July Update | As of June 30, 2015

# JUNE 2015 IN REVIEW

## ECONOMY:

### MORE SIGNS OF A SPRING ECONOMIC REBOUND

**Economic Data**

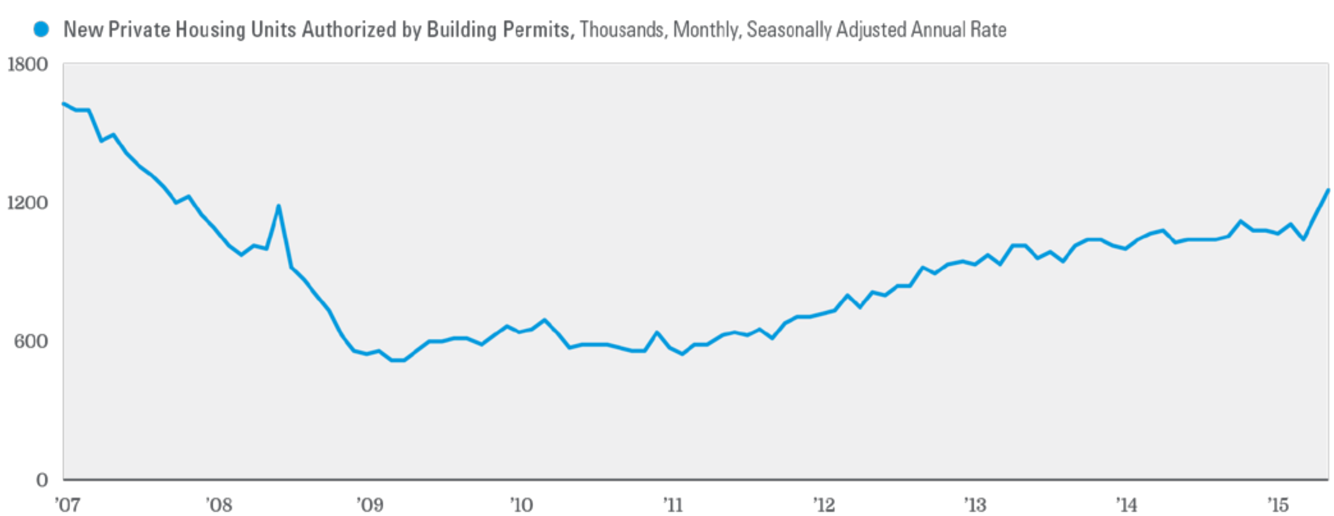
Stronger and more consistent signs of an economic rebound from first quarter weakness were the main themes in June's data releases (which largely reflect economic activity in May). An upward revision to Q1 2015's gross domestic product (GDP) growth, from -0.7% to -0.2%, also shed a somewhat more positive light on the prior quarter. Second quarter numbers continue to reflect a divide between consumer-driven economic data, which are leading the turnaround, and manufacturing data, which are rebounding more slowly, held back by lingering effects from the strong dollar and slowing capital expenditures in the oil patch.

Labor markets continue to improve. The Bureau of Labor Statistics' Employment Situation report showed the economy created 280,000 net new jobs in May, well above expectations (+226,000). The +280,000 reading was a big improvement from the 221,000 jobs created in April and the 119,000 created in March. The unemployment rate ticked up 0.1% to 5.5% while wage growth accelerated slightly from 2.2% to 2.3%.

Retail sales, which for some time have largely fallen short of analysts' expectations for a lift from lower energy prices, accelerated sharply in May; the key retail sales measure excluding autos and gasoline topped expectations, as did retail sales excluding building materials and food services. Overall consumer spending in May also rose solidly, as incomes rose and the savings rate, which had been rising, saw a small downtick. Housing-related numbers were also a source of some positive surprises this month. Permits for new housing in May jumped to their highest level since before the recession, posting a second consecutive strong month, and both new and existing home sales topped expectations and accelerated from the prior month.

