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Monthly Economic & Capital Market Update

May 2017

Economic Perspective

May 31, 2017

Economy

- Rising global economic growth has helped lift equity markets in 2017, a trend that continued during May. Strong corporate earnings, high consumer and business confidence, and accommodative central banks have helped fuel the global equity rally this year, with MSCI ACWI IMI gaining 2.0% in May and 10.7% year-to-date.

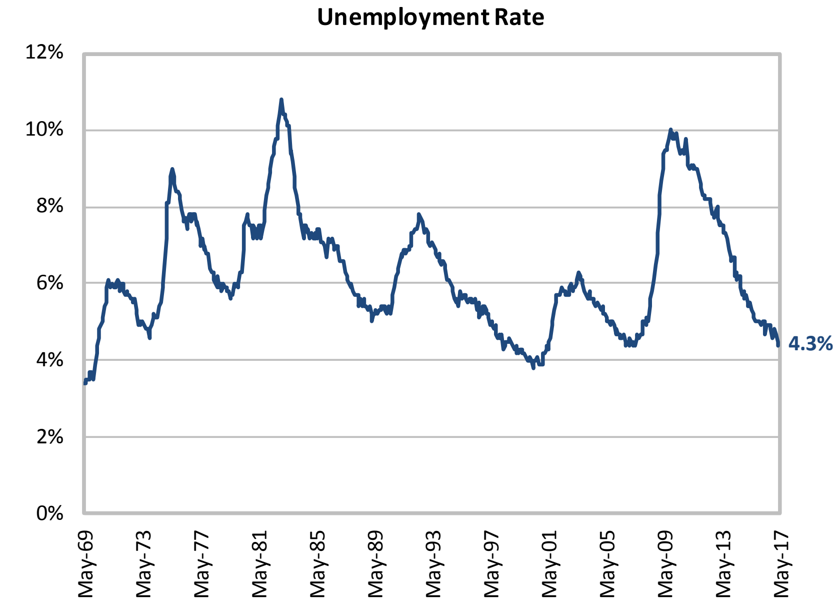
- The US economy experienced positive job growth for the 80th consecutive month in May as employers added 138,00 new payrolls, falling short of economists' expectations of 174,000 new jobs. The unemployment rate declined 10 bps to 4.3%, its lowest level since May 2001. Wage growth, as measured by the change in average hourly earnings of private sector workers, was 2.5% over the 12 months ending in May, unchanged month-over-month. Payrolls from March and April were revised downward by 66,000 total jobs. Over the past three months, job gains have averaged approximately 121,000 per month.

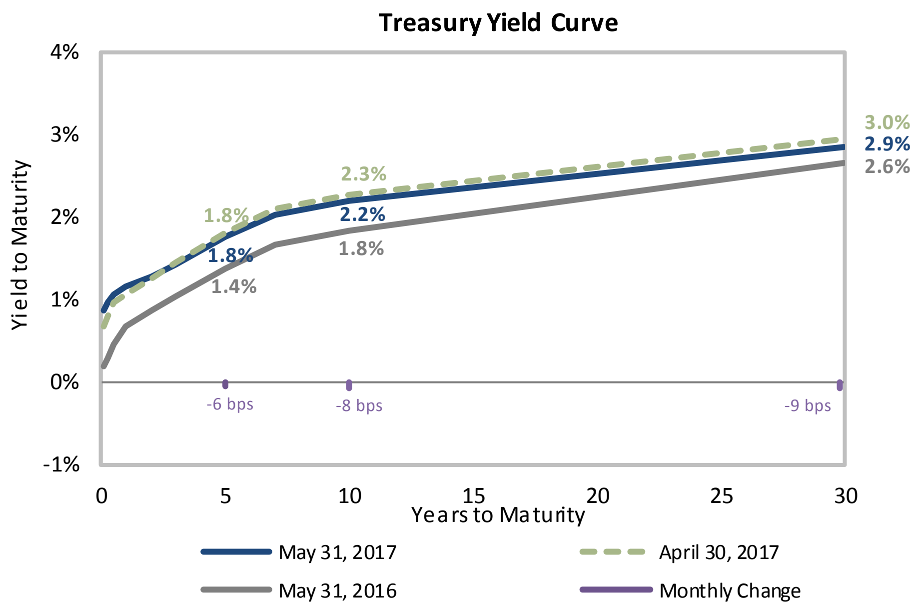
- Real GDP grew at a 1.2% annual rate during the first quarter of 2017, according to the second estimate released by the Bureau of Economic Analysis. The estimate was revised upward from the "advance" estimate of 0.7%, reflecting positive changes in nonresidential fixed income, personal consumption, and state and local government spending. GDP growth for Q2 2017 is estimated to be 3.8% annualized according to the Atlanta Federal Reserve.

