THE WHEAT FROM THE CHAFF:
OBSTACLES AND OPPORTUNITIES
January, 2016

I am proud to present *The wheat from the chaff: obstacles and opportunities*, our annual Capital Markets Forecast. We offer both a shorter-term outlook on what we believe 2016 has in store as well as a decade-long perspective.

The first theme we will explore is the near-term economic leadership of the United States, with employment, wage, spending, and business investment growth all promising. Still, bloated public debt levels and constrained growth weigh heavily and we expect another recession during the first half of our 10-year forecast period, albeit one that is shallower than the “great” one of 2008–2009, with a hopefully quicker recovery. As the decade wears on, however, the U.S. economy is at risk of reaching a point at which growth would begin to decelerate. Demographics should play a large role in this slowdown in the U.S. as it already has in Japan and many eurozone nations.

The next trend we see unfolding is one where income should reign supreme, as investor focus turns from capital appreciation to yield. After looking at the expected path of interest rates and yield curves, we see a relatively outsized role for the interest and dividend components of total returns for bond and stocks, respectively. We also discuss other potential income sources such as international real estate investment trusts and private markets.

Last, we explore the reemerging world of emerging markets and the corporate transformation that has already begun to take place, as many government-linked, commodities-intensive industrials give way to a newer crop of firms born of innovation and entrepreneurship. Evolution takes time. We expect the seeds of population growth and affluence to continue to bear fruit in the form of an expanding legion of companies that serve middle-class consumers over the coming decade. This in turn should create a raft of comparatively robust investment opportunities.

Thank you for your continued loyalty. As we shepherd your assets through life cycles, business transitions, and beyond, your best interests are always our first order of business. On behalf of the Investment Management team and the entire Wilmington Trust family, I wish you a healthy, happy, and prosperous year.

Sincerely,

Tony Roth  
*Chief Investment Officer*  
Wilmington Trust Investment Advisors
THE WHEAT FROM THE CHAFF:
OBS obACLES 
AND OPPORTUNITIES

U.S. economy strong...for now

The United States economy appears poised to outperform other developed economies in 2016. The post-financial crisis domestic growth trajectory has been tepid and uneven. Nonetheless, the lumbering pace of the recovery has been beneficial in the sense that it has kept at bay such precarious bubbles as those that burst in the technology and housing sectors during 2000 and 2008, respectively. As such, it has thus far shielded us from some of the usual risks that could trigger a recession in the near future.

We are on the heels of the Federal Reserve’s first short-term interest rate hike in nearly a decade. It is reasonable to infer that the data-dependent central bank felt recessionary clouds had sufficiently moved on and saw hopeful signs such as labor strength. As has been the case over the recovery thus far, we expect 2016 to comprise many positives on the domestic front, such as:

• Employment, where job growth has led to increased disposable income. Employment remained strong at the end of 2015, and we expect continued hiring in 2016. Demand for labor, shown by total job openings, remains at all-time highs reflecting

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companies’ desire to bring on more workers. We expect the pace of job gains to slow this year, yet still remain strong enough to be additive to consumer spending.

- **Stronger wage growth**, a key difference compared to recent years. At the end of 2015, the official unemployment rate reached 5%, a level we view as consistent with full employment. The higher measure of unemployment, which takes into account discouraged and part-time workers, remains high but has also drawn closer to normal levels. This tightness in labor markets led to stronger wage growth at the end of 2015, and we expect this phenomenon to drive further wage gains in 2016, thereby benefiting consumer spending.

- **Business investment**, which has been lackluster in recent post-recovery years, as businesses have not had much need to expand in light of existing, unused capacity and plentiful cheap labor. Even so, with increased capacity utilization and tighter labor markets, we expect stronger business investment this year. Acceleration has already occurred for certain industries in 2015 aside from energy, which was weighed down by sharp declines due to cutbacks in drilling activity.

- **Government spending**, which should add to growth. Spending cuts by state and local governments as well as by Congress during the recovery have translated to the overall government sector being a drag on economic growth for several years. The most recent spending bill out of Washington should lead to a positive contribution in 2016 which is good for short-term growth, but also slightly exacerbates the longer-term budget problem.

