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Global View

Five Investment Themes to Watch in 2017

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As the markets close the books on one year and turn their attention to the next, investors looking to make informed decisions need to understand what's driving markets and economies. Here are five core themes to watch in the coming year.

1. Global economic growth is still low, slow and dull
Investors should expect muted growth as the US enters its late-cycle period, Japan struggles with its ageing population and Europe suffers from Brexitosis. The US and European Union should ultimately avoid recessions while staying stuck in the weakest economic expansions ever recorded. Emerging markets should prosper as China rebalances and much of Asia reforms.

2. Rates will be "lower for longer" overall
We expect the US Federal Reserve to modestly increase rates, prompting central banks in emerging markets to lower their rates as inflation falls. The European Central Bank and Bank of Japan should maintain their loose monetary policies. We have passed peak global liquidity as central banks have pushed past negative interest-rate policies to begin supporting government spending.

3. China is still the big story, with Asia attractive overall
The biggest contributor to global growth is still China, which is requiring fewer industrial commodities and more oil and soft commodities as it urbanizes rapidly. Concerns remain over its capital position, but its "one belt, one road" policy for expanding trade and investment may be the new Marshall Plan the world needs after the Global Financial Crisis. With India and Indonesia now making significant reform progress, Asia offers the best balance of growth and investment.

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4. Oil demand and supply will fall into balance
For some time, we have advised investors not to expect oil prices to stay too low for too long, and our constructive position has begun to be validated. These very same low oil prices have led to receding industrial capital expenditures, and have helped demand and supply fall into balance. We believe a slightly rising oil price in 2017 should boost oil investment and global inflation, but we believe it will not ignite a new shale boom in the US. Supply will still be pressured by a fraught geopolitical situation in the Middle East, Latin America and Africa.

5. A change in political trends is underway
The tides of de-regulation continued shifting in 2016, and nationalism and populism gained ground: Brexit, the Walloons, Bernie Sanders and Donald Trump all played a part. Given the significant elections looming in Europe in 2017, politics should remain a key investment

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Allianz Global Investors

Perspective on Asia Pacific

Tough-Talking Trump Has Asia on Edge

Stefan Scheurer
Senior Investment Strategist

While much is unknown about the global economic consequences of Donald Trump's victory in the US presidential election, he has proposed some policies that would have a significant impact on Asia-Pacific countries – especially China.

Tougher trade stance could take a toll

Trump's campaign rhetoric suggests he would take a more restrictive trade stance, which could be a blow to export-reliant countries like Korea, Malaysia, Taiwan, Thailand and the Philippines. India and Indonesia may be less affected, given the smaller role exports play in driving local growth there. The Trans-Pacific Partnership (TPP) also seems to be off the table for now, which hurts export prospects for Australia, Malaysia, Japan and Singapore, among others. We could also see a massive increase in Asia's overall defence spending – particularly in Japan and Korea.

The TPP seems to be off the table, and we could see a massive increase in Asia's defence spending

Potential trade war puts China in the crosshairs

If Trump succeeds in imposing his proposed 45 per cent tariff on Chinese exports to the US, trade flows would collapse over time, with Chinese exporters potentially forced to exit US markets. Keep in mind that China is the world's largest exporter, with around 20 per cent of its total exports going to the US in 2015. In the short term, China could counter some of this downturn by relying on its growing domestic market, and it does have some policy ammunition to support growth. China has also been increasing its outward direct investments to the US, which may even help Trump protect some US jobs. Nevertheless, a unilateral increase in import tariffs would not only hurt China's exports to the US, but also US exports to China; this could be detrimental to growth in the entire Asia-Pacific region and globally.

A unilateral increase in import tariffs would hurt China's exports to the US – and US exports to China

