Eye On The Market Outlook 2018 – Executive Summary - Text Script – TIME: 8:07

On screen:

White text on a brown screen.

Text on screen:

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Note:

Upbeat introduction music plays.

On screen:

Black text on a white screen.

Text on screen:

J.P. Morgan.

On screen:

This video opens with a series of sketch drawings that turn into a finished painting of an ornate silver punch bowl filled with tiny vacationers sailing, surfing, waterskiing, and fishing. The bowl is engraved, "Central Bank Liquidity," and has a faucet on its side. A hand reaches over to turn the faucet's handle. Above the bowl, a banner attached to an airplane says: "Since March, 2009 - global equities up 240%; global bonds up 37%; and OECD inflation 2%. Then, a close up of Michael Cembalest, a man with short dark hair, glasses, and a blue jacket. White text appears, briefly, on screen.

Text on screen:

Michael Cembalest. Chairman of Market and Investment Strategy, J.P.

Morgan Asset & Wealth Management.

Mr. Cembalest:

When we thought about the cover this year, we wanted to convey what we think is the most important thing to keep an eye on over the next couple of years, which is what the Central banks are up to. There's a global recovery under way. It's built upon substantial foundations of Central bank liquidity. Something on the order of 11 Trillion dollars of asset purchases by Central banks over the last decade or so. There's a lot of liquidity that's going to have to be drained from the system at some point as monetary policy gets normalized.

On screen:

Close-up of the punch bowl painting.

Mr. Cembalest:

The punch bowl is one of the commonly known themes in discussions of central banking and date back to a prior fed chairman who described the job of the central bank is to take the punch bowl away right when the party's getting going. Right now, the party is getting going.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

If you look at the unemployment rate in the U.S., well below 5 percent, below 4 percent pretty soon. Unemployment rates are falling rapidly in Europe. I think we'll be back to a point where there's not a lot of excess labor or industrial capacity by the end of 2018.

On screen:

A line graph entitled, "Global economic expansion picks up steam" appears. The graph shows the percentage of countries with PMI leading indicator in expansion mode - at about 90% in 2017. Small text, beneath the graph reads, “Source - Based on Markit's 35 country universe using data as of October 2017.PMI of 50 denotes expansion. October 2017.”

Mr. Cembalest:

The global recovery is pretty broad based when you look across both the developed economies, the emerging economies, oil exporters are getting recovery, trade is hanging in there, and the list of troubled countries that are on the brink of something terrible happening to them is as small as it's been in a while.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

I think the central bankers of the world probably thought that it was going to take about 3 Trillion dollars of stimulus and happen in three years and it took nine years and $11 Trillion in stimulus. So, the surprise isn't that this global recovery is taking place. The surprise is that it took this long to get here.

On screen:

Close-up of the punch bowl painting.

Mr. Cembalest:

And now that we've finally gotten here and you're seeing things normalize, whether it's inflation or jobs or growth, eventually the stimulus is going to have to be withdrawn.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

We don't think that 2018 is the year where the stimulus gets withdrawn very rapidly.

On screen:

A line graph entitled, "G-4 central bank asset flows" appears. It projects a trillion dollar decline over the course of 2018. Small text, beneath the graph: Source - National central banks, J.P. Morgan. October 2017.

Mr. Cembalest:

So, 2018 to us looks like a year of a small amount of still net accumulation of assets by the central banks. 2019 is when we think they'll generally be acting in a more concerted way to all shrink the size of their balance sheets.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

The other question is what are they going to do with policy rates. We think the fed's going to hike three or four times next year. We're not expecting much hikes in Europe or Japan. But again, in 2019 I can certainly envision an environment where the ECB is normalizing its policy rates as well.

On screen:

Close-up of the punch bowl painting.

Mr. Cembalest:

So what the cover is meant to convey is we think that the good times probably are peaking right now. One last year of one final hurrah in 2018 before the cycle starts to get much more complicated in 2019, 2020.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

In all candor, this monetary policy experiment that we've seen is to a large degree unprecedented.

On screen:

Mr. Cembalest sits with a small group in an office. On a white board is a sketch of the punch bowl picture.

