Summit Strategies Group

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Monthly Economic & Capital Market Update

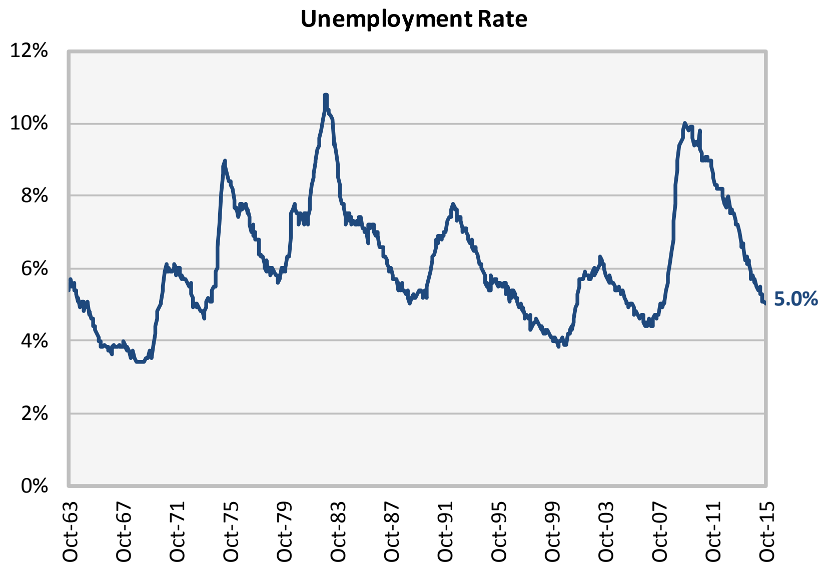
October 2015

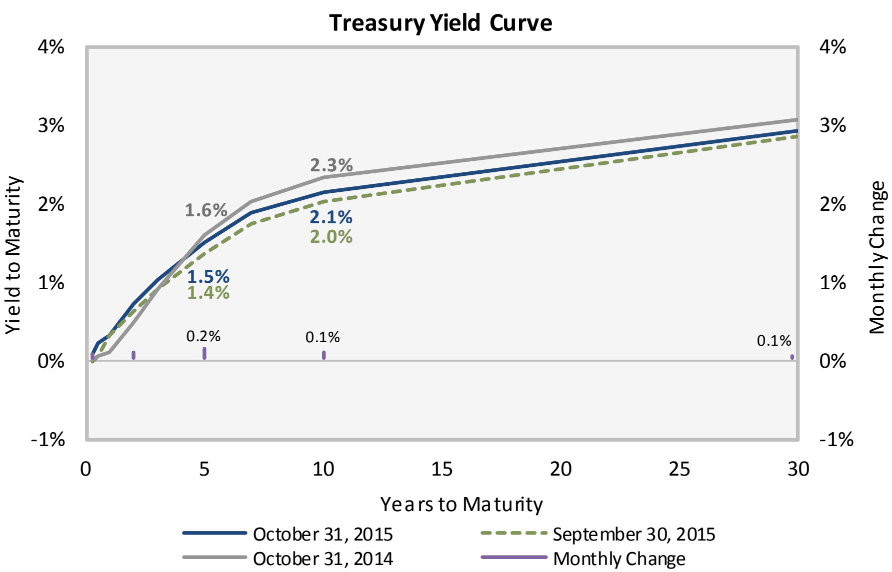
Economy

- Positive payroll numbers, wage gains, and financial market performance during the month of October were supportive of the Federal Reserve in their plan to raise interest rates in December 2015. After concerns over slowing global growth prompted the Federal Open Market Committee (FOMC) to keep rates unchanged at its September and October meetings, recent data releases have been positive and fears over a global downturn appear to have subsided. The Federal Reserve has kept rates near zero since 2008 and market participants have been focusing on the timing of the FOMC's first rate increase since 2006 for some time now. While the timing of the first interest rate increase may have short-term investment implications, Summit believes the focus for investors should be on the path of rate increases the FOMC takes compared to what is expected by market participants; investors continue to believe the Federal Reserve will not raise rates at the pace the Fed is projecting.
- The October employment report showed that US job growth surged during the month, exceeding market expectations. Employers added 271,000 jobs during the month, well above market expectations of 180,000 jobs. The unemployment rate fell 10 bps to 5.0%, its lowest level since April 2008. October's job growth comes as a rebound, with September and August adding just 137,000 and 153,000 jobs, respectively. Job growth has averaged 187,000 over the past three months, roughly in line with the recovery of the past seven years. Historically, 200,000 new jobs per month has been consistent with strong labor market expansion.
