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Monthly Economic & Capital Market Update

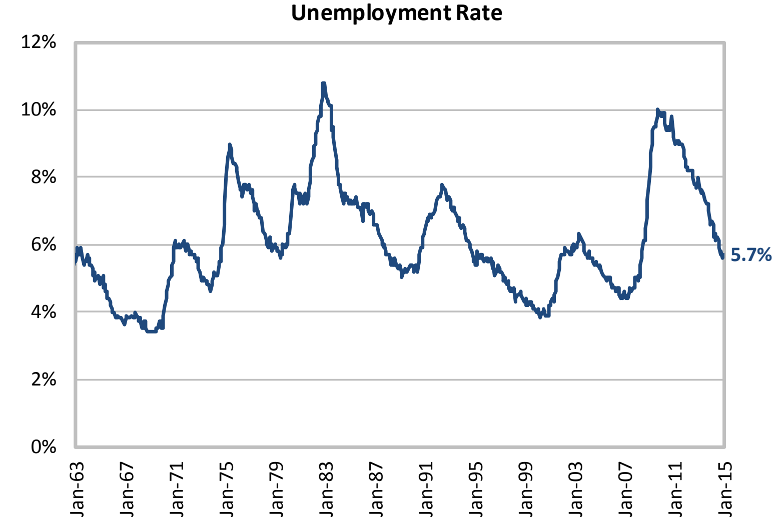
January 2015

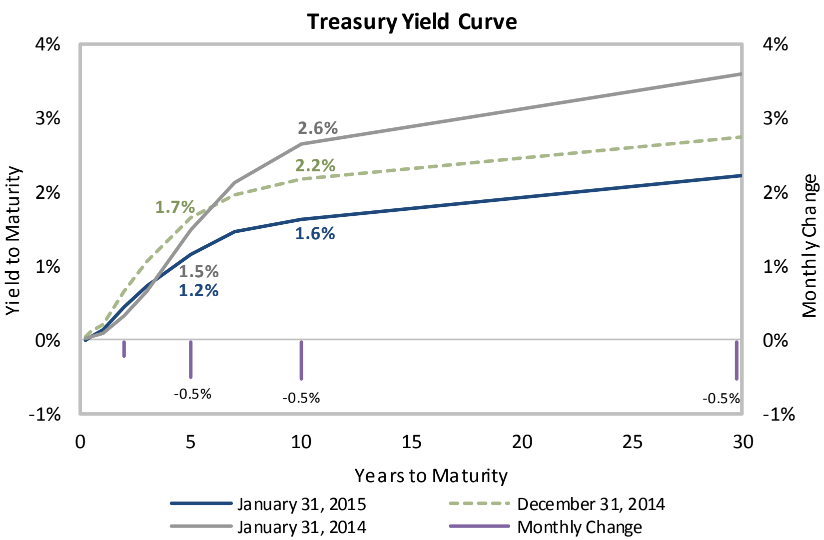
Economy

- Economic data released during January and the actions of policymakers to begin 2015 suggest the US remains a bright spot in an otherwise lackluster global economy. Fourteen central banks around the world took action to ease monetary conditions during the month in an effort to stimulate growth and fight mounting deflationary pressures. The US, on the other hand, is likely heading toward a more normal policy stance, as the domestic economy continues to exhibit slow but consistent improvement following the Great Recession.
- The unemployment rate rose from 5.6% to 5.7% in January. Job growth was strong, but more Americans rejoined the labor force and began looking for work during the month; the rise in the unemployment rate was a result of the increasing pool of job-seekers. Nonfarm payrolls increased by 257,000, beating economists' expectations of an increase of 228,000, and previously published figures for November and December were revised upward by a total of 147,000 jobs. The months of November, December, and January combined to be the strongest three-month period of job gains the US economy has seen since 1997.
- US consumer prices, as measured by the Consumer Price Index (CPI), fell 0.4% month-over-month in December 2014. Core prices, which exclude food and energy costs, were unchanged over the same period. For the one-year period ending December, headline CPI increased by 0.8% and core prices rose 1.6%. Inflation continues to run below the 2% objective of the Federal Reserve, whose dual mandate for the US economy includes maximum employment and price stability. Observed inflation and future inflation expectations have slowed throughout the rest of the world as well, and have become a main area of concern for central bankers.
- Real GDP growth for the fourth quarter of 2014 was 2.6% annualized according to the initial estimate from the Bureau of Economic Analysis, coming in below expectations of 3.0% growth. Lower energy prices have acted as a sort of tax break for Americans, as evident in the increase in private consumption during the quarter. The strengthening US dollar and weakening global economy were the main detractors from the GDP figure, serving to reduce exports from the US to outside countries during the quarter. Real GDP growth for calendar year 2014 was 2.4% on an annualized basis.

Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 30 bps to 180 bps during January, the lowest level for this spread since 2007. Short-term rates continue to rise in anticipation of the Federal Reserve's first rate increase, while yields along the long end of the curve continue to decline; the 30-year Treasury ended January yielding 2.2%, the lowest month-end yield ever for the 30-year.





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Public Equities

- A volatile first month of 2015 saw international equity markets outperform domestic. Heightened valuations and a disappointing start to the fourth quarter earnings season raised concerns for investors in US markets during January, as well as the continued decline in energy and commodity prices.
- Upstream MLPs fell for the fifth straight month, but moderated their decline to -2% in January. As of January 31, upstream MLPs are off -57% from their recent peak at the end of August 2014. Crude oil pipelines (-1%), refined products pipelines (-2%), natural gas pipelines (-4%), and gathering and processing MLPs (-5%) all declined modestly during the month.

Public Debt

- High yield bonds returned 0.7% as spreads widened 30 bps to 510 bps in January; high yield spreads have widened 105 bps over the past 12 months and are nearing 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 remains 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

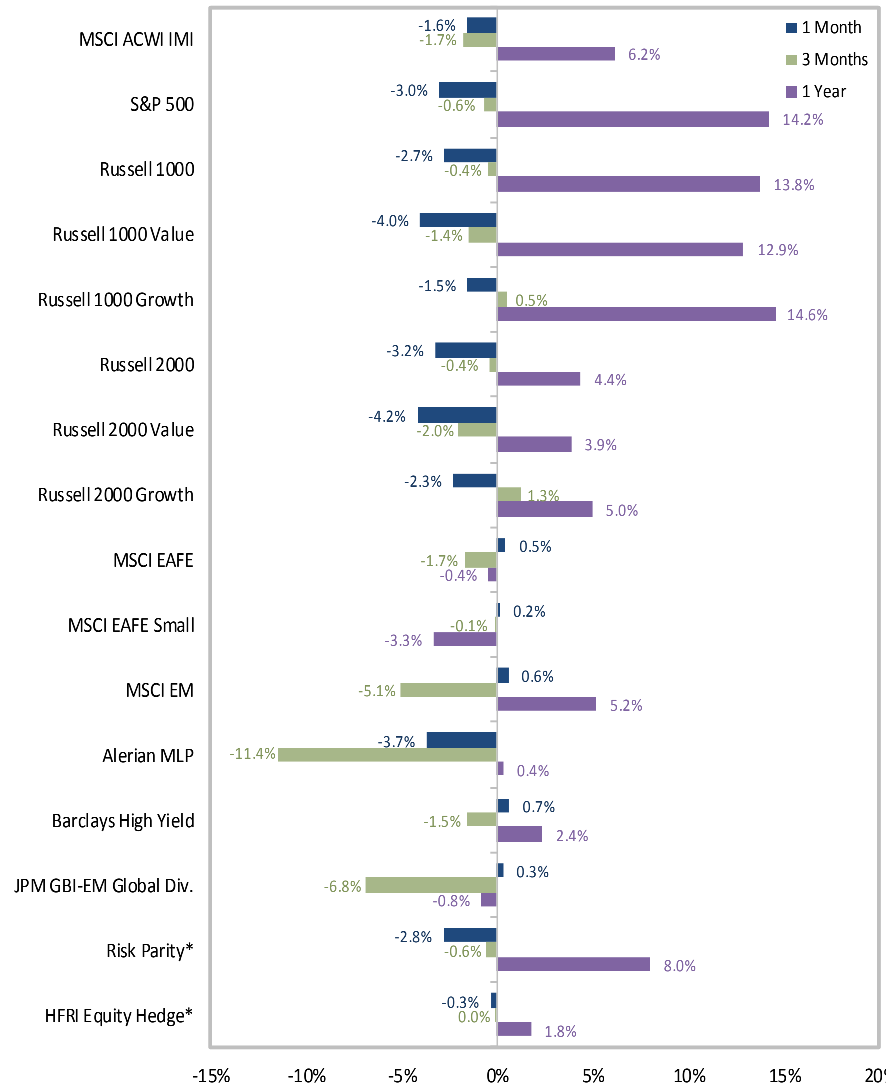
- Availability and aggressive terms from senior lenders have allowed debt levels in the larger end of the market to increase to another new cycle high of 5.9x EBITDA. This remains lower than the prior cycle high of 6.2x recorded in 2007. As the credit cycle has progressed, credit standards and spreads 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 appears to be a few years away as accommodative debt markets and economic momentum support low default rates.

