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2018 Themes

Economy
Global Divergence

Global recession risks remain low, but recent divergences persist.

The US economy remains on solid footing, aided by fiscal stimulus. International developed economic trends are mixed. We expect Chinese stimulus measures to aid global growth and emerging markets in late 2018 and into 2019.

Geopolitical uncertainty, including higher oil prices, and tighter financial conditions remain key risks to our outlook, with protectionism and trade a growing concern.

Equity
Bullish but Bumpier

The market path this year has been bumpier, consistent with our expectations.

Investors should continue to give the bull market the benefit of the doubt given firm global profits and valuations at the lowest levels in more than two years.

We maintain a US equity tilt. We are underweight international developed markets, but continue to have an optimistic view of Japan. We are neutral emerging markets.

Fixed Income
Step Up

Interest rates have stepped up consistent with our expectations. We expect the 10-year US Treasury yield to push toward 3.50% to 3.75% by early to mid-2019.

The Fed is set to continue raising rates this year. We expect the yield curve to remain relatively flat.

We maintain our focus on high quality within fixed income, which should act as ballast during periods of market volatility. We also still see value in bank loans as a hedge against rising rates.

Non-Traditional Investments

Given our outlook for a positive but bumpier path for stocks and headwinds for bonds, non-traditional strategies take on, arguably, heightened importance.
Third Quarter Recap

Most US economic data continued to push higher during September, although housing activity remains sluggish. Global trade skirmishes remained a headwind, although the new United States-Mexico-Canada forged a new trade pact. Meanwhile, incoming data from the European Union and Japan stabilized after cooling during the summer months.

The Federal Reserve (Fed) raised the federal funds target rate by another quarter point to a range of 2.00% to 2.25%, which was the third hike this year. The Fed also updated its growth outlook and effectively signaled another quarter-point increase in December.

Most of the major global stock indices posted gains during September and the third quarter. The lone exception was emerging markets, which declined for the seventh month in the past eight.

The US notched its best quarterly gain on a total-return basis in nearly five years and padded its hefty year-to-date lead over the rest of the world. The newly-rejiggered communication services sector, having engulfed the former telecom sector and shifted a sizable chunk of companies from technology sector, launched with strong returns. US small caps were not so lucky, snapping a six-month rally.

Interest rates finally broke out of its fairly narrow range—between 2.8% and 3%—since late May. Yields rose for the month across the board with the benchmark 10-year US Treasury yield ending September at 3.06%, its highest month-end close since December 2013.

Most bond indices stumbled for the month, although US high yield climbed. Yet some segments—aside from US Treasuries—were able to post modest gains for the quarter.

Municipal bond returns slipped for the month and declined for the quarter. Similarly, non-US government bond performance continued to be hampered by the stronger US dollar, which largely held steady for the month but climbed in the third quarter.

Crude oil jumped, helping commodities end a three-month slide. But commodities fell for the quarter and remain negative year to date. Master limited partnerships (MLPs) fell for the month, tipping negative for 2018, but posted gains for the quarter.
The global divergence continued to unfold as US economic growth accelerated, which naturally boosts inflation and interest rates. Yet, the rest of the world largely held steady and recession risk remains low. China is the main recent exception as trade worries are taking a toll, complicating the broader global growth outlook and stirring uncertainties in global markets.

Global Central Banks on the Move

One of the starkest areas of divergence is monetary policy as global central banks adjust policy to reflect the diverging trends within their respective economies and react to rapidly changing currency valuations.

The Federal Reserve (Fed) is at the forefront of monetary policy normalization. It raised the federal funds target rate by another quarter point at its September meeting to a range of 2.00% to 2.25%, which was the third hike this year and eighth increase in the past three years.

The Fed is seemingly no longer behind the curve with respect to inflation, which remains roughly in line with its 2% year-over-year target. Additionally, the Fed lifted its growth and inflation outlooks, prepping markets for more rate hikes over the course of this year and next. However, the US Treasury yield curve is not moving uniformly (see Figure 2). As the chart shows, the entire yield curve is getting squeezed as the yields on shorter maturities appear to be already pricing in the next few expected Fed hikes.

