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Second Quarter 2018

QUARTERLY MARKET REVIEW

T.RowePrice®
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Quarterly Market Review
U.S. STOCKS
2Q 2018

TECHNOLOGY SHARES AND SMALL-CAPS OUTPERFORM AS MARKET RECORDS MODEST OVERALL GAINS

Stocks recorded decent gains in the second quarter, although the performance of the major benchmarks varied considerably. The technology-focused Nasdaq Composite Index outpaced the large-cap benchmarks and reached new highs, helped by the continued strong performance of many "mega-cap" technology firms. The smaller-cap indexes also outperformed and set new records late in the quarter. The narrowly focused Dow Jones Industrial Average lagged as escalating trade tensions weighed especially on several of its export-focused components. Growth shares continued to outpace their value counterparts, except in the small-cap space. Volatility, as measured by the Cboe Volatility Index, subsided a bit from the multiyear peaks reached early in the previous quarter, but the market continued to see larger price swings relative to 2017's remarkably steady climb upward. Within the S&P 500 Index, energy shares performed best as oil prices climbed to four-year highs, while industrials and business services, financials, and consumer staples shares endured losses.

Total Returns

	2Q 2018	Year-to-Date
Dow Jones Industrial Average	1.26%	-0.73%
S&P 500 Index	3.43	2.65
Nasdaq Composite Index	6.33	8.79
S&P MidCap 400 Index	4.29	3.49
Russell 2000 Index	7.75	7.66

Past performance cannot guarantee future results.
Note: Returns are for the periods ended June 30, 2018. The returns include dividends based on data supplied by third-party provider RIMES and 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.

TAX CUTS AND GLOBAL GROWTH SPUR BEST PROFIT GAINS IN NEARLY A DECADE

Generally, the second quarter seemed characterized by a tug of war between positive corporate fundamentals and a negative political backdrop. April and May brought evidence that corporate earnings had accelerated even more than expected following the December 2017 tax cut and further stimulus provided by federal spending increases in March. According to data and analytics firm FactSet, earnings for the S&P 500 as a whole rose by 24.6% in the first quarter relative to a year earlier, marking the best increase since profits rebounded following the Great Recession nearly a decade ago. Steep cuts in the corporate tax rate deserved part of the credit, but top-line revenue growth also surprised on the upside. Indeed, more than three-quarters of firms reported higher-than-expected increases in both earnings and revenues.

Economic signals were less impressive overall but still encouraging. The quarter started on a down note, with the S&P 500 recording its biggest daily drop of the period on April 6, after March payroll gains came in substantially below expectations. T. Rowe Price Chief U.S. Economist Alan Levenson noted that the solid employment growth trend appeared intact, however—an outlook that later proved justified as payroll gains rebounded in April and May and brought the unemployment rate down to 3.8% in May, its lowest level in 18 years. Gauges of manufacturing and service sector activity remained elevated, if down a bit from multiyear peaks reached early in the year. Housing data were a bit more mixed. Home prices and existing home sales continued to increase at a healthy clip, but home construction lagged as builders appeared to focus on the higher end of the market.

FED LIKELY TO REMAIN PATIENT

Throughout the quarter, investors kept a close eye on whether the tightening labor market—with the unemployment rate already well below a level indicating full employment, according to most measures—would prompt the Federal Reserve to pick up its pace of interest rate increases. After keeping rates steady in May, the Fed raised rates by another quarter point at its June meeting, as was widely expected. Investors seemed to have modestly negative reactions to the Fed's accompanying statement, however, which indicated that a majority of policymakers now expected four interest rate increases in 2018, versus three—suggesting two more hikes were likely to come in the second half of the year.

Little evidence suggested the Fed's hand might be forced. Headline inflation increased in the quarter, reaching its highest level since early 2012 on a year-over-year basis, but core inflation (which excludes food and energy costs) remained near the Fed's 2% target. More importantly, perhaps, modest wage gains seemed to indicate that the kind of wage-price spiral that led the Fed to hike dramatically in the past remained highly unlikely. Indeed, after briefly touching a seven-year high in mid-May, the yield on the benchmark 10-year Treasury note—a measure of longer-term inflation expectations—ended only modestly higher than where it had started the quarter.

