

# Outlook for February 2019

## WORLD ECONOMY

### United States

- The government shutdown will likely have a negligible effect on Q1 GDP.
- This historically moderate expansion should continue into 2020 thanks in part to a strong labor market, lower energy prices and an expected increase in business capital spending due to higher retained earnings.

### Developed Markets

- Eurozone growth continues to weaken as uncertainties around trade tensions and Brexit have dampened business spending in the region. Most notably, German exports have slowed moving into 2019. Last year's currency depreciation and accommodative monetary policies may provide a much-needed lift in the coming months.
- The Chinese fiscal stimulus and reduced trade tensions should help boost Japanese exports and provoke a cyclical rebound in that country's economy. A postponement of the pending sales tax increase could provide further support.

### Emerging Markets

- The Chinese government continues to use fiscal policy to address economic weakness, including a reduction in tax rates and targeted government spending in key sectors of the economy. A resumption of the trade war with the U.S. could severely challenge the effectiveness of these initiatives.

## MONETARY POLICY & CURRENCIES

### United States

- Persistently low inflation and a flattening yield curve appear to have convinced the Fed to pause its tightening strategy. It seems a more "patient" Fed will rely on data to drive its monetary policy, including the magnitude of its balance sheet reduction in 2019.
- Dollar appreciation has stalled. However, we don't expect significant declines from current levels because most central banks, other than the Fed, have accommodative monetary policies.

### Developed Markets

- The Bank of England's desire to raise interest rates is being hampered by the uncertainty surrounding the contentious Brexit negotiations; an economically damaging "hard" Brexit remains a potential outcome.
- Due to the sharper than expected slowdown in Eurozone economic growth, the European Central Bank likely won't raise rates until Q1 2020 at the earliest.
- With lower inflation forecasted for this year and next, the Bank of Japan shows no signs of ending its extreme monetary ease or its yield curve policy that has a targeted 10-year yield of zero.

### Emerging Markets

- A more stable and stronger renminbi may allow the Peoples Bank of China to loosen its monetary policy to complement the government's expansionary fiscal policy.

## BOND MARKETS

### United States

- Moderate economic growth may prevent an outright inversion of the Treasury yield curve with the 10-year ending around 3.0% this year.
- The high-yield sector has become more attractive with the stabilization of oil prices and the likely end to Fed tightening, and default rates are expected to remain low. We favor a generally neutral weighting in this asset class due to the recent spread contraction against Treasuries.
- Despite a market slowdown in issuance, demand for municipal bonds has remained strong and has rendered current yields rather unattractive, compared to same-maturity treasuries.

### Developed Markets

- Slower economic growth has driven bond yields in many international markets lower. This asset class appears to be overvalued at current levels.

### Emerging Markets

- Many emerging debt markets have recovered a large portion of last year's losses. The expected end to Fed tightening is helping dollar-based issuers while local-currency issuers seem to be benefiting from relatively strong economic growth rates.
- Additional appreciation in this asset class may depend in part on the success of China's fiscal stimulus policies.

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## EQUITY MARKETS

### United States

- Equities have recovered roughly half of their Q4 declines, but are still trading at attractive levels given low bond yields and expected positive earnings growth for 2019. The anticipated slowdown in GDP warrants closer scrutiny of top-line growth as the year progresses.

### Developed Markets

- European equities are deservedly cheap compared to U.S. valuations primarily due to the uncertainties swirling around the U.K., Italy and France, and the somewhat surprising slowdown in German growth. Monetary policy remains a strong tailwind as long as companies in the region can generate positive earnings growth.
- The safe-haven status of the yen in global markets has restrained the appreciation of Japanese equities compared to other developed markets. While it's not likely Japan will outperform other developed markets this year, Japanese equities should generate positive returns nearly in line with most other global equity markets.

### Emerging Markets

- The stabilization/recovery of energy prices has driven many Latin American markets higher while Asian equities have benefited from the anticipated favorable resolution of the U.S.-China trade dispute.
- Continued outperformance of this still cheap asset class will be largely contingent upon the Chinese government's ability to control the magnitude of the economic slowdown.

## ALTERNATIVES & COMMODITIES

### Oil

- Concerns about the potential impact of a slowing Chinese economy on global demand for oil have eased, stopping the sharp fall in prices. However, the overhang of inventory in the U.S. shale fields may prevent substantial appreciation from current levels.

### Gold and Industrial Metals

- With overall low inflation globally, gold may struggle to advance. However, the end of Fed tightening should prevent any sharp declines; look for a \$1,225 to \$1,275 trading range over the coming months.
- Industrial metals prices experienced varied performance early this year, but they have all stabilized around a floor. Slower global growth remains a restraining factor, but the fear of a more abrupt Chinese slowdown has dissipated to some extent.

### Hedge Funds

- The global market sell-off and resulting spike in market volatility during Q4 2018 demonstrated the benefit of exposure to categories such as equity long/short, global macro and multi-strategy managers to help protect capital during turbulent markets.

### Private Equity

- After a challenging period of ever-rising valuations, the Q4 2018 market sell-off reduced public market comparables, which should help private equity managers acquire good companies at more reasonable valuations than in recent years.

## Important Information



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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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