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5 Themes for 2017

5 Themes Heading Into 2017

Pro-Growth Agenda

President-Elect Trump aims to increase U.S. economic growth, and has embraced such policies as cutting corporate and personal taxes, increasing infrastructure spending, and supporting some deregulation in various industries. We believe some of these policies have good chances of being enacted and have the potential to accelerate economic growth, but also potentially cause an acceleration in inflation.

Keep an Eye on Inflation

Persistent accommodative fiscal and monetary policy has resulted in more debt and an economy running at near full employment, which has the potential to push wages higher and cause higher inflation. If protectionist policies related to trade are in fact pursued by the new Administration, inflation will become more likely. It is reasonable to believe the Federal Open Markets Committee (FOMC) will not allow prices to rise too quickly but a prudent eye on inflation is warranted.

Beware of the Macro

The coming year has the potential to be ripe for additional macro events impacting financial markets. The recent populist moves such as BREXIT and the Italian referendum have the potential to continue with Angela Merkel's bid for reelection in Germany's upcoming election slated for as early as August 2017. Failure to reelect her will deal a considerable blow to the European Union if populism triumphs in the E.U.'s main growth engine.

Bond Volatility Ahead

Since the Federal Reserve pursues a dual mandate of both full employment and stable inflation, higher inflation has the potential to compel the FOMC to raise rates in 2017 to address this dual mandate. Rising treasury yields will cause short-term pain for bond prices, but our historical analysis shows that higher yields have historically more than offset the initial price declines in periods of rising interest rates.

Emerging Markets

We continue to have high conviction in the long term prospects of emerging markets equities given current attractive valuations. A cyclically adjusted earnings yield of approximately 9.0% is very attractive when compared to approximately 6.4% for International Developed equities and approximatively 4.4% for U.S. equities.

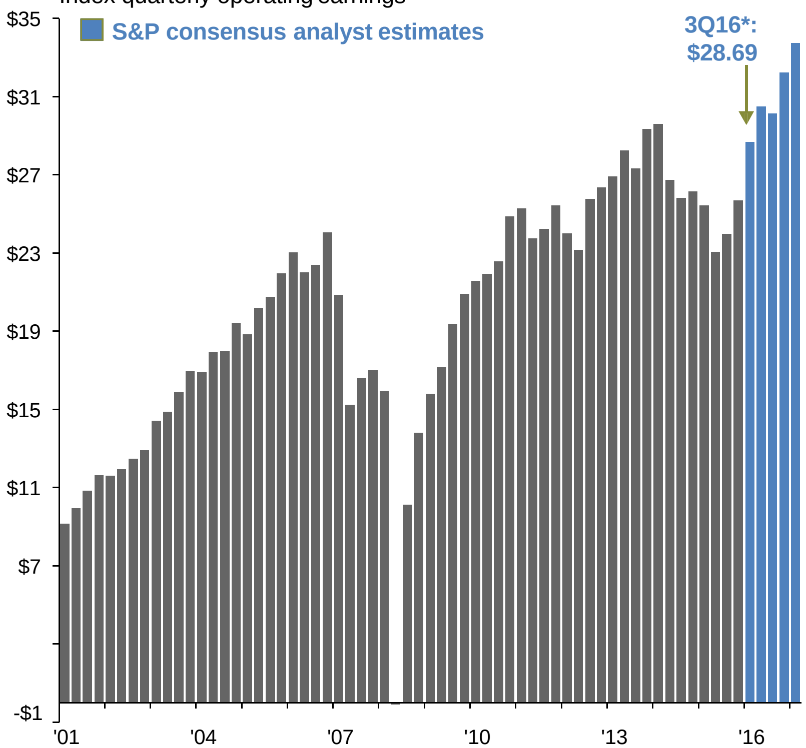
Pro-Growth Agenda

Portfolio Impact

As a result our 2017 assumptions for equities have risen. Despite a slightly rosier picture than last year for domestic and developed international equities we think it is worth noting as of March of this year we will be 8 years into a bull market. That will be the third longest bull market run since 1900. Our positive outlook is tampered by the fact that we think the easy money has already been made and we remain vigilant about the risks we seen in portfolios today.

