MARCH 2018 IN REVIEW

April Update | As of March 31, 2018

Economy:

SOLID ECONOMY OVERSHADOWED BY TRADE TENSIONS

Economic Data

Economic reports released in March 2018, largely reflecting economic activity in February, rebounded from subpar data released in February, putting the economy on track for solid but not spectacular first quarter growth. Improvements were seen more on the business side than the consumer side, although strong job growth continues to provide support for consumer spending.

The Bloomberg-surveyed consensus estimate for first quarter 2018 gross domestic product (GDP) growth was revised slightly downward during the month, from 2.6% to 2.5%, lower than the 2.9% growth rate reported in the fourth quarter of 2017. The Federal Reserve Bank (Fed) of New York's data-driven forecast for first quarter GDP growth stands at 2.7%, while the Atlanta Fed's comparable measure points to 2.3%.

Consumer inflation picked up slightly in February, as expected. The core Consumer Price Index (CPI, excluding volatile food and energy prices) rose 1.8% year over year, in line with consensus expectations and the prior month's reading. The Fed's preferred inflation measure, the personal consumption expenditures (PCE) deflator excluding food and energy (core PCE), remained within the Fed's comfort range at 1.6%. Headline inflation readings (including all items) were a bit higher, with the PCE up 1.8% and the CPI up 2.2%.

The Fed also closely follows wage inflation to help determine whether monetary policy may need to be tightened. On that score, pressure on the central bank eased a bit as the annual wage data in the February jobs report (average hourly earnings) came in below expectations, slowing to 2.6% from 2.8% the prior month. The pace of inflation, particularly wages, will be critical for market participants to assess the potential path of Fed rate hikes.

The increase in wages was accompanied by strong job growth in February, though likely partly inflated by weather-related dynamics. Nonfarm payroll employment increased by 313,000, well ahead of the 205,000 consensus forecast and a big jump from the 200,000 initially reported for the prior month. (That January figure was later revised lower to 176,000.) Other measures of labor market health also painted a positive picture, including job openings, the unemployment rate

FED'S PREFERRED INFLATION MEASURE REMAINS WELL WITHIN ITS COMFORT RANGE

Source: LPL Research, Bloomberg 03/31/18

(4.1%), and jobless claims.

Steady job gains and rising wages help provide a solid foundation for consumer spending, the biggest piece of the U.S. economy. In addition, consumer confidence readings are high, tax cuts just kicked in for individuals, and interest rates remain low by historical standards. All in all, the macroeconomic environment is supportive of consumer outlays. Still, retail sales for February disappointed, showing consumer spending may have lost some momentum after a strong finish to 2017. Autos and gasoline sales were the biggest drags, while some cited delayed tax refunds and weather for the modest shortfall.

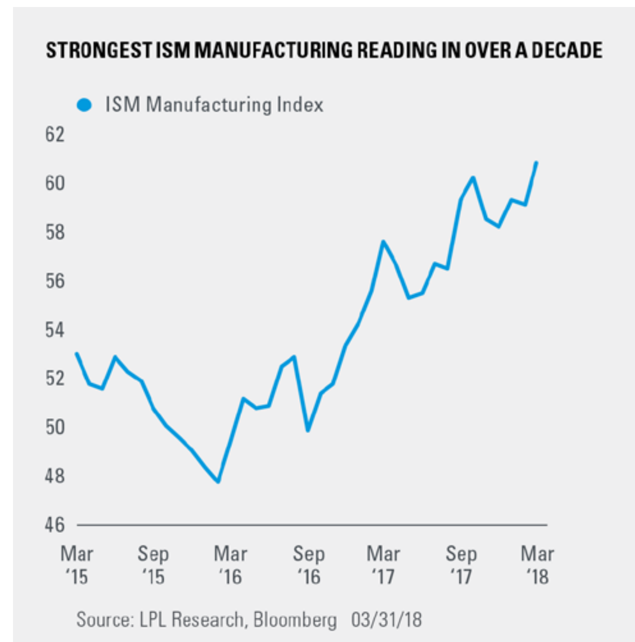
Manufacturing activity remained quite strong based on data released in March. The Institute for Supply Management (ISM) Manufacturing Index, at 60.8, beat consensus expectations, accelerated from the prior month, and was the strongest since 2004. The reading signaled continued expanding factory activity and solid growth in corporate profits. Details of the report featured an increase in new export orders (aided by a weaker dollar), solid job gains, and some upward pressure on prices. Further, like consumers, businesses remain confident, based on the NFIB Small Business Optimism Index, which rose to its highest level in 35 years on favorable outlooks on the economy and the climate for expansion. Meanwhile, incentives from the new tax law buoy the outlook for capital investment.

