

Overview

Following a period of unprecedented market calm in 2017, the first quarter of 2018 was characterized by higher levels of volatility as investors reacted to the prospect of higher future inflation, rising interest rates and a potential trade war between the United States and China.

The quarter began with a substantial global equity market rally in January. Drivers of the rally included improving global economic fundamentals, continuation of generally accommodative monetary policies among global central banks, and continued corporate earnings growth. At their peak, US and developed international equity markets traded up 7% with emerging market equity indices up nearly 10%. However, the market rally reversed sharply in February in response to an uptick in inflation expectations, a repricing of the yield curve, and a dramatic spike in equity market volatility. The correction resulted in a drawdown in broad US equity indices of just over 10%. The quarter ended with developed equity markets in negative territory, US duration sensitive assets down moderately, and global bond markets maintaining slight gains in part due to a weakening US Dollar.

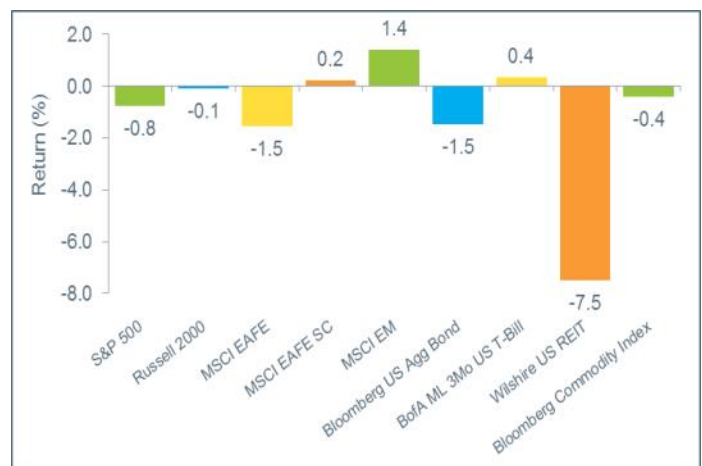
In its first meeting since Jay Powell assumed the role of Chairman, the Federal Open Market Committee set the federal funds target range at 1.50% to 1.75%, an increase of 0.25%, and maintained guidance for two additional rate increases in 2018. Treasury issuance rose during the quarter with deficits set to surge as a result of the recently passed tax reform, and interest rates increased across maturities compared to the start of 2018. Though various headlines grabbed investor attention throughout the quarter, US economic data continued to generally indicate a robust economic expansion. Non-farm payroll growth averaged in excess of 200,000 job gains per month while Purchasing Manager's data for both the US manufacturing and non-manufacturing sectors indicated continued expansion. The University of Michigan Consumer Sentiment survey maintained its highest six month average reading since 2001, and the NFIB small business optimism index reached its highest level since the 1980s. Amidst continued improvement in economic fundamentals, short-term borrowing costs increased as the spread between the USD LIBOR rate and overnight indexed swaps (FRA/OIS) materially widened, a potential leading indicator of tightening credit conditions.

In Europe, the EU increased its GDP growth estimate for 2017 from 2.2% to 2.4%, while also raising its forecasts for 2018 and 2019. The European Central Bank maintained guidance that it would continue to reduce the pace of asset purchases and likely end its quantitative easing program by 2019. Collectively, global central banks continued to pivot away from the use of extraordinary measures to stimulate economic activity.

