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Monthly Economic & Capital Market Update

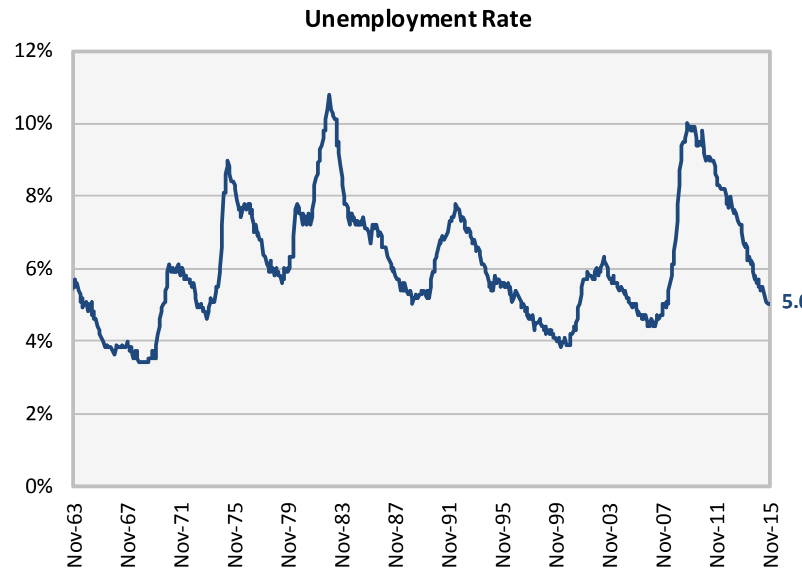
November 2015

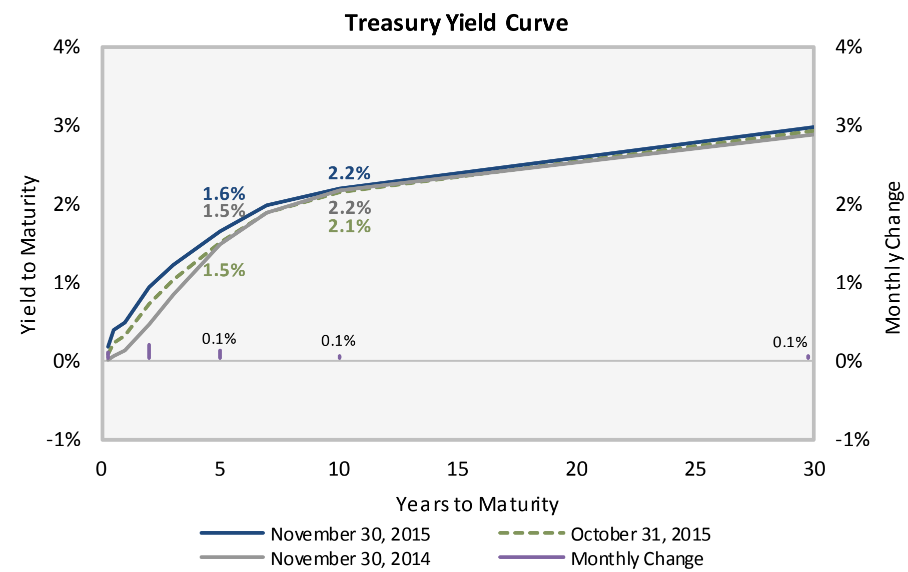
Economy

- Economic data releases during November continued to support a likely interest rate increase by the Federal Reserve at its December 2015 meeting. Third quarter market and global economic turbulence has given way to a fourth quarter equity market rebound and fewer concerns over a worldwide recession. At the end of November investors were placing approximately a 75% probability on a December interest rate increase by the Fed, and futures markets suggested the federal funds rate will reach 0.8% by the end of 2016. If rates increase at the pace expected by the market, it will be much slower than previous hiking cycles and rates will remain low compared to historical levels for years to come.
- The November employment report showed continued strength in the US labor market. Employers added 211,000 jobs during the month, exceeding market expectations of 200,000 jobs. The unemployment remained at 5.0%, its lowest level since April 2008. In addition to a strong November report, figures for September and October were revised upwards by a combined 35,000 jobs. Job growth has averaged 218,000 over the past three months; historically, 200,000 new jobs per month has been consistent with strong labor market expansion.
- Additionally, the November employment report highlighted modest wage growth for US workers. For the 12 months ending November, average hourly earnings grew 2.3%, down slightly from the 2.5% 12-month gain from October. Wage growth has averaged a lackluster 2.0% per year since 2008, compared to 4.5% annual growth prior to the financial crisis**.** As the unemployment rate continues to decrease, wage pressures are likely to continue to build; with a shrinking pool of unemployed workers, employers must pay more to attract and retain employees.
- Real GDP increased at a 2.1% annualized rate during the third quarter, according to the second estimate from the Bureau of Economic Analysis. Real GDP growth of 3.9% for the second quarter suggested the US economy rebounded following a slow start to 2015, which saw GDP increase just 0.6% in the first quarter. A drawdown of domestic inventories contributed to the slowdown in growth quarter over quarter.

