



**Asset
Management**

2017

**INVESTMENT
OUTLOOK**

WELCOME

We're pleased to share Goldman Sachs Asset Management's 2017 Investment Outlook. As investors, we seek to identify the most relevant trends and investment opportunities on behalf of our clients. We believe one key to investing is having a holistic view of markets, with insights and solutions that span asset classes and geographies.

With this in mind, we've synthesized views from across our investment teams around the world and outlined key signposts we are watching in the year ahead. We framed our observations around four key transitions we believe will shape global markets going forward: 1) populism challenging globalism, 2) inflation supplanting low growth as an area of concern, 3) the shift from monetary to fiscal policy, and 4) the evolution from new regulation to de-regulation.

We hope you find our insights helpful and we look forward to working with you in 2017.



Tim O'Neill

Eric Lane

Global Co-Heads of the Investment Management Division

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INTRODUCTION

The Long Cycle Continues

We expect the long post-crisis economic recovery to continue in 2017. As a base case, we think growth is poised to broaden out to more countries, with the global economy drawing on more sources of strength than at any point since 2010.

From an investment perspective, our base case view is broadly supportive for risk assets. We prefer equities over credit and credit over rates, but we expect low returns from these traditional exposures given 1) elevated valuations, 2) limited upside for corporate earnings from current levels and 3) limits to economic growth potential. Broadening exposure beyond conventional stocks and bonds, identifying opportunities in emerging markets and deploying more dynamic asset allocation strategies are some ways to adapt.

In some respects, our outlook represents an extension of the same long cycle we envisioned heading into 2016. The key difference for 2017 revolves around four emerging transitions. Populism is challenging globalism and creating new tail risks. Concerns about low growth are giving way to concerns about inflation. Years of focus on monetary policy are giving way to a close watch over fiscal policy. And concerns about new regulation are acceding to hopes for de-regulation.

Transition will be an evolving theme in 2017, and we will be re-visiting it in our publications throughout the year. In this Investment Outlook, we highlight specific signposts we will be watching, both to gauge the pace of transition and to test our base case view on the key investment questions.

Three Key Questions

Is it time to de-risk?

No. We think de-risking would be premature, at least from a purely return-generating standpoint. We expect the macro environment to remain supportive of risk assets during 2017 amid a slow-but-steady expansion in developed markets and an acceleration of growth in some emerging markets.

What's driving the expansion?

We believe this is a slow-growth recovery best explained by cyclical economic drivers. We believe the concerns about the developed world being mired in a pattern of underinvestment and stalled growth—so-called secular stagnation—are overdone.

Where do we see opportunities?

In a low-return world, we look for sources of return beyond conventional stock and bond market approaches. We also think range-bound or volatile markets create opportunities for more dynamic investment strategies.

For updates to our views, please visit: GSAM.com/2017-Investment-Outlook

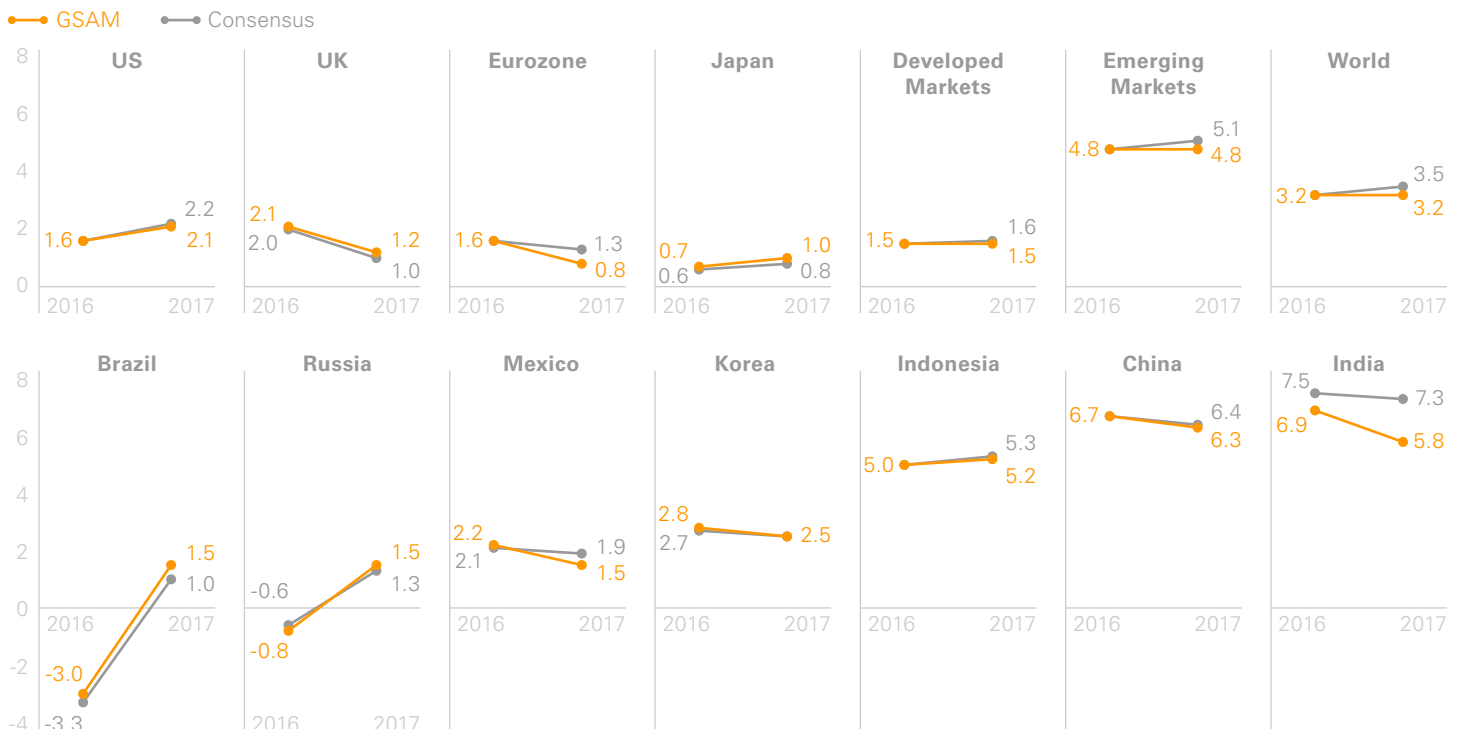


Our 12-Month Cross-Asset Views Compared to 2016



Source: GSAM Global Portfolio Solutions (GPS) as of December 2016 and are subject to change. Chart reflects GPS relative asset allocation views and may not be representative of each GSAM portfolio team's view on opportunities within individual markets.

2017 GDP Forecasts by Country, Region and Market (%)



Source: GSAM. As of December 2016.



Do low expected returns and the maturation of the economic cycle mean it's time to de-risk?

We think de-risking would be premature, unless it meets investors' strategic goals.

We acknowledge that the cycle is maturing and absolute valuations of many asset classes are high. At the same time, US equities—to take one key example—have offered an attractive risk-reward proposition even in the later stages of the economic cycle, though investors should be prepared for volatility. This is important context for the (correct) observation that US equity valuations stand near the top historical decile and are expensive by many measures.

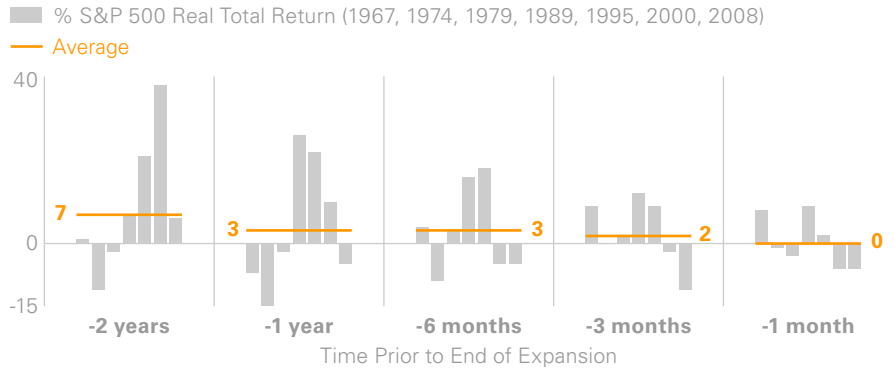
The cycle still has room to run, in our view.

The economic expansion is in late stages by some metrics, but remains mid-cycle by others. Two examples that indicate a mid-cycle environment include capacity utilization in the manufacturing sector and the current gap between actual and potential unemployment in the US versus previous cycles. Both measures suggest that utilization rates are more in line with what is seen in the middle of the expansion phase rather than at the end. Our central scenario is for the expansion to carry on for another couple of years.

The market continues to signal return potential for equities.

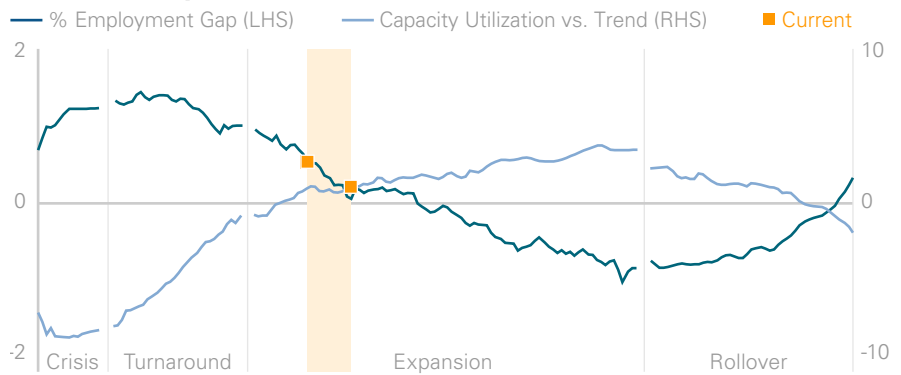
The equity risk premium measures the market-implied return expectations for owning stocks versus a "risk-free" asset. We note that the current equity risk premium (ERP) remains above the long-run average, and is somewhat higher than our estimated ERP given current macroeconomic conditions. We view this signal as a counterweight to elevated valuations.

