The Investment Outlook For 2017:
A Global Transformation

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An Inflection Point in
Global Economics and Politics Means…
An Inflection Point In Markets

In 2016, many political and economic trends reached a top or bottom, and changed direction.

Economic and Psychological Trends Reverse

Disinflation fears fade

Secular stagnation fears fade

Commodities bottom

Interest rates bottom and bonds top after a 30-plus-year bull market in bonds

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Interest Rates – About to End Their Long Decline?

Political Trends Reverse

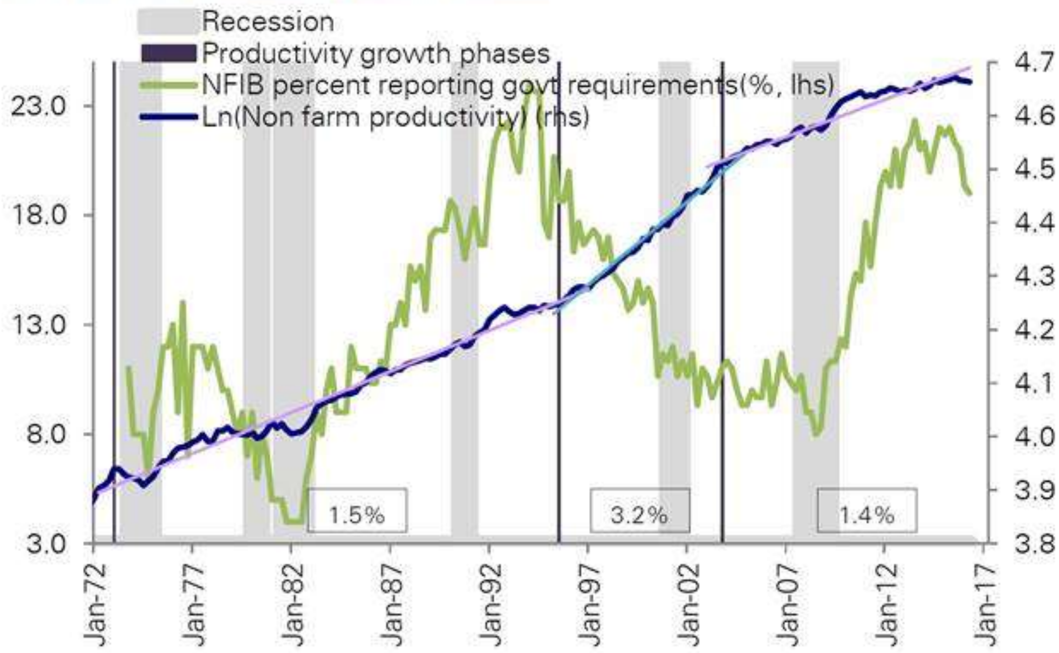
Back-to-back, the two previous administrations made large increases to U.S. regulatory burdens…

One permitted a substantial increase in regulatory bureaucracy in exchange for the funding of its foreign policy expenses (i.e., wars)…

The other pursued a high-tax, high-regulation response to the financial crisis, suppressing business and consumer optimism and causing record-low capital investment and productivity growth after the Great Recession.

