Outlook as of March 2015

World Economy

- Amid questions as to how the US economy can keep growing while the rest of the world is struggling, February provided encouraging signs that growth is picking up in the Eurozone and emerging markets, hopefully setting the stage for more synchronous global growth.
- US economic figures have been somewhat contradictory this year. Business capital investment has picked up, but consumers appear to be holding back on spending. We believe consumer confidence will return once the favorable effects of lower gasoline prices and higher real wages feed into the data on consumer spending.
- Europe, led by Germany, is showing signs of improvement as the weaker euro boosts exports. The implementation of quantitative easing in March should spur economic growth and help allay recessionary concerns.
- Japan is also benefitting from greater export growth from the weaker yen, but further easing may be necessary to counter the aging demographics and labor market rigidity that impede a broader recovery.
- China GDP growth is slowing, with the biggest question now being the magnitude of the drop. Lower energy prices will help mitigate the slowdown, both in China and other Asian economies dependent on imported energy.

Monetary Policy & Currencies

- The Federal Reserve is on track to raise US interest rates this summer for the first time in nine years. Continued low inflation will provide sufficient cover for the US Federal Reserve to take a gradual approach towards rate normalization.
- After some softening in February, the dollar should resume its advance against other developed market currencies and most emerging market currencies. The European Central Bank begins buying bonds in March, at a rate of €60 billion per month. ECB President Draghi has pledged to maintain the program until Eurozone inflation rises to the 2% policy target.
- The Bank of Japan is expected to pursue one additional large balance sheet expansion this summer, which would push the yen down further into the mid-to-high 120s range to the dollar.
- A number of emerging markets central banks are expected to implement more conventional rate reductions to reduce exchange rates and support exports
- Given the expectation of further easing, we recommend that to the extent possible, a portion of the investment in developed market equities should be currency hedged.

Bond Markets

- The impact of wage growth and impending Fed tightening should drive yields higher across the US yield curve.
- Strong company balance sheets and a return to more “normalized” macroeconomic conditions should allow corporate credits to resume outperforming Treasuries.
- We expect attractive returns from the high yield, or sub- investment grade, sector, where higher current yields should provide a better cushion as rates start to rise.
- Continued monetary easing in Europe and Japan will keep interest rates extremely low across the developed international bond markets. The ECB will be further challenged by the sparse supply of investment grade bonds available for purchase under its quantitative easing program..
- Emerging market bonds offer more promising returns as yield curves shift down in response to central bank easing. A measured US rate tightening cycle may prevent major disruption in emerging markets, but to be safe, investments in this sector should be made in dollars, rather than local currencies.

Equity Markets

- Global markets staged an impressive rally in February, despite somewhat disappointing 4th Quarter 2014 earnings and lowered full year 2015 earnings estimates for US companies. Multiple expansion continues to be the primary driver of returns.
- With the earnings bar lowered for the remainder of the year, we can expect US reported earnings to comfortably exceed these reduced expectations, particularly once the analyst community sees evidence of the economic benefit of lower energy prices feeding into the reported earnings.
- European equities have responded favorably to quantitative easing and the weakening currency. Continued improvement in economic growth will be necessary for further outperformance of these markets.
- After remaining range-bound for some time around the year-end period, Japanese equities advanced on the back of improved economic data and the expectation of further easing by the Bank of Japan. The country’s aging population and sclerotic labor market suggest that additional easing measures will be needed to maintain the growth trajectory.
- Investing in emerging market equities will require much greater selectivity. Investors should focus on countries with more solid fiscal and external trade positions and those that benefit from lower energy prices.

Alternatives & Commodities

- Reduced domestic production from the more expensive shale and offshore fields should allow the WTI crude benchmark to find a bottom at roughly $45/bbl.
- Gold prices should maintain their recent $1,200-$1,300 trading range as the impact of higher US interest rates is offset by continued easing elsewhere around the world.
- Uncertainty over the true magnitude of the economic slowdown in China, coupled with low demand from elsewhere, suggests that prices for other commodities will also remain under pressure.
- Hedge fund strategies should benefit as artificial constraints on market volatility and security correlations are removed. Managers who rely on security selection or low correlations to risky assets to drive investment returns should profit from policy normalization,
- Rising valuations make it difficult for private equity firms to acquire companies at reasonable prices; hence, we will focus on secondaries funds and other 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.

Benjamin Pace

Benjamin Pace
Chief Investment Officer