

Mitch on the Markets

The 2016 Year-in-Review...And Predictions for 2017



By Mitch Zacks
Portfolio Manager

At the beginning of 2016, I optimistically relayed my belief that stocks would perform better in 2016 than they did in 2015. In 2015, the S&P 500 rose a paltry +1.36% on weak earnings growth propelled by the Energy sector drag. Here is a direct quote from an article I wrote in early January of 2016:

“Another big part of looking ahead to 2016 is recognizing the forces that held stocks back in ’15. Earnings growth ex-Energy was healthy, so we think it’s safe to assume in the very least that there’s a ‘lane’ open for stocks to rise through. Aside from Energy, we think some of the other forces restricting stocks in 2015 should fade in coming year.”

2016 was indeed more about the fading of negatives than it was about the emerging of new positives. The bottom line, in my view, was that the global economy (particularly in the U.S.) was growing modestly in a low interest rate environment, and corporations outside

of the energy sector were doing just fine. The end result was an environment where economic strengths were underappreciated, which is basically a formula for rising stock prices. That’s what we saw in 2016.

The year got off to a tumultuous start. The Chinese government devalued the Yuan unexpectedly and put controls on their stock market, which global markets didn’t like. Fears of a hard economic landing for China made matters worse, and the S&P 500 cratered in the first month of the year, falling by approximately 11% in less than a month’s time – a legitimate correction.

We urged investors to remain calm, reminding you that corrections were (by definition) sharp, often steep declines accompanied by negative news stories. There were plenty of reasons to be fearful, but in our view they were never substantial enough to warrant a bearish posture. Our full-year 2016 GDP forecast was positive and we expected a significant earnings growth recovery, and as such we maintained that the stock market should rise by mid-to-high single digits on the year.

What's Ahead for 2017

2017 is an inherently tricky year to forecast, since the political shift in power creates so many unknowns. Policy implementation could play a big role in shaping economic output and corporate profitability, and both of these factors matter immensely to stock performance. Our belief here at Zacks Investment Management is that GDP should continue to rise modestly. The difference in the forecast is that we expect inflation and interest rates to rise too, which could hamstring the consumer a bit more than it has in past years.

From 30,000 feet, the economic picture in the U.S. and across developed countries generally looks good. If I had to predict it today, I'd say the global economy should grow around 3% on the year, giving more upward support to stock prices. The degree to which stock prices rise will depend on policy and sentiment, both of which we need more time to measure. By and large, however, we remain optimistic that stocks have more room to run.

Beware of Optimism and Euphoria

Perhaps the most interesting and unexpected item on this year's watch list is *sentiment*. In years past, we've been less concerned about sentiment because it's been largely negative or neutral. But, if policy changes and rising stock prices beget a mad rush of new

investments and renewed excitement about risk assets, that could drive prices further out into overpriced territory. The key is to watch just how willing investors are to pay for incremental rates of return. In other words, if investors become increasingly comfortable buying overpriced, risky assets because it "feels like a good time to invest" (and because everyone else is investing), then that is a big warning sign. It means too much optimism and euphoria could be seeping into markets, and that's a bull-killer. Think tech bubble.

Bottom Line for Investors

The end of the year and the beginning of a New Year mark a good opportunity for investors to rebalance portfolios and position your assets for the year ahead. I'd continue to favor stocks for growth-oriented investors, though our allocation recommendations have changed from the previous year. To find out how Zacks Investment Management would reposition your portfolio and prepare you for the year ahead, contact us at your convenience at 1-800-918-3114. There is no better time than now!

-Mitch

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.



Disclosure:

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss.

Zacks Investment Management, Inc. is a wholly-owned subsidiary of Zacks Investment Research. Zacks Investment Management is an independent Registered Investment Advisory firm and acts as an investment manager for individuals and institutions. Zacks Investment Research is a provider of earnings data and other financial data to institutions and to individuals.

This material is being provided for informational purposes only and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. Do not act or rely upon the information and advice given in this publication without seeking the services of competent and professional legal, tax, or accounting counsel. The information contained herein has been obtained from sources believed to be reliable but we do not guarantee accuracy or completeness. Publication and distribution of this article is not intended to create, and the information contained herein does not constitute, an attorney-client relationship. No recommendation or advice is being given as to whether any investment or strategy is suitable for a particular investor. It should not be assumed that any investments in securities, companies, sectors or markets identified and described were or will be profitable. All information is current as of the date of herein and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole.

The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large-company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.