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Monthly Economic & Capital Market Update

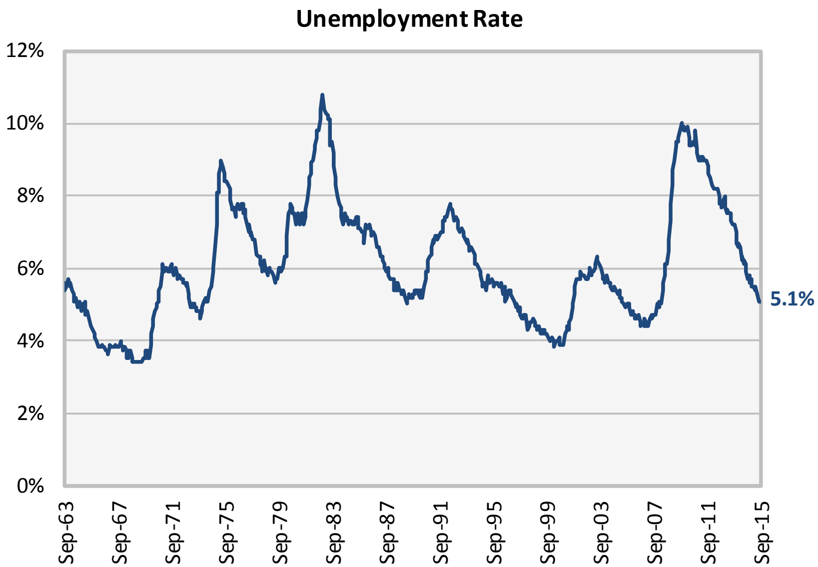
September 2015

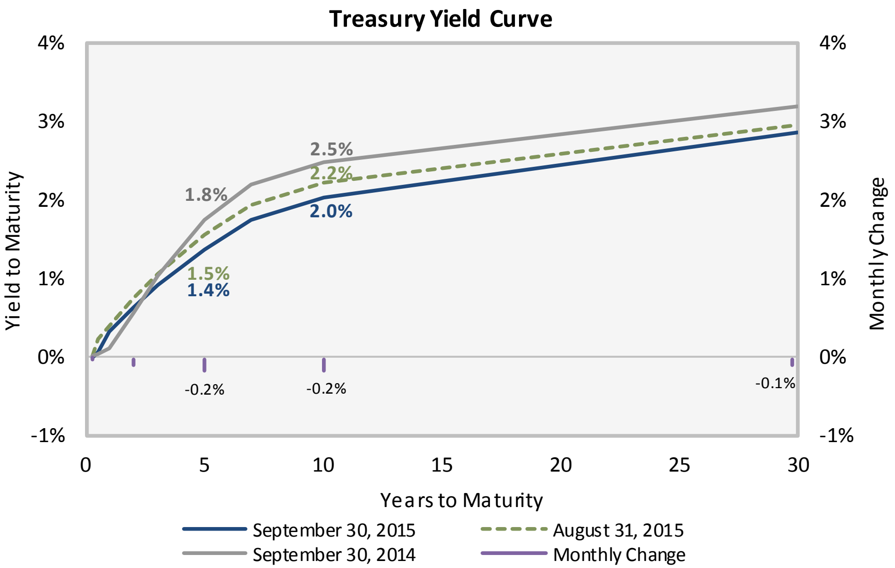
Economy

- Concerns over slowing global economic growth prompted the Federal Open Market Committee (FOMC) to keep short-term US interest rates unchanged at its September meeting, in line with the market's consensus prior to the meeting. The FOMC acknowledged that the US economy continues to grow at a moderate pace, but believes slowing demand outside the US and a stronger dollar may put downward pressure on US inflation in the short run. The Federal Reserve has an objective of maximum employment and price stability. The labor market continues to expand while inflation remains below the Fed's 2% target; for the 12 months ending August consumer prices rose just 0.2%.
- The September employment report showed that job growth has slowed in the US in recent months, but remains positive. Employers added 142,000 jobs during the month, well below market expectations of 200,000 new jobs. The unemployment rate held constant at 5.1%, its lowest level since April 2008. In addition to the weaker-than-expected September print, payroll figures for July and August were revised lower by a combined 59,000 jobs. Over the past year the economy has added 229,000 jobs per month; however, job growth has only averaged 167,000 over the past three months. Historically 200,000 new jobs per month has been consistent with strong labor market expansion.
- Additionally, the September employment report reinforced the fact that wage growth has been lackluster in the US. For the 12 months ending September 2015, wages grew 2.2%. Since August 2008, wage growth has averaged just 2.1% per year, while prior to 2008 average annual wage growth was 4.6%, per the Bureau of Labor Statistics. The Federal Reserve is monitoring wage pressures as a sign of a tightening labor market and signal to raise interest rates. As the unemployment rate continues to decrease, wage pressures are more likely to emerge; with a shrinking pool of unemployed workers, employers must pay more to attract and retain employees.
