Global Economic Update

Second Quarter 2017

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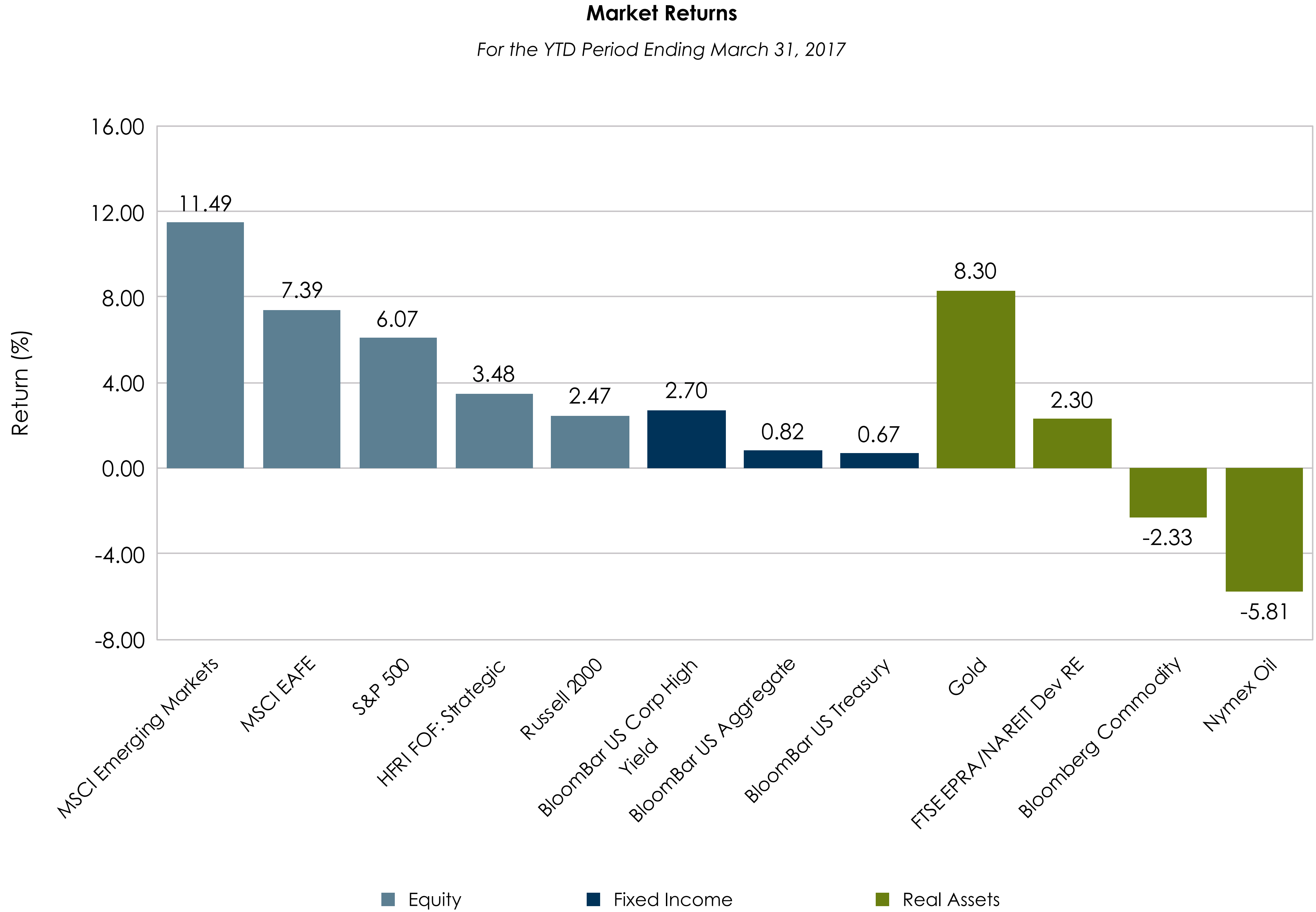

