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Monthly Economic & Capital Market Update

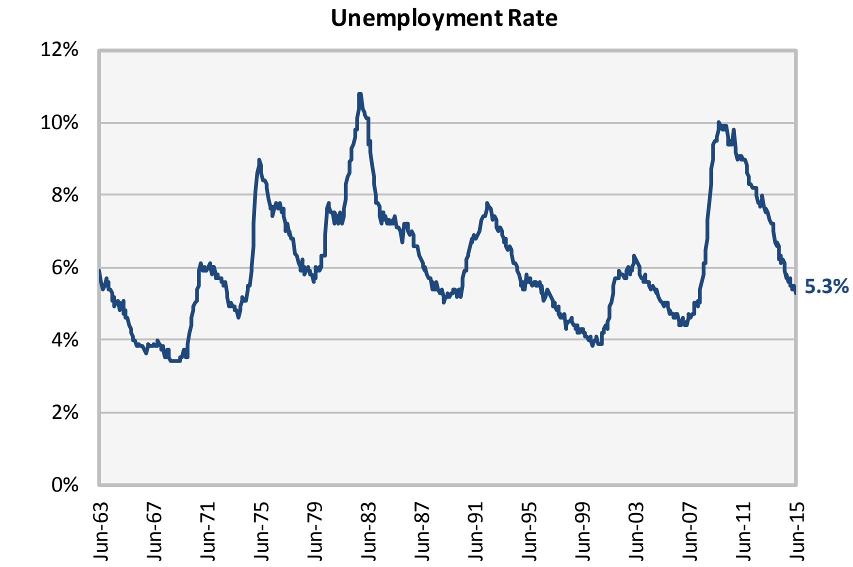
June 2015

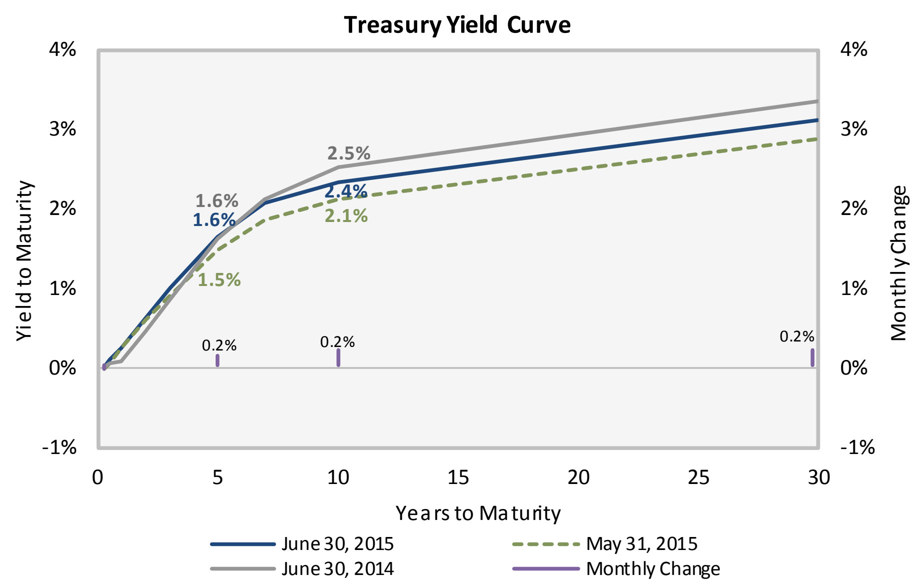
Economy

- The US economy continued to show modest improvement in June relative to the sluggish start to 2015. Economic data releases generally surprised to the upside, with housing and labor market indicators leading the way in the US. During the month the global economy turned its focus to Greece, a country currently experiencing what many are equating to the US Great Depression. Concerns regarding the future of Greece as a member of the eurozone and the potential ripple effect of Greece's actions on other European countries and the rest of the world raised financial market uncertainty, as many issues remain to be resolved in coming weeks and months.
- The June employment report suggests continued expansion in the US labor market, as employers added 223,000 jobs during the month. The unemployment rate fell 20 basis points to 5.3%, its lowest level since April 2008; however, workers continued to leave the labor force in June, and the labor force participation rate reached its lowest level since 1977. While job gains have been strong following the Great Recession, the declining labor force participation rate has also helped lower the unemployment rate. Average hourly earnings were unchanged in June from the previous month, a sign that although the unemployment rate continues to decline, there remains some degree of slack in the job market.
- US inflation continues to run below the 2.0% target of the Federal Reserve. While consumer prices, according to the Consumer Price Index (CPI), rose 0.4% during May, they declined 0.2% over the 12 months ending May. Core prices, which exclude food and energy, rose 0.1% during May and were up 1.7% for the 12 months ending May. The decline in energy prices over the past year mainly account for the difference between core and headline inflation figures.
- The Institute for Supply Management's Purchasing Managers' Index (PMI), a gauge of future demand and manufacturing activity in the US, rose to 53.5 versus expectations of 53.1 in June; a number over 50 implies economic expansion. While the PMI has been above 50 throughout 2015, it has generally declined since late 2014, when US growth was stronger.
