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Economic Outlook and Market Forecast

August 2018

Advice-driven financial service.

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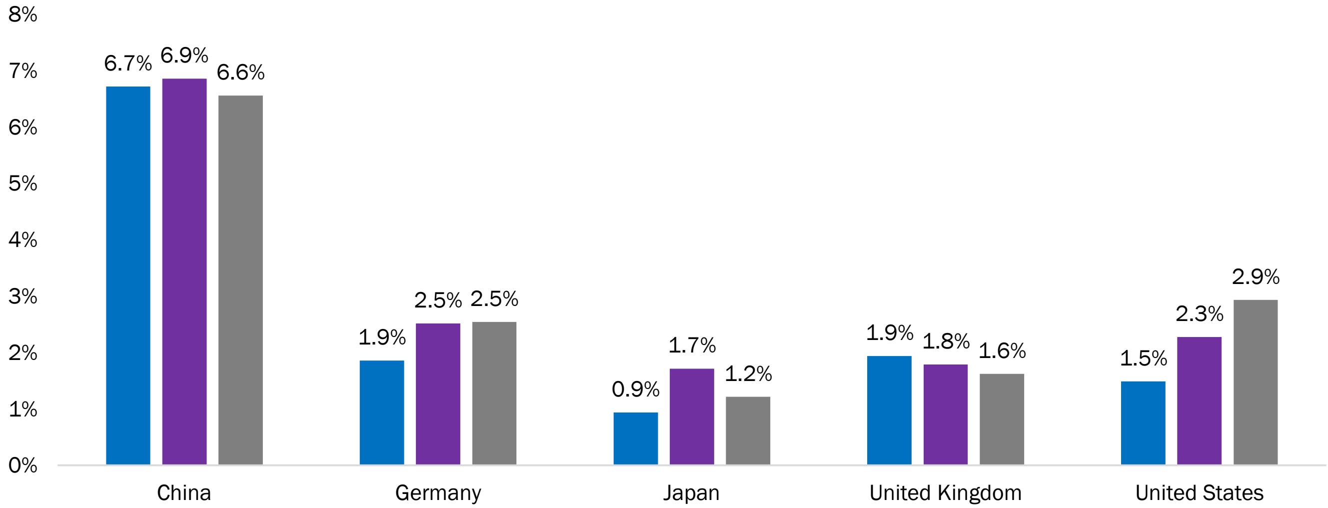
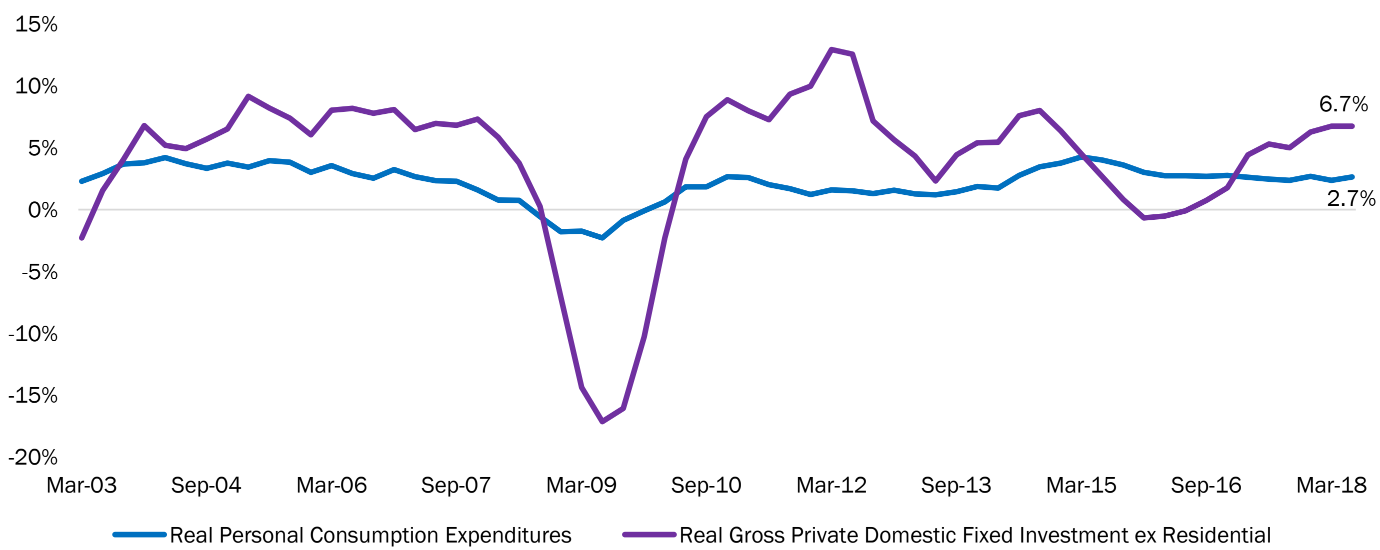
The Global Economic Backdrop

Real GDP Growth



U.S. Investment & Consumption Continue to Grow



Global growth should sustain its current level into 2019, as positive momentum in the US compensates for slowdowns in other regions. Escalation of trade tensions would have an obvious negative impact, but the magnitude remains highly uncertain.

Tax reform, healthy labor market, and lagged impact of last year's dollar depreciation are fueling a marked increase in the US GDP growth rate. Maintaining this strong momentum is very much predicated on the expected rise in capital spending by corporations, many of which are flush with cash in this strong earnings environment.

