Global Economic Update

Fourth Quarter 2016

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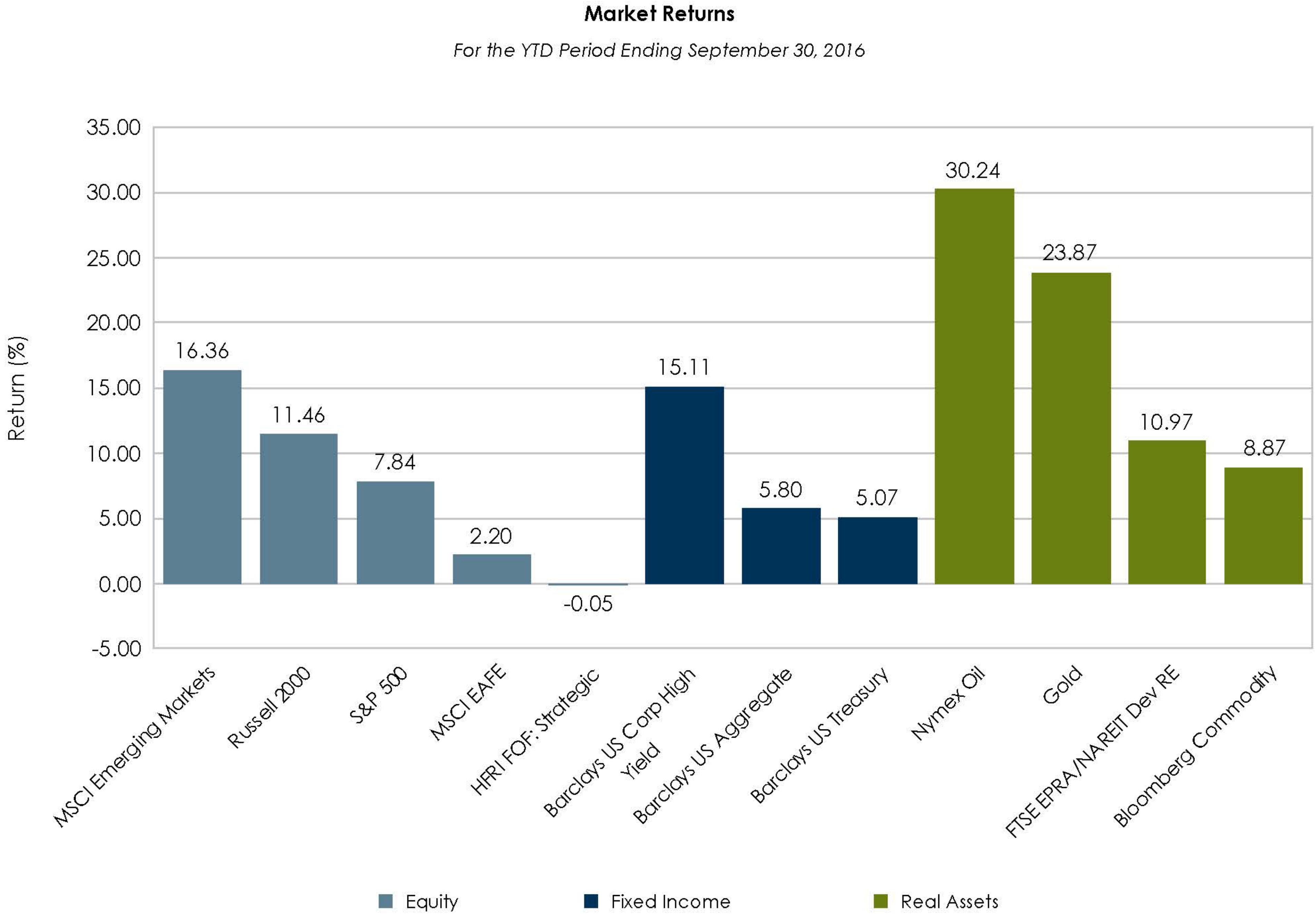
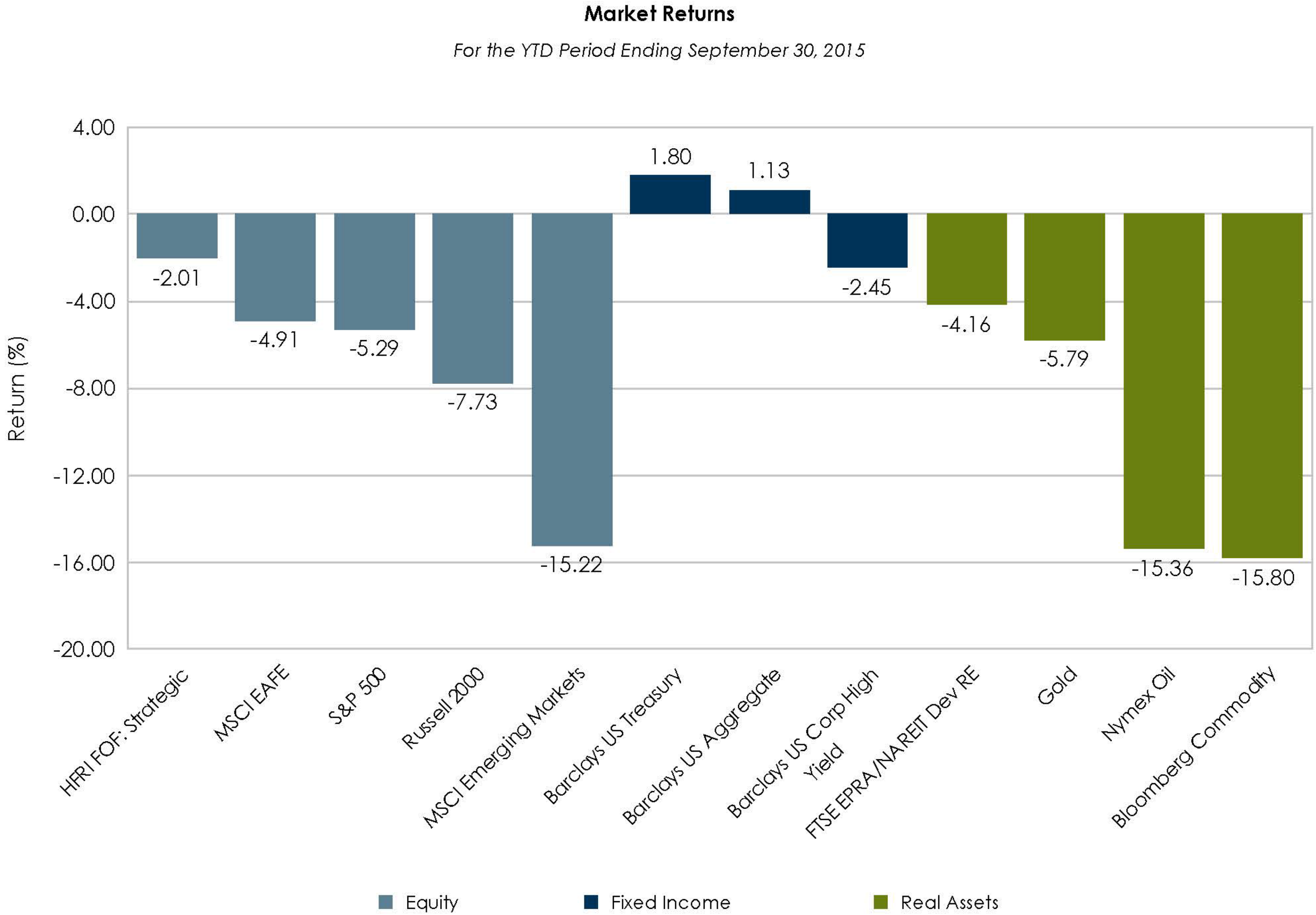
Year to Date Returns (September 2016)



