Market Recap

Dec. 2017

The S&P 500® Index gained 6.64% for the fourth quarter of 2017, resulting in a return of 21.83% for the year. The equity market posted positive returns each month of the quarter with the S&P 500® Index returning 2.33%, 3.07% and 1.11% for October, November and December, respectively.

The equity market's fourth quarter advance had two distinct phases, with a significant development in the legislative effort to reform U.S tax policy serving as a dividing line at the quarter's midpoint. The initial rounds of Q3 corporate earnings reports helped drive the S&P 500® Index to a return of 2.05% through November 15th. The equity market's rate of return accelerated over the second half of the quarter, propelled in part by the tax reform package passed by the House of Representatives on November 16th. The tax package included steep cuts in corporate tax rates and an increase in the standard deduction for individuals, features that survived the legislative process as the House worked with the Senate to draft a compromise bill that was signed into law by President Trump on December 22nd. From its closing value on November 15th through year-end, the S&P 500® Index returned 4.50%.

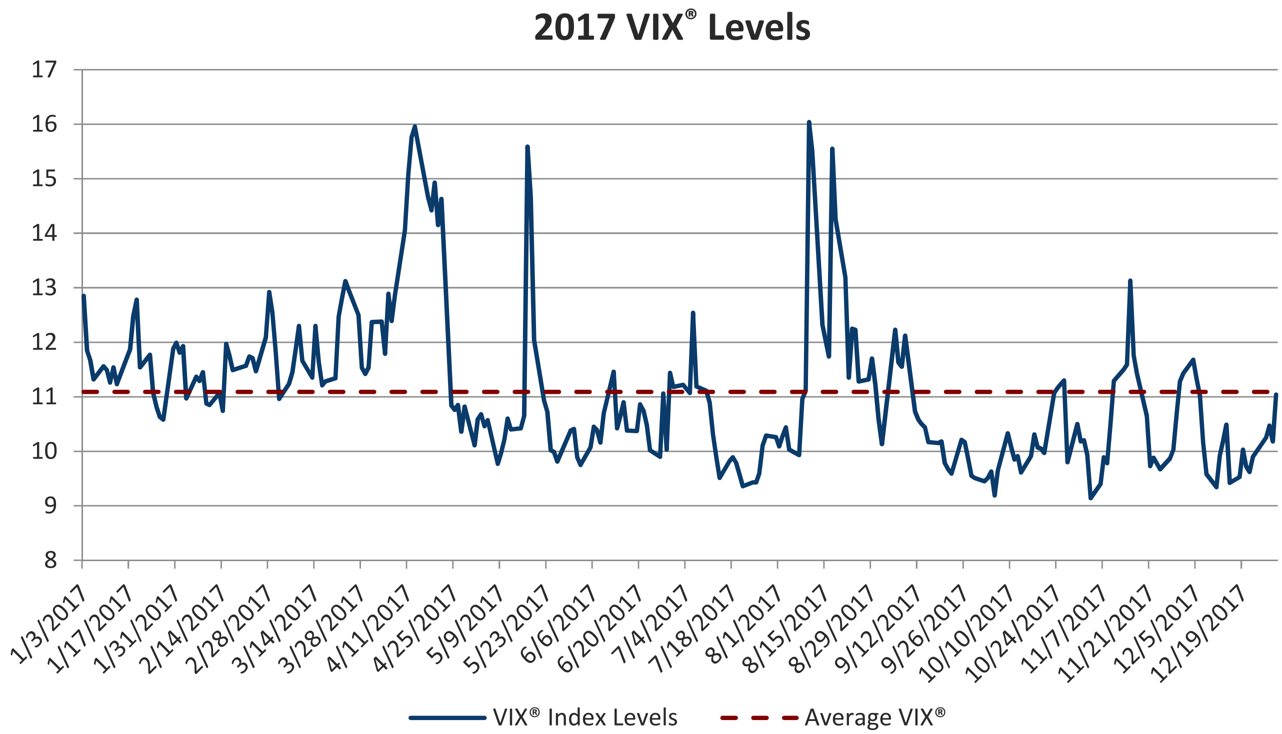
The market backdrop remained positive throughout the fourth quarter. Data releases showed strong economic growth, robust corporate profitability and continued improvement in employment statistics. The unemployment rate dropped to a 17-year low of 4.1% in early November, a level that was maintained in December's report. Even with tightening employment conditions, the November year-over-year change for the Consumer Price Index was just 1.7%, indicating that inflation remains below the Federal Reserve's (the Fed's) 2% target. Despite three late-summer hurricanes causing significant disruption in the Southeast, the economy expanded and corporate earnings grew in Q3. On December 21st, the final revision of Q3 GDP growth came in at 3.2%. The revision was a downgrade from the 3.3% second estimate, but a slight increase over Q2 GDP growth of 3.1%. Aggregate operating earnings for S&P 500® Index companies grew 2.3% in Q3, with more than 80% of companies meeting or exceeding analyst estimates.

