Outlook as of February 2016

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World Economy

- A healthy US consumer with a greater propensity to spend remains key to offsetting slow growth in most other developed and emerging economies and helping avert a global recession in 2016.
- US economic growth slowed markedly in the second half of 2015, as inventory drawdowns, lower capital spending in the energy and materials industries, and weakness in net exports effectively neutralized growth in real final sales. Looking ahead, consumer spending, together with the first boost to GDP from higher government spending this decade, should allow for at least 2.5% GDP growth in 2016.
- The weaker euro engineered by the ECB in the last year is beginning to positively impact economic growth, predominantly in Germany. With China a major export market, the economic slowdown there and recent devaluation of the yuan could potentially derail the burgeoning economic recovery in the Eurozone.
- Japanese economic growth continues to disappoint. Weak economic growth among its export markets has overcome any benefit from the sharply depreciated yen over the last three years.
- Uncertainty around the magnitude of the slowdown in Chinese economic growth continues. More easily verified statistics for electricity usage and railcar traffic indicate the deterioration in GDP is much worse than in official government reports. Strong growth in consumer spending is needed to offset the steep drop in industrial production.

Monetary Policy & Currencies

- Global economic weakness, and the potential impact of the strong dollar and low oil prices, should lead to a much more gradual US rate tightening cycle than the Fed originally envisioned.
- Mario Draghi has again reiterated the ECB is ready, willing and able to counteract tightening financial conditions and weakening growth in some of Europe's important export destinations. Expect more monetary stimulus and a further depreciation in the euro in the coming months.
- The Bank of Japan surprised markets with its historic move to negative short term interest rates in January. The BoJ will likely be the first central bank to test the limits of monetary easing as a policy tool.
- China devalued its currency and injected more reserves into its financial system in an attempt to stanch capital outflows and stabilize falling equity markets.
- In an environment of monetary policy decoupling and growing economic uncertainty, the dollar should resume its appreciation against most currencies, at least through 2016.

Bond Markets

- A slower rate of Fed tightening and lower rates overseas will be a potential barrier to the expected upward shift in the US yield curve from improving US economic growth.
- High yield spreads have widened as commodity prices continued to fall and equity markets weakened in January. We expect defaults to rise, but these should be restricted to the energy and materials sectors, with very little follow-through to other corporate sectors.
- Outside of a few pockets such as Illinois and Puerto Rico, municipal credits remain healthy overall. Expect some pressure on budgets in the oil belt, where tax revenues have already begun to decline.
- Yields continue to fall across developed country fixed income markets in reaction to central bank easing amid the persistently low inflation environment. Peripheral European debt may see some pressure from widening fiscal deficits.
- Emerging market debt will remain under pressure from external capital outflows and continued currency weakness.

Equity Markets

- The inauspicious start to global equity markets in 2016 reflects growing concerns of a global recession, catalyzed by a sharper-than-expected slowdown in China and resultant collapse in commodity prices.
- US earnings are now in a technical recession, with the energy and material sectors being the primary culprit. Comparisons will get easier as we move past Q1 and earnings should show positive growth for all of 2016.
- European economic growth is much more leveraged to exports and emerging markets. As EM growth remains weak, European equity markets will depend heavily on additional monetary stimulus and exports to the strengthening US economy to grow revenues and earnings.
- Japan's strong economic ties to a slowing China, and potential competition the weakening yuan, suggest caution around Japanese equities. The latest BoJ move to negative interest rates may alleviate some pressure, but we should not be surprised to see Japan underperform other developed equity markets in 2016.
- Falling commodity prices and growing concern over the magnitude of the Chinese slowdown are overwhelming cheap valuations in EM equities. We expect the weakness to continue, together with a growing divergence in performance between commodity producers and commodity consumers.

Alternatives & Commodities

- We are seeing the first signs of reduced production from US shale fields. However, the imminent re-entry of Iran into global markets, and the lack of consensus on production curbs among OPEC producers, suggests continued volatility and little prospect of prices rising in the near term.
- Gold prices have benefitted from global economic uncertainty and incrementally easier monetary policies recently implemented, or discussed, around the world. (Lower interest rates reduce the cost penalty of holding gold). With deflation a growing concern globally, caution is advised - historically, gold has not been an effective deflation hedge.
- Industrial metals appear to be finding a bottom near current levels as capacity is reduced. However, further signs of weakening in China could cause prices to resume sliding.
- With the advent of US policy normalization, 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 asset valuations make it challenging for private equity firms to buy assets at reasonable prices. We focus on disciplined managers and secondary funds to add value. We also look to opportunities in private debt and infrastructure, where valuations are more reasonable.

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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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