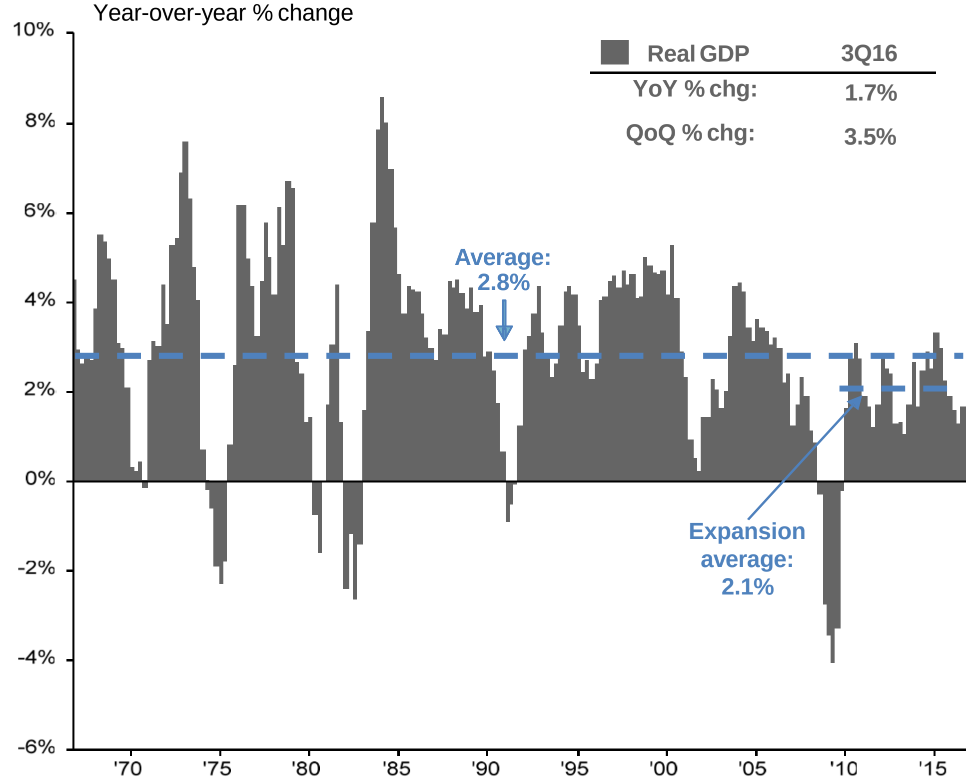
S&P 500 earnings per share

Index quarterly operating earnings



Real GDP

Year-over-year % change



Source: BEA, Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management

*3Q16 earnings are calculated using actual earnings for 98.6% of S&P 500 market cap and earnings estimates for the remaining companies.

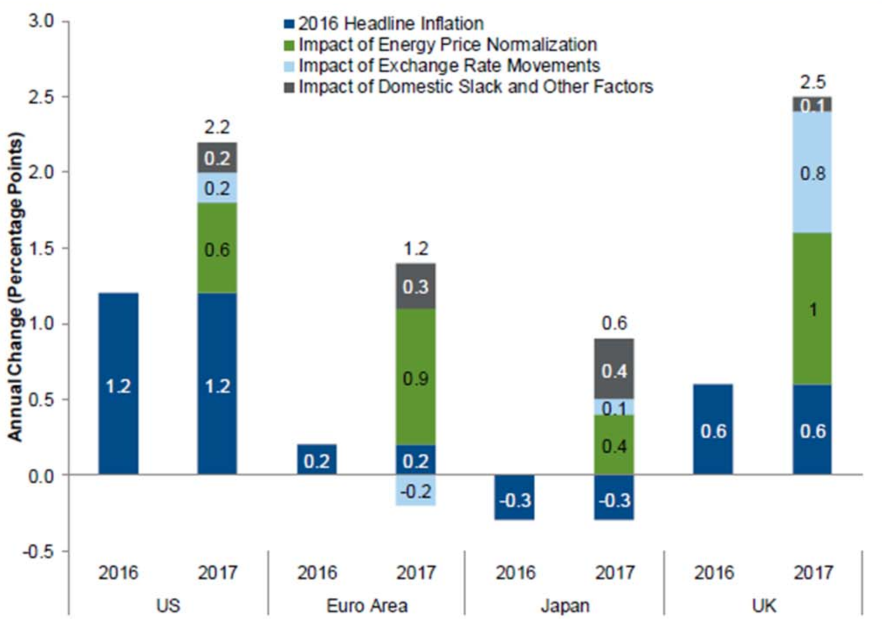
See disclosures at the end of this document for information on indexes used for asset class, sector and country returns referenced.

