1Q 2018

The Advisor

EXECUTIVE SUMMARY

- Economic growth slowed as fourth quarter 2017 GDP decreased to a 2.9% annualized growth rate, which is expected to continue into the first quarter.
- Global and U.S. manufacturing and services PMI data remain strong, but the rate of increase has begun to slow.
- Business and consumer confidence readings reflect heightened levels of optimism that is expected to translate into more spending and investment.
- Escalation of trade wars could increase downside risks to the economy; we hope that a major trade conflict can be avoided.
- The Federal Reserve's ("Fed") upbeat assessment of economic conditions has positioned markets to expect further interest rate increases.
- The yield curve will be a key determinant for fixed income returns in 2018.
- Equity market volatility has risen sharply as monetary liquidity is slowly removed from the system and investors become more risk averse.

ECONOMIC REVIEW

The rate of growth for the U.S. economy backed off slightly in the fourth quarter and is expected to slow further in the first quarter, but the outlook remains bright with healthy job creation and no threat of significant inflation on the horizon. However, a shadow was cast on this sunny view when President Trump declared tariffs on solar panels and washing machines in January, on steel and aluminum in the beginning of March, and then closed the quarter with an announcement that he would set tariffs on Chinese goods.

Consumer confidence remains high, but spending growth weakened slightly in the first quarter. This was due in large part to higher fourth quarter sales of automobiles and building materials for reconstruction and replacement due to the severe weather damage in the preceding quarter. Consumers also appear to be saving a larger share of their tax breaks and slight income gains after taking on more credit over recent years.

Jerome Powell assumed the position of Federal Reserve ("Fed") Chair in early February and was put to the test on his very first day, as stocks spiraled lower in one of the most violent sell-offs since June 2016. The Fed met twice during the quarter and, after taking no action at the January meeting, set the federal funds rate at 1.50% to 1.75% in a widely anticipated raise at the March meeting. The Fed communicated its recognition that the outlook for U.S. growth and inflation has improved as well as the expectation of two more rate hikes this year. The Fed also bumped its 2019 outlook for interest rates up to three hikes from two.

Manufacturing output is expanding across the globe against a backdrop of synchronized growth, but the rate of advance has visibly slowed this year. Many major central banks remain accommodative and, in most cases, are still in quantitative easing mode — in contrast to the U.S. Fed's tightened monetary policy. However, the U.S. dollar has remained relatively weak, despite the higher rate advantage, helping exports and corporate profits.

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MACRO SUMMARY

GDP

- Fourth quarter GDP growth slowed to 2.9%, reflecting lower inventory investment.
- First quarter growth likely weaker at 1.5% to 2.5% and consistent with current expansion's history of "weak first quarters" where shortfall is made up in subsequent quarters.
- Stronger growth of 2.5% to 3.5% should resume in second quarter 2018 as U.S. economy continues to benefit from tax reform, reduced regulation and improved global growth.
- Federal government spending is contributing to growth, but debt has jumped $1.2 trillion since the debt ceiling was lifted in September 2017.

Employment

- March was the sixth consecutive month of a 4.1% unemployment rate and is near full employment, with the Midwest experiencing a shortage of workers.
- Initial unemployment claims hit the lowest level since 1973.
- Wage increases remain flat at about 2.7% annual growth, but is reaching the point of producing wage inflation and employers are finding it hard to hire skilled workers.
- The ratio of jobs openings to unemployed reached 1.0 for the first time since the government started tracking the data.

Housing

- Existing home sales in February showed a 1.1% increase year-over-year and median home prices increased 5.9%.
- A very tight 3.4 month supply is driving prices higher and is weakening affordability.
- Demand is transitioning from more abundant multi-unit structures to single family homes, which are in short supply.

Consumer

- Consumer confidence is near an 18-year high, bolstered by confidence in a strong jobs market.
- Consumers reined in their spending in first quarter and increased their savings.
- Continued slowdown in consumption growth is doubtful, given a tax cut windfall, solid job growth, and high level of consumer confidence.

