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QUARTERLY MARKET INSIGHTS
1ST QUARTER 2018

SPOTLIGHT

THE RETURN OF VOLATILITY

The post-election calm which spread across the U.S. stock market for 14 months beginning in November 2016 ended abruptly in the first week of February. The major U.S. averages mostly ignored the persistent political and foreign policy headlines that dominated 2017 to march steadily higher. Synchronized global economic growth and U.S. corporate tax reform supported last year's rally which resulted in the S&P 500 Index closing 2017 with a total return of 21.9%. Importantly, the path of this strong rally was remarkably stable. For all of 2017, the S&P 500 avoided a correction of more than 3% between any two daily closing levels for the first time since 1995.

This placid landscape seemed to change on Groundhog Day when the U.S. Bureau of Labor Statistics' January payrolls report revealed average hourly wages grew 2.9% from the previous year. The reading marked the highest level of annual wage growth since June 2009 and sent fears of higher inflation and faster Fed rate hike paths pulsing through stock and bond markets. The following Monday, February 5, the Dow Jones Industrial Average (DJIA) plummeted 1,175 points or 4.7%. After a partial recovery mid-week, the blue-chip index declined 1,033 points or 4.1% on Thursday, February 8. The broader-based S&P 500 Index suffered a 10% decline in ten trading days ending from January 26 to February 8. Volatility, or large swings in asset prices over short-term periods, appeared to have awaken.

These sharp moves rattled many market participants, especially after the lulling tranquility of 2017. Gradually climbing interest rates, trade policy uncertainty and concerns about tightened regulation for some of the largest U.S. technology firms were the biggest drivers of this paradigm shift. Yet, it all seemed to herald a shift back to a more normalized environment of risk asset volatility where stock prices are relatively unstable over short- to intermediate-term periods but typically climb higher over full market cycles. For instance, the DJIA's two daily declines of more than 1,000 points in early February mentioned above were not among its worst 30 days over the last 40 years. According to Bloomberg data, over the 72-year post-World War II period from 1946 to 2017, the S&P 500 Index generated positive returns in 57 calendar years with an average annualized return of 11.1% and a median calendar year return of 14.0%. Over this period, the S&P 500's average peak-to-trough drawdown during the course of a year was 13.6%, with an average length of 75 days. While jolting, the sharp declines in February were actually more normal than many investors may realize when compared to the U.S. stock market's long-term history.

A commonly used measurement of U.S. stock market volatility is the Chicago Board Options Exchange (CBOE) Volatility Index, or VIX. Colloquially known as "Wall Street's fear gauge," the VIX was developed by academics in the late 1980s and its contract was launched on the CBOE shortly thereafter. It was designed as a tool to measure the implied volatility of a broad set of put (sell) and call (buy) options on the S&P 500 Index expiring between 23 and 37 days. As such, the VIX seeks to measure the implied variability of S&P 500 Index price movements over the next three to five weeks. The VIX tends to spike during periods of pronounced economic and market stress. Volatility spikes prior to early February 2018 included the Asian economic crisis of fall 1997, the Long-Term Capital Management default in the fall of 1998, the September 2001 terrorists attacks, the technology bubble and NASDAQ crash of 2002, the Lehman Brothers bankruptcy of fall 2008, the S&P U.S. debt downgrade of August 2011, and the Chinese currency devaluation in August 2015.

In general, the VIX typically trades between 12 and 25 with a median daily closing level over its 28-plus year history of 17.49. Its all-time closing high of 80.86 was reached in the throes of the Lehman bankruptcy and subsequent financial crisis on October 27, 2008; its lowest closing level ever of 9.14 was just five months ago on November 3, 2017. The subdued volatility of 2017 resulted in a median daily closing level for the VIX of 10.85, the lowest ever for a calendar year since the VIX's 1990 inception. Unfortunately, some traders and investors were severely punished by bets on volatility remaining low indefinitely through several exchange-traded products. These bets played out extraordinarily well right up until late January. The VelocityShares Daily Inverse VIX Short-Term exchange-traded note (XIV) generated a return of 479% from June 30, 2016 to January 22, 2018, before plunging more than 95% over the next several weeks. It was finally liquidated on February 15, wiping out several billion dollars of investor assets.

