PATHSTONE
FEDERAL STREET

MARKET FLASH REPORT

Q4 2017 Review

January 2018

KEY TAKEAWAYS

- The past twelve months were historic for the S&P 500 Index, marking the first calendar year since 1926 when every month experienced a positive total return. In fact, there has not been a negative monthly total return since October 2016.
- The Federal Reserve increased short-term rates at their December meeting (the range for the Fed Funds rate is now between 1.25% - 1.5%), a move highly anticipated by investors. This marks the fifth increase in the past two years. At the same meeting, Fed officials also increased their GDP expectations for the coming years.
- President Trump signed off on the Tax Cuts and Jobs Act, passing the tax reform promised during his presidential campaign. Two key changes from a corporate standpoint are lower tax rates for corporations (from 35% to 21%) and a one-time tax on the repatriation of overseas earnings. Lawmakers are hopeful the reform will provide a boost to investment spending and increase wages for workers. The reform should provide a modest tailwind to corporate profits. However, since the financial crisis, corporations have shown a preference for dividends and share buybacks rather than reinvesting profits back into their businesses.
- International equities had strong returns in 2017 as well with U.S. investors benefitting from a weakening dollar. The rebounding global economy is expected to continue to strengthen into 2018 with synchronized growth across all regions. International and Emerging Market equities remain more attractively valued compared to their U.S. counterparts.

INDEX PERFORMANCE (as of 12/31/17)

Equity	Quarter	One-Year	Three-Year
U.S. Large Cap	6.6%	21.8%	11.4%
U.S. Small Cap	3.3%	14.6%	10.0%
Developed Non-U.S.	4.2%	25.0%	7.8%
Emerging Market	7.4%	37.3%	9.1%
Real Assets			
Real Estate	3.8%	16.2%	6.8%
Commodities	4.7%	1.7%	-5.0%
Natural Resource Equities	5.9%	1.2%	0.1%
Fixed Income			
Core Plus			
U.S. High Yield Debt	0.5%	7.5%	6.4%
Emerging Market Debt	0.8%	15.2%	2.5%
Core Bonds			
U.S. Aggregate Bonds	0.4%	3.5%	2.2%
U.S. Treasuries	0.1%	2.3%	1.4%
U.S. Municipal Bonds	-0.2%	3.5%	1.9%

Month-End Values/Yields	Current	Prior Month	One-Year Ago
CBOE Volatility Index	11.0	11.3	14.0
10-Year Treasury Yield	2.4%	2.4%	2.4%

NEW JERSEY
201-944-PATH (7284)

