Asset Class Relative Rankings

1st Quarter 2016

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Market Overview

- Current asset class views represent the **outlook for the next twelve months**. **Expected returns** for the next twelve months are **compared to the intermediate-term assumptions** for each asset class to determine if the outlook is positive (i.e. expected return greater than intermediate-term assumption) or negative (i.e. expected return lower than intermediate-term assumption).

- The overall market **outlook is mixed**; expectations for **cash and global fixed income are relatively negative**; expectations for **global equities are neutral to overweight** reflecting a modestly positive overall view.

- **Fixed income strategies may struggle** in the coming months due to expected short-term rate increases in the US; relatively **low levels of coupon income provide little protection** against rising rates.

- ACG continues to favor **fixed income strategies with greater flexibility** to better navigate the increased volatility and challenges of markets in transition. Portfolios with diversified exposure to a **variety of risk and return drivers** offer the potential to **protect against downturns** while retaining the **opportunity to participate** in market gains.

- Despite significant gains since the financial crisis, **global equity markets are likely to continue to provide positive, albeit modest, returns** going forward. Stock markets around the world have been buoyed by easy monetary policy. Today, many of these markets must begin the **difficult transition from a liquidity-fueled to a growth-led** environment, where corporate profitability becomes increasingly important.

At A Glance – Our Current Asset Class Views

Asset Class Relative Rankings as of 1Q2016

Cash

Tactical Outlook

Current: 5 – Negative

4Q15: 5 – Negative

- Although the Federal Reserve (Fed) raised the Fed funds interest rate to a target range between 0.25% and 0.50% in December 2015, their lowered projections for US economic growth in 2016, suggests the future path of interest rates would likely increase at a "gradual" pace.
- Additionally, the Fed maintained its projection that inflation will meet its 2% target over the medium term, but noted that declining energy prices would keep inflation low over the near term. The Fed's preferred measure of inflation, the core personal consumption index (YoY), is projected to be within a range of 1.2% and 1.7% in 2016, and has been below 2% since May 2012.
- As a result, this subdued inflation outlook has financial markets scaling back their expectations of Fed action. The Fed funds futures market places a 37% probability of one rate hike by December 2016, falling short of the Feds projected pace of four rate hikes.
- Nominal cash rates are projected to shift higher in tandem with Fed normalization, but could remain below future inflationary expectations. As a result, cash would continue to produce negative real rates and offer limited value.

US Core Fixed Income

Tactical Outlook

Current: 4 – Underweight

4Q15: 4 – Underweight

- Continued below trend US growth and muted inflationary pressures has suppressed risk premiums for US Treasury rates (UST) that have yet to revert to their pre-crisis trend of 2007. Going forward, uncertainty regarding the outlook for the global economy and continued balance sheet expansion by the European Central Bank (ECB) and Bank of Japan (BOJ) could likely weigh on risk premiums. Moreover, markets project the US Treasury curve will flatten. The 2-year UST rose 36 basis points (bps) to 1.08% in anticipation of Fed tightening, while tame inflation expectations led to the 10-year UST modestly declining to 1.95% from 2.27% at the start of the year.
- Overall the moderate US growth and inflation environment remains supportive of fixed income. However, for US investment grade (IG) corporate bonds, issuer earnings are under pressure from the collapse in commodity prices, US dollar (USD) strength and a bout of volatility from Fed uncertainty. When combined with heavy supply from a record issuance in 2015 (up 13% to $1.3 trillion), corporate spreads have widened. Recent spreads on the Barclays IG corporate bonds index stood at 162 bps after averaging 111 bps in 2015. At current levels, these bonds are relatively attractive as compared to other developed market peers.
- US macro factors are supportive for US municipal bonds: modest inflation, low expectations for rising government yields and continued US economic growth. However, rich valuations reflect these positive trends as the recent rally across all maturity sectors has flattened the yield curve and tightened relative ratios versus UST. Two-year AAA muni bonds recently yielded 0.71%, a ratio of 81% with comparative UST versus a historical average of 108%. 5-year AAA bonds yielded 1.26% or 86% of 5-year UST versus 92% historically. At the long-end, subdued inflation expectations offer protection from spread widening. 10-year AAA yields offer an advantage of 106% of 10-year UST compared with 97%, on average.

Absolute Return / Opportunistic Credit

Tactical Outlook

Current: 3 – Neutral

4Q15: 3 – Neutral

- 2015 was generally a year in which economic growth and asset returns came in below expectations. Falling commodity prices, slowing emerging market growth and the Federal Reserve's recent (and potential future) rate hikes are a few of the items that kept volatility elevated and asset returns depressed. As the calendar flips to the New Year, there is a multitude of approaches and outlooks for managers in the face of cheapening valuations and widening spreads. Where some are in risk reduction mode, others are taking advantage of what they see as newly relevant opportunities. Regardless of where they are on this spectrum, there is more agreement amongst them that volatility is not likely to subside quickly.
- The downturn in energy prices has entered its second year and volatility continues in the early days of 2016. Some of the first movers have experienced difficulties thus far while others have been able to extract alpha in this vacillating market environment. While the overleveraging of some energy companies has been a big part of many trades, newer developments like oil hedges rolling off and potential restructurings and bankruptcies may increase in importance. While timing is uncertain, a value-orientation and an expertise in distressed investing is increasingly likely to pay dividends in this space.
- After much anticipation for multiple years, the Federal Reserve finally increased the Fed Funds rate. Discussions around future Fed activity are not only about the potential pace of future increases, but the potential for "taking back" that rate increase or even negative interest rates due to market weakness. Low correlations to long only benchmarks can be valuable with this backdrop. The repricing of risk across many asset classes has increased the potential implementable prospects for these managers, either now or in the future.

US High Yield Fixed Income

Tactical Outlook

Current	4Q15
2 – Overweight	3 – Neutral

- Yields on below investment grade US corporate bonds have increased due to weak commodity prices and investor uncertainty regarding the future path of Fed normalization. Investors are demanding 9.2% on average to own high yield bonds compared to 8.0% in in early December 2015.
- Moreover, the recent high yield bond spread to UST of 795 bps is up sharply from last year's average of 513 bps and the historical average of 581 bps. Current borrowing costs are elevated at a different point this cycle as compared to previous time periods. Generally, borrowing costs rise in concert with the general level of interest rates and peak around the time the Fed begins to ease monetary policy. For example, in mid-2000 the Fed discontinued policy tightening just before the spread moved above 600 bps and defaults reached an eight-year high of 6.6%.
- For the overall high yield sector (ex-energy), accelerating US economic growth expected in 2016 could support corporate profits and provide a positive backdrop for debt service. Further, history suggests this sector can absorb much of Fed tightening through spread compression.
- Additionally, issuers have taken advantage of the low borrowing costs in recent years to refinance their debt, reducing interest expenses and pushing out debt maturity profiles. There is additional technical support due to the expected decline in new issuance in 2016. This would be the third straight year of declining supply, per Moody's.
- The impact from plummeting oil prices has been especially damaging to energy issuers, causing stress on their ability to service the debt. Looking forward, commodity sensitive names are at risk of above market default rates. The 2016 high yield default rates are forecasted at 11% for energy, but the remainder of the high yield universe has a more modest expectation of 1.5%, per Fitch.
- Still, stripping out energy, the average yield and spread for the high yield market is 8.17% and 689 bps. These above average yields and spreads could drive demand for alternative sources of yield.

Non-US Core Fixed Income

Tactical Outlook

Current	4Q15
4 – Underweight	4 – Underweight

- In the euro zone, growth and inflation forecasts for the region are subdued, as the ECB pushed policy rates further into negative territory and committed to increase and/or lengthen its quantitative easing program in support of its objective of price stability. Thus, the outlook for inflation is a key driver of ECB policy.
- However, sovereign bond yields have discounted further policy support as yields up to 5-year maturities have turned negative on the Barclays Euro Treasury bond index, representing 38% of market value. Additionally, core German 10-year yields have fallen to 0.44% from 0.68% prior to recent ECB statements. Peripheral 10-year sovereigns in both Italy and Spain have moved lower. Still, countries such as Spain and Italy, offer higher yields relative to core countries and could attract investors seeking yield advantage.
- The BOJ adopted negative interest rates, implementing a policy rate of -0.10% on top of aggressive quantitative easing in an effort to generate an inflation rate of 2%. Japan's headline and core inflation have trended just above zero, on a year-over-year basis, since May 2015. Economists expect inflation to climb to 0.8% YoY by the end of 2016. Thus, it is expected that the BOJ will remain aggressive through 2016.
- This BOJ support will likely cap upward pressure on Japan's sovereign yields, as 10-year sovereign JGB's are expected to rise from 0.02% to 0.12% over the next year. Maturities less than 10-years are projected to remain negative.
- The outlook for United Kingdom rates remains subdued as policy makers believe inflationary pressures are too weak to end nearly seven years of stimulus. Recent data showed a modest uptick in headline inflation, rising an annual 0.2%, while core inflation accelerated to 1.4%, both below the Bank of England's (BOE) 2% target. Economists forecast headline inflation will edge up from a lower base to 1% by 4Q16. With the economy near full employment, this could provide impetus for a rate hike. However, investor expectations for BOE policy rates show no tightening until beyond the first quarter of 2017. Rates could move marginally higher as forecasted by sovereign futures, projecting a 18 bps rise in UK 10-year sovereign yields to 1.61% in 12 months.

