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Monthly Market Commentary

February 2018

U.S ECONOMY: Global Economic Fundamentals Still Strong

MARKETS GET SPOOKED

Several economic data points helped to spook investors in early February, leading to a correction for the S&P 500.

- Average hourly earnings rose faster-than-expected in January coming in at 2.9% versus a consensus 2.6%.
- Tax reform, along with a new budget deal that boosts spending could lead to higher fiscal deficits.
- Inflation increased 0.5% in January and is up 2.1% over the past year.

Wages and inflation trending higher, along with higher fiscal deficits potentially increases the pace and rate with which the Fed will tighten monetary policy.

FED CHAIR SAYS "ALL'S WELL"

Fed Chair Jerome Powell's testimony before the House Financial Services Committee indicated the Fed can continue gradually raising interest rates. He noted that the Fed does not currently view market volatility and higher rates, "as weighing heavily on the outlook for economic activity." The market currently anticipates 3-4 rate hikes in 2018.

CONFIDENCE CAN'T BE SHAKEN

The Conference Board ***Consumer Confidence Index®*** increased in February, following a modest increase in January. Both the Present Situation Index and the Expectations Index improved for the month. *"Consumer confidence improved to its highest level since 2000 after a modest increase in January. Consumers' assessment of current conditions was more favorable this month, with the labor force the main driver. Despite the recent stock market volatility, consumers expressed greater optimism about short-term prospects for business and labor market conditions, as well as their financial prospects. Overall, consumers remain quite confident that the economy will continue expanding at a strong pace in the months ahead."*

HOME SALES DISAPPOINT

New home sales slipped in January, falling 7.8% despite market expectations for a 3.5% gain. Pending home sales fell 4.7% in January to the lowest point in nearly four years.

RECOVERY IN LATIN AMERICA

Brazil, the ninth-largest economy in the world, finally exited a recession that lasted more than two years. Economic growth was not great, but the economy managed to grow 1.0% in 2017. Likewise, Argentina's economy grew 2.8% in 2017, after declining 2.2% in 2016.

CHINESE MANUFACTURING GROWING, BUT SLOWING

The manufacturing sector in China continued to expand in February, albeit at a much slower rate. The latest survey from the National Bureau of Statistics came in at 50.3, down from 51.3 in January and short of the 51.1 forecast. However, the Caixin/Markit manufacturing index, a measure of small & mid sized firms, came in at 51.6 for February. This marked a 6 month high for the index.

NO POLICY CHANGES FROM ECB

The minutes from the European Central Bank (ECB) meeting in January showed policymakers arguing that it was premature to signal policy normalization given weak inflation. It is still widely believed that the ECB will end its bond buying program later this year, and potentially begin raising interest rates based on continued positive economic data from the region.