Risk Parity

- Risk parity strategies were negative in December. Losses in commodities were the largest detractor, and developed market bonds made the only significant contribution.

Growth Hedge Funds

- Growth hedge funds detracted in December. Long/short equity strategies posted mixed performance, with funds exposed to the energy sector posting losses following the decline in oil prices; technology and healthcare-oriented funds performed well. Event-driven funds were also negative, as losses in distressed strategies from widening credit spreads more than offset good performance from activists.



* 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 fell during January from what were already low levels. The 10-year US Treasury ended January yielding just 1.6%, well below its 20-year average of 4.3%. Yields outside the US also remain very low; the Barclays Global Aggregate ex-US Index ended the month yielding just 0.9%.
- Core fixed income (Barclays Aggregate) outperformed core plus (Barclays US Universal) by 20 bps during the month.
- US Government bond prices rose in January as yields fell, returning 2.5%.
- Corporate bonds also showed strong performance in January as spreads widened 5 bps to 135. Corporate bond spreads have averaged 145 bps over the past 20 years.
- Mortgage-backed securities returned 0.8% for the month as agency MBS spreads widened 5 bps to 35 bps, below the 20-year average of 60 bps.
- International bonds were once again the worst-performing fixed income sector during January as they continued to face the headwind of the strengthening US dollar, with the Barclays Global Aggregate ex-US Index returning -1.8%.

