



***Summit Strategies Group***

*8182 Maryland Avenue, 6th Floor*

*St. Louis, Missouri 63105*

*314.727.7211*

**Monthly Economic & Capital Market Update**

*September 2016*

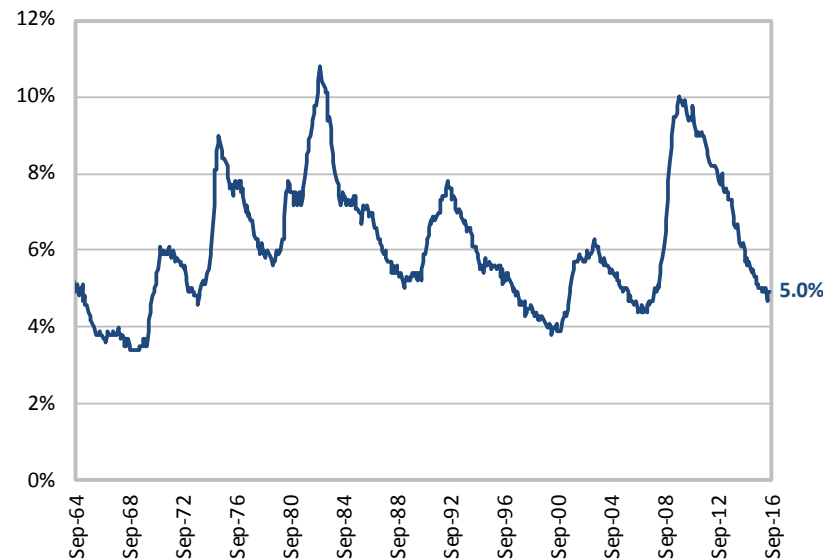
## Economy

- September proved to be a relatively uneventful month for the economy and markets. The US Federal Reserve met and did not raise interest rates, as expected. Market-implied interest rate projections at the end of September suggested an approximately 60% chance the Fed raises rates in December (up 10 percentage points since August). While the next move from the Fed is likely to be an interest rate increase, central banks outside the US, particularly in Europe and Japan, are continuing to increase monetary policy accommodation. In this regard, the Bank of Japan increased the scope of its quantitative easing to include a target rate of 0% on 10-year Japanese government bonds during September.
- The US economy saw positive job growth for the 72nd consecutive month in September, adding 156,000 payrolls during the month. Despite September's figure coming in below economists' expectations of 175,000 new jobs, the labor market continues to expand at a pace that is likely to put upward pressure on inflation in coming months. Wages, as measured by average hourly earnings of private-sector workers, rose 2.6% over the 12 months ending September, matching the highest wage growth of the expansion. Historically there has been a strong relationship between wage growth and inflation in the US, as consumer spending is the biggest driver of changes in GDP and inflation. The unemployment rate and labor force participation rate both rose 10 basis points to 5.0% and 62.9%, respectively, and payrolls from July and August were revised downward by 7,000 total jobs.
- Real GDP grew at a 1.4% annualized rate during the second quarter of 2016 according to the final estimate from the Bureau of Economic Analysis. This estimate was above expectations for 1.2% growth, yet it marks the third straight quarter of growth below 2.0%. An increase in consumer spending contributed to the increase in real GDP but was modestly offset by drawdowns in inventory, as GDP less inventory investment increased 2.6% in the second quarter.
- The ISM non-manufacturing Purchasing Managers Index report rose to 57.1 in September, exceeding expectations of 53.0 and suggesting that August's figure of 51.4 was likely an outlier. The 5.7 point increase from last month is the largest increase on record for the Index, which uses 50.0 as a neutral reference point, or level of zero demand growth. September marked the 80th consecutive month of growth in the US services sector.

