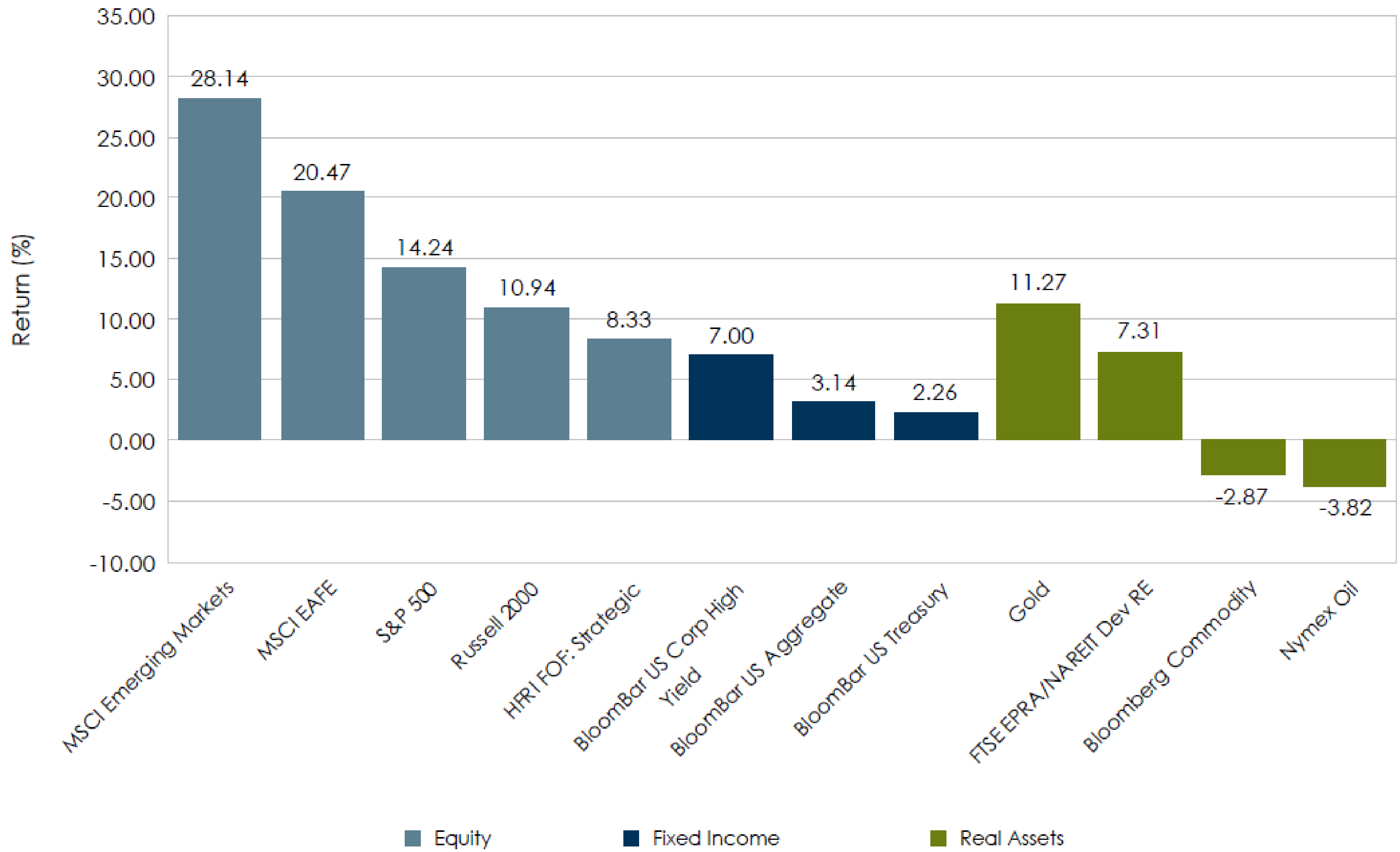
Global Economic Update

Fourth Quarter 2017

231 South Bemiston Avenue ♦ 14th Floor ♦ Saint Louis, Missouri 63105 ♦ www.acgnet.com ♦ 314.862.4848

