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GLOBAL ECONOMY MUDDLES ALONG

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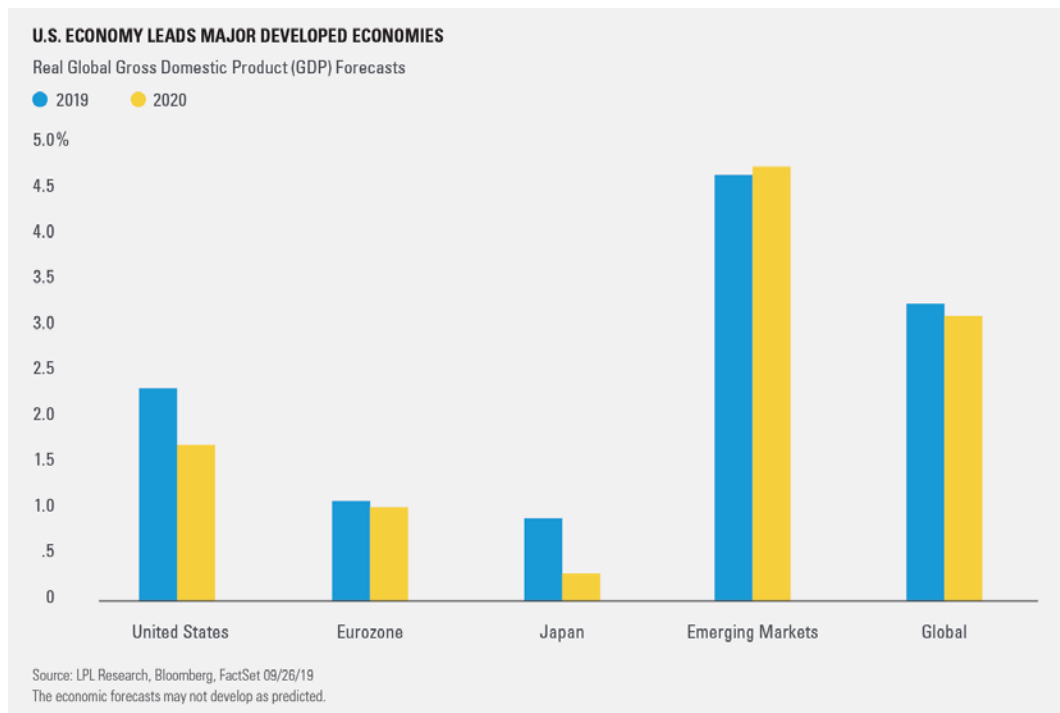
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The U.S. economy continues to perform well when compared to the rest of the developed world, and is still exhibiting growth near its long-term trend. The outlook in other developed economies is not quite as bright, however, as unconventional and aggressive policy decisions from global central banks are becoming increasingly ineffective.

OUR VIEW

The United States and emerging markets still stand out to us as relatively more attractive investment opportunities than developed international markets, based in large part on relatively stronger outlooks for economic growth and corporate profits. The outlook for emerging markets depends on trade, but if the progress we expect later this year and in early 2020 materializes, we would expect the impact on emerging markets economic growth and profits to result in higher stock prices. Meanwhile, we will continue to watch for signs of improvement in Europe and Japan.

U.S. ECONOMY LEADS MAJOR DEVELOPED ECONOMIES



GLOBAL ECONOMIES

The U.S. economy, paced by the consumer, continues to chug along at trend growth near 2%. Meanwhile in Europe, Germany is on the cusp of recession as its manufacturing sector contracts, Brexit uncertainty continues to cloud the outlook for businesses operating in the United Kingdom, deficit spending remains a challenge—particularly in Italy—and the benefits of monetary policy appear exhausted, despite the best efforts by the European Central Bank (ECB). After growing gross domestic product (GDP) by nearly 2% in 2018, the Eurozone may struggle to deliver 1% growth this year. Europe has not been immune to trade uncertainty, and the specter of European auto tariffs remains.

The picture is no better in Japan. Last week's trade agreement between Japan and the United States on agriculture, investment, and digital trade was encouraging, but the Japanese manufacturing sector has contracted for five consecutive months. As with Europe, auto tariffs remain a risk. A consumption tax increase on the books for October further clouds the outlook for an economy that is not expected to grow even 1% for the foreseeable future, based on Bloomberg's consensus forecasts. The Bank of Japan has been every bit as aggressive as the ECB and has little growth to show for it.

Slower growth in China has weighed some on growth in emerging markets economies, but Bloomberg's consensus forecast for emerging markets GDP is still 4.6% for 2019 and 4.7% for 2020 [\[Figure 1\]](#). Our forecast of 4.4% may prove conservative, particularly if the United States and China make progress on trade in the next couple of months. The U.S.-China trade conflict remains a big risk, but policies and demographics remain more supportive for emerging markets economies than their developed counterparts.

GLOBAL RATES

Negative interest rates internationally are one of the most perplexing developments in the markets in recent years. With negative interest rates, interest rates have dropped below zero and the lender in theory pays the borrower for the "privilege" of providing the borrower a loan. While we have concerns about how these rates normalize over time, that process will not begin anytime soon, and we see central bank actions as supportive for markets right now. *(For more on negative interest rates, please read ["The Curious Case of Negative Yields,"](#) Sept. 16, 2019.)*

The ECB delivered bold actions earlier in September at Mario Draghi's last meeting as head of the central bank, cutting its target interest rate further into negative territory (to -0.50%) and restarting open-ended bond purchases until inflation targets are reached. The ECB and Draghi's successor Christine Lagarde are now committed to policy accommodation that could potentially last years.

The Bank of Japan decided against additional policy stimulus at its September 19 meeting, but it is poised to do more—likely in October. Japanese monetary officials have suggested they are open to the idea of further reducing interest rates into negative territory in response to weaker global growth, and they likely want to get ahead of any economic weakness resulting from the upcoming tax increase.

European and Japanese rates may stay negative until growth and inflation in those economies pick up; however, with the benefits of monetary policy largely exhausted, that may take a while. The gap between U.S. and international yields likely will remain in place and potentially could get wider, keeping upward pressure on the U.S. dollar.

GLOBAL PROFITS

In one sense the outlook for global profits follows the pattern of economic growth, with the United States on top. Based on consensus estimates from FactSet, S&P 500 Index earnings growth of 2% this year is expected to outpace Europe and Japan. The story is different in emerging markets, where the relatively stronger economic growth this year is not translating into earnings, which are expected to fall in 2019. We still believe a modest allocation to emerging markets equity makes sense for suitable investors, but the inability of those markets to turn economic growth into profits is concerning.

Emerging markets earnings are expected to rebound solidly in 2020, with consensus (FactSet) calling for a 13% increase. That pace is more than double the forecast for Japan (5%) and ahead of Europe (9%) and the United States (10%). We believe all of these forecasts are too high, as early earnings forecasts almost always are. However, assuming progress on trade, we could envision emerging markets earnings increasing by more than the mid-single-digit pace we see for the United States next year, a level of potential acceleration that could be attractive to global investors.

WEEKLY MARKET PERFORMANCE REPORT

We are pleased to share our new [Weekly Market Performance](#) report with insights on major asset classes.

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