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INVESTMENT STRATEGY QUARTERLY

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Investment Strategy Quarterly is intended to communicate current economic and capital market information along with the informed perspectives of our investment professionals. You may contact your wealth manager to discuss the content of this publication in the context of your own unique circumstances. Published April 2017. Material prepared by Raymond James as a resource for wealth managers and investors.

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INVESTMENT STRATEGY COMMITTEE RECAP – MEETING HELD ON MARCH 1, 2017

Economic and financial market headwinds for the next six to 12 months include political uncertainty, a strong dollar and protectionism. Top tailwinds include potential tax reform, earnings growth, a low interest-rate environment and positive sentiment overall.

U.S. ECONOMY – Scott J. Brown, Ph.D., Chief Economist, Equity Research

- "Economists generally increased their 2017 to 2018 gross domestic product (GDP) forecasts following the election, but not by a lot. While the labour market has grown closer to full employment, it's unclear how much slack remains. Business fixed investment has some room to run, but the consumer is what drives the overall economy. Labour market constraints and moderately higher inflation should be a restraint."

- "A rollback of regulations is seen as business-friendly, but despite one-party control of the White House and both chambers of Congress, added infrastructure spending and large-scale tax reform will be difficult to achieve."

- "Tailwinds include reduced regulation, improved business sentiment, and an improved global economy. Headwinds include possible missteps on foreign trade and immigration policy, which would lead to supply chain disruptions, further limit labour force growth, and create some volatility in exchange rates."

- "The Federal Reserve is in the process of normalizing monetary policy and Chair Yellen has indicated that the pace of rate increases should be faster than in the last two years. The removal of policy accommodation is a sign that officials are more comfortable with the economic outlook."

INTERNATIONAL – Chris Bailey, European Strategist, Raymond James Euro Equities* (unless otherwise noted)

- "In Holland coalition building involving an effective political circling of the wagons of all of the more mainstream, pro-Europe parties will help keep the large populist party out of power. That would be the first stage in a positive domino effect on Europe."

- "We are starting to see inflows back to Europe, and I think this is very positive. Elections in places like Holland and France could induce further inflows if the populists don't gain control, and I don't think they will. With this virtuous circle of inflows pushing the euro up even further in value, cheap European stocks, and corporate earnings growth along with very loose European Central Bank policy should lead to outperformance over the rest of the year."

- "The bottom line is this, I would be favoring domestic plays in Europe including the UK. Brexit is a two-year scenario with lots of technicalities and its impact on the market – that's really a backend of 2018, early 2019 situation in my view."

- "I would say in Europe, small caps have experienced a bit of a valuation anomaly because larger-cap companies have benefited more from the weak euro and the weak pound. There is greater value there with the potential for those parts of the market outperforming if Europe, overall, did a little bit better and the euro appreciates."

- "Aside from European equities, I have a sense of opportunity across other parts of the world as well, particularly in emerging markets of Asia, etc."

- "We have an overweight to non-U.S. markets, as they are doing quite well this year. The big theme last year was U.S. earnings growing at mid-single digits year-over-year, depending on where you are looking. But, in Europe and Japan, earnings grew at low double-digit rates, giving you twice the earnings growth relative to the U.S. While developed markets may not be cheap, they are relatively inexpensive compared to the U.S."

  – Nicholas Lacy, CFA, Chief Portfolio Strategist, Asset Management Services

U.S. EQUITY

- "We've transitioned from an interest-driven secular bull market where interest rates come down and price-to-earnings multiples expand to an earnings-driven bull market. We had the earnings trough in the second quarter of last year, earnings flipped positive in the third quarter, and comparisons in the first and second quarter of 2017 are going to look terrific."

  – Jeff Saut, Chief Investment Strategist, Equity Research

- "Equities may have limited upside in the next two to three months, but there are few signs that they are in for major trouble. Bonds will likely have their periods of outperformance as well, and seem to be out of favor at the moment, which may make for a good time to buy for diversification."

– **Andrew Adams, CMT**, Senior Research Associate, Equity Research

- "This is a market that wants to continue to push the envelope to the upside and we are going to continue in this phase. From a longer term, bigger picture perspective, in a market that has been running eight years and has gone from a 10 multiple to 20

INVESTMENT STRATEGY COMMITTEE MEMBERS

Each quarter, the committee members complete a detailed survey sharing their views on the investment environment, and their responses are the basis for a discussion of key themes and investment implications.

Andrew Adams, CMT, Senior Research Associate, Equity Research

Chris Bailey European Strategist, Raymond James Euro Equities*

Scott J. Brown, Ph.D. Chief Economist, Equity Research

Robert Burns, CFA, AIF® Vice President, Asset Management Services

James Camp, CFA Managing Director of Fixed Income, Eagle Asset Management*

Doug Drabik Senior Strategist, Fixed Income

J. Michael Gibbs Managing Director of Equity Portfolio & Technical Strategy

Nick Goetze Managing Director, Fixed Income Services

Peter Greenberger, CFA, CFP® Director, Mutual Fund Research & Marketing

Harry Katica, CFA Senior Vice President, Director of Private Client Research

Nicholas Lacy, CFA Chief Portfolio Strategist, Asset Management Services

Pavel Molchanov Senior Vice President, Energy Analyst, Equity Research

Kevin Pate, CAIA Vice President, Asset Management Services

Paul Puryear Director, Real Estate Research

Jeffrey Saut Chief Investment Strategist, Equity Research

Scott Stolz, CFP® Senior Vice President, PCG Investment Products

Benjamin Streed, CFA Strategist, Fixed Income

Jennifer Suden, CAIA Director of Alternative Investments Research

Tom Thornton, CFA, CIPM Vice President, Asset Management Services

Anne B. Platt, AWMA®, AIF® – Committee Chair
Vice President, Investment Strategy & Product Positioning, Wealth, Retirement & Portfolio Solutions

Kristin Byrnes – Committee Vice-Chair
Product Strategy Analyst, Wealth, Retirement & Portfolio Solutions

multiple, we are getting a little dear, and we are robbing potential gains from down the road and whatever comes out of D.C."

– Michael Gibbs, Managing Director of Equity Portfolio & Technical Strategy

FIXED INCOME

- "Central banks have been a major influence on interest rate markets over the last couple years. I think it's interesting that now Trump seems to be more influential in what the market does. It's a major shift how these influences are now based on headlines rather than fundamentals."

  – Doug Drabik, Senior Strategist, Fixed Income

- "The bond market is saying "hey, things might get bumpy here for a couple of years…but that can also be an opportunity. Municipals, I think, are a screaming buy. They are still cheap."

  – Benjamin Streed, CFA, Strategist, Fixed Income

- "Municipal bonds, in particular, reacted negatively to the Trump election. Fears of changing tax rates, fiscal spending, and reflation all conspired to send muni yield ratios over 100% of Treasuries. This has historically been a strong buy signal for tax-free bonds. We believe this time is no different."

  – James Camp, CFA, Managing Director of Fixed Income, Eagle Asset Management*

REAL ESTATE – Paul Puryear, Director of Real Estate Research, Equity Research

- "Renting still has momentum. But when interest rates rise, mortgage rates will go up as well. It matters – 25 basis points matters in housing. So, housing is not going to lead us to higher growth as it has done in some cycles."
- "We need to get more income to the consumer, and we need more houses. However, if you own a house, depending on the neighborhood, more than likely the value is going to go up."

