UNION

MONTHLY UPDATE AND COMMENTARY
OCTOBER 2017

Recap: As expected, the U.S. economy has turned in a solid performance over the first half of the year, averaging just above 2% annualized, with consumers spending and business investment posting the best back-to-back quarters since 2014. Slightly less expected was the considerable momentum that carried into the third quarter (Q3). Growth was tracking roughly 3% annualized prior to the devastation caused by Hurricanes Harvey and Irma. The impact of these storms have been a setback in Q3, while subsequent quarters should likely give way to a strong rebound. For 2017, GDP should grow at a 2.1% pace.

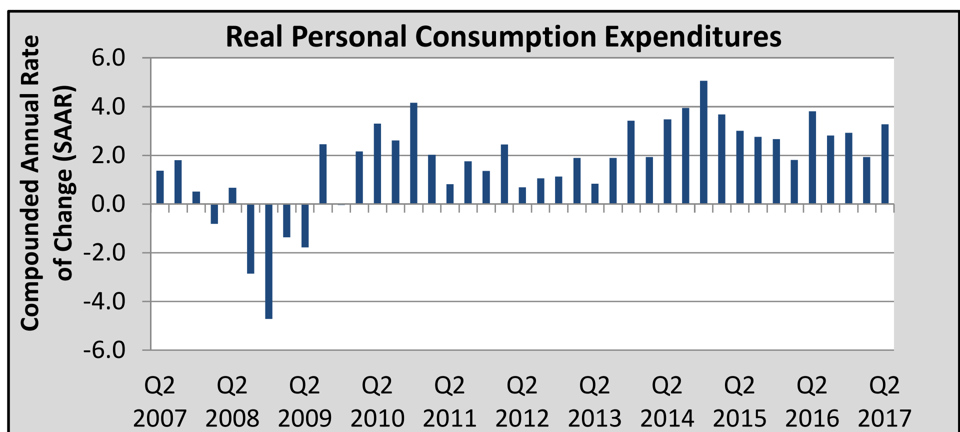
A broadening and strengthening of expansions in advanced and emerging economies has helped restore a sense of optimism in the global economy that has been missing for several years. Global growth in the first half of 2017 averaged 3.5%, marking the best start since 2014. Moreover, the composition of growth globally has shifted towards a more self-sustaining dynamic of rising domestic demand accompanied by an uptick in global trade. This improved economic momentum, which has been supported by accommodative monetary and fiscal policies, should keep global economic activity at a 3.5% pace this year followed by a slightly higher growth in 2018.

This stronger economic activity could go a long way to countering the drag from structural headwinds and elevated geopolitical uncertainty. Persistent outperformance by G7 economies is eliminating excess production capacity faster than anticipated, resulting in tighter labor markets. The competition for scarcer skilled labor should move wages higher, squeezing profit margins and eventually leading to a more durable move up in consumer prices.

GDP: U.S. economic output grew at a 3.1% annual rate in the second quarter, slightly stronger than previously thought and marking the best growth in two years. Stronger business spending led to the upward revision.

The U.S. economy rebounded in the spring after a lackluster winter and then lost momentum again after hurricanes Harvey and Irma. The economy at its core, however, remains stable as steady job growth and a booming stock market encouraged households to spend. Consumers, accounting for more than two-thirds of economic demand, increased spending at a 3.3% rate in the second quarter.

Economic activity was expected to drop between 1% and 2% in the third quarter due to the impact of the hurricanes. However, growth should more likely rebound in the year's final months and early next year as hurricane-hit communities rebuild, consumers and businesses step up spending and the global economy gains further traction.



Consumer Confidence: The consumer confidence index fell to 119.8 in September, down from 120.4 in August. The decline was concentrated in the present situation component while expectations for the future were stronger in the month. Hurricanes Harvey and Irma weighed on sentiment about the present. The share of consumers saying business conditions were "good" pulled back slightly, but expectations for future business conditions and job growth have improved. Consumer confidence should move sideways in the coming months given the uncertainties both in the U.S. and globally.