The Conference Board's Leading Economic Index (LEI), an aggregate of 10 leading indicators, rose 0.6% in February versus consensus expectations of 0.5%, pointing towards continued strength in the U.S. economy in 2018. Labor market indicators were strong contributors, including average hours worked and jobless claims, along with ISM new orders; while lower stock prices and a dip in building permits detracted from the index. Strength in leading indicators in recent months suggests the odds of a recession in the next year remain low.

Central Banks

Four major central banks met in March, but only the Fed made any change to policy. As expected, the Fed raised rates by 0.25% at the conclusion of its March 20–21 meeting, the sixth rate hike of the current cycle, lifting the fed funds target range to 1.50–1.75%. The Fed's statement noted that the economic outlook has strengthened in recent months and upgraded its inflation view, stating that year-over-year data should move up in the coming months.

In addition to a statement, the Fed released an updated set of dot plots, in which each Federal Open Market Committee member (both voting and non-voting) offered their view on the future path of interest rates, as well as their updated economic projections. The group's median expectation remained at three rate hikes in 2018, though expectations for 2019 did increase and now sit at between three and four hikes. The Fed also upgraded its GDP growth forecasts to 2.7% for 2018 and 2.4% for 2019, from its December forecasts of 2.5% and 2.1%, respectively. Overall, the Fed continues to communicate a gradual path of data-dependent rate hikes.



Global Equities:

VOLATILITY CONTINUED IN MARCH AMID TRADE WAR FEARS

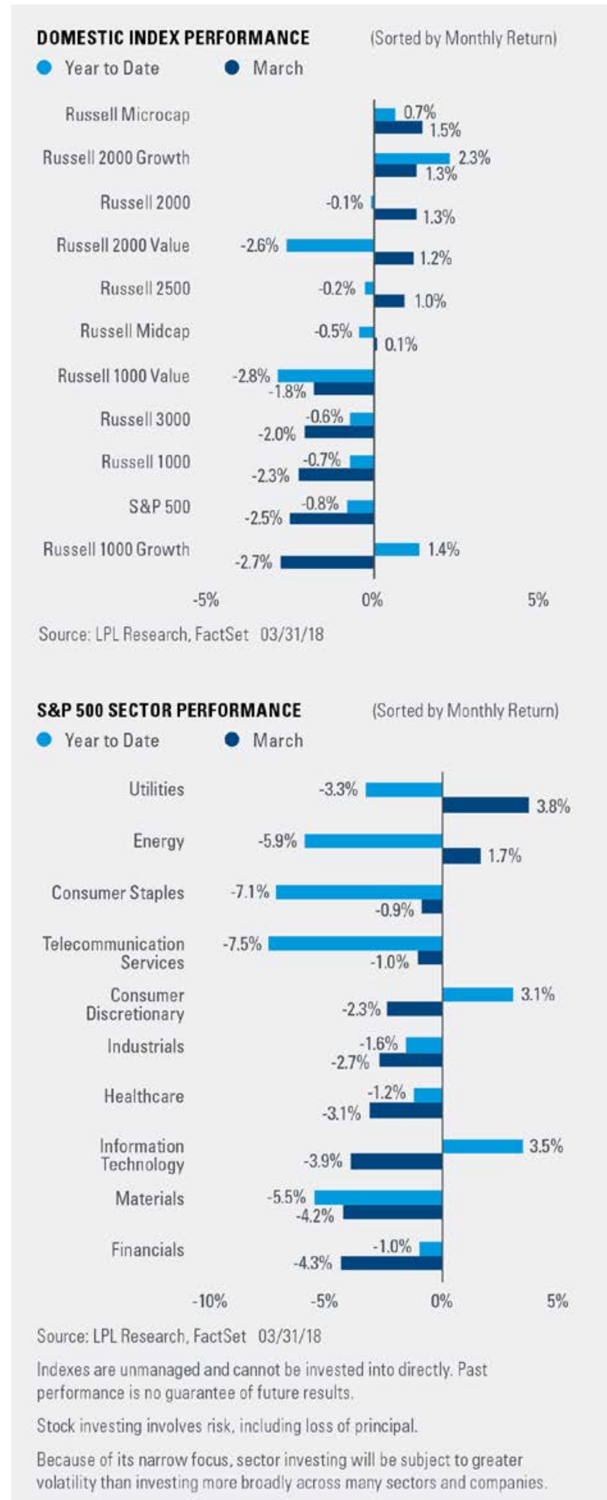
U.S.