MASSACHUSETTS
617-350-8999

FLORIDA
239-214-7931

GEORGIA
404-592-0180

WASHINGTON D.C.
301-998-0300

CALIFORNIA
310-734-5320

OREGON
503-228-3941

www.Pathstone.com

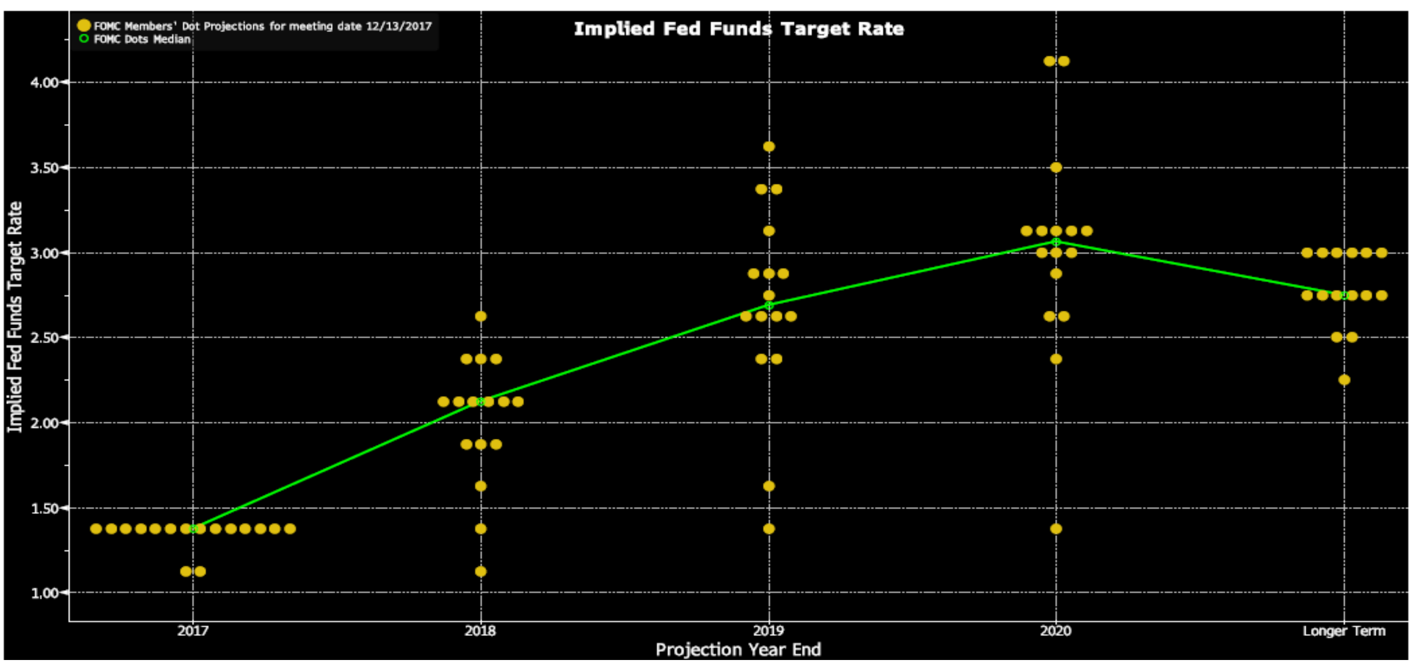
Sources: Bloomberg, Morningstar

You cannot invest directly in an index; therefore, performance returns do not reflect any management fees. Returns of the indices include the reinvestment of all dividends and income, as reported by the commercial databases involved.

Global Central Bank Update

- December was a busy month for major central banks, including the U.S. Federal Reserve (Fed), Bank of England (BOE), and the European Central Bank (ECB). Local economies have continued to improve and central banks have increased their GDP projections for the coming years.
- The Fed raised rates to a range of 1.25% - 1.5%. The BOE maintained rates at 0.50%. The ECB, which seems years behind the U.S. in its monetary policy program, elected to keep its main refinancing rate unchanged at 0%. In a recent press release, the ECB confirmed plans to keep rates low for an extended period of time or as they put it "well past the horizon of our net asset purchases" in an effort to get inflation rates up.
- The Fed's dot plot has shifted, suggesting three rate hikes in 2018, compared to four previously anticipated. Continued growth in economic activity and a strong labor market is expected to persist within the U.S. Inflation should move closer to its 2% target rate over the medium term.
- England is one of the few countries with an inflation rate above their 2% target, as it currently sits at 3.1%, but is expected to fade back to 2% within the next three years. The heightened inflation rate is largely due to depreciation of the Pound Sterling. The BOE, unlike the other central banks, is trying to balance the inflation rate and economic activity which they foresee will be highly influenced by the BREXIT proceedings.
- The ECB is continuing to buy €30 billion of bonds per month, at least through September of 2018, and has left the door open for further purchases beyond that if need be.
- Given the continued support and patience of central banks around the world, it is no surprise that we have seen such tremendously stable and strong equity market performance in recent years. Investors hope to see much of the same in 2018, given the improving global economic conditions coupled with fiscal and regulatory reforms that are seen as additional tailwinds.

US Federal Reserve Dot Plot (as of 12/13/2017)



Sources: Bloomberg

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U.S. Large Cap Equity is represented by the S&P 500 Index, with dividends reinvested. U.S. Small Cap Equity is represented by the Russell 2000 Index. Developed Non-U.S. Equity is represented by the MSCI EAFE Index. Emerging Market Equity is represented by the MSCI EM Index. Real Estate is represented by the S&P Global Property Index. Commodities are represented by the DJ UBS Commodity Index. Natural Resource Equities are represented by the S&P North American Natural Resources Index. U.S. High Yield Debt is represented by the Bloomberg Barclays U.S. Corporate High Yield Index. Emerging Market Debt is represented by the JPM GMI-EM Global Diversified Index. U.S. Aggregate Bonds is represented by the Bloomberg Barclays U.S. Aggregate Bond Index. U.S. Treasuries is represented by the Bloomberg Barclays U.S. Treasury Index. U.S. Municipal Bonds is represented by the Bloomberg Barclays Municipal 1-10yr Index.