GLOBAL MONTHLY FOCUS
February 2018

Global Financial
Private Capital

KEY TAKEAWAYS

- To describe the markets as a "wild ride" in February would be an understatement. U.S. equity markets closed out last month in negative territory, ending a 15-month period of record gains as investors expressed concern for rising inflation and interest rates. The S&P 500 index experienced a 10% intra-month correction before recovering most of the losses. Defensive stocks in the U.S. were hurt more, given their higher interest rate sensitivity. International equities trailed weak domestic results as the market downturn extended globally.
- In fixed income markets, both real and nominal interest rates increased in February, as strengthening economic data stoked fears of a faster rate hike from the Federal Reserve. Most major bond indexes ended in negative territory for the month and the year.
- While a pullback never feels good, these types of corrections are more typical than the recent period of sustained low volatility we experienced in 2017. A new favorite quote from Jurrien Timmer at Fidelity puts things in perspective: "Corrections are like vegetables – they don't always taste good, but they can be good for you."

Diversification is often referred to as "the only free lunch" on Wall Street. The selloff in early February reminds investors that stocks are volatile and capable of losses. Investors should be mindful of owning a diversified mix of assets that zig and zag in different directions to maintain their goals.

GLOBAL ECONOMIC SUMMARY

Strong economic data likely played a role in preventing a more sizeable market correction. In the U.S., the annual pace of economic growth as measured by GDP was broadly steady at 2.5% in the fourth quarter. The job market remains strong, with jobless claims continuing to trend lower and unemployment at 4.1%. Strong job prospects mean that consumer confidence and spending also remain healthy. On February 5, Janet Yellen handed over the baton of Federal Reserve Chair to Jerome Powell; markets do not anticipate many changes to policy as a result of this handover. Inflation remains at 1.7%, below the Fed's inflation target of 2.0%. The minutes of the January Federal Open Market Committee meeting suggested that the committee remains optimistic on the outlook for the U.S. economy but believes policy needs to be normalized very gradually.

Abroad, the annual pace of real GDP in the eurozone grew at 2.7% for the fourth quarter of 2017, with broad-based growth across the region. In China, economic growth was stronger than expected, with a 6.8% year-on-year increase in GPD for the fourth quarter. In Japan, fourth-quarter GDP growth eased but remained positive, with an annualized quarterly growth rate of 0.5%.

The key concern among investors is that, as the recovery proceeds, economies start to reach the limit of their resources. Moreover, as unemployment grinds lower, inflation reasserts itself, causing central banks to reassess their monetary policy.

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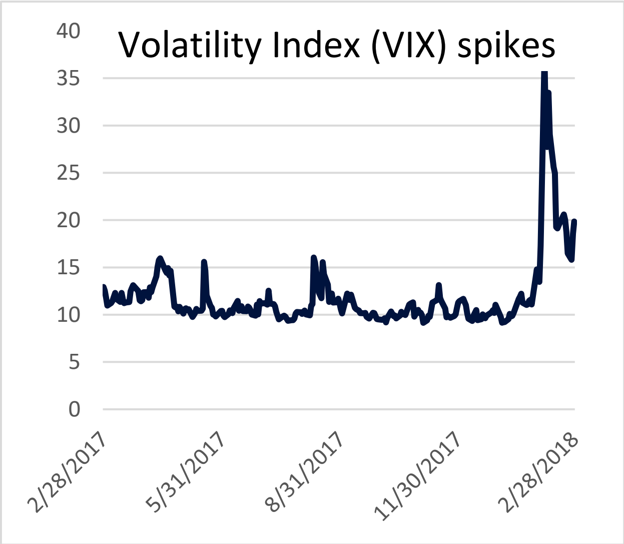
GLOBAL MARKETS SUMMARY

