

# Outlook

JANUARY 2018



Time for  
balance and  
flexibility.



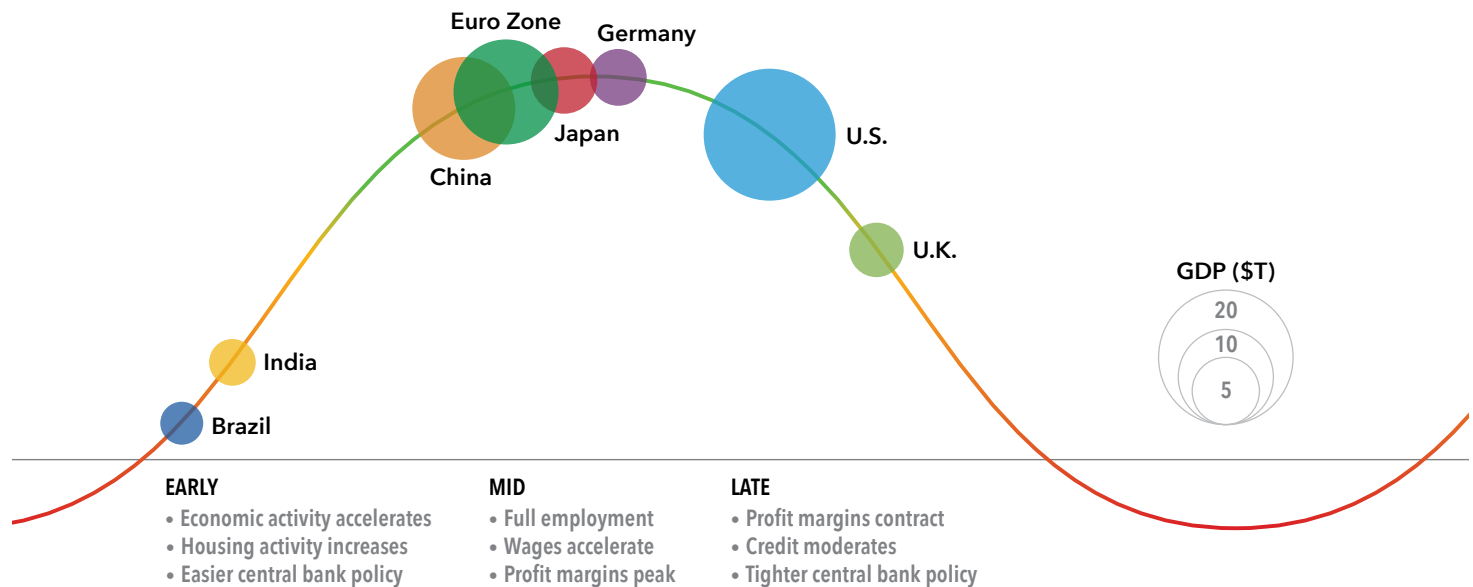
# Global economies continue to gain ground

Among the first to experience recovery, U.S. edges toward late-cycle territory

“There is mounting evidence that near-term momentum is building in the global economy and the cycle appears to be self-sustaining, particularly with respect to Europe. The synchronization of global growth has raised the possibility that the cycle can be stronger for longer.”

**ROBERT LIND**  
EUROPE ECONOMIST

## Most major economies are experiencing early- to mid-cycle characteristics



SOURCES: Capital Group, FactSet. GDP data as of 6/30/17. Country position within the business cycle are estimates by Capital Group economists.

Investors can see blue skies just about anywhere they look heading into 2018, as the synchronized global economic recovery gathers a head of steam. After eight years of expansion in the U.S., investors may be concerned that the American economy is nearing the end of the cycle. But don't cue the closing credits yet. Corporate profit growth remains healthy and inflation has been

relatively tame. That said, with wages rising, look for inflation to pick up later in the year.

For most of the rest of the world, it is still early in the cycle. Europe appears to have entered a prolonged period of strength and the euro-zone economy is expected to grow nearly 2% in 2018, according to the International Monetary Fund (IMF).

Overall, the IMF expects global gross domestic product (GDP) to increase 3.7% in 2018, up from 3.6% in 2017, with each of the world's major economies firmly in the growth column.

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

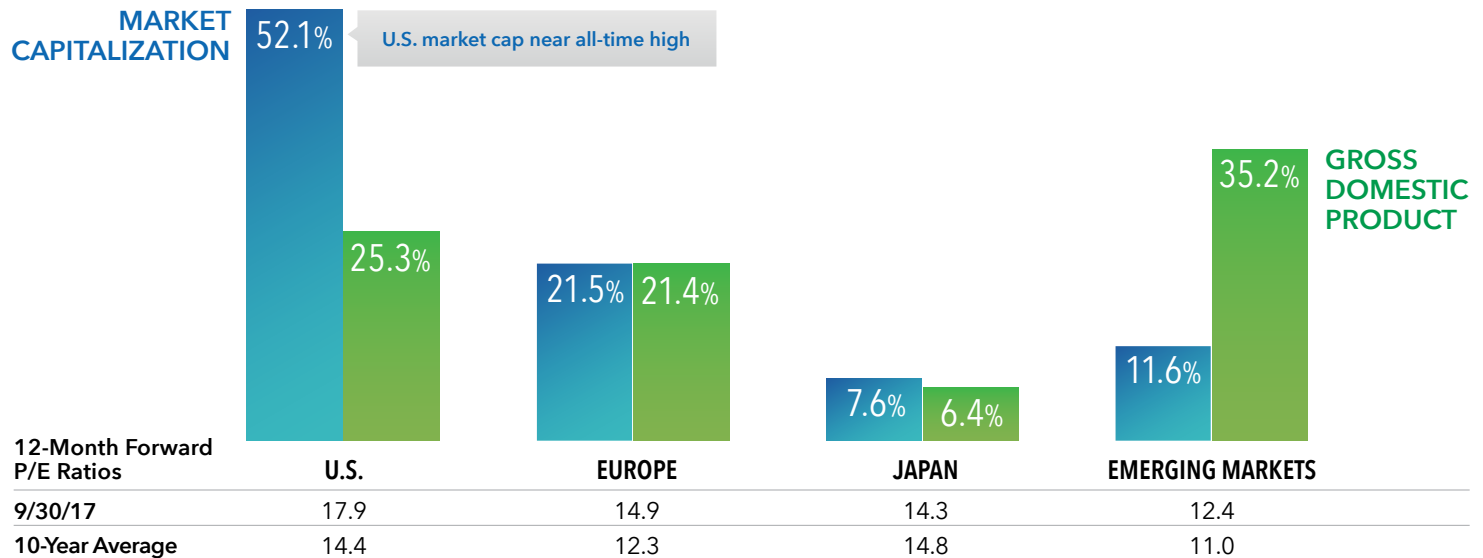
# Market levels suggest better opportunities abroad

Valuations point to relatively attractive opportunities outside the U.S.

“I am concerned that people are getting very complacent, expecting this low-growth, low-volatility environment to last. In my view the tail risks are increasing the longer it continues. So I am getting more cautious, focusing on unloved investment ideas: anti-momentum stocks with good cash flows and compelling valuations.”

**LISA THOMPSON**  
PORTFOLIO MANAGER

## Percentages of total world market capitalization and global GDP



SOURCES: Capital Group, FactSet, MSCI, RIMES, Thomson Reuters. As of 9/30/17. Market capitalization is each country or region's weight within MSCI All Country World Index (ACWI). GDP is each country or region's percentage of total world nominal GDP. Price-to-earnings ratios (P/E) as of 9/30/17.

Most of the world's equity market indexes achieved or neared multiyear highs in 2017, as investors set aside concerns about politics and focused on the broadening expansion. European stocks went on a tear in 2017, rising 23% and outpacing U.S. shares for the first time since 2012. Emerging markets equities also outpaced the U.S., soaring 32%.

In fact, market levels suggest that these better investment opportunities may

continue in non-U.S. markets. Consider that the U.S. accounts for 52% of global market capitalization, near a historic high, and its market cap is 106% of its GDP. Granted, a number of factors justify a relatively higher share of market cap for U.S. companies, as it is the home market for many of the world's dominant companies, and roughly 40% of Standard & Poor's 500 Composite Index company earnings come from overseas.

