

# GLOBAL ECONOMIC & MARKET UPDATE

Synchronized  
Global Growth >



# GLOBAL ECONOMIC & MARKET UPDATE



Millan Mulraine  
Director and  
Chief Economist

We are pleased to introduce the inaugural edition of the Quarterly Global Economic Report and Market Outlook Dashboard, which consolidates and summarizes our in-house views on the key macro themes affecting the global economy and financial markets. We believe that the range of economic views and analytical inputs available to us through the lens of the Ontario Teachers' Global Economic Framework is unique, informing a highly comprehensive view of the world. Our starting point is that an appropriate understanding of the economic backdrop is central to appreciating the underlying dynamics shaping the market environment.

In this edition, we discuss an encouraging outlook for a modest but sustained and synchronized upswing in the global economy, with a relatively subdued inflation backdrop. Given global central banks' gradual withdrawal of monetary stimulus, we are optimistic about the near-term outlook for financial markets. Nevertheless, with ever present geopolitical risks and potential for central bank policy error, we remain attentive to potential headwinds over the medium term.



## SYNCHRONIZED GLOBAL GROWTH

The synchronized global economic recovery is being sustained. The upswing in growth momentum has been supported by strong demand across a broad swathe of countries, reinforcing positive growth dynamics.

## CENTRAL BANK CONFIDENCE

The encouraging global growth backdrop has injected confidence into developing market central banks, providing justification for the start of a pivot from synchronized easing to synchronized tightening. Along with the Fed and the BoC, the BoE appears to be on the verge of taking the first step towards stimulus withdrawal. The ECB and BoJ are also expected to eventually shift away from their easing bias.



## SUBDUED INFLATION OUTLOOK, FOR NOW

Notwithstanding a sustained period of slack-absorbing growth across an increasing number of economies, the global inflation backdrop remains disconcertingly weak. The cross-currents of downward structural forces and upward cyclical pressures have added further uncertainty to the outlook.

## RISK REVIEW

We maintain a constructive view on the medium-term outlook for the global economy. However, we remain mindful of a number of key risks that could derail this outlook. These include, *inter alia*, excessive DM central bank tightening, a hard landing in China, or a major global geopolitical risk event.



# Eyes on the World

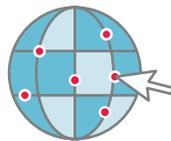
## PHILOSOPHY

Our competitive edge stems from our unique access to key global decision-makers and a diverse platform of portfolio companies. This unique information gateway informs our view of the world, and provides a benchmark against which our global outlook (and associated risks) for growth, inflation and the discount rate (interest rates) can be judged. The underlying views are forged by an analysis of the interconnections between three key pillars of the economic infrastructure (namely the structural trends, cyclical dynamics and global adjusting forces) that shape the medium-term outlook for the global economy and financial market performance.

### ONTARIO TEACHERS' GLOBAL MACROECONOMIC FRAMEWORK



#### Unique Information Gateway

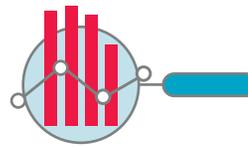


**The Competitive Edge**

- Portfolio companies
- Hedge fund partners
- Research community



#### The Analytical Framework



**The Ontario Teachers' Tri-Cycle**

- Structural Trends
- Cyclical Dynamics
- Global Adjusting Forces



#### Market Assessment and Outlook



**The Investment Outlook**

- Financial Market Outlook
- Global Macro Risk Monitor
- Global Scorecard

## THE ONTARIO TEACHERS' TRI-CYCLE

**1 Structural Trends**  
The long-term trends or secular regimes that define the investment environment, and influence the decision-making process of firms, households and non-market actors at both the individual and aggregate level.

**2 Cyclical Dynamics**  
Forces related to fluctuations in the economy, policy and credit regimes that are driving forces behind economic and asset market performance.

**3 Global Adjusting Forces**  
These forces define the avenues for spillovers across economies and regions. In particular, they form the mechanism through which DM and EM economies and financial markets become integrated through trade and capital investment flow.

# Global Macroeconomic Outlook



## DEVELOPED MARKETS:

### Sustained and Synchronized, Above-Trend Growth:

Cyclical conditions are gaining momentum and broadening globally. Our expectation is for this shift from “muddle-through” to a more synchronized above-trend growth to be sustained over the medium term, more than compensating for the lingering structural headwinds.



### Inflation to Remain Tepid, Drift Modestly Higher:

Despite strong above-trend growth, the inflation picture remains tepid as the secular forces continue to constrain price pressures. Nevertheless, we view cyclical conditions as biasing inflation higher, but we may not be at the threshold yet where wages accelerate meaningfully.



### Fed Leads Gradual Hiking Cycle:

As the Fed leads the way on higher rates, we expect yields to drift modestly higher. However, the gradual pace of policy tightening should temper any risks of a disorderly adjustment higher, ensuring relatively favourable global financial conditions.



## EMERGING MARKETS:

Favourable Global Environment to Drive Steady Cyclical Upturn

Most EMs are in the early days of a cyclical upturn that we expect to strengthen over the next few years, barring an unexpected external shock. Three key forces are aligning in EMs favour – easing global USD funding conditions, a healing global trade cycle and contained short-term China downside risks. This should pave the way for a continued steady capital inflow recovery back into EMs following recent years’ retrenchment.



