

Perspectives

Keeping you informed and engaged about macroeconomic trends and market events



Keep Calm and Invest On

“After rain, there’s a rainbow, after a storm, there’s calm, after the night, there’s a morning, and after an ending, there’s a new beginning.”

DESPITE THREE DEVASTATING HURRICANES that wreaked physical and economic havoc on Texas, Florida, Puerto Rico and the majority of the Caribbean, political divisiveness in Washington, tragedy in Las Vegas, and nuclear saber rattling from North Korea, global stock markets posted another set of strong returns in the third quarter that added to the year’s impressive gains. Indeed, markets have become seemingly impervious to headlines, remaining doggedly focused on improving global economic fundamentals and rising corporate profits. Optimism is also beginning to build again over the prospect of tax reform, even after repeated setbacks

to repeal and replace the Affordable Care Act. And the same resilience holds true overseas. While the global news cycle was focused on French President Macron’s stumbles, Japanese Prime Minister Abe’s corruption scandal, and the rise of the far right evidenced in German national elections, markets instead applauded the return of Chancellor Angela Merkel and the growing strength of the European and Japanese economies. Even with the recent violence on the streets of Catalonia, market fallout has thus far been contained to the Spanish markets and the euro currency. Thanks to an acceleration of growth momentum, stock markets have been

IN THIS ISSUE

1

The global economy is experiencing a relatively steady, synchronized expansion with low risk of recession. A shift toward tighter global monetary policy and geopolitical threats may boost market volatility, underscoring the importance of diversification.

2

Even in consideration of recent devastating hurricanes and ongoing political divisiveness, the U.S. economy is in better shape than commonly appreciated. Hopes for tax-cut legislation represent a potential upside for corporate earnings.

3

While the global news cycle had its fill of geopolitical events, scandal, and tragedy, the growing strength of the European and Japanese economies cannot be denied, and another key milestone of stability was achieved with the reelection of German Chancellor Angela Merkel.

4

Emerging market growth has stabilized against a backdrop of smaller current account deficits, larger foreign exchange reserves, and more flexible currencies, enabling expanding corporate profits and reducing the risks of U.S. protectionism and rate hikes by the Fed.

Ropes Wealth Advisors

Ropes Wealth provides customized and unbiased investment management and financial planning advice that is seamlessly integrated with your wealth management strategies.

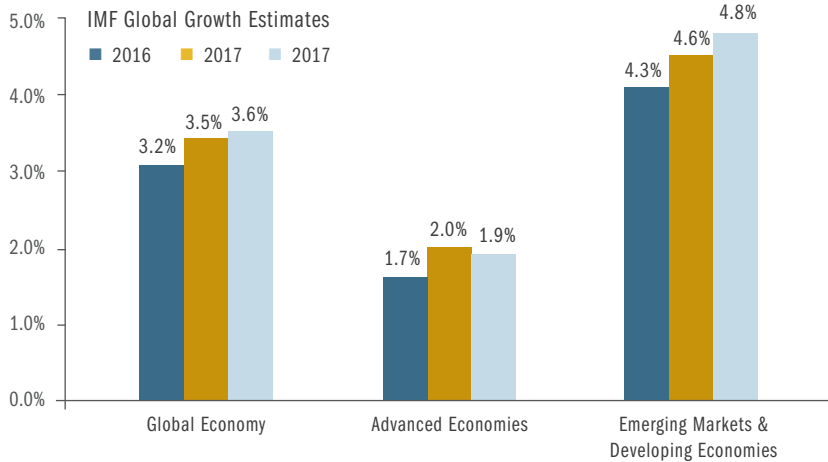
P 1-617-235-4260

F 1-617-235-4261

ropeswealthadvisors.com

SOURCE FOR ALL GRAPHS: Bloomberg.

The projected pickup in global growth remains on track and on firmer footing



more than willing to accept anything that is thrown at them, and nothing seems to be able to dent the positive sentiment currently seen in the riskier parts of the financial markets. Against all odds, investors have been able to keep calm and invest on.

The lynchpin of investor enthusiasm and steadiness in the wake of adversity has been the realization of synchronized global growth in 2017. For the first time in seven long years, the global economy—meaning both developed and emerging market economies—are recovering at the same time. Global purchasing manager indices are in expansion territory, consumer spending is on the rise almost everywhere, and both producer and consumer confidence indicators are at levels we have not seen for quite some time. As for GDP, in the second quarter the U.S. economy posted its fastest growth rate in two years; growth in the eurozone remains robust and broad; Japan has now experienced six consecutive quarters of growth, its longest expansion in over a decade; and growth in China continues to exceed the government’s target. Indeed, of the 43 major economies tracked by the OECD that have reported second-quarter real GDP, only Iceland had negative GDP growth, and the IMF reaffirmed its estimate of global growth of 3.5% for this year and 3.6% for next.

Even better, this synchronous recovery is creating a positive feedback loop. In developed markets, aggregate demand is recov-

ering due to a private sector that is now willing to take on debt and more spending, shifting away from a previous focus on balance-sheet repair. At the same time, emerging markets, which have been adjusting for the past four years amid slack commodity prices and weak global demand, are also in recovery mode. With developed markets accounting for 60% of emerging-market exports, as real import growth accelerates in the former, exports are on the rebound for the latter. Meanwhile, the improved outlook for emerging markets is helping to reduce disinflationary pressures on developed markets.

Critical to the sustainability of synchronized growth is whether this constructive environment is accompanied by the low inflation, low interest rates, and relatively loose financial conditions that we have now. This “Goldilocks” environment has

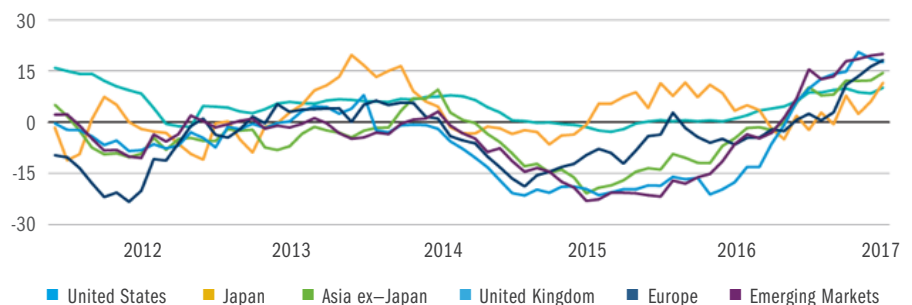
been extremely supportive of rising equity prices, lifting both earnings and earnings forecasts. However, there may be changes coming, at least in the realm of monetary policy.

Central bankers have continued to indicate that they want to gradually reduce the level of monetary policy stimulus in place in consideration of such a positive economic backdrop. During the quarter, the U.S. Federal Reserve announced that it will start the process of “quantitative tightening”. This reduction in the size of its balance sheet will begin to reverse some of the quantitative easing (QE) that has been so supportive of bond prices in recent years. The Fed also continues to suggest that another rate rise is on the cards for December, which will bring the target range for the fed funds rate to above 1.25%. Meanwhile, the European Central Bank (ECB) looks set to announce a further slowdown in the pace of its own QE programme and, not to be left out, even the Bank of England (BoE) has strongly suggested that it will raise interest rates before the year is out. While a tightening in global policy can often be a precursor for an economic slowdown, these changes are being made off such a low base of interest rates and from a position of such extraordinary accommodation (and in such a telegraphed fashion) that we suspect their impact may be more muted than in past cycles. That said, unwinding such an unprecedented amount of stimulus carries risks.

But for now, politics are the far bigger question mark, and in this area, risks and opportunities abound. Optimism over tax

Stellar earnings supported by synchronized global growth

Next 12 Months Earnings Growth—MSCI Regional Indices (Y/Y % change)



reform under a Republican President and Congress has developed despite the Party's inability to revamp President Obama's Affordable Care Act. Any simplification of the tax code, lowering of tax rates, discussion of repatriation of capital, or fiscal stimulus tends to buoy investor sentiment. It is beyond anyone's ability to foretell the end result, but many believe that the prospect of some tax reform or repatriated capital are higher today than they have been for some time. Should profits held overseas be granted favorable tax treatment, investors are likely to see further dividend growth and stock buybacks.

