Global Economic Update

Fourth Quarter 2019

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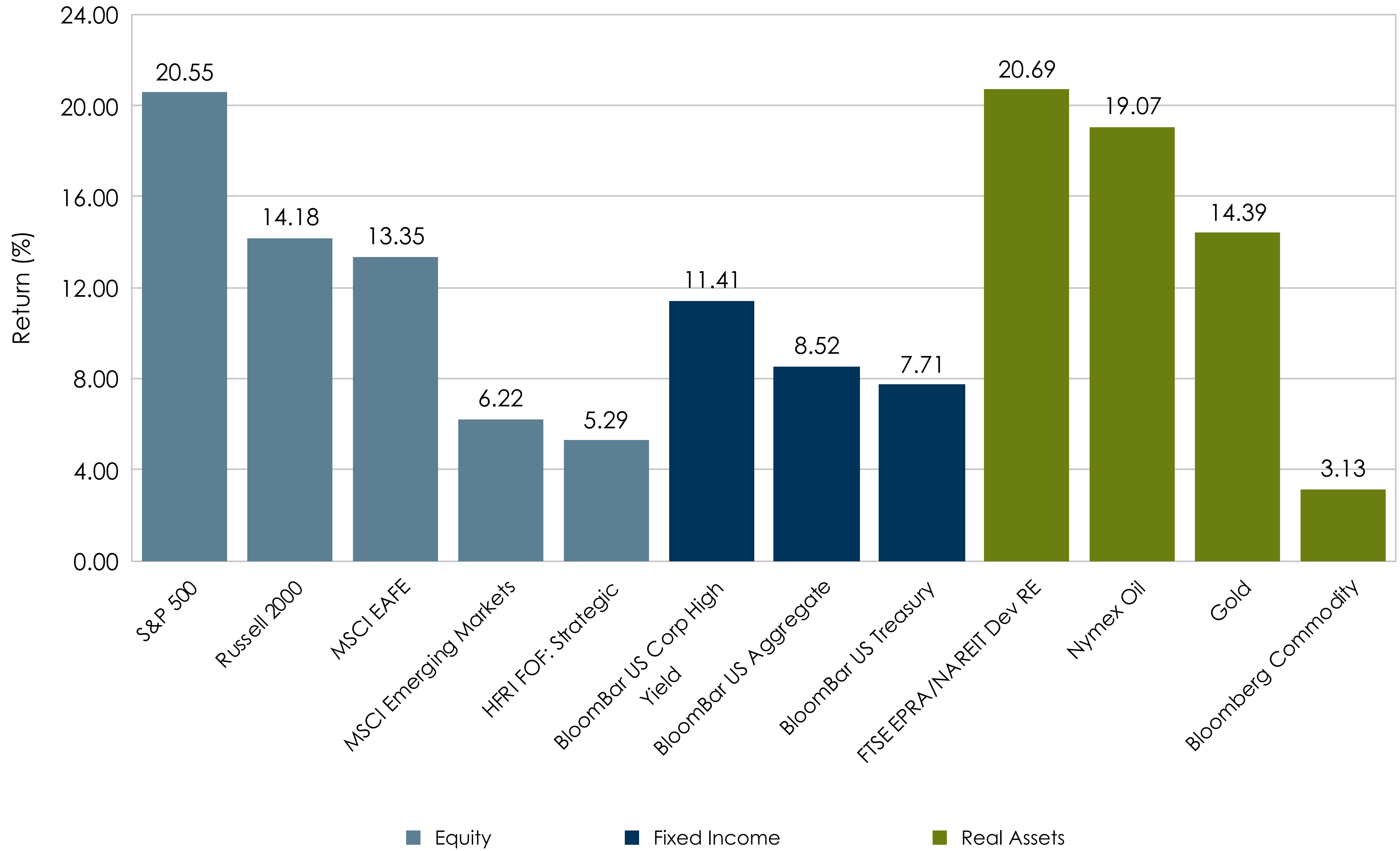
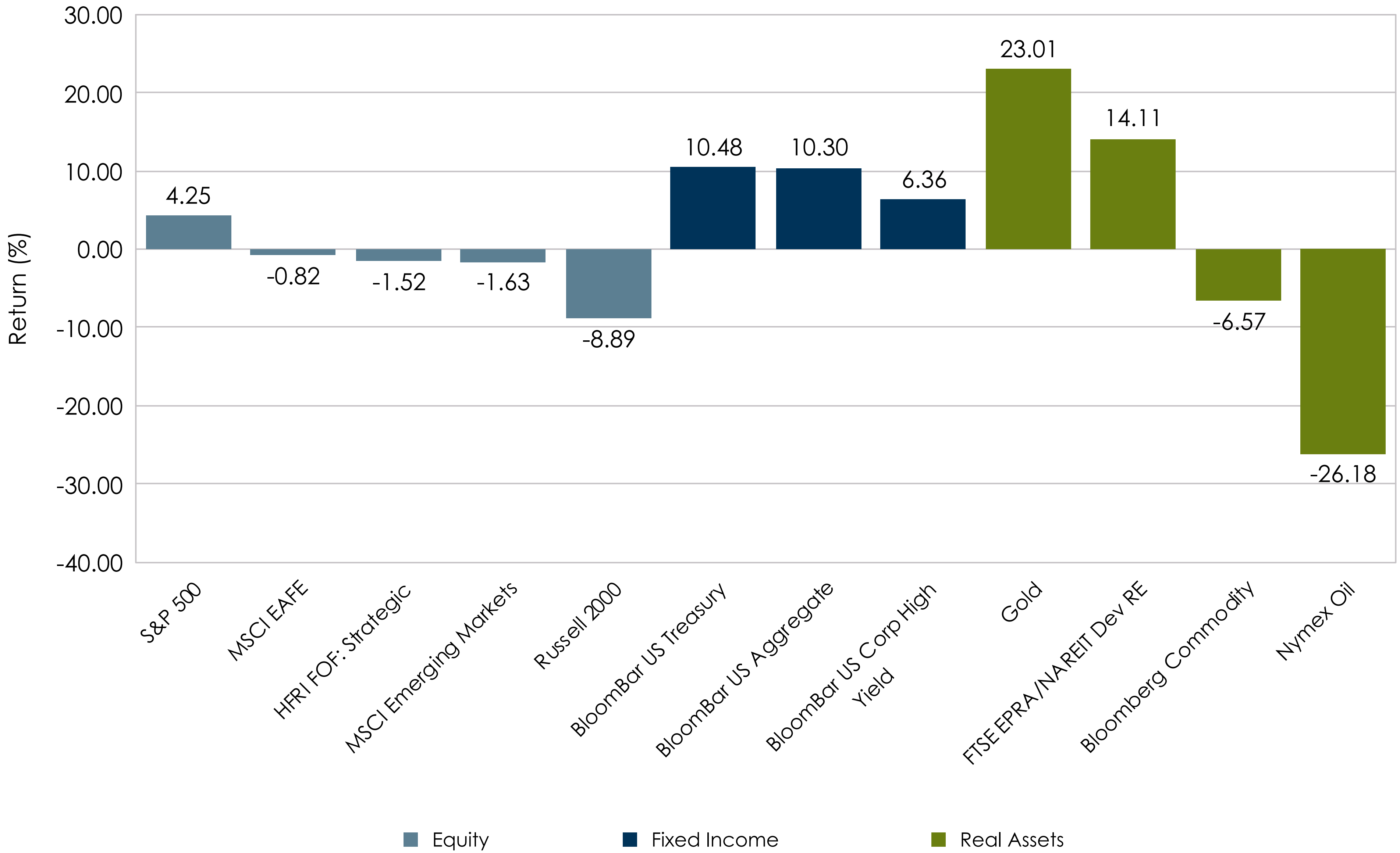
Market Returns

