Market Environment

First Quarter 2018

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

The U.S. macroeconomic environment remained relatively healthy during the first quarter as 4th quarter GDP was revised upward from 2.5% to 2.9%. The U.S. unemployment rate of 4.1% is the lowest since 2000 while inflation pressures remain modest given the length of the economic expansion and tight labor markets. Several geopolitical issues continue to drive uncertainty about future global economic growth, including President Trump's actions relating to trade negotiations and potential conflict with Russia and North Korea given recent sanctions over their threatening behavior. Outside the U.S., economic activity across the Euro zone remained solid despite high unemployment rate of 8.6%; Japan appears to be on a solid footing, while China's growth is being tempered by calls for economic and trade reforms.

- **The Fed raised its target**
  - Targeting Fed Fund range of 1.50 % – 1.75%
  - New Fed Chair, Jerome Powell, announced his first rate hike in March
  - Market projecting another two hikes this year, and three to four more in 2019
- **Inflation notched higher**
  - Headline CPI +2.3% as of February (year-over-year)
  - Core CPI was +1.9%
  - Estimates for Personal and Disposable Personal Income both increased by 0.4% in February
- **Unemployment rate sunk further to 4.1%**
  - Lowest unemployment rate since 2000
- **Strong corporate earnings**
  - Supported by recent tax cuts
  - February IBES estimates : anticipating another year of strong EPS growth of nearly 20%
- **Existing home sales bounced back in February**
  - Current sales 1.1% above a year ago (after two straight months of declines)
- **Geopolitical tensions add to uncertainty**
- **Euro area GDP growth continued to hover above 2%**
  - Unemployment still trended lower: 8.6% as of January 2018
  - Inflation remained manageable at just over 1% as of February
- **Political risks remain within Eurozone**
  - Uncertainty around Italy's ability to manage coalition talks
  - Ongoing Brexit-related negotiations between the U.K. and European Union
- **Japan shows strength**
  - 4th quarter GDP +2.0%
  - Unemployment rate continued to decline to 2.5% as of February
  - Wage growth ticked up slightly to 0.8% as of January
  - CPI rose by 1.5% y-o-y in February
  - GDP is expected to boost from 2020 Tokyo Olympics-related spending in the coming quarters

- **China continues to target healthy growth in challenging economic and geopolitical environment**
    - Targeting growth around 6.5%
    - The market remained focused on the country's ability to balance much-needed supply-side reform
    - Growing trade-related tensions between the U.S. and China continue to be an area of concern

Fixed Income

Through the first two months of the first quarter, the 10-year U.S. Treasury yield marched steadily higher on the heels of positive economic data, only to fall through March as equity market weakness and concerns over a looming trade war pushed yields lower. Municipal bonds underperformed Treasuries in the first quarter in spite of shrinking supply and continued inflows to the sector. Conversely, non-U.S. fixed income market returns benefited from U.S. dollar weakness.

- **Yields rise**
  - The 10-year U.S. Treasury yield climbed up to a peak of nearly 3% before closing at 2.74%, 34 bps higher than at year-end
  - The 2-year U.S. Treasury yield rose nearly 40 bps to their highest level since 2008, closing the quarter at 2.27%
- **U.S. Aggregate Bond Index fell 1.5% for the quarter**
  - Corporate and securitized sectors underperformed Treasuries for the first time in many quarters
- **High yield corporates suffered outflows**
  - Bloomberg High Yield Corporate Index: -0.9%
- **Short term credits and leveraged loans benefited from higher rates**
  - The S&P/LSTA Leveraged Loan 100 Index rose 1.4%
- **Currency movements drove global fixed income returns more than interest rate changes**
  - Bloomberg Global Aggregate ex-U.S. (hedged): -0.1%
  - Bloomberg Global Aggregate ex-U.S. (unhedged): +1.4%
- **Emerging markets debt delivered muted returns**
  - Credit underperformed government bonds
  - Local currency emerging markets debt was a top performing asset class: local currency-denominated JPM GBI-EM Global Diversified Index returned +4.4% in Q1
  - Spreads widened in sympathy with the broader risk-off environment: U.S. Dollar-denominated JPM EMBI Global Diversified Index returned -1.7% in Q1

Global Equity

Volatility returned to U.S. equity markets in February and March, spurred by an unexpected uptick in wage gains, geopolitical tensions, and a looming threat of a trade war. The S&P 500 Index saw six days of movements greater than 2% during the quarter versus zero 2% swings in all of 2017; ultimately, the benchmark fell 0.8% which is its first quarterly loss since 2015. This modest loss belied volatile intra-quarter results where the S&P 500 reached a record high on January 26, then fell about 8% to close the quarter. Most non-U.S. markets also posted negative results in local terms, however a weakening U.S. dollar benefited U.S.-based investors. Emerging Markets were one of the only market segments to generate positive results for the quarter.