On the flip side, the threat of trade wars stemming from Trump's protectionist agenda carries the risk of disrupting the delicate balance of synchronized global growth. Even more scary is the frightening war of words between President Trump and North Korean leader Kim Jong-Un in

the wake of North Korea's tests of intercontinental ballistic missiles and an alleged hydrogen bomb. As of this writing, the threat of an attack persists, and represents a grave risk not acknowledged by the markets in current valuations.

Without a doubt, geopolitical tensions (particularly in North Korea), the risk of monetary policy mistakes, a failure to raise the debt ceiling, and potential protectionist measures are the biggest risks to the outlook and to market sentiment in the short-term. When we take a step back and filter out the sometimes deafening din of news headlines, we see a world where these risks to economic and corporate profit growth still look low, at least for the final part of this year. To be sure, markets will have to contend with the gradual removal of some of the monetary stimulus which has supported them but in the U.S. and Europe this stimulus is being removed because of solid growth and has been well flagged.

In the medium term, as this economic expansion matures and monetary policy tightens, the risk of recession naturally rises. For now, none of the signs that have historically warned that a global recession is imminent are flashing red. While no expansion lasts forever, we think this one has further to go and that investors should enjoy the good times while they last. The 2008 financial crisis is far in the rear-view mirror now, yet financial companies still demonstrate a discipline that suggests the recession that often thwarts bull markets is not yet on the horizon. And it is not at all unusual for equity returns to be very strong in the later stage of an economic expansion. We will continue to monitor factors likely to signal a shift in the investment landscape, and track the progress of the economy's expansion, but think the stock market will continue to hold and build on its gains in this "not-too-hot, not-too-cold" environment.

GLOBAL ECONOMIC OVERVIEW: Escape Velocity

THE THIRD QUARTER continued to reflect growth in domestic and international economies. Escape velocity, only aspirational a few years ago, has resulted in the continuation of one of the longest economic and bull market expansions in modern financial history. Aggressive monetary macroeconomic stimulus, among other factors, was more successful than anyone had any right to expect. The U.S. and Europe have lifted up the global economy back to grudging but robust health. Even with the handicap of immature financial markets and investors in China and demographic and cultural challenges in Japan, and in spite of geopolitical events rattling global economics, global growth continues its acceleration forward.

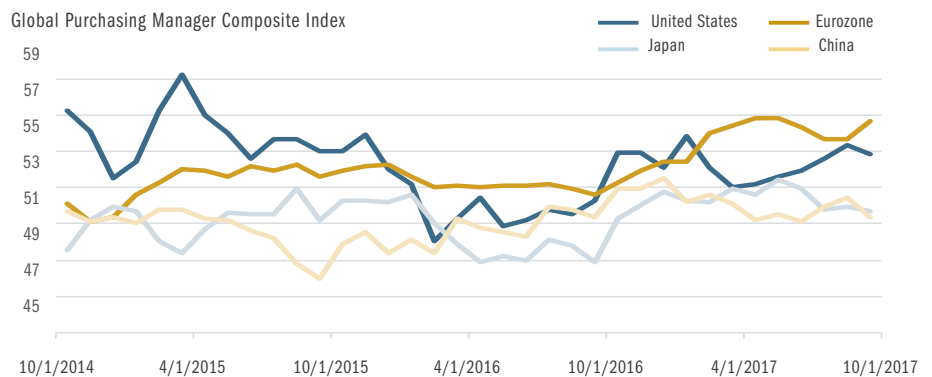
Looking ahead, multiple domestic hurricanes have resulted in devastating social and economic losses in the U.S. during the quarter. The U.S. economy is likely to experience a temporary slowdown in economic growth as reconstruction will likely take months. Growth in the eurozone has been firing on all cylinders, but may adjust if the ECB takes steps to end its QE stimulus

and increase short-term rates. The Chinese economy has continued to manage a corruption campaign and capital controls while still hitting their growth targets. To be sure, the outcome of this month's 19th National Congress of the Communist Party will be closely watched for clues about economic policy in the years ahead and the next phase of how their focus on financial risk control and macro stability will take shape. Japan is in the midst of an election that may fundamentally change its pacifist constitution and its ability to ramp up economic activity. Bra-

zil displayed impressive growth in the first half of the year despite intense political turmoil and two full years of recession. Geopolitical fears have not abated and have taken some ominous turns. However, as of this writing, U.S. and North Korea posturing has abated somewhat. The proposed Trump trade war with China has taken a back seat to the importance of their help with North Korea. Unfortunately, horrific terrorism incidents continue. Revelations of Russian misinformation campaigns on cultural wedge issues are still emerging.

Global PMIs are strong and improving

Global Purchasing Manager Composite Index



U.S. ECONOMY: Hammered by Hurricanes

THE U.S. ECONOMY SAW SOLID PERFORMANCE in the second quarter, recording GDP growth of 3.1% after the first quarter’s anemic 1.2% rate. However, the effects of Hurricanes Harvey and Irma have already dented economic activity in the third quarter, with analysts expecting around a half a point of drag on Q3 growth. Leading data has begun to show the extent of Harvey’s impact, with both industrial output and retail sales recording bleak performances in August. But it was the September jobs report that took the biggest hit.

Nonfarm payrolls were hammered by the hurricanes in September with total nonfarm payrolls contracting -33,000 during the month. This marks the first monthly contraction for payrolls in seven years, since the immediate aftermath of the Great Recession. The hurricane impact was clear in the sector data with -111,000 payrolls lost in the leisure sector, including -100,000 in the food/beverage industry. There was some better news as the unemployment rate fell from 4.44% to 4.22% as 575,000 more people reported as being in the labor force and 935,000 more people reported as being employed. While the unemployment report looks exceptionally strong, it is hard to square with the more modest trend in job growth seen in the

payroll reports, even excluding the most recent weather-affected data. Average weekly hours worked held steady at 34.4 while average hourly earnings jumped a surprising 0.5% month-over-month. July and August earnings data were also revised up from 2.5% year-over-year to 2.6% and 2.7%, respectively.

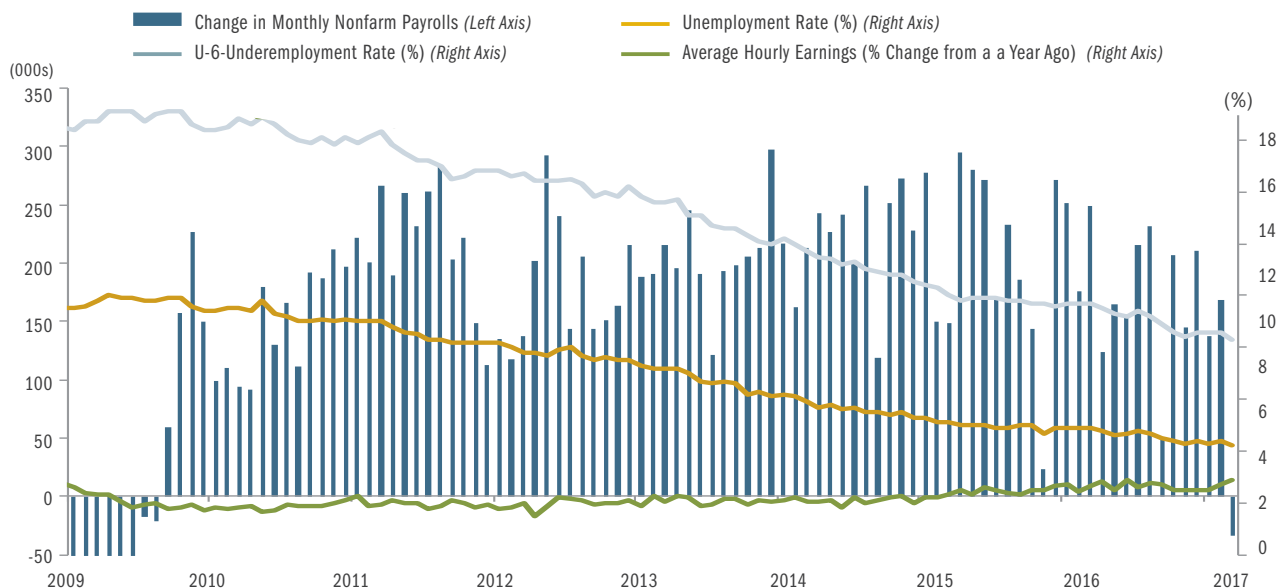
Scant inventory and rising prices slowed sales of new and existing homes in August. Total existing-home sales slipped -1.7% for the month following a -1.3% drop in July. Over the last 12 months, sales of existing homes are up only 0.2%. The August median price for existing homes was \$253,500, -1.9% lower than July’s median price of \$258,300 but up 5.6% from the price last August. Inventory for existing homes declined -2.1% for the month and is now -6.5% lower than a year ago. The Census Bureau’s latest report reveals sales of new single-family homes fell -3.4% in August to an annual rate of 560,000 — down from July’s upwardly revised rate of 580,000. The median sales price of new houses sold in August was \$300,200, -6.6% below the median price in July. The number of houses for sale increased at the end of August to 284,000, which represents a supply of 6.1 months at the current sales rate.

