CIO View

Monthly Strategy Snapshot

November 2019

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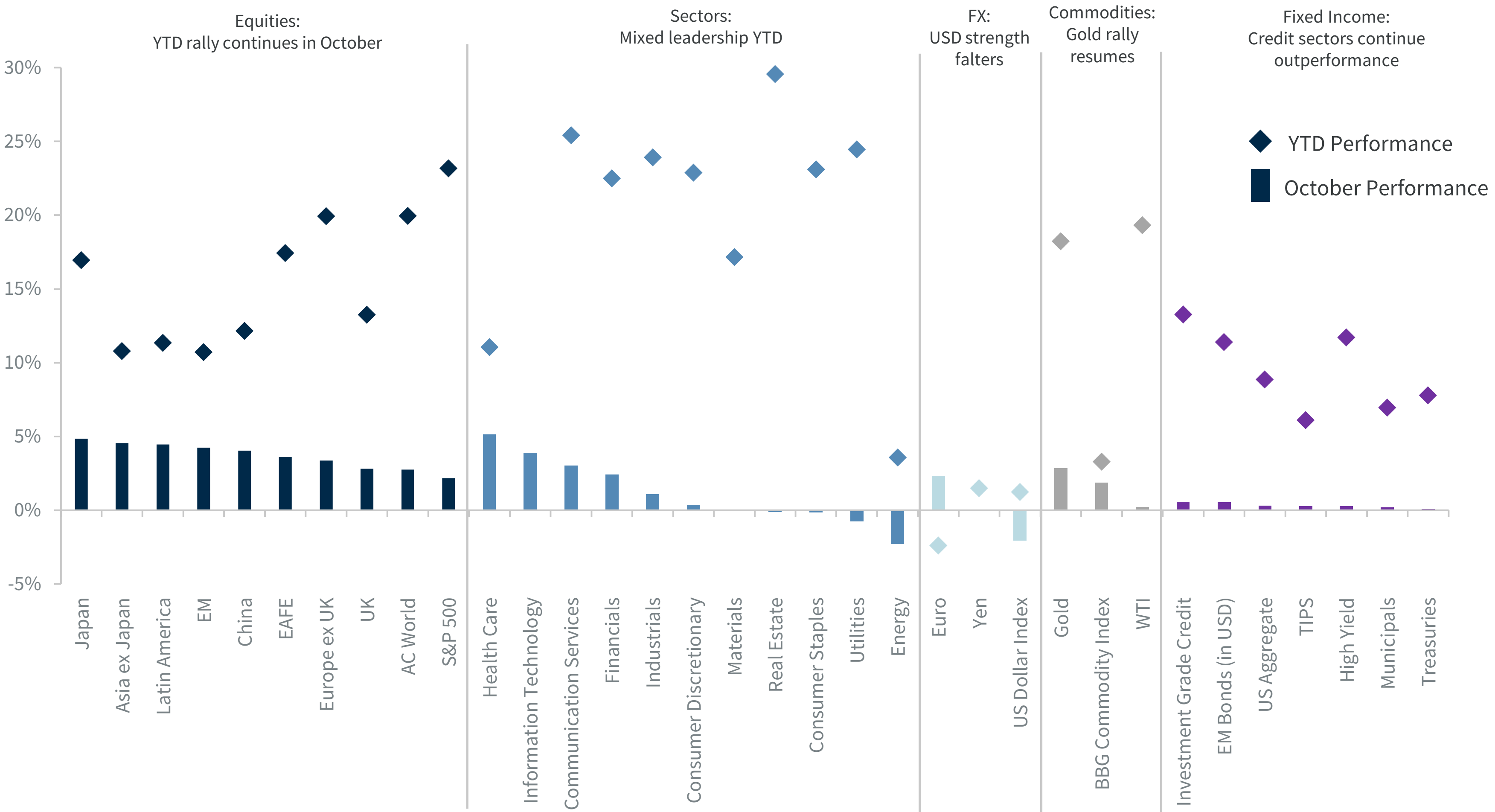
Returns By Asset Class | October and Year-to-Date

Returns by Asset Class | Risk assets rebound in October and continue outperformance YTD



Data as of October 31, 2019. All international equity indices are MSCI indices and in USD. Diamonds represent year-to-date, total returns and bars represent monthly, total returns.

