Northern Trust | What Lies Ahead for the Markets

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With an ugly start to the fourth quarter, investors have been faced with some troubling macro news, and have voted with their feet, sending risk assets into the red. It's time to examine what lies beneath the concerns, and what lies ahead for the markets. Let's break it down. Global macroeconomic data has skewed to the weak side so far in October, with dismal purchasing manager reports out of Europe, a continued slowdown in China manufacturing, and a surprisingly weak manufacturing and services PMI out of the US, adding to investor anxiety.

The R word has reared its ugly head, as many worry that after a lengthy economic cycle, we're headed towards a recession. Adding to the concern is heightened political and geopolitical risk, and what seems to be a pretty empty global central banking toolbox. We've been forecasting weaker growth for some time now.

So the numbers are not necessarily a surprise. We do not, however, forecast a global recession at this point. But we're not naive in this assumption. We do see some warning signs that bear watching. In addition to the weakening data, we're mindful that credit spreads have widened in October, as growth has become more challenged.

We also recognize that the now lengthy inversion of the US yield curve, 3 month to 10 year, provides a cautionary signal. That brings us to some potential remedies. First and foremost, central banks will have to remain accommodative, and the US Federal Reserve needs to continue to ease, probably several times over the next six months.

This will be necessary, but not sufficient to drive growth going forward. Second, we could see an amping up of the thus far measured stimulus out of China. Third, there remains a possibility of a fiscal impulse out of Germany, perhaps made more probable as Christine Lagarde assumes leadership at the ECB. For investors, the risks remain relatively high. We have the ongoing trade tensions between the US and China. We have Brexit, and we have a Fed that remains out of step with the market.

That said, we continue to believe that investors will be compensated for taking these risks. However, we think that the markets will continue to be volatile, and we encourage investors to maintain vigilance over their allocation between risk and risk control assets, making sure that the proportions are aligned with goals, and any near-term liquidity needs. It might be a bumpy ride, but we remain constructive on risk.

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