PRAMERICA INTERNATIONAL INVESTMENTS ADVISERS, LLC. ("Pramerica")

# Global Investment Outlook & Strategy

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# 2017 Year Ahead – Global Investment Outlook

## Equity Rally likely to Continue into 2017 Fueled by Strong Earnings Rebound & Solid U.S. GDP Growth with Trump Tax Cuts, Reduced Regulations & Increased Spending, ECB & BoJ QE Stimulus, Modest Fed Rate Hikes, Emerging Markets Growth Improves & Some Rate Cuts

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***John Praveen's 2017 Year Ahead Global Investment Outlook expects the global equity markets rally to continue into 2017 with strong earnings rebound, improved global GDP growth with Trump reflation, liquidity support from ECB & BoJ QE buying and rate cuts by some emerging central banks, and stocks still cheap relative to bonds.***

***Stocks:*** Global stock markets ended a volatile 2016 with strong post U.S. election gains in the U.S. and other Developed Markets. Emerging Market stocks posted solid gains through Q3 but trimmed gains in Q4 following the Trump victory. ***Developed Markets rose 5.4% in Q4 and 7.8% in 2016 (through December 20th) led by 11.1% gains in the U.S., while Emerging Markets declined -2.8% in Q4, trimming 2016 gains to 6.1%.***

***Looking ahead to 2017, the post-election U.S. equity rally is likely to continue into 2017 driven by: 1) Solid Earnings Rebound*** with strong U.S. earnings growth fueled by Trump tax cuts & reduced regulations, strengthening GDP growth and a boost to Energy & Materials earnings growth from higher oil and commodity prices. Eurozone and U.K. earnings are expected to rebound after the declines in 2016, while Japanese earnings are expected to remain solid. Emerging Market earnings are expected to strengthen in 2017; ***2) Improving Global GDP Growth*** with stronger U.S. GDP growth from Trump's fiscal stimulus and reduced regulations. GDP growth in Eurozone and U.K. is likely to be modest with limited Brexit impact, ECB stimulus and currency weakness boosting exports. Japanese GDP is expected to improve with weak yen boost to exports and BoJ QE. Emerging economies growth is likely to improve; ***3) Liquidity & Interest Rate Backdrop remains favorable but less supportive in 2017*** as continued QE stimulus from the ECB and Bank of Japan is offset by the Fed rate hikes. Emerging central bank policies are likely to be mixed in 2017.

***Bonds:*** Bond yields declined in H1 2016 and remained low through Q3. Yields rose following the U.S. elections on expectations that Trump fiscal stimulus could lead to higher U.S. inflation and potentially more aggressive Fed rate hikes. ***Looking ahead to 2017, bond yields likely to face upward pressure from:*** **1)** ***Inflation rising*** with higher oil and commodity prices from OPEC production cuts. U.S. inflation is also likely to be under pressure with Trump fiscal stimulus, while U.K. inflation is likely to be under pressure from the Sterling weakness; ***2) Improving global growth*** with strong U.S. GDP rebound fuelled by Trump stimulus. GDP growth in Eurozone and U.K. is likely to be modest with limited Brexit impact, ECB stimulus and currency weakness boosting exports. Japanese GDP is expected to improve with export recovery on weak yen and BoJ QE stimulus; ***3) Rate Hikes*** with the Fed signaling three hikes in 2017. However, the Fed could raise rates at a faster pace if U.S. inflation rises faster than expected with Trump's fiscal stimulus or protectionist policies. The BoE is expected to remain on hold in 2017, but could be forced to hike rate if further Sterling weakness leads to higher inflation. ***However, bonds are supported by:*** 1) ***Continued QE Stimulus*** from the ECB & BoJ; 2) ***Inflation remains low*** in Eurozone and Japan; and 3) ***Safe haven demand*** from Brexit & European political uncertainty with elections in several countries.

