FIRST QUARTER 2018 REVIEW AND OUTLOOK EXECUTIVE SUMMARY

Portfolio Themes

- **Quality Tilt:** As the bull market progresses, we favor equities with stronger balance sheets and consistent margins.
- **Overweight to Information Technology:** The Information Technology sector is heavily skewed toward large, high-quality firms—a segment we expect to outperform in the later stages of a bull market. The sector should also benefit from robust global IT spending driven by the growing demand for products and services related to mobile, cloud computing and the "Internet of Things."
- **Underweight to Commodity-Oriented Sectors:** The Energy and Materials sectors likely continue to struggle as supply growth constrains commodity prices.

Market Outlook

- **Growing Investor Confidence:** Investor optimism typically increases as a bull market matures. Recent correction angst notwithstanding, US sentiment has improved but is not yet euphoric. Meanwhile, growing optimism in the US remains unmatched by European investors.
- **Strong Economic Drivers:** In both developed and emerging markets, economic drivers remain strong. We believe these fundamentals will come to the forefront as sentiment improves.
- **European Leadership:** As euroskeptic fears fizzle and renewed gridlock reduces legislative risk, Europe should continue to outperform in 2018.

A tumultuous first quarter of 2018 saw the MSCI All Country World Index (ACWI) finish down -1.0% as increased volatility tested investors' patience.[i] After posting strong returns in January, global markets tumbled, with the S&P 500's pullback crossing -10%, reaching official correction territory. The MSCI ACWI came close but regained some ground in the quarter's final week.

Last quarter's volatility doesn't shock us—nor does it change our outlook. 2017 was unusually calm, with only a handful of declines exceeding 1% and no drawdown approaching correction territory. Bracing for more volatility this year is prudent. Yet, bigger swings don't preclude the great year we anticipate. Corrections usually end as quickly as they start—trying to time them often leads investors astray.

As Benjamin Graham famously quipped: "Markets are voting machines in the short term and weighing machines in the longer term." Short-term swings come from sentiment—emotional reactions (or overreactions) to recent events. Longer term, markets weigh fundamentals. We expect today's positive drivers to significantly outweigh the negatives. Forward-looking indicators like the yield curve, new orders in services and manufacturing, and The Conference Board's Leading Economic Indexes suggest global growth should continue powering corporate earnings growth. Major governments remain gridlocked, unable to significantly disrupt property rights or commerce. Party infighting, White House turnover and increasing focus on upcoming midterm elections only add to US political gridlock.

Globally, we expect Continental European equities likely outperform the US. Sentiment toward Europe remains overly cautious. Pundits lament slight slowdowns in eurozone purchasing managers' indexes and presume the expansion there is stalling. They continue fixating on the ECB, worrying its "tightening" monetary policy risks renewed weakness, ignoring the fact that last year's eurozone outperformance and strong economy occurred while the ECB slowed its long-term

i Source: FactSet, as of 04/04/2018. MSCI All Country World Index return with net dividends in USD, 12/31/2017 – 03/30/2018.

asset purchases. In our view, this shows positive surprise potential appears greater in Europe, although we still expect US equities to do well.

Meanwhile, Emerging Markets (EM) overall are growing and contributing to broader global expansion. Economies with growing services sectors and bustling consumer classes are leading and countries reliant on commodity prices are now beginning to recover. However, while the global expansion is benefiting EM broadly, several countries face domestic economic and political challenges. Looking ahead, the EM countries best situated to benefit from the bull market's current economic drivers have strong trade ties and factor prominently in global Tech.

It is difficult to know how much longer this pullback will last, although we believe it has all the indicators of a normal correction—not the start of a bear market. Like most corrections, it was sharp and fast. Meanwhile, pundits searched for reasons to justify the drops, projecting a far larger impact. In February, inflation and rising interest rates were hot topics—then they were quickly forgotten. In March, discussion largely shifted to tariffs. Trade tensions—particularly between China and the US— have spurred concerns of a trade war between the world's two largest economies.

However, we believe these fears are overblown. Current tariffs lack the scale to meaningfully impact the global economy, and harsh rhetoric has given way to more moderate actions. In a bear market, investors do the opposite, seeking justification for their optimism and overlooking reasons why more pain might await. While bull markets climb a wall of worry, bear markets usually start as investors slide gently down a mild slope of hope.

Yet sentiment during this correction has been calmer than during this bull's earlier corrections—likely a reflection of overall improving sentiment. Investors took the recent correction as a given in a bull market lasting over nine years and counting. We believe a recovery will eventually prove them correct, but corrections usually feature more angst than this one has so far, suggesting more volatility may come before an eventual rebound. That said, more volatility shouldn't prevent a great year for equities.

Should you have any questions about any of the information in the First Quarter 2018 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.

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