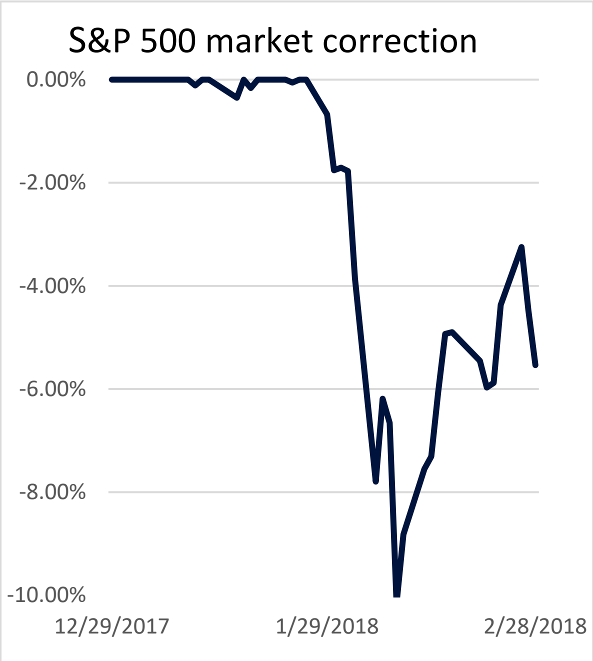
GLOBAL EQUITY

After 15 months of equity markets rising steadily, volatility returned abruptly at the beginning of February. Volatility, as measured by the VIX index, spiked after closing out 2017 in record low territory. The volatility index, which has a long-term average level of around 20, was extremely low in 2017. The market volatility seen in February demonstrates how sensitive investors are to the prospects of rising inflation. The January labor market report, which indicated that the annual pace of wage growth rose 0.2% to 2.9%, triggered concerns of higher inflation. Investors seemed concerned that rising wages would eventually lead to higher prices, and ultimately create the potential for the economy to overheat.



Source: Bloomberg as of 2/28/18.

This concern led the 10-year government bond yield to rise sharply to 3.0%, which in turn caused the equity markets to sell off. The S&P 500 lost 10.2% of its value from the previous high, officially entering correction territory, but swiftly recovered much of those losses. The S&P ended the month -3.7%, bringing YTD returns to 1.8%. While it's easy to get swept up by the volatility and the negative news, the underlying earnings for the stocks in the S&P 500 index remain strong, and that strength is the main driver of equity returns in the long run. According to FactSet's latest earnings insight: "For Q4 2017 (97% of the companies in the S&P 500 reporting actual results for the quarter), 74% of S&P 500 companies have reported positive EPS surprises and 77% have reported positive sales surprises. If 77% is the final number for the quarter, it will mark the highest percentage since FactSet began tracking this metric in Q3 2008."



Source: Bloomberg as of 2/28/18.

Bottom line: Market corrections are a normal part of the market cycle – events to be tolerated, not feared, especially when underlying earnings and economic growth remain strong.

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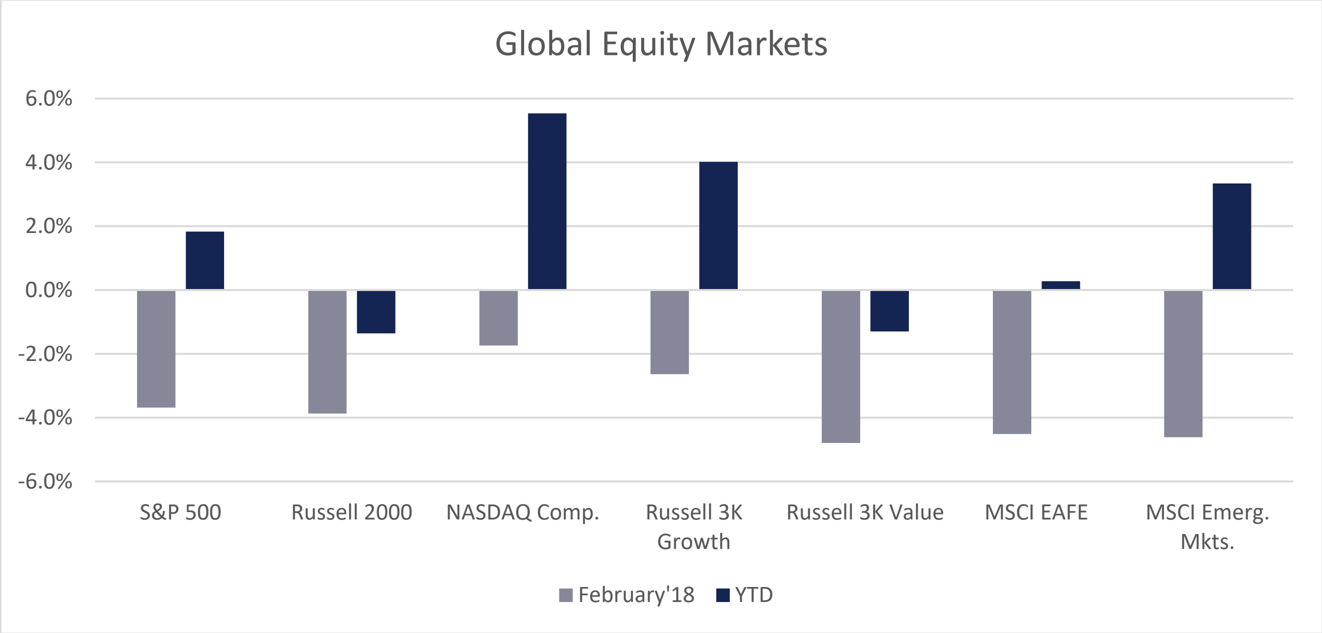
Defensive stocks with higher sensitivity to interest rates sold off more in February, as indicated by the Russell 3000 value index. The index ended the month -4.8%, as the ten-year government bond yields rose sharply, bringing YTD returns to -1.3%. Technology stocks were more resilient and ended the month -1.7%, bringing YTD returns to 5.5% as measured by the Nasdaq composite index. Finally, small cap stocks, as represented by the Russell 2000 index, posted -3.9% for the month, bringing YTD returns to -1.4%. In international markets, developed international market equities, as measured by MSCI EAFE (Europe, Australasia and Far East), ended -4.5%, bringing YTD returns to 0.3%. Emerging market equities, as measured by the MSCI EM Index, ended -4.6%, erasing strong gains from January and bringing YTD returns to 3.3%.