Emerging Market Fixed Income

Tactical Outlook

Current	4Q15
3 – Neutral	3- Neutral

- As the Fed sent signals in 2015 it was on the cusp of initiating a tightening in interest rates, anticipation of tighter EM financial conditions weighed on market sentiment. As a result, risk aversion caused extreme volatility, intensified capital outflows and higher risk premiums.
- Still, in past Fed tightening cycles, EM debt (EMD) yields initially adjusted higher to discount increased competitiveness from USD yields, but eventually markets refocused on underlying fundamentals and yields typically moved lower.
- The rise in market volatility resulted in USD sovereign debt spreads widening significantly, reaching 474 bps at the end of January 2016, levels last seen during the European sovereign debt crisis in 2011 and compared with an average of 386 bps historically. Besides the attractive valuations, USD bonds are relatively liquid and do not involve currency risk for US based investors.
- Valuations are also increasingly attractive in local currency EMD markets where average yields have recently moved back above 7% with significant adjustments to currency valuations occurring in 2015.
- EM corporate USD bonds offer solid credit quality and attractive yield relative to US investment grade credits. The average quality on the JPMorgan CEMBI index is BBB, with an average yield of 6.60% vs. an average yield of 4.34% for BBB rated US investment grade corporate bonds. Additionally, current spreads to comparable UST are 501 bps compared to an average of 326 bps historically.

US Large Cap Equity

Tactical Outlook

Current	4Q15
3 – Neutral	3 – Neutral

- The extreme market volatility during the fourth quarter of 2015 spilled over into January. Investors are struggling to determine if this is simply a pause in an ongoing bull market or is there a legitimate risk of a US recession. Both economists and market based indicators forecast the current economic expansion is likely to persist in 2016.
- One market indicator, the UST yield curve has inverted (2-yr UST yields greater than 10-yr UST yields), on average, 17 months prior to the last three US recessions. Based on current UST Treasury futures, the UST yield curve is projected to remain steep over the next year even while two-year yields are projected to rise 35 bps, discounting the potential for higher short term rates.
- Ongoing US and global economic expansion provides prospects for improved earnings in 2016. Although profit margins appear to have peaked during the fourth quarter of 2014, they have only adjusted slightly lower in recent quarters even while revenues have been hurt by the appreciation of the USD. Going forward, the tightening US labor market from job gains could lead to rising labor costs, leaving profit margins struggling to expand from current levels.
- However at the same time, a sustained healthy pace of job creation will continue to improve labor market conditions, thus bolstering wage growth, consumer confidence and consumer spending which could feed into corporate profits. Corporate profits for the S&P 500 are projected to grow 8.4% in 2016, with expectations resource company profits will recover as they adjust to lower commodity prices.
- Large cap stocks are trading at more reasonable levels, as valuations are back in line with fair value, as the S&P 500's 12M forward P/E is 15.4x compared to an historical average of 16.4x.
- Based on current estimates, 2016 is expected to post a fifth year of record dividend payments, increasing in the mid-single digits, following a 13% rise in 2015. The S&P 500's current dividend yield is 2.4% vs. 1.7% on the US 10-year Treasury yield.

US Small Cap Equity

Tactical Outlook

Current	4Q15
3 – Neutral	3 – Neutral

- As is typical during bouts of market uncertainty, the extreme financial market volatility witnessed in the second half of 2015, and spilling over into 2016, had the greatest impact on the riskiest assets. The Russell 2000 index fell 20% from its peak in June 2015 as compared to a 10% decline in the Russell 1000 through January 31.
- However, the recent bout of market volatility dropped valuations below historical norms. The Russell 2000 index trades at a 12M forward P/E of 14.5x 2016 earnings vs. 17.5x historically.
- Small cap valuations are also attractive relative to large cap stocks. Recently the current ratio of 12-month trailing P/E ratios of the Russell 2000 to Russell 1000 fell below 1.0x to 0.95x. The last time this ratio fell below 1.0x was in February 2010, but from that point forward averaged 1.09x for nearly the next five years.
- Furthermore, steady gains in employment and wage growth and lower gas prices have added to consumer spending power indicating continued improvement in the domestic economy. Given that small cap companies generate a substantial percentage of their revenue domestically, they are more levered to growth in the US. Therefore, they may benefit more meaningfully from top line growth as the US economy gathers momentum.
- Performance from small cap stocks could also be supported through potential increases in M&A activity. This activity could be driven by large cap stocks that struggle to deliver organic earnings growth and turn to the purchase of smaller companies with higher profit growth.
- M&A activity on the Russell 2000 index of small cap companies has increased to $320 billion in 2015, following activity totaling $293 billion during 2014.

Non-US Developed Equity

Tactical Outlook

Current	4Q15
2 – Overweight	2 – Overweight

- Outside the US, developed market equities should continue to benefit from ongoing central bank easing providing excess liquidity, helping sustain the ongoing economic recovery and potentially feeding through to corporate profits.
- Economic activity in the euro zone is expected to pickup in 2016. Real GDP growth will modestly accelerate from 1.5% in 2015 to 1.7% in 2016 due to increased consumer spending driven by lower unemployment and higher wage growth. Furthermore, the ECB's negative interest rate monetary policy pledge for all of 2016 could weaken the euro and boost exports.
- Additionally, European equities are still early in the earnings cycle and growth trends remain broadly positive. European corporate profits are 21% below the previous peak and the ECB has pledged additional support to fight deflationary forces, helping to sustain the ongoing economic recovery and boost earnings. Analysts forecast 2016 EPS growth of 13.4% for the MSCI Europe index.
- Japan's economy is expected to firm in 2016 driven by lower oil prices, rising wages and the BOJ's quantitative easing program. Economists project GDP growth of 1% in 2016, following 0.6% in 2015. Japanese stocks could continue to benefit from a weak yen and reallocation of the government's pension fund assets to stocks. Additionally, analysts project corporate earnings will grow 10% in 2016 for the MSCI Japan index.
- Valuations appear attractive across a range of valuation metrics. Japan's 12M forward P/E is 12x, compared with 25.5x historically and is below that of Europe, which is 12.6x versus 23.5x, on average.

Emerging Market Equity

Tactical Outlook

Current	4Q15
2 – Overweight	2 – Overweight

- Global activity is projected to gather momentum in 2016. In advanced economies, the modest recovery in 2015 is expected to strengthen further, providing the impetus to support EM economic growth. Emerging market economies are forecast to grow 4.3% in 2016 from 4.0% in 2015.
- The uncertainty surrounding the timing of the first Fed Funds rate hike has now been removed and markets are pricing only gradual increases in 2016. A tepid pace of Fed tightening could provide policy flexibility for EM central banks to support growth and help reduce external funding stress for those countries with current account deficits.
- Additionally, global macro headwinds could diminish. Commodity prices may stabilize after severe declines in oil and other commodities. After a sharp strengthening, the USD could moderate. Finally, the pace of weakening in Chinese economic growth could slow (6.3% growth forecasted in 2016, from 6.9% in 2015).
- EM currencies are a key driver going forward. The USD is up 40% from its trough in the summer of 2011 against a basket of EM currencies. As such, EM currencies are now as low as they were during the global financial crisis in 2008. Typically the first Fed rate rise has marked a near-term peak in the USD so the worst of the EM currency weakness may be behind us.
- Valuations in absolute terms are at a discount to historical averages as the MSCI EM index 12M forward P/E of 11.2x, compares with 13.9x historically. Further, on a relative basis, the recent price to book ratio for the MSCI Emerging Market index, a conservative valuation measure, stands at 1.3x versus 2x for the MSCI World index. This represents a 65% relative ratio to the developed markets, below the average ratio of 79% since 2000.

Global Equity Long/Short

Tactical Outlook

Current	4Q15
2 – Overweight	2 – Overweight

- Investor anxiety about the global economic environment (China, oil, interest rates, terrorist attacks) has caused increased volatility and broad selling across equity markets as fundamentals have not mattered. This is creating opportunities for investors who have a longer time horizon and are willing to stomach the shorter-term volatility. In the near term, managers agree that with the dislocation in fundamentals many companies look cheap but no one wants to step in to buy in a market driven by fear and not valuations.
- Equity long/short managers have reduced net exposures down to levels not seen since 2010. Gross exposure has also been reduced but not to the magnitude of the net decrease. The larger reduction in net exposure is because most of the selling has been on the long side and managers have maintained their short exposure. The ability to be flexible in moving exposure and the skill to pick among opportunities in sectors and regions will be key factors for success in equity long/short.
- Event driven/special situations strategies struggled in 2015 despite the large number of M&A deals announced (but not closed). The regulatory environment has delayed/extended the timeline for deals to be finalized and the current market downturn has caused many IPOs to be postponed. Due to the increase in supply and decrease in demand many managers point to the current deal spread opportunity as the widest it has ever been in Merger Arb strategies.

Commodities

Tactical Outlook

Current	4Q15
3 - Neutral	3 - Neutral

- China's rebalancing toward services and less resource intensive manufacturing sectors led to softening commodity prices in 2015. Crude oil and other industrial metals both experienced sharp declines. As commodity prices capitulate, the worst of the downward adjustment may be behind us.
- The performance of commodities is closely tied to the strength of the trade-weighted US dollar (USD). Since its bottom in July 2011, the USD has appreciated 35% against a basket of its major trading partners, as capital flowed to US higher yielding assets. If history provides a guide, the USD may be relatively flat in 2016. In past Fed cycles, the USD has peaked in the early stages of tightening. In fact, the USD has already declined 2% from its January peak.
- Nevertheless, leading indicators of world industrial activity point to weakness. Therefore, it is unlikely that world growth will run at a sufficient pace to absorb excess supply and prices could remain under pressure in the near term.
- The potential for modestly higher interest rates and existing lending stress in the energy and minerals sector could limit new capital expenditures and may lead to production cuts, thereby providing more balance within markets. For oil, analysts forecast the median price of WTI crude oil will advance to $39.67 per barrel by Q416.
- The median price of gold is currently projected to move modestly higher to $1,200 oz by Q416. A key driver for this year is the path of the Fed tightening cycle. If the Fed is unable to continue raising rates at its current projected pace of four hikes in 2016, it would be a tailwind for prices, reducing the probability of rising real yields and short term interest rates.
- Geopolitical risks are now elevated. An escalation of war with ISIS, uncertainty around Britain's vote to exit the EU, or numerous other issues could increase the appeal of commodities as a store of value.

