# MARKET REVIEW
# THIRD QUARTER, 2017

| INDEX | 3RD QUARTER % | 1 YEAR % | 3 YEAR % | 5 YEAR % |
|---|---|---|---|---|
| Dow Jones Industrials | 5.58 | 25.45 | 12.35 | 13.57 |
| NASDAQ Composite | 6.06 | 23.68 | 14.41 | 17.27 |
| Standard & Poor's 500 | 4.48 | 18.61 | 10.81 | 14.22 |
| Russell 1000 | 4.48 | 18.54 | 10.63 | 14.27 |
| Russell Midcap | 3.47 | 15.32 | 9.54 | 14.26 |
| Russell 2000 | 5.67 | 20.74 | 12.18 | 13.79 |
| BBgBarc US Aggregate Bond | 0.85 | 0.07 | 2.71 | 2.06 |
| MSCI World ex. US | 5.62 | 18.73 | 4.57 | 7.81 |
| MSCI Emerging Markets | 7.89 | 22.46 | 4.90 | 3.99 |
| **COUNTY OF SAN BERNARDINO 457(b) PLAN PERFORMANCE** | **4.39** | **17.18** | **9.04** | **12.33** |
| **COUNTY OF SAN BERNARDINO 401(k) PLAN PERFORMANCE** | **4.39** | **17.36** | **9.25** | **12.62** |
| **COUNTY OF SAN BERNARDINO RMT PLAN PERFORMANCE** | **3.83** | **13.64** | **7.49** | **9.97** |

In spite of heightened geopolitical uncertainty and multiple destructive hurricanes, equity markets marched to a new highs during the third quarter. U.S. equities posted a positive 4.6 percent return for the third quarter (Russell 3000). Equity returns were bolstered by solid economic and earnings reports, continued low interest rates and inflation, and a tax reform proposal from the White House late in the quarter. International equities outperformed domestic equities with a 5.5 percent gain over the quarter (MSCI EAFE). After briefly dipping down near 2 percent intra-quarter, 10-year treasury yields finished the quarter relatively unchanged at 2.3 percent. The broad U.S. fixed income market posted a 0.8 percent gain for the quarter (Barclays Aggregate).

The U.S. economic expansion continued with unemployment hitting another cycle low of 4.2 percent in September. Second quarter GDP growth accelerated to 3.1 percent and third quarter GDP is projected to show growth above 2 percent. The markets also welcomed news from the White House of potential tax reform. The tax proposal includes: a simplification from seven tax brackets into three; repatriation of foreign profits; elimination of estate tax; and a reduction in the corporate tax rate from 35 to 20 percent.

One of the unique attributes of this economic recovery has been the lack of inflation in the economy. Inflation remains below the Federal Reserve's target rate despite being multiple years into economic expansion and U.S. unemployment hitting cycle lows. The Fed held off on further rate hikes this quarter as they digested this lack of inflation, but signaled a likely rate hike later in the year. As the chart of the quarter

shows, Core CPI (Consumer Price Index) is tracking well below the 50-year average of 4.1 percent, and the Fed's primary inflation gauge, the Core PCE (Personal Consumption Expenditure), is at 1.3 compared to their target of 2 percent.