Mr. Cembalest:

I think the central bankers themselves are aware of the known and unknown risks and as we explain in the outlook this year, their plan is to withdraw this liquidity very, very, slowly.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

We obviously know the central banks are paying attention to wage inflation and consumer price inflation, the tightness of labor markets and things like that. But, there are some other factors I think the central banks are looking at that may force them to start withdrawing this liquidity sooner rather than later. That has to do with the distortions that all of their intervention have created.

On screen:

A bar graph entitled, "Government bonds trading below 0% yield" appears, which includes the countries: Germany; Netherlands; Finland; Sweden; Ireland; Austria; Denmark; France; Belgium; Spain; Italy; Portugal; Eurozone Countries; and Japan. Small text, beneath the graph: Source - J.P. Morgan Securities LLC, JPMAM. November20th, 2017. The chart also lists the 5 of total government bonds by market value with Germany at about 60%; Netherlands at about 55%; Finland, Sweden, Ireland, and Austria at about 50%; Denmark and France at about 45%; Belgium at 35%; Spain at about 25%; Italy at 20%; Portugal at about 18 %; Eurozone Countries at about 40%; and Japan at about 50%.

Mr. Cembalest:

This is my 30th year at J.P. Morgan and I never thought I would see a world where somewhere between 40 to 60 percent of the government bonds in Europe and Japan are trading with negative nominal rates below zero.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

I never thought I would see a world where around half of all of the high yield bonds in Europe and even places like Italy are trading in tighter yields than U.S. treasuries. The longer that these distortions exist, the more difficult they are to walk away from. So, I think that's another factor that may force their hand over and above what's taking place with respect to inflation.

On screen:

Mr. Cembalest sits with a small group in an office. On a large monitor is the finished punch bowl picture.

Mr. Cembalest:

One of the reasons that we think that the up side for financial markets will be constrained, positive but constrained, in 2018 is where things are priced.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

When people talk about valuation and optimism, often they'll cherry pick a single statistic. What we do is we have a barometer of 15 or 20 different measures of valuation and optimism. Most of them, not all, but most of the measures we look at are somewhere between the 80th and 95th percentiles compared to history, which means they're on the expensive end of history. That's a signal to us that broadly speaking that the markets are already pricing in a lot of the good news related to this global recovery that we're now seeing.

On screen:

A line graph entitled, "Improving small business sentiment," appears. It shows capex plans, pricing plans and hiring plans all increasing from 2010 to 2017. Small text, beneath the graph: Source – NFIB, October 2017.

Mr. Cembalest:

With respect to the U.S., the growth numbers look good. Most of the surveys are showing increased levels of hiring, CEO business confidence, higher capital spending.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

One of the things we do is in the U.S. section is look at some of the tailwinds or headwinds that could come from the Trump administration. I think the biggest one, obviously, is the tax bill. As I sit here and record this video, we don't know how the reconciliation between the Senate and the House is going to take place. But if they do pass a bill based on the contours of what we're seeing now, we don't think it's going to have a very big impact on the economy, the aggregate amount of tax cuts are less than 1 percent of GDP, and given where the debt and deficit levels are already, there's limited room for real stimulus at this point. As it relates to Europe, I actually never thought I would say the words Europe and 3 percent growth again for the rest of my career, but now it finally looks like we're getting a synchronized recovery in Europe. We also think that there's another leg, at least, left in the emerging markets recovery. Industrial metals prices are firming and global growth is picking up and a lot of the benefits accrue to the regions that are either manufacturing or commodity exporters. So, while the valuations have picked up and conditions aren't quite as attractive as they were in the beginning in 2016 when we really began pounding the table on emerging markets, we still think there's room left for more rising asset prices in the emerging markets in 2018.

On screen:

Mr. Cembalest looks at the punch bowl painting on a large monitor screen with co-workers in an office.

Mr. Cembalest:

So, 2018 looks like the last year of low inflation, accommodative central banks, and rising profits and rising growth.

On screen:

Close-up of Mr. Cembalest.

Mr. Cembalest:

Our sense is that equity investors will earn returns equal to whatever earnings growth turns out to be. Something on the order of 6 to 8 percent on developed world equity markets maybe a little bit higher in the emerging markets. And you're going to start to see actually some lower returns than we've seen recently in the credit markets as both rates and spreads start to widen a little bit. So, 2018 to us looks like a year of modest single digit returns on diversified portfolios.

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