OCTOBER 2017 IN REVIEW

November Update | As of October 31, 2017

ECONOMY:
DATA REFLECTS CONTINUED SOLID GROWTH

Economic Data

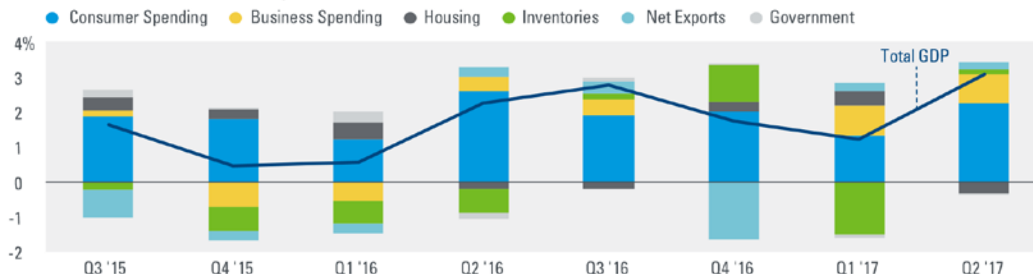
Economic reports released in October 2017, which mostly reflect economic activity in September, largely exceeded expectations throughout the month. The Citi Economic Surprise Index, which measures how economic data is coming in versus expectations, rebounded strongly from negative territory in September to end October at a very strong 40.5 level. (We generally consider data to be in line with expectations when the index reads between -25 and +25). That corresponds to roughly 60% of economic reports beating estimates during the month and reflects an improving overall U.S. economy.

The initial read on third quarter 2017 gross domestic product (GDP) was released in October. Real (inflation-adjusted) annualized GDP for the quarter came in at 3.0%, well above the 2.6% consensus forecast and slightly below the second quarter's 3.1% growth rate. Consumer spending was the main driver of the beat, though business fixed investment also picked up. Consumer spending, which rose 2.4% quarter over quarter annualized, contributed just over half of the quarter's 3% GDP growth; while inventories, business spending, and trade (net exports) also contributed meaningfully.

In the GDP release, the Bureau of Economic Analysis did not mention the impact of the hurricanes directly, but at least part of the gain in consumer spending was driven by auto sales, as consumers replaced storm-damaged vehicles. The hurricane impacts, which were limited in geographical scope, were more than offset by strength in the broader U.S. economy.

Consumer spending was supported by a still-solid job market, despite job losses reported in the September payroll data due to the impacts of the hurricanes. U.S. payrolls fell 33,000 in September (before revisions) compared to consensus expectations for 80,000 (net) new jobs, marking the first monthly job loss since 2010. Nearly 1.5 million people were reportedly unable to work due to bad weather (worst in more than 20 years). At the same time, the unemployment rate, derived from a different survey, dropped from 4.4% to 4.2%, the lowest level since February 2001. Hurricane impacts were evident in accelerating wages, which rose 0.5% month over month and 2.9% year over year, above consensus expectations and the 0.1% and 2.5% readings from the prior month.

Data reported in October reflected a continued favorable business spending environment. Business equipment spending rose more than 8% annualized for the second



straight quarter based on the GDP report. The Institute for Supply Management (ISM) Manufacturing Index for September came in at a very strong 60.8, the highest reading since 2004, and a positive signal for corporate profits (readings over 50 are expansionary). The ISM Services Index — representing a larger portion of the economy than manufacturing — was similarly strong at 59.8. Headline durable goods orders beat expectations while capital goods orders and shipments increased month over month and accelerated from the prior month.

The Conference Board's Leading Economic Index (LEI) for September fell 0.2% month over month, snapping a 12-month string of advances and falling from August's +0.4% reading. Part of the decline was attributed to hurricane-related impacts with labor markets and residential construction cited as the primary sources of weakness. The Conference Board noted that the majority of LEI components contributed positively, and it sees September's decline as a one-off reading with the overall index trend pointing to continuing solid growth in the U.S. economy. The year-over-year change in the LEI, at +4.0%, has historically been associated with a low chance of recession in the next 12–18 months and signals continued near-term economic growth.