Also consider that the forward P/E ratio for the U.S. market, at 17.9, is notably higher than other major markets. Conversely, the emerging markets share of global market cap appears relatively modest compared with its contribution to GDP. And, emerging economies are expected to contribute half of global GDP by 2021.



# U.S. economic engine reaches higher gear

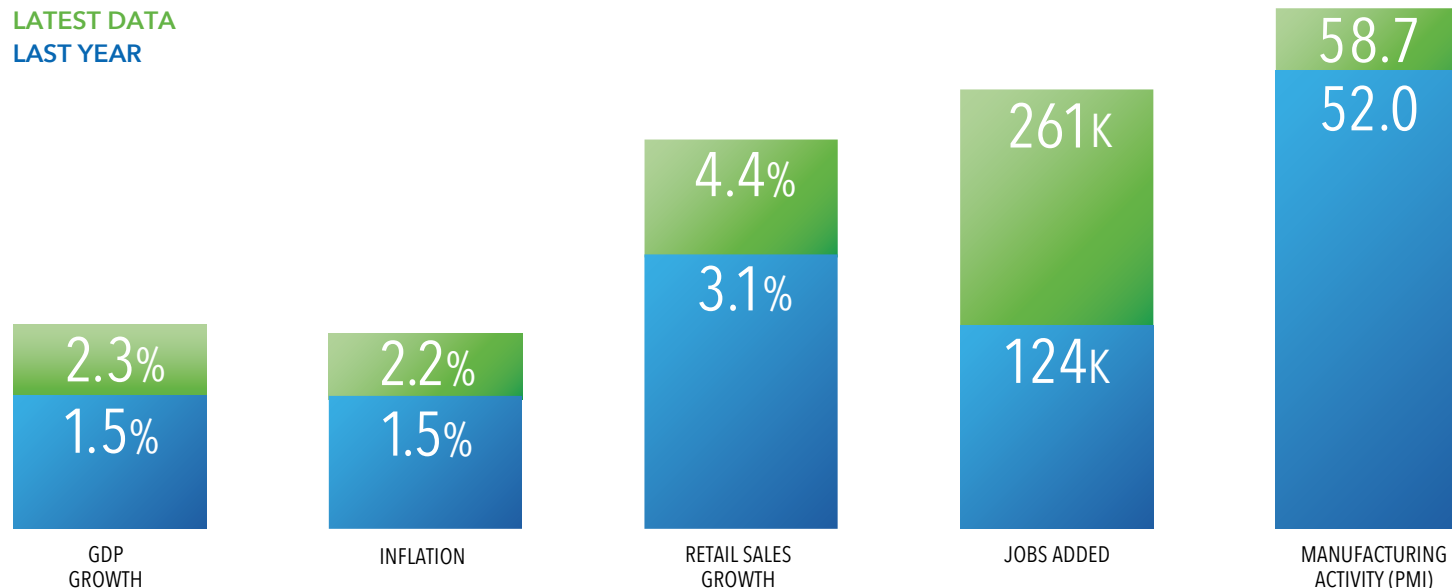
Consumer strength, modest inflation point to an extended expansion

"The U.S. economy seems to be chugging along nicely, and I don't see much on the horizon to be concerned about other than higher equity valuations. We have had market appreciation for nearly a decade now, so I think it will increasingly be a stock-pickers' market."

**HILDA APPLBAUM**  
PORTFOLIO MANAGER

The American economy is drawing from numerous sources of strength

LATEST DATA  
LAST YEAR



SOURCES: Bureau of Economic Analysis, Bureau of Labor Statistics, Thomson Reuters. GDP growth is the year-over-year growth in 3Q16 and 3Q17. Inflation and retail sales growth are year-over-year changes on 9/30/17, and 9/30/16. Inflation uses the change in the consumer price index. Jobs added is the monthly change in the payroll survey as of 10/31/17, and 10/31/16. Manufacturing activity is the manufacturing component of the 9/30/17, and 9/30/16, Institute of Supply Management (ISM) Purchasing Managers' Index (PMI) reports.

After more than 100 months of expansion, the U.S. economy appears to be in a period of self-sustaining equilibrium. The jobs market is solid, consumer confidence is soaring and retail sales growth is picking up. The U.S. unemployment rate fell to 4.1% in October, a 17-year low. As a result, wages have been strengthening, rising 2.4% in October. Thus far, wage growth has been subdued, helping keep a lid on inflation. But given the improving jobs

market and strengthening economy, wage inflation is likely to rise later in the year.

Consumer spending on durable goods rose at an 8.3% annual rate in the third quarter, and capital expenditures rose 7.4%, providing an additional tailwind to the economy. In addition, corporate profits rose 5.8% in the third quarter. On the policy front, the prospect of corporate and personal income tax cuts could propel the expansion further.

With consumer spending healthy and wages rising, consumer-facing businesses have the potential to do well in the next phase of the economic expansion. Companies across a wide variety of industries are exposed to rising consumption, including home improvement retailers such as The Home Depot, online retailer Amazon and shopping mall developer Simon Properties, which could benefit from higher traffic at traditional retailers.

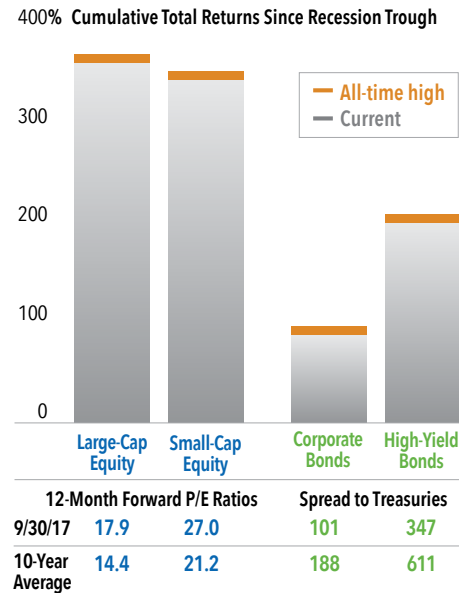
# But U.S. assets have gotten expensive

Research is critical to uncover value in soaring equity market

“In my view the U.S. is priced for perfection, so I am taking a more cautious approach, gravitating to areas that I believe can hold up better in choppy markets, like select financial companies. Financials have substantially increased their capital base, they have been conservative in their lending and the interest rate cycle is favorable to them.”

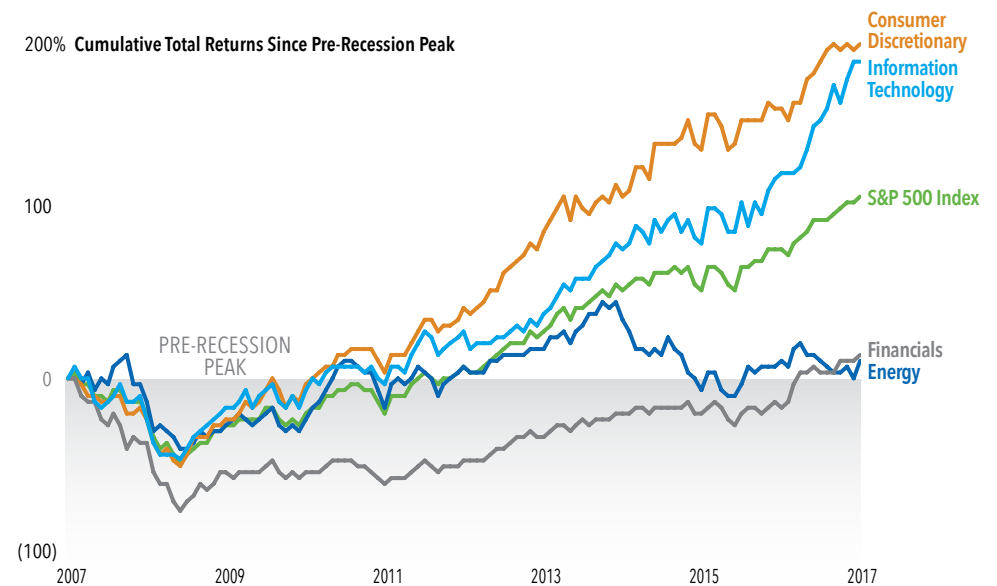
**GREG JOHNSON**  
PORTFOLIO MANAGER

## Stock and bond markets have reached all-time highs ...



The U.S. stock market has soared since the end of the global financial crisis, reaching its prior peak in 2012 and more than doubling since, pushing up equity valuations. But stocks aren't the only expensive asset class. High-yield and corporate bond returns too have been robust, leaving credit spreads at their tightest levels in years. Conditions remain favorable and markets tend to climb a wall of worry, so the rally could continue. But the rising tide can't lift all

## ... But a look beneath market averages reveals differentiation



ships forever. At this stage of the cycle, caution and selectivity are essential.

