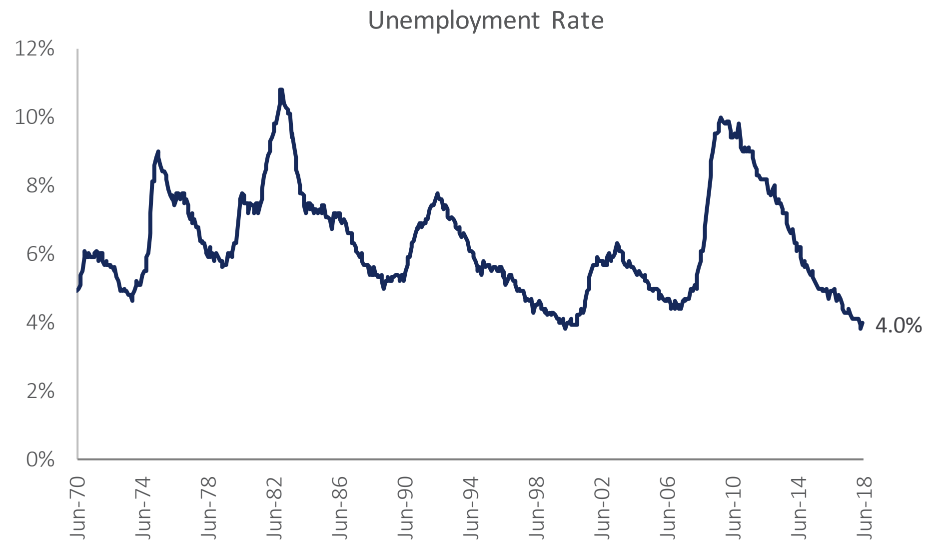
Summit Strategies Group

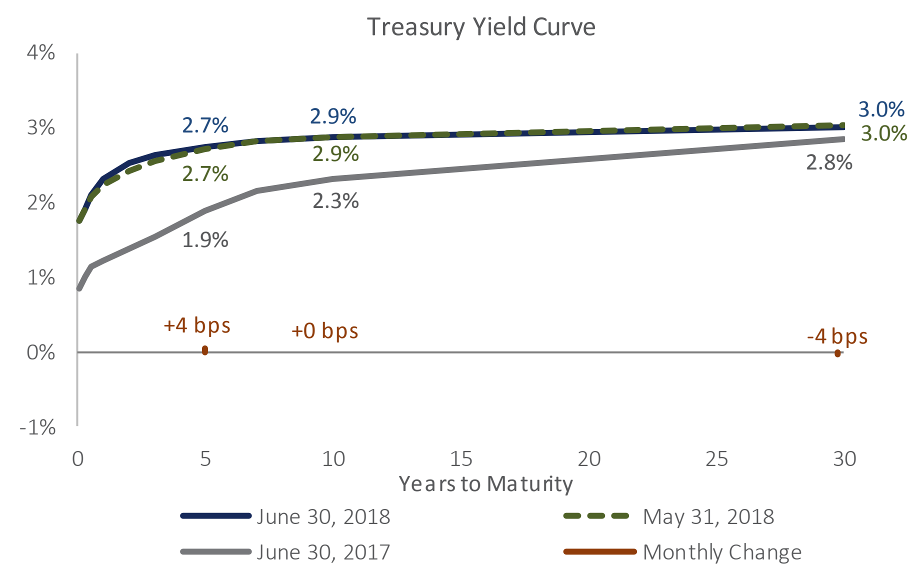
Economic and Capital Market Update

June 2018

Economic Perspective

- Economic reports from June indicate the global expansion remains intact, with growth accelerating over the course of the second quarter. Trade tensions continued to make headlines during the month, with the US announcing tariffs on $50B of Chinese goods and China retaliating in-kind. While the tariffs currently implemented make up a small percentage of US imports and GDP, financial markets have been focused on trade developments and appear to be pricing a continuation of tensions. The Federal Reserve mostly dismissed trade concerns while raising interest rates by 25 bps at the June meeting of the Federal Open Market Committee (FOMC). At the end of June the Federal Reserve was targeting a short-term interest rate of 1.75% to 2.00%, the highest level of short-term rates since 2008.
- US non-farm payrolls increased by 213,000 during June, above consensus estimates of 190,000 new jobs. The unemployment rate rose 20 bps to 4.0% as the labor force participation rate increased, suggesting more Americans are looking for work. The US economy has now experienced positive job growth for 93 consecutive months, the longest streak since labor market data collection began in the 1940s. During the first half of 2018 employers added 215,000 jobs per month, outpacing 2017's average of 182,000. Wage growth, remains relatively muted but has increased in recent months; wages grew 2.7% over the 12 months ending June, up 20 bps from one year ago.