- Real GDP rose 3.9% on an annualized basis during the second quarter of 2015 according to the third and final estimate from the Bureau of Economic Analysis. The figure for the second quarter, revised upward from the preliminary reading of 2.3%, suggests the US economy rebounded following a slow start to 2015. Higher-than-expected inventory investment and consumer spending led to the upward revision for the second quarter figure.

Yield Curve

- The spread between 2-year and 30-year Treasuries was unchanged at 220 bps in September. Over the past year, yields have fallen with declining inflation expectations.





Public Equities

- Global equity markets extended their August losses in September. Price action remained volatile, as the VIX had its longest run of weekly closes above 20 since the European Debt Crisis in the fall of 2011. Despite the volatility, US large cap equities outperformed international markets. One relative bright spot among international markets were developed small caps, with MSCI EAFE Small Cap outperforming its larger peers, losing 3.4% for the month vs. 5.1% for MSCI EAFE.
- September was the third worst month for the Alerian MLP Index since its inception in 1996. The current yield of the asset class stood at 8.3% as of month end. All MLP sub-sectors declined as the asset class was affected by technical selling pressures, including low crude oil prices (below $50 per barrel) and forced liquidations as closed end funds de-levered and retail products exhibited outflows.

Public Debt

- High yield bonds declined in September; spreads widened by 86 bps to 630 bps and yields topped 8%, a level not seen since the Greek Crisis in 2011/2012. Energy-linked issuers once again suffered the most with the sector down nearly 5%.
- Continued concern over China growth and falling commodity prices impacted local emerging market debt as it fell nearly 3% over the month. Weaker currencies have been the primary contributor to the cumulative 12-month drawdown of -19.8% in local markets. Brazil lagged, down 10.8% in September largely due to its currency, the real. The real fell more than 7% on the heels of S&P's downgrade to below investment grade.

