

Outlook for Financial Markets

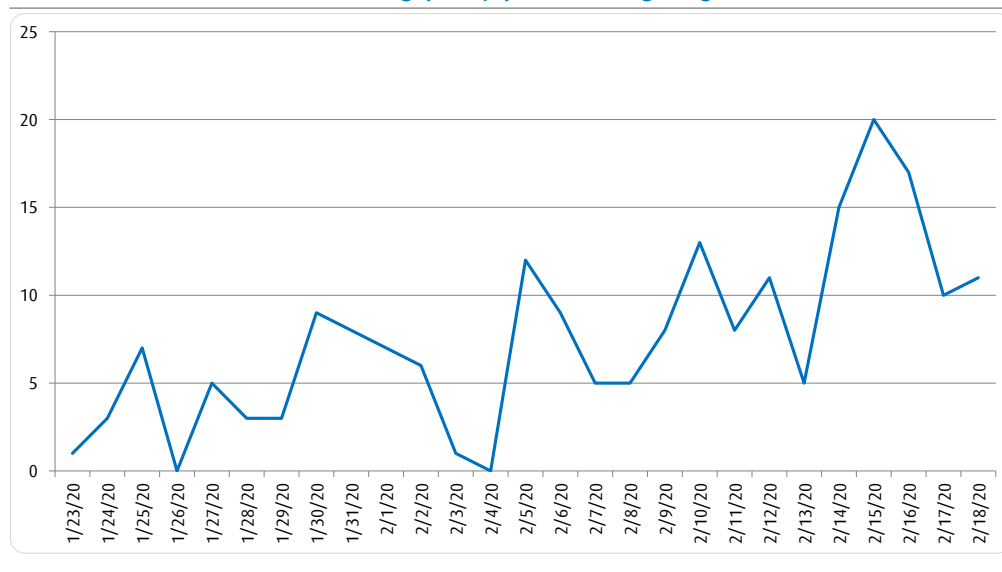
“It’s like astronomy, where what you see isn’t the star as it is right now, but the star as it was 10 years ago . . . Epidemics are like that: We are seeing information generated by last week’s epidemic process ... we can’t see this week yet.”

- Dr. David N. Fisman, professor of epidemiology at the University of Toronto

The coronavirus has dealt a hard blow to China’s Hubei province and its capital, Wuhan. The area has experienced over 80% of the confirmed cases worldwide and over 95% of the confirmed deaths, which have now surpassed the 2,000 mark.¹ That plight is very real, but fortunately other Chinese regions have seen

a sharp slowdown in new cases and other Asian countries have thus far seen limited outbreaks. Outside of Mainland China, Japan, Singapore, and Hong Kong are among the areas with the highest number of cases² (see Exhibit 1), and remain vigilant in their effort to prevent further spreading. Reflecting the fast-moving nature of coronavirus

Exhibit 1 » New Coronavirus Cases: Singapore, Japan, and Hong Kong



Source: World Health Organization

¹South Korea has recently seen a large spike in cases and the mayor of a city of 2.5 million has asked people to stay indoors.

²Excluding the Diamond Princess cruise ship that has been docked and quarantined in Japan.

Executive Summary

Near-term market dynamics are likely to follow the ebb and flow of coronavirus news

China’s stimulus in response to the outbreak points to the possibility of a “V-shaped” recovery, but whether the virus spread will re-accelerate as China returns to work remains a key risk

Our 2020 Outlook themes of a strong U.S. labor market and a tailwind from fiscal and monetary policy remain favorable

While Bernie Sanders’ likelihood of securing the democratic nomination have shot up in the polls and prediction markets, so have Donald Trump’s odds of winning re-election

developments, South Korea has seen a recent spike in cases and the mayor of a city of 2.5 million has asked people to stay indoors. Though the final impact remains unknown, a worst case global pandemic looks unlikely at present.

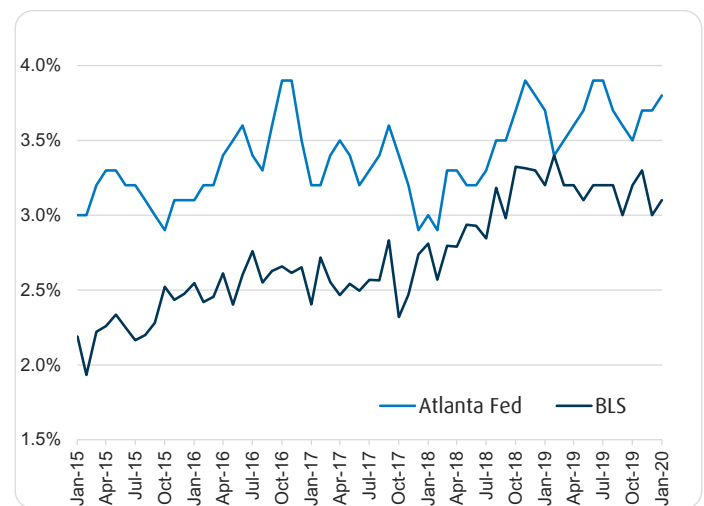
Equity markets, meanwhile, have taken comfort in a belief that the largest coronavirus impacts will be relatively short-lived and that subsequent Chinese stimulus will lead to a quick, steep “V-shaped” recovery. Indeed, China has already rolled out a litany of monetary and fiscal stimulus measures in response, and is planning additional tax cuts and rent reductions for businesses.³ A quick recovery is a reasonable working thesis, but questions remain as to how fast China will be able to resume normal business activity, and whether the virus spread will reaccelerate once business resumes. Near-term market dynamics, especially those outside of the U.S., are likely to follow the ebb and flow of virus related news for the next few months.

