

# Outlook as of April 2017

## WORLD ECONOMY

- The global economy is starting to reap the benefits of the extremely loose monetary policies implemented by most of the world's central banks since the Great Recession. With interest rates expected to remain at these low levels through the rest of the year, the primary concern continues to be the specter of possible trade wars should populist policies continue to advance.
- The strong “soft” data we have seen from the various US consumer and business confidence surveys need to translate soon into stronger “hard” data on consumer and business spending. The contentious and uncertain political environment may be dampening the relationship between how people and businesses feel and how much they actually spend.
- The pronounced depreciation of the euro in the second half of last year has boosted European exports, while the weaker momentum of populist candidates has helped to allay fears of a breakup of the EU. The falling pound has had a similar beneficial effect on UK exports and helped shield the economy from any post-Brexit fallout, although that could change now that the UK government has invoked Article 50 and officially commenced the withdrawal process.
- In Japan, there are growing concerns that the recent improvements in economic growth may not be sustainable if the strong yen hinders exports and any slowing of the economy causes consumers to cut back on spending.
- The primary challenge for China continues to be the winding down of over-investment in property and industrial capacity that occurred over the past decade. But we expect India and a number of Latin American economies to benefit from structural improvements and stabilizing commodity prices.

## MONETARY POLICY & CURRENCIES

- The path to Fed policy normalization should remain on its gradual course. Lower energy prices seen this year should balance the inflationary impact of higher wages in a tight labor environment. In addition to two more rate hikes this year, we believe the Fed will consider steps to reduce its balance sheet and not replace maturing securities as they roll off.
- The ECB generally accepts and understands that the recent pickup in European inflation is largely due to energy prices, which are denominated in dollars. With those prices coming down, and the peripheral economies still showing subpar growth, we expect monetary policy to remain loose into next year, keeping the euro weak and benefiting exports.
- The safe haven status of the yen presents unique challenges to the Bank of Japan, which will have to maintain at least the current level of quantitative easing in order to keep the yen from strengthening and having the country slip back into economic stagnation.
- In an attempt to prevent capital flight from a weakening renminbi, the People's Bank of China is being forced to follow the Fed's tightening bias despite the slowing Chinese economy.
- Recent downward pressure on the dollar is most likely more a factor of rising US political uncertainty, as opposed to any change in economic fundamentals, which still favor the US over other economies. Fiscal policy expansion from the promised tax cuts and infrastructure spending program should be bullish for the dollar against other developed market currencies, even if the measures are delayed until 2018.

## BOND MARKETS

- The slight flattening of the yield curve since the mid-March Fed tightening should not be a cause for concern as it is still early in the tightening cycle. We expect yields across the maturity spectrum to increase proportionately as the Fed continues to tighten.
- Credit conditions and corporate balance sheets are strong in most industry sectors except automobiles, where subprime loans are under pressure. The recent widening in high yield credit spreads is due mainly to the decline in energy prices, which should be nearing a floor as OPEC output restrictions take effect.
- Recent problem credits in the municipal market are largely issue-specific and not indicative of a broader deterioration of credit conditions across the sector. Rising Treasury yields will have a similar effect on municipal bond yields.
- With monetary policy still very accommodative in most developed economies, there is little worry of an upward spike in rates. The very low absolute level of yields renders bonds in these markets unattractive compared to their US counterparts, and most other asset classes.
- Emerging market debt is well-positioned, given improving economic fundamentals. The higher absolute level of EM interest rates gives their central banks the added flexibility to cut rates if economic conditions should weaken.

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### EQUITY MARKETS

- The Q1 2017 earnings reporting season should be even better than Q4 2016, as the year-over-year comparisons among the energy and multinational companies remain easy. The biggest challenges for US companies will be to show top line revenue growth and maintain cost and margin discipline as the year progresses. Gradual and measured interest rate increases should allow the maintenance, and perhaps, further expansion, of valuation multiples.
- European equities have gotten through the Dutch elections and the UK's invocation of Article 50 unscathed, as attractive valuations and improving earnings have superseded politics. As we head into the French elections in May, waning extreme populism appears to be the trend, but caution is advised.
- With no sign of improving domestic consumption, a weaker yen appears to be a minimum requirement to boost exports and elicit any meaningful advance in Japanese equities. With fiscal policy constrained by very high deficits and monetary policy effectiveness nearly exhausted, the export sectors remains the sole driver of economic and earnings growth.
- In many Asian, European and Latin American countries, cheap valuations plus improving economic fundamentals have combined to drive equity prices higher. Uncertainty over the outlook for China in this important transition year prevents us from returning to a fully bullish position in the asset class.

### ALTERNATIVES & COMMODITIES

- A trading range for WTI crude of \$60 on the upper end and \$40 at the floor should last well into 2018, as rising US shale production easily offsets the OPEC-engineered production cuts.
- The recent decline in energy prices has reduced concerns over rising inflation. As the Fed continues with rate normalization, the opportunity cost of holding bullion will continue to rise and put a ceiling on further appreciation in precious metals prices. Thus, the sector is more vulnerable to price declines at current levels.
- While a US infrastructure spending initiative may be necessary to sustain the rally in industrial metals, expectations of better global growth, including a controlled slowdown in China, should allow base metal prices to continue drifting higher.
- Hedge funds positioned for rising interest rates and macroeconomic uncertainty should benefit from the current environment as investors seek ways to mitigate exposure to unstable, volatile markets.
- High asset valuations make it challenging for private equity managers to acquire assets at reasonable prices. We maintain our focus on seasoned, disciplined managers and continue to seek opportunities in dislocated markets and those facing disruption from regulatory or technological change.



Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, Benjamin Pace was Chief Investment Officer and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S. Ben has more than 25 years of experience in investment management. Prior to joining Deutsche Bank in 1994, he managed equity income funds for two investment organizations.

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