

NEPC QUARTERLY MARKET UPDATE

Q3 2018 OBSERVATIONS AND ACTIONS

October 25, 2018

NEPC Research



BOSTON | ATLANTA | CHARLOTTE | CHICAGO | DETROIT | LAS VEGAS | PORTLAND | SAN FRANCISCO

TODAY'S SPEAKERS



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Timothy O'Connell, CFA, Consultant, Traditional Research

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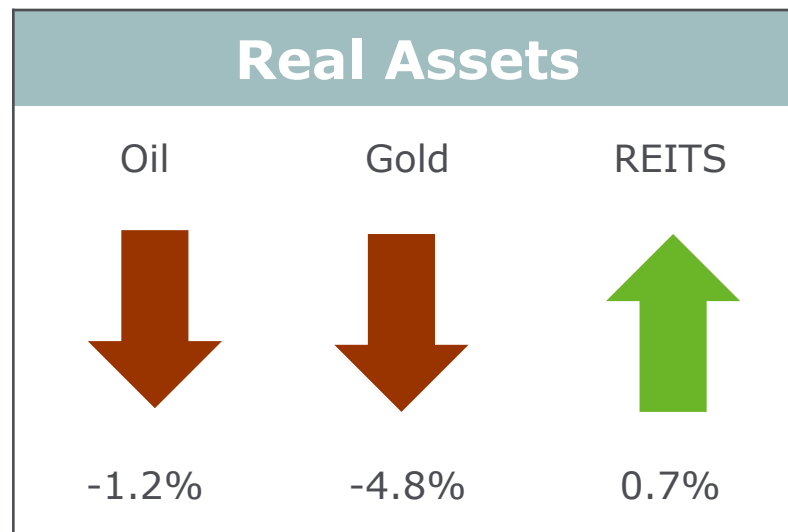
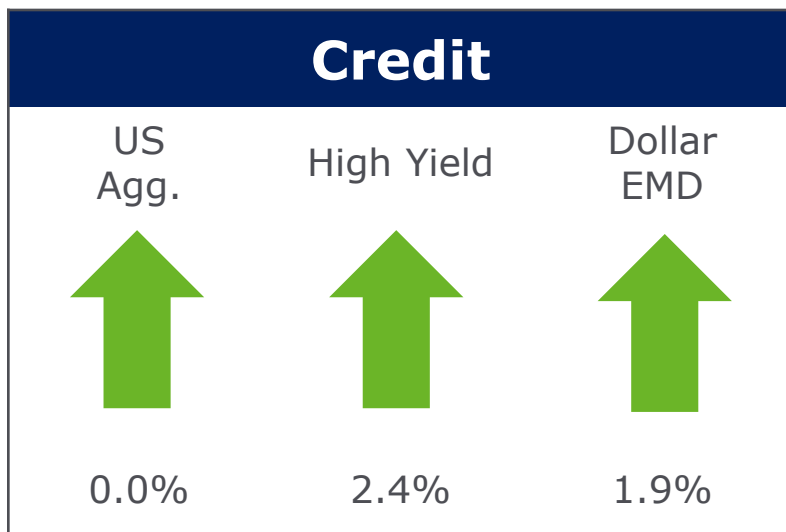
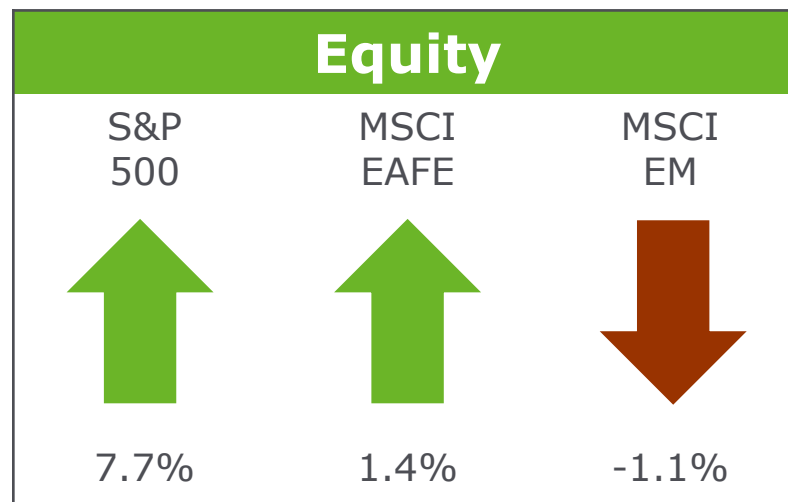
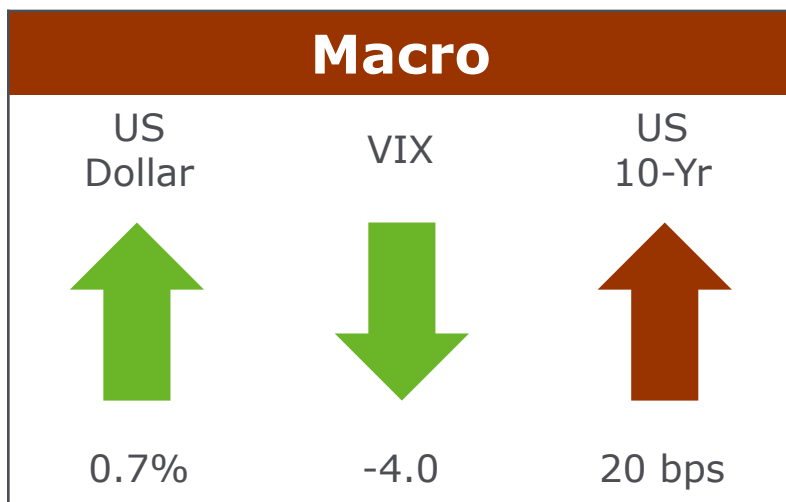
Market Focus - Equities