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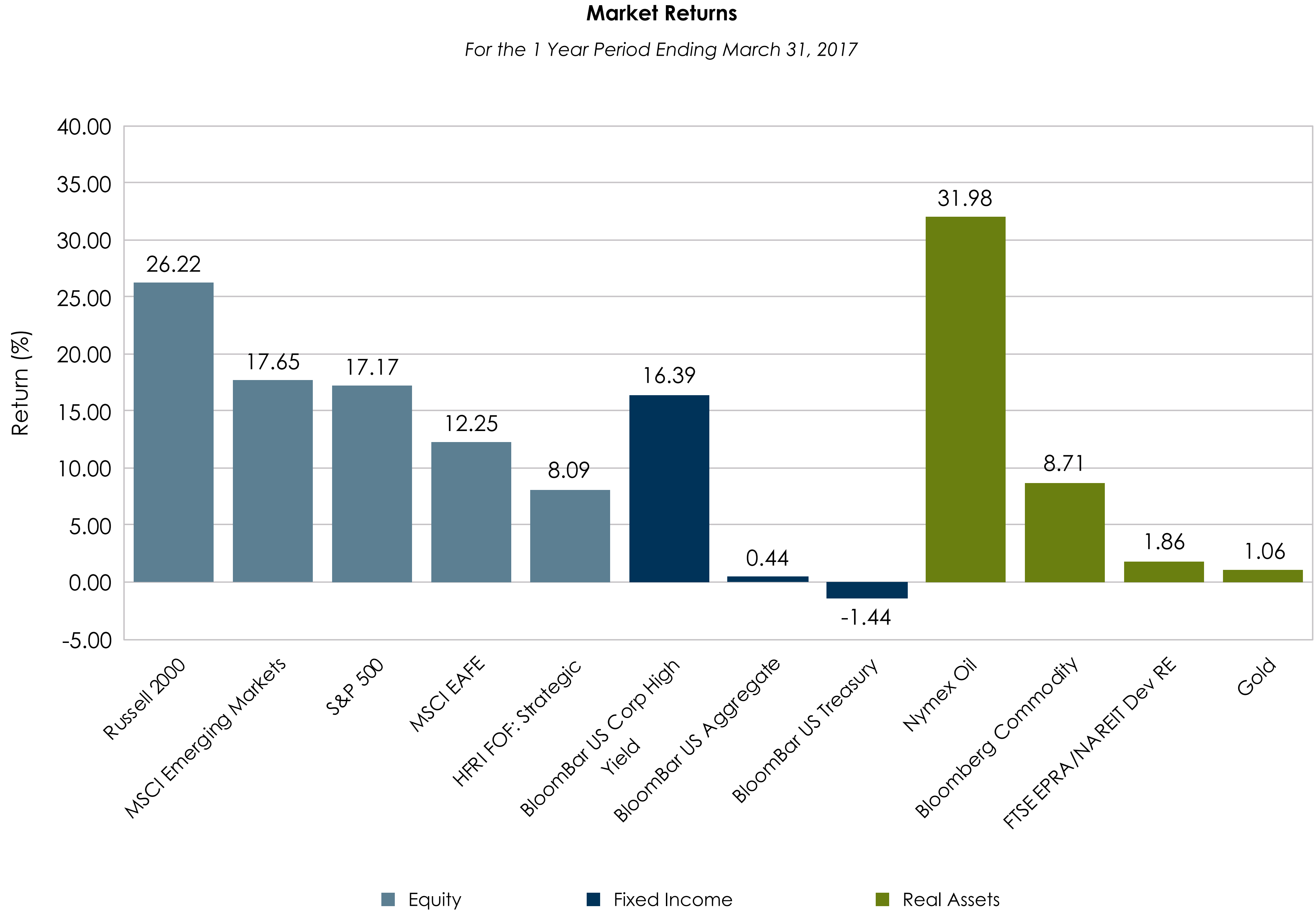

