



### PHILLIPS CURVE

One of the early economic theories published by William Phillips described a historically inverse relationship between unemployment rates and inflation. In theory, the relationship appeared fairly straight forward. When unemployment rates are low we should expect inflation to be high, and vice versa. The intuitive case seems very strong. Increased levels of employment should result in higher wages and inflation. So why then is the current domestic economy sporting near all-time unemployment lows, yet wage growth and inflation remain stubbornly subdued? The Fed (and frankly the majority of investors) has been wrangling with this seeming disconnect for several years now.

The Fed officially adopted an inflation target of 2% in 2012. Since this target was set, inflation has been above target only 6% of the time. In February of this year, inflation reached 1.8% and the economy appeared on track to finally reach the 2% inflation target. However, the May report showed inflation stood at 1.4%, a 17-month low. The recent drop in inflation in the face of falling unemployment rates stands in direct conflict with the concepts of the Phillips Curve. Has the relationship suddenly broken down? Over history there have been rare times when the relationship appears to have broken down. Most notable is a multi-year period of stagflation in the 1970s and early 1980s when the economy experienced virtually no growth, yet faced high unemployment and high inflation. Many economists have since used this time period to challenge the validity of the Phillips Curve. However, this period of time also corresponded to a period of wage and price controls under the Nixon administration and artificial supply constraints by OPEC that sent energy prices skyrocketing. We believe this outlier event was more reflective of economic intervention and the lack of free market forces than a failure of the underlying economic theory.

Most economists now argue that the original theory proposed by Phillips remains valid in the short-term, but is too simple and over time the curve has actually flattened (inflation being less responsive to unemployment rates) to where the relationship is less pronounced. Early observations were done during periods in which most economies were largely closed economic systems with strong labor union power and low labor mobility. We now live in a global economy with less union representation and higher levels of labor mobility and traded goods. Globalization's largest impact on inflation has come through the deflationary effect on traded goods prices. In particular, the entry of China into the global economy has been deflationary on a global scale. Prices and wage inflation are no longer constrained within the domestic economy, they are driven by global economic factors. This also helps explain why low unemployment rates in the UK, Germany and Japan have failed to drive any meaningful acceleration in inflation, they are facing the same global economic factors.

Globalization has reduced the Fed's level of influence on domestic inflation. Open borders and immigration policy help to reduce wage inflation pressures and global trade helps export goods inflation. To make the Fed's job even more complicated, globalization influences vary significantly across US economic sectors. The US service and healthcare sectors tend to be more sheltered from global influences, while consumer goods are highly exposed. Bottom line, the Fed's 2% inflation target is proving harder to achieve than expected. The 2% target may likely be achieved only through an acceleration of global growth and/or overheating of certain sectors within the US economy.

## GLOBAL ECONOMIC LANDSCAPE

- The US June jobs report came in stronger than expected with non-farm payroll up 220,000 jobs. This represented a re-acceleration in job creation up from 170,000 new jobs in May.
- Domestic unemployment ticked up slightly from 4.3% to 4.4% reflecting a modest rise in labor participation rates.
- The Jolts job opening report currently shows 6 million jobs are currently unfilled, the highest level since the inception of the report in 2000.
- Consumer Confidence in labor markets is presently at a 16-year high.
- Wage growth remains subdued with a year-over-year gain of 2.6%.
- The Bank of Canada recently became the first major central bank outside the US to raise interest rates since the US began tightening in 2015.
- The economic recovery across Europe continues to show positive momentum. The UK labor market added 175,000 jobs over the last three months while the unemployment rate dropped from 4.6% to 4.5%. Euro-zone industrial production rose by 1.3% in May to its highest level since 2008.
- Global inflation rates also reflect continued slow growth in the world economy. Developed market inflation rates have increased from 0.6% in June of 2016 to 1.7% currently.
- The Japanese economy has posted positive growth for the past eight consecutive quarters. The current growth rate is 1.3%, twice the 20-year average. Unemployment rates have dropped to 3.1%, a 20-year low yet wage growth remains nearly non-existent.
- Emerging market growth rates are nearly twice that of the developed markets despite continued weakness in commodity prices.

