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# Monthly Economic & Capital Market Update

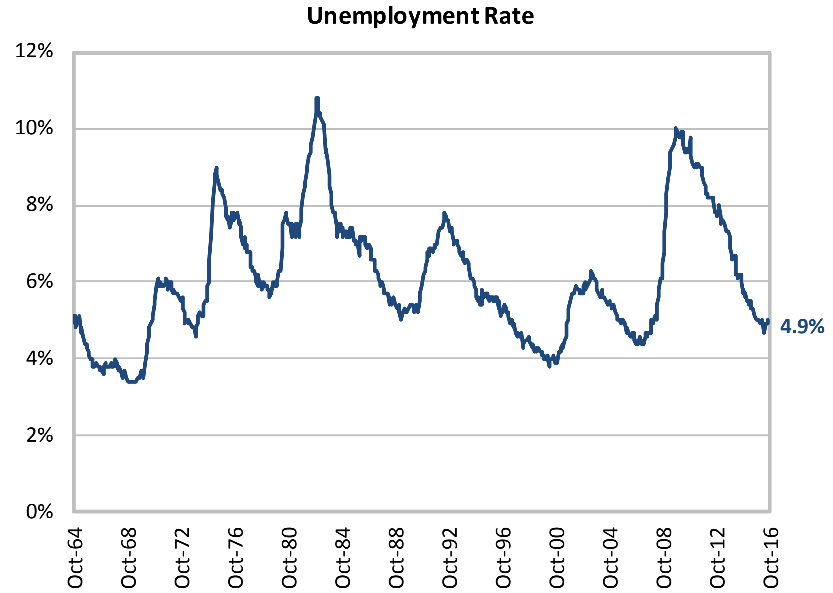
*October 2016*

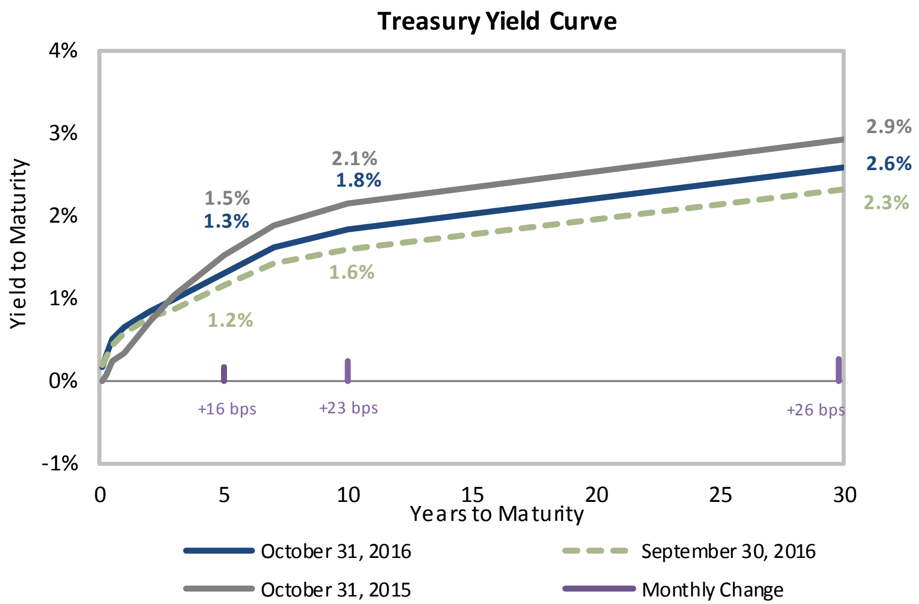
## Economy

- The month of October saw increased volatility in financial markets due to the upcoming US election and increased expectations for an interest rate increase in December by the Federal Reserve. Market-implied interest rate projections at the end of October suggested an approximately 70% likelihood the Fed will raise rates in December, up from roughly 60% at the end of September. Economic data released during October remained consistent with the low growth environment of the past several years. Consumer spending appears to have moderated somewhat and the housing sector cooled modestly as well; these developments have been more recent, however, and as the labor market continues to tighten it should support consumer spending and wage gains. Notably, October was a record month for mergers and acquisitions, with roughly $500 billion in transactions announced globally. Contributors to record deal making include a prolonged period of low interest rates, high stock prices, and sluggish economic growth, which has encouraged companies to create growth through acquisitions.
- The US economy saw positive job growth for the 73rd consecutive month in October, adding 161,000 payrolls. Year-to-date, employment growth has averaged 181,000 per month, down from an average increase of 229,000 in 2015. Wages, as measured by average hourly earnings of private-sector workers, rose 2.8% over the year ending October, the highest wage growth of the economic expansion. The unemployment rate and labor force participation rate both declined 10 basis points to 4.9% and 62.8%, respectively, and payrolls from August and September were revised upward by 44,000 total jobs.
- Real GDP grew at a 2.9% annualized rate during the third quarter of 2016 according to the initial estimate from the Bureau of Economic Analysis. The increase in real GDP growth reflected positive contributions from personal consumption expenditures, exports, private inventory investment, federal government spending, and nonresidential fixed investment. Detractors that partly offset growth included negative contributions from residential fixed investment and state and local government spending.
