The Incredible Shrinking Earth: Have We Reached Peak Globalization?

Introduction

The world we live in is ever-shrinking. Perhaps not literally, but as global business and culture become increasingly intertwined, it sure feels as though the vastness of our world is becoming less pronounced. Think about it: no more than a few decades ago it would have taken weeks for a letter to be sent from New York to London. Today, that same message can be delivered in seconds...and sent from a small computer we can carry around in our pockets. Advancements in technology have allowed capital and labor to be divided across the world within a global economy. Indeed, developments in communications technology, transportation, and efficiencies gained through specialization have created a system in which the whole is greater than the sum of its parts.

Globalization has been an incredibly powerful economic force, and the extent to which global markets have become integrated has had a profound impact on the way the world operates. On balance, most studies indicate the net effect of a more globalized marketplace has been positive in terms of enhancing economic growth, reducing poverty, and achieving greater cost efficiencies. Is this an accurate assessment? The answer really depends on who you ask.

At one end of the spectrum we have,

“The best evidence available shows ... the current wave of globalization, which started around 1980, has actually promoted economic equality and reduced poverty.”  

While at the other end we have,

“Globalization has dramatically increased inequality between and within nations.”

Both views may actually be right, depending on one’s point of view. Globalization, specifically trade, has become a hot button political issue, and changes in trade policy are likely to play an important role in shaping the world’s economic and financial future. In many ways, to understand the current state of global politics, one must understand the winners and losers of globalization. We believe that although it may be hard to acquire data that detail a precise causal relationship between globalization and economic growth, it is equally difficult to find evidence that globalization has led to an increase in poverty or broad economic malaise. In fact, we find it hard to find any example of an underdeveloped country that was able to sustainably increase its economic growth without opening its borders to trade. India, which began liberalizing trade policies in the early 1990s, has benefited immensely in terms of economic growth from this choice (Chart 1, page 2).

That said, as with any tectonic shift of this magnitude, there have been winners and losers. Society as a whole may be “better off,” but there are industries and geographies (along with their workers and investors) that are no doubt “worse off,” having effectively been left behind. We believe the primary transmission mechanism of globalization is through the price of goods and individual wages. In some cases, particularly in India and Latin America, research has shown that...

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1 When referring to globalization, we are most focused on the increased worldwide integration of goods and services (that is, trade), capital (as in, the financial markets), and labor mobility.
education level is another key factor in determining the individual impact of globalization. In these regions, those who are more educated have reaped the most reward. Increases in inequality do not necessarily equate to increases in poverty, however, and individual experiences are often dictated by the sector in which one works and/or the existence of labor mobility within the workforce. According to the World Bank, “In 2013, 10.7% of the world’s population lived on less than US$1.90 a day compared to 12.4% in 2012. That’s down from 35% in 1990.”\(^4\) We believe the bottom line impact of globalization has been positive, but in the United States, for example, there is a growing population that feels marginalized by the evolution of global trade and its impact via slower-than-expected wage growth and fewer employment opportunities (Charts 2 and 3).

In this quarter’s Investment Strategy Quarterly, we take a deeper look into the history and impact of globalization while also analyzing current global trends. We try to answer the following key questions:

- How has globalization evolved?
- What are the likely consequences of a world that appears to be turning increasingly inward?

The History of Globalization

The earliest evidence of localized trade, with the first record of long-distance trade (between Mesopotamia and the Indus Valley in Pakistan), dates back to 3000 BC. Complex trade networks developed using waterways such as the Nile, the Tigris, and the Euphrates, integrating both goods and cultures across larger and larger geographic areas. Important stops along these trade routes encouraged the rapid development of smaller towns, changing the opportunity sets available to people in those regions. As these networks developed, the culture of pure self-reliance began to fade, giving birth to a world that was becoming increasingly interconnected.

Fast-forward a few thousand years to more modern times, and trade as a percentage of world GDP has continued its rapid ascent (Chart 4). As Adam Smith so aptly stated in his 1776 work *An Inquiry into the Nature and Causes of the Wealth of Nations*, “as it is the power of exchanging that gives occasion to the division of labor, so the extent of this division must always be limited by the extent of that power, or, in other words, by the extent of the market.” As the ability to transport goods improved over time, and the cost of doing so greatly diminished, the global marketplace became larger and exchange easier. This has encouraged more economic integration by allowing countries and regions to specialize in line with their comparative advantages.

