FLASH

A guide to income in a low yield environment

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As the world is experiencing low nominal growth and investors brace for a long-lasting “Japanification” of economies worldwide the hunt for income steps up.

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Since 2018, developed economies have experienced a slowdown in growth, with the US expected to grow at approximately 2% and Europe and Japan at less than 1%. Emerging markets are not immune to this trend of tensioning global trade.

Industrial activity has also been contracting globally since 2018, alongside business confidence, which in the case of Germany is at post-crisis lows. Inflation continues to be well below target and trends lower for most developed and some EM economies. Moreover, it is expected to remain low for longer due to structural factors such as technology, the rising share of services in economies and high level of indebtedness.

In this context, central banks had no other option but to perform a U-turn towards easing, in sharp contrast to only a year ago when normalization was attempted by ending quantitative easing programs and raising interest rates. Arguably, monetary policy has reached its limit, especially in Europe and Japan, where central banks have little, if any, room left for maneuvering. The Fed has more flexibility but the question is, for how long?! The only reasonable conclusion is that fiscal stimulus will be required next time a downturn occurs, as was recently indicated by ECB president Mario Draghi.

On the positive side, we observe no slowdown in the service sector, which represents 65-75% of the GDP of developed economies and keeps growing across developed economies and China. Additionally, household consumption remains firm as unemployment is low and trending lower, the value of assets is not decreasing and there is affordable financing available. It’s worth noting that for now, household consumption more than offsets the weakness in industrial activity and capital spending.

This will continue to be the case until negative business sentiment has an impact on employment, asset value declines (real estate, equity markets) or an exogenous inflationary shock (higher oil prices, tariffs…) lowers real purchasing power.

In this low growth world, we design portfolios with our risk-based investment process, striving to strike the right balance between managing downside risk and maintaining upside potential. Therefore, in fixed income we currently recommend investing in a “new barbell” way: combining long duration government bonds with short-duration high yield and short-duration hard currency emerging debt.

In equities, we favor our core equities. Core equities are company shares to hold onto in the long run, regardless of the economic cycle. These companies have robust balance sheets, good profitability and sustainable growth. They can be found across different sectors but all have one common denominator: they each have a strong competitive advantage. They also offer a very welcome source of yield in a low interest rates World.

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