Outlook as of August 2015

World Economy

- China has rightfully supplanted Greece as the primary concern in assessing the health of the global economy. Reported growth of 7.0 % is not confirmed by independently measurable statistics such as electricity consumption, railcar loadings, and industrial profits.
- US growth has indeed improved from the anemic first quarter rate, but business spending continues to be rather disappointing and the overall magnitude of US economic growth may not be enough to fully offset weakness in many international economies.
- Greece accounts for less than 2% of Eurozone GDP growth. Hence, emerging markets weakness has a far greater impact on European economic growth than a potential Grexit. Markedly slower growth in exports to developing economies is already affecting industrial production, especially in Germany.
- Massive monetary policy easing over the last three years has failed to have the desired stimulative effect on the Japanese economy. While no longer technically in recession, Japan struggles with low wage growth, an aging population, and an overall lack of competitiveness.
- The slowdown in China growth is impacting global commodity prices, exacerbating recessions in Russia and Brazil, and weakening growth in many other commodity-dependent emerging market economies.

Monetary Policy & Currencies

- The July FOMC meeting statement continues to guide investors towards a September rate hike. However, the deflationary impact of the strong dollar and weak commodity prices could cause the Fed to delay tightening until it sees higher wage growth.
- The ECB will continue to supplement near-zero interest rates with monthly purchases of government securities through fall 2016. It is already facing pressure to extend its quantitative easing program into 2017.
- The IMF is calling on the Bank of Japan to ease rates further, to help counter the negative fiscal effects of structural reforms the Abe government is attempting to implement.
- Policy divergence among the three major central banks, coupled with the relative differentials in economic growth and interest rates between the US and other countries, suggests that the current secular bull market for the dollar will continue for some time.
- The dollar bull market extends to emerging market currencies as most of these central banks will be biased towards monetary policy ease to bolster economic growth.

Bond Markets

- Inconsistent US economic statistics and lower commodity prices have kept Treasury yields in a tight trading range, but the anticipated Fed tightening on improving economic data should lead to upward pressure on the whole yield curve through the remainder of the year.
- Renewed pressure in the energy sector has caused some spread widening in both high yield and investment grade corporate debt. This has been particularly pronounced in the high yield debt market where low default rates outside of energy should lead to a more sanguine view of many below investment grade credits.
- The anticipation of a default by certain Puerto Rican debt issuers continues to be viewed by the markets as an isolated event with little carryover to the mainland municipal bond market. Fiscal conditions of most issuers across the country remain rather strong.
- Debt of developed international issuers is expensive with the ten year notes of Japan and many northern European issues trading below 1.0%. Peripheral debt in southern Europe has higher yields, but not high enough to compensate for inherent credit risk in those countries with high debt and weak economic growth.
- Emerging market currencies have been very weak, but bonds priced in dollars issued by these countries continue to benefit by the monetary policy flexibility available to their central banks. Downward shifts in yield curves should lead to positive total returns through year end.

Equity Markets

- Excluding the energy sector, second quarter US corporate earnings have generally exceeded estimates. Revenues were hurt by the strong dollar and weak commodity prices, but year-on-year top line growth is still positive. Better GDP momentum and continued positive growth in sales and earnings should bolster US equity prices for the remainder of the year.
- Aggressive monetary easing by the ECB has caused the euro to weaken considerably, which has boosted profits for Eurozone companies. We expect earnings growth will be the primary driver of positive equity returns over the coming months, as revenue growth remains hobbled by weak global growth and tight fiscal policies in the peripheral countries.
- Japanese equities have risen 15% year to date; however, revenue growth has been inconsistent, while economic growth has failed to keep pace with the markets. Another round of monetary easing and yen depreciation may be necessary to help reflate the economy and drive prices higher.
- The large correction in Chinese equities and rampant currency weakness have driven emerging market equities to negative total returns through July. Caution continues to be advised although opportunities are developing at the current much more attractive valuation levels.

Alternatives & Commodities

- The global supply glut has driven oil prices down to levels where more expensive production should soon be shut down. Continued weak demand in emerging markets will limit any sharp rebound in prices.
- Gold has fallen along with most other commodity prices, and is liable to fall further, as confidence in the rising dollar causes demand for an alternative currency store to wane.
- Prices for industrial commodities may be close to a floor. Weak emerging market demand will remain a headwind to any meaningful advance.
- Policy normalization should benefit hedge fund managers who rely on security selection or low correlation to risky assets to drive returns, as artificial constraints on market volatility and security correlations are eliminated.
- High valuations are making it challenging for private equity firms to buy assets at reasonable prices. We continue to focus on disciplined managers, secondary funds, and 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