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INVESTMENT COMMITTEE MARKET COMMENTARY

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U.S. EQUITIES

U.S. equity markets closed lower last week on thin trading due to the holidays, and new geo-political concerns that Russia may have supplied fuel to North Korea over the past few months. But overall the major US indexes closed within a percent or two of their recent all-time highs.

a) **Dow Jones -0.14%, MTD +1.92%, YTD +28.11%** b) **S&P 500 -0.33%, MTD +1.11%, YTD +21.83%**
c) **Russell 2000 -0.42%, MTD -0.40%, YTD +14.65%**

Drivers: I) The major market indexes were lower last week, but the S&P 500 and DJIA closed within 1.0% of record levels, while the NASDAQ was within 2.0%. All three indices posted their best year since 2013, and the Nasdaq rose for its sixth straight year, its longest such streak since the period 1975 to 1980.

II) The **major surprise in 2018** was the **equity market's** ability to **shrug off geo-political and economic uncertainty**, thus avoiding any major correction or spikes in volatility. According to the WSJ Market Data Group, the **S&P 500 absolute daily percentage change was 0.30%**, which is the **lowest level seen in 53 years**. On a monthly basis, the S&P 500 volatility level was lower than any other year since 1970.

III) The **S&P/Case-Shiller national index rose** a seasonally adjusted 0.7% in the three-month period ending in October. It was **up 6.2%** compared to the same period a year ago. Prices rose in more than half of the largest U.S. markets, led by San Francisco and Las Vegas, reflecting once again the high cost of U.S. housing, especially in tech dominated areas. The Case-Shiller national index is now 6% above its prior year-to-year peak.

IV) **Consumer confidence fell in December**, a month after hitting a 17-year high, **but the level of optimism** among Americans this year was the **highest since 2000**. The index slipped to 122.1 this month from a revised 128.6 in November, the Conference Board said Wednesday. Despite the decline in confidence, consumers' expectations remain at historically strong levels, suggesting economic growth will continue well into 2018.

V) **Equity prices in December are higher with Large-Cap, Value, Consumer Discretionary and Energy leading equity price performance. The laggards for the month are Small-Cap, Growth, Healthcare and Utilities.**

Capitalization: **Large Caps +1.11%** (YTD +21.69%), Mid-Caps +0.93% (YTD +18.52%) and **Small Caps -0.40%** (YTD +14.65). **Style: Value** +**0.29%** (YTD +12.08%) and **Growth -0.30%** (YTD +18.37%). **Industry Groups (Leaders):** Info. Tech -0.11% **(**YTD +37.29%), Tech +0.40% (YTD +34.27%), Materials +2.01% (YTD +23.96%), Industrials +2.07% (YTD +23.85%), **Con. Discretionary +2.38% (**YTD +22.77%), Financials +1.95% (YTD +22.03%), **Healthcare -0.67%** (YTD +21.70%), Con. Staples +2.19% (YTD +12.91%), **Utilities -6.13%** (YTD +11.94%) and REITs -0.51% (YTD +10.67%). **(Laggards): Energy +5.04%** (YTD -1.01%) and Telecom +0.30% (YTD -5.55%).

EUROPEAN EQUITIES

The MSCI Europe index was higher last week rising by +1.19%, and ended with its best annual showing since 2013. Though returns hit multi-year highs, European equities lagged other major markets due to the strength of the euro that rallied 14.0% against the USD, which was a drag on exports.

Drivers: I) The **2017 gain for European stocks** stemmed from a combination of **stronger earnings** coming through because operational leverage finally kicked in, and the **macro data being stronger**. Big earnings beats came from auto makers, luxury goods and mining and construction companies. Standouts within the European equity markets this year included the German DAX which hit an all-time high with a 13% rise for the year.

II) **The European Central Bank upgraded** the 2017 forecast for eurozone **GDP growth to 2.4%,** supported by record high readings in business sentiment surveys, notably in France and in powerhouse Germany, and fading worries about a rising tide of populism underscored the bullish views held by banks. A **six-year high in the eurozone manufacturing PMI** and the best reading in Germany's Ifo business climate index since 2011.

III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was higher by +1.19% for the week (MTD +1.51%, YTD +25.51%).**

ASIAN EQUITIES

Asian markets ended the year on a positive note, as the region was led by the sharp rise in the Nikkei posting its biggest gain since 2013, helped by a price surge from September to November. The Dow Jones Asia Index rose by +0.76% for the week, (MTD +2.40%, YTD +25.71%).

Drivers: I) The **Bank of Japan published the minutes** of the meeting of the **Monetary Policy Board** held October 30 and 31. At this meeting, members of the MPB left policy settings unchanged, keeping the short-term rate for excess reserves at minus 0.1% and retained the target level for the 10-year government bond yield at around 0%. Members also concluded that **maintaining the BoJ's purchases of government bonds** at an annual pace of Y80 trillion **would be appropriate** to meet their 10-year yield target.

II) **Household spending in Japan**, in real terms, **rose 1.7%** on the year in November after no change in October. Spending, in seasonally adjusted real terms, increased 2.1% on the month in November after falling 2.0% in October. The increase in headline year-on-year growth in November largely reflects **stronger spending on food**. This grew 2.2% in real terms on the year in November after no change in October. Spending on fuel, light and water charges also rebounded strongly, up 2.5% on the year in November after dropping 2.7% in October.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was lower by -0.46% (MTD +0.32%, YTD +21.33%), the Hang Seng Index rose by +1.18% (MTD +2.45%, YTD +34.94%) and the Shanghai Composite was higher by +0.31% (MTD -0.30, YTD +6.56%).**

FIXED INCOME

Treasury yields were lower last week as the overall expectations for inflation remained muted.

