Transcript

Better conversations. Better outcomes.

Episode 42 – Looking ahead: 2018 Five-Year Outlook

John Adams - I would say that for investors, inflation's the key metric that we're looking at, kind of on a 6 to 12-month basis. This is a very long-term focus here. But over the next 6 to 12 months, it's definitely inflation whether that comes through.

Ben Jones - Welcome to *Better conversations. Better outcomes*. presented by BMO Global Asset Management. I'm Ben Jones.

Emily Larsen - And I'm Emily Larsen. In each episode, we'll explore topics relevant to today's trusted financial advisors, interviewing experts and investigating the world of wealth advising from every angle. We'll also provide you with actionable ideas designed to improve outcomes for advisors and their clients.

Ben Jones - To access the resources we discuss in today's show, or just to learn more about our guests, visit bmogam.com/betterconversations. Again, that's bmogam.com/betterconversations. Thanks for joining us.

Emily Larsen - Before we get started, one quick request. If you have enjoyed the show and found them of value, please take a moment to leave us a rating or a review on iTunes. It would really mean a lot to us.

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Emily Larsen - Every year, BMO gathers our investment teams and strategists for an event we call the Global Investment Forum. This forum does include outside speakers, but ultimately consists of two days of intensive briefing and debate among the BMO team that culminates with the output of our five-year outlook. The outlook unveils an investment thesis and market trends we anticipate in the next five years, and contains three likely future market scenarios with each being assigned a certain probability. This document can be used by advisors to position client portfolios for the long-term, determine signs to watch for that might change the scenario thesis, and is useful in gaining a global perspective on political and economic events that may unfold in the coming years.

Ben Jones - Last year, we spoke with John Adams about the forum and outlook. So this year, it seemed appropriate to sit down with John again and discuss what they got right, what may have changed, and what the scenarios look like on our path to 2023. John and I had the opportunity to sit down for a conversation at BMO's U.S. headquarters in Chicago.

John Adams - I'm the portfolio manager with BMO Global Asset Management Multi Asset Solutions Team. We have 21 individuals on our multi asset team globally, managing about $50B. What we really do is help to solve client problems through our multi asset solutions.

Ben Jones - John, how do you describe your role. So that's the technical aspects of your role. But you're out with your family, you're at a dinner party, your neighbor says, what do you actually do? How do you describe that?

John Adams - Sure. So we're managing multi asset portfolios, really making top down asset allocation decisions. So ideas like, do we want to be overweight equities versus bonds? Do we want to be overweight U.S. equities relative to international equity? So really making those high level decisions and generating trade ideas that we can implement in our portfolios.

Emily Larsen - This is the fifth year of the annual forum, and it brings expert speakers from across the world to talk about themes that they believe will affect the market over the next three to five years. It's a great chance for you to step away from the short-termism in the markets and look at what the market isn't focused on right now, but might be in the future.

Ben Jones - The purpose of the event after you discuss all these things is to do what in each of the regions with your team?

John Adams - Well I think in the best case scenario it impacts positioning, portfolio positioning, maybe not immediately but it's kind of going in the back of our mind, kind of what's going to be important over that long-term time horizon. Also, very important we put out a document, a five-year outlook document that we distribute to clients, share as kind of an example of really our best thinking from a global investment perspective.

Ben Jones - Wonderful. So our investment forum considers factors globally, not just with a single country or a home country biased viewpoint. Can you kind of discuss what you think that's important to take that global perspective?

John Adams - I think first of all, we're global investors. Our portfolios are able to touch multiple asset classes, multiple countries and portfolios. So it's very important from that perspective that we're investing on a global basis. I would say secondly, getting that local expertise as far as looking at ideas like Brexit for example or the European election cycle this year. Getting that expertise from our European colleagues or talking about Nafta, the future of Nafta, the future of oil, the long-term outlook for oil prices. Talking to our Canadian colleagues who are much more in tun with that, that overall oil market, I think is very helpful from this overall process.

Ben Jones - Now last time when we talked, you laid out kind of the views from the forum.

John Adams - Right.

Ben Jones - So before we jump into this year's discussion about the next five years, I want to just take a step back and go back to your predictions last year. Let's maybe grade ourselves, give ourselves a score. How did we do?

John Adams - Yeah, because it's always tough to grade yourself, people usually grade on kind of a curve when they grade their self on these kinds of things. I think we gave ourselves a B- overall.

