A Long-Range Economic Look at the Year 2017
Economy

**POSITIVES**
- Rising spending on big ticket items
- Potential for lower taxes and regulations
- Upsurge in consumer expectations
- Recession tripwires are benign

**NEGATIVES**
- More active Federal Reserve
- Stronger dollar
- Uncertain tax and spending policies

Gross Domestic Product (GDP) growth over the last ten years has been among the lowest in our nation’s history. However, recent upsurges in consumer and business expectations could prove beneficial.

While hope is rising, concerns remain on when and what will get done in Washington. Campaign promises have included lowering corporate tax rates and eliminating two federal regulations for every new one passed. Proposed infrastructure spending is for $1 trillion over the next ten years. Too often campaign promises are delayed, watered down or abandoned.

Among the challenges for the economy are the ending of the lax monetary policy era. Further, rising inflation could eventually prove problematic. While unlikely, a trade war would put pressure on U.S. and worldwide GDP growth. Overall, we believe economic activity should improve over 2016.

Stocks

**POSITIVES**
- Excessive institutional bearishness
- Smaller cap stocks rebounding
- Market moving out of doldrums
- Improving economy

**NEGATIVES**
- Post-election year
- High valuations
- Excessive indexing
- Federal rate hikes

After a case of the doldrums, the election appears to have triggered a “hope” rally in stocks. These often continue for a period of months. Institutional investors have built up high liquidity reserves due to their bearishness, a solid positive. Valuation methods like Shiller’s CAPE*, Tobin’s Q* and Market-to-GDP* are all extended and large stocks usually underperform over the next five years. Retail investors have aggressively moved into index funds leaving the market vulnerable to shifting sentiment. The Federal Reserve will likely hike short-term rates, historically a damper for stocks. Compared to large stocks, we believe smaller ones offer better bargains. Smaller stocks have lagged for years and are finally showing signs of strength, which could prove long-lived.

Bonds

**POSITIVES**
- Repatriation could reduce borrowing needs
- Potential overreaction to Trump proposals
- Municipal bonds attractive

**NEGATIVES**
- 35-year era of lower rates may be ending
- Wage inflation picking up
- Foreign Treasury selling suggests low demand
- Low yields mean greater volatility

Interest rates have been steadily falling for the past 35 years. The potential for higher rates is afar. Wages, one of the main contributors to inflation, is rising. Inflation expectations are near multi-year highs and suggest overall inflation could be above the Fed’s target rate of 2%. Lower demand for U.S. Treasuries across the globe could also affect rates. Even with a long-term outlook of higher interest rates, we have found some potentially sound approaches to bond investing. These include less volatile shorter-term instruments.

International

**POSITIVES**
- The global economy is growing faster
- Growing number of new pro-business countries
- Europe moving away from austerity
- Many commodity producers are cheap

**NEGATIVES**
- Migration issues stress European economies
- Federal Reserve Bank (Fed) raising rates could scare emerging markets
- China slowdown drag on global growth

The world breathlessly waits for the Trump administration to show its hand. But we believe the global economy will likely grow at a faster rate in 2017 than in 2016. Central bankers are calling for more stimulative fiscal policy, while holding rates close to historic lows.

For Business Executives

- **Prepare for potentially lower taxes**
- **Plan on stronger dollar**
- **Import prices should fall**
- **Export growth to slow**
- **Borrow while rates are low**
- **Emphasize U.S. facilities**
- **Overall growth likely to improve**

For Investors

- **The Year of Transition**
- **Key: being nimble**

**Domestic Stocks**
- **Expensive valuations problematic for indexing**
- **Smaller stocks better bargains**
- **Bargain/active investing likely to improve**
- **Overweight: financial, telecoms, discretionary sectors**
- **Underweight: electric utilities and certain basic material stocks**
- **Precious metals not as compelling**
- **Market vulnerable to negative surprises**

**Bonds**
- **Fed rate hikes likely**
- **Inflation to pick up slightly**
- **Expect more bond volatility**
- **Utilize ladder approach: diversify across maturities**
- **Select municipal bonds attractive**
- **TIPS and floating rates may offer opportunities**

**Foreign Investments**
- ** Favor pro-growth countries, especially commodity producers like Australia, Argentina and Peru**
- **Lower taxes could benefit certain Western European countries**
- **Wildcards: successful trade negotiations would benefit Russian and Indonesian stocks**

This information is of a general nature and does not constitute financial advice. It does not take into account your individual financial situation, objectives or needs, and should not be relied upon as a substitute for financial or other professional advice to assess, among other things, whether any such information is appropriate for you and/or applicable to your particular circumstances. In addition, this does not constitute an offer to sell, or the solicitation of an offer to buy, any financial product, service or program. The information contained herein is based on public information we believe to be reliable, but in accuracy is not guaranteed. Investing involves risk, including loss of principal.

Past performance is no guarantee of future results.

The James Advantage Funds are distributed by ALPS Distributors, Inc. 1290 Broadway, Ste. 1100, Denver, CO 80203 (Member FINRA). ALPS is not affiliated with James Investment Research, Inc.