

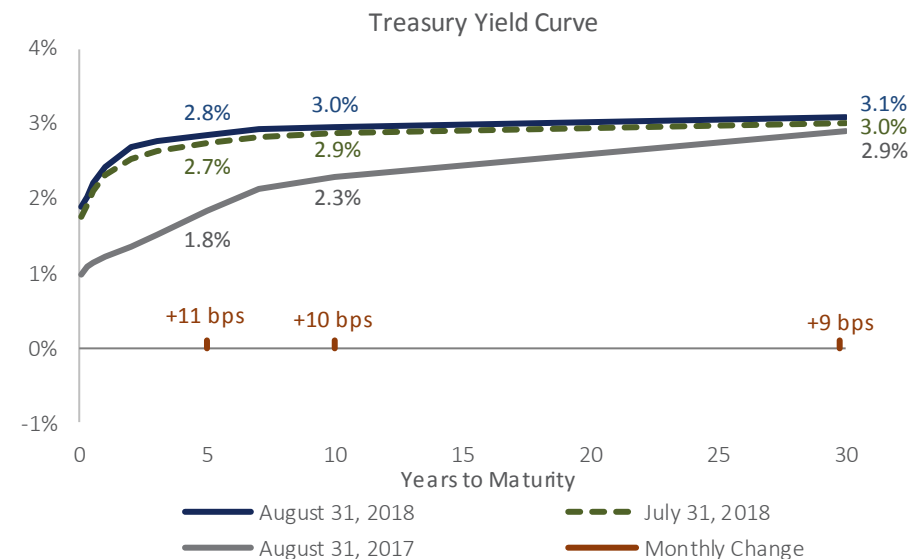
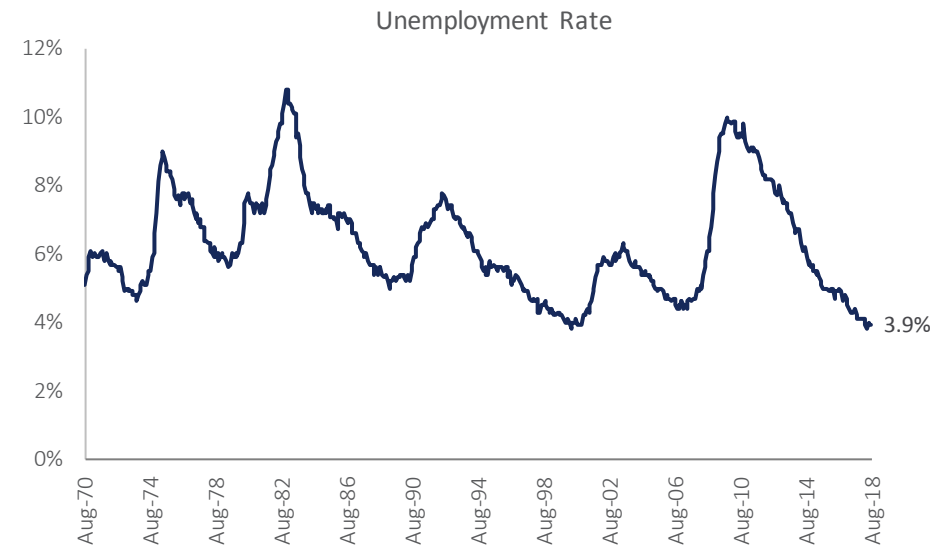
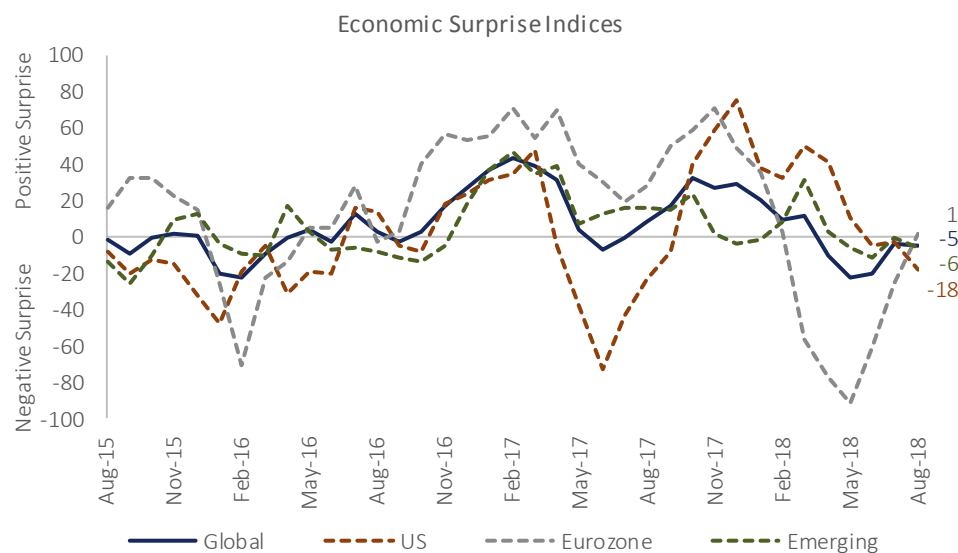