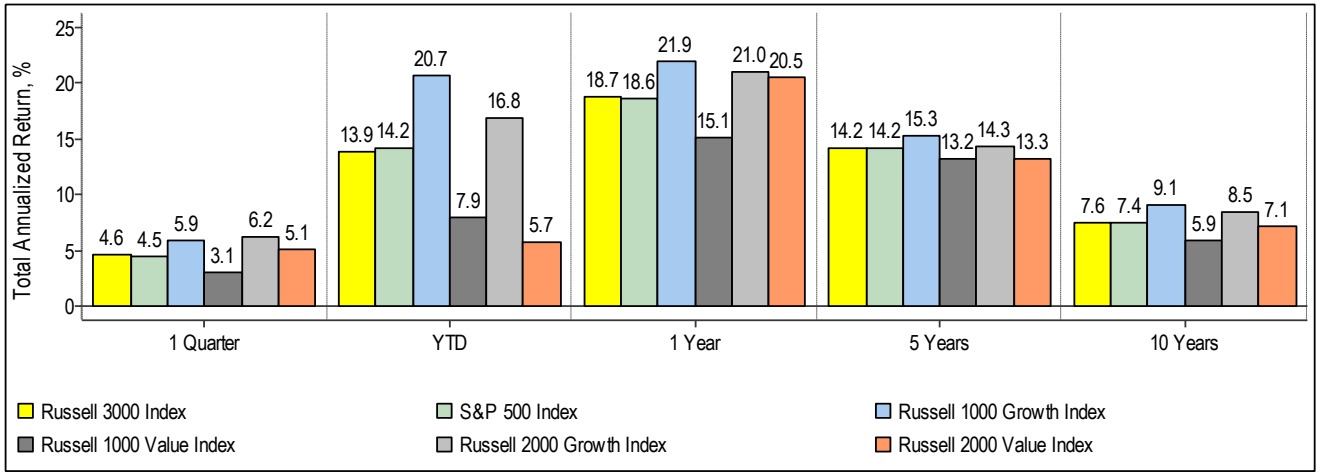
| U.S. Equity | International Equity | Fixed Income |
|---|---|---|
| U.S. equity posted a positive 4.6 percent return for the quarter (Russell 3000). All U.S. equity styles posted positive returns for the quarter as growth outperformed value. Small growth was the best performing U.S. equity style, posting a positive 6.2 percent return (Russell 2000 Growth) and large value was the worst performing style , returning a positive 3.1 percent return (Russell 1000 Value). | Developed international equity outperformed U.S. equity, returning a positive 5.5 percent (MSCI EAFE). The best performing region for the quarter was emerging markets which posted a positive 8.0 percent return (MSCI EM). Pacific ex Japan was the worst performing region, returning a positive 3.7 percent (MSCI Pacific ex Japan) for the quarter. | The broad U.S. fixed income market posted a positive 0.8 percent return (Barclays U.S. Aggregate). High yield was the best performing sector, returning a positive 2.0 percent (BC High Yield Corporate Bond). Government bond was the worst performing sector, returning a positive 0.4 percent (BC Government). |

# Market Review - 3rd Quarter 2017

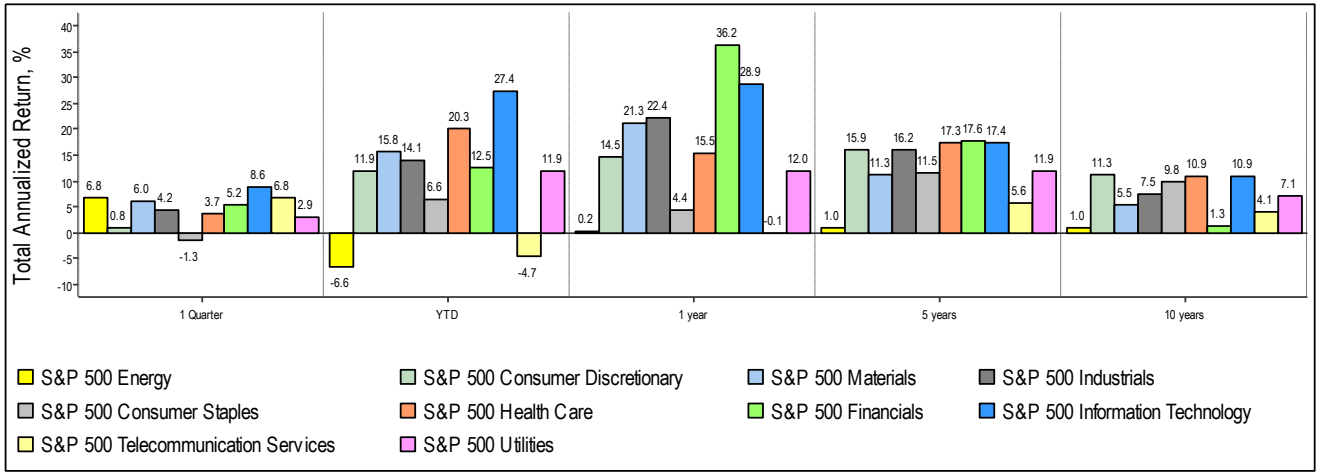
*Domestic Equity Overview*

- All U.S. equity styles were positive for the quarter
- Growth outperformed Value
  - Small growth was the best performing style, up 6.2%
  - Large value was the worst performing style, up 3.1%
- Best performing sectors for the quarter:
  - Technology, up 8.6%
  - Energy, up 6.8%
- Worst performing sectors for the quarter:
  - Consumer Staples, down 1.3%
  - Consumer Discretionary, up 0.8%

