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Monthly Economic & Capital Market Update

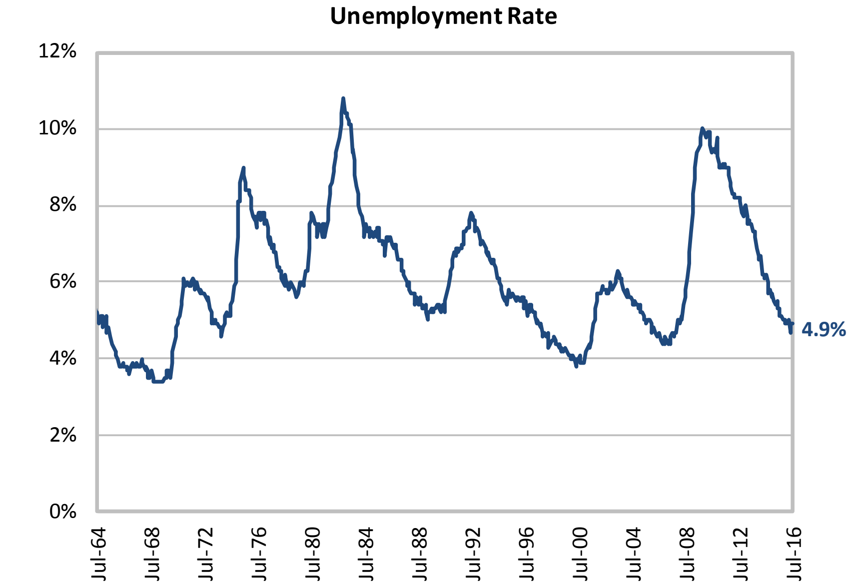
July 2016

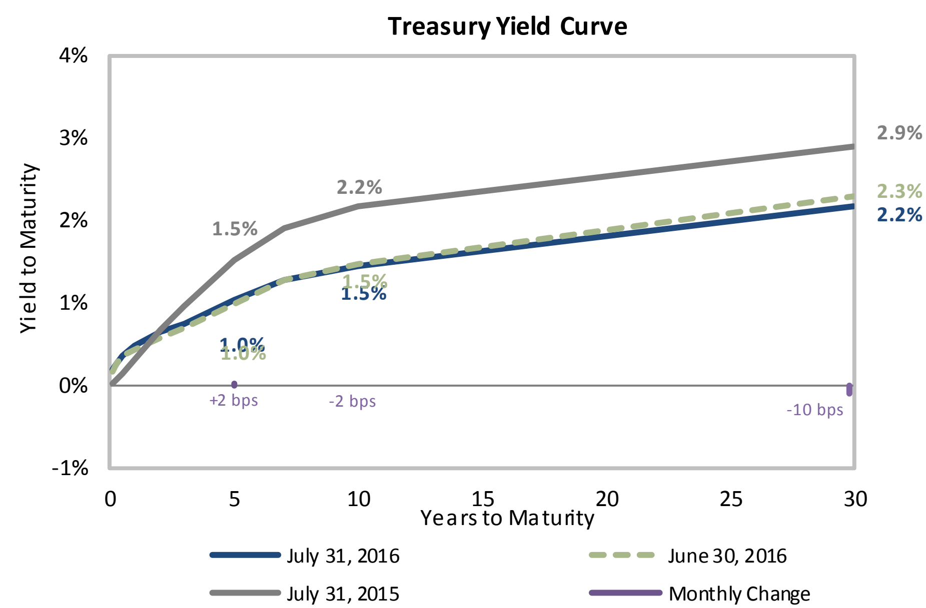
Economy

- The beginning of July was defined by uncertainty following the United Kingdom's decision to exit the European Union in June. Central bankers in developed economies around the world responded to Brexit concerns by increasing monetary policy accommodation; markets reacted positively to these developments, as evidenced by the strong equity market performance during the month. The US Federal Open Market Committee meeting in July resulted in no change in interest rates, as expected. Investors expect a very slow pace of interest rate hikes going forward, which helped stabilize equity markets following Brexit, pushed the S&P 500 to a new all-time high in July, and generated equity gains throughout the world.
- The July employment report showed continued strength in the US Labor market as employers added 255,000 payrolls, exceeding economists' expectations of 180,000 new jobs. The unemployment rate remained at 4.9% as more workers joined the labor force during the month, and reports from May and June were revised upwards by a combined 18,000 payrolls. Although job gains have averaged 186,000 per month in 2016 versus 229,000 per month in 2015, the strong pace of expansion should continue to tighten the labor market and put upward pressure on wages. For the 12 months ending July, average hourly earnings rose 2.6%, matching the highest wage growth the economy has seen over the course of the recovery.
- Real GDP grew at a 1.2% annualized rate during the second quarter of 2016, according to the Bureau of Economic Analysis. This estimate trails expectations for 2.5% growth and marks the third straight quarter below 2.0%. However, inventory drawdowns, which are volatile and affect GDP on a short-term basis, negatively impacted the second quarter figure. As inventories revert in coming quarters, they should be additive to GDP growth. Fourth quarter 2015 and first quarter 2016 growth were 0.9% and 0.8%, respectively.

Yield Curve