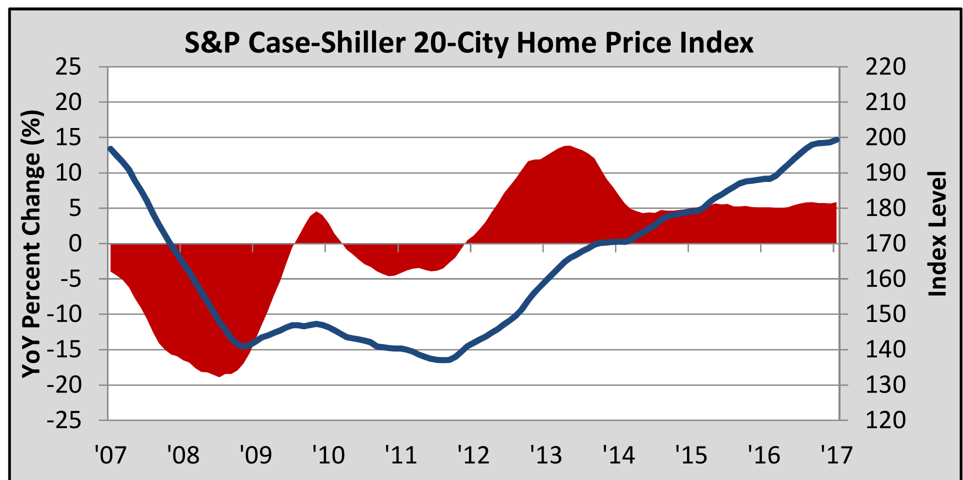
Personal Income: Personal income rose 0.2% in August from a downwardly revised 0.3% increase in July. Real disposable personal income edged down 0.1% in the month. Personal consumption rose by 0.1% in nominal terms. In real terms spending fell 0.1%. The PCE price deflator rose 0.2% month-on-month while the core PCE deflator ticked up just 0.1%.

The consumer appeared to have lost some momentum after a strong second quarter. This may be due to the impact of the hurricanes. The negative impact could continue through September, before spending gets a lift as rebuilding and the holiday spending season begins. Having said that, the broader outlook for U.S. consumers has remained positive. With few signs of a slowdown in the pace of job growth and increasing evidence of accelerating wage growth, household spending should continue to support demand growth.

Housing: Fundamentals in the housing market remained strong and should continue to support residential investment in the coming months. Housing starts surprised to the upside in August even amidst Hurricane Harvey's wrath, which disrupted activity in the final days of August. Housing starts in August rose to 1.174 million from an upwardly revised July figure. Although the continued effects of Hurricane Harvey and Irma led to a cooling in September's housing starts, this activity should be recouped as residential investment receives a boost in the fourth quarter of 2017 and first half of 2018 as rebuilding gets underway.

Existing home sales, however, continued to slide in August, falling 1.7% to 5.35 million (annualized), marking the fourth decline in five months. The decline was concentrated in the single-family segment. Regional performances were mixed, as resale activity pulled back sharply in the South given the likely impact from Hurricane Harvey. It also dropped in the West while improving in the Midwest and soaring in the Northeast.

The inventory of homes available for sale also fell. Despite the low inventory, the upward pressure on median home prices moderated slightly, with prices advancing by 5.6% year over year. In 2018, sales momentum is expected to advance at a steady pace, with demand for homes supported by continued job, low interest rates and income gains. Low inventories will continue to keep a lid on activity, but fast-rising prices could pull sales forward.



Federal Reserve: The Federal Reserve has finally embarked on a course of gradual balance sheet normalization that will begin next month. The Committee announced its plan to gradually reduce its balance sheet by tapering reinvestments in its Treasury and MBS portfolio. The Fed will runoff at $10 billion per month initially, raising it gradually to $50 billion per month by October 2018, with a 60/40 split between Treasury and MBS. The Federal Open Market Committee (FOMC) will leave the target range for the federal funds rate unchanged between 1 and 1-1/4 percent.