In contrast, both manufacturing and service activity as measured by the Institute

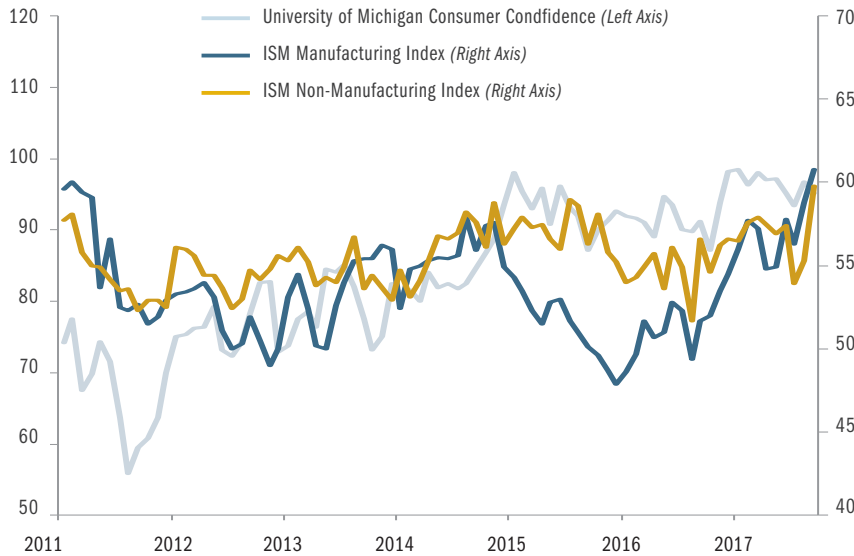
for Supply Management (ISM) remained on a roll, expanding once again as of September’s readings. After only modest growth in July and August, retail sales surged in September to record their biggest increase in 2-1/2 years as reconstruction and clean-up efforts in areas devastated by Hurricanes Harvey and Irma boosted demand for building materials and motor vehicles. The University of Michigan and Conference Board measures of consumer confidence remain at or near all-time highs as of September as consumers expressed growing confidence in current economic conditions. Business confidence, at least as measured by the National Federation of Independent Business (NFIB) and Conference Board CEO Confidence Index, were less sanguine, contemplating the impact of hurricanes and the political divisiveness in Washington. Business leaders are also very mindful of the Fed, not only in terms of interest rates and QE but also the leadership of the Committee as it is widely expected President Trump will not ask Fed Chairwoman Janet Yellen to continue past the end of her term in February.

At its September meeting, the FOMC left the target federal funds rate range at 1.00%-1.25%, noting moderate economic activity, stagnant inflation, and

Hurricanes hit payrolls but the hurt is not expected to last



U.S. consumer confidence and business activity levels remain robust



inflation continues to be weak. Indeed, the personal consumption expenditures (PCE) price index (a measure of what consumers pay for goods and services) trended at only 1.4% in August, while the core PCE (excluding energy and food) price index stood at a 1.3% level—well below the Fed’s target of 2%.

Turning briefly to politics, Congress reached a deal in early September to increase the debt ceiling and extend government funding for three months. With these short-term hurdles cleared, Congress and the administration released a framework for overhauling the U.S. tax code, including simplified frameworks for both business and individual taxes (see key elements in the chart below). The Committee for a Responsible Federal Budget said the proposal would result in approximately \$5.8 trillion in tax cuts over the next ten years offset by \$3.6 trillion in increased revenues. In other words, these tax cuts will be deficit-financed, pushing U.S. Treasury issuance up and interest rates up with it. The key pillars of the package should revive investment, especially among small and mid-size businesses where top tax rates are targeted at 20% with a maximum small business rate of 25%. While many are expressing optimism that a deal can get done, unlike repeated efforts to repeal and replace Obamacare, tax policy is notoriously thorny. Congress has not overhauled the tax system in such an ambitious manner since 1986.

the temporary effects of two damaging hurricanes. Nevertheless, the Committee forged ahead with plans to begin unwinding their massive \$4.5 trillion balance sheet in October. More surprisingly, the Federal Reserve kept its projected path of interest rate hikes unchanged from June and thus a third interest rate increase is expected at the December meeting. This took some by surprise, who had expected the Fed might temper its near-term outlook given the hurricane devastation.

However, even though the Fed has already hiked the overnight interest rate four times in this expansion, they have not engendered any real tightening from an economic perspective. The 10-year U.S. Treasury yield is lower today than it was in December 2015, the U.S. dollar is weaker, credit spreads are tighter, and the U.S. equity markets are stronger. Furthermore, the Fed may be reacting to recent evidence of rising wage inflation, now at its highest levels in 8 years, even as upward price

Trump administration’s opening salvo on tax reform gets markets fired up

Corporate Tax Code Proposal	Individual Tax Code Proposal
20% top corporate rate	Reduction from seven to four brackets: 12% 25%, 35%, and a TBD rate set by Congress for the highest earners
25% rate for pass-through businesses	Increase in the standard deduction to \$12,000 for single filers and \$24,000 for married taxpayers filing jointly
Immediate expensing of new capital investments in depreciable assets	Increase in the child tax credit and introduction of a \$500 credit for the care of non-child dependents
One-time repatriation rate to draw foreign cash back to the U.S. then a territorial tax system	Repeal of AMT and the death tax
Repeal or restriction of various deductions	Elimination of most itemized deductions excluding mortgage interest and charitable deductions
	Retain benefits for college savings and retirement accounts

DEVELOPED INTERNATIONAL ECONOMIES: Great Expectations

EUROZONE ECONOMIC DATA REMAINED ROBUST over the last three months, with GDP growth confirmed at 2.3% in the second quarter. We have seen a rebound in consumption as an improving labor market supports consumer confidence: for example, car sales in Spain and Italy have been bouncing back strongly. The European Commission’s economic sentiment indicator rose to 111.9, its highest level since July 2007. Unemployment in the eurozone remained at 9.1% in August - stable compared to July and the lowest rate since February 2009. Industrial production rebounded, and both manufacturing and service sector PMIs increased in September. However, the euro has appreciated notably this year and recent figures suggest that its strength could be taking a bite out of overseas sales: the trade surplus narrowed more than had been expected in July.

In a sign of growing confidence in the eurozone’s recovery since the doldrums of the European sovereign debt crisis, Standard & Poor’s restored Portugal’s government debt rating to “investment grade” status after holding it at “junk” for five years. At the height of the crisis, the yield on Portugal’s benchmark 10-year bond rose above 16%, but as of September 2017 it stands at around 2.5%. Equally, other formerly “frail” economies have been on an upward trajectory. Spain has been growing above trend and in excess of euro area averages since 2014.