Meanwhile, the Bank of England and Bank of Canada also raised their respective benchmark rates by a quarter point during the third quarter, although rates for both remain very low. While the European Central Bank stayed put during the quarter, saying it will continue to hold interest rates below zero through at least summer 2019, it is winding down its bond buying program, which will halt by year end. The Bank of Japan has also maintained its commitment to keep yields near zero.

Amidst an ongoing slump in China’s bank lending and an overall growth slowdown, China’s central bank has repeatedly provided stimulus through a variety of measures in 2018, including cutting reserve requirements and lending facilities.

However, while monetary policy is loose in the major developed economies and China, a number of central banks within emerging markets are in tightening mode (see Figure 3 on next page), attempting to support their currencies and keep inflation in check. These moves will likely impact growth along with any fiscal adjustments to repair budget deficits.

Ultimately, we are past the peak of global central bank accommodation, though still accommodative for growth. Yet the growing divergences will also continue to spur volatility in global currencies.
Trade Tensions Will Likely Linger

Global trade skirmishes and protectionist worries are heightened on multiple fronts: Brexit, US-Europe, US-Japan, China versus everyone, etc. Indeed, tariffs and protectionism are creating uncertainty and are a real risk to the global economic outlook.

The US economy has the luxury of being buffered by a trillion dollars of fiscal stimulus in the pipeline. Thus, in the short term, the US economy can absorb much of the trade escalation.

Yet, in the long term, trade tensions and tariffs are a drag on global economic growth. Tariffs act as a tax on consumers, which negatively impacts demand and results in fewer goods purchased. Furthermore, these trade skirmishes are generally complex (i.e., not just a single-issue such as tariffs), which means resolutions while take time and are harder to achieve.

On a positive note, one major problem was tackled in late September with the new United States-Mexico-Canada Agreement (USMCA), which updated and replaced the 24-year-old North American Free Trade Agreement (NAFTA). Each side compromised to get the deal done, but it was also a relatively straightforward negotiation within an existing agreement. We are hopeful that similar pacts with the European Union, the United Kingdom and China are in the offing.
Global stocks performed well during the third quarter, led by the US, which widened its year-to-date lead over international markets. Emerging markets were down modestly on the back of tightening financial conditions and tariff concerns. Heading into the final quarter of the year, the bull market remains intact, but we expect a bumpy path. We maintain a US equity tilt. We are underweight international developed markets, but continue to have an optimistic view of Japan. We are neutral emerging markets.

Mature Cycle, but Not Yet Over

We are in a mature part of the cycle, and there is a confluence of positive and negative factors affecting global markets. The weight of the evidence suggests the bull still has legs, though we expect the path forward to be bumpy.

Despite an extended cycle, global recession risks are low, particularly in the US. The backdrop has become more challenging for some emerging markets (EM) countries with tariff tensions heating up, rising US rates and a stronger dollar. However, the number of EM economies in expansion mode improved during the third quarter, while 95% of the developed countries remain in expansion mode, as defined by positive monthly manufacturing trends.

Further, the forward price-to-earnings (PE) ratio for the global equity market—aided by strong earnings growth—has dropped to 14.9 times, the lowest since 2016. While valuations have become more attractive, the technical profile of the global market has deteriorated, with fewer markets with positive price trends (45% now compared 95% in January). This speaks to a more selective opportunity set and is consistent with a divergent global economic backdrop.

Regional Outlook

United States

The US extended its performance advantage in the third quarter, and we retain a domestic tilt. Indeed, US stocks are cheaper than they were earlier in the year as earnings have risen at a faster pace than prices. At a current forward P/E of 16.8 times, down from 18.5 at the January peak, the US market appears fairly valued. Since 1950, when inflation has been in the 2% to 4% range, the average P/E has been 16.4. From here, future returns should be primarily driven by earnings growth.

Importantly, new highs in the market tend to be a good sign, with the S&P 500 averaging a one-year forward return of 13.6% after such historical events. Similarly, US markets have also generated positive one-year returns in 85% of the periods when the US economy has been in expansion, which continues to be our base case (see Figure 4).
That said, there are several risks to our outlook. Rising interest rates are making other investment options more competitive with stocks, tariff uncertainty lingers, and the US dollar, oil prices, and wages are all rising, which is likely to challenge profit margins. These factors, along with the upcoming US mid-term elections, are all reasons to expect a bumpy path forward.

