» INVESTMENT STRATEGY INSIGHTS JAN: 2017

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MAKING AMERICA A GREAT PLACE TO DO BUSINESS AGAIN

A quick verdict was reached after the US election that Trump was a "net" positive for the markets due to: 1) regulatory rollback; 2) lower taxes; and 3) an infrastructure spend. This was offset by one negative: trade friction. We drilled down on each.

Regulatory rollback. For the second year running, the top concern in PwC's 19th Annual Global CEO Survey was overregulation, cited by 79% of CEOs. It was No. 3 just three years ago at 62%, and mentioned by only 41% of CEOs in PwC's first survey. Yet for relief in 2017, "repeal" is quickly giving way to "roll-back." Legislation takes time, yet the zeal with which existing regulations are implemented can be softened more quickly within the regulatory bodies. In 2017, expect regulatory roll-backs in the energy area and delays where existing rules have yet to go into effect (like the implementation of the Volcker and Fiduciary Rules). Over four years, expect regulation on US business to decline materially, removing the apparent wet blanket that had been placed upon growth and profitability. Such a visible change in direction can affect business behavior and markets sooner, by boosting business confidence and capital spending soon. Bank of America CEO Brian Moynihan recently noted a post-election rise in animal spirits among corporate clients, citing an increasing desire to draw upon their bank lines.

Lowering taxes. Comprehensive tax legislation is too vast for 2017. For those expecting stepped up consumer spending in 2017, individual tax rates will likely not be addressed until 2018. Repatriation of overseas cash and cutting corporate tax rates are the priorities. Lowering the corporate statutory rate from 35% to 20% will help small cap value stocks the most (with effective tax rates over 30%) and large cap growth stocks the least (with effective tax rates closer to 12%). If passed by year-end, these could be made retroactive to the beginning of 2017. While old preferences like interest deductibility are unlikely to survive, new ones like border adjustability (which favors domestic content) will take their place.

Infrastructure. Infrastructure is "not prioritized for 2017," according to Trump's new chief of staff. Legislation in 2018 starts shovel-ready projects in 2019. These will either take the form of an infrastructure bank or public-private partnerships. Either keeps spending off the income statement with respect to the federal deficit.

Trade. Expect the bark to be worse than the bite. Border adjustability in the context of lowering the corporate tax, combined with business-friendly regulation, is designed to incent business to stop leaving the US. Trump's administration is shaping up to be possibly the most business-seasoned in history. To us, this suggests practicality over any particular philosophy with respect to trade. Everything will be a negotiation, though the bark will come first.

The net impact. We expect a meaningful net plus to world growth, yet with more growth tilted toward the US. Border adjustable taxes will force the US dollar to rise further to offset any advantage. For traders, markets may be a little ahead of themselves. But for intermediate-term investors, Making America a Great Place To Do Business Again is likely to have far more to it than what is currently priced in.

DIFFERENCES OF OPINION

THE WHOLE SHALL BE GREATER THAN THE SUM OF ITS PARTS:
PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. As a multi-asset firm with investment professionals in nearly two dozen countries, we have a special platform to elevate and nurture debate across investment teams and regions. Such debate hones in on our internal differences of opinion in an attempt to develop well-rounded views within PineBridge, seeking an edge on other market participants. The objective of our Investment Strategy Insights meeting is that all our teams will contribute to, and benefit from, the firm's investment strategy ecosystem.

ABOUT THIS REPORT

Once a month, investment leaders from our Global Multi-Asset, Equities, and Fixed Income teams meet to share information, opinions, and viewpoints. They are joined once a quarter by our Alternative Investments teams. This cross-asset class discussion allows us to learn from differences of opinion.

THE PINEBRIDGE MULTI-ASSET SERIES:

CAPITAL MARKET LINE
Quarterly five-year forecast of relative risk and return across asset classes.

MULTI-ASSET STRATEGY
Monthly asset class convictions and risk positioning.

