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Monthly Economic & Capital Market Update

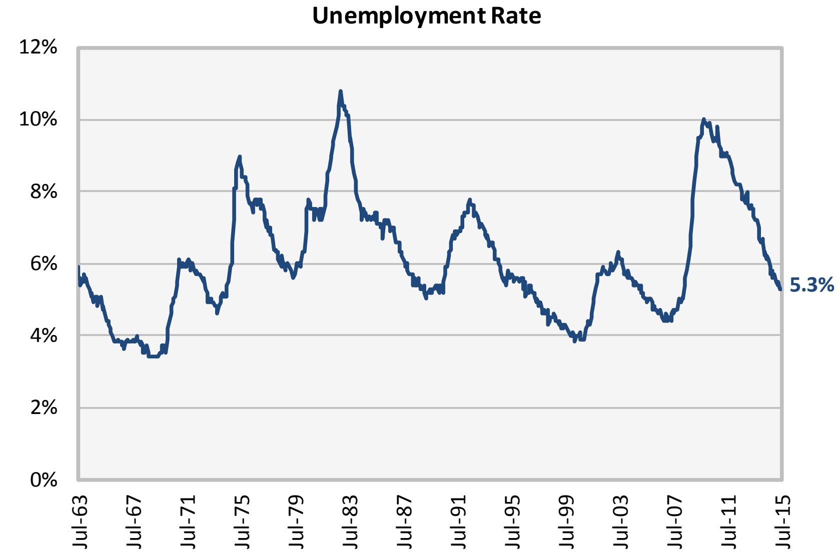
July 2015

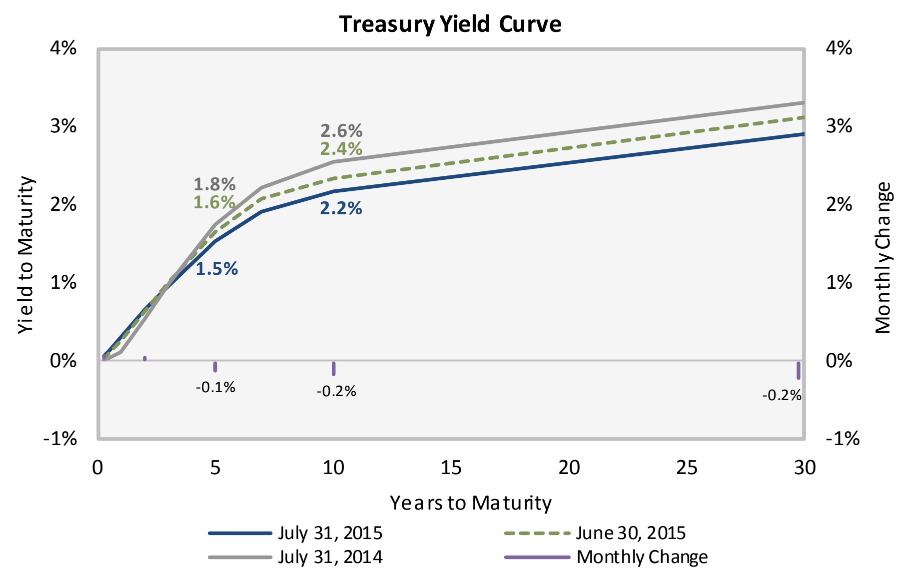
Economy

- Economic data releases in July were generally consistent with the slow, steady improvement the US economy has experienced over the past several years.
- The July employment report suggests continued expansion in the US labor market. Employers added 215,000 jobs during the month, in line with market expectations, and the unemployment rate held steady at 5.3%. Payroll figures for May and June were revised upward by a combined 14,000 jobs. Job growth continues to be strong, as an average of 216,000 jobs have been added per month in 2015; 200,000 new jobs each month has historically been consistent with a healthy labor market. Conversely, wage inflation continues to be lackluster. For the 12 months ending July 2015, wages grew just 2.1%. While there are signs that wage growth is likely to increase in the short to intermediate horizon, wage growth has been largely stagnant since 2008-09.
- Inflation measures continue to run below the 2.0% target of the Federal Reserve. Over the 12 months ending June 2015, the Consumer Price Index rose 0.1% while core prices, which exclude food and energy, increased 1.8%. The decline in energy prices over the past year mainly account for the difference between core and headline inflation figures. The Personal Consumption Expenditure (PCE) index, the Fed's preferred measure of inflation, rose just 0.3% over the 12 months ending June. The Fed has kept its policy interest rate near 0% since 2008 in an attempt to fuel growth and bring inflation back closer to its long term goal.
- The Institute for Supply Management's Purchasing Managers' Index (PMI), a gauge of future demand and manufacturing activity in the US, fell to 52.7 versus expectations of 53.5 in July; a number over 50 implies economic expansion. The non-manufacturing PMI rose to 60.3 in July, its highest level since 2005, suggesting continued progress in the US service sector.
