Outlook as of January 2017

World Economy

- The global growth uptick evidenced in the 4th quarter of 2016 should carry over into early 2017, on the back of a stronger US economic outlook and hope that governments can keep the populist wave from turning into outright protectionist policies.
- Improved business and consumer sentiment has begun to translate into better data for both the consumer and capital spending. Corporate and individual tax proposals need to go through the painful legislative process, but the prospect of broad tax cuts suggests a better US economic growth environment in 2017.
- Continued weakness of the pound and euro against the dollar, plus rising import demand from the stronger US economy should support UK and European growth in 2017, despite the lack of meaningful structural reform on the continent and uncertainty over the timing and ultimate impact of Britain exiting the EU.
- With no end in sight for monetary easing by the Bank of Japan, the Japanese economy should benefit from an increase in exports aided by the weaker yen, as well as the job growth which normally accompanies earnings growth in export-led sectors. Japan's rapidly aging population and resistance to immigration remain daunting challenges for policy makers.
- President-elect Trump appears to have focused on China as an unfair trade partner. If he follows through on imposing tariffs and quotas, these will have a painful effect on the Chinese economy while it is still working off excess capacity in the housing and manufacturing sectors. And, of course, retaliatory action by China and other trading partners would have significant repercussions on our forecast for US and global economic growth in 2017.

Monetary Policy & Currencies

- The Federal Reserve finally announced a 0.25% rate rise following the December FOMC meeting. The only surprise was its projection of three further rate hikes in 2017. We expect the Fed to move only twice in 2017, as the planned tax cuts and fiscal policy expansion will not begin to contribute to economic growth until later in the year.
- The Bank of England and European Central Bank remain locked into extremely accommodative monetary easing, with both economies notably below their core inflation targets.
- The recent yen depreciation should help lift Japanese inflation this year, but the Bank of Japan will need to maintain the current level of quantitative easing to keep the economy growing.
- China will struggle to maintain a stable currency against the dollar as reserves continue to flow out of the country. The People's Bank may have to consider following the Fed in tightening policy in order to maintain any semblance of a peg to the dollar.
- Fundamental factors around rates, economic growth, and monetary policy continue to favor the dollar in 2017, although we may be nearing the end of the bull market which began earlier this decade.

Bond Markets

- While much of the credit, or blame, for the late spike in US interest rates was given to the election results and the expectation of deficit-financed fiscal initiatives from the new administration, we believe the rising yields reflect much stronger growth prospects for the US economy, which should lead to a return of more "normal" growth rates.
- The recent narrowing of credit spreads as rates have risen is another market confirmation that the rise in yields is being driven more by economic growth than by less-accommodative monetary policy. In this environment, we can expect high yield bonds to outperform investment grade bonds.
- The prospect of lower individual tax rates in 2017 may reduce the attractiveness of municipal bonds just as issuance needs to rise to fund state-mandated infrastructure projects. If so, expect municipal bonds to underperform taxable investment grade debt in the coming months.
- The higher coupon offered by emerging market debt, plus the flexibility of EM central banks to cut rates, should lead to strong relative performance in this category, so long as the Fed tightens rates very gradually.

Equity Markets

- US equity markets may be a bit ahead of themselves following the recent advance in prices, but the prospect of positive earnings growth, no recession in sight and a gradually increasing interest rate environment should allow US equities to rise 7% to 10% in 2017.
- Weaker currencies on the continent and the UK, stronger German economic statistics, and the delayed impact of Brexit should lead to positive returns for UK and European equities in 2017. Political uncertainty in an important election year will keep us cautious around this asset class.
- With the recent retracement of the yen to year-ago levels and lessening concern that the Abe government will revive a consumption tax, Japan should also participate in the continued rally of developed global equities.
- Higher commodity prices will help Latin American equity markets, but concern over the magnitude of the economic slowdown in China and uncertainty about the imposition of protectionist trade policies in the US keep us from advocating a full weighting in emerging market equities for 2017.

Alternatives & Commodities

- The recent joint agreement by OPEC members and certain non-OPEC countries to cut oil production will put a firmer floor under the oil price this year, but will very likely be offset by rising US shale production at these price levels. Hence, we expect to see crude prices in a trading range with some upside potential if global demand exceeds current forecasts.
- A strong dollar in a Fed tightening environment is not conducive to higher gold prices. Unexpectedly higher US inflation could be a catalyst for higher prices if the economic data turn out to be stronger than expected.
- Industrial metals have backed off to more reasonable levels over the last month, given the uncertainty over Chinese economic growth. Higher US economic growth in 2017 may provide some upside from these levels.
- Hedge funds positioned for rising interest rates and macroeconomic uncertainty should benefit from the current environment as investors seek ways to mitigate exposure to unstable, volatile markets.
- Sustained high asset valuations make it challenging for private equity managers to acquire assets at reasonable prices. We maintain our focus on seasoned, disciplined private equity managers and continue to seek opportunities in dislocated markets, and those facing disruption from regulatory or technological change.

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.

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