ENERGY AND OIL – Pavel Molchanov, Senior Vice President, Energy Analyst, Equity Research

- "The recent drop in oil prices reflects Saudi Arabia's publicly expressed displeasure with the rest of OPEC (and Russia) for their poor level of compliance with the agreed-upon production cut. As a result, the market has become more skeptical about an extension of the agreement beyond mid-year."
- "Oil prices are also weighed down by a strong dollar and still high levels of refined product inventories."
- "Reasons for our optimism in further price recovery toward cyclical highs of $70/Bbl in 2017 include the likelihood of further supply declines this year in several non-OPEC geographies (China, Mexico, Colombia), ongoing supply outages (Libya, Nigeria, Venezuela), and a broadly upbeat picture for global demand."

ALTERNATIVE INVESTMENTS – Jennifer Suden, Director of Alternative Investments Research, PCG Investment Products

- "Across the board, this past year was challenging for the more liquid alternative investment strategies, both in terms of performance and asset gathering."
- "The active versus passive management debate is certainly a key issue in the industry. We continue to see signs that point to active management coming back into play."

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Brexit: The Timetable for the Next Two Years... and Beyond?

Chris Bailey, *European Strategist, Raymond James Euro Equities**

"Very few conflicts in the history of the world have been satisfactorily concluded according to a published timetable, because you lose all flexibility in dealing with your opponents" William Hague

Let's be clear, Brexit is a political conflict only, but William Hague's observation about published timetables feels very applicable to the next couple of years – and quite possibly beyond. The theatre surrounding the writing and delivery of the Article 50 letter notifying the EU Council of the UK's intention to leave the European Union on 29 March, in the wider scheme of things, is a mere initial sideshow. Similarly, any emotions contained within the letter or in the days following its receipt should not be over-interpreted. The Brexit discussions are most certainly a marathon and not a sprint.

For investors, there are three key periods for Brexit related discussions. Conveniently, they fall neatly into this calendar year and the following two. Let's get the crystal ball out and describe them.

2017 – establishing the framework

Anyone who has followed the seemingly annual discussions around the restructuring of the Greek debt burden knows that the European Union loves to take everything to the wire. Before negotiation and any settlement however, comes process… and the European Union loves putting in place the correct structure before any substantive negotiations can even begin.

If the 29th March was the letter delivery date and an opportunity for the UK government to give some early views, then 29 April is the first proper opportunity for the European Council Summit to give some views back… but they probably will not, due to the proximity of the final round of the French Presidential elections.

Probably more important – before focus refocuses on that inevitable late June/early July Greek debt negotiation – will be a June summit of the UK and the rest of the continuing European Union to agree the process for negotiation: essentially when and how discussions are to be conducted.

No doubt, following William Hague's earlier observation, any discussion sequencing timetable will by the autumn have already fallen awry, potentially skewered initially by the provocative concept of the bill given to the UK for exiting…

2018 – negotiations

By the dawn of next year, concerns about the hoped-for timetable will be legion. Every day will bring new stories about what is going on in the arranged negotiations and every utterance by anyone even remotely involved will be appraised for insight.

Probably around the middle of 2018, the fear factor will be most apparent. With less than a year remaining until the end of the mooted two year discussion period, the pressure will be on all sides given the economic risks of the UK slipping towards a disruptive trade regime akin to an average World Trade Organisation member and not a previously integral European Union member. Exporters and importers on both sides of the English Channel are likely to be agitating.

The penny (or euro cent) will drop after the summer holidays that the original two year timetable is not going to be adhered to. And then the focus will move to stage three.

The Brexit discussions are most certainly a marathon and not a sprint

*An affiliate of Raymond James & Associates and Raymond James Financial Services.

HOW WILL THE UK ECONOMY FARE AFTER BREXIT?

	Better (%)	Worse (%)
July 2016	39	42
August 2016	35	47
November 2016	31	48
March 2017	29	52

Source: IHS Market Polling

2019 (and beyond) – next steps

What is your least favourite Brexit related term? Perhaps it is 'Brexit' itself. I would wager that by two years' time, it will be 'transitional arrangement' – essentially professional politician speak for a fudge agreement.

Forget wholesale ratification of new UK specific policies, and anticipate a pragmatic series of arrangements which in some cases will look rather akin to the existing European Union wide legislation. In short, anything that stops either a legislative logjam in the UK Parliament or which creates too much of an uncertainty gap.

Two years time will roll around quicker than anyone could ever believe. However it is likely to a period that correctly will be characterised as the end of the beginning of the current UK-EU relationship and not the beginning of the end. Geographic proximity, the lobbying powers of global businesses and pragmatic choices will leave Brexit in limbo by the end of the formal two year 'divorce' period with meetings, discussions and legislative fine-turning carrying on until surprisingly deep into the 2020s.

Breaking up is never easy to do… and then there is the small challenge of how the financial markets perceive all of this. The Brexit debate will not be far from our minds up to and beyond the end of the current decade.

> What is your least favourite Brexit related term?
>
> Perhaps it is 'Brexit' itself

KEY TAKEAWAYS:

- Brexit discussions are most certainly a marathon and not a sprint
- Before negotiation and any settlement however, comes process
- Concerns about the hoped-for timetable will be legion
- Look out in time for 'transitional arrangement' discussions

2017 Themes to Watch

EARNINGS GROWTH

Earnings are the driver of the equity markets over the long term. Over the past couple of years, stagnant earnings growth played a major role in the equity market's failure to advance. Subsequently, positive earnings growth in the third quarter of 2016 played a role in the uptrend in stock prices.

J. Michael Gibbs, *Managing Director of Equity Portfolio & Technical Strategy,* and **Joey Madere**, *Senior Portfolio Analyst, Equity Portfolio & Technical Strategy,* share thoughts on earnings before and after the U.S. presidential election.

"... we still see healthy growth in the years ahead, especially if fiscal reform transpires."

CURRENT EARNINGS ESTIMATES

Post-election, stocks rallied further fueled by investor enthusiasm that earnings will surge even higher in the coming years due to fiscal stimulus. Although our estimates are below current consensus forecasts, we still see healthy growth in the years ahead, especially if fiscal reform transpires.

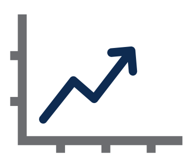
SINCE 1954
S&P 500 EARNINGS UP **6.2%** CAGR*

S&P 500 PRICE INDEX UP **7.4%** CAGR*

Prior to the election, we were comfortable with the consensus estimate for sales growth in 2017 of 5%; however we used more conservative margin assumptions due to our expectations of rising interest rates and wages. The result was a base case earnings estimate of $128 in 2017 (8% growth from 2016)**. This was also in line with the downward trend in consensus earnings revisions that has taken place in recent years, which would likely bring the consensus earnings estimate of $131 closer to our more conservative assumptions.

Post-election, our conviction that these estimates will be met has increased, as the odds of earnings growth picking up have improved on the heels of anticipated fiscal stimulus. However, until these policies come closer to being passed, we are holding our $128 earnings estimate steady.