ACG Relative Ranking

1 – Positive	2 – Overweight	3 – Neutral	4 – Underweight	5 – Negative

Global Private Equity

- The Preqin Private Equity Index was up 13.0% for the one year period ending 2Q 2015 versus 6.5% for the Russell 2000, 13.3% for NASDAQ and 0.7% for the MSCI ACWI. The equity oriented strategies of venture and buyout managers performed best with returns of 20.5% and 16.3%. On the private credit side, mezzanine managers posted a very respectable 13.4% return for the period while distressed managers fared poorly with a 4.1% return.
- Preliminary reports indicate that fourth quarter fundraising for private equity strategies was up 14.9% versus the prior quarter but down 10.3% versus the fourth quarter of 2014. The fundraising environment remains good with the final 2015 private equity fundraising total projected to be in line with the 2014 total.
- The IPO market stumbled in the third quarter and never regained its footing. US issuance fell to a six year low as 2015 ended with 45% lower IPO issuance than 2014. All sectors were down, particularly technology and energy. Numerous private equity backed companies delayed offerings into 2016 including Albertsons, Neiman Marcus, Univision and McGraw-Hill Education. The year ended with a large backlog of companies in waiting with no visibility into the timing of an IPO re-launch. Outside the US, IPO results were down by a similar amount. Of note, 9 of the 10 largest IPOs of 2015 occurred outside the US.
- As the IPO market faltered, the M&A market sprinted ahead with a record $4.7 trillion in activity for the year. Both venture and private equity sponsors took advantage of the trend and posted another year of strong exit and distribution activity.
- In the buyout market, the number of deals fell slightly for the year up but the aggregate value of those deals rose 18%. The market ended the year on a down note as volatility in the public equity markets and a pause in the credit markets made deal making more difficult.
- Looking forward, opportunities in the credit and buyout sectors are likely to become more attractive. Distressed debt managers are watching for opportunities created by the increase in high yield default rates and the spike in default rates for energy related credits. An extended pullback in the senior lending markets should result in opportunities for flexible lenders to fill the gap and should eventually moderate what has been a high purchase price environment.

Real Estate

- The NCREIF indexes completed their sixth consecutive year of positive returns with a strong showing in the fourth quarter. The NPI produced a solid 2.9% return for the quarter with the ODCE showing slightly better at 3.1% (net). For the full year of 2015, the ODCE index is up 13.9% (net), once again materially outperforming all major equity and credit indexes for the period. The ODCE quarterly income return fell 3 bps from 1.17% to 1.14% during the quarter and was down 9 bps from the beginning of 2015. Appreciation gains also moderated for the quarter but still returned a healthy 2.20%.
- Retail assets performed best in the fourth quarter and in the full year of 2015. Industrial assets trailed only slightly. Retail assets returned 15.3% and industrial assets 14.9% for the year. The worst performing property type, apartments, returned 12.0% in 2015.
- Fundamental signals were again strong in the quarter with occupancy and NOI up materially. The NPI occupancy rate rose 10 bps to 92.9%, above the 3Q 2007 peak level of 92.3% and NOI was up 4.7% for the quarter. NOI growth was particularly strong in the apartment sector which posted a 9.6% gain for the year contrasted against a small 1.5% gain for office assets. The full year income return of 5.1% for the NPI and 4.8% for the ODCE compared favorably to the ten year treasury rate of 2.3% at year end. Over the course of 2015 the ten year yield rose 10 bps and the ODCE trailing year income yield fell 27 bps. ODCE index leverage levels reversed trend and rose 60 bps to end the quarter at 21.7% (average leverage since 2000 = 21.8%).

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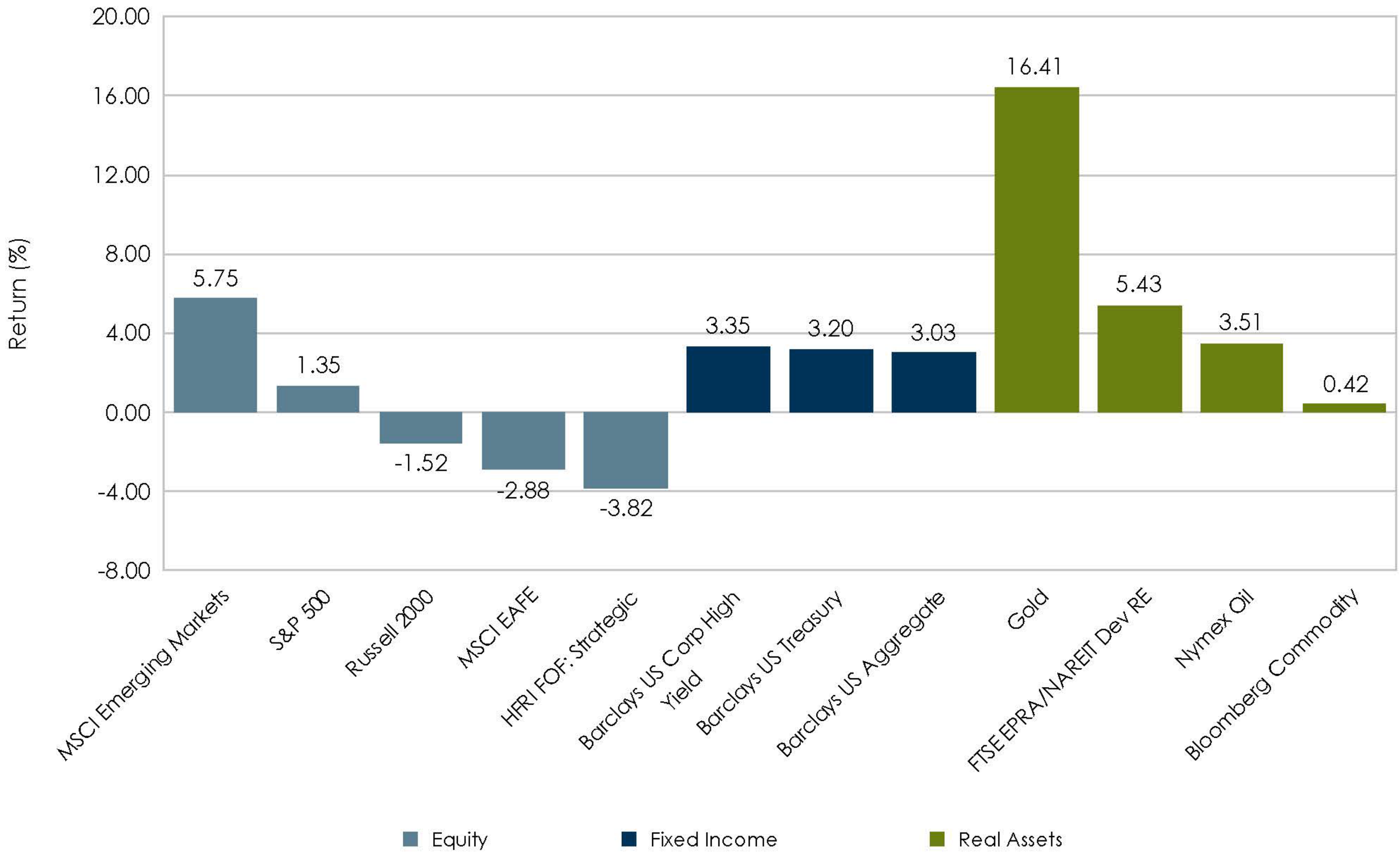
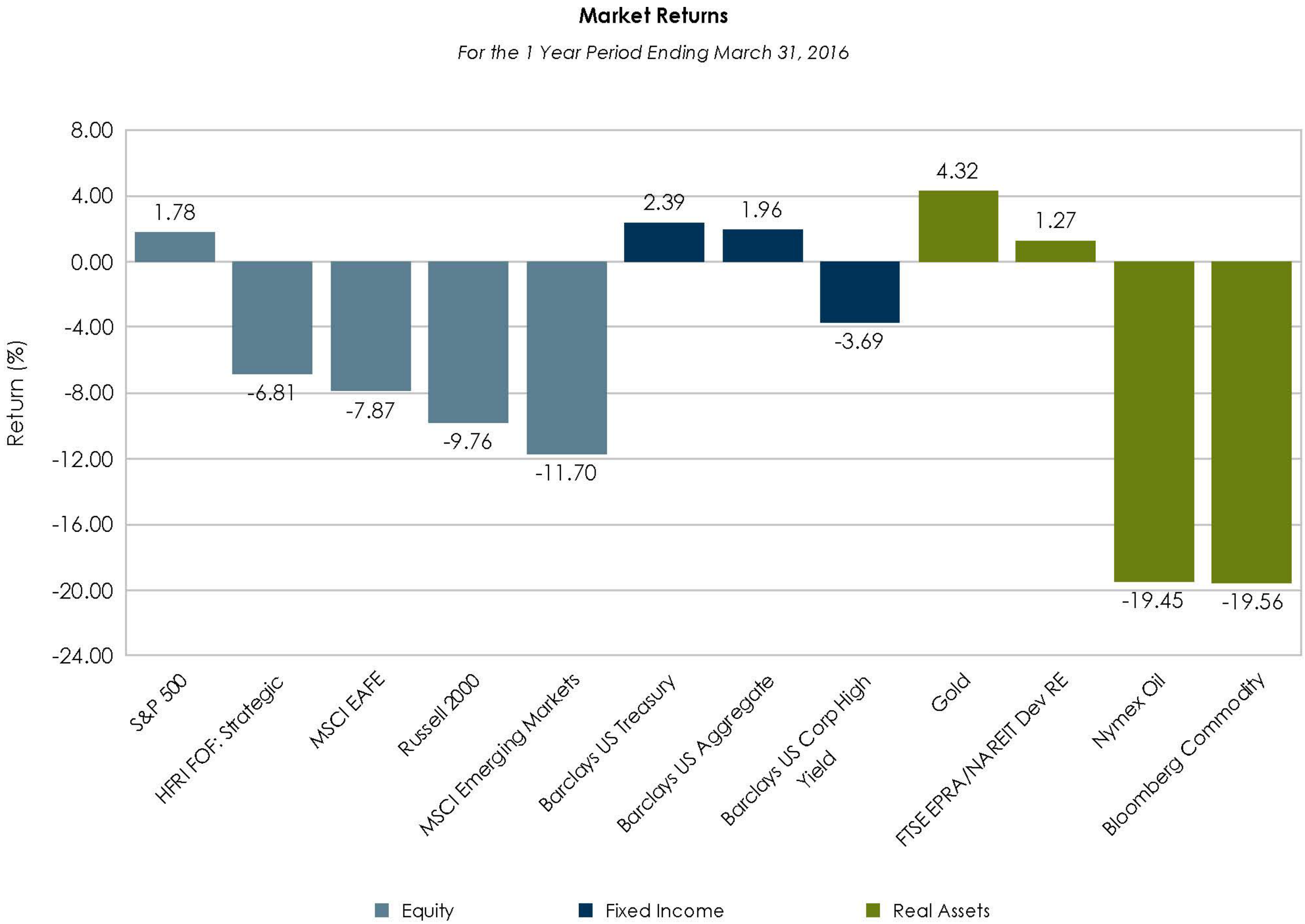
Global Economic Update

