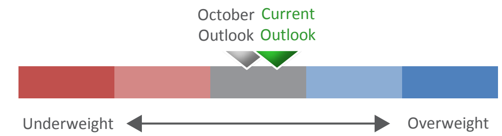
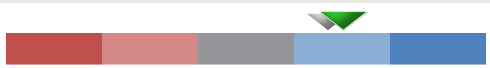
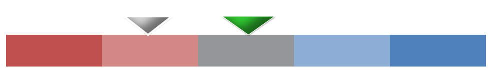
# Near-Term Asset Class Outlook

(January 2017)

Each quarter Envestnet | PMC's Global Macro Committee evaluates market trends and considers where to best position client's portfolios relative to baseline asset allocation weights. The team considers a variety of economic, valuation, and market signposts and bases their views on a **six-month time horizon**.




| Asset Class | Outlook | Overview |
|---|---|---|
| **U.S. EQUITY** | | |
| U.S. Equity – Large Cap |  | – Maintain overweight; segment has performed strongly of late, and cautious optimism about spending and tax plans in a new Washington have been adding momentum.<br>– Leadership has been rotating, away from healthcare and tech and toward industrials and financials; expect continued rotations.<br>– Imperative to keep a close watch on developments in first months of Trump administration should there be any material policy changes that alter expected trajectory of markets and sectors. |
| U.S. Equity – Small Cap |  | – Maintain overweight; small-cap stocks as represented by Russell 2000 have been on a tear, and that reflects overall investor confidence in a stronger American economy.<br>– Valuations are surging, but for the moment, investors appear more interested in overall economic backdrop and on prospects for accelerated growth. |
| **INTERNATIONAL EQUITY** | | |
| Developed |  | – Maintain overweight; political uncertainty remains high in Europe given elections upcoming in Germany and France and the unfolding of Brexit, but few signs of systemic strain. Global appetite for equities also remains high as interest rates creep up. |
| Emerging Markets |  | – Maintain modest overweight; surge in commodity prices globally has offset the negative effects of stronger U.S. dollar. The rise in democratic authoritarianism does not seem to have altered the prudent economic policies many emerging countries have been pursuing. |
| **U.S. FIXED INCOME** | | |
| Corporate |  | – Maintain neutral weight. Balance sheets remain pristine, and cost of capital while rising is still quite modest.<br>– Central bank tightening on interest rates and market anticipation likely to be a source of continued volatility and put a cap on gains. |
| Treasuries / Government |  | – Move to neutral from underweight. The sharp sell-off in longer dated Treasuries after the November election may have priced in a good bit of 2017 inflation and interest rate increase. Rarely do bonds move as quickly as they did in November into early December, and that sell-off could be an opportunity for adding to some positions.<br>– Overall rate outlook, however, remains for somewhat higher rates and modest price declines (or at least the absence of strong price increases) for medium to long-term U.S. government bonds. |
| Municipals |  | – Maintain underweight. While yields and credit quality remain attractive, issuers may pause to see what is in store for government infrastructure spend. Some may want to get in ahead of policy clarity, but for most, it may be appropriate to wait and see. |

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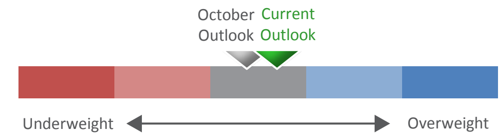


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|---|---|---|
| **High Yield** |  | – Maintain neutral. High-yield bonds did not see as much movement as Treasuries and have been less volatile than usual. Rates are relatively attractive with lower default rates, but the spread between high-yield and higher rated corporates and Treasuries has become narrower. That implies investors may be paid less for equivalent risk. |
| **GLOBAL FIXED INCOME** | | |
| **Global Developed** |  | – Reduce to slight underweight. While the sector has been relatively stable, it may be less attractive on a relative basis in the near term. Headwinds include political uncertainty and Brexit, as well as rising rates and a potentially favorable environment for capital in the United States. |
| **Global Emerging Markets** |  | – Maintain neutral weight with a downside bias. Emerging debt much like high yield was spared much of the late fall volatility. Like high yield, the spread between emerging debt and developed and higher rated has come in, which means that investors are being paid less for possibly more risk. Dollar strength could also be a challenge, offset however by generally higher returns. |
| **OTHER** | | |
| **Commodities** |  | – Increase to neutral weight. While the commodity and industrial metal complex has soared in the past months, there could be continued albeit more modest gains if infrastructure and stimulus spending unfolds in the United States and as global infrastructure build continues. |
| **Alternatives** |  | – 2016 was on the whole a rocky year for alternatives. Investors should privilege those that offer an offset to long-only positions and overall portfolio exposure, as well as funds poised to profit from volatility. |