PRIOR TO ELECTION
2017 RAYMOND JAMES CONSENSUS ESTIMATE FOR SALES GROWTH **5%**



2017 RAYMOND JAMES BASE CASE EARNINGS ESTIMATE **$128**

8% GROWTH FROM 2016

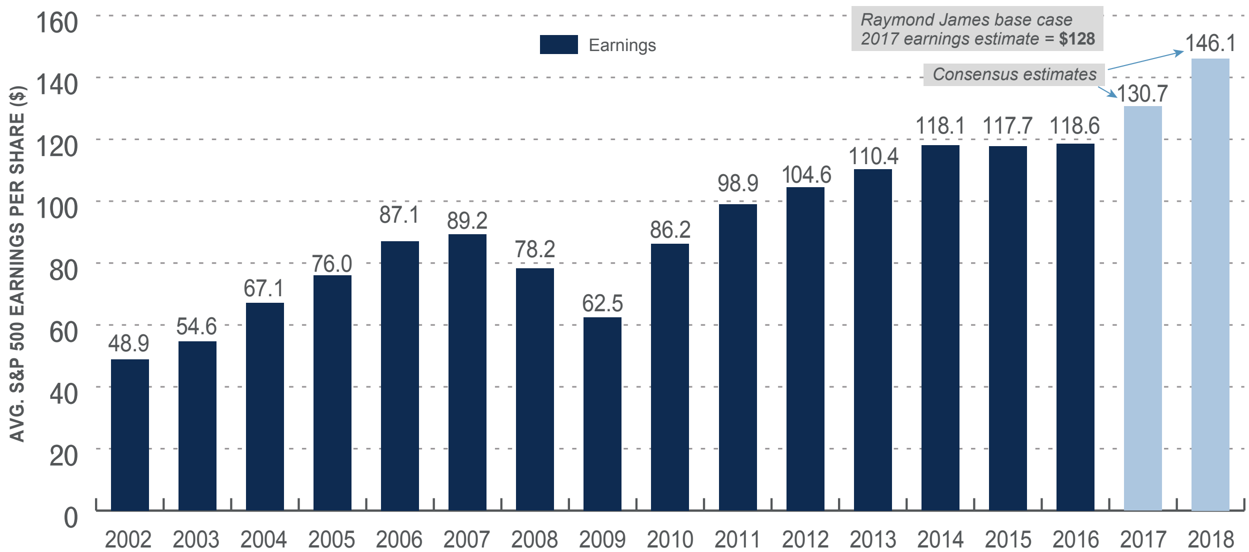
POST-ELECTION
2017 RAYMOND JAMES BASE CASE EARNINGS ESTIMATE **$128** HOLDING STEADY FOR NOW

TAX REFORM CONSIDERATIONS

We feel that cutting the U.S. corporate tax rate to 20% has the potential to boost S&P 500 earnings by an additional 6% to 7%. Please note that although the statutory U.S. corporate tax rate is currently 35%, the S&P 500's effective tax rate is roughly 27% as tax-savvy companies have used accounting rules to their advantage. A tax reduction to 20% may not be possible given the negative impact such a large reduction could have on the deficit and debt levels. If the tax rate declines to 25%, the benefit is approximately 3%.

* Compound Annual Growth Rate
** The earnings estimate of $128 is the earnings per share of all of the companies represented by one share of the index.

EARNINGS PER SHARE



Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

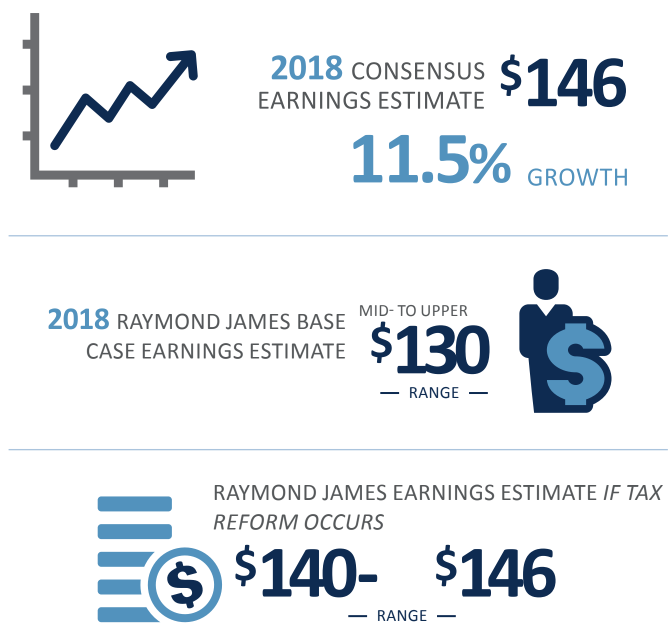
Also, a favorable repatriation tax (assumed 10%) would likely result in a large amount of the estimated $2.4 trillion in overseas cash coming back to the U.S. While that cash can be used on capital expenditures and reducing debt, it is also likely that a portion would be spent in the near future on mergers and acquisitions, stock buybacks, dividend increases and other shareholder-friendly actions. In our estimate, we see that potential increases in share buybacks from the repatriated cash could improve earnings by an additional 1% to 2.5%. The limitations of our calculations regarding lower tax rates and repatriated cash should not be minimized given the many unknowns. Other possible changes, such as interest deductibility and depreciation, could alter our estimates substantially. With tax reform being the more likely outcome, as opposed to easy-to-implement tax cuts, the process may take some time.

INFRASTRUCTURE AND OTHER UNKNOWNS

Increased infrastructure spending, another potential boost to the economy under the Trump administration, is often a slow process as well. Therefore, the increase to earnings will likely not be fully felt until 2018. It is also important to note that a stronger U.S. dollar would be a headwind to earnings, as would tighter trade policies; so there remain downside concerns as well.

A LOOK AHEAD AT EARNINGS

For 2018, the consensus estimate for earnings is $146 (11.5% growth), however we conservatively estimate 2018 earnings in the mid to upper $130 area. Similar to our 2017 earnings estimates, our 2018 estimates are also held back (relative to consensus) due to elevated profit margins, the likelihood of rising interest rates and wages, and the tendency for forward estimates to be revised lower over time. If tax reform does occur, earnings could reach the $140 to $146 area in 2018. In this scenario, applying a P/E of 19x (vs. 20x currently) would result in the S&P 500 reaching a level in the upper 2,600s to mid 2,700s (or 10% to 15% above current levels over the next two years). Because of this, (and due to lofty valuations) the timing and size of actual fiscal policies will be a key influence on earnings growth and market movements in the coming years.



2017 Themes to Watch (cont.)

ECONOMIC GROWTH: FISCAL POLICY

The stock market rallied following the November election, largely on the belief that fiscal stimulus, in the form of tax cuts and a large-scale infrastructure spending package, would spur growth. However, achieving these goals is certain to be more difficult than was initially assumed.

Scott J. Brown, Ph.D., *Chief Economist, Equity Research*, provides some clarity around the complicated topic of policy change.