- The spread between 2-year and 30-year Treasuries narrowed 17 bps to 153 bps in July, below the 30-year average spread of 166 bps.





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Public Equities

- Global equity markets posted positive returns, rebounding from June's post-Brexit declines. In the US, the S&P 500 gained 3.7% and small caps outperformed large with the Russell 2000 gaining 6.0%. After underperforming in June, international developed markets outperformed their domestic peers with the MSCI EAFE Index returning 5.1% and the MSCI EAFE Small Cap Index returning 6.1%. Emerging markets continued to add to their year-to-date gains, returning 5.0% for the month.
- Master limited partnerships (MLPs) gained for the fifth straight month in July despite the 13.9% decline in crude oil prices. The recent decoupling of MLP performance and oil price changes comes as an encouraging sign for MLP investors, as the two had been highly correlated for the past two-plus years.

Public Debt

- High yield bonds also disconnected from energy during the month. The energy sector of the Barclays High Yield Index returned 0.9%, and the overall Index gained 2.7%. Energy sector gains have been a significant driver of returns year-to-date within high yield, and the asset class has been among the top performers over this period as well.
- Local currency emerging market debt posted another positive returning month, bringing the year-to-date return to 14.7%. Declining yields as well as positive currency performance have both contributed to asset class gains in 2016.

Private Equity

- Larger deals continue to sell for relatively higher price multiples with the average over the first half of 2016 greater than the 2015 average, although there was a decrease in the second quarter of 2016. In contrast to this, deals involving companies that have less than $50m in EBITDA experienced significantly lower multiples in the second quarter, with an average of 7.2x for the period; this is dramatically lower than the 10.7x average experienced in 2015. Data and manager sentiment suggest the lower multiples in the middle market demonstrate managers staying disciplined on pricing and walking away from deals with higher valuations, causing fewer deals to be completed.

