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Quarterly Economic Outlook A Pivotal Year Ahead

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

- Europe's debt crisis will continue to fester, although the endgame—including a restructuring of the eurozone—is within sight.
- We expect recessionary conditions in much of Europe in the early part of next year.
- The U.S. should avoid a recession. However, as has occurred in each of the past two years, there will likely be growth scares that temporarily pull down equity prices.
- Emerging economies should continue to grow more quickly than developed markets, although the banking crisis in the eurozone will hurt the prospects of Eastern Europe.
- China's slowing growth could depress growth rates elsewhere in Asia.
- SEI looks for another year of easy monetary policy in the U.S. and a further shift toward easing by the European Central Bank, as the latter combats recession and the impact of the sovereign debt crisis on the banking system.
- Even in a scenario where the eurozone remains intact, we believe the euro itself could come under substantial downward pressure.
- We expect inflation to remain mostly inactive for another year. However, unpredictable, high-impact events (so-called black swans), along the lines of last year's Arab spring and Japanese earthquake/tsunami/nuclear meltdown, cannot be ruled out. Obvious candidates include an uncontrolled breakup of the eurozone, intensifying political and military tensions with Iran over its expanding nuclear capabilities and a political and economic collapse of North Korea in the wake of ruler Kim Jong Il's death.
- In terms of active asset allocation, we took advantage of the pop in stock prices during the final quarter of 2011 to even up our stock/bond positioning relative to strategic weights in the portfolios over which we have discretion. However, we continue to favor high-yield fixed-income assets versus investment-grade and sovereign debt. Within equities, we are overweight U.S. large-cap versus international, and remain particularly cautious on Europe ex-U.K. We also believe the exchange value of the euro could be at risk.

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

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