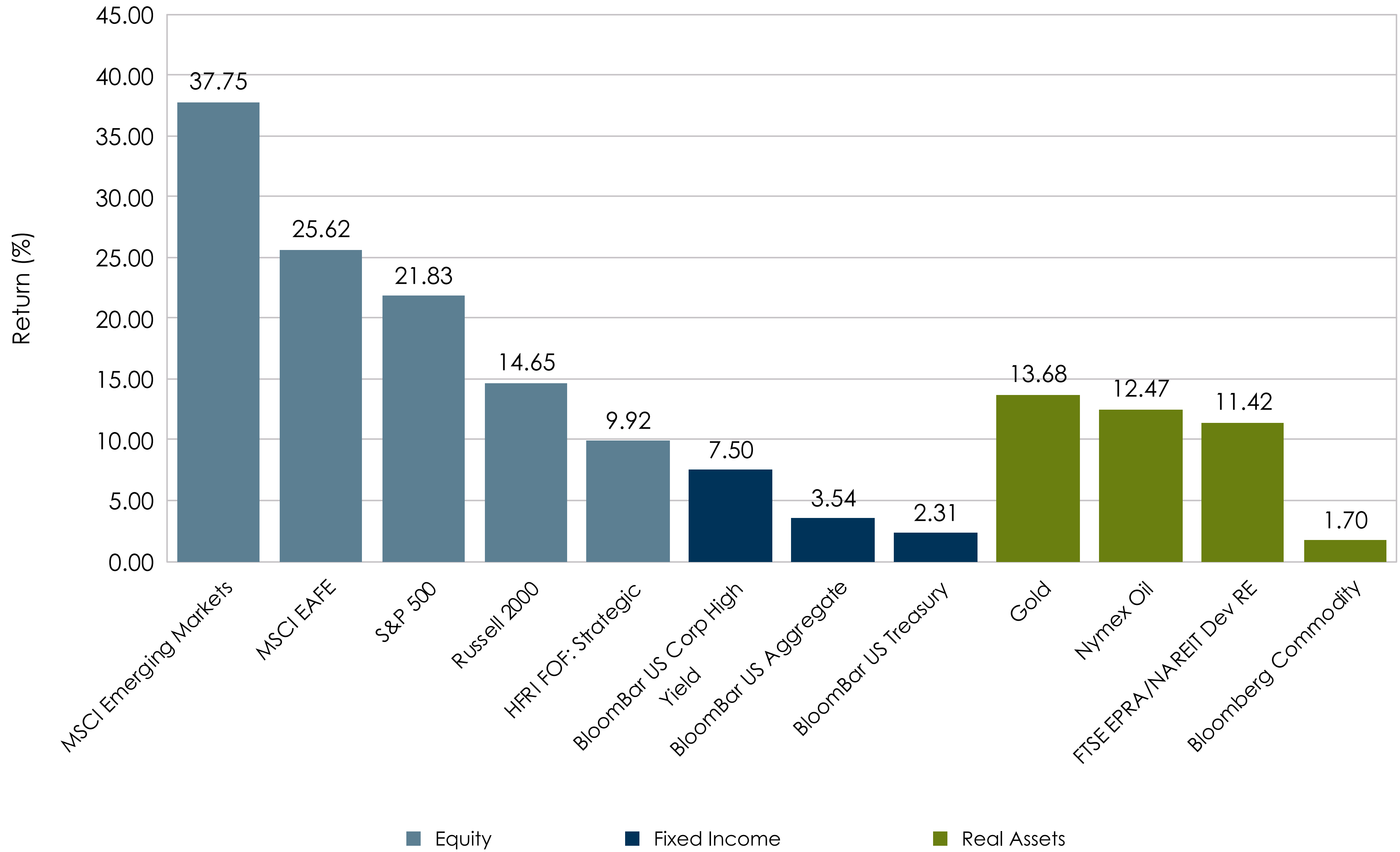
Global Economic Update

First Quarter 2018

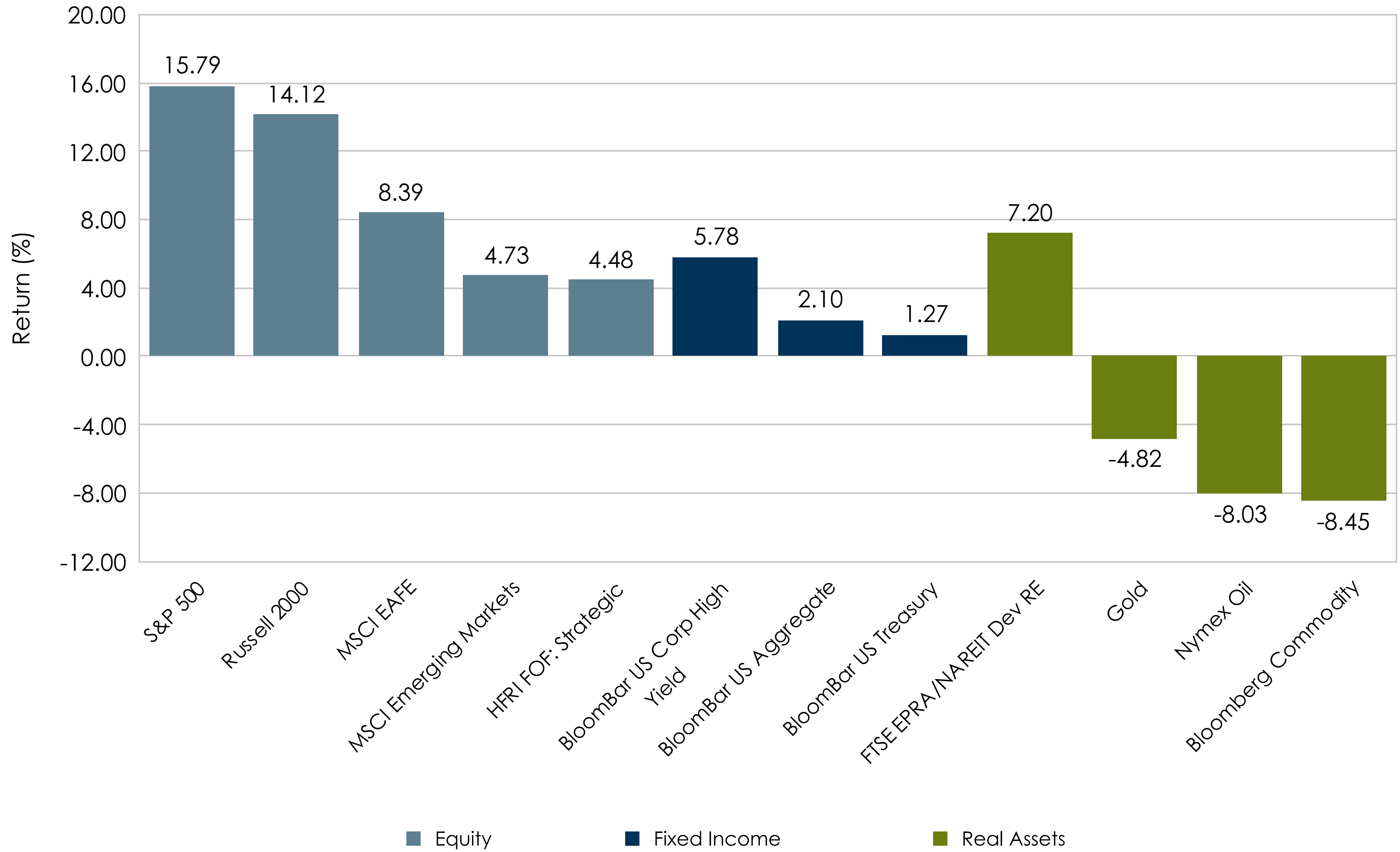
Market Returns

For the 1 Year Period Ending December 31, 2017



Market Returns

For the 5 Years Period Ending December 31, 2017



US

- **Economic fundamentals in the US generally surprising to the upside.** Annualized growth in real GDP has surpassed 3% for two consecutive quarters, and the passage of Federal tax reform is expected to deliver an incremental near-term boost. **Consensus GDP estimates for 2018 are trending higher**, although secular factors may ultimately limit sustainability.

- Labor conditions remain solid, with the **unemployment rate sitting at a 17-year low.** Most economists, including those at the Fed, are forecasting sub-4% levels on the horizon. Still, **wage growth is quite tepid for a maturing cycle**, and markets are pondering the relative lack of inflationary impulse.

- **Corporate earnings growth is combining with elevated sentiment** to drive equity markets to all-time highs. Despite persistent noise around a myriad of issues, the ongoing lack of volatility in stocks and bonds is perhaps equally historic. **Following a year considered "as good as it gets," investors are lining up on both sides as they assess the prospects for 2018.**

