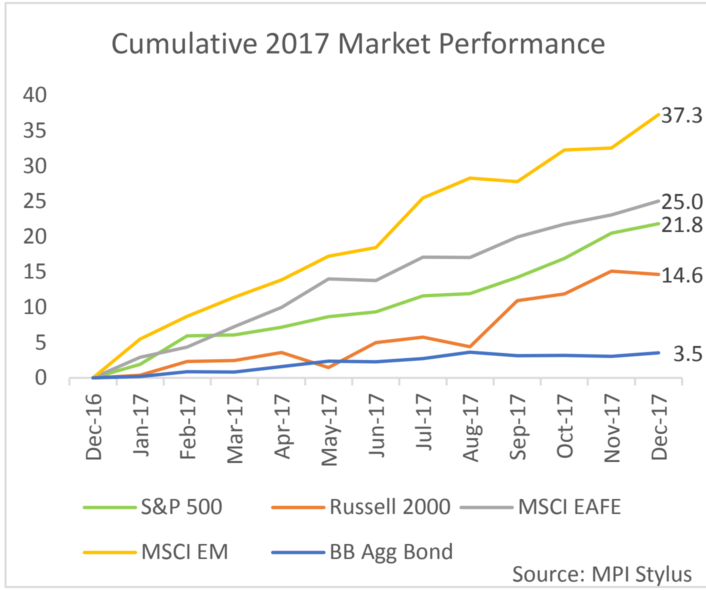
Investment markets were firing on all cylinders in 2017, as increasingly synchronized global economic growth invigorated corporate financial health, thereby encouraging (and rewarding) essentially any measure of risk taking during the year. The abundantly transparent guidance tendered by the world's major central banks lent additional inspiration to such investing postures. Yet investors may find themselves hard-pressed in the New Year to replicate that success. While our **baseline expectation for the global economy in 2018 is centered on a notion of enduring strength**, we remain ever more mindful that **elevated valuations both diminish the margin of safety for taking risk and generally moderate our return expectations** in the coming year.

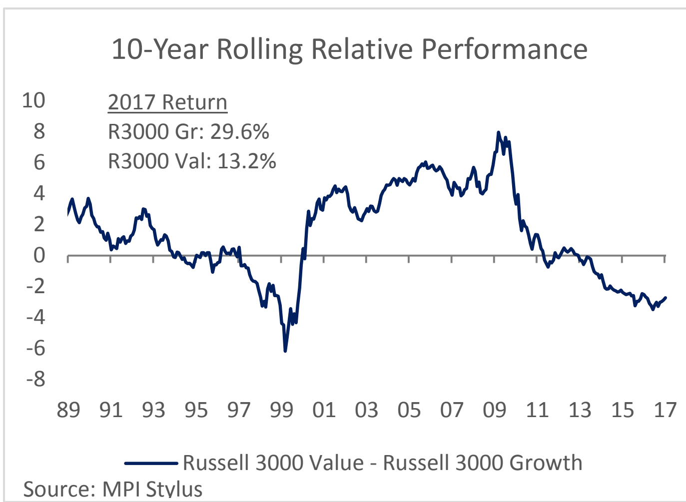
Investable markets advanced in basically a step-wise manner across 2017, as recognized major market segments (commodities aside) generated uniformly positive returns in each and every quarter of the year (see chart at right). We are somewhat **circumspect that a repeat of such consistency will be in the offing this year**. A host of considerations provoke our caution, including most prominently: 1) a U.S. recovery a year further in its maturation; 2) a Federal Reserve managing both a transition of its Chair and the next (and arguably more fragile) phase of its efforts to normalize monetary policy and shrink its balance sheet; 3) an executive branch that continues to espouse a protectionist-leaning trade policy; 4) the investing challenges that can be evoked by a flattening yield curve; and 5) the tightrope on which Chinese authorities find themselves perched in addressing heightened levels of indebtedness.