As November began and hurricane rebuilding efforts continued, expectations were for another solid GDP growth performance in the fourth quarter, based on the GDPNow forecast from the Atlanta Federal Reserve (Fed) at 3.3% and the New York Fed's Nowcast (3.1%). While the Bloomberg consensus forecast is lower at 2.3%, data available through October pointed to continued expansion.

Central Banks

As the October 31–November 1 Federal Open Market Committee policy meeting got underway, markets continued to expect a rate hike from the Fed at its December policy meeting, despite the weak September jobs report and low inflation — at +1.3% year over year based on the Fed's favorite measure, the core personal consumption expenditures (PCE) deflator excluding food and energy (headline PCE is +1.6% year over year all in). Ahead of the Fed announcement, fed fund futures markets were pricing in an 85% chance of a December rate hike and a 76% chance of at least one additional hike in 2018. The Fed projects a total of three as market expectations continue to trail the Fed by a large margin. Meanwhile, balance sheet normalization — a slower pace of Fed bond purchases — began in October as previously announced.

Throughout October, there was widespread speculation on who the next Fed chair would be (later revealed to be Jerome [Jay] Powell). Some had been concerned that the nominee would raise rates more quickly than Fed Chair Janet Yellen or a dovish Jay Powell might.

Turning overseas, as expected, the European Central Bank announced on October 26 that it would taper bond purchases by half to 30 billion euros per month starting in January 2018. However, the softening of its language around the expected cutoff date of purchases (September 2018) and new guidance that it would reinvest proceeds of maturing debt "as long as necessary" gave the overall message a dovish tilt. At its October 30–31 policy meeting, the Bank of Japan left interest rates unchanged and lowered its inflation forecasts as expected.

GLOBAL EQUITIES:

ANOTHER POSITIVE MONTH FOR U.S. STOCKS

U.S.

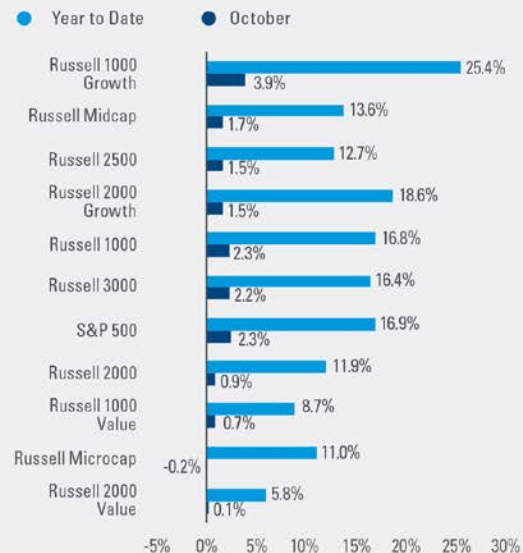
Stocks rose again in October, the seventh straight monthly gain for the S&P 500 Index and twelfth straight including dividends. Year to date through October, the S&P 500 has produced an impressive 16.9% return. The Dow, which has returned +20.6% year to date, has produced seven straight monthly gains while the Nasdaq has been higher 11 out of 12 months and has returned +26.1% so far in 2017.

October gains were driven by a combination of macroeconomic and policy factors. On the macroeconomic side, data released during October generally reflected a healthy economy, including third quarter GDP and the ISM Purchasing Managers' Survey for September, while data mostly beat expectations. Market participants appropriately looked past the hurricane-driven softness in the labor markets. The first half of third quarter earnings season was well received, with solid results relative to expectations despite heavy hurricane-related insurance losses. As November began, S&P 500 earnings were tracking toward a solid 7% year-over-year increase, or more than 10% excluding the hurricane-riddled financials sector.

The policy environment in October was also supportive as Congress passed a 2018 budget resolution, paving the way for the tax reform process to begin in earnest, and increasing the odds that an agreement is reached. If enacted, tax reform may provide a 5% or greater boost to 2018 S&P 500 earnings, making it of particular importance for markets. Expectations of a dovish successor to Fed Chair Janet Yellen also helped buoy investor sentiment.

Technology topped the sector leaderboard for the month with a 7.8% return, driven by double-digit gains in semiconductor stocks and strong software stock performance. The sector continues to benefit from several powerful trends such as artificial intelligence (machine learning), cloud computing, and mobile, which are contributing to strong earnings. Utilities, with a +3.9% return, was the second best performing sector in October despite slightly higher 10-year Treasury yields. The rest of the defensive sectors lagged, including healthcare, consumer staples, and telecommunications, which each suffered losses during the month. Energy also underperformed, despite rising oil prices.