- Economic activity in both the manufacturing and services sectors continues to expand, as measured by purchasing managers indices (PMI). The US ISM Manufacturing PMI came in at 54.9 in May, up 0.1 from April; an Index reading over 50 suggests expansion in the sector. Manufacturing has now been a boost to US growth for nine consecutive months, following a period during which slowing trading partner growth and a strong US dollar weighed on US manufacturing. The Non-Manufacturing (or services) PMI remains strong, led by consumer spending; US services have expanded 88 consecutive months.

Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 11 bps to 158 bps in May. Over the past two years the 2-30 spread has tightened by 70 bps, with the long end of the curve mostly unchanged while short-term yields have been lifted by Federal Reserve rate hikes. The 20-year average spread between 2-year and 30-year Treasuries is 190 bps.





Growth Assets

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Public Equities

- Improving conditions outside the US has resulted in outperformance for international stocks versus their domestic counterparts in 2017. During May, developed international (MSCI EAFE, +2.5%) and emerging markets (MSCI EM, +2.2%) once again outperformed the US (Russell 3000, +1.0%). The results of the French presidential election, which saw the pro-euro candidate defeat the euro-skeptic candidate, boosted European stocks given that in recent months concerns have been rising with regard to the long-term viability of the eurozone.
- Master limited partnerships (MLPs) returned -4.5% in May. All sectors except exploration and production (E&P) experienced negative returns for the month, as distribution yields for the Alerian MLP Index rose 30 bps to 7.0%.

Public Debt

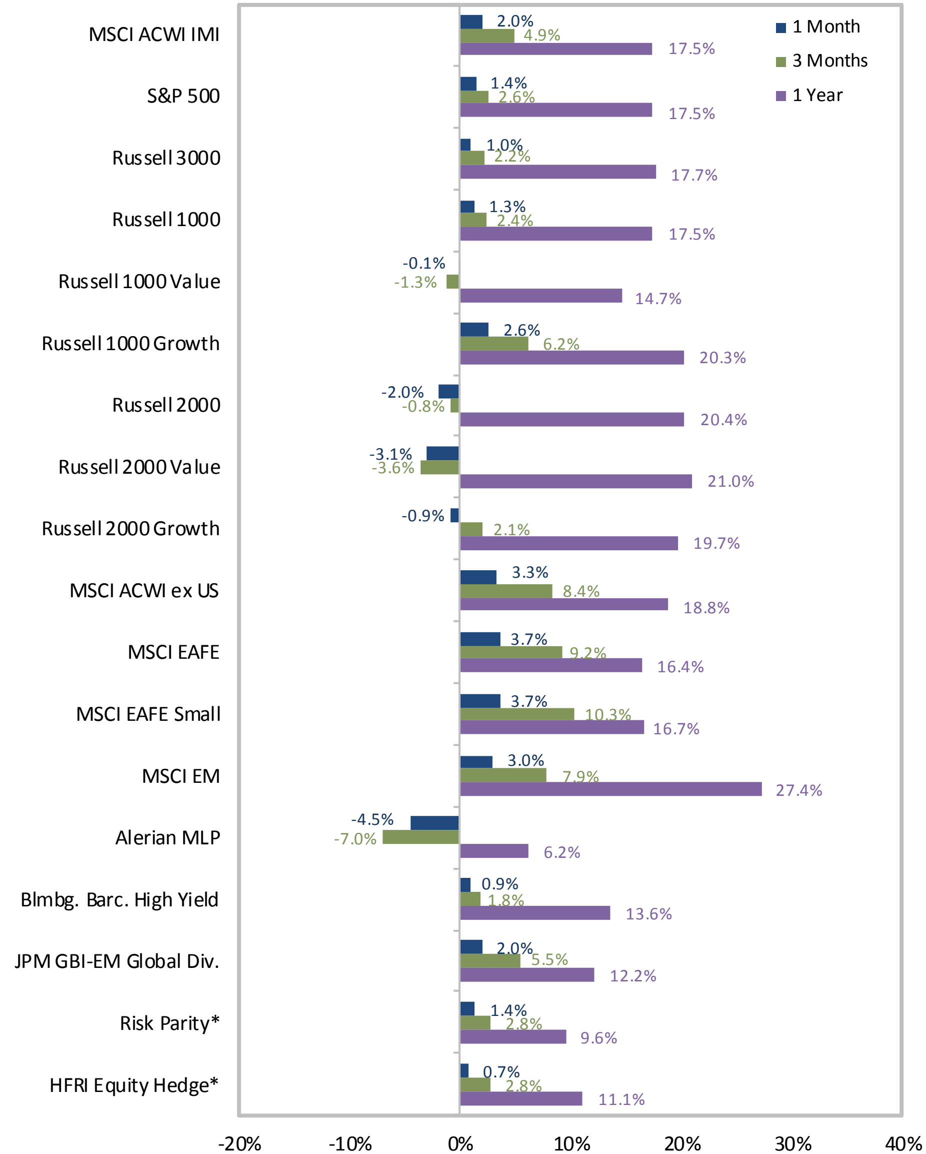
- The Bloomberg Barclays High Yield Index returned 0.9% during May, bringing YTD returns to 4.8%. Spreads continued to tighten, decreasing by 7 bps to 363 bps at month end. High yield spreads have tightened considerably over the past several months; the Index option-adjusted spread was 594 bps at the end of June 2016.
- Local currency-denominated emerging market debt gained 2.0%, with currency and local rates contributing to the positive returns. South American countries were underperformers, while Eastern European countries outperformed.