- Additionally, the October employment report showed accelerated wage growth in the US. For the 12 months ending October, average hourly earnings grew 2.5%, the highest one-year gain since July 2008. 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 1.5% annualized rate during the third quarter, according to 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 third quarter slowdown.

Yield Curve

- The spread between 2-year and 30-year Treasuries was unchanged at 220 bps in October. Over the past 30 years the spread between 2- and 30-year Treasuries has averaged 165 bps.





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Public Equities

- After the first major pullback in four years during Q3 2015, global equity markets rebounded strongly in October. Strong October gains erased most of the losses from the previous three months as global central banks continued to dominate market price action. The S&P 500 was up 8.4% for the month, pulling the Index back into positive territory for 2015. Emerging markets, which were hit the hardest during Q3, also rebounded strongly, returning 7.1% for the month of October.
- MLPs recovered from a difficult prior quarter that was driven by technical selling pressures to end September. Pipeline subsectors were up between 10% and 11%. General partner (+6%) and gathering & processing (+7%) MLP sub-sectors failed to keep pace with broad indices.

Public Debt

- High yield bonds bounced back in October, returning 2.7%. Spreads tightened 70 bps to 560 bps, leaving the sector yielding 7.4%. A perceived delay to rate hikes, stabilizing macro data, and the combination of very strong mutual fund inflows and lower issuance volume helped performance in October.
- Local currency emerging markets debt rose 4.5% in October on EM currency strength and lower local interest rates. Speculation that the FOMC would delay raising interest rates led to USD depreciation, especially versus some rate sensitive countries (Russia, Columbia, Turkey, and Indonesia). Further, local interest rates have been aided by falling EM inflation, giving EM central banks room to ease rates.

