Fund Evaluation Group®
investment advisors

RESEARCH REVIEW

JANUARY 2017

INSIDE THIS ISSUE

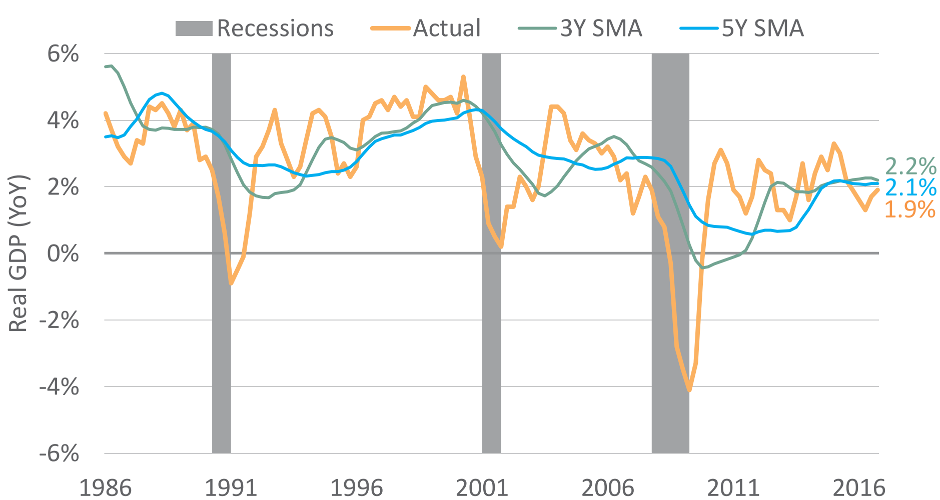
Economic Update

January witnessed the release of the advance estimate of fourth quarter 2016 U.S. GDP, which showed that economic growth cooled during the last three months of the year. Additionally, the U.S. dollar took a breather during the month after surging during the fourth quarter 2016.

U.S. GDP Growth Cools in Fourth Quarter 2016

The first estimate of fourth quarter 2016 real gross domestic product (GDP) showed that economic growth cooled to a 1.9% quarter-over-quarter, seasonally-adjusted rate, from the 3.5% rate witnessed in the third quarter. Year-over-year, real GDP growth ticked 0.2 ppts higher to 1.9%, essentially matching the average rate witnessed during the current business cycle. Smoothed measures of real GDP growth highlight a coalesce around 2%, with realized GDP falling in a somewhat narrow range of 1%-3% over the current cycle period.

U.S. REAL GDP GROWTH AND BUSINESS CYCLES



Data sources: BEA, NBER, Bloomberg, L.P.; data as of 4Q2016 (first estimate)

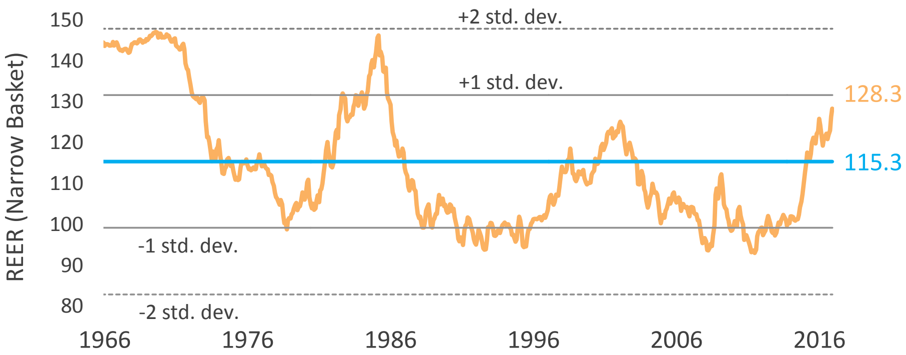
A strengthening U.S. dollar (USD) during the quarter helped to serve as a drag on the net-export component of aggregate GDP, detracting 1.7 ppts. Because the U.S. is a net importer, GDP growth remains susceptible to bouts of USD strength. A strengthening USD applies downward pressure to the price of imported goods and helps drive the net-export component of GDP lower, as import growth outpaces export growth. Indeed, during the fourth quarter 2016, the USD, as proxied by the ICE DXY Index, appreciated 7.1%.

Strengthening USD Takes a Breather

After a strong fourth quarter, the USD took a step back in January and the DXY declined 2.6% for the month. Currencies with impressive appreciation versus the USD in January included the Brazilian real (+4.2%), the South Korean won (+4.1%), the Japanese yen (+3.2%), and the euro (+2.2%). Further USD weakness has the potential to serve as a tailwind to domestic inflationary pressures, which have recently increased. While forecasting the future direction of currency exchange rates is painfully difficult—and FEG makes no attempt to do so—understanding the global relative value of the USD and its likelihood of serving as a *headwind* or *tailwind* to asset allocation positioning is an important component of understanding the fundamental backdrop of the market.

