Summit Strategies Group
8182 Maryland Avenue, 6th Floor
St. Louis, Missouri 63105
314.727.7211

Monthly Economic & Capital Market Update

February 2017

Economic Perspective

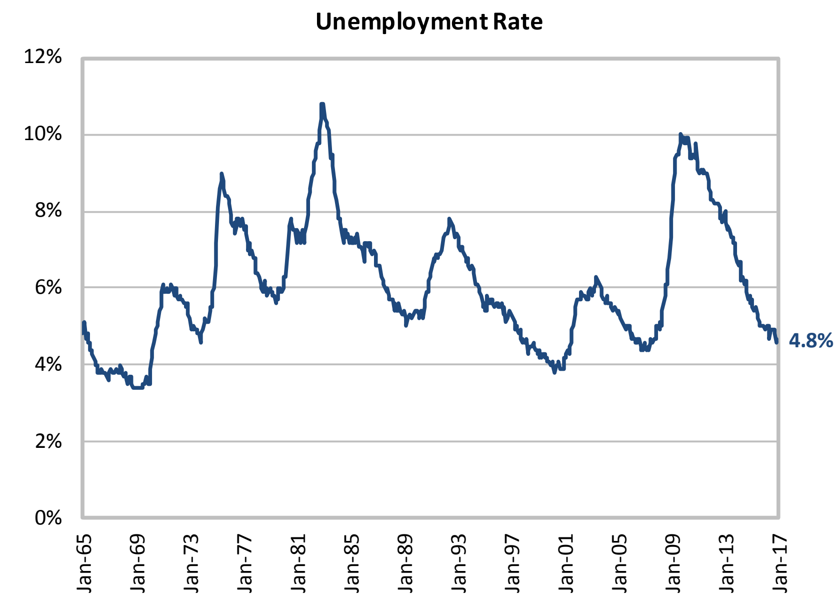
February 28, 2017

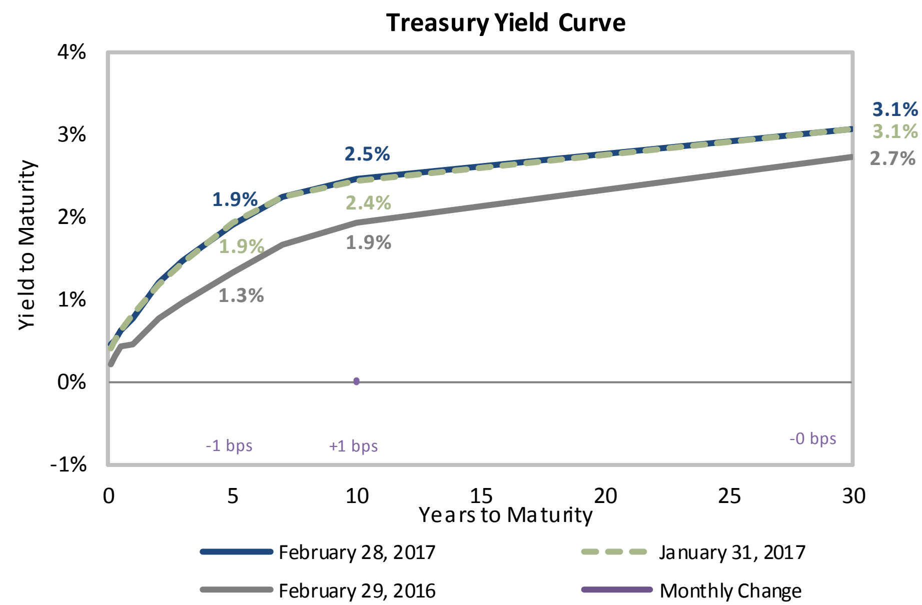
Economy

- February saw continued strong economic surveys and estimates, consistent with the trend that has been in place since November's US election. The increase in expectations has helped propel global equity markets higher on low levels of volatility. During February, President Trump announced the upcoming proposal of a "phenomenal tax plan" focused on cutting individual and corporate tax rates, along with a potential border adjustment tax; however, specifics have yet to emerge. The strong market performance and levels of surveys over the past several months reflect higher expectations for effective policies, which are expected to be implemented over the next several months and years. The Federal Reserve has taken notice of the improvement in optimism and throughout February Fed members became more vocal about raising rates in March. Comments from Fed Chair Yellen suggest the potential for three rate hikes for 2017, and during February market expectations for a March rate hike rose from below 30% to above 80%.
- The US economy experienced positive job growth for the 76th consecutive month in January as employers added 227,000 jobs during the month. The unemployment rate rose slightly to 4.8% from December's 4.7%, and the labor force participation rate was unchanged at 62.9%. Wages, as measured by average hourly earnings of private sector workers, increased 0.1% for the month and 2.5% year-over-year. Payrolls from November and December were revised downward by 39,000 total jobs. Economist expectations for the February employment report are for 190,000 new payrolls and for the unemployment rate to decline 10 bps to 4.7%.
- Real GDP grew at a 1.9% annual rate during the fourth quarter, according to the second estimate released by the Bureau of Economic Analysis. The 1.9% GDP growth overall for the US economy in 2016 matches 2015's growth rate and remains well below historical levels. The fourth quarter figure, which remained stable from the first estimate earlier this year, reflected lower exports and government spending than the previous quarter.