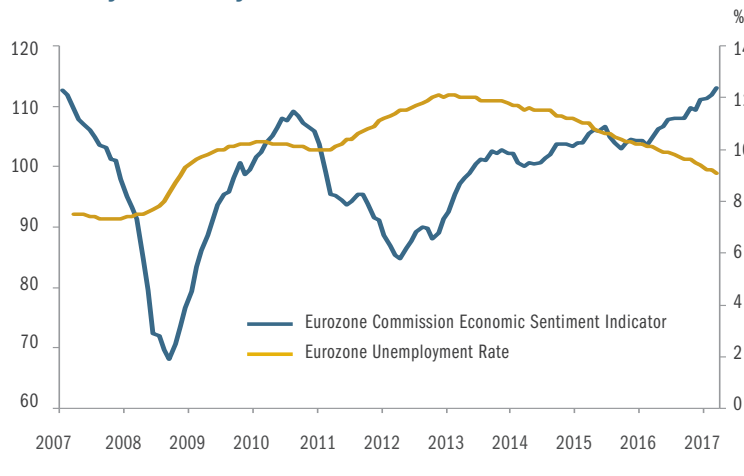
With all this strength, the possibility that the European Central Bank could reduce its stimulus measures continued to be a focus for the market. For now, though, the ECB has scope to remain accommodative as the Harmonized Index of Consumer Prices—the ECB’s preferred measure—currently stands at 1.5%. Despite inflation’s short-lived foray between 1.5% and 2.0% from January through April, consumer prices have yet to show convincing

signs of a sustained upward trend, a key requirement for the ECB to withdraw its ultra-loose monetary policy. At the same time, the stronger euro also effectively implies a tightening of financial conditions and further disinflationary pressure, if sustained, as it pushes down import costs. In September, ECB President Mario Draghi said that the central bank governing council was discussing various scenarios to do with the quantitative easing programme. Details are expected to be released after

single-currency area, some political rumblings are almost to be expected, and when viewed within a global context, we consider this risk to be relatively benign. The Sicilian regional election in November will be an important barometer, particularly given the ground gained by the 5-Star Movement, a eurosceptic party, there. However, it is worth considering that Italian politics typically exhibit some degree of instability and uncertainty. In the last 17 years, there have been 15 regional elections alone.

In the UK, incoming data for Q3 is mixed. On the positive side, the manufacturing sector rebounded in July, and a rise in the manufacturing PMI in August signals an acceleration in the expansion of output. A healthy labor market propelled the unemployment rate to another multi-decade low in July amid signs of a mild recovery in real wage growth. Consumer sentiment edged up in August, indicating brighter prospects for private consumption. On the down-

Economic indicators in Eurozone show strong sustainable recovery underway



their October 26 meeting. The prospect of tighter monetary policy pushed up the euro for much of the period. However, in late September, a weaker-than-expected performance for Angela Merkel’s Christian Democratic Union party in the German elections saw the euro soften slightly.

Though German Chancellor Angela Merkel secured a fourth term in office, the gains for the far-right party Alternative für Deutschland in the German election came as a surprise—making the party the first openly nationalist party to reside in parliament in almost 60 years. This will likely change the tone of the Bundestag, though we do not anticipate coalition talks to be materially impacted by their presence in parliament. However, we would argue that Italy and Spain—given Catalonia’s ongoing campaign for independence—remain flash points of political risk in Europe, albeit relatively contained. Given that 19 countries comprise the

side, growth in total industrial production fell in July. In August, the housing market cooled further and the services PMI dropped. Brexit uncertainty continues to deter investment, and Prime Minister May’s speech on September 22 failed to offer sufficient clarity on the UK’s desired trading relationship with the EU. Hours after the speech, Moody’s downgraded the country’s credit rating by a notch to Aa2 from Aa1 and changed the outlook from negative to stable, citing mounting policy challenges around the complexity of Brexit negotiations.

Also challenging the outlook is a more hawkish tone from the Bank of England that seemed less concerned over the medium-term economic drag from Brexit. Instead, the communiqué that followed the September meeting stated for the first time that inflation was likely to rise above 3.0% in October, which gave way to speculation that monetary tightening—

previously penciled in for next year—could be imminent.

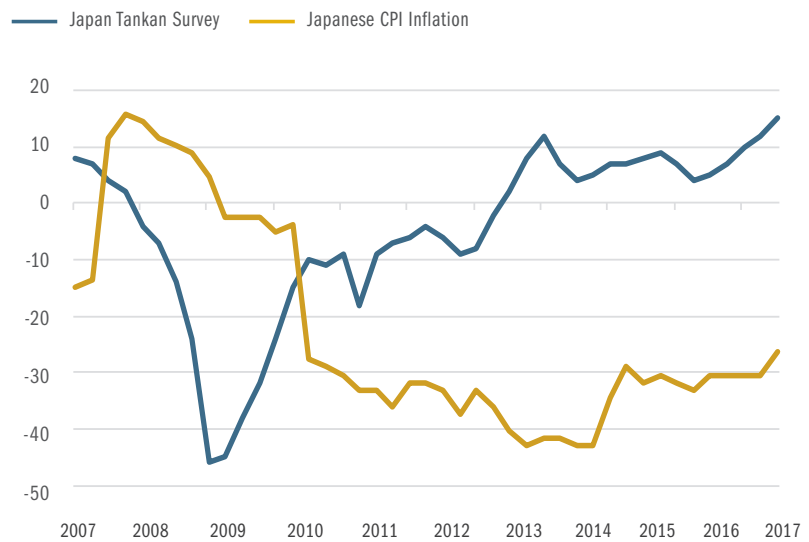
Turning to Japan, following a slow-down in private non-residential investment, growth in the second quarter was revised down to 2.5% in seasonally-adjusted annualized terms, significantly below the 4.0% figure reported in a preliminary estimate. Despite this revision, the print marked the fastest expansion since Q1 2015 and puts the economy on a steady track to recovery. The latest data suggests that healthy growth is being sustained in the third quarter. Machinery orders rebounded in July, and exports had the fastest pace of expansion in almost four years in August. Industrial production was better than forecast and there was also a jump in headline inflation, with core CPI rising to 0.7%. The Bank of Japan released its quarterly Tankan survey showing further improvements in business conditions. Japanese companies in aggregate now see themselves as short of labor and capacity. This has led to an upward revision in their previously overly-conservative expectations for capital expenditure. Meanwhile, there were no changes in policy from the Bank of Japan. Ten-year bond yields remained close to the central bank's target of zero percent.

For the second consecutive quarter, the principal risks have come from outside Japan as the uncertain prospects for the implementation of a US growth-oriented policy and moves towards increased isolationism have held back sentiment. The quarter started with a sweeping defeat for the Liberal Democratic Party (LDP) in the Tokyo Assembly elections at the hands of Governor Yuriko Koike, but ended with current Prime Minister Shinzo Abe calling a snap general election to be held in late October in a bid to consolidate his grip on power. This appears to be a calculated gamble by Abe to take advantage of a rebound in his personal popularity which had previously dipped sharply following some relatively minor scandals. With other opposition parties in disarray, Ms. Koike is in the process of forming a new party to contest the election but it may

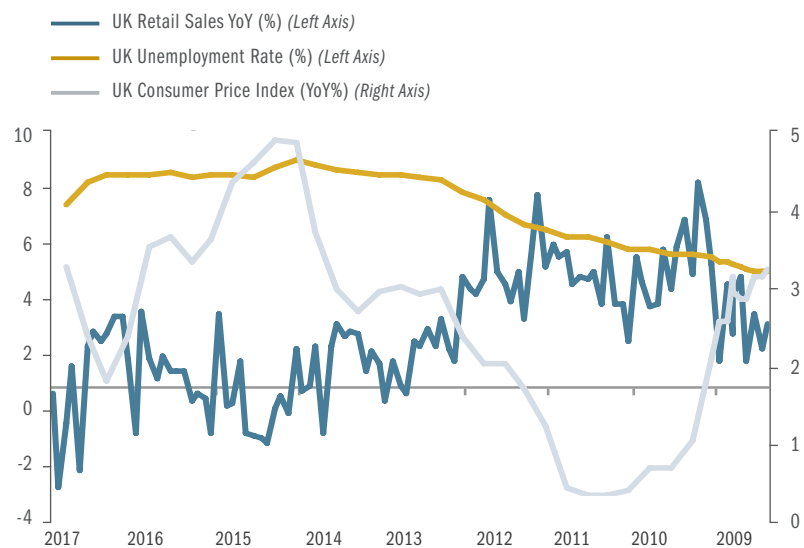
prove difficult to quickly replicate her local success at the national level. However, unlike in previous elections, Prime Minister Abe is not expected to postpone an unpopular 10% sales tax hike projected in 2019 to lower astronomical public debt, despite the adverse effects it could have on private consumption and economic

growth. That said, Abe did announce in September plans for an \$18 billion stimulus package intended to foster a “productivity revolution.” Otherwise, the escalation of tension over North Korea created uncertainty though Abe's hard line stance on the matter has resonated among citizens fearful of a nuclear warfare repeat.

