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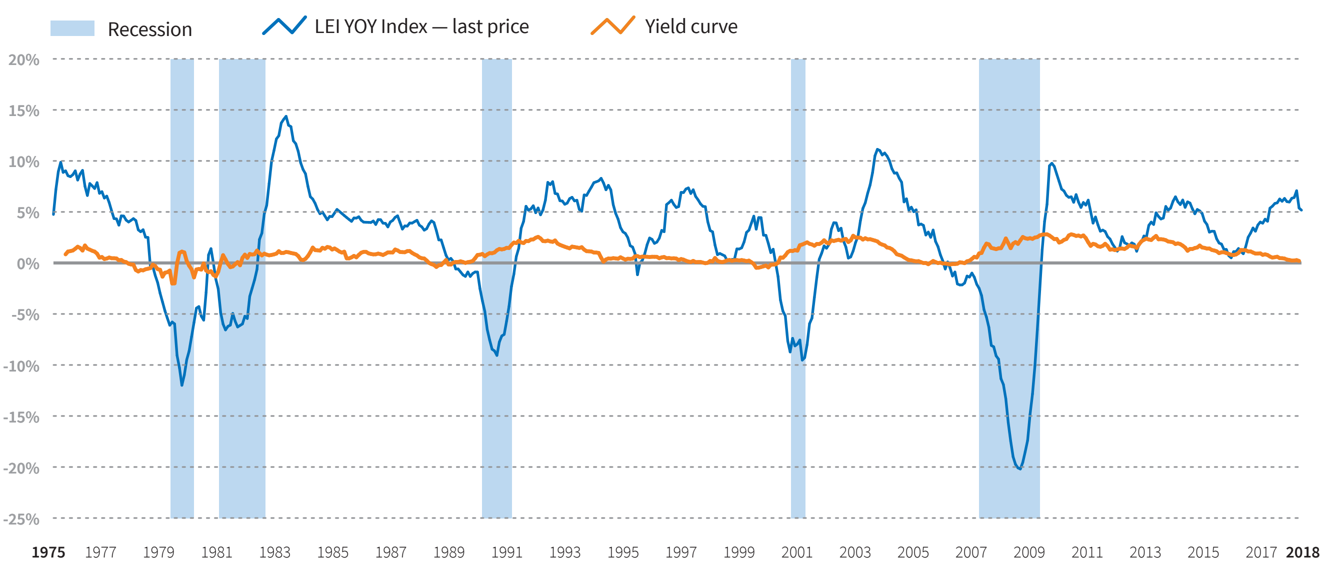
Global growth has slowed, but economic fundamentals remain healthy and supportive of risk assets.

Active insights

From great to good

Real GDP is going to decline in 2019 versus 2018. We have passed the peak rate of change in economic activity. World real GDP is forecast to be just under 3% this year, with the U.S. to be around 2.5% and China around 6%. The good news for investors is that, while the rate of growth for this cycle has already peaked, the economy remains in expansion territory and supportive of risk assets. Further, an economic recession is not yet in sight. Consider two key indicators.

The Conference Board Leading Economic Index — an aggregate of ten economic indicators — has contracted year over year ahead of every recession since 1975. The yield curve — the spread between the 2-year Treasury yield and 10-year Treasury yield — has inverted ahead of every recession since 1956. Today, both metrics remain positive. While the yield curve is close to inverting, remember that after the yield curve inverts, there is generally a 12- to 18-month lag time before the economic recession gets underway.

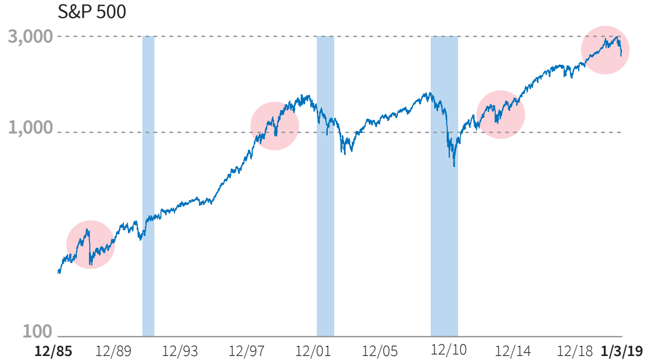


Sources: Bureau of Economic Analysis, Bureau of Labor Statistics.

Equities: Now what?

Volatility returned to the equity market in a major way in 2018 and that trend has carried into 2019. However, we believe the stock market overshot on the downside during the end-of-year sell-off. Also, solid economic fundamentals combined with positive earnings growth could prove fruitful for equities in 2019. Historically, dramatic sell-offs absent an economic recession have represented a buying opportunity for equity investors. We feel the United States will have the most durable economy in 2019, fueled by low cost of capital and tepid inflation. As a result, we generally favor U.S. risk assets versus the rest of the world. We are cautious on emerging markets, with great concerns around trade and tariffs.

S&P 500

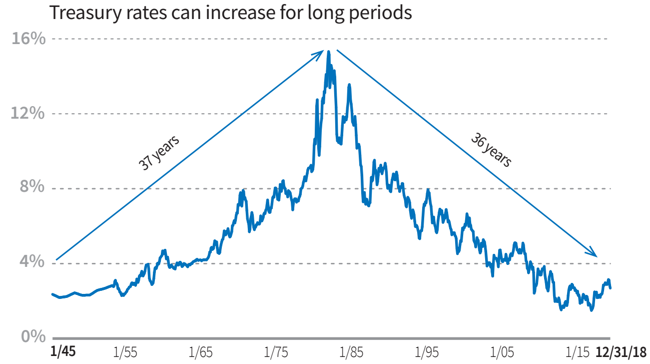


Sources: Conference Board, Bloomberg, as of 1/3/19.

Where are rates headed next?

In our view, central bank divergence remains a major theme for investors. The Fed appears confident in the U.S. growth outlook, while the ECB and BoJ remain a bit more cautious. U.S. Treasury yields may continue to rise by a modest amount. Ten-year yields follow long-term cycles, and as the chart below illustrates, we may be near the beginning of a multi-decade secular shift upward. However, low rates globally and U.S. pension fund demand for bonds remain important constraints on yields. Unless economic growth accelerates dramatically, we would expect rates to be range bound over the next few years.

Treasury rates can increase for long periods



Source: U.S. Treasury.

Key point: Global economic growth and U.S. earnings growth are both slowing, but are likely to remain positive. We expect such an environment to be conducive for opportunities in risk assets in 2019.

The views and opinions expressed are those of Chris Galipeau as of February 2019, are subject to change with market conditions, and are not meant as investment advice.

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