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Outlook as of March 2017

WORLD ECONOMY

- The global economy is maintaining its upward momentum in 2017, although we remain wary of rising populism and protectionist policies that could slow global economic growth, especially among the more export-reliant emerging economies.
- In the US, we await implementation of fiscal policy and regulatory initiatives which will allow the very positive sentiment survey and economic data reports since the election to translate into higher real consumer and business spending.
- With upcoming elections in the Netherlands, France and Germany and a renewal of the decade-long Greek fiscal drama, heightened political uncertainty in Europe is overshadowing the improving economic picture, especially for Germany. The timing and ultimate impact of the UK's exit from the European Union adds a further element of uncertainty.
- Japan continues to struggle with weak domestic sales of both consumer goods and capital equipment. With export growth the only positive element of GDP, the recent yen strength is a major impediment to any meaningful economic revival in 2017.
- We do not expect a repeat of the fiscal spending surge that allowed China to register surprisingly strong GDP growth last year. Even without the threat of looming global trade tensions, the Chinese authorities have their hands full dealing with the effects of over-investment in manufacturing capacity and excessive leverage in the domestic economy.

MONETARY POLICY & CURRENCIES

- Higher year-over-year energy prices and a tightening US labor market are reviving inflationary concerns and keeping the Fed on its stated path of 2-3 rate hikes in 2017. As part of the policy normalization process, we expect the Fed to stop reinvesting bond maturities and principal paydowns to reduce its balance sheet.
- Fighting pressure from Germany, whose economy is beginning to experience some inflation, the ECB will be careful to keep policy accommodative to ensure continued recovery in the peripheral countries, and as insurance for an adverse outcome in any of the upcoming elections.
- Unless the Japanese fiscal authorities surprise markets with a truly stimulative combination of tax and spending initiatives, the strong yen may again force the Bank of Japan to take the lead in further monetary easing, even as its effectiveness is being questioned.
- The People's Bank of China may be forced to follow the Fed and raise short term rates, to keep the renminbi stable against a global basket led by the dollar, and to prevent further capital outflows.
- The dollar bull market has taken a pause, as market participants await details of the Trump administration's fiscal policy initiatives and any monetary policy response. Improving economic growth, supported by fiscal policy expansion, should allow the dollar to resume its advance over the coming months.

BOND MARKETS

- As we are still at the beginning of a Fed tightening cycle, we expect a parallel upward shift in the yield curve across maturities. The curve will only begin to flatten when the Fed tightening policy begins to slow the economy. This is more likely to occur in 2018.
- Corporate bond spreads continue to narrow, a sign that credit quality remains strong in an improving US economy at the start of a contractionary tightening cycle.
- With tax reform and rate cuts more focused on the corporate sector, we see minimal impact on demand for municipal bonds. Supply may increase slightly over the coming months should the government form public/private partnerships to implement the promised infrastructure spending initiatives.
- We do not see rates rising in the developed international bond markets in the near future. With the absolute level of coupon income still so low, investors are not adequately compensated for the risk of a surprise spike in rates.
- Emerging market debt continues to perform very well. Many commodity markets have benefited from improved pricing. So long as the Fed maintains a very gradual tightening policy, investors will benefit from exposure to the category. Rate cutting flexibility on the part of central banks in this market is an advantage the developed central banks do not possess.

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EQUITY MARKETS

- Strong Q4 earnings and the outlook for a generally accommodative combination of fiscal and monetary initiatives have fueled a continued rally in US equity prices. Any disappointment on the subsequent earnings outlook or policy follow-through could lead to a pullback, although we see no signs of a recession on the horizon.
- European equities are at much more attractive valuation levels than US equities. However, the uncertain political environment will inhibit any expansion of earnings multiples unless investors have some confidence that moderate/centrist candidates can prevail in the upcoming elections.
- The strong yen will remain a major headwind to the Japanese economy and equity markets. Increased fiscal and monetary accommodation will both be needed to drive equity prices higher. Continued strengthening of the US economy will also be helpful, both in raising demand for Japanese exports and reducing pressure on the yen if the dollar continues to rise.
- Higher commodity prices and expectations of a gradual Fed tightening cycle have boosted the attractiveness of emerging market equities, which are already at low relative valuations to the US and other developed markets. The uncertain outlook for Chinese economic growth in a crucial transition year precludes our raising the sector weighting for now.

ALTERNATIVES & COMMODITIES

- Oil prices should remain in a rather tight trading range. Somewhat surprisingly, OPEC has managed to hold members to the announced production cuts, which could help push prices towards $60, the upper end of the range, in the coming months.
- Signs of at least a temporary revival in headline inflation have driven up the price of gold. If the Fed maintains a disciplined tightening policy, it will be difficult for gold prices to appreciate beyond current levels as the opportunity cost of holding gold rises in tandem with interest rates.
- Better US economic growth and the promise of a massive investment in infrastructure spending by the Trump administration should help sustain the rally in industrial metals prices and offset any falloff in demand from the economic slowdown in China.
- 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 private equity managers and continue to seek opportunities in dislocated markets, and those facing disruption from regulatory or technological 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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