Ben Jones - Uh huh.

John Adams - I think we're pretty happy with our scenario, our base scenario from last year. It was really a global recovery, U.S. led but spreading out globally. We really identified themes like populism, nationalism that were pretty pervasive throughout the year, especially in Europe. So I think it was positive from that perspective. From an asset allocation perspective, we wanted to be overweight equities versus bonds. That played out pretty well as expected over the last year. I would say kind of what we got wrong, we had a bit more confidence in the U.S. dollar outlook than really played out in markets over the last year. We thought the dollar would really be stronger. I would also say our implications from fiscal policy for example, we probably overdid the fiscal policy part of our base case scenario. We didn't get the fiscal policy that we really expected to come through on a global basis.

Ben Jones - So if you look back over the year, what as the biggest surprise that maybe wasn't on your radar last year that maybe is this year?

John Adams - Sure. I would say the biggest surprise is that we got market friendly outcomes across the European election cycle. We talked a lot about populism, nationalism, the idea that countries were going to look more inward. And we didn't really get that election surprise. A year ago we got the U.S. election surprise, we got the Brexit election surprise, but really very few I would say election surprises in 2017.

Ben Jones - It's interesting you say that. I was just reading in the *Journal* yesterday about the optimism around global trade coming back in a big way.

John Adams - Sure, sure.

Ben Jones - I can't imagine that being a theme last year in the middle of the election cycle in the U.S.

John Adams - Right, right. Yeah, yeah. Global trade really, really peaked probably a few years ago. There's been a lot of talk about what's going to -- what's the catalyst for the resumption of global trade. I think really from our perspective, it's just that we've seen this synchronized global growth and we're kind of sick of talking about synchronized global growth. But I think that's really what's going to drive trade forward and kind of integrate countries more on trade bonds.

Ben Jones - During the forum, they're developing an investment outlook for 2018 through 2023. This year, much like last year, they ended up with three scenarios for the future. A base case, an upside scenario, and a downside scenario. Each of these was given a probability of occurring.

Emily Larsen - The base scenario, which was given a 60% probability this year, was called *Steady as she goes*, and we'll discuss it in a moment. The second was a downside scenario that was given a 30% probability and called *Policy makers pull the punch bowl*. The final scenario was an upside scenario called *Perfect policy prevails*, which was given only 10% probability.

John Adams - I would say really that the base case was essentially a continuation of our base case from last year. It's really that we get continued resumption in global growth and global earnings growth, and also still I would say muted inflationary pressure. It's really a best case outcome for market. We focused a lot this year saying hey, our base case actually looks pretty good, almost looks like an upside scenario. I think that was part of the reason we placed a higher weight in our downside scenario is because the base case was really so rosy and we defined that we called that S*teady as she goes*. Basically a continuation of the environment that we've seen over the last year or so that's been very, very strong for equities especially, but risk assets really in general.

Ben Jones - And what does this type of environment mean for investors?

John Adams - Sure. I think it means investors are really pushed out the risk spectrum, encouraged to take on additional risk. Because there are always tail risks that we can see, you can point to North Korea, Middle East, potential China slow down as a more medium term risk. But I would say it's really encouraging investors to go off the risk spectrum, pushing those investors further out. So high-yield investors into equities for example. But that was really the clear take away this year was that we really favored equities over fixed income. That was really the highest conviction.

Ben Jones - Now, we have listeners that listen to the show from all over the world.

John Adams - Sure.

Ben Jones - So, how would that view change regionally, say if you were in Canada versus Europe versus maybe Asia Pac.

John Adams - I would say it wouldn't change a great deal. Our preference for equities was really pretty widespread. We had a preference for global equities, U.S., and international equities and emerging market equities. I think we liked all those asset classes relative to fixed income. I would say where there might be a difference as far as our preference for being underweight to fixed income. We'd prefer to be underweight German bunds and Japanese government bonds, JGBs, and not as underweight to U.S. treasuries for example.

Ben Jones - Got it. You guys had a lot of discussion about the Phillips Curve.

John Adams - Yes, yes.

Ben Jones - I know a lot of our listeners are probably familiar with this. But maybe just in layman's terms, describe what the Phillips Curve is.

John Adams - It's a bit of a technical concept. But it's essentially saying that there's an inverse relationship between inflation and unemployment. So at stretch levels of unemployment similar to where we are now around 4% unemployment here in the U.S., inflation typically picks up.