Business

- The March ISM Manufacturing Index's 59.3 reading is still well in expansionary territory. The Prices Paid Index hit a seven year high, indicating tighter availability of materials and labor.
- ISM Non-Manufacturing Index's 58.8 reading in March is close to its 13-year high and suggests that the apparent slowdown in first quarter GDP growth will not be sustained.
- Duke University's March CFO Survey showed an all-time high in optimism due to tax reform.
- M&A activity is strong, driven by companies' need to bolster modest organic growth and aided by the desire to lock in a low cost of capital.

The Fed

- The Fed's decision to raise interest rates by 25 bps to 1.50% - 1.75% in March was widely expected.
- Fed officials increased their projections for the fed funds rate to 2.75 - 3.00% at the end of 2019.
- The Fed's balance sheet continues to shrink gradually.
- U.S. money supply growth has slowed due to increased debt issuance by the U.S. Treasury.

Inflation

- The Personal Consumption Expenditure ("PCE") deflator remained at a relatively flat 1.8% increase in February, still short of the Fed's 2.0% objective, with Core PCE's growth rate also lagging at 1.6%.
- February's Core CPI, at 1.8%, also trails the Fed's target, but many sources of deflation appear to be moderating; recent dollar weakness should also contribute to higher prices.
- The Atlanta Fed Core Sticky CPI remained at a 2.1% annual rate of increase in March.
- Tight labor markets and stronger economic growth, fueled in part by the massive injection of fiscal stimulus, are some of the reasons for potential higher inflation ahead. The U.S. economy is now operating at full capacity.

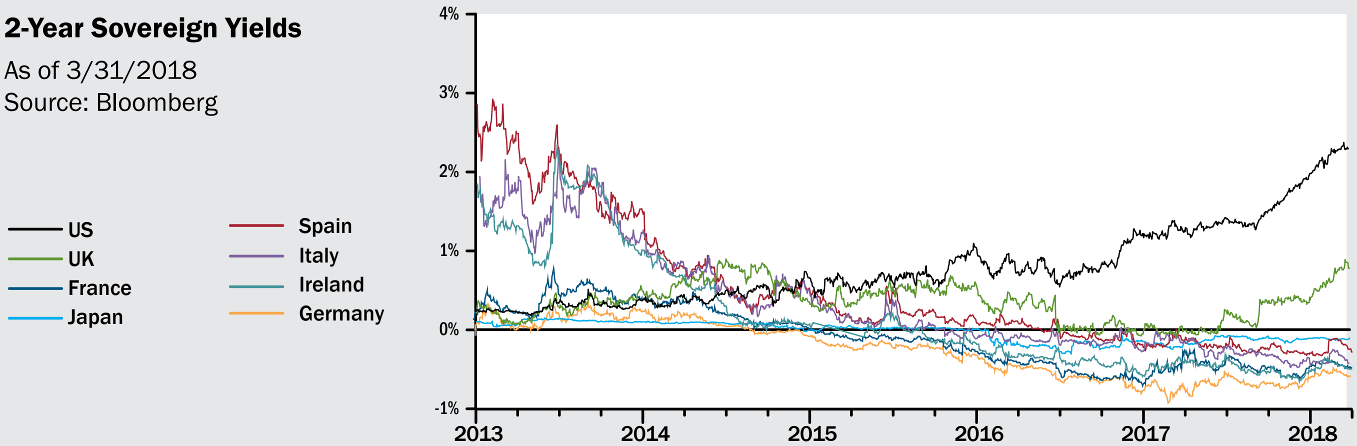
Commodities

- The dollar index of major currencies fell by 2.3% in the first quarter, as many global economies showed improving relative conditions. The lower dollar has been a positive factor for U.S. companies with high exports.
- The price of West Texas Intermediate oil rose 7.5% over the quarter to finish at $64.94 per barrel, but the forward market is factoring in a drop in future prices.
- Prices of key industrial metals weakened in the first quarter, with Copper prices down 8.3% and Aluminum prices 11.9% lower.

