

Quarterly Outlook

Investment Insights

October 2015



AMERICAN
FUNDS®

From Capital Group

Multiple Perspectives. One Approach.®



Take on
Near-Term
Volatility With
a Long-Term
Focus.

This quarterly outlook provides perspective on topics like slowing growth in China, rising market volatility, evolving conditions in Europe and dividend opportunities in Japan. We hope it proves valuable as you seek to keep clients apprised of market conditions and committed to their investing objectives. As always, our near-term views are balanced by our strong belief that investors should:

- Keep a long-term perspective
- Know what they own
- Understand that building portfolios based on country of domicile has its limits
- Recognize the value of advice

Seek Global Growth

“I need my portfolio to grow but worry about world events. How do I get growth in the current environment?”

U.S. page 1

Solid growth, but expect volatility

Accelerating growth, an improving employment picture and benign inflation provide a favorable backdrop for continued investment. But with valuations at relatively high levels in many areas of the market, selective investing is essential.

International page 2

It's about companies, not countries

Europe and Japan face muted growth prospects, but currency weakness and falling energy prices could provide an earnings tailwind for attractively valued export-oriented businesses.

Emerging Markets page 3

Growth slows, but the base broadens

Market volatility has risen, but demographic and economic trends together with attractive valuations argue for selective long-term investment.

Pursue Sustainable Income

“I rely on my investments to produce income but low stock and bond yields present a big challenge. What's the right approach to income generation in today's market?”

Dividends page 4

Income holds appeal even if rates rise

The global dividend opportunity continues to broaden, and although conventional wisdom suggests rising rates are bad for dividend stocks, a closer look shows growers and payers faring well when rates tick up.

Bonds page 5

Interest rates expected to move slowly higher

As rates rise, the bond market faces a challenging road ahead. But bonds will continue to provide needed diversification in uncertain times.

Munis

Tax-exempt yields offer relative value

In a rising rate environment, the vast credit market should still be a source of compelling income and capital preservation opportunities for selective investors.

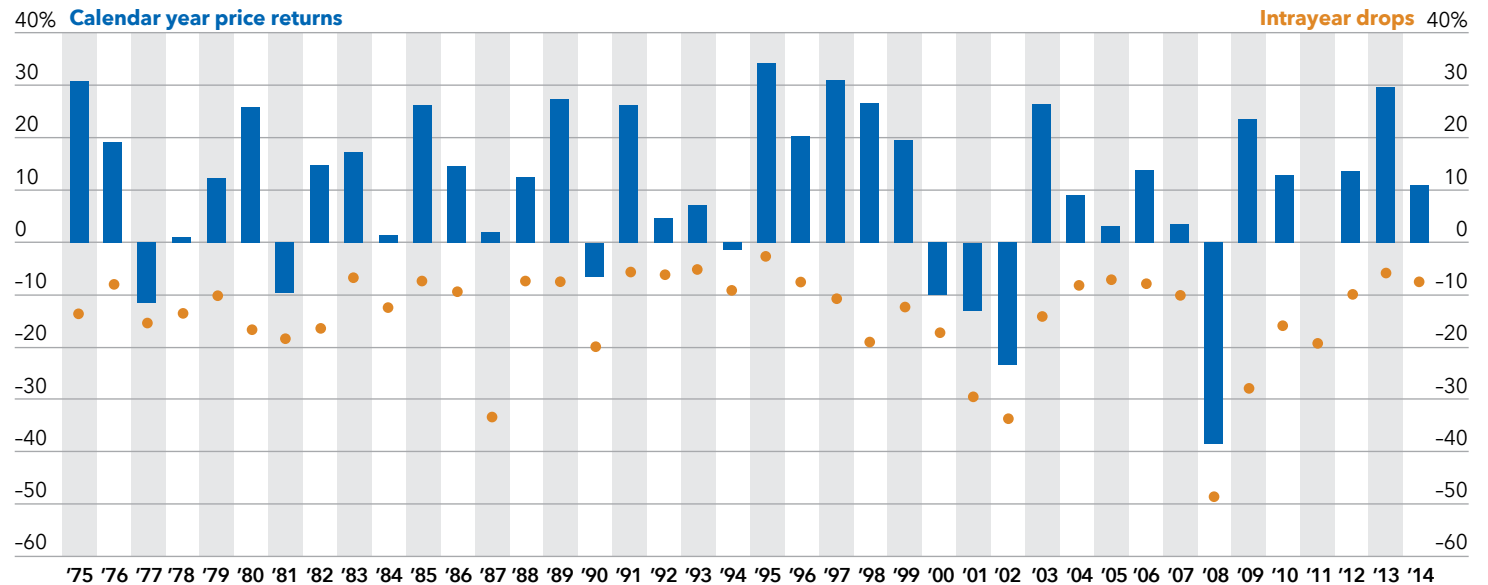
Welcome Back Volatility

The Recent Market Turbulence Is a Reminder That Declines Have Been Relatively Routine Events

