World Markets Review — Fourth Quarter 2016
Global stocks ended the year on a high note, boosted by investor enthusiasm for U.S. political change and expectations for an improving world economy. U.S. stocks drove markets higher even as a strong dollar threatened to weigh on corporate earnings. Financial stocks soared as the Federal Reserve raised interest rates for just the second time in a decade. High-grade bonds declined and the dollar rallied against the euro, the yen and most other currencies.

<table>
<thead>
<tr>
<th>Index returns</th>
<th>December 2016</th>
<th>Q4 2016</th>
<th>YTD 2016</th>
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<tbody>
<tr>
<td></td>
<td>U.S. dollar %</td>
<td>Local currency %</td>
<td>U.S. dollar %</td>
</tr>
<tr>
<td>MSCI World</td>
<td>2.4</td>
<td>2.8</td>
<td>1.9</td>
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<tr>
<td>MSCI EAFE</td>
<td>3.4</td>
<td>4.5</td>
<td>-0.7</td>
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<tr>
<td>MSCI EM IMI</td>
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<td>0.1</td>
<td>-4.4</td>
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<tr>
<td>MSCI Europe</td>
<td>5.2</td>
<td>5.8</td>
<td>-0.4</td>
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<tr>
<td>MSCI Pacific ex Japan</td>
<td>-0.6</td>
<td>0.8</td>
<td>-2.7</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>2.0</td>
<td>2.0</td>
<td>3.8</td>
</tr>
<tr>
<td>MSCI Japan</td>
<td>1.0</td>
<td>3.4</td>
<td>-0.2</td>
</tr>
<tr>
<td>MSCI UK</td>
<td>4.1</td>
<td>5.3</td>
<td>-0.9</td>
</tr>
<tr>
<td>Barclays Global Aggregate Index</td>
<td>-0.5</td>
<td>—</td>
<td>-7.1</td>
</tr>
<tr>
<td>Barclays U.S. Aggregate Index</td>
<td>0.1</td>
<td>0.1</td>
<td>-3.0</td>
</tr>
<tr>
<td>J.P. Morgan EMBI Global</td>
<td>1.4</td>
<td>1.4</td>
<td>-4.2</td>
</tr>
<tr>
<td>J.P. Morgan GBI–EM Global Diversified</td>
<td>1.9</td>
<td>1.0</td>
<td>-6.1</td>
</tr>
</tbody>
</table>

MSCI index returns reflect net dividends. Source: RIMES

North America
U.S. stocks touched new heights during the quarter. The Standard & Poor’s 500 Composite Index rose 4%, while the Dow Jones Industrial Average gained 9%, ending 2016 just below the 20,000 milestone. The Nasdaq composite advanced 2%. Small-cap stocks surged, with the Russell 2000 Index climbing 9% to end the year near an all-time peak.

Financial stocks led the S&P 500, spurred by rising interest rates and the potential for a looser regulatory environment. President-elect Donald Trump repeated his campaign pledge to “dismantle” Dodd-Frank reforms. Goldman Sachs, Comerica and Bank of America all advanced more than 40%. Airline stocks supported the industrials sector. Their share prices rose after Warren Buffett’s Berkshire Hathaway revealed it had invested in four major passenger carriers. Energy shares rose 7% as oil prices stabilized above $53 a barrel and OPEC members agreed on production curbs. Materials gained 5%, boosted by prospects for increased infrastructure spending.

Consumer discretionary stocks had mixed results, rising 2% overall. Shares of Amazon fell 10% after the online retailer fell short of consensus earnings estimates for the third quarter; Macy’s and Urban Outfitters also declined after missing analysts’ estimates. But streaming video provider Netflix climbed 26% after reporting better-than-expected earnings and subscriber growth.