Nevertheless, when taking into account record profits and the significant amount of money corporations are returning to shareholders through dividends and company buybacks, stocks still appear attractive relative to fixed income. Moreover, the economy and market is being buffered by a trillion dollars of US fiscal stimulus in the pipeline, which currently dwarfs imposed tariffs.

Further, when looking at the relationship between the equity market and a rising 10-year US Treasury yield, stocks have risen in 12 of the 15 periods we studied, or 80% of the time since the 1950s. This makes sense so much as higher rates tend to coincide with an expanding economy. Finally, since 1950, stocks have averaged a fourth-quarter gain of nearly 8% during mid-term election years (though we are not anticipating returns that high).

**Positioning Within the US**

We maintain a positive view of US large caps and prefer higher quality given the cycle maturity, even though the rising dollar poses a risk to multinationals. We see a relative opportunity in US mid-cap equities as earnings revision trends and expectations for revenue growth next year have significantly improved relative to small-cap equities. Likewise, mid-cap equities are trading at a 3% discount to US large-caps, their lowest level since 2009. Despite a multi-week pullback, US small-cap companies were still trading at a 4% premium to their larger-cap brethren as of quarter end.

We are neutral on large cap value relative to growth. The value style’s underperformance has moved to an extreme, and valuations are attractive; however, relative price trends are mixed, and earnings momentum is neutral. Evidence that the technology sector is leadership could prompt us to move toward a value tilt as could improved trends in financials.

**Regional Outlook**

**International Developed Markets: Remain Underweight but Favor Japan**

Following significant underperformance, comparative valuations for international developed markets to the US have cheapened to the lower-end of the historical range. However, we still advise an underweight position, particularly in Europe, given political headwinds, mixed earnings trends, and high exposure to European banks in the various indices, which are in a weaker position relative to the US.

Further, we downgraded our view of international developed small caps markets in early August after being positive since the spring of 2014. Price trends had been weakening, relative earnings trends have stagnated and relative valuations have become more expensive.

Economic growth has also decelerated in these regions and the environment for international developed small caps is likely to become more challenging as we move past peak monetary accommodation.
On the other hand, we retain an optimistic view of Japan. The Japanese economy and stock market appear to be on a sustained growth path, supported by structural reforms, such as corporate tax cuts, easy monetary policy, increasing women in the workforce, and better corporate governance along with a sharper focus on profitability. Moreover, Japan’s economic growth (in nominal terms) has accelerated under Prime Minister Abe and is at a multi-decade high as is Japan’s stock market. valuations remain attractive (Figure 5).

**Emerging Markets: Maintain Neutral Stance**

Emerging markets have been this cycle’s casualty of higher interest rates (and a stronger US dollar) as the cost to service debt rises. This is hurting those countries with a high degree of external debt and higher current account deficits, such as Turkey, South Africa, Columbia and Argentina. In perspective, though, these countries combined account for less than 3% of global GDP, whereas China is 16%.

The good news is Chinese easing can be seen across several metrics—such as lower short-term rates, easing credit, and increasing government spending—which should help stabilize EM growth in late 2018 and into 2019. Importantly, valuations for EM are now below the level seen around the 2016 US elections and relative valuations to the US are now at the lowest level since 2008. Still, before taking a more positive stance we are watching for signs that the Fed is slowing its tightening cycle, US dollar momentum is waning, and/or improvement in earnings and technical trends.

Lastly, valuations for EM are below the level seen around the 2016 US elections, another period of heightened concerns, and the level prior to the big EM gains witnessed in 2017 (see Figure 6).
Longer-term rates rose during the quarter (and shortly thereafter), breaking out of their tight range to the upside. We expect rates to gradually move higher over the intermediate term. Accordingly, we recommend staying at the lower-end of policy ranges, staying focused on shorter duration and high quality bonds, and maintaining a modest position in bank loans. That said, we still view bonds as an important source of income and portfolio ballast during bumpier equity market periods.

