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QUARTERLY MARKET COMMENTARY | Q4 2018

Late-Year Selloff Snowballs on Uncertainty

Quarterly Snapshot

- The final quarter of 2018 hosted precipitous declines in stock markets around the globe, which settled into full-year losses.
- Government bonds led fixed-income performance in the three-month period, while riskier segments like high-yield bonds had the sharpest descent, consistent with a flight-to-safety environment.
- As painful as 2018 was for risk assets, their gyrations were not outside the norm. We see another important risk-on opportunity developing in equities and elsewhere.

Economic Backdrop

The final quarter of 2018 hosted precipitous declines in stock markets around the globe, exceeding corrections of the first quarter and erasing recoveries that followed during the second and third quarters in some parts of the world, settling into full-year losses. The three-month period began with swift and sharp selloffs, followed by a comparatively flat November overall in most regions; the final month of the quarter saw many markets hit with losses that were more severe than those experienced in October.

Government bonds led fixed-income performance, while riskier segments like high-yield bonds had the sharpest losses, consistent with a flight-to-safety environment (see Fixed-Income Performance exhibit on page 3). Sovereign yields fell in the UK and Europe during the fourth quarter, while the US Treasury yield curve continued to flatten as short-term rates increased and longer-term rates fell; intermediate-term segments of the US yield curve inverted at the beginning of December and broadened through the end of the year. Commodity prices generally tumbled during the fourth quarter, with West-Texas Intermediate crude-oil prices falling by 38%.

EU leaders agreed to terms of the UK's divorce in November, establishing a set of domestic challenges for Prime Minister Theresa May given the absence of parliamentary majority support. December was an especially eventful month, with the European Court of Justice ruling the UK could unilaterally halt Brexit by revoking Article 50; May surviving of a no-confidence vote that was brought about by a subset of her Conservative colleagues (in part by promising to stand down before the next election scheduled for 2022); and a growing chorus of politicians calling for a second referendum. Details of contingency plans for a no-deal Brexit also began to trickle out on both sides of the English Channel near year-end, addressing a range of subjects that included travel, trade and financial services.

Elsewhere, German Chancellor Angela Merkel did not seek re-election as leader of the Christian Democratic Union (CDU) party in December after poor turnout in regional elections, leaving Annegret Kramp-Karrenbauer (who was installed as the party's general secretary by Merkel in early 2018) to win the leadership in a vote for continuity. This outcome means that Merkel may be able to serve the remainder of her term as Head of Government through 2021. France was stricken by anti-establishment riots during most of the fourth quarter that were seemingly triggered by the perceived injustice of President Emmanuel Macron's tax policy; the

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Key Measures: Q4 2018

EQUITY		
Dow Jones Industrial Average	-11.31%	↓
S&P 500 Index	-13.52%	↓
NASDAQ Composite Index	-17.29%	↓
MSCI ACWI Index (Net)	-12.75%	↓
BOND		
Bloomberg Barclays Global Aggregate Index	1.20%	↑
VOLATILITY		
Chicago Board Options Exchange Volatility Index PRIOR QUARTER: **12.12**	25.42	↑
OIL		
WTI Cushing crude oil prices PRIOR QUARTER: **$73.25**	$45.41	↓
CURRENCIES		
Sterling vs. US dollar	$1.28	↓
Euro vs. US dollar	$1.13	↓
US dollar vs. yen	¥113.55	↓

