



Economic and Capital Market Update

February 2018

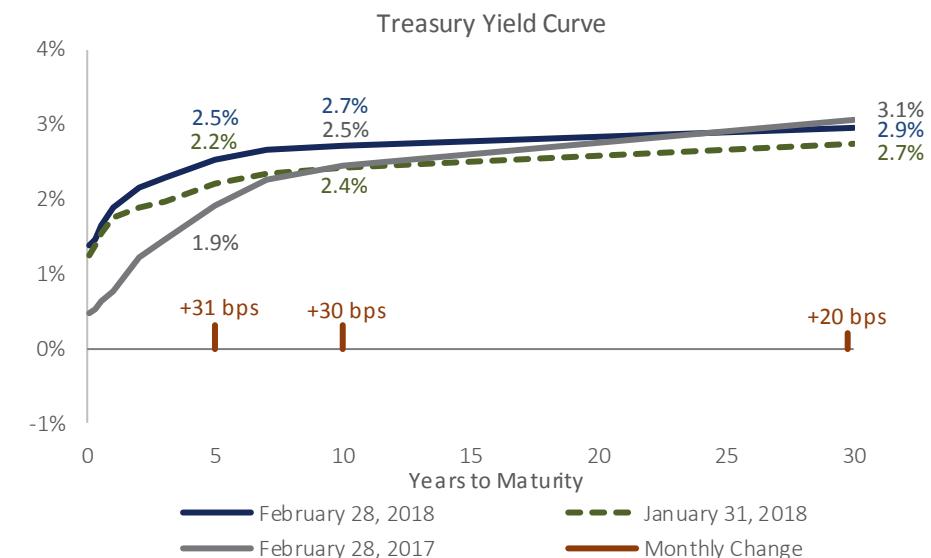
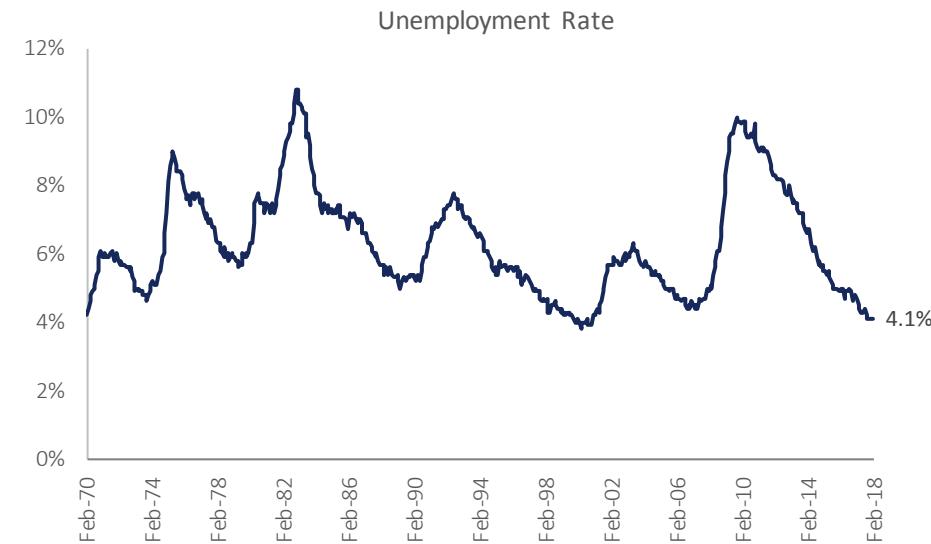
Economic Perspective

