Capital Market Review

Third Quarter 2017

By Jack Peluso, Allegheny Research Team

The broad market has continued to rise steadily over the course of 2017. The S&P 500 Index has now produced a positive return each month this year, which extends the streak to eleven consecutive months with no negative returns. Following a decent first quarter (and despite a few slow months), the S&P produced a solid 4.5% return for the three-month period ending 9/30/2017. Six, nine, and twelve-month returns for the index were all increasingly positive coming in at 7.7%, 14.2%, and 18.6% respectively.

As of 9/30/2017, eleven of past twelve months have resulted in positive returns for the S&P 500, with the -1.8% drop during last October resulting in the only negative month. The highest monthly returns for that period came in November 2016, and February 2017, with gains of 3.7%, and 4.0%, followed by July and September of 2017, when the index returned 2.1%.

The bond market managed to remain positive for the quarter, although the three-month return was nearly halved in comparison to last quarter's figure, likely a result of the Fed raising rates following the June meeting. The June 14th increase marked the second hike of 2017 and the third rate-hike in the past ten months. Meanwhile, the Bloomberg Barclays Aggregate Index produced positive results across the board for periods ending 9/30/2017. During the three, six, and nine-month time periods, the index saw returns of 0.9%, 2.3%, and 3.1% respectively. While still positive, the index came in much lower at 0.1% for the twelve months.

Inflation, as expressed by the Consumer Price Index, was up across the board, coming in at 0.5% for the month, 0.8% for the quarter, 1.2% for the six-month period, and 2.2% for both the YTD [nine-month] and trailing twelve-month periods ending September 30th, 2017.

STOCK MARKET

The major market averages were all positive during the third quarter. The S&P 500, an index of large company stocks, was up 4.5%, while the Dow Jones Industrial Average climbed 5.6%. The Dow Jones US Select REIT, an index representing real estate companies, produced the lowest quarterly return of the group, coming in at 0.4% for the three months. The Russell 2000, an index of small-company stocks, produced a 5.7% return for the third quarter. The MSCI EAFE, an index representing international stocks from developed markets, rose by 5.4% over the three-month period. Meanwhile, the MSCI Emerging Markets, an index representing the international stock of emerging countries, lead the pack for the third straight quarter with a healthy return of 7.9%. Lastly, the Bloomberg Commodity Index, up from last quarter, produced a modest three-month return of 2.5%.

Six- and nine-month returns followed a very similar pattern, except the Bloomberg Commodity Index, which returned to last quarter's trend by falling into negative territory over both time periods. The S&P 500 Index was up 7.7% and 14.2%, and the Dow returned 9.8% and 15.5%. The Russell 2000 Index came in with returns of 8.3% and 10.9%, and the MSCI EAFE Index returned an impressive 11.9% and 20.0%, while the MSCI Emerging Markets Index led the pack with returns of 14.7% and 27.8%. The Dow Jones US Select REIT Index rose by 2.0% for the six months and again by 1.8% for the nine-month period. Trailing the group, and the only index that fell during the six- and nine-month periods, the Commodity Index was down -0.6% and -2.9% respectively.

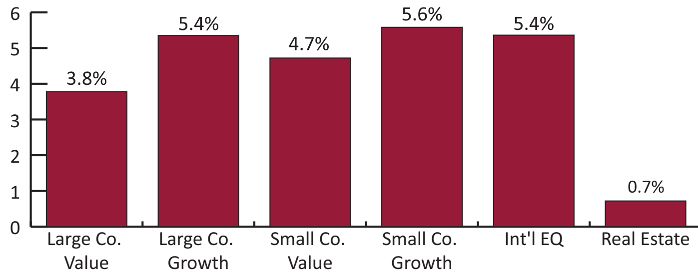
Results were mainly strong for the trailing twelve-month period, with five out of seven indices producing double-digit returns. The S&P 500 Index was up 18.6% for the twelve months, while the Dow led the pack with a twelve-month return of 25.5%. The Russell 2000 Index returned 20.7% for the twelve-month period, the MSCI EAFE Index posted a 19.1% return, while the Emerging Markets Index rose by a solid 22.5%. The Dow Jones US Select REIT Index joined the Commodity Index in the red, coming in negative both YTD and over the twelve months with returns of -0.8% and -0.3% respectively.

