Summit Strategies Group
8182 Maryland Avenue, 6th Floor
St. Louis, Missouri 63105
314.727.7211

Monthly Economic & Capital Market Update

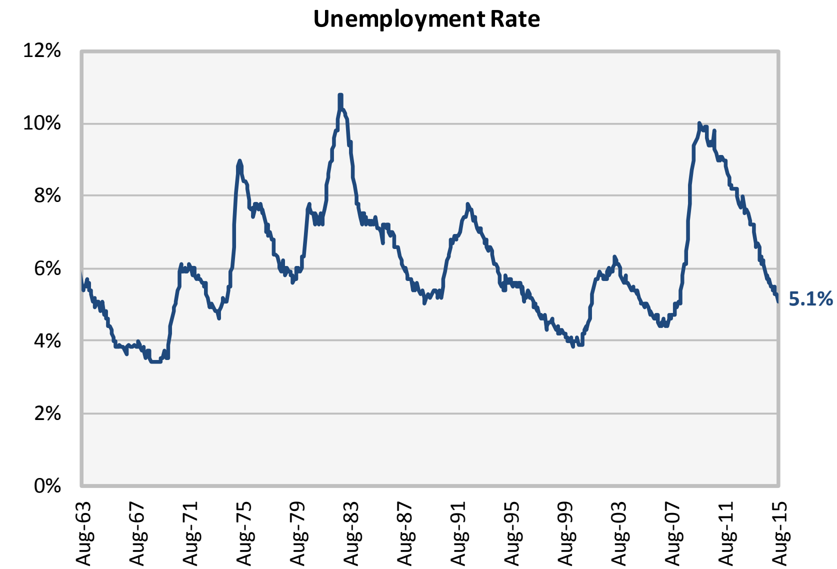
August 2015

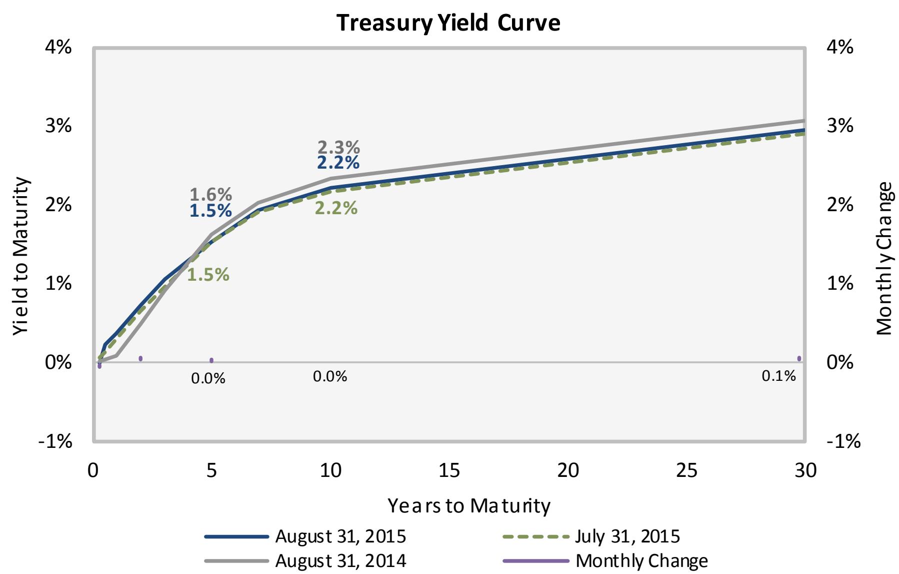
Economy

- Economic data releases from August suggest the US economy is growing at a modest pace and appears strong relative to most international economies. Consumer spending and the housing market have accelerated in recent months, acting as tailwinds for US growth. Outside the US, growth has been slowing in many major economies, including China. While China's reported GDP growth was 7.0% in the second quarter, central bank actions from the world's second largest economy, including interest rate cuts and currency devaluation, suggest slowing activity is an area for concern. Chinese growth is forecasted to continue slowing over the next year or so, but to what degree is the main question to be answered.
- The August employment report showed continued expansion in the US labor market. Employers added 173,000 jobs during the month, below market expectations of 220,000 jobs added. The unemployment rate fell 20 bps, from 5.3% to 5.1%, and stands at its lowest level since April 2008. Additionally, payroll figures for June and July were revised upward by a combined 44,000 jobs. Job growth continues to be strong, as on average over the past three months 221,000 jobs have been added; 200,000 new jobs has historically been consistent with an improving labor market. Conversely, wage inflation continues to be lackluster but may be on the upswing. For the 12 months ending August 2015, wages grew 2.5%. Since August 2008, wage growth has averaged just 2.1% per year, while prior to 2008 average annual wage growth was 4.6%, per the St. Louis Federal Reserve. The Federal Reserve is monitoring wage pressures as a sign of a tightening labor market and signal to raise interest rates. As the unemployment rate continues to decrease, wage pressures are more likely to emerge; with a shrinking pool of unemployed workers, employers must pay more to attract and retain employees.