Wrap-Up and Questions

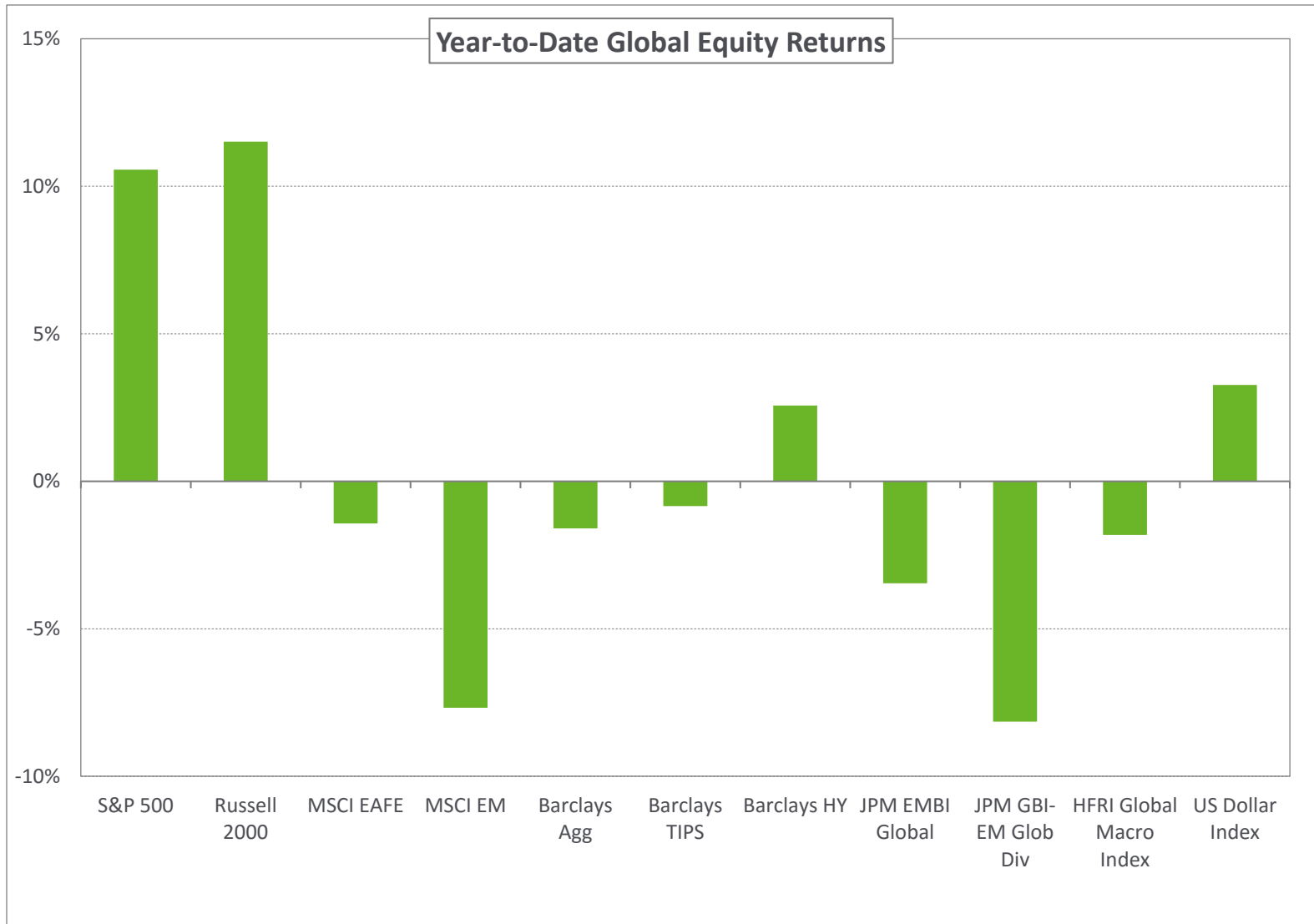
GLOBAL OUTLOOK

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MARKET OVERVIEW – Q3 2018



US EQUITIES ARE THE OUTLIER IN 2018



Source: S&P, Russell, MSCI, JPM, HFRI, Bloomberg

JANUARY 2018 KEY MARKET THEMES

Extended US Economic Cycle

Synchronized Economic Resurgence

Federal Reserve Gradualism

China Transitions

Globalization Backlash

MAJOR UNDERCURRENTS IN 2018

US Fiscal Stimulus	Extended US Cycle
US Fed Tightening	Synchronized Resurgence
Strong Dollar	Fed Gradualism
EM Challenges	China Transitions
Trade Tensions	Globalization Backlash

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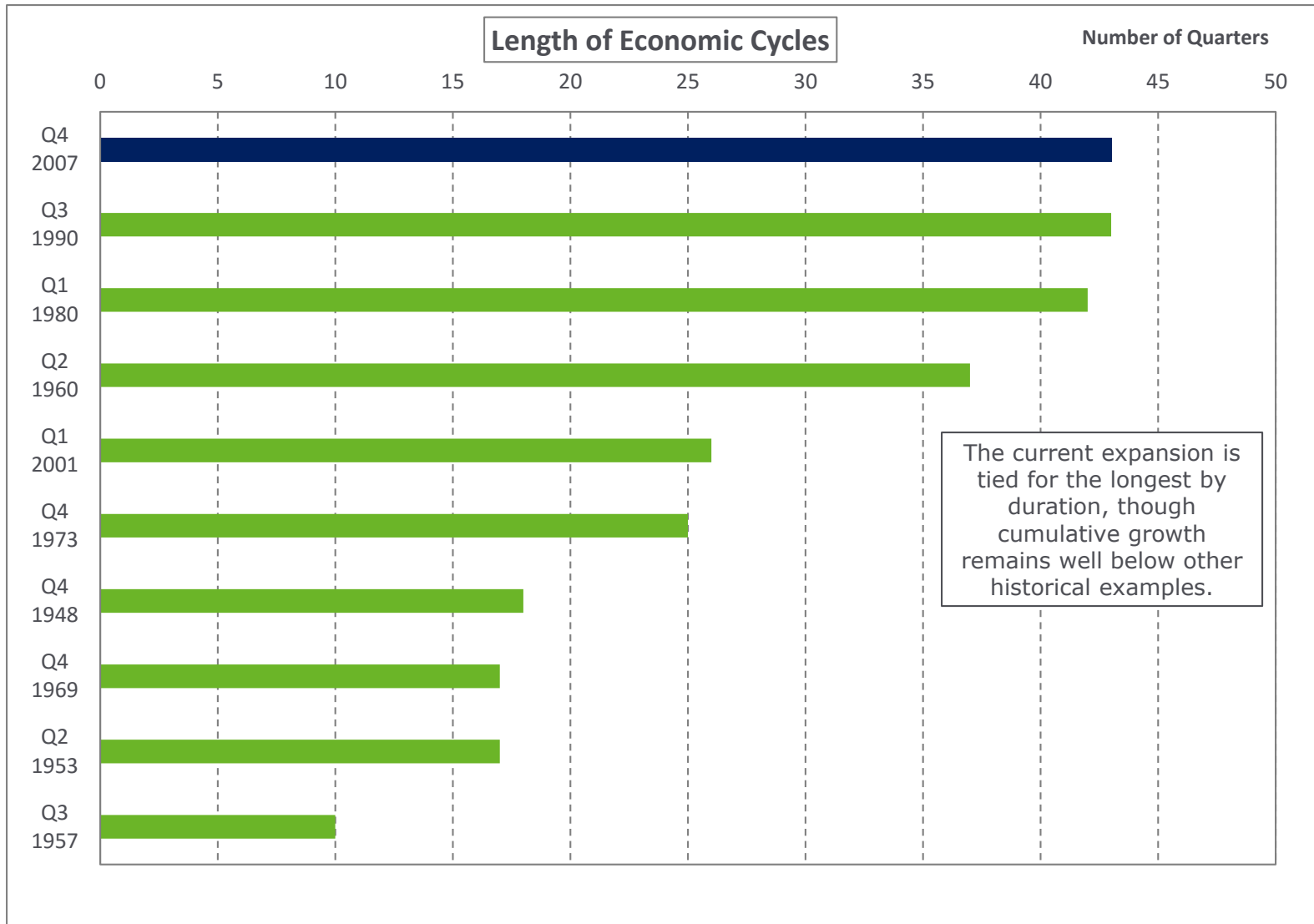
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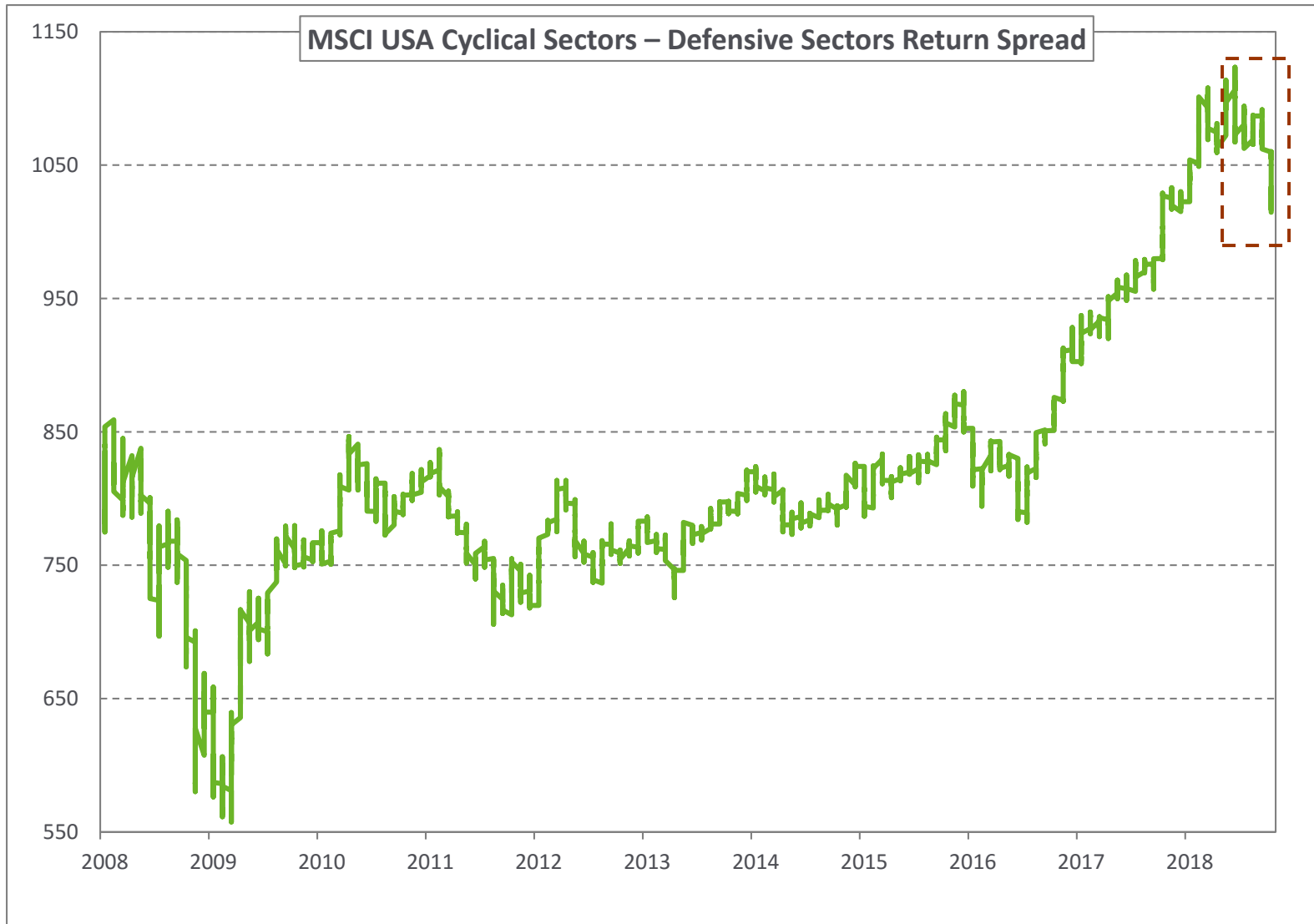
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US ECONOMY REMAINS STRONG



