

Global Economic Growth: In Concert

Quarterly Snapshot

- › Senate Republicans retired their latest Obamacare repeal effort as the quarter came to a close, and attention shifted to a tax-reform proposal that favored a substantial reduction in the corporate tax rate.
- › Stocks continued to advance around the globe; the U.S. dollar continued to weaken versus other major currencies; and WTI Cushing crude-oil prices bottomed in early July before climbing to finish the quarter above \$50 per barrel.
- › A large portion of the world appears to be growing at a slightly better-than-trend pace. While we would not rule out a correction in asset values more notable than those seen in the recent past, our buy-on-the-dip approach still holds.

Economic Backdrop

Senate Republicans seemed to accept that their recent Obamacare repeal effort was unlikely to succeed in its current form as the quarter came to a close. Attention shifted to tax reform; the Trump administration's proposal favored a substantial reduction in the corporate tax rate and lower top-individual income-tax rates, as well as the elimination of estate taxes and consolidated deductions typically claimed by the middle class. Natural disasters wrought havoc around the globe: a brutal hurricane season left the Caribbean in tatters and the U.S. with one of its largest recovery bills in history; earthquakes in Mexico killed hundreds; more than 1,000 people lost their lives in monsoon floods on the Indian sub-continent; and tens of thousands in Indonesia were forced to evacuate areas near expected volcanic activity.

Elsewhere, a late-quarter speech by U.K. Prime Minister Theresa May in Florence—the birthplace of the Renaissance and symbol of common European ideas—helped thaw the contentious postures on both sides of the Brexit negotiating table by offering concessions as she formalized the U.K.'s expectations and proposed timetable. Afterward, German Chancellor Angela Merkel's Christian Union received the largest share of votes in a federal election (ensuring her continued leadership)—but in smaller proportion than in the past and at the cost of her coalition with the Social Democrats. Near the end of the quarter, an independence referendum held in Iraqi Kurdistan voted overwhelmingly in favor of independence—yet the outcome was not recognized by Iraq's federal government. Similarly, Catalonians held an independence vote immediately after the end of the quarter that the Spanish government declared illegitimate and sought to disrupt.

Stocks continued to advance around the globe, driven by Brazil and other emerging markets. European and Japanese stocks finished modestly higher, rallying in September after sliding for much of the quarter. U.S. stocks gained, led by smaller companies that accelerated in the second half of the quarter. U.K. stocks also delivered healthy performance. China performed well, with Hong Kong stocks outperforming the mainland. U.S. Treasury yields increased (yields move inversely to prices), with shorter-

Key Measures: Q3 2017

EQUITY	
Dow Jones Industrial Average	5.58% ↑
S&P 500 Index	4.48% ↑
NASDAQ Composite Index	6.06% ↑
MSCI ACWI Index (Net)	5.18% ↑
BOND	
Bloomberg Barclays Global Aggregate Index	1.76% ↑
VOLATILITY	
Chicago Board Options Exchange Volatility Index	9.51 ↓
<small>PRIOR: 11.18</small>	
OIL	
WTI Cushing crude oil prices	\$51.67 ↑
<small>PRIOR: \$46.04</small>	
CURRENCIES	
Sterling vs. U.S. dollar	\$1.34 ↑
Euro vs. U.S. dollar	\$1.18 ↑
U.S. dollar vs. yen	¥112.57 ↑

Sources: Bloomberg, FactSet, Lipper

term rates rising by more than longer-term rates. Currency trends held for most of the quarter, as the U.S. dollar weakened further versus the euro and yen before reversing course and strengthening in early September. The U.S. dollar-British pound relationship was fairly steady until mid-September, when the dollar resumed its slide. Oil prices bottomed in early July, climbed to a late-September peak and finished the quarter above \$50 per barrel.

Global central banks continued to migrate slowly toward tighter policy, most notably with the U.S. Federal Reserve's (Fed) formal announcement in September that it would begin to modestly reduce balance-sheet assets accumulated through its quantitative-easing programs during and after the global financial crisis. The Fed also projected an additional interest-rate increase before the end of the calendar year. In its September statement, the Bank of England's (BOE) Monetary Policy Committee expressed that it may tighten policy by more than markets expect. The European Central Bank's (ECB) September meeting did not yield new information regarding an anticipated reduction (and ultimate cessation) of its asset-purchase program; although prior comments by ECB officials suggest a firm announcement could be made in the relative near future. The Bank of Japan did not take any new policy actions during the quarter.

