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INVESTMENT COMMITTEE MARKET COMMENTARY

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U.S. EQUITIES

U.S. equity markets were mostly higher as Congress passed a stopgap spending bill late Thursday that will prevent a government shutdown this weekend, and U.S. jobs data came in stronger than expected.

a) **Dow Jones +0.46%, MTD +0.30%, YTD +26.06%** b) **S&P 500 +0.39%, MTD +0.19%, YTD +20.72%**
c) **Russell 2000 -0.97%, MTD -1.42%, YTD +13.47%**

Drivers: I) **Nonfarm payrolls rose a stronger-than-expected 228,000** in November, following a 244,000 rise in October, which together more than reverse September's hurricane-depressed 38,000 increase. Payrolls were led by **outsized gains for manufacturing** at 31,000, construction at 24,000, and professional services at 46,000. These payroll gains are significant and support expectations for a strong fourth-quarter showing for the economy.

II) The demand for labor together with the **lack of supply of labor** have **yet to translate into wage inflation,** which instead remains subdued. Average hourly earnings rose by $0.05 or 0.2% to $26.55. **Wages are up only 2.5% year-on-year** which is better than October's level of 2.2%, but still not much of an improvement. Wages need to heat up and give a boost to overall inflation.

III) **Factory orders have had a solid year**, moving to roughly $480 billion per month and near a 3-year high. Year-on-year, **orders are up $17 billion or 3.7%.** Vehicle orders have been showing recent strength and reflect the rush of hurricane-replacement sales and the big contributor has been capital goods where annual gains are approaching 10%.

IV) The **Institute for Supply Management's index of service-oriented companies,** such as banks and retailers, **fell to 57.4% in November,** from a 12-year high of 60.1% in October. Economists played down the declines in the ISM's manufacturing and services indexes in November, noting that both are **still historically strong**. The two **ISM indexes are still consistent** with annualized **GDP growth of around 3.5%** according to Capital Economics.

V) **Equity prices in December are mixed with Large-Cap, Value, Financial and Consumer Staples leading equity price performance. The laggards for the month are Small-Cap, Growth, Telecom and Utilities.**

Capitalization: **Large Caps +0.17%** (YTD +20.55%), Mid-Caps +0.09% (YTD +17.53%) and **Small Caps -1.42%** (YTD +13.47). **Style: Value -0.62%** (YTD +11.06%) and **Growth -0.88%** (YTD +17.67%). **Industry Groups (Leaders):** Info. Tech -0.60% (YTD +36.62%), Tech -0.41% (YTD +33.19%), Healthcare -0.58% (YTD +21.82%), **Financials +1.75%** (YTD +21.80%), Industrials +0.31% (YTD +21.71%), Materials -0.24% (YTD +21.23%), Con. Discretionary +0.63% (YTD +20.66%), **Utilities -1.30%** (YTD +17.70%), **Con. Staples +0.96%** (YTD +11.54%) and REITs -0.77% (YTD +10.38%). **(Laggards):** Energy +0.22% (YTD -5.56%) and **Telecom -2.23%** (YTD -8.03%).

EUROPEAN EQUITIES

The MSCI Europe index was higher last week rising +0.49%. Traders were in positive mood after the UK reached a separation deal with the European Union, setting the stage to move on to future trade talks as the negotiations proceed.

Drivers: I) The Final third estimate of **third quarter gross domestic product** was up an unrevised 0.6% on the quarter and was up a marginally firmer **revised 2.6% on the year**. The quarterly rate was just 0.1 percentage points short of its second quarter rate, but the latter was slightly stronger than its weaker adjusted second quarter print.

II) In **Germany**, **October manufacturing orders** were **up a monthly 0.5%** following a sharper revised 1.2% gain in September. Orders have now **expanded in five of the last six months**. Annual unadjusted growth declined from 9.7% to 6.8%, but this was simply due to a particularly large monthly increase a year ago. The monthly gain reflected a 0.9% increase in capital goods and a 0.6% advance in consumer and durable goods.

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III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was higher by +0.49% for the week (MTD -0.69% YTD +22.79%).**

ASIAN EQUITIES

Asian markets though down for the week, ended on a positive note driven by Chinese trade data which beat expectations. The U.S. Congress passed a stopgap spending bill to keep the government funded until December 22. The Dow Jones Asia Index fell by -1.01% for the week, (MTD -1.05%, YTD +21.47%).

Drivers: I) In **Japan**, **third quarter gross domestic product** was revised upward to quarterly 0.6% growth from the initial estimate of 0.3% or at an **annualized pace of 2.5%** (initial estimate was 1.4%). The upward revision was mainly driven by **stronger, private non-residential investment**, which is now estimated to have grown by 1.1%, up from the initial estimate of 0.2%.

II) In **China, the November merchandise trade surplus widened** from $38.2 billion in October to $40.21 billion. Exports were up 12.3% from 6.9% in October on the year while imports increased to 17.7% from 17.2%. Exports grew at their fastest pace since March, reflecting stronger external demand in key markets.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was lower by -0.03% (MTD +0.38%, YTD +21.40%), the Hang Seng Index fell by -1.46% (MTD -1.84%, YTD +29.29%) and the Shanghai Composite was down by -0.83% (MTD -0.82%, YTD +6.00%).**

FIXED INCOME

Treasury yields were mostly higher last week, pushed higher by solid economic data and expectations that US tax legislation would be passed by the US Senate.