MACRO SUMMARY

2-Year Sovereign Yields

As of 3/31/2018
Source: Bloomberg

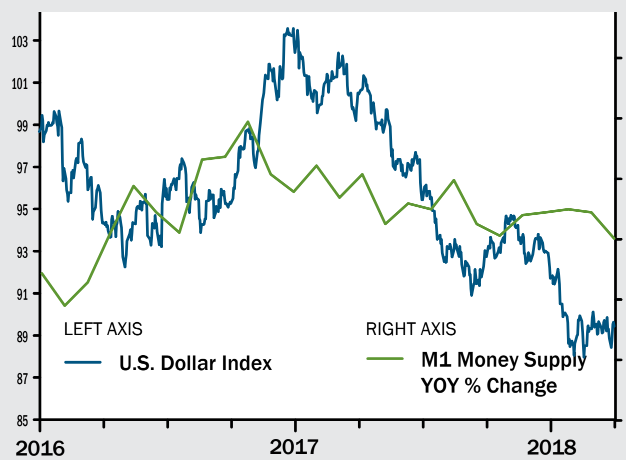


Treasury Yield Spread

As of 3/31/2018 Source: Bloomberg

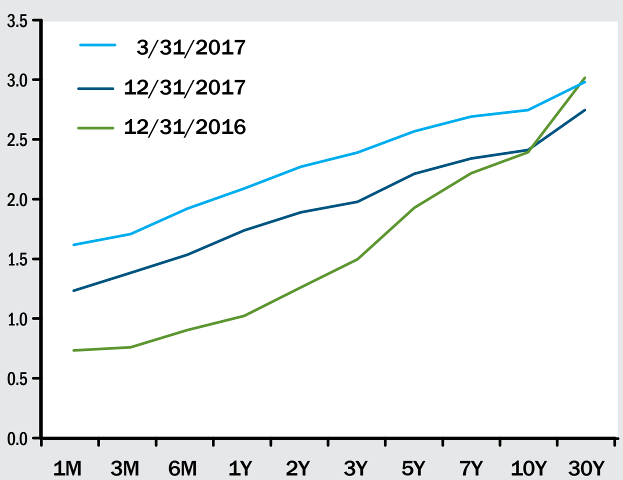
Money Supply vs U.S. Dollar

As of 3/31/2018 Source: Bloomberg



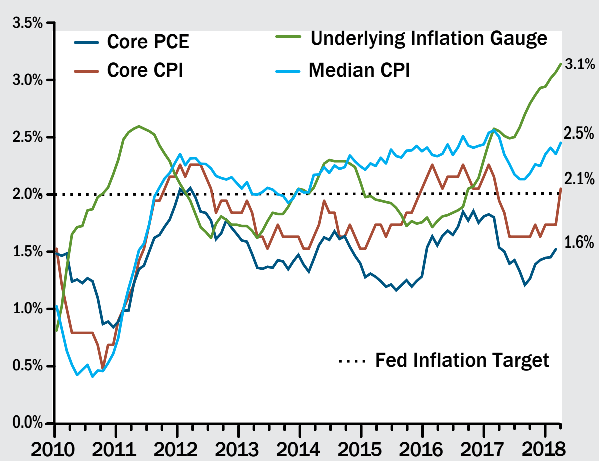
Yield Curve

As of 3/31/2018 Source: Bloomberg



Inflation Data (YOY percent change)

As of 3/31/2018 Source: Bloomberg



FIXED INCOME MARKET REVIEW

While there has been a general consensus that three rate hikes were expected, there were rumblings that four rate hikes might be prudent as well before the re-emergence of volatility in late January. There was much discussion surrounding the goldilocks jobs figure that recently posted - a number that seemed to be in line with other sweet spot data that we are seeing. As recently as February 1, the Atlanta Federal Reserve GDP Now Q1 2018 forecast hit 5.40%. Predicted growth in that range, unseen for some time, ramped up speculation that a fourth hike was still on the table. Inflation - largely seen as the best indicator of an overheating economy and the reason to expect a final rate hike - has remained frustratingly elusive. Core CPI inflation is expected to increase as lower inflation periods roll off of the timeline, replaced by periods of higher measured Core CPI that will, by default, increase above the Fed's self-imposed 2.00% threshold. 10-year Treasury Inflation Protected Securities ("TIPs") breakeven spreads reached 2.14% during the quarter (up from 1.98% at the end of 2017 and the highest since 2014) as investors sought protection from the threat of rising inflation.