As bumpiness returned to markets in the first quarter, the VIX posted a median daily close of 17.23, right in line with its long-term median of 17.49. The highest VIX closing levels of the first quarter were 37.32 and 33.6 on February 5 and 8, respectively. Zooming in on the bumpiest month of the quarter, the median VIX daily closing level in February was 19.85, less than the median level of the entire decade from 2000 to 2009, and 12 of the 28 calendar years between 1990 and 2017. So, while U.S. stock market volatility as measured by the VIX has most certainly picked up in recent months, its reemergence is actually more aligned with long-term market history than was the calmness of 2017.

ECONOMY

SOLID ECONOMIC TRENDS THROUGH THE WINTER

U.S. fourth quarter Gross Domestic Product grew at a 2.9% annual rate according to the final estimate released by the Commerce Department, beating the median economists' estimate by 0.2%. Upward revisions in the personal consumption and non-residential fixed investment components of GDP were the biggest contributors to the headline number revision. Growth in consumer spending, which accounts for more than two-thirds of U.S. economic activity, was revised up to a 4.0% rate in the fourth quarter from the 3.8% previously reported. That was the strongest growth since the fourth quarter of 2014 and followed a 2.2% rate of consumer spending growth in the third quarter. Government spending grew 3.0%, revised up from a 2.9% pace. Imports grew at an upwardly revised 14.1% and overshadowed a rise in exports driven by weakness in the dollar. The full impact of tax cuts and higher government spending may contribute to above 2.5% GDP growth in 2018 despite slowing productivity growth.

In March, the Federal Open Market Committee (FOMC), meeting for the first time under new chairman Jerome Powell's leadership, raised the central bank's benchmark rate by 0.25% to a range of 1.50% to 1.75%. The hike was widely anticipated, so most of the market reaction appeared to be related to changes in the FOMC's so-called dot plot, which serves to indicate FOMC members' rate path expectations. According to the dot plot, the FOMC's baseline projection is for three total quarter point hikes in 2018, another three in 2019 and two in 2020.

The Conference Board's Consumer Confidence Index decreased in March, following an increase in February. The Index now stands at 127.7, down from 130.0 in February. "Consumer confidence declined moderately in March after reaching an 18-year high in February," said Lynn Franco, Director of Economic Indicators at The Conference Board.

ECONOMIC INDICATORS	LATEST	3MO PRIOR	CHANGE*
REAL GDP (QoQ ANNUALIZED)	2.9%	3.2%	▼
TRADE BALANCE	-57.59	-50.88	▼
UNEMPLOYMENT RATE	4.1%	4.1%	-
NON-FARM PAYROLLS	103K	175K	▼
ISM MANUFACTURING	59.3	59.3	-
ISM NON-MANUFACTURING	58.8	56.0	▲
RETAIL SALES (LESS AUTOS)	0.3%	1.0%	▼
INDUSTRIAL PRODUCTION	1.0%	0.5%	▲
HOUSING STARTS	1236M	1299M	▼
CONSUMER PRICE INDEX (YoY)	2.4%	2.1%	▼
CONSUMER CONFIDENCE	127.7	123.1	▲
EXISTING HOME SALES	5.54M	5.72M	▼
CONSUMER CREDIT	10.601B	32.56B	▼
CRUDE OIL PRICE	64.94	60.42	▼

Source: Bloomberg. Past performance does not guarantee future results. *The change arrow is indicative of a positive or negative change in the economic nature of the data series. For example, a downward-pointing change arrow assigned to the crude oil price field will correspond with an increase in the actual price of crude oil over the last three months. This is because a short-term increase in the price of crude oil has historically been detrimental to U.S. economic growth.

ECONOMY CONTINUED

HOUSING

Housing prices in the U.S. continued their ascent amid strong demand and low inventory. The S&P CoreLogic Case-Shiller National Home Price Index rose 6.3% year over year in March. Economists expect the pace of price acceleration to slow this year due to home price growth outpacing wage growth, rising mortgage rates, and a reduction in the mortgage interest deduction limit. Sales of existing homes in the U.S. during February increased 3.0% to an annualized rate of 5.54 million units following two consecutive monthly declines. Supply was approximately 8.0% lower than one year ago, while the median sales price increased 5.9% to $241,700 from February 2017. New homes sales in February slowed for a third straight month to an annualized rate of 618,000 units, while the median sales price increased 9.7% year over year to $326,800. This set of new home sales data suggests climbing prices and muted new construction may be discouraging buyers.