Two potential domestic obstacles to our overall bright U.S. outlook for 2016 are housing and exports. Construction of new homes and apartment buildings has been a welcome contributor to growth for several years, but may face challenges as the Fed embarks on interest rate hikes (see Figure 1). We don’t expect this will lead to a collapse in housing starts or the real estate market, but we do expect it to have a dampening effect.

The second obstacle, exports, is tied to the Fed’s hike cycle, too, and hinges on the degree of dollar appreciation. Strong appreciation of the greenback since mid-2014 has hampered exports and the domestic manufacturing industry. We don’t expect the same dramatic appreciation that has already occurred, but any additional appreciation will have a negative effect on manufacturing and exports.

China remains the biggest wild card in terms of a sudden shock to world economic growth, which could hamper the U.S. economy. Throughout 2015 and even into the onset of 2016, China was facing challenges in its transition from an industry-led economy to one led by consumers. Of all the policy levers the Chinese government pulled in 2015, the most important, and the most challenging to predict, has been the management of its currency. We believe there is fundamental economic pressure for the currency to weaken further. How the authorities deal with that pressure is a risk to global growth.

**Around the developed world—uphill battle persists**

Our 2016 outlook is a much different one, however, for some of the U.S.’s international developed counterparts, which are facing relatively poor growth prospects.

The eurozone has advanced haltingly, with vastly different experiences across its member countries. Germany has been strong but slow, while France’s growth has been only barely positive for three years. Spain has grown at much faster rates but progress is still constrained by very high unemployment. Italy, on the other hand, has faced challenges across the board, including low growth and a troubled banking sector. All of this, combined with low inflation, has prompted the European Central Bank (ECB) to embark on a more aggressive quantitative easing (QE) campaign, initiated...
Figure 1
Short-term lift in growth, followed by deceleration

-4% to 4%

Long term: 10-YEAR PROJECTION

Sources: Bureau of Economic Analysis, WTIA

Potential Obstacles
- Housing construction
- Exports and dollar appreciation
- China

GDP growth y/y Forecast 2016–2017 Forecast 2018–2026
-4% -2% 0% 2% 4%
**Figure 2**
The *graying of America*
Demographic projections by age and gender show aging of the baby boomers

![Graph showing population projections by age and gender for 2010 and 2030](image)

- **2010**: 12.4% of the population will be over 65.
- **2030**: 20.6% of the population will be over 65.

**Source**: U.S. Census Bureau

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**Figure 3**
Federal debt held by the public

![Graph showing federal debt projections](image)

- **Actual**
- **Extended baseline projection**

**Source**: Congressional Budget Office
in January 2015 and then expanded in December. The ECB has pledged to continue this program through most of 2016. As witnessed in the U.S., QE programs tend to be supportive to stock markets but have not been as helpful to building economic growth. We believe there are pockets of opportunity in the eurozone, but are mindful of the inherent currency risks.

We see a similar situation in Japan, where investment return potential is tempered by currency concerns due to the central bank’s QE program which aims to spur growth and inflation. The Japanese economy has now struggled to achieve real growth for three decades, but increasingly so since the Great Recession, with recent signs of life dragged down by weakness from emerging markets leading to weaker exports.

Demographics is destiny
Look for the longer-term tables to turn. The world’s largest developed economy faces significant challenges, mainly it runs the risk of becoming overdeveloped, in our view. By overdeveloped, we mean one that is facing structural decelerations or even declines in key long-term determinants of growth: labor force growth, capital investment, and productivity expansion. In our 10-year forecast horizon, we expect labor force growth to continue a long-term trend of deceleration—a result of slowing population growth, the aging of the existing labor force, and reduced labor force participation.

America is graying (see Figure 2). The last of the U.S. baby boomer generation (born 1946–1964 and roughly 76 million strong at this point) will be of retirement age by the time the next decade comes to a close. The aging population poses long-term challenges for fiscal policy that are likely to negatively affect growth. The Congressional Budget Office projects that, under current taxing and spending laws, the programs built for seniors, Social Security and Medicare, will gravely exacerbate existing debt levels. As a share of gross domestic product (GDP), the federal debt would approach levels not seen since World War II (see Figure 3). Ultimately, we feel the federal government must face the politically challenging task of cutting spending or raising taxes (or both) if it is to avoid an explosion of debt. All of those options would hinder growth in the long term.

