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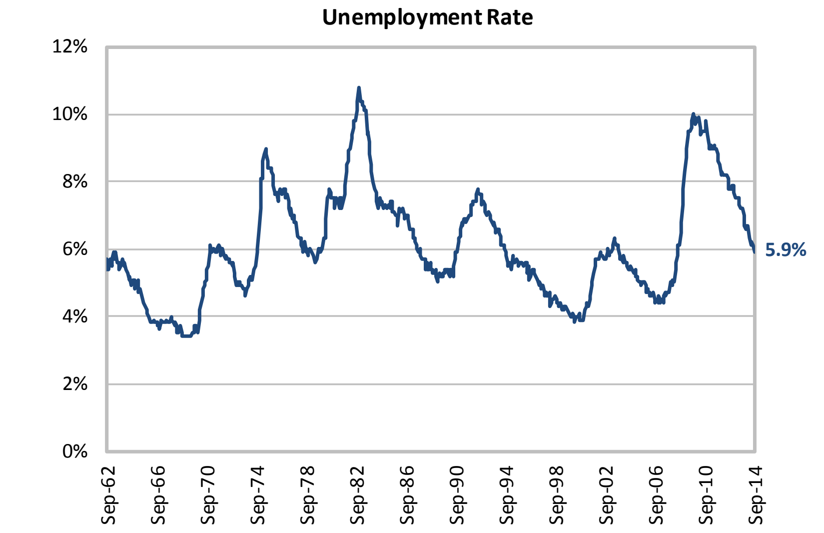
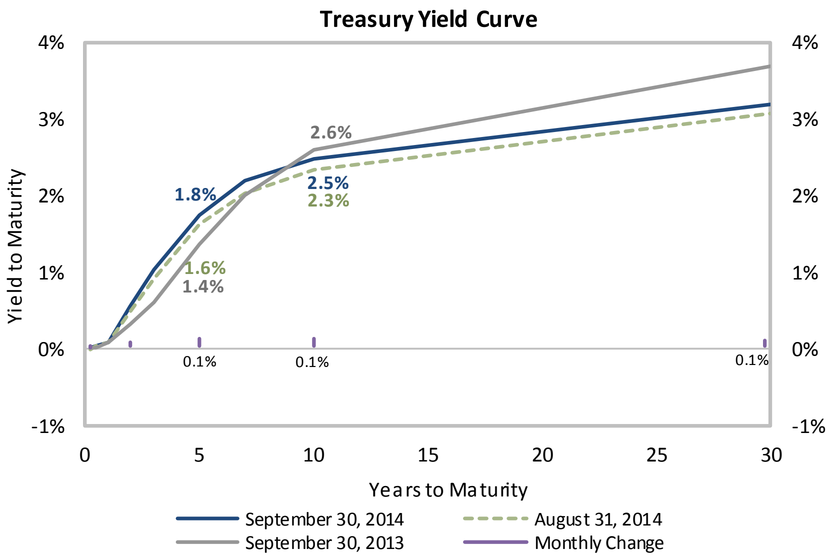
Monthly Economic & Capital Market Update