Trailing Period Market Performance (%)

	QTD	CYTD	1 Year	5 Years	10 Years
S&P 500	-0.8	-0.8	14.0	13.3	9.5
Russell 2000	-0.1	-0.1	11.8	11.5	9.8
MSCI EAFE	-1.5	-1.5	14.8	6.5	2.7
MSCI EAFE SC	0.2	0.2	23.5	11.1	6.5
MSCI EM	1.4	1.4	24.9	5.0	3.0
Bloomberg US Agg Bond	-1.5	-1.5	1.2	1.8	3.6
BofA ML 3Mo US T-Bill	0.4	0.4	1.1	0.3	0.3
Wilshire US REIT	-7.5	-7.5	-3.6	6.1	6.2
Bloomberg Commodity Index	-0.4	-0.4	3.7	-8.3	-7.7

Quarter-to-Date Performance (%)



Key Economic Indicators

		As of	12/29/2017	9/29/2017	10 Year Average
Federal Funds Rate	1.67%	3/31/2018	1.33%	1.06%	0.38%
Treasury - 1 Year	2.09%	3/31/2018	1.76%	1.31%	0.53%
Treasury - 10 Year	2.74%	3/31/2018	2.40%	2.33%	2.57%
Treasury - 30 Year	2.97%	3/31/2018	2.74%	2.86%	3.42%
Breakeven Inflation - 1 Year	2.24%	3/31/2018	0.85%	1.24%	0.79%
Breakeven Inflation - 10 Year	2.06%	3/31/2018	1.98%	1.85%	1.96%
Breakeven Inflation - 30 Year	2.07%	3/31/2018	2.02%	1.93%	2.15%
Barclays US Corp: Hi Yld Index - OAS	3.54%	3/31/2018	3.43%	3.47%	5.98%
Capacity Utilization	77.66%	2/28/2018	77.05%	75.73%	75.75%
Unemployment Rate	4.10%	3/31/2018	4.10%	4.40%	6.95%
ISM PMI - Manufacturing	59.30%	3/31/2018	58.20%	59.30%	52.83%
Baltic Dry Index - Shipping	1,055	3/31/2018	1,366	1,356	1,758
Consumer Confidence (Conf. Board)	127.70	3/31/2018	128.60	120.40	77.39
CPI YoY (Headline)	2.36%	3/31/2018	2.11%	2.23%	1.65%
PPI YoY - Producer Prices	3.00%	3/31/2018	4.20%	3.00%	1.71%
US Dollar Total Weighted Index	\$86	3/31/2018	\$87	\$88	\$80
WTI Crude Oil per Barrel	\$65	3/31/2018	\$60	\$52	\$76
Gold Spot per Ounce	\$1,325	3/31/2018	\$1,303	\$1,280	\$1,276

Asset Class Commentary

US Equity

Despite strong returns in January, US equity markets faltered during the final two months of the quarter, delivering mixed results across market cap and style. The S&P 500 Index's return of -0.8% marks the first negative quarter for the index since Q3 2015. Declines were relatively widespread, with nine of eleven sectors producing negative returns.

Small cap stocks outperformed large cap stocks, and growth continued to outperform value. Increased global macroeconomic uncertainty indirectly favored small cap stocks, which tend to be more domestically-focused providing greater insulation from global headwinds. Active management delivered a wide spread of results amidst the volatility, but many growth managers fared the best with higher success rates across the market cap spectrum. Further, active managers with a high quality bias benefitted from the market's increased sensitivity to rising interest rates, which punished companies with higher debt levels.

Technology as a whole performed well during Q1. The S&P 500 Technology Index returned 3.5%, leading all other sectors. Despite a pullback by several FAANG stocks, namely Facebook and Alphabet, the group as a whole produced an average return of 13.2% during Q1, led by Amazon and Netflix. Broad-based positive

performance across the technology sector, buoyed by strong earnings growth and cash flow, generally benefitted active managers with overweight exposure to the space.

Non-US Equity

Developed international markets lagged during the quarter, ending with negative returns and underperforming their domestic counterparts. Growth stocks continued to outperform value stocks, while small cap stocks outperformed large cap stocks, ending the quarter in slightly positive territory. Market movements were affected by headlines related to global trade negotiations, however there were also significant political events within developed international markets. In Germany, after the current ruling party conceded key terms in negotiations, the two leading parties agreed to form a grand coalition under the continued leadership of Angela Merkel. In Italy, the elections in early March resulted in a hung parliament, as no party garnered sufficient support to win a majority. In Japan, Prime Minister Shinzo Abe's approval rating dropped due to a scandal involving tampered documents and preferential treatment for business interests closely tied to the Prime Minister.

