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MONTHLY MARKET COMMENTARY | OCTOBER 2017

Central Banks Take Centre Stage

Monthly Snapshot

- The European Central Bank announced policy changes that pleased global markets; the Bank of England began to raise its benchmark rate amid elevated inflation; and US President Donald Trump nominated a safe-pick candidate to lead the Federal Reserve.
- Equity markets were broadly positive, while fixed-income performance varied across regions as the US dollar strengthened.
- While we would not rule out a notable correction in asset values, our investment mantra of buying on the dip still holds.

Economic Backdrop

UK government leaders found themselves in a set of double binds as October progressed: Chancellor Philip Hammond was cautioned that London-based companies would begin to enact Brexit contingency plans if a transitional deal with the European Union (EU) was not agreed upon by year-end, and Brexit Secretary David Davis was forced to assure parliament it would receive a final vote on any UK-EU agreement despite warning the Brexit select committee there may not be time if negotiations run long. Talks in Brussels between UK Prime Minister Theresa May and European leaders produced progress on these issues, albeit not enough to begin transition discussions.

Elsewhere, the Catalan regional parliament vote for and declaration of independence from Spain was followed immediately by a vote in the Spanish legislature to suspend the largely autonomous Catalan regional government; leaders of the independence movement may face criminal charges. Austrian and Czech election results handed the largest share of votes to parties that campaigned on populist messages with an emphasis on restrictive immigration policies. The Communist Party of China held its twice-a-decade National Congress, where President Xi Jinping publicly cemented his leadership. Japanese Prime Minister Shinzo Abe won re-election, and his party retained a parliamentary supermajority—giving him more time to enact policies designed to stimulate the economy. In the US, the focus throughout October remained on tax-reform plans and a change in Federal Reserve (Fed) leadership. At the end of the month, Special Counsel Robert Mueller announced the first criminal charges (including one guilty plea) stemming from his probe into possible Russian interference in the 2016 US election.

The US Fed met on the last day of October and announced no changes to its policy stance at the beginning of November, but noted that a benchmark-rate increase could be forthcoming after its December meeting. US President Donald Trump followed the Fed announcement with the nomination of Jerome Powell—current member of the Fed's Board of Governors who is perceived as a continuity candidate—to replace Janet Yellen as Fed chair. The European Central Bank (ECB) announced a reduction in its monthly asset purchases—from €60 to €30 billion starting in January—and extended the programme until at least next September. The Bank of England's (BOE) Monetary Policy Committee, meanwhile, increased its benchmark rate for the first time in a decade in early November. The Bank of Japan maintained its policy stance following a late-October meeting.

All references to performance are in US dollar terms unless otherwise noted.

Key Measures: October 2017

Equity		
Dow Jones Industrial Average	4.44%	↑
S&P 500 Index	2.33%	↑
NASDAQ Composite Index	3.61%	↑
MSCI ACWI Index (Net)	2.08%	↑
Bond		
Bloomberg Barclays Global Aggregate Index	-0.38%	↓
Volatility		
Chicago Board Options Exchange Volatility Index PRIOR MONTH: **9.51**	10.18	↑
Oil		
WTI Cushing crude oil prices PRIOR MONTH: **$51.67**	$54.38	↑
Currencies		
Sterling vs. US dollar	$1.33	↓
Euro vs. US dollar	$1.17	↓
US dollar vs. yen	¥113.63	↑

