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Monthly Economic & Capital Market Update

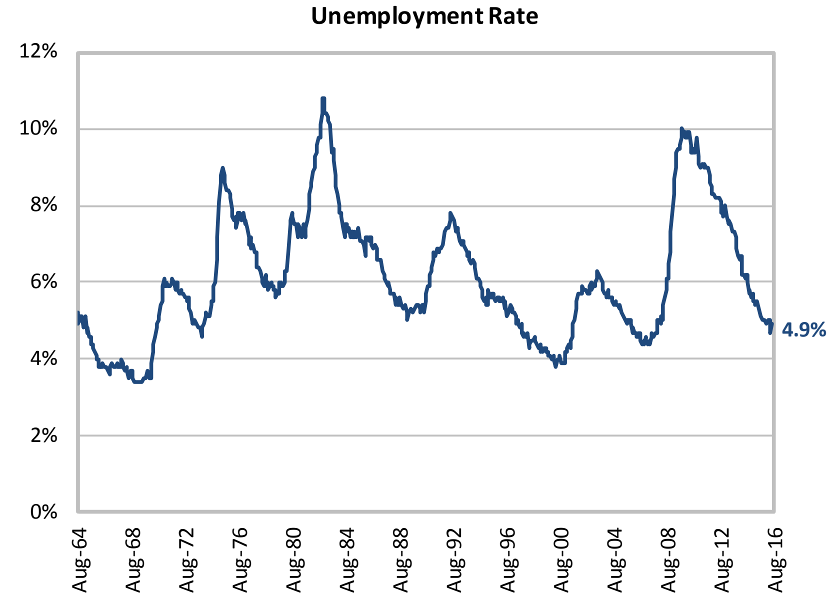
August 2016

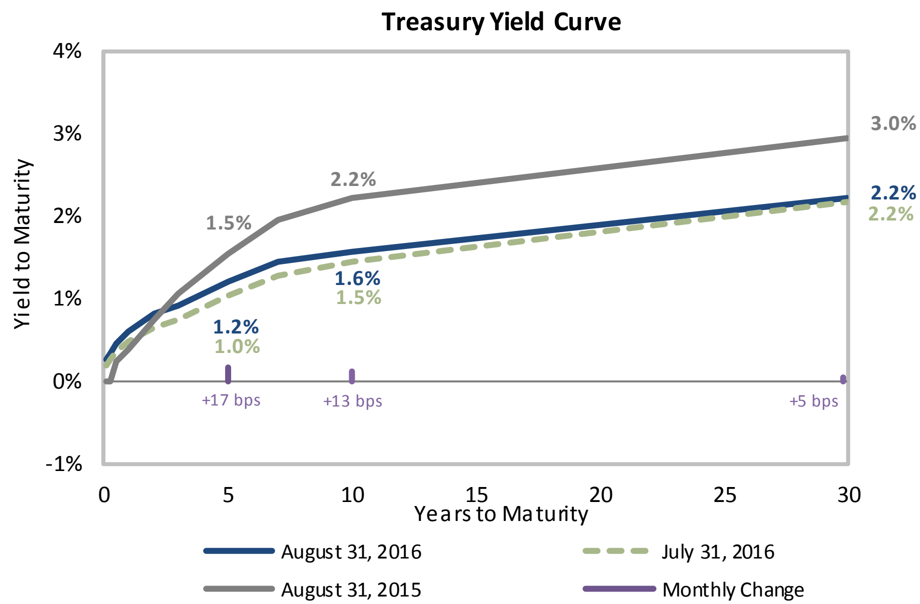
Economy

- The month of August was characterized by low economic and financial market volatility. While growth and inflation in major economies around the world remain low, fluctuations in economic data from quarter to quarter have also been relatively muted. Along these lines, August's employment report showed continued progress in the US labor market, GDP figures remained lackluster throughout most of the world, and inflation data showed little change. As a result, investors are continuing to expect very low interest rates for the foreseeable future. Market-implied interest rate projections at the end of August suggested an approximately 20% chance the Fed raises rates in September (down 10 percentage points month-over-month) and a 50% chance one rate hike occurs by the end of 2016.
- Looking at the August employment report in more detail shows that 151,000 payrolls were added during the month, below economists' expectations of 180,000 new jobs. Despite being below expectations, August marked the 71st consecutive month of job gains, the longest streak on record. The unemployment rate remained steady at 4.9% and the labor force participation rate also remained unchanged at 62.8%. Average hourly earnings for all employees on private nonfarm payrolls rose by 3 cents to $25.73, while average hourly earnings have risen by 2.4% for the past year. June and July estimates were relatively unchanged, as the upward revisions totaled less than 1,000 jobs combined.
- Real GDP grew at a 1.1% annualized rate during the second quarter of 2016, according to the second estimate from the Bureau of Economic Analysis. This estimate was slightly below expectations for 1.2% growth and marks the third straight quarter of growth below 2.0%. Inventory drawdowns continue to negatively impact GDP on a short-term basis, but should be a tailwind during the second half of 2016. Also of note is the upward revision of first quarter's GDP growth to 0.8% from an initial estimate of 0.5%.
- While the service sector of the US economy has been relatively strong over the past few years, the August ISM non-manufacturing Purchasing Managers' Index report showed a slowdown in growth in the sector. The PMI came in at 51.4, 4.1 points lower than July and the lowest number reported since February 2010; a reading above 50 signals economic expansion. One month does not make a trend, but this will be worth monitoring in months to come as an indicator for the US economy.