U.S. manufacturing activity accelerated in September, maintaining momentum from August. Growth in the services sector settled, albeit at healthy levels. Personal income and consumer spending growth both slowed in August from stronger July reports; the core personal consumption expenditure index (the Fed's go-to inflation gauge) moved lower for the year-over-year period. Overall U.S. economic growth accelerated to an annualized 3.1% during the second quarter, primarily thanks to strong consumer spending.

The eurozone manufacturing and services sectors both accelerated during September from already-robust levels earlier in the quarter; manufacturing activity pushed to its highest level in more than six-and-a-half years. Price pressures rebounded during the quarter, but remained relatively subdued at the consumer level for the year-over-year period, while producer prices were more elevated. Improvement in the headline unemployment rate levelled off during the quarter through August, holding at 9.1%.

U.K. retail activity finished the quarter on a promising note, with a significant jump in retail sales volumes. Manufacturing growth was off a bit in September from its August peak, but finished the quarter in better overall circumstances. Economic growth was a firm 0.3% in the final second-quarter reading, but revised downward to 1.5% for the year-over-year period.

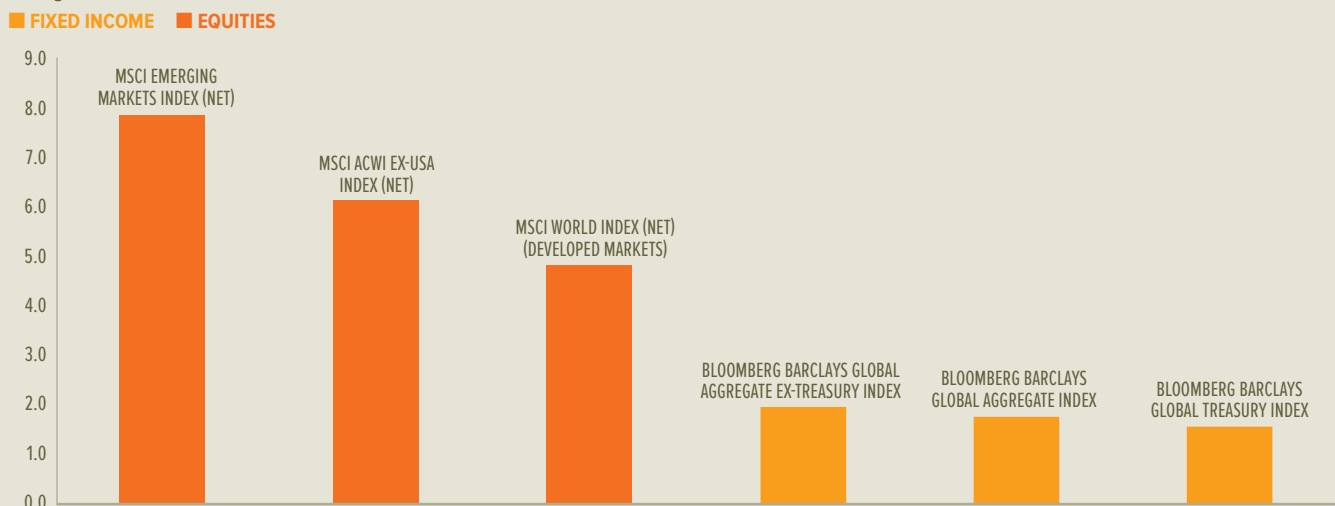
Portfolio Review

Equity markets continued to rise around the globe, and U.S. stocks were no exception. Our large-cap strategies performed well during the quarter primarily due to allocation decisions, with underweights to the real estate and utilities sectors contributing to relative returns by more than enough to counter an unfavorable underweight to technology. Small-caps outperformed large-caps as optimism returned to the pro-growth agenda, with an early draft of the tax-reform plan taking shape. Our small-cap strategies were challenged, however, as weak selection in industrials and healthcare more than offset strong stock selection in technology and allocations to industrials and real estate. Overseas, developed markets advanced, but trailed the U.S. and emerging markets. Our international developed-market strategies performed well on strong selection, particularly in Asian technology stocks, and on underweighting sectors within countries facing macroeconomic headwinds. Underweights to Japanese and Australian financials contributed, as did selection in Europe. As emerging markets continued to outperform other regions, our strategies performed well there—principally due to positioning in Latin America. Brazil was the best country-level performer during the quarter, as its economic recovery was boosted by a central-bank rate cut; an overweight to and selection within the country therefore contributed. Emerging Asia also performed well; our strategies benefited from selection in technology there, particularly within China and Taiwan. Positioning in Korean telecommunications detracted, as did overall exposure to Indonesia, while an overweight to and selection in Russia helped.