Ben Jones - Okay. So there is a lot of talk about the Phillips Curve.

John Adams - Right.

Ben Jones - You go anywhere in our industry, I never thought I'd see the time when it becomes dinner conversation, but the Phillips Curve is a hot topic.

John Adams - Sure, sure.

Ben Jones - So, why?

John Adams - I think the reason why it's a hot topic is that it hasn't really worked over the last few years. It hasn't done what the historical relationship says it should do. That we've seen unemployment improve quite a bit, the rate go down to 4%, we haven't seen that subsequent increase in inflation. The Phillips Curve really talks about wage inflation and that's been really, really soft as far as wage inflation pressures in the U.S. depending on what measure you're looking at. We're seeing about 2.5% to 3.5% wage growth right now. You typically see more like 4% wage inflation at this point in the economic cycle with unemployment this low. So I think the debate right now is, is the Phillips Curve as a model still valid or are there really structural forces that are keeping inflation lower?

Ben Jones - Yeah, so maybe just in my mind the way I was thinking about this when I was reading about your writings was, is it no longer valid, or this time it's different?

John Adams - Sure.

Ben Jones - Versus, is it a coiled spring?

John Adams - Mhm, mhm.

Ben Jones - So, where does your team fall out on your scenario?

John Adams - Sure, sure. I would say we're more in the coiled spring camp. We had a great speaker from Goldman Sachs; their chief economist who I think presented a very compelling case for why inflation has been muted. It's been a lot of really one-off factors if you look at things like telecom pricing, very little healthcare inflation that we really think could unwind. So the market expects one to two rate hikes by The Fed next year. The Fed's telling us what their median dot expect three. We think there's a chance for three, perhaps even four rate hikes next year as these kind of temporary pressures roll off. There's been a lot written, as well, on the Phillips Curve about how it translates on a state by state basis. So the idea is that in the U.S. on a state by state basis, the Phillips Curve really has worked as a model. The relationship is really still intact. That leads us to believe that it's more really driven by globalization, that's kept wage pressures down. I think that's a really interesting discussion too as far as Central Banks are now not just targeting domestic inflation, they're looking at global inflation. That could be a theme kind of for coming years as how do Central Bank reaction functions change, targets change in the coming years.

Ben Jones - That's a really interesting concept. So the more granular the geographic area, the better the Phillips Curve works. Then as you put a bunch of different areas, say 50 states together that all have very different economic drivers, it looks more muted.

John Adams - Right, right.

Ben Jones - So it just kind of gets muted as the data gets larger.

John Adams - Sure, sure.

Ben Jones - I think there's a lot of things that function that way.

John Adams - Yeah, I think that leads us to believe that yeah, globalization is really kind of the main factor that's really keeping wage inflation down. Also, technology to a large extent, demographics, you can definitely point to quite a few factors there.

Ben Jones - Mhm. So let's talk about scenarios. You touched on them briefly a minute ago. But 60% for *Steady as she goes*, 30% for *Policy makers pull the punch bowl*, so a downside scenario, and then of course this *Perfect policy prevails*, which is a 10% upside scenario. Which of these scenarios would have the highest magnitude of impact on advisors and their clients?

John Adams - Sure, sure. Yeah I would say it's really *Policy makers pull the punch bowl* would have the most impact. I think people are not really looking for that scenario overall. But we had a lot of debate as far as what's the downside scenario this year? In past years it's been really the economy is too cold, inflation's too cold, we were more worried about deflation about global recession. I think that dynamic has changed quite a bit. The paradigm shifted this year to more, we're worried about that too hot scenario that we actually finally get that inflation that we talked about, that economies overheat, inflation overheats, and Global Central Banks are really behind the curve as far as inflation. They have to raise rates very quickly, faster than the market expects, and that really chokes off inflation but it also chokes off global growth.

Ben Jones - So let's talk a little bit about that scenario first. First of all, *Policy makers pull the punch bowl* is a reference to an old term, maybe kind of describe that a little bit.

John Adams - Right, right. Yeah, the idea essentially is that there's a party and the Fed's going to kind of end the party by pulling the punch bowl from the party. We've seen exceptionally loose monetary policy not only in the U.S. but all around the world over the last eight years. The idea is that perhaps it's gone too far and The Fed's going to have to kind of pull that back. Not only The Fed, but also the ECB, the Bank of Japan, etcetera.

Ben Jones - Maybe talk to me a little bit about some of the requirements for a curve for this scenario to play out.

