Economic Outlook

Fourth Quarter 2018

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The Outlook for 2019: Party Over, or Will the Beat Go On?

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

- After a promising start in 2018, financial markets across the globe largely moved lower during the year.
- Despite the severity of recent declines in U.S. equities, we believe U.S. economic expansion has a good deal of life left in it. While bearish investors probably disagree with the notion that the stock market can still be considered a turnaround candidate, we think the odds favor a strong rebound in equity prices.
- Our base case is supported by the expectation that the U.S. economy will continue to grow and corporate earnings per share are expected to post a mid-to-high single-digit gain over the course of the year.
- Valuations for the S&P 500 have declined from almost 19 times one-year forward earnings per share to an attractive level of almost 14 times. Investor risk aversion has increased, and so we think much of the bad news flow of recent months is reflected in current stock prices.
- Bond yields remain low, and have moved down again in the past two months, bolstering the case for riskier assets.
- Fiscal policy will not be the strong catalyst for growth it was in 2018, but the impact of political gridlock in Washington should still be mildly expansionary.
- The bear market in oil is largely the result of excess supply, a condition that is expected to improve as low prices reduce shale output in the U.S., sanctions on Iran come into play and both OPEC and Russia reduce output.
- While we don't agree with the notion that Federal Reserve (Fed) rate hikes have ended completely for this cycle, we do see sufficient reasons for a pause. The Fed's dot plot, which reflects the individual policy-rate expectations of all the Fed Governors and regional Fed Presidents, has shifted a bit to the downside. This reverses the upward revision revealed six months ago in the Federal Open Market Committee's Summary of Economic Projections report. Regardless of the number of hikes we see in 2019, the central bank is adopting a wait-and-see approach to monetary policy that is dependent on economic data, ending the nearly automatic quarterly rate increases of 2017 and 2018.
- This outlook sits against a backdrop of political and economic uncertainties that marked 2018 and that show few signs of changing as the New Year begins. Economic activity in most countries (including the U.S.) is not recessionary, but shows signs of further deceleration in the first half of 2019. European countries appear particularly depressed: Germany posted a negative gross domestic product reading as it works through the diesel emission scandal; Italy is close to falling into a recession; and Brexit hangs over the U.K. and its trading partners.
- Upside surprises remain possible. China and the U.S. could step back from a full-blown tariff war; the Fed may halt further rate increases until later in 2019; the U.K. could agree to a soft Brexit/no Brexit deal; corporate profit margins could stay elevated as unit labor costs continue to track below expectations.
- During periods of market volatility such as those we are now experiencing, investors should stick with a strategic, disciplined approach to investing that is aligned with their goals and risk tolerances and not focus on daily market gyrations.

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