2019 investment outlook: A more balanced view forward

Quarterly outlook

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Executive summary

As we head into 2019, we retain a more balanced view of asset returns relative to risks than the pro-growth prospective we carried into 2018. Last year, the world enjoyed a confluence of synchronized global economic growth, expansionary fiscal policy in the form of domestic corporate and individual tax cuts, and generally still pro-liquidity central bank policies in major economies (except for the United States). The new year reflects a markedly different picture, with uneven and largely slowing global growth trajectory, waning fiscal policy that could be thwarted domestically through a more balanced legislative branch, and major central banks potentially following the U.S. Federal Reserve's (Fed's) lead and raising interest rates to offset inflation threats.

We continue to see the credit cycle as the most important variable when assessing the forward path of asset prices. In a credit-driven economy, individuals and businesses desire to consume now with the promise to pay back in the future — borrowing money to facilitate current consumption. When interest rates or the cost of borrowing (from a debtor's perspective) are low, the credit cycle endures. When interest rates rise, a consumer's and borrower's ability to repay debts can be more challenged. Interest rates can go up due to central banks wanting to cool the economy or from creditors demanding more compensation from borrowers should they have concerns about borrowers' repayment capacity.

With our focus on the credit cycle, entering 2019, we view policy risk as the chief risk enveloping the investment landscape. Monetary policy risk, or the possibility that central banks raise interest rates too quickly in light of economic softening, could raise borrowing costs too far and thwart consumption. Trade policy risk, or a prolonged period where economic superpowers clash, could also increase borrowing costs for companies and individuals should growth levels face challenges amidst ongoing negotiations.

Despite the risks outlined above, and a more difficult policy setup, note that the global economy is slowing, although from a strong base. Several upside scenarios for global growth exist, including ongoing durability in corporate earnings that can justify increases to current asset prices, which have already reflected some of the risks mentioned earlier. In the sections that follow, we detail current issues and outlooks for a number of asset classes. Please connect with your Private Wealth Advisor if you have questions.

Global economic views

Solid 2018 for the U.S. economy may create headwinds for 2019.

In 2018, the U.S. economy maintained its strength relative to the rest of the world. This reflected the tailwind of 2017 U.S. dollar weakness and the benefits of tax cuts and fiscal stimulus. As we close out 2018, the strength in U.S. economic data has softened. As we enter 2019, economic growth is likely to continue to slow as the tailwinds of 2018 likely turn into headwinds. With fiscal stimulus and tax cuts already benefitting the economy, headwinds in 2019 are likely to include the impacts from 2018 strength in the U.S. dollar and higher U.S. interest rates. Trade policy is a bit of a wildcard, although the potential for higher U.S. tariffs against China may lead to retaliation and further dampen U.S. economic growth prospects. Despite our view for slower growth, we believe recession risks remain modest for now. Debt growth has been high, but is not excessive, and we see evidence of few imbalances emerging given the very modest trend in economic growth since the great financial crisis.

- Inflation measures in the United States have generally accelerated, lifted by higher prices for housing and energy. In the fourth quarter of 2018, price trends for both factors have softened. Higher interest rates appear to be weakening home prices and softer global growth appears to be hurting demand growth for energy. While the U.S. labor market remains tight, wage growth has remained somewhat modest. Acceleration in wage growth could lift inflation in 2019, but for now, our view is for more modest inflation measures, in line with our view for moderating U.S. growth.
- Still positive trends in growth and inflation have led the Fed to remove monetary accommodation by raising interest rates and reducing balance sheet bond holdings in 2018. This trend of tighter monetary policy is likely to continue into 2019, unless market or economic events alter the Fed's course. This could include a substantial financial market dislocation or a sudden spike in the unemployment rate. Fiscal policy, in the meantime, is shifting to a more neutral footing as the benefits of tax cuts have been absorbed by the U.S. economy in 2018. Higher U.S. deficits are a likely policy headwind in 2019.

Weaker trend growth in Europe and Japan may stabilize at low levels in 2019.