John Adams - Sure. I would say first, it's a surprise on the inflationary side. That some of these temporary factors begin to reverse and we start to see some inflationary pressures. Also, we talked a lot about the idea that you could get finally some fiscal stimulus, some tax reform in the U.S. perhaps at exactly the time where you get the inflationary pressures. Maybe that really exacerbates that trend in inflation and surprises the market on the upside. So you've had this synchronized growth, perhaps it gets a little bit too hot. That could be good over a short-term time period but over the medium term, Central Banks wake up to the fact, we're really behind the curve, our policy operates with a six-month lag typically, we need to raise rates and do it pretty quickly.

Ben Jones - I know that interest rates aren't necessarily your specific area of expertise, but you've got a lot of knowledge in the space when it comes to asset allocation. I mean, there's a lot of people who have talked about the yield curve itself flattening and -- the potential for it to invert. In general, that tends to be a leading indicator of what?

John Adams - Yes, yes. Usually it means that you're headed for bad things, you're headed for a recession, and typically global yield curves are pretty highly correlated. But we have seen some flattening in the U.S. over the last few months, but we're still, I would say, at a point where we're not concerned about the yield curve yet. But if you do see the yield curve begin to invert, meaning that long-term yields are lower than short-term yields, that typically means investors are very concerned, they're worried about risk overall and they want to focus on kind of those shorter term assets and more comfortable holding those.

Ben Jones - For everyone listening to this, are there some things they should be watching for that would be increasing this probability of this scenario so that they know, okay, this is happening, I might want to position for this?

John Adams - Sure, sure. I don't think that the yield curve inverting is really a specific scenario that we're really concerned about as far as this overall scenario. We're more worried about that inflationary pressure coming through. So I would say that for investors, inflation's the key metric that we're looking at, kind of in a 6 to 12-month basis. This is a very long-term focus here, but over the next 6 to 12 months, it's definitely inflation and whether that comes through. I think that'll be the either confirmation or disconfirmation that these factors are either structural or more temporary.

Ben Jones - Okay, wonderful. And you put the scenario this year at 30%, which is higher than last year's downside scenario.

John Adams - It is, it is.

Ben Jones - Why?

John Adams - Sure.

Ben Jones - Why only 30?

John Adams - I would say it's kind of a function of number one, the base case being pretty rosy. Our base case last year was 70%, we lowered that to 60% this year. But we're another year further along in the cycle. We've been of the view that the cycle has room to run given the global economic backdrop, given the earnings backdrop. But we are now eight years into the cycle, the cycle is getting pretty long by historic standards. So we placed a little bit higher weighting on that downside scenario. I would say also the upside scenario we only placed a 10% probability on because that was really kind of everything comes together, everything's perfect, and that was a pretty low probability for us as an overall team.

Emily Larsen - As John talked about, the base case scenario is that we'll continue to see steady market growth with inflation staying within expectations. John also shared how the base case plays out in Europe and in emerging markets.

Ben Jones - So, one thing that surprised me about this base case scenario is that I don't live overseas, but in Europe and particularly in London, our colleagues talk a lot about some of the negotiations of Brexit and with the EU and whatnot.

John Adams - Sure, right.

Ben Jones - How does Brexit factor into this base case scenario?

John Adams - Sure, sure. I don't think we factor Brexit to a large part into the base case scenario. I would say it's a very difficult scenario to predict. I think the base case right now is that nothing really gets done in the UK for at least another year until really the time's starting to run out as far as negotiations. We've seen a weakness for support for Theresa May in the UK. I would say it's a very unpredictable kind of situation in Brexit. I think we really focus on what we think we have an edge as far as what we can predict. Brexit I would say is very uncertain as far as the overall environment. But any kind of bad outcome for Brexit would be a negative for our base case scenario. Implicitly, we're assuming that we don't get any bad political outcomes in that base case scenario. Whether it be in the UK, whether it be in Italy with the upcoming elections there.

Ben Jones - So, shifting from kind of those developed markets to the emerging markets. Talk about in the base case scenario how this impacts emerging markets. I mean, they've been on an absolute tear this year.

John Adams - Yes, definitely, definitely.

Ben Jones - How does this fit into this base case scenario?

