

# Bargaining Breakthroughs in November?

## Monthly Snapshot

- › Brexit negotiations hit a magic number on the financial-settlement issue; EU member states enacted a mutual-defence pact; US congressional Republicans negotiated tax-reform legislation; and Asia-Pacific nations resurrected a commitment to the Trans-Pacific Partnership agreement.
- › Equity markets were mixed, with areas of strength in Asia and weakness in South America and the Middle East. Fixed-income performance favoured foreign-currency-denominated debt over US-dollar debt.
- › Our equity strategies remain positioned for further strengthening of economic growth around 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.

## Economic Backdrop

The financial-settlement leg of Brexit negotiations appears to have hit a magic number that both sides can digest despite its unpopularity in the UK—likely at least €50 billion in total payments from the UK to the European Union (EU) over the course of many years, which is roughly equivalent to the UK's projected net EU contributions from 2017 to 2021. Two other aspects of the divorce—citizens' rights and the possible re-imposition of a hard Irish border—remained a source of grave contention among negotiators, which could preclude discussions from advancing to issues concerning future commercial relations. Elsewhere, German Chancellor Angela Merkel struggled to find a governing-coalition partner and considered calling new elections in the absence of progress. Nearly two dozen EU member states signed a mutual-defence pact made possible by Brexit's removal of the UK as a roadblock to European military integration.

US congressional work on tax reform progressed throughout November, with passage appearing probable but contentious due to a thin Republican majority. The likelihood of a December government shutdown increased as a stopgap spending agreement wound down with little apparent appetite for the bipartisan compromises necessary to strike another budget deal. Canadian lumber exports to the US were subjected to tariffs amid renegotiation of the North American Free Trade Agreement, while Asia-Pacific nations reasserted their commitment to an updated Trans-Pacific Partnership trade deal—this time without the US—at a regional summit during the month.

The Bank of England's (BOE) Monetary Policy Committee increased its benchmark rate for the first time in a decade in early November, and issued a quarterly report signaling expectations for above-target inflation to remain through 2020. BOE stress-test results indicated that major UK banks could be expected to continue operations, even amid disorderly Brexit proceedings. The US Federal Reserve (Fed) said it in its 1 November announcement that it made no changes to monetary policy, but Fed Chair nominee Jerome Powell expressed confidence during his confirmation hearing that conditions appeared to warrant a benchmark rate hike in December. The European Central Bank and Bank of Japan did not convene for monetary policy meetings during November.

## Key Measures: November 2017

EQUITY		
Dow Jones Industrial Average	0.25%	↑
S&P 500 Index	3.07%	↑
NASDAQ Composite Index	2.34%	↑
MSCI ACWI Index (Net)	1.94%	↑
BOND		
Bloomberg Barclays Global Aggregate Index	1.11%	↑
VOLATILITY		
Chicago Board Options Exchange Volatility Index	11.28	↑
PRIOR MONTH: 10.18		
OIL		
WTI Cushing crude oil prices	\$57.40	↑
PRIOR MONTH: \$54.38		
CURRENCIES		
Sterling vs. US dollar	\$1.35	↑
Euro vs. US dollar	\$1.19	↑
US dollar vs. yen	¥111.9	↓

Sources: Bloomberg, FactSet, Lipper

UK and European stocks declined in the first half of November but recovered by the end of the month, while US equities were flat for much of the month before advancing in the final week as tax reform came into focus; the rally started earlier and was more pronounced in small-company stocks given their sensitivity to US tax rates. Japanese and Hong Kong equities advanced during the month, while mainland Chinese stocks rallied in the first half of the period before dropping and finishing lower overall. Brazil had a negative month; volatility generally increased in emerging markets as November came to a close. Sterling, the euro and the Japanese yen all strengthened against the US dollar; sovereign yield curves flattened in the UK, eurozone and US as short-term rates generally increased and long-term rates declined. West Texas Intermediate crude-oil prices advanced in anticipation of a late-November agreement by the Organization of Petroleum Exporting Countries and non-member states to extend production cuts through 2018.

Expectations for UK retail sales in November looked strong after a better-than-expected rebound in October. Manufacturing growth accelerated during November to its best overall showing in more than four years. October unemployment and earnings growth were unchanged for the second straight month. The country's overall economic growth was unrevised at 0.4% for the third quarter and 1.5% year over year ending 30 September.

