Ellwood's Capital Markets Committee

Investment Outlook

2018

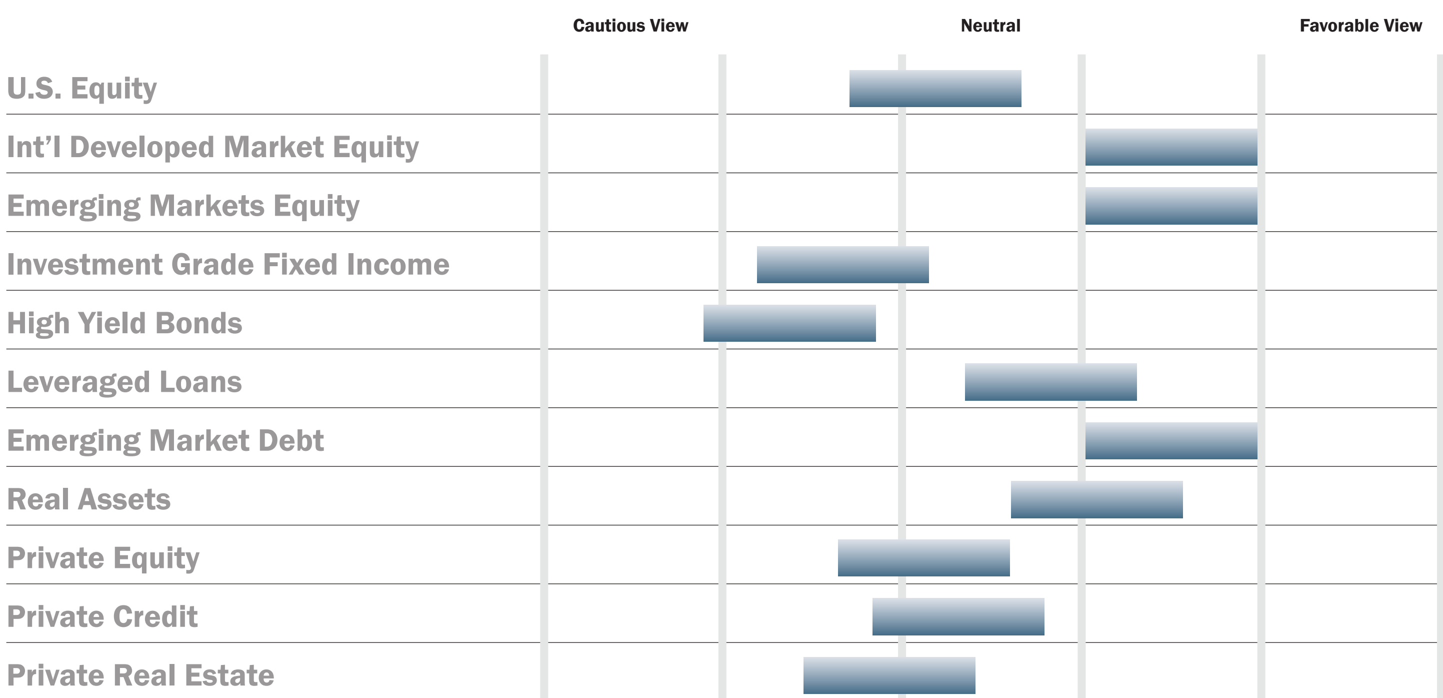
CAPITAL MARKETS VIEWS

Ellwood's 2018 capital market views evaluate the risk and return potential for each asset class within the anticipated economic environment (below).

We expect economic conditions will be supportive of equities, with valuations leading us to favor international developed and emerging markets relative to a more neutral view on U.S. markets.

We anticipate economic conditions and inflation to place upward pressure on bond yields, leading us to a cautious view on U.S. investment grade bonds. Within below investment grade corporate credit markets, we favor the floating rate structure of leveraged loans relative to high yield bonds. We are encouraged by the improving economic environment within emerging markets, steering us towards a more favorable view of emerging market debt.

With the potential for inflation to trend higher in 2018, we see an opportunity for real assets to contribute to portfolio returns. Finally, with higher valuations in private capital markets (equity, credit and real estate), we see value in a careful approach to the level and type of private capital commitments.