Our core fixed-income strategies performed well during the quarter, as non-government sectors outperformed U.S. Treasuries in a generally positive environment for bonds. A yield-curve-flattening bias contributed to returns; long-term yields rose by less than short-term yields, while

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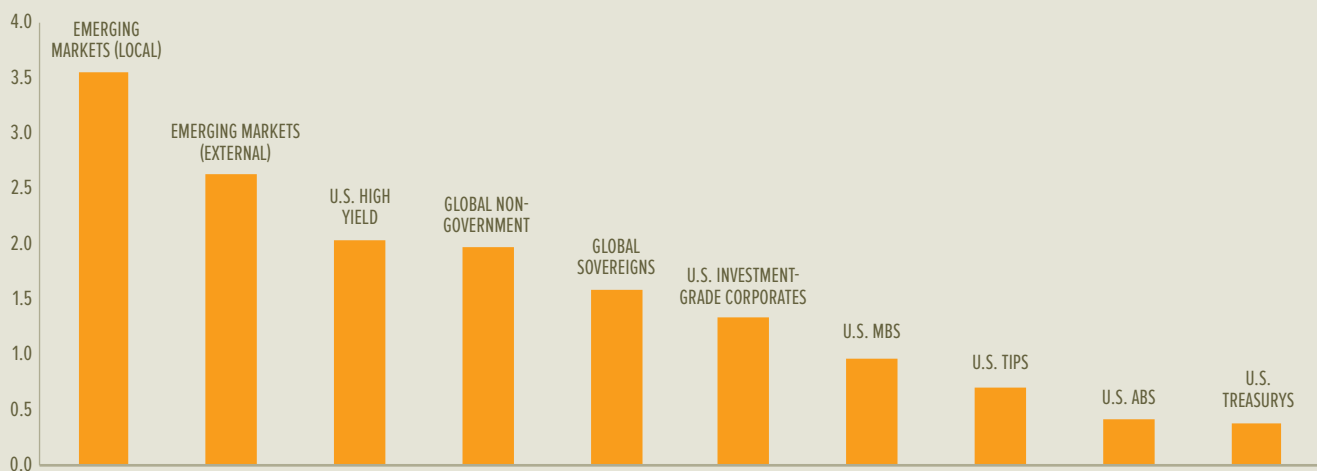
Major Index Performance in Q3 2017 (Percent Return)



Sources: FactSet, Lipper

strategy duration was effectively neutral and had little impact. Credit-quality spreads narrowed to their tightest levels of the year, as corporate-bond fundamentals remained supportive amid rising rates. Positioning within the financial sector contributed, while small underweights to industrial and utility issuers were a slight drag on performance. Securitized-sector positioning was also beneficial, with overweights to non-agency mortgage-backed securities (MBS), asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS) all contributing; higher-quality positioning helped ABS performance but hindered CMBS. Increasing the allocation to the agency MBS sector from an underweight toward a neutral weight during the quarter was beneficial, as the sector outperformed. The high-yield market continued to rally, and our strategies performed in line with the benchmark. Selection within the energy and healthcare sectors, along with an underweight to telecommunications, were top contributors; an allocation to bank loans detracted the most, while selection in retail and overall positioning within media also weighed on performance. Emerging markets continued to outpace other fixed-income segments, with local-currency debt retaining its lead on foreign-currency (external) debt. Our emerging-market debt strategies performed well, as a result of overweights to Argentinian external debt and the Egyptian pound as well as a long position to the Chilean peso. Currency underweights were the chief detractors, as most emerging-market currencies strengthened versus the U.S. dollar during the quarter.

