CERITY PARTNERS

Outlook as of August 2017

WORLD ECONOMY

- Economies around the world continue to enjoy positive economic growth with little risk of recession. The intensely competitive global pricing environment should prevent the buildup of inflationary pressure until next year, at the earliest.
- Led by consumer spending, the US economy recovered in the second quarter after the disappointingly slow first quarter, and is now poised to grow at a rate above 2% for the second half of the year. Any economic boost from fiscal policy initiatives, such as tax cuts or infrastructure spending, is more likely to occur in 2018, if at all.
- Eurozone growth has been better than expected in 2017, although we expect some headwinds in the second half from the negative impact of the strong euro on exports. The nascent rise in German domestic spending may help sustain the growth rate near the current 2% level.
- Increased global spending on capital equipment has helped boost Japanese GDP this fiscal year, despite continued weak consumer spending in this demographically challenged economy. We expect growth to level off in the second half, as the strong yen begins to cut into exports.
- Ahead of the Communist Party Congress in October, China will continue its attempts to manage the economic slowdown through higher government spending. The recent stabilization of capital outflows will allow the government to implement policies to curb excessive investment, while continuing to open up the economy and markets to global investment.

MONETARY POLICY & CURRENCIES

- The Federal Reserve is expected to outline the timing of the previously announced balance sheet reduction program in September. This will likely delay any further rate tightening until December. Any disappointment around fiscal policy initiatives, or Congressional failure to raise the US debt ceiling this fall, could delay the normalization plan.
- Waning prospects of fiscal policy expansion have put downward pressure on the dollar as it may cause the Fed to move even slower in their quest to normalize rates. Improving US economic prospects for the second half of the year should keep the dollar from dropping further.
- The ECB will begin discussing plans to reduce the level of government bond purchases at the September meeting. With inflation still below the stated 2% target and the recent currency strength likely to restrict growth, we expect the central bank to hold rates steady for now, and to espouse only a very gradual reduction of monetary easing.
- Higher consumer prices following the drop in the pound, coupled with uncertainty over the ultimate structure of Brexit, are discouraging both domestic and foreign investment spending in the UK. This reduces pressure on the Bank of England to tighten prematurely as economic growth softens.
- There appears to be no end in sight to the easy money stance at the Bank of Japan, with inflation well below the 2% target.

BOND MARKETS

- Treasury yields across the maturity spectrum should gradually increase over the coming months, as the Fed scales back its bond purchases and the Treasury finances the growing fiscal deficit by issuing incrementally more bonds.
- The recovery in energy prices last month allowed high yield investors to focus on the generally strong credit quality among issuers of sub-investment grade debt. We do not expect interest rate spreads to Treasurys to contract beyond current levels, nor do we expect them to widen appreciably over the coming months.
- Outside of some of the high profile issuers with daunting pension and retiree health obligations, municipal credit conditions remain favorable overall and municipal yields should move in tandem with changes in Treasury yields.
- Hawkish language from the ECB last month caused Eurozone bonds to fall, highlighting the risk that today's low yields in developed international bond markets afford little protection from rising rates.
- Emerging markets debt, on the other hand, does provide sufficient current yield to compensate investors for both interest rate and credit risk, although we do not anticipate any capital appreciation from further spread narrowing for the remainder of the year.

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EQUITY MARKETS

- Earnings growth continues to drive the US stock market to record highs. Comparisons to last year become more difficult in the second half, although the weaker dollar this year should boost the revenue and earnings of US multinationals.
- Despite the strong performance of international equity markets this year, European equities still trade at an appreciable discount to their developed market peers. Earnings growth may be constrained by the stronger euro, but the recent rise in German consumer spending may be a sign that the earnings advance is sustainable in the coming months.
- Cheap relative valuations and continued aggressive monetary easing by the Bank of Japan drive the allure of Japanese equities, although the strong yen will have a negative impact on earnings in the coming quarters.
- Emerging market equities have shrugged off the recent protectionist saber rattling from the US administration, as recovering commodity prices, the controlled slowdown in Chinese growth, and very gradual Fed tightening have combined to focus investors' attention on the large valuation advantage of EM equities relative to developed market equities.

ALTERNATIVES & COMMODITIES

- Oil prices are likely to remain range-bound in the near term. The OPEC production cuts should prevent oil prices from falling below $40 per bbl, while rising US shale production will keep prices from rising above $55 per bbl. Any breakout of this range will likely be to the downside.
- The lack of global inflation pressure has restrained gold prices since the spring. To the extent this keeps central banks very accommodative, inflation expectations may pick up, and increase demand for the precious metal over the coming months.
- Despite the diminishing prospects for a large US infrastructure program this year, industrial metals are reacting positively to better-than-expected Chinese growth and environmentally- driven supply constraints. Further appreciation is likely to depend on the promised US fiscal initiatives being approved in the next 12 months.
- Persistently low market volatility has stymied many hedge fund managers since the financial crisis. Moves toward policy normalization by central banks should create a more favorable environment for investors seeking to mitigate risks arising from unstable markets or policy/geopolitical uncertainty.
- High asset valuations make it difficult for private equity managers to buy assets at reasonable prices. We maintain our focus on seasoned, disciplined managers and continue to seek value in dislocated markets and those experiencing disruption from technological or regulatory change.

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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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