Trend growth for Europe and Japan, the other major developed global economies, has been quite disappointing over the course of 2018. Political risks, tighter fiscal policies and softening global trade have slowed growth, although both economies have avoided recession. Trends in the fourth quarter of 2018 remain quite soft, which likely means we start the new year with a weaker tone to growth. However, some tailwinds could provide some lift over the course of 2019. In 2018, both the yen and the euro have been weaker relative to the U.S. dollar. This historically translates into relative trade benefits for these economies in the subsequent year. Global trade policy remains a risk to most economies, but for now, the weaker currency could provide some support for economic results. Lastly, monetary policy has been quite supportive over the course of 2018 and this should continue to provide lift in 2019, despite the likely conclusion to asset purchase programs by these major global central banks.

Emerging market growth needs some help from the Fed.

Emerging market economies have generally suffered over the course of 2018 and trends in the fourth quarter are not yet improving. Higher crude oil prices (albeit with some giveback towards the end of 2018), a stronger U.S. dollar and a tighter Fed have been the primary culprits, with global trade headwinds also an issue. The recent easing of oil prices should help some economies eventually. Should the Fed pause in rate hikes or major economies engage in some fiscal stimulus, we could see growth trends improve. The major risk to emerging market economies in 2019 is the change or resolution to global trade policy. Further restriction to global trade is likely a meaningful headwind while any resolution could provide some benefit to these economies.

Equity markets

We expect U.S. equities to trend higher in 2019, bolstered by rising earnings, benign inflation and still relatively low interest rates.

The fundamental backdrop appears constructive for equities to trend higher in 2019, roughly at the pace of earnings growth, absent ramping inflation or a looming recession.

- Earnings for the S&P 500 are projected to increase roughly 8 percent year-over-year in 2019, decelerating from the 20 percent increase in 2018, in part reflecting waning tax benefits, lingering trade tensions, slowing in the rate of global growth and a rising dollar. The lackluster equity performance in the fourth quarter of 2018 may partially be explained by investors adjusting expectations to a slower pace of earnings growth in 2019. Importantly, rising earnings are needed to provide valuation support while serving as a basis for stocks to trend higher.
- Broad-market valuations are fair, neither at high nor low extremes. The S&P 500 is approaching the new year trading at roughly 18 times trailing 12-month and 16 times forward 12-month estimates, both in line with the 25-year average, according to Bloomberg. While valuations are near the longer-term average, we see limited opportunity for meaningful multiple expansion in 2019. It seems most probable that multiples (and earnings) have a downward bias given evidence of peaking margins associated with wage pressures and higher input costs. This is likely to result in overall U.S. equity performance being positive, yet more subdued.

Technicals, or price trendlines, remain challenged following fourth quarter volatility, suggesting more time is still needed before gleaning compelling technical support.

The technical price trendlines of equities are under repair given that the popular indices recently violated key levels of support, a process that will continue into 2019. A trading pattern of higher highs and higher lows, which requires time to develop, is needed to provide technical support.

Bull markets don’t die of old age. Rather, they tend to die of excesses, suggesting that the current bull market still has room to run.

Being in the later stages of the economic cycle does not mean that the long-running bull market in U.S. equities is over. Historically, excesses or “bubbles” in either inflation or investor sentiment (valuation) have spurred the Fed to raise interest rates to slow the pace of growth or remove pockets of euphoria, resulting in lower equity prices. At present, neither valuation nor inflation are at high or low extremes.

We believe investment opportunities exist in all market environments, in all stages of the economic cycle and among all sectors despite a rising degree of investment difficulty.

The rate of change in the world today has never been faster, and it presumably will never be this slow again. This presents both angst and opportunities for equity investors.

Machine learning, artificial intelligence, cloud computing, robotics and automation, social media, eCommerce, and precision farming are changing how we live, work and play. Machine learning and artificial intelligence, for instance, are displacing the concept of an "average consumer" in favor of target marketing. eCommerce and online shopping is changing the landscape for retailers and how consumers shop for goods and services. Affordability of cloud computing and storage is fueling the rate at which companies can start, scale and succeed. Importantly, investment opportunities exist in today's market environment. To become and remain agile to compete and succeed in a fast-changing world, we believe that among successful companies with attractive investment profiles are those that provide the "central nervous systems" that enable these advancements to operate, as well as those that are flexible and able to quickly change their structure and cultures.