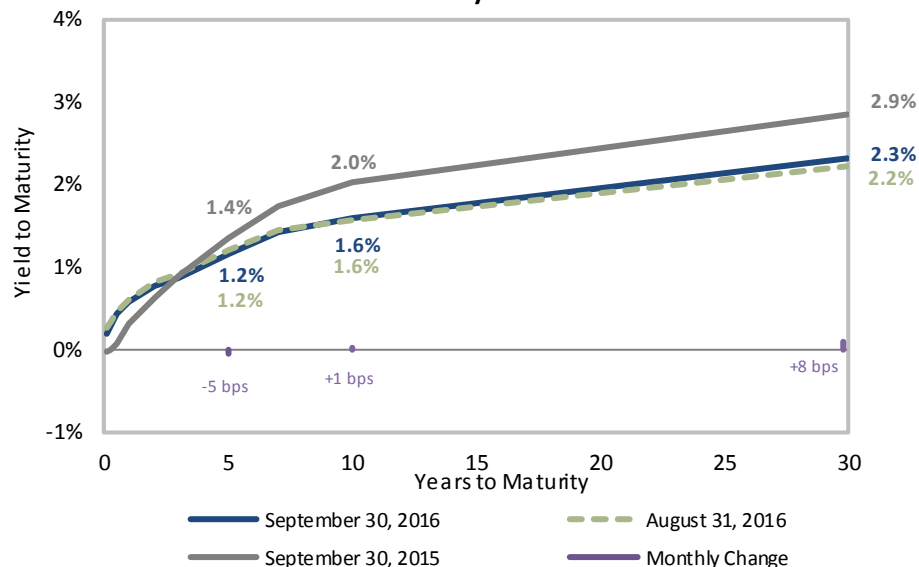
## Yield Curve

- The yield curve was mostly unchanged during September. The spread between 2-year and 30-year Treasuries expanded 12 bps to 155 bps in September, remaining below the 30-year average spread of 167 bps.

### Unemployment Rate



### Treasury Yield Curve



# Growth Assets

September 30, 2016

## Public Equities

- During the month of September global equity markets were positive across the board. Within the US market, small cap stocks outperformed their larger counterparts by 100 bps, bringing the one-year outperformance of small cap over large cap to 60 bps. International markets outperformed the US, with the MSCI EAFE Index and the MSCI EAFE Small Cap Index ending the month up 1.2% and 3.0%, respectively. As commodities continued to rebound, specifically oil, emerging markets continued to perform well, posting a return of 1.3% for the month.
- Master limited partnerships (MLPs) were up 1.9% for the month of September, regaining ground after returning -1.3% in August. Energy services were the biggest contributor for the month and year-to-date periods, returning 8.2% and 56.9%, respectively. The downstream sector was the only negative performer for the month, returning -3.6%; year-to-date downstream remains down -5.2%. MLP year-to-date returns were 15.9% as of the end of September.

## Public Debt

- High yield continued its impressive 2016 run, posting gains for the seventh straight month. Spreads continued to tighten across the board, coming in by 7 bps.
- Local currency-denominated emerging market debt was the best-performing fixed income asset class for the month, with the index returning 2.1%. Yield compression was the primary driver of returns, with currency appreciation contributing as well.

