Outlook for July 2019

WORLD ECONOMY

United States

- Uncertainty about the trade war between the U.S. and China is causing businesses to delay capital spending. Indices for U.S. manufacturing could start to contract over the summer.
- The U.S. should avoid a recession thanks in part to a healthy consumer and service economy. Job and wage growth have allowed consumers to rebuild their balance sheets, and they will likely keep spending as long as businesses don't begin reducing staff.

Developed Markets

- The German consumer remains one of the few bright spots within the European economy, which has been impacted by the U.S.-China trade war and supply chain disruption within the countries' respective industries.
- The uncertainty surrounding Brexit may impede the relatively strong U.K. economy as businesses delay spending plans & consider moving out of the country.
- Japanese consumption has been impressive this year, but this may be a case of buyers pushing up purchases ahead of the consumption tax increase this fall. Manufacturing in Japan continues to suffer from the proximity to China and other Asian trading partners, which have been affected by increased trade friction.

Emerging Markets

- To control the natural slowdown of its economy, the Chinese government has implemented significant fiscal policy initiatives to offset the anticipated impact of actual and threatened tariffs. Targeted tax cuts and spending increases should help mitigate the slowdown in the second half of this year, but the long-term effects of businesses adjusting supply chains away from China remain uncertain.

MONETARY POLICY & CURRENCIES

United States

- The Fed is likely to cut rates within the next few months although it may delay action to better assess the magnitude of the economic slowdown.
- The dollar may drift lower as the Fed eases rates, but any decline should not be significant since many other central banks are expected to adopt similar policies.

Developed Markets

- The outgoing head of the European Central Bank, Mario Draghi, has signaled further monetary ease and a resumption of the asset purchase program to combat dangerously slow European growth. These actions will likely keep the key rate below zero for the foreseeable future.
- The Bank of Japan, a prime example of a central bank that may have run out of ammunition to combat a recession, will nonetheless likely lower rates and increase its asset purchases of equities and government bonds.

Emerging Markets

- While the Chinese government is concentrating primarily on fiscal policy initiatives, it does expect the central bank to help offset the economic slowdown. Policy responses should be limited to slight decreases in rates and the required reserve ratios at banks to avoid currency depreciation and a subsequent flight of capital out of the country.

BOND MARKETS

United States

- Expected Fed rate cuts of 0.50% to 0.75% (50-75 basis points) over the next 12 months should drive short-term rates below the 10-year Treasury, resolving the inverted yield curve. Intermediate-term rates should drift higher as the U.S. economy avoids a recession and benefits from this monetary stimulus.
- One important indicator that a recession isn't imminent is the narrowing spread between high-yield bonds and same-maturity Treasuries. High-yield securities appear fairly valued at the currently low expected levels of default rates.
- The municipal bond yield curve is not inverted, and value can still be found in the longer end of the maturity spectrum when compared to taxable equivalents. Reduced concern about a spike in interest rates adds to the attractiveness of this asset class.

Developed Markets

- Government bonds in the stronger international markets have fallen deeper into negative yield territory as the European Central Bank and Bank of Japan prepare to increase their asset purchases. There remains little value in these markets as well as bond markets where deficit fundamentals are worsening.

Emerging Markets

- Higher oil prices and the Chinese fiscal stimulus have fueled the emerging debt markets this year. The performance of this asset class serves as further evidence the global economy isn't approaching recessionary levels.

Outlook for July 2019

EQUITY MARKETS

United States

- Lower interest rates in this current economic environment should support higher valuation multiples for U.S. equities. Q2 earnings reports and accompanying management commentary will likely reveal a slowdown, but not a reversal, of revenue and earnings growth rates.

Developed Markets

- European equities are notably cheaper than U.S. stocks, which is warranted due to slower growth, a less dominant technology sector and more cyclical exposure. Exports and the avoidance of recession should allow these markets to perform roughly in line with the U.S.
- A strengthening yen continues to restrain Japanese equities compared to other global markets. While these stocks are relatively cheaper than equities of many developed countries, unresolved trade tensions and the pending sales tax increase may delay any outperformance through year-end.

Emerging Markets

- Trade negotiations between the U.S. and China will likely continue to send conflicting signals and lead to heightened volatility. That said, China's fiscal stimulus and the stabilization of commodities markets should positively impact earnings growth and allow emerging markets equities to close the valuation gap with developed markets.

ALTERNATIVES & COMMODITIES

Oil

- Fluctuations in oil prices will likely continue through summer, but within a limited trading range that's capped by ample U.S. production on the upside and normal seasonal drops in inventory and production restraint by OPEC and Russia on the downside.

Gold

- Gold prices have reacted to the Fed's apparent pivot towards monetary easing. With other central banks ready to join in with comparable policies, gold and other real assets have become more attractive to investors. Ultimately, the lack of inflationary pressures should restrain the price and cause it to drift downward over the next year.

Industrial Metals

- China's fiscal stimulus is battling the negative impact of U.S. tariffs to be a price driver of industrial metals. As it is difficult to determine the outcome of trade negotiations at this time, the stimulus should help control the slowdown and allow this sector to trade close to current levels for the next quarter.

Hedge Funds

- Our outlook for this market remains the same as reported in June. 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

- Our outlook for this market remains the same as reported in June. 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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