- Real GDP rose 3.7% on an annualized basis during the second quarter of 2015 according to the second estimate from the Bureau of Economic Analysis. The figure for the second quarter, revised upward from the preliminary reading of 2.3%, suggests the US economy rebounded rather strongly following a slow start to 2015. Higher-than-expected inventory investment and consumer spending led to the upward revision for the second quarter figure.

Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 5 bps to 220 bps in August. Real yields rose while 10-year inflation expectations (1.64%) reached their lowest level since August 2010.





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Growth Assets

August 31, 2015

Public Equities

- In August, the global equity market experienced its worst month of performance since May 2012. The broad equity sell-off was mainly fueled by concerns surrounding the slowing growth of China's economy and its implications for the rest of the world. The S&P 500 entered correction territory (-10% from peak) briefly for the first time since 2011. The 46 months without a 10% decline in the S&P 500 was the third longest such streak since 1950.
- MLPs declined again in August, although began to show modest recovery in the back half of the month. General partners (-8%), crude oil pipelines (-9%) and gathering & processing (-11%) performed the worst during the month on concerns over crude oil producer volumes going forward. Natural gas pipelines (-1%) performed the best of energy infrastructure MLP sub-sectors.

Public Debt

- High yield bond spreads widened 31 bps to 544 bps, pushing yields to 7.3%, the highest level at month-end in three years. Hard commodity-linked issuers suffered the most with the energy sector down 7.0% and metals and mining down 3.4%.
- A surprise devaluation of the Chinese renminbi, along with another leg down in currencies tied to commodity risk, led local currency emerging market debt to fall 5.4% in August. Notable laggards were Brazil, Columbia, Malaysia, and Russia, all significant exporters of commodities.

Private Equity

- Purchase price multiples, as measured by S&P Leveraged Commentary and Data (LCD), remain at record high levels; the easy availability of credit and record levels of dry powder have been the main drivers. Higher purchase price multiples could be more of a new normal rather than the result of a market cycle peak. The asset class continues to become more efficient as investors commit more and more dollars to the space.

