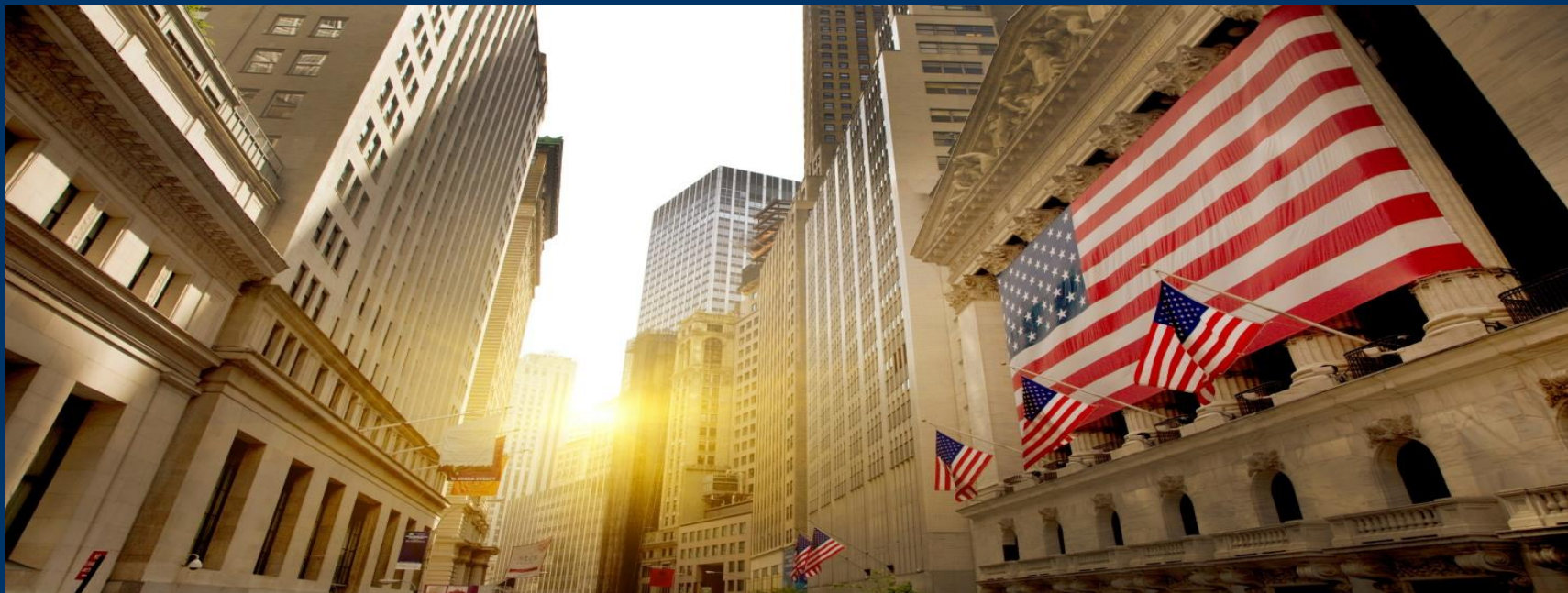


# Economic Review and Market Outlook

Where to Next? What to Do Now?



*Fred Walls and Colleen Doremus*  
*Foundations and Endowments Specialty Practice*

*October 2016*



# Today's Discussion

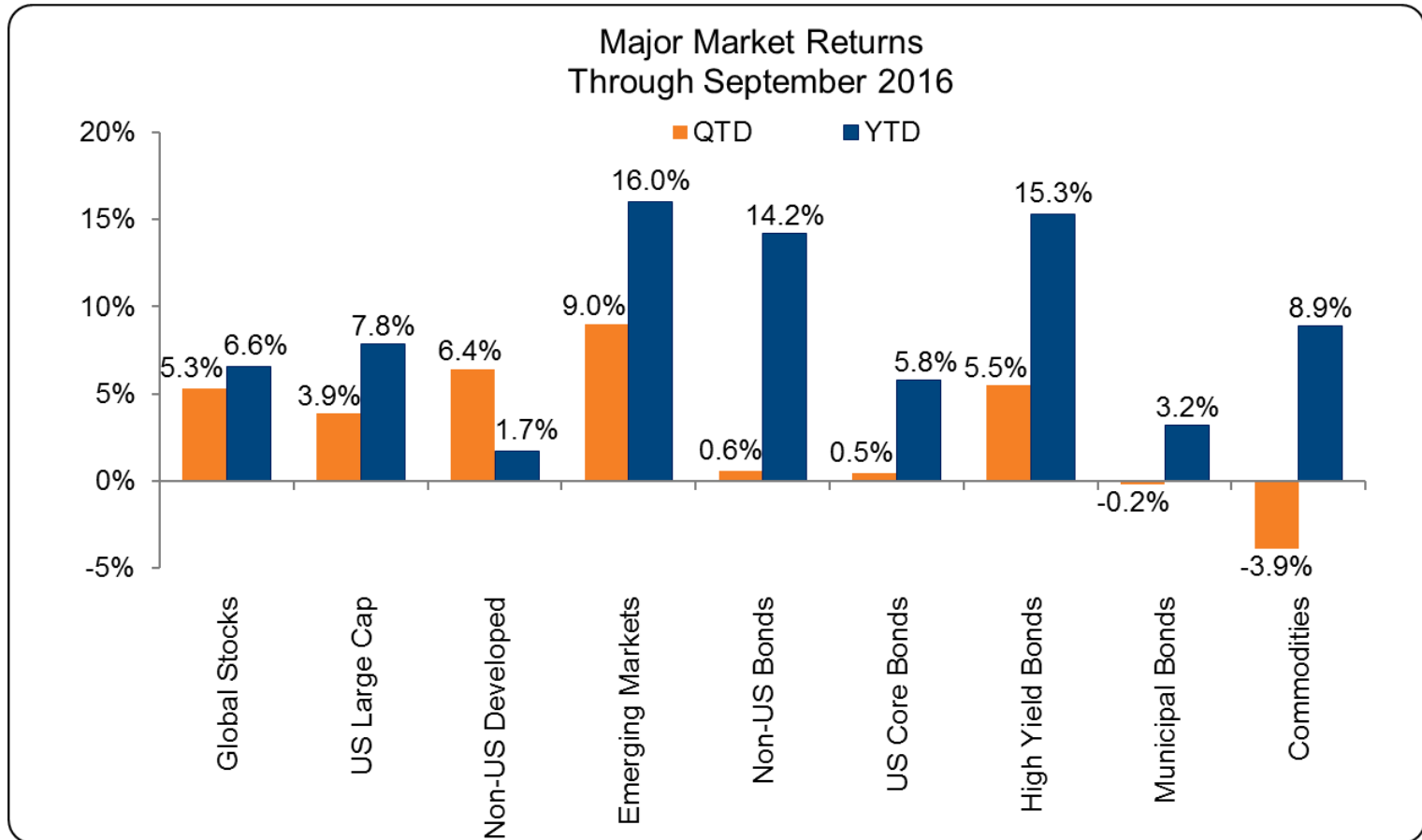
- Market Review 3Q
- Macro Themes Going Forward
- Fixed Income Review
- The Federal Reserve
- Money Market Reform Update



"It has this E.S.P. app, to give you a heads-up on market trends."

# Market Overview

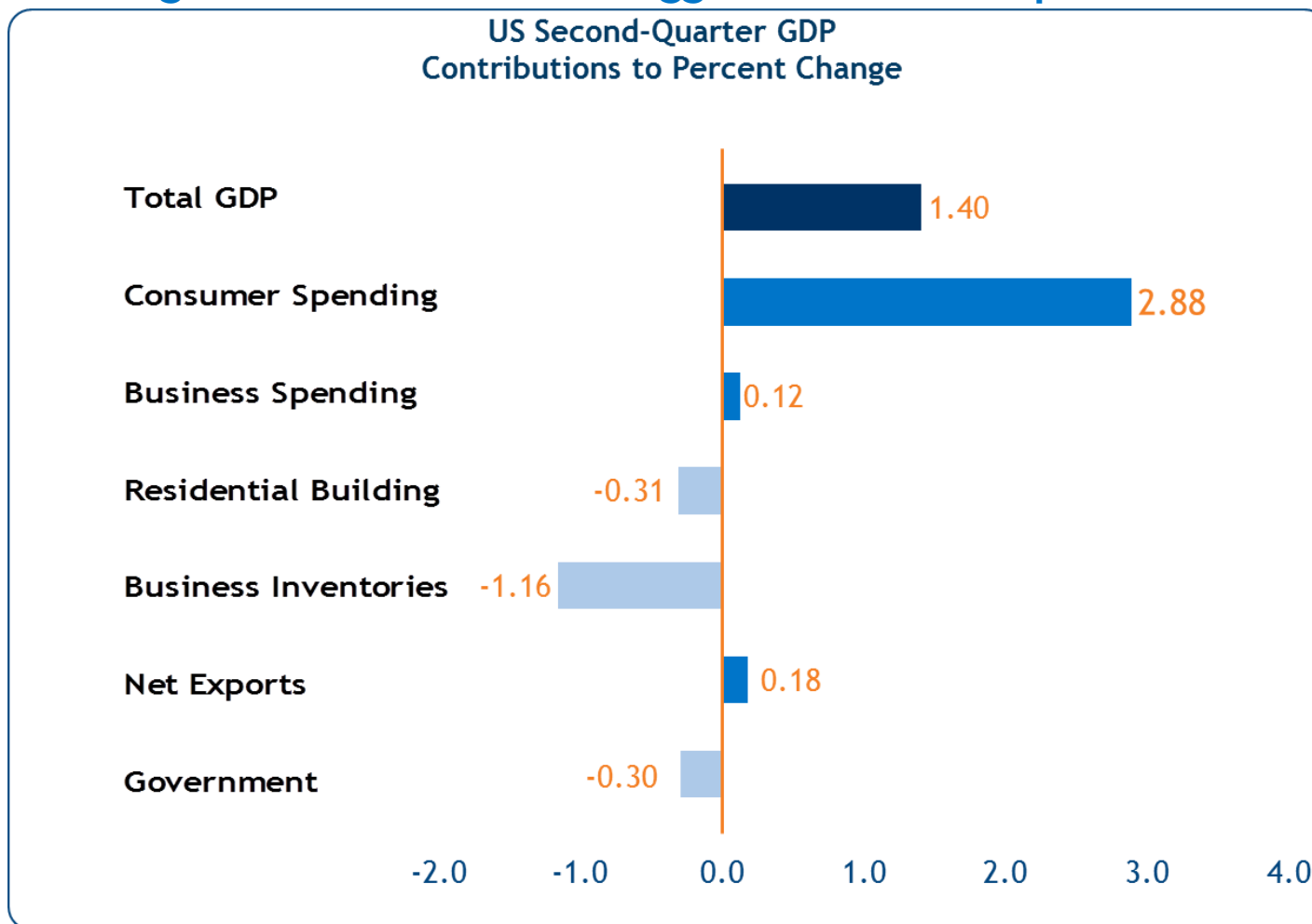
## Stocks outpace bonds for the third quarter