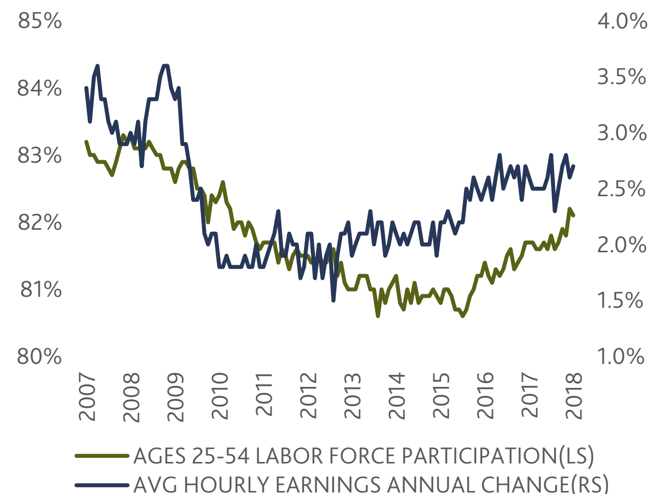
EMPLOYMENT AND MANUFACTURING

The unemployment rate remained at 4.1% in March for the sixth consecutive month and total nonfarm payroll employment rose by a less-than-expected 103,000 according to the U.S. Bureau of Labor Statistics. Average job growth for February was revised higher to a gain of 326,000 while January was revised lower to 176,000. Looking at the first three months of the year, monthly employment gains have averaged 202,000 per month. For all of 2017, monthly job gains averaged 171,000. The tight labor market has also been moving wage growth higher. Average hourly wages rose 0.3% in March. The twelve-month increase in wages crept up to 2.7% from 2.6%. For most of the nearly nine-year expansion, wage gains have averaged around 2% per year. Encouraging labor force participation trends have continued this quarter. The percentage of the U.S. population between the prime working ages of 25 and 54 who are in the labor force, defined as working or looking for work, in February hit its highest since June 2010.

Economic activity in the manufacturing sector expanded in March with the overall economy growing for the 107th consecutive month, according to the latest PMI® report from the Institute for Supply Management. The March PMI® came in at 59.3, a decrease of 1.5 points from the February reading of 60.8. The New Orders Index registered 61.9, a decrease of 2.3 points from the February reading of 64.2. Of the 18 manufacturing industries measured, 17 reported growth in March. Comments from the panel reflect continued expanding business strength. Demand remains robust, with the New Orders Index at 60 or above for the 11th straight month, and the Customers' Inventories Index is at its lowest level since July 2011.

U.S. LABOR FORCE PARTICIPATION AND WAGE TRENDS

MARCH 2007 THROUGH MARCH 2018



Source: Bloomberg. Past performance does not guarantee future results.

EQUITY

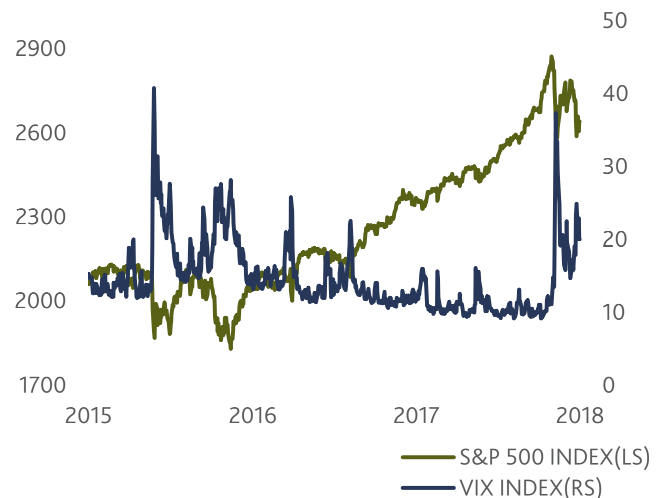
JANUARY GAINS TURN TO FEBRUARY PAIN

U.S. and developed market international stocks stumbled in the first quarter of 2018, tripped up by concerns surrounding inflation, trade policy spats and the threat of increased regulatory focus on high-flying technology sector giants. After surging 7.5% in the first 26 days of January, the S&P 500 Index abruptly succumbed to a bout of negative sentiment to end its streak of nine consecutive quarterly gains dating back to 2015. While the magnitude of the overall quarterly declines for the three major U.S. stock averages was moderate, the paths they followed were much choppier than seen since 2016. For instance, the Dow Jones Industrial Average declined a pedestrian 2.5% or 616 points during the quarter. Yet, the blue-chip index suffered a 12.2% peak-to-trough drawdown of 3,247 points from its closing level on January 26 to its intraday low on February 9.

