2017 & BEYOND

A World of Possibilities

During the last quarter of 2016 one thing became undeniably clear - the scene is set for uncertainty in 2017. From an economic standpoint, times are good in the U.S. Unemployment is steady near pre-recession lows, wage growth is picking up, and inflation is getting close to the Fed's 2% target. These positive trends are projected to continue into 2017, with expectations having been reinforced by the Fed's recent rate hike and more aggressive stance on raising interest rates, announcing the projection for three interest rate increases in 2017. Regardless of what happens during the coming year, the strong stance by the Fed should be seen as a positive sign for our economy. According to a survey conducted at the end of 2016 by the Securities Industry and Financial Markets Association (SIFMA), forecasts for real growth in GDP and core inflation in 2017 are 2.2% and 1.8%, respectively.

Turning away from the Fed, changes in the White House will create questions about policy change. While some of the items at the top of President Trump's agenda are not directly related to economic growth, his stances on infrastructure spending and tax cuts should have positive effects on the economy. The late 2016 rally in U.S. stocks and sell-off in bonds following Trump's surprise victory reflect market expectations of higher growth and inflation. On the other side of the spectrum, there are concerns that Trump's trade and immigration policies could hamper growth. The market will be watching closely what happens in the days following his inauguration in January.

In the international arena, all eyes will be on the U.K. as Prime Minister Theresa May has until March 31, 2017 to officially invoke Article 50 and formally announce Britain's exit from the European Union. If Article 50 is invoked, the separation process will conclude in 2019. Higher trending global interest rates could pose a threat to foreign countries that have failed to trim balance sheets in recent years, as higher interest rates could lead to a debt build-up in those countries. Rising oil prices, on the other hand, could boost profitability in heavy oil exporting countries. They could also likely benefit the commodities allocation in the alternatives asset class.

While the large number of unknowns in 2017 could fuel greater volatility, we remain focused on the long-term implications. Higher interest rates mean initial declines in bond prices, but bonds are self-healing in the way that losses are offset by higher yields going forward. Higher future yields suggest higher forward-looking bond returns than what current yields suggest. For example, Savant's 20-year forward-looking return estimate for intermediate-term bonds is 4.2%, but the current yield for an intermediate-term bond index is 2.4%. Furthermore, our estimate is much lower than historical bond returns which should be an important consideration for financial planning purposes. It is also important to lend consideration to the risk-return tradeoff between bonds and stocks. For example, our long-term expected return range for large cap global stocks is 7.5-9.0%; the cost of higher returns will be higher volatility relative to bonds. The third major component of our portfolios is alternatives for which our forward-looking return estimates range from 5.5% to 7.5%. The return range is fairly wide because the asset classes we implement are very different from one another, adding an important diversification element in portfolios.

The future holds many possibilities and risks, but that also means opportunity. Our diversified portfolios are built to weather all market environments. If inflation is higher than expected, inflation-protected bonds help protect principal and income. If corporate tax rates are cut, stocks could get an earnings boost. If interest rates trend higher, short- and intermediate-term bonds should adjust to the higher rates much quicker than long maturity bonds. As new policies, regulation, and legislation come to fruition, we remain steadfast in our philosophy to evaluate what the long-term implications are for investment portfolios and act accordingly.

Contact Savant to obtain information regarding our Forward Looking Returns methodology.

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