Reflationary Tailwinds

Reflation trends are likely to continue in 2017 thanks to broader fiscal easing, a positive outlook for commodity prices and Central Banks' sustained support. We expect to enter an heterogeneous phase, in which countries that rely more heavily on fiscal policy are set to outperform.

Watch for Earnings Growth

Earnings are improving in the US and are likely to be further supported by Trump's policies. In Japan we expect a favourable path going forward for corporate profits, supported by the weaker yen. We expect earnings growth to sustain stocks in US and Japan, less so in Europe due to political risk.

Risk-Aware Approach

Even though the outlook has improved, we continue to see risks on the radar, from political uncertainty to reflation disappointment. Setting up efficient hedging strategies and broadening the sources of diversifications will continue to be crucial to try to protect investors' assets.

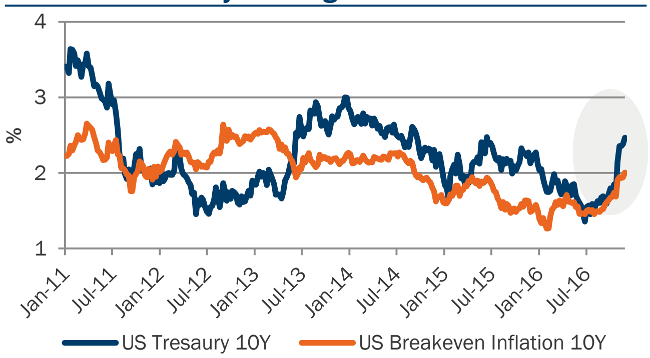
Keywords for 2017: *Trumponomics*, Reflation and EU Elections

The last few months have been marked by significant developments. The limitations of monetary policy's supremacy in stimulating the economy have emerged as well as unbalances deriving from stretched policies and negative interest rates. The low growth/low inflation scenario and its consequences, in terms of rising inequality and middle class erosion, has been revealed as not being socially sustainable and has triggered a search for alternatives. *Brexit* and Trump's election emerged as one possible answer and the political environment is now in the process of being redefined in Europe as well.

Trumponomics will be a key factor to watch in 2017 and not only for geopolitical equilibrium. If his proposed infrastructure spending, fiscal easing and tax reforms are effectively implemented, the US reflation stimulus will likely strengthen GDP growth, inflation and earnings growth. At least in the US, the era of financial repression seems to be fading, and nominal yields have started to reconnect with the improving macro backdrop. This new dynamic scenario is setting the stage for a heterogeneous phase in which countries that rely more heavily on fiscal policy are set to outperform. We expect inflation to move modestly higher, particularly in DMs[1]. While the US is already on a solid growth trajectory, with a strong labour market and inflation coming up, Europe is dealing with modest growth, albeit resilient, and very low inflation, and so is in urgent need of benign fiscal policy and pro-growth initiatives. Under the assumption that US protectionist threats are contained and the commodity cycle is benign, EMs[2] will likely benefit from a growth pick up, especially those with more fiscal and monetary capacity and further commitment towards structural reforms. Asia, in this regard, continues to be our most favoured area.

How does the reflationary environment translate into investment decisions? We believe investors can exploit growth opportunities, currently through Japanese and US equities. In fixed income, we believe inflation-linked bonds in the US and in Euroland are pricing in an inflation pattern that is too low. Credit markets in DMs are expected to outperform sovereign bonds. Given the risks on the radar, we believe that broadening the sources of diversification and incorporating hedging strategies will continue to be crucial to try to protect investors' assets.

The Reflation Story has Begun



Source: Pioneer Investments, December 13, 2016.

» The last few months have been marked by significant developments, setting the stage for a heterogeneous phase in which countries that rely more heavily on fiscal policies are set to outperform.

1. DMs: Developed Markets.
2. EMs: Emerging Markets.

Diversification does not guarantee a profit or protect against a loss.