Stocks fell in March for the second straight month, wiping away the year-to-date gain for the S&P 500 Index. Still, on March 9, the bull market celebrated its ninth birthday. The index's 2.5% decline, on a total return basis, left it with a 0.8% first quarter loss. The Dow Jones Industrials (-3.6%) and the Nasdaq Composite (-2.8%) did not fare any better in the broad-based decline.

Stock market weakness was driven by several factors, but escalating trade tensions were at the top of the list. President Trump announced global tariffs on steel and aluminum at the start of the month, which was then followed later in the month by fresh tariff proposals totaling roughly $50 billion in products levied on China. China retaliated with tariffs of its own against the United States (though on a small dollar value of goods with more anticipated), sparking trade war fears. Amidst all of that, National Economic Council Chief and noted free trade advocate Gary Cohn resigned. Though stocks fell on these concerns, markets did show some signs of stability on indications that China and the United States would come to the negotiating table.

Another source of weakness in the U.S. market was regulatory concerns around internet privacy that hurt the technology sector during the latter half of March. Technology's volatile March weighed on investor sentiment and, because of the sector's substantial weight, dragged down the broad indexes. The technology sector ended the month with a 3.9% loss, outpacing only financials and materials which each lost more than 4%. The top sector performers for the month were interest rate sensitive areas, namely real estate and utilities. Energy also performed well, gaining 1.7% for the month as crude prices rose.

Small caps outpaced large and mid caps during March, the first month on top of the market cap rankings for small caps since September 2017. The Russell 2000 Index returned 1.3% for the month, ahead of the flat Midcap Index and the 2.3% loss for the large cap Russell 1000 Index. After lagging throughout much of 2017, markets appeared to recognize the relatively larger benefit from tax reform generally enjoyed by smaller cap companies. Escalating trade tensions also played a role, as smaller companies tend to be more domestically focused. Year to date, the Russell 2000 has been flat, compared with a



Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Stock investing involves risk, including loss of principal.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

0.5% loss for the Midcap Index and a 0.7% loss for the Russell 1000.

During March, the strong performance by energy and the interest rate sensitive sectors, mostly categorized as “value,” helped value hold up relatively better than growth, which was weighed down by technology sector weakness. The Russell 3000 Value Index slipped 1.5% for the month, less than the 2.4% decline for the Russell 3000 Growth Index.

International

International equities were broadly lower during March despite continued solid economic growth globally. Trade tensions certainly played a role, as did some evidence that European economies are slowing. Developed foreign equities still held up slightly better than the S&P 500 and the MSCI Emerging Markets (EM) indexes during the month. A slightly weaker U.S. dollar was broadly supportive of international equity returns for U.S. investors via currency translation.

Among developed international equity markets, Italy managed a modest gain despite political uncertainty following the populist wave in the country’s national election. U.K. equities held up relatively well thanks to a strong British pound. Swiss and French markets also held up better than the broad index, while Australia was among the biggest laggards. The MSCI EAFE Index’s 1.9% loss in March brought the year-to-date return to a loss of 1.6%.

EM equities lost 2% in March, better than the S&P 500 and just slightly behind the Developed International Equity Index. South Korea was among the best-performing country markets, reflecting North Korea’s supposed willingness to establish diplomatic relations. The Taiwan equity market also performed well, buoyed by technology sector gains. On the flip side, trade tensions dragged on China, as the MSCI China Index lost more than 3% despite a strong yuan and generally upbeat economic data, while Indian and South African equity markets underperformed. The March loss pared EM’s year-to-date return to 1.2%, ahead of both the S&P 500 and MSCI EAFE indexes.