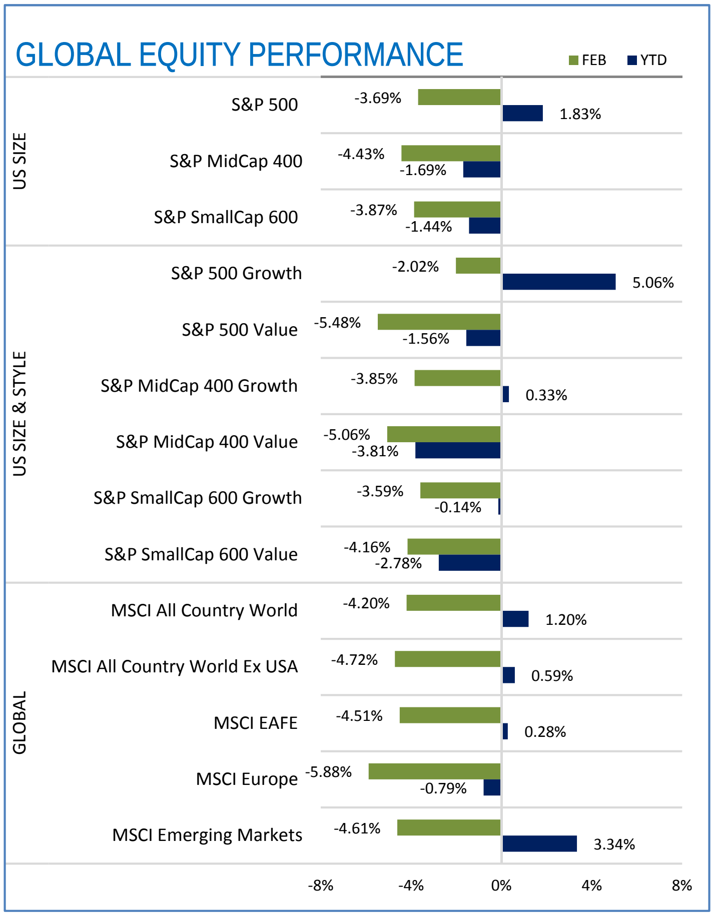
NO MORE JUNK FOR RUSSIA

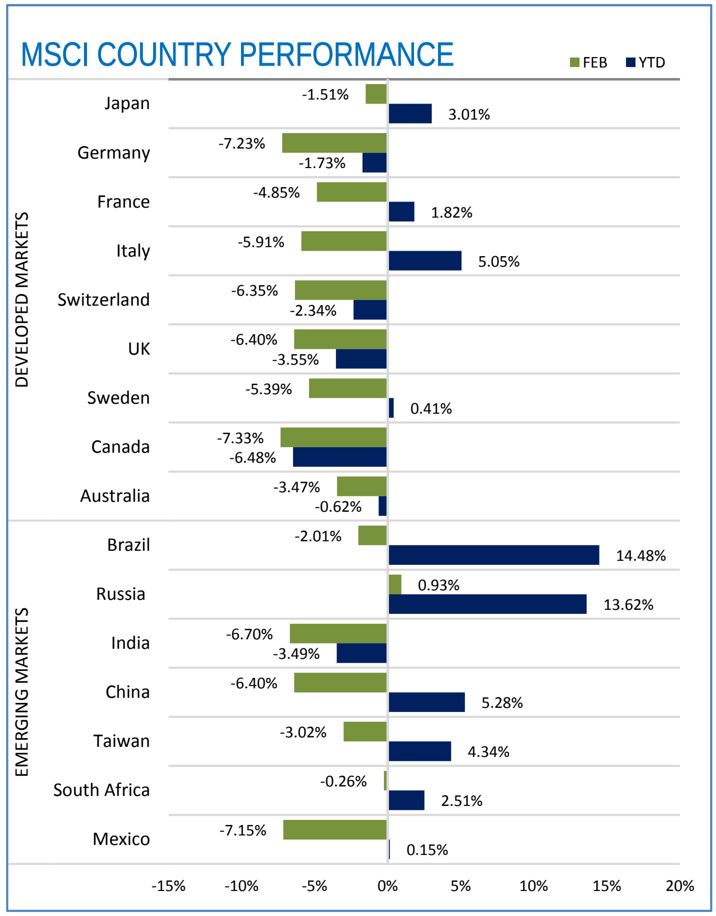
Russia's credit rating was upgraded by S&P Global Ratings for the first time since 2006. This moves Russia, one of the worlds largest energy exporters, back to investment grade after three years in junk status. S&P Global Ratings raised Russia's long-term and short-term credit ratings to 'BBB-/A-3' from 'BB+/B,' citing low debt levels, policy management and monetary flexibility.

THE CRYPTO CRAZE…

Officials of the Marshall Islands, a collection of more than 1,100 islands in the Pacific Ocean with a population of around 70,000, announced plans to issue its own cryptocurrency as an official legal tender. The digital currency, the Sovereign, will likely be issued later this year. This follows February's presale launch of Venezuela's cryptocurrency, the Petro.

