

ECONOMY:

WINTER DOLDRUMS CONTINUE WITH SOME EARLY SIGNS OF A SPRING SNAPBACK

Economic Data

March 2015's U.S. economic data (which largely reflect economic activity in February 2015) continued the prior month's trend of weaker than expected numbers that increasingly point to soft growth in the first quarter of 2015. Unusually harsh winter weather in the East and Midwest, a slowdown in economic activity due to West Coast port strikes, the effect of a strong dollar on exports (see the figure below), and the impact of lower oil prices on capital expenditures in the oil industry have all acted as constraints on economic growth. However, overall levels of economic activity and leading indicators, such as the Conference Board's Leading Economic Index (LEI), point to slow but sustainable growth — with the potential to return to trend growth, or better, once short-term negative factors stabilize.

Labor market improvement has been a bright spot in the U.S. economy over recent months and the numbers for February were no exception. Nonfarm payrolls data indicated the economy had added 295,000 jobs in February, a strong surprise to the upside, and the unemployment rate declined to 5.5%. Average hourly earnings grew only 0.1% after rising 0.5% the previous month, indicating wage pressures are still modest. Personal income data for February were more encouraging, climbing 0.4% year over year and topping consensus expectations following a solid prior month. Despite income growth, consumer spending disappointed with a month-over-month gain that missed expectations, and retail sales declined for the second consecutive month. Some loss of activity is likely weather related, potentially creating pent-up demand. In the meantime, consumers are banking some of the gains from lower gas prices and falling prices on imports, reflected in the personal savings rate, which has climbed to its highest level since December 2012 (see the figure on the following page).

Growth in economic activity clearly slowed in February. The Institute for Supply Management (ISM) Manufacturing Purchasing Managers' Index (PMI) came in at its weakest level since January 2014, but at 52.9 remained well above the 50 level that indicates expansion. By contrast, ISM's Non-Manufacturing PMI topped expectations at 56.9. Markit provides preliminary "flash" PMIs for the current month toward month-end; for March, both the manufacturing index, at 55.3, and the services index, at 58.6, topped economist consensus and accelerated from the prior month, giving an early indication that some of the economic drags on the economy from early 2015 may be starting to fade.

THE DOLLAR HAS BEEN STRENGTHENING, MAKING U.S. EXPORTS MORE EXPENSIVE ABROAD



Source: LPL Research, Federal Reserve 03/31/15



Higher energy prices in February led to a month-over-month increase in the Consumer Price Index (CPI), a measure of inflation. On a year-over-year basis, lower oil prices, lower prices on imports due to a strong dollar, and limited wage pressure extended a mild deflationary period from the prior month, with a year-over-year price decline of 0.1%. Core CPI, which excludes the volatile food and energy components, ticked up to 1.7% year over year. The broad CPI reading tends to converge on core CPI over time, and with the core reading near the Federal Reserve’s (Fed) target rate, the broad reading does not indicate a significant likelihood of an extended deflationary period.

accompanied the policy statement showed that Fed members, on average, had lowered their forecast for the fed funds rate, gross domestic product (GDP) growth, and inflation over the next several years. Markets reacted strongly to the guidance that rates would likely be held “lower for longer,” with equity markets climbing, interest rates falling, the dollar weakening, and commodities strengthening over the ensuing week.

Central Banks

With few exceptions, global central banks continued to remain accommodative in March. The Federal Open Market Committee (FOMC), the policymaking arm of Fed, took center stage among central banks at its March meeting, as market participants waited to see if the Fed would remove the word “patient” from its policy statement. While “patient” was removed, the Fed signaled a rate hike was not imminent and any future move would be data dependent, a perspective reinforced by Fed Chair Janet Yellen’s comments at her post-meeting press conference. Economic projections that

GLOBAL EQUITIES:

EARNINGS CONCERNS TRUMP FED FOR U.S.