Yield Curve

- The spread between 2-year and 30-year Treasuries declined 15 bps to 205 bps in November. Over the past 30 years the spread between 2- and 30-year Treasuries has averaged 165 bps.





Public Equities

- After a volatile October, equity market performance was mixed throughout the world during November. The S&P 500 gained 0.3% while the MSCI EAFE Index returned -1.6%. Domestic small cap stocks outpaced their larger peers, reversing the trend from prior months, with the Russell 2000 Index gaining 3.3%. Emerging markets continued to underperform developed markets, returning -3.9% during the month.
- MLPs gave back October gains during November, as all sub-sectors declined. Downstream MLPs (-3%) and refined products pipeline MLPs (-4%) held up best as low energy commodity prices have led to a response of increased refined product demand supporting these sectors. MLPs with asset exposure closer to the point of production continued to trade down amid production volume uncertainty. The asset class yield remains above 8%.

Public Debt

- High yield resumed its selloff in November with the index returning -2.2%. Spreads widened 42 bps to 600 bps, leaving the index yielding 8%. Commodity sensitive bonds slumped with metals/mining and energy the main laggards. Mutual fund flows were negative for the month, serving as a headwind amid increased issuance.
- Local currency emerging markets debt returned -2.2% in November. European countries (Czech Republic, Hungary, Poland, and Romania) were weighed down by Euro weakness as monetary policy continues to diverge between the FOMC and ECB. Outside Europe, the Columbian peso and South African rand fell amid concerns about their commodity dependence and sensitivity to an FOMC rate hike.

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. However, several market participants are noticing widening bid/ask spreads as lenders are beginning to tighten. Additionally, public market volatility combined with peak earnings has begun to spook buyers.