- February marked the 86th consecutive month of expansion in the US services sector. The ISM non-manufacturing Purchasing Managers Index (PMI) came in at 57.6, slightly above December's record high of 57.2. Any reading over 50.0 indicates expansion in the services sector.

Yield Curve

- The spread between 2-year and 30-year Treasuries contracted 13 bps to 173 bps in February. Over the past 30 years, the spread between 2-year and 30-year Treasuries has averaged 167 bps.





Growth Assets

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Public Equities

- In February, global equity markets extended their 2017 gains. The S&P 500 earned 4.0% for the month and the Russell 2000 gained 1.9%. Both international large and small cap equities performed well, with the MSCI EAFE and MSCI EAFE Small Cap Indices gaining 1.4% and 2.2%, respectively. Emerging markets also posted positive performance, gaining 3.1% for the month.
- Master limited partnerships (MLPs) returned 0.4% in February. MLPs saw negative returns across almost all sectors, with the exception of general partners (4.0%), gathering and processing (3.6%), and crude oil pipelines (0.5%). Major detractors of performance included downstream (-5.3%) and energy services (-3.9%). MLPs have gained 5.3% year-to-date, with gathering and processing the best performers at 9.3%.

Public Debt

- The Bloomberg Barclays High Yield Index returned 1.5% for the month of February, with spreads tightening 25 bps from January. Spreads at 363 bps are low relative to historical levels, with a 20-year median of 510 bps for the Index.
- Local currency-denominated emerging market debt returned 1.8% during February, making it the best-performing fixed income asset class for the month.

Private Equity

- The private equity environment proved to be robust in 2016, with over 800 funds closing globally for a total of $345 billion. This marks the fourth consecutive year of fundraising totals exceeding $300 billion, which remains below the nearly $400 billion raised in both 2007 and 2008. Purchase price multiples for larger deals, as measured by S&P Leveraged Commentary and Data (S&P LCD), remained steady from 2015, while multiples in the middle market declined by 10%. Manager sentiment suggests that the lower multiples in the middle market demonstrate that managers remain disciplined on pricing, resulting in fewer deals being completed.

