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Monthly Economic & Capital Market Update

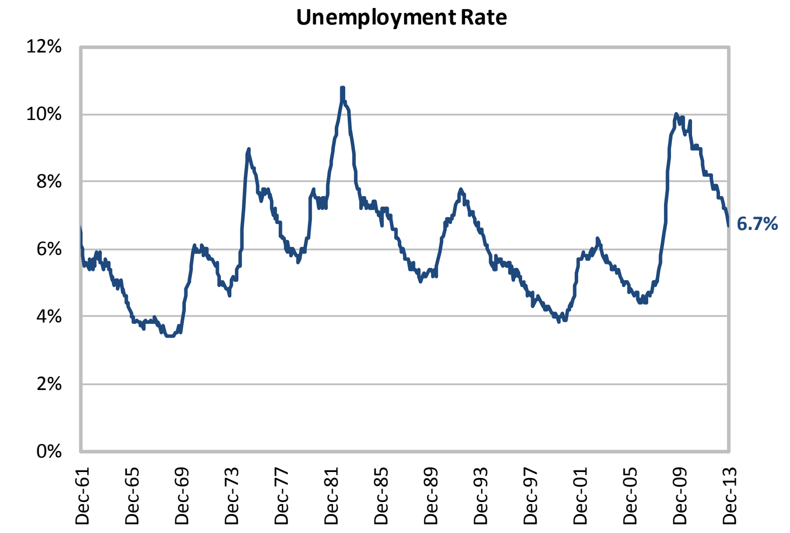
December 2013

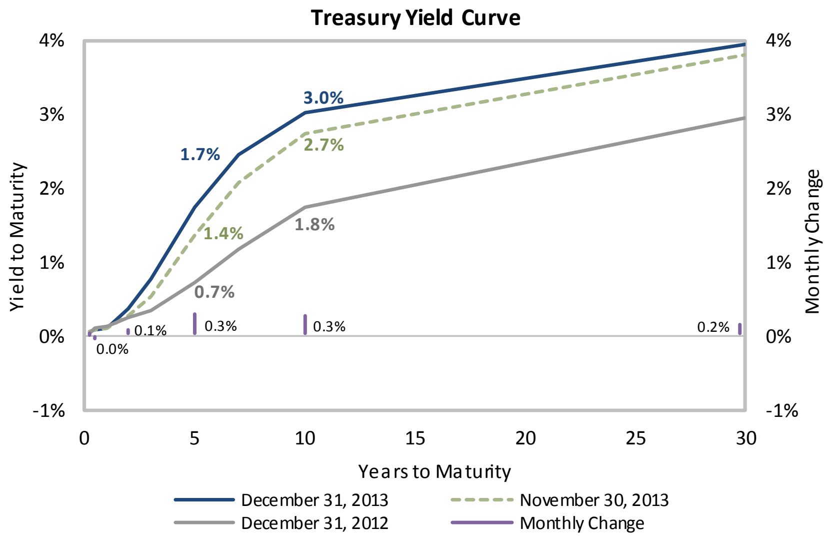
Economy

- The US economy continued along its slow path of recovery in December. The Federal Reserve, citing improvement in the labor market and economy, announced at its December meeting that it will reduce monthly asset purchases to $75 billion from $85 billion beginning in January.
- The unemployment rate fell to 6.7% in December, its lowest level since October 2008. Nonfarm payrolls increased by 74,000, well short of expectations of 197,000. The labor force participation rate fell during the month as people continue to leave the workforce.
- Gross domestic product expanded at a 3.6% annual rate during the third quarter, up from the BEA's initial estimate of 2.8%.
- Consumer prices, as measured by the Consumer Price Index, held constant in November. Core CPI, which excludes food and energy, increased 0.2%. Consumer prices were up 1.2% for the 12 months ending November, while the core rate increased 1.7%.
- The Producer Price Index decreased 0.1% in November. Excluding food and energy, the PPI increased 0.1%. The PPI rose 0.7% year-over-year ending November, while core prices rose 1.3%.
- Rising mortgage rates negatively impacted the housing market during November. Building permits decreased 3.1% month-over-month, existing home sales fell 4.3%, and new home sales fell 2.1%.
- US manufacturing continued its expansion in December, as the ISM Index came in at 57.0, well above economists' expectations of 54.7. An ISM figure over 50 implies expansion.
- Retail sales (ex auto and gas) increased 0.6% in November, while inventories at US wholesalers are expected to have increased by 0.4% in November.

