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Rocky 2020s, but Rock-Solid Returns

"With this foresight, only investors with a very optimistic mindset would – at the start of the 2020s – have predicted rock-solid equity market returns for the first half of the decade."

As we approach halfway through the decade of the 2020s, "rocky" seems like a suitable term when reflecting on the past five years. It has been a turbulent period with many crosscurrents and unprecedented events.

Looking back, we have experienced:

- A transition from a unipolar to a multipolar world. With China's global aspirations and the increased domestic focus in the US, the US is gradually losing its position as the dominant global superpower.
- Geopolitical upheaval and two major ongoing wars in the Western world.
- A global Covid-19 pandemic causing a historical global lockdown.
- A climate crisis with trillions of dollars needed for investments in an urgent energy transition that is struggling due to the high costs of new and greener technologies.
- An end to central banks' zero-interest-rate policy.

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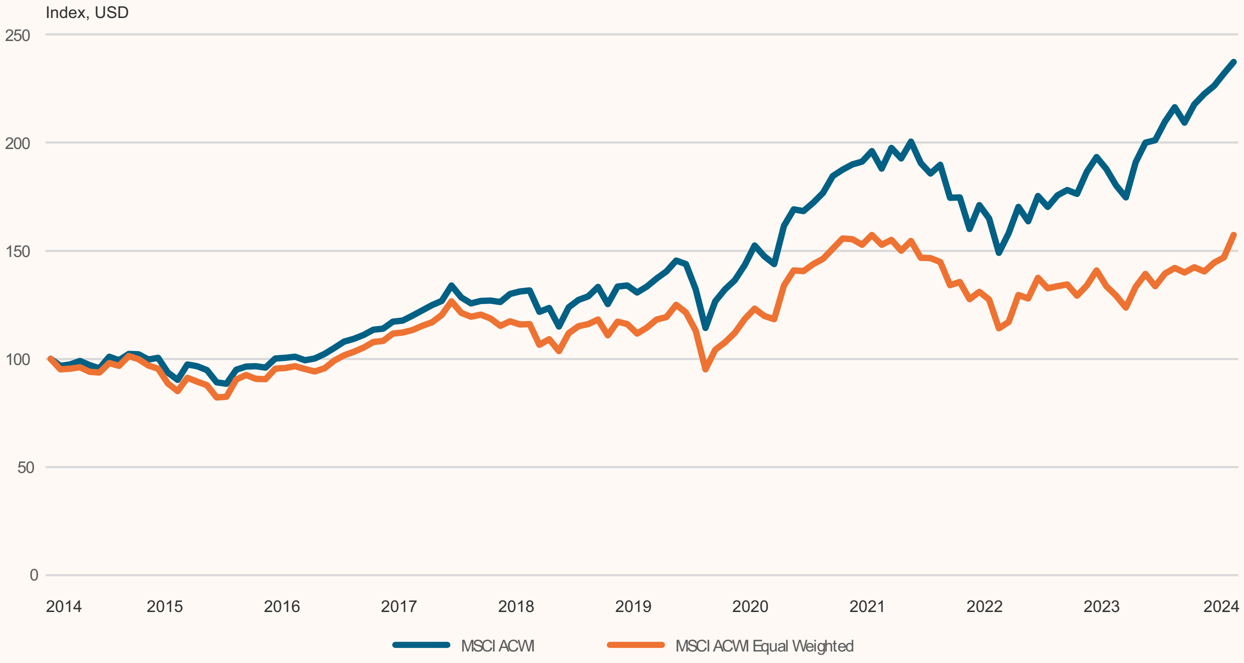
Figure 1

Returns led by the large companies



Source: Bloomberg, September 2024 (Net Total Return, 10-year monthly data).

- A historically swift monetary tightening, especially in the US, as a reaction to the inflation scare. The tightening changed the investment environment from a prolonged period of real interest rates oscillating around 0% to 10Y real rates trading above 2%. Higher real interest rates typically act as a valuation drag on long-duration assets like equities.

With this foresight, only investors with a very optimistic mindset would – at the start of the 2020s – have predicted rock-solid equity market returns for the first half of the decade. At the end of Q3, global equity markets have compounded an impressive above-average annual return of 11%. In the table below, we show the stock market calendar returns, with 4 out of 5 years exhibiting positive returns.

“At the end of Q3, global equity markets have compounded an impressive above-average annual return of 11%.”

However, as we have written before, among others in the article “AI to The Rescue” from Q32023, it has been a market of two tales – with the US market outperforming Eu-

Table 1

Positive returns in 4 out of 5 calendar year

Year	2020	2021	2022	2023	2024
Return (MSCI AC World) (USD)	16%	19%	-18%	22%	19%

Source: MSCI, October 2024.

rope and Asia, and technology-driven by AI outperforming significantly. It has been a market dominated by the few, as illustrated in Figure 1, which shows the equal-weighted market index underperforming the normal market capitalisation-weighted index by a wide margin.

Better environment ahead

Looking ahead, it is hard to imagine a worse environment for equities, perhaps barring a severe and deep recession in the US. This is a scenario we don't expect, although we have been worried about the well-known lags in the transmission of monetary policy into the real economy. However, with the yield curve again turning positive (spread between 2Y and 10Y T-bills), rates and, importantly mortgage rates coming down, the supportive wealth effects of the strong equity market and a continued high level of employment with decent growth in real disposable income, the all-important US consumer seems to be in a position to avoid a recession.

