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The 2016 Global Economic Outlook

Volatility will likely be the most significant feature of the market in 2016. The global economic outlook is fraught with a number of serious concerns and heightened volatility. A few areas of concern for investors include the following:

▪ Disappointing and uneven global economic growth ▪ Currency depreciation ▪ Declining industrial production ▪ Declining global trade	▪ Deteriorating economic fundamentals ▪ Emerging market capital outflows ▪ Potential defaults ▪ Forced restructuring in weaker economies

The German financial newspaper *Handelsblatt* published an article on Wednesday, December 30th, 2015, consisting of an interview with the International Monetary Fund (IMF) Managing Director, Christine Lagarde, and Chief Economist, Maury Obstfeld.[1] Lagarde warned of a substantial decline in the growth of world trade, stating that "global growth will be disappointing and uneven in 2016" due to the continuing fall of commodity prices, the considerable slowdown in world trade, the stagnant Chinese economy, and the Fed's decision to raise rates.

In an interview with Bloomberg on January 6, 2016, Marc Faber, editor and publisher of *The Gloom, Boom & Doom Report*, observed that higher volatility and potential financial dysfunction will negatively impact and destabilize markets of all assets, including real-estate, stocks and bonds in 2016. He believed these factors will contribute to market volatility:[2]

- Increasing decline in global exports
- Decelerating industrial production
- Crashing commodity prices
- Disconnect between elevated equity prices and reduced corporate earnings
- Underlying poor global economic fundamentals
- Credit bubble in China

He foresees a continued reminbi (RMB) currency depreciation and further economic weakness in China in 2016.

Maury Obstfeld agrees that the Chinese economy must still combat several major issues. In an IMF blog post on Monday, January 4, he observed, "Serious challenges to restructuring remain in terms of state-owned enterprise balance-sheet weaknesses, the financial markets, and the general flexibility and rationality of resource allocation."

China, as the world's second largest economy, has a significant impact on the health of the global economy!

Mohamed El-Erian, Allianz Chief Economic Adviser, stated in an interview on December 10, 2015, that "Central banks are no longer on the same side." He continued by saying that while the Fed will be "easing its foot off the stimulus accelerator," the ECB, the Bank of Japan, and the People's Bank of China will be "pressing harder on the stimulus accelerator." El-Erian questions whether global economic fundamentals can improve fast enough to offset the current negative factors of lower global GDP growth, over-production, massive credit expansion and collapsing commodity prices. Longer-term, El-Erian is positive on select emerging market equity purchases in both single asset mining and petroleum companies now trading at significant price discounts.[3]

"Out of adversity comes opportunity!"

Additionally, Obstfeld warns that the troubles facing emerging markets are likely to continue for some time. "The year will offer an abundance of challenges…Emerging markets will be at center stage," Obstfeld said. More specifically, he asserts that a continuing decline in commodity prices may only escalate problems for exporting countries, "including sharper currency depreciations that potentially trigger still-hidden balance sheet vulnerabilities or spark inflation."

According to Christine Lagarde, the Fed raising the benchmark interest rate from near zero could spark a panic outflow of capital from emerging market countries with high levels of dollar-denominated corporate debt. Lagarde believes that the crisis could spread more broadly across the financial system, and suggests that the strength of the dollar could cause companies to default on their payments, and "infect" banks and state treasuries.[4]

Jeremy Siegel, finance professor at the Wharton School of the University of Pennsylvania, shared these thoughts on 2015. "I have never seen a shortfall of earnings relative to estimates as sharp as we had this year. We had a total collapse of earnings." Additionally, he indicated concern regarding the labor participation rate and a collapse in productivity. Siegel, however, suggested that "if we get an earnings recovery," we may see the S&P reach 2,300 by the end of 2016. He continued by saying, "The major driver of equity prices will be a bounce back of earnings. If we don't see a bounce back in earnings, we are not going to have a good year in stocks."[5]

Although many headwinds confront investors in 2016, one must remember that opportunities often are at their greatest when bleakness abounds. "Out of adversity comes opportunity!"

Index	2015 Return
S&P 500	-0.73%
Dow Jones Industrial Average	-2.23%
NASDAQ Composite	5.94%
MSCI EAFE	-3.30%
MSCI Emerging Markets	-16.96%
China Shanghai Composite	9.4%
Japan Nikkei	9.3%
Hong Kong Hang Sang	-7.16%

Source: WSJ and MSCI

Footnotes:
1. Full article at http://on.wsj.com/1PIvO7I
2. Full interview at http://bloom.bg/1mBs24L
3. Full interview at http://cnb.cx/1OTkjKg
4. Full article at http://reut.rs/1R7B0ll
5. Full article at http://wp.me/pnkGG-423