Northern Trust | Jim McDonald: 2018 Outlook: Global Momentum

We remain overweight equities as we entered 2018. The global economy is showing broad momentum and inflation is putting little pressure on monetary policy. We believe the two biggest risks to our positive outlook are a central bank mistake, and a Chinese slowdown.

Our themes of entrenched growth, stock flation, and waiting for monetary gadot remain front and center. Global economic growth has shaken off concerns over the age of the recovery and has actually been gaining momentum. The inflation outlook remains stuck at low levels as technology adds supply to the economy and restrains pricing power.

This is leading to monetary gadot as central bankers debate the cyclical versus secular nature of inflation, and whether they might make a mistake by tightening too soon. We see the intersection of these three themes continuing to support risk taking in 2018.

Global equities had a great year in 2017 led by better than expected earnings. In 2018, US earnings should get a boost from tax reform leading to earnings growth of around 14%. We expect earnings growth of 7% in the developed ex US and emerging markets.

We do expect some valuation headwind in the US, but valuation expansion in many markets outside the US. Our return expectations for 2018 are more modest than last year, but still show a healthy return outlook. We think the fixed income markets have sufficiently priced in future rate hikes along for a positive return during 2018.

We expect just one fed rate hike, a slower pace than the fed has been indicating as we believe they will be hesitant to risk inverting the yield curve. Appetite for US municipal bonds has moved beyond the typical US taxable investor and the favorable technical backdrop for municipal bonds should continue. Most sovereign bonds outside the US look unattractive due to the low level of interest rates.

So what does all this mean for investors? We remain positive on risk taking in 2018. In response to strong market returns, we've been reallocating toward asset classes that are less expensive, such as developed ex US and emerging market equities. As always, we'll be debating our investment strategy outlook monthly and look forward to updating you as 2018 unfolds.