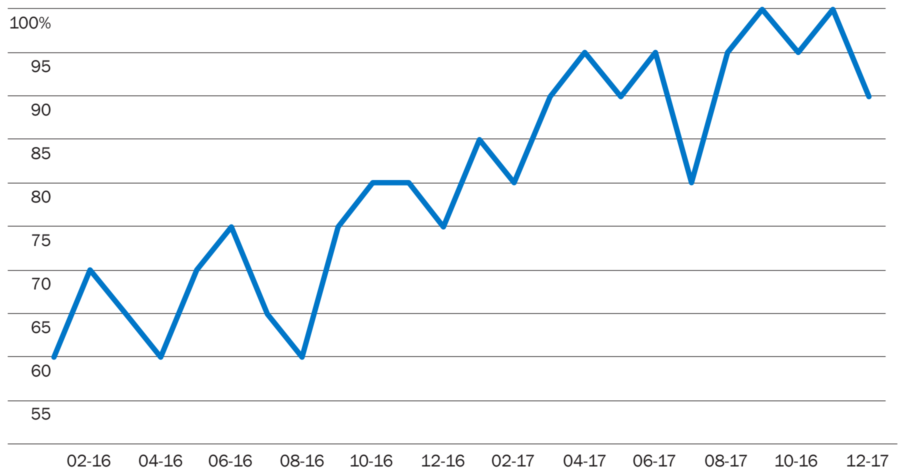


ECONOMIC GROWTH

In 2017, synchronized global economic growth was the foundation for a strong rebound in corporate profits as earnings growth accelerated 10–20%+ globally, according to MSCI. Ellwood sees this positive global growth trend continuing into 2018 with U.S. corporate tax reform enhancing after-tax profits and setting the stage for an acceleration in new business investment.

The breadth of global economic growth is evident in the manufacturing PMI data (right). In tracking the largest twenty countries by gross domestic product, the number of countries registering expansionary growth trends (PMI above 50) during each month of 2017 ranged from 80 to 100%. At the start of 2016, only 60% of these countries were in an expansionary mode.

Percent of Countries with Manufacturing PMI Greater than 50
Largest 20 Countries by GDP



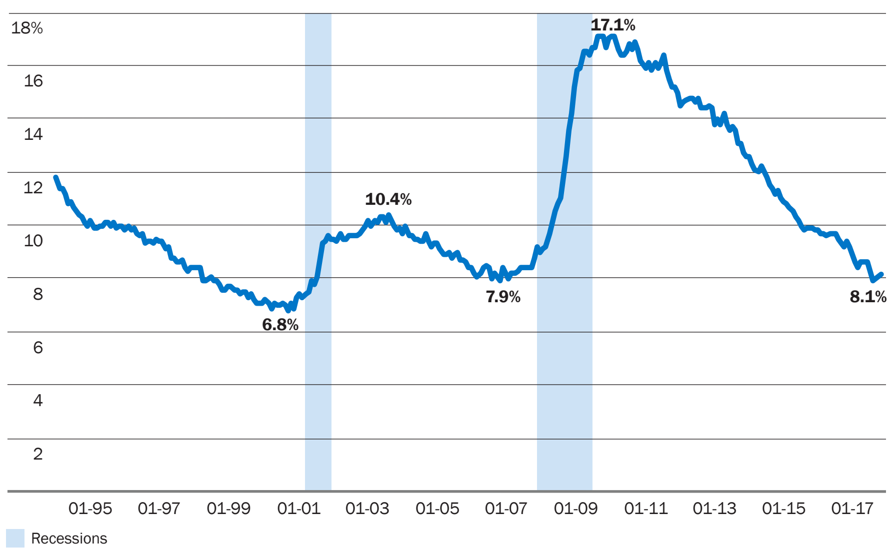
Source: Bloomberg

INFLATION

Over the past five years, U.S. inflation[1] has consistently been below the Federal Reserve's 2% target level. Ellwood believes a continuation of economic growth trends in 2018 can support firmer wages and industrial commodity prices, leading to an investment environment in 2018 in which inflation risk may be underpriced in markets.