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

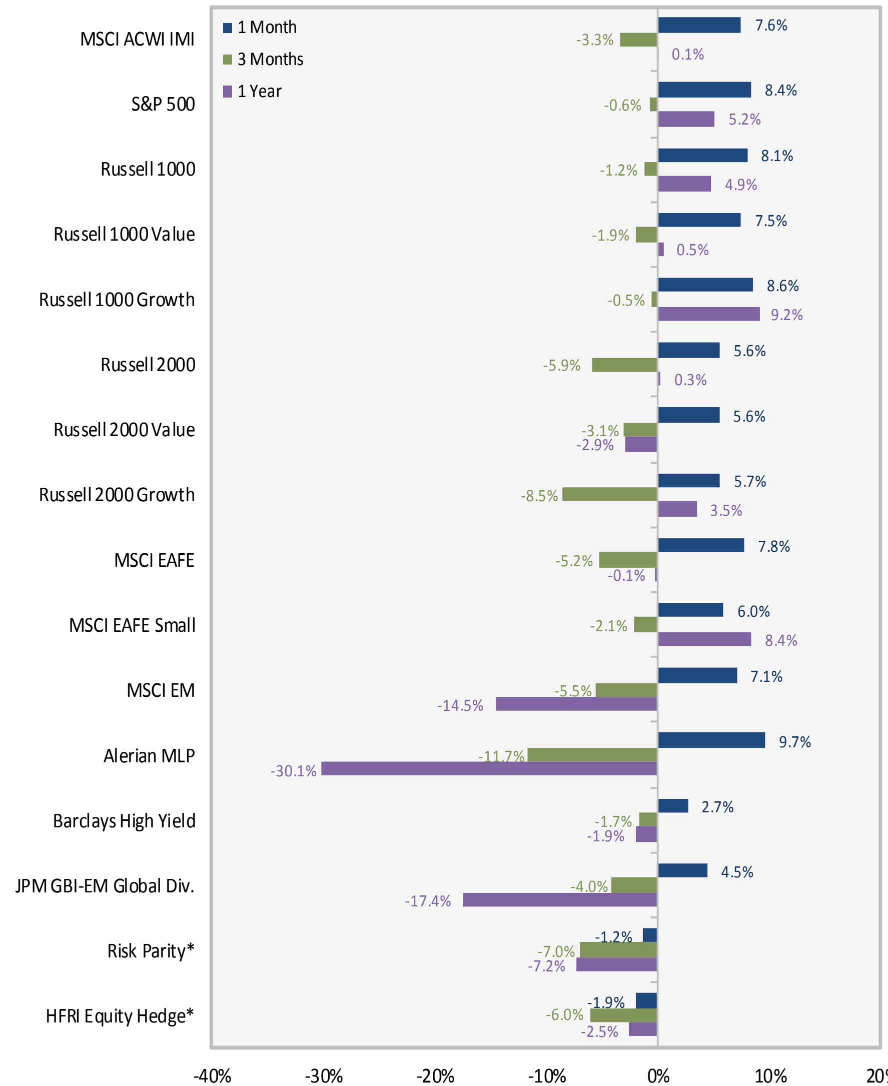
- The third quarter delivered another uptick in covenant relief amendments; however, there has been no concentration in any one industry. More amendments are possible in coming quarters as oil prices test the capital structures of energy-related, sponsor-backed deals. Debt/EBITDA ratios are near all-time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

Risk Parity

- Risk parity strategies detracted in September. Losses in equities, credit, and commodities were not offset by gains in bonds.

Growth Hedge Funds

- Growth hedge funds detracted in September. Activist strategies were the weakest performers, while long/short equity and distressed credit strategies also detracted.



* 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

- Following a strong end to the third quarter, US Treasuries lagged with a return of -0.4% in October as rates rebounded. Rates remained unchanged up until the FOMC's October 28th statement before moving up sharply after a seemingly hawkish FOMC kept rates unchanged but indicated a potential move in December if economic data warranted the move. The front end of the curve rose with the 5-year Treasury up 16 bps while the 10-year was up 11 bps for the month.
- Investors moved to take advantage of attractive valuations in spread sectors with investment grade credit spreads moving 10 bps tighter, helping to offset the increase in rates and generate a 0.5% return. Spreads remain wide for the year at 150 bps despite sound credit fundamentals. At $973B year-to-date, supply should cross $1 trillion for the fourth straight year with M&A activity accounting for approximately 21% of issuance in 2015. Approximately $200B in supply backlog of M&A activity remains.
- Securitized assets did not fare as well as credit in October with MBS marginally positive at 0.1% while ABS and CMBS returned -0.2% and -0.2%, respectively. ABS suffered from elevated supply as issuance increased by $10B month-over-month in October
- International bonds returned 0.3% in October as ECB easing speculation led to euro weakness that weighed on returns. Canadian and Australian bonds were index leaders on currency appreciation tied to higher oil prices and a delay to the initial FOMC rate hike.

