5 Good & 5 Bad Scenarios for Investors in 2017

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Peering into the next 12 months, Neil Dwane looks at how 10 hypothetical events – including a "soft Brexit", the rise of "green bonds" and a Le Pen victory in France – could affect economies and markets around the world.

The Good

1. Europe progresses

After a torrid 2016 political environment for Europe – starting with the surprising Brexit decision and culminating in a dispiriting "no" from Italy's voters – fears about the "dis-integration" of Europe may end up misplaced. If the elections Europe faces in 2017 affirm a constructive journey forward, political tensions could fall, confidence could grow about a "soft Brexit" outcome and progress could emerge. This, in turn, could help investment and employment to rise, which would be another important step toward a fully united Europe. Low valuations and reduced political risks might then combine to generate good equity returns.

2. Green funding takes off

Despite President Trump shifting US energy policy back toward coal and oil, global efforts to improve the quality of future economic growth could accelerate quickly thanks to "green bonds". Issued by governments and companies to sustainability-conscious investors, these securities promote lower pollution and cleaner water and energy systems. With the idea of climate change challenged by sceptics in the US, corporations and investors could instead join forces to promote investment in less carbon-generating or more hydrogen-powered opportunities, which would minimize ecological damage. For Europe, China could lead the way.

3. Fiscal stimulus boosts global growth

The realization that negative interest rates were a policy error has led to demands for a more fiscally stimulative set of economic policies globally. If enacted, they could help relax the investment tension created by a distorted environment of interest rates hovering near zero. The presence of populism, whether in Europe or the US, could combine with new spending to boost economic activity after a period of draining austerity and narrowing deficits. If successful, we could see more investment and lower unemployment as confidence increases.

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4. "Ch-India" consumption takes off

With China rebalancing toward a consumption-based economy, and with reform movements converging in India and Indonesia, the world is witnessing the creation of a new consumer market with 4 billion people. Incomes here are expected to grow rapidly in coming years, with the "American dream" alive and well in the south-eastern part of the region. Global brands may lose out to more local and affordable Asian names, but the direction of travel seems set as this upward-looking market follows in the economic footsteps of Japan and Korea.

5. Active managers add alpha

After a generally woeful year adding alpha in 2016, active managers could resume serving clients better by improving pricing and performance transparency, and by aligning costs to meet client objectives. At the same time, the so-called "free costs" of passive investing could become unstuck as volatility widens spreads, lifts interest expenses, and reveals greater illiquidity and positioning concentration – all of which would further detract from indexed returns. Additional efforts to control high-frequency trading and implement extra financial transaction taxes, as well as the addition of MiFID 2 regulatory changes, could further increase costs, which would play to the strengths of the more skilful active stock picker.

The Bad

1. Trump inspires trade protectionism

True to his campaign promises, Trump could introduce trade policies that "make America great" – but at everyone else's expense. NAFTA might be realigned, which would hurt Mexico, cause dramatic consequences for an already-collapsing Venezuela and reverberate through Brazil, which is already in the third year of recession. A stronger US dollar would, ironically, make life harder for Trump, so he could begin to target the key exporters to the US – China, Japan, South Korea and Germany, with the Asian countries feeling the painful effects as one.

2. The Middle East stays troubled

This region could easily become even more challenged in 2017. While the Islamic State may be targeted more effectively by its enemies, the recent coup in Turkey, the regional effectiveness of the Kurds, the disarray in Egypt and Libya, and the deteriorating detente between the US and Iran all hint at worse to come. For example, a new kind of Thirty Years War between the Sunni and Shia people still seems probable. Investors should be mindful that any of these developments may well underpin a stronger oil price.

3. "Solar minimum" causes another polar winter

While many weather-watchers focus on the El Niño and La Niña rotations in the Pacific, another key driver of global weather and temperatures is our sun, whose radiation and sun-spot activity may fall to record lows this winter. Despite occurring during a period of record agricultural abundance, the latest El Niño parched many major farm regions globally, leaving them vulnerable to a truly polar winter – which could reduce upcoming harvests. La Niña seems slow to arrive this time, raising fears about rising food prices and adding another leg to the reflationary inflation cycle.

4. Central-bank credibility falls

Some aspects of central-bank credibility failed in 2016 when negative interest rates did more harm than good in Japan and Europe. With Japan now adopting "fiscal dominance" – which makes monetary policy a slave to fiscal policy – interest rates may indeed remain low, but monetary policy could begin accommodating any and all fiscal desires of governments. Europe cannot follow this route per se, but with insolvent euro-zone banks still at risk, the European Central Bank will do everything it takes to keep economic growth moving forward – that is, until its efforts no longer work. The yen and euro should remain weak currencies until the US dollar changes course.

5. France chooses Le Pen

After enduring recent political shocks in the UK and Italy, Europe could be convulsed by the election of Marine Le Pen to the French presidency. Her suite of policies would be hostile to the EU, although some domestic gridlock should occur in France's National Assembly. With France uncooperative, Europe would remain directionless and unable to move forward, beset by populism across the continent, confused by the complexities of Brexit and unnerved by the apathetic attentions of President Trump – all of which could further undermine NATO.

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