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Monthly Economic & Capital Market Update

June 2017

Economic Perspective

June 30, 2017

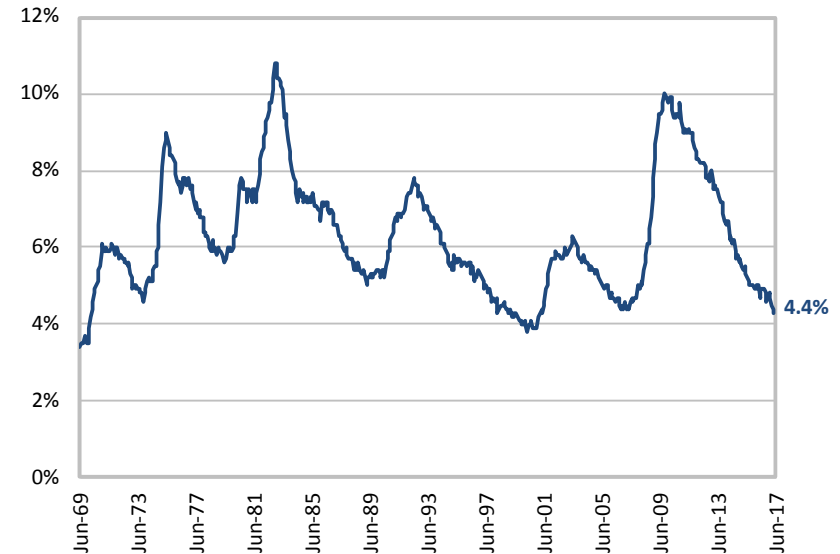
Economy

- Economic conditions throughout the world continued to improve during June, lifting global equity indices to new all-time highs. Low interest rates, increased consumer sentiment, and higher company earnings have helped generate strong equity market gains over the past year.
- The US economy saw positive job growth for the 81st consecutive month during June. Employers added 222,000 new payrolls, exceeding economists' expectations of 175,000 new jobs, and the unemployment rate increased 10 bps from May's 16-year low of 4.3%. Wage growth, as measured by the change in average hourly earnings of private sector workers, was 2.5% over the 12 months ending in June, unchanged month-over-month. Payrolls from April and May were revised upward by 47,000 total jobs. Job gains averaged 194,000 per month during the second quarter, above the average of 185,000 per month since the beginning of 2010.
- Real GDP grew at a 1.4% annual rate during the first quarter of 2017 according to the final estimate released by the Bureau of Economic Analysis. The estimate was revised upward from the second estimate of 1.2%, reflecting positive changes in nonresidential fixed income, personal consumption, and state and local government spending. GDP growth for Q2 2017 is estimated to have been 2.7% annualized according to the Atlanta Federal Reserve.
- Economic activity in both the manufacturing and services sectors continues to expand, as measured by purchasing managers indices (PMI). The US ISM Manufacturing PMI expanded 2.9 points in June to 57.8; an Index reading over 50 suggests expansion in the sector. Manufacturing has now been a boost to US growth for ten consecutive months, following a period during which slowing trading partner growth and a strong US dollar weighed on US manufacturing. The Non-Manufacturing (or services) PMI also continues to reflect strength, led by strong consumer spending; US services have expanded 90 consecutive months.

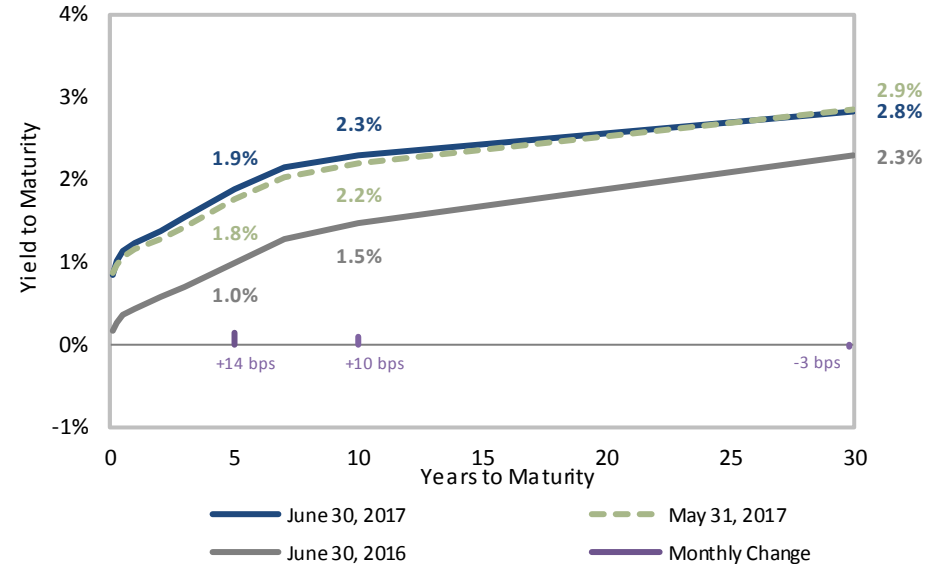
Yield Curve

- The spread between 2-year and 30-year Treasuries tightened 13 bps to 145 bps in June. Over the past two years the 2-30 spread has tightened by 103 bps, with the long end of the curve mostly unchanged while short-term yields have been lifted by Federal Reserve rate hikes. The 20-year average spread between 2-year and 30-year Treasuries is 190 bps.

