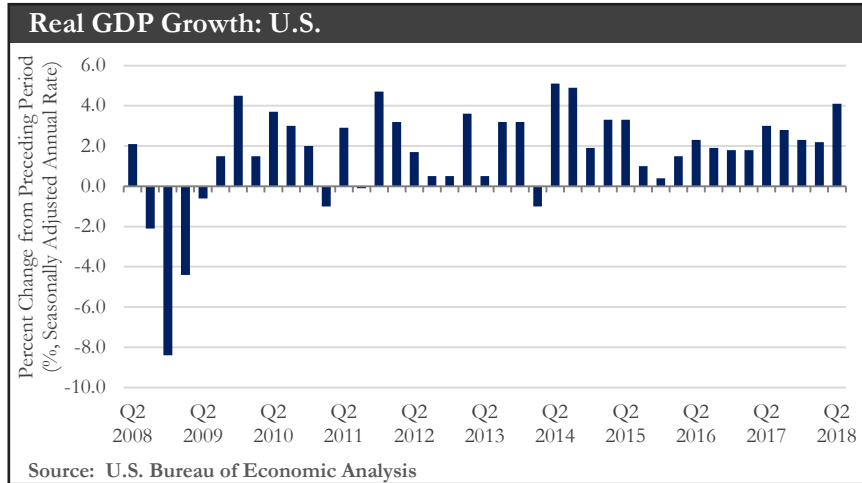


**Recap:** The U.S. economy has been on course to post another strong showing in the third quarter after a 4.2% growth in the second quarter. Despite trade policy uncertainty and ever more acute labor shortages, small business optimism has remained at a historical high. Although housing market indicators in July were somewhat disappointing, the combination of strong permits and rising wages should support a gradual uptick in construction in the coming months.



Stronger economic growth should keep the Federal Reserve on its current course of gradually raising the federal funds rate. Quarter point hikes in September and December, respectively would seem likely. The US economy has appeared to be well positioned to absorb further increases in interest rates. The yield curve is not expected to invert either this year or next and should steepen modestly later this year.

assets and the lira has fallen as the government has failed to take action in calming debt fears. Last quarter, concerns about the financial outlook for Argentina drove a dramatic depreciation in the peso, forcing the central bank to raise interest rates in an attempt to slow capital outflows from the country.

Though the U.S. economy has been humming along nicely, other economies have not fared so well. Turkey experienced a large selloff of

The eurozone entered 2018 on a high, having racked up its most rapid expansion in a decade during 2017. But growth slowed sharply in the first three months of this year, a setback that could be partially attributed to unusually cold weather and labor strikes in Germany and France. The failure of the economy to rebound in the second quarter has shown other forces may be at work. The divergence in economic growth between the U.S. and others should continue for the rest of this year.

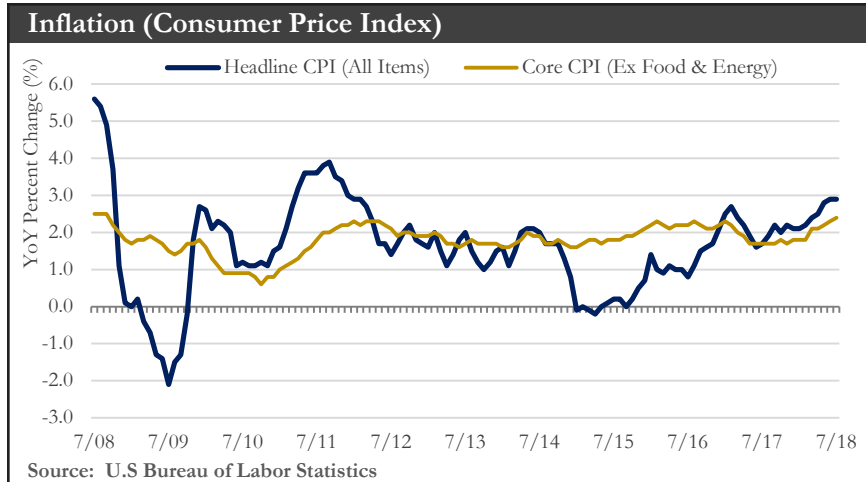
**Housing:** While the U.S. economy, broadly, has been running at full throttle, the housing market has hit a speed bump. Home sales, new home construction and outlays for renovations and repairs have failed to make headway in the first half of the year, and recent data has suggested that the softness has extended into the third quarter. One reason for the shortfall has been the lack of homes on the market. The inventory of existing homes available for sale fell on a year-to-year basis for 36 consecutive months. Rising mortgage rates, which were up nearly 60 basis points since last year, have dented affordability. These and other headwinds would be likely to persist in the near term. There have also been some silver linings: price growth appeared to be slowing and housing inventory finally stopped shrinking in July (on a year over year basis), stabilizing for the first time since the end of 2014. A slowdown in price increases could help draw people back in, creating new momentum in the market.