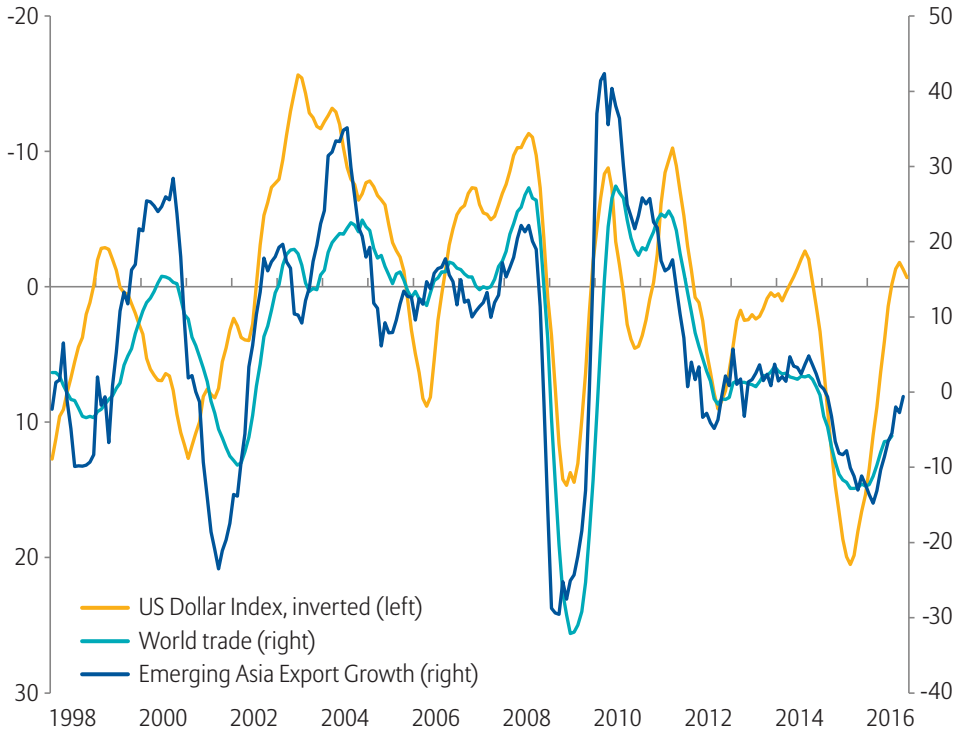
In the long run, these issues may give China greater incentive to continue rebalancing away from exports, and to diversify more into emerging markets. This could strengthen China's role in the region, especially with regard to the Regional Comprehensive Economic Partnership, which includes most countries in Asia-Pacific – but not the US.

Will China be labeled a currency manipulator – or not?

During his campaign, Trump hurled accusations of "currency manipulation", claiming that China is devaluing its currency at the expense of the US economy. In fact, China has actively been trying to prevent its currency from depreciating, and the latest US Treasury report to the US Congress states that China only met one of three criteria needed to earn the currency manipulator label. It is important to note that a sharp renminbi depreciation would be destabilizing not just for China, but also for other Asian currencies and the US as well.

The Impact of a Trump Victory on Asia

A stronger US dollar index is becoming less favorable for global trade and Asian countries alike.*



*Measured by a simple average of exports from China, Korea and Taiwan as the region's bellwethers for the global industrial cycle. Past performance is not a reliable indicator of future results.

Source: Datastream, AllianzGI Global Economics & Strategy as at 10 November 2016.

Perspective on Europe

Will Europe Feel the Force of 'Trumponomics'?

Stefan Hofrichter
Chief Economist

3 ways Trump's economic policy could affect Europe

When Donald Trump assumes office, he is expected to focus US economic policy on fiscal easing, primarily by cutting taxes for corporations and the wealthy, deregulating banks and other industries, and increasing trade barriers and immigration hurdles. Given that the US has the world's largest economy, his "Trumponomics" will likely have a range of significant effects on Europe. Here are three of the most pronounced:

1. Direct economic influence
Fiscal easing is likely to have a slightly positive near-term impact on global growth and, consequently, on European growth. Over the longer term, however, the United States' negative view of globalization and immigration should dampen trend growth.

2. Monetary policy spillover
In response to Trump's focus on fiscal easing – and the already observed improvement in cyclical data – we expect the US Federal Reserve to hike rates by more than the markets currently anticipate. The combination of easier fiscal policy and tighter monetary policy should result in a stronger US dollar versus the euro. The euro area will therefore get additional growth stimulus, and the ECB could potentially cease its quantitative easing policy sooner than expected.

Trump's focus on fiscal easing should prompt the Fed to hike rates more than the markets currently anticipate

3. Political effects
Trump's surprising victory could provide a tailwind for populist, anti-European and anti-establishment parties and movements in Italy, France and Germany. Consequently, political uncertainty is likely to increase. Europe's economic landscape could also shift toward policies that are unfriendly toward the free movement of labour, services and capital, which would hurt growth in the long term.