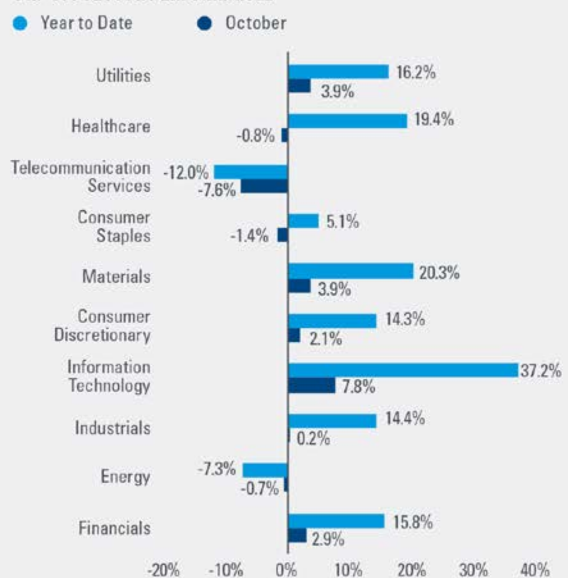
DOMESTIC INDEX PERFORMANCE



Source: LPL Research, FactSet 10/31/17

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

S&P 500 SECTOR PERFORMANCE



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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.

The growth style benefited from strong technology performance, outpacing value for the eighth month out of ten this year, based on the Russell 3000 style indexes. The biggest value sector, financials, outperformed in October, but not by nearly as much as the growth-heavy technology sector. For the year, the Russell 3000 Growth Index has returned +24.9%, well ahead of the Russell 3000 Value's +8.5% return.

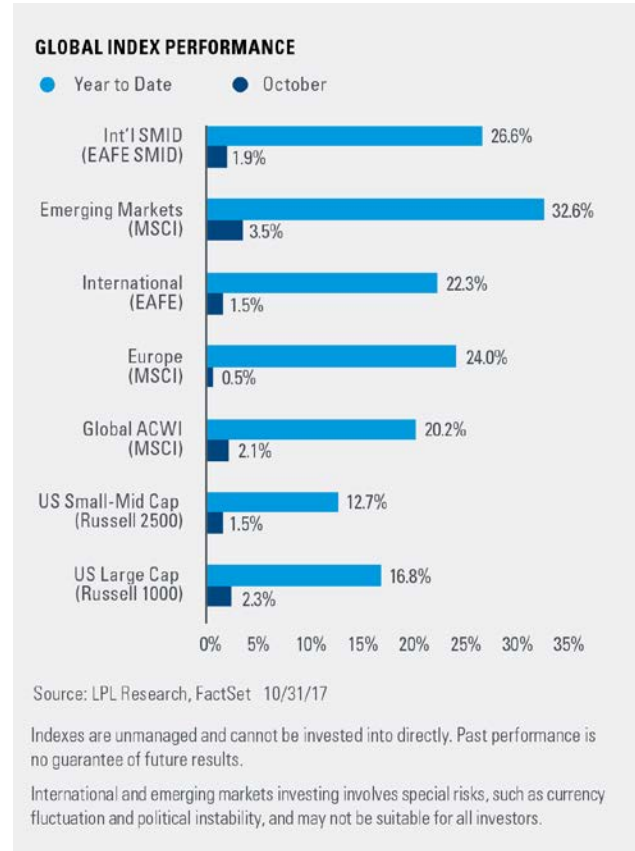
The small cap Russell 2000 (+0.85%) underperformed the large cap Russell 1000 (+2.29%) in October, despite improving tax reform prospects. A lower corporate tax rate would generally benefit smaller, more domestic companies more than large because they tend to pay higher tax rates. Small cap underperformance was concentrated in the consumer discretionary and technology sectors. Small caps have returned a very respectable +11.9% year to date, though trailing the +16.8% return for large caps.