- Real GDP rose 2.3% on an annualized basis during the second quarter of 2015 according to the initial estimate from the Bureau of Economic Analysis. The figure for the second quarter suggests the US economy rebounded somewhat following a slow start to 2015. Additionally, figures for the years 2012 – 2014 were revised by the Department of Commerce. While growth was previously estimated at 2.3% annualized, revisions resulted in growth estimates of 2.0% per year. The revisions were an attempt to correct the seasonal adjustment process that had recently been called into question by economists.

Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 25 bps to 225 bps in July. Both real yields and inflation expectations fell during the month.





Growth Assets

July 31, 2015

Public Equities

- Following a broad sell-off in June, most global equity markets recovered during July. In developed markets, the US (S&P 500, 2.1%) performed largely in line with international developed (MSCI EAFE, 2.1%). Emerging markets (MSCI EM, -6.9%) broadly sold off as the US Federal Reserve reiterated plans to increase interest rates and the China A-share market continued to be highly volatile.
- MLPs declined again in July, as broad energy market weakness persisted. Upstream MLPs (-31% in July) continued their severe decline as crude oil prices tumbled again, settling below $50 per barrel to end the month. The upstream MLP business model remains challenged. General partner MLPs returned -5% as potential LP earnings weakness began to influence GP pricing.

Public Debt

- High yield bond spreads widened 37 bps to 513 bps, pushing yields to 6.9%, the highest level at month-end in three years. The energy sector was down -4.9% in conjunction with a significant drop in both spot oil prices and oil futures.
- A stronger dollar, sharp declines in the Chinese equity market, continued weakness in global trade, and commodity weakness combined to lead local currency emerging market debt down -2.6%. Commodity-dependent countries Brazil, Colombia, and Russia were notable laggards.

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. Higher purchase price multiples could be more of a new normal rather than the result of a market cycle peak. The asset class continues to become more efficient as investors commit more and more dollars to the space.

