Summit Strategies Group

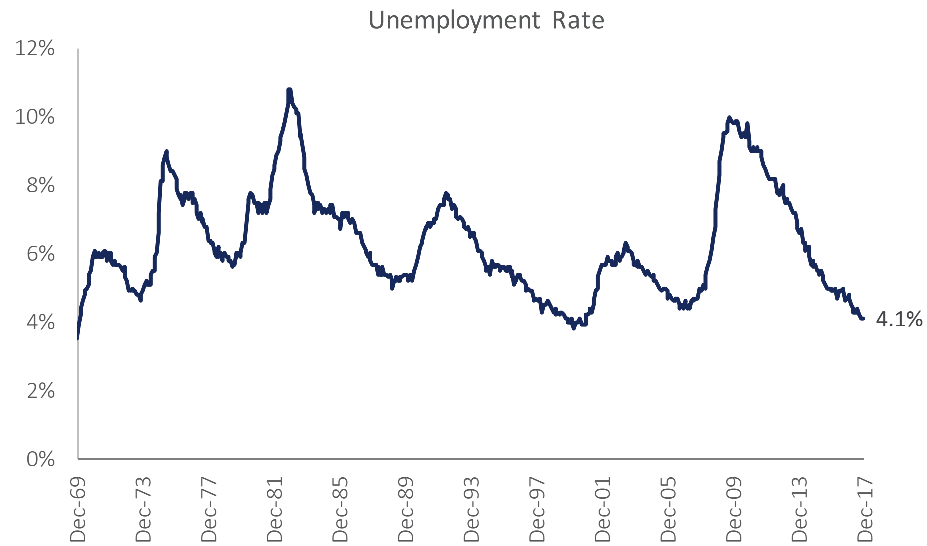
Economic and Capital Market Update

December 2017

Economic Perspective

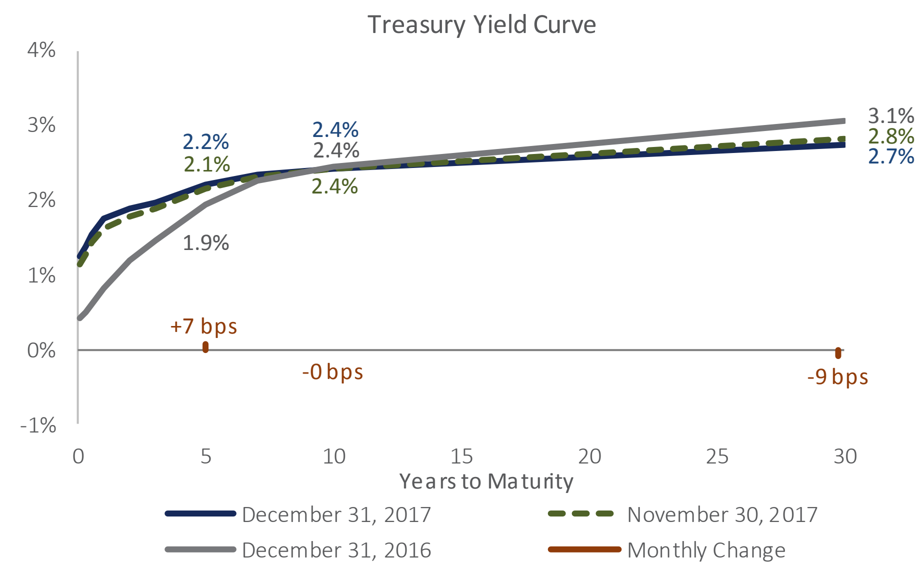
Economy

- Many of the economic and market themes seen throughout 2017 continued during the month of December. Inflation remained below the Federal Reserve's target despite continued labor force progress and rising GDP growth. In keeping with the strategy of raising interest rates gradually the Federal Open Market Committee (FOMC) increased rates for the third time in 2017 to a range of 1.25%-1.50%. Equity markets continued to produce strong returns during the month, supported by strong earnings, continued stable economic growth, and the passing of the GOP tax bill.
- US employers added 148,000 jobs in December and the unemployment rate was unchanged at 4.1%, matching its lowest level since December 2000. The US economy has experienced positive job growth for 87 consecutive months, the longest streak since labor market data collection began in the 1940s. Wage growth, as measured by the change in employees' average hourly earnings, was 2.5% over the 12 months ending in December; annual wage growth was unchanged from November.
- Real GDP in the US grew at a 3.2% annualized rate during the third quarter of 2017, according to the third estimate released by the Bureau of Economic Analysis. This final estimate marks back-to-back quarters of 3% growth for the first time since 2014. Continued strong household demand, rising business investment, and increased exports stemming from strong global growth have contributed to the rise in GDP.
- Purchasing Managers Indices (PMI) remain at high levels, suggesting increased activity in both the service and manufacturing sectors of the US and global economy. The US ISM Manufacturing PMI increased 1.5 in December to 59.7; an Index reading over 50 indicates expansion in the sector. Manufacturing has now been a boost to US growth for 16 consecutive months. The Non-Manufacturing (or services) PMI declined 1.5 in December to 55.9 but continues to reflect strength. US services have expanded 96 consecutive months. Global PMI levels were also consistently high in 2017, reflecting the broad-based pickup in global economic activity.



Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 19 bps to 86 bps in December, declining to its lowest level since October 2007. Over the past two years, the 2-30 spread has tightened by 111 bps; long-term yields have declined despite stronger US growth, while short-term yields have been lifted by Federal Reserve rate hikes. The 20-year average spread between 2-year and 30-year Treasuries is 192 bps.



Growth Assets

Public Equities

- Global equity markets continued to produce strong gains in December. US equities delivered positive returns for each month of 2017, a phenomenon not seen since 1958; positive domestic performance was driven by strong earnings, continued stable economic growth, and tax reform. MSCI ACWI IMI extended its streak of consecutive monthly gains to 14, the longest since the inception of the Index in 1994. During 2017 international markets outperformed US for the first time since 2012, supported by strengthening fundamentals.
- Master limited partnerships (MLPs) gained 4.7% in December as each sector produced positive returns for the month. For the trailing 12 months, MLPs distributions were not enough to overcome price declines and the Alerian MLP Index returned -6.5%.

Public Debt

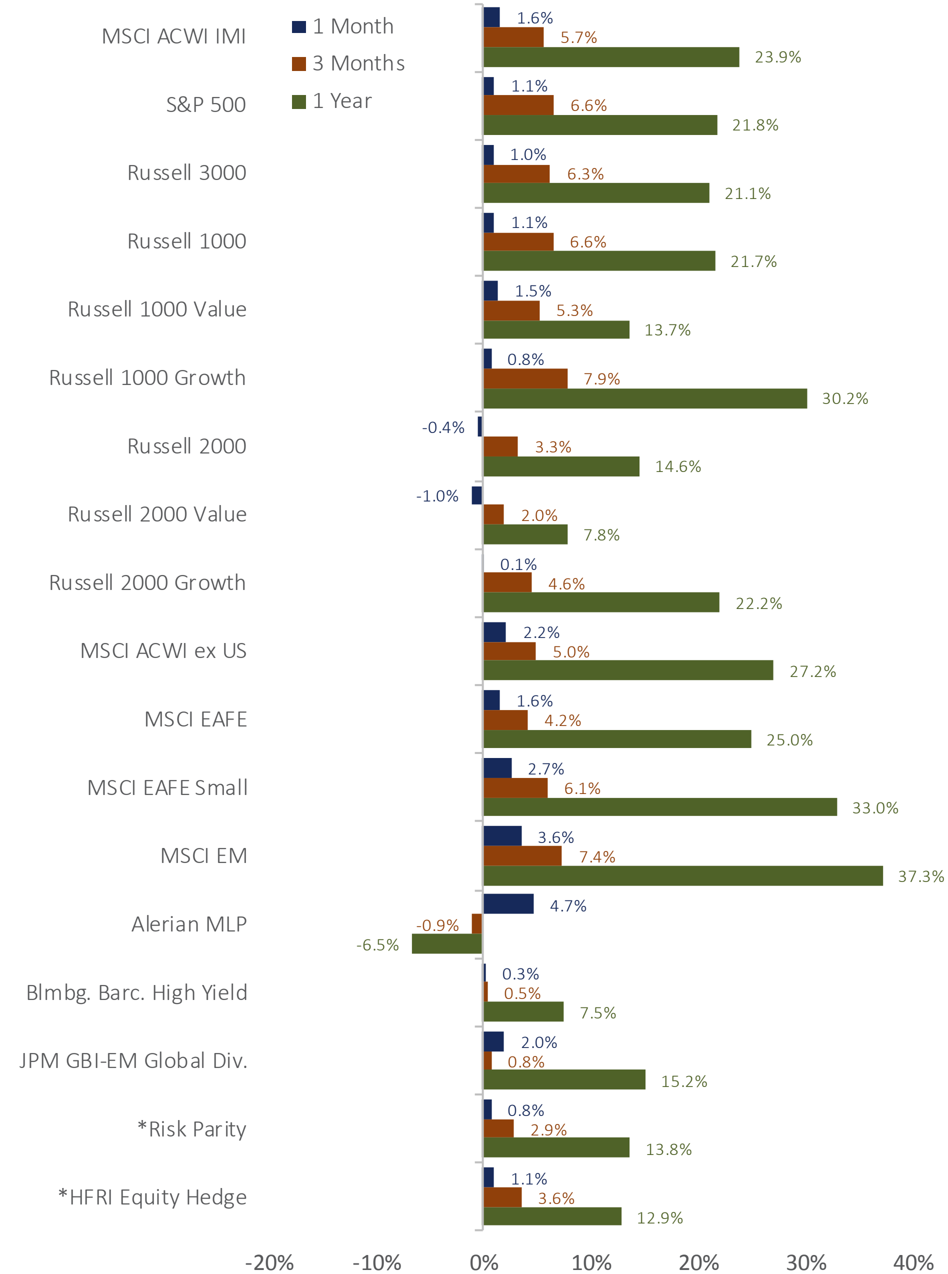
- High yield bond yields rose 4 bps during the month, ending at 5.72%. Over the past year continued investor demand for yield, strong risk asset performance, and low default rates have supported the high yield market, which returned 7.5% in 2017.
- Local currency-denominated emerging market bond yields declined 6 bps to 6.13% in December. Continued gains for EM debt were once again supported by FX appreciation.

