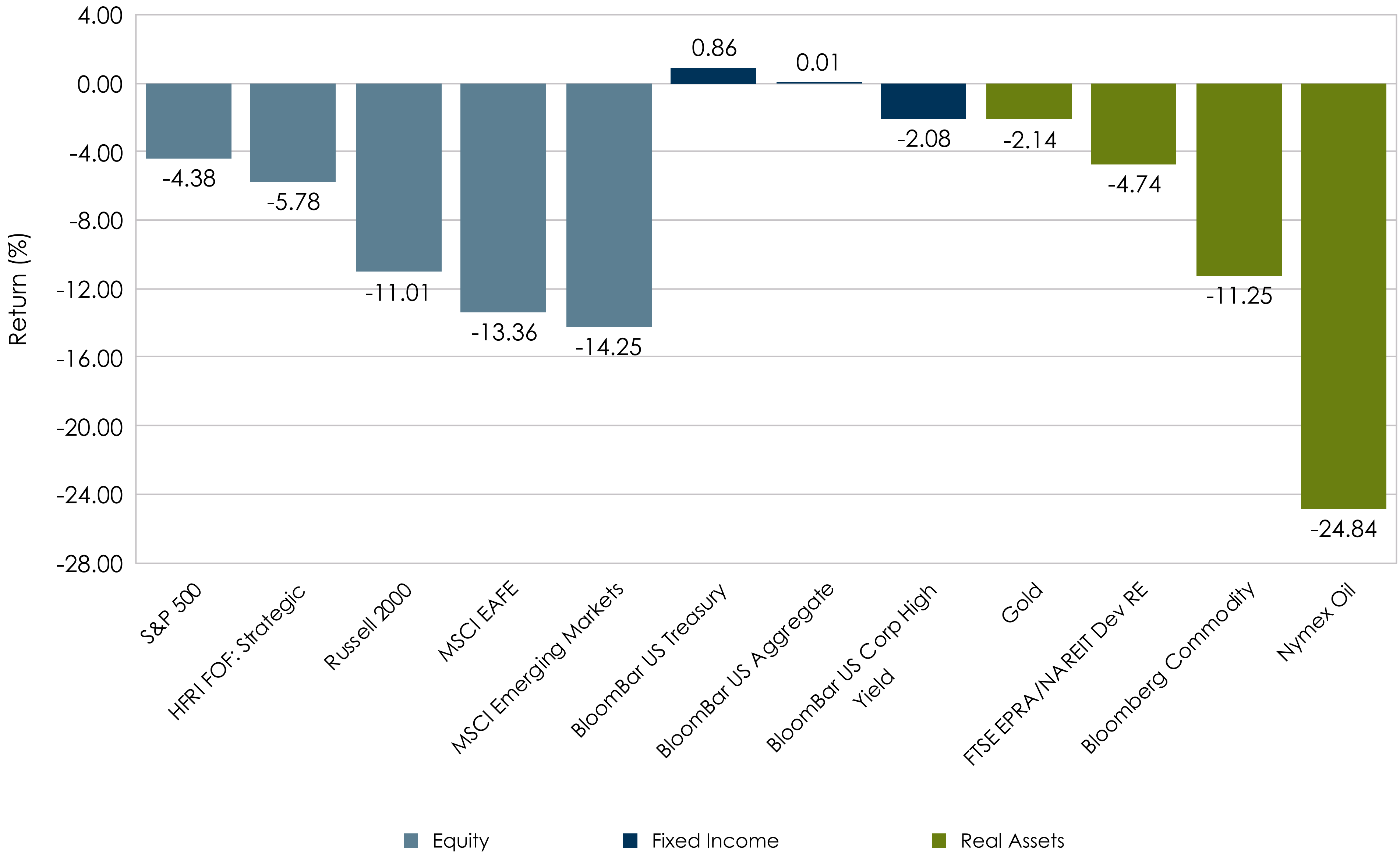
Global Economic Update

First Quarter 2019

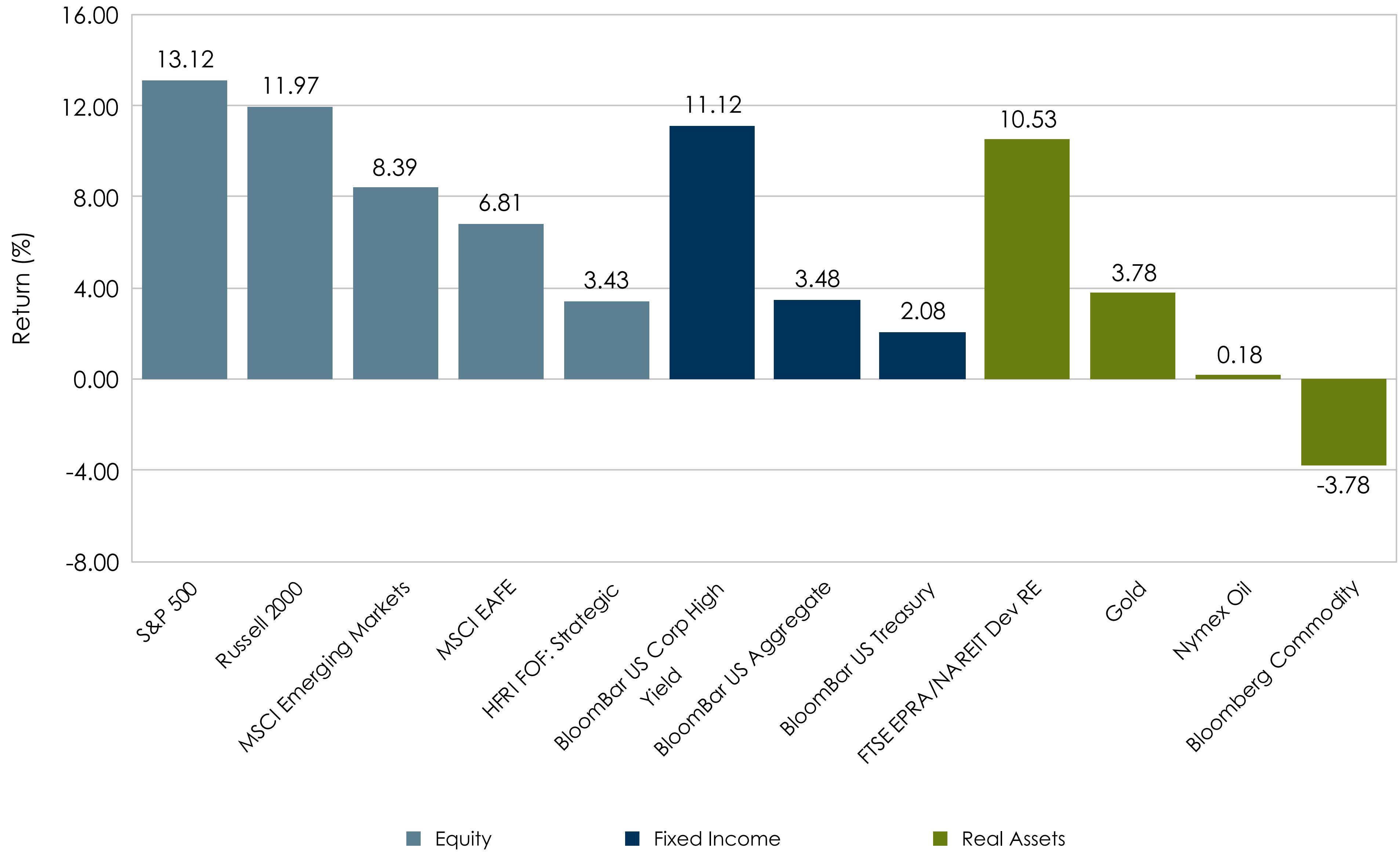
Market Returns

For the YTD Period Ending December 31, 2018



Market Returns

For the 10 Years Period Ending December 31, 2018



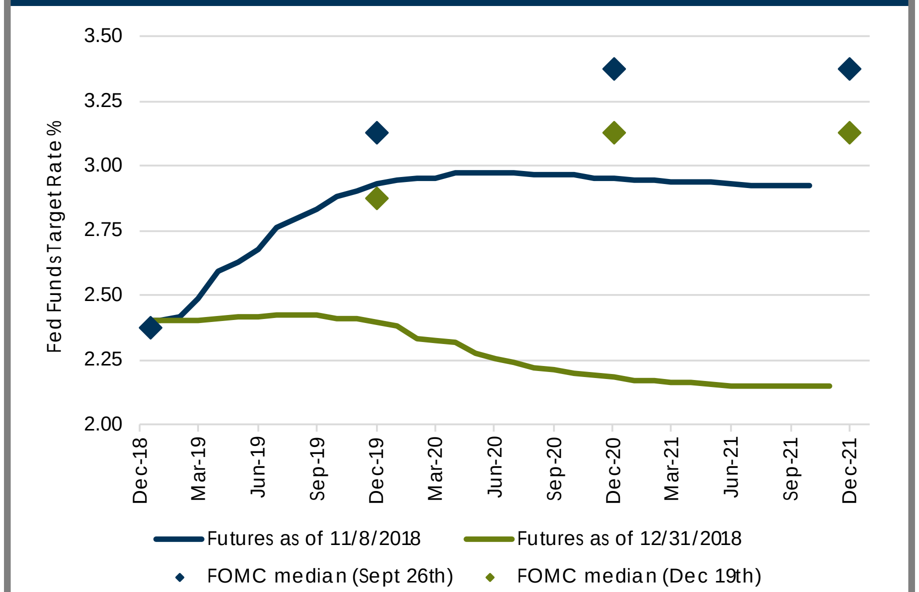
US

- 3rd quarter annualized GDP grew at 3.4%. Consensus **projections for 4th quarter GDP are between 2.5% and 3.0%**.
- Labor conditions remain robust, with the **3.9% unemployment rate reflecting the addition of 2.6 million jobs in 2018.** Most economists are forecasting continued hiring demand, and real wage gains have picked up as inflation expectations declined into year-end.
- The Democrats reclaimed the House of Representatives in November's mid-term elections, while the Republicans slightly increased