Private Debt

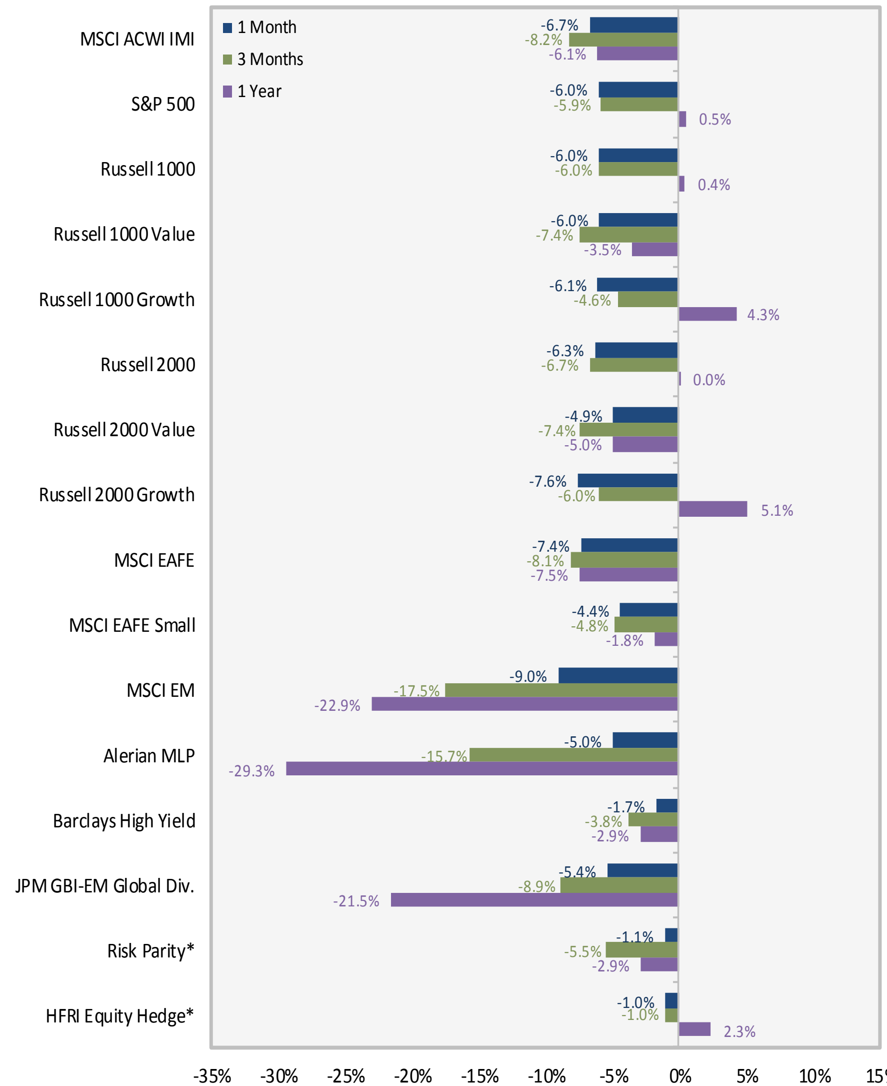
- While the first quarter experienced an uptick in covenant relief amendments, there was no corresponding increase in the second quarter. More reliefs are possible in coming quarters as oil prices test the capital structures of several energy-related, sponsor-backed deals. Debt/EBITDA ratios are near all-time highs, but capex and interest coverage remain significantly higher than those seen in 2006 and 2007.

Risk Parity

- Risk parity strategies detracted in July. Commodities were by far the largest detractors, while equity and nominal bond exposures contributed.

Growth Hedge Funds

- Both long/short equity and event-driven strategies were negative in July. Equity strategies with exposure to China and the global energy sector were the largest detractors. Activist strategies were positive while distressed, and other credit-linked event strategies detracted.



* 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

- Modest month-over-month changes in the US Treasury yield curve hid a fairly volatile period as the market grappled with concerns over falling commodity prices, a drawdown in equity markets, and fears over the extent of a Chinese economic slowdown. The 10-year Treasury traded between 2.14% and 2.27% for the first half of the month before a 19 bps decline over four days brought the 10-year to 2.00% as global equity markets fell sharply. However, yields quickly rebounded and finished the month on a steep rise to end modestly higher. The market-implied probability for a September Fed rate hike began the month at 50%, fell to as low as 24%, and ended the month at 42%.
- Investment grade credit fell over the month as spreads widened by 9 bps alongside a rise in Treasury yields. Spreads are at 155 bps or 30 bps wider for the year despite favorable fundamentals within credit. The rapid pace of issuance decelerated during a traditionally slow month but overall supply is expected to cross $1 trillion this year.
- Within securitized assets, ABS and Agency MBS were able to side-step a volatile month and produce positive returns. CMBS, however, saw spreads gap out 10 bps leading to a -0.35% return.
- International bonds barely managed a positive month in August, turning in a 0.4% return. A slight pull back from the US dollar strengthening trend provided the main tailwind. Among leaders, Japanese bonds did well as the yen appreciated in an Asian flight-to-quality bid post-China's devaluation. Among laggards, Canadian bonds suffered as the CAD depreciated along with other commodity sensitive currencies.

