Outlook as of July 2015

World Economy

- US economic data showed considerable improvement in Q2 after the weak Q1 reports. Consumer spending is finally rising in response to job and wage growth, lower energy prices, and healthy balance sheets.
- A key uncertainty going into H2 is the fate of Greece, the euro and Eurozone following the Greek default on IMF debt and the ECB's decision to cap further aid to Greece. We expect the situation to remain unsettled at least until the July 5 referendum.
- Setting aside the Greece issue, the latest purchasing managers' indices show the Eurozone growing at a 1.5% annualized rate; however, the Greek drama is a reminder of the inherent structural weaknesses across the periphery.
- Mixed economic signals continue to emanate from Japan. Industrial production continues to fall and despite improvements in exports and corporate earnings from the weaker yen, Abenomics has yet to provide the expected boost to real wages and consumer spending.
- China suffers from an oversupply of capital goods and real estate. To correct these excesses, industrial production will need to decline and exports to rise. Strong import demand from the US may help offset the lack of currency flexibility in a basically fixed exchange rate regime.

Monetary Policy & Currencies

- Based on the improving economic picture in the US, the Fed appears to be on a clear path to raise interest rates at the September FOMC meeting, although Chairman Yellen has stressed rate normalization will be very gradual.
- The recent dollar weakness should prove transitory. In addition to its traditional safe haven status in times of rising economic and political uncertainty, the relative strength of the US economy, coupled with higher US interest rates and the Fed's willingness to raise rates while most other central banks stay loose, all favor the dollar over virtually all currencies.
- Uneven economic growth and the potential need for liquidity to counter any fallout from Greece suggest the ECB will maintain its announced path of monthly bond purchases at least through September 2016.
- One further round of easing by the Bank of Japan may be necessary to combat the anemic economic growth and lack of wage inflation in the Japanese economy.
- Emerging market central banks are being careful to avoid sharp currency declines, but they remain biased towards easing monetary policy to boost domestic spending in this slow global growth environment.

Bond Markets

- Despite investors seeking refuge in US Treasurys amid the uncertainty over Greece, the expected shift upward in the Treasury yield curve has begun. Continued dollar strength and low inflation should keep rates contained, but we expect the 10 year yield to track higher by year-end.
- Strong corporate balance sheets allowed investment grade and high yield debt to outperform Treasurys in H1. Spreads in both sectors are approaching fair value against Treasurys.
- Municipal bonds have experienced a few isolated credit events with the most recent being Puerto Rico. The forecasted growth rate in the US should lead to better tax collection and stronger state and municipal tax revenues thus preventing any contagion across the tax exempt asset class.
- Beyond the safe haven element of certain northern European issuers, bonds of developed international markets remain unattractive, with historically low yields and the potential spillover impact of Greece on the other peripherals.
- Emerging market central banks have the ability to cut rates to maintain economic momentum. As rates fall and yield curves shift down, emerging market debt can produce attractive returns, but investors are advised to stick to dollar-denominated bonds.

Equity Markets

- Trepidation around impending Fed tightening has kept the US markets in a tight trading range and produced negligible returns in H1. With the Fed stressing a very gradual rise in interest rates, investors should be willing to pay higher multiples on earnings as they gain confidence in earnings momentum forecasts.
- Some European equity markets experienced full 10% corrections in June, as concerns over Greece and the strength of the economic recovery temporarily overcame aggressive monetary easing as the primary market driver. Now that the ECB has reiterated its commitment to continued easing, European equity markets should perform well in H2 as companies benefit from currency weakness.
- Japanese equities have benefited from positive currency translation effects for exporters; however, top line revenue growth remains inconsistent. With the yen trending stronger, we believe another round of quantitative easing will be needed for markets to advance further. If so, hedging the subsequent currency risk is still strongly advised.
- Aggressive monetary policies have allowed emerging markets equities to generate positive returns in H1, despite recessions in Russia and Brazil and lower growth across the board. The difficulty in hedging currency risks dictates caution when investing, as EM currencies remain vulnerable to US monetary policy.

Alternatives & Commodities

- Crude oil prices have stabilized at an equilibrium level little changed over the past three months. Absent a geopolitical supply shock, current production should continue to exert downward pressure on prices as we proceed through the summer and into the fall.
- The prospect of Fed rate tightening and continued low inflation globally renders gold unattractive at current price levels.
- Prices for industrial commodities reflect adequate supply in the face of weak demand from most developed and emerging markets.
- Hedge fund strategies should benefit from policy normalization as artificial constraints on market volatility and security correlations are removed, particularly for managers who rely on security selection or low correlation to risky assets to drive returns.
- High valuations are making it more difficult for private equity firms to buy assets at reasonable prices. We continue to focus on secondary funds, as well as on 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.

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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