

Still Climbing that Big, Beautiful Wall of Worry

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SEI recently released its second-quarter Economic Outlook. A summary of the conclusions is provided below:

- The bull market in U.S. equities (as measured by the S&P 500 Index) reached its tenth birthday in March. The S&P 500 Index seemed to celebrate these achievements just a few weeks ago by moving into new-high territory—but there now seems to be more fear than cheer on Wall Street. What is the basis for this sense of fear?
- There is deep-seated anxiety that the bull market in equities is on its last legs, the victim of a slowing global economy, the lagged impact of last year's interest-rate increases and, perhaps most importantly, a worsening trade war between the U.S. and China. There is no denying that the bull market in U.S. equities has been one for the record books, both in terms of magnitude and duration. At SEI, we would need to see a severe deterioration in financial and leading economic indicators before climbing on the recession train.
- It is our view at SEI that the U.S. economy should be able to weather this storm. We believe there is still life in the economic expansion, both in the U.S. and globally. If we're right, that means corporate profits should continue to expand and push global stock markets to higher levels in the months ahead. In all, we think the U.S. economy will demonstrate resiliency in the face of what is admittedly a stiff headwind.
- In May of this year, as stocks swooned and bond yields fell sharply, the yield gap widened dramatically in favor of equities. U.S. equities, in our opinion, still appear attractive, at least relative to bonds. In the absence of a recession or a complete meltdown of investor confidence, we believe that these yield spreads strongly support the case for maintaining exposure to equities versus bonds.
- The recent decline in bond yields to levels last seen in 2016 ranks as one of the biggest surprises of the year. The general expectation at the beginning of 2019 was for bond yields to drift higher; instead, the 10-year Treasury benchmark bond has plunged 70 basis points to 2%. We find it hard to justify these moves. In our view, recession is not likely in the absence of a severe policy mistake.
- The most recent (June) FOMC median projection of the Federal funds rate represents a dramatic change from the Committee's December survey. Rather than policy rate increases, the dot-plot suggests there could be one rate cut by the end of this year, followed by another cut next year. However, the median forecast is highly misleading. Seven FOMC members think the Fed is likely to cut two times this year, while seven see no reason to change the funds rate from its current range of 2.25%-to-2.5%.
- It has been a long, lost decade for investors in European equities—at least when juxtaposed against the performance of the U.S. Europe currently faces a variety of idiosyncratic challenges, both economic and political, that makes it hard even for a contrarian investor to get terribly enthusiastic about the near term. Economically, there is no question that the region is going through another soft patch.
- And then there's the looming cloud of Brexit. Although the Brexit date has been delayed until October 31 (Mr. Draghi must be relieved he won't be around to deal with the issue), there is little sign that the breathing space will be put to good use. We can't help but think Brexit will prove to be a highly disruptive event for the U.K. and the European Union, if it indeed occurs. Roughly half of the United Kingdom's trade in goods, both imports and exports, is with the European Union.

A full-length paper is available if you wish to learn more about these timely topics.

Index Definitions

S&P 500 Index: The S&P 500 Index is an unmanaged, market-weighted index that consists of 500 of the largest publicly-traded U.S. companies and is considered representative of the broad U.S. stock market.

Glossary

Idiosyncratic refers to characteristics that are unique or specific to a person or entity.

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