



Asset Strategy Consultants

# MARKET ENVIRONMENT

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Second Quarter 2017

# Market Environment: Economy

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*The U.S. economy entered its 96<sup>th</sup> month of expansion, but its pace of growth slowed and economic data was mixed. Inflation was lower than expected. Projections for 2017 U.S. GDP growth were cut by the International Monetary Fund from 2.3% to 2.1% in response to diminished hopes for fiscal stimulus, including tax reform. Overseas, news was brighter.*

- First quarter U.S. GDP growth was revised slightly upward from +1.2% to +1.4%
- The Fed raised its Fed Funds target 25 bps to a range of 1.0% - 1.25%
  - Consistent with expectations
  - Fed also announced its plans to reduce its \$4.5 trillion balance sheet
- Inflation remained stubbornly low as of May
  - Headline CPI +1.9% y-o-y; Core CPI +1.7% y-o-y
  - Personal Consumption Expenditures +1.4% y-o-y; below Fed's 2% target for nearly 5 years
- Unemployment fell to a 15-year low of 4.3%
  - Declining workforce participation continued to influence this metric
  - Wage growth remained elusive
- Vehicle sales were down from record high set in 2016
- Median home price reached new high: \$345,800
- Euro zone first quarter GDP +2.3% (annualized)
  - The highest in two years
- Euro zone unemployment dropped to 9.3%
  - The lowest since 2009
- Inflation in the U.K. hit a four-year high of 2.9% y-o-y in May
  - A weaker pound, post Brexit news, has been a key driver
- Japanese first quarter GDP +1.3% (annualized)
  - Fifth quarter of expansion; the longest in more than ten years
- Chinese first quarter GDP +6.9% (annualized)
  - Stronger than expected
  - Manufacturing data also beat expectations



# Market Environment: Fixed Income

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*Intermediate and long U.S. Treasury yields fell modestly in the second quarter as inflation data remained persistently weak. Short rates rose, consistent with the Fed hike, and thus the yield curve flattened. Risky assets continued their long streak of outperformance. Overseas, broad-based U.S. dollar weakness boosted returns.*

- U.S. Aggregate Index up 1.4%; +2.3% y-t-d
  - Corporate bonds performed the best on strong demand
- High yield performed well but lagged investment grade corporates
  - Blmbg Barc High Yield Corporate Index +2.2%; +4.9% y-t-d
  - Blmbg Barc Corporate Index +2.5%; +3.8% y-t-d
- Municipal bonds outperformed Treasuries
  - Results were bolstered by lowered expectations for tax reform and favorable supply/demand technicals
  - Blmbg Barc Municipal Bond Index +2.0%; + 3.6%
  - Blmbg Barc US Treasury Index +1.2%; +1.9% y-t-d
- TIPS underperformed as expectations for inflation sank
  - Blmbg Barc U.S TIPS Index -0.4%; +0.9% y-t-d
  - 10-year breakeven spread was 1.73% as of quarter-end
- Foreign bonds (unhedged) helped by weaker dollar
  - Blmbg Barc Global Aggregate ex-US (unhedged): +3.5%; +6.1% y-t-d
  - Blmbg Barc Global Aggregate ex-US (hedged): +0.6%; +0.6% y-t-d
  - U.S. dollar lost nearly 7% versus the euro and almost 5% versus a broad basket of developed markets currencies
- Emerging markets debt posted strong returns
  - Dollar-denominated JPM EMBI Global Diversified Index +2.2%; +6.2% y-t-d
  - Local currency-denominated JPM GBI-EM Global Diversified Index +3.6%; +10.4% y-t-d



# Market Environment: Global Equity

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*In the U.S., the S&P 500 Index hit a new high. Investors focused on climbing after-tax corporate profits rather than stalled pro-growth initiatives and ongoing political drama. Non-US markets were bolstered by dollar weakness and outperformed U.S. markets.*

## U.S. Equity

- Large stocks outperformed mid and small caps
  - S&P 500 +3.1%; +9.3% y-t-d
  - Russell Mid Cap +2.0%; +8.0% y-t-d
  - Russell 2000 +2.5%; +5.0% y-t-d
- Growth outperformed value
  - Russell 1000 Value +1.3% vs. Growth +4.7%
  - Russell 2000 Value +0.7% vs. Growth +4.4%
  - Growth was bolstered by Technology sector while value was hurt by Energy stocks
- Sector returns divergent in S&P 500
  - Health Care (+7.1%), Industrials (+4.7%), Financials (+4.2%) and Technology (+4.1%) were strong performers
  - Telecom (-7.0%) and Energy (-6.4%) were the worst

