

Market Environment

Third Quarter 2017



ASSET STRATEGY
CONSULTANTS

6 North Park Drive | Suite 208
Hunt Valley, MD 21030
Tel 410-528-8282 | Fax 410-528-8305
mail@assetstrategyconsultants.com
www.assetstrategyconsultants.com

Global Economy

Second quarter real GDP growth was revised up to 3.1% (annualized), the fastest pace since the first quarter of 2015. While hurricanes Harvey and Irma may provide a temporary setback to U.S. growth, rebuilding efforts are likely to provide a boost to GDP in the fourth quarter and into 2018. Developed markets economies outside of the U.S. continued to gain traction.

- The Fed left rates unchanged at its September meeting
 - 12 of the 16 FOMC members expect one more hike this year and markets put that probability at about 70%
 - Tapering will begin in October
 - Vice Chairman Stanley Fischer resigned and Janet Yellen's term as Chair expires in February 2018 with no clear replacement
- Inflation continued to fall short of the Fed's 2% target
 - Headline CPI was 1.9% as of August (year-over-year)
 - Core CPI was 1.7%
 - Both were unchanged from levels three months ago
 - Fed's favored measure, the PCE price deflator, gained 1.4% year-over-year (also unchanged)
- Unemployment fell in September to 4.2% but hurricane impact cut payrolls slightly
 - Wage growth pushed up 2.9% (year-over-year). Prior month's revisions upward were also large.
- Manufacturing showing signs of strength
 - ISM Index reached 58.8 in August (anything above 50 signals expansion)
 - The September reading, released in early October, rose to 60.8 with both its employment and new orders components signaling broad-based strength
- Euro zone 2nd quarter GDP growth +2.3% (annualized)
 - Confidence ticks up to highest level since 2013
- ECB President Draghi indicated that decisions around tapering bond purchase program are imminent
 - Policy rates left unchanged
- Euro zone inflation remains low
 - August headline CPI +1.5 year-over-year; Core +1.2%
- Japan 2nd quarter GDP growth +2.5%
 - Less than expected but sixth consecutive quarter of growth
- Strong data from China
 - But S&P downgrades to A+ on concerns over credit growth
- Manufacturing outside of U.S. also robust
 - In developed markets, numbers are strong across the board
 - Emerging markets less strong, but generally above 50 (signaling expansion)



Fixed Income

Interest rates were range-bound during the third quarter. The yield on the 10-year U.S. Treasury closed the quarter at 2.33%, only two basis points higher than at the end of the second quarter. The risk-on environment continued and lower quality securities outperformed.

- U.S. Aggregate Index up 0.8%; +3.1% y-t-d
 - Corporate bonds performed the best on strong demand
- High yield corporates outperformed investment grade
 - Blmbg Barc High Yield Corporate Index +2.0%; +7.0 y-t-d
 - Blmbg Barc Corporate Index +1.3%; +5.2% y-t-d
- Municipal bonds benefited from strong technicals
 - Supply down 17% from 2016 through September
 - Blmbg Barc Municipal Bond Index +1.1%; + 4.7% y-t-d
 - Lower quality outperformed
- TIPS outperformed nominal Treasuries
 - Blmbg Barc U.S TIPS Index +0.9%
 - 10-year breakeven spread was 1.84% as of quarter-end, up from 1.75% at the end of the second quarter
- Foreign bonds (unhedged) helped by weaker dollar
 - Blmbg Barc Global Aggregate ex-US (unhedged): +2.5%; +8.7% y-t-d
 - Blmbg Barc Global Aggregate ex-US (hedged): +0.7%; +1.3% y-t-d
 - U.S. dollar lost 3% over the quarter versus a broad basket of developed markets currencies
- Emerging markets debt posted strong returns
 - Dollar-denominated JPM EMBI Global Diversified Index +2.6%; +9.0% y-t-d
 - Local currency-denominated JPM GBI-EM Global Diversified Index +3.6%; +14.3% y-t-d



Global Equity

In the U.S, the S&P 500 Index gained 4.5% in the third quarter and is up 14.2% for the year. Several U.S. stock market indices hit record highs going into quarter-end as investors shrugged off bad news and pinned their hopes on meaningful tax reform. Non-US markets were bolstered by growing economies and U.S. dollar weakness.