Market Returns

	3 months ending 9/30/2017	12 months ending 9/30/2017
S&P 500	4.5%	18.6%
Dow Jones Industrial Avg	5.6%	25.5%
Russell 2000	5.7%	20.7%
MSCI EAFE	5.4%	19.1%
MSCI Emerging Markets	7.9%	22.5%
DJ US Select REIT	0.4%	-0.8%
Bloomberg Commodity Index	2.5%	-0.3%

Comparison of Equity Styles

3 months ended 9/30/2017



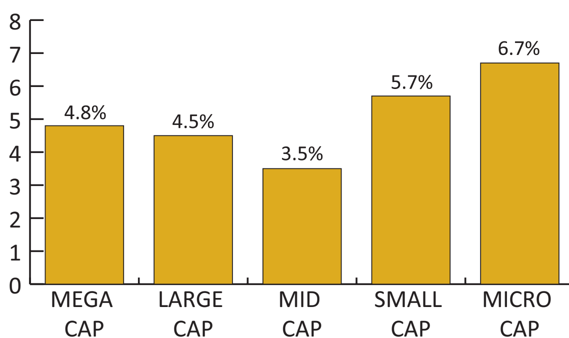
The Equity Styles all remained positive for the quarter. Large Value gained 3.8%, trailing Large Growth at 5.4%. The value/growth trend was the same for small companies during the first quarter, with Small Value up 4.7%, and Small Growth gaining 5.6%. The average International Equity manager finished the quarter tied with Large Growth, producing a return of 5.4%, while Real Estate trailed the pack, gaining only 0.8% during the three-month period.

Six- and nine-month returns were all positive, as the value/growth trend continued across both time periods. Large Value underperformed Large Growth – gaining 5.6% vs. 10.6% for the six months, and 9.5% vs. 20.2% for the nine months. Similarly, Small Value underperformed Small Growth – gaining 5.1% vs. 10.2% for the six months, and 5.4% vs. 16.3% for the nine-month period. International Equity led the pack over both the six- and nine-month periods, gaining 12.0% during the six months and 20.6% during the nine months. The average Real Estate manager trailed again, producing modest returns for both six- and nine-month periods, with gains of 2.5% and 3.5% respectively.

All Equity Styles were strongly positive for the twelve months ending 9/30/2017, except Real Estate, and we saw the value/growth trend carry-through as well. Large Value gained 16.4%, while Large Growth returned 19.8%. Small Value increased by 18.2%, while Small Growth gained 20.2%. The average International Equity manager finished the twelve months with a return of 17.9%. Real Estate, at the bottom again, remained barely positive with a return of 0.7% for the twelve-month period.

Return by Market Cap

3 months ended 9/30/2017



All five of the market cap segments were increasingly positive across all four time periods: the trailing three-month, six-month, nine-month, and twelve-month periods ending September 30th, 2017.

For the three-month period ending 9/30/2017, only Mid-caps underperformed the broader market return of 4.5%, coming in at 3.5%. Large-caps came in third place, and tied the broad market results, with a return of 4.5% for the three-month period. Mega-caps came in just above the market with a three-month return of 4.8%, Micro-caps led the way with a respectable 6.7% return for the three-month period, and Small-caps trailed micro slightly coming in at 5.7% for the quarter.

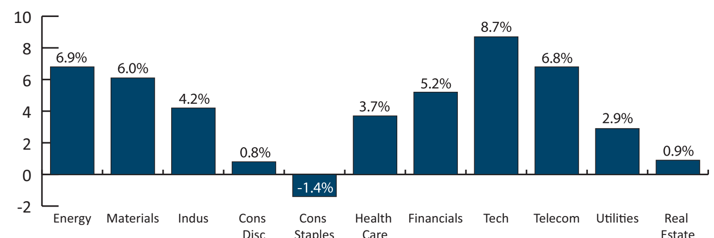
For the six-month period, only Micro-caps were able to outperform the broader market return of 7.7%. The Mid-cap segment trailed the group again with a six-month return of 6.3%. Large and Mega-caps filled out the bottom half of the group, with Mega in second-to-last at 7.4% and Large-caps tying the broader market return of 7.7% for the trailing six months. Meanwhile, Small and Micro-cap stocks led the group again, gaining 8.3% and 10.7% over the six-month period.