Market Returns

For the YTD Period Ending March 31, 2016




Market Returns
For the 1 Year Period Ending March 31, 2016
8.00
4.00
0.00
-4.00
-8.00
-12.00
-16.00
-20.00
-24.00
Return (%)
1.78
-6.81
-7.87
-9.76
-11.70
2.39
1.96
-3.69
4.32
1.27
-19.45
-19.56
S&P 500
HFRI FOF: Strategic
MSCI EAFE
Russell 2000
MSCI Emerging Markets
Barclays US Treasury
Barclays US Aggregate
Barclays US Corp High Yield
Gold
FTSE EPRA/NAREIT Dev RE
Nymex Oil
Bloomberg Commodity
Equity
Fixed Income
Real Assets

U.S.

- The US economy grew at a faster pace than previously estimated during Q415, advancing 1.4% compared with an earlier estimate of 1.0%.
- Consumer spending rose at a 2.4% annual pace during the quarter, but weak global demand weighed on exports, while corporate outlays for equipment declined at a 2.1% annualized pace.
- The pace of Q415 activity was slower than the 2.2% average pace in the first three quarters of 2015. For 2015, the US economy grew 2.4%, matching the 2014 advance.
- The US labor market strengthened further adding 628,000 jobs during Q116, while the unemployment rate ticked up slightly to 5.0%.
- The robust pace of job creation continues to support consumer demand and demonstrates US corporate confidence in the US economic expansion.

Global/Non-U.S.

- Japan's economy contracted in Q415 hurt by slower consumer spending and a stronger yen, which is weighing on corporate profits and spending.
- In a surprise move in January, the Bank of Japan (BoJ) adopted negative interest rates, setting its benchmark rate to -0.10% on reserves held at the bank. After trading slightly above zero following the move, Japan's 10-year yield fell to -0.03% by quarter end.
- The euro zone economic recovery remains lackluster expanding only 0.4% (QoQ), on average, over the last four quarters, supported by domestic spending, while business spending has declined.
- Tepid growth prompted the European Central Bank to follow the BoJ and cut the rate on overnight cash further to -0.40% and lowered its benchmark rate to zero. It expanded bond purchases to 80 billion euros per month from 60 billion euros. In addition, the purchases will now include non-bank corporate bonds.

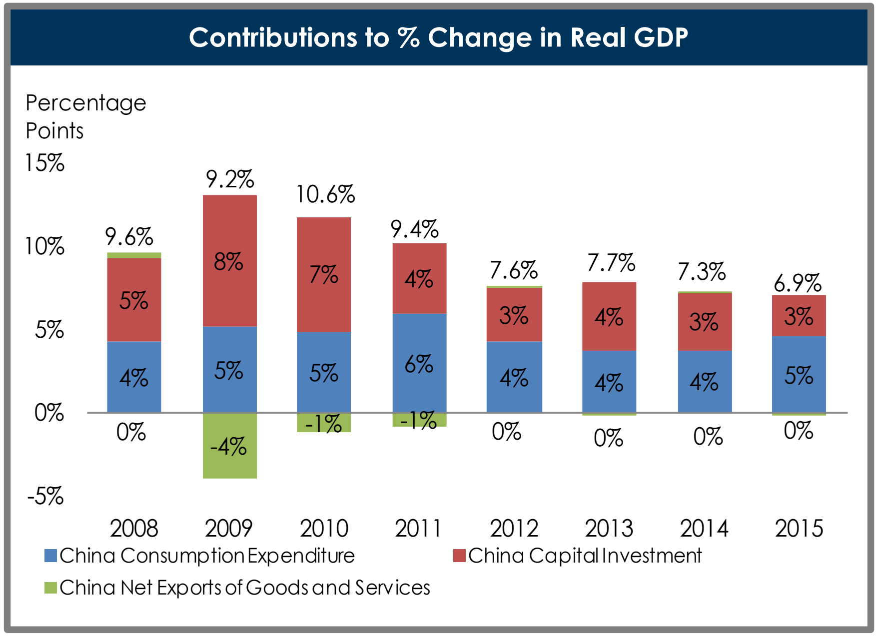
What ACG is Talking About

- China – economic growth, policies, currency, market volatility, and possible impact on global markets.
- US Economic Outlook – likelihood of recession, corporate health, engine of growth for globe, downside risks, and market impact.
- Brexit – upcoming referendum, timing, process, possible outcomes and likely impact.
- Protectionism – increased focus on protectionist policies in trade and political arena.

Source: Bloomberg

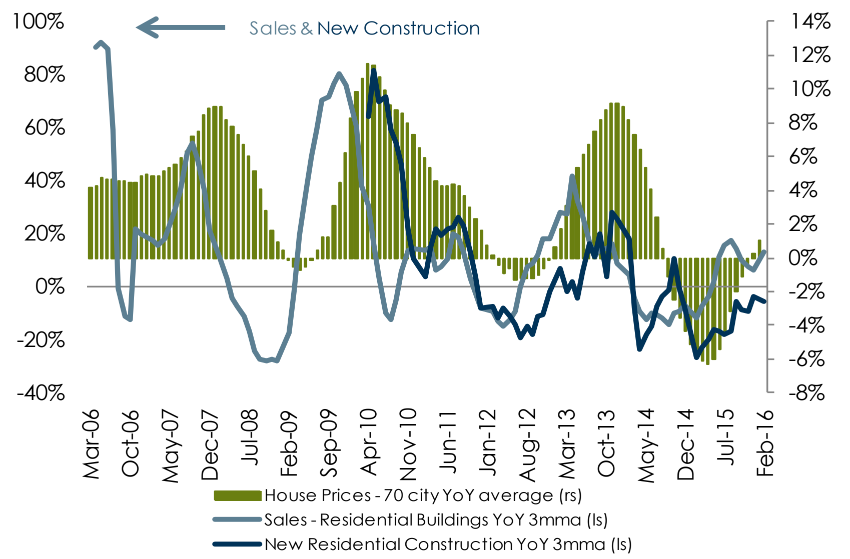
- China's industrial output has trended lower since peaking in January 2010 at 21.0% annual growth to 5.4% annual growth in January 2016.
- Similarly, annual growth in fixed asset investments edged down to 10% in January after averaging 25% growth for five years through 2013.
- In contrast, retail sales remain in a double-digit growth range, supported by rising wages. Domestic spending is contributing an increasing share to economic growth.
- Overall, as the economy shifts toward consumption and services, its potential growth will continue to slow. The government has set a growth target for 2016 between 6.5% and 7.0%.

- The Chinese economy is undergoing a major transition, rebalancing from an investment model toward consumption.
- This transformation from a manufacturing-based economy has resulted in a slowdown from 10%+ growth, to 6.9% in 2015, which aligns with the government's published plans.
- Signs of slowing growth in three key sectors, manufacturing, real estate and construction, has renewed fears that the economy could soon suffer a hard landing.



Source: Bloomberg

The Real Estate Sector Showing Signs of Recovery

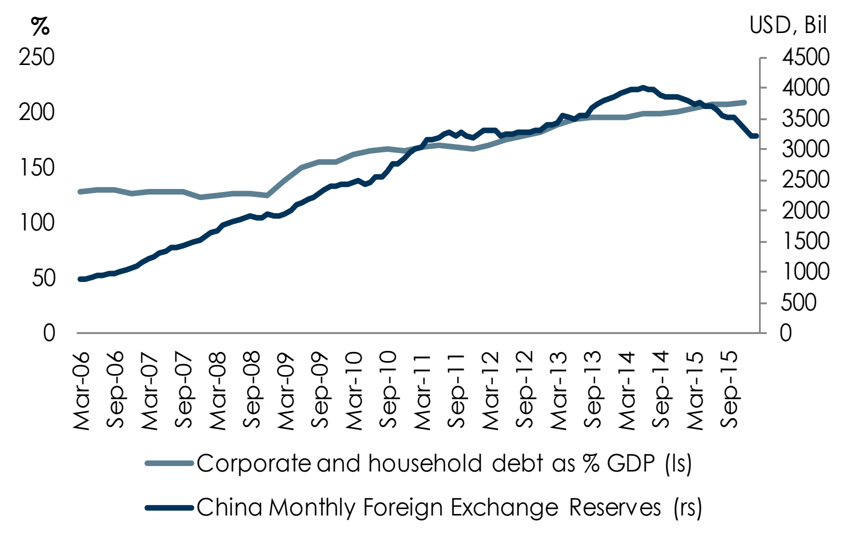


Source: Bloomberg

- Similar to the US, the Chinese housing sector suffered a meltdown after years of rapid home construction led to oversupply and plummeting property values.
- But a concerted government effort to restore growth to the sector is taking shape. A reduction in mortgage rates drove a rebound in sales, averaging 13% annual growth in the three months ended February 2016.
- In addition, the pace of the contraction in new construction is slowing and housing prices appreciated in January 2016 after falling for 15 consecutive months.

