# 2017 REFLECTION + 2018 OUTLOOK

## Main Themes

- Reflection
- Outlook
- 2018 Top of Mind

## Reflection

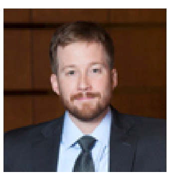
It may seem obvious now that 2017 was poised to be a very strong year. After all, global growth was already gaining momentum through 2016, particularly in Europe and in the Emerging Markets ("EM"). However, even with this positive global growth backdrop, there had been a lot of uncertainty in the investment markets that caused most market forecasters to recommend caution.

As we entered 2017, elevated equity valuations and a mature market cycle combined with political and geopolitical uncertainty globally clouded the fundamental growth picture. In the US, there was a new administration with a very large legislative agenda. In Europe, the integrity of the European Union was in question due to Brexit and significant pending elections in France and Germany. China, Japan, Brazil, and several other key regions also had (and still have) unique geopolitical, political, and economic issues. The outcome of these political events were difficult to predict, leading us to rely more than ever on our disciplined investment process that is steeped in fundamental economic research.

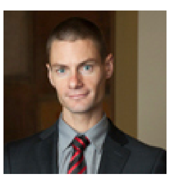
At Syntrinsic, our Investment Committee evaluates economic data, third-party perspectives, as well as historic perspectives to formulate a top–down view of global economies and markets. This top-down fundamental analysis informs our allocation decisions blending reasonable long-term assumptions and three-year forward expectations for opportunities and threats. We seek to avoid uninformed speculation on events that have not occurred, cannot be reasonably predicted, or have unknown consequences.

### Syntrinsic Investment Committee

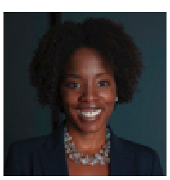
Syntrinsic's internal Investment Committee collaboratively evaluates economic data, forecasts capital markets, evaluates manager suitability, and develops client portfolios.



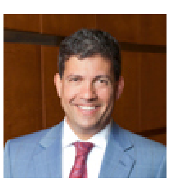
**Mike Duffy, CFA®**
Chief Investment Officer



**Alex Haun, CFA®, CAIA®**
Senior Analyst



**Akasha Absher**
Chief Consulting Officer



**Ben Valore-Caplan**
Chief Executive Officer

Syntrinsic Investment Counsel

## OUTLOOK

### Long-Term Forecast and Near-Term Sentiment

In the middle of 2017, our Investment Committee's research showed signs that indicated a positive picture for economic growth globally with momentum expected to build over the next year. That growth picture combined with improving local conditions within EM led to our mid-year upgrade of EM equities to neutral.

As we look into 2018, we acknowledge that several of the risks outlined in 2017 remain, such as elevated equity valuations, a mature market cycle, and political uncertainty. Coupling those risks with the strength of global equity markets and historically low volatility in 2017, our sentiment remains cautious and we recommend staying fully invested.

**Exhibit I: Syntrinsic Capital Markets Forecast**

| Asset Class/ Segment | 2018 LTCM | 2017 LTCM | 1Q 2018 Near-Term Sentiment |
|---|---|---|---|
| Global Equity | 7.25% | 7.25% | Neutral/Positive |
| US (52%) | 6.75% | 6.75% | Neutral |
| Foreign (36%) | 7.10% | 7.10% | Neutral |
| EM (12%) | 9.75% | 9.50% | Neutral |
| Global Fixed Inc. | 2.00% | 1.75% | Neutral/Negative |
| ST Bond | 2.75% | 2.50% | Neutral/Positive |
| Core Bond | 3.00% | 2.75% | Neutral |
| Int'l Bond | 1.00% | 0.75% | Negative |
| EM Bond | 5.25% | 6.00% | Neutral |
| Global Real Estate | 6.50% | 6.00% | Neutral/Positive |
| Commodities | 2.50% | 2.50% | Neutral |
| Hedged Strategies | 4.00% | 3.50% | Neutral/Positive |

Source: Syntrinsic Investment Counsel

The majority of the gains experienced in the global equity markets in 2017 were a result of improving economic global growth and strong corporate earnings across almost all major regions. We believe that fundamental growth picture endures.

Additionally, we do not foresee a secular downturn in economic activity in the near-term because of broadly positive global growth, healthy consumers and companies, limited market imbalances, and the gradual normalization of central banks policies. All of these factors lead us to a cautiously optimistic near-term sentiment and only a modest change to our long-term forecast. We summarize our 2017 and 2018 long-term capital markets forecast and near-term sentiment in Exhibit I. For a more detailed view, please see our 2018 Capital Markets Forecast, www.syntrinsic.com/what-we-say/research/ .

Even though our near-term sentiment is cautiously optimistic, we do not expect that the recent environment of extremely low volatility and relentless positive gains will be the new status quo. Elevated equity valuations provide a smaller margin for error and increase the importance of broad portfolio diversification, high quality active management, and disciplined allocation decisions.

In the following section, we discuss in more detail some of the opportunities and risks that are top of mind in 2018.

## 2018 Top of Mind

Syntrinsic's Investment Committee continues to evaluate monthly and quarterly the potential for different types of investment risks to derail the global growth picture. Several of these investments risks, such as inflation, interest rates, and new legislative policies (tax reform bill) remain on our radar and are worthy of noting.