GLOBAL EQUITIES: Rates & Inflation Spark Volatility & Declines





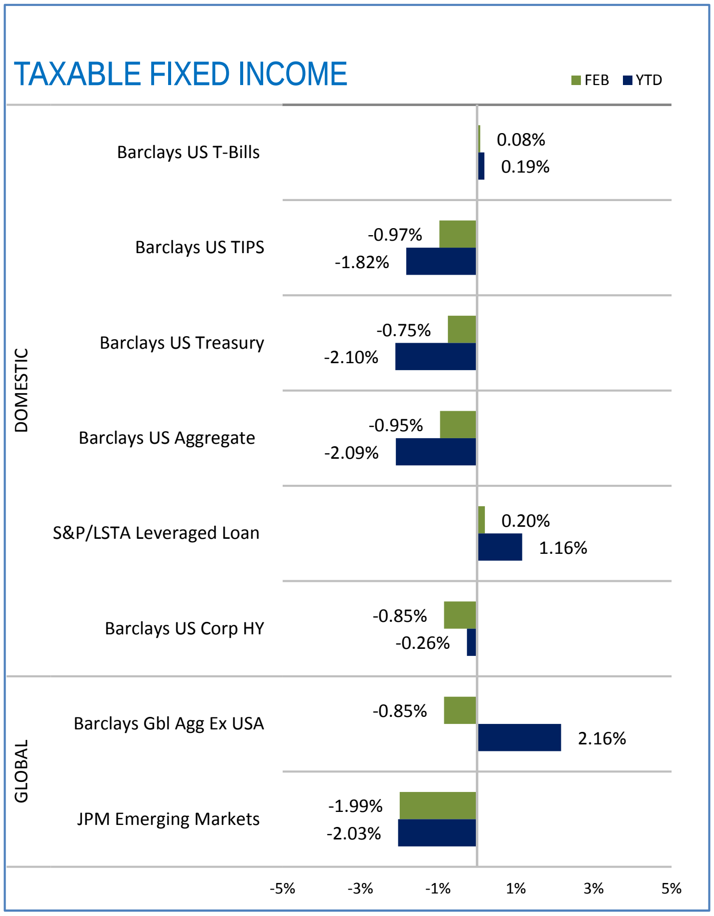
VOLATILITY COMES ROARING BACK

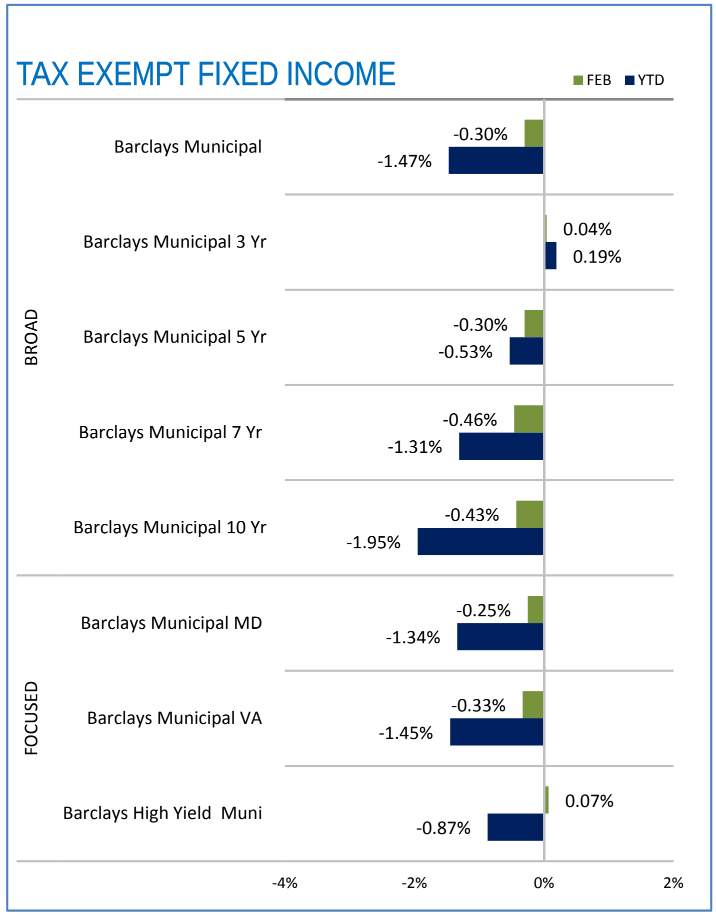
Volatility spiked and U.S. equities suffered large losses in February. The S&P 500 officially posted a "correction" on February 8th, as it declined 10.1% from its previous high. The index declined 3.69% for the month, it's worst monthly performance since January 2016. All U.S. equity indices, regardless of size or style, posted losses in February.

