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Monthly Economic & Capital Market Update

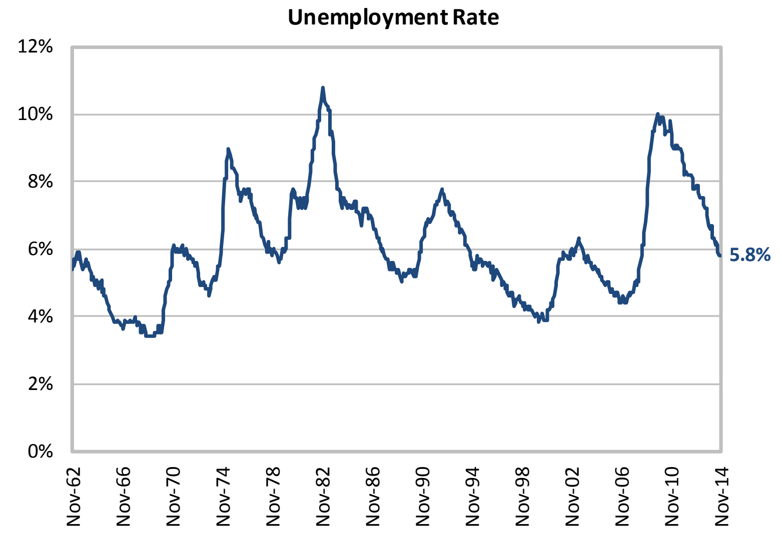
November 2014

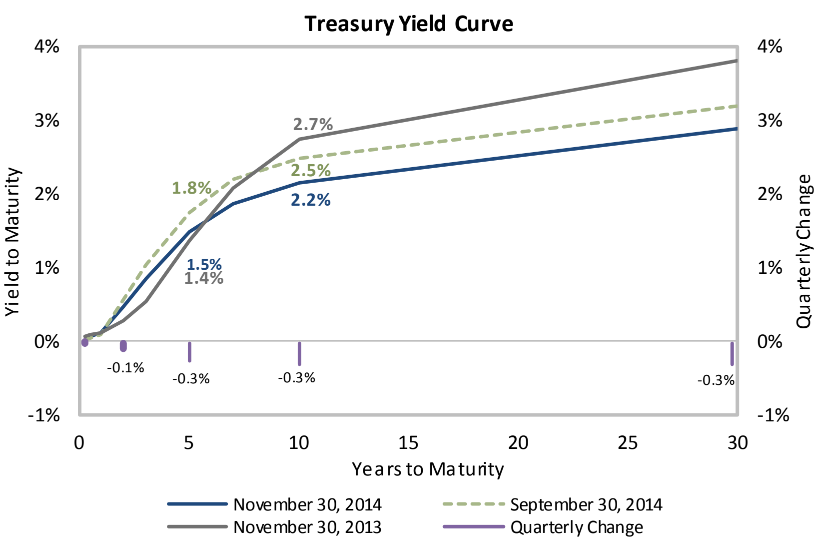
Economy

- The month of November saw a continuation of many of the trends that have been in place year-to-date in 2014. The strength of the US economy relative to the rest of the world is a key theme that has driven financial markets in past months and continued to do so in November. The US dollar rose 1.7% against major foreign currencies during the month, bringing the year-to-date gain for the dollar to 10.4%; the strengthening of the dollar has been a result of diverging growth trends and central bank policy across economies. The announcement of the US Federal Reserve ending QE, its asset purchase program, in October was followed by announcements of further accommodation in Europe, Japan, and China in November. While overall global central bank policy remains supportive of increased economic activity, the US and UK appear to be on the track to a more neutral stance; at the same time, other major economies continue to ease.
- The unemployment rate remained at 5.8% in November, its lowest level since July 2008. Nonfarm payrolls increased by 321,000, coming in well above economists' expectations of an increase of 230,000. November's 321,000 jobs were the most added in a single month since January 2012, and marks the tenth straight month of more than 200,000 added jobs. Figures for October and September were revised upward by a total of 44,000 jobs, another encouraging sign for the labor market.
- US consumer prices, as measured by the Consumer Price Index (CPI), rose 1.7% year-over-year in October. Inflation has slowed throughout the world in recent months and has become a main area of concern for central bankers. Prices in the eurozone rose just 0.3% year-over-year in November, prompting European Central Bank (ECB) President Draghi to urge eurozone officials for more stimulus measures in the near term.
- Crude oil prices fell 18% to multi-year lows in November and were down over 30% year-to-date at the end of the month. The positive effects of this drop in prices have been felt by consumers, as the average price of gasoline has fallen below $3.00 per gallon for the first time since 2011.
- Real GDP growth for the third quarter of 2014 was 3.9% annualized according to the second estimate from the Bureau of Economic Analysis. All components of GDP were positive contributors to the higher-than-expected number with the exception of private inventory investment, which contracted slightly. This estimate of GDP will be revised again in coming weeks as more information is collected. Real GDP growth for the first three quarters of 2014 has been 2.1% on an annualized basis.