Indeed, not all areas of the market have reached elevated heights together. Financials recently reached its pre-recession peak after 10 years and energy has returned to 2007 levels. These sectors may have room to run, but select companies are likely to fare better than others. Fundamental research will be key to identifying the potential winners.

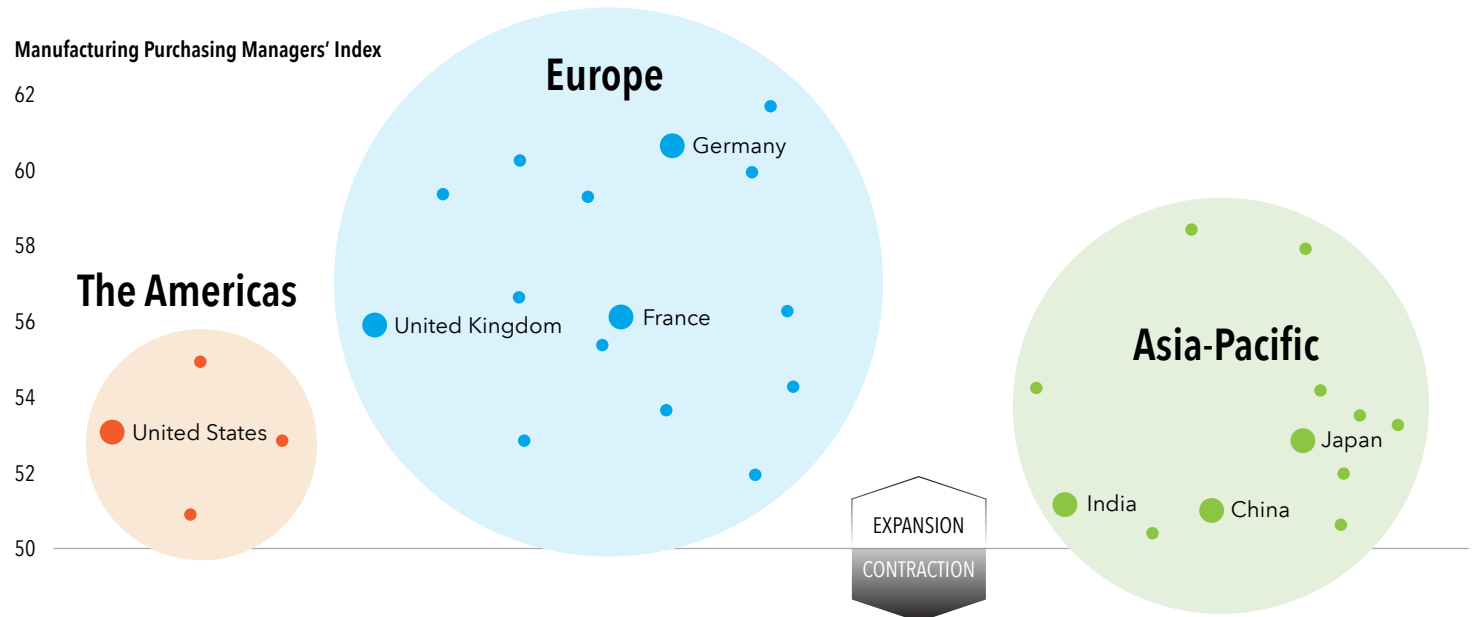
The potential for credit growth driven by solid consumer fundamentals, and the prospect of rising interest rates, could help drive profit growth for banks. Regional bank PNC Financial Services and conglomerates JPMorgan Chase and Wells Fargo are examples of companies that have strong credit card and commercial banking divisions.

SOURCES: Bloomberg Index Services Ltd., MSCI, RIMES, Standard & Poor's, Thomson Reuters as of 9/30/17. Large-cap and small-cap equity valuations provided by IBES, for the S&P 500 Index and Russell 2000 Index, respectively. Investment-grade and high-yield corporate bond valuations are option-adjusted spread to Treasuries provided by Bloomberg Index Services Ltd. for the Bloomberg Barclays Corporate Bond Index and Bloomberg Barclays High Yield Corporate Index, respectively.

# Europe and its factories are back in business

Resurgent Europe leads a global manufacturing recovery as demand picks up

31 of 32 countries tracked are in expansion territory



“Among developed economies, Europe looks like the best place to invest right now. We are seeing a broad-based recovery across the continent, particularly in countries that have engaged in fiscal reform over the past few years.”

**MARK DENNING**  
PORTFOLIO MANAGER

SOURCES: Capital Group, Haver as of 9/30/17. The Purchasing Managers' Index is an indication of whether business conditions for a number of variables in the manufacturing sector have improved, deteriorated or stayed the same compared to the previous month. An index reading above 50 indicates an expansion, whereas a reading below 50 indicates a contraction. The PMI tracks 32 countries. Each dot in the chart represents one of the 31 tracked countries with a PMI over 50. The only tracked country not included is South Africa, which had a PMI of 44.9.

Europe has enjoyed a remarkable recovery in recent months, driven by a powerful combination of central bank stimulus, ultra-low interest rates and improving growth. Third-quarter GDP in the 19-member euro zone grew at an annualized rate of 2.5%, and the unemployment rate has fallen to 8.9%, its lowest level since 2009. Moreover, corporate earnings are up across the board, led by a strong rebound in the energy, mining and banking sectors, thanks in part to the strengthening global economy.

The political picture has also stabilized, as continental Europe has essentially lined up in support of the European Union's governing authority.

Europe's manufacturing activity – previously a weak point on the region's path to recovery – has increased dramatically, supported by rising orders for everything from new aircraft to highly sophisticated technology components. Many euro-zone factories have reported labor shortages amid the surging demand.

Thanks to improving global growth, select European companies are thriving – particularly those that operate on a global stage. Dutch semiconductor equipment-maker ASML, for instance, has continued to exceed earnings expectations, benefiting from soaring demand for computer chips used in mobile devices. The so-called internet of things investment theme is alive and well in Europe, powered in part by Dutch technological innovation.

# Weaker dollar could boost international equities

Longer term, look for extended strength in non-U.S. currencies to further fuel overseas returns

“While we may see short-term periods of U.S. dollar strength now and then, my view is that the dollar will continue its downward trajectory over the course of 2018 and into 2019, providing a further boost to international investing.”

**JENS SONDERGAARD**  
CURRENCIES ANALYST

## A weaker dollar helped boost non-U.S. returns in 2017



SOURCES: RIMES, Thomson Reuters  
as of 10/31/17.

Currency trends have formed a nice tailwind for dollar-based investors in international equities. After the dollar peaked in early 2017, the currency effect on overseas investments reversed from previous years, when a strong dollar hurt returns. With the dollar slipping in 2017, European equities have far outpaced U.S. stocks in dollar terms. The dollar also has declined against many other currencies, including the yen, producing a similar tailwind for Japanese equities.

Investors should keep a close eye on this trend, however. Improving U.S. economic growth, gradually rising U.S. interest rates and the European Central Bank's stimulus-program extension combined to push the dollar higher in September and October. Capital Group currencies analyst Jens Sondergaard believes this near-term dollar strength will fade, and that the dollar will continue its decline through 2018 and into 2019.

In the financials and industrials sectors, a valuation gap has emerged between some European and U.S. companies. Airbus and Barclays, for example, have recently traded at significant valuation discounts to comparable companies in the United States. The gap has started to close in other sectors as European equities have rallied, but these two sectors remain areas of potential opportunity for value-oriented investors.

