

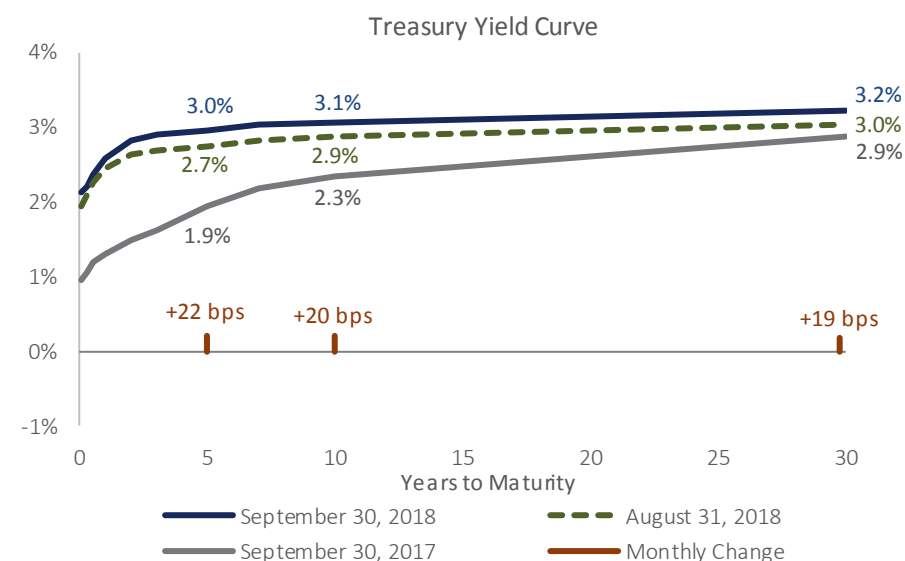
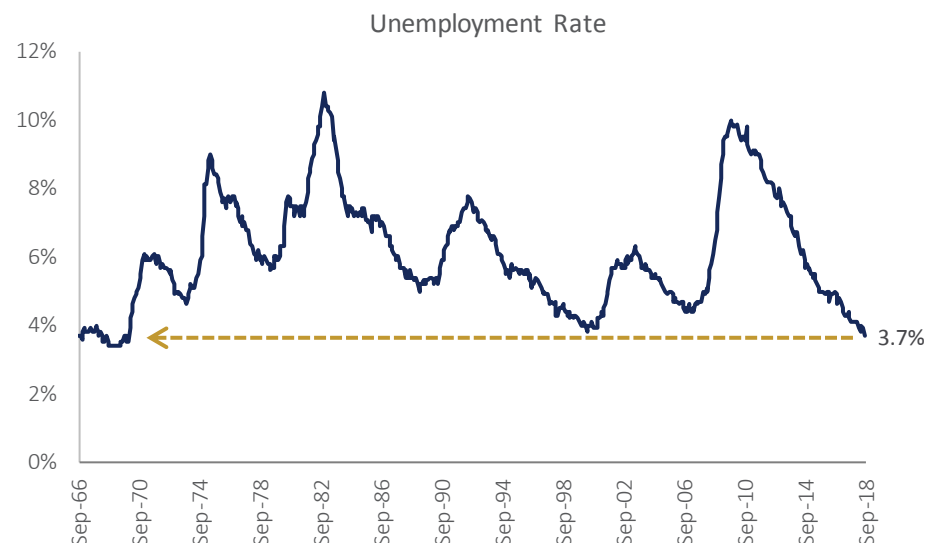


