Outlook as of December 2015

HPM PARTNERS

World Economy

- Lower global interest rates, the beneficial impact of weaker currencies, and stronger US consumption are having a positive influence on the global economy, as reflected in recent rises for Purchasing Managers Indices around the world.
- Persistently low energy prices, combined with higher job and wage growth, should drive steady growth in US consumer spending through year-end, and into 2016. Higher consumer spending will help offset any weakness in capital spending, particularly from the mining and energy sectors.
- With the continuing slowdown in China, the government has been quick to implement fiscal and monetary policy initiatives to assure continued growth, albeit at lower rates. In the transition to a consumer-driven economy, higher spending by the growing middle class is expected to buffer the accompanying decline in investment spending.
- Despite the tragic terrorist events in Paris, the Eurozone reported a slight improvement in economic growth in November, driven by higher exports and a surprising uptick in German consumer spending.
- Japan has fallen back into technical recession, measured by a steep drop in capital spending and meaningful inventory drawdown. On the positive side, the declining yen is finally boosting export growth and consumer spending has remained healthy.

Monetary Policy & Currencies

- The strong October employment report and consistent verbiage from FOMC members sets up the Federal Reserve to raise interest rates at the December meeting. The Fed appears to be guiding markets towards a dovish tightening cycle by stressing the gradual nature of future rate increases.
- In contrast to the US, the Eurozone is facing potential deflation, and the ECB has reiterated its readiness to broaden its bond purchase program to prevent deflation from taking hold.
- The Bank of Japan appears hesitant to expand its monthly bond buying program, despite the current recessionary indicators. Instead, the central bank is calling for additional fiscal policy initiatives to support the flagging economy.
- The divergence of monetary policy among the major central banks favors the dollar, which has resumed its appreciation against all developed market currencies after a brief summer respite.
- Ample currency reserves and lower market volatility should allow many emerging market central banks to ease monetary policy and fight slowdowns in their respective economies. Any resulting currency weakness against the dollar should provide a boost to exports.

Bond Markets

- Commencement of a US rate tightening cycle should cause the entire yield curve to shift upwards, as the Fed reacts to better economic growth and signs of incipient inflation. We expect the bellwether 10-year US Treasury note (currently yielding 2.22%) to move towards 2.50% over the coming months.
- The recent widening of interest rate spreads in the corporate bond market, and particularly for sub-investment grade issuers, is a cause for concern as it can be a sign of impending economic weakness. However, almost all of the balance sheet problems are confined to the energy and mining industries, and expected default rates remain very low for the other industry sectors.
- Aside from the high profile credit issues affecting Puerto Rico and Illinois, the municipal bond market is experiencing an overall improvement in credit conditions, a by-product of the improving US economy. A potential drawback may be a decreased focus on cost containment and spending discipline as municipal revenues rise.
- International debt of developed market issuers is unattractive at current yields. Emerging market debt yields are much more appealing, and total returns can be potentially higher across the maturity spectrum when central banks implement easing by lowering rates. With the prospect of continued dollar strength, investing in the dollar-based debt of these countries is strongly advised.

Equity Markets

- The strong dollar and the dramatic decrease in commodity prices have pressured US corporate earnings and capped equity price movements so far this year. The upcoming anniversaries of the sharp drop in energy prices and the advancing dollar should make for easier year-on-year comparisons as we look towards 2016 earnings. We expect valuation multiples to advance in a continued low interest rate environment.
- The weaker euro is helping both the sales and earnings of European exporters. Sustained domestic weakness is weighing on the ECB to implement a higher level of bond purchases. European equities should respond positively to the additional stimulus, at least in the near term.
- Unless exports to the US improve dramatically, Japanese equities are subject to the whims of the Bank of Japan as it appears a weaker yen is necessary to pull the Japanese economy out of recession.
- As economic growth in China finds a plateau around the 6% mark, investors may start to look more favorably at emerging markets in the coming months, attracted by their very low relative valuations. Selectivity and differentiation between commodity producers and consumers will be key as we move into 2016.

Alternatives & Commodities

- While overall supply has begun to slow, some energy producing countries have maintained stubbornly high levels of production and continued to drive down prices. Oil and gas prices should not move much lower from current levels, but absent a geopolitical event or supply disruption, it is hard to envision prices rising in the near to mid term.
- The prospect of higher US interest rates is a barrier to meaningful price appreciation in gold and other precious metals.
- Industrial metals are trying to find a floor, but until Chinese industrial demand stops falling, it will be difficult to call a bottom. An underweight to commodities, and investments tied to commodity prices, remains advised.
- With the anticipation of higher US interest rates, hedge funds positioned for macroeconomic uncertainty and market volatility are attracting greater interest from investors seeking downside protection and lower correlations to less stable public markets.
- High valuations are making it challenging for private equity firms to buy assets at reasonable prices. We remain focused on disciplined managers, secondary funds, and sectors such as private debt and infrastructure, where valuations are more reasonable.

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.

Ben has been featured in the *Wall Street Journal* and *Reuters*, and is a frequent commentator on Bloomberg TV and radio, Fox TV and CNBC, appearing regularly on network programs such as *Power Lunch, The Closing Bell, Squawk Box, and Worldwide Exchange.*

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