## U.S. Equity Index Performance




## U.S. Equity Sector Performance

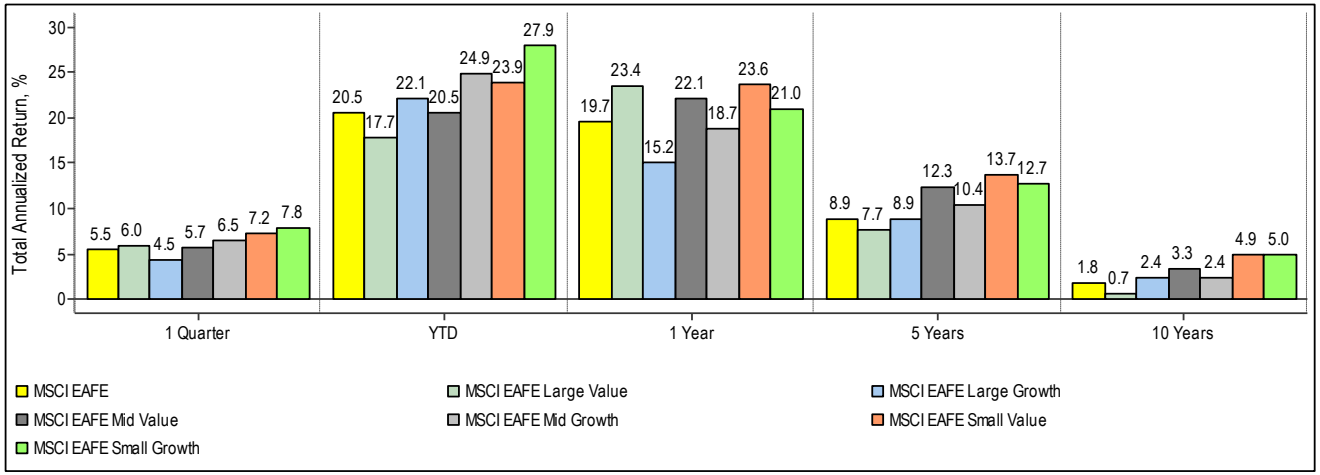


# Market Review - 3rd Quarter 2017

*International Equity Overview*

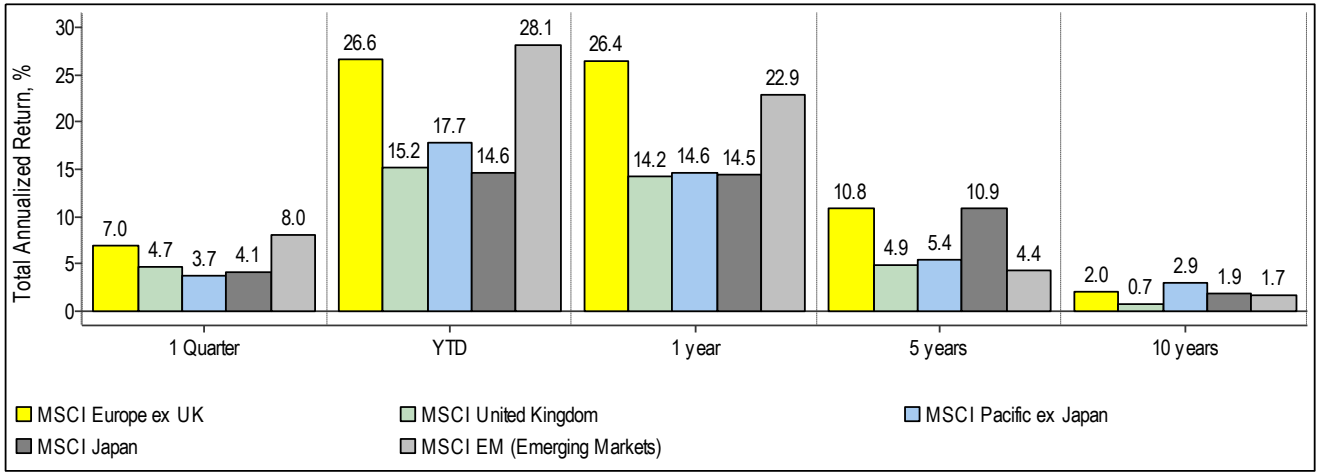
- All international equity styles posted strong returns for the quarter
- The best performing international equity style for the quarter:
  - Small growth, up 7.8%
- The worst performing style for the quarter:
  - Large growth, up 4.5%

