QUARTERLY ECONOMIC OUTLOOK | SECOND QUARTER 2023

Peeking at possible peaks.

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SEI recently released its second-quarter Economic Outlook. Here is summary of our key perspectives.

- While professional forecasters have been making recession predictions for the U.S. economy since the first half of 2022, at present there are no signs currently suggesting that the economy is about to fall off a cliff.
- Unemployment rates in North America, Europe, and the U.K. remain exceptionally low, despite the slowing of overall economic growth. In the U.S., the U.K., and Canada, unemployment levels remain near all-time lows.
- The Conference Board's Composite Index of Leading Economic Indicators has been in sharp decline since April 2022, consistent with a recession. However, coincident indicators, which track the current health of the real economy, continue to advance.
- The yield curve, a predictor of past economic downturns, has been inverted since November 2022. Since an inversion has often occurred a year or less before a recession, it is understandable why economists have underestimated the economy's resiliency.
- The Organisation for Economic and Development's version of the Leading Economic Indicators suggests that the global economy is not firing on all cylinders. As of April, only three of the 18 countries represented are delivering better-than-average growth.
- The surprising resilience of the global economy reflects the long tail of the post-COVID recovery. It also explains the divergence of the services sector, which is keeping the global economy afloat, and manufacturing, which is in stagnation or decline.
- Although the banking panic has subsided, we worry about the impact on small businesses. Recent readings of lending conditions are already at levels consistent with previous recessions. While hiring plans of companies dependent on local banks are still reasonably strong, a further tightening of credit conditions could spark the recession many economists have been forecasting.
- China continues to struggle with a disappointing economic recovery. The equity market got off to a strong start in January on hopes that the end of COVID lockdowns would spark growth, only to turn lower during February and March. More recently, economic data have been coming in below consensus expectations, leading to additional declines in equity prices.
- Inflation has peaked, but remains high. We continue to think that inflation pressures will remain persistent in labor-intensive service industries, at least until some slack opens up in the labor markets and spending by households fades more dramatically.
- Sticky inflation and ongoing labor-market tightness have forced central banks to keep raising rates. Although the Federal Reserve left its benchmark federal-funds rate unchanged in June, it warned of two potential rate hikes by year-end.
- We continue to believe that inflation and interest rates will remain higher for longer. While U.S. inflation is decelerating, we doubt it will fall below 3% on a sustainable basis. Nonetheless, we think the end of the interest-rate hiking cycle is within sight.
- Japan's monetary policy remains expansionary. Our belief that a new central-bank head and finance minister would bring about change hasn't happened—yet. As a result, the yen has been quite weak against the dollar and other major currencies.
- The yen's depreciation has accelerated as traders short the currency. We believe this dynamic will add to inflationary pressures in Japan. If their monetary policy turns restrictive, the unwinding of these short positions could spur a rally in the yen.
- The U.S. stock market's advance this year has been highly concentrated, with 27% of the S&P 500's constituents outperforming the index itself. If this figure holds through year-end, it would mark the lowest level in the 50-year history of the dataset.
- Adding to the woes of active managers, seven stocks account for about three-quarters of the S&P 500's 16.9% year-to-date return, with the remaining 493 companies posting a cumulative year-to-date total return contribution of only 4.4%. A reversal in relative performance may not be far off.
- The rally in equities has surprised us, especially in recent months. But, while buoyant stock indexes have engendered increasing optimism among investors, it makes us more cautious. Investors with a tactical bent should take a contrary view of the rally.

A full-length paper is available if you wish to learn more about these timely topics.

Glossary

The S&P 500 Index is a market-weighted index that tracks the performance of the 500 largest publicly traded U.S. companies and is considered representative of the broad U.S. stock market.

The Composite Index of Leading Indicators (U.S. Conference Board) is designed to predict peaks and troughs in the business cycle. The index comprises 10 economic components for which changes tend to precede changes in the overall U.S. economy.

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