## GLOBAL FINANCIAL MARKETS

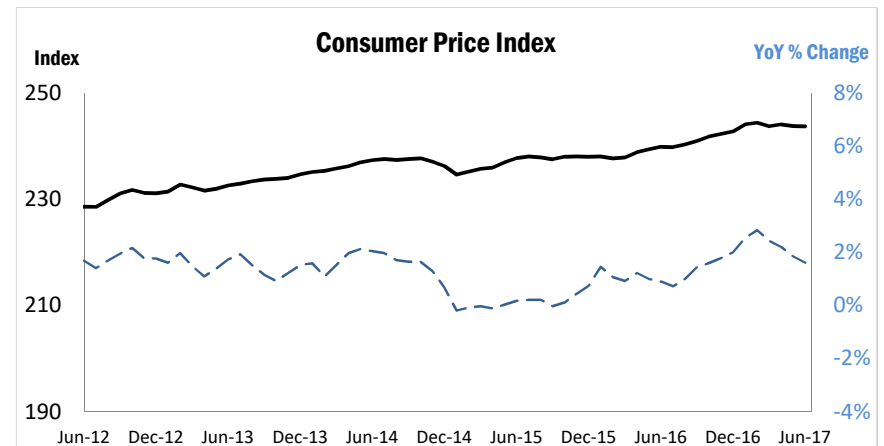
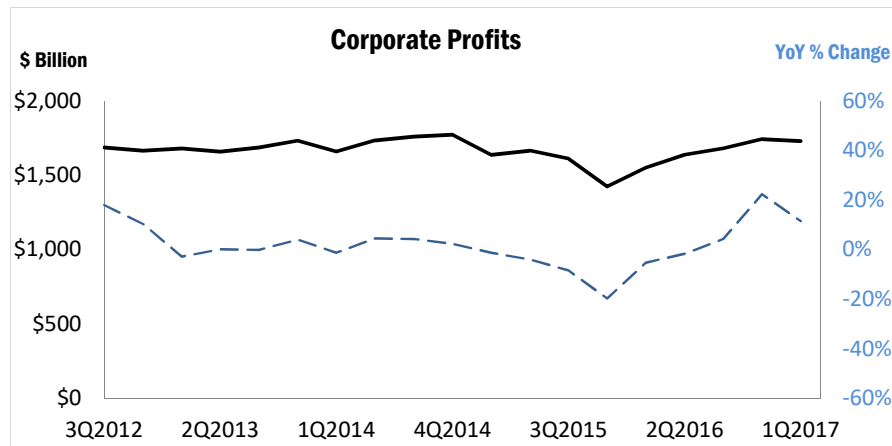
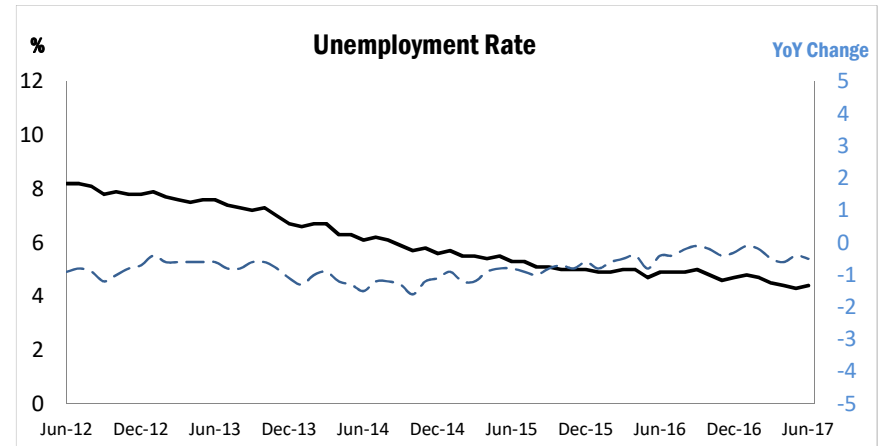
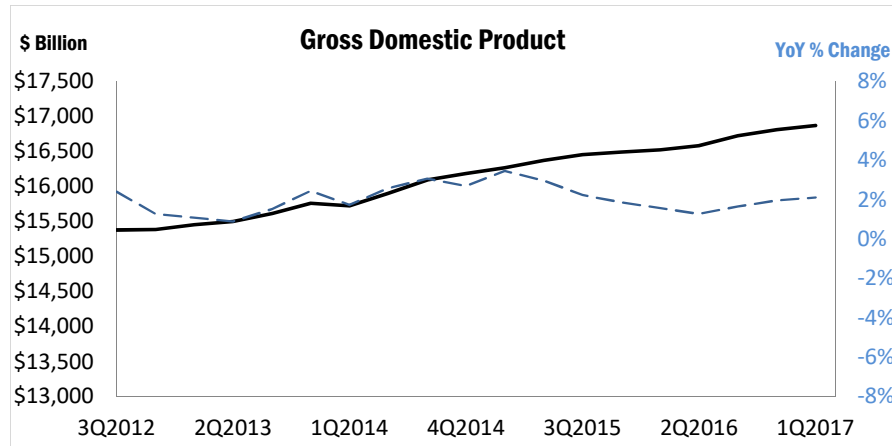
- The current bull market in domestic stocks, presently in its 9<sup>th</sup> year, is the second-longest in American history. No bull market has ever seen a 10<sup>th</sup> birthday, could this be the first?
- Cyclical stocks have been trading at a discount in recent years. However, post-election cyclical stocks have rebounded strongly (ex-energy) and now trade roughly at parity with defensive stocks.
- Growth stocks handily outperformed value stocks for the quarter and year-to-date.
- Large cap stocks continued to outpace smaller cap stocks for the quarter and year-to-date.
- International stocks outperformed domestic stocks for the quarter and year-to-date. Returns have been buoyed by stronger economic data out of a broad range of developed and emerging markets.