The Fed's statement made few changes to its assessment of the economy, noting the continued strength in job growth, and pick up in investment activity. The Committee recognized the negative impact of recent hurricanes on near-term economic activity with a boost expected thereafter as rebuilding begins.

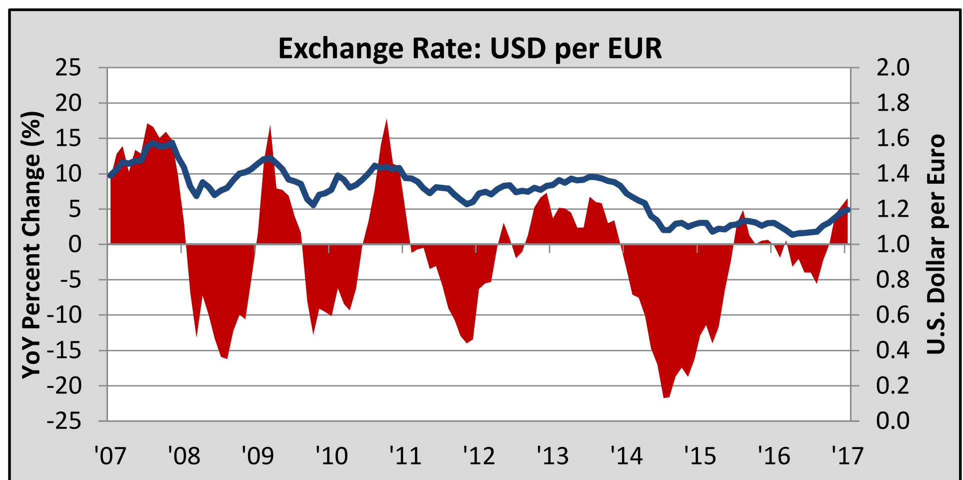
Fed Leadership: The search for a new Chairman of the Federal Reserve System has been largely informal until recently. Janet's Yellen's term expires in February 2018 and the chances of her getting reappointed are 50-50. Other names said to be in contention would include Gary Cohn, Jerome Powell, Kevin Warsh and John Taylor. On monetary policy, Powell and Cohn have backed Yellen's strategy of gradual interest rate increases as the economy improves. On regulatory policy, they would be in favor of easing some of the bank rules put in place following the financial crisis. This puts them largely in sync with President Trump's position on financial deregulation. Their appointment would signal a continuation of the current gradual tightening policy of the Fed.

In contrast, both Kevin Warsh and John Taylor have been critics of the Fed's aggressive monetary easing, warning that it increased the risks of a financial bubble. Appointment of either Warsh or Taylor would signal more aggressive monetary tightening by the Fed in 2018 and thereafter.

Global: Global growth is on track to average 3.5% this year, and over the next two years. Highly accommodative monetary policy has done its job in sowing the seeds for self-sustaining economic growth across a number of regions. Now, with economic slack being absorbed at a faster rate, central banks are increasingly scaling back that stimulus. In the Euro Area, real GDP growth of 2.4% in the first half of the year was faster than expected, and nearly double the economy's estimate of trend growth. As a result, the European Central Bank looks set to announce an end to its asset purchases. The Federal Reserve is further along in reducing monetary stimulus, with four rate hikes under its belt.

Euro: After trending lower between 2010 and 2015, the trade-weighted value of the euro reversed course in 2016 and has risen more than 5% in 2017 (13% against the U.S. dollar). Stronger-than-expected economic data, which have prompted expectations of less accommodative ECB monetary policy going forward, undoubtedly have contributed to the rise in the value of the euro.

Real appreciation in the euro exchange rate has been associated with slower export growth in the Eurozone, everything else equal. But the effects of economic growth in the rest of the world have been significantly more important for real export growth than the real exchange rate. As long as the global economy has continued to expand at a healthy pace, real export growth in the euro area likely will remain positive. As long as the economic expansion in the euro area remains healthy, inflation should slowly trend higher over time.



Consequently, the ECB will likely dial back its bond purchases further in coming months and should commence a slow pace of rate hikes in late 2018.

