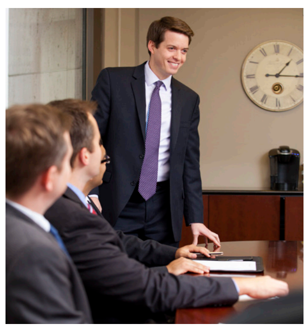
RESEARCH REVIEW

THIRD QUARTER 2018

INSIDE THIS ISSUE



Most measures of U.S. business activity remained strong and witnessed further improvement throughout the third quarter, a trend which has likely supported the continuing ascent of inflation and interest rates, as well as the near-term Federal Reserve policy tightening sentiment. Throughout the quarter, strong tailwind forces supported solid returns across domestic equities, while international equity performance suffered amid growing trade-related tensions, an appreciating U.S. dollar, and country-specific macro headwinds. The robust domestic economic backdrop and increasing inflation rates helped drive a meaningful increase in U.S. Treasury interest rates, in turn hampering the performance of the higher quality segments of the fixed income market. Within real assets, energy infrastructure experienced a second consecutive quarter of healthy total returns, while real estate-related asset categories posted muted performance against rising interest rate pressures.

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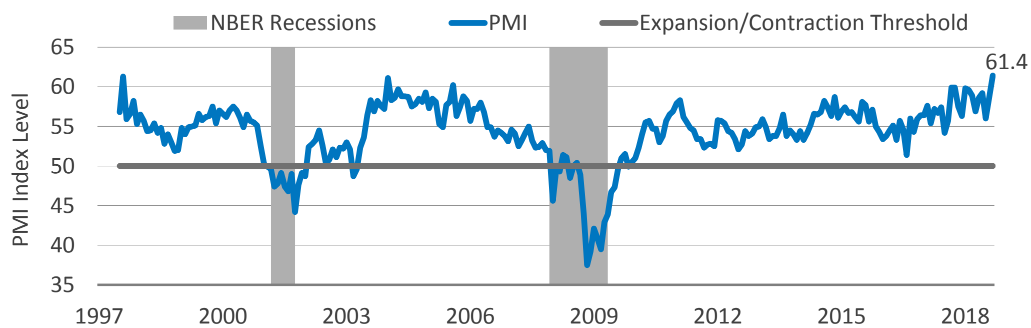
ECONOMIC UPDATE

Robust Economy Pressuring Inflation, Interest Rates, and Rate-Hike Sentiment Higher

The U.S. economy currently finds itself in a position of marked strength, both in absolute terms as well as relative to many key trading partners. Factors central to this improvement include the fiscal stimulus-related tailwinds behind consumption patterns, survey-based measures of anticipated business activity, and risk preferences among global asset allocators. Generally supportive domestic conditions have been a driver behind the year-to-date increase in realized inflation levels, interest rates, the U.S. dollar, and sentiment for near-term Federal Reserve (Fed) tightening activities.

Through the quarter, the Institute for Supply Management (ISM) reported that the service sector of the U.S. economy posted its second strongest quarter on record, with data dating back to 1997. Specifically, the ISM Non-Manufacturing Purchasing Manager Index (PMI) concluded September with an index reading of 61.6, nearly 12 index points above the critical expansion/contraction threshold level of 50. Moreover, the ISM reported that the Economy-Weighted PMI increased to 61.4 during the month, representing the strongest reading on record and exemplifying the expansionary trajectory of the U.S. economy.

