



MARKET
ENVIRONMENT

MARKET ENVIRONMENT 3Q18: GLOBAL ECONOMY

At the head of the pack, the U.S. economy continued to feel the shot of adrenaline provided by early 2018 tax cuts and fiscal stimulus, recording +4.2% real GDP growth in the second quarter and an estimated +3.6% in the third quarter. Overseas, the economic picture was less bright with trade headwinds and several idiosyncratic stories weighing on growth.

U.S.

- Second quarter GDP growth surged 4.2% (annualized)
 - Fastest in four years
 - Consumer spending up 3.8% (annualized); up from tepid 0.5% in Q1
 - Non-residential business fixed investment soared 8.7% (annualized)
- Labor market strong
 - Unemployment at 3.7% in October; lowest since 1969
 - Job gains averaged just over 185,000 for past three months
 - Wages inching up +2.8% (y/y) in September
- Inflation remained well-behaved
 - Headline CPI was 2.7% in September (y/y); Core CPI was 2.2% (y/y)
 - Rising oil prices, tariffs, tight labor market conditions could pose a threat?
 - Core PCE in line with Fed's 2% target
- Consumer confidence soars
 - Conference Board Consumer Confidence Index highest since September 2000
 - Retail spending slowed in August, but up 6.6% y/y; a multi-year high
- The Fed raised rates as expected
 - A 25 bp hike in September brought target to 2.00% –2.25%; “accommodative” dropped from language
 - The Fed expects one more rate hike this year and three in 2019
 - Markets have priced in fewer but are moving closer to Fed projections

Overseas

- Euro zone
 - Core inflation for the EMU unchanged at 1.1%
 - Euro zone manufacturing sank to a 2-year low in September on slowing exports
 - ECB affirmed plan to cut asset purchases in half from October through December and likely halting altogether at year-end
 - Left benchmark rate unchanged at -0.4%
 - Politics and fiscal woes in Italy worried investors, causing yields on Italian bonds to surge
 - ECB lowered 2018 growth forecast to 2.0% from 2.1%
- Brexit negotiations are thorny, prospect of a “hard” Brexit remains
 - Rates unchanged at 0.75% in spite of a surprise spike in inflation (2.7% in August)
- Japan's economy gained traction; 2nd quarter GDP of 3% was the fastest since 2016
 - Capital expenditures was a key driver
 - Demographic woes pushed jobless rate to lowest in more than 25 years
- China / U.S. trade “wars” continue
 - Trump imposed a 10% tariff on \$200 bn in goods - rising to 25% on January 1st – and on top of \$50 billion earlier this year
 - China responded with \$60 bn in tariffs and cancelled trade talks

MARKET ENVIRONMENT 3Q18: EQUITY

The U.S. equity market posted broad-based gains in the third quarter fueled by strong economic growth, soaring corporate profits, and record-breaking stock buybacks. Several major indices hit record levels during the quarter, and the S&P 500 Index's 7.7% gain was its biggest since the fourth quarter of 2013. Non-U.S. developed markets underperformed the U.S. and emerging market equities fared the worst, posting modest losses for the quarter.

U.S. Equity

- S&P 500 Index rose 7.7%
 - Bringing y-t-d return to 10.6%
 - Best quarterly result since 4Q 2013
 - All sectors were positive, but differences were sharp
 - Health Care (+14.5%), Industrials (+10.0%), Technology (+8.8%), and the new Communication Services (+9.9%) sectors were the top performers
 - Materials, Energy, and Real Estate returned less than 1% for the quarter
- Growth continued to outperform Value, widening y-t-d divergence
 - R1000 Growth: +9.2%; +17.1% y-t-d
 - R1000 Value: +5.7%; +3.9% y-t-d
- Large caps outperformed small caps and pulled ahead y-t-d
 - R1000: +7.4%; +10.5% y-t-d
 - R2000: +3.6%; +11.5% y-t-d
 - Large caps helped by double-digit returns from Amazon, Apple and Microsoft
 - “FAANG” stocks plus Microsoft had a more muted impact than in previous quarters, but still contributed nearly 25% of the S&P 500's quarterly return