Outlook: Although the outlook for solid real economic growth and continued below-target inflation in the second half of the year remains intact, the policy outlook in the U.S. is quite fluid. The fundamentals of employment, manufacturing and construction picking up will provide the backdrop for a positive economic outlook. The outlook is for GDP and real final sales growth in the second half to be higher than 2.5%, with solid contributions from the consumer, business and government sectors.
At 4.4%, the current unemployment rate is in the neighborhood of full employment. Only modest declines are expected from here. As the labor market tightens further, it is likely to pull underlying inflation higher, although the process will take longer than previously anticipated. From 1.5% in 2017, core inflation, as measured by the Fed's benchmark of core personal consumption expenditure (PCE) price index, is expected to rise to 2.0% in 2019, slightly later than previously

expected.

Given the growth and inflation outlook, the FOMC is expected to move ahead with policy normalization by raising the fed funds rate in December. The dollar is anticipated to see relative weakness. Meanwhile, corporate profit gains should remain modest given a cap on top line nominal GDP growth and rising unit labor costs. However, the outlook on fiscal policy going forward is very uncertain. Two rate increases by the FOMC in 2018 are expected—not the three the FOMC has currently penciled in -- simply because the inflation outlook remains modest compared to the 2% target.

The stance of fiscal policy remains uncertain and presents both upside and downside risks to economic growth. Congress will begin to tackle a long to-do list of legislative deadlines in October. A tax cut for 2018 is assumed, but on a far more modest scale than the Administration's proposal would suggest given the political haggling about to ensue. Should this change, the outlook will change as the direction of policy becomes clearer. Given the proximity of the economy to full employment, any upside surprise in terms of the size of fiscal stimulus would be expected to pull forward the path of inflation and monetary tightening.

Over the next two years the economy is expected to continue its current performance, with growth edging above 2%. That performance is likely to be shaped by robust consumer spending, solid investment and renewed strength in housing. These figures, however, do not build in any anticipated fiscal impacts from tax policy, which offers upside potential to an economy currently outpacing its longer-term cruising speed.

Capital Markets in Review

Recap: The S&P 500 Index closed out the third quarter by posting a positive monthly total return for the eleventh month in a row (the last negative monthly return for the S&P 500 Index was October 2016 when it declined 1.8%). The domestic stock market index rose 2.06% for the month, to bring the quarter-to date and year-to date total returns to 4.48% and 14.24%, respectively. The commonly reported Dow Jones Industrial Average was up 5.58% in the third quarter, while the Technology heavy NASDAQ 100 Index saw a total return of 6.17%. Meanwhile, the Barclays U.S. Aggregate Bond Index also moved higher in the third quarter, rising 0.85% as interest rates continued to defy market expectations and the Federal Reserve's efforts to talk U.S. interest rates higher.

Global stock markets continued to see strong interest in the third quarter with solid performance so far this year and investor attraction to these areas has remained undaunted. Both actively managed international equity mutual funds and their passive investment vehicle counterparts like index funds and ETFs, have experienced massive inflows over the course of 2017.

Not much changed during the quarter on the economic front from a market perspective. Investor optimism around improvements to economic growth through new policies and real changes in Washington D.C. waned as little progress has been made on the legislative front. However, positive momentum to corporate earnings appears to have taken center stage for the stock market's continued advances to record levels. Primary concerns for the markets include above average equity valuations, the impacts of rising interest rates off of historically low levels, periodic conflicting signals from officials at the Federal Reserve regarding the timing and number of rate hikes in 2017 and beyond, and the potential for political surprises here and overseas that could influence market clarity.

Domestic Stocks: Domestic stock market indexes repeatedly set new record highs again this quarter and were supported by an economy that continued to show signs of gradual improvement (more or less), or at least few signs of slippage. Performance results for the S&P 500 Index have surpassed the average strategist forecast of an approximate 6% return for all of 2017. Foreign markets also performed well as many of these economies also appeared to be gaining traction and gradual improvements in corporate earnings appear to be on the horizon.