Risk/Reward in Equities Still Worthwhile Towards End of Expansion



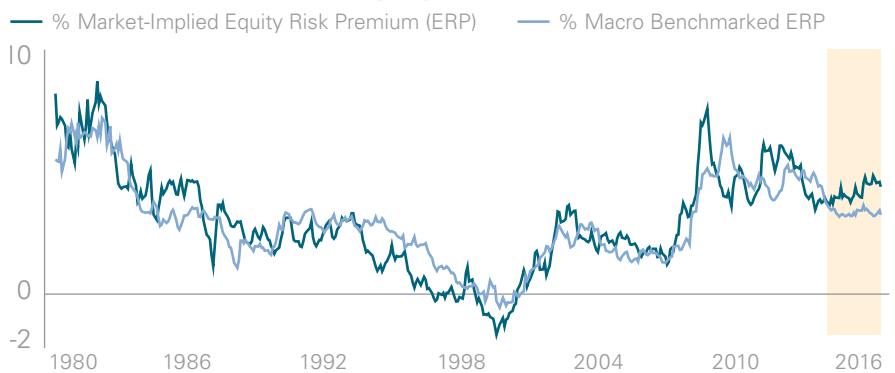
Source: Haver Analytics, GSAM Global Portfolio Solutions. Real return is the return after adjusting for inflation. As of December 2016. Shows returns for economic expansions ending Jan. 1967, Feb. 1974, May 1979, July 1989, June 1995, Sept. 2000 and Jan. 2008.

US Employment and Capacity Utilization Show Room for Continued Expansion



Source: Haver Analytics, GSAM Global Portfolio Solutions. As of December 2016.

The Risk Premium Offered by Equities is Above Historical Norms



Source: Haver Analytics, Robert Shiller data, GSAM Global Portfolio Solutions. As of December 2016. The market implied ERP is based on a 1-stage dividend discount model and cyclically adjusted earnings. The macro benchmarked ERP is GSAM's estimate of the fair level of the ERP given prevailing macro conditions.



Is this a slow-growth cyclical recovery or is the economy stuck in “secular stagnation”?

We believe 2017 will look increasingly normal.

With growth broadening out to more countries and inflationary pressures building in the US, we think the economy will feel increasingly normal in 2017. This should push the market in the direction of our view. Namely, that we are in a slow but cyclical recovery, where interest rates should rise over time, rather than “secular stagnation,” where rates could stay at super low levels on a more structural basis.

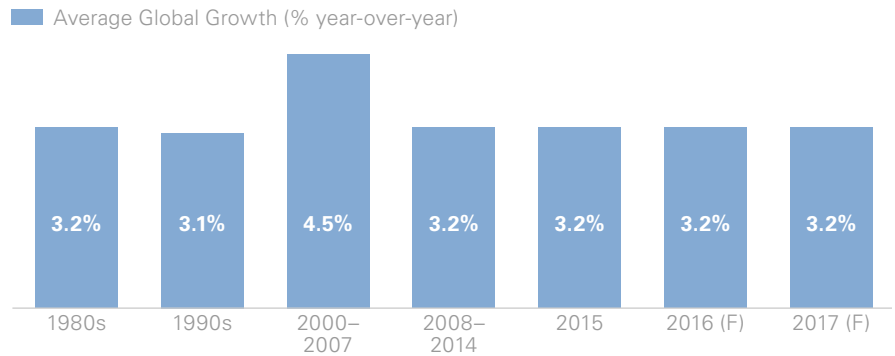
“Secular Stagnation” concerns were driven by temporary factors...

Our conviction in the cyclical recovery is strengthened by our view that the factors which made “secular stagnation” a particularly powerful story in 2016 were cyclical rather than structural: the disinflationary impact from the fall in oil prices and the weakness in macro data in the beginning of the year, followed by the rise in political uncertainty after the UK referendum.

...whereas economic performance has been better than is often acknowledged.

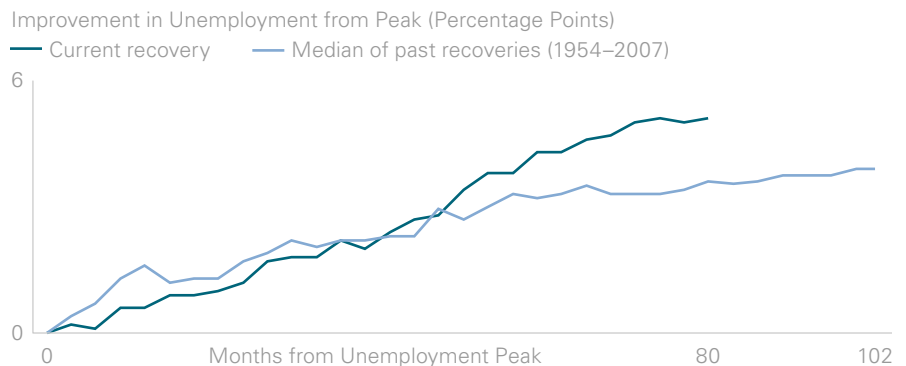
Our conviction is further strengthened by the fact that global growth in the post-crisis environment has been in line with the experience in the 1980s and 1990s. Even in the US where nominal growth has been weak, improvements in the labor market have been in line with past recoveries.

Remarkably Steady Global Growth



Source: Haver Analytics, GSAM Global Portfolio Solutions.

Current Employment Recovery Consistent with Previous Cycles



Source: Haver Analytics, GSAM Global Portfolio Solutions. Represents the median improvement from peak during past recoveries from 1954–2007.



If expected returns on traditional assets are low, where do we see opportunities?

We see opportunities in alternatives, emerging markets and dynamic asset allocation.

We think de-risking would be premature with developed economies likely to continue growing (albeit slowly) and emerging market growth improving as Russia and Brazil rebound from recession (see page 4). Equities may benefit from recent earnings improvements and market expectations of fiscal spending and de-regulation, but this is balanced by the potential for rising bond yields and political uncertainty. As a result, we think return prospects for traditional equity and fixed income assets are low and alternative sources of return may offer more opportunity.

Our focus on sources of return beyond traditional exposures begins with alternative investment strategies and alternative risk premia. Examples include lower-beta strategies within equity long/short and macro strategies that look for opportunities across multiple asset classes. We see these exposures as improving diversification and as useful tools in the pursuit of attractive risk-adjusted returns.

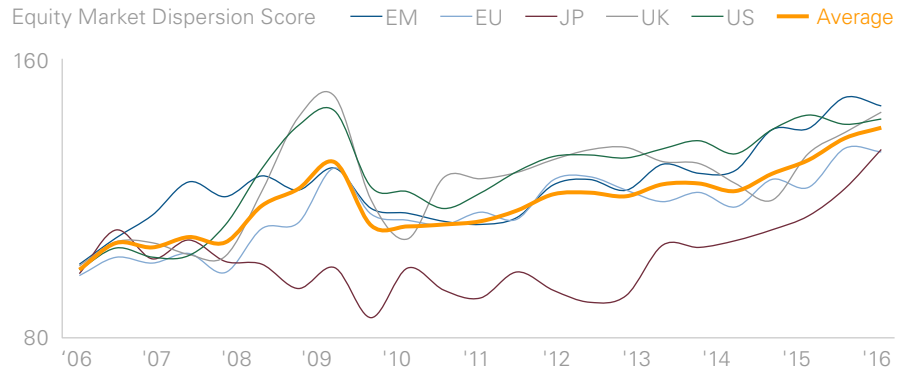
Emerging market assets have room for recovery

In our view, emerging market underperformance versus developed markets from 2011 until the beginning of 2016 was driven by excessive valuations, economic pressures from imbalances, slowing growth and high investor expectations. Progress on these fronts created attractive opportunities across emerging market equities and fixed income. Despite possible policy shocks from the incoming US administration, the initial conditions supporting emerging market assets in 2016 remain in place. These include continued demand for high yielding assets, a cyclical uplift from improving emerging market growth, improved currency reserve coverage and supportive valuations.

Emerging markets also offer many investment dimensions: importers versus exporters, consumption-driven versus investment-driven economies, state-owned versus private companies and local currency versus external currency fixed income. We think this diversity provides fertile ground for security selection and diversification.

Diversification does not protect an investor from market risk and does not ensure a profit. The economic and market forecasts presented herein have been generated by GSAM for informational purposes as of the date of this publication. They are based on proprietary models and there can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this publication. **Past performance does not guarantee future results, which may vary.**

Increased Dispersion within Equity Markets Can Create Opportunity



Source: GSAM. Quarterly data through September 2016. Dispersion score is a measure of the difference between the price of the top 25% and bottom 75% of equities in each market.

We believe a more dynamic approach can add value.

We expect a series of transitions to play an important role in shaping our investment views in 2017: 1) populism challenging globalism, 2) inflation supplanting low growth as an area of concern, 3) the rising prominence of fiscal policy versus monetary policy, and 4) the shift from new regulation to de-regulation in several key spots around the globe. As these transitions play out, we will be looking at a variety of signposts to measure the investment implications.

Equities, corporate bonds and emerging market assets could each trade in a wide range, where temporary volatility causes periods of weakness followed by recoveries. Such an environment increases the opportunities for tactical asset allocation and more dynamic investment management. We believe this approach will be critical in the context of overall valuations.

We also think active security selection is both attractive and more meaningful to portfolio returns in an environment of more modest returns on major asset classes. From a macro perspective, we think the transitions from monetary to fiscal policy and from globalism to populism should lead to more differentiation and divergence in fundamentals. While valuations may be elevated at the asset class level, dispersion within asset classes is elevated, providing potential opportunity to seek returns via security selection.



GLOBALISM TO POPULISM

The biggest transition in the current environment is a shift away from the dominant trend of globalism, which brought increased cross-border flows of goods and people. After years of slow economic growth and rising wealth inequality, support for parties with more populist messages—often focused on easier fiscal policy, immigration reform and/or protectionist trade policy—has been rising steadily over the past few years.

Populism claimed two major victories in 2016 with Britain’s decision to leave the European Union and the election of Donald Trump as president of the United States. In 2017, we will be closely monitoring the strength of the populist trend given its potential to impact Europe and the increased likelihood of more protectionist trade policies.

Signposts to Watch

Trump’s First 100 Days

The first 100 days of the Trump administration will be critical for assessing policy details and priorities, from tax rates to trade agreements.