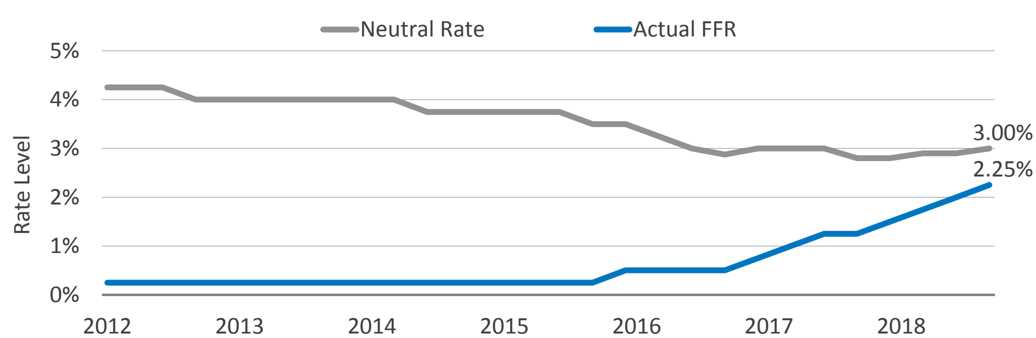
ISM ECONOMY-WEIGHTED PURCHASING MANAGER INDEX



Data sources: ISM, NBER, Boomberg, L.P.; data as of Sptember 2018

Acknowledging economic conditions that appear to be experiencing broad-based strength, the Fed hiked the federal funds rate (FFR) for the third time in 2018—the eighth occasion in the current tightening campaign—at their late-September policy meeting. Notably, through updates to their Summary of Economic Projections, the Fed upwardly-revised their estimate of the theoretically “neutral” level for the FFR from the previous estimate of 2.875% in June to 3.00% in September. This upward revision likely reflects progress made on the inflation front, as well as a continued tightening of the labor market. The “neutral” FFR—the policy rate level deemed neither accommodative nor restrictive—sits just 75 basis points (bps) above the actual FFR.

"NEUTRAL" FEDERAL FUNDS RATE (FFR) vs. ACTUAL



Data sources: Federal Open Market Committee, Bloomberg, L.P.; data as of September 26, 2018
Note: Long-run FOMC median shown for neutral rate

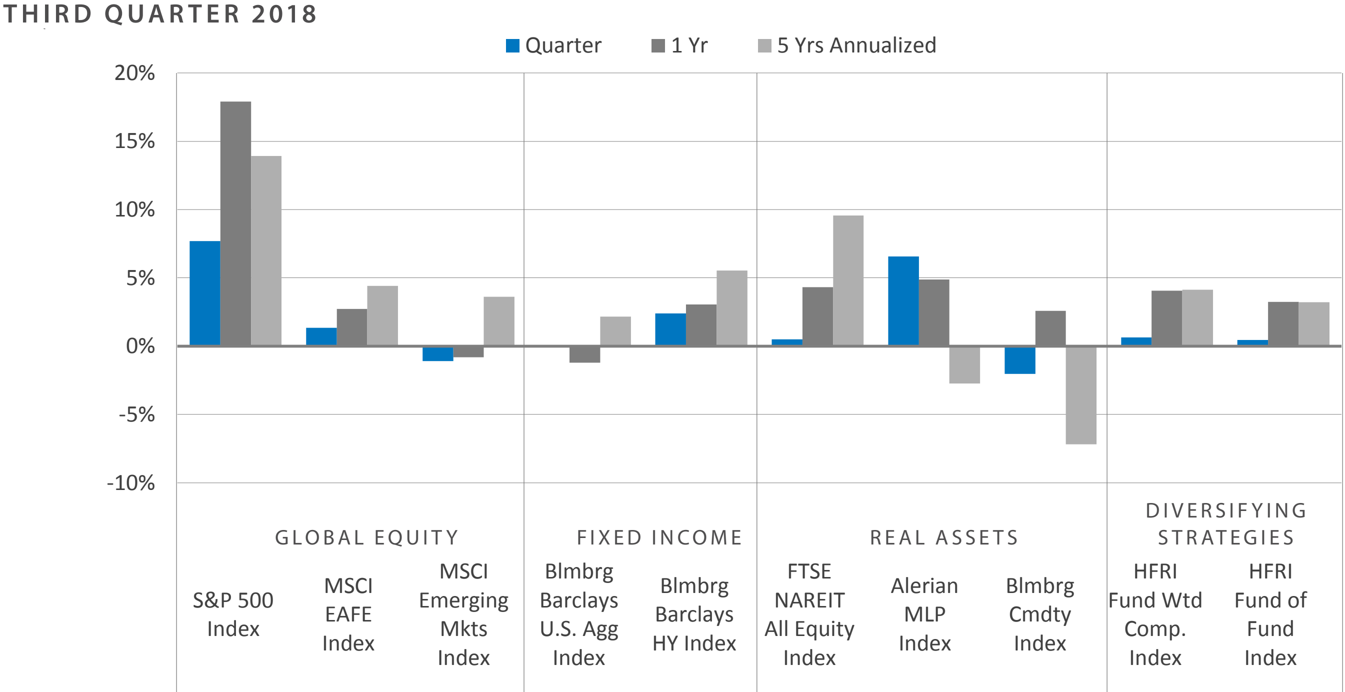
This spread implies that monetary policy remains modestly accommodative, however, should the labor market tighten even further and inflation resume its upward trajectory, the Fed may hike rates through this neutral level, placing a monetary inhibitor over the economy's growth potential. Given extremely low levels in headline measures of unemployment, inflation rates at or near half-decade highs, and solid positive momentum behind these developments, the likelihood of this risk materializing in the near term remains greater today than at any point in the current tightening cycle.