For the YTD Period Ending September 30, 2019



Market Returns

For the 1 Year Period Ending September 30, 2019



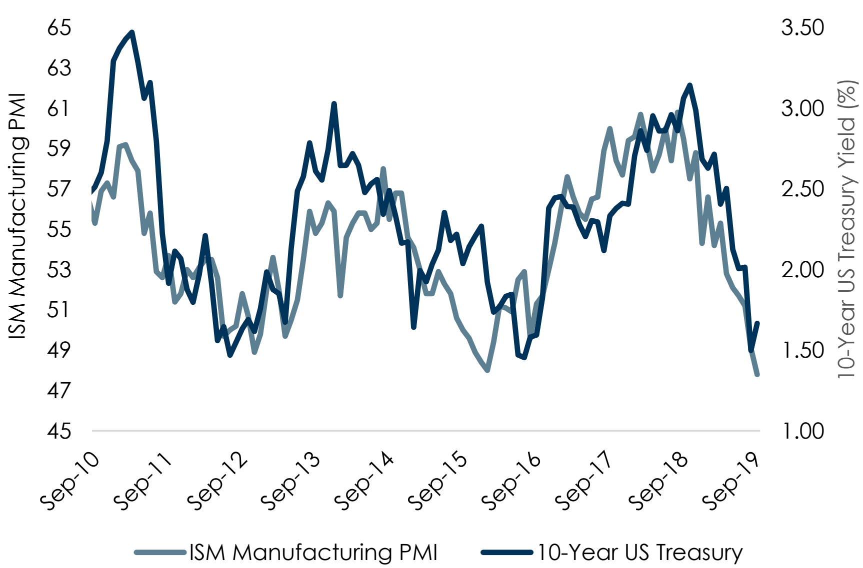
US

- **2Q-19 Real GDP grew at an annualized rate of 2.0%,** slightly exceeding original estimates. Consumer spending was the standout contributor, even as government spending and net exports softened. Consensus GDP expectations for 3Q-19 recently resided between 1.5% and 2.0%.
- **Labor conditions remain strong,** with the unemployment rate at a 50-year low of 3.5% in September. Average hourly wage increases appear well-contained at 2.9% as the pace of new job creation has slowed in 2019.
- **Consumer confidence measures have been mixed** amid heightened geopolitical noise. The global manufacturing slowdown has pulled that sub-set of the US economy into contraction territory and threatens business investment. Key service-based readings have maintained resilient growth.
- The **Federal Reserve** took action in both July and September, cutting short-term interest rates to a targeted range of 1.75% to 2.00%. The Committee's latest projections suggests the "mid-cycle adjustment" may be complete, even as the futures market is pricing in further cuts over the next 12-months.

Global/Non-US

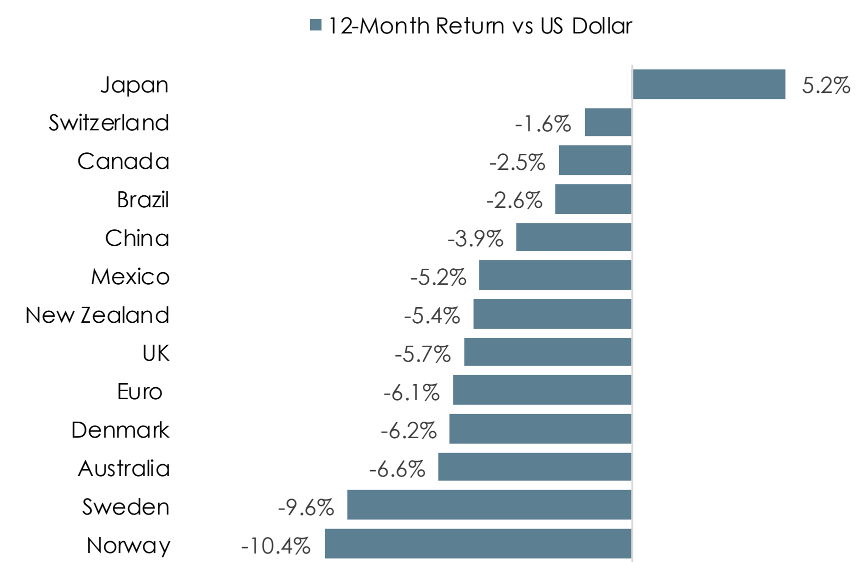
- **US-China relations induced periodic bouts of volatility,** and the matter clearly goes beyond unresolved trade/tariff issues. China has recently utilized increased openness as it relates to their once-pegged exchange rate and access to financial markets as tools in the strategic rivalry.
- The **European economy continues to show signs of weakness**, most notably as it relates to export-dependent manufacturing and weak inflation. The ECB's outgoing President Mario Draghi responded in mid-September, with a rate cut, a renewed asset purchase program, and calls for fiscal stimulus.
- **2Q-19 GDP for the UK contracted** as Brexit uncertainty weighed on trade and confidence more generally. Political and legal challenges will test the Prime Minister's bid to resolve negotiations by the October 31st deadline.
- **Currencies around the world have fallen versus the US Dollar**, with the "safe-haven" Japanese Yen being the only notable exception. Export-driven countries clearly benefit from cheaper currencies, which enhance competitiveness abroad and boost overall economic growth.