Growth style U.S. stocks extended their sharp 2017 outperformance of value peers during the quarter, as the Russell 3000 Growth Index generated a total quarterly return of 1.5% compared to the Russell 3000 Value Index's 2.8%. Meanwhile, the small capitalization Russell 2000 Index performed a modest 0.7% better than the large cap focused S&P 500 Index for the quarter. Emerging market stocks were among the only major equity asset classes to notch a positive return during the period. Boosted by strong returns from the Brazilian and Russian stock benchmarks, the MSCI Emerging Market Equity Index posted a total quarterly return of 1.4% in U.S. dollar terms.

The road for the broad global stock market first became bumpy with a higher-than-expected wage growth number from the U.S. Bureau of Labor Statistics' January payrolls report. This otherwise positive sign for domestic workers suggested to some market participants that climbing wage costs could point to rising inflationary pressure across the U.S. economy. This, in turn, could make it more likely that the Federal Reserve would accelerate its path of interest rate hikes in 2018. A hastened bout of selling in the first week of February pushed Wall Street's fear gauge, the CBOE Volatility Index, or VIX Index, to an intra-day high of 50.30 on February 6 and a daily average of 29.50 for the week ending February 9. This compares to an average VIX Index level of 11.0 during January 2018 and 11.1 for all of 2017. The volatility shock created a negative feedback loop whereby traders and some investors who bet against higher volatility (a successful strategy for all of 2017) were forced to rapidly unwind their positions. This boosted the VIX Index higher and pushed U.S. stock averages sharply lower

U.S. STOCKS AND VOLATILITY
MARCH 2015 THROUGH MARCH 2017



Source: Bloomberg. Past performance does not guarantee future results.

until a near-term bottom was reached on the Friday before the week of both Mardi Gras and Valentine's Day.

The remainder of February and first week of March saw the S&P 500 Index recover about two-thirds of its February losses against a backdrop of strong, broad-based fourth quarter earnings results and optimism surrounding the December tax cuts. All eleven S&P 500 sectors reported positive year-over-year earnings and sales growth for the first quarter since 2011. The energy, materials and technology sectors shined brightest, as all three groups recorded sales growth of at least 11.5% and earnings per share growth of at least 22.4%.

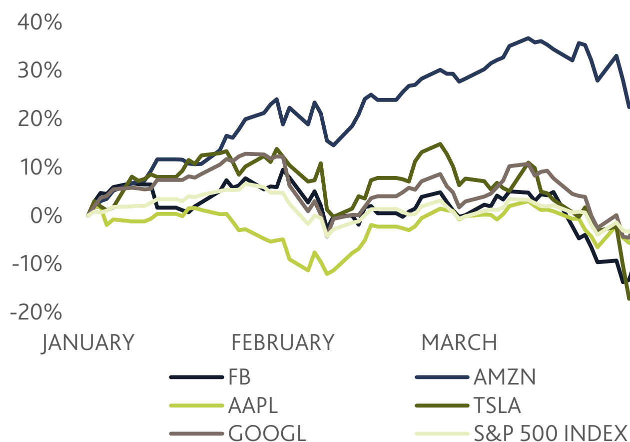
Following the end of earnings season, the Ides of March brought a return of negative news flow headlined by a burgeoning data privacy scandal at social media platform Facebook, Inc. and autonomous vehicle deaths related to programs at Uber, Inc. and Tesla, Inc. Facebook shares declined 13.9% during the week of March 16, shedding close to $80 billion of market capitalization in the wake of reports that a British political advertising firm gained access to over 50 million users' personal data without their consent. Calls from politicians and consumers for regulators to take a closer look at Facebook's business model and privacy controls dragged down stocks across the U.S. technology sector. After outpacing the broad S&P 500 Index by 7.3% from the beginning of the year through March 15, the S&P 500 technology sector index trailed the broad benchmark by 2.5% in the final two weeks of the quarter.

While regulatory jitters pulsed through the technology sector in late March, the beginning salvos of a trade policy skirmish between the Trump administration and China materialized. A series of tit-for-tat tariff threats presented by each side kept pressure on U.S. stocks during the final days of the quarter, as investors struggled to digest the effects of both sets of tariff threats on the economy and individual companies.