Private Debt

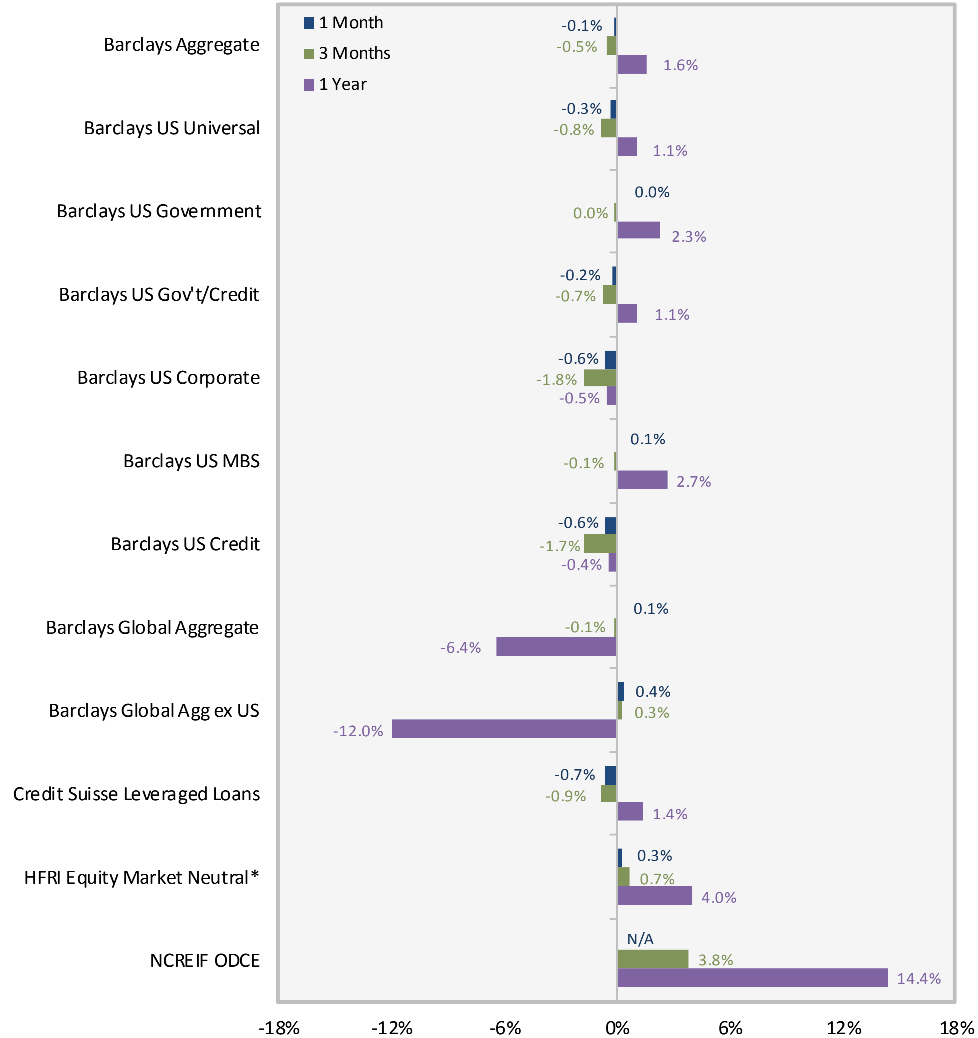
- Bank loan prices fell to $95.4, a year-to-date month-end low. Returns for energy and metals/minerals sectors were hit hardest, down -6.7% and -3.3%, respectively. Yields to a 3-year takeout rose 27 bps to 6.2%. Issuance slowed in August with $24.1B priced, $8.3B lower than 2015's monthly average. Retail funds saw -$2.7B in outflows, bringing the year-to-date total to -$9.6B.

Relative Value Hedge Funds

- Equity market neutral funds were positive on average, while most other relative value strategies detracted, especially credit and convertible arbitrage strategies. Volatility trading was a notable exception.

Core Real Estate

- Core real estate continued to perform well in the second quarter with a 3.8% gross return as measured by the NCREIF ODCE Index. Continued economic growth throughout the US has accelerated income returns, which in turn has also advanced appreciation returns. With a limited amount of new supply, economic growth has supported a landlord-friendly environment.



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Inflation

- TIPS fell 0.8% in August as breakeven inflation expectations compressed and real yields rose. As of month end, the breakeven inflation rate for the 10-year TIPS was 1.6%, down from 1.7% in July. The recent slide in BEI lines up with market sentiment that a higher USD will lead to lower inflation in the long run. Five-year forward, 5-year inflation expectations, a favorite of the Federal Reserve, dipped to 2.0%, well below the more typical level of 2.5%.

