2019 Semiannual Sentiment

Syntrinsic Investment Committee

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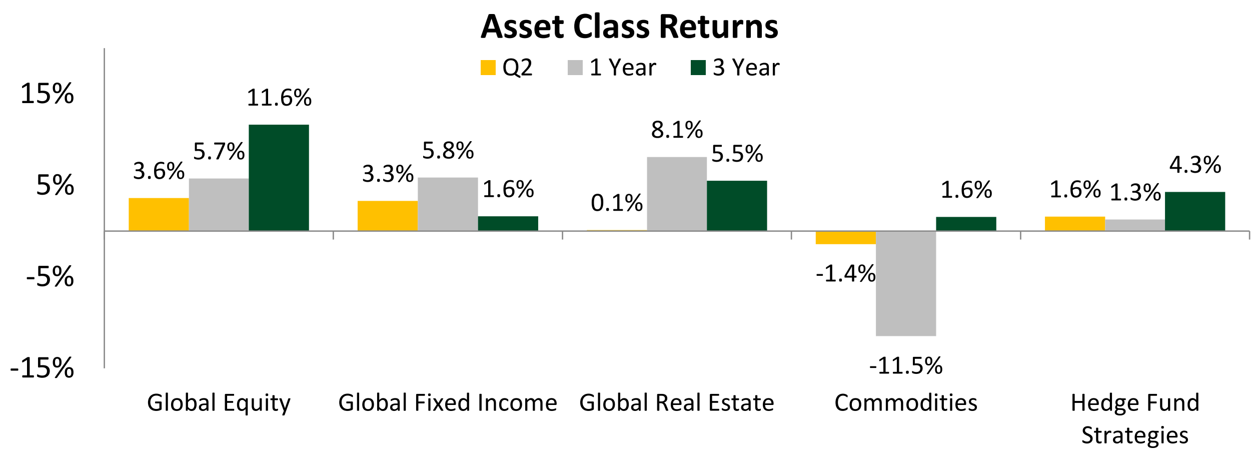
2019 Second Quarter Market Performance Review

While 2Q 2019 proved volatile across the globe and across asset classes, most asset classes were positive in the second quarter.



Source: Morningstar. Indexes: Global Equity: MSCI All Country World Index; Global Fixed Income: Bloomberg Barclays Global Aggregate; Global Real Estate: FTSE EPRA/NAREIT Global Index; Commodities: S&P GSCI; Hedge Fund Strategies: HFRI Fund of Funds Index

Global Equities performed the best relative to other asset classes, gaining 3.6%. Trade tensions created volatile conditions all quarter that were only partially ameliorated by the (eventual) decision of central banks to loosen or cease tightening of monetary policy in response to slowing economic growth.

Global Fixed Income followed close behind Global Equities, returning 3.3% in Q2. Declining interest rates once again added total return over yield. Within fixed income, global bonds led thanks to the European Central Bank's signals that further easing could be required to stimulate the economy. U.S. Bonds also performed positively as U.S. yields fell, the yield curve steepened, and corporate spreads tightened.

Global Real Estate returned just 0.1% despite lower yields.

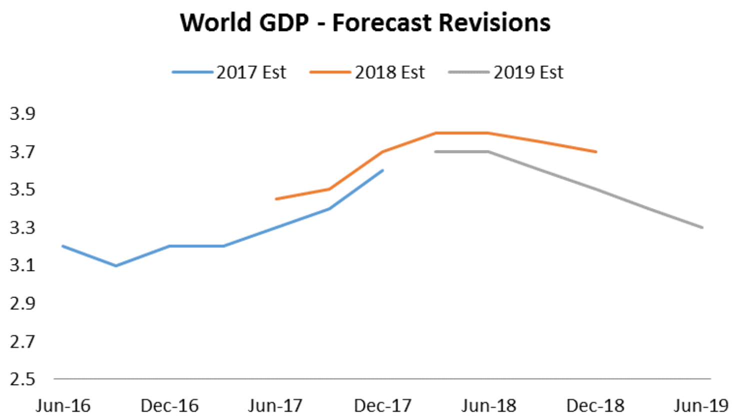
Commodities fell 1.4% due to slower global growth extending investor concerns about commodity demand. That same worry increased demand for safe-havens; thus, within commodities precious metals and oil did well.