Yield Curve

- The spread between 2-year and 30-year Treasuries shrunk 20 bps to 240 bps during November. 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

November 30, 2014

Public Equities

- The global equity market was once again led higher by US stocks during the month. Domestic equities (S&P 500, +2.7%) outperformed international (MSCI EAFE, -1.4%) by 130 basis points, while in the US market large cap continued to outperform small cap. The strengthening dollar and weakening foreign currencies have had a negative impact on international equity returns in USD terms; year-to-date the currency impact on MSCI EAFE (USD) has been -9.0% and the impact on MSCI EM (USD) has been -5.3%.
- MLPs (-2.6%) were only modestly affected by a further decline in global crude oil prices. Year-to-date MLPs have returned 11.0%, consistent with return expectations of distribution yield (5-6% currently) plus distribution growth (typically 4-6%). Smaller capitalization MLPs have underperformed in this recent correction, as capitalization-weighted indices have outperformed on a relative basis.

Public Debt

- High yield bonds returned -0.7% as spreads widened 35 bps to 450 bps. Over the past 20 years, high yield spreads have averaged 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

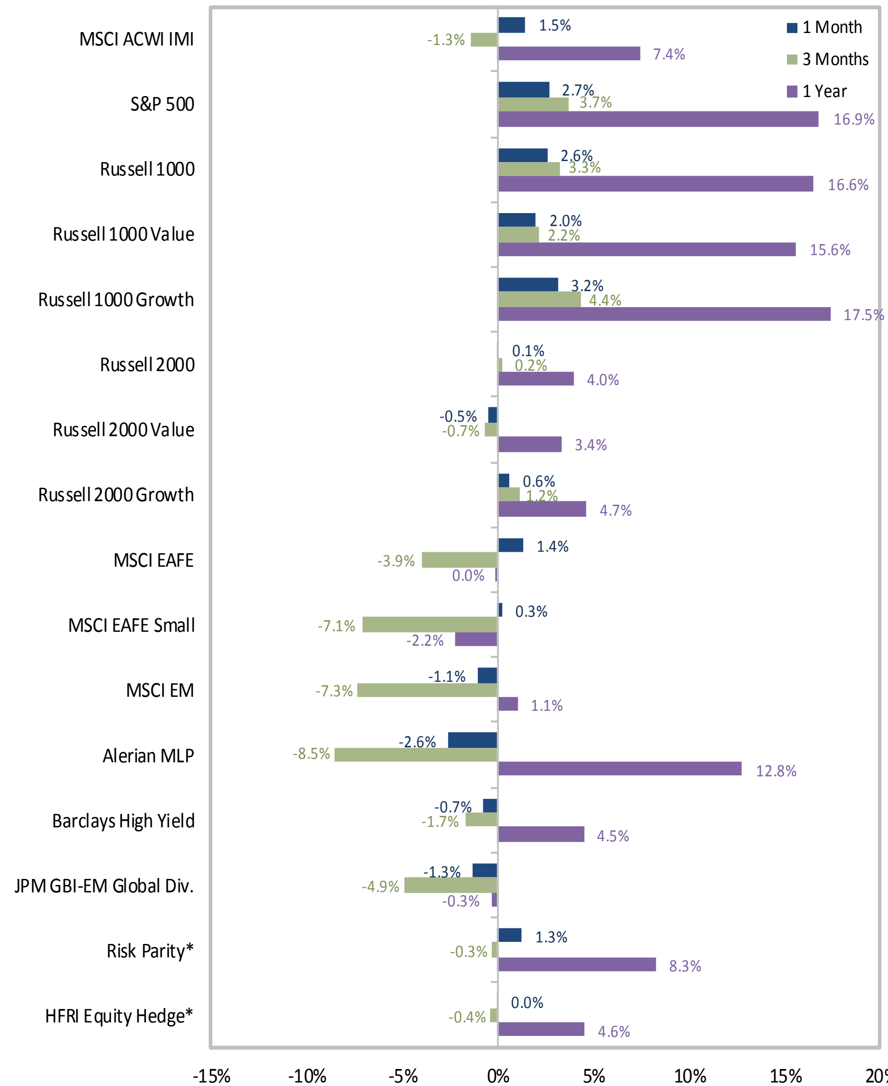
- Availability and aggressive terms from senior lenders has allowed debt levels in the larger end of the market to increase to another new cycle high of 5.9x EBITDA. This remains lower than the prior cycle high of 6.2x recorded in 2007. As the credit cycle has progressed, credit standards and spreads 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 were positive in October. Nominal bonds drove performance as interest rates fell; credit allocations also contributed while commodities detracted.