TRADE WORRIES APPEAR TO KEEP A LID ON GAINS

Trade tensions clearly deserved much of the blame for stock prices being unable to follow profits higher. Market indexes recorded sharp intraday declines on several occasions in the quarter following the announcement of new tariff threats from the Trump administration, as well as vows of reprisals from U.S. trading partners. The growing trade conflict between the world's two largest economies—the U.S. and China—garnered the most attention. Over the quarter, the Trump administration announced a steady escalation in possible tariffs on Chinese goods, eventually reaching $200 billion on a range of goods by late June. In late May, the U.S. also extended the metals tariffs to Canada, Mexico, and the European Union (EU), while the Department of Commerce announced that it was considering raising tariffs on auto imports on national security grounds.

Whether the mounting threats were merely negotiating tactics on all sides remained unclear, but markets appeared to waver late the in the quarter as evidence emerged that the prospect of tariffs was already impacting corporate strategy and profit outlooks. Stocks slumped in particular on June 21, after German automaker Daimler lowered its profit outlook due to prospective higher tariffs on SUVs it manufactures in the U.S. and sells in China. A few days later, Harley-Davidson revealed in an SEC filing that it was planning to move some of its motorcycle production overseas to avoid retaliatory tariffs recently announced by the EU. Shares of Boeing, Caterpillar, and other U.S. industrial firms also fell sharply late in the quarter as concerns grew about their export markets. Signs of slowing growth in Europe and China, even in advance of an all-out trade war, also weighed on sentiment toward exporters.

EARNINGS CONTINUING TO RISE FASTER THAN STOCK PRICES WOULD MAKE VALUATIONS MORE COMPELLING

T. Rowe Price Group Chief Investment Officer Rob Sharps observes that earnings growth will likely slow from its rapid first-quarter pace over the rest of the year, but only moderately. Nevertheless, he cautions that investors should expect lower returns relative to the last couple of years. On balance, U.S. large-cap valuations, as measured by the S&P 500 Index, still appear moderately expensive—off recent peaks but still far from compelling. A relatively painless path to more attractive broad valuations, he observes, would be if earnings continued to rise at a faster pace than equity prices over the balance of 2018 and into 2019.

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Quarterly Market Review
INTERNATIONAL STOCKS
2Q 2018

INTERNATIONAL EQUITIES SLIDE INTO NEGATIVE TERRITORY

International stock markets posted losses in the second quarter. Emerging markets recorded the largest declines, as tariff threats, increased geopolitical tensions, and currency weakness weighed on Latin American and Chinese stocks. President Donald Trump's tariffs on steel and aluminum imports rattled international markets, and retaliatory tariffs against U.S. products sparked worries about a global trade war amid slowing growth in some key markets.

Within the MSCI EAFE Index, which tracks developed markets in Europe, Australasia, and the Far East,the energy, health care, materials, utilities, and consumer staples sectors posted gains. Financials, telecommunication services, consumer discretionary, and industrials and business services shares underperformed the EAFE benchmark. Growth stocks outperformed value stocks.

Total Returns

MSCI Indexes	2Q 2018	Year-to-Date
EAFE (Europe, Australasia, Far East)	-0.97%	-2.37%
All Country World ex-U.S.A.	-2.39	-3.44
Europe	-0.87	-2.17
Japan	-2.80	-1.85
All Country Asia ex-Japan	-5.31	-4.65
EM (Emerging Markets)	-7.86	-6.51

All data are in U.S. dollars and represent gross returns, as of June 30, 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. Investors cannot invest directly in an index.
Source: MSCI.
Note: MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI.

EUROPEAN STOCKS TURN VOLATILE

European equities began the quarter in positive territory, buoyed by favorable economic news and relatively strong corporate earnings reports. In May, key indexes in France, Germany, and the UK reached their highest levels this year before losing ground as political and trade concerns came to the fore. U.S.–China trade negotiations and announcements of new tariffs put a chill on trade volumes, while mixed economic data, including weaker manufacturing output in France and Germany, disappointing retail sales in the UK, and a rally in oil prices, injected volatility. The Bank of England voted 7 to 2 to keep rates on hold and remarked that "only limited

tightening" would be needed in the coming years, and the European Central Bank said it would reduce asset purchases from €30 billion to €15 billion at the end of September and stop purchases at the end of December.