Source: IMF & Factset; 2018 GDP Growth Rates are forecasts

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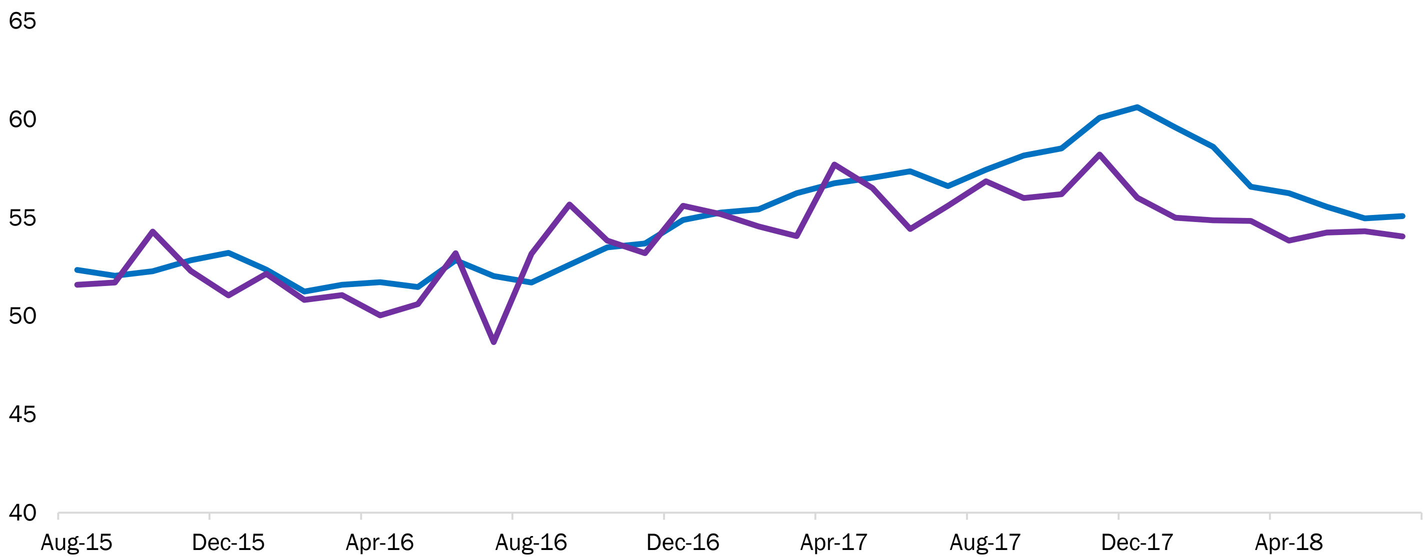
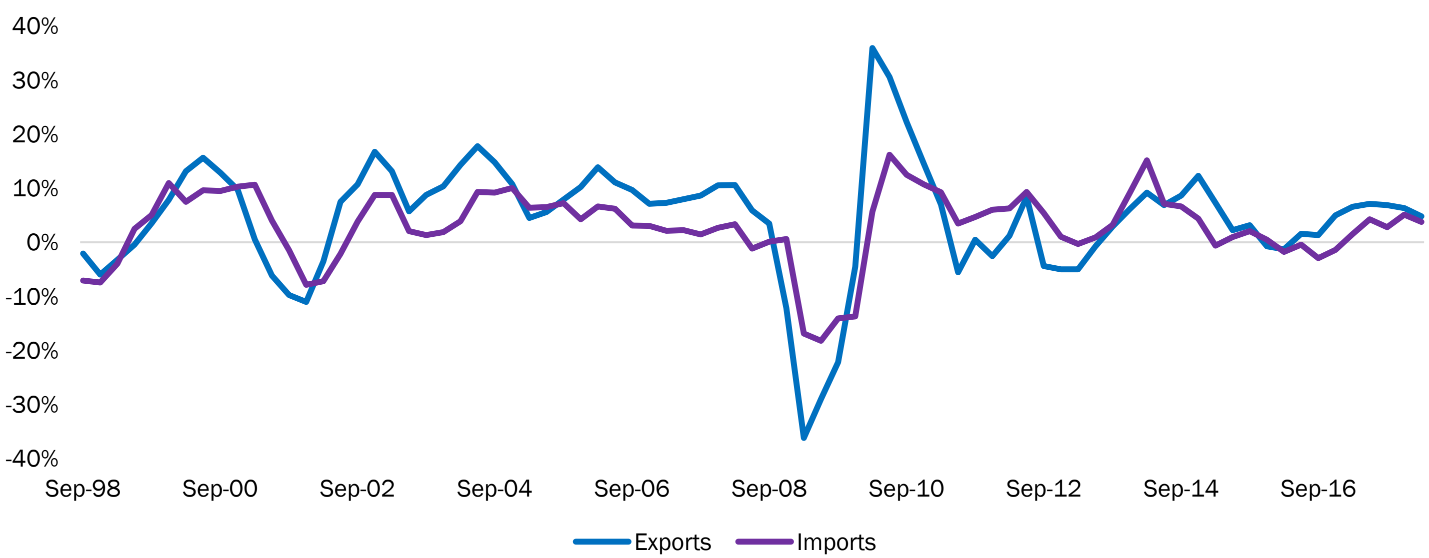
Developed Economies

PMI Manufacturing



Japanese Real YoY Export & Import Growth



The slowdown in European GDP growth is notable, but not of a magnitude that would imply a near term recession. A de-escalation of US trade tensions with the EU and progress towards a negotiated “softer Brexit” would allow the recent currency declines to provide a floor for European growth rates not far from current levels of approximately 2.0%.

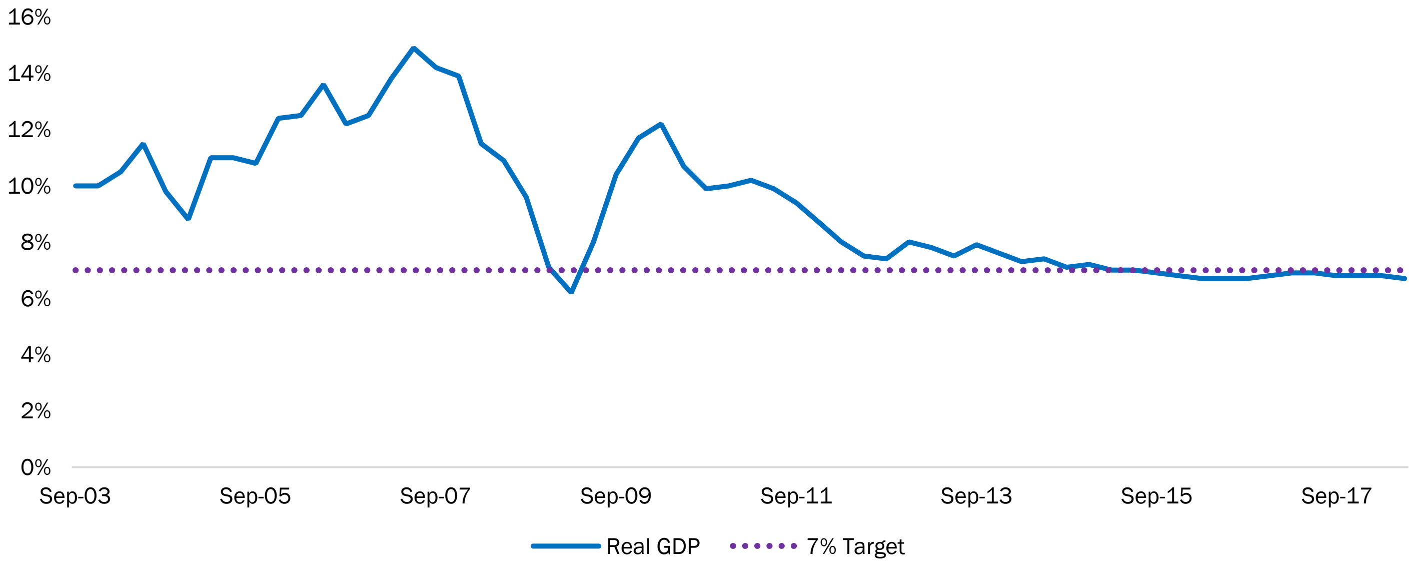
Japanese economic growth, while positive, remains rather anemic. The imposition of tariffs on China, Japan’s largest trading partner, and the impending sales tax hike should keep GDP growth below 1% in the coming quarters.