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# Global Macro Indicators

(January 2017)

On the domestic front, the economy continues to show resilience, and recently, a slight uptick, even seven years into a recovery. There are several positive trends: the employment situation continues to steadily improve; the housing market remains on an upward trajectory; consumer confidence hovers at very high levels; energy prices exhibit few signs of resurgence; and stock prices are at record levels. The results of the US presidential election have also generated a significant surge in enthusiasm in the weeks since the election. The Bureau of Economic Analysis reported its third estimate of third-quarter 2016 gross domestic product (GDP) of +3.5%, higher than both the prior estimate of +3.2% and the +1.4% reading of the second quarter. The employment situation remained stable, with an average of about 176,000 jobs added each month, a level that allowed the Federal Open Market Committee (FOMC) to raise short-term interest rates at its December meeting. The unemployment rate was at a cyclical low of 4.6%.

On a global basis, the environment is not as promising. The U.K.'s decision in June to leave the European Union – "Brexit" – appears to have been only an initial sign of nationalism in the Eurozone. Italy's referendum in December, in which Italians voted down constitutional reforms, has the potential to further jeopardize the EU's viability. GDP growth in the Eurozone came in at a respectable +0.3% in the third quarter, and +1.6% year-over-year. Asia is likely to experience a slowdown as a result of slowing growth in China, but policy reforms enacted by Chinese policymakers could be a catalyst for a turnaround in 2017.

At its most recent meeting in December, the FOMC voted to raise the target range of the fed funds rate by 25 basis points, to 0.50%-0.75%. The committee also indicated that additional hikes can be expected in 2017 and into 2018, with some analysts anticipating the fed funds rate will reach 4% by 2020.

## Indicator Trend Line

| Indicator | Trend | Comment |
|---|---|---|
| **U.S. GDP** | Unchanged | Third quarter GDP growth was quite strong at 3.5%, but the fourth quarter appears to have been more muted. Overall annual growth remains in the 2% range, with few signs of dramatic moves up or down in the near term. |
| **China GDP** | Unchanged | China's official GDP figures show modest growth in the 6% annualized range, as targeted by the government. Regional and sector data indicate that the slowdown might be more acute, but on the whole China's economy continues its multi-year adjustment to lower growth and more domestic consumption. |
| **E.U. GDP** | Unchanged | There is little indication of dramatic moves outside of the low-growth band that the Eurozone has been stuck in for years. Politics this year may augur for economic policy changes, but for the time being, there is little sign that the Eurozone will emerge from its low gear anytime in the near future. |
| **U.S. Interest Rates** | Increasing | The Federal Reserve at last pulled the proverbial trigger and raised short-term rates by 25bps in its December meeting, and it also signaled as many as three more rate increases in 2017. That said, market rates came back somewhat after a sharp rise in late fall. It seems probable that rates will drift modestly up over the near term. |
| **Global Interest Rates** | Unchanged | The United States is an exception to the global regime of low interest rates and highly accommodative central banks. Yes, some such as India and Brazil have higher rates and different dynamics, but on the whole slow growth, low inflation, and easy money remains the global norm. |
| **U.S. Employment** | Unchanged | Recent jobs reports have shown modest job gains and continued low headline unemployment below 5%. The pace of gains has notably slowed, however, with little increase in labor force participation. |
| **U.S. Inflation** | Increasing | In relative terms, inflation is creeping up, but in absolute terms, inflation remains very low indeed, barely 2% annualized. With energy prices on the rise and potential tax and federal stimulus programs, there may be a tad more inflation ahead. |
| **Housing** | Unchanged | Housing continues to be the slow and steady of the U.S. economy, which should be taken as a positive sign after the excesses that preceded the last financial crisis. |
| **Wages and Income** | Unchanged | Recent government and private sector data shows some gains in low-end retail wages as well as continuing municipal adaptation of minimum wage laws, but the pace of overall gains remains glacial. |

= Increasing = Unchanged = Decreasing

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