# Emerging markets have only just begun making up ground

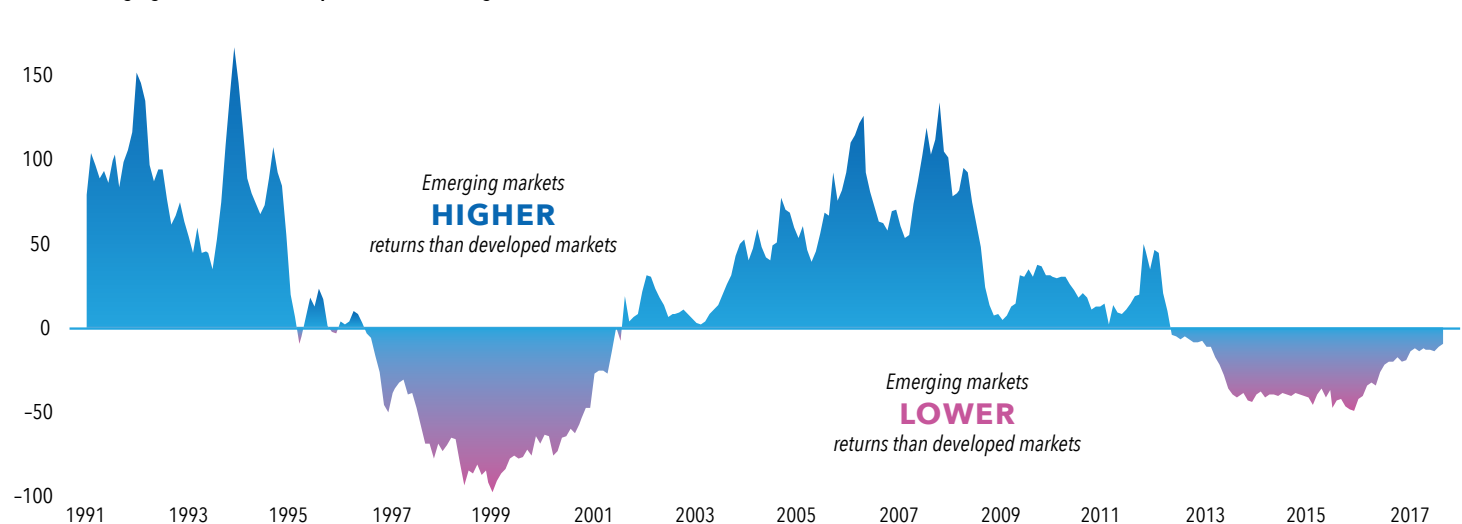
Rising middle classes, more stable China suggest developing world has room to run

"The stability and reform we are seeing in places like China and India are resulting in greater investment opportunities. It's not just obvious areas like Indian banks and Chinese internet companies, but I am also interested in domestic industries like cement and power, as well as retail companies and consumer-orientated businesses."

**CHRIS THOMSEN**  
PORTFOLIO MANAGER

Until recently, emerging markets equities had been trailing developed markets for years

200% **Emerging Markets vs. Developed Markets: Rolling 3-Year Returns**



SOURCES: Capital Group, MSCI, RIMES.  
Data represents cumulative rolling three-year total returns in U.S. dollars of MSCI Emerging Markets Index versus the MSCI World Index through 9/30/17.

The rally in emerging markets equities is more than 20 months old, with stocks up 70% since a trough in early 2016. Is the rebound getting long in the tooth? It really could just be getting started.

An expanding global economy, strengthening currencies and robust demand for technology-related components all bode well for emerging markets. A synchronized global recovery is an ideal environment for emerging markets, similar to the period that lasted from 2003 to 2007.

Amid the ongoing rebound, overall valuations are still attractive from a historical basis and compared to developed markets. For instance, China, Taiwan and Brazil all trade around 13 times projected earnings over the next year, compared with 17 times estimated earnings for the MSCI World Index. Company cash flows are also increasing, which could lead to higher earnings revisions. Corporate profits are forecast to climb 13% in 2018, and historically rising profits have been good for share prices.

An improving global economy and dollar weakness can be tailwinds for companies in a broad range of industries, from information technology to consumer goods to financials and commodities exporters. For example, Chinese internet giants Tencent and Alibaba could benefit from rapid growth in mobile commerce and financial services. Banks with solid consumer lending businesses may benefit from stronger global growth.



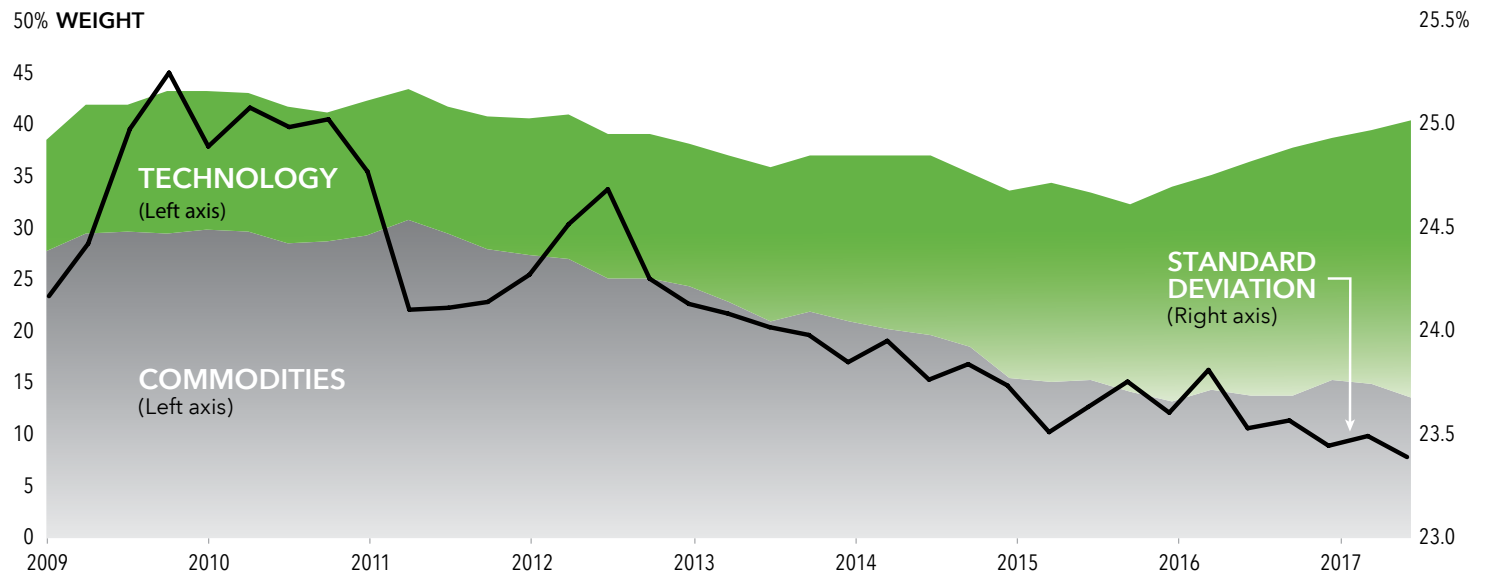
# Signs of maturity emerge in China and emerging markets

As the market has shifted from commodities to tech, volatility has declined

“In today’s emerging markets, there are some very strong technology companies that deliver e-commerce services in a very efficient fashion and the adoption rate is high. Chinese internet businesses are now leading innovation in financial services and other areas, a divergence from the past.”

**SHAW WAGENER**  
PORTFOLIO MANAGER

## An increasing number of world-class technology companies are domiciled in emerging markets



SOURCES: Morningstar, MSCI, RIMES as of 9/30/17. Commodities includes energy and materials sectors. Technology includes information technology sector. Standard deviation is for rolling 10-year periods.

Emerging markets have shifted from smokestacks to smartphones. Back in 2008, energy and materials companies dominated the MSCI Emerging Markets Index with a 38% weighting, and many of these firms were state-owned enterprises that were more susceptible to infrastructure-driven booms and busts.