Yield Curve

- The spread between 2-year and 30-year Treasuries narrowed 10 bps to 143 bps in August, below the 30-year average spread of 166 bps.





Growth Assets

August 31, 2016

Public Equities

- The S&P 500 hit an all-time high and implied volatility (VIX Index) hit a 2-year low during August, yet global markets finished the month with mixed performance. Both domestic and international developed markets were virtually unchanged, with both the S&P 500 and MSCI EAFE Index gaining 0.1%. Small cap equities saw more of a divergence, with the Russell 2000 gaining 1.8% and the MSCI EAFE Small Cap Index falling 0.6%. Emerging markets continued to outperform their developed peers, gaining 2.5%.
- Master limited partnerships (MLPs) declined for the first time in six months, returning -1.3% in August. Natural gas pipelines was the largest detractor at -4.1%, but remain positive year-to-date at 12.5%. Energy services MLPs were the best performers, returning 8.0% for the month and bringing year-to-date gains for the sector to 45%.

Public Debt

- High yield was the best-performing fixed income asset class during August, returning 2.1%. Lower quality assets continued to drive the returns for the index, with CCC-rated issues outperforming B and BB securities during the month and year-to-date.
- Emerging market debt was flat for the month, with Russia and Colombia being the top performers while South Africa and Chile were the largest underperformers, largely due to currency-related movements.

Private Equity

- Larger deals continue to sell for relatively higher price multiples with the average over the first half of 2016 greater than the 2015 average, although there was a decrease in the second quarter of 2016. In contrast to this, deals involving companies that have less than $50m in EBITDA experienced significantly lower multiples in the second quarter, with an average of 7.2x for the period; this is dramatically lower than the 10.7x average experienced in 2015. Data and manager sentiment suggest the lower multiples in the middle market demonstrate managers staying disciplined on pricing and walking away from deals with higher valuations, causing fewer deals to be completed.