their majority in the Senate. This divided Congress means **compromises will be an essential part** of enacting any sort of meaningful legislation for the next two years.
- As expected, the Fed **increased short-term interest rates in December**, to a targeted range of 2.25% to 2.50%. The overall tone of the message was slightly more dovish than prior statements, with the unofficial dot-plot now **projecting only two more increases by the end of 2019**. The futures market became skeptical of additional tightening amid market volatility.

Global/Non-US

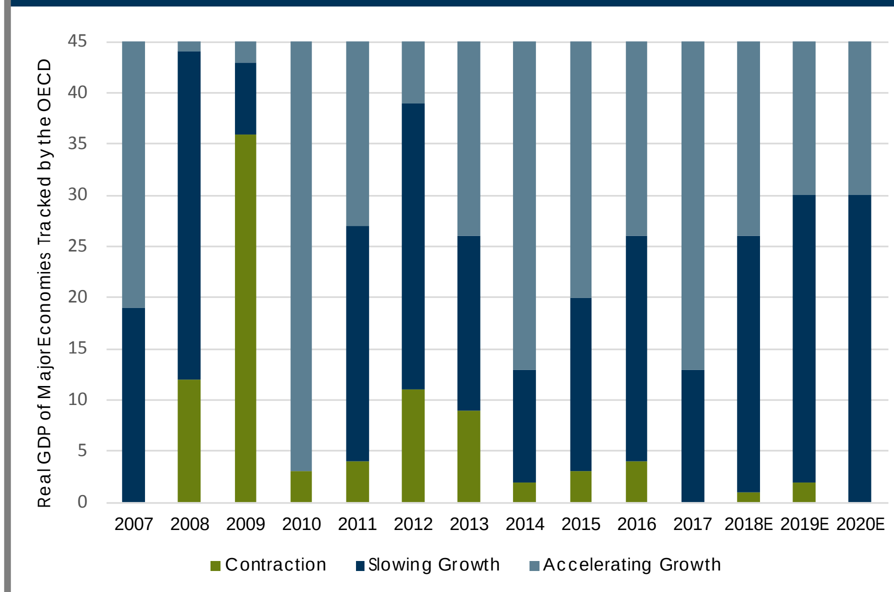
- Despite ongoing discussions meant to defuse tensions and a 90-day "truce" with China**, the trade tariff issue has not gone away.** Well-entrenched globalization trends are unlikely to be reversed, but protectionism could weigh on growth.
- As expected, the **ECB ended its bond purchase program at the end of the year.** Rates are unlikely to increase in the near term, but the period of abnormally easy monetary policy is coming to an end even as **global growth and earnings appear to be softening.**
- **International political tensions are mixed**. With the Brexit deadline looming on March 29th, the UK has made limited progress in negotiations. Italy's latest budget deal helped ease concern about EU cohesion, even as a growing wealth gap contributed to strikes and protests in France.
- **Sharp declines in oil and other commodities** combined with tightening global financial conditions may pressure emerging market economies. That said, **currencies have stabilized after notable weakness earlier in 2018.**