INFRASTRUCTURE SPENDING

Both presidential candidates proposed about a trillion dollars in added infrastructure spending. The difference was in how that would be paid for: tax increases (Clinton) or a public/private partnership (Trump). Democrats in Congress have long pushed for more infrastructure spending, but Republicans in the House are expected to resist adding to the federal budget deficit. Privatization could be a partial solution. While Europe has privately-owned airports, most Americans do not want to pay fees for using private roads and bridges, and a public/private partnership is unlikely to deliver funds to where they are most needed (water and sewage systems, for example).

> "Republicans could try to cut taxes through budget reconciliation, which would require only a simple majority but, in using this process, only one extra thing can be done per calendar year – Hence, tax cuts may be more likely to show up in 2018."

CHALLENGES OF TAX REFORM

Tax cuts seem simple enough. This is what Republicans do – and with one-party control of the White House and both chambers of Congress – this is a critical opportunity. However, broad tax reform, which is what the country needs, is extremely difficult. By law, tax legislation must originate in the House. However, a tax reform bill would require 60 votes in the Senate, and Republicans hold a 52 to 48 majority. Getting eight or more Democrats on board is possible, but the end result would likely be watered down. There are several tax issues embedded in the Affordable Care Act. Failure to repeal/replace the ACA means that true tax reform has become even more difficult. A simple lowering of business and individual tax rates is possible, but on a much smaller scale than was expected earlier.

Tax cuts do not pay for themselves and would have to be offset through elimination of deductions and cuts in spending. This is where things get sticky. One early proposal is to eliminate all deductions except for research and development, home mortgage interest payments and charitable deductions. The U.S. has one of the highest business tax rates in the world, but the effective rate (what firms actually pay) is a lot lower. The U.S. could develop an efficient and fair tax system, but it can't start from scratch. The greatest difficulty in tax reform is that no one wants to give up their deductions.

Cutting spending is also not so easy. You can't do anything about interest payments on the federal debt. If you want to increase defense spending and leave Medicare and Social Security untouched, there isn't enough left to cut. You could reduce nondefense discretionary spending to zero and the U.S. government would still run a deficit. Moreover, spending on entitlements is rising as the baby-boom generation moves into retirement. Something has to give.

Congress could institute a border adjustment tax (BAT), taxing imports, to make up about half of the revenue that is expected to be lost after business tax rates are reduced, but there will be enormous challenges. The Europe Union has indicated that it would make a case before the World Trade Organization if the U.S. imposes a BAT. U.S. businesses, especially manufacturing, use parts and supplies from around the world. Setting up the apparatus to collect BAT revenues will take time, and the transitional costs to firms would be huge (firms have already expressed concerns to Congress).

It seems fiscal stimulus is still possible, but the road is likely to be long and bumpy.

Global Uncertainty: A Balanced Perspective for Worldwide Concerns

Chris Bailey, *European Strategist, Raymond James Euro Equities**, infuses cautious optimism into worldwide concerns with a reminder not to let fear get the best of us.

> "Uncertainty and expectation are the joys of life. Security is an insipid thing."
> – William Congreve

Have you heard the old market adage that a pessimist can always find a reason to be pessimistic and an optimist can always find a reason to be optimistic? This is why uncertainty and expectation are the inevitable backdrops to any engagement with the world's financial markets. The key for successful financial market investment over time is to acknowledge these attributes and avoid falling excessively under their spell – whether overly optimistic or pessimistic.

> "The "Brexit implementation" debate continues apace and, while important decisions concerning the start of the implementation of the divorce proceedings will be taken in upcoming months, the big policy and trade decisions won't take place until at least 2018."

A WORLD OF EASE OR LATENT UNCERTAINTY?

> "Great minds discuss ideas; average minds discuss events; small minds discuss people." – Eleanor Roosevelt

How should we interpret today's world? Even outside of the hopes and fears swirling around the new American administration, the global media is full of European election and regional stability concerns, as well as discussions about political shifts and economic reform in the world's emerging markets. While this sounds like a series of challenges, the strong performance of the majority of the world's stock markets for over the past six-plus months and the suppressed nature of global volatility measures argue for a more positive tune.

So, what is the reality?

Change expressed as innovation is generally a good thing. Although the current status of the financial market environment appears to be generally firm, when you scrape away the surface, an underlying latent uncertainty exists. This uncertainty is surrounding the impact of the pervading current economic policy idea of unorthodox central bank stimulation, commonly referred to as quantitative easing. For the last eight years, low interest rates and policy programs printing money to buy government bonds have been the background music for global investors. Cheap and more plentiful money has unsurprisingly buoyed financial markets, but the lack of engagement and benefit for those individuals who do not own substantial amounts of financial assets has not been so clear.

This tension begs us to address the grubbier world of events. Outside of the United States, there is only one place to start: Europe.

EUROPE: A RISE IN POPULISM

> "In remembering the appalling suffering of war on both sides, we recognize how precious is the peace we have built in Europe since 1945." – Queen Elizabeth II

"Europe" remains enigmatic to many, including plenty of Europeans. At its heart was a collaborative response to the two large wars of the 20th century that scarred its landscape and population. Progressively, since the 1960s, this has manifested itself in an ever-deeper economic and political linkage. Ultimately, the 21st century was born in the creation of the euro and, in the formation of the European Union, a broader free-trade bloc that could look North America squarely in the face.

Europe did not have a good last decade, with economic growth intermittent and increasing discontent with the European ideal. In late June, this resulted in the never-fully-aligned UK deciding to vote to leave the European Union. The "Brexit implementation" debate continues apace and, while important decisions concerning the start of the implementation of the divorce proceedings will be taken in upcoming months, the big policy and trade decisions won't take place until at least 2018.

*An affiliate of Raymond James & Associates, Inc., and Raymond James Financial Services, Inc.

Global Uncertainty: A Balanced Perspective for Worldwide Concerns (cont.)

In Europe, the beguiling events for investors are also political and centered on important elections in the mainstream euro zone nations including The Netherlands, France and Germany. The lack of individual-level electoral engagement has manifested itself in a clear rise of more populist political thoughts and political parties. A decade ago, Europe was not threatened by a cadre of overtly anti-euro and anti-establishment political leaders and parties. The French presidential election is undoubtedly the key, given not only the country's pre-eminent role in Europe but the poll-leading status of the Le Front National candidate. If the Brexit vote indicated an alternative path for European nations, the election of an overtly anti-euro French president would threaten to blow apart the coordination of the last couple of generations.

> "There are always reasons to be both pessimistic and optimistic. The intelligent investor acknowledges both but also trusts in the ingenuity of humans over time. Today, back opportunity … carefully."

Fortunately, at least for this year, this remains an unlikely outcome. Move past the newspaper headlines, and there is just enough residual faith in the European ideals to keep the continental European nations together with the current euro and European Union structures. Additionally, the European economy – right on cue – has started to improve a little and brought with it a little more hope that election results will ultimately prove to be a "pulling away from the precipice," helping to make Europe's lower valuations and underperforming markets more of an opportunity than a threat during 2017. However, the debate is not over. If European political leaders fail to engage with the broader electorates over the rest of the decade, then it is unlikely that the UK would be the only country to leave the European Union.

CHINA: SO FAR, JUST ABOUT SO GOOD

> "China adopted a capitalist system in the 1980s, and they went from a 60% poverty rate to 10%." – Bill Gates

Unlike in Europe, uncertainty in Asia tends to be not so much about an electorate looking to punish an incumbent government, given the lack of opposition in Japan and the one-party regimes in other influential countries such as China and North Korea. The Middle Kingdom is, however, evolving the composition of its leadership in the fourth quarter of this year, including a new chief executive overseeing Hong Kong – where the elections may be free but the candidate selection is certainly not.

