

U.S. A BRIGHT SPOT IN SLOW-GROWTH WORLD

Investors face a world with uneven economic growth and a general lack of market direction. We believe our active management investment approach can help uncover opportunity in this uncertain environment.



U.S. consumers lead the way

Amid an uncertain global backdrop and slow economic growth worldwide, the U.S. economic expansion has remained relatively steadfast. We believe the U.S. is a relative bright spot in the world's economy in the near term, especially related to the U.S. consumer. We think U.S. consumers will continue to benefit from lower energy prices and lower inflation in general. They are better positioned to take on debt for mortgages and car loans, use credit cards and generally spend more on home furnishings, technology and consumer goods.

"The U.S. labor market continues to improve, as indicated by increases in payroll levels, employment and wages," says **Mike Avery, executive vice president of Ivy Investment Management Co. and co-portfolio manager of Ivy Asset Strategy Fund**. "Business and consumer sentiment indicators generally are at or near their levels prior to the global financial crisis that began in 2008."

We think consumers will continue to benefit from the accommodative policies of the U.S. Federal Reserve (Fed). The policy-setting Federal Open Market Committee on Dec. 16 announced an increase in the fed funds lending rate of 0.25% after holding it near zero since 2008. That increase will filter through to other consumer and business lending

rates. Fed officials have struggled in trying to gauge whether the U.S. economy can sustain growth as rates increase, which added to financial market uncertainty in 2015. Fed Chair Janet Yellen repeatedly emphasized in recent months that policymakers would analyze a wide range of data on the labor market, inflation and economic activity in order to decide on the timing of a rate hike.

The latest rate hike may have been historically significant since it was the first increase since the financial crisis, but the move was small and the fed funds rate remains exceptionally low by historical standards.

Even as interest rates begin to rise, we think current modest economic growth and low inflation mean the Fed is likely to be very cautious and methodical about future increases. We expect rates to remain low through 2016, given our expectations of slow growth in the developed world.

In our view, that means the long end of the bond yield curve may show some volatility but is likely to stay relatively anchored, allowing interest rate-sensitive sectors to continue to expand.

"We expect to see a continuation of the structural changes under way in fixed-income markets," says **Mark Beischel, Ivy Funds global director of fixed income and portfolio manager of Ivy Global Bond Fund**. "Wall Street dealer's

Key themes and investment ideas for 2016



The U.S. remains a bright spot for economic growth versus the rest of the world, offering the potential for continued market gains.



Income-seeking investors may find opportunity at a time of low interest rates by moving beyond government securities and highly rated bonds.



International markets may gain tailwinds from the "Three Es": European Central Bank policy, lower Energy prices and Emerging Market growth.

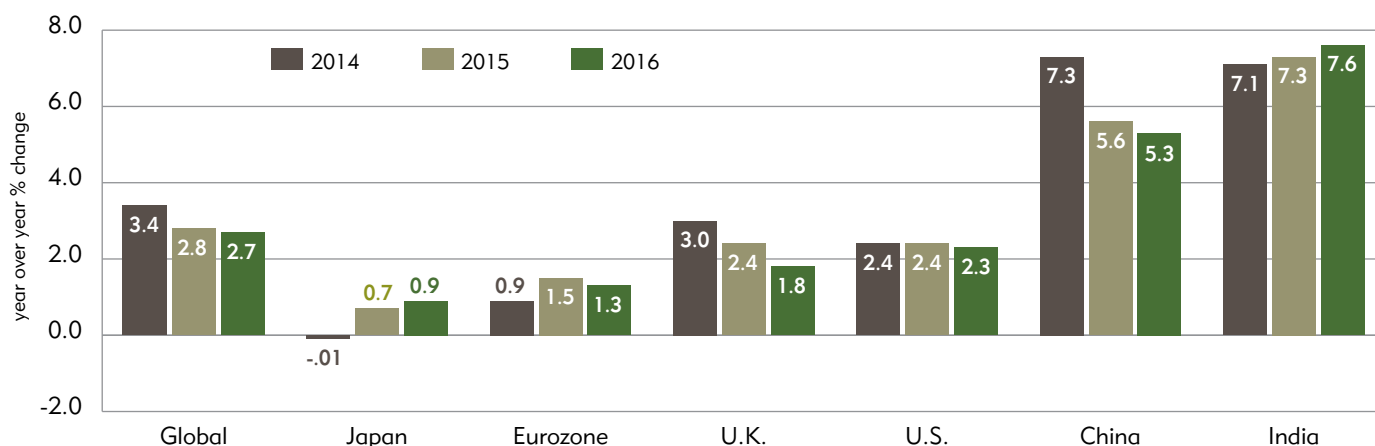


Economic growth may aid business confidence and consumer demand, increasing the potential for key sectors around the world.



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GLOBAL ECONOMIC GROWTH STAYS IN STEADY RANGE



Forecasts are for annual gross domestic product growth.

