
WISDOMTREE'S THOUGHTS ON THE MARKETS FOR 2018

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Nine years into the U.S. [bull](#) market in stocks, we are still optimistic for the year ahead. But there are some risks that investors need to be mindful of. Fortunately, we do not believe recession is one of them, and so we remain bullish headed into 2018.

Pending recessions typically end bull markets. And recessions are often presaged by certain signals: rising jobless claims, falling home sales, an inverted [yield curve](#), wage pressures that impact corporate margins, exogenous shocks, including oil spikes, or destabilizing [valuations](#) in key asset classes. We don't see those red flags on the horizon as we enter the new year, so we continue to believe that 2018 will witness strong U.S. and global [GDP](#) growth. Equity gains will likely moderate from 2017, but we continue to favor stocks over bonds.

This is not to say that there aren't risks being 100% invested in [beta](#) exposures 100% of the time. In fact, we are looking to lower our beta exposures in certain areas of global equity markets. For instance, the technology and [momentum](#) trade is getting long in the tooth. Momentum as a factor tends to do well late in the cycle when folks don't have a better idea than to buy what already has gone up in the expectation that someone will be there to pay more for it in the future. Now is the time, in our view, as valuations become stretched, to begin balancing out one's factor exposures; the next large drawdown will likely create an opportunity to bank some alpha relative to traditional beta exposures.

We continue to believe that investors should tilt their U.S. equity allocations toward large-cap quality. We feel this provides the best trade-off in terms of valuations, shareholder yield, growth expectations and the potential to buffer some of the downside if markets sell off. The dollar weakened by 8.5% in 2017, creating a tailwind for the technology sector and certain multinational companies that should benefit from lower tax rates on the repatriation of foreign profits. The [WisdomTree U.S. Quality Dividend Growth Index](#), for example, beat the [S&P 500 Index](#) by more than 550 [basis points \(bps\)](#) in 2017, and we continue to prefer the company and sector tilts within this Index relative to the broader market.

In the developed world outside the U.S., we continue to see opportunities in Japan. We expect to see a continuation of synchronous global growth in 2018, which is typically good for Japanese companies. If continued U.S. small business and consumer confidence leads to a tighter U.S. labor market, we could see upward pressure on long-term yields in the U.S. If Japan's central bank continues to suppress 10-year yields in Japan, that could lead to further yen weakness, which would be good for their exporters. For these reasons, we continue to favor Japanese equities.

We also remain positive on emerging market equities. Although broad emerging market indexes have rallied 70% from their lows in January 2016, we still believe the asset class offers compelling value on both an absolute and relative basis. We continue to like companies that are freer to compete globally, thus favoring exposures that exclude state-owned enterprises.

On the fixed income front, it is difficult to find sectors we would consider inexpensive. The rally in risk assets has tightened credit spreads considerably, and the much flatter yield curve presents diminished prospects for extending duration. Fixed income investors should be realistic in expecting this to be a year of relatively low returns across asset classes in general—a year in which small ball becomes much more important than swinging for the fences.

With respect to interest rates, we continue to see a bifurcation for U.S. rates where shorter-dated yields move higher in response to possibly two or three more Fed rate hikes, while the U.S. Treasury 10-Year yield trades in a 2.25% to 2.75% range, with a temporary move toward 2.00% possible if geopolitical risks become realities.

Outside of a military confrontation on the Korean peninsula, a big risk for the market in 2018 remains inflation rising quicker than expected, which could force the Fed to move faster than it presently intends to in the U.S. In the second half of the year, it will also be worth watching whether the European Central Bank (ECB) begins to signal intentions to end its quantitative easing program. The global stock market rally since 2009 has been assisted by global monetary expansion. Once the world's major central banks cease, in aggregate, to create new currency, we will likely enter a new phase in the global expansion and global rally in stocks. If that occurs in the fourth quarter of 2018, around the time of the U.S. midterm elections, investors should expect greater uncertainty and volatility in the markets.

Unless otherwise noted, data source is Bloomberg, as of December 30, 2017.

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You cannot invest directly in an index.

DEFINITIONS

Bullish : a position that benefits when asset prices rise.

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

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.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

Momentum : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

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.

Basis point : 1/100th of 1 percent.