Private Assets

- The strong fundraising environment for private equity has continued into 2017, as the industry is likely to have seen the highest levels of first quarter capital raising since the global financial crisis. Preqin expects Q1 fundraising to surpass the $90b raised by funds closed in Q1 2016. Purchase price multiples for middle-market LBOs, as measured by S&P Leveraged Commentary and Data (S&P LCD), have remained relatively stable from 2016 at 9.6x YTD.
- In Q1 2017, private debt funds raised a total of $21b, surpassing last year's Q1 level of $11b, as the momentum for direct lending strategies continued; direct lending funds accounted for 62% of total capital raised. Nearly two-thirds of all private debt funds closed during the quarter exceeded their target size.

Hedge Funds

- Risk parity performed well in April, with the largest gains coming from nominal bond positions. Equities and credit also contributed, while commodities detracted.
- Growth hedge fund strategies also gained in April. Equity long/short, activist, merger arbitrage, and distressed debt strategies were all broadly 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

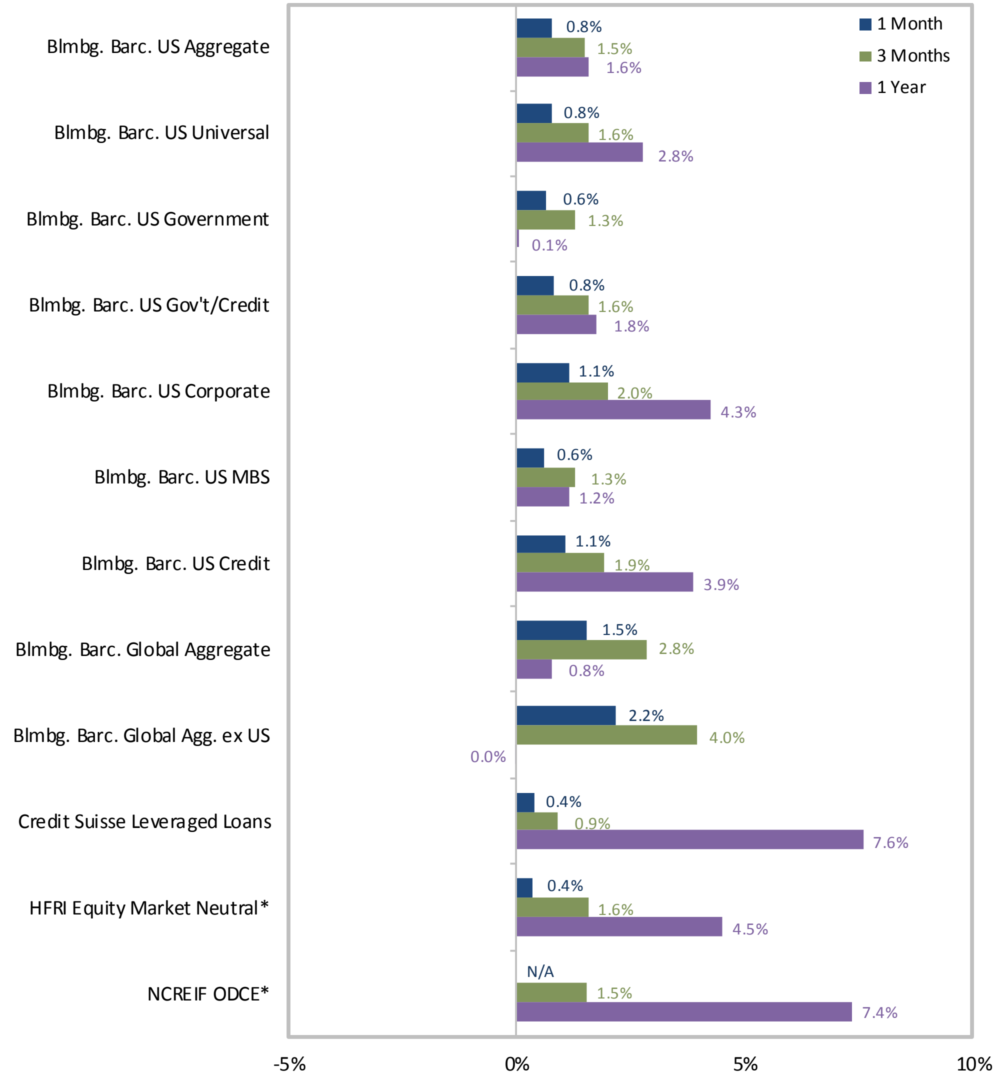
- The 10-year US Treasury yield continued to be volatile, trading within a range of 21 bps and ending the month at 2.21%; the year-to-date low for the 10-year yield was 2.18% in April, while the high was 2.63% in March. Each month in 2017 has seen yield swings of over 20 bps.
- The Bloomberg Barclays Aggregate generated returns of 0.8% during the month. Two-year yields rose by 2 bps while 30-year yields fell by 9 bps, causing the long duration portion of the Index to outperform shorter duration.
