CBIS®
Catholic Responsible Investing

Market Overview 3Q 2017

Aging Bull

GLOBAL ECONOMIC REVIEW

Global economic sentiment notably improved in Q3. In the U.S., real GDP growth for Q2 was revised upward to 3.1% from the prior estimate of 2.7% on strength from consumer spending and non-residential investment. However, growth estimates remain in the 2.2% to 2.4% range for 2017 and 2018 given the uncertainty surrounding September's hurricanes and the Trump administration's tax reform plan announced in September. The outlook for the European economy has steadily strengthened. The European Commission's economic confidence index in September reached its highest level in 10 years and eurozone real GDP growth estimates for 2017 and 2018 have risen from 1.5% when 2017 began to 2.2% and 1.8%, respectively, at the end of Q3. The Japanese economy also surprised on the upside, growing at an annualized 2.5% rate in Q2 with its jobless rate falling to the lowest in two decades. Japan's 2017 GDP is now projected to grow 1.5%, double the expectation a year ago. Even Latin America has seen growth strengthen, now tracking at about 3% after zero growth in 2016 and a 1% decline in 2015.

One riddle in the macro picture is persistently low inflation, which has remained well below the 2% level sought by the U.S. Fed, European Central Bank (ECB) and Bank of Japan (BOJ). Eurozone inflation reached only 1.5% in September while the Fed's preferred inflation measure slowed to 1.4% over the summer from nearly 2% earlier this year — despite the growing economy and a 4.4% unemployment rate. Inflation in Japan remains well below 1%. Both the Fed and ECB have said they see low inflation as transitory and appear set on slow policy normalization. The Fed in October began its long-telegraphed plan to shrink it's $4.5 trillion balance sheet by gradually reducing reinvestment of principal payments, initially by $10 billion per month, and is widely expected to raise the Fed Funds rate again in December. The ECB hopes to develop its own tapering plan this autumn and begin implementation early in 2018. The BOJ, for its part, remains aggressively accommodative. Moreover, markets seem ready to bet any renewed weakness will derail a tightening program by either central bank; the "central bank put" remains alive and well until proven otherwise.

Summary

- Global equities extended 2016's rally through Q3 2017. The U.S. economy continued on a growth path, Europe's economic outlook has brightened and global growth has also strengthend. Analysts are forecasting strong corporate earnings gains in 2017 and 2018.
- Global government yields were relatively unchanged in Q3. Yields rose 30 to 70 basis points for the trailing year, depending on region and maturity. Credit spreads narrowed somewhat in both the U.S. and Europe. One macro riddle is persistently low inflation, which has remained well below the 2% level sought by the U.S. Fed, European Central Bank and Bank of Japan.
- The current U.S. equity bull market and economic expansion are among the longest in U.S. history. Investing comes with no guarantees and U.S. stocks have gone nine years with only one 15% correction (April to June 2010). Yet, at least for now, in a world of continued low interest rates and strong earnings growth it is hard to bet against this aging bull.

I. Equity Market Returns

	3 months	12 months
S&P 500	4.5	18.6
Russell 1000 Value	3.1	15.1
Russell 1000 Growth	5.9	21.9
Russell 2000	5.7	20.7
MSCI ACWI ex-U.S. (USD)	6.2	20.1
MSCI ACWI ex-U.S. (Local)	4.5	19.6
MSCI EM (USD)	8.0	22.9
MSCI EM (Local)	7.7	22.2

II. Fixed Income Market Returns

	3 months		12 months	
	Absolute	Duration-Adjusted Excess Return	Absolute	Duration-Adjusted Excess Return
ML 91-Day T-Bill	0.2		0.6	
Barclays U.S. Aggregate	0.8		0.1	
U.S. Treasury	0.4		-1.7	
MBS	1.0	0.5	0.3	-0.1
ABS	0.4	0.1	0.9	0.7
CMBS	0.8	0.3	0.1	1.2
Corporate	1.3	0.9	2.2	4.3
High Yield	2.0	1.6	8.9	9.6