## International Index Performance by Style and Capitalization




- Best performing region for the quarter:
  - Emerging Markets, up 8.0%
- Worst performing region for the quarter:
  - Pacific ex Japan, up 3.7%

## International Index Performance by Region

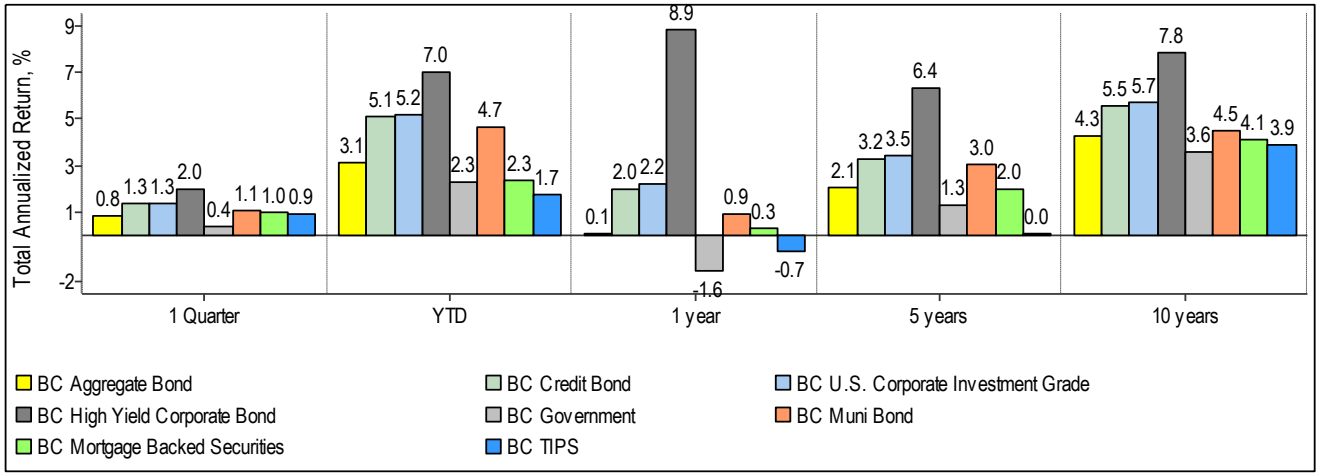


# Market Review - 3rd Quarter 2017

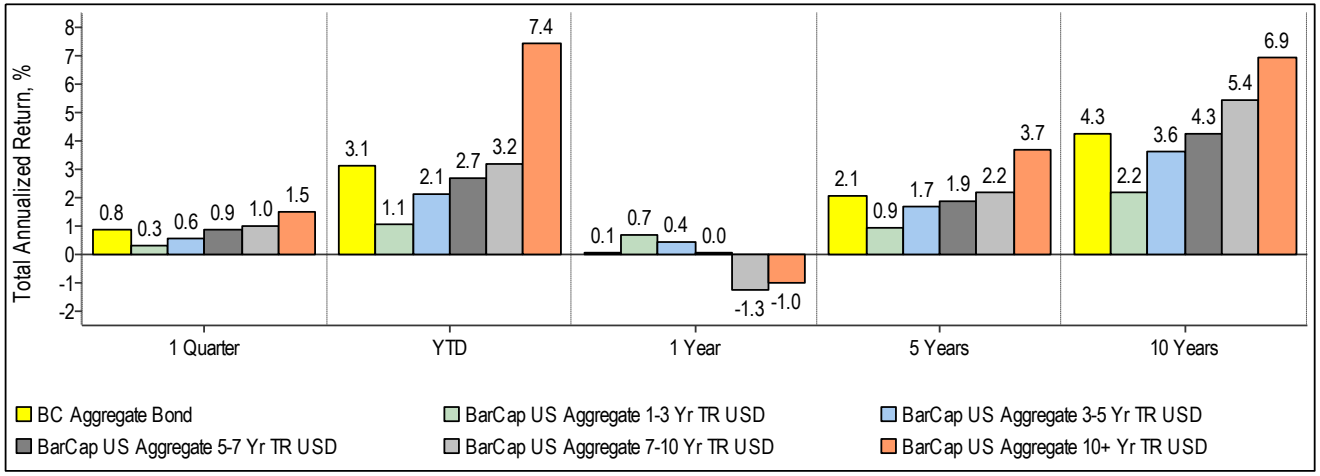
*Fixed Income Overview*

- Fixed income was slightly positive for the quarter
- The best performing sector for the quarter:
  - High Yield, up 2.0%
- The worst performing sector for the quarter:
  - Government, up 0.4%
- Performance was positive across all maturities. Longer dated maturities performed better

## Fixed Income Sector Performance




## Fixed Income Performance by Maturity



# Market Review - 3rd Quarter 2017

*Kaleidoscope: Changing Leadership*

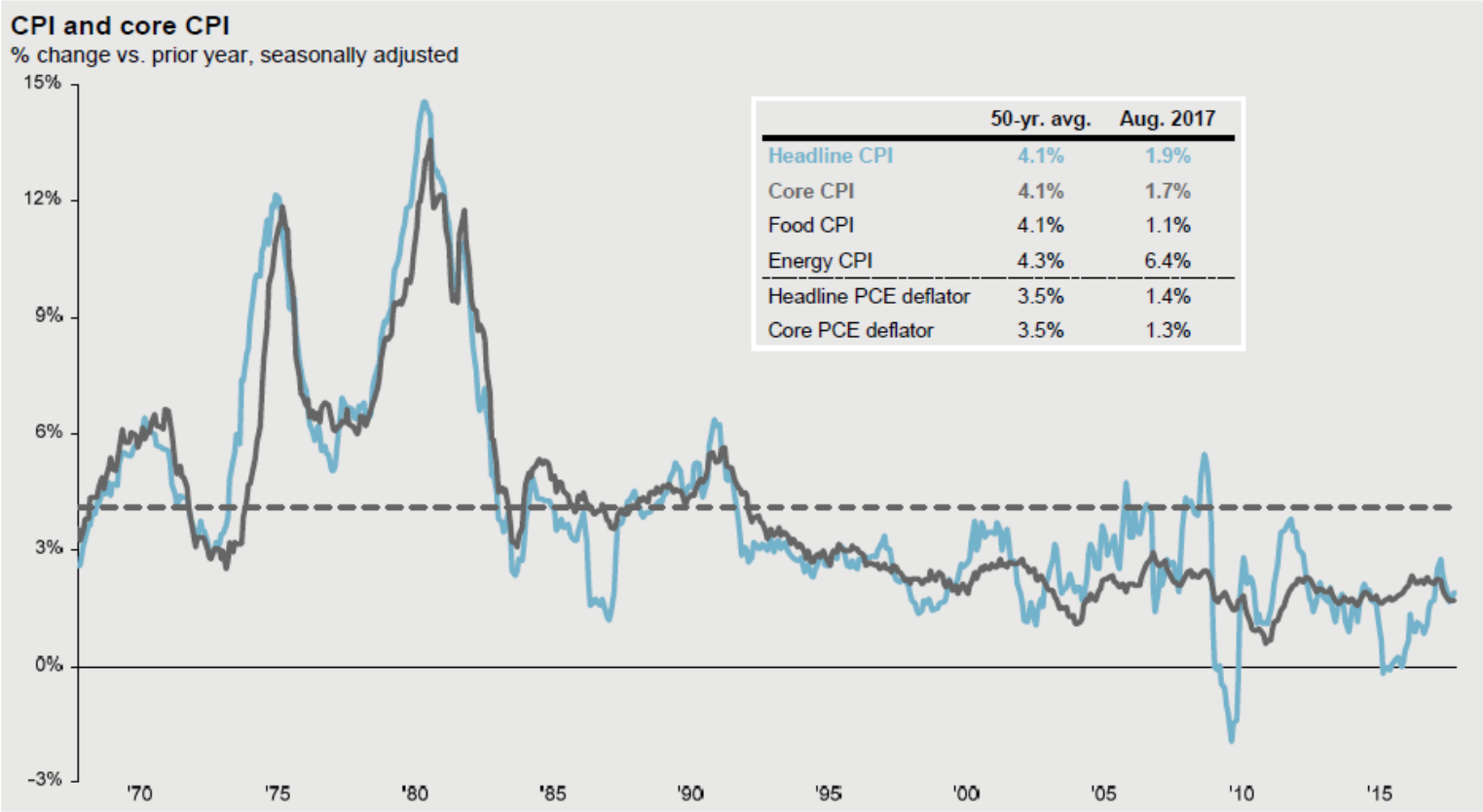
The following chart exhibits the volatility of asset class returns from year to year by ranking certain key indices in order of performance. Also included in the chart is a balanced index, which represents a mix of U.S. equity, international equity and fixed income indices. The chart graphically displays the volatility of asset class returns from year to year, highlighting the importance of diversification. Top-performing asset classes in a given year do not tend to repeat their stellar performance in subsequent years. Accordingly, the worst performing asset classes in a given year often tend to outperform in future years. Said differently, past performance is not a good indicator of future performance. Diversification, demonstrated by the balanced index, helps reduce volatility and the uncertainty that accompanies trying to pick the best asset class (or avoid the worst) in any given year.