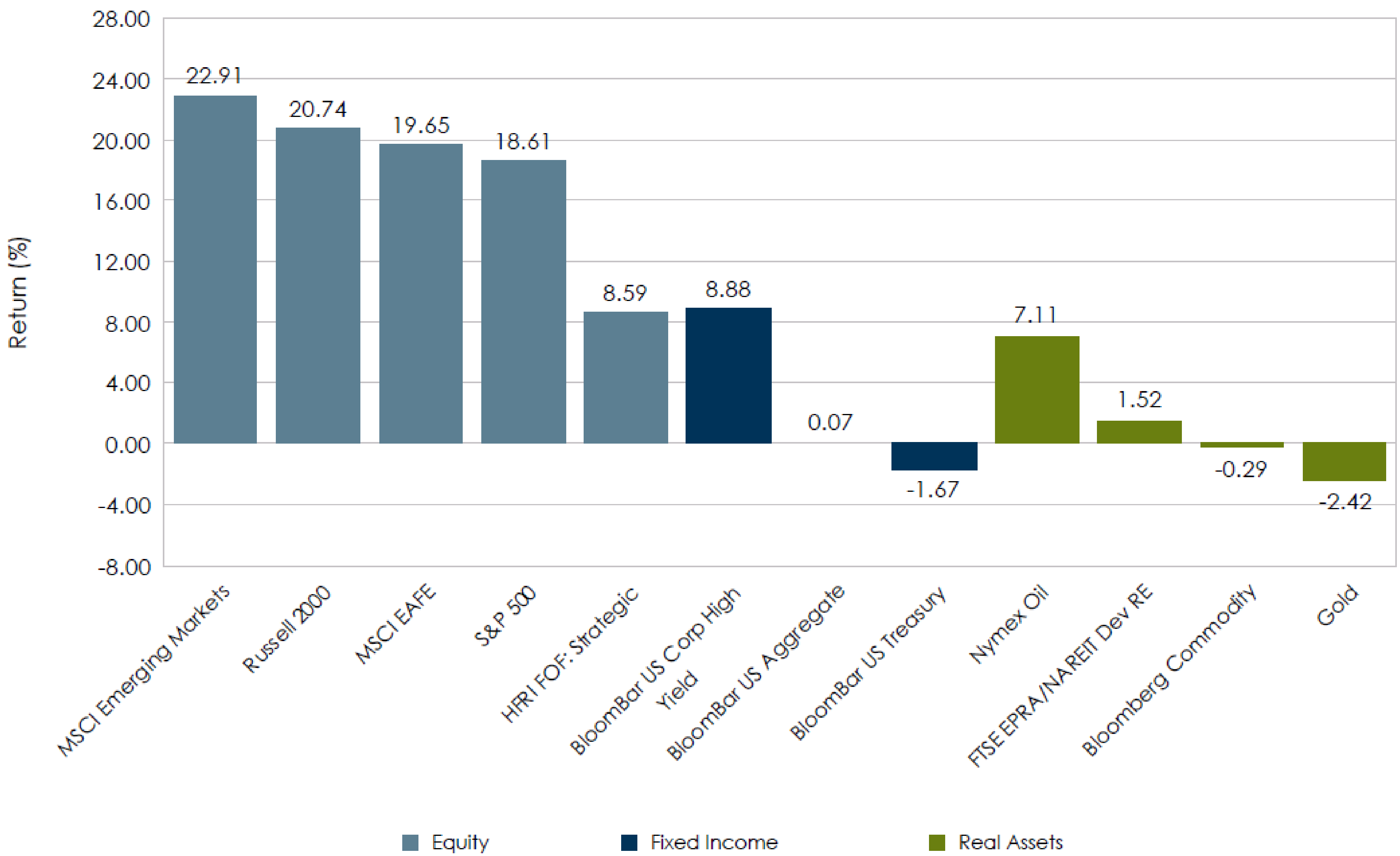
Market Returns

For the YTD Period Ending September 30, 2017



Market Returns

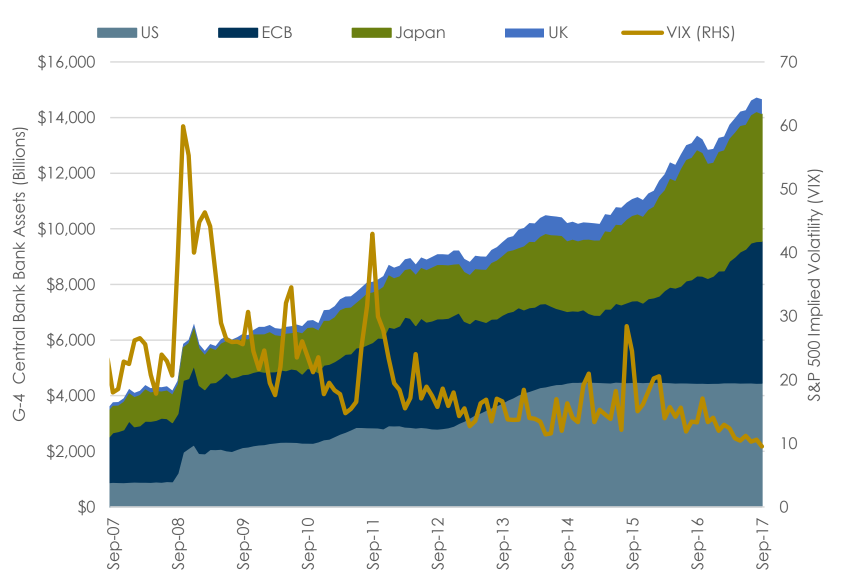
For the 1 Year Period Ending September 30, 2017