The fourth quarter's steady equity market advance with low volatility was a continuation of conditions that existed throughout 2017. In fact, for the first time in its history, the total return of the S&P 500® Index was positive in each month of a calendar year. The market shrugged off a contentious domestic political environment, three major hurricanes, escalating rhetoric between the Trump Administration and North Korea, and tightening monetary policy conditions. Monetary policy actions by the Fed included three rate hikes and a move toward shrinking the size of its balance sheet.

Contributors to the market's upward momentum included a globally-synchronized economic expansion and strong earnings growth for U.S. corporations. Trailing 12-month growth in aggregate operating earnings for S&P 500® Index companies came in at nearly 17% as of September 30th, and analysts estimate that, once companies report fourth quarter earnings in early 2018, earnings for calendar year 2017 will have grown nearly 18%.

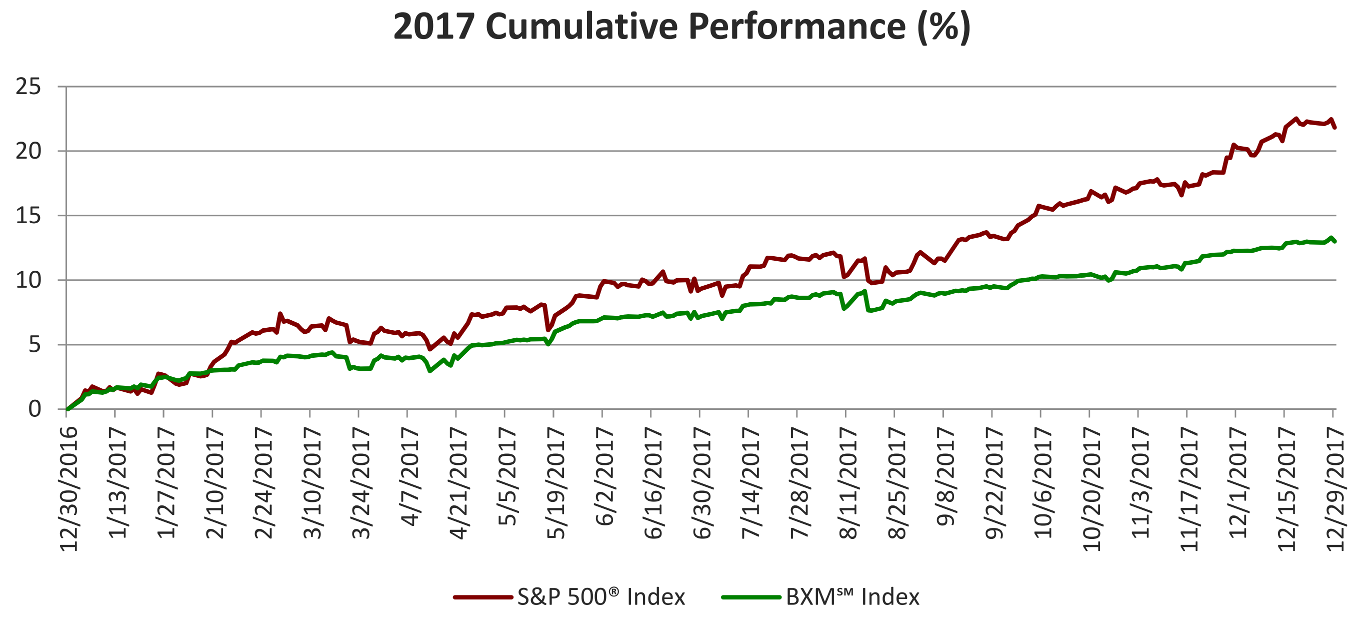
The equity market exhibited historically low volatility in 2017. Realized volatility for the year (as measured by the annualized standard deviation of daily returns for the S&P 500® Index) was just 6.78%, the lowest reading since 1964. Moreover, the largest peak-to-trough decline experienced by the S&P 500® Index for the year was a loss of just 2.58% from March 1st through April 13th. Implied volatility, as measured by the Cboe® Volatility Index® (the VIX®), averaged 11.09 in 2017, the lowest annual average in the history of the statistic, which began in 1990. The VIX® also set new all-time records for intra-day low, 8.56 on November 24th, and closing low, 9.14 on November 3rd. The VIX® closed below 10 on 52 days in 2017. Prior to 2017, the VIX® closed below 10 just nine times in its history.