- Both emerging market equity and debt markets have seen strong inflows following a period of improved financial conditions and corporate earnings. Generally, periods of strong inflows have coincided with strong returns.
- Global equity market correlations peaked during the great recession in 2009 at 0.77. Current correlations are at 0.39, the lowest levels since 2004. The lower correlation is generally viewed as a positive for active management.
- The US dollar came under pressure late in the quarter against the Euro and Pound, reversing an extended strong US dollar trend. This reversal reflected stronger economic data out of Europe and the likelihood of a regime change toward tighter monetary policy in those markets going forward.

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## 2Q2017 Economic Data



Labor Market Statistics (Monthly)					
Category	Recent	5-Yr High	5-Yr Low	5-Yr Avg.	Date
Jobs Added/Lost Monthly	222,000	344,000	43,000	206,283	Jun-17
Unemployment Rate	4.4%	8.2%	4.3%	6.0%	Jun-17
Median Unemployment Length (Weeks)	7.6	20.3	7.6	13.6	Jun-17
Average Hourly Earnings	\$26.25	\$26.25	\$23.49	\$24.79	Jun-17

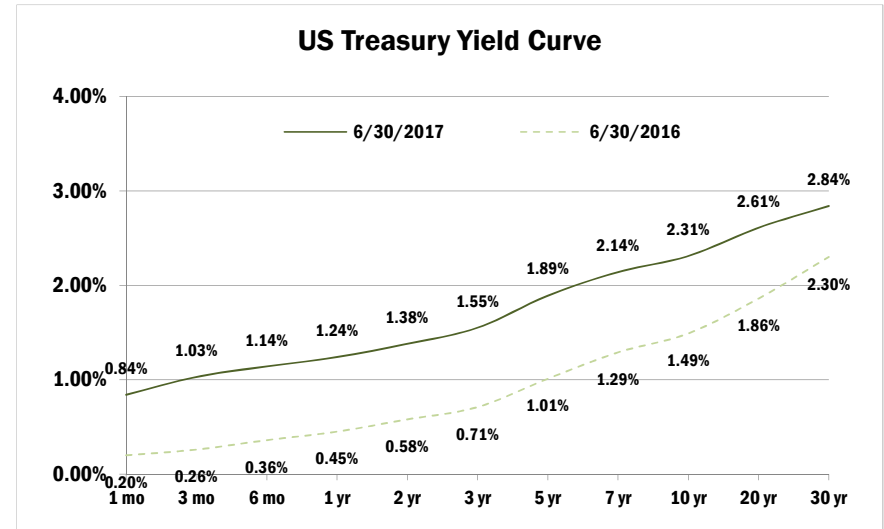
Source: Federal Reserve Bank of St. Louis and Bureau of Labor Statistics

Other Prices and Indexes (Monthly)					
Category	Recent	5-Yr High	5-Yr Low	% Off Peak	Date
Gas: Price per Gallon	\$2.37	\$3.86	\$1.79	-38.6%	Jun-17
Spot Oil	\$45.18	\$106.57	\$30.32	-57.6%	Jun-17
Case-Shiller Home Price Index	198.5	198.5	139.8	41.9%*	Apr-17
Medical Care CPI	474.4	474.4	416.8	13.8%*	Jun-17