Unemployment Rate



Treasury Yield Curve



Growth Assets

June 30, 2017

Public Equities

- Global stocks achieved modest gains for the month, with US markets outperforming international by 60 bps. Over the first half of 2017 MSCI ACWI IMI earned 11.3%, the best performance over the first half of a year for the Index since 2003. Strong gains in the equity markets over the past year have been supported by an improvement in earnings growth, but price gains continue to outpace earnings and valuations remain elevated as a result.
- Master limited partnerships (MLPs) returned -0.6% in June, led by underperformance in exploration and production (E&P) and energy services sectors. Year-to-date, the Alerian MLP Index has returned -2.7% and the distribution yield has increased 10 bps to 7.2%.

Public Debt

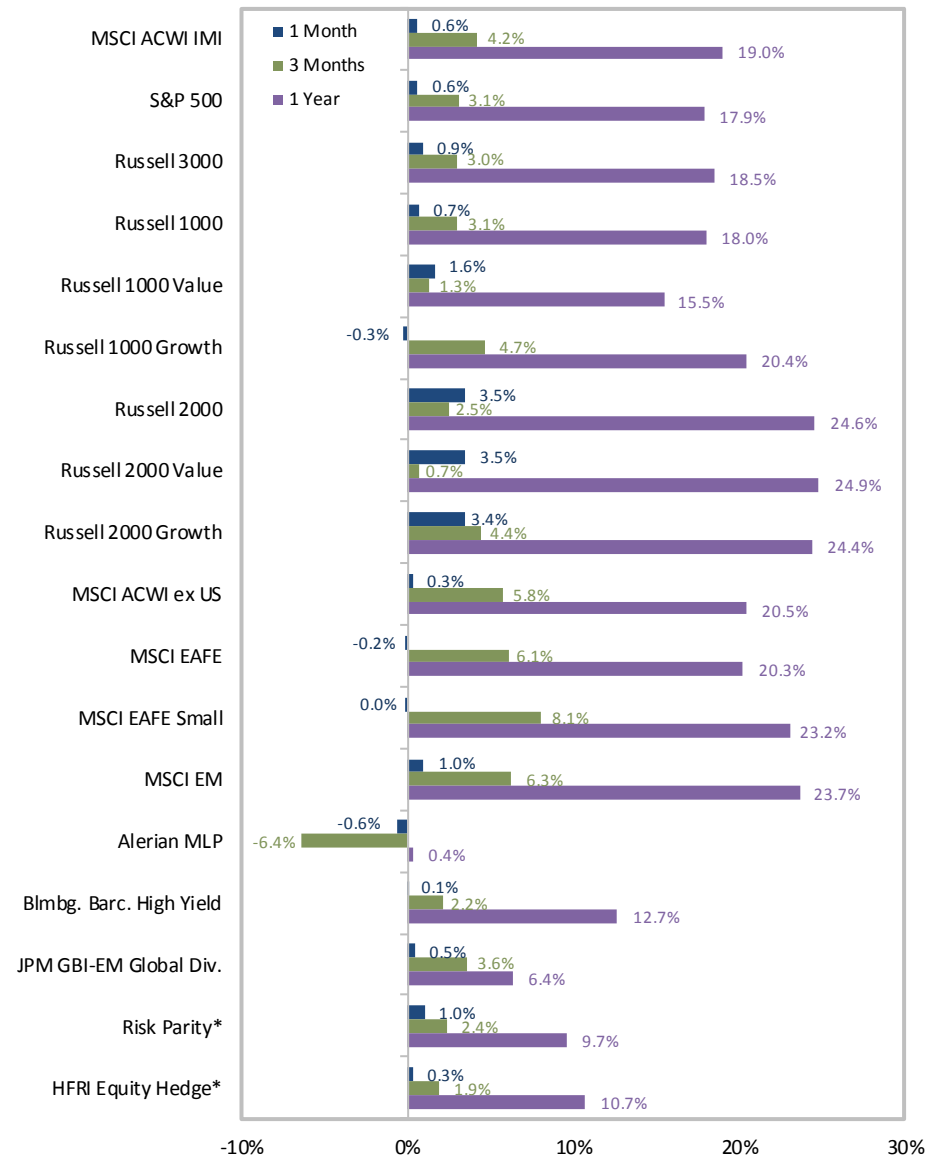
- The Bloomberg Barclays High Yield Index gained 0.1% during June as coupon payments were nearly offset by price declines. High yield spreads were mostly unchanged, ending the month at 364 bps over treasuries.
- Local currency-denominated emerging market debt returned 0.5%, with currency detracting approximately 0.2%. EM local bonds ended June yielding 6.15%, 13 bps lower month-over-month.

Private Assets

- The strong fundraising environment for private equity has continued into 2017, as the industry is likely to have seen the highest levels of first quarter capital raising since the global financial crisis. Preqin expects Q1 fundraising to surpass the \$90b raised by funds closed in Q1 2016. Purchase price multiples for middle-market LBOs, as measured by S&P Leveraged Commentary and Data (S&P LCD), have remained relatively stable from 2016 at 9.6x YTD.
- In Q1 2017, private debt funds raised a total of \$21b, surpassing last year's Q1 level of \$11b, as the momentum for direct lending strategies continued; direct lending funds accounted for 62% of total capital raised. Nearly two-thirds of all private debt funds closed during the quarter exceeded their target size.

Hedge Funds

- Risk parity funds gained in May, with positive contributions from equity and nominal bond allocations. Commodities were negative and inflation-linked bonds were generally unchanged.
- Growth hedge funds gained in May, with the largest gains coming from long/short equity. Merger arbitrage strategies were also positive, while activist and distressed debt funds 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.