Economic and Capital Market Update

August 2018

Economic Perspective

- Global economic data released during August generally met expectations, as indicated in the chart below. The Citigroup Economic Surprise Index measures how economic reports compare to economist estimates; a positive reading suggests reports have exceeded expectations, while a negative reading indicates disappointing results. Europe has recovered after a relatively slow start to 2018, and despite strong growth in the US its surprise index has recently turned negative (suggesting expectations in the US are for the strong growth trend to continue).
- US non-farm payrolls increased by 201,000 in August, near consensus estimates of 195,000 new jobs, and the unemployment rate was unchanged at 3.9%. The US economy has now experienced positive job growth for 95 consecutive months, the longest streak since labor market data collection began in the 1940s. Wage growth remains relatively muted but has increased in recent months; wages grew 2.9% over the 12 months ending August, the highest rate of wage growth since 2009.
- Real GDP in the US grew at a 4.2% annualized rate during the second quarter, the highest quarterly GDP growth rate since the third quarter of 2014. First quarter real GDP was 2.2% annualized and growth for 2017 was 2.3%.



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

Growth Assets

Public Equities

- Global stocks gained 0.9% during August and have risen in five of the past six months, bringing the year-to-date return for MSCI ACWI IMI to 3.5%. The US market (Russell 3000, +3.5%) outperformed international (MSCI ACWI ex US, -2.1%) by 560 bps as continued trade tensions, US dollar strength, and relatively stronger US growth contributed to the US outperformance.
- Master limited partnerships (MLPs) gained 1.6% in August as the trailing 12-month distribution yield for the Alerian MLP Index rose 15 bps to 8.0%. MLPs have been among the best-performing asset classes of 2018, gaining 7.6% year-to-date amid strong earnings reports and improving investor sentiment.

