World Markets Review — 2016

In a year marked by volatility and political upheaval, global stocks rallied on signs of improving U.S. economic growth and aggressive central bank stimulus measures around the world. U.S. stocks led developed markets higher, particularly late in the year as investors cheered Donald Trump’s unexpected victory over Hillary Clinton in the U.S. presidential election. Emerging markets also enjoyed strong returns, supported by rising commodity prices and political reform efforts.

Economically sensitive sectors outpaced defensive areas of the market, highlighted by strong returns in energy, materials and industrial stocks. Health care and other traditionally high-dividend-paying sectors lagged the overall market. Investment-grade bonds advanced despite a modest rise in interest rates and signs of higher inflation. The U.S. dollar rose against the euro, the yen and most other currencies.

### Index returns

<table>
<thead>
<tr>
<th>Index</th>
<th>December 2016</th>
<th>Q4 2016</th>
<th>YTD 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>U.S. dollar %</td>
<td>Local currency %</td>
<td>U.S. dollar %</td>
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<tr>
<td>MSCI World</td>
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<td>2.8</td>
<td>1.9</td>
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<tr>
<td>MSCI EAFE</td>
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<td>MSCI EM IMI</td>
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<td>-4.4</td>
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<tr>
<td>MSCI Europe</td>
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<tr>
<td>MSCI Pacific ex Japan</td>
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<td>0.8</td>
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<tr>
<td>S&amp;P 500</td>
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<tr>
<td>MSCI Japan</td>
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<td>MSCI UK</td>
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<td>5.3</td>
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<tr>
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<td>J.P. Morgan GBI-EM Global Diversified</td>
<td>1.9</td>
<td>1.0</td>
<td>-6.1</td>
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</table>

MSCI index returns reflect net dividends. Source: RIMES

North America

U.S. equities bounced back from a flat 2015 with the help of solid economic data and low interest rates. Stocks got off to a rocky start early in the year, retreating on worries about a decelerating Chinese economy, falling oil prices and a potential U.S. recession. But after China announced stimulus measures and the Federal Reserve said it would proceed cautiously on rates, stocks then proceeded to rise, with a notable hiccup following the U.K.’s surprise vote to exit the European Union in June. Another surprise – Republican Donald Trump’s win in the November presidential election – sent stocks higher on hopes his administration would follow through on campaign pledges to cut taxes, reduce regulations and increase spending on infrastructure and the military.

The Dow Jones Industrial Average rose 16% to end December just shy of the 20,000 milestone. The Standard & Poor’s 500 Composite Index and the Nasdaq composite gained 12% and 9%, respectively. All three indexes eclipsed previous all-time highs during the year. Other financial assets also did well; the dollar touched its highest level in almost 14 years against the Fed’s Trade-Weighted U.S. Dollar Index.

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.

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After a double-digit decline in 2015, energy had the biggest gain among S&P 500 sectors, rising 27%. The price of U.S. crude oil rose 45% to just under $54 per barrel as OPEC nations finally agreed to curb production late in the year. Metals & mining and construction-related stocks rebounded, supporting the materials sector’s 17% advance. Financials rose 23%, helped by prospects for higher interest rates. In September, real estate–related companies were moved from financials to the newly launched real estate sector.

Health care was the only sector to decline. Pharmaceutical companies were hurt by pricing pressure and a dearth of new products. Concerns over the future of the Affordable Care Act also weighed on the sector. The information technology sector gained 14%, supported by semiconductor companies such as Nvidia, whose shares tripled as it unveiled innovative graphic chips. Tech bellwethers Apple, Alphabet and Microsoft had more modest results, rising 12%, 2% and 15%, respectively. S&P 500 earnings growth turned positive in the third quarter after five periods of contraction, according to data provider FactSet.

Fueled by low interest rates, mergers-and-acquisitions activity remained strong, though off 2015’s record-setting total. Mega-transactions of more than $10 billion continued to dominate the M&A landscape. These included AT&T’s $85 billion offer for Time Warner, Monsanto’s acquisition by Germany’s Bayer for $66 billion, and Microsoft’s purchase of LinkedIn for $26 billion. The year set a record for failed M&A, including the largest collapsed deal of all time: Pfizer’s proposed acquisition of Ireland-headquartered Allergan. The $160 billion offer was withdrawn in April after the Treasury Department enacted new rules designed to curb corporate inversions.

The U.S. economy continued to expand at a modest pace. Gross domestic product growth was revised to an annualized rate of 3.2% in the third quarter, up from 1.4% in the second quarter. The unemployment rate fell to 4.6% in November, down 0.4% from a year previous. Job gains averaged 180,000 per month for the year to date through November, roughly 20% less than in 2015, while hourly wages increased an average of 2.5%. The Institute for Supply Management’s November survey showed the overall economy growing for the 90th consecutive month.