- The ISM non-manufacturing Purchasing Managers Index (PMI) declined to 54.8 in October, 2.3 points lower than September's record high of 57.1. A reading over 50.0 indicates expansion in the services sector. October marked the 81st consecutive month of growth in the US services sector.

## Yield Curve

- The yield curve rose modestly during the month. The spread between 2-year and 30-year Treasuries expanded 19 bps to 174 bps, above 30-year average spread of 167 bps.



### Public Equities

- In October, global equity markets generally declined as uncertainty of the US election outcome increased. US market declines were led by small cap equities, with the Russell 2000 falling 4.8% and the S&P 500 falling 1.8%. Developed international markets fell alongside their US counterparts, with large cap and small cap equities declining by 2.0% and 2.8%, respectively. Despite the increased volatility, emerging markets ended the month with a 0.2% gain, bringing the year to date return to 16.3%.
- Master limited partnerships (MLPs) declined 4.5% during the month. Coal and energy services were the only sectors with positive performance, turning in gains of 2.6% and 0.7%, respectively. Energy services, coal, and gathering and processing have been the strongest performing MLPs in 2016 at 58.0%, 30.5%, and 29.7%, respectively. Year-to-date, the Alerian MLP index has returned 10.8%.

### Public Debt

- High yield returned 0.4% for the month, consistent with coupon-like returns and modest principal depreciation as the trailing 12-month default rate increased to 4.8%.
- Local currency-denominated emerging market debt had its first negative-returning month since May, as rising yields and currency depreciation detracted.

### Private Equity

- Purchase price multiples, as measured by S&P Leveraged Commentary and Data (S&P LCD), continue to suggest significantly different environments for larger deals vs. those in the middle market. In 2015, larger deals and middle market deals both had an average purchase price multiple of 10.7x; in 2016 purchase price multiples for larger deals have increased, while those of middle market deals have moderated. Manager sentiment suggests that the lower multiples in the middle market demonstrate managers remain disciplined on pricing.