IMPLICATIONS FOR ASSET ALLOCATION
Playing Divergences and Reflation with an Active Approach

INVESTMENT APPROACH
Active and Risk Aware Mind-Set in Asset Allocation

A new economic and political scenario is emerging with economic divergences within regions widening and inflation moving modestly higher, particularly in DMs. We believe investors should consider embracing an active approach to exploit the opportunities that asynchronous monetary and fiscal policies may create across assets or within asset classes. We believe that the search for income will continue, but requires an increasingly selective approach towards credit markets and broader sources of income from equity, multi assets and real assets.

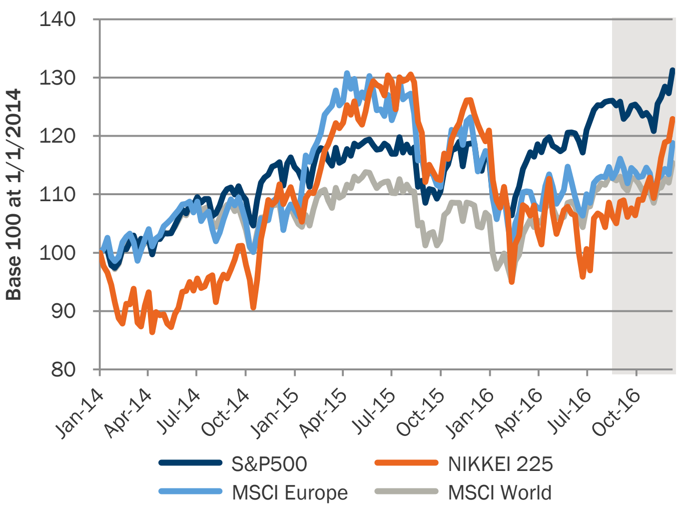
EQUITIES
Exploit Growth Opportunities in Japan and US

We are now more constructive on global equities. Growth is expected to pick up in Japan as in the US, fiscal policies are more favourable and should support an improvement in earnings growth in these markets. We prefer equities in these areas over Europe, where the economic and political uncertainty remains high.
In EMs, we are constructive on Asia over the medium term.

FIXED INCOME
A Flexible Approach to Invest in a Reflationary World

Reflationary policies around the world will likely mark the end of ultra-low/negative interest rate policies. Interest rates will likely remain lower than the historical norm, but financial markets will start anticipating a normalization of monetary conditions and "tapering" of unconventional policies. We believe that navigating these new market conditions will require an active approach, a focus on inflation-linked securities, and a selective preference for credit markets in developed world. EM bonds can still be considered as a source of income. A selective approach may be needed here as EM bonds will tend to suffer from US dollar appreciation and the pick-up in US yields.

Global Equities Supported By Stronger Growth



Source: Bloomberg, data as at December 12, 2016.

Tactical Currency Opportunities

In our multi-asset approach, we believe FX may become a relevant part of value generation in 2017. We believe that the US dollar will remain well supported at least in H1; within EMs, we see tactical opportunities driven by asynchronous policies and differing economic transition approaches.

ALTERNATIVES AND HEDGING
Keep a Well Diversified Portfolio

With geopolitical risks still on the radar (changing geopolitical equilibria, *Trumponomics* and China slowdown) we believe it will be important to keep structural hedges in a well diversified portfolio.

Macro Themes & Investment Implications

1 HIGHER INFLATION	Curve Steepening, Inflation Linkers
2 STRONGER GROWTH IN DMs	Positive on Global Equities (Japan and US)
3 SEARCH FOR INCOME	Selective on DM Credit Markets and EM Debt
4 HEDGING RISKS	Enhance Diversification