Economy

- Consistent with the trend of recent months, the global economy continued its broad-based expansion during February; consumer spending and confidence, corporate earnings growth, and manufacturing all remained near post-crisis highs. Signs that further tightening in the US labor market and rising wage growth may cause the Federal Reserve to raise interest rates faster than expected were a catalyst for higher global equity market volatility, with MSCI ACWI IMI declining 4.2% for the month. Despite the monthly declines, at the end of February global stocks remained up 1.0% year-to-date after strong gains in January.
- US employers added 313,000 jobs in February, marking the most jobs added in a month since October 2015. The unemployment rate was unchanged at 4.1%, matching its lowest level since December 2000. The US economy has experienced positive job growth for 89 consecutive months, the longest streak since labor market data collection began in the 1940s. Wages grew 2.6% over the 12 months ending February, a 30 bps decrease from January's nine-year high.
- Real GDP in the US grew at a 2.5% annualized rate during the fourth quarter of 2017, according to the second 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% and current expectations for Q1 2018 growth, according to the Atlanta Federal Reserve's GDPNow, are 2.8% annualized.
- 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 increased 1.7 in February to 60.8; an Index reading over 50 indicates expansion in the sector. Manufacturing has now been a boost to US growth for 18 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 rose 8 bps from January's 10-year low to 87 bps in February. Over the past two years, the 2-30 spread has tightened by 102 bps; long-term yields have risen modestly while short-term yields have increased with Federal Reserve rate hikes. The 20-year average spread between 2-year and 30-year Treasuries is 193 bps.



Growth Assets

Public Equities

- Global stocks saw their first monthly decline since October 2016 during February, breaking the longest stretch in history of consecutive monthly gains for MSCI ACWI IMI. Across equity regions, US stocks (Russell 3000, -3.7%) outperformed international (MSCI ACWI ex US, -4.7%) as the dollar strengthened against foreign currencies. Within the US market, small caps modestly outperformed large caps and growth outperformed value.
- Master limited partnerships (MLPs) returned -9.7% in February, with oil price declines (WTI Crude, -4.8%) contributing to losses. The Alerian MLP Index distribution yield rose 92 bps to 8.25% during the month.

Public Debt

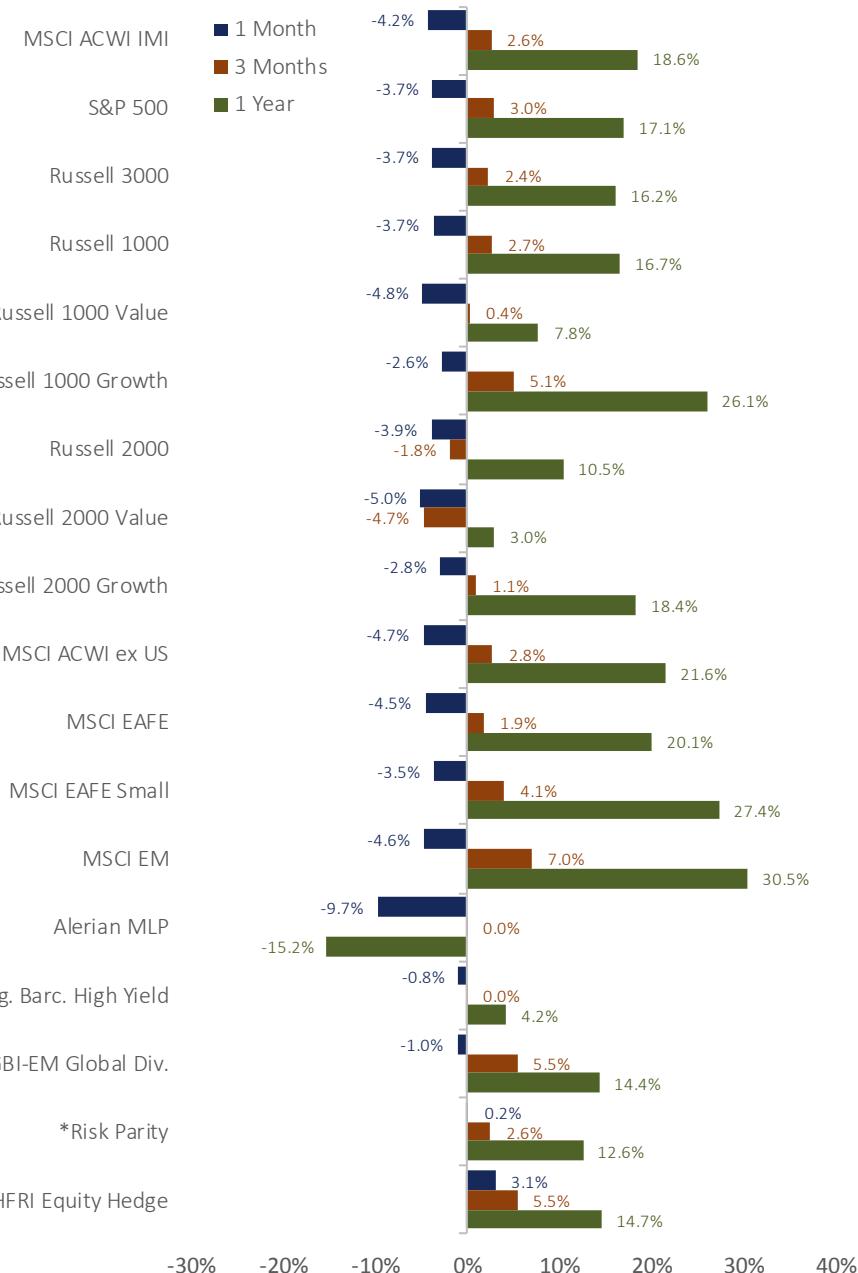
- High yield bonds declined modestly during the month, returning -0.8%. High yield spreads over treasuries widened by 17 bps but remain near their lowest levels in years, while the high yield index ended February yielding 6.1%.
- Local currency-denominated emerging market bond yields rose 3 bps to 6.1% during February. EM currency declines versus the dollar primarily drove the -1.0% return for the month.

