Geo-political risks, particularly North Korea, are elevated and episodically impacting financial markets. Combining this with higher stock market valuations, some signs of late cycle economics, and a challenging legislative environment might suggest that portfolios should be underweight risk assets, such as equities. However, we remind ourselves that unpredictable geo-political events are always present and are very difficult to assess with certainty as to timing and outcome. We also believe it is possible that a series of virtuous economic and business outcomes could evolve. As a result, we believe it is still too early to be underweight equities, although we have eliminated the overweight that portfolios had previously exhibited.

The current economic cycle has been extended in large part because the recovery from the financial crisis has not been as robust as historical experience. The current cycle might be extended further if underlying business confidence remains elevated and/or continues to improve. Here is how that could happen:

- A corporate tax cut seems like a growing possibility even if the magnitude of the cut is not equal to that originally envisioned. This may also include a tax amnesty or reduced rate for offshore profits to be repatriated.

- An infrastructure plan might be implemented and could mirror the positive feedback loop that President Eisenhower's 1956 Federal Aid Highway Act created.

- Currently, Congress is not inclined towards new regulations and there is momentum towards the repeal of some existing regulations which would add to positive corporate sentiment.

Each of these steps on its own, or in aggregate, would send a message to corporate America that the environment for business is improving and strong. This in turn would lead to additional job growth and importantly an increase in capital expenditures, all of which would have a positive multiplier effect on the economy.

We do not mean to imply that any of this is a sure thing. However, a virtuous feedback loop from this positive scenario would certainly extend the current economic cycle for a period of time and push back the start of the next recession. Predicting the exact timing of a recession is a challenge, much like predicting the exact path of a hurricane. But as a hurricane's path is critical to understanding the potential for damage, the timing of recessions is important because they are the primary cause of bear markets. When we look at our recession indicators, we are hard pressed to find meaningful signals of concern either from high frequency economic data or from signs of market excesses. As a result, our view continues to be to position portfolio risk exposures at a "neutral" level, balancing the combination of risks we cited with the opportunities that can still evolve.

By necessity, portfolio positioning must take into account the current and intermediate term investment environment, while also maintaining an appreciation for longer term investment opportunities and expected returns. With this in mind, we have come to a view that over a long period of time the generation of higher returns must come from developing economies – due to a combination of better growth opportunities and lower financial obligations such as government and private debt service and entitlement programs. By definition this will require a willingness to take on additional volatility and exposure to some risk factors.

One example of investing within this framework is an Indian private equity investment we are initiating in most portfolios[1] in the second half of this year. This investment manager makes growth capital investments in relatively early stage businesses primarily in the consumer sector. As with any private equity investment, the total life of the investment strategy will be about a decade, with realizations starting earlier. Our focus on India is intentional, as we are very positive on the long-term opportunity in this country for a number of reasons:

- **Strong growth profile:** India is one of the fastest growing major economies in the world, growing GDP at over 7%, more than double the current global growth figure, and four times the OECD average. A rising middle class, increasing urbanization, and favorable demographics are driving the consumer story.

- **Favorable demographics:** India has an attractive population age profile and growth. Not only is India's population one of the largest in the world and growing (estimated to surpass China by 2025), but it is also one of the youngest. About half of India's population is under 25, giving the country a significant advantage in terms of availability of labor, productivity, and lower wage costs. This demographic profile stands in sharp contrast to every other sizable economy in the world including the U.S., Europe, Japan, and China, which are experiencing rapidly aging or declining workforces.

- **Positive policy changes:** Prime Minister Narendra Modi's ambitious policy agenda has already produced positive economic changes and a pro-business government. Key agenda items include opening up the economy to foreign investment, revitalizing domestic manufacturing, suppressing inflation, and cracking down on corruption. Since his landslide victory in the 2014 general election, Modi has achieved a series of significant reforms: the Goods and Services Tax ("GST"), demonetization, and the Real Estate Regulation Act ("RERA") to name three. India, unique in the world, has completed the digitization of nearly its entire population based on biometric and demographic data. One benefit of this project, named Aadhaar, is the enormous efficiency achieved in the delivery of financial subsidies, benefits and other services. These reforms increase India's economic growth and corporate earnings, while reducing the cost of capital.

To discover more opportunities such as this, our research efforts will continue to focus on developing regions of the world which have the growth dynamics we seek and investment managers that share our values and beliefs regarding governance and cash flows, and who seek to invest in strong business models that can compound capital at attractive rates over long periods of time.

[1] Some client portfolios may not include this investment due to investment policy guidelines or liquidity parameters.