Keep an Eye on Inflation

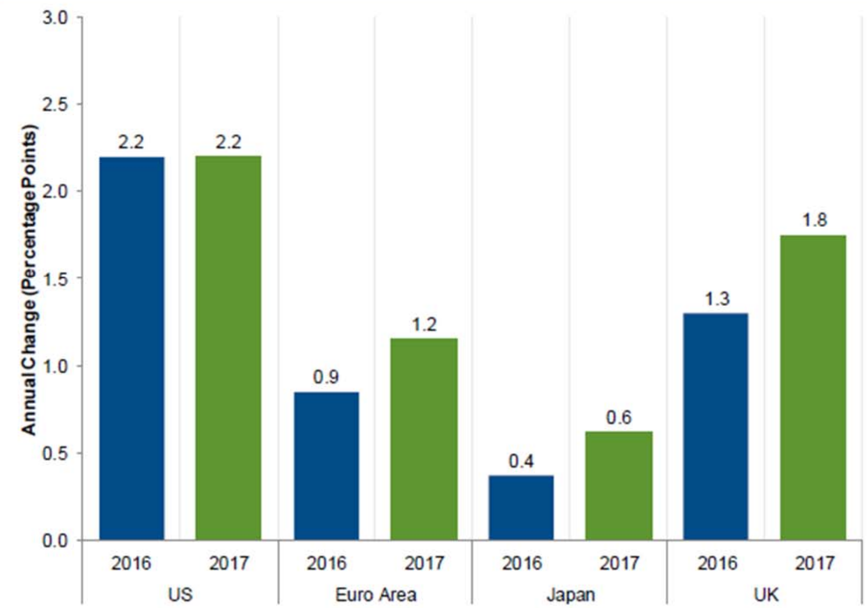
Portfolio Impact

Our inflation assumption has increased as a result and has impacted our allocations accordingly. Assets respond differently to inflation; some poorly, others favorably. In anticipation of the potential for inflation we are favoring assets with the ability to fight-off rising inflation (such as Real Assets).

1. Headline CPI Inflation (%YoY)[1]



2. Core CPI Inflation (%YoY)[1,2]



(1) 2016 figures include data up to November. 2017 figures represent the mid-point of ISG forecast ranges.
(2) Core inflation excludes food and energy.
Source: Investment Strategy Group, Datastream, Goldman Sachs Investment Strategy Group