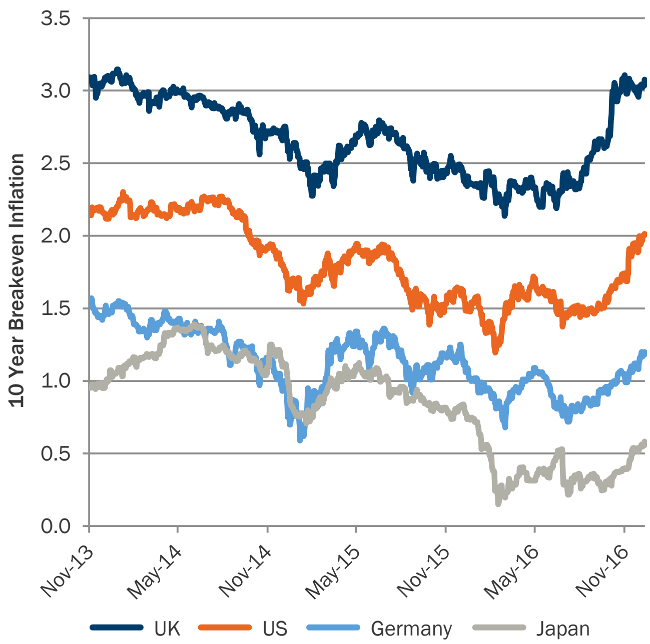
DM equities are favoured in a reflationary environment. EMs are under watch as they can be hit by Trump's protectionist policies, a stronger dollar and higher interest rates.

MACRO THEME

CENTRAL BANK FOCUS
Evolving Divergences in Line with Inflation Expectations

Conditions were finally there for the Fed to go ahead with its interest rates normalization process. We expect three hikes in 2017, amid positive and accelerating economic growth in the US; the economic and fiscal policy in the US, post the Presidential election, is also likely to have a role in determining the future path of interest rates, influencing inflation expectations. The other major Central Banks are dynamically managing their accommodative policies. The European Central Bank, at its December meeting, lowered monthly purchases from 80 to 60Bln Euros, but extended the purchasing programme until December 2017 (or beyond if necessary), assuring a sustained presence of the ECB in the financial system for a longer length of time, in a period of high political uncertainty. Trimming the amount of monthly purchases does not constitute tapering according to Draghi, and the stock of the balance-sheet expansion is similar to previous regimes. That said, the flow of purchases makes a difference for the market: the ECB's new stance seems to embrace a firmer pace of economic growth and a financial environment of higher yields. The BOJ maintains its full speed expansion, continuing the current QQE (Quantitative and Qualitative Easing), and even broadening it if necessary, in the aim to exceed, rather than reach, its medium term 2% inflation target.

The Root of Divergences in Breakeven Inflation



Source: Bloomberg, data as at December 12, 2016.

Inflation expectations recovered in the last few months, but the outlook remains varied.

INVESTMENT STRATEGY

With the US being the only country with inflation pressures so far, the monetary policy divergence argument will remain strong and will continue to support a USD strengthening bias against the other DM currencies.

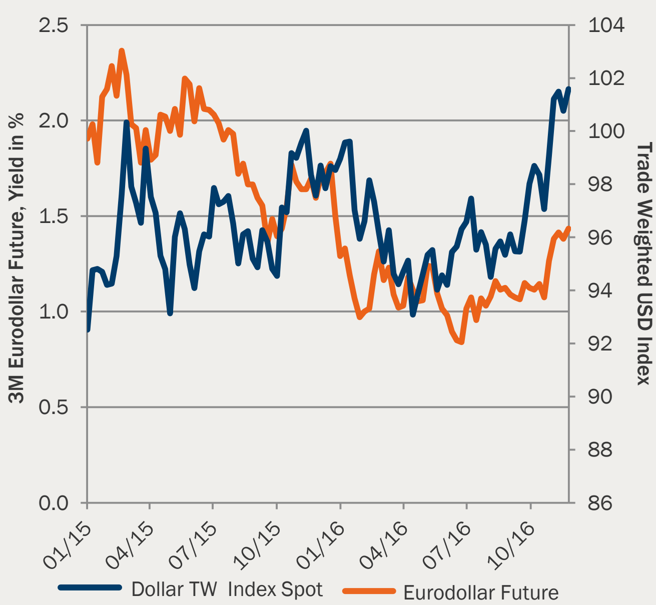
Inflation was already moving higher before the elections, with pressure coming from the tight labour market and from rising commodity prices. Trump's victory reinforces this path as fiscal expansion and the potential imposition of tariffs will likely have an inflationary impact.