**Inflation:** Consumer prices matched expectations and edged up 0.2% in July. The monthly gain kept the headline index at a 2.9% increase on a year-to-year basis, the fastest pace in six years. Energy prices were a drag on the headline figure and dropped 0.5% for the month, mostly the result of lower gas prices. Excluding food and energy prices, the core index also rose 0.2% during the month. Much of the monthly increase in core prices was due to a gain in services, notably in housing.

**Import Prices:** As escalating trade disputes have threatened to drive up the cost of imported goods for U.S. consumers and businesses, a stronger dollar may be helping to offset some of the pain. Import prices excluding volatile fuel items fell 0.3% in July after posting a similar drop in June, reversing five straight months of increases earlier this year. The price declines

came after the dollar rallied as much as 10% between mid-February and late August against a basket of currencies, bolstering Americans' purchasing power relative to the rest of the world.

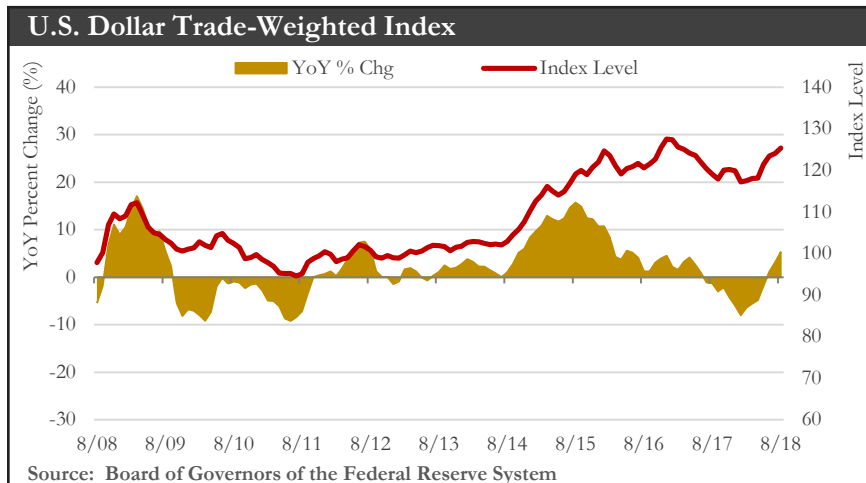
Global trade contracts have been decided months in advance, so movements in exchange rates affected import prices with some lag. Accordingly, the dollar appreciation should weigh on import prices and push up export prices in coming quarters. Another potential downward force on prices has been tariff retaliation from U.S. trade partners, which constrained demand for U.S. goods abroad.



**Labor Market:** Wage growth, stubbornly sluggish for years following the 2007-2009 downturn, has picked up as the labor market has tightened and employers have raised pay to attract and retain workers. Wages and salaries rose 2.8% from a year earlier, the strongest gain since September 2008, a sign the strong labor market has boosted wages as employers compete for scarce workers. Wage gains have come with a modest pickup in inflation, which is eating at some of the gains for workers. Inflation has continued to hover near the Federal Reserve's 2% year-over-year target.

**Dollar:** Countries with large U.S. currency debts and big foreign capital flows have been at risk as

the U.S. dollar has climbed. The dollar's continued rise has injected further risk into emerging markets, particularly those which have been borrowing heavily in the U.S. currency and benefiting from foreign investment, such as, Turkey, Hungary, Argentina, Poland, and Chile.



Countries with large chunks of equities and bonds held by foreign investors have also become increasingly vulnerable as markets turn more volatile. A rising dollar has pressured prices for commodities, which are denominated in the U.S. currency and become less affordable to foreign buyers when the dollar appreciates. That could be bad news for commodity exporters like Brazil, Chile and Russia. Meanwhile, commodity importers whose currencies have been battered, like Turkey, India and China, now have to pay up for oil and other raw materials.