Fed Projections vs. Market Expectations

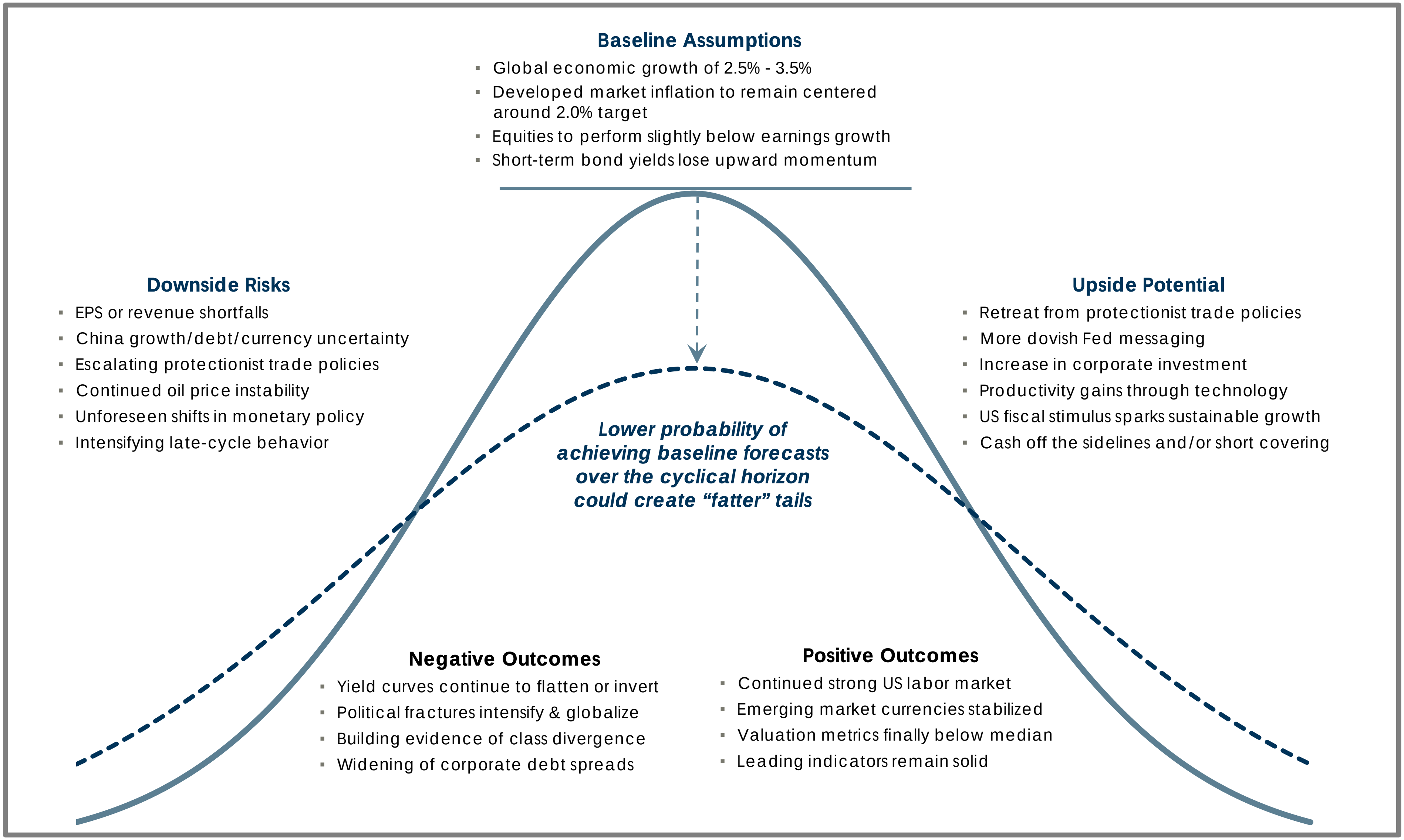


Source: ACG Research, Bloomberg, Federal Reserve

Global Growth Slowdown



Source: ACG Research, Organization for Economic Co-operation and Development (OECD)


