Weekly Economic Commentary

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Gauging Global Growth in 2014 & 2015

Update: Acceleration Expected

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Highlights

The pace of growth in the global economy is a key driver of global earnings growth, and ultimately, the performance of global equity markets.

Global GDP growth in 2014 remains on track to accelerate versus 2013's pace, and the consensus is forecasting acceleration in global growth in 2015.

Potential growth headwinds in 2015 include the prospect for slowing growth in emerging markets, the drop in global commodity prices, ongoing geopolitical tensions, and the likelihood of U.S. and U.K. rate hikes in 2016.

The outlook for global growth is important to investors, since it defines the ultimate pace of activity that creates value for countries, companies, and consumers. As investors begin to digest the S&P 500 earnings reports for the third quarter of 2014, we provide an update on how consensus estimates for economic growth for 2014 and 2015—in the United States and worldwide—have evolved over the past few years.

The International Monetary Fund (IMF) cut its global growth forecasts for both 2014 and 2015 last week (October 6–10, 2014), noting that the outlooks for the Eurozone, Brazil, Russia, and Japan have deteriorated since the summer of 2014, the last time it released a forecast. The IMF's downgrade of global growth—along with its warning about a "frothy" equity market—was cited by many market participants as the catalyst for the equity market sell-off and related volatility last week.

As we have noted in our previous updates on the global growth outlook, the new forecast from the IMF should not have generated the reaction it did. Typically, when the IMF releases a forecast, the majority of financial market participants take little notice of the report. Why? Because consensus forecasts for global gross domestic product (GDP) growth are available monthly from sources like Bloomberg News, and because markets constantly react to changes in projected paths of economic growth amid the daily, weekly, and monthly drumbeat of economic data and global events.

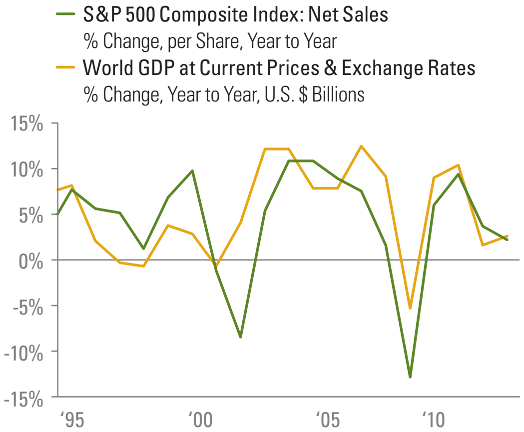
A good proxy for global revenue growth is global GDP growth plus inflation.

Why Global GDP Growth Matters

In the past, prospects for U.S. economic growth garnered the most attention from market participants, but in recent years markets have focused more on the prospects for global GDP growth. Why does global GDP growth matter? As we have noted in prior *Weekly Economic Commentaries*, financial markets—especially equity markets—focus intently on earnings. Broadly speaking, earnings growth is driven by "top-line" growth, or revenue growth, less the costs incurred earning that revenue, with labor accounting for more than two-thirds of total costs. A good proxy for global revenue growth is global GDP growth plus inflation. Thus, the pace of growth in the global economy is a key driver of global earnings growth, and ultimately, the performance of global equity markets [Figure 1]. Analysts expect S&P 500 companies to see more than 4% revenue growth and 7% earnings growth in the third quarter of 2014.

China will report its Q3 2014 GDP data on October 20, 2014, while the United States, United Kingdom, and South Korea will publish Q3 2014 GDP estimates at the end of October 2014. In November, the Eurozone, Indonesia, Poland, Japan, Mexico, Brazil, India, and Canada will report Q3 GDP data. Russia, Australia, and Turkey won't report Q3 GDP until December 2014.

1 Global GDP Has Been a Good Proxy for Corporate Revenue Growth



Source: LPL Financial Research, Haver Analytics, Standard and Poor's 10/10/14

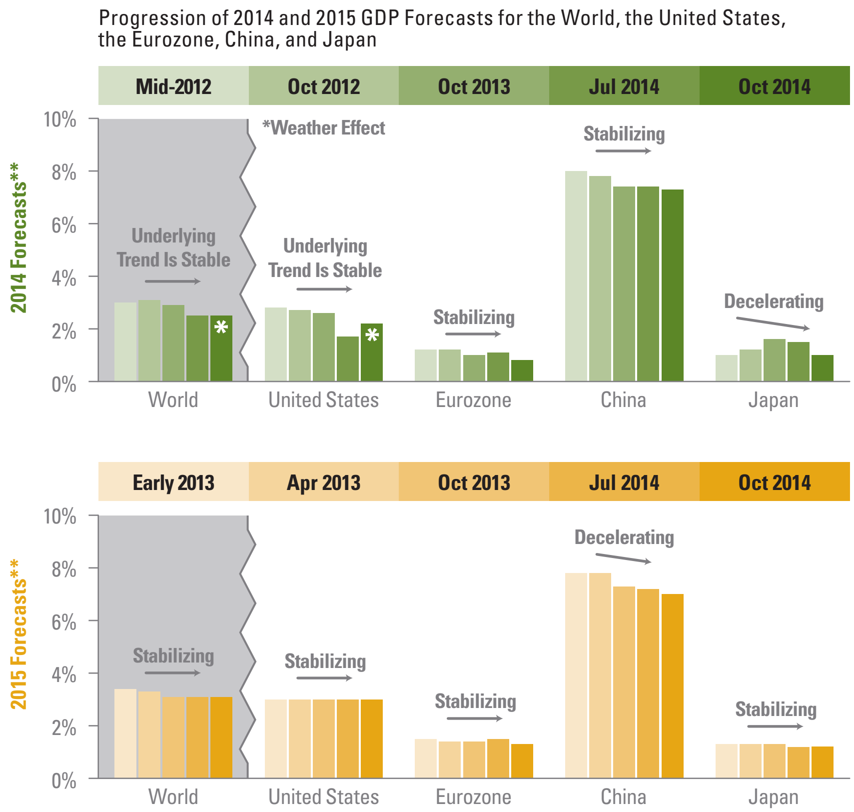
Past performance is no guarantee of future results.