Public Debt

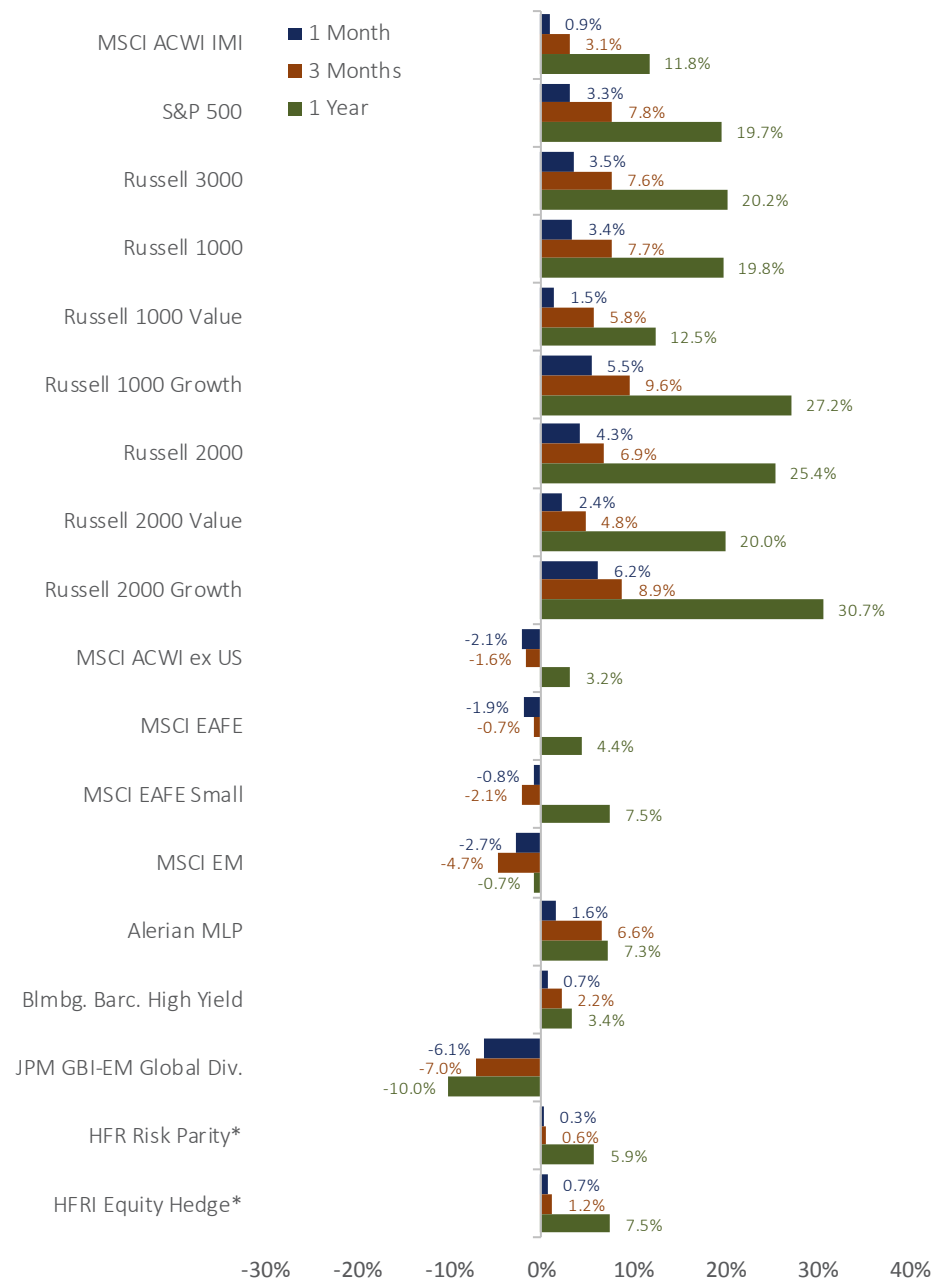
- High yield bonds gained 0.7% for the month as yields fell 4 bps to 6.3%. High yield spreads over treasuries ended the month at 338 bps after widening 2 bps from July; over the past 20 years high yield spreads have averaged 510 bps over treasuries.
- Local currency-denominated emerging market debt declined 6.1% in August, bringing the three-month loss to 7.0%. Local currency yields reached their highest level since February 2017 during the month, ending August at 6.6%. Emerging markets bond funds saw outflows for the third month out of the last four as investors have broadly redeemed from emerging markets given trade developments and dollar strength.

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 Prequin). 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 gained 0.3% during July, with equity and nominal bond exposures contributing gains while commodities and inflation-linked bonds detracted from performance.
- Growth hedge funds returned 0.7% in July, lagging the 3.7% gain for the S&P 500.