Market implications of Trump's presidency

The euro is likely to weaken in the near term, but because current valuations are already quite low, we view USD/euro parity as an extreme scenario. As the ECB is also set to become less expansionary, at least marginally, the euro may very well be in a stronger position in a year's time. The euro bond markets are likely to see their prices move lower and yields higher as a consequence of

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Perspective on the US

Time to Pay Attention to 'Trumpflation'

Greg Meier
Senior Investment Strategist

For some time, conventional wisdom held that the financial markets would be more comfortable with Hillary Clinton than Donald Trump as the next US president. True to form, on election night, many major indices fell along with Clinton's chances as the results rolled in. Surprisingly, however, once the election's results became clear the next day, markets re-priced quickly, seemingly happy to anticipate a future US economy with Donald Trump at the helm. Since then, burgeoning optimism has driven the large-cap S&P 500 Index, the small-cap Russell 2000 Index and the US dollar to their highest levels since at least March 2003.

Among the forces underpinning the shift is the growing likelihood of rising US inflation: Since the 8 November vote, investors have piled on bets that inflation will pop. The 5-year/5-year breakeven rate – the market-implied average for inflation between 2021 and 2026 – is up from just 1.4 per cent in July to more than 2 per cent, the highest level in more than a year. As a result, bond yields rose violently as prices fell during a widespread bond selloff – not just in the US, but in much of the world. In the futures market, the odds of a US Federal Reserve rate hike are surging, as prospectively higher inflation translates into faster Fed tightening.

Since the 8 November vote, several major indexes have hit record highs as investors have piled on bets that inflation will pop

It is worth clarifying that higher inflation is not necessarily a "bad" thing for the US or any other economy – especially if inflation is the result of higher growth, and provided that the economy's central bank is able to hold inflation at a healthy level without letting it get too low or high.

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Soundbites from Research

Two Sectors to Watch if Trump Opens Taps

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Defence industry should get a boost

Donald Trump's victory should be a positive development not only for US defence contractors, but for European firms with a significant US presence. The Republican Congress would likely help Trump boost the defence budget by raising Budget Control Act caps, and Trump has said he would focus his efforts on more US ships, more fighter jets and a much larger US army. To help finance his plans, he plans to conduct a full audit of the Pentagon, targeting bureaucracy and inefficiency – though this raises questions about longer-term contract conditions for the defence industry. Trump has yet to give cost estimates for his ideas, but independent think tanks have published a wide range of estimates, from USD 150bn to USD 900bn over 10 years.

Trump has also said he would consider withdrawing from NATO if its members do not meet the organization's target spending levels of 2 per cent of GDP – a level that NATO says only five members (including the US) out of 28 will meet in 2016. While defence spending has already returned to growth in most NATO countries, and while medium-term growth plans are in place, there would still be a significant upside for defence contractors if other nations strive to reach the 2 per cent level.

Trump plans to build more US ships, more fighter jets and a much larger US army

Infrastructure spending could soar

With Trump hoping to pass an ambitious infrastructure bill within his first 100 days in office, we expect to see positive demand developing in the US materials and construction sector. Trump campaigned for USD 1 trillion spending over 10 years to fix America's crumbling infrastructure assets, which would create large economic opportunities. His proposal relies on private financing and tax incentives and aims to be deficit-neutral, but there are limits to how much can be really financed privately, especially for repair, maintenance and improvement work.

Trump's ambitious infrastructure bill could generate positive demand in the US materials and construction sector

Many aspects of Trump's proposals are unclear, so more detailed information is needed to better assess the true economic impact of his plans. In addition, Trump first needs to get the support of Congress, and then the speed of delivery would depend on establishing an improved project delivery system. Overall, however, Trump's bill – if enacted – should have a positive impact on the US economy, and on material suppliers and contracting companies, starting in 2018.

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Global View

consideration – though some investors may simply stay away from certain markets despite attractive valuations. Monetary policy will also become more political as it becomes subsumed by explicit government policies of fiscal domination. As to where governments will spend the money their central banks print, we believe domestic infrastructure and defence spending will be the focus of many countries in the coming years.

Given the significant elections looming in Europe in 2017, politics should remain a key investment consideration

A new year calls for a renewed focus on active investing

In many ways, 2017 will offer the same diet as 2016: Thanks to low market returns, investors who take insufficient risk will generally find insufficient results. Moreover, the historical long-term performance many investors hope to see again looks to be just that – a thing of the past. The future demands active, incisive hunting for capital-growth and income opportunities as we wait for a turn in the economic cycle to come one year closer.