In 2016, the USD's trade-weighted, inflation-adjusted value against a narrow basket of 26 economies increased to 128.3, representing a gain of 4.6% for the year. The 128.3 real effective exchange rate placed the USD not only at its highest valuation in the post-global financial crisis era, but also at its highest since January 1986.

U.S. REAL EFFECTIVE EXCHANGE RATE
Narrow Basket



Data sources: BIS, Bloomberg L.P.; Data as of December 2016; Base = 2010

While the chart shows that the USD could possibly ascend to even higher levels, a great amount of appreciation has already taken place since 2011. As the USD is nearing a full standard deviation above its historical average, it is likely safe to say that it is "expensive" relative to key trading partners. Tighter Fed policy, a growing debt burden, lackluster economic growth, and cooling inflation—among other factors—may help propel the USD even higher in 2017. On the other hand, should the USD's January decline continue, assets with profiles sensitive to a declining USD—such as commodities, precious metals, and inflation-sensitive securities—may attract investor attention.

Summary

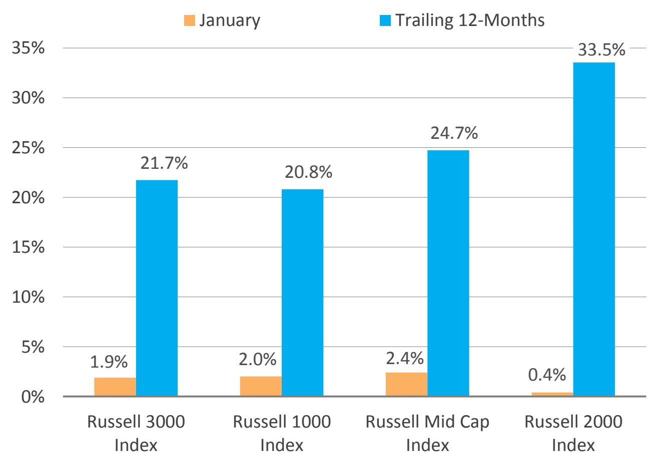
Real GDP growth eased in fourth quarter 2016 to 1.9%—in spite of a strong contribution from consumption—due to a large detraction from the net-export component, as the USD strongly appreciated during the quarter. However, recent USD strength reversed in January as the DXY index declined nearly 3%.

Global Equity

U.S. Equity

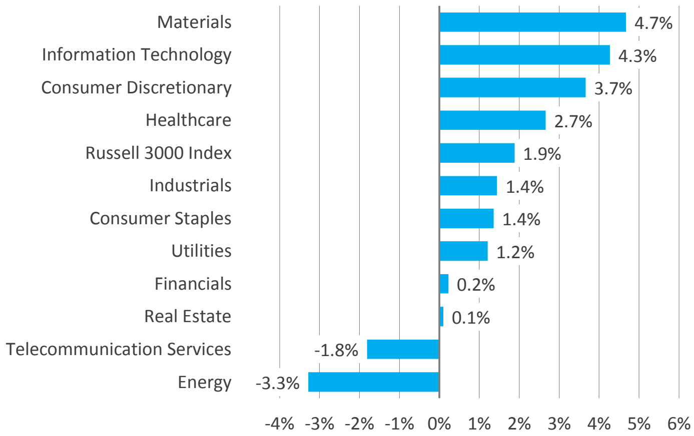
- The U.S. stock market, represented by the Russell 3000 Index, gained 1.9% in January. Equities continued to rally after the U.S. election, with investors viewing the new administration's policies and proposed initiatives as positive for U.S. businesses and the economy. This optimism helped drive major U.S. equity indices to all-time highs, such as the record-breaking Dow Jones Industrial Average close topping 20,000.
- Small cap stocks (+0.4%) experienced the most tepid growth thus far in 2017, underperforming both large cap (+2.0%) and mid cap (2.4%) stocks.
- Most of the 11 sectors posted gains in January, with only the telecommunication services and energy sectors declining. Economically-sensitive sectors generally outperformed defensive sectors such as consumer staples and utilities, which lagged the broader index. The flight to quality and yield that has supported these stocks waned during the month. Financials slowed down relative to their strong performance in the fourth quarter of 2016, posting a mere 0.2% gain in January, which also lagged the broader index.
- The materials and information technology sectors were among the best performers in January, up 4.7% and 4.3%, respectively. Technology stocks failed to rally with the rest of the index immediately following the election, but later picked up as an increase in capital expenditure by American corporations helped propel a revival in the sector. Energy was the worst performing sector for the month, down 3.3%, a turnaround from 2016 performance. This was a global issue, as price weakness in some of the major oil producing countries—including emerging markets—continued with Brent crude falling 2.0% in the month.
- Value stocks underperformed relative to growth stocks across all market capitalizations in January, as valuations neared peaks for most sectors of the markets in the fourth quarter of 2016.