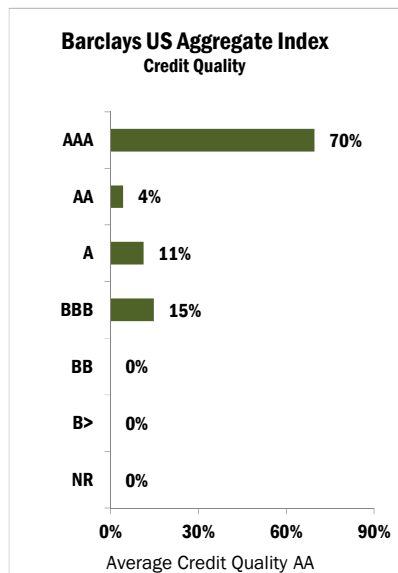
\*% Off Low

## 2Q2017 Bond Market Data

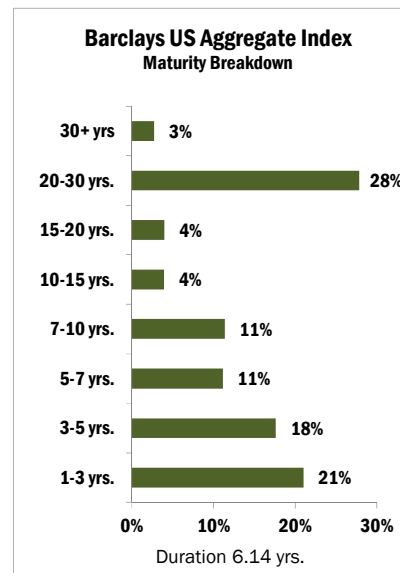
Index	QTR	YTD	1 yr.	3 yrs.	5 yrs.	10 yrs.
90-Day T-Bill	0.16%	0.25%	0.39%	0.18%	0.14%	0.56%
Barclays US Aggregate	1.45%	2.27%	-0.31%	2.48%	2.21%	4.48%
Barclays Short US Treasury	0.18%	0.30%	0.48%	0.33%	0.26%	0.77%
Barclays Int. US Treasury	0.66%	1.21%	-1.33%	1.48%	1.06%	3.47%
Barclays Long US Treasury	3.96%	5.41%	-7.22%	5.58%	2.76%	7.34%
Barclays US TIPS	-0.40%	0.85%	-0.63%	0.63%	0.27%	4.27%
Barclays US Credit	2.35%	3.68%	1.84%	3.40%	3.68%	5.61%
Barclays US Mortgage-Backed	0.87%	1.35%	-0.06%	2.17%	2.00%	4.31%
Barclays US Asset-Backed	0.60%	1.14%	0.63%	1.66%	1.49%	2.98%
Barclays US 20-Yr Municipal	2.49%	4.02%	-1.02%	4.24%	4.15%	5.29%
Barclays US High Yield	2.17%	4.93%	12.70%	4.48%	6.89%	7.67%
Barclays Global	2.60%	4.41%	-2.18%	-0.35%	0.78%	3.69%
Barclays International	3.55%	6.12%	-3.80%	-2.42%	-0.36%	3.05%
Barclays Emerging Market	1.77%	5.11%	5.57%	4.49%	5.32%	7.14%