From a fixed income perspective we see value in US inflation-linked bonds as they still priced in a relatively low inflation outlook, especially considering recent oil price dynamics.

We also like EU inflation-linked securities, as they discount a very pessimistic inflation scenario in the Eurozone. The growth outlook has modestly improved and remains supported by the still expansionary monetary policy stance of the ECB.

In this context of improving conditions in the Eurozone, we continue to consider 2-year German Government bonds overpriced, especially as we don't expect any further deposit rate cut from the ECB.

Stronger USD, Supported by Expectation of Higher Rates



Source: Bloomberg, data as of December 12, 2016.

We believe the monetary policy divergence argument will remain strong and will continue to support a USD strengthening bias against the other DM currencies.

REFLATION POLICIES AT WORK
US at the Forefront

MACRO THEME

The US economy is accelerating in the second half of the year and still creating a respectable numbers of jobs, with unemployment below 5% (4.6% according to November's labour report).

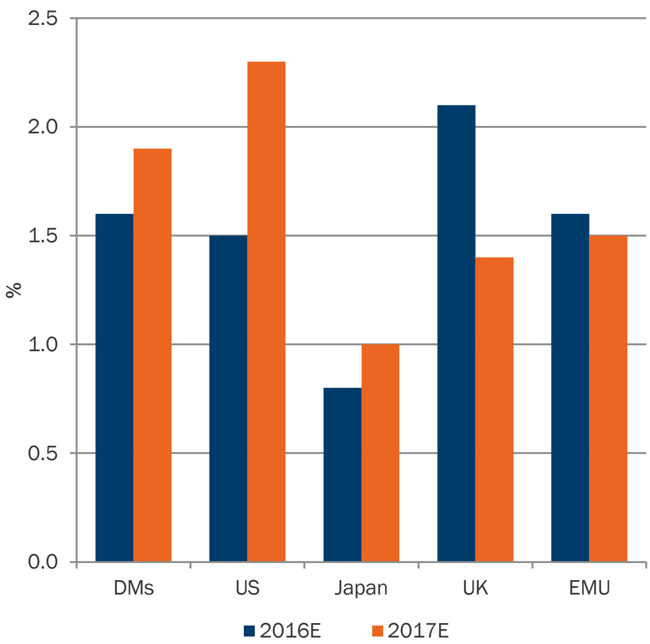
Wages have (just) started to give some sign of rising. Consumer spending is sustaining the economy thanks to real disposable income gains. Inflation is still absent in Europe, but seems to be on track in the US. Trump's trade policies (the imposition of tariffs) and a sustained commodity cycle would pose upside risks to inflation.

In Japan, core inflation is far from the BoJ's target in our forecasting horizon; however, it is comfortably heading towards 1.0% in our base case. Risk coming from the cost side (weak yen, oil and commodity prices) is on the upside.

Political developments are working as a booster for reflation dynamics: Trump's election, bringing fiscal stimulus and infrastructure expenditure, should be stimulative for economic growth. Interestingly, his pro-business attitude could tighten the economic ties with corporate Japan.

In Europe the fiscal policy is slowly turning more expansionary; the electoral races could favour further expansion, but a structural turn towards pro-growth fiscal policy and reform is still weak, scattered and threatened by political risks.

US Expected to Lead Growth in DMs in 2017



Source: Pioneer Investments, as at December 12, 2016.

Trump's election is working as a booster for the reflation dynamics. We expect the US economy to lead DM growth in 2017.

INVESTMENT STRATEGY

US and Japanese equities may benefit most from a broad reflation environment and national initiatives.

Earnings are already improving in the US and are likely to be further supported by Trump's policies.