- Real GDP in the US grew at a 2.0% annualized rate during the first quarter of 2018, according to the third and final estimate released by the Bureau of Economic Analysis. Decelerating consumer spending and exports were the main contributors to the decline in growth from the fourth quarter of 2017, when growth was 2.9%. The current estimate of second quarter GDP growth, according to the Atlanta Federal Reserve, is 3.8% annualized.
- 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 10-month low of 53.0 in June, down from 53.1 in May; an index level over 50 implies expansion in the sector. Global manufacturing reached a 6-year high of 54.5 at the end of 2017. The JPMorgan Services PMI increased from 54.3 to 54.8 during June, its highest level since February. In aggregate PMIs suggest global economic growth remains on a positive trajectory and purchasing managers are expecting continued strong demand.





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

Growth Assets

Public Equities

- Global equity markets saw modest declines in June, with trade headlines contributing to daily market volatility. US stocks (Russell 3000, +0.7%) outperformed international (MSCI ACWI ex US, -1.9%) by 260 bps, due in part to relatively strong US economic data and the dollar strengthening against foreign currencies; international markets outperformed domestic by 600 bps in 2017. Emerging markets declined as capital broadly exited the space despite recent positive economic releases and earnings.
- Master limited partnerships saw modest losses in June after gaining 8.1% in April and 5.0% in May. Distribution increases and improving fundamentals (including higher distribution coverage and demand for more pipeline infrastructure) contributed to the strong 11.8% gain for the Alerian MLP Index during the second quarter.