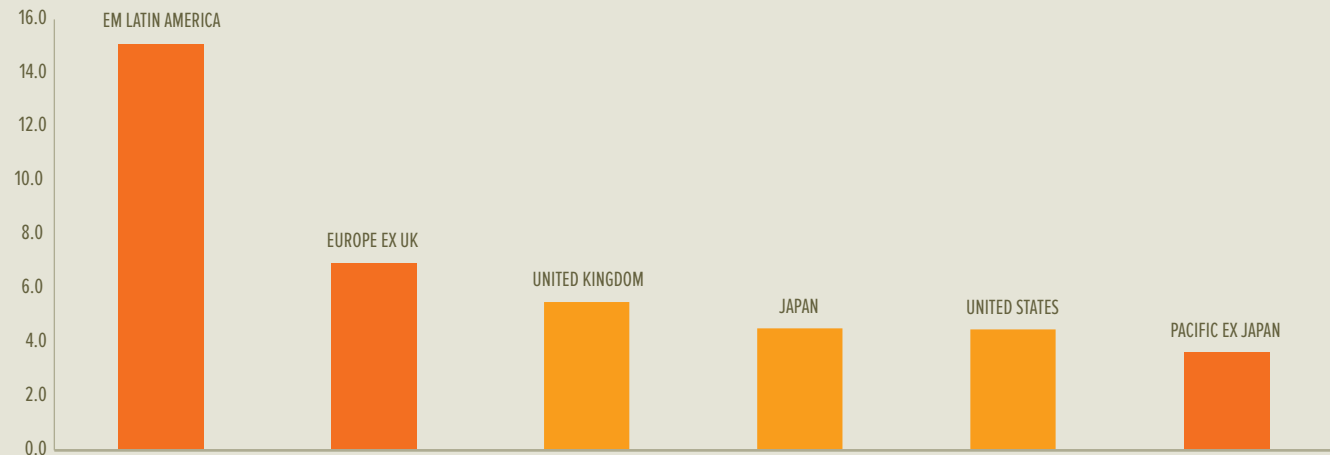
Fixed-Income Performance in Q3 2017 (Percent Return)



Sources: FactSet, Lipper. See "Corresponding Indexes for Fixed-Income Performance Exhibit" in the Index Descriptions section for more information.

Regional Equity Performance in Q3 2017 (Percent Return)

■ COUNTRIES ■ REGIONS



Sources: FactSet, Lipper. See “Corresponding Indexes for Regional Equity Performance Exhibit” in the Index Descriptions section for more information.

Manager Positioning and Opportunities 🧑‍🤝‍🧑

U.S. company earnings were better than expected in second-quarter reports, the global economy has strengthened, and interest rates remain low from a historical standpoint. These factors have led to higher-than-normal valuations for the U.S. equity market—so much so that there could be significant downside risk for the market if earnings expectations do not come through, or if geopolitical issues come to a head. Within our U.S. equity strategies, allocations to cash and stability-oriented managers are expected to cushion downside risk in case of a market correction. From a return perspective, we remained tilted toward value in an effort to capture long-term premium from undervalued securities. Overseas, our developed-market strategies retained overweights to areas of high potential growth, particularly technology and industrial companies. We maintained underweights to Australian and Japanese financials, as well as to traditional defensive sectors (telecommunications, utilities and consumer staples). Within emerging markets, Asian equities remained both a structural underweight and our largest absolute regional exposure. We continued to underweight most Asian emerging-market countries—with the exception of India; we moved the country to an overweight, as it experienced what we view as temporary weakness after the implementation of a new goods and services tax. We continued to emphasize Latin America, with a primary focus on Brazil, a slight overweight to Mexico and an off-benchmark allocation to Argentina. Elsewhere, we retained an overweight to Turkey as policy appears to be driving an improved outlook.

Our core fixed-income strategies have been gradually reducing their yield-curve-flattening bias as the curve has flattened during 2017. We remained overweight the corporate sector, particularly banking; however, we selectively trimmed bonds that exceeded valuation targets, as a heavy new-issuance calendar could provide opportunities to add back risk at more-favorable levels. Securitized overweights remained, given their