Despite average intrayear drops of 14%, annual price returns were positive in 31 of 40 calendar years

S&P declines: 1975-2014

Type	Total number	Frequency
-5%	120	3.0 per year
-10%	31	0.8 per year or once about every 1.3 years
-15%	11	0.3 per year or once about every 3.6 years
-20%	5	0.1 per year or once about every 8.0 years



* Price return for 2011 was 0.0%

Source: Rimes. S&P 500 annual returns, as represented in the bar chart, are based on price returns only and, therefore, do not include dividends. Intra-year drops refer to the largest decline for each calendar year. Total number of positive years and average intra-year drops are for the 40 years ended 12/31/14. Average frequency of declines, as shown in the table, assumes 50% recovery of lost value. Investors cannot invest directly in an index.

- The old normal has become the new normal. This summer's market correction proved to be an unpleasant reminder that stock prices don't go up forever. The downturn, which was the first decline of 10% or more in more than four years, disrupted the third-longest equity rally in U.S. market history.
- Sharp market drops can unnerve even the most seasoned investors, but a look back over the past 40 years shows that declines are a relatively routine occurrence. As the table above left shows, drops of 10% or more have occurred about once a year.
- While there have been significant setbacks in each of the last 40 calendar years, the S&P 500 recorded a positive return in 31 of those years, or 78% of the time.
- What's more, conditions in the U.S. remain generally upbeat. After months of stagnation, U.S. consumer spending turned up in May, and unemployment dipped to 5.3% in June. Corporate cash as a percentage of current assets for S&P 500 companies also rose to a record high by some measures.
- However, given that earnings growth has slowed recently and valuations in some areas of the market have become stretched in recent months, we believe that selective investing will be essential going forward.

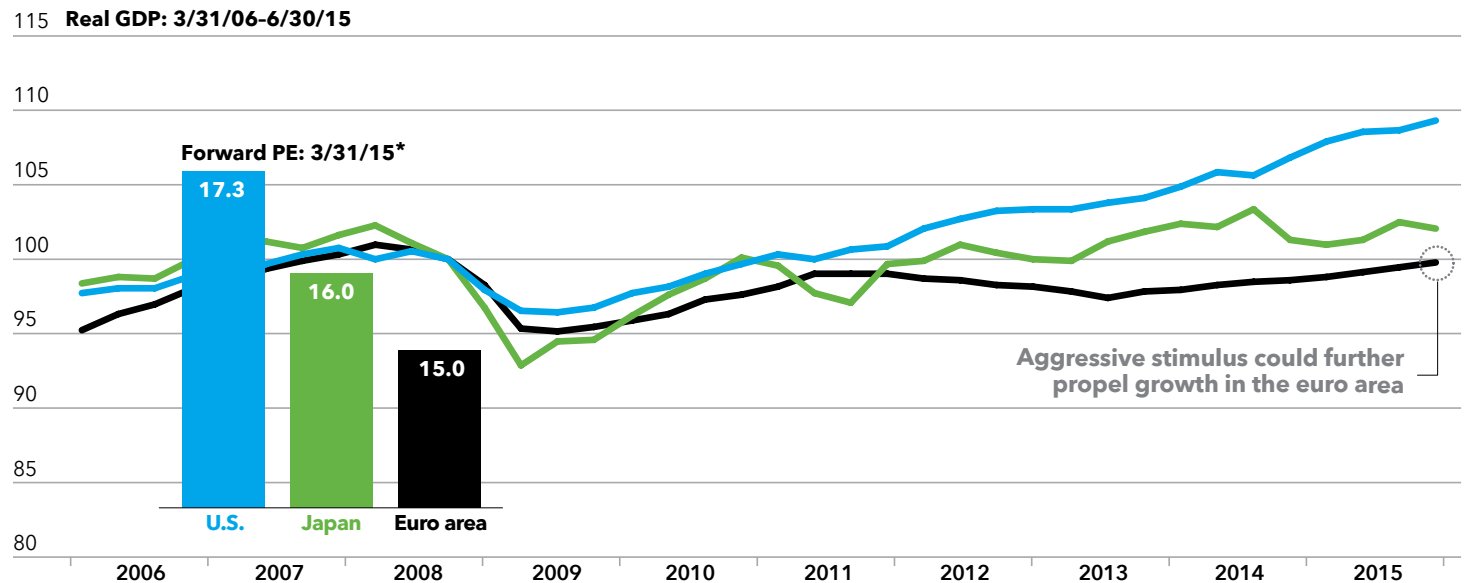
While Europe Plays Catch-Up, Valuations Look Attractive