Another potential headwind is a talent shortfall due to immigration cutbacks. We have historically relied on immigration to supply a steady stream of entrepreneurship and innovation. But there is now considerable uncertainty as to whether that source of talent will continue, as immigration policies are now in flux—a result of geopolitical turmoil and 2016 presidential campaign rhetoric.

To sustain economic growth meaningfully above 2% over the long term, the U.S. will need stronger growth from capital investment and productivity. In terms of the latter, we don’t believe the U.S. is stuck in “secular stagnation,” a situation of chronically weak demand and weak growth for an economy, as some have argued. We expect productivity gains to continue to elevate modestly even after the coming year. But in the longer term, we do not believe that productivity alone will be strong enough to accelerate overall economic growth.

We view potential growth in the U.S currently as 2.25%, but expect that to drift down steadily to 2.0% over the coming decade due to the slowdowns in labor force growth.

In the eurozone and Japan, we see attractive short-term investment opportunities thanks to aggressive central bank activity. But the structural determinants of growth make for a far weaker picture over the long term. Japan’s weakest factor is the labor force, which peaked in the late 1990s and has since been in slow decline. This negative is the key reason for that country’s “lost decades” of no economic growth and deflation. Japan’s overall population is in decline. Barring any major—and unexpected—structural changes to birth rates or immigration patterns, the country is facing continued weak economic growth for the foreseeable future.

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Though somewhat less dire than that of Japan, the outlook for the eurozone’s population and labor force growth are still anemic. A major challenge is the viability of the currency union. While the benefits of a common currency can be beneficial for growth, the current construct of a unified currency without a federal government or a unified debt market will continue to create stresses between strong and weak member-countries, as we have seen for many years now. We view the creation of a stronger, centralized government as unlikely, hence our pessimistic view for the decade-long prospects of the currency union. Actions to correct deeply embedded and labyrinthine complications are usually not implemented unless a crisis develops. However, if they are left tangled for some time to come, Europe’s potential will remain unfulfilled.

Meanwhile, outside the eurozone, there is the prospect that certain member-states of the political and economic European Union (EU) may break away in 2016 or beyond. (Note that nine of the EU’s twenty-eight members continue to use their own national currency and are not members of the eurozone.) For example, the United Kingdom may leave (i.e., “Brexit”), depending on the results of a referendum this year or next. A Brexit could well impair the capacity of London’s financial markets to provide capital to continental European firms. Damaging the world’s second-leading financial center would reduce global liquidity and increase global volatility.

**Preeminence of income in a low-return environment**

Since March of 2009 when stocks bottomed, marking an end to the freefall from the financial crisis, all major U.S. stock indices have fully recouped their losses. In fact, by 2015, domestic markets succeeded in setting all-time highs. Regardless of that noteworthy achievement, however, market momentum eventually shifted, leaving stock prices to finish the year essentially where they began. We take this development as a sign of existing or impending full valuation based on current earnings and cash flows. Furthermore, our slow U.S. growth projections foretell depressed long-term capital market returns, in our view. With capital appreciation less a part of future performance, we believe it is time to focus on investments that can derive a greater portion of their total return from current income.

**Income and U.S. bond returns**

Persistently low inflation—likely to move up only modestly above 2%, in our view—should help temper the magnitude of any increases in shorter- and especially longer-term interest rates (see Figure 4). This in turn should have a flattening effect on the yield curve (see Figure 5), with shorter rates moving higher as overnight rates are normalized, but only modest increases taking place further out the curve to reflect modest inflation expectations. Although the Federal Reserve has just begun to raise short-term rates again, we envision those hikes taking place at a cautious, deliberate pace.
Figure 4
Near and far inflation outlook expects a return to more normal levels

Figure 5
Projected yield curve shift

Sources: Bureau of Labor Statistics, WTIA

Sources: WTIA, Bloomberg
The likely result? In our view, low inflation and tentative rate hikes should further result in relatively modest principal declines during the early part of our forecast period. This should further result in total returns around breakeven, once current income is taken into account. Ultimately, we anticipate yield levels similar to those seen in the late 1990s and early 2000s (see Figure 6). At this point, total returns should revert to positive levels, accruing income at the new, higher rate levels.