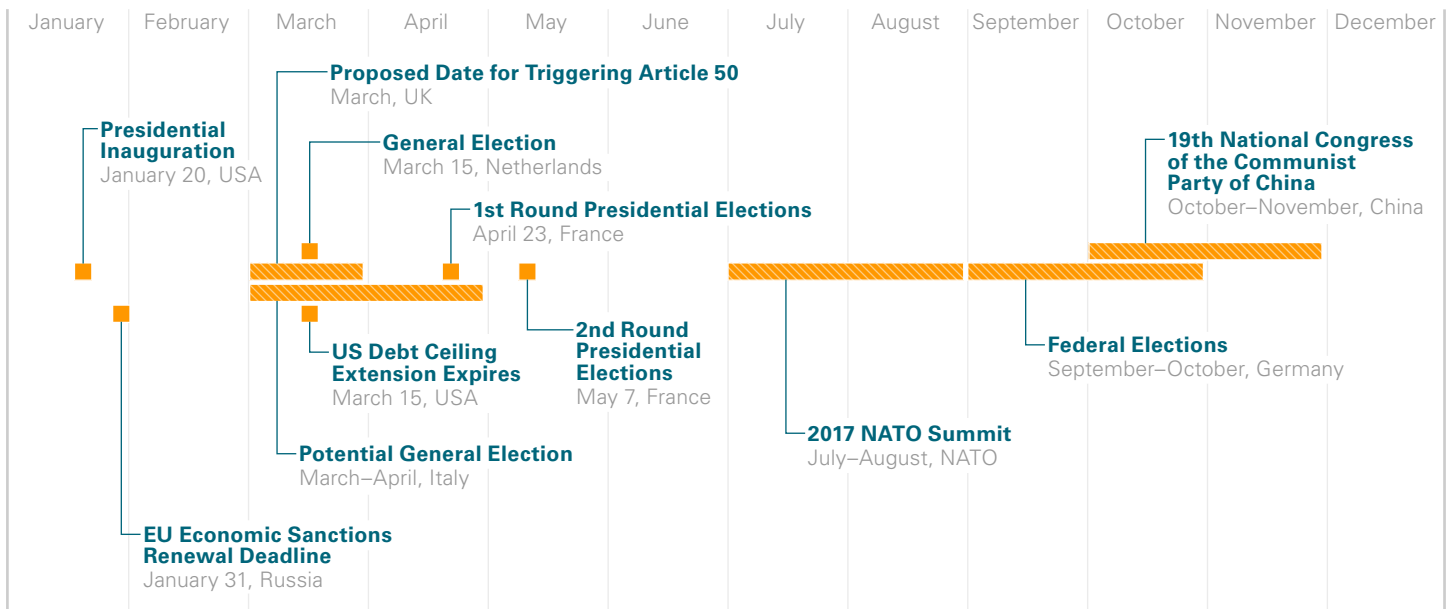
Europe’s Election Calendar

We think a Eurozone break-up scenario is unlikely in 2017, but the strength of populist gains in upcoming elections will be an important indicator of Eurozone cohesion.

Trade (Dis)agreements

The US is likely to become more protectionist in 2017 and the response of China and other countries will be critical to assessing the economic and market implications.

Key Political Events We’re Watching in 2017



Source: GSAM.



Trump's First 100 Days

The balance and composition of Trump's policy agenda between stimulus, trade, immigration and foreign policy is still largely unknown and hard to generalize, and therefore leads to a wide range of macroeconomic and market outcomes.

—Neill Nuttall, Co-CIO, Global Portfolio Solutions

We think a change in the US policy regime will have many cross-currents for investors to consider. An agenda emphasizing fiscal spending, tax cuts and de-regulation will likely spur economic growth, inflation and higher interest rates. On the other hand, the potential for increased protectionism and tighter immigration may constrain long-term economic growth, while also contributing to higher inflation.

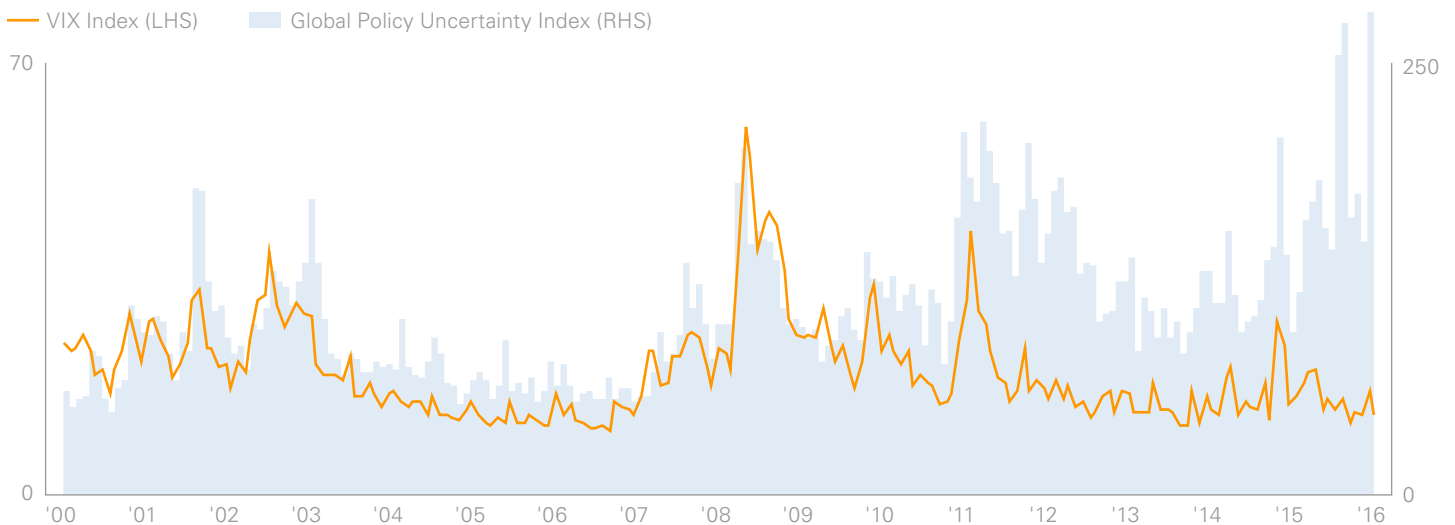
The Trump administration's agenda during the first 100 days will be critical to gauging its priorities and preferences on trade, regulation, fiscal stimulus and monetary policy over the rest of the year. More emphasis on fiscal spending and de-regulation could generate both growth and inflation, whereas an emphasis on trade tariffs might bring more inflation than growth (see "Stagnation to Inflation," page 12). Regulatory changes might first affect industries such as finance, energy or healthcare, but

could gradually impact much larger parts of the economy as effects pass through to businesses and consumers (see "Regulation to De-Regulation," page 20). Tax cuts could have a more immediate broad-based effect on the economy, but the impact could be limited if inflation continues to rise and the Federal Reserve (Fed) becomes more hawkish (see "Monetary to Fiscal Policy," page 16).

Investment Implications

With the US becoming more of a driver of global policy uncertainty than a stabilizer, we think the range of potential scenarios has increased. Markets have moved to price in stronger growth, higher inflation risk and high expectations for de-regulation. We see a risk that the market may be underestimating the potential negatives of protectionist trade policies, where the president has more discretion, and overestimating the positives of tax cuts and fiscal spending, which require more difficult congressional approval. The interplay between fiscal and monetary policy will also be important in gauging the overall impact of Trump policies and the implications for interest rates, risk assets and volatility.

Markets Appear to be Priced for Benign Scenarios Despite Policy Uncertainty



Source: Bloomberg. Baker, Bloom & Davis. As of Dec. 6, 2016. The Global Economic Policy Uncertainty Index is a GDP-weighted measure of news references to policy uncertainty. The VIX Index is a measure of S&P 500 implied volatility.



Europe's Election Calendar

The populist push is forcing mainstream parties to listen to people's concerns about globalization, immigration and austerity. We think a Eurozone break-up scenario is unlikely in 2017, but we do see the potential for Trump-like policies in terms of trade, taxes and infrastructure spending.

—Alexis Deladerrière, Portfolio Manager, International and Global Equity

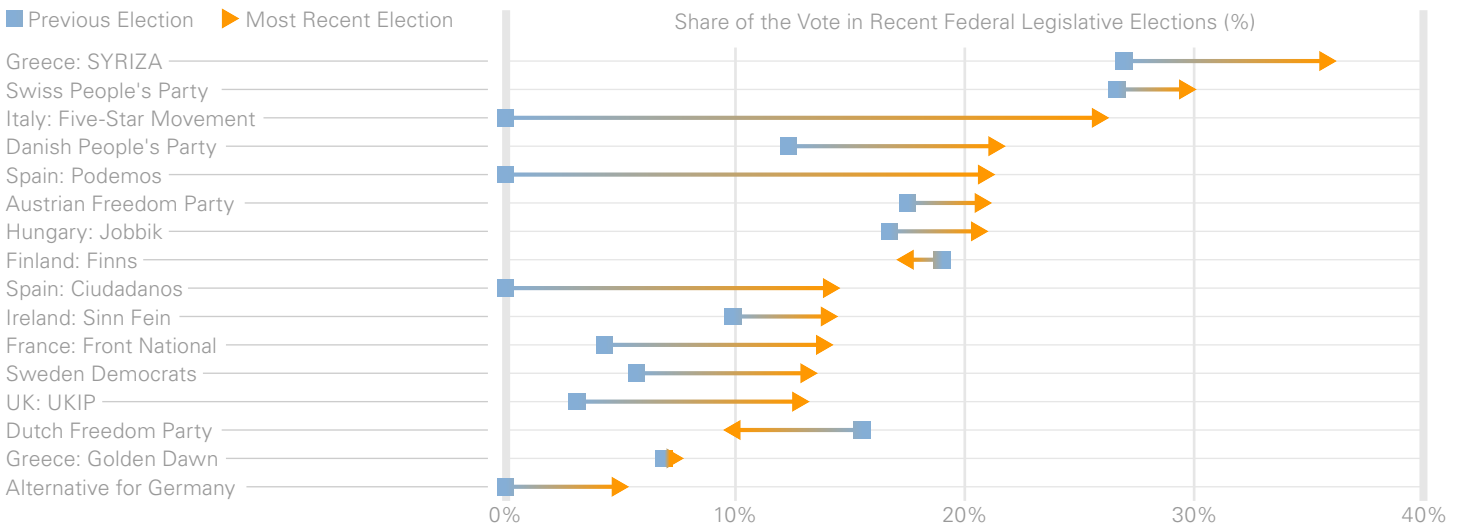
Populism has infused both right- and left-wing parties in Europe over the last few years, largely fueled by Eurosceptic, anti-austerity and anti-immigration sentiment. Populist impact on policy has been limited because mainstream parties remained in power. Now, populist victories in the UK referendum (Brexit), the US election (Trump) and Italy (the defeat of the constitutional referendum) are putting increased focus on 2017 national elections in France (April/May), Germany (September–October) and the Netherlands (March).

The potential for real populist influence at the national level—whether through additional parliament seats, partnership in a coalition government or a national leadership position—will be an important gauge of the strength of the populist movement. It could have implications for broader European policy, the economy and the Eurozone itself.