EQUITIES

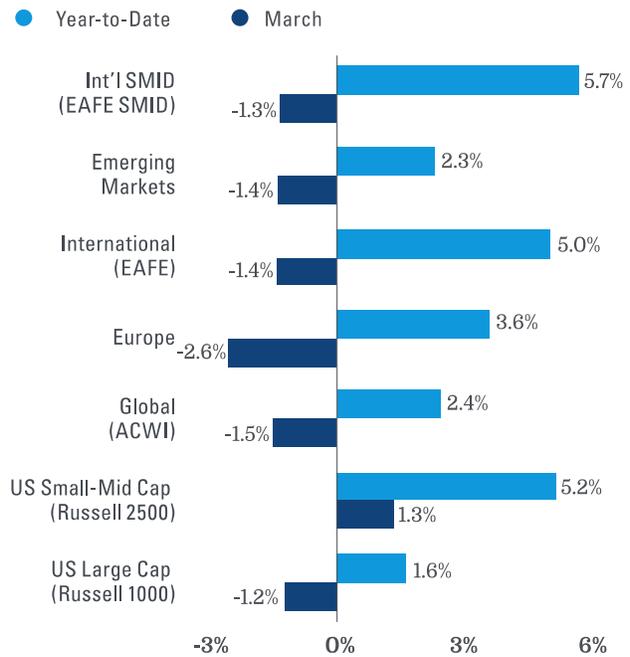
U.S.

The March battle of bulls and bears ended with the bears prevailing, driven by signs of slowing economic growth and a probable drop in first quarter earnings on dollar strength, export weakness, and sharply lower energy earnings expectations for the first half of the year. The S&P 500 Index returned -1.6% for the month, while still posting a small gain for the quarter. Despite the loss, the VIX, a measure of implied market volatility, remained relatively stable, never rising above 18, compared to intraday spikes of over 23 in January. The lower volatility came despite the S&P 500 going from February 17 to March 27 without seeing two consecutive trading days of gains.

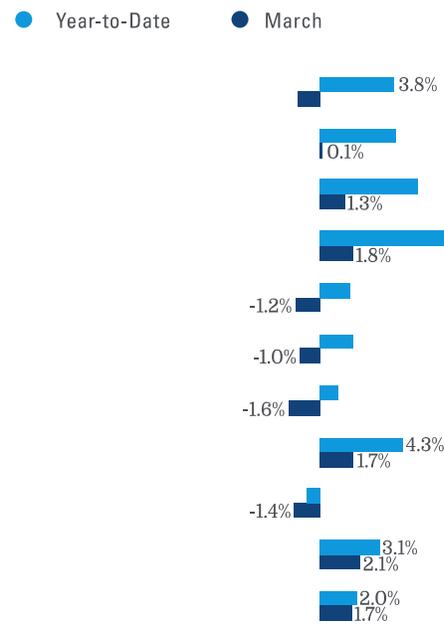
March losses were broad based, with 9 out of 10 equity sectors falling. The standout was healthcare, which posted a small gain, supported by strong merger and acquisition activity, continued investor interest in the growth prospects of biotech, and more resilient expected earnings growth than most other sectors. The consumer discretionary sector posted a small loss for the month but was the strongest sector outside of healthcare on strengthening labor markets, the potential bump to consumer spending from lower oil prices, and some improvement in housing data. Healthcare and consumer discretionary were also the leaders for the first quarter. Materials was the sector laggard in March, hit by falling expected demand from China and declining earnings expectations in metals and mining.

Small caps continued to post solid returns in 2015, with the Russell 2000 and its growth and value indexes outperforming corresponding Russell 1000 indexes in March and for the quarter. Small caps have benefited from investor desire for greater domestic revenue exposure as the dollar has strengthened and improved relative valuation following 2014's underperformance. Growth also outperformed value across capitalization categories for the month and quarter, as measured by Russell 1000, Russell 2000, and Russell Midcap style indexes. Investors remain willing to pay a premium for growth prospects in a low-growth environment.