POLITICAL TURMOIL IN ITALY AND SPAIN RATTLES MARKETS

Italy struggled to form a government for months after the populist Five Star Movement and far-right League party topped national elections. Markets were rattled by concerns that the two parties would increase fiscal spending and propose anti-European Union (EU) establishment policies that could threaten Italy's membership in the EU. Bank stocks were notably weak amid concerns about Italy's vast public debt and high level of nonperforming loans. European markets recovered some of their losses after the two political parties strongly endorsed the EU. T. Rowe Price Fixed Income Manager Ken Orchard said that while the coalition is fragile and several issues, including debt and new spending initiatives, could be troublesome, he doesn't believe Italy's issues will trigger a major debt crisis soon. In Spain, the Socialists, the country's biggest opposition party, ushered in a new government after a no-confidence vote led to the ouster of Prime Minister Mariano Rajoy, who was replaced by Pedro Sanchez in early June. T. Rowe Price traders noted that key risks have been slightly mitigated by the new government's commitment to maintain the Conservative party's 2018 budget.

JAPAN EQUITIES WEAKEN

Japanese equities weakened for U.S. dollar investors as the yen fell versus the dollar and underperformed the broad EAFE benchmark. Markets posted particularly sharp declines following the Trump administration's announcement that it might levy additional tariffs on Japanese imports. Weakness in business spending, residential investment, and private consumption combined to push the country's gross domestic product into contraction territory, ending eight consecutive quarters of economic expansion. The Bank of Japan (BoJ) maintained its negative short-term interest rate target and kept its yield curve control policy in place. The June meeting statement indicated that while the economy is expanding modestly, inflation remains in the range of 0.5% to 1%, well below target. BoJ Governor Haruhiko Kuroda warned about "significant consequences" for the Japanese economy due to the brewing trade battle between the U.S. and China.

EMERGING MARKETS SINK DEEP INTO NEGATIVE TERRITORY

Emerging markets stocks tumbled as demand for higher-risk assets fell out of favor following rising concerns about the prospect of a global trade war. Political uncertainty also acted as a weight in some markets. Equities in Latin America fared worst, dragged lower by a 26% drop in Brazilian stocks. Rising diesel fuel prices sparked national worker strikes that dramatically slowed commerce, forced the government to lower diesel prices, and exposed the difficulty that Brazil's reform government faces as it seeks to liberalize prices. Trade tension between China and the U.S. caused weakness in Asia. Chinese A shares, which are shares of mainland China-based companies, sank nearly 17%. The yuan dropped to its lowest level since late 2017. South Korea, Indonesia, and Philippines stocks were notable laggards in Asia. The Europe, Middle East, and Africa region underperformed the MSCI Emerging Markets Index, weighed down by a nearly 26% fall in Turkish stocks. The Turkish lira weakened against the U.S. dollar, as the country's ability to arrest double-digit inflation and address its large trade deficit eroded investor confidence.

OUTLOOK: GLOBAL GROWTH REMAINS POSITIVE IN 2018

Global growth remains positive but has slowed from the strong pace in 2017. Europe, the most notable area of strength among developed markets in 2017, has seen the sharpest slowdown. While external liabilities are a risk for certain emerging market countries, fundamentals remain broadly favorable. Risks to the outlook for global equities include a rise in geopolitical or trade tensions and the possibility of monetary policy missteps.

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Quarterly Market Review
FIXED INCOME MARKETS

2Q 2018

SOLID ECONOMIC NEWS HELPS MOVE TREASURY YIELDS HIGHER

The Treasury yield curve flattened in the second quarter as yields on shorter-maturity Treasuries increased more than longer-term yields. Generally strong economic data reduced demand for Treasury debt (bond yields and prices move in opposite directions). The two-year Treasury note's yield, which is more closely correlated with the Federal Reserve's monetary policy decisions, increased to its highest level since 2008 as the central bank signaled a slightly faster pace of rate increases. However, demand for safe-haven securities amid geopolitical uncertainties helped restrain yield increases on 10- and 30-year Treasuries.

The benchmark 10-year Treasury note's yield reached a seven-year closing high of 3.11% on May 17 as concerns grew about increased borrowing by the Treasury, less support from the Fed, and higher inflation. However, a risk-averse environment following political turmoil in Italy and concerns about the impact of tariffs on global growth increased demand for safer assets. On May 29, the 10-year Treasury note had its largest one-day yield decrease since the UK voted to leave the European Union in June 2016. The yield difference between the 2- and 10-year notes finished the quarter at just 33 basis points (0.33 percentage point), the narrowest level since 2007.

