Outlook for May 2019

WORLD ECONOMY

United States

- The momentum that led to surprisingly strong first-quarter growth appears to have carried over to second quarter. A healthy consumer and the potential resolution to the tariff war with China should give businesses the confidence to spend more freely on productivity-enhancing capital projects.

Developed Markets

- Continental Europe has skirted a recession. Italy and Germany now have positive gross domestic products (GDP) while peripheral countries, led by Spain, are growing at comfortably positive rates with improving momentum. Most encouraging is the increase in domestic demand, which has offset the negative impact of trade tensions on net exports.
- The Japanese economy should continue to grow but at a weaker rate than expected. Still vibrant growth in China, improving momentum in the U.S., and a possible end to trade disputes should help drive exports. The pending sales tax increase will likely constrain domestic consumption.

Emerging Markets

- China's government and central bank continue to effectively manage the difficult task of controlling the inevitable economic slowdown. The domestic stimulus has mostly offset the negative impact of the tariff wars, and GDP for all of 2019 should be in the 6%-6.5% range. Where it ends up will likely depend in part on any trade deal with the U.S.

MONETARY POLICY & CURRENCIES

United States

- Stronger than anticipated first-quarter growth may awaken the hawks on the Federal Open Market Committee and increase the probability of one more 0.25% rate hike before the tightening cycle ends. Low core inflation is a strong counter-argument against any further tightening at least through the remainder of the year.
- The dollar will likely trade in a tight range through the summer as the Fed assesses its response to the improved economic outlook.

Developed Markets

- The ongoing low growth/low inflation environment in Europe means the European Central Bank won't be able to raise rates this year. With no imminent threat of a recession, discussions about renewed quantitative easing aren't likely.
- The Bank of England may be tempted to raise rates this year given the country's better than expected economic growth. The lack of clarity around the ultimate impact of Brexit should be a sufficient constraint on any tightening tendencies.
- The Bank of Japan is exploring the possibility of increased quantitative easing through the purchase of a more substantial amount of equity exchange-traded funds. While this is unlikely to happen because growth should remain positive, negative policy rates could persist for quite some time.

Emerging Markets

- The Peoples Bank of China has taken note of improved economic trends and should refrain from further easing through year-end.

BOND MARKETS

United States

- Economic growth currently at its long-term potential with little inflationary pressure should allow the Treasury yield curve to return to its normal upward slope. Intermediate to longer-term maturities may move approximately 0.25% (25 basis points) higher throughout the year while short rates remain at current levels.
- High-yield debt has performed well year-to-date thanks in part to diminished recessionary concerns. The valuation of this asset class fully reflects expectations for a continued low default rate.
- With fewer concerns about a sharp upward spike in overall yields, municipal bonds are more attractive at the longer maturity end of the yield curve.

Developed Markets

- The very low, and in some cases negative, yield environment in many developed international bond markets make this asset class expensive. We remain cautious about its utilization at current price levels.

Emerging Markets

- Emerging market debt valued in both dollars and local currency remains attractive given the favorable global economic fundamentals and a notable appreciation of commodity prices.

Outlook for May 2019

EQUITY MARKETS

United States

- U.S. equity markets are looking past flat first-quarter earnings towards the expected improvement for the remainder of the year. Top line revenue growth has remained strong and should help maintain valuations around current levels. Concerns exist around the upcoming debt ceiling negotiations in a fiercely partisan environment.

Developed Markets

- The strength of European equities so far this year is a reminder that the larger companies in these markets are impacted by growth prospects in China and the United States. Weaker domestic economies on both the continent and U.K. support a continued valuation discount to U.S. markets.
- Year-to-date, Japanese stocks are positive but have lagged behind most other global equity markets. A satisfactory outcome to U.S. trade negotiations and some level of yen depreciation may be needed to produce relative outperformance over the summer months.

Emerging Markets

- Emerging markets stock prices should move higher through year-end, driven upward by a combination of the end to Fed tightening, robust Chinese growth, and higher oil and industrial metals prices. This environment should bode well for valuations and earnings growth.

ALTERNATIVES & COMMODITIES

Oil

- Current crude oil prices should provoke a meaningful supply response from U.S. shale producers. Although, sanctions on Iranian sales and ongoing turmoil in Venezuela and Libya should prevent any significant price declines at least through the summer.

Gold and Industrial Metals

- Low inflation and competitive short-term interest rates should exert downward pressure on gold prices. The apparent hesitancy of the Fed to raise rates any further should limit the downside, but gold is still likely to exhibit negative returns over the remainder of the year.
- Industrial metals at current price levels likely fully reflect the improved global growth outlook. Look for these commodities to trade around current levels. Any surprise would probably be to the upside based on improving global economies.

Hedge Funds

- 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

- 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.