INVESTMENT VIEWS & CONVICTION SCORE (CS)

Economy

Markus Schomer, CFA, Chief Economist, Global Economic Strategy

CS 2.50 (unchanged)

The November Purchasing Managers' Index (PMI) for developed markets improved to the highest levels in more than two years; if sustained, this would indicate more synchronous global improvement. Growth trends are also improving in major emerging markets. China showed robust November economic activity, and higher oil prices are improving Russia's growth prospects. One hitch to this narrative is the adverse effect of demonetization in India. We continue to expect global growth to accelerate in 2017, though global economic policy uncertainty is running high, increasing the risks to our outlook. Greater certainty about business-friendly US reforms might improve our conviction score.

Rates

Roberto Coronado, Senior Portfolio Manager, Developed Markets Investment Grade

CS 3.00 (unchanged)

Higher US growth and inflation expectations, plus a surprisingly hawkish Fed, have driven a further selloff in US Treasuries. We believe the market is overly optimistic about the impact of expected policies on the US economy. Also, it will be difficult for Treasuries to decouple further from low rates in the other developed markets. Although we continue to expect US rates to trade in a lower range (1.75%-2.25%) in the medium term, potentially higher year-end volatility is keeping our score on hold. Given recent Treasury volatility, we advocate an overall neutral position, favoring the five- to seven-year part of the curve and a cautious long-end position, given the risk of further steepening. Because more European Central Bank (ECB) support seems likely, we advocate long Europe versus short US rates. Treasury Inflation-Protected Securities remain attractive versus nominal Treasuries over a six- to 12-month period. We prefer the five- to 10-year part of the curve.

Credit

Steven Oh, CFA, Global Head of Credit & Fixed Income

CS 2.50 (-0.50)

Higher near-term growth expectations should drive credit markets and further spread compression in 2017, likely through current fair value levels in many assets. Reduced new issuance supply should benefit the technical environment. We believe markets may test post-crisis low spreads in first-quarter 2017. We favor leveraged finance over investment grade and emerging market (EM) corporates. We prefer loans versus high yield but in the short term (about 60 days) maintain a favorable view on high yield because spreads could tighten further while loans have hit a convexity ceiling. Although EM is becoming more attractive, potential near-term volatility merits caution.

Currency (USD Perspective)

Anders Faergemann, Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 3.50 (unchanged)

We think resumed US dollar strengthening is predicated on higher growth prospects, widening yield differentials versus the rest of the world, and the perceptions of Trump-led fiscal stimulus and restrained Fed monetary policy. Technical resistance has been cleared for the US dollar index, providing a signal for it to rise another 5%-8% broadly. The yen is again the world's favorite funding currency, with the Bank of Japan focused on yield curve control and fiscal policy measures likely inadequate to spark sustainable economic growth. Higher yields elsewhere may lead Japanese pension funds to buy more foreign bonds, boosting the yen's appeal. A break below the recent 1.05-1.15 range in the euro and dollar paves the way for a bigger adjustment toward parity and beyond. The ECB might welcome a weaker euro with political risk creeping higher and premature talk of bond market tapering.

CONVICTION SCORE (CS)

Investment team views on how portfolios should be positioned for the next six to nine months.

1 = Bullish 5 = Bearish

Change from prior month is indicated in parentheses.

INVESTMENT VIEWS & CONVICTION SCORE (CS)

EM Fixed Income

Steve Cook, Senior Portfolio Manager, Co-Head of Emerging Markets Fixed Income

Risk assets have largely stabilized following November's post-US election selloff. US Treasury yields continue to grind higher, and we still see little to change our current conviction level in EM sovereigns and corporates. The impact of Trump's new policies is hard to predict, but tax cuts should improve consumption and benefit EM finished goods exporters such as China and Mexico. We're still waiting for tangible evidence of growth in some key EM economies, with a focus on Brazil, China, and Russia.