FOREIGN MARKETS OFFER NO SHELTER

Overseas markets provided little shelter from the equity declines in February. The MSCI EAFE Index fell 4.51% while the MSCI Europe index was down 5.88%. Emerging markets were also not immune to the spike in volatility and declines in February. The MSCI Emerging Markets Index fell 4.61% in February but is still up 3.34% YTD. Russia and Thailand were the only two emerging markets to end February with gains.

FIXED INCOME: Yields Move Higher Again





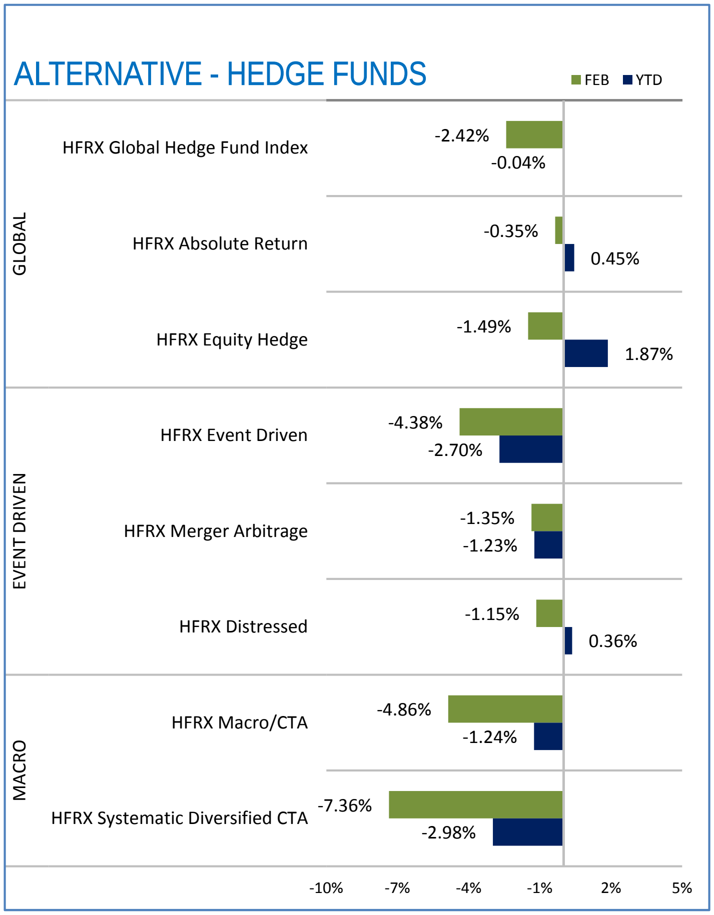
Yield Curve Shifts Upwards Again

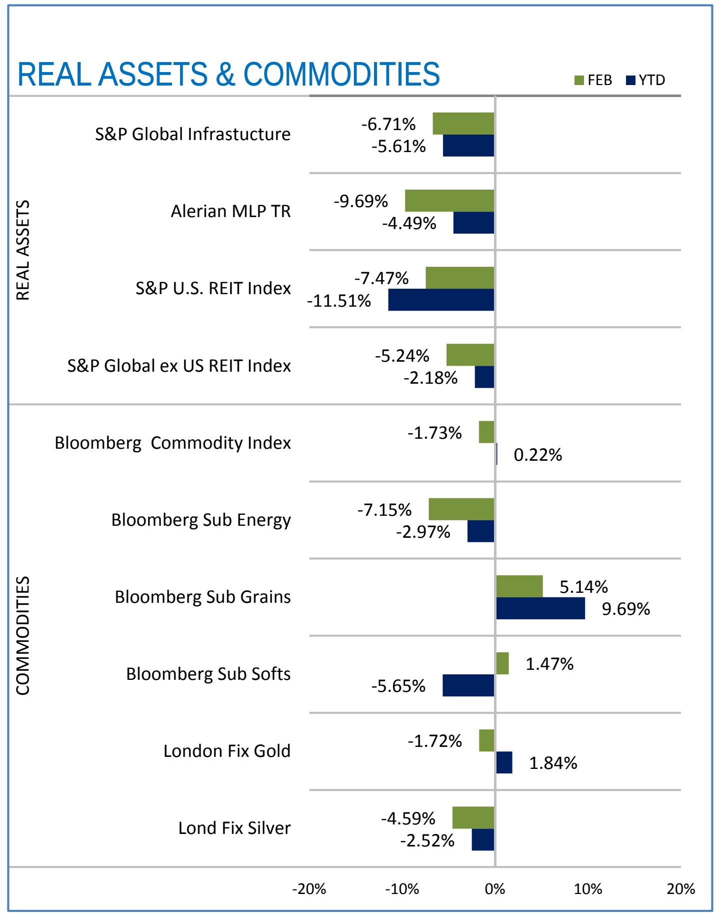
Treasury yields moved higher across the yield curve for a second consecutive month in February. The upward pressure on rates was due to a variety of factors, including stronger economic growth and higher inflation. The January employment report showed average hourly earnings rose 2.9%, while inflation rose 2.1%. These were both above consensus estimates, and along with potentially higher fiscal deficits, investors were concerned. The Barclays U.S. Aggregate Bond Index fell 0.95% in February and is now down 2.09% YTD. Higher Treasury yields pushed all investment grade bond sectors down for the month.

Higher Yields Push Munis Lower