Overseas

- Non-U.S. developed indices continued to underperform U.S. as growth did not keep pace and trade worries weighed on markets
 - ACWI ex-US: +0.7%; -3.1% y-t-d
 - Japan was a top performer +3.7% as economic news surprised on the upside and the Prime Minister retained his role as President
 - Switzerland and Sweden both up over 7%
 - Italy (-4.5%) was roiled by political and fiscal woes
 - Concern over the fate of Brexit hurt the UK (-1.7%)
 - As in the U.S., Health Care (+4.3%) was a top performing sector while Real Estate (-2.8%) was among the worst
- Dollar was mixed
 - Up versus the Japanese yen, Australian dollar and British pound
 - Down versus the Canadian dollar
 - Essentially flat versus the euro
- Emerging markets lagged
 - MSCI EM: -1.1%; -7.7% y-t-d
 - Not atypically, returns across countries highly divergent
 - China sank (-7.5%) on trade angst and a sell-off in tech companies
 - Greece (-17.6%) and Turkey (-20.5%) were among the worst
 - Mexico (+6.9%), Brazil (+6.1%) Russia (+6.2%) and Poland (+10.6%) on top

MARKET ENVIRONMENT 3Q18: FIXED INCOME

Yields in the U.S. rose during the quarter and the yield curve continued to flatten as the Fed continued on its rate hike trajectory. Outside of the U.S., the U.S. dollar turned in mixed performance and yields were generally modestly higher. Emerging market currencies continued to struggle while external emerging markets debt managed to eke out modest gains.

U.S. Fixed Income

- U.S. rates rose modestly and the yield curve continued to flatten
 - 2-year U.S. Treasury Note climbed nearly 30 basis points to close at a multi-year high of 2.81%
 - 10- and 30-year Treasury yields rose roughly 20 bps
 - Spread between the 2-year and 10-year shrank to 24 bps
- Bloomberg Barclays Aggregate was flat (+0.0%)
 - Investment grade corporates (+1.0%) beat Treasuries (-0.6%) for the first time this year
 - However, concerns about rising leverage and significant growth in BBB rated bonds weigh on investors' minds
- Breakeven inflation expectations rose
 - 10-year breakeven inflation rate rose modestly to 2.14% (9/30) from 2.11% (6/30)
 - Bloomberg Barclays TIPS Index -0.8%; -0.8% y-t-d
- High yield corporates outperformed investment grade
 - Bloomberg Barclays High Yield: +2.4%; +2.6% y-t-d
 - Supply down sharply from 2017; demand for yield continued
- Municipal bonds posted modest losses as rates rose
 - The Bloomberg Barclays Municipal Bond Index: -0.2%; -0.4% y-t-d
 - Fundamentals remain solid and issuance down from last year

Non-U.S. Fixed Income

- Non-US developed bonds posted negative returns
 - Blmbg Barclays Global Agg ex-U.S. (unhedged): -1.7%; -3.0 y-t-d
 - Blmbg Barclays Global Agg ex-U.S. (hedged): -0.2%; +1.3% y-t-d
 - U.S. dollar up 0.7% versus basket of developed markets currencies
- Emerging markets debt mixed; external debt outperformed local currency debt with some notable underperformers
 - JPM EMBI Global Diversified +2.3%; -3.0% y-t-d
 - JPM GBI EM Global Diversified -1.8%; -8.2% y-t-d
 - Argentina -35%; y-t-d -59%
 - Turkey -27%; y-t-d -46%
 - Brazil -1.7%; -13.5% y-t-d
 - Mexico +5.5%; y-t-d +9.2%

MARKET ENVIRONMENT 3Q18: REAL ASSETS

Oil prices continued their ascent, but rising interest rates and a stronger U.S. dollar weighed on some real asset sectors. MLPs were again a top performing sector.