### Private Debt

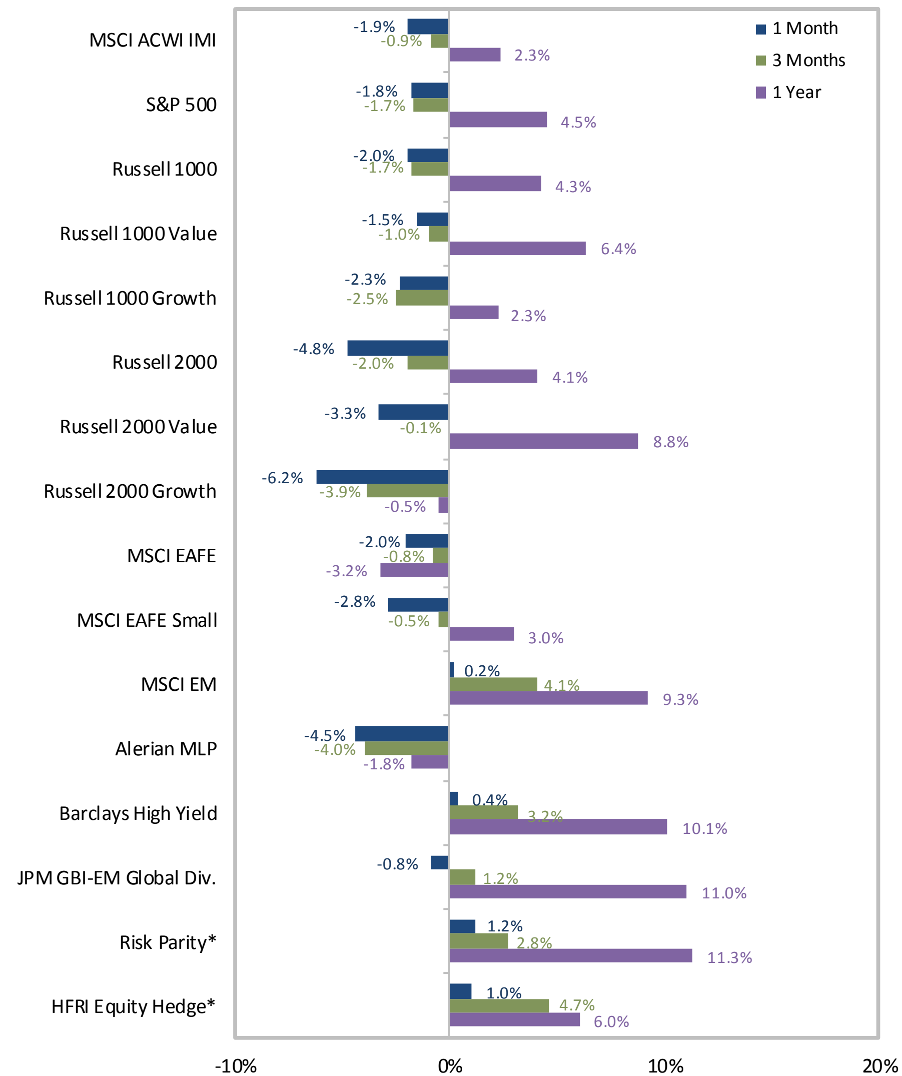
- Debt multiples for both middle market deals and larger deals have on average been lower than those experienced in 2015. After declining significantly during the first half of 2016, multiples of deals less than $50m in EBITDA reverted back to levels seen over the past few years during the third quarter. Equity contribution in deals of all sizes in 2016 has been consistent with what was experienced in 2015, around 44%.

### Risk Parity

- Risk parity strategies saw gains in September. Commodity and bond positions contributed while equities were roughly flat.

### Growth Hedge Funds

- Growth hedge funds contributed gains in September, led by long/short equity in technology and healthcare. Distressed debt strategies contributed, while activists 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