Source: LPL Research, FactSet 03/31/18

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International and emerging markets investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

Fixed Income:

YIELD CURVE FLATTENS AS LONGER-TERM RATES FALL FROM RECENT HIGHS

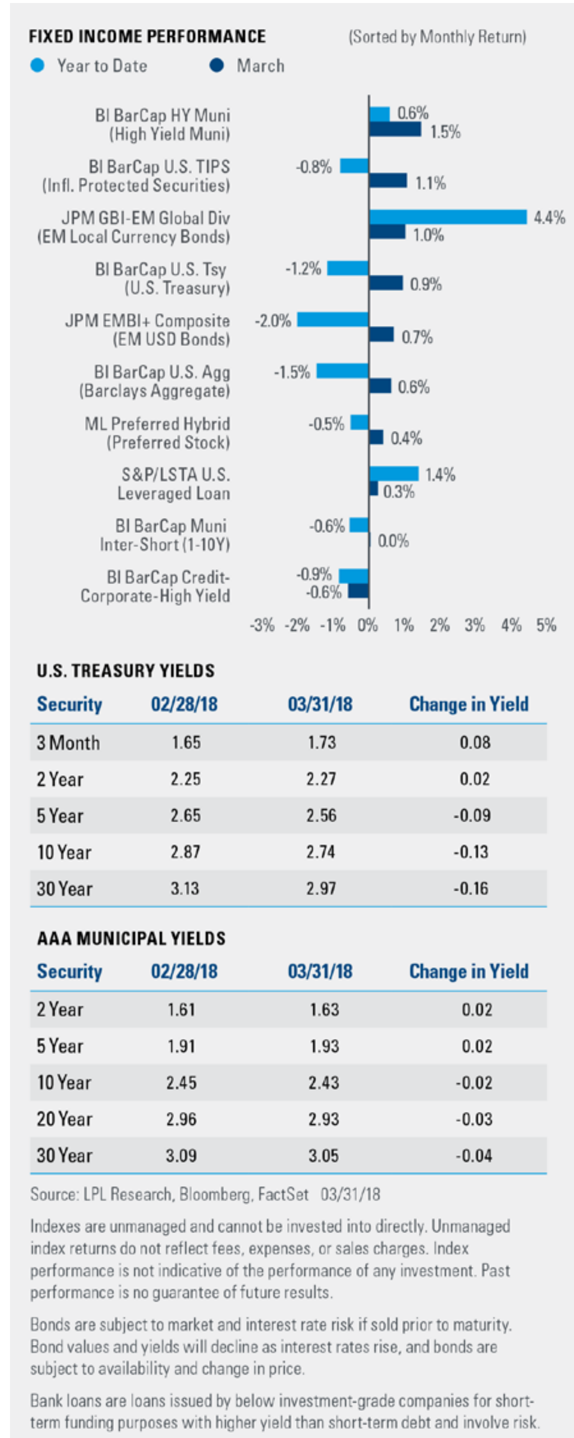
Treasury yields rose in shorter maturities and declined in longer maturities during March. The 2-year Treasury rose by 2 basis points (0.02%), while the 10-year and the 30-year Treasury fell by 13 and 16 basis points (0.13% and 0.16%), respectively. Inflation expectations declined from local highs. The Fed followed through with a rate hike during its March 20–21 meeting, which pressed short-term rates higher. This led to a further flattening of the yield curve during the month.

The risk-off tone led to a largely positive month for high-quality fixed income. The broad Bloomberg Barclays U.S. Aggregate Bond Index returned 0.6% in March, with Treasuries outperforming, returning 0.9%. Mortgage-backed securities and investment-grade corporates returned 0.6% and 0.3%, respectively.

Economically sensitive sectors of fixed income were hamstrung by equity market volatility, with high yield returning -0.6% during March. Developed foreign bonds performed well amid a global decline in longer-term rates, with hedged foreign bonds returning 1.4%. Unhedged foreign bonds returned 1.8%, due to the tailwind of a 0.7% decline in the dollar over the course of March.

Investing in foreign and emerging markets debt securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.