## 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

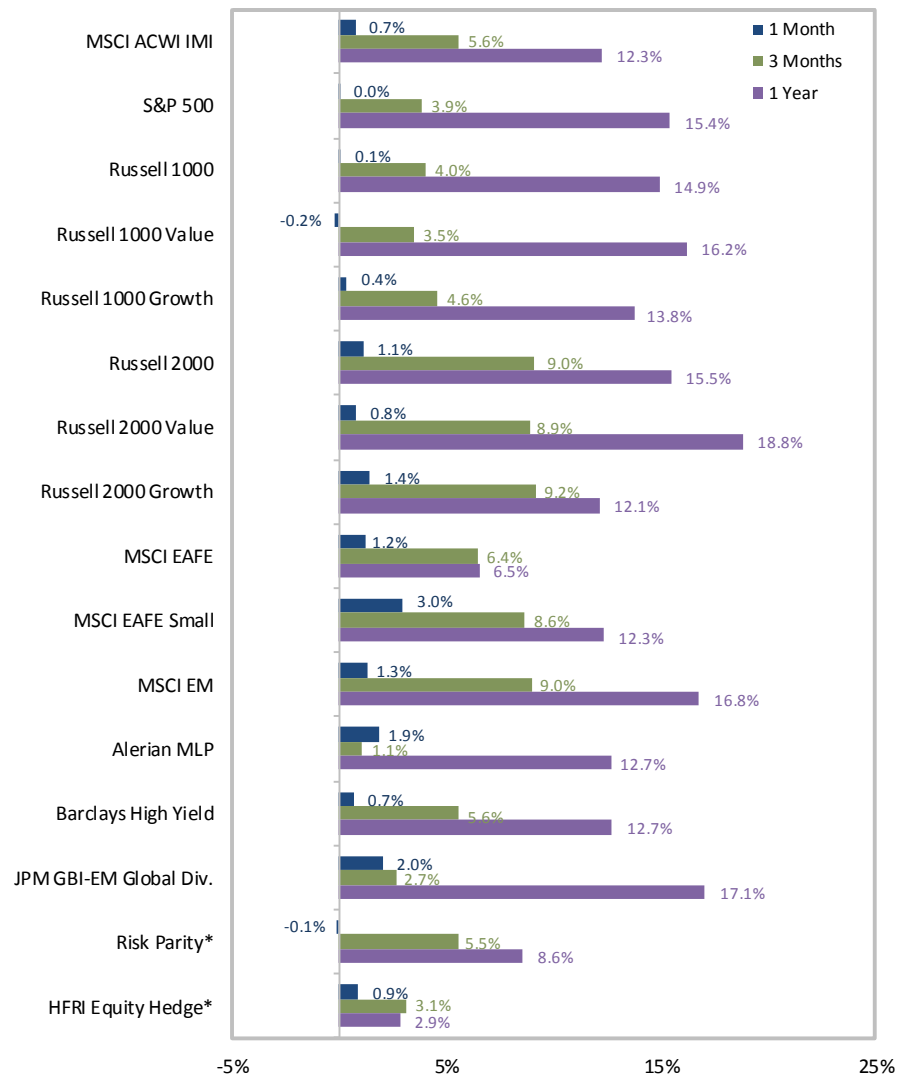
- Debt multiples suggest a similar dichotomy between middle market deals and larger deals. Average debt multiples for deals larger than \$50m in EBITDA essentially held constant with the multiples experienced in 2015 while deals in the middle market decreased markedly from 5.3x to 4.3x over the first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

## Risk Parity

- Risk parity strategies saw modest declines in August. Nominal bonds and commodities detracted while equities contributed.

## Growth Hedge Funds

- Growth hedge funds contributed gains in August, led by activist and distressed strategies. Long/short equity also performed well, particularly value-oriented funds.



