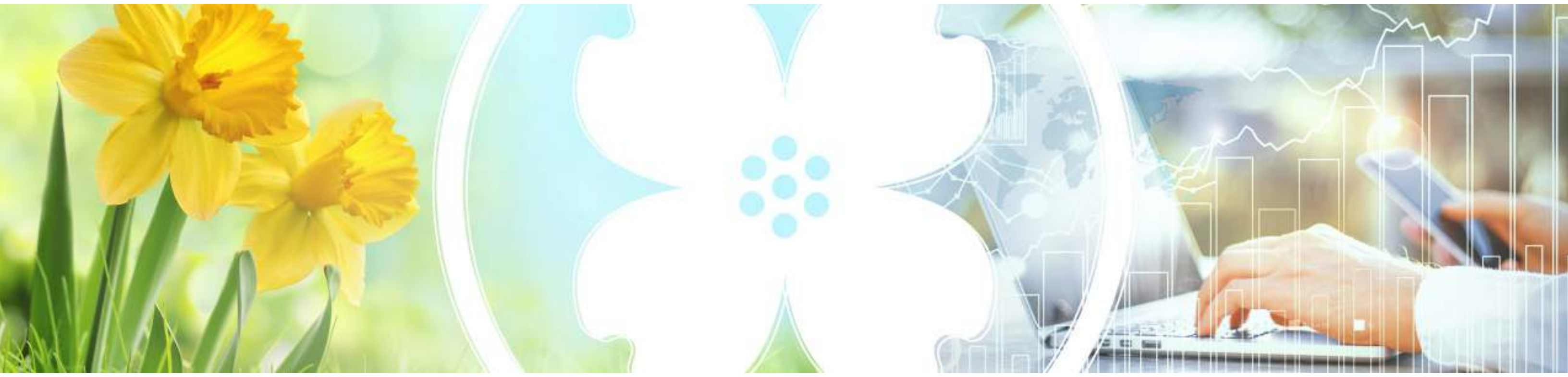


# INVESTMENT OUTLOOK FOR 2018

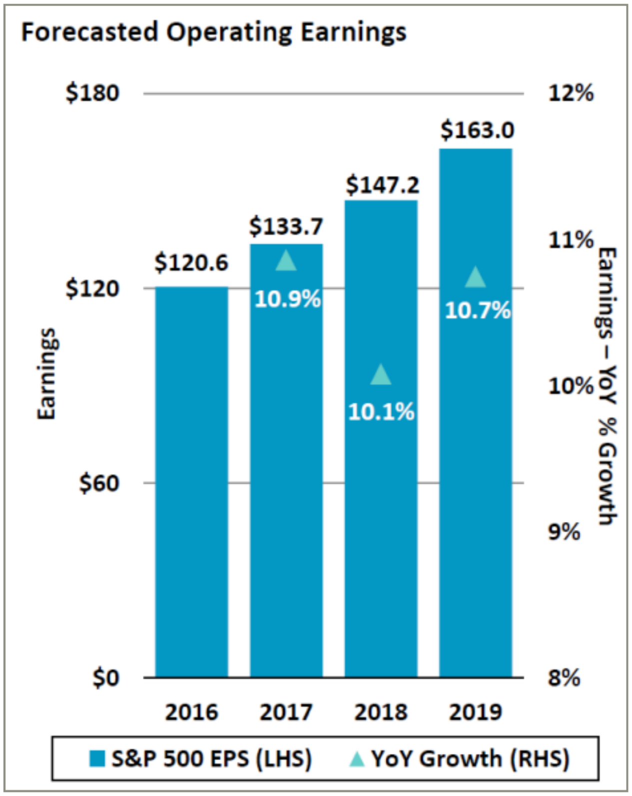
FIRST QUARTER **2018**

2017 was an almost perfect year for investors. Growth surprised to the upside as the year progressed. Global growth accelerated and became more synchronized. Inflation and interest rates remain subdued. Global monetary policy remained accommodative despite the Federal Reserve increasing short term interest rates. The combination of synchronized global growth, low inflation, low interest rates, and accommodative monetary policy has been an excellent environment for risk assets. As a result, global stock markets closed the year at record highs.