Chinese technology-related firms are now the biggest companies by market value in emerging markets as mobile phone usage is accelerating and

internet penetration rates are rising. Along with middle class growth, these developments are changing consumption patterns and delivery methods for financial services.

This “tech- tonic” shift over the past decade (information technology now accounts for 28% of index weight) has also come with a decrease in volatility as cyclical, commodity-oriented companies are no longer index heavyweights.

Look for growth in the technology sector to be driven further by demand for handheld electronic devices and mobile-focused services among the large populace of China and India. Some Asian companies, including Taiwan Semiconductor and Samsung Electronics, have also developed specialized knowledge in areas of semiconductors and are key cogs in the global technology supply chain.

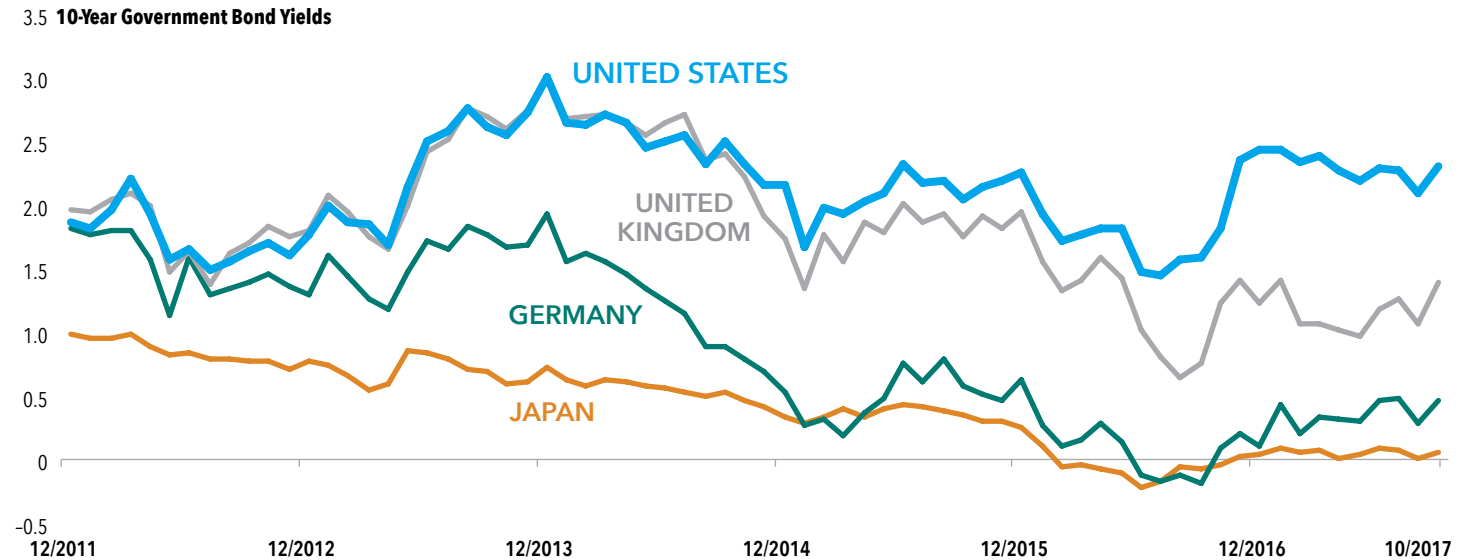
# Global rates should stay low despite improving economies

Higher relative yields should continue to support demand for U.S. bonds

“Long-term U.S. interest rates should remain range bound unless you get a geopolitical event in places like North Korea or inflation breaks out unexpectedly.”

**PRAMOD ATLURI**  
PORTFOLIO MANAGER

## U.S. interest rates remain higher than those of other developed markets



SOURCE: Thomson Reuters as of 10/31/17.

A number of factors have kept yields low, such as modest economic growth in the U.S., persistently low inflation and strong demand from global investors for U.S. bonds. Long-term rates could rise modestly as U.S. economic growth remains robust and the Federal Reserve has started to trim its balance sheet, which means it will no longer be the largest buyer of bonds. Capital Group's fixed income team expects the benchmark U.S. 10-Year Treasury yield to remain in a 2.25% to 3% range despite a higher policy-driven rate.

Despite these relatively low levels, U.S. interest rates remain higher than many

other developed markets, partly because the U.S. economy has sustained a significantly higher growth rate. The higher yields in the U.S. relative to other developed markets should continue to support demand for U.S. Treasuries. Meanwhile, against the backdrop of low interest rates in developed economies, demand for higher yielding emerging markets debt has risen substantially. The fixed income team expects this demand to continue. Many emerging markets economies are growing at a steady clip and do not have any significant economic imbalances.

Consider holding broadly diversified fixed income portfolios without tilting too heavily in favor of credit or interest rate exposure. Although at tight valuations, credit and mortgage-backed securities provide a yield spread over Treasuries that can add to meaningful additional income over time. On the other hand, Treasuries and municipal bonds provide valuable diversification from equities and credit. Meanwhile, emerging markets bonds continue to offer value, supported by improving fundamentals.

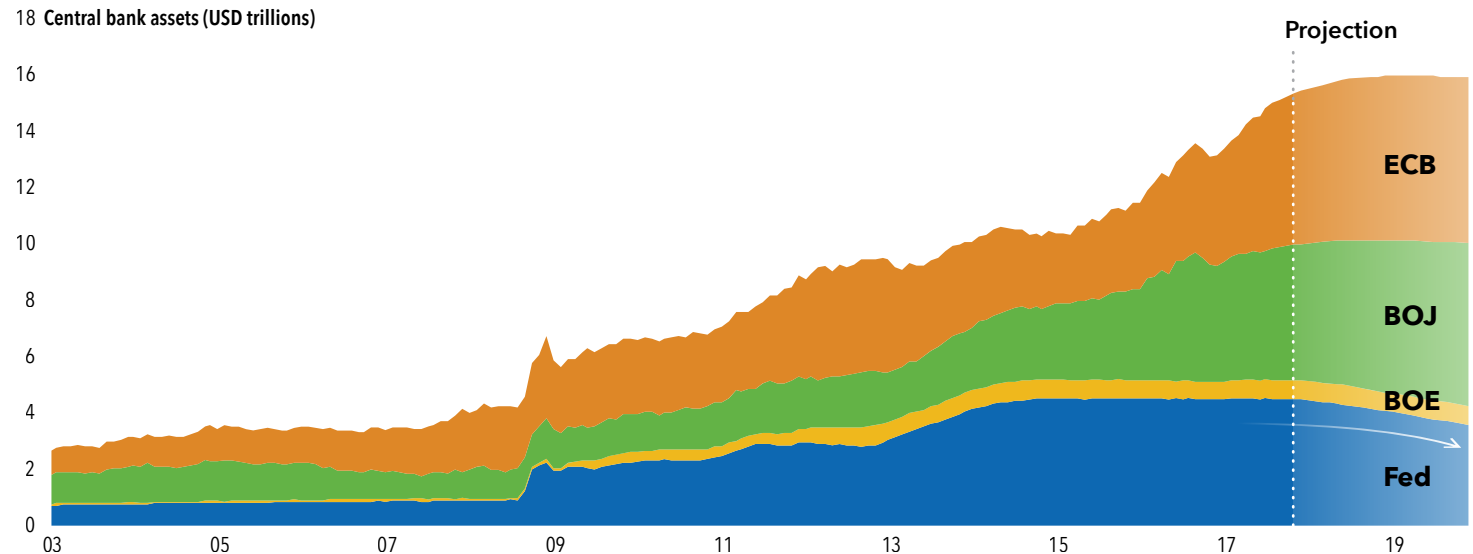
# Central banks take gradual approach to tapering

Financial conditions should not tighten dramatically

“The Fed started reducing the size of its balance sheet in October and I would expect U.S. financial conditions to tighten as a result. With global central bank balance sheets set to decline in late 2019, for me it is a question of when markets will start to get concerned.”

**RITCHIE TUAZON**  
PORTFOLIO MANAGER

After expanding balance sheets for years, the Fed has begun reducing its holdings



SOURCES: Capital Group, Thomson Reuters as of 9/30/17. European Central Bank (ECB), Bank of Japan (BOJ), Bank of England (BOE), U.S. Federal Reserve (Fed).

