



Getting the “Big Picture Call” Right: Ten Defining Issues for the Teens Decade

By Jack Malvey, CFA
Chief Global Markets Strategist
BNY Mellon Investment Management

A real estate-inspired economic trough looks highly unlikely in this decade.

EXECUTIVE SUMMARY

Our profession devotes a great deal of time to pondering the future. And for good reason. The right “big picture call” about the forward course of economic conditions and capital market values confers a substantial portfolio performance advantage.

The benefits of identifying the correct “big picture call” have been striking so far in the early 21st century. On a naïve market-weighted allocation from January 1, 2000 to January 31, 2014, global equities (0.42%) and global bonds (5.41%) combined to produce a mediocre composite average annual return of just 2.68% as shown in Figure 1. But astute, big-picture aware portfolio managers could have done much better.

The equity valuation excesses of the late 1990s’ dot.com era were rinsed from the financial system during 2000–2002. A reduction in equity allocation, especially to the tech sector, in the late 1990s, followed by a reversal to a higher equity exposure in late 2002 would have rewarded portfolios.

So too, the systemic overindulgence in financial leverage peaked in 2008 and is still rightsizing in 2014. These systemic purifications ultimately will be recalled as therapeutic and as having laid the foundation for a sounder global financial system. For asset managers, a pre-2007 reduction in portfolio exposure to equities, credit, and real estate securities and a subsequent switch back in early 2009 generally would have made for handsome relative portfolio returns.

Of course, such perfect portfolio allocation agility is easier to portray in hindsight than to achieve through foresight. In a forecasting field already crowded with bias errors, the two most common mistakes in forging asset class return expectations are the tendency to extrapolate the immediate past into the future and to become inordinately influenced by the headlines of the moment. Accordingly, a real estate-inspired economic trough like 2007-2009 looks highly unlikely in this decade. And Fed “tapering” of U.S. Treasury bond purchases, to conclude in 2014, will not figure in the economic discourse of the late Teens.



When and how does the next U.S. recession arise?

The most adept pension funds balance attention to current events with their obligation to meet the long-term needs of their beneficiaries. This difficult process can be facilitated by the simplification of global financial system scenarios into a concise set of pivotal issues that define the "big picture call."

To illustrate this process, we suggest the following ten issues that in our view likely will define the paths of key capital market parameters and hence pension fund returns over the balance of this decade.

FIRST, when and how does the next U.S. recession arise? The longevity and magnitude of this unfolding global and U.S. economic expansion (about to celebrate its fifth anniversary in June 2014) will become an increasing concern as the end of this decade approaches. Although many pension plan sponsors refrain from high-frequency timing tactics, a late-business cycle portfolio rotation from risky to less-risky asset classes likely will prove beneficial before 2020 in our opinion.

SECOND, the normalization of monetary and fiscal policies without mishap by advanced economies would imply the defeat of deflation, the suppression of inflation, the resuscitation of corporate animal spirits, and the attainment of more vigorous global economic growth. This happy scenario would support extended economic growth, equity valuation advances, just a modest increase in interest rates, moderate housing value appreciation, alternative asset class attractiveness, and stable commodity values. Although likely to be realized over the long run, chances are high of a zig-zag trail rather than a linear path in the Teens in our opinion.

THIRD, the vast regulatory revamp of the global financial system, aimed at systemic risk mitigation, may bring unintended consequences along with its hopeful advantages. For example, volatility may run higher than in past business cycles while liquidity remains scarce, which could influence investor allocation and security selection preferences.

FOURTH, after nearly four decades of blistering economic growth, China has commenced a deceleration from a 7%-10%+ velocity to sub-7%. After 2014, Chinese transition to more internally-based consumption, stepped-up environmental remediation, and full currency convertibility could alter global capital market flows and curb world economic growth, especially for EM economies. Key commodities, like copper, may wind up with lower prices.

FIFTH, although emerging market (EM) economies likely will converge in the long run to advanced economy (AE) status, EM and AE business cycles are asynchronous. In turn, the budding economic recoveries in Europe and Japan in the mid-Teens could be restrained by EM economic slack. This would also chill enthusiasm for frontier markets like sub-Saharan Africa.

SIXTH, from a widely entertained "twilight thesis" a decade ago, U.S. hydrocarbon production has been soaring thanks to the fracking revolution. The apparent global abundance of fossil fuels will aid consumers and energy-intensive industries. This will help corral inflation and promote economic growth. Like the early-to-mid 1980s, energy producers and the commodity asset class may suffer from lower energy prices.