Global Economy | A Mixed Bag, But US Remains the Pillar of Strength

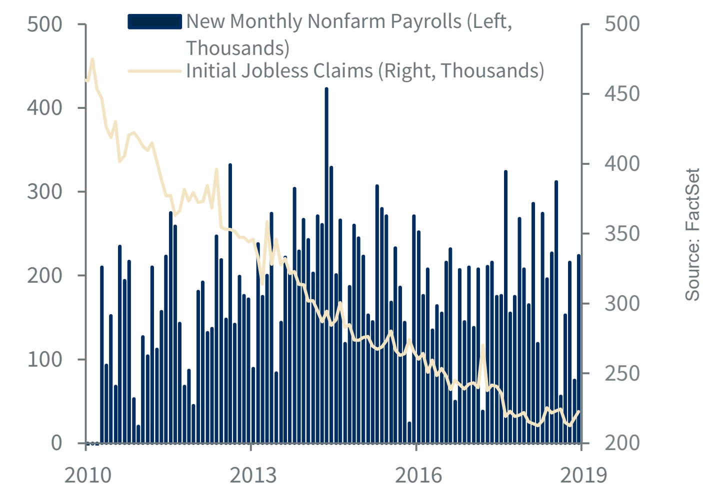
Global Economy | Recent Trends

- **The global economy remains under significant pressure** as showcased by the International Monetary Fund's (IMF) recent projections, which forecast that the global economy will only grow by 3% in 2019 (down from 3.2% in April), its lowest level since the financial crisis. Chief amongst the factors cited by the IMF are the headwinds posed by tariffs and trade uncertainty, which has hampered business confidence and investment spending.
- Amidst the slowing global economy, **the US labor market continues to remain solid** with jobless claims (218,000 as of October) and unemployment (3.6%) still near multi-decade lows.
- **3Q19 US GDP growth (1.9%) was robust and approximately inline with the last quarter (2Q19 GDP: 2.0%)** though off the high notched at the beginning of the year (1Q19: 3.1%). Residential investment offset a second consecutive quarterly decline in business investment, while consumer spending remained robust (albeit modestly lower than last quarter).
- Following its recent dip, **US Manufacturing** rebounded modestly, but remains in contraction.
- Meanwhile, **Chinese economic growth** slowed to 6%, a new all-time low. However, the Caixin **Chinese Manufacturing Purchasing Managers Index (PMI)** rebounded into expansion after its decline into contraction earlier this year.

Global Economy | 12-Month Outlook

- While the **US economy** (2019 estimate: 2.2%) is projected to decelerate relative to its robust annual pace in 2018 (2.5%), it should grow above potential with muted recession risk in 2019. The current economic expansion is the longest on record (125 months).
- Driving 2019 US economic growth is solid consumer spending and continued tailwinds from fiscal stimulus (e.g., increased spending due to tax cuts and government spending).
- The **US remains the bright spot** in the developed world as US consumer strength (~15% of global economy) continues to drive economic growth despite elevated global headwinds.
- Our expectation is the **Fed will refrain from cutting interest rates again at its December meeting**, baring further economic deterioration.
- **Political** (e.g., Brexit, France, Italy, etc.) and **trade concerns** will continue to hamper European economic prospects. After cutting interest rates and re-instituting its QE program (€20 billion/month), the ECB is likely to ease policy further if inflation remains muted.
- Despite trade headwinds, **emerging market growth** should benefit from a stabilization in the US dollar and the potential for easing fiscal and monetary policy (e.g., interest rate cuts and/or reserve requirement cuts).