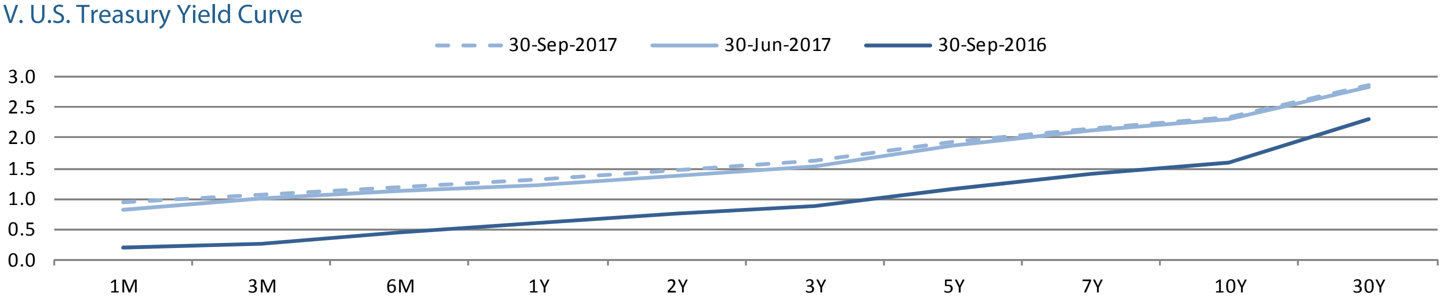
III. S&P 500 Sector Returns (USD)

	3 months	12 months
Consumer Discretionary	0.9	14.7
Consumer Staples	-1.4	4.4
Energy	6.8	0.2
Financials	5.3	36.2
Healthcare	3.7	15.5
Industrials	4.2	22.4
Information Technology	8.6	28.8
Materials	5.5	21.1
Real Estate	1.0	2.7
Telecom. Services	6.8	-0.2
Utilities	2.9	11.6
Total	4.5	18.6

IV. MSCI ACWI ex-U.S. Sector Returns (USD)

	3 months	12 months
Consumer Discretionary	6.9	19.7
Consumer Staples	1.1	5.5
Energy	12.7	17.3
Financials	6.1	28.8
Healthcare	1.0	7.7
Industrials	5.6	20.6
Information Technology	10.0	35.1
Materials	10.7	25.1
Real Estate	6.1	10.3
Telecom. Services	2.4	5.4
Utilities	4.6	10.7
Total	6.2	20.1

V. U.S. Treasury Yield Curve



VI. Still Less Than Zero — Global Government Yields (September 30, 2017)

Red = negative yield

	3M	1Y	3Y	5Y	7Y	10Y	30Y
Switzerland	--	0.87	0.70	0.49	0.31	0.02	0.45
Japan	0.17	0.14	0.11	0.08	0.03	0.06	0.86
Germany	0.66	0.72	0.60	0.27	0.01	0.46	1.29
Austria	0.07	0.61	0.49	0.15	0.37	0.64	1.61
Netherlands	-	0.69	0.59	0.32	0.10	0.58	1.30
Belgium	-	0.62	0.49	0.21	0.16	0.73	1.77
Finland	0.01	0.32	0.47	0.23	0.13	0.45	1.43
France	0.58	0.61	0.48	0.01	0.15	0.74	1.84
Sweden	0.66	0.69	0.44	0.01	0.27	0.92	1.63
Denmark	-	0.63	0.59	0.34	0.06	0.54	1.03
Ireland	0.05	0.52	0.40	0.06	0.26	0.75	1.91
Italy	0.40	0.38	0.10	0.69	1.43	2.11	3.29
Spain	-	0.17	0.15	0.26	0.91	1.60	2.84
Portugal	0.07	0.01	0.14	0.93	2.00	2.40	3.62
United States	1.06	1.31	1.61	1.92	2.16	2.33	2.86
United Kingdom	-	0.40	0.54	0.79	1.02	1.36	1.91

Source for Tables I-VI: Factset, Bloomberg

MARKET REVIEW

Global Equity Markets

Global equities powered higher in Q3 on strengthening global economic confidence, rising corporate earnings, low to negative global bond yields and ongoing aggressive stimulus from the Bank of Japan (BOJ) and European Central Bank (ECB).

The MSCI EAFE developed market index gained 3.4% in local currencies, emerging markets rose 7.7%, the MSCI ACWI ex-U.S. Index (containing both developed and emerging markets) gained 4.5% in local currencies, while the S&P 500 also returned 4.5% — its eighth-straight quarterly advance and 18th of the past 19 quarters).