Economic and Capital Market Update

September 2018

Economic Perspective

- Economic data released during September suggests the pace of global growth remains above average compared to the current cycle, but below the elevated rate of early 2018. The Federal Reserve, citing positive current conditions and expected further expansion for the US economy, raised interest rates by 25 bps for the third time in 2018. The September rate increase brings short-term interest rates to a target range of 2.00% to 2.25%, the highest rates have been since 2008.
- US non-farm payrolls increased by 134,000 during September, below consensus estimates of 185,000 new jobs. The unemployment rate declined 20 bps to 3.7%, its lowest level since December 1969. The US labor market has now experienced positive job growth for 96 consecutive months, the longest streak since labor market data collection began in the 1940s. The recovery in the labor market following the financial crisis is unprecedented: since reaching 10.0% in October 2009, the unemployment rate has declined by 630 bps and 19.2 million payrolls have been added to the US economy. Despite the strong jobs recovery, wage growth remains relatively muted; wages grew 2.8% over the 12 months ending September 30, down 10 bps from the previous month. The 2.9% year-over-year wage growth in August was the highest rate since 2009.
- Real GDP in the US grew at a 4.2% annualized rate during the second quarter, according to the third estimate released by the Bureau of Economic Analysis. The second quarter saw the highest quarterly GDP growth rate since the third quarter of 2014; first quarter real GDP was 2.2% annualized and growth for calendar year 2017 was 2.3%. The strong GDP figure for Q2 was inflated by a one-off increase in soybean exports before tariffs were implemented; regardless, strong global conditions and the boost from fiscal policy have been catalysts for US growth in 2018.