Source: Factset

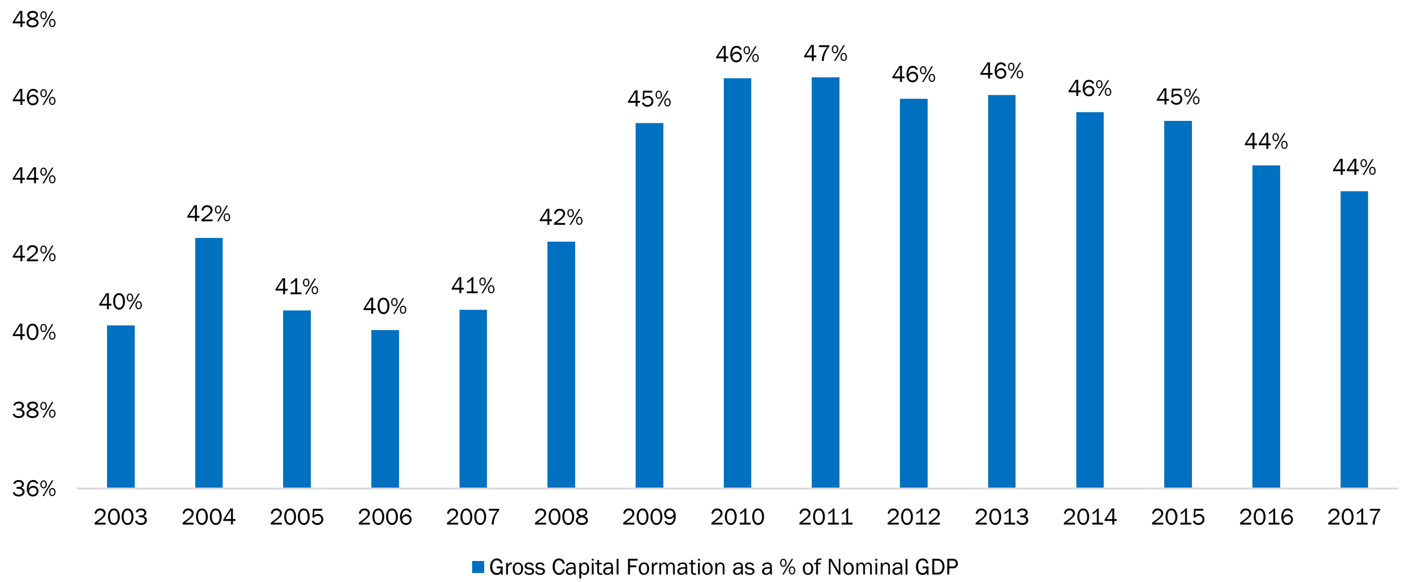
Confidential & Proprietary

Emerging Market Economies

Chinese Real GDP Growth



Chinese Investment as a % of GDP

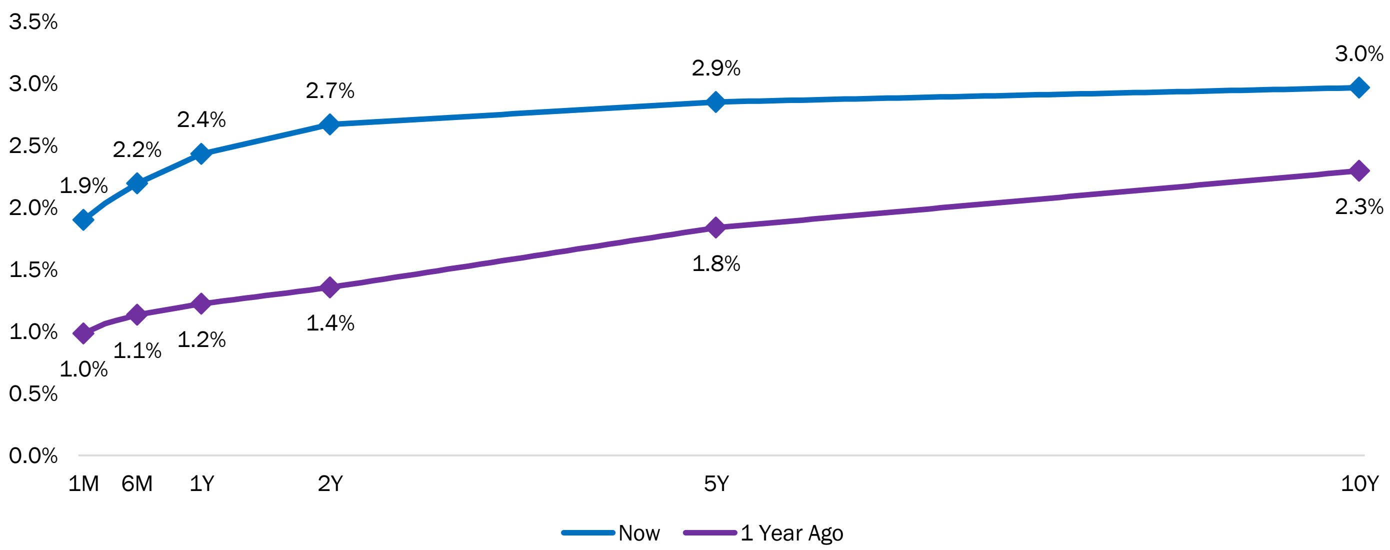


Source: Factset

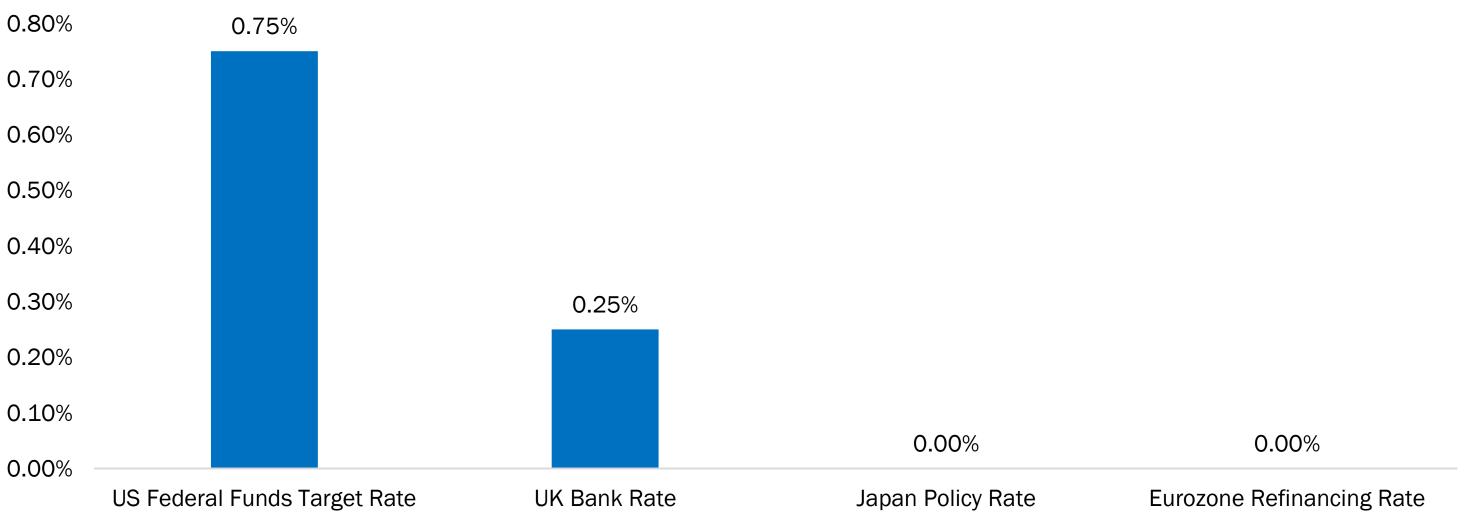
The focus of US trade angst will center more on China for the remainder of the year. The current and proposed tariffs complicate the government's ongoing efforts to reduce excessively high debt levels and correct imbalances from the historical over-investment in manufacturing.

Monetary Policy

U.S. Yield Curve



One Year Change in Policy Rates