Since the financial crisis, central banks have expanded their balance sheets to unprecedented levels. These banks became the largest buyers of bonds and other securities as a way of increasing money supply to boost struggling economies. The four major central banks increased securities held on their books from around \$4 trillion in 2007 to about \$15 trillion in 2017. Now, as the global

economy improves, some of them are beginning to move in the other direction. The Fed began shrinking its balance sheet in October. The European Central Bank signaled it will begin to trim its purchases of securities starting in January. With the Fed stepping away from its role as the largest buyer of securities, the risk of a modest rise in yields cannot be ruled out.

As financial conditions tighten, credit assets and mortgage-backed securities remain vulnerable. Investors should maintain a balance between interest rate and credit exposure. Within credit, consider moving up in credit quality so that portfolios can withstand a period of potential market volatility.

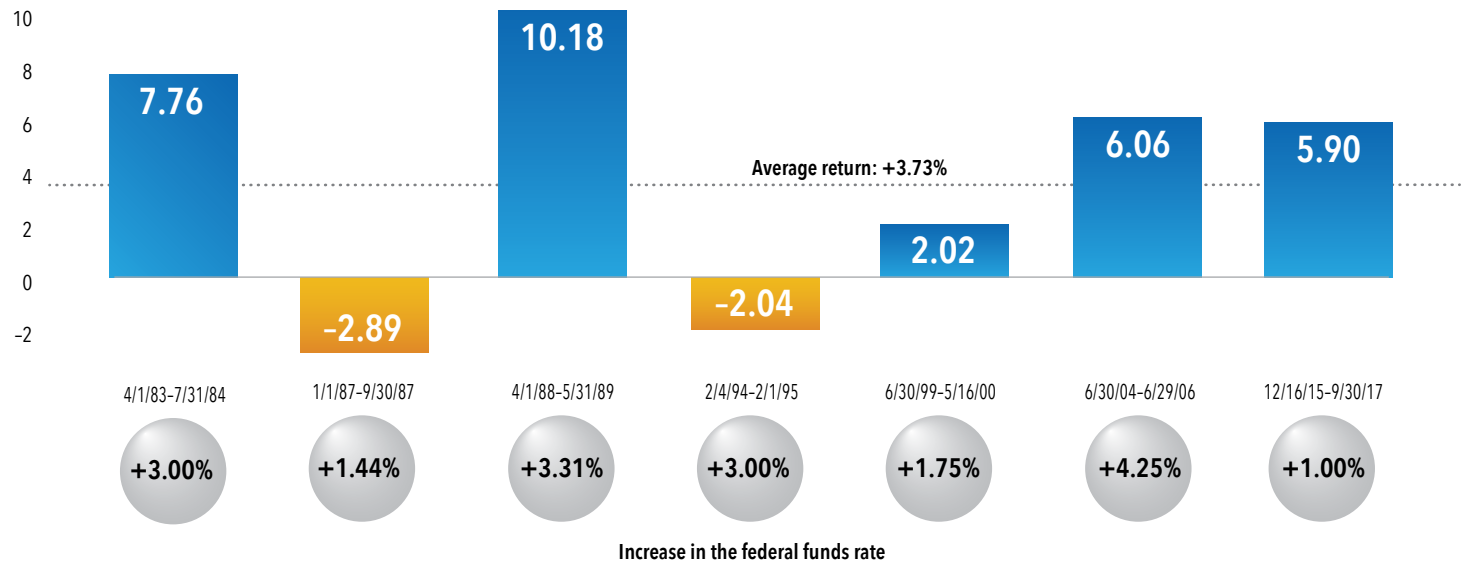
# Fed rate hikes don't have to translate to bond losses

In periods of rising rates, higher income can help to keep returns positive

"With inflation running below the Fed's target and the economy growing at a modest pace, I think the Fed will take a gradualist approach to raising rates."

**JOHN QUEEN**  
PORTFOLIO MANAGER

Core bond returns have been positive in five of the last seven prior periods of Fed hikes



SOURCES: Bloomberg Index Services Ltd., Federal Reserve. Data through 9/30/17. Daily results for the index are not available prior to 1994. For those earlier periods, returns were calculated from the beginning of the month containing the first hike through the end of the month containing the final hike.

As the Fed continues on a path of gradually raising interest rates, many investors are moving to cash, short-term bonds and floating-rate securities. But the view that bonds have to suffer losses when short-term rates rise is a misconception. Looking at the past seven periods of interest rate hikes, including the current period, investment-grade (BBB/Baa and above) bonds have generally delivered positive returns, as can be seen from results for the Bloomberg Barclays U.S. Aggregate Index.

If rate hikes are gradual, interest earned by bonds can overcome the price impact to deliver a positive return. Indeed, since the Fed began on its current course of rate hikes, the index has gained nearly 6%, even as the Fed funds target has risen by 100 basis points. The Fed has signaled that it will maintain a gradual pace in raising rates and tightening monetary policy. Against this backdrop, interest rates will likely remain range bound.

Investment-grade and high-yield credit valuations continue to hover near historically tight levels not seen since the period before the 2007 financial crisis. In this market environment of range-bound long-term rates and tight credit spreads, investors should consider holding well-diversified core fixed income portfolios that do not take excessive credit risk. Credit-heavy strategies have performed well as stocks have soared, but they could suffer losses should stock markets reverse.



# Seeking diverse income potential? Consider muni bonds

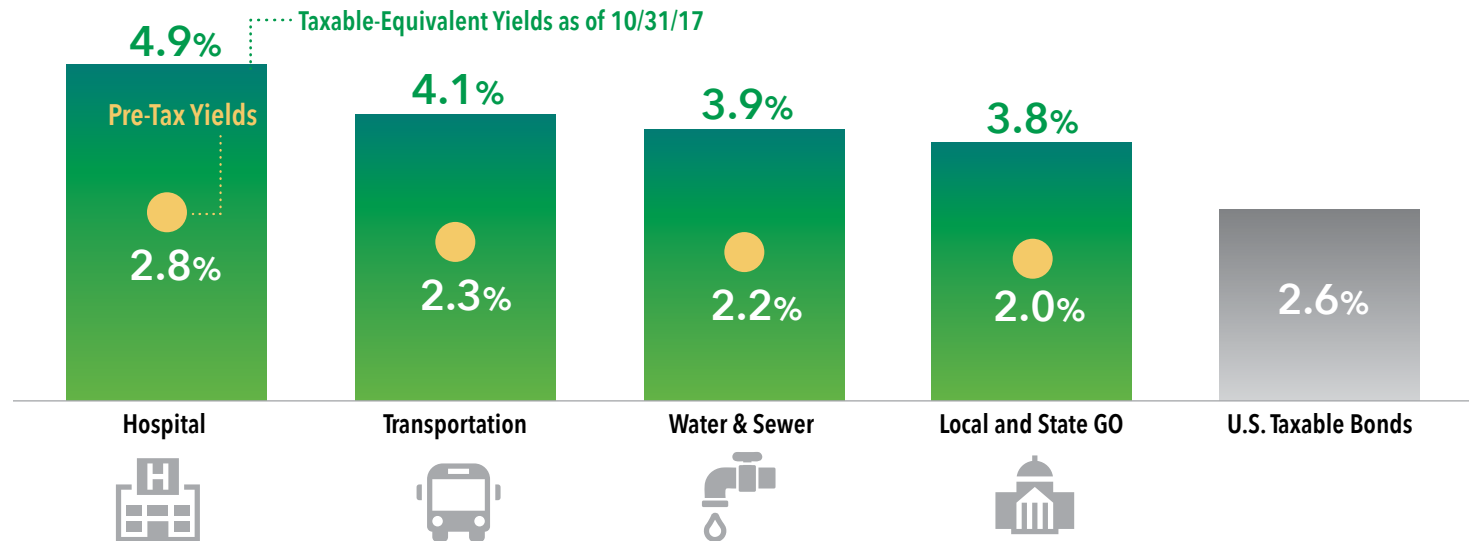
Attractive tax-advantaged yields make municipals a compelling choice for income seekers

“Municipal credit has enjoyed a powerful rally in 2017. However, return potential may moderate overall and policy developments may disrupt the balance of supply and demand. Even so, we’ve often found that volatility can create attractive entry points for long-term investments.”