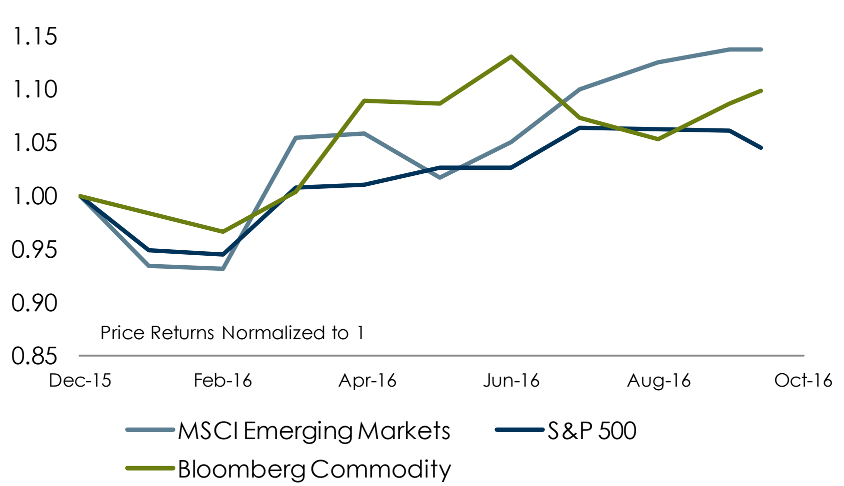
Year to Date Returns (September 2015)