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US

- Embarking on its ninth year of economic expansion, **recent indicators for the US economy have been mixed.** While survey-based "soft data" signals are increasingly robust, the transition into "hard data" results is not fully assured. The consensus GDP estimate for 2017 remains modest at 2.2%.
- Past **growth has been supported by the resiliency of the US consumer**, but forward estimates for GDP assume a meaningful improvement in business investment. **Markets may be pricing too little risk** as it relates to the timing/ implementation of the new administration's expansionary objectives.
- The labor market continues to show **signs of tightening,** even as better employment prospects draw more people into the workforce. That said, **real wage increases (net of inflation) are lagging expectations.**
- The Federal Reserve took steps **to normalize interest rates** in mid-March. While a variety of indicators point to more frequent policy adjustments in coming periods, the Committee generally maintains the view that **future rate hikes are likely to remain at a gradual pace.**

Global/Non-US

- **Economic recovery is becoming more apparent in the Euro area**, with consumer demand, composite PMI's, and non-financial credit all trending higher. Momentum in the region has spurred **an acceleration in inflation.**
- That said, the **ECB remains cautious on the sustainability of the rise**. Given notable political uncertainties that could compromise continued growth, **near-term tapering of monetary policy accommodation appears remote**.
- Japan's economy has produced **four consecutive quarters of growth**, boosted by exports, government spending and private non-residential investment. Still, household consumption is flat given limited wage growth, and **the BoJ sees "no reason" to change its aggressive stimulus policies.**
- A 6.8% year-over-year **expansion in China's fourth quarter GDP** was within the government's 6.5-7.0% target range. Full-year growth was the weakest since 1990, as consumption and investment softened. Stability is expected through the Communist Party conference in November, and **officials seem to have enough levers of power to get what they want near-term**.

Current Issues

- Keeping Score: Evaluating the Facts on the Ground
- Perception vs. Reality: US Equities Due for a Pause?
- Perception vs. Reality: Non-US Equities Reflecting Fundamentals or Risks?
- Reminders from Past Market Cycles

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Market View:

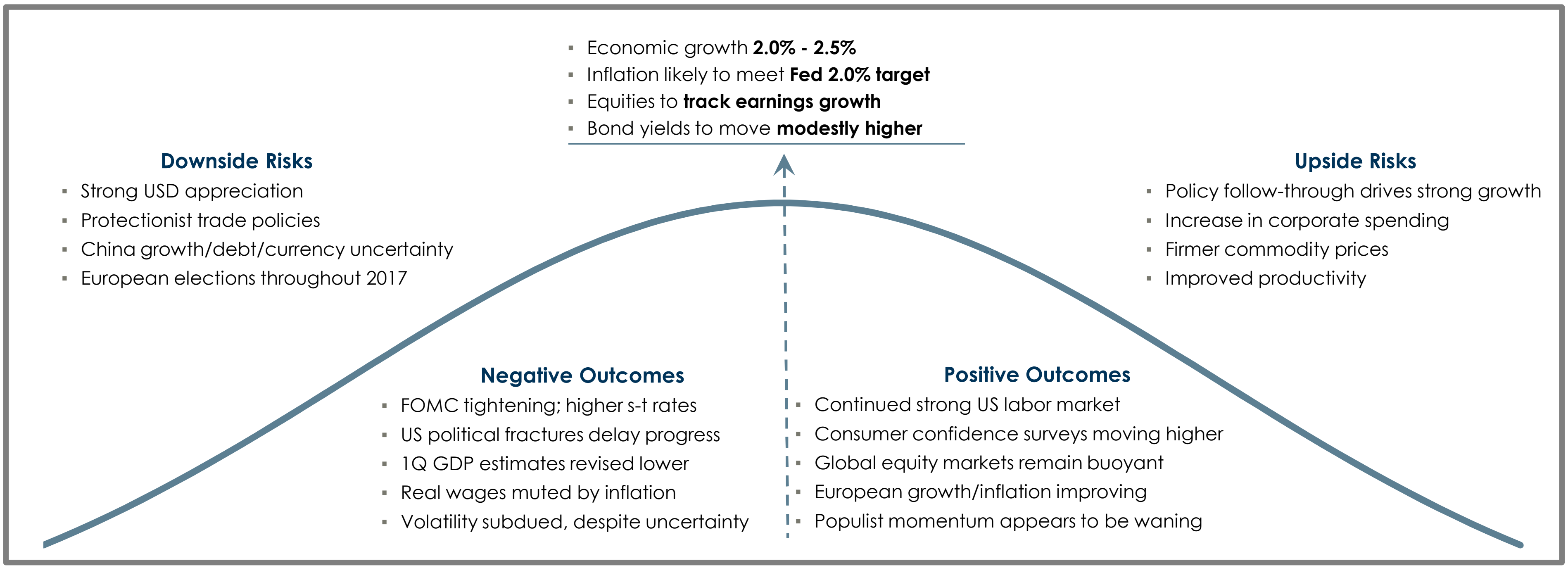
- Global monetary **policy actions** going forward **may differ from market expectations**.
- Growth of populism and/or nationalism could **disrupt global trade**.
- **Brexit** negotiations are creating further potential for **political instability** within Europe.
- China's **slowing growth and growing debts** are a global market concern.
- Global equity prices may be **getting ahead of economic fundamentals**.