International

Developed international equities rose in October but trailed the U.S. and emerging markets equity benchmarks. The MSCI EAFE Index returned +1.5% for the month, bringing the year-to-date return to a very solid +22.3%. The U.S. Dollar Index rose 1.6%, trimming international equity gains for U.S.-based investors, though a weaker dollar has boosted year-to-date performance. Dollar strength did not slow Japan down, as the MSCI Japan Index returned +4.6% during the month. Along the way, Nikkei produced a record-setting 16-session win streak and broke through to new multi-decade highs. Japanese investors applauded the election victory for Prime Minister Shinzo Abe's ruling coalition, paving the way for more so-called "Abenomics," including monetary and fiscal stimulus and structural reforms. Yen weakness buoyed prospects for exporters.

European markets rose but lagged the developed international equity benchmark, despite firming economic growth, on political concerns and dollar strength. The ECB's plan to taper bond purchases in January 2018 was generally well received due to the message's overall dovish tilt. Spanish equities were flat, largely shrugging off Catalonia's independence push, Swiss stocks lagged due to drug stock weakness, and the U.K. struggled with Brexit uncertainty.

Emerging markets produced strong gains during October despite dollar strength. The MSCI Emerging Markets Index returned +3.5% for the month, bringing the year-to-date return to +32.6%. Asian markets were particularly strong, benefiting from continued strong global growth, technology strength, and a well-received National Congress in China, which takes place every five years. Markets in South Korea, Taiwan, and China were particularly strong. The Mexican stock market, which lost 7.5% for the month, continued to struggle with fears of a U.S. NAFTA withdrawal or unfavorable renegotiation.



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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 MARKET PRICES IN DECEMBER RATE HIKE

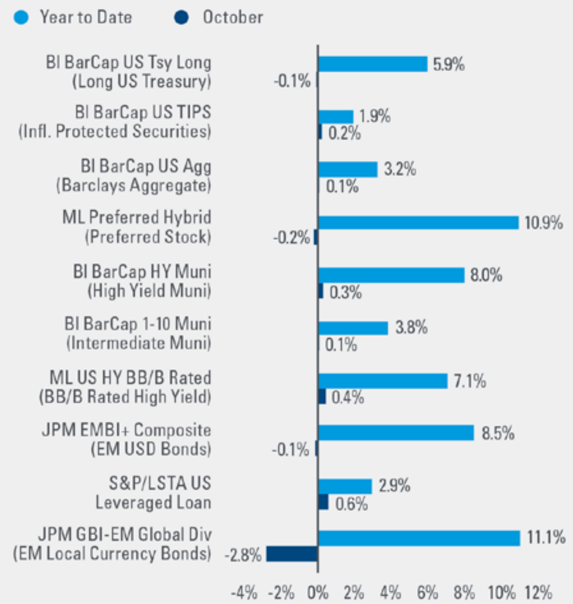
Treasury yields rose across the maturity spectrum during October, but more so in shorter maturities. The 2-year Treasury rose by 12 basis points (0.12%), while the 10- and 30-year Treasuries rose by just 5 and 2 basis points, respectively (0.05% and 0.02%). These dynamics led the Treasury yield curve to its flattest level since late 2007. Inflation expectations notched higher, as the price of oil gained another 5%. Increased expectations for a December rate hike pressed short-term rates higher, as markets largely priced in a hike during the month. Jerome Powell's ascension to be the next Fed chair sent longer-term rates lower at the end of the month.

The upward pressure on yields led to a mixed month for high-quality fixed income. The broad Bloomberg Barclays U.S. Aggregate Bond Index returned +0.1% during the month, with Treasuries underperforming, returning -0.1% (Bloomberg Barclays U.S. Treasury Index). Investment-grade corporates were the standout performer within high-quality fixed income, returning +0.3% amid progress on tax reform and good corporate earnings.

Economically sensitive sectors of fixed income were boosted by strong equity markets and a rise in the price of oil. Major beneficiaries of lower-quality fixed income strength were high yield and bank loans, which returned +0.4% and +0.6%, respectively.

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	09/30/17	10/31/17	Change in Yield
3 Month	1.06	1.15	0.09
2 Year	1.47	1.60	0.13
5 Year	1.92	2.01	0.09
10 Year	2.33	2.38	0.05
30 Year	2.86	2.88	0.02

AAA MUNICIPAL YIELDS

Security	09/30/17	10/31/17	Change in Yield
2 Year	1.02	1.07	0.05
5 Year	1.38	1.44	0.06
10 Year	2.09	2.12	0.03
20 Year	2.74	2.77	0.03
30 Year	2.91	2.95	0.04

Source: LPL Research, Bloomberg, FactSet 10/31/17

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

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.