May manufacturing data, however, was mixed. The Institute for Supply Management's (ISM) Manufacturing Purchasing Managers' Index (PMI) for May rose for the first time since September 2014 and remains in expansionary territory, although only modestly so. Industrial production for May contracted outright versus consensus expectations for expansion, including weakness in the manufacturing component. Durable goods orders for May also slipped, driven by the volatile aircraft component, but orders and shipments for nondefense capital goods excluding aircraft (core durable goods) were

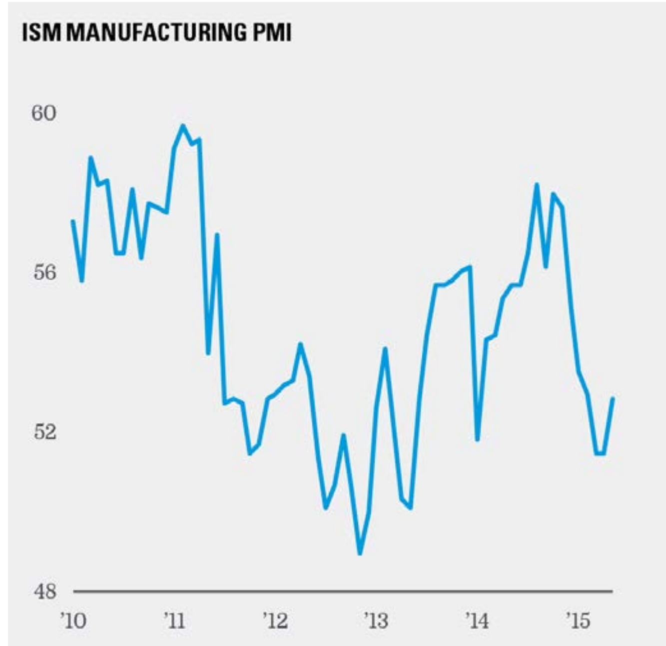
**HOUSING PERMITS**



in-line with expectations and accelerated from downwardly revised April readings. Core shipments, which feed directly into the business capital spending portion of GDP, remain on track for the first quarterly gain since Q3 2014.

Improving trade data in May highlighted that the negative economic impact of the West Coast port strike has begun to wind down. Imports fell over 3% following a spike in April due to catch-up following the strike. At the same time, exports rose and the trade surplus in services expanded, showing the continued importance of good old American know-how to the U.S. economy.

The Conference Board's Leading Economic Index (LEI) for May posted a solid upside surprise and accelerated from the prior month, continuing to support a low probability of a recession in the next year. Strong growth in building permits and a steepening yield curve made the largest contributions to month-over-month growth. In addition, the pace and size of positive economic surprises, as measured by Citigroup's Economic Surprise Index, improved steadily in June.




## Central Banks

Markets responded positively to the Federal Reserve's (Fed) policy statement following the conclusion of the Federal Open Market Committee (FOMC) June 16 – 17 meeting. The statement, and press conference by Fed Chair Janet Yellen, maintained a balanced tone with a dovish leaning and continued to emphasize the Fed would not act precipitously to raise rates, the pace of rate increases would likely be moderate, and any decision would be data dependent. G20 major economies that lowered rates in June included India, South Korea, Russia, and China. In addition, the Bank of Japan and European Central Bank (ECB) continue to implement quantitative easing (QE). Brazil was the only G20 central bank to raise rates in June.

# GLOBAL EQUITIES:

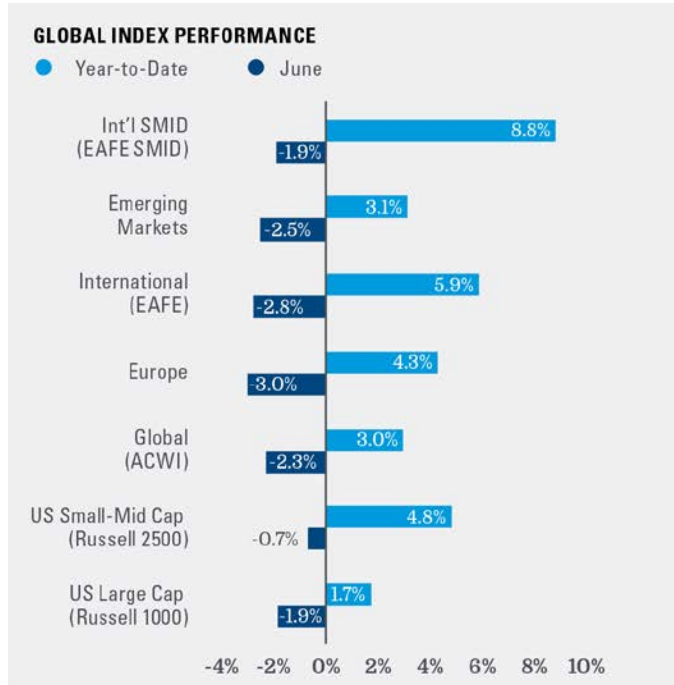
## GREECE DEFAULT BRINGS LATE MONTH VOLATILITY

