Cherry Bekaert Wealth Management

Market Update: The Year in Review

2017 Summary

At the beginning of 2017, a common view among money managers and analysts was that the financial markets would not repeat their strong returns from 2016. Many cited the uncertain global economy, political turmoil in the US, implementation of Brexit, conflicts in the Middle East, North Korea's weapons buildup, and other factors. The global equity markets defied their predictions, with major equity indices in the US, developed ex-US, and emerging markets posting strong returns for the year.

The broad global advance underscores the importance of following an investment approach based on diversification and discipline rather than prediction and timing. Attempting to predict markets requires investors to not only accurately forecast future events, but also predict how markets will react to those events. The 2017 markets were a good reminder that there is little evidence suggesting either of these objectives can be accomplished on a consistent basis.

Instead of attempting to make predictions about future events, investors should appreciate that today's price reflects the expectations of market participants and information about future expected returns. The following quote by the late Merton Miller, Nobel laureate, describes this view:

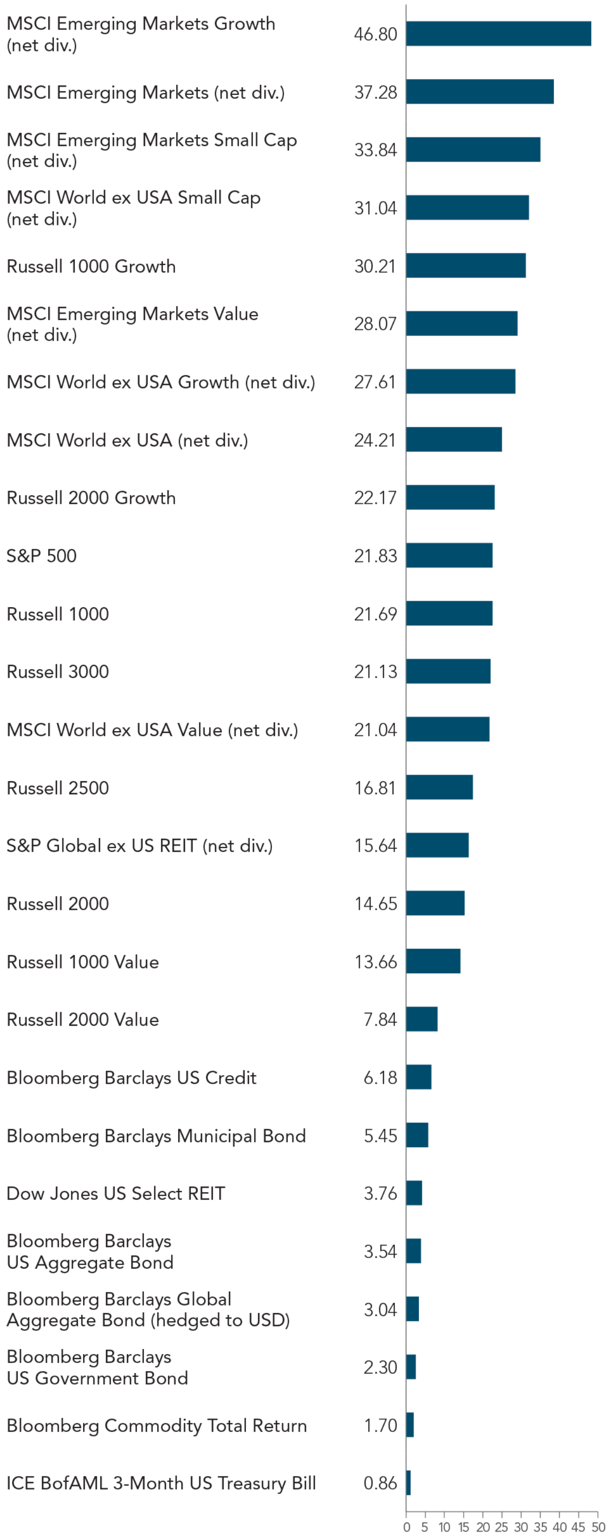
> "Everybody has some information. The function of the markets is to aggregate that information, evaluate it, and get it incorporated into prices."
> —Merton Miller

In 2017, the global economy showed signs of stronger growth, with 45 countries tracked by the Organization for Economic Cooperation and Development (OECD) all on pace to expand.[1] Economic outlook and the expected impact on future cash flows are among the many variables markets consider when setting prices. Therefore, investors should remember that growth in the economy is not always linked to stock market performance.