Source: Bloomberg

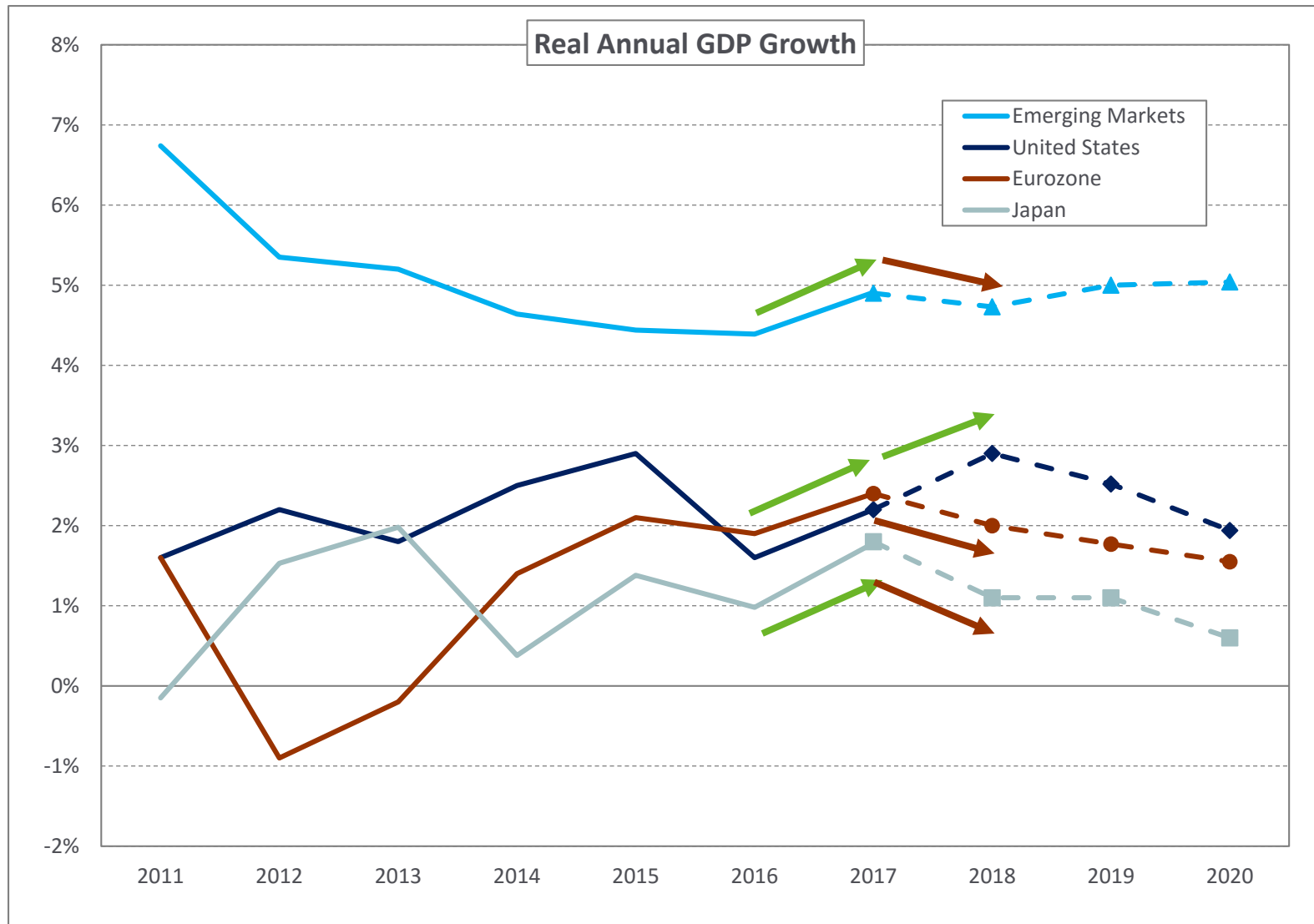
SECTOR PERFORMANCE INDICATING A TURN



Source: MSCI, Bloomberg

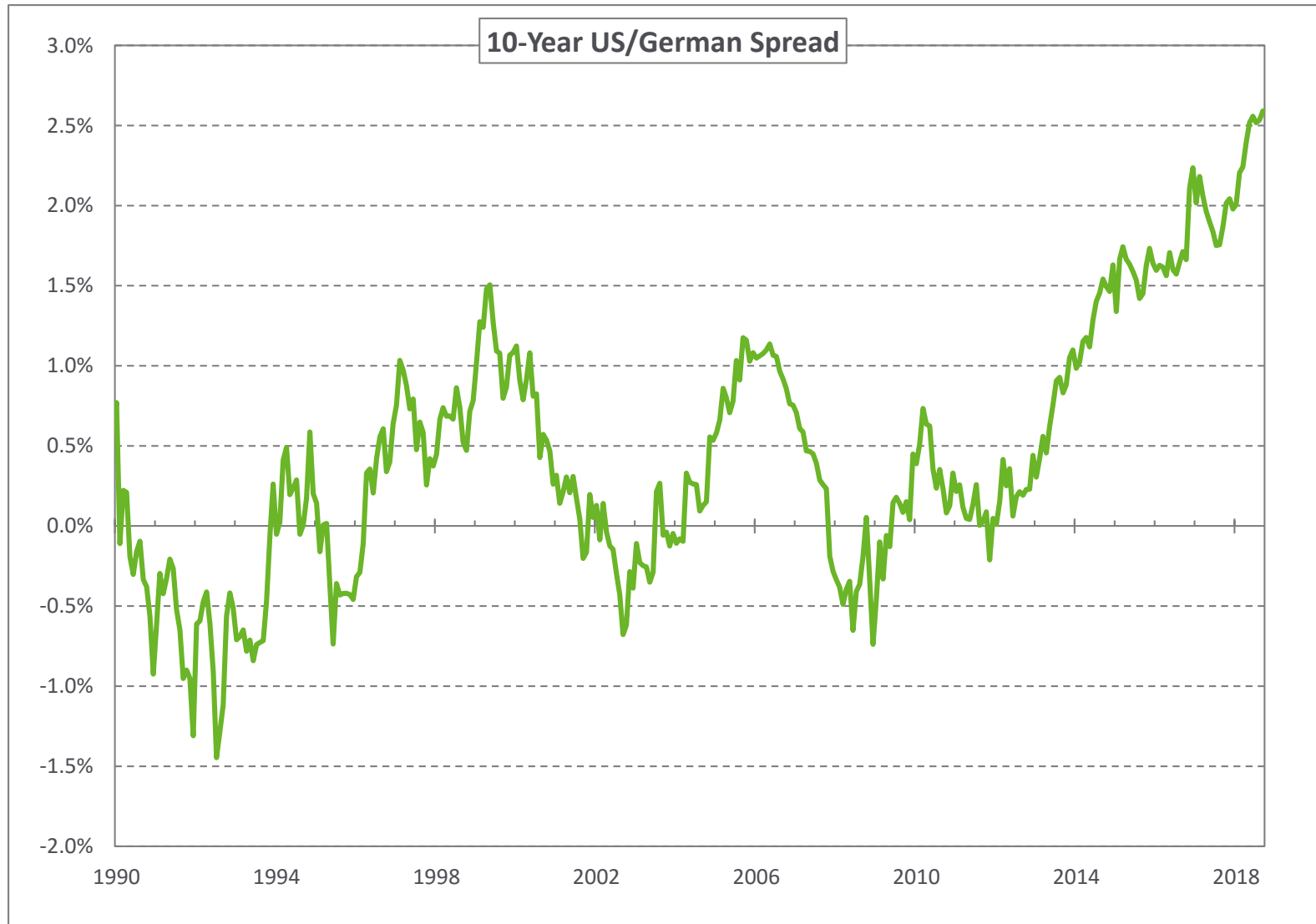


A LESS SYNCHRONIZED GLOBAL ECONOMY



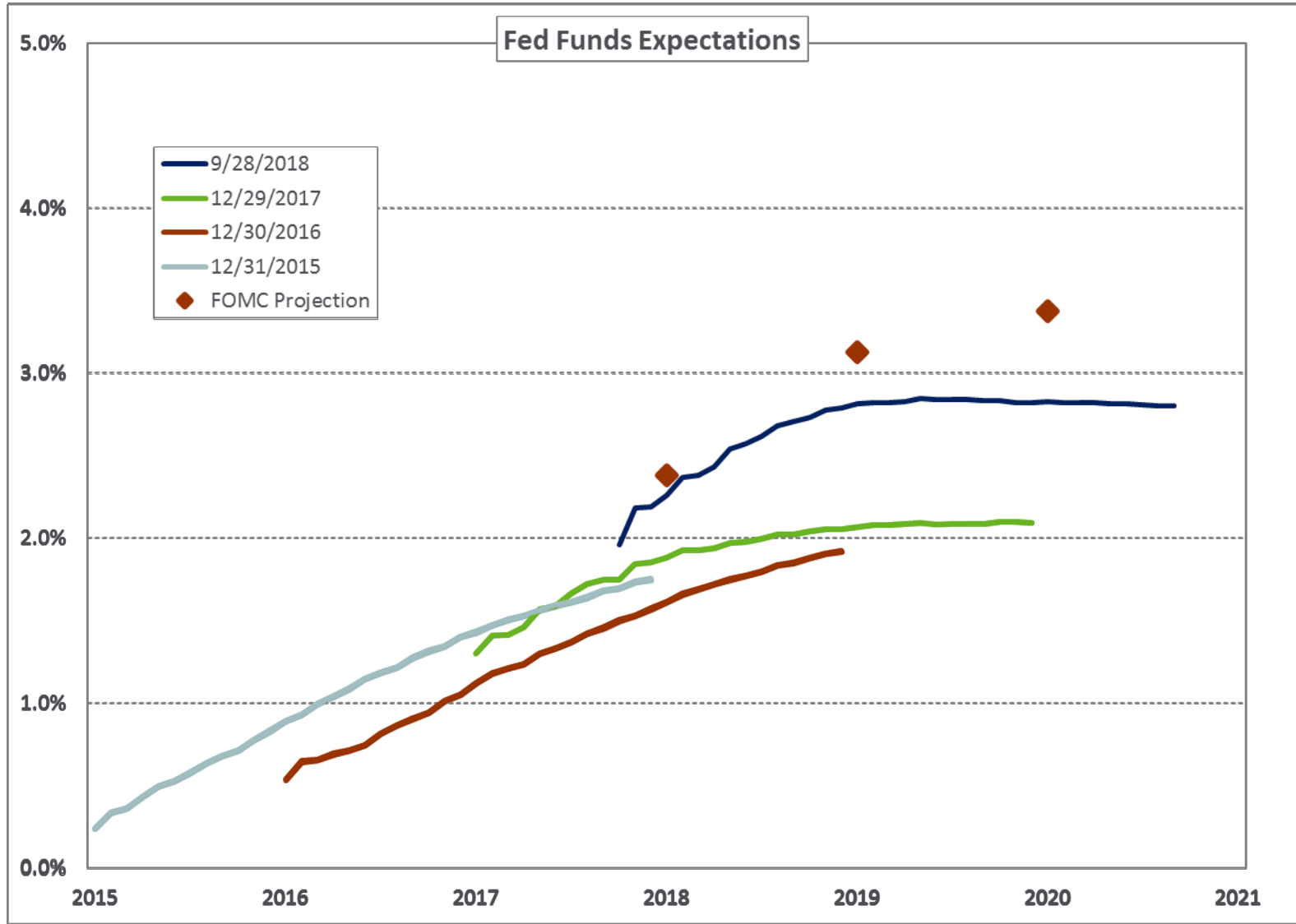
Source: Bloomberg

THE US CONTINUES TO DIVERGE



Source: Bloomberg

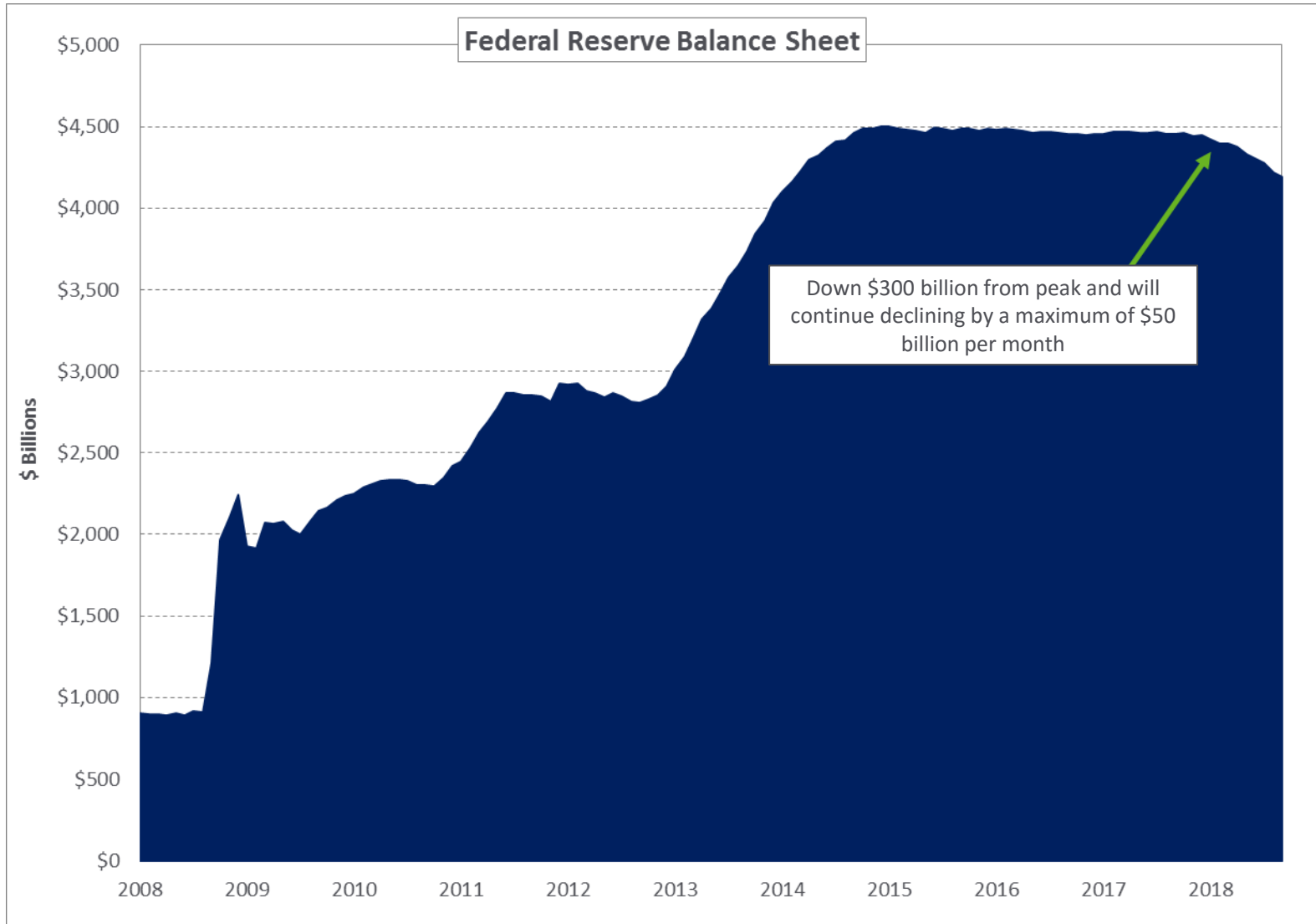
THE EVOLUTION OF FED GRADUALISM



Source: Bloomberg



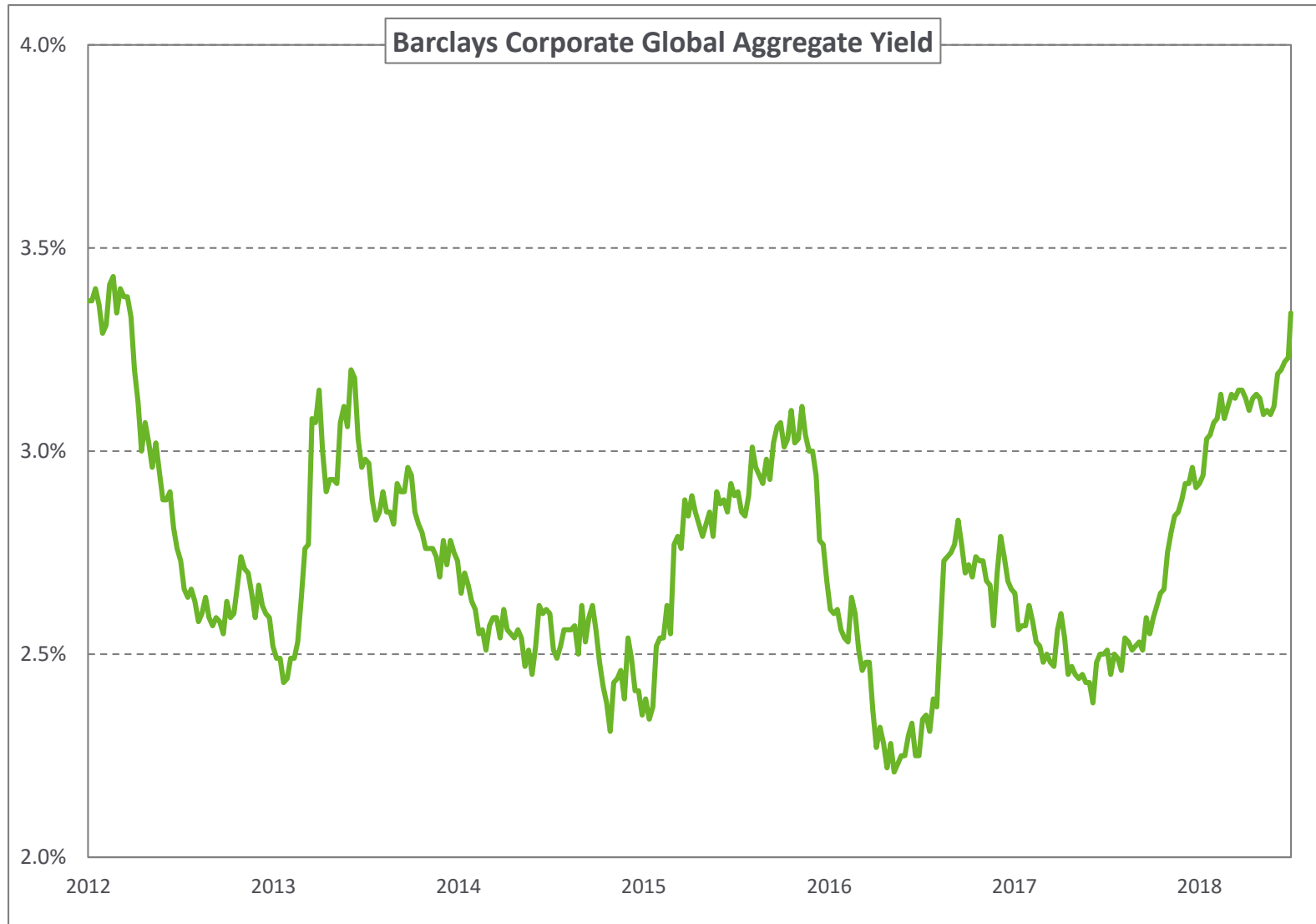
THE FED IS REDUCING MARKET LIQUIDITY



Source: Fed, Bloomberg



A SHIFT TO TIGHTER FINANCIAL CONDITIONS



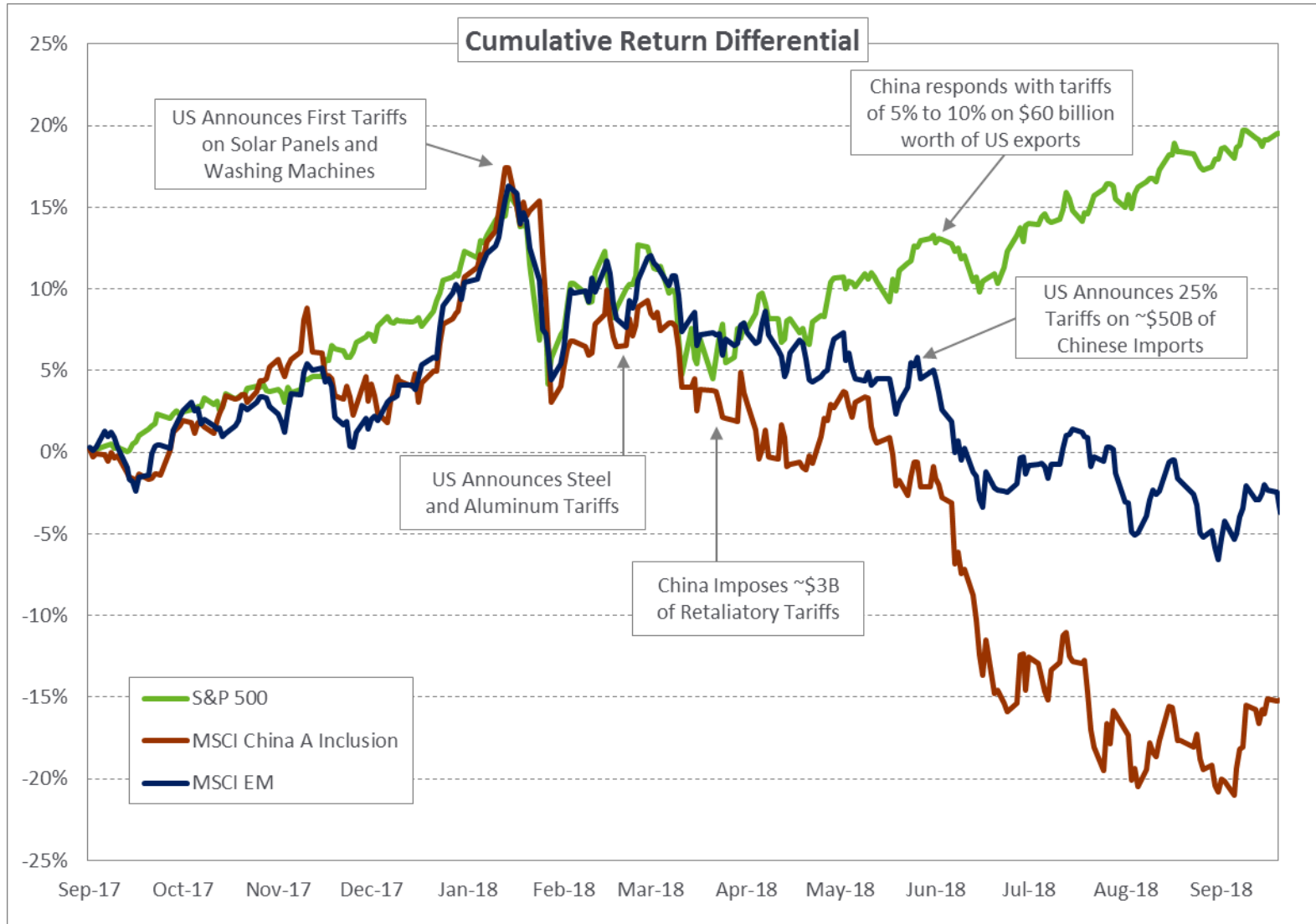
Source: Barclays, Bloomberg

US-CHINA TRADE POLICY



<p>30% tariff on imported solar panels and taxes on large residential washing machines</p>	<p>January 2018</p>	<p>China calls the tariffs “a serious attack on international trade”</p>