We retain a neutral outlook for foreign developed equities in 2019 as waning economic impulse and fading investor sentiment weigh against modest earnings growth, attractive dividend yield and reasonable valuation.

Foreign developed equity markets peaked in late January and ended November amid a broad-based decline marked by lower highs and lower lows throughout the year. A strengthening dollar compounded negative foreign equity market returns, with the trade-weighted U.S. dollar index rising 5 percent in 2018 (at the time of this writing). A rising dollar decreases the relative value of foreign assets for U.S. investors and contributed nearly 4 percent of the 9 percent year-to-date decline in the MSCI EAFE index.

Equity price declines were notable in a year when corporate profits in foreign developed markets were expected to grow a robust 16 percent for the full calendar year. The combination of falling equity prices and double-digit year-over-year profit growth has resulted in the valuation of foreign equities compressing from above long-term averages at the beginning of the year to well below average as we conclude 2018.

Current economic conditions in Europe and Japan are healthy and provide a generally positive backdrop for equities, with the majority of economic indicators registering above long-term average readings. Corporate profits across foreign developed markets are estimated to grow at a healthy 8 percent over the full year in 2019. Adding 8 percent expected earnings growth to a current dividend yield of 3.5 percent provides a reasonably solid base for foreign developed equity prices to move higher. As noted earlier, valuation has moderated below long-term averages and is near 20-year lows when compared to U.S. equities.

Tempering our positive outlook, economic momentum in Europe clearly has waned based on our analysis of a broad range of macroeconomic indicators. Our work suggests the cyclical recovery in the region may have peaked in early 2018. The Japanese economy also decelerated in the second half of 2018. Corporate profit growth across foreign developed markets also reflects a "peak growth" condition, with annual earnings growth slowing from 39 percent in 2017 to approximately 16 percent in 2018 and an estimated 8 percent in 2019. Finally, investor sentiment, reflected in various measures of equity market valuation, and price momentum, or the trend in stock price movements, both remain weak.

Balancing still-positive profit growth, supportive dividend yield and more attractive valuation with softening macroeconomic data, decelerating earnings growth and weak price and valuation trends, we maintain a neutral outlook on foreign developed equities into 2019.

Despite disappointing returns, we continue to view opportunities and risks in emerging markets as fairly balanced as we look to 2019 and retain our neutral stance.

Emerging market equities finished as the strongest performers in 2017 but reversed course sharply in 2018, similarly peaking in late January and ending November as the weakest performing asset class. Negative emerging market equity performance was also compounded by strength in the U.S. dollar, which contributed nearly 5 percent to the more than 13 percent decline in emerging market equities for U.S.-based investors.

Corporate profits in emerging markets are expected to grow a solid 12 percent for the full calendar year in 2018. The combination of sharply falling equity prices and double-digit year-over-year profit growth has resulted in the valuation of emerging market equities also compressing from well above long-term averages at the beginning of the year to slightly below average as we conclude 2018. In addition to falling valuation (reflecting worsening investor sentiment), price momentum, or the movement in emerging market equity prices, is also weak.

An environment of rising U.S. interest rates and an appreciating U.S. dollar relative to other currencies persisted into the second half of 2018. This combination creates one of the most challenging macro environments for emerging market countries. Borrowing costs for emerging market countries and companies, along with rising U.S. interest rates, increase the competitiveness of U.S. Treasury yields to other, riskier investments, such as emerging markets equities. Of note, the interest rate on the two-year U.S. Treasury note is slightly higher than the dividend yield on the emerging market equity index.

In addition, uncertainty regarding ongoing trade negotiations between the United States and China, the world's two largest economies, has also served to increase the "premium" that investors demand for riskier assets, such as investments in emerging market equities.

