Global Economic Update

Third Quarter 2019

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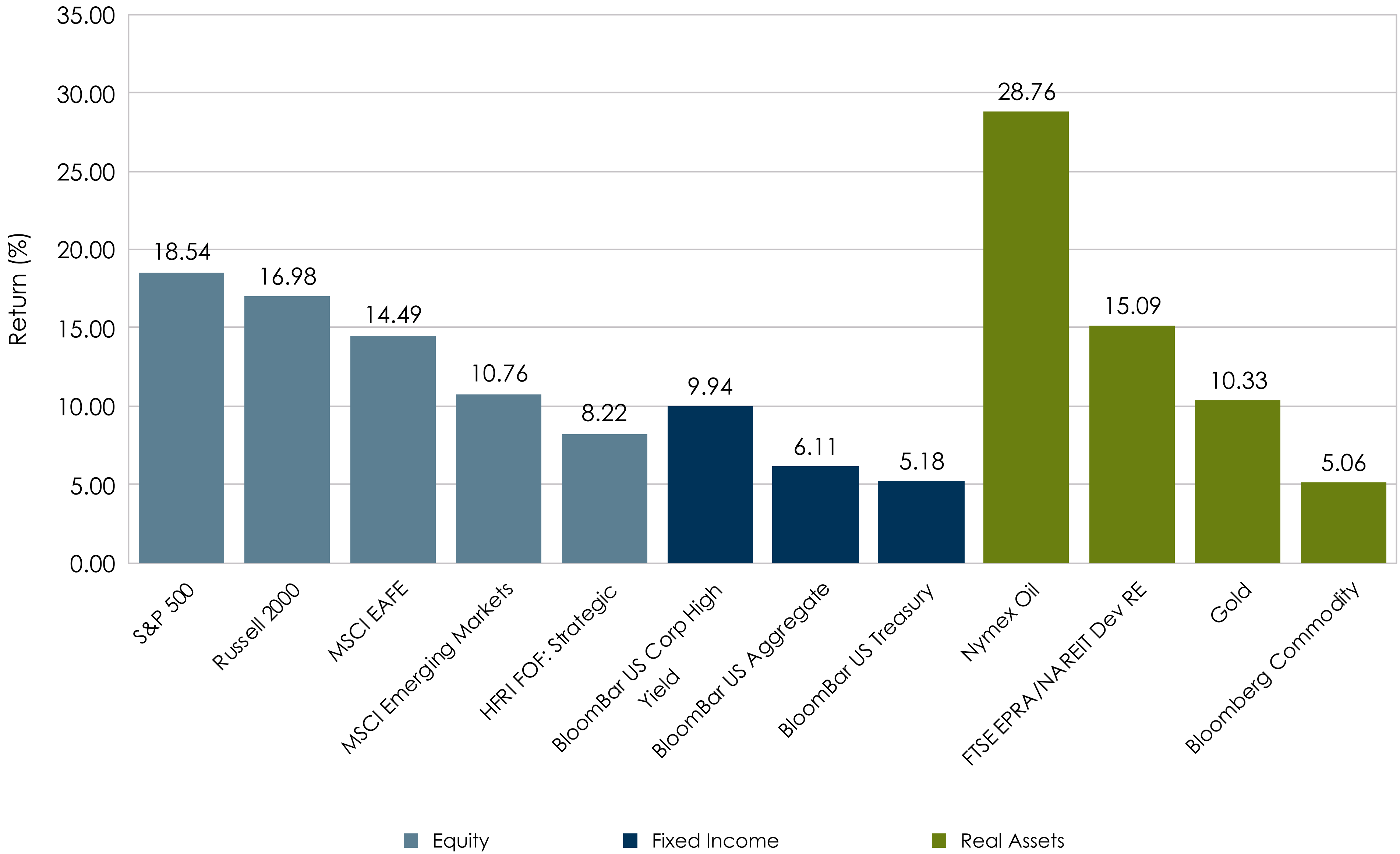
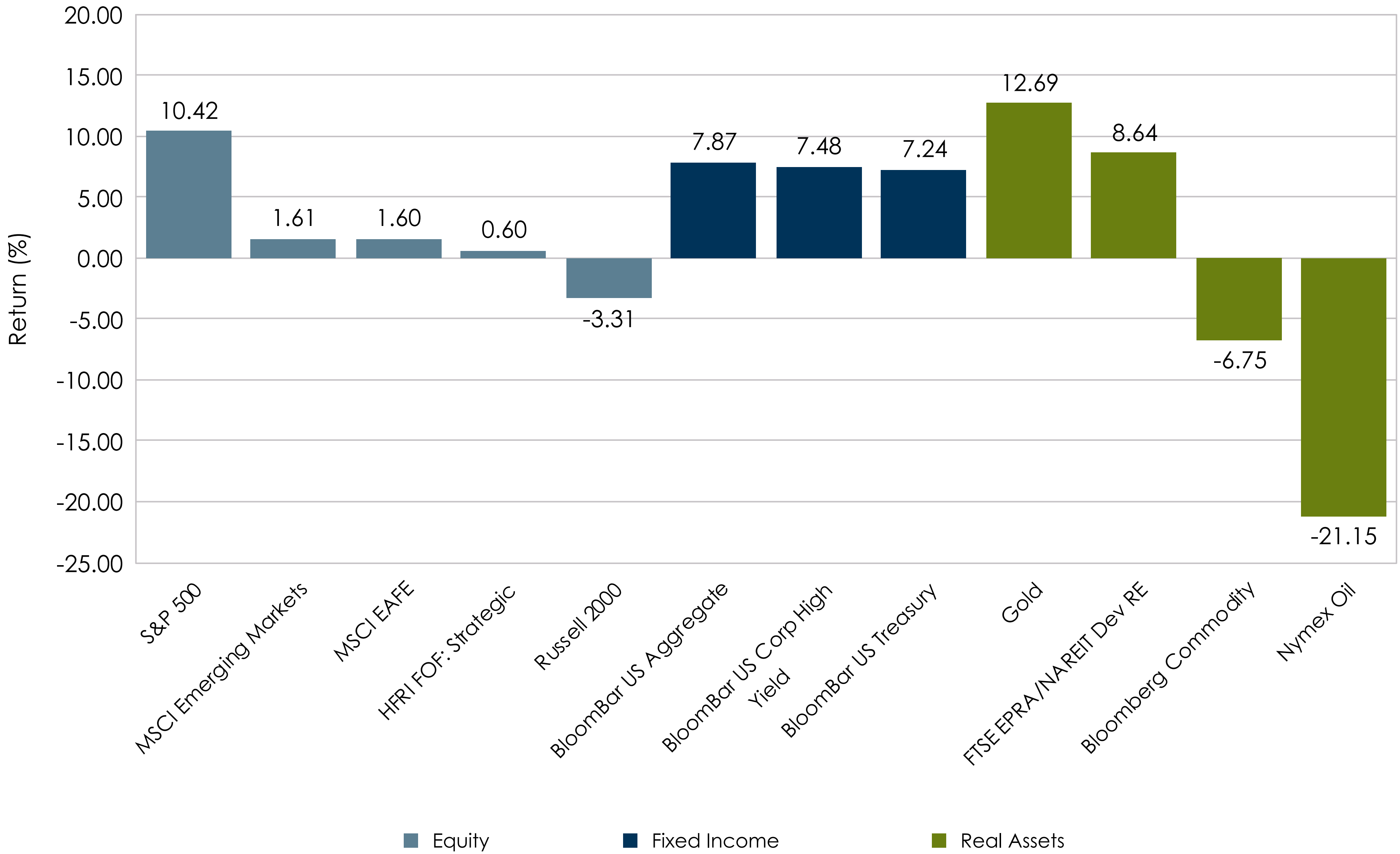
Market Returns

