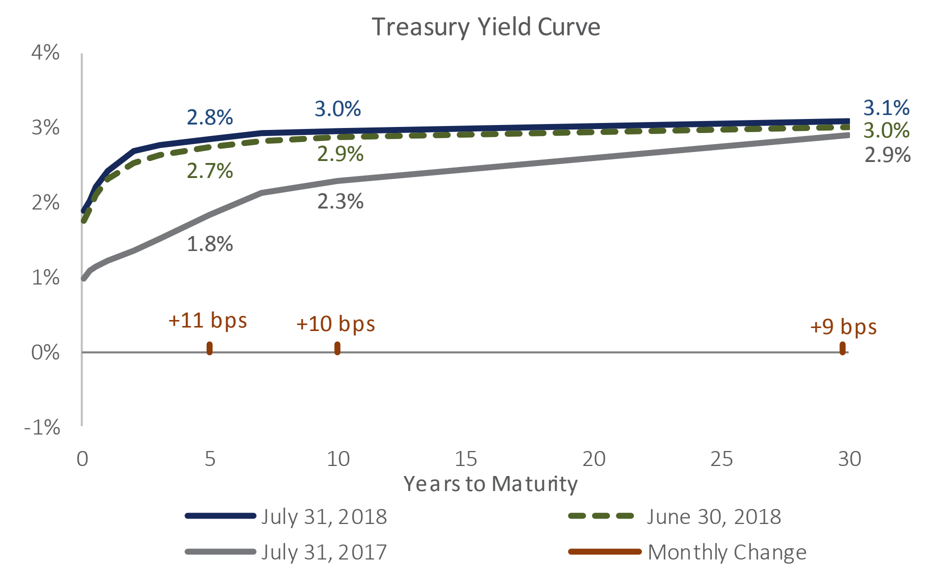
Summit Strategies Group

Economic and Capital Market Update

July 2018

Economic Perspective

- Economic reports released during July suggest the global expansion remains sound, although it has proceeded at a moderately slower pace than early in 2018. The positive growth trend, combined with limited inflation pressures, positive corporate earnings reports, and a slowing in trade-related headlines, contributed to the strong monthly gain for global equity markets (MSCI ACWI IMI, +2.8%).
- US non-farm payrolls increased by 157,000 during July, below consensus estimates of 193,000 new jobs. The unemployment rate fell 10 bps to 3.9% as the labor force participation rate continued to increase, suggesting more Americans are looking for work. The US economy has now experienced positive job growth for 94 consecutive months, the longest streak since labor market data collection began in the 1940s. Over the past three months employers have added 224,000 jobs per month, outpacing 2017's average increase of 182,000. Wage growth remains relatively muted but has increased in recent months; wages grew 2.7% over the 12 months ending July, up 20 bps from one year ago.
- Real GDP in the US grew at a 4.1% annualized rate during the second quarter, according to the initial estimate released by the Bureau of Economic Analysis. Higher consumer spending, as well as an increase in soybean exports (as US producers exported more soybeans to China before tariffs were implemented) mostly accounted for the increase from the first quarter's 2.0% growth rate. These impacts are likely to moderate in future quarters.
- Purchasing managers indices (PMI), which provide a timely measure of sentiment and growth, remain elevated but below 2017 levels. The JPMorgan Global Manufacturing PMI posted a 11-month low of 52.7, down from 53.0 in June; an index level over 50 implies expansion in the sector. Activity in the services sector also moderated in July, but continues to expand at an above-average rate. Incorporating both the services and manufacturing sectors, the all-industry PMI declined 0.5 to 53.7 during July; at the end of 2017 the all-industry PMI was 53.7.



Source: Bureau of Labor Statistics for Unemployment Rate, Bloomberg for Yield Curve.

Growth Assets

Public Equities

- The global equity market turned in its strongest month of performance since January's 5.4% rise, gaining 2.8% during July. US stocks (Russell 3000, +3.3%) outperformed international (MSCI ACWI ex US, +2.4%) by 90 bps, due in part to relatively strong US economic data and the continued strengthening in the dollar against foreign currencies; international markets outperformed domestic by 600 bps in 2017. Emerging markets rebounded 2.2% following a 4.4% loss in June amid trade concerns.
- Master limited partnerships (MLPs) gained 6.6% in July after posting modest losses in June. Contributors to the strong performance included positive earnings reports from MLP companies, the recent FERC ruling pertaining to favorable treatment of income taxes for interstate natural gas pipeline operators, and increased drilling activity.