The S&P 500 Composite Index is an unmanaged index of 500 widely held common stocks that measures the general performance of the market. One cannot invest in an index.

Emerging Markets Growth Estimates Marked Down the Most

Figure 2 details the progression of the consensus GDP forecasts for 2014 and 2015 for the world, the United States, China, the Eurozone, and Japan over the past several years. The latest (mid-October, 2014) Bloomberg-tracked economists' consensus forecast for 2014 global GDP growth stands at 2.5%, unchanged from the expectation for 2014 back in July 2014. A year ago, in October 2014, the consensus expected 2.9% growth in 2014. In mid-2012, when Bloomberg first began tracking consensus estimates for global GDP growth for 2014, the consensus expected 3.0% world GDP growth. While the bulk of the markdown of global growth estimates for 2014 was due to unusually cold and snowy winter weather in the United States in the first quarter of 2014, the consumption tax increase in Japan in early 2014 and the persistent weakness in the Eurozone have also been big contributors to the downside. However, outside of the United Kingdom, South Korea, and Australia, every major region of the globe—including the United States and China—has seen growth prospects revised lower over the past year. In general, the downward revisions are equally split between the developed world and emerging markets (EM).

2 Deteriorating EM GDP Forecast Is Weighing on Global Growth



Source: LPL Financial Research, Bloomberg 10/13/14

**Forecasts for 2014 and 2015 made in 2012, 2013, and 2014.

3 Growth Estimates for EM Nations Revised Down Sharply Over the Past Year

Changes to Consensus GDP Forecasts Since October 2013

	2014	2015
World	Down	Flat
United States	Down	Flat
Eurozone	Down	Flat
China	Flat	Flat
India	Up	Flat
Japan	Down	Flat
Russia	Down	Down
Brazil	Down	Down
United Kingdom	Up	Up
Mexico	Down	Flat
South Korea	Up	Flat
Canada	Flat	Flat
Indonesia	Down	Down
Turkey	Down	Down
Australia	Up	Flat
Poland	Up	Flat

Source: LPL Financial Research, Bloomberg 10/13/14

Bloomberg consensus GDP growth estimates are available for the 15 largest economies in the world, which account for 83% of global GDP. Over the past year, just five (United Kingdom, South Korea, Australia, India, and Poland) have seen upward revisions to 2014 GDP estimates [Figure 3], while one (Canada) has seen growth estimates hold steady over the past year. Russia (double whammy of lower oil prices and Ukraine incursion), Brazil (high inflation, hangover from the World Cup, lower commodity prices), and Japan (consumption tax increase) have seen the biggest downward revisions.

Despite all the media attention around China's outlook, estimates for China's economy in 2014 have not moved much. A year ago, in October 2013, the consensus was looking for the Chinese economy to grow at 7.4% in 2014. Today, the consensus is looking for 7.3%. In recent weeks, China's leaders have set the stage for a downshift in growth expectations in China and want markets to focus on a set of broader economic and social indicators as the best measures of China's economy.

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At this point in the year, 2015 growth matters much more than 2014; and global growth estimates have held relatively steady over the past year, but have moved lower nevertheless. When Bloomberg first tallied up 2015 global growth estimates in early 2013, the consensus was for 3.4% growth. Today, the forecast stands at just 3.0%, which is an acceleration from 2014's forecast increase of 2.5%, but still relatively sluggish by historical standards.

Over the past year, 2015 forecasts for 4 of the 15 top global economies have come down, led by Russia, Brazil, and Turkey. Ten of the 15 haven't seen much movement in their 2015 forecasts, while one, the United Kingdom, has seen a noticeable markup of growth estimates for 2015.

On balance—excluding the impact of the weather—global GDP growth in 2014 remains on track to accelerate versus 2013's pace, and the consensus is forecasting acceleration in global growth in 2015. Still, the prospect for slowing growth in emerging markets has sent a shiver through global equity markets in recent weeks, despite the relative stability in developed market economies' forecasts for 2015. The likelihood of rate hikes in both the United States and United Kingdom in 2016, along with the drop in global commodity prices and ongoing geopolitical tensions, are also potential growth headwinds in 2015. But, in recent weeks, Chinese authorities have enacted a series of targeted fiscal, monetary, and administrative actions aimed at stabilizing China's economy. Japan's economy is still benefitting from quantitative easing (QE), fiscal stimulus, and regulatory reform, together known as the Three Arrows, and the Bank of Japan (BOJ) is likely to provide more QE ahead of a planned October 2015 tax hike. In the Eurozone, the release of the results of bank stress tests could pave the way for the European Central Bank (ECB) to embark on its own QE program, aimed at stabilizing the world's second largest economy. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

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