Rising Treasury yields and a steepening municipal yield curve pushed returns into negative territory for the second month in a row. The longest segments of the curve underperformed the shortest maturities due to the steepening trend. The Barclays Municipal 3 Year Index gained 0.4% while the Barclays Municipal 10 Year Index fell 0.43%. There was little difference in the performance across investment grade categories as AAA's and BBB's performed similarly. However, additional credit risk benefitted high yield municipals, which gains 0.07% in February.

ALTERNATIVES: Real Assets Decline





The Trend Was No Friend In February

Hedge funds posted losses in February as interest rates rose and global equity markets posted steep declines. The HFRX Global Hedge Fund Index fell 2.42% for the month and is in negative territory now YTD. Global Macro strategies posted some of the largest declines. The HFRX Macro/CTA Index fell 4.86%, while the HFRX Systematic Diversified CTA Index fell 7.36%. CTA (commodity trading advisor) strategies follow trends in global financial markets and sharp reversals in equities and increasing interest rates negatively impacted performance.

For Real?

Despite the yield on the 10-year U.S. Treasury only rising 0.2% in February, REITs took it on the chin again. The S&P U.S. REIT Index fell 7.47% in February after a 4.37% decline in January. REITS have been hit by a perfect storm of bad news, as rising interest rates and rate expectations, along with slowing fundamentals have continued to worry investors. Other real asset categories such as listed infrastructure and master limited partnerships (MLPs) also fell sharply in February.