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First Quarter 2018

QUARTERLY MARKET REVIEW

T.RowePrice®
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Quarterly Market Review

U.S. STOCKS

1Q 2018

STOCKS FALTER AFTER LONG WINNING STREAK

After a strong start, stock prices fell and volatility spiked in the first quarter, bringing an end to an especially long and steady winning streak—the broad Standard & Poor's 500 Index recorded its first quarterly loss since 2015. The small-cap Russell 2000 Index fared better than the larger-cap benchmarks, while the technology-heavy Nasdaq Composite was the sole major index to record a gain in the quarter. Despite sharp declines late in the period, technology shares performed best within the S&P 500 Index, helping growth stocks handily outpace value shares. Consumer discretionary stocks were also strong, thanks, in part, to strong early performance from Internet-related media and retailing stocks. The small telecommunications sector performed the worst, and consumer staples, energy, materials, and real estate shares were also notably weak.

Total Returns

	1Q 2018	Year-to-Date
Dow Jones Industrial Average	-1.96%	-1.96%
S&P 500 Index	-0.76	-0.76
Nasdaq Composite Index	2.32	2.32
S&P MidCap 400 Index	-0.77	-0.77
Russell 2000 Index	-0.08	-0.08

Past performance cannot guarantee future results.

Note: Returns are for the periods ended March 31, 2018. The returns include dividends based on data compiled by T. Rowe Price, except for the Nasdaq Composite, whose return is principal only. Russell Investment Group is the source and owner of the trademarks, service marks, and copyrights related to Russell indexes. Russell® is a registered trademark of Russell Investment Group.

QUARTER BEGINS ON HIGH NOTE AS EARNINGS GROW AT FASTEST PACE SINCE 2011

Throughout January, it appeared that the first quarter would be a happy repeat of 2017's market dynamics, with stocks steadily moving higher and setting new records amid minimal volatility. Investors appeared to remain enthused about the passage in December of significant corporate tax cuts, along with new tax provisions that would encourage U.S. corporations to use repatriated foreign profits to boost merger and acquisition activity and share repurchases. Strong economic data, particularly on retail sales, further boosted sentiment. Most importantly, perhaps, fourth-quarter earnings reports came in much better than expected, with overall profits for the S&P 500 increasing by nearly 15% on a year-over-year basis, according to FactSet—the best performance since late 2011.

INFLATION FEARS SPARK REVERSAL

February brought an abrupt reversal in stock prices, seemingly sparked by inflation fears. On the second trading day of the month, the Labor Department reported that employers had added 200,000 jobs in the previous month,

modestly above expectations. More notably, the report also revealed that average hourly earnings had increased 2.9% over a year earlier, the healthiest gain since 2009 (although later revised lower). Stocks plunged as investors appeared to conclude that the tight labor market was feeding through into increased labor costs while also providing the Federal Reserve with a reason to quicken its pace of interest rate hikes. The decline continued over the next four trading days as subsequent data seemed to confirm that the economy was picking up speed and perhaps in danger of overheating. The S&P 500 reached its low point for the quarter and entered correction territory—defined as a retreat of over 10% from recent highs—on February 8, following a report showing that weekly jobless claims had fallen to their lowest level since January 1973.

The prospect of increased Treasury borrowing may have added to fears of higher bond yields and interest rates. T. Rowe Price traders noted that stocks suffered a rapid sell-off on the afternoon of February 7, following word that Senate leaders had reached a two-year spending deal that sharply increased both defense and other forms of discretionary spending. Long-term Treasury yields reached a peak for the quarter in mid-February, with the yield on the 10-year note reaching a four-year high. Meanwhile, the Fed continued to push up short-term interest rates, announcing another quarter-point hike in the federal funds rate on March 21. The increase was widely expected, but the Fed also concerned some investors by noting that "the economic outlook has strengthened in recent months."

HEIGHTENED TRADE TENSIONS ALSO WEIGH ON SENTIMENT

As the quarter wound down, fears that the economy was overheating seemed to give way to concerns that growth might be undermined by trade wars. On March 1, President Trump made the surprise announcement that the U.S. would impose tariffs on imported steel and aluminum. The tariff announcement was soon followed by the departure of two leading free trade advocates in the administration, top economic advisor Gary Cohn and Secretary of State Rex Tillerson, alongside reports of the growing influence of senior trade adviser Peter Navarro, a noted proponent of trade restrictions. Trade fears intensified again late in March after the administration revealed that it was planning on imposing tariffs on roughly USD $50 billion to USD $60 billion worth of imports from China, as well as new restrictions on technology transfers and acquisitions of U.S. firms by Chinese competitors. The Chinese Commerce Ministry referred to the tariff plans as setting a "vile precedent," and Chinese officials declared that they would target USD $3 billion in U.S. goods with import duties of their own.

