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50 Predictions For 2017

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Summary

- In an ongoing effort to frame my views for the coming year, I offer a reprisal of a format that covers 50 predictions for global markets.

- Predictions for U.S. stocks, international stocks, bonds, and the economy point to modest gains for domestic assets and more positive returns abroad.

- I plan to periodically revisit these predictions in 2017 for readers.

I recently recounted My 10 Favorite Articles I've Published, and one in particular stuck out. It was a predictions article for 2013, which I found immensely fun to write and discuss with readers. In that version of the article there were some prescient picks (the Safeway buyout, Hewlett-Packard, financials, and Alcoa as the Dow laggard) as well as some bad misses (EM, the Detroit bankruptcy, the outperformance of CCC bonds, gold miners). Thinking through these predictions was a good way to frame my thoughts for the coming year about many different asset classes, and I encourage readers to attempt the exercise as well.

Given the eventful nature of 2016, I must admit that I am glad that this article was on hiatus. Many events (the commodity sell-off and rebound, Brexit, Trump presidency) were not accurately forecasted by markets. Yesterday's article on 2017 Market Themes, and my previous articles on How It All Goes Wrong in 2017... and Right were used to illustrate what I believed to be the central tendency and potential extremes for capital markets in the coming year. This article will be another effort in framing markets in the coming year, but with more direct predictions and views.

With 2017 shaping up as a pivotal year for financial markets, I am dusting off this format once again. Thoughts, comments, and your own predictions are welcome.

U.S. Stocks

1. After strong gains in the back half of 2016, gains in 2017 for the S&P 500 (NYSEARCA:SPY) disappoint market bulls, returning just 6%.

2. The equal-weighted S&P 500 (NYSEARCA:RSP) outperforms its capitalization-weighted alternative.

3. The S&P SmallCap 600 (NYSEARCA:IJR) outperforms the S&P 500 as domestic-focused small caps outpace large caps once again.

4. Low volatility stocks (NYSEARCA:SPLV) beat high beta stocks (NYSEARCA:SPHB) as the economic expansion priced into financial markets underwhelms.

5. The combination of Low Volatility and Value (NYSEARCA:RPV) continues its consistent pattern of outperformance.

6. Similarly, the combination of the Dividend Aristocrats (NYSEARCA:NOBL) and The S&P 500 Equal Weight Index continue their equally consistent pattern of market-beating performance.

7. Efficiency gains spur healthy cash flow generation for domestic producers, and the Energy Index (NYSEARCA:XLE) outperforms the S&P 500 despite only marginally higher oil and gas prices.

8. After a 25% drop in 2016, the SPDR Pharmaceuticals Index (NYSEARCA:XPH) rebounds to outperform the S&P 500 as pressure on drug pricing recedes.

9. REITs (NYSEARCA:RWR) modestly outperform the S&P 500, including reinvested dividends as the fear of higher rates that plagued the sector in the second half of 2016 largely fail to materialize in the New Year.

10. After strongly outperforming in 2016, the Materials sector (NYSEARCA:XLB) lags the broader market.

11. Equal-weight technology (NYSEARCA:RYT) meaningfully outperforms the top-heavy capitalization-weighted technology index (NYSEARCA:XLK), a sector fund that is 15x more popular with investors than the alternative weighting scheme.

12. Facebook (NASDAQ:FB) falls as the number of unique visitors drops, and advertisers begin to question the efficacy of the platform in turning pageviews into consumer activity.

13. Amazon (NASDAQ:AMZN) earnings grow by 25%, but equity gains are in the single digits as the company's stratospheric equity multiple contracts modestly.

14. Friendly overtures by Softbank to the Trump Administration, which included the onshoring of thousands of jobs, leads to the support of a merger between Sprint (NYSE:S) and T-Mobile U.S. (NASDAQ:TMUS).

15. Spurned in the cable media derby for Time Warner Cable by anti-trust concerns, Comcast (NASDAQ:CMCSA) re-enters the content fray via a large-scale acquisition.

16. Domestic steel companies, which experienced tremendous gains in 2016, fail to outpace the broader market and experience volatility more than 2x the S&P 500 as overcapacity plagues the industry and infrastructure spending disappoints.

17. Phillip Morris International (NYSE:PM) and Altria (NYSE:MO) combine, reversing a 2008 separation of the faster growing international business as the litigation risk environment is viewed as improved in the United States.

18. The cost of financing advantage of regulated utilities sees multiple large U.S. utilities acquire gas midstream businesses in a bid to revive stagnant growth and to offset the potential for equity price headwinds from higher domestic interest rates.