Total Returns

Index	2Q 2018	Year-to-Date
Bloomberg Barclays U.S. Aggregate Bond Index	-0.16%	-1.62%
J.P. Morgan Global High Yield Index	0.17	-0.53
Bloomberg Barclays Municipal Bond Index	0.87	-0.25
Bloomberg Barclays Global Aggregate Ex-U.S. Dollar Bond Index	-4.76	-1.31
J.P. Morgan Emerging Markets Bond Index Global Diversified	-3.54	-5.23
Bloomberg Barclays U.S. Mortgage Backed Securities Index	0.24	-0.95

Figures as of June 30, 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.

Source: Third-party vendor RIMES.

FED FORECASTS TWO MORE RATE HIKES IN 2018 AMID SOLID ECONOMIC DATA

The Fed kept rates unchanged at its May meeting, but, as expected, the central bank raised the target range for the federal funds rate to 1.75% to 2.00% at its June meeting, the second increase this year. With the latest move, the real, or inflation-adjusted, effective fed funds rate is now close to 0%, meaning future rate hikes could move monetary policy into a tightening phase. Besides raising rates, the Fed also revised its median rate projections in

a slightly more hawkish direction, and policymakers are now penciling in two more hikes this year and three hikes in 2019. Solid economic data seemed to bolster the Fed's confidence in its path toward normalizing monetary policy. The unemployment rate fell to an 18-year low of 3.8%, and various inflation measures were at or slightly above the Fed's 2% target. Although first-quarter gross domestic product growth was revised down to a 2.0% annualized rate, preliminary data have pointed to a strong pickup in the second quarter.

MUNI RETURNS BENEFIT FROM DROP IN SUPPLY

Municipal bonds benefited from a favorable technical environment as issuance for the first half of the year was down about 20% from the same period in 2017 amid a sharp drop in refunding deals. Lower-rated munis such as tobacco bonds outperformed as investors sought out higher yields. Although market fundamentals remained solid overall, S&P Global Ratings lowered its credit ratings on Connecticut and Kentucky amid concerns about the states' unfunded pension liabilities.

U.S. Treasury Yields

Maturity	March 31	June 30
3-Month	1.73%	1.93%
6-Month	1.93	2.11
2-Year	2.27	2.52
5-Year	2.56	2.73
10-Year	2.74	2.85
30-Year	2.97	2.98

Source: Federal Reserve Board.

RISING OIL PRICES CONTRIBUTE TO POSITIVE HIGH YIELD RESULTS; INVESTMENT-GRADE CORPORATES UNDERPERFORM

High yield bonds benefited from stock market gains, generally positive earnings reports, and low default levels. The sector generally is less sensitive to interest rate fluctuations than other fixed income segments. Light issuance and inflows also provided support, and below investment-grade energy issuers received a boost from rising oil prices. Bank loans also recorded gains.

In the Bloomberg Barclays U.S. Aggregate Bond Index, Treasuries and mortgage- and asset-backed securities produced positive results, but investment-grade corporate bonds lost ground. Rising rates and heavy supply driven by merger activity weighed on the sector. Investment-grade corporate credit spreads—the excess yield offered versus comparable-maturity Treasuries—had widened to a year-to-date high by the end of the quarter but remained below longer-term averages.

ECB ANNOUNCES COMING PHASEOUT OF BOND-BUYING PROGRAM

Global economies continued to grow but slowed relative to the U.S. As a result, the U.S. dollar strengthened against nearly all other currencies, weighing on the returns of nondollar-denominated bonds. Developed market central banks outside the U.S. generally kept interest rates unchanged in the second quarter. However, the European Central Bank (ECB) announced at its June meeting that it will cut its bond purchases in half in October and end the asset purchase program by December. The ECB's statement also signaled that policymakers don't plan to begin raising rates until the end of next summer, at the earliest, and will continue reinvesting the proceeds from maturing debt, focusing on longer-maturity bonds in an effort to hold down long-term rates. Yields on 10-year sovereign debt in Germany, the UK, and Japan finished the quarter lower. Italian bond yields increased sharply in May as the country struggled to form a government, and political uncertainty also contributed to higher yields in Spain.

CURRENCY WEAKNESS WEIGHS ON EMERGING MARKETS BONDS

Emerging markets bonds produced negative returns, hampered by faltering investor sentiment, a stronger dollar, and some country-specific issues. Argentina's central bank hiked rates 12.75 percentage points over an eight-day period starting on April 27, lifting the country's benchmark lending rate to 40% as the bank sought to halt a precipitous drop in the peso. Several other emerging markets' central banks, including India and Turkey, also raised rates to try to strengthen their currencies. In Russia, bonds were pressured after the U.S. imposed sanctions in April on Russian business leaders, government officials, and companies with ties to President Vladimir Putin in retaliation for alleged meddling in the 2016 U.S. elections.

