MARKET NOTES

Week of July 24, 2017

Markets Rise as Earnings Start Rolling In

The U.S. economy showed signs of strength in key areas last week, with both housing starts (the number of new residential construction projects begun during a given month) and initial jobless claims coming in better than expected. Overseas, however, Germany's ZEW Economic Sentiment Survey was lower than expected, while the UK's inflation rate slowed unexpectedly.

In the U.S. equity markets:

- Commodity-related sectors outperformed last week, led by precious metals producers and energy companies, as commodity prices rose due to factors such as a weaker dollar and rising oil prices.
- Markets in commodity-focused countries such as Australia and South Africa also outperformed.
- Interest-rate-sensitive sectors, such as utilities and REITs, outperformed as interest rates fell.
- Financials underperformed for the week on disappointing earnings results, as well as lower interest rates, which can dampen their profits.

In the fixed-income markets, falling interest rates helped long-term Treasury bonds outperform but acted as a drag on the performance of short-term Treasuries.

GAIN: Active Asset Allocation

Global stocks rose modestly during the relatively quiet week, with small-cap stocks and U.S. large-cap growth stocks generating the best performance.

Second-quarter corporate earnings results are coming in, which is leading to a wide spread among various U.S. market sectors. Last week, for example, positive earnings results benefited utilities, healthcare and technology. Basic materials and financials lost ground on disappointing results. We continue to overweight growth and technology in the equity portion of the portfolios, as we believe we will see continued market gains going forward.

continued on next page >

Bond markets also gained last week, with both Treasuries and corporate bond prices rising. We expect duration risk to remain volatile as investors react to the Fed's decisions. We also believe corporate credits offer a better risk-reward trade-off than do other types of bonds.

PROTECT: Risk Assist

All Risk Assist portfolios remained unhedged last week, which allowed them to fully participate in the market's gains.

Many Risk Assist clients last week achieved ratchets—our systematic process of raising protection levels as gains are generated in the portfolios. When account values rise to meet certain targets, the protection level (or "floor") is reset to reflect that higher level.

SPEND: Real Spend

Strong equity markets continued to provide a tailwind for the Real Spend portfolios, which take a more equity-oriented approach than do many other types of legacy retirement income portfolios. The spread between global equity markets and the broad U.S. fixed-income market over the past 12 months now exceeds 18%.

Although the overall market environment has been positive for the portfolios, our positions in dividend-focused investments have come under pressure lately, while duration risk remains volatile.

Meanwhile, market expectations for inflation going forward remain at the low end of their range for the year, hovering at around 2.2%.