Beware the Macro

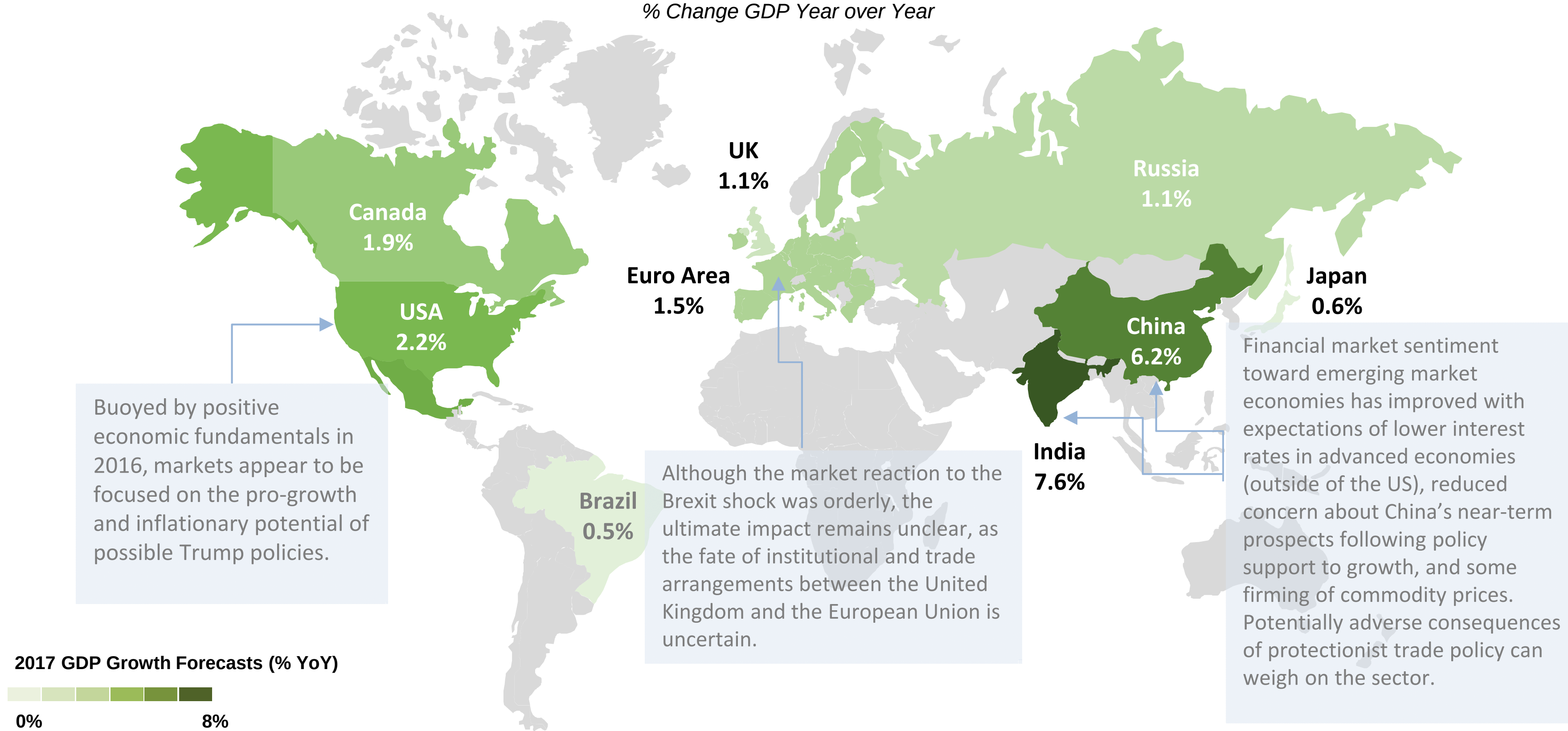
Beware the Macro

Portfolio Impact

Vigilance in diversification will be important to weather any storm that comes from these unpredictable events. We think it is a losing bet to invest based on the potential of election results. Selecting the outcome of the election is just as difficult as then subsequently judging the resulting reaction from the markets. A thoughtfully diversified portfolio helps remove the emotion from these events and is just as important now as it has ever been.