Sources: Bloomberg, FactSet, Lipper

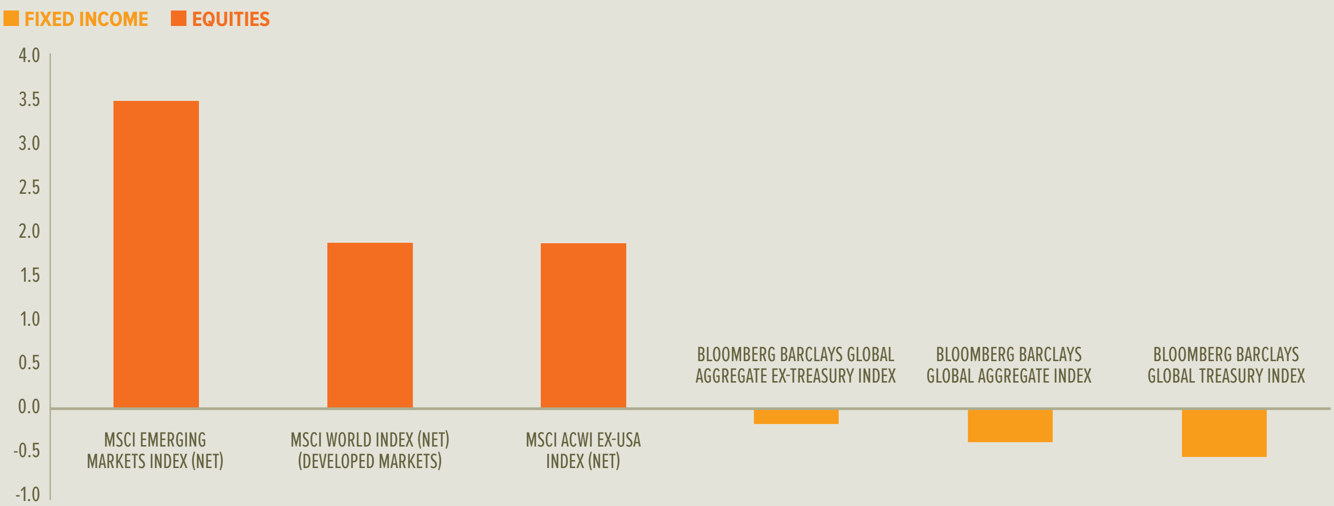
US and Japanese stocks climbed throughout most of the month and ended near the top of their respective ranges, while European stocks were flat until rallying late in the month. UK stocks were up overall, but finished considerably off their highs after some late-month volatility. Hong Kong stocks initially advanced and then sold off heading into the National Party Congress, while mainland Chinese stocks climbed post-Congress. Brazilian stocks rallied through early October, yet ultimately sold off to finish the period virtually unchanged. Volatility increased globally late in the month and then receded quickly, as third-quarter earnings season got underway and the ECB Governing Council convened its monetary policy meeting.

Energy prices rose, with West-Texas Intermediate crude-oil prices bumping up against two-year highs late in the month. The UK gilts yield curve flattened as short-term rates increased and long-term rates declined; the US Treasury yield curve flattened as short-term rates rose by more than long-term rates; and eurozone rates generally declined. The US dollar strengthened versus the euro—primarily after the ECB announcement—as well as against sterling and the Japanese yen.

UK construction activity bounced back to modest expansion territory during October, while manufacturing sector strength increased and services sector growth accelerated. Retail sales volumes appeared to decline sharply in October, however, and consumer prices remained elevated. The unemployment and earnings growth rates were unchanged in September's report. Overall economic growth increased to 0.4% during the third quarter and 1.5% year over year.

Eurozone manufacturing activity accelerated from already-impressive levels to an 80-month peak in October, while inflation actually ticked down. The unemployment rate edged lower in September to 8.9%, led by improvements in smaller countries. Economic growth was recorded at 0.6% for the third quarter and 2.5% for the one-year period ending September.

Major Index Performance in October 2017 (Percent Return)



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

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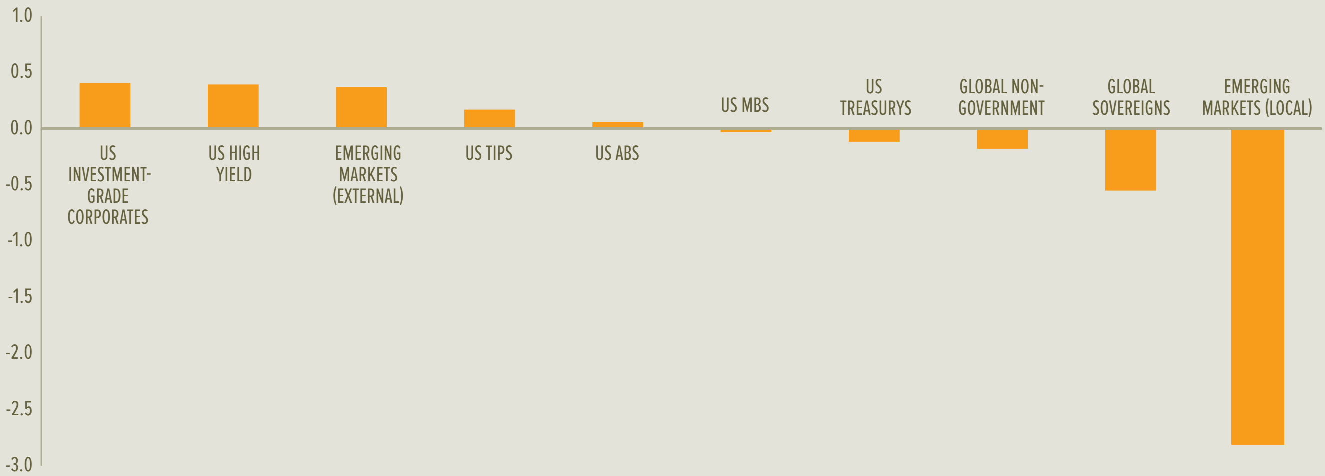
Fixed-Income Performance in October 2017 (Percent Return)



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

The US manufacturing and services sectors both appeared to maintain strong levels of growth in October, while the Fed's preferred gauge of consumer inflation remained low in September. Third-quarter economic growth was measured at a 3.0% annualised rate, more-or-less maintaining the prior quarter's healthy pace.

