# Global Economic Update

Third Quarter 2016


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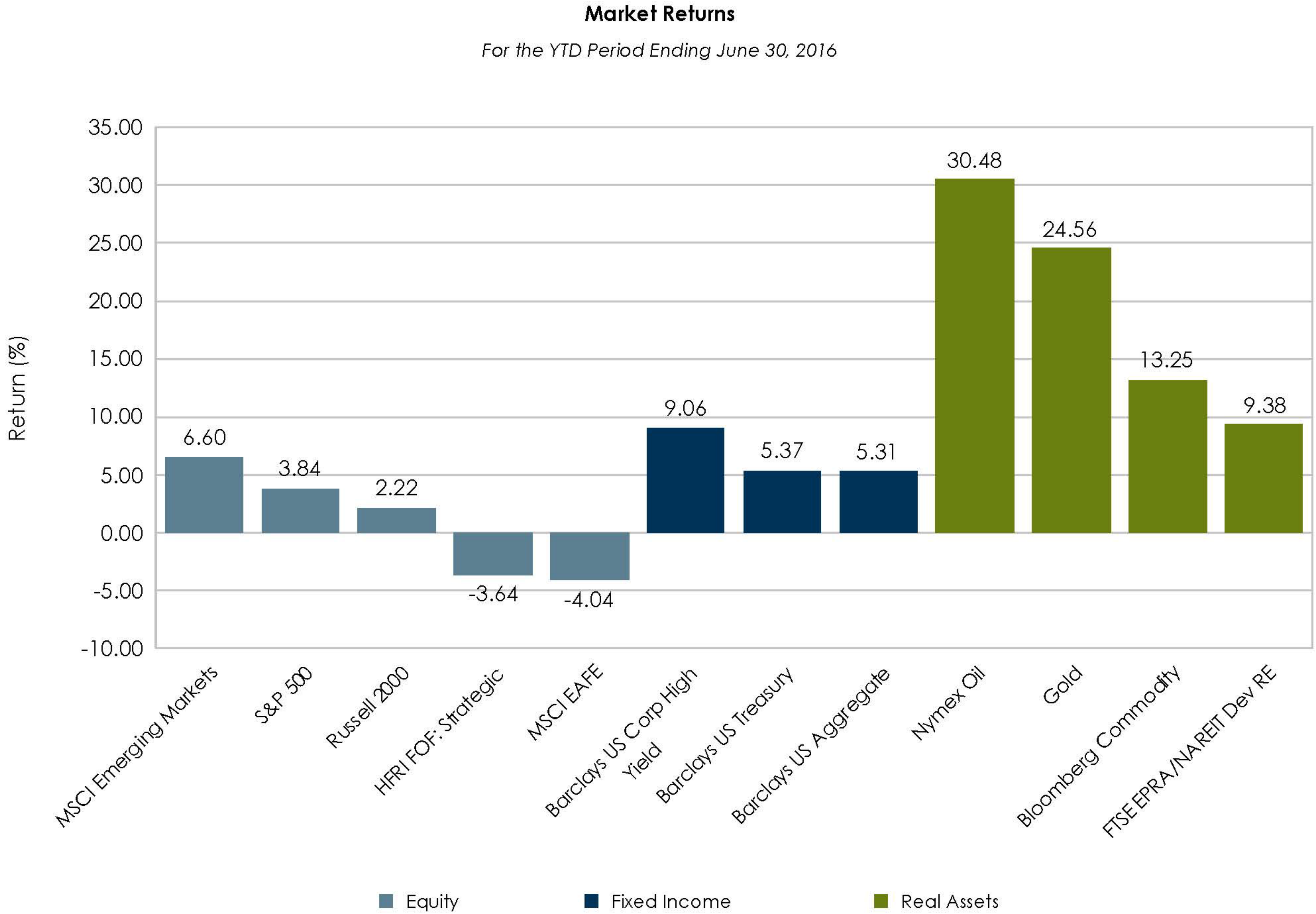
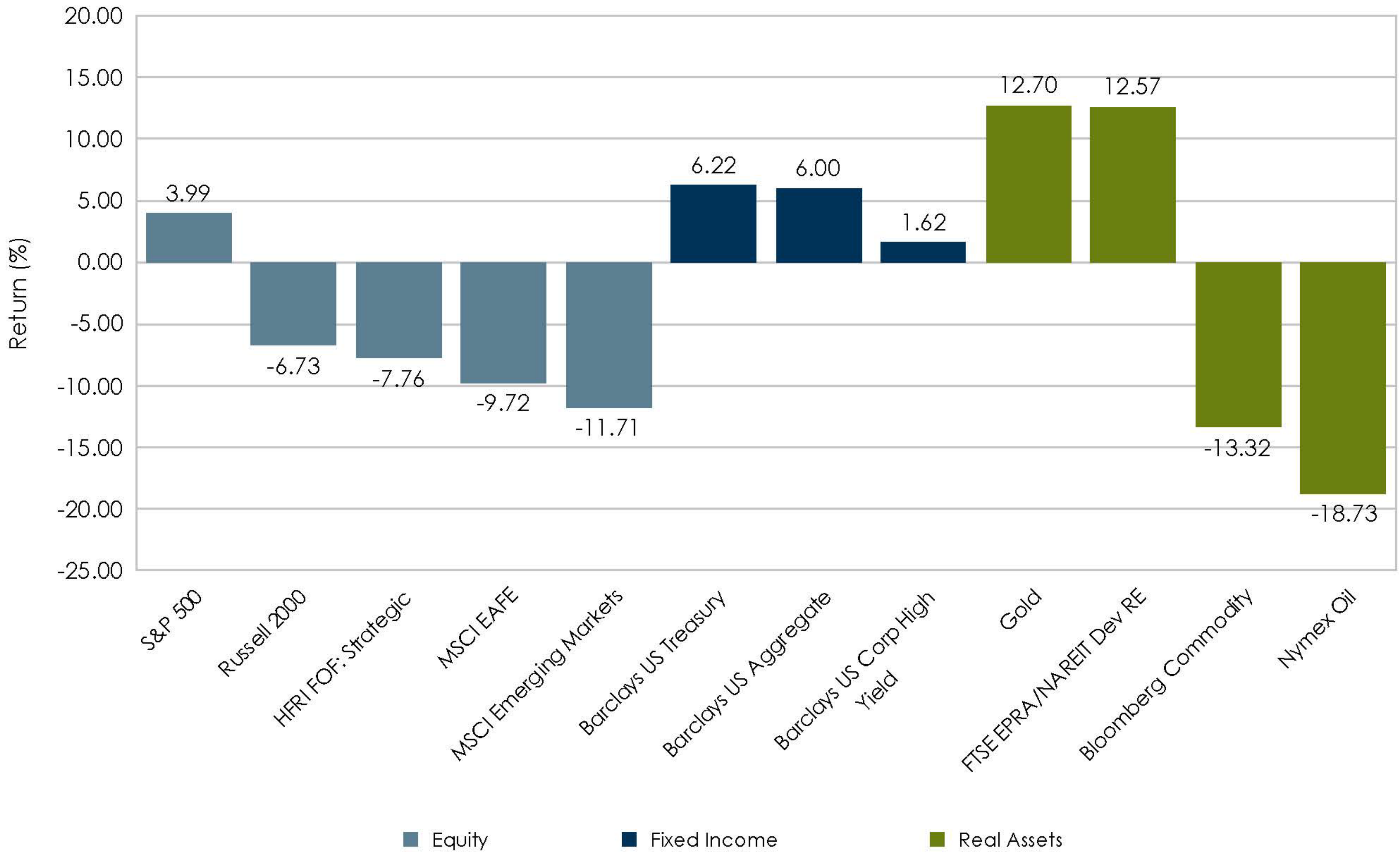