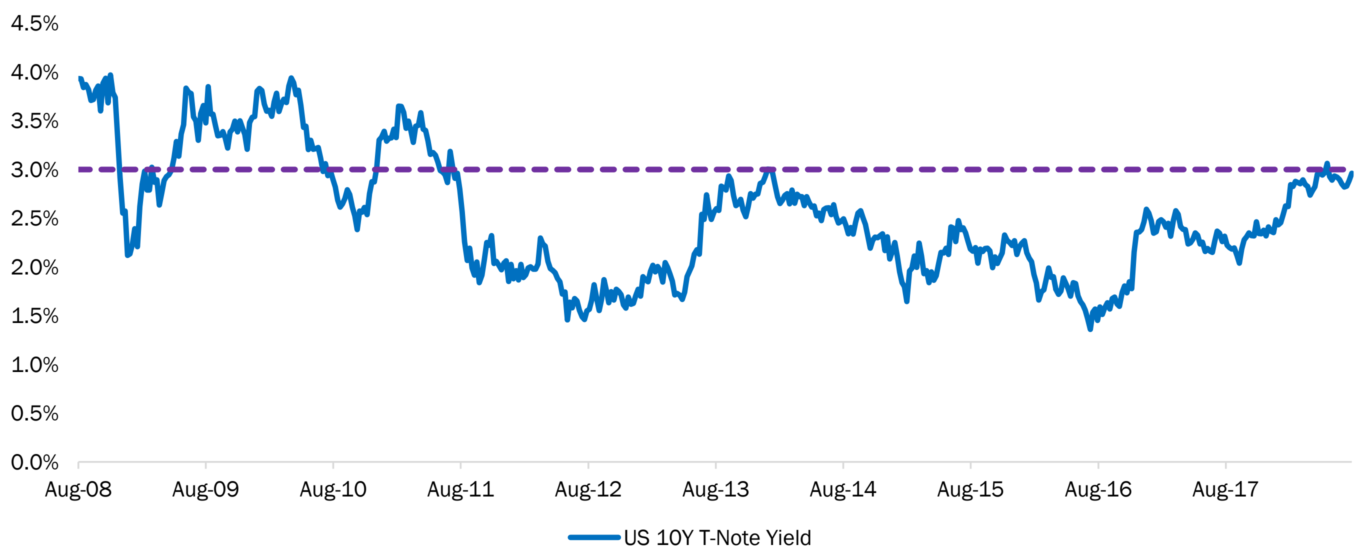
The continued flattening of the US yield curve is beginning to alarm a number of Fed governors, given the lack of a tangible pickup in inflation indicators. Two additional 0.25% hikes in the Fed funds rate should set the stage for ending the tightening cycle some time in 2019.

With the announcement of an end to longer term bond purchases by December, the European Central Bank has reinforced the need for continued accommodative monetary policy to sustain economic momentum and achieve its 2.0% inflation target. Any rise in interest rates should not occur until the fall of 2019.