Emerging markets were a bright spot for the quarter, outpacing developed markets and ending Q1 in positive territory. Contrary to the rest of the world, value

outperformed growth and small cap stocks underperformed large cap stocks. In China, a 2,958 to 2 vote raised the presidential term limit, opening the way for President Xi Jinping to rule indefinitely. In Russia, President Vladimir Putin won reelection with 77% of the vote. During the quarter, key economic data in emerging markets surprised to the upside, which factored into the decision by the International Money Fund to raise its forecast for global growth.

Fixed Income

Treasury yields increased across all maturities leading to negative returns across rate-sensitive fixed income indices. The Bloomberg Barclays US Aggregate Bond Index posted a loss of -1.5% in Q1. Longer duration bonds were hit hardest with the Bloomberg Barclays US Long Government/Credit Index returning -3.6%.

Investment grade credit spreads widened, ending a nine-quarter streak of spread tightening. High yield bond spreads widened modestly and returned -0.9%, as measured by the Bloomberg Barclays US High Yield Index.

However, not all markets suffered in response to higher rates. For example, the bank loan market posted strong returns due to their floating rate structure. As LIBOR continued its climb, with the 3 month rate up 0.62%, bank loans returned 1.6% for the quarter as measured by the Credit Suisse Leveraged Loan Index.

Global bonds also posted strong returns for the quarter, due in part to a weakening US dollar. One of the best performing sub-asset classes in fixed income was, once again, non-dollar denominated emerging market debt, which returned 4.4% as measured by the JPM GBI-EM Global Diversified Index. In contrast, hard currency and corporate emerging market debt ended the quarter with negative returns after four consecutive quarters of posting positive returns.

Diversified Hedge Funds

The hedge fund industry produced modestly positive returns during the first quarter of 2018 as measured by the HFRI Fund Weighted Composite, though heightened levels of market volatility created significant dispersion across strategies. The Fund of Hedge Fund (“FoHF”) managers RVK follows closely produced returns that ranged between -0.6% and 1.8%. FoHFs that

outperformed benefitted from manager selection within the discretionary macro space, where several managers correctly bet on rising interest rates and produced near double digit returns or higher during the quarter. Managers with significant exposure to systematic macro did not fare as well, as this was the quarter’s worst performing broad based strategy peer group.

Equity Long/Short managers generally provided satisfactory performance relative to global equity markets. The HFRI Equity Hedge Index posted quarterly returns of 0.7%. Managers with low net exposure profiles were particularly resilient during the mid-quarter equity market drawdown, aided by short portfolios that effectively preserved capital. Managers with limited long investment exposure across technology and consumer sectors generally lagged indices during the recovery that followed, though prime brokerage data indicate that hedge fund net exposure to the technology sector remains near all-time highs. Interestingly, the highest level of “crowded” short investments also happens to be in technology and consumer related stocks.

Managers within the multi-strategy space produced negative returns on average according to HFR, but the firms RVK tracks closely were modestly positive during the quarter, producing average returns near 1%. Exposure to merger-arbitrage played a significant role in the success of these firms, as global M&A activity reached a 17 year high and several catalysts led to positive results despite broader equity market sell-offs. Particularly noteworthy for these strategies were the positive returns generated in February, despite global equity market declines.