GLOBAL INDEX PERFORMANCE



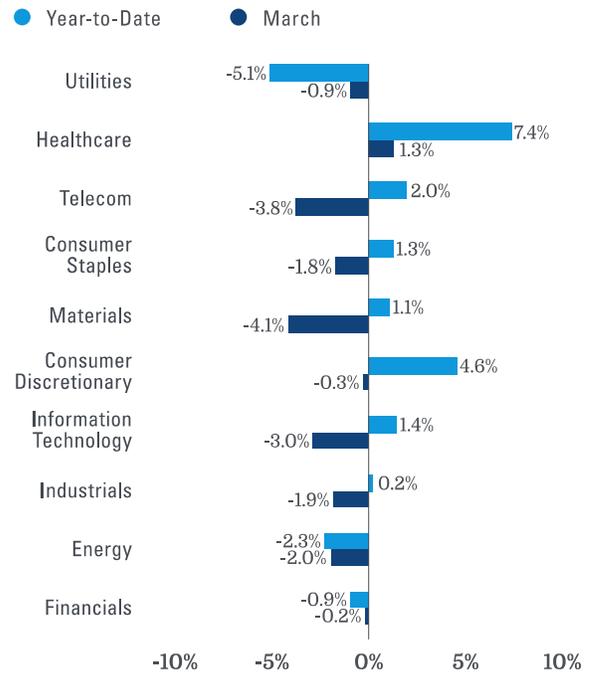
DOMESTIC INDEX PERFORMANCE



According to Thomson Reuters estimates, S&P 500 earnings are now expected to contract 2.7% for Q1 2015. Growth expectations of multinationals that derive more revenue abroad and companies that rely on export demand have seen comparatively larger downward revisions. Energy sector earnings are expected to contract -63.4% and continue to weigh heavily on overall index earnings expectations.

International/Emerging Markets

International developed markets, as measured by the MSCI EAFE Index, and international emerging markets, as measured by the MSCI Emerging Markets Index, both fell 1.4% in March, edging out the S&P 500 but trailing the Russell 1000. Both indexes topped the S&P 500 for the quarter based almost entirely on strong outperformance in January. The Organisation for Economic Co-operation and Development's (OECD) March global Composite Leading Indicators (CLI) pointed to accelerating growth momentum in the Eurozone in March, led by Germany, with early signs of similar prospects for France and Italy, while growth momentum for Japan and the U.K., like the U.S., remained stable. Dollar strength and inexpensive oil continue to provide added stimulus to international developed countries, which are largely net oil importers, and earnings growth expectations exceed the S&P 500's, but economic growth in Japan and Europe has generally lagged the U.S. due to a less dynamic business environment, stronger demographic headwinds, and higher sovereign debt levels. Among emerging markets, China stood out after its central bank lowered rates at the end of February while signaling the prospect of more stimulus in March. Russia's and Brazil's markets continue to be tied to commodity strength, while India's market, which had a strong 2014 based on the election of a business-friendly government, stalled in March after markets seemed to get ahead of fundamentals.



FIXED INCOME:

INTEREST RATES STAY RANGE BOUND IN MARCH

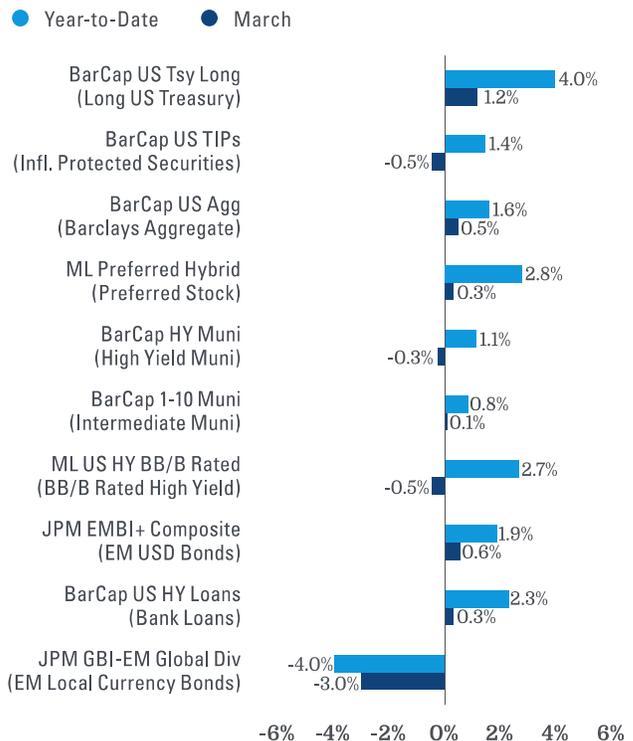
AFTER TURBULENT START TO 2015

Interest rates stayed range bound in March, resulting in mainly modest gains in fixed income after a turbulent start to the year. As January was a standout month for the Barclays Capital U.S. Aggregate Bond Index, and February very tough, March offered a more moderate return to cap off a solid quarter for fixed income on the whole. March saw the 10-year Treasury yield open at 2.0%, rise to 2.24%, and then fall to 1.88% intra-month, before finally settling at 1.94%, down slightly for the month. Returns were positive across major fixed income sectors, with the Barclays Aggregate posting a total return of 0.46%. Fed action, including drastically cutting its 2015 rate hike expectations, pushed yields down during March. Slightly falling long-term rates were a tailwind for sectors with greater interest rate exposure (duration) such as Treasuries, which outperformed the Barclays Aggregate Index by 17 basis points (0.17%), posting a 0.63% total return for the month.