Public Debt

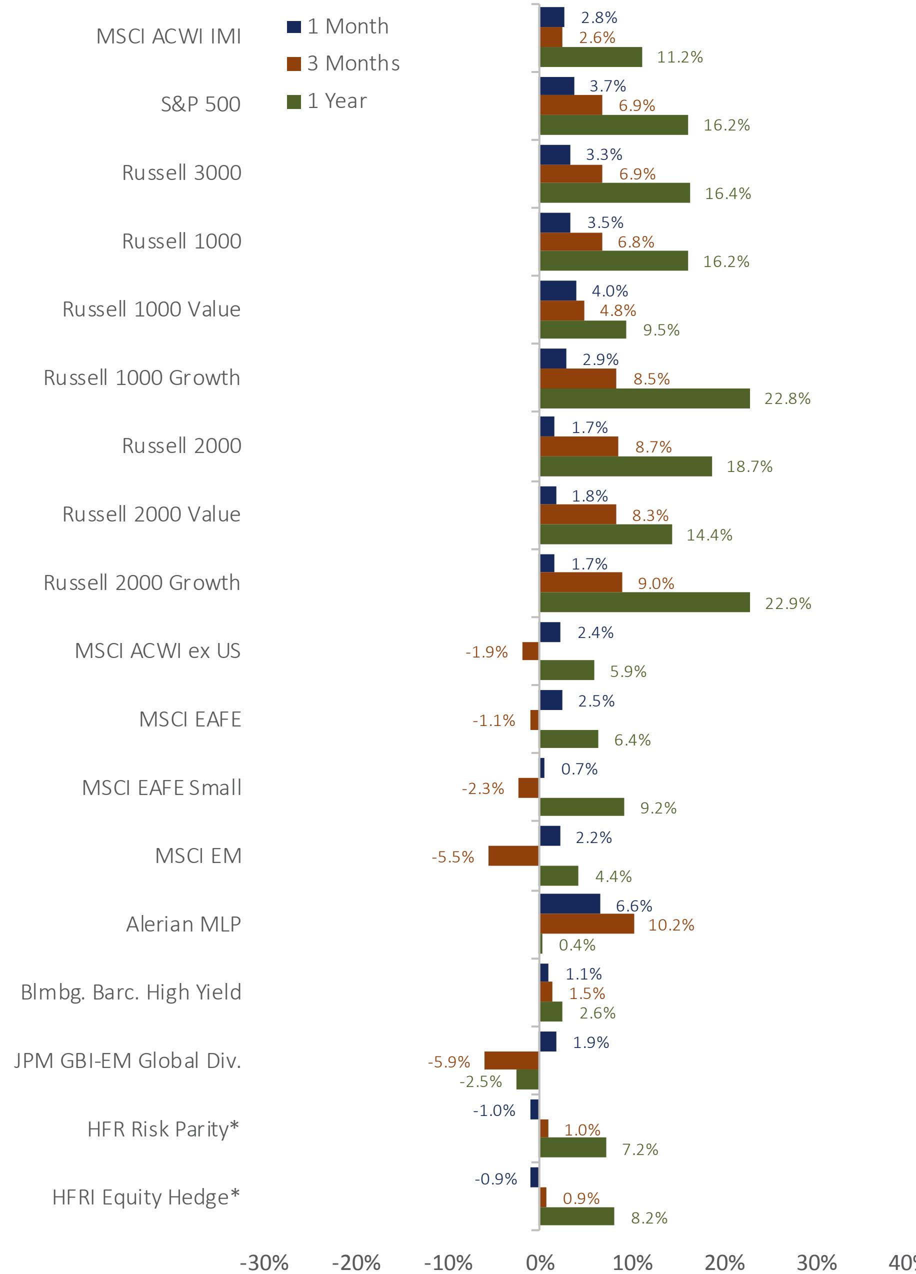
- High yield bonds gained 1.1% for the month as yields fell 18 bps to 6.3%. High yield spreads over treasuries ended the month at 336 bps after contracting 27 bps from June; over the past 20 years high yield spreads have averaged 510 bps over treasuries.
- Local currency-denominated emerging market debt gained 1.9%, rebounding modestly from June's 2.9% loss. Local currency EMD yields declined 5 bps to 6.5%; EMD yields have risen 40 bps in 2018 as rising rates in developed economies have resulted in investors demanding increased compensation for owning more volatile emerging market debt.