Sources: Bloomberg, FactSet, Lipper

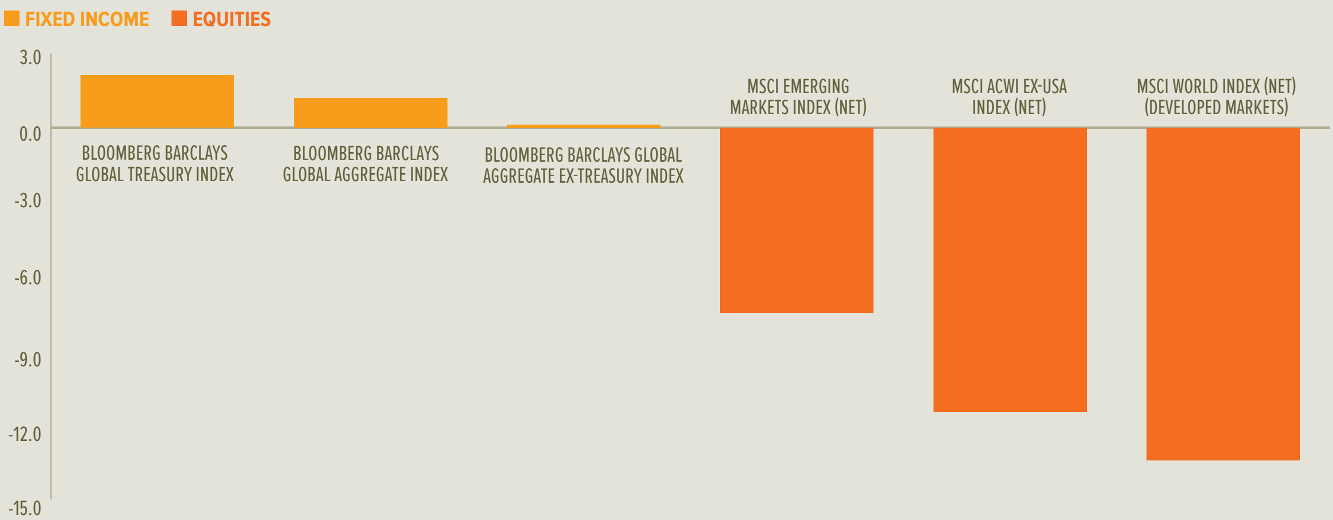
French president attempted to appease protesters in December with concessions that included cutting taxes for pensioners, increasing wages for underprivileged workers and reversing planned fuel-tax hikes. The Italian coalition government passed a budget at the end of December that retained some promised working-class relief after initial drafts were rejected by the EU for unacceptably large deficits.

US elections in early November produced a partial shift in power away from Republicans and toward Democrats in Congress and statehouses across the country. The new balance of authority in Congress should substantially limit the ability of President Donald Trump and Republicans to pass meaningful legislation; it also enhances the investigatory powers available to Democrats, thereby adding to political risk for the Trump administration. The US-China trade relationship began the fourth quarter on a downbeat, with President Trump threatening to expand tariffs to essentially all of China's imports. The situation improved after the countries' leaders conducted a trade-focused meeting on the sidelines of the early-December G20 summit, agreeing to delay punitive actions and producing a three-month roadmap toward more substantive progress.

The European Central Bank (ECB) unsurprisingly announced and issued the final net purchase of bonds as part of its quantitative-easing programme in mid-December. Guidance reassured that benchmark rates will remain unchanged as long as needed to achieve the ECB's inflation goal, and that its expanded balance sheet will not begin to shrink until after it begins raising rates. The US Federal Open Market Committee increased the federal-funds rate in mid-December—the fourth time in 2018—while softening its projections for future rate increases. The Bank of England and Bank of Japan's respective monetary policy groups each convened twice during the quarter, and neither introduced new policy actions.

UK services growth re-accelerated slightly in December after coming perilously close to contractionary conditions in November; manufacturing activity followed a similar pattern, but at relatively healthier levels. Eurozone business activity softened into year-end, with the services sector slowing