KEY GLOBAL MACRO RISK MONITOR		RISK LEVEL
1	U.S. encounters an economic recession over the next 12 months	Green
2	The Canadian economy enters a recession in the next 12 months	Yellow
3	China experiences severe economic and financial dislocations over the next 12 months	Green
4	Global geopolitical tensions rise owing to competitive devaluation and protectionism	Yellow

# Financial Market Outlook

**EQUITIES:** Equities are largely fully priced for our base-case economic outlook. Given a relatively attractive equity risk premium and healthy corporate fundamentals, we are not overly concerned about a material decline in stock markets in the near term.

Fairly Priced for Benign Outlook

**OUTLOOK:**  
Neutral

**FIXED INCOME:** The cyclical improvement in the economic backdrop along with the evolving central bank policy bias towards tightening will more than compensate for any structural headwinds to yields over the medium term. However, with long-run equilibrium rates lower than previous cycles, long duration assets remain attractive from a strategic perspective.

Slight Upside Bias to Yields

**OUTLOOK:**  
Slightly Bearish

**U.S. DOLLAR:** A final rally is still possible in the event of a positive U.S. policy shock. We see modest upside risks for the USD, owing to a more advanced business and credit cycle relative to other major Developed Markets, raising the likelihood of more Fed tightening than the market expects through the end of 2018.

One More Leg to Go?

**OUTLOOK:**  
Slightly Bullish

**CREDIT:** Cyclically, the credit space looks broadly rich as spreads continue to tighten. While the spread compression dynamics may still have legs, the risk/reward payoffs do not look particularly compelling.

Risk-Reward Fails to Impress

**OUTLOOK:**  
Neutral

**COMMODITIES:** Firming global demand should provide a favourable backdrop for commodity prices going forward, and even though excess capacity remains in a number of key commodities (such as energy) the supply-demand dynamics should begin shifting more constructively.

Firm Global Demand to Support Prices

**OUTLOOK:**  
Slightly Bullish

## ON OUR RADAR

### STRUCTURAL FACTORS

Changing global demographic dynamics, weakening globalization impulse as well as ongoing deleveraging have been constraining forces on growth. Collectively, the net impact on interest rate and inflation has also been negative.

### DISRUPTIVE TECHNOLOGY

The development and adoption of new revolutionary technologies is occurring at an unprecedented pace. The economic ramifications of these disruptive technologies are profound as they have the potential to transform the economic landscape in meaningful ways.

### CENTRAL BANK POLICY

There is increased confidence among DM policy makers about the sustainability of the economic rebound and increased conviction about moving away from the current emergency policy settings. The monetary pendulum is beginning to swing from synchronized global easing, to the cusp of synchronized, albeit gradual, global tightening – a major post-crisis inflection point.

### GEOPOLITICS

The global geopolitical risk level remains elevated, even though the worst fears of a protectionist pivot under the Trump Administration have receded. Nevertheless, the risk of a confrontation between the U.S. and China is a non-trivial risk as tensions with North Korea rise.

# Global Medium-term Scorecard

The scorecard reviews the directional impact of economic indicators ranging from structural trends like geopolitics and the regulatory backdrop to cyclical dynamics and global adjusting forces on the three key primitives – growth, inflation and interest rates. This is compared to our assessment of what the market is pricing in for these factors.

GLOBAL					CANADA					
		Growth	Inflation	Discount Rate			Growth	Inflation	Discount Rate	
Structural Trends	Geo-Political Trends	↓	↓	↓	Structural Trends	Geo-Political Trends	↓	↓	↓	
	Regulatory Backdrop	↓	↔	↑		Structural Trends	Regulatory Backdrop	↓	↑	↑
	Secular Growth Drivers	↔	↓	↓			Structural Trends	Secular Growth Drivers	↔	↔
Cyclical Dynamics	Credit Cycle	↑	↑	↑	Cyclical Dynamics			Credit Cycle	↓	↓
	Business Cycle	↑	↑	↑		Cyclical Dynamics		Business Cycle	↔	↑
	Policy Cycle	↔	↔	↑			Cyclical Dynamics	Policy Cycle	↔	↔
Global Adjusting Forces	Investment Cycle	↓	↔	↔	Global Adjusting Forces			Investment Cycle	↓	↓
	Trade Cycle	↑	↑	↑		Global Adjusting Forces		Trade Cycle	↑	↑
	Capital Flow Cycles	↑	↑	↓			Global Adjusting Forces	Capital Flow Cycles	↔	↔
Ontario Teachers' Bias		↑	↑	↑	Ontario Teachers' Bias			↓	↑	↑
Relative to Market		↔	↓	↔	Relative to Market			↓	↑	↔

↑ = Upward   ↓ = Downward   ↔ = Outcome uncertain

Opinions, estimates and projections contained herein are Ontario Teachers' as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Ontario Teachers' nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. Information may be available to Ontario Teachers' or its affiliates that is not reflected in this report.

This report is provided to you for informational purposes only. This report does not constitute investment advice. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap, investment or trading strategy involving a swap or any other transaction. Ontario Teachers' may engage in transactions or have positions that are inconsistent with the views discussed in this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

**This information may not be reproduced without the prior express written consent of Ontario Teachers'.**



**For questions and comments on this report, please contact:**

Millan Mulraine  
Chief Economist  
millan\_mulraine@otpp.com  
(416) 730-6192

TORONTO | LONDON | HONG KONG

WWW.OTPP.COM



MYOTPP



@OTPPINFO



OTPP.COM/LINKEDIN



OTPPINFO