\* 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

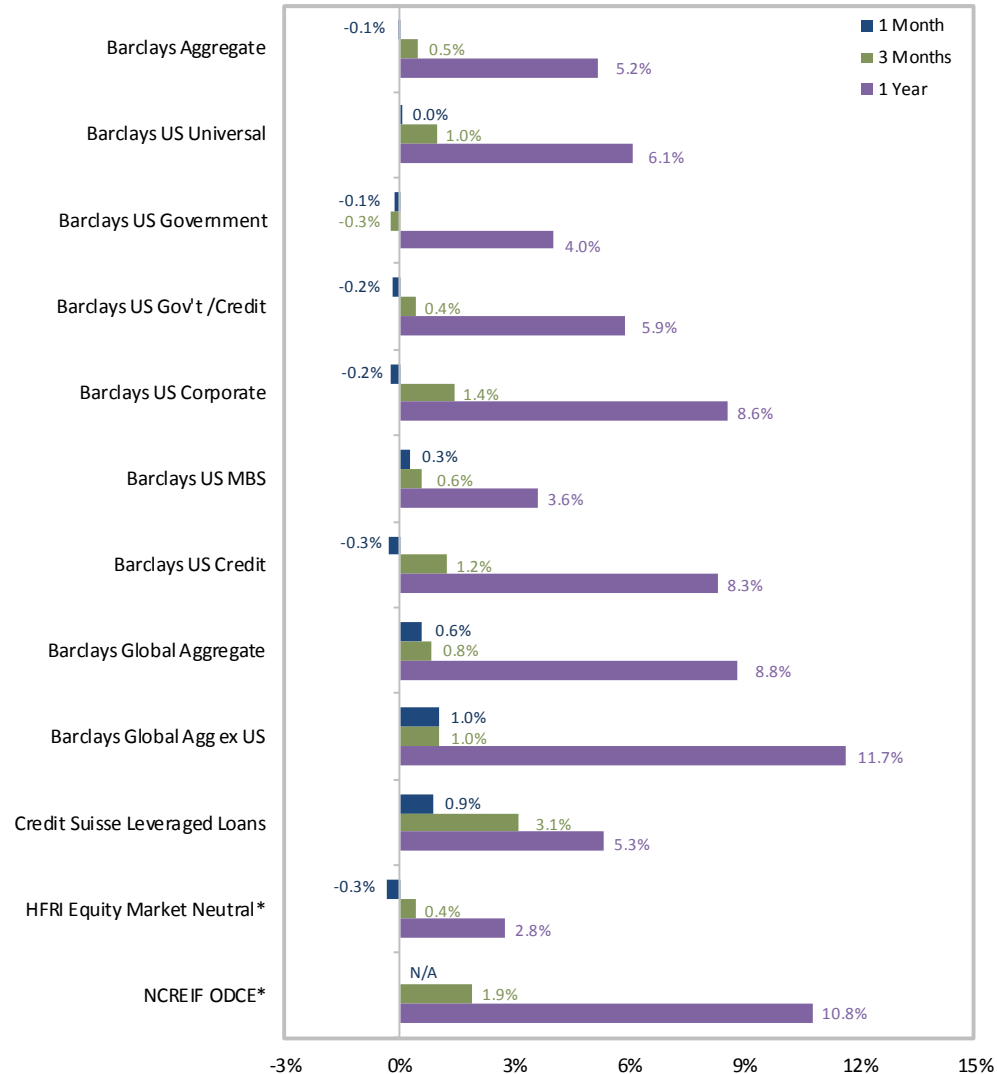
- The 10-year US Treasury yield ended September at 1.6%, the highest month-end yield since May's 1.8%. Markets are not expecting a Federal Reserve rate increase in November, though market-implied odds of a rate increase in December ended the month over 50%.
- Investment grade credit saw spreads increase during the month by 2 bps, and over the quarter spreads widened by 14 bps.
- Both the MBS and ABS segments of the Barclays Aggregate were the top-performing segment of the index during the month, returning 28 bps and 26 bps respectively.
- International bonds returned 1.0% during the month, with yield declines primarily driving returns.
- Leveraged loan prices continued to climb during the month, with almost 60% of the index trading above par at the end of September compared to \_\_% one year ago.

## Relative Value Hedge Funds

- Income hedge funds were mixed in August. Equity market neutral funds detracted, while fixed income-oriented strategies contributed.

## Core Real Estate

- The second quarter NCREIF ODCE Index return was 2.1% gross, 1.9% net, with 110 bps of the return comprised of income, and 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. Seventy-six consecutive months of job growth in the US have been a tailwind for core real estate returns.



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## Inflation

- Inflation expectations continued to increase in September. At the end of the month ten-year breakeven inflation expectations were 1.62% compared to 1.47% at the end of August.