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.
Real estate, consumer staples and health care shares declined as higher interest rates took the shine off traditional dividend-paying sectors. Pharmaceutical stocks were hurt by ongoing criticism of their drug-pricing policies. The information technology sector rose just 1%, but semiconductor shares posted strong returns. Nvidia had the largest gain in the index for the quarter and the year – 56% and 224%, respectively – as it blew past sales and earnings forecasts. Nvidia’s innovative graphics chips are used by Apple and other major tech firms.

The S&P 500’s estimated earnings growth rate for the fourth quarter rose to 3.2%, according to market data provider FactSet. S&P 500 earnings growth turned positive in the third quarter after five periods of contraction.

Mergers-and-acquisitions activity remained strong, making 2016 the third-biggest year on record for M&A, according to Reuters. Notable transactions included AT&T’s $85 billion offer for Time Warner, British American Tobacco’s $47 billion bid to acquire full control of Reynolds American, and Qualcomm’s purchase of Dutch-based NXP Semiconductors for about $47 billion in stock and debt — the biggest semiconductor deal on record. In December, Monsanto shareholders approved the company’s acquisition by Germany’s Bayer for $66 billion.

The Federal Reserve raised the federal funds target rate at its December meeting by a quarter of a percentage point, and signaled three rate hikes in 2017 – an increase from its previous meeting. Supporting the central bank’s outlook, gross domestic product growth was a better-than-expected 3.5% in the third quarter, and the unemployment rate fell to 4.6% in November. The Institute for Supply Management reported the economy expanded for the 90th consecutive month in November, and the Conference Board’s consumer confidence index hit its highest level since 2001. The S&P CoreLogic Case-Shiller index of home prices rose 0.6% in October.

In bond markets, the Bloomberg Barclays U.S. Aggregate Index lost 3.6%. The quarter was a turbulent one, with fixed income markets affected by Donald Trump’s surprise election win and the Federal Reserve delivering a hawkish tone with its December rate hike. These and other trends shifted the market expectation for growth and inflation higher for 2017. Bond yields rose across the curve, with the yield on the benchmark 10-year Treasury note up 85 basis points to 2.45%.

Bond prices fell in most sectors. Investment-grade corporates declined by 3.5%, while municipal bonds lost 4.0%. Despite stronger inflation expectations, Treasury Inflation-Protected Securities fell 3.1%. High-yield bonds were a bright spot, rising 1.5%. Investment-grade corporate spreads to Treasuries tightened 15 basis points to end the month at 123 basis points. A notable offering came from Abbott Labs, which sold $15.1 billion in bonds. The proceeds will be used to finance its $25 billion acquisition of St. Jude Medical.

Europe

European stocks rose in local currency terms, boosted by central bank stimulus measures and investor optimism for an improving global economy. Markets advanced despite political turmoil in Italy that triggered the resignation of Prime Minister Matteo Renzi, following the defeat of a controversial government reform referendum. Overall, the MSCI Europe Index gained 5%; however, a sharp decline in the euro erased nearly all of that return for U.S. dollar-based investors. In dollar terms, European stocks were essentially flat for the quarter.

Markets shrugged off Renzi’s December 5 resignation, which he announced after voters rejected his signature policy initiative to streamline the federal government. The Italian referendum failed with a “no” vote of nearly 60%. Days later, the European Central Bank provided a boost to markets by announcing that it would extend the timeline of its aggressive bond-buying program to the end of 2017. At the same time, the ECB said it would lower the amount of its monthly purchases to €60 billion from €80 billion.
The euro declined 6% against the dollar, pressured by the ECB’s stimulus program and the Fed’s move to raise U.S. interest rates in mid-December. At year end, the euro was approaching parity with the dollar, trading at approximately $1.03. In the United Kingdom, meanwhile, the pound sterling fell 5% versus the dollar, extending a long slide that accelerated after British voters approved a June 23 referendum to leave the European Union. For the year, the pound tumbled 16% against the dollar.