September 2014

Economy

- The FOMC met during September and, as expected, continued to reduce the rate of asset purchases under its monetary policy stimulus program, QE3. Over the next month, the Federal Reserve will purchase $15 billion of long duration US Treasuries and mortgage-backed securities; at the peak of QE3, the Fed was purchasing assets at a rate of $85 billion per month. The Committee will meet again in October, and it is widely expected that QE will come to an end at this meeting.
- The unemployment rate fell from 6.1% to 5.9% in September, its lowest level since July 2008. Nonfarm payrolls increased by 248,000, beating expectations of an increase of 215,000. July and August's figures were revised upward by a total of 69,000 jobs. The labor force participation rate fell 20 basis points to 62.7%, as demographics and the effects of the 2008-2009 financial crisis continue to weigh on the labor market. The Federal Reserve is using the labor market as an indicator of the strength of the economy, which will be a major determinant of when the Fed will raise short-term interest rates. Upon the release of the jobs report, yields rose across the curve as investors viewed the strong print as a sign that rates may rise sooner than anticipated.
- Consumer prices continue to increase at a rate below the 2.0% long-run target set by the Fed. The Personal Consumption Expenditure (PCE) Index, the Fed's preferred measure of prices, increased 1.5% year-over-year in September. In addition to labor market measures, the Fed is taking price and wage inflation into consideration when determining the appropriate time to raise rates. Wage inflation remains muted and continues to come in around the level of price inflation. Americans have experienced minimal improvement in purchasing power, a headwind for rising consumer demand.
- Real GDP growth for Q2 2014 was 4.6% annualized, according to the BEA's third and final release, an upward revision of 40 basis points from the previous estimate. Exports and nonresidential fixed investment were higher than previously expected, leading to a final figure that was higher than the previous two estimates. Real GDP growth for Q1 2014 was -2.1% annualized.
- US manufacturing continued to expand in September, albeit at a lower rate than in August. The ISM Manufacturing Index, a survey of purchasing managers that is a gauge of future manufacturing (and economic) activity, fell from 59.0 to 56.6 during the month; a figure over 50 implies expansion.





Yield Curve

- The spread between 2-year and 30-year Treasuries widened 5 bps to 265 bps during September. Over the past year, short-term rates have risen as the date for interest rate liftoff approaches, while long-term rates have rallied as global growth concerns and low foreign rates have kept long Treasury rates low.

Growth Assets

September 30, 2014

Public Equities

- The global equity market was led lower by international stocks during September. The US market (S&P 500, -1.4%) outperformed international (MSCI EAFE, -3.8%) by 240 basis points, while within the US market large cap continues to outperform small cap. Domestic stocks have fared the best thus far in 2014, as growth concerns and geopolitical tensions have weighed on international markets
- All MLP subsectors outside of general partners (+0.2%) declined during the month. Energy infrastructure sectors declined modestly (ranging between -0.3% and -2%), while commodity-sensitive and other energy MLP segments declined more dramatically with exploration and production MLPs returning -9% and energy services MLPs returning -13%. M&A continues to be a trend in the MLP asset class highlighting slowing project backlogs amongst large cap MLPs. Another trend among MLPs is organic growth opportunities related to exports, including liquefied natural gas, propane, ethane, and other refined products.

Public Debt

- In September, high yield bonds returned -2.1% as spreads widened 60 bps to 425 bps. Historically, high yield spreads have averaged 520 bps.

Private Equity

- Deal value in the second quarter of 2014 was flat compared to the first quarter of 2014 at $80B. The US and rest of the world were down after large first quarter gains, but Europe's increase almost entirely offset the decline of the US and the rest of the world. Fundraising continued to be very strong, creating record levels of uninvested capital (dry powder). Globally, dry powder increased to $1.2T, up from $950B at the end of Q1. Accommodative debt markets and increasing levels of uninvested capital continue to sustain high deal prices and a challenging investment environment, according to managers.