The VIX® averaged 10.31 for the fourth quarter, the lowest quarterly average over its 112-quarter history. Implied volatility exceeded realized volatility of 5.73% for the quarter by a 4.58-point spread, an above-average reading for the statistic. The closing high for the VIX® during the quarter was 13.13 on November 15th.



Datasource: Bloomberg, L.P.

The Cboe® S&P 500 BuyWrite℠ Index (the BXM℠) had a return of 2.79% for the fourth quarter, resulting in a return of 13.00% for the year. The premiums collected when the BXM's℠ new index call options were sold on the third Friday of each month (as the previous months' index call options expired) were a significant determinant of both the BXM's℠ participation in market advances and the amount of downside protection delivered during market declines. Premiums collected as a percentage of the BXM's℠ underlying value were 0.70%, 0.77% and 1.04% for October, November and December, respectively. The premiums received were consistent with the low volatility environment that persisted throughout the quarter and resulted in monthly returns of 0.59%, 1.53% and 0.65% for October, November and December, respectively. The BXM℠ underperformed the S&P 500® Index in each month of the quarter as the relatively low premiums received by the BXM℠ did not allow it to keep pace as the equity market advanced at a steady, above-average rate. The equity market's low-volatility advance over the course of the year is also the primary explanation for the return differential between the BXM℠ and the S&P 500® Index for 2017. Monthly premiums collected by the BXM℠ in 2017 ranged from a low of 0.70% to a high of 1.24% and the BXM℠ underperformed the S&P 500® Index in all but three months of the year. During the equity market drawdown from March 1st to April 13th, the BXM℠ declined 1.06%, delivering 152 basis points (bps) of downside protection relative to the S&P 500® Index.



Datasource: Bloomberg, L.P.

Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results.

[1] The Cboe® S&P 500 BuyWrite℠ Index (the BXM℠) is a passive total return index designed to track the performance of a hypothetical buy-write strategy on the S&P 500® Index. The construction methodology of the BXM℠ includes buying an equity portfolio replicating the holdings of the S&P 500® Index and selling a single one-month S&P 500® Index call option with a strike price approximately at-the-money each month on the Friday of the standard index-option expiration cycle and holding that position until the next expiration.

Fixed Income Markets

The Bloomberg Barclays U.S. Aggregate Bond Index returned 0.39% for the fourth quarter, bringing its year-to-date return to 3.54%. The yield on the 10-year U.S. Treasury Note (the 10-year) ended the third quarter at 2.33% and rose to a fourth quarter high of 2.50% on December 20th before falling to end the year at 2.41%. Over the course of 2017, the yield on the 10-year was rangebound while the yield curve flattened as the Fed raised the federal funds target rate three times. Starting the year at 2.44%, the yield on the 10-year initially rose to a 2017 high of 2.63% on March 13th and then trended down to a low of 2.04% on September 7th before generally rising over the remainder of the year. The spread between the 10-year and the 2-year U.S. Treasury Note narrowed from 125 bps at the beginning of the year to 52 bps at the end of the year.