<p>25% tariff on imported steel and 10% tariff on imported aluminum</p>	<p>Q1 2018</p>	<p>Retaliatory tariffs of ~\$3B worth of US exports</p>
<p>25% tariff levied on \$50 billion of imports from China</p>	<p>Q2 2018</p>	<p>China responds with tariffs of 25% on \$50 billion worth of US exports, with soybeans being a sizable target</p>
<p>10% tariff on \$200 billion of imports from China. Tariffs will be increased to 25% at the end of year.</p>	<p>Q3 2018</p>	<p>China responds with tariffs of 5%-10% on \$60 billion worth of US exports</p>
<p>US may announce additional tariffs on \$267 billion of imports from China. This would essentially add a tariff to the remaining products that China exports to the US.</p>	<p>Future</p>	<p>China may cut tariffs on non-US goods to reduce the impact of US tariffs. China could further restrict the sale of rare earth elements that are inputs for many end products such as batteries and televisions.</p>

TRADE TENSIONS WEIGHED ON RETURNS



Source: S&P, MSCI, Bloomberg, NEPC

CURRENT OPPORTUNITIES

Trim US Equity Gains

Overweight Non-US Developed Market Equities

Maintain Overweight to Emerging Market Equities

Raise Safe-Haven Fixed Income Exposure

Fund MLP/Midstream Energy Exposure From Risk Assets

Fund Emerging Local Debt

Add Macro Hedge Funds

Add Long Volatility Exposure

EQUITIES

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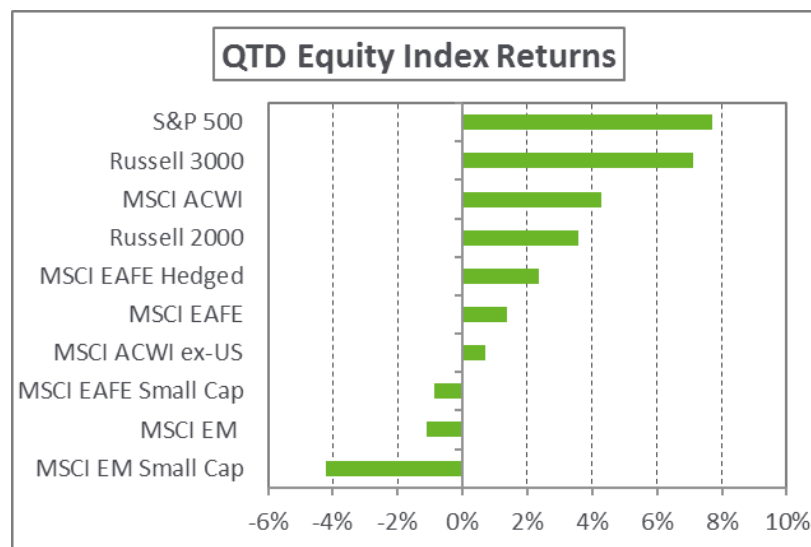
EQUITY PERFORMANCE OVERVIEW