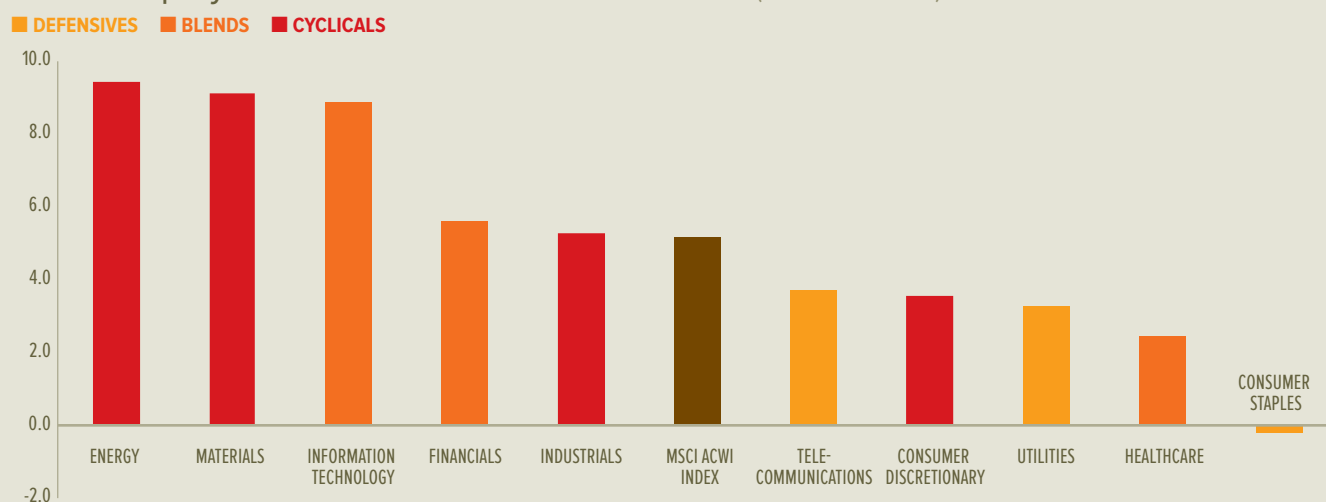
competitive risk-adjusted yields. We now have a modest overweight to agency MBS, as their spreads nearly doubled in the second quarter. High-yield positioning continued to feature an allocation to bank loans and an overweight to leisure. This was offset primarily by underweights to capital goods, basic industry, telecommunications and services. Within emerging markets, we remained overweight local-currency debt and underweight external debt, with a continued allocation to corporates. Our largest active positions were an expanded underweight to the Philippines and an increased overweight to Mexico. We also moved from an underweight in China to an overweight. In currency terms, our largest positions were overweights to the Mexican peso and Egyptian pound, and an underweight to the Philippine peso (which was previously a neutral weight). We reduced our overweight to the Polish zloty and moved from a neutral weight to an overweight in the Chinese yuan.

Our View

Neither devastating hurricanes nor all-around political dysfunction have done much to halt the U.S. equity market's rise. Even the game of nuclear chess being played between North Korea's Kim Jong-un and President Donald Trump has failed to elicit much of a response. To be sure, all good things eventually come to an end. Yet when we consider valuations, the upward momentum of the U.S. economy and earnings, and the likely path of Fed policy and inflation, we still conclude that the U.S. equity bull market isn't dead yet.

On the issue of valuations, there is no denying that U.S. equities are trading at elevated levels. But the exceedingly low level of prevailing interest rates is an important mitigating factor. There has been a strong inverse relationship between bond yields and valuations over the past four decades, which we believe justifies structurally elevated valuations.

Global Equity Sector Performance in Q3 2017 (Percent Return)



Sources: FactSet, Lipper. MSCI ACWI Index Components (as defined by SEI).

U.S. equities also appear relatively expensive when comparing their valuations against those of other countries. Indeed, many other countries are on the cheap side—not only against the U.S., but also against their own histories. This is one reason we currently favor international equity markets versus U.S. equities.

High valuations imply the U.S. equity market could be a performance laggard in the years ahead relative to other stock markets; but they cannot predict an imminent downturn. We believe that valuations are a lousy timing tool for the simple reason that expensive markets can get more expensive.

The overriding question among investors is a simple one: is a recession on the horizon? We are confident that the answer is “no.” Financial stress, a harbinger of recession, is virtually non-existent. Recent economic data also point to the continuation of slow-but-steady economic growth.

A large portion of the world appears to be growing at a slightly better-than-trend pace. The breadth of the improvement is particularly impressive; as of July 2017, 72% of the countries that make up the Organisation for Economic Cooperation and Development’s (OECD) Composite Leading Indicator index have posted improvement over the past year—and 75% of countries in the index came in above 100. This means above-trend growth will likely continue in the months ahead on a global basis.

According to the OECD’s calculations, Brazil’s economic situation is improving at the fastest rate. The eurozone as a whole looks set to grow above trend, as does Japan. China’s momentum remains toward the upside, even though recent economic data suggest some deceleration. The U.S. economy, by contrast, is growing somewhat below trend. India also is signaling below-trend growth, but has begun to rebound. On balance, things are looking up in much of the world.

