Investment Insights
2017 Outlook

December 2016

BANK OF THE WEST
WEALTH MANAGEMENT
BNP PARIBAS GROUP

2017 Outlook

Fiscal Rotation

Monetary policy has been the only game in town, but fiscal stimulus just rolled in and is looking to take over the scene.

Forecasted Themes 2017

- Next year will see a tightening of Monetary Policy and a shift toward Fiscal Policy. Although monetary policy will continue to be accommodative by historic measures, fiscal policy will take some of the weight off of its monetary cousin.
- An acceleration in domestic growth from accommodative policies will result in higher rates for the short-end of the curve, while the long-end will stay relatively steady.
- Inflation will rise marginally above the Fed's target; the Fed will potentially only raise interest rates twice versus three times, as the fiscal multiple being considered will not be fully realized.
- The U.S. Dollar will continue its relevance as a major economic and investment factor to contend with throughout the year. Emerging markets will likely suffer from currency movements and reduced capital infusions.
- Political risk domestically, as well as abroad, will drive uncertainty throughout the year, resulting in higher volatility levels in equities than seen in the past year, but still below historical standards.
- As rates advance, higher yielding equity and alternative asset classes will see a rotation back toward traditional fixed income securities or higher-quality-yielding assets and variable rate securities. Additionally, equities may see a value to growth rotation as potential economic strength lifts rates.
- Although international equities may be cheap relative to U.S. equity markets, the discount is in-line. Until fundamentals turn further, a neutral to moderate overweight is warranted. As in the U.S. it took time for monetary stimulus to take effect, it will take even longer abroad.
- Oil will not see a breakout to the downside nor to the upside during the year as OPEC agreements fall short of expectation and shale producers in the U.S. keep supply in-check.
- Global equities will outperform global bonds as global demand picks up around the world and interest rates remain anchored around zero in a majority of developed markets, with the U.S. actually seeing rate increases.
- Active management will be key as global markets decouple with policy and as political movements take different paths.

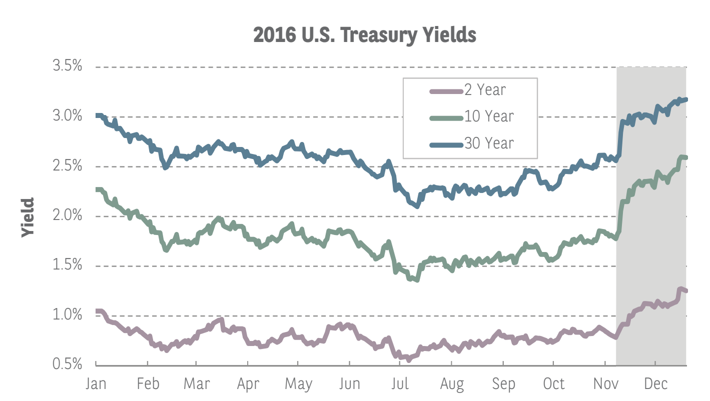
"Probable possibilities are preferred to improbable possibilities"

-- Aristotle

Filling in the Voids of Yesteryears

The president-elect's victory and the Italian's declination of reform in the waning months of 2016 was a final crescendo for a central theme of 2016, populism. Additionally, stresses in regions like the Middle East and East Asia were accompanied by growing inequality and unrest, while concerns over the refugee crisis and a snowballing income gap were key drivers in the result of the Brexit. Despite news headlines on these topics injecting volatility into the markets this year, the U.S. equity markets have remained surprisingly resilient. Unfortunately, the Global Investment Management team does not forecast this for the equity market or the fixed income markets into 2017. Volatility will likely tick up as uncertainty builds, resulting in the opportunity for some boiling points in markets. We expect a minor correction in the first half of the year.

A significant part of this year's rally in domestic stocks is directly related to President-elect Trump's victory. The so called "Trump trade" stems from the potential pro-growth and pro-U.S. competition policies his administration would enact. This has revealed strong investor optimism and a revival of the "animal spirits" for U.S. equities. We do encourage caution, as we believe that this is a little bit of a sugar high and that markets have overshot in the interim. We believe that fiscal policy will occur but it will vary from proposals expressed on the campaign trail and even those of late. Regardless of the fiscal policy enacted, the U.S. has been on fairly firm ground throughout 2016 as seen in an unemployment rate at or below full employment, GDP increasing at an annual rate of 3.2% in the 3rd quarter of 2016, and the U.S. consumer who has reaped the benefits of rising home and financial asset prices.