- Brent crude oil prices closed the quarter at \$83/barrel, a 4-year high on worries over reduced supply from Iran
 - S&P 1200 Energy: +1.3%; +8.2 y-t-d
 - Alerian MLP Index: +6.6%; +5.9% y-t-d
- Commodities mixed
 - Bloomberg Commodity TR Index: -2.0%; -2.0% y-t-d
 - GS Commodity Index: +1.3%; +11.8% y-t-d
 - Heavier weight in energy
 - S&P Gold Spot Price Index: -4.6%; -8.6% y-t-d
- Listed Infrastructure and Real Estate relatively flat in spite of rising rates
 - DJ-Brookfield Global Infrastructure Index: -0.8%; -2.1% y-t-d
 - FTSE NAREIT: +0.8%; +1.8% y-t-d
- TIPS hurt by rising rates
 - Bloomberg Barclays U.S. TIPS Index: -0.8%; -0.8% y-t-d
 - 10-yr Breakeven Inflation Rate at 2.14%, up from 2.11% as of 6/31

HISTORICAL INVESTMENT PERFORMANCE

Benchmark performance over past 30 years

Returns for periods ended September 30, 2018

	Last Quarter	Year to Date	Last Year	Last 2 Years	Last 3 Years	Last 4 Years	Last 5 Years	Last 7 Years	Last 10 Years	Last 15 Years	Last 20 Years	Last 25 Years	Last 30 Years
Domestic Equity Benchmarks													
Russell:3000 Index	7.1	10.6	17.6	18.1	17.1	12.4	13.5	16.9	12.0	9.9	7.8	9.8	10.6
Russell:1000 Index	7.4	10.5	17.8	18.2	17.1	12.4	13.7	16.9	12.1	9.8	7.7	9.9	10.7
Russell:1000 Value	5.7	3.9	9.5	12.3	13.6	8.8	10.7	15.0	9.8	8.9	7.6	9.5	10.3
Russell:1000 Growth	9.2	17.1	26.3	24.1	20.6	16.0	16.6	18.7	14.3	10.7	7.2	9.8	10.7
Russell:Midcap Index	5.0	7.5	14.0	14.6	14.5	10.6	11.7	16.1	12.3	11.1	10.3	11.0	11.8
Russell:Midcap Value	3.3	3.1	8.8	11.1	13.1	9.1	10.7	15.5	11.3	10.8	10.2	11.1	11.7
Russell:Midcap Growth	7.6	13.4	21.1	19.4	16.6	12.6	13.0	16.9	13.5	11.1	9.4	10.1	11.1
Russell:2000 Index	3.6	11.5	15.2	18.0	17.1	12.9	11.1	16.4	11.1	10.1	9.4	9.4	10.0
Russell:2000 Value	1.6	7.1	9.3	14.8	16.1	11.4	9.9	15.3	9.5	9.5	9.8	10.2	10.8
Russell:2000 Growth	5.5	15.8	21.1	21.0	18.0	14.3	12.1	17.5	12.7	10.6	8.6	8.1	8.8
Non-US Equity Benchmarks													
MSCI:EAFE	1.4	(1.4)	2.7	10.6	9.2	4.5	4.4	8.3	5.4	6.8	5.2	5.2	5.2
MSCI:ACWI ex US	0.7	(3.1)	1.8	10.3	10.0	4.0	4.1	7.2	5.2	7.2	--	--	--
MSCI:EM	(1.1)	(7.7)	(0.8)	10.2	12.4	3.4	3.6	5.0	5.4	9.7	--	--	--
MSCI:EAFE Small Cap	(0.9)	(2.2)	3.7	12.4	12.4	9.2	8.0	11.5	9.7	9.5	--	--	--
MSCI:Frontier Markets	(2.0)	(12.6)	(7.7)	7.6	5.3	(3.0)	2.9	5.5	(0.2)	5.7	--	--	--
Domestic Fixed Income Benchmarks													
Blmbg:Aggregate	0.0	(1.6)	(1.2)	(0.6)	1.3	1.7	2.2	2.0	3.8	3.8	4.5	5.0	6.1
Blmbg:Corporate High Yld	2.4	2.6	3.0	5.9	8.1	5.1	5.5	7.6	9.5	7.7	6.9	7.3	8.1
Blmbg:Municipal Bond	(0.2)	(0.4)	0.3	0.6	2.2	2.5	3.5	3.4	4.8	4.1	4.5	4.9	5.8
Blmbg:Gov/Cred 1-3 Yr	0.3	0.4	0.2	0.4	0.7	0.8	0.8	0.9	1.7	2.2	3.1	3.7	4.5
Blmbg:US TIPS	(0.8)	(0.8)	0.4	(0.2)	2.0	1.3	1.4	1.3	3.3	3.9	5.2	--	--
Non-US Fixed Income Benchmarks													
Blmbg:Glob Agg ex USD	(1.74)	(3.03)	(1.45)	(1.93)	2.41	(0.21)	(0.33)	(0.06)	2.20	3.27	3.37	4.36	--
Blmbg:Glob Agg ex USD H	(0.17)	1.25	2.40	0.91	3.07	3.15	3.80	3.84	4.25	4.11	4.48	5.53	--
JPM:EMBI Global Dvsfd	2.30	(3.04)	(1.92)	1.29	6.04	4.33	5.38	5.87	7.55	7.43	9.81	--	--
JPM:GBI-EM Global Dvsfd	(1.83)	(8.15)	(7.40)	(0.31)	5.17	(1.71)	(1.68)	(0.05)	2.70	6.00	--	--	--