While risks to the cyclical outlook remain—particularly should a full-blown trade war erupt between the U.S. and China—the effect of the aforementioned trends on the investment opportunity landscape contain an important silver lining. The growing divergence that is taking place among public sector policies (both monetary and fiscal), fundamental economic trends, and asset valuations, appears to (finally) be driving dispersion meaningfully. The persistence of this event may benefit portfolios that place an emphasis on skillful active management at the expense of passive vehicles which, by design, provide market-like performance less fees.

To conclude, in the third quarter, the U.S. economy enjoyed broad-based improvement across many key economic data points, the strength of which has helped apply upward pressure to interest rates, inflation levels, and near-term sentiment for tighter monetary policy. The strengthening domestic economy has coincided with growing weakness abroad, likely increasing market dispersion and thus potentially improving the investment opportunity landscape.

MARKET RETURNS

THIRD QUARTER 2018



	S&P 500 Index	MSCI EAFE Index	MSCI Emerging Mkts Index	Blmbrg Barclays U.S. Agg Index	Blmbrg Barclays HY Index	FTSE NAREIT All Equity Index	Alerian MLP Index	Blmbrg Cmdty Index	HFRI Fund Wtd Comp. Index	HFRI Fund of Fund Index
Quarter	7.7%	1.4%	-1.1%	0.0%	2.4%	0.5%	6.6%	-2.0%	0.6%	0.4%
1 Yr	17.9%	2.7%	-0.8%	-1.2%	3.0%	4.3%	4.9%	2.6%	4.1%	3.3%
5 Yrs Annualized	13.9%	4.4%	3.6%	2.2%	5.5%	9.6%	-2.7%	-7.2%	4.1%	3.2%

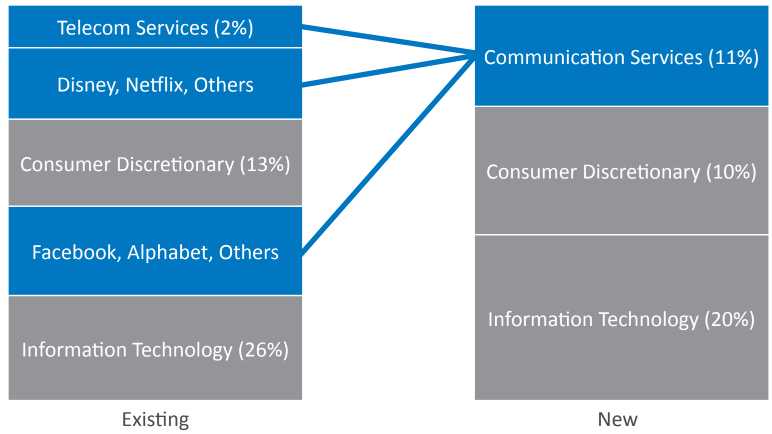
Data sources: Lipper, HedgeFund Research