Private Debt

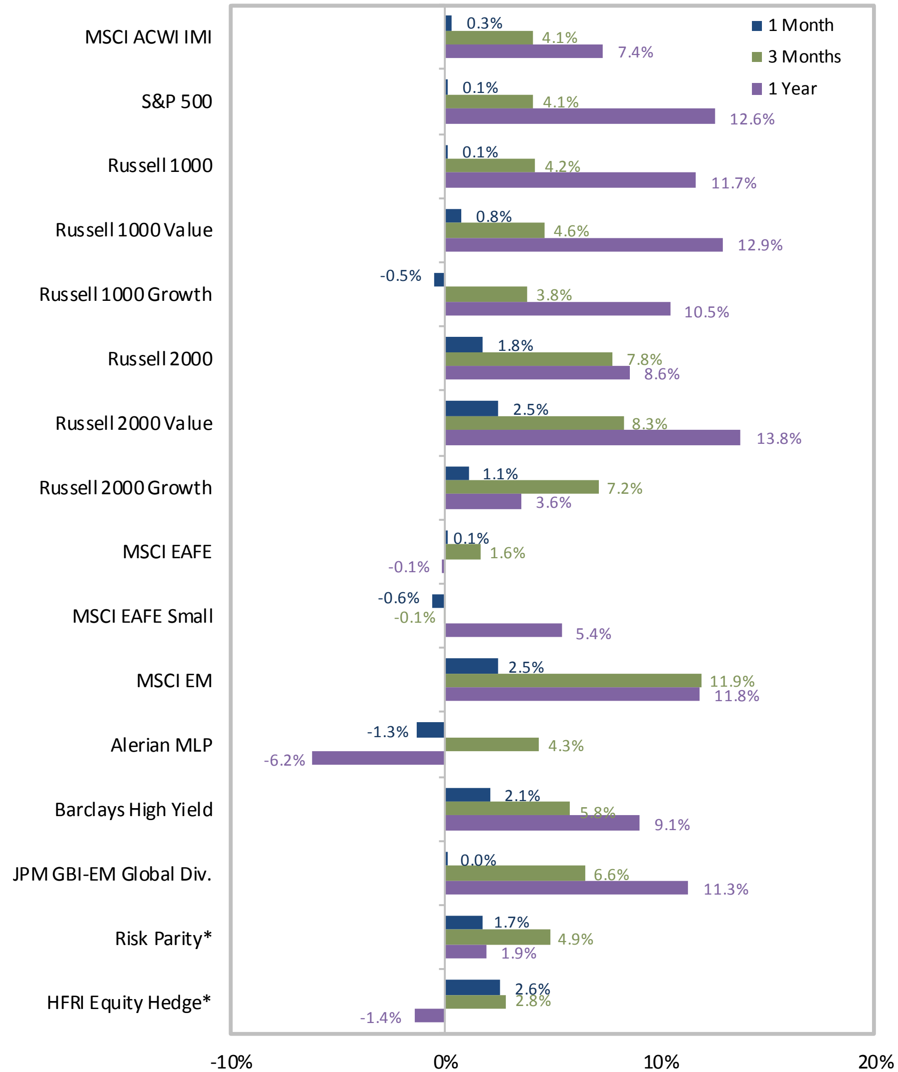
- Debt multiples suggest a similar dichotomy between middle market deals and larger deals. Average debt multiples for deals larger than $50m in EBITDA essentially held constant with the multiples experienced in 2015 while deals in the middle market decreased markedly from 5.3x to 4.3x over the first half of 2016.

Risk Parity

- Risk parity strategies performed well in July. Equities drove gains, while nominal bonds and inflation linked bonds were also additive; commodities detracted.

Growth Hedge Funds

- Growth hedge funds gained in July but lagged broad equity markets. Equity long/short strategies were the top performers, with gains led by the technology/healthcare sector. Fundamental and emerging markets strategies also contributed, along with activist, distressed, and merger arbitrage strategies.