Yield Curve

- In addition to scaling back Quantitative Easing, Chairman Bernanke also stated the FOMC will continue to closely monitor unemployment and inflation in the coming months. The Committee meets next on Wednesday, January 29.
- Yields increased across the curve in December. The spread between 2-year and 30-year Treasuries widened 6 bps to 359 bps.





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Growth Assets

December 31, 2013

Public Equities

- Domestic equities (S&P 500) outperformed international equities (MSCI EAFE) by 100 bps in December. Large cap growth was the best equity performer, up 2.9% for the month.
- Commodity-exposed MLPs, coal (+5%) and upstream (+4%), outperformed during the month, along with MLP General Partners (+8%). Pipeline MLPs were positive but returned less, with natural gas pipeline (+4%) and gathering and processing (+2%) MLPs leading the midstream sector. Small cap modestly outperformed large cap MLPs during the month, reflecting the full valuation of many of the largest and most broadly owned MLPs.

Public Debt

- In December, high yield bonds returned 0.5% as spreads tightened 25 bps to 380 bps.

Private Equity

- Private equity new deal volume remained light in the third quarter, and exit activity moderated. Aggregate exit value totaled $64 billion, which was down 33% vs. the second quarter of 2013, and down 13% vs. the third quarter of 2012. Fundraising has picked up, with year-to-date through the third quarter already matching funds raised in all of 2011. If Q4 stays on pace, 2013 will be 18% greater than 2012.

Private Debt

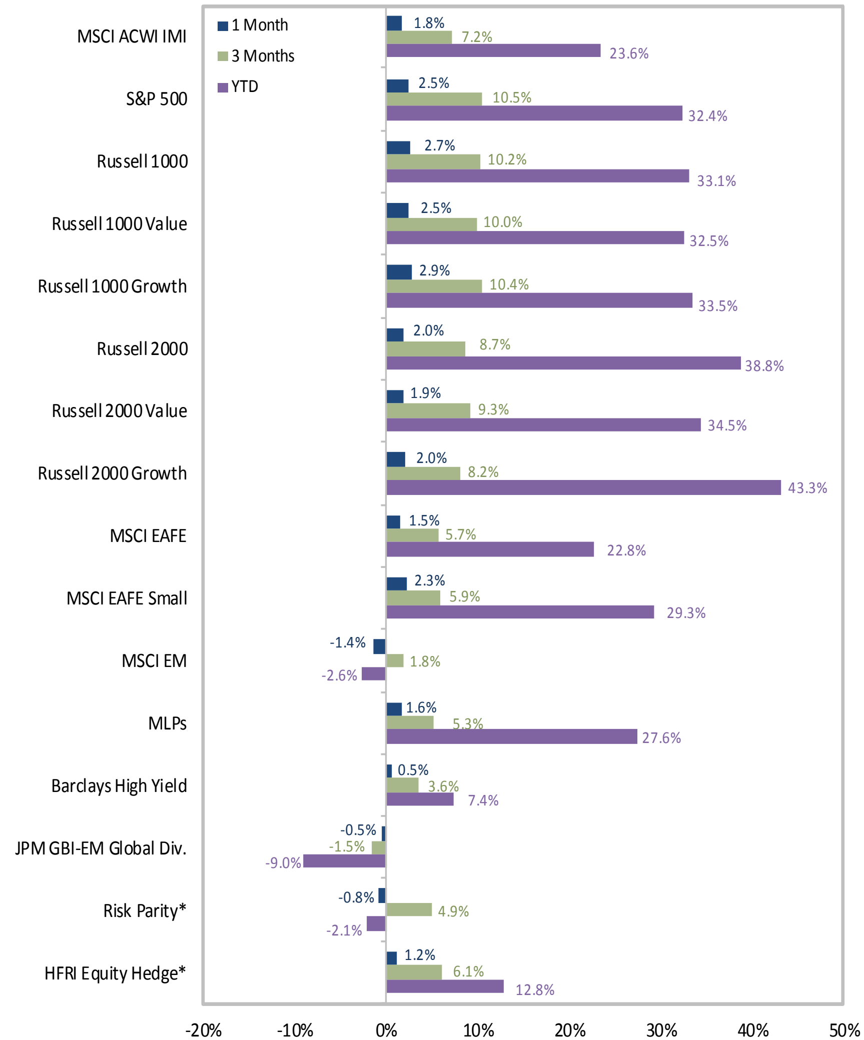
- Debt markets remain extremely accommodating to corporate issuers. The loan market is approaching frothy levels, as evidenced by the return of covenant lite loans, increasing leverage ratios, and attractive pricing (for the borrower). Inflows from both retail and institutional investors (including new CLO issuance) continued in Q3, providing support for senior floating rate debt markets as lenders are pressured to put their capital to work. Refinancing of existing deals has been the main driver of supply in the loan market this year. However, new deal volume picked up in the end of the third quarter, driven by five LBO deals each in excess of $2 billion. Pricing has tightened, with an average reduction of 121 bps throughout the year, stabilizing around L+500 bps with a 1.25% floor plus fees. Leverage ratios are creeping higher, with senior debt/EBITDA into the 5x range for senior loans with average equity contribution of 30%, matching 2007 lows.