As it became possible to separate the production process from the ultimate source of demand, businesses began to take advantage of the cost differential between markets by moving productive capital investment to its cheapest source. In doing so, the industry composition of regions across the world began to change, especially between developed and emerging economies. Since the early 2000s, China and India’s share of world GDP doubled from about 12% to 24% while certain developed market sectors have not kept pace. U.S. manufacturing is one such example of this phenomenon (Chart 5). As global trade grew, manufacturing employment in the United States began to fall, rapidly decreasing right around the time China entered the World Trade Organization (WTO) in 2001.

Technological advancements (namely, robotics) have also been an important driver of declining trends in manufacturing employment, but it is interesting to note that as global trade activity peaked in 2009–10, U.S. manufacturing employment bottomed. Massachusetts Institute of Technology

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economist David Autor argues that competition from Chinese imports alone can explain over 25% of the decline in U.S. manufacturing employment between 1990 and 2007.⁶

Further Assessing the Impact of Globalization

The integration of the world’s two most populous countries (that is, China and India) effectively doubled the world’s labor supply, triggering several outsized economic consequences. In our view, the largest financial market impact of globalization came in the form of a secular trend toward lower real interest rates and inflation (Chart 6).

The labor force and technology shocks that drove production to China and India dramatically increased potential global output. In the process, wealth and income were transferred from relatively low saving rate developed markets such as the United States to countries with very high saving rates, in particular China. As a result, global aggregate demand lagged the growth of potential output, putting downward pressure on inflation while global savings rose relative to investment. Consequently, there has been downward pressure on real global interest rates.

Besides creating a backdrop conducive to general asset price inflation, we also saw distinct winners and losers. For example, from January 1, 2001 to January 1, 2008 (that is, leading up to the peak in globalization) emerging market equities increased 232% compared to just 11% for the S&P 500®.

Breaking down U.S. wage growth trends in a bit more detail shows that since 1979 the cumulative change in real hourly wages for low income workers has declined 5%, while for middle income workers it has risen 6%, and for the highest earners it has grown a much more robust 41%.⁷ From an economic perspective, it seems the most influential “losers” in this scenario have been low and middle class wage earners.

From a global perspective, the story is very much the same for other developed markets. The emerging market middle class were globalization winners; however, the international developed market middle class saw their wages stagnate. In the world of economists and investment strategists, the so-called “Elephant Chart” (that is, because it resembles the profile of an elephant with a raised trunk) has become ubiquitous when illustrating those who were left behind on the global wage distribution continuum (Chart 7, page 5).

Chart 7 may offer the clearest explanation of how certain macro-economic trends have led to a paradigm shift in global politics. Whether it be the election of President Donald Trump, the Brexit vote, or separatist momentum building in Europe, we are beginning to see a clear shift away from the multidecade globalization trend toward

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⁷ http://www.epi.org/publication/charting-wage-stagnation/. Note: Low wage is 10th percentile, middle wage is 50th percentile, and highest wage is 95th percentile.
protectionism. We think the frustration of those left behind by globalization has been clearly underappreciated, and it may be that we are at the precipice of a new era of more isolationist policymaking. In his most recent address to Congress, President Trump quoted Abraham Lincoln from an 1847 speech: “Abandonment of the protective policy by the American government will produce ruin among our people.” The underlying message here suggests that President Trump believes the pendulum has swung too far in one direction, and investors may be well served to understand the implications of the pendulum swinging back in the opposite direction—and toward the rising anti-globalization movement.

Trends in Economic Nationalism and Potential Investment Implications

“America First”

In his January 20, 2017, inaugural address, President Trump said, “We assembled here today are issuing a new decree to be heard in every city, in every foreign capital, and in every hall of power. From this day forward, a new vision will govern our land. From this moment on, it’s going to be America First.” This quote is the most concise way we could find to summarize the current political tide in the United States. It was this mantra all along the campaign trail that led to one of the biggest surprise victories in U.S. political history. Thus far, the message from the Trump administration has not changed but, if anything, has been reinforced by members of his cabinet. Simply put, we believe the administration is likely to pursue policies that seek to reverse the country’s widening trade deficit in an attempt to increase U.S. wages and bring back jobs to flagging sectors of the economy (Chart 8, page 6).