* 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

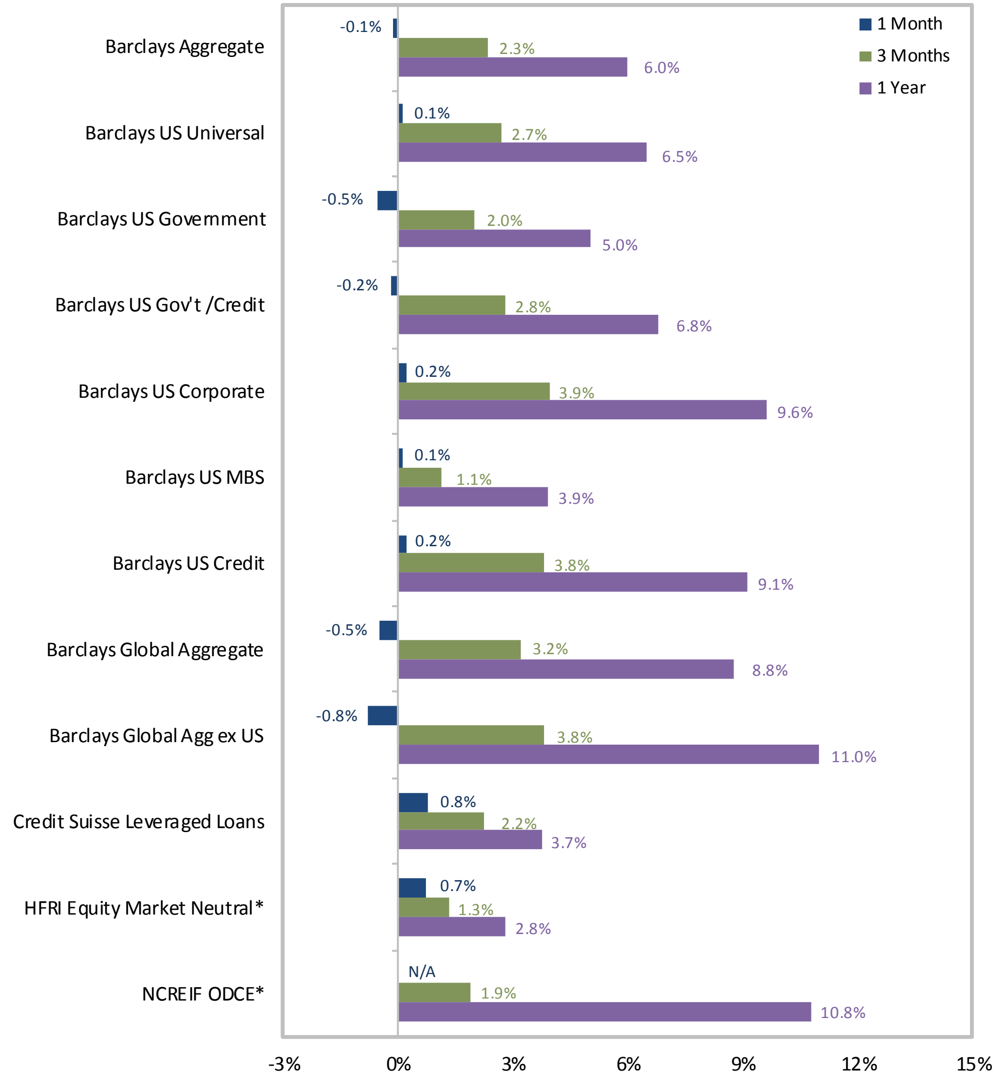
- August exhibited unusually low volatility for the 10-Year Treasury, with the yield remaining within a 12 basis point range (1.50% to 1.62%) for the entire month versus 22 bps during July. As mentioned previously, the market implied probability of a rate rise by the end of the year had fallen to about 50% at month-end.
- Investment grade credit gave coupon-like returns during the month, returning 0.2% while the Barclays Aggregate Index returned -0.1%.
- Securitized products outperformed treasuries across the board during the month, as MBS was the top-performing securitized sector.
- International bonds returned -0.8% for the month of August as the dollar strengthened modestly against foreign currencies and yields moved higher.
- Discount margins for the leveraged loan asset class continued to tighten, ending the month at 519 bps compared to 537 bps at the end of July and 643 bps at the end of 2015. As a result, the Credit Suisse Leveraged Loan Index has turned in modest gains of 2.2.% over the past three months.

Relative Value Hedge Funds

- Income hedge funds were positive in July. The top performers included relative value credit and convertible arbitrage, in addition to the positive contributions of equity and volatility strategies.

Core Real Estate

- The second quarter NCREIF ODCE Index return is 2.1% gross, 1.9% net, with 110 bps of the return comprised of income, and appreciation making up the other 100 bps. While these returns reflect a drop in appreciation from previous quarters they remain in line with historic norms. Seventy-six consecutive months of job growth in the US have been a tailwind for core real estate returns.



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Inflation

- Breakeven inflation expectations fell by 2 bps during the month, ending August at 1.47%. Over the past ten years inflation expectations have averaged 2.0%.