2017 IMF World Economic Outlook Projections

% Change GDP Year over Year



Source: IMF 2017 World Economic Outlook Projections, PIMCO 2017 Economic Outlook

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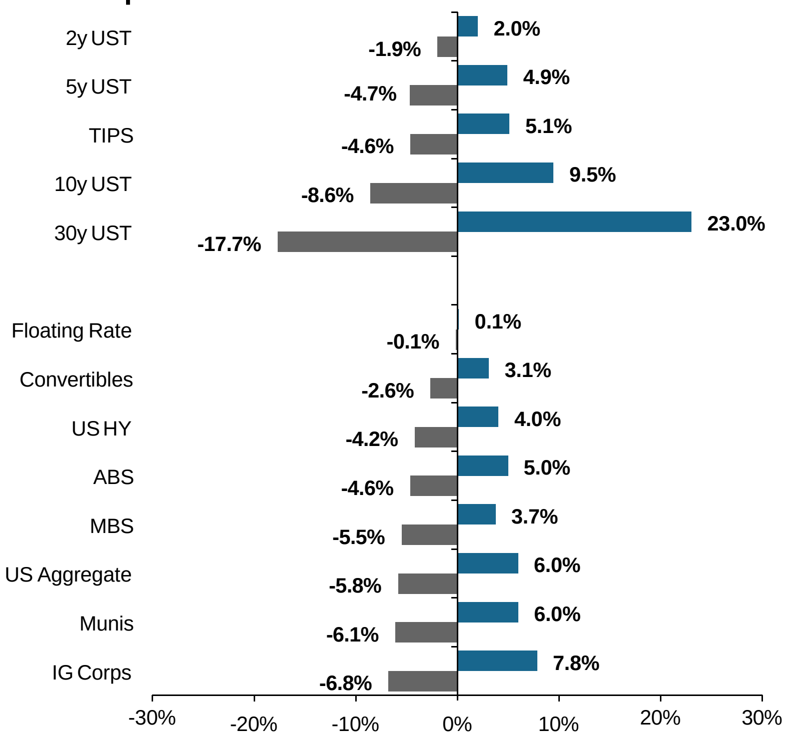
Bond Volatility Ahead

Portfolio Impact

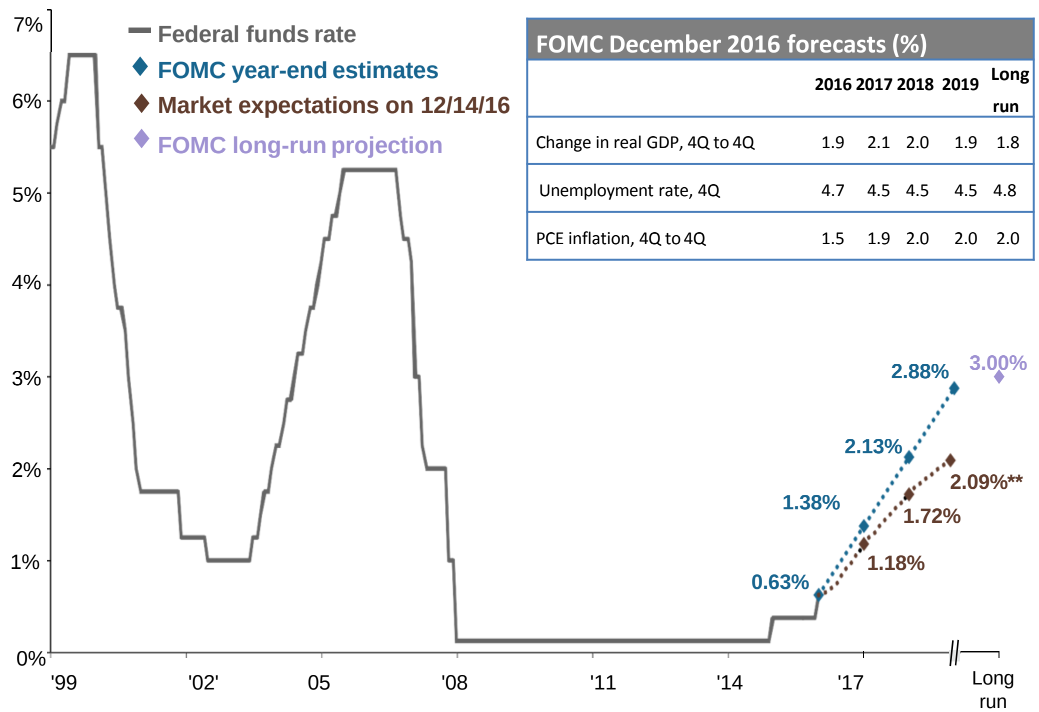
All else equal, rising rates produce higher yields for bonds. Higher yields over the longer-term mean higher returns for investors. The downside to higher yields is lower prices in the short-term. The likelihood of the FOMC raising rates and the potential for the unwinding of nearly $1 trillion that has gone into bond funds since the Financial Crisis paints a backdrop for more volatility in the bond market. Rising rates do not spell disaster for bonds, but it is a word of caution for those current owners of bonds, or those looking to add capital, that patience will be required. We continue to see value in bonds that offer credit exposure rather than just government bonds.