Returns represented by the following indices: MSCI ACWI Index, S&P 500 Index, MSCI EAFE Index, MSCI Emerging Markets Index, Citi WGBI NonUSD USD, Barclays Aggregate Bond Index, BofAML US High Yield Master II Index, Barclays Municipal Bond 1-15 Index, Bloomberg Commodity Index. Data source: Morningstar

# Economic Overview

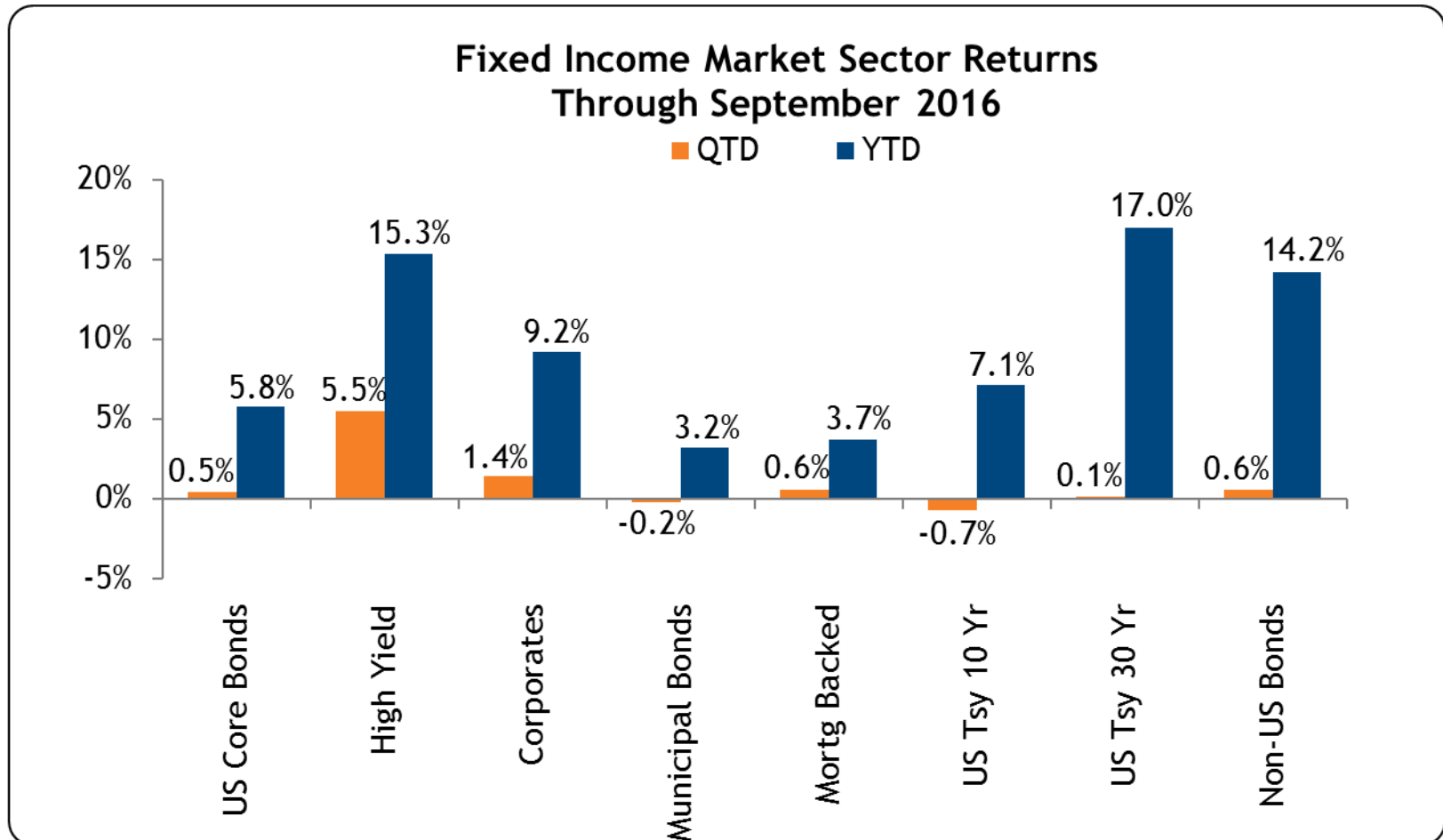
US economic growth remains on a sluggish and uneven path



Data source: Bureau of Economic Analysis

# Taxable Bond Market Overview

Bond index returns mixed in September, but most posted quarterly gains

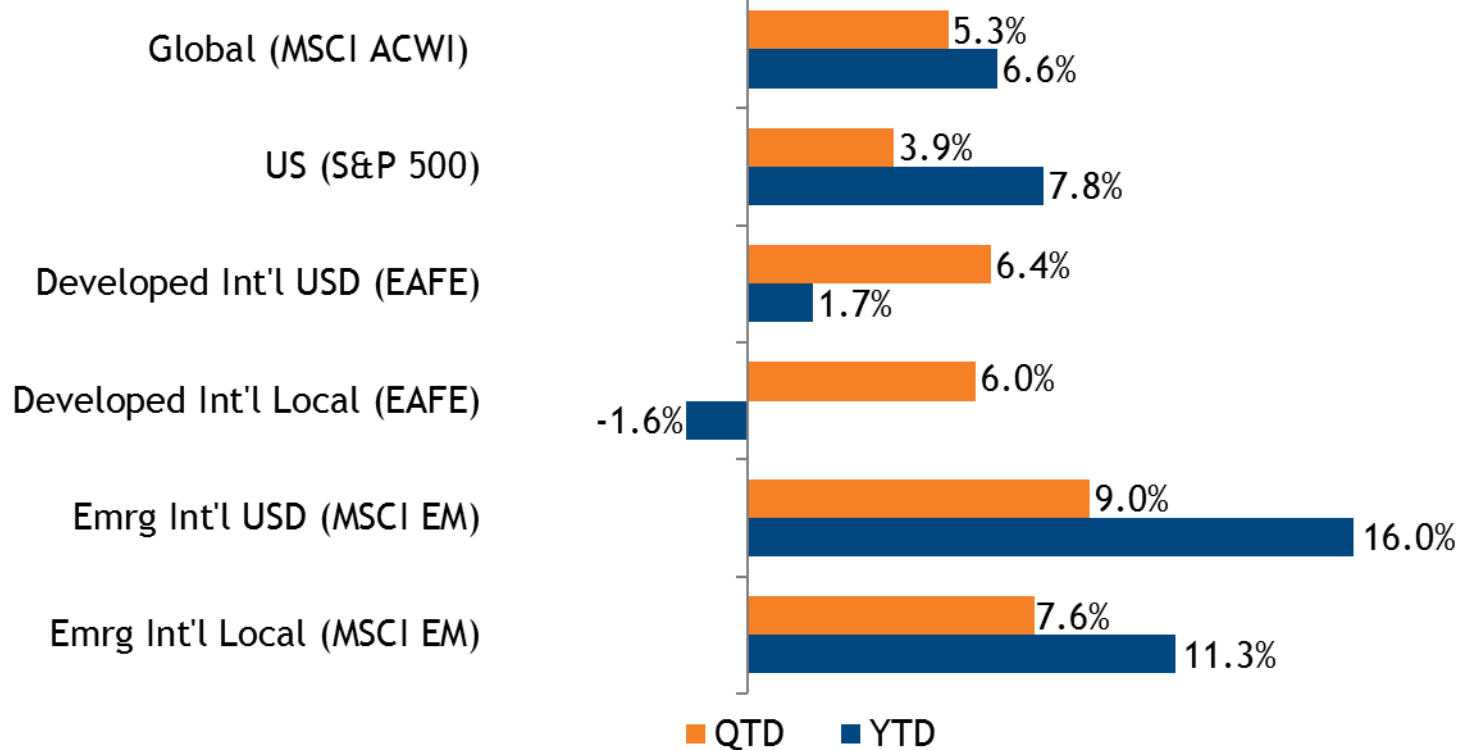


Returns are represented by the following indices: Barclays Aggregate Bond Index, BofA Merrill Lynch US High Yield Master II, Barclays US Investment Grade Corporate Index, Barclays Municipal 1-15 Year Index, Barclays MBS Fixed Rate Bond Index, Barclays Bellwether 10 and 30 year US Treasury Index, and Citi WGBI NonUSD USD. Data source: Morningstar