- Purchasing managers indices (PMIs) are a timely measure of demand in the global economy and suggest growth remains positive throughout the world. The JPMorgan global manufacturing PMI dropped from 52.6 to 52.2 during September, its lowest level of 2018. However, the index remains in expansion territory, as a reading over 50 suggests a positive growth rate. The JPMorgan services PMI declined from 53.5 to 53.0 during September, its lowest reading of 2018.



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

Growth Assets

Public Equities

- Mixed economic data and ongoing trade tensions resulted in modest gains for global equity markets during September. US equities (Russell 3000, +0.2%) underperformed international equities (MSCI ACWI ex US, +0.5%) by 30 bps during the month. At the end of September further tariffs were levied between the US and China, although the market reaction was muted as tariffs had been anticipated leading up to the announcement.
- Master limited partnerships (MLPs) returned -1.6% in September following strong gains in July and August. The trailing 12-month distribution yield for the Alerian MLP ended September at 8.0%, up 9 bps from the end of August and 40 bps from the end of 2017.

Public Debt

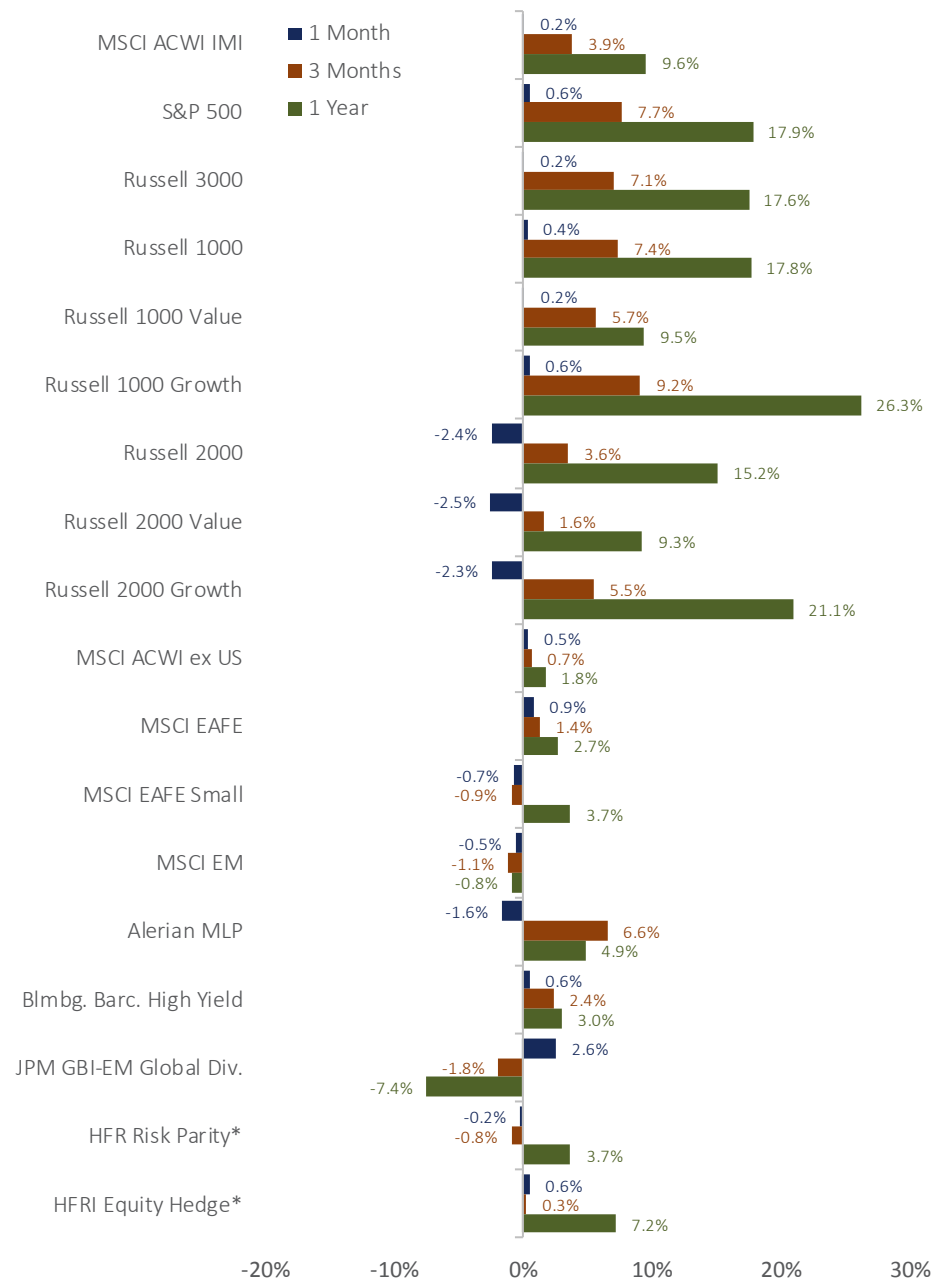
- High yield bonds gained 0.6% for the month, the fourth consecutive month of gains for the Bloomberg Barclays High Yield Index. Yields fell 3 bps to 6.2% during the month and spreads over treasuries tightened 22 bps to 316 bps. High yield spreads remain near all-time lows as demand for higher-yielding securities has persisted; the 20-year average spread for high yield bonds over treasuries is 504 bps.
- Local currency-denominated emerging market debt returned 2.6% in September, as inflows to emerging market debt funds resumed after outflows in three of the past four months. Local currency yields increased 1 basis point during the month and remain near their highest levels of 2018 at 6.6%.