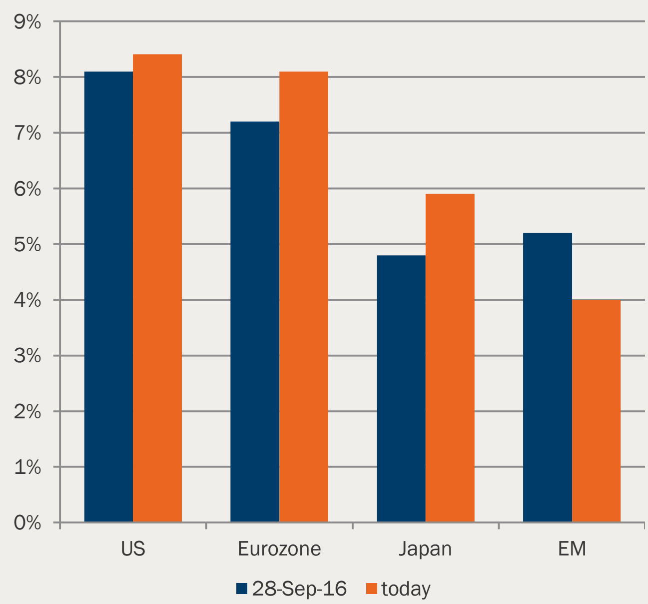
In Japan top down corporate profits for Q3 2016 have reversed their declining path and have come out even stronger than expected. We anticipate this to continue, supported by the favourable yen.

We maintain a cautious approach on European equities, as political risks are still high and concerns over the financial system may trigger volatility.

In fixed income, reflationary trends will probably tend to steepen the yield curves, so we prefer the 5-year part of the curve to the 30-year as the long end will price in higher inflation expectations.

We remain constructive on European Investment Grade Credit overall, continuing to see value in segments of the market. The details of the ECB's Corporate Sector Purchasing Programme are supportive of the demand for European corporate bonds. Even if valuations are less compelling than before, they remain acceptable if compared with government yields.

Acceleration in Corporate Earnings (View for Dec '17)



Source: Pioneer Investments, Bloomberg, data as of December 12, 2016. Earnings growth expectation for December 2017.

US and Japan equities may benefit the most from a broad reflation environment and national initiatives.

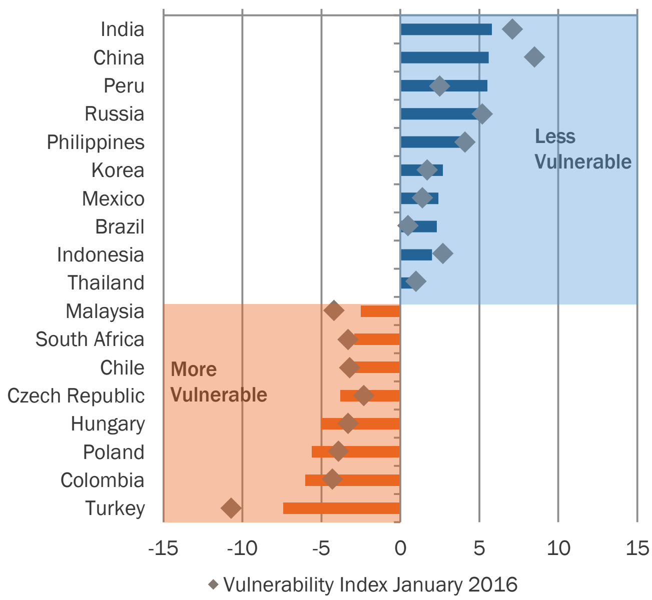
MACRO THEME

EMERGING MARKETS
Strong Headwinds May Test EM Resilience

Under the assumption of a moderate "Trump factor" and a more benign commodity cycle, China and the Emerging Markets will, in our view, proceed or even accelerate in the transition of their economic model towards more domestically driven quality growth.

On the negative side, rising inflation in the US, a stronger dollar and rising yields are not a positive factor for Emerging Markets. However, Emerging Markets are less vulnerable today than they were during the 2013 taper tantrum and have improved significantly compared to beginning of 2016. They are better equipped, in terms of fundamentals, to deal with the new economic challenges. The positive outlook for commodities, which should come with the cyclical uptrend in growth, could favour exporters. At the same time, countries more insulated from US trade policies and the rise in US yields may be less exposed to these headwinds. Broadly speaking, the winners will be those with more fiscal and monetary capacity and further commitment towards structural reform. Asia, in this regard, continues to be our most favoured area. China, in particular, shows more stable economic and political conditions and an accelerating structural transition over the medium term.