For the YTD Period Ending June 30, 2019



Market Returns

For the 1 Year Period Ending June 30, 2019



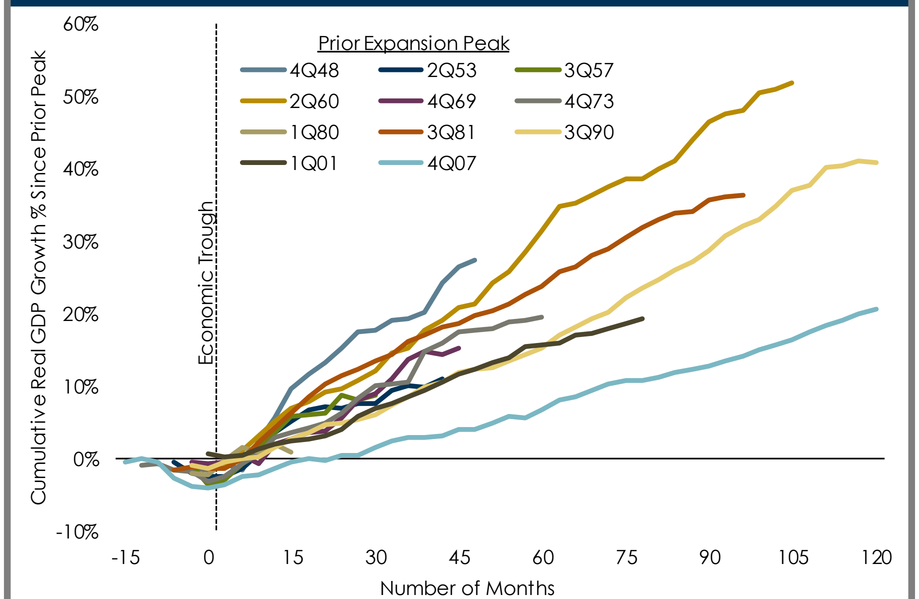
US

- **1Q-19 Real GDP grew at an annualized rate of 3.1%,** up moderately from initial estimates. The increase in real GDP reflected greater inventory buildup and exports pulled forward amid tariff fears. Forecasts for 2Q-19 are measurably lower, with consensus between 1.5% and 2.0%.
- **Labor conditions remain strong,** with the unemployment rate at 3.7% in June. New job creation has slowed from the pace witnessed in 2018, with average hourly wage increases staying well-contained at 3.1%.
- **Sentiment indicators have softened**, with consumer confidence trending down as forward expectations trail the appraisal of current conditions. CFO surveys of projected CapEx suggest a declining trend, and the level of stock buybacks has now contracted for the first time in seven quarters.
- While taking no action on short-term interest rates, the **Federal Reserve's** messaging turned increasingly dovish. The latest dot-plot showed slightly less than half of the members are expecting at least one rate cut in 2019. The futures market is pricing in at least three cuts over the next 12-months.