There is reason to believe the rest of the year will be calmer for the dollar, meaning less risky

for emerging markets and other volatile assets. Against major currencies like the euro, the dollar has stopped climbing. A good deal of divergence between growth and monetary policy in Europe and the U.S. already looks priced in. Where the dollar's strength has exposed weak links in emerging markets, such as Turkey, it could continue to cause problems. The Turkish turmoil has shown that, even without direct economic links among countries, one currency's fall can trigger others to follow suit. At the very least, seeing one currency tumble has reminded investors of the risks that come with emerging markets.

The bigger picture will be influenced a good deal by the trade dispute between the U.S. and China and whether the Chinese yuan continues to fall, raising depreciation pressures on other currencies.

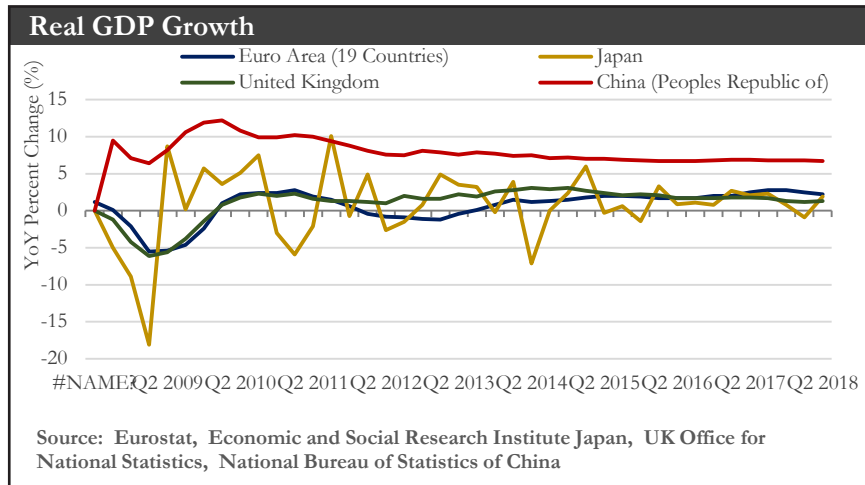
**Tariff:** The U.S. and Mexico have agreed on the key sticking points between the two countries that had held up renegotiating of the NAFTA for over a year. The deal would still need approval by the U.S. and Mexican legislatures and negotiators still hope that Canada will join as well.

The Trump administration has heralded economic strength as a source of leverage in its quest to force rivals to make concessions to the U.S. on trade. Those talks have entered a new phase, with an understanding with Mexico on the NAFTA, and an agreement to hold off on tariffs against Europe after a Washington visit by European Commission President.

The U.S. and China, meanwhile, have made little progress in behind-the-scenes efforts to restart formal trade talks. A trade war with the United States, should one come to pass, would weigh on Chinese economic growth, but it probably would not bring the economy completely to its knees.

The first round of U.S. tariffs has begun to reverberate globally, and the economic effects could become more apparent if they remain in place—and as other countries retaliate. But for many U.S. trading partners, the tariffs may be just one of many challenges they face.

**Eurozone:** Real GDP growth in the Eurozone slowed modestly in Q2 to 2.1%. That said, the manufacturing sector and consumer spending were bright spots. A tight labor market along with slowly rising incomes should support economic growth in the coming quarters. While GDP growth has remained solid, inflation in the Eurozone has been benign. Although headline inflation has picked up to reach the ECB’s 2% target in recent months, core inflation still remained steady around 1% and has restrained the more rapid removal of policy accommodation on the part of the ECB. The ECB has planned to end its QE program at the end of this year. Assuming economic growth and inflation continue to pick up, the ECB should begin raising interest rates in mid-2019.



Amid the backdrop of solid economic growth and accommodative monetary policy, trade tensions in the Eurozone heated up in Q2 as the Trump administration threatened a 25% tariff on auto imports from the European Union (EU). A recent Washington, D.C. summit has since calmed the nerves of trade watchers as the EU and US agreed to work toward removing trade barriers. However, the situation could deteriorate again if negotiations were to reach an impasse.

A full-blown trade war, should one come to pass, probably would not completely derail the Eurozone economy. Exports to the United States have totaled just 2.5% of Eurozone GDP in 2017,

meaning that the effect from tariffs could be painful, but not large enough to meaningfully drag on the overall economy. Although trade tensions have presented a downside risk, the economic expansion should remain in place, and real GDP should grow roughly 2% in 2018.