U.S. Equity

- **Small caps outperformed large caps across style**
  - S&P 500: -0.8%
  - Russell 2000: -0.1%
- **Growth outperformed value for the quarter**
  - Russell Growth: +1.4% vs. Russell 1000 Value: -2.8%
  - Russell Growth: +2.3% vs. Russell 2000 Value: -2.6%
- **Volatility Surges**
  - Biggest jump ever recorded, albeit from historically low levels
  - VIX spiked 116% on Feb 5 when the market sank 4%
- **Consumer Discretionary and Technology lead the S&P**
  - Both up by more than 3%
  - Amazon (+24%) and Netflix (+54%) were key drivers
  - High-flying tech stocks - "FAAMG" - experienced volatility and divergence of returns:

	QTD
Facebook	-9.45%
Apple	-0.48%
Amazon	23.76%
Microsoft	7.19%
Google (Alphabet A&C)	-2.94%

- **Consumer Staples and Telecommunication were laggards; both fell by more than 7%**

International Equity

- **Currency**
  - Most major Developed Market currencies rose vs. the U.S. Dollar
  - Emerging Market currencies appreciated vs. the U.S. Dollar, with exceptions to the Indian Rupee and Philippine Peso
  - Growing worries over a trade war with China
  - Signs that rates may be poised to rise in other countries as global economies improve

- **Developed markets**
    - MSCI EAFE: -1.5% in USD terms; -4.3% in local terms
    - Japan's equity benchmark fell by nearly 6% in local terms, but was up +0.8% in U.S. dollar terms due to the strength of yen
    - U.K. market posted -8% in local terms but -4% in USD terms due to pound's appreciation
    - Utilities (+1.3%) and Technology (+1.1%) were the best performers; Telecommunications (-3.9%) and Materials (-3.8%) were laggards
- **Emerging Markets**
    - MSCI EM USD: +1.4%
    - BRICs: Brazil (+12.4%); Russia (+9.4%); India (-7%); China (+1.8%)
    - Energy (+7.5%) and Health Care (+7%) were the top contributors; Technology posted a modest gain of just over 2%; Consumer Discretionary fell by 6.1% mostly in India, Mexico and UAE

Liquid Real Assets

Commodities were among the top-performing major asset classes in the first quarter of 2018 as strong grain and crude-oil prices offset weak livestock and base metal performance.

- **Brent crude oil prices closed the quarter at $66.31/barrel, highest since 2014.**
- **Commodities indices mixed**
  - The energy-heavy S&P GSCI Commodity Index was up +4.8% while the more diversified Bloomberg Commodity Index was down -0.4%
  - Despite higher crude prices, the S&P Energy sector underperformed (-6%) as the market appears skeptical that the rise in Oil prices can be sustained over the longer term
- **Gold shines, Industrial and Precious Metals Mixed**
  - S&P Gold Spot Price Index: +1.4%
  - Wide dispersion within the Industrial Metals sub-sector: Nickel was up +4% while Aluminum was down -12%
  - Outside of Gold, other key Precious Metals underperformed during the quarter: Platinum slightly down -0.75% and Silver down -5%
  - Agriculture was the largest contributor (within the S&P GSCI), led by Corn, Soybeans, and Wheat
- **Master Limited Partnerships continued to decline in spite of rising oil prices**
  - Alerian MLP Index down -11% on rate hike concerns and the negative ruling by FERC on March 14, which led to a widespread sell-off across the sector
- **Listed Infrastructure and Real Estate posted negative returns**
  - DJ-Brookfield Global Infrastructure Index: -5.3%
  - MSCI U.S. REIT Index: -8.4%
  - MSCI World REIT Index: -3.8%
- **TIPS outperformed nominal Treasuries**
  - Bloomberg Barclays U.S. TIPS Index: -0.8%
  - 10-yr Breakeven Inflation Rate at 2.05% as of March 29

