Summit Strategies Group

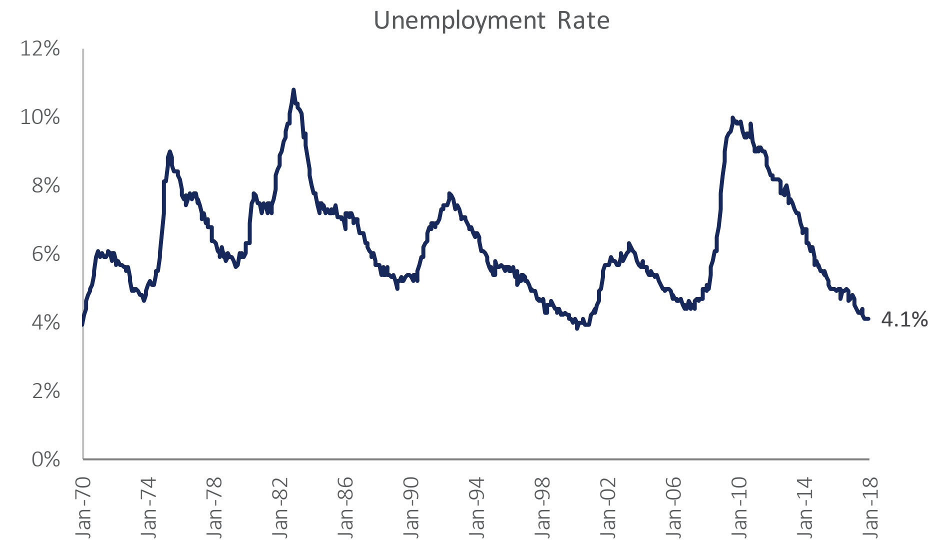
Economic and Capital Market Update

January 2018

Economic Perspective

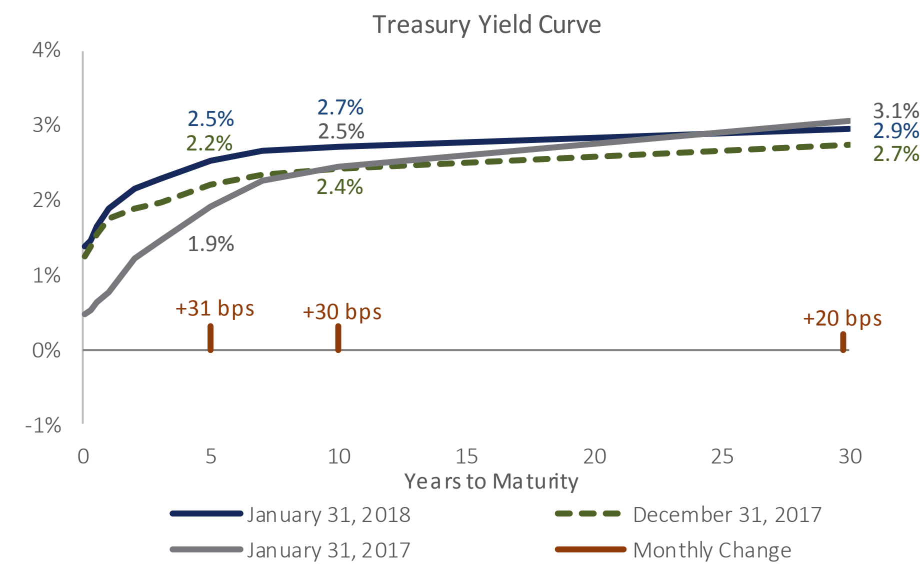
Economy

- The first month of 2018 saw a continuation of many trends that were in place at the end of 2017. Positive economic data and corporate earnings reports remained supportive of risk assets, as global equity markets turned in their 15th consecutive month of gains (MSCI ACWI IMI, +5.4%). Consistent with the current economic environment, the International Monetary Fund (IMF) increased its global growth forecasts for 2018 and 2019 during January. The forecast of 3.9% growth in 2018 and 2019 (up 20 bps from the previous forecast) would be the fastest growth rate for the global economy since 2011. Short-term growth increases in the US, due in part to tax reform, and improving activity outside the US contributed to the IMF's more optimistic near-term outlook.
- US employers added 200,000 jobs in January 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 88 consecutive months, the longest streak since labor market data collection began in the 1940s. Wages grew 2.9% over the 12 months ending January, marking the fastest pace of wage growth since 2009.
- Real GDP in the US grew at a 2.6% annualized rate during the fourth quarter of 2017, according to the initial estimate released by the Bureau of Economic Analysis. Strong consumer spending and exports were somewhat offset by drags from inventory and imports during the quarter. Overall, the growth rate for the US in 2017 was 2.3%.
- 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 decreased 0.6 in January to 59.1; an Index reading over 50 indicates expansion in the sector. Manufacturing has now been a boost to US growth for 17 consecutive months. Global PMI levels have also remained consistently high, reflecting the broad-based pickup in global economic activity.



Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 6 bps to 79 bps in January, declining to its lowest level since October 2007. Over the past two years, the 2-30 spread has tightened by 105 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 January. Emerging markets remained the best-performing equity region (MSCI EM, +8.3%). US equities continued to produce positive returns (Russell 3000, +5.3%) driven by strong earnings, continued stable economic growth, and tax reform. MSCI ACWI IMI extended its streak of consecutive monthly gains to 15, the longest since the inception of the Index in 1994.
- Master limited partnerships (MLPs) gained 5.8% in January as nearly every sector produced positive returns for the month. Energy services lead the outperformance, returning 13.8% for the month. For the trailing 12 months, MLPs distributions have not been enough to overcome price declines and the Alerian MLP Index returned -5.7%.

Public Debt

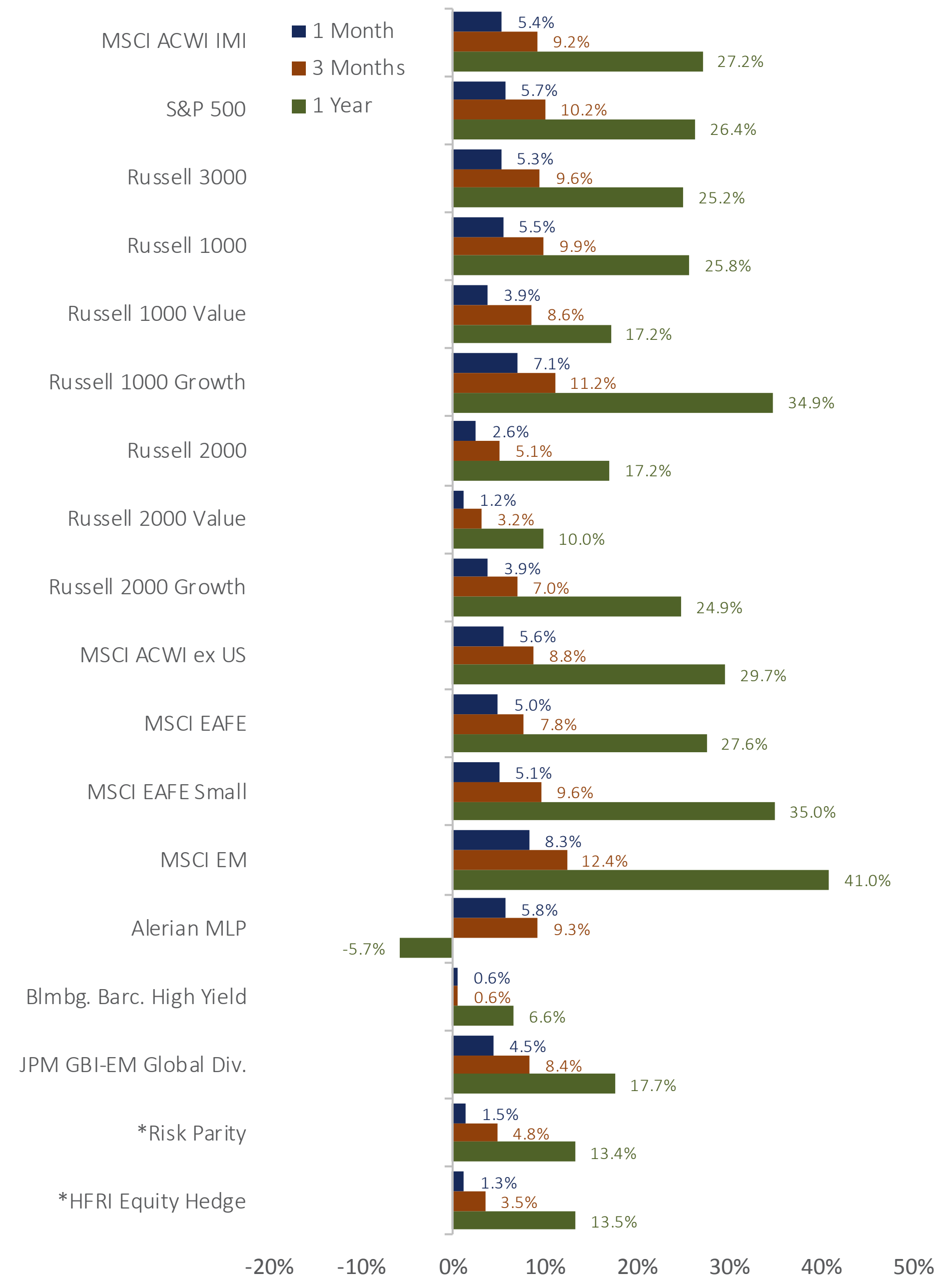
- High yield bond yields rose 6 bps during the month, ending at 5.8%. Over the past year continued investor demand for yield, strong risk asset performance, and low default rates have supported the high yield market, which has returned 6.6%.
- Local currency-denominated emerging market bond yields declined 6 bps to 6.1% in January. Strong gains for EM debt were once again supported by FX appreciation.