Baseline Assumptions
▪ Global economic growth of 2.5% - 3.5%
▪ Developed market inflation to remain centered around 2.0% target
▪ Equities to perform slightly below earnings growth
▪ Short-term bond yields lose upward momentum
Downside Risks
▪ EPS or revenue shortfalls
▪ China growth/debt/currency uncertainty
▪ Escalating protectionist trade policies
▪ Continued oil price instability
▪ Unforeseen shifts in monetary policy
▪ Intensifying late-cycle behavior
Upside Potential
▪ Retreat from protectionist trade policies
▪ More dovish Fed messaging
▪ Increase in corporate investment
▪ Productivity gains through technology
▪ US fiscal stimulus sparks sustainable growth
▪ Cash off the sidelines and/or short covering
Lower probability of achieving baseline forecasts over the cyclical horizon could create “fatter” tails
Negative Outcomes
▪ Yield curves continue to flatten or invert
▪ Political fractures intensify & globalize
▪ Building evidence of class divergence
▪ Widening of corporate debt spreads
Positive Outcomes
▪ Continued strong US labor market
▪ Emerging market currencies stabilized
▪ Valuation metrics finally below median
▪ Leading indicators remain solid

Current Issue: Global Earnings & Valuations

What is the issue?

- One common measure of equity valuation uses future earnings projections, which are generally provided by Wall Street analysts
- Historically, initial projections tend to be quite optimistic, only to be guided down by company management teams who want to "beat" the estimate
- In recent periods, actual earnings growth has been relatively high, supported by corporate tax cuts, share buybacks, and general margin expansion
- While the level of corporate earnings is a long-term driver of value, markets can have shorter-term reactions to even subtle trends in earnings

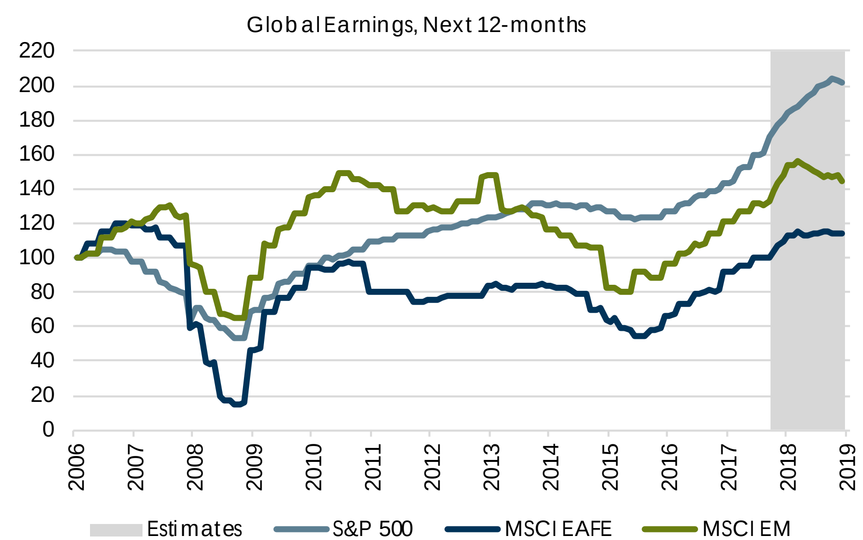
Where do things stand?