Hedge Fund Strategies returned 1.6%, lagging the stronger performance of Equities and Global Bonds. Diversified sources added the most risk-adjusted return relative to benchmark.

Trends Impacting Client Portfolios

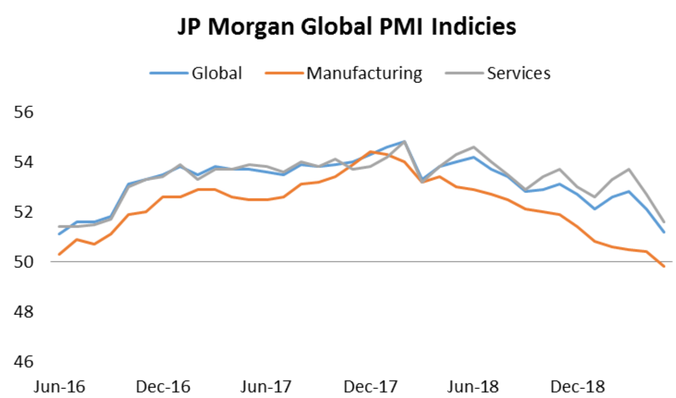
Through Syntrinsic's monthly investment committee meetings, we identify key global themes influencing economies and markets. Below, we highlight the most important of these themes and how they shape our perspective.

Slower Growth…Less Margin for Error



Source: Bloomberg

Global growth accelerated from 2016 to 2018, but the pace of growth has been slowing in 2019, in both the services and manufacturing sectors. Globally, revised forecasts for Gross Domestic Product (GDP) and Purchasing Manager Index (PMI) survey results remain in positive territory, but are trending down. Near-term potential growth is in the low single digit range.



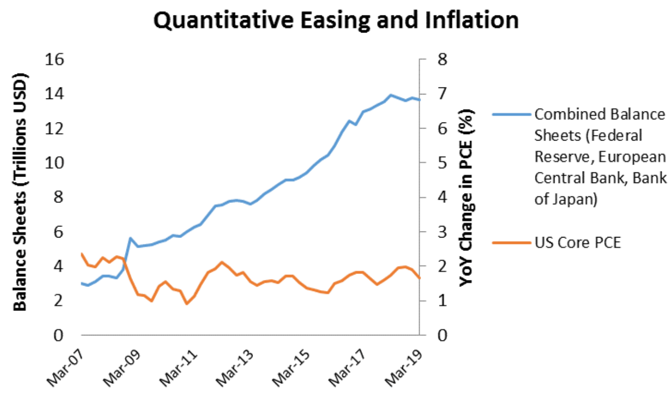
Source: Bloomberg

In recent years, multiple factors pushed growth above its long-term potential. Statistically, growth had benefitted from easy comparisons to a weak growth environment occurring concurrent with central bank stimulus, low interest rates, and tax cuts. With those factors rolling off or normalizing, growth is bound to weaken from a relative standpoint.

In addition, uncertainty due to geopolitical issues—primarily trade—has compounded the pressures against growth at a time when there is little positive offset. While not necessarily predictive of recession, these factors reduce the economy's margin for error to avoid continued and perhaps even accelerated slowing in the near-term.

Weak Inflation Continues

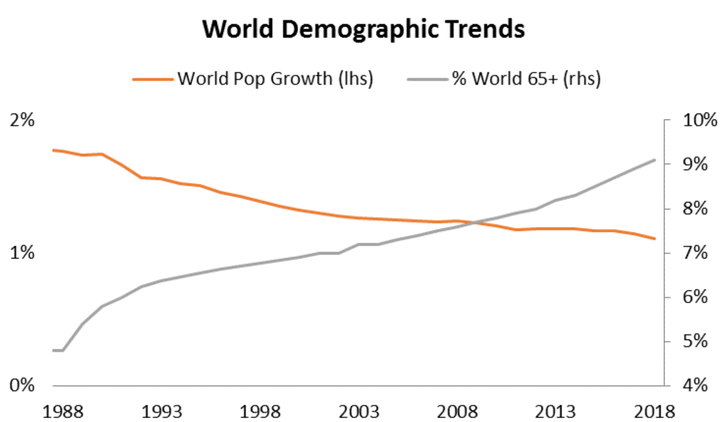
Since the last global recession, central banks around the globe have implemented aggressive growth policies, and unemployment is at historic lows in most regions. Still, core inflation in the U.S. is only 1.6%, in Europe 1.1%, and Japan 0.8%: all below the 2.0% central bank targets.