Market Returns
For the YTD Period Ending June 30, 2016
Return (%)
35.00
30.00
25.00
20.00
15.00
10.00
5.00
0.00
-5.00
-10.00
6.60
3.84
2.22
-3.64
-4.04
9.06
5.37
5.31
30.48
24.56
13.25
9.38
MSCI Emerging Markets
S&P 500
Russell 2000
HFRI FOF: Strategic
MSCI EAFE
Barclays US Corp High Yield
Barclays US Treasury
Barclays US Aggregate
Nymex Oil
Gold
Bloomberg Commodity
FTSE EPRA/NAREIT Dev RE
Equity
Fixed Income
Real Assets

**Market Returns**

*For the 1 Year Period Ending June 30, 2016*



## US

- First quarter US economic growth expanded more than previously estimated largely due to improved trade and corporate investment. Gross domestic product rose at a 1.1% annualized rate in 1Q16, following 1.4% in 4Q15.
- The economy shows signs of accelerating so far during the second quarter due to a rise in consumer spending. Gains in employment and low mortgage rates have helped bolster US housing activity.
- The Federal Reserve recently left rates steady, influenced by uncertainty surrounding Britain's vote to leave the European Union (EU). Financial markets project a low probability of the Fed raising interest rates in 2016.
- US consumer prices increased 1.0% in May from a year ago as energy prices jumped 1.2%. Core prices, which exclude volatile food and fuel costs, rose 2.2% primarily due to rising rent costs.

## Global/Non-US

- The European economy could likely slow this year and next due to the United Kingdom exit from the EU. The recent Brexit vote is expected to increase uncertainty among both businesses and consumers.
- Japan's 1Q16 GDP rose an annualized 1.9%, after a 1.8% drop in 4Q15, allowing the economy to avoid a technical recession. However, after the result of the Brexit vote was known, there was a rush towards safe haven assets, causing a surge in the Japanese yen against the US dollar. The stronger yen could dampen economic activity during 2Q16.
- Concerns about China's economy at the start of the year appear to have eased. A recent survey of economists forecasted GDP growth of 6.5% for 2016. Domestic consumption is expected to remain the largest contributor to growth followed by investment buoyed by a ramp in infrastructure spending.

## Current Issues

- Brexit – expected impact and portfolio considerations.
- US vs. Non-US Equities – historical performance cycles and current valuations.
- US elections – an added layer of uncertainty and increased volatility.
- Return expectations – continued challenges expected to dampen returns.

**Market Concerns:**

- The United Kingdom's (UK) referendum vote to leave will create a protracted period of economic uncertainty for the European region.
- Markets will weigh the benefits of further fiscal and monetary stimulus against the possibility of other countries leaving the EU.

**ACG Position:**

- Brexit introduces additional uncertainty but is more of a political than an economic crisis.
- The impact on economic growth will vary by region and country with limited overall impact to the global economy.
- Interest rates are likely to remain low with a "flight to quality" bias.

**Portfolio Implications:**

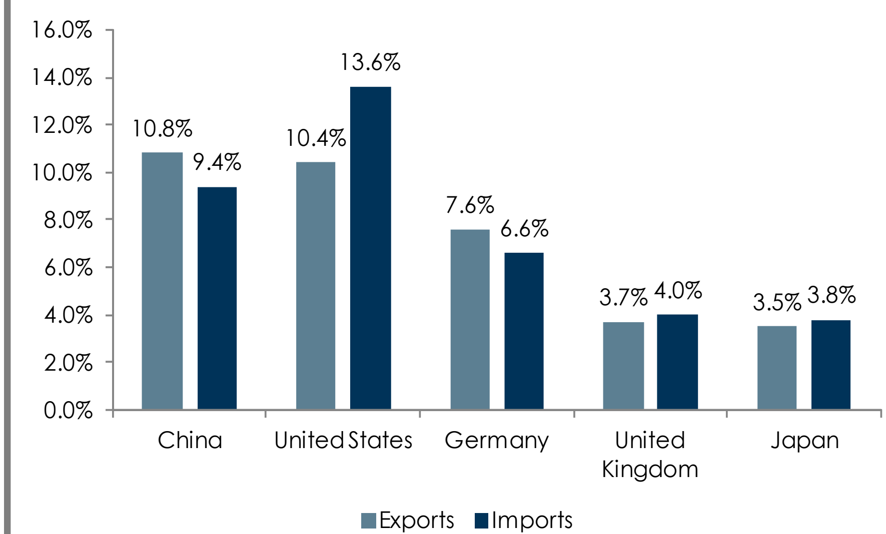
- Implement strategies with greater flexibility to take advantage of attractive opportunities across asset classes and regions. Maintain core holdings tied to US based assets to benefit from flight to safety periods.

