Economic & Market Overview

Markets drop around the world
Equities had a rough start to the fourth quarter, as widespread risk-off sentiment sent U.S. and international stocks sharply lower. Markets ignored strong economic data in the U.S., focusing instead on fears about the impact of rising interest rates, increased U.S.-China trade tensions, and future earnings uncertainty. This led to the S&P 500’s largest monthly decline in seven years. The swift change in market sentiment was especially notable in shares of widely followed technology giants, many of which saw large pullbacks amid heavy selling pressure. Foreign developed and emerging market equities trailed U.S. markets as the U.S. dollar rose to its highest level in a year. Refer to Table 1 for trailing returns across equity markets.

What worked in October?
Nine out of 11 sectors in the S&P 500 declined for the month. More defensive utilities and consumer staples sectors posted a small gain for the month. The real estate sector had modest losses but outperformed the broader market. Larger declines were seen in the consumer discretionary and energy sectors, while disappointing results from key technology companies battered that sector. Amid steep market declines investors gravitated towards larger capitalization, higher dividend yielding, and value-oriented stocks. Refer to Chart 2 for trailing returns across sectors in equity markets.

Bonds fell too
Fixed income assets were not spared in October as concerns over rising interest rates pushed bonds returns to their worst month since February. Strong U.S. economic data and concerns over the end of easy monetary policies led to a surge in yields, especially on the long end of the curve. Rates on 10-year Treasury notes rose 9 basis points to end the month at 3.14%. The weakness in the bond market was most pronounced in lower quality sectors, with high-yield bonds posting their worst monthly drop in nearly three years. Refer to Table 1 for trailing returns across fixed income sectors.

Volatility strikes again
Investors have enjoyed a prolonged period of low volatility and strong returns. Over the last few weeks, however, markets have been turbulent and weak. A similar tantrum occurred in early February this year when volatility spiked over concerns of rising inflation and wages. But markets quickly bounced back from that rout. This time investors are feeling the heat, even with a growing economy, rising incomes, positive consumer sentiment and strong earnings. Instead, they appear to be focused on heightened risks in the market. Higher interest rates, escalating trade tensions and ongoing geo-political risks are shaking investor complacency. But despite the choppy markets, economic fundamentals remain strong and market valuations are more reasonable today. Investors

(continued on back)

Student loan debt has doubled in the past 10 years, accelerating faster than other loans
As the U.S. economy rebounded strongly from the 2008-2009 financial crisis, most Americans enjoyed rising disposable incomes. But many college graduates missed out, cash strapped under the weight of growing student loans. Over 44 million Americans owe more than $1.5 trillion in student loans, double the debt 10 years ago. This growth rate is sharply higher than that of credit card debt, mortgages or even car loans. Ballooning balances and rising interest rates are making servicing the debt increasingly difficult and roughly 11% of student loans are now past due. In turn, this crisis is restricting the ability of younger Americans to save and get access to credit.

Source: Board of Governors of the Federal Reserve System
should remember that volatility is a normal part of investment markets and not necessarily an indicator of crisis.

**Earnings coming through but markets not reacting positively**

Third quarter earnings reports for S&P 500 companies through late October were very solid. Over three-quarter of companies reporting have beaten analysts’ estimates. Earnings per share growth of more than 20% year-over-year is on track to be the third largest gain in five years. Yet stock markets were in full retreat mode during October and even companies that beat expectations saw their share price fall. Investors may be focusing on the deceleration in earnings growth. Third quarter growth was actually lower than in the past two quarters. In addition, companies’ outlooks were more cautious than in past quarters, in part due to concerns about tariffs. Analysts are cutting estimates in October for the fourth quarter and full year 2019. The jolt to earnings growth from lowered tax rates will fall away in 2019. Indeed, expectations for 2019 are for continued growth but at about 10%—roughly half the growth rate in 2018. Still, equity valuations have also fallen dramatically. Lower valuations may support the market going forward if trade fears prove overdone.