Source: 2014 International Monetary Fund actual data, 2015-2016 Ivy Funds forecasts, all based on purchasing power parity.

Past performance is not a guarantee of future results.

incentives to carry high inventory levels of corporate bonds have been reduced by higher capital requests, making them more expensive to hold.”

As a result, market liquidity has been reduced and there are more opportunities for dislocations in the corporate bond market going forward. Globally, Beischel says he believes the U.S. still will be seen as a “safe haven” investment and will continue to attract funds from outside the U.S.

Looking forward, we think the Millennial Generation (those born in 1980-1995) presents the next wave of U.S. growth potential. This group is showing rising confidence, as can be seen in household formation data supported by improving employment levels, better wage prospects, housing’s continued recovery and rising rent levels.

We think the positives in the economy should be enough to offset the negatives, allowing earnings and stock prices to move modestly higher.

While the underpinnings of a healthy labor market, strong auto sales and a solid housing recovery remain, overall corporate profit growth has largely stalled. “While there are clear pockets of strength in select areas of health care, consumer and technology, there is also a profit recession in much of the energy, materials and industrial areas of the economy,” **says Phil Sanders, Ivy Funds chief investment officer and co-portfolio manager of the Ivy Large Cap Growth Fund.** “There is currently a much more diverse profit outlook across sectors than we typically observe.”

We think the positives in the economy (employment, housing, lower energy prices, more accommodative lending) should be enough to offset negatives, allowing earnings and stock prices to move modestly higher. We think these positives can outweigh the negatives as we progress through 2016. The real question is: Can the U.S. economy generate growth without further policy accommodation? “We do not see a clear catalyst to get the U.S. economy to accelerate much from its current growth level, but we also are not forecasting a downturn,” Avery says. “While the recovery seems solid, the risk is that the current level of about 2.5% growth in real gross domestic product is as good as it gets for the near term as the rest of the world plods along.”

Eurozone still challenged

The eurozone showed improvement during 2015 in gross domestic product (GDP), employment and consumer spending, and consumer and business sentiment indicators turned higher. We think Europe will show continued economic recovery in 2016, although the growth rate is likely to stay near 2015’s low level. In the current market environment, we think three factors can serve as tailwinds for the eurozone economy:

- **European Central Bank (ECB) accommodative policy**

The ECB continued its quantitative easing program in 2015, aimed at satisfying its price stability mandate. The goal is to encourage lending, keep interest rates low and support asset prices. The ECB is likely to keep this policy in place in 2016, given Europe’s continued slow overall growth rate.

- **Lower Energy costs**

The eurozone imports the majority of its oil, meaning low oil prices have been positive for both consumers and corporations. We think cheaper oil will continue to put money back in the pockets of consumers and result in spending in other areas, which will spur growth and benefit consumer-facing sectors. European corporations are likely to continue to benefit from the increase in revenue and sales growth, as well as lower input costs because of cheaper energy.

- **Emerging Market growth**

As household incomes rise in emerging economies, more individuals are achieving middle-class status and seeking access to more discretionary goods. The slowdown in China and sluggish economic growth in developed markets should continue to pressure exports from emerging markets. But we still see evidence of a growing consumer culture across key emerging markets, including China, India and Indonesia. These new consumers are generating demand for health care, high-technology hardware and software, home improvement products, entertainment and more. There are potential benefits for companies that can serve this growing consumer demand.

The ECB in early December 2015 said it will continue its program of economic stimulus, extending its asset purchase program to mid-2017 from the previously planned close in late 2016 and further cutting an already negative deposit rate to encourage lending. Despite the ECB's actions and the potential tailwinds, the longer-term path for Europe's economy still is not clear.

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The full impact of the growing refugee population in Europe – estimated at 1.5 million individuals in 2015 and perhaps that many or more arriving again in 2016 – will not be known for years and is another question mark for growth in Europe.

“As migrants come into Europe, they typically are given food, shelter, clothing and other benefits, which can vary by country,” says **Derek Hamilton, Ivy Funds global economist**. He estimates the benefit to GDP from extra fiscal spending will add 0.1 to 0.3% in the European Union (EU) as a whole. In addition,

a potential employment boost from increases in government services or private building projects in response to the larger population “could add another 0.1 to 0.2% to GDP growth in the short-term,” he says.

However, there could be a longer-term downside. While an increase in the labor force would be positive for Europe, a large influx of mainly young refugees with uncertain skills may not solve Europe's demographics problem from an aging pool of workers and could add to unemployment in some countries.

One of the fundamental tenants of the EU is the free movement of people and labor under the Schengen Agreement of 1985. The agreement allows the reinstatement of border controls for limited periods from threats to “public policy or internal security” and in “exceptional circumstances,” and several countries already have done so. In addition, there have been calls to suspend or replace Schengen entirely. The imposition of border checks could have important economic implications for Europe, disrupting supply chains, increasing travel times for goods and adding to inventories as delivery times are extended.

