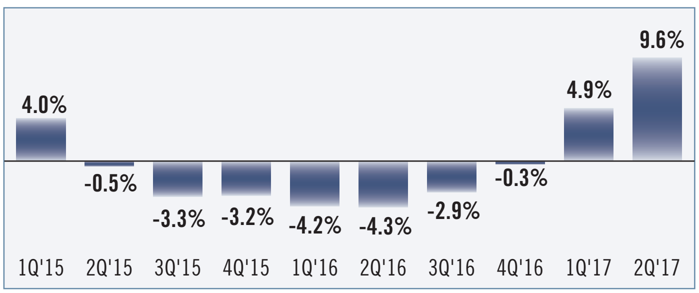
Focus On Global Growth

Despite natural disasters, rising tensions with North Korea, dysfunction in Washington, and continued acts of global terrorism, global equity markets continued their steady upward movement in the third quarter, with the S&P 500® Index up 4.5%, the Europe STOXX® 600 Index up 2.8%, the Nikkei 225 Index up 2.2%, and the Hang Seng Index up 7.4%. For the S&P 500, it was the eighth straight quarterly advance.

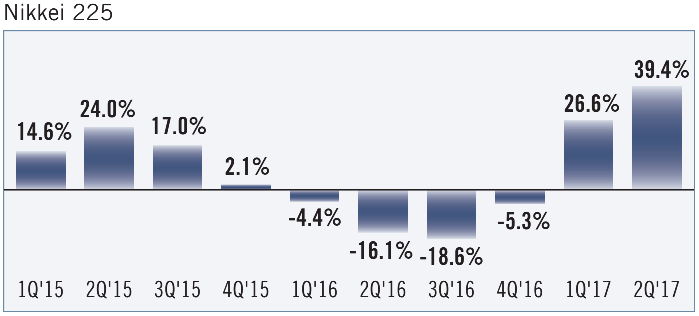
Investors appear to be ignoring the global distractions and are focused on a global economy that has truly gotten stronger. Global manufacturing readings continued to move higher, and consumer confidence remains robust. Company earnings are also finally growing as operating earnings for the S&P 500, STOXX, and Nikkei jumping significantly higher year to date.

GLOBAL EARNINGS GROWTH (Trailing 12-Month Earnings Growth, YOY)

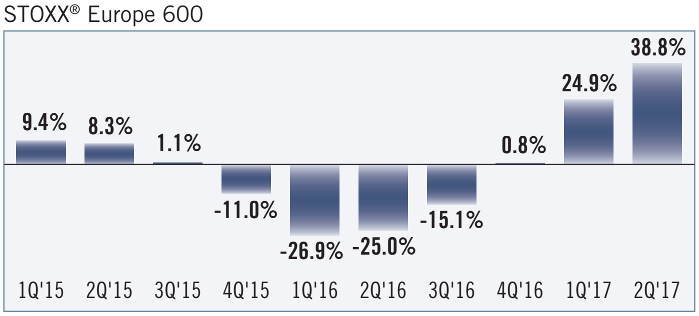
S&P 500



Nikkei 225



STOXX® Europe 600



Source: Bloomberg. S&P 500® tracks the 500 of the largest U.S. companies. Nikkei 225 represents Japan's top 225 blue-chip companies. STOXX® Europe 600 represents large, mid, and small-cap companies across 17 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.
Past performance is no guarantee of future results.

SELECT SECTOR HIGHLIGHTS

Global Listed Infrastructure – The FTSE Developed Core Infrastructure 50/50 Index finished up 2.3% for the quarter and rose 15.9% year to date. Not surprisingly, some of the higher beta stocks in the transportation sector, such as rails, toll roads, and ports, were among the best performers in the quarter.

Energy – After struggling in the first half of 2017, energy stocks, especially Canadian midstream names, also had a good quarter, helped by rising oil prices. Admittedly, sentiment and investor interest in the space still remains weak, but oil above $50 per barrel and rising U.S. production bodes well for midstream fundamentals. Interestingly, oil and energy stock prices actually rallied as Hurricanes Harvey and Irma moved through Texas and Florida. Although Harvey had a major impact on both Gulf Coast refining and chemical production, knocking roughly 50% of Gulf Coast capacity off-line, there was little permanent damage. While midstream energy has been a disappointment in 2017, we remain convinced that these stocks are long overdue for a catch-up trade as midstream fundamentals are much improved.