With yield levels edging higher and overall capital appreciation likely to be modest or even negative, current income should become an increasingly significant part of the return stream. For example, the Barclays Aggregate Index is likely to return less than 2% annualized over the entire 10-year horizon as higher interest rates take hold and spread levels in the corporate and mortgage-backed securities markets normalize. The yield level on the index however (currently 2.5%), is likely to be close to 5% by the end of our forecast time horizon.

Credit conditions will be as important a determinant as rate dynamics in bond performance over the next decade. We expect corporate balance sheets to remain generally sound, due to the temperate pace of the economic recovery which appears to have stemmed excessive risk taking. While we have seen strong activity in new issue volume, much of this has been aimed at taking advantage of the low interest rate environment or funding merger activity at reasonable debt levels. Consequently, we do not believe the supply excess in corporate debt experienced over the past several years bespeaks a systemic weakness in the domestic corporate debt markets.

When looking for income, few markets can compare to high-yield bonds, but the speculative-grade market brings with it a host of risks involving credit quality and defaults. We are initiating strategic allocations in this market but in so doing we are looking to manage these risks through active tactical and manager implementations. This is particularly important since our outlook over the next two or three years includes the prospect of a recession. As such, managing risk exposures in the high-yield market during periods when the recession storm clouds gather is critically important, since rising defaults can lead to permanent capital impairment. However, we believe the flip side is just as important, since adding to holdings when yield levels are extraordinarily high is critical to maximizing income returns as well as laying the groundwork for possible principal appreciation when yield spreads normalize.

**Income and U.S. stock returns**

Low investment returns will work their way into the boardroom where we expect dividend policies to become important in supporting stock valuations. As such, we are looking to specific companies where dividend policies have included a history of growth, a consistent payout approach, and a record of stability that shows promise of being sustained. In examining historical and projected return stream compositions for large-cap U.S. markets, we see the increasing role of dividends (see Figure 7).

The Russell 1000 Index indicates that the past five years have been very rewarding. This is mostly due to the contribution from stock price appreciation. Income returns have averaged about 2.3% (see Figure 8), which is less than 15% of the overall returns earned. Going forward will likely be a considerably different story, as we expect total returns to shrink down to a little over 7% while income returns move up to around 2.6%. In this case, more than a third of the total return is expected to come from dividends paid out to shareholders. Given the care companies take in maintaining their dividend payouts, these cash payments have tended to cushion overall investment risk, in our view.

And where do we expect dividend income growth to come from? In our opinion, it is critical to analyze stocks through a sector lens, as we believe economic sectors may provide a more refined, differentiated insight into how asset classes will perform. Our view has been formalized continued
28% of stocks raised their dividends in each of the past five years.

Source: FactSet
Projections reflect the informed judgment of Wilmington Trust and are subject to various assumptions. Actual events or results may differ from underlying estimates or assumptions, which are subject to various risks and uncertainties. No assurance can be given as to actual future market results. Investing involves risks and you may incur a profit or a loss. Past performance is no guarantee of future results.

Sources: WTIA, Barclays Capital, Bloomberg
in the recent implementation of our new Wilmington Trust Large-Cap Sector Allocation Strategy.*

With a sector emphasis in mind, let’s look at those segments where dividends appear poised to figure prominently. Technology companies that have enjoyed significant income gains in the last few years are beginning to pay out profits to shareholders in increasing amounts. Also, financial services firms have largely satisfied capital requirements set by stringent regulations enacted after the financial crisis, and are now able to resume more generous dividend policies. Meanwhile, declining oil prices and subsequent earnings drops will likely keep energy companies’ dividends from expanding in the near term. In recent months, our preferred investment themes have included the healthcare, information technology, and financials sectors. To the extent the first two may grow at a faster clip, they may increasingly prove sources of strong dividend growth over our decade-long horizon. This has already begun in the tech and financials sectors, as explained above.