- The Fed took further steps **to normalize monetary policy** in mid-December. While the Committee's leadership will certainly evolve in the coming quarters, the market is reflecting the view that future policy adjustments will occur in a gradual and well-communicated manner. **Any perceived change in direction or pace would likely prompt a reaction in asset prices.**

Global/Non-US

- The phrase "synchronized global growth" is perhaps wearing thin, but **the self-reinforcing nature of widespread economic acceleration cannot be dismissed.** The relative strength of momentum abroad has caused the US dollar to depreciate for the first time since 2012. For the Eurozone in particular, this may act to temper inflation and global competitiveness.

- While certainly lagging the Fed's established normalization path, through recent actions and/or rhetoric, **both the ECB and the BoJ have shown signs of moving toward reduced accommodation over the next 12- to 18-months.** Investors emboldened by unprecedented monetary policy efforts will have to find greater satisfaction in underlying fundamentals.

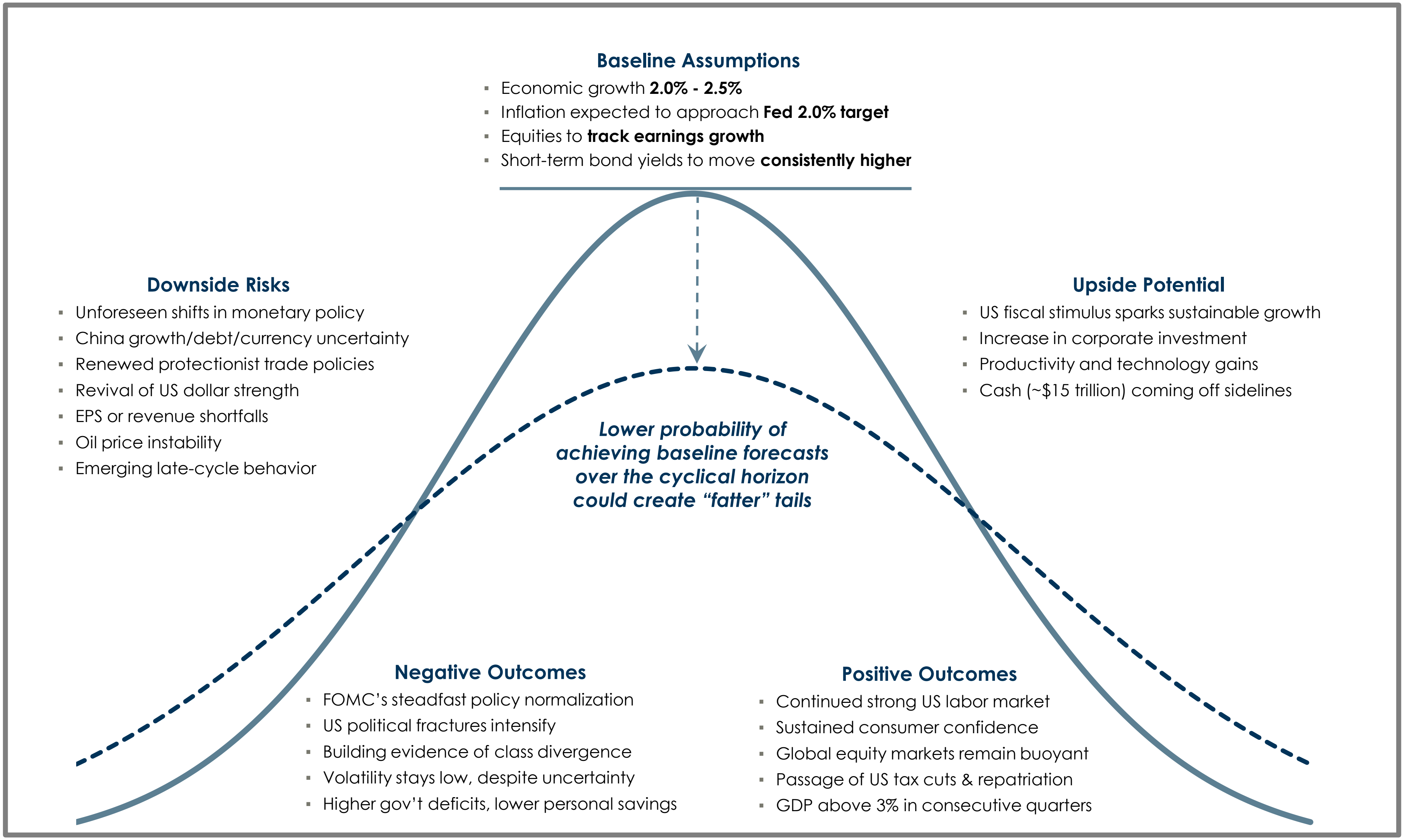
- **Emerging markets economies are benefitting from developed market growth, cyclical disinflation, and relatively stable global trade dynamics.** Chinese policymakers are removing stimulus from the economy, as they appear focused on addressing key structural issues following the consolidation of power during October's 19th National Party Congress.

