Outlook as of September 2015

World Economy

- The magnitude of the slowdown in the Chinese economy is being hotly debated. Independently measurable statistics around electricity consumption, railcar loadings and corporate profits show an economy that is still growing, but at a rate substantially below the 6.5-7.0% the government is currently claiming.
- The impact of the Chinese slowdown is being felt by neighboring Asian countries as well as the commodity producing economies which benefitted so much from the China growth story in the last decade.
- Decelerating growth in the world's second largest economy will impact all countries that export to China and cause a slowdown in growth globally. US exposure is small, as exports to China represent less than 1% of total US GDP.
- We believe the strengthening US consumer and the recent pickup in business capital spending should help drive US GDP growth close to 3% in the second half of 2015.
- European exports, especially those from Germany, are more vulnerable to slowing emerging markets growth. A weaker euro and strengthening US economy should provide sufficient offsets, and allow the continent to grow at 1.5- 2.0% over the next few quarters.
- Japan has close trading ties to emerging markets, and its very important export industries are vulnerable to the EM slowdown. Without any fiscal or monetary relief, Japanese GDP growth could slow to zero for the second half of this year.

Monetary Policy & Currencies

- The market disruption of late August has lessened the chances of the Federal Reserve raising interest rates starting in September; however, the Fed seems committed to moving off the zero bound by the end of the year.
- Slower emerging market growth will hold the ECB firmly to its schedule of government bond purchases through fall 2016, and may even precipitate calls for further monetary easing in an attempt to increase the currently anemic rate of inflation.
- The Bank of Japan should see pressure to undertake another quantitative easing program, to help offset the impact of Chinese weakness and domestic fiscal contraction.
- Continued easing in Europe and Japan, coupled with the beginning of a Fed tightening cycle, should lead to renewed dollar strength against the euro and yen. The pound sterling should trade in a tight range against the dollar, but the Bank of England may be forced to delay tightening to maintain competitiveness with the Eurozone.
- Emerging market currencies weakened notably in August and may be finding a bottom at these levels. We believe monetary easing will be used judiciously as a tool to boost flagging economic growth.

Bond Markets

- The August disruption in equity markets has had an impact on credit spreads, in both the investment grade and high yield sectors. Continued low default rates outside the energy issues suggests good value exists, especially in the high yield sector.
- The municipal market has experienced a few isolated credit events, but a stronger national economy should help improve state and municipal finances into 2016.
- Intermediate-term US Treasuries have somewhat surprisingly maintained their yields, given the equity market declines of August. Better economic growth indications are keeping some buyers out of the market, in anticipation of rates rising
- Developed market foreign bond yields continue to decline, with questions increasing around the impact of slowing emerging markets growth on their already slow-growing developed economies. It is difficult to find value in this sector.
- Emerging market debt was impacted by the August selloff, but dollar-denominated bonds declined much less than debt issued in local currency. This trend should continue through year end.

Equity Markets

- Global equity markets have been roiled by the uncertainty over the slowdown in Chinese growth. US equities experienced their first 10% correction in nearly 4 years. With sales and earnings expected to grow over the next 12 months, stocks appear cheap relative to other asset classes as they trade at roughly 15x earnings.
- European equities tend to be more sensitive to exports, so slower growth in many destination countries may offset the benefit of euro depreciation against the dollar. Enhanced and extended easing by the ECB may be necessary for these markets to fully recover from the recent declines.
- Anticipation of another quantitative easing program from the Bank of Japan should lead investors to maintain, and even enhance, positions in Japanese equities. The resulting lower yen should continue to be hedged at least through year end.
- Valuations appear very attractive across the emerging markets, but the prospect of further Chinese economic deceleration, plus the difficulty in fully hedging EM currencies, suggests increased caution regarding this asset class.

Alternatives & Commodities

- Oil prices may have finally found a floor, after trading below $40 in the recent selloff of risk-based assets. While anecdotal evidence exists of production declining in certain North American basins, lower prices have yet to create a meaningful rise in demand.
- Gold has exhibited some safe haven attributes in the recent volatile markets. With little sign of inflation and US monetary tightening on the horizon, it is difficult to build a case for higher prices.
- While it may be merely a bounce from extremely oversold conditions, industrial commodities are beginning to firm in pricing, even with continued weak Chinese economic data.
- Preliminary reports indicate that hedge funds fared well during the August turmoil. Policy normalization should benefit hedge fund managers who rely on security selection or low correlation to risky assets to drive returns, 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 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.

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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