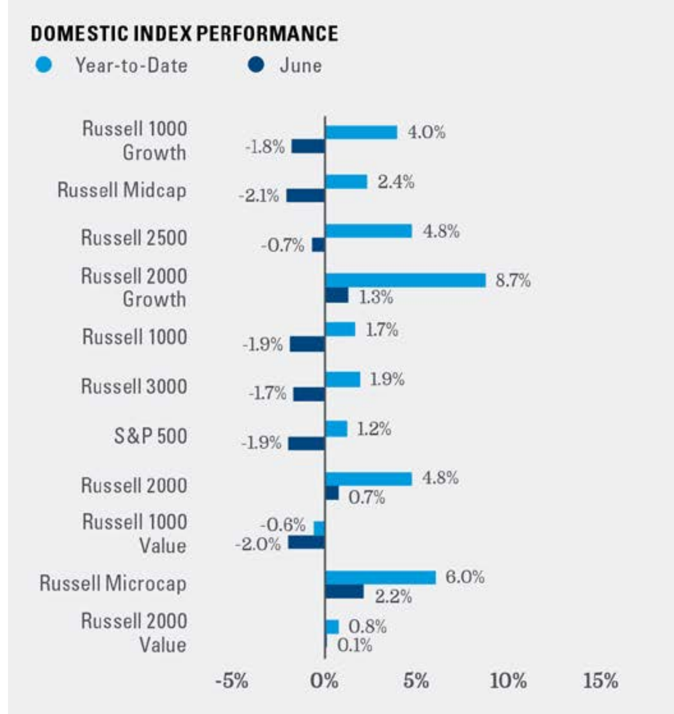
### U.S.

U.S. stocks fell modestly in June. They held on to monthly gains with one week left in the month before several market concerns — primarily Greece but also stock market volatility in China and risk of default in Puerto Rico — contributed to market declines that left the S&P 500 down 1.9% for the month. Volatility generally remained low throughout 2015, up until Greece failed to reach an agreement to free up more rescue funds or to extend its bailout over the weekend of June 27. The news that Greece would default on its payment due to the International Monetary Fund (IMF) drove the biggest one-day percentage decline in the S&P 500 Index since February 3, 2014. The total return of the S&P 500 year to date stands at 1.2%.

Looking beyond Greece, the U.S. macroeconomic backdrop has improved and was supportive of gains throughout the first three weeks or so of the month. As discussed above, more signs that U.S. economic growth was picking up emerged in June after the slow start to the year. This improved economic backdrop should help to support the near-term earnings outlook. At the same time, despite improving domestic economic data, the Fed may be slow in starting to hike interest rates and the pace of subsequent hikes is expected to be gradual (developments in Greece may even slow this timetable further), a factor that likely helped limit the magnitude of the decline in the waning moments of the quarter. This has generally created a favorable environment for stocks, in our view, as the second half of the year begins.

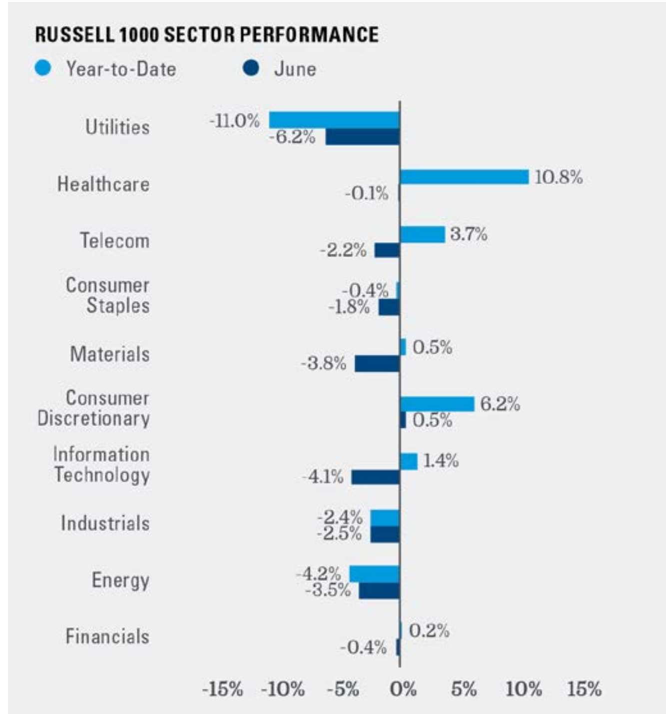
Consumer discretionary was the only sector to rise for the month, although financials and healthcare suffered only marginal losses (less than 1%). Consumer discretionary got a boost from the better housing data during the month. Positive fundamentals have supported the healthcare sector even amid the uncertainty — though now resolved — surrounding the Supreme Court ruling on the Affordable Care Act issued on June 25. Financials, despite Greece jitters, garnered support from rising interest rates, which benefit lending margins for banks and reinvestment rates on insurers' bond portfolios. On the downside, utilities lost the most ground during the month, falling 6% as rising interest rates hurt the higher-yielding sector. Earnings weakness weighed on semiconductor stocks, which contributed to technology sector underperformance. Healthcare and consumer discretionary have produced the best returns