We are modestly overweight equities in our asset allocation with an emphasis on high quality and diversification across regions and asset classes. Synchronized global growth, the recovery in corporate earnings, and low but slowly rising inflation & interest rates are likely to continue in 2018. Much of these fundamentals are reflected in most asset prices, although the recent tax cuts and budget deal present potential upside to corporate earnings and growth. Risks to our outlook include reduced monetary accommodation, inflation and interest rates overshooting to the upside, and higher volatility.

**FIGURE 1:**

*Source: Blackstone - January 2018*




Entering 2018, investment markets had tailwinds from synchronized global growth, improving corporate earnings (Figure 1), low and gently rising inflation and interest rates (Figure 2), and the recently passed tax cuts in the United States. Volatility is likely to climb and market returns will be bumpier in 2018 than in 2017.

The macroeconomic backdrop of expanding global growth, low inflation, and slowly rising interest rates is likely to persist in 2018. Looking across the horizon we see low odds of a recession with easy financial conditions at present, and growth momentum remaining strong. Leading economic indicators remain high (Figure 3) and typically top out 12 months before bull markets

*...continued on page 2*

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end. Reinforcing this underlying trend is the coming fiscal stimulus in the U.S. from tax cuts and higher federal spending for defense and disaster relief. That should boost growth in 2018. Global GDP is projected to rise from 3.8% in 2017 to 4.1% in 2018 (Figure 4) with strength in both U.S. and emerging markets.

**FIGURE 2 – INFLATION: CPI AND CORE CPI**


Source: BLS, FactSet, J.P. Morgan Asset Management.

**FIGURE 3 – U.S. LEADING ECONOMIC INDICATOR**

*Source: Bloomberg*


**FIGURE 4 – REAL GDP GROWTH Y/Y**

| GDP Growth Forecasts | 2016 A | 2017 E | 2018 E | 2019 E |
|---|---|---|---|---|
| World | 3.1% | 3.8% | 4.1% | 4.0% |
| EM | 4.5% | 5.1% | 5.5% | 5.6% |
| Advanced Economies | 1.7% | 2.3% | 2.4% | 2.0% |
| USA | 1.5% | 2.3% | 2.7% | 2.1% |

*Forecasts—Source: Goldman Sachs* *As of January 2018*

# POTENTIAL RISKS ENTERING 2018

## GLOBAL CENTRAL BANK BALANCE SHEET EXPANSION IS COMING TO AN END.

The Fed is in the process of reversing the unprecedented accommodation put in place during the Great Recession of 2008-09 by hiking short term interest rates in a structured way and by reducing the size of its balance sheet of government bonds. Overseas, the European Central Bank is expected to end its asset purchases in the fall, and the Bank of Japan may do the same in 2019. The removal of accommodation by Central Banks will likely increase market volatility.

## INFLATION AND INTEREST RATES OVERSHOOT ON THE UPSIDE.

The broad based and above trend growth in the U.S., with unemployment at 4.1%, is causing wages to rise. The new tax plan is adding additional stimulus to the economy and will require higher financing needs that could put upward pressure on inflation and interest rates. If the economy runs "too hot" that could cause the Fed to tighten interest rates more aggressively and tip the economy toward recession.