[1] Wall Street Journal, "Everything Went Right for Markets in 2017— Can That Continue?", 29 Dec. 2017.

Major World Indices Ranked by One-Year Performance (%)

As of December 31, 2017



Major World Indices

As of December 31, 2017

Index	One Year	Three Years*	Ten Years*
US Equity Returns (%)			
Russell 3000	21.13	11.12	8.60
Russell 2500	16.81	10.07	9.22
Russell 2000	14.65	9.96	8.71
Russell 2000 Value	7.84	9.55	8.17
Russell 2000 Growth	22.17	10.28	9.19
Russell 1000	21.69	11.23	8.59
Russell 1000 Value	13.66	8.65	7.10
Russell 1000 Growth	30.21	13.79	10.00
S&P 500	21.83	11.41	8.50
Non–US Equity Returns (net div.) (%)			
MSCI World ex USA	24.21	7.36	1.87
MSCI World ex USA Small Cap	31.04	12.96	5.16
MSCI World ex USA Value	21.04	6.26	1.32
MSCI World ex USA Growth	27.61	8.38	2.36
MSCI Emerging Markets	37.28	9.10	1.68
MSCI Emerging Markets Small Cap	33.84	8.44	2.78
MSCI Emerging Markets Value	28.07	6.21	0.91
MSCI Emerging Markets Growth	46.80	11.88	2.35
Fixed Income Returns (%)			
Bloomberg Barclays Global Aggregate Bond (hedged to USD)	3.04	2.66	4.16
Bloomberg Barclays US Aggregate Bond	3.54	2.24	4.01
Bloomberg Barclays US Credit	6.18	3.63	5.42
Bloomberg Barclays US Government Bond	2.30	1.40	3.23
Bloomberg Barclays Municipal Bond	5.45	2.98	4.46
ICE BofAML Three-Month US Treasury Bill	0.86	0.41	0.39
REIT and Commodity Returns (%)			
Dow Jones US Select REIT	3.76	4.97	7.07
S&P Global ex US REIT (net div.)	15.64	4.78	2.05
Bloomberg Commodity Total Return	1.70	−5.03	−6.83

**Annualized*

Past performance is not a guarantee of future results. In US dollars. Indices are not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio Please see page 4 for additional footnotes and disclosures.

2017 Market Perspective

Equity Market Highlights

Global equity markets posted another positive year of returns in 2017. The S&P 500 Index recorded a 21.83% total return and small cap stocks, as measured by the Russell 2000 Index, returned 14.65%, both above their long-term average return of 11.96% and 11.73%, respectively, since 1979.

Returns among non-US equity markets were even higher. The MSCI World ex USA Index, which reflects non-US developed markets, logged a 24.21% return and the MSCI Emerging Markets Index a 37.28% return[2], making this the fifth highest return in the index history.

Similar to the US equity market, value stocks posted a healthy 21.04% return for 2017 as measured using MSCI World ex USA Value Index. However, growth stocks performed even better with a 27.61% return, as measured by the MSCI World ex USA Growth Index.

In emerging markets, small cap stocks underperformed large cap stocks and value stocks underperformed growth stocks. Similar to the US equity market, high profitability stocks outperformed those with low profitability.

Value stocks returned 28.07% as measured by the MSCI Emerging Markets Value Index, but growth stocks fared better returning 46.80% using the MSCI Emerging Markets Growth Index. The value premium, measured as MSCI Emerging Markets Value Index minus MSCI Emerging Markets Growth Index, was the lowest since 1999.

Though 2017 generally marked a positive year for absolute equity returns, it marked a change in premium performance from 2016 when the size and value premiums were generally positive across global markets. Taking a longer-term perspective, these premiums remain persistent over decades and around the globe despite recent years' headwinds. It is well documented that stocks with higher expected return potential, such as small cap and value stocks, do not realize these returns every year. Maintaining discipline to these parts of the market is the key to effectively pursuing the long-term returns associated with the size, value, and profitability premiums.

