GLOBAL QUARTERLY FOCUS

Second Quarter 2017

Global Financial Private Capital

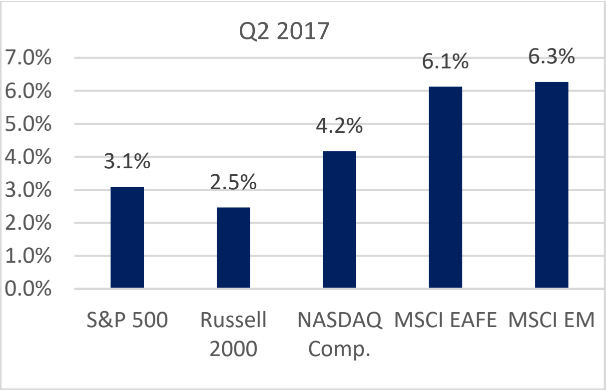
KEY TAKEAWAYS

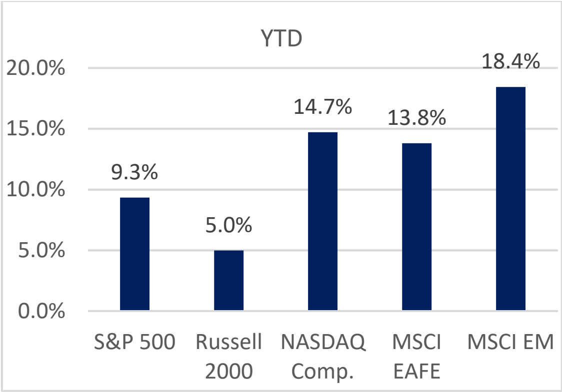
- The global expansion is on firm ground, and non-U.S. economies have closed the gap
- International equities have outperformed domestic stock markets
- In U.S. equity markets, growth-oriented sectors have taken the lead in 2017
- Lower credit quality bonds have outperformed interest rate sensitive bonds
- Oil prices fell on excess supply concerns

MARKET SUMMARY

GLOBAL EQUITY

Improving economic and earnings data led international equity markets to outperform U.S. equity markets. Within the international markets, emerging markets were the biggest winner in the quarter and YTD, returning 6.3% in 2Q, bringing YTD returns to 18.4%. Emerging markets stocks climbed higher, led by strong growth from technology-related firms and positive earnings in China and South Korea. Similarly, developed market economies (Europe, Japan, etc) returned 6.1% over the quarter and 13.8% YTD. In the U.S., large cap equities continued their upward trajectory, up 3.1% in 2Q and 9.3% YTD, driven largely by the technology sector as seen in the performance of the NASDAQ. Small cap stocks, as measured by the Russell 2000, underperformed as the strength of the domestic recovery was called into question after the potential that President Trump's tax deal may not get done by year-end and, a weak 1Q GDP came into play, thus returning 2.5% for the quarter and 5.0% YTD.

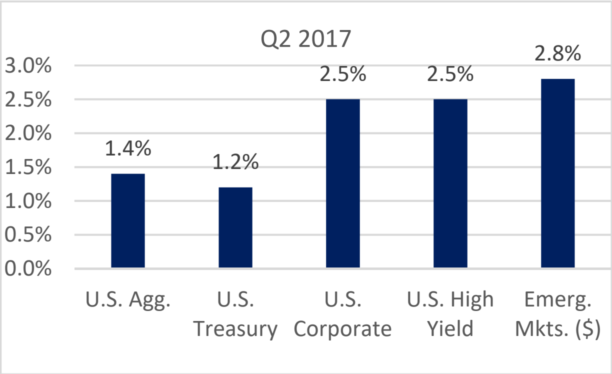


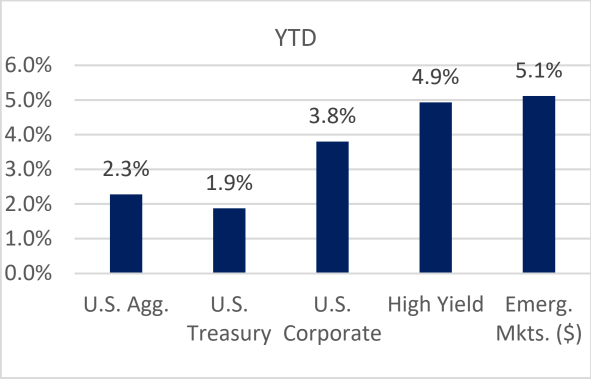


Source: Bloomberg as of 6/30/17.