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

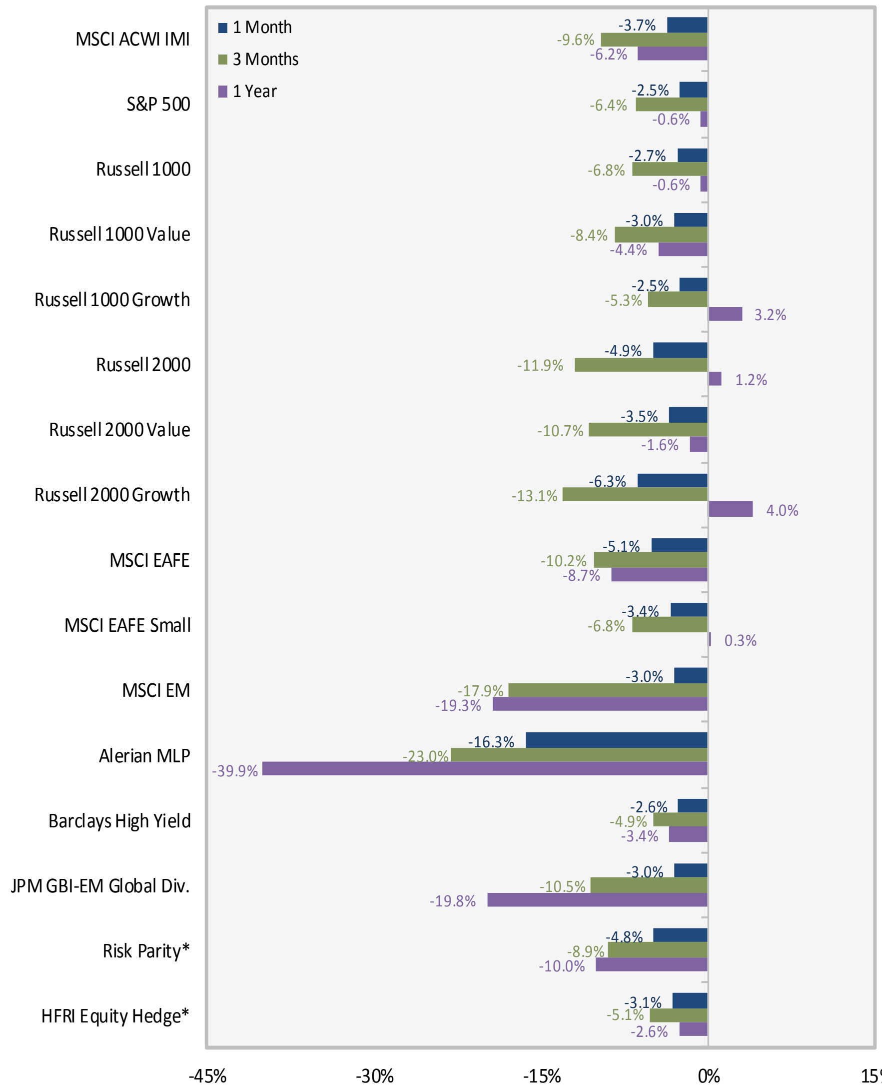
- While the first quarter experienced an uptick in covenant relief amendments, there was no corresponding increase in the second quarter. More reliefs are possible in coming quarters as oil prices test the capital structures of several energy-related, sponsor-backed deals. Debt/EBITDA ratios are near 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 August, with equities and commodities driving losses. Credit also detracted while nominal bonds were slight contributors.

Growth Hedge Funds

- Long/short equity hedge funds were also down in August. Funds with an emerging markets orientation were the worst contributors. Event-driven strategies also detracted on falling equity prices and widening credit spreads.



* 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.

Income Assets

September 30, 2015

Public Debt

- US Treasuries generated a 0.9% return in September as all eyes were on the Fed and its rate decision. Prior to the Fed's decision to leave rates unchanged, 10-year Treasury rates hit 2.29% before falling for the remainder of the month, finishing at 2.04% or 18 bps lower for the month. Fed comments still point to a possible December rate hike but a large disconnect still remains between the market and the Fed over the projected path of rates. The Fed remains more optimistic about economic growth, meaning a steeper expectation for the future path of interest rates.
- Falling rates helped investment grade credit generate a positive return although spreads widened five bps. Spreads sit at 160 bps or 35 bps wider for the year despite favorable fundamentals within credit. Issuance increased after a slow August with $92B issued, but remained 15% below the average monthly pace in 2015. At $973B year-to-date, supply should cross $1 trillion for the fourth straight year.
- Within securitized assets, CMBS led major Barclays Aggregate sectors with a 1.2% monthly return as spreads tightened in the sector. ABS and Agency MBS lagged behind CMBS but still posted positive returns.
- International bonds underperformed US markets, returning 0.4% in September. Among monthly leaders, Japanese and South Korean bonds led the pack with 1.5% and 1.3% returns, respectively. Eurozone inflation came in under expectations, raising speculation for further quantitative easing and helping move Eurozone yields lower. Among laggards, Canadian bonds suffered as the CAD depreciated along with other commodity sensitive currencies.

