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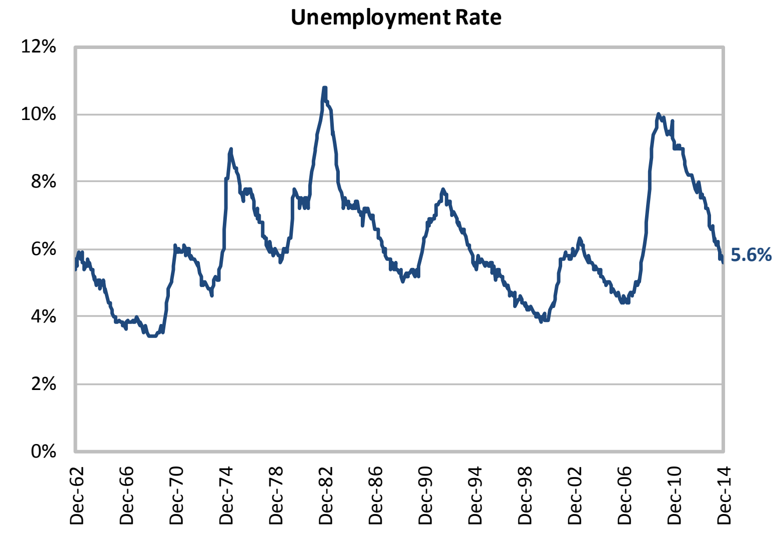
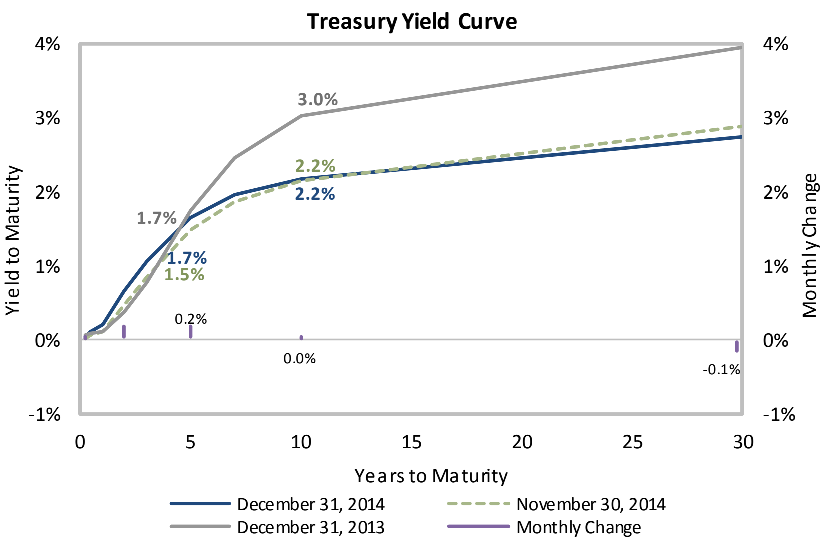
Monthly Economic & Capital Market Update

December 2014

Economy

- December 2014 featured many prevailing market themes that had been in place throughout much of the year. The US economy continued to show signs of strength relative to other major economies and relative to prior years since the Great Recession. GDP, unemployment, and manufacturing data released during December suggest that falling energy prices, low interest rates, and an improving labor market are supportive of increased consumption and broad economic growth.
- The unemployment rate fell from 5.8% to 5.6% in December, its lowest level since June 2008. Nonfarm payrolls increased by 252,000, beating economists' expectations of an increase of 240,000, and previously published figures for October and November were revised upward by a total of 50,000 jobs. The labor market theme for 2014 was strong job growth unaccompanied by increases in wages. 2014 was the best calendar year for job growth in the US since 1999, but average hourly earnings for all employees increased just 1.7% during the year; wages did not rise at a faster pace than inflation, meaning that workers have not experienced an improvement in real purchasing power.
- US consumer prices, as measured by the Consumer Price Index (CPI), rose 1.3% year-over-year in November. Core prices, which exclude food and energy costs, rose 1.7% over the same period. Observed inflation and future inflation expectations have slowed throughout the world in recent months and have become a main area of concern for central bankers.
- After falling 18% in November, crude oil prices dropped another 20% during December to their lowest level since 2009. As of December 31, 2014, the national average price of a gallon of gasoline in the US was $2.26, the lowest price per gallon since May 2009. Higher than expected supply and decreasing global demand drove oil prices down over 45% during 2014.
- Real GDP growth for the third quarter of 2014 was 5.0% annualized according to the third and final estimate from the Bureau of Economic Analysis, the fastest rate of economic growth in the US since 2003. Higher than expected consumer spending, as a result of an improving labor market and broader economy, was the main reason for the upward revision from the second estimate of 3.9%. Real GDP growth for the first three quarters of 2014 has been 2.4% on an annualized basis.





Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 30 bps to 210 bps during December. Over the past year, short-term rates have risen as the date of the expected Fed rate hike approaches, while long-term rates have rallied as inflation expectations continue to decline.

Growth Assets
December 31, 2014

Public Equities

- Domestic stocks once again outperformed international during December, although most major indices ended the month in negative territory. US small caps were the best equity performers during the month, benefiting from lower gas prices and their isolation from the rest of the global economy.
- Despite the decline in crude oil prices, crude oil pipeline MLPs generated positive returns in December, gaining 2%. Overall the sector declined during the month due to negative performance in natural gas pipeline MLPs (-2%), gathering & processing MLPs (-9%), and most notably upstream MLPs which declined -31% following the sharp decline in crude oil (-19%) and natural gas (-29%) prices during the month. Other MLP subsectors declined as well including downstream, coal, energy services and general partners. Smaller capitalization MLPs underperformed large capitalization MLPs for the fourth straight month.

Public Debt

- High yield bonds returned -1.4% as spreads widened 30 bps to 480 bps in December; spreads have widened 100 bps over the past 12 months, yet remain below their 20-year average of 530 bps.

Private Equity

- Deal value has remained flat throughout 2014 as managers compete against increasingly acquisitive strategic buyers. While competing for new deals, managers have benefited from the same dynamic by selling portfolio companies to the same buyers. Exits via a strategic sale are 50% higher in 2014 than they were in 2011, 2012, and 2013. Fundraising continues to be very strong, and managers are taking advantage to raise larger pools of capital with shorter fundraising cycles than the period since 2007. Fundraising has persisted despite record high levels of uninvested capital.