U.S. TREASURY YIELDS

Security	02/28/18	03/31/18	Change in Yield
3 Month	1.65	1.73	0.08
2 Year	2.25	2.27	0.02
5 Year	2.65	2.56	-0.09
10 Year	2.87	2.74	-0.13
30 Year	3.13	2.97	-0.16

AAA MUNICIPAL YIELDS

Security	02/28/18	03/31/18	Change in Yield
2 Year	1.61	1.63	0.02
5 Year	1.91	1.93	0.02
10 Year	2.45	2.43	-0.02
20 Year	2.96	2.93	-0.03
30 Year	3.09	3.05	-0.04

Source: LPL Research, Bloomberg, FactSet 03/31/18

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Bank loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

Alternatives:

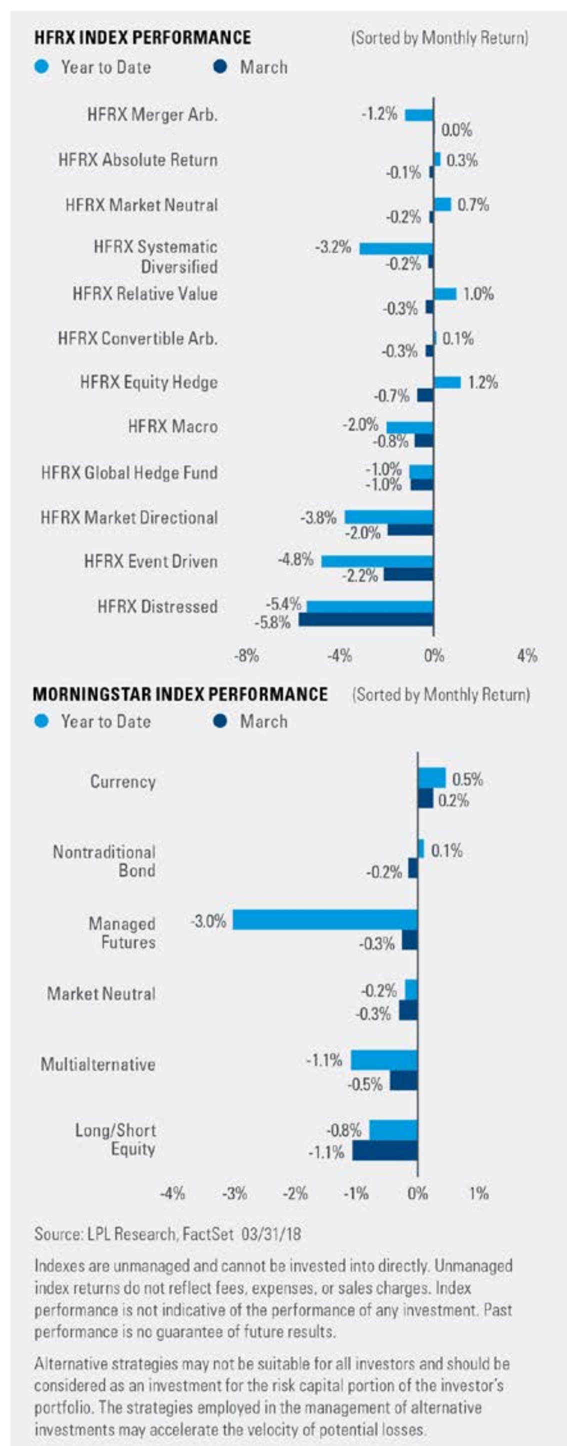
ALTS NAVIGATE INCREASE IN VOLATILITY

Alternative investment strategies were broadly lower during March; however, all but one subcategory was still able to outperform the 2.5% loss in the S&P 500. The HFRX Merger Arbitrage Index (+0.04) was the only alternative strategy to edge out a positive return for the month, as the industry's limited equity beta profile provided strong downside protection.

Managed futures rebounded from an extremely difficult February, as the HFRX Systematic Diversified CTA Index declined a modest 0.2%. This marked a significant improvement over the 7.4% February loss, as long British pound and gains in smaller commodity markets such as cocoa (long), sugar, and livestock (short exposure) supported portfolios. Long equity exposure has been drastically reduced across most strategies, as the increase in volatility and recent market weakness has moderated risk taking across most trading programs.

While also negative for the month, long/short equity strategies provided downside protection in line with the industry's beta profile, as the HFRX Equity Hedge declined 0.7%. In contrast to previous months, where overweights to the technology and consumer discretionary sectors contributed to returns, March saw a reversal of growth and momentum positions which contributed to the monthly loss. Additionally, short exposure to rate-sensitive names proved costly, as firms in these sectors outperformed. Year to date, the HFRX Equity Hedge Index has delivered a 1.2% return, outperforming the S&P 500 by 2.0%.