Income Assets

June 30, 2017

Public Debt

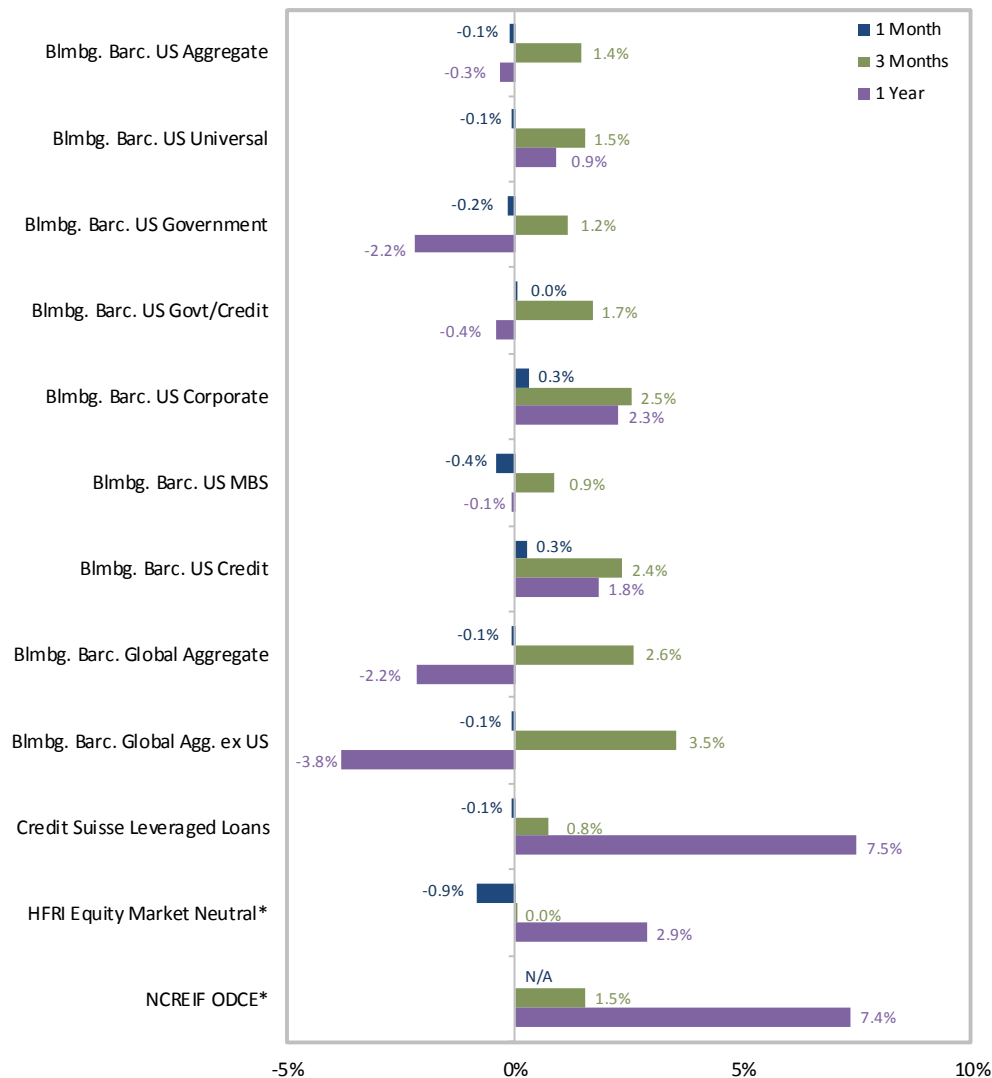
- The yield curve continued to flatten during June; the Federal Reserve once again raised short-term interest rates 25 bps while yields along the long end of the curve declined.
- The 10-year US Treasury yield ended June at 2.3%; June was the first month of 2017 in which the trading range of the 10-year Treasury did not exceed 20 bps, with the yield trading within a 17 bps range.
- The Bloomberg Barclays Aggregate returned -0.1% for June, slightly out of trend as the Index has had a negative return for only one other month in 2017. The longer duration portion of the Index continued to outperform and lower-quality outperformed higher-quality issues.
- The Bloomberg Barclays Global Aggregate reversed the positive momentum observed in prior months, returning -0.1% for June. Price return was the sole detractor during the month, while coupon and currency partially offset price losses.
- Public bank loans, as measured by the Credit Suisse Leveraged Loan Index, returned -0.1% for the month. Principal returns were negative due to technical outflows from the asset class, as well as outsized losses in the energy and retail space (which make up small portions of the Index). The trailing 12-month default rate in loans has remained relatively constant year-to-date at 1.5%, approximately in line with forecasts. Recovery rates have averaged 73% year-to-date compared to 63% in 2016.

Relative Value Hedge Funds

- Relative value hedge funds posted mixed performance in May. Equity market neutral funds were negative, while credit and volatility arbitrage contributed gains.

Core Real Estate

- Core real estate returns for the first quarter of 2017 were 1.8% gross, 1.5% net, bringing the one-year gain for core funds to 7.4%. Continued strong gains in the commercial real estate market have coincided with the US economic expansion, with strong labor market growth fueling demand while supply remains limited. Of note is that in recent quarters price appreciation has slowed compared to prior in the expansion, with a larger percentage of real estate gains now being generated through income.



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Note: All returns are USD.

Diversification Assets

June 30, 2017

Inflation

- TIPS experienced their largest monthly decline since November 2016 during June. Declining inflation expectations and rising real yields resulted in returns of -0.9% for the Bloomberg Barclays US TIPS Index. 10-year market-implied inflation expectations ended the month 9 bps lower at 1.74%.