Private Debt

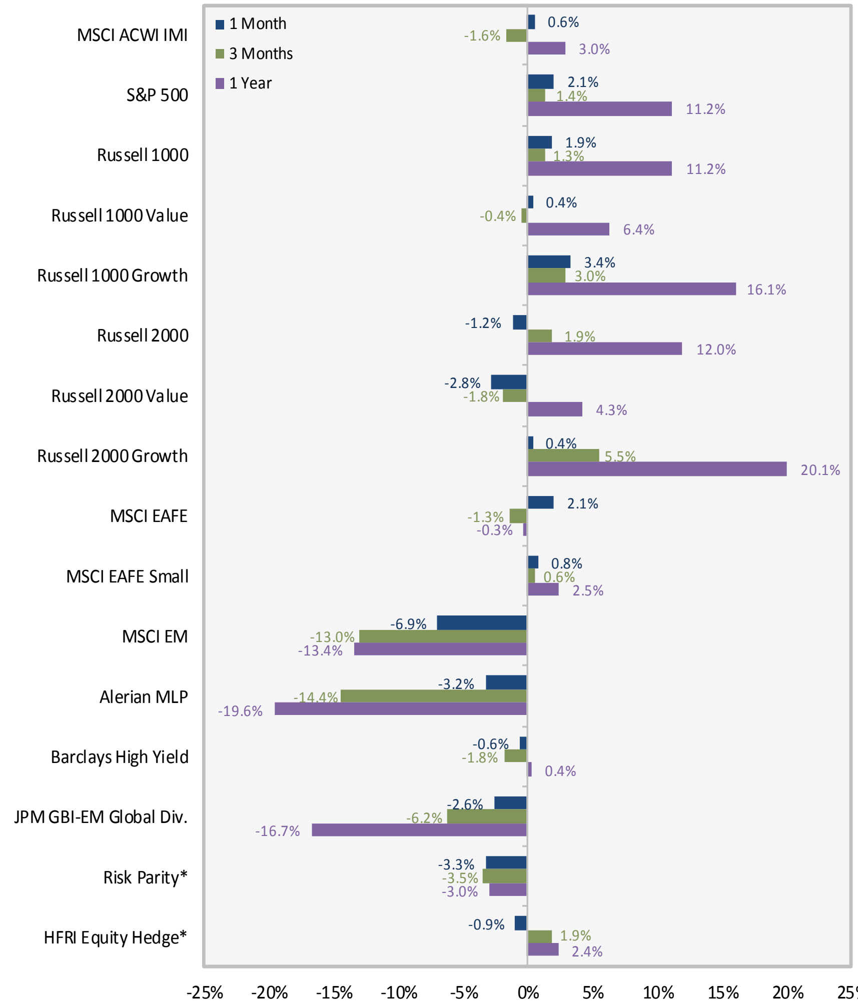
- While the first quarter experienced an uptick in covenant relief amendments, there was no corresponding increase in the second quarter. More reliefs are possible in coming quarters as oil prices test the capital structures of several energy-related, sponsor-backed deals. Debt/EBITDA ratios are near all-time highs, but capex and interest coverage remain significantly higher than those seen in 2006 and 2007.

Risk Parity

- Risk Parity strategies detracted in June. Losses in bonds were the largest detractors, though equities and credit also diminished returns.