Economically sensitive stocks generally outgained defensive sectors, led by an 18% rise in financials. Bank stocks, in particular, staged a strong rally as global lending rates moved higher in the aftermath of the Fed rate hike. Shares of HSBC, Europe’s largest bank, rose 15%. In a sign of the improving health of some European banks, Lloyds launched a $2.35 billion bid to acquire Bank of America’s U.K. credit cards business. Pending regulatory reviews, the deal is expected to close by the middle of 2017.

Energy stocks also rallied, gaining nearly 18% amid rising oil prices and an improving outlook for the global economy. Shares of BP, Total and Royal Dutch Shell advanced as OPEC nations agreed to reduce oil production for the first time in eight years, sending oil prices sharply higher. Stocks in the materials sector rose 9% in aggregate, reflecting the overall rise in commodity prices. BASF shares gained 16% as higher oil prices provided a boost to the German conglomerate’s chemical and energy-related businesses.

Consumer staples stocks declined the most, losing 5%. The traditionally high dividend-paying sector was hurt by rising global interest rates and a widespread sector rotation out of defensive stocks. Shares of Anheuser-Busch InBev, British American Tobacco and Nestlé were among the largest detractors in the index. Utilities stocks declined 4% as “bond proxy” sectors came under intense selling pressure. Shares of U.K.-based National Grid, Europe’s largest utility company, lost about 11% during the quarter.

In fixed income markets, sovereign debt prices declined as global interest rates followed the Fed’s lead into higher territory. European government bonds rallied for most of the year, but fell sharply after Trump’s November 8 election fueled investor speculation that inflation and global economic growth would be higher than previously thought heading into 2017. German bond yields moved higher in concert with U.S. Treasuries. The yield on Germany’s benchmark 10-year note rose from negative territory to end the year at 0.20%.

Asia-Pacific
Japanese equities rose sharply in the fourth quarter amid a weakening yen following results of the U.S. presidential election. All sectors gained, with financials leading the rally. Overall, the MSCI Japan Index surged 15%, while the MSCI Pacific Index advanced 10%. The yen declined 13% against the U.S. dollar.

Positive economic data improved sentiment toward Japan’s economic growth prospects, while reducing expectations for additional stimulus from the Bank of Japan. Industrial production increased 1.5% in November. Retail sales climbed 1.7% in the same period, the first increase since February. Japan’s business confidence also rose for the first time in more than a year. Results of a business survey indicated rising inflation forecasts for the short and long-term, although inflation currently remains muted. Japan’s consumer price index increased 0.5% in November, while prices excluding food and energy edged up 0.1%.

Financials was the top-returning sector, gaining 31% amid expectations for higher global interest rates and looser financial regulations from the new U.S. presidential administration. Nomura Holdings and major banks Mitsubishi UFJ, Sumitomo Mitsui and Mizuho Financial, were among the top contributors to index returns.

The weak yen lifted exporters, including automobile manufacturers. Toyota, Honda and Fuji Heavy each gained at least 19%. Fast Retailing, operator of the Uniqlo chain, rallied 30% amid strong operating profits in the second quarter.
half of the year. Following the U.S. presidential election, SoftBank rose sharply after pledging to invest $50 billion in U.S. startups, which was expected to lead to 50,000 new jobs.

**Toshiba was a notable detractor** after announcing that it may make a multibillion-dollar write-down due to cost overruns and missed deadlines by a nuclear power subsidiary. Shares of the conglomerate plunged 42% in a three-day span following the announcement.

**Australian equities gained 6%**, led by strong returns in the financials sector. Shares of the country’s largest banks all rose by double digits as higher interest rates are expected to boost profitability in the industry. Equity returns were strong despite the country’s third-quarter gross domestic product declining 0.5%, its first economic contraction since 2011 and its largest quarterly decline since 2008. The Australian dollar depreciated 5% against its U.S. counterpart. Elsewhere, the MSCI Hong Kong Index retreated 9%. Poor returns from real estate stocks and insurer AIA weighed on results.