OUTLOOK: BENIGN INFLATION BACKDROP SHOULD KEEP RATE HIKES GRADUAL

In their Midyear Market Outlook, T. Rowe Price's chief investment officers noted that, although inflation measures firmed in the second quarter, the U.S. and other developed debt and equity markets were benefiting from a relatively benign inflation environment as we entered the second half of 2018. This should allow the Fed to remain on a gradual policy course, avoiding the kind of sudden or large rate hikes that might cause the yield curve to invert in the near term (which occurs when shorter-term bonds offer higher yields than longer maturities). "Historically, a flattening or flat yield curve has not necessarily spelled imminent trouble for the economy or for financial assets," said Rob Sharps, the firm's group chief investment officer. "But once the yield curve inverts, it's important to pay attention, because then the risks really do increase."

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Quarterly Market Review
GLOBAL CAPITAL MARKETS ENVIRONMENT
2Q 2018

U.S. stocks rose in the second quarter of 2018, supported by favorable earnings and economic data. Domestic equities were volatile but overcame political upheaval in some European countries, rising oil prices and interest rates, and weakness in many emerging markets currencies and assets. Trade tensions periodically weighed on the market, as the U.S. imposed tariffs on various imports from China and other major trading partners, including Canada, Mexico, and the European Union (EU). Many of these parties retaliated or threatened to do so, sparking fears that continued trade actions could hurt global commerce and the worldwide economic expansion.

Small-cap shares easily outperformed mid- and large-cap indexes. The small-cap Russell 2000 Index returned 7.75% versus 4.29% for the S&P MidCap 400 Index and 3.43% for the large-cap S&P 500 Index. As measured by various Russell indexes, growth stocks outperformed value among large- and mid-cap shares; the opposite was true among small-caps.

In the large-cap universe, as measured by the S&P 500, energy stocks far outperformed other sectors, lifted by an increase in oil prices stemming in part from the U.S. withdrawal from the 2015 nuclear deal with Iran. By the end of June, U.S. oil prices reached $74 per barrel, near a four-year high, amid a drop in U.S. oil inventories as well as U.S. demands that countries stop importing Iranian oil by November 4. Consumer discretionary stocks also did very well. Information technology shares were strong for most of the quarter, though there are concerns that the Trump administration will issue new rules to restrict Chinese investments in U.S. technology companies. On the other hand, industrials and business services stocks retreated as actual and threatened tariffs and a stronger dollar weighed on the prospects for large export-oriented companies. Financial stocks fell; although, late in the quarter, many major financial institutions passed the Federal Reserve's stress tests—which measure their financial health in a hypothetical economic downturn—and some announced substantial increases in share buybacks or dividends. Consumer staples stocks also declined.

	S&P 500 Index	S&P MidCap 400 Index	Russell 2000 Index
2Q 2018	3.43%	4.29%	7.75%
Year-to-Date	2.65	3.49	7.66

Past performance cannot guarantee future results.

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Source: Third-party vendor RIMES, as of June 30, 2018.

U.S. bond returns were mixed. The Bloomberg Barclays U.S. Aggregate Bond Index returned -0.16%. In the U.S. Treasury market, short- and intermediate-term yields increased as the Federal Reserve, in a widely expected move, raised its overnight fed funds target rate range in mid-June. Long-term yields rose to a lesser extent, but the 10-year U.S. Treasury note yield reached a seven-year high in May. (Bond prices and yields move in opposite directions.) In the investment-grade universe, corporate bonds declined amid heavy supply. Mortgage- and asset-backed securities edged higher. Municipal securities outperformed taxable bonds, helped by limited issuance and strong demand. High yield bonds, which have less interest rate sensitivity than high-quality issues, outperformed, helped by light issuance and strength in some energy bonds as oil prices rose.

	Bloomberg Barclays U.S. Aggregate Bond Index	Bloomberg Barclays Municipal Bond Index	JPMorgan Global High Yield Index
2Q 2018	-0.16%	0.87%	0.17%
Year-to-Date	-1.62	-0.25	-0.53

Past performance cannot guarantee future results.

Source: Third-party vendor RIMES, as of June 30, 2018.

