As trade tussles continue on the world stage and low to negative interest rates dominate developed market economies, investors have begun to ponder the likelihood of a recession in 2020 and how extreme it might be. We asked experts from BNY Mellon Investment Management for their views.

Q: Has the probability of a global recession increased recently?

“I do think the probability of a recession has increased in recent months. I think one of the big reasons active management has struggled, particularly over the past couple of years, is that equity has really stopped following fundamentals. If you look at just simple earnings growth, we had great earnings growth last year and yet the market ended the year in the negative. This year we've had flat to negative earnings growth and market performance has been high double digits year-to-date. When the markets stop following fundamentals and we have active managers that are looking at fundamentals so closely they're going to naturally fall behind,” Liz Young, director of market strategy, BNY Mellon Investment Management

“We're very long in the tooth in this economic cycle and I would argue we're overdue for a small market correction. I'm concerned that global monetary policies have done all of the heavy lifting since the global financial crisis. The fact that you have $15 trillion in negative nominal yields—that's a violation of everything I learned in economics. I think they've been trying to hammer in a nail with a screwdriver for the last decade and it's been the wrong tool for the job. The central banks also have their hands tied. They're using goods inflation and a price target as their only objective function metric. That's created its own set of distortions, which I think is ultimately going to cause things to become unstuck,” Curt Custard, CIO at Newton, a BNY Mellon Investment Management company

Q: What's your main concern about the next recession?

“I worry about the water going out of the pool and people's swim trunks getting exposed when we do have a recession. The negative impact of monetary policy since the global financial crisis is how it's increased financial asset returns and diminished future expected returns. It has pushed more money into less liquid assets. When you put less liquid assets in a highly liquid structure, those are some of the places I believe we're going to see problems erupt when we get the next downturn. It won't be subprime mortgages this time,” Dave Leduc, active fixed income CIO, Mellon, a BNY Mellon Investment Management company

“I'm less concerned about a global recession and more concerned over the five-year time frame for the impact of populism, which could potentially change the fundamental rules of capitalism—whether it's a Tobin tax, or the loss of independence by monetary authorities,” Curt Custard, CIO at Newton, a BNY Mellon Investment Management company

1 Financial Times: Negative rate: investors go through looking glass to sub-zero yields, October 3, 2019
Q: What could the ramifications for investors and their portfolios be?

“As investors, I think we have to redefine what diversification really means. It’s not just the way the market has dislocated from fundamentals—another factor behind this is the blurring of sectors. So take a company like Tesla, for example, where does that belong? Is that an auto company or is that a technology company? It used to be that we could say ‘alright if I fill in all the sector boxes and if I fill in all the style boxes I am diversified’. That is no longer the case. Now you have to think about what's driving each these different securities. Is it AI, the consumer, or fiscal spending? It’s not enough to simply diversify your asset classes or sectors anymore, you have to diversify your drivers too, which is a lot trickier to do,” Liz Young, director of market strategy, BNY Mellon Investment Management

“Right now, credit spreads around the world are reasonably tight. In our view, the answer isn’t to avoid credit risk or investing in assets with default risk—but instead to spend more time with your research teams to identify threats and opportunities in those markets and build diversified portfolios. Investing in an uncertain world isn’t about running for cover and staying under the rocks—it's about realizing all these developments can impact your portfolio in ways you might not expect, therefore broad asset allocation decisions may not necessarily help,” Curt Custard, CIO at Newton, a BNY Mellon Investment Management company
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