Investment Themes Last Year

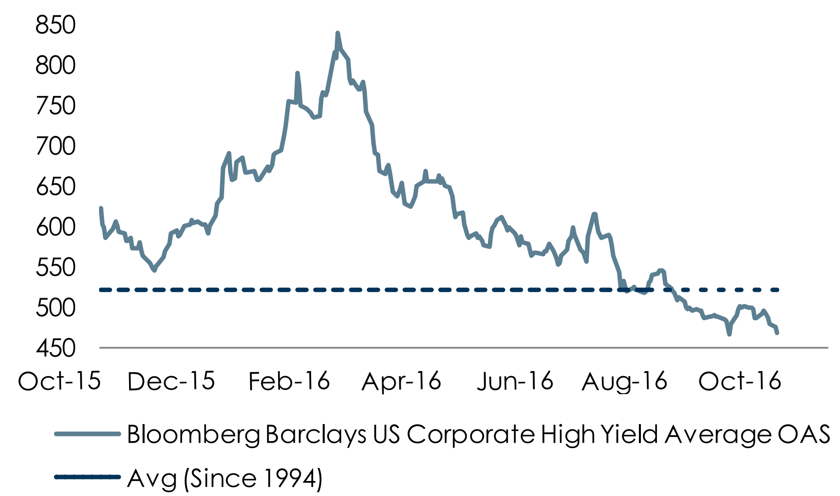
Theme	What We Said	What Happened
Fed Monetary Policy Challenges	▪ The Fed has a desire to raise rates but **will not risk destabilizing financial markets**.	▪ Slack in US labor markets and inflation below the Fed's target **kept short-term interest rates steady**.
Continued Market Uncertainty	▪ After an extended period of low volatility (since 2012), expect a **revival of market turbulence**.	▪ Market **volatility exceeded its five-year daily average** three times year to date.
High Yield Credit Dislocation	▪ Credit spreads have widened despite the expanding economy but appear technical in nature. This may provide an **attractive entry point**.	▪ Spreads narrowed considerably and fundamentals remained supportive, resulting in a **15% return** year to date (through September).
Value in Emerging Markets	▪ Worst of the currency devaluation is behind us; current low valuations are typically followed by **periods of outsized gains.**	▪ Basket of EM currencies **up 9%** from January lows versus the USD. EM assets have rallied sharply with **EM debt up 15% and EM equity up 16%** year to date (through September).
Stabilizing Commodity Markets	▪ Although the near term will likely be characterized by **continued excess global supply**, the normal production response should help stabilize these markets longer term.	▪ Supply response resulted in **broad based commodity recovery** with the Bloomberg Commodity Index up 9% year to date (through September).

Rebound in both EM equities and commodities in 2016



Source: Bloomberg

High Yield Credit Dislocation – Credit Spreads



Source: Bloomberg

Economic Overview & Current Issues

US

- **US consumers remain the primary driver** of economic growth as the US economy rose at a 1.4% annualized rate during the second quarter, following a 0.8% pace from January through March. Household consumption, which accounts for 70% of the economy, grew at 4.3%.
- **Lackluster business investment** continued to weigh on the economy as corporate spending to replenish inventories and purchase equipment fell during the quarter.
- The **Federal Reserve recently left rates unchanged** to await more evidence of progress toward its dual mandate of full employment and price stability. Still, officials noted the case for an increase had strengthened.
- **US consumer prices increased** more than projected in August as a rise in energy prices and wage gains coupled with a stabilizing US dollar are gradually building inflationary pressures.