Q3 Equity Market Summary

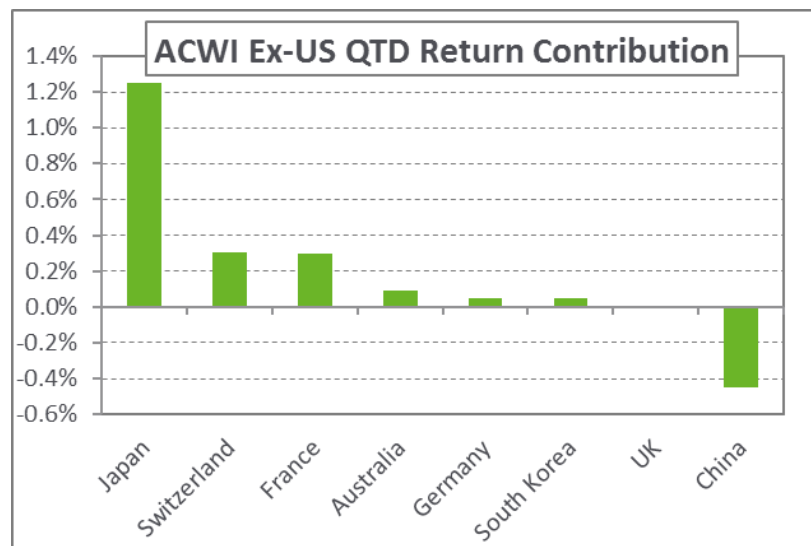
- **Strong economic data and positive sentiment helped US equities to outperform global equities**
- **Trade-sensitive economies disproportionately declined as escalating trade tensions and currency weakness weighed on returns**

Russell 3000 QTD Sector Return Contribution	
Information Technology	1.7%
Consumer Discretionary	0.3%
Financials	0.5%
Industrials	1.4%
Consumer Staples	0.0%
Energy	0.4%
Materials	0.0%
Health Care	0.5%
Real Estate	0.6%
Communication Services	-1.0%
Utilities	0.1%

