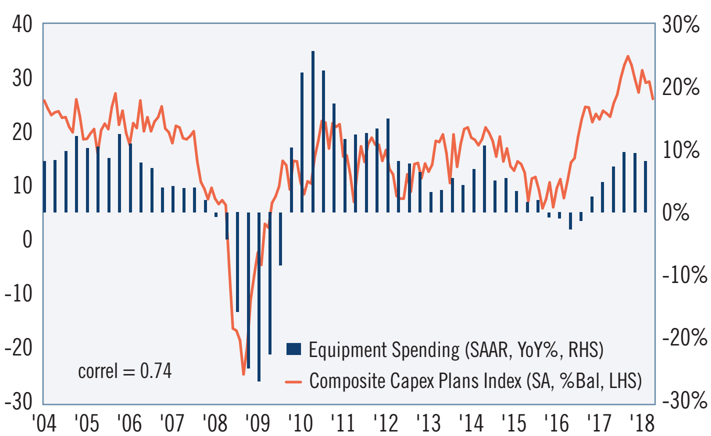
Expansion Holds Strong As Cycle Matures

During the third quarter, U.S. equities, as measured by the S&P 500® Index, delivered a total return of 7.71%, bringing the year-to-date return to 10.56%. Unfortunately, this strength was not shared broadly, with the MSCI EAFE® and MSCI Emerging Market Indexes returning 1.35% and -1.09%, respectively, for the quarter.

After nearly a decade of U.S. expansion and a surging market that continues to confound bulls and bears alike, it's not surprising that some see the end as nigh. A case can be made that certain indicators like corporate profits and (still-restrained) wage growth are more consistent with the middle of a business cycle than the end. At the same time, other metrics, such as the unemployment rate and business confidence, suggest that we aren't all that early in the cycle either. Some notable hedge fund managers have recently expressed views that the U.S. is in the late innings of this economic cycle.

Still, as our friends at Strategas Research note, recessions have never started when the real fed funds rate is zero. What is likely to define the nature of the economy and the performance of financial assets in the next few years will be the degree to which the change in monetary policy does not overwhelm other economic policy tools—like tax cuts, spending, and regulatory policy. The Fed must walk a fine line between its wish to normalize rates and creating further dislocations in the emerging markets and global economy. We are watching capital spending closely, viewing it as a good indicator that the expansion still has legs.

CAPEX PLANS VS ACTUAL CAPEX



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Fears of a global trade war have subsided to a degree, now that deals were signed with two of our biggest trading partners, Mexico and Canada. This leaves China as the remaining issue for the administration's trade negotiators to iron out. However, a smooth and speedy resolution of this issue seems unlikely, with negotiations likely to resume after November's midterm elections. By all accounts, the fact that the S&P 500 Index has been mostly positive this year while China's Shenzhen Composite Index is negative gives the administration some confidence that it is "winning" thus far.

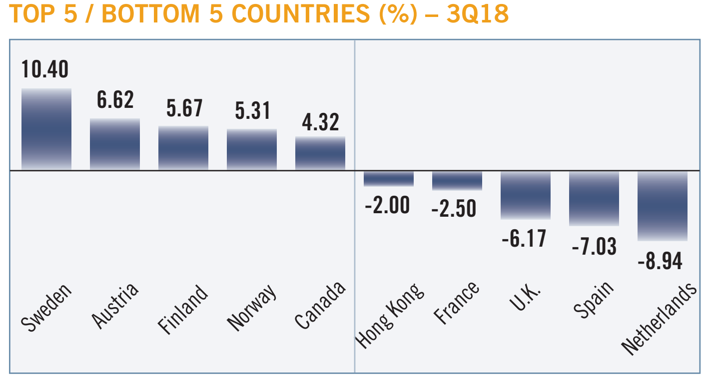
SECTOR HIGHLIGHTS

Global Real Estate – For the quarter, global real estate securities returned -0.30%, as represented by the FTSE EPRA Nareit Developed Index, while global equities returned 4.98%, as represented by the MSCI World Index, expressed in U.S. dollars.

Movement in the U.S. dollar was less of a headwind to international returns in the quarter, as the U.S. Dollar Spot Index increased 0.7%. A notable currency movement that ran counter to U.S. dollar appreciation was the significant reversal in the Mexican peso, which increased 6.4% relative to the U.S. dollar on the back of improved sentiment towards the incoming Mexican administration and negotiations surrounding the updated NAFTA trade agreement.

The top-performing countries in the FTSE EPRA Nareit Developed Index during the quarter were Sweden, Austria, Finland, Norway, and Canada, with all posting positive returns on a total return basis and measured in U.S. dollars. Sweden and Norway continued to benefit from healthy economic fundamentals and commercial real estate markets, particularly within the office property sector. Finland's returns were boosted by M&A activity.

**FTSE EPRA NAREIT DEVELOPED INDEX (NET)
TOP 5 / BOTTOM 5 COUNTRIES (%) – 3Q18**



Sources: FTSE, Bloomberg, L.P.

The Netherlands, Spain, U.K., France, and Hong Kong were the bottom-performers within the Index, with all five producing negative returns. In the Netherlands, the potential elimination of the REIT-like structure utilized by listed real estate companies weighed on their performance. European-focused retail real estate companies in the Netherlands, U.K., and France continued to come under pressure given their mixed fundamental outlook. Several Hong Kong-based companies suffered due to the trade noise between the U.S. and China and concerns surrounding Hong Kong's residential real estate market.

