Outlook for December 2018

WORLD ECONOMY

United States

- Despite relatively strong U.S. economic results, global growth is slowing amid worries about escalating trade tensions and incrementally tighter financial conditions.
- Healthy consumer and business balance sheets should keep U.S. GDP growth at approximately 2.7% in 2019, down from its peak this year but still a relatively high number. The probability of a U.S. recession over the next 18 months is very low. A sustained increase in business capital spending could extend this expansion cycle even further.

Developed Markets

- Uncertainties in Europe, including the outcome of the U.K.'s withdrawal from the European Union (EU) and the showdown between the EU and Italy over excessive deficit spending, continue to restrain growth. Absent any disruption from trade tariffs, continued currency weakness versus the dollar plus robust demand from the U.S. should boost exports in 2019.
- Japanese GDP should experience a tangible Q4 rebound from its natural-disaster-induced negative Q3. However, the government may have to reassess the planned sales tax increase to keep the country from falling into another recession.

Emerging Markets

- China's economic growth has slowed from the unsustainably high rates experienced for most of this century. The government's primary challenge will be controlling the magnitude of the slowdown given the uncertain impact of U.S. tariffs on exports.
- Economic growth across the broader emerging markets is stabilizing after the Q3 falloff, with higher industrial production helping to offset weakness in consumer spending. Reassuringly for investors, current forecasts show EM GDP growth will remain steady into 2019.

MONETARY POLICY & CURRENCIES

United States

- Even though the Fed is almost certain to raise rates another 0.25% in December, the end of the tightening cycle appears near as the fed funds rate approaches the elusive "neutral" rate. Continued low inflation and a strong dollar should provide sufficient rationale for a pause in quarterly increases early next year.
- The dollar has naturally benefitted this year from global growth and monetary policy differentials. Signals of a slowdown in the Fed tightening cycle will exert some downward pressure on the greenback as we progress through 2019.

Developed Markets

- The hands of central bankers in the U.K. are currently tied as they await the outcome of the protracted and somewhat contentious Brexit negotiations. A "soft" exit, as proposed by Prime Minister May, could lead to more monetary tightening, while a harder withdrawal could be economically damaging enough to provoke rate decreases in order to cushion the blow.
- The end of quantitative easing is the only rate normalization measure the European Central Bank will likely implement over the coming year. Slower growth will force the Bank to tread lightly to avoid falling closer to a recession.
- The Bank of Japan is expected to maintain its very aggressive easing policies until the country experiences stronger economic growth, and signs appear that inflation is moving towards the Bank's target level.

Emerging Markets

- Chinese authorities will primarily use fiscal policy to control the country's economic slowdown. However, they will also look to the Peoples Bank of China to maintain enough monetary ease without driving the currency to meaningfully lower levels.

BOND MARKETS

United States

- Continued economic growth into 2019 should cause the entire Treasury yield curve to shift higher and remain upward sloping, a reassuring sign for investors worried about the recessionary implications of a downward sloping (inverted) yield curve.
- The dramatic fall in energy prices and heightened equity market volatility have placed further pressure on high-yield bond prices. Recent spread widening has corrected a good portion of the valuation excesses in this asset class. We do not anticipate a significant rise in expected default rates.
- The outperformance of municipal bonds compared to their taxable brethren has produced full valuations and continued calls for below-market duration positioning in the space.

Developed Markets

- It remains difficult to find value in developed international bond markets, given the extremely low yields offered by the stronger countries and the risks reflected in the higher yields of struggling countries such as Italy.

Emerging Markets

- The anticipated end of Fed tightening should reduce pressure on the emerging market debt asset class and allow stronger countries with lower debt levels to draw greater investor interest. Oil prices may exacerbate pressures on commodity-heavy economies with high levels of dollar-based debt

CERITY PARTNERS

Outlook for December 2018

EQUITY MARKETS

United States

- After explosive earnings growth this year due to corporate tax reform, the growth rate for U.S. companies should settle in the mid to high single digit range for 2019. Maintenance of the current multiple on that growth should lead to similar price returns for U.S. equities over the coming year.

Developed Markets

- European economies are expected to avoid recession despite the recent slowdown in growth rates. As a result, European equities should be able to close some of the valuation gap that has developed over the last few years.
- The Japanese equity market remains captive to the ebbs and flows of the U.S./China trade negotiations. Any thawing of the tariff wars combined with an expected economic rebound could lead to solid equity returns.

Emerging Markets

- The stability of emerging equity markets in November was likely due to their very cheap valuations and anticipation of a breakthrough in the trade battles between China and the U.S. In the near term, we remain cautious of this asset class because of the uncertainty around the ultimate outcome of the trade disputes.

ALTERNATIVES & COMMODITIES

Oil

- Persistent supply pressures finally won out over surprising OPEC and Russian production discipline. Oil prices smashed through the bottom of the trading range, which had held for most of the year. We anticipate production cuts from Saudi Arabia and Russia, but only at a magnitude that will keep prices around the $50 to $55 level over the coming months.

Gold and Industrial Metals

- Without a distinct rise in global inflation or an abrupt end to monetary tightening, gold prices should hover around current levels well into 2019.
- Deleveraging in the Chinese economy and the country’s ongoing transition from a manufacturing to a consumer-driven model has led to a secular decline in many industrial metals prices. Better global growth and a reduction in trade tensions could lead to a moderate cyclical advance in prices moving into next year.

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.

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.