One of the big surprises of 2017 is the extensive weakness of the U.S. dollar, which has fallen by about 8% against a trade-weighted basket of foreign currencies since the end of last year. The U.S. dollar can appreciate and depreciate in long cycles. If the peak at the end of 2016 proves to be the top of the current cycle, the most recent upswing would be shorter in duration than previously experienced—but the magnitude of the trough-to-peak rise would be similar to that of the up-cycle that occurred from April 1995 to March 2002 (about 41%).

The drop in the greenback coincides with the improved global macroeconomic outlook. Economic growth of developed economies around the world is converging with that of the U.S. While U.S. monetary policy is further along the path toward tightening, other central banks have already begun to raise rates (Canada) or may do so soon (the U.K.). Even the ECB is expected to announce its first steps away from unconventional monetary stimulus by the end of this year.

Political considerations are coming into play as well. Participants in the currency markets have adopted a far more sanguine view regarding the political stability of the eurozone following a series of national elections

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this year that enhanced the position of parties favoring further European integration. While confidence in the eurozone has increased, international confidence in the U.S. has ebbed. The Trump administration's decision to pull out of the Trans-Pacific Partnership and Paris climate accord was controversial in the U.S.; it was especially confounding to those outside the U.S., and raised questions of whether it is relinquishing its role as leader of the free world. Confidence in the existing international economic order was also hurt by the threat of additional U.S. trade discord with Canada, Mexico, South Korea and China. Trump was voted into office partially owing to his populist stance on trade; but we think a trade war could be as dangerous an economic blunder today as it was during the Great Depression.

We continue to expect a U.S. business-friendly tax package to be enacted and signed by the Trump administration before the end of the year. However, the absence of such legislation could further dampen investors' expectations for U.S. economic growth—thereby causing a serious correction in the overall U.S. equity market, especially hurting economically sensitive small-company and value stocks.

As noted above, the upturn in global economic activity has spurred the world's major central banks to reassess their policy stance. The danger is that they could make a policy mistake, either by acting too quickly or not fast enough. The BOE faces the greatest policy challenge, with an accelerating inflation rate at a time when its overall economic growth has been somewhat below that of the U.S. and eurozone. Although the BOE has signaled its intention to reverse the easing implemented in the aftermath of the Brexit vote, it is unclear whether the correct policy course calls for further tightening moves.

In the run-up to this October's all-important National Congress of the Communist Party of China, the country's economic policy has been geared toward growth. President Xi Jinping's government has been focused on restraining rampant speculation in the property markets and curtailing growth of the shadow-banking system—with mixed success. As soon as China's economy begins to weaken and financial markets exhibit signs of stress, its economic planners tend to reengage the accelerator.

It may be time to step on the brake again following the National Congress and the likely strengthening of President Xi's political power coming out of that meeting. The current inflation rate for Chinese manufacturing producer prices is near the peak levels recorded in 2004, 2008 and 2011. A cyclical slowdown in China's economy would likely be bad news for commodity prices and other emerging economies. Since the overall consumer price index remains at less than a 2% rate, we expect the People's Bank of China to try a gentle tap on the brake.

While we would not rule out a correction in asset values more notable than others that occurred in the past 18 months, our investment mantra of buying on the dip still holds.

Our equity strategies remain positioned for further cyclical improvement around the world. They generally have a smaller-company and value bias versus their benchmarks. We tend to favor momentum-oriented opportunities, and view equity markets outside the U.S. as more attractive than U.S. equity markets. Indeed, our caution toward equities is most pronounced in the U.S., where the outlook for earnings growth is more modest than elsewhere in the world.

On the fixed-income side, we expect yields will slowly move higher as global growth becomes more entrenched and central banks begin to remove the extraordinary stimulative measures of quantitative easing and zero (or negative) interest rates. Our underlying managers are generally short duration versus their benchmarks, favor credit-spread strategies and are positioned for a further narrowing of the yield curve, especially in the U.S.

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Index Descriptions

All indexes are quoted in gross performance unless otherwise indicated.

The Bloomberg Barclays 1-10 Year U.S. TIPS Index measures the performance of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of one to ten years.

The Bloomberg Barclays U.S. Asset Backed Securities (ABS) Index measures the performance of ABS with the following collateral types: credit and charge card, auto and utility loans. All securities have an average life of at least one year.