Price impact of a 1% rise/fall in interest rates



Federal funds rate expectations

FOMC and market expectations for the fed funds rate



FOMC December 2016 forecasts (%)	2016	2017	2018	2019	Long run
Change in real GDP, 4Q to 4Q	1.9	2.1	2.0	1.9	1.8
Unemployment rate, 4Q	4.7	4.5	4.5	4.5	4.8
PCE inflation, 4Q to 4Q	1.5	1.9	2.0	2.0	2.0

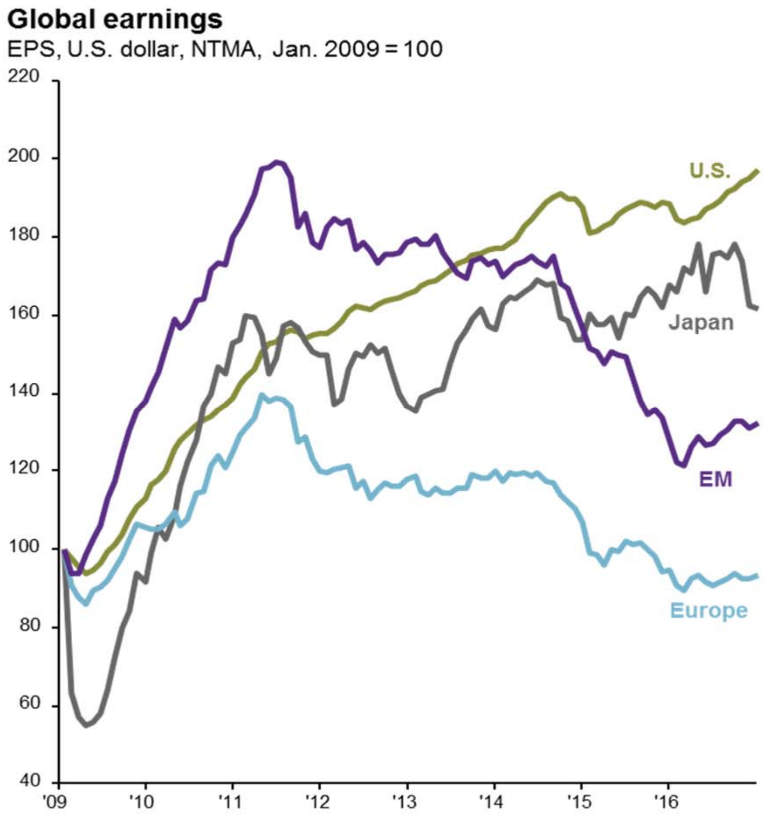
Source: FactSet, Federal Reserve

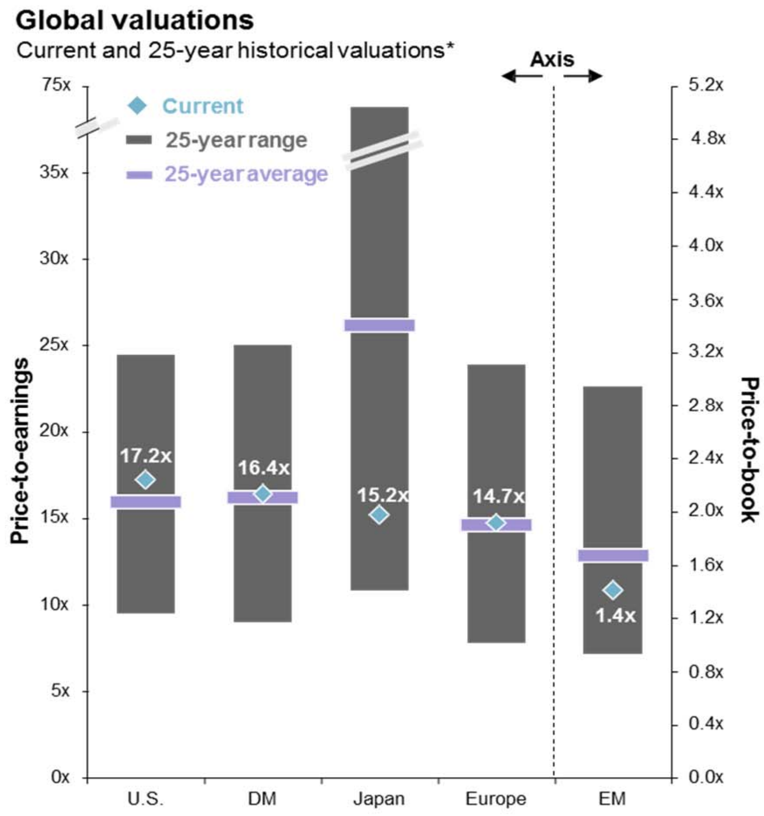
Note: Change in bond price is calculated using both duration and convexity according to the following formula: New Price = (Price + (Price * -Duration * Change in Interest Rates))+(0.5 * Price * Convexity * (Change in Interest Rates)^2). Chart is for illustrative purposes only.

Emerging Markets

Portfolio Impact

With a slight reduction in expectations comes a slight reduction in allocations; however, on an absolute basis we remain overweight to Emerging Markets relative to market weights mainly due to attractive relative valuations.