Eurozone manufacturing activity continued to accelerate in November, pushing output to its greatest level in almost seven years; new orders to 17-year highs; and exports, backlogs and headcount to record-breaking growth. Services sector growth also quickened. Economic sentiment extended an uninterrupted six-month advance, with improvement in both the industrial and consumer components. The latest reading of broad economic growth held at 0.6% for the third quarter and 2.5% for the one-year period ending 30 September.

## Major Index Performance in November 2017 (Percent Return)

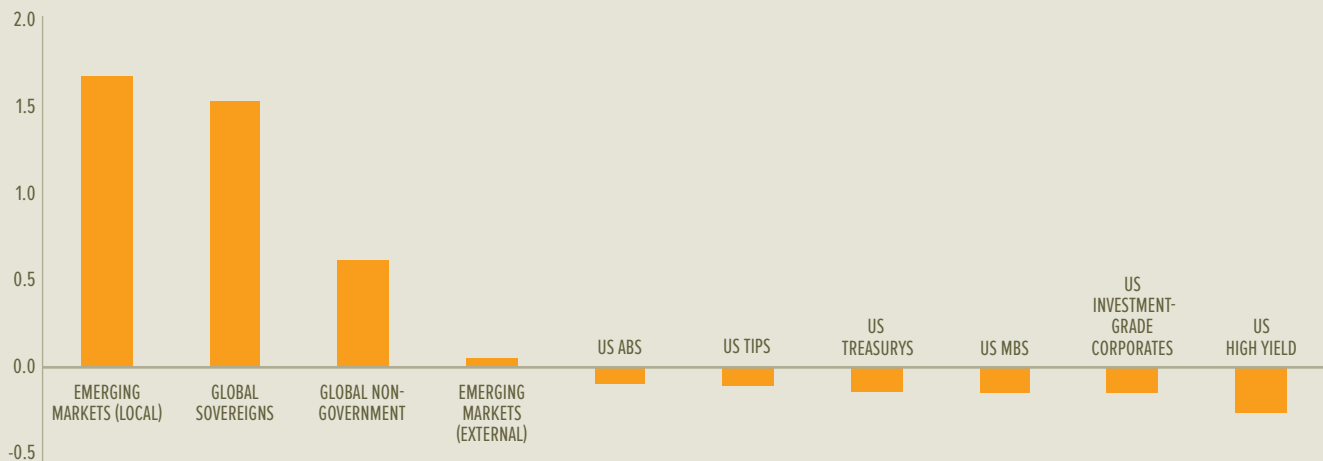
■ FIXED INCOME ■ EQUITIES



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.

## Fixed-Income Performance in November 2017 (Percent Return)



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

US consumer confidence pushed to a 17-year high in November, as labour-market perceptions turned more optimistic in terms of the current environment as well as expectations. Personal incomes remained healthy in October, while consumer spending growth settled to more-normal levels. Core personal consumption expenditure prices—the Fed’s preferred inflation gauge—edged closer to reaching the central bank’s target range. Total economic growth was measured at a 3.3% annual rate, an improvement on already-strong preliminary readings.

### Our View

Political dysfunction—up to and including the ongoing game of nuclear chess between US President Donald Trump and North Korea’s Kim Jong-un—has done little to halt the ascension of the US equity market. 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 a simple one: is a recession 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.