Slower growth in China

We believe China's economy is in a multi-year slowdown because of demographic issues, overcapacity and the need to deleverage following a rapid build-up of debt. The government is attempting to orchestrate a rebalancing toward consumption and away from investment, which historically has resulted in slower growth.

“However, we do believe that China's downside from here is likely limited in the near-term,” Hamilton says. “The government has been responding with targeted measures to put a floor under the economy, which we believe should be successful in stabilizing economic growth.”

The global environment remains complex. Our focus across all market cycles is to consistently find investment opportunities around the world with ongoing potential. As uncertainty will continue to be part of any forecast, we believe investors should maintain a well-diversified portfolio across asset classes and sectors.

10 KEY INSIGHTS FOR 2016

Financial markets and uncertainty have a complicated and familiar history. They are never too far removed from each other, and 2015 was no exception.



Hank Herrmann
CEO
Chairman of
the Investment
Policy Committee

Last year at this time, we projected that 2015 would bring high single-digit returns in U.S. equities and very modest returns in bonds. By the end of 2015, the market brought us modest returns in U.S. equities, as judged by the S&P 500 Index, and marginally negative returns for bonds. Some of the uncertainties that disrupted our projections have not dissipated as we enter 2016. Among the issues hanging over financial markets heading into 2016:

- the soft economies of U.S. trading partners
- increasing value of the dollar
- low energy prices
- ongoing geopolitical risk

Despite the intractability of those points, we continually draw insight from economic data, our global research and daily market analysis. Here are our primary points for investors over the next 12 months.

1. As the Federal Reserve (Fed) begins tightening monetary policy, it is likely to proceed slowly. While the financial markets seem to have accepted the first rate increase, the Fed remains committed to a measured pace. Any future increases will be data dependent, with job growth and wage levels being most important.
2. In the U.S., we have a bifurcated economy. Economic activity is growing, employers are adding jobs and wages are increasing slowly. That typically leads to stronger consumer spending. However, the industrial side is less robust, which we attribute to the impact of low oil prices on the energy sector, a stronger dollar and the weaker economies of our global trading partners prompting softer U.S. exports.
3. Despite the above, we believe the U.S. has achieved a self-sustaining economic recovery, perhaps expanding at a 2% or 2.5% rate in 2016.
4. For U.S. stocks in this environment, profit growth is likely to be the biggest determinant of relative winners.
5. Our focus currently is on valuations and individual stock characteristics. Stock selection is important and will impact

portfolio returns. We believe active investment managers who have independent, differentiated ideas and an understanding of the implications of ongoing market activity can make a meaningful difference when selecting investments and specific allocations.

6. For bonds, anomalies in credit spreads are likely to materially contribute to relative performance. Fixed-income investors may want to diversify holdings by moving beyond government and other highly rated bonds.
7. Internationally, the major central banks are actively engaged in aggressively easing monetary policy. Developed economies are showing very little growth. More aggressive policy action likely is on the way in Japan and the eurozone.
8. The good news for developed international markets is that central bank policies should lead to stronger economic activity. If results are similar to what we've seen in the U.S., monetary policy easing should bring stronger equity performance in developed Europe and Japan.
9. While we still believe the U.S. equity market is a good place for investors, it is possible that developed markets overseas could bring stronger results for equity investors in 2016.
10. Looking at China, the world's second-largest economy is slowing, though it still shows higher growth than developed economies at this point. China's leadership faces the difficult task of fostering a new consumer economy while attempting to maintain gross domestic product growth near 6% or so. While we see some sector or company opportunities there, volatility remains likely.

At the outset of a new year, it is important to work with your financial advisor to evaluate your investment portfolio based on overall goals and risk tolerance and make necessary adjustments or reallocations.

Past performance is no guarantee of future results. The opinions expressed in this article are those of the investment team and are current through December 2015. Views are subject to change at any time based on market and other current conditions, and no forecasts can be guaranteed.

The S&P 500 Index is composed of 500 selected common stocks chosen for market size, liquidity, and industry grouping, among other factors. Investments cannot be made directly in an index.

Risk factors: Investment return and principal value will fluctuate and it is possible to lose money by investing. International investing involves additional risks including currency fluctuations, political or economic conditions affecting the foreign country, and differences in accounting standards and foreign regulations. Investing in emerging markets may accentuate these risks. Investing in companies involved in one specified sector may be more risky and volatile than an investment with greater diversification. Fixed-income securities are subject to interest-rate risk and, as such, the net asset value of a fund may fall as interest rates rise. Investing in high-income securities may carry a greater risk of nonpayment of interest or principal than higher-rated bonds. Diversification cannot ensure a profit or protect against loss. These and other risks are more fully described in a fund's prospectus.

Investors should consider the investment objectives, risks, charges and expenses of a fund carefully before investing. For a prospectus, or if available, a summary prospectus, containing this and other information for any of the Ivy Funds, call your financial advisor or visit www.ivyfund.com. Please read the prospectus carefully before investing.



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