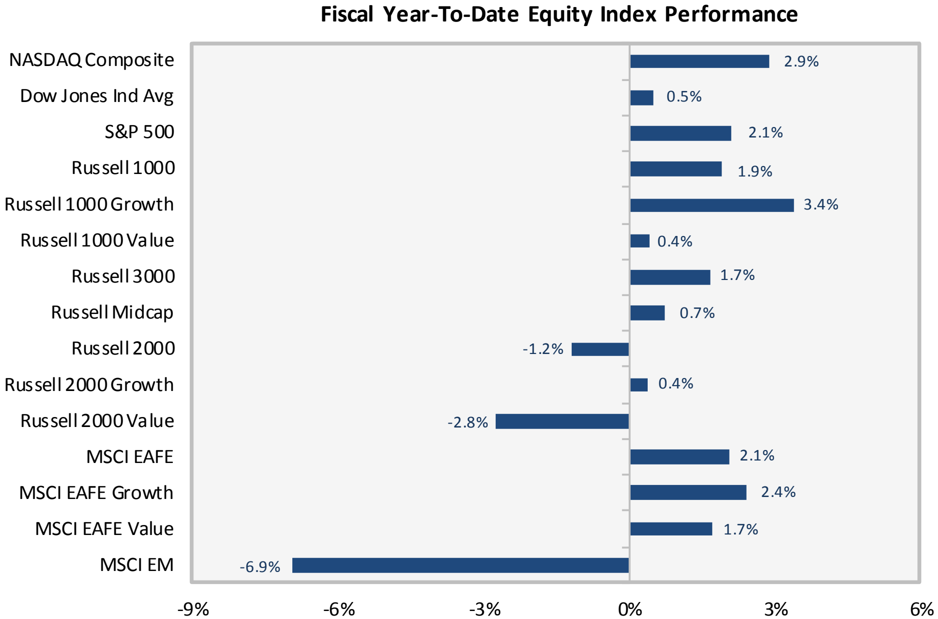
Growth Hedge Funds

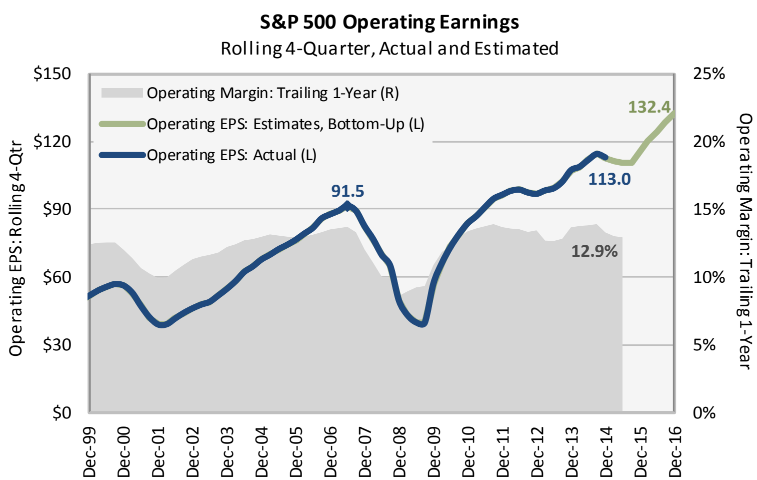
- Both long/short equity and event-driven strategies were negative in June. China exposures weighed heavily on long/short equity, while activist and distressed debt