Private Debt

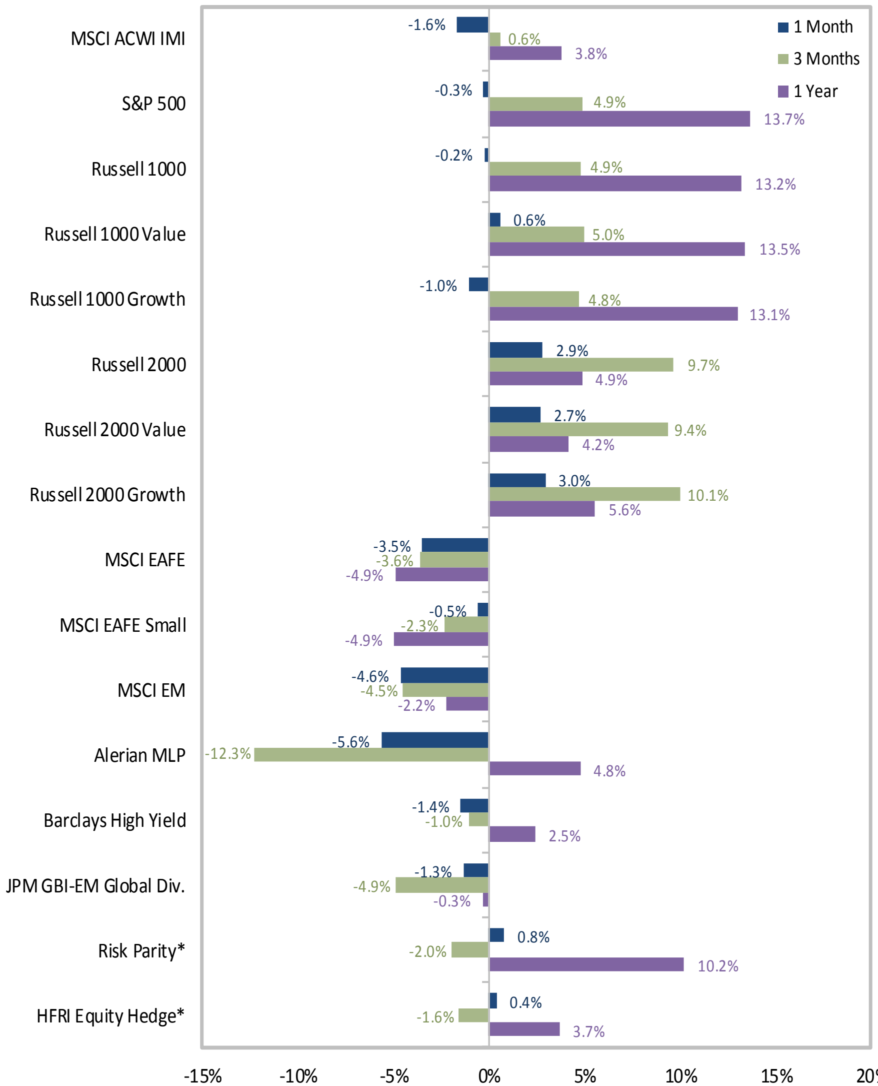
- Availability and aggressive terms from senior lenders has allowed debt levels in the larger end of the market to increase to another new cycle high of 5.9x EBITDA. This remains lower than the prior cycle high of 6.2x recorded in 2007. As the credit cycle has progressed, credit standards and spreads among lenders to private equity sponsors have decreased. Some managers have reported an improved pricing environment for senior lenders since May 2014 resulting in 25-50 bps of return premium. The opportunity for distressed buyers of corporate paper still appears to be a few years away as accommodative debt markets and economic momentum support low default rates.

Risk Parity

- Risk parity strategies contributed slightly in November. Equities and bonds performed well while commodities weighed down performance.

Growth Hedge Funds

- Event-driven hedge funds performed well in November following two months of turbulence. Activists were the top performers, while multi-strategy and merger arbitrage funds also contributed strongly.



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

Public Debt

- Interest rates in most developed economies ended the month mostly unchanged, remaining at historically low levels. The 10-year US Treasury ended December yielding 2.2%, well below its 20-year average of 4.4%. Yields in foreign developed countries also remain very low; the Barclays Global Aggregate ex-US Index ended December yielding just 1.1%.
- Core fixed income (Barclays Aggregate) outperformed core plus (Barclays US Universal) by 30 bps during the month.
- US Government bond prices were relatively unchanged during the month as yields held constant, returning 0.1%.
- Corporate bonds also returned 0.1% in December as investment grade spreads widened 5 bps to 130 bps. Corporate bond spreads have averaged 145 bps over the past 20 years.
- Mortgage-backed securities returned 0.2% for the month as agency MBS spreads held constant at 30 bps, below the 20-year average of 60 bps.
- International bonds were once again the worst-performing fixed income sector during December, with the Barclays Global Aggregate ex-US Index returning -1.2%.