Helping to offset U.S. dollar and interest rate headwinds and trade-related uncertainty, China's policymakers have recently enacted a variety of measures to stimulate the economy, including monetary easing, middle-class tax cuts and regulatory reforms. In addition, oil prices, which had risen steadily in 2018, suddenly reversed course beginning in early October and are now below beginning-of-the-year prices. This should serve as an additional stimulus to the global economy in general, but in particular to emerging market economies that are dependent on oil imports, such as China, South Korea and Taiwan, as we look to 2019. Finally, corporate earnings in emerging market equities are estimated to rise by a solid 10 percent in 2019. When combined with a 2.75 percent dividend yield, this provides a solid base for equity prices to move higher.

Within emerging market equities, we continue to have a positive view of "thematic" approaches that focus on China's maturing economy (areas such as healthcare, the environment and infrastructure that connects China to the world) and the growing ranks of middle class consumers in emerging markets. On Singles Day (November 11), China's version of Black Friday or Cyber Monday in the United States, China's e-commerce giant generated a record 213.5 billion yuan ($30.7 billion) in one-day sales, a 27 percent increase over 2017. To put the size of the emerging middle class into perspective, an Adobe Analytics report estimated that this year's Cyber Monday (November 26) was the largest online shopping day in U.S. history, with $7.9 billion in estimated one-day sales, which translates to roughly one-quarter of China's Singles Day take.

Balancing poor price momentum, falling valuation and trade uncertainty with easing oil prices, Chinese policy stimulus, still healthy earnings growth and relatively moderate valuations, we remain neutral on emerging market equities. While recent price declines present an appearance of value and falling oil prices remove one major headwind, we continue to watch for a reversal in the challenging macro conditions described above and a commensurate decline in risk "premium" before adjusting our forward view.

Fixed income markets

Fed actions and heavy Treasury bond issuance are likely to push rates higher early in 2019.

The Fed has already raised interest rates three times in 2018 but bond yields are still low by historical standards. Questions around the sustainability of higher rates are emerging as we see softer housing turnover and auto sales. We expect yields to rise in coming months, due in large part to likely Fed rate hikes that remain underappreciated by the market. However, if investor risk sentiment continues to deteriorate, we could see downward pressure on longer-term Treasury yields. In the near term, we believe catalysts for higher rates such as Fed rate hikes, stable inflation and U.S. growth, increased U.S. Treasury debt issuance (due to a rising fiscal deficit) and weak demand for U.S. Treasuries by foreign investors will provide ample evidence for higher rates.

We advocate for shorter-than-normal bond portfolio maturities due to the current limited reduction in yields, along with our expectation for higher rates. Treasury bonds, particularly those with shorter maturities, offer increased competition and a more balanced risk/reward versus riskier income-producing assets. Further, as the Fed continues lifting short-term rates, short maturity bond portfolios will capture higher yields as maturities are reinvested in new, higher-yielding bonds.

Weakening sentiment could be a sign the current business cycle is nearing an end, but current credit valuations appear reasonable.

Investment-grade and high yield credit valuations are near long-term medians after being expensive for most of 2018. While investor risk sentiment has begun to shift, trailing corporate fundamental metrics remain mixed to strong and domestic economic indicators have only moderated slightly. We believe normal allocations to credit investments should still receive fair compensation for risk for the time being. If fundamentals deteriorate, we would consider reducing exposure in favor of safer U.S. Treasury bonds or other currency-hedged sovereign debt.

Allocation to Treasury Inflation Protected Securities (TIPS) is warranted, and we remain neutral on the category. Inflation data trends have softened. Inflation expectations have also weakened, narrowing TIPS valuations relative to nominal bonds. TIPS also provide a hedge against a late-cycle inflationary surprise, which remains a possibility (though not our base case) given the strong labor market.

Global central bank policy is likely to shift into neutral with the United States continuing to tighten.

We believe the Fed is likely to increase the target funds rate twice in 2019. There is two-sided risk in this estimate, and the result is heavily dependent on economic data. Market-based odds price less than one hike in 2019, which we believe underappreciates the Fed's likely path. Until growth slows, corporate fundamentals deteriorate or capital markets experience a more meaningful decline, the Fed is likely to remain on track to meet their expected rate increases. Treasury yields should move modestly higher as the market further acknowledges the Fed's resolve.

