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FINANCIAL ADVISORS

Global Market Outlook 2018

2018 Global Market Outlook – themes

1. Global Synchronized Growth

For the first time in a decade, all 45 countries tracked by the Organization for Economic Cooperation and Development (OECD) grew at the same time, led by rebounding economies in China, Brazil, and Mexico, as well as across Europe. The same is expected for 2018.

Consensus GDP Forecast for 2018	
Global	3.7%
G10	2.1%
U.S.	2.5%
Euro Area	1.9%
Japan	1.3%
UK	1.4%
EM	4.9%
China	6.4%
India	7.5%
Brazil	2.4%
Russia	1.8%

Source: Organization for Economic Cooperation and Development

2018 Global Market Outlook – themes continued

2. Emerging Markets Growth Expected to be Stronger than Developed Markets Growth in 2018

    - Forecasts suggest earnings growth in Emerging Markets in 2017 will be strongest since 2010.

    - Growth is being driven increasingly by domestic demand and intra EM trade – Within EM equity markets, secular growth sectors such as Information Technology and Consumer are displacing 'old EM' Commodity sectors.

    - While it is expected that Chinese growth will be moderate in 2018 and 2019, this is a byproduct of a prolonged shift towards a more sustainable growth model. At this point in the cycle, the Emerging Markets are less dependent on Chinese growth. There is positive momentum in the Latin American economies and oil-producing countries such as Russia as they recover from sharp downturns in prior years.

3. Inflation at Secular Low but not Dead

    - Most believe that inflation is unlikely to move beyond targets in 2018. Although inflation is a real risk that bears monitoring, it could take a long time to materialize.

    - While consumer price inflation may be tame, wage inflation could be an issue. It is likely that wage growth has merely been delayed by massive dislocations caused by the global financial crisis and recession, as well as by more structural factors such as demographics, productivity and technology. Thus, there is a risk that inflation will accelerate, although perhaps less in countries where there is still significant slack in the labor market (Europe).

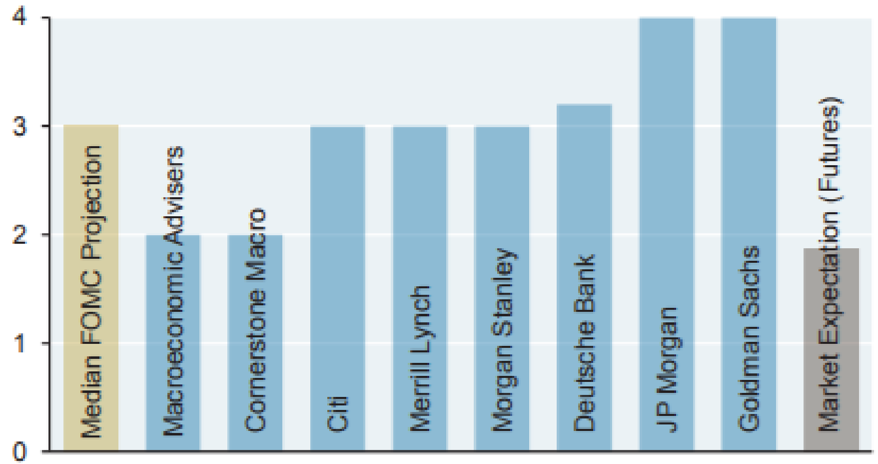
4. Monetary Policy

- The Fed indicated three rate hikes during 2018. While most economists believe them, the market expects two. With tight labor markets, central banks are setting a lower bar for rate hikes despite only gradually rising inflation.

- The market and economists do not expect much policy rate tightening in 2018 from the European Central Bank or Japan.

Fed Hike Expectations

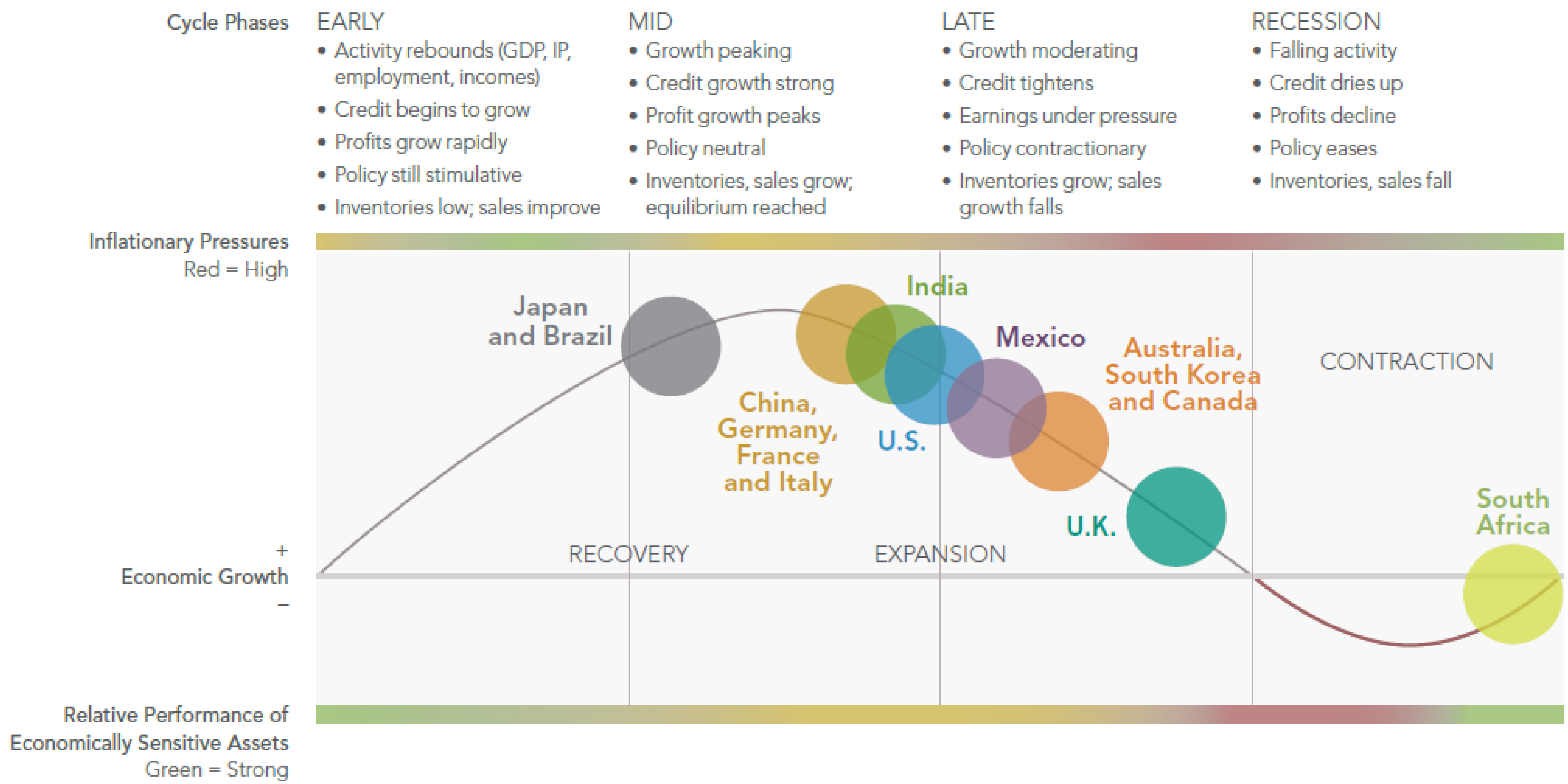
(Number of 0.25% rate hikes expected through year-end 2018)