Investment Topics from Last Year

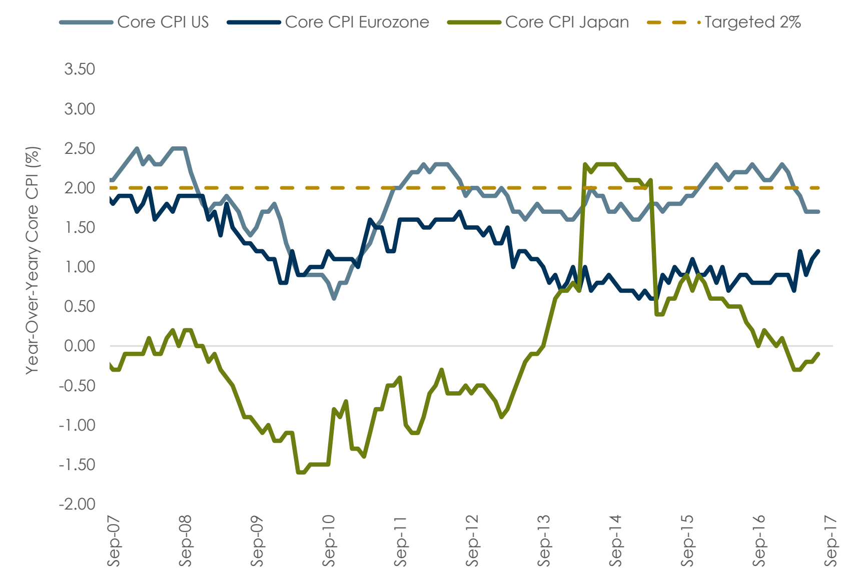
Topics	What We Said	What Happened
Fixed Income Strategies May Struggle	▪ Relatively **low overall yields and spreads provide little protection** against the Fed's desire to raise rates from crisis levels.	▪ **Short-term interest rates moved higher** with three Fed rate hikes, but a flatter yield curve and tighter credit spreads cushioned the downside.
Continued Market Uncertainty	▪ After an extended period of low volatility, below historic averages since 2012, investors should **expect a revival of market turbulence**.	▪ Market **volatility has remained subdued** given ongoing liquidity from global central banks, and we have actually witnessed new record lows for VIX.
Corporate Profits Increasingly Important	▪ With the post-crisis equity rally driven primarily by multiple expansion, **rebounding earnings growth will be needed to sustain upward momentum**.	▪ **S&P 500 constituents reported 10% year-over-year EPS growth** (through August), analyst estimates being revised higher for the coming 12-months.
Value in Emerging Markets	▪ **Multiple drivers in place to produce favorable outcome;** currency stabilization vs USD, relatively low valuations, expectations for better growth.	▪ Basket of major EM currencies up 10% versus the USD from the lows of 2016. **EM debt up 8% and EM equity up 28% year-to-date** (through September).
Uncertain Global Inflationary Environment	▪ **Inflationary impulse generally limited across the globe.** Ongoing improvement in the US labor market could stoke wages/inflation pressure.	▪ Although deflationary pressures in Europe and Japan have abated, **core inflation levels have remained below expectations in all regions**.