among equity sectors year to date.

In terms of market capitalization, small caps enjoyed another strong month with the Russell 2000 outpacing the return of the large cap Russell 1000 by more than 2%. Small cap strength was broad based as 9 of 10 small cap equity sectors outpaced their large cap counterparts. The outperformance appeared in part a function of relatively less business exposure overseas where the market's growth concerns have been centered. Small caps have outperformed large caps year to date by 3% thanks to the Russell 2000's 4.8% return and continue to recapture relative losses versus large caps from 2014.




### International Developed/Emerging Markets

Overseas markets gave investors a wild ride during June with several moves of 3% within the month. In the end, it was a down month for both the MSCI EAFE Index (-2.8%) and the MSCI Emerging Markets Index (-2.5%), with each producing larger losses than the S&P 500. The biggest drivers of the weakness, which came to the fore during the last week of the month, were Greece's default on its payment due to the IMF and stock market volatility in China. As in the U.S., the economic backdrop in the developed world (Greece aside) has improved with raised economic growth expectations (based on Bloomberg consensus estimates) and solid year-over-year earnings gains over the past three months. Exporters in Europe and Japan received a boost from their weaker currencies, mostly resulting from bold monetary policy from their central banks. Weaker currencies also boosted profits for international companies operating in the U.S. due to currency translation impacts.

Among developed markets, Germany and France held up relatively well during the month, while commodity-sensitive Australia lagged. In emerging markets (EM), China was hit hardest amid concerns about excessive margin lending fueling a stock market bubble, even amid more stimulative policy actions from the Chinese government and central bank, while Brazil managed a positive month. Year to date, the 5.9% and 3.1% returns for the MSCI EAFE and EM indexes, respectively, are both ahead of the S&P 500's 1.2% return.

# FIXED INCOME:

## VOLATILITY RISES AS BOND WEAKNESS CONTINUES IN JUNE

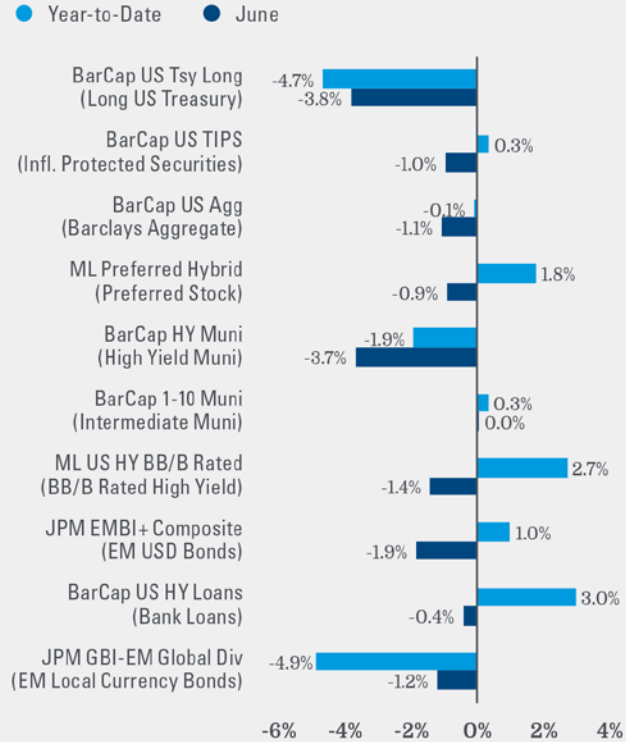
Interest rates rose modestly during June, with the 10-year Treasury yield rising from 2.1% at the end of May to 2.4% at the end of June. The backdrop of rising interest rates was a headwind for fixed income, and June proved to be another challenging month as a result. The overall market, represented by the Barclays Aggregate, posted a 1.1% loss for the month.