## International Equity

- Developed markets outperformed U.S.
  - MSCI EAFE +6.1%; +13.8% y-t-d
  - Small cap outperformed (MSCI EAFE Sm Cap +8.1%; +16.7% y-t-d)
  - Gains were broad-based and helped by U.S. dollar weakness
- Emerging markets modestly outperformed
  - MSCI EM +6.3%; +18.4% y-t-d
  - BRICs:
    - ❖ *Brazil (-6.7%) on widening corruption charges*
    - ❖ *China (+10.6%) on better than anticipated growth*
    - ❖ *Russia (-10.0%) on falling oil prices and strained U.S. relations*
    - ❖ *India (+2.9%) but remains a top performer y-t-d at +21%*



# Market Environment: Liquid Real Assets

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*Real assets had a tough quarter with few exceptions. Oil prices fell on supply concerns. Gold reversed some of its first quarter gains. TIPS fell on declining inflation expectations.*

- Oil prices fell 10% over the second quarter
  - WTI was at \$47 at quarter-end
- Commodities lost ground
  - Bloomberg Commodity Index -3.0%; -5.3% y-t-d
- Gold down after a strong first quarter
  - Nearly -1.0% for the quarter; +7.9% y-t-d
- MLPs suffered alongside oil
  - Alerian MLP -6.4%; -2.7% y-t-d
- REITs up modestly
  - MSCI REIT +1.7%; +2.7% y-t-d
- Inflation remained stubbornly low
  - Headline CPI +1.9% y-o-y; Core CPI +1.7% y-o-y
  - PCE Price Index +1.4%
- TIPS underperformed as expectations for inflation sank
  - Bloomberg Barclays U.S. TIPS Index -0.4%; +0.9% y-t-d
  - 10-year breakeven spread was 1.73% as of quarter-end
- Global Infrastructure posted strong gains
  - DJB Global Infrastructure Index +3.7%; +11.5% y-t-d