## Inflation

In the near-term, an unexpected and sharp rise in inflation could force Central Banks, particularly the U.S. Federal Reserve (Fed), to act more aggressively by raising interest rates faster than expected. This action could potentially impact global investment markets.

We view an unexpected and sharp rise in inflation as a modest risk, and our base case is for a moderate rise in inflation in the near-term. On the other hand, we anticipate that aging global demographics, the rise of automation, and ongoing pressures from globalization will limit the increase in inflation over the long-term. We do, however, recognize that Central Bank actions in response to supply and demand fundamentals is a delicate process and missteps could have adverse effects on the investment markets; thus we continue to monitor inflation trends very closely.

## Interest Rates

Forecasting interest rates can be challenging because of the varying drivers that can cause changes in short-term and long-term interest rates such as Central Bank policy, legislative actions, demographics, supply and demand fundamentals, growth, and inflation. However, in the US, the Fed is currently tightening monetary policy, there is a new tax reform bill, and expectations for the cyclical environment are improving, thus increasing the potential for a rise in US interest rates. A dramatic increase in interest rates could be a risk to the global markets.

In our near-term sentiment, we analyzed the drivers that would cause a significant movement in short-term and intermediate interest rates. We review some of the drivers for intermediate to long-term rates and their impact in Exhibit II. Based on that analysis, we see several offsetting factors that would prevent intermediate rates from significantly increasing. However, based on our confidence in the US economy and likelihood that the Fed will continue to increase short-term rates via the Fed Fund Rates, we would expect higher short-term rates in the near-term. We do not expect that increase to be a drag on global growth.

**Exhibit II: Intermediate to Long-Term Interest Rate Matrix**

| Drivers | Direction |
|---|---|
| Fed B/S Unwind | ↑ |
| Growth | — |
| Inflation | — |
| Aging Demographics | ↓ |
| Government Deficit | ↑ |
| Institutional Demand | ↓ |
| Globalization/Automation | ↓ |

Source: Syntrinsic Investment Counsel

## Tax Reform

At the end of 2017, the first major tax reform bill in over 30 years was passed. Even though this current bill does little to simplify the tax code, we are mildly positive on the changes for consumers in the near-term. For companies, we believe a lower corporate tax rate could also be beneficial. The longer-term effects of the tax bill are more difficult to forecast and are summarized in Exhibit III.

**Exhibit III: Tax Reform Effects and Questions**

| Near-Term Effects | Long-Term Questions |
|---|---|
| **Consumers** | |
| Potentially higher after-tax incomes | Consumer spending increase? |
| **Corporations** | |
| Higher corporate profits | Will corporations increase business investment? |
| Potential increase in buybacks, M&A and business investment | Will US corporations become more competitive? |
| **Economy/Government** | |
| Potentially higher government deficit | Can increased growth offset higher deficit? |

Source: Syntrinsic Investment Counsel

For consumers, we believe this could be a short-term positive with modest gains to discretionary income until 2025. We are, however, skeptical about how much this will change the average US consumers' spending behavior because unemployment is already at record lows, consumer balance sheets are healthy, and the cut is temporary. Even harder to predict is the indirect benefit that consumers could experience from lower corporate taxes potentially trickling down in the form of higher wages.

For companies, we view the reduction in the corporate tax rate as a positive. The previous tax rate was uncompetitive and an outlier compared to other countries. Higher after-tax earnings combined with the repatriation of overseas assets may help extend this already mature market cycle in the US. Lower taxes could help some companies reduce debt levels, buy back shares, and possibly make capital investments. That said, companies on average have had strong earnings, improved balance sheets, and access to cheap financing for several years now. The lower corporate tax rate may not provide additional motivation for companies to make significant capital investments, especially this late in the cycle. It is also worth noting that not all companies will be affected in the same way. For example, companies with higher levels of debt may be disadvantaged due to limits on interest deductions.

Prior to passing the tax reform bill, we were moving closer to an underweight sentiment for US equities because of elevated valuations and limited room for incremental improvements to margins. Overall, the passing of the tax reform bill has improved our near-term sentiment for US equities, keeping our sentiment at Neutral. However, given the uncertainties around both companies' and consumers' appetite to increase spending and make investments, we will continue to monitor closely the effects of the tax reform bill on US equities and the broader market.

## DISCLOSURES

The information in this document is not intended as a recommendation to invest in any particular asset class or strategy or as a promise of future performance.

Given the complex nature of risk-reward trade-offs involved in portfolio construction, we advise clients to consult with financial professionals on specific investment-related decisions. References to future returns are not promises or even estimates of actual returns a client portfolio may achieve. In addition, past performance is not a guarantee of future results.

Assumptions, opinions and estimates are provided for illustrative purposes only and are subject to significant limitations. Expected return estimates are subject to uncertainty and error. Expected returns for each asset class can be conditional on economic scenarios to which actual returns could be significantly higher or lower than forecasted. They should not be solely relied upon as recommendations to buy or sell securities.

Forecasts of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. We believe the information provided here is reliable, but do not warrant its accuracy or completeness.

This material has been prepared for information purposes only and is not intended to provide, and should not be relied on for, accounting, legal, or tax advice.