Private Debt

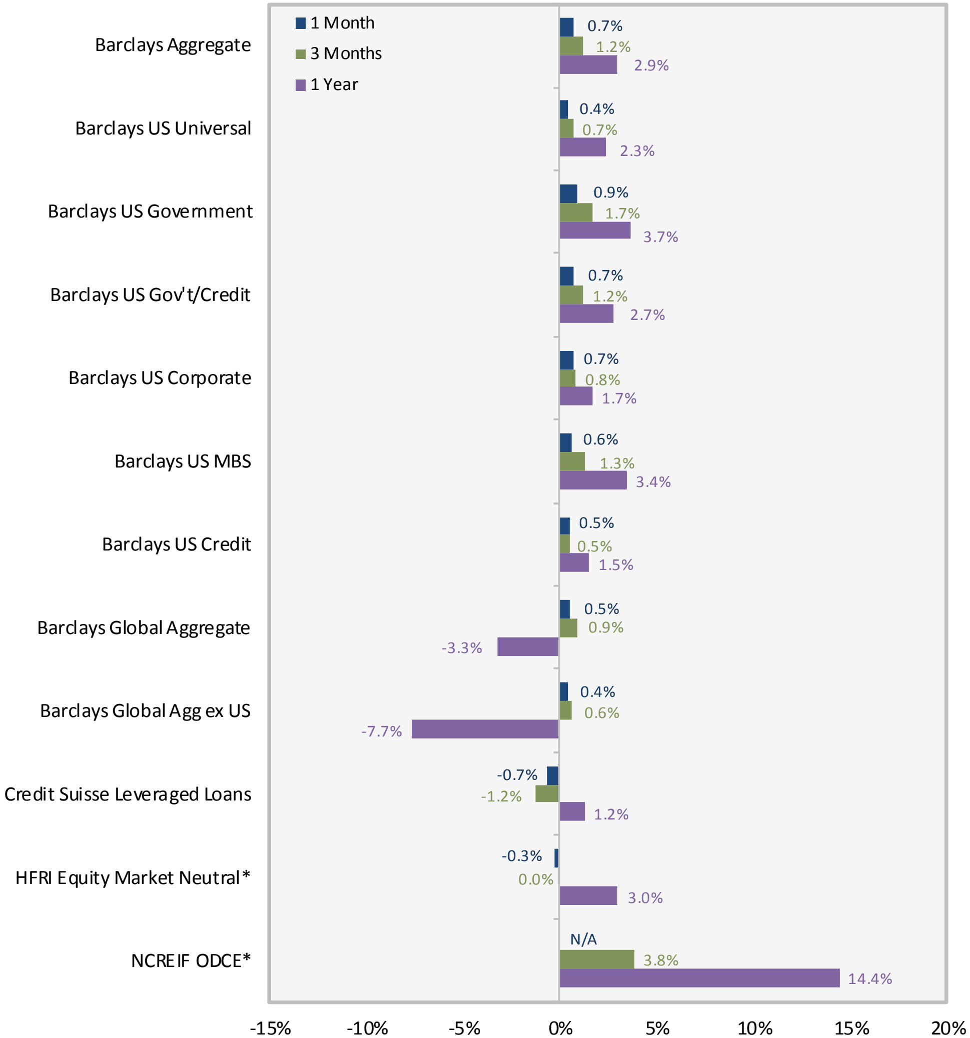
- For a second straight month bank loans fell with a total return of -0.7%. Average prices slipped $1 to finish at $94.3, a 3-year low. Returns for energy was again at the center of the storm falling -5.1%. Yields to a 3-year takeout rose 11 bps to 6.3%. Issuance slowed substantially in September to $9.5B, well below the average monthly volume of $29.6B this year.

Relative Value Hedge Funds

- Equity market neutral strategies were approximately flat in aggregate in August. Most other strategies saw losses, including volatility trading, long/short credit, fixed income arbitrage, and convertible arbitrage.

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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Inflation

- TIPS declined in September as inflation expectations continued to fall. The 10-year inflation rate implied by the bond market fell to 1.43% in September, its lowest level since March 2009.