Investment Implications

We think the potential for meaningful populist gains in core European countries may present the biggest potential risk of a significant market inflection point in 2017. European cohesion already appears fragile, particularly following the UK referendum. Concerns about a Eurozone break-up could lead to stalled businesses and investment decisions while driving increased volatility in financial markets. Populist outcomes in other countries are also likely to meaningfully impact European financial markets. If US policy leads to fiscal spending but also protectionism, the result may be higher inflation, rising interest rates and a stronger dollar, all of which may pressure emerging markets, which are important end markets for many European companies. At the same time, European companies with business lines in the US may benefit from these conditions.

Europe's Non-traditional Parties are Gaining Power



Source: <http://www.parties-and-elections.eu/>, and GSAM. As of November 2016.



Trade (Dis)agreements

Trade protectionism poses a downside risk to China's growth, mainly via indirect effects on investment and the labor market. A strong desire for stability ahead of the upcoming political transition suggests the government will respond, leading to worsening imbalances.

—Prakriti Sofat, Emerging Markets Economist, Global Fixed Income

Trade policy was a major focus of the Trump campaign and is an area where the president has significant discretion. As a result, even if the Trump administration takes a softer line in many areas relative to campaign rhetoric, we expect the administration to follow through on pledges to take a tougher line on trade, with focus on country and sector-specific trade imbalances. By country, the US' largest goods trade deficits are with China, followed by the rest of Asia, Mexico and to a lesser extent Western Europe. By sector, the deficits are largest in technology and related products, motor vehicles and apparel. If policymakers are to focus on country-sector combinations, computers from China account for the largest goods trade deficit, making the country a notable target for trade action.

Emerging economies that have benefitted from global trade are likely to see growth headwinds, notably in China and Mexico. China is likely to respond to growth pressure with additional credit growth and fiscal stimulus focused on infrastructure given a strong desire for stability ahead of the Communist Party Congress in the fall of 2017. As a result, China's imbalances could worsen, which could prompt capital outflows and renewed concerns about the country's growing debt. In Mexico, where the economy has already shown signs of slowing, trade uncertainty acts as another headwind.

The aggressiveness of US protectionist measures will also be an important indicator of the potential for retaliatory tariffs on US imports. Retaliatory tariffs by China may be less effective because US exports to China are not as great as Chinese exports to the US. Still, tariffs would put upward pressure on the price of imported goods and could contribute to higher inflation, adding to the case for Fed rate hikes in the US.

Investment Implications

China could look to partially offset US tariffs by allowing its currency to depreciate more quickly. Chinese currency depreciation has been a source of market volatility in the past, but unless a full-scale trade war breaks out, currency-driven volatility would likely be temporary. In a full trade war scenario, where the US imposes large, permanent tariffs on China and Mexico and those countries reciprocate, the negative effect on growth and investor sentiment could be a catalyst for a larger inflection point in markets.

Tariffs Could Affect Key Business Sectors

	\$bn in US Exports		\$bn in US Imports
	Mexico	China	All Countries ¹
Agriculture	-3.0	17.8	29.5
Oil, Gas, Minerals	-20.8	1.9	-149.7
Food	4.9	0.7	9.5
Beverages, Tobacco	-3.3	1.3	-10.6
Textile	2.8	-12.3	-14.7
Apparel	-4.2	-56.3	-69.9
Paper	4.3	-2.7	-5.8
Petroleum	16.6	0.6	32.9
Chemical	19.1	-3.9	-4.7
Plastics	5.7	-15.7	-15.0
Non-metallic Minerals	-1.2	-6.1	-8.9
Primary Metals	1.0	-3.1	-19.1
Fabricated Metals	2.8	-17.9	-18.5
Machinery	3.9	-19.9	-22.4
Computer	-11.0	-151.9	-155.0
Electrical Equipment	-8.5	-35.9	-40.4
Transportation	-59.5	10.9	-106.3
Furniture	-1.5	-18.3	-22.6
Misc. Manufacturing	-2.8	-35.3	-25.8
All Goods	-54.9	-346.1	

Source: Data as of 2014. Department of Commerce, Goldman Sachs Global Investment Research.

¹ Sample limited to 30 Trading Partners.



STAGNATION TO INFLATION

We have already seen a shift from an outlook plagued by low inflation and nominal growth to higher expectations for both. In 2017, we expect concerns around potential secular stagnation to give way to a more inflationary paradigm in the US.

With tightening labor markets, a boost from energy price-related base effects and a potentially more inflationary fiscal outlook, prices and inflation expectations have already risen markedly from lows. We highlight the investment implications of this across rates and equities. We also highlight a risk; modestly higher inflation driven by an improving global growth outlook should be beneficial for assets, but unanchored expectations or a central bank response that is too aggressive could cause upsets.

Signposts to Watch

How Much Inflation is Too Much?

Many of the factors that lift prices are already rising, and we believe we will see them manifest in higher inflation prints next year. We will be watching not only actual inflation data and indicators of wages, employment and commodity prices, but perhaps more importantly, how markets start to price inflation expectations.

Earnings Up, Costs Up, Equities Up?

An inflationary environment should be positive for equities broadly, but not all companies and sectors will benefit equally. Wage growth supports demand, which could boost revenues, but labor and material prices are costs for companies. Those that cannot pass cost pressures on to consumers may experience some margin pressure.

Could Rates Become the Risk Asset?

An inflationary background is likely to be negative for government bonds and we think in the US there is a risk of a sudden re-pricing in rates markets. This implies that bonds could become a source of volatility in other markets, such as credit. If rates move higher, we will closely watch their correlation to risk assets.



How Much Inflation is Too Much?

The US Core Consumer Price Index (CPI) has been above 2% throughout 2016. Headline CPI has risen from a low of 0.8% this year to 1.6% (as of October 2016). And the tightness in US labor markets is manifesting in higher wages. Outside of US employment data, European manufacturing capacity utilization is also higher than any time since 2008 and most broadly of all, the IMF estimates the aggregate G7 output gap next year to be half what it was in 2015. We expect all of this to continue to drive prices higher.

Oil has been one of the standout contributors to lower inflation. We believe that, barring a further fall in the oil price, it now stands to be a key driver of higher inflation, purely through the mechanics of the year-on-year measurement of the CPI. These so-called base effects could be substantial, especially in the early part of 2017. We will be monitoring them closely.

We see the return of inflation as a positive development, as it represents a shift away from fears of secular stagnation to a healthier nominal growth environment. Higher employment and wage growth, more stable commodity prices, potential corporate profit growth and moderately higher rates will all have beneficiaries. However, inflation could be a double-edged sword in 2017 if too much gets priced in too quickly.

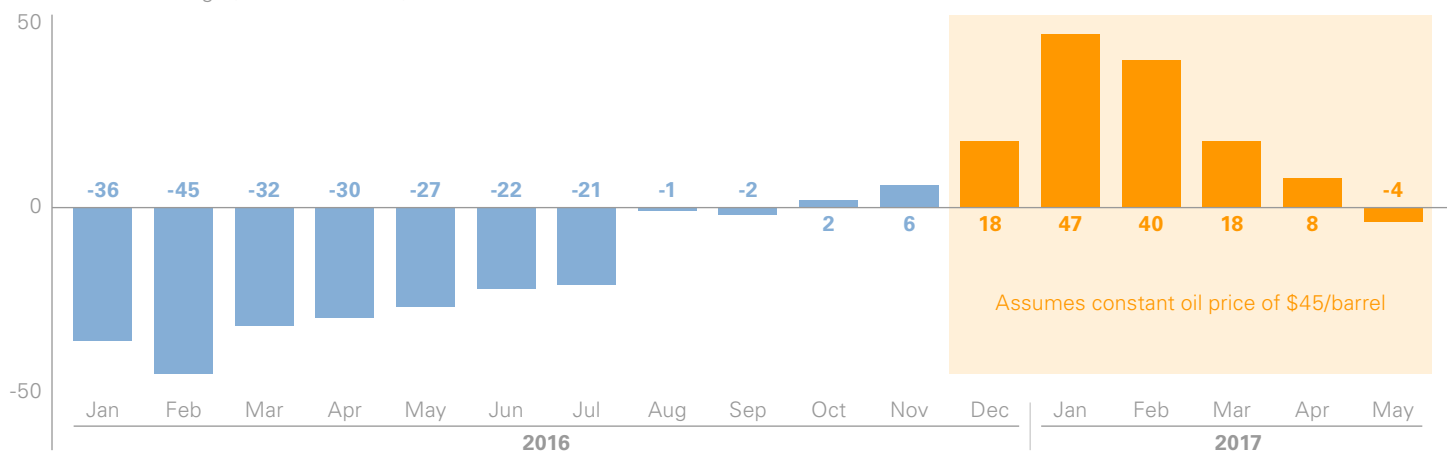
With US unemployment at 4.6% (as of November 2016), labor markets are tight and firms are struggling to fill positions. Inflation has been held down by its most volatile components (notably, energy prices). More stable components such as the cost of rent, insurance and utilities have been gradually rising. As a result, the risk of a sharp rise in the perception of price movements is elevated. Existing inflationary pressures, coupled with the expectation of some fiscal expansion globally—and potentially significant expansion in the US—have aligned to drive up market expectations of inflation. Bond markets are reflecting this risk; the 5-year, 5-years forward, rate of inflation has risen markedly. As a result, we will be watching market-based measures of inflation as closely as CPI prints themselves in 2017.

Investment Implications

We believe the market’s perception of inflation will have the greatest impact on asset prices. In the event of expectations becoming unanchored, assets than can benefit may be hard to come by; bonds and equities will likely suffer and commodities will probably offer a limited cushion. US inflation-linked bonds (“TIPS”) may benefit, but after a substantial rally in 2016 we think TIPS are fairly valued relative to corporate credit and equities.

Oil Prices May Be Reflationary Even if They Stand Still from Here

Brent Oil Price Change (% Year-over-Year)



Source: Haver analytics and GSAM calculations. December 2016 to May 2017 assumes oil price remains unchanged at \$45/barrel.



Earnings Up, Costs Up, Equities Up?

A tighter labor market has resulted in steady wage growth, which is weighing on corporate profitability. We are observing this trend across a number of private companies. Private equity managers are finding it increasingly difficult to fill the skill gap in industries such as software and engineering services.