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. Continued strong demand from investors for private debt funds has supported higher leverage levels and kept a ceiling in place for loan spreads.

Hedge Funds

- Risk parity strategies were positive in January, as equities and commodities gained while nominal and inflation-linked bonds detracted.
- Growth hedge funds gained in January. Equity long/short was the strongest performer, with technology and EM exposure contributing strongly. Event-driven strategies including distressed debt, merger arbitrage, and activist strategies also contributed.



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

Income Assets

Public Debt

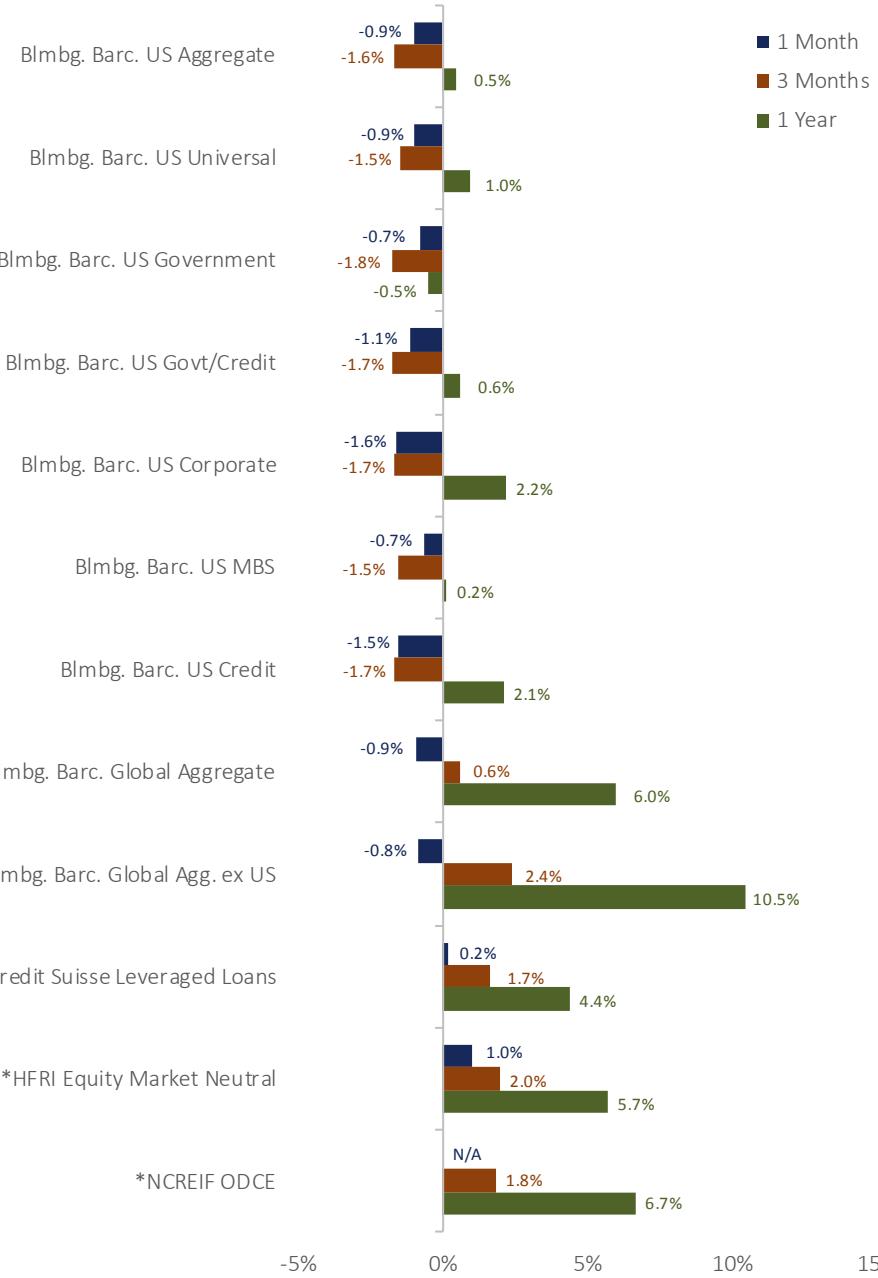
- Fixed income markets broadly declined for the second consecutive month during February, as yields continued their 2018 rise. The yield on the 10-year Treasury began 2018 at 2.41% and has risen 45 bps to end February at 2.86%. Deconstructing the rise in bond yields year-to-date shows that 14 bps of the 45 bps rise has been a result of higher market expectations for inflation over the next 10 years (2.1%), while real yields (which often change with expectations for Federal Reserve rate increases) have accounted for the remaining 31 bps.
- Rising yields resulted in a return of -0.9% for the Bloomberg Barclays US Aggregate for the month. Within the Index, credit underperformed treasury allocations as credit spreads widened; the option-adjusted spread for corporate bonds over treasuries widened by 10 bps to 96 bps. While spreads widened modestly, they remain near their lowest levels of the current cycle.
- The Bloomberg Barclays Global Aggregate ex US outperformed the US Aggregate by 10 bps, as international bond outperformance was mostly offset by foreign currency declines against the dollar. Over the past year the Global Agg ex US has outperformed the US Agg by 10%, primarily a result of a weaker dollar.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, gained 0.2% to lead fixed income market performance. Investor demand for floating-rate debt during the recent rise in yields has resulted in outperformance of bank loans over core fixed income.

Relative Value Hedge Funds

- Relative value hedge funds gained in January, with convertible arbitrage posting the largest gains. Equity market neutral and credit-based strategies also contributed.

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 -1.0% during February, with rising real yields contributing to declines. At the end of February, 10-year breakeven inflation expectations were 2.12%, up 1 basis point from the end of January and reaching their highest level since August 2014.