The nine-month period ending 9/30/2017 saw strong results, as each segment produced double-digit returns, though this time the small/large trend reversed entirely from the three- and six-month periods. The Small and Micro-cap segments trailed the group YTD, gaining 10.9% and 11.2% respectively, while the Large and Mega-cap segments led the way, with YTD returns of 14.2% and 14.5% respectively. Meanwhile, Mid-cap stocks rose to the middle of the pack, with a year-to-date return of 11.7%.

The twelve-month period saw the same small/large trend as the nine-month period, and once again, all segments produced positive double-digit returns. The Russell Micro Cap Index rose by 22.3%, while the small-cap Russell 2000 Index was up 20.7%. Large and mega-cap companies, represented by the Russell Top 50 Mega Cap Index and the Large Cap Russell 1000 Index, were both up 18.5%. The Russell Mid-Cap Index returned to the laggard position, but still managed to produce a substantial gain, coming in at 15.3% for the trailing twelve-month period.

Stocks by Sector

3 months ended 9/30/2017



With Real Estate separated from the Financials sector last year, the S&P 500 now has eleven individual sectors. These sectors, along

Stocks by Sector Cont.

with their respective quarter-end weightings in the index, are as follows: Energy 6.1%, Materials 3.0%, Industrials 10.2%, Consumer Discretionary 11.8%, Consumer Staples 8.2%, Healthcare 14.5%, Financial Services 14.6%, Technology 23.2%, Telecom 2.2%, Utilities 3.1%, and Real Estate 3.0%.

Ten of the eleven sectors produced positive returns during the second quarter, with five outperforming the broad market return of 4.5%. Technology was the strongest at 8.7%, followed by Telecom and Energy, both of which gained 6.8% during the third quarter. Materials and Financial Services were the other two sectors to come in above the broad market, with third-quarter returns of 6.1% and 5.2% respectively. Industrials produced a three-month return of 4.2% (coming in just below the broad market), Healthcare followed with a return of 3.7%, while Utilities came in at 2.9%. Both Real Estate and Consumer Discretionary remained barely positive, with three-month returns of 0.8% and 0.9% respectively. Consumer Staples played the laggard for the quarter, and was the only negative sector, with a loss of -1.4%.

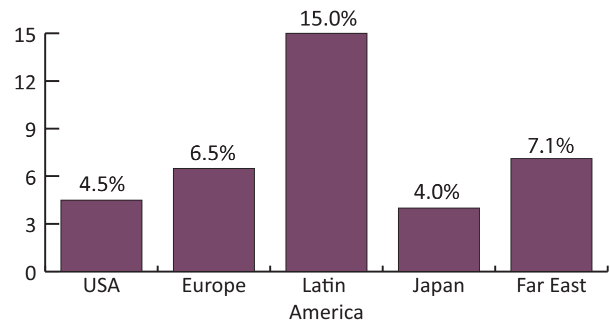
Just like the three-month period, ten of the eleven sectors produced positive returns for the six months, with five outperforming the broad market. The Technology sector led the pack again with a six-month return of 13.1%, while Healthcare and Financials both posted six-month gains of 11%. Materials and Industrials also outperformed the broad market return of 7.7%, with solid gains of 9.4% and 9.2% respectively. Utilities underperformed the broad market slightly with an increase of 5.2% for the trailing six months, followed by Real Estate at 3.7%, and Consumer Discretionary at 3.2%. Consumer Staples and Energy also underperformed the broad market but both managed to remain positive over the six-month period, returning 0.2% and 0.1% respectively. Meanwhile, Telecom lagged all other sectors, producing a loss of -0.8% for the six-month period ending 9/30/2017.