**CHAD RACH**

PORTFOLIO MANAGER

## Tax-advantaged yields in diverse muni sectors look relatively attractive



SOURCES: Bloomberg Index Services Ltd. Income from municipal bonds may be subject to state or local income taxes and/or the federal alternative minimum tax. Certain other income, as well as capital gain distributions, may be taxable. Methodology for calculation of taxable-equivalent yield: Based on 2017 federal tax rates. For the year 2017, there will be an Unearned Income Medicare Contribution Tax of 3.8% that applies to net investment income for taxpayers whose modified adjusted gross income exceeds \$200,000 (for single filers) and \$250,000 (for married filing jointly). Thus taxpayers in the highest tax bracket will face a combined 43.4% marginal tax rate on their investment income. The federal rates do not include an adjustment for the loss of personal exemptions and the phase-out of itemized deductions that are applicable to certain taxable income levels. Index proxies: municipal sectors from Bloomberg Barclays Municipal Bond Index; Bloomberg Barclays U.S. Aggregate Bond Index for U.S. taxable bonds. The indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in indexes.

Municipal bonds are sometimes viewed as vulnerable amid rising interest rates. And yet, the past two years have shown that the asset class can provide solid returns when rate increases are modest and gradual – an environment that appears likely to persist. Also, demand for tax-advantaged income is unlikely to diminish. That said, valuations have been elevated. Greater emphasis on bonds of higher credit quality is one way investors can prepare for more mixed market conditions.

The asset class offers diverse income opportunities across sectors. For instance, toll roads are an area where research can uncover value by assessing prospects in a way that reflect risks associated with financing, operation and the regional economy. Consolidation among not-for-profit hospitals is creating great return potential. Look out for opportunities if uncertainty around the future of tax and health care reform prompts volatility and creates favorable entry points.

Municipal bonds offer a powerful combination of tax-advantaged income and equity-diversification potential. Consider higher quality issues when valuations are expensive. Investors comfortable with higher risk can also consider high-yield municipal bonds; they’ve tended to be significantly less correlated to equities than corporate high-yield bonds and have offered comparable average yields on an after-tax basis.

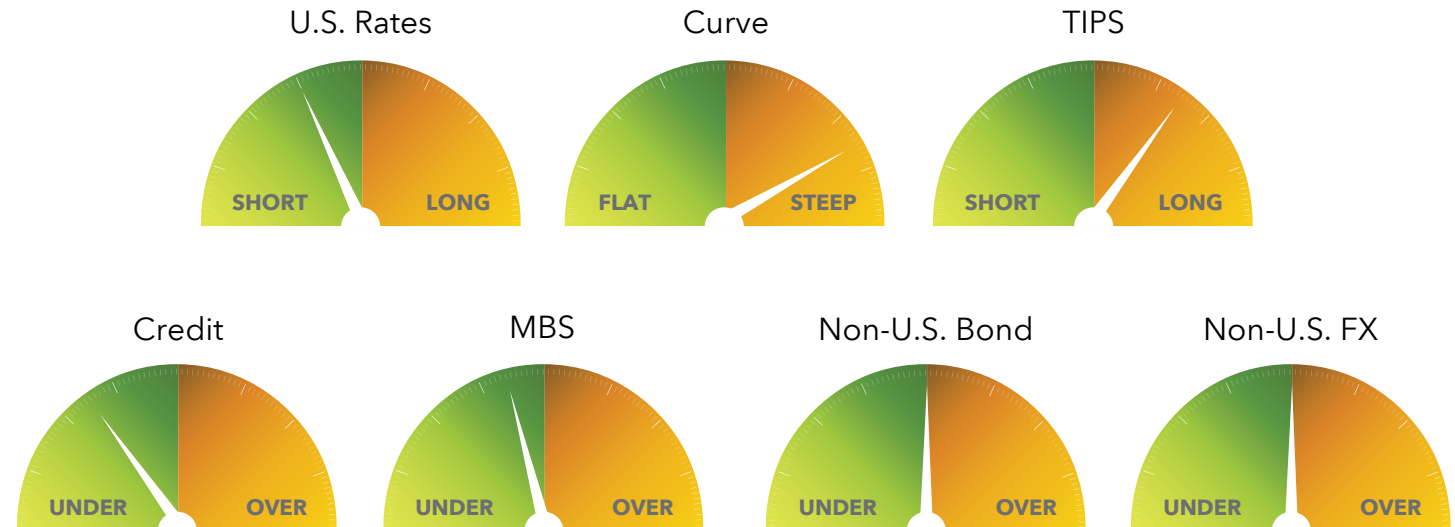
# Position core bond portfolios for higher volatility

Global growth is improving, but markets may underestimate uncertainties and possible shocks

## What is PSG?

Capital Group's fixed income team convenes a Portfolio Strategy Group (PSG) that meets regularly for an in-depth discussion on the macroeconomic environment and fixed income markets. This fixed income group's latest insights are reflected in the dials shown, which represent guidance to our portfolio managers when building our core fixed income portfolios.

Caution is warranted, given current macroeconomic and market conditions



**Duration:** Capital's Portfolio Strategy Group (PSG) continues to believe in a "lower for longer" thesis regarding the future level of interest rates. Modest global growth and inflation, as well as the attractiveness of U.S. interest rates in a global context, are a few factors contributing to this view. However, current consensus expectations for the path of short-term interest rates are more conservative than the PSG view.

**Yield Curve:** Although the Fed is tightening monetary policy, the bias of central banks remains supportive of economic growth. In this environment, the fixed income group thinks the yield curve could steepen and long-term interest rates may rise somewhat more than intermediate rates.

**Inflation:** In light of the fixed income group's view that inflation will continue to rise modestly, particularly in the U.S., the group suggests considering an allocation to Treasury Inflation-Protected Securities (TIPS). Further, TIPS valuations are attractive relative to prospective inflation.

**Credit:** High credit valuations suggest caution, given stable to declining fundamentals. Although the fixed income group does not expect a material rise in defaults for high-yield corporations, minimal allocations are appropriate to high-yield in core bond portfolios.

**Mortgages:** The fixed income group continues to recommend a less-than-index weighting in agency mortgage-backed securities on expectations of future spread widening as the Fed's balance sheet reduction ramps up.

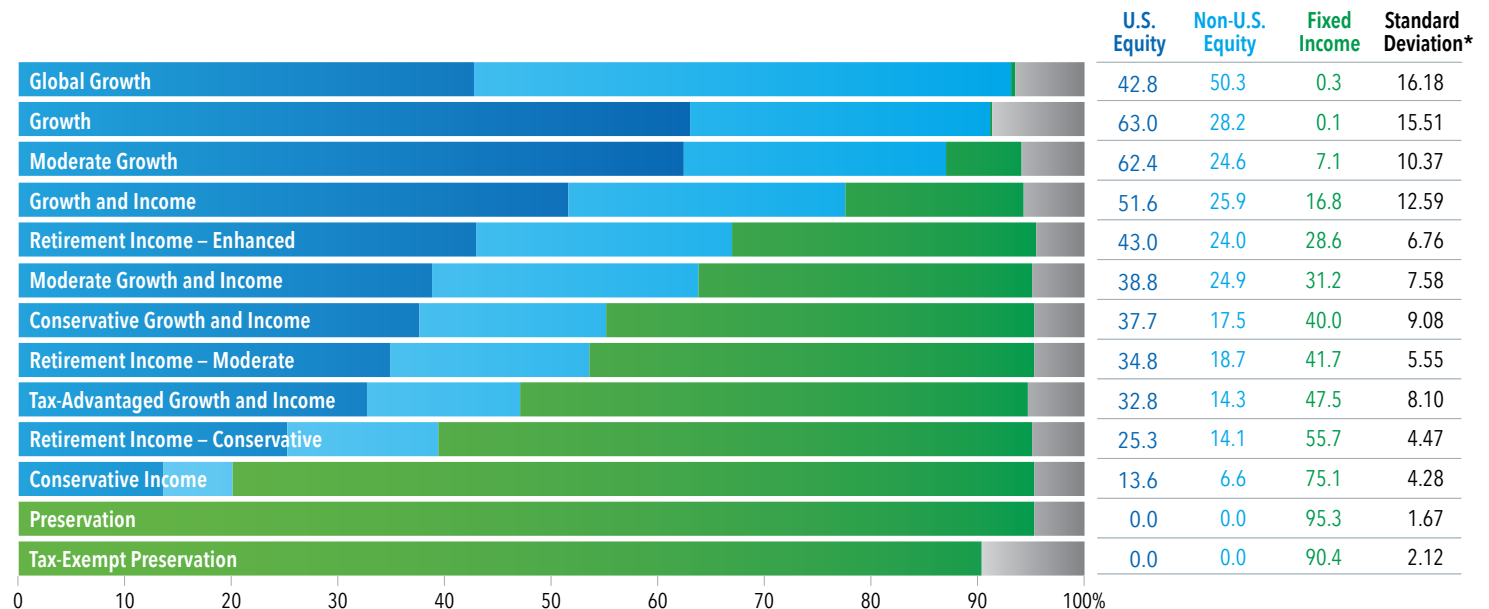
# Put these insights to work in portfolios