# Equity Market Overview

Emerging markets playing catchup after several years of underperformance

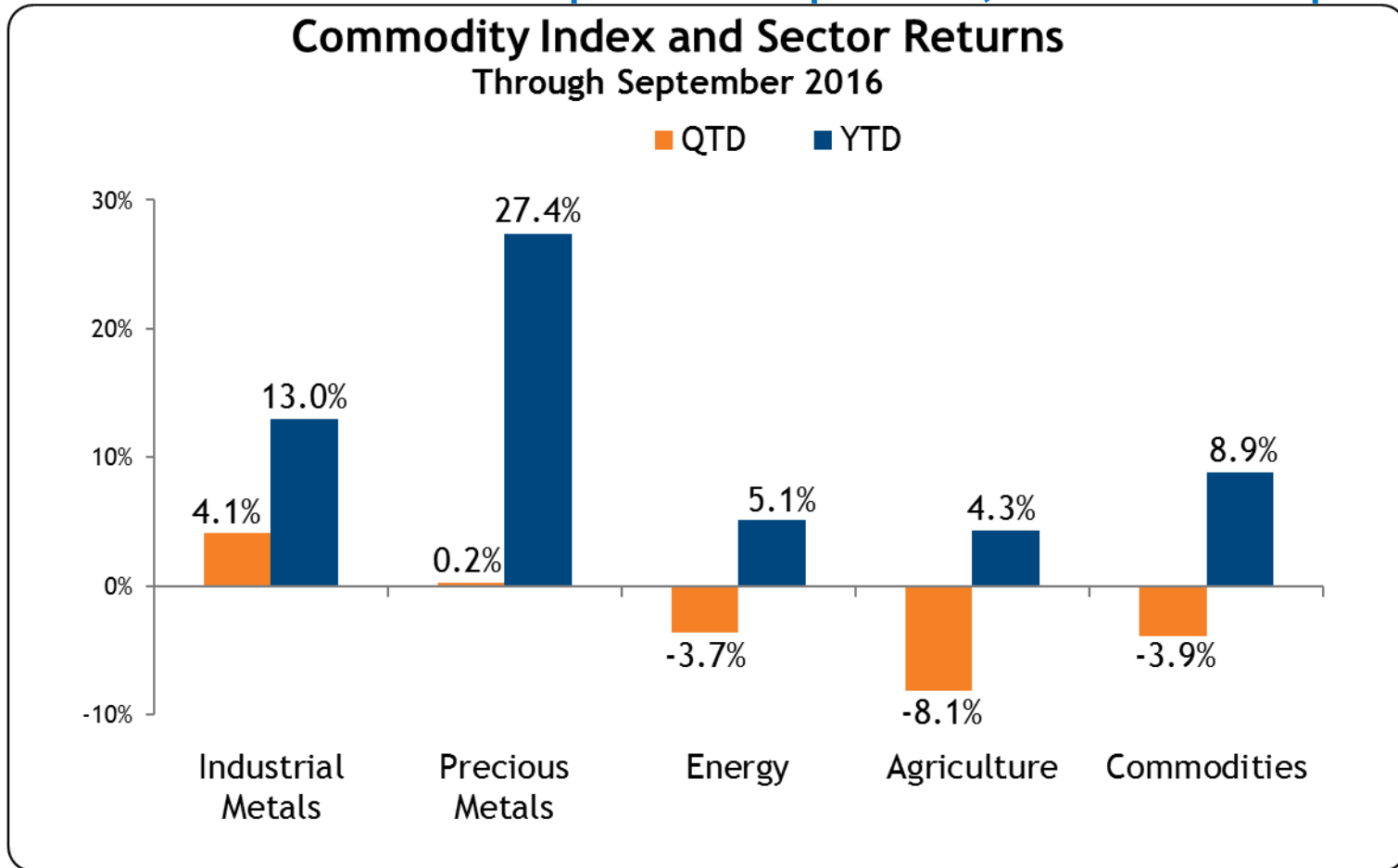
US & International Equity Market Returns  
Through September 2016



Returns are represented by the following indices: S&P 500 Stock Index, MSCI Emerging Market Index in US dollars and local currencies, MSCI EAFE developed country index in US dollars and local currencies. Data source: Morningstar

# Non-Traditional Investments: Commodities

Commodities rose with crude prices in September, but down for quarter

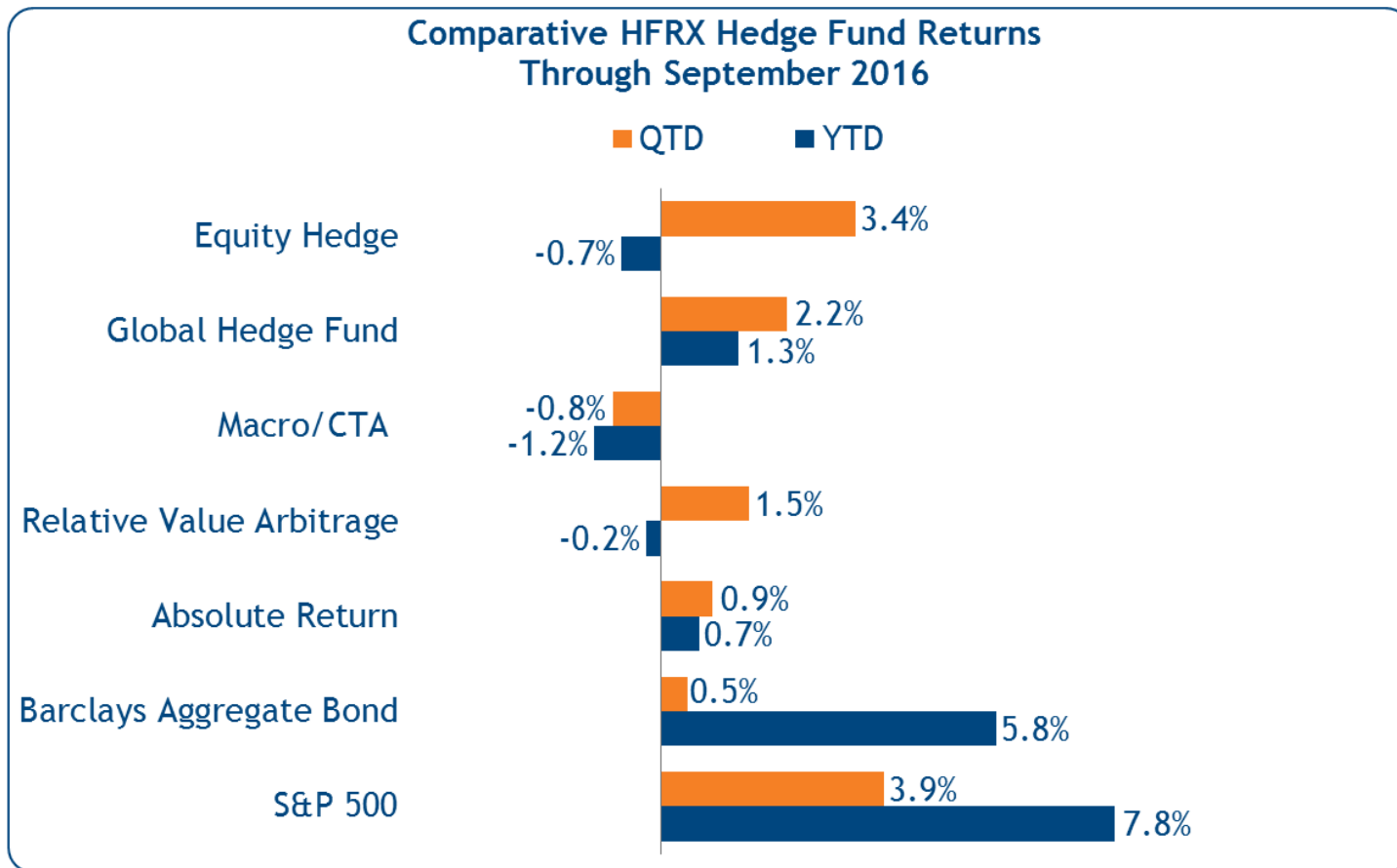


Returns are represented by the follow indices: Bloomberg Commodity Index and the following Sector Sub-Indexes of the Bloomberg Commodity Index: Industrial Metals, Precious Metals, Energy, and Agriculture. Data source: Morningstar



# Non-Traditional Investments Overview

Most hedge funds surged in third quarter, yet still behind for 2016



Data source: Hedge Fund Research, Factset

*Hedge fund investing involves substantial risks and may not be suitable for all clients. Hedge funds are intended for sophisticated investors who can bear the economic risks involved. Hedge funds may engage in leveraging and speculative investment practices that may increase the risk of investment loss, can be illiquid, and are not required to provide periodic pricing or valuation information to investors. Hedge funds may involve complex tax structures, have delays in distributing tax information, are not subject to the same regulatory requirements as mutual funds and often charge higher fees.*