Performance: I) **The 10-year Treasury yield was higher last week ending at 2.375 up from 2.363%. The 30-year yield rose last week climbing from 2.763% to 2.767%.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays U.S. Aggregate Bond Index fell -0.03% last week, MTD +0.29% and YTD +3.36%. The Bloomberg Barclays U.S. MBS TR was down -0.11% last week, MTD +0.14% and YTD +2.28%. The Bloomberg Barclay's US Corporate HY Index rose by +0.13%, MTD +0.01% and YTD +7.19%.**

COMMODITIES

The DJ Commodity Index was lower by -2.90 last week, and is down month to date -1.83% (YTD +2.39%), as gold declined due to a rising USD. Industrial metals plummeted on concerns over a China slowdown of consumption.

Performance: I) **Oil prices dropped last week by -1.63%,** down to $57.34 and is lower month to date for December -0.10% (YTD +6.40%). Oil was lower last week due to recent data showing an **unexpectedly large rise in U.S. inventories** of refined fuels last week. Increasing output from U.S. shale continues to complicate OPEC efforts to rebalance markets, oil is still exposed to downside risks.

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **rose +1.08%** to 93.90 for the week (MTD +0.91%, YTD -8.28%). The U.S. dollar was **boosted by the passage of a tax reduction bill by the Senate** which still needs to be reconciled with a bill passed earlier by the House of Representatives.

III) Gold finished down for the week at its **lowest level in nearly five months**, as the U.S. dollar and stocks firmed in the wake of stronger-than-expected U.S. jobs data for November. Gold was down by -2.54% last week, dropping from $1283.1 to $1250.5 (MTD -2.05% YTD +8.55%).

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HEDGE FUNDS

Hedge fund returns in December are down for the month, as core strategies Equity Hedge, Event Driven, Distressed, Macro and Relative Value are all lower.

Performance:

I) The HFRX Global Hedge Fund Index is lower at -0.37% MTD and +4.83% YTD.
II) Equity Hedge is down -0.77% MTD but is up +8.01% YTD.
III) Event Driven has declined MTD -0.25% and is higher YTD +5.79%.
IV) Distressed Debt is lower by -0.02% MTD and is positive YTD +2.17%
V) Macro/CTA has fallen by -0.52% MTD and is up +1.14% YTD.
VI) Relative Value Arbitrage has declined by -0.05% and is higher by +3.16% YTD.

ECONOMIC DATA WATCH AND MARKET OUTLOOK

In a look forward to **next week**, the **Federal Reserve is expected to raise rates for a third and final time** this year. The rate hike which is nearly priced at 100% certainty, is being somewhat **ignored by the markets**, which are now **being driven higher by fundamental factors** instead of loose monetary policy. After a sell-off in equity markets prompted by a rotation out of technology, stock prices have recovered due to **solid economic data and stellar corporate earnings**. But investors should **keep vigilant watch** on the actual pace of interest rates hikes in 2018, as the market maybe be underestimating **Fed action next year**. According to the Fed funds futures market, investors expect only about two rate increases by the end of 2018.

The **Fed dot plot** is suggesting **rates** will be **raised four times next year**. Many economists project the Fed will deliver three rate hikes in 2018, as the US economy looks like it will post three straight quarters of plus 3.0% GDP growth. The **solid growth** should continue to **drive the unemployment rate lower**, and the **Fed** would like to **prevent** the economy from **over-heating.** But the Fed does not want to derail economic growth, and they will be **leery of driving rates up too fast** and bringing on an **unintended recession**.

In turning to next week's **economic calendar**, the **FOMC is the week's highlight** and is expected to be headlined by a **rate hike** and perhaps **warnings over the risks of inflation and asset bubbles**. The economy is at full employment and the Federal Open Market Committee appears guaranteed to raise its federal funds target for a third time as planned this year. Street economists see the **target rising 25 basis points** to a **range of 1.25 to 1.50%.** Quarterly FOMC forecasts will be of special interest and whether they reflect any early expectations for tax cut stimulus.

Wage inflation will be the focus of the JOLTS report on Monday amid high levels of job openings and lagging rates of hiring. At 4.1%, the unemployment rate is low and consistent with full employment which is also the signal from the JOLTS report where job openings have been running very strong, at 6.093 million in September. Street consensus for **October job openings is 6.100 million.**

The week's biggest **reading on inflation** will come on **Wednesday** with the **CPI report** where, the **core** is once again expected to **come in flat.** The core, which excludes food and energy, rose 0.2% with this yearly rate inching up 0.01% to 1.8%. Wireless service prices, which have fallen steeply this year, have been rebounding in recent months, but have been offset by **weak prices for vehicles.** For November, forecasters see the overall CPI rising 0.4%, with the lesser food and energy rate at 0.2%. **Year-on-year**, the **CPI is seen rising 2.2%** with the core at 1.8%.

The end of the week will see major releases with **November retail sales on Thursday** and the first definitive information on holiday shopping, industrial production on Friday and the first hard data on the November factory sector. Special interest will be paid to **department store and non-store data** to measure the success of Black Friday and Cyber Monday. Retail sales in November are expected to **rise 0.3% with ex-auto sales much higher at 0.7%**. Two core readings, less auto, gas and control group sales, are both expected to post solid increases of 0.4%.

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