**Turkey:** Like a number of other emerging markets Turkey has depended heavily on foreign capital to finance domestic spending. Moreover, Turkish government has refused to allow domestic interest rates to rise. This has amplified concerns that Turkey could be headed for a debt crisis.

Turkey is too small a share of the global economy to trigger a broader global crisis. Contagion risk via trade linkages has been low, although Europe is most exposed. Similarly, financial contagion has been limited, with Spanish, Italian,

and French banks at risk to lose a tiny proportion of foreign loans.

Although concerns have eased in recent weeks, Turkey is not out of the woods yet. It should remain in the early stages of a balance of payments crisis. A sudden stop to capital inflows has occurred, and the next step for Turkey would involve spending cuts and an emphasis on boosting exports to help generate foreign currency required to pay for its large external obligations. The medicine will be bitter, but the sooner Turkish authorities follow through with interest rate increases, capital controls, and fiscal spending cuts, the more likely they can mitigate the economic fallout.

That said, contagion to other economies could still occur through confidence and sentiment channels. That has been evident recently with the turmoil in global financial markets that have driven a selloff in risk assets and emerging market currencies, and a bid for developed market bonds. Further bouts of volatility could occur as emerging market economies with large imbalances have been targeted one-by-one by increasingly discerning investors.

**Outlook:** U.S. Real GDP grew at a 4.2% pace during the second quarter. Moreover, the underlying details were even stronger than the headline number, with real final sales surging at a 5.1% annual rate, as inventories were drawn down sharply. While there is doubt in seeing another 4% GDP number in coming quarters, the economy clearly has strong momentum going into the second half of the year. Part of the second quarter's strength came from efforts to produce and ship products ahead of retaliatory tariffs. The inventory drawdown pulled production forward and left inventories exceptionally lean throughout the supply chain. Despite a fading boost from fiscal stimulus and rising short-term interest rates, rebuilding inventories should keep output growing at around a 3% pace for the next two quarters.

Looking forward, the global economic expansion should remain intact through at least the end of 2019. Although many central banks have started the process of slowly raising interest rates, monetary policy remains accommodative in most economies, which should continue to support global economic expansion.

countries like Malaysia, South Korea and Thailand pass through China, given its central role in the global supply chain. The trade conflict has also slowed a revival in global growth, stoking worries over demand for raw materials and hurting the economies of commodity exporters.

Index Performance as of: 8/31/2018

	<u>1 Week</u>	<u>1 Month</u>	<u>QTD</u>	<u>3 Month</u>	<u>YTD</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>
3000 Value	0.26	1.55	5.39	5.69	4.17	13.04	12.57	11.25
3000	0.98	3.51	6.95	7.65	10.39	20.25	15.86	14.26
3000 Growth	1.70	5.53	8.52	9.55	16.60	27.50	19.10	17.22
1000 Value	0.28	1.48	5.49	5.76	3.71	12.47	12.32	11.22
1000	0.98	3.45	7.02	7.71	10.07	19.82	15.84	14.37
1000 Growth	1.69	5.47	8.56	9.61	16.44	27.23	19.32	17.48
Mid Cap Value	0.23	1.36	4.12	4.96	3.95	12.67	12.11	11.81
Mid Cap	0.64	3.11	5.67	6.40	8.15	17.89	13.36	12.80
Mid Cap Growth	1.24	5.76	8.03	8.45	13.87	25.06	15.29	14.20
2000 Value	0.02	2.38	4.19	4.82	9.86	20.05	15.73	11.72
2000	0.91	4.31	6.13	6.89	14.26	25.45	16.11	13.01
2000 Growth	1.77	6.23	8.05	8.90	18.53	30.72	16.35	14.20
S&P 500	0.98	3.26	7.10	7.76	9.94	19.66	16.11	14.53
Consumer Disc	1.85	5.13	7.06	10.93	19.39	32.27	17.84	17.05
Consumer Staples	-0.41	0.52	4.61	9.32	-4.33	1.00	7.37	9.27
Energy	-0.14	-3.30	-1.92	-1.23	4.75	22.10	7.29	1.16
Financials	0.36	1.39	6.73	4.68	2.37	16.92	16.44	14.59
Health Care	1.06	4.37	11.27	13.08	13.31	16.12	11.51	15.43
Industrials	0.50	0.30	7.64	4.08	2.59	13.16	16.09	13.64
Information Technology	2.04	6.93	9.17	8.78	21.03	32.77	27.38	23.18
Materials	0.48	-0.45	2.50	2.85	-0.66	9.96	13.41	10.20
Real Estate	0.87	2.49	3.60	8.20	4.44	6.31	9.96	11.08
Telecom Services	-1.57	3.05	5.44	7.95	-3.36	3.65	6.92	5.67
Utilities	-0.49	1.12	3.00	5.86	3.33	0.71	11.90	11.44
Dow Jones Industrial Avg.	0.79	2.56	7.51	6.99	6.73	21.00	19.16	14.64
Wilshire 5000 (Full Cap)	0.91	3.57	6.98	7.76	10.59	20.45	15.76	14.09
MSCI EAFE	0.28	-1.93	0.48	-0.74	-2.28	4.39	7.04	5.73
MSCI EM	0.60	-2.70	-0.57	-4.70	-7.18	-0.68	11.42	5.04
MSCI Frontier Markets	-1.75	-5.39	-1.92	-5.40	-12.58	-5.79	4.53	3.57
MSCI ACWI	0.66	0.79	3.82	3.26	3.38	11.41	11.85	9.67