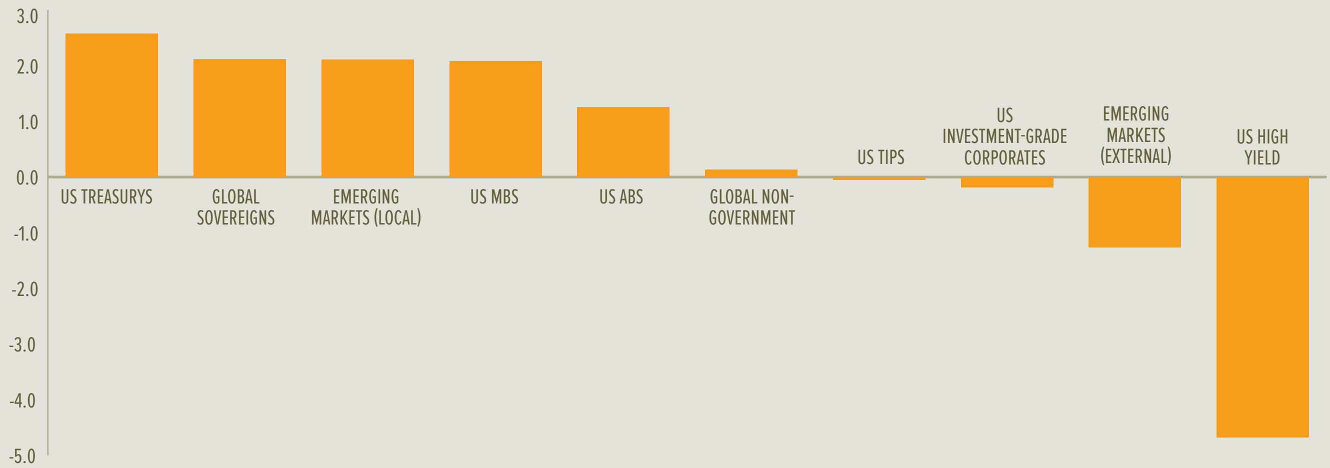
Major Index Performance in Q4 2018 (Percent Return)



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

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Fixed-Income Performance in Q4 2018 (Percent Return)



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

toward no-growth territory in December and slow-growth manufacturing conditions holding firm. US manufacturing growth eased considerably, yet still ended 2018 at solid levels. Services sector growth was unchanged, remaining in expansion territory at the end of the year.

Our View

As painful as 2018 was for risk assets, their gyrations were not outside the norm. Rather, given our views that the global economy will continue to grow and that market participants are overreacting to the concerns of the day, we see another important risk-on opportunity developing in equities and other risk assets. We believe a rebalancing of assets back toward undervalued equity classes is an appropriate and timely response.

In our view, the US economic position remains fairly solid. Points of strength include the improving economic position of US households as labour markets tighten and real wage growth accelerates, while increased government spending has also helped. With Democrats controlling the House of Representatives and Republicans holding power in Senate, any fiscal-policy agreement made during a period of political gridlock will likely mean slightly more federal-government spending—not less.

The decline in energy prices is especially good news for the broader economy since it reduces concerns about inflation accelerating beyond the US Federal Reserve's (Fed) comfort zone anytime soon. It also can lower costs for consumers and businesses on a broad range of petroleum-based products.

Some Fed officials, including Chairman Jerome Powell himself, explicitly acknowledge that the federal-funds rate now is near a level that can be considered neither stimulative nor deflationary. We are pencilling in just one increase in the federal-funds rate during 2019, and perhaps one in 2020—but these are just guesses. The important thing to remember is that the central bank is adopting a wait-and-see approach to monetary policy and has ended the nearly automatic quarterly rate increases of 2017 and 2018.

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Investor risk aversion has increased, and we think much of the bad news of recent months is reflected in current stock prices—creating space for potential upside surprises on trade wars, the Fed's policy path, Brexit, corporate profits and elsewhere.