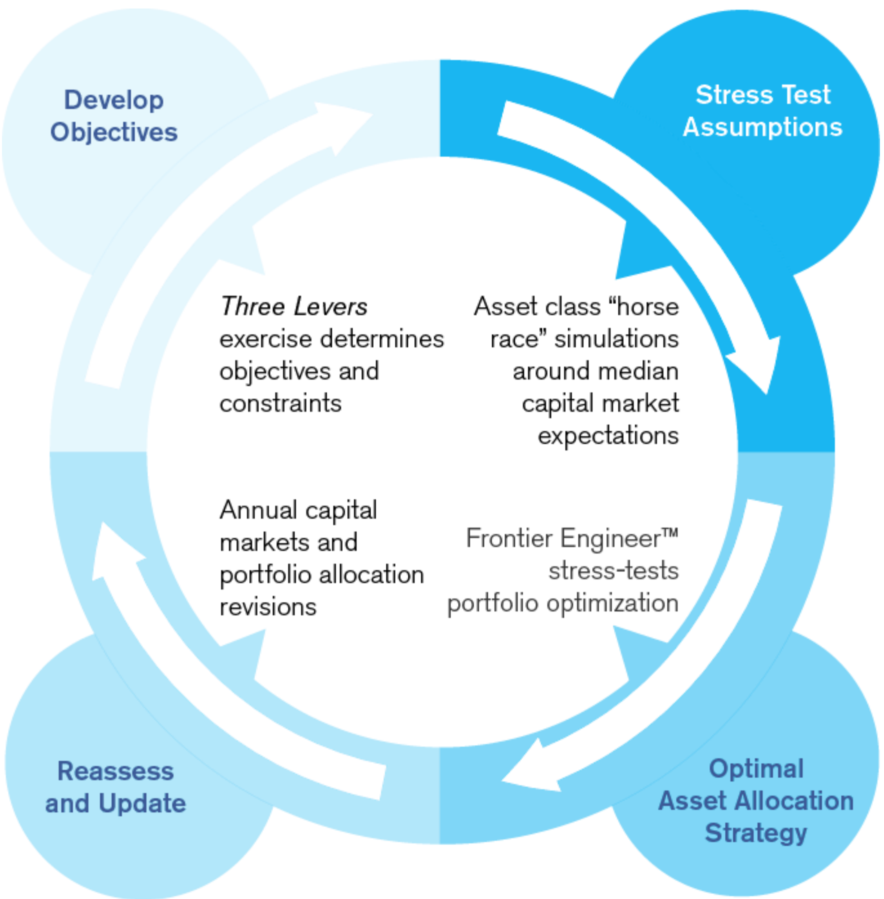




Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management

Themes for 2017 = Frontier Engineer Updates

Our allocation methodology, The Frontier Engineer^{TM}, constructs portfolios already considering a variety of scenarios (e.g. – higher/lower inflation, GDP growth, stimulus, etc.).



Observation / Outcomes for 2017

- Increasing inflation assumptions approximately 40 bps (note that inflation serves as one of the "building blocks" in determining valuation for numerous asset classes)
- Largely due to higher inflation/yields, we raise fixed income return expectations slightly across the board.
- High Yield return assumptions are lowered due to spreads tightening but are modestly improved by lower expected loss rates.
- Equity asset class returns are similar, to a bit higher
- Emerging Market equities are an exception in that the 10-year return expectation is a bit lower compared to this time last year though EM is still one of our highest expected return asset classes
- MLP return expectations lowered slightly (however, remain one of our highest return asset classes)

Assumption Changes Summary (2017 vs. 2016)

Executive Summary of Year-Over-Year Return Assumption Changes

Asset Class	2016-2025 E(R)	2017-2026 E(R)	2017 vs. 2016
Cash	0.2%	0.5%	0.3%
TIPS	2.1%	2.3%	0.2%
Muni Bond	2.5%	2.2%	-0.3%
Muni High Yield		6.5%	
US Bond	2.5%	2.6%	0.1%
For. Dev. Bond	1.7%	1.8%	0.1%
HY Bond	5.8%	5.2%	-0.6%