While unemployment rates in the largest global developed economies have fallen sharply since the end of the 2008 financial crisis (with several at or near 25-year lows), an important determinant of wage growth (or lack thereof) has been the level of "hidden" unemployment—including those involuntarily working part-time but available to work full-time. In the U.S., a broader measure of unemployment (known as the "U-6" measure of labor utilization) is near lows reached prior to the financial crisis, indicating the potential for tighter labor conditions in 2018 (right). Outside of the U.S., the level of involuntary part-time workers remains at elevated levels in most major developed economies.

Labor Underutilization Rate (U-6)



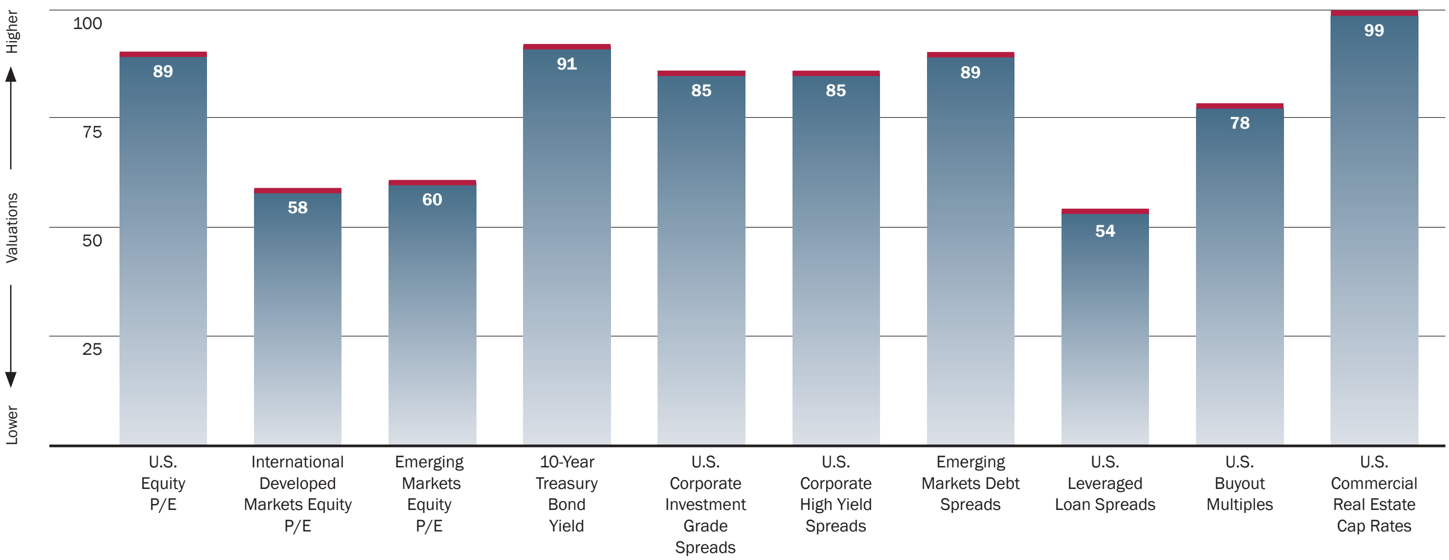
Sources: Bureau of Labor Statistics; data is seasonally adjusted; accessed 1/12/2018; last updated 12/2017. Source of recession periods (highlighted in the chart): National Bureau of Economic Research, Inc.; data accessed 1/12/2018.

1 U.S. Bureau of Economic Analysis, "Table 2.8.4. Price Indexes for Personal Consumption Expenditures by Major Type of Product, Monthly," http://bit.ly/2mSn6uy.

ASSET CLASS VALUATIONS

Valuations across most public and private asset classes—equities, debt and real estate—are trading towards the higher end of their historic ranges (below). While our generally upbeat outlook mitigates at least some of this risk, high valuations are the basis for an asymmetric risk/return profile (more downside than upside potential).

Valuation Percentile Ranks



The most recent data point available for each asset class is compared to historical observations, with its percentile ranking shown from lowest valuation (1) to highest valuation (100).

Source: MSCI, U.S. Department of the Treasury; Bloomberg Finance, LP; Pitchbook Data Inc.; National Council of Real Estate Investment Fiduciaries. See footnotes for index information.