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## Market Outlook: U.S. Equity Rally to lead Global Stocks Higher in 2017. Strong Earnings Growth & U.S. GDP Rebound with Trump Tax Cuts, Reduced Regulations & Increased Spending. ECB & BoJ QE Stimulus, Modest Fed Rate Hikes, Emg Markets Growth Improves & Some Rate Cuts

## Bond Yields Likely to Face Upward Pressure in 2017 from Rising Inflation, Trump Stimulus & Risk of More Aggressive Fed Rate Hikes. Low Inflation, ECB & BoJ QE to Keep Eurozone/Japan Yields Low

**Stock Market Outlook (2017):** Global stock markets were volatile in 2016 with strong gains in the U.S. & U.K. and modest gains in Eurozone and Japan. Emerging Market stocks posted solid gains through Q3 but trimmed gains in Q4 following the Trump victory in the U.S. Presidential elections. ***Developed Market stocks rose 5.4% in Q4 and 7.8% in 2016 (through December 20th) led by 11.1% gains in the U.S., while Emerging Market stocks declined -2.8% in Q4, trimming 2016 gains to 6.1%.***

***Looking ahead to 2017, the post U.S. election equity rally is likely to continue into 2017 driven by solid earnings rebound, improved global GDP growth, liquidity support from ECB & BoJ QE buying and rate cuts by some Emerging central banks, and stocks still cheap relative to bonds. However, equity valuations are less compelling which could limit market gains.***

***However, stock markets face several risks which could keep markets volatile. These include:*** 1) More aggressive Fed rate hikes; 2) Valuations are not compelling/expensive, limiting equity gains; 3) Risk of Trump embarking on protectionist policies; 4) Brexit & European political uncertainty with elections in France, Germany, Netherlands, Czech Republic and risk of snap elections in Italy.

***Despite these risks, we expect global stock markets to post solid gains in 2017 driven by:*** 1) Strong earnings rebound; 2) Improved global GDP growth; 3) Liquidity support from ECB & BoJ QE buying and rate cuts by some Emerging central banks, and 4) Stocks still cheap relative to bonds. However, equity valuations are less compelling which could limit market gains.

***1) Solid Earnings Rebound in 2017 led by U.S. after Weak Earnings in H1 2016 & Recovery in H2 2016:*** Global earnings are expected to rebound to around 13% in 2017 from the modest 2% earnings growth in 2016 with a boost to U.S. earnings from Trump's proposed tax cuts, reduced regulations and increased spending, and the fading drag from weak Energy and Materials earnings. ***U.S. corporate earnings were already recovering in H2 2016 and are expected to rebound to over 12% in 2017*** with an extra boost from the corporate friendly reflationary policies of the Trump administration, including tax cuts, reduced regulations and increased spending. In addition, U.S. GDP growth is expected to strengthen to around 3% from Trump fiscal stimulus. Further, the drag from lower oil and commodity prices on Energy and Material sector earnings are likely to abate in 2017. ***Eurozone (+13%) and UK (+21%) are expected to rebound after the declines in 2016.*** However, Eurozone and U.K. earnings expectations may be too optimistic as GDP growth is likely to remain modest in 2017, while there are increased political uncertainties from Brexit and elections in several European countries. ***Japanese earnings (+10%) are expected to remain solid*** with the yen weakening to above 115/$ and with the GDP growth improving. ***Emerging Markets earnings (+12%) are expected to strengthen in 2017 driven*** by improvement in earnings growth across the major markets***.***

***2) Strong U.S. GDP Growth to lift Other Developed & Emerging Economies in 2017: Global GDP growth is on track to strengthen in 2017*** with stronger U.S. GDP growth from Trump's fiscal stimulus and reduced regulations. GDP growth in Eurozone and U.K. is likely to be modest with limited Brexit impact, ECB stimulus and currency weakness boosting exports. Japanese GDP is expected to improve with export recovery on weak Yen, BoJ QE & fiscal stimulus. Emerging Economies growth is likely to be stable.