GLOBAL EQUITY

- The two major index providers, S&P Dow Jones and MSCI, announced changes to how they will classify companies in defined sectors. The providers stated that the revision is designed to reflect the evolution in which people communicate and access entertainment, as well as information. Accordingly, media companies from the consumer discretionary sector and internet services companies from the information technology sector will move to communication services, and e-commerce companies will move from the information technology sector to consumer discretionary.
- A strong economy that supported consumer confidence and strong corporate earnings drove the U.S. equity market ahead of other markets across the globe.
- Emerging market equities lagged the broader equity market due in part to a slowdown in China, fears over the potential impact of trade tensions, and tighter U.S. monetary policy. Additionally, the rise in oil prices hurt emerging market economies that import oil for their energy needs.
- The United Kingdom faced headwinds due to difficulties in the ongoing Brexit negotiations that weighed on markets and led to a decline in the British pound.
- Economic news from the eurozone showed weakening since the beginning of the year that continued during the third quarter, which pressured consumer confidence in the region, particularly in France. Also, exports to China from the eurozone decreased amid China's slowdown, illustrating the ramifications of global trade.

GICS SECTOR CHANGES

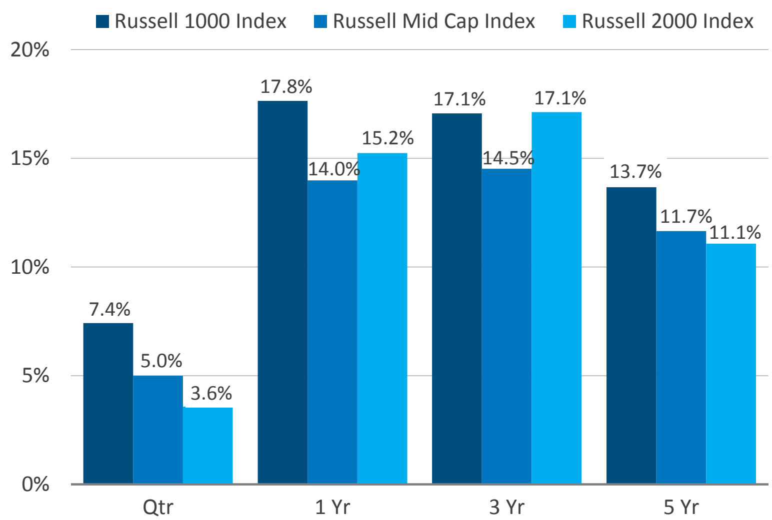