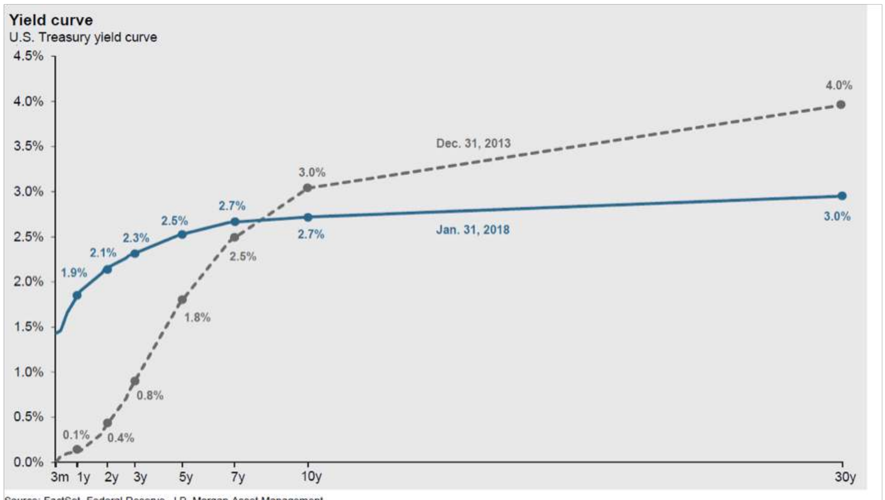
# CTC 2018 OUTLOOK 10 THEMES

Against this backdrop, we highlight our major investment themes for 2018. Our base case is continued synchronized global growth in 2018. Our goal is to identify the most important themes that will drive investment markets and returns in 2018. Our views are subject to revision and we will use deviations from these ten themes in our base case to make adjustments to portfolios as the year progresses.

1. **Global Synchronized Expansion Continues With OECD Countries' PMIs Expanding.** The broad-based growth that is above trend continues in 2018 with global GDP increasing to 4.1%.

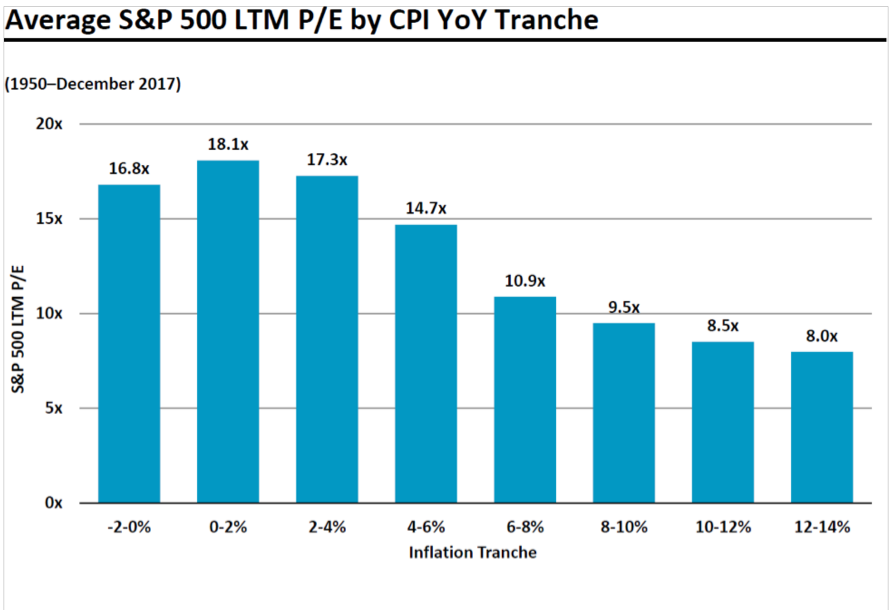
2. **U.S. Growth Improves and Real GDP Expands at 3% Plus Rate.** Strong momentum from 2017 continues into 2018 aided by fiscal stimulus from tax cuts and increased defense, discretionary spending on disaster relief, and domestic spending.