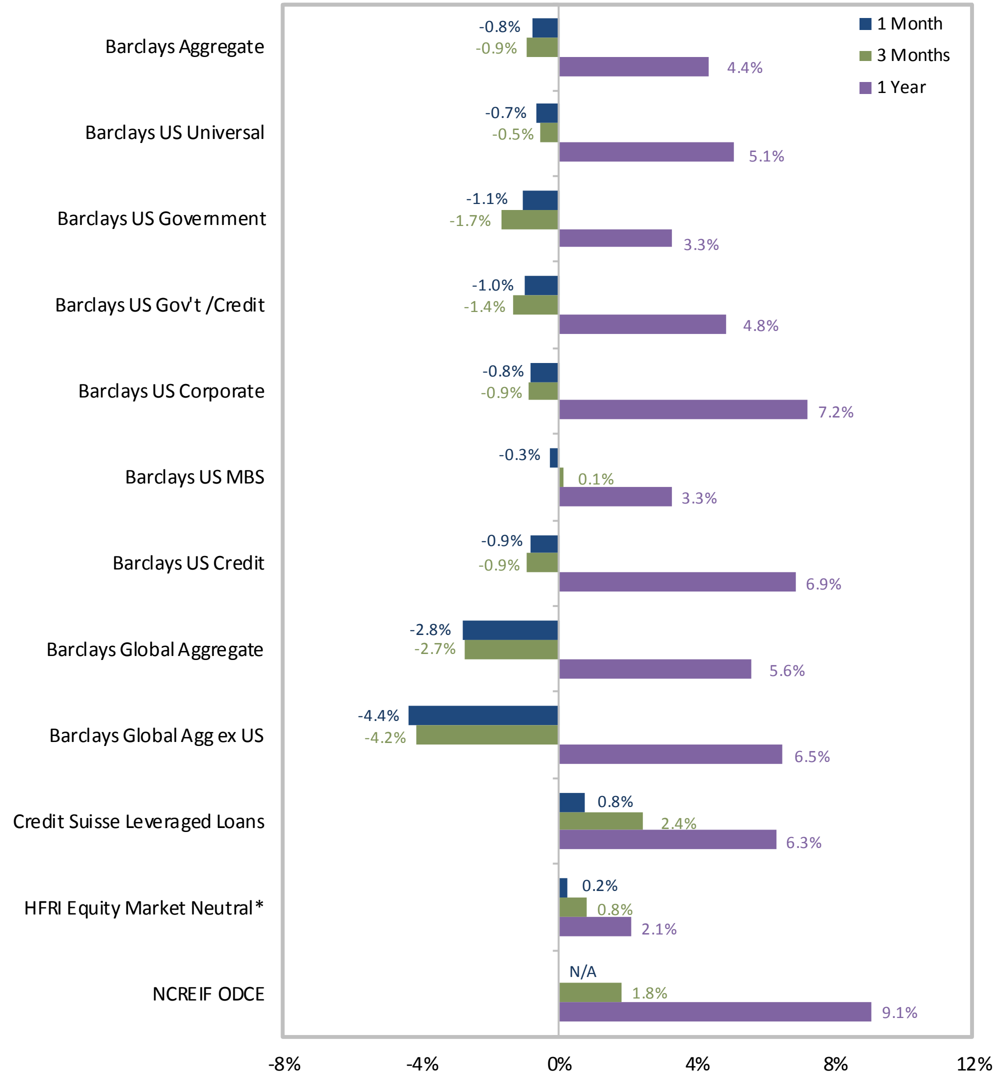
- The 10-year US Treasury yield ended October at 1.8%, up 24 bps from the end of September. Reasonably strong economic data compared to market expectations continued to support the case for a Federal Reserve interest rate increase in December, causing yields to rise.
- Investment grade credit saw spreads decrease during the month by two basis points, reversing the modest widening observed in September.
- Despite negative returns for the month, securitized sectors outperformed the Barclays Aggregate. The outperformance was a result of the securitized sector exhibiting shorter duration and paying a higher coupon rate than the broader index.
- International bonds retreated following the strong gains of the first three quarters, returning -4.4% in October. Despite the declines during the month, year-to-date gains for the Barclays Global Aggregate ex US Index were 8.2% at the end of October.
- Loans were the top-performing fixed income asset class during the month, generating a coupon-like return with modest capital appreciation. CLO origination in October totaled $16.7B, outpacing the $15.2B of net new issuance of loans.

### Relative Value Hedge Funds

- Income hedge funds contributed in September. Relative value volatility, equity market neutral funds, and fixed income-oriented strategies all contributed.

### Core Real Estate

- The third quarter return for the NCREIF ODCE Index was 2.1% gross (and 1.8% net), composed of 1.1% income and 1.0% appreciation. The third quarter returns reflect historic norms, as outsized appreciation returns have diminished but overall real estate fundamentals remain healthy. Positive job creation, continued high consumer confidence, and a limited amount of new supply have all contributed to strong returns.

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### Inflation

- Inflation expectations continued to increase during October, with 10-year breakevens reaching their highest level since July 2015 at 1.73%. Despite this, increasing real yields, due to rising expectations of a December Federal Reserve interest rate increase, detracted from TIPS returns.

