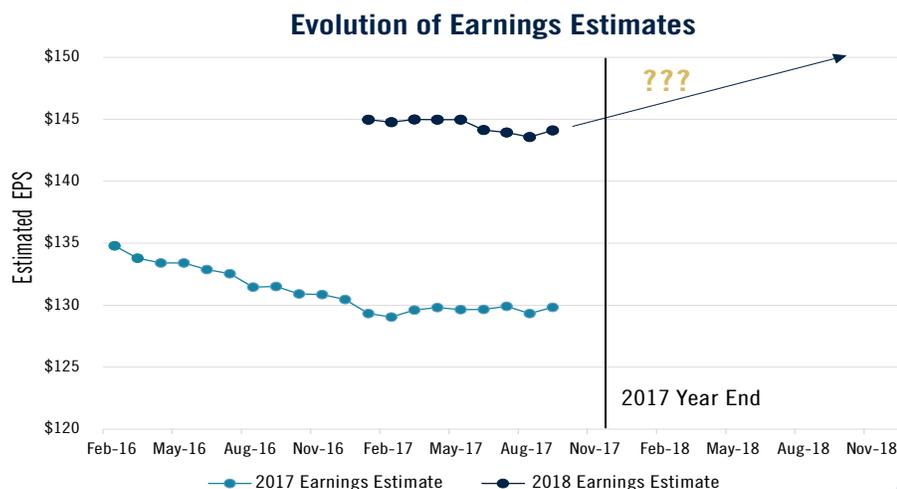




MARKET PULSE

Why the Tax Bill Might Lift Earnings and Equities in 2018

- Despite worrisome valuations, we think the equity market rally is likely to continue into 2018, and we remain overweight stocks in our dynamic asset allocation portfolios. One reason is that we think analysts' earnings estimates are likely to rise as a result of the tax bill.
- Analysts' estimates play an important role in QMA's investment strategies for both stock selection and asset allocation. Both academic research and our own practical experience have demonstrated the value of these forecasts.
- Typically, analyst forecasts are issued starting a full year before the calendar year in question. In the aggregate, the forecasts tend to start out too optimistic and fall as the months progress. Part of the tremendous market gains in 2017 have been driven by forecasts that have stayed steady all year, as S&P 500 companies have delivered double-digit growth.
- It is relatively rare for analysts' forecasts for a year to rise; it has happened only seven times since I/B/E/S began collecting these data in 1979.
- In the years when estimates rise, the market has also risen, never having a negative year. The average gain has been 13.3%.
- There are several important caveats: the tax bill is not final, so it is not guaranteed that there will be a tax cut at all. Important details still need to be worked out in conference, including the effective date. Having seven observations is too few to offer statistical significance; it is suggestive but not definitive. Even if the tax cut helps earnings, it might be offset by other factors that take 2018 forecasts lower by year end.
- Nevertheless, combined with the global synchronized expansion that still seems to be gaining momentum, we think an overweight in stocks in a diversified portfolio makes sense for now, despite high valuations. If the fundamental momentum starts to slow, the high valuations will matter more, but that is a concern for another day.



AUTHOR

Ed Keon, Managing Director and Portfolio Manager
QMA's Asset Allocation Team

FOR MORE INFORMATION

To learn more about QMA's capabilities, please contact Stephen Brundage, CFA, Managing Director and Portfolio Strategist, at stephen.brundage@qmallc.com or 973-367-4591.

ABOUT QMA

Serving investors since 1975, QMA targets superior risk-adjusted returns by combining research-driven quantitative investment processes built on economic and behavioral foundations with judgment from experienced market practitioners. Ultimately, each portfolio is constructed to meet the individual financial needs of the client. An independent boutique backed by the capabilities of one of the world's largest asset managers, QMA is the quantitative equity and dynamic asset allocation business of PGIM, the global investment management businesses of Prudential Financial, Inc. Today, we manage approximately \$133 billion* in assets for a wide range of global clients.

*As of 9/30/2017.

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