Source: Bloomberg

We believe that technology and demographics are the two most important reasons inflation remains low.

The effect of technology on inflation is difficult to measure in aggregate, but anecdotal examples are pervasive and—we think—representative of larger trends. A $200 43" TV sold today performs significantly better than a similarly sized $2,000 TV sold in 2009. Business sectors such as retail and transportation also are seeing disinflationary technological disruption such as Amazon and Uber/Lyft. While quantifying the cost to inflation of technological innovation is beyond the scope of this piece, the ease and cost with which we are able to research, develop, and distribute this document is in itself a testament to disinflationary pressures.



Source: Bloomberg

Demographics are another headwind to inflation. In most major regions, people are living longer. Populations are aging while working-age population growth rates are stagnant to declining. We expect these trends to limit demand and prices.

While we had expected modestly higher short-term inflation by this point in the economic cycle, our long-term outlook remains intact. We think demographic and technology headwinds will keep cyclical inflationary pressures in check.

The impact of persistent low inflation limits the degree to which central banks will be able to tighten policies. Low inflation expectations also limit the potential for interest rates to materially increase, as investors require less compensation to cover the cost of anticipated inflation. In the very short-term, the combined effects of tight labor markets and tariffs between the U.S. and China could cause a modest inflationary spike; that said, we do not expect any such impact to be significant or sustainable.

U.S. and China Trade Uncertainty

While increased uncertainty about the United Kingdom's exit from the European Union (EU) and simmering political and economic discontent across the E.U. are concerning, trade between the U.S. and China is the largest potential stumbling block on the horizon for the global economy. The situation remains unstable, but the ongoing turmoil causes ripple effects across the global supply chain and uncertainty for corporate investment.

The U.S. and China are the two largest economies in the world. The U.S. has imposed a 25% tariff on $250B of Chinese imports, and may add another $300B on Chinese goods if negotiations falter. China has responded with tariffs on $110B in U.S. goods. Disruptions to trade between the U.S. and China affect regions far beyond their borders. The International Monetary Fund has indicated that a 25% tariff on all trade between the U.S. and China will reduce global GDP by 0.5%.

Source: Bloomberg

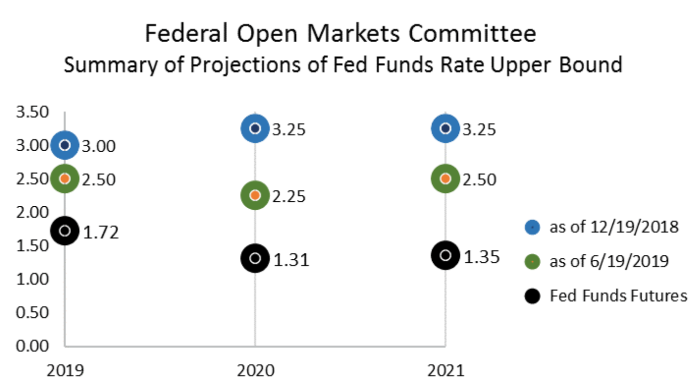
With increased globalization, McKinsey estimates that two-thirds of world trade is in intermediate inputs rather than finished goods. As a result of this dynamic, U.S. tariffs on Chinese goods also affect Chinese trade partners further up the supply chain. Indeed, there has been a sharp decrease in trade from China's largest import partners, South Korea and Japan.

