Outlook as of October 2015

World Economy

- A lower rate of growth and outright recession in a number of emerging market economies is slowing global economic growth. Improving GDP growth rates in key developed market economies should prevent the onset of a global recession.
- US 2Q GDP growth of 3.9% was a nice rebound from the weather induced 1Q weakness. A healthy consumer, helped by better job growth and lower energy prices, will allow 2H 2015 GDP to grow close to its long term potential of roughly 3.0%.
- The magnitude of the slowdown in China remains uncertain, but it is clear the country faces an excess of production capacity. The burgeoning service sector has picked up some of the slack from weak manufacturing, allowing the economy to continue growing, albeit at lower rates.
- The impact of the weaker euro and healthier US economy is being reflected in Eurozone GDP through better export growth. However, the 1.5% – 2.0% growth expectations for 2H GDP could be challenged by lower growth among China and other emerging market export destinations.
- As China's biggest trading partner, Japan is even more exposed to slowing Chinese growth. The Abe government is under pressure to provide further stimulus as their inflation targets remain untenable at the current anemic rate of GDP growth.

Monetary Policy & Currencies

- As expected, the Federal Reserve did not begin the move from zero interest rates in September. The somewhat sloppy communication of their rationale impacted market confidence, and it drove a number of FOMC voting members to reaffirm their commitment to begin tightening by year-end.
- The European Central Bank will be pressured to help offset the effects of weaker emerging market growth and the potential fallout from the Volkswagen scandal by extending the government bond buying program beyond the September 2016 termination date.
- While the Bank of Japan did not boost its monthly asset purchases at the September meeting, with economic growth stagnant and desired wage inflation non-existent, further easing looks inevitable to help counter the effects of the slowdown in China.
- The combination of impending Fed tightening and further stimulus in Europe and Japan should lead to another round of dollar strength against most developed market currencies.
- Emerging market currencies continued to weaken in September, making it difficult for monetary policymakers in these countries to lower interest rates to stimulate their economies.

Bond Markets

- US Treasury yields have fallen again, in reaction to slowing global growth and the delay in Fed tightening, with a more pronounced decline in yields at the shorter end of the curve. Continued GDP growth at current levels should exert upward pressure on yields through year end.
- Credit spreads in both investment grade and high yield continue to widen, but default conditions outside the energy and mining sectors remain very low, making certain high yield issues and sectors more attractive at current levels.
- Improving US GDP growth should drive higher state and municipal tax revenues, allowing municipal bonds to perform well, despite the well-publicized credit problems affecting Puerto Rico, Detroit, and Chicago.
- Most developed international bond yields remain at historically low levels. At these levels, any pickup in rates will have a sharp negative impact on total returns.
- Emerging market bonds, including dollar-denominated debt, have been hurt by the economic slowdown in the various regions. Monetary policymakers have lost some flexibility in providing any needed stimulus to boost their flagging economies.

Equity Markets

- Many global equity markets, including the US, are in the process of retesting their August lows. 3Q earnings season in the US is likely to be flat to slightly negative, but this will mask underlying strength evident in sectors outside energy and mining that have lower exposure to the stronger dollar. With the pullback, valuations are more attractive for many of these companies.
- Another round of monetary easing and euro depreciation may be needed to revive confidence and resume the upward trajectory in European equities. Germany, a former bright spot, is feeling the impact of slowing exports to emerging market, while the Volkswagen scandal has shaken confidence.
- Japan has been one of the better equity performing markets YTD, but it will need additional monetary stimulus to sustain the momentum, as slow domestic economic growth and weak export markets weigh on earnings growth over the coming quarters.
- Emerging market equities seem to be finding a floor at current levels, but the difficulty of hedging currencies and the uncertainty of corporate earnings growth suggest caution in this asset class.

Alternatives & Commodities

- Crude oil prices at the mid $40 level have begun to impact production among the North American shale producers. Given the outlook for continued slow growth in emerging markets, we don't see much of a catalyst for prices to rise in the near term.
- Gold does provide a hedge against competitive currency devaluations, but with little developed market inflationary pressures and the prospect of eventual tightening by the Fed, gold prices will struggle to regain the highs established earlier this year.
- After a somewhat encouraging bounce last month, industrial metals are back at or even below their August lows, as questions about the magnitude of the Chinese slowdown continue to weigh on prices.
- Once the Fed begins to raise rates, hedge fund managers who rely on security selection or low correlation to risky assets to drive returns should benefit from the return to normality as artificial constraints on market volatility and security correlations are eliminated.
- High valuations are making it challenging for private equity firms to buy assets at reasonable prices. We continue to focus on disciplined managers, secondary funds, and sectors 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.

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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