US Unemployment Remains Near Record Low



Chinese Growth Slows to Record Low

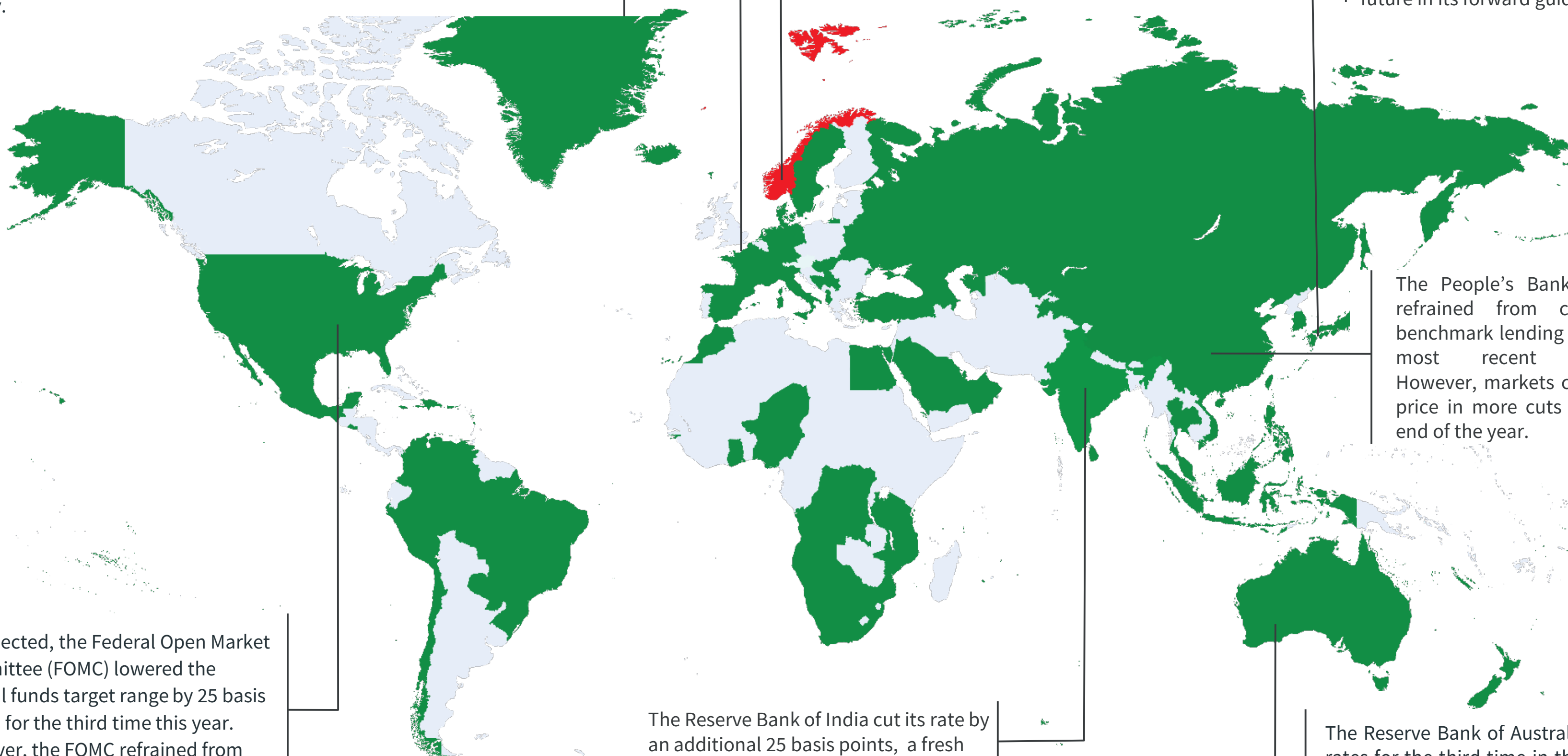
Global Economy | Global Easing Cycle Gains Momentum

Global Economy | Global Central Banks Turn More Dovish

The European Central Bank (ECB) refrained from cutting its deposit facility, leaving it at -0.50%. The ECB also formally began its asset purchase program (purchasing €20 billion per month). ECB President Mario Draghi relinquished the reins of the central bank to his successor, Christine Lagarde, who is expected to continue the ECB's accommodative approach to monetary policy.

Norway's central bank held its benchmark lending rate unchanged at 1.50% following a recent hike in September.

The Bank of Japan left interest rates unchanged at its most recent BoJ meeting, but signaled its willingness to cut rates in the future in its forward guidance.



The People's Bank of China refrained from cutting its benchmark lending rates at its most recent meetings. However, markets continue to price in more cuts before the end of the year.