Explore our 2017 outlook

This article was adapted from our 2017 outlook, "Focus Shifts to Fiscal Policy and Populist Politics". Read the complete version on ***www.allianzgi.com****.*

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Perspective on Europe

several factors, including reflationary policies in the US; slightly less accommodative monetary policy during 2017 in the US and, in all likelihood, the euro area as well; and bond valuations that are still expensive. Equities may benefit from Trump's presidency in the near term, not least because European stocks are already slightly cheap. However, the expected political uncertainty, the potential change in ECB policy and the clouds hovering over the long-term US growth outlook are likely to dampen the upside in the medium term. As such, we expect today's rather low-growth environment to linger.

Equities may benefit from Trump in the near term, not least because European stocks are already slightly cheap

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Perspective on the US

The root causes of 'Trumpflation'

There are three primary reasons why Trump's proposed policies, if enacted, could soon begin pushing inflation higher:

- During his campaign, Trump announced plans for big tax cuts, less regulation and more public spending – initiatives that should foster faster growth and pressure prices.
- On the trade front, Trump's proposals to slap tariffs on Chinese goods and renegotiate NAFTA would mean higher import costs for US consumers and businesses.
- Tighter immigration standards and deportations would generate wage inflation in industries ranging from technology to construction and agriculture.

If enacted, Trump's proposed tax cuts, trade tariffs and tighter immigration standards could all begin pushing inflation higher

The economic pros and cons of Trump's proposals

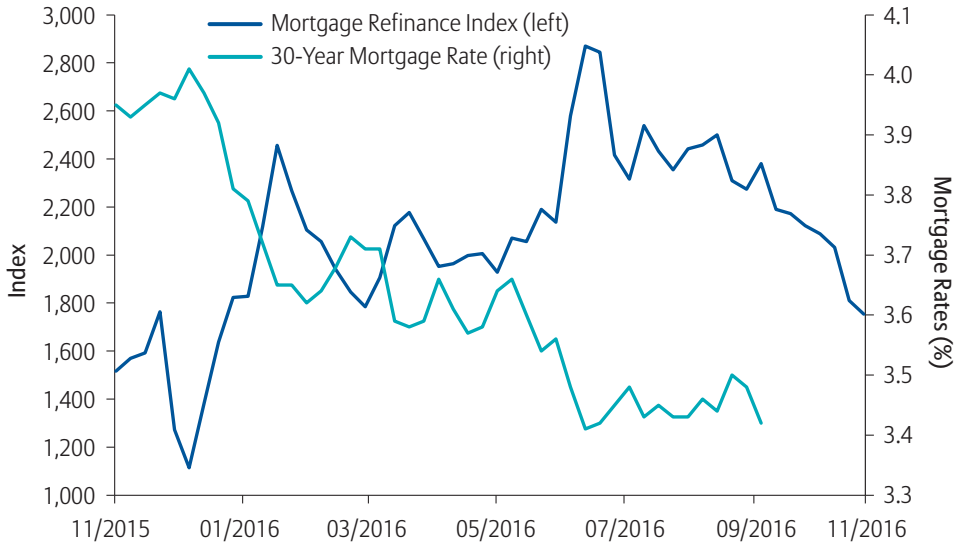
One can find compelling reasons for Trump to focus on his proposed, inflationary path. For instance, America's 39 per cent corporate tax rate is the highest in the developed world, and onerous regulations are a perennial complaint among small business owners – the people who employ the bulk of the workforce. From a public spending standpoint, there is also scope for expansion: the US government accounted for just 17 per cent of GDP last quarter, the lowest level on record. In addition, America's trade deficit ballooned from -0.3 per cent of GDP in 1992 to -2.5 per cent today.

At the same time, there are also compelling arguments to be made against Trump's proposals. US debt is at a record high and appears set to move higher, which is why Trump's deficit-financed fiscal splurge will be challenged by many legislators – including conservative Republicans in his own party. Moreover, the "Trump Tantrum" in bond yields could dampen growth; indeed, home mortgage refinancing is already sagging. Meanwhile, the recent run-up in the US dollar is disinflationary for commodities and import prices, which suggests that the markets could be overshooting their assessment of inflation expectations.

Trump won the presidency by rallying support across America's "Rust Belt", yet like other elements of his agenda, bringing back factory jobs displaced by technological advances could prove tough. Time will tell if Trump's policies can bring back the right level of inflation as well.

Will Mortgage Refinancing Continue Sliding Under Trump?

Despite low mortgage rates, refinancing activity was already falling – and it could get worse if rates keep rising due to a "Trump Tantrum" selloff in US Treasuries.



Source: FactSet as at 18 November 2016 (mortgage rates as at 30 September 2016).

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