Japanese sentiment and inflation make a significant upswing



UK's sliding economy suffers a spike in inflation



CHINA & EMERGING ECONOMIES: Slight slowdown after stellar growth

CHINA'S ECONOMY EXPANDED 6.9% in the second quarter, beating expectations and providing reassurance about its economic stability. However, recent economic data releases suggest that China may be slowing slightly following a stellar first half as efforts by authorities to rein in credit growth across all sectors dampened economic activity. The Chinese central bank's deleveraging/liquidity-tightening campaign is paying off: it was reported that interbank leverage declined in the first half for the first time since 2010, and the value of "wealth management products" dropped in May by the most in a decade. Continued gradual progress in this direction should gradually ease ongoing concerns about the risk of a hard landing for the world's largest economy.

Notably, China will appoint its next generation of leaders in October, when the

19th National Congress convenes. This rotation is expected to further consolidate President Xi Jinping's authority, which should help the president more effectively implement the market and domestic reforms that he has championed. Xi will likely continue to focus on reforms that improve the country's financial stability and social welfare and promote economic rebalancing. Although there has been increased rhetoric about trimming excess capacity, particularly in the coal and steel industries, we expect progress to be slow in those areas.

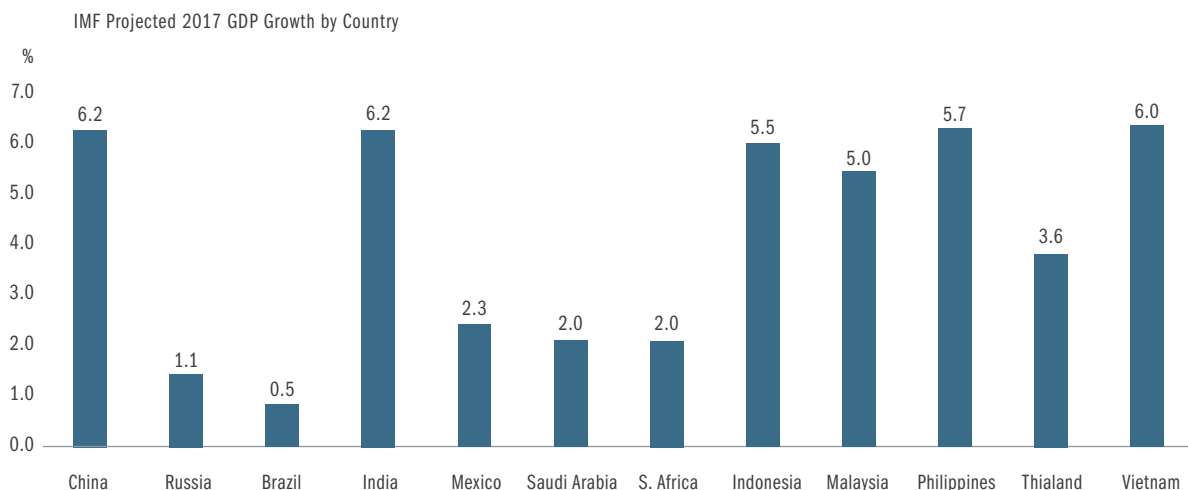
Among the other Asian economies, Taiwan has been motoring ahead thanks to healthy demand abroad, particularly from China. The economy should also benefit from the government's forward-looking \$3.3 billion infrastructure development program. Thailand, the Philippines, and

Indonesia have likewise been posting healthy growth rates, but are showing some signs of hangover as we get into the second half. For its part, South Korea has been in the eye of the storm but as of yet the economic data does not show a material deterioration despite the escalating war of words between the U.S. and North Korea.

India's economy suffered a slowdown on account of the effects of the Goods & Services Tax (GST), but both hard data and survey-based data suggest that the worst is over and growth should pick up this quarter. India's Chief Economic Advisor Arvind Subramanian warned that fiscal slippages could interfere with the economy's momentum and voiced concerns over farm loan waivers by states, while at the same time reiterating the government's commitment to hitting budget targets.

In Brazil, although GDP expanded for

Key emerging market countries find their growth footing in 2017



the first time in over three years in Q2, the recovery remains tentative with mixed high-frequency data for Q3. President Michel Temer survived an August 2 vote in Congress and avoided the possibility of being tried for corruption. An interruption of the government's reform agenda was thus sidestepped for now, although political noise is still high. The government is trying to pass a critical pension reform by

October and a tax overhaul by the end of the year, two badly needed measures to correct imbalances in the hobbled economy. However, Temer is not off the hook yet and is facing abysmal approval ratings along with the likelihood that the public prosecutor's office will file more corruption-related cases against him in the coming months.

The Russian economy has also shown incipient signs of losing some steam in

Q3 after a robust Q2 performance, when growth reached a near-five year high. Recent events are casting a shadow on the country's outlook as the U.S. Congress voted in July to step up sanctions on Russia, a move that could undermine confidence in the economy and investment and possibly put a lid on the pace of economic recovery in the long-term. In addition, the low-oil-price environment is weighing on the econ-

omy's growth trajectory and shows little chance of improving, as a production cut deal by petroleum-exporting nations has failed to boost prices. Elsewhere, Chile and Peru benefited from a recovery in commodity prices. In Chile, sentiment was also boosted by opinion polls which showed center-right candidate, Sebastian Piñera, had extended his lead ahead of a presidential election in November.

Finally, President Jacob Zuma narrowly survived another no-confidence vote on August 8 despite having introduced secret

voting in the legislative body for the first time ever. The victory, although important, is short-lived and shows how support for Zuma's battered image continues to erode due to multiple scandals involving graft and mismanagement. The ultimate test for the embattled president, however, is the December ANC convention where the party will choose a new leader for the 2019 presidential elections. To be sure, Zuma's persistent political debacles are causing collateral damage in the economy. South Africa entered a technical recession

in Q1 and an uncertain political landscape is keeping investment at bay. The unemployment rate was 27.2% in Q2, manufacturing output was stagnant in June and survey-based data was disappointing at the outset of Q3.

Universally, emerging market current account deficits remain less than half their size four years ago in countries including South Africa and Turkey, a key indicator of the underlying strength and resilience of the developing world that is critical to the ongoing stability of growth.

GLOBAL MARKET OUTLOOK: Unstoppable

IT WAS A GOOD QUARTER for global equity markets, which overlooked the headlines of the day and remained focused on economic data that continued to point to a healthy global economy. In addition to the meteorological issues in the quarter, aggressive rhetoric with North Korea did increase volatility in mid-August temporarily. The VIX Index, a measure of uncertainty using option prices inputs, spiked twice in the third quarter, reflecting the insecurity over geopolitical issues under President Trump. These spikes were short-lived however, and the VIX Index returned to a historically low level below 10 in September.