EMs Less Vulnerable than at start of 2016



Sources: Vulnerability Index takes into account: CA and Funding; External Debt and ST External Debt; Reserve Adequacy; Domestic variables. Source: Pioneer Investments, December 12, 2016 compared to January 2016.

Headwinds for EMs are strong but we acknowledge that they are better equipped, in terms of reserves and fundamentals, to deal with the new economic challenges.

INVESTMENT STRATEGY

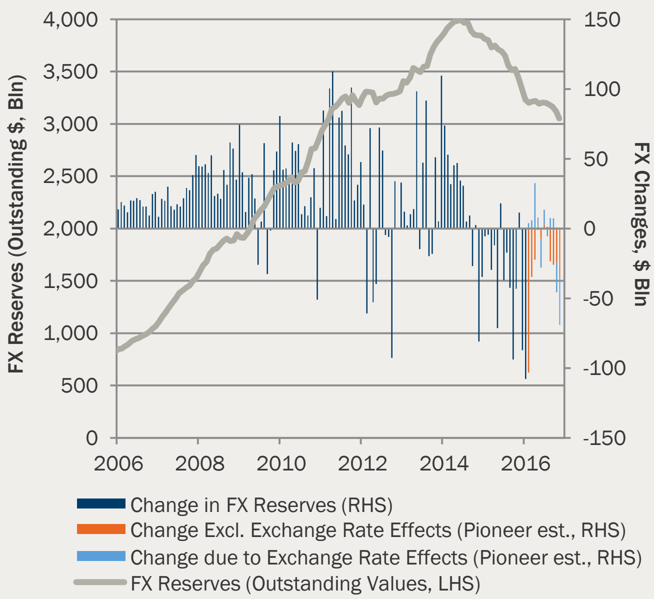
We believe that the risk-adjusted return for EM assets is not particularly appealing at the moment, given the headwinds which may come from the rise in US treasury yields and the dollar appreciation. These two combined factors weigh on corporates indebted in USD, but may also put pressure on EM FX reserves. The decline in reserves has been particularly remarkable in China in November.

Part of the movement is explained by the People Bank of China's intervention. Part is attributable to the depreciation of assets denominated in euros and yen, which weakened versus the USD, and the pickup of US yields, which directly impacted the market value of China's US Treasury holdings (worth more than $1trn).

We believe that outflow pressures could ease if additional strength in USD is limited, at least in the near term. Should we see faster and more sudden movements rather than gradual adjustments on the dollar and on interest rates, we would expect volatility to return on EM bonds.

We still believe fundamentals are strong in the area and we may see opportunities, especially in Asian equities, as US foreign policy becomes clearer. However, at the current stage, we prefer to keep a neutral view on EM assets.

Risk to Watch: China FX Reserves



Source: Pioneer Investments, Datastream, as of December 12, 2016.

Risk-adjusted returns for EM assets are not particularly appealing at the moment, given the headwinds which may come from the rise in US treasury yields and US dollar appreciation.

HEDGING THE RISKS
Hedging a Multiple Risk Environment

THE RISK MAP

Time Horizon	Risks	Impact	Probability	Trend (vs. Last Quarter)
3-12 Months	Political Paralysis in EU	●	HIGH	=
3-12 Months	Global Geopolitical risks	●	MEDIUM	↑
3-18 Months	EM Headwinds	●	MEDIUM	↑
3-18 Months	Monetary Policy Ineffectiveness	●	MEDIUM	=

● Low Impact ● Medium Impact ● High Impact

Source: Pioneer Investments. Data available as of December 12, 2016.

HEDGING STRATEGY

Even though we expect slightly stronger economic growth in 2017, we continue to see a number of structural risks on the radar, such as the risk of policy mistakes, the high debt exposure of global economies, and political uncertainty in Europe, where the electoral calendar in 2017 will be very crowded.