Private Debt

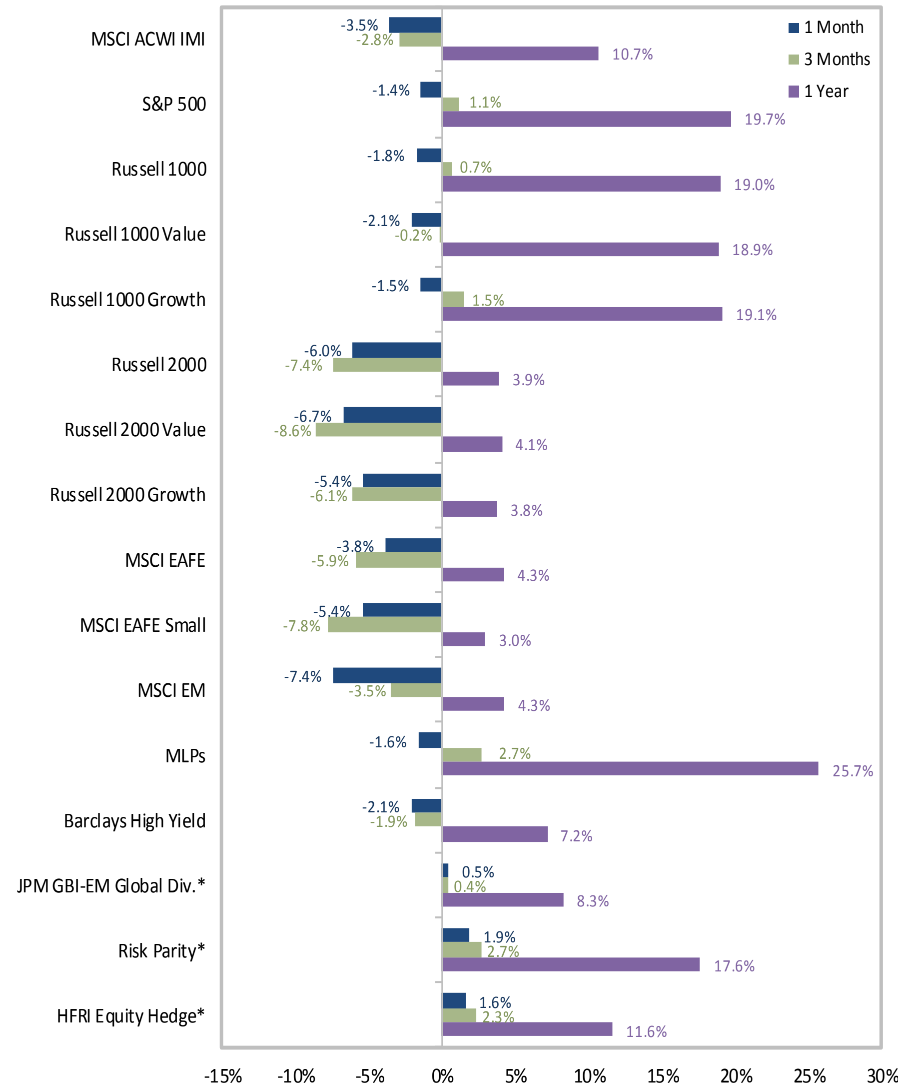
- The availability of credit and aggressive terms from senior lenders has allowed debt levels to increase to a new cycle high of 5.8x EBITDA. This remains lower than the prior cycle high of 6.2x recorded in 2007. The willingness of senior lenders to reach deeper into capital structures and accept higher levels of risk has been particularly challenging for mezzanine providers. According to data from S&P, mezzanine's share of new deal capital structures was 0% in the first and second quarters of 2014. This compares to a typical share of 5-10% over the prior ten years.

Risk Parity

- Risk parity strategies continued strong year-to-date gains in August as stocks, bonds, and credit contributed; only commodities detracted from performance during the month.

Growth Hedge Funds

- Long/short equity funds led hedged strategies higher in August, with the largest gains coming from technology and healthcare-oriented and quantitative strategies. Event-driven hedge funds also contributed, led by activist and multi-strategy funds.



* Data was not available at time of publication - data is previous month's.
Note: Risk Parity returns are based on an internally comprised benchmark.

Public Debt

- Interest rates in developed economies rose slightly during September, but remain low relative to historical levels. The 10-year US Treasury ended September yielding 2.5%, well below its 20-year average of 4.4%. Yields in foreign developed countries remain very low; the Barclays Global Aggregate ex-US ended September yielding just 1.3%.
- Core plus fixed income (US Universal) returned -0.8% for the month, performing roughly in line with core bonds (US Aggregate).
- US Government bonds were also negative in September on rising yields, returning -0.5% for the month.
- Corporate bonds saw returns of -1.4% in September as investment grade spreads widened 10 bps to 110 bps. Corporate bond spreads have historically averaged 135 bps.
- Mortgage-backed securities were down slightly for the month as agency MBS spreads were tightened 5 bps to 30 bps, below the historical average of 65 bps.
- International bonds were the worst-performing fixed income sector during September, returning -4.3%.