The S&P 500 rose over the quarter amid some supportive macroeconomic data, a robust quarterly reporting season, and further weakness in the U.S. dollar. Small cap

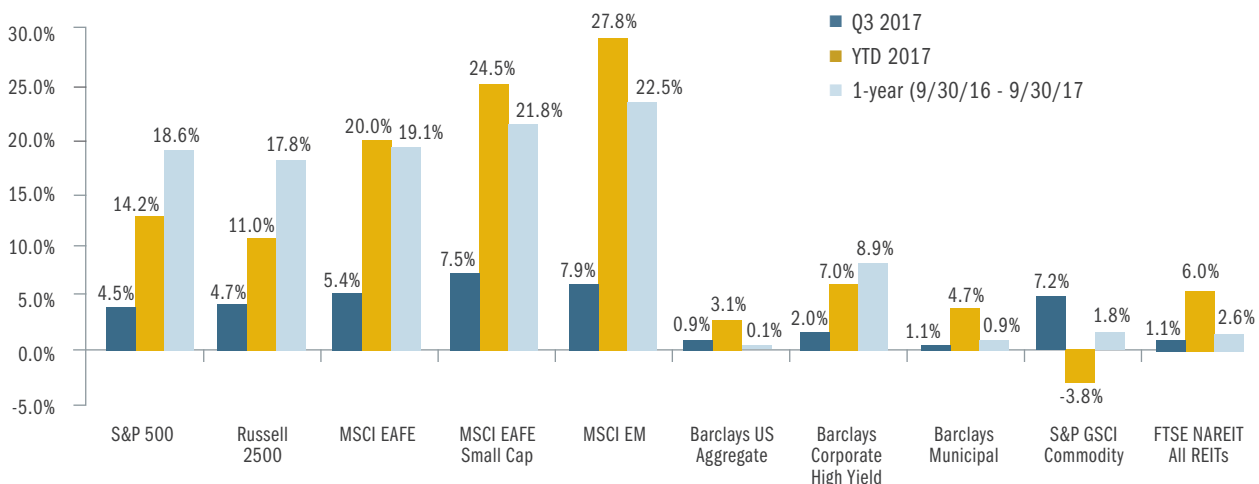
stocks finally picked up the pace, especially in the wake of the Trump administration's reveal of their proposed corporate and personal tax reform plan. Developed non-U.S. equity markets outperformed U.S. markets once again this quarter, helped by a weaker dollar versus the euro and pound sterling, which lifted eurozone and UK returns in dollar terms. Emerging markets outperformed, posting broad-based gains though Brazil was the standout amid some reform progress, coupled with a reduced prospect of a return for the leftist Workers Party in the 2018 elections. Bond yields were little changed over the quarter, reflecting a largely unchanged global economic backdrop. Corporate bonds made positive returns, outperforming government bonds, and municipals had a muted and

skeptical reaction to the prospect of tax reform. Commodities had a bit of a comeback in the third quarter, as the hurricane season prompted a recovery in energy prices while tensions with North Korea created a bid for gold. All in all, global market returns in 2017 have been truly stunning considering the backdrop of geopolitical uncertainty, and show little sign of ebbing as we approach the fourth and final quarter of the year.

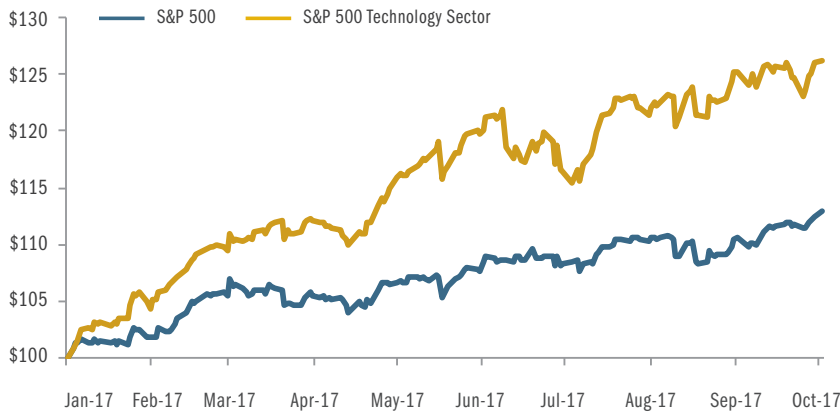
U.S. equity gains once again led by tech titans

Despite continued policy uncertainty, a bruising from back-to-back hurricanes, and concerns regarding developments on the Korean peninsula, domestic equity markets are hitting record levels and volatility is at

Strong third quarter returns further build on the market's stunning gains



Technology stocks trounce the rest of the market in 2017



an all-time low. The S&P 500 gained 4.5% during the quarter, and 14.2% for the year. In their relentless climb higher, the biggest stumble U.S. equities have faced so far this year has been a pullback of less than 3%. Healthy U.S. stock market gains, with low volatility, are being driven by the fact that investors are seeing decent earnings growth come through from corporates with little sign of any near-term recession risk. Consumer confidence remains buoyant and business investment intentions are rising.

The best-performing sector in the quarter and year-to-date has been technology, including the so-called FAANG group of Facebook,

Amazon, Apple, Netflix, and Alphabet (Google), which collectively posted a 6.4% gain on a market capitalization-weighted basis. Utilities boasted strong performance as well. Healthcare stocks climbed on a spike in M&A activity among biotech companies and increased demand for health-care equipment. In contrast, financials suffered during most of the quarter due to a dovish interest-rate outlook, but rebounded somewhat after the Fed’s announcement of plans to unwind its balance sheet. Consumer staples and REITs were weak, and nearly all constituents of the telecommunications sector posted losses.

From a style perspective, growth stocks continued to outperform value stocks. Large caps outperformed small caps through August, but small caps staged a strong recovery in September on the back of the proposed tax reform framework. Domestic companies demonstrated strength with a season of healthy earnings announcements. During the third quarter, a weaker U.S. dollar and robust global demand helped S&P 500 earnings achieve a blended growth rate of 10.3%, with nearly 74% of S&P 500 constituents beating earnings expectations. Technology companies were particularly strong, aided by favorable foreign exchange rates for those companies that earn revenues outside the U.S. Among the S&P’s technology constituents, 87% surprised to the upside, leading to a 27.4% year-to-date return for the sector. The broad trade-weighted U.S. Dollar Index fell 4.9% in the first half of 2017. However, with potential tax reform on the table and a Fed rate hike coming, the dollar has regained strength in recent weeks.

Developed international equities continue their streak, except for Spain

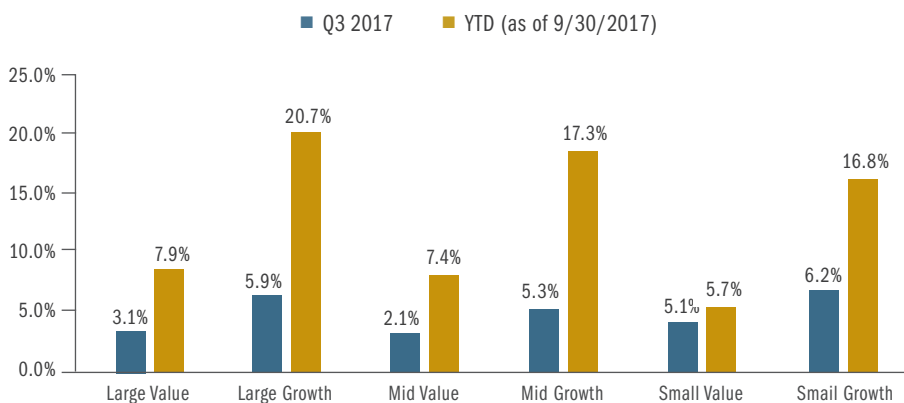
International stock markets posted strong returns in the third quarter. The key equity market drivers included strengthening economic growth, buoyant manufacturing data, solid corporate earnings, and a rise in oil prices. Geopolitical concerns, including terrorist incidents, swelling tension between North Korea and the rest of the world, and natural weather disasters have weighed on some sectors, albeit only temporarily. Many major currencies strengthened against the U.S. dollar during the period, lifting returns in dollar terms.

Within the MSCI EAFE Index, the energy, materials, information technology, consumer discretionary, and industrials and business services sectors outperformed the benchmark. No sector lost ground during the quarter. Value stocks outperformed growth stocks.