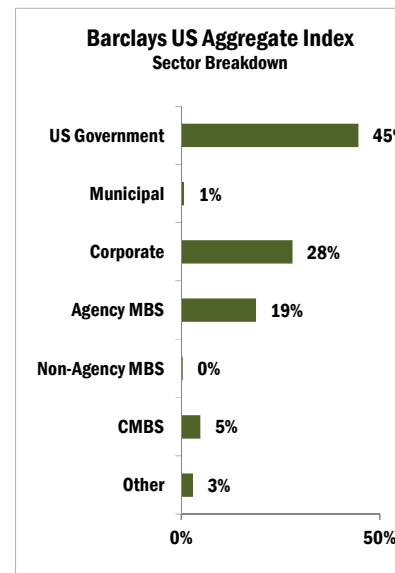
Source: Department of US Treasury



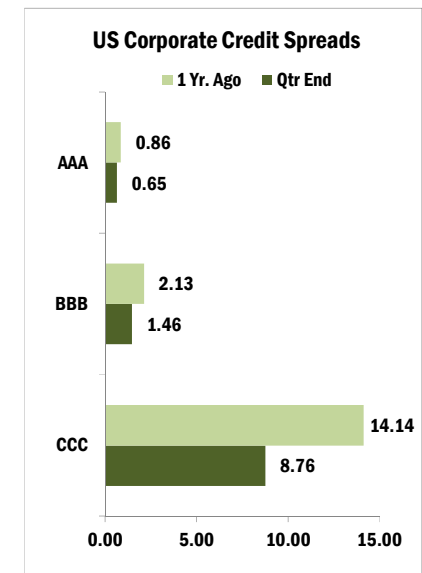
Source: Morningstar



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Source: Morningstar



Source: Federal Reserve / Bank of America

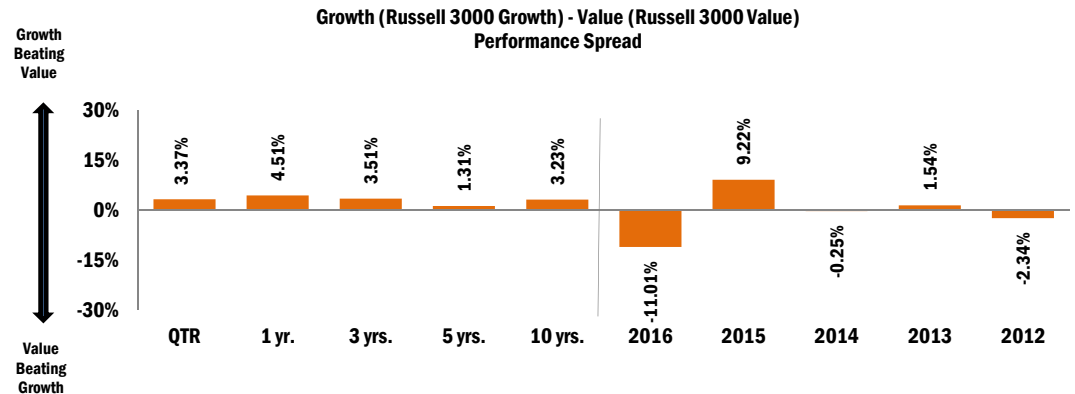
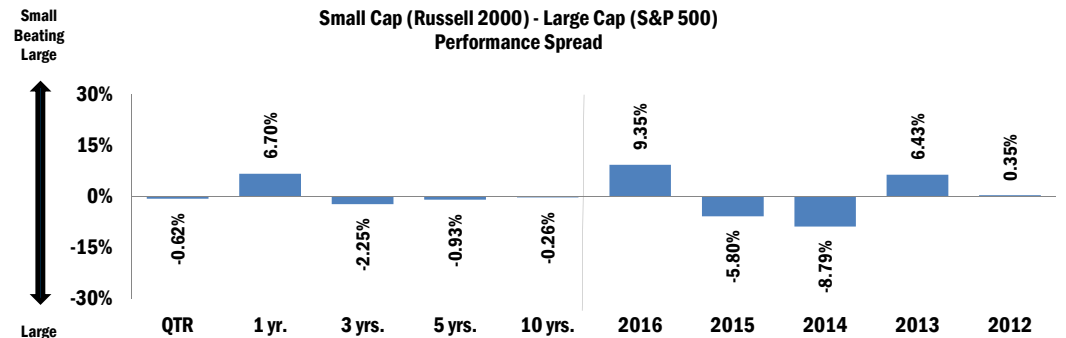
# 2Q2017 US Equity Market Data

## Sectors Weights/Returns (ranked by quarter performance)

	Wgt.	Sector	QTR	1 Yr.
S&P 500 Index	15%	Health Care	7.10%	12.47%
	10%	Industrials	4.73%	22.27%
	15%	Financials	4.25%	35.37%
	22%	Information Technology	4.14%	33.89%
	3%	Materials	3.17%	18.59%
	3%	Real Estate	2.76%	-0.42%
	12%	Consumer Discretionary	2.35%	16.90%
	3%	Utilities	2.21%	2.47%
	9%	Consumer Staples	1.57%	3.06%
	6%	Energy	-6.36%	-4.14%
2%	Telecom Services	-7.05%	-11.71%	
S&P Midcap 400 Index	9%	Health Care	11.72%	27.00%
	18%	Information Technology	4.34%	31.83%
	15%	Industrials	3.62%	28.47%
	12%	Consumer Discretionary	1.98%	14.90%
	16%	Financials	1.07%	25.41%
	8%	Materials	1.07%	22.45%
	10%	Real Estate	0.92%	0.46%
	5%	Utilities	0.33%	5.82%
	4%	Consumer Staples	-3.93%	-3.04%
	3%	Energy	-18.55%	-19.98%
0%	Telecom Services	-19.53%	-32.36%	
S&P Smallcap 600 Index	13%	Health Care	9.54%	24.16%
	1%	Telecom Services	5.95%	7.11%
	3%	Utilities	4.08%	8.00%
	15%	Consumer Discretionary	3.85%	15.62%
	7%	Real Estate	2.03%	8.22%
	19%	Industrials	1.57%	24.63%
	14%	Information Technology	1.43%	33.80%
	17%	Financials	0.95%	29.87%
	5%	Materials	0.32%	35.11%
	3%	Consumer Staples	-2.73%	1.43%
3%	Energy	-26.99%	-17.53%	

## Index Performance Data

Index	QTR	YTD	1 yr.	Annualized		
				3 yrs.	5 yrs.	10 yrs.
S&P 500	3.09%	9.34%	17.90%	9.61%	14.63%	7.18%
Russell 1000 Value	1.34%	4.66%	15.53%	7.36%	13.94%	5.57%
Russell 1000 Growth	4.67%	13.99%	20.42%	11.11%	15.30%	8.91%
Russell Mid Cap	2.70%	7.99%	16.48%	7.69%	14.72%	7.67%
Russell Mid Cap Value	1.37%	5.18%	15.93%	7.46%	15.14%	7.23%
Russell Mid Cap Growth	4.21%	11.40%	17.05%	7.83%	14.19%	7.87%
Russell 2000	2.46%	4.99%	24.60%	7.36%	13.70%	6.92%
Russell 2000 Value	0.67%	0.54%	24.86%	7.02%	13.39%	5.92%
Russell 2000 Growth	4.39%	9.97%	24.40%	7.64%	13.98%	7.82%
Russell 3000	3.02%	8.93%	18.51%	9.10%	14.58%	7.26%
DJ US Select REIT	1.64%	1.36%	-2.43%	8.04%	9.00%	5.42%