High-yield corporate bonds, based on the Barclays High Yield Bond Index, underperformed the Barclays Aggregate Index, posting a total return of -0.55%. Treasury Inflation-Protected Securities (TIPS) also underperformed the larger market, returning -0.47% in March, due to falling inflation expectations over the month. TIPS and high-yield were affected by oil's slight further weakening, domestic economic data that largely disappointed, and consensus earnings expectations that have fallen from high single digits to just 2% for full-year growth. High-yield spreads relative to comparable Treasuries widened during the month, from 4.4% to 4.7%, led largely by high-yield energy, which widened from 6.5% to 7.1%.

Based on first quarter performance, the Barclays Aggregate and Treasuries are on pace for mid-single-digit gains for 2015. We believe this projected performance to be unlikely, and that the bond market may cool off from its strong performance in the first quarter.

FIXED INCOME PERFORMANCE



US TREASURY YIELDS

Security	02/28/15	03/31/15	Change in Yield
90 Day	0.02	0.03	0.01
2 Year	0.63	0.56	-0.07
5 Year	1.50	1.37	-0.13
10 Year	2.00	1.94	-0.06
30 Year	2.60	2.54	-0.06

AAA MUNICIPAL YIELDS

Security	02/28/15	03/31/15	Change in Yield
2 Year	0.48	0.51	0.03
5 Year	1.23	1.25	0.02
10 Year	2.31	2.26	-0.05
20 Year	3.66	3.63	-0.03
30 Year	4.28	4.26	-0.02

ALTERNATIVES: TURNING THE CORNER?

Alternative investment strategies provided one of their more compelling months of late, as all but one of the HFRX Indexes delivered positive performance, while the sideways-trading S&P 500 Index eventually ended in negative territory for the month. Using the HFRX Equal Weighted Strategies Index as a proxy, this stands to be only the second month in the past three years in which alternatives produced a positive return during a month the broader equity market was down. This is not to imply that alternatives have underperformed every month, rather, the HFRX Equal Weighted Strategies Index has only outperformed in the limited number of monthly market pullbacks during this time frame.

By category, discretionary and systematic-related strategies saw continued strength, as the HFRX Macro and HFRX Macro: Systematic Diversified Indexes returned 0.71% and 1.30%, respectively. Gains here were concentrated in the first half of the month, as the established long U.S. dollar and short oil positions moved against many funds as a result of the dovish Federal Open Market Committee (FOMC) minutes on March 18.

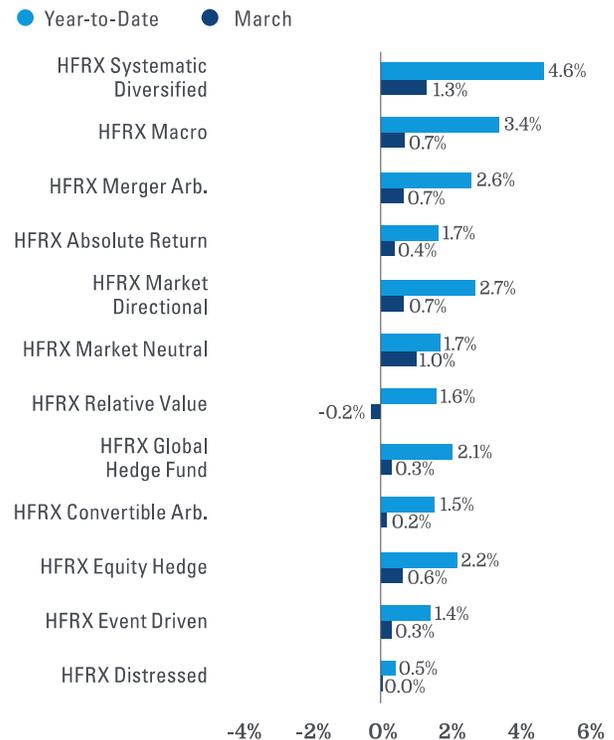
Event driven managers continued to see steady gains during the month, with the HFRX Event Driven Index returning 0.35%. Pharmaceutical-related activity persisted, as firms look to expand their drug pipelines. Importantly, the market has yet to experience a sequence of deal breaks similar to what occurred during Q4 2014, which led to outsized losses and a significant widening of existing deal spreads.

Long/short equity managers delivered a second straight month of positive returns. With 9 out of 10 S&P GICS sectors down, funds were able to find ample profit opportunities on the short side, while managers with Asian related exposure—specifically China—took part in the broad rally in those markets.

