This summary provides a snapshot of key takeaways from The Way Forward, the 2019 Global Investment Outlook from Delaware Funds® by Macquarie. The Way Forward brings together our investment professionals around the world, who capture the themes expected to drive market conditions in the coming year. As you read these highlights, we invite you to dive deeper into each section by reading the full outlook.

 Perspectives

As forces ranging from rising rates to trade disputes have raised the stakes for global markets and investors, our investing leaders step back for big-picture views of what these may portend for equity, fixed income, and real assets and other alternative markets.

Investor roundtable

Our investor roundtable suggests 2019 may be shaping up as an inflection point. Our CIOs expressed caution about the global macro forecast, with fixed income leaders cognizant about structural headwinds re-emerging as monetary stimulus recedes. Global Head of Equities John Leonard is “marginally more optimistic” when it comes to the 2019 outlook for growth, based in part on signs of “pent-up US economic demand.”

If you look back over the past 10 years, we have had a stream of central bank support that has translated into average growth and elevated asset prices. It’s led to crazy things like negative interest rates and it’s been fantastic for financial markets.

Brett Lewthwaite
Global Co-Head of Fixed Income | Sydney

No one is very positive, comfortable, or constructive about the US equity market, which leads me to think it’s probably not yet time for it to come unwound.

John Leonard
Global Head of Equities | Philadelphia

It’s hard to imagine anything else right now that could lead to a renewed boost in US gross domestic product (GDP) apart from massive infrastructure spending — especially if you look at it in terms of the budget deficit and the debt-to-GDP ratio. These are pretty clear signs to me that we’re near the end of the cycle.

Stefan Löwenthal
CIO, Global Multi-Asset Solutions | Vienna

We’re probably at the end — or very close to the end — of the peak benefits provided by the US tax cuts in 2018. The uptick in economic growth that we’ve had in the United States, especially in the second and third quarters of 2018, just doesn’t seem sustainable. I don’t think this means that we’re headed for a recession — I think it just means that we’re not going to keep growing in the 3.5% to 4% range.

Roger Early
Global Co-Head of Fixed Income | Philadelphia

When it comes to bull markets, they don’t have to end with a seismic repricing of the market. They certainly can end that way, but they can also end with a sideways, grinding movement. It’s important to recognize that the returns from US equities over the past few years have stemmed from growing earnings — not because of expanding multiples.

John Leonard
Global Head of Equities | Philadelphia
Global equities

It was another interesting year for equities in which the US markets continued to show robust growth for most of 2018 even as volatility picked up and other areas such as emerging markets tended to struggle.

Large-cap value equity

Looking out over the next three to five years, we are cautious about the prospects for US equities because of the potential for slower economic growth, the outsized returns investors have already experienced, and, most importantly, high stock market valuations.

Ty Nutt
Large-Cap Value Equity | Philadelphia

- The US economy appears to be benefiting from a number of key supports that we think have been helped by the tax law changes, and we wonder to what extent their effects will be temporary.
- From current valuation levels, risks seem higher than usual and we can foresee annualized total returns in the mid-single-digit range.

International value equity

The scope and aggressiveness of shifting US trade policy is a new phenomenon in the lifetimes of most market participants and must be taken seriously.

Ned Gray
Global and International Value Equity | Boston

- We expect the strength and mix of prospective equity returns in 2019 to be a function of overlapping economic and political factors, expressed in price valuation.
- Likely winners, in our view, would be both the direct beneficiaries of shifting competitive winds as well as companies with adequate pricing power to pass new costs along to customers.
- Long-term relative valuation trends suggest we have seen a dramatic overshoot in favor of US versus non-US equities.

Global ex-US equity

The trade tensions that have dominated the headlines this year have raised fresh concerns over constrained supplies. China is likely to aggressively develop its own technology. We see this as an underappreciated opportunity that will play out over the next 5 to 10 years and should, in our view, generate many opportunities.

Joseph Devine
Global Ex-US Equity | San Diego

- There are definitely areas at higher risk than a year ago, particularly, in our view, among companies that are exposed to global supply chains threatened by political influence.
- If you look back at how emerging markets have historically performed, you will notice many periods like this one, in which macro headwinds come and go, and the group has tended to be pretty resilient. In some cases, those headwinds can even accelerate longer-term trends.

Small/mid-cap value equity

We think we’re going to face more difficult year-over-year earnings comparisons against the boost many US companies received from the drop in their corporate tax rates in 2018.

Christopher Beck
Small/Mid-Cap Value Equity | Philadelphia

- We’re focusing on those companies that have historically paid high cash tax rates because they’re likely enjoying an increase in their cash flow as well as in their earnings.
- Consumer discretionary firms tend to be higher taxpayers and they aren’t overly expensive given how confident consumers are.