Year-to-date, nine of the eleven sectors were positive, with only three outpacing the broad market return of 14.2%. The strongest performing sector was again Technology, gaining 27.4% over the nine-month period. Healthcare and Materials also outperformed the broad market, with nine-month returns of 20.3% and 15.8% respectively. Industrials came in with a 14.1% gain, placing the sector just below the broad market's results year-to-date. Consumer Discretionary and Utilities followed, both up 11.9% YTD. Real Estate and Consumer Staples came next with nine-month returns of 7.4% and 6.6%; both underperformed the broad market but managed to remain positive. Telecom lost -4.7% over the nine-month period, followed only by the Energy sector, which was down -6.6%.

Ten of eleven sectors were positive for the trailing twelve-month period ending 9/30/2017, with four outpacing the broad market return of 18.6%. Financials took the lead this time with a hefty twelve-month return of 36.2%, while Technology fell to second place, gaining 28.9% for the year. Industrials and Materials also beat the broad market, posting annual returns of 22.4% and 21.3% respectively. Healthcare, Consumer Discretionary, and Utilities all underperformed the broad market, but managed double-digit positive returns for the year, coming in at 15.5%, 14.5%, and 12.0% respectively. Consumer Staples, Real Estate, and Energy were the other sectors landing in the green for the year, with annual returns of 4.4%, 2.7%, and 0.2% respectively. Just barely negative, Telecom landed at the bottom again, with a twelve-month return of -0.1%.

Stocks by Region

3 months ended 9/30/2017



Looking at average stock market returns in five main regions (USA, Europe, Latin America, Japan, and the Far East), we saw entirely positive returns across all four time periods: the trailing three-month, six-month, nine-month, and twelve-month periods ending September 30th, 2017.

The USA came in second-to-last with the S&P 500 Index gaining 4.5%, trailed only by Japan, which rose by 4.0% during the quarter. Latin America led all regions with a three-month return of 15.1%, while the Far East followed in second place and Europe in third, with three-month returns of 7.1% and 6.5% respectively.

The Far East took the lead for the trailing six-month period, returning 16.7%. Europe claimed second place with a six-month return of 14.3%, followed closely by Latin America at 13.1%. Japan returned 9.4%, while the USA fell to the last place, yielding a return of 7.7% during the trailing six months.

All five regions produce double-digit positive results over the trailing nine months. A similar trend to the six-month results can be observed in the nine-month figures as well, with the Far East leading all other regions again, with a lofty 31.8% gain. However, this time Latin American slightly outperformed Europe, returning 26.7% versus 22.8% for the nine months. The USA stayed at the bottom of the pack, increasing by 14.2%, with Japan just slightly outperforming, coming in at 14.3% over the nine months.

Again, all five regions produced strongly positive results for the trailing twelve-month period, with each area posting double-digit positive returns. The top three regions remained the same as the previous periods, but the order varied slightly. This time Latin

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American took the lead with a twelve-month return of 25.6%, followed by the Far East at 23.7%, and Europe at 22.3%. Rounding out the bottom once again, the USA and Japan produced yearly returns of 18.6% and 14.1% respectively.

Please note that these returns are in U.S. Dollar terms, and the change in currencies will have an effect on the return.

BOND MARKET

Rates held relatively steady across the yield curve through September – except for the 2-year Treasury-bill, which went from around 1.4% to just under 1.5%. Longer-term rates barely increased with the 5-year, 10-year, and 30-year rates all rising 2-3 basis points above where they were at the end of June. Because the Fed rose rates twice this year, and the market is already pricing in a third increase, one would expect longer-term rates to dip slightly. Despite the slight increase from June to September, longer-term [5-year, 10-year, and 30-year] rates are all lower than they were at the beginning of the year.