ACG Position:

- Near-term **monetary policy surprises are unlikely** given the Fed's telegraphing of rate hikes and accommodative policy of non-US central banks.
- **Economic and political uncertainties** will affect markets for the foreseeable future.
- Increasing global uncertainties create **near-term risks and long-term opportunities** for investors.

Portfolio Implications:

- Continue to **favor equities and real assets over fixed income**.
- Employ **actively managed strategies** in less efficient asset classes; utilizing more **opportunistic managers** when appropriate.
- Maintain **hedged strategies** for downside protection and continually **monitor/evaluate portfolio** for compliance with strategic objectives.



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Perception vs. Reality: US Equities Due for a Pause?

Market View:

- US economic **growth and corporate profitability likely to surge** in the period ahead.
- Business and the economy will **benefit from policy changes** (tax reform, reduced regulations, infrastructure spending, etc.).

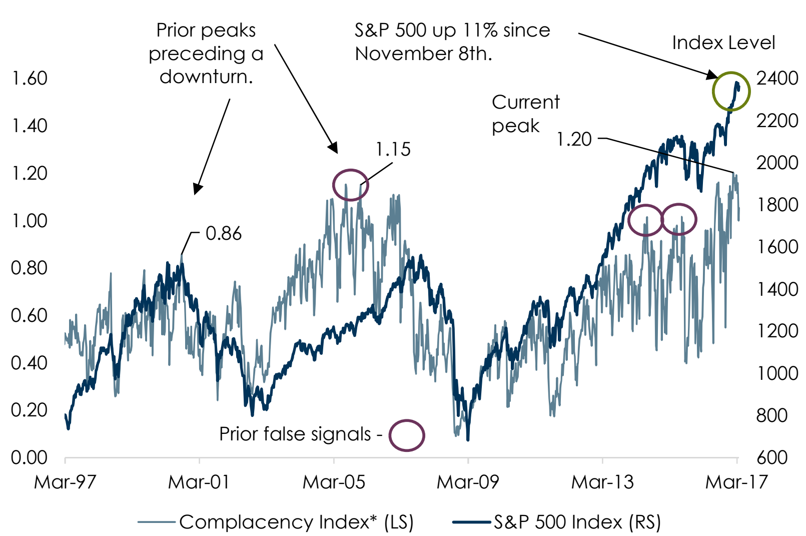
ACG Position:

- US investors remain **overly complacent** and markets may have **underestimated the time/effort** required to enact proposed policy changes.
- Additional potential headwinds include **rising wages, rising interest costs, and a slowdown in trade** due to a stronger US dollar and/or rising tariffs.
- **Volatility is likely to increase** as markets begin to re-evaluate political uncertainty and extended legislative timeframes.

Portfolio Implications:

- **Closely monitor portfolio allocations** for US equities relative to strategic objectives, and **rebalance as appropriate**.
- Employ **active managers** that can respond to potential opportunities that may arise.
- **Maintain hedged strategies** for downside protection.