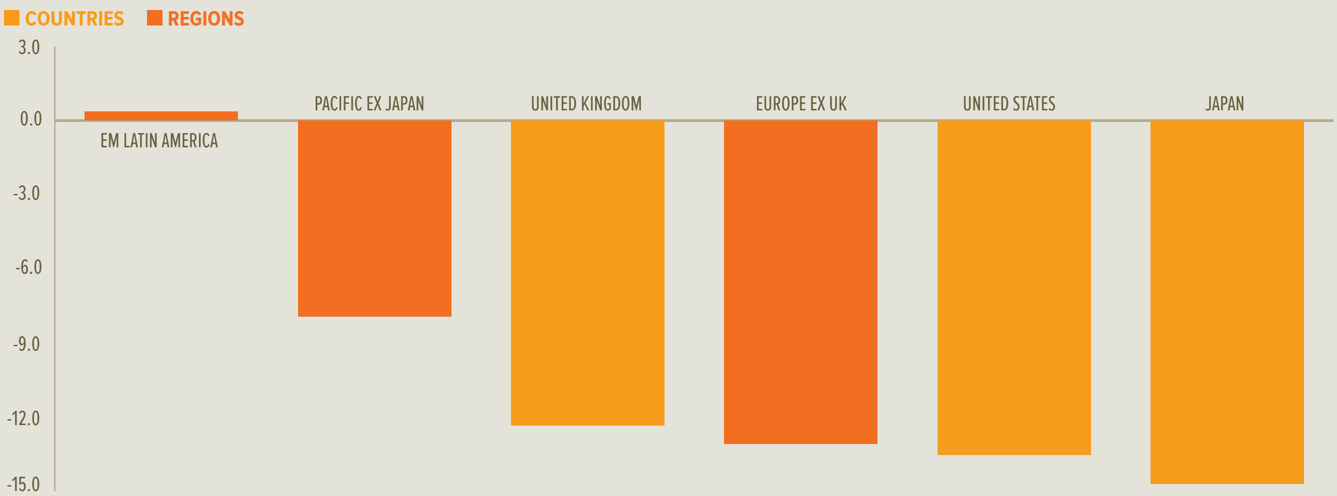
We think the odds favour a strong rebound in US equity prices for the following reasons:

- The US economy should continue to grow, and corporate earnings per share are expected to post a mid-to-high single-digit gain in 2019.
- Valuations for the S&P 500 Index have declined from almost 19 times one-year forward earnings per share to an attractive level of almost 14 times following the decline in share prices.
- US bond yields remain rather low and have moved down again in late 2018, bolstering the case for riskier assets.
- Investor risk aversion has increased, and we think much of the bad news of recent months is reflected in current stock prices—creating space for potential upside surprises on trade wars, the Fed's policy path, Brexit, corporate profits and elsewhere.
- We believe fiscal policy will not be the strong catalyst for growth in the US that it was in 2018, but the impact of political gridlock should still be mildly expansionary.

As for Brexit, we believe it's unlikely that the UK will fall out of the EU without some sort of deal in place. A no-deal divorce would deliver a mighty blow to the economy. In our view, the real choice now is between May's Brexit deal or no Brexit at all. A no-Brexit-at-all scenario could take one of two forms. The UK government could unilaterally revoke Article 50, basically calling off the divorce from the EU. The second alternative is to go back to voters and hold a second referendum. Although the legality would be disputed, we think this is the far more likely scenario. The financial markets probably would respond quite positively to this decision, yet the next few months can still be volatile as the late-March Brexit date nears.

Although the European banking system is in better shape than it was in the immediate aftermath of the global financial crisis, it is still vulnerable at a time when the ECB is in a holding pattern, policy-wise, and possesses only a few options in the event of a financial emergency. A lack of enthusiasm

Regional Equity Performance in Q4 2018 (Percent Return)