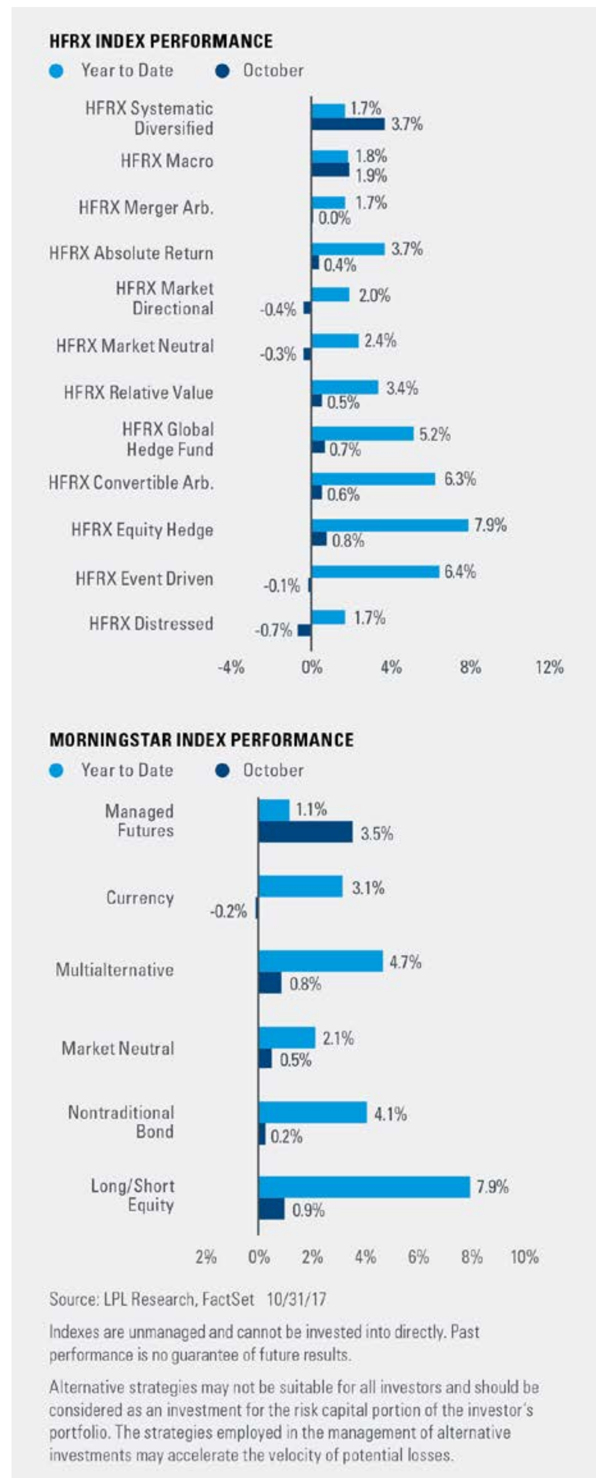
Alternatives:

EQUITY MARKETS SUPPORT MANAGED FUTURES

The HFRX Macro: Systematic Index gained 3.7% during October, bringing year-to-date returns into positive territory at +1.7%. This represents the industry's best month of performance since July 2015, as managers profited from a diverse set of market trends. In the equity space, the persistent upward trend continued across the globe, while in the energy markets, long crude oil exposure provided an additional source of returns for trend-following strategies. In addition to long equity and energy, at the end of the month, top positions across the industry included long British Pound and Euro exposure, as well as as well as recently initiated short positions across the U.S. Treasury curve.

The HFRX Equity Hedge Index gained 0.8%, failing to keep pace with broader market returns, as the S&P 500 gained 2.3%. However, on a risk-adjusted basis, the index has outperformed the S&P 500, having gained 7.9% year to date, with a typical monthly beta in between 0.25–0.35. Additionally, the index has been positive in 11 of the past 13 months. The industry's overweight to the technology sector (+7.8%) and Europe (+0.48%) during the month continue to support overall gains, however, long positions in the healthcare sector detracted from overall performance during the month.