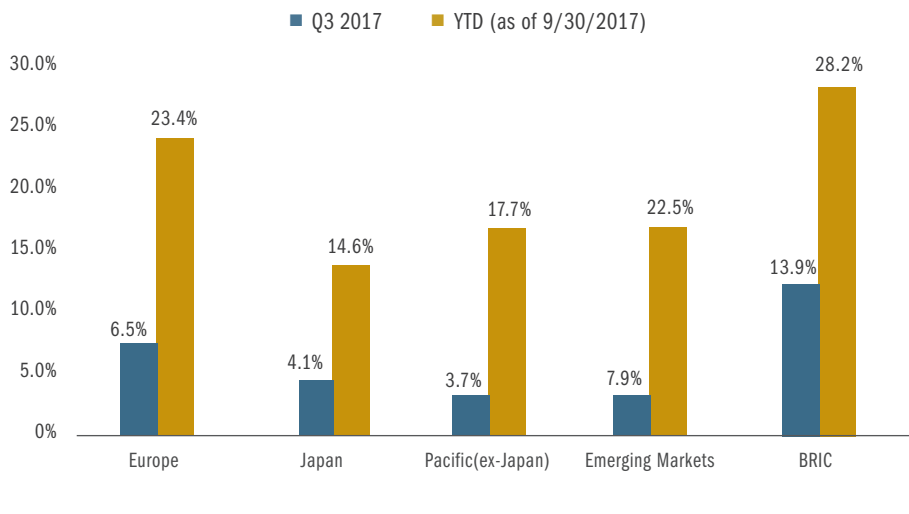
Throughout the period, European markets reacted to a string of favorable economic news, including a mid-August report that the eurozone’s economic recovery was stronger in the spring than previously estimated, a sustained drop in unemployment rates each month in the quarter, and a continuing trend in the rise of consumer and business senti-

Style and market cap have major influence on U.S. market performance this year

U.S. Stock Market Performance by Market Cap & Style



Developed international and emerging markets extend their hot streak



ment. The strength in metals and mining stocks was particularly notable, as demand from emerging markets rose and earnings outlooks from key companies helped boost overall equity market results for the period. The Italian, Portuguese, and Norwegian markets posted above-benchmark gains. Italian financial stocks rallied after its government rescued a troubled bank in July, and Norway, a big oil producer, benefited from the rise in oil prices. German stocks rose in the last week of September following the election of Angela Merkel’s fourth term win as the German chancellor. Also in September, French markets were largely unfazed by swelling protests against President Emmanuel Macron’s labor law reforms.

In contrast, Spanish stocks fell sharply on August 18 following a terrorist attack in a tourist-heavy section of Barcelona that killed at least 13 people and injured more than 100 and another attack in Cambrils, a town southwest of Barcelona. In Spain’s IBEX 35 Index, airlines, hotels, and other tourism-related stocks bore the brunt of losses. Spain also struggled at the end of September following uncertainty surrounding the independence referendum movement in Catalonia, despite the Spanish government’s assertion that the vote would be illegal.

After moving sideways in July and August, the Japanese market rose in September to record a gain of 4.7% for the

quarter. During the quarter, Japanese corporate profits rose by 21% over the previous year, providing a much-needed lift to both the earnings outlook and equity valuations. However, despite these positive economic signals, investors settled into self-preservation mode. Japanese technology companies, which have recently performed well, gave up gains while traditionally low volatility defensive stocks were relatively resilient during the quarter. Oil and mining stocks, as well as auto stocks, led market gains, while financial-related and real estate stocks posted significant underperformance.

Chinese stocks gain despite S&P downgrade while Brazil surges on recovery hopes

Emerging markets stocks rose in the third quarter of 2017 as buoyant risk appetite overcame a growing nuclear threat from North Korea and policy uncertainty in the U.S. Steady global growth, strong earnings growth expectations, and relatively cheap valuations versus developed markets stocks sustained demand for emerging markets assets. In July, the International Monetary Fund (IMF) said that emerging and developing economies would see a “sustained pickup in activity” for the next two years and projected 4.6% growth in the emerging world in 2017, up slightly from its April forecast. The MSCI Emerging Markets Index rose to a three-year high in September but pared gains near month-end

as President Donald Trump’s proposed tax cut plan spurred fears that investors would repatriate dollars, leading to large capital outflows from developing countries. Even so, all eleven sectors in the index advanced, led by real estate and energy stocks.

In terms of regional performance, Chinese stocks advanced as Q2 GDP growth showed a 6.9% increase, though July’s indicators signaled the start of a widely anticipated second-half economic slowdown. Standard & Poor’s cut its credit rating for China citing the country’s rising debt risk, marking the agency’s first ratings cut for China since 1999 and the country’s second major downgrade this year. Indian stocks advanced on optimism about the country’s growth prospects, though concerns about the economic outlook resurfaced at quarter-end after growth slowed to a three-year low in the June quarter. Speculation that India’s government would boost growth through stimulus measures that could widen its fiscal deficit pressured the rupee to a six-month low against the U.S. dollar near the end of September. Meanwhile, Southeast Asian stock markets were mixed. Thailand was the best performer, gaining nearly 11%, followed by the Philippines, whose domestic benchmark hit record levels in September. Most Southeast Asian countries reported better-than-expected GDP growth in the second quarter except for Indonesia, whose second-quarter growth lagged expectations and the government’s own target. Indonesia’s central bank lowered its benchmark rate for the second straight month in September.

Brazilian stocks climbed a stunning 23% as President Michel Temer managed to avoid prosecution, allowing him to press on with economic reforms. In September, Brazil reported that its economy grew a better-than-expected 0.2% in the second quarter from the first, marking the second straight quarter of growth and raising recovery hopes after the country’s worst recession on record. Mexican stocks rose slightly as data pointed to a resilient economy, defying fears of a slowdown after the U.S. election. Signs that the Trump administration was softening some of its protectionist rhetoric in renegotiating NAFTA also lifted the outlook for Mexico’s

exporters. Stocks in Chile and Peru posted double-digit gains as global copper prices rallied to a three-year high in September. In Chile, sentiment was also boosted by opinion polls which showed center-right candidate, Sebastian Piñera, had extended his lead ahead of a presidential election in November. Colombian stocks lagged with a single-digit rise. Colombia's central bank cut its benchmark rate twice over the quarter to bolster growth.

South African stocks added nearly 4%, driven by gains in mining companies as commodity prices surged. South Africa's economy grew a better-than-expected 2.5% in the second quarter from the first quarter

due to its high current account deficit, despite the news that Turkey's economy expanded a surprisingly strong 2.1% in the second quarter from the first quarter and 5.1% from a year ago, making it one of the world's faster growing economies.

Credit and munis once again trounce Treasuries

Bond market yields essentially made a round trip over the course of the quarter, as 10-year Treasury rates initially fell to a low of almost 2% before settling higher at 2.33%. Increased demand for safe-haven securities, largely as a result of growing concerns about the potential for conflict on the

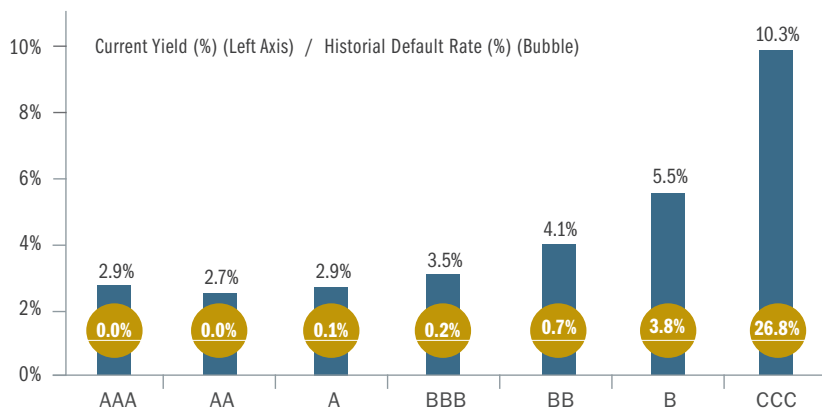
Investment-grade and high-yield credit spreads have not been as tight as they are now since the summer of 2014, such that credit vastly outperformed government bonds. Default rates remain low, even in high-yield junk bonds. Flows also continued to pour into emerging market bonds as investors continued to seek higher real yields than those available from developed market government debt.

The high yield bond market benefited from higher oil prices and generally favorable corporate earnings reports. Energy-related issuers outperformed as U.S. oil prices in September hit their highest levels since April. 30% of the U.S. high yield market traded with credit spreads below 2.5% by the end of September, the first time that has happened since 2007.