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**TABLE 1 – Index Returns (%)**

Performance for periods ending October 31, 2018

<table>
<thead>
<tr>
<th></th>
<th>1-Month</th>
<th>3-Month</th>
<th>YTD</th>
<th>1-Year (annualized)</th>
<th>5-Year (annualized)</th>
<th>10-Year (annualized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Large Cap (S&amp;P 500®)</td>
<td>-6.84</td>
<td>-3.25</td>
<td>3.01</td>
<td>7.35</td>
<td>11.52</td>
<td>11.34</td>
</tr>
<tr>
<td>U.S. Small Cap (Russell 2000®)</td>
<td>-10.86</td>
<td>-9.26</td>
<td>-0.60</td>
<td>1.85</td>
<td>10.68</td>
<td>8.01</td>
</tr>
<tr>
<td>U.S. Growth (Russell 3000® Growth)</td>
<td>-9.23</td>
<td>-3.90</td>
<td>6.19</td>
<td>10.20</td>
<td>13.45</td>
<td>13.06</td>
</tr>
<tr>
<td>U.S. Value (Russell 3000® Value)</td>
<td>-5.46</td>
<td>-4.00</td>
<td>-1.52</td>
<td>2.78</td>
<td>9.02</td>
<td>8.50</td>
</tr>
<tr>
<td>Foreign Developed Markets (MSCI® EAFE®)</td>
<td>-7.96</td>
<td>-8.95</td>
<td>-9.28</td>
<td>-6.85</td>
<td>3.62</td>
<td>2.02</td>
</tr>
<tr>
<td>Foreign Emerging Markets (MSCI® EM)</td>
<td>-8.71</td>
<td>-11.65</td>
<td>-15.72</td>
<td>-12.52</td>
<td>6.52</td>
<td>0.78</td>
</tr>
<tr>
<td>U.S. Bonds (Bloomberg Barclays U.S. Aggregate)</td>
<td>-0.79</td>
<td>-0.79</td>
<td>-2.38</td>
<td>-2.05</td>
<td>1.04</td>
<td>1.83</td>
</tr>
<tr>
<td>U.S. TIPS (Bloomberg Barclays U.S. TIPS)</td>
<td>-1.43</td>
<td>-1.77</td>
<td>-2.27</td>
<td>-1.24</td>
<td>1.46</td>
<td>0.97</td>
</tr>
<tr>
<td>U.S. HY Bonds (Bloomberg Barclays U.S. HY 2% Issuer Cap)</td>
<td>-1.60</td>
<td>-0.32</td>
<td>0.93</td>
<td>0.98</td>
<td>6.60</td>
<td>4.69</td>
</tr>
</tbody>
</table>

Sources: SAAMCo and Wilshire Compass. Indices are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

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**CHART 2 - S&P 500 Sector Returns**

(Global Industry Classification Standards (GICS) sectors)

Periods ending October 31, 2018

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The price of equity securities may rise or fall because of changes in the broad market or changes in a company’s financial condition, sometimes rapidly or unpredictably.

Bonds may cause the value of your investment to go up or down in response to changes in interest rates or defaults (or even the potential for future defaults) by bond issuers.

Value Investing - The investor’s judgment that a particular security is undervalued in relation to the company’s fundamental economic value may prove incorrect.

Growth Investing - These stocks normally carry higher price/earnings ratio than many other stocks. If earnings expectations are not met, market price of growth stocks will often decline more than others stocks.

International investing involves a greater degree of risk and increased volatility. In emerging countries, these risks may be more significant.

S&P 500® Index tracks the common stock performance of 500 large-capitalization companies publicly traded in the United States.

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index and is widely recognized as representative of small-cap stocks.

Russell 3000® Growth Index measures the performance of those Russell 3000® Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 3000® Value Index measures the performance of those Russell 3000® Index companies with lower price-to-book ratios and lower forecasted growth values.

MSCI® EAFE® Index is a free float-adjusted market capitalization index designed to measure the equity market performance of developed markets. It includes stocks from 21 developed markets, but excludes U.S. and Canada.

MSCI® Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index of domestic investment-grade bonds, including corporate, government and mortgage-backed securities.

Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index is a component of the Bloomberg Barclays U.S. Corporate High-Yield Bond Index, which covers fixed-rate, non-investment grade corporate debt of issuers in non-emerging market countries. It is not market capitalization-weighted—each issuer is capped at 2% of the index.

Bloomberg Barclays U.S. Treasury Inflation Protected Securities (TIPS) Index consists of Treasury inflation-protected securities issued by the U.S. Treasury with a remaining maturity of one year or more.

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