2017 Midyear Outlook

Seize the Opportunities

2017 Targets as of May 31, 2017

ECONOMY

Year-end forecasts	
U.S. GDP growth *Rolling four quarters*	2.3%
U.S. unemployment rate *End of period*	4.5%
U.S. inflation *12-month average*	2.4%
Global GDP growth	3.3%

Overview

- A strong labor market and solid household spending should support U.S. economic growth. We do not expect a recession in the coming 12 months.
- Economic growth is gaining strength in Europe, Asia, and Latin America.
- Modest U.S. dollar appreciation is likely in the coming 12 months, which could support earnings for non-U.S. companies.

Investor Watch

- Slow-but-steady U.S. economic growth and low inflation should continue into 2018 and support equity markets while leading to higher bond yields.
- Overseas, economic conditions are improving, but the U.S. dollar still should appreciate modestly through year-end 2017.
- The U.S. economic expansion is maturing, but a recession between now and mid-2018 remains unlikely.

EQUITIES

Year-end forecasts	
S&P 500 Index	2230-2330
S&P 500 operating earnings per share	$127
Russell Midcap® Index	1750-1850
Russell Small Cap Index	1270-1370
MSCI EAFE Index	1790-1890
MSCI Emerging Markets Index	935-1015

Overview

- We expect U.S. earnings growth to continue, but expect prices to fade in the second half as valuations appear to be extended.
- International earnings are improving, but political uncertainties remain.
- We are overweight the Consumer Discretionary, Financials, Health Care, and Industrials sectors.

Investor Watch

- Volatility is likely to rise as the Federal Reserve (Fed) slowly raises rates.
- Investors should rebalance equity portfolios to avoid overweighting asset classes and sectors that have run higher since November.
- In the U.S. we favor Large Cap Equities and Mid Cap Equities. We remain underweight Small Cap Equities

FIXED INCOME

Year-end forecasts	
10-year U.S. Treasury yield	2.25-2.75%
30-year U.S. Treasury yield	3.00-3.50%
Fed funds rate	1.25-1.50%

Overview

- We increased our 10- and 30-year U.S. Treasury yield targets in recognition of a maturing economy.
- As open Fed leadership positions are filled, changing views on policy may provoke increased volatility.
- We recommend that investors consider moving up in credit quality.

Investor Watch

- We favor underweighting high-yield bonds while moving up in credit quality.
- Investors looking to better position a fixed-income portfolio for a rising-rate environment should consider premium bonds.
- A stronger dollar and higher global rates are significant headwinds to international developed fixed-income markets. We continue to strongly reiterate our underweight to this asset class.

REAL ASSETS

Year-end forecasts	
West Texas Intermediate *crude-oil price per barrel*	$40-50
Brent *crude-oil price per barrel*	$45-55
Gold price	$1,150-1,250
Dollar/euro exchange rate	$1.01-1.09

Overview

- Commodity bear super-cycles have averaged 20 years, and this one is in its sixth year. Sideways price action is likely in the coming years.
- Of the different commodity sectors—energy, agriculture, industrial metals, and precious metals—we believe that agriculture offers the best long-term potential.

Investor Watch

- We recommend an overweight position to REITs and an underweight to commodities.
- We expect gold to trade like other commodities—stuck in a wide price range.
- MLPs should perform more in line with the overall market.

ALTERNATIVE INVESTMENT STRATEGIES

Overview

- As inflation and interest rates normalize, security selection could become more important, which should benefit Alternative Investments.
- The removal of monetary stimulus should result in increased equity and fixed-income volatility. As late-cycle volatility increases, we favor tactical, trading-oriented strategies.

Investor Watch

- We favor tactical, strategies such as Low-Net Equity and Relative Value, which should benefit from higher stock and bond market volatility as well as greater dispersion among securities.
- We continue to see opportunities within Structured Credit.
- The growing number of debt downgrades and increased risk of default should create opportunities for Long/Short Credit and Distressed Credit strategies.

There is no assurance that any of the target prices or other forward-looking statements mentioned will be attained. Any market prices are only indications of market values and are subject to change.

Top Five Recommendations for the Second Half of 2017

Reduce Certain Riskier Asset Classes

We see risks among U.S. equities and lower-quality bonds.

Broaden Your Geographic Exposure

Fundamentals have improved in many overseas markets.

Increase Nontraditional Sources of Return

Investors may benefit from exposure to real assets and alternative investments.

Be Agile with Tactical Shifts

Short-term allocation shifts can aid performance and help manage risk.

Reconsider Your Active/Passive Mix

We recommend a balanced approach that includes a mix of strategies.

Risk Considerations

All investing involve risks, including the possible loss of principal. Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially **foreign markets**, are volatile. Their values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Foreign markets have additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. **Mid- and small-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, call, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield** (junk) bonds have lower credit ratings and are subject to greater risk of default and greater principal risk. **Real assets** are subject to the risks associated with real estate, commodities, MLPs and other investments and may not be suitable for all investors. The **commodities** markets, including investments in physical commodities such as gold, are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. **MLPs** may be sensitive to price changes in oil, natural gas, etc. and other risks including the volatility associated with the use of leverage; volatility of the commodities markets; market risks; supply and demand; natural and man-made catastrophes; competition; liquidity; market price discount from Net Asset Value and other material risks. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions. **Alternative investments** trade in diverse complex strategies that are affected in different ways and at different times by changing market conditions. Strategies may, at times, be out of market favor for considerable periods with adverse consequences. Alternative strategies may expose investors to the risks associated with short selling, leverage, the use of derivatives and other investment practices that are extremely speculative and involve a high degree of risk.

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