strategies led losses in event-driven strategies.

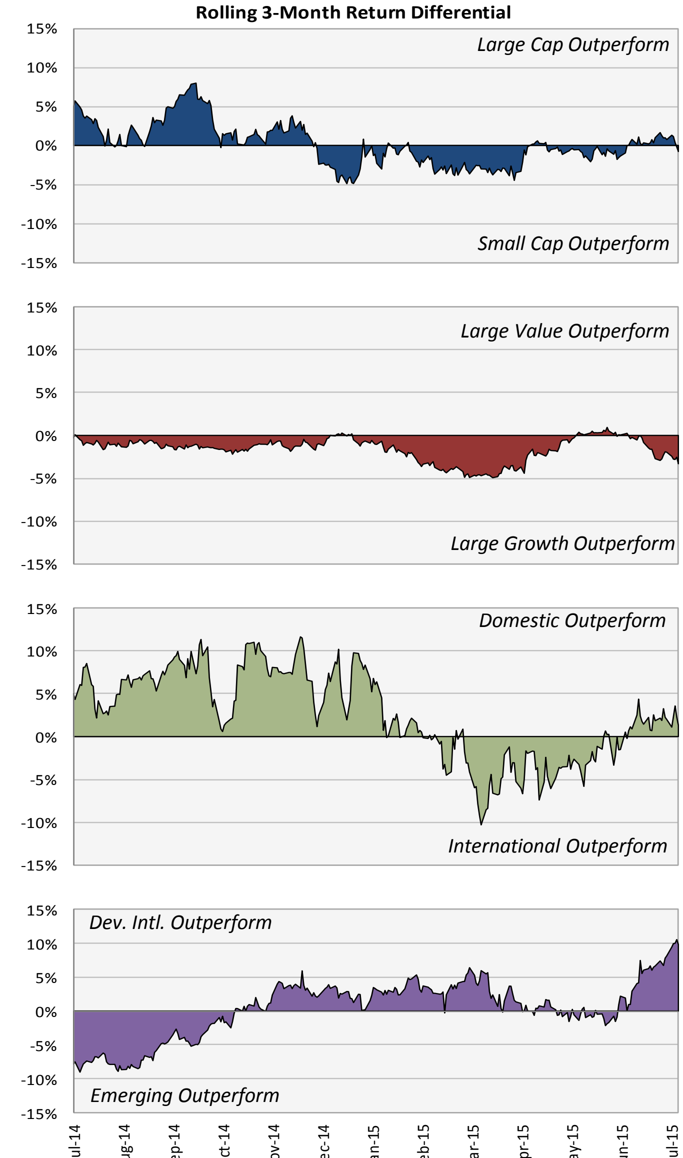


* Data was not available at time of publication – returns are previous month's.
Note: Risk Parity returns are based on an internally comprised benchmark.
All returns are USD.