Looking forward to the remaining three quarters of 2018, U.S. stock valuations appear less extended than in the second half of 2017. This is largely due to the moderate index declines of the first quarter coupled with increased analysts' expectations for full-year 2017 S&P 500 earnings per share expectations. At the end of the fourth quarter, the S&P 500 Index traded at nearly 19 times forward twelve-month earnings expectations based on Bloomberg analysts' estimates. This forward price-to-earnings multiple for the S&P 500 Index declined to approximately 16.7 by the close of the quarter, much more in line with its five- and ten-year averages.

HIGH PROFILE TECHNOLOGY NAMES STUMBLE IN MARCH

JANUARY 2018 THROUGH MARCH 2018



Source: Bloomberg. Past performance does not guarantee future results.

FIXED INCOME

YIELDS FLOAT HIGHER

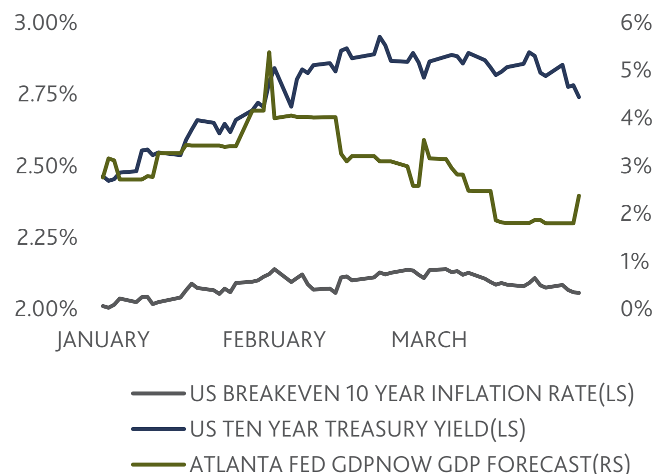
U.S. bond investors faced a challenging start to the year, as nearly every Bloomberg Barclays domestic fixed income index posted a negative return in the first quarter of 2018. Many have pointed to a larger-than-expected increase in hourly wages in the January employment report as the reason for the surge in U.S. Treasury yields. Yet, some anomalies in that report may have made those numbers look more inflationary than they really were. During January, 10-year breakeven inflation rates were already on the rise, climbing from 1.98% to 2.12% the day before the release of the January employment report. While inflation expectations were moving up, so too were estimates of real GDP growth in the first quarter. The Atlanta Fed's real-time projection for growth in the first quarter climbed as high as 5.38% the day before the January employment report was released.

As inflation fears persisted through February, rates continued to climb higher, even as first quarter GDP estimates fell. Rates declined in the second half of the quarter as inflation fears eased; yields on the benchmark 10-year U.S. Treasury bond traded down from 2.95% on February 21 to 2.74% on the final trading day of the quarter. Concerns about the potentially adverse effects of the Trump Administration's trade policy agenda on near-term growth, as outlined in the final weeks of March, contributed to the decline in market rates. For now, the potential case is similar to what we referenced in our last quarterly insight, as consumer credit looks to be extended and technology and demographics remain headwinds to higher inflation.

At the beginning of 2017, many analysts were calling for municipal bonds to outperform other fixed income asset classes in the first quarter due to lower supply and greater demand. The projections for better muni returns were largely based on the idea that much of the potential supply in the first quarter had been brought forward to the fourth quarter due to tax changes as well as the removal of the tax-free status of advanced refundings. Analysts' projections did not come to fruition, as the Bloomberg Barclays Municipal Bond Total Return Index lost 1.10% in the first three months of the year, marking its worst first quarter in 15 years according to the Wall Street Journal. Meanwhile, the Bloomberg Barclays U.S. Treasury Index lost 1.18% over the same time period. This suggests that despite restricted supply and strong flows into muni funds, Treasury rates drove much of the return in municipal bonds in the first quarter of 2018.

INFLATION INTIMIDATES IN Q1

JANUARY 2018 THROUGH MARCH 2018



Source: Bloomberg. Past performance does not guarantee future results.