Small/mid-cap growth equity

We believe that some current fear is misguided, an aftereffect of the experiences of 2008. Instead, we see continued economic and fundamental strength ahead for 2019.

Alex Ely
Small/Mid-Cap Growth Equity | New York

- We’re excited about enormous markets like food, content, transportation, and banking that are being completely transformed in a disruptive process that shows no signs of slowing. It is technologically induced, providing many industries with a better, faster, cheaper way of doing things.
- While there are many risks to monitor, we think it’s inflation that’s most likely to end the current market run, but we don’t think this will happen soon.

Core equity

We see a number of reasons to be both optimistic and pessimistic next year, while on balance, the glass is more than half full, in our view.

Francis X. Morris
Core Equity | Philadelphia

- Historical forward return analysis, based on relative valuations, suggests to us positive market returns when looking out 12 months.
- We anticipate earnings per share (EPS) growth rates will come down but not fall too far, which should be sufficiently supportive as long as margins and capital spending remain healthy.
Global fixed income

Fixed income markets in 2019 could very well continue to be marked by some of the same forces from 2018 — divergence in growth between the US and the rest of the world, the effect of rising interest rates, and other vulnerabilities exposed by the receding tide of central bank policy.

Global taxable fixed income perspectives

We’re positioning for less credit exposure and more duration, in some instances, while moving higher on the capital structure in others. Essentially, we are expecting a year with flight-to-quality episodes favoring risk-free assets as investors contend with US Federal Reserve actions and the potential ripple effects.

Paul Grillo
CIO—Diversified Income | Philadelphia

David Hillmeyer
Head of Multisector/Global Fixed Income | Philadelphia

• Going into last year, a key issue in global markets was the divergence in growth between the US and the rest of the developed world. This year, the focus is shifting to the delta between the US and China.

• Beyond the US and China, we still see a story of growth muddling along. Global markets face added stresses from higher US rates, a slower China pressuring demand and metals prices, and lower global trade volumes.

• We believe the 10-year US Treasury is likely to head higher in the short term, unless US growth drops off, in which case we could see considerable softening. Beyond the US, we expect to see rates tick up slightly, but no sharp moves.

Credit perspectives

Michael Wildstein
Head of Credit and Insurance Asset Management | Philadelphia

• Global credit investors are faced with some mental gymnastics in the year ahead: Company fundamentals are strong, but we may face growing signs of recession.

• Investment grade investors have to hold two conflicting realities in their minds: Things are great, and it’s time to be on notice. We’re resolving this quandary by staying invested but moving incrementally more defensive.

US high yield

John McCarthy
Portfolio Manager | Philadelphia

• We’re in a market that reacts to credit events and in which companies are punished for earnings misses. This scenario is markedly different from earlier in the cycle, when extreme liquidity around the globe was a rising tide that lifted all boats.

• Success in this market is a credit-by-credit process with emphasis on avoiding negative credit events. By all measures, we are late in the cycle, and we believe there is little to be gained from extreme positions on the risk spectrum.

US municipal bond perspectives

The municipal market should face some of the same technical issues this year as it did in 2018, as the Fed continues to normalize rates. But perhaps the biggest surprises will emerge from the 2017 tax legislation and the new 116th Congress.

Joseph Baxter
Head of Municipal Bonds | Philadelphia

• We think that after individual taxpayers assess the net effect of some tax law provisions on their tax returns — notably the elimination of state and local tax (SALT) deductions and capping of property tax deductions — there may be a reckoning leading some investors to return to municipal bonds.

• Important to municipal bond market watchers is the need for infrastructure investments in the US. Hopes were dashed when legislation failed to materialize in 2018, but we think there is a possibility that the new 116th Congress could be open to such legislation, at least to help fund the types of projects undertaken by municipalities, such as roads, bridges, and airports.

• An influential public interest group, the Government Finance Officers Association, indicated its resolve to reinstate prerefunding of municipal debt, which will positively impact supply in the market. We think the group, which in the past has represented state and local interests to Congress, may find a sympathetic ear in the incoming 116th Congress.
Real estate investment trusts (REITs) came under pressure in recent quarters, as rising US interest rates led to underperformance relative to other equity assets during a stretch of 2018. However, we saw continued US economic strength generally lead to stabilized yields and positive earnings surprises in sectors such as retail, which more recently appeared to buoy REIT markets.

Global REITs

We remain upbeat about REITs’ ability to perform up to par in a gradually rising rate environment, but we are also cautious and selective, late in the cycle.

Bob Zenouzi
CIO, Real Estate Securities and Income Solutions | Philadelphia

To read the full 2019 Global Investment Outlook, please visit delawarefunds.com/outlooks