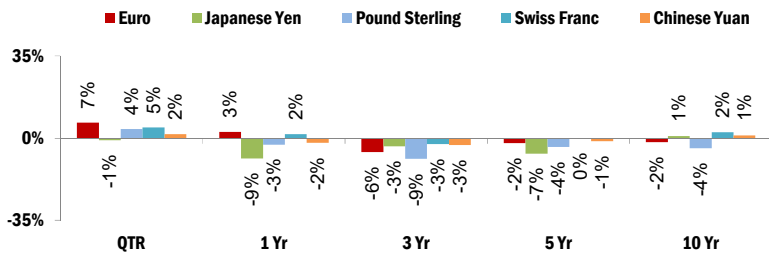


# 2Q2017 International Market Data

## Index Performance Data (net)

Index (US\$)	QTR	YTD	1 yr.	3 yrs.	5 yrs.	10 yrs.
<b>MSCI ACWI ex-US</b>	<b>5.78%</b>	<b>14.10%</b>	<b>20.45%</b>	<b>0.80%</b>	<b>7.22%</b>	<b>1.13%</b>
<b>MSCI EAFE</b>	<b>6.12%</b>	<b>13.81%</b>	<b>20.27%</b>	<b>1.15%</b>	<b>8.69%</b>	<b>1.03%</b>
<b>Europe</b>	<b>7.37%</b>	<b>15.36%</b>	<b>21.11%</b>	<b>-0.24%</b>	<b>8.82%</b>	<b>0.62%</b>
United Kingdom	4.72%	10.00%	13.35%	-2.96%	5.28%	0.25%
Germany	6.42%	15.32%	28.71%	0.95%	11.10%	1.63%
France	9.11%	17.05%	28.14%	1.82%	10.64%	0.12%
<b>Pacific</b>	<b>3.92%</b>	<b>11.11%</b>	<b>19.26%</b>	<b>3.99%</b>	<b>8.54%</b>	<b>2.01%</b>
Japan	5.19%	9.92%	19.18%	5.54%	9.56%	1.21%
Hong Kong	7.19%	21.56%	23.84%	7.48%	11.41%	7.11%
Australia	-1.87%	8.90%	18.33%	-1.02%	5.35%	2.41%
<b>Canada</b>	<b>0.64%</b>	<b>3.16%</b>	<b>11.68%</b>	<b>-3.94%</b>	<b>3.04%</b>	<b>1.09%</b>
<b>MSCI EM</b>	<b>6.27%</b>	<b>18.43%</b>	<b>23.75%</b>	<b>1.07%</b>	<b>3.96%</b>	<b>1.91%</b>
<b>MSCI EM Latin America</b>	<b>-1.74%</b>	<b>10.12%</b>	<b>15.01%</b>	<b>-6.62%</b>	<b>-3.76%</b>	<b>-1.15%</b>
<b>MSCI EM Asia</b>	<b>8.64%</b>	<b>23.18%</b>	<b>27.86%</b>	<b>5.00%</b>	<b>7.75%</b>	<b>3.83%</b>
<b>MSCI EM Eur/Mid East</b>	<b>1.04%</b>	<b>2.56%</b>	<b>15.51%</b>	<b>-8.16%</b>	<b>-3.35%</b>	<b>-4.33%</b>
<b>MSCI ACWI Value ex-US</b>	<b>4.08%</b>	<b>11.03%</b>	<b>23.62%</b>	<b>-1.00%</b>	<b>6.35%</b>	<b>0.31%</b>
<b>MSCI ACWI Growth ex-US</b>	<b>7.56%</b>	<b>17.38%</b>	<b>17.38%</b>	<b>2.55%</b>	<b>8.04%</b>	<b>1.89%</b>
<b>MSCI AC World Sm Cap ex-US</b>	<b>6.24%</b>	<b>15.56%</b>	<b>20.32%</b>	<b>3.31%</b>	<b>10.02%</b>	<b>2.91%</b>