Following the March and June rate-hikes, the probability of an additional increase before the end of 2017 was still being predicted to be around 50% – as the year progressed, the likelihood of a third hike fluctuated up, down, and back up again to where it is now, highly likely. Easing the Fed's cautious approach, we are finally seeing a slight uptick in inflation so far this year, and third quarter fundamentals seem too strong to ignore. The CME Group is only predicting the probability of a third hike during the November meeting at around 1.5%; however, they are now predicting an 83% probability of a rate hike in December.

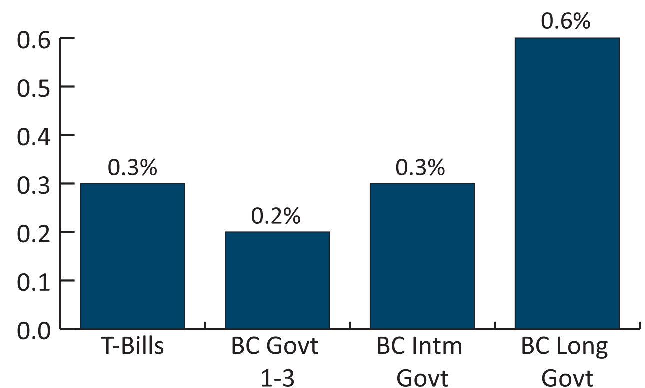
The main reason for the Fed's cautious approach to raising rates has been due to the [essentially unexplained] dip in inflation. The Fed's framework for forecasting inflation applies a version of the Phillip's Curve, which posits an inverse relationship between unemployment and inflation. To simplify, this means that when the unemployment rate falls, wages will go up; this will lead to higher prices, which leads to higher inflation. However, over the past few years, there seems to be a breakdown in this relationship. While we've seen lower and lower unemployment in the U.S., it has not led to higher inflation. Now, low inflation is not necessarily a bad thing, but if the Fed doesn't understand why inflation is low, it is difficult for them to have confidence in their ability to meet their "inflation target." There are several theories regarding the reasoning behind this breakdown, such as anti-inflationary trends, or merely a lag in the Phillip's curve. However, until a better explanation arises, expect the Fed to continue their cautious and data-dependent approach, at least for the foreseeable future.

As we've seen for the last few quarters in a row, rates across the yield curve are higher now than they were twelve months previous – which is likely a residual effect of the unfounded bump following Trump's victory. However, year-to-date, shorter-term rates continue to increase while longer-term rates have dropped off slightly – which (with little [to none] of what Trump promised being accomplished) is more along the lines of what we might come to expect during a year with multiple rate hikes.

Treasury	*9/30 2017*	*6/30 2017*	*3/31 2017*	*12/31 2016*	*9/30 2016*
2 Year	1.47%	1.38%	1.27%	1.20%	0.77%
5 Year	1.92%	1.89%	1.93%	1.93%	1.14%
10 Year	2.33%	2.31%	2.40%	2.45%	1.60%
30 Year	2.86%	2.84%	3.02%	3.06%	2.32%

Bonds by Maturity

3 months ended 9/30/2017



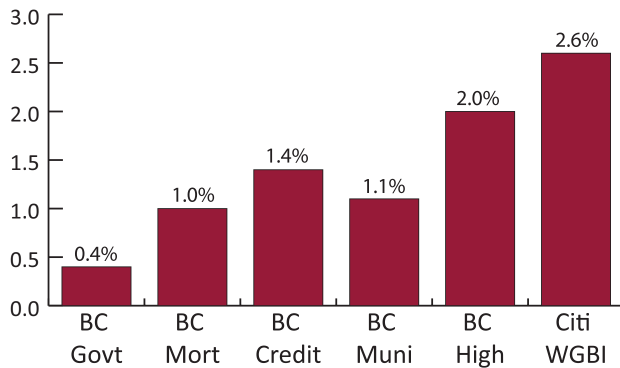
As rates held relatively steady across the yield curve for the second quarter in a row, all maturity sectors of the bond market had positive three- and six-month returns ending 9/30/2017. US T-Bills produced a 0.3% return for the quarter and 0.4% for the six months. The Bloomberg Barclays 1-3 Year Government Index returned 0.2% for the quarter and 0.4% for the six-month period. The Bloomberg Barclays Capital Intermediate Government Index rose by 0.3% for the three-month period and 1.0% over the six months. Despite the Fed's mid-June rate increase, the Barclays Capital Long Government Index (which is generally the most sensitive to changes in interest rates) led all other maturity sectors with three- and six-month returns of 0.6% and 4.5%, respectively.