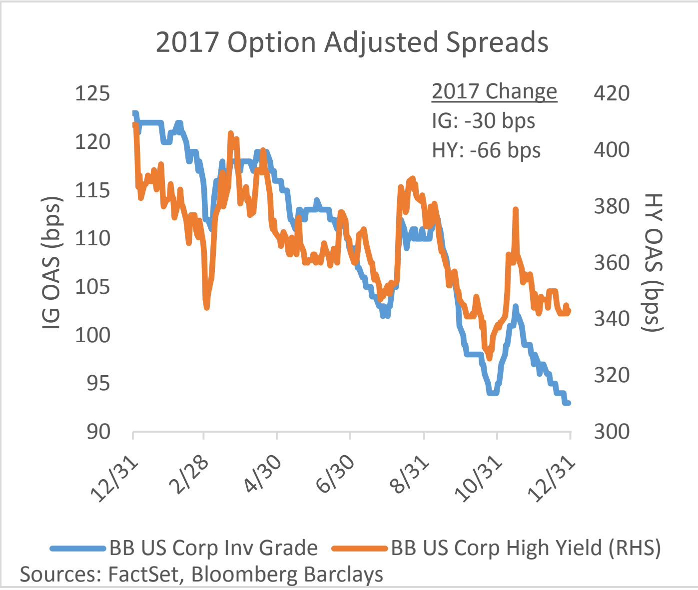
In our estimation, a concise review of what transpired in the markets last year, when interlaced with our 2017 predictions, offers the best context for what might occur in the coming year. Emerging market equities cast aside worries of looming U.S. dollar strength potentially emanating from Fed rate hikes (the dollar, in fact, finished the year notably weaker) and, instead, drew strength from a robust global trade backdrop to lead the performance rolls with a 37.3% gain. Meanwhile, developed international markets returned 25.0%, a response that hinged in large part on strengthening economic data across Europe and in Japan. U.S. equities gained 21.1% for the year, with meaningful incremental returns sourced from both larger capitalization names (which has historically been the case deeper into an economic recovery) and growth as a style. Interest rates remained reasonably well-behaved, and, as a result, global fixed income markets delivered positive returns. Intermediate maturity, investment-grade markets in the U.S. delivered a 3.5% return, with higher returns still from those segments of the bond market commonly perceived to be more volatile. Both longer duration and high yield paper produced measurably higher total returns, as did the developed and emerging market debt arenas.

A year ago we suggested that investors' "mettle and conviction" might be tested and, furthermore, that there were not "obvious sources of out-sized returns to be readily captured in the markets." **Our sentiment toward the investing landscape a year ago could perhaps best be summarized as one of deliberate vigilance**. In retrospect, of course, our conservatism was unnecessary, as investors readily cast aside diverging central bank policies and marginally extended valuations in favor of a global macroeconomic profile that grew increasingly strong as the year progressed. Accordingly, we somewhat underestimated the magnitude of returns achieved across certain markets. However (and importantly), **many of the portfolio orientations that we endorsed a year ago proved to be reassuringly prescient**. We postulated that global GDP growth hovering in the mid 3% range (the IMF's latest estimate anticipates a 3.6% result for full year 2017) could serve as the primary stimulant for decent investment returns more broadly and as the overarching determinant favoring equities over fixed income. Moreover, **our expectations that international equities would outpace their domestic counterparts and that "spread" would outperform across the fixed income markets were definitively fulfilled**. Admittedly, a degree of inaccuracy in terms of absolute return estimates is, in our view, somewhat more tolerable when coupled with accurate forecasting of our broad allocation preferences.

Equity markets are not completely devoid of opportunity in the quest to source incremental return this year. We are of the overall mindset that the **momentum exhibited by international equity markets last year may be replicated in 2018**. Valuations present less of an obstacle, and less mature economic recoveries overseas provide a fundamentally stronger link to improving corporate financial health and, potentially, higher returns. In our view, **opportunities exist in Europe, Japan, and the emerging markets** for selective, thoughtful investors. **Sourcing outsized returns across the domestic equity markets will likely prove to be more challenging**, a byproduct of the aforementioned elevated valuations and comparatively mature economic cycle. Disciplined investing is instinctively contrarian and fosters **interests for us in value equity (see chart at right) and, perhaps, a renewed interest in active management**. The relative neglect recently encountered by each of these approaches to domestic equity investing instigates their consideration.



Akin to many areas of the equity markets, some segments of the fixed income markets possess elevated valuations. In response, we are inclined to **tilt somewhat more conservatively within fixed income this year**, as prospects for inflation remain uncertain, spreads are



tight, and bond prices remain vulnerable to higher interest rates. In our estimation, these **circumstances require a flexible mindset and further oblige both an up-in-quality and "duration-aware" orientation**. We expect that opportunities for price appreciation as a source of total return will be limited this year, with the bulk of any gain likely derived from coupon income. Investors' best frame of reference this year respecting potential bond returns should be drawn from the awareness that base interest rates, while reasonably well-behaved, are still low.

While we embrace the consensus prognosis that **2018 should ultimately prove to be a constructive year for investors**, our return expectations are grounded and somewhat modest. Moreover, later cycle investing, in our view, is best addressed via **diversified portfolio expressions regularly recalibrated to your particular risk, return, and liquidity objectives**. No doubt, the current state of the global economy can aptly be labeled to be stout and, on balance, supportive of risk assets. However, our fervor for the coming year is partially tempered by valuation levels, which for many areas of the investable markets hover at, or above, historical averages. In our estimation, **the general state of valuation affords investors less "cover," indicating that an attentive and nimble mentality will likely work best in 2018**.

We look forward to expanding upon our views with you in the coming weeks as the New Year begins to take form.