Deflation

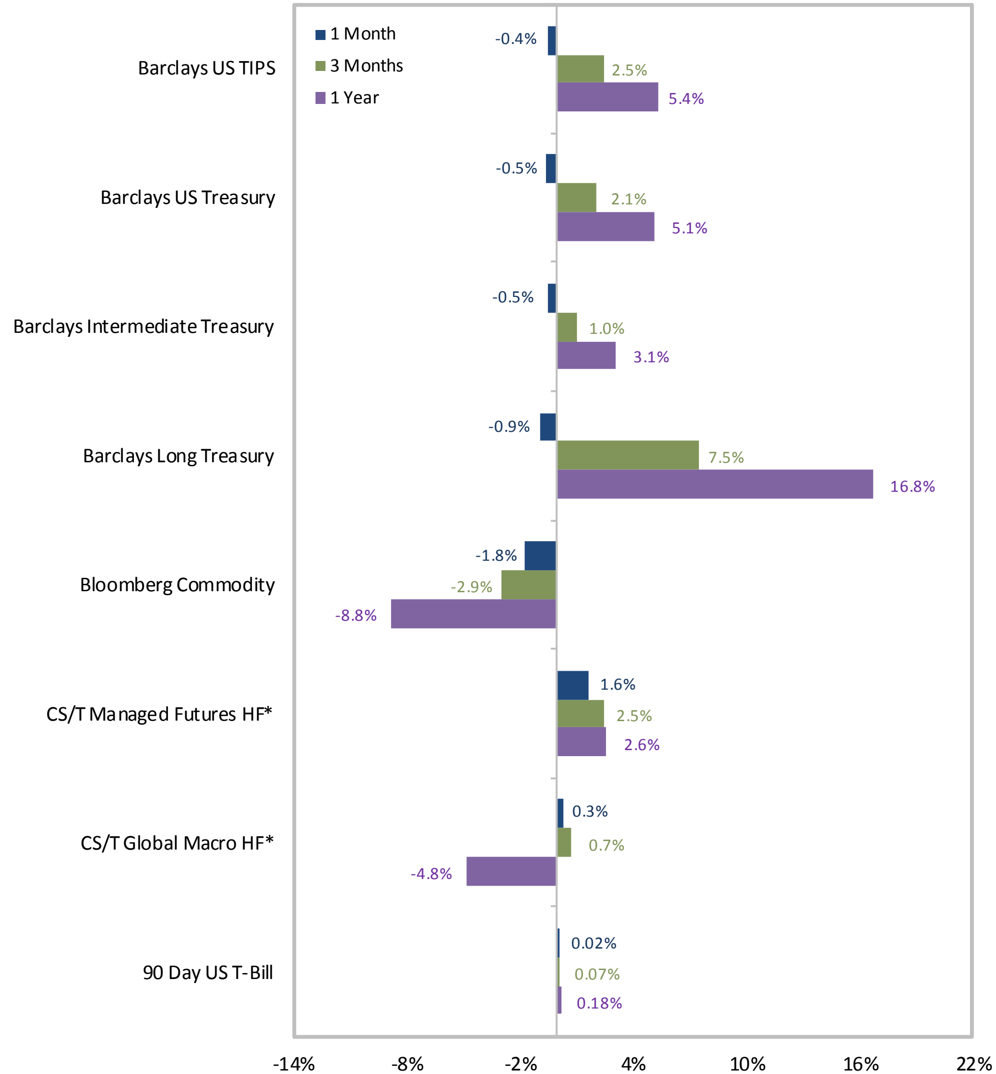
- The Barclays Long Treasury Index returned -0.9% as yields rose along the long end of the curve. Despite the negative month, long treasuries have returned an impressive 16.8% during the past year.

Commodities

- The Bloomberg Commodity Index declined 1.8% during August. Wheat and cotton contributed to underperformance, declining 11.5% and 11.9%, respectively. Major metals such as gold, silver, and nickel also declined in August, following previous outperformance in June and July. Soybeans continued to decline this month (-10.8%). Energy was an outperformer for August as WTI crude oil advanced 7.5%, and heating oil and gasoline gained 10.5% and 6.9%, respectively.

Tactical Trading

- Diversification hedge funds contributed for July. CTAs were the strongest contributors, while discretionary global macro also additive.



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