Private Assets

- The pace of fundraising remains elevated but below 2017's record levels. In the private capital space, 327 funds closed during the third quarter and raised a total of \$214B (per Preqin); funds have raised on average \$192B each quarter in 2018, more than every previous year with the exception of 2017. 2018 has also seen greater capital concentration in larger funds, as 63% of capital secured YTD has come from funds of \$1B or more compared to 59% during 2017. Dry powder continues to increase, reaching \$1.1T at the end of September.

Hedge Funds

- Risk parity strategies in aggregate declined 0.2% during August, with equity and commodity exposures contributing gains while bonds detracted from performance.
- Growth hedge funds returned 0.6% in August, lagging the 3.3% 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

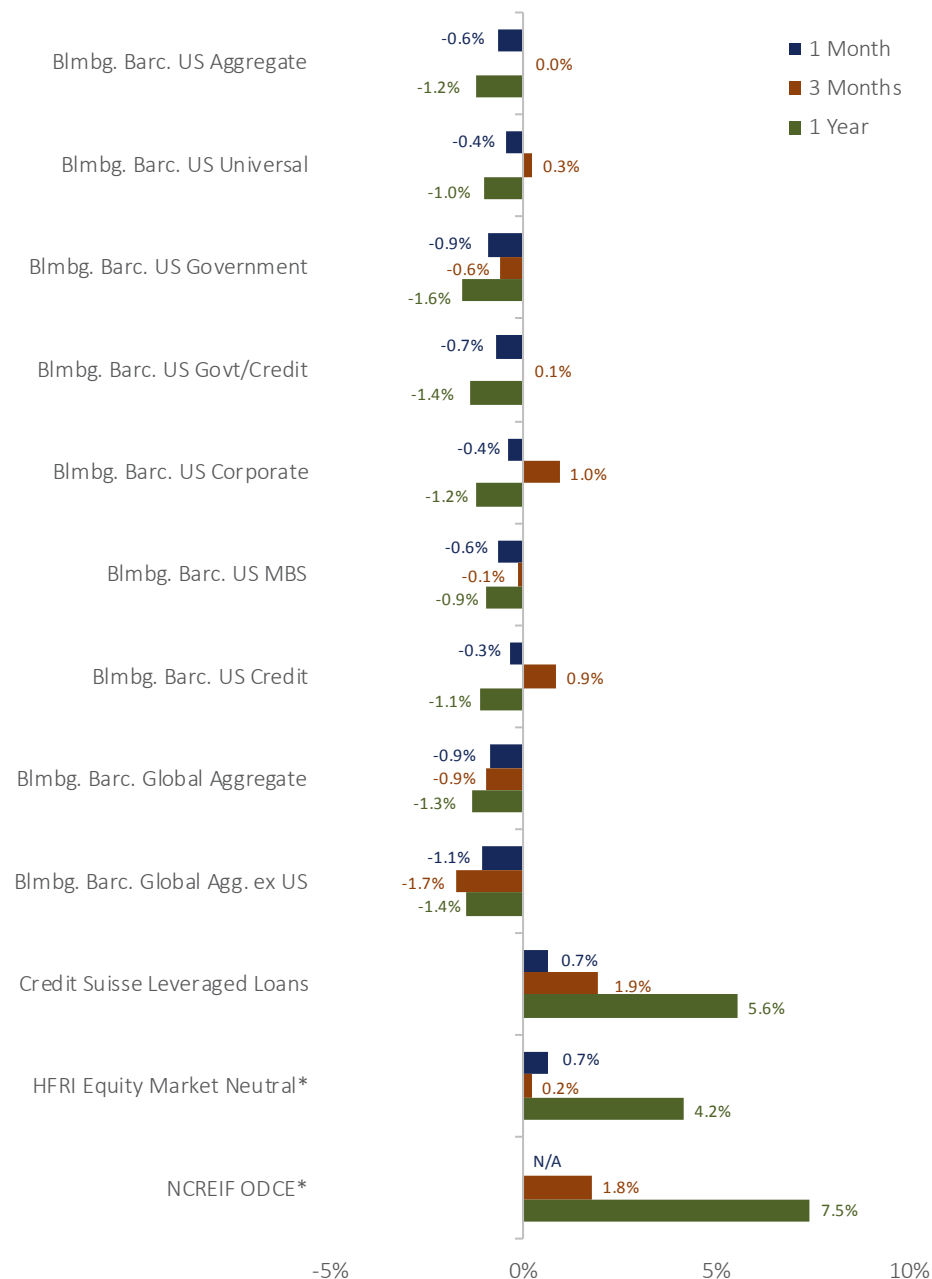
- Yields rose across the curve during September, resulting in negative returns for most bond indices. The Federal Reserve raised short-term interest rates by 25 bps to a target rate of 2.00% to 2.25%, and fixed income markets were pricing the probability of one more rate increase in 2018 to be 77% at the end of September. Longer-term yields rose during the month as inflation expectations increased along with the expected pace of Federal Reserve rate hikes. At the end of September the 10-year Treasury was yielding 3.1%, up from 2.4% at the beginning of 2018.
- The Bloomberg Barclays US Aggregate declined 0.6% for the month, with the yield of the Index rising 13 bps to 3.5%. Within the Index, credit outperformed treasury allocations as credit spreads tightened modestly; the option-adjusted spread for corporate bonds over treasuries tightened 8 bps to 106 bps. Credit spreads remain near their cycle lows, which occurred at the end of January 2018 (86 bps).
- The Bloomberg Barclays Global Aggregate ex US underperformed the US Aggregate by 30 bps as the rise in international yields exceeded that of the US. Recent underperformance for international fixed income can mostly be attributed to a strengthening dollar versus foreign currencies; year-to-date, the dollar has risen 3.3%.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, were among the few fixed income benchmarks to gain during September. 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 0.7% in August, outperforming core fixed income by 10 bps. Over the year ending August 31, relative value strategies gained 4.2% and out-earned the Bloomberg Barclays US Aggregate by 520 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 declined 1.1% in September as 10-year real yields rose to their highest level since March 2011 at 92 bps. Real yields have risen in 2018 as US growth has increased along with expectations for future Fed rate hikes. At the end of September, 10-year breakeven inflation expectations were 2.2%, their highest level since July 2014.