Deflation

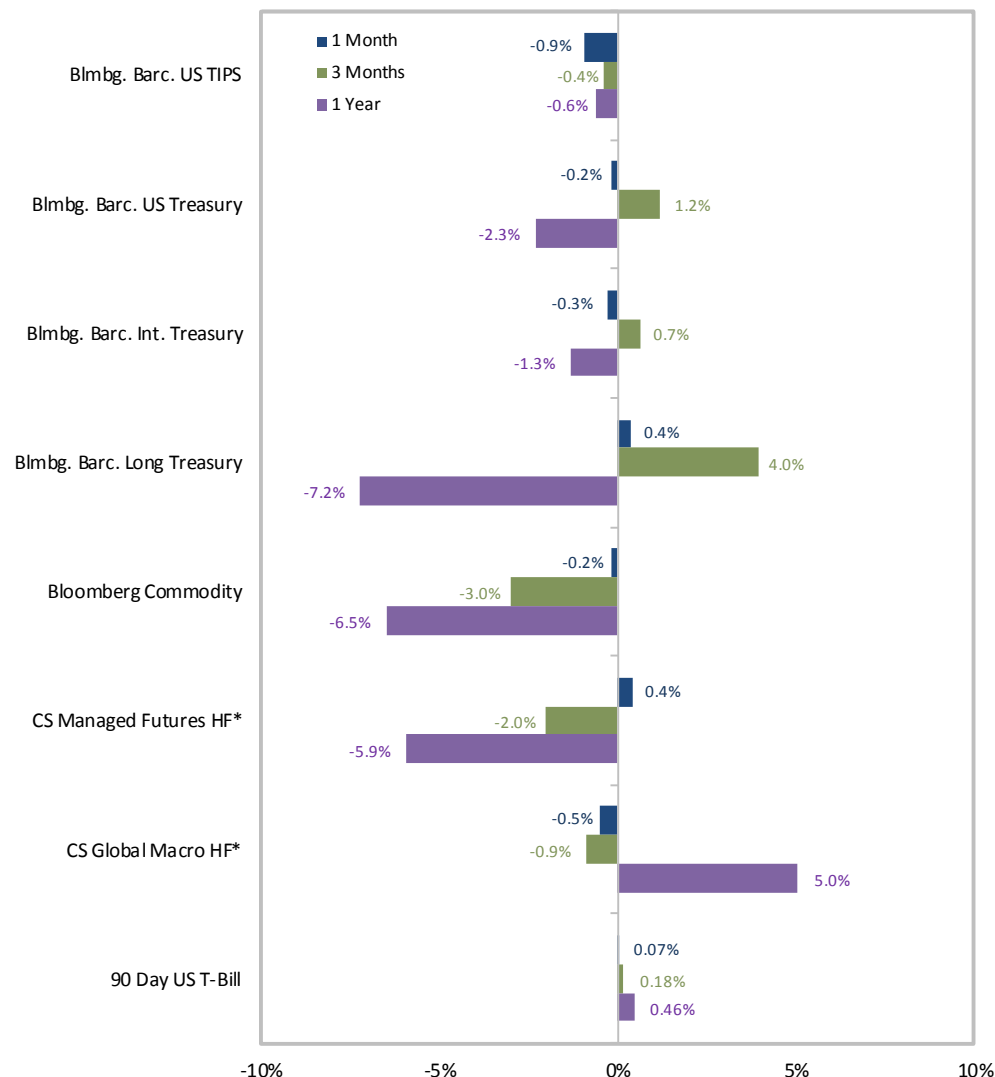
- The Bloomberg Barclays Long Treasury Index returned 0.4% for the month, 0.1% of which can be attributed to price return and the remainder to coupon. 30-year Treasury yields ended the month 2 bps lower at 2.84%.
- Cash continues to offer low returns, as 90-day T-bills gained 7 bps during June and 46 bps over the past year.

Commodities

- The Bloomberg Commodity Index returned -0.2%, with the largest detractors being soft commodities (-6.6%) and energy (-3.7%). Conversely, grains and industrial metals produced strong performance as they returned 6.2% and 3.4%, respectively. The Bloomberg Commodity Index returned -6.5% for the trailing year, with soft commodities and energy being the main detractors from performance.

Tactical Trading

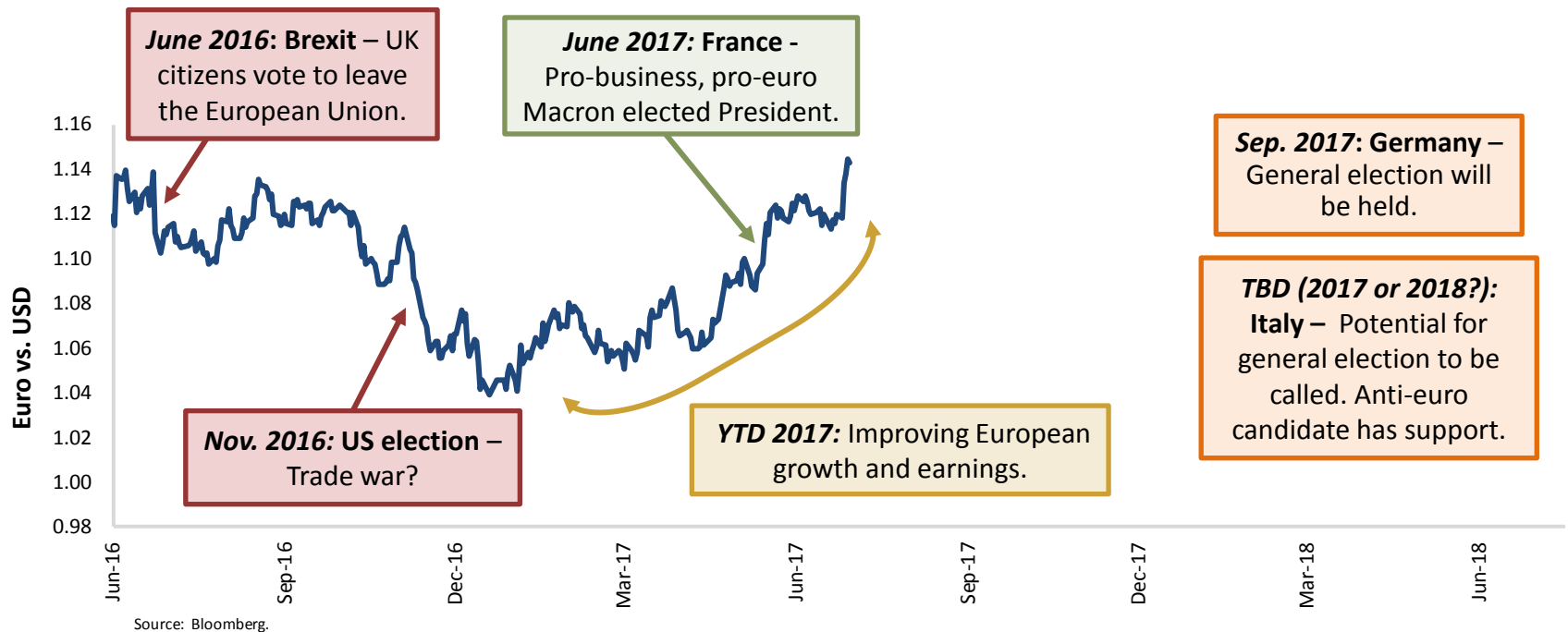
- Tactical trading hedge funds were mixed in May. Global macro strategies detracted while trend following strategies saw modest gains.