Private Debt

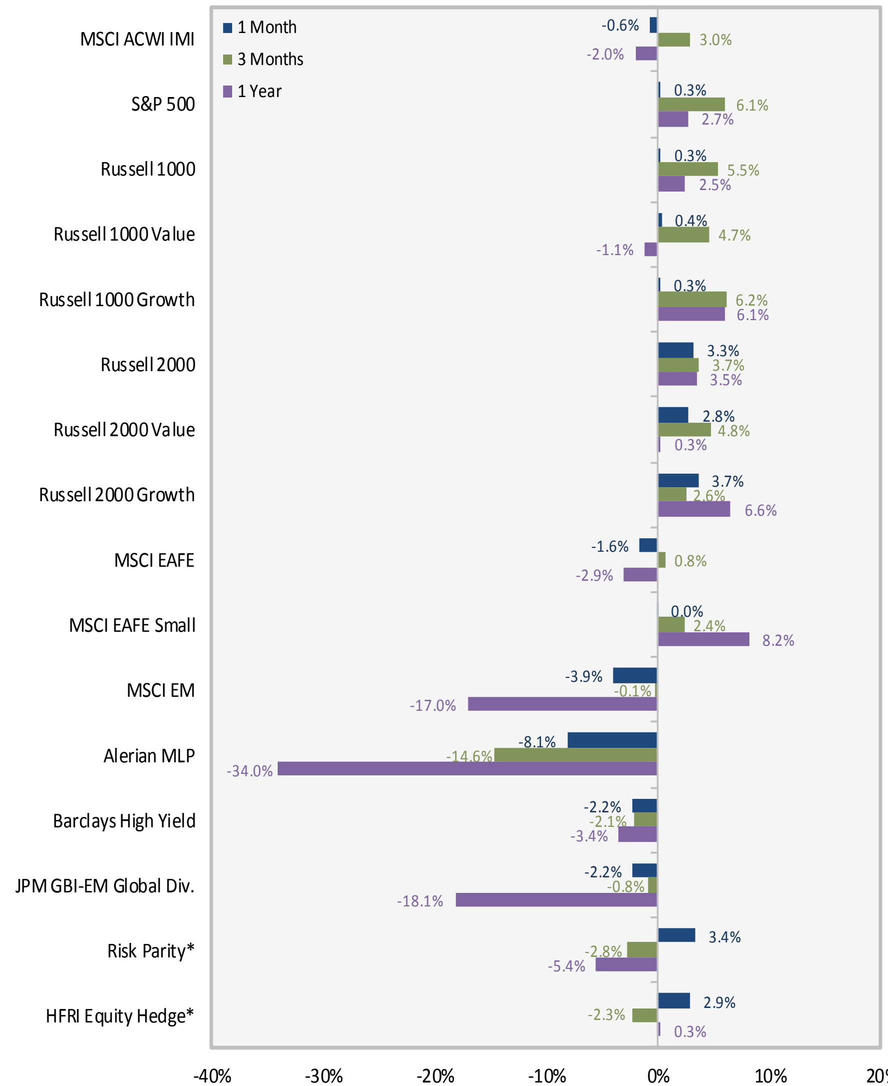
- The third quarter delivered another uptick in covenant relief amendments; however, there has been no concentration in any one industry. More amendments are possible in coming quarters as oil prices test the capital structures of energy-related, sponsor-backed deals. Debt/EBITDA ratios are near all-time highs, but capex and interest coverage remain significantly higher than the low coverage rates seen in 2006-07.

Risk Parity

- Risk parity strategies gained in October. Equities and credit drove returns while global nominal bonds detracted.

Growth Hedge Funds

- Growth hedge funds gained in October, with gains in long/short equity and event-driven strategies. Fundamental long/short equity and activist strategies drove returns.



* 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

- US Treasuries lagged with a return of -0.4% in November as rates increased. The curve flattened with the two-year Treasury up 21 bps on elevated expectations for a rate increase while the long end rose only five bps due to investor demand on the heels of Paris terrorist attacks and relative attractiveness versus non-US yields.
- Investment grade credit spreads were marginally tighter in November, falling three bps as investors continued to take advantage of attractive valuations. Credit outperformed Treasuries with a return of -0.2%. Spreads remain wide for the year at 147 bps despite sound credit fundamentals. Supply still continued to weigh on the market with $98 billion coming to market, bringing the 2015 total to $1.2T and surpassing 2014's record breaking year by $50B.
- Securitized assets fared better than government and credit sectors. Agency MBS produced a -0.1% return while ABS and CMBS returned -0.2% and -0.2%, respectively. For the year, securitized assets are the clear outperformers among major Barclays Aggregate sectors.
- International bonds returned -2.8% in November due to broad-based currency weakness versus the USD. Currency weakness was particularly acute in the Eurozone as monetary policy expectations further diverged between the ECB and FOMC.