FISCAL YEAR-TO-DATE: JULY 1, 2015 THROUGH JULY 31, 2015







Public Debt

- The US Treasury yield curve flattened in July with 10-year and 30-year yields falling 17 and 22 bps, respectively. After a brief sell-off sparked by the near-term resolution for Greece's debt issues, the struggles in the Chinese equity market/economy and rapid declines in commodity prices led to a flight-to-quality bid mid-month that carried yields lower through the rest of the month. The front-end of the curve actually saw upward pressure in July in response to increased expectations for a September liftoff in the Fed Funds rate.
- Falling rates helped all investment grade sectors produce positive returns for the month, although spreads widened across the board. Investment grade credit spreads returned to levels last seen during June 2013's "taper tantrum" but still are below their historic average. At $830B year-to-date, the 21% increase in issuance year-over-year has not helped the sector's performance as companies work to issue debt prior to a shift to tightening monetary policy.
- Within securitized assets, CMBS and Agency MBS led ABS, benefiting more from falling rates due to their longer duration relative to ABS.
- International bonds lost a bit of ground over the month, with the Barclays Global Aggregate ex-US Index returning -0.1%. The US dollar strengthened against foreign currencies in July, gaining 1.9% for the month. Given the low level of yields, this creates a substantial headwind to international fixed income returns from the perspective of a US investor. Over the last 12 months, international bonds have returned -12.3%, mostly due to dollar appreciation.

Private Debt

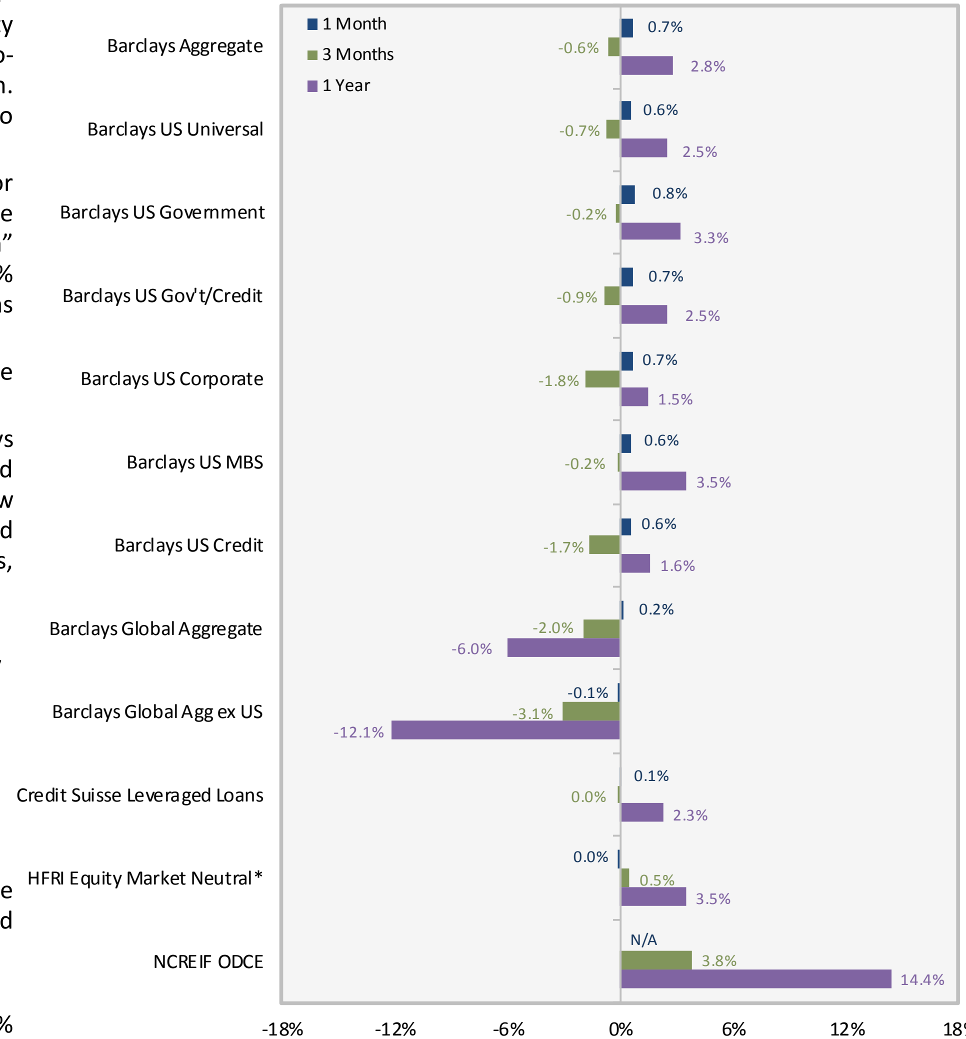
- Limited rate sensitivity kept leveraged loans from participating in the rate rally in July. The sector did manage to produce a small 0.1% return in July despite widening spreads. Year-to-date, the sector continues to lead other fixed income segments with a 3.0% return. While issuance volumes are lagging last year's pace due to wider spreads and increased enforcement by regulators of leveraged lending guidelines, they remain robust at $232B.