Like many, we have been hoping for better clarity on U.S.-China trade relations by year-end; however, also like many, we have become more sanguine about the possibility for persistent long-term trade uncertainty. While it would seem to serve the political interest of both sides to reach agreement, both parties also need to be able to declare victory, making resolution extremely difficult. If volatile periods of uncertainty continue, the downside risk will be more significant than the dollar value of tariffs. Prolonged uncertainty likely will lead to less business and consumer confidence, reduced investment, and lower consumption.

The U.S.-China trade situation, combined with our expectation for lower growth, leads to our generally cautious outlook with heightened expectations for volatility. Our portfolios reflect this perspective with broad diversification across regions and industries, a focus on exposure to higher quality companies where possible, and multiple sources of ballast and liquidity.

Central Banks Pivot…But With Less Room to Maneuver

Slower growth, persistent low inflation, and geopolitical uncertainty provide justification for major central banks to pivot toward a more supportive policy approach. However, central banks have helped keep interest rates relatively low and have flooded the globe with abundant money supply for nearly a decade. As central banks take steps toward policy easing yet again in order to re-stimulate economies, the potential impact of doing so will be smaller than in recent years.



Source: Bloomberg

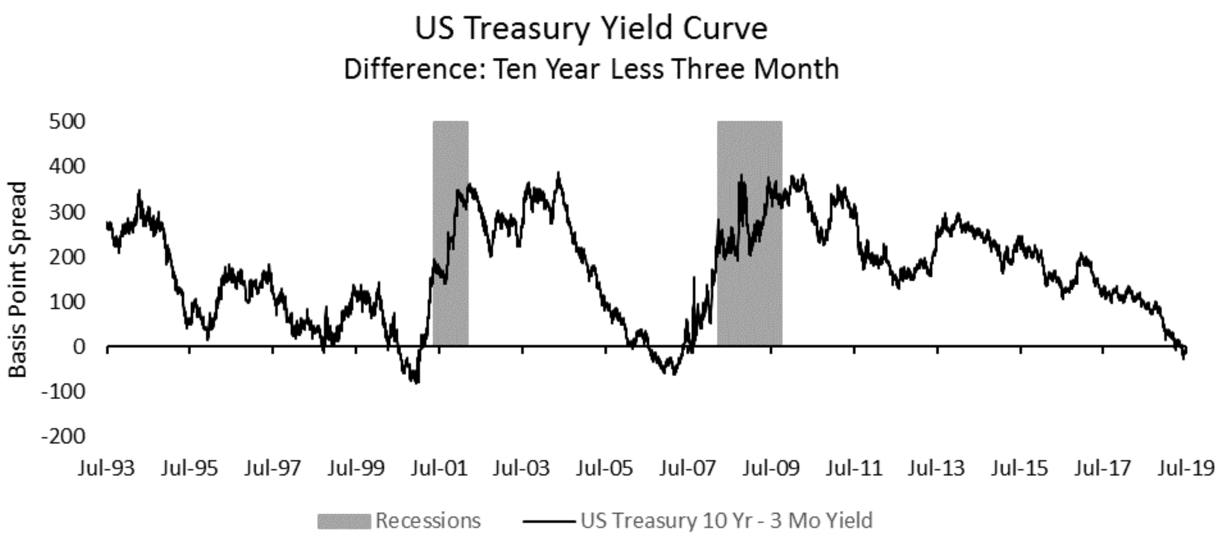
The U.S. Federal Reserve is open to the possibility of reducing rates if needed, and markets have jumped ahead, pricing in multiple reductions to their target rate. As seen through the Fed Funds Futures Rate, markets are expecting over 100bps of rate cuts by the end 2020. Almost the entire U.S. Treasury interest rate curve is below the upper-end target Fed rate of 2.5%.

China began increased, significant stimulus measures late last year that should gain better traction later this year. Recently, China launched substantial fiscal spending projects, corporate tax cuts, and easier credit conditions. China appears to have more flexibility to stimulate compared to other major regions simply because they have a more robust balance sheet and much lower debt-to-GDP ratio.

The European Central Bank and Bank of Japan also have indicated they might increase stimulus measures if conditions worsen. From a practical standpoint, however, both the EU and Japan already have low to negative interest rates and their central banks are carrying even more cumbersome balance sheets. In short, there is little room for additional stimulus in Europe or Japan.