RUSSELL INDICES PERFORMANCE



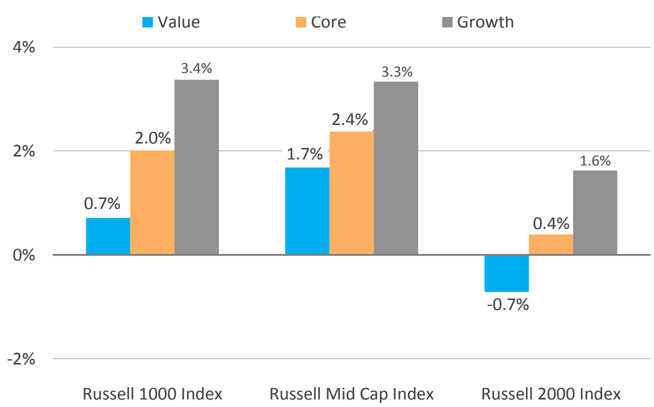
Data source: Russell

JANUARY RUSSELL 3000 SECTOR PERFORMANCE



Data source: Russell

JANUARY RUSSELL INDICES PERFORMANCE



Data source: Russell

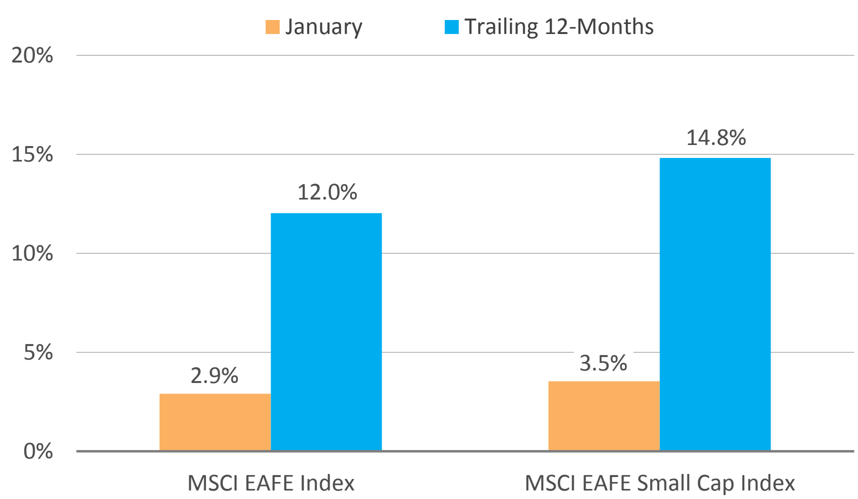
International Equity

All returns in local currency unless otherwise indicated.

INTERNATIONAL DEVELOPED MARKETS

- International developed equity markets were essentially flat in January (+0.1%), but currency fluctuations had a positive impact for U.S. investors due to the weakening of the USD against the Japanese yen, the euro, and the British pound. Returns for U.S. investors were 2.9% after adjusting for currency changes.
- As the post-Brexit era pushed into 2017, European stocks slid slightly in local terms, down 0.3%. In USD terms, however, European stocks were up 2.1%. Many of the issues following Brexit necessitate a long-term time horizon, and investor optimism for an improving economic outlook was offset by concerns for rising political risks.
- Pacific markets appreciated in both local terms (+0.9%) and USD (+4.4%), and were led by Hong Kong (+7.8%) and Singapore (+5.7%). Hong Kong returns were boosted by a double-digit return from insurer AIA. Japanese exports rose for the first time in 15 months, but equities remained essentially flat (+0.1%).
- Small cap stocks, as measured by the MSCI EAFE Small Cap Index, gained 0.6% (+3.5% in USD) in January, outperforming large cap stocks.