Private Debt

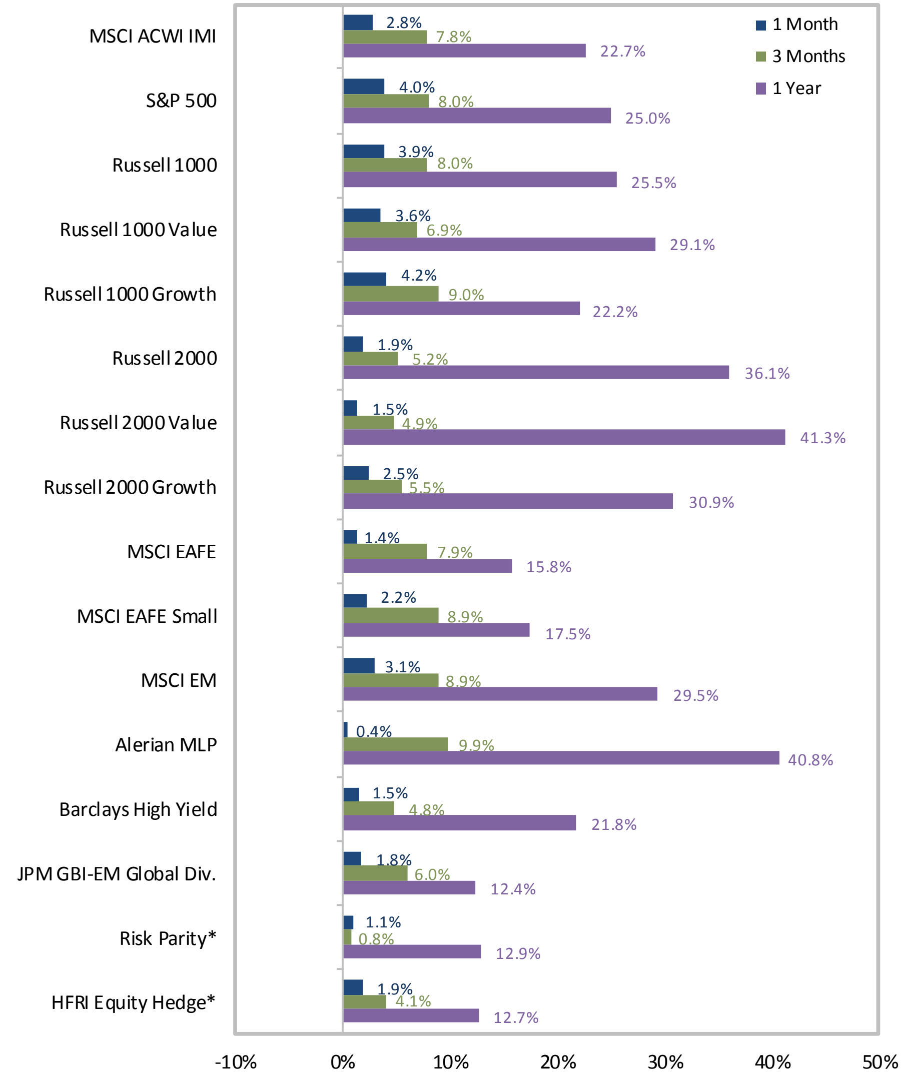
- In 2016, private debt saw 119 funds close for a combined total of $74 billion, below the 2015 value of $96 billion. According to Preqin, 2016 had the lowest number of fund closures since 2013, as the pace of fundraising slowed to an average of 20 months, up from a 16-month average in 2015. Fundraising pace has slowed as capital is becoming increasingly concentrated among a small group of fund managers.

Risk Parity

- Risk parity strategies gained in January, with equities driving returns. Commodity allocations also contributed while nominal bonds detracted.

Growth Hedge Funds

- Growth hedge funds performed well in January. Equity long/short funds led returns as equity markets gained for the quarter. Event-driven strategies also contributed, with distressed strategies contributing strongly.



* Data was not available at time of publication – returns are previous month's.
Note: Risk Parity returns are based on an internally comprised benchmark.
All returns are USD.