Second quarter earnings for S&P 500 Index companies came in quite strong and have been supportive of above average valuation levels. Corporate earnings for index constituents saw growth of over 19% from the same quarter one year ago, marking the third quarter in a row of approximately 20% growth. Annual growth (4 quarter totals) was also up about 18% versus one year ago. Analysts remain bullish in the current corporate environment and are predicting another good

quarter for the recently closed quarter, with about 15% growth predicted for the third quarter of 2017 versus the same period a year ago. Research analysts began the year expecting overall 2017 S&P 500 operating earnings to come in near $131, a 20% increase over the 2016 tally. Through the end of June that had slipped a bit and now stands near $127 (which is normal as the year progresses) – a drop of about 3%. All of this is good news for domestic stock investors.

Mid and small-cap stocks were mixed relative to large-cap stocks in the quarter but still posted nice positive total returns. The Russell Mid-Cap Index still rose a solid 3.47% in the quarter and the Russell 2000 Index representing small stocks rose 5.67%. This brings their year-to-date total returns to 11.74% and 10.94%, respectively. So mid-cap stocks trailed behind large-caps for the quarter while small caps fared better, although both trail their larger brethren for the year so far. These areas have not appeared to benefit as much from the passive investment push seen in the large-cap stock benchmarks. However, total returns for mid and small cap stocks at these levels for nine months' time are very respectable.

Growth stocks maintained their performance momentum over Value stocks so far in 2017. The Russell 1000 Growth Index climbed 5.9% based on total return in the quarter, while the Russell 1000 Value Index came in at 3.11%. Similar margins were seen within the Russell Mid Cap universe, but the spread between the Russell 2000 Growth and Value universes was tighter. Sector performance was a primary driver of this divergence as the Technology sector performance remained a darling for investors and drove Growth stocks higher in the quarter. However, there was also a resurgence in the more value-oriented Energy, Telecom, and Materials sectors – each climbing over 6% (based on S&P 500 companies). Financials performed well again this quarter (+5%) and make up a larger share of the Value universes and are expected to benefit from higher interest rates going forward, particularly on the short end of the interest rate curve. Sector performance for the S&P 500 Index was predominantly positive for the quarter with 10 of 11 sectors in positive territory. Consumer Staples was the only negative sector, slipping 1.35% in the quarter.

Foreign Stocks: Developed and Emerging Market equities remained in the sweet spot during the third quarter. The MSCI EAFE rose an additional 5.4% for the quarter to bring its year-to-date result to 19.96%. The MSCI ACWI ex USA Index (that has greater emerging markets exposure) was up 6.16% in the quarter and has risen 21.13% so far in 2017. The MSCI Emerging Market Index rose 7.89% for the quarter, bringing its year-to-date total return to 27.78%. Foreign stock markets started 2017 with some uncertainty due to a fair number of elections, particularly in Europe, with concerns centered on whether any additional populist victories could ultimately lead to the demise of the European Union. So far these elections have not trended this direction and markets have responded in a positive fashion. Central banks remain biased towards stimulative policies, recent economic traction has shown initiative, and corporate earnings have benefited overseas. Currency trends have also generally been positive for international investment returns.

Bonds: The US 10-Year Treasury closed the quarter with a 2.33% yield (up a touch from June's 2.31% close, down slightly from 2.40% at March 31, and underneath the 2.45% at year-end 2016). Similar 10-Year notes for Germany and Japan posted yields near 0.46% and 0.06%, respectively. The Barclays U.S. Aggregate Index rose 0.85%, despite the Federal Reserve outlining some details around working down its balance sheet and remaining steadfast (so far) in its intentions to raise rates again in December. The Barclays Global Aggregate ex U.S. rose 2.48% - with Emerging Market debt also performing well.

Throughout 2017 high yield bonds have seen insatiable demand from investors seeking higher levels of income (with some additional interest likely stemming from the positive returns the asset class has seen of late). For the quarter the Barclays High Yield Corporate Index was up another 2%, to bring year-to date results to 7%. High yield spreads have continued to come in and are close to record tight levels relative to Treasuries. But with low default rates and borrowers benefiting from improved stability in earnings and improved balance sheets, investors are optimistic. Continued gradual economic improvements have also been supportive of this debt segment.