Global/Non-US

- **Euro zone second quarter growth was bolstered** by a surge in exports while domestic demand was weak and government spending slowed. Uncertainty may continue as concern about a "Hard Brexit" increases.
- A drop in business investment and lackluster export activity from a strengthening yen contributed to moderate **Japanese second quarter economic activity that slowed** from the previous quarter.
- **China's economic growth in the second quarter held steady**, underpinned by government stimulus and a weaker yuan that bolstered exports. The manufacturing sector showed signs of moderate expansion.
- A recent announcement by the **Organization of Petroleum Exporting Countries (OPEC) regarding plans to manage supply** led to a jump in the price of oil.

Current Issues

- US elections – an added layer of uncertainty and increased volatility
- Potential market shocks
- Investing in a muted return environment

Market Concerns:

- US presidential election could **increase policy uncertainty** and **boost market volatility**.

ACG Position:

- **Congress will play an important role** in determining which policy changes will be enacted, reducing the probability of candidates' proposals being fully implemented.
- Currently, financial markets are **not anticipating dramatic changes** in the outlook for growth, earnings and inflation resulting from proposed policies.
- Historically, **election cycles have limited influence** on markets although it is true that volatility often increases modestly.

Portfolio Implications:

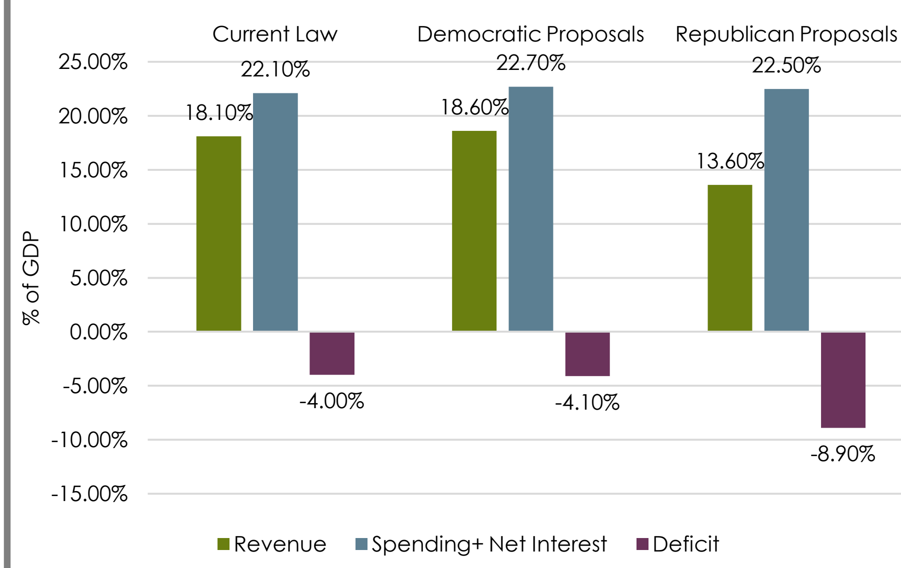
- Maintain volatility management strategies to navigate choppy markets. Utilize **actively managed, opportunistic strategies** to capitalize on market movements, where appropriate.

Candidate Positions & Potential Impact on Corporate Profits

	Candidate Position		Potential Impact on Profits	
	Democrat	**Republican**	**Democrat**	**Republican**
TAXES	Increase	Decrease	Negative	Positive
MINIMUM WAGE	Increase	Maintain	Negative	Neutral
GOVT SPENDING	Increase	Increase	Positive	Positive
REGULATION	Increase	Decrease	Negative	Positive
IMMIGRATION	Increase	Decrease	Positive	Negative
TRADE	Increase	Decrease	Positive	Negative

Source: ACG Research, BCA, Credit Suisse.