Public Debt

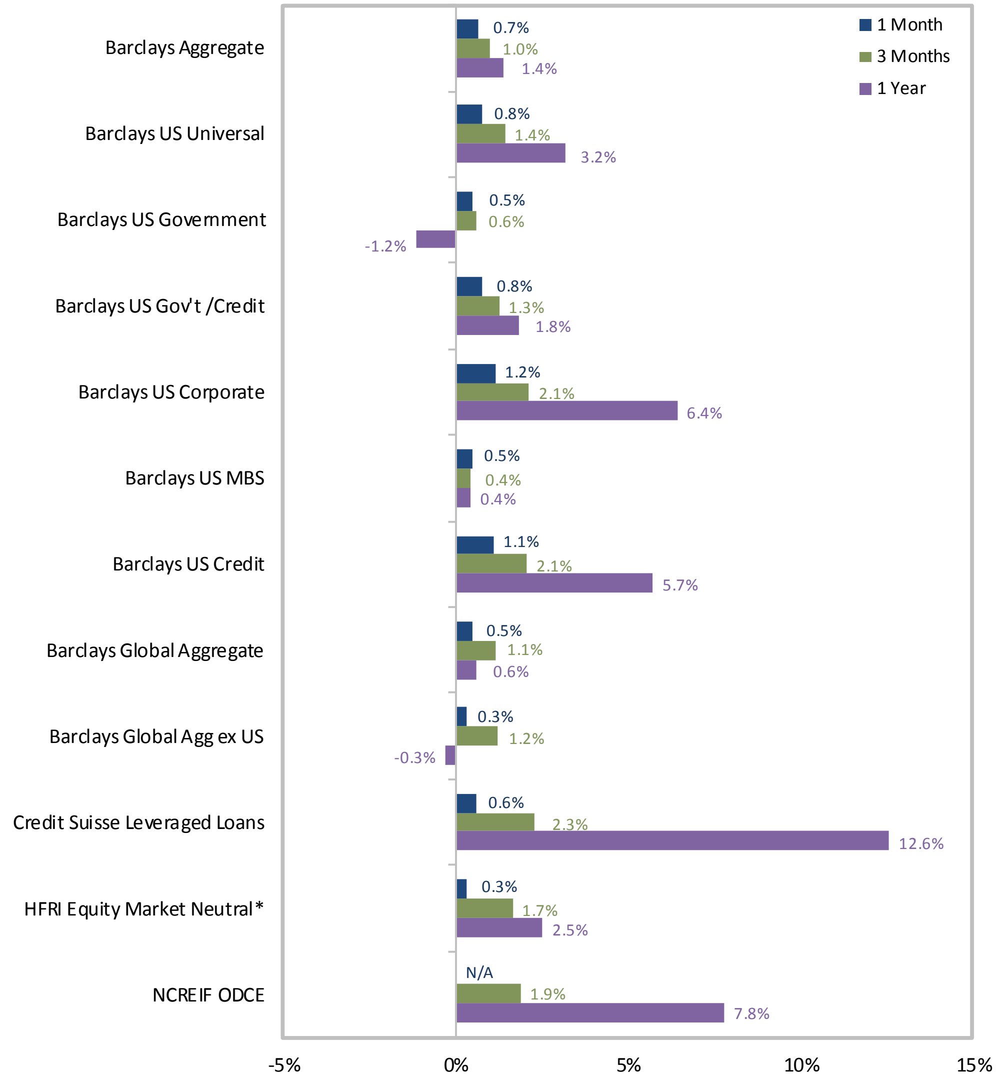
- The 10-year US Treasury yield traded within a 20-bp band during the month before ending February at 2.4%, mostly unchanged from the end of January.
- After the spread volatility observed at the end of 2016, February was a relatively calm month for core fixed income; option-adjusted spreads tightened one basis point during the month.
- International bonds posted a return of 0.3% during February, with gains on principal and interest of 0.9% overwhelming a 0.6% loss on currency.
- Bank loans returned 0.6% during the month of February, which is consistent with coupon-like returns. Gross issuance of loans are on record pace to start the year, totaling $220B in January and February compared to $22B for the same period in 2016.

Relative Value Hedge Funds

- Relative value hedge funds posted gains across strategies in January. Credit-related strategies were the strongest contributors, while volatility arbitrage and equity market neutral strategies also contributed.

Core Real Estate

- The fourth quarter return for the NCREIF ODCE Index was 2.1% gross and 1.8% net, with the majority of gains coming from income rather than price appreciation. Continued progress in the labor market and economic recovery have acted as a tailwind for real estate performance, with the asset class turning in a strong gain of 7.7% in 2016. As capitalization rates have decreased in recent years, so have core real estate returns; 2016's return was the lowest since 2009 for the asset class.



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Diversification Assets

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Inflation

- Inflation expectations remained relatively stable during February, ending the month with 10-year breakeven inflation expectations slightly above 2.0%.