Percentage of Index



Data source: Goldman Sachs Asset Management

RUSSELL INDICES PERFORMANCE

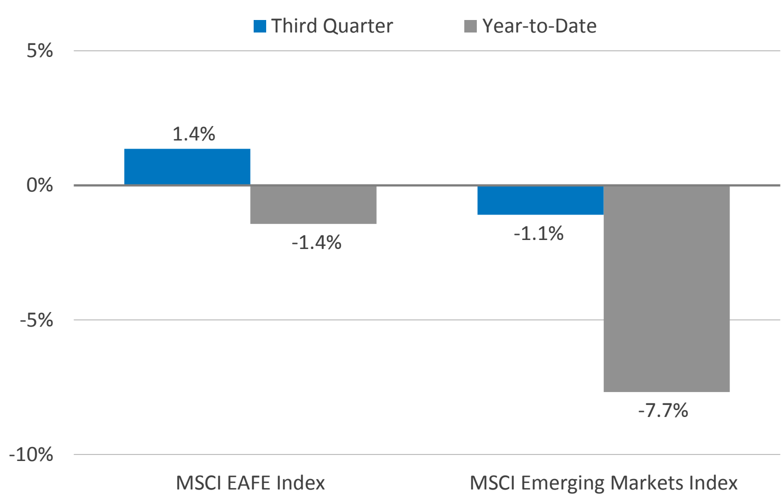
Returns in U.S. Dollars



Data source: Russell

MSCI INDICES PERFORMANCE

Returns in U.S. Dollars

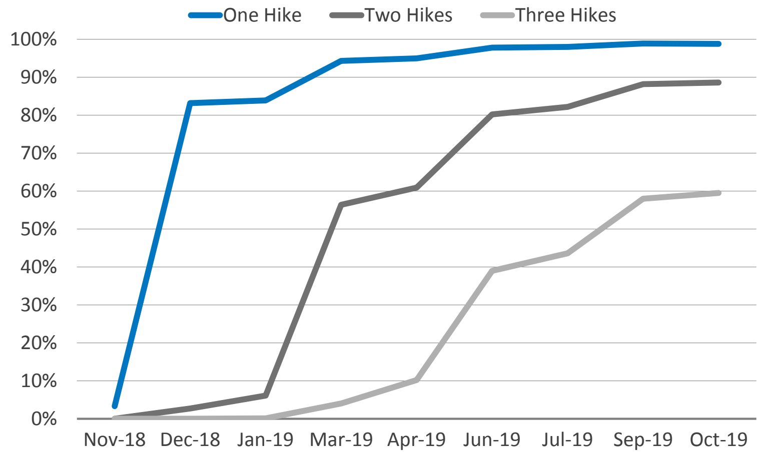


Data source: MSCI

FIXED INCOME

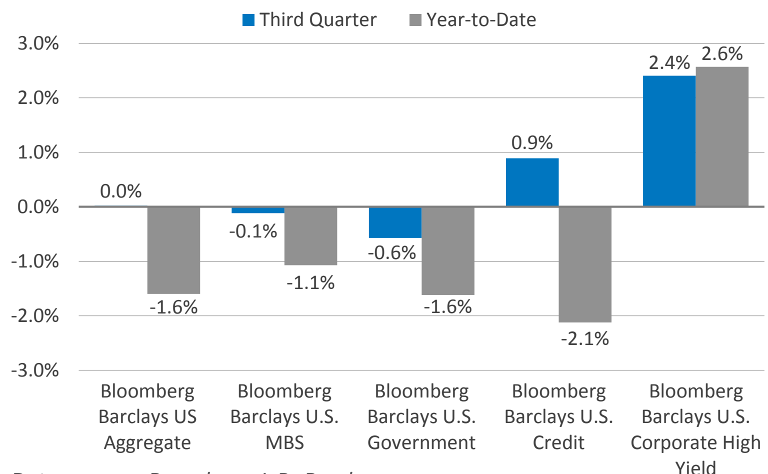
- The Federal Open Market Committee increased the federal funds rate at their September 25-26th meeting by 25 bps, bringing the target range to 2.0%-2.25%. Furthermore, the committee dropped "accommodative" from the description of their current policy stance, while also increasing the longer-run estimate of the federal funds rate from 2.875% at their June meeting to 3.000% at their September meeting. Market expectations are for one more rate hike in 2018.
- In the Fed's flow of funds report, released the third week of September, the Fed highlighted corporate defined-benefit plan activity in the Treasury market. The September increase in the 10-year Treasury yield coincided with the deadline for companies to contribute to their pensions at the previous 35% tax rate. Market speculation is that the end of this tax benefit may reduce Treasury demand and support higher yields.
- The U.S. Treasury yield curve, as measured by the spread between the yields of 10-year and 2-year U.S. Treasuries, flattened from 33 bps to 18 bps during the third quarter, before rebounding to end the quarter at a spread of 24 bps. Market participants are watching this metric closely as a potential recession indicator.