Global/Non-US

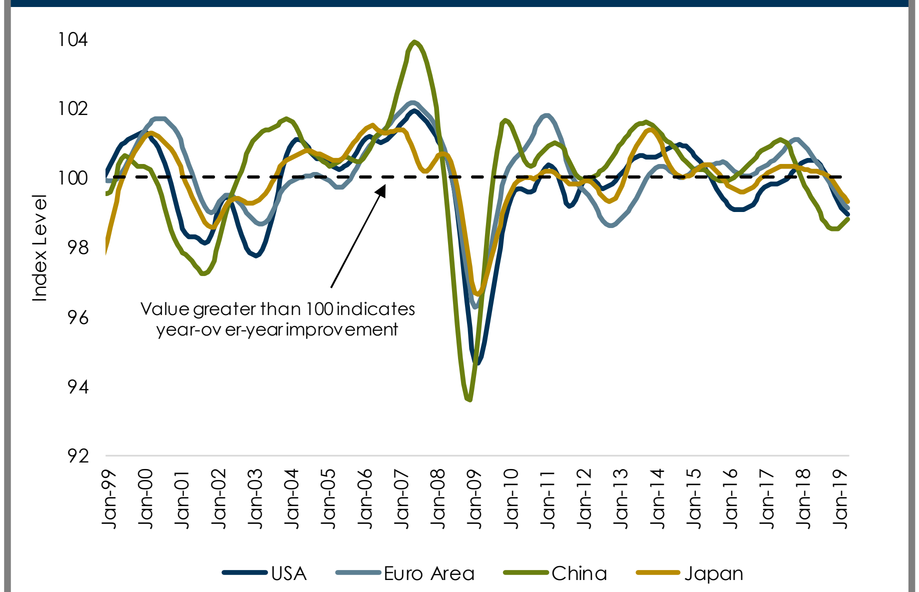
- **Focus on US-China relations** goes beyond unresolved trade/tariff issues. Despite another "truce" agreement at the G20 Summit in late-June, the strategic nature of the rivalry between these global powers could certainly weigh on trend growth and induce periodic bouts of volatility.
- The **European economy continues to show signs of weakness**, most notably as it relates to export-dependent manufacturing and subdued inflation. The ECB's outgoing President Mario Draghi has responded, indicating both an ability and willingness to employ further monetary policy tools.
- **Leading indicators are trending lower** in most major economies. China may still be an exception, as their stimulative policy began in mid-2018 and has continued as President Xi's overarching priority remains the "Chinese Dream" of becoming a high-income country by 2021.
- **Geopolitical tensions** remain a source of potential volatility, as heightened conflict with Iran recently impacted oil markets. The Brexit situation remains fluid, while the Eurozone faces other coordination issues on fiscal policy.

