MARKET UPDATE
FEBRUARY 2018 REVIEW

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CORPORATE OFFICE:

95 Glastonbury Blvd.
Suite 102
Glastonbury, CT 06033
860.652.3239

USI Consulting Group is the parent company of both USI Advisors, Inc. and USI Securities, Inc.

USI CONSULTING GROUP OFFICES:

350 Fifth Avenue
Suite 3700
New York, NY 10118

900 South Gay Street
Knoxville, TN 37902

312 Elm Street 24th Floor
Cincinnati, OH 45202

50 Cabot Street
Needham, MA 02492

2400 East Commercial Blvd
Suite 600
Fort Lauderdale, FL 33308

5200 N. Palm Ave
Fresno, CA 93704

6501 So Fiddlers Green Circle
Suite 100
Greenwood Village, CO 80111

2711 N. Haskell Ave
Suite 2000
Dallas, TX 75204

601 Union Street, Suite 1000,
Seattle, WA 98101

"Market volatility returns"

After two years of low volatility, the market went on a very bumpy roller-coaster ride in February. Investors were torn between the optimism of solid economic fundamentals and corporate earnings and the fears of rising interest rates and inflation. These events triggered large swings in the equity markets with an average daily change of 1.3% in February compared with an average daily move of 0.3% for all of 2017.

February was the worst month for the markets in two years, as U.S. equities dipped into correction territory. The Dow Jones Industrial Average experienced over1,000 point daily swings throughout the month, while the S&P 500 tumbled 10% in nine days before trimming some of its losses. The equity markets have suffered increased volatility mainly due to concerns over stronger-than-expected inflation and a dramatic rise in interest rates. The Headline Consumer Price Index posted a higher-than-expected increase of 0.5% month-over-month, above forecasts of 0.3%. Core inflation, which excludes goods with high price volatility such as food and energy, also increased 0.3% for the month and 1.8% year-over year. Meanwhile, average hourly earnings grew at 2.9% compared to market consensus of 2.6%, the largest increase since June 2009. Wage growth started to put pressure on corporate profits and further exacerbated the market pullback.

Investors became worried that the economy could overheat due to fiscal stimulus and force the Fed to hike interest rates faster than expected. In general terms, the Fed raises interest rates to tighten financial conditions and slow economic activities and bank borrowing. The Fed's minutes from the January FOMC meeting showed further improvement in the U.S. economy and an uptick in inflation, supporting a gradual hike in the federal funds rate, along with the continuation of the balance sheet reduction. The new Fed Chairman, Jerome Powell, delivered an optimistic economic outlook to Congress, indicating that the Fed may raise interest rates four times in 2018 instead of three as it had previously signaled.

	February 2018	YTD
DJIA	-3.96%	1.69%
S&P 500	-3.69%	1.83%
NASDAQ	-1.87%	5.35%
MSCI EAFE	-4.51%	0.28%
MSCI Emerging Markets	-4.61%	3.34%
Barclays Aggregate	-0.95%	-2.09%
Barclays Corp High Yield	-0.85%	-0.26%
	2/28/2018	1/31/2018
US 10-Year Treasury	2.87%	2.72%

Long-term market drivers remain solid despite the recent market selloff. U.S. economic fundamentals and corporate earnings continue to provide a positive outlook for the equity markets. In the fourth quarter of 2017, the real U.S. GDP increased at an annualized rate of 2.5%, below a previous reading of 2.6%. The economic growth was supported by strong consumer spending, federal government spending, nonresidential fixed investment, and exports. Many economists forecast that the growth will accelerate in the first half of 2018, benefitting from fiscal stimulus. Consumer confidence also had a solid start this year. The Conference Board's measure of U.S. consumer confidence increased to 130.8 from 124.3 in February. The unemployment rate remained unchanged at 4.1% for the fourth consecutive month, whereas the participation rate registered at 62.7%. The Bureau of Labor Statistics reported that 200,000 jobs were added in January, exceeding consensus estimates of 175,000.

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Meanwhile, corporate earnings continue to impress. Of the 447 companies that have reported their earnings for the fourth quarter, 68% beat revenue expectations, the strongest level since 2010. The new tax reform should help boost corporate profits even further in the upcoming quarters. Sectors benefitting the most from tax cuts such as financials and telecom posted the strongest earnings revisions, whereas sectors with lower effective tax rates, such as technology, experienced lower revision gains.

For the month of February, the Dow Jones Industrial Average tumbled 1,120.19 points, ending at 25,029.20, a monthly drop of 4%. The S&P 500 Index also ended its 15-month winning streak, falling 3.7% for the month. All 11 major industry sectors finished in the red with U.S. REIT topping the underperformers, followed by energy due to a sharp decline in oil prices during the month. The Nasdaq Composite Index also closed in negative territory, sliding 1.9% in February and registering its worse month since October 2016. Internationally, the MSCI EAFE Index also suffered a 4.5% decline in February, whereas MSCI EAFE Emerging Markets plunged 4.6% amid concerns of rising U.S. interest rates.

The fixed income markets have been drawing more attention recently as bond yields started to rise, pushing total bond returns into negative territory in February. The 10-year Treasury yield jumped over 40 basis points from 2.43% at the beginning of the year to 2.87% in February, falling from a four-year high of 2.95%. As a result, the Bloomberg Barclays US Aggregate Government-Treasury Long Index fell 3% while the Bloomberg Barclays US Aggregate Index dipped around 1% for the month.

Looking ahead, we expect market volatility to remain elevated with interest rates and inflation on the rise. While investors may experience further market swings, the underlying fundamentals remain positive. Synchronized global economic momentum, solid corporate earnings, and fiscal stimulus continue to provide strong support for the equity markets. As the economic trends of 2017 persist as we move into 2018, maintaining a long-term perspective and a diversified portfolio will be most beneficial for investors.

For previous market commentaries please click here.

An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this timeframe, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment. The higher the yield, the better the economic outlook.

The S&P Case Shiller Index is a group of indexes that tracks home prices in the U.S.. It seeks to measures the value of residential real estate in 20 major U.S. cities.

Michigan Consumer Sentiment Index is a survey of consumer confidence conducted by the University of Michigan. The Michigan Consumer Sentiment Index (MCSI) uses telephone surveys to gather information on consumer expectations regarding the overall economy.

Conference Board's Consumer Confidence Index an index by the Conference Board that measures how optimistic or pessimistic consumers are with respect to the economy in the near future.