John Adams - When we show year-to-date returns for clients, That's the one that always really stands out as far as the emerging market returns, about 30% on a year-to-date basis. I would say really more differentiation as far as emerging markets, that was really kind of a core theme in this year's scenario. We had a China expert come in and talk to us, give us kind of an overview as far as Chinese policy. It was really interesting around the party congress and President Xi really consolidating his power over the last couple of months here. That was something that the speaker talked about, it was before that party congress. But he talked about President Xi consolidating his power, whether he'd kind of designate a successor. He really didn't. So that's more evidence that he wants to consolidate further. We talked a lot about Chinese investment, not only the military but also wanting to be a global super power, a leader in technology. So the focus is really on China I would say as far as emerging markets. We also talked a lot about countries like India. That was really a theme from a prior session with really China versus India from a prior secular forum and the view there. But I would say it's really kind of further differentiation between the emerging markets versus commodity importers, commodity exporters. Then you have kind of China and kind of the rest of the emerging market world. I would say pretty optimistic outlook for emerging markets overall. But recognizing they have outperformed by quite a bit over the last 12 months.

Ben Jones - It seems as though politics globally plays a really big part in this scenario. Are there any specific things that our listeners can watch for that would indicate this scenario is playing out as expected?

John Adams - Sure. Yeah I would say it's more a lack of information coming from the media. We do have the Italian election that I mentioned earlier, that's probably the one kind of risk scenario I would say that we need to happen by next May. But if we can kind of get through the Brexit negotiations without anything too terrible really happening there, if we don't really get any surprises on the U.S. side, I think that's probably further confirmation that we continue in this base case. Now of course the big surprise would be if we get some kind of tax reform in the U.S. That's really what our upside was predicated on was you get this policy stimulus that the market doesn't really expect right now. That could be tax reform in the U.S. that could be reforms in China, reforms in Japan, but overall kind of a healthier political backdrop.

Ben Jones - Wonderful. Let's go to this kind of rosy upside scenario, the 10% probability, *Perfect policy prevails*.

John Adams - Yeah.

Ben Jones - What are kind of the requirements that just make this whole puzzle come together perfectly?

John Adams - We probably got a little carried away with the P words as far as the upside and downside scenario.

Ben Jones - Peter Piper picked a pickle.

John Adams – Exactly. exactly. But yeah, it's basically we termed it as base case plus. So it's everything in the base case, which is again a very rosy scenario, plus it's really, you get a lot of unexpected political outcome. So you got a lot of optimism when President Trump was elected that we're going to get infrastructure spending, healthcare reform, tax reform. We haven't really seen any of that through the first year. So I think is we finally get this coming through this perfect policy. But I think the other side of that coin is, if you do get that perfect policy, what does that mean for inflation, especially if we talked about the shorter term factors begin to reverse. If you get tax reform, which should stimulate the economy, if you also get some kind of infrastructure reform on a global basis, what does that do to inflation? That might be concerning for inflation overall.

Ben Jones - This is another one where it's nearly impossible to predict politics --

John Adams - Right.

Ben Jones - And how these things come out. Given the track record this year of not being able to get anything passed in the U.S. at least, is that what led to this kind of low probability on this scenario?

John Adams - You know, kind of half joking, a lack of any kind of policy could be a good thing for markets. It kind of removes the uncertainty for markets overall. So I think what you have now is a lot of pessimism as far as the administration, whether they can get any policy through. That could be a good thing for markets from the perspective that we kind of know what's coming and it's probably going to be nothing. So we thought earlier this year we had reached the point of kind of maximum pessimism as far as the administration, especially as far as tax reform. So we've been of the view as a global team that we think there's a higher probability than the market expects of tax reform actually getting through.

Ben Jones - This might be a surprise to the upside.

John Adams - I think it's a surprise to the upside yes. I think it's, I would say partially priced in. But I think it would be a significant surprise if we were to get tax reform. But the administration needs a victory, Republican party needs a victory. It's very clear the momentum is moving toward the Democrats right now. I think the idea is Republicans could unite, could finally come together to try to put some points on the board to so speak.

Ben Jones - So I want to just shift into some other views. I mean, you guys get all these smart people together and a lot of these views seem to be somewhat in consensus with what I'm hearing --

John Adams - Sure, sure.

Ben Jones - From many other thinkers in the industry.

John Adams - Right, right.

Ben Jones - Maybe could you walk me through some of the out of consensus thinking that your team has?