2020 Outlook Themes Still at Work

While the coronavirus has dominated the headlines thus far in 2020, we are encouraged that the major themes highlighted in our 2020 Outlook continue to trend in a favorable direction. The strength of the U.S. labor market is showing no signs of abating, and continues to underpin healthy consumer spending and our thesis of steady economic growth. Wage increases continue to trend well above inflation (*see Exhibit 2*) which is very positive for spending power, and job creation continues to expand at a healthy clip whether measured by the private ADP survey or the official government labor data (*see Exhibit 3*). It is important to note that a “balanced” U.S. labor market only requires the creation of between 60K and 100K jobs per month to absorb the natural growth in labor force entrants, so the job growth trend remaining well above that range means that the labor market continues to tighten and pull in new workers from the sidelines – which in turn increases U.S. economic potential.

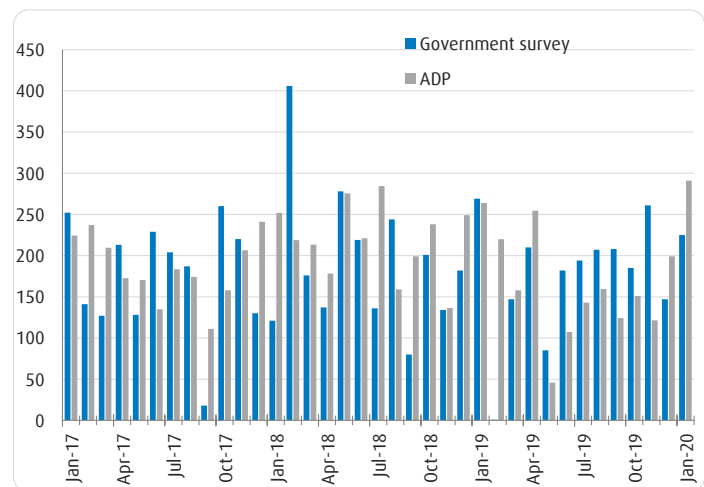
A second theme – the prospect of a manufacturing rebound in 2020 – also began showing signs of life as the recent ISM PMI Manufacturing reading moved into expansionary territory for the first time in six months. These PMI readings have a meaningful forward-looking component, but enthusiasm will likely be

Exhibit 2 » U.S. Wage Growth (Year-over-Year)



Source: Bureau of Labor Statistics; Atlanta Federal Reserve

Exhibit 3 » U.S. Payroll Growth (thousands)



Source: Bloomberg Financial; BMO Wealth Management

³ <https://www.scmp.com/news/china/society/article/3051236/china-takes-new-steps-help-revive-coronavirus-hit-economy>

tempered by the still uncertain path of coronavirus developments. A similar story is playing out in Europe, where the manufacturing PMI hit a five-month high in late January, but again based on data that does not incorporate the fast-developing effects of the virus outbreak on global supply chains and demand.

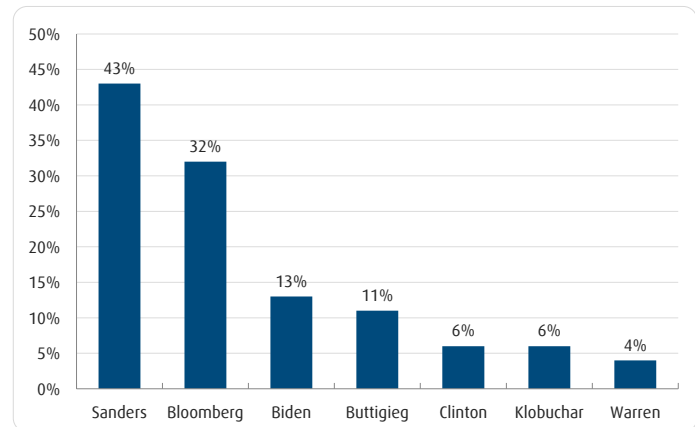
The tailwind from monetary and fiscal policy, another 2020 Outlook theme, also continues to support economic growth. The Fed maintains a dovish bias and China's recent stimulus measures include a central bank interest rate cut. On the fiscal policy front, U.S. House Democrats recently unveiled a proposed \$760 billion infrastructure spending package over five years and are looking to make a bipartisan push to bring it to fruition.⁴ Not to be outdone, the Trump administration recently floated the prospect of new middle-class tax cuts and tax incentives for investors. The monetary and fiscal spigots remain open.