Aggressive Stimulus, Accelerating Growth Could Boost Earnings for Some Companies

“We have some very strong cyclical tailwinds hitting the European economy at the moment. We have low oil prices, looser monetary policy by the European Central Bank and we have a cheap euro. I believe these tailwinds can keep a robust growth momentum in the euro area for some time.”

Jens Søndergaard, Economist

The euro-area economy is just now nearing its pre-crisis peak, but the growth rate has been picking up



*Forward price-to-earnings ratios for each market using forecasted earnings.
Sources: Factset, RIMES

- The developed world appears to be hitting its stride. The U.S. economy recently was more than 10% bigger than it was before the start of the global financial crisis. Since that time, economic recovery in Europe has proceeded at a much more muted pace, but as you can see in the chart, euro area GDP has just recently approached pre-crisis levels.
- More recently, however, the recovery in the euro area appears to be gaining traction. And there are a number of tailwinds that could support accelerated growth. Both Europe and Japan are benefiting from accommodative central bank policies – at a time when the U.S. Federal Reserve is poised to boost short-term interest rates. A weaker currency and lower oil prices could further boost euro area growth.
- Given the improving economic backdrop – and that forward price-to-earnings ratios suggest European companies offer more attractive values than U.S. firms – select European firms may offer better return potential going forward.

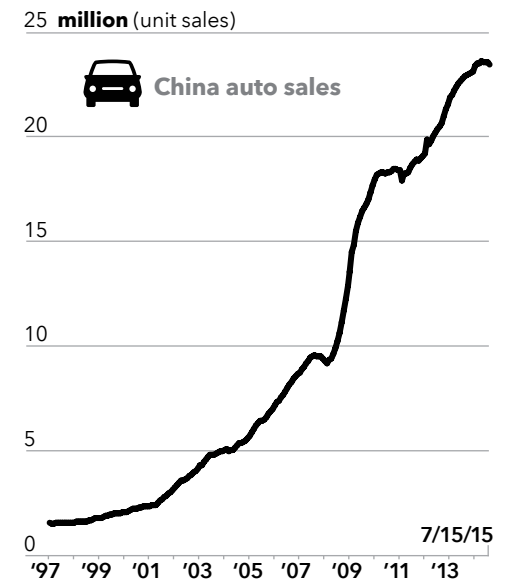
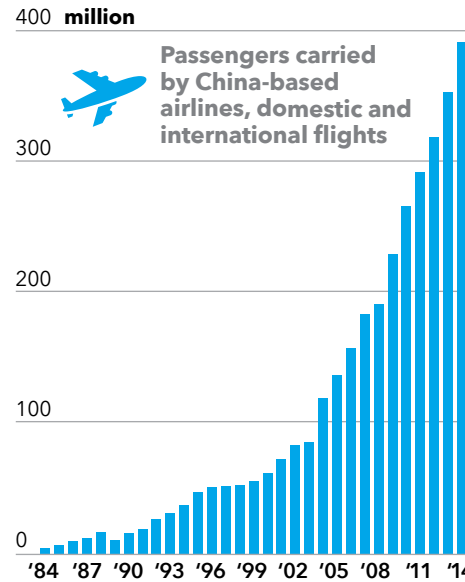
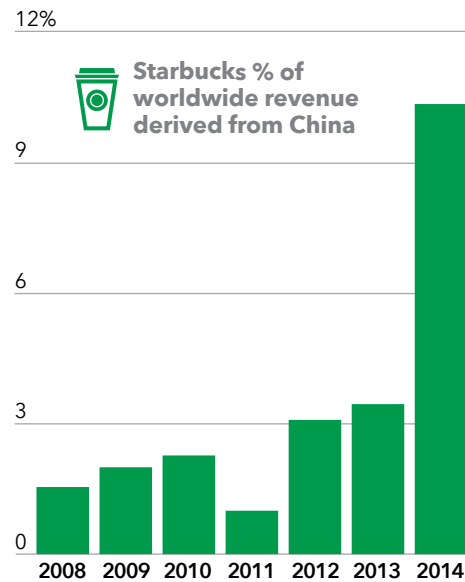
As Macro Economy Founders, Chinese Consumers Go Shopping