John Adams - Sure, sure. Yeah I would say probably two things. Number one, on the Phillips curve, while that is a pretty consensus topic to discuss, our view is that we are going to see the inflationary pressures, we are going to see inflation surprise on the upside. That's part of the reason we had high conviction in being overweight equities relative to core fixed income. That was really the highest conviction view coming out of the forum.

Ben Jones - What does that mean when we say, inflation comes? Like is it really fast inflation like the 70s or high inflation? When we say we think this quilt spring's going to uncoil or is it just more inflation?

John Adams - I think it's probably just more inflation and it's the trend in inflation. We're not expecting 70s type of inflation by any means. But given that we've been below Central Bank targets for so long, I think our behavioral tendencies are to kind of extrapolate that low inflation out. I think that would be a big surprise for markets if we saw a two-handle on inflation finally after all this time on Core PCE for example, what does that mean for The Fed's kind of reaction function. It usually comes through wage gains. We haven't seen those wage gains yet, but I think that's one likely place to see those inflationary pressures.

Ben Jones - Okay, so number one out of consensus view is inflation. What's the second one?

John Adams - I would say two, the issue we talked about as far as the death of dynamism as far as the consolidation of profits, not only in technology, that's kind of the typical example that people talk about, but across a lot of industries not only in the U.S. but also on a global basis. Kind of what that means for policy overall, what are the investment implications? I think the more immediate implications are that equities continue to do well, probably growth continues to outperform value for some time, but I think the long-term implication is very interesting, what does that mean for government policy? At some point, do governments step in and say, we've created a lot of oligopolies, this is an unhealthy environment, we're kind of favoring technology versus the average worker, so kind of capital versus labor, and what is the impact from that? I think any kind of policy prescriptions that come out of that issue overall.

Ben Jones - What you're talking about is kind of this winner take all economy --

John Adams - Yes, exactly.

Ben Jones - Where there's one social network, there's one search engine --

John Adams - Right.

Ben Jones - There's one large online retailer.

John Adams - Right.

Ben Jones - What are the things that you believe would unseat this trend from continuing to move forward?

John Adams - Sure. Yeah I would say it's kind of the general populous, if the general populous wakes up one day and says, I think this is bad for this kind of winner take all mindset. I think what could be a catalyst for it is if companies choose automation, choose technology and workers begin to lose jobs overall and those jobs aren't replaced. So I think that could be potential catalyst.

Ben Jones - Kind of like a Luddite scenario.

John Adams - That's exactly right. Right. Or it could be governments saying from a tax perspective, this isn't a healthy thing overall for the consolidation of gains to happen from these large multinational companies who aren't paying a higher tax rate overall. I think it could from the general populous or it could come from government. But I don't think it's going to happen anytime soon. But again, this is over a five-year time period, those issues could be called into question.

Ben Jones - And besides just the kind of oligopoly or monopolistic type --

John Adams - Right.

Ben Jones - Domains that these create, it has to have some sort of impact on innovation, as well, because they can stifle innovation that might unseat them as a leader.

John Adams - Yeah you get increased barriers to entry for other firms, right, it could be very expensive to get into those industries overall. But this is really exactly the type of situation that our policies were designed to discourage in the U.S. at least is kind of a winner takes all or one firm dominating this monopoly concept. I think these companies have been allowed to expand to this point, but the real question is, will they continue to be allowed to expand to this degree? We have seen a lot of innovations from the Amazons of the world. I think you're exactly right, I think that could stifle innovation at some point if you don't have these kind of startups putting pressure on those companies. So we talked a lot about what can policy do to encourage entrepreneurship, access to capital, those kinds of things. I don't think there are any easy solutions to that, but I think those are the efforts that governments around the world are going to need to make.

Ben Jones - Yeah it's interesting, you know, you hear people talk about how big these companies are. And it's like people have forgot what we did as a country to Standard Oil back in the day --

John Adams - Sure, sure.

Ben Jones - Which was the technology of that time.

John Adams - Right, right, yeah, yeah.

Ben Jones - Well let's move onto one other interesting question that I have, which is we have a lot of people that are listening and they get finished with this podcast and they say, well that was all interesting --

John Adams - Right.

Ben Jones - But, what do I do with that information?

John Adams - Sure.

Ben Jones - So we've got this framework, 30/60/10, what should an advisor do to position a client's portfolio and maybe say different clients have different objectives. But say someone who's near decumulation or retirement --

John Adams - Sure.

Ben Jones - Someone who's mid-career and someone who's just starting out.

John Adams - Sure.