- Consumer confidence remains strong and 2018 holiday spending was robust, suggesting near-term revenues are not meaningfully at risk
- Rising interest rates are a threat to earnings over time, as more leveraged companies must pay more to borrow and refinance
- Across global stock indices, next 12-months earnings are projected to grow (led by the US), but pacing is down from the recent mid-20% range
- Valuations became more favorable throughout 2018 as earnings increased while market volatility in the 4th quarter caused stock prices to decline

Potential Outcomes:

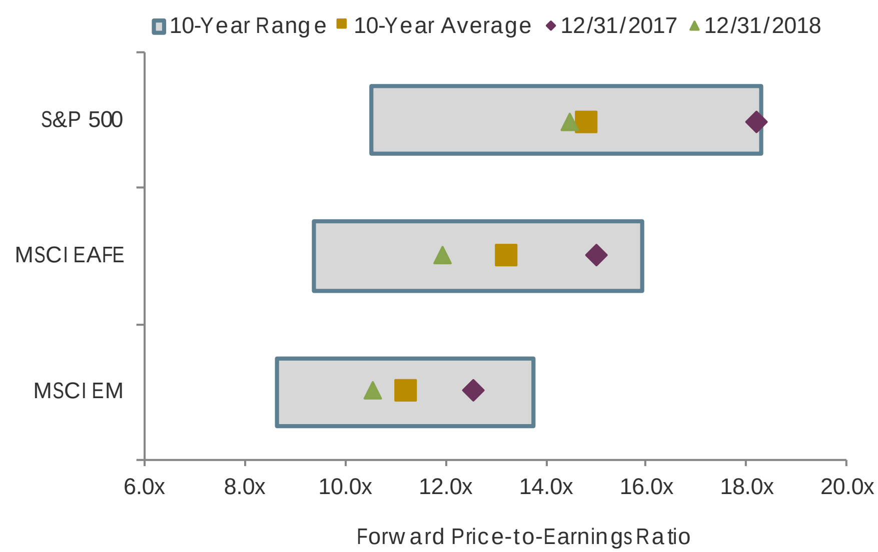
- In past periods of significant P/E multiple contraction, the coming year has resulted in positive returns as investors perceive a buying opportunity
- Tighter monetary policy, shrinking excess capacity, slower global growth, and lingering trade issues may act to limit late-cycle price increases

Corporate Profit Growth Coming off the Boil



Source: ACG Research, Bloomberg

Equity Valuations Moderated Throughout 2018



Source: ACG Research, Bloomberg

What is the issue?

- China boasts the second largest Gross Domestic Product (GDP) in the world, and is a legitimate rival to the United States
- The impact of China's economy on other economies, particularly regional counterparts and other Emerging Markets (EM), is significant
- China is evolving from a manufacturing/export-driven economy to a more consumption/service-driven economy
- The Communist Party of China has granted significant power to President Xi, allowing him to focus more on long-term planning and reforms

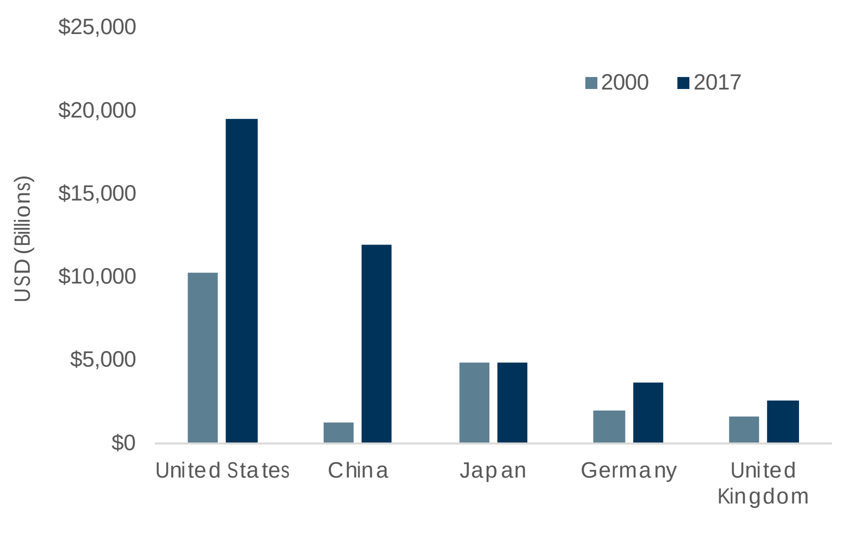
Where do things stand?