FIGURE 5: THE YIELD CURVE HAS FLATTENED BUT NOT INVERTED



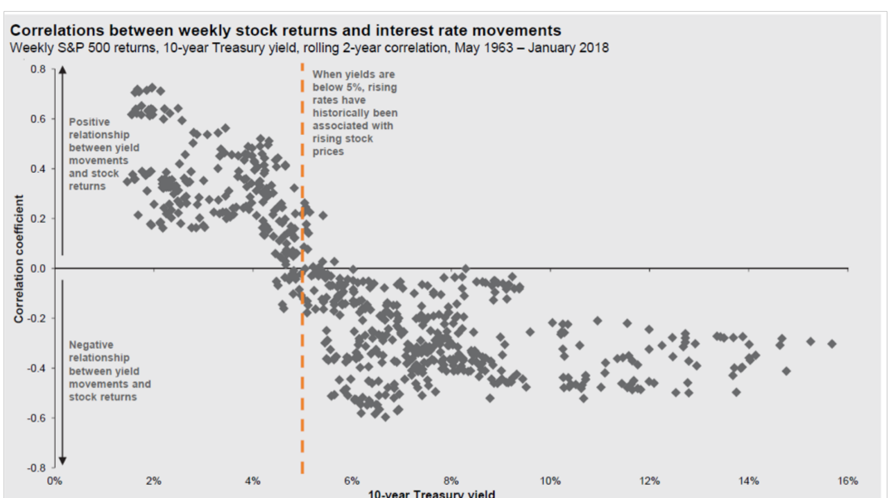

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.

FIGURE 6: PRICE-EARNINGS RATIO REMAIN ABOVE 17X WHEN INFLATION IS BELOW 4%




Source: Strategas Research Partners (December2017).

FIGURE 7: WHEN YIELDS ARE BELOW 5%, RISING RATES ARE CORRELATED WITH RISING STOCK PRICES




Source: FactSet, Standard & Poor's, FRB, J.P. Morgan Asset Management.

3. **Inflation Reaches Fed's 2% Target Driven by Rising Commodity Prices and Wages.** After running below the Fed's target, inflation rises toward 2% on the PCE driven by full employment and commodities prices that have stabilized and are rising. Trade tariffs and a weak dollar may cause the consumer price index to surprise to the upside.

4. **Interest Rates Move Higher and the Yield Curve Flattens. The U.S. 10-Yr Treasury Reaches 3%.** Based on higher growth, the 10-Yr yield hits 3%, but importantly, the yield curve does not invert. This is important as an inverted yield curve typically leads to a market downturn 12 months later (Figure 5).

5. **Earnings Growth Exceeds 15% Based on Rising Global Growth and the Effects of Tax Reform.** The earnings recovery continues. After rising 10% in 2017, growth accelerates over 15% in 2018 based on solid growth and tax cuts.

6. **The U.S. Dollar Stabilizes and Remains Range Bound.** The U.S. dollar fell 12% last year. As interest rates move higher, the dollar stabilizes and trades in a narrower range.

7. **Stocks Outperform Bonds for the Seventh Consecutive Year but Experience a 10% to 15% Correction.** With global growth and corporate earnings accelerating, inflation and yields will rise. This environment is a headwind to bonds and favors stocks, provided the increase in yields and inflation is gradual (Figure 6 and Figure 7).

8. **Protectionism Continues to Rise Without All Out Trade Wars.** Trade frictions and tariffs are likely to rise in 2018, but countries avoid all-out trade wars that would be negative for global growth.

9. **Political Backdrop Expands Volatility With Populism Still Alive and Major Elections in the U.S. and Mexico in 2018.** With populism alive, and high levels of partisanship, market volatility increases around elections and partisan events.

10. **Market Volatility Rises With Divergences Rising Among Regions, Asset Classes and Sectors.** With the winding down of global monetary accommodation, the period of unusually low volatility is ending, which underscores the need for flexible and dynamic portfolio positioning.

# ASSET ALLOCATION VIEWS AND PORTFOLIO POSITIONING

The following are our major asset class and asset allocation views. We build globally diversified portfolios by utilizing five major asset classes: equities, fixed income, real assets, alternatives and cash. The implications to your portfolio may vary depending on your particular individual situation. Please consult with your Central Trust Company team.

## ASSET ALLOCATION

Entering 2018, the markets had a solid fundamental backdrop with strong momentum and prospects synchronized global growth and growing corporate earnings that took hold in 2017 continuing into 2018. Global GDP is estimated to grow over 4%. Inflation and interest rates are low and slowly rising with still accommodative global monetary policy. The recently passed tax bill will be positive for consumers, corporate earnings, and investments. Interest rates will rise as the Fed increases short-term interest rates three times in 2018 and global growth remains strong. The political backdrop in the U.S. may become less favorable as mid-term elections approach. Partisanship is at an all-time high making the passage of major legislation difficult.