The HFRX Distressed Debt Index lagged all categories with a decline of 5.8%. This represents the worse monthly loss for the space since December 2008. Positions in the energy and industrial sectors weighed on portfolios during the month.



Source: LPL Research, FactSet 03/31/18

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Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

REAL ASSETS:

MIXED MONTH FOR REAL ASSETS

Liquid real assets performance was mixed during March, with REITs and global infrastructure higher, while commodities and master limited partnerships (MLP) suffered losses.

MLPs

The Alerian MLP Index lost 6.9% during the month, trailing broad global equity markets and liquid real asset benchmarks. Weakness was mainly driven by the Federal Energy Regulatory Commission's decision to no longer allow MLPs to recover an income tax allowance for certain regulated rates on a portion of their pipeline contracts. That news drove the Alerian MLP Index down by more than 4% on March 15, even though the change only impacts a minority of the partnerships in the sector and reduces overall cash flows for the group by a very small amount. Other factors have also weighed on MLPs, including slowing distribution growth, higher interest rates, and energy sector weakness.

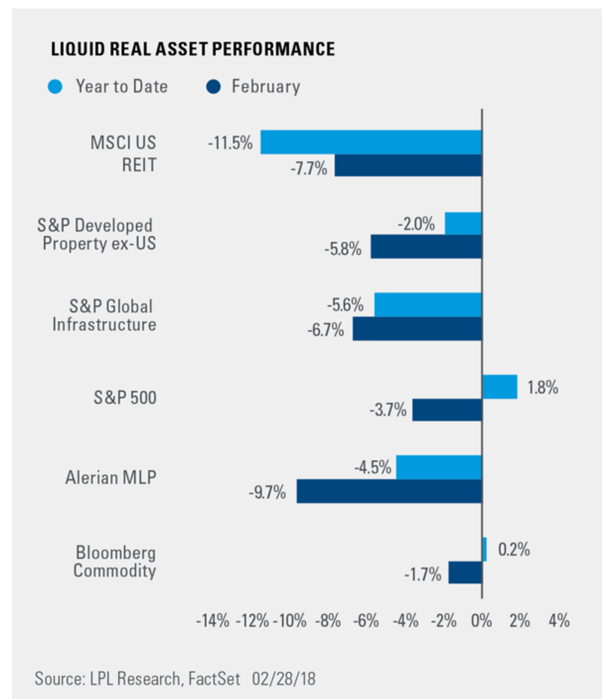
REITs & Global Listed Infrastructure

The S&P Global Infrastructure Index eked out a marginal 0.1% return in March, outperforming global equities while trailing the U.S. and international real estate indexes. The infrastructure space, like REITs, benefited from the dip in interest rates that supported higher yielding investments during March, as well as market volatility that attracted investors to investments with defensive characteristics. Year to date, the S&P Global Infrastructure Index has lost 5.5%.

U.S. and international REITs outperformed the broad U.S. and international equity market indexes during the month. U.S. REITs are still underperforming broad equities year to date, but strong relative performance in March helped narrow the gap. U.S. REIT gains were broad-based, with all major real estate subsectors posting positive returns in March — led by data centers and residential. International real estate's March gain (+1.1%) trailed U.S. REITs, but international real estate equities have lost just 0.9% year to date, well ahead of U.S. REIT's more than 8% loss.

Commodities

The Bloomberg Commodity Index lost 0.8% during March, but outperformed global equities. Weakness was driven by declines in both agriculture commodities and industrial metals. In the agriculture category, most commodities fell — wheat and sugar in particular. Among



industrial metals, copper, aluminum, zinc, and nickel all dragged on index performance for the month. Positive contributors to the index's performance included energy and precious metals, notably gold.

Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

Investing in MLPs involves additional risks as compared with the risks of investing in common stock, including risks related to cash flow, dilution, and voting rights.

MLPs may trade less frequently than larger companies due to their smaller capitalizations, which may result in erratic price movement or difficulty in buying or selling. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment, including the risk that an MLP could lose its tax status as a partnership. Additional management fees and other expenses are associated with investing in MLP funds.

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