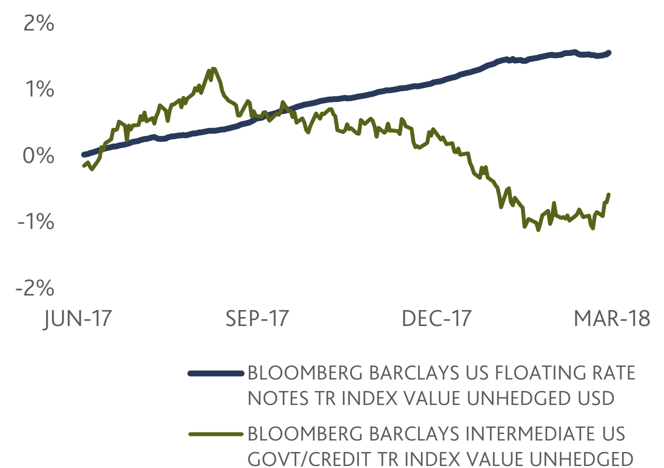
FIXED INCOME CONTINUED

Jerome Powell took over as the Fed Chair in the first quarter of 2018, and given his comments in 2012 FOMC meetings about the decision to implement the third round of Quantitative Easing, it was thought he might be more "hawkish" than the previous two Fed Chairs. In his February congressional testimony Powell indicated, "We've seen some data that will, in my case, add some confidence to my view that inflation is moving up to target." Investors interpreted this as increasing the likelihood of four Fed rate hikes in 2018, instead of the previously projected three. While the tone of the FOMC statement and press conference was also somewhat hawkish, overall early indications are that the committee under Powell should remain relatively data dependent, accounting for both the risks and the benefits of further rate hikes.

As the business cycle ages, it becomes more likely that the Fed will continue to gradually tighten monetary policy by hiking rates in order to prevent inflation from overheating. Historically, rising short rates had a flattening impact on the slope of the yield curve, essentially making long duration bonds less attractive relative to shorter maturity bonds. We're seeing the same result this time around as the Fed continues to hike federal funds. The yield per unit of duration (yield divided by duration) is much higher for the 2-year Treasury than for longer maturities (10 to 30 year). Based on the current yield/duration ratio for the 10-year Treasury, if interest rates increase by 0.34% in the future, the price would likely decline enough to completely offset its 2.74% annualized yield as of March 29. As a result, we continue to underweight duration relative to our benchmark. Exposure to floating rate products including bank loans and investment grade floating rate bonds might make more sense than traditional fixed rate bonds in such an environment.

The yields of these securities reset quarterly based on a short-term interest rate benchmark. Moreover, floating rate securities have little interest rate (duration) risk and allow investors to capture the change in yields more quickly. In fact, The Bloomberg Barclays US Floating Rate Note Index has returned 1.51% since the end of the second quarter of 2017, while the Bloomberg Barclays Intermediate US Govt/Credit Index has lost 0.59% over that same period. While floating rate bonds perform well when short-term rates rise, they will likely underperform fixed rate bonds in an environment where longer-term rates are falling.

FLOATING RATE RELATIVE PERFORMANCE
JUNE 2017 THROUGH MARCH 2018



Source: Bloomberg. Past performance does not guarantee future results.

SENTIMENT VS. FUNDAMENTALS

Depending upon how close investors were paying attention to the markets in the first quarter of 2018, their reaction is either one of slight disappointment or deep concern. While focusing on the long-term is key to the investment process, investors can be caught off guard when shorter-term market developments look drastically different from recent years. For those who casually compared their March 30, 2018 statements to their 2017 year-end statements, the equity market's decline of 1-3% in the first quarter should not be all that bothersome. However, others who follow the markets on a daily, or even a weekly basis, could be feeling more anxiety given the roughly 10% correction suffered by the S&P 500 Index from the peaks in late January to lows in early February and late March.

These short-term declines typically are characterized as corrections and pullbacks if they are 10% or less, while a decline of 20% or more is termed a bear market. Notably, there is not a commonly used phrase to describe a short-term rally of 10%-20%. Many market commentators and professional advisors use the term "volatility" to describe short-term market declines. Over the long-term, however, the U.S. stock market exhibits volatility on both the upside and downside. According to Morningstar data, the S&P 500 Index's 50-year average annual return is 10.2% and its annualized standard deviation of returns over this period is 15.9%. In statistical terms, this means investors can assign a roughly 67% probability that the U.S. stock market will return between -6% and 26% in any given year.

When volatility increases despite economic and corporate fundamental strength, often a change in sentiment occurs. In the first quarter of 2018, fundamentals remained strong. Inflation did not spike, unemployment remained at, or near, historical lows, and fourth quarter GDP growth of 2.9% was above the Federal Reserve's long-term potential growth rate. This followed consecutive quarters of 3.0%-plus growth in the summer. Skeptics may argue that markets only care about future growth rates, and thus equity market weakness suggests slower growth ahead.