Private Debt

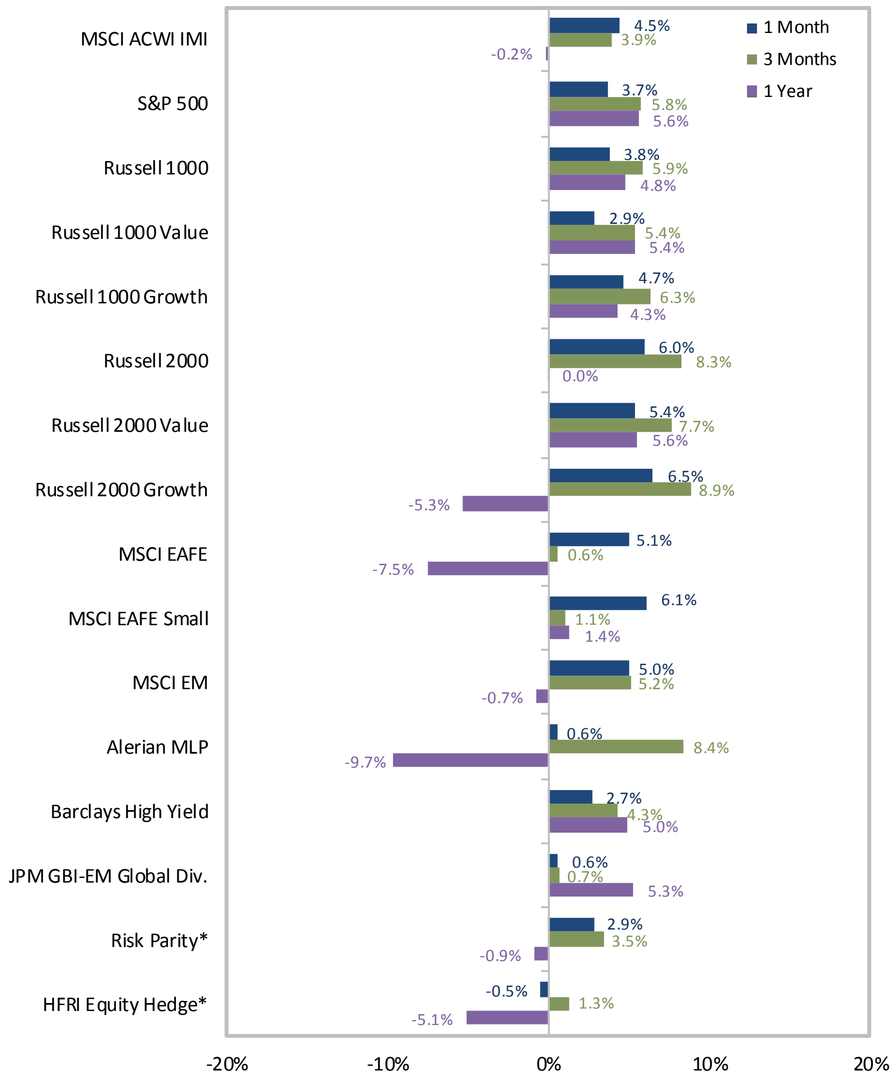
- Debt multiples suggest a similar dichotomy between middle market deals and larger deals. Average debt multiples for deals larger than $50m in EBITDA essentially held constant with the multiples experienced in 2015 while deals in the middle market decreased markedly from 5.3x to 4.3x over the first half of 2016.

Risk Parity

- Risk parity strategies were positive in June, with strong contributions from nominal and inflation-linked bonds. Commodities also contributed, while equities and credit were slightly negative.

Growth Hedge Funds

- Growth hedge funds declined in June. Long/short equity strategies were negative, with the largest losses coming from fundamental value strategies. Activist and merger arbitrage strategies also detracted, while distressed strategies were positive.



* Data was not available at time of publication – returns are previous month's.
Note: Risk Parity returns are based on an internally comprised benchmark.
All returns are USD.