# Market Outlook

# Four Main Themes Going Forward

LOWER FOR LONGER

• Long-term structural forces

THE US SHINES BRIGHT

• Sustainable leadership

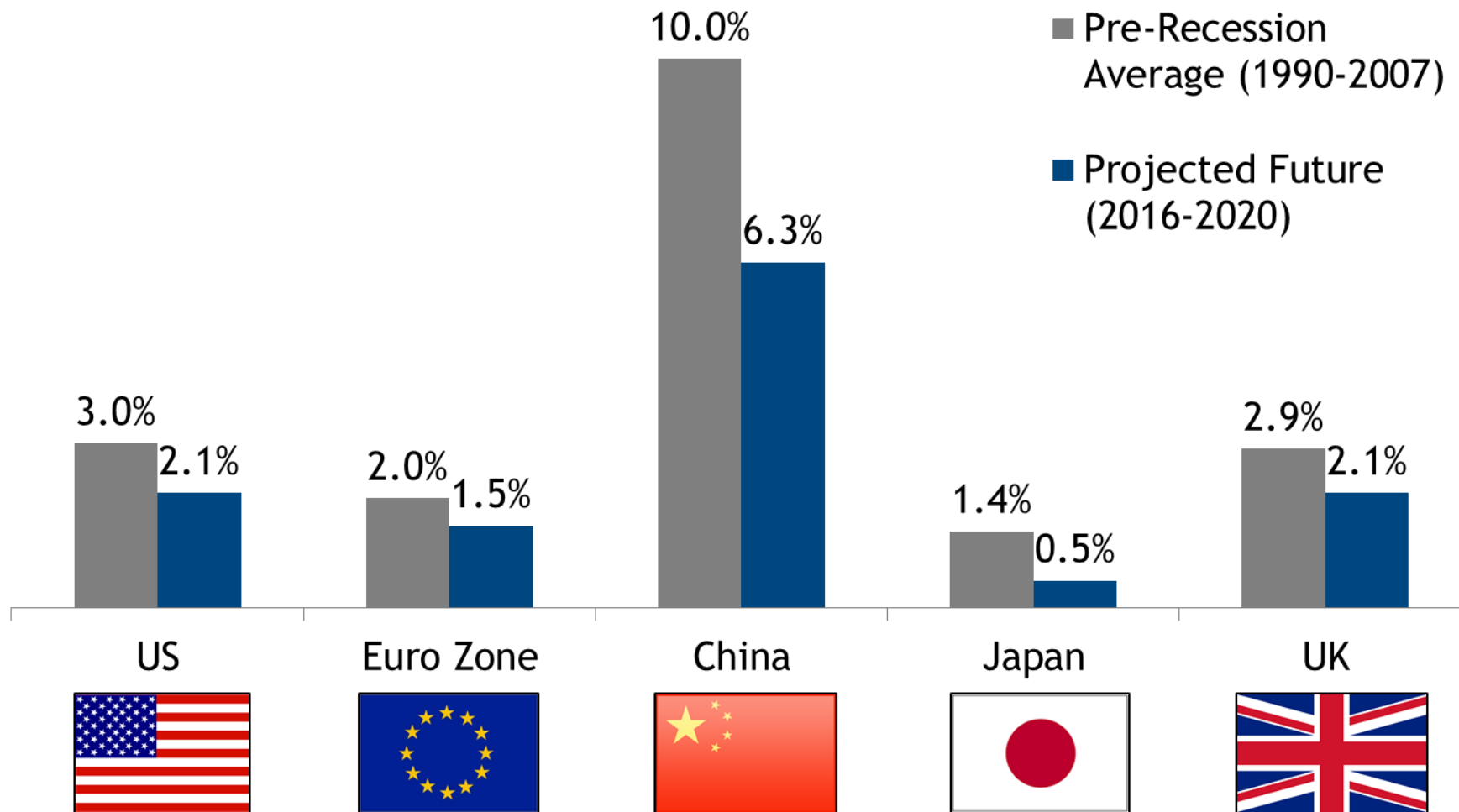
STARTING POINTS MATTER

• Current valuations

TUG-OF-WAR PERSISTS

• Immediate implications

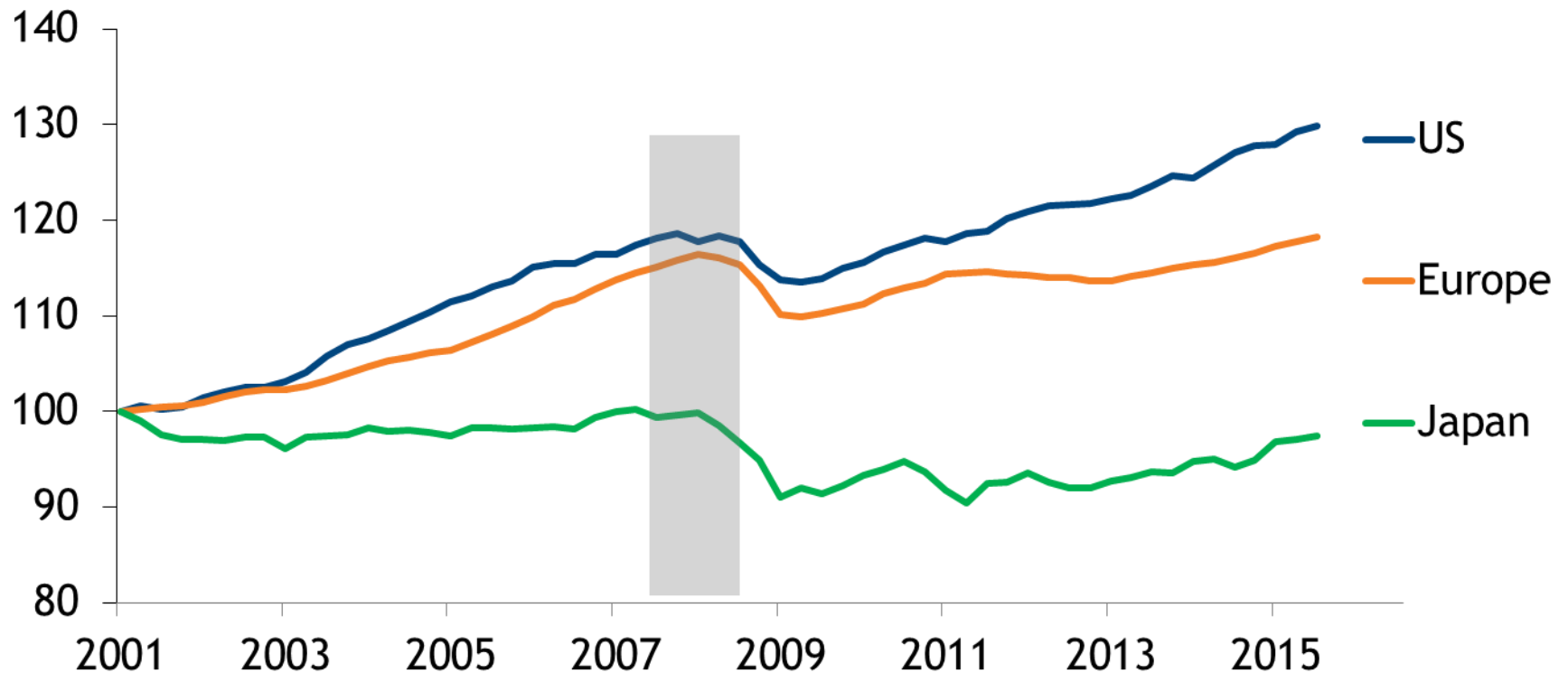
# Projected Growth Rates Remain Low



Data Source: International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations, Bureau of Economic Analysis

# US Shines Bright in Low Growth World

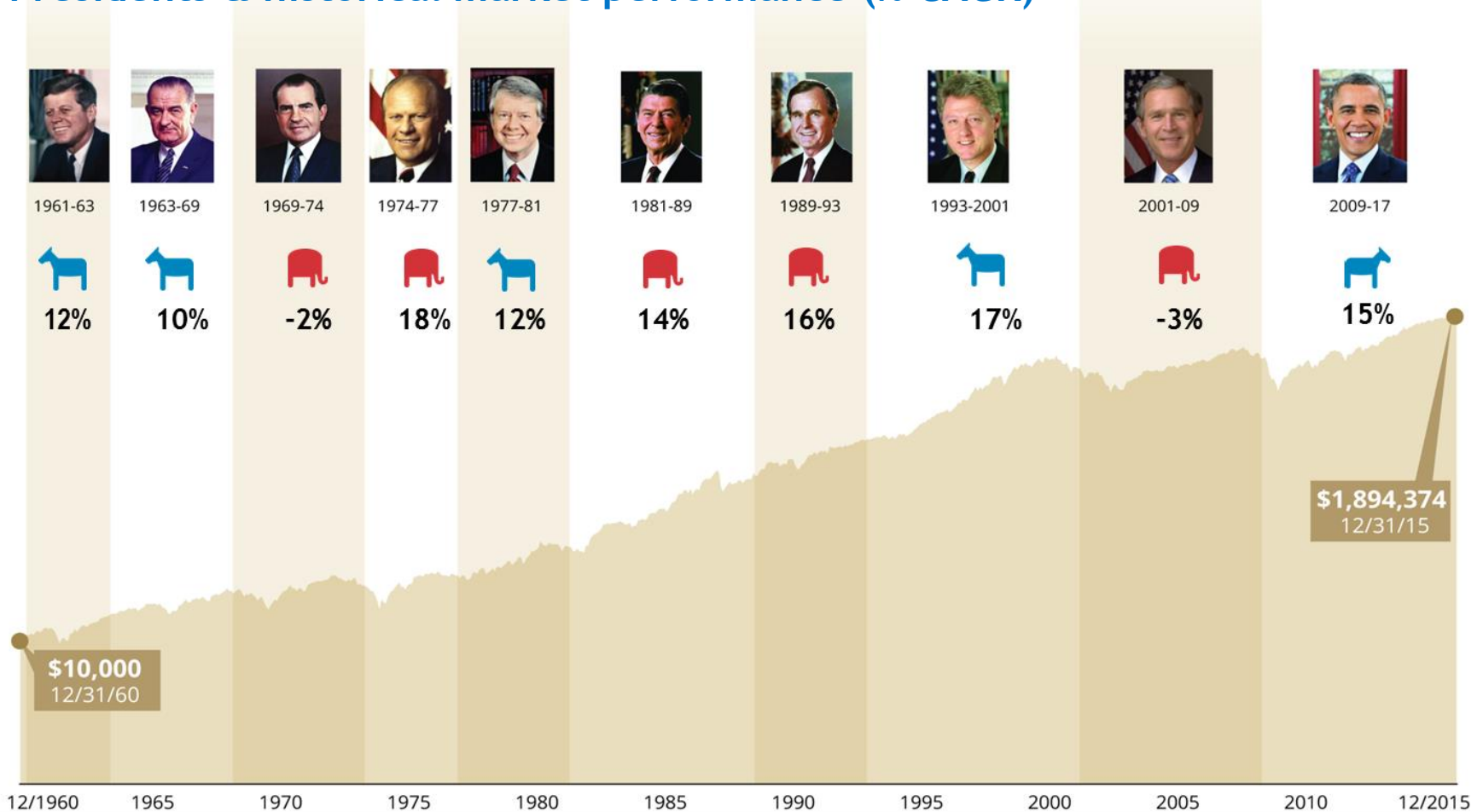
## Economic Growth Indexed to 100 at Tech Bust