Private Assets

- Fundraising recovered in Q4 2017, as Preqin estimated total commitments of $162B versus $96B in Q3. 2017 represented a record year for private equity fundraising, as 1,420 funds secured a combined $754B in commitments, surpassing the 2016 record of $728B raised by 1,860 funds.
- Leverage multiples increased to over 5.7x EBITDA in 2017, following a decline in 2016. The ongoing strong demand from investors for private debt funds has helped support higher leverage levels and kept a ceiling in place for average loan spreads.

Hedge Funds

- Risk parity strategies contributed in December. The strongest gains came from commodities, followed by equities. Nominal and inflation-linked bonds were mostly flat.
- Growth hedge funds gained in December, with gains spread across strategies. Distressed debt strategies were the strongest contributor, followed closely by long/short equity. Activist and merger arbitrage strategies also contributed.



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

Income Assets

Public Debt

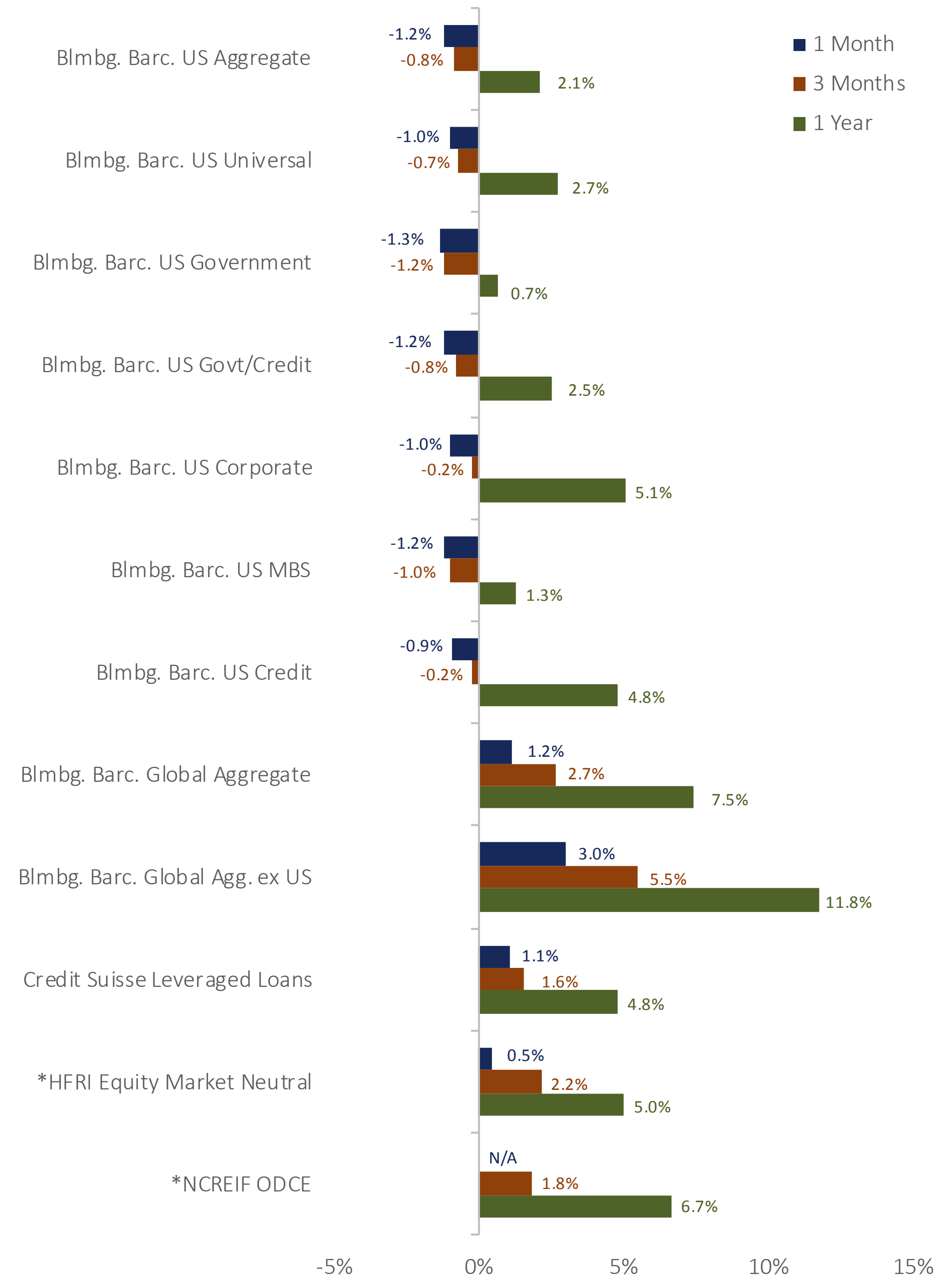
- While the Federal Reserve met and did not raise interest rates in January, the FOMC and market participants are broadly expecting three rate increases during 2018. Consistent with strong economic growth and expectations for further Fed rate increases, yields rose across the curve during January; the 10-year Treasury yield rose 30 bps to 2.71%, its highest month-end level since March 2014.
- Rising yields resulted in the worst month of performance for the Bloomberg Barclays US Aggregate since the US election in November 2016, as the Index returned -1.2%. Within the Aggregate, credit outperformed governments as spreads tightened further, and short-term bonds outperformed long-term bonds.