Private Assets

- The fundraising slowdown from the first quarter continued throughout the second quarter, with the 326 funds that closed during the quarter raising a total of $159B (per Preqin). During every quarter in 2017 firms raised in excess of $200B, bringing current fundraising activity more in line with 2015-2016. Dry powder levels have risen to a record $1.8T in private markets, with private equity accounting for $1.0T. Despite the competitive environment allowing general partners more favorable terms and fees, the largest and highest-profile funds generally remain oversubscribed.

Hedge Funds

- Risk parity strategies in aggregate declined -1.0% during June, underperforming global equities and fixed income and outperforming commodities.
- Growth hedge funds returned -0.9% in June, underperforming US equities by 150 bps.



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

Income Assets

Public Debt

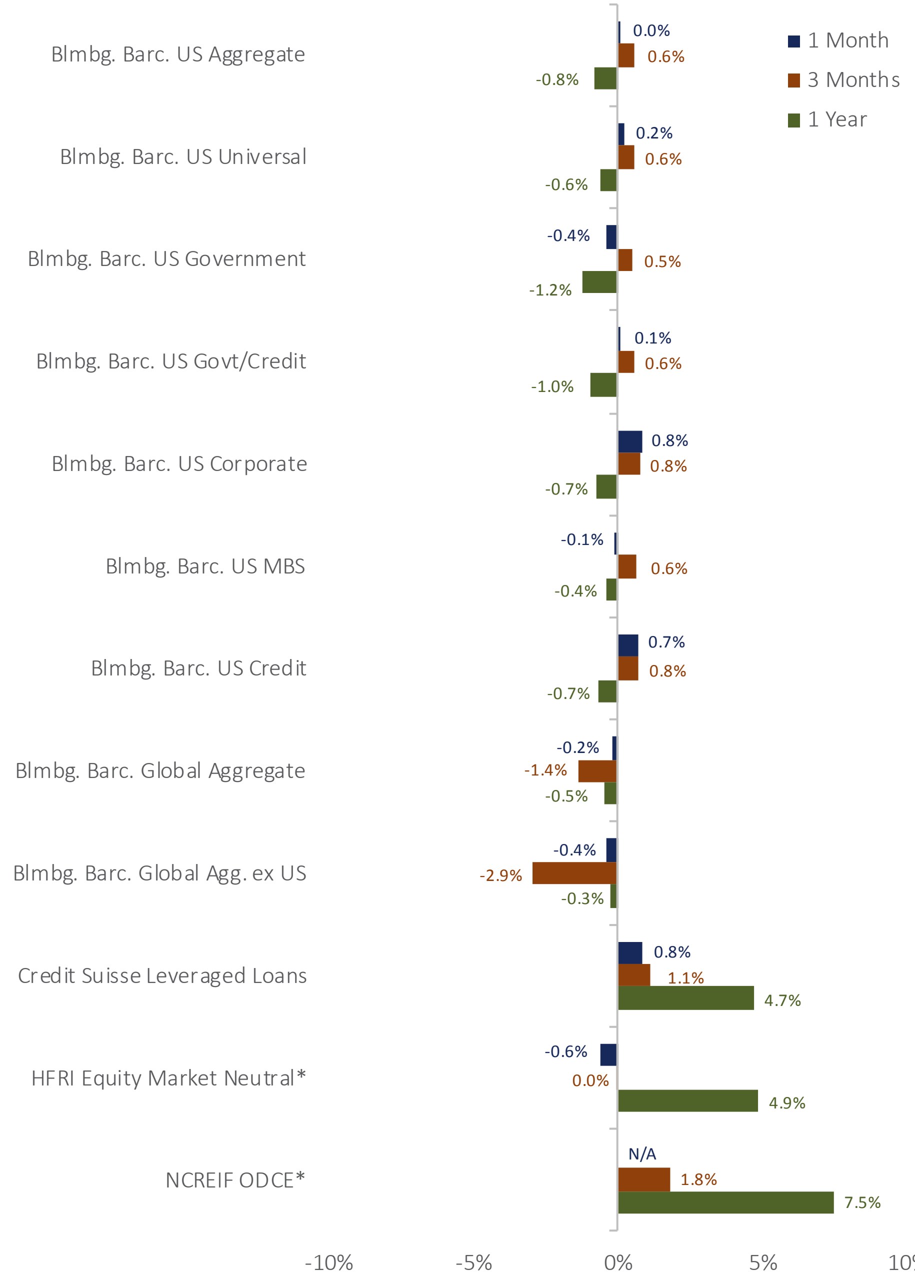
- 10-year Treasury yields rose 10 bps during July, from 2.9% to 3.0%. After a strong increase from 2.4% at the end of December to 2.9% at the end of February, yields have traded in a relatively narrow range of 2.8% to 3.1% over the past five months. The market's pricing of inflation and Federal Reserve interest rate policy have not changed significantly in recent months; at the end of July fixed income markets were fully pricing a rate hike in September and approximately a 50% chance of a rate hike in December.
- The Bloomberg Barclays US Aggregate was unchanged for the month, with the yield of the Index rising 7 bps to 3.4%. Within the Index, credit outperformed treasury allocations as credit spreads contracted; the option-adjusted spread for corporate bonds over treasuries contracted 14 bps to 109 bps. Credit spreads remain near their lowest levels of the current cycle.
- The Bloomberg Barclays Global Aggregate ex US underperformed the US Aggregate by 20 bps as a result of the continued appreciation in the dollar. Over the 3-month period ending in July, the Global Agg ex US underperformed the US Agg by 200 bps, primarily as a result of dollar appreciation versus foreign currencies amid mounting trade tensions. The recent underperformance for international fixed income comes after a strong year of outperformance; during 2017 the Global Aggregate ex US outperformed the US Aggregate by 700 bps.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, gained 0.8% during July. Investor demand for floating-rate debt during the year-to-date rise in yields has resulted in outperformance of bank loans over core fixed income and most other fixed income assets.