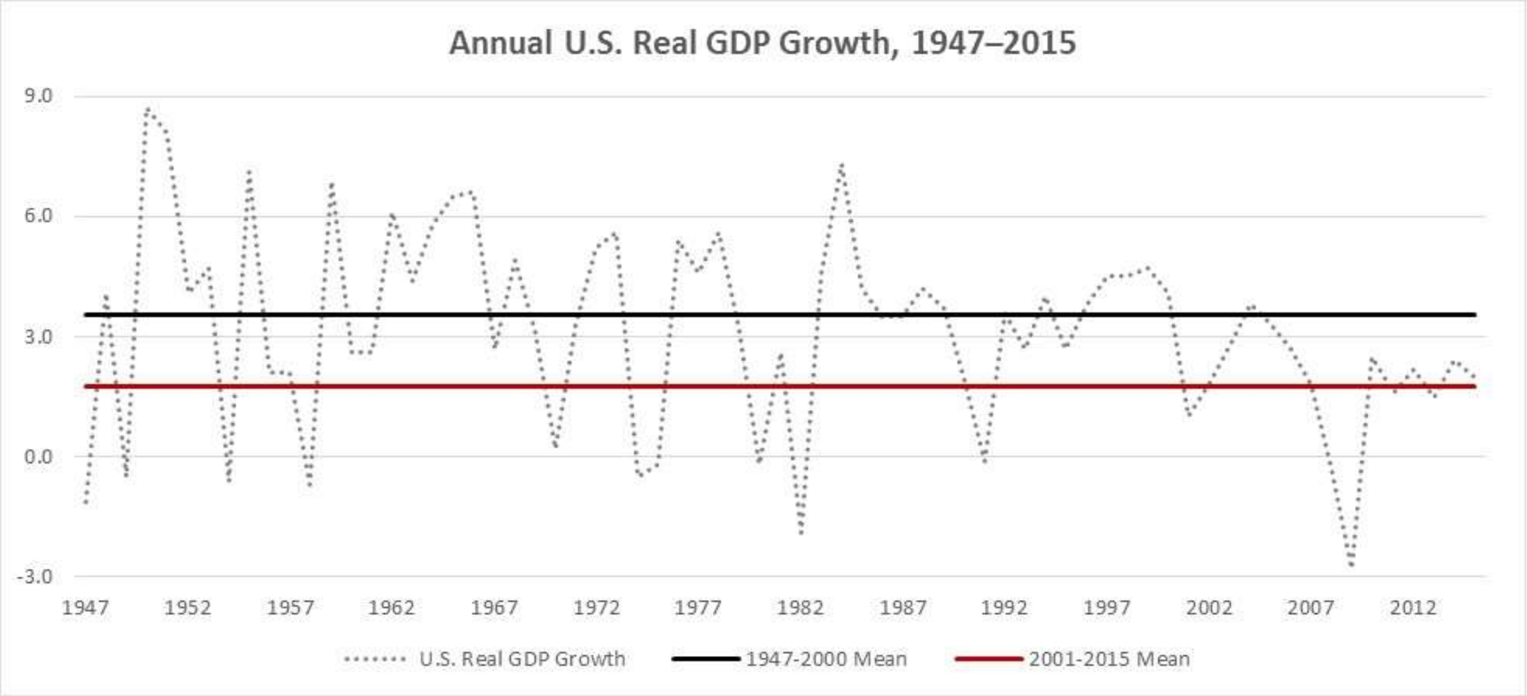
Rising regulations have correlated with lower productivity growth…

Figure 11: Government requirements look to have played some role in driving the different productivity growth phases



Source: BLS,NFIB, Haver, Deutsche Bank

And the last two administrations saw trend GDP growth decline sharply from the long-term average.



The New Landscape In 2017:
A Fundamental Change

A turn in U.S. economic fundamentals… reinforced by a projected turn in U.S. fiscal policy.

From high-tax to low-tax
(Although tax cuts may currently be in jeopardy)

From regulation-as-solution
to *deregulation*-as-solution

From idealism and academic understanding
to pragmatism and "skin-in-the-game" understanding

Small and new businesses are the most important engine of economic growth, employment growth, and productivity growth.

Most job creation over the last 30 years has come from businesses employing fewer than 50 people, including many start-ups.