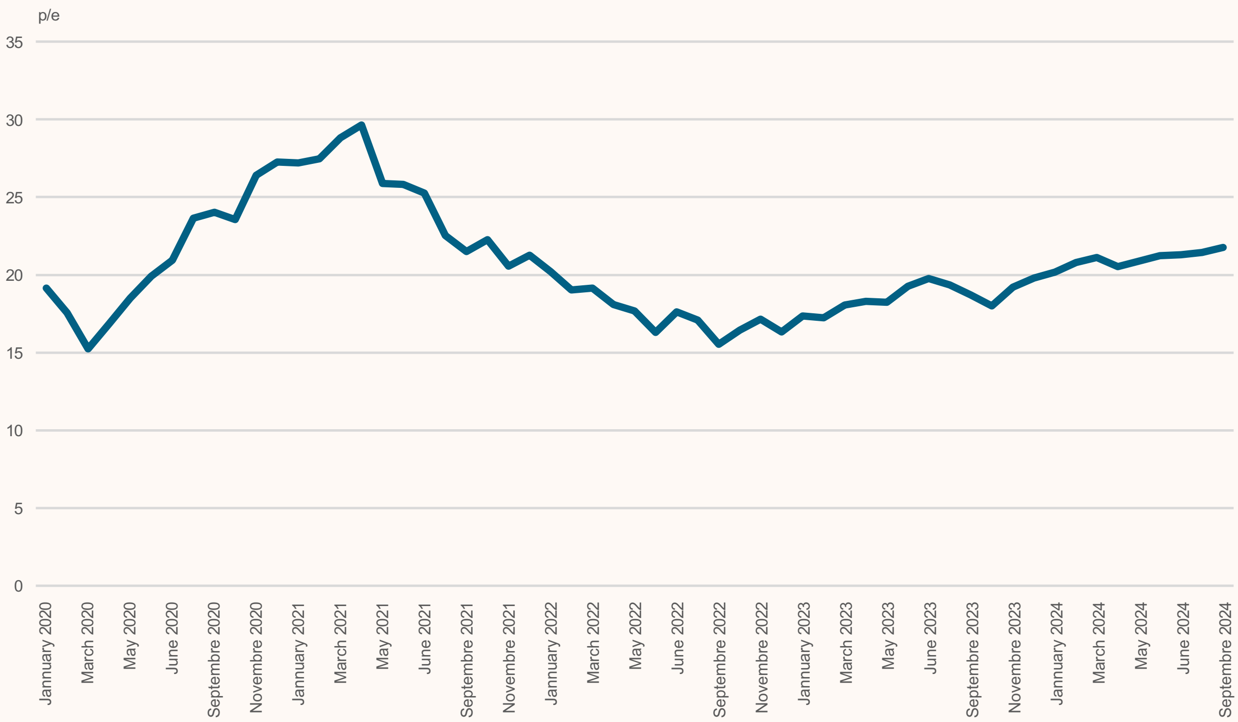
One caveat, though, the valuation of equities has risen over the past five years, even in an environment of rising interest rates. Figure 2 shows the valuation of the global stock market, which has risen from a P/E of approx. 19x to 21x measured on 12-month trailing earnings. However, looking forward, the valuation on 12-month forward estimates is more moderate at approx. 18x.

Given the outlook of looser monetary policy globally, valuation levels shouldn't be an immediate concern with the expectation of long-term growth in corporate earnings.

Revival of China?

Chinese equities staged a remarkable rally in the last week of Q3 as the Chinese authorities rolled out a range of measures to support the consumer, property and equity markets. Chinese equities have been dramatically out of favour, with some investors even labelling the market as non-investable. This made the market ripe for a strong

Figure 2
Valuation of the global stock market (MSCI AC World)



Source: MSCI, October 2024.

rebound upon positive news. The announced package won't solve China's depressed property market and sluggish consumer confidence right away, but it does mean that China is set to adopt a more reflationary policy stance.

The comeback of predictable growth

Stable growth companies have lagged the market significantly since 2020, with the MSCI Minimum Volatility Index returning just shy of a 6% compounded annual return. These companies generally have delivered steady earnings growth, but rising interest rates have depressed valuation. At the start of 2020, the stable growth companies (measured by the MSCI Minimum Volatility Index) were trading at a P/E premium to the MSCI AC World Index of 18%. Today, they are trading at an 18% discount. As growth becomes scarcer in a slower growth environment, stable and predictable growth becomes more valuable and lower rates should become a tailwind to valuation.

Strong themes

We are convinced that AI will change and improve the world with strong growth, especially around AI infrastructure and semiconductor equipment for chip production. Also, investments in the energy transition are a necessity and supply chain repatriation will continue driving the need for advanced manufacturing. Stocks within these themes should continue to benefit from long-term structural growth.

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"From a portfolio perspective, few investments in our global strategies have direct exposure to the outcome of the US election."

Upcoming US election

Much media focus is on the upcoming US election, with polls adding to the drama with a prediction of an extremely tight election. Furthermore, the choice of the American people sets the stage for two very different directions, with domestic policies split on immigration and taxes, while foreign policy diverts on the US's role as a global superpower, tariffs, commitment to the green agenda, and the handling of urgent geopolitical issues, including the war in Ukraine.

From a portfolio perspective, few investments in our global strategies have direct exposure to the outcome of the US election. Investments in the semiconductor food chain, like Taiwanese TSMC, could be exposed to renewed geopolitical upheaval between China and the US, and luxury goods companies like LVMH could be exposed if the war on tariffs escalates.

"Stay calm – stay invested"

In conclusion, we think the overall environment for equities looking into the second half of the 2020s will not be more turbulent than the first half of the decade, yielding rock-solid returns. Furthermore, the headwind of tighter monetary policy is reversing. Although we may not get a repeat of the above historical market returns, a solid outlook is nevertheless appreciable. Higher interest rates have pressured quality and stable growth companies over the past couple of years, but this trend could be ending. With a constructive long-term equity market outlook, we revert to the saying, "Stay calm – stay invested".

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