**Potential Financial Market Reactions**

| Financial Markets | Brexit Official Outcome | | |
|---|---|---|---|
| | Leave | Compromise | Stay |
| **US Dollar (USD) vs. TWI** | Strengthen | Stable | Stable |
| **Global Interest Rates** | Lower | Mixed | Mixed |
| **US Equities** | Higher | Stable | Stable |
| **Non US Developed Equities** | Mixed | Stable | Higher |
| **Emerging Market Equities** | Mixed | Higher | Higher |

Source: ACG Research

**Shares of World Exports and Imports – 2017 Estimates**




Source: OECD

**Market Concerns:**

- With the degree of uncertainty in global markets, US large cap stocks will continue their dominance relative to non-US investments due to perceived higher quality status.

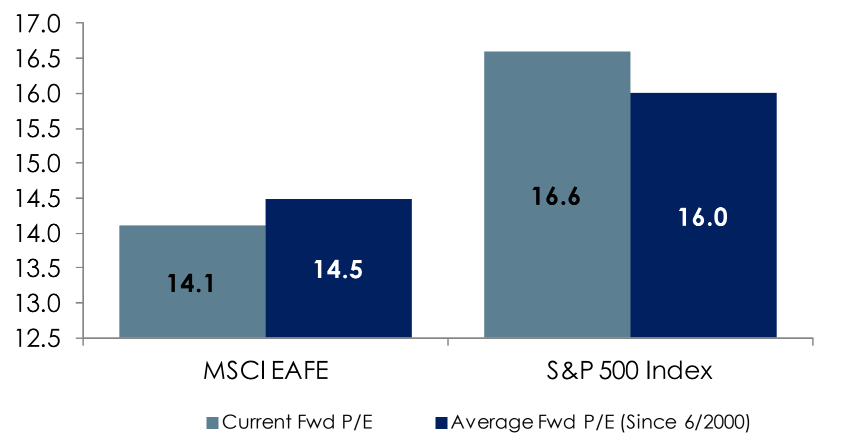
**ACG Position:**

- Valuations, which generally favor non-US markets, will likely drive subsequent returns.
- Stabilization of the US Dollar (USD) should support returns in non-US markets going forward.

**Portfolio Implications:**

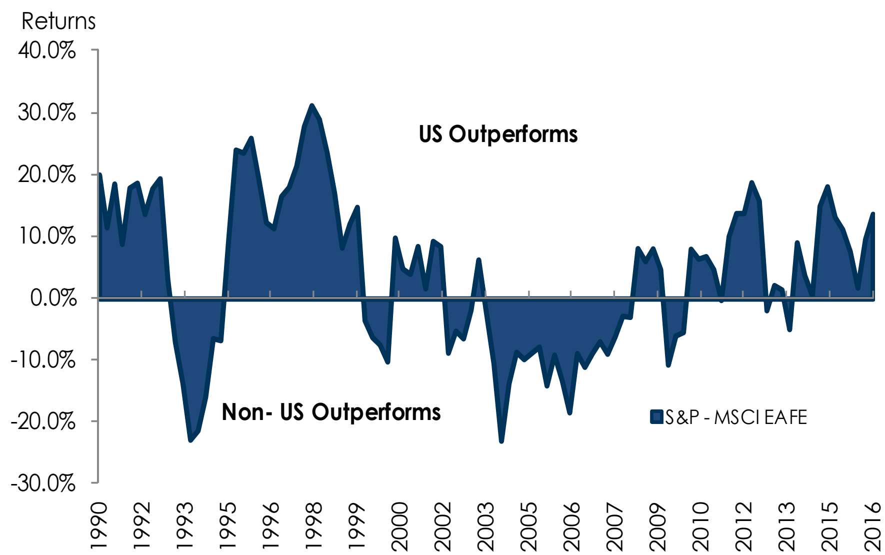
- Consider rebalancing portfolios, as needed, to ensure adequate exposure to non-US markets.