Whether policy actions ultimately take the form of a protectionist border adjustment tax (BAT), labeling China a currency manipulator, or directly encouraging certain companies to maintain or add to U.S. jobs/production, we believe the primary challenges for global financial markets will likely manifest through the currency markets. BCA Research, in its January 25, 2017, article in Geopolitical Strategy, “The ‘What Can You Do For Me’ World?”, points out,

The fundamental problem for the global economy is that in order to reduce the U.S. current account deficit, the world must experience [a period of] severe global tightening [of financial conditions]. Dollars held by U.S. multinationals abroad, which finance global credit markets, will come back to the United States and tighten liquidity.
[availability] abroad. And emerging market corporate borrowers who have overextended themselves borrowing in U.S. dollars will struggle to repay debts in appreciating dollars.

At this still early stage we will refrain from making any policy predictions because any specific policy forecast regarding taxes or trade would be at best a guess, not a fully informed probability distribution. However, we do think it is fair to say that investors should be prepared for more U.S.-centric policy proposals. With that in mind, we have highlighted some key investment implications of the current backdrop that investors should keep in mind.

**Market Volatility**

For now, tax reform, repatriation, and deregulation seem to be the primary focus for the markets. We think these agenda items have the potential to be economic game changers, but the market is not currently discounting certain policy risks. As can be seen in Chart 9, implied market volatility is extremely low, and looking six months out, put options on the S&P 500 have not been this cheap since before the financial crisis. There have been 196 trading days without a correction of 5% (the average is 50 days), and consistent with our view that economic momentum may start to slow in the second quarter, we think market volatility is likely to rise, a particularly concerning issue for investors with shorter time horizons and fairly high required spending policies.

**Developed International versus Emerging Markets Equities**

One of the key risks to emerging markets identified in our 2017 outlook was a rising U.S. dollar. In January, both the U.S. dollar and interest rates actually trended lower, allowing emerging market equities to push higher. Over the past 12 months, weakness in rates and the dollar have coincided with strength in emerging market equities, and vice versa. In late February/early March, we saw both interest rates and the dollar resume their upward trend, with emerging market equities beginning to come under some pressure. We also think a partial relief rally may have also helped buoy emerging market equities higher early in the year, as the initial concerns postelection regarding large scale protectionist shifts in policy and specifically U.S.-China trade and currency relations appeared to take a back seat to other priorities. President Trump’s policy agenda appears to favor/support higher interest rates and a stronger U.S. dollar. However, if there are major delays or outright policy failures, we will likely see market turbulence/volatility increase. Both scenarios may result in emerging
markets giving back some of their relative gains year-to-date.

Currency Hedging in a Strong U.S. Dollar Scenario

In an international equity portfolio that has exposure to a basket of currencies, some will likely have positive returns in local currency terms, while others will surely be negative. In theory, this counterbalancing effect should result in currency exposures netting themselves out over time. In addition, currency returns are largely uncorrelated (or at least, not strongly positively correlated) and, as such, they tend to help an equity portfolio on the diversification front. Further, there is ample empirical evidence (cited by the CFA Institute and others) suggesting that the standard deviation (that is, volatility) of currency is only about half the standard deviation of stock prices. This suggests unhedged currency exposure may actually help to reduce an international equity portfolio’s volatility over time. As currencies also tend to revert to a theoretical “fair value” over time, currency-related volatility/risk tends to fall or wash out, so to speak, becoming a less critical component of equity risk. Thus, over the long term (that is, on a strategic basis) it is better to be unhedged.

That said, in certain situations (that is, on a tactical basis) when we feel there are real and persistent catalysts for a continued relatively stronger U.S. dollar, hedging some equity exposure can make sense. Although the dollar likely will not appreciate to the extent we saw toward the end of 2016, we find it hard to make the case that it will weaken dramatically versus other major currencies. Although some in the administration have tried to talk down the dollar lately, actual policy proposals are dollar-bullish—policies on trade, the potential for border adjustability, and possible interest rate hikes, to name a few. In certain circumstances, it is possible that the dollar strengthens dramatically. The inclusion of a border tax, in theory, would cause a parallel shift higher in the currency, having a neutral effect on trade. Of course, it is possible that theory does not play out in reality, or if it does it may take time and the currency shift may be less dramatic. Even so, a border tax would likely push the dollar higher to some degree. Further, tax cuts have the potential to be inflationary, likely encouraging the Federal Reserve (Fed) to raise interest rates more quickly. Again, this would help the dollar move higher. It is certainly possible, in our view, that the market is underwhelmed by the ultimate impact of new policy actions (or such actions are delayed). In this case it is likely the dollar weakens.

