LPL RESEARCH

MIDYEAR OUTLOOK 2017

Read the full *Midyear Outlook 2017: A Shift In Market Control*

June 2017

MIDYEAR OUTLOOK 2017: EXECUTIVE SUMMARY

The gauges say the growth engine for the U.S. economy and markets is changing. Monetary policy is powering down, business fundamentals are powering up, and fiscal policy and economic growth are on the verge of being taken off standby.

Key Themes

Monetary policy

Slow path to normalization.

Maintaining economic growth without extraordinary central bank support will be key.

Business fundamentals

Now taking control.

A focus on well-run businesses with the potential for earnings gains may favor active management.

Economic growth

Confidence not enough, yet.

Business and consumer confidence has improved, but greater policy clarity may be needed to spur growth.

Fiscal policy

Pro-growth potential, but when?

Fiscal policy support remains likely, but timetable may be pushed back to 2018.

2017 Forecasts

U.S. Economy	Stocks	International Markets	Bonds
Near 2.5% GDP Growth	**6–9% Returns**	**Emerging over Developed**	**Limited Return Potential**

Active management involves risk as it attempts to outperform a benchmark index by predicting market activity, and assumes considerable risk should managers incorrectly anticipate changing conditions.

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U.S. ECONOMY

Near 2.5% GDP Growth

Despite a weak first quarter, we still see U.S. gross domestic product (GDP) growth approaching our 2017 forecast of 2.5%, with potential for further acceleration in 2018. The recent improvement in job growth, with only moderate wage pressure, may allow for consumption growth without the need for an accommodative central bank. Meanwhile, anticipated fiscal legislation may provide further incentives for businesses to invest in the future. Policy uncertainty remains a concern, and greater clarity will be needed to convert increased confidence into economic activity. Improvements in productivity remain the key to better growth and the recent pickup in business spending is a positive development.

STOCKS

6–9% Returns

As investors increasingly trust that the economy can stand on its own without the need of monetary policy support, business fundamentals should take over as the primary market driver. As a result, corporate profits will be increasingly important for stocks. Our confidence that earnings growth will come through over the balance of the year has led us to slightly raise our 2017 S&P 500 Index forecast to 6–9%, up from mid-single-digits previously, driven by: 1) a pickup in U.S. economic growth; 2) mid- to high-single-digit earnings gains; 3) a stable price-to-earnings ratio (PE) of 19 – 20; and 4) prospects for a fiscal policy boost to earnings in 2018.

INTERNATIONAL MARKETS

Emerging over Developed

We are seeing improvements in fundamentals, both economically and in corporate earnings, across international markets. At this point, we prefer emerging markets to developed ones due to faster growth rates and lower valuations. Furthermore, there are still some political milestones yet to go in Europe, like Italian and German elections, as well as the European Central Bank's plan to extend its quantitative easing policy. There is stable growth in most of the emerging market economies, though we remain conscious of risks, most notably the Chinese debt problem.

BONDS

Limited Return Potential

We continue to believe that government policy, central bank policy, and steady economic growth have the potential to push the 10-year Treasury yield higher, and that our year-end target of between 2.25% and 2.75% remains reasonable. Our bias is toward the upper end of the range, and we could see the 10-year Treasury yield rise as high as 3%, should Congress make meaningful progress toward enacting fiscal stimulus. Scenario analysis based on this potential interest rate range indicates low- to mid-single-digit returns for the Bloomberg Barclays Aggregate Bond Index. Despite our expectation for stability in credit markets, tight spreads versus long-term averages limit return potential and warrant caution for investors.

CONCLUSION

It is important for investors to appreciate the implications of a new stock market driver. Much like a portfolio can benefit from diversification, the economy and markets can benefit from different drivers working at different times. As monetary policy powers down, business fundamentals power up, and we wait for fiscal policy to help get the U.S. economy off of standby mode, we hope LPL Research's *Midyear Outlook: A Shift In Market Control* will enable you to identify opportunities that may arise, navigate the challenges that will inevitably come, and help you stick to your long-term investing plan. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

Investing in foreign and emerging markets debt securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio.

Diversification does not ensure against market risk.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond and bond mutual fund values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

INDEX DEFINITIONS

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

This research material has been prepared by LPL Financial LLC.

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