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

Income Assets

Public Debt

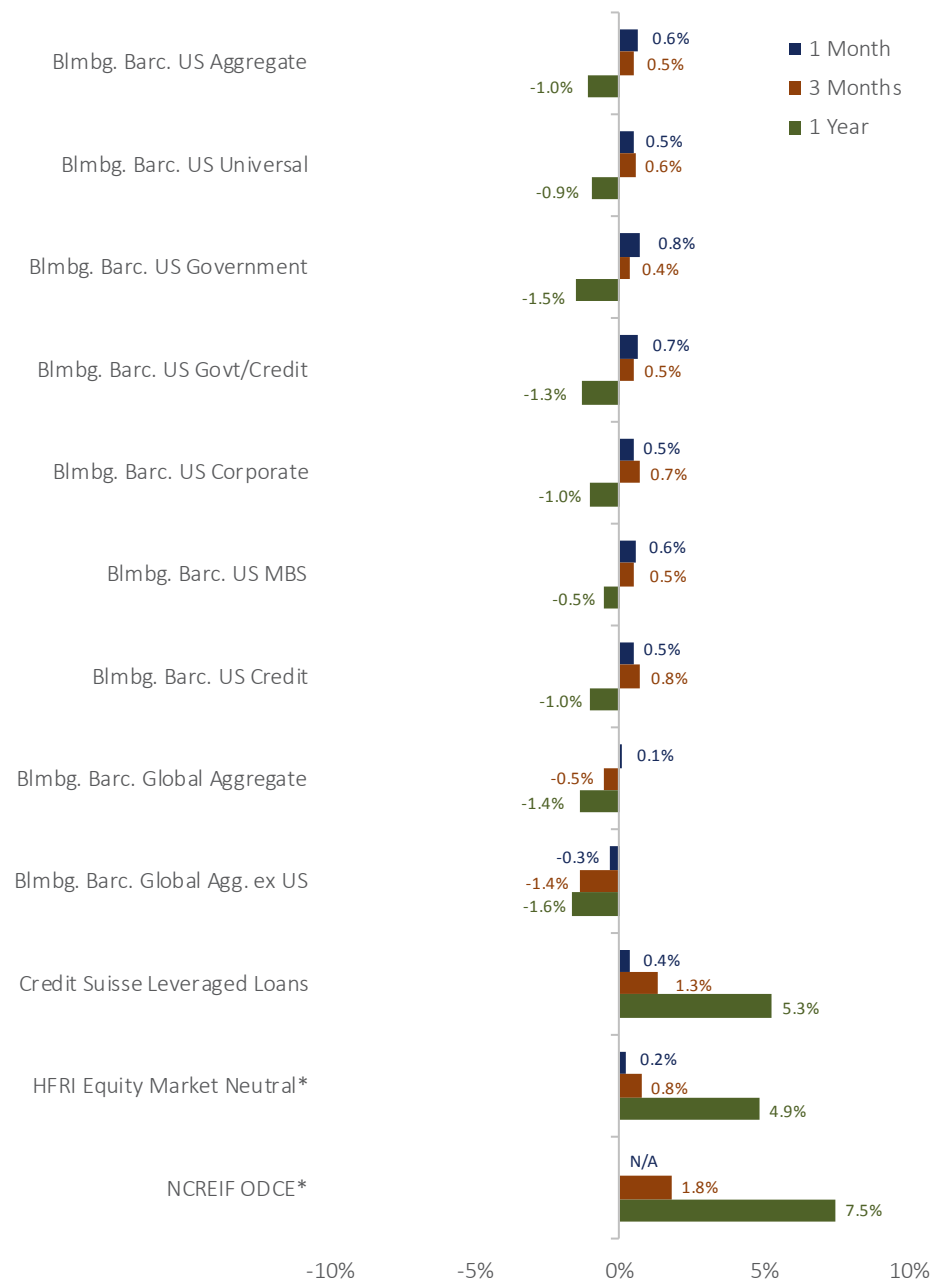
- 10-year Treasury yields contracted 10 bps to 2.9% in August and have consistently traded in a range between 2.8% and 3.0% since the end of May. The fixed income market's expectations for future inflation and Federal Reserve rate increases have not shifted significantly in recent months, resulting in low interest rate volatility.
- The Bloomberg Barclays US Aggregate gained 0.6% for the month, with the yield of the Index declining 6 bps to 3.3%. Within the Index, credit underperformed treasury allocations as credit spreads widened modestly; the option-adjusted spread for corporate bonds over treasuries expanded 5 bps to 114 bps. Credit spreads remain near their lowest levels of the current cycle.
- The Bloomberg Barclays Global Aggregate ex US underperformed the US Aggregate by 90 bps as the US dollar continued to appreciate versus foreign currencies. Over the 3-month period ending in August, the Global Agg ex US underperformed the US Agg by 190 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 0.4% during August. 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 rose 0.2% in July, outperforming core fixed income by 20 bps. Over the year ending July, relative value strategies gained 4.9% and out-earned the Bloomberg Barclays US Aggregate by 570 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 gained 0.7% in August as 10-year real yields declined 6 bps from July's 7-year high of 0.8%. Real yields have risen in 2018 as US growth has increased along with expectations for future Fed rate hikes. At the end of July, 10-year breakeven inflation expectations remained at 2.1%, up 11 bps from the beginning of 2018.