Private Debt

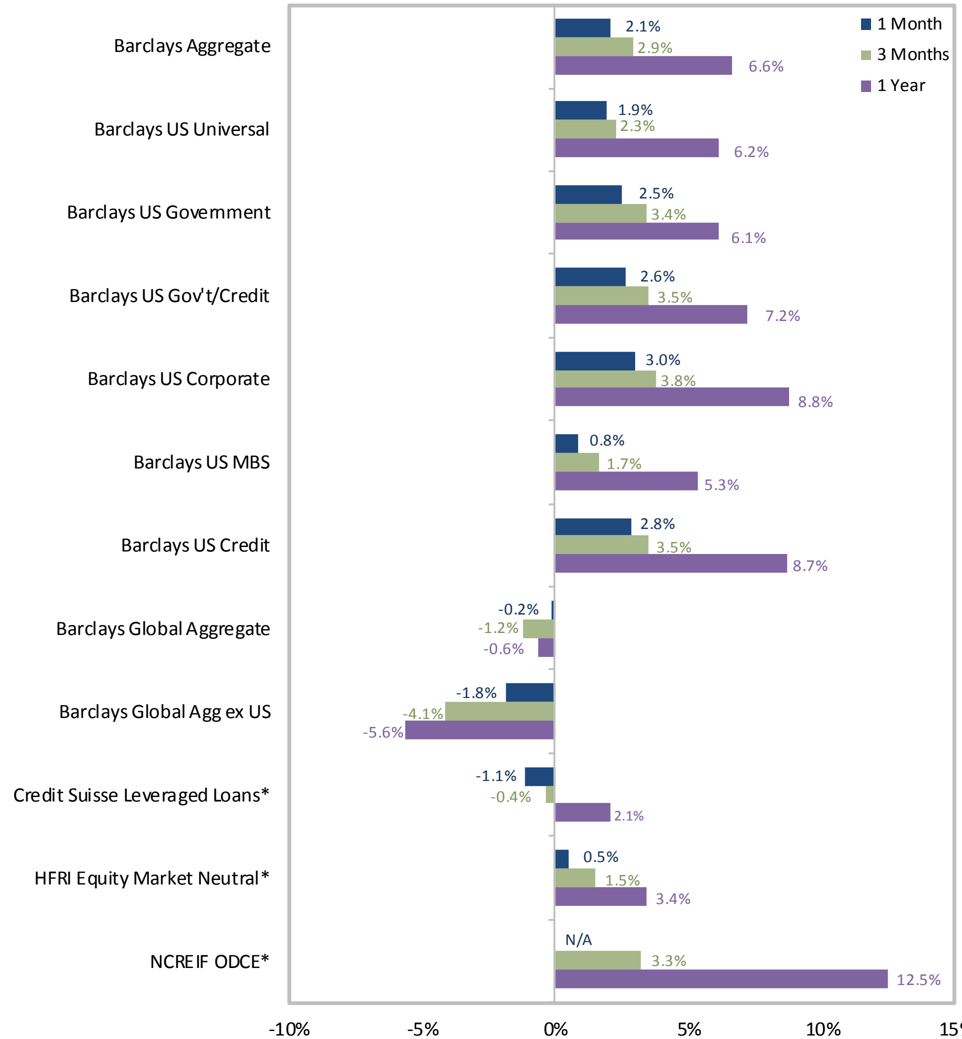
- Leveraged loans saw modest losses in December and were up 2.1% for the 12 months ending December.

Relative Value Hedge Funds

- Equity market neutral hedge funds posted positive results, while non-equity relative value strategies were negative in aggregate. Corporate bond and volatility-oriented strategies were the largest detractors.

Core Real Estate

- The fourth quarter return for core real estate was 3.3%, as measured by the NCREIF ODCE Index. As a result, the 2014 calendar year return for the Index was 12.5%. Continued improvement in fundamentals and income growth for most properties throughout the US fueled the strong performance during the quarter. Cap rate compression continues to play a minimal role when looking at the total return attribution – even in spite of the decline in US Treasury rates. Finally, new construction projects have increased at a modest pace, supporting favorable supply-demand metrics in several key markets.



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Diversification Assets

January 31, 2015

Inflation

- TIPS showed strong performance to begin 2015, returning 3.1% in January. The 12-month gain for the Barclays US TIPS Index was 4.8% as of January 31.