MSCI INDICES PERFORMANCE
Returns in U.S. Dollars



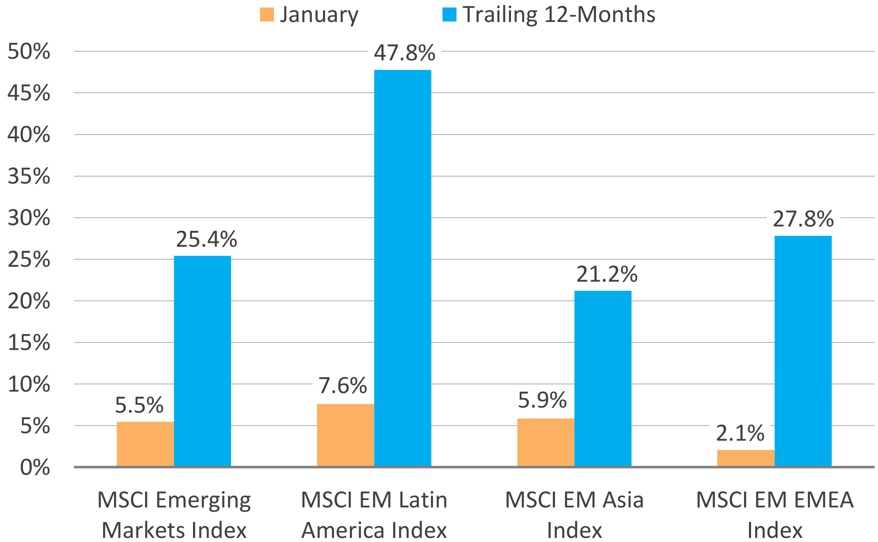
Data source: MSCI

EMERGING MARKETS

- Emerging markets, as measured by the MSCI Emerging Markets Index, outperformed developed international markets, rising 4.0% in January (+5.5% in USD).
- Emerging markets rebounded strongly in January after a difficult fourth quarter 2016. This was the strongest start to a year for emerging markets since 2012. Key drivers of the performance were the fall in the USD combined with a rise in commodity prices. Turkey (+11.2%), Peru (+9.1%), and Brazil (+7.0%) led emerging markets in the first month of 2017.
- Latin America produced a positive gain, as Brazil performed exceptionally well in January due to continued political and economic improvements. Mexico rebounded slightly from an initial negative reaction to the agenda of the Trump administration, posting a 3.0% gain in January.
- Asian markets were generally strong, with China (+6.9%) at the top. Chinese returns were fueled by encouraging economic data and strong information technology gains.

- Emerging European markets were mixed, with the strong gains in Turkey (+11.2%) offset by the decline in Greece (-10.1%). Russia was also a negative performer in January after a very positive fourth quarter. The impact of currency fluctuations was positive for U.S.-based investors, as the USD weakened against many currencies during January.

MSCI INDICES PERFORMANCE
Returns in U.S. Dollars

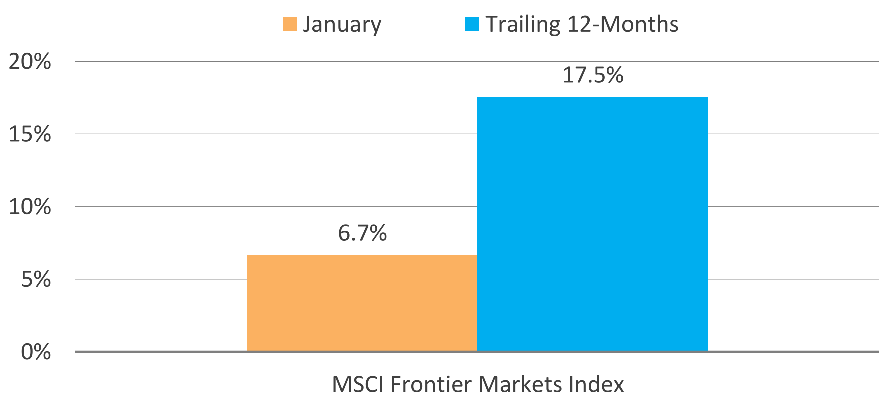


Data source: MSCI

FRONTIER MARKETS

- Frontier markets gained 6.0% for the month (+6.7% in USD). Currency fluctuations impacted U.S. investors positively, as the dollar fell in value relative to most major currencies.
- Performance was mixed geographically, with Latin America—in particular Argentina (+18.4%)—performing strongly as well as parts of the Middle East. Kazakhstan (+21.7%) and Kuwait (+13.9%) posted strong returns on the heels of a rebound in commodity prices and the announced production cut by OPEC. Other Middle-Eastern countries struggled to perform at similar levels, with Oman, Bahrain, and Jordan posting negative returns. African countries had particularly poor performance in January, with four of the five worst-performing countries located in Africa. Kenya generated the weakest performance at negative 9.0%.