FIXED INCOME

In the U.S., investors started to question the path of the Fed rate hikes given weaker than expected inflation data, leading 10-year rates to fall slightly during the quarter. As rates fell, the core fixed income represented by Barclays U.S. Aggregate Index posted a positive return of 1.4% over 2Q. High-yield bonds and emerging market debt led bond market returns as rates fell. Global bond markets were stronger across the risk spectrum in the quarter as financial and economic data remained broadly positive and investors weathered geopolitical concerns.

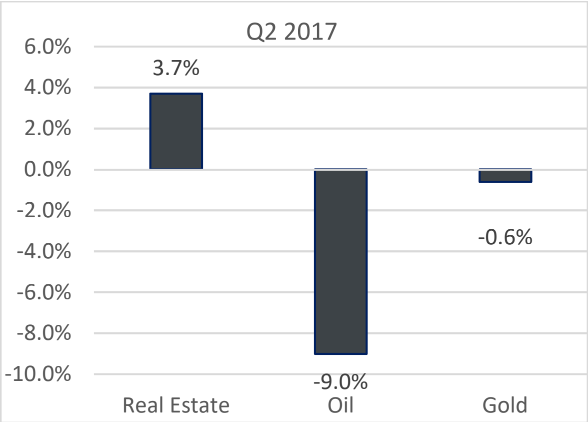


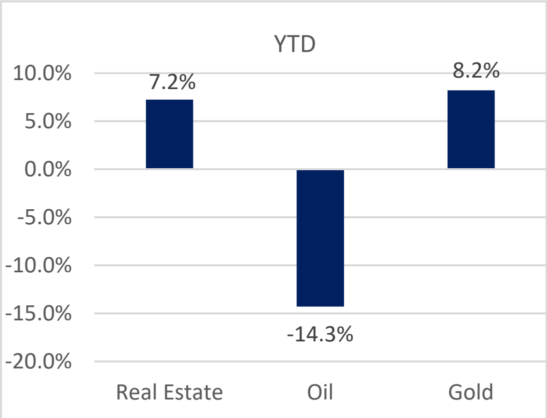


Source: Bloomberg as of 6/30/17.

ALTERNATIVE ASSETS

Alternative assets include investments such as REITs, commodities and MLPs whose returns are driven by the value of the underlying asset class. Global developed economy REITs returned 3.7% in 2Q, cushioned by flows into higher-yielding sectors of the equity markets, thus continuing the YTD rally at 7.2%. Commodities suffered as oil prices fell steeply amid concerns over a supply glut stemming from persistent U.S. production. Oil, as measured by West Texas Intermediate index (WTI) was down 9.0% in 2Q and -14.3% YTD. Lower oil prices are typically beneficial to the U.S. consumers. Finally, gold pulled back slightly for the quarter, down 0.6% as inflation concerns softened. Gold returned 8.2% YTD as it's been considered an inflation-resistant investment.



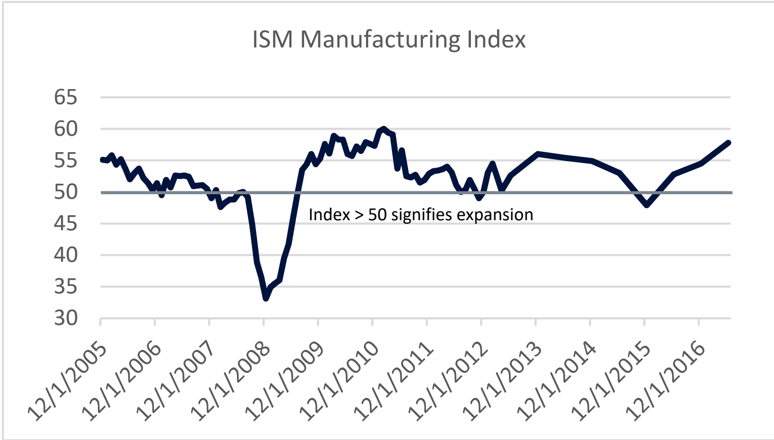


Source: Bloomberg as of 6/30/17.

