2015 Economic & Market Outlook

- The United States rose to international prominence in large part thanks to its entrepreneurial spirit. It is this entrepreneurial spirit that has revived the economy in 2014 and laid the foundation for sustainable economic growth as we head into 2015. This revival has led the United States to diverge from the rest of the developed world in 2014 as growth decelerated in China and Europe, and contracted mildly in Japan.
- 2015 is likely to be a year marked by aberration. Since the financial crisis of 2008/2009, the world's largest central banks have generally moved in the same direction. This tide appears to be turning as the U.S. Federal Reserve appears poised to raise rates in 2015 – whereas the Bank of Japan has ramped up its monetary stimulus and the European Central Bank inches towards full-fledged quantitative easing.
- Depressed commodity prices, currencies, and increased policy easing should prevent non-U.S. growth from weakening dramatically in 2015.
- As it stands now we believe the Federal Reserve will begin raising rates, albeit slowly, in mid-to-late 2015 as projected by the FOMC members. It is important to remember that these projections are dependent on economic data. Policy rates in the United States will only rise if the economy is strong enough to warrant them. Hence, equity markets should welcome increases in policy rates as they will be a sign of robust growth that should be accompanied by growth in corporate profits.
- In 2015, bond markets are likely to transition to an environment where coupon returns dominate price returns after a volatile, but surprisingly positive, return environment in 2014. Investors need to be aware of the maturity structure of their bond portfolios and prepare for the inevitable process of rising rates (bond prices fall as rates rise).
- While investment grade bonds do not provide as much total return potential near term relative to most other asset classes, they still do a much better job of protecting capital and play a key role in a diversified portfolio. Our belief is that U.S. intermediate and long-term rates will remain range bound for 2015 with the 10-year yield trading between 2.5% and 3%.
- We remain constructive on equities, but caution investors against increased volatility and unrealistic expectations (we will not enjoy another +32% year of returns as we did in 2013, for quite some time). We expect earnings, and not valuations, to take over as the driver of returns in the U.S. equity markets. Our belief is that the S&P 500 will deliver mid-to-high single digit returns in the range of 4-7% in 2015.
- Recent actions taken by the European Central Bank may set the stage for a transition from the fragile economic backdrop that is teetering on its 3rd recession since 2007 to a more stable environment in coming years. While it may take years to restart Europe's journey toward fully participating in the global economy, 2015 may mark the beginning. European equities are likely to be the initial beneficiaries of additional monetary easing in the Eurozone.
- Active portfolio management, compared to that of passive, has been challenged in recent years but we believe 2015 will lead to a regime change. We anticipate more differentiated performance among individual equity securities going forward and believe stock selection through active management strategies will be a key driver of returns in 2015.
- With the potential for greater levels of volatility in the markets, it is more important than ever for investors to focus on broad global diversification.