Private Assets

- Fundraising slowed in Q3 2017, as Preqin estimated total commitments of $96M versus $137M the quarter prior. However, of note is that Apollo Global Management raised the largest private equity fund in history at $25 billion in total commitments, indicative of the ongoing frothy environment for private equity. This increase in capital has caused LBO purchase price multiples to rise above 10x EBITDA, up from 2016.
- Leverage multiples have increased to over 5.5x EBITDA in 2017, following a decline in 2016. We continue to see robust demand for private debt funds, as momentum increased in Q3 2017. This ongoing demand from investors has helped support higher leverage levels and kept a ceiling in place for average loan spreads.

Hedge Funds

- Risk parity strategies contributed in November, with most gains coming from equity strategies. Commodity returns were nearly flat, while bonds detracted slightly.
- Growth hedge funds contributed in November, with gains concentrated in equity strategies. Event-driven performance was mixed, with gains in distressed strategies offset by losses in merger arbitrage and activist strategies.



*Data was not available at time of publication – returns are previous month's. All returns are USD.

Income Assets

Public Debt

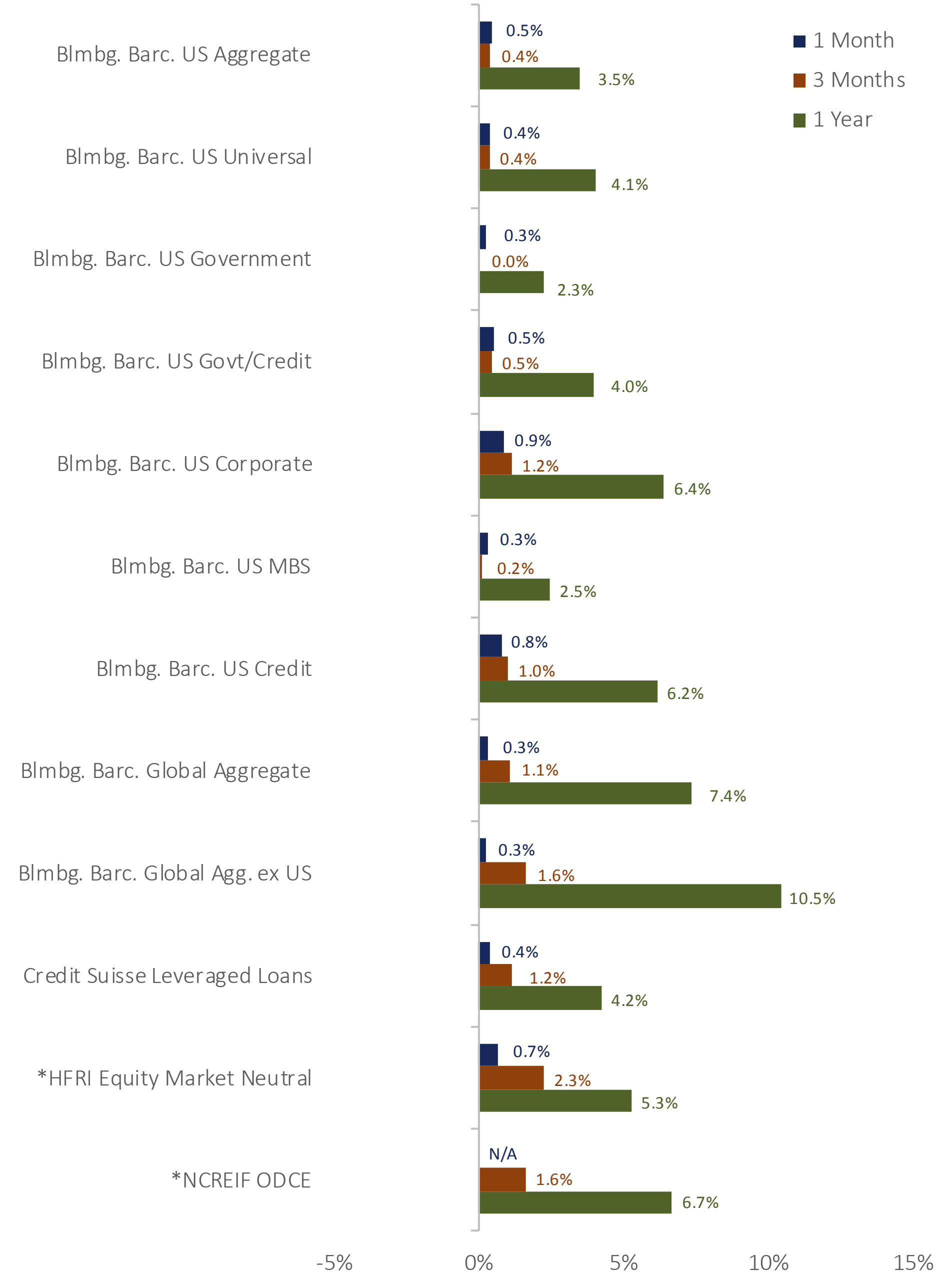
- Despite the increase in growth experienced during 2017, long-term yields remained anchored. Low yields throughout the rest of the developed world and continued strong foreign demand for the relatively attractive yields of US bonds has kept 10- and 30-year bond yields near all-time low levels. Given this continued demand for long-term bonds while the Federal Reserve continues to raise short-term interest rates, the slope of the yield curve has declined to its lowest level since the financial crisis.