Public Debt

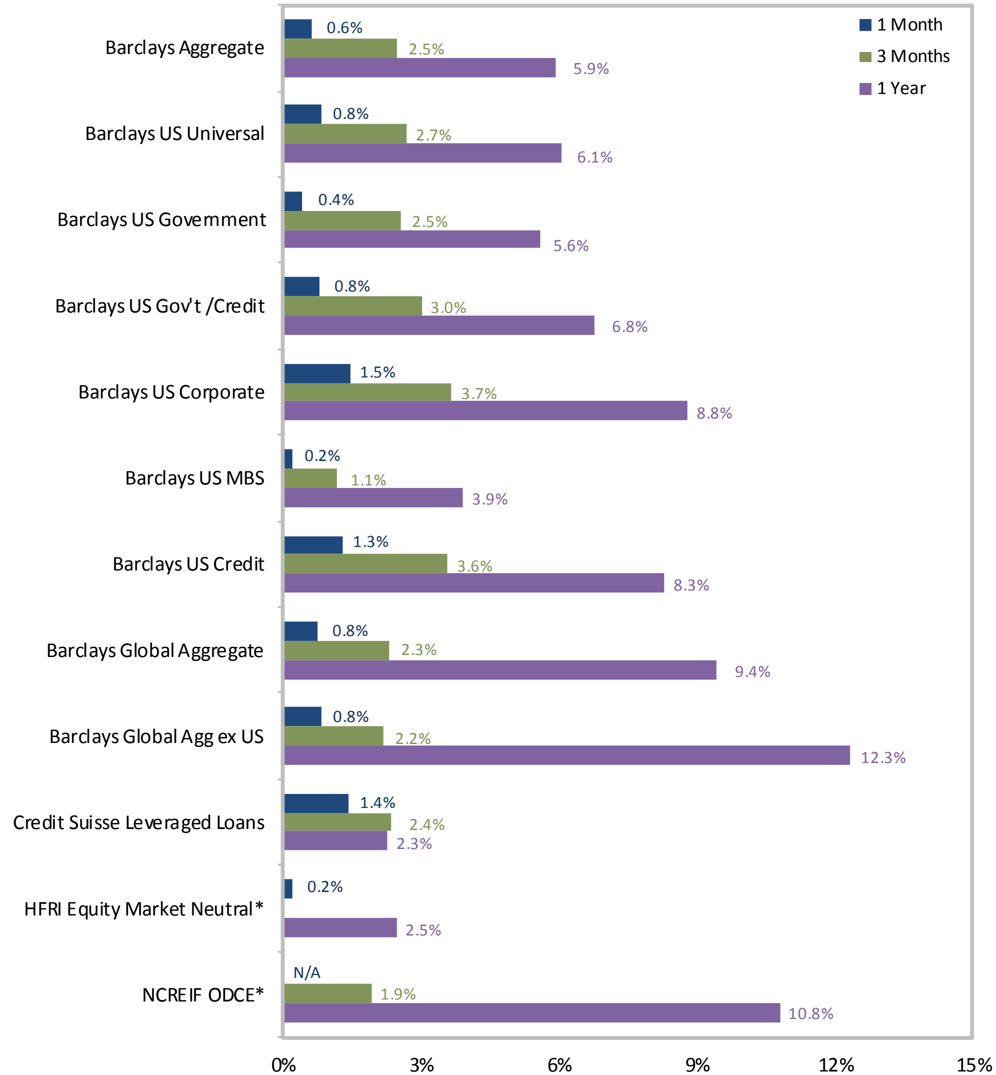
- 10-year Treasury yields reached all-time lows in early July as investor expectations for growth and inflation remain muted. Core fixed income strategies have performed well over the past year despite the low level of yields, with the Barclays Aggregate gaining 5.9% over this period.
- The investment grade corporate portion of the Barclays Aggregate returned 1.5% during July, outperforming duration-neutral treasuries by 81 bps during the month. Corporate bond spread declined 11 bps to 145 bps, near the 20-year average of 138 bps.
- Securitized assets were contributors to the Aggregate during the month, with MBS and CMBS outperforming Treasuries while ABS underperformed.
- International bonds returned 0.8% during July as rates continued to fall around the globe. International bonds are the second best performing asset class in fixed income year-to-date, only being outperformed by local currency emerging market debt. However, a large percentage of outstanding international bonds are trading at negative yields, an indicator of limited return potential looking forward.
- Bank loans generated a positive return of 1.4% during the month as discount margins continued to compress, decreasing from 581 bps at the end of June to 537 bps in July.

Relative Value Hedge Funds

- Income hedge funds gained in June. Equity market neutral and most credit-related strategies were positive, while volatility arbitrage strategies detracted.

Core Real Estate

- The second quarter NCREIF ODCE Index return is 2.1% gross, 1.9% net. 110 bps of the return is comprised of income, with appreciation making up the other 100 bps. While these returns reflect a drop in appreciation from previous quarters they remain in line with historic norms. 76 consecutive months of job growth in the US have been a tailwind for core real estate returns.



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Diversification Assets

July 31, 2016

Inflation

- TIPS returned 0.9% in July as 10-year breakeven inflation expectations increased modestly, rising 6 bps during the month. Despite the increase during July, market expectations for inflation remain near all-time lows.