Proposed Ten-Year Spending, Revenue, and Deficits By Candidate



Source: CRFB – (Committee for a Responsible Budget) calculations, CBO projections

Potential Market Shocks

Market Concerns:

- Chance of **monetary policy missteps** or communication issues across the globe.
- Rising tide of populist movement and anti-globalization sentiment may **pressure trade and economic growth prospects**.
- Potential for **distress in European financials** due to Brexit, mounting **non-performing loans**, and challenges maintaining **adequate capital levels**.
- Possibility of **destabilized currency in China** as the government intervenes to support the yuan and implements fiscal stimulus to support growth. Greater fluctuation in yuan may be exacerbated by entry into Special Drawing Rights (SDR) basket.

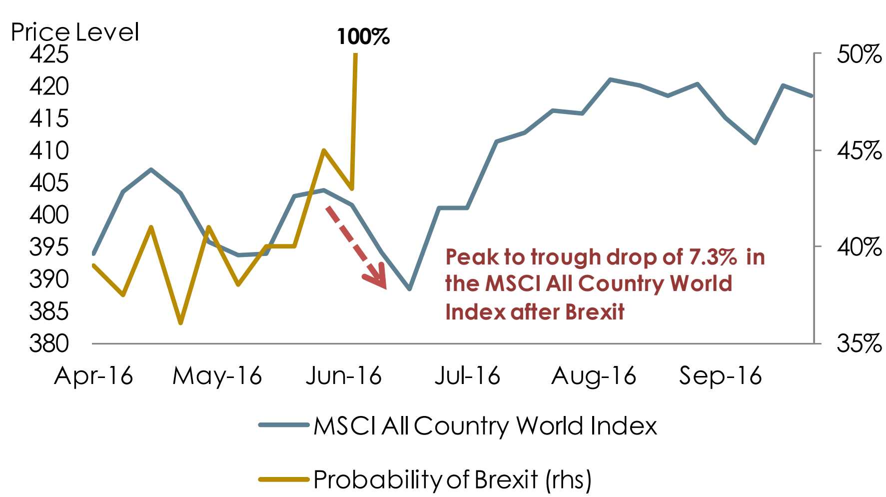
ACG Position:

- Although valid concerns, each of these issues may have **mixed impact on markets** over short-term and longer-term investment horizons.
- During periods of complacency, markets are prone to **short-term corrections during shock events**.
- These events often trigger **panic selling** and become technical in nature, which **creates opportunities** for long term investors.

Portfolio Implications:

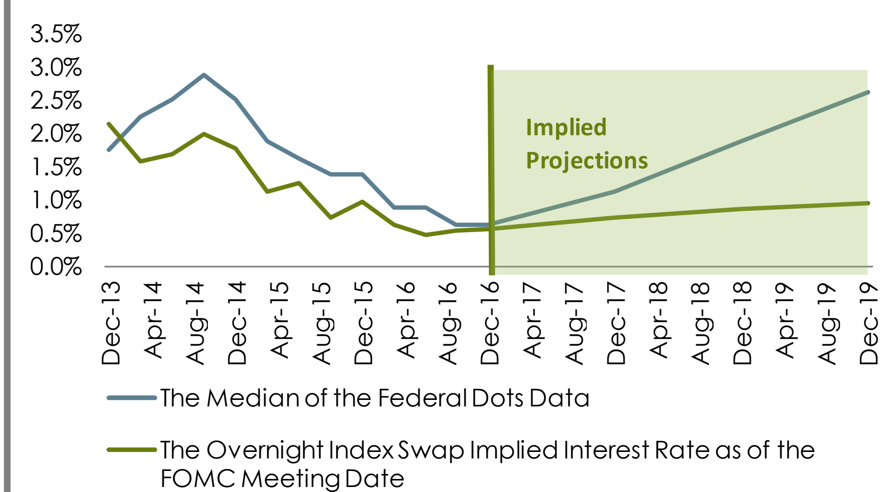
- Strategic allocations with **significant diversification, downside protection, and active management** are designed to navigate challenging markets.
- Consider **unconstrained/absolute return strategies,** which provide downside protection during shock events yet maintain positive return expectations.