In summary, the overarching considerations for when to currency hedge tend to be focused on situations where a client’s time horizon is rather short and their risk tolerance is low, and the trajectory of the U.S. dollar relative to the currency/currencies in question is such that it might rapidly erode investment returns. Absent that, better to be unhedged over the long run.

Domestic Equities

We still favor domestic equities over most, if not all, other asset classes. Large cap companies look the most attractive on a relative valuation basis and if volatility rises, as we mentioned the possibility of it doing earlier, large caps can provide nice ballast in equity portfolios. However, at the same time, small and mid cap companies may enjoy an outsized benefit from changes in regulation and tax policy while also being more insulated from the risks associated with a rising dollar and material shifts in trade policy.

Repatriation Policy Beneficiaries

Tax policy details are still somewhat limited as of this writing, but our view is that some form of repatriation appears likely. During the 2005 repatriation tax holiday, companies with large amounts of unremitted cash as a percentage of their market capitalization were rewarded with pretty strong relative outperformance. We think a similar pattern could emerge this time around too. From a sector perspective today, this would be most positive for Information Technology and Health Care, as that appears to be where most of the companies with large unremitted cash positions are concentrated. A BAT in some form is also possible as Republicans look for ways to raise revenue to help balance the budget in the wake of
potential personal and corporate tax cuts. In the event a border tax is included in the final legislation, net exporters (companies such as 3M Company and General Electric Company, for example) stand to benefit since export revenues would not be subject to U.S. tax. On the other hand, companies with large manufacturing operations outside of the United States (for example, Nike, Inc.) are potential losers. Consumer Staples, Consumer Discretionary, and Energy would likely experience the largest negative impact from an earnings-per-share perspective.

Not Just a U.S. Phenomenon

Whether it be Brexit, the upcoming European election season, or general skepticism regarding the viability of the common currency union, we see plenty of evidence that populist trends are gaining momentum in certain international regions. In the Dutch election, Prime Minister Mark Rutte’s center-right party won parliamentary seats by a wide margin instead of populist candidate Geert Wilders’ anti-European Union (EU)/anti-Islam party. The Dutch election was viewed as a good near-term gauge of the strength/pervasiveness of European populism.

The more critical issue for the markets is the upcoming French presidential election(s) on April 23/May 7. Issues and societal divisions run much deeper there (certainly relative to the Netherlands). The spread between 10-year German and French bonds widened significantly in February, evidence that the French election is likely causing some degree of market anxiety. Still, based on the outcome of the Dutch election, it looks as though betting markets are marginally reducing odds of a Marine Le Pen (populist candidate) victory in France. Italy remains another important risk.

Euroscepticism in Italy is on the rise according to recent polling data, and without speculating about election results, we expect headline risk may persist for some time. With more elections to come this year across the EU, we think populist political risks remain at the forefront for the markets.

Our base case is that populist parties will not take control in any Eurozone country in 2017, although we respect the probability, especially over the longer term. There are a number of exogenous factors in play, but the large-scale immigration challenges we have witnessed across Europe is one example of a long-term variable that should not be ignored or underestimated. Generally, recent immigrants have had some difficulty assimilating into European society, and any economic or social disruption would likely turn into a positive campaign theme for future populist candidates.

Putting populism aside for a moment, a single currency is most efficient in the presence of labor mobility (something the Eurozone lacks, unfortunately). The key criterion for a successful currency union never really existed in Europe from the outset, and still does not, so we can envision a scenario where countries naturally choose to exit the Eurozone over time since full fiscal integration remains elusive within the current structure of the union. This is a long-term risk, and perhaps seems a bit extreme, but we believe the probability is high enough that it is a risk worth highlighting when thinking about the possible implications of anti-globalization trends on international investment allocations.

Conclusion

The bottom line is we believe globalization and international trade have been net positives for the world economy. However, the groups that have suffered as a result have become a louder voice, and are beginning to dictate changes in political leadership as well as future policy direction. As a result, we are seeing the beginning of a potentially lasting trend toward more nationalism in the global economy. We have identified the potential investment implications of certain policy proposals and have discussed certain asset allocation decisions that may add value if this trend continues. Of course, we cannot guarantee this trend continues, but it has gathered enough momentum.

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8 A more detailed discussion of this view can be found in the Second Quarter 2015 Investment Strategy Quarterly, Mr. Draghi’s Europe.
that we believe investors should consider the risks that may not yet be fully appreciated by the market.

State of the Outlook—Reviewing Some of Our Key 2017 Calls

Optimism can be a powerful force in the markets, and we believe positive “animal spirits” may be the biggest wildcard during first-half 2017, with investors digesting and interpreting policy changes and beginning to predict winners and losers.