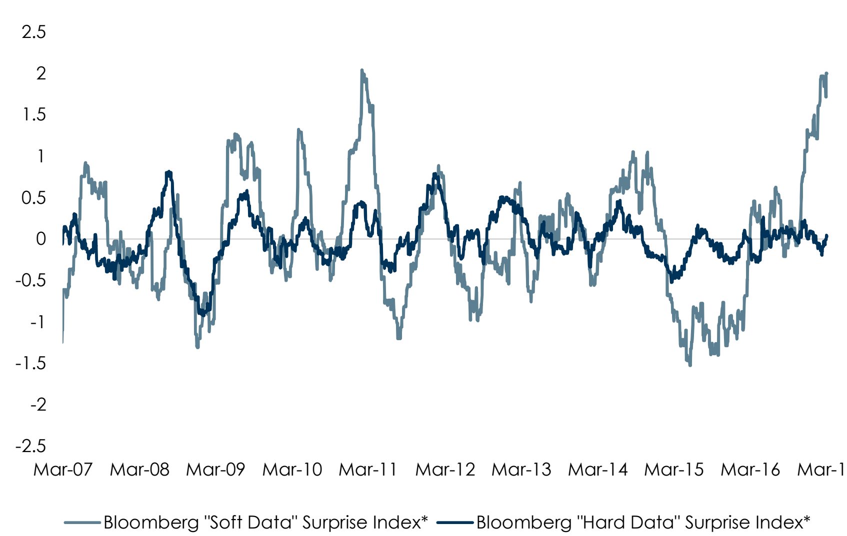
S&P 500 Index vs. Complacency Index*



*Relates the ratio between enterprise value and EBITDA in the S&P 500 index to the VIX

Source: ACG Research, Bloomberg

Gap Between Hope & Reality Keeps Growing



*Measures deviations of surprise in economic data. "Soft Data" refers to survey-based data while "Hard Data" refers to housing, industrial, labor, and retail data.

Source: Bloomberg

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Perception vs. Reality: Non-US Equities Reflecting Fundamentals or Risk?

Market View:

- On the heels of Brexit, **key upcoming elections** in France, Germany, and Italy **have created further political instability** within Europe.
- **European growth/inflation** is improving, which **may compromise the ECB's accommodative monetary policy**.
- Emerging market economies are broadly stabilizing, but **China remains a wild card**.

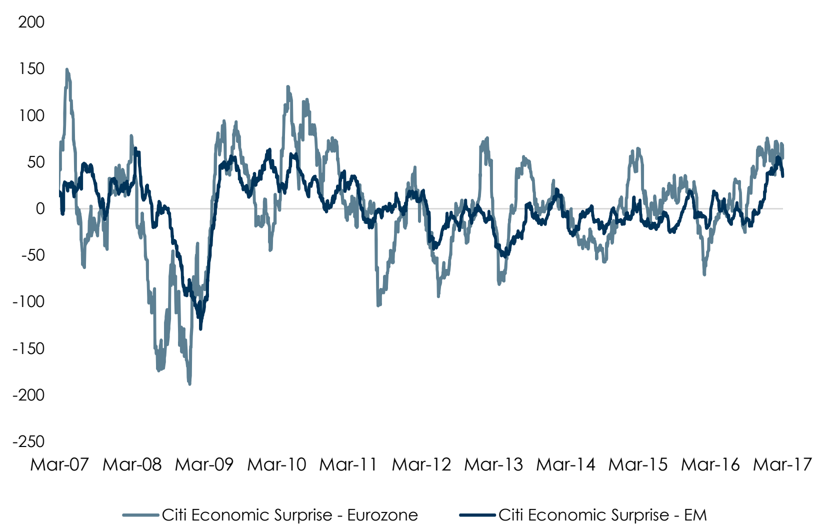
ACG Position:

- Global growth is becoming more synchronized, but **non-US monetary policy will likely remain accommodative** in the near-term.
- **Non-US corporate earnings will continue to benefit** from a relatively strong US dollar.
- Improving economic prospects and **attractive valuations compared to US equities** support investments in non-US developed and emerging market equities.

Portfolio Implications:

- Maintain non-US equity exposure **at or above target allocations**.
- **Employ active managers** that can respond to potential dislocations that may arise.
- **Maintain hedged strategies** for downside protection.