Source: Bloomberg, Wall Street Journal, Fed, listed institutions, December 2017.

2018 Global Market Outlook – global expansion expected to continue

Business Cycle Framework



In 2017, almost all of the world's major economies were in some phase of expansion, leading to a self-reinforcing global acceleration and the most synchronized global upturn in several years. The primary driver of the pick-up in global activity was China's reacceleration over the past 18 months, which catalyzed a turnaround in global industrial production, exports, commodity industries and the profits of multinational corporations.

Source: Fidelity Investments (AART)

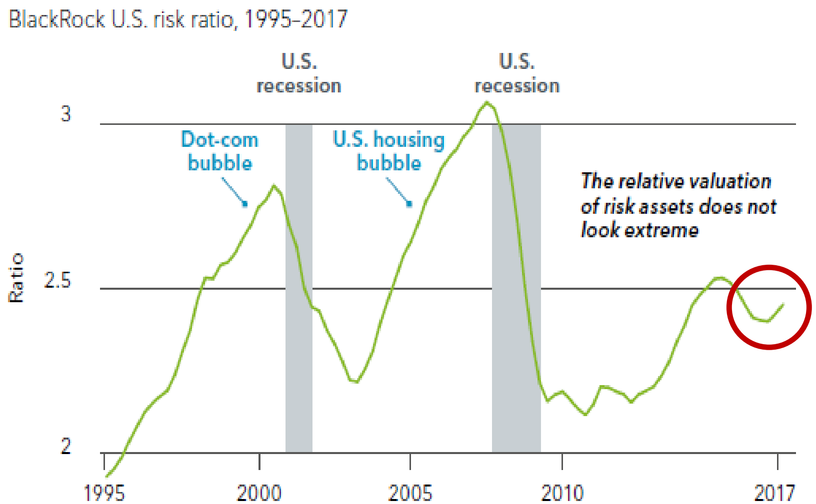
Developed International and Emerging Markets expected to outperform the U.S.

Asset class		View	Comments
Equities	U.S.	—	Earnings momentum is strong heading into 2018. U.S. corporate tax cuts could provide an extra leg up for earnings. We like the momentum and value style factors, financials, technology and dividend growers.
	Europe	▲	We see sustained above-trend economic expansion and a steady earnings outlook supporting cyclicals. Euro strength is still playing out in company results, but we believe it should become less of a drag.
	Japan	▲	Positives are improving global growth, more shareholder-friendly corporate behavior and solid earnings amid a stable yen outlook. We see BoJ policy and domestic investor buying as supportive. Yen strengthening would be a risk.
	EM	▲	Economic reforms, improving corporate fundamentals and reasonable valuations support EM stocks. Above-trend expansion in the developed world is another positive. Risks include a sharp rise in the U.S. dollar, trade tensions and elections. We see the greatest opportunities in EM Asia, and like Brazil and India. We are cautious on Mexico.
	Asia ex-Japan	▲	The economic backdrop is encouraging. China's growth and corporate earnings appear solid in the near term. We like selected Southeast Asian markets but recognize a faster-than-expected Chinese slowdown would pose risks to the entire region.
Fixed income	U.S. government bonds	▼	We expect rates to move moderately higher amid a sustained economic expansion and a tightening Fed. Rising inflation and lower valuations give TIPS an edge over nominal Treasuries. We are neutral on agency mortgages, given full valuations and the uncertain effect of the Fed's unwinding its balance sheet.
	U.S. municipal bonds	—	Increased issuance driven by tax reform expectations should reverse in 2018, creating a more supportive supply/demand balance. This, plus solid appetite for tax-exempt income, underpins the asset class. We favor maturities of 0-2 and 20+ years.
	U.S. credit	—	Sustained growth supports credit, but high valuations limit upside. We prefer up-in-quality exposures as ballast to equity risk. Higher-quality floating rate instruments and shorter maturities appear increasingly well positioned for rising rates.
	European sovereigns	▼	The ECB's negative interest rate policy has made yields unattractive and vulnerable to the improving growth outlook. We expect core eurozone yields to rise, and spreads of semi-core and selected peripheral government bonds to narrow.
	European credit	▼	Ongoing ECB purchases have compressed spreads across sectors and credit-quality buckets. Negative rates have crimped absolute yields – and rising rate differentials make currency-hedged positions increasingly attractive for U.S.-dollar investors.
	EM debt	—	Sustained global growth benefits EM debt, alongside a benign inflation backdrop in many economies. High valuations make further capital gains less likely, leading us to focus on the benefits of relatively high income.
	Asia fixed income	—	Steady global expansion and positive corporate fundamentals support Asian credit. We favor high-quality corporate debt in China and India. We have a selective stance on high yield, but see opportunities in Indonesia and China.