Global Liquidity Acting to Suppress Volatility



Source: ACG Research, Bloomberg

Core Inflation in Developed Markets



Source: ACG Research, Bloomberg

US

- **The US economy appears stable, despite the extended tenure of the current recovery.** Consensus GDP estimates for 2017 & 2018 remain within the 2.0% to 2.5% range. While secular trends may limit upside growth potential, **the typical signatures of a protracted downturn are not present.**
- **Unemployment continues to grind lower**, and the Fed's latest estimates forecast sub-4% levels even as participation rates may recover further. That said, wage growth continues to trail expectations, and **economists are grappling with the relative lack of inflationary impulse.**
- **Equity markets have remained buoyant**, with volatility continuing to trend lower as risk-off periods caused by faltering domestic policy, natural disasters, or even international security issues have proven transitory. **Consumer and business confidence measures remain relatively strong,** with the recently revived hope of tax reform seen as a catalyst.
- The Fed took further steps **to normalize monetary policy** in mid-September. The market is reflecting the view that future policy adjustments will occur in a gradual and well-communicated manner. However, the Committee's leadership structure may evolve in coming quarters, and **any perceived change in direction or pace would likely prompt a reaction in asset prices.**

Global/Non-US

- **It has been a decade since global growth appeared as synchronized as it does today.** Data out of the Eurozone has been sustained at a comfortable level, with manufacturing PMI's and sentiment clearly reflecting expansion. That said, **momentum in the region has caused the Euro to appreciate**, which may temper inflation and competitiveness.
- Political instability has moderated, even as the recent German election resulted in a more populist tilt. Although the **ECB has remained cautious on the sustainability of the recovery, reduced stimulus appears to be part of the 12-month outlook.** Investors emboldened by monetary policy efforts may have to begin finding satisfaction in underlying fundamentals.
- Irrespective of North Korea's aggressive military posturing, **Japan's economy appears to be on a more sustainable path.** Still, inflation remains stubbornly low, and the BoJ will likely be the last to roll back aggressive stimulus policies (targeted low interest rates, and even equity purchases).
- **Emerging markets economies are benefitting from solid developed market outcomes, and the continuation of stable global trade dynamics.** Improving local fundamentals have enabled currency appreciation, which helps to contain inflation. October's 19th Party Congress may formalize key reforms, but **Chinese stability is expected near term.**

Current Issues

- Keeping Score: Evaluating the Facts on the Ground
- The Music Plays On: Is the "Bubble" Less Obvious this Time Around?
- Slow and Steady: What is the Catalyst to Change Market Direction?
- Correlations Appear High: Does Diversification Still Help?

Keeping Score: Evaluating the Facts on the Ground

Market View:

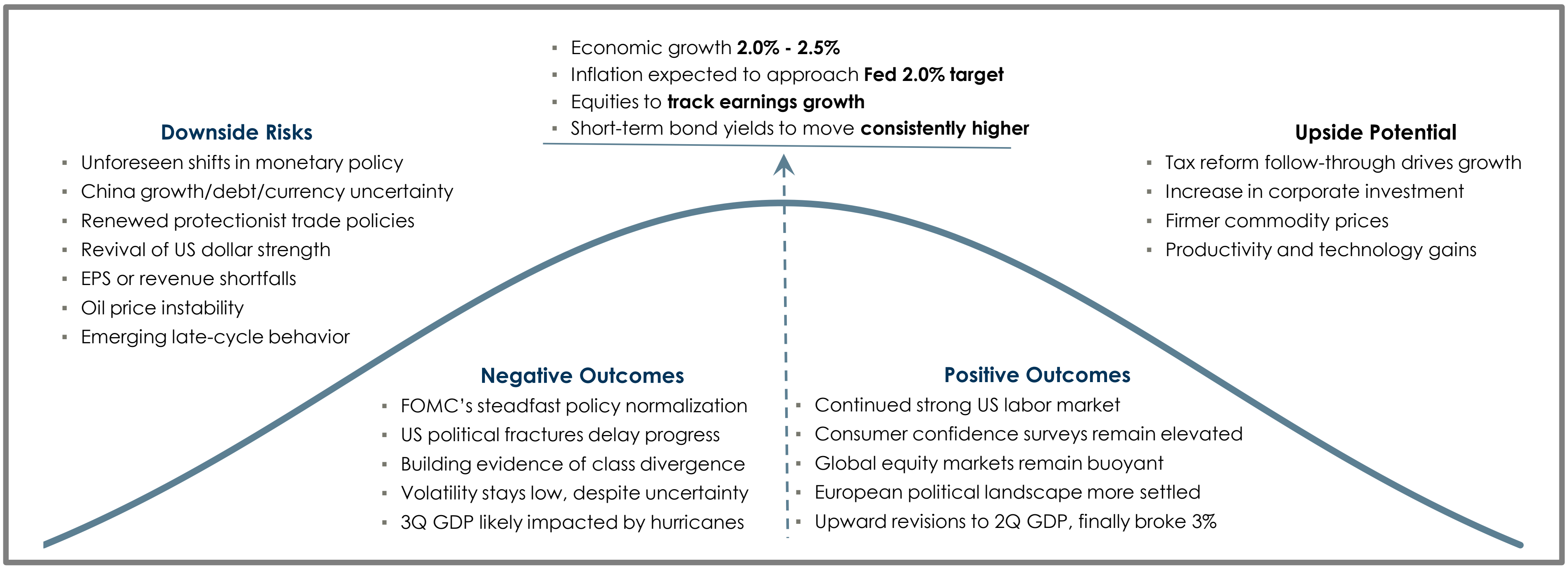
- Global monetary **policy action** remains in focus, and will be a dominant **driver of both volatility and price levels**.
- China's 19th Party Congress is expected to further consolidate leadership, yet **slowing growth and growing debts** are a global market concern.
- The suppression of risk premia has **elevated pricing for assets globally** such that they may be **getting ahead of economic fundamentals**.