Still, with global economic conditions sluggish the Fed delayed raising the federal funds rate until December, a year after its first hike since 2008. Fed Chair Janet Yellen cited full employment and inflation nearing the 2% target as factors in the unanimous decision. Significantly, the central bank’s outlook for rate hikes in 2017 rose from two to three.

In bond markets, the Bloomberg Barclays U.S. Aggregate Index gained 2.6%. The turbulent year began with corporate spreads widening on fears of a China slowdown and low energy prices. In time, the market stabilized and spreads tightened 42 basis points to 123 basis points. Most major bond sectors saw positive returns. Investment-grade corporates rose 6.1%, while high-yield corporates gained 17.1%. Treasury Inflation-Protected Securities prices rose 4.7%. Municipal bonds were about flat, rising 0.2%.

Yields also experienced volatility. They declined early on, with low global rates boosting demand for U.S. bonds, then rose through year-end, on rising inflation and economic optimism following the U.S. election. The benchmark 10-year Treasury yield ended 18 basis points higher at 2.45%.

Corporate issuance was strong, with $1.5 trillion of new investment-grade and high-yield bonds brought to market. Anheuser-Busch InBev’s $46 billion deal was the second largest ever. Proceeds were used to help finance its acquisition of SABMiller.
Europe

European stocks advanced in local currency terms, supported by central bank stimulus measures and modestly improving economic growth. Markets moved higher despite rising political tensions, including Great Britain's pivotal vote to leave the European Union. The Brexit decision raised fears of dire economic consequences, but the short-term impact hit currencies harder than the economy. Overall, the MSCI Europe Index rose 7% for local currency investors. In U.S. dollar terms, however, European stocks ended the year essentially flat.

The euro declined 3% against the dollar, driven lower by the European Central Bank’s aggressive bond-buying program, as well as massive outflows from European financial assets. In a volatile year, investors pulled a record amount of assets out of European markets, the most since the single currency was adopted in 1999, according to the ECB. At year end, the euro was approaching parity with the dollar, trading at approximately $1.03. Meanwhile, the British pound tumbled 16% against the dollar, highlighted by a rapid decline after the June 23 Brexit vote.

Political turmoil claimed several high-profile leaders, including British Prime Minister David Cameron, who resigned in the wake of the Brexit vote. Italian Prime Minster Matteo Renzi announced his resignation after voters rejected a proposed constitutional referendum to streamline Italy’s federal government. French President Francois Hollande said he will not run again in 2017, bowing to record-low approval ratings. It was the first time since 1958 that a standing French president declined to seek a second term.

Economically sensitive stocks generally outpaced defensive stocks, highlighted by a 45% gain in the energy sector. After years of grinding lower, a sharp rebound in oil prices sent energy-related stocks soaring. Shares of Royal Dutch Shell, BP and Total experienced double-digit gains. The materials sector enjoyed a 33% advance, benefiting from the global rebound in commodity prices. Shares of mining giant Glencore rose more than 200%, boosted by higher iron ore prices and asset sales as the company moved to reduce its long-term debt.

Industrial stocks climbed 14% amid an improving outlook for the global economy. Significantly stronger U.S. GDP growth and signs of economic stabilization in China helped the sector bounce back from a years’ long decline in industrial manufacturing activity. Siemens shares rallied as the German conglomerate twice raised its 2016 earnings guidance, partly due to the strong performance of its energy division. Meanwhile, financial stocks gained 5% as global interest rates moved higher toward the end of the year. Shares of HSBC, Europe’s largest bank, rose more than 30%.

Telecommunication services stocks declined the most, losing 8% in aggregate. The sector was hurt by rising interest rates, a selloff in “bond proxy” sectors, and fierce competition among wireless service providers. Shares of BT Group and Telecom Italia endured double-digit declines. Health care stocks fell 7%, pressured by concerns about generic drug competition and political criticism of drug-pricing practices. Shares of Novo Nordisk, the world’s largest supplier of insulin products, declined 35%.

In fixed income markets, the ECB’s bond-buying program and easy monetary policy helped to support sovereign debt prices. Government bonds rallied for most of the year, despite a run-up in rates during November and December. For the 12-month period, the yield on Germany’s benchmark 10-year note declined 43 basis points to 0.20%. In the corporate market, Anheuser-Busch InBev sold a €13 billion bond offering in March to help finance its acquisition of SABMiller. It was the largest euro-denominated bond sale in history.