- **The political landscape outside of the US remains somewhat unchanged.** In Europe, the upcoming Italian election is being watched, alongside the ongoing Brexit negotiations. North Korea's aggressive military posturing, and the potential for disruption in the Middle East remain notable.

Current Issues

- Keeping Score: Evaluating the Facts on the Ground
- Inflation: An Underappreciated Risk?
- Tax Reform: Impact on Real Economy and Markets?
- Recessionary Signals: Inevitable in Time, but How Far Away Are We?

Keeping Score: Evaluating the Facts on the Ground



Market View:

- With Goldilocks resting comfortably under the blanket of policy support, **investors have grown complacent about the threat of rising prices**.
- **Low – and stable – inflation helps to boost the relative appeal of stocks** and has been a key driver behind the global market rally of the past few years.
- As producer prices are trending higher, commodity prices are rallying, and intentions around capital expenditures are accelerating, **market-based measures of expected inflation have only recently returned to 2%.**

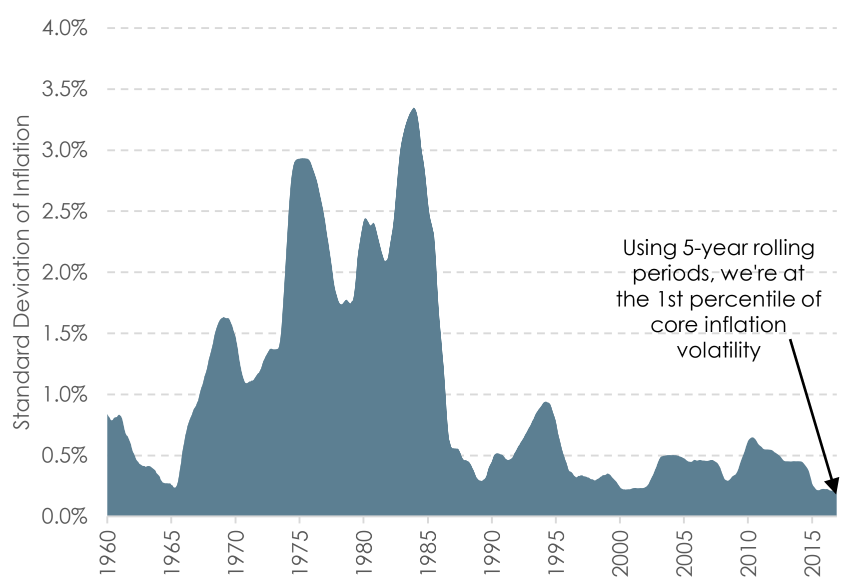
ACG Position:

- Because of their fixed coupons, **traditional bonds with long-dated maturities are known to suffer from unexpected bouts of inflation.**
- Less understood is how **P/E multiples also contract in tandem with rising term premiums**, and this may be compounded by any hawkish central bank response.
- **Consumers who have favored spending over saving would benefit from rising wages**, but this critical input could pressure lofty corporate profit margins.

Portfolio Implications:

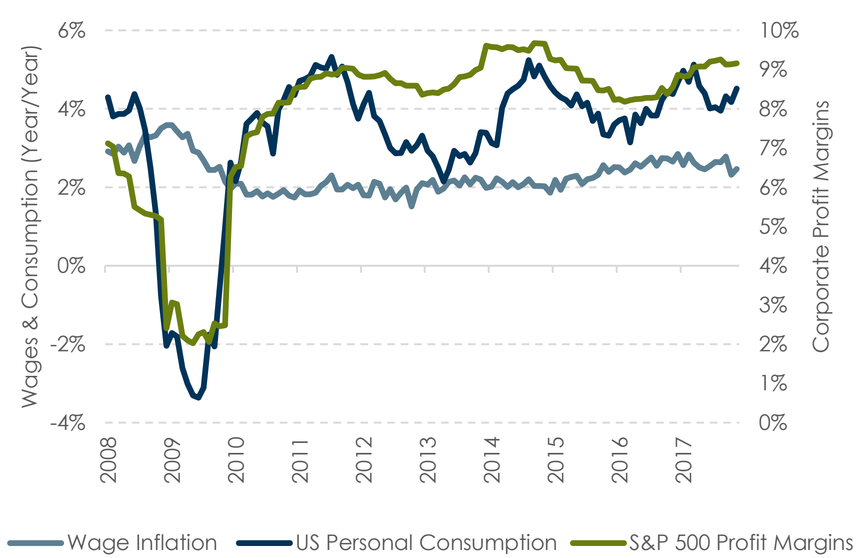
- **Take into account long-term relationships** when establishing portfolio strategy and avoid cyclical traps.
- Employ **active managers** with niche strategies and/or the flexibility to respond to potential opportunities that may arise.
- **Consider incorporating diversified commodities exposure**, which tends to perform well alongside inflation and offers a relatively attractive entry point.

