

Overview

Negative investor sentiment and economic uncertainty drove sharp declines in equity and commodity markets during the first two months of 2016. However, this trend reversed dramatically in March due to renewed optimism leading to marginal gains from global equities. Global fixed income appreciated as concern over disinflationary pressure and weak global growth led several developed market central banks to intensify accommodative monetary policies. In some cases, this included further reducing negative interest rates. In the US, investors reacted positively toward a perceived shift by the Federal Reserve toward a less aggressive monetary policy forecast. The US Dollar reacted accordingly, reversing a prolonged strengthening trend. The weakening Dollar provided price support to dollar-based commodities, and also served as a tailwind for emerging market equity and debt assets.

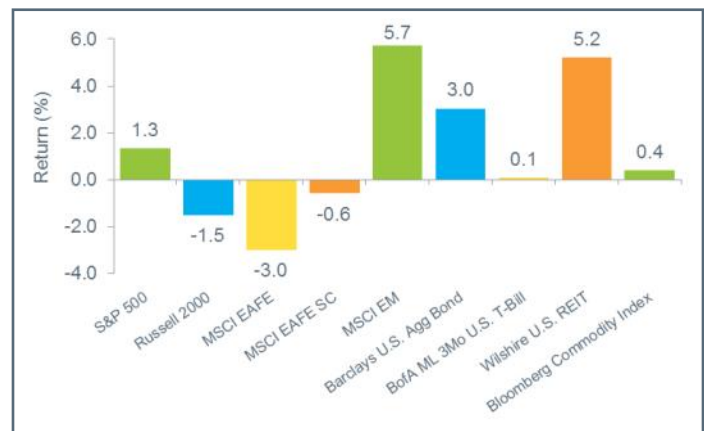
After raising the Federal Funds target rate by 25 basis points during its December meeting, the Federal Reserve Open Market Committee (“FOMC”) communicated a more dovish policy stance following its meeting in March. Meeting minutes indicated that the FOMC factored in weakening non-US financial conditions in its expectations for domestic growth and inflation to a greater degree than it had previously. Additionally, several FOMC participants cited asymmetric risks from further tightening given the limited ability and scope of the central bank to ease further should growth and inflation expectations miss to the downside. After weighing all factors, FOMC chose to leave rates steady despite anecdotal evidence of tightening labor market conditions and a moderately strong outlook for domestic growth. Core PCE, the FOMC’s preferred measure of inflation, remained below its 2% target, though market implied inflation expectations increased meaningfully from mid-February through the end of the quarter. Non-farm payrolls grew at an average pace of 209,000 per month with the unemployment rate ticking up slightly to 5.0% as more workers entered the labor force.

Many economists continue to moderate their expectations for global growth. This sentiment was recently evidenced by the IMF’s downward revision of its 2016 growth forecast from 3.4% to 3.2%. The Bank of Japan (“BoJ”) and European Central Bank (“ECB”) each announced additional monetary stimulus in January and March to boost growth. The BoJ enacted a negative interest rate policy on marginal new reserves, and the ECB announced a substantial expansion to its existing quantitative easing program. The ECB actions included an expansion of its asset purchases from 60 billion euros per month to 80 billion euros per month, and also the addition of investment grade corporate bonds to its list of eligible securities. Despite these actions, early results of these efforts have been disappointing with the Yen and Euro strengthening relative to the US Dollar.

Trailing Period Market Performance (%)

	QTD	CYTD	1 Year	5 Years	10 Years
S&P 500	1.3	1.3	1.8	11.6	7.0
Russell 2000	-1.5	-1.5	-9.8	7.2	5.3
MSCI EAFE	-3.0	-3.0	-8.3	2.3	1.8
MSCI EAFE SC	-0.6	-0.6	3.2	5.6	3.4
MSCI EM	5.7	5.7	-12.0	-4.1	3.0
Barclays U.S. Agg Bond	3.0	3.0	2.0	3.8	4.9
BofA ML 3Mo U.S. T-Bill	0.1	0.1	0.1	0.1	1.1
Wilshire U.S. REIT	5.2	5.2	4.8	12.1	6.3
Bloomberg Commodity Index	0.4	0.4	-19.6	-14.1	-6.2

Quarter-to-Date Performance (%)