The "Trump factor" is a booster in the reflation story, but failure to meet these expectations, in terms of fiscal expansion and infrastructure spending, may be a source of volatility. Moreover, should Trump's pledged stimulus emerge as short-term oriented and lack a structural component, the positive reflationary story could be undermined.

Another risk relates to the trade policy of the President-elect, which may have negative repercussion for some countries; furthermore, as Trump is an outsider in geopolitics, relationships with some of the most sensitives areas tend to be quite delicate and mistakes are possible.

In this context we believe it may be wise to keep structural hedges. Gold, while not having fundamentals on its side – the strong USD is making gold more expensive, while higher real interest rates are making it less appealing - continues to be a hedge against potential spikes in volatility or market stress, in our opinion. In general, we believe that broadening the source of diversification and incorporating efficient hedging strategies will continue to be extremely important to try to protect investors' assets.

» We continue to see a number of structural risks on the radar, such as the risk of policy mistakes, the high debt exposure of global economies and political uncertainty in Europe. The risks related to Trump's pledged fiscal stimulus are also crucial in this context.

GLOBAL ASSET ALLOCATION

12 Months Return Outlook		Relative Value Opportunities: Underweight	Neutral	Overweight	
+	**Global Equities**			●	The ingredients for reflation are becoming more evident: fiscal expansion in many areas, the strong dollar favouring European and Japanese corporates. The outlook for Earnings per Share in Developed Markets is improving; we think global equities should benefit from this environment.
+	USA			●	US data has been generally positive and expansionary fiscal policies should support a general reflationary environment. Earnings growth is expected to resume on the back of the solid growth outlook. Valuations may not be as expensive considering potential corporate tax cuts.
-	Europe	●			We still remain very cautious on European Equities, as the headline risk from political events is very high. Next year Germany, France and the Netherlands will hold elections; in Italy the political situation may generate some uncertainty even if we do not expect it will trigger political or economic instability in the medium term.
+	Japan			●	Macroeconomic momentum has been improving mainly thanks to the external sector. Japanese yen depreciation is also supportive. We consider Japanese equity market valuations attractive and the new fiscal package should support this asset class.
=	Pacific ex Japan		●		The area remains vulnerable to China's transition to a more service-oriented economy. We are keeping a neutral stance on this area.
=	Emerging Markets		●		We keep a neutral stance on EM equities, as Trump defines his trade strategies and clearer geopolitical equilibria emerge. In China, reforms and structural transition are accelerating. China's mismanagement of transition remains a key risk, as does the relationship between China and the new US administration. Asia is our favourite area in EMs.
=	**Global Bonds**		●		Government bond yields are still close to their lows and the reflation environment is not favourable for yields, so they do not seem to offer much value. Opportunities, in our view, can be found in corporate bonds, although we expect lower total returns for 2017.
=	US Govies		●		After the hike in December, we expect the Fed to keep a cautious pace of tightening over 2017. We expect the 5-30y segment of the US curve to steepen, as the long end of the curve could incorporate some inflation expectations.
=	US Corporate		●		Solid macroeconomic environment and the potential earnings pick up should favour US Corporate, but we prefer to keep a neutral stance in an environment of rapidly rising interest rates.
-	Euro Govies	●			Safe haven assets, such as the govies, become less attractive in a reflation environment, especially with yields so low. We think inflation-linked securities offer value as they still discount a very pessimistic scenario for inflation.
+	Euro Corporate			●	Although we acknowledge that there is not much space left for further tightening, euro corporate bonds remain supported by the search for yield and by the ECB bond purchasing programme.
=	Emerging Markets Bonds		●		Higher US treasury rates and stronger dollar are generally negative for EM sovereign and corporates debtors in the USD market. Spreads are fairly valued at the current levels. We prefer to focus on selective opportunities, keeping an overall neutral stance.

COMMODITIES STRATEGIES

We have a positive bias on commodities, based on demand and supply dynamics.

CURRENCY STRATEGIES

We expect the USD strength to remain sustained on the back of monetary policy divergence.

DISCOVER OUR INVESTMENT VIEW

Investment Outlook 2017

Investing Ideas, Blue Paper

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