**Stock Market Valuations – Price to Earnings (P/E) ratio**




Source: JP Morgan

**US Stock Returns vs. Non-US (1 Year rolling returns)**




Source: Bloomberg

**Market Concerns:**

- Market volatility and downward pressure may increase leading into, and as a result of, the upcoming US elections.

**ACG Position:**

- Generally, election cycles have limited influence on markets although it is true that volatility often increases modestly, post election.
- Due to the low level of economic growth, a risk in this cycle is the increased focus on protectionist policies that could restrict trade.
- There has been a rise in populist politics globally and markets will need to assess ongoing political developments and any impact on the fundamental global growth outlook.

**Portfolio Implications:**

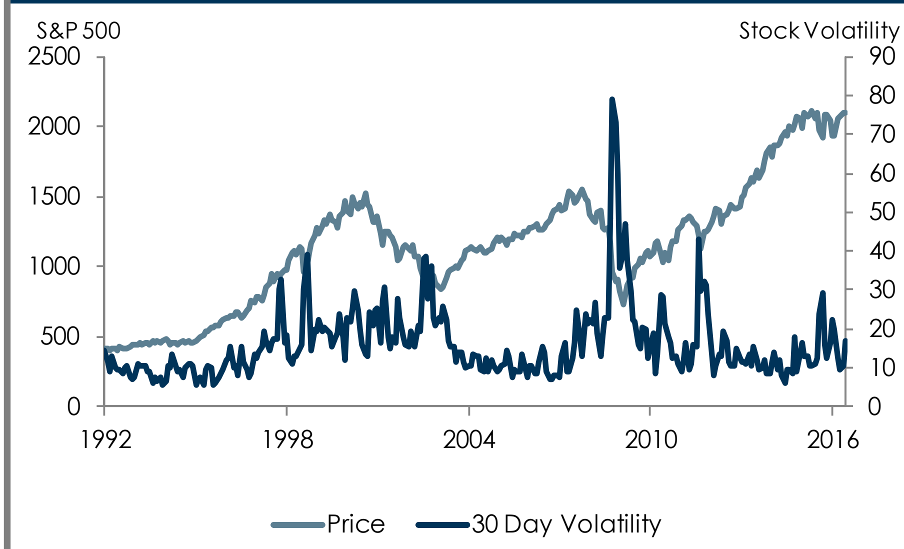
- Maintain volatility management strategies to navigate choppy markets. Utilize actively managed, opportunistic strategies to capitalize on market movements.