Private Debt

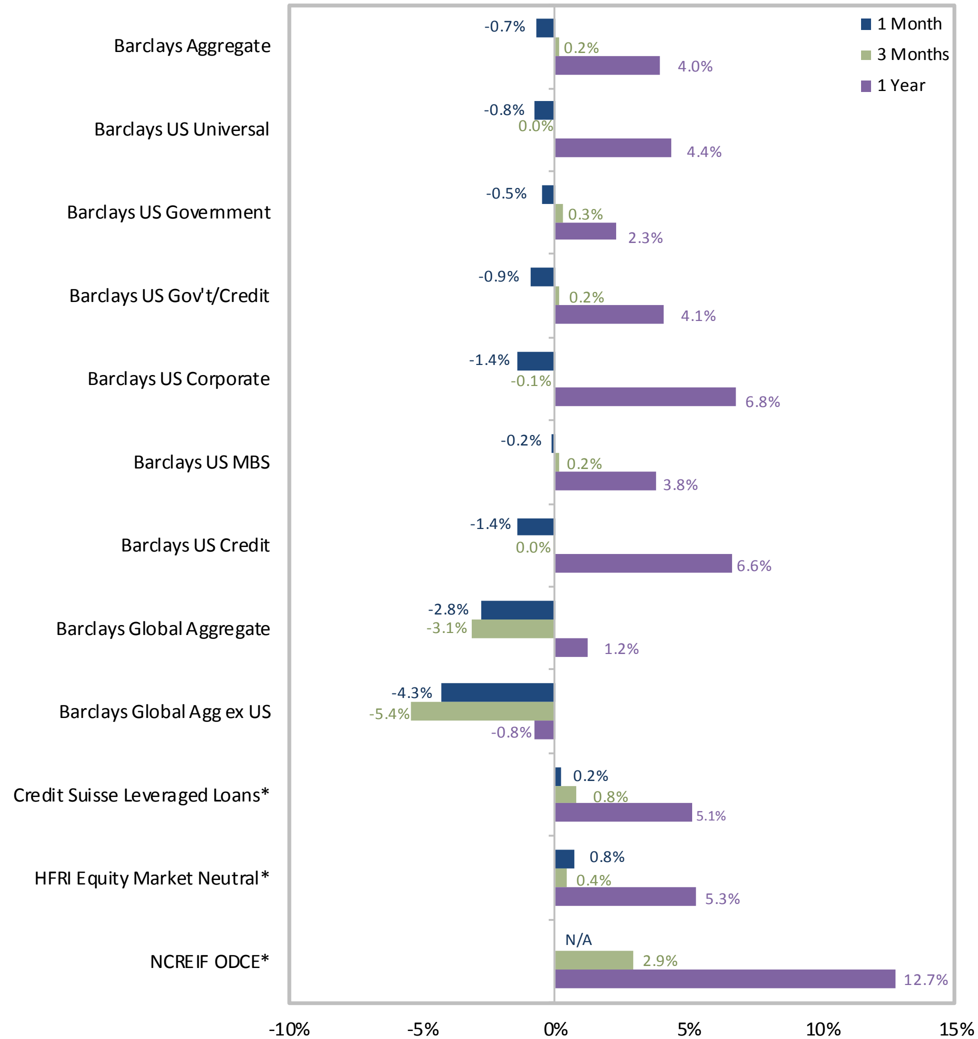
- Leveraged loans rose slightly in August and were up 5.1% for the 12 months ending August.

Relative Value Hedge Funds

- Market-neutral hedge funds in aggregate generated gains for the month of August. Other relative value strategies were also positive, with volatility strategies and relative value arbitrage leading the group.

Core Real Estate

- Core real estate returned 2.9% during the second quarter, a modest improvement of 41 bps from the previous quarter. Through the first half of 2014, core real estate continued to perform well, having generated a 5.5% return for investors. While cap rate compression has been decelerating for most property sectors, net operating income growth has been fueling the recent strong results. Specifically, landlords have exercised their pricing power to push rents higher because of the improving economy and years of below-trend new property supply.



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Diversification Assets

September 30, 2014

Inflation

- TIPS returned -2.5% in September and are up 1.6% over the past year.