The three- and six-month trend stayed the same for the nine-month period ending 9/30/2017, but then reversed course for the trailing twelve months – with most returns landing in the red and the Long Government Index trailing the group significantly. US Treasury Bills rose by 0.5% for the nine months and 0.6% for the year, while the 1-3 Year Government Index produced a 0.7% return over the nine-month period and gained 0.3% over the twelve months. The Intermediate Index rose by 1.6% for the nine months, but then fell -0.7% over the trailing twelve months. The Long Index led the pack by returning 6.1% for the nine-month period, but then trailed

significantly over the trailing twelve months, losing -6.1%.

Bonds by Sector

3 months ended 9/30/2017



Though not as high as the previous quarter, three-month returns were positive across all sectors of the bond market once again. The Bloomberg Barclays US Government Index returned 0.4% for the three-months ending 9/30/2017, while the US Mortgage Index rose by 1.0%. The Bloomberg Barclays US Credit Index increased by 1.4% over the quarter, while the Municipal Index was up 1.1%. The Bloomberg Barclays High Yield Index rose by 2.0% during the quarter, with credit concerns continuing to ease throughout the year (especially in the energy market, which makes up a large portion of the high yield index). Lastly, leading all other sectors over the trailing three-month period, the Citi World Government Bond Index gained 2.6%.

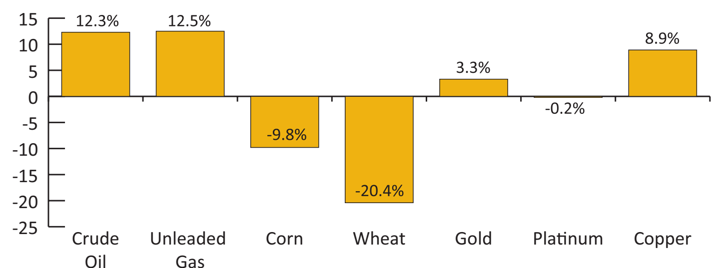
Six-month returns followed the same trend as the trailing three-month numbers, with all sectors turning in positive results over the period, Government trailing the group, and the WGBI leading. The Government sector played the laggard again rising by 1.6%, the Mortgage sector was up just slightly higher at 1.8%, and the Credit sector gained 3.7% for the trailing six months. Municipals increased by 3.0%, while High Yield gained 4.2% over the six-month period. In the lead again, the Citi WGBI rose by 6.5% over the six months ending 9/30/2017.

The same trend continued year-to-date, with the Government and Mortgage both up 2.3%, and Credit increasing by 5.1%. The Municipal Index rose by 4.6% during the nine months, the High Yield Index came in with a gain of 7.0% , while the Citi World Government Bond Index came out on top again with a healthy year-to-date return of 8.6%.

The twelve-month period saw much more mixed results. The Government sector produced a negative annual return of -1.6%, while Mortgage managed to stay positive for the year, coming in at 0.3%. The Credit sector also remained positive with a return of 1.9% for the year, Municipals managed an annual return of 0.9%, while the High Yield sector led the pack, tallying 8.9% over the trailing twelve-month period. In a total reversal from the three-, six-, and nine-month periods, the World Government Bond Index trailed all other sectors, falling by -3.1% over the twelve-month period ending September 30th, 2017.

COMMODITIES MARKET

3 months ended 9/30/2017



The Bloomberg Commodity Index was up 2.5% during the third quarter. The six and nine-month returns ending 9/30/2017 for the Index came in negative, at -0.6% and -2.9% respectively. The index produced another negative return for the year, falling by -0.3%.