Public Debt

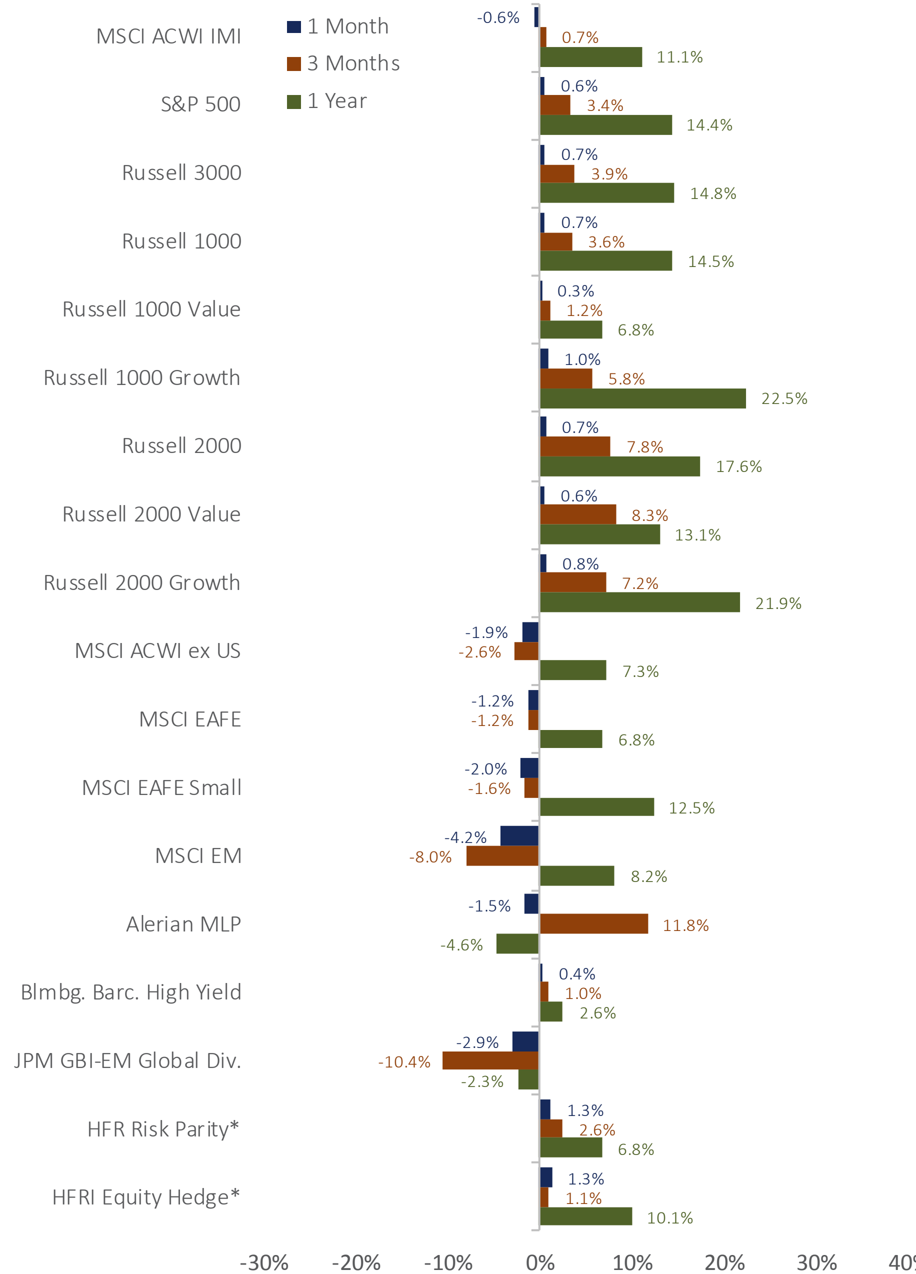
- High yield bonds gained 0.4% for the month as yields rose 7 bps to 6.5%. High yield spreads over treasuries ended at a 2018 high of 363 bps after widening 1 bp during the month; over the past 20 years high yield spreads have averaged 510 bps over treasuries.
- Local currency-denominated emerging market debt declined 2.9% during June, pushing local EMD yields up 18 bps to 6.6%. EMD yields have risen 45 bps to-date 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 gained 1.3% during May as equities, fixed income, and commodity exposures all contributed to gains for the month.
- Growth hedge funds returned 1.3% in May, 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

