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# Outlook as of September 2018

## WORLD ECONOMY

- Rising trade tensions have yet to detract meaningfully from global growth as the actual tariffs imposed to date have been rather mild. Progress in negotiations between the US, Mexico, and Canada is helping to mitigate the risk that the trade skirmishes turn into a recession-inducing global trade war.
- Capital spending on business equipment by US companies is showing notable improvement in both the office equipment and energy sectors. To the extent these expenditures help boost the lagging productivity experienced this decade, the US economy should continue to grow well into 2020.
- Currency strength last year and fears of a global trade war this year have combined to slow economic growth across Europe, while uncertainty around the final terms of the UK/EU exit package has constrained growth in Britain. Weaker currencies in 2018 will help cushion the slowdown as we await more clarity on the difficult-to-predict political outcomes.
- Japanese consumers continue their spending reticence, with the upcoming sales tax hike a further barrier to higher spending growth moving into 2019. Low interest rates may help to pull this demographically challenged economy out of its lethargic state.
- As it did in 2015/2016, the Chinese government is using aggressive fiscal and monetary incentives to offset a slowdown and maintain growth above the 6.5% target rate. While these measures may be effective in the near term, they risk exacerbating the excess capacity issues that have plagued the economy in recent years.

## MONETARY POLICY & CURRENCIES

- Despite growing concerns over the flattening yield curve, the Federal Reserve appears resolved to continue its rate normalization policy, with 25-basis point hikes highly probable both this month and again in December. Lack of inflationary pressure is causing some FOMC members to question whether the tightening program should be paused or terminated at that point.
- The Bank of England has embarked on its own rate normalization program, which will likely be even more gradual than the Fed's, with one 25-basis point rate increase forecast for each of the next two years.
- The ECB is anxious to begin the process of withdrawing excessive monetary stimulus and has announced it will end longer term bond purchases by year-end. However, it will be very cautious about raising rates, with muted economic growth across the region and continued deflationary risks in some peripheral economies.
- To offset any slowdown from the imposition of US trade tariffs, the Peoples Bank of China has lowered interest rates and boosted liquidity, allowing the renminbi to weaken and benefiting exports. It appears the central bank will stabilize the currency at these lower levels and continue to provide stimulus to help manage the slowdown.
- Despite the recent jawboning from the US administration, the economic growth and interest rate advantages currently accruing to the US should allow the dollar to advance against most currencies, albeit at a more measured pace, for the balance of the year.

## BOND MARKETS

- Longer term US bond yields are being pulled lower by strong foreign demand and concerns that the Fed may be raising short term rates too aggressively, given the benign inflationary environment. Sustained GDP growth of over 3% in the coming quarters should push yields higher across the maturity curve as we move to year end.
- The recent acceleration in US economic growth has forestalled fears of an impending recession and allowed high yield bond spreads to narrow further over the summer. With default rates expected to remain low, we believe the favorable environment is fully priced in at current levels.
- Developed market international bonds suffer from extremely low yields in the highest quality credits, coupled with the risk of yield spikes due to budget deficit issues in a number of the Eurozone countries such as Italy.
- The emerging market debt sector has suffered this year from what appear to be country-specific concerns, specifically Argentina and Turkey, where much of the debt is funded in hard currency. The first Fed tightening cycle in a decade has pressured the entire sector, although pockets of value have been created in the stronger credits, which will begin to be recognized in the coming months.

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## EQUITY MARKETS

- US equity markets are now back above their January highs, but have not matched the explosive earnings growth experienced this year. With corporate earnings estimates now reflecting robust sales growth and the large benefit from the corporate tax cuts, we believe the bull market in US equities should be sustained into 2019.
- We see some gravitation towards European equities by investors, given the low relative valuations and apparent easing of trade tensions with the US. A favorable Brexit outcome would provide a further catalyst for unlocking value in this sector.
- The recent depreciation of the yen against the dollar should benefit export activity and allow Japanese equities to participate in the expected recovery of international markets from the losses sustained year-to-date. Containment of the Chinese economic growth slowdown should help Japan to maintain exports to the neighboring countries.
- Uncertainty around the ultimate scope and outcome of what now can be considered a trade war with China calls for continued caution towards the emerging markets asset class, despite the attractive valuations.

## ALTERNATIVES & COMMODITIES

- Increasing production from US oilfields should fully offset any lower production due to renewed Iranian sanctions and Venezuelan economic mismanagement. The price of WTI crude should remain in the $65-$75 per bbl trading range, with any breakout likely at the lower end.
- Based on the lack of inflationary pressures and the continued Fed tightening cycle, gold prices are unlikely to rise appreciably over current levels.
- Stabilization of the Chinese growth slowdown has stemmed the year-long price declines of copper and other industrial metals. Although the ongoing trade tensions could have an impact, strong global growth led by the US should prevent substantial depreciation from current levels.
- Persistently low market volatility and high correlations have been a challenge for hedge funds over the last decade. The pickup in market volatility and asset class dispersion in recent months has begun to benefit managers pursuing differentiated strategies and has allowed investors to hedge portfolio risks more easily.
- Rising asset values are a continuing challenge for private equity managers seeking to buy good companies at reasonable prices. We aim to overcome these challenges by focusing on seasoned, disciplined managers, and by seeking value in niche markets or sectors 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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