Selective, Long-Term Investors Should Still Find Attractive Return Potential as Economies Diverge

“Wages continue to grow on average 5%-7% per year on a nationwide basis, and are still growing in some regions and sectors 10%-15% per annum, even in the current slower growth environment. This puts money in the pockets of the masses. Even though luxury goods consumption has fallen sharply, mass market consumption is still quite healthy.”

Andrew Dougherty
China Affairs Specialist

From flat whites, to flights and cars – China’s shift to a consumption-based economy is well underway



Sources: Energy Information Administration and *Short-Term Energy Outlook*, World Bank, Factset; China Association of Automobile Manufacturers. Auto sales are unit sales for rolling 12-month periods.

- Concerned that the “emerging markets story” is over? Sharp declines in China’s stock market, plummeting commodity prices and the prospect of higher U.S. interest rates has left some investors feeling unsettled. And yet, while these are significant developments and sources of near-term volatility, for longer term investors there are still many attractive opportunities across stock and bond markets in developing nations.
- For example, China’s transition away from investment-led growth toward an economic structure more reliant on consumption is well underway. So while

the overall pace of economic activity has slowed, Chinese consumers have continued to serve as a source of earnings growth for many domestic firms and multinationals.

- Higher U.S. interest rates could initially dampen demand for emerging markets assets, but it’s important to note that emerging markets may have already made significant adjustments to tighter Fed policy. In many markets, stocks have moved lower, bond yields have risen and, significantly, currencies have depreciated.

Generally, valuations appear attractive, with forward price-to-earnings ratios below historical averages. Our research suggests pockets of attractive return potential continue to be evident across emerging markets in sectors offering high-growth such as Chinese Internet firms, as well as more defensive areas such as healthcare companies.

Push for Better Corporate Governance Pays Dividends in Japan

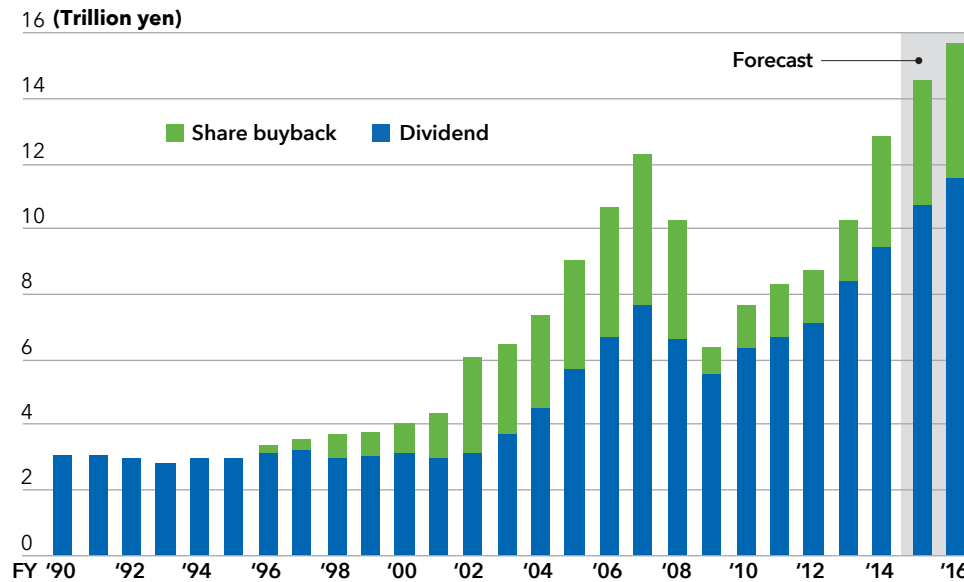
Japanese Companies Are Returning More Cash to Their Shareholders

“It is no longer about being invested in Japan or being out of Japan. You actually have a true distinction between companies that are behaving in a much more shareholder-friendly point of view and companies that are still engrossed in their old-fashioned way of managing the business.”

Gerald du Manoir, Portfolio Manager

Dividends and share buybacks are on the rise in Japan ...