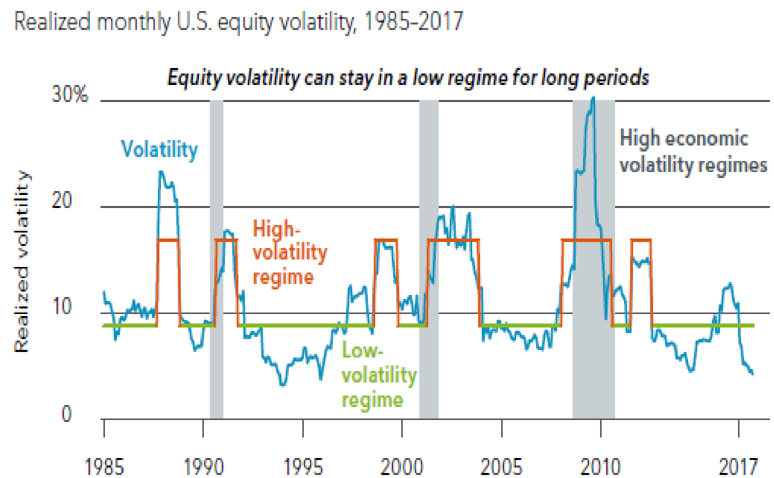
Source: Blackrock

U.S. Equities – Volatility and Relative Valuations

Room to Run?



Unusual Volatility? Low Volatility is Normal



- This risk ratio is calculated by taking the value of outstanding U.S. risk assets (equities, corp. bonds, mortgages, bank loans) and dividing this by the value of perceived safe-haven assets (govt., agency mortgages, bank deposits).
- Even with the equity market reaching new highs, the ratio shows few signs of the type of euphoria seen in 2000 and 2008.
- This risk gauge suggests that there is room for investors to embrace more risk.

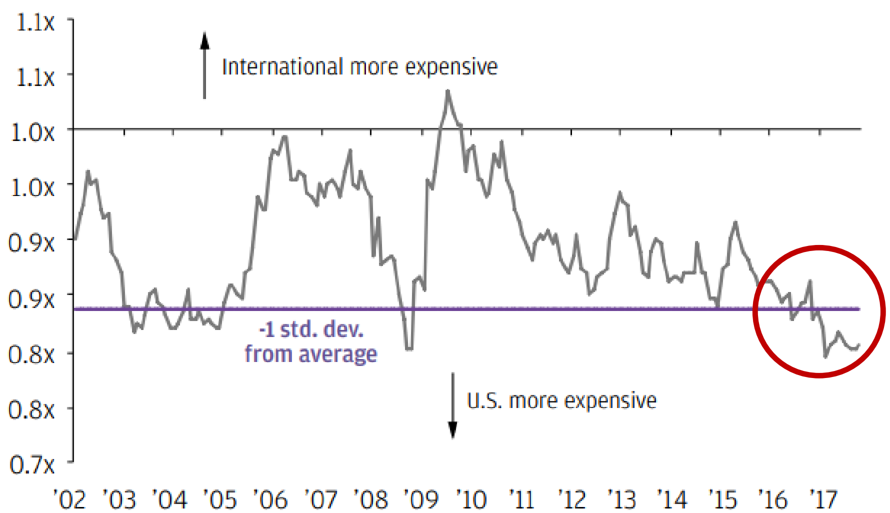
- Long, sustained stretches of low equity volatility are the norm, not the exception.
- Outbreaks of higher equity market volatility have tended to overlap with periods of elevated volatility in economic data.
- The steady economic backdrop today suggests little risk of a shift to a high equity-volatility regime. A move to such a regime typically requires excessive financial sector leverage but leverage metrics appear low in developed markets.

Source: Blackrock, Thomson Reuters

International versus U.S. Equities

- International Equities are expected to outperform their U.S. counterparts in 2018. They are at recent historical low levels relative to the U.S.
- After years of U.S. earnings outpacing International, a reversal appears to have started.

MSCI ACWI ex-U.S. versus S&P 500
Forward P/E Ratio



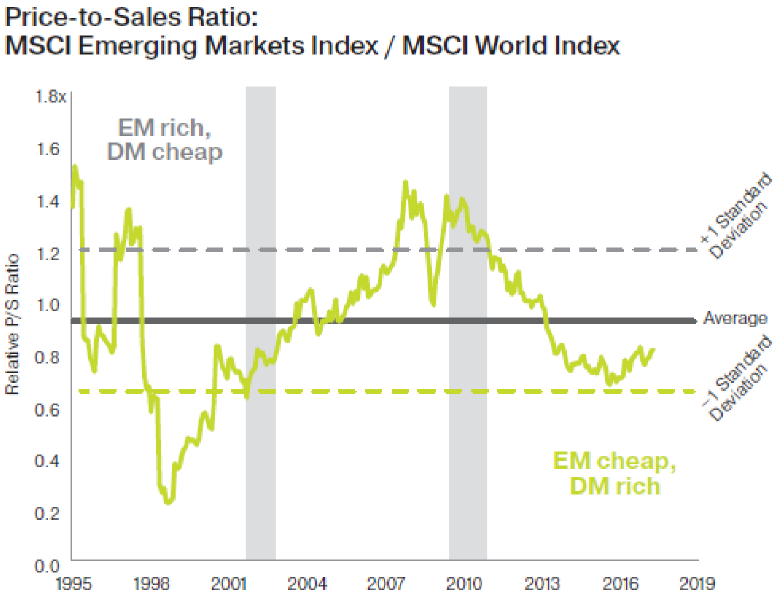
MSCI ACWI ex-U.S. versus S&P 500
Forward EPS (USD)