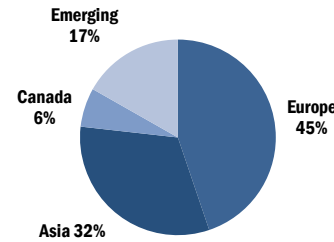
## Foreign Currency v. US\$ Returns



Exchange Rates	2Q17	1Q17	4Q16	3Q16	2Q16	1Q16
Japanese Yen	112.40	111.41	116.80	101.21	102.77	112.42
Euro	0.88	0.93	0.95	0.89	0.91	0.88
British Pound	0.77	0.80	0.81	0.77	0.76	0.70
Swiss Franc	0.96	1.00	1.02	0.97	0.98	0.96
Chinese Yuan	6.78	6.88	6.94	6.67	6.65	6.45

## Regional Exposure

MSCI ACWI ex-USA

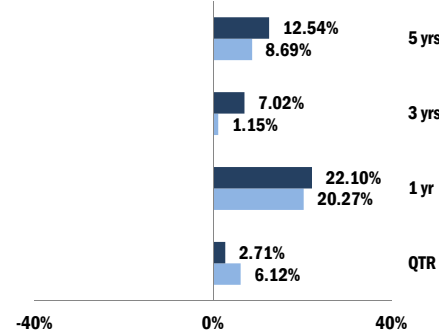


## Top 10 Countries (MSCI AC World ex-USA)

Japan	17%
UK	11%
France	7%
China	7%
Germany	7%
Canada	7%
Switzerland	6%
Australia	5%
South Korea	4%
Hong Kong	4%

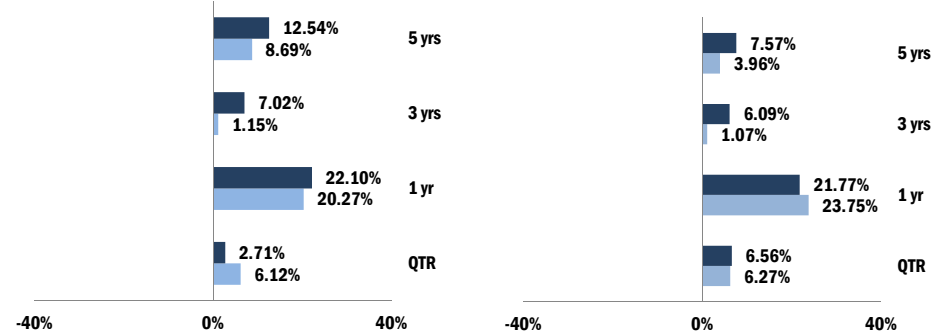
## MSCI EAFE Index Return

Local (Dark Blue), US\$ (Light Blue)



## MSCI Emerging Index Return

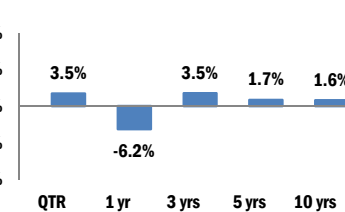
Local (Dark Blue), US\$ (Light Blue)



