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Confidential & Proprietary

Outlook for August 2019

WORLD ECONOMY

United States

- The U.S. economy doesn't appear at immediate risk of recession due primarily to healthy consumer spending. The consumer savings rate is now more than 8% thanks in part to consistent job and wage growth.
- Capital spending is an area of potential concern. The decline in energy prices late last year and continued trade frictions with China have made businesses more cautious with their spending. A sustained pickup in the purchase of intellectual property products would be an encouraging sign that tax reform is having a positive impact on productivity-enhancing capital investments.

Developed Markets

- Weakness in German industrial production is inhibiting growth throughout the Eurozone. Export growth may get a boost in the coming months from a healthy U.S. economy and a controlled slowdown in China. While the region should avoid recession, the European economy remains vulnerable to an intensification of trade conflicts.
- The ascension of Boris Johnson to Prime Minister of the U.K. heightens the risk of a "no-deal" Brexit, which could have adverse economic consequences for the region.
- The looming increase in the Japanese consumption tax continues to impede the country's GDP growth. A resolution to the U.S.-China trade conflict would help bolster exports.

Emerging Markets

- The Chinese economy is slowing. However, the fiscal policy initiatives implemented by the government should allow GDP growth to exceed 6% this year. An overall loosening of global monetary policies could prompt the central bank to cut interest rates. Longer term, the government needs to implement structural reforms to transition from its investment-driven economy.

MONETARY POLICY & CURRENCIES

United States

- The Fed pivoted from its year-end tightening stance with a 0.25% (25 basis point) reduction in July. We anticipate one to two more cuts in reaction to continued low inflation.
- The dollar's strength year-to-date is mainly due to the higher yields available in U.S. fixed income markets compared to most other developed markets. The expected decline in short-term rates may cap further appreciation. Although, we don't anticipate any meaningful declines as other central banks are also looking to decrease rates in this slow-growth environment.

Developed Markets

- An even more dovish-leaning policymaker will soon lead the European Central Bank. Look for further interest rate decreases as early as September with a simultaneous resumption of longer-term asset purchases to combat anemic economic growth and persistently low inflation.
- The Bank of Japan is trying to delay any further easing, knowing it has already taken extreme measures. While the effectiveness of these actions is up for debate, the bank will likely need to lower rates to counter the impact of prospective fiscal tightening.

Emerging Markets

- Recent and prospective U.S. rate decreases may give the Peoples Bank of China the flexibility to implement an easing program without the risk of an unwanted decline in the country's currency and currency reserves.

BOND MARKETS

United States

- Expected Fed rate cuts of 0.25% to 0.50% over the next year should move short rates below intermediate rates and bring the overall yield curve to its more natural upward slope. The 10-year Treasury yield should drift slightly higher given current growth rates and the monetary policy boost.
- The spreads between high-yield bonds and same maturity Treasuries remain at rather low levels and are indicative of continued economic growth and a low expected default rate. These securities appear fairly valued and may be a little vulnerable to spread widening at current prices.

Developed Markets

- Many government bond markets are in negative yield territory, and yields have fallen more deeply in anticipation of further or resumed central bank asset purchases. It is difficult to forecast positive returns for developed market bonds over the remainder of the year

Emerging Markets

- Emerging bond markets have surprisingly outperformed emerging equity markets year-to-date. The performance has been driven by China's fiscal stimulus and higher oil prices, which have helped large debt issuers such as Russia. Besides confirming the overall positive health of the global economy, this asset class is becoming more fairly valued.

Outlook for August 2019

EQUITY MARKETS

United States

- Given the strong year-to-date performance, it's reasonable to expect some form of pullback in the equities markets over the remainder of the summer. Lower short-term rates combined with positive earnings growth should let valuation multiples continue to expand through year-end.

Developed Markets

- European equities have a distinct valuation advantage over their U.S. counterparts. We don't expect the valuation gap to close this year given the slow growth environment and the potential geopolitical headwinds around Brexit, trade and upcoming elections.
- Japanese equities have underperformed so far this year, albeit in an environment of attractive absolute returns, due to the strength of the yen and the country's proximity to China and the related trade conflicts. The pending tax increase should keep the discount to U.S. stocks at current levels despite any easing by the Bank of Japan. Investors should also be wary of trade tensions broadening to areas such as Japanese autos.

Emerging Markets

- Current trade negotiations between the U.S. and China are focused more on export agreements for distinct goods and services than structural issues. The avoidance of additional tariffs on Chinese products would bode well for the impact of China's fiscal stimulus on the economic and earnings growth rates for many countries in the emerging markets space. As these stocks are currently among the cheapest in the world, we expect the valuation gap with the U.S. to narrow somewhat by year-end.

ALTERNATIVES & COMMODITIES

Oil

- Absent a geopolitically-induced supply shock, crude oil should continue to trade in the $55-$65 range. The commitment of OPEC and Russia to supply reduction agreements will continue to be tested. U.S. shale producers will quickly take advantage of any price bumps to increase production.

Gold

- In an environment of incrementally greater global monetary ease, gold prices have pushed upwards. Low inflation around the world should cap further appreciation. With the Fed's currently cautious tone around monetary easing, prices may decline over the coming months.

Industrial Metals

- China's fiscal stimulus and continued economic growth should offset the potential for additional tariffs to keep industrial metals in a tight trading range.

Hedge Funds

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