Data Source: Haver

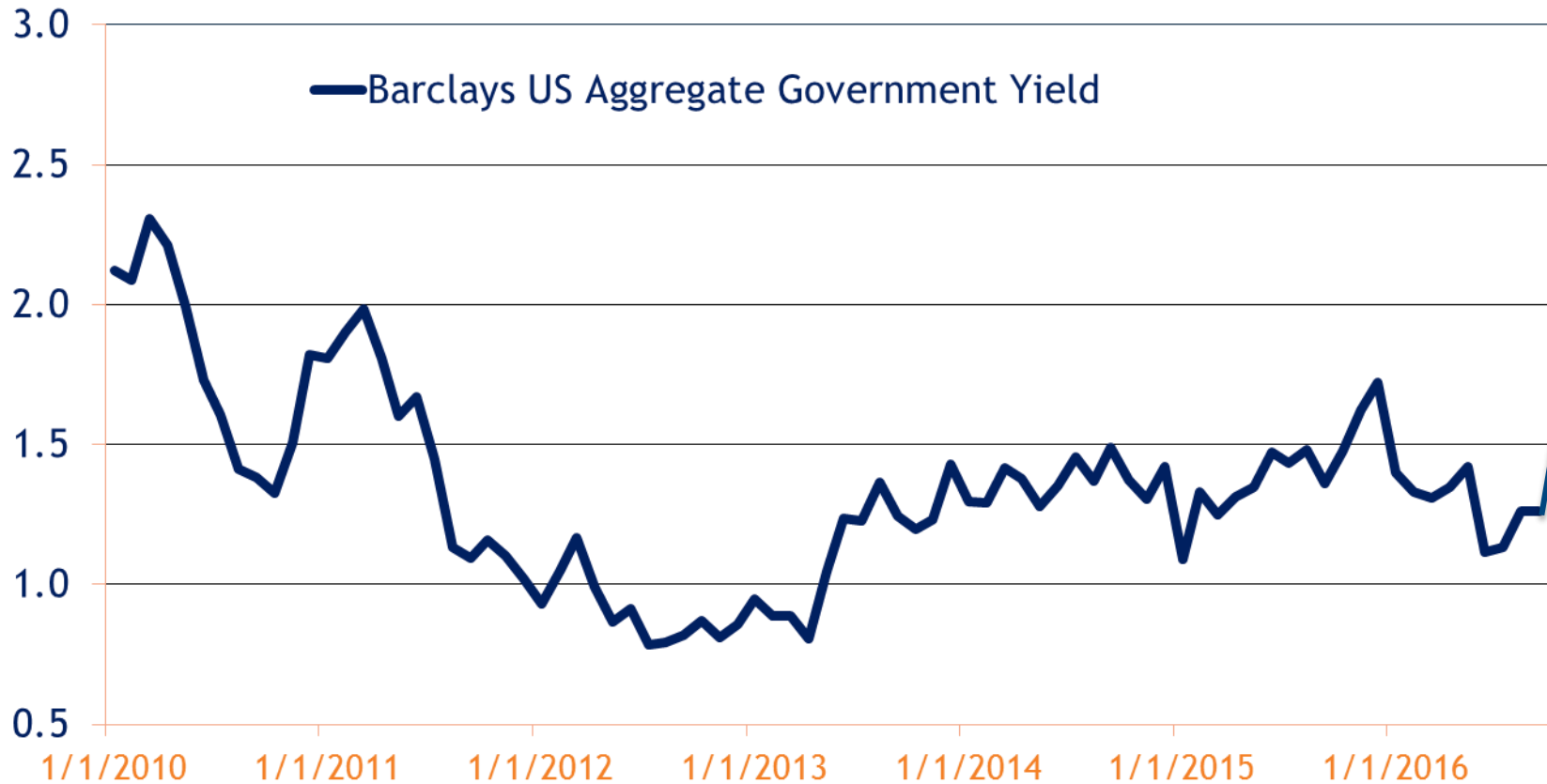
# Who Will Win the US Election & Market Impact?

## Presidents & historical market performance (% CAGR)



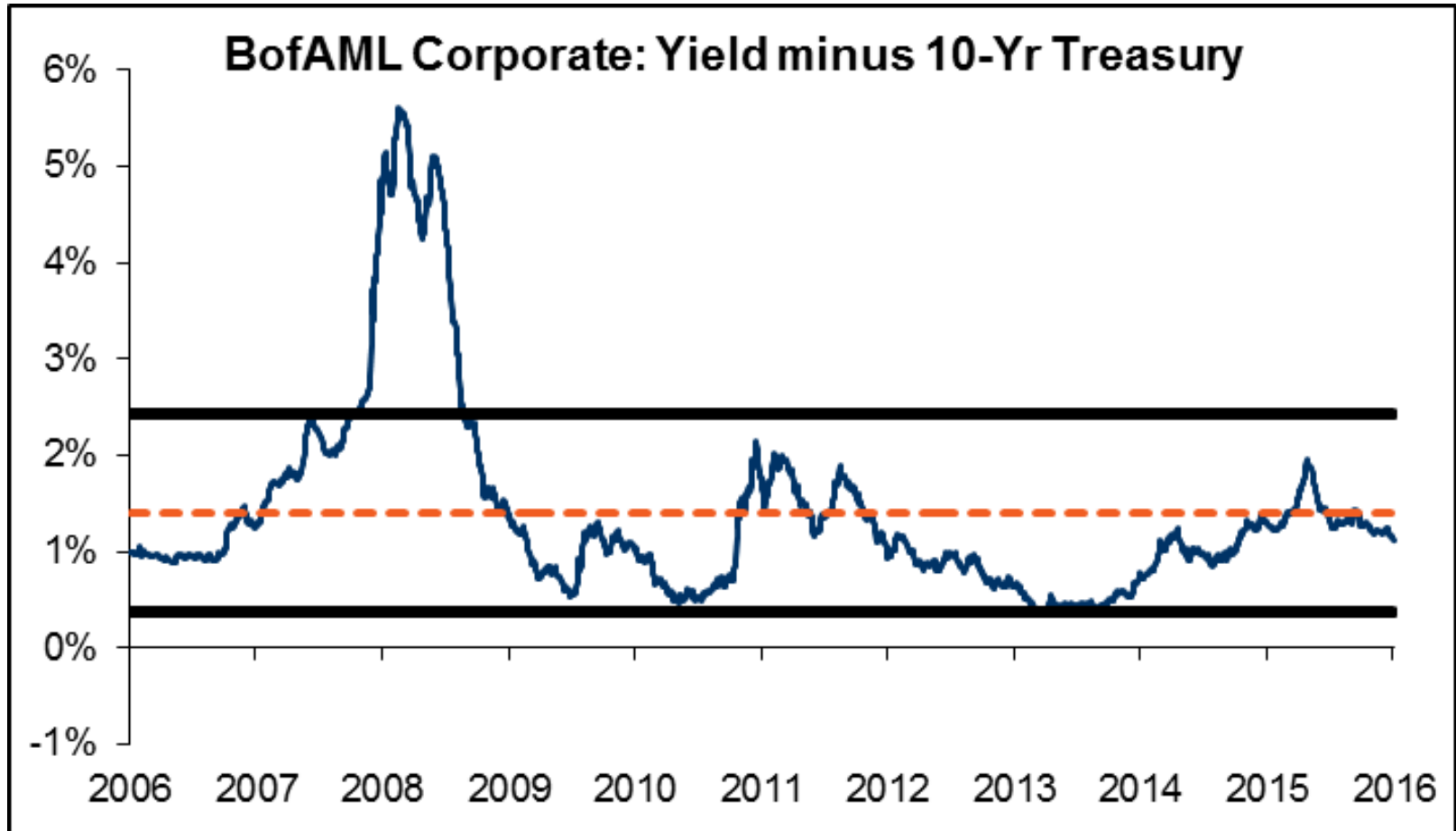
\*\$10,000 Invested in 1961 Would Have Grown to Nearly \$2 Million in 2015—S&P 500 Index Returns; Past performance is not indicative of future results  
Data Source: Hartford Funds

# Tight Trading Band Despite Anticipated Rate Increases



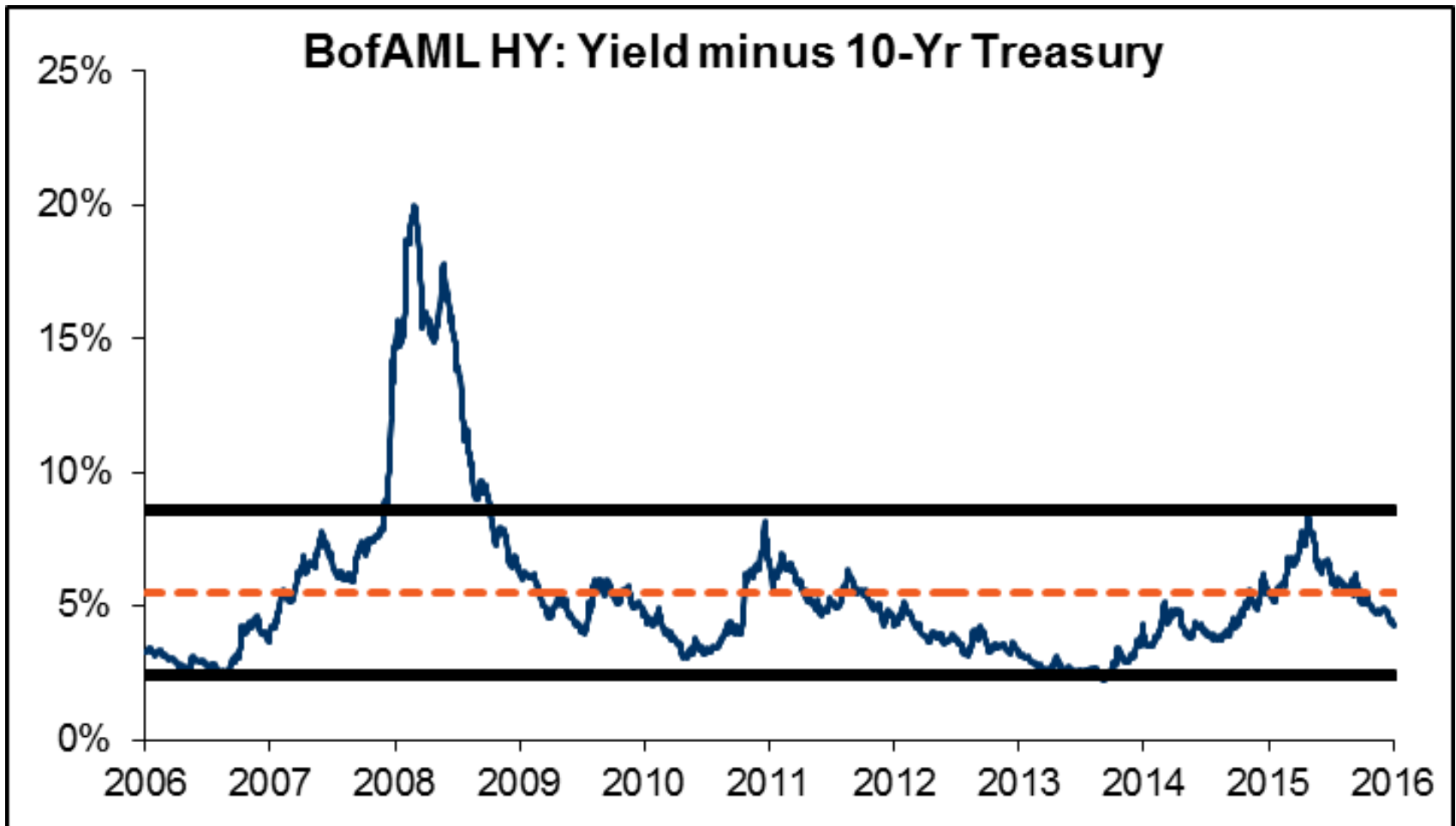
Still a solid risk/reward tradeoff within fixed income.