Longest Expansion in US History is Slow & Steady

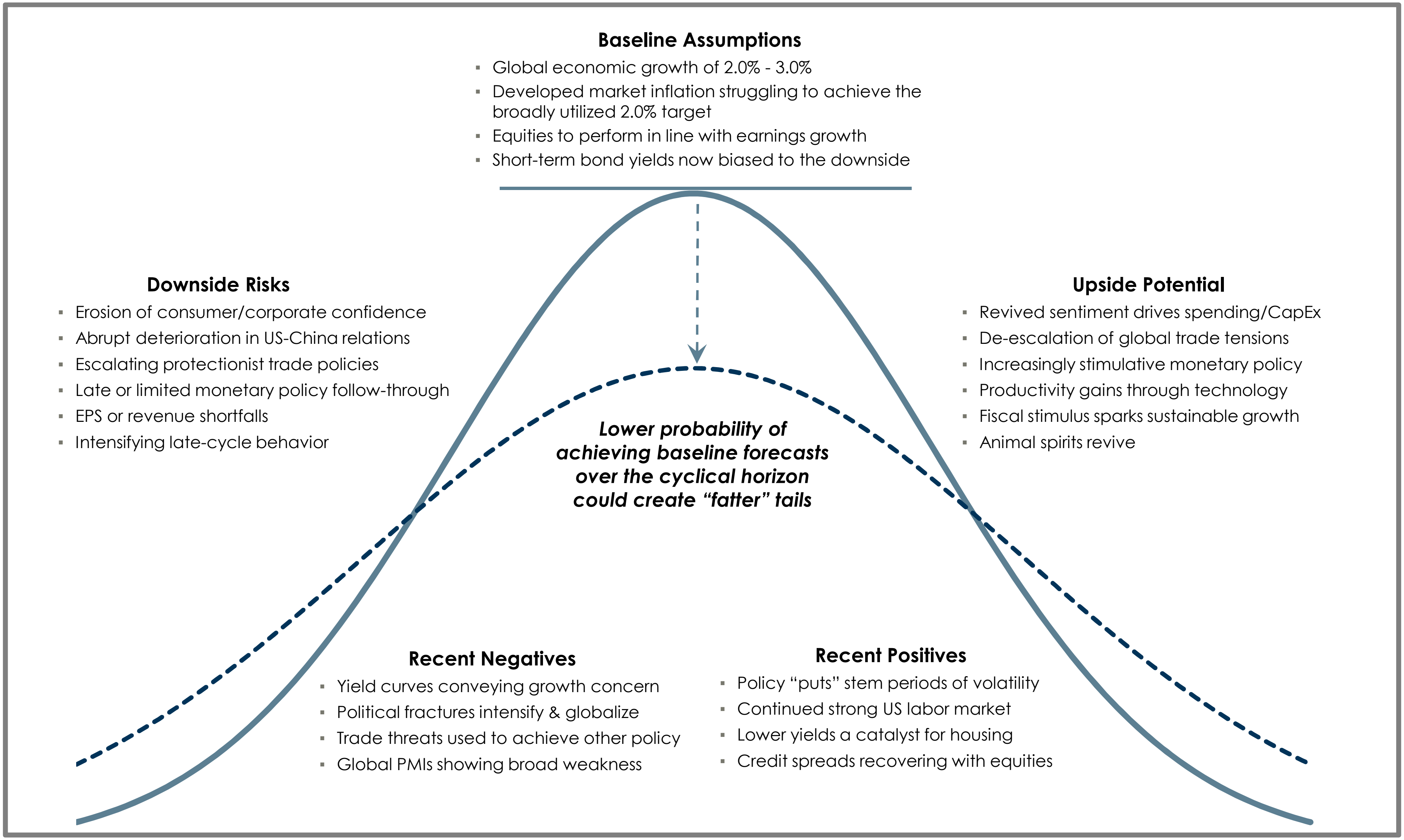


Source: ACG Research, St, Louis Federal Reserve (FRED database), Bloomberg

Widespread Decline In Leading Indicators



Source: ACG Research, Bloomberg



Baseline Assumptions
- Global economic growth of 2.0% - 3.0%
- Developed market inflation struggling to achieve the broadly utilized 2.0% target
- Equities to perform in line with earnings growth
- Short-term bond yields now biased to the downside

Downside Risks
- Erosion of consumer/corporate confidence
- Abrupt deterioration in US-China relations
- Escalating protectionist trade policies
- Late or limited monetary policy follow-through
- EPS or revenue shortfalls
- Intensifying late-cycle behavior

Upside Potential
- Revived sentiment drives spending/CapEx
- De-escalation of global trade tensions
- Increasingly stimulative monetary policy
- Productivity gains through technology
- Fiscal stimulus sparks sustainable growth
- Animal spirits revive

Lower probability of achieving baseline forecasts over the cyclical horizon could create "fatter" tails

Recent Negatives
- Yield curves conveying growth concern
- Political fractures intensify & globalize
- Trade threats used to achieve other policy
- Global PMIs showing broad weakness

Recent Positives
- Policy "puts" stem periods of volatility
- Continued strong US labor market
- Lower yields a catalyst for housing
- Credit spreads recovering with equities

What is the issue?

- While most investors stop short of suggesting the presence of excessive "bubbles" in the market, corporate debt is widely considered the weakest link
- Credit spreads typically maintain an inverse relationship with risk-off interest rates, and can provide early notice of strain in the broader economy
- Default rates remain quite low, but periodic bouts of volatility suggest investor concern around the possibility of a coming downgrade/distressed cycle
- The investment grade credit market is 5x the size of the high yield market, with over 50% of this category now represented by lower-rung BBB securities