Deflation

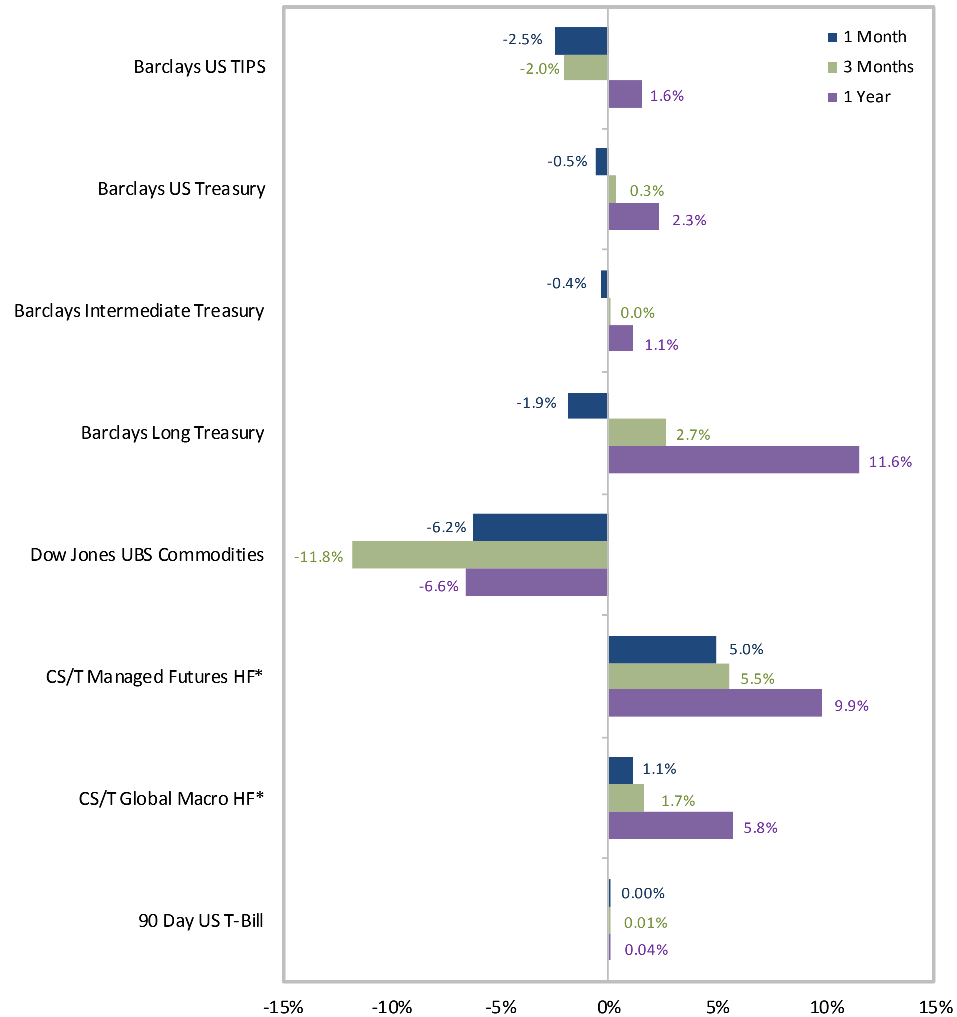
- Treasuries declined as yields rose during September, returning -0.5%.
- Intermediate Treasuries returned -0.4% and long duration Treasuries returned -1.9%. Intermediate and long Treasuries have earned 1.1% and 11.6%, respectively, over the past year.
- Cash continues to offer virtually no return, as 90-Day T-Bills have gained just 4 bps over the past year.

Commodities

- 18 of 22 commodities in the Bloomberg Commodity Index declined in September. Positive returning commodities included lean hogs (+10%), live cattle (+6%), natural gas (+1%), and soybean oil (+1%). All metals declined during the month, as well as all crude oil and refined products commodities, largely due to slowing Chinese economic data and a strengthening US dollar relative to other currencies. All agricultural commodities outside of soybean oil declined in September due to continued expectations of high production levels. At the current negative year-to-date return for the asset class, this would mark the fourth consecutive year of decline, something that has never occurred over the BCI return history, which dates back to 1991.

Tactical Trading

- Diversification hedge funds performed well in August. Managed futures posted strong returns, concentrated in trend-following strategies. Global macro hedge funds also solidly contributed.



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