Source: Russell, Bloomberg



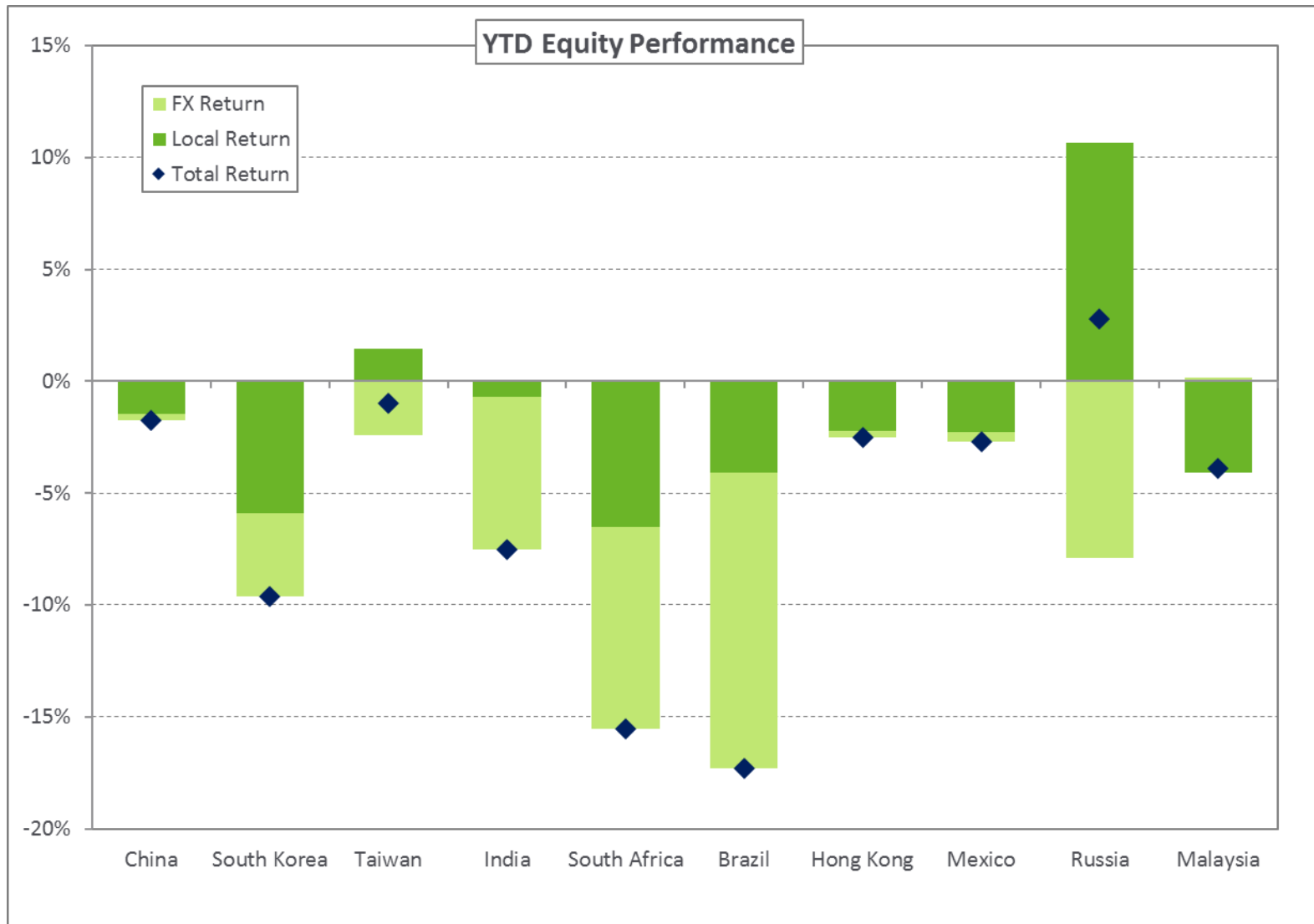
Source: MSCI, Russell, S&P, Bloomberg



Source: MSCI, Bloomberg. QTD top country contributors to index return

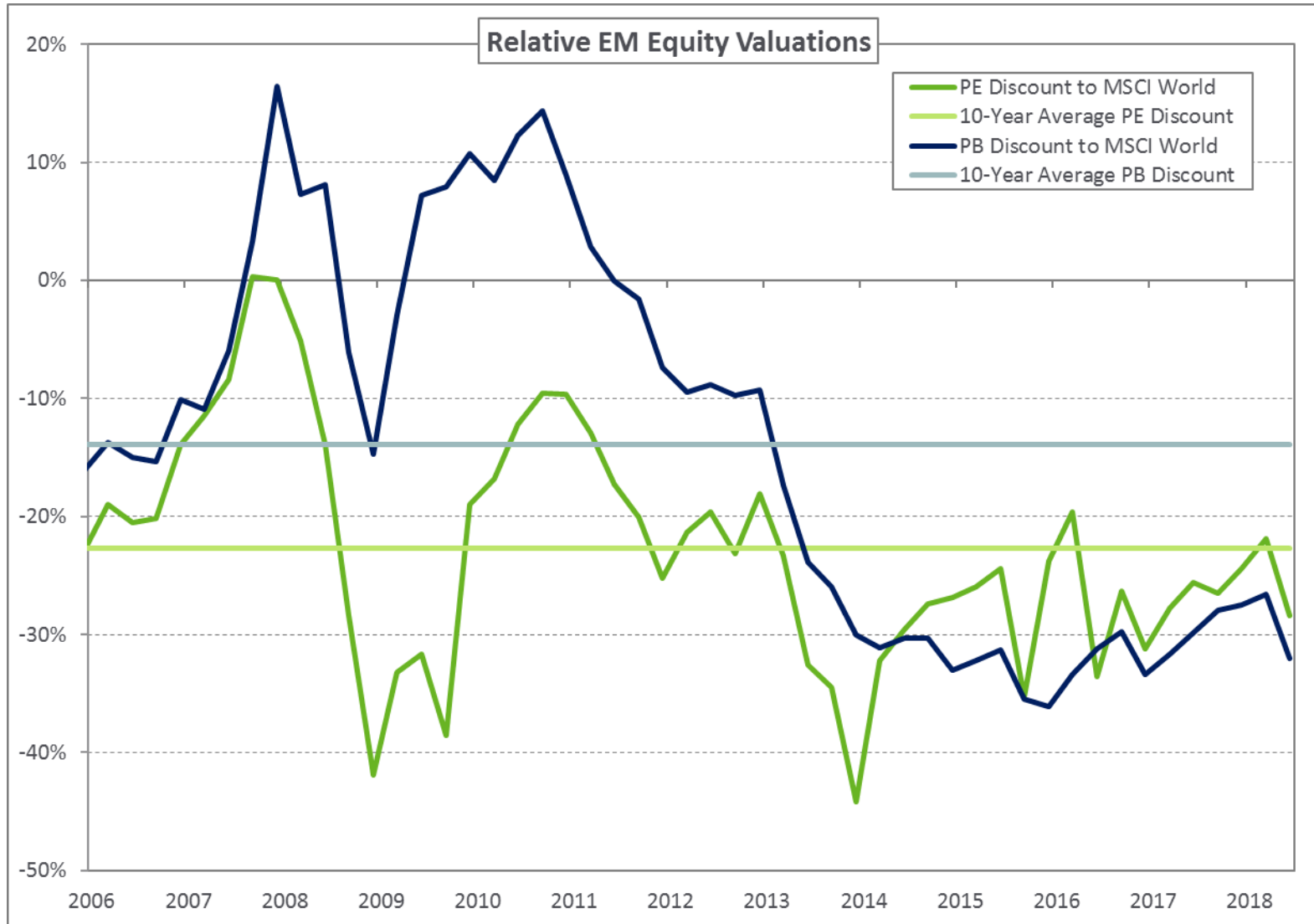


CURRENCY DETRACTED FROM EM RETURNS



Source: MSCI, Bloomberg, NEPC

ATTRACTIVE VALUATIONS



Source: MSCI, Bloomberg

VALUE VS. GROWTH

Published a Blog Post in September on Value vs. Growth

- [WILL GROWTH HAVE THE LAST WORD](#)

Recommendations

- Re-evaluate your benchmarks
- Look at the underperforming manager holistically not as a line item

Actions

• US Equities

- Trim US Equity Gains
- Redeploy to non-US equities and safe-haven fixed income
- Reposition within equities to ensure balance between value and growth

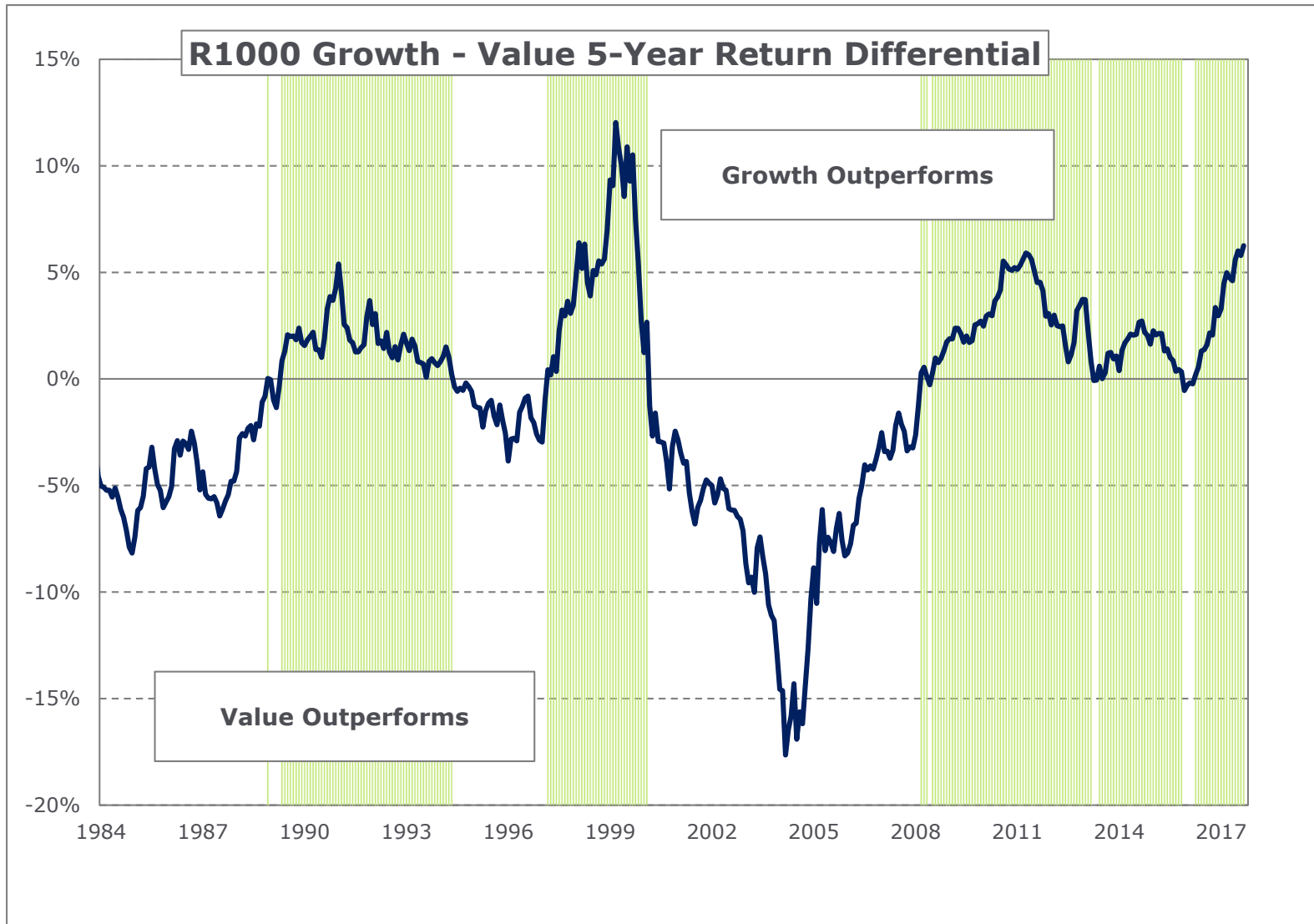
• Emerging Markets

- Evaluate EM exposure across portfolio- ACWI-ex US, Global Equity, Emerging Markets
- If sole exposure is Value consider complementing exposure (Large and Small)

• International Developed

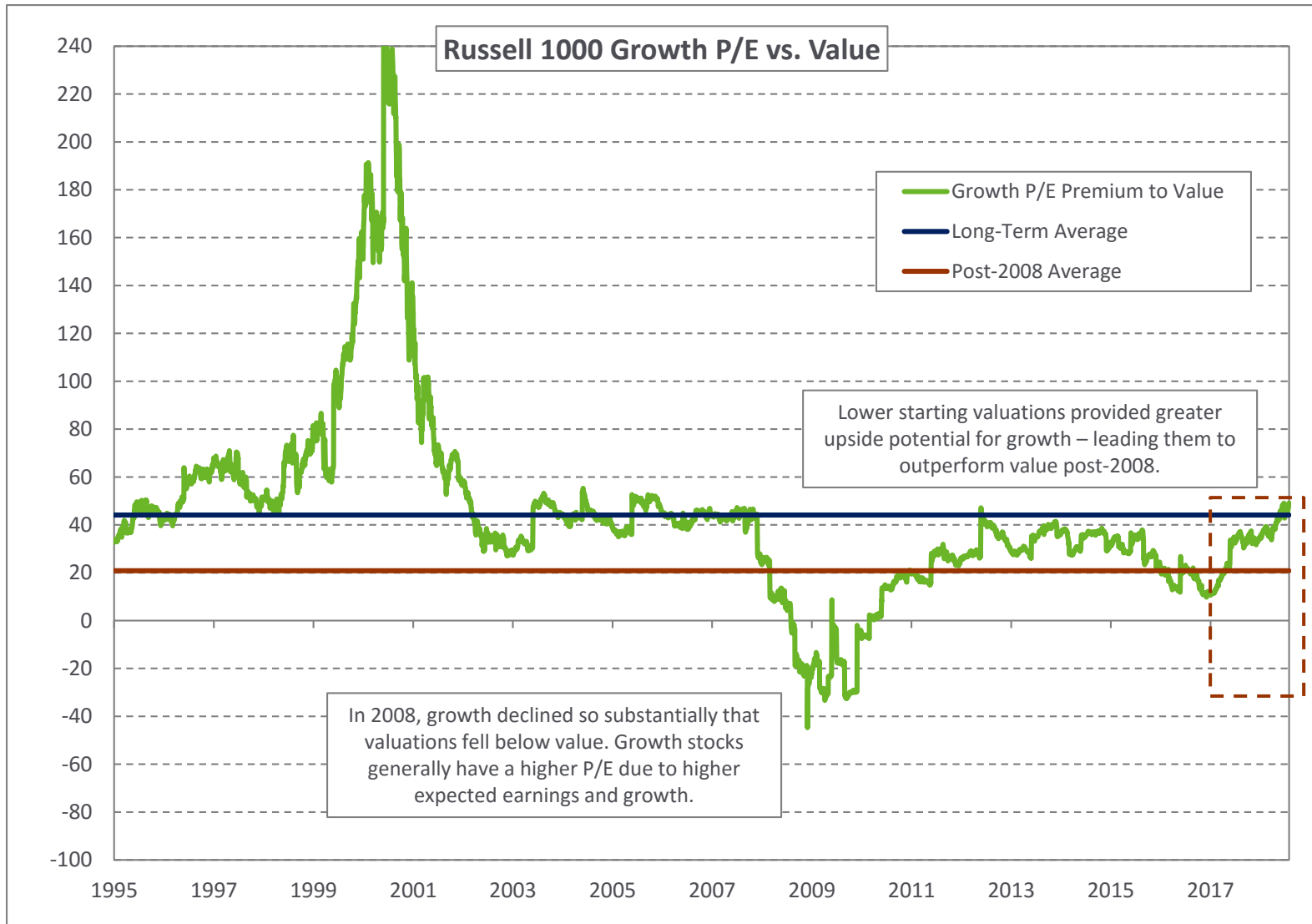
- Look at Non-US exposure holistically - Value Growth Dispersion less pronounced