The end of the quarter also brought a sharp reversal in highly valued technology shares. The first blow came on March 16, when news surfaced that a British political consulting firm had made undisclosed use of Facebook customer data. Facebook's stock tumbled in response, soon followed by shares of Twitter, Alphabet (parent of Google), and other companies perceived to be vulnerable to accusations about the misuse of customer information. Subsequently, two fatal accidents involving self-driving cars weighed on Tesla, Nvidia, and other prominent companies involved in the technology. Finally, Amazon.com shares fell following reports that President Trump was "obsessed" with the company. Indeed, the president soon tweeted accusations that Amazon was not paying its fair share of taxes or adequately reimbursing the U.S. Postal Service for deliveries, leading to speculation that antitrust action or other regulations might follow.

T. ROWE PRICE CIOs: DOMINANT INTERNET FIRMS ARE VULNERABLE TO REGULATORY HEADWINDS

In a recent investment roundtable, T. Rowe Price's chief investment officers (CIOs) acknowledged that increased regulations could disrupt the business models of dominant Internet companies—specifically, privacy concerns and antitrust laws that may yield significant headwinds. In Europe, firms are subject to increasing concerns about data privacy, and U.S. firms Google and Facebook were recently pulled into investigations regarding Russia's alleged involvement in the 2016 U.S. presidential election. Furthermore, these business models have monopolistic features, and T. Rowe Price's top investment professionals recognize that governments' previous actions to rein in monopolies have often come at unexpected times—and much to investors' detriment. The firm's analysts and managers are closely monitoring developments that could attract the attention of regulators or the general public.

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Quarterly Market Review

INTERNATIONAL STOCKS

1Q 2018

INTERNATIONAL EQUITIES FALL INTO LOSING TERRITORY

International stock markets posted negative returns in the first quarter. Emerging markets generated a small gain, outperforming developed markets. Key market drivers included strong synchronized global economic growth and solid corporate earnings, geopolitical uncertainty and fears of an unexpectedly fast rise in inflation and interest rates, and fears of an international trade war following President Donald Trump's announcement of tariffs on steel and aluminum imports. Many major currencies, including the euro, the British pound, and the Japanese yen, strengthened against the U.S. dollar, lifting returns in dollar terms.

Within the MSCI EAFE Index, which tracks developed markets in Europe, Australasia, and the Far East, the utilities, information technology, and consumer discretionary sectors posted gains. The health care, industrials and business services, and real estate sectors recorded losses. Growth stocks outperformed value stocks.

Total Returns

MSCI Indexes	1Q 2018	Year-to-Date
EAFE (Europe, Australasia, Far East)	-1.41%	-1.41%
All Country World ex-U.S.A.	-1.08	-1.08
Europe	-1.86	-1.86
Japan	0.98	0.98
All Country Asia ex-Japan	0.69	0.69
EM (Emerging Markets)	1.47	1.47

All data are in U.S. dollars as of March 31, 2018. **Past performance cannot guarantee future results.**
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EUROZONE STOCKS CALM THEN GROW VOLATILE

European shares rose following a string of favorable economic news, including the strongest recorded annual gross domestic product (GDP) rate in a decade, solid employment numbers, and U.S. corporate tax reform. T. Rowe Price Chief International Economist Nikolaj Schmidt notes that the strength in Europe is supported by low interest rates, continued implementation of quantitative easing, low commodity prices, and rising equity prices, but Schmidt believes that the growth will continue, although at a decelerated rate. Stocks lost their relative subdued trading and became more volatile toward the middle of the quarter. Fears that robust growth would spark higher labor costs and an unexpectedly faster increase in interest rates and inflation prompted investors to sell shares. On February 6, the pan-European STOXX 600 Index posted its biggest one-day percentage drop since June 2016, around the time of the UK's Brexit referendum.

UK CONTINUES TO TRAIL EUROZONE

The performance of UK stocks for U.S. dollar investors lagged, and the UK's blue chip FTSE 100, whose companies earn much of their revenue outside the UK, dropped to a one-year low. Stocks in the UK lost almost 4%, more than double the losses of the benchmark MSCI Europe Index. Manufacturing activity slowed as new orders slumped and fell short of the eurozone. Not all economic news in the UK was lackluster. Despite the downdraft, stocks were boosted following an agreement between the European Union and the UK on a 21-month Brexit transition plan, although the treatment of the Irish border remained unresolved. Retail strength also provided a boost to UK stocks.

CENTRAL BANKS STAND PAT

The Bank of England (BoE) held its official short-term interest rate at 0.5%. However, the BoE stoked expectations of a future hike, commenting that "given the prospect of excess demand over the forecast period, an ongoing tightening of monetary policy over the forecast period will be appropriate to return inflation sustainably to its target at a more conventional horizon." The European Central Bank (ECB) kept its key lending rates and its bond-buying program unchanged, as expected.