***U.S. GDP growth is expected to strengthen to around 3% in 2017 after modest GDP growth of 1.7% in 2016.*** The U.S. economy is expected to get a boost from Trump's fiscal stimulus with a combination of personal and corporate tax cuts and increased spending on infrastructure and defense, and supply-side reforms. Further, with the Republican Party

 

retaining control of both the Senate and the House, the Trump agenda is likely to be approved by Congress. ***Stronger U.S. GDP growth in 2017*** is likely to be driven by a rebound in ***business investment spending*** with lower corporate taxes and reduced regulation. Further, the recovery in oil and commodity prices should lead to a revival in capex in these sectors. ***Consumption spending*** is expected to be strengthened by lower personal taxes and increased job and wage growth. ***Government spending*** is likely to get a boost from increased spending on infrastructure and defense. ***Trade is, however, likely to remain a drag*** with a strong U.S. dollar.

***Eurozone GDP growth is expected to remain stable around 1.5% in 2017 after 1.6% growth in 2016.*** Growth is expected to be stable across most Eurozone economies, with the exception of Greece where growth is expected to turn positive. Eurozone GDP growth in 2017 is likely to be driven by domestic demand, in particular by consumption spending which is likely to be supported by falling unemployment. Further, exports are likely to improve with a weaker Euro and stronger U.S. growth. Investment spending is likely to be soft with some tightening of financial conditions as the ECB slows QE buying to €60bn from €80bn in March. ***The U.K. economy was resilient in 2016 and weathered the Brexit impact with GDP growth slowing modestly to 2%. Looking ahead, GDP growth is likely to slow to around 1.5%*** with continued uncertainty about "soft vs. hard Brexit". The Brexit uncertainty is likely to lead to a contraction in investment spending and keep consumer spending restrained. However, the sharp decline in the pound sterling should give a boost to U.K. exports, though Brexit-related trade issues should limit the export gains. ***Japanese GDP growth is likely to improve to around 1.5% in 2017 from 1% in 2016***, driven by recovery in corporate activity, and stronger exports with yen depreciation. Consumption spending growth is likely to be modest as wage growth has been relatively modest. The government's fiscal stimulus, coupled with the BoJ's QE, is likely to be positive for growth.

***Among Emerging Economies, China's GDP growth is expected to remain stable around 6.5% in 2017*** with steady consumption and net exports, but higher infrastructure spending. ***India's GDP growth is expected to recover from the currency demonetization drag*** with consumer spending remaining solid, RBI likely to cut interest rates further, and increased government infrastructure spending. Growth should also get a boost with the implementation of Goods & Services Tax (GST) and increased liquidity as the currency demonetization deposits provides a boost to bank lending. However, with the bulk of the negative impact of the currency demonetization felt in Q4 2016 and H1 2017, India's GDP growth is expected to slow to 6.7% in 2017 from 7.2% in 2016. ***Brazil is on track to emerge from recession with GDP expected to grow around 1% in 2017*** with interest rate cuts, rising oil and commodity prices, and improving political environment enabling President Temer to pursue market-friendly reforms. Russia's economy is expected to grow around 1.2% in 2017 benefitting from rising oil prices and recovering domestic demand with rate cuts. ***Taiwan's economy*** is expected to grow around 1.7%. ***Mexican GDP growth is expected to slow to 1.8% in 2017*** with rate hikes and trade uncertainty with the Trump administration.

***3) Liquidity & Interest Rate Backdrop Less Supportive: The global liquidity and interest rate backdrop remains favorable but less supportive in 2017 than in 2016*** as continued QE stimulus from the ECB and the Bank of Japan (BoJ) is offset by rate hikes by the Fed. ***2017 is also likely to see the stimulus baton passing from monetary to fiscal policy in the U.S.*** Emerging Central Bank policies are likely to be mixed in 2017.