SEVENTH, the power of demographics will intensify as boomers retire in record numbers throughout advanced economies. This likely will occasion a shift into more defensive financial products like bonds. As the world economic system becomes more open, human capital migration also will increase along with associated capital flows like remittances.

EIGHTH, the comparative dormancy of geopolitical risk hopefully persists far into the 21st century. But history does not reassure, as Russia's incursion into Ukraine shows.

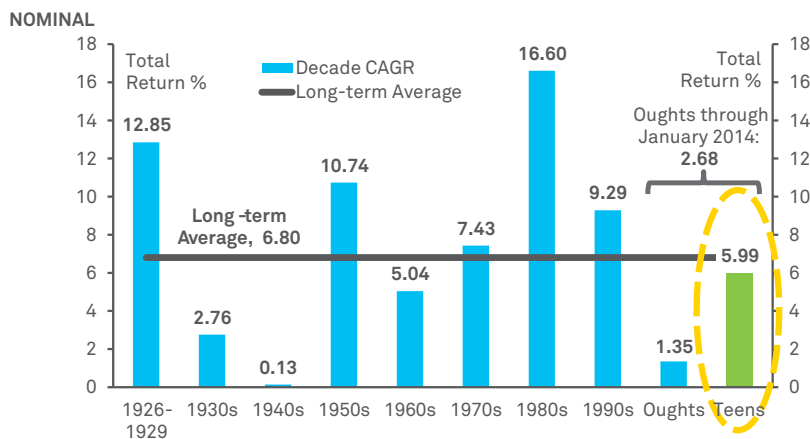
NINTH, a kind of Moore's Law guides innovation. The rate of technological change appears to be quickening in the early 21st century. Thanks to the pursuit of "big data," markets have never been as richly informed. Technological progress breeds new products and new methods. Financial markets largely will be beneficiaries.

TENTH, the philosophy and methods of asset management will evolve. Horizon extensions to multi-year performance calibrations, the severance of allegiance to generic and even customized indices in the pursuit of absolute return maximization, increased allocation timing flexibility, and a growing preference for green, socially-responsible issuers will number among a few of the forthcoming methodological adjustments.

Fraught with old and new challenges, the second half of the Teens will unlikely be a golden age for financial asset returns rivaling the 1980s and 1990s. But compared to the opening decade of the 21st century, plan sponsors may look back favorably on the Teens. Indeed, the best working title for the next "big picture call" may be "Coping with Relative AE Prosperity."

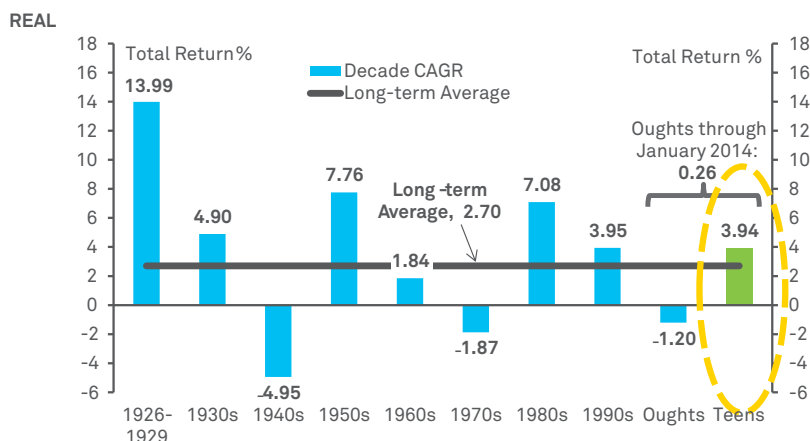
The philosophy and methods of asset management will evolve.

Figure 1. Global Financial Asset Returns by Decade: 1926 to January 31, 2014



	1926 - 1999	1946 - 1999	1970 - 1999	1970s	1980s	1990s	Oughts	2010 - January 31, 2014	Oughts through January 31, 2014	Jan-14
GLOBAL EQUITY	9.64	11.19	12.11	6.96	20.77	9.09	-2.60	8.22	0.42	-3.31
GLOBAL BOND	4.78	5.48	9.07	7.16	12.02	8.08	5.84	4.39	5.41	1.38
GLOBAL FINANCIAL ASSET	7.60	8.69	11.04	7.43	16.60	9.29	1.35	5.99	2.68	-0.73

	1926 - January 31, 2014	1980 - January 31, 2014
GLOBAL EQUITY	8.11	8.61
GLOBAL BOND	4.89	8.10
GLOBAL FINANCIAL ASSET	6.80	8.55