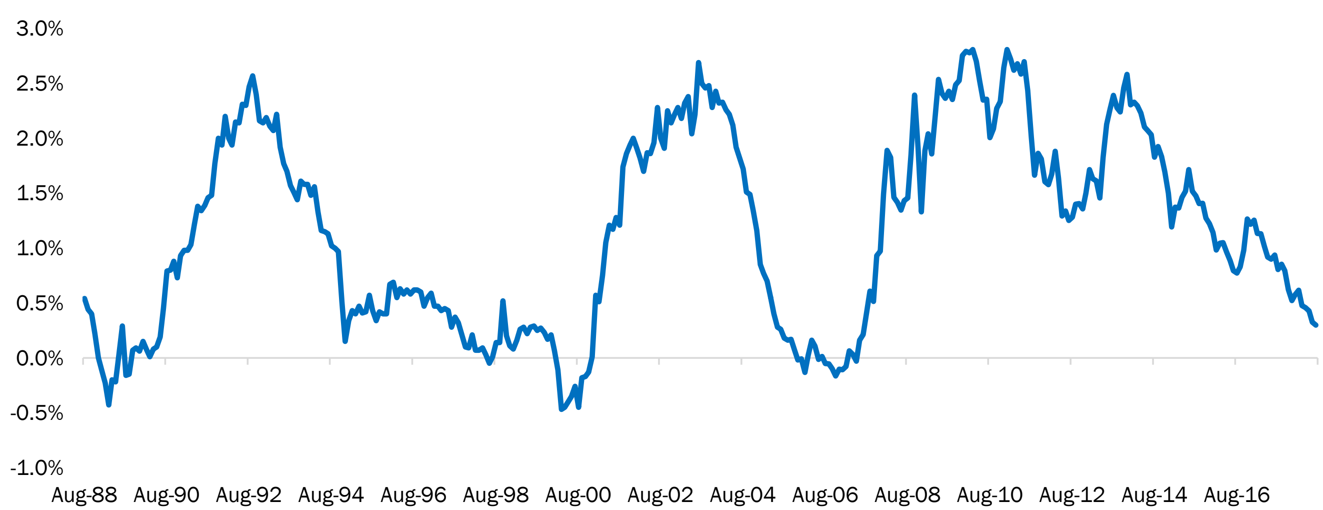
Source: Factset

U.S. Fixed Income

10 Year Treasury Yield



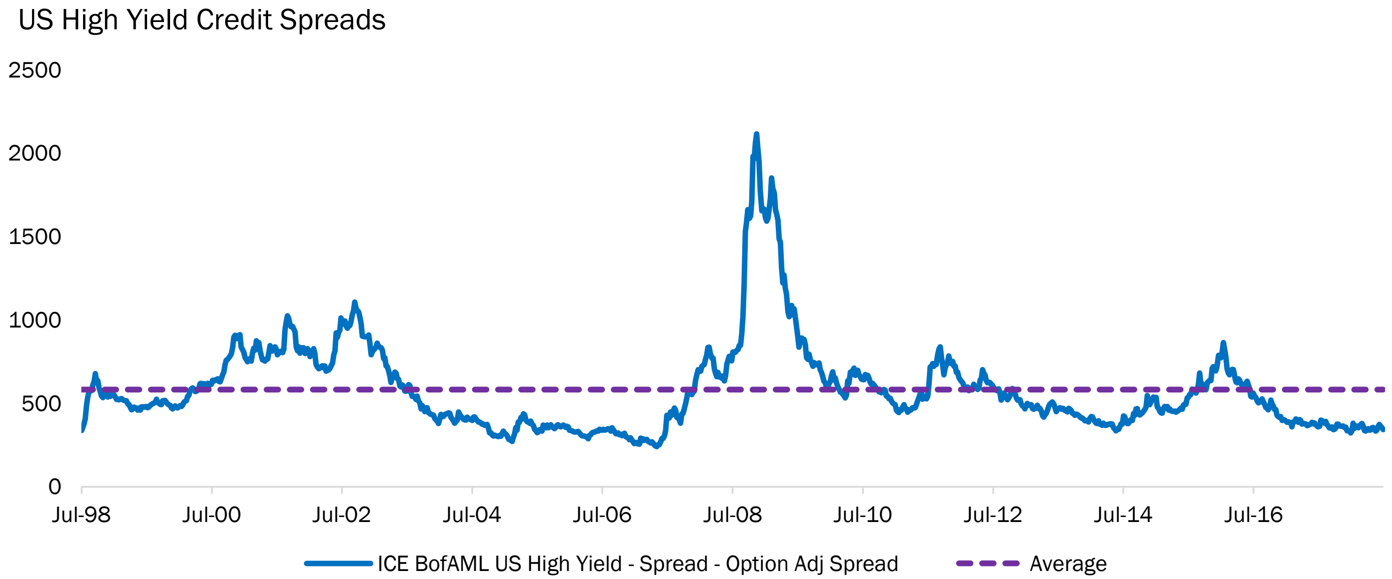
Yield Curve (10Y Yield - 2Y Yield)

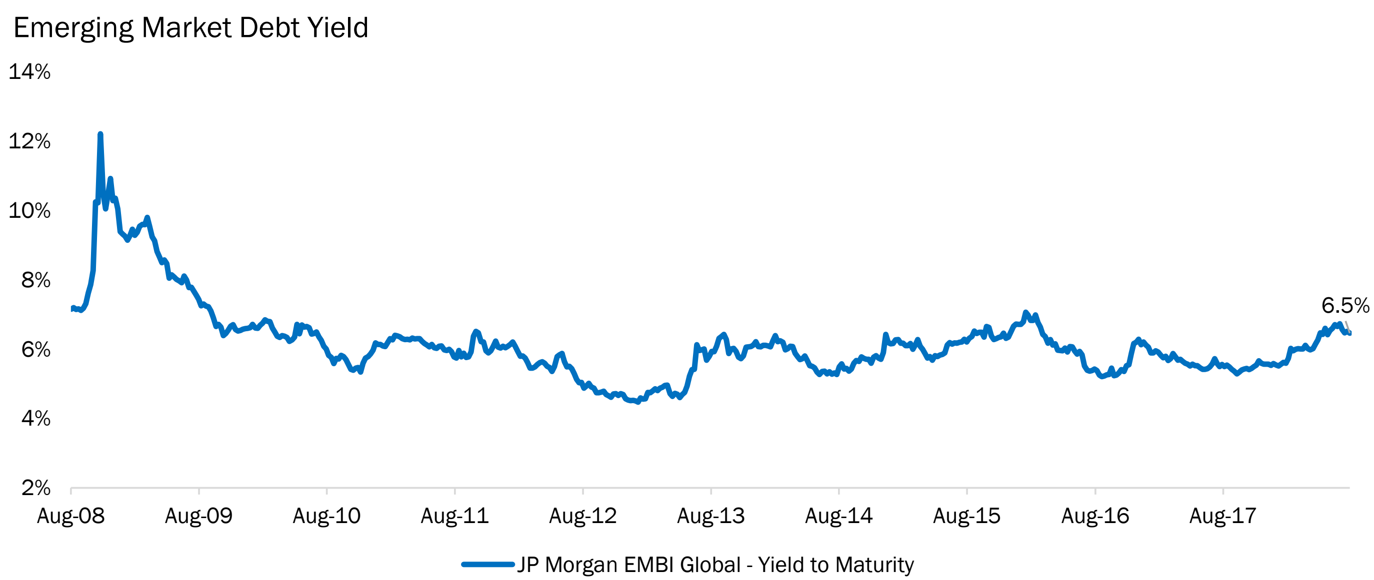


A US economy at full employment, an expected increase in business capital spending, and the need to fund growing deficits, should drive the 10-year Treasury note above 3% in coming months and prevent the yield curve from fully inverting, a worrying sign of impending recession.