- No question optimism has ruled the day. The S&P 500 is up another 6% thus far in 2017, credit spreads continue to tighten, and many investors have focused on the pro-growth elements of the administration’s policy agenda. Under the surface, however, the market may not be as “risk-on” as some may think. For example, large cap is outperforming small cap, growth is outperforming value, and sector performance would indicate to us some trepidation as it relates to the reflation story (cyclical sectors such as Energy, Financials, Industrials, Materials all underperforming). For now, we think momentum can carry the market higher, but our business cycle work indicates a moderation of economic data as we get closer to midyear, possibly causing investors to rethink what is realistic/achievable from a growth perspective in 2017. The market has also begun to price in winners and losers, as seen by the sharp drop in equity correlations and rising dispersions more recently. We think this should begin to provide a better environment for active managers going forward.

The Institute for Supply Management™ (ISM) Manufacturing Index is likely to have peaked at the end of 2016, with some renewed pressure likely heading into early 2017. Growth is unlikely to accelerate significantly in the coming quarters.

- Admittedly, this call was a bit early, but our economic activity indicators and business cycle analyses still forecast a moderation of the ISM Manufacturing PMI this year. From an overall growth perspective, according to the Atlanta Fed GDPNow index, first-quarter GDP is tracking at just 1.0%. This slow growth trend is unchanged from what we have experienced in recent years, and our view continues to be that any material impact on growth from changes in policy is unlikely to be a 2017 event. We are now starting to see the first signs of a peak in leading indicators, with Markit PMI data for March retreating to levels not seen since the fall of 2016, while other regional manufacturing surveys also appear to have peaked in February.

Over the longer term (that is, five years and beyond), we still think equity market returns are likely to be below historical averages.

- This is principally a valuation argument, and a view that is unlikely to change until we see current valuations adjust to more attractive levels. This can happen by prices falling or growth accelerating, or perhaps more commonly by some combination of the two. Given our view that we remain in the later innings of the business cycle, it seems likely that a decline in prices will be the more influential determinant of equity valuations.

We favor U.S. equities, Financials, Health Care, and Consumer Discretionary sectors, large cap over small cap, and value over growth.

- By and large, this positioning has been constructive thus far in 2017. The Health Care and Consumer Discretionary sectors have outperformed the S&P 500 year to date. The Information Technology sector has led the way, an area of the market also highlighted as an outperformer in our business cycle analysis. Sectors that looked relatively less attractive in our outlook included Consumer Staples, Telecommunication Services, and Materials. Year to date, Materials and Telecommunication Services have underperformed the S&P 500, with
Telecommunication Services one of only two negative sectors. Large caps have also significantly outperformed small cap, and although we feel small cap companies will ultimately reap greater rewards from tax cuts and deregulation, in 2017 we still believe large cap stocks can deliver strong risk-adjusted returns. Although U.S. equities have outperformed developed international, emerging markets have surprisingly outperformed domestic equities. Growth has outperformed value, with technology stocks driving much of that performance.

- We missed the mark in those areas in the first quarter, but continue to favor domestic equities over emerging markets and value over growth going forward. We believe Financials can ultimately lead the value style category higher (although this may become a longer-term perspective given the flattening of the yield curve and range-bound longer-term interest rates), and emerging markets are still vulnerable to appreciation in the U.S. dollar and higher interest rates. We do not expect growth to materially accelerate in emerging markets this year, further weighing on equity markets in those regions.

Our view is benchmark neutral duration in fixed income portfolios best balances our belief that although interest rates are likely to gradually move higher over time, the visibility for growth and inflation is even more unclear and may somewhat temper the rise in yields.

- We continue to hold this view, and intermediate duration bonds have outperformed shorter duration holdings year to date. In all of the last nine tightening cycles, the yield curve has flattened. We expect the yield curve to continue to flatten as the Fed raises interest rates, which reinforces our neutral duration positioning.

Our current conviction regarding high yield is not pound-the-table positive or negative. We are coming off an extremely good year for high yield, so we believe returns are likely to moderate some in 2017. That said, conditions are in place for the asset class to generate respectable returns.

- While high yield has remained a solid performer thus far in 2017, returns are slightly trailing 2016 returns relative to this point in the year (and even after the major selloff in high yield during January 2016). We continue to believe that if the economy expands at a modest pace, then investors will still have an appetite for higher yielding assets throughout the year. Risks to high yield are stretched valuations (spreads have continued to tighten in 2017) and competition from higher quality income-generating assets as yields rise.