## MSCI ACWI Ex US Value v. Growth Performance Spread

Growth Beating Value

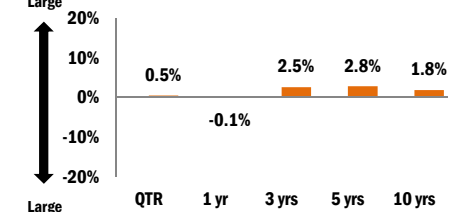
Value Beating Growth



## MSCI ACWI Ex US Large v. Small Cap Performance Spread

Small Beating Large

Large Beating Small



# Historical Market Returns

Ranked by Performance

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	YTD	2017
Emerging Markets 55.82%	Emerging Markets 25.55%	Emerging Markets 34.00%	Emerging Markets 32.14%	Emerging Markets 39.42%	US Bonds 5.24%	Emerging Markets 78.51%	Small Cap 26.85%	Core Real Estate 14.96%	Emerging Markets 18.22%	Small Cap 38.82%	Large Cap 13.68%	Core Real Estate 13.95%	Small Cap 21.30%	Emerging Markets 18.43%	Emerging Markets 6.27%
Small Cap 47.25%	Intl 20.91%	Commod. 21.36%	Intl 26.65%	Intl 16.65%	Global Bonds 4.79%	High Yield 58.21%	Mid Cap 25.48%	TIPS 13.56%	Mid Cap 17.28%	Mid Cap 34.76%	Mid Cap 13.21%	Large Cap 1.38%	High Yield 17.12%	Intl 14.09%	Intl 5.78%
Intl 40.83%	Mid Cap 20.22%	Core Real Estate 20.15%	Small Cap 18.37%	Commod. 16.23%	Cash 1.39%	Intl 41.45%	Emerging Markets 18.88%	US Bonds 7.84%	Intl 16.83%	Large Cap 32.39%	Core Real Estate 11.44%	US Bonds 0.55%	Mid Cap 13.79%	Large Cap 9.34%	Global Balanced 3.33%
Mid Cap 40.06%	Small Cap 18.33%	Intl 16.62%	Large Cap 15.79%	Core Real Estate 14.84%	TIPS -2.35%	Mid Cap 40.48%	Commod. 16.83%	Global Bonds 5.64%	Small Cap 16.35%	Intl 15.29%	US Bonds 5.97%	Cash 0.03%	Large Cap 11.95%	Mid Cap 7.99%	Large Cap 3.09%
High Yield 28.97%	Global Balanced 12.18%	Mid Cap 12.65%	Core Real Estate 15.27%	TIPS 11.64%	Core Real Estate -10.70%	Small Cap 27.17%	Core Real Estate 15.26%	High Yield 4.98%	Large Cap 16.00%	Global Balanced 14.46%	Small Cap 4.89%	TIPS -1.43%	Commod. 11.76	Global Balanced 7.93%	Mid Cap 2.70%
Large Cap 28.68%	Core Real Estate 12.00%	Large Cap 4.91%	Mid Cap 15.26%	Global Bonds 9.48%	Global Balanced -24.51%	Large Cap 26.46%	High Yield 15.12%	Large Cap 2.11%	High Yield 15.81%	Core Real Estate 12.95%	TIPS 3.64%	Global Balanced -1.45%	Emerging Markets 11.18%	Small Cap 4.99%	Global Bonds 2.60%
Global Balanced 24.27%	High Yield 11.13%	Small Cap 4.55%	Global Balanced 14.53%	Global Balanced 9.07%	High Yield -26.16%	Global Balanced 20.49%	Large Cap 15.06%	Cash 0.06%	Global Balanced 11.06%	High Yield 7.44%	Global Balanced 3.17%	Mid Cap -2.43%	Core Real Estate 7.76%	High Yield 4.93%	Small Cap 2.46%
Commod. 23.93%	Large Cap 10.88%	Global Balanced 4.16%	High Yield 11.85%	US Bonds 6.97%	Small Cap -33.79%	Commod. 18.91%	Intl 11.15%	Global Balanced -0.97%	Core Real Estate 9.76%	Cash 0.07%	High Yield 2.45%	Global Bonds -3.15%	Global Balanced 5.38%	Global Bonds 4.41%	High Yield 2.17%
Global Bonds 12.51%	Global Bonds 9.27%	Cash 3.25%	Global Bonds 6.64%	Mid Cap 5.60%	Commod. -35.65%	TIPS 11.41%	Global Balanced 9.40%	Mid Cap -1.55%	TIPS 6.98%	US Bonds -2.02%	Global Bonds 0.59%	Small Cap -4.41%	TIPS 4.68%	Core Real Estate 3.05%	Core Real Estate 1.49%
TIPS 8.40%	Commod. 9.15%	TIPS 2.84%	Cash 4.85%	Large Cap 5.49%	Large Cap -37.00%	Global Bonds 6.93%	US Bonds 6.54%	Small Cap -4.18%	Global Bonds 4.32%	Global Bonds -2.60%	Cash 0.04%	High Yield -4.46%	Intl 4.50%	US Bonds 2.27%	US Bonds 1.45%
Core Real Estate 8.28%	TIPS 8.46%	High Yield 2.74%	US Bonds 4.33%	Cash 4.44%	Mid Cap -41.46%	US Bonds 5.93%	TIPS 6.31%	Commod. -13.32%	US Bonds 4.21%	Emerging Markets -2.60%	Emerging Markets -2.18%	Intl -5.66%	US Bonds 2.65%	TIPS 0.85%	Cash 0.16%
US Bonds 4.10%	US Bonds 4.34%	US Bonds 2.43%	Commod. 2.07%	High Yield 1.87%	Intl -45.53%	Cash 0.16%	Global Bonds 5.54%	Intl -13.71%	Cash 0.08%	TIPS -8.61%	Intl -3.86%	Emerging Markets -14.90%	Global Bonds 2.09%	Cash 0.25%	TIPS -0.40%
Cash 1.03%	Cash 1.44%	Global Bonds -4.49%	TIPS 0.41%	Small Cap -1.57%	Emerging Markets -53.33%	Core Real Estate -30.40%	Cash 0.15%	Emerging Markets -18.42%	Commod. -1.06%	Commod. -9.52%	Commod. -17.00%	Commod. -24.60%	Cash 0.25%	Commod. -5.25%	Commod. -3.00%

Global Balanced is composed of 60% MSCI World Stock Index, 35% Barclays Global Aggregate Bond Index, and 5% US 90-Day T-Bills.