- Real GDP contracted 0.2% on an annualized basis during the first quarter of 2015 according to the final estimate from the Bureau of Economic Analysis; the previous estimate of Q1 GDP was for contraction of 0.2%. Consumer spending and inventories were revised higher in the final estimate.

Yield Curve

- The spread between 2-year and 30-year Treasuries widened 20 bps to 250 bps in June. Both real yields and inflation expectations rose during the month.





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Growth Assets

June 30, 2015

Public Equities

- Concerns regarding the debt crisis in Greece weighed on equity markets, with most major indices falling more than 2% in the final week of the month. In developed markets, the US (S&P 500, -1.9%) outperformed international (MSCI EAFE, -2.8%) by 90 bps. US small cap stocks gained, as they benefited from their isolation from overseas events as well as from M&A activity in the small cap space.
- All MLP sub-sectors declined in June, as the asset class broadly traded down as Treasury yields rose sharply during the month. Other yield-oriented asset classes (REITs, utilities) traded off more heavily than broad equities during the month as well. Gathering & processing MLPs declined the most (-12%), while refined products MLPs declined the least (-5%) during the month.

Public Debt

- High yield bond spreads widened 40 bps to 475 bps and yields rose 65 bps to 6.55% in June. The 20-year average for high yield spreads and yields are 530 bps and 9.40%, respectively. Emerging market debt yields rose 25 bps to 6.80%.

Private Equity

- Purchase price multiples, as measured by S&P Leveraged Commentary and Data (LCD), were 9.5x at the end of the first quarter; this multiple is higher than any annual average on record. Pricing is being driven by managers competing with each other and a renewed vigor from corporate buyers, who have a lower cost of capital and significant cost synergies that support higher prices. Despite this market dynamic, fundraising has not dropped significantly from the robust pace of 2014. Fundraising continues to be fueled by record distributions across the industry as well as investors increasing allocations in a search for higher-returning assets.