Growth Hedge Funds

- Long/short equity managers posted mixed results, with quantitative strategies generally performing well while energy-focused managers followed global energy prices lower. Event-driven managers performed worse, as many funds were hurt by poor performance of Fannie/Freddie and the termination of the Shire/AbbVie merger.



* 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.

Income Assets

November 30, 2014

Public Debt

- Interest rates in most developed economies moved lower from already low levels during November. The 10-year US Treasury ended October yielding 2.2%, well below its 20-year average of 4.4%. Yields in foreign developed countries remain very low; the Barclays Global Aggregate ex-US Index ended November yielding just 1.2%.
- Core fixed income (Barclays Aggregate) outperformed core plus (Barclays US Universal) by 20 bps during the month.
- US Government bond prices rose as yields fell, returning 0.8% for the month.
- Corporate bonds returned 0.6% in November as investment grade spreads widened 5 bps to 125 bps. Corporate bond spreads have averaged 145 bps over the past 20 years.
- Mortgage-backed securities returned 0.7% for the month as agency MBS spreads were widened 5 bps to 30 bps, below the 20-year average of 60 bps.
- International bonds were the worst-performing fixed income sector during November, with the Barclays Global Aggregate ex-US Index returning -1.1%.

Private Debt

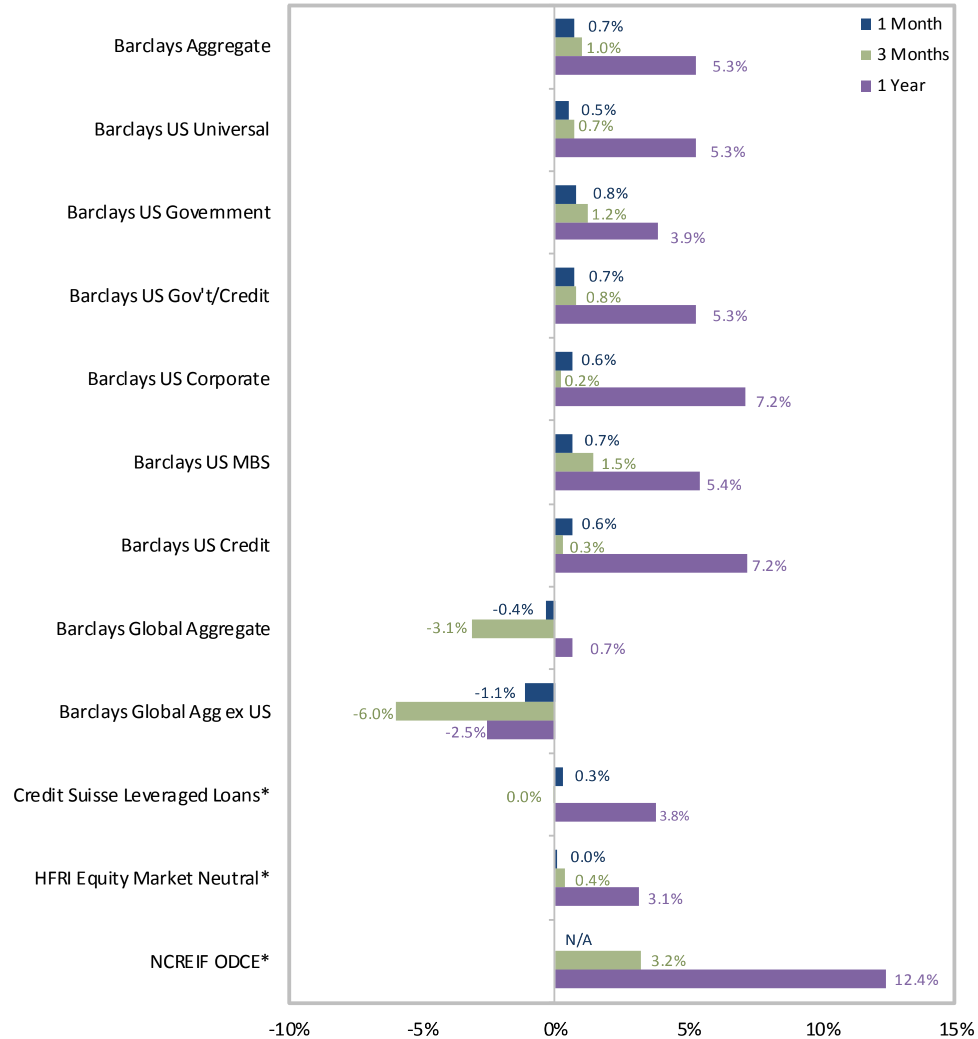
- Leveraged loans produced modest returns in October and were up 3.8% for the 12 months ending October.

