Outlook as of June 2015

World Economy

- GDP growth rates around the world are showing some signs of improvement in response to aggressive monetary policies that have generally weakened currencies and boosted exports.
- In this rather mercantilist approach to central bank policy, strength in the US is paramount. After a difficult first quarter, we are seeing advances in housing and capital spending, along with continued steady job growth. Consumer spending is expected to rise in the coming months, spurred by wage gains and low energy prices.
- The continuing Greek drama has become a larger focus than the slight improvements beginning to develop in Spain, France, and Ireland. Weariness around economic austerity is a looming threat to a full European recovery.
- The Japanese economy grew at a surprisingly robust 0.6% rate in Q1; however, a large portion of that came from inventory accumulation. We see scant evidence that the steep devaluation of the yen has produced the desired growth in exports, wages and inflation.
- The magnitude of the economic slowdown in China remains uncertain, but there is no question of the negative impact on growth in neighboring countries. Stabilizing energy prices are providing a welcome reprieve to struggling Latin America economies.

Monetary Policy & Currencies

- While some Fed governors are still keeping June in the mix and others are talking about deferring any action on interest rates into 2016, we feel the Fed is likely to act around September. By then, policymakers will have accumulated sufficient data on the economy to guide their decision-making on interest rates.
- The dollar has resumed rising against most currencies. It should continue to benefit from the relative strength of the US economy and any tightening by the Fed.
- Dangerously low inflation and fiscal policy reticence should keep ECB monetary policy on its current course through the end of next year. The Bank of England will find it difficult to tighten for fear of creating an undue competitive advantage for the continental neighbors.
- Better than expected Japanese GDP growth in Q1 may forestall further easing by the BoJ for now. However, sustainable growth remains elusive and we expect further easing by Q3.
- Many emerging market central banks maintain the flexibility to ease monetary policy. We expect depreciation against the dollar in many of these countries

Bond Markets

- US policy normalization should exert upward pressure on bond yields across the maturity spectrum. The strong dollar, continued low inflation and inflows from foreign investors should help counteract any sharp spikes as yields rise.
- Contracting credit spreads have enabled both investment grade and high yield credit to outperform US government bonds. Healthy corporate balance sheets suggest some additional outperformance in the coming months, but investors should be mindful that valuations are stretched in the credit sector.
- After having been driven too low by quantitative easing measures and fears of deflation, yields in developed market bonds snapped back in May. Low yields and prospects for continued easy monetary policy make this an unattractive asset class.
- The flexibility existing in emerging market central banks for additional ease to combat slowing economies should generate relatively attractive returns from the emerging market debt market. These investments should be dollar denominated to avoid the expected currency depreciation from these easier monetary policies.

Equity Markets

- Outside the energy sector, US corporate earnings per share are expected to be comfortably positive over the coming quarters, through a combination of positive GDP growth, tight cost control, and continued share buybacks.
- Although US markets are already at above-average valuation levels, we believe investors will remain willing to pay even higher multiples for positive earnings growth, given the extremely low yields on cash and bonds.
- European and Japanese equities have outperformed US equities so far this year, narrowing their valuation gap with the US market. Additional international outperformance will require tangibly stronger economic growth, whether through supplemental quantitative easing or further currency depreciation.
- Given relatively low valuations which could provide a cushion should equities sell off over the summer, we remain cautious on our outlook for emerging market equities. The rise in Chinese equities is contradictory to the deteriorating growth conditions in their economy. Latin American equities can be adversely affected by the commodity bear market.

Alternatives & Commodities

- Crude oil inventories are moderating, but a supply imbalance persists. We expect prices to remain around current levels for the remainder of the year.
- Gold holds little attraction at current prices, given low global inflation and the specter of Fed tightening by late summer.
- Industrial commodity prices struggled in May and should remain weak, given abundant supplies and weak global demand
- Hedge fund strategies should benefit as artificial constraints on market volatility and security correlations are eliminated. Managers who rely on security selection or low correlation to risky assets should benefit from policy normalization.
- High valuations make it challenging for private equity firm to acquire companies at reasonable prices. Hence, we continue to focus on secondary PE funds and to seek out opportunities in areas such as private debt and infrastructure, where valuations are more 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.

Benjamin Pace

Benjamin Pace
Chief Investment Officer