- The Bloomberg Barclays Global Aggregate gained 1.2% for the month, adding to recent strong gains for global fixed income in USD terms. The outperformance for global fixed income versus the US can primarily be explained by foreign currency appreciation versus the dollar, as the dollar declined to its lowest level since 2014 during January.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, gained 1.1% during January. Investor demand for floating-rate debt has lifted aggregate bank loan prices to their highest levels August 2014, with the Credit Suisse Leveraged Loan Index average price reaching $98.42 at month-end.

Relative Value Hedge Funds

- Relative value hedge funds contributed in December, with strong gains in credit-related strategies. Equity market neutral, convertible arbitrage, and volatility arbitrage were more modest contributors.

Core Real Estate

- Core real estate returns for the fourth quarter of 2017 were 2.1% gross and 1.8% net, bringing the one-year gain for core funds to 6.7% net. While still positive, core real estate gains in 2017 were the lowest since 2009. Declining but still positive returns in the commercial real estate market have been supported by the US economic expansion; continued labor market growth has been a tailwind for demand while supply remains limited.



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Diversification Assets

Inflation

- TIPS returned -0.9% during January, with rising real yields contributing to declines. At the end of January, 10-year breakeven inflation expectations were 2.11%, up 13 bps from the end of December and reaching their highest level since August 2014.