On a net basis, major central banks' net asset purchases are now negative and still falling. This removal of support adds an incremental tailwind to rising yields. We expect the Fed to continue allowing the balance sheet to decline at the current pace of $50 billion per month for the time being. It is possible the Fed halts purchases late in 2019 or in 2020 if they determine a certain amount of reserves are necessary. The European Central Bank (ECB) has been a major asset buyer, but is scheduled to conclude their purchase program at year-end 2018.

Monetary policy could become restrictive in 2019 if growth trends weaken. These fears have been the primary catalyst to widening spreads in the fourth quarter of 2018. However, domestic credit and economic fundamentals appear mixed to strong for the time being.

Balanced risk/reward between corporate credit and U.S. Treasuries.

We recommend a balanced allocation between U.S. investment grade corporate bonds and U.S. Treasuries. Growing fears of a restrictive Fed have pushed investment grade yield spreads to Treasuries near median long-term levels after remaining rich for much of 2018. Credit fundamentals are mixed while credit trends are positive, supporting a neutral allocation. Flows have weakened in 2018 after a strong 2017 as investors cooled to BBB-rated issuance comprising a growing share of investment-grade corporate indices.

We are neutral on high yield corporate bonds, with a negative bias. High yield bonds offer meaningful incremental yield relative to investment grade corporates and U.S. Treasuries. Weakening sentiment has contributed to weak performance of late, and serves as an important reminder of the susceptibility of high yield bonds to repricing risk. Valuations are near long-term median levels and limited supply remains a supporting factor for the category. Deteriorating issuance quality in the bank loan segment of the high yield market warrants caution. We strongly advocate for active management within the high yield space, reflecting the higher risk and diverse nature of the market.

Balanced view of municipal debt, with elevated valuations offset by limited supply.

Municipal bond valuations are reasonable based on historical breakeven tax rates versus U.S. Treasuries. Limited supply continues to support prices, and munis continue to provide value for taxable investors in higher tax brackets. Longer term, legacy liabilities (such as underfunded pensions, increased healthcare spending and deferred maintenance on infrastructure) may pose risks to certain segments of the municipal bond market. For crossover investors, municipals with longer-maturity profiles may offer more compelling value relative to longer maturity Treasury and investment-grade corporate bonds.

Mixed view on non-U.S. bonds leads us to prefer currency-hedged or U.S. dollar-denominated investments.

Yields in developed markets remain low, though like U.S. yields, are trending higher. Monetary policy outside the United States remains in the early stages of removing accommodation, which should push yields higher. When currency risk is unhedged, low yields and incremental currency volatility make the category unattractive. On a currency-hedged basis, U.S. investors can generate reasonably attractive yields with relatively low credit risk.

For investors with higher-than-average risk tolerance, emerging market debt remains an opportunity for diversification, though ongoing volatility is likely.

Emerging market debt experienced a challenging 2018 as yield spreads to Treasuries widened. With risk sentiment weak, valuations are near long-term medians and are attractive relative to U.S. high yield spreads. However, emerging market economic fundamentals and momentum remain weak, both on an absolute basis and relative to developed markets. If the Fed proceeds with further rate hikes, monetary conditions in emerging markets could continue to tighten due to heavy reliance on U.S. dollar debt issuance. We remain neutral on emerging market debt, with a negative bias based on the balance between reasonable valuations versus weakening economic momentum. We continue to recommend active management. Like non-U.S. developed markets, incurring emerging market foreign currency risk has often resulted in uncompensated price volatility. As such, we advocate for U.S. dollar-denominated bonds within the emerging market bond category.

Real estate markets

Rising interest rates and rich valuations are limiting price gains, but income still solid.