President Xi – fresh from his seemingly successful first meeting with President Trump – does not appear to be under pressure. The Chinese system is in the midst of an unprecedented change with its first stage captured nicely in Bill Gates' sentiment. The next stage centers on supply side-reform or, more directly, making China a fully functioning and modern 21st century economy as it evolves from an agricultural and manufacturing focus to one which fully encompasses the service sector. Targets and data from early-March's National People's Congress – including unchanged and "in line with hopes" economic growth numbers – indicate that the sensitive mix of stability and reform is still being pursued. If Europe's leaders are being reactive, China's are being more overtly proactive, hoping that a creaking banking system and high corporate debts do not get caught up in the transition.

We should all hope they are successful in their policy balancing act. So far, just about so good.

OTHER EMERGING MARKETS: CAUTIOUS OPTIMISM

> "Opportunity often comes disguised in the form of misfortune, or temporary defeat." – Napoleon Hill

Of course, other international events in 2017 can be cited. These include North Korea's current proclivity to launch test missiles,

discontent and conflicts in the Middle East such as an Iranian presidential change as well as the ongoing status of Brazil's and Argentina's recovery from recessionary conditions. Given the combination of firm markets and the integrated nature of the global macroeconomic system, the world can catch a cold from a sneeze that originated from an unlikely source. For example, the late 1990s Thai economic crisis worked its way through Asia and ultimately into the broader world in the early years of this century.

Still, let's end where we began. There are always reasons to be both pessimistic and optimistic. The intelligent investor acknowledges both but also trusts in the ingenuity of humans over time. Looking at the evidence, opportunity appears to be greater this year than threat in the world outside of the United States, and a slightly weaker U.S. dollar would likely deepen such trends and absent other risks surfacing. Today, back opportunity … carefully.

KEY TAKEAWAYS:

- Europe: If the Brexit vote indicated an alternative path for European nations, the election of an overtly anti-euro French president would threaten to blow apart the coordination of the last couple of generations.
- China: The Chinese system is in the midst of an unprecedented change. The next stage centers on making China a fully functioning and modern 21st century economy as it evolves from an agricultural and manufacturing focus to one which fully encompasses the service sector.
- China: Targets and data from early-March's National People's Congress – including unchanged and "in line with hopes" economic growth numbers – indicate that the sensitive mix of stability and reform is still being pursued.
- This year, opportunity appears to be greater than threat in the world outside of the United States and a slightly weaker dollar would likely deepen such trends and absent other risks surfacing.

U.S. Equities: The Trump Effect?

Andrew Adams, CMT, *Senior Research Associate, Equity Research,* shares how the U.S. equity market has responded to recent events and outlines future risks and opportunities.

There are very few certainties when it comes to the stock market, but one maxim investors have usually been able to count on is that the market hates uncertainty. That is, of course, the common refrain any time some ambiguity enters the market and causes stocks to sell off. The phrase has become so widely used by pundits over the years that we all simply assumed it to be true.

> "It's expected that business tax cuts will take precedence over income tax cuts, and reforming how we tax the foreign profits of U.S. firms will be a key focus."

EMBRACING UNCERTAINTY

However, ever since Donald Trump's election win, investors have faced almost nothing but uncertainty, and yet they have hardly flinched, bidding the S&P 500 up over 15% without so much as a 2% dip until late March. This buying stampede has left many scratching their heads as to how the market can possibly perform this well despite a constant barrage of negative headlines and with few details about the new administration's policies. It's a fair question.

Still, the market has had every chance to show its concern and, not only does it seem unfazed by President Trump, it has actually embraced him and, by extension, the uncertainty that comes along with him. Consequently, the essential questions to ask now are:

- How much of the post-election rally can be directly attributed to this newfound optimism surrounding the Trump administration?
- How long can that optimism last before the market requires real action out of Washington instead of just policy talk?

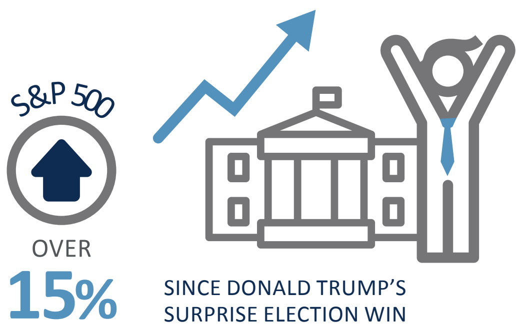
Attempting to answer these questions likely brings even more uncertainty into the equation, but those answers will go a long way in determining how the stock market behaves over the next couple of years.

A JUMP IN CONFIDENCE

The good news is that while the jump in confidence over the last few months has certainly aided in powering stocks higher, it's not the only reason behind the steep climb. The U.S. economy appeared to be improving even before the election last year, and the data since then has largely supported our view that the economy is trending in the right direction. This expansion has been reflected at the company level, as well, with corporate earnings growing once again after an almost two-year earnings recession that made for some very difficult markets from 2014 to 2016.

Investors do seem to feel that things can get even better with some of the Trump administration's expected policies, but the market may not exactly be "baking in" all of those expectations quite yet. For one, research analysts have not raised their aggregate earnings estimates for the S&P 500 in 2017 and 2018, due to the fact that we still know very little about what policies will be passed and in what form, which makes it hard to speculate on how they will impact a company's bottom line. Moreover, the market also appears to understand that it is going to be a while before the policies will have an impact on the U.S. economy and corporate earnings, with stocks holding onto their gains even as Treasury Secretary Steven Mnuchin recently reiterated that the administration does not expect to see effects on the economy until late 2018.

So, when you add these details up, it supports the view that much of the strength over the last few months could be because of an improving economy and earnings landscape, with the optimism surrounding the proposed stimulus measures just the icing on the cake instead of the cake itself. Simply having the election behind us did remove some of the uncertainty, and if overall conditions can continue to improve and help fundamentally support the stock market, it may buy Trump some additional time to get his policies up and running.