ACG Position:

- Near-term **monetary policy surprises are unlikely** given the sensitivity and awareness of global central bankers, **but the tail risk cannot be ignored**.
- **Economic and political uncertainties** will affect markets for the foreseeable future, but evidence suggests **investors are becoming de-sensitized to the noise**.
- Increasing global tensions (most notably North Korea) 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** where appropriate.
- Maintain **hedged strategies** for downside protection and continually **monitor/evaluate portfolio** for compliance with strategic objectives.



The Music Plays On: Is the "Bubble" Less Obvious this Time Around?

Market View:

- Consistently **re-established record highs** have many thinking that equities, particularly within domestic markets, have nearly run their course.
- The notable rise of indexing via mutual funds and ETFs, now more than 35% of invested equity assets, has resulted in **less true price discovery in the market**.
- **P/E ratios are in the top quartile versus history**, but this may be justified given lower interest rates and the greater proportion of high-margin sectors (IT & Financials).

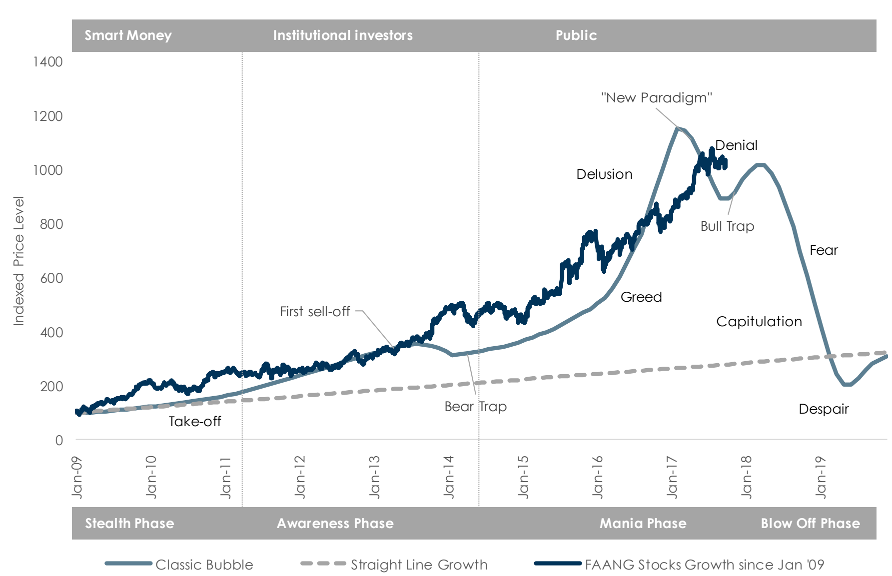
ACG Position:

- Mixed signals between long-term growth, unemployment and inflation suggest **we are not in "bubble" territory**, but rather continuing a slow steady recovery.
- **Thus-far traditional late-cycle forces have not overwhelmed**, and the upward trend could persist as it's the strength and not the length of expansions that matter.
- The anointment of "super-stocks" such as FAANG (Facebook, Amazon, Apple, Netflix and Google) is a **sign of investor optimism that must be carefully watched.**
- Measuring total stock market capitalization relative to the country's GDP illustrates the **enhanced wealth of the invested class versus the broader economy.**

Portfolio Implications:

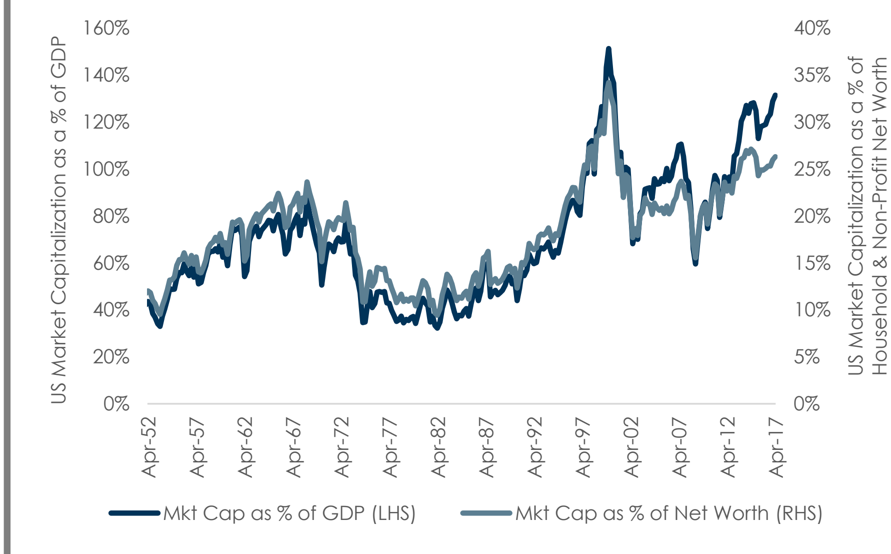
- Maintain targets in large cap US stocks, but **remain diligent with rebalancing** given valuations and economic sensitivity.
- **Favor international equities,** which offer more attractive relative valuations along with economic cycle and currency diversification.
- **Maintain hedged strategies** for downside protection.

Defining a Classic Bubble



Source: ACG Research, Bloomberg, Financial Times

Potential Indicators of Fully Valued Markets



Source: ACG Research, Federal Reserve Bank of St. Louis (FRED)

Slow and Steady: What is the Catalyst to Change Market Direction?

Market View:

- **Low volatility in GDP, inflation, interest rates and equity returns has persisted** despite North Korean threats, hurricane impacts, and isolated violence.
- Markets have benefitted from **upward trends in economic data and corporate earnings report**, but this increasingly comes with rising expectations.
- The **tax reform framework has generally been met with optimism**, even as the details are far from clear.

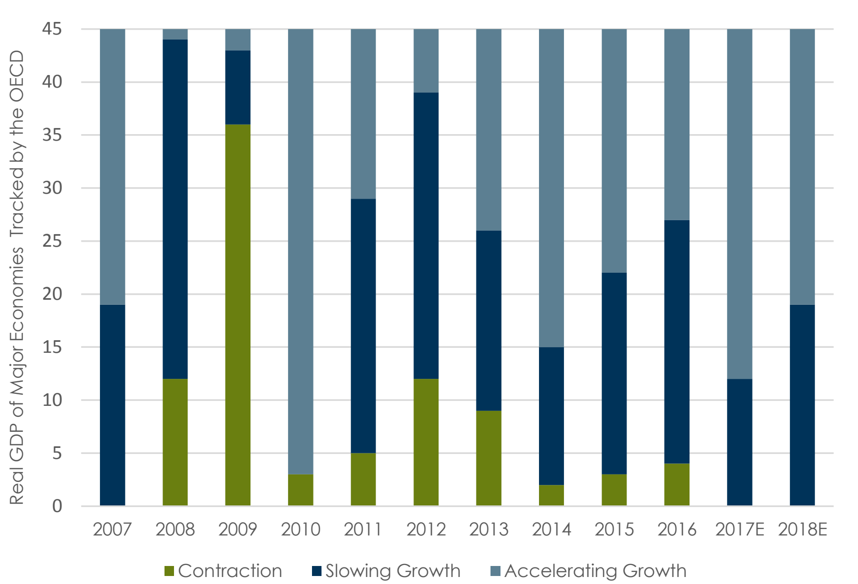
ACG Position:

- **History suggests P/E multiples contract as central banks raise rates**, and this may be compounded by the wind down of quantitative easing (QE).
- An increasingly **tight labor force tends to drive rising wages and consequently inflation**, keeping central bankers focused on the need to normalize policy.
- **Markets can climb the "wall of worry"** longer than some might expect, but volatility has always been extremely low ahead of market turbulence.