Utilities – U.S. utilities (S&P 500® Utilities Index) traded off -2.7% in September. This likely had much to do with the 10-year U.S. Treasury yield rising to 2.33% at the close of the quarter from the low for the year of 2.04% on September 7. Still, U.S. utilities have been the surprise sector of the year, gaining 11.9% year to date, and European utilities (Bloomberg European Utilities Index) have been even stronger, rising 14.8%. Both moves have occurred in the face of fears around rising interest rates and the risk-on trading environment that has largely prevailed for 2017. With utilities trading at the high end of their historical multiple range, we think a pullback is a possibility, especially as we move into year-end. Company-specific fundamentals, especially for mid-cap utilities, remain very solid, but the story is more difficult for some of the larger-cap, index-heavy utilities such as Duke, Southern, and Consolidated Edison. We continue to avoid many of the large-cap U.S. utilities as well as Asian utilities, and instead focus on higher-growth regulated U.S. electric utilities, U.S. water, and gas utilities.

Real Estate – For the fourth quarter in a row, global REITs trailed broader global equities, as measured by the 1.6% increase in the FTSE EPRA/NAREIT Developed Index versus the 4.8% increase in the MSCI World Index. Italy, Ireland, Spain, Austria, and Sweden were the strongest performing real estate markets, as measured by the FTSE EPRA/NAREIT Developed Index, on a total return basis in U.S. dollars. Not surprisingly, most are located in the eurozone where the euro appreciated an additional 3.4% in the quarter relative to the U.S. dollar. Where each of these countries has its own idiosyncratic factors that influenced returns, a common thread across all of them is solid underlying real estate fundamentals benefiting from healthy economic growth. In contrast, New Zealand, Japan, Switzerland, the Netherlands, and Israel were the weakest real estate markets in the quarter. Japan posted a negative total return as two large-cap Japanese developers performed poorly and Japanese REIT shares were pressured by fund outflows from local Japanese real estate investment products, particularly those offered by Japanese trust banks.

We believe the global real estate market cycle has room for further growth. We expect demand to continue to exceed supply across most property sectors and major cities. The global weight of capital looking for a home in high-quality, core real estate is meaningful and continues to support asset pricing. Additional price appreciation will likely be driven by cash flow growth. We expect M&A activity to continue into 2018. Low, but positive global economic growth and manageable new real estate supply are positive tailwinds. Should growth continue to improve, this would facilitate further increases in real estate operating cash flows and dividends through higher property occupancies and, in cases where occupancy has reached equilibrium, higher rents. On a country basis, real estate fundamentals remain more attractive in Ireland, Spain, the Nordics, Germany, and the U.S.

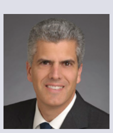
OUTLOOK

We are frequently asked for our thoughts on the length of the current economic cycle. The National Bureau of Economic Research (NBER) is officially tasked with defining and dating recessions in the U.S. According to NBER, the definition of a recession is much more involved than the relatively simplistic rule of thumb many people use – i.e., two consecutive quarters of negative GDP growth. NBER research actually focuses on four time series, although not exclusively, to determine when a recession has taken place: industrial production, total nonfarm employees, real personal income, and real manufacturing & trade sales. By these measures it would seem that, despite the length of the current expansion, we are not even close to a recession, and whatever past notions we have of typical cycles may not apply this time around.

In our view, the outlook for global markets continues to look bright. The world's central bankers are talking about the need to tighten, but for now monetary policy remains loose and supportive. The fourth quarter should see another rate hike in the U.S. by the Federal Reserve and 2018 will likely usher in a new Federal Reserve Chair appointed by President Trump. We are seeing solid economic growth across most regions, and inflation remains very much in check. The biggest issue we see is simply that stocks have run and valuations are looking quite full. In terms of catalysts and events, we will also need to keep a close eye on tax reform in the U.S. Markets will clearly react negatively if the Republican tax bill suffers the same fate as the Obamacare repeal. Investors are looking towards the earnings bump that a tax bill would provide; additionally, it is important for investors to see that Washington is not in total gridlock. Outside the U.S., we continue to keep a close eye on world political events including China's upcoming leadership changes, the independence movement in Catalonia, and the latest news from the Korean peninsula.

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 investment strategies on which we have built our reputation.

Authored by:



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