IMPLIED PROBABILITY OF FED RATE HIKES



Data source: CME Group

BOND INDICES PERFORMANCE



Data sources: Boomberg, L.P., Barclays

REAL ASSETS

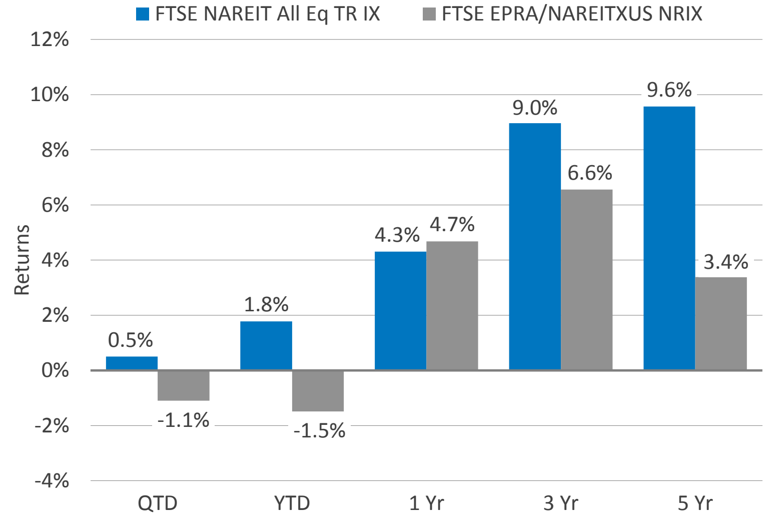
REAL ESTATE

- Although public real estate experienced six straight months of positive total return, growth came to an end in September as REITs declined amid rising short-term interest rates. While rising interest rates brought headwinds to REITs in general, certain sectors, such as hotels and resorts, had stronger gains during the quarter. These two sectors rose almost 10% due in part to strong corporate earnings and U.S. economic growth that supported business and leisure travel.

NATURAL RESOURCES

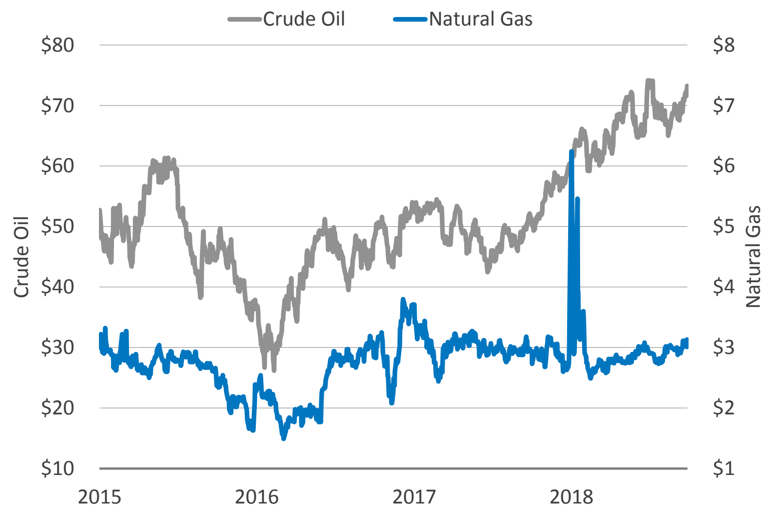
- Crude oil (WTI) prices rose almost 5% over the third quarter and were up over 25% year-to-date through September. At the beginning of September, the Texas Railroad Commission stated that Texas crude production had declined by seven million barrels in June, the first decline in over 16 months. Trade tensions with China and supply disruptions in Venezuela contributed to further oil price volatility. However, oil prices began to march higher to end the quarter, as the upcoming U.S. sanctions on Iran came into focus and Iranian crude exports declined. Moreover, sentiment was also bolstered by the decision of the Organization of the Petroleum Exporting Countries (OPEC) and its allies to leave production steady.
- Overall, commodity prices declined over the third quarter under the negative impact of rising U.S. interest rates and trade issues between the U.S. and China. Higher short-term interest rates in the U.S. are supportive of a stronger U.S. dollar, and this tends to put downward pressure on the commodities sector.

DOMESTIC vs. INTERNATIONAL REIT RETURNS
As of September 30, 2018



Data source: Bloomberg, L.P.