USD EM (Sovereign and Corp.)

CS 3.25 (unchanged)

Local Markets (Sovereign)

CS 3.00 (unchanged)

Multi-Asset

Deanne Nezas, FSA, MAAA, Portfolio Manager, Multi-Asset

CS 2.20 (unchanged)

We believe we have exited the post-crisis liquidity trap regime and entered a growth regime. Initially, this was subtle, triggered by the end of US private sector deleveraging and fiscal expansion in China. In the US, we think regulatory rollbacks, tax cuts, and privately financed infrastructure spending will also stimulate growth. Although an outright global trade war could offset these positives, we see a more muted cold war over trade. Our convictions are in small caps, which are more insulated from trade issues; value styles, which will benefit from economic acceleration; US financials to hedge rising rates; and select emerging markets, such as Brazilian debt and Indian equities.

We recommend positioning for growth, favoring equities in select markets. We find select exposures in the US most attractive: financials, as a hedge against rising rates and benefiting from regulatory rollback; small caps, benefitting from tax cuts and insulated from the expected global trade lull; and value equities. Japan remains attractive, particularly with recent yen weakness. We have conviction in India and Indonesia in EM. For fixed income, rising US rates have pressured EM debt and foreign exchange. However, we retain conviction in Brazil local bonds, with inflation set to fall over the intermediate term, leading to falling rates. In alternative investments, because a shakeout is underway in hedge funds, we recommend reducing already underweight positions.

Global Equity

Graeme Bencke, ASIP, Portfolio Manager and Head of Equity Strategy

CS 2.75 (unchanged)

We believe US and global markets are in a period of transition that will widen the disparity between winners and losers and might increase volatility. Following the US election, we have seen sharp gains across nearly all sectors. Looking further ahead, however, the Fed's December hike and 2017-2018 rate forecast suggest a transition to a more normalized market with lower stock and sector correlations. Potential policy overhauls in areas including tax, trade, and industry regulations could enhance disparity and lead to greater market volatility. Ultimately, we expect the incoming administration's policies to be pro-growth and positive for markets.

Global Emerging Markets Equity

Andrew Jones, CFA, Portfolio Manager and Head of Equity Research, Global Equities

CS 2.50 (unchanged)

While Trump shock continues to course through emerging market equities, we find increased opportunities given valuations, lowered expectations, and fundamental progress. US yield increases and uncertainties over trade have weakened EM currencies, but supply chains are not easily dismantled, and structural improvements (or forward movement) in markets such as Brazil and India provide a constructive view over a 12-month horizon. China presents a near-term concern because a rapid rise in local rates, as well as a combination of capital outflow pressure and weakness in non-US dollar currencies (euro, yen, pound, and EM), has led the renminbi to drift downward in line with its target basket.

Quantitative Research

Sheedsa Ali, CFA, Portfolio Manager and Head of Quantitative Equity Alpha Research
Haibo Chen, Quantitative Analyst, Quantitative Research

We expect higher inflation in 2017. One hundred years of data show rising inflation is generally a tailwind for value strategies. Mean reversion of value should continue, with spreads still wide. We recommend fundamental investment styles for value, quality, and size. Technical styles – favoring price momentum and low volume — are already implicit factor timing strategies, with time varying loadings to fundamental styles.

The US Market Cycle Indicator (MCI) improved to neutral, with a steeper yield curve and tighter credit spread. On corporate credit, both investment grade and high yield were slightly richer in the short end compared with long-term averages. We favored banking, basic industry, technology, and insurance. We disliked REITs, consumer non-cyclical, natural gas, and electric. In EM credit, we liked Brazil, Russia, and Croatia, and disliked South Africa and Israel. In rates, we expected the yield level to decrease in the US and UK, increase in Japan, and remain unchanged in Europe; slopes to flatten in the US and UK and steepen in Japan; and curvature to increase in Europe and the UK but stay flat in the US and Japan.

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