Source: Callan.

HISTORICAL INVESTMENT PERFORMANCE

Annual benchmark performance

3
Qtrs.

2018 2017 2016 2015 2014 2013 2012 2011 2010 2009 2008 2007 2006 2005 2004 2003 2002 2001 2000 1999

Domestic Equity Benchmarks

Russell:3000 Index	10.6	21.1	12.7	0.5	12.6	33.6	16.4	1.0	16.9	28.3	(37.3)	5.1	15.7	6.1	11.9	31.1	(21.5)	(11.5)	(7.5)	20.9
Russell:1000 Index	10.5	21.7	12.1	0.9	13.2	33.1	16.4	1.5	16.1	28.4	(37.6)	5.8	15.5	6.3	11.4	29.9	(21.7)	(12.4)	(7.8)	20.9
Russell:1000 Value	3.9	13.7	17.3	(3.8)	13.5	32.5	17.5	0.4	15.5	19.7	(36.8)	(0.2)	22.2	7.1	16.5	30.0	(15.5)	(5.6)	7.0	7.3
Russell:1000 Growth	17.1	30.2	7.1	5.7	13.0	33.5	15.3	2.6	16.7	37.2	(38.4)	11.8	9.1	5.3	6.3	29.7	(27.9)	(20.4)	(22.4)	33.2
Russell:Midcap Index	7.5	18.5	13.8	(2.4)	13.2	34.8	17.3	(1.5)	25.5	40.5	(41.5)	5.6	15.3	12.7	20.2	40.1	(16.2)	(5.6)	8.2	18.2
Russell:Midcap Value	3.1	13.3	20.0	(4.8)	14.7	33.5	18.5	(1.4)	24.8	34.2	(38.4)	(1.4)	20.2	12.6	23.7	38.1	(9.6)	2.3	19.2	(0.1)
Russell:Midcap Growth	13.4	25.3	7.3	(0.2)	11.9	35.7	15.8	(1.7)	26.4	46.3	(44.3)	11.4	10.7	12.1	15.5	42.7	(27.4)	(20.2)	(11.7)	51.3
Russell:2000 Index	11.5	14.6	21.3	(4.4)	4.9	38.8	16.3	(4.2)	26.9	27.2	(33.8)	(1.6)	18.4	4.6	18.3	47.3	(20.5)	2.5	(3.0)	21.3
Russell:2000 Value	7.1	7.8	31.7	(7.5)	4.2	34.5	18.1	(5.5)	24.5	20.6	(28.9)	(9.8)	23.5	4.7	22.2	46.0	(11.4)	14.0	22.8	(1.5)
Russell:2000 Growth	15.8	22.2	11.3	(1.4)	5.6	43.3	14.6	(2.9)	29.1	34.5	(38.5)	7.0	13.3	4.2	14.3	48.5	(30.3)	(9.2)	(22.4)	43.1

