

2017 OUTLOOK: INVESTMENT CONSIDERATIONS FOR TRUMP ADMINISTRATION

Luciano Siracusano — Chief Investment Strategist, Jeremy Schwartz — Global Chief Investment Officer, Rick Harper — Chief Investment Officer, Fixed Income and Model Portfolios, Kevin Flanagan — Head of Fixed Income Strategy

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WisdomTree's Chief Investment Strategist, Luciano Siracusano (L.S.), its Director of Research, Jeremy Schwartz (J.S.), its Head of Fixed Income and Currency, Rick Harper (R.H.), and Senior Fixed Income Strategist Kevin Flanagan (K.F.) sat down in mid-December to reflect on 2016 and discuss the forces that could impact global financial markets in 2017. Below is an excerpt from the discussion. You can also access the full roundtable piece below.

Q: What do you see as the key investment considerations as the world prepares for the new Trump administration?

J.S.: Everyone has focused on how Trump's policies are going to "make America great again," and from an asset allocation perspective, it is rather conventional thinking to favor U.S. equity markets. But the U.S. equity market has also been where some of the greatest returns have been for the last 10 years. Part of this U.S. bias is motivated by rising yields and a rising U.S. dollar that have made some exposures to international markets appear less attractive, particularly for emerging markets, which tend to be most vulnerable to U.S. dollar shocks. Because the default for many is to overweight in the U.S., I believe it is useful to consider markets that investors are most fearful of, or where [valuations](#) look more attractive. This includes Europe, Japan and the emerging markets.

Certainly, if Trump were to initiate a global trade war, all bets would be off for global equities—whether U.S. markets or international markets. But what if Trump initiates a global corporate tax-cutting war, where countries compete to lower tax rates and incentivize companies to invest or increase hiring? This could be very positive for global equities over the long term.

In allocating overseas, I see value and diversification in blending exposures to areas of the market and world that benefit from a strong U.S. dollar compared to those that benefit from a weak U.S. dollar. Examples of this diversification synergy would be to over-weight in U.S. mid- and small-cap companies, which tend to outperform large caps during strong dollar environments, along with Japan (a strong dollar beneficiary) paired with emerging markets allocations that are on the opposite side.

L.S.: We are all starting from the assumption that Trump will be able to pass most of his tax-cut plan through the Republican Congress and that lower rates will more than compensate for any elimination of deductions—and that this will take effect for taxes paid in 2017. I think we will get a tax cut, and to the extent it brings down corporate tax rates, creates incentives to bring home cash held overseas and increases investment in the U.S., I believe you can see stronger [GDP](#) growth in the U.S. in 2017 and 2018. However, if the tax cuts don't pass until late summer, it's possible they may not take effect until 2018, so the timing will be important for equity markets. If you get reductions in individual rates above and beyond corporate tax reform that, on balance, raises take-home pay (even after the loss of certain deductions), then we may also get rising consumer confidence and consumer spending. Rollbacks on some financial and energy regulations and a repeal of Obamacare may also help fuel regional and community bank lending, energy investment and job growth for small businesses. All these anticipated tax and regulatory changes should benefit companies that produce in the U.S. and that derive a lion's share of their revenues and profits within the U.S. So I agree with Jeremy that this may bode well for small- and mid-cap stocks over the next 12 to 24 months. The key is what price you pay to own these asset classes. Given the run-up in small and mid-caps in 2016 and since the election, here I prefer to own these asset classes with predominately profitable companies—companies that can maximize the impact of lower corporate tax rates. The advantage of [dividend](#) weighting or earnings weighting that exposure—rather than weighting by market value—is you

can often raise the dividend yield or lower the [P/E ratio](#) on the asset class. After our December [rebalance](#), for example, the [WisdomTree SmallCap Earnings Index](#) had a forward P/E ratio just 16 times—a significant discount compared with both the [S&P 500 Index](#) and the [Russell 2000 Index](#).

R.H. & K.F.: Investors are pulling forward the perceived positive economic impacts of a potential [fiscal stimulus](#). This is creating a new dynamic for fixed income markets. In our view, domestic politics may be moving from a growth inhibitor to a growth agitator. Ultimately, the long-term impact hinges on several key questions: how clear is the pathway, how long is the fuse, and is government reform even capable of shaking the economy from its “new normal” state? We anticipate one of three scenarios to emerge:

- Our base case is best characterized as “Good Trump, Healing World”—the near-term satisfaction of tax cuts and regulatory rollback offset the reality that fiscal stimulus has a longer fuse. Fiscal policy proves to be uplifting but not life changing in 2017.
- “Failure to Launch”—the Trump administration gets a wake-up call as to the way politics is conducted in D.C., while renewed troubles in Europe and Asia keep markets on edge.
- “Shock & Awesome”—everything clicks on the policy front, the economy wakes from its “new normal” slumber and [inflation](#) is higher than expected. As a result, the economy begins to accelerate, resulting in a global reflation trade.

Each of these scenarios has very different long-term implications for the capital markets.

[To read the full 2017 Outlook roundtable discussion, click here.](#)

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DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Dividend : A portion of corporate profits paid out to shareholders.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Rebalance : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

Fiscal Stimulus : Using fiscal policy as a tool to provide economic growth.

Inflation : Characterized by rising price levels.