The trade-weighted U.S. dollar continued its 2017 decline and is now down about 9% from its late-2016 high, once again adding to international returns for U.S. investors. The MSCI ACWI ex-U.S. Index returned 6.2% in dollar terms, but the euro's strength (about 3% higher versus the dollar for the quarter and 12% year-to-date) eroded returns for euro-based global equity portfolios. Oil recovered from Q2's weakness, rising from June's low near $43/barrel to $52 by late September before closing the quarter just over $50.

International sector returns were broadly positive, led by energy (+12.9%), materials (+10.8%) and information technology (+10.0%); most other sectors posted low- to mid-single-digit returns. S&P 500 sector returns were also led by information technology (+8.6%) and energy (+6.8%), with telecomm services also up nearly 7%. U.S. growth again outperformed value as a result of its far higher exposure to strong information technology names.

Trailing 12-month returns show the strength of the market rally that resumed after a brief correction in early 2016, when concerted action by global central banks in the face of global recession and deflation fears reversed a 10% market decline. Since then, equities have been lifted by the ongoing economic expansion in the U.S., an evident turnaround from borderline recession to growth in Europe, growing corporate profits in both regions, relative stability in China, improvement in Japan's economy and signs of growth in most global regions. These bullish trends have been augmented by the rocket fuel provided by low to negative interest rates and aggressive asset purchases by global central banks, which have amounted to roughly $2 trillion so far this year. Nearly a decade on since the 2008/2009 financial crisis, central banks seem to have adopted quantitative easing — buying not only government bonds but mortgages and equities — as a standard policy tool. And they seem ready to use and expand QE in the face of any renewed market instability.

For the year that ended on September 30, global developed markets returned nearly 20% in local currencies, emerging markets gained about 22% and the S&P 500 returned 19%. Financials and information technology led sector returns in the U.S. and globally, while materials, industrials and consumer discretionary — all beneficiaries of stronger growth — produced 20%+ returns. The defensive consumer staples and telecom services lagged in the U.S. and globally. Energy also lagged in the U.S. but gained 18% in the MSCI ACWI ex-U.S. Index as benchmark names BP, Royal Dutch Shell, Total, Suncor and Eni rose 20% to 30%. Market-friendly European election outcomes and improving economic trends produced strong local currency returns in Italy (+40%), Spain (+26%) and France (+25%), while BOJ stimulus and signs of stronger growth produced a 27% gain in Japan.