Risk Parity

- Risk parity-based strategies underperformed balanced allocations (60/40 blends) during November, as equity gains were more than offset from losses across commodities, inflation-linked bonds and nominal bonds on the month.

Growth Hedge Funds

- The HFRI Equity Hedge Index posted gains in the month of November, leading all hedge fund strategies but continued to lag the equity market rally. Technology and healthcare sector-focused funds posted the largest gains for the month. Event-driven managers also posted gains for the month, with distressed and restructuring strategies outperforming merger arbitrage.



* 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

- The Barclays Capital Aggregate returned -0.6% in December.
- Government bonds were also down, returning -0.9% for the month.
- Corporate bonds saw returns of -0.2% in November as spreads tightened 10 bps to 115 bps.
- Mortgage-backed securities returned -0.5% for the month as agency MBS spreads tightened 5 bps to 35.
- The Barclays Global Aggregate ex US Index returned -0.6% for the month, performing in line with the US Aggregate.

Private Debt

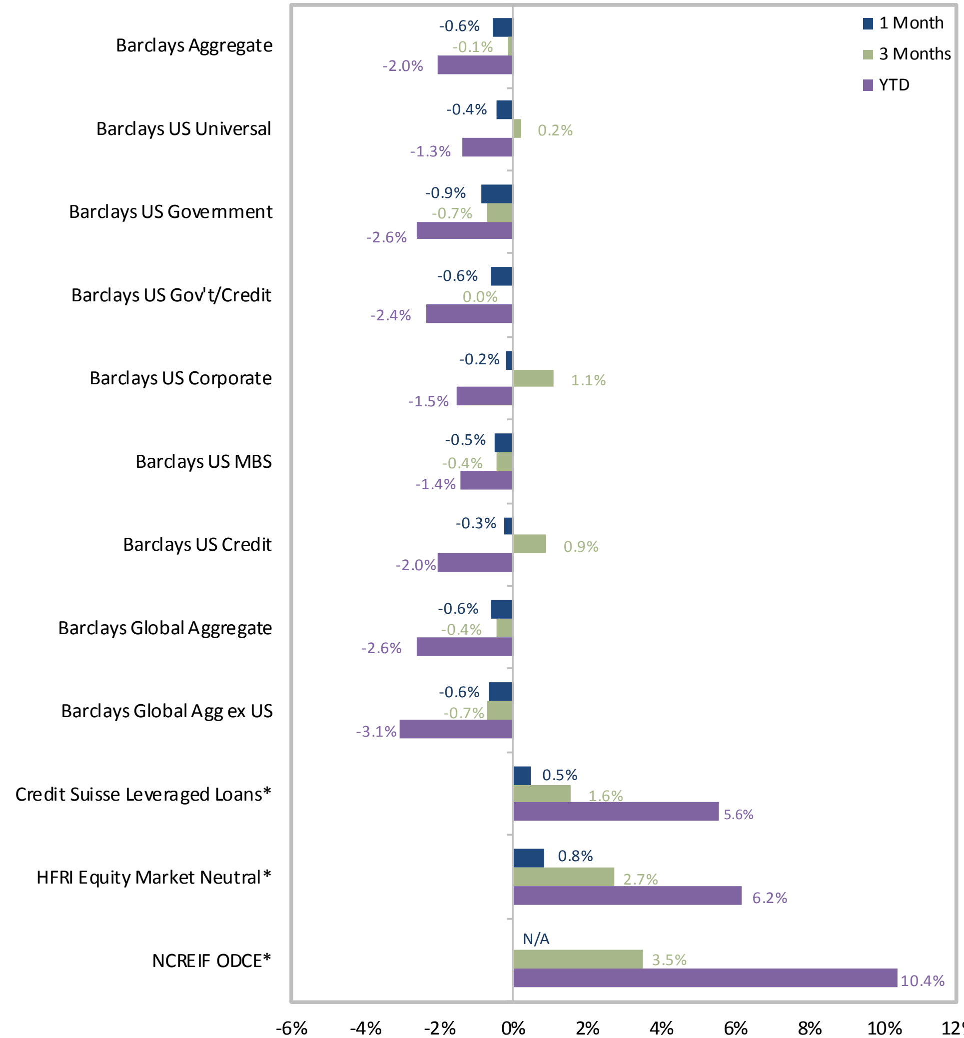
- Leveraged loans returned 0.5% in November and were up 5.6% year-to-date through November.

Relative Value Hedge Funds

- The HFRI Equity Market Neutral Index continued its strong performance in November, bringing year-to-date performance to over 6% and on pace for the best-performing calendar year since 2006. Other relative value strategies, including mortgage/ABS relative value funds and corporate credit funds, posted additional gains on continued spread tightening during the month.

Core Real Estate

- Core real estate returns for the third quarter were quite strong, with the index posting a 3.5% gain. The total return was driven by accelerated income growth fueled by rising rents and occupancies. Commercial real estate fundamentals continue to improve and demand for core real estate remains strong, as evidenced by the $7 billion in fund contribution queues.



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Diversification Assets

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Inflation

- TIPS returned -1.5% in December and ended 2013 with the worst calendar year return (-8.6%) in the history of the asset class (16 years).

