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Outlook as of December 2017

WORLD ECONOMY

- Global growth momentum should continue into 2018, supported by continued low interest rates and widespread fiscal reforms affecting both tax and spending policies.
- US economic growth should be more evenly balanced between healthy consumer spending and business investment in productivity-enhancing business equipment. The nation's aging capital stock and expected corporate tax cuts will be important factors in driving capital spending.
- Business and consumer sentiment and actual spending remain at levels that should produce greater than 2% growth in Europe for at least the first half of 2018. A sustained increase in German consumption can help offset any drop-off in exports caused by the strengthening of the euro this year.
- Japanese domestic consumption continues to disappoint, but structural reforms initiated by the Abe government will help drive business investment spending into next year. We expect job and wage growth to help draw consumers out of the doldrums.
- China is managing a controlled slowdown in GDP growth in the transition to a consumer-driven economy. Challenges will persist due to government environmental initiatives and slower credit growth to combat ever-widening budget deficits.

MONETARY POLICY & CURRENCIES

- Based on recent testimony from both the incoming and outgoing Chairs, the Federal Reserve is very likely to raise the Fed funds rate at this month's meeting and implement an additional two or three 25 bps hikes in 2018, as continued economic growth confirms the path to rate normalization.
- The November rate increase by the Bank of England is viewed as a clawback of last year's emergency easing after the Brexit vote. Given the uncertain economic impact of exiting the EU, the BOE will be careful not to start tightening monetary policy prematurely.
- The ECB will not raise rates until 2019, with some debate around a firm end-date for its bond purchase program. Look for a year-end 2018 termination to be announced early in the year.
- The Bank of Japan may be starting to prepare markets for the eventual withdrawal of elements of its extreme quantitative easing program. Recent speeches by BOJ members have discussed reducing equity ETF purchases and relaxing yield curve controls; however, purchases of government bonds will persist for quite some time.
- Fiscal policy expansion and relatively tight monetary policy in the US should allow the trade weighted dollar to bottom around current levels and begin to advance as we enter 2018.

BOND MARKETS

- The proposed US tax legislation is forecast to widen the deficit and lead to more Treasury bond issuance, just as the Fed is purchasing fewer bonds through the reinvestment program. This will put upward pressure on yields, although the low-inflation environment will limit the magnitude of rate increases.
- The Treasury yield curve has flattened notably this year, but is still a healthy distance away from signaling an oncoming recession. We expect the curve to shift upwards and continue flattening in 2018, as short rates rise faster than long-to-intermediate maturities.
- High yield spreads widened last month, due primarily to weakness in the telecom sector and some isolated earnings disappointments in the reporting season. We do not expect an increase in default risk moving into the New Year, but the asset class appears fully valued.
- Any surprise in the expected QE withdrawal policies by any of the developed market central banks will render their bond markets highly vulnerable to the downside, given the low absolute level of rates in many of these bond markets.
- Monetary policy flexibility and stronger economic growth across emerging markets, coupled with a very gradual Fed tightening program, are hallmarks of the bullish thesis on emerging market debt. The residual impact of slowing Chinese growth on its emerging Asia neighbors and Latin American commodity producers bears monitoring.

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Outlook as of December 2017

EQUITY MARKETS

- Imminent Congressional passage of a tax bill which concentrates much of the tax rate relief on corporations is adding a further boost to an already strong year for US equities. Higher interest rates may constrain further multiple expansion, in which case, earnings growth in the mid single digits should drive a similar magnitude of equity price appreciation over the coming 12 months.
- European stocks trade at a valuation advantage to the US. With rates expected to stay low and earnings growth following a similar pattern to the US, European equities may outperform US equities on local currency terms in 2018.
- With little chance of rate hikes to challenge valuations, Japanese equities will benefit from what appears to be a sustainable economic and earnings recovery. Any currency weakness from current levels can be a further catalyst for price appreciation.
- Emerging markets equities have largely recovered from their mid-decade weakness and have strongly outperformed developed markets equities this year. Valuations remain relatively cheap, but we are somewhat guarded over the outlook for China which is an important driver of economic demand and earnings growth for the sector.

ALTERNATIVES & COMMODITIES

- Extension of the current OPEC + Russia production agreement will provide a solid floor for oil prices. Demand growth in a strengthening global economic environment may boost prices above $60, but this, in turn, would cause US shale production to ramp up and prevent prices from spiking further.
- Gold will likely tread water around current levels, as solid global growth provokes incrementally tighter monetary policies among global central banks.
- Industrial metals have shown marked appreciation this year, in a strong environment for growth globally. Greater clarity on Chinese demand and any forthcoming US infrastructure initiative will be important determinants of the direction and magnitude of future price moves.
- Persistently low market volatility has stymied many hedge fund managers since the global financial crisis. Moves toward policy normalization by central banks should create a more favorable environment for managers following differentiated strategies, while also benefitting investors seeking to mitigate risks from unstable markets or policy and geopolitical uncertainty.
- High asset valuations have made it difficult for private equity managers to acquire assets at reasonable prices. We maintain our focus on seasoned, disciplined managers and continue to seek value in dislocated markets, or 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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