MARKET
NOTES

Week of July 3, 2017

Market Volatility Shows its Face Again as Quarter Ends

The U.S. economy during the first quarter of 2017 grew at a faster pace than initially reported, according to data released last week. U.S. GDP increased at a 1.4% annual rate (versus the 1.2% rate reported in May) due in large part to stronger consumer spending. Although that growth rate was low relative to several recent quarters, it beat analysts' expectations.

In the U.S., equities posted small losses for the week as faltering tech stocks pulled down the market. The technology sector once again came under pressure on investors' continued worries about tech stocks' valuations in the wake of their run-up earlier this year.

Additionally, last Tuesday's decision by the Senate to postpone the vote on its controversial healthcare bill had some investors worried about the prospect of tax reform happening this year. They argue there may not be enough time to pass tax reform, given Congress' late summer vacation followed by debt ceiling issues to address near Labor Day.

After impressive results from the Fed's annual "stress test" on some of the nation's largest banks, many of those banks immediately announced aggressive share buybacks and dividend increases for shareholders. Those announcements helped bank shares rally.

In the fixed-income markets, global interest rates rose after the European Central Bank president suggested that European economic strength could prompt the ECB to start winding down its fiscal stimulus policies. Likewise, the head of the Bank of England indicated that the BOE may raise rates in the coming months if the UK economy continued to strengthen.

Those statements, coupled with a Fed that has already started raising rates, prompted investors to sell bonds—pushing down their prices and boosting their yields. Longer-duration securities that are most sensitive to changes in interest rates suffered the worst returns. In addition, the euro rose sharply against the U.S. dollar in the wake of the statements.

GAIN: Active Asset Allocation

As U.S. markets faltered toward the end of last week on tech stock losses, it's important to

continued on next page >

keep in mind that the Gain portfolios are globally diversified. Throughout the year, we have gradually increased the portfolios' international allocation, which recently stood at nearly 50% of assets. Direct Eurozone exposure benefited relative performance last week, as developed international markets were bolstered by signs of continued strength in European economies.

In contrast, our positions in growth stocks and the technology sector were drags on performance.

The fixed-income portions of the portfolios maintained their diversified exposure to corporate credits such as high-yield bonds and preferred stocks. That approach was beneficial, as the spike in rates last week put pressure on broad-based fixed income markets.

PROTECT: Risk Assist

Market volatility, which was historically low during most of the quarter, spiked toward the end of last week. The CBOE Volatility Index (VIX) surged more than 30% intra-day late Thursday to its highest levels since mid-May. That said, the VIX remains well below its long-term average.

Possible reasons for the sharp rise in volatility may include end-of-quarter moves by money managers attempting to protect profits and lock in on-paper gains generated during the second quarter. In addition, the European Central Bank president's comments earlier in the week caused volatility in global spreads, while the Senate's postponed vote on its health care bill increased the risk that tax reform efforts will be further delayed.

The Risk Assist portfolios remain fully invested and globally diversified, similar to the positioning of the Gain portfolios. With volatility generally at historically low levels lately, Risk Assist is calibrated to allow for some short-term price fluctuations before hedging. By staying out of the way of short-term bursts in volatility, Risk Assist attempts to add value by seeking to reduce the overall cost of hedging.

SPEND: Real Spend

As the second quarter ended, all Real Spend models were set to be rebalanced due to positive performance.

Our equity-centric approach to retirement income (coupled with our research-based belief that many retirees should maintain a significant allocation to equities) is a view that looks to have increasing traction in the investment community. According to a 2017 Morningstar survey paper on target-date funds:

- The amount of equity exposure is the largest determinant of relative performance in these funds.
- Mid-career investors in target-date funds have seen the greatest rise in equity exposure and,

continued on next page >

on average, equity exposure in these funds has increased over the past five years.

- Among the top 10 target-date fund companies by assets under management, the average equity exposure for 2060 funds is 87% and the average equity exposure for 2020 funds is 50%.

Morningstar Inc, "2017 Target-Date Fund Landscape"