Private Debt

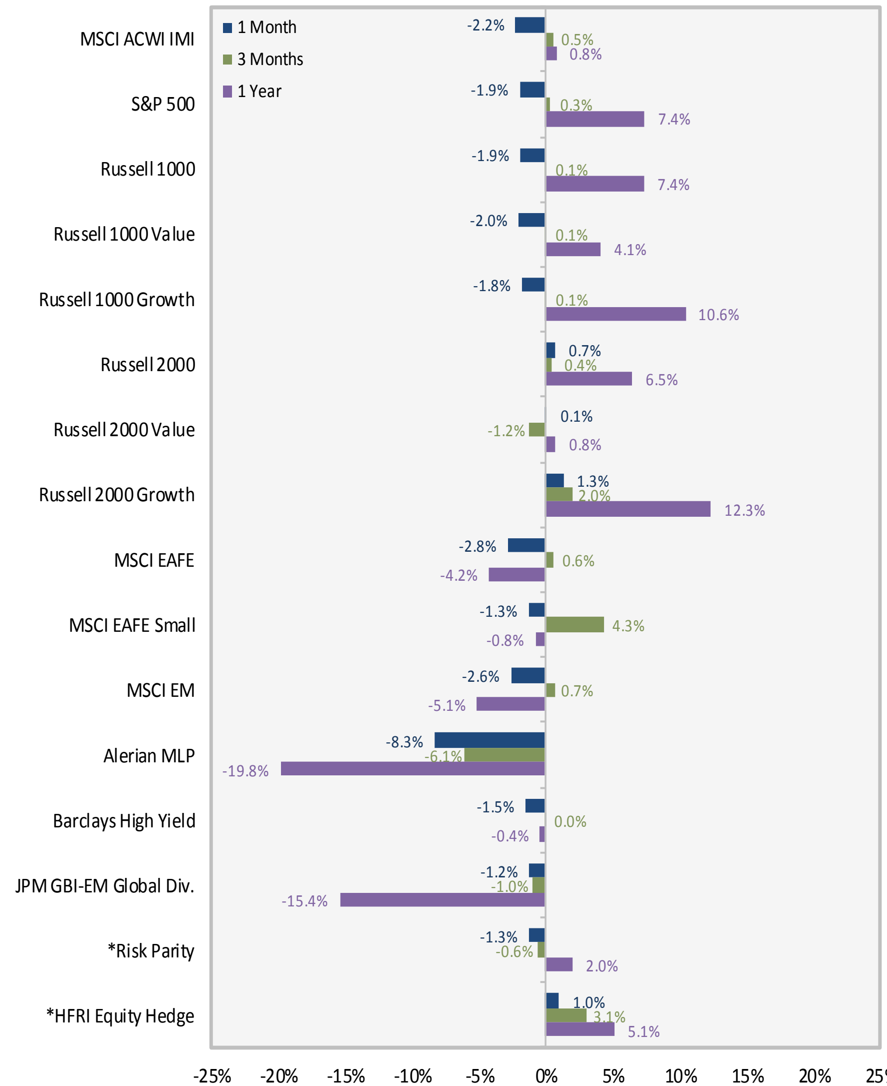
- There was an uptick in covenant relief amendments in the first quarter. While it is only one quarter of data, we will be monitoring for more reliefs in coming quarters as oil prices test the capital structures of several sponsor-backed deals in the oil patch. Debt/EBITDA ratios remain near all-time highs, but capital structures appear to be on firm footing; CapEx and interest coverage remain significantly higher than the low coverage rates seen in 2006 and 2007.

Risk Parity

- May was a poor month for risk parity strategies, with losses in bond and commodity allocations.

Growth Hedge Funds

- Equity long/short funds performed well in May, with the largest gains from technology and healthcare funds. Other growth-linked strategies were positive as well, including activists, merger arbitrage, and diversified multi-strategy 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

- Interest rates rose across the world during June. Better than expected US economic data, including a strong May jobs report, led US rates higher, while international rates rose with US rates and concerns regarding Greece. US yields ended June near their highest levels of 2015, but remain low by historical standards. Over the past 20 years, the average yield on the 10-year US Treasury has been 4.20%; this yield was 2.35% at the end of June. Fixed income markets suggest the Federal Reserve will raise the federal funds rate for the first time since 2006 later this year, most likely in September. The Fed has kept its policy interest rate near zero since 2008 in order to help the US recover from the Great Recession and stimulate borrowing and economic activity.
- Core fixed income (Barclays Aggregate) performed in line with core plus (Barclays US Universal) during the month, with both indices declining on rising rates and spread widening.
- Corporate bonds also declined in May, with spreads widening 10 bps to 145 bps, which is the 20-year average for corporate bond spreads.
- Mortgage-backed securities declined as MBS yields rose 25 bps to 2.75%; MBS yields remain well below their 20-year average of 5.10%.
- International bonds saw muted gains for the month, with the Barclays Global Aggregate ex-US Index returning 0.1%. The US dollar declined against foreign currencies, boosting international fixed income returns from the perspective of a US investor. Over the last 12 months, international bonds have returned -13.2%, mostly due to dollar appreciation.