Credit spreads hit cycle lows in the beginning of February at +82 bps, but ended March at +103 bps. This was 21 bps wider on the quarter for -2.13% total return and -66 bps of excess return in Q1. During the first quarter, investment grade corporate supply and demand dynamics pointed towards eroding technical support for U.S. Credit from both domestic and international investors. Q1 net inflows totaled $42 billion, down over 50% versus this point last year. The two biggest sources of demand for high grade corporate bonds (foreign investors and bond funds/ETFs) declined by over half compared to 2017. Total new issues in corporate supply in Q1 was $343 billion - 11% shy of last year's record start to the year, but up 9% from the trailing twelve month average. During this period, short and intermediate maturities increased more than long term treasury yields.

As in 2017, curve positioning continued to be extremely important. The 10-year Treasury was on an upward trajectory right out of the gate in 2018. The 10-year U.S. Treasury yield increased 33 bps over the course of the quarter to end at 2.74%. Since the start of the year the 10-year has been in a remarkably tight trading range near 2.80%, +/- 5 bps. It appears inflation fears have been overtaken by trade war worries, keeping 10-year yields from moving much. Elsewhere along the curve, the U.S. 2-year Treasury rose 38 bps and the 30-year Treasury rose 23 bps to 2.27% and 2.97% respectively for total returns of -0.17% and -3.89%. The Treasury 2-year/10-year yield curve flattened by a total of 5 bps in Q1 to 45 bps. The short end of the yield curve continues to be influenced by the market's expectation of the Fed's multiple rate hikes over the next several years. Longer term treasuries have sold off on the expectation of higher inflation and a strong economy. Mortgage-Backed Securities ("MBS") underperformed duration matched Treasuries by -39 bps, besting Corporate credit, for a total return of -1.19% in Q1. We believe that some of this can be attributed to the expectation for higher rates, although we would place much more of the cause on the increase in volatility. In summary, after a strong start to 2018, credit markets sold off after hitting cycle tights due to higher equity market volatility, weaker demand, and supply indigestion.

EQUITY MARKET REVIEW

First quarter 2018 equity markets reached new highs in January before selling off on interest rate fears and "volatility short covering" in early February. After recovering somewhat by mid-March, equities lost ground on apprehensions over trade tariff announcements.

In a classic case of portfolio de-leveraging or de-risking, market turbulence picked up as the result of macro factors including: a global trade war, problems in the market-leading tech sector, and rising expectations that further central bank monetary largess is on a short leash.

PERFORMANCE: 1Q 2018	Value	Core	Growth
Large Cap	-3.58%	-0.76%	1.93%
Mid Cap	-3.01%	-0.77%	1.35%
Small Cap	0.57%	2.81%	4.93%

Source: Bloomberg
As of 3/31/2018. Returns calculated on Standard & Poor's equity market indices.

- For the quarter, companies displaying better historical growth, higher price momentum and strong capital efficiency outperformed stocks with more favorable valuation and higher earnings quality.
- S&P 500 Index operating earnings rose 21.4% year-over-year in the fourth quarter - a marked increase from the 9.2% growth rate of the previous quarter.
- Companies in the S&P 500 Index reported a 75.0% rate of earnings estimates "beats" in the fourth quarter – the highest in the past six years. Stock buybacks by companies over the last several years have provided a tailwind for earnings growth and tax repatriation will allow the trend to continue.
- Multinational large cap growth stocks are benefiting from faster foreign growth and dollar weakness.
- Market volatility gauges jumped in the first quarter.

FORWARD EARNINGS

Analysts' initial estimates of future earnings are frequently overly optimistic and tend to fall over the course of the year, but estimates for 2018 and 2019 have risen by almost 5% since the beginning of 2018. The table below which shows EPS estimates by sector.

S&P 500 INDEX EPS	March 29, 2018			YOY Change		
	2017 EPS	2018 EPS	2019 EPS	2017 EPS	2018 EPS	2019 EPS
S&P 500	$124.53	$156.13	$172.62	14.4%	25.4%	10.6%
Consumer Discretionary	$35.23	$40.15	$45.68	6.3%	14.0%	13.8%
Consumer Staples	$27.35	$30.72	$33.50	7.9%	12.3%	9.0%
Energy	$13.28	$25.16	$28.15	N/A*	89.5%	11.9%
Financials	$26.59	$34.58	$38.59	9.5%	30.0%	11.6%
Health Care	$45.08	$60.37	$66.53	0.9%	33.9%	10.2%
Industrials	$30.29	$35.95	$40.31	9.9%	18.7%	12.1%
Information Technology	$50.59	$62.90	$68.95	30.1%	24.3%	9.6%
Materials	$17.18	$22.15	$24.42	25.7%	28.9%	10.2%
Telecom Services	$10.18	$14.45	$14.96	0.6%	41.9%	3.5%
Utilities	$14.53	$15.71	$16.37	3.4%	8.1%	4.2%
Real Estate	$5.60	$4.82	$5.45	-16.4%	-13.9%	13.1%