Deflation

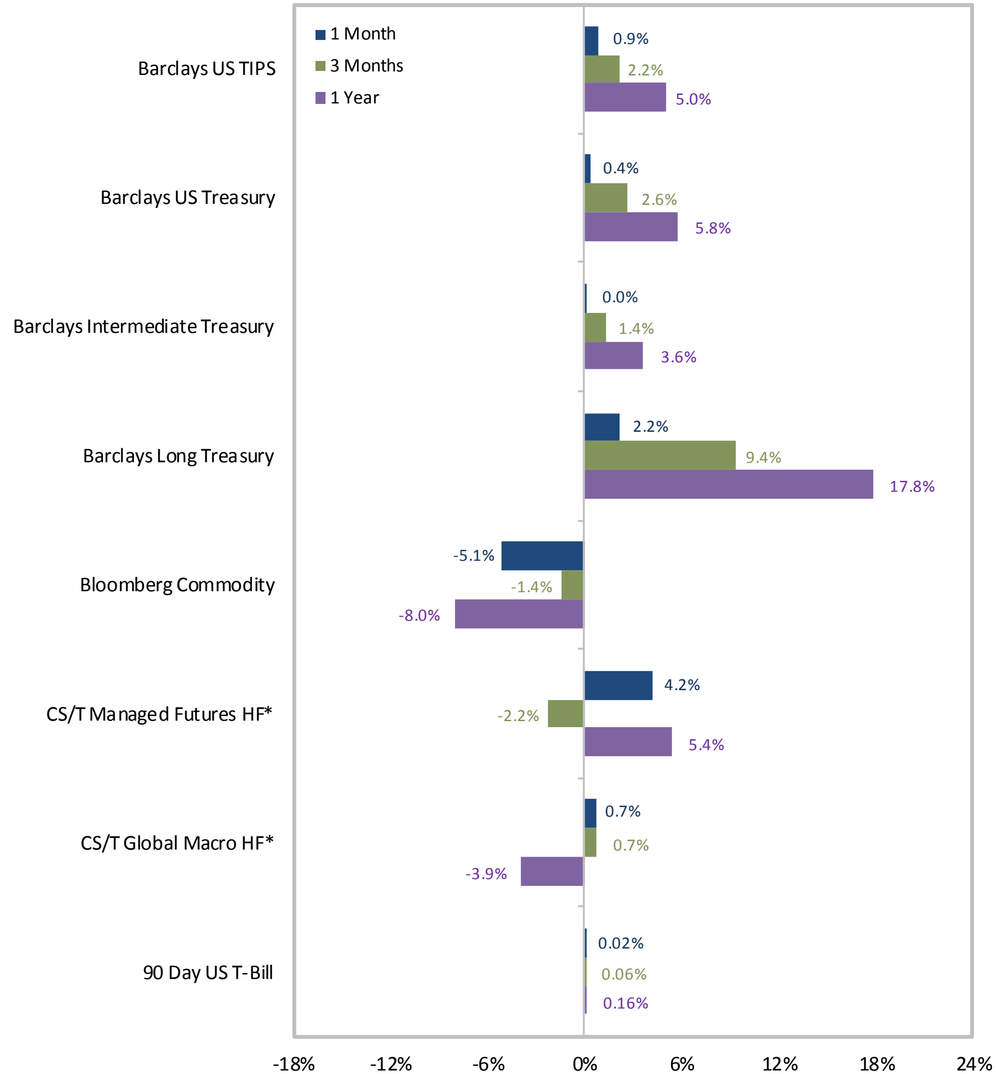
- The Barclays Long Treasury Index returned 2.2% as yields declined along the long end of the curve. The 30-year Treasury yield reached an all-time low during July and ended the month yielding 2.2%, 6 bps lower than the end of June.

Commodities

- The Bloomberg Commodity Index declined 5.1% during the month. Energy underperformed during July as WTI Crude oil declined 13.9% and gasoline was down 12.0%. Major metals such as gold, silver, and nickel continued their advance at 2.2%, 9.3% and 12.6%, respectively. Soybeans declined in July by 12.1%, following last month's gain due to lower South American production expectations and strong overall demand.

Tactical Trading

- Diversification hedge funds posted strong gains in June. CTAs drove performance, while discretionary global macro strategies were also positive.



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