Our View

Neither devastating hurricanes nor all-around political dysfunction have done much to halt the US equity market's rise. Even the game of nuclear chess being played between President Trump and North Korea's Kim Jong-un 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 US economy and earnings, and the likely path of US Fed policy and inflation, we reason that the US equity bull market is not yet dead.

On the issue of valuations, there is no denying that US 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.

US 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 US, but also against their own histories. This is one reason we currently favour international equity markets versus US equities.

High valuations imply the US 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.

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The overriding question among investors is whether or not a recession is on the horizon. We contend 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.

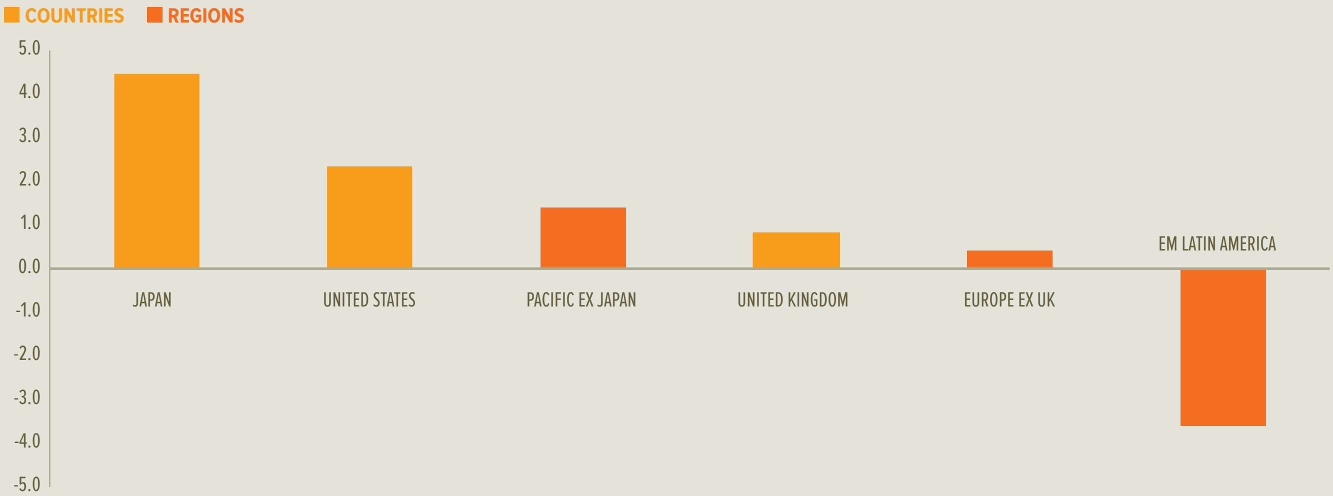
A large portion of the world appears to be growing at a slightly better-than-trend pace. The breadth of the improvement is particularly impressive; as at July 2017, 72% of the countries that make up the Organisation for Economic Cooperation and Development's (OECD) Composite Leading Indicator index have posted improvement over the past year—and 75% of the 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 US economy, by contrast, is growing somewhat below trend. India also is signalling below-trend growth, but has begun to rebound. On balance, things are looking up in much of the world.

Economic growth of developed economies around the world is converging with that of the US. Although US monetary policy is further along the path toward tightening, other central banks have already begun to raise policy rates (the UK and Canada).