Municipal bonds outperformed Treasuries as cash flows into the sector remained solidly positive, while new issuance has fallen off more than 16% year-to-date compared with last year. Bonds from Illinois outperformed after the state finally passed a budget at the start of July, ending a legislative stalemate that had lasted more than two years. Illinois remains the lowest-rated state in the U.S. but seems to have avoided a downgrade to below investment grade, or junk, status.

Despite the Fed's decision to begin tapering its MBS holdings, mortgage-backed securities outperformed the broader U.S. taxable investment-grade market. Mortgage rates fell to a year-to-date low in August, but refinancing activity, which can weigh on MBS results, has so far been muted.

Corporate bond spreads stay tight as defaults remain low and earnings come in high



ter, exiting its second recession in 10 years, though full-year growth is expected to hover near last year's 0.3% expansion. The South African Reserve Bank stayed pat on interest rates in September, defying expectations of a rate cut, due to inflation risks. Russian stocks rallied about 18% as surging global oil prices boosted the outlook for the country's oil-driven economy. Russia's central bank cut its key rate by a half-percentage point in September as inflation slowed and forecast that the economy would expand up to 1.1% this year, up slightly from its earlier target. Greece registered one of the biggest declines due to uncertainty about whether the indebted country would be able to stand on its own feet when its bailout program enters its final year. Finally, Turkish stocks were weak over concerns

Korean Peninsula, was offset by a rebound in inflation and the Trump administration's announcement of its tax reform proposal later in the period. In addition, the Federal Reserve announced that its plan to reduce its balance sheet would commence in October. The Fed will initially allow \$6 billion of Treasuries and \$4 billion of mortgage-backed securities (MBS) to roll off its balance sheet each month as securities mature, and that total will gradually increase. Fed Chair Janet Yellen struck a hawkish tone in public comments late in the period, causing the odds of a December rate hike as measured by fed funds futures prices to rise above 75% at the end of September. The two-year note, which is more sensitive to expectations for Fed rate increases, finished the period at 1.47%, its highest level since November 2008.

Commodities play catch-up

The commodities index rose in Q3. The energy component generated the strongest return, with Brent crude rallying 20.1% over the quarter. It was supported by a faster-than-expected fall in U.S. crude inventories and increased expectation for an extension of production cuts amid rising global demand. Industrial metals also recorded a robust return as economic momentum in China remained firm. Iron ore was up 14.9% while zinc (+15.5%) and copper (+9.5%) both posted sizeable gains. In contrast, the agricultural component lost value. Wheat and corn prices fell sharply amid record global supplies. In precious metals, gold was up 3.2%, in part given an

uptick in geopolitical concerns. While the recovery in prices in the quarter is welcome, supply/demand conditions for commodities remain unfavorable long-term. Despite continued modest supply cuts by OPEC, crude oil supply is still more than sufficient to meet demand. Improved technology is allowing shale oil wells to be more productive at lower costs. Lower energy prices are contributing to lower agricultural commodity prices. Industrial metal prices have increased recently but are still below 2014 levels for most metals.

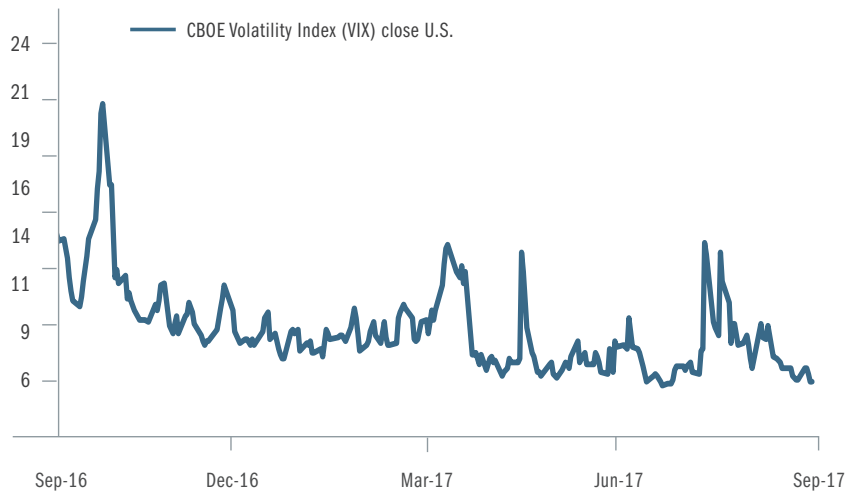
Looking ahead

Bull markets, it is said, must climb a wall of worry, and this summer threw worries aplenty at the market. But for all this, stock markets pushed on to all-time highs, and with the world economy now enjoying its best period of growth this decade we see further upside. This is not to ignore entirely any tail risks, or to overlook the advanced age of this business cycle, but instead to reflect that in a period of synchronized above-trend growth and loose policy, risky assets probably have room to run.

Indeed, summer worries over geopolitics have been amply offset by the continued and synchronized pick-up in global growth. Global central banks remain in mostly dovish mood; and even with balance sheet normalization in the U.S. and tapering of quantitative easing in Europe set to start this autumn, policy around the world is still loose. Rates are set to rise, but only slowly. Despite the relative maturity of the business cycle, recession risks remain muted and a combination of global earnings upgrades and loose financial conditions are supportive for stocks and other risky assets.

Regarding earnings, companies are projecting double-digit EPS growth globally in 2017 and 2018. In the U.S., a combination of steady revenue growth, improved margins, and heavy share buybacks has boosted earnings growth for several years, and we expect this to continue. In Europe, corporate profits are growing for the first time in six years, although we do acknowledge further euro strength as a potential headwind. Strong

Volatility remains exceptionally low and well-behaved



operating leverage for Japanese corporations should help propel earnings gains this year and next. In emerging markets, we project high double-digit profit growth in 2017.

But optimism should be somewhat restrained. Higher equity valuations—and the absence of a significant market correction for quite some time—make us more cautious now. Investors should now expect average, not outsize, gains over the next 18 to 24 months. The eventual unwinding of global central bank balance sheet expansion, slated to begin with the Fed in October, will surely present challenges. And after a strong run for global equity markets, we must guard against the trap of investor complacency and excessive risk taking.

For this reason among others, we remain focused on prudent diversification and periodic rebalancing. We want you to be prepared for a market pullback but not yet positioned for the more substantial downside that usually comes with recessions. Given our positive view on growth, we maintain a pro-risk tilt in our recommended asset allocation, with a bias toward equities at the expense of bonds. Correlation across regional indices remains low, favoring broad diversification across global equity markets. As the U.S. economy moves into late cycle, we are naturally more attuned to any dip in

higher frequency data, but currently we see little risk of recession in the next 12 months. We are favorable toward developed international markets, especially the eurozone and Japan, and prefer a small company tilt in these markets. We maintain a strong conviction in our emerging markets allocation, and are happy to have an Asia-focus in our recommended positioning. In bond markets we expect yields to grind higher over the fourth quarter and favor corporate bonds and municipals over government bonds as we believe spreads will maintain their current levels if not tighten further. In a distinctly mature credit cycle, returns from credit will come from carry rather than capital appreciation. In all respects, we are mindful that with the economic cycle maturing, liquidity and diversification are paramount.

Overzealous policy tightening still represents the greatest threat to our pro-risk stance, but that risk seems to be receding. Indeed, with activity data positive but inflation subdued, the Fed’s balance sheet normalization plan seem to be subtly changing to have a scope at the minimum edge of what they feel is responsible and required. And as the last few years have shown us, modest growth, dovish language, and easy financial conditions are the holy trinity of prolonged bull markets.

DISCLOSURE: The information set forth in these materials is presented by Ropes Wealth Advisors LLC (“Ropes Wealth”) a wholly owned subsidiary of Ropes & Gray LLP. Ropes Wealth cautions the reader that past results are not indicative of future performance. The historical return of markets generally and of individual assets classes or individual securities may not be an accurate predictor of future returns of those markets, asset classes or individual securities. The economic commentary contained in this newsletter is for informational and educational purposes only and is not intended as investment advice.

SOURCE FOR ALL GRAPHS: Bloomberg.