Source: MSCI, Compustat, FactSet, Standard & Poor's, JPM Asset Management

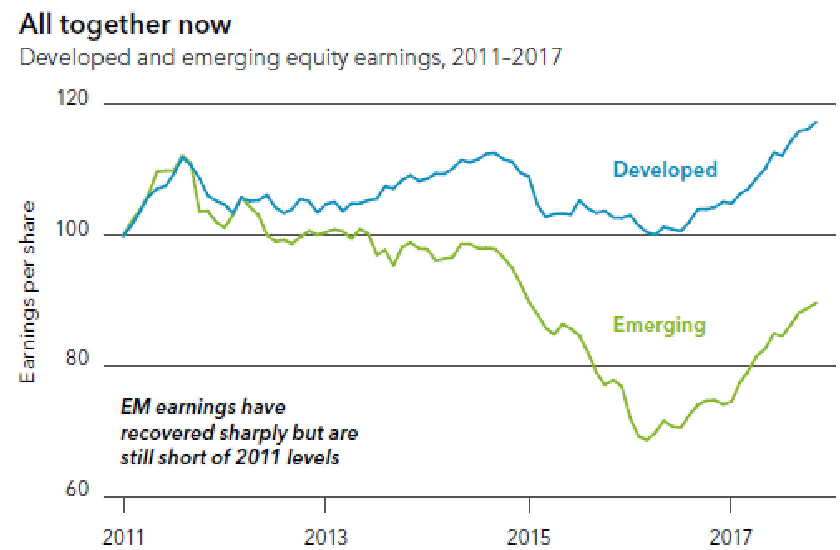
International versus U.S. Equities

- Emerging Markets equities are well positioned to outperform Developed Market equities.
- While International markets are cheaper than the U.S., Emerging Markets are cheaper than Developed Markets as a whole.

MSCI ACWI versus MSCI World
Price-to-Sales Ratio



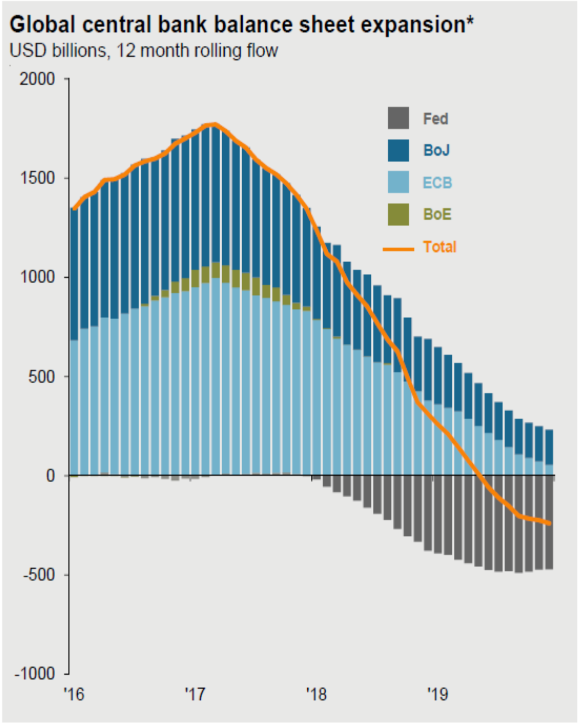
MSCI EM versus MSCI World
12 Month Forward EPS

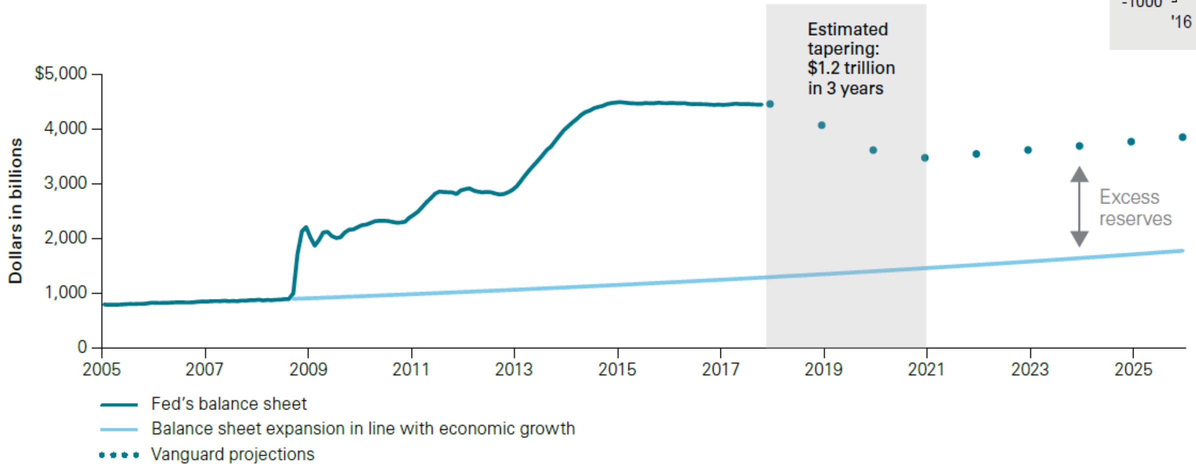


Source: Bloomberg, Oppenheimer, BlackRock, Thomson Reuters

Theme 1: Central Banks Continuing Current Policies

- In the U.S., the transition to new Federal Reserve Chair Jerome Powell leaves room for uncertainty, though he has tended to favor similar policies as Yellen, and the market expects at least 3 rate hikes in 2018.
- Abroad, the European Central Bank and Bank of Japan are expected to continue a measured paring back of their stimulus policies.
- The Federal Reserve is expected to continue its gradual unwinding of the balance sheet. The ECB is also expected to begin their own gradual unwind.