The Bloomberg Barclays Global Aggregate Bond Index (formerly Lehman Brothers Global Aggregate Index), an unmanaged market-capitalization-weighted benchmark, tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.

The Bloomberg Barclays Global Aggregate ex-Treasury Index is an unmanaged market index representative of the total-return performance of ex-Treasury major world bond markets.

The Bloomberg Barclays Global Treasury Bond Index is composed of those securities included in the Bloomberg Barclays Global Aggregate Bond Index that are Treasury securities.

The Bloomberg Barclays U.S. Corporate Investment Grade Index is a broad-based benchmark that measures the investment-grade, fixed-rate, taxable corporate bond market.

The Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index measures the performance of investment-grade, fixed-rate, mortgage-backed, pass-through securities of Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Freddie Mac (FHLMC).

The Bloomberg Barclays U.S. Treasury Index is an unmanaged index composed of U.S. Treasuries.

The BofA Merrill Lynch U.S. High Yield Constrained Index contains all securities in The BofA Merrill Lynch U.S. High Yield Index but caps exposure to individual issuers at 2%.

The BofA Merrill Lynch U.S. High Yield Index tracks the performance of below-investment-grade, U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The Chicago Board Options Exchange Volatility Index (VIX) tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.

The Dow Jones Industrial Average is a widely followed market indicator based on a price-weighted average of 30 blue-chip New York Stock Exchange stocks that are selected by editors of The Wall Street Journal.

The FTSE All-Share Index represents 98% to 99% of U.K. equity market capitalization. The Index aggregates the FTSE 100, FTSE 250 and FTSE Small Cap Indexes.

The JPMorgan EMBI Global Diversified Index tracks the performance of external debt instruments (including U.S. dollar-denominated and other external-currency-denominated Brady bonds, loans, eurobonds and local-market instruments) in the emerging markets.

JPMorgan GBI-EM Global Diversified Index tracks the performance of debt instruments issued in domestic currencies by emerging-market governments.

The MSCI ACWI Index is a market-capitalization-weighted index composed of over 2,000 companies, representing the market structure of 48 developed- and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The Index is calculated with net dividends reinvested in U.S. dollars.

The MSCI ACWI ex-USA Index includes both developed- and emerging-market countries, excluding the U.S.

The MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.

The MSCI Emerging Markets Latin America Index captures large- and mid-cap representation across five emerging-market countries in Latin America.

The MSCI EMU Index (European Economic and Monetary Union) Index is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of countries within EMU. The MSCI EMU Index consists of the following 10 developed-market country indexes: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal and Spain.

The MSCI Europe ex-UK Index is a free float-adjusted market-capitalization-weighted index that captures large- and mid-cap representation across 14 developed markets countries in Europe (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden and Switzerland). The Index covers approximately 85% of the free float-adjusted market capitalization across European developed markets, excluding the U.K.

The MSCI Pacific ex Japan Index captures large- and mid-cap representation across four of five developed-market countries in the Pacific region (excluding Japan).

The MSCI World Index is a free float-adjusted market-capitalization-weighted index designed to measure the equity market performance of developed markets. The MSCI World Index consists of the following 23 developed-market country indexes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the U.K. and the U.S.

The NASDAQ Composite Index is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system.

The S&P 500 Index is a capitalization-weighted index made up of 500 widely held U.S. large-cap companies.

The TOPIX, also known as the Tokyo Stock Price Index, is a capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange. The Index is supplemented by the subindexes of the 33 industry sectors. The Index calculation excludes temporary issues and preferred stocks, and has a base value of 100 as of January 4, 1968.

Corresponding Indexes for Fixed-Income Performance Exhibit

U.S. High Yield	BofA Merrill Lynch U.S. High Yield Master II Constrained Index
Global Sovereigns	Bloomberg Barclays Global Treasury Bond Index
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index
U.S. Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage Backed Securities Index
U.S. Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index
U.S. Treasuries	Bloomberg Barclays U.S. Treasury Index
U.S. Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index
U.S. Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index

Corresponding Indexes for Regional Equity Performance Exhibit

United States	S&P 500 Index
United Kingdom	FTSE All-Share Index
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)
Japan	TOPIX, also known as the Tokyo Stock Price Index
Europe ex UK	MSCI Europe ex UK Index (Net)
EM Latin America	MSCI Emerging Markets Latin America Index (Net)

Disclosures

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