We are overall constructive on equity markets although volatility will likely climb and stock returns will moderate and become more challenging in 2018 compared to the near perfect 2017. An environment of strong and broad economic growth and expanding earnings supports the probability of continued positive equity market returns. A long overdue 5 -15% correction in the stock market is likely this year.

Our base case for 2018 calls for continued synchronized, improving global economic growth, still accommodative monetary and fiscal policy, and low, but gently rising, inflation and interest rates. We remain moderately overweight equities and underweight bonds in balanced portfolios that have broad diversification of risk across global markets. At this stage in the cycle, we see benefits from global equity diversification and have increased exposures to international developed and emerging markets. Within fixed income, we favor shorter duration, high quality bonds and up-in-quality credit sector bonds. Gold, alternatives and cash act as portfolio diversifiers. In a late cycle environment, we continue to be watchful for signs of deterioration in economic and financial market data.

Overall, our asset allocation shifts over the last 18 to 36 months have been very additive to returns, while continuing the construction of diversified, high quality global portfolios.

## FORWARD LOOKING INVESTMENT RETURNS

Due to the age of the business cycle, high levels of global debt, low productivity, prospects for less monetary accommodation, and generally full valuations, the prospects for investment returns are muted across almost all the major asset classes over the intermediate term.

### EQUITIES

Based on a favorable macro environment, we maintain a positive tilt on equities relative to other risk assets. We prefer broad diversification of risk across global equity markets. In the U.S., tax cuts, disaster/infrastructure spending and reduced regulation provide additional support to domestic companies. We have increased allocations, beginning in late 2016, to developed international and emerging markets that are benefiting from broadening global expansion. Europe, Japan and China all had upside surprises in growth

in 2017. Internationally, valuations appear reasonable and operating earnings are increasing off of low levels from the pickup in global growth.

We have increased our allocation to the hedged equity sub-class to lessen tail risks and be a bit more defensive given the current business expansion is 103 months old. Historically, markets experience a 10% correction about once a year on average. We would not be surprised by a pullback, which would be healthy and normal in a bull market.

### FIXED INCOME

With the economy at full employment and global growth expanding, we continue to be cautious on longer-dated fixed income due to the potential of higher bond yields. Therefore, we remain defensive on interest rate exposure and prefer shorter durations. With the Fed in a gradual tightening mode and global growth expanding, interest rates will have an upward bias. On a global basis, U.S. yield levels are significantly higher than in the Eurozone and Japan, which make the U.S. market attractive to foreign investors. Eurozone bonds are at risk given their low and even negative yields at a time the European Central Bank is likely to taper asset purchases in the fall.

U.S. Treasury and investment grade bonds diversify riskier growth oriented investments in portfolios like stocks, which is important in the late stages of the business cycle. In periods when stocks have negative returns due to economic downturns or shocks, bonds historically have positive returns.

We have an allocation to TIPS (Treasury Inflation Protected Securities) that provide a hedge against rising inflation.

For diversification, we utilize the credit sector of fixed income that has less interest rate sensitivity. We are neutral on credit, as spreads over U.S. Treasury bonds are tight on a historical basis and typically widen in the late stages of an economic cycle. Within credit, we prefer floating rate bonds with yields that increase as interest rates rise, offering protection in a rising rate environment. High yield bonds spreads are tight and remain near full value. International developed market fixed income is avoided due to the low levels of interest rates relative to the U.S.

## REAL ASSETS

Real assets provide inflation protection and are an important portfolio diversifier. We have an allocation to gold as a portfolio diversifier that acts as insurance during periods of inflation and financial uncertainty.

## ALTERNATIVES

The alternative strategies we utilize in building portfolios are designed to lower portfolio volatility and improve portfolio efficiency due to low correlations with other asset classes. Alternatives act as a hedge in volatile markets and provide better performance in a rising interest rate environment than bonds.

## CASH

Portfolios will typically have a small amount of cash due to interest income and dividends being generated. At times, higher allocations of cash are beneficial to dampen portfolio risk and provide a source of funds for purchase of attractive opportunities in times of market volatility.

