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Nationwide Market Insights℠

2018 Outlook: Robust economic growth and earnings expected to continue

The broad-based global economic recovery that began to take shape in 2016 finally hit its stride in 2017, and helped deliver solid gains in corporate earnings and equity markets. We expect this synchronized economic expansion, and the accompanying stock market gains, to continue in 2018. Central banks have been supportive, and the positive backdrop should remain in place in 2018. And while the U.S. economic expansion is entering the later stages of the business cycle, other major economies have much farther to go. Over the near to intermediate term, therefore, global business activity and corporate earnings should continue to rise, which in turn should support equity prices.

We expect the U.S. economy to remain strong in the coming year, and global synchronized growth appears likely to continue.

Global earnings momentum should persist, supporting equity prices.

Domestic and international stock markets could both post gains in 2018, while U.S. tax reform may benefit small caps, manufacturers and multinational technology companies.

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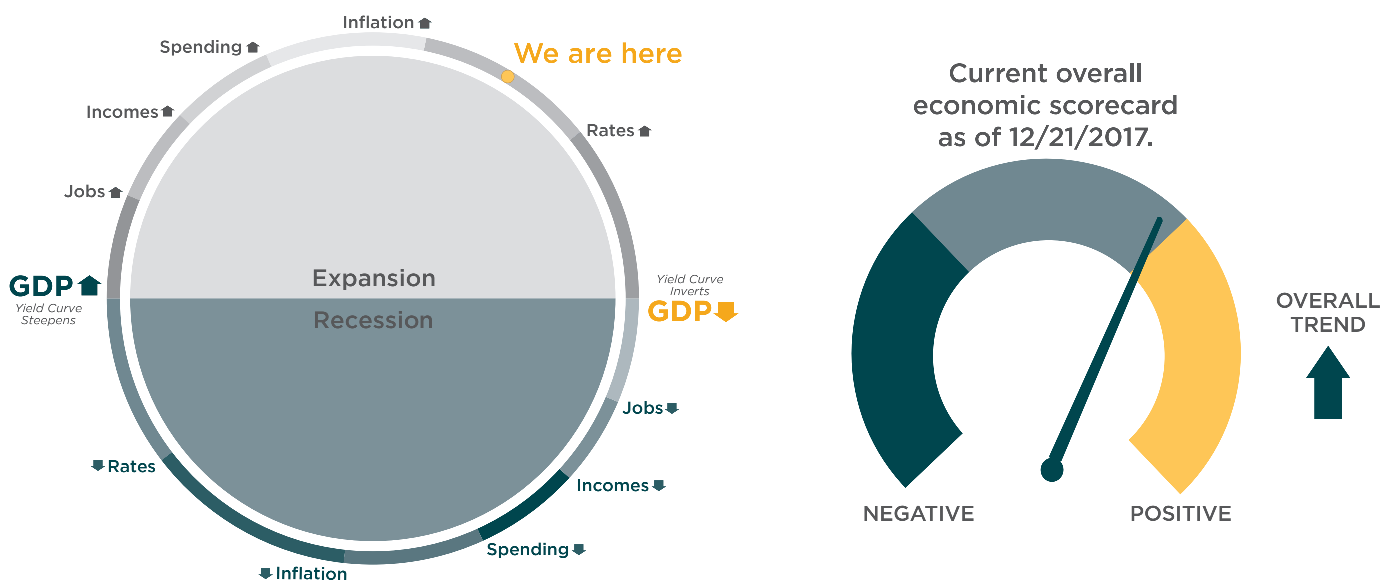
- Although the U.S. economy is entering the later stages of the economic cycle, the Nationwide Economics team remains positive on the near and intermediate economic trends.
- Growth has accelerated, with the economy posting annualized GDP gains of more than 3% in the second and third quarters. If it also reaches 3% in the fourth quarter, this would mark the first such stretch since 2005.
- It's unclear whether this pace will continue, but the recent passage of a tax reform bill has lifted expectations for 2018. Growth is now anticipated to reach 2.9% for the year, up from a baseline forecast of 2.1%. The tax plan's impact is expected to come primarily from changes to the corporate tax code. The impact on consumer spending is more uncertain.
- Rising economic growth has led the Fed to tighten monetary policy, raising short-term interest rates, while inflation should trend higher next year. The 10-year Treasury note could end 2018 at 3%, up from around 2.4% as of late 2017. If the current pattern prevails, we believe the Fed could hike rates three times in 2018.
- The Nationwide Economics team remains bullish on the global economy as well, as the synchronized recoveries have significant momentum. The fact that much of the world is two to three years behind the U.S. economy in the business cycle should help extend the global expansion.

Chart 1: The U.S. is in the later stages of the business cycle, but the near-term outlook remains positive



Source: Nationwide Economics Team (12/17).