- With regard to international bonds, the Bloomberg Barclays Global Aggregate ex US continued to generate positive returns from both price and currency. The Index returned 2.2% for the month and has gained 4.0% over the past three months.
- The Credit Suisse Leveraged Loan Index returned 0.4% for the month, relatively muted gains compared to other below investment grade fixed income. May marked the lowest institutional loan issuance of any month year-to-date, as refinancings have slowed. The trailing 12-month default rate in loans has remained relatively constant year-to-date at 1.5%, approximately in-line with forecasts.

Relative Value Hedge Funds

- Relative value hedge funds gained in April, with gains distributed across strategies. Relative value credit and volatility were the strongest performers, while equity market neutral strategies were modestly positive.

Core Real Estate

- Core real estate returns for the first quarter of 2017 were 1.8% gross, 1.5% net, bringing the one-year gain for core funds to 7.4%. Continued strong gains in the commercial real estate market have coincided with the US economic expansion, with strong labor market growth fueling demand while supply remains limited. Of note is that in recent quarters price appreciation has slowed compared to prior in the expansion, with a larger percentage of real estate gains now being generated through income.



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Diversification Assets

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Inflation

- TIPS were mostly unchanged during May, but have benefited from declining real yields in 2017. For the month, 10-year breakeven inflation expectations declined 9 bps to 1.83%, their lowest month-end level of 2017.