Private Debt

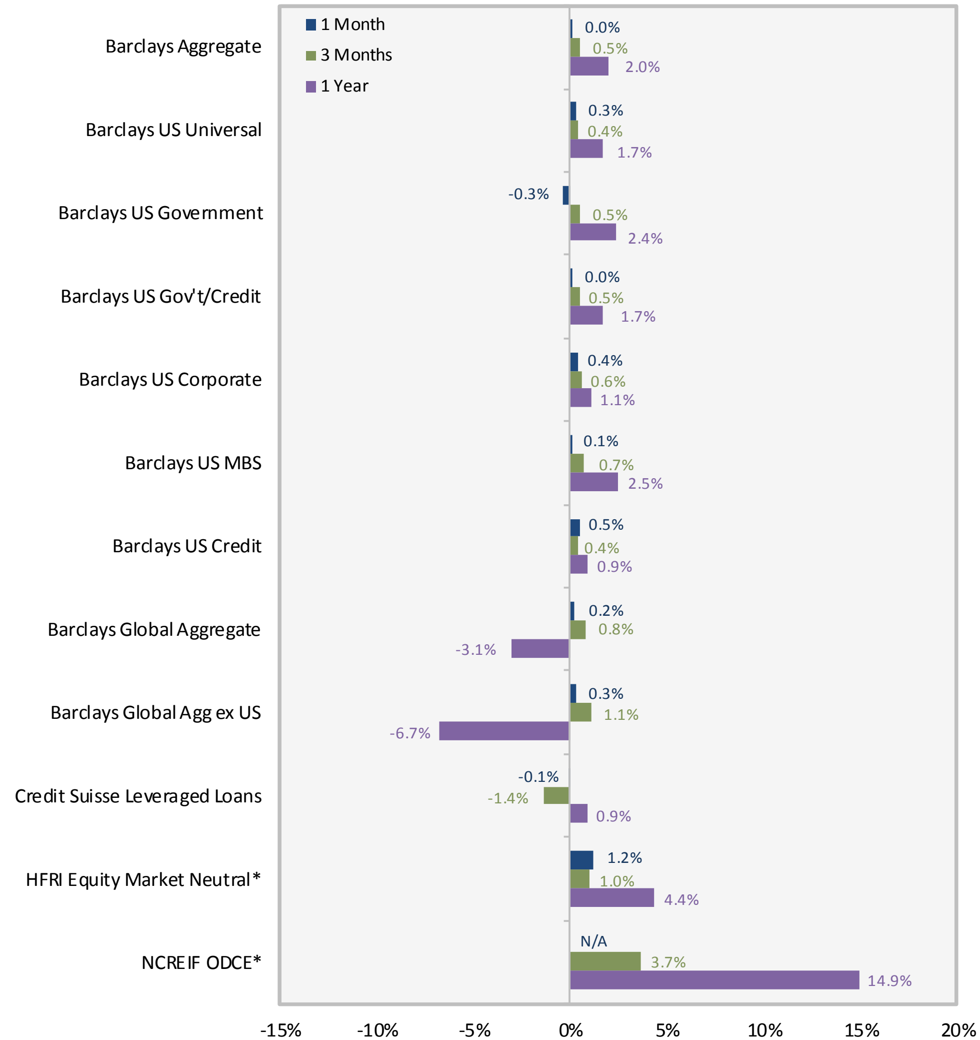
- Bank loans lagged for the third straight month, returning -0.1% and failing to keep up with the overall risk rally. Outflows continued on reduced fears of increased rates and investors' favoring the relative value seen in high yield debt. Energy names also did not rebound in loans as they did in high yield.

Relative Value Hedge Funds

- Equity market neutral funds gained in September, as did relative value volatility strategies. Credit related strategies detracted.

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

October 31, 2015

Inflation

- TIPS rose by 0.3% in October despite the setback in nominal Treasuries. Driving the divergence were break-even inflation expectations, which managed to modestly expand as real yields dipped in the long end of the yield curve. As of the end of October, the breakeven inflation rate for the 10-year TIPS was 1.5%, up 11 bps on the month. While five-year forward, five-year inflation expectations, a favorite of the Federal Reserve, rose 20 bps to 1.7%, they remain well below the more typical level of 2.5%.