MSCI INDICES PERFORMANCE
Returns in U.S. Dollars

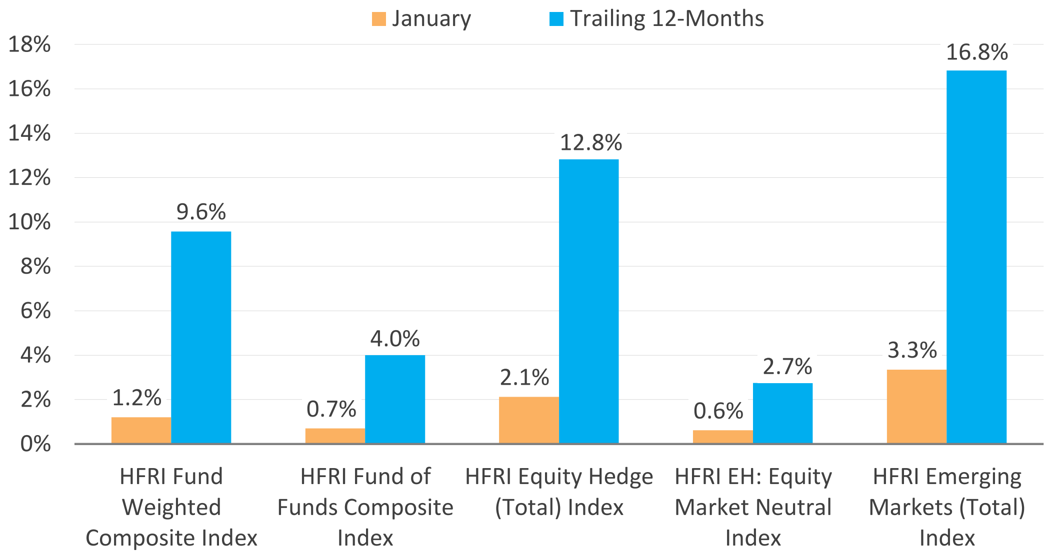


Data source: MSCI

Hedged Equity

- Global equity markets crept higher, with the HFRI Equity Hedge (Total) Index returning 2.1%, outpacing the S&P 500 (+1.9%).
- Hedged equity sub-indices were positive, with growth outperforming value, a reversal from the post-election rally. The HFRI EH: Fundamental Growth Index returned 3.4% and the HFRI EH: Fundamental Value Index returned 1.6%. Sector-specific indices also generated positive returns, and were led by the HFRI EH: Sector-Technology Index (+3.6%) and the HFRI EH: Sector-Healthcare Index (+2.8%).
- Quantitative strategies continued to underperform fundamental equity strategies. The HFRI EH: Quantitative Directional Index returned 0.2%, while the HFRI EH: Fundamental Value Index returned 1.6%. The HFRI EH: Fundamental Growth Index returned 3.4%, as the growth sector bounced back after selling off in the fourth quarter.
- Growth-oriented sector specialists tended to outperform long-only indices for the month, as technology and healthcare-focused managers led in a reversal from previous months. The HFRI EH: Sector – Energy/Basic Materials Index (0.2%) saw more muted returns after returning over 20% in 2016.
- The broad HFRI Emerging Markets (Total) Index returned 3.3%, but trailed the public market return of 5.5%. The HFRI Emerging Markets: Latin America Index (+6.1%) led as Latin American equities and currencies appreciated. Asian markets also saw solid returns as the HFRI Emerging Markets: China Index was up 4.3% and the HFRI Emerging Markets: India Index increased 3.4%.

HFRI INDICES PERFORMANCE
Returns in U.S. Dollars



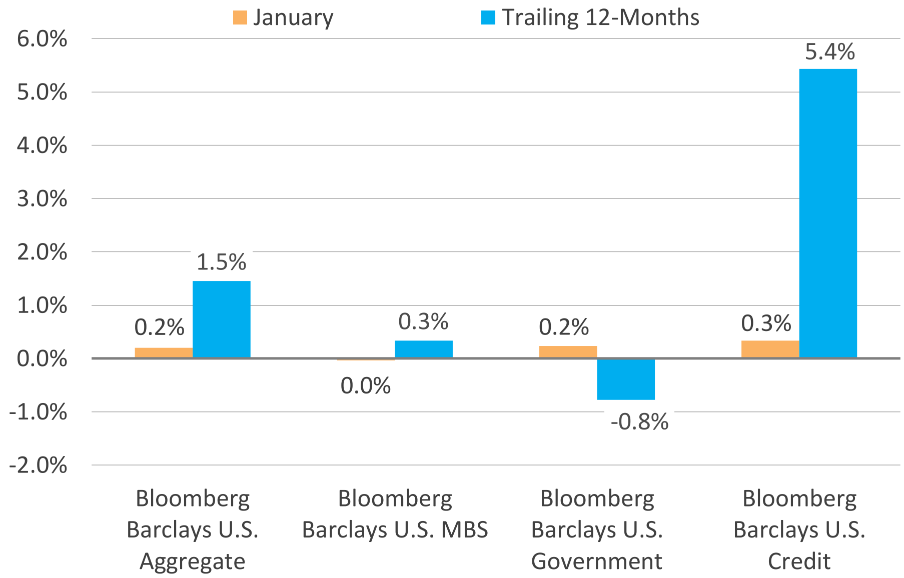
Data source: HedgeFund Research

Fixed Income

OVERVIEW

- The Bloomberg Barclays U.S. Aggregate Bond Index (BAGG) increased 0.2% in January. Agency mortgage-backed securities were flat during the month. Investment-grade securities increased 0.3% and U.S. government securities increased 0.2% during the month.
- Investment-grade commercial mortgage-backed securities (CMBS), a smaller component of the BAGG, increased 0.7% during the month.
- Emerging market debt (EMD) local currency posted a gain of 1.8%, and dollar-denominated EMD increased 1.5%.

