Outlook as of May 2015

World Economy

- Easy monetary policies implemented by global central banks are starting to show tangible, if uneven, results in boosting GDP growth rates. Based on the latest PMI readings, developed markets should see a turnaround in H1, with emerging economies following during H2.
- US first quarter GDP growth was revised down to a negligible 0.2%, with economists trying to sort out the transitory impact of inclement weather and labor stoppages from the more lasting effects of lower energy prices and the strong dollar. Looking forward, steady job growth, an increase in wages, and lower energy prices should lead to stronger US consumer spending through the year and allow GDP to approach the 3% threshold for normal growth.
- In the Eurozone, Germany has been the largest beneficiary of the weakening euro, while Spain is beginning to rebound from the austerity induced recession. Growth prospects among the other European economies remain elusive.
- Japan continues to struggle with its goal to revive inflation, particularly in employee wages. Additional monetary easing and further weakening of the yen look necessary to finally break the deflationary cycle.
- Growth expectations for emerging markets are generally slowing, with India a notable exception: Latest IMF estimates show India growing at 7.5% in 2016, well ahead of its 6.8% forecast for China and 5.3% for emerging economies as a whole.

Monetary Policy & Currencies

- The weak first quarter US GDP report has pushed our expectation for the first Fed tightening to September. By then, the FOMC will have more data points on the expected rise in growth as the year unfolds. We expect any subsequent tightening moves to be measured and geared to signs of rising inflation, which we do not expect to see until 2016.
- The dollar softened in April in response to weaker US economic data and signs of improvement in other regions. As US economic growth picks up, we expect the dollar to resume its bull run, based on higher US growth and interest rate differentials relative to other countries.
- The ECB has reiterated its intention to stay the course on the current level of monetary stimulus despite the improvement in some European economies.
- The Bank of Japan left interest rates unchanged in April, but with inflation still stubbornly low, we expect at least one more expansionary program to help reflate the economy.
- The recent weakening of the dollar provides some flexibility for many emerging market central banks to reduce rates in an effort to boost economic growth.

Bond Markets

- Despite the weak first quarter economic growth, US bond yields have begun to drift higher in anticipation of higher rates. We expect rates to keep moving higher as we get closer to the beginning of Fed tightening, but the stronger dollar and low inflation suggest it will be a gradual process.
- Improving economic growth prospects through the remainder of the year suggest continued outperformance of corporate bonds over Treasuries. In sub-investment grade bonds, higher absolute yields should help to buffer the impact of rising rates.
- Central bank purchases of longer maturity bonds have driven yields down sharply across the developed bond markets. Investors should be very cautious navigating these markets as the very low absolute yields provide little cushion should rates spike for any reason.
- Monetary policy easing by emerging market central banks should lead yields to fall across the maturity spectrum and cause their currencies to weaken. Hence, we favor dollar-denominated debt, to help hedge as any resulting currency weakness.

Equity Markets

- First quarter earnings reports have generally exceeded analysts' sharply reduced estimates. For companies, headwinds from the strong dollar and falling energy prices are expected to dissipate in subsequent quarters. Consumers have been slow to adjust to low gasoline prices, but we expect to see the beneficial impact reflected in consumer spending patterns as the year progresses.
- Given low interest rates and positive expectations for economic growth, we believe multiple expansion can help drive US equity markets higher in 2015, as long as investors feel confident that earnings growth momentum will continue for the remainder of the year.
- European and Japanese equities have outperformed their US counterparts in 2015, largely on the back of currency depreciation. Valuation discounts have narrowed this year and we will be watching for more sustained economic growth and an increase in earnings beyond only the export led industries.
- Despite sharply lower economic growth, Chinese equity markets have surged 120% over the last year and caution is advised. By contrast, Indian equities have been flat year to date and the outlook is favorable, with markets benefiting greatly from a combination of central bank easing, low energy prices, and continued structural reforms by the Modi government.

Alternatives & Commodities

- Oil prices have appreciated markedly from their mid-March lows as the steep decline in US rig counts suggests a meaningful supply reduction down the line. Large current inventories of both crude and refined products, together with continued record high production in Saudi Arabia, make us skeptical of this rally and hesitant to add to positions.
- The combination of low global inflation and anticipated Fed tightening later in the year makes gold a rather unattractive asset at this time.
- A reversal in the dollar in April helped drive industrial commodity prices higher, but this recent move appears largely speculative, due to ample supplies and continued weak demand globally.
- Hedge fund strategies should benefit as artificial constraints on market volatility and security correlations are eliminated. Managers who rely on security selection or low correlations to risky assets should profit from policy normalization.
- Rising valuations are making it more difficult for private equity firms to acquire companies at reasonable prices. Hence, we will continue to 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

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