Economic data releases in June, particularly consumer-driven data, were largely supportive of a strengthening recovery and led yields higher, with the 10-year Treasury yield climbing to 2.5% intra-month. However, a likely default by Greece and the uncertainty around a resolution to its debt negotiations prompted a flight to safety, helping pressure yields lower off their intra-month highs.

The rise in interest rates resulted in a modest loss for Treasuries, returning -0.9% for the month, as measured by the Barclays U.S. Treasury Index. Treasuries outperformed the Barclays Aggregate, as increasing uncertainty around events in Greece and Puerto Rico were a headwind for more economically sensitive sectors. High-yield corporate bonds, based on the Barclays High Yield Bond Index, underperformed the Barclays Aggregate Index, posting a total return of a -1.5%.

Entering the seasonally strong period of July and August, municipal bonds enjoyed richening valuations over the month, allowing municipals to outperform Treasuries. Intermediate municipals were flat during the month. However, the deteriorating situation with Puerto Rico resulted in a large loss for municipal high-yield, down 3.7% for the month.

**FIXED INCOME PERFORMANCE**




**US TREASURY YIELDS**

| Security | 5/31/15 | 6/30/15 | Change in Yield |
|---|---|---|---|
| 3 Month | 0.01 | 0.01 | 0.00 |
| 2 Year | 0.61 | 0.64 | 0.03 |
| 5 Year | 1.49 | 1.63 | 0.14 |
| 10 Year | 2.12 | 2.35 | 0.23 |
| 30 Year | 2.88 | 3.11 | 0.23 |

**AAA MUNICIPAL YIELDS**

| Security | 5/31/15 | 6/30/15 | Change in Yield |
|---|---|---|---|
| 2 Year | 0.61 | 0.66 | 0.05 |
| 5 Year | 1.41 | 1.45 | 0.04 |
| 10 Year | 2.43 | 2.47 | 0.04 |
| 20 Year | 3.87 | 3.91 | 0.04 |
| 30 Year | 4.57 | 4.60 | 0.03 |

## ALTERNATIVES:

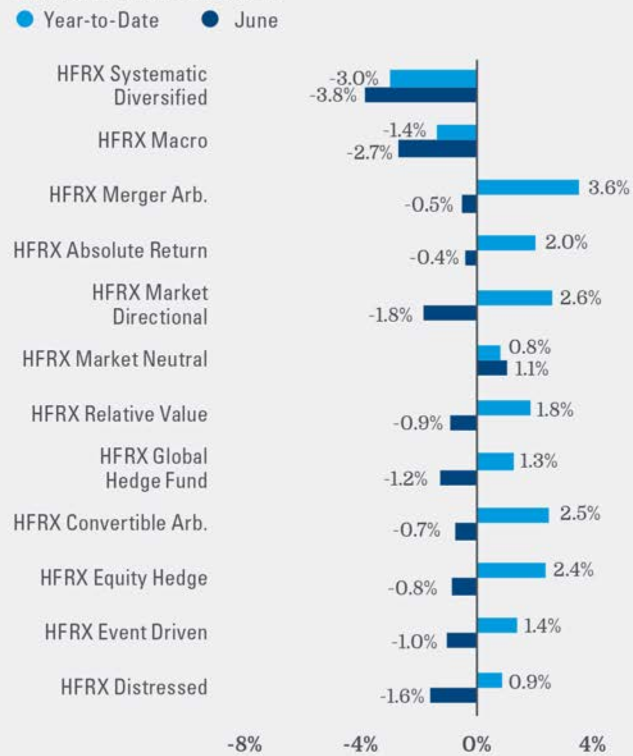
### EQUITY MARKET NEUTRAL LONE GAINER

A late month sell-off across risk assets weighed heavily on alternative investments in June, with all but low-beta equity market neutral managers (+1.1%) ending the month in negative territory. Performance in this space was most impressive during the last few trading days, as managers here were a source of positive performance, while the broader market dropped significantly. More directional long/short equity managers struggled, as the HFRX Equity Hedge Index fell 0.8%, bringing year-to-date performance to 2.4%.