Deflation

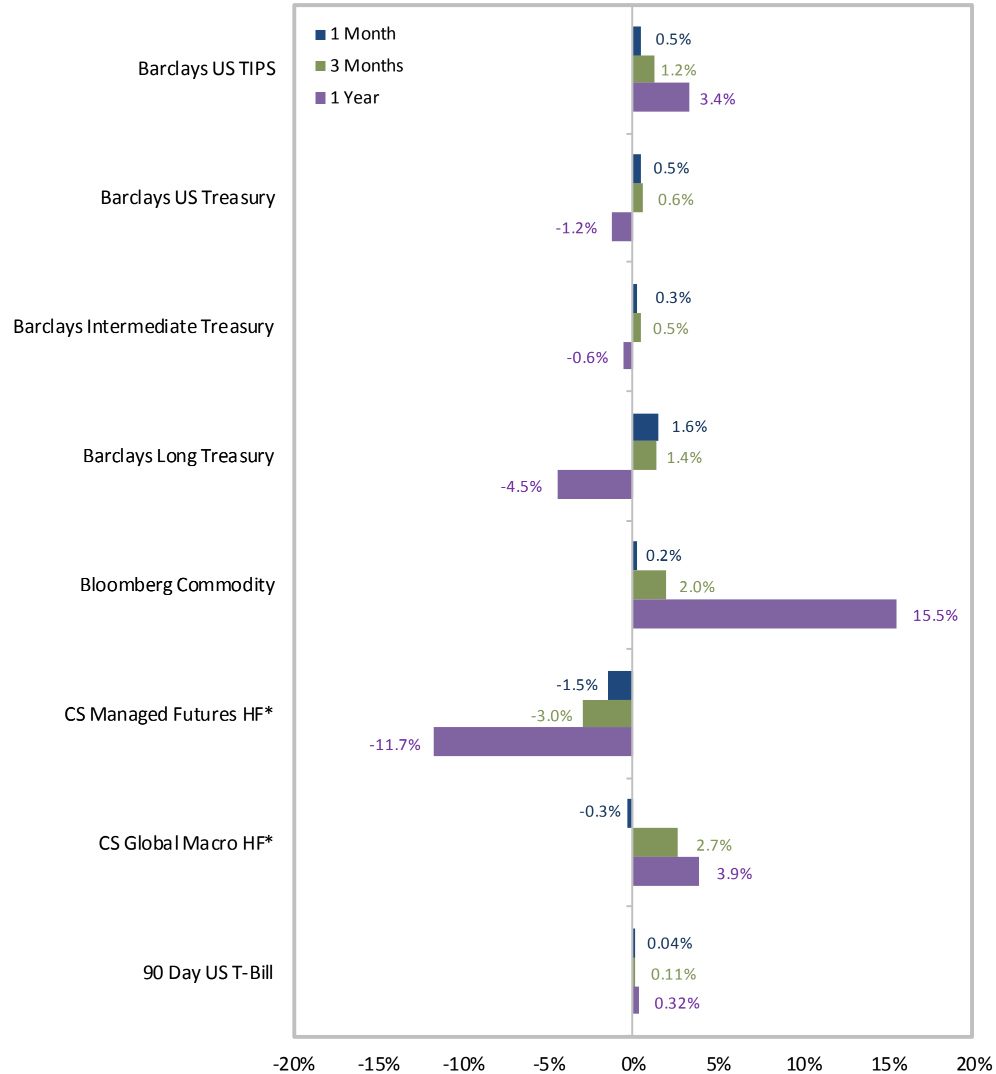
- The Bloomberg Barclays Long Treasury Index returned 1.6% for the month, 131 bps of which can be attributed to price return and the remaining to coupon payments.
- Cash continues to offer no relative return, as 90-day T-bills gained 4 bps during February and 0.3% over the past year.

Commodities

- The Bloomberg Commodity Index returned 0.2% for the month of February. Industrial metals generated positive returns while agriculture experienced modest declines. The largest detractor from overall performance was energy, with natural gas declining 11.0% for the month as inventories continue to swell. Nickel and live cattle produced the highest returns of 10.4% and 9.5%, respectively. Year-to-date, the index remains positive at 2.2% with natural gas and WTI Crude as the largest contributors to performance.

Tactical Trading

- Tactical trading hedge funds detracted in January. Both managed futures and discretionary global macro strategies detracted.



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