Deflation

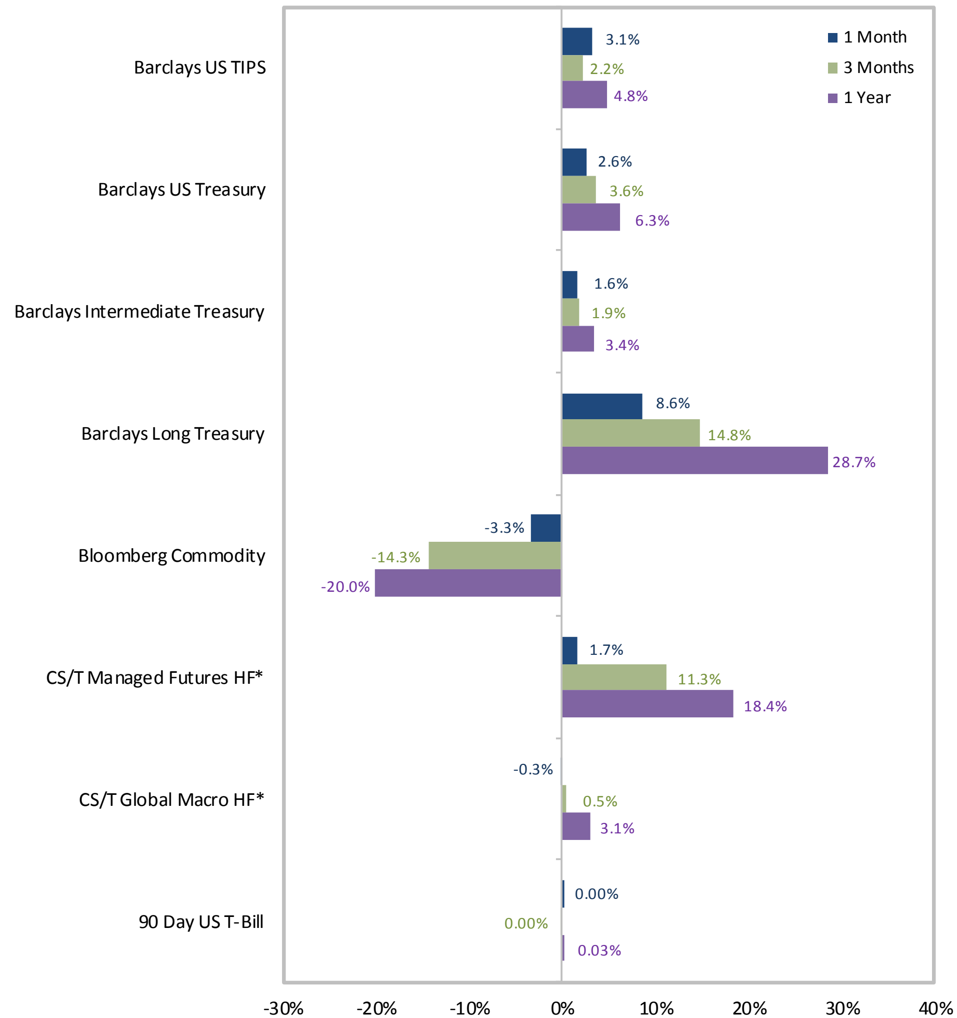
- Treasuries benefited from declining yields, returning 2.6% during the month.
- Intermediate Treasuries returned 1.6% and long duration Treasuries returned 8.6% in January. Intermediate and long Treasuries have earned 3.4% and 28.7%, respectively, over the past year.
- Cash continues to offer virtually no return, as 90-Day T-Bills have gained just 3 bps over the past year.

Commodities

- The strong dollar continues to hurt commodities. Precious metals, both gold and silver, appreciated during January amid rising global geopolitical tensions, highlighted by the escalating Ukraine conflict. Wheat (-15%) declined the most among agricultural commodities, as international exports, namely European, continued to take market share from domestic producers. All energy commodities continued to fall, with crude oil (-9%) and natural gas (-7%) declining during the month on supply-related issues. Industrial metals were all generally flat with the exception of copper, which returned -12% due to oversupply.

Tactical Trading

- Diversification hedge funds continued a strong positive streak in December. CTAs continue to drive performance on positive trend-following results, while discretionary global macro strategies detracted slightly.



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