Relative Value Hedge Funds

- Relative value hedge funds were generally flat in June. Credit strategies were the largest detractors, followed by volatility traders. Equity market neutral and asset-backed securities strategies were slightly positive.

Core Real Estate

- Core real estate continued to perform well in the second quarter with a 3.8% gross return as measured by the NCREIF ODCE Index. Continued economic growth throughout the US has accelerated income returns, which in turn has also advanced appreciation returns. With a limited amount of new supply, economic growth has supported a landlord-friendly environment.



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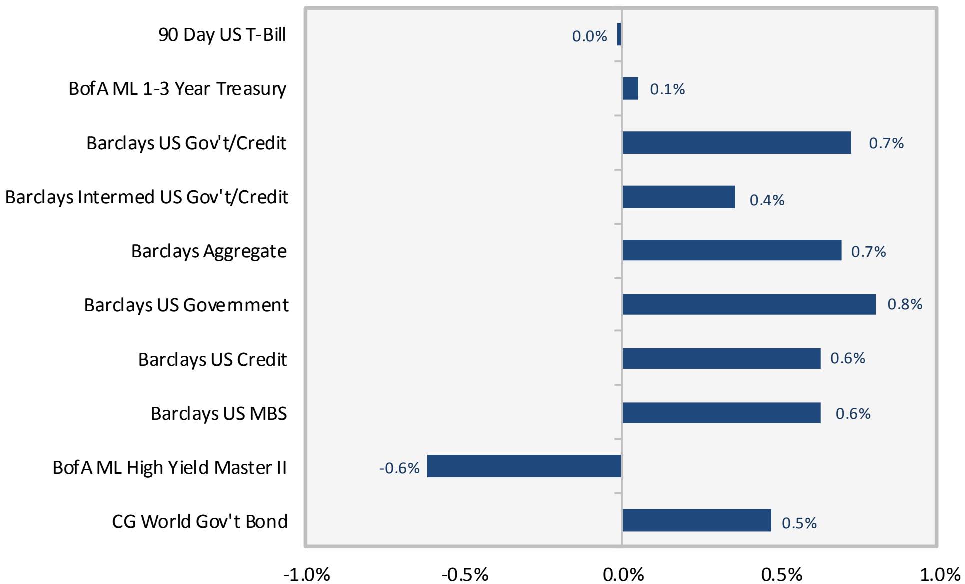
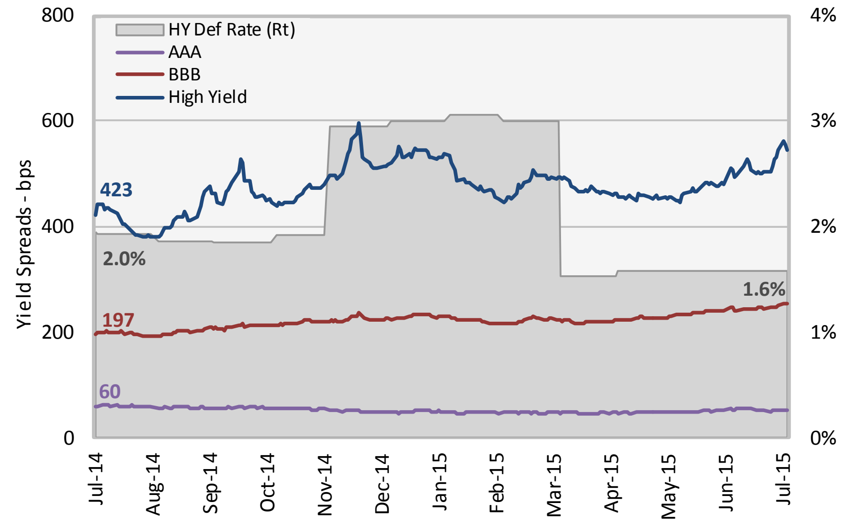
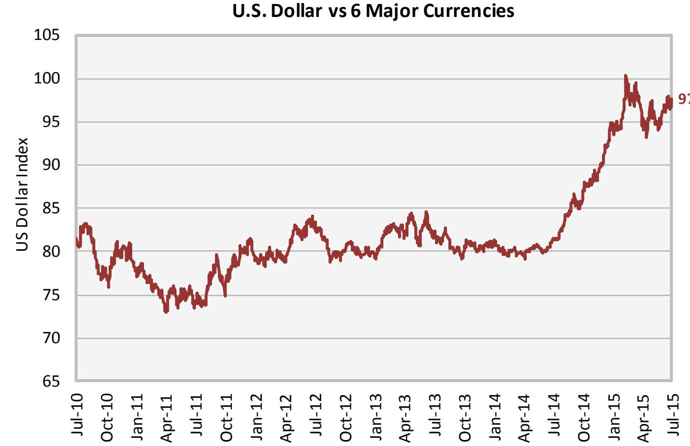
Fiscal Year-To-Date Fixed Income Index Performance



Fixed Income Spreads & Defaults



U.S. Dollar vs 6 Major Currencies



	$/Euro	Yen/$	$/GBP	CAD/$	SEK/$	CHF/$
Spot	1.098	123.900	1.562	1.309	8.625	0.966

Implied Break-even Inflation Rates

	2-yr	5-yr	10-yr	30-yr	5y, 5y
Current	**0.8%**	**1.4%**	**1.7%**	**1.9%**	**2.2%**
Beg of Qtr	1.2%	1.7%	1.9%	2.0%	2.2%
1-Year Ago	1.5%	2.0%	2.3%	2.4%	2.6%
Real Yield	-0.1%	0.1%	0.4%	1.0%	0.8%

Inflation

- TIPS posted a 0.2% return in July as the fall in real yields was partially offset by declining breakeven inflation expectations. As of month end, the breakeven inflation rate for the 10-Year TIPS was 1.7%, down from 1.9% in June, as the weakening in commodity prices weighed on expectations for future inflation.

