

Late Cycle vs. End Cycle Investing

INSIGHTS FOR AN AGING EXPANSION

As the economic expansion aged and volatility increased throughout 2018, consensus shifted from viewing the U.S. expansion as likely to continue for the foreseeable future to believing that we are in the late stages. We believe we are late cycle, not end cycle, and our key view is that one should continue to be invested, but judiciously prefer securities that are higher in quality and liquidity across asset classes.

Here is how we are positioning asset allocation portfolios in light of our outlook for the global economy and markets.



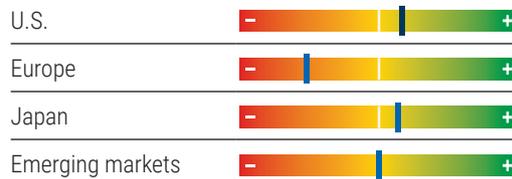
OVERALL RISK

Given broadly slowing growth, lower levels of monetary policy support and generally higher levels of volatility, we are maintaining overall risk close to our benchmark, but building liquidity to take advantage of tactical buying opportunities.

POSITIONING



EQUITIES

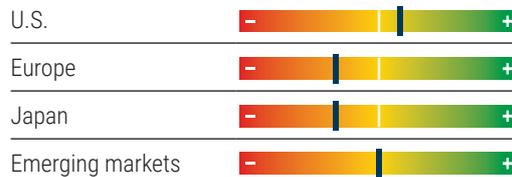


OPPORTUNITIES

We expect volatility and slowing profit growth to continue to impact investor appetite for equities in 2019. Therefore, we have a modest underweight to equities with an emphasis on liquidity and high quality, defensive sectors. We favor large caps over small caps, U.S. equities over European equities and are modestly overweight Japanese equities given positive earnings, low leverage and still supportive Bank of Japan.



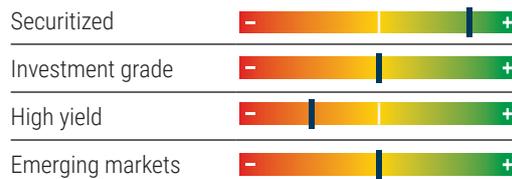
RATES



We prefer high quality duration as we move toward the later part of the cycle as we still believe that fixed income offers an attractive diversifier for risk in portfolios. However, we are selective in our exposures. We find U.S. rates the most attractive in developed markets. Beyond the U.S., we find UK gilts and Japanese government bonds rich, and we believe valuations of eurozone peripheral bonds are suspect without continued ECB support.



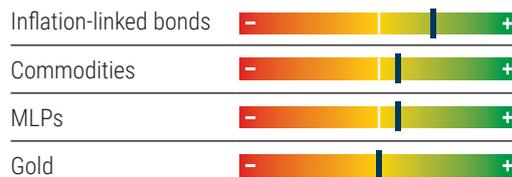
CREDIT



Given our late-cycle view, we expect corporate credit will underperform over the coming year. Within corporate credit, we prefer shorter-dated bonds from high quality issuers, especially in defensive and noncyclical sectors, which is in keeping with our quality and liquidity theme. The high yield underweight reflects in particular the glut of low quality leveraged loan issuance. We continue to favor non-agency mortgage-backed securities (MBS) as they remain a relatively stable high quality alternative to corporate credit. We are also keeping dry powder in order to pursue targeted opportunities which we think offer attractive risk/reward characteristics.



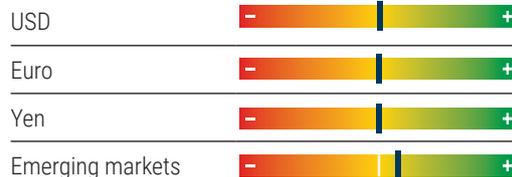
REAL ASSETS



Historically, real assets tend to perform well in late-cycle environments; however, that relationship has become less stable in recent periods. That said, we still view real assets as an effective tail risk hedge against rising inflation as well as a portfolio diversifier, and we therefore maintain a modest allocation to what we feel are attractively valued opportunities, including TIPS and MLPs which should benefit from U.S. production growth.



CURRENCIES



We have a nuanced view on currencies, and expect more significant alpha opportunities to emerge outside of the majors. We are currently close to neutral in U.S. dollars (USD) versus the other majors, and will pursue idiosyncratic opportunities in emerging markets as they unfold. We expect downward pressures on the Chinese yuan (CNY) to persist, and therefore also maintain Asian currency shorts versus the USD.

Past performance is not a guarantee or a reliable indicator of future results.

All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Current reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Sovereign securities** are generally backed by the issuing government. Obligations of U.S. government agencies and authorities are supported by varying degrees, but are generally not backed by the full faith of the U.S. government. Portfolios that invest in such securities are not guaranteed and will fluctuate in value. **Inflation-linked bonds (ILBs)** issued by a government are fixed income securities whose principal value is periodically adjusted according to the rate of inflation; ILBs decline in value when real interest rates rise. **Treasury Inflation-Protected Securities (TIPS)** are ILBs issued by the U.S. government. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. Investing in **foreign-denominated and/or -domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Currency rates** may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. **Commodities** contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors. Investing in **MLPs** involves risks that differ from equities, including limited control and limited rights to vote on matters affecting the partnership. MLPs are a partnership organized in the US and are subject to certain tax risks. Conflicts of interest may arise amongst common unit holders, subordinated unit holders and the general partner or managing member. MLPs may be affected by macro-economic and other factors affecting the stock market in general, expectations of interest rates, investor sentiment towards MLPs or the energy sector, changes in a particular issuer's financial condition, or unfavorable or unanticipated poor performance of a particular issuer. MLP cash distributions are not guaranteed and depend on each partnership's ability to generate adequate cash flow. **Mortgage- and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and while generally supported by a government, government-agency or private guarantor, there is no assurance that the guarantor will meet its obligations. The **credit quality** of a particular security or group of securities does not ensure the stability or safety of the overall portfolio. **Diversification** does not ensure against loss.

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