Stocks in developed non-U.S. markets underperformed U.S. shares, as weaker currencies versus the greenback reduced returns in U.S. dollar terms. The MSCI EAFE Index, which measures the performance of stocks in Europe, Australasia, and the Far East, returned -0.97%. Developed Asian markets were mixed in dollar terms. Japanese stocks declined about 3%, as the yen fell 4% versus the greenback. The country's eight-quarter growth streak recently ended, with the economy contracting at an annualized pace of 0.6% in the first quarter. European markets were also mixed in dollar terms, as the euro and British pound both fell more than 5% versus the dollar. On the plus side, shares in the UK and oil producer Norway rose about 3%. In contrast, Italian stocks fell almost 7% and bond yields spiked as a new populist coalition government came to power and raised fears about increasing government spending. Spanish shares slipped 4%, as Prime Minister Mariano Rajoy from the Popular Party was ousted in a no-confidence vote following the corruption conviction of former party aides, and a new Socialist-led government took power in early June.

Emerging equity markets significantly underperformed stocks in developed markets, as broad currency weakness reduced returns in dollar terms and trade tensions between the U.S. and various trading partners, especially China, threatened to hurt global growth. The MSCI Emerging Markets Index returned -7.86%. Asian markets fell broadly. Indian stocks held up well, however, slipping less than 1%. Emerging European markets declined across the board. Russian stocks fell about 6%, despite higher oil prices, as the ruble weakened 8% versus the greenback in part because of new U.S. sanctions in April on individuals and entities with ties to President Vladimir Putin. Shares in Turkey, which has been struggling with elevated inflation, tumbled more than 25% in dollar terms. The lira plunged more than 13% as investors recoiled at President Recep Tayyip Erdogan's intentions to have a greater role in determining monetary policy—thus reducing the central bank's independence—following his victory in the June 24 elections.

Several Latin American markets fell sharply in dollar terms. Colombia bucked the negative trend with a nearly 7% gain, as an investor-friendly candidate won the country's presidential election in June. Mexican stocks fell more than 3% amid uncertainty regarding the future of the North American Free Trade Agreement, U.S. tariffs on Mexican exports, and the outcome of the July 1 elections—in which Andrés Manuel López Obrador was elected president. Brazilian shares fell more than 26%, as a truckers' strike related to fuel subsidies and diesel prices crippled commerce in the country. The resignation of the CEO of state-owned oil company Petrobras, the inability of the central bank to stop the falling real, and uncertainty about elections in October also weighed on the market.

Stocks in Argentina, a frontier market that MSCI recently decided would return to emerging markets status in May 2019, skidded almost 42%—with the peso sliding 30%—amid investors' doubts about the central bank's commitment to reduce elevated inflation. The International Monetary Fund (IMF) has endorsed the government's economic reform efforts, however, and provided a $50 billion line of credit in exchange for accelerating certain reforms.

	MSCI EAFE Index	MSCI Emerging Markets Index
2Q 2018	-0.97%	-7.86%
Year-to-Date	-2.37	-6.51

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Source: Third-party vendor RIMES, as of June 30, 2018.

Bonds in developed non-U.S. markets produced negative returns in dollar terms due to weaker currencies versus the U.S. dollar. In June, the European Central Bank (ECB) decided to cut its monthly bond purchases in half (from €30 billion to €15 billion) starting in September, and to stop purchases completely at the end of 2018. The ECB also said that it would keep rates on hold until "at least through the summer of 2019." In the eurozone, German bond yields declined, but Italian bond yields surged as the formation of a populist government in late May raised fears about increased government spending. In the UK, the yield curve flattened as weak growth and easing inflation pressures led to reduced expectations for central bank interest rate increases in the months ahead. In Japan, the central bank kept its benchmark short-term interest rate at -0.1% and continued targeting a yield of around 0% for the 10-year government bond.

Emerging markets bonds fared poorly in dollar terms due to general currency weakness versus the U.S. dollar, which prompted various central banks to raise short-term interest rates in an attempt to defend their currencies. Also, rising long-term rates in several countries hurt local bond market performance. Bonds denominated in local currencies performed much worse than dollar-denominated debt.

	Bloomberg Barclays Global Aggregate Ex-U.S. Dollar Bond Index	JPMorgan Emerging Markets Bond Index Global Diversified	JPMorgan GBI-EM Global Diversified Index
2Q 2018	-4.76%	-3.54%	-10.42%
Year-to-Date	-1.31	-5.23	-6.44

Past performance cannot guarantee future results.

Source: Third-party vendor RIMES, as of June 30, 2018.