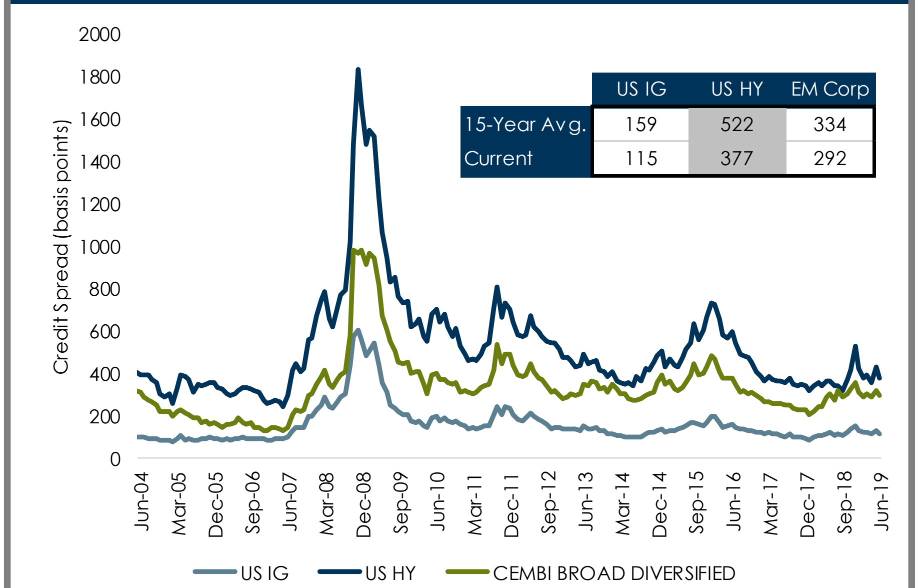
Where do things stand?

- While remaining well off all-time lows, spreads across categories have tightened materially following late-2018 weakness and reside below long-term averages
- Even with a brief interruption in investor risk appetite in May, strong price appreciation has driven the year-to-date returns for high yield to approximately 10%
- Most believe we are late in the market cycle, but generally strong technicals create a divergence in managers' willingness to get outright defensive in their portfolios
- Concerns about market structure and liquidity suggest that any sudden and/or large scale attempt to de-risk will be difficult to accommodate without disruption

ACG Thoughts:

- We expect investors will see the most value-add from idiosyncratic relative value situations, with strong research and portfolio flexibility superior to outright beta plays
- A diversified hedge fund approach to credit has provided solid up/down capture relative to long-only high yield, with slightly below 50% of the overall volatility

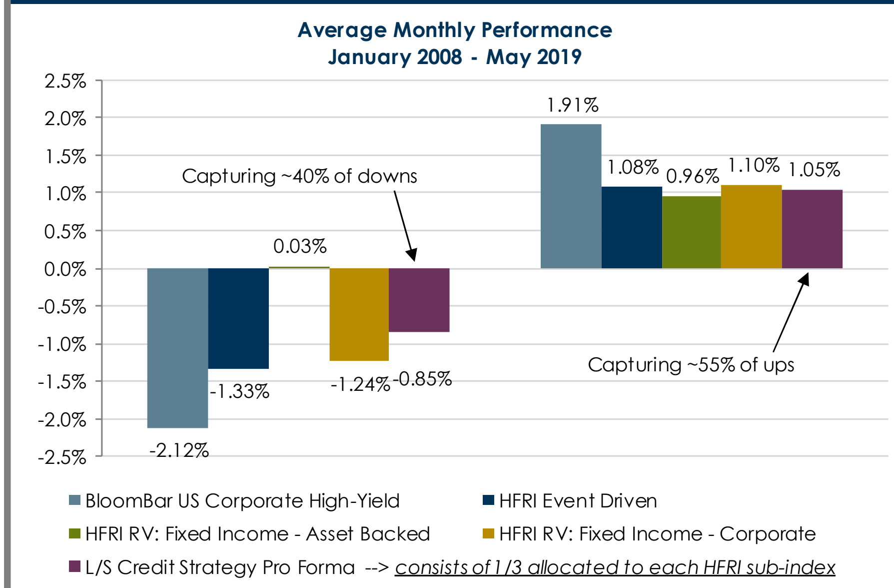
Relatively Tight Spreads Foster Late-Cycle Concern



	US IG	US HY	EM Corp
15-Year Avg.	159	522	334
Current	115	377	292

Source: ACG Research, J.P. Morgan, Bloomberg

Long/Short Credit Hedge Funds A Differentiated Approach



Source: ACG Research, HFRI, Bloomberg

What is the issue?