U.S. Equity

- Small caps outperformed large caps across styles for the quarter, but trail on a year-to-date basis
 - S&P 500 +4.5%; +14.2% y-t-d
 - Russell 2000 +5.7%; +10.9% y-t-d
- Growth outperformed value
 - Growth +5.9% vs. Russell 1000 Value +3.1%
 - Growth +6.2% vs. Russell 2000 Value +5.1%
 - A handful of Technology stocks continued to fuel the growth indices' returns, especially in the large cap space
- Tech and Energy sectors lead in S&P
 - Both up 8.6%
 - Consumer Staples (-1.3%) was the sole sector to deliver a negative result for quarter

International Equity

- Developed markets also performed well
 - MSCI EAFE +5.4%; +20.0% y-t-d
 - Gains were broad-based with several countries posting double-digit returns
 - U.S. dollar continued to weaken, down 3-4% versus the euro, Canadian dollar, and the U.K. pound
 - Small cap outperformed (MSCI EAFE Sm Cap +8.1%; +16.7% y-t-d)
 - Energy and Materials posted double-digit gains
 - Health Care and Consumer Staples were laggards with results of less than 1%
- Emerging markets outperformed developed markets
 - MSCI EM +7.9%; +28.0% y-t-d
 - BRICs:
 - Brazil (+22.9%) as political worries diminished and economy showed signs of improvement
 - China (+14.7) on better than anticipated growth
 - Russia (+17.6%) as oil rebounded
 - India (+3.0%) muted on disappointing growth



Liquid Real Assets

Real assets generally performed well in the 3rd quarter.

- Brent crude oil prices rose nearly 20% for the quarter on relatively strong demand and signs that OPEC's production cuts may be easing the supply glut
 - Brent crude closed the quarter at nearly \$58
- Commodities indices gained
 - The energy-heavy S&P GSCI Commodity Index + 7.2%
 - More diversified Bloomberg Commodity Index +2.5%
- Gold up 3.4%
- The Alerian MLP Index declined in spite of rising oil prices
 - Alerian MLP -3.0%; -5.6% y-t-d
 - Index was hurt by one of its largest constituents cutting its dividend
- REITs up modestly
 - S&P Global REIT +1.4%; MSCI US REIT +0.9%
- TIPS outperformed on rising expectations for inflation
 - Bloomberg Barclays U.S. TIPS Index +0.9%; +1.7% y-t-d
 - 10-year breakeven spread was 1.84% as of quarter-end
- Global Infrastructure up as well
 - DJB Global Infrastructure Index +3.3%; +15.2% y-t-d