Source: Bloomberg as of 12.20.16

"The only certainty is that nothing is certain" -- Pliny the Elder

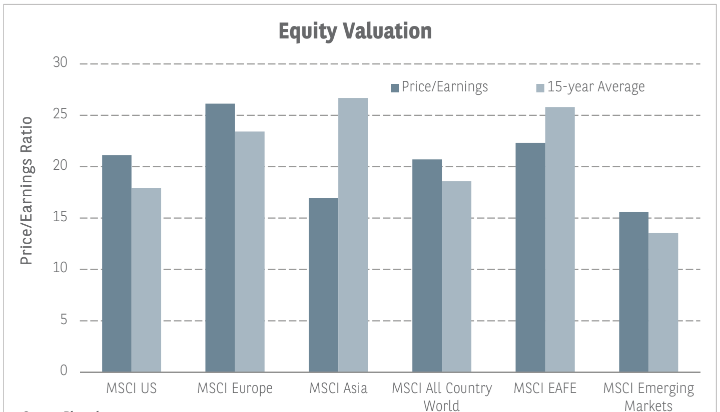
Policy potential was also reflected in bonds, with the 10-year Treasury yield climbing over half a percent from the November low on the 4th, due to the same market sentiment which has driven equity markets. It seems the bond and the equity markets agree that accelerated growth will beget accelerated inflation, which will more than likely beget front-end loaded interest rate increases. The short-end of the curve will increase while the long-end will remain relatively stable, meaning that the fixed income team is predicting a bit flatter curve as the Fed comes off the bottom.

Although the resurrection of animal spirits was already making its way into the markets, the election of Donald Trump was the spark that ignited the fiery end of the year. However, the Global Investment Management team believes markets have overshot near-term in both the price levels of equities to the upside and the declination in fixed income asset prices to the downside as we remain wary given current valuations and how fast the markets have moved in the face of uncertainty within domestic policy and economics. Bond investors in particular are now forecasting increased inflationary pressure but we would caution that although inflation will reach above the Fed's target for much of the year, it won't move high enough to undermine fixed income profits. The Global Investment Management team sees the 10-year Treasury moving to around 2.75 percent by the end of the year.

“In most things success depends on knowing how long it takes to succeed” -- Charles de Montesquieu

As we saw in 2016, U.S. equities will likely see a minor correction in the first half of 2017, but should end the year in positive territory based on increased earnings for corporations, if the U.S. dollar can remain relatively contained. A large portion of S&P 500 companies’ revenues come from abroad, with a stronger U.S. dollar it will put pressure on these exporters as they translate foreign currency back to the U.S. dollar. U.S. corporations will likely contend with pressures from increases in wages and the contingency of other developed and developing markets with more accommodative policy in hopes of depreciating currencies and increasing exports. Certain sectors might see a double negative; margin compression and importation of deflation as the USD churns higher. Overall, it will be a push and pull from the U.S. dollar versus a strong U.S. economy to determine if U.S. profit growth can increase after 18 months of declining profits. We expect U.S. Large Cap stocks to post mid-single digit returns based on 2 percent dividend growth and 5 to 8 percent earnings growth, and some multiple contraction. The possibility of dislocation between the markets and economic growth has increased in our view.

International stocks, barring emerging markets for some of the year, have underperformed in 2016, but may be an opportunity in 2017. Europe’s economies have surprised a bit to the upside this year although deflationary pressures are still prevalent. This will most likely keep the European Central Bank and Mario Draghi purchasing bonds well through 2017, thus putting a pseudo cap on market volatility and a footing for equities. It seems as though investors have more transparency and a clearer roadmap for international markets, such that a conviction may be made with investments in the region. The concurrent economic improvement in the U.S. with the rest of the world has improved prospects for equity markets abroad. While



Source: Bloomberg

there is still a marked amount of uncertainty regarding equity levels, developed international stocks seem to be attractive and retain upside potential in our view.

Emerging markets are a different story. The outlook for emerging markets is still murky with developed market policies becoming a possible headwind for the group. Currency will also play a key factor as the ever-strengthening U.S. dollar weighs on trade from developing nations like China. Even as growth starts to pick up in developed markets like the U.S., Europe, and Japan it will not be enough to produce a much rosier picture for emerging markets if commodity prices don’t surprise to the upside. Additionally, rising interest rates in the U.S. and a stronger dollar is generally detrimental to emerging market economies and capital rotates away from emerging economies. The same returns seen this year likely will not be replicated as commodity prices and internal credit cycles will be detrimental to total return for 2017; remain underweight.