Weaker Data Reflected in Interest Rates



Source: ACG Research, Bloomberg

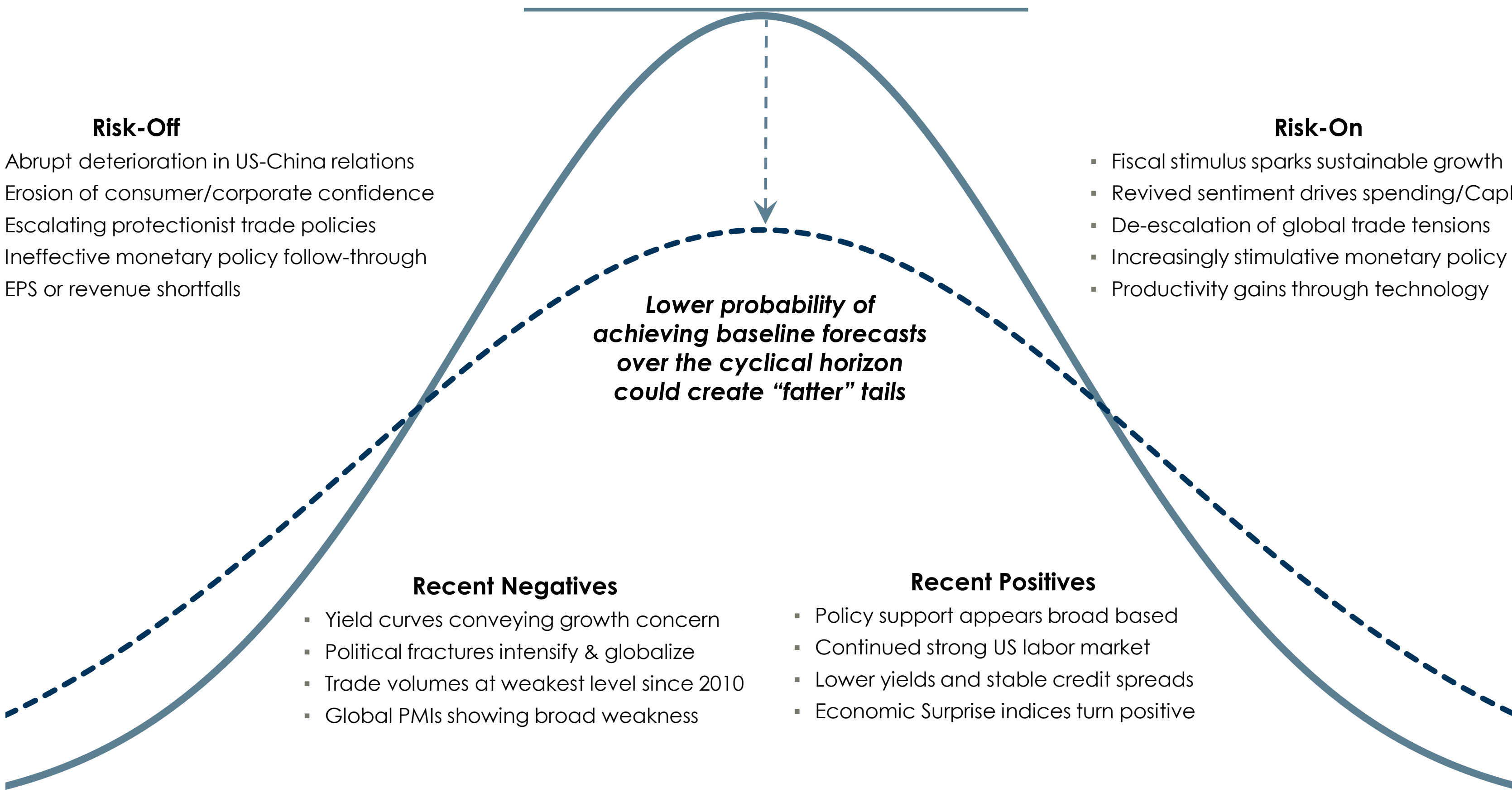
Exchange Rates Impacting Global Markets



Source: ACG Research, Bloomberg (as of 9/30/19)

Baseline Assumptions

- Global economic growth of 2.0% - 3.0%
- Developed market inflation struggling to achieve the broadly utilized 2.0% target
- Equities to perform in line with earnings growth
- Short-term bond yields now biased to the downside