# MARKET RECAP FOR 2017

2017 was a very good year for global equity markets and most asset classes. Global growth expanded and became more synchronized with Europe, Japan and China exceeding expectations. Earnings accelerated globally while inflation and interest rates remained muted. Global monetary policy remained accommodative despite the Federal Reserve and the ECB beginning to slowly tighten interest rate policy.

## EQUITIES

Global equities ended the year near record highs as global growth became more synchronized. Stocks easily outperformed bonds in 2017 for the sixth consecutive year. The U.S. Dollar declined 12% benefiting international assets due to the currency effect. The U.S. market has enjoyed an eight year advance and is over triple the level of the lows reached in 2009.

| *As of December 31, 2017* | | Trailing Performance (annualized for periods > 1 year) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Asset Class** | **Index** | **MTD** | **QTD** | **YTD** | **1Y** | **3Y** | **5Y** | **10Y** |
| **EQUITIES** | | | | | | | | |
| **Benchmark** | MSCI All Country World IMI | 1.6% | 5.7% | 23.9% | 23.9% | 9.5% | 11.0% | 5.0% |
| Large Cap | S&P 500 | 1.1% | 6.6% | 21.8% | 21.8% | 11.4% | 15.8% | 8.5% |
| *Styles* | Russell 1000 | 1.1% | 6.6% | 21.7% | 21.7% | 11.2% | 15.7% | 8.6% |
| | R1000 Growth | 0.8% | 7.9% | 30.2% | 30.2% | 13.8% | 17.3% | 10.0% |
| | R1000 Value | 1.4% | 5.3% | 13.6% | 13.6% | 8.6% | 14.0% | 7.1% |
| *Long-Short* | S&P 500 / LIBOR plus 3 | 0.7% | 3.9% | 13.0% | 13.0% | 7.6% | 9.7% | 6.1% |
| Small/Mid Cap | Russell 2500 | 0.3% | 5.2% | 16.8% | 16.8% | 10.1% | 14.3% | 9.2% |
| International | MSCI World Ex US (net) | 1.8% | 4.2% | 24.2% | 24.2% | 7.4% | 7.5% | 1.9% |
| Emerging Markets | MSCI Emerging Markets (net) | 3.6% | 7.4% | 37.3% | 37.3% | 9.1% | 4.3% | 1.7% |

The S&P 500 gained 21% and the MSCI All Country World Index advanced 24%. International developed equity markets increased 24%, while emerging markets led all equity markets last year with a gain of 37%. Growth outperformed Value (on a style basis) by a wide margin (1600 basis points for large cap). Large cap outperformed small cap stocks.

## FIXED INCOME

Bonds had a surprisingly good year with the Barclays Aggregate Index gaining 3.5% as interest rates ended the year nearly unchanged. TIPs (Treasury Inflation Protected Securities) gained 3.3%. Inflation expectations picked up at year-end. The credit sector outperformed investment grade bonds. High yield advanced 7.5%, floating rate debt rose 4.1%, and emerging market debt gained 9.3%.

| *As of December 31, 2017* | | Trailing Performance (annualized for periods > 1 year) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Asset Class** | **Index** | **MTD** | **QTD** | **YTD** | **1Y** | **3Y** | **5Y** | **10Y** |
| **FIXED INCOME** | | | | | | | | |
| **Benchmark** | Citi World Broad Investment Grade | 0.3% | 1.0% | 7.4% | 7.4% | 2.0% | 0.9% | 3.1% |
| U.S. Aggregate | Barclays US Aggregate | 0.5% | 0.4% | 3.5% | 3.5% | 2.2% | 2.1% | 4.0% |
| U.S. Government | Bloomberg Bond Index US Govt (LT) | 1.7% | 2.4% | 8.6% | 8.6% | 2.8% | 3.5% | 6.6% |
| U.S. TIPS | Citi U.S. Inflation Linked Securities | 1.0% | 1.4% | 3.3% | 3.3% | 2.1% | 0.2% | 3.6% |
| Tax Exempt | BOFA Merrill Lynch US Municipal | 1.0% | 0.7% | 5.4% | 5.4% | 3.1% | 3.2% | 4.6% |
| U.S. Corp High Yield | Barclays US Corporate High Yield | 0.3% | 0.5% | 7.5% | 7.5% | 6.4% | 5.8% | 8.0% |
| U.S. Floating Rate | S&P/LSTA Leveraged Loan | 0.4% | 1.1% | 4.1% | 4.1% | 4.4% | 4.0% | 4.8% |
| International | Citi Non USD WGBI | 0.1% | 1.6% | 10.3% | 10.3% | 2.0% | -0.3% | 2.4% |
| Emerging Markets | JPM Emerging Markets | 0.6% | 0.5% | 9.3% | 9.3% | 6.8% | 3.8% | 7.1% |