Global Listed Infrastructure – For the quarter, infrastructure stocks, as measured by the FTSE Developed Core Infrastructure 50/50 Index (net), ended down slightly at -0.28%, significantly underperforming the broader global market. Communications and utilities posted gains, while transportation and energy infrastructure had negative returns. The U.S. was the only developed region to record positive performance for infrastructure stocks, supported by strong economic conditions. Asia/Pacific infrastructure stocks declined modestly while Europe (including the U.K.) was a notable laggard again.

> **Transportation** had another tough quarter. Weak performance by airports and toll roads was partially offset by U.S. rails, which continued to benefit from healthy economic growth and operational improvements. However, the key event was Italy's devastating Morandi bridge collapse, which is operated by Atlantia.

> **Utility** stocks held their own versus other infrastructure sectors despite rising interest rates. While the yield on the U.S. 10-year Treasury rose to 3.05% from 2.87% at the beginning of the quarter, U.S. utilities (Philadelphia Utility Index) gained 2.4%.

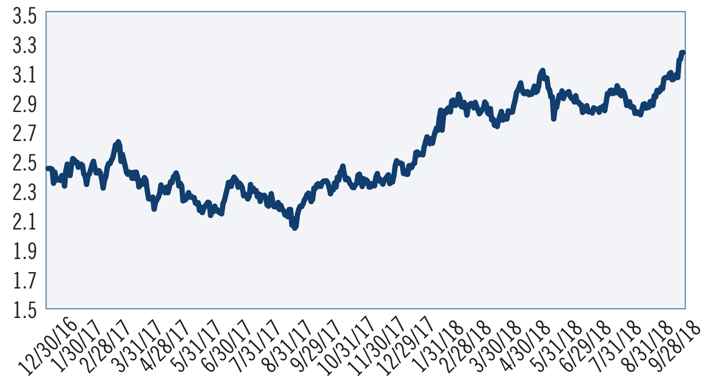
> **Energy infrastructure** stocks underperformed, although there was a real dichotomy between international and U.S. Rising rates, the strong dollar, and trade wars pushed international stocks lower, especially large Canadian infrastructure companies. U.S. stocks, however, performed much better as fundamentals around U.S. energy infrastructure remained very strong. For additional perspective, read Duff & Phelps' Third Quarter Market Review & Outlook: Energy & MLPs.

> **Communication** stocks performed relatively well as the group posted positive returns for the quarter. Investors reacted favorably as the wireless tower companies reported solid fundamental results and a positive outlook.

LOOKING AHEAD

The move higher in U.S. Treasury yields has been a source of discussion in recent weeks. Our sense is that this is due to the strengthening U.S. economy. Lower tax and regulatory burdens, muted credit risk, and strong financial conditions are a recipe for higher yields. These yields are not being driven by higher inflation expectations (yet) as real yields are increasing, a sign consistent with a stronger economy. The recent increase in longer-term yields has also been matched with a slight steeping of the yield curve. Not coincidentally, as companies have accrued the benefits of tax reform, yields have moved higher. The 10-year U.S. Treasury yield increase also coincided with the September 15 deadline for companies to contribute to their pension plans at the old 35% tax rate. Now that the pension program is ending, this might also be reducing some demand for Treasuries.

U.S. 10-YEAR TREASURY YIELDS (%)



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During the quarter, President Trump made a critical decision on trade policy by realizing he could not fight three trade wars at one time. If China is the real target, then the U.S. would need to accelerate NAFTA discussions immediately and form a peace treaty with the European Union (EU) so that it could focus on China. With the EU framework agreed upon and the revised NAFTA agreement (now called USMCA) in place, the pivot to China is ensured. Financial markets were generally upbeat when these two negotiations were done, and this may give Trump a longer leash on China because the potential outcome could lead to better world growth.

Midterm elections generally have low voter turnout. Therefore, the party with the most motivation to vote usually wins. The Democrats have far more motivation than Republicans as evidenced by their strong performance in Republican areas in this year's special elections. More recently, polls have shown increased enthusiasm among Republican voters. It is too early to tell if this is a one-time bump or a more lasting change. The market is priced for a Republican Senate and a Democratic House. The market seems to be underpricing a sweep by either party waiting to see which direction undecided voters will break in the next couple of weeks.

As a fundamentally driven global equity boutique, our investment teams remain focused on executing on our core values of quality, reliability, and specialization in the highly targeted strategies on which we have built our reputation.

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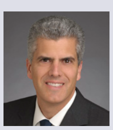
Authored by:



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Duff & Phelps Investment Management offers specialty investment strategies that strive to enhance outcomes for clients. The product mix, which includes Global Listed Infrastructure, Global Real Estate, Energy & MLPs, and International Equity, developed from the in-depth fundamental research expertise in income-producing securities that the firm first established back in 1932.

FTSE EPRA Nareit Developed Index (net): A free-float market capitalization-weighted index measuring publicly traded equity REITs and listed property companies from developed markets, which meet minimum size and liquidity requirements. **FTSE Developed Core Infrastructure 50/50 Index**: A free float-adjusted market capitalization weighted index that gives participants an industry-defined interpretation of developed market infrastructure companies and adjusts the exposure to certain infrastructure subsectors. Constituent weights: 50% Utilities, 30% Transportation (including capping 7.5% for railroads/railways), and a 20% mix of other sectors including pipelines, satellites, and telecommunication towers. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.