Source: CAPIQ. Estimates are CAPIQ bottom up analyst consensus estimates using operating earnings at March 29, 2018.
*The Energy sector had a -$3.49 loss in 2016 resulting in a large yoy change

ANALYSTS' 2018 EPS ESTIMATES

- Analysts' estimates for the Information Technology sector were consistently revised higher throughout 2017, but the growth is expected to be in-line with the broad market for 2018 and 2019.
- The Financials sector shows strong relative earnings growth for 2018 and 2019, as the sector is expected to benefit from the new tax laws and reduced regulation.
- Earnings estimates for the Energy and Materials sectors grew over the course of the 2017 due to higher oil prices. The trend is expected to carry into 2018, but begin slowing in 2019.

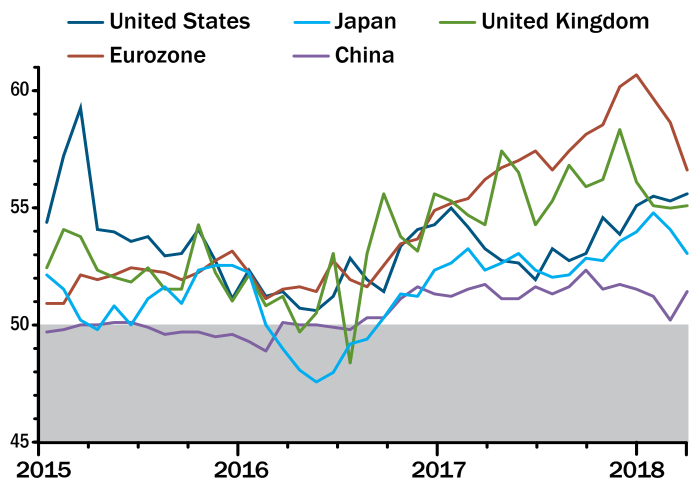
ECONOMIC OUTLOOK

Strong global growth and a moderately priced dollar combined with fiscal stimulus to promote real demand; the near-term prospects for the U.S. manufacturing sector and the broader economy still appear bright. Despite rising fears of trade tensions and other geopolitical rumblings, U.S. and global economic fundamentals continue to point to a sustained economic expansion with the odds of a recession in 2018 appearing very low. However, the extended expansion of the U.S. economy has produced historically low unemployment and diminishing excess capacity, which can lead to higher inflation in the absence of reaccelerating productivity gains.

Stimulative fiscal policy combined with tightening monetary policy have historically coincided with dollar strength, faster economic growth and rising interest rates. U.S. fiscal policy is likely boosting final aggregate demand as the U.S. economy is running out of spare capacity. As the economy strengthens, the risk heightens that unanticipated strong inflationary forces could prompt a quicker tightening of financial conditions by monetary authorities.

An escalation of trade tariffs and restrictions could hinder economic growth prospects and would increase downside risks to the economy, but we hope that we will see trade skirmishes rather than an all-out global trade war. The current harsh rhetoric and accompanying anxieties is an unpleasant part of the negotiating process and is exacerbated by President Trump's contentious bargaining style. We are optimistic that both sides recognize that a trade war is in no one's best interest and could be averted through constructive dialogue. Aside from the disruption of a potential trade war, geopolitical concerns in the Middle East, North Korea, and other areas of the world remain a concern. Recent events concerning personal data security, along with Russia's attempted interference in the U.S. elections, serve to underscore the growing cyber-security threat to governments, corporations, and individuals.

Global Purchasing Managers' Index (PMI)



Source: Bloomberg. As of 3/31/2018.

