LPL RESEARCH
MIDYEAR
OUTLOOK
2018

July 2018

MIDYEAR OUTLOOK 2018
EXECUTIVE SUMMARY

Read the full
Midyear Outlook 2018: The Plot Thickens

At the beginning of 2018, the handoff in leadership from monetary policy to fiscal policy was well underway as a driver of consumer spending, business investment, and corporate profits, ultimately supporting continued economic growth and stock market gains.

KEY THEMES

Fiscal Policy
Tax cuts, a more business-friendly regulatory environment, and increased government spending should support consumer spending, business investment, and corporate profits—key drivers of our economic and stock forecasts. The biggest risk to investor confidence this year has been around trade, including new tariffs. When we compare the fiscal measures with the potential impact of increased tariffs, however, the benefits appear to outweigh the costs.

Market Signals
We are starting to see peaks in several economic and market indicators, such as manufacturing growth and earnings, while short-term interest rates are rising faster than long-term rates. However, growth can still be steady after a peak. The context is also critically important here—reaching these points in a positive growth environment is expected and not necessarily a warning sign. So although we are in the later stages of the economic cycle, we don't see a recession in the near term.

Rising Volatility
Given that we are in the later stages of this economic cycle, with factors such as increased trade tensions and geopolitical uncertainty at play, we do expect greater volatility in 2018. But it's important to remember that volatility isn't defined simply as market declines, and experiencing these ups and downs is a normal aspect of our market environment. If we try to embrace it, instead of fearing it, we have the potential to create opportunities.

ECONOMY

Up to 3% U.S. GDP Growth

Early this year we slightly upgraded our gross domestic product (GDP) forecast, as tax cuts should improve personal and business spending. Add the government spending package signed earlier this year and the benefits of increased lending capacity (from recent financial deregulation), and we're looking at significant fiscal tailwinds. We continue to believe that the combination of these forces will result in GDP growth of up to 3% for the U.S. in 2018.

3.8% International GDP Growth

We believe that the global growth story will continue, with an expectation of 3.8% GDP growth for the world economy, thanks to new fiscal policies and improved business vitality. We continue to expect the U.S. economy to remain a primary driver, aided by the anticipated higher growth trajectory of emerging markets, while international developed markets may lag. Primary risks to our global and U.S. economic forecasts include an unexpected rise in inflation, a substantial increase in trade friction, or a policy mistake.

STOCKS

10+% Returns

We expect returns of 10% or higher for the S&P 500 Index (including dividends), with earnings growth the primary driver. The S&P 500 may be well positioned to generate mid-teens or better earnings growth in 2018 thanks to a combination of steady economic growth and better corporate profits, thanks to the new tax law. Although we do expect volatility to increase, in the context of steady economic growth and strong corporate profits, we see the potential for further stock gains in the second half of 2018. Risks to our stock market forecast include potential negative impacts on companies' profit margins due to wage increases, geopolitical risks and trade tensions, and political uncertainty around the midterm elections.

BONDS

Flat to Low-Single-Digit Returns

As expected, accelerating global growth and rising interest rates continue to pressure bonds. We maintain our forecast of flat to low-single-digit returns for the Bloomberg Barclays U.S. Aggregate Bond Index. However, we want to emphasize that fixed income continues to play an important role in a diversified portfolio. Bonds can provide income and liquidity, and may serve to help manage portfolio volatility during periods of stock market turbulence. We continue to position portfolios with below-benchmark (Bloomberg Barclays Aggregate) interest rate risk, preferring to take credit risk in the current environment.

For more investment insights, read the full *Midyear Outlook 2018: The Plot Thickens*.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. Indexes are unmanaged and cannot be invested into directly.

Economic forecasts set forth may not develop as predicted.

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond and bond mutual fund values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

Additional descriptions and disclosures are available in the *Midyear Outlook 2018: The Plot Thickens* publication.

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