Index Performance as of: 8/31/2018

	<u>1 Week</u>	<u>1 Month</u>	<u>QTD</u>	<u>3 Month</u>	<u>YTD</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>
MSCI ACWI Ex USA	0.30	-2.09	0.25	-1.64	-3.53	3.18	8.08	5.44
MSCI AC Asia Ex Japan	1.16	-1.02	-0.19	-4.98	-4.94	2.76	13.15	8.07
MSCI Brazil	-0.25	-11.34	-0.86	-9.11	-18.00	-16.23	12.97	-1.97
MSCI BRIC	0.39	-4.12	-3.03	-7.42	-7.53	-0.53	12.93	6.36
MSCI China	0.38	-3.80	-6.20	-11.09	-7.83	0.22	13.48	9.27
MSCI Europe	-0.32	-2.79	0.44	-0.23	-2.80	2.62	5.88	5.07
MSCI India	-0.07	0.96	7.54	6.49	-0.54	7.12	10.63	13.77
MSCI Japan	1.72	0.22	0.62	-1.91	-1.42	9.05	8.44	7.84
MSCI EM Latin America	-1.10	-8.37	0.08	-2.99	-11.08	-11.80	9.01	-1.55
MSCI Russia	2.82	-6.99	-3.31	-2.96	-0.64	8.22	14.05	0.04
Barclays U.S. Aggregate	-0.12	0.64	0.67	0.54	-0.96	-1.05	1.76	2.49
ICE BofAML US 3M Trsy Bill	0.04	0.18	0.34	0.51	1.15	1.52	0.79	0.49
Barclays U.S. Gov't	-0.09	0.76	0.35	0.36	-0.71	-1.50	0.85	1.67
Barclays U.S. Credit	-0.22	0.51	1.23	0.76	-1.79	-0.99	3.27	3.64
Barclays High Yield Corp.	0.08	0.74	1.84	2.25	2.00	3.40	7.00	5.63
Barclays Municipal	-0.03	0.26	0.50	0.59	0.25	0.49	2.71	4.12
Barclays TIPS	-0.18	0.72	0.24	0.64	0.21	0.83	2.20	1.88
Barclays Gbl Agg Ex USD	0.10	-0.31	-0.67	-1.37	-1.98	-1.64	2.92	0.44
Barclays Global Aggregate	0.01	0.10	-0.06	-0.51	-1.52	-1.36	2.44	1.34
JPM EMBI Global Div	-0.55	-1.73	0.78	-0.42	-4.49	-3.37	5.05	5.61
Alerian MLP	-3.46	1.58	8.27	6.59	7.58	7.30	-0.67	-1.97
Bloomberg Commodity	0.09	-1.77	-3.87	-7.23	-3.87	0.51	-1.89	-8.01
FTSE NAREIT Equity REIT	0.36	2.59	3.42	7.93	4.47	6.01	9.61	10.42
S&P Global Natural Res.	0.14	-3.23	-2.21	-3.22	1.41	13.60	14.33	4.38
S&P N. Amer Natural Res.	-0.65	-3.90	-2.86	-2.02	2.28	16.91	6.88	-0.04

Sources: Department of Labor, Department of Commerce, Eurostat

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