EM Bond	4.1%	3.9%	-0.2%
Global Equity	8.0%	8.3%	0.3%
US Equity (AC)	6.4%	6.7%	0.3%
US Equity (LC)	6.2%	6.4%	0.2%
US Equity (MC)	6.7%	6.9%	0.2%
US Equity (SC)	6.8%	7.1%	0.3%
Non-US Equity (ACWI)	9.0%	9.4%	0.4%
Int'l Dev. Equity	7.9%	8.4%	0.5%
EM Equity	11.5%	11.1%	-0.4%
Real Estate	5.5%	6.0%	0.5%
MLPs	11.4%	10.6%	-0.8%
Commod. Fut.	2.4%	3.4%	1.0%
HFoF Multi-Strat	8.1%	6.9%	-1.2%
Private Equity	9.4%	9.7%	0.3%

Summary of Return Forecast Changes

- Inflation expectations higher by approximately 40 bps, as well as rising real yields across most of fixed income
- Decline in high yield YTW offset somewhat by a reduction in loss rate assumptions of approximately 100 bps
- Decline by approximately 20 bps in local YTM; currency and credit assumptions constant from 2016
- Developed equities up modestly with higher inflation expectations; CAPEs modestly down in U.S. by approximately 20 bps offsets some rise in inflation expectations; CAPE flat in Non-Developed U.S.
- EM CAPE down by approximately 90 bps
- U.S. REIT yield up modestly and higher inflation expectations
- Decline in MLP yield of approximately 110 bps offsets uptick in inflation
- Hedge fund alpha assumption reduction

Please see disclosures at the end of this presentation for important information regarding the returns displayed above. For additional information on forecast methodologies, please ask for a copy of DiMeo Schneider's white paper titled 10-Year Capital Market Forecasts (2016-2025 and 2017-2026).