Portfolio Implications:

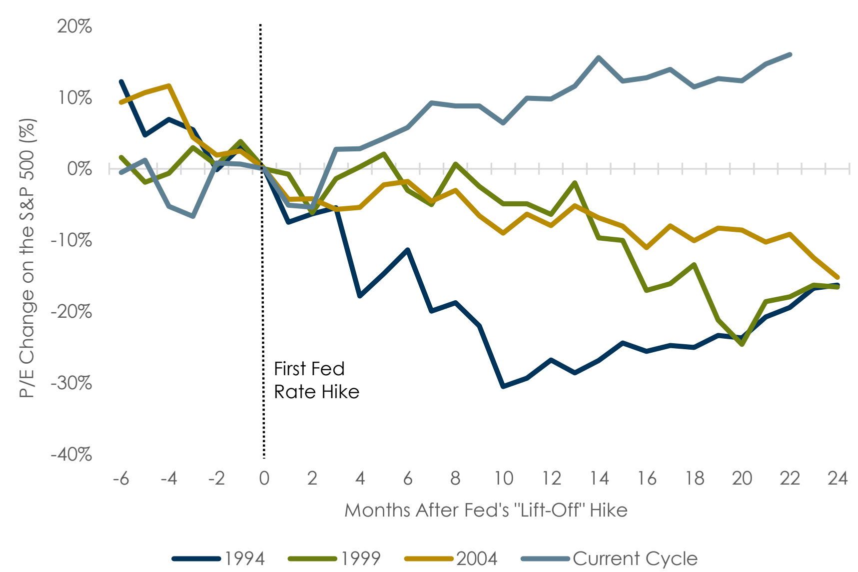
- **Closely monitor overall portfolio allocations relative to strategic objectives**, maintaining upside exposure without getting over-extended.
- Employ **active managers** with niche strategies and/or the flexibility to respond to potential opportunities that may arise.
- Incorporate **volatility dampening** strategies.

Synchronized Global Growth Creates a Tailwind



Source: ACG Research, Organization for Economic Co-operation and Development (OECD)

Valuations Typically Decline During Rate Hiking Cycles



Source: ACG Research, Bloomberg

Correlations Appear High: Does Diversification Still Help?

Market View:

- **It's unusual for stocks and bonds to appreciate together**, and recent performance trends call into question longer-term correlations.
- There appear to be **no "beta markets" that offer generous forward-looking returns**, but the emotional fear of missing out often overtakes discipline.
- If investors can **accept the illiquidity premium** offered by private investments, they may obtain differentiated results and return targets can be maintained.

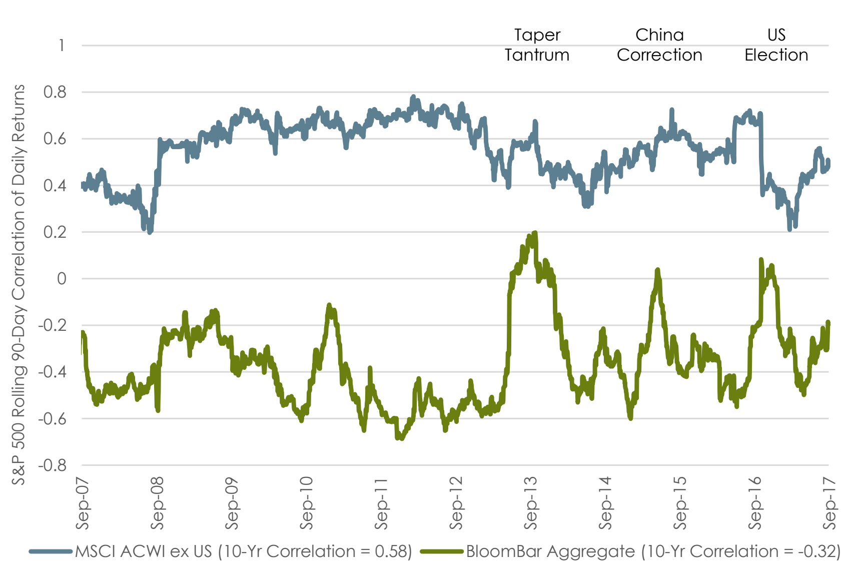
ACG Position:

- De-risking may be prudent at this stage of the cycle, but "**getting out" or even deviating materially from strategic objectives is very difficult to time properly.**
- **While correlations certainly cycle through time**, and may elevate at times of stress, diversification remains key to a successful long-term strategy.
- Interest rates have not yet reached the level where bonds offer attractive valuations versus equities, but **investors still must acknowledge the "value of bonds" as a preserver of capital .**

Portfolio Implications:

- **Take into account long-term relationships** when establishing portfolio strategy, and avoid cyclical traps.
- Consider active managers willing to utilize an **allocation to long US Treasuries** as part of their fixed income strategy.
- Maintain investment discipline and minimize asset allocation drift by **tightening the bands around each target allocation.**

Correlations Between Assets Evolve Through Time



Source: ACG Research, Bloomberg

S&P 500 Earnings Yield Favors Stocks

Source: ACG Research, Bloomberg

Investment Themes (3-5 Years)

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 ▪ Political polarization – rising in US, declining in Europe ▪ Terrorism concerns, immigration, nuclear issues, territorial disputes, climate change concerns, social media impact	▪ Maintain global diversification; meaningful non-US exposure ▪ Increase risk-reducing and private strategies ▪ Maintain disciplined rebalancing strategy
Improving Global Growth Expectations	▪ Pro-growth policies in the US and abroad ▪ 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, fixed income) ▪ Allocate to specialized / differentiated managers ▪ Consider strategies with sustainability orientation
Fixed Income Market Headwinds	▪ Stretched sovereign valuations at low yields ▪ Fed policy normalization ▪ Inflation expectations driving yield volatility ▪ Later stage of economic/credit cycle ▪ Liquidity challenges may increase volatility	▪ Retain high-quality 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
Global Inflation Conundrum	▪ Wage pressure building, but still slack in labor market ▪ Rising consumer spending driving demand ▪ Technological efficiencies lowering prices ▪ Energy prices normalizing/stabilizing ▪ Trade policy uncertainty – inflationary/deflationary?	▪ 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/confirm investment objectives, constraints and strategic allocation ▪ Implement private equity and/or debt strategies ▪ Consider active strategies with enhanced flexibility ▪ Employ risk management solutions

Disclosures and Legal Notice

The views contained in this report are those of Asset Consulting Group (ACG). The information contained herein is given as of the date hereof and this does not purport to give information as of any other date. Neither the delivery of this memorandum nor any information contained herein shall, under any circumstances, create an implication that there has been no change in the matters discussed herein since the date hereof.

The information presented herein is for informational purposes only and is not intended as an offer to sell or the solicitation of an offer to purchase any securities or any product or service.

Past performance is not indicative of future results. Given the inherent volatility of the securities markets, it should not be assumed that investors will experience returns comparable to those shown here. Market and economic conditions may change in the future producing materially different results than those shown here.

Although the information presented herein has been obtained from and is based upon sources ACG believes to be reliable, no representation or warranty, express or implied, is made as to the accuracy or completeness of that information. Such information is not necessarily all-inclusive and is not guaranteed as to its accuracy. Accordingly, ACG does not itself endorse or guarantee, and assumes no liability whatsoever for, the accuracy or reliability of any third party data or the financial information contained herein.

All information presented herein is subject to a disclaimer included in all research. Any material excerpted or summarized from a full research report is subject to the terms of the disclaimer. The information in this report, including research, is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

Comparisons of the performance of any portfolio to the market indicators, benchmarks and indices presented herein may not be meaningful since the constitution and risks associated with each market indicator, benchmark or index may be significantly different. Accordingly, no representation or warranty is made to the sufficiency, relevance, importance, appropriateness, completeness, or comprehensiveness of the market data, information or summaries contained herein for any specific or purpose.

Please be aware that there are inherent limitations to all financial models, including Monte Carlo Simulations. Monte Carlo Simulations are a tool used to analyze a range of possible outcomes and assist in making educated asset allocation decisions. Monte Carlo Simulations cannot predict the future or eliminate investment risk. The output of the Monte Carlo Simulation is based on ACG's capital market assumptions that are derived from proprietary models based upon well-recognized financial principles and reasonable estimates about relevant future market conditions. Capital market assumptions based on other models or different estimates may yield different results. ACG expressly disclaims any responsibility for (i) the accuracy of the simulated probability distributions or the assumptions used in deriving the probability distributions, (ii) any errors or omissions in computing or disseminating the probability distributions and (iii) and any reliance on or uses to which the probability distributions are put.

The information and views described herein is general in nature and is not intended as investment advice or recommendations. This material is distributed with the understanding that it is not rendering accounting, legal or tax advice. Please consult your legal or tax advisor concerning such matters.

No part of this publication may be copied, or duplicated in any form without the written consent of ACG. ACG is not responsible for typographical or clerical errors in this report or in the dissemination of its contents. Reliance upon information in the report is at the sole discretion of the reader.