Interest Rates Decline…Yield Curve Inversion Continues

Lower interest rates and the inversion of the yield curve are the natural result of lower growth, low inflation, trade uncertainty, and the central bank pivot. Conventionally, an inverted yield curve means that interest rates on ten-year US Treasury Bonds actually are lower than short-term issues, identified as the three-month US Treasury Bill in the chart below.



Source: Bloomberg

As the graphic above illustrates, the yield curve is now modestly inverted, which some interpret to mean that bond investors expect a recession. The rationale for such a view posits that because bond investors are willing to accept lower yield for longer maturities than shorter maturities, they anticipate negative growth—not just slow growth, but actual economic contraction. Indeed, two of the last three inverted yield curves ended in a recession; however there is not a clear causal link between an inverted yield curve and recession. Thus, one cannot simply assume that inverted yield curves cause recessions or that impending recessions cause inverted yield curves. In addition and importantly, we are operating in a market severely skewed by enormous central bank balance sheets, a market in which bond yields are heavily influenced by factors other than natural market forces. We have no precedent for the economic and market forces now in play.

Impact on Portfolios: Stick With the Long View

Given the economic and market concerns outlined above, some investors might feel compelled to move out of risky assets altogether. For people intent on timing the market, there is always a rationale to justify getting out. More disciplined investors, however, recognize that the opportunity cost of poor market timing is often more dangerous than the ups and downs of market cycles.

To navigate economic concerns today and in the future, our investment committee maintains a grounded understanding of global economies and markets, makes measured allocation decisions based on opportunities and threats, and aggressively evaluates the potential value add of every investment manager we use.

Over the past few years, given the ongoing reality of an aging economic cycle, we have gradually shifted our allocations. Rather than dedicated allocations to micro-cap stocks, commodities, emerging market small-caps, and high yield bonds, we have opted to maintain access to these market segments through strategies that have the option rather than the obligation to invest in these segments when the expected risk and returns are justified. In recent years, we have also increased our allocation to high-quality intermediate bonds and reduced the expected market beta (or systemic risk, relative to the market) to our hedge fund strategies. We have made these adjustments while staying fully invested and giving our clients a strong opportunity to meet their long-term return needs.

These adjustments are grounded in Syntrinsic's Near-Term Sentiment, a framework for evaluating asset classes and regions on a tactical view of less than three years. Every six months, we formally review and publish our Near-Term Sentiment, recognizing of course that conditions could call for a revision on an interim basis as well. Our monthly economic review enables us to track data and sentiment over time. While we monitor conditions with monthly frequency, we only infrequently change our sentiment in a manner that impacts client portfolios.

Near-Term Global Equity Sentiment

The themes outlined above, combined with our in-depth country level analysis, support a cautious view across asset classes. Our global equity allocation sentiment is unchanged from January 2019. Across global equities, we prefer U.S. stocks to stocks from foreign developed regions and maintain a neutral sentiment towards emerging market stocks.

Near-Term Global Equity Sentiment Relative to the MSCI All-Country World Index	Negative	-	Neutral	-	Positive
United States	-	-	-	●	-
Foreign Developed	-	●	-	-	-
Emerging Markets	-	-	●	-	-

United States: Consumer demand is healthy, unemployment is low, and personal balance sheets have strengthened. In addition to the Federal Reserve's recently expressed commitment to lower rates if necessary to support the economy, we think headwinds from trade uncertainty are manageable for now. That said, an escalation in tariffs or a complete breakdown in talks could lead to materially weaker economic conditions. Tempering our view, U.S. companies have higher valuations and elevated margins relative than many companies based elsewhere, limiting room for earnings growth beyond revenue growth. All in, U.S. stocks still represent the most attractive relative allocation option within equities.

Foreign Developed: Our sentiment is more cautious for Europe, the United Kingdom, and Japan. We expect the aggregate group growth to come in below historic trends and do not see any likely catalysts for acceleration. If anything, we expect that political pressures in Europe—especially Germany, Italy, and France—combined with ongoing Brexit uncertainty and continued structural challenges in Japan will be headwinds to confidence, investment, and equity performance in foreign developed regions.