Deflation

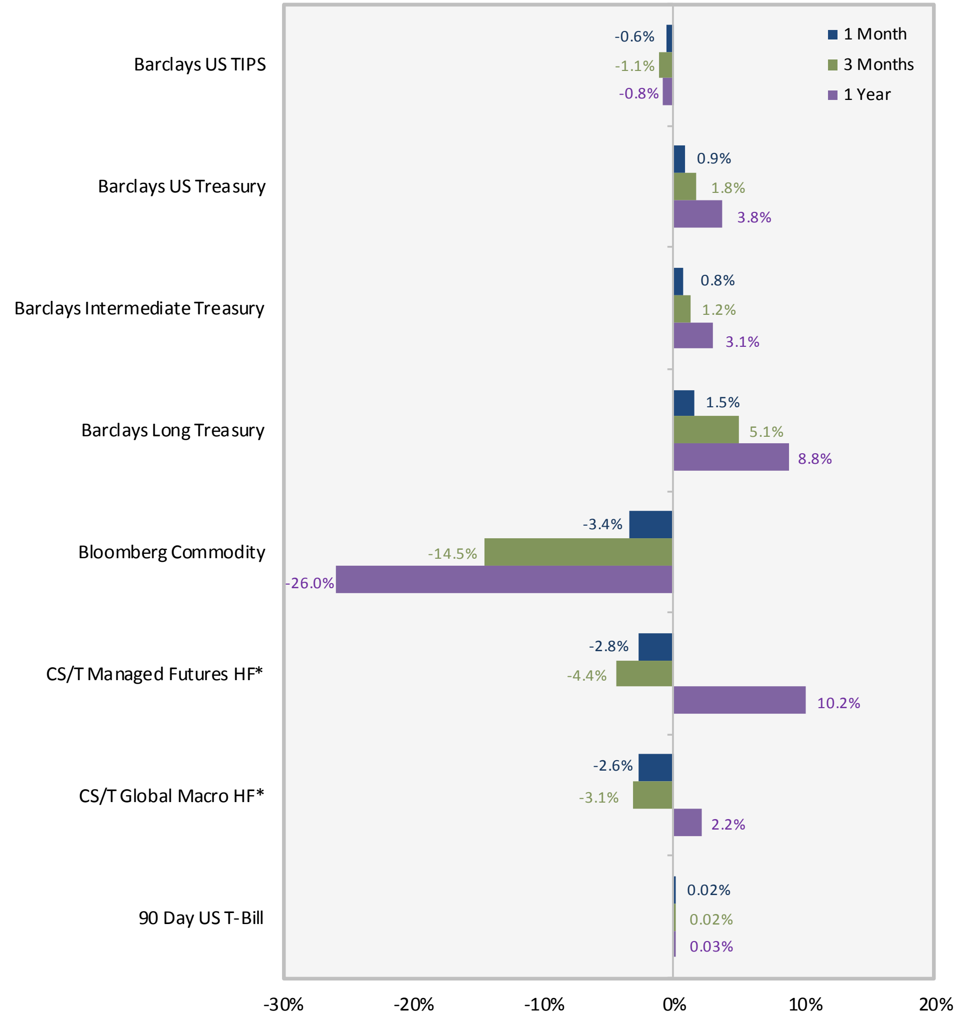
- Long bonds benefited from the reduction in inflation expectations and future interest rate hikes. 30-year Treasury rates fell 11 bps in September, pushing Barclays Long Treasury Index returns up 1.5%. Month-to-date returns for the Index had slid as far as -2.3% leading up to the mid-September Fed decision. The yield on the 30-year Treasury finished the month at 2.85% but was as high as 3.08% over the month.
- Cash continues to offer virtually no return, with 90-day T-Bills returning just 3 basis points over the past year.

Commodities

- The Bloomberg Commodity Index declined in September. The agricultural sub-sector was led by advancing commodities: sugar, lean hogs, wheat and corn. Energy commodities were all down on strong production and inventory levels globally. Precious metals were essentially flat during the month in both gold and silver. Industrial commodities generally fell again in September, with a lone positive commodity in nickel despite elevated inventory levels globally.

Tactical Trading

- Tactical trading strategies were down in August, with losses split roughly equally between discretionary global macro and CTA strategies.



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