Centrally located, Class A property prices, as measured by the Greenstreet Commercial Property Price Index, have been relatively flat for two years now. Although vacancies have declined to near record lows, income growth net of certain expenses (NOI) has been slowing. We expect the deceleration in NOI growth to continue due to growth in the supply of properties and the late stage of this business cycle. Additionally, NOI relative to property values is near all-time low levels, indicating valuations for property are quite rich. Finally, commercial mortgage interest rates are now just slightly below the average earnings yield on Class A property, limiting returns to property holders once they account for financing costs. As the Fed continues to raise rates and, if inflationary pressures build, the spread between mortgage rates and property earnings yields could compress further. Historically, commercial property prices have come under pressure when commercial mortgage rates reach the level of the property market's earnings yield.

As we look forward into 2019, these factors should limit any significant upside to property market prices. Those forces have kept prices in check for the past two years and they are moving in the wrong direction. While many of our property market indicators are urging caution, we believe investors can still earn the dividend yield of real estate investments. Furthermore, property investments do offer a compelling risk/reward tradeoff relative to other asset classes. Therefore, we remain tactically cautious as more Fed rate increases could dislodge capitalization rates from historical lows, causing price declines in commercial real estate.

Commodities markets

Supply and demand imbalances affecting prices, but opportunities arise.

Commodity markets from industrial metals to oil have come under serious pressure in the second half of 2018. Trade wars, fed tightening and emerging market currency scares have caused the market to question global growth assumptions and the demand side of the commodity market, especially oil. On the supply side of the oil market, U.S. shale production has broken out to new record highs as it appears some bottlenecks to production, especially in the Permian basin, have been resolved. On the global supply front, OPEC ramped up production to record levels to offset any supply disruptions from Iranian sanctions. When those sanctions were watered down by President Trump, the market moved from fears of a supply disruption to fears of a supply glut.

However, the oil market is not in the same supply situation as a few years ago when oil fell to $30 per barrel. Inventories in the United States are still 25 percent below levels of early 2016 and inventory levels at the critical storage hub of Cushing, Oklahoma, are 50 percent below the level of three years ago. Globally, there does not appear to be excess productive capacity in any meaningful amounts. While further downside risk to oil prices still exists, we do not see prices falling to the levels of early 2016 unless global demand declines significantly.

One casualty of the oil price decline has been the midstream infrastructure space, which is currently trading near cycle lows. From a fundamental perspective, the midstream industry is improving. Earnings before interest, tax, depreciation and amortization (EBITDA), which is a measure of a company's operating performance, is growing at a high rate and conversion of master limited partnerships (MLPs) to C corporations has greatly improved corporate governance. However, valuations have been going the other way. With valuation metrics lower than 95 percent of historical ratios relative to itself and relative to the broader market, we believe the midstream space looks cheap.

Alternative investments

No shortage of political and economic undercurrents heading into 2019.

A slowing global economy, potential for further interest rate hikes, the continuing trade war jostling between the United States and China and the shift in the power structure within Washington D.C. makes for interesting times. Two additional factors for investors to consider are: the steady decline in the number of publicly listed securities, and companies remaining private longer before publicly listing. In our view, all of the above provide fertile ground for private capital and hedge fund investments.

However, it is important that investors remain diligent when investing in private capital funds and only do so with those that have identifiable competitive advantages, such as an established network for sourcing proprietary investments and/or a track record of improving companies' businesses via new products, cost reductions and optimizing working capital on the highest returning projects. The increase in the number of private companies is expected to be beneficial for investors due to increased demand for private equity and private debt.

For hedge funds, the diminishing list of public companies may further widen the disparity between well-run companies and those that ultimately end in mediocrity or failure. Interestingly, we are observing that the amount of technology utilized by businesses is a common factor, separating winners from the losers. Also, if the increase in stock market volatility in the fourth quarter of 2018 is indicative of the investment landscape in 2019, then hedge funds, in general and when appropriate, may warrant consideration given the potential to help reduce overall portfolio volatility. Protecting capital is critical to a hedge fund's investment discipline. During times of market volatility and uncertainty, hedge funds can be nimble and quickly make changes to portfolios to potentially reduce losses.

Changes are underway in the alternative investment landscape.