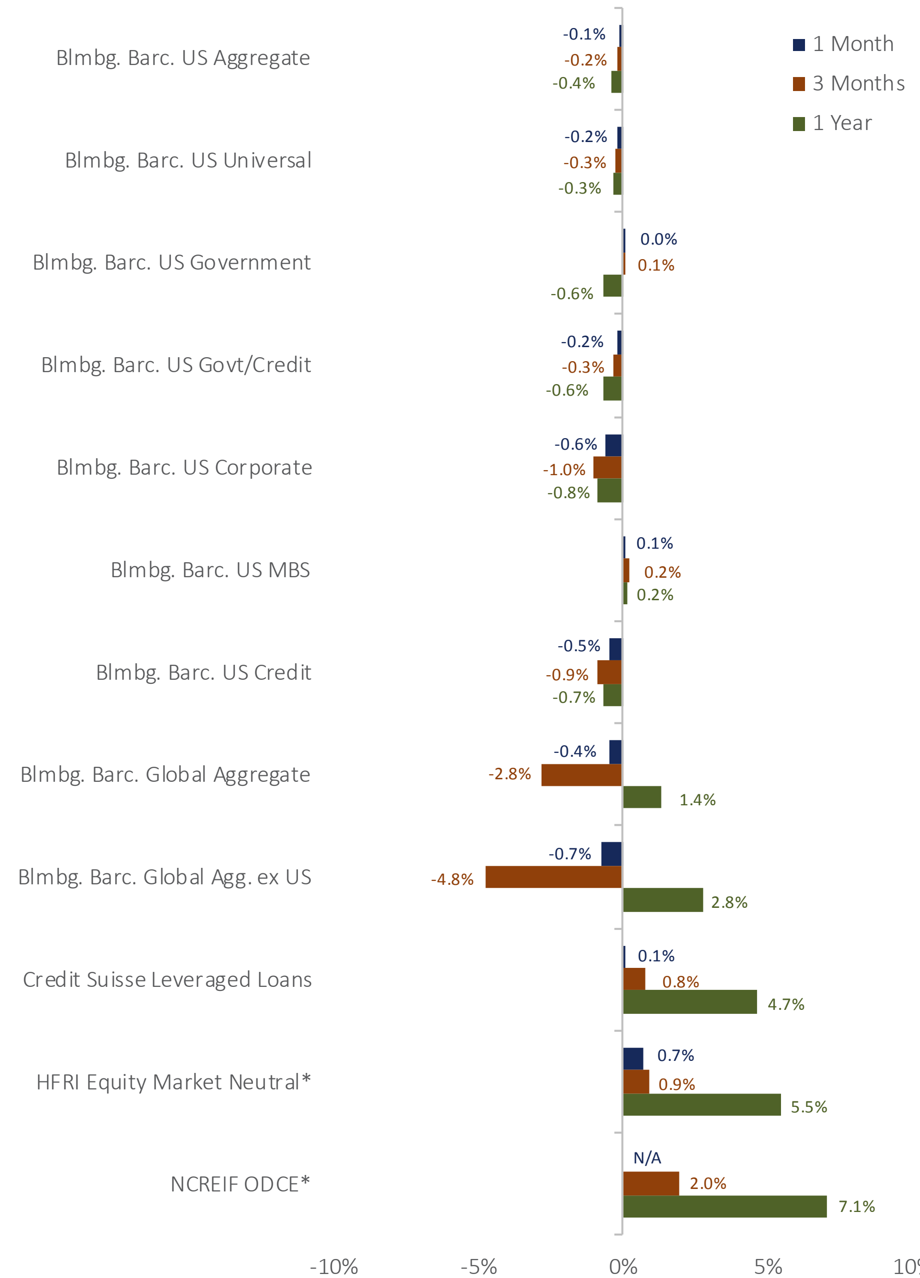
- 10-year Treasury yields were unchanged month-over-month at 2.9%. Over the first half of 2018 10-year yields rose 45 bps, with the rise in yields driven by increased expectations for Federal Reserve rate hikes and rising inflation expectations.
- The Bloomberg Barclays US Aggregate returned -0.1% for the month, with the yield of the Index rising 7 bps to 3.3%. Within the Index, credit underperformed treasury allocations as credit spreads widened; the option-adjusted spread for corporate bonds over treasuries expanded by 8 bps to 129 bps. Credit spreads have widened but remain near their lowest levels of the current cycle.
- The Bloomberg Barclays Global Aggregate ex US underperformed the US Aggregate by 60 bps as a result of appreciation in the dollar. Over the past year, however, the Global Agg ex US has outperformed the US Agg by 180 bps, primarily as a result of dollar depreciation versus foreign currencies.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, gained 0.1% during June. 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 gained 0.7% in May, performing in line with core fixed income. Over year ending May, relative value strategies gained 5.5% while the Bloomberg Barclays US Aggregate returned -0.4%.

Core Real Estate

- Core real estate returns for the first quarter were 2.2% gross and 2.0% net, bringing the one-year gain for core funds to 7.1% 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 returned 0.4% during June as real yields declined, supporting TIPS gains. At the end of June, 10-year breakeven inflation expectations were 2.1%, up 15 bps from the beginning of 2018. 10-year real yields were 0.7% at the end of June and have nearly doubled after beginning 2018 at 0.4%.