Deflation

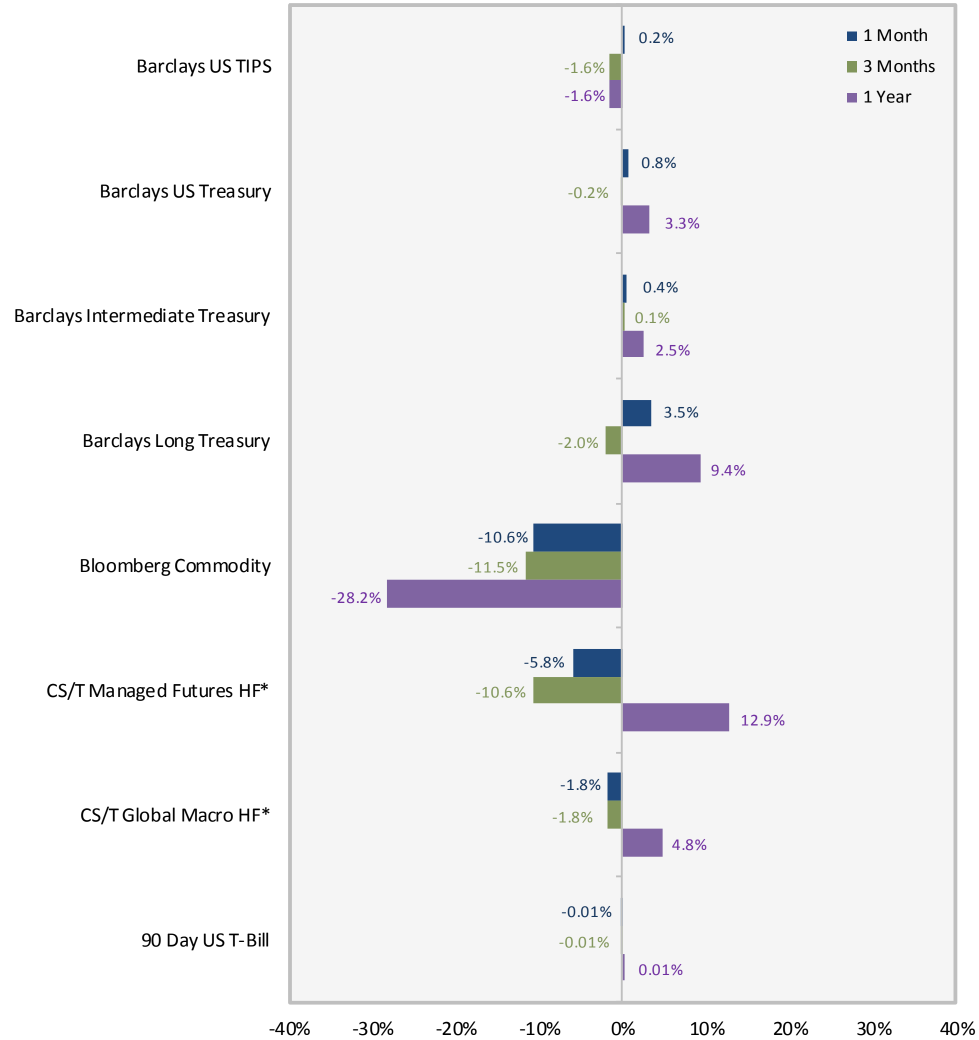
- Consistent with easing deflationary pressures, assets to protect against deflation continue to struggle. As interest rates have risen, bonds (particularly those with longer-dated maturities) have performed poorly. However, deflation-protecting assets enjoyed a reprieve in July on the back of falling long-end rates, with the Barclays Long Treasury Index generating a 3.5% return. The yield on the 30-year Treasury finished the month at 2.9%, the middle to high end of its 2015 range. The 30-year yield has fluctuated in a 100 bps range, falling as low as 2.3% and rising as high as 3.3% in 2015.
- Cash continues to offer virtually no return, with 90-day T-Bills returning just 1 basis point over the past year.

Commodities

- A broad sell-off in commodities occurred during the month, with only lean hogs (+3%) posting a positive in July. All other commodities declined. Energy and metals commodities were influenced by weak Chinese demand. Crude returned -21% as the prospect of Iran sanctions being lifted created the potential of additional Iranian supply coming onto an already oversupplied market. Copper led declining industrial metals commodities, returning -10%. Key agriculture commodities including wheat (-18%), corn (-10%), and soybeans (-7%) declined on stronger-than-expected supply and favorable growing conditions.

Tactical Trading

- Tactical trading strategies were poor performers in June, following reversals in trend-following strategies. Discretionary macro traders also detracted.



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