Navigating the challenging economic backdrop is difficult enough. Alternative managers are also grappling with the velocity of technology innovation, understanding the impact of changing demographics, the blurring of industries and how each of these factors are reshaping the companies/businesses they invest in. Equally daunting is the shifting alternative investment landscape, which is forcing fund managers to: 1) utilize next-generation technology to deal with lower fees demanded by investors, 2) optimize firm resources to maximize value-add for clients, 3) hire employees with the skill sets for "tomorrow's" investment firm, and, 4) become more of a partner to the clients, not just an asset manager. These and other factors are the catalysts for alternative fund managers developing strategies that incorporate more technology to become nimbler in making investment decisions. Expected results from implementing technology is more timely and accurate processing of data to improve analytical capabilities. We believe that managers making these changes will likely remain competitive and those late to change will not likely exist over the long term.

Below are some of our thoughts on hedge fund and private capital investment opportunities:

- **Hedged equity:** It should be no surprise after all the references to technology that we have a positive outlook for funds that invest in sectors that benefit from the use of technology, developing technology or processing technology, etc. Biotech companies are a good example. These companies benefit from the use of technology that speeds up the research, development and testing processes to get a drug to market. Decreasing the time and money spent on the research and development process allows smaller companies to focus on developing "orphan" drugs targeting a small number of patients suffering from debilitating diseases. Prior to having today's technology available, most small companies were unable to pursue these types of medical solutions due to the time and expense spent on the research and FDA approval process.

- **Hedged fixed income:** We still prefer funds that invest in below investment grade credits that are well positioned to take advantage of any credit deterioration. In our view, trading-oriented funds (with strong credit analysis) that understand the dynamics of how these markets trade are best positioned to take advantage of the dispersion between companies with well-managed capital structures versus those burdened with too much debt that is likely to become troublesome to service during an economic slowdown. Another advantage is that these credit prices are driven by credit quality and less sensitive to interest rates if they rise further.
- **Private equity:** We expect demand for funds to continue into 2019 based on our belief of higher expected returns over public markets. Assuming a modest growth environment for 2019, we are looking for funds that invest in companies with high barriers to entry and pricing power that will remain stable if the economy slows more than expected. Healthcare fits this profile due to its lower correlation to the economic cycle and how technology is improving efficiencies to reduce costs.

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Past performance is no guarantee of future results. All performance data, while deemed obtained from reliable sources, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for investment. The **S&P 500 Index** is an unmanaged, capitalization-weighted index of 500 widely traded stocks that are considered to represent the performance of the stock market in general. The **MSCI EAFE Index** includes approximately 1,000 companies representing the stock markets of 21 countries in Europe, Australasia and the Far East (EAFE).

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. The value of **large-capitalization stocks** will rise and fall in response to the activities of the company that issued them, general market conditions and/or economic conditions. **Stocks of small-capitalization companies** involve substantial risk. These stocks historically have experienced greater price volatility than stocks of larger companies and may be expected to do so in the future. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible difference in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investment in debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return, but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issuers of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes, but may be subject to the federal alternative minimum tax (AMT), state and local taxes. **Treasury Inflation-Protected Securities (TIPS)** offer a lower return compared to other similar investments and the principal value may increase or decrease with the rate of inflation. Gains in principal are taxable in that year, even though not paid out until maturity. There are special risks associated with an investment in **commodities**, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors. Investments in **real estate securities** can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risks related to renting properties (such as rental defaults). **Hedge funds** are speculative and involve a high degree of risk. An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem or transfer interests in a fund. **Private capital investment funds** are speculative and involve a higher degree of risk. These investments usually involve a substantially more complicated set of investment strategies than traditional investments in stocks or bonds, including the risks of using derivatives, leverage, and short sales, which can magnify potential losses or gains. Always refer to a Fund's most current offering documents for a more thorough discussion of risks and other specific characteristics associated with investing in private capital and impact investment funds. **Private equity investments** provide investors and funds the potential to invest directly into private companies or participate in buyouts of public companies that result in a delisting of the public equity. Investors considering an investment in private equity must be fully aware that these investments are illiquid by nature, typically represent a long-term binding commitment and are not readily marketable. The valuation procedures for these holdings are often subjective in nature.

