# Outlook as of April 2015

## World Economy

- Signs of “green shoots” emanating from Europe and Japan are helping to offset a recent soft patch in the US.
- US economic growth in the first quarter was mixed and inconsistent, reflecting exogenous factors such as harsh winter weather conditions in the Midwest and Northeast and the impact of the West Coast port strike. We expect second quarter growth will benefit from a rebound in home sales and construction activity, while robust consumer demand will provide a boost to both domestic suppliers and exporters to the US.
- Although not all countries in the Eurozone will benefit equally due to competitive differences, the weaker euro should help sales and employment in the export industries.
- Japanese economic growth is arguably more reliant on currency weakness than Europe. The Bank of Japan is widely expected to announce a further round of monetary easing, to help maintain economic momentum and ensure that exports are not hurt by the recent levelling off in the Yen.
- The Chinese government is beginning to acknowledge the magnitude of the economic slowdown and the need to work through the supply overhang created by over-investment in manufacturing capacity in the past few years.

## Monetary Policy & Currencies

- The Federal Reserve has signaled an initial rate hike at either the June or September Federal Open Market Committee meetings. Slower first quarter growth, combined with low inflation and the continued strong dollar, suggest that the tightening cycle will be gradual, with full normalization of the Fed Funds rate accomplished no earlier than 2017.
- The upward trend in the dollar continues, despite some narrowing in the relative economic strength between the US and other developed economies. Divergent US monetary policy and expectations of improved longer term US economic growth will be important drivers of dollar appreciation against most currencies.
- Other than improvement in Germany, there is enough weakness and stagnation in the other Eurozone countries to keep the ECB on its path of intermediate maturity bond buying until at least September of next year.
- The Bank of Japan will most likely implement one more notable balance sheet expansion to push the Yen into the high 120’s in order to support the key export industries.
- Among the emerging markets, countries with ample currency reserves and manageable current account deficits should continue to use conventional rate reductions to maintain economic growth. Thus, exposures should be hedged for dollar based investors.

## Bond Markets

- Markets have priced in higher yields across the curve once the Federal Reserve starts tightening. We expect the pace will be moderated by continued low inflation and muted wage growth, while the rate impact will be offset by higher demand for US Treasurys from foreign investors facing lower relative rates at home.
- Improved prospects for second quarter growth suggest continued outperformance of corporate bonds, both investment grade and high yield, over Treasurys. Quality bonds with low yields may experience negative returns as rates rise, whereas the higher absolute yields on sub-investment grade bonds should help to buffer the impact of rising rates.
- Continued monetary easing in Europe and Japan will keep interest rates extremely low across the developed international bond markets. The ECB will remain challenged by the sparse supply of investment grade bonds available for purchase under its quantitative easing program.
- Anticipated central bank easing among emerging markets should cause yields to fall across the maturity spectrum, generating positive total returns for investors. As monetary easing will likely lead to currency weakening, investors should focus on dollar-denominated bonds, rather than local currency debt.

## Equity Markets

- Q1 earnings reports will likely be impacted by inconsistent economic growth early in the year and the impact of the strong dollar on large multinational companies translating foreign earnings back into the dollar. These effects have largely been reflected in downward revisions to earnings estimates, whereas analysts have not fully factored in the economic benefit of sharply lower energy prices.
- Though historically expensive, valuations can continue to expand in this secular bull market as economic and earnings growth remain comfortably positive and the Fed initiates a very gradual tightening cycle.
- European and Japanese equities experienced multiple expansion in the first quarter with the valuation gap with the US narrowing somewhat. Continued, and perhaps increased, monetary easing should benefit markets, but as the year progresses, the effectiveness of further easing will be watched closely.
- Disparities in economic performance across the emerging market economies have led to sharply different return profiles in their respective equity markets. Chinese equities appear rather stretched, but monetary ease should help India and a number of other Asian countries who largely benefit from lower energy prices.

## Alternatives & Commodities

- An element of geopolitical risk has been reintroduced to oil prices, with Saudi-led airstrikes into Yemen and controversy around nuclear talks with Iran. Supply/demand fundamentals point towards continued lower prices - US production remains high and Iran is poised to resume exports if sanctions are lifted.
- Gold remains unattractive, as global inflation remains muted and impending tightening by the Fed is offset by very loose monetary policy elsewhere around the world.
- The outlook for industrial commodities remains weak, due to soft demand from China and the impact of dollar pricing on import markets with weaker currencies.
- Hedge fund strategies should perform well as artificial constraints on market volatility and security correlations are removed. Managers who rely on security selection or low correlations to risky assets should profit from policy normalization.
- Rising valuations make it more difficult for private equity firms to acquire companies at reasonable prices. We will remain focused on secondaries funds and other sectors such as private debt and infrastructure, where valuations are still reasonable.

# Important Information

Ben is the firm's Chief Investment Officer and a member of the Investment Committee. He has more than 25 years of experience in investment management. Prior to joining HPM Partners, he was Chief Investment Officer and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S.

*Benjamin Pace*

Benjamin Pace
Chief Investment Officer