JAPAN IS A BRIGHT SPOT

Japanese equities strengthened modestly for U.S. dollar investors and outperformed the broad EAFE benchmark. Stronger exports, imports, and optimistic business sentiment helped fuel the rise in equity prices. Japan's economy grew for an eighth consecutive quarter—the longest GDP growth streak since 1989. However, later in the period, a decline in manufacturing and employment growth and fears of a brewing international trade war sparked a late-month sell-off of Japanese shares. President Trump did not exclude Japan from his aluminum and steel tariffs, and the announcement of further tariffs on roughly USD $50 billion in annual imports from China weighed on equity markets. While weak inflation continued to be an issue, Bank of Japan Governor Haruhiko Kuroda said that the bank was considering exiting its ultra-accommodative monetary policy in fiscal 2019 depending on whether the pace of inflation picks up.

EMERGING MARKETS STOCKS ADVANCE

Emerging markets stocks rose as synchronized global growth helped drive demand for higher-risk assets, but those gains were tempered later in the quarter by rising concerns over the prospect of a trade war, as well as some negative economic news in key regions. Emerging markets in Latin America produced robust gains, led by a more than 12% rise in Brazilian shares. The domestic Bovespa benchmark rose to a record level in January after an appeals court upheld a graft sentence against former President Luiz Inácio Lula da Silva. Brazilian stocks weakened later in the quarter, however, as its economy grew more slowly than expected, and the central bank cut its benchmark interest rate in February and March. Peruvian stocks were another strong performer amid improved sentiment following the resignation of President Pedro Pablo Kuczynski amid accusations of bribery. Mexican stocks edged higher despite concerns about the continuation of the North American Free Trade Agreement. Chinese stocks performed in line with the broad emerging markets benchmark, but shares were hurt as investors worried that a trade war with the U.S. could hurt growth just as Beijing steps up financial reforms. Emerging markets in Europe, the Middle East, and Africa logged the only negative regional returns, driven by losses in Turkey, South Africa, Greece, Hungary, and Poland.

OUTLOOK: GLOBAL GROWTH REMAINS POSITIVE IN THE LONG TERM

The broadening global economic recovery should be supportive for risk assets in 2018, according to T. Rowe Price's Asset Allocation Committee. Positive factors include continued domestic demand-driven recoveries underway in Europe and Japan to underpin their respective markets, although Schmidt notes that growth in both regions is decelerating. Risks to the outlook include a rise in geopolitical or trade tensions and the possibility of a central bank policy misstep.

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Quarterly Market Review

FIXED INCOME MARKETS

1Q 2018

TREASURY YIELDS CLIMB TO MULTIYEAR HIGHS

Treasury yields reached multiyear highs during the first quarter as the prospect of an increasing supply of Treasury securities and rising inflation expectations worried investors. Bond prices and yields move in opposite directions. The two-year Treasury note's yield reached its highest level since January 2008, the benchmark 10-year Treasury yield hit a four-year high, and the 30-year yield climbed to a two-and-a-half-year high. Longer-term Treasury yields peaked for the quarter on February 21 before receding somewhat in March.

Other factors may have also weighed on Treasuries during the three-month period: The Federal Reserve continued to slowly shrink its holdings of Treasuries and mortgage-backed securities, a process it began in October, and also appeared more committed to a gradual tightening of monetary policy. In addition, there were concerns about other central banks starting to reduce their stimulus programs, and a weakening dollar reduced the appeal of Treasuries for non-U.S. investors.

The interest rate hike at the Fed's March policy meeting, which was widely expected, moved the federal funds rate to a range of 1.50% to 1.75%. It was the first meeting under the leadership of Jerome Powell, who succeeded Janet Yellen as Fed chief in early February. The Fed's median projection is currently for two more hikes this year. Another measure of short-term interest rates, the three-month London interbank offered rate (Libor), also increased. Libor, the interest rate that banks charge each other for U.S. dollar loans, rose to 2.31% by the end of March from 1.69% at the end of 2017. Many analysts believe an increased supply of Treasury bills and commercial paper (short-term corporate debt) contributed to the bump in Libor.

Total Returns

Index	1Q 2018	Year-to-Date
Bloomberg Barclays U.S. Aggregate Bond Index	-1.46%	-1.46%
J.P. Morgan Global High Yield Index	-0.69	-0.69
Bloomberg Barclays Municipal Bond Index	-1.11	-1.11
Bloomberg Barclays Global Aggregate Ex-U.S. Dollar Bond Index	3.62	3.62
J.P. Morgan Emerging Markets Bond Index Global Diversified	-1.74	-1.74
Bloomberg Barclays U.S. Mortgage Backed Securities Index	-1.19	-1.19

Figures as of March 31, 2018. **Past performance cannot guarantee future results.** This chart is shown for illustrative purposes only and does not represent the performance of any specific security.
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Source: Third-party vendor RIMES.

