Outlook as of June 2018

WORLD ECONOMY

- Accelerating growth in the US should help offset the slowdown in Europe and Asia, allowing 2018 global GDP growth to improve over last year. Heightened trade tensions will introduce more risk to the 2019 global growth forecast.
- Continued expansion of the aging economic growth cycle in the US will be heavily reliant on a meaningful increase in business capital investment, spurred by the recent tax reform and spending initiatives. Improved labor force productivity will be needed to mitigate the inflationary impact of the late cycle fiscal expansion.
- The Q1 slowdown in European growth has been blamed on weather, labor strikes, and even a particularly virulent flu strain, but simmering political dysfunction has also resurfaced in the UK, Italy, and Spain; a reminder of the difficulty in implementing the requisite structural reforms to allow Europe to grow to its full potential.
- Stagnant wage growth, higher gasoline prices, and the impending sales tax will continue to constrain Japanese consumer spending as the economy attempts to rebound from a first quarter GDP contraction.
- Relaxation of some pollution controls and stronger global economic growth led by the US has allowed the Chinese government to better control the inevitable slowdown in economic growth. As the trade conflicts are clearly centered on China, continued protectionist volleys with the US will make it more difficult to avoid a harder economic landing.

MONETARY POLICY & CURRENCIES

- The buoyant US growth outlook suggests three more 25 basis point rate hikes this year by the Fed, although policymakers are paying close attention to the flattening yield curve. The absence of persistent inflationary pressures should allow the Fed to end the tightening cycle some time next year at a 3.0% fed funds rate.
- The Bank of England has delayed the commencement of its own tightening cycle, as economic growth and inflation have slowed below expectations. We are now unlikely to see any UK rate hikes in 2018.
- The ECB would like to announce in June its plans to end its stimulus program by year-end. However, slower economic growth and core inflation well below its 2% target may delay the announcement until later in the summer, and may push back any talk about increasing rates until well into 2019.
- The Bank of Japan is even further away from beginning the process of removing extreme monetary accommodation as impending fiscal policy contraction in the form of a sales tax hike will add further pressure on the already weakening economy.
- The clear relative economic growth advantage enjoyed by the US has led to the recent strength of the dollar, although higher fiscal deficits should constrain the rate of appreciation as the year progresses.

BOND MARKETS

- The flattening yield curve in the US is causing some concern about the Fed being too aggressive in its tightening campaign, but the robust growth outlook and expectation of burgeoning wage pressures should cause rates to rise across the entire maturity spectrum in the coming months.
- Improving US economic growth should keep default rates low in the high yield credit sector, although spreads against like-maturity Treasuries are now tight by historical standards, providing little cushion to investors if economic conditions deteriorate.
- There is less concern about an upward spike in interest rates in developed international bond markets, given their slowing growth dynamics and persistently low inflation. The extremely low yields are the primary reason we view the asset class as unattractive at current levels.
- Federal Reserve tightening and higher interest rates are exposing the weaker players in the emerging markets debt category, such as Turkey and Argentina. Beyond country specific issues, usually characterized by above-average budget and current account deficits, the flexibility of the central banks in the stronger economies to cut rates as need to maintain growth should allow the broader asset class to generate solid returns over the remainder of the year.

CERITY PARTNERS

Outlook as of June 2018

EQUITY MARKETS

- The 2017 corporate tax cuts will allow US companies to post roughly 20% earnings growth for the balance of the year. Revenues should also continue to grow strongly as GDP growth improves. Maintenance of top line growth will be important to the continuation of the decade- long bull market in equities.
- Protectionist trade measures imposed by the US will have a heavy impact on the more export oriented European markets, offsetting some of the valuation advantage in European equities. However, recent weakness in European currencies should boost exports and help earnings growth over the second half of 2018 into 2019.
- The Bank of Japan is forecast to maintain its extreme monetary easing policy for the foreseeable future, which should allow the yen to weaken enough to benefit export activity and enhance the relative attractiveness of Japanese equities. Maintaining strong global demand for Japanese export goods is crucial to offsetting weak domestic demand.
- Heightened global trade tensions and lower global demand for commodities, principally from China, are proving to be major headwinds for emerging markets equities. Valuation levels appear very attractive, given the expectation that earnings growth will remain comfortably positive over the coming quarters.

ALTERNATIVES & COMMODITIES

- US withdrawal from the Iranian nuclear deal and the reimposition of sanctions may ultimately lead to the end of the OPEC + Russia supply agreement, as these countries fight over who is best positioned among them to fill the supply gaps. Additional supply from US shale production should maintain further downward pressure on oil and gas prices.
- Barring any looming inflation threat, gold prices are expected to decline from their current levels as the Fed continues to tighten rates and the opportunity cost of holding gold continues to rise.
- Tariff wars notwithstanding, industrial metals prices will ultimately be more influenced by lower global demand, due to slower Chinese economic growth and delayed implementation of a US infrastructure program.
- Persistently low market volatility and high market correlations have been a challenge for hedge funds over the last decade. Steps towards policy normalization by global central banks should result in higher volatility and dispersion going forward and benefit managers pursuing more differentiated strategies, while allowing investors to hedge portfolio risks more effectively.
- High asset valuations have made it increasingly 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.

CERITY PARTNERS

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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