Deflation

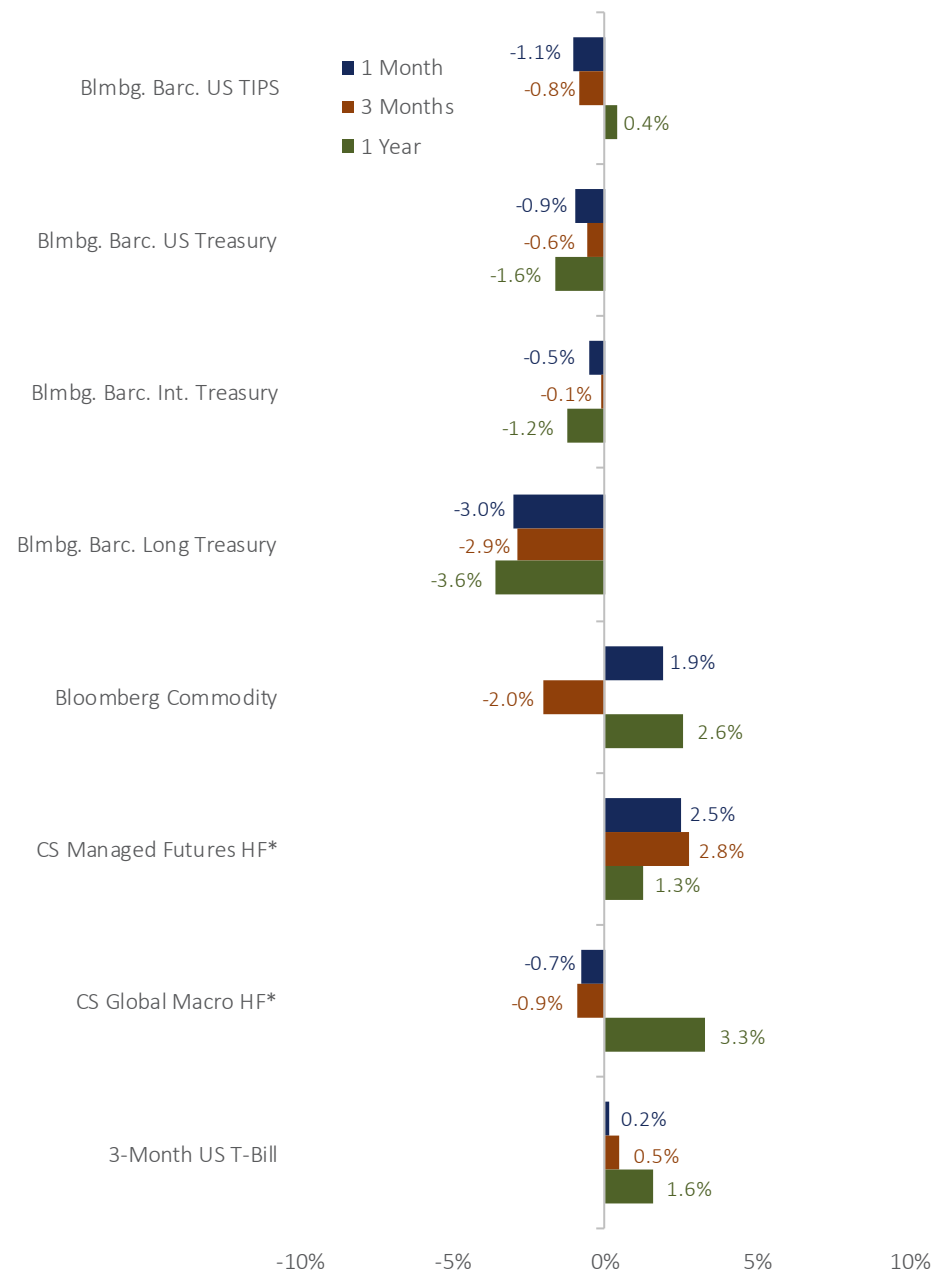
- The Bloomberg Barclays Long Treasury Index returned -3.0% for the month, as the 30-year Treasury yield rose 19 bps to 3.2%. Over the 12 months ending September 30, the spread between 2- and 30-year Treasuries contracted 61 bps to 39 bps as the yield curve has flattened. 30-year yields have increased 35 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 gained 1.9% during September, bringing the 3-month return to -2.0%. Industrial metals posted weaker returns given global trade uncertainty; aluminum (-2.5%) and nickel (-1.5%) were down for the month, and all industrial metals were down for the third quarter. Energy was among the best-performing commodity sectors, with Brent crude oil prices rising 6.8% to \$82.69/barrel (a four-year high). 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 gained 0.9% on average during August, with managed futures gaining while global macro strategies saw modest declines. Over the past year global macro strategies and managed futures have both gained.



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