Asia-Pacific

Japanese equities declined slightly as the benefits of an accommodative Bank of Japan were largely offset by lackluster economic data and currency headwinds. The central bank continued aggressive monetary stimulus, but
inflation and economic growth remained low. The yen rose 3% against the U.S. dollar, hurting some exporters. The MSCI Japan Index lost 1%, while the MSCI Pacific Index climbed 2%.

The Bank of Japan continued to experiment with monetary policy in an effort to stimulate the sluggish economy. In January, the bank adopted negative interest rates, following the economy’s fourth contraction in seven quarters. Yields on government debt with maturities up to 20 years dropped below zero during the summer. At its September meeting, the BOJ introduced an interest rate target near 0% for 10-year government bonds in an attempt to steepen the yield curve. The country also turned to fiscal stimulus, announcing a ¥28 trillion package in July, shortly after Prime Minister Shinzō Abe’s ruling coalition won a majority of seats in Japan’s upper house.

Despite the stimulus, inflation remained well below the central bank’s 2% target. In November, the consumer price index rose 0.5%, while prices excluding food and energy ticked up by 0.1%. In the third quarter, the country’s economy grew at an annualized pace of 1.3%, well below expectations and at a slower pace than the previous two quarters. The labor market was one of Japan’s bright spots, as the unemployment rate hovered near 3.0% throughout the second half of the year, matching its lowest mark since 1995.

Telecommunication services was the highest returning sector, led by SoftBank’s 27% gain. Japan’s largest banks had mixed results, weighed down by profitability concerns stemming from negative interest rates through much of the year before rallying in the fourth quarter. Nintendo shares surged 47%, lifted by the summer release of Pokémon Go — one of the fastest selling mobile games in history. However, the strengthening yen generally hurt exporters, including automobile manufacturers. Mitsubishi Motors declined 34% after admitting to manipulating fuel economy test data. Toyota, Mazda, Nissan and Honda also traded lower.

Pharmaceutical stocks were among the largest detractors to index returns. Criticism over the industry’s aggressive drug pricing, as well as valuation concerns in the wake of 2015’s strong returns, weighed on shares. Ono, Takeda, and Santen Pharmaceutical all fell sharply.

Australian equities gained 12%, led by a rebound in metals and mining companies amid higher commodities prices. Fortescue Metals’ market cap more than tripled, while shares of BHP Billiton, South 32, Rio Tinto and Newcrest Mining all climbed more than 40%. Australia’s megabanks rose modestly, as the prospect of higher interest rates late in the year offset earlier profitability concerns among global financial firms. However, telecommunication services companies Vocus Communications and TPG Telecom both declined by more than 30% amid poor financial results and low subscriber growth. During the year, the Reserve Bank of Australia lowered its cash rate twice, bringing it to an all-time low of 1.5%.

The MSCI Hong Kong Index rose 5%. Most Macau-based casino operators traded sharply higher amid signs gaming revenues were stabilizing after a multiyear decline in visitors. MGM China, Wynn Macau and Galaxy Entertainment each rose by at least 40%. Elsewhere, shares of Cathay Pacific Airways declined due to increased competition from Chinese carriers and fuel hedging losses. The MSCI New Zealand Index had the highest return in the region, gaining 16%.

Emerging Markets
Emerging markets notched their strongest returns since 2012, helped by strengthening commodity prices, accommodative monetary policies and reform efforts in some countries. The MSCI Emerging Markets Investable Market Index rose 10%, fueled by gains in the energy, materials and information technology sectors. Emerging markets debt also rallied, with investors seeking higher yields amid ultralow rates in the developed world. U.S. dollar–denominated debt, as measured by the J.P. Morgan EMBI Global index, rose 10%; the local currency–denominated J.P. Morgan GBI-EM Global Diversified index increased by the same rate in dollar terms.
Rising prices for oil and industrial commodities helped Brazil and Russia post the strongest returns on a global basis. Brazilian equities soared 66% after several years of declines. President Dilma Rousseff was removed from office following impeachment proceedings, sparking enthusiasm that new government leaders can institute fiscal reforms to lay the groundwork for an economic recovery. Mining giant Vale surged 141% on rising iron ore prices and moves to reduce its debt, while state-owned energy firm Petrobras skyrocketed 140% on higher oil prices and asset sales to raise cash. Elsewhere, shares of privately run banks Itaú Unibanco and Banco Bradesco registered strong gains.

Russian stocks rebounded amid a sharp rise in oil prices. The MSCI Russia IMI shot up 57%. Sentiment was further bolstered by signs the country’s economy could emerge from recession in 2017 after several consecutive quarters of negative growth. Sberbank, Russia’s biggest lender, rose 107% on strong profits. Lukoil, Russia’s second-largest oil producer, climbed 86%.