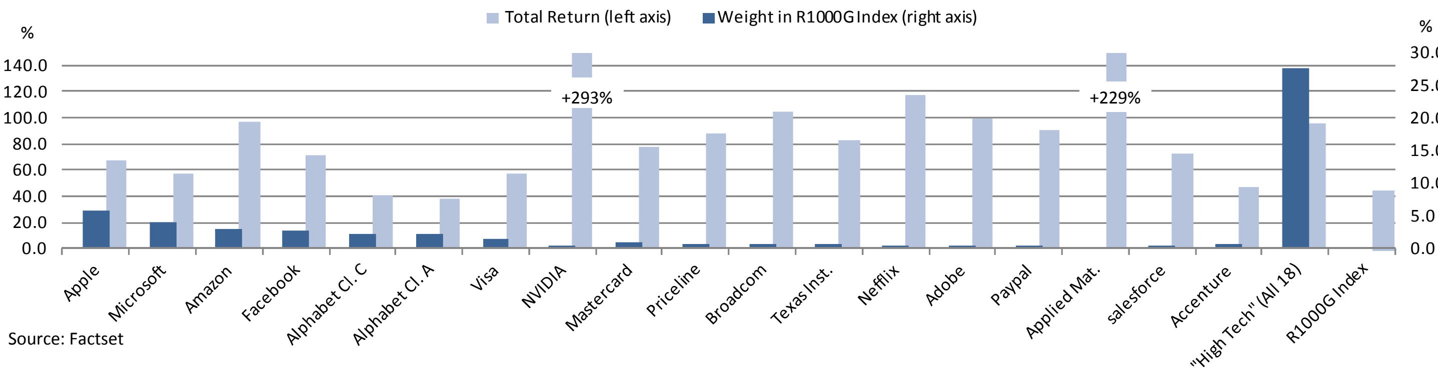
"High" Technology

A notable feature of the market's now-18-month rally is the concentration of high returns in a handful of big tech companies — called the FAANG (Facebook, Apple, Amazon, Netflix, Google) phenomenon. The Russell 1000 Growth Index gained 45% from the market's February 2016 low through September 30, 2017. Of the top 30 drivers of the Index's gain measured by contribution to return (i.e. weight times return) 18 are tech companies. (We consider internet retail marketing giants Amazon, Priceline and Netflix as tech companies for this exercise). These 18 names produced an unweighted average return of 81% for the period, nearly double the growth benchmark's gain. As a group, they accounted for fully 27% of the benchmark's total market capitalization. Only Alphabet (formerly Google) underperformed the growth benchmark — but only slightly, with a 40% gain, and had outperformed through May. Such concentrated strength may have created a headwind, if not a headache, for active managers in the large growth space. Strong gains in a small handful of big names raises the bar for stock selection elsewhere, since equally strong gainers — and potentially more numerous ones if they are smaller companies that make up for underweights — need to be found to keep up.

Global Fixed Income Markets

Global government bond yields were relatively unchanged in Q3 as inflation readings remained weak and economic growth

VII. "High" Technology — Info Tech Market Leaders (February 8, 2016 Low through September 30, 2017)



Source: Factset

(while gaining strength) remained muted. As in Q2, credit spreads in the U.S. and Europe were little changed. The U.S. Federal Reserve held the Fed Funds rate steady at its September meeting while the ECB seemed even less inclined to raise short-term rates until well into 2018, if not later.

The Bloomberg Barclays U.S. Aggregate Bond Index returned 0.8% for the quarter while mortgage-backed (MBS) and asset-backed (ABS) indices returned 1.0% and 0.4%. U.S. high-yield returned 2.0% and investment-grade corporates returned 1.3%. On a duration-adjusted basis in the U.S., high-yield notably outperformed other sectors, followed closely by corporates, while the mortgage-backed (MBS) and agency indices lagged. The Bloomberg Barclays Global Aggregate Bond Index in euros returned -1.8%; governments returned -2.0% while corporate credit returned -1.4%, with negative returns due to continued euro currency strength and a small uptick in yields on the short end of the curve.

Government bond yields rose roughly 30 to 70 basis points over the trailing year, depending on region and maturity, while credit spreads narrowed somewhat in both the U.S. and Europe. The Bloomberg Barclays U.S. Aggregate Bond Index returned 0.1% while U.S. investment-grade corporates gained 2.2%. U.S. high-yield returned 8.9%, helped by strong returns from energy. The Bloomberg Barclays ABS Index returned 0.9% while MBS lagged, with a 0.3% return. The Bloomberg Barclays Global Aggregate Bond Index (in euros) returned –6.1% for the trailing year; its Treasury Index component returned –8.5% while corporates returned –2.0%. The euro's appreciation in 2017 weakened results, as the Bloomberg Barclays Global Aggregate Bond Index returned -1.3% in local currencies. High-yield notably led duration-adjusted excess returns in the U.S. for the year, followed by corporates. The Agency, ABS and CMBS indices performed comparably while MBS lagged.

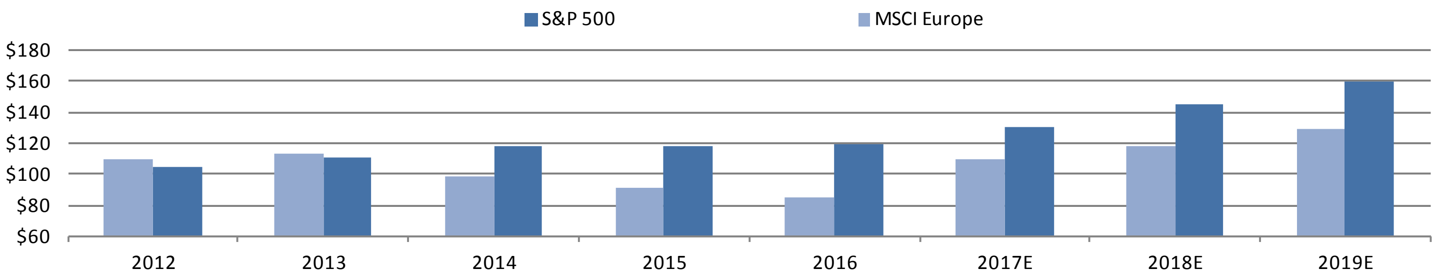
AGING BULL

The bull market that began in March 2009 reached a milestone of sorts over the summer. By at least one measure — daily closing price of the Dow Jones Industrial Average — it became the oldest bull market seen in more than a century of market data. The current economic expansion is likewise aging, now the third-longest since 1854, based on data compiled by the National Bureau of Economic Research.