Deflation

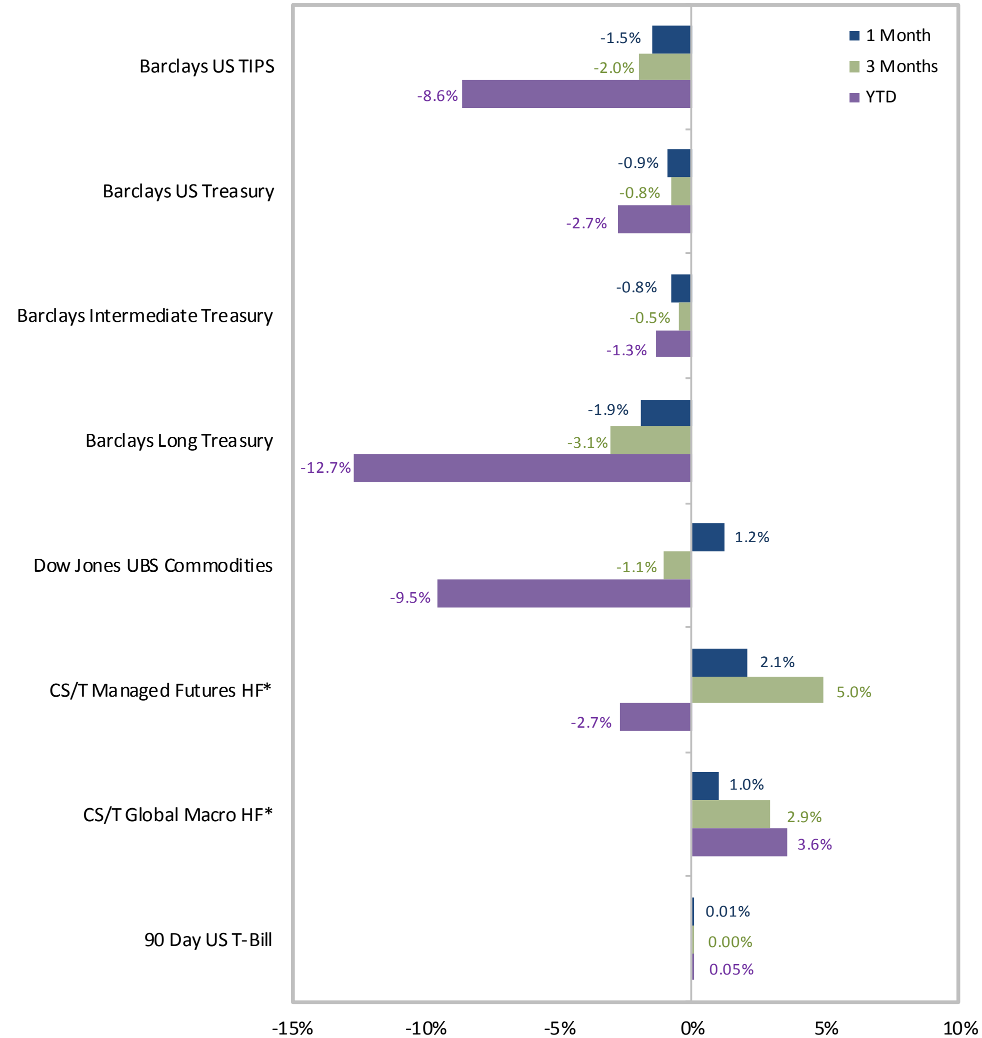
- Treasuries fell 0.9% in December.
- Intermediate Treasuries returned -0.8% during the month and long duration Treasuries returned -1.9%. Intermediate and long Treasuries earned -1.3% and -12.7%, respectively, in 2013.
- 90-day T-bills returned 5 bps in 2013.

Commodities

- Commodities halted a three-month slide and returned 1.2% during December. Agriculture and livestock remain challenged amid elevated supply levels. The exception was cotton, which was up 8% in December. China, the world's largest producer and consumer of cotton, announced it will end its inventory program, reducing future supply expectations. All energy commodities were positive during the month with WTI crude oil (+6%) and natural gas (+7%) leading the way. The cold winter has reduced natural gas inventories below seasonal levels. Precious metals, both gold (-4%) and silver (-3%) declined in response to broad signals of a recovering economy. Industrial metals all rebounded in December, with zinc prices climbing 10% amid mine depletions and closures in Canada and Australia.

Tactical Trading

- Managed futures posted strong performance during November, benefiting from long stock exposure; short precious metals continued trends.
- Global macro hedge funds also posted gains for the month, with long exposure to developed equities and Japanese reflationary trades driving performance.



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