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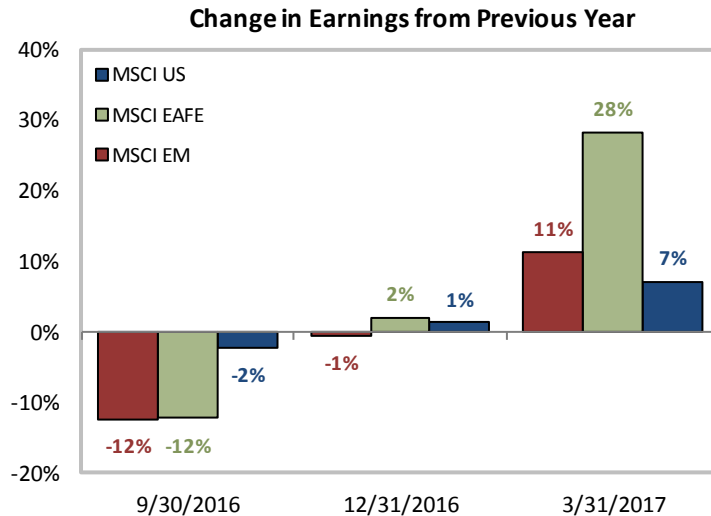
INTERNATIONAL MARKETS: POLITICAL PERSPECTIVE

- Political events, specifically in Europe, have become increasingly frequent and impactful.
- Less traditional candidates have gained support due to the slow economic recovery and other issues such as immigration and terrorism.

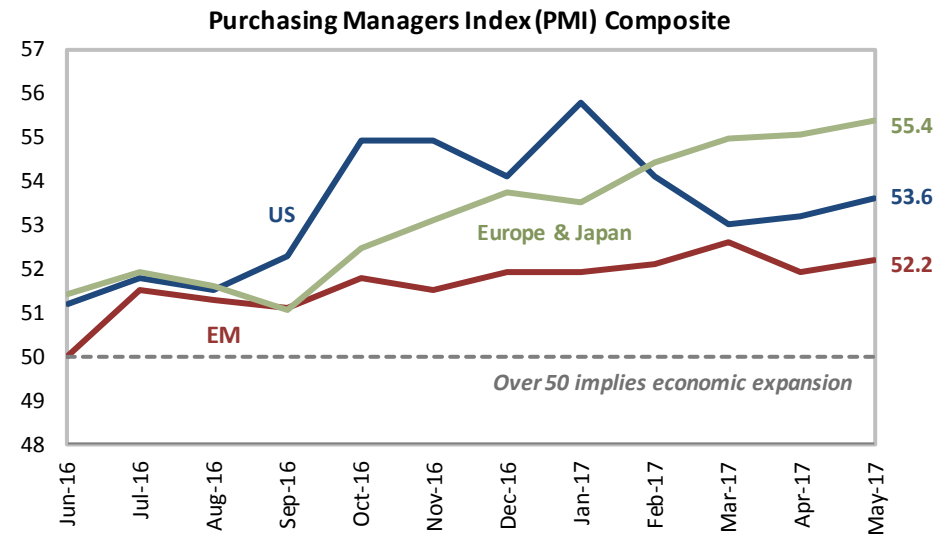


Political events have impacted markets in spurts, but the most important driver has been economic fundamentals.

INTERNATIONAL RECOVERY: FUNDAMENTALS



Source: Bloomberg, MSCI.