| *2006* | *2007* | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* | *2014* | *2015* | *2016* | *YTD* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 26.86 MSCI EAFE USD | 11.81 Russell 1000 Growth | 5.24 BarCap US Agg | 37.21 Russell 1000 Growth | 29.09 Russell 2000 Growth | 7.84 BarCap US Agg | 18.05 Russell 2000 Value | 43.30 Russell 2000 Growth | 13.45 Russell 1000 Value | 5.67 Russell 1000 Growth | 31.74 Russell 2000 Value | 20.72 Russell 1000 Growth |
| 23.48 Russell 2000 Value | 11.63 MSCI EAFE USD | -22.48 Balanced Index* | 34.47 Russell 2000 Growth | 24.50 Russell 2000 Value | 3.04 Balanced Index* | 17.90 MSCI EAFE USD | 34.52 Russell 2000 Value | 13.05 Russell 1000 Growth | 0.59 Balanced Index* | 17.34 Russell 1000 Value | 20.47 MSCI EAFE USD |
| 22.25 Russell 1000 Value | 7.05 Russell 2000 Growth | -28.92 Russell 2000 Value | 32.46 MSCI EAFE USD | 16.71 Russell 1000 Growth | 2.64 Russell 1000 Growth | 17.51 Russell 1000 Value | 33.48 Russell 1000 Growth | 8.15 Balanced Index* | 0.55 BarCap US Agg | 11.32 Russell 2000 Growth | 16.81 Russell 2000 Growth |
| 13.35 Russell 2000 Growth | 6.97 BarCap US Agg | -36.85 Russell 1000 Value | 20.58 Russell 2000 Value | 15.51 Russell 1000 Value | 0.39 Russell 1000 Value | 15.26 Russell 1000 Growth | 32.53 Russell 1000 Value | 5.97 BarCap US Agg | -0.39 MSCI EAFE USD | 7.56 Balanced Index* | 10.15 Balanced Index* |
| 12.17 Balanced Index* | 6.61 Balanced Index* | -38.44 Russell 1000 Growth | 20.05 Balanced Index* | 12.47 Balanced Index* | -2.91 Russell 2000 Growth | 14.59 Russell 2000 Growth | 23.29 MSCI EAFE USD | 5.60 Russell 2000 Growth | -1.38 Russell 2000 Growth | 7.08 Russell 1000 Growth | 7.92 Russell 1000 Value |
| 9.07 Russell 1000 Growth | -0.17 Russell 1000 Value | -38.54 Russell 2000 Growth | 19.69 Russell 1000 Value | 8.21 MSCI EAFE USD | -5.50 Russell 2000 Value | 11.79 Balanced Index* | 17.42 Balanced Index* | 4.22 Russell 2000 Value | -3.83 Russell 1000 Value | 2.65 BarCap US Agg | 5.68 Russell 2000 Value |
| 4.33 BarCap US Agg | -9.78 Russell 2000 Value | -43.06 MSCI EAFE USD | 5.93 BarCap US Agg | 6.54 BarCap US Agg | -11.73 MSCI EAFE USD | 4.22 BarCap US Agg | -2.02 BarCap US Agg | -4.48 MSCI EAFE USD | -7.47 Russell 2000 Value | 1.51 MSCI EAFE USD | 3.14 BarCap US Agg |