"Price Stability" Alive and Well with Low Inflation Volatility



Source: ACG Research, Bureau of Labor Statistics (BLS)

Lack of Wage Pressure Supporting Margin Upside



Source: ACG Research, Bloomberg

Tax Reform: Impact on Real Economy and Markets?

Market View:

- The **passage of US tax reform has generally been met with optimism**, as expectations are calling for a 0.2% to 0.8% boost to near-term GDP.
- Reduction in corporate tax rate from 35% to 21% is expected to **enhance already solid EPS growth projections by 4% to 6% in 2018.**
- **The repatriation provision helps cash flow for multi-national entities**, and could support business spending, special dividends, buybacks, or M&A activity.

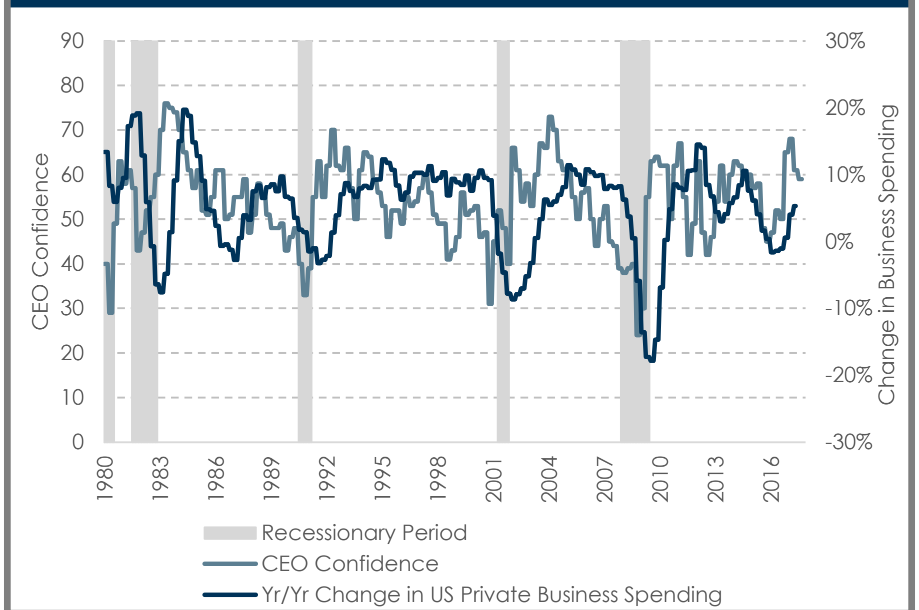
ACG Position:

- Even knowing the details of the law, it's **difficult to precisely judge the impact** on the real economy and markets may have priced in much of the benefit.
- **Adding fiscal stimulus at this stage in the recovery may limit potential upside,** especially considering the opposing action of the Fed and high debt burdens.
- Certainly, not all corporations benefit equally, and this **reform appears to favor well-capitalized firms that have historically paid close to the full rate.**

Portfolio Implications:

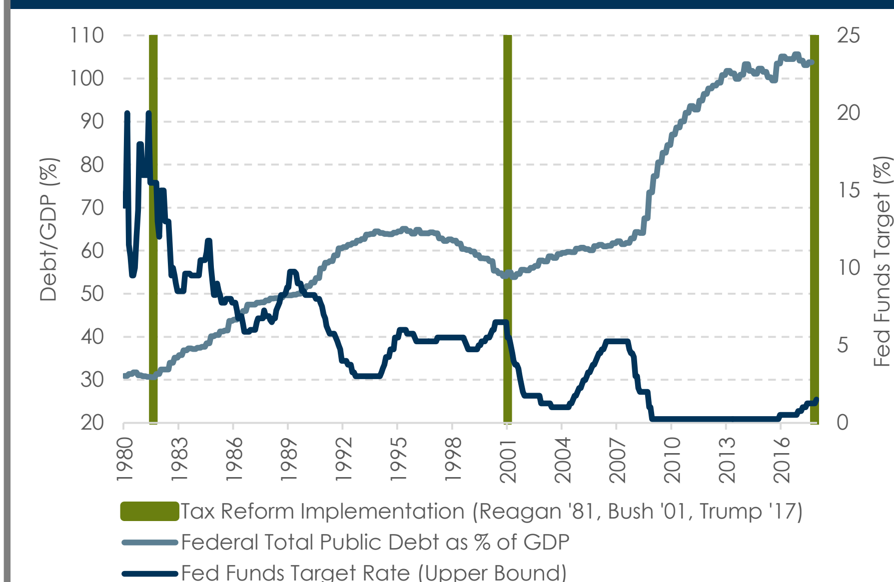
- Maintain targets in large cap US stocks but **remain diligent with rebalancing** given valuations and economic sensitivity.
- Closely monitor overall portfolio allocations relative to strategic objectives, **preserving upside exposure without getting over-extended.**
- **Incorporate hedged strategies** for downside protection, especially as market volatility has been absent for an extended period.

Confidence Supports Business Spending Boost



Source: ACG Research, The Conference Board, Bureau of Economic Analysis (BEA)

Impact on Economic Growth May Be More Restrained



Source: ACG Research, Bloomberg, Federal Reserve, Internal Revenue Service

Recessionary Signals: Inevitable in Time, but How Far Away Are We?

Market View:

- Apart from potential exogenous shocks, there **appears to be little threat of a US or global recession in the coming year.**
- Deceleration in the Leading Economic Indicators provide notice, but **risk assets will likely react once growth momentum moderates.**
- While there are seemingly **no "beta markets" that offer generous forward-looking returns**, the emotional fear of missing out often overtakes discipline.