***The ECB is expected to continue QE buying in 2017, having extended the program from March 2017 to December 2017.*** However, the ECB announced a slowing of the pace of purchases to €60bn per month from March (from €80bn currently). ***The Bank of Japan (BoJ) introduced a new policy framework in 2016, the "QQE with Yield Curve Control".*** The BoJ's plan is to purchase JGBs so that the 10-year yield remains around 0%. With the yen depreciating and yields inching higher into positive territory, ***the BoJ is likely to continue QE but unlikely to expand QE buying, unless inflation remains negative.***

***The U.S. Fed is on track to gradual, measured rate hikes in 2017. Earlier in 2016, the Fed raised rates just once, in December,*** as a rolling series of uncertainties prompted the Fed to remain on hold till December. ***The Fed's "dot plot" suggests the Fed will raise rates three times in 2017*** with U.S. GDP growth on track to strengthen, inflation edging higher to the Fed's 2% target and the unemployment rate trending to below the Fed's long run estimate of 4.8%.

 

However, Trump's economic policies are likely to be reflationary with a potential to lead to inflationary pressures either from fiscal stimulus or anti-trade policies. If Trump's fiscal stimulus leads to higher inflation, the Fed could raise rates at a faster pace than the current expectations of three rate hikes in 2017.

***The BoE is likely to remain on hold in 2017 but has left itself open to tighten or loosen policy depending on the impact of Brexit uncertainty on growth and the impact of weaker Sterling on inflation.*** The Brexit impact on U.K. growth was more modest than feared in 2016, taking pressure off the BoE to ease. However, the pound sterling has fallen sharply since the Brexit vote and carries risks for U.K. inflation, complicating the BoE's task.

***Emerging Central Bank policies are likely to be mixed in 2017.*** Central banks in India, Brazil and Russia are likely to cut rates and undertake easing measures as falling inflation gives them scope to cut rates. China is expected to remain on hold and unlikely to expand stimulus due to concerns about financial stability. Taiwan, Korea, Hungary, Czech Republic and Poland are expected to remain on hold with improving growth outlook. Mexico is expected to raise rates further in tandem with the Fed and to keep the peso from weakening. Turkey is expected to raise rates to contain currency weakness.

***4) Equity Valuations less Compelling with P/E Multiples Rising, Stocks less attractive relative to Bonds:*** Stock market P/E multiples rose in 2016 with equity gains. Further the earnings yield gap between stocks and bonds narrowed, reducing the relative attractiveness of stocks. Looking ahead to 2017, we expect the U.S. P/E multiple to remain stable with downward pressure from Fed rate hikes and higher bond yields. However, this is likely to be offset by upward pressure from Trump tax cuts, reduced regulation and increased spending. Eurozone multiples are likely to remain stable in 2017 after rising during 2016 with ECB continuing its QE program through 2017-end, but offset by the heavy election schedule for the year. However, there is some scope in 2017 for further P/E expansion in Japan with continued BoJ QE and fiscal stimulus. ***Stock valuations remain cheap relative to bonds but the yield gaps narrowed in the U.S. with stock P/E multiples and bond yield rising during the year.*** However, the stock-bond yield gap remains wide in the Eurozone, U.K. and Japan.

***Bottom-line:*** Global stock markets ended a volatile 2016 year with strong post U.S. election gains in the U.S. and other Developed Markets. Emerging Market stocks posted solid gains through Q3 but trimmed gains in Q4 following the Trump victory. ***Developed Markets rose 5.4% in Q4 and 7.8% in 2016 (through December 20th) led by 11.1% gains in the U.S., while Emerging Markets declined -2.8% in Q4, trimming 2016 gains to 6.1%.***

