Outlook as of February 2015

World Economy

- US GDP growth slowed in 4Q from the sharply higher rate experienced over the Spring and Summer. The benefits to consumers from lower energy prices and higher wage growth should begin to be reflected this quarter. Capital spending will likely be inconsistent over the first half of 2015 as the energy industries react to sharply lower oil prices.
- The Eurozone economies are showing some signs of bottoming. Low energy prices and the weaker euro may help to ward off a recession. Negotiations between the European Union and the new Greek government on debt relief add a major element of uncertainty to the outlook for the region.
- The Japanese economy is also showing tentative signs of improvement as it benefits from cheap oil, easy money and a weaker currency. The falling yen has led to a slight increase in exports and encouraged capital spending. Recent negotiations with the trade unions offer some hope the economy may finally achieve the elusive wage gains the government has been seeking.
- Chinese economic indicators continue to point to slower growth as the oversupply generated from the investment driven structure will need to be worked down. Commodity producing economies such as Brazil and Russia will see continued deterioration in GDP throughout the year.

Monetary Policy & Currencies

- The Fed appears to be on track to implement the first rate increase in the summer. At its January meeting, the FOMC noted the improving US economy, but indicated that path to policy normalization will be very gradual, due to the impact of weak global growth and low energy prices.
- The greater than expected quantitative easing program announced by the ECB in late January drove the euro down further, which should boost exports and stimulate job creation.
- The Bank of Japan appears to be holding off on further easing while it assesses the impact of previous stimulus measures. Additional policy responses will most likely be necessary later in the year and the yen should continue to decline into the 120's by year end.
- Slowing economic growth and lower inflation have led a number of central banks to ease interest rates. We expect continued weakness in emerging markets currencies throughout the year, especially in the face of a strengthening dollar.

Bond Markets

- The US yield curve flattened further in January, as low CPI and wage inflation data called into question the timing and magnitude of Fed tightening. However, anticipated GDP growth of 3% to 3.5% should boost rates across the curve.
- The high yield sector will see rising defaults among issuers tied to energy and commodity markets. Issuers outside these sectors should continue to benefit from improving economic conditions and low default rates. Investors should gain from spread contraction in these sectors.
- Interest rates will remain low across the developed international markets. Quantitative easing will absorb much of the new supply, while weak economic growth discourages issuance. With rates so low in Europe and Japan, the sector remains unattractive even if the currency risk is hedged out.
- A number of EM central banks have already eased interest rates to support their economies. If global growth remains weak, others will follow suit, driving down rates across the impacted yield curves. Hard currency bonds will continue to outperform local currency bonds.

Equity Markets

- The strong dollar and steep fall in energy and commodity prices took a toll on US companies' earnings for Q4 2014. Analysts are taking down 2015 estimates aggressively, particularly for companies in the Energy and Materials sectors. Analysts in sectors that benefit from lower energy prices are waiting for company guidance before raising their forecasts.
- Heightened geopolitical risk and the ongoing adjustment to a strong dollar/weak commodity environment should increase market volatility. Nonetheless, valuation multiples should continue to expand, as investors shift allocations towards equities and foreign investors move more aggressively into the market.
- High levels of monetary easing should drive equity markets higher in Europe and Japan, but currency weakness will temper returns for unhedged dollar investors.
- Emerging markets equities are attractively valued in relation to their long term growth prospects, but selectivity will be a key driver of returns. The greatest performance differential will be between the commodity producing economies and the commodity consuming economies , especially if prices remain weak.

Alternatives & Commodities

- Oil prices seem to be stabilizing around the $45 to $50 per barrel level. There are early signs of lower production (lower rig count, lower capital expenditures) among the non-OPEC producers. It is still too early to call a definitive bottom and caution around oil and energy stocks is still advised.
- Central bank easing in both the developed and developing world pushed up the price of gold early in the year. Barring any rise in geopolitical tensions or unexpected pickup in inflation, impending Fed tightening should limit further appreciation,.
- Prices for most other commodities are expected to remain weak in response to low inflation and subdued economic growth worldwide.
- Policy normalization should remove artificial constraints on market volatility and security correlations, benefiting strategies that rely on security selection or low correlations to other risky assets to drive investment returns.
- Merger and acquisitions activity is again on the rise, creating opportunities for event driven managers.
- Rising valuations make it difficult for private equity firms to make acquisitions at reasonable prices. Conversely, higher prices have created a better exit environment for sellers.

Important Information

Benjamin Pace

Benjamin Pace
Chief Investment Officer

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*.