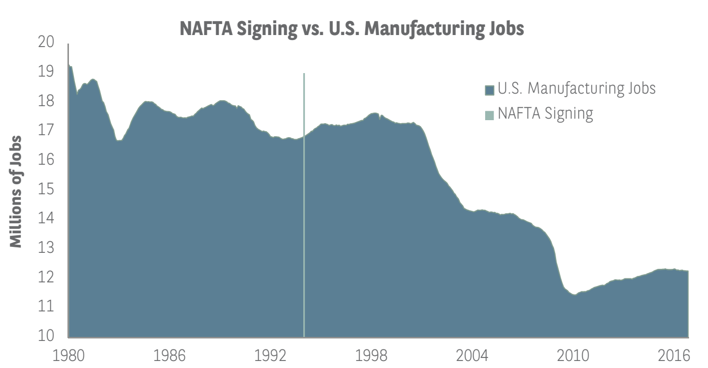
“You can never leave footprints that last if you are always walking on tiptoe” -- Leymah Gbowee

We won’t go so far as to say a China-like roaring economic boom is in store for the U.S. in 2017, but we are definitely more optimistic – and so are the markets. Some of the improvement in the forecast

comes from fiscal spending plans that are gaining steam with the new regime in Washington. Calls for infrastructure outlay have finally been heeded and the incoming cabinet has laid out infrastructure and tax cut plans that could add 0.5 percent and 1 percent to U.S. GDP growth over the next two years, according to the Organisation for Economic Co-operation and Development. Alongside these changes, the president-elect has taken a hands-on approach of directly meeting with large corporations in an attempt to dissuade them from moving jobs overseas and to bring manufacturing back to American soil.

The rotation from monetary policy to fiscal spending to spur growth will be a major factor for markets next year and economists are already increasing their projections. In addition to the OECD's comments about more robust growth domestically and globally, the Bank of the West Economics team has weighed in. While also mentioning the promise of "Trumponomics" as a driver for markets, the team is forecasting real growth in the U.S. of 2.2 percent in 2017. Other economic contributors to Bloomberg's forecasts are predicting a full fiscal multiplier to take hold, with even higher GDP growth forecasted for 2018, some reporting a robust 2.8 percent expected after policy has been enacted. It seems spending by the federal government has taken the spotlight away from the monetary policymakers at the Federal Reserve.

While not completely out of the limelight, Janet Yellen and her cohorts at the Fed still have work to do. The economy seems to have hit a point where the Fed governors are comfortable with a less accommodative stance. The Fed's counterparts within the European Central Bank have also opted to begin tightening stimulus and monetary growth measures. On December 8th, ECB head Mario Draghi announced the central bank will begin tapering its program to reduce bond purchases, but also extended the timetable for buying and left an open-ended expiration date. It seems central banks globally will need to work together to keep the global economy stable and in-sync.



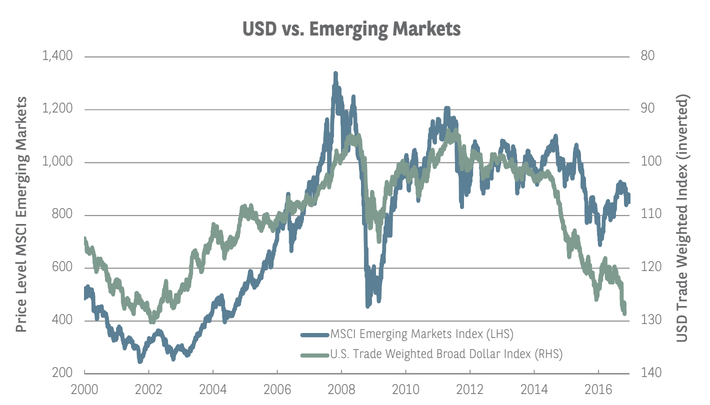
Source: Bureau of Labor Statistics

"Fortune favors the bold" -- Virgil

Equity markets will depend a great deal on policy changes coming into effect in 2017 and have already benefited from improvement in employment, wages, and corporate profits. There is some substance to the recent rally. This does not mean there aren't risks to the recent climb. What we also said is the "Trump trade" has been based on sentiment and the promise of policies – this is likely transitory until material changes are actually set in motion. While the current rally could continue into the new year, we believe the upside potential in 2017 will be constrained as most of the optimism is being priced into the end of 2016.