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

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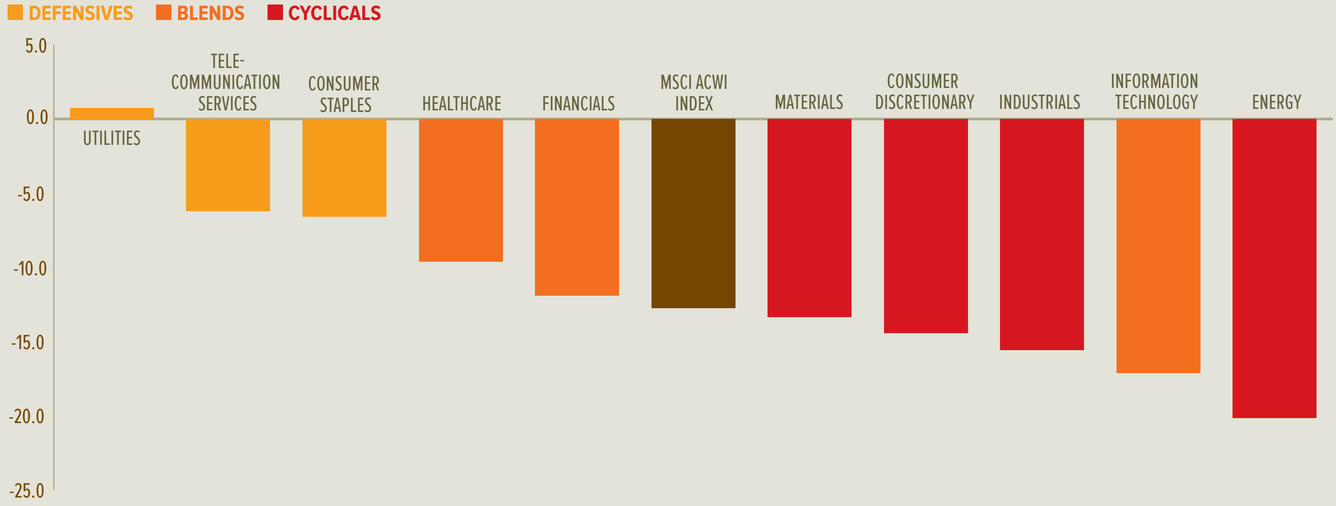
Global Equity Sector Performance in Q4 2018 (Percent Return)



Sources: FactSet, Lipper. MSCI ACWI Index Sector Components (Cyclicality determined by SEI).

for Europe's economic prospects is reflected in its equity-market valuations: the MSCI European Economic and Monetary Union (EMU) Index price-to-earnings ratio has sunk to less than 12 times from nearly 15 times at the start of the year. Note that European equities outperformed US equities in fourth quarter 2018.

We are leaning on the optimistic side for emerging markets in 2019. The valuation piece is already in place, in our opinion, with the price-to-forward-earnings ratio of MSCI Emerging Markets Index collapsing from 13 times at the end of January to 10.5 by year-end. But what could be the catalyst for a turnaround? Big debt expansions in China typically lead to big gains in emerging-market equities. The question is whether the Chinese government has the will to go back to the debt well one more time.

It surely would be a big positive for the country if the threat of tariffs was negotiated away, but we're not holding our breath. On the contrary, the US-China economic relationship will likely continue to deteriorate as the Trump administration seeks to level the playing field—even if it means a less efficient global trading system. When push comes to shove, the Chinese government will probably get even more aggressive in easing lending constraints if the situation warrants.

Commodity prices and the earnings of emerging-market companies are closely correlated in inverse fashion with the movements of the US dollar. For most of 2018, the dollar gained against other currencies, putting downward pressure on commodity prices and the earnings of energy and materials companies that are a large part of the MSCI Emerging Markets Index. In 2017, the opposite conditions held.

We are looking for another change in the dollar's trend in 2019. In our view, US economic and corporate-earnings performance will move toward that of other developed countries. If there are positive developments in some of the pressure-point issues that have roiled markets, investment capital could flow away from the US and back into the world—thereby removing an important source of support for the US currency and a big headwind from the rest of the world. This potential for a reversal in investment flows could

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accelerate if Fed policy becomes more dovish than currently projected by the central bank.

The awful performance of risk assets in the fourth quarter can certainly prey on investors' emotions. But the global economy is not exactly in dire straits. Yes, there are an unusually large number of uncertainties and concerns, some of which could have a material impact on growth if the worst comes to pass. However, even in an extraordinarily unfavourable economic scenario in which the tariff wars with China and other countries deepen and the Fed raises interest rates too far and too fast, we doubt that the US economy would experience anything worse than a garden-variety recession by 2021. The economic and credit excesses that usually precede a deeper recession simply aren't to be found.