PRICE OF CRUDE OIL AND NATURAL GAS
As of September 30, 2018



Data source: Energy Information Agency

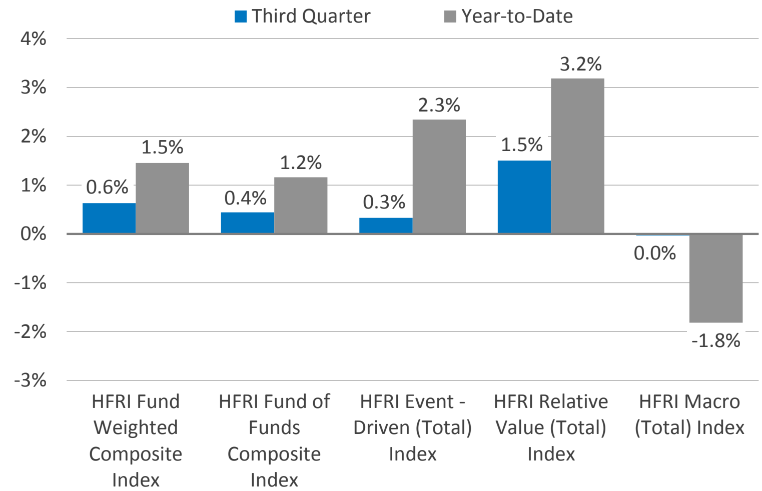
MLPs

- MLPs performed well in the third quarter. If oil prices stabilize, with continued global demand growth and better production discipline by OPEC, an increase in North American production could lead to higher volumes through pipelines and increased revenue for midstream MLPs. MLP balance-sheet quality has improved due to deleveraging over the last 12-18 months, and distributions are expected to grow by 3%-5% over the coming years.

DIVERSIFYING STRATEGIES

- Hedge funds focused on emerging markets (EM) struggled throughout the quarter. A number of idiosyncratic events—ranging from tariff negotiations between the U.S. and China to extreme measures taken by the Argentinian government to protect its currency—adversely impacted certain countries and led to spillover effects more broadly across EM.
- Systematic macro strategies rebounded from a challenging start to the year. Also, persistent trends in the U.S. dollar and certain commodities drove gains for trend followers during the third quarter.
- Event driven strategies performed well, particularly those with large merger and acquisition (M&A) portfolios. The courts overruled the Department of Justice's attempt to block the vertical merger of AT&T and Time Warner earlier in the year, clearing the way for the closure and announcement of similar deals.

HFRI INDICES PERFORMANCE
Returns U.S. Dollars



Data source: HedgeFund Research

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All data is as of September 30, 2018 unless otherwise noted.

INDICES

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

Barclays Capital Fixed Income Indices is an index family comprised of the Barclays Capital Aggregate Index, Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, Municipal Index, High-Yield Index, and others designed to represent the broad fixed income markets and sectors within constraints of maturity and minimum outstanding par value. See https://ecommerce.barcap.com/indices/index.dxml for more information.

The CBOE Volatility Index (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index. FTSE Real Estate Indices (NAREIT Index and EPRA/NAREIT Index) includes only those companies that meet minimum size, liquidity and free float criteria as set forth by FTSE and is meant as a broad representation of publicly traded real estate securities. Relevant real estate activities are defined as the ownership, disposure, and development of income-producing real estate. See www.ftse.com/Indices for more information.

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Russell Investments rank U.S. common stocks from largest to smallest market capitalization at each annual reconstitution period (May 31). The primary Russell Indices are defined as follows: 1) the top 3,000 stocks become the Russell 3000 Index, 2) the largest 1,000 stocks become the Russell 1000 Index, 3) the smallest 800 stocks in the Russell 1000 Index become the Russell Midcap index, 4) the next 2,000 stocks become the Russell 2000 Index, 5) the smallest 1,000 in the Russell 2000 Index plus the next smallest 1,000 comprise the Russell Microcap Index. See www.russell.com for more information.

S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation, among other factors by the S&P Index Committee, which is a team of analysts and economists at Standard and Poor's. The S&P 500 is a market-value weighted index, which means each stock's weight in the index is proportionate to its market value and is designed to be a leading indicator of U.S. equities, and meant to reflect the risk/return characteristics of the large cap universe. See www.standardandpoors.com for more information.

Information on any indices mentioned can be obtained either through your consultant or by written request to information@feg.com

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Research and Investments Team as of date of publication.