Emerging Markets: China is key to emerging markets equities and remains on track for a soft economic landing, transitioning from a heavily manufacturing and infrastructure oriented economy toward a slower but higher-quality, local-consumption economy. Stimulus measures enacted since late last year are showing some promise and should gain better traction through year-end. As mentioned in our views on trade, U.S. trade tariffs are a headwind to China and other emerging market economies.

Near-Term Global Fixed Income Sentiment

Our global fixed income allocation sentiment is unchanged from January 2019. Year-to-date declines in interest rates and credit spreads limit upside in most segments beyond current yields.

	Near-Term Global Fixed Income Sentiment Relative to the Bloomberg Barclays Global Agg Bond Index				
	Negative	-	Neutral	-	Positive
Short-Term (1-5 Year)	-	-	-	●	-
Core Bond	-	-	●	-	-
Core Plus Bond	-	-	●	-	-
Foreign Developed	●	-	-	-	-
Emerging Markets	-	-	●	-	-

Short-Term (1-5 year): Current short-term yields look compelling compared to the interest rate and credit spread sensitivity of longer maturities. The flat to inverted U.S. Treasury yield curve has improved relative attractiveness of short-term bonds as well, though should yields come down with projected Federal Reserve policy changes, that relative attractiveness could be quickly mitigated away.

Core Bond: High quality, core fixed income is represented by investment grade government and corporate bonds, which remain a key source of diversification. While lower interest rates and tighter credit spreads over recent quarters have reduced yields, we see value in the ballast provided by high-quality liquid bonds for portfolios that prioritize volatility mitigation.

Core Plus Bond: Strategies that can take on greater credit, yield curve, interest rate, or structural risk are finding few obvious opportunities at compelling prices. And, while elevated earnings levels and low yields are helping companies manage growing balance sheet debt, any decline in earnings or significant rise in interest rates will likely reveal challenges to those issuers with lower quality positions.

Foreign Developed: Low yields remain unattractive across the major developed market bond issuers such as Japan, the UK, Germany, Italy, and France. Given that the European Central Bank and Bank of Japan are likely to maintain low interest rate policies, return potential is quite limited and will struggle to outpace inflation.

Emerging Markets: Yields of debt issues by companies and governments across the emerging markets remain above their long-term average spread to U.S. Treasuries. Risk in the emerging markets is highly idiosyncratic and while a strong active manager can find compelling opportunities, the broader space remains neutral.

Near-Term Real Asset and Hedge Fund Sentiment

	Near-Term Global Real Asset and Hedge Fund Sentiment				
	Negative	-	Neutral	-	Positive
Listed Real Estate	-	-	●	-	-
Commodities	-	-	●	-	-
Hedge Fund Strategies	-	-	-	●	-

Listed Real Estate: We maintain a neutral view on listed real estate. Strong labor market conditions and positive, albeit low, growth continue to support reasonable demand for real estate. In most markets, supply and demand are in a healthy balance, supporting a relatively stable outlook. Tempering our view, we expect price appreciation and rental rate growth to be limited by an environment of slower growth and low inflation. Valuations also will limit price growth potential, ranging from fair value to slightly elevated.

Commodities: We maintain our neutral sentiment toward commodities due to moderating global growth and the lack of ways to replace Chinese demand. Absent a new catalyst, we see roughly balanced supply and demand across most commodities. As the long-term risk-return profile of commodities remains unattractive, inflation protection unnecessary, and portfolio diversification benefits limited, we do not recommend dedicated commodity allocations within portfolios.

Hedge Fund Strategies: The opportunity set for hedge fund strategies remains attractive in both absolute terms and relative to expensive valuations for stocks and bonds. We expect more frequent periods of volatility and elevated levels of asset dispersion, which can create opportunities for hedge funds to add value. Given the idiosyncratic nature of hedge fund strategies—as well as expensive cost models and often complicated structures, hedge fund strategies must be evaluated at the specific investment manager level.

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. Please consult your investment advisor regarding your specific situation.

References to forecast returns are not promises of actual returns a client portfolio may achieve. Past performance is not a guarantee of future results.

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