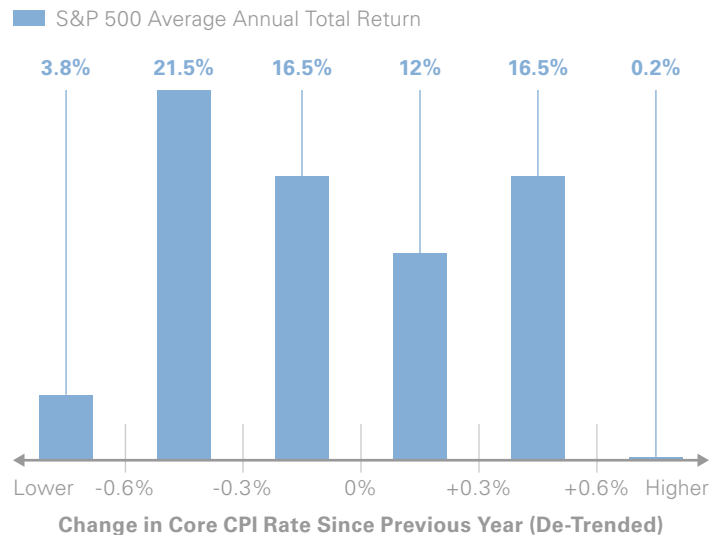
—Michael Brandmeyer, Co-CIO, Alternative Investments and Manager Selection (AIMS)

The effect of inflation on equities is a kaleidoscope of contradictions, making firm conclusions hard to come by. Overall, we think a reflationary environment should be a good thing for equities, especially relative to other asset classes, and we expect modest positive returns to stocks next year.

To an extent, higher inflation is a reflection of better GDP growth, which should benefit revenues. For example, higher wages could support consumption, boosting both growth and company earnings. At a macro level, this has to be weighed against the headwind of higher wage costs for companies and higher expected interest rates, which will also arise from more inflation. Unlike bonds, equities have the ability to grow their cash flows and, assuming rising rates are met with improved economic growth, earnings growth typically outstrips the negative impact on rising cost of capital. Additionally, many management teams have been mindful of the rate risk posed to their businesses and have managed their balance sheets accordingly by fixing and terming out their debt such that, even when rates rise, it will take quite some time for it to filter into a rising cost of capital. By our estimates, equities can potentially withstand yields at the 10-year point around 2.8% without compromising valuations.

The distribution of tail- and headwinds matters across equity sectors and company margins. Likewise, higher commodity prices may reflect demand growth, but for companies represent a drag on earnings. We think that companies with pricing power to pass on such cost pressures should benefit relative to those for whom margins could come under pressure. Already purchasing manager survey data in the US shows both input and output prices rising at the end of 2016.

Equities Prefer Moderate Changes in Inflation



Source: Bloomberg, Haver analytics and GSAM Calculations. Represents time period from 1982 to 2015. These examples are for illustrative purposes only and are not actual results. If any assumptions used do not prove to be true, results may vary substantially. **Past performance does not guarantee future results, which may vary.**

Investment Implications

We think inflation trends, and the likelihood of tighter monetary policy in response, suggest US interest rates will continue to rise in 2017. Different sectors of the equity market will likely respond differently to the rising rate environment that higher inflation will prompt. Financial stocks may outperform, while stocks that have historically offered higher income or lower volatility (e.g., utilities or consumer staples) may underperform broader equities. Real estate investment trusts (REITs) could come under pressure, but we expect some offset as rising inflation leads to rising rents (in contrast to the negative effect that inflation could have on consumer staples via rising input costs).

Could Rates Become the Risk Asset?

The shift in investor focus from deflation to inflation likely reflects a healthy evolution of this economic cycle. However, uncertainty with respect to the level and volatility of real yields and inflation expectations will generate investment opportunities.

—Raymond Chan, Head of Markets Team, Global Portfolio Solutions

Market expectations of a more inflationary environment—coupled with improving growth and a shift from monetary policy stimulus to fiscal stimulus—have driven interest rates higher. We expect the rising-rate trend to continue in 2017, and to exceed what is currently priced into markets. This has several implications.

First, if rates rise in a disorderly fashion, volatility is likely to increase across many markets. This could be driven either by markets anticipating aggressive tightening policy or by Fed hikes that exceed expectations. So far, credit markets have resisted the rise in yields seen since the summer and spreads have remained tight. We expect them to remain range-bound and see them as essentially fairly valued given the current macro environment. However, an abrupt re-pricing of rate markets could change that, and a disorderly unwinding of credit positioning, especially in the mutual fund space, could cause a technically-driven sell-

off. This could occur across both investment grade and high yield bonds.

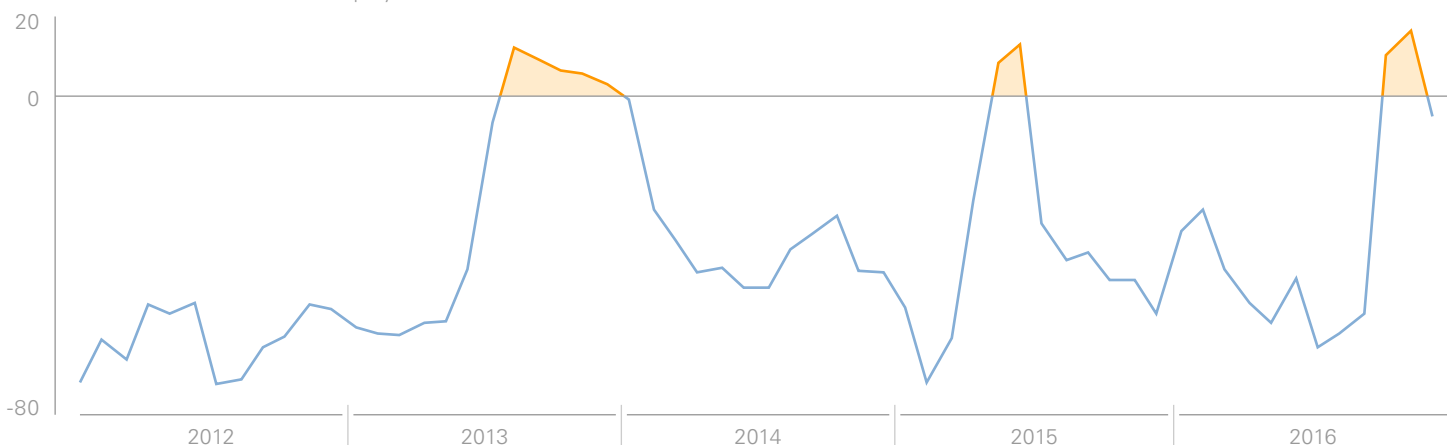
Second, higher rates in the US may encourage the dollar to continue its recent surge. A stronger dollar is often a drag for US companies—many of which have substantial overseas operations—and US economic growth overall. Dollar strength may also pose a challenge for emerging markets with high dollar-based funding requirements; higher interest rates present an additional burden here (see “Taper Tantrum 2.0”).

Investment Implications

The final, broader, implication follows from the notion that rising rates could cause volatility. Bonds are normally used in portfolios to diversify riskier asset holdings. If a bond sell-off were to cause risk asset prices to fall, that negative, diversifying correlation is lost and investors will have to search in different places for allocations that can hedge risk positions. Some of that behavior can be seen by looking at the chart of correlations between equities and bonds which turned positive after the summer, similar to the “Taper Tantrum” of 2013.

Higher Stock-Bond Correlations Have Historically Undermined Diversification

% Correlation of Bond Returns to Equity Returns



Source: Bloomberg and GSAM calculations. Bonds is the Barclays US Government Index, Equities is the S&P 500. As of Nov. 30, 2016. Past correlations are not indicative of future correlations, which may vary. Diversification does not protect an investor from market risk and does not ensure a profit.

Past performance does not guarantee future results, which may vary.



MONETARY TO FISCAL POLICY

We see monetary policy divergence reaching a new extreme in the year ahead. We think the Fed is likely to hike interest rates at least twice, while the European Central Bank (ECB) and Bank of Japan (BoJ) stretch further toward the limits of their easing ability.

With growth still struggling on both sides of the Atlantic, the focus for stimulus is shifting toward fiscal spending, both as a backlash against years of painful austerity and in recognition of a need for infrastructure upgrades. This transition is important to watch as it could provide a better policy mix to support growth and corporate earnings, or it could drive debt and inflation sharply higher and spark more volatility in developed or emerging market assets.

Signposts to Watch

Taper Tantrum 2.0?

The ECB and BoJ cannot sustain the current pace of asset purchases indefinitely, and signs of a material change in policy, or policy missteps, may drive volatility and a pullback in risk appetite.

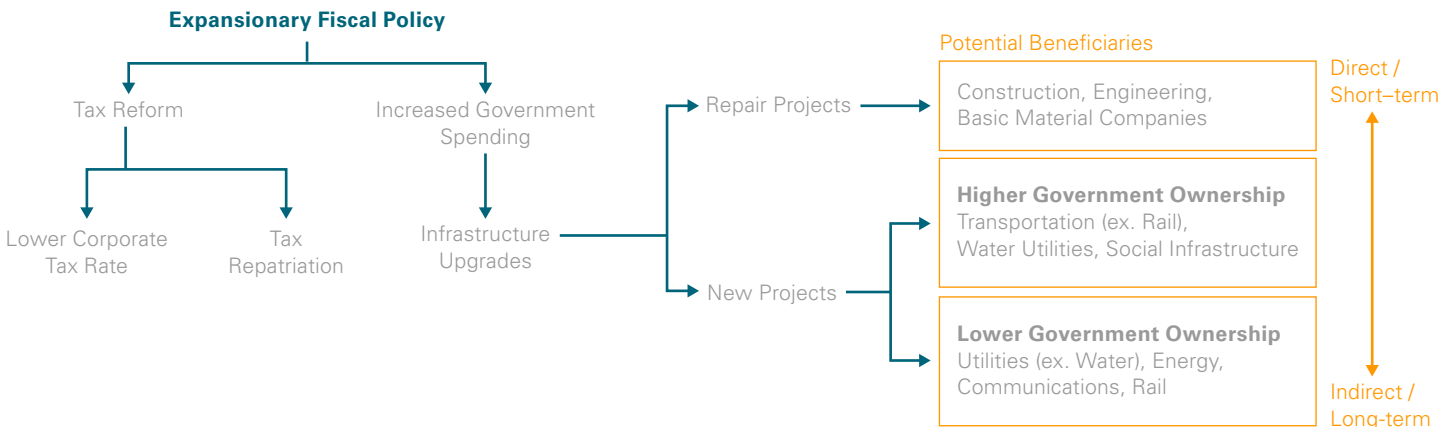
Trump’s First Fed Picks

Trump can fill several open seats on the Fed. His first nominations will provide important insights into the central bank’s policy direction.

A Global Fiscal Big Bang?

How much does Trump need to deliver on his proposed tax cuts and spending package to change the economic trajectory of the US—for better in terms of growth, or worse in terms of debt and inflation—and how would the impact be felt around the world?