Deflation

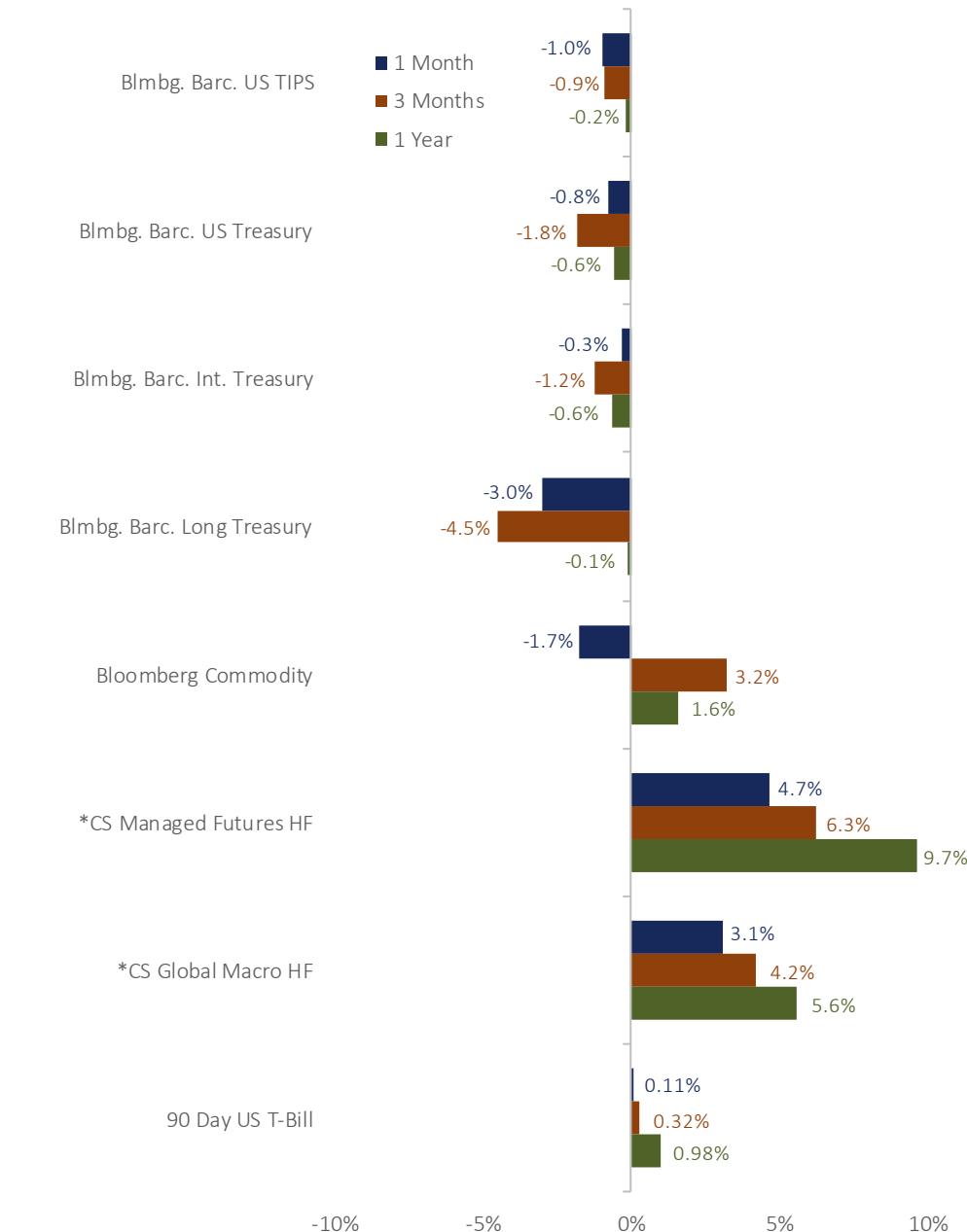
- The Bloomberg Barclays Long Treasury Index returned -3.0%, with the 30-year Treasury yield rising 19 bps to its highest month-end level since September 2014 at 3.13%.

Commodities

- The Bloomberg Commodity Index declined 1.7%, driven by underperformance in natural gas, industrial metals, and energy. Over the trailing 12 months, the Bloomberg Commodity Index has returned 1.6%; industrial metals and energy were the largest contributors to commodity gains over the trailing year.

Tactical Trading

- Macro hedge funds produced strong gains in January, with positive contributions from both discretionary global macro and CTA strategies.



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