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Quarterly Market Review
EMERGING MARKETS STOCKS

2Q 2018

EMERGING MARKETS STOCKS SLUMP IN Q2 AS STRONGER DOLLAR AND RISING U.S. RATES CURB RISK APPETITE

Emerging markets stocks slumped in the second quarter of 2018 as a stronger dollar and policy tightening in the U.S. diminished the appeal of riskier assets. The dollar surged against nearly all global currencies, raising the cost of paying off U.S. dollar-denominated debt in the developing world. In June, the Federal Reserve increased its benchmark rate for the second time this year and forecast a total of four increases in 2018, up from a prior forecast of three increases. The more aggressive pace of U.S. rate hikes reduced the attractiveness of foreign assets and increased worries about further currency depreciation. During the quarter, central banks in Indonesia, Turkey, and the Philippines repeatedly raised interest rates to stabilize their currencies. A brewing trade dispute between the U.S. and China also dampened risk sentiment as investors fretted that an escalating conflict would hurt the synchronized growth that drove last year's global economic expansion. The MSCI Emerging Markets Index recorded its worst quarterly performance since September 2015. All 11 sectors in the index fell, led by financials stocks. Energy stocks declined the least as oil prices surged to multiyear highs.

Total Returns

MSCI Index	2Q 2018	Year-to-Date
Emerging Markets (EM)	-7.86%	-6.51%
EM Asia	-5.75	-4.93
EM Europe, Middle East, and Africa (EMEA)	-10.02	-10.79
EM Latin America	-17.66	-10.99

All data are in U.S. dollars as of June 30, 2018. **Past performance cannot guarantee future results.**
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Investors cannot invest directly in an index.
Source: MSCI
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CHINESE STOCKS FALL AS TRADE BATTLE ESCALATES; SOUTHEAST ASIAN STOCKS FALL ON CURRENCY WEAKNESS

- Chinese stocks fell, with yuan-denominated A shares dropping nearly 17%. China's benchmark Shanghai Composite Index entered bear market territory and the yuan fell to its lowest level since November near quarter-end as weaker economic signals and rising trade tensions with the U.S. worried investors.
- Indian stocks declined. India's rupee currency slid to a record low near quarter-end as surging crude oil prices revived inflation concerns and caused the country's fiscal and current account deficits to widen. In June, the

Reserve Bank of India raised its key rate for the first time since 2014 and maintained its 7.4% annual economic growth forecast.

- Southeast Asian stocks fell, led by Thailand's nearly 15% drop. The Philippine central bank raised its benchmark rate twice during the quarter to curb inflation and shore up the peso. Bank Indonesia hiked its key rate three times within six weeks to stabilize the rupiah, which has shed more than 5% in 2018 and ranks among the worst-performing currencies in Asia. However, Thailand's central bank left its key rate unchanged near a record low and raised its economic growth forecasts for 2018 and 2019.

MEXICAN STOCKS DECLINE ON POLITICAL UNCERTAINTY; BRAZILIAN STOCKS DROP AS STRIKE WEIGHS ON RECOVERY

- Mexican stocks shed 3.5% amid uncertainty regarding the fate of ongoing trade talks with the U.S. and the outcome of the country's presidential election in July. In June, Mexico's central bank increased its benchmark rate for the second time this year to support the peso. It also warned that the balance of inflation risks has worsened and that Mexico's growth outlook remained tilted to the downside.

- Brazilian stocks sank about 26% as the real weakened, at one point touching its lowest level in more than two years in early June. Brazil's economy grew more than expected in the first quarter, but a crippling nationwide truckers' strike in May, uncertainty ahead of the presidential election in October, and rising interest rates worldwide undermined confidence in the country's outlook.

- Andean markets were mixed: Stocks advanced in Colombia after Ivan Duque, an investor-friendly candidate, won the country's presidential election in June, as expected. Stocks in Chile and Peru retreated. Central banks in both countries left their respective interest rates on hold over the quarter. However, in June, Chile's central bank revised its 2018 growth target upward and hiked its inflation forecast amid surging prices for copper, the country's top export.

RUSSIAN STOCKS DECLINE ON U.S. SANCTIONS; TURKISH ASSETS FALL AFTER POSTELECTION RALLY FADES

- Russian stocks shed nearly 6%, weighed by large declines in April after the U.S. imposed sanctions on Russian oligarchs and companies with ties to President Vladimir Putin in retaliation for the country's actions in Syria and other aggressions worldwide. In June, Russia's central bank kept its benchmark interest rate unchanged but lifted its inflation forecast, a surprisingly hawkish move that arose from a proposed hike in the nation's value-added tax.