... and there may be room for growth



Index	Dividend growth		Yield
	1 year	3 year	
Japan Nikkei 225	22.0	13.5	1.39%
S&P 500	11.2	14.0	1.94
MSCI Europe	(13.6)	(3.4)	3.32
MSCI EM	(4.4)	(4.6)	2.60

Share buybacks are based on common stocks, excluding purchases from Resolution and Collection Corp and repurchase of preferred shares. FY2015 and FY2016 are forecasts by Nomura Securities. Figures for dividend growth are the compound annual growth rate. Sources: Left chart, Nomura Securities, based on companies' disclosures and Toyo Keizai's materials. Right chart, Factset.

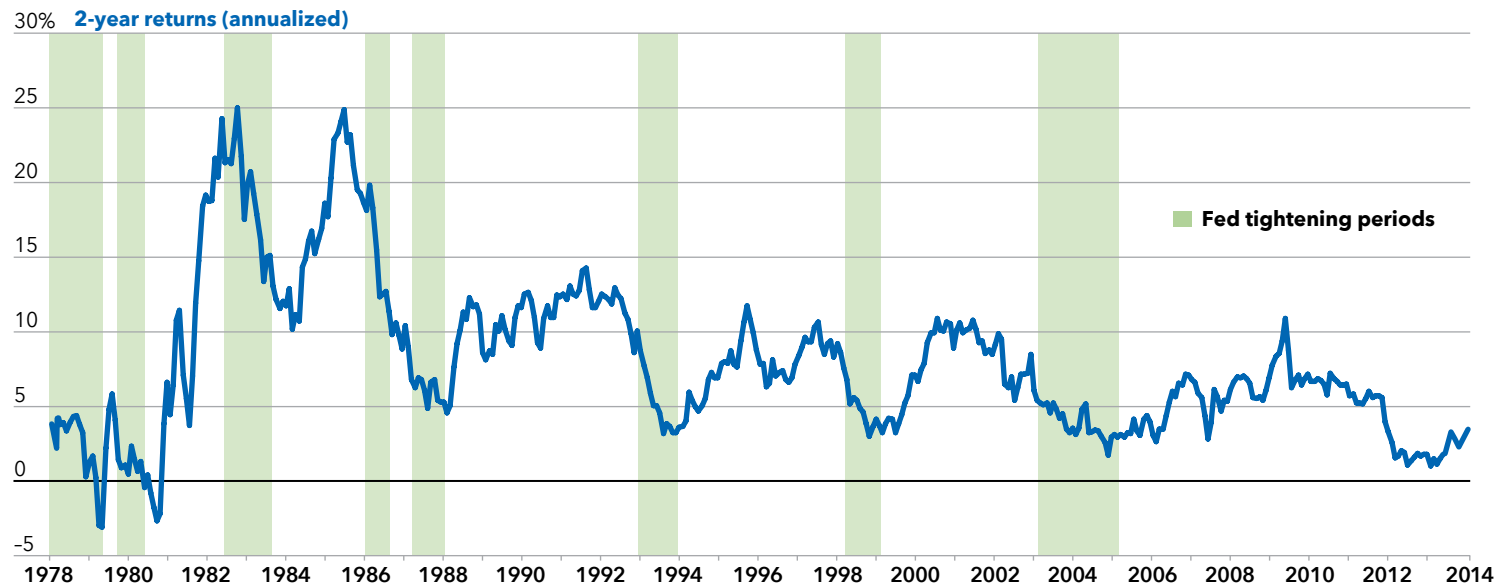
- There are indications that Japanese companies are placing a greater emphasis on investor returns and breaking with a tradition of hoarding cash.
- Returns on equity for Japanese businesses historically have lagged companies in other developed markets. In an effort to change that, Prime Minister Shinzo Abe's administration is pushing for improvements in corporate governance as part of its economic recovery plan. A new corporate governance code encourages companies to focus on profitability, capital efficiency, and the appointment of outside directors.
- Japanese companies appear to have received the message loud and clear. Some have begun to implement new policies aimed at improving returns on equity. What's more, dividend payments and share buybacks have been rising in recent years, a trend that the market expects to gain momentum in the coming quarters.
- As you can see in the chart on the right, dividend growth among Japanese companies has outpaced growth in other markets.

Select companies in a wide variety of sectors and industries have been growing dividend payments at a faster rate than the broader Japanese market. Among these are KDDI, an integrated telecom company, electronic components maker Murata Manufacturing and Toyota.