BLOOMBERG BARCLAYS BOND INDICES PERFORMANCE



Data sources: Bloomberg Finance, L.P., Barclays

RATES

- The 2-year note yield remained at 1.2%, while the 10-year note yield increased six basis points (bps) to 2.5%, and the 30-year bond yield increased three bps to 3.1%.
- Inflation expectations increased during the month. The 10-year break-even rate of inflation increased 13 bps to 2.1% and concluded the month 10 bps above the Fed's 2.0% target. The yield on the benchmark 10-year Treasury Inflation-Protected Securities (TIPS) moved 12 bps higher to 0.39%, and the Barclays U.S. TIPS Index posted a gain of 0.8% during the month.

CREDIT

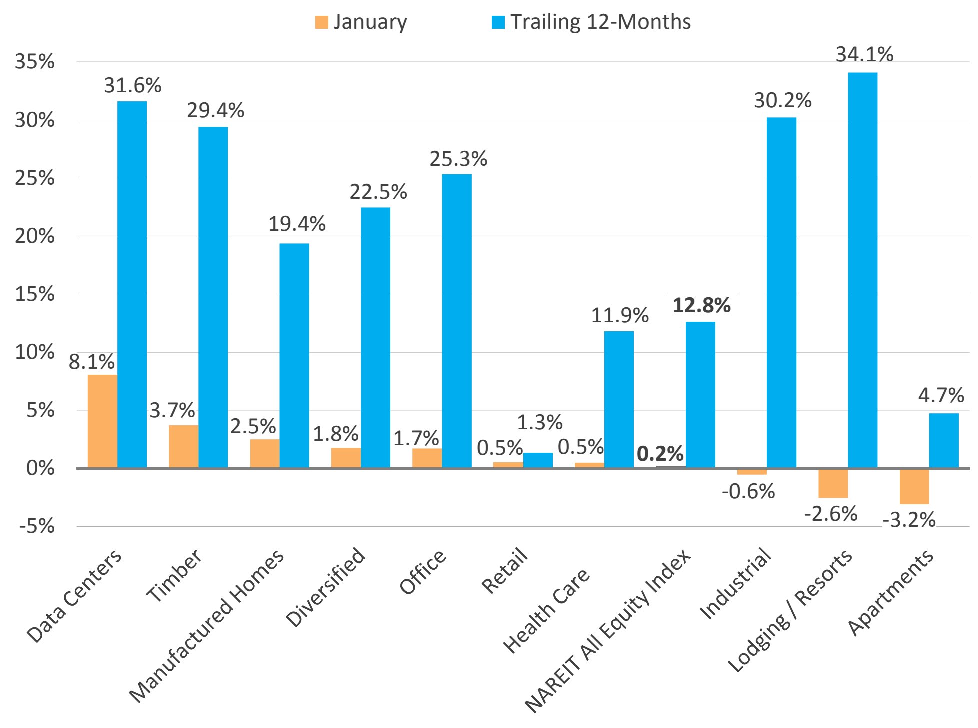
- Investment-grade corporate bonds increased 0.3% for the month. Utilities were the strongest sector, up 0.5%. Financials and industrials were both up 0.3%.
- The fixed income risk sectors both increased in January, with a 1.5% gain for the Bloomberg Barclays U.S. Corporate High Yield Index and a 0.3% gain for bank loans.

Real Assets

DOMESTIC REITs

- Real estate investment trusts (REITs), as measured by the FTSE NAREIT All Equity Index, gained 0.2% for the month of January and 12.8% on a trailing 12-month basis. This gain can be attributed to companies posting positive earnings throughout January, as well as expectations that the Trump administration's tax and infrastructure plan will positively impact REIT fundamentals. Additionally, despite the rate hike, many REITs have trimmed debt in recent years, providing protection from higher interest rates.
- At the end of January, the REIT dividend yield stood at 3.9%, versus a yield of 2.4% for the 10-year Treasury.
- Lodging/Resorts declined by 2.6% during the month of January. This may be due to an increase in supply and reduced demand from foreign travelers because of the strengthening USD. Additionally, new travel restrictions under the Trump administration led to concerns of reduced demand from foreign travelers.
- Conversely, the manufactured homes sector gained 2.5% for January. This gain was due in part to a lack of supply growth, resulting in tighter rental markets, as well as higher rent and occupancy levels.