Key Economic Indicators

		As of	12/31/2015	9/30/2015	10 Year Average
Federal Funds Rate	0.25%	3/31/2016	0.20%	0.07%	1.18%
Treasury - 1 Year	0.59%	3/31/2016	0.65%	0.33%	1.20%
Treasury - 10 Year	1.78%	3/31/2016	2.27%	2.06%	3.05%
Treasury - 30 Year	2.61%	3/31/2016	3.01%	2.87%	3.83%
Breakeven Inflation - 1 Year	2.10%	3/31/2016	0.85%	-1.75%	0.96%
Breakeven Inflation - 10 Year	1.63%	3/31/2016	1.58%	1.43%	2.08%
Breakeven Inflation - 30 Year	1.79%	3/31/2016	1.76%	1.63%	2.30%
Barclays US Corp: Hi Yld Index - OAS	6.56%	3/31/2016	6.60%	6.30%	5.90%
Capacity Utilization	75.44%	2/29/2016	75.39%	76.41%	76.43%
Unemployment Rate	5.00%	3/31/2016	5.00%	5.10%	7.00%
ISM PMI - Manufacturing	51.80%	3/31/2016	48.00%	50.00%	52.00%
Baltic Dry Index - Shipping	429	3/31/2016	478	900	2,703
Consumer Confidence (Conf. Board)	96.20	3/31/2016	96.30	102.60	74.77
CPI YoY (Headline)	0.90%	3/31/2016	0.70%	0.00%	1.90%
PPI YoY - Producer Prices	-0.90%	3/31/2016	-2.70%	-4.10%	2.20%
US Dollar Total Weighted Index	\$90	3/31/2016	\$94	\$92	\$78
WTI Crude Oil per Barrel	\$38	3/31/2016	\$37	\$45	\$80
Gold Spot per Ounce	\$1,233	3/31/2016	\$1,061	\$1,115	\$1,161

Asset Class Commentary

US Equity

Despite a sharp uptick in volatility, the US equity market finished the quarter in positive territory, as strong March gains erased heavy losses incurred during January's market sell-off. The Russell 3000 Index returned 1.0%, and was led by defensive sectors, which benefitted from expectations of a continued low interest rate environment and general economic uncertainty. These market conditions proved difficult to navigate for active management, especially for managers who favored exposure to cyclical and growth-oriented sectors.

The S&P 500 Telecom and Utilities sectors were the strongest large cap sectors, posting returns of 16.6% and 15.6%, respectively. These returns easily outpaced the performance of the rest of the sectors in the index. Subsequently, dividend yield strategies outperformed, as the S&P 500 Low Volatility High Dividend Index returned 12.7% versus 1.3% for the S&P 500 Index.

In sharp contrast to 2015, value outperformed growth across the market cap spectrum for the quarter. In terms of capitalization, mid cap outperformed all other market cap ranges, with the Russell Mid Cap Index returning 2.2%. Large and mega cap stocks ended the quarter positive, while small and micro cap continued to

lag, as the Russell 2000 Index and the Russell Micro Cap index returned -1.5% and -5.4%, respectively. **Figure 1** plots YTD growth of \$1 for US equity factor indices. Dividend yield and minimum volatility factors have outperformed YTD, a reversal from the significant momentum leadership during 2015.

Figure 1: Cumulative U.S. Factor Performance



Non-US Equity

Developed international markets had a strong rebound in March, but remained negative for the quarter. Small cap developed stocks outperformed their larger counterparts. Value, yet again, underperformed growth by a significant margin. Japan was one of the largest performance detractors for the quarter. Reacting to a 1.4% decline in GDP during the previous quarter, the BoJ adopted a negative interest rate policy. Europe also posted weak performance, as economic growth continued to disappoint. In response, the ECB announced additional monetary stimulus and further interest rate cuts to an already negative rate policy.

Performance from emerging markets diverged positively for the quarter following a year of significantly better returns from developed markets. The rebound in March pushed emerging market equity returns well into positive territory. Large cap stocks outperformed small cap stocks and value outperformed growth. Brazil was the best performing country in the MSCI Emerging Markets index (“MSCI EM”), in part due to renewed hope tied to the potential impeachment of President Dilma Rousseff. China, which represents roughly a quarter of the MSCI EM, produced negative returns despite a strong late quarter rally. The Chinese economy showed mixed results as the government continues to shift the economy from being driven by investment and manufacturing to consumption and services.

Fixed Income

The Barclays US Aggregate Bond Index posted a return of 3.0%, the strongest single quarterly return since the third quarter of 2011. Strong fixed income performance can be attributed to several factors. First, the Fed’s shift toward a more accommodative monetary policy forecast for 2016 led to a decline in Treasury yields. Second, the rebound in energy prices had a generally positive impact on credit, especially in the US high yield market. Finally, market volatility stabilized somewhat after increasing in December and January.

The effect of the Fed’s accommodative policy was most notable in long duration bonds and TIPS. The Barclays US Long Treasury Index was up 8.2% and the Barclays US TIPS Index was up 4.5%.

High yield bonds posted a strong rebound, returning

3.2% as measured by the BofAML US High Yield Master II Index. Declining interest rates detracted from floating rate bank loan securities, but improvement in the credit markets allowed bank loans to post positive performance with a return of 1.5% as measured by the S&P/LSTA Leveraged Loan Index.