Non-Traditional Investments: Commodity-related investments performed a bit better during the quarter with the Bloomberg Commodity Index rising about 2.5%. MLP investors saw results slide 3.05% primarily on concerns on the potential longer-term negative impacts on pipeline infrastructure from Hurricane Harvey in Texas. However prices for West Texas Intermediate crude oil moved past $50 in the quarter from approximately $46 at the end June.

Real estate investments fared all right again this quarter as fears of sharply higher interest rate levels seemed to dissipate

from investor concerns. The FTSE NAREIT Equity REIT Index rose 0.94% in the quarter. Rising interest rate environments can stoke investor concerns of negative impacts to property values. However, often times these fears prove short-lived, particularly in markets with positive fundamentals and rental rates adjusting higher.

Outlook: We remain constructive on the primary asset classes that comprise our investment portfolios. Domestic stock valuations linger at above average levels, although productive improvement in corporate earnings growth and economic conditions may be able take some of the edge off. International stocks are now contributing meaningfully to portfolio performance following several years of disappointing results. Even bonds are adding incremental value, albeit small, as interest rates have been stubborn to move higher (bonds also serve the important purpose of risk diversification should the equity markets experience turbulence). Overall, investors should be pleased with the investment outcomes they have been achieving in 2017.

It is appropriate to reiterate that strategic investors should keep their focus on maintaining a disciplined long-term positive perspective on capital markets. Attempts to make substantial portfolio adjustments as markets ebb and flow for all kinds of reasons are not likely to prove fruitful. Preference should be placed on meaningful and purposeful strategic allocations to client portfolios and adjusting them modestly from time to time as needs arise or conditions change. With relatively reasonable market expectations, diversified portfolios should continue to provide investors an appropriate balance of risk and return.

Index Performance as of 9/30/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	0.94	3.26	3.27	3.27	7.72	15.54	8.79	13.20
3000	0.89	2.44	4.57	4.57	13.91	18.72	10.73	14.23
3000 Growth	0.83	1.62	5.93	5.93	20.43	21.89	12.64	15.18
1000 Value	0.78	2.96	3.11	3.11	7.92	15.13	8.53	13.20
1000	0.73	2.13	4.48	4.48	14.17	18.55	10.63	14.27
1000 Growth	0.68	1.30	5.90	5.90	20.72	21.96	12.69	15.26
Mid Cap Value	1.25	2.73	2.14	2.14	7.43	13.38	9.19	14.33
Mid Cap	1.09	2.77	3.47	3.47	11.74	15.33	9.54	14.26
Mid Cap Growth	0.89	2.83	5.28	5.28	17.29	17.83	9.96	14.18
2000 Value	3.04	7.08	5.11	5.11	5.68	20.56	12.11	13.27
2000	2.83	6.24	5.67	5.67	10.94	20.76	12.17	13.79
2000 Growth	2.62	5.45	6.22	6.22	16.81	21.00	12.17	14.28
Standard & Poors								
S&P 500	0.72	2.06	4.48	4.48	14.24	18.62	10.81	14.23
Consumer Disc	0.60	0.84	0.84	0.84	11.93	14.53	12.42	15.93
Consumer Staples	0.05	-0.86	-1.35	-1.35	6.57	4.42	8.99	11.47
Energy	1.87	9.94	6.84	6.84	-6.63	0.16	-5.73	1.02
Financials	1.55	5.14	5.24	5.24	12.48	36.24	13.41	17.62
Health Care	0.18	0.99	3.65	3.65	20.31	15.50	10.38	17.30
Industrials	0.23	4.00	4.22	4.22	14.13	22.37	12.17	16.20
Information Technology	1.00	0.64	8.65	8.65	27.36	28.91	17.36	17.44
Materials	0.38	3.52	6.05	6.05	15.82	21.28	6.73	11.29
Real Estate	0.45	-1.39	0.93	0.93	7.39	2.66	9.76	9.76
Telecom Services	0.48	3.52	6.78	6.78	-4.69	-0.14	5.26	5.60
Utilities	-0.41	-2.74	2.87	2.87	11.87	12.04	11.90	11.92
Other U.S. Equity								
Dow Jones Industrial Avg.	0.25	2.16	5.58	5.58	15.45	25.47	12.34	13.57
Wilshire 5000 (Full Cap)	0.93	2.39	4.50	4.50	13.75	18.64	10.39	14.08
International Equity - Broad Market								
MSCI EAFE	-0.02	2.49	5.40	5.40	19.96	19.12	5.03	8.38
MSCI EM	-1.83	-0.40	7.89	7.89	27.78	22.48	4.90	3.99
MSCI Frontier Markets	-0.31	2.04	8.03	8.03	24.86	25.49	-1.36	8.73
MSCI ACWI	0.12	1.93	5.18	5.18	17.25	18.66	7.43	10.20
MSCI ACWI Ex USA	-0.47	1.86	6.16	6.16	21.13	19.62	4.70	6.97
MSCI AC Asia Ex Japan	-1.59	-0.12	6.62	6.62	30.95	22.70	7.88	7.44
International Equity - Country Region								
MSCI Brazil	-2.60	4.23	22.95	22.95	26.64	29.25	1.66	-1.62
MSCI BRIC	-1.94	0.90	13.81	13.81	32.95	27.94	7.36	5.22
MSCI China	-1.98	1.04	14.66	14.66	43.16	33.06	12.58	10.96
MSCI Europe	0.07	3.30	6.45	6.45	22.79	22.32	4.36	8.36
MSCI India	-2.70	-3.69	2.95	2.95	24.08	14.19	4.48	6.57
MSCI Japan	0.39	1.96	3.97	3.97	14.28	14.11	7.75	10.60
MSCI EM Latin America	-2.21	1.58	15.07	15.07	26.71	25.61	-0.30	-1.92
MSCI Russia	1.89	4.47	17.58	17.58	0.91	19.65	2.98	-2.02