Yet, we see several important tailwinds which could support broad-based growth in 2018 including the recent U.S. tax reforms, strong corporate earnings momentum and low interest rates across most of the world.

If fundamentals are strong, we believe weakening investor sentiment is partly responsible for the first quarter's market volatility. Sentiment could have been impacted by high profile stocks receiving unfavorable news. Facebook, Inc.'s data privacy issues and critical tweets from President Trump directed at Amazon.com, Inc. are two examples. With incoming Federal Reserve Chairman Jerome Powell announcing plans to hike rates three times in 2018, and implementing the first hike in March also has the potential to unnerve investors. As the quarter came to a close, fears of protectionism materialized, as the Administration announced plans to renegotiate NAFTA, establish tariffs on imported steel and aluminum and enact

ECONOMIC INDICATOR	LATEST	SIGNAL
FED FUNDS POLICY	1.75%	BEAR
STEEPNESS OF YIELD CURVE	1.03%	BULL
UNEMPLOYMENT RATE	4.10%	BULL
WTI OIL PRICE	$ 64.94	BEAR
S&P 500 INDEX	2,641	BULL
S&P/CASE-SHILLER HOME PRICE INDEX	205.10	BULL
PRODUCER PRICE INDEX	2.70%	BULL
PHILADELPHIA FED SURVEY	22.30	NEUTRAL

Source: Bloomberg

tariffs on up to $50 billion of Chinese imports. For a market that had been mostly sailing smoothly on fundamentals, headlines like these could weigh on investor sentiment and make a correction more likely.

Despite the apparent shift in investor sentiment, the eight macroeconomic factors we track to gauge how strongly or weakly the economic and market fundamentals support the stock market over the near to intermediate term remain fairly constructive. Five indicators are bullish, two are bearish and one is neutral. Though these indicators number the same as last quarter, inflation as measured by the Producer Price Index (PPI) has reversed from bearish to bullish by declining to less than the long-term average. Yet, the year-over-year change in crude oil has turned bearish.

OIL PRICES

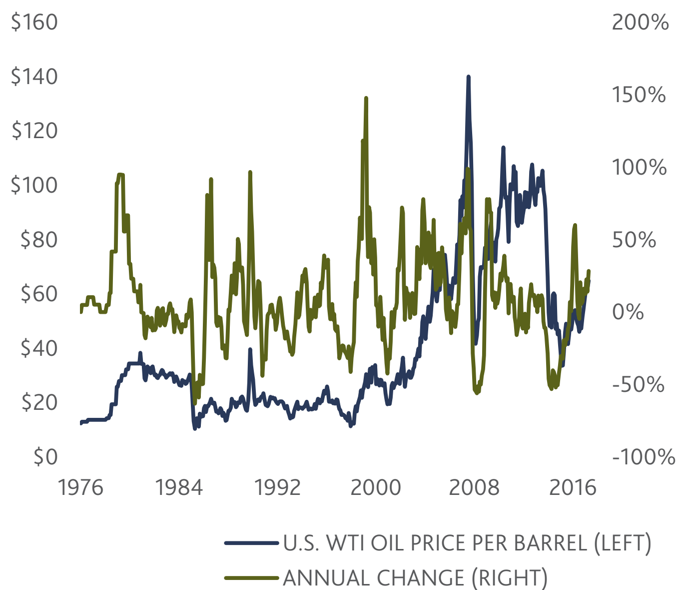
Oil prices recently have changed to a bearish indicator because the barrel price of oil is 20% higher than last year. Since the 1970's embargo of imported Middle Eastern oil, the annual change in oil prices has been about 8%. This annual change, absent the short-lived spikes, usually ranges from -50% to 50%, as can be viewed in the chart to the right.

The impact on equity markets is related to the effects of higher gasoline and oil prices on the typical American consumer's discretionary spending. If oil prices gradually rise, or fall, compared to last year, consumer spending is not typically affected. However, if prices rise too much in any year (our analysis indicates a 20% rise is too much), then American consumers will feel the impact in their pocketbooks and should spend less on other goods and services. Since the retrenched spending of American consumers is larger than the positive effects of sharply higher oil prices in energy-producing regions of the U.S., the overall effect has often been a deceleration of economic activity and pressure on stock prices.