Deflation

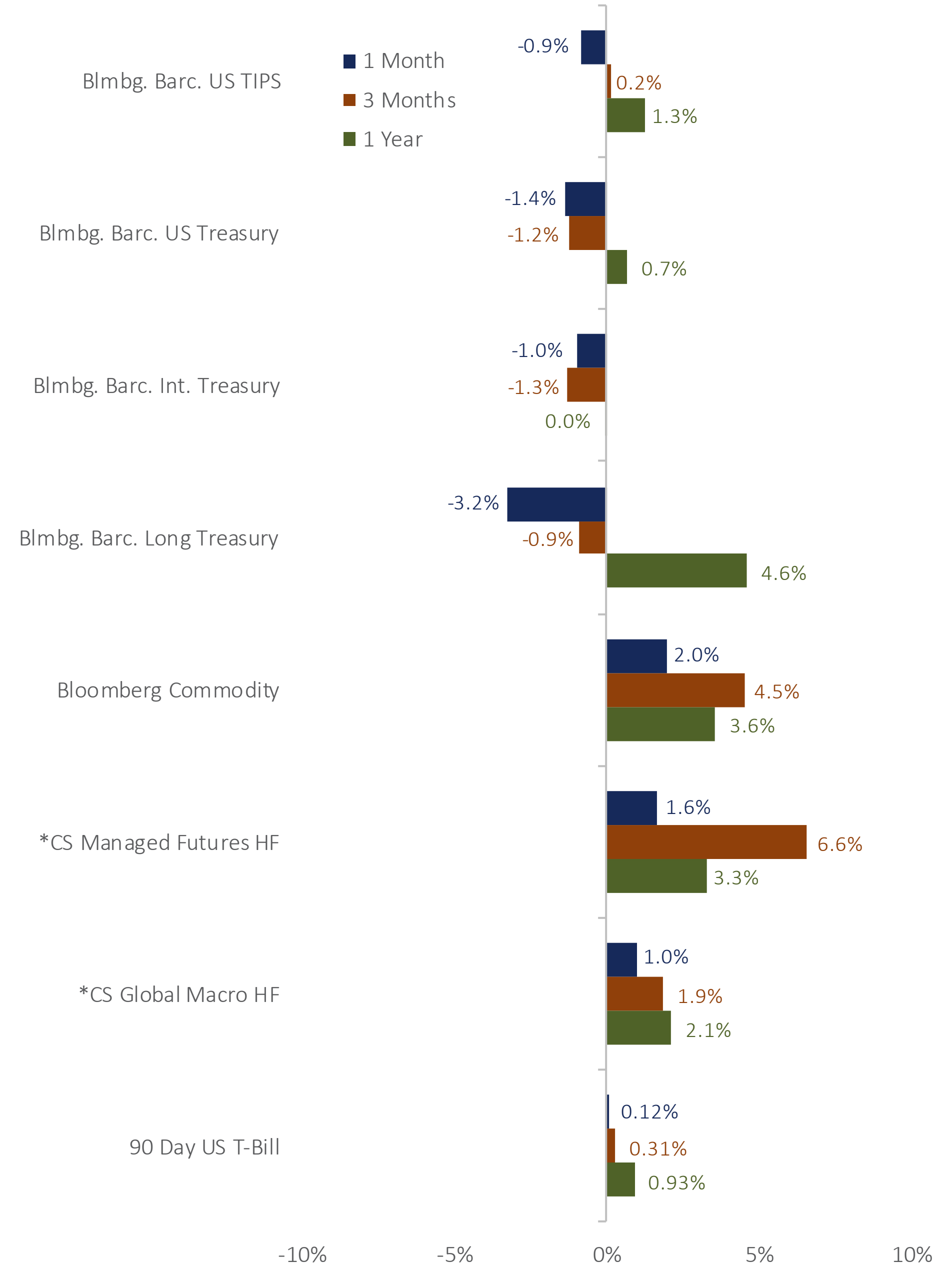
- The Bloomberg Barclays Long Treasury Index declined 3.2%, with the 30-year Treasury yield rising 20 bps to 2.94%. Given strong demand for the relatively high yield and safety of long-term US government bonds compared to yields available throughout the rest of the world, 30-year yields have remained mostly anchored. Compared to the US 5-year Treasury yield, which has risen 60 bps over the past year, 30-year yields have risen just 12 bps.

Commodities

- The Bloomberg Commodity Index gained 2.0% in January driven by outperformance in grains, industrial metals, and energy. Over the trailing 12 months, the Bloomberg Commodity Index has returned 3.6%; industrial metals and energy were the largest contributors to commodity gains over the trailing year.

Tactical Trading

- Macro hedge funds gained in December, with solid contributions from both discretionary global macro and trend-following CTAs.



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