**Income and international markets**

Over the past five years, income has been a major contributor to developed international market returns and we do not expect this to change. As discussed earlier, our general outlook is for developed economies to suffer the same type of economic slowness, similarly limiting growth potential. Interestingly, developed markets have provided an even stronger source of income than U.S. markets, as dividend yields have averaged more than one percentage point higher.

The trick over the next decade will be to reap this income potential while avoiding possible losses on the principal side, in particular, due to likely further strengthening of the U.S. dollar. We anticipate that currency hedging can, from time to time, serve as a tool to meet this challenge. Furthermore, we will also need to pay attention to fundamentals as demonstrated by the role of financial companies in creating the dividend income premium.

Compared to the U.S., developed international markets are typically more heavily capitalized by financial institutions, which tend to put greater emphasis on income. European banks are behind their U.S. counterparts in stabilizing their capital structures but as the decade unfolds, we expect this trend to even out and provide support to income returns (see Figure 9).

In our view, emerging markets should continue to have a fairly high dividend, now at 3%. We also expect yield levels to decline, as this segment recovers in the latter part of the coming decade, a trend we will expand upon in the final theme on developing nations.

**Income and other asset types**

As part of our investment process, we examine portfolios dynamically for both traditional and nontraditional opportunities. We will continue to do so in the coming year and decade, but want to highlight two areas we currently believe merit close attention.

First, we anticipate that the international real estate investment trust (REIT) market can offer sizeable income returns, amounting to more than three-quarter of the total return. This is not unusual for this space, as income has traditionally provided a significant portion of the overall return, averaging more than 60% over the past five years. International REITs (which exclude the U.S.) is a new strategic asset class for our capital markets forecast and is one we believe can add considerable value over a narrower, purely U.S.-centric real estate focus (see Figure 10).

Meanwhile, in another corner of the investment universe, lies the world of private markets. These exclusive, complex, illiquid, and often high-risk investments can cross the asset class spectrum and may offer qualified investors with a potential source of enhanced diversification and overall returns. Private debt, in particular, may be a strong source of higher-than-average income returns. Talk to your Investment Advisor to discuss whether they may be right for your portfolio.
Reemergence of emerging markets

Emerging markets (EMs) such as China, India, and Brazil present considerable potential long-run opportunity for robust stock returns. In many ways, such opportunity is more promising than what is offered by stocks in the U.S., Europe, or Japan, which are much further along the development, income, and wealth curves. In particular, EMs offer a rapidly expanding middle class that wields increasing discretionary income and is hungry for consumer goods and services—with years still to go before demographics (like an aging population, such as in China) is destined to constrain discretionary consumption growth.

Notwithstanding this potential, the stock returns of firms domiciled in EMs have disappointed in recent years—relative to both developed market stock returns and EM GDP growth (see Figures 11 and 12). Unfortunately, we don’t see this trend reversing before the next year or two at the earliest.

The principal obstacle to improved EM investment returns is the continued prominent role of low-profitability, high-volatility “old-economy” heavy industries and their intense focus on commodities and other resources. The lumbering old-economy industries are those in oil and gas production, metals and mining, capital goods, chemicals, and power production. Most of these firms are basic industries, unsuited to satisfy the demands of an expanding legion of companies targeting middle-class consumers. Moreover, many of these firms were originally established by governments as state enterprises decades ago and have a continuing legacy of bureaucratic state control or influence.

Consequently, these firms often lack entrepreneurial zeal and flexibility. Some of them could even be described as “zombies”—firms that may still be operating, but hold no hope of a profitable resurgence and produce scant returns for their shareholders. These old-economy industries face the following challenges and vulnerabilities:

- **Stressed power, rail, highway, and port facilities,** which impinge on the ability of companies to operate at full capacity and deliver products to customers. Consider India, where power outages often shut down production for many hours each day. Or Brazil or China, whose highways are frequently clogged.

- **High sensitivity to volatility in global crude oil and metals prices.** Consider Russia’s oil and gas firms, or Brazil’s mining firms.