In China, stocks finished essentially flat after beginning the year with steep declines. Chinese equities suffered huge losses in January as worries intensified about China’s economic health and a potential devaluation of the country’s currency. However, fears subsided following steady GDP growth that was largely bolstered by government stimulus measures, including funding new infrastructure projects, easing restrictions on property purchases and tax incentives for car purchases. Overall, the MSCI China IMI was unchanged. Internet services giant Tencent was a top gainer, climbing 25% on a string of solid earnings reports.

Most Asian markets rose, fueled by technology stocks and economic-reform momentum. The MSCI Taiwan IMI leaped 16%, with the country’s technology component suppliers benefiting from the release of Apple’s iPhone 7. Shares of index heavyweight Taiwan Semiconductor, a chip contract manufacturer for Apple, gained 34%. Indonesian stocks climbed 18%, spurred by business-friendly reforms and six interest rate cuts. Indian equities finished essentially flat as a surprise currency recall in November left consumers and businesses strapped for cash and raised growth concerns. The recall stunted share gains made earlier in the year from reforms designed to aid India’s economy, including a goods and services tax bill expected to make it easier to conduct business.

In South Africa, stocks overcame political turmoil and a stagnant economy as prices for industrial metals rebounded. The MSCI South Africa IMI rose 21%. Shoprite Holdings, Africa’s largest food retailer, was one of the largest gainers. Its shares climbed on solid sales and profit growth.

Stocks in Mexico and Turkey lagged. The MSCI Mexico IMI fell 9%, weighed down by weakening economic forecasts and fears of slowing trade with the U.S., its top trading partner. Meanwhile, Turkish stocks lost 8%. The country’s economy has been challenged by military conflicts in the region, declining tourism and more authoritarian rule stemming from a failed coup in July.

Returns for developing-world currencies diverged. The U.S. dollar stormed to a near 14-year high late in the year, driving several currencies to new lows. The Mexican peso and the Turkish lira fell 16% and 17%, respectively. The Chinese renminbi lost 7% against the dollar, plumbing its lowest level since 2008; the decline was partly due to the dollar’s strength following the U.S. election. The Brazilian real and the Russian ruble recorded the strongest gains against the greenback. The real surged 22% and the ruble appreciated 20%.

In debt markets, Saudi Arabia and Argentina completed the two largest deals on record for emerging markets countries. In October, Saudi Arabia sold $17.5 billion of bonds to help ease a budget shortfall caused by the low price of oil. Argentina returned to the international debt markets in April after a 15-year absence caused by its 2002 default and subsequent litigation. Proceeds from the $16.5 billion dollar-denominated offering will be used in part to repay holders of its previously defaulted bonds.
Developed market returns are in local currency and include net dividends. Emerging markets returns are in U.S. dollars.

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Barclays Global Aggregate Index represents the global investment-grade fixed income markets. This index is unmanaged, and its results include reinvested distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes. This index was not in existence as of the date Class A shares became available; therefore, lifetime results are not shown.

Barclays U.S. Aggregate Index represents the U.S. investment-grade fixed-rate bond market. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

Dow Jones Industrial Average is a price-weighted index of 30 component common stocks, the components of which are determined by the Averages Committee, which is composed of the managing editor of The Wall Street Journal, the head of Dow Jones Indexes research and the head of CME Group research.

J.P. Morgan Emerging Markets Bond Index Global measures total returns for foreign-currency-denominated emerging markets bonds.

J.P. Morgan Emerging Markets Bond Index Global Diversified measures total returns for foreign-currency-denominated emerging markets bonds, employing limits on the weight of countries with large debt stocks.

MSCI EAFE® (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization weighted index that is designed to measure developed equity market results, excluding the United States and Canada. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI Emerging Markets Investable Markets Index includes large, mid-cap and small-cap segments, targeting a coverage range of close to 99% of the free-float-adjusted market capitalization of more than 20 emerging equity markets. Results reflect dividends gross of withholding taxes through December 31, 2000, and dividends net of withholding taxes thereafter.

MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure developed equity market results across 15 developed markets countries in Europe. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI Japan Index is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of Japan. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI Pacific ex Japan is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region, excluding Japan. It consists of Australia, Hong Kong, New Zealand and Singapore. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI United Kingdom Index is a free float-adjusted market capitalization weighted index that is designed to measure the results of the U.K. market. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure equity market results of developed markets. The index consists of more than 20 developed market country indexes, including the United States. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

Nasdaq Composite is an unmanaged index representing the companies traded on the Nasdaq stock market and the National Market System.

S&P/TSX Composite Index is an unmanaged market capitalization weighted index of stocks traded in the Canadian markets.

S&P 500 Index is a market capitalization-weighted index based on the results of 500 widely held common stocks. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

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