SECOND QUARTER 2017 REVIEW AND OUTLOOK: EXECUTIVE SUMMARY

Portfolio Themes

- **Overweight to Information Technology:** The Information Technology sector is heavily skewed toward large, high-quality firms—a segment we expect to outperform in the later stages of a bull market. The sector should also benefit from robust global IT spending driven by the growing demand for products and services related to mobile, cloud computing and the "Internet of Things."
- **Quality Tilt:** As the bull market progresses, we favor stocks with stronger balance sheets and consistent margins.
- **Underweight to Defensive Categories:** Defensive categories should underperform given our forecast for an ongoing bull market.

Market Outlook

- **European Leadership:** As euroskeptic fears fizzle and renewed gridlock reduces legislative risk, Europe should outperform in the second half of 2017.
- **Falling Uncertainty:** Investor sentiment should continue rising as gridlocked governments elsewhere around the world reduce the likelihood of sweeping legislation.
- **Strong Economic Drivers:** In both developed and emerging markets, economic drivers remain strong. We believe these fundamentals will come to the forefront as sentiment improves.

Global markets continued their rise in Q2, with the MSCI All Country World Index (ACWI) adding another 4.3% — bringing year to date returns to 11.5%.[i] Non-US stocks again outperformed, with European stocks faring particularly well. We see 2017's back half as amplifying early-year trends, and all seems on track for a great 2017 led by non-US stocks.

While Q2 was strong, stocks didn't move straight up. European and Technology shares outperformed in Q2 but experienced some volatility mid-quarter, leading investors to think the year's great start may be unraveling — a myopic viewpoint, in our view. Recent developments look quite typical of US presidents' inaugural years, as we will detail in the full Review & Outlook. Since 1970, when good sector-level data began, the non-US sectors and countries leading in inaugural-year first quarters have outperformed for the full year the majority of the time, frequently gaining steam in the second half. Yet leadership often fluctuates in Q2. In his April 24 column for Britain's Financial Times, Ken called inaugural years' second quarters "relatively quiet compared to the year's back half." History strongly argues Q1 is the guide, suggesting a bright second half awaits the year's early leaders.

The volatility in big Tech companies such as Facebook, Amazon, Netflix and Google — the so-called FANG or FAAMG stocks—looks typical of a quick reversal or countertrend. FANG was mostly a CNBC curiosity until they plunged on June 9, rendering it front-page news on almost every media outlet. Such fast, universal media coverage is typical of short-term moves, not longer-term, lasting negatives. To us, it recalls 2013's short-lived "taper tantrum" over quantitative easing's potential end, 2010's "Flash Crash" and other short lived stories.

In our view, FANG hype is distracting from other, more meaningful developments—chiefly, another year of falling uncertainty, which is right on track. President Trump is filling out his administration to little excitement while accomplishing much less than hoped or feared. Meanwhile, media is overselling the James Comey and Jeff Sessions hearings (which under-delivered), burying more important considerations for investors: After President Trump's five-plus

i Source: FactSet as of 07/07/2017. MSCI All Country World Index return with net dividends, 03/31/2017 – 06/30/2017 and 12/30/2016 – 06/30/2017.

months in office, we have a good sense of his relative political muscle. Businesses and investors largely know what they are dealing with, enabling risk-taking.

While uncertainty is falling somewhat in America, the real nexus is Europe, where euroskeptic fears fizzled. Three months ago, investors were concerned about far-right, anti-euro French presidential candidate Marine Le Pen and her Front National party. But she lost decisively to centrist Emmanuel Macron, whose En Marche party then took a solid majority in June's Parliamentary contest while voters relegated Le Pen to the fringes. Euroskepticism's decline in France and Holland bolstered sentiment, easing fears over radicalism in Italy and Germany. UK political uncertainty ticked up when Prime Minister Theresa May lost her majority in June's snap election, but renewed gridlock should reduce legislative risk, helping clear the fog as the year progresses.

In Emerging Markets, China's recent economic data suggests continued growth, with consumer-related and industrial segments of the economy looking strong. Additionally, index provider MSCI announced it will include mainland Chinese stocks (known as A-shares and traded in Shanghai and Shenzhen) in its Emerging Markets index starting in May 2018. To us, this is largely a symbolic change. While the addition is recognition that China has made some progress in opening up its capital markets, it still has ways to go. India will implement its long-awaited Goods and Services Tax (GST) at the start of July. While it will likely be painful in the short term, the GST would likely have a beneficial long-term impact – a more streamlined tax system should help the government's ability to collect taxes. In Brazil, Michel Temer is now even more deeply embroiled in political scandal. While Temer likely has enough congressional support to block a trial, the scandal is damaging his ability to enact reforms.

While a correction—a short, sharp, sentiment-driven decline exceeding -10%—is always possible and unforeseeable, overall we see lots of potential for the second half to mimic and amplify Q1. Animal spirits are stirring in Europe, where economic data keep improving and beating expectations. Corporate earnings, up in America, are soaring even higher abroad. Strong Emerging Markets growth is boosting export-oriented Asia, especially big Asian Technology companies. Meanwhile, sentiment is still relatively warmer toward America, creating more room for positive surprise elsewhere. As uncertainty melts away and investors appreciate these positives, we believe stocks should enjoy a strong run.

Should you have any questions about any of the information in the Second Quarter 2017 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.

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