## REAL ASSETS

Gold had a strong year gaining 13%. Commodities posted strong gains in the fourth quarter on accelerating economic growth. Oil gained 12% and closed above $60 a barrel. Real assets benefit from the reflation trend of higher growth and inflation.

| *As of December 31, 2017* | | Trailing Performance (annualized for periods > 1 year) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Asset Class** | **Index** | **MTD** | **QTD** | **YTD** | **1Y** | **3Y** | **5Y** | **10Y** |
| **REAL ASSETS** | | | | | | | | |
| **Benchmark** | Gold | 2.7% | 1.9% | 12.8% | 12.8% | 2.7% | -5.4% | 3.8% |
| *Inflation* | Consumer Price Index (CPI) | 0.0% | 1.0% | 2.2% | 2.2% | 1.6% | 1.4% | 1.6% |
| Commodities | Bloomberg Commodities | 3.0% | 4.7% | 1.7% | 1.7% | -5.0% | -8.5% | -6.8% |
| Silver | LBMA Silver Price | 1.8% | 0.0% | 3.8% | 3.8% | 1.8% | -10.9% | 1.3% |

## ALTERNATIVES

Alternatives posted solid gains in 2017. Alternatives provide additional stability to portfolios by enhancing diversification and reducing volatility due to low correlations with stocks and bonds. Low volatility alternatives are an attractive alternative to traditional fixed income in a rising interest rate environment.

| *As of December 31, 2017* | | Trailing Performance (annualized for periods > 1 year) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Asset Class** | **Index** | **MTD** | **QTD** | **YTD** | **1Y** | **3Y** | **5Y** | **10Y** |
| **ALTERNATIVES** | | | | | | | | |
| **Benchmark** | LIBOR + 3 | 0.4% | 1.1% | 4.3% | 4.3% | 3.8% | 3.6% | 3.8% |
| Conservative | Hedge Fund Research HFRI FOF C | 0.0% | 1.2% | 4.6% | 4.6% | 2.0% | 3.3% | 0.9% |
| Multi-Strategy | Hedge Fund Research HFRI RV Mu | 0.0% | 0.0% | 4.6% | 4.6% | 3.4% | 4.3% | 3.9% |
| Global Macro | Credit Suisse Global Macro Ind | 0.0% | 1.0% | 2.2% | 2.2% | 1.6% | 2.5% | 4.3% |
| Managed Futures | Credit Suisse Managed Futures | 0.0% | 2.1% | 1.8% | 1.8% | -2.1% | 1.6% | 2.2% |

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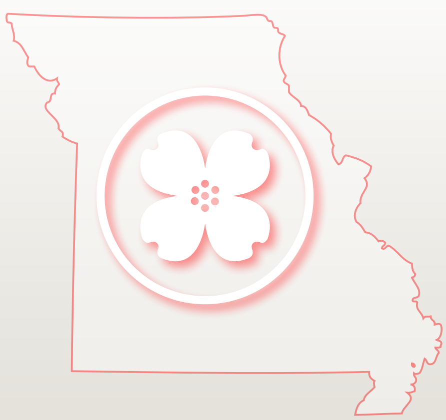

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# THE CENTRAL VIEW

*A publication produced by Central Trust Company providing you with up-to-date market commentary.*

Central Trust Company

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Each quarter, our investment team identifies the key forces that will drive the global economy and financial markets over the horizon and delivers them directly to your inbox!

Please consult with your Central Trust Company advisor for more guidance on how Central Trust can tailor solutions for your particular needs based on these evolving economic and market conditions.

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