Ben Jones - How would you position a portfolio based on your thought process?

John Adams - Sure, sure. Yeah I would say first of all, we always try to tie this directly to our positioning. We're not just getting in a room talking about these issues with no investment implications. That's always the end game is, what do we do in portfolios based on these themes, based on these ideas? I would say we typically try to invest on the base case scenario. It's impossible to invest on all three scenarios kind of simultaneously. The upside, the downside, and the base case. But if you focus on the base case scenario, I think really the clear outcome there is you want to be overweight equities relative to fixed income in that scenario. And I would say broad equities relative to fixed income. Now that being said, I don't think it's a time to really reach out for additional risk, so we have a pretty modest, I would say, view preference toward equities versus fixed income as a global multi asset team right now. A few years ago we might have had an even stronger preference for the equities versus bonds. But I think the underweight bonds really helps to hedge you against that downside scenario, as well, if you have the inflation surprise. Equities probably do alright in that scenario; bonds usually do pretty poorly in that scenario. So I think that's really the key take away for investors overall.

Ben Jones - They position for this base case scenario, they're overweight equities from what they maybe normally would be --

John Adams - Right.

Ben Jones - At their stage in life and towards their objectives.

John Adams - Right.

Ben Jones - What are the indicators that would make them position more conservatively? We talked about inflation. Is that something that they take a wait and see approach to or at what point do they see something and they say okay, I want to position more conservatively?

John Adams - Yeah, I think it's a bit of wait and see approach. But I think it's if you saw any kind of sharp increase in inflationary pressures. A modest increase I wouldn't be too concerned about. I'd be concerned about a much sharper, above 2%, maybe 2.5% to 3% type of inflation prints to begin to get concerned about. Secondly, I would say we haven't talked a lot about earnings yet. But that's been a really large factor driving equities higher has been in the U.S. kind of five consecutive quarters of very strong earnings growth. So I would say for investors to look to earnings growth, if we can sustain that momentum. I think we forget sometimes how rare it is at this point in the cycle to see accelerating global economic growth, accelerating earnings growth eight, nine years into a cycle. It's very, very rare. So I think any kind of disconfirmation that we're not on that synchronized growth, synchronized global earnings cycle, could be a cautionary environment for investors, as well.

Ben Jones - You can download a copy of the five-year outlook or executive summary in the show notes for this episode at bmogam.com/betterconversations. Positioning your clients' portfolios for the long-term requires an investment thesis that looks well into the future. You have to do this while still keeping a lookout for indicators that might lead to an upside or downside scenario that ultimately might play out.

Emily Larsen - We wanted to end the discussion with a few rapid fire questions for John.

Ben Jones - If you could summarize our entire conversation today in two sentences, what would you say?

John Adams - I would say, there's more room to run but we are getting more concerned going forward.

Ben Jones - If you were to kind of write your own warning label to put on this episode, what would it say?

John Adams - I would say beware of the surprise to inflation.

Ben Jones - Alright, last question John. How can our listeners follow you and your team's thoughts about this topic?

John Adams - Sure, you can go to bmogamviewpoints to subscribe to our insights.

Ben Jones - Wonderful. My guest today has been John Adams from BMO Global Asset Management. Thanks for joining the show, John.

John Adams - Thanks, Ben.

Emily Larsen - Again, you can visit bmogamviewpoints.com to see John and his team's views. We're grateful for John who made the time to return to the show and share his thoughts again this year.

Ben Jones - Thanks for listing to *Better conversations. Better outcomes*. This podcast is presented by BMO Global Asset Management. To learn more about what BMO can do for you, visit us at www.bmogam.com/betterconversations.

Emily Larsen - We value listener feedback and would love to hear about what you have thought about today's episode. Or, if you're willing to share your own experiences or insights related to today's topic, please e-mail us at betterconversations@bmo.com. And of course, the greatest compliment of all is if you tell your friends and co-workers to subscribe to the show. You can subscribe to our show on iTunes, Google Play, the Stitcher app, or your favorite podcast platform. Until next time, I'm Emily Larsen.

Ben Jones - And I'm Ben Jones. From all of us at BMO Global Asset Management hoping you have a productive and wonderful week.

Emily Larsen - This show is supported by a talented team of dedicated professionals at BMO, including Pat Bordak, Gayle Gipson and Matt Perry. The show is edited and produced by the team at Freedom Podcasting, specifically Jonah Geil-Neufeld and Annie Fassler.