FTSE NAREIT ALL EQUITY INDEX SECTOR RETURNS



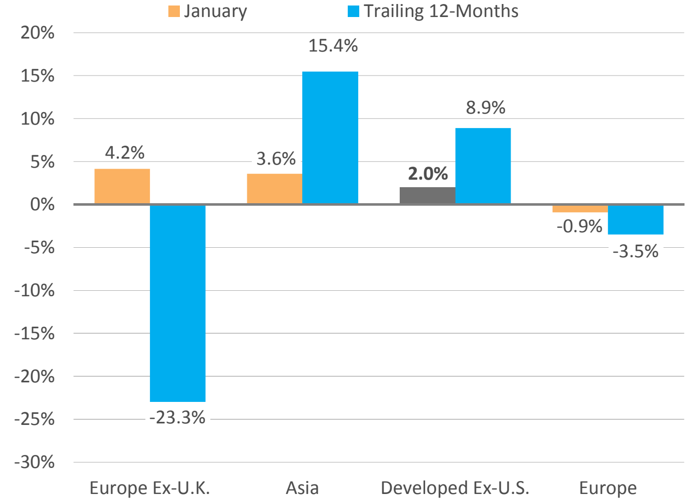
Data source: NAREIT

INTERNATIONAL REAL ESTATE SECURITIES

- International real estate securities, as measured by the FTSE EPRA/NAREIT Developed Ex-U.S. Total Return Index, gained 2.0% in USD terms for January.
- European property returns were -0.9% for the month of January due to the strengthening USD. Conversely, the U.K. established some clarity on Brexit, helping the country gain 5.3%. Elsewhere in the region, France and Germany gained 6% and 2.4%, respectively.

- Asian property markets gained 3.6% in January. Asia's continued property development was primarily due to GDP growth and low interest rates. However, tighter financial conditions may pressure continued development.

FTSE EPRA / NAREIT DEVELOPED MARKET INDICES REGIONAL RETURNS (U.S. DOLLARS)

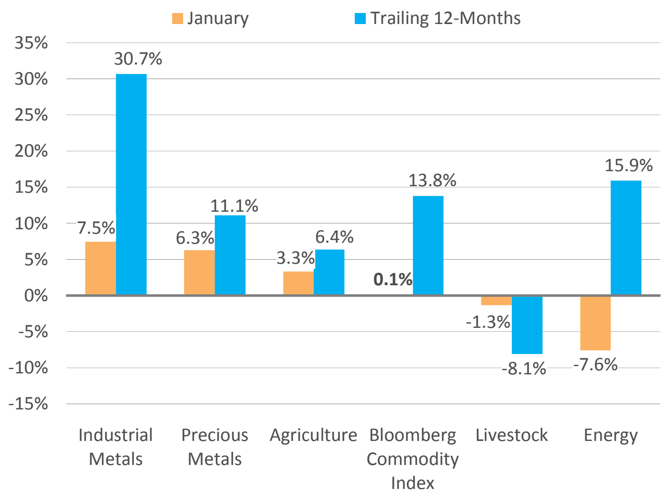


Data source: Bloomberg, L.P.

COMMODITIES

- Commodities, as measured by the Bloomberg Commodity Index (BCOM), gained 0.1% during the month. Gains in industrial metals were offset by declines in energy, specifically natural gas. Broadly, commodities were impacted by the energy sector as mild winter weather negatively impacted natural gas prices.
- The Industrial Metals sector posted the strongest returns, gaining 7.5%. The complex benefitted from strength in zinc (+11%), copper (+8.9%), and aluminum (+7.2%). Rising inflation and PMI levels in China helped move the sector.
- Conversely, energy declined by 7.6%, but gained 11.9% on a trailing 12-month basis. While oil prices remained stable, detractors from performance included natural gas (-15.3%), unleaded gasoline (-8.0%), and ULS diesel (-6.1%).

BLOOMBERG COMMODITY INDEX SECTOR RETURNS

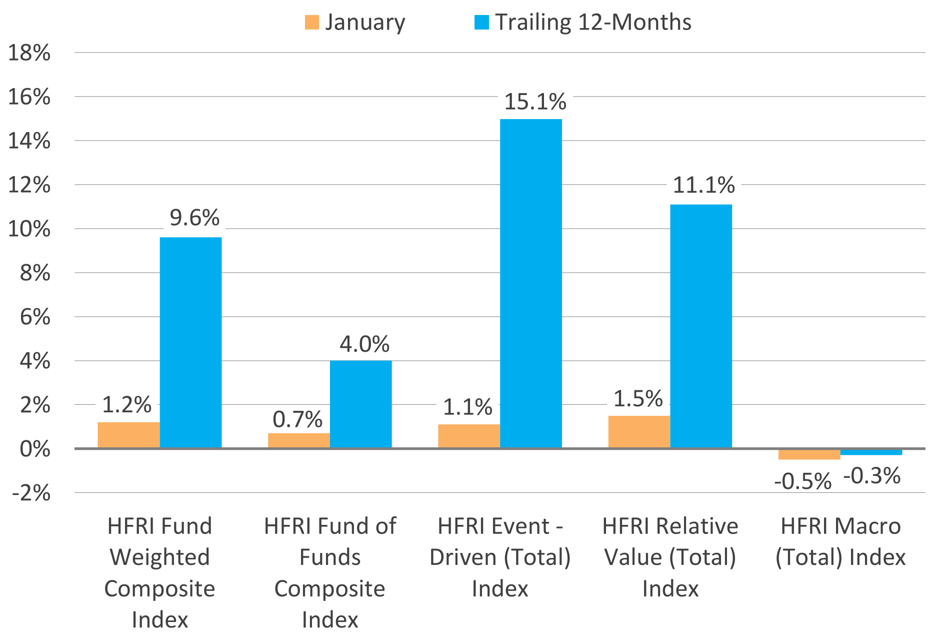


Data source: Bloomberg, L.P.