- Since the global financial crisis, China has accumulated substantial debt. Some market participants predict this increase in lending, along with slower growth, could lead to financial instability and a recession.
- In fact, outstanding credit to the corporate and household sector ballooned to about 209% ($21 trillion) of GDP in 2015 from 125% in 2008.
- However, China has a substantial stock of assets, comprised of foreign exchange reserves ($3.2 trillion) and the assets of state owned enterprises (SOE). In addition, they have a money supply of $22 trillion* and no foreign debt.
- Combined, these factors help minimize the risk of a debt crisis. However, given the amount of debt accumulated, its unwinding provides a source of risk and potential instability.

Credit Expansion vs. Foreign Reserves



Source: Bloomberg

*M2 includes savings deposits, money market mutual funds and other time deposits. High money supply leads to more spending power and lower interest rates, which makes more capital available for investments, businesses and spending.

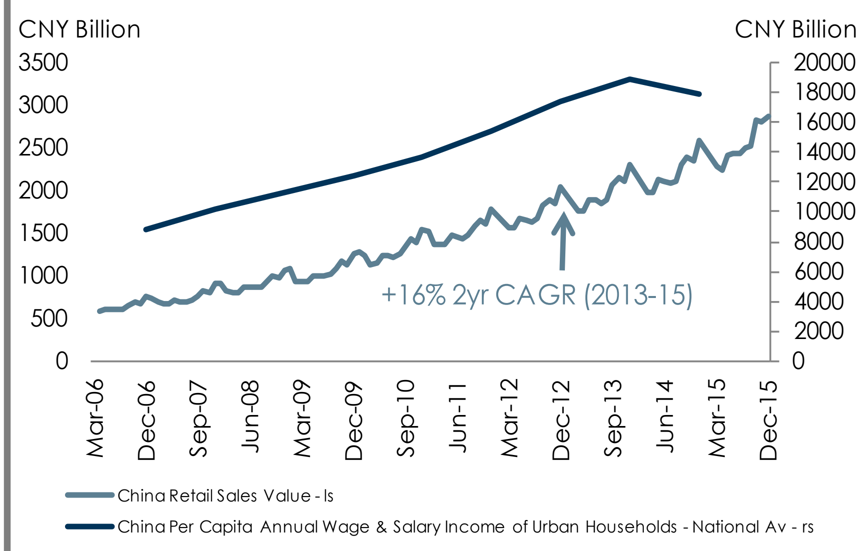
Chinese Yuan vs. Chinese Stocks

Source: Bloomberg

- China continues to rebalance away from investment toward household consumption, as rising wages have allowed domestic consumption to overtake investment as the main contributor to GDP growth.
- However, the economy started 2016 with weakness in the manufacturing and real estate sectors, and rising credit formation, that present potential recessionary forces that might curb growth.
- Meanwhile, growth in domestic consumption, an expanding service sector, and new government spending initiatives work to offset these headwinds.
- The government has laid out plans to increase domestic wealth and consumption, reduce over capacity in commodity based sectors, revive the housing market, and trim risks in the financial sector.
- Successfully achieving this new balance brings global implications. Hitting current growth targets of 6%+ will support global growth, while the increase in infrastructure investment could provide stabilization to commodity markets.

- China's benchmark stock index, the Shanghai Stock Exchange Composite (Shanghai) index, soared 153% during the year ending June 2015.
- In August 2015, the People's Bank of China lowered the yuan's value relative to the USD by 1.9%, a move viewed by markets to promote trade (exports) and bolster economic growth.
- From that point, the Shanghai index tumbled 42%.
- China has also experienced a massive flight of capital, as it is estimated that $1 trillion was moved overseas in 2015*. Policy makers have also been using foreign reserves to help stabilize the currency, depleting its stockpile by $513 billion last year.
- Recently, policy makers stated that China will not pursue a competitive devaluation of its currency to benefit export growth and equities have stabilized on added government support measures.

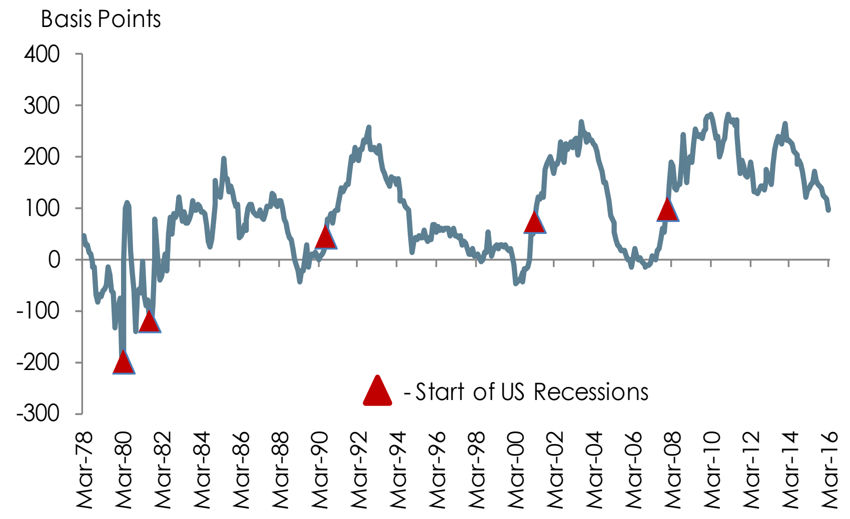
Rising Incomes Sustaining Consumption



Source: Bloomberg

*Estimated per Bloomberg

US Treasury Yield Curve 10-yr less 2-yr



Start of recessions as stated by NBER the official determiner of US recessions.

Source: Bloomberg

- The US does face potential threats to the current expansion.

- The significant decline in oil prices has produced pain in the energy and materials sector. Also, a measure of financial stress within US credit, equity and interbank markets has spiked. The Cleveland Financial Stress Index is nearing the level experienced in past periods of significant stress, but a Q116 rebound in US risk assets has lessened these pressures.

- However the economy has bright spots:

    - The momentum in employment and wages is forecasted to last through 2016.

    - Retail sales growth has been solid and poised for further acceleration, while corporate profits outside energy have remained steady. Improved GDP growth should support the profit trend in 2016.

- Finally, even though the cycle is approaching its seventh year, it still does not display late-cycle characteristics, such as wage pressures, high inflation or elevated interest rates.

- Given that recessions are rare and typically caused by an unexpected shock, they are hard to predict.

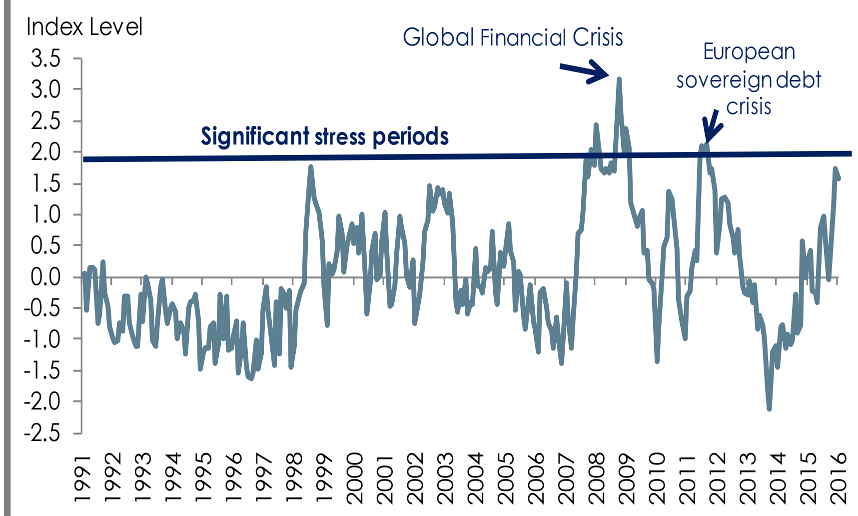
- Equity markets are especially poor predictors; there have been five recessions since 1980, but equity markets have declined by more than 10%+ (6-month rolling) more than 35 times.

- One market based measure, the US Treasury yield curve, has shown the ability to warn of an imminent US recession well in advance.

- The spread between the US 10-year Treasury yield and the 2-year Treasury yield has inverted on average 16 months prior to the start of the past 5 recessions.

- Today, the spread has declined to 100 bps from peak of 247 bps in November 2013. This flattening has been caused by the combination of an increase in short-term yields and the decline in longer-term yields.