Global Tactical Asset Allocation (“GTAA”)

GTAA managers provided modestly positive performance and for the most part, tended to outperform traditional asset classes including a static, US-centric portfolio of 60% equity and 40% fixed income. Although performance diverged widely among multi-asset managers, most provided a diversification benefit relative to traditional asset classes during the quarter. Globally-oriented managers that rely on fundamental, value-based investment processes have continued to allocate to various exposures in emerging markets, which they believe to be undervalued. These managers have also observed high valuations across other asset classes. As such, many GTAA managers have held larger than

typical cash allocations, which benefitted their performance during the bond and equity selloffs in February and March. Yield-oriented and US-constrained tactical multi-asset managers provided disappointing performance due, in part, to regulatory rulings on MLP tax structures and exposure to yield-sensitive equity sectors such as REITs, listed infrastructure, and the broader US fixed income market. Risk parity managers faced several concurrent headwinds including rising US yields, declining developed markets equity prices, mixed commodity performance, and short term sensitivity of TIPS to duration. Performance for lower volatility managers, who target an absolute return, diverged widely. Those that lagged were negatively impacted by a declining US dollar amid an increased yield on the 10 Year Treasury, increases in US real yields, and a general increase in risk premia across asset classes globally during the quarter.

Diversified Inflation Strategies (“DIS”)

DIS managers posted weak returns despite increases in market-based measures of future inflation and heightened press attention about the potential for further acceleration of inflationary pressure. Manager performance varied widely due in part to substantial differences in returns for different types of inflation sensitive asset classes. The Bloomberg Commodity Index declined -0.4%, but performance within its subcomponents diverged. For example, the -6.2% return for industrial metals was partially offset by gains of 1.8% and 3.2% in the energy and agriculture subcomponents, respectively. The S&P Global Natural Resources Index, which tracks the performance of natural resources companies, returned -1.6%. During this time, the year-over-year change in Headline CPI increased from 2.11% as of December 31, 2017 to 2.36% as of March 31, 2018. Market expectations of future inflation also increased modestly from 1.98% to 2.06% based on 10 Year Treasury breakevens. Managers with greater exposure to floating rate credit-sensitive fixed income and foreign currency performed toward the top of the peer group. However those with TIPS, REITs, global listed infrastructure, and similar exposures performed toward the bottom of the group. Finally, managers with significant MLP exposure within global listed infrastructure allocations lagged by the widest margins. The Alerian MLP Index declined -11.1% as markets analyzed revisions to the tax treatment for a certain type

of revenue derived from the investment structure.

Real Estate

The Core private real estate index, NCREIF-ODCE, returned 2.2% during Q1, on a preliminary basis, comprised of 1.0% income and 1.2% appreciation. This represented a 0.14% uptick over last quarter’s appreciation component of total return. Investors in publicly traded real estate significantly underperformed their private market counterparts during the quarter as measured by FTSE/NAREIT All REIT’s Index return of -6.7%.

In response to the upward pressure on interest rates, RVK has held numerous discussions with investment managers to gauge how real estate return expectations could be affected. One important observation is that there is a tendency by the media to oversimplify forecasts by relying on the premise that higher interest rates lead to higher borrowing costs, lower property values and higher cap rates. However, the relationship is more complex, and this simplified approach fails to consider several other important factors that can decrease or increase Net Operating Income (“NOI”) or its growth forecasts. For instance, in addition to interest rate levels, NOI and NOI growth are influenced by factors such as lease rollover, rent growth, and real estate supply/demand fundamentals. Cap rate estimates, which are calculated by dividing a property’s NOI by its market value, can be heavily influenced by the failure to consider a full set of market factors.

Historical analysis of the relationship between the NCREIF Property Index (“NPI”) and the US 10 Year Treasury rate shows that, throughout market cycles, cap rates and interest rates do not follow in lockstep. There are multiple periods in prior cycles where real estate valuations held up as rates increased because the overall economic environment supported the Fed’s decision to raise rates. Currently, the Fed contends that modest rate hikes are warranted by strengthening economic fundamentals. While the general consensus is that the real estate recovery has entered its latter stages, it is important to note that the current valuations appear to be supported by the NPI cap rate spread over the 10 Year Treasury yield being near its long-term average, NOI growth across most property sectors and a generally positive economic environment.

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