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OUR WORLD AFTER GREECE

QUICK POINTS

As Greece moves out of the headlines, what does the rest of the world look like?

Crude oil prices, still well off last year's highs, should be a boon to global growth.

I expect this cycle to progress as revenues and profits at large multinationals gain traction.

For months now, the Greek debt repayment saga has been front-page news. At long last, an agreement has been reached between the country and its creditors. Efforts to meet the conditions of this bailout deal will play out over the next few days and weeks, with economic and political consequences in Greece and across Europe.

If the past is any guide, this issue will probably resurface again, reminding investors everywhere of the long-running battle between creditors and over-indebted governments. But until then, we can get back to the business of understanding the economic cycle.

Back to the basics

While investors were distracted with Greece's troubles, the global economy has been moving forward. Here is a brief refresher on the basics — my top ten list of positive signs for the US economy:

1. Interest rates around the world remain at historical lows.
2. Industrial production in the United States has picked up.
3. Better employment numbers are evident across the US in almost all job categories.
4. Consumer confidence has risen, though US retail sales have continued to disappoint as households have yet to spend the gasoline dividend arising from lower oil prices.
5. US auto sales have accelerated and may soon return to annual volumes not seen since 2007.
6. Spurred by low inventories of existing homes, the building of new houses in the US has gained momentum — allowing the labor-intensive construction sector to recover the jobs lost in the last recession.
7. Bank lending to commercial enterprises, usually a leading indicator of more growth, has been rising.
8. The US dollar has stopped rising, and many exporting companies have started to reclaim sales growth from non-US firms.
9. Nonresidential business spending is no longer stalled.
10. Inflation has remained lower than expectations, helping the US Federal Reserve to delay the beginning of the rate-tightening cycle.

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Since the drawn-out negotiations over Greece dominated the headlines, the following trends have been clear outside the US:

- Japan's manufacturing economy has improved and labor force participation has been rising — both good signs for US-based multinational corporations that sell products in Japan.
- We have seen further evidence that Europe is recovering from its economic slowdown: German consumers have been spending, exports have risen and the peripheral countries have shown some progress.
- The news from the emerging markets has been mixed, with China's economy weakening but other parts of Asia faring better and with stronger signals coming out of Mexico and Eastern Europe.

I conclude that the Greek debt crisis has been an opportunity to add to risk assets. The fall in crude oil from highs near $100 per barrel a year ago should be a boon to global GDP growth — and I think that is exactly what we are likely to see.

US equities still supported by fundamentals

Now six years old, the US business cycle has shown no signs of flagging or falling into recession. The US consumer leads the economy, driven by increasing employment opportunities and longer hours worked — now as high as in the previous cycle — along with better wages and a stronger sense of job security. All these factors appear to be falling into place, pushing the economy forward.

The US equity market is widely discussed as being a bubble or at a peak. While the debate on the valuation of US stocks rages on, it is interesting to note that rolling 10-year returns on US stocks have been driven first by earnings and next by dividends, with almost no contribution from price-to-earnings ratios rising — which we call multiple expansion.

The past 10 years have been a story of two full cycles of business activity and a market that has been rising in tandem with earnings — but not wildly ahead of earnings, as the bubble talk would suggest.

Depending on the path of profits over the next two quarters, we shall see whether the claim that stocks have peaked turns out to be true. Meanwhile, margins of companies in the S&P 500 Index have been quite resilient, and profits as a share of GDP are at 50-year highs.

Smaller and mid-sized companies have posted decent profit and revenue growth during this cycle, in contrast with the bigger multinational corporations that have exhibited margin strength despite weakness in revenue reports. Yet this divergence may be about to change. An acceleration in world economic activity now seems to be underway, which ought to push up sales at those large companies while their costs remain contained. This could be a recipe for stronger US profit growth in the second half of 2015.

What can we expect to see next? In my view, the cycle should continue to move ahead. Growth will probably rise, and thus profits should also do well. In 2016 and 2017, however, this slow but steady business cycle may begin to show signs of aging. We may finally see exuberance and excesses emerge — that always seems to happen eventually. In particular, we are monitoring merger and acquisition activity. But for now, none of the indicators we watch are flashing red.

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