INVESTMENT COMMITTEE MARKET COMMENTARY

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U.S. EQUITIES

U.S. equity markets ended the week higher, rallying for a sixth straight session showing underlying strength in the market. This may be an indication that inflation is not as great a threat as investors first made it out to be a few short weeks ago.

a) **Dow Jones +4.36%, MTD -3.31%, YTD +2.37%** b) **S&P 500 +4.37%, MTD -3.09%, YTD +2.46%**
c) **Russell 2000 +4.49%, MTD -1.93%, YTD +0.63%**

Drivers: I) The **consumer-price index rose 0.5% in January** to mark the largest increase in five months. The cost of rent, clothes, gasoline, health care and auto insurance all rose. Economists had forecast a 0.4% increase. Higher consumer prices in January, did not substantially alter the overall picture on inflation. The increase in the CPI over the **past 12 months remained unchanged at 2.1%.**

II) In taking a closer look at the **CPI data**, after **stripping out volatile gas and food**, the more closely followed core rate of inflation rose 0.3% last month. The **12-month rate** of core inflation was also **flat at 1.8%.** Inflation-adjusted U.S. wages declined by 0.2% in January.

III) Construction on new homes in the U.S., **housing starts**, **jumped almost 10% in January** to an annual rate of 1.33 million. This is the second highest level since the Great Recession and it easily exceeded the 1.24 million forecast of economists**. Permits to build new homes** also hit a **10 1/2-year high**, rising 7.4% to an annual rate of 1.4 million. Housing starts bounced back in January after a sharp decline in December due to poor weather.

IV) **Sales at U.S. retailers fell by 0.3% in January,** the largest drop in almost a year, due primarily to **declines at auto dealers** and home centers. And a previously reported increase in sales in December was wiped out. Economists had forecast a 0.2% increase in sales. Auto dealers got a boost toward the end of 2017 after a pair of major hurricanes damaged thousands of cars, but essentially the replacement cycle has run its course.

V) **Equities in February are lower with Small-Cap, Growth, Technology and Information Technology leading equity price performance. The laggards for the month are Large-Cap, Value, Energy and REITs.**

Capitalization: **Large Caps -3.01%** (YTD +2.31%), Mid-Caps -2.80% (YTD +0.86%) and **Small Caps -1.93%** (YTD +0.63). **Style: Value -2.52%** (YTD -1.19%) and **Growth -2.20%** (YTD +1.83%). **Industry Groups (Leaders):** Consumer Discretionary -2.75% **(**YTD +6.30%), **Info. Tech -1.78% (**YTD +5.54%), **Technology -1.82%** (YTD +5.13%), Financials -2.48% (YTD +3.81%), Healthcare -3.04% (YTD +3.39%), Industrials -3.08% (YTD +2.27%) and Materials -3.90% (YTD +0.02%). **(Laggards):** Telecom -3.13% (YTD -1.87%), Consumer Staples -3.84% (YTD -2.23%), Utilities -1.83% (YTD -4.82%), **Energy -9.00%** (YTD -5.61%), and **REITs -5.03%** (YTD -6.81%).

EUROPEAN EQUITIES

The MSCI Europe index was higher last week climbing 5.00% with equity indexes up four of five days. Markets tended to follow the U.S. lead in recovering lost ground as investors began to get more comfortable with rising bond yields and the potential for Federal Reserve to increase rates four rather than three times.

Drivers: I) Fourth quarter flash **gross domestic product** estimate was **up a quarterly 0.6%,** down from the third quarter rate of 0.7%. **On the year, GDP was up 2.7%** and similarly just below the previous period's 2.8%. The report showed another good period for three of the four larger members. On a quarterly basis, France and Germany both expanded 0.6% and Spain was up at 0.7%, while Italy (0.3%) slightly disappointed.

II) In the **UK**, **January consumer prices were down a monthly 0.5%** and up 3.0% on the year. The yearly rate has now posted 3.0% in four of the last five months. The main downward pressure on the monthly change in the yearly CPI rate came from transport which subtracted 0.04% points as fuel prices rose by less than in January 2017.

III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was higher by +5.00% for the week (MTD -3.82%, YTD +1.38%).**

ASIAN EQUITIES

Asian markets rebounded this week after last week's heavy losses shrugging off concerns about inflation and higher interest rates. At week's end, trading volumes remained thin as markets in China, Hong Kong, Indonesia, Malaysia, Singapore and Taiwan remained closed for the Lunar New Year holiday. The Dow Jones Asia Index rose by +2.35% for the week, (MTD -5.18%, YTD +0.95%).

Drivers: I) **In Japan**, equity markets staged a relief rally in Japan after the **government nominated Haruhiko Kuroda** to serve a second five-year term as **governor of the Bank of Japan**, a signal that **easy monetary policies will continue**. Kuroda's current term ends at the end of April. The appointment was interpreted as a sign of Premier Shinzo Abe's confidence in the governor's efforts to stimulate the economy out of stagnation.