Yields Broke Out of Tight Range

Yields climbed steadily through September, particularly in the US, but global bond yields rose sharply higher in early October (after quarter end). The bond sell-off appeared to be a function of several factors, with the biggest driver being strong US economic growth. For example, the ISM Services Index reached a 21-year high, while ADP payrolls and auto sales surprised to the upside. Other contributing factors included escalating crude oil prices and inflation expectations, widening US fiscal deficits and an incrementally more hawkish tone from Fed Chairman Powell.

Coming into 2018, our main fixed income theme called for a step up in interest rates. That said, the recent move higher was sharper than we anticipated. From here, we expect the 10-year US Treasury yield to push toward 3.50% to 3.75% by early to mid-2019. We anticipate the Fed to raise short-term rates in December and then again in the first quarter. It is also important to recall that the 10-year yield traded around 4% in 2009 and 2010 without negatively impacting growth. Today, however, the US economy is stronger, crude oil prices are rising along with inflation expectations, the budget deficit is increasing, the Fed is raising short-term rates and gradually unwinding its balance sheet, and we are past the peak of global central bank accommodation. Therefore, in this context, it makes sense that yields are climbing and the yield curve would steepen.

The recent action in the fixed income market serves to validate our current portfolio positioning, which is at the lower-end of policy ranges. We are also focused on a slightly short duration and high quality bonds as well as maintaining a positive view of bank loans as a hedge against rising interest rates. Moreover, given a challenging rate environment, we value active management within fixed income investments.

While we are currently underweight bonds, investors should recognize that over a longer time horizon, the opportunity to reinvest at higher yields helps offset potential price declines. Moreover, bond drawdowns historically have not even been remotely comparable to bad years in stocks. However, when the global equity markets sold off, interest rates moved down accordingly, reinforcing fixed income’s role as ballast for the total portfolio during more challenging periods.
Investment Grade Corporates

After the worst six months since 2013, selling pressure was overdone at the end of the second quarter and investment grade corporate bonds rebounded in the third quarter.

The asset class has been caught in a tug of war between a stronger economy and concerns around corporate bonds in general. As the US economy continues to strengthen, the fundamental backdrop for corporate bonds remains strong. The economy supports better corporate earnings, which in turn allows companies to support their financial obligations. On the other hand, there are a number of concerns about investment grade corporate bonds generally. Valuations, which have improved since early in the year, still appear relatively expensive compared to recent history. In addition, tightening monetary policy as a result of the rate hikes and declining Fed balance sheet will likely continue to create a challenging environment for the asset class—especially given its longer duration and the more competitive rates from shorter-term Treasuries. Furthermore, there is a burgeoning amount of bonds in the riskiest tier of the investment grade space (BBB-rated bonds).

That said, there is a tight supply of investment grade corporate bonds as year-to-date supply is running 9% below that of 2017, which should provide price support. This is aided by lower corporate tax rates, higher interest rates and repatriation flows alleviating the need for companies to refinance their outstanding debt.

Given these competing dynamics, we believe active management offers investors a better option for navigating the credit cycle.

High Yield Corporates

Within the non-investment grade space, high yield corporate bonds outperformed investment grade as spreads narrowed further, while floating-rate bank loans outpaced both. Much like investment grade corporate bonds, there is a confluence of factors impacting the returns for both high yield corporate bonds and loans. Valuations have become more expensive for both high yield bonds and loans. In fact, high yield spreads are at their lowest level in a decade (see Figure 8). These tight spread levels have been aided by decreased issuance compared to 2017, despite outflows from investors.

Figure 8:
High Yield Corporate Bond Spreads Remain Tight

![Graph showing high yield corporate bond spreads](Image)

Data Source: FactSet, SunTrust IAG.

In contrast, loan issuance is higher than in 2017. While issuance has increased, high investor demand, spurred by fears of rising rates, has kept spreads tightening. This level of issuance has brought investors pause due to fears around loosening underwriting standards; however, fundamentals for
the asset class remain strong. Net leverage for loans, although currently elevated, has declined a bit over the last couple of years. Moreover, interest coverage looks fairly healthy. Finally, due to a robust US economy, default activity continues to be low for loans, as well as, for high yield corporate bonds. Therefore, we maintain our recommendation for floating-rate bank loans as a valuable source of diversification within our fixed income portfolios and expect them to benefit from the stronger economy.

