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Outlook for November 2018

WORLD ECONOMY

United States

- Having passed its peak in Q2, U.S. GDP may not grow fast enough for the remainder of the year to offset the economic slowdowns occurring in many other countries.
- Strong consumer spending and aggressive fiscal policy initiatives are driving healthy economic growth in the U.S. and offsetting some weakness in housing and net trade. Capital spending by businesses remains key for this long economic expansion to continue.

Developed Markets

- Economic growth in Europe has slowed to its lowest level in four years due to concerns around the spreading of trade conflicts, the outcome and economic impact of the U.K. leaving the European Union, and the Italian budget dispute. A recovery in Germany, led by improved consumer spending, will be necessary to achieve 2% growth going into next year.
- Economic growth in Japan stopped in Q3 as a result of natural disasters and the Chinese economic slowdown. While a recovery is expected early this quarter, the pending sales-tax increase next year will likely dampen domestic spending. A weaker yen should help boost exports.

Emerging Markets

- The Chinese government is currently implementing fiscal stimulus policies to offset the impact of U.S. tariffs and the necessary deleveraging of some overbuilt sectors of the economy. GDP growth will likely move below the current 6.5% rate as we enter 2019.

MONETARY POLICY & CURRENCIES

United States

- The Fed is set to raise the fed funds rate by another 0.25% at its December meeting and may be nearing the end of its tightening cycle. Expect only two more increases in 2019 if inflation remains benign.
- The dollar is likely to stay strong through year-end and then weaken in 2019 amid growing concerns over the mounting fiscal deficits.

Developed Markets

- The Bank of England would like to join the Fed on its monetary normalization path. Any changes will have to wait until it becomes clearer how the upcoming separation from the European Union will affect the country's economy.
- The European Central Bank will end the bond-buying element of its aggressive monetary stimulus this December. It will use the cover of very low inflation to maintain negative interest rates for most of 2019.
- The Bank of Japan recently lowered its inflation forecast and admitted it wouldn't hit the 2% target in the near future. Consequently, there's no end in sight to zero interest rates and the bank's extreme quantitative easing.

Emerging Markets

- Chinese central bankers are attempting the tricky task of easing interest rates just enough to manage the economic slowdown without causing a sharp decline in the currency and heightened capital outflows. Look for greater market angst if the seven renminbi to the dollar threshold is broken.

BOND MARKETS

United States

- As the market reacts to above-trend U.S. growth, we expect the entire yield curve to shift higher. The shape of the curve and any sign of flattening will help determine whether the current level of economic growth is sustainable.
- Heightened equity market volatility has caused some concurrent weakness in the high-yield bond sector, although there is no discernable pickup in current or expected default rates. Valuation remains the major impediment to an increased weighting in this asset class.
- The municipal bond sector has fought off higher rates and produced flat returns year-to-date thanks in part to restricted supply. Valuation has become rather rich in this space and investors should maintain shorter durations.

Developed Markets

- Given the low-inflationary environment, bonds of fiscally stronger countries are trading at very low yields. Any spike in yields, caused by central bank pronouncements or surprise growth spurts, could negatively impact total returns.

Emerging Markets

- The decline in the Emerging Markets (EM) Debt sector Despite continued Fed tightening, the Emerging Market Debt asset class has largely stabilized over the past two months. Opportunities have developed in countries that have relatively low trade deficits and can finance their debt in local currency.

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EQUITY MARKETS

United States

- The multiple expansion phase of this U.S. equity bull market is likely over, which means investors will look to earnings as a primary driver of higher returns. While earnings growth rates are expected to slow, they should remain in a healthy range of 7% to 10% for all of 2019.

Developed Markets

- The expected rebound in the German economy and the nearly 6% depreciation of local currencies against the dollar should allow for continued earnings growth and the recovery of European stock prices.
- After giving back some of its strong performance in the October market correction, the Japanese equity market remains undervalued. However, these stocks are more exposed to the impact trade wars may have on China and their other Asian neighbors.

Emerging Markets

- Chinese stocks traded on both the mainland and Hong Kong have fallen into bear market territory, taking the Emerging Markets Equity sector with them. While certain markets are beginning to attract interest, investors should remain cautious of this asset class given the uncertainty surrounding China and the trade wars.

ALTERNATIVES & COMMODITIES

Oil

- WTI oil prices continue to trade in the $65 to $75 range. Saudi, Russian and U.S. production is expected to offset the loss of Iranian and Venezuelan supply. A stronger dollar is helping put a ceiling on prices.

Gold and Industrial Metals

- Despite increased volatility in the equity markets, Fed tightening and the lack of tangible inflation should keep gold prices near current levels through year-end.
- The outlook for China's economic growth has driven industrial metals prices for most of the 2000s. Any slowdown in the world's second-largest economy, especially in its industrial production, will restrain prices in this sector.

Hedge Funds

- (Unchanged from last month) 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.

Private Equity

- (Unchanged from last month) 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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