Outlook as of March 2016

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World Economy

- Economic weakness in China is beginning to have an impact on its Asian neighbors, Japan, and even Europe. However, the relative health of the US consumer sector should help prevent a global recession in 2016.
- A higher level of consumer spending from revived job and wage growth, rebuilt balance sheets, and dramatically lower energy prices should offset slow capital spending growth to allow for comfortably positive US GDP growth in 2016. Of note, capital spending outside the energy and materials sectors has been positive for a number of months.
- The recent appreciation of the euro and slowing Chinese growth has stalled the developing economic recovery in Europe. Pressure is being exerted on Germany to allow fiscal policy expansion to supplement monetary easing. Structural reforms to reconcile monetary and fiscal policy remain elusive.
- The flight to the yen as a safe haven currency and its subsequent appreciation has so far negated the recent monetary policy initiatives. With the Japanese economy stagnating around zero growth, tax increases to confront large fiscal deficits should be postponed.
- The growing consumer sector is cited as a countervailing strength to steep declines in industrial output as China attempts to work off its investment growth excesses, but the resultant job losses in the capital goods sectors will have a negative impact on consumer spending in the coming quarters.

Monetary Policy & Currencies

- Financial market tightening around the world, lower energy prices, and the recent resumption of the strong dollar trend should allow the Fed to keep rates steady at the March FOMC meeting. A recent uptick in the core inflation rate will keep the Fed vigilant in its attempt to stay ahead of building price pressures.
- The ECB will try to placate markets with more monetary easing at its March meeting. The euro should retest its 2015 lows over the coming months. Sterling has fallen as the Bank of England has moved from a prospective tightening stance to one of continued easing. Concerns around the implications of a Brexit will assert additional pressure on the pound.
- The Bank of Japan appears to be testing the limits of monetary policy effectiveness. The recent move to negative interest rates has not caused the yen to depreciate as much as in prior moves, mainly due to the currency's safe haven status during the current economic turmoil.
- Currency devaluations against the dollar continue to be implemented by China and the government should add further monetary stimulus mostly in the form of targeted liquidity injections and interest rate decreases.
- Relative economic growth rates and direction of monetary policy should favor the dollar against most developed and emerging market currencies.

Bond Markets

- Improving US economic growth should prevent further flattening of the yield curve and even precipitate a shift upwards in yields across the curve as the Fed remains in a very gradual tightening mode.
- Spread widening in the high yield sector has been largely a function of higher expected default rates in energy and materials issues, but these risks are not expected to spread to other sectors. If oil prices stabilize, we expect spreads to contract over the coming months.
- The only projected areas of pressure in the municipal debt sector are in regions and projects heavily exposed to the energy industry, along with already-identified problem credits such as Chicago, Illinois and Atlantic City, NJ. Elsewhere, better economic growth should support rising tax revenues.
- Continued monetary ease has driven many developed market bond yields even lower and has rendered these bonds very unattractive in countries such as Germany, Switzerland, and Japan.
- A slower than originally projected rate of Fed tightening should help slow capital outflows from the emerging market economies. Owning emerging market debt priced in dollars continues to be prudent.

Equity Markets

- Contagion effects from the slowdown in China and the continuing fall in commodity prices will have an impact on global markets, but should also lead to a decoupling of returns, with commodity consumers benefiting from low prices at the expense of commodity producers.
- The earnings recession of 2015 should end after Q1 of 2016, as comparisons get easier in the energy sector and for those companies greatly impacted by currency moves. Positive earnings growth in the last three quarters of the year should be a tailwind for US equities.
- Weaker emerging market economic growth is a larger problem for the more export oriented European companies where the equity markets are much more reliant on the uncertain effect of additional monetary ease.
- The recent strengthening in the yen against the dollar and the Chinese yuan will have some repercussions for the Japanese equity market as the appreciating currency curtails exports. The uncertain benefit of further monetary stimulus calls for caution in this asset class.
- Emerging markets valuations are compelling, but revenues and margins need to stabilize to prompt investor interest. The first evidence of improvement should materialize in the markets of commodity consuming countries.

Alternatives & Commodities

- The agreement between Russia and OPEC members to freeze production, along with signs of declining production in the US shale fields, has provided a temporary floor for oil prices. The prospect of resumed exports from Iran and Iraq and greater production efficiencies in the US should prevent prices from rising much further.
- Continued global easing and the effective monetization of government debt have driven gold prices up markedly. Any delay in Fed tightening could provide a temporary boost; however, widespread deflationary pressures should contain further appreciation.
- The recent price appreciation of some industrial metals is an encouraging sign that commodity prices may be bottoming, but further appreciation will be contingent on a stabilization in demand from China and other consuming economies.
- 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.

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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