During periods of market volatility like the one we've been going through, investors should be mindful about the importance of sticking with a strategic and disciplined approach to investing that is consistent with personal goals and risk tolerances. Diversification is the key to that approach, and the construction of portfolios is consistent with our long-term capital market assumptions.

Ultimately, the value of our assumptions is not in their accuracy as point estimates, but in their ability to capture relevant relationships—as well as changes in those relationships as a function of economic and market influences.

Standardised Performance

		1 year to 31-Dec-18	1 year to 31-Dec-17	1 year to 31-Dec-16	1 year to 31-Dec-15	1 year to 31-Dec-14
KEY MEASURES						
Dow Jones Industrial Average		-3.48%	28.11%	16.50%	0.21%	10.04%
S&P 500 Index		-4.38%	21.83%	11.96%	1.38%	13.69%
NASDAQ Composite Index		-2.84%	29.64%	8.87%	6.96%	14.75%
MSCI ACWI Index (Net)		-9.42%	23.97%	7.86%	-2.36%	4.16%
Bloomberg Barclays Global Aggregate Index		0.99%	2.47%	1.67%	1.51%	0.59%
MAJOR INDEX PERFORMANCE						
Bloomberg Barclays Global Aggregate ex-Treasury Index		-2.16%	7.51%	2.59%	-3.00%	2.22%
Bloomberg Barclays Global Aggregate Index		-1.20%	7.39%	2.09%	-3.15%	0.59%
Bloomberg Barclays Global Treasury Index		-0.38%	7.29%	1.65%	-3.29%	-0.79%
MSCI ACWI ex-USA (Net)		-14.20%	27.19%	4.50%	-5.66%	-3.87%
MSCI Emerging Markets Index (Net)		-14.58%	37.28%	11.19%	-14.92%	-2.19%
MSCI World Index (Net)		-8.71%	22.40%	7.51%	-0.87%	4.94%
FIXED-INCOME PERFORMANCE						
US Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index	-0.25%	1.90%	4.01%	-0.52%	0.91%
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index	-2.16%	7.51%	2.59%	-3.00%	2.22%
Global Sovereigns	Bloomberg Barclays Global Treasury Index	-0.38%	7.29%	1.65%	-3.29%	-0.79%
US Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index	-2.51%	6.42%	6.11%	-0.68%	7.46%
US Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index	1.77%	1.55%	2.03%	1.25%	1.88%
US Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage-Backed Securities Index	0.99%	2.47%	1.67%	1.51%	6.08%
US Treasurys	Bloomberg Barclays U.S. Treasury Index	0.86%	2.31%	1.04%	0.84%	5.05%
US High Yield	ICE BofAML US High Yield Constrained Index	-2.27%	7.48%	17.49%	-4.61%	2.51%
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index	-4.26%	10.26%	10.15%	1.18%	7.43%
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index	-6.21%	15.21%	9.94%	-14.92%	-5.72%
REGIONAL EQUITY PERFORMANCE						
United Kingdom	FTSE All-Share Index	-14.77%	23.82%	-2.12%	-4.55%	-4.75%
EM Latin America	MSCI Emerging Markets Latin America Index (Net)	-6.57%	23.74%	31.04%	-31.04%	-12.30%
Europe ex UK	MSCI Europe ex UK Index (Net)	-15.14%	26.82%	-0.56%	-0.65%	-6.55%
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)	-10.30%	25.88%	7.85%	-8.47%	-0.50%
United States	S&P 500 Index	-4.38%	21.83%	11.96%	1.38%	13.69%
Japan	TOPIX, also known as the Tokyo Stock Price Index	-13.73%	26.55%	3.46%	11.69%	-3.33%
GLOBAL EQUITY SECTOR PERFORMANCE						
MSCI ACWI Index		-9.42%	23.97%	2.88%	7.86%	4.16%
MSCI ACWI Consumer Discretionary Index		-8.35%	25.16%	1.52%	2.88%	3.47%
MSCI ACWI Consumer Staples Index		-10.47%	17.73%	27.66%	1.52%	6.15%
MSCI ACWI Energy Index		-13.27%	6.77%	12.38%	27.66%	-13.47%
MSCI ACWI Financials Index		-15.66%	24.09%	-6.83%	12.38%	3.43%
MSCI ACWI Healthcare Index		1.71%	20.14%	11.92%	-6.83%	18.13%
MSCI ACWI Industrials Index		-14.40%	25.27%	12.20%	11.92%	0.19%
MSCI ACWI Information Technology Index		-5.81%	41.77%	23.59%	12.20%	15.20%
MSCI ACWI Materials Index		-16.01%	29.63%	7.86%	23.59%	-7.49%
MSCI ACWI Telecommunication Services Index		-10.91%	7.72%	5.03%	5.03%	-1.83%
MSCI ACWI Utilities Index		1.37%	13.93%	5.68%	5.68%	13.78%