Non-US Equity Benchmarks

MSCI:EAFE	(1.4)	25.0	1.0	(0.8)	(4.9)	22.8	17.3	(12.1)	7.8	31.8	(43.4)	11.2	26.3	13.5	20.2	38.6	(15.9)	(21.4)	(14.2)	27.0
MSCI:ACWIxUS Gross	(2.7)	27.8	5.0	(5.3)	(3.4)	15.8	17.4	(13.3)	11.6	42.1	(45.2)	17.1	27.2	17.1	21.4	41.4	(14.7)	(19.5)	(15.1)	30.9
MSCI:EM	(7.7)	37.3	11.2	(14.9)	(2.2)	(2.6)	18.2	(18.4)	18.9	78.5	(53.3)	39.4	32.2	34.0	25.6	55.8	(6.2)	(2.6)	--	--
MSCI:EAFE Small Cap	(2.2)	33.0	2.2	9.6	(4.9)	29.3	20.0	(15.9)	22.0	46.8	(47.0)	1.4	19.3	26.2	30.8	61.3	(7.8)	(12.5)	(7.6)	19.7
MSCI:Frontier Markets	(12.6)	31.9	2.7	(14.5)	6.8	25.9	8.9	(18.7)	23.7	11.6	(54.1)	41.9	(8.9)	72.7	22.6	43.5	--	--	--	--

Domestic Fixed Income Benchmarks

Bloomberg:Aggregate	(1.6)	3.5	2.6	0.5	6.0	(2.0)	4.2	7.8	6.5	5.9	5.2	7.0	4.3	2.4	4.3	4.1	10.3	8.4	11.6	(0.8)
Bloomberg:Corporate High Yld	2.6	7.5	17.1	(4.5)	2.5	7.4	15.8	5.0	15.1	58.2	(26.2)	1.9	11.8	2.7	11.1	29.0	(1.4)	5.3	(5.9)	2.4
Bloomberg:Municipal Bond	(0.4)	5.4	0.2	3.3	9.1	(2.6)	6.8	10.7	2.4	12.9	(2.5)	3.4	4.8	3.5	4.5	5.3	9.6	5.1	11.7	(2.1)
Bloomberg:Gov/Cred 1-3 Yr	0.4	0.8	1.3	0.7	0.8	0.6	1.3	1.6	2.8	3.8	5.0	6.8	4.3	1.8	1.3	2.8	6.3	8.8	8.1	3.2
Bloomberg:US TIPS	(0.8)	3.0	4.7	(1.4)	3.6	(8.6)	7.0	13.6	6.3	11.4	(2.4)	11.6	0.4	2.8	8.5	8.4	16.6	7.9	13.2	2.4

Non-US Fixed Income Benchmarks

Bloomberg:Glob Agg ex USD	(3.0)	10.5	1.5	(6.0)	(3.1)	(3.1)	4.1	4.4	4.9	7.5	4.4	11.0	8.2	(8.6)	12.5	19.4	22.4	(3.7)	(3.9)	(8.8)
Bloomberg:Glob Agg ex USD H	1.3	2.5	4.9	1.4	8.8	1.2	6.5	3.9	3.3	4.4	5.7	4.3	3.2	5.4	5.3	2.4	6.8	6.3	9.1	2.1
JPM:EMBI Global Dvsfd	(3.0)	10.3	10.2	1.2	7.4	(5.2)	17.4	7.3	12.2	29.8	(12.0)	6.2	9.9	10.2	11.6	22.2	13.7	9.7	12.7	19.6
JPM:GBI-EM Global Dvsfd	(8.1)	15.2	9.9	(14.9)	(5.7)	(9.0)	16.8	(1.8)	15.7	22.0	(5.2)	18.1	15.2	6.3	23.0	16.9	--	--	--	--

Source: Callan.