Private Debt

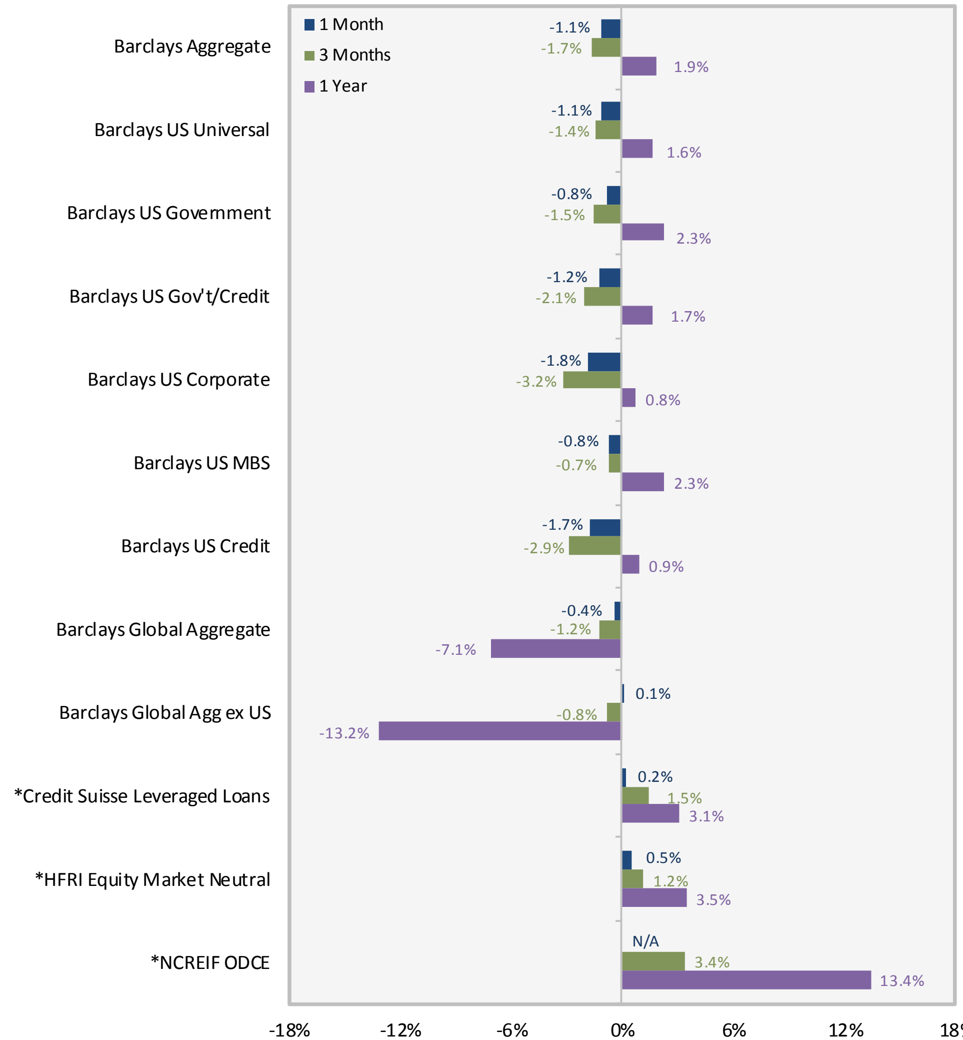
- Leveraged loans gained in May, bringing the one-year return for the Credit Suisse Leveraged Loan Index to 3.1%.

Relative Value Hedge Funds

- Equity market neutral funds were positive in aggregate in May, and most credit-linked strategies were positive as well. Volatility arbitrage and convertible debt arbitrage were among the leading contributors.

Core Real Estate

- The first quarter gross return for core real estate was 3.4%, as measured by the NCREIF ODCE Index. Economic growth throughout the US has fueled favorable returns in the commercial real estate sector. Another contributing factor to the appreciating returns by the NCREIF ODCE Index has been financing, as funds with maturing debt continue to benefit from historically low Treasuries.



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Diversification Assets

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Inflation

- TIPS declined in June as real yields rose rather sharply, returning -1.0%. Inflation expectations rose modestly during the month, with the bond market pricing that over the next ten years inflation will be 1.90% per year. At the end of January the ten-year inflation expectation was 1.65%; concerns regarding deflationary pressures appear to have eased slightly in recent months.

