# Economic Outlook

Fourth Quarter 2015

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# More of the Same in 2016…With a Little Less Certainty

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

- The challenges that investors faced in 2015 began in January with the election of Alexis Tsipras in Greece. His anti-establishment Syriza party set in motion another round of high-stakes negotiations with Germany and the rest of the eurozone that threatened a Greek debt default and exit from the monetary union. Almost as soon at the Greek drama reached a more-or-less happy resolution, the bubble in the Chinese stock market burst.

- In the U.S., the ongoing speculation over when the Federal Reserve (Fed) would raise the federal funds rate and begin the process of interest rate normalization didn't end until December 19, when the Federal Open Market Committee (FOMC) voted for the first increase in the funds rate since 2006.

- Political turmoil, acts of religious extremism and the collapse in oil prices continued to make headlines through year-end. While the financial markets have seen notable volatility — the S&P 500 Index registered a correction in the third quarter (a decline in prices of 10% or more) with the first decline of this magnitude since 2011 — markets have generally reacted with a yawn (the S&P 500 Total-Return Index gained 1.4% for the year).

- Our broad expectations for 2015 — significantly lower energy prices and more accommodative monetary and fiscal policies boosting economic growth, moderately positive equity-market performance for the U.S. that nonetheless lagged Japan and the eurozone on a local-currency basis, and a strong U.S. dollar compared to most other currencies — proved reasonably accurate. As for U.S. interest rates, our base case for 2016 is for more of the same: we expect yields to move slowly higher, much closer to the market's expectations than those expressed by the FOMC members.

- The Fed will remain data-dependent, which means it is expected to be exceedingly careful in jumping to conclusions about the economy's strength and its impact on inflation. If it pursues a cautious approach to interest-rate normalization, it should prove benign for global risk assets (those with significant price volatility, such as equities, commodities, high-yield bonds, real estate and currencies).

- The volatility of the past year and the pain felt in certain asset classes reminds us more of the 2011 experience than the calamitous tumult of 2008. We believe that the proper course is to maintain exposure to risk assets and continue buying selectively on the dips. We still like the odds of equities outperforming fixed income.

- The lagged impact of monetary policy easing and the big decline in value of the euro against the U.S. dollar over the past 18 months should keep the eurozone economy on its expansionary track. We do expect the European Central Bank to push inflation closer to its 2% target rate, which will likely entail a further expansion of the central bank's quantitative-easing program. We still view an additional decline in the euro toward parity against the U.S. dollar as more likely than not. It is still our contention that the monetary union is slowly coming out of its long period of financial crisis and economic stagnation.

- In some ways, the outlook seems more worrisome now than at the beginning of 2015. The damage in commodities, emerging-market debt and equity, and high-yield securities suggest a sharp deterioration in global economic fundamentals.

- Until central banks begin to pursue tighter money policies that raise interest rates to much higher levels and cause the yield curve to invert (short-term interest rates move above longer-term rates) we will give risk assets the benefit of the doubt. Although the U.S. has embarked upon a rising interest-rate phase, even Fed policy remains quite easy by the yardstick of previous cycles.

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

**Index Definitions**

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

**S&P 500 Total Return Index:** The S&P 500 Total Return Index assumes that any cash distributions, such as dividends, are reinvested back into the Index.

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