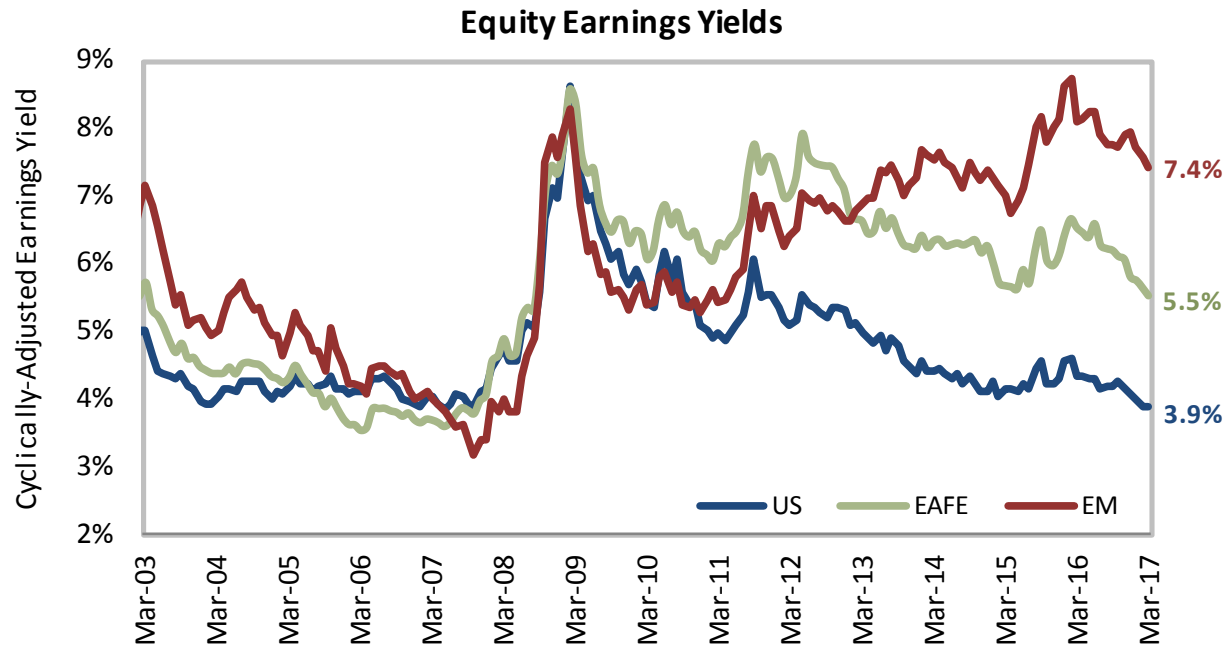
Source: Bloomberg. Europe and Japan composite based on country weights in MSCI EAFE.

- International developed equity markets have experienced the strongest earnings growth of any region over the past year.
- EAFE earnings have been supported by:
 - Increased consumer confidence and spending.
 - Higher trading partner growth (EAFE is more sensitive to global growth than the US).
 - Profit margin expansion through higher sales while costs remain low.
 - Continued low interest rates.

- The Purchasing Managers Index (PMI) has been a reliable indicator of future growth.
- All major regions have been expanding, with EAFE increasing significantly over the past year.

The international equity recovery has been supported by strengthening fundamentals and economic growth.

INTERNATIONAL RECOVERY: VALUATIONS

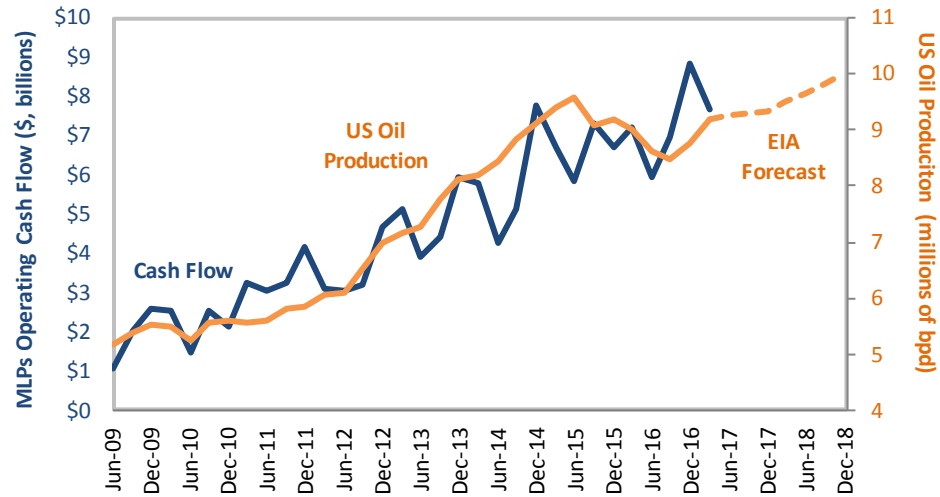


Source: AQR. Earnings yields are cyclically-adjusted, which averages earnings over the trailing ten years and adjusts for inflation.

- Yields have compressed across markets over the past year as markets have experienced strong gains.
- From a valuation perspective, emerging markets remain the most attractive, followed by developed international.

MASTER LIMITED PARTNERSHIPS (MLPS)

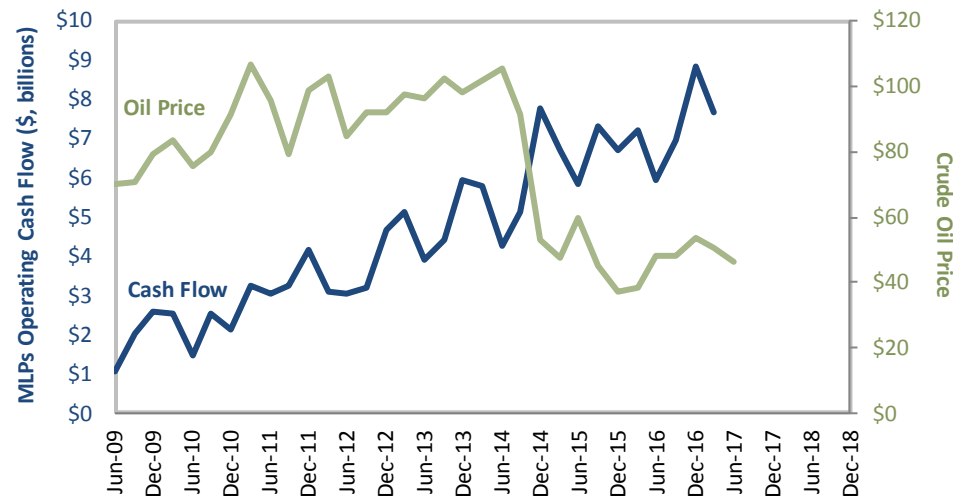
MLP Cash Flow vs. US Production



Source: Bloomberg, Energy Information Administration.

