2017: A Year of Transition as Markets Return to Fundamentals

NUVEEN ASSET MANAGEMENT

INVESTMENT PERSPECTIVES AND MARKET OUTLOOK

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2016 Recap: A Tale of Two Markets

In many ways, the beginning and ending of 2016 were mirror images. As the year began, financial markets were dominated by fears of recession and deflation, and investors were uneasy over the Federal Reserve's December 2015 rate hike. This environment produced a sense of malaise that resulted in a 10% drop in equity markets by early February.[1] From that point, dovish global central bank policies, improving liquidity and a stronger labor market boosted economic growth modestly. As corporate earnings began to recover, stock market indices rose through most of the rest of the year, and rallied strongly following the presidential election.

In addition to changes in equity market performance, we saw several other key inflection points. Amid economic growth concerns, the yield on the 10-year U.S. Treasury bottomed at 1.37% on July 8 and has climbed more than 100 basis points since then.[1] We believe the July low marked the end of what had been a 35-year bull market for bonds. Fed policy also shifted as the central bank again hiked rates in December and indicated additional increases would follow in 2017. And, of course, the global political environment changed markedly. The Brexit vote, Donald Trump's election and the Italian constitutional referendum all point to a world that is increasingly rejecting globalization and growing more nationalistic and protectionist.

Amid this complex backdrop, we venture forth with our Ten Predictions for 2017.

2017 Ten Predictions

1. **U.S. and global economic growth improves modestly as the dollar strengthens and reaches parity with the euro.**
2. **Unemployment drops to its lowest level in 17 years as wages increase at the fastest pace since the Great Recession.**
3. **Treasury yields move higher for a third consecutive year for the first time in 36 years as the Fed raises rates at least twice.**
4. **Stocks hit their 2017 highs in the first half of the year as earnings rise but price/earnings multiples fall.**
5. **Stocks outperform bonds for the sixth year in a row for the first time in 20 years while volatility rises.**
6. **Small caps, cyclical sectors and value styles beat large caps, defensive and growth areas.**
7. **The financials, health care and information technology sectors outperform energy, utilities and materials.**
8. **Active managers' performance improves as flows into equities rise.**
9. **Nationalist and protectionist trends rise as pro-domestic policies are pursued globally.**
10. **Initial optimism about the Trump agenda fades in light of slow legislative progress.**

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Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through equity portfolio management and ongoing market commentary.

2017 Outlook

We dub 2017 as "A Year of Transition," as many of the trends that emerged in 2016 should continue and perhaps accelerate. We expect a shift from an environment of secular stagnation and deflation fears to one marked by somewhat better growth, higher inflation and rising interest rates. This environment will likely trigger several key changes in the economic, investing and political landscape:

2017: A YEAR OF TRANSITION

From...	...To
Economic stimulus driven by monetary policy	Stimulus driven by fiscal policy
A world progressing toward globalization	Rising nationalism, protectionism and isolationism
Fears of stagnant growth and deflation	Improving growth and rising inflation
Investors focusing on safety	Higher appetites for risk amid rising volatility
A "rising tide lifting all boats" market	An environment where selectivity is critical

2017 will also likely produce a high degree of uncertainty. The election of Donald Trump may usher in significant changes to tax, trade, immigration and regulatory policies. At the same time, fiscal stimulus should lead to higher wage inflation. As interest rates rise, a critical question is whether an equity bull market that has been driven by liquidity can continue as one driven by revenue and profit growth.

In this environment, investors may be in for a difficult ride. The 35-year disinflationary, falling interest rate world is coming to an end, and that brings with it some challenges. We think investors should expect mediocre returns over the next 5 to 10 years from nearly all asset classes as a result of relatively slow long-term global economic and earnings growth and generally full valuations.

We expect the investing environment will be driven less by broad macro issues and more by security-specific fundamentals. Given the changes we expect, we forecast the following investment themes: stocks over bonds, small caps over large caps, value over growth, cyclical sectors over defensive ones and credit sectors over government bonds. More critically, we think that making the right portfolio decisions will require a focus on individual security selection to generate outperformance in all asset classes. ■

Key Themes for 2017:

Economy

- *Secular stagnation and deflation fears should give way to somewhat better growth, higher inflation and rising interest rates.*
- *2017 will bring high degrees of uncertainty about the economy, markets and politics.*

Markets

- *Investors should expect a difficult ride and mediocre returns in most asset classes over the next 5 to 10 years.*
- *In such an environment, markets are likely to be driven less by broad macro trends and more by security-specific fundamentals.*

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RISKS AND OTHER IMPORTANT CONSIDERATIONS

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