- The US and China are in the midst of a tariff war, with each country threatening and imposing tariffs of various levels
- As a result of limitations on outside investors, China remains underrepresented in global equity indices (just 3.5% of the MSCI ACWI Index)
- Social and economic reforms have been beneficial to its economy and population, with per capita income up over 800% since 2000
- Stimulative investment programs have ballooned China's debt to GDP ratio to approximately 270%, a level that will have to be managed in the future

Potential Outcomes:

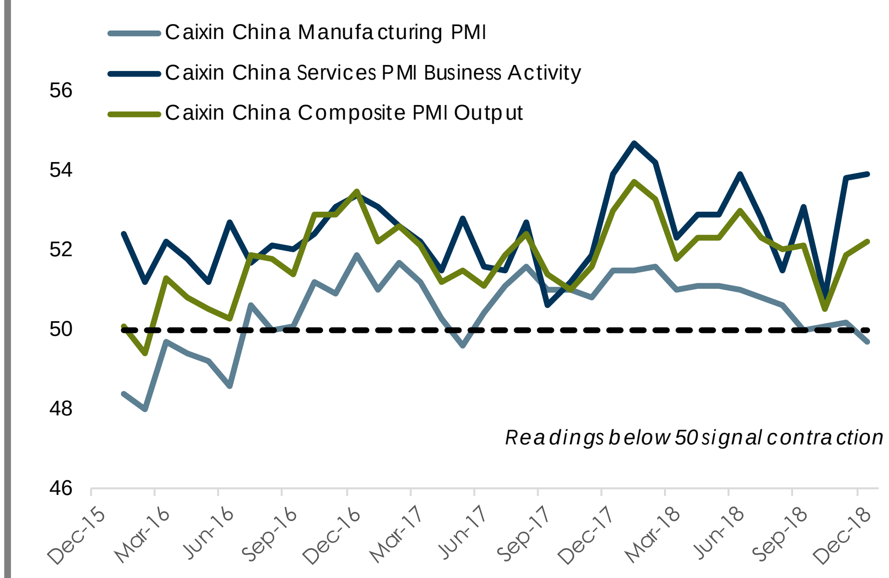
- With limited capacity to further expand debt, and given the scale that now exists, GDP growth targets (6.5% in 2018) will likely have to moderate
- Further escalation in the trade war creates notable spill-over risks, although a trade deal could result in substantial upside for markets (particularly EM assets)

China's Nominal GDP Trails Only the United States



Source: ACG Research, IMF WEO Database, October 2018

Manufacturing Weakness Offset by Strength in Services



Source: ACG Research, Bloomberg

Investment Themes

Theme	Considerations (3-5 Years)	Implementation Strategy
Growth	▪ Late-cycle slowdown ▪ Withdrawal of monetary stimulus ▪ Slowing productivity and population trends ▪ Earnings deceleration ▪ China's increasing role	▪ Maintain long-term strategic allocations ▪ Passive exposure in efficient markets ▪ Active/focused/opportunistic in less efficient areas ▪ High-quality orientation
Yield Environment	▪ Short-term real yields improving ▪ Policy shifts affecting supply/demand ▪ Underwriting standards a late-cycle risk ▪ Liquidity challenges may increase volatility	▪ Maintain high-quality core fixed exposure ▪ Shorter-dated assets provide attractive yield ▪ Yield enhancement via private debt or opportunistic strategies (e.g. HY, Loans, EMD) ▪ Absolute return strategies
Inflation	▪ Expectations falling short of 2% target ▪ Tight labor markets - building wage pressure ▪ Uncertain impact of technology, global market efficiency, secular demographic trends, trade policy	▪ Rising prices – benefit earnings (equity) ▪ Rising rents – benefit core real estate (RE) ▪ Active managers with niche alpha strategies ▪ Shorter-dated fixed income - positive real yield
Risk & Uncertainty	▪ Waning gov't influence - high debt, demographics ▪ Disparate global fiscal/monetary policies ▪ Trends toward protectionism ▪ Political polarization and rising inequality ▪ Immigration, war, climate change, social media, cyber attacks, terrorist activity	▪ Global diversification ▪ Private strategies can limit near-term price impacts ▪ Enhanced liquidity ▪ Disciplined rebalancing strategy
Return Expectations	▪ Policy stimulus acted to "pull forward" returns ▪ Potential for increased market volatility ▪ Economic slowdown could cap equity valuations ▪ Low yield and inflation environment still challenging	▪ Revisit investment objectives and constraints ▪ Employ risk-reducing/hedged strategies ▪ Maintain liquid and illiquid assets exposure ▪ Seek active strategies with enhanced flexibility

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