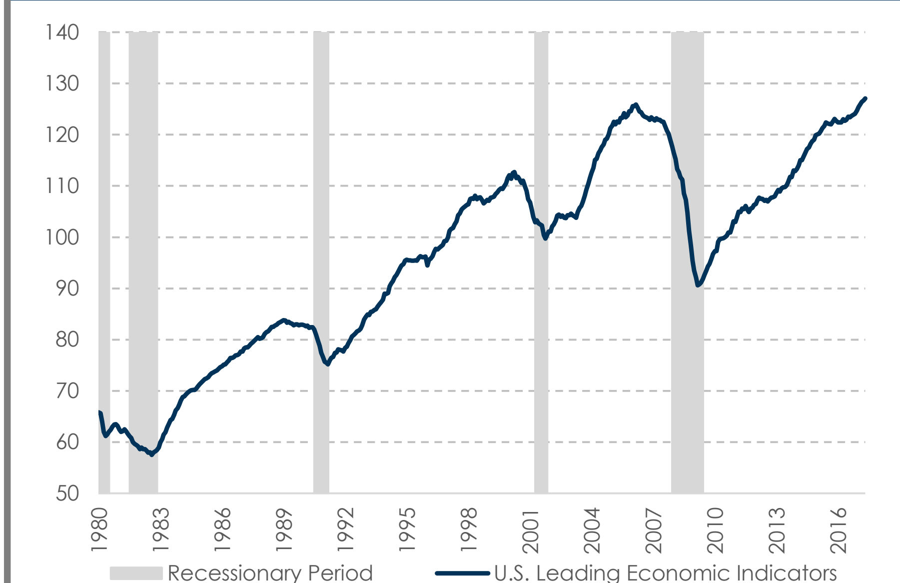
ACG Position:

- **Thus far, traditional late-cycle forces have not overwhelmed** and the extremely deliberate actions of the Fed suggest "murder by rate hikes" is near-term remote.
- A defensive posture may be prudent at this stage of the cycle but "**getting out" or deviating materially from strategic objectives is difficult to time consistently.**
- **Recessionary probabilities are cumulative** and once tighter monetary policy and capacity pressures materialize, tougher times will lie ahead.

Portfolio Implications:

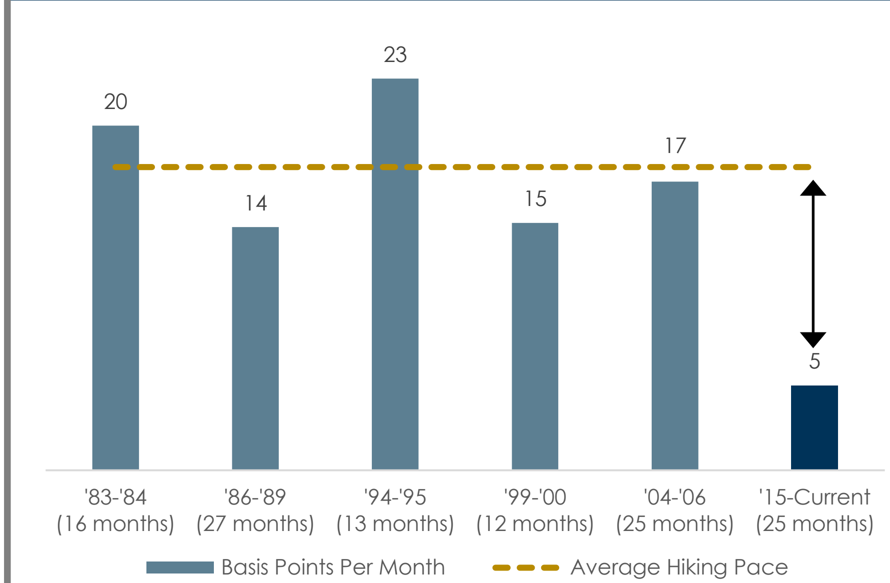
- **Favor international equities,** which offer more attractive relative valuations along with economic cycle and currency diversification.
- Maintain investment discipline and **minimize asset allocation drift** through thoughtful rebalancing and cash flow decisions.
- **Accept the illiquidity premium offered by private investments** as these strategies offer differentiated results and can enhance long-term outcomes.

No Deceleration Yet in the Leading Economic Indicators



Source: ACG Research, Bloomberg, The Conference Board, National Bureau of Economic Research (NBER)

A Slow Fed Could Keep Away the Red



Source: ACG Research, Bloomberg, Federal Reserve

Investment Themes (3-5 Years)

Geopolitical & Policy Uncertainty

- Disparate global fiscal/monetary policies shaded by political polarization and rising inequality
- Left-tail shock events can never be fully discounted, and by definition are disruptive to markets

Maturing Growth Cycle

- Post-crisis recovery entrenched globally, driving improved economic conditions and corporate profitability
- Dependence on policy stimulus to be tested (near-term), alongside the constraint of high debt levels (longer-term)

Fixed Income to Remain Challenging

- Initial conditions are generally unattractive, with low yields across both sovereign and corporate debt
- Central bank policy adjustments to influence supply/demand dynamics, with the potential for increased volatility

Global Inflation Conundrum

- Unprecedented global stimulus and tightening labor markets
- Difficult to fully gauge the influence of technology, global market efficiency, and secular demographic trends

Muted Return Expectations

- Relatively high valuations persist across asset classes, with policy stimulus acting to "pull forward" returns
- Potential for increased market volatility would likely result in a period of mean reversion