Deflation

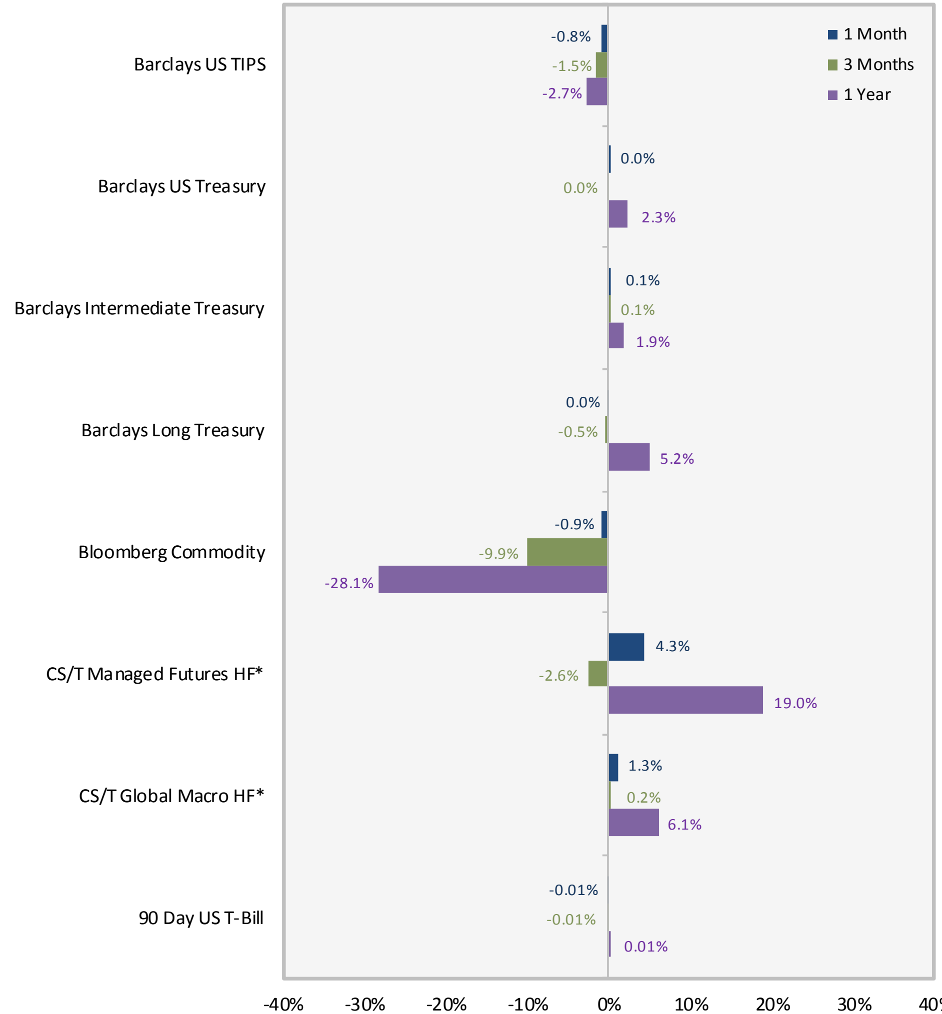
- As interest rates have risen, bonds (particularly those with longer-dated maturities) have performed poorly. August was no exception, although returns were essentially flat for the Barclays Long Treasury Index which generated a -0.02% return. Returns for the index were as high as 3.7% during the worst of the equity market sell-off in August. The yield on the 30-year Treasury finished the month at 2.96% but was as low as 2.72% over the month. The 30-year yield has fluctuated in a 100 bps range, falling as low as 2.3% and rising as high as 3.3% in 2015.
- Cash continues to offer virtually no return, with 90-day T-Bills returning just 1 basis point over the past year.

Commodities

- Declining Chinese demand growth estimates influenced nearly all commodities during the month with indexes general flat to modestly declining. All agriculture and livestock commodities priced lower during the month due to strong growing conditions and increased output estimates. Energy commodities rebounded modestly with crude oil prices up +4%, settling in at around $50 per barrel. Gold (+3%) led advancing metals commodities, while industrial commodities fell during the month.

Tactical Trading

- Tactical trading strategies performed well in July. Gains were led by CTAs, as trend following returned to profitability. Discretionary macro traders also averaged gains.



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