Global Infrastructure: Many Variables Will Determine the Potential Beneficiaries



Potential Implications

Higher Corporate Earnings	Increased Business & Household Spending	Higher Employment	Higher Deficit	Inflation	Stimulate Economic Growth
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Source: GSAM. As of December 2016. For illustrative purposes. Goldman Sachs does not provide accounting, tax or legal advice. Please see additional disclosures at the end of this publication.



Taper Tantrum 2.0?

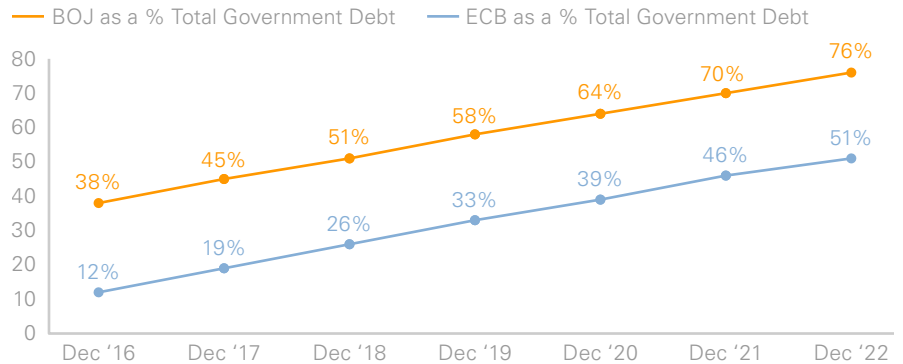
Monetary policy since the financial crisis has played a key role in suppressing volatility and supporting both developed and emerging market asset prices. But this regime of global easing has likely peaked with the Fed tightening and the ECB and BoJ nearing the practical limits of their asset purchase programs.

What the ECB and BoJ do next could be pivotal. In 2013, the first indication that the Fed would reduce its asset purchases drove global markets into a “Taper Tantrum” marked by sharp declines in emerging market assets and developed market corporate bonds. With the ECB and BoJ buying bonds at a pace that cannot be sustained indefinitely, markets are on guard for Taper Tantrum 2.0.

For now, we think the BoJ and ECB can manage market perceptions of their asset purchase programs. In December, the ECB combined its announcement of an initial reduction in monthly asset purchases from €80bn to €60bn with a nine-month extension of the program to end-2017. The market response was benign, as the ECB seems to have taken the scarcity issue off the table until sometime after Europe’s key 2017 elections (see “Europe’s Election Calendar,” page 10). Since we think inflation will remain below target in 2017 and continued easing will be necessary, we expect the ECB will announce a more explicit tapering in the second half of the year, and may follow the BoJ’s lead with some form of yield curve control.

In the near term, however, higher rates and potential additional bond issuance, driven by fiscal easing, should help somewhat to increase the availability of bonds the central banks can purchase. And if tapering is driven by a material improvement in growth or inflation—not our base case in Europe or Japan—markets may be reassured by the prospect of a sustainable recovery in the developed world’s largest economies.

The Path of ECB and BoJ Bond Buying Is Unsustainable



Source: Autonomous Research. As of Dec. 9, 2016.

Investment Implications

We believe Europe’s low inflation and continued ECB accommodation will continue to support German Bunds, and policy divergence with the US could drive the euro to parity versus the US dollar. The weaker economies of peripheral Europe are vulnerable to volatility-driven spikes in borrowing costs, along with the emerging markets that took the brunt of the Fed-related upheaval. However, some of the more fragile emerging markets have narrowed current account deficits in the intervening years, and may be better able to withstand shocks. In Japan, we think the BoJ’s policy of yield curve control will probably keep downward pressure on the yen, though we see limited downside for government yields.

From a quantitative perspective, monetary easing has driven valuations across both equities and bond portfolios to high levels, but dispersion with these markets remains historically wide. As the policy balance shifts in favor of fiscal easing, we see potential for this dispersion to narrow in 2017, which may benefit value-oriented investment strategies.

Trump's First Fed Picks

Since the crisis, the Fed's bias toward easier monetary policy—and more recently a gradual tightening—to support US growth has been relatively uncontroversial. That may change under Trump's administration. While the Fed's independence is a cornerstone of its credibility, the board is composed of political appointments. The Fed has two open seats that Trump can fill soon and Chair Janet Yellen and Vice Chair Stanley Fischer could leave when their terms come up for renewal in early 2018. Trump will have significant ability to re-shape the Fed and his early nominations for the two vacant Board seats could be an important indicator of the direction of the Fed in years to come.

One idea popular with some Republicans is that Fed policy should be more rules-based. If Trump appoints candidates that support such an approach, the market could price in a more hawkish Fed outlook. The Taylor Rule, which models the appropriate level of interest rates primarily according to changes in inflation and output, suggests rates should be higher than they are now.

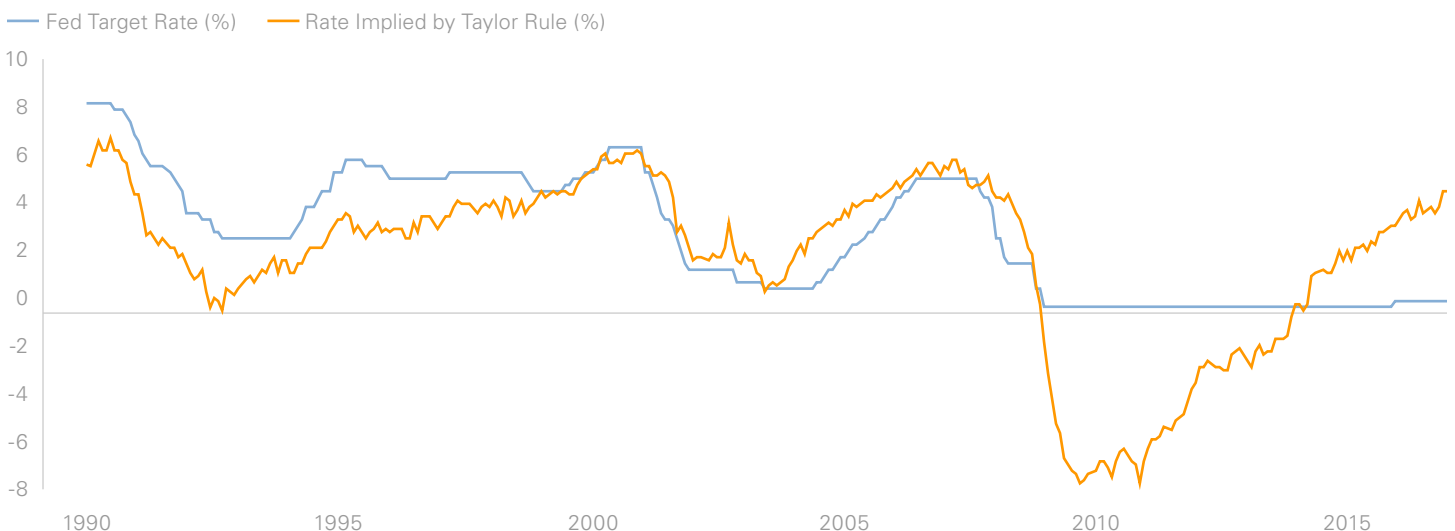
The President-elect wants to spend money on a significant infrastructure package and tax cuts, increasing the deficit, and he needs low rates to do that. A Fed appointee favoring a more discretionary approach could mean Trump

considers his policy priorities better aligned with the Fed's current stance. Moreover, the proposed fiscal expansion is in line with the government spending boost that Yellen has been advocating for years to complement the Fed's monetary support. If this fiscal expansion boosts US growth and inflation as intended, the economy should be able to support higher rates, allowing policymakers to find a compromise between "lower for longer" and "higher in haste."

Investment Implications

US government bond markets may be underestimating the potential for Fed rate hikes over the coming year. Although government bond yields have increased since the US election, we expect the market to continue adjusting to a somewhat steeper path of Fed rate hikes in the coming years. We also see relative value opportunities in the contrast between tightening US financial conditions and looser conditions elsewhere. Broadly speaking, an orderly increase in inflation should be beneficial for corporate profits, supporting the outlook for US equities.

A Taylor-Rule Approach Suggests US Interest Rates Should Be Higher



Source: Bloomberg. As of Nov. 30, 2016. The Taylor Rule is a model for adjusting policy rates based on actual inflation relative to the central bank's target, actual employment versus an estimate of full employment and an estimate of the "neutral" policy rate consistent with full employment.



A Global Fiscal Big Bang?

The economic impact of infrastructure spending will manifest years down the road and will not be as significant as one might expect. We think it's positive, but not transformational.

—Collin Bell, Client Portfolio Manager, Fundamental Equity

Since the financial crisis, many economists have criticized the lack of fiscal spending to support the recovery. Years of austerity have helped correct the worst of Europe's deficits, and now the tide seems to be turning—the European Commission already has plans for infrastructure spending in place. A similar shift seems likely in the US, as President-elect Trump has pledged massive spending on infrastructure, funded by repatriation taxes and with possible tax credits to boost private spending. The question remains: will his Republican colleagues reverse their opposition to deficit spending to allow a meaningful stimulus through both Republican-controlled houses of Congress? And if they do, can the benefit to growth offset concerns about debt sustainability?

Ideally, government spending creates a multiplier effect across the economy, stimulating confidence and spending among businesses and households and boosting productivity. We would look for positive signals in consumer sentiment and budget estimates for business investment as signals. Allocation is key—for instance, new building projects will be more stimulative than repairs—and funding can be optimized by harnessing private sources in public/private partnerships.

The multiplier effect is easiest to achieve in a low rate, low growth and low employment environment. The current conditions are conducive for fiscal stimulus in our view, and under our assumptions the proposed US tax cuts and spending policies could add about 0.8% to GDP over up to two years, probably starting from the second half of 2017. That said, we believe the US' comparatively tight labor market could stoke inflation. And the positives of fiscal spending for the US economy may be offset by adverse trade and immigration policy (see "Globalism to Populism," page 8). Moreover, inefficient or wasteful government spending poses risks to debt sustainability, and in the US, debt is already higher than it has been at the outset of prior fiscal expansions.

In emerging markets, infrastructure spending has generally been more substantial, given that many countries are at an earlier stage of economic development. China, in particular, has employed infrastructure spending as a driver of economic growth. But we do see a risk of indirect impact on emerging markets if a heavy US fiscal expansion drives rates and inflation meaningfully higher, inviting the Fed to tighten policy more sharply than is currently anticipated.