Source: Bloomberg as of 2/28/18.

FIXED INCOME

Broad-based growth, expectations for higher inflation, and greater supply put upward pressure on developed market bond yields throughout the month. In the U.S., rates moved higher as generally positive economic data pointed toward a rate hike in March. The U.S. Treasury market was not the only one to struggle, as rates increased globally. Core U.S. bonds, as represented by Bloomberg Barclays U.S. Aggregate Index, fell -0.9%, bringing YTD returns to -2.1%. High yield bonds, as measured by Bloomberg Barclays U.S. High Yield Index, posted -0.8% for the month, bringing YTD returns to -0.3%. Finally, emerging market debt, as measured by Bloomberg Barclays EM USD Agg (in dollar-denominated terms), fell -1.4%, bringing YTD returns to -1.5%.

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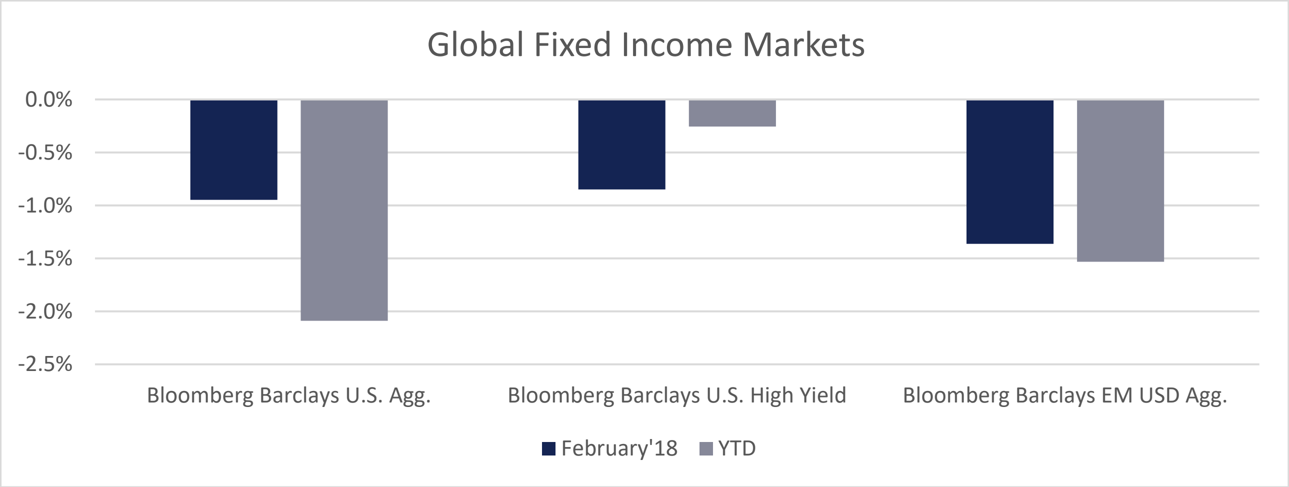
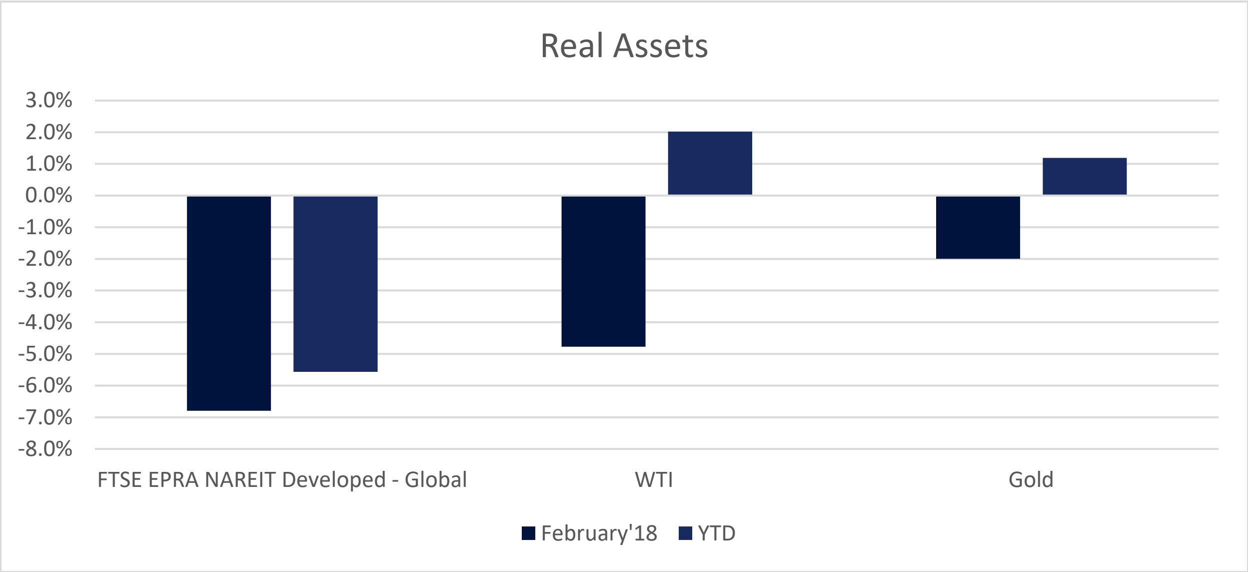