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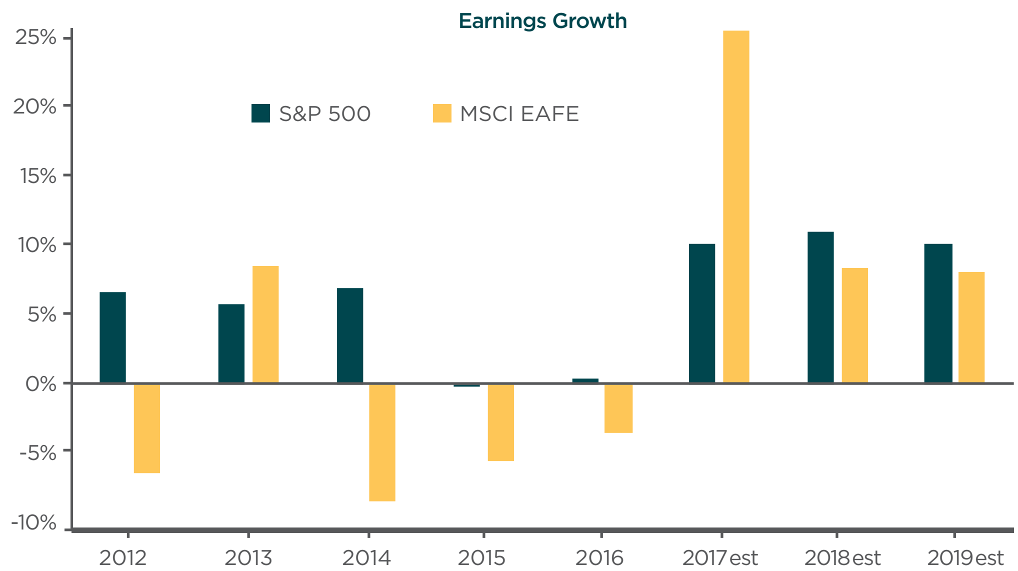
Global earnings momentum should persist, supporting equity prices.

- Corporate earnings in international markets rebounded strongly in 2017, following three down years. A robust global economic backdrop could generate revenue growth of 5% next year, producing quality earnings and sustainable growth.
- We expect U.S. profits to post gains as well, despite the lateness of the economic cycle. Earnings on the Index (S&P® 500) could rise by 10% in 2017, 11% in 2018 and 10% in 2019 — a marked change from 2015 and 2016, when growth was flat.
- Tax reform in 2018 could also add another 5% to 10% to S&P 500 profits. Domestically focused sectors — including telecom, retail and utilities, which generally have higher tax rates — may gain the most. Small caps, which also tend to concentrate on domestic markets, could be among the big beneficiaries as well.

Chart 2: Global earnings are recovering



Source: FactSet (December 2017).

Domestic and international stocks could both post gains in 2018, while in the U.S. certain segments are also likely to benefit from tax reform.

- After years of underperformance, global markets have generally outperformed U.S. stocks in 2017. Conditions are in place for this to occur again in 2018, as valuations are more attractive and strong economic and earnings growth may keep the momentum going.
- In the U.S. market, small caps have historically underperformed in the later stages of the cycle. But they could be among the big winners from U.S. tax reform as could the domestically focused sectors including telecom, retail and utilities. They may see their tax rates fall more than multinational companies already advantaged by lower overseas corporate rates.
- In addition, manufacturers are likely to gain from the expensing of capital expenditures while multinational tech companies may benefit most from repatriation.
- In the event that the U.S. economy enters the final stages of the expansion sooner than expected, quality growth stocks could be big winners. Large, high-quality growth companies typically have more ways to drive earnings when revenue growth slows, including margin expansion, reinvestment of cash flow, share repurchases and deleveraging.

Chart 3: In 2017, developed and emerging markets have outperformed the S&P 500
Q1 2010 through Q4 2017

	2010				2011				2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Developed Markets	▼	▼	▲	▼	▼	▲	▼	▼	▼	▼	▲	▲	▼	▼	▲	▼
Emerging Markets	▼	▼	▼	▼	▼	▼	▼	▼	▲	▼	▲	▲	▼	▼	▲	▼

	2014				2015				2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Developed Markets	▼	▼	▼	▼	▲	▼	▼	▼	▼	▼	▲	▼	▲	▲	▲	▼
Emerging Markets	▼	▲	▼	▼	▲	▼	▼	▼	▲	▼	▲	▼	▲	▲	▲	▲

▲ Outperformed S&P 500 ▼ Underperformed S&P 500 ■ Both indexes outperformed

Developed markets represented by the MSCI EAFE Index. Emerging markets represented by the MSCI Emerging Markets Index. Source for index data: FactSet Research Systems.

Key takeaways

U.S. equities have been in a bull market since March 2009, but with the economy strengthening, it appears the bull can run a while longer. Despite its late position in the business cycle, the U.S. economy has recently accelerated, and corporate earnings have improved substantially over 2017. The synchronized growth of the global economy may also continue for some time as many major economies are in earlier phases of expansion. If equities keep pace with earnings, additional gains are possible in the coming year.

- International and emerging markets could still be well positioned, as valuations are more attractive and growth is likely to be stronger over the next few years.
- In the U.S. market, small caps, manufacturers, tech companies and domestically focused sectors may deserve some consideration as well, as they are likely to benefit from tax reform.
- Maintain portfolio allocations in line with your risk tolerance, keeping your fixed-income allocation steady. Bonds provide income and diversification benefits, and despite what many believe, gradual rises in interest rates typically do not result in bond market losses.

For more help or information, contact your financial advisor.

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MSCI EAFE® Index: An unmanaged, free float-adjusted, market capitalization-weighted index that is designed to measure the performance of large-cap and mid-cap stocks in developed markets as determined by MSCI; excludes the United States and Canada.

MSCI Emerging Markets® Index: An unmanaged, free float-adjusted, market capitalization-weighted index that is designed to measure the performance of large-cap and mid-cap stocks in emerging-country markets as determined by MSCI.

S&P 500® Index: An unmanaged, market capitalization-weighted index of 500 stocks of leading large-cap U.S. companies in leading industries; gives a broad look at the U.S. equities market and those companies' stock price performance.

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