Market participants have adopted a far more sanguine view regarding the political stability of the eurozone following a series of national elections this year that enhanced the position of parties favouring further European integration. While confidence in the eurozone has increased, international confidence in the US has ebbed. The Trump administration's decision to pull out of the Trans-Pacific Partnership and Paris climate accord was controversial in the US; it was especially confounding to those outside the US, and raised questions of whether it is relinquishing its role as leader of the free world. Confidence in the existing international economic order was

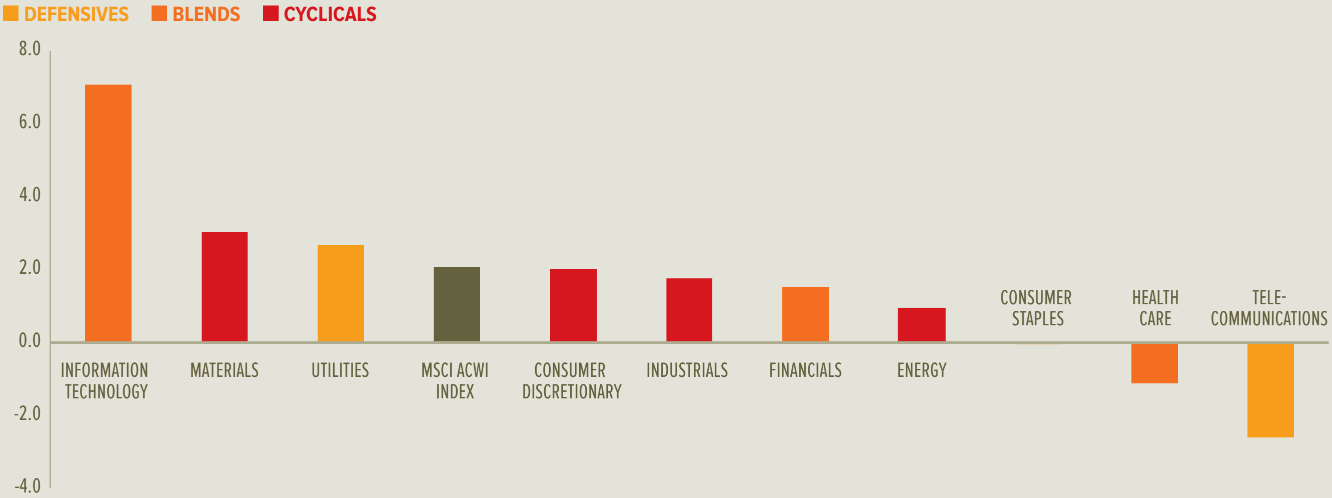
Regional Equity Performance in October 2017 (Percent Return)



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

All references to performance are in US dollar terms unless otherwise noted.

Global Equity Sector Performance in October 2017 (Percent Return)



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

also hurt by the threat of additional US 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 US 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 US economic growth—thereby causing a serious correction in the overall US equity market, especially hurting economically sensitive small-company and value stocks.

As noted above, the upturn in global economic activity is spurring the world's major central banks to reassess their respective policy stances. The danger is in potentially making policy mistakes, 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 US and eurozone. Although the BOE has begun to raise rates, it is unclear whether the correct policy course calls for further tightening moves.

In the run-up to the National Congress of the Communist Party of China, the country's economic policy has been geared toward growth. President Xi'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 strengthening of Xi's political power coming out of that meeting. The inflation rate for manufacturing producer prices at the end of August was near 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 remained at less than a 2% rate through August, we expect the People's Bank of China to try a gentle tap on the brake.

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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 favour momentum-oriented opportunities, and view equity markets outside the US as more attractive than US equity markets. Indeed, our caution toward equities is most pronounced in the US, 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 (yields move inversely to prices) 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, favour credit-spread strategies and are positioned for a further narrowing of the yield curve, especially in the US.

Glossary of Financial Terms

Bull market: A bull market refers to a market environment in which prices are generally rising (or are expected to do so) and investor confidence is high.

Credit spread: Credit spread is the additional yield, usually expressed in basis points (one basis point is 0.01%), that an index or security offers relative to a comparable duration index or security (the latter is often perceived as "risk-free" credit, such as sovereign government debt).

Cyclical: Cyclical sectors or stocks are those whose performance is closely tied to the economic environment and business cycle. Managers with a pro-cyclical market view tend to favour stocks that are more sensitive to movements in the broad market and therefore tend to have more volatile performance.

Duration: Duration is a measure of risk in bond investing and indicates how price-sensitive a bond is to changes in interest rates. A long (overweight) duration stance indicates the portfolio duration is higher than that of the benchmark whereas a short (underweight) duration stance indicates a lower duration. Duration is measured in years and securities with longer durations are more sensitive to interest-rate changes.

Quantitative easing/tightening: Quantitative easing refers to expansionary efforts by central banks to help increase the supply of money in the economy; quantitative tightening refers to efforts by central banks to help decrease 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 curve indicates the yields are closer together.

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-capitalization-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-capitalization-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.

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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-capitalization-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-capitalization-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-capitalization-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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