19. Johnson & Johnson (NYSE:JNJ) makes a leveraging acquisition that sacrifices its unique AAA rating.

20. Continuing its long history of levering low volatility investments, Berkshire Hathaway (BRK.A, BRK.B) makes an acquisition above $10B in both the utility and consumer non-cyclical industries.

21. Driven by the difference in valuations, Ford (NYSE:F) outperforms Tesla (NASDAQ:TSLA).

22. Apple (NASDAQ:AAPL) retains its spot as the most valuable company in the world, but Alphabet (NASDAQ:GOOGL) closes the gap.

23. An activist investor takes a large stake in battered health and wellness store operator, GNC (NYSE:GNC), which more than doubles the annual return of the S&P 500.

International Stocks

24. Emerging market stocks (NYSEARCA:VWO) outpace the S&P 500 as the combination of an economic growth rebound, weak EM currencies, and low valuations all prove to be tailwinds after years of underperformance.

25. Low volatility emerging market stocks (NYSEARCA:EEMV) generate 2017 returns in the high teens.

26. Buoyed by its weakened currency, Mexican stocks (NYSEARCA:EWW) outperform their brethren north of the border.

27. After lagging in 2016, European stocks (NYSEARCA:VGK) outperform their domestic counterparts.

28. The European Dividend Aristocrats generate low double digit returns.

29. Similarly, low volatility developed market equities (NYSEARCA:EFAV) produce low double digit returns and outpace their U.S. counterparts.

Bonds

30. The 10-year Treasury yield briefly eclipses 3% mid-year, but ends 2017 at 2.65% as another year passes without the prospect of meaningfully higher long interest rates materializing.

31. The yield curve ends 2017 flatter as the market reprices its optimistic expectations for economic growth.

32. Corporate credit spreads, backed by improving economic growth and corporate profitability, tighten modestly. The leading high yield corporate bond exchange-traded funds (NYSEARCA:HYG) and (NYSEARCA:JNK) produce a 6% total return.

33. Given the relatively high prices on BB and single-B rated bonds, the gains in high yield bonds are driven by the most speculative CCC-rated securities as realized corporate defaults recede from the level of the prior year.

34. Financial sector corporate bond spreads outperform industrials.

35. Non-agency residential mortgage-backed securities, a driver of the previous financial crisis, make a meaningful return to the primary market in less complex form, boosting available home credit.

Economics

36. The Fed hikes rates twice, increasing the Fed Funds rate in June and December by 25bp.

37. Pressured by a higher U.S. dollar domestic manufacturing employment falls slightly, countering hopes of a manufacturing renaissance in the United States.

38. In a counter to Trump's stated policy, import growth outpaces export growth - largely a function of the strong dollar.

39. The unemployment rate falls to 4.7%, and the labor force participation rate moves marginally higher (to 63%), reversing a decade of declines.

40. Commercial real estate prices rise 4%.

Other

41. U.S. home prices eke out 3% gains, but high valuations and modestly higher mortgage rates lead to a small contraction in home prices in major coastal metros.

42. Oil prices stay range bound between the high $40s and high $50s as increased U.S. supply is encouraged through a constructive regulatory environment and OPEC members fudge on the pace of agreed to production cuts. The strong dollar also proves a headwind to sustainably higher prices.

43. Gold remains range bound between $1050 and $1250.

44. Two leveraged buyouts of at least $10B are completed in the United States.

45. Debate over the future Fed Chairperson and Vice Chairman prompts some minor market volatility. Ultimately, both roles are filled by individuals not currently on the Board of Governors.

46. A notable cyberattack on our nation's infrastructure leads to a minor risk flare in financial markets and Congressional investigations.

47. A late night tweet from President Trump on trade prompts a 1% drop in U.S. equity markets the next day.

48. Overall, the VIX averages 19 in 2017, a pickup in volatility from 2016 when the VIX averaged 16, but still near historical averages.

49. There is no progress on a wall on the southern U.S. border.

50. Driven by record valuations, a National Football League team offers a minority stake in the franchise to public investors to monetize value in front of emerging viewership concerns.

The sum of these predictions would signal below trend gains for U.S. stocks and outperformance by international stocks. In fixed income, these predictions signal that credit will outperform rates, but that returns will not be as weak as many fear given a muted rise in interest rates. Normal disclaimers about the variability of outcomes should be echoed from my earlier pieces on market scenarios in the tails. Best wishes for a happy and prosperous 2017.

Disclaimer

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Disclosure: I am/we are long SPY, RSP, IJR, SPLV, EFAV, EEMV, NOBL.

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