**Election Year Performance**

| | | | | S&P 500 Performance | | | |
|---|---|---|---|---|---|---|---|
| Year | President | Senate | House | Feb - Aug | Sep - Oct | Nov - Jan | Whole Year |
| 1960 | Democrat | Democrat | Democrat | 2.4% | -6.3% | 15.7% | -3.0% |
| 1964 | Democrat | Democrat | Democrat | 6.2% | 3.7% | 3.2% | 13.0% |
| 1968 | Republican | Democrat | Democrat | 7.2% | 4.6% | -0.4% | 7.7% |
| 1972 | Republican | Democrat | Democrat | 6.9% | 0.4% | 4.0% | 15.6% |
| 1976 | Democrat | Democrat | Democrat | 2.0% | 0.0% | -0.8% | 19.1% |
| 1980 | Republican | Republican | Democrat | 7.2% | 4.2% | 1.6% | 25.8% |
| 1984 | Republican | Republican | Democrat | 2.0% | -0.4% | 8.2% | 1.4% |
| 1988 | Republican | Democrat | Democrat | 1.7% | 6.7% | 6.6% | 12.4% |
| 1992 | Democrat | Democrat | Democrat | 1.3% | 1.1% | 4.8% | 4.5% |
| 1996 | Democrat | Republican | Republican | 2.5% | 8.2% | 11.5% | 20.3% |
| 2000 | Republican | Democrat | Republican | 8.8% | -5.8% | -4.4% | -10.1% |
| 2004 | Republican | Republican | Republican | -2.4% | 2.4% | 4.5% | 9.0% |
| 2008 | Democrat | Democrat | Democrat | -6.9% | -24.5% | -14.7% | -38.5% |
| 2012 | Democrat | Democrat | Republican | 7.2% | 0.4% | 6.1% | 13.4% |
| Election years ex 2008 (avg) | | | | 4.1% | 1.5% | 4.7% | 9.9% |
| All years ex 2008 (avg) | | | | 3.3% | 0.8% | 4.6% | 8.8% |

Source: S&P/Haver Analytics, Deutsche Bank

**Stock Market Volatility**




Source: Bloomberg

**Market Concerns:**

- Major macro-economic issues (e.g. debt levels, demographics) are likely to depress global growth and market returns for the foreseeable future.

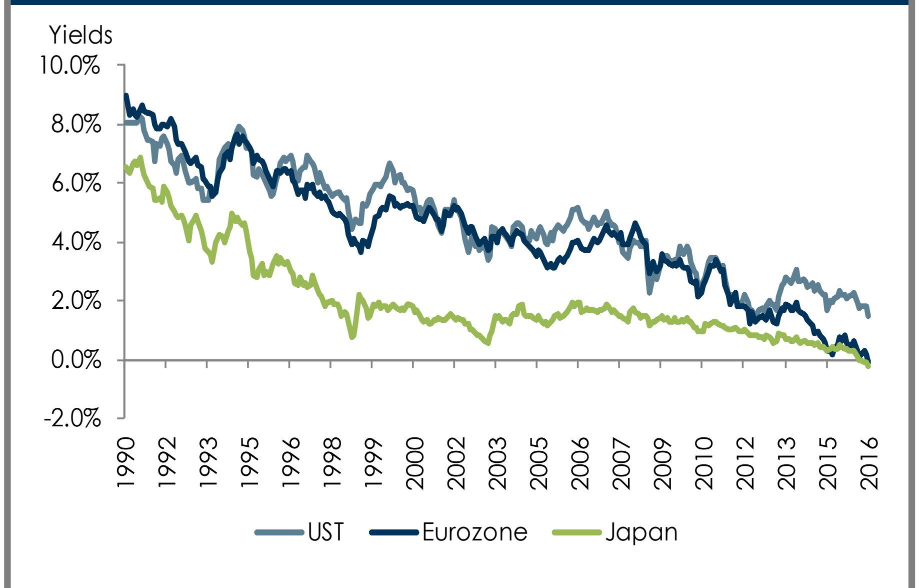
**ACG Position:**

- Due to lackluster growth and continued uncertainty, interest rates are likely to remain low and could go lower. The low level of base rates will impact expected returns across asset classes.
- Quality and yield are likely to remain in demand during this period.