As expected, the Federal Open Market Committee (FOMC) lowered the federal funds target range by 25 basis points for the third time this year. However, the FOMC refrained from committing to further cuts.

The Reserve Bank of India cut its rate by an additional 25 basis points, a fresh low for the central bank.

The Reserve Bank of Australia cut rates for the third time in the last five months. This cut of 25 bps lowered the cash rate to 0.75%.

Equities | Trade Optimism, Fed Lift Markets

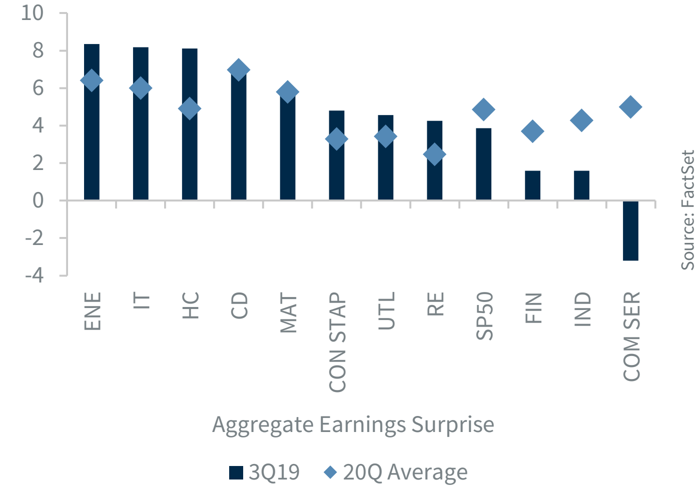
Global Equities | Recent Trends

- Despite the continued slowdown in global economic momentum and uncertainty surrounding US/China trade, **equity markets around the world rebounded in October.**
- **The S&P 500** rallied to a new all-time high on the back of renewed trade optimism, a dovish Federal Reserve (Fed) and supportive seasonality. However, much of the trade optimism lifting markets higher is predicated upon a continuation of constructive dialogue between the US and China and the completion of “Phase One” of the potential trade deal.
- **Better than expected 3Q19 earnings** have also supported the recent rise in US equities as **73% of S&P 500 companies beat EPS estimates**, with the strongest beats seen in more cyclical sectors. While earnings have come in better than expectations at the start of the quarter, the S&P 500 is on pace to post its first YoY EPS decline since 2Q16 in 3Q19.
- Despite increased headwinds as a result of protests (Hong Kong, Chile, etc.) and economic sanctions (Turkey), **Emerging Markets modestly outperformed** the S&P 500 through October on the back of easing dollar strength and building trade optimism. **Developed Markets** largely kept pace with the US in the wake of easing Brexit concerns.