Bond Investors Don't Need to Fear Rising Rates

Over Two-Year Periods, Bond Returns Have Been Mostly Positive, Even During Fed Tightening Cycles

High quality U.S. bonds can provide a cushion against losses in other parts of a diversified portfolio



Source: Federal Reserve, Barclays

- U.S. economic growth has rebounded following a weaker-than-expected first quarter. The remainder of the year is likely to see stronger growth than the first half as long-term trends in key indicators, such as employment and housing, continue to reflect an improving economy.
- As the Federal Reserve seeks to normalize monetary policy, U.S. interest rates will likely head higher; however, we believe the pace of rate increases will be slower than many investors expect.

Turmoil in China, Greece, the Middle East and elsewhere is keeping a lid on U.S. rates as investors flock to buy safe-haven U.S. Treasuries.

- Despite losing some ground against other currencies during the second quarter, the U.S. dollar has strengthened significantly over the past 12 months, driven by the stronger relative economic position of the U.S. Given the imbalances that still exist in the global economy, continued pockets of dollar strength may be a feature of the investment landscape over the medium term.

While it is true that rising interest rates hurt bond prices in the near term, it is important to remember that over the long term, higher rates are beneficial for fixed-income investors because they allow reinvestment to occur at higher yields – ultimately producing better total-return opportunities down the road.

Quarterly Outlook: Seek Global Growth and Sustainable Income

	U.S.	International	Emerging Markets	Dividends	Bonds
Headwinds	<ul style="list-style-type: none"> Stocks in many areas of the market appear to be fairly valued Any policy misstep by the Fed could dampen growth 	<ul style="list-style-type: none"> Structural underemployment Slowing emerging markets demand Political opposition to moral hazard Deflation in Europe could impact asset prices 	<ul style="list-style-type: none"> Global credit cycle/interest-rate normalization and possible currency weakness Geopolitical tensions, country-specific challenges may lead to volatile asset flows 	<ul style="list-style-type: none"> Valuations appear lofty in some high-yielding sectors Rising rates could hurt bond surrogates 	<ul style="list-style-type: none"> Interest rates likely moving slowly higher Valuations are high for most bonds Fed faces challenge of managing expectations
Tailwinds	<ul style="list-style-type: none"> Economic growth picking up and employment picture brightening Consumer health improving Lower energy prices have boosted consumer purchasing power State and local governments no longer pose a fiscal drag 	<ul style="list-style-type: none"> Political will to find a solution to sluggish economic growth Currency weakness helping exporters Lower oil prices providing a boost for consumers. 	<ul style="list-style-type: none"> Secular growth drivers remain in place Political change and regulatory reform should bolster investor confidence in certain markets Fiscal and trade imbalances are improving 	<ul style="list-style-type: none"> Low yields on fixed income Payouts are low and cash is high, implying companies can grow dividends Demographics driving need for income and yield 	<ul style="list-style-type: none"> Relatively low interest rates for now Geopolitical unrest may spur safe-haven assets Foreign buying of U.S. Treasuries Rising demand for bonds from pension funds
Key takeaways	U.S. equities have room to rise, but fewer mispriced investment opportunities put stock selection at a premium.	Healing economies could bolster earnings for select companies.	Don't let China's slowing growth distract from the compelling valuations and fundamentals among emerging markets stocks.	With uneven global economic growth, dividends may account for a greater portion of total return in 2015.	Expect a more challenging and volatile bond market, but remember the important risk-dampening role that bonds play in a diversified portfolio.
Investments to consider	AMCAP Fund® A - AMCPX; C - AMPCX; F-1 - AMPFX; F-2 - AMCFX American Mutual Fund® A - AMRMX; C - AMFCX; F-1 - AMFFX; F-2 - AMRFX	International Growth and Income FundSM A - IGAAX; C - IGICX; F-1 - IGIFX; F-2 - IGFFX	New World Fund® A - NEWFX; C - NEWCX; F-1 - NWFFX; F-2 - NFFFX	Capital Income Builder® A - CAIBX; C - CIBCX; F-1 - CIBFX; F-2 - CAIFX	The Tax-Exempt Bond Fund of America® A - AFTEX; C - TEBCX; F-1 - AFTFX; F-2 - TEAFX Capital World Bond Fund® A - CWBFX; C - CWBCX; F-1 - WBFFX; F-2 - BFWFX

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.

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