Investment Implications

Sizable US fiscal spending, coupled with tax measures to encourage companies to repatriate foreign profits, could have a significant effect on US inflation, given the economy is close to full employment. As a result, fiscal policy expectations have favored the reflation trade, benefiting assets correlated to growth and weighing on government bonds. We think the actual impact will play out over several years with different effects across sectors. We expect that near-term beneficiaries will likely be the "builders" of infrastructure, specifically the engineering, construction and basic material companies that supply them. Longer-term, "owners" of infrastructure should also benefit, starting with those exposed to higher government ownership. Over an even longer horizon, we see potential benefits for assets geared to increased inflation, including inflation-linked bonds, real assets beyond infrastructure and equities.

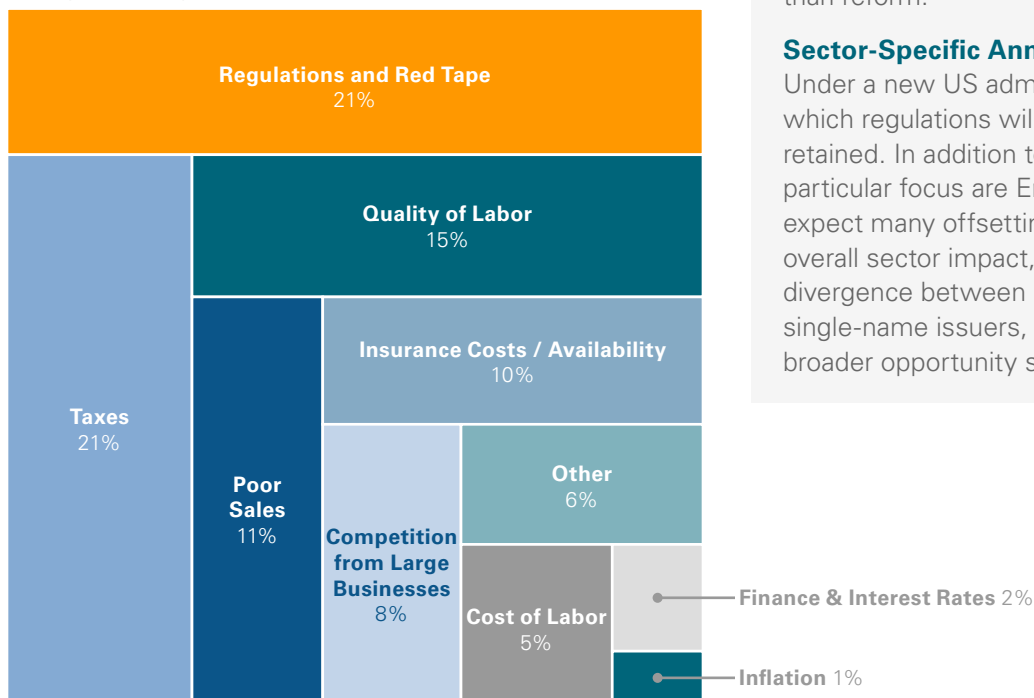


REGULATION TO DE-REGULATION

The outlook for more fiscal spending has received significant attention, but the potential for de-regulation may have a bigger impact on growth and markets in 2017. In the US, Trump's proposed regulatory changes are focused on improving access to capital and reducing barriers to business formation. In Europe, corporate support for a Brexit outcome was driven by concerns about excessive regulation, and European financial institutions have begun to push back against the wave of post-crisis regulation. Meanwhile, China continues to seek the right mix of regulation and stimulus to drive structural reform while maintaining economic growth. As a result, we will be watching the degree of regulatory divergence across the global economy and the potential for competitive de-regulation.

Regulation Among the Top Concerns of US Small Businesses

% Single Most Important Business Problem



Source: Bloomberg, National Federation of Independent Business. As of November 2016.

Signposts to Watch

Divergence in Financial Sector Regulation

The Trump administration's regulatory appointments of US regulators will be a key indication of the extent of de-regulation in the financial sector. How far the US pendulum swings from regulation to de-regulation will hold important implications for financial regulation in Europe and the UK, which have adopted more than 80 new rules and pieces of legislation between 2007 and 2015.

China's Regulatory Agenda

China's Communist Party will hold its National Congress in the Fall of 2017. This twice-a-decade event will be critical for the longer-term regulatory agenda in China, and we expect any regulatory changes ahead of that to focus on stability rather than reform.

Sector-Specific Announcements

Under a new US administration, it is not yet clear which regulations will be repealed, revised or retained. In addition to Banks, two sectors of particular focus are Energy and Healthcare. We expect many offsetting factors will contribute to the overall sector impact, and as a result, we see more divergence between industry groups and among single-name issuers, creating the potential for a broader opportunity set for generating alpha.



Divergence in Financial Sector Regulation

Appointments at agencies such as the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) will be important signals of the regulatory direction we can expect a Trump administration to pursue. Steven Mnuchin, who has been nominated as Treasury Secretary for the incoming administration, has echoed Trump’s view on the Dodd-Frank Act, stating his ‘number one priority’ will be to reduce aspects that prevent bank lending.

The Trump administration’s regulatory agenda could have global implications. Fed Governor Daniel Tarullo, who also serves as Chair of the US Federal Financial Institutions Examination Council (FFIEC), has been an influential proponent of harmonization of global banking regulations. However, Tarullo’s term as FFIEC chair ends in March 2017 and Trump seems likely to push for a new chair more aligned with his agenda. A softer US regulatory approach, plus less push for regulatory harmonization from the US, could provide an environment where European and UK banks, which have digested more than 80 new rules and pieces of legislation between 2007 and 2015, are able to press for less regulation going forward.

The outlook for the UK banking sector will remain uncertain into 2017 as the government and policymakers decide whether to continue to adopt EU regulatory

standards without being able to influence them, or whether to diverge and establish a less stringent regulatory framework. Retaining membership of the single market would see continued harmonization of regulations across all sectors, notably banking, and enable UK banks to continue to passport financial goods and services across Europe. That being said, we cannot assume exiting the single market will result in regulatory divergence.

Investment Implications

In the US, amendments to existing financial regulations may spur loan growth and help to offset tightening of financial conditions arising from higher rates and a higher currency. A softer regulatory stance may also encourage loan growth in Europe, where reliance on bank lending is greater. Demand for loans from businesses and households remains weak, and we continue to expect growth and inflation to lack any upward momentum into 2017. In the UK, regardless of the regulatory direction, we expect the trend of rising compliance costs to continue in the near term. This, combined with a weak growth and inflation outlook, as the Brexit impact begins to play out, will weigh on profitability prospects.

Europe Has Historically Been More Reliant on Bank Lending than the US

Euro Area

Reliance on Bank Lending

Reliance on Market Lending



US

Reliance on Bank Lending

Reliance on Market Lending



0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%

Source: Haver Analytics, Federal Reserve, European Central Bank. Based on 2014 data.



China's Regulatory Agenda

China is attempting to balance stimulus and reform against a backdrop of slower growth and capital outflows. Policymakers have pursued a combination of easy liquidity and fiscal stimulus. This policy mix is driving higher leverage in state-sponsored sectors, a hunt for return by the private sector and capital outflows as domestic investors seek to diversify out of China.

We think the Chinese government is committed to reform, including anti-corruption measures and measures to promote industrial restructuring to reduce excess capacity in sectors such as coal and steel. Significant changes are unlikely to occur ahead of the Communist Party Congress in the fall, when President Xi Jinping will have an opportunity to consolidate power.

Ahead of the Congress, we expect China's regulatory agenda to focus on stability rather than reform. We think this direction has been evident in recent changes. For example, in late November, the State Council announced new measures to tighten corporate overseas direct investment, which will be in effect until September 2017. These measures are largely aimed at reducing overseas

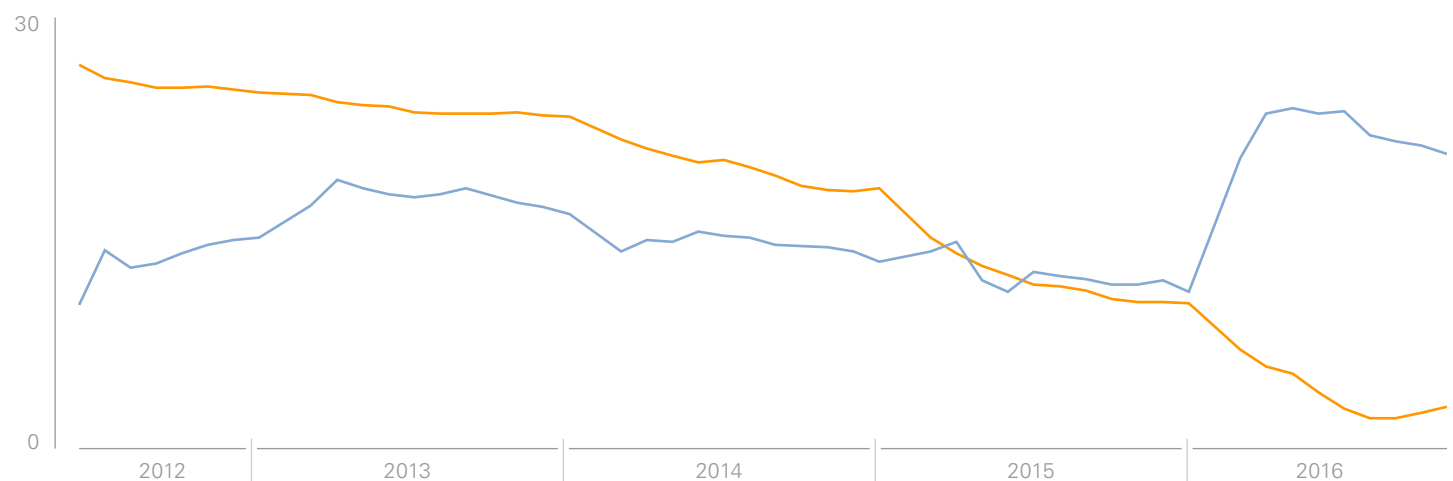
investment as a channel for capital outflows by companies looking to move money offshore. Similarly, policymakers have introduced several measures to tighten real estate regulations since August, including restrictions on ownership and land sales as well as higher down-payment requirements.

Investment Implications

China faces a growth drag from reduced trade, a further increase in imbalances from policies designed to support growth while reforms are put on hold ahead of the fall Congress and increased pressure from capital outflows. We see no obvious catalyst for China-induced volatility, but we are cautious of the view that the government's focus on stability means China is unlikely to be a major source of market volatility in 2017. In our view, medium-term risks from China are likely to get worse and the timing of an eventual reckoning is shifting closer.

China Focusing on Stimulus and Stability Ahead of Communist Party Congress

China Fixed Asset Investment (% Year-over-Year) — Private — State or State-Owned



Source: Bloomberg. As of October 2016.