An asset allocation for every investment objective

## What is POC?

Capital Group's Portfolio Oversight Committee (POC) is a team of seven experienced portfolio managers who set the asset allocations for our model portfolios. The committee makes strategic allocations to underlying funds, based on stated investment objectives. Funds with flexible mandates allow for "tilts" to asset class exposure. This allows fund portfolio managers and investment analysts to act on their highest conviction ideas based on fundamental, bottom-up research.

Allocations reflect meaningful exposure to non-U.S. holdings, particularly for investors seeking growth



The asset allocations above are drawn from the 13 American Funds model portfolios, which are established by Capital Group's Portfolio Oversight Committee (see above). The committee makes strategic allocations to underlying American Funds based on stated investment objectives. The following themes are reflected in the asset allocations:

**U.S. Equity:** Maintain a core allocation of U.S. equities but market levels call for selectivity and rebalancing toward international and emerging markets equities.

**International Equity:** Seek meaningful exposure to international and emerging markets equities for the potential to gain from Europe's improving health and

rising consumer purchasing power in emerging markets.

**Fixed Income:** Seek to ensure core bond portfolios are positioned for rising volatility, with limited exposure to lower quality credit or high yield in order to provide relative stability and diversification.

\*Annualized standard deviation is calculated at net asset value based on monthly returns and is a measure of how returns over time have varied from the mean. A lower number signifies lower volatility.

# 2018 Outlook: Time for balance and flexibility

Themes	Big Picture Market levels call for balance and flexibility.	U.S. Equity The U.S. economy is strong, but markets are relatively expensive.	International Equity There is room to run in markets outside the U.S.	Taxable Fixed Income It's time to de-risk core bond portfolios.	Tax-Exempt Fixed Income Municipal bonds still offer attractive opportunities.
Key takeaways	The global expansion is gaining momentum as the U.S. forges ahead and conditions improve in Europe. Low rates and mild inflation across the globe further contribute to a benign economic environment. But with volatility at multiyear lows, complacency has spread.	Consumer optimism and rising wages have provided a further boost to a strengthening U.S. economy. Valuations are near multiyear highs across a number of asset classes. But a deeper look beyond market averages reveals opportunity for selective investors.	After outpacing U.S. equity markets in 2017, European and emerging markets continue to offer relatively attractive valuations in select areas. Improving economic conditions, a weaker U.S. dollar and rising profit growth all contribute to an encouraging outlook for investing in non-U.S. markets.	Fixed income assets are relatively expensive across sectors, reflecting expectations that financial conditions will remain supportive. Even as they tighten monetary policy, the bias of central banks remains supportive of economic growth. With inflation muted and growth rates modest, we expect the Fed will take a gradualist approach.	After broad gains in 2017, municipal bond valuations are relatively high. But higher volatility from uncertainty over tax and health care reform could create opportunities for selective investors.
Investment implications	At this stage of the cycle, make sure portfolios are well-diversified, with the flexibility to pivot to select areas of opportunity.	Maintain a core allocation of U.S. equities but be selective and consider rebalancing toward international and emerging market equities.	Seek meaningful exposure to Europe's improving health and rising consumer purchasing power in emerging markets.	Ensure your bond portfolio is broadly diversified and does not have excessive high-yield exposure. Invest selectively in credit. Don't be afraid to have some duration. Consider small allocations to emerging markets bonds.	Consider shifting a portion of core bond portfolios to municipal bonds.
Select investments to consider	<b>New Perspective Fund®</b> A - ANWPX; F-2 - ANWFX; R-3 - RNPCX; R-6 - RNP GX <b>American Balanced Fund®</b> A - ABALX; F-2 - AMBFX; R-3 - RLBCX; R-6 - RLBGX	<b>AMCAP Fund®</b> A - AMCPX; F-2 - AMCFX; R-3 - RAFCX; R-6 - RAFGX <b>Fundamental Investors®</b> A - ANCFX; F-2 - FINFX; R-3 - RFNCX; R-6 - RFNGX	<b>EuroPacific Growth Fund®</b> A - AEPGX; F-2 - AEPFX; R-3 - RERCX; R-6 - RERGX <b>New World Fund®</b> A - NEWFX; F-2 - NFFFX; R-3 - RNWCX; R-6 - RNWGX	<b>The Bond Fund of America®</b> A - ABNDX; F-2 - ABNFX; R-3 - RBFCX; R-6 - RBFGX <b>American Funds Strategic Bond Fund®</b> A - ANBAX; F-2 - ANBFX; R-3 - RANCX; R-6 - RANGX <b>American Funds Inflation Linked Bond Fund®</b> A - BFIAX; F-2 - BFIGX; R-3 - RILCX; R-6 - RILFX <b>American Funds Emerging Markets Bond Fund®</b> A - EBNAX; F-2 - EBNFX; R-3 - REGCX; R-6 - REGGX	<b>The Tax-Exempt Bond Fund of America®</b> A - AFTEX; F-2 - TEAFX <b>American High-Income Municipal Bond Fund®</b> A - AMHIX; F-2 - AHMFX

MSCI has not approved, reviewed or produced this report, makes no express or implied warranties or representations and is not liable whatsoever for any data in the report. You may not redistribute the MSCI data or use it as a basis for other indices or investment products. The S&P 500 is a product of S&P Dow Jones Indices LLC and/or its affiliates and has been licensed for use by Capital Group. Copyright © 2018 S&P Dow Jones Indices LLC, a division of S&P Global, and/or its affiliates. All rights reserved. Redistribution or reproduction in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC.

Bloomberg® is a trademark of Bloomberg Finance L.P. (collectively with its affiliates, "Bloomberg"). Barclays® is a trademark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Neither Bloomberg nor Barclays approves or endorses this material, guarantees the accuracy or completeness of any information herein and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

**Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.**

Investing outside the United States involves risks such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in fund prospectuses. These risks may be heightened in connection with investments in developing countries. The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with underlying bond holdings. Bond prices and a bond fund's share price will generally move in the opposite direction of interest rates. For tax-exempt bond funds, income may be subject to state or local income taxes. Income may also be subject to the federal alternative minimum tax (except for The Tax-Exempt Bond Fund of America). Certain other income, as well as capital gain distributions, may be taxable. Bond ratings, which typically range from AAA/Aaa (highest) to D (lowest), are assigned by credit rating agencies such as Standard & Poor's, Moody's and/or Fitch, as an indication of an issuer's creditworthiness. Market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

The statements attributed to an individual in 2018 Outlook represent the opinions of that individual as of the date published and do not necessarily reflect the opinions of Capital Group or its affiliates. This information is intended to highlight issues and not to be comprehensive or to provide advice.

Content contained herein is not intended to serve as impartial or fiduciary advice. The content has been developed by the distributor of the American Funds mutual funds, which receives fees for distributing and servicing the funds.