2017 Ideas for Fundamental Investors

January 19, 2017

The outlook for central bank policy has continued to significantly influence market sentiment, and we expect a number of recent macroeconomic and market trends to persist in 2017, affecting our investment decisions.

Ultimately, inflationary forces are likely to lead to less accommodative central-bank policy, led by the Federal Reserve. Additionally, the efficacy of actions from European and Japanese central banks is increasingly being called into question.

From a portfolio strategy perspective, we have been considering a further move into some of the more cyclical areas of the market, as we think the risk to growth remains to the upside. Our primary portfolio sector exposures currently are consumer discretionary, financials, industrials, and information technology.

Within the consumer discretionary sector, we are finding compelling opportunities in the media, specialty retail, and leisure industries.

Within financials, we have continued to focus more on capital markets-related companies and have become more constructive on the outlook for higher-quality developed market banks due to a potentially more favorable interest rate environment.

We have maintained exposure to investments in the insurance industry, including rate-sensitive life companies and select emerging market insurers that are benefitting from favorable secular trends and growth, given under-penetration.

Our industrials sector exposure primarily comprises leading capital goods companies in Europe and Japan. Although demand recovery has been choppy overall for the sector, leading indicators are suggesting stabilization in 2017.

Within information technology, we are interested in companies with differentiated product offerings in the structurally attractive internet software and payments areas.

As global investors, the macroeconomic environment is also affecting our investment decisions. Europe remains our largest regional allocation, but we have become incrementally more positive on select countries within emerging markets and Japan, where valuations are generally more compelling and the earnings outlook is stabilizing.

Within emerging markets, we are focusing on consumption rather than investment-led growth; our exposure is underpinned by secular trends such as e-commerce and mobile advertising market expansion, financial-services penetration, and the migration from paper to plastic payments.

We are finding opportunities in some of the more obvious countries such as India and China, in addition to Brazil, where the economic outlook has recently stabilized under the new Temer administration.

Within Japan, we have added selectively to high-quality leaders in the machinery and construction industries, which we expect to benefit from improving demand and positive earnings revisions in the coming months.

We note that the unwinding of central bank stimulus measures will likely continue to be a key risk factor in 2017. From a valuation perspective, the market has assigned a significant premium to those companies that have been able to deliver top- and bottom-line growth during what has been a difficult backdrop.

We—and others—have noted that the valuations of these dependable performers have been extended relative to the rest of the market for some time now.

This scarcity premium is likely to come under some pressure in an environment of broader growth. Additionally, higher rates could compress the valuations of so-called long duration stocks, as well as make the higher yielding “bond proxy” stocks less appealing.

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