Source: Factset

Credit Markets





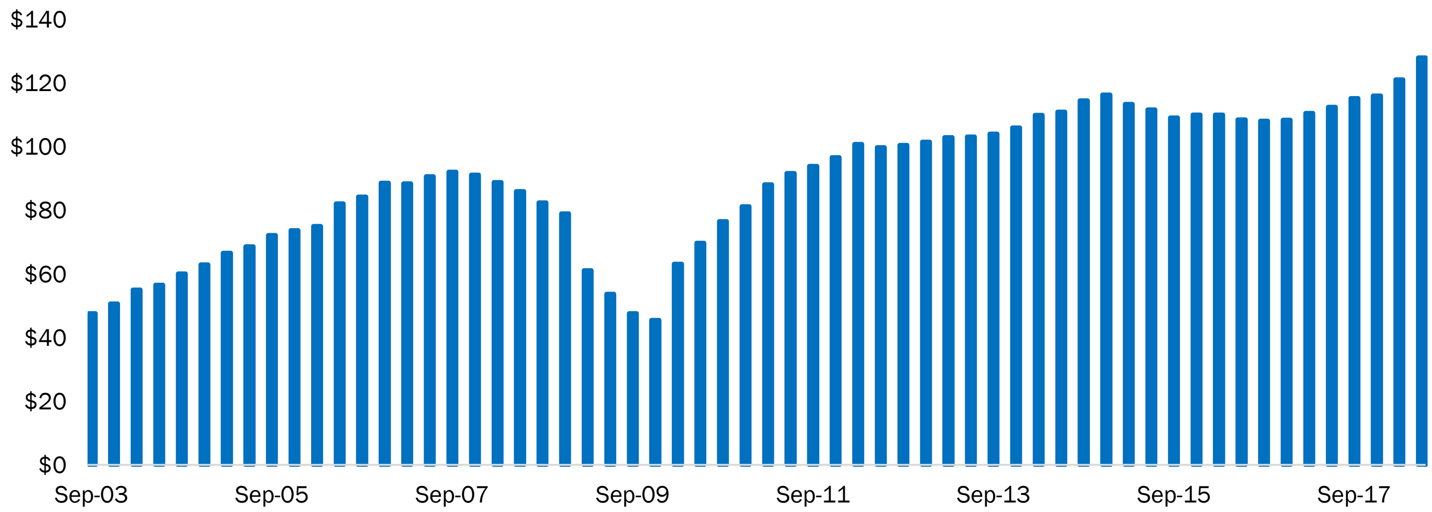
The US high yield bond market appears fully to somewhat over-valued at current levels although the narrow spreads against like-maturity Treasurys are an indication that economic growth should continue in the near term and that default rates will remain low.

The deterioration this year in the emerging market debt category has brought to light the differences between the weaker economies versus the stronger. In our view, the market has yet to distinguish between these two groups and in the process, marked down the debt of the stronger issuers to very attractive values.

Source: Factset

U.S. Equities

S&P 500 EPS LTM



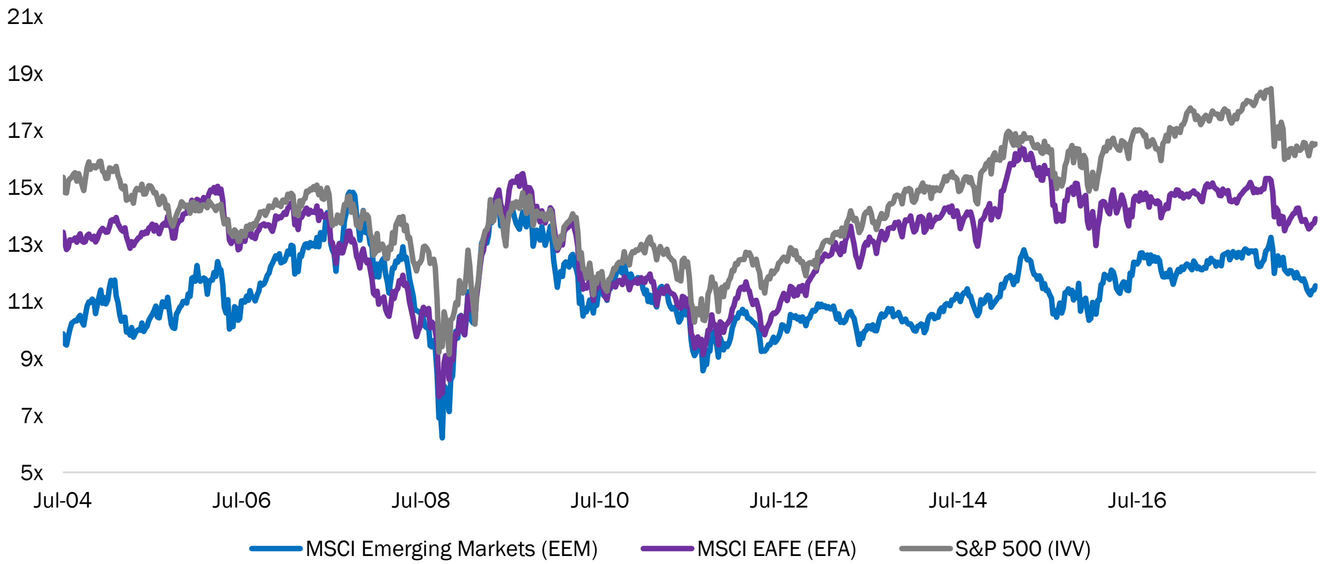
S&P 500 PE Ratio

The Q2 corporate earnings season is confirming the strong top and bottom line earnings dynamics, driving many US stock prices back to their January highs. Absent any intensification of protectionist trade policies, we expect US equity prices will reflect the explosive earnings growth forecast over the coming quarters.