Index Returns

PRELIMINARY RETURNS FOR VARIOUS PERIODS: 1Q18

			Jan-18	Feb-18	Mar-18	Last Quarter	Year to Date	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
EQUITY	1	Russell:3000 Index	5.27	(3.69)	(2.01)	(0.64)	(0.64)	13.81	10.22	13.03	9.62	10.43
	2	Russell:1000 Index	5.49	(3.67)	(2.27)	(0.69)	(0.69)	13.98	10.39	13.17	9.61	10.35
	3	Russell:1000 Growth	7.08	(2.62)	(2.74)	1.42	1.42	21.25	12.90	15.53	11.34	10.88
	4	Russell:1000 Value	3.87	(4.78)	(1.76)	(2.83)	(2.83)	6.95	7.88	10.78	7.78	9.71
	5	Russell:Midcap Index	3.76	(4.13)	0.06	(0.46)	(0.46)	12.20	8.01	12.09	10.21	12.21
	6	Russell:Midcap Growth	5.66	(3.14)	(0.16)	2.17	2.17	19.74	9.17	13.31	10.61	12.12
	7	Russell:Midcap Value	2.30	(4.93)	0.25	(2.50)	(2.50)	6.50	7.23	11.11	9.81	12.08
	8	Russell:2500 Index	3.05	(4.11)	0.96	(0.24)	(0.24)	12.31	8.15	11.55	10.28	12.05
	9	Russell:2500 Growth	4.99	(3.28)	0.82	2.38	2.38	19.92	9.11	13.37	11.17	12.58
	10	Russell:2500 Value	1.26	(4.91)	1.10	(2.65)	(2.65)	5.72	7.26	9.88	9.34	11.38
	11	Russell:2000 Index	2.61	(3.87)	1.29	(0.08)	(0.08)	11.79	8.39	11.47	9.84	11.50
	12	Russell:2000 Growth	3.90	(2.85)	1.35	2.30	2.30	18.63	8.77	12.90	10.95	12.04
	13	Russell:2000 Value	1.23	(5.00)	1.24	(2.64)	(2.64)	5.13	7.87	9.96	8.61	10.85
	14	S&P:500	5.73	(3.69)	(2.54)	(0.75)	(0.75)	14.00	10.78	13.31	9.50	10.10
	15	S&P:400 Mid Cap	2.87	(4.43)	0.93	(0.77)	(0.77)	10.97	8.96	11.97	10.90	12.28
	16	S&P:600 Small Cap	2.53	(3.87)	2.04	0.57	0.57	12.68	10.76	13.56	11.35	12.76
	17	MSCI:ACWI ex US	5.57	(4.72)	(1.76)	(1.18)	(1.18)	16.53	6.18	5.89	2.70	9.22
	18	MSCI:EAFE	5.02	(4.51)	(1.80)	(1.53)	(1.53)	14.80	5.55	6.50	2.74	8.62
	19	MSCI:EM	8.33	(4.61)	(1.86)	1.42	1.42	24.93	8.81	4.99	3.02	12.88
	20	MSCI:ACWI	5.64	(4.20)	(2.14)	(0.96)	(0.96)	14.85	8.12	9.20	5.57	9.31
FIXED INCOME	21	Blmbg:Aggregate	(1.15)	(0.95)	0.64	(1.46)	(1.46)	1.20	1.20	1.82	3.63	3.95
	22	Blmbg:Gov/Credit	(1.15)	(1.08)	0.65	(1.58)	(1.58)	1.38	1.22	1.84	3.65	3.97
	23	Blmbg:Credit	(0.93)	(1.51)	0.31	(2.13)	(2.13)	2.59	2.16	2.83	5.15	4.91
	24	Blmbg:Corporate High Yld	0.60	(0.85)	(0.60)	(0.86)	(0.86)	3.78	5.17	4.99	8.27	8.39
	25	Blmbg:Municipal Bond	(1.18)	(0.30)	0.37	(1.11)	(1.11)	2.66	2.25	2.73	4.40	4.24
	26	Blmbg:US TIPS	(0.86)	(0.97)	1.05	(0.79)	(0.79)	0.92	1.30	0.05	2.93	4.19
	27	Blmbg:Glob Agg ex USD	3.03	(0.85)	1.43	3.62	3.62	11.75	4.63	1.23	1.85	4.24
	28	S&P:LSTA Levg Loan	0.96	0.20	0.28	1.45	1.45	4.43	4.20	3.90	5.62	5.11
	29	ML:US Treasuries 1-3 Yrs	(0.29)	(0.04)	0.20	(0.13)	(0.13)	0.03	0.40	0.52	1.13	1.95
	30	LIBOR - 3 Month	0.15	0.14	0.17	0.46	0.46	1.46	0.90	0.64	0.74	1.67
	31	3 Month T-Bill	0.12	0.09	0.14	0.35	0.35	1.11	0.53	0.34	0.34	1.28
REAL ASSETS	32	Blmbg:Commodity TR Idx	1.99	(1.73)	(0.62)	(0.40)	(0.40)	3.71	(3.21)	(8.32)	(7.71)	(0.49)
	33	GS Commodity Index	3.42	(3.34)	2.22	2.19	2.19	13.83	(4.15)	(11.88)	(10.82)	(2.64)
	34	MSCI:US REIT Index	(4.18)	(7.68)	3.90	(8.09)	(8.09)	(4.38)	0.87	5.86	6.32	10.13
	35	Alerian:MLP Index	5.76	(9.69)	(6.94)	(11.12)	(11.12)	(20.07)	(11.24)	(5.85)	5.60	9.32
	36	DJB:Glbl Infrastructure	(0.02)	(6.29)	1.12	(5.26)	(5.26)	2.03	2.22	5.70	7.07	12.11
	37	US DOL:CPI All Urban Cons	0.54	0.45	--	--	--	--	--	--	--	--

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