Private Debt

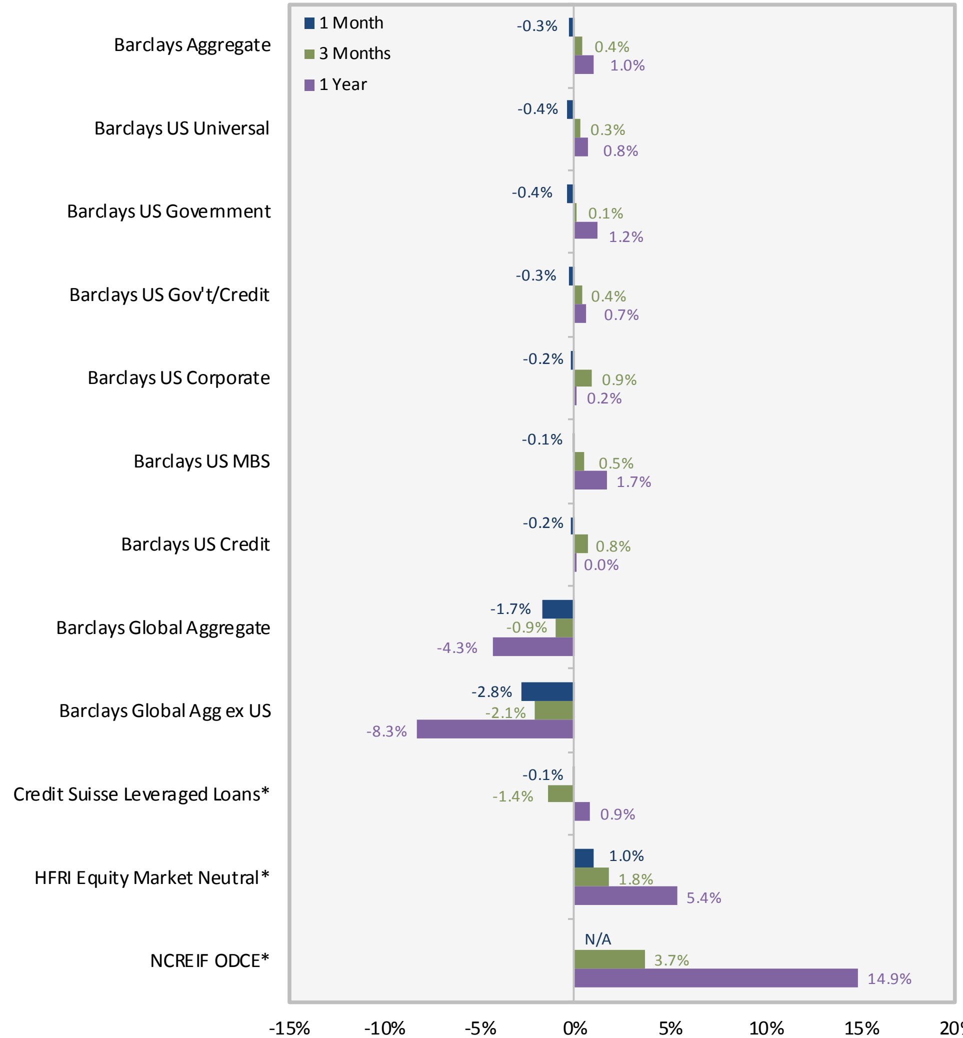
- Bank loans lagged for the fourth straight month pushing the average price to $92.7, a four-year low. Three-year discount margins have risen to 623 bps and yields (3-year life) are nearly 7%. A worsening technical environment impacted returns with fund outflows for the 18th month out of the last 20 months despite the increasing possibility of rate hikes.

Relative Value Hedge Funds

- Relative value hedge funds gained in October. Convertible arbitrage, credit, and equity market neutral strategies led returns.

Core Real Estate

- Core real estate continued to perform well, with preliminary returns for the NCREIF ODCE Index coming in at 3.7% for the third quarter. New job openings are near all-time highs, new claims for unemployment are at their lowest levels in decades, and supply-demand fundamentals remain favorable for core real estate.



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Diversification Assets

November 30, 2015

Inflation

- Though TIPS slipped 0.1% in November, they still outperformed nominal Treasuries as breakeven inflation expectations widened along the curve. As of the end of November, the breakeven inflation rate for the 10-year TIPS was 1.6%, up 11 bps on the month. While the five-year forward, five-year inflation expectation, a favorite of the Federal Reserve, rose 7 bps to 1.8%, it remains well below the more typical level of 2.5%.