We continue to enjoy our slight overweight to U.S. equities within our global equity portfolio. It is hard to argue with upward revisions to revenue and earnings growth, the promise of policies which will lift GDP growth, an unemployment rate well below full employment with labor slack falling off, and sentiment or confidence building for consumers and businesses. Sectors which derive revenues from domestic sources as well as those which can control wage pressures should fare well in 2017. International markets, specifically Europe, will most likely remain accommodative with policies and should break to the upside, although investors will be cautious with dramatic overweights as there are green shoots rather than a healthy forest of growth. We remain neutral with an expectation for an overweight in the coming year.

In our opinion emerging and frontier markets will falter in 2017 as China decelerates and other emerging economies are hurt by rising rates in the United States and a stronger U.S. dollar. The growth in developed markets should help dampen the decline but not enough for the Global Investment Management Team to move the asset class much further than a moderate underweight. Valuations are cheap compared to history and to developed markets for a good reason, as the asset class is dangerous to become too excited about.



Source: Bloomberg

Fixed Income has seen a 35 year bond rally which will come to an end this year. On July 8th, 2016 the 10 year Treasury recorded a yield of 1.359%, the lowest traded bond yield in 226 years of trading. Since then we have seen rates increase by more than a percent and will likely close 2016 around 2.50 percent. The Fed Fund futures are suggesting a high likelihood of 2 rate hikes next year with an even chance of a third hike, according to Bloomberg. We think that 2 rate hikes seem about right as the U.S. dollar will dampen economic growth. The majority of the movement is likely to come from increased inflation expectations, as well as implied rate hikes, and will result in a flatter curve for bond investors. Fixed Income returns are likely to come from interest payments versus price appreciation as rates tick up a bit. Corporate bonds and debt secured by the strength of the United States consumer should perform well. We remain overweight U.S. Mortgages and corporate bonds, investing slightly underweight to benchmark duration. A bond bear hasn't come out of hibernation yet but is starting to stir.

Finally, we have been adding allocation dollars over the years to alternative assets. The ability to allocate to lower correlated asset classes has helped our strategies overcome volatile times. We are advocating for a few specific areas for 2017. We continue to overweight multi-strategy alternative funds which have the ability to follow tradeable themes in financial markets. Additionally, we are overweighting reinsurance bonds, long/short fixed income, and a fund which invests in direct lending. We believe that commodity prices, including oil, remain range bound for the coming year and as such have placed an underweight on the allocation.

Overall, 2017 will see some major themes for all markets and could produce a rotation out of higher yielding and what investors deem "riskier" investments, in lieu of yield solutions which are generally deemed higher quality; such as U.S. government bonds, high quality corporates, etc. Additionally, higher dividend yielding securities will see some pressure as equity investors look to growth securities after a tremendous run-up in higher dividend yielding securities since the bottom in 2009. To date, we have seen the second-longest bull market in the history of the S&P 500 and valuations reflect the run-up in prices. Will 2017 be the end? We don't believe so, but some of the shine will rub off in the coming year.

Glossary

A **10-Year Treasury note** is a debt obligation issued by the United States government that matures in 10 years. A 10-year Treasury note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity. An advantage of investing in 10-year Treasury notes, and other federal government securities, is that the interest payments are exempt from state and local income tax. However, they are still taxable at the federal level.

Alternative investments are investments that are not one of the three traditional asset types (stocks, bonds and cash).

Bank Credit Analyst is a publication which provides big-picture insight and analysis of major investment trends, covering equities, fixed income, currencies and commodities. BCA Research is a world leading provider of independent investment research. Since 1949, the firm has supported its clients in making better investment decisions through the delivery of leading-edge economic analysis and comprehensive investment strategy research.

Barclays U.S. Universal Bond Index is an unmanaged index comprising US dollar-denominated, taxable bonds that are rated investment grade or below investment grade.

Bloomberg is a major global provider of 24-hour financial news and information including real-time and historic price data, financials data, trading news and analyst coverage, as well as general news.

Bloomberg Commodity Index is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. The Index is composed of commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME).

Brexit is an abbreviation of "British exit", which refers to the June 23, 2016 referendum by British voters to exit the European Union. The referendum roiled global markets, including currencies, causing the British pound to fall to its lowest level in decades.

Bureau of Labor Statistics is the arm of the U.S. Department of Labor that researches and publishes a range of data, from inflation and consumer spending to employment, productivity and wages, as well as other economic measures.

Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Sometimes referred to as "headline inflation."

Corporate bonds are debt obligations issued by corporations. An investment in corporate bonds is subject to a variety of risks including credit and default risk, market risk, event risk, call risk, interest rate risk, foreign risk, and sector risk.