Deflation

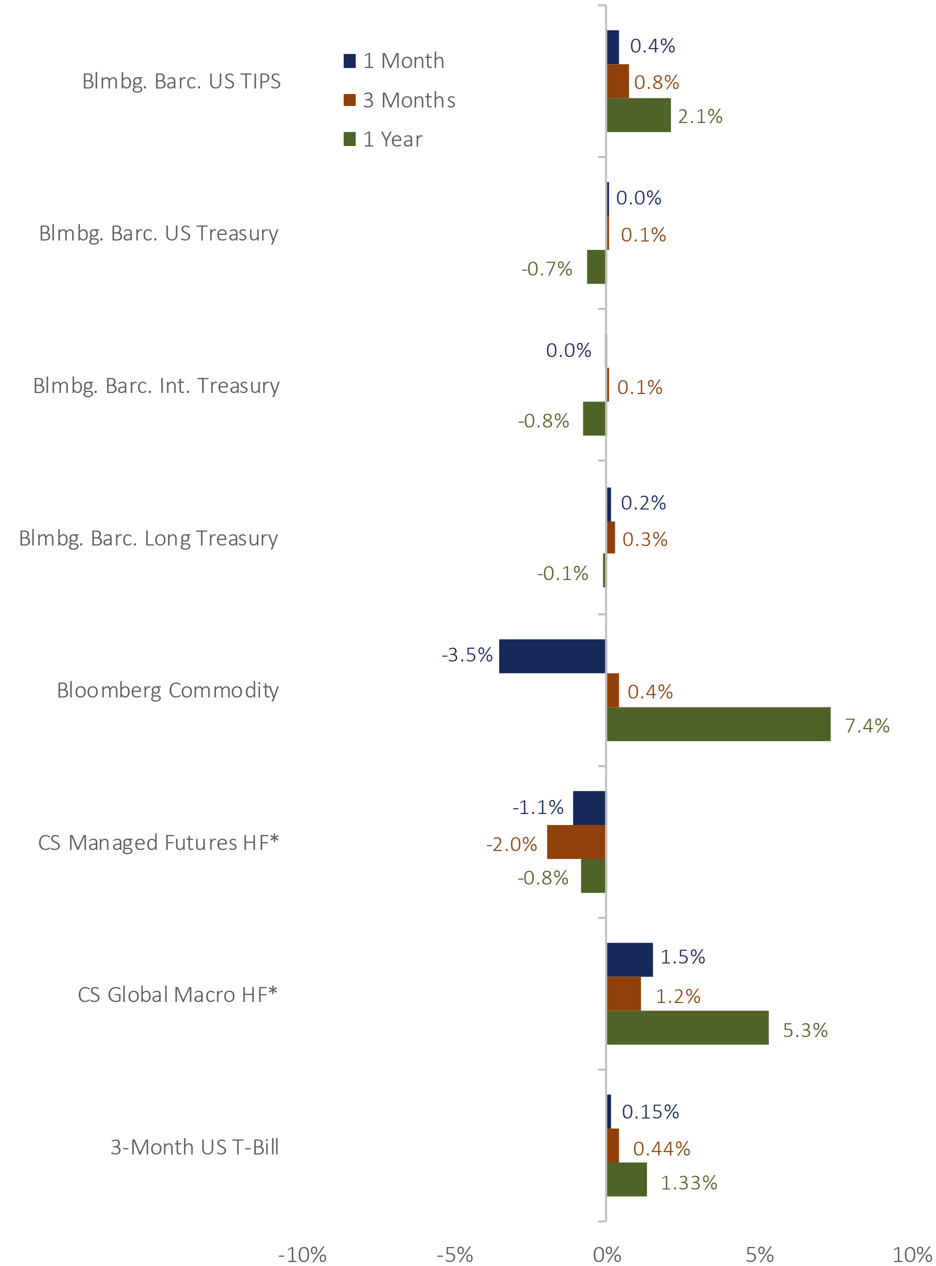
- The Bloomberg Barclays Long Treasury Index was mostly unchanged for the month, returning 0.2%. The 30-year Treasury yield fell 4 bps to 3.0%. Over the past year, 30-year yields have risen 16 bps while yields on all other treasury maturities have risen by significantly more. Anchored long-term treasury 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 3.6% during June, bringing the second quarter return to 0.4%. Grains (with the exception of corn) and industrial metals were particularly negatively impacted by trade tensions during the month. Oil remained a top performer, gaining 10.6% during June and 14.2% during the second quarter. Continued strong demand, expectations for reduced supply from Iran and Libya, and the drawdown of global inventories have contributed to the 61.1% gain for oil over the past year.

Tactical Trading

- Tactical trading strategies were mostly unchanged in aggregate during June, with managed futures declining and global macro funds gaining. Shifting trends across asset classes have challenged managed futures funds, which have returned 0.8% over the past year.



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