

Outlook as of April 2018

WORLD ECONOMY

- Global GDP growth should maintain its current rate for the remainder of the year, with improving US economic growth offsetting some slowing out of Europe and Asia.
- After the typical seasonal slowdown, capital spending in the US has resumed the momentum exhibited in late 2017. Given the advanced age of the current capital stock and the tax benefits accruing to corporations, capital spending is expected to be a key driver of US economic growth for 2018. Strong job growth and higher wages in a tighter labor market will keep the American consumer on a steady spending path.
- The Continental European economy is showing signs of slowing, due primarily to the effect of the stronger euro on exports; however, healthy domestic demand should offset some of the impact. Brexit negotiations are proceeding reasonably well. The two sides agreed to a basic framework in March, whereby the outcome may not hurt the UK economy to the extent originally feared.
- Despite the very tight Japanese labor market, wage pressures have yet to materialize. Sluggish Japanese consumer spending and the negative effect of the stronger yen on important export industries are contributing to a slowdown in economic growth.
- The imposition of US tariffs will have a dampening effect on the Chinese economy; however, the bigger issue for China's growth prospects is the success of the controlled slowdown in manufacturing, to address both pollution and oversupply concerns.

MONETARY POLICY & CURRENCIES

- Fiscal policy has finally taken the baton from monetary policy as the primary government driver of US GDP growth. The expected economic boost from the 2017 tax package has raised the probability of three further rate hikes by the Fed this year beyond the 0.25% increase announced in March.
- The inflationary impact of the sterling decline after the Brexit vote is beginning to abate. With minimal near-term damage expected to the UK economy from the EU exit, the Bank of England is better-positioned to follow the Fed with a gradual tightening of UK interest rates.
- With no signs that inflation is moving towards the 2% target, the European Central Bank can maintain its schedule of paring back bond purchases this year and delaying actual rate increases until later in 2019.
- Given the stubbornly high yen valuation and persistently low inflation, the Bank of Japan has pledged to maintain its historically loose monetary policy for the foreseeable future, despite concerns around the impact on the structure of their fixed income and equity markets.
- Watch for a potential retaliatory response by the Chinese to US tariffs to be a PBOC-engineered depreciation of the renminbi. The impact would be two-fold - facilitate Chinese exports, while making US exports less competitive.

BOND MARKETS

- Lower inflation expectations and trade skirmishes have caused US intermediate and longer term yields to back off from their February highs. Higher deficits caused by the recently passed tax reform and spending legislation, coupled with a lower volume of purchases from the Fed, should push the bellwether 10-year Treasury yield back to 3.00% by year-end.
- The municipal bond market should be minimally impacted by prospective decreased demand due to lower tax rates. Duration positioning for a rising rate environment and credit selectivity remain the primary factors for constructing durable portfolios in the current environment.
- Despite higher rates and greater bond issuance this year, the lack of any meaningful spread widening in the high yield sector is an important indicator of the health of the US economy; thus, corporate default rates should also remain low.
- Yields continue to be extremely low in most developed international bond markets. With rates at historical lows and central banks poised to start tapering bond purchases this year, any surprising uptick in economic growth could cause rates to spike, exposing investors to the uncompensated interest rate risk embedded in these bonds.
- The continued low inflation environment overseas allows many emerging market central banks to use their traditional rate cutting flexibility to spur economic growth, which, in turn, would boost total returns for investors in EM debt.

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EQUITY MARKETS

- We are roughly halfway through the Fed tightening cycle and do not expect further valuation multiple expansion in US equity markets. Earnings growth, driven not just by lower tax rates but also by improved revenue growth rates, should generate respectable returns across the capitalization spectrum.
- Greater clarity around the Brexit terms should allow UK equities to close the performance gap which has developed against both US and continental equities since the vote.
- The ebb and flow of global trade tensions will likely be the greatest catalyst for mainland European equities, whose largest companies tend to be more exposed to global sales. Valuations are even more compelling in the current low rate/low inflation environment.
- The persistent inability of Japanese policymakers to revive domestic consumption makes equity markets far more vulnerable to the effect of the strong yen on exports. Japan's proximity to China, together with its dependence on trade with neighboring countries, puts Japanese equities more at risk should trade tensions escalate.
- Low valuations and sustained strength in the global economy should lead to relative outperformance of emerging markets equities compared to developed markets. Protectionist policies would likely have the largest negative impact in this space.

ALTERNATIVES & COMMODITIES

- The combination of continued production discipline by OPEC and Russia plus the weak dollar has been a tailwind for oil prices this year. Incremental production brought to market by the US shale sector is a natural headwind, and should cause a drift downward in prices over the coming months, as the higher prices encourage shale producers to boost drilling activity.
- Unless we experience an unexpected spike in inflation, gold should be pressured downward over the coming months by rising interest rates and tighter global monetary policy.
- With China in the midst of a controlled slowdown in industrial spending and the US infrastructure spending bill likely delayed until the new Congress convenes next year, it is difficult to see a catalyst to drive industrial metals prices higher from current levels.
- Persistently low market volatility and high market correlations have been a challenge for hedge fund managers over the last decade. Policy normalization moves by global central banks should create more favorable conditions going forward, which should benefit managers following differentiated strategies and allow investors to offset portfolio risks more effectively.
- High asset valuations have made it difficult for private equity managers to acquire companies at reasonable prices. We maintain our focus on seasoned, disciplined managers and continue to seek value in niche markets, or those experiencing disruption from technological or regulatory 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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