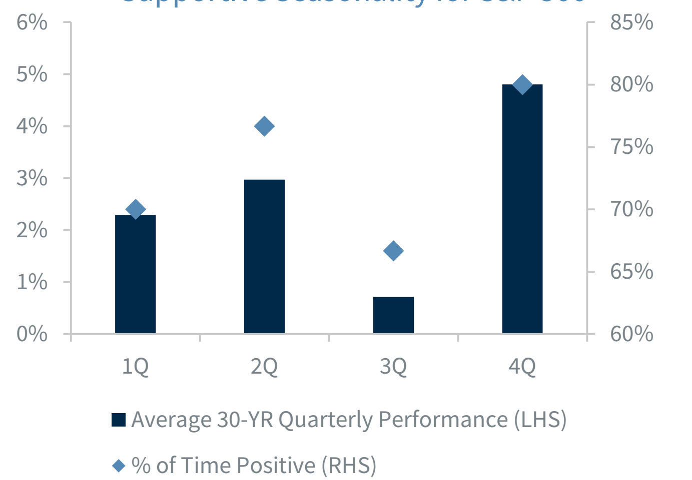
Global Equities | 12-Month Outlook

- Despite sharp positive performance year-to-date, we continue to see modest upside for the S&P 500 although **the risk/reward for US equities is becoming less attractive** as we are within ~2% of our next 12-month S&P 500 target (3127). However, given both positive near and longer-term seasonality (fourth quarter and fourth year of a presidential cycle) and our expectation of positive earnings growth (2020 earnings estimate: $173) with muted recession risk, we would continue to use periods of weakness as a buying opportunity.
- We remain biased to **cyclical sectors** (vs. defensive sectors) based on stronger earnings growth, valuations, dividend growth, and buybacks. Our favorite sectors include **Technology, Communication Services and Health Care.**
- The **US is favored over other developed regions** (specifically Europe and Japan) based on better earnings growth, favorable sector composition, and less political uncertainty (especially relative to Europe given Brexit, and political concerns in France and Italy).
- **Emerging-market equity regions**, particularly Asia, are attractive based on valuations and positive sector composition. EM has more monetary policy flexibility (e.g., China reserve requirement cuts), more fiscal flexibility (e.g., tax cuts) and should benefit if a US/China trade deal is consummated. However, trade uncertainty remains the biggest risk for global equities.

Cyclicals Seeing Strongest Earnings Beats



Supportive Seasonality for S&P 500

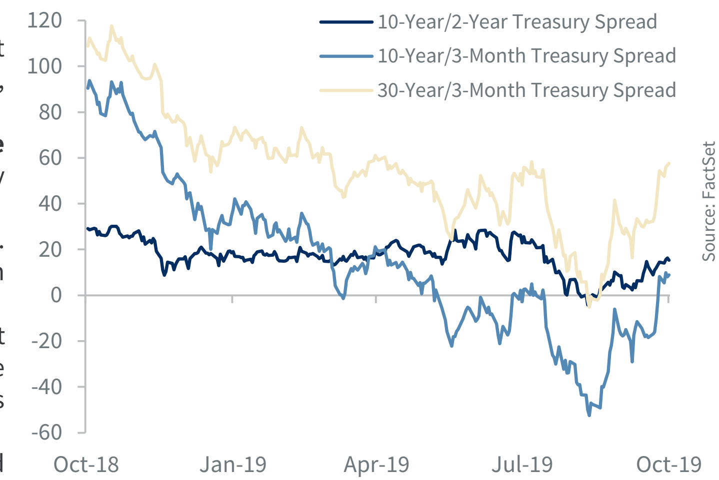


Fixed Income | Long-Term Yields Rise

Global Bonds | Recent Trends

- As US economic fundamentals were resilient and recession fears waned in October, **longer duration Treasury yields (10-Year Treasury: 1.69%) rose** for the second straight month.
- **As longer duration yields rose, the US Treasury yield curve steepened** throughout October, leading the spread between key Treasury yields (10-year/2-year, 10-year/3-month, and 30-year/3-month) out of inversion territory to three-month highs.
- As widely expected, **the Federal Reserve (Fed) cut its benchmark rate for the third time this year by** 25bps to 1.50%-1.75%, which fueled the decline in short-term US Treasury yields. However, the Fed refrained from committing to any further future rate cuts.
- Consistent with US Treasury yields, **long-term European yields rose** through October. Though they remain in negative territory, both the 10-year German (-0.42%) and French (-0.11%) benchmark yields rose to their highest levels in three months.
- Both the **European Central Bank (ECB) and Bank of Japan (BOJ) held rates unchanged** at their October policy meetings. ECB President Mario Draghi relinquished the reins of the central bank to his successor, Christine Lagarde, who is expected to continue the ECB's accommodative approach to monetary policy.
- While Treasury yields rose during the month, resilient economic fundamentals pushed investment-grade spreads to the lowest level intra-month in 12 months in October.

US Spreads Widen as Curve Steepens



Global Bonds | 12-Month Outlook

- The 10-year Treasury yield **is expected to be range bound around 1.40%** over the next 12 months as factors supporting higher yields such as above-trend US economic growth and rising deficits are offset by central bank easing, slowing global economic growth, an aging population, and increased foreign demand due to the relatively elevated US Treasury yields.
- Given that we expect Treasury yields to remain range bound and a fairly stable yield curve into year end, we recommend a **neutral benchmark duration** for bond portfolios.
- While less attractive relative to their value earlier in the year, **investment-grade bonds** remain supported by above-trend economic growth and a continued appetite for yield.
- We are cautious on **high-yield bonds** and recommend an active money manager in this space. The biggest near-term risk is the potential for Baa bonds to be downgraded from investment grade to high yield. More supply in high yield serves as a headwind.
- **EM bonds** remain attractive given spread levels and the expectations that strong EM growth and a stabilization of the dollar will lead to spread narrowing. A trade compromise could lead to additional fund flows that should support EM bonds.