Risk-Off

- Abrupt deterioration in US-China relations
- Erosion of consumer/corporate confidence
- Escalating protectionist trade policies
- Ineffective monetary policy follow-through
- EPS or revenue shortfalls

Risk-On

- Fiscal stimulus sparks sustainable growth
- Revived sentiment drives spending/CapEx
- De-escalation of global trade tensions
- Increasingly stimulative monetary policy
- Productivity gains through technology

Recent Negatives

- Yield curves conveying growth concern
- Political fractures intensify & globalize
- Trade volumes at weakest level since 2010
- Global PMIs showing broad weakness

Recent Positives

- Policy support appears broad based
- Continued strong US labor market
- Lower yields and stable credit spreads
- Economic Surprise indices turn positive

What is the issue?

- Representing nearly 70% of US economic output, trends in personal consumption often define the overall growth picture
- Consumer spending was up 4.6% year-over-year in 2Q-19, allowing for the sustained growth advantage versus non-US economies
- On a global scale, the US consumer contributes more to overall GDP than all of China or the top-five Eurozone countries combined
- Aging demographics are a secular headwind, and income/wealth inequality often means those that want to consume don't have the money

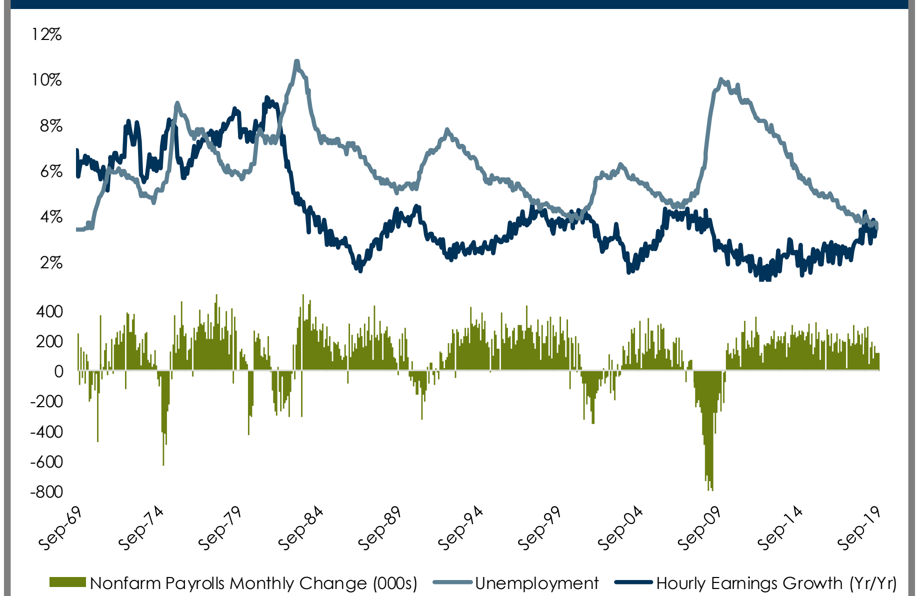
Where do things stand?

- The unemployment rate is at a 50-year low as national payrolls have expanded for 108 consecutive months and job openings remain plentiful
- Consumer balance sheets are in a much more resilient position than before the crisis, while wage growth and low interest rates help with debt service
- Confidence is perhaps the biggest concern, as consumer surveys increasingly convey the belief that the future will be less robust than the current situation
- The trade war is negatively affecting US consumer spending and employment in sectors most impacted by tariffs (furniture, appliances, auto parts)

ACG Thoughts:

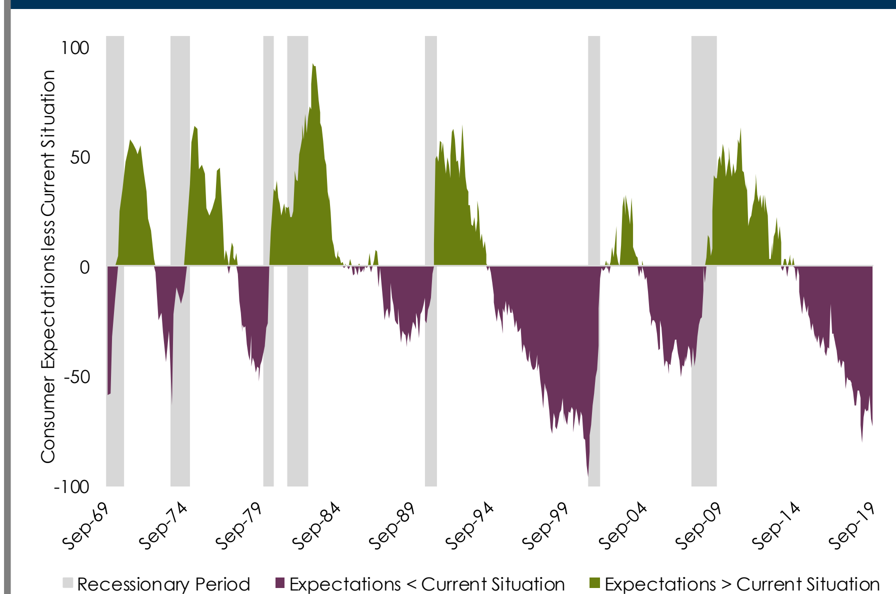
- The risk scenario is that businesses, challenged by tariffs or other cost pressures, begin to cut back on labor to help preserve margins and ultimately earnings
- With overall economic and market signals mixed amid "entrenched uncertainty," we believe portfolios should be near strategic allocation targets

Strong Labor Trends Support the Current Situation



Source: ACG Research, BLS, Bloomberg

Less Robust Expectations May Eventually Curtail Spending



Source: ACG Research, US Conference Board, Bloomberg

What is the issue?

- Weak issuance combined with rising M&A and buyback activity has resulted in falling net supply of public equity in the US and globally
- With prospective return assumptions under pressure, investors have embraced private market alternatives in search of an illiquidity premium
- Historically, as investors "reach" for excess returns to meet their return objectives they have encountered underappreciated sources of risk

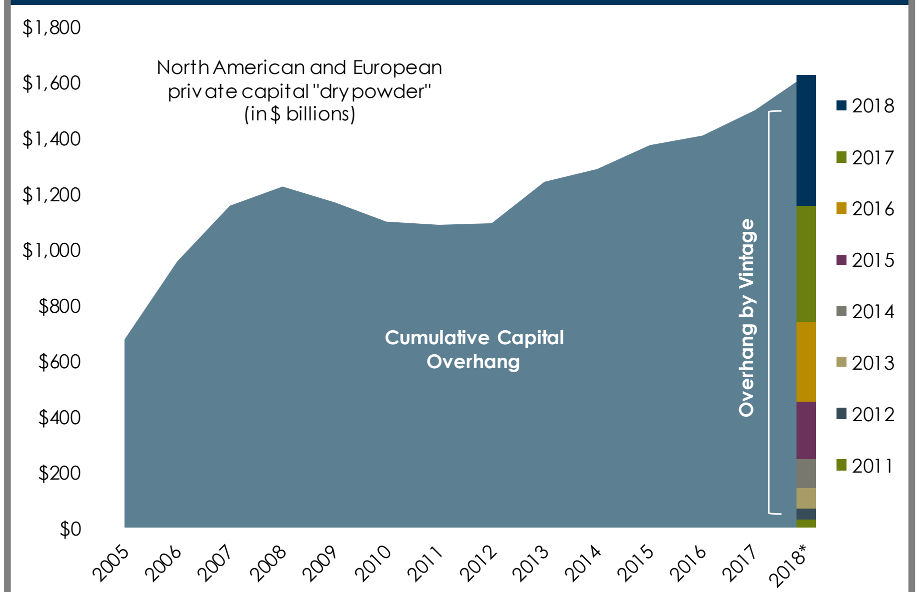
Where do things stand?

- Amid favorable conditions for fundraising, the cumulative buildup of "dry powder" in the private markets is meaningful
- Uncalled capital commitments from prior years could hamper the benefits of vintage year diversification, particularly in large (> $1 billion) funds
- Demand for assets is testing manager discipline, and private equity purchase price and leverage multiples have both moved higher in 2019
- We have witnessed a notable compression between Small Cap (Russell 2000 Index) valuations and those being paid for private takeout opportunities

ACG Thoughts:

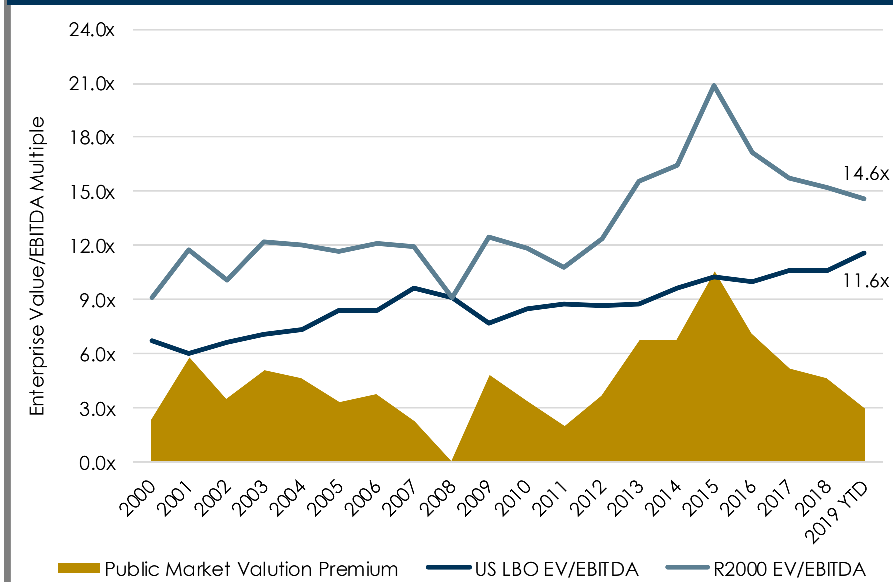
- While there are clear benefits to private market exposure, investors must not forget the lessons of the past and these positions should be sized appropriately
- Private strategies can buffer near-term price impacts within portfolios, which may be beneficial if market and geopolitical uncertainty drive volatility higher
- When venturing into private markets, it will be critical to utilize "cycle tested" firms and investment teams with proven discipline and closely-aligned interests

Uncalled Private Capital Commitments Building



Source: ACG Research, Pitchbook (as of 6/30/2018)

Potential Reach for Returns Erasing the Illiquidity Premium



Source: ACG Research, S&P LCD M&A Stats, Bloomberg

What is the issue?

- Unconventional monetary policy has succeeded in driving financial asset inflation, yet traditional inflation measures continue to fall short of targets
- Aggregate demand growth is thought to be challenged in a world of aging demographics, and it follows that inflation could also be limited
- Technological innovation has driven more efficient and responsive supply chains, a factor that acts to limit supply shocks and thereby pricing power
- Weakness in a particular country's currency may lead to isolated inflation shocks, but the impact to global inflation is a zero sum game

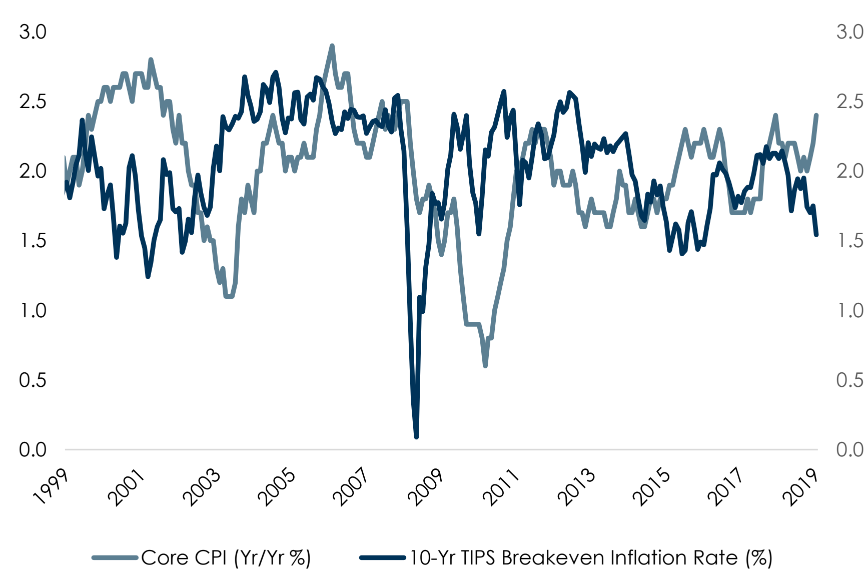
Where do things stand?