Deflation

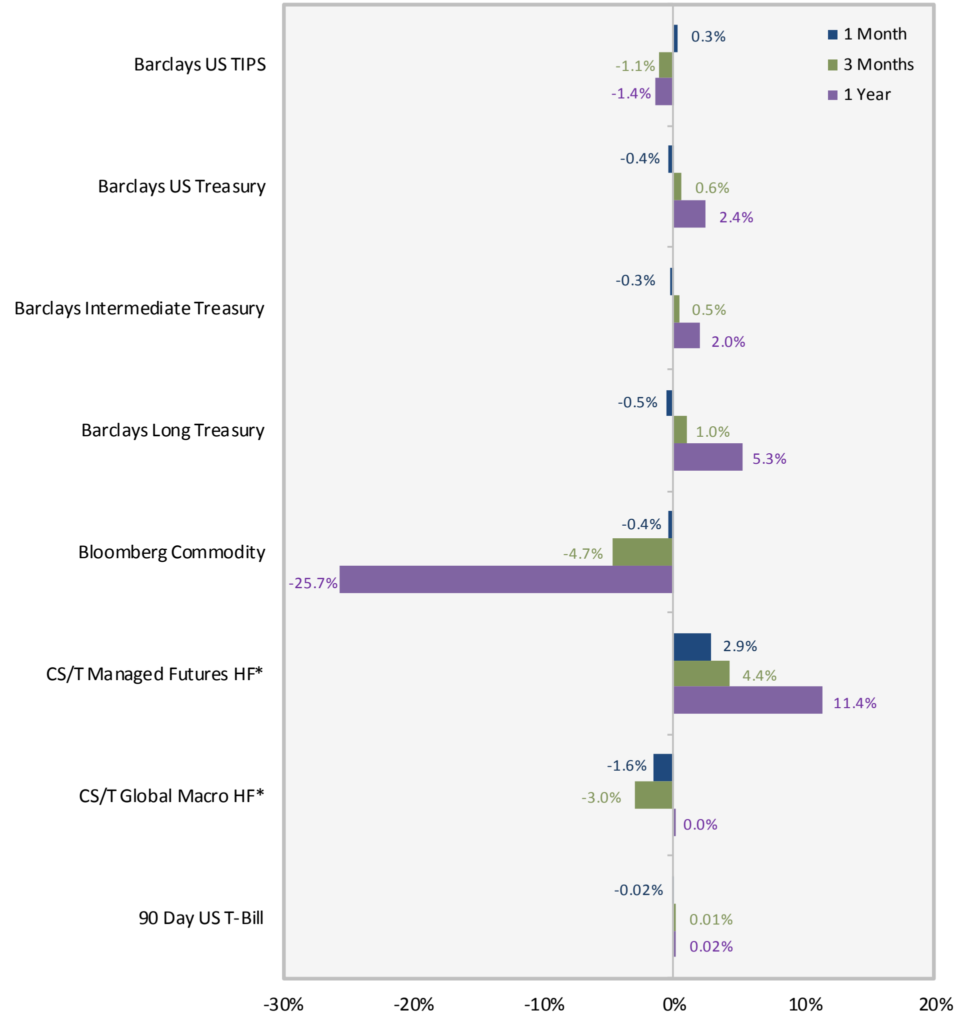
- Long bonds fell in October on the back of late month concerns over future rate increases following the FOMC's statement and a strong consumer spending print contribution to third quarter GDP growth. 30-Year Treasury rates rose seven bps, bringing the Barclays Long Treasury Index down by 0.5%.
- Cash continues to offer virtually no return, with 90-day T-Bills returning just 2 basis points over the past year.

Commodities

- The Bloomberg Commodity Index was generally unchanged in October. Energy commodities exhibited modest price movements with crude oil rising 3%. Natural gas was an exception, falling 8% during the month on mild temperatures, high inventory, and strong production levels. Industrial metals largely declined, while both precious metals were up during the month. Agriculture commodities were generally flat, with the exception of sugar (+19%), lean hogs (-19%), cattle (+12%), and cotton (+6%).

Tactical Trading

- Managed futures strategies contributed in September, while global macro detracted.



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