BANK OF ENGLAND, ECB HOLD RATES STEADY BUT HINT AT FUTURE TIGHTENING

The major developed market central banks outside the U.S. generally kept their monetary policies unchanged in the first quarter, but the Bank of England raised expectations of a future hike in its March post-meeting statement,

noting that “an ongoing tightening of monetary policy over the forecast period will be appropriate to return inflation sustainably to its target.” The European Central Bank (ECB) also shifted to a slightly less accommodative policy as it dropped language from its statement that mentioned a commitment to expand its quantitative easing program if necessary.

The yields on 10-year government notes in Germany and the UK rose during the period, with the German bund increasing from 0.430% to 0.498%, while the British gilt moved from 1.191% to 1.353%. The Japanese 10-year note yield finished little changed, ticking down from 0.050% to 0.048%. The generally weaker dollar boosted the returns in U.S. dollar terms of debt denominated in other developed market currencies.

U.S. Treasury Yields

Maturity	December 31	March 31
3-Month	1.39%	1.73%
6-Month	1.53	1.93
2-Year	1.89	2.27
5-Year	2.20	2.56
10-Year	2.40	2.74
30-Year	2.74	2.97

Source: Federal Reserve Board.

MORTGAGE-BACKED SECURITIES HOLD UP BETTER THAN CORPORATE DEBT

Mortgage-backed securities (MBS) performed in line with Treasuries and held up better than the broader investment-grade bond market. The Fed’s continued slow reduction of its MBS holdings was a headwind for the sector; however, rising interest rates helped reduce mortgage prepayment risk, and investor demand for high-quality securities provided support.

Investment-grade corporate bonds faced headwinds from elevated supply and waning demand outside the U.S. The issuance of USD $40 billion of new bonds in March by pharmacy chain CVS to fund its purchase of health insurer Aetna was the third-largest investment-grade corporate bond deal on record and was generally well received by the market. High yield bonds lost ground but held up better than the broad U.S. investment-grade market. The sector was supported by solid corporate earnings reports and a low default rate. Generally higher oil prices during the quarter were also beneficial for energy issuers, which make up a large portion of the high yield indexes. Below investment-grade credit spreads—the yield premium offered by riskier bonds compared with similar-maturity Treasuries—reached the tightest levels since 2007 in January, but spreads widened later in the period as equity weakness weighed on the sector.

MUNI BONDS FACE CROSSWINDS FROM TAX REFORM

Municipal bonds recorded negative results for the quarter but narrowly outperformed Treasuries. *The Wall Street Journal* noted that this year’s first-quarter return was the weakest start to the year for the sector in 15 years. Tax-exempt bonds faced a mixed technical environment as a result of tax reform. New issuance was muted, but with lower corporate tax rates, some banks and insurance companies had less need for munis in their portfolios. Lower-rated segments of the muni market, including high yield tobacco bonds and debt from troubled issuer Puerto Rico, outperformed higher-quality tax-exempt securities.

EMERGING MARKETS BONDS STRUGGLE IN RISK-OFF ENVIRONMENT

Emerging markets bonds struggled later in the period as equity market volatility and concerns about the potential for trade wars weighed on demand for riskier assets. Credit news was mixed in the sector. In a widely expected decision, S&P Global Ratings cut Brazil’s credit rating to BB- from BB, noting that the country had failed to pass meaningful fiscal reform needed to support continued economic growth. However, in South Africa, the rand rose

more than 1% after Moody's Investors Service kept that country's credit rating above junk status and lifted its outlook to stable. In the wake of the announcement, yields on South Africa's benchmark local currency government bonds fell to their lowest level in almost three years. The other major ratings agencies, S&P and Fitch Ratings, downgraded South Africa to junk status last year. If Moody's had also downgraded the country's debt, South African bonds would have been pushed out of the key investment indexes and the government would have likely faced higher borrowing costs.

OUTLOOK: LEVERAGED LOANS OFFER POTENTIAL IN RISING RATE ENVIRONMENT

T. Rowe Price's multi-sector bond portfolio managers believe that leveraged loans are a compelling option for fixed income investors who are seeking an asset class with less sensitivity to rising interest rates. Unlike most other fixed income alternatives where prices fall as rates rise, leveraged loans, which are also called bank loans, have their coupons reset higher as rates increase. As a result, leveraged loans have historically outperformed other fixed income sectors during periods of rising Treasury rates and monetary policy tightening.

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Quarterly Market Review

GLOBAL CAPITAL MARKETS ENVIRONMENT

1Q 2018

Major U.S. stock market indexes edged lower in the first quarter of 2018. After rising to record highs through late January—helped by favorable corporate earnings reports and momentum from the tax reform legislation passed in late 2017—major indexes fell sharply in response to stronger-than-expected wage growth data and concerns that the Federal Reserve would respond to rising inflation with a faster pace of interest rate increases. Equities pared their losses after bottoming in early February, but stocks turned south again in March in response to the Trump administration's announcements of steel and aluminum tariffs, as well as tariffs targeting Chinese imports and restrictions on technology transfers and acquisitions. Allegations that a data analysis firm improperly acquired information about millions of Facebook users weighed on the tech sector and raised concerns about data privacy and security among Internet and social media companies and the potential for new regulations.