Emerging Market countries have economies that are progressing towards becoming advanced, as shown by some liquidity in local debt and equity markets and the existence of some form of market exchange and regulatory body.

The European Central Bank (ECB) is the central bank responsible for the monetary system of the European Union (EU) and the euro currency.

Federal Reserve (Fed) is the federal banking authority in the U.S. that performs the functions of a central bank and is used to implement the country's monetary policy, providing a national system of reserve cash available to banks.

Federal Open Market Committee (FOMC) is a committee that sets interest rate and credit policies for the Federal Reserve System, the U.S. central bank. The committee decides whether to increase or decrease interest rates through open-market operations of buying or selling government securities.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. Real Gross Domestic Product is an inflation-adjusted measure that reflects the value of all goods and services produced in a given year, expressed in base-year prices. Often referred to as "constant-price," "inflation-corrected" GDP or "constant dollar GDP". Real GDP can account for changes in the price level, and provide a more accurate figure.

High yield bonds are high paying bonds with a lower credit rating than investment-grade corporate bonds, Treasury bonds and municipal bonds. Because of the higher risk of default, these bonds pay a higher yield than investment grade bonds. Based on the two main credit rating agencies, high-yield bonds carry a rating below 'BBB' from S&P, and below 'Baa' from Moody's. Bonds with ratings at or above these levels are considered investment grade. Credit ratings can be as low as 'D' (currently in default), and most bonds with 'C' ratings or lower carry a high risk of default; to compensate for this risk, yields will typically be very high.

Investment-grade (IG) is typically used in reference to fixed income securities that possess relatively high credit quality and have credit ratings in the upper ranges of those provided by credit rating services. Using Standard & Poor's ratings as the benchmark, investment-grade securities are those rated from AAA at the highest end to BBB- at the lowest. To earn these ratings, securities, in the judgement of the rating agency, are projected to have relatively low default risk.

MSCI AC Asia Pacific Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31, 1987.

MSCI All Country World Index (ACWI) is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International, and is comprised of stocks from both developed and emerging markets.

MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed by Morgan Stanley International to measure the equity market performance of the developed markets in Europe.

MSCI USA Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31 1969.

Municipal bonds are debt obligations issued by states, cities, counties, and other public entities that use the loans to fund public projects. The interest income from municipal bonds is generally exempt from federal taxes and may be exempt from state and local taxes. Municipal bonds are subject to a number of risks such as interest rate risk, call risk, inflation risk, credit and default risk, and tax risks.

North American Free Trade Agreement (NAFTA) is a 1994 free trade agreement made by the U.S., Canada, and Mexico.

Organisation for Economic Co-operation and Development (OECD) is a group of 34 member countries that discuss and develop economic and social policy. OECD countries are democratic countries that support free market economies.

Organization of Petroleum Exporting Countries (OPEC) is an organization consisting of the world's major oil-exporting nations. It was founded in 1960 to coordinate the petroleum policies of its members, and to provide member states with technical and economic aid. OPEC is a cartel that aims to manage the supply of oil in an effort to set the price of oil on the world market, in order to avoid fluctuations that might affect the economies of both producing and purchasing countries.

Price-Earnings Ratio (P/E Ratio) is a valuation ratio of a company's current share price compared to its per-share earnings.

The S&P 500 Index is a capitalization-weighted index of 500 stocks traded on the NYSE, AMEX and OTC exchanges, and is comprised of industrial, financial, transportation and utility companies.

Treasuries are debt obligations issued and backed by the full faith and credit of the U.S. government. Treasuries are subject to interest rate risk, call risk, and inflation risk. As Treasuries are backed by the full faith and credit of the federal government, they have low credit or default risk. As a result they generally offer lower yields relative to other bonds.

U.S. Trade Weighted Broad Dollar Index is a measure of the value of the U.S. dollar relative to other world currencies. It is similar to the U.S. Dollar Index in that its numerical value is determined as a weighted average of the price of various currencies relative to the dollar, but different currencies are used and relative values are weighted differently. The base index value is 100 in March 1973.

One cannot invest directly in an index.

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Investing involves risk, including the possible loss of principal and fluctuation in value.

Among other risks, fixed income securities are subject to interest rate, inflation, credit and default risk. The bond market is volatile. As interest rates rise, bond prices usually fall, and vice versa. The return of principal is not guaranteed, and prices may decline if an issuer fails to make timely payments or its credit strength weakens.

Alternative investments contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors.

International securities involve additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

Diversification and asset allocation does not ensure a profit or guarantee against loss.

Index performance is shown for illustrative purposes only. You cannot invest directly in an index.

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