Politics, the final theme of our 2020 Outlook, will most likely begin to take center stage for the financial markets as the Democratic nominee comes into clearer view. In a string of surprise twists, Bernie Sanders has become the clear front-runner but is trailed by a surging Michael Bloomberg in prediction markets (*see Exhibit 4*). Based on modeling by FiveThirtyEight, it's close to even odds that Sanders will secure enough pledged delegates to win the nomination prior to the Democratic Convention in July (*see Exhibit 5*). The odds of a "brokered convention" are also meaningful, with Democratic "super-delegates" then coming squarely into play. These super-delegates likely have less enthusiasm for a Sanders nomination. Should the Democratic convention arrive without a nominee, President Trump is the primary beneficiary. So, it is no surprise that in the background of these Democratic primary developments, President Trump's odds of re-election have also been rising in prediction markets.

Barring any unforeseen political developments (always a possibility...), at this point the coronavirus outbreak represents the most tangible risk to our 2020 narrative calling for favorable equity markets built on a backdrop of improving global growth. Should the perceived containment change course, we will readdress our position. Until then, we expect a "bend but don't break" outcome in the first half of 2020 as economies around the world navigate this difficult, human crisis.

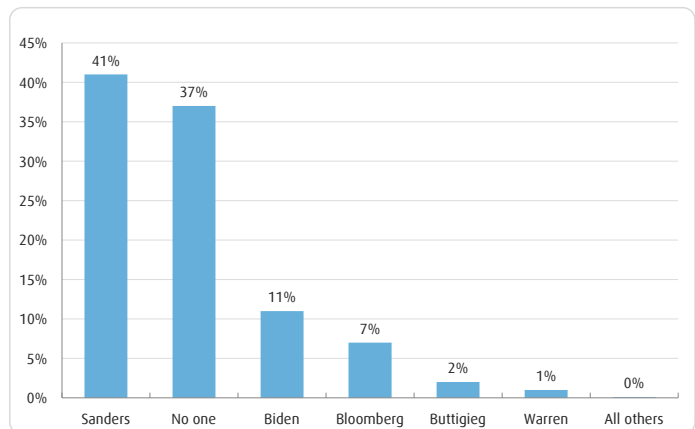
⁴ https://www.washingtonpost.com/local/trafficandcommuting/house-democrats-unveil-760-billion-infrastructure-package--and-call-on-trump-for-bipartisan-push/2020/01/29/2656e2d0-42ce-11ea-b5fc-eefa848cde99_story.html

Exhibit 4 » Prediction Markets: Probability of Securing Democratic Nomination (as of mid-February 2020)



Source: Predict.org

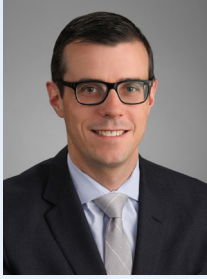
Exhibit 5 » Probability of Winning Nomination Before the July Democratic Convention



Source: fivethirtyeight.com

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As Chief Investment Officer and National Head of the Investment team, Michael chairs the Personal Asset Management Committee and is responsible for setting investment policy and strategy for our

clients throughout the United States. He joined BMO Wealth Management in 2013 as a Managing Director of Investments for our Ultra High Net Worth group, and became National Head of Investments in 2015. In January 2018, Michael took over the role of Chief Investment Officer. With close to two decades of experience in money management, Michael has a deep background in economic analysis, portfolio construction and risk management.

Michael earned a BA in economics from Northwestern University and an MBA with distinction in finance and decision sciences from the J.L. Kellogg Graduate School of Management at Northwestern University in Evanston, Illinois. He is a member of the Beta Gamma Sigma International Honor Society, holds a Chartered Financial Analyst designation, and is a member of the CFA Institute, CFA Society of Chicago, and the Chicago Quantitative Alliance. He is also a graduate of the American Bankers Association – National Trust School.



Yung-Yu Ma, Ph.D.
Chief Investment Strategist
BMO Wealth Management – U.S.

As Chief Investment Strategist, Yung-Yu is responsible for performing macroeconomic analysis, valuation modeling and market analysis across asset classes to guide strategic and tactical asset allocations for client portfolios.

Prior to joining BMO Wealth Management, Yung-Yu was a finance professor at Lehigh University, where he taught courses in fixed income, equities and derivatives. His academic studies have been cited in the *Wall Street Journal*, in leading finance journals, top law journals, the *Handbook of High Frequency Trading*, and in *Oxford Handbook of Corporate Governance*. During his tenure at Lehigh, he was awarded the Staub Outstanding Teacher Award, awarded to one faculty member by a vote of faculty and students. Prior to his academic career, Yung-Yu worked for a global consulting firm performing financial and market analysis for global companies with operations in Hong Kong, Taiwan and Mainland China. Later, he oversaw the operations at a Fortune 500 subsidiary in Taipei and Mainland China.

Dr. Ma earned his Ph.D. in Finance at the University of Utah and his B.A. in Economics and Political Science, *magna cum laude*, at Williams College.

Yung-Yu lives in Portland, Oregon with his wife and two children. He is a basketball fan and enjoys cheering on his children's teams.



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