The HFRX Event-Driven Index declined 0.13% and performance in the underlying categories was mixed, as the HFRX Distressed Index fell 0.69% and Merger Arbitrage strategies returned only +0.01%. Legislative progress on tax reform and greater clarity on the end form continue to occupy the interest of most strategies, as they digest how their current portfolio's may be impacted, while considering
what new opportunities may develop as we head into 2018.



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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: OIL AND INDUSTRIAL METALS GAINS DROVE COMMODITIES HIGHER

October was mixed for liquid assets. Domestic real estate and master limited partnerships (MLP) struggled, failing to keep up with global equities. Commodities produced similar gains as global equities, while global infrastructure and international real estate delivered gains but lagged.

MLPs

Unlike September, MLPs did not benefit from the rise in oil prices in October, much like the energy sector, as falling natural gas prices weighed on the group. MLPs have also struggled with reduced distribution prospects because of the industry's increasing focus on sustained cash flow growth and balance sheet improvements. Other concerns that have arisen in recent weeks include possible adverse impacts from tax reform and inefficient capital allocation decisions.

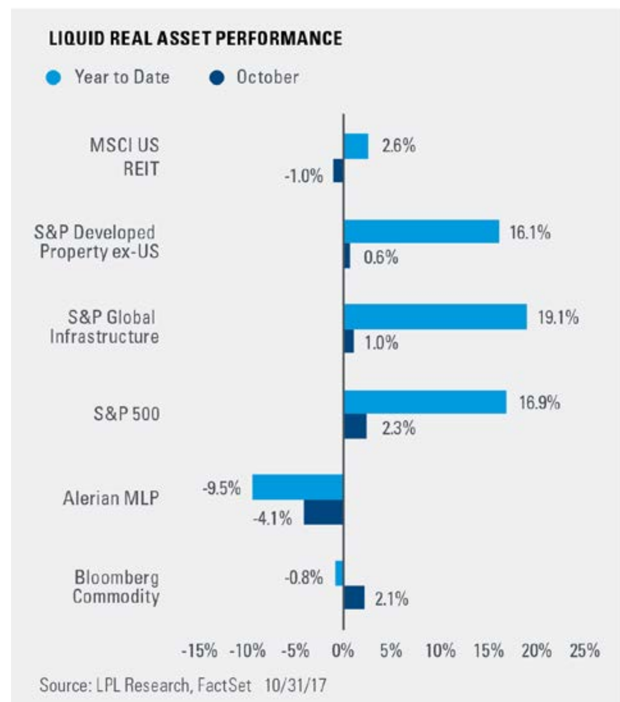
REITs & Global Listed Infrastructure

The MSCI U.S. REIT Index lost 1.0% during the month, while the international real estate benchmark gained 0.6%. Gains in the industrial, lodging/hotel, and data center subsectors were offset by weakness in the healthcare and retail subsectors. Retail continues to struggle with the online threat, while healthcare was weighed down by Affordable Care Act uncertainty.

Although global infrastructure underperformed in October, the S&P Global Infrastructure Index continues to outperform the broad equity market year to date. The recent weakness in real estate investment trusts (REIT) and global infrastructure can be partly attributed to rising interest rates and U.S. dollar strength, both of which continued through the end of the month. Global infrastructure and international real estate were negatively impacted by strength in the U.S. dollar during the month. Central bank tightening also likely contributed to underperformance of income-oriented investments such as real estate and global infrastructure.

Commodities

The Bloomberg Commodity Index rose 2.1% in October, driven by solid gains in oil and industrial metals, which offset weakness in natural gas, precious metals, and grains. Oil's 5% rally stemmed from a combination of factors, including: improving global growth prospects, drawdowns in domestic inventories, geopolitical tensions, and the likelihood that OPEC-led production limits may be extended beyond March 2018. Natural gas weakness reflected ample inventories and mild weather forecasts. Firming global growth and related strong demand, including in China, helped push industrial metal prices higher, notably copper. The strong dollar and the market's preference for more economically sensitive assets weighed on precious metals. Wheat prices fell amid global supply pressures while increased U.S. production contributed to falling corn prices.



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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