VALUE & GROWTH EXHIBIT CYCLICAL BEHAVIOR



Source: Russell, Bloomberg, NEPC
Shaded area represents growth outperformance
As of September 2018

GROWTH HAS BECOME MORE EXPENSIVE



Source: Russell, Bloomberg, NEPC
As of August 2018

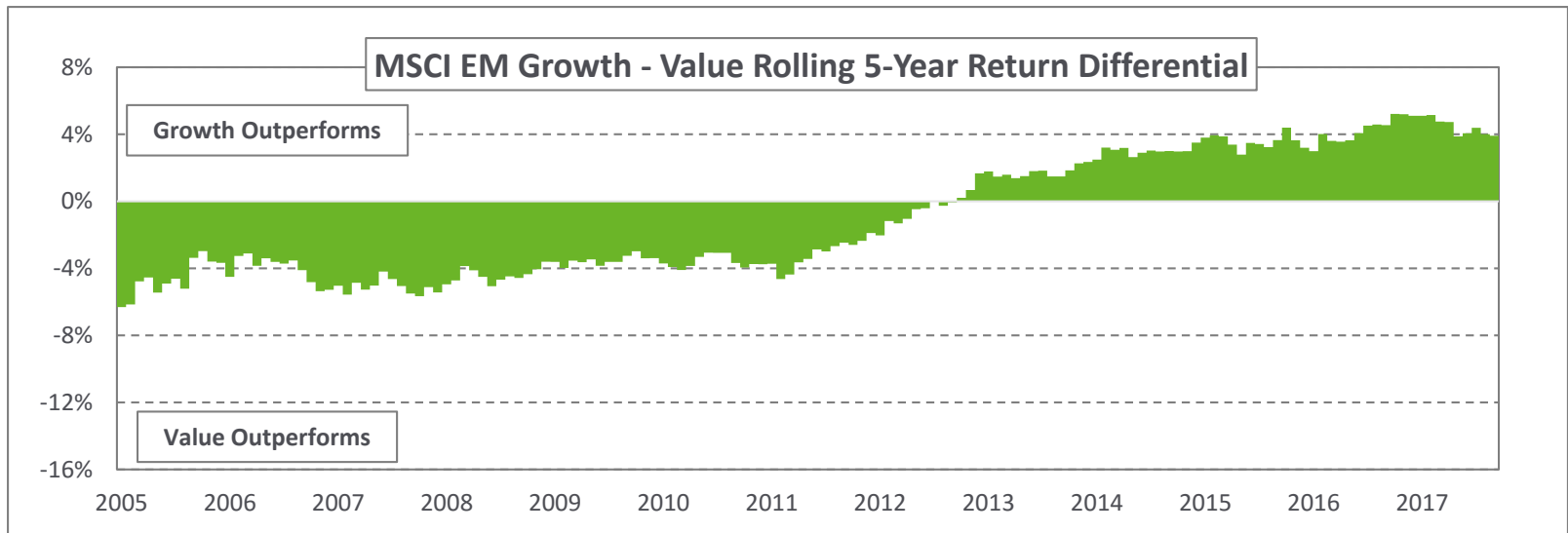
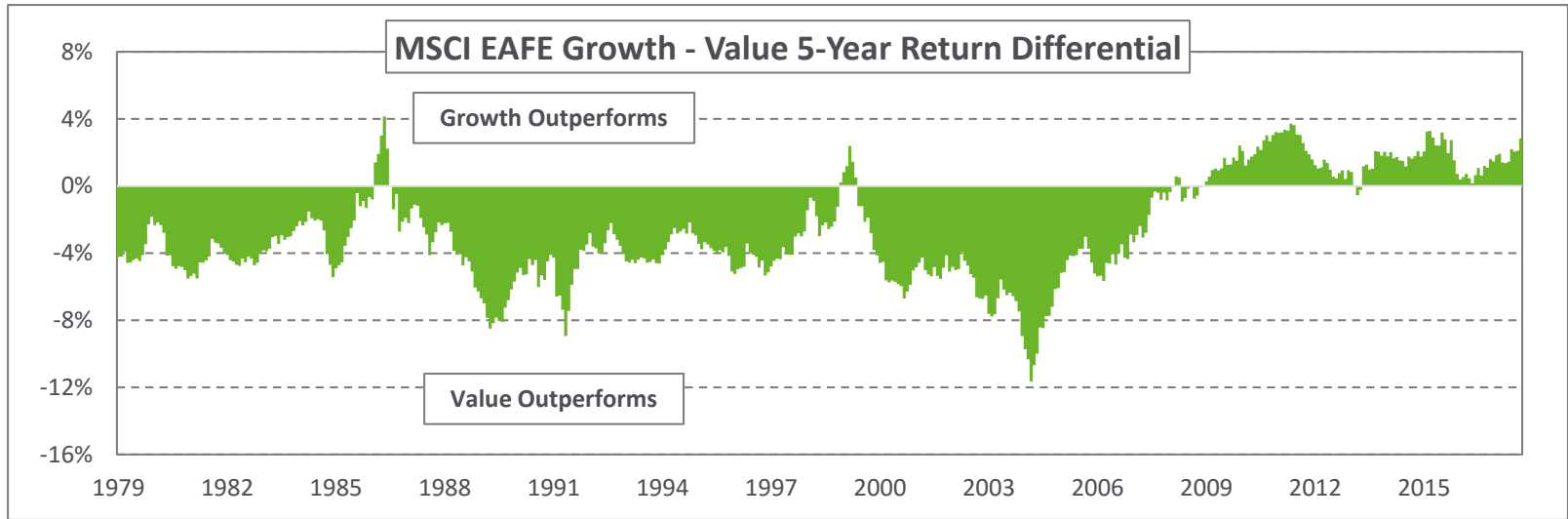
IS THIS TRUE OUTSIDE THE US AS WELL?

	Trailing 1-Year	Trailing 3-Years	Trailing 5-Years	Trailing 10-Years	Since Inception
Russell 1000 Growth	26.3%	20.6%	16.6%	14.3%	11.6%
Russell 1000 Value	9.5%	13.6%	10.7%	9.8%	12.1%
MSCI EAFE Growth	5.8%	10.3%	5.6%	6.2%	8.5%
MSCI EAFE Value	-0.4%	8.1%	3.1%	4.5%	10.9%
MSCI EM Growth	-3.9%	13.0%	5.1%	6.2%	8.7%
MSCI EM Value	2.3%	11.6%	2.0%	4.5%	9.3%

Source: Russell, MSCI, Bloomberg, NEPC
 Inception dates as follows: Russell 1000 - 12/31/1978; MSCI EAFE - 12/31/1974; MSCI EM - 12/29/2000
 Data through September 31, 2018

- While growth has outperformed in the current market regime, there is a case to be made for holding value as well, which has outperformed over the long-term, even with the strong growth rally of the past decade**
 - The macroeconomic backdrop of low interest rates, muted volatility, and strong economic growth combined with low starting valuations has fueled growth's run
 - However, rising rates and the potential for economic disruption indicate a combination of value and growth will likely provide the best diversification benefit

A SIMILAR STORY IS FOUND INTERNATIONALLY



Source (Top): MSCI, Bloomberg
Source (Bottom): MSCI, Bloomberg
As of September 2018

SUMMARY: EQUITY BETA GROUP TRENDS

Beta Subset	Q4 2017	Q1 2018	Q2 2018	Q3 2018
Public				
Global	Positive	Positive	Positive	Positive
United States	Neutral	Neutral	Neutral	Neutral
International	Strong Positive	Strong Positive	Strong Positive	Strong Positive
Emerging Markets	Positive	Positive	Positive	Positive
Private				
Venture	Neutral	Neutral	Neutral	Neutral
Growth Equity	Positive	Positive	Positive	Positive
Buyouts	Neutral	Neutral	Neutral	Neutral
Special Situations	Positive	Positive	Positive	Positive
Asia	Positive	Positive	Positive	Positive

WRAP-UP AND QUESTIONS

Questions

APPENDIX

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