FIXED INCOME MARKET OUTLOOK

The Federal Reserve's ("Fed") interest rate policy and inflation target will most likely continue to be the most influential factors affecting asset prices throughout the rest of 2018. We should see continued growth if both continue to move gradually higher, as expected. With Core CPI remaining stubbornly below the Fed's self-imposed 2.0% threshold, the potential for a fourth rate hike seems unlikely. There are now an equal number of Federal Open Market Committee ("FOMC") participants expecting four rate hikes this year as there are expecting three — an interesting development from the March meeting of the FOMC. Earnings growth over the last seven years continues at a very healthy pace, fueling GDP growth and allaying fears of disinflation. Other tailwinds such as continued synchronized European Central Bank ("ECB") intervention promoting global growth, maturation of new U.S. tax laws, and Washington's business friendly deregulation agenda should continue throughout the rest of the year.

We are positioned at 93% of duration, underweight 5-year and shorter U.S. Treasuries and slightly overweight 10-year to 30-year maturities expecting the curve to remain flat and potentially flatten more. The effects of harmonized ECB policy - coupled with attractive relative yields — should continue to have a positive effect on pricing. The Fed recently upgraded its Personal Consumption Expenditure inflation target for 2019 and 2020 to 2.1%. Recall, their target is 2%. We anticipate that this Fed, under Powell, will be willing to see inflation run hotter before tightening more aggressively. As a result, we still look for two more rate hikes in 2018. The Fed's GDP growth outlook also improved to 2.7% for this year and 2.4% for next year. It is interesting to note that with nearly 3% growth this year and a longer run unemployment rate forecast of 3.6% — the inflation forecast is still benign at 2.1%. Perhaps this is a nod to persistent labor slack and a very flat Phillips curve. We expect trends in place to continue. Namely, rates should continue to rise gradually as the Fed continues to tighten. Treasury Inflation Protected Securities ("TIPs") will remain firm but already reflect the 2% Fed target inflation rate. Credit spreads (high yield and high grade) should continue to be supported by the favorable macro backdrop however we have reduced our positioning to neutral given historically rich valuations, increased volatility and the reduction in overseas demand due to punitive dollar funding and currency hedging levels.

We expect Mortgage-Backed Securities to underperform as the Fed's balance sheet normalization accelerates over the course of 2018. Currently, we are neutral and will move to an underweight position as we move into the second half of the year if conditions warrant.

EQUITY MARKET OUTLOOK

- S&P 500 Index operating earnings appear to have grown year-over-year by about 17%, resulting in an EPS of about $124.50 for 2017.
- Tax reform and faster nominal growth could push S&P 500 operating earnings over the $150 mark this year, a 20% plus increase from 2017.
- Companies with U.S. based operations and customers that are leveraged to capital spending and currently have higher effective tax rates will likely benefit most from the new bill.
- Companies with lower effective tax rates and high levels of debt servicing will likely not benefit from the new tax bill.
- Multinational large cap growth stocks have benefited from faster foreign growth and U.S. dollar weakness over 2017, but further significant dollar depreciation is less likely in 2018 if U.S. interest rates move higher.
- Valuation becomes an increasingly attractive driver of performance, on a factor basis, in an environment of improved economic growth.
- High P/Es have been supported in large part by lower interest rates. While the market has shown recent concerns over higher rates, the flattened yield curve suggests a continuation of modest inflation expectations.
- At quarter-end, the S&P 500 Index traded at 17.6x one-year forward operating earnings estimates, just below its 20-year average of 18.2x.
- The regime of low market volatility may be ending and we would not be surprised to see market price volatility remain at more elevated levels.

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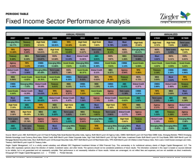
We are based in Chicago, Illinois with additional offices in New York, New York; San Francisco, California; St. Louis, Missouri; and Milwaukee, Wisconsin. Our clients include corporations, mutual fund sub-advisory, municipalities, pension plans, foundations, endowments, senior living and healthcare organizations, and high net worth individuals. Ziegler Capital Management has grown significantly in recent years through strategic business combinations with experienced investment teams nationwide. Through these combinations, we have expanded our investment strategy offerings and broadened our portfolio management teams to best serve our expanding client base.

Other Market Insights



Periodic Table: Fixed Income Sector Performance

A detailed look at the S&P 500 Index's performance over the past decade, broken down by its 11 sectors. **Recently Updated**

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