Index Returns

RETURNS FOR VARIOUS PERIODS - September 30, 2017											
	Last Mo.	Mo. Ending 8/31/17	Mo. Ending 7/31/17	Last Quarter	Last 2 Quarters	Last 3 Quarters	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
MSCI:ACWI	1.93	0.38	2.79	5.18	9.68	17.25	18.65	7.43	10.20	3.88	9.13
Russell:3000 Index	2.44	0.19	1.89	4.57	7.72	13.91	18.71	10.74	14.23	7.57	10.37
Russell:3000 Growth Index	1.62	1.68	2.52	5.93	10.86	20.43	21.87	12.65	15.18	9.03	10.73
Russell:3000 Value Index	3.26	-1.26	1.28	3.27	4.60	7.72	15.53	8.79	13.20	6.01	9.89
MegaCap											
Russell:Top 50	1.36	1.12	2.20	4.75	7.43	14.50	18.45	10.82	13.00	6.85	8.94
Russell:Top 200	1.88	0.74	2.18	4.88	8.23	15.14	19.84	11.06	14.26	7.35	9.60
Russell:Top 200 Growth	0.82	2.20	2.98	6.10	11.22	21.91	23.39	13.73	15.69	9.48	10.31
Russell:Top 200 Value	3.07	-0.83	1.33	3.58	4.96	8.16	15.95	8.26	12.72	5.15	8.87
Large Cap											
S&P:500	2.06	0.31	2.06	4.48	7.71	14.24	18.61	10.81	14.22	7.44	10.04
Russell:1000 Index	2.13	0.31	1.98	4.48	7.68	14.17	18.54	10.63	14.27	7.55	10.29
Russell:1000 Growth	1.30	1.83	2.66	5.90	10.84	20.72	21.94	12.69	15.26	9.08	10.65
Russell:1000 Value	2.96	-1.16	1.33	3.11	4.50	7.92	15.12	8.53	13.20	5.92	9.82
MidCap											
S&P:400 Mid Cap	3.92	-1.53	0.88	3.22	5.26	9.40	17.52	11.18	14.43	9.00	11.97
Russell:Midcap Index	2.77	-0.78	1.47	3.47	6.27	11.74	15.32	9.54	14.26	8.08	12.20
Russell:Midcap Growth	2.83	0.71	1.67	5.28	9.72	17.29	17.82	9.96	14.18	8.20	12.12
Russell:Midcap Value	2.73	-1.87	1.33	2.14	3.54	7.43	13.37	9.19	14.33	7.85	12.07
Small Cap											
S&P:600 Small Cap	7.71	-2.56	0.97	5.96	7.78	8.92	21.05	14.07	15.60	9.27	12.34
Russell:2000 Index	6.24	-1.27	0.74	5.67	8.27	10.94	20.74	12.18	13.79	7.85	11.37
Russell:2000 Growth	5.45	-0.12	0.85	6.22	10.88	16.81	20.98	12.17	14.28	8.47	11.78
Russell:2000 Value	7.08	-2.46	0.63	5.11	5.81	5.68	20.55	12.12	13.27	7.14	10.86
Russell:Microcap	8.15	-0.83	-0.56	6.65	10.74	11.16	22.33	12.16	13.89	6.65	10.76
Non-US Equity											
MSCI:ACWI ex US	1.86	0.52	3.69	6.16	12.30	21.13	19.61	4.70	6.97	1.28	8.88
MSCI:EAFE	2.49	-0.04	2.88	5.40	11.86	19.96	19.10	5.04	8.38	1.34	8.26
MSCI:EAFE Growth	1.89	0.56	2.42	4.94	12.83	22.45	15.68	6.48	8.89	2.12	8.17
MSCI:EAFE Value	3.08	-0.62	3.34	5.87	10.93	17.63	22.55	3.50	7.80	0.49	8.26
MSCI:EAFE Small Cap	2.85	0.82	3.62	7.46	16.16	25.42	21.84	11.13	12.85	4.63	11.77
MSCI:EM	-0.40	2.23	5.96	7.89	14.66	27.78	22.46	4.90	3.99	1.32	12.49
Fixed Income											
Blmbg:Aggregate	-0.48	0.90	0.43	0.85	2.31	3.14	0.07	2.71	2.06	4.27	4.23
Blmbg:US TIPS	-0.64	1.06	0.45	0.86	0.46	1.72	-0.73	1.62	0.02	3.90	4.38
Blmbg:Long Gov/Credit	-0.96	2.25	0.26	1.53	5.98	7.65	-0.79	5.45	3.94	7.37	6.70
Blmbg:Long Credit A	-0.40	1.62	0.71	1.92	6.82	7.98	1.82	6.25	4.68	7.16	6.59
Blmbg:High Yield Cash Pay	0.90	-0.04	1.11	1.98	4.18	6.99	8.86	5.82	6.36	7.85	9.35
Blmbg:Muni 1-10 Yr	-0.51	0.56	0.68	0.73	2.13	3.72	1.00	2.20	2.12	3.77	3.57
Blmbg:Glob Agg ex USD	-1.26	1.07	2.68	2.48	6.11	8.74	-2.42	0.20	-0.73	2.57	4.56
Blmbg:Glob Agg ex USD H	-0.47	0.93	0.23	0.68	1.27	1.33	-0.55	3.40	3.74	4.29	4.22
JPM:EMBI Plus	-0.11	1.92	0.41	2.23	4.69	8.64	2.86	6.30	4.03	7.10	10.04
Other Assets											
Blmbg:Commodity TR Idx	-0.15	0.40	2.26	2.52	-0.56	-2.87	-0.29	-10.41	-10.47	-6.83	-0.31
CS Commodity Index	3.32	-0.78	4.58	7.22	1.36	-3.76	1.79	-19.56	-14.38	-10.02	-2.89
S&P:Gold Spot Price Ix	-2.83	3.83	2.50	3.42	2.69	11.56	-2.45	1.97	-6.25	5.53	9.59
FTSE:NAREIT Equity Index	-0.03	-0.25	1.22	0.94	2.47	3.67	0.67	9.86	9.69	5.83	10.82
Alerian:MLP Index	0.69	-4.94	1.29	-3.05	-9.21	-5.62	-3.70	-12.93	-0.57	6.49	11.04