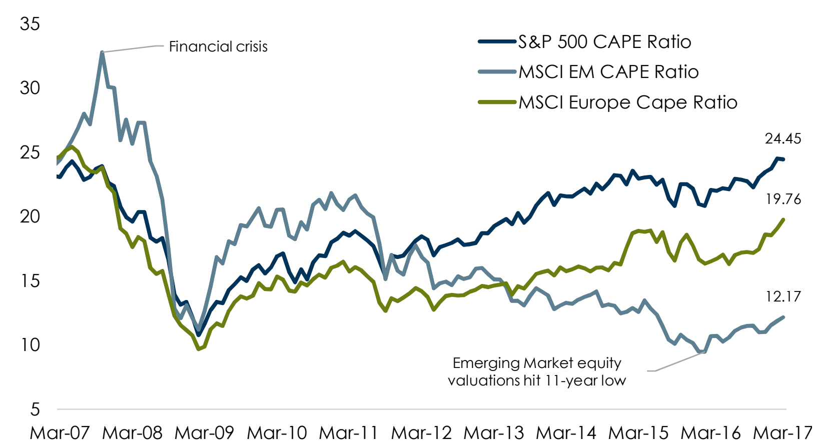
Favorable Economic Indicators Abroad



*Measures the actual outcome of economic data releases relative to consensus estimates.

Source: Bloomberg, Citigroup

Non-US Equity Valuations Relatively Attractive



*CAPE is a cyclically adjusted price to earnings ratio.

Source: Bloomberg, Robert Shiller

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Market View:

- Investors have **significantly increased US equity exposure** in recent months as the S&P 500 has achieved an all-time high market cap of $20 trillion.
- Investors are increasingly using passive investment vehicles as **active management has fallen out of favor.**
- Investors are more concerned with **earning return than decreasing risk**, and arguments against portfolio diversification are on the rise.

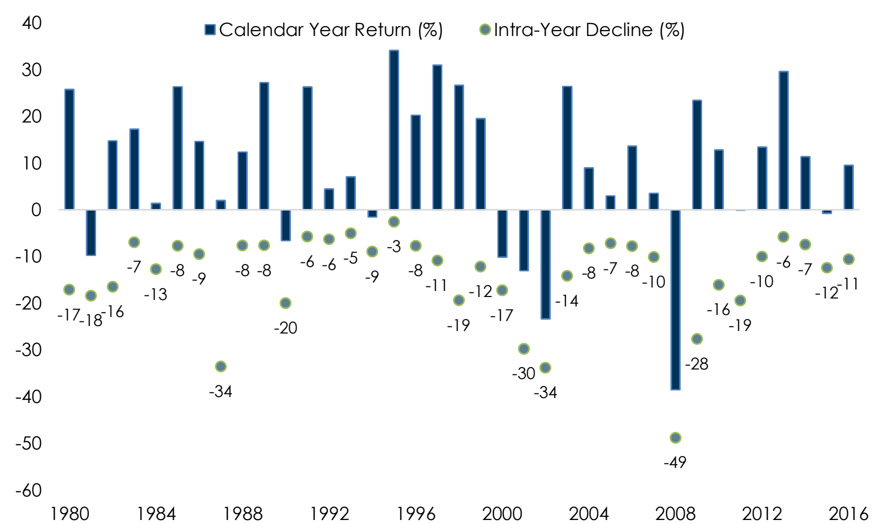
ACG Position:

- **Equity market pullbacks are a natural part of the investing cycle**; on average the S&P 500 has dropped **-14.2% intra-year** since 1980.
- **Portfolio diversification and active management** can help mitigate downside and better position investors for the eventual recovery.
- **Risk and return** should always be considered together as focusing on either in isolation **results in a sub-optimal portfolio**.

Portfolio Implications:

- **Don't be tempted to chase performance**; maintain portfolio diversification and **stay disciplined**.
- **Employ active managers** and maintain **hedging strategies and fixed income** for downside protection.
- **Remain patient and avoid emotional/behavioral biases** by sticking with the strategic plan.