But economic and corporate earnings fundamentals matter just as much as time. The bullish case for equities remains persuasive and the old bull may yet have more room to run. Corporate earnings in the U.S. have now shrugged off the stagnation seen from 2014 through 2016 and are pegged to rise 9% to 10% in 2017, 2018 and 2019 by analyst estimates. Europe is emerging from a steep earnings recession over the 2014-2016 period, with earnings set to jump 30% in 2017 and 8% to 9% in 2018 and 2019. Such gains won't occur without global economic growth, but for now that seems in the cards based on current global trends. Bulls also note that very low to negative bond yields offer little immediate competition for stocks, which can produce dividend income (the S&P 500 dividend yield is 1.8%) and the prospect of dividend gains over time. If one adds the evident global regime change in central banking since the 2008/2009 financial crisis — where QE programs that support faltering markets are now a core tool with a track record of what is deemed successful use — then it's hard not to view the current landscape as largely supportive of further equity gains.

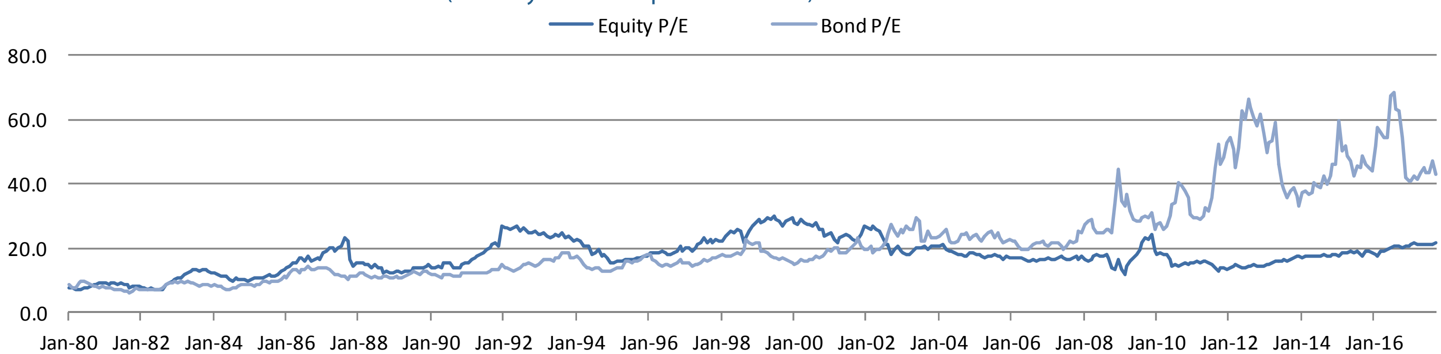
Markets have also shrugged off political risk; North Korea's missile launches and U.S./Russia tensions at their worst since the Cold War have made hardly a dent. Bear market declines are typically accompanied, if not caused, by contracting credit, earnings recessions and economic weakness, although sometimes stocks are pulled down by the weight of extended price/earnings

VIII. Looking Up: U.S. and European Earnings Per Share



Source: Factset / Note: E = consensus analyst estimates at September 30, 2017

IX. Stocks vs. Bonds: Relative Valuation (January 1980 – September 2017)



Source: Bloomberg
Note: Equity P/E is S&P 500's trailing 12-month price/earnings ratio; Bond P/E is 100 divided by 10-year Treasury yield

ratios in the face of over-exuberant earnings outlooks. Market bears say buoyant stocks face a variety of threats, from the impact of coordinated tapering by the Fed and ECB, high PEs (at least in the U.S.) when adjusted for rich corporate profit margins and cyclically smoothed earnings streams, the risk of rising interest rates and resultant P/E compression or, conversely, the risk that slow economic growth or recession torpedoes today's ambitious earnings outlooks. To be sure, investing comes with no guarantees and U.S. stocks have gone nine years with only one 15% correction (April to June 2010). Yet, at least for now, in a world of continued low interest rates and strong earnings growth it is hard to bet against this aging bull.■