Solid Fundamentals for Municipals
Investment grade municipal bonds slightly underperformed core taxable bonds in the third quarter but are still significantly ahead on a year-to-date basis, supported by lower issuance and stronger demand. While valuations are still richer on the short-end of the municipal bond curve, they have improved since last quarter, and we continue to use a barbell approach to manage interest-rate sensitivity.

Also, we maintain our focus on a step up in quality, preferring higher-rated obligors with dedicated revenue streams such as hub airports, toll roads and water and sewer credits. A recent study by the Mercatus Group at George Mason University examines state fiscal health using criteria such as cash solvency, budget solvency, long-range solvency, debt levels and fiscal slack in the face of demands for services. Overall results indicate most states are stable; the exception are those with large unfunded liabilities for pensions and other post-employment benefits, and low levels of cash, either of which would exacerbate budget shortfalls in the event of a recession. This underlines the importance of credit research as an essential part of municipal bond management.

International: Stay on the Sidelines
International developed and local currency emerging markets (EM) bonds underperformed US core bonds again during the third quarter, driven mostly by currency losses. In contrast, hard currency emerging markets bonds rebounded, paring back some of their year-to-date losses, as the 10-year US Treasury yield stayed in a range. However, as Treasury yields broke to the upside in early October, international bonds saw continued weaker performance.

At this time, we are avoiding international developed sovereign bonds. While yields have risen slightly, they are still at low levels, and these bonds have currency risk along with higher sensitivity to rising rates given their longer duration. Furthermore, the European Central Bank is stopping its bond buying program at year-end, creating a less supportive environment for Eurozone bonds, which is a significant part of the universe.

With the Fed on a determined path to hike rates, a stronger US dollar and a heightened level of geopolitical risks, we also recommend avoiding the emerging markets bond space. The environment has been challenging for local currency EM bonds this year, which were down more than EM equities for the year at quarter-end. While yields are more attractive, local currency EM bonds still do not represent a favorable risk/reward profile. These bonds have more exposure to countries with more vulnerable macro fundamentals such as Turkey and Argentina. Furthermore, a number of EM central banks have hiked rates to support their currencies and to combat inflation, which has started to creep up.
Given our outlook for a positive but bumpier path for stocks and headwinds for bonds, non-traditional strategies take on, arguably, heightened importance.

We see value in having exposure to less-correlated assets given the maturity of the equity bull market along with higher bond yields. We favor an anchor in diversified strategies, which invest in opportunities across the hedge fund spectrum and can generally provide relative performance consistency in different markets.

We view the choppiness in equities this year as a healthy reset in an overheated market. While we expect the stock market to ultimately grind higher, volatility is likely to persist as markets contend with the tug of war between firm US economic and earnings trends against Fed policy, rising global macro uncertainty and geopolitical risks. Additionally, with bond yields moving into a higher range, we expect hedge fund strategies to fare reasonably well against fixed income. This environment, moreover, demonstrates the importance of basic diversification and creates opportunities for certain non-traditional strategies within a balanced portfolio.

Moreover, as we move later in the business cycle and past peak monetary accommodation, we see a more fertile environment for some strategies, such as hedged equity, in which managers can take advantage of greater stock dispersion across various market segments. Thus, with risk assets decoupling, equity valuations should be more reflective of underlying fundamentals.

Relative value strategies should be able to take advantage of greater differentiation within and across markets. However, while we expect managed futures to offer downside support in extended market declines, the lack of sustained trends in some markets along with increased volatility in systematic trading strategies has challenged returns this year.

On the event-driven side, we remain constructive on merger arbitrage strategies given continued merger activity, specifically for larger deals. Despite higher valuation multiples, repatriated cash from corporate tax reform and reduced regulatory uncertainty from Washington should further encourage deal activity as companies seek to obtain top-line growth through improved synergies.