II) In **Japan, annualized growth was 0.5%**, down from 2.5% in the three months to September. **On the year, GDP was up 1.6%** after increasing 1.9% in the previous quarter. Net exports and investment spending were the main factors driving weaker headline GDP growth in the three months to December. After boosting headline growth by 0.5% points in the three months to September, net exports did not contribute during the quarter reflecting a strong rebound in imports.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was higher by +1.58% (MTD -5.97%, YTD -4.58%), the Hang Seng Index climbed by +5.41% (MTD -5.43%, YTD +3.90%) and the Shanghai Composite was up by +2.21% (MTD -8.09%, YTD -3.27%).**

FIXED INCOME

Fixed income market yields were mostly up for the week after a strong inflation reading raised the outlook for the Federal Reserve to deliver more interest-rate hikes than bond buyers had expected.

Performance: I) **The 10-year Treasury yield was higher last week ending at 2.875 up from 2.854%. The 30-year yield fell last week dropping from 3.157 to 3.133%.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays US Aggregate Bond Index dropped by -0.21% last week, MTD -0.98% and YTD -2.12%. The Bloomberg Barclays US MBS TR was lower by -0.14% last week, MTD -0.73% and YTD -1.89%. The Bloomberg Barclay's US Corporate HY Index was higher by +0.80%, MTD -1.07% and YTD -0.48%.**

COMMODITIES

The DJ Commodity Index was higher by +3.09 last week and is down month to date -1.73% (YTD +0.86%), led by a rally in energy which rose based on expectations of increased demand and metals that climbed higher as the USD declined.

Performance: I) The price of **oil rallied last week up +4.33%** to $61.61 and is lower month to date in February -4.82% (YTD +2.51%). Oil prices rose last week, regaining some of the ground lost since late January as traders weighed **demand expectations** versus worries over rising U.S. shale oil output.

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **fell -1.37%** from 90.32 to 89.08 for the week (MTD -0.06%, YTD -3.49%). The U.S. dollar dropped this week after data showed a decline in U.S. retail sales and industrial production, accompanied by reports showing higher consumer and producer prices.

III) **Gold posted its sharpest weekly gain** in more than a year, as the dollar extended a month-long slump. Gold was higher by +2.37% last week, rising from $1318.1 to $1349.4 (MTD +0.47%, YTD +3.39%).

HEDGE FUNDS

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

Performance:

I) The HFRX Global Hedge Fund Index is lower at -1.17% MTD and +1.24% YTD.
II) Equity Hedge is down -0.83% MTD and is up +2.55% YTD.
III) Event Driven has declined MTD -1.18% and is higher YTD +0.56%.
IV) Distressed Debt is lower by -0.49% MTD and is positive YTD +1.02%
V) Macro/CTA has declined by -2.78% MTD and is up +0.92% YTD.
VI) Relative Value Arbitrage has dropped by -0.40% and is higher by +0.69% YTD.

ECONOMIC DATA WATCH AND MARKET OUTLOOK

As we look ahead to next week's trading session, investors will come back from the President's Day holiday knowing **US equity markets** had just completed one of the **strongest upside weeks in years**. Yet market participants are still **concerned about markets** that are susceptible to a technical correction of -10.0%, which over-rode and ignored solid fundamentals. This was a blunt reminder to investors that **complacency, leveraged/derivative products and crowded positions** can **lead to a swift and ugly unwinding of positions**. Fortunately, the global back drop of strong economic growth and **solid corporate earnings are still with us.**

Undeniably, the **fourth-quarter earnings season** has been **very strong**. According to FactSet, with about **400 S&P 500 companies having reported** results, **75% have beaten on profits and 78% on sales estimates**. Whether the stock market fully regains confidence in earnings and the economy will become clearer over the next few weeks. It will depend on the market's on-going perception of higher inflation and interest rates, which could cause problems for households and corporations with high debt levels. A forced de-leveraging would have a deleterious effect on risk assets.

In turning to **next week's economic calendar**, all eyes will focus entirely on Wednesday and Thursday. **Existing home sales will be posted Wednesday** morning and are expected to extend their uneven climb. Existing home sales have been choppy, but did finish 2017 on the uptrend. But the number of homes for sale are at a 19-year low which should limit January's sales results. Against December's 5.570 million annualized rate, **a 5.650 million rate is January's consensus.**

On **Wednesday afternoon** we will have the **release of FOMC minutes** that will be the week's highlight. The minutes cover the **meeting in January** when the Fed raised their assessment of inflation in a move that was soon followed by the stock market selloff. FOMC members **turned up inflation concerns** in their January statement, essentially saying they **expect inflation to move up and stabilize around 2.0% this year**. Closely watched in the minutes will be the debate on inflation and especially wage pressures and any clues whether members, have already set **expectations for three rate hikes this year**, while **discussing the possibility of a fourth**

On **Thursday,** we will get **jobless claims and the index of leading economic indicators** which may get a boost from the stock market that, despite the sell-off, still ended last month with a strong gain. **Initial claims** are expected to come in at **230,000** in the February 17 week which would be **unchanged** from the prior week. Claims have been low and consistent with minimal layoffs and strong demand for labor.

Despite all the turbulence, January was still a positive for the stock market which looks to contribute solidly to the month's index of leading economic indicators. Outsized strength in ISM new orders will be a key positive as will the month's decline in jobless claims. **January's call for the LEI is a very strong 0.6% gain.**