Local currency emerging markets bonds had a very strong quarter due to the weakening of the US Dollar and a recovery of energy prices. Local currency bonds finished the quarter with a return of 11.0%, while hard currency emerging markets debt finished the quarter with a return of 5.0% as measured by the JPM GBI-EM Global Diversified Index and JPM EMBI Global Diversified Index, respectively.

Diversified Hedge Funds

The hedge fund industry performed poorly during the first quarter of 2016, with a variety of factors contributing to the uninspired returns. As it relates to the Fund of Hedge Fund (“FoHF”) managers RVK follows closely, the most consistent relative detractor was negative alpha from Long/Short Equity (“ELS”), in part due to tactical over-weights to heavily trafficked sectors like healthcare, technology, and financials, which underperformed. Style factor exposures were also a meaningful return predictor within ELS, as managers who tended to be long momentum and growth oriented stocks saw negative excess returns on both sides of their portfolios. Amid the intra-quarter volatility, prime brokerage data indicates that most managers maintained net exposure, but significantly reduced gross. This led to a whipsaw effect that hurt upside capture across the industry as markets found their footing and rallied in March. Most of RVK’s direct multi-strategy managers fared better than the FoHFs, though there was a wide dispersion of returns. Managers with tactically over-weight allocations to merger-arbitrage gained from wide deal spreads and continued robust M&A activity, and some managers were able to take advantage of idiosyncratic events in distressed sovereign debt. On the whole credit detracted, however, especially as markets dislocated through mid-February. The best performing strategies during the quarter were systematic managed futures/CTAs, which benefitted from long developed bond exposure throughout the quarter and short energy exposure in January and February.

GTAA

There was dispersion among the returns for diversifying tactical strategies with exposures beyond US fixed income and US equity adding value. Managers using disciplined value-oriented processes, especially those with fewer constraints on emerging market allocations, performed well. Macro-oriented, fundamental value-based approaches, which remained underweight — or even short — US equities relative to emerging markets, provided the strongest performance over the quarter. Fundamentally-oriented strategies that remained underweight emerging markets and had excess exposure to developed foreign equities, most notably Japan, largely underperformed. Managers positioned for interest rate increases in the US, and those that avoided duration for the quarter lagged due to the Fed's accommodative stance. Income-oriented positioning benefitted as a result of positive returns from energy-sensitive holdings. Several risk parity managers meaningfully outperformed a static domestic 60/40 portfolio, with traditional risk parity performing near the top of the broad GTAA group. Risk parity approaches that de-emphasize inflation sensitive allocations lagged other risk parity managers by the widest margin, but still performed within range of a domestic 60/40 portfolio. Macro-discretionary strategies that emphasize idiosyncratic alpha positioning lagged the furthest and concentrations in US Dollar positions relative to several foreign currencies detracted significantly.

Diversified Inflation Strategies (Real Return)

Several measures of inflation increased over the quarter, driving strong relative performance in Diversified Inflation Strategies (DIS). However, market expectations for inflation in 10 year Treasuries remain muted at around 1.6%, about the same level at the beginning of the quarter. Although the market's expectation for future inflation did not increase over the quarter, inflation-sensitive asset classes benefited from a higher CPI, as core CPI increased moderately from 2.1% to 2.2%, headline CPI increased from 0.7% to 0.9%, and Core PCE rose from 1.4% to 1.7%. DIS managers with REIT exposure, precious metals, and non-US Dollar denominated emerging markets exposures provided the strongest performance. Interestingly, TIPS allocations had little explanatory power over the divergence of returns among DIS managers. Those with heavier TIPS

allocations performed approximately even with those that rely upon more significant commodity and natural resource equity allocations. Strategies that avoided natural resource equity exposure significantly underperformed DIS peers.

Real Estate

Real Estate was not immune to the effects of broader uncertainty and volatility in the global markets during the first quarter. In the US, cap rates flattened in certain property sectors for the first time in six years and property valuations showed modest changes as a whole. This cooling off in the market can be partly explained by recent sharp increases to new-issue CMBS yields, particularly to non-AAA-rated securities. This increase in yields reduced overall liquidity, and also led to a reduction in year-over-year transaction volumes. While property fundamentals remain strong on the whole, some markets experienced slight increases in vacancy and declines in rental income as new supply became available to real estate end users.

Despite slowed growth relative to recent time periods, real estate provided investors with positive returns in both the public and private spaces. Domestically, REITs returned 5.6% during the quarter while achieving 5.1% globally, according to the FTSE EPRA/NAREIT US REIT and FTSE EPRA/NAREIT Global indexes, respectively. In the private markets, core US real estate increased its run of consecutive quarters of positive returns to 25 quarters, albeit with relatively muted growth at 2.2% percent as reported by the NCREIF ODCE Index. Furthermore, the quarterly appreciation return of 1.1% represents the lowest such mark in several years. Overall, real estate fundamentals remain strong, but recent performance suggests that the unsustainable appreciation levels experienced in recent years may finally be reverting closer to long-term levels.

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