# Returns for Various Periods

	Last Qtr.	Year to Date	Last Yr.	Last 2 Yrs.	Last 3 Yrs.	Last 5 Yrs.	Last 7 Yrs.	Last 10 Yrs.
<b>Capital Growth</b>								
Russell:3000 Index	3.00	8.90	18.50	<b>10.00</b>	<b>9.10</b>	14.60	15.30	7.30
Russell:1000 Index	3.10	9.30	18.00	<b>10.20</b>	<b>9.30</b>	14.70	15.40	7.30
Russell:1000 Growth	4.70	14.00	20.40	<b>11.40</b>	<b>11.10</b>	15.30	16.50	8.90
Russell:1000 Value	1.30	4.70	15.50	<b>9.00</b>	<b>7.40</b>	13.90	14.30	5.60
Russell:1000 Def Index	2.70	8.40	11.40	<b>10.80</b>	<b>9.20</b>	13.50	15.10	7.50
Russell:1000 Dyn Index	3.50	10.20	24.90	<b>9.40</b>	<b>9.10</b>	15.70	15.60	6.80
Russell:Midcap Index	2.70	8.00	16.50	<b>8.20</b>	<b>7.70</b>	14.70	15.30	7.70
Russell:2500 Index	2.10	6.00	19.80	<b>7.40</b>	<b>6.90</b>	14.00	14.80	7.40
Russell:2500 Growth	4.10	10.60	21.40	<b>5.90</b>	<b>7.70</b>	14.30	15.50	8.20
Russell:2500 Value	0.30	2.00	18.40	<b>8.90</b>	<b>6.20</b>	13.70	14.10	6.50
Russell:2000 Index	2.50	5.00	24.60	<b>7.80</b>	<b>7.40</b>	13.70	14.40	6.90
Russell:2000 Growth	4.40	10.00	24.40	<b>5.40</b>	<b>7.60</b>	14.00	15.20	7.80
Russell:2000 Value	0.70	0.50	24.90	<b>10.30</b>	<b>7.00</b>	13.40	13.50	5.90
S&P:500	3.10	9.30	17.90	<b>10.70</b>	<b>9.60</b>	14.60	15.40	7.20
S&P:400 Mid Cap	2.00	6.00	18.60	<b>9.60</b>	<b>8.50</b>	14.90	15.40	8.60
S&P:600 Small Cap	1.70	2.80	22.50	<b>10.60</b>	<b>9.30</b>	15.50	16.20	8.40
MSCI:ACWI ex US	5.80	14.10	20.50	<b>4.00</b>	<b>0.80</b>	7.20	6.70	1.10
MSCI:EAFE	6.10	13.80	20.30	<b>3.90</b>	<b>1.10</b>	8.70	7.90	1.00
MSCI:EM	6.30	18.40	23.70	<b>4.30</b>	<b>1.10</b>	4.00	3.90	1.90
MSCI:EAFE Small Cap	8.10	16.70	23.20	<b>8.90</b>	<b>5.60</b>	12.90	11.40	3.40
MSCI:ACWI	4.30	11.50	18.80	<b>6.90</b>	<b>4.80</b>	10.50	10.50	3.70
MSCI:World	4.00	10.70	18.20	<b>7.20</b>	<b>5.20</b>	11.40	11.40	4.00
<b>Real Assets</b>								
Blmbg:US TIPS	-0.40	0.90	-0.60	<b>1.80</b>	<b>0.60</b>	0.30	2.90	4.30
Blmbg:Commodity TR Idx	-3.00	-5.30	-6.50	<b>-10.00</b>	<b>-14.80</b>	-9.20	-5.70	-6.50
GS Commodity Index	-5.50	-10.20	-9.00	<b>-18.00</b>	<b>-24.80</b>	-13.70	-8.50	-9.70
S&P:1200 Materials Idx	2.20	10.20	25.20	<b>6.60</b>	<b>0.30</b>	4.40	4.70	0.90
S&P:1200 Energy Idx	-4.90	-9.20	-0.50	<b>-2.00</b>	<b>-10.60</b>	0.40	4.20	-0.10
MSCI:US REIT Index	1.70	2.70	-1.80	<b>10.40</b>	<b>8.20</b>	9.40	13.20	5.90
FTSE:NAREIT Equity Index	1.50	2.70	-1.70	<b>10.40</b>	<b>8.40</b>	9.50	13.20	6.00
Alerian:MLP Index	-6.40	-2.70	0.40	<b>-6.60</b>	<b>-11.20</b>	1.80	6.00	5.70
S&P:Gold Spot Price Ix	-0.70	7.90	-5.90	<b>3.00</b>	<b>-2.10</b>	-5.00	0.00	6.70
US DOL:CPI All Urban Cons	0.50	1.50	1.60	<b>1.30</b>	<b>0.90</b>	1.30	1.70	1.60
DJB:Glbl Infrastructure	3.70	11.50	8.00	<b>5.60</b>	<b>2.40</b>	9.60	12.80	7.00
<b>Fixed Income</b>								
Blmbg:Aggregate	1.40	2.30	-0.30	<b>2.80</b>	<b>2.50</b>	2.20	3.20	4.50
Blmbg:Gov/Credit	1.70	2.70	-0.40	<b>3.10</b>	<b>2.60</b>	2.30	3.40	4.60
Blmbg:Credit 1-5 Yr	0.80	1.70	1.30	<b>2.20</b>	<b>1.90</b>	2.20	2.80	3.80
Blmbg:Corporate High Yld	2.20	4.90	12.70	<b>7.00</b>	<b>4.50</b>	6.90	8.20	7.70
Blmbg:Municipal Bond	2.00	3.60	-0.50	<b>3.50</b>	<b>3.30</b>	3.30	4.20	4.60
Blmbg:US TIPS	-0.40	0.90	-0.60	<b>1.80</b>	<b>0.60</b>	0.30	2.90	4.30
Blmbg:Glob Agg ex USD	3.50	6.10	-3.80	<b>3.50</b>	<b>-2.40</b>	-0.40	1.80	3.00
S&P:LSTA Levlg Loan	0.80	1.90	7.40	<b>4.10</b>	<b>3.40</b>	4.60	5.10	4.50
ML:US Treasuries 1-3 Yrs	0.20	0.40	-0.10	<b>0.60</b>	<b>0.70</b>	0.60	0.80	1.90
LIBOR - 3 Month	0.30	0.60	1.00	<b>0.70</b>	<b>0.60</b>	0.50	0.40	1.00
3 Month T-Bill	0.20	0.30	0.50	<b>0.30</b>	<b>0.20</b>	0.20	0.20	0.60