**Balanced Index comprised of 50% Russell 3000, 10% MSCI EAFE and 40% Barclays Capital U.S. Aggregate, rebalanced quarterly.*

# Inflation

One of the unique attributes of this economic recovery has been the lack of inflation in the economy. Inflation remains below the Fed's target rate despite being multiple years into economic expansion and U.S. unemployment hitting cycle lows. As the chart of the quarter shows, Core CPI (Consumer Price Index) is tracking well below the 50-year average of 4.1 percent and the Fed's primary inflation gauge, the Core PCE (Personal Consumption Expenditure), is at 1.3 compared to their target of 2 percent.




Source: BLS, FactSet, J.P. Morgan Asset Management.
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixedweight basket used in CPI calculations.

*Source: J.P. Morgan's 4Q'17 Guide to the Markets.*

# Market Review - 3rd Quarter 2017

## Disclosures

Performance of indexes reflects the unmanaged result for the market segment the selected stocks represent. Indexes are unmanaged and not available for direct investment.
Citigroup Corporate Bond is an index which serves as a benchmark for corporate bond performance. You cannot invest directly in an index.

Citigroup Mortgage Master is an index which serves as a benchmark for U.S. mortgage-backed securities performance.

Citigroup WGBI Index is an index which serves as a benchmark for global bond performance, including 22 different government bond markets.

Credit Suisse High Yield Index is an unmanaged, trader priced index constructed to mirror the characteristics of the high yield bond market.

BC (Barclays Capital) U.S. Aggregate Bond Index represents securities that are U. S., domestic, taxable, and dollar denominated. The index covers the U. S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

BC Credit Bond Index includes publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

BC U.S. Corporate Investment Grade represents investment grade corporate securities that are U. S., domestic, taxable, and dollar denominated.

BC High Yield Corporate Bond represents below investment grade corporate securities that are U. S., domestic, taxable, and dollar denominated.

BC TIPS Index includes publicly issued U.S. government treasury inflation protected securities that meet the specified maturity, liquidity and other requirements.

BC Mortgage Backed Securities covers agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARMs) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

BC Muni Bond covers the USD-denominated long term tax exempt bond market with four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

BC Government Index includes publicly issued U.S. government securities that meet the specified maturity, liquidity and other requirements.

BarCap U.S. Aggregate 1-3 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 1 to 3 years.

BarCap U.S. Aggregate 3-5 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 3 to 5 years.

BarCap U.S. Aggregate 5-7 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 5-7 years.

BarCap U.S. Aggregate 7-10 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 7 to 10 years.

BarCap U.S. Aggregate 10+ Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over 10 years.

DJW 5000 (Full Cap) Index measures the performance of all U.S. common equity securities, and serves as an index of all stock trades in the United States.

MSCI FI Emerging Markets is a rules-based index which serves as a benchmark for emerging country fixed income performance.

MSCI FI EAFE International is a rules-based index which serves as a benchmark for developed international country fixed income performance.

MSCI EAFE Index is listed for foreign stock funds (EAFE refers to Europe, Australia, and Far East). Widely accepted as a benchmark for international stock performance, it is an aggregate of 21 individual country indexes.

