MARKET PERSPECTIVES | AUGUST 2019

Vanguard economic and market update

Vanguard's key points:

- Major global equity markets have fallen in the last month, many by more than 5%, amid heightened US-China trade tensions, among other factors.
- Against a backdrop of weakening growth and uncertain policymaking globally, investors should expect more volatility.
- It is important that investors have a balanced portfolio that they can remain committed to, says Vanguard Chief Investment Officer Greg Davis.

Recession risk

The phenomenon of shorter-term interest rates exceeding longer-term rates is known as an inverted yield curve, and it's traditionally a harbinger of recession.

- Vanguard has been closely watching the yield curve since the yield on US 3-month Treasury bills exceeded that of 10-year notes in March. On August 14, the 2-year/10-year curve similarly inverted, for the first time since 2007. Equity markets took notice, with the S&P 500, as an example, falling nearly 3%.
- Vanguard's base case currently isn't for a US recession in 2020. But if the yield curve doesn't normalise after the September US Federal Reserve meeting, Vanguard is poised to reassess its outlook for both a US recession and the Fed's interest-rate target.

Economic growth

Vanguard expects softening **global growth** to continue over the next 12 months owing to trade tensions and policy uncertainty. A global or major regional recession still is not our base case, but the risk is more elevated than normal.

- In the **United States**, with US-China trade tensions still high, Vanguard sees growth slowing to below trend by the end of the year. On June 10, Vanguard cut its outlook for US economic growth to 1.7% (annualized) for the second half of the year, with full-year 2019 growth now lower at close to 2%.
- In **China**, Vanguard still sees 2019 real GDP growth at 6.2%, but with risks to the downside. With China in a prolonged structural slowdown, we see growth further slowing to closer to 5.8% in 2020 given continued private-sector weakness and drags from US tariff escalations.
- In the **euro area**, following continued deterioration in global manufacturing and an escalation of US-China trade tensions, we have downgraded our 2019 GDP forecast from 1.0% to 0.8%. We now place a 35% to 40% probability on a euro area recession in the next 12 months.
- In the **UK**, we expect growth to remain sluggish given the ongoing drag from Brexit uncertainty, and the weaker global backdrop.

Monetary policy

All signs point to central banks lowering interest rates as they aim to stimulate economic growth amid low inflation.

- In a change to our view since our July update, we now expect both the **Bank of England** and the **Bank of Japan** to lower rates later this year. And we foresee other emerging markets following the lead of India, Indonesia, and Thailand, all of which have cut benchmark interest rates recently.

Note: This document represents the house view of the Vanguard Investment Strategy Group's global economics team as of August 14, 2019.

- In the United States, the **US Federal Reserve** cut the target for its federal funds rate, as we expected, by 25 basis points on July 31 to a range of 2.0% to 2.25%. We expect an additional cut by the end of the year, with the magnitude dependent on the shape of the yield curve.

- We maintain our view that the **European Central Bank** will cut rates by up to 20 basis points and restart quantitative easing—an increase in the money supply through central bank purchases of government securities—at a pace of around €30 billion a month by the end of the year.

Inflation

Vanguard's outlook on inflation is mixed, with weaker global growth offset by upward pressure from tariffs. But the sensitivity of core inflation to tight labour markets is likely weaker than in past cycles, owing to increased labour market competition from low-wage offshore workers and advances in technology.

Trade

The **US-China** trade dispute has continued to move global financial markets.

- In the most recent development, the United States said on August 13 that it would delay imposition of 10% tariffs on certain Chinese goods including certain consumer electronics, toys, and clothing until December 15. Still, a sharp escalation in tariffs and concomitant spillovers to global trade represent the greatest downside risk to several of our economic projections.

- Yet despite challenges, global trade isn't dead. In late June, the European Union and the South American trading bloc known as Mercosur reached a broad trade agreement that, among other things, removes most tariffs on EU exports to Brazil, Argentina, Uruguay, and Paraguay.

Brexit

We expect Brexit-related uncertainties to persist into the new year, with a rebound in UK GDP in the quarters following an agreement, which we see as the most likely longer-term outcome.

- The ISG research paper *It's not EU, it's me: Estimating the impact of Brexit on the UK economy* presents Vanguard's findings on the potential effects of Brexit under a variety of scenarios.

Employment

Vanguard expects unemployment rates in most major economies to remain broadly stable in the year ahead.

- However, Vanguard foresees the decline in US employment growth continuing as the labour market's ability to fill jobs disappears and businesses curb hiring over heightened policy uncertainty and trade concerns.

Connect with Vanguard® > global.vanguard.com

Important Information

This document is directed at professional investors only, as defined under the MiFID II Directive, and should not be distributed to or relied upon by retail investors. It is for educational purposes only and is not a recommendation to buy or sell investments. Not for public distribution.

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested. Any projections should be regarded as hypothetical in nature and also do not reflect or guarantee future results.

For Israeli clients only. This document has not been approved by the Israeli Securities Authority and will only be distributed to Israeli residents in a manner that will not constitute "an offer to the public" of units of a fund ("Units") under sections 15 and 15a of the Israel Securities Law, 1968 ("the Securities Law") or section 25 of the Joint Investment Trusts Law, 1994 ("the Joint Investment Trusts Law"), as applicable.

The Units are being offered to a limited number of investors (35 investors or fewer during any given 12 month period) and/or those categories of investors listed in the First Schedule ("the Schedule") to the Securities Law ("Sophisticated Investors") as may be amended from time to time.

An offeree identifying itself as a Sophisticated Investor will be required to confirm in writing that it falls within one of the criteria for being deemed as such (and, in certain cases, additionally to provide third party confirmation of the same) and that it is aware of the consequences of being classified as a Sophisticated Investor.

Any offeree who purchases Units is purchasing such Units for its own benefit and account and not with the aim or intention of distributing or offering such Units to other parties (other than, in the case of an offeree which is an Sophisticated Investor by virtue of it being a banking corporation, portfolio manager or member of the Tel-Aviv Stock Exchange, as defined in the Schedule, where such offeree is purchasing Units for another party which is an Sophisticated Investor).

Vanguard Asset Management, Limited ("Vanguard") does not hold a licence to conduct investment marketing, under the Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 1995 ("the Investment Advice Law"), nor does it carry the insurance as required of a licensee thereunder. Investors are encouraged to seek competent investment advice from a locally licensed investment adviser prior to making the investment, as well as legal, business and tax advice from competent local advisers.

This document may not be reproduced or used for any other purpose, nor be furnished to any other person other than those to whom copies have been sent. As a prerequisite to the receipt of this document, a recipient must either be capable of being deemed to be a Qualified Client as defined in the Investment Advice Law, or alternatively may be required by Vanguard to provide confirmation that it is a Sophisticated Investor, purchasing Units for its own account or, where applicable, for other Sophisticated Investors. If any recipient in Israel of this document is not a Qualified Client nor a Sophisticated Investor, such recipient should promptly return this document to Vanguard.

This document does not constitute an offer to sell or solicitation of an offer to buy any securities other than the Units offered hereby, nor does it constitute an offer to sell to or solicitation of an offer to buy from any person or persons in any state or other jurisdiction in which such offer or solicitation would be unlawful, or in which the person making such offer or solicitation is not qualified to do so, or to a person or persons to whom it is unlawful to make such offer or solicitation.

Issued by Vanguard Asset Management, Limited which is authorised and regulated in the UK by the Financial Conduct Authority.

Issued by Vanguard Investments Switzerland GmbH.

Vanguard Research

FAVEMOBF 082019