Small-cap stocks held up slightly better than their larger peers. The small-cap Russell 2000 Index returned -0.08% versus -0.76% for the large-cap S&P 500 Index and -0.77% for the S&P MidCap 400 Index. From January 26 through February 8, the S&P 500 Index experienced a "correction," or a drop of at least 10%. This was the broad market's first correction since falling about 14% from May 2015 to February 2016. As measured by various Russell indexes, growth stocks performed better than value stocks across all market capitalizations.

S&P 500 sector performance was mixed. Despite losses in March, information technology shares performed best, thanks to a vigorous rally in January. Consumer discretionary stocks also outperformed the broad index. All other sectors declined, especially the telecommunication services and consumer staples sectors. Telecoms were hurt as rising interest rates weighed on shares of some companies that pay relatively high dividends. Consumer staples stocks struggled due to weakness in sector heavyweight Wal-Mart, whose shares tumbled in February due to lower-than-expected earnings.

	S&P 500 Index	S&P MidCap 400 Index	Russell 2000 Index
1Q 2018	-0.76%	-0.77%	-0.08%
Year-to-Date	-0.76	-0.77	-0.08

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Source: Third-party vendor RIMES, as of March 31, 2018.

Domestic bonds declined in the first quarter, as interest rates increased broadly. The Bloomberg Barclays U.S. Aggregate Bond Index returned -1.46%. In the investment-grade market, long-term Treasury bonds were among the worst performers. Ten-year Treasury yields rose to four-year highs in February—in part due to expectations that a two-year federal spending deal would lead to increased Treasury borrowing—but they retreated somewhat in March as equity market weakness and global trade uncertainty raised the appeal of U.S. government bonds. (Bond prices and yields move in opposite directions.)

Corporate bonds faced some headwinds from elevated supply and waning demand from outside the U.S. Mortgage- and asset-backed securities held up better than the broad market index. Municipal bonds outperformed taxable bonds in a mixed technical environment. New issuance was muted, but there was reduced demand from some banks and insurance companies. High yield bonds declined, but losses were limited by strong investor demand and by the bonds' lower interest rate sensitivity. Floating rate loans outperformed high yield bonds amid strong demand and rising LIBOR rates.

	Bloomberg Barclays U.S. Aggregate Bond Index	Bloomberg Barclays Municipal Bond Index	JPMorgan Global High Yield Index
1Q 2018	-1.46%	-1.11%	-0.69%
Year-to-Date	-1.46	-1.11	-0.69

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Source: Third-party vendor RIMES, as of March 31, 2018.

Stocks in developed non-U.S. equity markets fared modestly worse than U.S. shares, even though a weaker U.S. dollar versus major currencies reduced losses in dollar terms. The MSCI EAFE Index, which measures the performance of stocks in Europe, Australasia, and the Far East, returned -1.41%. Shares in developed Asian markets were mixed; Japanese shares returned about 1%. Developed European markets were also mixed. In the eurozone, Italian stocks rose more than 5%, even though early-March elections resulted in a hung parliament and no coalition government has yet been formed. UK shares lagged with a decline of nearly 4%, hindered by continuing Brexit uncertainty and elevated inflation that may prompt the central bank to raise rates in May.

Stocks in emerging equity markets outperformed developed markets. The MSCI Emerging Markets Index returned 1.47%. Latin American markets rose broadly, led by a 12% gain in Brazil, where shares rallied because an appeals court upheld a corruption sentence in January against former President Luiz Inacio Lula da Silva, raising hopes that a more business-friendly candidate will win the presidential election in October. Emerging Asian markets were widely mixed. In dollar terms, shares in the Philippines and Indonesia fell approximately 11% and 7%, respectively, hurt in part by concerns about a U.S.-China trade war. Indian shares also dropped about 7%. On the plus side, stocks in Thailand and Malaysia rose more than 8%. In emerging Europe, Russian stocks advanced more than 9%, thanks in part to rising oil prices, falling domestic interest rates, and an S&P Global credit rating upgrade of the sovereign debt into investment-grade territory. As expected, President Vladimir Putin was reelected to another six-year term in March. On the other hand, shares in Poland and Turkey dropped 8% and 5%, respectively.

	MSCI EAFE Index	MSCI Emerging Markets Index
1Q 2018	-1.41%	1.47%
Year-to-Date	-1.41	1.47

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Source: Third-party vendor RIMES, as of March 31, 2018.