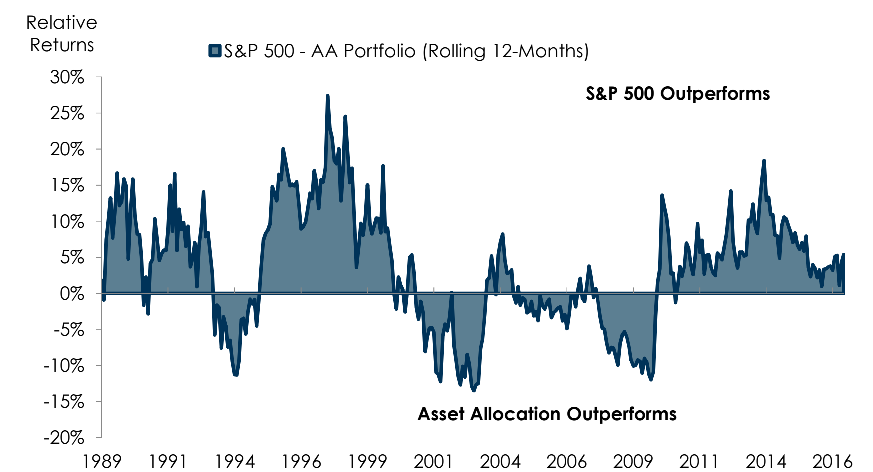
S&P 500 Intra-Year Declines vs. Calendar Year Returns



*Returns are based on S&P 500 price only, and do not include dividend income.

Source: Bloomberg, JP Morgan, ACG Research

Diversification Benefits Run in Cycles



*Asset Allocation portfolio consists of 65% MSCI ACWI and 35% Bloomberg Barclays Aggregate Bond.

Source: FactSet, ACG Research

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Investment Themes

Theme	Rationale	Implementation Strategy
Geopolitical & Policy Uncertainty	▪ Disparate global fiscal/monetary policies ▪ Potential US fiscal stimulus; reduced Euro area austerity ▪ Long term constraint from high government debt ▪ Rise of nationalism; populism vs. globalism ▪ Terrorism concerns, immigration, nuclear issues, territorial disputes, climate change concerns, social media	▪ Maintain global diversification ▪ Increase risk-reducing strategies ▪ Maintain disciplined rebalancing strategy
Improving Global Growth Expectations	▪ Rebound in commodity-sensitive economies ▪ Pro-growth policies in the US ▪ Continued monetary support in Europe/Japan ▪ China transitioning to consumer-driven economy ▪ Improving growth metrics across regions	▪ Prefer equities over fixed income ▪ Focus on actively managed, opportunistic strategies in less efficient asset classes (e.g. US Small Cap, Non-US, EM, Multi-sector fixed income) ▪ Maintain dedicated, differentiated managers ▪ Consider strategies with sustainability orientation
Fixed Income Market Headwinds	▪ Stretched sovereign valuations at low yields ▪ Fed policy normalization ▪ Later stage of economic/credit cycle ▪ Liquidity challenges may increase volatility	▪ Retain fixed income allocation for diversification ▪ Prefer credit and securitized over sovereign debt ▪ Include exposure to private debt or other yield enhancing strategies (e.g. high yield, EM debt) ▪ Incorporate absolute return oriented strategies
Return of Global Inflation	▪ US wage pressure building ▪ Consumer spending rising ▪ Energy prices normalizing/stabilizing ▪ Corporate pricing power improving ▪ Import prices rising (potential tariffs)	▪ Retain meaningful equity exposure ▪ Retain core real estate (RE) exposures ▪ Incorporate diversified commodity exposure
Muted Return Expectations	▪ Relatively high valuations across asset classes ▪ Shrinking public equity market ▪ Global economic growth remains positive but tepid ▪ Longer-term challenges of demographics/debt levels ▪ Yields and inflation advancing from historic lows	▪ Revisit investment objectives, constraints and strategic allocation ▪ Implement private equity and/or debt strategies ▪ Consider active strategies with enhanced flexibility ▪ Employ risk management solutions

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