Diversifying Strategies

- Hedge funds enjoyed a strong month, which may be attributable to the noteworthy decline in asset correlations. The HFRI Fund Weighted Composite Index returned 1.2%. Performance was mixed across strategies, with gains in event-driven and relative value strategies offset by losses in global macro.
- The HFRI Event - Driven (Total) Index returned 1.1%. Most sub-indices generated positive performance aside from the HFRI ED: Merger Arbitrage Index, which lagged slightly, losing 0.1%. Distressed was the leading contributor, with the HFRI ED: Distressed/Restructuring Index producing a 2.0% gain. Several large distressed investments continued to make progress within the restructuring process.
- The HFRI Relative Value (Total) Index returned 1.5%. Each sub-index generated positive performance, most notably the HFRI RV: Yield Alternatives Index (+3.2%) and the HFRI RV: Volatility Index (+1.8%). The HFRI RV: Yield Alternatives Index enjoyed a strong bounce back from its lackluster performance in December.
- The HFRI Macro (Total) Index declined by 0.5%. Systematic managers detracted modestly from performance, getting caught off guard by choppy markets. The HFRI Macro: Systematic Diversified Index and the HFRI Macro: Active Trading Index generated the largest losses declining 1.2% and 1.9%, respectively. Discretionary managers and commodity strategies were the only macro categories to generate positive performance. The HFRI Macro: Discretionary Thematic Index and the HFRI Macro: Commodity Index returned 0.9% and 1.0%, respectively.

HFRI INDICES PERFORMANCE
Returns in U.S. Dollars



Data source: HedgeFund Research

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Past performance is not indicative of future results.

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All data is as of January 31, 2017 unless otherwise noted.

INDICES

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

Barclays Capital Fixed Income Indices is an index family comprised of the Barclays Capital Aggregate Index, Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, Municipal Index, High-Yield Index, and others designed to represent the broad fixed income markets and sectors within constraints of maturity and minimum outstanding par value. See https://ecommerce.barcap.com/indices/index.dxml for more information.

The CBOE Volatility Index (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index. FTSE Real Estate Indices (NAREIT Index and EPRA/NAREIT Index) includes only those companies that meet minimum size, liquidity and free float criteria as set forth by FTSE and is meant as a broad representation of publicly traded real estate securities. Relevant real estate activities are defined as the ownership, disposure, and development of income-producing real estate. See www.ftse.com/Indices for more information.

HFRI Monthly Indices (HFRI) are equally weighted performance indexes, compiled by Hedge Fund Research Inc. (HFX), and are used by numerous hedge fund managers as a benchmark for their own hedge funds. The HFRI are broken down into 37 different categories by strategy, including the HFRI Fund Weighted Composite, which accounts for over 2000 funds listed on the internal HFR Database. The HFRI Fund of Funds Composite Index is an equal weighted, net of fee, index composed of approximately 800 fund- of- funds which report to HFR. See www.hedgefundresearch.com for more information on index construction.

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Merrill Lynch high yield indices measure the performance of securities that pay interest in cash and have a credit rating of below investment grade. Merrill Lynch uses a composite of Fitch Ratings, Moody's and Standard and Poor's credit ratings in selecting bonds for these indices. These ratings measure the risk that the bond issuer will fail to pay interest or to repay principal in full. See www.ml.com for more information.

Morgan Stanley Capital International – MSCI is a series of indices constructed by Morgan Stanley to help institutional investors benchmark their returns. There are a wide range of indices created by Morgan Stanley covering a multitude of developed and emerging economies and economic sectors. See www.morganstanley.com for more information.

Russell Investments rank U.S. common stocks from largest to smallest market capitalization at each annual reconstitution period (May 31). The primary Russell Indices are defined as follows: 1) the top 3,000 stocks become the Russell 3000 Index, 2) the largest 1,000 stocks become the Russell 1000 Index, 3) the smallest 800 stocks in the Russell 1000 Index become the Russell Midcap index, 4) the next 2,000 stocks become the Russell 2000 Index, 5) the smallest 1,000 in the Russell 2000 Index plus the next smallest 1,000 comprise the Russell Microcap Index. See www.russell.com for more information.

S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation, among other factors by the S&P Index Committee, which is a team of analysts and economists at Standard and Poor's. The S&P 500 is a market-value weighted index, which means each stock's weight in the index is proportionate to its market value and is designed to be a leading indicator of U.S. equities, and meant to reflect the risk/return characteristics of the large cap universe. See www.standardandpoors.com for more information.

Information on any indices mentioned can be obtained either through your consultant or by written request to information@feg.com.

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Research and Investments Team as of date of publication.