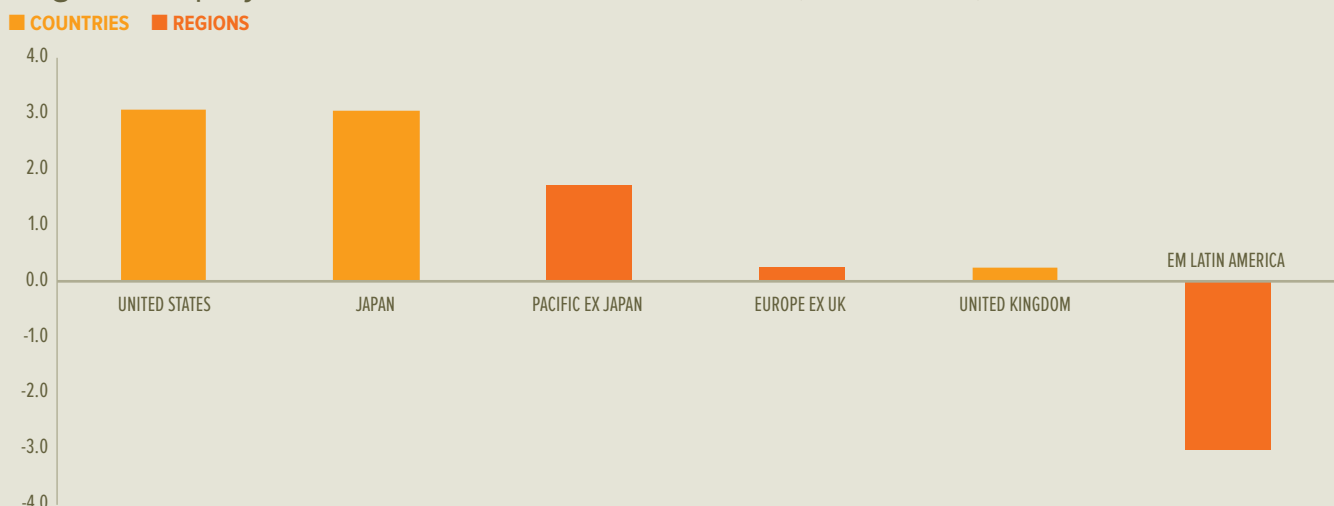
A large portion of the world appears to be growing at a slightly better-than-trend pace. The breadth of the improvement is particularly impressive; as at September 2017, 68% of the countries that make up the Organisation for Economic Cooperation and Development’s (OECD) Composite Leading Indicator index have posted improvement over the past year—and 66% of the countries in the index came in above 100. This suggests above-trend growth could 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. 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, while India is signalling a rebound toward trend-line growth. 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 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

## Regional Equity Performance in November 2017 (Percent Return)

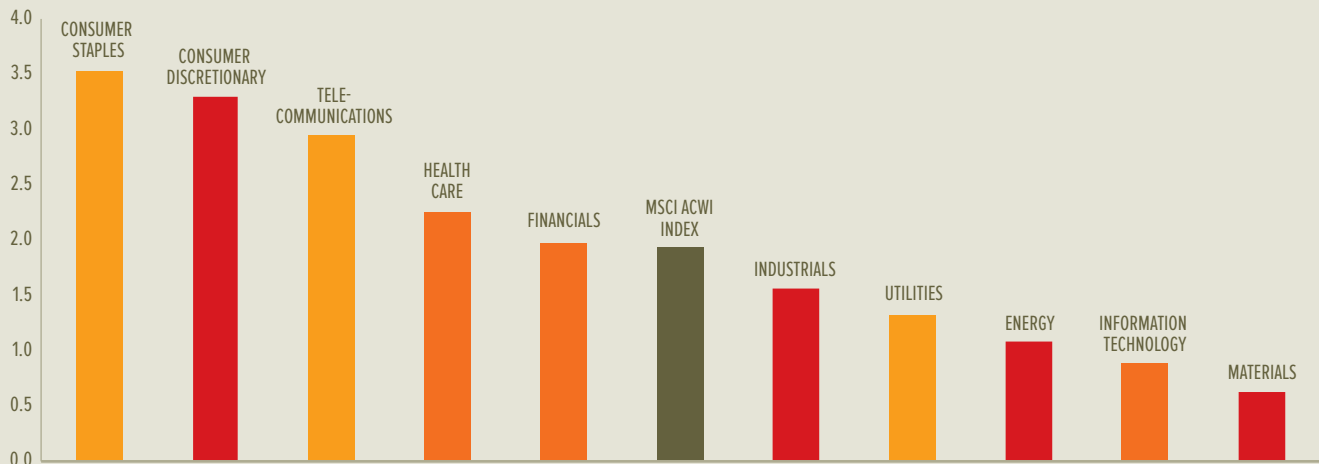


Sources: FactSet, Lipper. See “Corresponding Indexes for Regional Equity Performance Exhibit” in the Index Descriptions section for more information.

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

## Global Equity Sector Performance in November 2017 (Percent Return)

■ DEFENSIVES ■ BLENDS ■ CYCICALS



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

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 failure 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 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 strengthening of President Xi's political power coming out of that meeting. The inflation rate for manufacturing producer prices at the end of October 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 October, we expect the People's Bank of China to try a gentle tap on the brake.

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.

While we would not rule out a correction in asset values more notable than others that occurred in the past 19 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 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; 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.

## 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 Treasuries	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)



## Important Information

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