# Corporates - spreads have tightened, some value remains

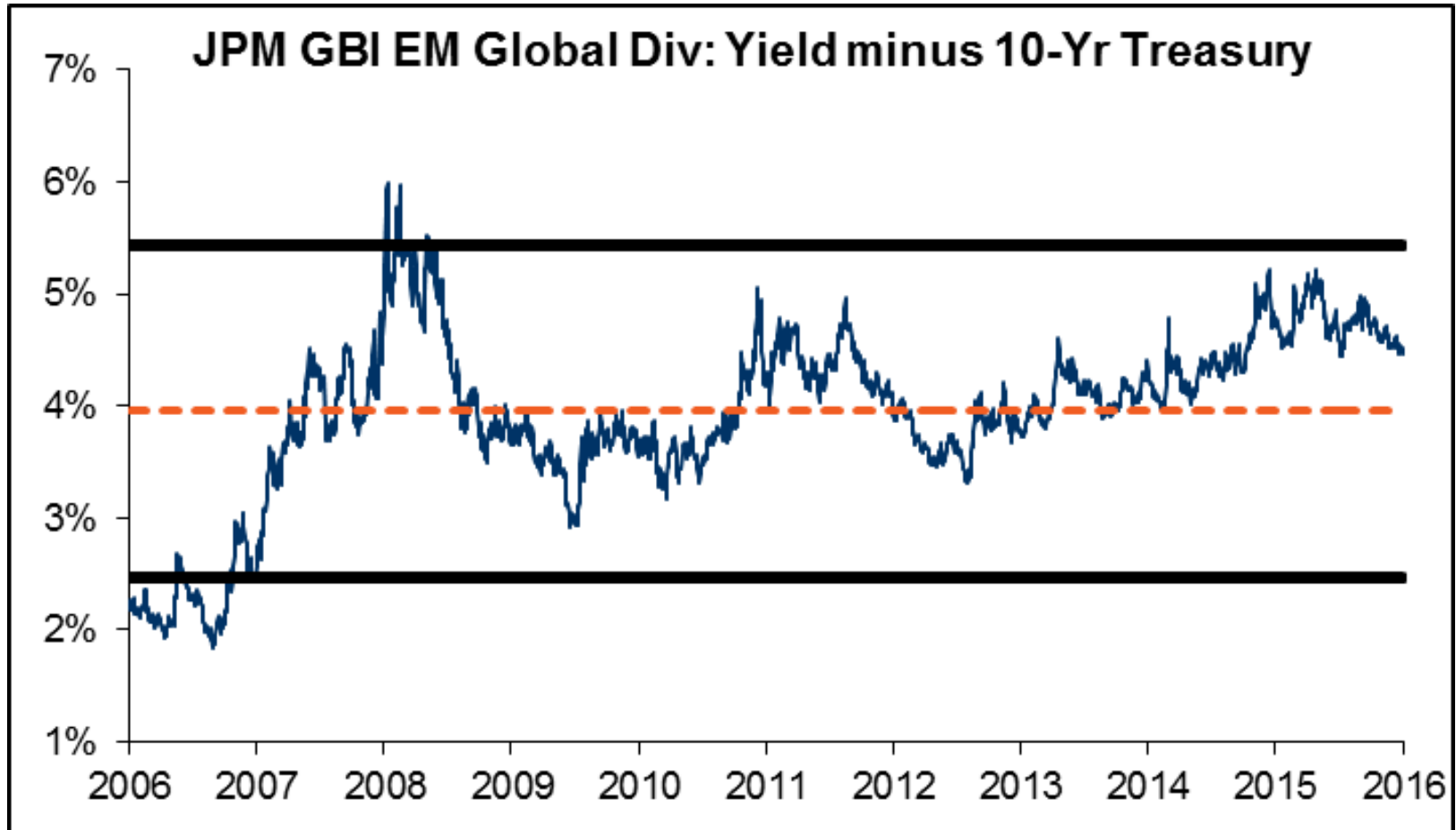




## High Yield - spreads have tightened to below long term average

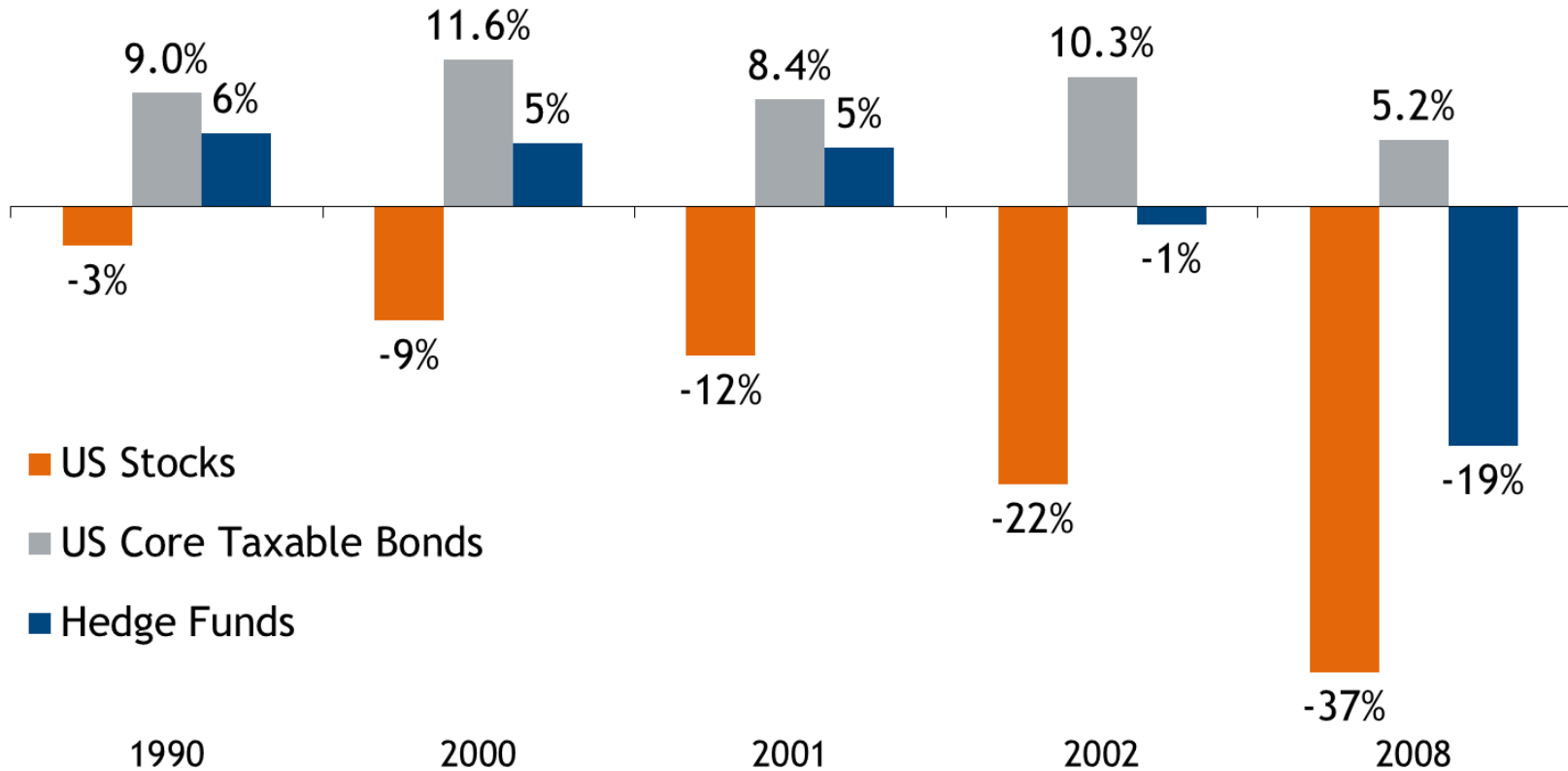


# Emerging Market Bonds - spreads have tightened, but are above long term averages



# High Quality Bonds and Alternatives Have a Role

## Down Stock Market Years



Core US Taxable Bonds = Barclays US Agg Bond; US Stocks = S&P 500; Hedge Funds: HFRI Fund Weighted Composite Index  
 Source: Morningstar, HFR; Past Performance does not guarantee future performance

*Hedge fund investing involves substantial risks and may not be suitable for all clients. Hedge funds are intended for sophisticated investors who can bear the economic risks involved. Hedge funds may engage in leveraging and speculative investment practices that may increase the risk of investment loss, can be illiquid, and are not required to provide periodic pricing or valuation information to investors. Hedge funds may involve complex tax structures, have delays in distributing tax information, are not subject to the same regulatory requirements as mutual funds and often charge higher fees.*