Performance: I) **The 10-year Treasury yield was lower last week ending at 2.410 down from 2.484%. The 30-year yield fell last week declining from 2.883% to 2.743%.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays US Aggregate Bond Index climbed +0.51% last week, MTD +0.46% and YTD +3.54%. The Bloomberg Barclays US MBS TR was up +0.36% last week, MTD +0.33% and YTD +2.47%. The Bloomberg Barclay's US Corporate HY Index rose by +0.21%, MTD +0.30% and YTD +7.50%.**

COMMODITIES

The DJ Commodity Index was higher by +3.05 last week and is up month to date +2.97% (YTD +4.36%), as energy and industrial metals rallied on increases in demand and decline in the US dollar.

Performance: I) **The price of oil rose last week by +3.00%** up to $60.10 and is higher month to date for December +4.70% (YTD +11.52%). Oil rose as the market has improved amid optimism about years of **oversupply finally ebbing**, capped by rising demand. The production-limit deal, led by the Organization of the Petroleum Exporting Countries, is being extended through 2018.

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **fell -1.09%** from 93.32 to 92.30 for the week (MTD -0.80%, YTD -9.84%). The U.S. dollar ended the year on the downside, as the greenback suffered its **first annual setback since 2012**. The dollar decline was caused by the convergence of global economic growth, and expectations that the BOJ and ECB would soon follow the Fed in reducing ultra-accommodative monetary policies.

III) Gold finished up the year at a three-month high, prompted by a decline in interest rates and the USD. Gold was up by +2.03% last week, rising from $1279.1 to $1305.1 (MTD +2.22%, YTD +13.29%).

HEDGE FUNDS

Hedge fund returns ended the year in positive territory, as all core strategies Equity Hedge, Event Driven, Distressed, Macro and Relative Value are all higher for the month.

Performance:

I) The HFRX Global Hedge Fund Index is higher at +0.73% MTD and +5.99% YTD.
II) Equity Hedge is up +1.11% MTD and is up +10.06% YTD.
III) Event Driven has advanced MTD +0.28% and is higher YTD +6.36%.
IV) Distressed Debt is higher by +0.95% MTD and is positive YTD +3.17%
V) Macro/CTA has risen by +0.77% MTD and is up +2.45% YTD.
VI) Relative Value Arbitrage has advanced by +0.71% and is higher by +3.85% YTD.

ECONOMIC DATA WATCH AND MARKET OUTLOOK

As we enter the **New Year of 2018**, the **global economy** is poised to continue a **synchronized above trend economic growth**, last seen in 2004. Since the middle of 2017, we have seen an acceleration of global growth to an annualized 3.7%, propelled by solid hard economic and sentiment data which has helped to greatly improve financial conditions. The positive economic momentum leads us to believe there can be upside surprises regarding growth for 2018, led by the long-awaited **increase in CAPEX**, the continued **decrease in unemployment** and the expected rise in wages due to the declining slack in the global job market.

Investors are sadly leaving the "goldilocks" environment seen in 2017, that helped virtually every asset class post a positive return in 2017. This puts us the unenviable position of **trying to find cheap assets to invest in**, while traversing global markets that will be subject to **greater volatility**, due to **divergence central bank policy** and **geo=political uncertainty**. Corporate earnings should remain robust, supported by solid global GDP growth, interest rates should begin their normalization process, and inflation should edge higher as global labor markets will continue to tighten. Risk assets such as equities will be preferred over fixed income.

Within the **projected investment environment, selective and active management will be key**, as **global equities** should provide a **low double-digit return**, value can be found in **securitized credit**, developed market sovereign debt should lag, IG and HY bonds will provide income, but experience less spread compression. Commodities will be mixed, while hedge funds and real assets can serve to lower equity beta and serve as a fixed income surrogate, insulting portfolios from interest rate and duration risks.

In turning to **next week's economic calendar**, we will get data on December auto sales, the ISM surveys, and several other indicators in addition to Friday's December employment report. On Tuesday, the **Markit manufacturing PMI**'s headline composite is projected to **come in at 55.0** in the final December report, **unchanged from the flash reading** for the month and up 1.1 relative to the final figure reported for November. Revisions to the headline figure have tended to be very small in recent years.

For Wednesday, the composite for the **ISM manufacturing survey** is estimated to **decline 0.7 to 57.5** in December. The ISM survey has been stronger than the PMI survey in recent months, and economists believe that the ISM survey could move down to narrow this gap. But regional manufacturing survey data available for December signal that we should not see much deterioration in the ISM data during the month.

Also on Wednesday, the **December estimate for light vehicle sales is 17.7 million units** based on available industry guidance. This would be **below the paces of sales** reported for both September and October when activity **was boosted as a result of the earlier hurricanes**, but otherwise would be the strongest month for sales of 2018 and would stand as one of the highest figures reported so far in the expansion.

On Friday, the **forecast for nonfarm employment** is an **increase to 175,000** in December while the **unemployment rate held at 4.1%.** Recent initial jobless claims data signals little change in the labor market relative to the past few months. Tightening labor market conditions should keep upward pressure on **wages**, but they **should hold at 2.5%** in December.