Source: Bloomberg as of 2/28/18.

REAL ASSETS

Oil, as measured by the West Texas Intermediate index, sold off with the broader equity market sell-off and posted -4.8% for the month, bringing YTD returns to 2.0%. Global REITS, as measured by FTSE EPRA NAREIT Developed Global Index, sold off sharply on concerns of rising interest rates and ended -6.8% for the month, bringing YTD returns to -5.6%. Due to an increase in interest rates and yields, investors sought these higher-yielding safer assets instead of the traditional safe haven of gold; as a result, gold fell -2% for the month, bringing YTD returns to 1.2%.



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DEFINITIONS

All indexes are unmanaged and an individual cannot invest directly in an index. Index returns do not include fees or expenses.

The Standard & Poor's 500, often abbreviated as the S&P 500, or just the S&P, is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ.

Russell 2000 The Russell 2000 Index is a small-cap stock market index of the bottom 2000 stocks in the Russell 3000 Index. The Russell 2000 is by far the most common benchmark for mutual funds that identify themselves as "small-cap".

The NASDAQ Composite is a stock market index of common stocks and similar securities (e.g. ADRs, tracking stocks, and limited partnership interests) listed on the NASDAQ stock market. Along with the Dow Jones Industrial Average and S&P 500, it is one of the three most-followed indices in US stock markets.

Russell 3000 Value Index is a market-capitalization weighted equity index maintained by the Russell Investment Group which measures how U.S. stocks in the equity value segment perform. Included in the Russell 3000 Value Index are stocks from the Russell 3000 Index with lower price-to-book ratios and lower expected growth rates.

Russell 3000 Growth Index is a market capitalization weighted index based and includes companies that display signs of above average growth. The index is used to provide a gauge of the performance of growth stocks in the U.S. Companies within the Russell 3000 that exhibit higher price-to-book and forecasted earnings are used to form the Russell 3000 Growth Index.

The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada. It is maintained by MSCI Inc., a provider of investment decision support tools; the EAFE acronym stands for Europe, Australasia and Far East.

The MSCI Emerging Markets Index is an index created by Morgan Stanley Capital International (MSCI) designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 23 emerging economies.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

The Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index is a flagship hard currency emerging markets debt benchmark that includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

The FTSE EPRA NAREIT Developed Global is designed to represent general trends in eligible real estate equities worldwide.

West Texas Intermediate (WTI), also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content.

The Gold Spot Price is the current market price at which an asset is bought or sold for immediate payment and delivery.

Gross domestic product is the best way to measure a country’s economy. GDP is the total value of everything produced in the country.

Nonfarm payroll employment is a compiled name for goods, construction and manufacturing companies in the U.S. It does not include farm workers, private household employees, or non-profit organization employees.

The unemployment rate is a measure of the prevalence of unemployment and it is calculated as a percentage by dividing the number of unemployed individuals by all individuals currently in the labor force.

Average hourly earnings are the average amount employees make per hour in the United States in each month and is calculated monthly by the Bureau of Labor Statistics.

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options.

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