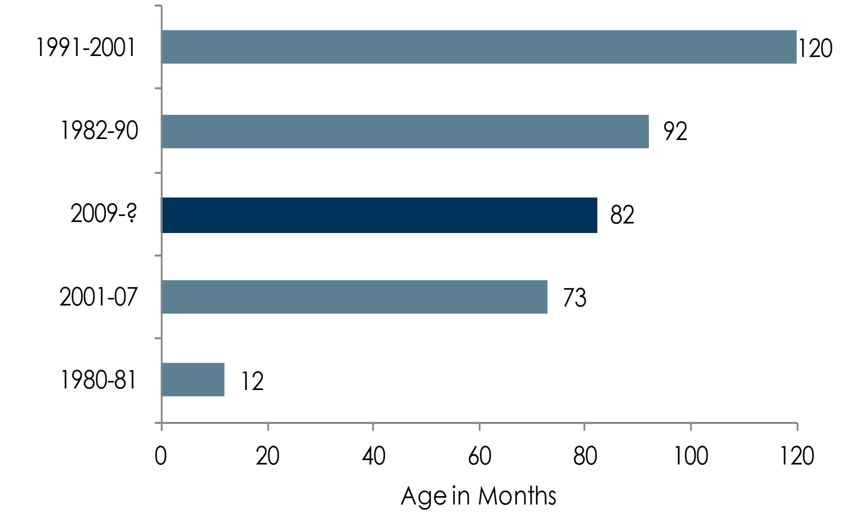
Federal Reserve Bank of Cleveland Financial Stress Index



Source: Bloomberg

US Recession – Current Expansion vs. Previous Expansions

Length of Expansions

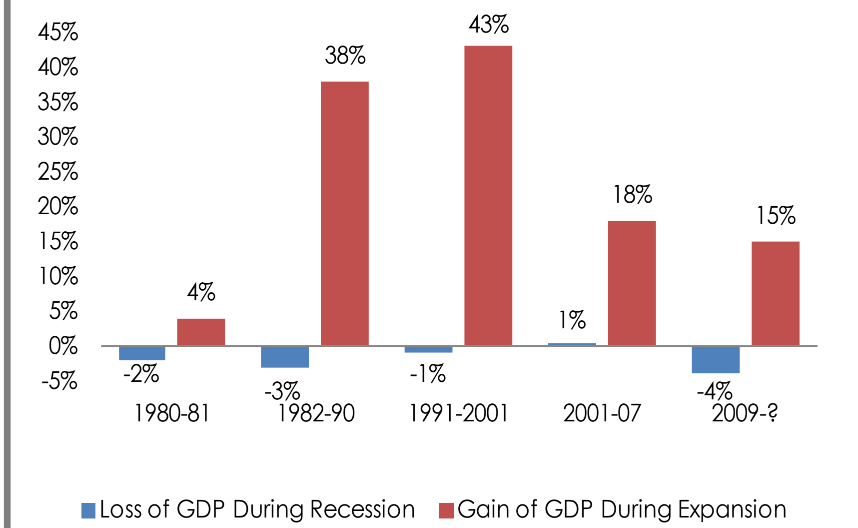


Source: Bloomberg

- Since 1980, the US has encountered only five recessions, three of them very mild, lasting 7 months on average.
- The Global Financial Crisis (GFC) resulted in the longest economic contraction (18 months) since the Great Depression.
- Over the same period, the US enjoyed three of the longest expansions in US history. The current expansion began in June 2009 and is currently in its 82nd month.
- Although the duration of the current expansion ranks among the longest, the devastation caused by the GFC has left the rebound in economic activity well behind other expansionary periods.

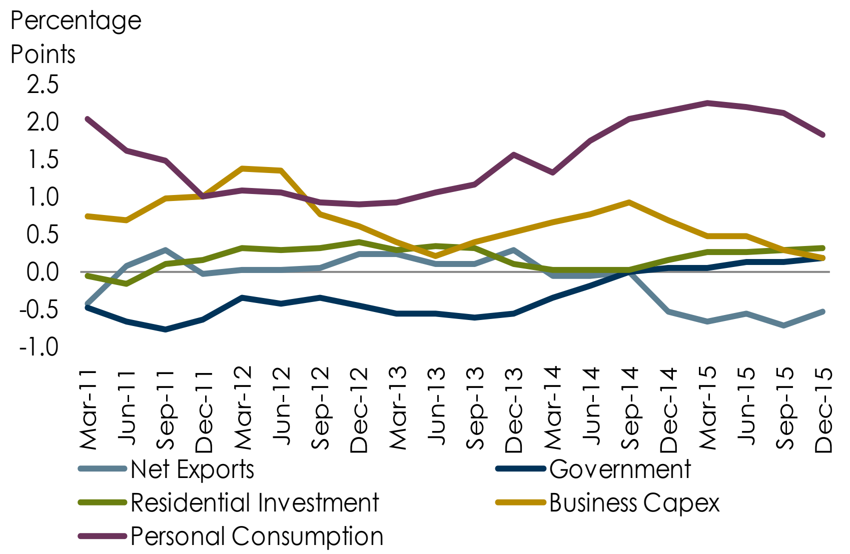
- Today, below potential growth in the US has market surveys reflecting a higher possibility the US could begin a recession in the next 12 months.
- However, the odds are still modest, with only 18% of economists surveyed projecting a recession (per Bloomberg). This is up from 10% at the start of 2015.
- Economists generally define a recession simply as two consecutive quarters where gross domestic product (GDP) declines. Generally, these are caused by some kind of shock.
- The two prior recessions were caused by the subprime mortgage meltdown in 2008 and the bursting of the technology bubble in 2001. Because shocks are unexpected, recessions are hard to predict.

Gain /Loss of GDP During Expansions



Source: ACG Research, Bloomberg

The Five Pillars of US GDP – Contributions to Overall Activity

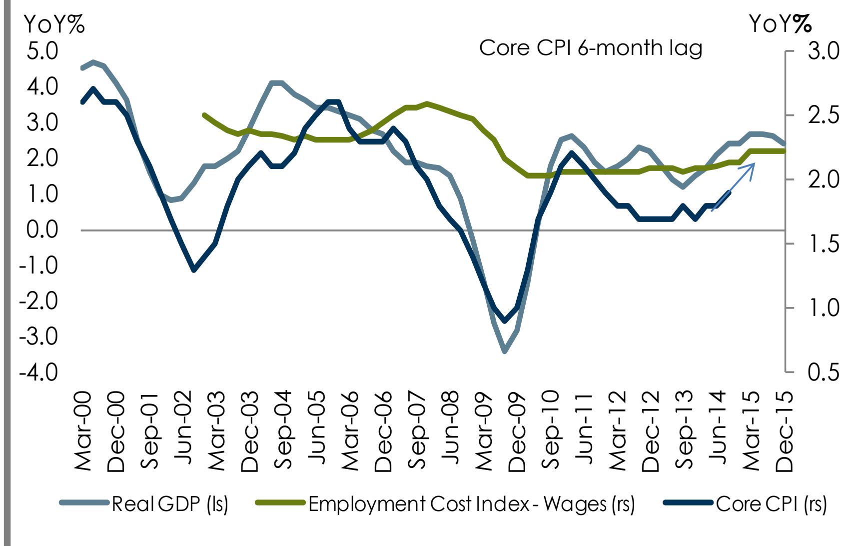


Source: Bloomberg

- Personal consumption, over time, is the largest contributor to US economic activity, representing around 70% of total US GDP.
- Early in the current expansion, exports increased. Ultimately, domestic drivers such as consumer spending, new home construction and more recently, government spending recovered and remain central today.
- For instance, consumer spending has contributed 2.0%, on average, to GDP over the past two years. However, there has been a slight deceleration recently due to a slowdown in auto purchases and reduced gasoline sales.

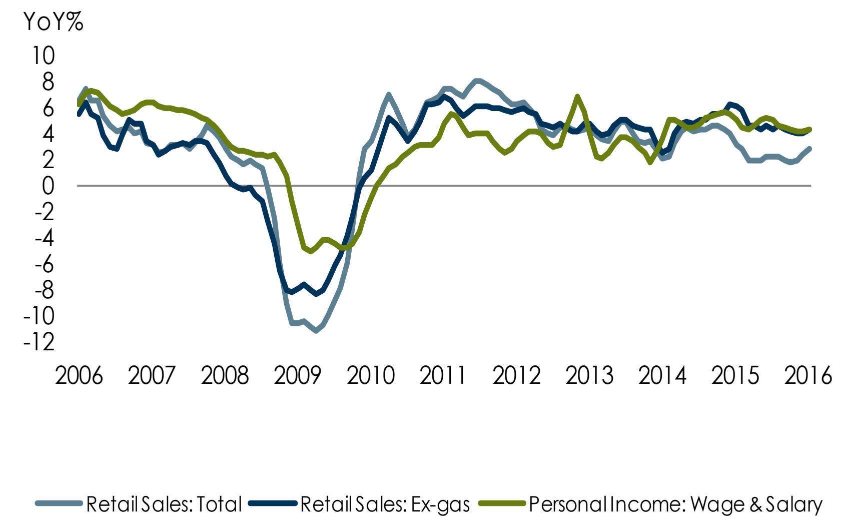
- Robust job growth has fueled employment income gains giving consumers support for further spending.
- The US economy generated more than 2.7 million jobs in 2015, resulting in the second strongest annual gain in the post recession era.
- However, despite the tightening labor market, wage pressures have been slow to emerge.
- While the Employment Cost Index trended higher in the second half of 2015, it has yet to achieve levels experienced in prior expansions.
- Nonetheless, if GDP growth remains above its recent trend of 2.0%, then inflation will likely rise more appreciably, as inflation is a lagging indicator.

