INVESTMENT STRATEGY OVERVIEW; PEAK RETURNS, BIG ROTATIONS

"The era of excess liquidity is over."

– Michael Hartnett, Chief Investment Strategist

Our view

No big easing
For the first time since 2006, we don't expect a big easing of monetary policy in the G7 nations. Interest rates and inflation could be an upside surprise. We anticipate an acceleration in global growth. In the U.S., nominal growth could rise to 3 to 4 percent, with a real GDP gain of 2 percent. In the rest of the world, nominal growth could be near 7 percent, with a real economic gain of 3.8 percent and inflation of 3.0 percent.

Big rotations
Domestically and globally, investments and policies that have done well in a low-rate, low-growth world have reached their peak. Look for long-term winners to be supplanted in 2017 as 10-year treasury yields rise toward 2.65 percent. Expect inflation rather than deflation; Main Street to prevail over Wall Street; fiscal winners to beat out zero-interest rate winners; and real assets to triumph over financial assets.

Sell Wall Street, buy Main Street
This is one of our key themes. Electorates want a "war on inequality," with less taxpayer money spent on bonds and more on people, via fiscal spending or tax cuts to boost wages. Fiscal easing in Japan, Canada, Korea, Europe and the U.S. could amount to more than $1 trillion of stimulus by the end of 2017. This phenomenon favors Main Street picks (such as U.S. homebuilders) over Wall Street (including real estate investment trusts).

Key calls

- **Long and short of it** – Overall, we would go long stocks, real estate, commodities and the U.S. dollar. We expect all to have single-digit gains. The same can be said for emerging markets, though they're likely to have a tough start to the year. Bigger gains, in the area of double digits, are likely for Japanese, European and British stocks, as well as for oil. We would short bonds, which will see low or negative returns.

- **Key trades** – We favor banks over bonds, U.S. homebuilders over REITs, U.S. small-cap value over U.S. small-cap growth, global small-cap stocks over American technology companies and the British pound over the Brazilian real. We like both robotics and biotech.

- **Core calls** – Over the next three to six months, the following represents our core view of key asset categories:
    - **Bullish** – Eurozone, U.K., Japanese and Pacific Rim stocks, energy, precious metals and the U.S. dollar.
    - **Bearish** – North American and emerging market stocks, bonds across all categories (government, investment grade, high yield and emerging market) and industrial metals.
    - **Neutral** – Cash