CERITY PARTNERS

Outlook for October 2018

WORLD ECONOMY

United States

- The growing strength of the U.S. economy should be sufficient to minimize the impact of any slowdowns in international economies.
- Going into 2019, U.S. GDP (gross domestic product) is expected to hold steady around 3% from a combination of healthy consumer spending and capital expenditures. Productivity gains from increased business spending should prevent this growth from stoking inflation.

Developed Markets

- European economies have slowed from their surprisingly strong 2017 growth rates but could get a boost from stronger exports. The recent lift in German domestic spending is particularly encouraging.
- Uncertainty continues to swirl around the outcome of the Brexit debate and the potential impact on the U.K. economy.
- The pronounced yen weakness over the summer could bolster Japanese exports for the remainder of the year. However, a pending sales tax increase in 2019 could dampen already weak consumer spending and keep overall Japanese economic growth at roughly 1% to 1.5% going into next year.

Emerging Markets

- China's economy may start to feel the negative effects of U.S. tariffs. The government will try to temper the impact through a combination of fiscal stimulus and currency depreciation. Growth may hover around 6.5% for the next two quarters.

MONETARY POLICY & CURRENCIES

United States

- In September, the Fed removed the word "accommodative" from the description of its monetary policy, which suggests they're approaching the end of the current tightening cycle.
- More rate hikes are on the horizon, but will likely not happen every quarter due to the flattening yield curve and lack of inflationary pressures. Look for another 0.25% rate hike in December and possibly two more next year.
- The dollar should remain strong relative to most global currencies, although its strength could be hampered by the growing U.S. deficit.

Developed Markets

- The Bank of England announced its intention to raise interest rates in the future, but it's prepared to change course should the Brexit outcome prove damaging to the U.K. economy.
- •Given the lack of inflationary pressures, the European Central Bank might proceed more cautiously with its plan to end the bond-purchase program (quantitative easing) instituted after the 2008 financial crisis. We expect no outright rate hikes until late 2019.
- •With inflation still below 1% and their target inflation rate remaining at 2%, the Bank of Japan will likely maintain its current level of monetary easing for the remainder of the decade.

Emerging Markets

- The People's Bank of China will attempt to use monetary policies to stimulate the country's economy and offset the effect of tariffs.

BOND MARKETS

United States

- With sustained GDP growth at or above 3%, bond yields may continue to push higher across the maturity spectrum. Foreign demand for U.S. Treasuries could mitigate the upward pressure, keeping the yield on the 10-year Treasury at or below 3.25%.
- High-yield bonds continue to outperform U.S. government and investment-grade corporate bonds thanks in part to low default rates and a strong economic environment. However, given the narrow spreads between high-yield bonds and Treasuries, investors may not get compensated for the added risk, particularly if we see a deterioration in the economy.

Developed Markets

- The Italian bond markets reacted negatively to the country's somewhat surprising budget compromise. This reaction illustrates the effect policies of deficit-constrained countries can have on bond prices, especially when nominal bond yields are too low to compensate investors for the risk.

Emerging Markets

- The decline in the Emerging Markets (EM) Debt sector seems to have stabilized, and investors are beginning to differentiate between weaker economies with high budget deficits and high levels of external debt and those that have managed their budgets and debt more prudently.

Outlook for October 2018

EQUITY MARKETS

United States

- With interest rates continuing to rise, U.S. equity markets may see P/E multiples contract as cash and bond yields become more appealing. Even so, earnings are expected to keep growing, albeit at a lower rate, into 2019, which should ultimately allow stock prices to slowly advance through year-end.

Developed Markets

- European equities are trading at more attractive valuations than U.S. stocks. Easing trade tensions and an economy-friendly Brexit outcome may allow investors to focus on the solid underlying sales and earnings of many companies in this region.
- The Japanese equity market has had the sharpest rebound of any developed market this year. The weaker yen has helped unleash the earnings power of their export-dominated industries. There is still considerable uncertainty about how the trade war will affect China and its Asian neighbors, which could impact the upward momentum of Japanese stocks in the coming months.

Emerging Markets

- Chinese mainland equities have been the most pronounced victims of the ever-heightening trade tensions. Until more is known about the impact of tariffs on exports, investors should remain cautious about this admittedly inexpensive equity sector.

ALTERNATIVES & COMMODITIES

- The OPEC countries and Russia have pledged to maintain oil production at current levels despite the prospect that U.S. sanctions on Iran and Venezuela will reduce global supply. Increased supply from U.S. shale fields should keep oil prices from rising to economically damaging levels.
- With higher short-term rates and only mild inflationary pressures, gold will likely keep trading at current price levels through year-end.
- China's expansionary monetary and fiscal policies used to offset the impact of the trade war should allow industrial metals to recover some of their year-to-date losses. Strong global growth will be required to further boost demand.
- For the last decade, hedge fund managers have been challenged by persistently low market volatility and high correlations. But the tide appears to be changing. 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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