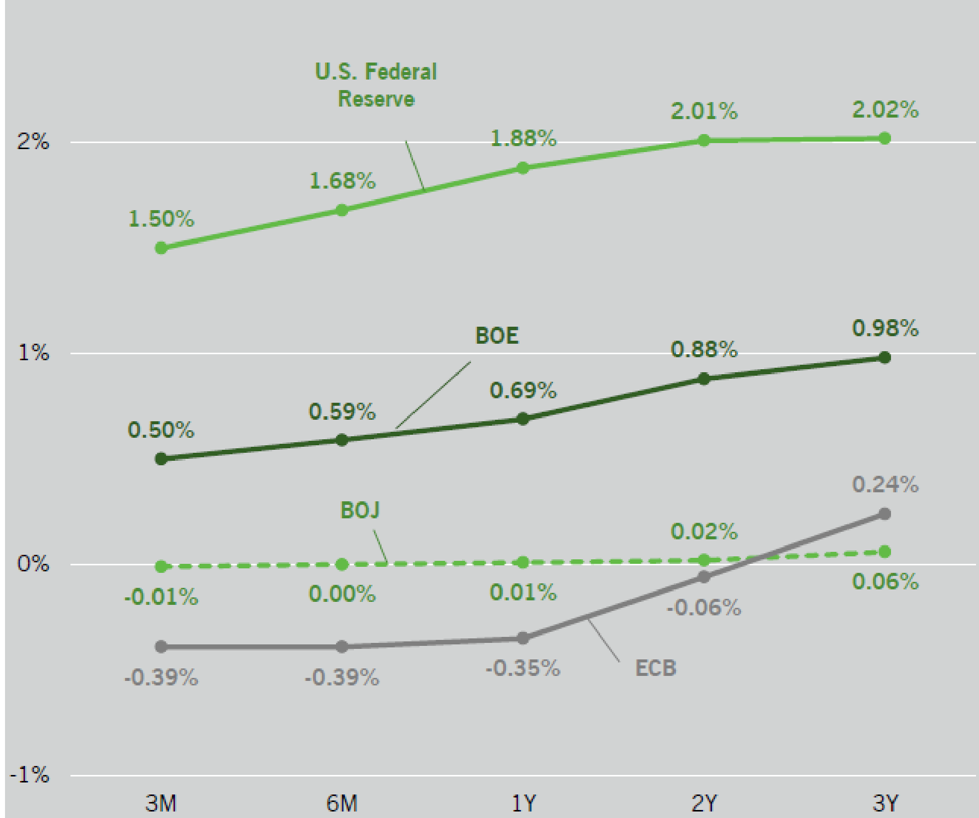
Source: JP Morgan, Vanguard

Fixed Income: Top Themes & Trends

Theme 2: Yield Curve Likely to Remain Flat

- Regular rate hikes by the Federal Reserve will continue to put upward pressure on short rates.
- With global yields still near long-term lows, and global market volatility muted, downward pressure on long rates will likely remain. There is not an obvious catalyst to spur long rates higher.
- In International markets, meaningful increases in policy rates are not expected until at least 2019.

Market Expectations for Future Central Bank Rates

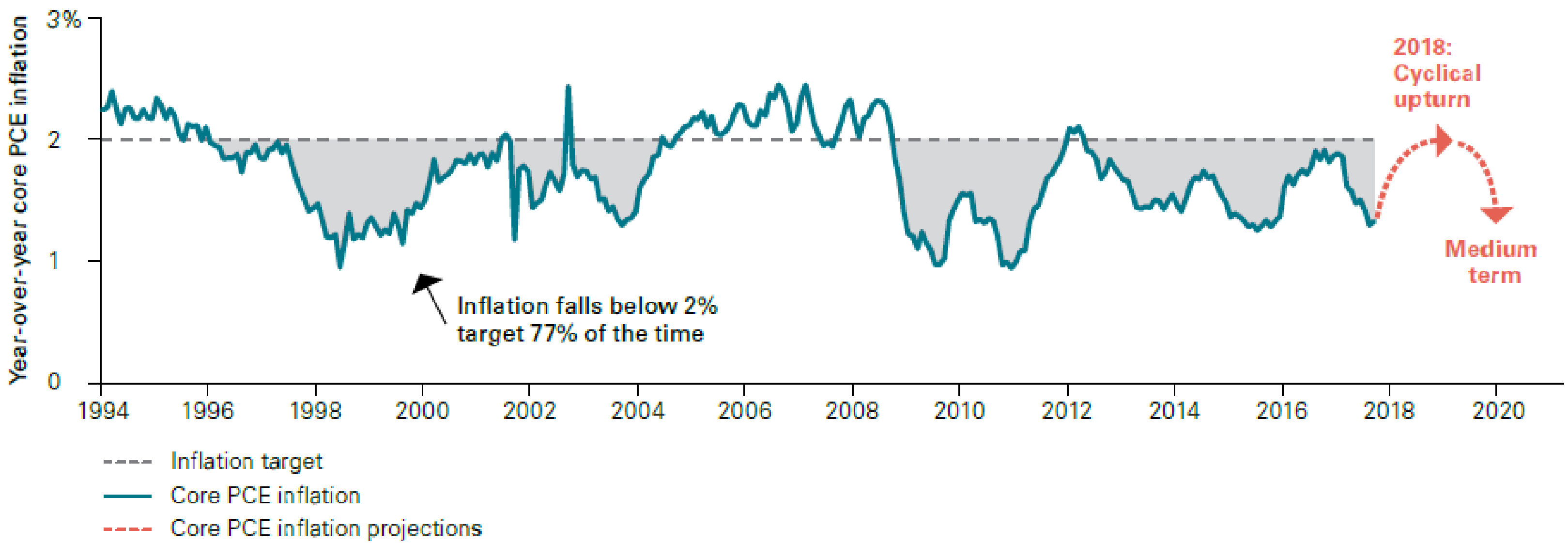


Source: Eaton Vance

Fixed Income: Top Themes & Trends

Other significant themes and trends possible in 2018:

- Spreads remain remarkably tight, though fundamentals are still strong and credit markets are open. Spread sectors will be favored over governments.
- Inflation remains low, and at least in this cycle, the Phillips curve is broken (typically decreased unemployment in an economy will correlate with higher rates of wage increases) – low inflation and low unemployment are co-existing.
- For investors, Fixed Income returns are expected to be modestly positive.
    - Returns are likely to come from income as appreciation should be muted.
- **In short, 2018 is likely to be characterized by a continuation of 2017's trends in fixed income markets.**



Source: Vanguard

Fixed Income: Biggest Risks to Expectations

- **Inflation surprises:** Inflation beyond the current levels is largely unpriced in fixed income assets. Any measurable uptick, even if overall inflation rates remain modest, carries the potential for meaningful volatility.

- **Fed balance sheet wind-down:** Though the Fed's reductions have thus far been shrugged off by the markets, continued reductions create potential for increased volatility in fixed income markets.

- Global central bank balance sheet reductions, at this point, appear to be more likely a headwind beginning in 2019.

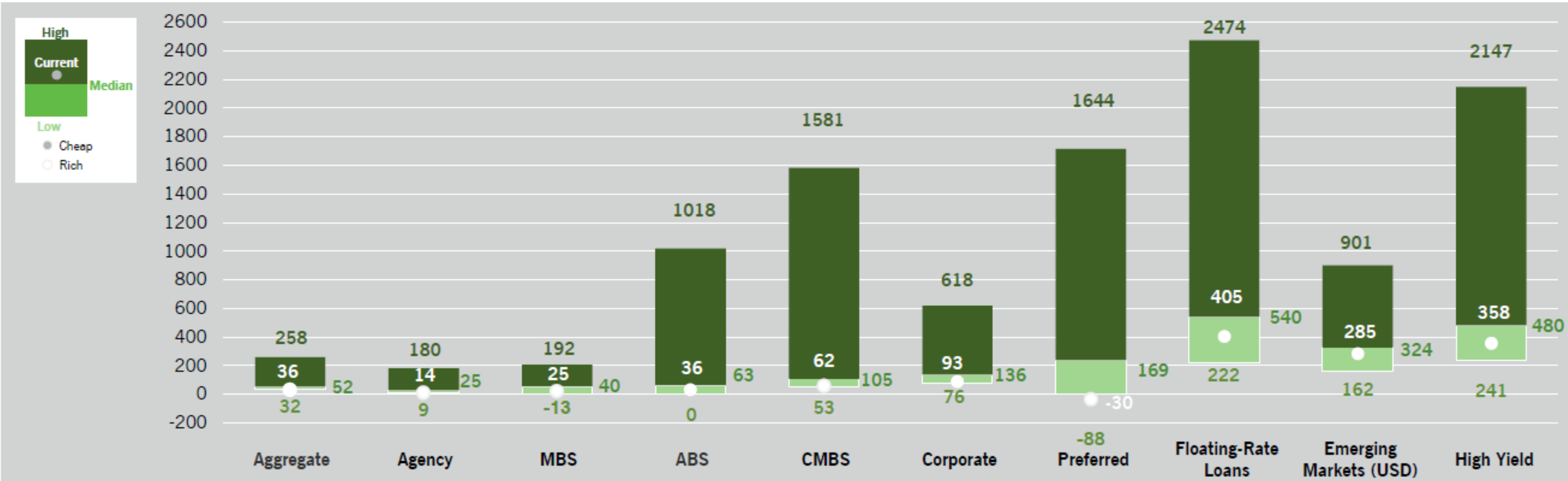
- **ECB tightening:** European growth has steadily picked up, leading to the ECB's current policy to reduce stimulus. Should growth further accelerate, the ECB may possibly shift to an outright tightening stance sooner than expected, potentially stirring volatility.

- **Credit cycle turns:** Defaults remain near historical lows and fundamentals appear strong, though credit has been easy and covenants increasingly lighter. Spreads are near historical lows across most fixed income sectors. Any catalyst (such as subsiding economic growth or rising interest rates) could destabilize credit markets.

- **Generally speaking, risks are apparent, but are expected to be at least a year away from materializing.**

Source: Vanguard

Fixed Income Sectors



	Aggregate	Agency	MBS	ABS	CMBS	Corporate	Preferred	Floating-Rate Loans	Emerging Markets (USD)	High Yield
Max Spread Date	12/3/2008	11/20/2008	12/3/2008	1/6/2009	11/21/2008	12/3/2008	3/9/2009	12/19/2008	10/24/2008	12/15/2008
Min Spread Date	2/23/2005	3/12/2013	7/27/2010	10/1/2009	12/8/2004	3/11/2005	12/6/2017	3/31/2006	6/1/2007	6/1/2007
Spread on 12/31/17	36	14	25	36	62	93	-30	405	285	358
Spread on 12/31/16	43	21	15	59	75	123	213	465	342	422
Spread on 12/31/15	56	21	24	72	121	165	158	714	415	695