Deflation

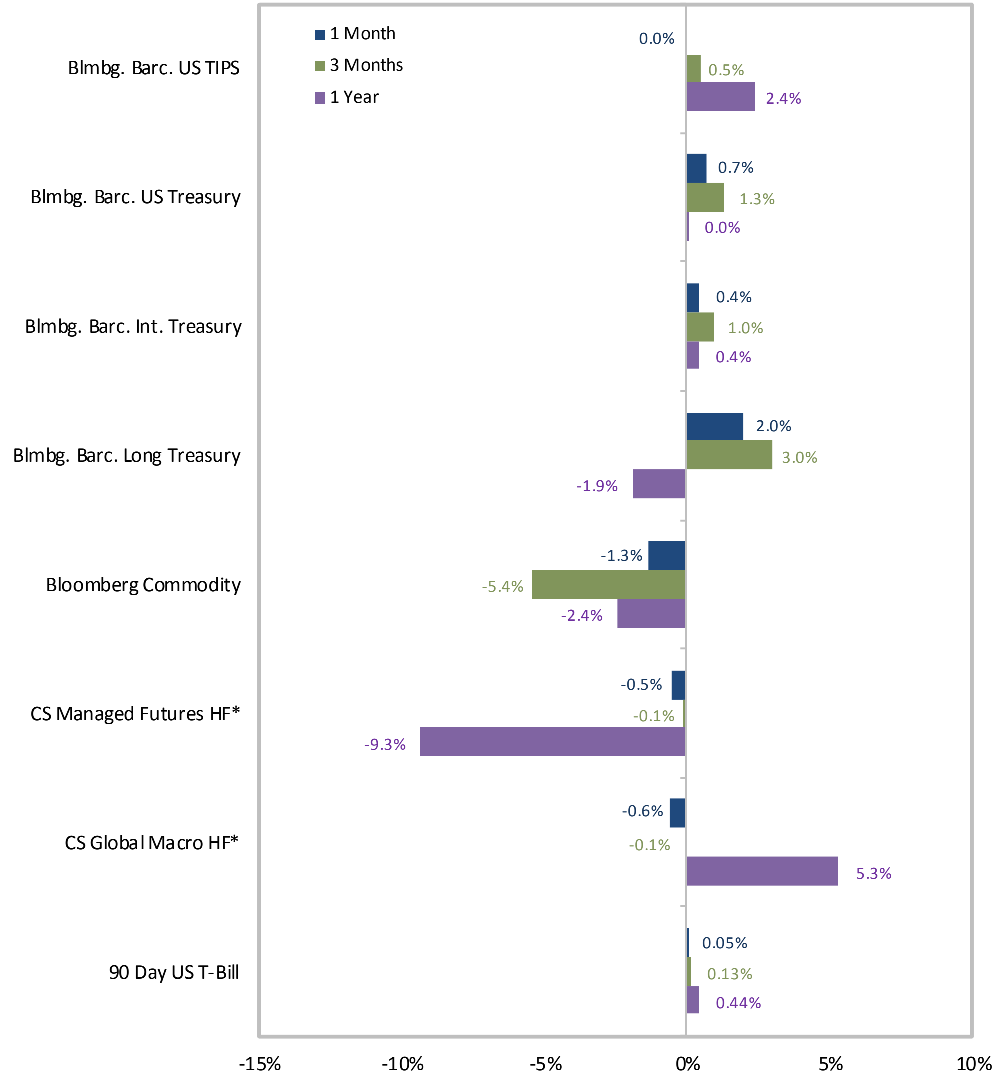
- The Bloomberg Barclays Long Treasury Index returned 2.0% for the month, 170 bps of which can be attributed to price return. Over the past year, 30-year Treasury yields have risen 21 bps to 2.86%.
- Cash continues to offer low returns, as 90-day T-bills gained 5 bps during May and 44 bps over the past year.

Commodities

- The Bloomberg Commodity Index returned -1.3% during May. Performance was driven by weak returns across several sectors with the largest underperformers being live cattle, sugar, and natural gas. Despite OPEC's agreement to extend production cuts to March 2018, the energy sector underperformed for the month, with natural gas returning -6.3% and Brent Crude Oil and WTI Crude Oil declining over 2% each. The Bloomberg Commodity Index returned -2.4% for the trailing year, with grains being the main detractor from performance.

Tactical Trading

- Tactical trading strategies declined in April. CTAs detracted on negative trend-following performance, while the average discretionary global macro manager also declined.



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