Consistent with our fixed income theme to step up quality, we are less constructive on credit strategies. Despite a favorable economic growth backdrop, which is generally good for credit, richer valuations, historically low yields and few defaults elevate the risk profile of these strategies.

Hedge funds may involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager. Managed Futures and commodity investing involve a high degree of risk and are not suitable for all investors. Investors could lose a substantial amount of money in a very short period of time. The amount you may lose is potentially unlimited and can exceed the amount you originally deposit with your broker. This is because trading security futures is highly leveraged, with a relatively small amount of money controlling assets having a much greater value. Investors who are uncomfortable with this level of risk should not trade managed futures or commodities.
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High-yield Fixed Income Investments, also known as junk bonds, are considered speculative, involve greater risk of default and tend to be more volatile than investment-grade fixed income securities.

International investing entails greater risk, as well as greater potential rewards compared to US investing. These risks include potential economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in emerging market countries, since these countries may have relatively unstable governments and less established markets and economies.

Investing in smaller companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations, and illiquidity.

Emerging Markets: Investing in the securities of such companies and countries involves certain considerations not usually associated with investing in developed countries, including unstable political and economic conditions, adverse geopolitical developments, price volatility, lack of liquidity, and fluctuations in currency exchange rates.

Leveraged loans bear more risk than traditional investment grade loans because they are issues by below investment grade companies. Asset classes are represented by the following indexes:
Global stocks are represented by MSCI ACWI index (Morgan Stanley Capital International All Country World) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 45 country indices comprising 24 developed and 21 emerging market country indices. MSCI World captures large and mid-cap representation across 23 Developed Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country. Emerging Markets is represented by MSCI EM index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. Non-US Developed is represented by MSCI EAFE index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. MSCI USA Index is designed to measure the performance of the large and mid-cap segments of the US market. With 640 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US. Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. US Large Cap is represented by S&P 500 Index is comprised of 500 widely-held securities considered to be representative of the stock market in general. NASDAQ Composite Index includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index is a broad based index. Leveraged Loans are represented by the S&P/LSTA (Loan Syndications and Trading Association) U.S. Leveraged Loan 100 Index measures the performance of 100 large loan facilities meeting specific inclusion criteria. The index is modified market value-weighted and is fully rebalanced semi-annually. Russell Mid Cap index is a measure of the performance of the mid-cap segment of the US equity universe. The Russell Midcap is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap represents approximately 31% of the total market capitalization of the Russell 1000 companies. Russell 2000 Index is comprised of 2000 smaller company stocks and is generally used as a measure of small-cap stock performance. FTSE NAREIT US Real Estate Index Series is designed to present investors with a comprehensive family of REIT performance indexes that span the commercial real estate space across the US economy, offering exposure to all investment and property sectors. Commodities are represented by Bloomberg Commodity Index is composed of futures contracts on physical commodities. It currently includes 22 commodity futures in six sectors. The weightings of the commodities are calculated in accordance with rules that ensure that the relative proportion of each of the underlying individual commodities reflects its global economic significance and market liquidity. US Core Bonds is represented by Bloomberg Barclays Aggregate Bond Index is the broadest measure of the taxable U.S. bond market, including most Treasury, agency, corporate, mortgage-backed, asset-backed, and international dollar-denominated issues, all with investment-grade ratings (rated Baa3 or above by Moody’s) and maturities of one year or more. Bloomberg Barclays Intermediate Government/Credit index represents securities that are SEC-registered, taxable, and dollar denominated. The index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment-grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years. Bloomberg Barclays US MBS Fixed Rate Index covers agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). Pool aggregates must have at least USA 250mn current outstanding, fixed-rate pool aggregates comprise individual TBA deliverable MBS pools mapped on the basis of agency, program, coupon, and origination year of the pool. Rated investment-grade (Baa3/BBB-/BBB-) or higher using the middle rating of Moody’s, S&P, and Fitch after dropping the highest and lowest available ratings. When a rating from only two agencies is available, the lower (“more conservative”) is used. When a rating from only one agency is available, that is used to determine index eligibility. Pool aggregates must have a weighted average maturity of at least 1 year. Preferreds are represented by the ICE BofAML Fixed Rate Preferred Securities Index tracks the performance of fixed rate US dollar denominated preferred securities issued in the US domestic market. ICE BofA Merrill Lynch Treasury Master is an unmanaged index tracking government securities. ICE BofA Merrill Lynch U.S. Inflation-Linked Treasury Index: Tracks the performance of US dollar denominated inflation linked sovereign debt publicly issued by the US government in its domestic market. Qualifying securities must have at least one year remaining term to final maturity, interest and principal payments tied to inflation and a minimum amount outstanding of $1 billion. Strips are excluded from the Index; however, original issue zero coupon bonds are included in the Index and the amounts outstanding of qualifying coupon securities are not reduced by any portions that have been stripped. Municipal Bonds is represented by Bloomberg Barclays Municipal Bond Blend 1-15 Year (1-17 Y) is an unmanaged index of municipal bonds with a minimum credit rating of at least Baa, issued as part of a deal of at least $50 million, that have a maturity value of at least $5 million and a maturity range of 12 to 17 years.
High Yield is represented by ICE BofAML US HY Master index is an index that tracks US dollar denominated below investment-grade corporate debt publicly issued in the US domestic market.