**Small-business optimism rose in December at the fastest pace since the Reagan administration.
It remains high.**

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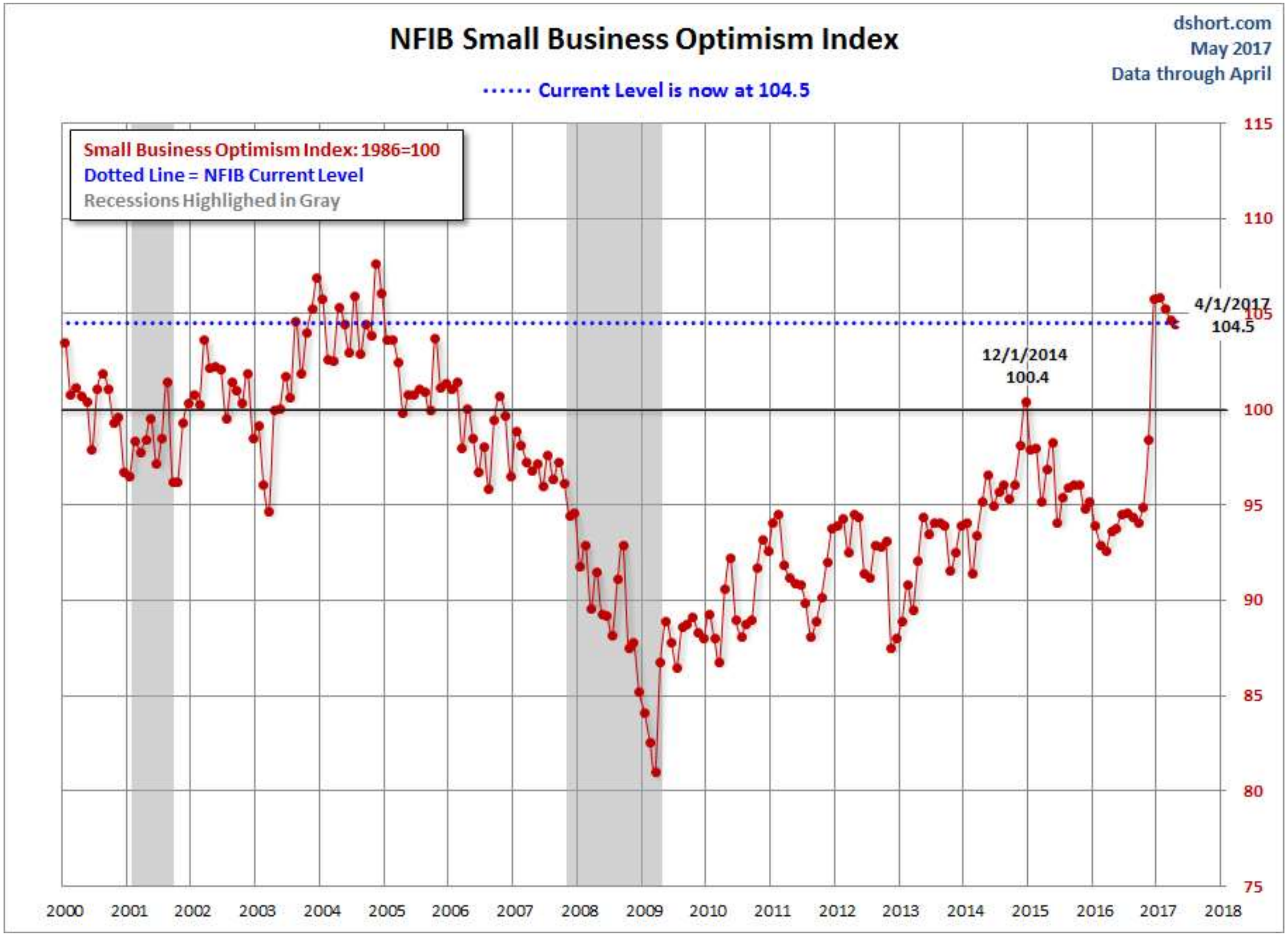

The new administration says that they are focused on supporting business, restoring trend GDP and productivity growth, encouraging capital investment, and creating jobs.

The economic and psychological environment has changed.

We believe that investment strategy must also change.

The key is tax reduction: if it happens, stocks will rise; if it doesn’t, stocks will fall.

**Since the financial crisis,
extraordinary monetary policy has increased
the correlation of stock prices:
all the components of indices have tended
to move together more and more closely.**

The new environment will be one in which differentiation in investment performance once again becomes the norm: differentiation of specific sectors and industries, and differentiation of specific stocks.

Investors who have relied on index funds, rather than on the selection of industries and individual stocks, will miss opportunities for profit.

In 2017, the broad indices – S&P 500, Dow Jones, Russell 2000, NASDAQ, and others – may rise…

But that rise will conceal strong outperformance by some sectors, industries, and individual stocks…

And strong underperformance by others.

Investors must be prepared to identify the correct sectors, industries, and companies in which to invest.

Our style selects sectors and industries from the top down on the basis of large-scale social, economic, political, and technological trends...

And then finds specific stocks on the basis of bottom-up fundamental examination of a company's position and growth prospects.

Current Potential Winners

1. **Buy European and emerging-market stocks with rising earnings that can benefit from a "reversion to the mean." Many ETFs are available for Europe and emerging markets.**

2. **In the U.S., buy disruptors that can claim market share from companies that have taken advantage of the public purse: for example, social media and advertising, semiconductors and storage, e-commerce, artificial intelligence, connected vehicles, internet of things.**

3. **For income-producing stocks which can survive higher interest rates, some REITs and MLPs; some emerging-market bonds. For example, Intel [INTC]*, Colony NorthStar [CLNS]*, Magellan Midstream Partners [MMP], Brazilian, Indian, and/or Mexican bonds.**

* *Owned by GIM for clients/principals; may buy or sell at any time.*

4. **Inflation is returning to the developed world; buy gold and gold shares on dips.**

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Current potential losers:

Companies that sell to the Federal government (particularly pharmaceuticals and biotechnology), which may see profits challenged by the new administration's negotiators.

Companies that do a lot of business with countries where contentious trade renegotiation could occur.

Companies that resist "America first" policies.

To sum up:

Opportunities abound for investors in 2017 as we enter a new environment.

Look for the beneficiaries of disruption.

Don’t follow the indices; dig deep to find the countries, sectors, industries, and companies that will be differentiated.

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In addition to our investment management services, we publish a weekly *Market Commentary* offering a global perspective on both short- and long-term social, political, technological, and economic trends, and their significance for investors.

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