**Portfolio Implications:**

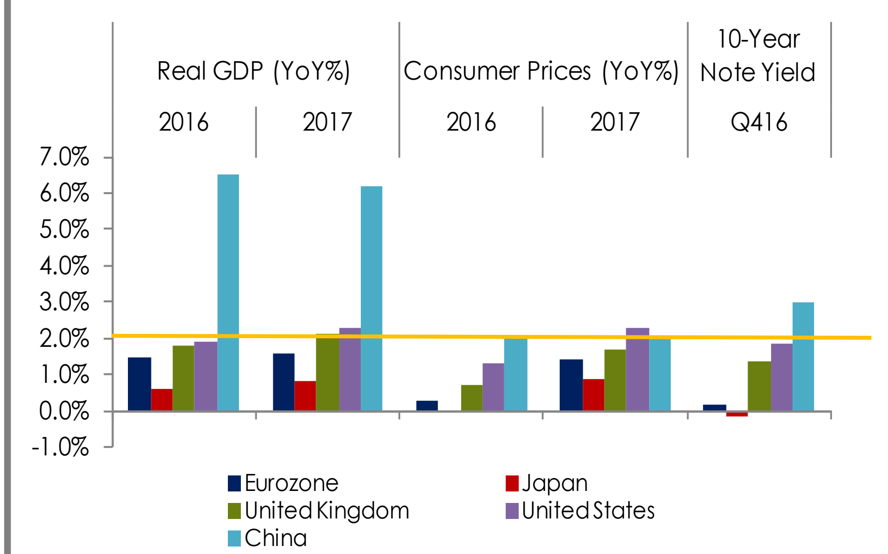
- Consider private strategies that offer enhanced return potential in exchange for reduced liquidity. Diversify risk drivers across equity and fixed income asset classes.

**10-year Sovereign Yields**




Source: Bloomberg

**Economic Forecasts**




Source: Bloomberg

# Investment Themes

| Theme | Rationale | Implementation Strategy |
|---|---|---|
| Geopolitical & Policy Uncertainty | ▪ Disparate global monetary policies<br>▪ Fiscal policy initiatives limited; high government debt; political challenges<br>▪ Terrorism concerns, election uncertainty, refugee crises, nuclear issues, territorial disputes, climate change concerns<br>▪ Oil price pressures on less stable countries | ▪ Maintain global diversification<br>▪ Focus on risk-reducing strategies<br>▪ Maintain disciplined rebalancing strategy<br>▪ Consider strategies including "bottom up" and "top down" analysis |
| Desynchronized Global Growth Expectations | ▪ Ongoing divergence within developed markets (DM) and emerging markets (EM)<br>▪ China/EM structural challenges present<br>▪ Commodity-sensitive EM growth pressured<br>▪ US/UK leading, Europe/Japan lagging<br>▪ Demographic differences<br>▪ Increased currency volatility | ▪ Maintain dedicated, differentiated managers in EM<br>▪ Focus on actively managed, opportunistic strategies across asset classes<br>▪ Consider managers that evaluate currency impact in portfolio construction |
| Fixed Income Market Headwinds | ▪ Stretched valuations at low yields<br>▪ Fed lift-off<br>▪ Extended credit cycle<br>▪ Liquidity challenges may increase volatility<br>▪ Continued search for yield | ▪ Broaden fixed income opportunity set<br>▪ Incorporate absolute return oriented strategies<br>▪ Maintain diversified risk factors |
| Uncertain Global Inflationary Environment | ▪ Deflationary pressures remain<br>▪ Inflationary pressures still limited<br>▪ Recent uptick in wage growth offset by lower commodity prices, productivity gains<br>▪ Further improvement in US labor markets could increase wage/inflation pressure | ▪ Retain core real estate (RE) exposures<br>▪ Complement core with value-add and/or opportunistic RE<br>▪ Maintain diversified commodity exposure<br>▪ Consider hedged approaches to limit further downside |
| Muted Return Expectations | ▪ Relatively high valuations across asset classes<br>▪ Global economic growth remains tepid<br>▪ Challenging demographics and high debt levels<br>▪ Low yields, low inflation, limited growth, increased volatility | ▪ Revisit investment objectives, constraints and strategic allocation<br>▪ Consider active strategies with enhanced flexibility<br>▪ Consider global mandates<br>▪ Employ risk management solutions |

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