Relative Value Hedge Funds

- Relative value hedge funds fell 0.6% in June, underperforming core fixed income. Over the year ending June, relative value strategies gained 4.9%, outperforming the Bloomberg Barclays US Aggregate by 350 bps.

Core Real Estate

- Core real estate returns for the second quarter were 2.0% gross and 1.8% net, bringing the one-year gain for core funds to 7.5% net. Core real estate gains have moderated from the 11%+ annualized returns of 2013-2015, but limited supply increases and continued strong demand have acted as tailwinds for the market.



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Diversification Assets

Inflation

- TIPS fell 0.5% in July as real yields rose. At the end of July, 10-year breakeven inflation expectations remained at 2.1%, up 15 bps from the beginning of 2018. 10-year real yields were 0.8% at the end of June and have doubled after beginning 2018 at 0.4%.

Deflation

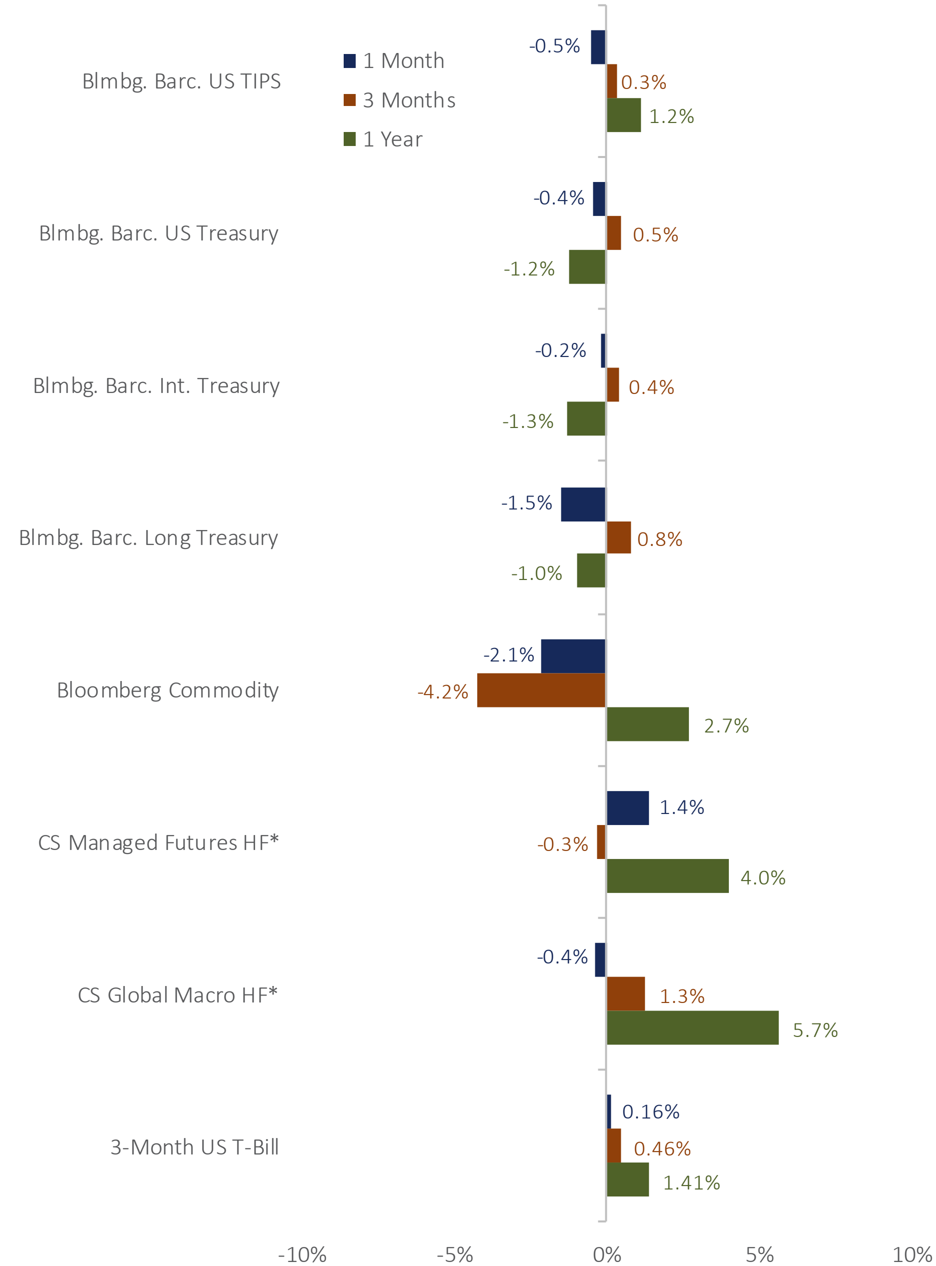
- The Bloomberg Barclays Long Treasury Index declined 1.5%. The 30-year Treasury yield rose 9 bps to 3.1%. Over the past 12 months ending in July, the 30-2 year spread has contracted 99 bps to 41 bps as the yield curve has flattened. 30-year yields have risen 9 bps while yields on all other treasury maturities have risen by significantly more. Anchored long-term treasury yields suggest the bond market's pricing of long-term growth and inflation have not changed significantly over the past year. Continued strong demand for the perceived safety of US bonds from global investors has also capped yields at the long end of the curve.

Commodities

- The Bloomberg Commodity Index declined 2.1% during July, bringing the 3-month return to -4.2%. Energy, industrial metals, and precious metals were particularly negatively impacted by trade tensions during the month. Detractors for the month included lean hogs (-26.2%) and sugar (-11.0%); contributors included winter wheat (+18.2%) and wheat (+11.3%). Despite recent muted performance, top performers for the 12-month period ending in July are Brent Crude (+41.0%) and WTI Crude (+37.1%).

Tactical Trading

- Tactical trading strategies experienced modest gains in aggregate during June, with managed futures outperforming global macro funds by 180 bps. Over the past year managed futures and global macro strategies have both generated gains of 4% or greater.



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