***Looking ahead to 2017, the post U.S. election equity rally is likely to continue into 2017 driven by: 1) Solid Earnings Rebound*** with strong U.S. earnings fueled by Trump corporate tax cuts & reduced regulations, strengthening GDP growth and boost to Energy & Materials earnings growth from higher oil and commodity prices. U.S. earnings were already recovering in H2 2016 and are likely to get an extra boost in 2017 from the Trump reflation and rebound to over 12%, with upside risks. Eurozone (+13%) and UK (+21%) are expected to post a rebound after the declines in 2016 while Japanese earnings (+10%) are expected to remain solid. Emerging Markets earnings are expected to strengthen in 2017 (+12%) driven by improvement in earnings growth across major emerging markets; ***2) Improving Global GDP Growth*** with stronger U.S. GDP growth from Trump's fiscal stimulus and reduced regulations. GDP growth in Eurozone and U.K. is likely to be modest with limited Brexit impact, ECB stimulus and currency weakness boosting exports. Japanese GDP is expected to improve with export recovery on weak Yen, BoJ QE & fiscal stimulus. Emerging Economies growth is likely to be stable with steady growth in China (around 6.5%), recovery in Brazil and Russia from deep recessions, India rebounds after the currency demonetization drag on growth, and higher oil and commodity prices combined with U.S. infrastructure spending boost to oil and commodity exporters; ***3) Liquidity & Interest Rate Backdrop remains favorable but less supportive in 2017*** than in 2016 as continued QE stimulus from the ECB and the BoJ is offset by rate hikes by the Fed. The Fed is on track to raise rates in 2017 and has signaled three rate hikes. ***2017 is also likely to see the stimulus baton passing from monetary to fiscal policy in the U.S.*** Among Emerging Markets, falling inflation in some countries

 

(India, Brazil and Russia) gives their central banks room to cut rates, while others are likely to raise rates or remain on hold due to inflation pressures, or to keep pace with Fed rate hikes or to defend their currencies (Mexico, Turkey).

***However, stock markets face several risks which could keep markets volatile. These include:*** 1) More aggressive Fed rate hikes; 2) Valuations are not compelling/expensive limiting equity gains; 3) Risk of Trump embarking on protectionist policies; 4) Brexit & European political uncertainty with elections in France, Germany, Netherlands, Czech Republic & risk of snap elections in Italy.

***Despite these risks, we expect global stock markets to post solid gains in 2017. We look for bigger market gains in U.S. and our target for the S&P 500 index is to reach 2,575 by 2017 year-end (from 2300 in 2016). We expect healthy gains in the Emerging Markets and Japan, and more modest gains in Eurozone and U.K.***

## Bond Yields Face Upward Pressure from Rising Inflation, Trump Stimulus & Risk of More Aggressive Fed Rate Hikes. Low Inflation, ECB & BoJ QE to Keep Eurozone/Japan Yields Low

***Bond yields declined in H1 2016 and remained low through Q3.*** While bond yields began to rise in October as inflation data began to reverse***, yields spiked following the U.S. elections*** on expectations that Trump fiscal stimulus could lead to higher U.S. inflation and potentially more aggressive Fed rate hikes***.***

***Looking ahead to 2017, bonds yields are likely to remain under upward pressure in the U.S. and U.K., but edging up modestly in Japan and Eurozone.*** Bond yields are likely to be under upward pressure from: ***1) Inflation rising*** with higher oil and commodity prices from OPEC production cuts and fading base effects from earlier oil price declines. Inflation in the U.S. is also likely to be under pressure with Trump fiscal stimulus, and low unemployment driving wage gains. U.K. inflation is likely to be under pressure from the sharp decline in Sterling after the Brexit vote; ***2) Improving global growth*** with strong U.S. GDP rebound fuelled by Trump tax cuts, increased spending & supply-side reforms. GDP growth in Eurozone and U.K. is likely to be modest with limited Brexit impact, ECB stimulus and currency weakness boosting exports. Japanese GDP is expected to improve with export recovery on weak Yen and BoJ QE stimulus; ***3) Rate Hikes*** with the Fed on track to hike rates three times in 2017. However, the Fed could raise rates at a faster pace than current expectations if U.S. inflation rises faster than expected with Trump's fiscal stimulus or protectionist policies. The BoE is expected to remain on hold in 2017, but could be forced to hike rate if further Sterling weakness leads to higher inflation***. However, bonds remain supported by: 1) Continued QE Stimulus from the ECB & BoJ***. The ECB announced an extension of its QE buying program to December 2017 from its current end in March 2017. While the pace of bond buying has been reduced to €60bn in March from €80bn currently, it reduces the risk of a taper tantrum. The BoJ remains focused on implementing its new policy of "QQE with Yield Curve Control" with purchase of JGBs so that the 10-year yield remains around 0%. The BoE is likely to remain on hold due to Brexit risks; ***2) Inflation remains low in Eurozone and Japan,*** as the impact of higher oil and commodity prices is likely to be offset by modest GDP growth; and ***3) Safe haven demand*** from Brexit & European political uncertainty with elections in France, Germany, Netherlands, Czech Republic and risk of snap elections in Italy with the resignation of PM Renzi on constitutional referendum defeat.

