Market Outlook 2017: Reflating The Low Growth World

KEY TAKEAWAY

Even in the face of unanticipated upheavals, the global economic growth outlook has brightened. Eurozone and Japan are gaining momentum. The robust rebound in energy and commodity prices is helping resource exporters such as Brazil and Russia and in the rest of the emerging world, healthy domestic demand should stabilize growth rates in the short to medium term.

2016 was marked by a series of unexpected political events that could potentially unleash major changes in the established global economic framework in the coming years. After several years of slow growth, supported only by the extraordinary monetary policies by the world's major central banks, fiscal policy tools are back in favor in the developed world. If implemented judiciously, moderate fiscal stimulus measures and tax cuts could boost domestic demand just enough to revive business investment and sustain the current pace of hiring, in most developed economies. The resultant inflation push should allow the central banks to raise interest rates or, in Europe and Japan, wind down long running quantitative easing programs. This should provide much relief to the financial sector that was plagued by low margins and negative interest rates.

Last year also marked a turning point in regulatory direction, especially for the banking and healthcare industries. Some of the restrictions imposed on banks after the 2008 financial crisis could ease, allowing them to rebuild high margin, but also higher risk trading businesses. While these changes are likely to be initiated in the U.S., other developed countries could also see easier regulation, if not on the same scale. The healthcare sector could face more pressure to bring down costs, even as they grapple with significant policy changes in the U.S.

The sharp rise in political rhetoric on trade protectionism can only be expected to escalate in the near future, especially in Europe where such ideas are gaining more attention ahead of national elections in several countries. If the new U.S. administration unilaterally initiates higher import tariffs and other trade barriers, other large countries are expected to retaliate with their own measures. Though it is premature to call this a reversal of globalization, it is very likely that the long established process of global trade integration may come to a standstill. Brexit and the growing resistance to large trade deals have also challenged the idea of multilateral economic and political integration.

Even in the face of these unanticipated upheavals, the global economic growth outlook has brightened. Eurozone and Japan, two major economies where growth has been tepid at best for so long, are gaining economic growth momentum. The Eurozone was marginally ahead of the U.S. in terms of growth pace for 2016. Their cheaper currencies should give the Eurozone, Japan and the U.K. enough fuel to extend the recovery. The robust rebound in energy and commodity prices is helping resource exporters, especially emerging economies such as Brazil and Russia that were in deep recession until last year. In the rest of the emerging world, healthy domestic demand should stabilize growth rates in the short to medium term.

Business sentiment has improved across the world and CEOs who were stressing "defense" just months ago, have now returned to playing "offense". Earnings outlook has brightened, especially for the financials as well as extractive industries. Finally, and most importantly, we believe valuations remain attractive in international as well as emerging markets that have lagged U.S. equities for a number of years.

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