- Turkish stocks plunged almost 26% as the lira hit a record low in April, and the central bank hiked interest rates each month during the quarter to stop the currency's slide. A rally in Turkish assets following President Recep Tayyip Erdogan's election fizzled out within a day as investors resumed worrying about the overheated economy and the direction of economic and monetary policy under the president's newly expanded powers.

- South African stocks ended down almost 12% as investor optimism following February's election of President Cyril Ramaphosa gave way to renewed focus on the country's flagging economy. South Africa's economy shrank an annualized 2.2% in the first quarter from the previous quarter, the government reported in June. The worse-than-expected contraction marked South Africa's biggest growth decline in nine years.

SOLID FUNDAMENTALS IN EMERGING MARKETS OFFSET NEAR-TERM RISKS

We are optimistic about the longer-term 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

2Q 2018

Tax-free municipal bonds posted modest gains in the second quarter of 2018, largely driven by a favorable technical environment as issuance was down following the new tax law's elimination of advance refunding deals. Tax-exempt municipal debt outperformed taxable bonds over the period, with the Bloomberg Barclays Municipal Bond Index returning 0.87% versus -0.16% for the Bloomberg Barclays U.S. Aggregate Bond Index and -0.98% for the Bloomberg Barclays U.S. Corporate Investment Grade Index. However, high yield municipal debt easily outperformed both investment-grade munis and investment-grade taxable bonds, returning 3.06% for the quarter as price appreciation for high yield tobacco and certain Puerto Rico issuers continued to boost the overall high yield municipal index's return.

ECONOMY AND INTEREST RATES

The Federal Reserve kept rates unchanged at its May meeting, but, as expected, the central bank raised the target range for the federal funds rate to 1.75% to 2.00% at its June meeting, the second increase this year. The Fed also revised its median rate projections in a slightly more hawkish direction, and forecasters are now penciling in two more hikes this year and three hikes in 2019. With the real, or inflation-adjusted, effective fed funds rate now close to 0%, the projections imply that the stance of monetary policy could be roughly neutral in a year's time. Solid economic data seemed to bolster the Fed's confidence in its path toward normalizing monetary policy. The unemployment rate fell to an 18-year low of 3.8% in May, and various inflation measures were at or slightly above the Fed's 2% target. Although first-quarter gross domestic product growth was revised down to a 2.0% annualized rate, preliminary data have pointed to a strong pickup in the second quarter.

Short-term municipal yields decreased while longer-term rates were generally little changed, resulting in a moderate steepening in the municipal yield curve. However, the Treasury yield curve flattened as rates on shorter-maturity Treasuries increased more than longer-term yields. The two-year Treasury note's yield, which is closely correlated with the Fed's monetary policy decisions, increased to its highest level since 2008 as the central bank signaled a slightly faster pace of rate increases. 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 June 30, 2018, the 2.94% yield offered by a 30-year tax-free general obligation (GO) bond rated AAA was about 99% of the 2.98% 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 (ACA), 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 4.97% 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 $96 billion, according to *The Bond Buyer*, which was about 12% lower than in the same period in 2017. A steep drop in refundings accounted for most of the decline in issuance from the second quarter of last year. The new tax law enacted at the end of 2017 eliminated the tax benefits of advance refundings, which had allowed issuers to refinance existing debt with new bonds.

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. In the second quarter, S&P Global Ratings lowered its credit ratings on Connecticut and Kentucky amid concerns about the states' unfunded pension liabilities. 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, modestly outperformed the broad muni market in the second quarter as investors' demand for yield remained strong. Puerto Rico's municipal bonds—particularly its uninsured debt with high yield ratings—posted another quarter of strong gains after a group of holders of senior sales-tax-backed bonds (known as COFINA) reached a tentative agreement on a split in sales tax collections with the commonwealth's GO bondholders. While contingent on Judge Laura Taylor Swain's approval as part of the larger bankruptcy case, bonds across the Puerto Rico debt complex rallied on the development.

All major segments of the municipal market recorded modest gains in the second quarter. Revenue bonds performed approximately in line with GO debt. Prerefunded bonds slightly lagged the broad muni market. 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. Within revenue bonds, all subsectors produced positive returns, with hospital debt generating the best results, while resource recovery bonds were the laggards. High yield tobacco debt easily outperformed other municipal segments for the quarter to post strong 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 impact 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.

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. 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.

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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