Theme #1 – Geopolitical & Policy Uncertainty

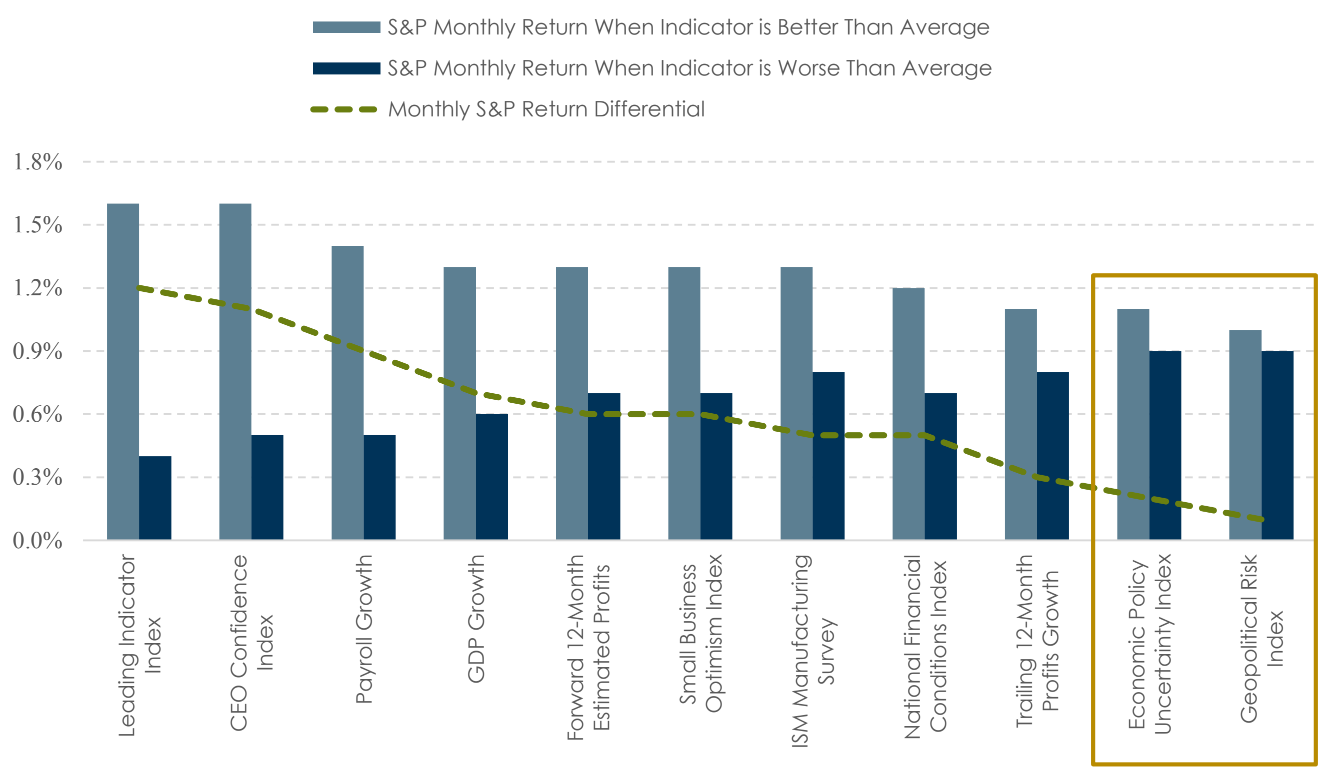
Rationale

- Disparate global fiscal/monetary policies
- Unknown impact of US fiscal stimulus
- Long term constraint from high government debt
- Political polarization and rising inequality
- Terrorism, immigration, nuclear threats, territorial disputes, climate change, social media impact, cyber attacks

Implementation Strategy

- Maintain global diversification; meaningful non-US exposure
- Increase risk-reducing and private strategies
- Maintain disciplined rebalancing strategy

Ranking the Market Impact of Key Investment Signals



Source: ACG Research, JP Morgan, The Conference Board, BLS, BEA, National Federation of Independent Business (NFIB), Institute for Supply Management (ISM), Chicago Fed, S&P, Boston College, Stanford University (data from 1985 to 2017)

Theme #2 – Maturing Growth Cycle

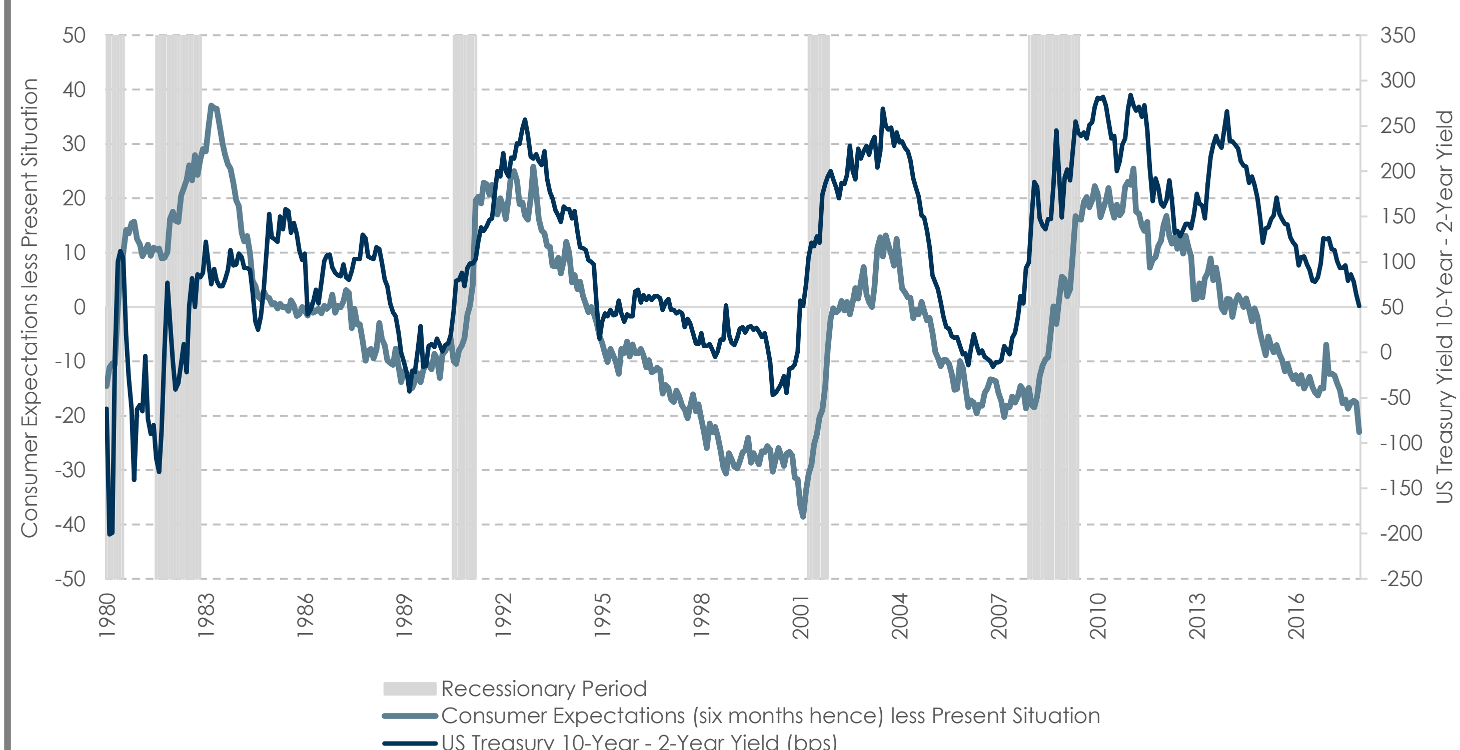
Rationale

- Pro-growth policies in the US and abroad
- Eventual and slow unwind of global monetary policy
- China transitioning to consumer-driven economy, reduced gov't spending
- Improving metrics across regions precedes "peak growth"
- Productivity and population trends remain a challenge