**Emerging Markets**

**Emerging markets lost ground**, blunted by a surge in the U.S. dollar and the U.S. Federal Reserve’s move to hike interest rates for the first time in a year. The MSCI Emerging Markets Investable Index fell 4%, but rising oil prices did lift energy stocks. Several currencies scraped new lows against the dollar, including the Mexican peso and Turkish lira. Emerging markets debt sold off as the greenback rallied. U.S. dollar–denominated debt, as measured by the J.P. Morgan EMBI Global index, lost 4%; local currency debt, as measured by the J.P. Morgan GBI-EM Global Diversified index, fell 6% in dollar terms.

**Russian stocks bucked the sell-off in emerging markets.** The MSCI Russia IMI soared 19%, led by energy companies including Lukoil and Gazprom, both of which had double-digit gains. Returns were broadly supported by a surge in oil prices following an OPEC agreement to curb output and speculation Russia-U.S. relations would improve under a Trump administration. Sberbank, Russia’s biggest lender, also advanced. Its shares jumped 23% as the bank reported its third-quarter profit more than doubled from a year earlier. Meanwhile, the ruble rose 3% against the dollar.

**Stocks in India posted their weakest quarterly return since 2012**, upended by the government’s sudden move to pull a majority of the country’s currency from circulation and replace it with new bills. Aimed at curbing tax evasion and corruption, the effort raised concerns that it would choke spending in the world’s fastest-growing economy. Overall, the MSCI India IMI tumbled 8%, with the Indian rupee plumbing a new low and finishing 2% lower against the dollar. Mortgage lender Housing Developing Finance Corporation slid 11%, while automotive giant Tata Motors sank 13%.

**The MSCI China IMI slumped 7% as concerns about trade relations with the U.S. and currency weakness offset encouraging economic data.** On another front, government officials sought to cool a red-hot real estate market with new restrictions on home purchases. Property developer China Overseas Land & Investment dropped 22%. Shares of fast-growing technology firms Tencent and Alibaba lost 11% and 17%, respectively, after strong year-to-date gains. Meanwhile, the Chinese renminbi fell to an eight-year low against the dollar, prompting regulators to impose additional controls on currency withdrawals. The renminbi lost 4%.

**Overall, Asian markets declined.** Indonesian equities lost 7% as investors questioned the pace of economic growth and spending on new infrastructure projects. Korean stocks fell 7%, hurt by a stagnant economy and the impeachment of President Park Geun-hye over her role in an influence-peddling scandal. Taiwanese shares declined 3%, primarily falling on concerns about how any change to U.S.-China trade relations would affect Taiwan’s technology component suppliers. Taiwan Semiconductor fell 3%.
Mexican equities declined the most in Latin America, largely hit by fears of slowing trade with the U.S., its key trading partner. The MSCI Mexico IMI sank 8%, with the peso depreciating 6%. Brazilian stocks edged higher by 2% as gains for commodity-related stocks helped offset concerns about the country’s deteriorating economic and fiscal situation. Mining giant Vale soared 45%, boosted by skyrocketing prices for iron ore and planned asset sales to reduce debt. Ordinary shares of state-owned oil giant Petrobras rose 12%.

Turkish stocks fell for a third consecutive quarter, hammered by a faltering economy that has been challenged by military conflicts and more authoritarian rule following a July coup attempt. The MSCI Turkey IMI plunged 14% in dollar terms. The lira sank 15% amid a broad flight to the dollar, forcing Turkey’s central bank to raise interest rates for the first time in nearly three years.

In debt markets, Saudi Arabia completed the largest emerging markets bond deal ever, selling $17.5 billion of dollar-denominated debt in a heavily oversubscribed deal. The offering included 10-year bonds yielding 3.25%. The oil-rich country sold the bonds to help shore up its budget as oil prices retreated over the past 12 months. In corporate debt issuance, Mexico’s state-owned oil giant Pemex raised $4 billion to buy back existing debt and help with 2017 financing needs.

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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Lit. No. ITGEFL-105-0117O  CGD/10357- S56478