	1926 - 1999	1946 - 1999	1970 - 1999	1970s	1980s	1990s	Oughts	2010 - January 31, 2014	Oughts through January 31, 2014	Jan-14
GLOBAL EQUITY	5.12	4.99	3.98	-2.30	10.91	3.76	-5.05	6.13	-1.94	-3.22
GLOBAL BOND	0.47	-0.40	1.16	-2.12	2.88	2.80	3.17	2.37	2.94	1.47
GLOBAL FINANCIAL ASSET	3.17	2.63	2.98	-1.87	7.08	3.95	-1.20	3.94	0.26	-0.64

	1926 - January 31, 2014	1980 - January 31, 2014
GLOBAL EQUITY	3.96	3.37
GLOBAL BOND	0.86	2.88
GLOBAL FINANCIAL ASSET	2.70	3.30

Global Financial Asset: Equally weighted average return of Global Equity and Global Bond from 1926 to 1989; market-value weighted average return from 1990 to current. Global Equity: Data provided by Global Financial Data, a provider of historical market datasets and indices as described at www.globalfinancialdata.com, from 1926 to 1987; MSCI-Hedged World U.S. \$ Index from 1988 to current. Global Bond: Data provided by Global Financial Data from 1926 to 1986; Barclays Live from 1987 to current. Global Bond U.S.-dollar hedged after 1986; Global Equity U.S.-dollar hedged after 1987. Financial asset total return series begins in 1926; Global Equity total return except from 1988 to current.

Source: BNY Mellon using data from FactSet, Bloomberg, Global Financial Data, and Barclays Live.

BNY Mellon Investment Management is one of the world's leading investment management organizations and one of the top U.S. wealth managers, encompassing BNY Mellon's affiliated investment management firms, wealth management organization and global distribution companies. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally. • The statements and opinions expressed in this document are those of the authors as of the date of the article, are subject to change as economic and market conditions dictate, and do not necessarily represent the views of BNY Mellon, BNY Mellon Investment Management EMEA Limited or any of their respective affiliates. The information contained in this document has been provided as a general market commentary only, and does not constitute legal, tax, accounting, other professional counsel or investment advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. The information has been provided without taking into account the investment objective, financial situation or needs of any particular person. BNY Mellon Investment Management EMEA Limited and its affiliates are not responsible for any subsequent investment advice given based on the information supplied. This document is not investment research or a research recommendation for regulatory purposes as it does not constitute substantive research or analysis. To the extent that these materials contain statements about future performance, such statements are forward looking and are subject to a number of risks and uncertainties. Information and opinions presented in this material have been obtained or derived from sources which BNY Mellon believed to be reliable, but BNY Mellon makes no representation to its accuracy and completeness. BNY Mellon accepts no liability for loss arising from use of this material. If nothing is indicated to the contrary, all figures are unaudited.

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When you sell your investment you may get back less than you originally invested. • While the information in this document is not intended to be investment advice, it may be deemed a financial promotion in non-U.S. jurisdictions. Accordingly, where this document is used or distributed in any non-U.S. jurisdiction, the information provided is for use by professional and wholesale investors only and not for onward distribution to, or to be relied upon by, retail investors. • This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country in which such distribution or use would be contrary to local law or regulation. This document may not be distributed or used for the purpose of offers or solicitations in any jurisdiction or in any circumstances in which such offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements. Persons into whose possession this document comes are required to inform themselves about and to observe any restrictions that apply to the distribution of this document in their jurisdiction. **The investment products and services mentioned here are not insured by the FDIC (or any other state or federal agency), are not deposits of or guaranteed by any bank, and may lose value.** This document should not be published in hard copy, electronic form, via the web or in any other medium accessible to the public, unless authorized by BNY Mellon Investment Management EMEA Limited.