<u>Likely to do best in 2018:</u>

Corporates
- Investment Grade
- Sub-IG: High Yield & Bank Loans

Emerging Markets Debt
- Both local & hard currency

Structured Credit
- CLOs
- ABS
- Non-Agency MBS

<u>Likely to do worst:</u>

Governments

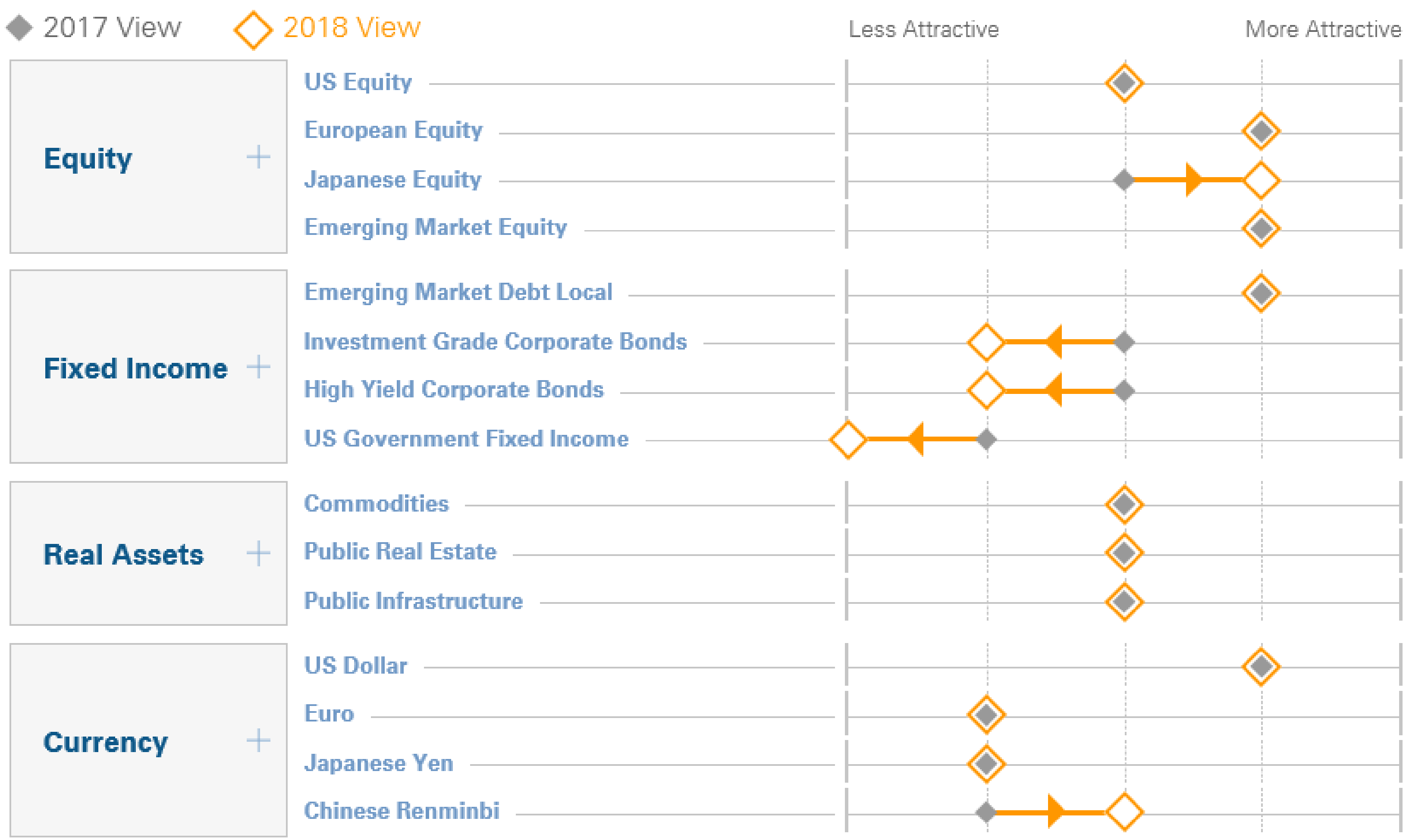
TIPs

Agency MBS

Source: Eaton Vance

Risks in 2018

Investors will have to navigate more risks in 2018 including moderating growth, central bank tightening and geopolitical developments.



Source: GSAM. As of November 2017

Risks in 2018

1. U.S. equity valuations are elevated relative to history but continue to offer a reasonable risk premium over other assets.

2. Uncertainty around Brexit talks as impending March 2019 date looms.

3. Central bank tightening could be a catalyst for broad market volatility.
    1. Markets are prepared for a gradual and well-telegraphed unwinding of central bank balance sheets.
    2. Rate hikes are most likely the bigger risk as market expectations for Federal Reserve rate hikes might be too low.

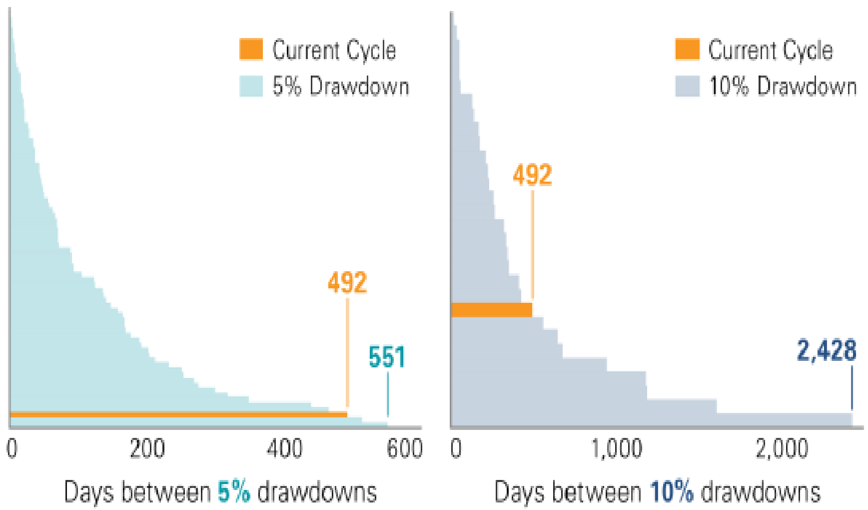
4. Consumer Staples companies look vulnerable to disruption in 2018. Major online retailers are becoming bigger players in Consumer Staples, pressuring traditional leaders in the sector.
    1. The internet has broken down traditional barriers to entry.
    2. Online retailers are developing their own staple brands and marketing them with the advantage of proprietary data.