THREE KEY THEMES

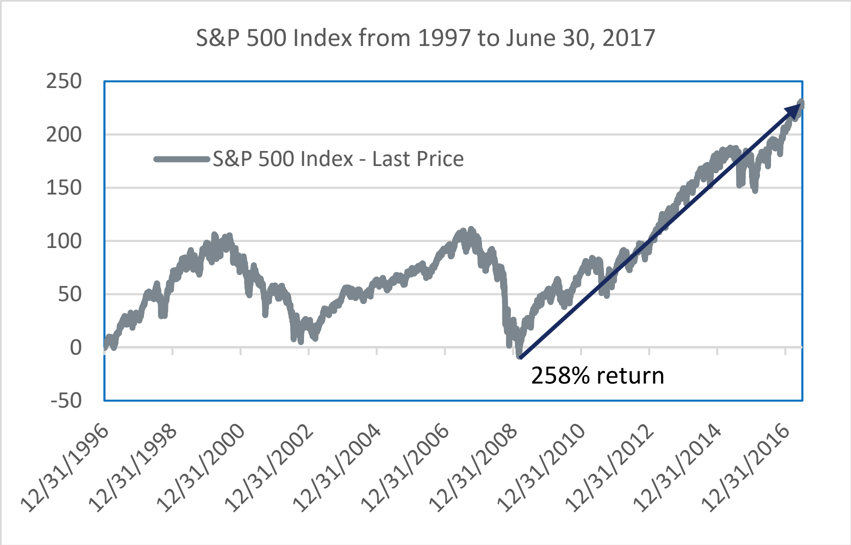
THE RISK OF A RECESSION IN THE U.S. REMAINS LOW

The U.S. economy continues to grow at a slow and steady pace. U.S. manufacturing, as shown, has rebounded alongside the global industrial recovery, and the post-election surge in positive business and consumer sentiment may represent potential upside for growth. The decline in unemployment claims suggest U.S. labor markets continue to tighten, which provides a solid backdrop for the U.S. consumer and continue overall expansion. Inflation concerns also remain relatively low, further supporting steady economic growth.



Source: Bloomberg as of 6/30/17.

The backdrop of economic growth has provided strong returns in the S&P 500, which has soared by more than 258% from its lows. While early returns were driven by earnings growth, valuations have also risen. U.S. stock valuations are close to fair value in absolute terms and cheap relative to bonds and cash. Earnings yields on stocks remain well above corporate bond yields, implying that stocks are significantly cheaper relative to bonds.

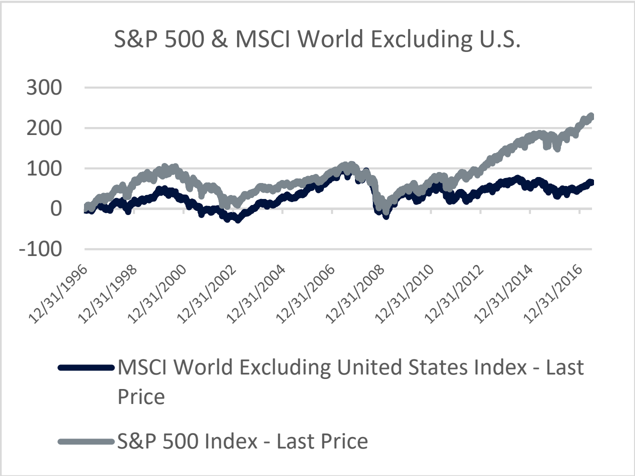


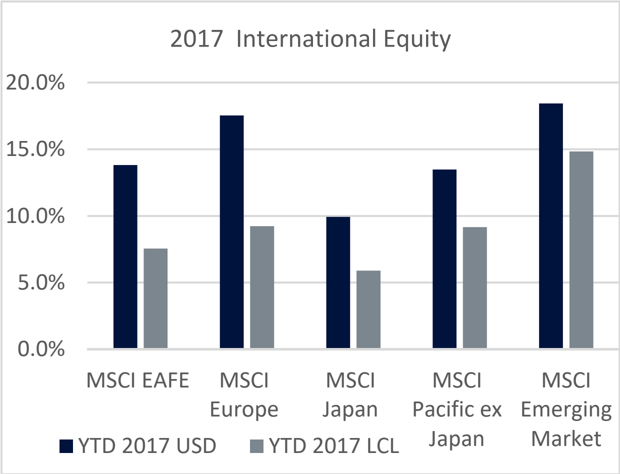
Source: Bloomberg as of 6/30/17.