Sector-Specific Announcements

After years of relatively predictable economic policymaking, 2016 has been a steep inflection point. Given uncertain political dynamics around the globe, we believe staying nimble in industry allocations and responsive to changing market dynamics will be critical in the coming years.

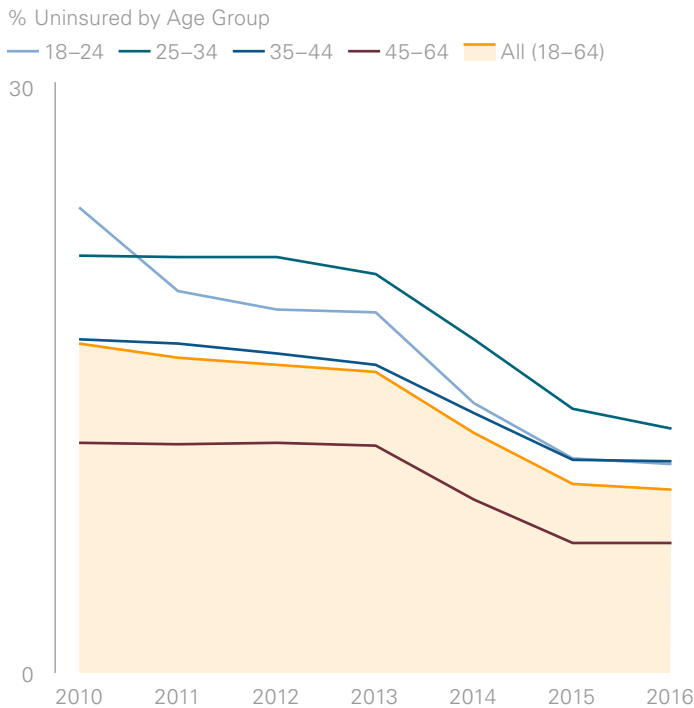
—Dennis Walsh, Portfolio Manager, Quantitative Investment Strategies

The ultimate direction of energy policy that Trump’s administration will pursue remains highly uncertain, though the immediate perception appears to be supportive of hydrocarbons, while adverse for renewables. Trump’s ‘America First’ energy plan involves support for domestic oil and gas production, which will be put into action through lessening of regulations which hinder exploration. Trump has also vowed to allow the US energy infrastructure build-out to move ahead with

greater ease. Meanwhile, the policy outlook for renewable energy is unclear; elimination of tax incentives which encourage investment in renewable energy could be disadvantageous, though corporate focus on the climate change agenda could support the industry.

On Healthcare, Trump was vocal about a “repeal and replace” of the Affordable Care Act (“ACA”) during his campaign but potential changes are unclear. While parts of the ACA may be retained, we expect modifications given Republican control of both the White House and Congress. Economic consequences will depend on the exact details. Since the ACA was implemented in 2014, the expansion of coverage boosted healthcare service consumption and its contribution to GDP. A repeal could result in a decline in covered population and subsidies, reducing demand. Elevated uncertainty while we await policy direction could also hamper investment and hiring decisions.

Affordable Care Act Repeal Could Affect Demand for Healthcare Services



Source: US National Center for Health Statistics. 2016 as of Q2 2016.

Investment Implications

Energy de-regulation would be a clear positive for US energy companies, with federally regulated midstream companies such as pipelines likely to be among the biggest beneficiaries of the potential policy shift. Plans to scale back emissions-reduction targets would be encouraging for gas demand and incentivize investment in power and chemicals. We see limited near- to medium-term impact on renewable companies as much of the current approved legislation provides support for the next few years. Furthermore, renewable goals are set at the State level, many of which have reaffirmed support for renewables.

Cross currents in Healthcare sector make the potential investment impact varied and complex. We expect lower industry volumes to be broadly negative for healthcare providers and facilities. On the other hand, we expect health insurers may benefit from expansion of private-market Medicare under favorable Republican policies. Pharmaceuticals may also benefit, since Trump has voiced less scrutiny on drug pricing than his Democrat counterparts.



12 SIGNPOSTS WE'RE WATCHING IN 2017

Globalism to Populism

Trump's First 100 Days

The first 100 days of the Trump administration will be critical for assessing policy priorities, from tax rates to trade agreements.

Europe's Election Calendar

A Eurozone break-up scenario is unlikely in 2017 but populist gains in upcoming elections will be an important indicator of Eurozone cohesion.

Trade (Dis)agreements

The US is likely to become more protectionist in 2017. How other countries respond will be critical to assessing the economic and market impact.

Stagnation to Inflation

How Much Inflation is Too Much?

With inflation trending higher, market expectations will be as important to the outlook as the actual data.

Earnings Up, Costs Up, Equities Up?

Reflation should be positive for equities broadly, but those that cannot pass cost pressures on to consumers may see margin pressure.

Could Rates Become the Risk Asset?

Reflation is likely to be negative for government bonds, which could become a source of volatility to other markets, such as credit.

Monetary to Fiscal Policy

Taper Tantrum 2.0?

A material change in the pace of ECB or BoJ asset purchases may drive volatility and a pullback in risk appetite.

Trump's First Fed Picks

Trump can reshape the Fed and his first nominations will provide important insights into the central bank's policy direction.

A Global Fiscal Big Bang?

Fiscal stimulus expectations have benefitted growth-oriented assets and weighed on government bonds. Long-term implications are more nuanced.

Regulation to De-Regulation

Divergence in Financial Sector Regulation

How far the US pendulum swings from regulation to de-regulation will hold important implications for UK and European financial regulation.

China's Regulatory Agenda

China is likely to focus on stability rather than reform ahead of the twice-a-decade National Congress in the fall of 2017.

Sector-Specific Announcements

Changes in energy and healthcare regulation could create divergence among companies and sectors, creating security selection opportunities.

THANK YOU

For updates to our views, please visit:
[GSAM.com/2017-Investment-Outlook](https://www.gsam.com/2017-Investment-Outlook)
or reach out to your GSAM relationship manager.

Views are as of December 2016 and subject to change in the future.

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Glossary

Consumer Price Indexes (CPI) are monthly reports on changes in the prices paid by urban consumers for a representative basket of goods and services.

Exchange rate premium (ERP) is the extra return that the stock markets must provide over gilts to compensate for the additional investment risk.

Inflation is the rate at which the general level of prices for goods and services rise.

Inflation-Linked Assets are assets with inflation-sensitive characteristics.

Liability-Driven Investment is an investment strategy based on the cash flows needed to fund future liabilities.

Median: The middle value in a consecutive series.

Public infrastructure investments are in infrastructure-related strategies can provide access to the physical systems of a business or country, including transportation, electric, and telecommunication systems.

Public Real Estate: Investors can gain exposure to residential, commercial, and industrial properties and land through strategies investing in public traded securities such as Real Estate Investment Trusts.

Satellite Asset Classes are those that have traditionally had low correlations to traditional market exposures such as large capitalization equities and investment grade fixed income.

Stagnation is a prolonged period of minimal or no growth in an economy.

The G7 is a group of seven of the largest developed nations, whose representatives meet periodically to discuss economic issues. It was formed in 1976 and consists of Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

The Taylor Rule is a model for adjusting policy rates based on actual inflation relative to the central bank's target, actual employment versus an estimate of full employment and an estimate of the "neutral" policy rate consistent with full employment.

Treasury Inflation-Protected Securities (TIPS) are Treasury bonds whose value rises with inflation.

US Government Bonds are bonds issued by the US government, denominate in US dollars.

Commodities are represented by the S&P GSCI Commodity Index. The S&P GSCI Commodity Index is a composite index of production-weighted commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

Emerging Market Debt is represented by the JPM EMBI Global Composite. The JPM EMBI is an unmanaged index tracking foreign currency denominated debt instruments of 31 emerging markets.

Emerging Market Equity is represented by the MSCI Emerging Markets Index. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Europe Equity is represented by the MSCI Europe Index. The MSCI Europe Index captures large and mid cap stocks across 15 developed market countries in Europe.

Global Diversified Index, used to represent Local Emerging Market Debt, is not available before 2003. The index is substituted from 2000 to 2002 by the JPM EMBI Global Composite, used to represent Emerging Market Debt.

Global High Yield Corporate Bonds are represented by the Barclays Global High Yield

Global Small Cap Equities are represented by the MSCI World Small Cap Index. The MSCI World Small Cap Index captures small cap representation across 23 developed markets countries.

Investment Grade Corporate Bonds are represented by the Barclays Global Aggregate USD Value Hedged Index. The Barclays Global Aggregate Index provides a broad-based measure of the global investment-grade fixed income markets. The three major components of this index are the U.S. Aggregate, the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities, and USD investment grade 144A securities.

Japan Equity is represented by the MSCI Japan Index. The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of Japanese stock markets.

Local Emerging Market Debt is represented by the JP Morgan GBI EM Global Diversified Index. The JP Morgan GBI EM Global Diversified Index is a comprehensive emerging market debt benchmark that tracks local currency bonds issued by emerging market governments. Data for the JP Morgan GBI EM representative of fixed-rate, non investment-grade debt of companies.

US Equity is represented by the S&P 500 Index is the Standard & Poor's 500 Composite Stock Prices Index of 500 stocks, an unmanaged index of common stock prices. The index figures do not reflect any deduction for fees, expenses or taxes. It is not possible to invest directly in an unmanaged index.

US Large Cap Equities are represented by the S&P 500. The S&P 500 Index is the Standard & Poor's 500 Composite Index of 500 stocks, an unmanaged index of common stock prices.

Value Unhedged Index. The Barclays Global High Yield Index is considered

Risks

Bonds are subject to interest rate, price and credit risks. Prices tend to be inversely affected by changes in interest rates. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Fixed income investing involves interest rate risk. When interest rates rise, bond prices generally fall.

Although **Treasury Inflation-Protected Securities (TIPS)** are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

Investments in **commodities** may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity.

Equity Securities are more volatile than bonds and subject to greater risks. Small and mid-sized company stocks involve greater risks than those customarily associated with larger companies.

High Yield Fixed Income Securities are considered speculative, involve greater risk of default, and tend to be more volatile than investment grade fixed income securities.

The **currency** market affords investors a substantial degree of leverage. This leverage presents the potential for substantial profits but also entails a high degree of risk including the risk that losses may be similarly substantial. Such transactions are considered suitable only for investors who are experienced in transactions of that kind. Currency fluctuations will also affect the value of an investment.

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The indices referenced herein have been selected because they are well known, easily recognized by investors, and reflect those indices that the Investment Manager believes, in part based on industry practice, provide a suitable benchmark against which to evaluate the investment or broader market described herein.

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