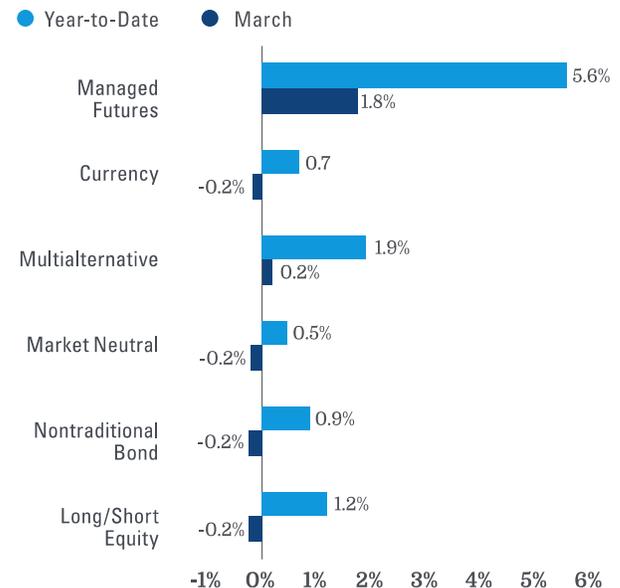
FED SPOOKS GROWTH

Several generations of quantitative easing (QE) have come and gone following a basic blueprint: QE extends, rates fall, markets rally. In March, market participants interpreted an overture by Fed Chair Yellen as a rate hike delay. Yet, protocol failed. Rates did fall, but risk assets weakened.

HFRX INDEX PERFORMANCE



MORNINGSTAR INDEX PERFORMANCE



MLPs & Global Listed Infrastructure

With no earnings reports to calm investors, master limited partnerships (MLP) struggled as renewed weakness in energy commodities brought another wave of corollary selling. The most commodity-exposed areas of the market suffered the brunt of investor angst, with exploration and production (upstream) MLPs falling more than 12%. Beyond the commodity headlines, secondary issuance weighed heavily on shares for a second consecutive month, with nearly \$10 billion hitting the tape at 3–5% discounts to previous close.

Infrastructure stocks also struggled outside of the U.S., with global utilities (-4.0%) and toll roads (-2.2%) leading the way down. Railways finished flat for the month, and remained the strongest performers over the trailing 12 months (+52.1%) thanks to continued volume growth in the U.S. (partially from Bakken oil shipments) and strong passenger numbers in Japan.

REITs

U.S. real estate investment trusts (REIT) were one of the few asset classes to follow rate protocol in March, rising in lieu of falling rates. It was a mixed bag of performance, however. The more interest–rate sensitive and defensive sectors (e.g., healthcare REITs, +0.5%) were joined at the bottom by the most cyclical (e.g., hotel and leisure, -1.05%) while residential and office space topped 3%, creating a rate–sensitivity barbell, where the intermediate part performed the strongest. This was consistent with fixed income performance, where curve flattening prevailed. Abroad, despite comparable interest rate declines, REITs struggled. The latest round of fears over a Greece exit helped pull European operators down, although there were pockets of strength in interest rate–sensitive areas (e.g., European healthcare property index, +7.0%). Japan (+0.9%) saw the opposite pattern, with cyclicals (hotel and leisure, +8.2%) leading the charge thanks to tourism spurred by the cheap yen.

Commodities

After a brief reprieve in February, commodities resumed their trek down with only live cattle (+6.1%) and copper (+2.6%) showing any signs of life. Brent (-12.3%) and WTI (-7.8%) resumed their respective downtrends despite geopolitical unrest on the Saudi-Yemeni border. In the

U.S., once a tentative agreement ended several refinery strikes, gasoline (-10.3%) tumbled. Industrial metals were effectively flat, with the exception of nickel (-12.2%), where a glut in Chinese inventories outweighed supply concerns coming from a 2014 Indonesian export ban. Gold fell 2.6% primarily due to dollar strength (+3.2% in March), but the metal was actually up 1.8% in euro terms. Last, and in this case least, the agricultural sector struggled across grains (-2.9%) and softs (-8.3%), dragged lower by sugar (-13.4%). The sweetener continued to face oversupply overhang stemming from the Indian government’s export subsidy aimed at reducing the country’s growing sugar stockpile. Soybeans (-5.7%) fell after a trucker strike in Brazil moderated, helping the grain get to ports for the first time in months without delay. As we mentioned last month, nearly 60% of Brazil’s soybean crop moves via truck.

LIQUID REAL ASSET PERFORMANCE