## Deflation

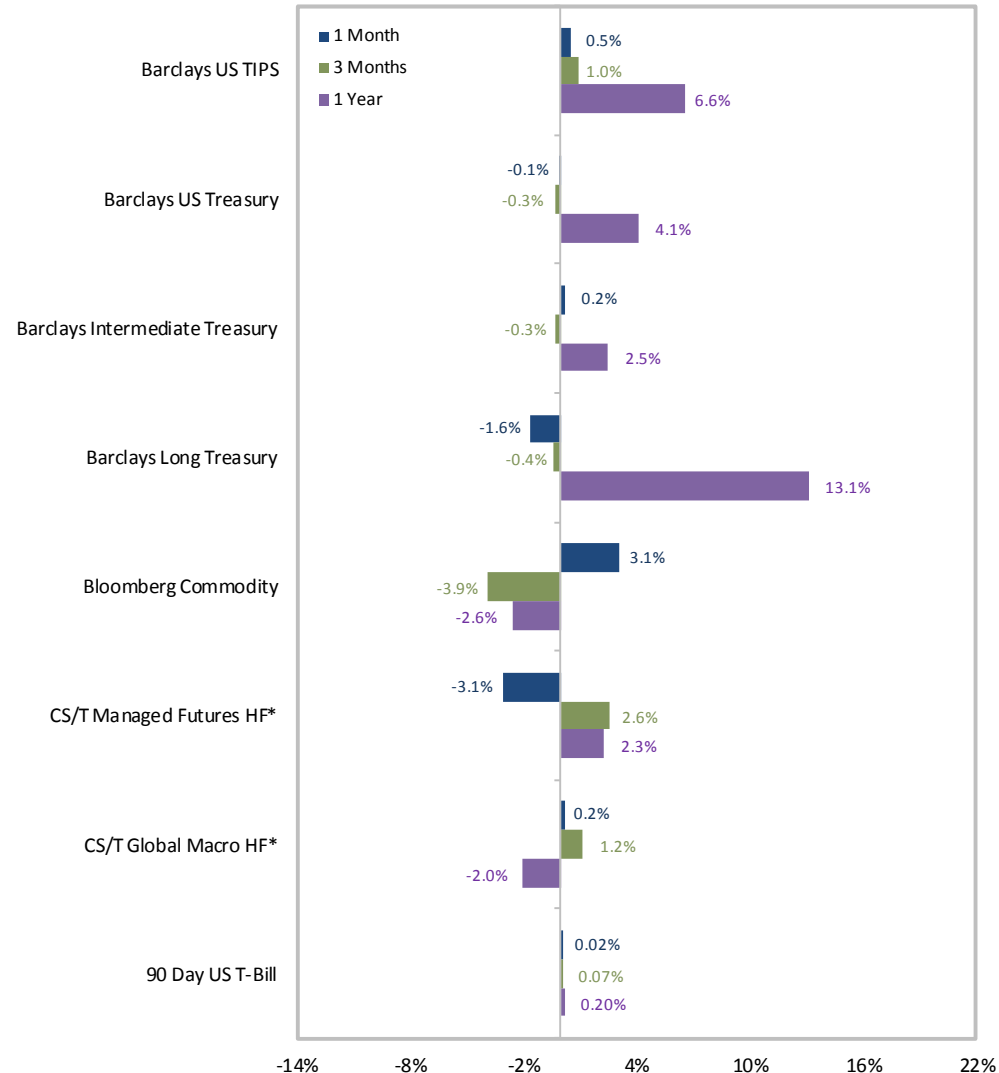
- The Barclays Long Treasury Index had a negative return for the second straight month, as the yield of the Index increased 10 bps to 2.21% versus 2.11% at the end of August.

## Commodities

- The Bloomberg Commodity Index gained 3.1% during September. Wheat was up 11.4% for the month of September, but remains down 21.6% for the trailing 12-month period. Energy outperformed as WTI crude oil advanced 7.9%, and heating oil and gasoline gained 8.3% and 5.3%, respectively. Outperformance in energy was stimulated by production freeze agreements made by OPEC leaders at the end of September, as well as a weaker US dollar. Live cattle and lean hogs were major detractors from performance; although they only account for approximately 4% of the Index, the sectors were down 11.7% and 22.0% for the month, respectively.

## Tactical Trading

- Diversification hedge funds detracted in August. CTAs detracted on trend reversals, while global macro funds were slightly positive.



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