Private Debt

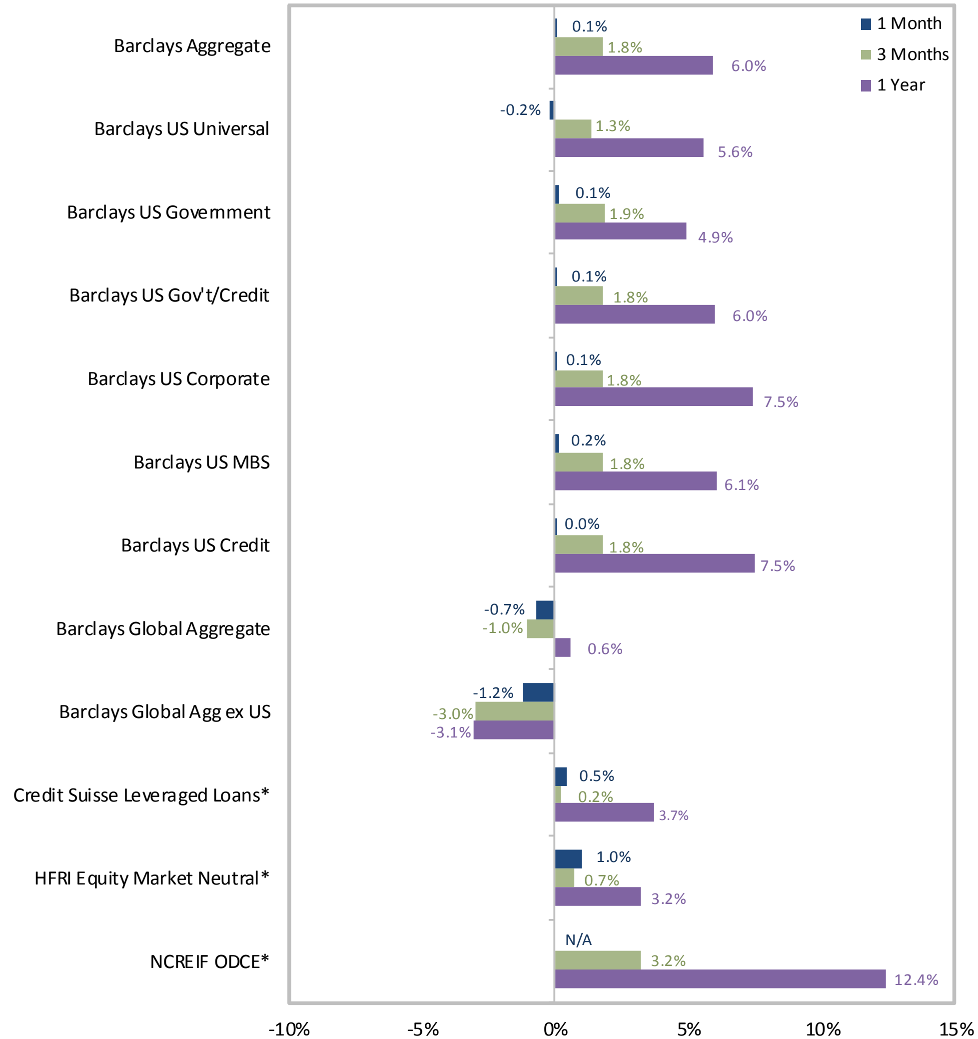
- Leveraged loans produced modest returns in November and were up 3.7% for the 12 months ending November.

Relative Value Hedge Funds

- Performance was slightly positive, though highly variable throughout the relative value complex in November. Equity market neutral hedge funds performed well, while more credit-oriented strategies tended to underperform.

Core Real Estate

- Core real estate returned 3.2% in the third quarter, the best quarter for the NCREIF ODCE Index in a year. The strong performance was fueled by an increase in occupancy rates, which created higher income levels for most properties throughout the US. Appreciation returns for office and industrial properties have also shown a steady increase over the last 18 months. Finally, new construction projects have maintained at a modest volume, creating favorable supply-demand metrics in several key markets.



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Diversification Assets

December 31, 2014

Inflation

- TIPS returned -1.1% in December and were up 3.6% in 2014.