Inflation Lags Economic Growth



Source: Bloomberg

Lower gas prices masking underlying strength in spending

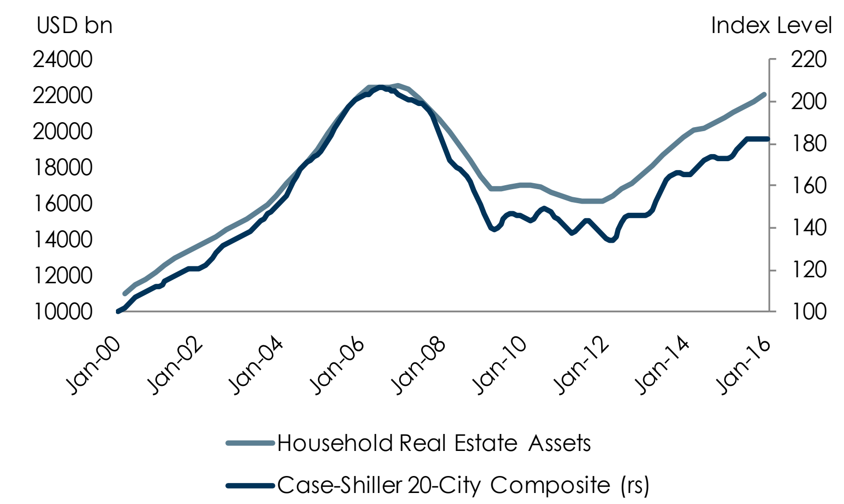


Source: Bloomberg

- Consumers are also diverting income into savings. The household savings rate moved higher for a third consecutive month, increasing to 5.4% in February from 5.0% in December.
- The US savings rate tends to fall after extended periods of acceleration, so going forward this pool of funds could be a source of additional consumption.
- After years of struggling, the US housing recovery seems to have found its footing. The value of consumer real estate assets has increased 31% from the start of the current expansion.
- Tight existing home inventories are helping drive prices higher and relatively low borrowing costs are making owning a home more affordable. This has helped home prices increase an average of 5% over the past year, thru January.
- Also, housing construction has become an engine of growth. After subtracting from US GDP for much of the initial stages of the current cycle, its average contribution to real GDP has recently been 29 basis points.

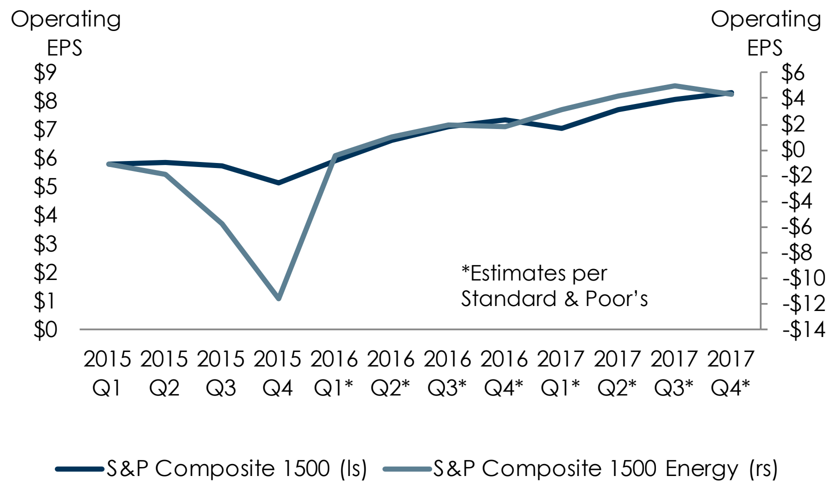
- The combination of strong job gains and modest wage acceleration lifted total personal income in 2015 by about $650 billion, relative to 2014.
- Although personal income climbed 4.3% (year over year) in February 2016, retail sales rose only 2.9%.
- Much of the difference between income growth and spending involves a combination of spending preferences and price trends.
- Low gas prices distort spending growth, as spending activity ex-gasoline sales actually gained 4.4% (year over year) in February.
- Data shows that consumers are spending much of the gas savings on durable goods and services such as healthcare.

Consumer balance sheets strong/Home prices underpinning



Source: Bloomberg

Corporate Profits Pressured by Energy/Materials Sectors



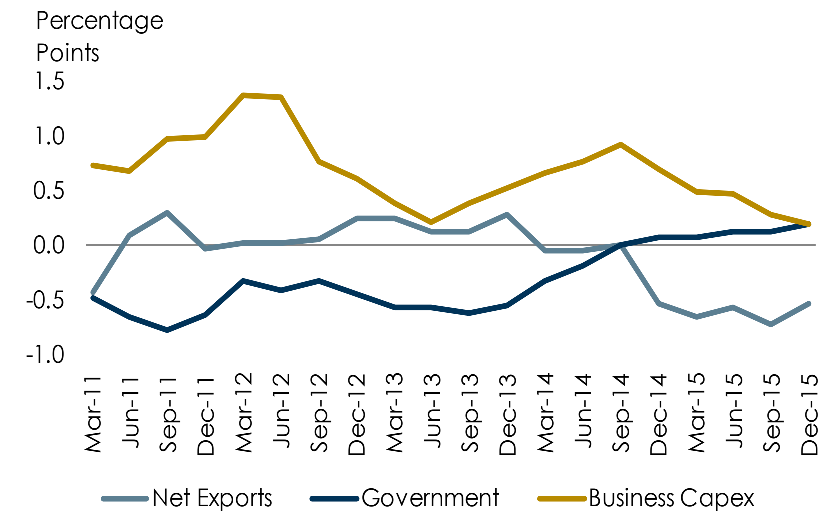
Corporate profits represented by S&P 1500 index

Source: Bloomberg

- The headwinds of a stronger US dollar have been fading in 2016 which could provide further momentum for US exports.
- Also, government spending has reversed course since the third quarter of 2014 providing positive contributions to US growth the last six consecutive quarters.
- Meanwhile, as the federal deficit has declined sharply, coupled with rising tax revenues from the expanding economy, federal, state and local governments are less fiscally restrained and re-opening projects that were previously stalled.
- Looking forward, analysts project earnings in the energy sector to recover by the end of 2016 and regain a profitable trajectory into 2017, which will boost overall profits.

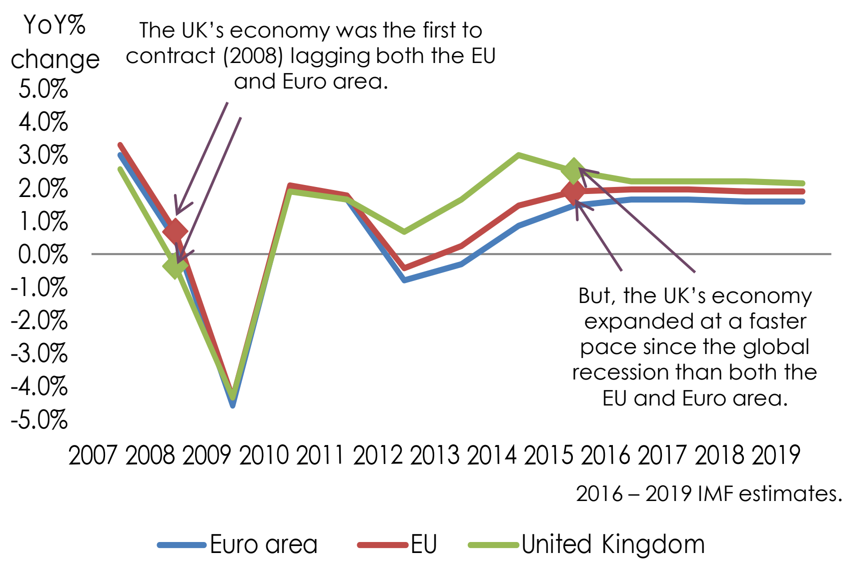
- A blend of US dollar strength and slack global demand has depressed demand for US goods. Added pressure from low energy prices has caused corporate profits to slump for two consecutive quarters.
- Forecasters continue to predict an uptick in business investment given the level of US corporate earnings, but it has yet to materialize.
- Overcapacity has weighed on business investment. As such, business investment is likely to remain meager until the capacity utilization rate rises toward 80% from its current level of 76%.
- Additionally, in recent quarters stockpiles at the retail and wholesale level have moved higher, as the total business inventory-to-sales ratio is near a cyclical high (a sign of weakening demand and/or excessive production).

Trend of Contributions to GDP from Business/Government



Source: Bloomberg

The UK economy has outshined its local peers (GDP)

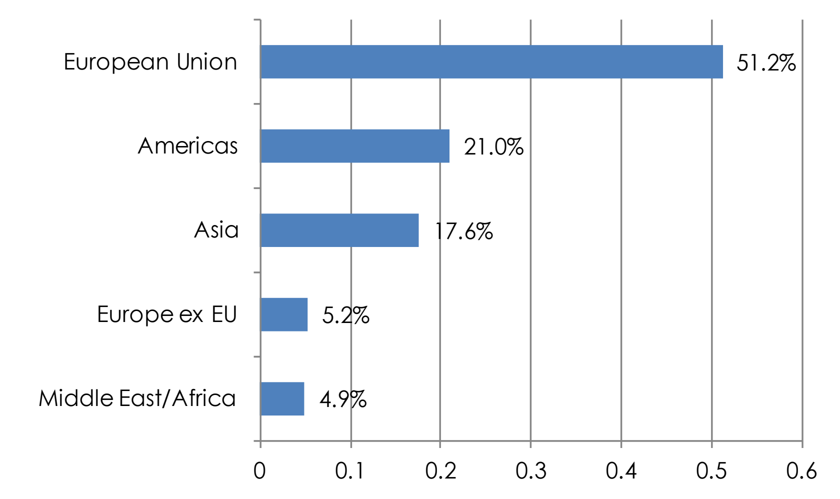


Source: International Monetary Fund

- As a result, many UK companies have expressed their continued support for EU membership as trade would likely decline upon exit.
- Notwithstanding concern about future growth, the UK economy has expanded at a 2.0% pace since 2014, faster than the overall EU. An exit could prove disruptive and curb its potential.
- For now, the vote is a close call. A January 24 poll indicated 55% would vote to stay, which is down from 58% in December.
- This uncertainty has impacted the economy as corporate investment has been held back and likely would slow further upon an exit.
- Markets have begun to discount a slowdown. Yields on 10-year Gilts have fallen 55 bps to 1.41% since the start of 2016. The British pound has also been one of the weakest currencies in 2016, down 10% vs. the US dollar.