Given the markets' recent highs, many investors may wonder what's next. Possibly a bear market? For investors who are concerned, history has shown certain conditions—including economic recessions, aggressive rate hikes, and oil price spikes—have all been associated with bear markets. Today, it is hard to see these conditions on the horizon, keeping concerns on a bear equity market at bay. For investors who may have seen their U.S. equity exposure increase beyond their strategic allocation, a closer look at rebalancing and diversification in global equities may be in order.

INTERNATIONAL STOCKS FINALLY STEAL THE SPOTLIGHT FROM U.S. STOCKS

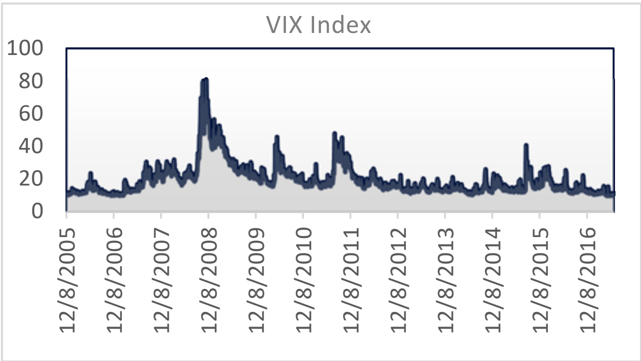
From the late 1990s up to the global financial crisis, U.S. and international equity markets performed relatively similarly—with international markets slightly outperforming U.S. markets (122% vs. 108%). However, since 2009, the U.S. stock market has gained over 250%, while the international market, as seen by the MSCI World Ex-U.S. Index is up less than half of that, up 106%. This outperformance is largely due to the stronger economic and earnings recovery in the U.S. post-financial crisis, while regions such as Europe and emerging markets were held back by falling commodity prices and a double-dip recession. However, after several years of underperformance, economic momentum has started to pick up in international markets, and earnings have started following suit, which could mean that we begin to see this gap close as the U.S. enters the later stages of its economic cycle and others are now just picking up speed. The strength of most major developed and emerging markets currencies against the U.S. dollar helped international equity returns in dollar terms with strong returns.





Source: Bloomberg as of 6/30/17.

LOW VOLATILITY AND CROWDS MEAN IT'S TIME TO LOOK FOR NEW OPPORTUNITIES



Source: Bloomberg as of 6/30/17.

Wall Street's fear gauge, the VIX index, remains near its all-time lows. In a remarkable display of fearlessness, the VIX index closed below 10 seven times in the past quarter. If we start from 2004, when the CBOE adopted a new methodology of calculating the VIX index, the fear index has closed below 10 only once since then (January 24, 2007). Lower volatility doesn't always mean higher volatility is about to happen. Low volatility periods historically have lasted a long time. They have generally occurred amid economic expansion and a steady monetary policy by central banks, both of which we see today. However, it's easy to get caught up in late-cycle equity market complacency, with many stock markets enjoying major gains and fund flows to support that. The strong returns and persistently low market volatility of late could easily lull investors into forgetting the importance of risk management and diversification in constructing portfolios.

Investors should be wary in asset classes where low volatility has encouraged many to herd into similar trades and the return potential may be diminished. Investors should look for investment managers who fish in a different pond that is far less crowded.

SUMMARY

So far 2017 has turned out to be a solid year for the capital markets. The Dow Jones Industrial Average (+9.35%) and the S&P 500 (+9.34%) each posted their best first half since 2015, despite the fact that the S&P's energy sector was hit hard by the tumbling price of oil. Meanwhile, the Nasdaq soared 14.76%, registering its most robust six-month start since 2009, with stocks such as Facebook (+31%) and Amazon (+29%) leading the way. International markets outperformed domestic equity markets led by strong corporate earnings. Emerging market equities have been the strongest performers for 2017.

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