Bonds in developed non-U.S. markets performed well, as stronger non-U.S. currencies boosted local returns in dollar terms. In the UK, 10-year government bond yields rose on expectations that the central bank will raise short-term interest rates in May due to continued elevated inflation. The pound sterling strengthened almost 4% versus the dollar. In the eurozone, 10-year German sovereign bond yields rose slightly for the quarter but finished well below their early February highs. In contrast, Spanish bonds rallied and yields fell, helped by an S&P Global

credit rating upgrade in March. The euro climbed more than 2% versus the greenback. In Japan, the central bank's yield curve control policy kept 10-year government bond yields close to 0.0%. The yen gained about 6% versus the dollar.

Emerging markets bonds were mixed in the first quarter. Dollar-denominated debt declined, but bonds denominated in local currencies performed well in dollar terms, as a generally weaker greenback boosted returns. A weaker Turkish lira and Philippine peso, however, hurt their local bond returns in dollar terms. Credit developments were also mixed: Brazilian sovereign debt was downgraded by S&P Global in January because the country failed to pass meaningful fiscal and pension reforms. On the other hand, Moody's raised its outlook for South Africa to "stable" and kept the country's credit rating above "junk" status in March. This took place on the heels of a change in the country's leadership and the government's commitment to cut spending.

	Bloomberg Barclays Global Aggregate Ex-U.S. Dollar Bond Index	JPMorgan Emerging Markets Bond Index Global Diversified	JPMorgan GBI-EM Global Diversified Index
1Q 2018	3.62%	-1.74%	4.44%
Year-to-Date	3.62	-1.74	4.44

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Source: Third-party vendor RIMES, as of March 31, 2018.

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Quarterly Market Review
EMERGING MARKETS STOCKS
1Q 2018

EMERGING MARKETS STOCKS GAIN IN FIRST QUARTER BUT RISING U.S. RATES, TRADE CONCERNS WEIGH

Emerging markets stocks rose in the first quarter of 2018 as a rally in January offset subsequent declines spurred by rising U.S. interest rates, a brewing trade spat with China, and a technology stock sell-off. After notching its fourth straight monthly gain in January, the MSCI Emerging Markets Index entered a correction in the first half of February as concerns about a pickup in U.S. growth and inflation pushed the benchmark 10-year Treasury yield to a four-year high. The pickup in yields raised fears that the Federal Reserve would increase interest rates at a faster-than-expected clip, a move that would make emerging markets stocks relatively less attractive. Declines mounted in March after the Trump administration threatened to impose tariffs on a reported $50 billion of Chinese imports, prompting China to hit back with retaliatory tariffs and raising the prospect of a global trade war. Losses in big U.S. technology companies spread to large-cap Asian tech stocks as March drew to a close, further eroding the quarterly gain. Six sectors in the index rose and five sectors fell. Energy was the top-performing sector, while consumer discretionary stocks fell the most.

Total Returns

MSCI Index	1Q 2018	Year-to-Date
Emerging Markets (EM)	1.47%	1.47%
EM Asia	0.87	0.87
EM Europe, Middle East, and Africa (EMEA)	-0.85	-0.85
EM Latin America	8.11	8.11

All data are in U.S. dollars as of March 31, 2018. **Past performance cannot guarantee future results.**
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CHINESE STOCKS MIXED AS TRADE TENSION RISES; INDIAN STOCKS FALL ON TWIN DEFICITS CONCERN

- Chinese stocks rose but yuan-denominated A shares declined as investors fretted that a trade war with the U.S. would hurt growth just as Beijing steps up measures to de-risk the economy. China's economy grew 6.9% in 2017, above the official 6.5% target and marking the country's first annual growth uptick since 2010.
- Indian stocks fell roughly 7%. The benchmark S&P BSE Sensex Index entered its first correction in 15 months in March after hitting a record closing high in January, weighed by fears about possible credit losses in the banking sector and concern about India's growing trade and fiscal deficits.
- Southeast Asian stocks were mixed, with gains in Malaysia and Thailand and declines in Indonesia and the Philippines. Indonesia's slump was partly due to weakness in the rupiah, which hit a two-year low in March amid capital outflow worries spurred by rising U.S. rates. Malaysia's central bank raised its benchmark rate in

January for the first time since 2014 to tamp down rising food and fuel costs, but central banks in Indonesia, the Philippines, and Thailand left their key rates unchanged.

BRAZILIAN STOCKS CLIMB AFTER JANUARY RALLY; MEXICAN STOCKS ADVANCE AS U.S. TRADE TALKS CONTINUE

- Brazilian stocks climbed 12.5%. The domestic Ibovespa benchmark rose to a record in January after an appeals court upheld a graft sentence against former President Luiz Inacio Lula da Silva, dealing a blow to his reelection campaign. However, Brazilian stocks declined in the ensuing months as the economy remained weak. Brazil's economy grew a slower-than-expected 0.1% in last year's fourth quarter from the prior three months and 1.0% for all of 2017, and the central bank cut its benchmark interest rate in February and March.

