are entering the 12th year of this credit cycle we are cautiously optimistic on the positive technical backdrop of the market. We are constantly monitoring the various sub-sectors that have a higher risk profile looking potential weakness that could impact overall total returns. As active managers we will continue to focus on the long-term durability of the business model with the emphasis on healthy and improving fundamentals.

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