Implementation Strategy

- Emphasize 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/quality orientation

Flattening Yield Curve & Guarded Expectations Typical of Later Stage Growth



Source: ACG Research, Bloomberg, The Conference Board, Federal Reserve

Theme #3 – Fixed Income to Remain Challenging

Rationale

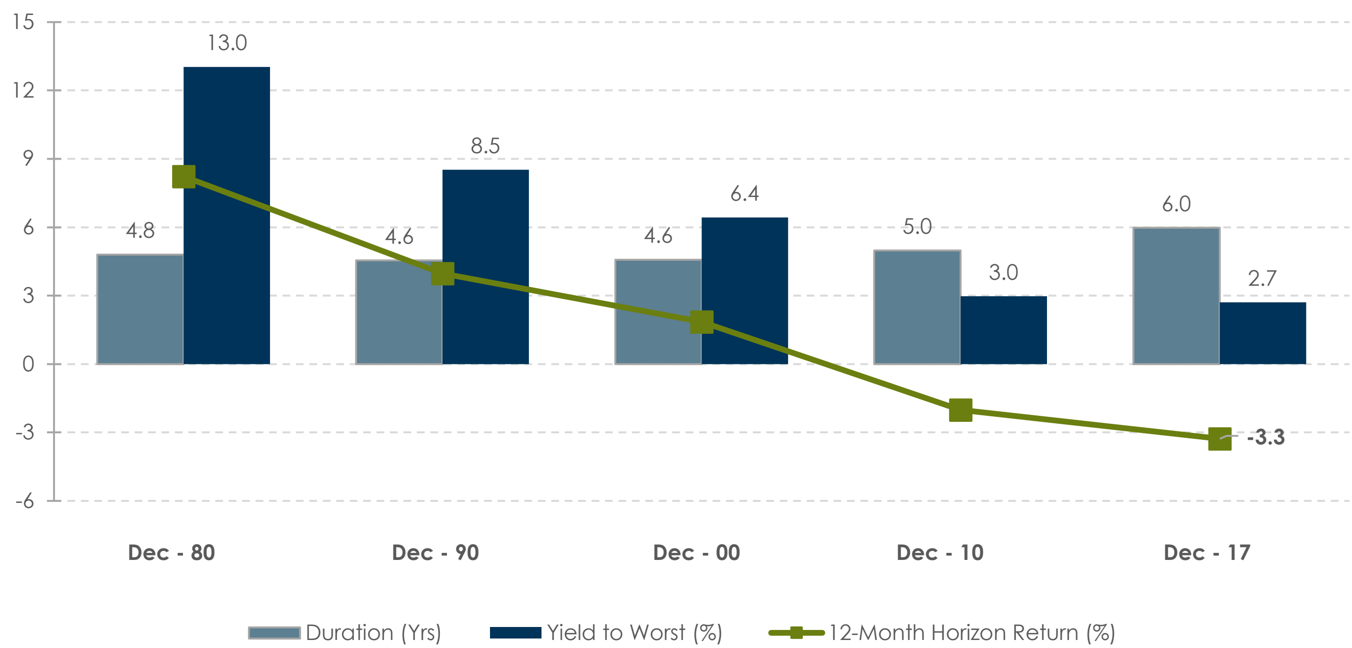
- Stretched sovereign valuations at low yields
- Fed policy normalization underway
- Inflation expectations driving yield volatility
- Later stage of economic/credit cycle
- Liquidity challenges may increase volatility

Implementation Strategy

- Retain high-quality fixed income allocation for diversification
- Favor credit and securitized over sovereign debt
- Opportunistically include exposure to private debt or other yield enhancing strategies (e.g. high yield, EM debt)
- Incorporate absolute return-oriented strategies with the ability to exploit a broad array of opportunities with lower volatility

Current Conditions Are Unforgiving

BloomBar US Aggregate Index
(12-Month Horizon Return for a 100 bps Increase in Yield)