Fixed Income

Both US and non-US fixed income markets posted positive returns in 2017. The Bloomberg Barclays US Aggregate Bond Index gained 3.54%. The Bloomberg Barclays Global Aggregate Bond Index (hedged to USD) gained 3.04%.

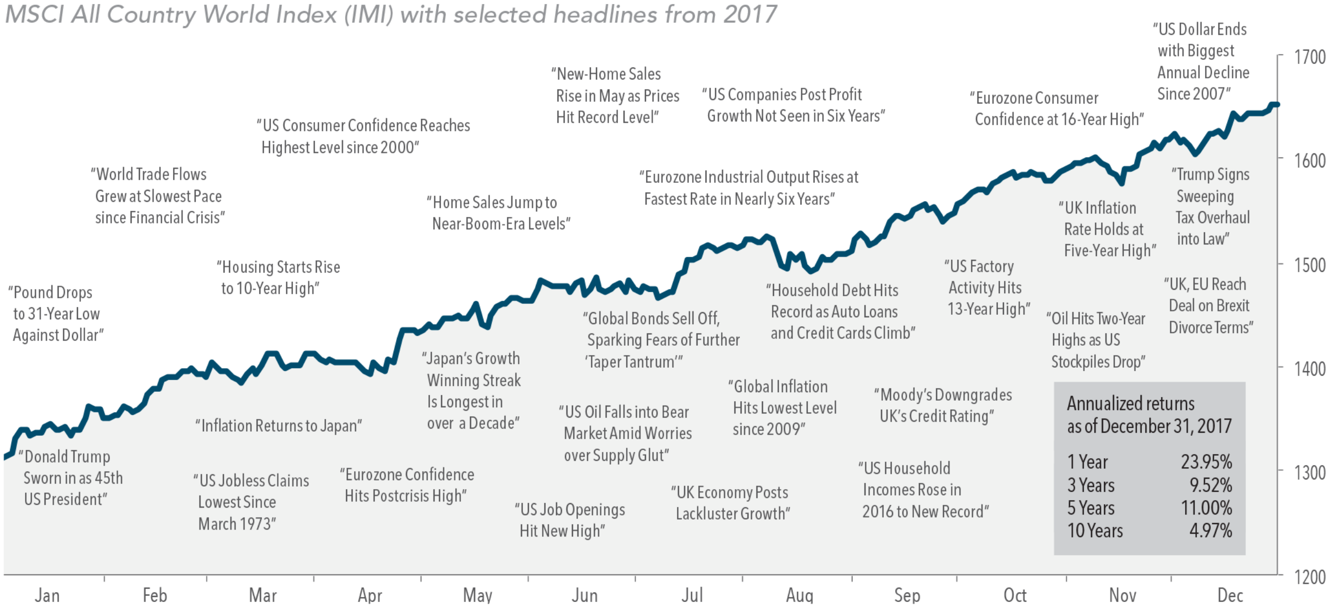
Yield curves were upwardly sloped in many developed markets for the year, indicating positive expected term premiums. Realized term premiums were indeed positive both globally and in the US as long-term maturities outperformed their shorter-term counterparts.

In the US, the yield curve flattened as interest rates increased on the short end and decreased on the long end of the curve. The yield on the 3-month US Treasury bill increased 0.88% to end the year at 1.39%. The yield on the 2-year US Treasury note increased 0.69% to 1.89%. The yield on the 10-year US Treasury note decreased 0.05% for the year to end at 2.40%. The yield on the 30-year US Treasury bond decreased 0.32% to end the year at 2.74%.

[2]All non-US returns are in USD, net dividends.

World Stock Market Performance

MSCI All Country World Index (IMI) with selected headlines from 2017



Source: MSCI.
Past performance is not a guarantee of future results. In US dollars, net dividends. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

The chart above highlights some of the year's prominent headlines in the context of global stock market performance as measured by the MSCI All Country World Index-Investable Market Index (MSCI ACWI IMI). These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Sources:

Past performance is no guarantee of future results. This information is provided for educational purposes only and should not be considered investment advice or a solicitation to buy or sell securities. There is no guarantee an investing strategy will be successful. Diversification does not eliminate the risk of market loss.

Investing risks include loss of principal and fluctuating value. Small cap securities are subject to greater volatility than those in other asset categories. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Sector-specific investments can also increase these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

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