Over the Horizon: Trends Reshaping the Business

The macroeconomist and author of *Thirty Tomorrows* forecasts what's ahead for the industry.

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"This stock market rally has legs. The U.S. won't go into a recession, which is all we need for the market to keep rising, barring a war in the Middle East."

The near-term outlook for the bond market:

› Bonds will be a mixed bag and a defensive strategy at best. But expect a continued flood of overseas money into the market; U.S. yields are better and ongoing trends are now priced in.

› Long high-quality bonds will be a bad proposition ("get paid a bad yield while you wait for your capital loss"). The only protection will be to go toward the short end of the yield curve; there may also be some protection in credit-sensitive instruments. Muni bonds will pay better after-tax yields than junk and offer a better credit profile.

On the equity side:

› Two metrics suggest that the market still holds value despite its recent new highs: (1) the S&P 500's P/E multiples are a little above the 35-year average, indicating the market is fairly valued and should be able to follow the rise of earnings; (2) as is usually the case, cash yields are 2% above stock dividend yields, giving us a cushion when rates rise.

› Real estate is improving, and the economy has never gone into recession under those conditions. Corporations are flush with cash, state and local government revenues are growing, and the household sector has dramatically improved its finances.

Over the longer term:

- We are in a climate of energy abundance, thanks to technologies that increase gas production from conventional oil and gas wells, a big new South Atlantic find, oil shale, and fracking. The U.S. now rivals Saudi Arabia in production and we are diversifying our supply. But 35% of the world's oil still passes through the Middle East, so we are not free of this unreliable source.

- The crash in oil prices was not because of new technologies or supply/demand factors, but because the risk premium on oil has dissipated. Russia depends on oil exports and needs to continue increasing production. ISIS is not disrupting the flow of oil and the Strait of Hormuz remains open.

- Time is on the side of oil users. We continue to make finds and exploration technologies have improved. The Middle East's share of global oil supply could drop to 20% or less. A world of more reliable energy is a positive for economic growth.

- The aging of the Baby Boom cohort will be a drag on the markets and economy. By 2030, the U.S. will have just three working-age people for every retiree; this could slow our growth rate by one-third. We can deal with this by keeping older people working and increasing women's participation in the workforce, changing immigration policy to attract the kind of people who will contribute more to the economy, and shifting our workforce toward higher value-added activities (if we can meet the tremendous educational and training needs this would entail).