Deflation

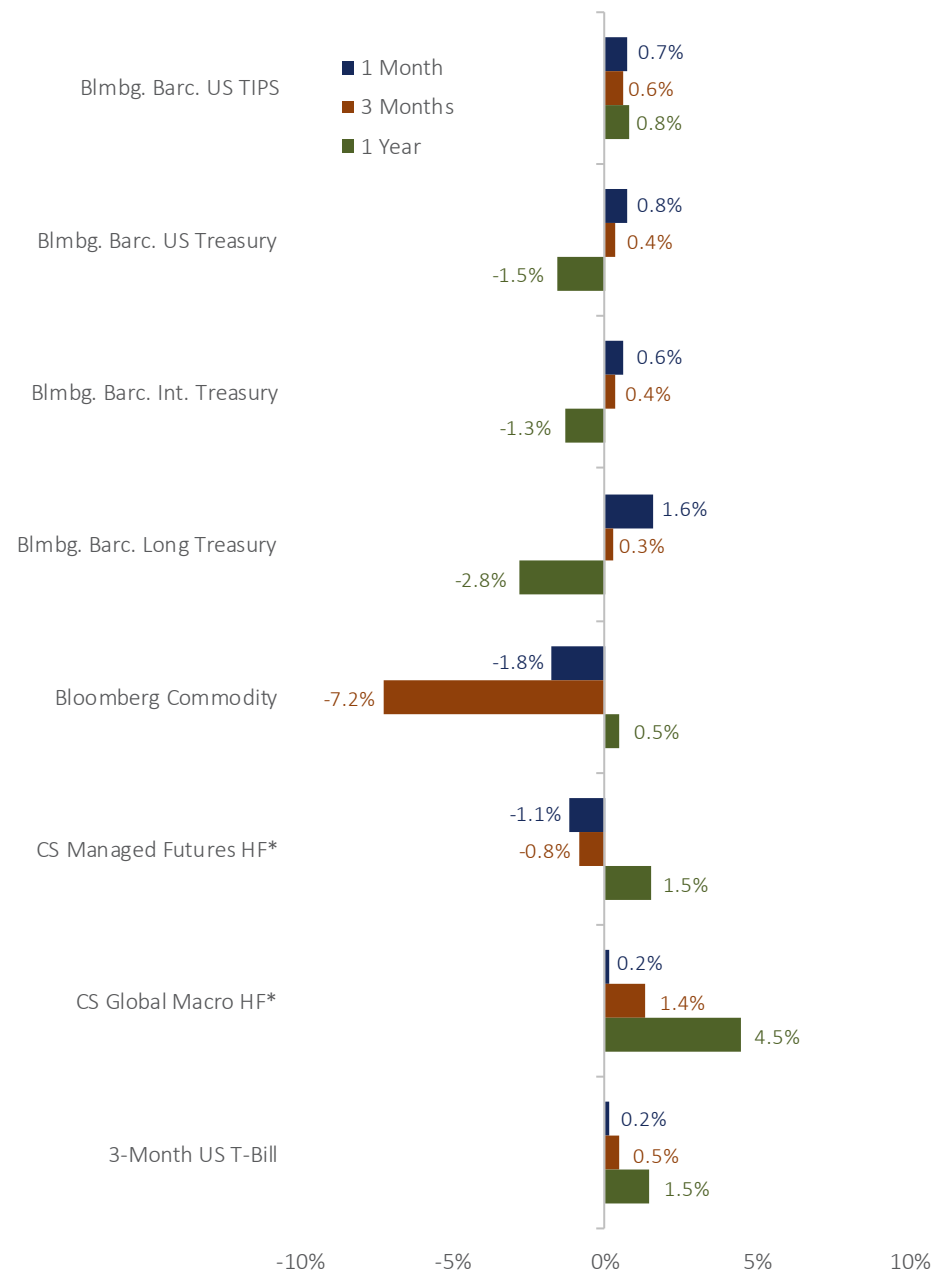
- The Bloomberg Barclays Long Treasury Index returned 1.6% for the month, as the 30-year Treasury yield contracted 6 bps to 3.0%. Over the 12 months ending in August, the spread between 2- and 30-year Treasuries has contracted 62 bps to 39 bps as the yield curve has flattened. 30-year yields have dropped 6 bps while yields on all other treasury maturities have risen by significantly more. Anchored long-term treasury yields partly reflect strong demand from institutional investors looking to hedge their liabilities with long-term bonds, as well as continued low interest rates in developed economies outside the US.

Commodities

- The Bloomberg Commodity Index declined 1.8% during August, bringing the 3-month return to -7.2%. Energy was among the best-performing commodity sectors, with WTI crude oil prices rising 1.5% to \$69.80/barrel. The strength of the US dollar in 2018 has contributed to commodity price declines; as most commodities are priced in dollars, commodity affordability and demand decline as the dollar appreciates.

Tactical Trading

- Tactical trading strategies experienced modest declines in aggregate during July, with managed futures underperforming global macro funds by 130 bps. Over the past year global macro strategies have outperformed managed futures by 300 bps.



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