- Although US Core CPI recently achieved a cycle high of 2.4%, the market-driven breakeven inflation rate has recently been in decline
- Initial tariffs were not highly visible to end consumers, but those scheduled for mid-December (smartphones, computers, toys) may be more impactful
- With "symmetrical" inflation objectives, it seems likely that central bank policy makers will let inflation run high for a time if it helps to foster growth
- While not expected to be anywhere near 1970's levels, elevated inflation could dampen future long-term bond and equity returns

ACG Thoughts:

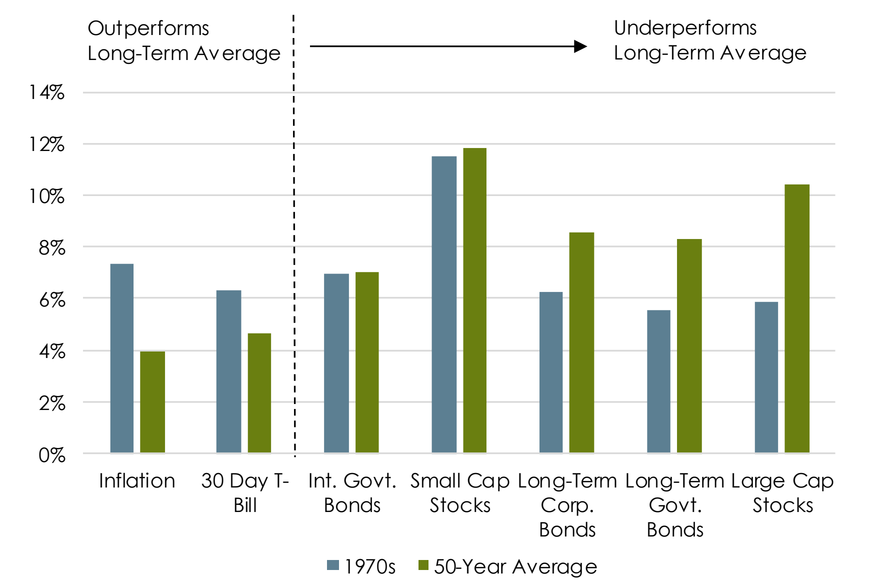
- It's typically a concern whenever the market gets convinced that something will or won't happen, so maintaining some degree of inflation protection is prudent
- Allocations to shorter-dated fixed income, floating rate assets that reprice, and niche alpha strategies are seen as optimal for handling unexpected inflation

Breakeven Rates Trending Opposite Reported Inflation



Source: ACG Research, Bloomberg

Unexpected Inflation an Enemy to Stocks & Bonds



Source: ACG Research, Morningstar Direct, Ibbotson

Investment Themes

Theme	Key Considerations	Implementation Strategy
Growth	▪ Late-cycle, 10-year expansion ▪ Consumer confidence high but moderating ▪ Global manufacturing contracting ▪ Leading economic indicators softening ▪ China's growth path plays increasing role	▪ Maintain long-term strategic allocations ▪ Passive exposure in efficient markets ▪ Active/focused/opportunistic in less efficient areas ▪ High-quality orientation
Yield Environment	▪ Yield curve flat/inverted (3mo – 10 Yr) ▪ Longer-term rates signaling shift in policy ▪ Futures market expecting rate cuts ▪ Underwriting standards a late-cycle risk ▪ Liquidity challenges may increase volatility	▪ Maintain high-quality core fixed exposure ▪ Shorter-dated assets provide attractive yield ▪ Yield enhancement via private debt or opportunistic strategies (e.g. HY, Loans, EMD) ▪ Incorporate "non-traditional" strategies
Inflation	▪ Tight labor markets - potential wage pressure ▪ Inflation expectations still falling short of 2% ▪ Uncertain impact of technology, worker productivity, demographic trends, trade policy	▪ Core real estate - rent escalation ▪ Shorter-dated fixed income - positive real yield ▪ Floating rate securities - protect against surprise ▪ Active managers with niche alpha strategies
Risk & Uncertainty	▪ Waning gov't influence - high debt, demographics ▪ Trends toward protectionism – trade disruption ▪ Political polarization and rising inequality ▪ Immigration, war, climate change, social media, cyber attacks, terrorist activity	▪ Global diversification ▪ Private strategies can limit near-term price impacts ▪ Enhanced short-term liquidity ▪ Disciplined rebalancing
Return Expectations	▪ Portfolio returns to remain below long-term average ▪ Low rates, potentially capped equity valuations ▪ Potential for increased market volatility ▪ Lower correlations between asset classes	▪ Revisit risk tolerance and investment objectives ▪ Focus on strategic plan vs. tactical shifts ▪ Employ risk-reducing/hedged strategies ▪ Maintain liquid and illiquid assets exposure ▪ Seek active strategies with enhanced flexibility

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