Cash flow generated by MLPs has grown
in line with US oil production...

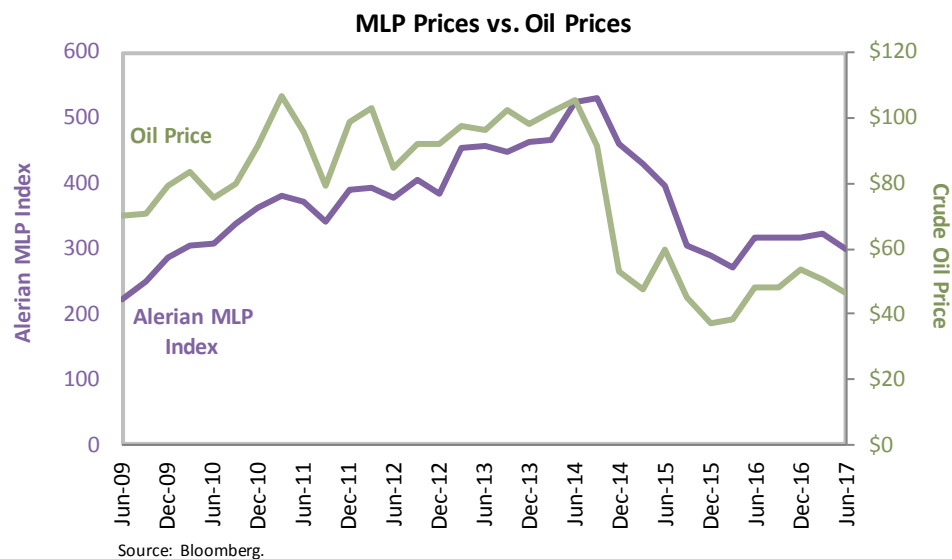
MLP Cash Flow vs. Oil Prices



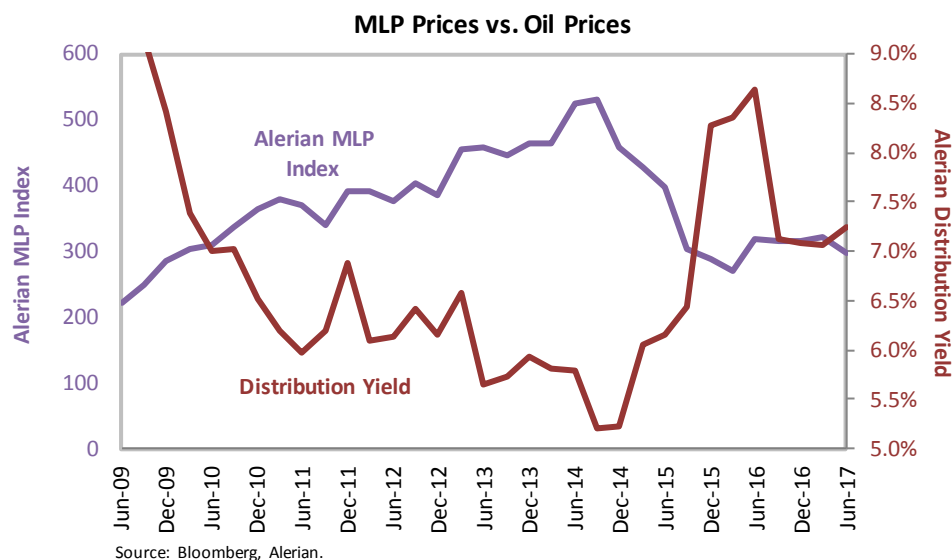
Source: Bloomberg.

... not with oil prices. \$110 billion of
pipeline and related projects expected
between now and the end of 2019 should
support production and MLP cash flow.

MASTER LIMITED PARTNERSHIPS (MLPS)



Despite this, MLPs have traded down with oil prices.



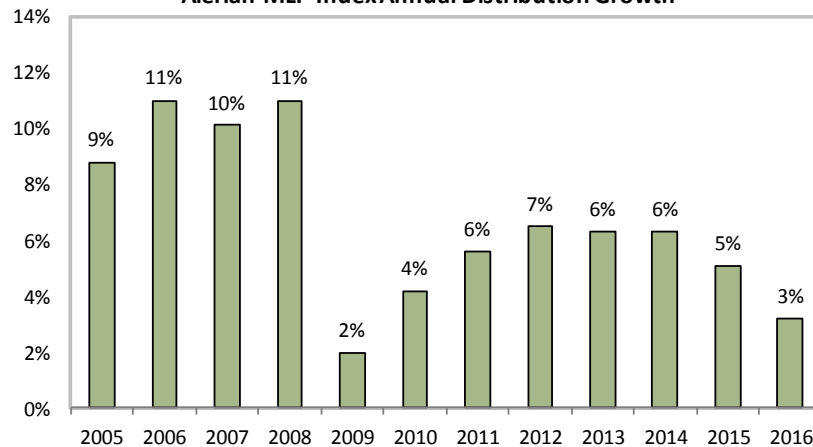
As a result, investors are now being compensated with a higher distribution yield (over 7% today compared to 5% in 2014).