Oil prices have significantly rebounded since the $25-$30 per barrel lows of early 2016. The closing price of a barrel of U.S. crude oil at the end of March was $64.94, nearly 28% higher than the closing price of $50.60 per barrel on March 31, 2017. With Saudi Arabian-led OPEC and Russia agreeing to restrict their production for most of 2018, oil prices may benefit from stabilization in the coming months as U.S. demand usually rises during the summer driving season. We will continue to monitor the effect of oil prices and see if consumer spending is further impacted and to what extent equities may be impacted.

OIL PRICES

1971 THROUGH PRESENT



Source: Bloomberg. Past performance does not guarantee future results.

ECONOMIC OUTLOOK

ECONOMIC FACTORS	CURRENT OUTLOOK
U.S. GDP Growth	Following the passage of the GOP-led tax bill, Fed officials raised their median forecast for U.S. GDP growth in 2018 from 2.1% to 2.5%.
Federal Funds Rate	The FOMC hiked the federal funds rate to 1.75% in March and indicated it expects a "slightly steeper" path of rate hikes over "the next few years."
Inflation	Broad consumer inflation rose to 2.4% in March; the U.S. 10-year Treasury inflation breakeven rate climbed to a four-year high of 2.14% in mid-March.
Employment	Monthly payroll additions might be smaller in 2018 than in recent years given the 17-year low 4.1% unemployment rate.
Consumer Confidence	Consumer optimism could remain elevated in 2018 given the healthy job market and lower personal income tax rates for most Americans.
Oil	OPEC and Russia's production cut extension until the end of 2018 and uncertainty around the Iran nuclear deal could support crude oil prices.
Housing	Sales of previously owned U.S. homes hit an 11-year high in November, but higher prices and shallow inventory could weaken housing demand in 2018.
International Economies	The euro zone, Japan and key emerging market nations continue to exhibit above-trend economic growth and strong corporate profits.

FIXED INCOME	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
FIXED INCOME	●				
Core Bonds				●	
TIPS				●	
Non-Investment Grade		●			
International	●				

CURRENT OUTLOOK

We expect the U.S. Federal Reserve to continue with two or three additional rate hikes in 2018 and the global economy to maintain its broad-based expansion. This suggests to us that the path of least resistance for global bond yields in 2018 could be higher. As such, we believe a significant underweight to the broad fixed income asset class relative to our strategic target allocations is justified. Outside of our core, investment grade allocation, we believe exposure to TIPS and floating rate bonds could serve as an effective hedge against inflation and higher short-term market interest rates in 2018.

Benchmark: BB BC Intermediate Government/Credit Index

EQUITIES	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
EQUITIES				●	
Large Cap			●		
Mid Cap			●		
Small Cap		●			
Developed International				●	
Emerging Markets		●			

CURRENT OUTLOOK

We believe an overweight to equities relative to our strategic allocation remains appropriate. After the volatility of February and March, forward twelve-month valuations of many global equity indexes are near or below long-term averages. The aggregate profit streams of major equity markets appear well supported given a backdrop of synchronized global economic growth and a resurgence in corporate profit growth in most major economies. We believe there is a case for developed market international equities to continue their upward trend given improving economic strength and pro-growth reforms in key European economies and Japan.

Benchmark: MSCI All Country World Index (ACWI)

ALTERNATIVES*	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
ALTERNATIVES*				●	
	CAP PRES	IWSG	BAL	GWSI	GROWTH
Global Real Estate				●	●
Global Infrastructure	●	●	●	●	●
Hedged Equity	●	●	●	●	●
Arbitrage	●	●	●		
Strategic Income		●	●	●	

CURRENT OUTLOOK

Given our expectation for pronounced periods of both equity and fixed income volatility in 2018, we believe an overweight to alternative investments is sensible. As of the end of the first quarter, it is our view that the broad equity asset class is close to fairly valued and the broad fixed income asset class is likely overvalued. As such, we have constructed diversified alternatives portfolios meant to decrease the risk profile of their respective investment objective-based, multi-asset class portfolios shown at left (CAP PRES, IWSG, BAL, GWSI, GROWTH).

Benchmark: HFRX Global Hedge Fund Index

The above underweight/neutral/overweight calls represent the MainStreet Advisors current positions relative to our Strategic Asset Allocation weights.
*Cap Pres: Capital Preservation, IWSG: Income with some growth, Bal: Balanced, GWSI: Growth with some income

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