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Glossary of Financial Terms

Dovish: Dovish refers to the views of a policy advisor (for example, at the Bank of England) who has a positive view of inflation and its economic impact and thus tends to favour lower interest rates.

Federal-funds rate: The federal-funds rate is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight in the US.

Price-to-earnings ratio: The price-to-earnings ratio is the ratio of a company's share price to its earnings over the past 12 months, which can be used to help determine whether a stock is undervalued or overvalued.

Quantitative easing: Quantitative easing refers to expansionary efforts by central banks to help increase the supply of money in the economy.

Yield curve: The yield curve represents differences in yields across a range of maturities of bonds of the same issuer or credit rating (likelihood of default). A steeper yield curve represents a greater difference between the yields. A flatter yield curve indicates the yields are closer together.

Index Descriptions

MSCI European Economic and Monetary Union (EMU) Index: The MSCI EMU Index captures large- and mid-cap representation across the developed-market countries in the EMU.

S&P 500 Index: The S&P 500 Index is an unmanaged, market-capitalisation-weighted index comprising 500 of the largest publicly traded US companies and is considered representative of the broad US stock market.

Corresponding Indexes for Key Measures Exhibit

Dow Jones Industrial Average	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.
NASDAQ Composite Index	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, representing a subset of the US equity market.
MSCI ACWI Index	The MSCI ACWI Index is a market-capitalisation-weighted index composed of over 2,000 companies, and is representative of the market structure of 46 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 US dollars.
Bloomberg Barclays Global Aggregate Index	The Bloomberg Barclays Global Aggregate Index is an unmanaged market-capitalisation-weighted benchmark that 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.
Chicago Board Options Exchange Volatility Index (VIX)	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.

Corresponding Indexes for Major Index Performance Exhibit

MSCI ACWI ex-USA Index	The MSCI ACWI ex-USA Index includes both developed- and emerging-market countries, excluding the US.
MSCI Emerging Markets Index	The MSCI Emerging Markets Index is a free float-adjusted market-capitalisation-weighted index designed to measure the performance of global emerging-market equities.
MSCI World Index	The MSCI World Index is a free float-adjusted market-capitalisation-weighted index that is designed to measure the equity market performance of developed markets.
Bloomberg Barclays Global Aggregate Index	The Bloomberg Barclays Global Aggregate Index is an unmanaged market-capitalisation-weighted benchmark that 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.
Bloomberg Barclays Global Aggregate ex-Treasury Index	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.
Bloomberg Barclays Global Treasury Index	The Bloomberg Barclays Global Treasury Index is composed of those securities included in the Bloomberg Barclays Global Aggregate Index that are Treasury securities.

Corresponding Indexes for Fixed-Income Performance Exhibit

US High Yield	BofA Merrill Lynch U.S. High Yield Master II Constrained Index
Global Sovereigns	Bloomberg Barclays Global Treasury 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
US Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage Backed Securities Index
US Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index
US Treasurys	Bloomberg Barclays U.S. Treasury Index
US Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index
US 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)

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Data refers to past performance. Past performance is not a reliable indicator of future results.

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