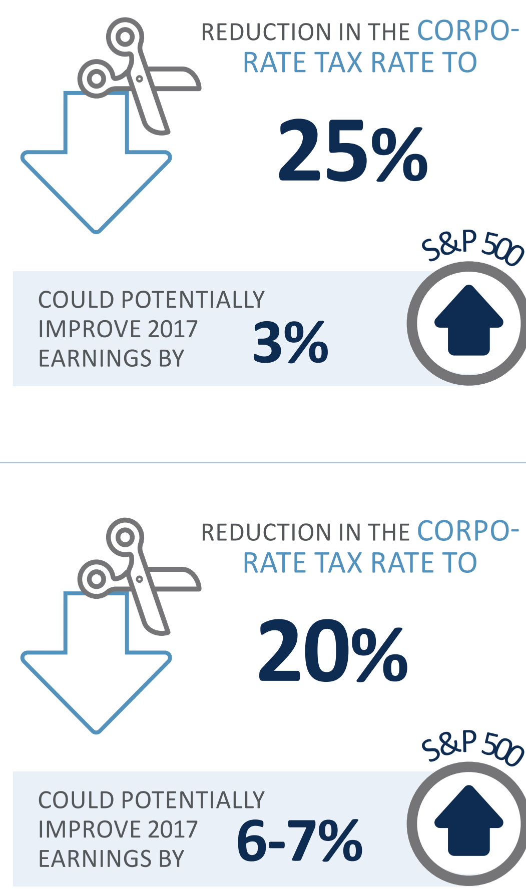


OPPORTUNITIES IN TRUMP POLICY

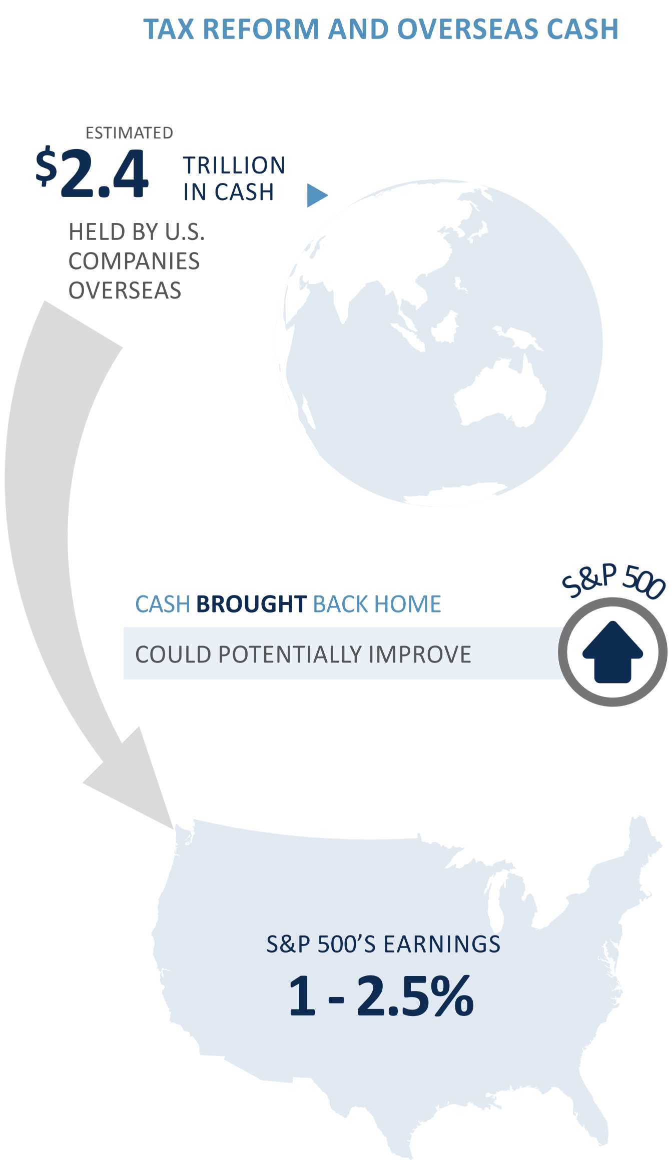
To be sure, those policies could potentially have the power to make things even better than they already are, which is a big reason why investors and companies have been so excited for the direction we may be headed. Measures such as tax reform, infrastructure spending and cutting regulations should, in theory, be very good for a company's bottom line and boost aggregate earnings for the market. Raymond James estimates that cutting the U.S. corporate tax rate to 20% has the potential to boost S&P 500 earnings by an additional 6% to 7%. Even if the tax rate declines to 25%, the benefit is approximately 3%.

There is also an estimated $2.4 trillion in cash held by U.S. companies overseas that could be repatriated back into the country if given a one-time window to do so as part of the tax reforms. Raymond James estimates that potential increases in share buy backs and repatriated cash could improve earnings by an additional 1% to 2.5%. Therefore, just the tax reforms alone could end up boosting corporate profitability and make valuations appear a little more reasonable. Then, when one adds the possible $500 billion to $1 trillion in infrastructure spending that the Trump administration has promised and the rolling back of regulations, companies could end up doing even better, which is why the rally has turned into a buying stampede at times.

RAYMOND JAMES ESTIMATES



U.S. Equities: The Trump Effect? (cont.)



> "Until the stock market begins to worry, investors are probably best served by not trying to outsmart Mr. Market. While President Trump may be a wild card, don't let politics get in the way of your portfolio."

DOES RISK TRUMP OPPORTUNITY?

There are certainly risks, even if the market does not appear to be concerned with them at the moment. While the market has so far been willing to give President Trump time for his policies to take shape, it is almost certain that something will be delayed until next year. Congress may be unwilling to do everything Trump wants done due to budget concerns, and ideological differences, which may lead to a fight with Congress on some of the policies he has discussed.

While the market is obviously optimistic that the policies will be implemented, the risk is that it either takes too long to happen or that Congress will only be willing to pass sanitis+ed versions of the policies, something to which the market may not respond well. And even if the policies do end up meeting expectations with respect to timing and structure, with an economy already approaching what the Federal Reserve (Fed) considers "full employment" and inflation expectations beginning to pick up, there is a chance some of the policies may have a limited impact on the economic data while only adding to inflation concerns. Consequently, the Fed may feel compelled to raise interest rates faster than expected, which may work to counter the fiscal stimulus measures proposed by Trump.

HEADED IN THE RIGHT DIRECTION?

Despite Donald Trump winning the election on a platform to "Make America Great Again," it appears the economy and corporate earnings were already heading in the right direction even before his policies begin to take formal shape. The

anticipation for those policies has most certainly increased optimism, and they do have the potential to make conditions even better, but there still exists tremendous uncertainty that the market must digest over the coming months.

Until the stock market begins to worry, investors are probably best served by not trying to outsmart Mr. Market since there are no rules that stocks must go down. As we have witnessed lately, even the "rule" about the market hating uncertainty did not end up being as hard and fast as we thought. So while President Trump may be a wild card, don't let politics get in the way of your portfolio.

KEY TAKEAWAYS:

- The market has had every chance to show its concern and not only does it seem unfazed by President Trump, it has actually embraced him and, by extension, the uncertainty that comes along with him.
- The U.S. economy appeared to be improving even before the election last year, and the data since then has largely supported our view that the economy is trending in the right direction.
- While the market is obviously optimistic that the policies will be implemented, the risk is that it either takes too long to happen or that Congress will only be willing to pass sanitised versions of the policies, something to which the market may not respond well.
- Until the stock market begins to worry, investors are probably best served by not trying to outsmart Mr. Market since there are no rules that stocks must go down.

Q&A: Confidence, Policy Normalisation and the Importance of Free Trade

Scott J. Brown, Ph.D., *Chief Economist, Equity Research*, provides insight on post-election optimism, Federal Reserve objectives and policy considerations.

The 2017 outlook is seen, by most economists, as a contest of two larger themes. One is the post-election optimism and expectations of pro-growth policies. The other is demographic constraints, the fact that labour force growth has been slowing as the population ages.

Q. HOW DOES CONSUMER AND BUSINESS CONFIDENCE AFFECT ECONOMIC GROWTH?

A. Consumers don't spend confidence. The key drivers of consumer spending are job growth and wage gains, both of which have been quite supportive. However, gasoline prices have risen from a year ago. While nominal (current dollar) wage growth has been trending higher, real (inflation-adjusted) wage growth has slowed significantly. Retail sales appear to have been relatively lackluster in the first quarter.