5. Views on China changed to positive over the past year as growth accelerated. That perception could change if growth were to moderate again exposing large debt levels and an expanding fiscal deficit. Also, economic reforms risk slowing growth.

6. NAFTA negotiations presents a risk to the U.S. biggest trading partners along with implications for other trade agreements.

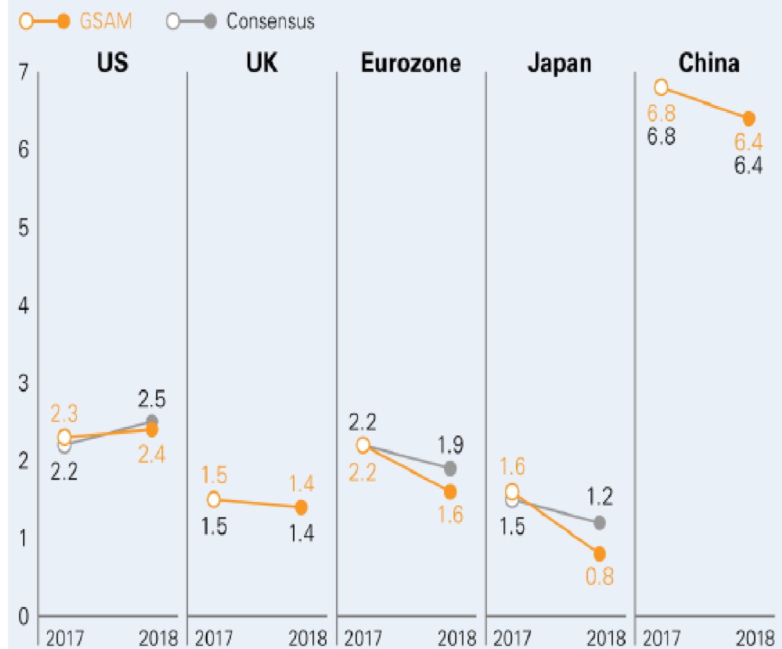
Risks in 2018

Exhibit 4: Policy tightening could drive temporary drawdowns in US equities



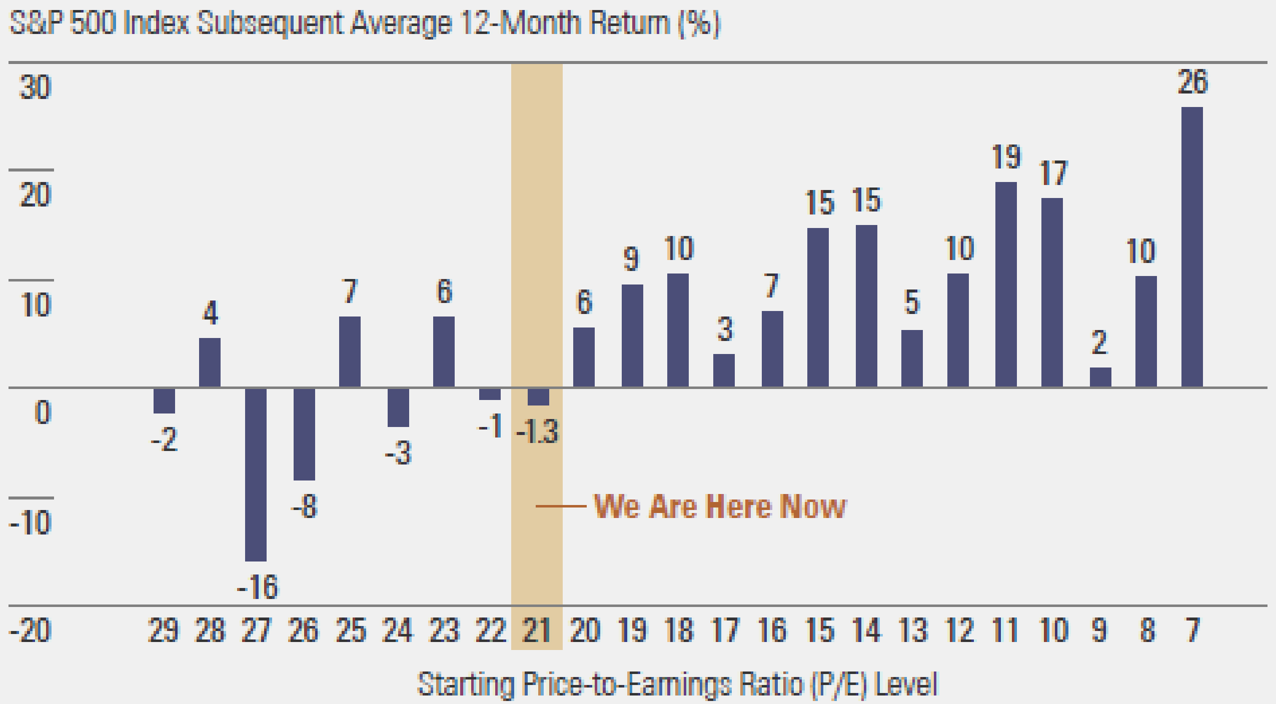
Source: Haver, GSAM. Based on S&P 500 daily data from January 2, 1952 through November 15, 2017.

Growth Forecast (%)



Source: GSAM, Bloomberg. As of November 2017.

High Valuations Lead to Lower Returns



Source: Bloomberg Finance L.P., State Street Global Advisors as of 11/17/2017. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

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