- **Extreme reactivity to volatility in currency exchange rates,** in the case of firms that are importers or exporters.

- **Capital-intensive reliance,** which affects those that depend heavily on bank lending.

- **A legacy of state ownership or control,** which makes them more susceptible to disruptive government intervention or political corruption. Consider the extensive corruption that has recently been exposed at Brazil’s Petrobras.
**Figure 11**
Emerging market returns have lagged developed market returns
Trailing 5-year annualized total returns through 12/7/2015

<table>
<thead>
<tr>
<th>Region</th>
<th>5-Year Annualized Total Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>All emerging markets</td>
<td>-4.8%</td>
</tr>
<tr>
<td>China</td>
<td>-1.1%</td>
</tr>
<tr>
<td>S. Korea</td>
<td>-1.6%</td>
</tr>
<tr>
<td>India</td>
<td>1.2%</td>
</tr>
<tr>
<td>Brazil</td>
<td>-18.8%</td>
</tr>
<tr>
<td>Russia</td>
<td>-12.4%</td>
</tr>
<tr>
<td>U.S. (S&amp;P 500)</td>
<td>12.8%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>3.2%</td>
</tr>
<tr>
<td>Japan</td>
<td>4.4%</td>
</tr>
</tbody>
</table>

Source: Bloomberg

**Figure 12**
GDP growth hasn’t generated consistent returns
Returns versus GDP growth on a 5-year rolling basis

Sources: IMF, Bloomberg
**Figure 13**
The old-economy share of market cap is expected to shrink further
Heavy industry stocks as a % of emerging market equity capitalization

[Bar chart showing market share of different sectors like Oil & gas, Capital goods, Industry, Metals & mining, Chemicals, and Power.]

Source: Bloomberg

**Figure 14**
More consumers using high-speed internet
Broadband subscriptions per 100 persons

[Bar chart showing broadband subscriptions in China, India, Brazil, Russia, Mexico, S. Korea, and U.S. across different years.] Source: World Bank

**Figure 15**
Rising consumer use of technology driving up mobile online market cap share
Mobile online as a % of emerging markets equity capitalization

[Bar chart showing mobile online market cap share across different categories like Devices, Wireless, Semiconductors, E-commerce, Media, Apps, and IT services.]

Source: World Bank
The share of these old-economy firms in developing economies (as illustrated by their stocks’ market capitalization in Figure 13) has diminished over the last five years and we expect that trend to intensify over the next decade. This trend would mitigate the vulnerabilities mentioned earlier, offering a more stable stream of stock returns. But change doesn’t happen overnight, and we have not yet reached the tipping point where the proportion of new-economy firms is great enough to merit enthusiastic investment in these countries.

As the old-economy firms recede into the background, a crop of innovative, consumer-focused “new-economy” firms have been gaining strength and are the precursors to potentially explosive growth in the EM space. We expect this potential to begin to be actualized in two to five years and to further accelerate in the latter half of the coming decade.

These firms, established by entrepreneurs instead of governments, more nimbly serve rapidly rising middle-class consumer demand, especially from technologically savvy urban young people with high discretionary income. Mainly based in the Asia ex-Japan region, they are much better positioned to take advantage of the rising prosperity of EM consumers.

The groundwork for growth is being laid, with EM consumer demand bubbling across a wide range of consumer products and services, in particular, the “mobile online complex.” Figure 14 presents data on broadband subscriptions across various EMs, with the U.S. provided as a yardstick for comparison.

The mobile online complex includes firms that manufacture mobile devices and the semiconductors that operate such devices; Internet mega-portals and e-commerce platforms; and wireless providers.

Figure 15 illustrates just how quickly the market capitalization of the EM mobile online complex has risen over the last five years. Moreover, we expect continued powerful growth in this space over the next decade, where new uses for mobile and Internet-based technology should help propel EM forth. (For a list of prominent firms in this space, many of which are familiar to U.S. investors, see Figure 16.) Beyond 10 years, we believe China’s recent abandonment of the one-child policy will at least partially help stem what would otherwise likely be a significant decline in the number of Chinese youth.