In contrast, business confidence is a key factor in capital investment. After a year-and-a-half soft patch in business investment, orders for nondefense capital goods began to turn up last summer, and we saw a further leg up after the election. Despite ongoing concerns about Brexit and China's economic transition, the global economic outlook has improved, which is also helpful for the U.S. capital investment outlook.

Business confidence may have also contributed to job gains in early 2017, although we also saw some benefit from mild weather. Job growth is expected to slow as the job market tightens, while we should see a further increase in wage growth.

Q. IS THE TRADE DEFICIT A PROBLEM FOR THE U.S. ECONOMY?

A. Net exports (exports - imports) are a component of GDP, and if we import more than we export, then that subtracts from GDP growth. However, that's simply the national income accounting arithmetic. It doesn't mean that foreign trade is a drag on the economy. Following the North American Free Trade Agreement (NAFTA), the U.S. gained and lost manufacturing jobs, but there was little difference in total. When China joined the World Trade Organization (WTO) in 2000, net U.S. manufacturing job losses picked up. However, roughly half of the factory sector job losses since 2000 have been due to technology improvements. We can produce more with fewer workers. Economists from the left and right support free trade. There will be winners and losers in different industries, and the loss of factory jobs can be devastating for communities, but both countries will be better off overall. U.S. manufacturers rely on parts and supplies from around the world. Putting up trade barriers risks retaliation (counter tariffs on U.S. exports), disrupting supply chains, adding to inflation and hurting job growth.

Q. THERE HAS BEEN MUCH TALK RECENTLY ABOUT THE "REFLATION" TRADE. IS HIGHER INFLATION A SERIOUS THREAT?

A. With the recent improvement in the global economy, there's been some pickup in commodity prices. However, in general, it takes a gigantic increase in the prices of raw materials to have much of an impact by the time you get to the consumer (the exception is the price of oil, which is always a wild card in the economic outlook). There is still plenty of excess capacity in manufacturing, so you're not going to see the kind of bottleneck inflation pressures where firms struggle to keep up with demand. The labour market is the widest channel for inflation pressure, and the trend in wage growth is moderately higher. Nevertheless, Federal Reserve officials will continue to closely monitor the inflation outlook and could react accordingly.

Q. WHAT CHALLENGES IS THE FEDERAL RESERVE CURRENTLY FACING?

A. The Federal Reserve (Fed) has two policy goals: maximum sustainable employment (or equivalently low unemployment) and stable prices (2% inflation in the Personal Consumption Expenditure Price Index). However, following an extended period of unusual accommodation, the Fed's key near-term objective is policy

normalisation, getting the federal funds rate closer to a long-term equilibrium level (provided conditions support that). There is still some slack in the job market and inflation pressures remain moderate, which allows the Fed to move gradually. There was some financial volatility following the Fed's initial rate increase in December 2015. Global financial conditions appear to have weathered the December and March rate hikes with few disruptions. That suggests that the markets are better able to withstand further rate increases.

Fed policymakers see considerable uncertainty about the timing, size and character of possible fiscal stimulus (infrastructure spending and tax cuts), but will wait to see what legislation is enacted before reacting. Monetary policy will remain data dependent, and rate increases may come quicker or more slowly depending on the inflation outlook and how labour market conditions evolve.

Note that for some time there have been two vacancies on the Fed's seven-member Board of Governors, one of which is the vice chair for regulation and supervision. Governor Daniel Tarullo has served in that capacity, but announced his resignation (effective in April). Janet Yellen's four-year term as Fed chair runs through January 2018, and President Trump is not expected to re-nominate her. Vice-Chair Stanley Fischer is likely to leave within the next year or so. Hence, President Trump, subject to Senate approval, will be able to shape the Federal Reserve leadership as he wishes. Following criticism of the Fed during the campaign, many observers expect to see someone nominated for chair who is more hawkish.

Q. WITH THE ECONOMY IN DECENT SHAPE, WHAT KEEPS YOU UP AT NIGHT?

A. The economy entered 2017 in good shape, with few signs of the kind of imbalances that would lead to a recession. There is considerable uncertainty about tax and spending policies, but the economy should do just fine even if we don't get much stimulus. In fact, if the economy is close to full employment, fiscal stimulus would not add to growth and be more likely to boost inflation or fuel an asset price bubble.

The biggest concern is a misstep on trade. Tariffs on foreign goods would add to inflation pressure and would likely lead to retaliation against U.S. exports. While there may be some industries that benefit, neither side wins in a trade war. Since WWII, global trade has been a key factor in cementing world peace. The rise of nationalism (Brexit, etc.) is worrisome, and not just for economic reasons.

KEY TAKEAWAYS:

- Despite ongoing concerns about Brexit and China's economic transition, the global economic outlook has improved, which is also helpful for the U.S. capital investment outlook.
- Following an extended period of unusual accommodation, the Fed's key near-term objective is policy normalisation – getting the federal funds rate closer to a long-term equilibrium level (provided conditions are supportive).
- Global financial conditions appear to have weathered the December and March rate hikes with few disruptions. That suggests that the markets are better able to withstand further rate increases.
- The biggest concern going forward is a misstep on trade. While there may be some industries that benefit, neither side wins in a trade war.

Can the Emerging Markets Remain Hot for the Rest of 2017?

Chris Bailey, *European Strategist, Raymond James Euro Equities**

"This world is clearly emerging before our eyes. The shifts ahead, the opportunities ahead are massive" Carly Fiorina

If you embraced the underperformance of emerging market equities during 2016 then you are likely to be reaping the benefits now, as geographically the emerging markets outpointed all other major asset classes during the first quarter of 2017.

This return to form will be viewed by many as a logical development. The theory is compellingly simple, based on the increasing net wealth of most emerging markets, pushed along by their inherent relative cost competitiveness, expanding urban middle classes, more professional governments and the sensible application of developed world technology. Like most compellingly simple theories it makes a lot of sense strategically but over shorter time periods a lot can go awry.

The relative emerging market malaise of the last few years before recent months was an almost direct corollary of rising US confidence – and a rising US dollar – and lower commodity prices. A strong US economy should be good for the emerging markets, but the higher US dollar pulled up costs at a time when general commodity prices pulled down many emerging markets with significantly sized metals, minerals and/or energy sectors. It was not a perfect storm, but versus the attraction of the US market in particular, investors voted with their feet and sold out, deepening the fear of capital outflow concerns in key emerging markets like China.

There are always reasons – as investors - to be concerned about even the largest emerging markets. Brazil's recession, Russia's sanction issues and India's monetary reform actions were all legitimate reasons during the last year or two to avoid the emerging markets. However, in the investment game of risk and reward, the opportunity set got skewed in a very positive manner.