Deflation

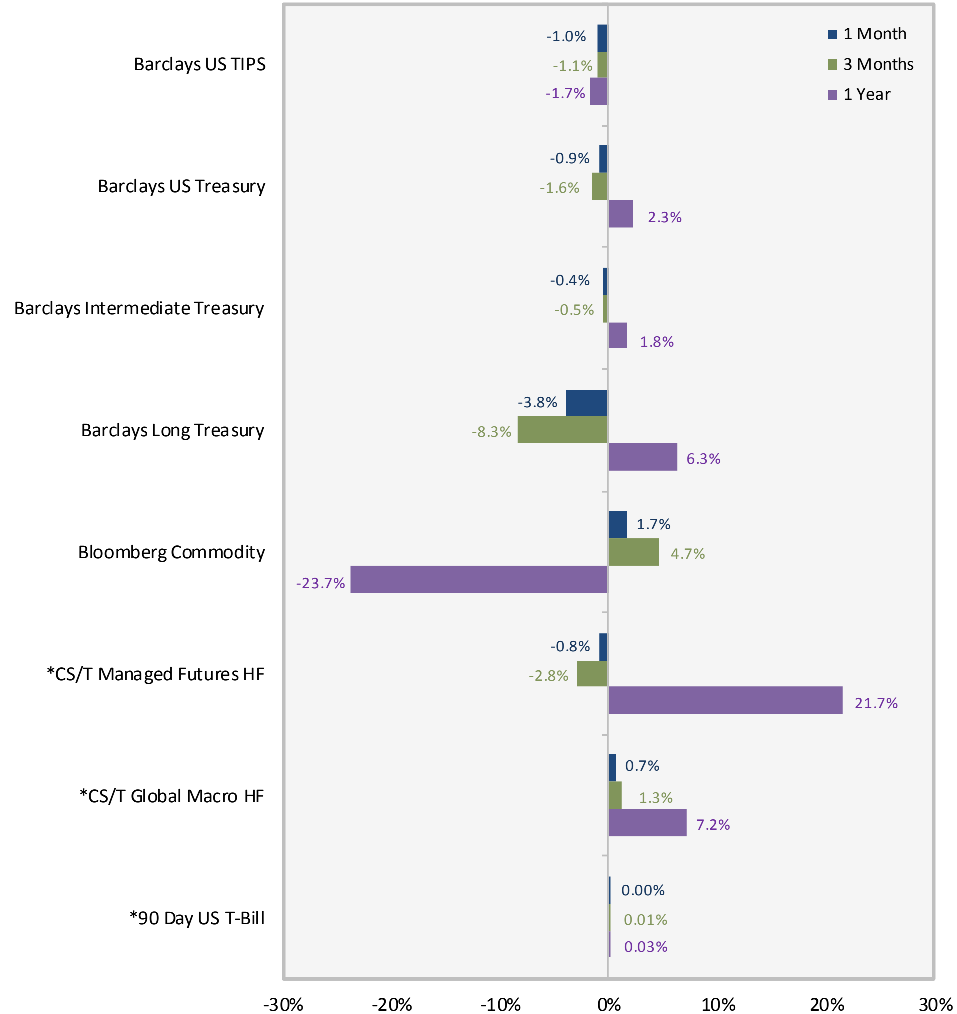
- Consistent with easing deflationary pressures, assets to protect against deflation continue to struggle. As interest rates have risen, bonds (particularly those with longer-dated maturities) have performed poorly.
- Treasury prices fell during June, with the Barclays US Treasury Index returning -0.9%.
- Intermediate Treasuries returned -0.4% and long duration Treasuries returned -3.8% for the month. While the one-year return for the Barclays Long Treasury Index is 6.3%, the Index has lost ground in 2015 as rates have risen. As of January 31, the 30-year Treasury yield was 2.2%; at the end of June, this yield had risen to 3.1%.
- Cash continues to offer virtually no return, as 90-Day T-Bills have gained just 3 bps over the past year.

Commodities

- All grains and soft commodities were up in June, with wheat (+29%) and corn (+18%) leading advancing commodities. Generally, inventories and new planting were lower than expectations. Both livestock contracts (live cattle and lean hogs) traded down modestly during the month. All metals, both precious and industrial, were also down as metals pricing continues to correlate with Chinese growth forecasts. Energy commodities only moved modestly with oil trading down (-1%) but natural gas advancing (+7%) with higher than average expected summer temperatures as well as inventory levels staying in line with expectations.

Tactical Trading

- Discretionary global macro managers were generally positive in May, while most CTAs detracted.



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