Relative Value Hedge Funds

- Market neutral equity managers posted slightly positive performance in October, while the relative value complex was negative; volatility strategies were the largest detractors.

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

November 30, 2014

Inflation

- TIPS returned 0.3% in November and are up 3.3% over the past year.

Deflation

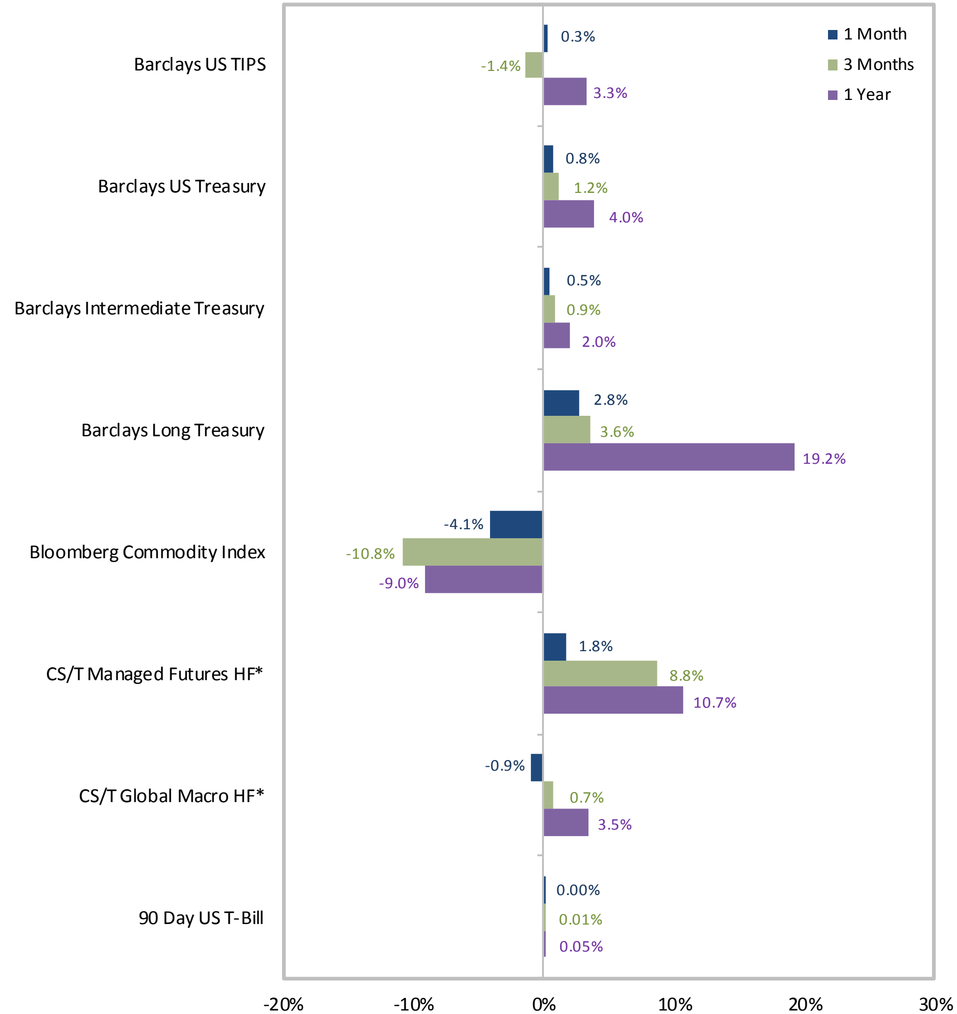
- Treasuries advanced as yields fell during November, returning 0.8%.
- Intermediate Treasuries returned 0.5% and long duration Treasuries returned 2.8%. Intermediate and long Treasuries have earned 2.0% and 19.2%, respectively, over the past year.
- Cash continues to offer virtually no return, as 90-Day T-Bills have gained just 5 bps over the past year.

Commodities

- Commodity prices fell (Bloomberg Commodity Index, -4.1%) in November, driven by the drop in crude oil prices , which settled at a mid-$60 per barrel price range. A combination of North American production growth as well as OPEC electing not to cut production in order to maintain market share have contributed to excess supply. This, coupled with reduced demand growth expectation in the near term from China and other emerging markets, has driven the price correction. The decline in crude oil has also sent refined products prices lower with heating oil (-11%) and gasoline (-12%) both declining. Agriculture commodities fared better with wheat gaining 8% and livestock slightly positive. Industrial metals declined on similar demand related pressures affecting crude oil, namely reduced demand expectations from emerging markets, with copper (-6%) and zinc (-4%) falling during the month. Precious metals were generally flat during the month.

Tactical Trading

- Diversification hedge funds continued their recent rally in October. Managed futures strategies once again drove returns, while discretionary global macro strategies detracted.



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