## Investment Strategy:

### *Asset Allocation:* U.S. Equity Rally to lead Global Stocks Higher. Bond Yields likely remain under Upward Pressure

**Stocks -** ***Overweight*** as equity markets are likely to post solid gains with strong earnings rebound, improved global GDP growth with Trump reflation, liquidity support from ECB & BoJ QE buying and rate cuts by some emerging central banks.

**Bonds -** ***Underweight*** as yields likely to remain under upward pressure with improved GDP growth, rising inflation and Fed rate hikes.

 

## Global Equity Strategy: U.S. Equity Rally Continues in 2017 & Outperforms Europe, Japan & Emerging Market Stocks

**U.S.: *Overweight*** as the U.S. equity rally is likely to continue into 2017 driven by strong earnings rebound and strengthening GDP growth with Trump tax cuts, increased spending and reduced regulations.

**Japan: *Modest Overweight*** as Japanese stocks are likely to post relatively modest gains with BoJ stimulus, continued earnings growth but offset by modest GDP growth.

**Emerging Asia: *Modest Overweight*** with steady growth in China, Taiwan & Korea, India recovers from demonetization drag and RBI rate cuts.

**Latin America & EM Europe: *Neutral*** as rate cuts and improving growth in Brazil and Russia offset by rate hikes in Mexico and political uncertainty in Turkey.

**Eurozone: *Underweight* as** Eurozone likely to underperform with elevated political uncertainty on a heavy election calendar and soft GDP growth.

**U.K.: *Underweight*** as U.K. stocks are likely to underperform with GDP growth slowing in 2017 on continued uncertainty about "soft vs. hard Brexit" and rising inflationary pressures putting pressure on BoE to raise rates.

## Global Bond Market Strategy: Eurozone Bonds & JGBs Likely to Outperform U.S. Treasuries, U.K. Gilts & Emerging Market Debt

**Eurozone Bonds: *Overweight*** with low inflation, modest GDP growth, and ECB extending QE to December 2017.

**Japan JGBs: *Overweight*** with yields expected to remain low in 2017 with depressed inflation, modest GDP growth, and BoJ continuing QE stimulus.

**Emerging Markets Debt: *Modest Overweight*** as outlook is modestly positive with improving EM GDP growth and potential rate cuts in some markets. But strong dollar is a negative**.**

**U.S. Treasuries: *Underweight*** as outlook remains negative with stronger U.S. GDP growth and risk of higher inflation from Trump fiscal stimulus and the potentially more aggressive Fed tightening.

**U.K. Gilts: *Underweight*** with risk of rising inflation from Sterling weakness and "soft vs. hard Brexit" uncertainty.

## Global Sector Strategy:

***Overweight***: Financials & Industrials***; Modest Overweight***: Information Technology, Energy & Materials;

***Neutral:*** Healthcare, Consumer Discretionary & Telecomm;

***Underweight***: Consumer Staples & Utilities***.***

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