In **Australia**, this document is issued by BNY Mellon Investment Management Australia Ltd (ABN 56 102 482 815, AFS License No. 227865). Authorized and regulated by the Australian Securities & Investments Commission. • In **Brazil**, this document is issued by BNY Mellon Serviços Financeiros DTVM S.A., Av. Presidente Wilson, 231, 11th floor, Rio de Janeiro, RJ, Brazil, CEP 20030-905. BNY Mellon Serviços Financeiros DTVM S.A. is a Financial Institution, duly authorized by the Brazilian Central Bank to provide securities distribution and by the Brazilian Securities and Exchange Commission (CVM) to provide securities portfolio managing services under Declaratory Act No. 4.620, issued on December 19, 1997. • Securities in **Canada** are offered through BNY Mellon Asset Management Canada Ltd., registered as a Portfolio Manager and Exempt Market Dealer in all provinces and territories of Canada, and as an Investment Fund Manager and Commodity Trading Manager in Ontario. • In **Dubai, United Arab Emirates**, this document is issued by the Dubai branch of The Bank of New York Mellon, which is regulated by the Dubai Financial Services Authority. This material is intended for Professional Clients only and no other person should act upon it. • In **Hong Kong**, this document is issued by BNY Mellon Investment Management Hong Kong Limited. Regulated by the Hong Kong Securities and Futures Commission. • In **Japan**, this document is issued by BNY Mellon Asset Management Japan Limited. BNY Mellon Asset Management Japan Limited is a Financial Instruments Business Operator with license no 406 (Kinsho) at the Commissioner of Kanto Local Finance Bureau and is a Member of the Investment Trusts Association, Japan and Japan Securities Investment Advisers Association. • In **Singapore**, this document is issued by BNY Mellon Investment Management Singapore Pte. Limited Co. Reg. 201230427E. Regulated by the Monetary Authority of Singapore. • This document is issued in the **UK** and in **mainland Europe**, by BNY Mellon Investment Management EMEA Limited, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorized and regulated by the Financial Conduct Authority. • This document is issued in the **United States** by BNY Mellon Investment Management.

BNY Mellon Cash Investment Strategies is a division of The Dreyfus Corporation. • BNY Mellon Western FMC, Insight Investment Management Limited and Meriten Investment Management GmbH do not offer services in the U.S. This presentation does not constitute an offer to sell, or a solicitation of an offer to purchase, any of the firms' services or funds to any U.S. investor, or where otherwise unlawful. • BNY Mellon Western Fund Management Company Limited is a joint venture between BNY Mellon (49%) and China based Western Securities Company Ltd. (51%). The firm does not offer services outside of the People's Republic of China. • BNY Mellon owns 90% of The Boston Company Asset Management, LLC and the remainder is owned by employees of the firm. • BNY Mellon owns a 19.9% minority interest in The Hamon Investment Group Pte Limited, the parent company of Blackfriars Asset Management Limited and Hamon Asian Advisors Limited both of which offer investment services in the U.S. • Services offered in the US, Canada and Australia by Pareto Investment Management Limited under the Insight Pareto brand. • The Newton Group ("Newton") is comprised of the following affiliated companies: Newton Investment Management Limited, Newton Capital Management Limited (NCM Ltd) and Newton Capital Management LLC (NCM LLC). NCM LLC personnel are supervised persons of NCM Ltd and NCM LLC does not provide investment advice, all of which is conducted by NCM Ltd. Only NCM LLC and NCM Ltd offer services in the U.S. • BNY Mellon owns a 20% interest in Siguler Guff & Company, LP and certain related entities (including Siguler Guff Advisers LLC). • BNY Mellon Investment Management EMEA Limited and any other BNY Mellon entity mentioned above are all ultimately owned by BNY Mellon, unless otherwise noted.

The Alcentra Group
ARX Investimentos Ltda
BNY Mellon Cash Investment Strategies
BNY Mellon Western Fund Management
Company Limited
The Boston Company Asset Management, LLC
CenterSquare Investment Management, Inc.
CenterSquare Investment Management Holdings, Inc.
The Dreyfus Corporation
EACM Advisors LLC
Hamon Investment Group
Insight Investment
Mellon Capital Management Corporation
Meriten Investment Management
The Newton Group
Siguler Guff & Company LP
Standish Mellon Asset Management Company LLC
Walter Scott & Partners Limited



BNY MELLON

本情報提供資料は、BNY メロン・グループ（BNY メロンを最終親会社とするグループの総称です）の資産運用会社が提供する情報について、BNY メロン・アセット・マネジメント・ジャパン株式会社が審査の上、掲載したものです。当資料は情報の提供を目的としたもので、勧誘を目的としたものではありません。当資料は信頼できると思われる情報に基づき作成されていますが、その正確性、完全性を保証するものではありません。ここに示された意見などは、作成時点での見解であり、事前の連絡無しに変更される事もあります。

BNY メロン・アセット・マネジメント・ジャパン株式会社
BNY Mellon Asset Management Japan Limited

金融商品取引業者：関東財務局長（金商）第 406 号
〔加入協会〕 一般社団法人 投資信託協会
一般社団法人 日本投資顧問業協会