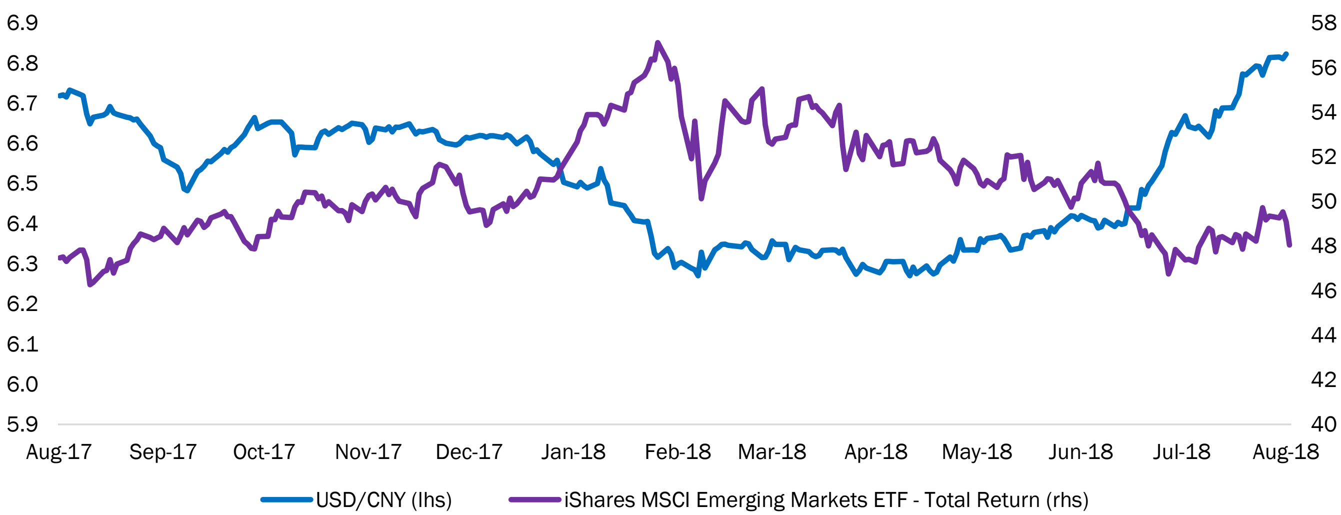
Source: Factset

International Equities

P/E Ratios NTM



The Renminbi & EM Equities



With an apparent détente negotiated between the US and EU in July, European equities can take advantage of vigorous global growth and their weaker currencies to recover the losses for the year.

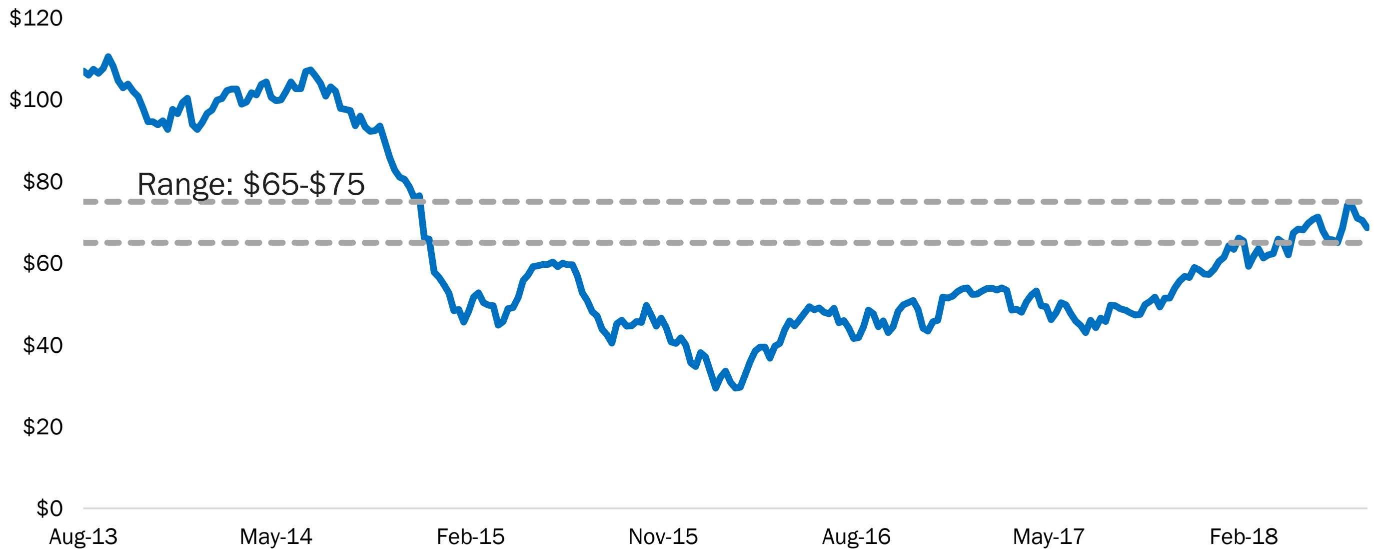
Whether viewed as a retaliatory measure or not, the People's Bank of China appears to have engineered a devaluation of the renminbi in its efforts to offset slowing domestic growth and trade tariffs. Given the predominant influence of China on other emerging markets economies, uncertainty around the ultimate impact of both the currency devaluation and the trade war escalation calls for near-term caution in emerging markets equities.

Source: Factset

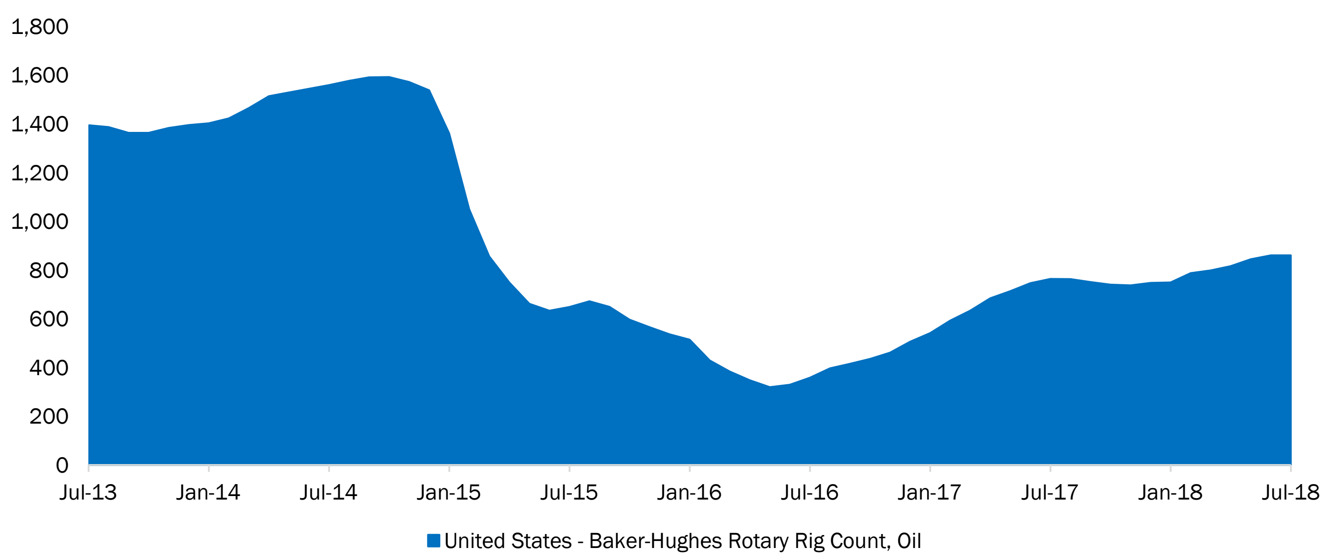
Oil

Oil prices should continue to trade in a range of $65 to $75 per bbl. Renewed US sanctions on Iranian oil and solid global demand should offer some protection on the downside, while higher production out of Saudi Arabia, Russia and the US will likely keep prices from rising appreciably.