PERIODIC TABLE OF INVESTMENT RETURNS

2009	2010	2011	2012	2013	2014	2015	2016	2017	3 Qtrs. 2018
MSCI Emerging Markets 78.51%	Russell 2000 Index 26.85%	Blmbg Barclays Aggregate 7.84%	MSCI Emerging Markets 18.23%	Russell 2000 Index 38.82%	S&P 500 13.69%	S&P 500 1.38%	Russell 2000 Index 21.31%	MSCI Emerging Markets 37.28%	Russell 2000 Index 11.51%
Blmbg Barclays Corp High Yield 58.21%	MSCI Emerging Markets 18.88%	JPM EMBI Global Dvsfd 7.35%	JPM EMBI Global Dvsfd 17.44%	S&P 500 32.39%	JPM EMBI Global Dvsfd 7.43%	JPM EMBI Global Dvsfd 1.18%	Blmbg Barclays Corp High Yield 17.13%	MSCI ACWI ex US 27.19%	S&P 500 10.56%
MSCI ACWI ex US 41.45%	Blmbg Barclays Corp High Yield 15.12%	Blmbg Barclays Corp High Yield 4.98%	MSCI ACWI ex US 16.83%	MSCI ACWI ex US 15.29%	Blmbg Barclays Aggregate 5.97%	Blmbg Barclays Aggregate 0.55%	S&P 500 11.96%	S&P 500 21.83%	Blmbg Barclays Corp High Yield 2.57%
JPM EMBI Global Dvsfd 29.82%	S&P 500 15.06%	Blmbg Barclays Global Agg ex US 4.36%	Russell 2000 Index 16.35%	Blmbg Barclays Corp High Yield 7.44%	Russell 2000 Index 4.89%	3 Month T-Bill 0.05%	MSCI Emerging Markets 11.19%	Russell 2000 Index 14.65%	3 Month T-Bill 1.30%
Russell 2000 Index 27.17%	JPM EMBI Global Dvsfd 12.24%	S&P 500 2.11%	S&P 500 16.00%	3 Month T-Bill 0.07%	Blmbg Barclays Corp High Yield 2.45%	Russell 2000 Index -4.41%	JPM EMBI Global Dvsfd 10.15%	Blmbg Barclays Global Agg ex US 10.51%	Blmbg Barclays Aggregate -1.60%
S&P 500 26.47%	MSCI ACWI ex US 11.15%	3 Month T-Bill 0.10%	Blmbg Barclays Corp High Yield 15.81%	Blmbg Barclays Aggregate -2.02%	3 Month T-Bill 0.03%	Blmbg Barclays Corp High Yield -4.47%	MSCI ACWI ex US 4.50%	JPM EMBI Global Dvsfd 10.26%	Blmbg Barclays Global Agg ex US -3.03%
Blmbg Barclays Global Agg ex US 7.53%	Blmbg Barclays Aggregate 6.54%	Russell 2000 Index -4.18%	Blmbg Barclays Aggregate 4.21%	MSCI Emerging Markets -2.60%	MSCI Emerging Markets -2.19%	MSCI ACWI ex US -5.66%	Blmbg Barclays Aggregate 2.65%	Blmbg Barclays Corp High Yield 7.50%	JPM EMBI Global Dvsfd -3.04%
Blmbg Barclays Aggregate 5.93%	Blmbg Barclays Global Agg ex US 4.95%	MSCI ACWI ex US -13.71%	Blmbg Barclays Global Agg ex US 4.09%	Blmbg Barclays Global Agg ex US -3.08%	Blmbg Barclays Global Agg ex US -3.09%	Blmbg Barclays Global Agg ex US -6.02%	Blmbg Barclays Global Agg ex US 1.49%	Blmbg Barclays Aggregate 3.54%	MSCI ACWI ex US -3.09%
3 Month T-Bill 0.21%	3 Month T-Bill 0.13%	MSCI Emerging Markets -18.42%	3 Month T-Bill 0.11%	JPM EMBI Global Dvsfd -5.24%	MSCI ACWI ex US -3.87%	MSCI Emerging Markets -14.92%	3 Month T-Bill 0.33%	3 Month T-Bill 0.86%	MSCI Emerging Markets -7.68%

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