Crude Oil rose by 12.3% in the third quarter, while Unleaded Gas prices increased just slightly more, returning 12.5% and leading all other commodities. Food prices were down during the trailing three months, with Corn falling by -9.8%, and Wheat trailing all other commodities with a staggering three-month loss of -20.4%. Metal prices were scattered for the quarter, with Gold prices up 3.3%, Platinum prices down -0.2%, and Copper prices up 8.9%.

During the six months ending 9/30/2017, Crude Oil gained 2.2%, while Unleaded Gasoline prices rose in tandem, with a respectable six-month return of 13.2%. Food Markets were mixed over the trailing six months – Corn fell by 6.5%, and Wheat, this time leading all other commodities, posted a six-month gain of 14.7%. Metals followed the same trend as the three-month period for the trailing six months as well, with Gold and Copper posting positive returns of 3.1% and 11.1% respectively. Platinum finished the six months in the red, decreasing by -2.1%.

Oil prices fell by -3.9% during the nine months ending 9/30/2017, while Unleaded Gas prices continued their positive trend, rising by 17.9%, leading all other commodities over the period. Oil was back to positive for the twelve months, increasing by 8.3%. Meanwhile, Unleaded Gas rose in unison, coming in at 19.1% for the trailing twelve months. Food Markets came in mainly positive over the nine- and twelve-month periods, with Corn producing the single negative return, falling by -5.9% over the nine months. Corn climbed out of the red for the trailing twelve months, generating a modest annual return of 2.6%. Wheat managed positive results across the board, returning 4.6% over the nine-month period, and 13.2% over the trailing twelve months. All three metal commodities produced

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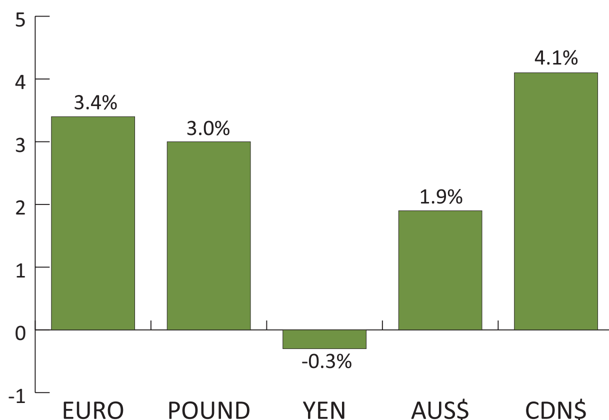
Commodities Market Cont.

positive results over the nine-month period, with Gold up 12.0%, Platinum up 2.5%, and Copper up 17.7%. Twelve-month returns came in more mixed, with Gold and Platinum both falling, with negative annual returns of -3.0% and -11.0% respectively. Copper managed to remain positive across the board, producing a hefty annual return of 33.5%, leading all other commodities over the trailing twelve-month period.

CURRENCY MARKET

3 months ended 9/30/2017



Except for the Japanese Yen, foreign currencies were primarily positive versus the U.S. Dollar across all four time periods. The Euro was up 3.4% against the U.S. Dollar during the third quarter, up 10.6% for the trailing six-month period, 12.3% for the nine months, and 5.4% for the year. The British Pound rose by 3.0% against the U.S. Dollar during the third quarter, 7.3% during the six-month period, 8.6% over the nine months, and 3.3% during the trailing twelve months. The only currency to depreciate versus the U.S. Dollar, the Japanese Yen, decreased in value by -0.3% during the third quarter and fell by -0.7% during the six-month period. The Yen was back to positive versus the U.S. Dollar for the trailing nine-month period, rising by 4.0%, but then fell significantly over the trailing twelve-months with a return of -10.1% for the year. The Australian Dollar (which is strongly influenced by commodity prices and the Chinese economy), saw its currency rise by 1.9% during the third quarter, 2.5% over the six-month period, 8.8% over the nine months, and 2.6% over the year. The Canadian Dollar followed the same trend as the Australian, producing positive returns for the trailing three-, six-, nine-, and twelve-month time periods ending September 30th, 2017, gaining 4.1%, 6.9%, 7.8%, and 5.4% respectively.

The information included herein was obtained from sources which we believe reliable.

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