New-economy stocks also include a rapidly growing “consumer financial services” complex consisting of firms that provide various kinds of specialized, non-bank financial services that are in high demand from the expanding EM middle class, e.g., insurance, real estate, capital markets services, and mortgage finance (see Figure 17). This cluster has profitably exploited niches that have been underserved by traditional, often partly state-controlled banks.

### Figure 16
**Mobile online complex: prominent firms**

**Mobile devices**
- Samsung Electronics (Korea)
- Hon Hai Precision Engineering (Taiwan)

**Semiconductors**
- Taiwan Semiconductor (Taiwan)
- SK Hynix (Korea)

**Internet portals**
- Tencent (China)

**Internet search**
- Baidu (China)

**E-commerce**
- Alibaba (China)
- C-Trip (China)
- China Mobile (China)
- America Movil (Mexico)
- Mobile Telesys (Russia)
Because firms in the mobile online and consumer financial services complexes generally provide services or lightweight high-tech products, they offer resilience to the classic EM challenges to which old-economy stocks have historically proven vulnerable. As a result, their return streams have been less volatile than those of the staid, older firms. These newer firms offer resilience against the problems that have traditionally afflicted EM because they are:

- Less dependent on stressed public infrastructure to deliver services and goods to consumers
- Less sensitive to fluctuations in global crude oil and metals prices
- Generally more service-oriented and domestically focused, and thus much less sensitive to fluctuations in currency exchange rates
- Less dependent on expensive bank financing
- Unburdened by a legacy of state ownership, and so less susceptible to political intervention or corruption

Don’t look for an “aha” moment, where EM stock returns will suddenly swing from weak to strong. We see new-economy stocks gradually achieving greater prominence as old-economy stocks give way. Our expectation, however, is that the crossover point will be somewhere between 2017 and 2020. Prior to that time, we do not expect this arena to consistently provide compelling buying opportunities, but we will remain vigilant and keep a close watch.

In our discussion of potentially overdeveloped U.S. and international economies, the anticipated preeminence of income in a low-return environment, and the reemergence of emerging markets, you can see that our expectations for 2016 evolve as the decade progresses. Demographics and other influences color economies, markets, and policies, which are all very fluid. But amidst all the turmoil, there remains one constant—our commitment to bringing our very best insights and perspective to bear on your portfolio, as we strive to preserve and enhance your wealth.
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Wilmington Trust offers five model asset allocation strategies each for taxable and tax exempt investors with particular sets of risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. Each strategy can be implemented with or without allocations to hedge funds. On a quarterly basis we publish the results of all of these strategy models versus benchmarks representing static investments without tactical tilts. Model Strategies may include exposure to the following asset classes: U.S. large capitalization stocks, U.S. small-cap stocks, developed international large-cap, developed international small-cap and emerging market stocks, inflation hedges (including global inflation-linked bonds and commodity-related and global real estate-related securities), investment-grade bonds (corporate or municipal), high yield corporate bonds and floating-rate notes, and cash equivalents. Directional and absolute return hedge funds are distinct to the strategies with hedge funds. Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.

Quality ratings
Quality ratings are used to evaluate the likelihood of default by a bond issuer. Independent rating agencies, such as Standard & Poor’s and Moody’s Investors Service, analyze the financial strength of each bond’s issuer. Moody’s ratings range from Aaa (highest quality) to C (lowest quality). Bonds rated Baa3 and better are considered “Investment Grade”. Bonds rated Baa1 and below are “Below Investment Grade” (also “High Yield” or “Speculative”). Similarly, Standard & Poor’s ratings range from AAA to D. Bonds rated BBB- and better are considered “Investment Grade” and bonds rated BB+ and below are “Below Investment Grade”.

Investing involves risk and you may incur a profit or a loss.
Past performance is no guarantee of future results.
Diversification does not ensure a profit or guarantee against a loss.
There is no assurance that any investment strategy will be successful.

Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs, that would reduce returns.

The names of actual companies and products mentioned herein may be the trademarks of their respective owners.
Through our Capital Markets Forecast, we seek to understand the forces that may help to shape investors’ experience in the years ahead. As always, we encourage you to contact us at any time to discuss our forecast and your individual portfolio.

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