Crude Oil (NYM $/bbl) - Price



United States - Baker-Hughes Rotary Rig Count, Oil



Source: Factset

Gold and Commodities

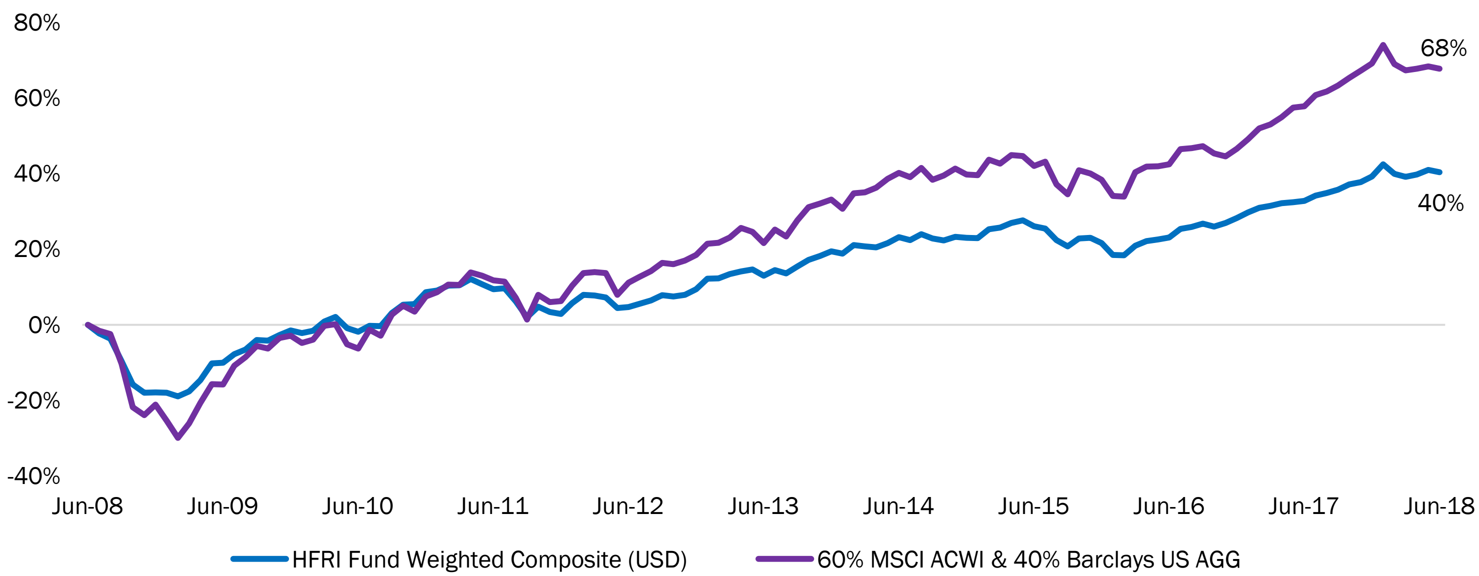
Gold prices have settled below our 12 month target of $1250 per oz. We do not anticipate prices to decline significantly below this level. Continued Fed tightening with only slight inflationary pressure should help keep prices contained for the balance of 2018.

The escalation of trade battles, and their ultimate impact on China, will likely continue to pressure industrial metals prices. Incrementally stronger demand from the developed market economies should allow a floor to develop on metals such as copper that have fallen into bear market territory.

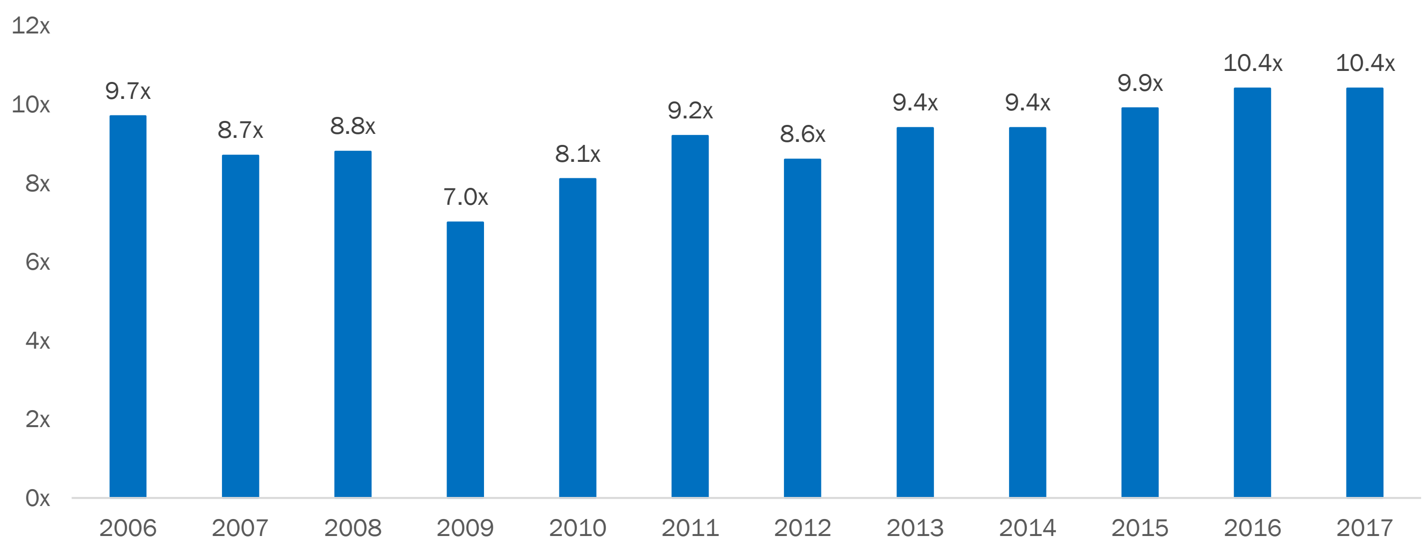
Source: Factset

Hedge Funds & Private Equity

Cumulative Returns of Hedge Funds and a 60/40 Portfolio



US Middle Market M&A Transaction Multiples



Persistently low market volatility and high correlations have been a challenge for hedge funds over the last decade. The pickup in market volatility and asset class dispersion in recent months has begun to benefit managers pursuing differentiated strategies and has allowed investors to hedge portfolio risks more easily.

Rising asset values are a continuing challenge for private equity managers seeking to buy good companies at reasonable prices. We aim to overcome these challenges by focusing on seasoned, disciplined managers, and by seeking value in niche markets or sectors experiencing disruption from technological or regulatory change.

Source: Factset, Pitchbook

Important Information

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