- Mexican stocks edged slightly higher despite concerns that the North American Free Trade Agreement will fall apart and that presidential elections in July could usher in a less business-friendly government. In February, the Bank of Mexico raised its key rate by 25 basis points to a nine-year high of 7.5% amid persistent inflation.

- Andean stock markets rose, led by Peru's roughly 10% rise. Peru swore in a new leader in March after President Pedro Pablo Kuczynski resigned over corruption charges. Additionally, the country's central bank cut its benchmark rate twice over the quarter and warned that inflation would likely fall below its target in March. Colombian stocks gained after a pro-business presidential candidate, Ivan Duque, scored a decisive victory in a primary vote in March, raising expectations that he would become the country's next leader.

TURKISH STOCKS SLUMP AS LIRA DROPS; RUSSIAN STOCKS GAIN ON RISING OIL PRICES

- Turkish stocks shed more than 4% as the lira weakened. Turkey reported in March that its economy grew a stronger-than-expected 7.3% and 7.4% in the final quarter and full year of 2017, respectively, driven by government and household spending. Rapid growth has raised concern that Turkey's current account gap, already among the biggest in the developing world, could further widen.

- Russian stocks added more than 9%, aided by rising oil prices early in the year and S&P's decision in February to upgrade Russia's credit rating to investment-grade status. However, Russia's central bank cut its benchmark interest rate in February and March as economic growth failed to take hold and inflation hovered at record-low levels. The bank forecast Russia's economy would expand from 1.5% to 2% this year.

- South African stocks retreated as investors pocketed previous months' gains spurred by rising optimism about a change in the country's leadership. South African assets rallied ahead of the removal of President Jacob Zuma, who resigned in February after many scandals and was replaced by his deputy, Cyril Ramaphosa. In March, South Africa's central bank cut its benchmark rate by a quarter-point to a two-year low of 6.5%.

SOLID FUNDAMENTALS IN EMERGING MARKETS OFFSET NEAR-TERM RISKS

We are optimistic about the outlook for emerging markets. Most developing countries have smaller current account deficits, larger foreign exchange reserves, and more flexible currencies than they did in previous decades, reducing the risk of a financial crisis. Compared with developed markets, most emerging markets have more attractive demographics and a stronger tailwind from rising consumption. Emerging markets stocks remain attractively valued relative to developed markets stocks.

Near-term risks include a rise in U.S. protectionism and a faster-than-expected pace of rate hikes by the Federal Reserve. However, we believe that emerging markets will be able to withstand a gradual tightening of monetary policy given that their financial positions have broadly improved in recent years. Economic growth in emerging markets has stabilized, and corporate earnings have begun to recover after years of disappointing performance. Nevertheless, we believe that careful stock selection will be crucial for producing good long-term returns as emerging markets continue to show wide dispersion in the performance of individual countries and companies.

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Quarterly Market Review

U.S. MUNICIPAL MARKETS

1Q 2018

Investment-grade tax-free municipal bonds posted losses in the first quarter of 2018, largely driven by a particularly weak January when a strong nonfarm payrolls report heightened concerns that the Fed would raise interest rates at a faster-than-expected pace and the yield curve steepened considerably. Investment-grade municipal debt held up better than investment-grade taxable bonds, with the Bloomberg Barclays Municipal Bond Index returning -1.11% versus -1.46% for the Bloomberg Barclays U.S. Aggregate Bond Index and -2.32% for the Bloomberg Barclays U.S. Corporate Index. However, high yield municipal debt easily outperformed both investment-grade munis and investment-grade taxable bonds, returning 0.58% for the quarter as price appreciation for certain Puerto Rico issuers boosted the overall high yield municipal index return. The shortest-maturity municipal debt also generated positive total returns for the quarter as their coupon return more than offset their price declines as their yields increased less than longer-term muni yields.

ECONOMY AND INTEREST RATES

The U.S. economy expanded at a solid 2.9% annual rate in the fourth quarter of 2017, faster than the 2.6% pace for the full year 2017. The U.S. labor market has been healthy, with the national unemployment rate holding at a 17-year low of 4.1% in the last few months. Inflation, while still low, is rising and is likely to increase further in 2018 amid dwindling labor and product market slack. Citing the strengthening labor market and expectations that inflation would move higher over the medium term, the Federal Reserve raised the federal funds target rate to a range of 1.50% to 1.75% in March. At present, the central bank is expected to raise rates at least two more times in 2018.

Municipal yields increased across the range of maturities in the first quarter, although the municipal yield curve steepened as longer-term rates rose more than those on shorter-maturity debt. Treasury yields also increased across the yield curve, but anticipation of continued gradual Fed rate hikes caused short-maturity yields to rise more than longer-term rates. At the end of the quarter, high-quality 30-year muni yields were slightly lower than the 30-year Treasury yield. Nonetheless, municipals still offer relative value for many fixed income investors on an after-tax basis.