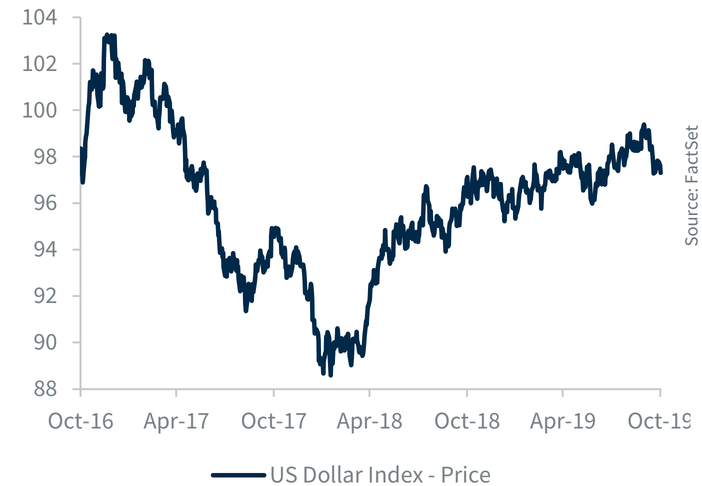
Investment Grade Spreads Narrow

Commodities & Currencies | US Dollar Falls Amidst Dovish Policy

Commodities & Currencies | Recent Trends

- In anticipation of further easing by the Federal Reserve (Fed) and narrowing interest rate differentials, the **US dollar posted the worst monthly decline** since January 2018.
- Renewed **strength in the British pound** was driven largely by the avoidance of a no-deal Brexit outcome. Following another failed Brexit vote in the UK Parliament, the EU extended the Brexit deadline from October 31 to January 31. Prime Minister Boris Johnson has called new elections (due to take place on December 12). A no-deal Brexit appears to be off the table for now, which should continue to support the pound.
- Given that the ECB held rates unchanged (while the Fed cuts rates) and optimism surrounding Brexit rose, **the euro** strengthened to the highest level in two months.
- Though still off its September high, the **Bloomberg Commodity Index** rose through October as a result of a weaker dollar and increased optimism surrounding a US/China trade deal.
- Despite the increase in global interest rates and positive risk asset performance, **gold prices modestly rose in October to back above the key $1,500/oz level** as muted inflation pressures and the third Fed rate cut of this easing cycle supported the precious metal.
- **Oil prices were relatively flat in October**, as supportive factors such as a weaker dollar and trade optimism were offset by softer global demand and rising US production.

US Dollar Index Declines



Commodities & Currencies | 12-Month Outlook

- **Crude oil likely has upside into year end** (year end WTI target: **$70/barrel**) as the extension of the OPEC production cut coupled with increased geopolitical risk (i.e., Venezuela, Iran and Libya) and a rebound in global demand should be supportive of oil prices.
- However, the expected increase in US production (the EIA expects US oil production to rise to 12.6 million barrels per day by year end 2019) should keep the rise in **oil prices contained**.
- **New emissions standards** for global marine transportation (e.g., large tankers), expected to go into effect in January 2020, present a potential upside catalyst for oil as 'sour' oil will need to be replaced by cleaner 'sweet' oil.
- While the **dollar** will continue to be supported by stronger US economic growth and wide interest rate differentials (from a historical perspective), a more 'dovish' Fed, the deterioration of the current account, slowing foreign direct investment, and the fading of repatriation of foreign profits will weigh on the dollar.
- As a result, we **expect the dollar to remain range bound** and decline only modestly from elevated current levels to 1.10 against the euro over the next 12 months.

British Pound Rallies on Brexit Optimism

Summary | Views and Key 2019 Year-End Targets

1 ECONOMY

2019 USGDP: +2.2%

2020 US GDP: +1.7%

US economic growth is expected to remain relatively robust (above trend) with only a small probability of recession. Fundamental activity is near or at record levels. 'Insurance' Fed cuts should help extend the longest expansion in the history of the US.