Index Performance as of 9/30/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Fixed Income								
Barclays U.S. Aggregate	-0.10	-0.48	0.85	0.85	3.14	0.07	2.71	2.06
BofAML 3-Month T-Bill	0.02	0.09	0.26	0.26	0.57	0.66	0.32	0.22
Barclays U.S. Gov't	-0.27	-0.84	0.38	0.38	2.25	-1.56	2.01	1.25
Barclays U.S. Credit	0.04	-0.22	1.35	1.35	5.08	1.96	3.87	3.23
Barclays High Yield Corp.	0.30	0.90	1.98	1.98	7.00	8.89	5.83	6.36
Barclays Municipal	-0.32	-0.51	1.06	1.06	4.66	0.87	3.19	3.01
Barclays TIPS	-0.40	-0.64	0.86	0.86	1.72	-0.73	1.62	0.02
Barclays Gbl Agg Ex USD	-1.12	-1.26	2.48	2.48	8.74	-2.42	0.20	-0.73
Barclays Global Aggregate	-0.67	-0.90	1.76	1.76	6.25	-1.26	1.30	0.48
BofAML Emerg. Mkt. Cred	0.13	0.93	3.08	3.08	9.22	9.71	9.90	7.85
Alternative Investments								
Alerian MLP	1.29	0.69	-3.05	-3.05	-5.62	-3.70	-12.92	-0.57
Bloomberg Commodity	-0.45	-0.15	2.52	2.52	-2.87	-0.29	-10.41	-10.47
FTSE NAREIT Equity REIT	0.77	-0.03	0.94	0.94	3.67	0.67	9.85	9.69
S&P Global Natural Res.	-0.01	3.16	10.79	10.79	12.96	20.53	1.34	1.11
S&P N. Amer Natural Res.	1.54	7.90	7.41	7.41	-4.45	0.35	-6.56	-0.72

Sources: Department of Labor, Department of Commerce, the Federal Reserve, Standard and Poors, National Association of Realtors, European Commission, European Central Bank, the Conference Board.

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