### Deflation

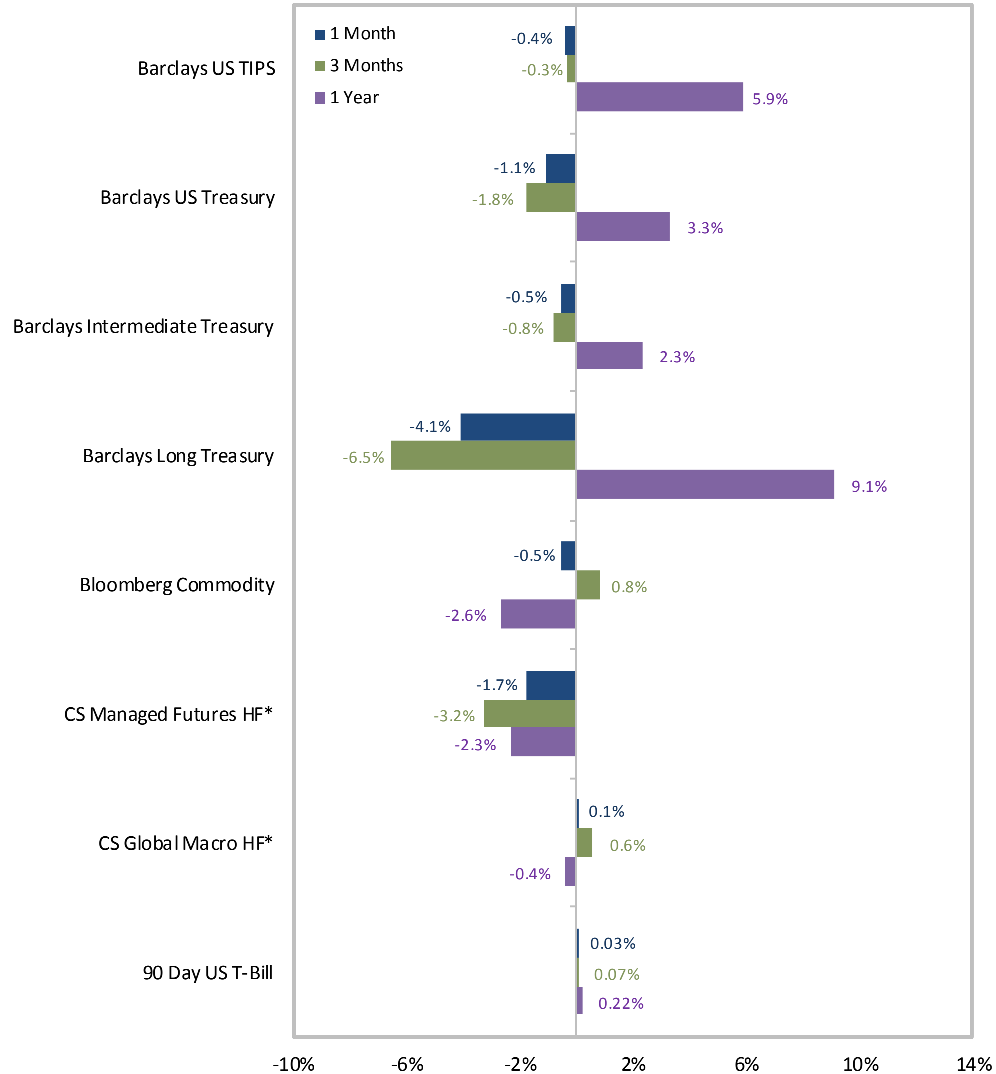
- The Barclays Long Treasury Index returned -4.1% as the yield on the 30-year Treasury increased 26 bps to 2.58%.
- Cash continues to offer no relative return, with 90-day T-bills returning 0.03% during the month of October.

### Commodities

- The Bloomberg Commodity Index declined 0.5% during October. Wheat gained 3.5% but remains down 20.3% for the trailing 12-month period, as good weather has contributed to stronger yields. Energy underperformed the broad Index as WTI crude oil fell 2.9%, and heating oil and gasoline lost 2.1% and 2.5%, respectively. Natural gas gained 4.1% and has returned 30.4% over the 12-month period. Silver and gold were major detractors from performance; the sectors were down 7.4% and 2.9% for the month, respectively.

### Tactical Trading

- Diversification hedge funds detracted in September. CTAs declined on trend reversals, while global macro funds were slightly positive.

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