Source: ACG Research, Bloomberg, Barclays Live

Theme #4 – Global Inflation Conundrum

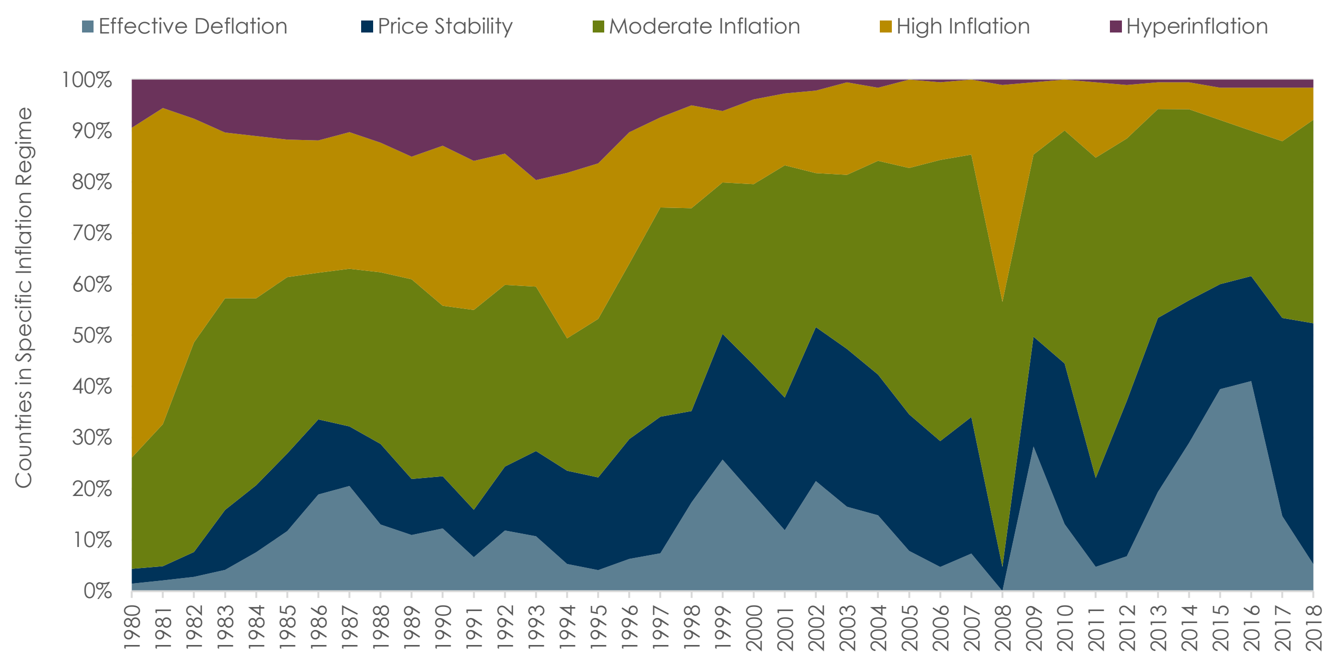
Rationale

- 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?

Implementation Strategy

- Retain meaningful equity exposure given re-pricing ability
- Retain core real estate (RE) exposures
- Incorporate diversified commodity exposure
- Employ active managers with niche strategies

Price Stability at an All-Time High Across 193 Economies



Notes: Effective deflation is below 1%, price stability is between 1% and 3%, moderate inflation is between 3% and 10%, high inflation is between 10% and 40%, and hyperinflation is above 40%.

Source: ACG Research, ACG Research, International Monetary Fund (World Economic Outlook as of October 2017)

Theme #5 – Muted Return Expectations

Rationale	Implementation Strategy

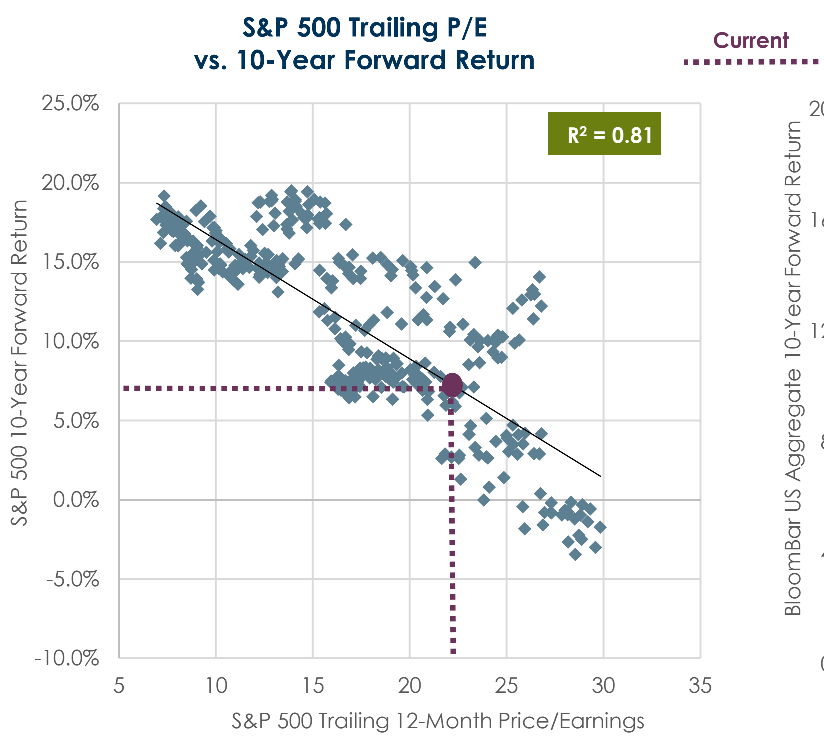
Rationale

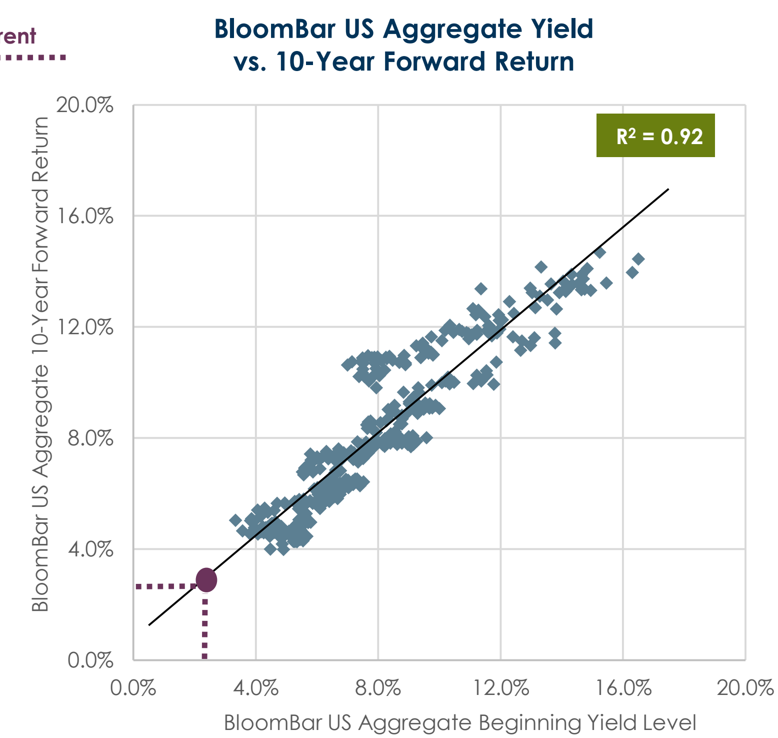
- Relatively high valuations across asset classes
- Shrinking public equity market
- Global economic growth remains positive but tepid
- Longer-term challenges of demographics/debt levels
- Yields and inflation advancing from historic lows

Implementation Strategy

- Revisit/confirm investment objectives, constraints and strategic allocation
- Remain diligent with rebalancing discipline
- Implement private equity and/or debt strategies
- Consider active strategies with enhanced flexibility
- Employ risk-reducing/hedged strategies

Valuation is the Single Greatest Predictor of Future Returns





Source: ACG Research, Bloomberg, Standard & Poor's, Barclays Live (data from 1976 to 2017)

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