RISKS TO THE OUTLOOK

The Federal Reserve faces a difficult task: balancing its growth and inflation objectives while ensuring financial stability (reducing the risks associated with excessive debt creation and asset price inflation). A misstep—either monetary policy that is too tight (disrupting credit conditions) or too loose (allowing inflation expectations to accelerate higher) would be a key source of risk to Ellwood's outlook. At the time of this writing, three of the seven positions on the Federal Reserve Board of Governors, are vacant (four including the departure of Janet Yellen in February 2018). This is also a potential source of uncertainty for markets with respect to the path of future Fed monetary policy. We expect Brexit negotiations will frequently be a source of news in 2018 and a potential source of volatility (positive or negative) to our constructive outlook on Europe. Finally, while not unique to 2018, surprise news out of China would be a considerable source of upside or downside risk to our outlook.

Market conditions are fluid and will change as new information becomes available. Ellwood will be closely watching a range of market indicators (such as the slope of the yield curve, bond spreads and commodity prices) and economic indicators (including wages, employment and credit conditions) to evaluate the precision of our views to determine if material modifications are necessary.

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Valuation Percentile Ranks chart index information. U.S. Equity P/E is P/E Trailing 12-Months EPS from 1970-2017 and is represented by the MSCI USA index; Int'l Developed Mkts P/E is P/E Trailing 12-Months EPS from 1970-2017 and is represented by the MSCI World ex USA index; Emerging Mkts Equity P/E is P/E Trailing 12-Months EPS from 1995-2017 and is represented by MSCI Emerging Markets Index; 10-Yr Treasury Bond Yield is 10-Year Treasury Constant Maturity Rate from 1962-2017 and is represented by the 10-Year Treasury Constant Maturity Rate; U.S. Corporate Inv Grade Spreads is option-adjusted spread from 1989-2017 and is represented by BloombergBarclays U.S. Corporate Investment Grade Index; U.S. Corporate High Yield Spreads is option-adjusted spread from 1994-2017 and is represented by the BloombergBarclays U.S. Corporate High Yield Index; Emerging Markets (USD) Spreads is option-adjusted spread from 2000-2017 and is represented by BloombergBarclays EM Hard Currency Aggregate Index; U.S. Leveraged Loans Spreads is Discount Margin 3-Year Life from 1992-2017 and is represented by Credit Suisse Leveraged Loan index; U.S. Buyout Multiples is implied EV/EBITDA median from 1995-2017 and is represented by United States, Deal Status: Completed, Deal Type - All Buyout Types; U.S. Commercial Real Estate Cap Rates is Current Value Cap Rates Equal Weighted from 1978-2017 and is represented by NCREIF Property Index.

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Investments in securities are subject to investment risk, including possible loss of principal. Investments in international securities, even though publicly traded in the U.S., may involve risks which are in addition to those inherent in domestic investments.

Bonds are subject to interest rate, price, and credit risks. Generally when interest rates rise, bond prices fall.

Investments in emerging markets may be less liquid and more volatile. Additional risks include currency fluctuations, and political instability.

Equity investments are more volatile than bonds and subject to greater risks. Small- and mid-cap stocks involve greater risk than large-cap stocks.

High-yield fixed income securities are subject to liquidity and credit risk, and tend to be more volatile than investment grade fixed income.

A real assets strategy is subject to the risk that its asset allocations may not achieve the desired risk-return characteristic, underperform other similar investment strategies or cause an investor to lose money. The risks of investing in REITs are similar to those associated with direct investments in real estate securities. Property values may fall due to increasing vacancies, declining rents resulting from economic, legal, tax, political or technological developments, lack of liquidity, limited diversification and sensitivity to certain economic factors such as interest rate changes and market recessions.

Bank Loans are subject to greater levels of credit risk and liquidity risk than certain other securities. Leveraged loans are considered predominately speculative with respect to the issuer's continuing ability to make principal payments. A downturn or period of risk aversion could adversely affect the market for leveraged loans and reduce an investor's ability to sell its securities.

ELLWOOD

ADVICE. ALIGNED.

Chicago

33 W Monroe Street
Suite 1000
Chicago, IL 60603
312.782.5432

Denver

5299 DTC Blvd
Suite 810
Denver, CO 80111
303.738.0300

ellwoodassociates.com