- The 10-year US Treasury yield ended December at 2.4%, unchanged from the end of November. Throughout 2017 the 10-year yield traded in a relatively narrow range, declining to as low as 2.1% in August before rising to end the year mostly unchanged from the end of 2016.
- The Bloomberg Barclays US Aggregate returned 0.5% in December, bringing year-to-date returns to 3.5%. Corporates were the best-performing sector in the Index, with long-duration issues outperforming the short-duration sector as rates fell along the long end of the curve.
- The Bloomberg Barclays Global Aggregate gained 0.3% for the month, consistent with the coupon payment of the Index. The outperformance for global fixed income versus the US during 2017 can primarily be explained by foreign currency appreciation versus the dollar.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, returned 0.4% during December bringing 2017 gains to 4.2%.

Relative Value Hedge Funds

- Relative value hedge funds gained in November, with the largest contributions coming from equity market neutral strategies. Volatility arbitrage also gained, while credit strategy performance was muted.

Core Real Estate

- Core real estate returns for the third quarter of 2017 were 1.9% gross and 1.6% net, bringing the one-year gain for core funds to 6.7%. Strong but declining gains in the commercial real estate market have been supported by the US cyclical expansion, with strong labor market growth fueling demand while supply remains limited. In recent quarters price appreciation has slowed compared to prior in the expansion, with a larger percentage of real estate gains now being generated through income.



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Diversification Assets

Inflation

- TIPS returned 0.9% during December, with gains supported by declining real yields and rising inflation expectations. At the end of December, 10-year breakeven inflation expectations were 1.98%, up 11 bps from the end of November.