MSCI EAFE Large Value represents the large cap value stocks within the MSCI EAFE Index.

MSCI EAFE Large Growth represents the large cap growth stocks within the MSCI EAFE Index.

MSCI EAFE Mid Value represents the mid cap value stocks within the MSCI EAFE Index.

MSCI EAFE Mid Growth represents the mid cap growth stocks within the MSCI EAFE Index.

MSCI EAFE Small Value represents the small cap value stocks within the MSCI EAFE Index.

MSCI EAFE Small Growth represents the small cap growth stocks within the MSCI EAFE Index.

MSCI EM (Emerging Markets) Index serves as a benchmark for each emerging country. The average size of these companies is (U.S.) $400 million, as compared with $300 billion for those companies in the World index.

MSCI World Index is a rules-based index that serves as a benchmark for the developed global equity markets.

MSCI Europe ex UK Index is a rules-based index that serves as a benchmark for the Europe's equity markets, excluding the United Kingdom.

MSCI Pacific ex Japan Index is a rules-based index that serves as a benchmark for Asia Pacific's equity markets, excluding Japan.

MSCI United Kingdom Index is a rules-based index that serves as a benchmark for the United Kindgom's equity markets.

MSCI Japan is a rules-based index that serves as a benchmark for Japan's equity markets.

Nareit All Reit Index includes all tax-qualified REITs with common shares that trade on the New York Stock Exchange, the American Stock Exchange or the NASDAQ National Market List.

3-Month T-bills (90 Day T-Bill Index) are government-backed short-term investments considered to be risk-free and as good as cash because the maturity is only three months.

Russell 1000 Growth Index is a market-capitalization weighted index of those firms in the Russell 1000 with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index is a market-capitalization weighted index of those firms in the Russell 1000 with lower price-to-book ratios and lower forecasted growth values.

Russell Top 200 Growth Index is a market-capitalization weighted index of those firms in the Russell Top 200 with higher price-to-book ratios and higher forecasted growth values.

Russell Top 200 Value Index is a market-capitalization weighted index of those firms in the Russell Top 200 with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Growth Index is a market-weighted total return index that measures the performance of companies within the Russell 2000 Index having higher price-to-book ratio and higher forecasted growth values.

Russell 2000 Index consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization.

Russell 2000 Value Index is a market-weighted total return index that measures the performance of companies within the Russell 2000 Index having lower price-to-book ratios and lower forecasted growth values.

Russell MidCap Growth Index is a market-weighted total return index that measures the performance of companies within the Russell MidCap Index having higher price-to-book ratios and higher forecasted growth values.

Russell Mid-Cap Index includes firms 201 through 1000, based on market capitalization, from the Russell 3000 Index.

Russell MidCap Value Index is a market-weighted total return index that measures the performance of companies within the Russell MidCap index having lower price-to-book ratios and lower forecasted growth values.

Russell Top 200 Index consists of the 200 largest securities in the Russell 3000 Index.

Russell 3000 Index is a market-capitalization weighted index, consisting of 3,000 U.S. common equity securities, reflective of the broad U.S. equity market.

Salomo n 1-10 Yr. Governments is an index which serves as a benchmark for U.S. Government bonds with maturities ranging from 1 to 10 years.

S&P 500 Index measures the performance of the largest 500 U.S. common equity securities, and serves as an index of large cap stocks traded in the United States.

S&P 500 Energy Index measures the performance of the energy sector in the S&P 500 Index.

S&P 500 Industrials measures the performance of the industrial sector in the S&P 500 Index.

S&P 500 Financials measures the performance of the financials sector in the S&P 500 Index.

S&P 500 Utilities measures the performance of the utilities sector in the S&P 500 Index.

S&P 500 Consumer Discretionary Index measures the performance of the consumer discretionary sector in the S&P 500 Index.

S&P 500 Consumer Staples Index measures the performance of the consumer staples sector in the S&P 500 Index.

S&P 500 Information Technology measures the performance of the information technology sector in the S&P 500 Index.

S&P 500 Materials measures the performance of the materials sector in the S&P 500 Index.

S&P 500 Health Care measures the performance of the health care sector in the S&P 500 Index.

# Disclosures

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