2 BOND MARKET

2019 10-Year Treasury: + 1.60%

12-Month 10-Year Treasury: + 1.40%

We do not forecast a material rise in interest rates from current levels due to declining inflation expectations, increasing global demand and positive demographic conditions. Continue to favor investment-grade and EM bonds over high-yield bonds.

3 EQUITIES

2019 S&P 500: 3053

12-Month S&P 500: 3127

Continued economic growth, solid earnings, and low interest rates support equities. We favor US and EM equities over other developed nations. Favorite sectors include Technology, Health Care and Communication Services.

4 DOLLAR DIRECTION

EUR/USD: 1.10

The dollar will likely remain range bound as stronger US economic growth along with higher US interest rates offset headwinds from a worsening current account balance and weakening foreign direct investment.

5 OIL

WTI: $70/bbl

While crude oil declined on trade uncertainty, strong global demand, continued OPEC production cuts, and new global emission standards for marine transportation should continue to place upward pressure on oil prices.

6 INCREASED VOLATILITY

Volatility: ↑

Expectations for an uptick in volatility as a result of continued policy uncertainty and an emphasis on selectivity should help active managers outperform.

DISCLOSURES

INTERNATIONAL INVESTING | International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

SECTORS | Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

OIL | Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors.

CURRENCIES | Currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

GOLD | Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

FIXED INCOME | Fixed-income securities (or "bonds") are exposed to various risks including but not limited to credit (risk of default of principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise.

US TREASURIES | US Treasury securities are guaranteed by the US government and, if held to maturity, generally offer a fixed rate of return and guaranteed principal value.

US DOLLAR | The US Dollar Index is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies,[1] often referred to as a basket of U.S. trade partners' currencies.[2] The Index goes up when the US dollar gains "strength" (value) when compared to other currencies.

DEFINITIONS

AGGREGATE BOND | **Bloomberg Barclays US Agg Bond Total Return Index:** The index is a measure of the investment grade, fixed-rate, taxable bond market of roughly 6,000 SEC-registered securities with intermediate maturities averaging approximately 10 years. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

HIGH YIELD | **Bloomberg Barclays US Corporate High Yield Total Return Index:** The index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

CREDIT | **Bloomberg Barclays US Credit Total Return Index:** The index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

MUNICIPAL | **Bloomberg Barclays Municipal Total Return Index:** The index is a measure of the long-term tax-exempt bond market with securities of investment grade (rated at least Baa by Moody's Investors Service and BBB by Standard and Poor's). This index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

BBG COMMODITY INDEX | Bloomberg Commodity Index is calculated on an excess return basis and reflects commodity futures price movements.

S&P 500 | The **S&P 500 Total Return Index:** The index is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 7.8 trillion benchmarked to the index, with index assets comprising approximately USD 2.2 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

EMERGING MARKETS EASTERN EUROPE | **MSCI EM Eastern Europe Net Return Index:** The index captures large- and mid-cap representation across four Emerging Markets (EM) countries in Eastern Europe. With 50 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

ASIA EX JAPAN INDEX | **The MSCI AC Asia ex Japan** Index captures large and mid cap representation across 2 of 3 Developed Markets (DM) countries* (excluding Japan) and 9 Emerging Markets (EM) countries in Asia. With 983 constituents, the index covers approximately 85% of the free float adjusted market capitalization in each country.

AC WORLD INDEX | **The MSCI AC World** Index is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International (MSCI) and is comprised of stocks from 23 developed countries and 24 emerging markets.

EMERGING MARKETS LATIN AMERICA | **MSCI EM Latin America Net Return Index:** The index captures large- and mid-cap representation across five Emerging Markets (EM) countries in Latin America. With 116 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

EMERGING MARKETS | **MSCI Emerging Markets Net Return Index:** This index consists of 23 countries representing 10% of world market capitalization. The index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 23 countries.

JAPAN | **MSCI Japan Net Return Index:** The index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 319 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

EUROPE EX UK | **MSCI Europe Ex UK Net Return Index:** The index captures large and mid cap representation across 14 Developed Markets (DM) countries in Europe. With 337 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across European Developed Markets excluding the UK.

MSCI EAFE | The **MSCI EAFE** (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

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DATA SOURCES

FactSet and Bloomberg.

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