- On June 23, United Kingdom (UK) citizens will vote to either stay or leave the European Union (EU). If they decide to exit, it would take two years to negotiate. This action comes after all 28 EU states agreed to a reform package at the February 19 summit to address the UK's concerns.
- While the government claims it achieved "substantial change" those in the "leave" camp believe it's a poor deal.
- The major issues at the heart of the debate center on immigration, trade and sovereignty. As a member of the EU, the UK has to abide by the policies of all 28 nations, so it has to compromise its own objectives.
- With immigration, the blue collar Brits perceive the intra-EU flows of immigrants as taking their jobs and reducing wages. The EU is the UK's largest trading partner and has no tariffs. The EU has 52 trade agreements, so an exit would cause the UK to strike new agreements.

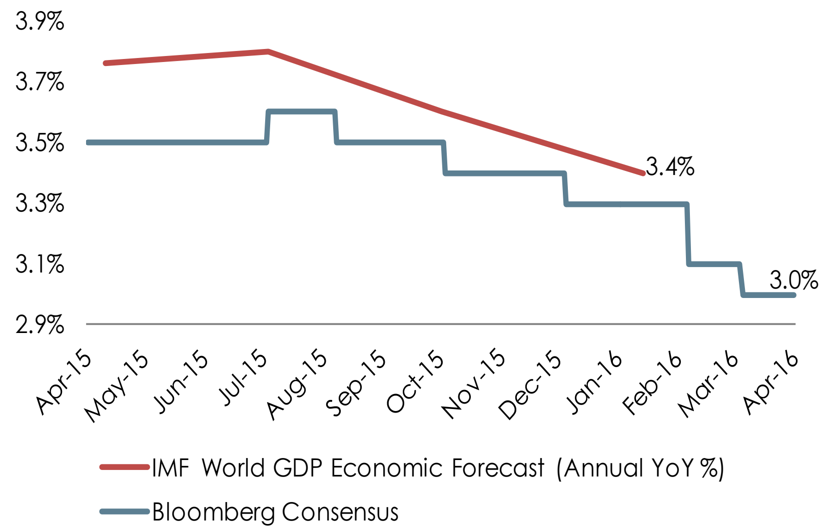
Top Export Regions for the United Kingdom



Source: Bloomberg

Protectionism

Global 2016 GDP Growth Expectations are Diminishing

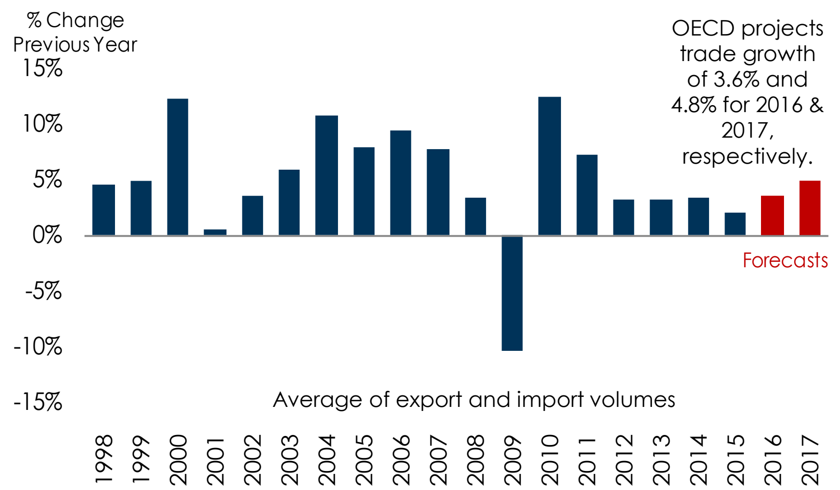


Source: Bloomberg

- Additionally, the pace of global trade continues to tumble, a threat to the viability of global economic growth.
- Historically, the pace of trade growth outpaces GDP. In fact, trade growth rebounded 12.5% in 2010 following the global recession. The rate of growth has shifted lower every year thereafter to 2.0% in 2015.
- Reviving trade is critical to sustaining growth and yet the trade policies of the leading US presidential candidates point toward an antitrade agenda.
- The Congress has handed the President more power to impose tariffs, so a protectionist stance could spur a trade war and might severely impair global economic activity.

- Projections for 2016 global growth continue to diminish from last year's expectations.
- In its last forecast, the International Monetary Fund projected 3.4% growth globally, while economists surveyed by Bloomberg forecast a growth rate of 3.3%. The consensus forecast by economists has fallen since then by 30 basis points to 3.0%.
- While slowing emerging market economic growth is often cited for weighing on the outlook, advanced economies have had a greater impact on these lowered estimates.
- The consensus growth forecast for the US has slipped to 2.1% from 2.7% since January, while Japan and the UK have also seen a sharp deterioration .

Annual Percentage Growth in World Trade



Source: OECD

Summary

U.S.

- Although the US economic expansion is approaching its seventh year, it still does not display late cycle characteristics, such as wage pressures, high inflation or elevated interest rates.
- Moreover, consumer spending, representing 70% of the US economy, appears poised for further acceleration amid labor market momentum projected in 2016.
- Therefore, the current probability of a recession remains low.
- The Congress has handed the President more power to impose tariffs, so a protectionist stance could spur a trade war and might severely impair global economic activity.

Global/Non-U.S.

- China's government has set an economic growth target between 6.5% and 7.0%. Initial data in 2016 show growth in investment continuing to edge down but still double digit consumption growth.
- This provides evidence China is gaining momentum in its effort to move toward a more consumption based model, but the deleveraging of the massive credit formation over recent years could be a recessionary force.
- The United Kingdom will vote in June to decide its future in the European Union. Recent polls reveal it will be a close decision. Still, if the UK leaves, it will take nearly two yeas to negotiate an exit agreement.

Investment Themes

Theme	Rationale	Implementation Strategy
Geopolitical & Policy Uncertainty	▪ Disparate global monetary policies ▪ Fiscal policy initiatives limited; high government debt; political challenges ▪ Terrorism concerns, election uncertainty, refugee crises, nuclear issues, territorial disputes, climate change concerns ▪ Oil price pressures on less stable countries	▪ Maintain global diversification ▪ Focus on risk-reducing strategies ▪ Maintain disciplined rebalancing strategy ▪ Consider strategies including "bottom up" and "top down" analysis
Desynchronized Global Growth Expectations	▪ Ongoing divergence within developed markets (DM) and emerging markets (EM) ▪ China/EM structural challenges present ▪ Commodity-sensitive EM growth pressured ▪ U.S./UK leading, Europe/Japan lagging ▪ Demographic differences ▪ Increased currency volatility	▪ Maintain dedicated, differentiated managers in EM ▪ Focus on actively managed, opportunistic strategies across asset classes ▪ Consider managers that evaluate currency impact in portfolio construction
Fixed Income Market Headwinds	▪ Stretched valuations at low yields ▪ Fed lift-off ▪ Extended credit cycle ▪ Liquidity challenges may increase volatility ▪ Continued search for yield	▪ Broaden fixed income opportunity set ▪ Incorporate absolute return oriented strategies ▪ Maintain diversified risk factors
Uncertain Global Inflationary Environment	▪ Deflationary pressures remain ▪ Inflationary pressures still limited ▪ Recent uptick in wage growth offset by lower commodity prices, productivity gains ▪ Further improvement in US labor markets could increase wage/inflation pressure	▪ Retain core real estate (RE) exposures ▪ Complement core with value-add and/or opportunistic RE ▪ Maintain diversified commodity exposure ▪ Consider hedged approaches to limit further downside
Muted Return Expectations	▪ Relatively high valuations across asset classes ▪ Global economic growth remains tepid ▪ Challenging demographics and high debt levels ▪ Low yields, low inflation, limited growth, increased volatility	▪ Revisit investment objectives, constraints and strategic allocation ▪ Consider active strategies with enhanced flexibility ▪ Consider global mandates ▪ Employ risk management solutions

Potential Global Economic/Market Scenarios (3 – 5 Years)

	Scenario A (Left Tail)	**Scenario B (Base Case)**	**Scenario C (Right Tail)**
	▪ U.S. slows more than expected ▪ Euro zone/Japan stall ▪ China slows more than expected	▪ U.S. steadily improves ▪ Euro zone/Japan steadily improve ▪ China growth ~ 6-7%	▪ U.S. accelerates, inflation ▪ Euro zone/Japan accelerate ▪ China growth greater than 7%
	IMPACT ON PORTFOLIO	**IMPACT ON PORTFOLIO**	**IMPACT ON PORTFOLIO**
Global Equities	▪ Equities decline ▪ Long/short protects ▪ U.S. & "high quality" do better than Non-U.S.	▪ Volatility reduced ▪ Equities positive ▪ EM better than Developed	▪ Equities positive ▪ Non-U.S. > U.S. ▪ EM > Developed
Global Fixed	▪ Yields decline ▪ Core - does better ▪ Multi-sector mixed	▪ Yields trend upward gradually ▪ Core - low real returns ▪ Multi-sector better	▪ Yields rise sharply ▪ Core - underperform ▪ Multi-sector defensive
Global Real	▪ Global REITS decline ▪ Global Private RE defensive in short term ▪ Commodities weak; Gold up	▪ Global REITS neutral ▪ Global Private RE neutral ▪ Commodities provide diversification	▪ Global REITS positive ▪ Private RE positive ▪ Commodities positive; gold down