- The return on international securities has two components: the return earned in local currency terms, and the change in the value of the currency itself
- While predicting currency fluctuations is exceedingly difficult, the relative value of the US dollar typically runs in cycles lasting between 5 and 10 years
- US and foreign governments often prefer to have a lower valued currency, as it makes exports more competitive and consequently supports growth

Where do things stand?

- Since mid-2011, the US dollar has generally strengthened against a diversified basket of foreign currency, with 2017 being a notable, albeit brief exception
- US stocks have materially outperformed international stocks over that time period, with the strengthening US dollar a significant headwind for ex-US returns
- The recent shifts by the Federal Open Market Committee (FOMC) and dovish statements by Chairman Powell have led to a modest weakening of the US dollar
- As the European Union and others have also outlined steps to ease access to money, the so called "race to the bottom" may counteract FOMC actions
- Elevated levels of negative yielding bonds creates generalized uncertainty around fiat currency, which has benefited safe havens of value such as gold

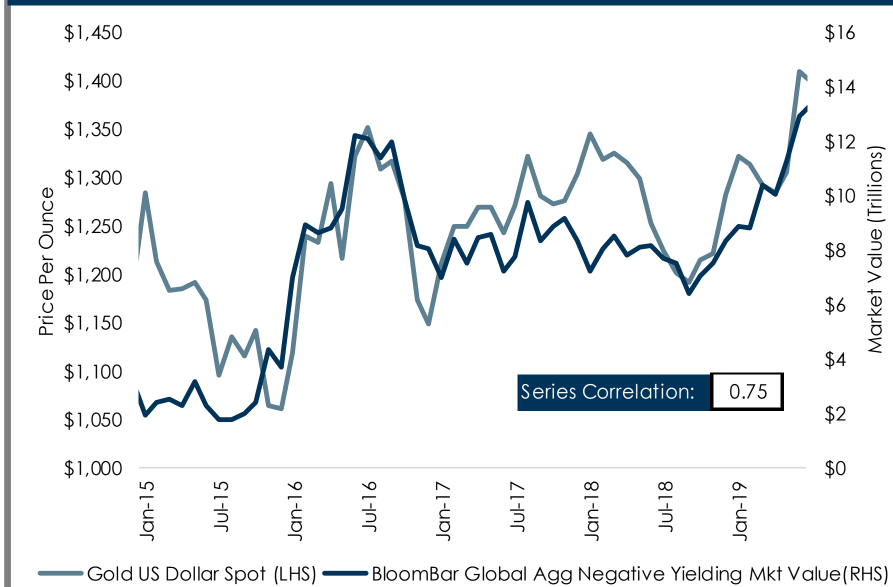
ACG Thoughts:

- A more supportive global monetary policy regime could restore investor enthusiasm and potentially act to extend the current cycle of economic growth
- Despite the ongoing potential of a safe haven bid, the US dollar is considered a counter-cyclical currency that should lag in a re-acceleration environment

The US Dollar Against its Major Trading Partners

Source: ACG Research, Bloomberg

As Cash Yields Tumble, Gold Has Been Shining



Source: ACG Research, Bloomberg

What is the issue?

- Internet driven companies, many a part of what is now called "Social Media," do not have the same structured regulatory environment as other industries
- Several of these companies are effectively monopolies, as they have accumulated millions and even billions of users despite limited barriers to entry
- As the tentacles of organizations such as Google (Alphabet), Facebook, and Amazon spread wider, there is greater attention to the influence they wield
- In contrast to prior "monopolies," many of these entities thrive on ad-clicks, rather than particular products or services they create