ICE BofAML Global Government Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. In order to qualify for inclusion in the Index, a country (i) must be a member of the FX-G10 or Western Europe; (ii) must have an investment grade foreign currency long-term sovereign debt rating (based on an average of Moody's, S&P and Fitch); (iii) must have at least $50 billion (USD equivalent) outstanding face value of Index qualifying debt (i.e., after imposing constituent level filters on amount outstanding, remaining term to maturity, etc.) to enter the index; (iv) must have at least $25 billion (USD equivalent) in outstanding face value of Index qualifying debt in order to remain in the Index; (v) must be available to foreign investors; and (vi) must have at least one readily available, transparent price source for its securities. The FX-G10 includes all Euro members, the US, Japan, the UK, Canada, Australia, New Zealand, Switzerland, Norwey and Sweden.

Non-US Bonds is represented by ICE BofAML Global Government ex US Index is a subset of ICE BofAML Global Government Index excluding all securities denominated in US dollars.

ICE BofAML Global Government ex US Index Hedged is a subset of ICE BofAML Global Government Index excluding all securities denominated in US dollars and where the currency exposure is hedged.

EM Local-Cur is represented by JP Morgan GBI-EM Global Diversified Composite is a comprehensive emerging market debt index that tracks local currency bonds issued by Emerging Market governments. It includes only those countries that are directly accessible by most of the international investor base and excludes countries with explicit capital controls, but does not factor in regulatory/tax hurdles in assessing eligibility. The maximum weight to any country in the index is capped at 10%.

EM Hard-Cur is represented by JP Morgan EMBI Global Diversified limits the weights of those index countries with larger debt stocks by only including a specified portion of these countries eligible current face amounts of debt outstanding.

HFRX Indices (HFRX) are a series of benchmarks of hedge fund industry performance which are engineered to achieve representative performance of a larger universe of hedge fund strategies. Hedge Fund Research, Inc. ("HFR, Inc.") employs the HFRX Methodology, a proprietary and highly quantitative process by which hedge funds are selected as constituents for the HFRX Indices. This methodology includes robust classification, cluster analysis, correlation analysis, advanced optimization and Monte Carlo simulations. More specifically, the HFRX Methodology defines certain qualitative characteristics, such as: whether the fund is open to transparent fund investment and the satisfaction of the index manager's due diligence requirements. Production of the HFRX Methodology results in a model output which selects funds that, when aggregated and weighted, have the highest statistical likelihood of producing a return series that is most representative of the reference universe of strategies.

The CBOE Volatility Index® is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Since its introduction in 1993, VIX has been considered by many to be the world's premier barometer of investor sentiment and market volatility. VIX is often referred to as the "investor fear gauge".

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The Alerian MLP Index is the leading gauge of large- and mid-cap energy Master Limited Partnerships (MLPs). The float-adjusted, capitalization-weighted index, which includes 50 prominent companies and captures approximately 75% of available market capitalization.

It is not possible to invest directly in an index.