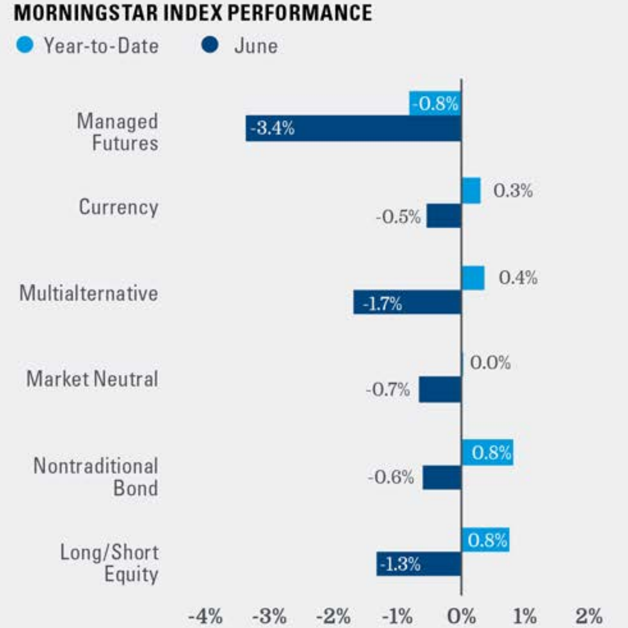
Event driven strategies encountered their first monthly loss since January 2015, falling 1.0%, as equity positioning was dragged down along with the broader market. While event driven managers focus on idiosyncratic opportunities that are typically independent of broader market movements, in the short term these positions may sell off in the event of a steep market drop. Managed futures also faced another difficult month, as long positioning in global equities, specifically in Asian markets, weighed on performance. Gains in agriculture commodity contracts helped offset these losses, as flooding in portions of the U.S. delayed planting and lowered inventory levels. After an impressive run from May 2014 through March 2015 (HFRX Systematic Diversified was up 11.2%), managed futures managers have been hindered by several markets trading in a sideways pattern, thus lacking significant trend signals.

Year to date, the broad-based HFRX Global Hedge Fund Index is up 1.3% versus the 1.2% return of the S&P 500. Of significance is how widespread the gains have been across the underlying strategies, as 10 of 12 categories are in positive territory — 8 of which have returns in excess of the S&P 500.

**HFRX INDEX PERFORMANCE**




**MORNINGSTAR INDEX PERFORMANCE**



## ANOTHER DISAPPOINTING MONTH FOR LIQUID REAL ASSETS

Liquid real assets (LRA) lost ground for the month of June, as lower oil prices contributed to declines in master limited partnerships (MLP) and commodities. REITs suffered losses due to rising rates as well as the increased possibility of an impending rate hike by the Fed.

### MLPs & Global Listed Infrastructure

MLPs had another month of underperformance, returning -8.3% compared with the S&P 500's return of -1.9%. Rising rates and lower oil prices aided in the sector's decline. The Alerian MLP Index had negative returns in four of the six months so far in 2015 and underperformed the S&P 500 Index in five of those six months. The specter of rising rates and depressed oil prices continues to weigh on this sector.

Global infrastructure fell for the second month in a row, returning -4.5% during June. The decline was led by Asia, which lagged the index overall for the month. Energy infrastructure companies, similarly to MLPs, also fell. Higher-yielding investments in the U.S. sold off, which served as another factor in the sector's decline. The S&P 500 utilities sector index fell -6.0%, lagging the S&P 500.

### REITs

Higher interest rates and lack of demand led the way for poor returns in the REIT sector in June. The Fed's posturing around a 2015 rate hike has diminished investors' appetite for yield securities, including REITs. The MSCI REIT Index fell -4.6% for the month, continuing a streak of three months of negative returns. Diversified, healthcare, retail, and specialized REITs lagged the index overall.

### Commodities

The Bloomberg Commodity Index was modestly higher for the month, ending up 1.7%, with a high dispersion of returns amongst its constituents. This occurred with a backdrop of a weaker dollar. The energy complex sold off relatively significantly outside of natural gas, which was positive. Oil declined slightly (WTI down -1.4%), while natural gas was up 7.2%. The precious metals complex lost ground with silver underperforming the index substantially.

Extreme weather in the Midwest contributed to higher grain prices. Wheat and corn gained more than 20% in June. Central and western Europe continued to experience dry and hot weather, which also factored into returns in the agriculture complex.