Outlook for June 2019

WORLD ECONOMY

United States

- The intensifying trade war with China and the threat of U.S. tariffs on Mexican imports may negatively impact U.S. and global GDP growth through year-end. While the magnitude of the slowdown is uncertain, the inherent strength of the U.S. economy, led by a financially healthy consumer, should preclude a recession in the near term.

Developed Markets

- Despite somewhat surprising growth in Q1, Europe would likely be more affected by any trade-induced slowdown in China. Continued uncertainty around Brexit and renewed tensions between the European Union and Italian government over burgeoning deficits will probably keep Eurozone growth below trend and only barely positive for the remainder of the year.
- The revival in Japanese manufacturing may be short-lived given the expected impact heightened trade frictions may have on exports. The government seems determined to implement the planned sales tax increase this fall, although an additional delay would relieve pressure on the Japanese consumer.

Emerging Markets

- The Chinese economy is most exposed to the increase and potential broadening of U.S. tariffs. To help offset the impact, the Chinese government could implement additional fiscal and monetary policy stimulus, but the effectiveness of such policies isn't guaranteed. Look for Chinese GDP growth to move towards 6.0% by year-end, and possibly lower.

MONETARY POLICY & CURRENCIES

United States

- With the short-end of the yield curve currently inverted, the Fed's next move may be a rate reduction. Although it will likely wait for evidence of any deflationary threats before acting.
- The dollar is viewed as a safe-haven currency, and as such, should benefit from flows out of riskier assets and regions. It may also benefit from a more deliberate Fed response to the trade conflicts as the U.S. remains a relatively high interest-rate country.

Developed Markets

- The European Central Bank likely won't raise rates until the middle of next year at the earliest. Targeted lending to banks appears to be the preferred option if economic growth falters. A more hawkish replacement as chairperson could spark debate over the effectiveness of the decade-long monetary easing.
- The Bank of England remains in a holding pattern for any rate changes, pending the ultimate outcome and economic impact of Brexit.

Emerging Markets

- To offset the trade-related slowdown, the Chinese government is expected to pressure the Peoples Bank of China to produce additional monetary ease through rate cuts and decreases in the required reserve ratio in the banking system. Watch for any breach above the important 7.0 threshold of the Chinese renminbi to the dollar as it could lead to notable capital flight out of the country.

BOND MARKETS

United States

- The uncertain economic impact of a multifront trade war has driven intermediate and long-term yields below short-term yields across much of the yield curve. Continued positive economic growth should push longer rates higher from current levels.
- Spreads in the high-yield asset class have widened amidst concerns about the potential adverse effects of the trade wars. While default rates are still historically low, the market may start to price in an uptick in a slower growth environment. Valuations seem fair at these levels.
- Municipal bonds remain attractive at the longer end of the yield curve. However, the recent decline in rates makes longer maturities more vulnerable to a rebound in yields should the U.S. economy stay reasonably healthy.

Developed Markets

- The developed international fixed-income market has diverged. Yields in the safe-haven markets of Germany, the U.K. and Japan have plunged while yields in weaker economies such as Italy have increased. Investors want to be better compensated for heightened recessionary and deficit risks. This asset class remains unattractive to us.

Emerging Markets

- Emerging market debt is holding up reasonably well, a potential sign the global economy may not sink into a recession. Higher oil prices year-to-date have been particularly beneficial to many issuers in this asset class.

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EQUITY MARKETS

United States

- Lower equity valuations are due in part to the deterioration in trade talks with China, concerns about broader tariff wars, and increased recession risk. Revenue and earnings growth are expected to remain positive over the next year, so the recent equity weakness is likely a correction, not the beginning of a bear market.

Developed Markets

- European equities may provide a downside cushion compared to the U.S. due to their cheaper valuations. However, they also tend to be more cyclically exposed given their industry concentrations and will not be able to avoid the gravitational pull from any protracted U.S. downturn.
- The safe-haven status of the yen puts additional pressure on Japanese equities during times of market stress. While not currently an issue, U.S. auto tariffs pose an impending risk to the Japanese equity market.

Emerging Markets

- Stalled trade negotiations and the imposition of higher tariffs have upended emerging markets equities over the past month. The apparently protracted impasse between the U.S. and China dictates a more cautious approach with this asset class.

ALTERNATIVES & COMMODITIES

Oil

- The usual seasonal depletion of crude oil inventories has so far failed to materialize. U.S. shale producers ramped up production in an environment of sharply higher prices. Concerns about weakening demand in a slowing global economy also helped bring prices back down to more reasonable levels. Ongoing geopolitical issues potentially affecting supply may provide a floor slightly below current prices of West Texas Intermediate ($54) and Brent crude ($62).

Gold and Industrial Metals

- While gold possesses a safe-haven status in times of market turmoil, it is primarily an inflation hedge. Continued low inflation around most of the world will likely limit the upside. The extremely low rates set by developed market central banks could provide a slight tailwind.
- Recent price declines in industrial metals reflect the potential impact of increased U.S. tariffs on the Chinese economy. The price of copper has been hit particularly hard; China is a voracious consumer of this metal. The uncertainty of the economic impact may lead to further declines across the metals complex.

Hedge Funds

- [Same forecast as last month] After a difficult period characterized by abnormally low market volatility, high intra-asset correlations and historically low interest rates, the return to more normal market conditions has allowed hedge fund managers to demonstrate their value-add in both good and bad markets. Defensive strategies provided beneficial downside protection during the Q4 2018 downturn while directional strategies participated strongly in the Q1 2019 rebound.

Private Equity

- [Same forecast as last month] High asset valuations and fierce competition to invest the rising backlog of committed funds awaiting deployment remain a major challenge for the category, particularly in buyouts. These risks can be mitigated by focusing on specialist managers with a demonstrated record of generating outstanding returns in different market cycles while maintaining investment discipline.

Important Information

Benjamin Pace
Chief Investment Officer

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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