Deflation

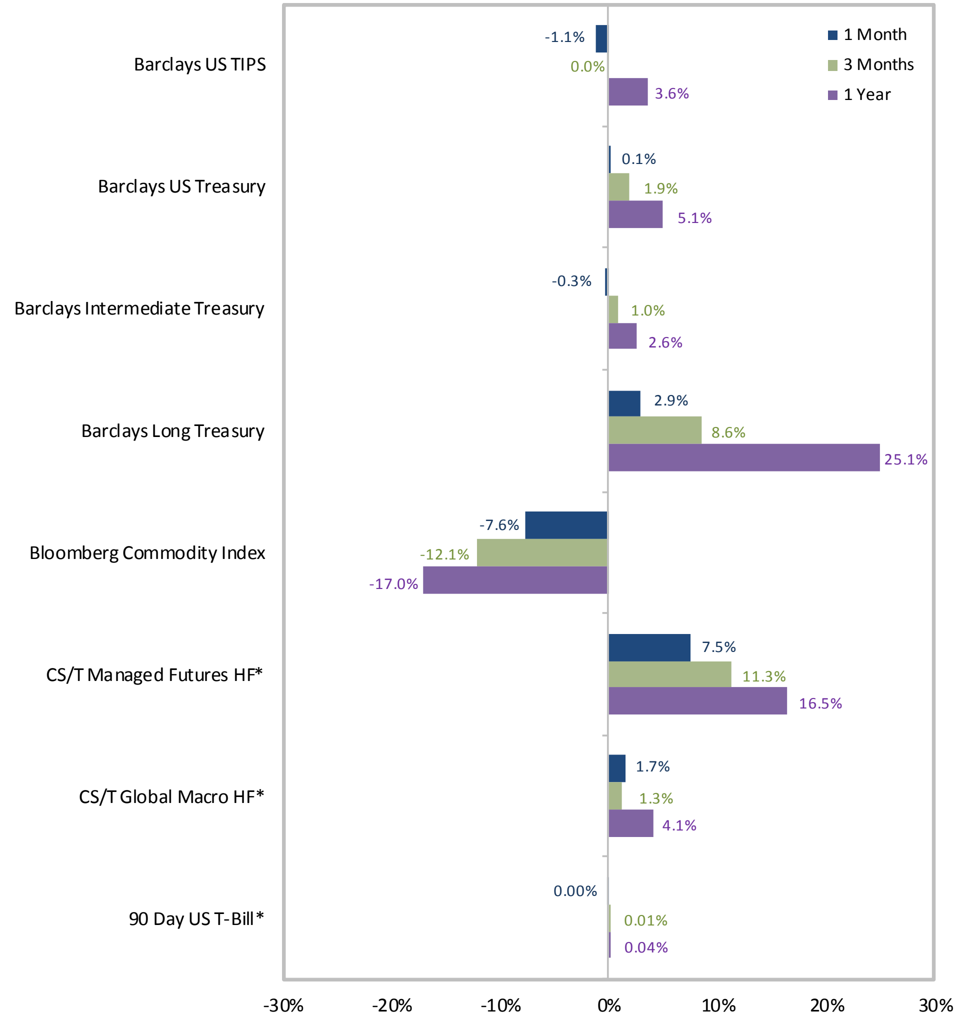
- Treasuries were roughly flat in December, returning 0.1%.
- Intermediate Treasuries returned -0.3% and long duration Treasuries returned 2.9% as yields fell across the long end of the curve. Intermediate and long Treasuries have earned 2.6% and 25.1%, respectively, over the past year.
- Cash continues to offer virtually no return, as 90-Day T-Bills have gained just 4 bps over the past year.

Commodities

- The strong dollar continues to negatively impact commodity markets. Energy commodities continue to dominate the performance of broad indices, with crude oil (-19%) and natural gas (-29%) prices both declining significantly during the month. Continued oversupply is driving crude oil prices lower, while a milder winter has kept demand lower than expected for natural gas. Other energy commodities declined as well with heating oil down -17% and gasoline down -25%. In agriculture commodities, corn (+6%) and wheat (+2%) led advancing commodities. Industrial metals all declined during the month, with aluminum down -9% and copper down -2%. Precious metals were both modestly positive during the month.

Tactical Trading

- Diversification hedge funds again posted strong returns in November. CTAs continue to drive performance with trend-following strategies, while discretionary global macro also contributed.



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