GDP PER CAPITA 2015

Country	GDP per capita 2015 (to nearest '000 US dollars)
US	55
UK	42
Germany	41
France	35
Spain	26
Poland	12
Hungary	11
Russia	9
Mexico	8
Brazil	8
China	7
India	2

Source: Franklin Templeton, Bloomberg, World Bank

There are always reasons – as investors- to be concerned about even the largest emerging markets

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Moving away from the rise of the middle class and over time enhanced consumption levels, the two key issues that will drive – or not – the emerging markets for the rest of 2017, are first the level of the US dollar and second the actions of US investors. As noted above, a lower US dollar would have the reverse effect of a couple of years ago by typically reducing the burden of dollar denominated debt as well as boosting the demand (via lower prices in emerging market currency terms) for commodities, creating a virtuous positive circle for many emerging market investors. This will not go unnoticed by the big American investors, who currently are usually underweight in their benchmarks in emerging market assets. This just potentially further deepens the aforementioned virtuous circle. Good news then, that the most recent Big Mac purchasing power parity currency index in *The Economist* again showed a large swathe of emerging market names as being the cheapest foreign exchange rates in the world.

> The two key issues that will drive emerging markets in 2017 are the level of the US dollar and the actions of US investors

What it will not be driven by, however, I feel is relative valuation across the whole of the markets. Yes, emerging markets are a little bit cheaper than many other developed markets but dig a little more deeply and sector mix is influential here. Simply put, the higher weighting in typically more lowly valued industrial or commodity sector assets impacts the cross-comparison.

A far better valuation angle would be to find strong performing emerging market listed names that look cheap, all matters considered against their developed market peers. This stock picking scope is undoubtedly the still hidden value within the emerging equity markets.

A muted dollar, continued inflows and mix opportunities equates to a positive backdrop for emerging markets in 2017. I would wager they continue to outperform from their strong first quarter start.

KEY TAKEAWAYS:

- Emerging markets outpointed all other major asset classes during the first quarter of 2017
- A muted dollar, continued inflows and mix opportunities equates to a positive backdrop for emerging markets in 2017
- Stock picking scope is undoubtedly the still hidden value within the emerging equity markets.

Inflation: Is it Back?

Chris Bailey, *European Strategist, Raymond James Euro Equities**

"Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair" Sam Ewing

Inflation has been creeping up both the investor and Central Bank watch-list stealthily over the last months. For the first time since December 2013, UK inflation has busted through the Bank of England's 2% target due to the pincer movement of the falling value of the Pound and – versus a year ago – enhanced input prices driven by higher oil prices.

However, the UK is not alone. The average inflation rate in OECD countries recently rose to its highest level in over five years, driven by both higher oil and food prices, a shift which has not only helped inspire higher US interest rates but even talk that a tapering of the stimulus policies by the European Central Bank could occur before the end of the year.

Inflation has always mattered. Governments since antiquity have noted its capability for reducing the real burden of accumulated debt whilst individuals struggling on non-indexed pensions can vouch for its impact on purchasing power and wealth. Since the early 1980s however, inflation rates around the world broadly have been falling, aided in no small part by the economic reforms initially in the West and then taken up by leading emerging markets like China and India. Funnily enough, increasing the supply side capabilities of the world have helped keep prices generally down. Sometimes it really is all about just supply and demand.

The impact of this has been considerable. Lower inflation rates has helped lead to lower interest rates and lower bond yields, which in turn has helped to drive the stock market boom over much of the last thirty plus years. The price fluctuations and grinding uncertainties of the 1970s – the last period of time with high and volatile global inflation rates – does now feel a completely different world.

The debate today is not about whether a return to the 1970s is imminent or not – despite the best efforts by OPEC to re-establish the credibility of their oil sector cartel. For anyone invested in the global financial markets, a little bit of inflation threatens to upset the world of ultra- low bond yields, ultra-low interest rates and potentially much of the underpinnings for high equity market valuations.

First the good news. The peak of the higher oil price induced inflation is imminent, as oil prices troughed in the first quarter of 2016 and hence progressively over the next few months the year-on-year comparisons become less… inflationary. This is why 'core inflation' measures that take out impacts like energy prices often remain muted and well below the 2% threshold that many Central Banks become concerned at.

Inflation has always mattered. Governments since antiquity have noted its capability for reducing the real burden of accumulated debt whilst individuals struggling on non-indexed pensions can vouch for its impact on purchasing power and wealth

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CONSUMER PRICE INFLATION %			
Country	**2015**	**2016**	**2017e**
Canada	1.13	1.43	1.78
China	1.40	2.00	2.17
France	0.04	0.18	1.17
Germany	0.23	0.48	1.48
Italy	0.04	-0.09	0.83
Japan	0.79	-0.12	0.30
Switzerland	-1.14	-0.43	0.28
UK	0.00	0.70	2.43
US	0.12	1.26	1.86
Average	0.29	0.60	1.37

Source: OECD

The less good news is that this optimistic view rests on some clear assumptions. The first is that the oil price is not going to push back sharply towards the levels of a few years ago. Shale oil provides potential new material supply, but a generalised lack of investment in the industry has the opposite impact of worsening the medium-term supply-demand balance. Oil alone though is unlikely to impact global inflation rates.

A bigger material impact though could come via exchange rates – specifically a higher US dollar, which raises oil and general input costs in a manner that the UK has been impacted by over recent months.

Even this has not been a concern, however. Look at the reaction from the Bank of England to upped inflation forecasts due to the Brexit referendum vote and a lower Pound? They 'looked through' these numbers and said because core inflationary expectations had not yet been impacted – as consumers and businesses remained uncertain and hence potentially important inflationary influences like wages remain quite muted – they were going to ignore the short-term inflation metrics and not respond as classically they should and increase interest rates.

And they are unlikely to be the only ones, with both the Federal Reserve and European Central Bank making similar noises.

Inflation: Is it Back?

These Central Banks look over to Japan – and their crab-style 25 year plus sideways economic movement – and worry that too aggressive a stamping on any fledgling inflation will suppress inflationary expectations at a time of high debt and typically patchy demographics. And given China remains wholly committed to supply side reform and the general application of technology is dis-inflationary the structural inflationary threat may not be so apparent.

Here's the irony, however. All this hope of muted inflation is to quell any fear of even moderately higher interest rates that could hurt economic growth levels in a still indebted world and buoyed asset market prices. This latter group – encompassing high stock markets and rampant major conurbation property prices – is in itself a form of inflation-led redistribution. Any risk of even a little bit of general inflation threatens the underpinnings to these sky high asset prices and stock market values as risk free rates/bond yields push back up, and alternatives like cash in the bank become more compelling.

> Over the next couple of years investors would be wise to remain well aware of the alternative inflation drivers out there

Whilst over time the best investments have the scope via pricing power to offset any general inflation issues, over the next couple of years investors would be wise to remain well aware of the alternative inflation drivers out there. Inflation is not yet a generalised issue but if it is too cold or too hot, then problems are likely to ensue.

Unfortunately, no-one said global investment themes are easy. Anyone worried about volatile weather conditions and hence the scope for higher food prices?

KEY TAKEAWAYS:

- Lower inflation rates has helped to drive the stock market boom
- The average inflation rate in OECD countries recently rose to its highest level in over five years
- Central Banks are currently looking through any shorter-term higher inflation rates
- Inflation is not yet a generalised issue but if it is too cold or too hot then problems are likely to ensure given high asset prices

DISCLOSURE

RAYMOND JAMES®

Head Office Broadwalk House 5 Appold Street London EC2A 2AG
www.RaymondJames.uk.com

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