MLP SCENARIOS LOOKING FORWARD SUGGEST FAVORABLE RETURNS

5-Year Forward Looking Scenarios Following Oil Market Deterioration

	Bear Scenario Low Distribution Growth + Reprice to Highest Yield	Low Growth Scenario Lowest Ever Distribution Growth	Base Case Scenario Historical Average Distribution Growth	Upside Scenario Reprice to Historical Average Yield
6/30/2017 Distribution Yield	7.2%	7.2%	7.2%	7.2%
Annual Distribution Growth	2.0%	2.0%	5.0%	5.0%
Ending Yield	12.1%	7.2%	7.2%	5.5%
IRR (Annual Return)	0.9%	9.3%	12.6%	17.7%

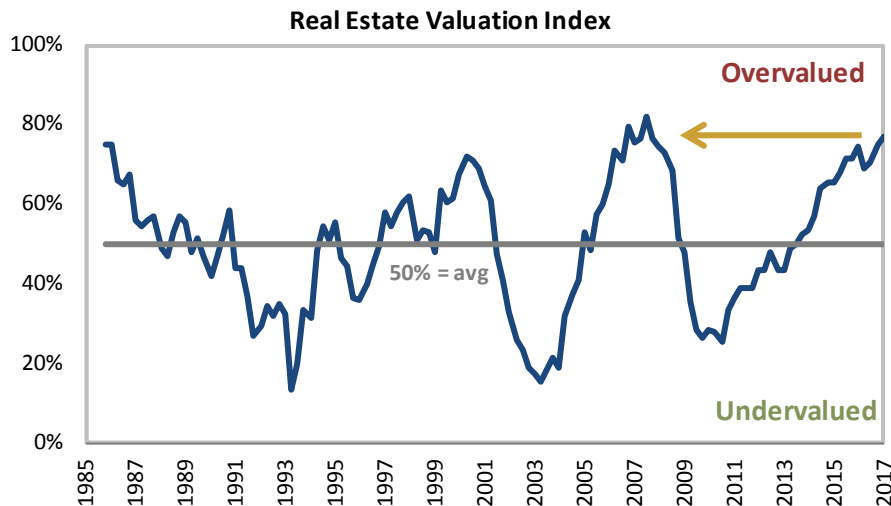
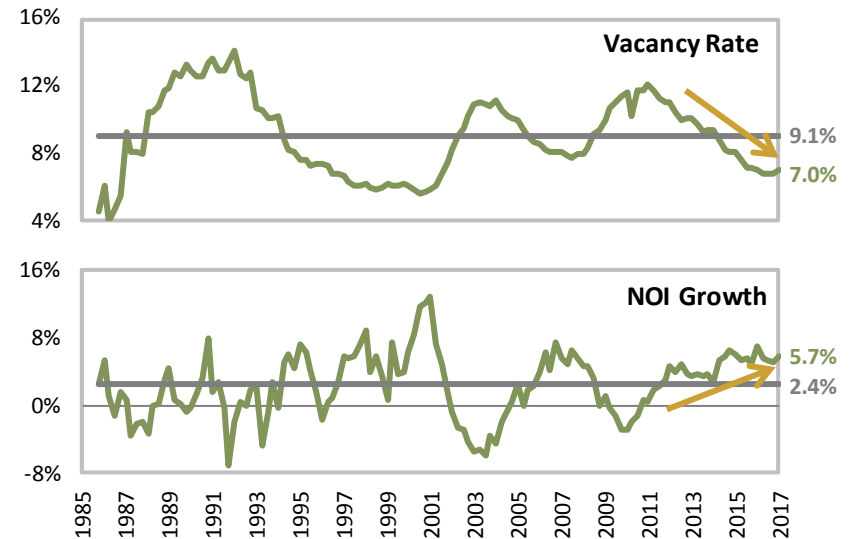
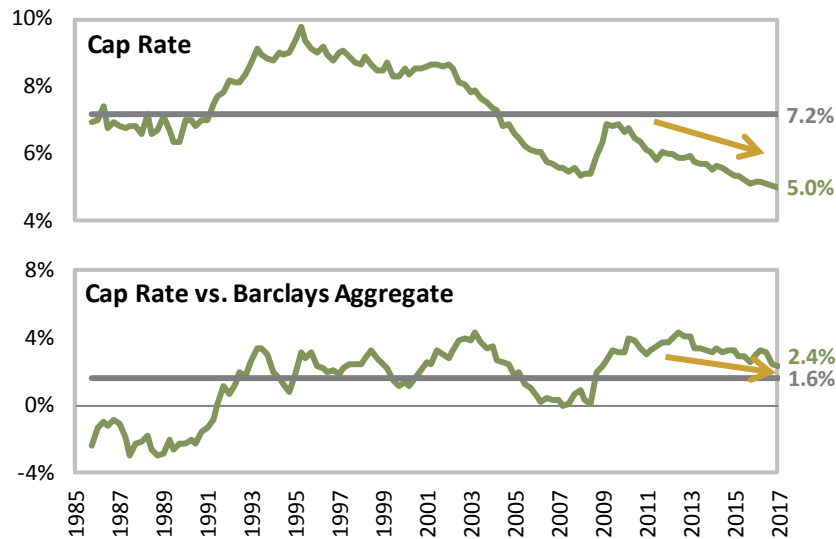
Alerian MLP Index Annual Distribution Growth



Source: Alerian.

Short-term price movements have been and may continue to be dominated by sentiment and oil prices, but investors with a longer time horizon are likely to see attractive returns.

CORE REAL ESTATE VALUATIONS REMAIN ELEVATED



Data from 1985 to March 2017. Index is based on Summit calculations using data from NCREIF and Barclays.

What is in the Index?

Metric	Comments
Cap Rates	Lowest in 30 years
Spread vs. Barclays Aggregate	Reasonable spread as interest rates remain low
Vacancy Rates	Lowest since 2001
NOI Growth	Near 2007 highs

The Index is most undervalued when cap rates, spreads vs. Agg, and vacancy rates are high, and when NOI growth is low.

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