Deflation

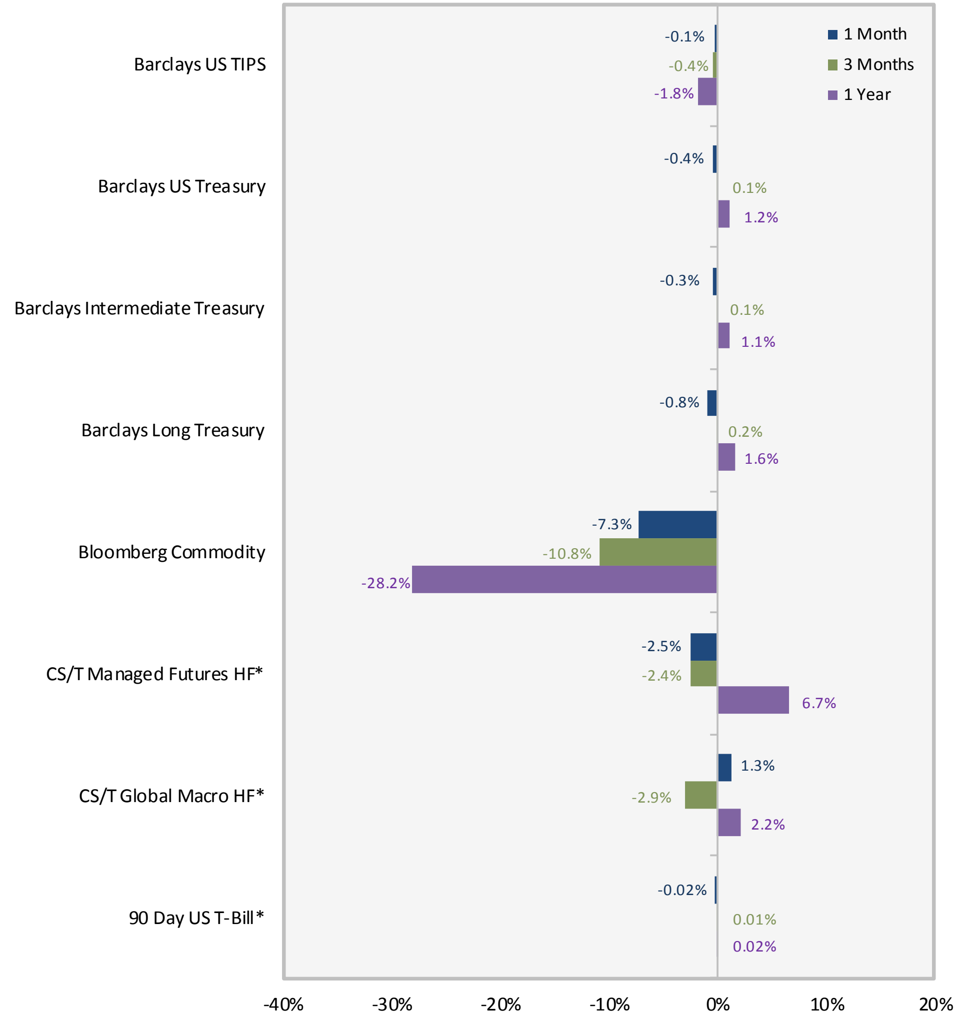
- Long bonds rose early in November alongside short and intermediate yields, with the 30-year Treasury rising 20 bps to 3.12%. From there, long bond yields fell 15 bps as investors grappled with global terrorism concerns and divergent monetary policies between the Fed (tightening) and the ECB (accommodating). The Barclays Long Treasury Index returned 0.8% for the month.
- Cash continues to offer virtually no return, with 90-day T-Bills returning just 2 basis points over the past year.

Commodities

- All sectors were generally down as commodity markets continued to struggle, with the exceptions of only soybean oil (+3%) and sugar (+3%) posting positive returns. All other commodities declined during the month. Crude oil, diesel, and copper declined the most in November, each returning -12%. Inventories globally remain elevated for energy and metals commodities, as incremental demand has not yet begun to reduce excess supply.

Tactical Trading

- Tactical trading strategies detracted for October, with gains in discretionary global macro offset by losses in managed futures.



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