Economic Outlook and Market Forecast

April 2019
As in the past six years, weak economic growth in the first quarter should pick up as the year progresses. A slight quarter-end increase in business capital spending was encouraging, but this sector needs to gain momentum to achieve our 2.5% GDP (gross domestic product) forecast for 2019.
Developed Economies

**Purchasing Managers’ Index (PMI) Manufacturing**

- Eurozone - PMI Manufacturing Sector
- United Kingdom - PMI Manufacturing Sector

**Japanese Real Year-Over-Year (YOY) Export & Import Growth**

- Exports
- Imports

Germany and France are currently struggling with weak growth while peripheral European countries like Spain are seeing tangible improvement. Increased exports from a weaker euro, higher consumer spending in Germany and the global impact of China’s fiscal stimulus should help avert a recession. Renewed trade negotiations with the U.S. remain a major uncertainty.

The Japanese economy is relying on the success of China's fiscal stimulus to support export growth. The pending sales-tax increase may spur higher consumer spending in the near term, but in the long run, it will likely be a detriment to economic growth in this already demographically-challenged economy.
Emerging Market Economies

**Chinese Real GDP Growth**

![Chart showing Chinese Real GDP Growth from Mar-04 to Mar-18](chart)

*Aggressive fiscal-policy expansion should help the Chinese government control the slowdown in economic growth. Successful trade negotiations with the U.S. may prove elusive, which would likely keep tariffs at current levels.*

**Real GDP Growth**

<table>
<thead>
<tr>
<th>Country</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>1.3%</td>
<td>2.5%</td>
</tr>
<tr>
<td>China</td>
<td>6.6%</td>
<td>6.2%</td>
</tr>
<tr>
<td>India</td>
<td>7.3%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5.1%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Mexico</td>
<td>2.1%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Russia</td>
<td>1.7%</td>
<td>1.6%</td>
</tr>
<tr>
<td>South Africa</td>
<td>0.8%</td>
<td>1.4%</td>
</tr>
</tbody>
</table>

Source: IMF & Factset; 2018 & 2019 GDP Growth Rates are forecasts
The Federal Reserve is likely finished with its rate-tightening cycle and has announced a September end to its balance sheet runoff. While markets are anticipating a rate cut as the Fed’s next possible move, expected economic growth should be sufficient to keep the central bank on hold well into 2020.

The end of Fed tightening means the dollar’s nearly decade-long bull market is probably over.
Global Monetary Policy

**European Central Bank Main Target Rate**

Given the current state of the continental European economy, the European Central Bank won’t be able to raise rates in 2019. The more significant concern is the lack of any meaningful tools to respond if these economies actually fall into recession.

The Bank of Japan also appears to have exhausted its toolkit in an effort to return to a 2% inflation environment. The bank may soon need to adjust its asset purchases due to the unintended consequences of price distortions in certain asset categories.
A larger portion of the U.S. Treasury yield curve is now inverted, but the spread between the two- and ten-year notes has remained relatively stable all year. An increase in longer-term rates in response to reasonably strong economic growth in the coming months should resolve this unusual flat-curve environment.

The municipal bond yield curve remains upward sloping, which may allow municipal bonds to outperform corporate bonds to some extent as Treasury yields rise.
The recessionary implications of a flattening, and at certain points an inverted, yield curve have been largely offset by the continued contraction of high-yield corporate bond spreads to the like-maturity Treasury notes. With default rates expected to remain low over the next year, the high-yield asset class appears fairly valued at current levels.

Emerging market debt, in both dollars and local currency, should continue to outperform during the year due to China’s fiscal stimulus, the recovery of the commodities markets and the end to the Fed rate-tightening cycle.
Equity markets may need a few months to digest the large year-to-date gains. International trade and domestic debt-ceiling negotiations will introduce greater volatility, although we do expect better earnings growth over the second half of the year. Some profit taking and rebalancing back to investors’ strategic target allocations should be contemplated for this asset class.
Despite their weakening domestic economies, European equities are riding the coattails of strong U.S. and Chinese stock markets. The current valuation discount to U.S. equities appears appropriate, so expect similar price moves over the coming months.

Even though a resolution to the U.S./China trade dispute remains uncertain, the fundamentals in emerging markets are improving due to the end of Fed tightening, China’s fiscal stimulus and a recovery in the commodities markets. This improvement should be reflected in strong earnings growth and the outperformance of equities compared to developed markets at least through the summer months.
The U.S. shale industry’s reaction to the rebound in prices and the hesitancy of Russia to extend supply cuts should cap oil prices around current levels, and offset the impact of sanctions on Iran and Venezuela.
Gold and Commodities

Gold may have registered its highs for the year. The lack of inflationary pressures should offset the end of the Fed-tightening cycle and continued monetary ease among many global central banks.

Industrial metals prices have stalled due to global growth concerns, and will likely trade in a narrow range around current levels for at least a few months.
Hedge Funds & Private Equity

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.

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.
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