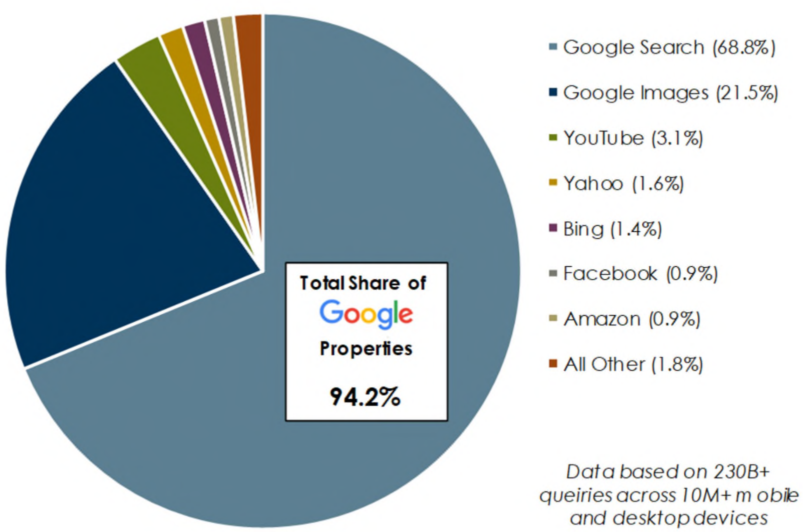
Where do things stand?

- As this is somewhat uncharted territory, countries and regulatory organizations have been moving slowly in their approach to monitoring these organizations
- A comparison could be made to internet companies in the late 1990s, where there were a number of initial players, but only a few ended up dominating
- Privacy and content regulation are two significant issues facing these organizations, and navigating scrutiny in disparate regions will be key to long-term success

ACG Thoughts:

- Looking back through history, the break-up of AT&T and the non-breakup of Microsoft stand out as two different outcomes from a similar type of scrutiny
- Challenges at Google and Facebook may be similar to those of Microsoft, where due to their dominant positions, they have significant access to customers
- Maneuvering within the court of public opinion will perhaps be as critical as enduring the costs and time spent in the legal and regulatory arenas

Dominance of Google in US Web Searches



Source: ACG Research, jumpshot, SparkToro (January through March 2019)

Long Term Returns Reflect Influential Trends

Market Cap ($ bn)	2012	Today	Growth
AMZN	$114	$932	8.2x
AAPL	$501	$911	1.8x
FB	$58	$551	9.5x
GOOG	$232	$750	3.2x
MSFT	$225	$1,027	4.6x
FAAMG	$1,129	$4,171	3.7x
S&P Industrials	$1,334	$2,430	1.8x
S&P Financials	$2,000	$3,250	1.6x
SPX	$13,165	$25,887	2.0x
SPX ex FAAMG	$12,035	$21,716	1.8x

Source: ACG Research, Bloomberg

Investment Themes

Theme	Key Considerations	Implementation Strategy
Growth	▪ Late-cycle, 10-year expansion ▪ Consumer confidence high but moderating ▪ Global manufacturing contracting ▪ Leading economic indicators softening ▪ China's growth path plays increasing role	▪ Maintain long-term strategic allocations ▪ Passive exposure in efficient markets ▪ Active/focused/opportunistic in less efficient areas ▪ High-quality orientation
Yield Environment	▪ Yield curve flat/inverted (3mo – 10 Yr) ▪ Longer-term rates signaling shift in policy ▪ Futures market expecting rate cuts ▪ 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) ▪ Incorporate "non-traditional" strategies
Inflation	▪ Tight labor markets - building wage pressure ▪ Inflation expectations still falling short of 2% ▪ Uncertain impact of technology, worker productivity, demographic trends, trade policy	▪ Core real estate - rent escalation ▪ Shorter-dated fixed income - positive real yield ▪ Floating rate securities - protect against surprise ▪ Active managers with niche alpha strategies
Risk & Uncertainty	▪ Waning gov't influence - high debt, demographics ▪ Trends toward protectionism – trade disruption ▪ 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 short-term liquidity ▪ Disciplined rebalancing
Return Expectations	▪ Portfolio returns to remain below long-term average ▪ Low rates, potentially capped equity valuations ▪ Potential for increased market volatility ▪ Lower correlations between asset classes	▪ Revisit risk tolerance and investment objectives ▪ Focus on strategic plan vs. tactical shifts ▪ Employ risk-reducing/hedged strategies ▪ Maintain liquid and illiquid assets exposure ▪ Seek active strategies with enhanced flexibility

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