- Also, leveraged loans may be a more attractive area in the higher yielding fixed income universe. Leveraged loans are higher in the capital structure (less risk in that sense) and a diversifier against rising rates. Leveraged loans also typically have coupon floors of 1% (based on LIBOR); as rates rise, investors would benefit from higher floating rate coupons.

Appendix: Asset Allocation Playbook

Table A1 on page 11 is the first iteration of Institutional Advisory Solutions’ asset allocation views summarized in one complete, concise format for your reference/use. The asset class views listed in the table apply to an intermediate-term horizon (that is, over the next 12–18 months). This summary depicts absolute direction and strength of conviction but is entirely independent of unique client needs, objectives, and constraints, as well as any portfolio construction considerations. We hope you find this useful, and plan to include it in future issues of the Investment Strategy Quarterly. As a disclaimer, we reserve the right to change, modify, or otherwise alter these views at any time based on shifting market and economic conditions.

Amanda E. Agati, CFA®
Managing Director,
Chief Institutional Investment Strategist
<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Sub Asset Class</th>
<th>Favorability</th>
<th>Points of View</th>
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<tbody>
<tr>
<td>Equities</td>
<td>Large Cap</td>
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<td>Mid Cap</td>
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<td>Public Real Estate (REITs)</td>
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<td>Non-U.S. Equity</td>
<td>Intl. Large/Mid Cap</td>
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<td>Even though valuations look relatively more attractive vs. the U.S., with numerous elections still to come this year across the European Union, we think populist political risks remain at the forefront for the markets. Fundamental pressures stemming from protectionism, stronger dollar, potential caps on commodity prices suggest emerging markets (EM) will begin to struggle as 2017 progresses.</td>
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<td>Intl. Small Cap</td>
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<td>Emerging Markets</td>
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<td>Taxable Fixed Income</td>
<td>Short Fixed Income</td>
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<td>With the possibility of longer-term rates remaining range bound, we favor intermediate duration fixed income. To date, core fixed income has outperformed short, and we believe this trend will persist for the balance of 2017.</td>
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<td>Core Fixed Income</td>
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<td>U.S. High Yield</td>
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<td>Overall credit conditions remain favorable, but credit spreads are tight, leaving high yield less room to outperform.</td>
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<td>U.S. Leveraged Loans</td>
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<td>Perhaps more attractive than high yield given their place higher in the capital structure and protection from rising rates.</td>
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<td>U.S. TIPS</td>
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<td>A reasonable hedge if inflation overshoots current expectations; however, that is not our base case forecast.</td>
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<td>Non-U.S. Fixed Income</td>
<td>Global Bond</td>
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<td>Sovereign credit looks fairly valued currently with the primary sources of return likely to come from countercyclical global trends in currencies and interest rates, hence our neutral stance.</td>
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<td>Unconstrained Bond</td>
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<td>Flexibility provides for diversification if rates should steadily rise (a primary risk to fixed income in this market).</td>
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<td>Emerging Market Bond</td>
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<td>Spreads look too tight currently (i.e., fundamentals in the region suggest wider spreads) and we expect this to occur in 2017. Relative yield advantage makes EM debt marginally more attractive than EM equities.</td>
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<td>Alternatives</td>
<td>Real Assets</td>
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<td>We do not believe long positions in commodities earn persistently positive and significant risk premia. Depending on the asset/environment, the risk premium may actually active to the short position. Still like the long-term theme, but valuation is a headwind.</td>
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<td>Commodities</td>
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<td>Infrastructure</td>
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<td>Private</td>
<td>Private Real Estate</td>
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<td>With the pendulum swinging more recently toward short-termism, we think this creates an opportunity at the opposite end of the spectrum for patient, long-term investors. At a time when expected returns on traditional asset classes are likely to be below historical norms, the illiquidity premium has become increasingly valuable.</td>
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<td>Private Debt</td>
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<td>Hedge Funds</td>
<td>Equity Long/Short</td>
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<td>Can generate outperformance in a market where the overall risk/reward balance may be skewed toward risk. Equity market correlations are falling, and the removal of extreme monetary policy accommodation which compressed the cost of capital across the quality spectrum should help swing the performance pendulum back in favor of certain hedge fund strategies. However, should the market move steadily higher with little volatility, these allocations will likely underperform.</td>
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<td>Event Driven</td>
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<td>Source: PNC</td>
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