# 2016 Outlook: The Tug-of-War ~~Persists~~ Revisited



## BULL SIDE

No US recession

Few attractive alternatives

Low oil prices

Global stimulus

Low expectations/last push

## BEAR SIDE

Global growth

Profits weakening

Low oil prices

Fed transition

China/EM troubles

## Investment Philosophy

# Diversify and Keep a Long Term perspective with Long Term funds

©2013, Dave Carpenter



## Bottom Line:

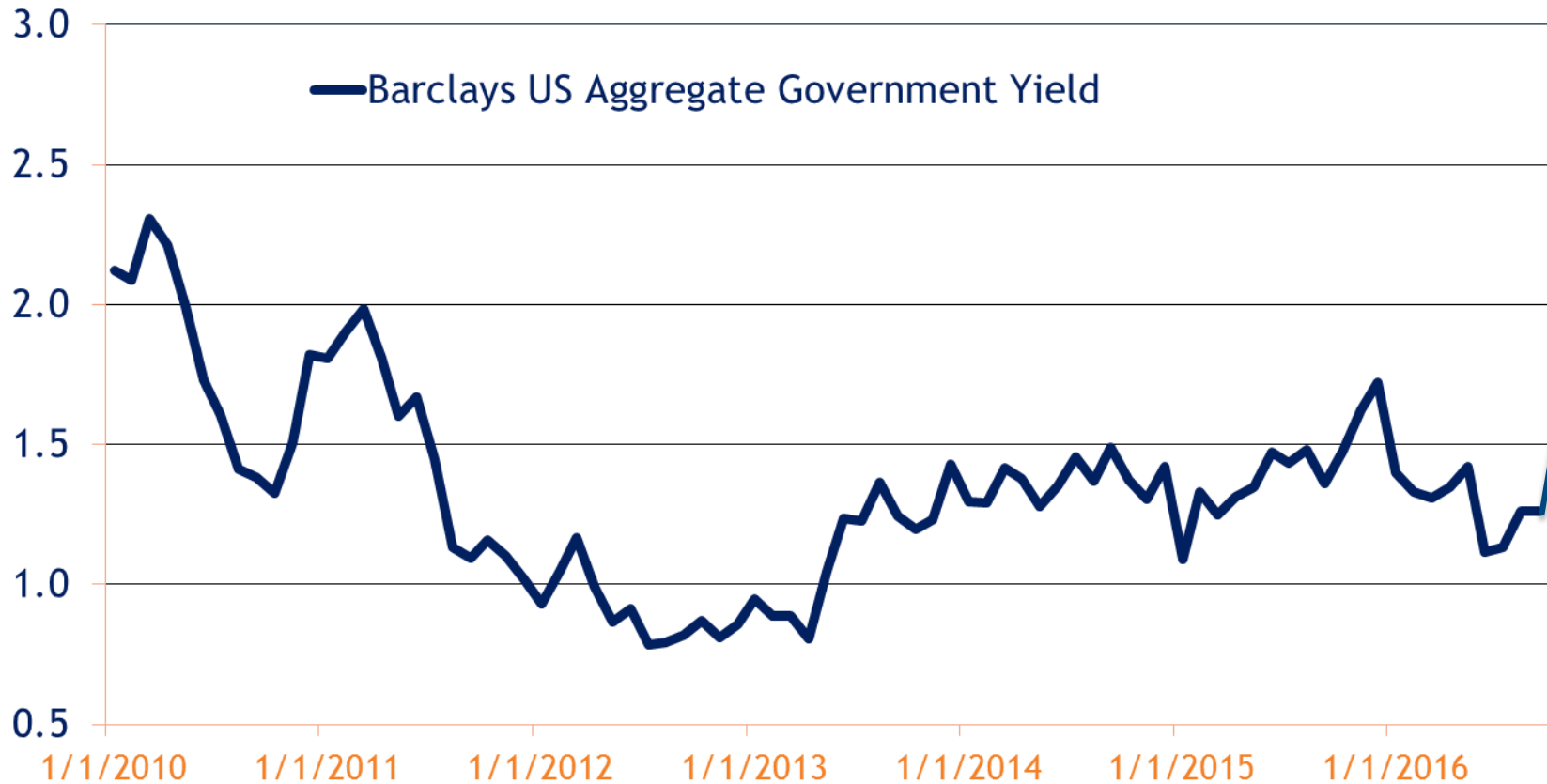
- Lower for Longer Has Broad Implications
- US Shines Bright on Relative Basis for Growth and Safety
- Tug-of-War Continues, but with Upward Market Bias
- Positioning: US Large, Small Cap Int'l, EM improvement, High Quality Bonds, and do not forget Alternatives
- Focus on the tradeoffs of further “Cash Stratification”

# Liquidity and Cash Management



**"I asked for an investment that was safe,  
not stagnant!"**

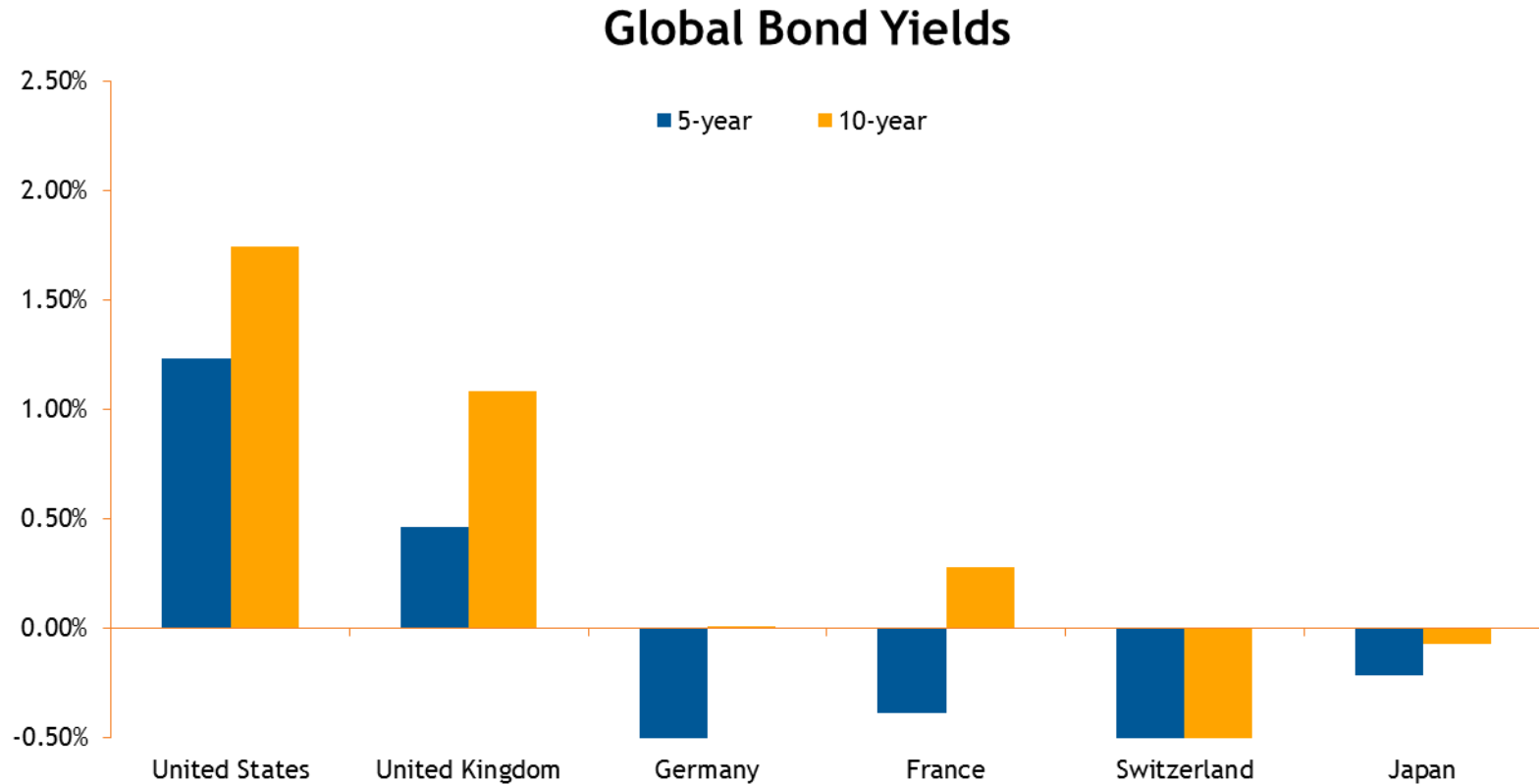
# Tight Trading Band Despite Anticipated Rate Increases



Still a solid risk/reward tradeoff within fixed income.