Deflation

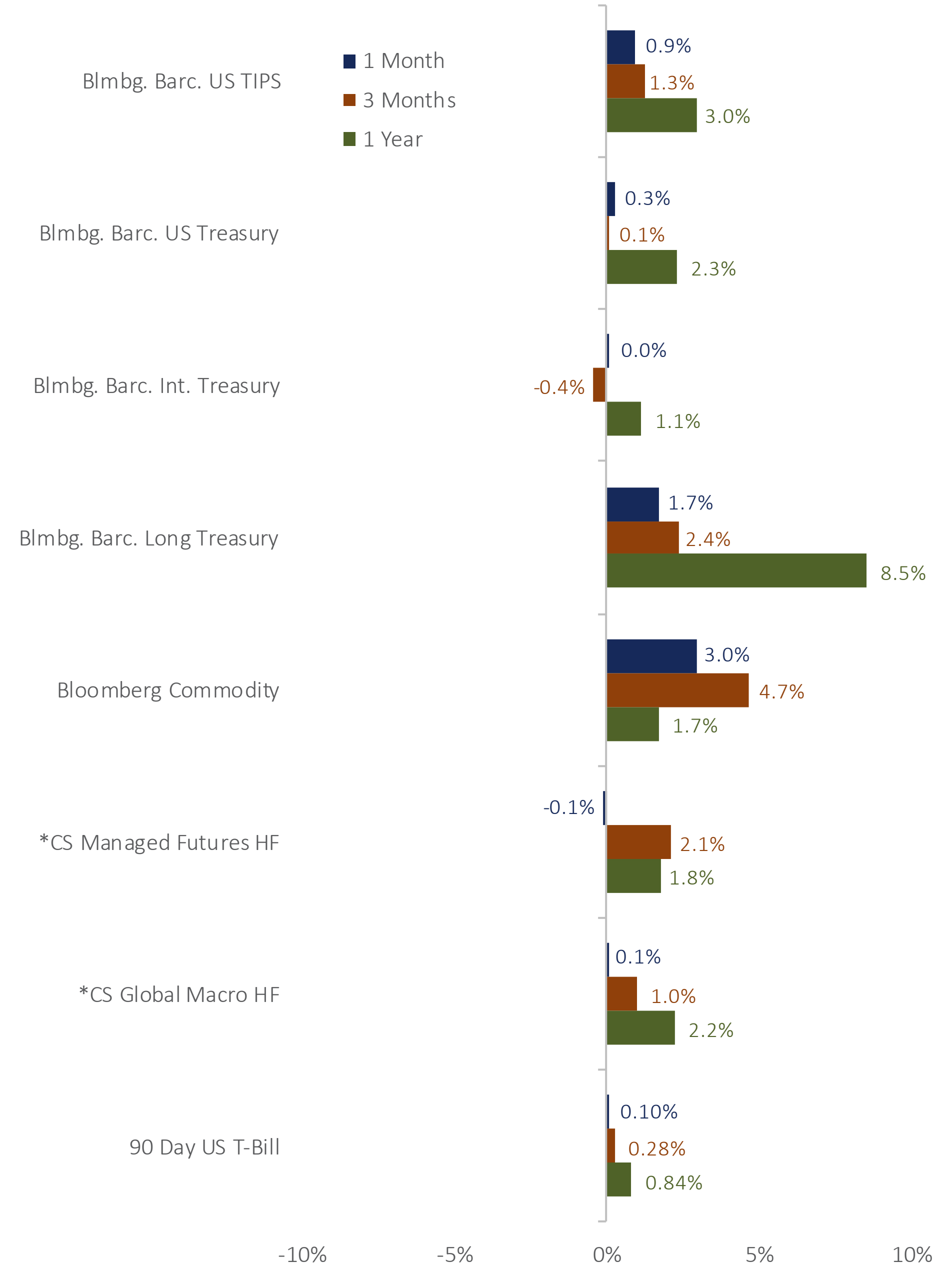
- The Bloomberg Barclays Long Treasury Index returned 1.7%, with both the coupon and principal contributing to returns during the month. Rates at the long end of the curve fell, with the 30-year Treasury yield declining 9 bps to end the month yielding 2.7%.

Commodities

- The Bloomberg Commodity Index gained 3.0% in December, driven by outperformance in industrial metals and energy, despite natural gas posting a negative return. Over the trailing twelve months, the Bloomberg Commodity Index has returned 1.7%; industrial metals and precious metals have continued to be the largest contributors to commodity gains over the trailing year, in addition to oil's 12.5% increase.

Tactical Trading

- Global macro hedge funds were flat in November, with little movement in both discretionary and CTA strategies.



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