

Quarterly Economic Outlook

Blood in the Streets: Time to Buy

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The Global Portfolio Strategies Group recently released its third-quarter economic outlook. A summary of its conclusions is provided below:

- During the third quarter of 2011, equity markets tumbled sharply, daily market volatility spiked and economic news went from bad to worse. However, we think the stage has been set for an improvement in equities and other risk-oriented investments over the next 12 months, most likely starting before year-end.
- We believe a recession is unlikely, as the main drivers of economic downturns—housing, business investment and durables consumption—are still at depressed levels that could hardly go lower.
- In SEI's view, the U.S. Federal Reserve has done its job by successfully preventing a slide into a Japanese-like deflation and taking the steps needed to prevent a collapse of the banking system.
- Trends in the U.S. financial system have been going in the right direction. The markets nevertheless remain in turmoil because no one knows if the U.S. is sufficiently protected against a European disaster.
- We believe the European debt crisis will continue to roil markets until necessary tools are in place to handle the systemic risk arising from a material deterioration in Italian and Spanish bond prices.
- Although the near term is admittedly fraught with uncertainty, we find ourselves becoming more optimistic about the longer-term outlook for riskier assets.
- SEI favors stocks over bonds, as equities are expected to benefit from continued earnings growth and exceptionally low valuations.
- We prefer U.S. large-cap equity over European and Japanese stocks. The U.S. enjoys stronger structural growth, better demographics and the privilege of having the world's reserve currency.
- We favor high-yield bonds over Treasuries and investment-grade debt, as high-yield bonds appear priced for a recession that we do not think will materialize.
- SEI remains neutral to emerging-market debt and equity. Emerging-market debt would be negatively affected by an increase in bond yields, while emerging-market equity valuations relative to developed markets are somewhat expensive.

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