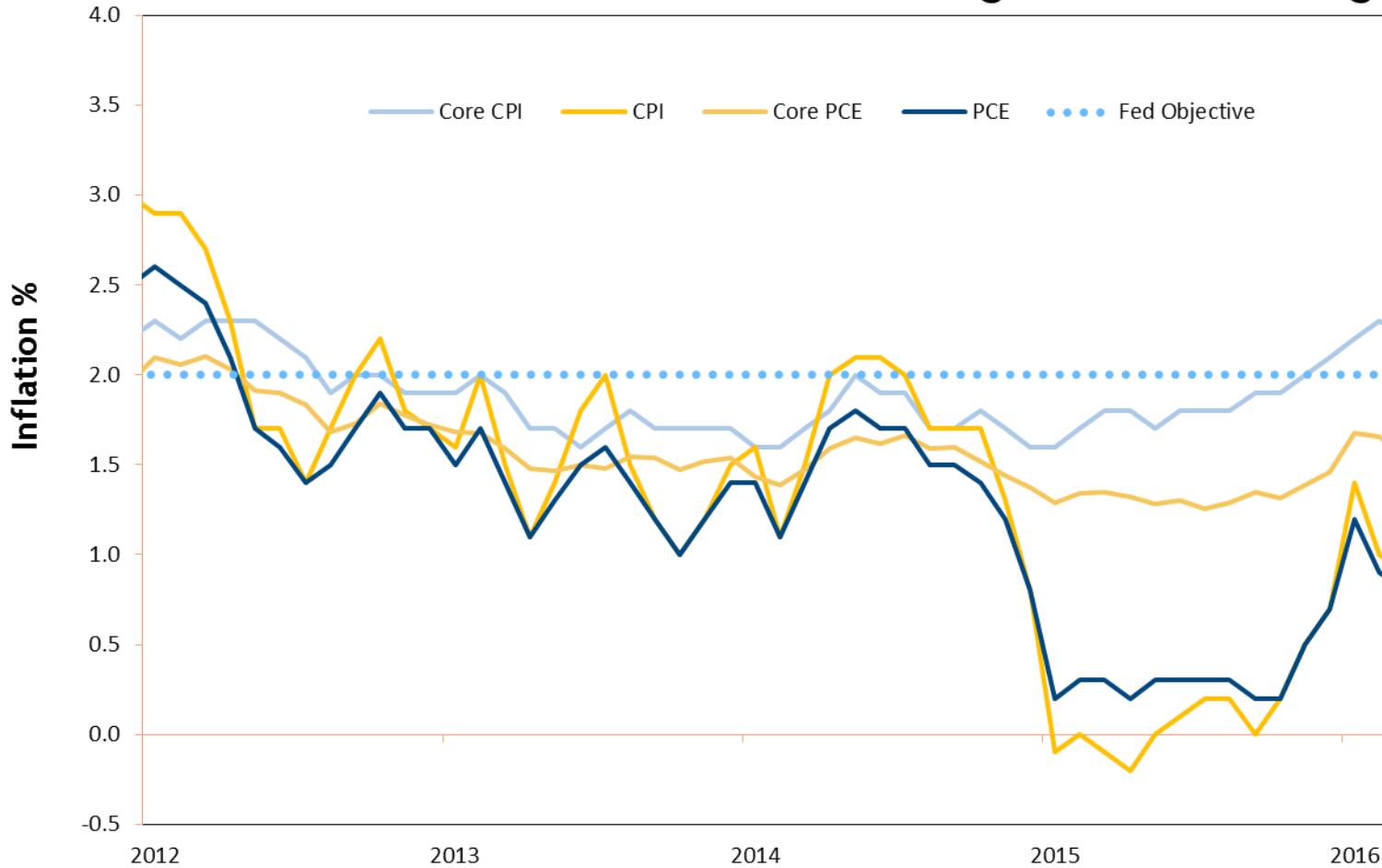


# Global Yields - Not Just Low, Some are Negative

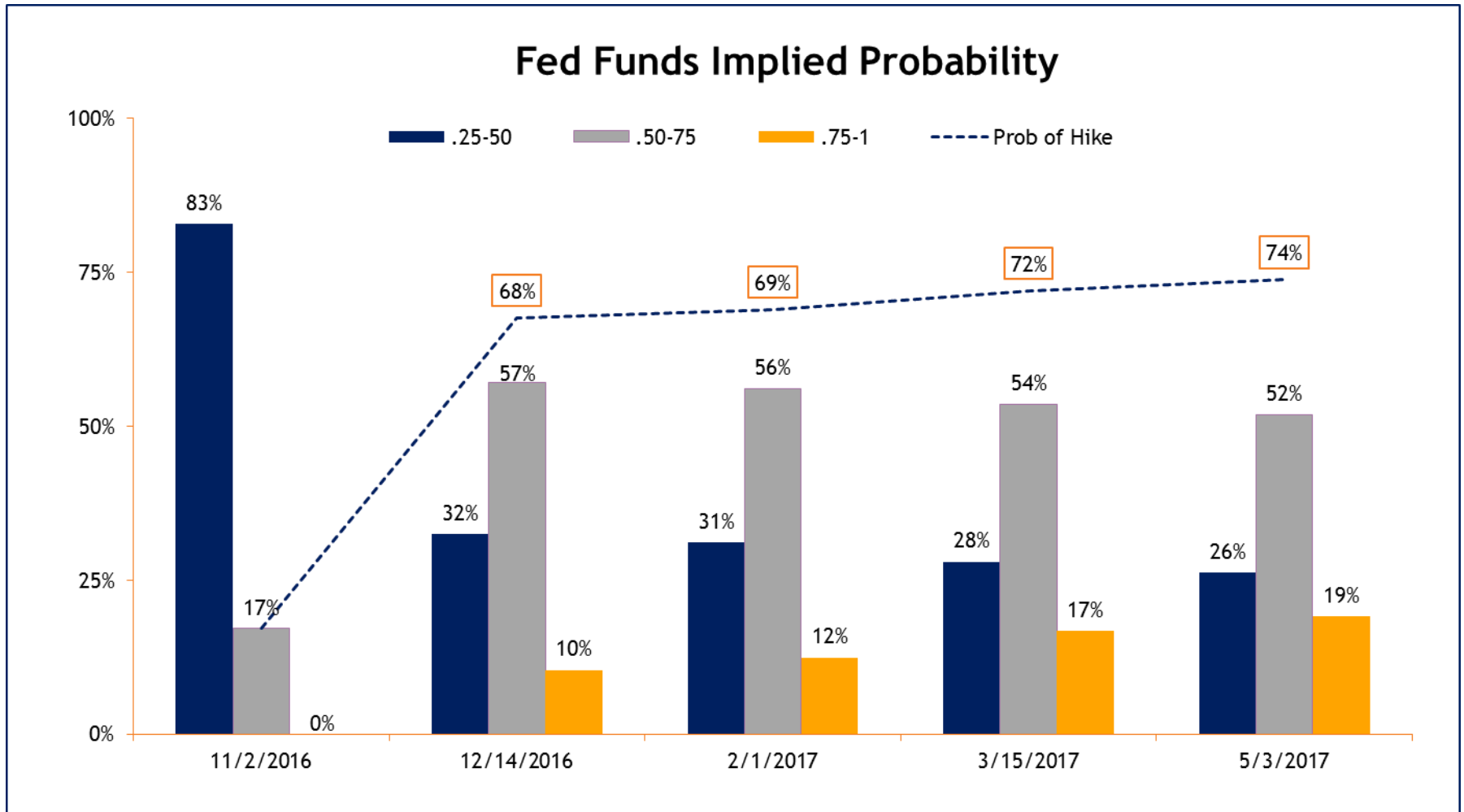


# Inflation Below Fed's 2% Target - But Rising

## Inflation Remains Well Below Fed Target But Core Rising



# Fed Rate Hike and Expected Policy Action in 2016



## Money Market Reform - October 2016

- New money market rules went into effect on October 14, 2016 and will have a significant impact on the structure of the funds
- New rules require institutional prime and tax-exempt funds to have a floating NAV
- Liquidity fees and/or redemption gates can be imposed on Prime and Municipal money market funds based on the weekly liquidity of the fund
- Rules are intended to increase transparency while reducing systemic risk during times of market stress

# Impact on Money Market Funds

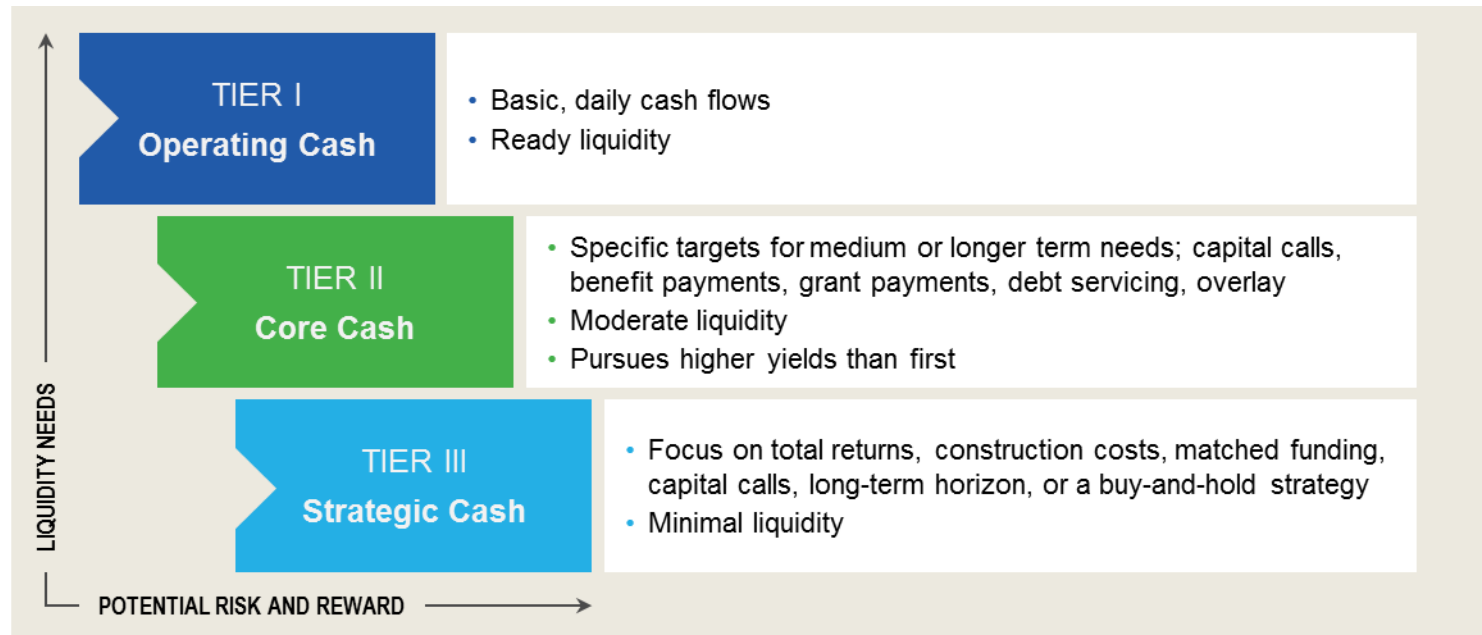
- Money market funds are used to protect from market volatility or manage liquidity needs - yield is a secondary concern
- Recommend clients think about how to actively manage liquidity needs - immediate versus strategic
- Focus on stable NAV funds for immediate cash needs
- Clients willing to tolerate a floating NAV or looking for enhanced yield have other options:
  - floating NAV money market funds, or
  - ultra-short fixed income funds

# Determine the Right “Liquidity Mix” for YOU



# A Graphical View of Further “Cash Stratification”

Creating an account plan using a “tiered” investment strategy can help break down your inventory of domestic and global cash to provide the necessary liquidity and income potential for your overall portfolio



#### Assessment of risk tolerance:

- Time horizon
- Amortized cost vs. marked-to-market
- Scenario analysis

#### Assessment of liquidity needs:

- Frequency
- Amounts
- Circumstances

# Questions?

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## Investments and Financial Planning



**“You’re confused. That means I explained it properly.”**



# Important Disclosures

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Emerging Markets: Investing in the securities of such companies and countries involves certain considerations not usually associated with investing in developed countries, including unstable political and economic conditions, adverse geopolitical developments, price volatility, lack of liquidity, and fluctuations in currency exchange rates.

Fixed Income Securities are subject to interest rate risk, credit risk, prepayment risk, market risk, and reinvestment risk. Fixed Income Securities, if held to maturity, may provide a fixed rate of return and a fixed principal value. Fixed Income Securities prices fluctuate and when redeemed, may be worth more or less than their original cost.

Hedge funds may involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager.

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**Global Equity** is represented by the **MSCI All World Country (ACWI) Index** which is defined as a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI Index consists of 44 country indices comprising 23 developed indices including Australia, France, Germany, Japan, the UK and the US and 21 emerging market country indices which include Brazil, India, Mexico, Taiwan and Turkey.

**US Small Cap Core Equity** is represented by the **Russell 2000** index which is a measure of the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index.

**Non-US Developed Markets Equity** is represented by the **MSCI EAFE** index which is defined as a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following 22 developed market country indices.

**Emerging Markets (EM) Equity** is represented by the **MSCI EM** index which is defined as a free float-adjusted market capitalization index that is designed to measure equity market performance of EM

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S&P sectors , including Consumer Staples and Industrials, represented by Standard & Poor’s GICs

**Intermediate Term Core Taxable Bonds** are represented by the **Barclays US Aggregate Bond** index which is the broadest measure of the taxable U.S. bond market, including most Treasury, agency, corporate, mortgage-backed, asset-backed, and international dollar-denominated issues, and maturities of one year or more.

**HFRX Indices (HFRX)** are a series of benchmarks of hedge fund industry performance which are engineered to achieve representative performance of a larger universe of hedge fund strategies

**Trade weighted US Dollar** is measurement of the foreign exchange value of the U.S. dollar compared against certain foreign currencies.

**Commodities** are represented by the **KR-CRB Spot Commodity Price Index:** Raw Industrials: is a measure of price movements of 22 sensitive basic commodities