Financial Markets "Shocked" by Brexit



Source: Bloomberg

Implied Fed Funds Rate – The Markets Don't Believe the Fed



Source: Bloomberg

Market Concerns:

- The subdued outlook for global economic growth, interest rates, and inflation coupled with relatively high asset class valuations provide a backdrop for **muted returns going forward**.

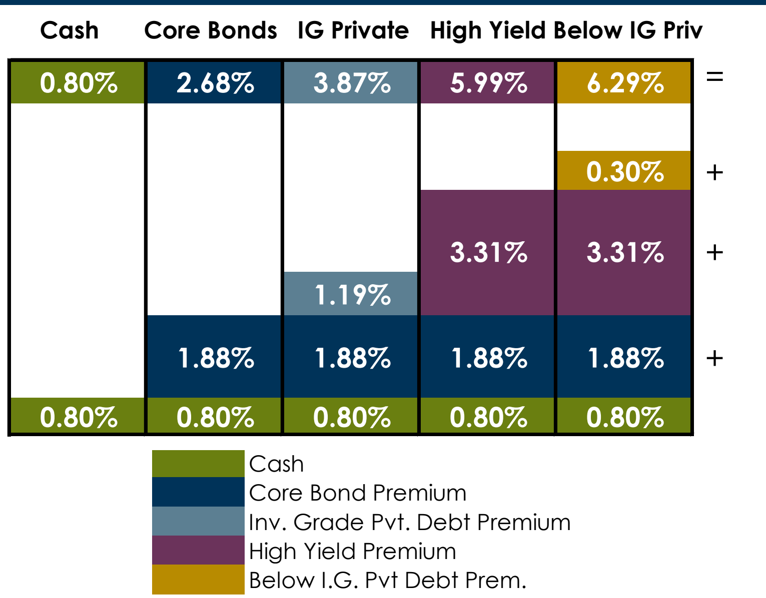
ACG Position:

- The global economy likely will continue to **grow below potential** and monetary policy may **remain accommodative** for an extended period.
- The global search for yield and quality provides consistent **demand for high yielding fixed income** sectors.
- US stock market **valuations are stretched** and require a **rebound in earnings growth** to support current price levels.
- Eight years of ultra easy central bank stimulus has probably **pulled forward financial market returns**.

Portfolio Implications:

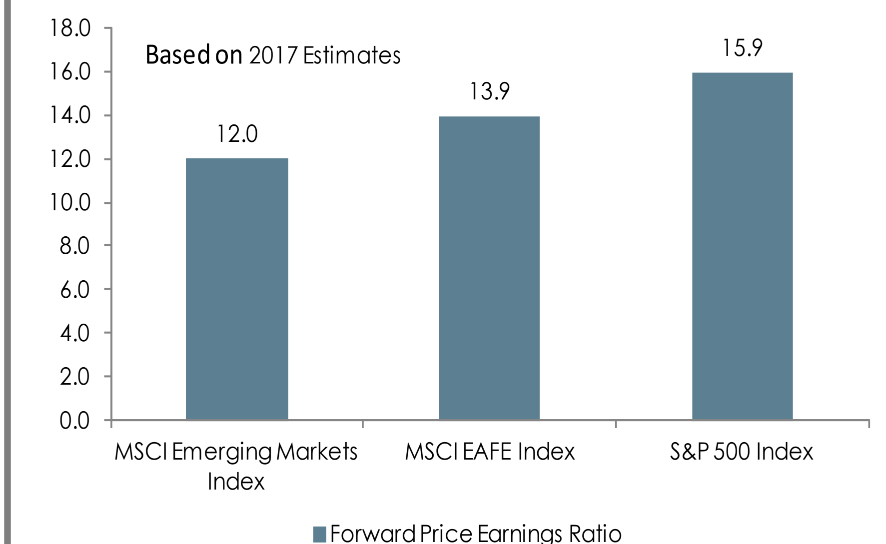
- **Diversify risk drivers** across equity and fixed income asset classes. Maintain **global allocation** to ensure exposure to asset classes with the potential for greater returns going forward.
- Consider **private strategies** that offer enhanced return potential versus traditional fixed income in exchange for reduced liquidity.

ACG Intermediate Capital Market Assumptions



Source: Bloomberg

Valuations Outside the US Are More Compelling



Source: Bloomberg

Investment Themes

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

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