As an illustration of their relative attractiveness, on March 31, 2018, the 2.95% yield offered by a 30-year tax-free general obligation (GO) bond rated AAA was about 99% of the 2.97% pretax yield offered by a 30-year Treasury bond. Including the 3.8% net investment income tax that took effect in 2013 as part of the Affordable Care Act, the top marginal federal tax rate (after tax reform) stood at 40.8%. An investor in this tax bracket would need to invest in a taxable bond of similar credit quality and maturity yielding about 4.98% to receive the same after-tax income as that generated by the municipal bond. (To calculate a municipal bond’s taxable-equivalent yield, divide the yield by the quantity of 1.00 minus your federal tax bracket expressed as a decimal—in this case, 1.00–0.408, or 0.592.)

MUNICIPAL MARKET NEWS

Total municipal bond issuance for the quarter was about USD $63 billion, according to *The Bond Buyer*, which was 32% lower than in the same period in 2017. Issuance in the first quarter of 2018 was meager because municipalities had accelerated a substantial amount of planned 2018 issuance into late 2017 as a result of concerns that the new tax law would no longer allow the tax-exempt issuance of private activity bonds (PABs), which can be used to fund projects such as hospitals and airports. Ultimately, the new tax law eliminated advance refundings, which had allowed issuers to refinance existing debt with new bonds, but PAB issuers retained their ability to issue tax-exempt debt.

Generally, fundamentals for municipal issuers remain solid, and most issuers in the USD $3.8 trillion municipal bond market have been fiscally responsible. State and local governments, in general, have been cautious about adding to indebtedness since the 2008–2009 financial crisis, and a strengthening economy has helped tax revenues rebound. Over 60% of the market, as measured by the Bloomberg Barclays Municipal Bond Index, is AAA or AA rated.

Although the market is overwhelmingly high quality, many states and municipalities are grappling with underfunded pensions and other post-employment benefit (OPEB) obligations. New reporting rules from the Governmental Accounting Standards Board are bringing greater transparency to state and local governments' pension funding gaps, long-term risks that investors often overlooked in the past.

Bonds from some troubled municipal issuers, including Illinois and New Jersey, posted losses approximately in line with the broad market after outperforming for much of 2017. However, Puerto Rico's municipal bonds generated strong gains after the U.S. territory released an updated fiscal plan that projects a cumulative cash flow of more than double the amount from the fiscal plan that was released in February. Some market participants believe that this development will translate into better restructuring terms. However, these figures are only projections and there are still many uncertainties as the recovery rates for various issuers will ultimately be determined in bankruptcy court.

Most major segments of the municipal market recorded losses in the first quarter. Revenue bonds performed approximately in line with GO debt. Prerefunded bonds held up better than the broad market to finish the quarter down only slightly. We continue to favor bonds backed by a dedicated revenue stream over GOs, as we consider revenue bonds to be largely insulated from the pension funding concerns facing state and local governments. Across our municipal platform, we have an overweight to the higher-yielding health care and transportation revenue-backed sectors. All subsectors of investment-grade revenue bonds produced negative returns. Resource recovery debt held up the best, while education bonds fared worst. High yield tobacco debt easily outperformed other municipal segments for the quarter to post solid gains.

OUTLOOK

We believe that the municipal bond market remains a high-quality market that offers good opportunities for long-term investors seeking tax-free income. While the uncertainty around the long-term impacts of tax reform and the increased chance of rising yields represent near-term headwinds for broad muni market performance, we believe fundamentals are sound overall, and global economic uncertainties could spur demand for the asset class. As the Fed continues on the path to interest rate normalization, muni bond yields are likely to rise along with Treasury yields—although probably not to the same extent. While higher yields pressure bond prices, munis should be less susceptible to slowly rising rates than Treasuries given their attractive tax-equivalent yields and the steady demand for tax-exempt income. We expect any potential Fed rate increases to be gradual and believe we could remain in a relatively low rate environment for some time.

While we believe that many states deserve high credit ratings and will be able to continue servicing their debts, we have longer-term concerns about significant funding shortfalls for pensions and OPEB obligations in some jurisdictions. These funding gaps stem from investment losses during the 2008–2009 financial crisis, insufficient

plan contributions over time, and unrealistic return assumptions. Although few large plans are at risk of insolvency in the near term, the magnitude of unfunded liabilities is becoming more conspicuous in a few states.

Ultimately, we believe independent credit research is our greatest strength and will remain an asset for our investors as we navigate the current market environment. As always, we focus on finding attractively valued bonds issued by municipalities with good long-term fundamentals—an investment strategy that we believe will continue to serve our investors well.

Note: Some municipal bond income may be subject to state and local taxes and the federal alternative minimum tax. Capital gains, if any, are generally taxable.

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

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