Summary: Global Investment Forum

Five-Year Outlook

2018-2023

BMO Global Asset Management's annual Global Investment Forum captures the views of a group of BMO's international investment leaders and strategists stimulated by the input of independent experts. Out of this discussion we try to anticipate how a realistic set of events could unfold over the next five years, and also consider some of the possible extreme outcomes of these scenarios.

We can face the future with increased confidence, knowing that we have anticipated what might be on (or over) the horizon and the associated opportunities and risks. This year we have identified the following three potential scenarios:

1. **Steady as she goes**
   High conviction scenario with a 60% probability
2. **Policymakers pull the punchbowl**
   Downside surprise scenario with a 30% probability
3. **Perfect policy prevails**
   Upside surprise scenario with a 10% probability

60%
probability

Steady as she goes

This year our base case scenario anticipates that the global economy continues to enjoy steady growth with modest inflation, despite the slight headwinds created by the gradual withdrawal of quantitative easing and higher interest rates. Muted inflation pressures and flexible markets mean that this is likely to be a gentle breeze rather than a disruptive gale.

Steady global economic growth continues

- Europe's cyclical recovery is a key component of our relatively optimistic base case. We anticipate that Europe moves from laggard to leader in the global growth race, able to enjoy several years of above-trend growth without hitting the labor supply buffer, in contrast to the U.S. where modest expansion has involved a significant reduction in unemployment.
- The European Union (EU) may chart a different course without the UK. Post Brexit, the EU may push hard towards further integration but in response to the rise in populism there are likely to be increased barriers to migration from outside.
- Emerging economies continue to recover and have the capacity to grow more rapidly.
- China avoids a hard landing, although annual growth will settle to a 5% pace over the next five years.
- Japan successfully fights deflation and demographics.

Political change and uncertainty continues, making world leaders attentive to the needs of their voters and sensitive to the impact of unexpected influences. Leaders are implementing domestic reforms and targeting improvements in corporate governance, tax and international trade.

Demographic headaches loom as baby boomers retire although this will be partially solved by developments in robotics and artificial intelligence. Japan continues to set the example, by embracing technology and encouraging women back into the workforce.

Monopoly power is a growing aspect within the corporate sector, delivering a positive outlook for profits given the robust economic background, with relatively low interest rates likely to continue, low corporate taxes, and weak labor power.

Energy changes are anticipated, including the growth of electric cars and the development of batteries for centralized energy storage. Additionally, the declining dependence of the U.S. on oil from the Middle East is changing the geopolitical risk dynamic into a more regional and less global conflict.

Protectionism continues to present a threat with world leaders demonstrating their strong domestic agendas. However, despite the rhetoric we believe it to be more a case of 'sabre-rattling,' unlikely to escalate.

Geopolitical risks may create challenges in the Pacific area. Despite the uncertainty we believe the chances of a catastrophic outcome are very low. We anticipate that diplomatic solutions are likely to be sought rather than warfare.

Fears that a U.S.-led recession may be on the horizon, but that threat seems to us neither heightened nor imminent. For the rest of the world, where capacity constraints are less severe, the risk of recession seems even less.

Investment implications With the world economy remaining in good shape and healthy profit margins being maintained, risk assets should generally do well in this scenario. Gradual tightening by central banks is a headwind, albeit a mild one, which will limit overall returns. Government bonds are likely to underperform and with spreads likely to widen, their corporate equivalents could fare even worse.

30% probability

Policymakers pull the punchbowl

We believe that the risk of a downside surprise is heightened (relative to previous years) given the following conditions:

Policy errors are our principal concern as either past monetary policy overstimulates markets, which then coincides with the tapering of quantitative easing, exaggerating their impact; or central banks take a more aggressive approach, tightening the expansionary policy too early and starting the chain reaction that leads the U.S. and then the rest of the world into a recession.

Eruption of populism and escalating protectionism could occur as trade disputes lead to punitive action and provide strong retaliation that impacts the world economy. Alternatively, there remains a serious concern that the leaders' rhetoric spirals out of control in a tit-for-tat exchange.

Disruptive technology across a number of new industries and products could seriously challenge the profitability of existing market leaders.

Investment implications This, our downside scenario, ultimately involves a significant correction in equity markets and a rally in bonds. The journey to this end result would involve heightened volatility and could easily begin with a late, last move higher in equities. Government bonds could sell off in the early stages of this scenario, as inflation and interest rates rise, before rallying hard as equities crack and recession looms.

10% probability

Perfect policy prevails

Finally, for the optimists amongst us, our upside scenario takes a look at what happens when the policies all go according to plan.

Policymakers get it right and central banks are successful at bringing their economies back to full employment smoothly and without pushing up inflation. Balance sheets and interest rates normalize without undue hiccups and markets continue to advance undisturbed.

Leaders' reform agendas are successful, including Trump's tax bill and President Xi Jinping in China's and Prime Minister Abe in Japan's domestic and corporate changes. Stimulating their local economies.

Integration of automation into the workplace through software automation and artificial intelligence systems bridges the gap in labor forces, without disenfranchising the low-paid workers who will be more easily able to transition into skilled roles with the help of the new systems in place.

Diplomacy wins the day enabling agreements to be reached and deals to be struck without the escalation to warfare.

Investment implications In this 'perfect world,' risk assets perform strongly and bonds come under only limited pressure; volatility remains low.

See the complete report for a thorough discussion of possible investment implications, including a table of geographies, asset classes and sectors we over- and under-emphasize. Please visit: **bmogam.com/fiveyearoutlook**

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