Fund Evaluation Group®
investment advisors

RESEARCH REVIEW

JULY 2016

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INTRODUCTION

Our Search for the Unique

GREGORY D. HOUSER, CFA, CAIA Senior Vice President / Capital Markets

A common news article one sees in the investment press, usually after the first of the year and often as a mid-year update, is an assessment of how active managers are doing as a whole. As the equity markets recovered and rallied following the financial crisis and the market's bottom in March 2009, many active equity managers failed to keep pace, and as a whole, lagged the degree of outperformance provided prior to the financial crisis.[1] The reasons for this are as many and as varied as the approaches these managers take to beating their benchmarks. Common quotes heard over the past few years address the environment of the day and include the often stated "junk rallies" and "fundamentals do not seem to matter" in the "new normal" of "central bank influence." The lack of outperformance is not limited to the U.S. equity market, as the issues persist in the international equity markets, fixed income, and even hedge fund arenas.

This is not a defense of active management, we view both active and passive investments as having critical roles in portfolio construction. We expect many in the full universe of managers to lag their benchmarks, with only a percentage providing consistent outperformance over a full market cycle. We know that the markets do not favor even the best of managers in all years. Readers most assuredly recall that the most notable "manager" to recently appear to have constant annual outperformance now has a nice view of prison bars and barbed-wire for running a Ponzi scheme.

[1] All perf Cox, Jeff, "Stock-picking active managers having their worst year ... ever" CNBC.com, 13 July 2016

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There are, however, skillful managers out there. We pride ourselves on finding those managers that have unique strategies, competencies, and expert knowledge. Those with unconstrained mandates and that operate in inefficient areas of the markets have the greatest opportunity to outperform. When strong alignment of interests with clients' goals are combined with skillful management and enough room for agile managers to exercise that skill, we believe our clients will reap the benefits. In short, to be different, you must invest with managers that are willing to be different, and that have the leeway to be different.

With that, we revisit the following, which provides greater insight into the tenets of our due diligence process that we thoroughly consider when searching for those skillful managers.

Manager Research... It's Not Just Performance

The process of investment manager research is an essential component of the advisory services we provide to our clients. While merely evaluating investment manager performance is straightforward, FEG's approach to manager due diligence is multi-faceted and intensive, and our dedicated research team is a reflection of the significant value we place on our distinctive approach. The process of identifying high-quality managers who have integrity and passion for the business, with skills that are competitive and sustainable is the crux of our research efforts. Why is this important, one may ask? As an advisor, we are a fiduciary and must act in good faith to represent our clients' interests in achieving their missions as organizations or individuals. As a fiduciary, we must have an independent and consistent methodology in evaluating investment managers, as well as a thorough and intensive due diligence process.

As research analysts, we are skeptical and believe that selecting skillful managers is difficult. This requires experienced investment professionals to thoroughly understand the quality of a manager and how a manager's interests are aligned with investors. The six tenets of our research process assist in providing a framework to evaluate managers, which is both a qualitative and quantitative methodology. We believe this analytical structure, which has been developed and refined for over 28 years, appropriately directs our research focus to select managers who have the ability to outperform over a long investment horizon. In order to evaluate the personnel, philosophy, and performance for a manager, FEG's research analysts utilize the following six attributes in our manager selection and ongoing due diligence process: conviction, consistency, pragmatism, investment culture, risk control, and active return.

SIX TENETS OF MANAGER RESEARCH

1. CONVICTION
2. CONSISTENCY
3. PRAGMATISM
4. INVESTMENT CULTURE
5. RISK CONTROL
6. ACTIVE RETURN

The six tenets of our research process assist in providing a framework to evaluate managers, which is both a qualitative and quantitative methodology.

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Clearly, five of the six measurements are qualitative, with only one tenet focusing on the quantitative perspective. This is intentional, as we view performance as a component of our research process, but not the dominant element. Furthermore, if a manager exhibits strong elements of the first five aspects, we believe solid performance should follow. As investors, we search for investment managers who are original thinkers, differentiate themselves from their peers, and are willing to put investment decisions before business decisions.

1 Conviction

We first seek to understand whether a manager truly believes their philosophy and process is an effective way to manage money. A well formulated philosophy and process will have supporting evidence that a strategy is viable. Portfolio concentration and positioning can demonstrate the level of confidence a manager has in their approach. For example, if a manager has minimal constraints, and is willing to position the portfolio significantly different than the benchmark, an analyst could contend that the manager has a high level of conviction. Likewise, in a fundamental approach, a manager with lower-than-average portfolio turnover would exhibit a high level of conviction because the manager is willing to invest in a security for a long time horizon versus a short-term view that may be focused on a company's future quarterly earnings. Research analysts expect that firms who manage concentrated portfolios with low turnover will have a deep understanding of portfolio positions. We will seek to understand if this is true by observing knowledge depth while asking detailed questions when interviewing investment teams.

Glossy pitch books do not demonstrate conviction – they can help to articulate a manager's strategy, but do not compensate for a manager's lack of intimate strategy knowledge. For example, a portfolio manager may state they have a catalyst for every security in the portfolio, but we need to understand if the manager truly has one for each position. If the philosophy and process sound great and graphs are attractive, but the manager cannot remember why they hold a position, what level of conviction do they really demonstrate and how well do they really know their portfolio? Conviction goes beyond portfolio construction, and can be observed from an economic perspective. A compensation structure based on long-term performance versus short-term gains can help align investment manager and investor interests. Additionally, a manager who invests a significant portion of their net worth in a strategy they manage is an indication of the manager's conviction. While it's standard for private capital and hedge fund managers to invest in their own funds, traditional long-only strategies do not often require personal investment. When an analyst discovers a strategy where the entire team invests a sizeable portion of their net worth in that strategy, however, it is notable.

2 Consistency

Consistency can be assessed by understanding changes over time in a firm's personnel, philosophy, process, and portfolio construction. Stability of a firm's personnel is crucial and a history of succession planning is vital. Experienced professionals are difficult to replace and are often key to a successful track record. This is especially true with strategies where an investment is locked up for an extended period of time (i.e., private equity). There is a heightened focus on key man risk, relationships, and team consistency. Portfolio managers and analysts who have worked through multiple market cycles and who have employed a consistent philosophy and process, even when it is out of favor, are valuable. The size

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of an investment team is less important than the experience and working relationships of the team. As long as staff size is sufficient for the manager to effectively research, analyze, and monitor their investable universe, an investment team may be a competitive edge.

A consistent philosophy, process, and portfolio construction is essential in manager selection as well. All managers will have periods where market cycles do not favor their strategies. What is important is that managers set expectations. If personnel turnover is high, there is a greater chance that the philosophy and process have changed over time. Some change is good. For example, an analyst would expect a quantitative manager to evolve its strategy over time as factors decay and better information is available to make investment decisions. If a portfolio manager trends from a concentrated portfolio to a diversified portfolio, however, this may be a sign of too many assets, a change in philosophy, or deterioration of manager conviction. Likewise, if a manager experiences a period of underperformance and begins to modify its buy or sell discipline, or decrease tracking error to limit performance volatility, this could be a sign of inconsistency. If a manager offers multiple vehicles to access the strategy, we must understand dispersion and sources of dispersion. If dispersion is high, this would lead an analyst to probe further to understand variances in portfolio construction and portfolio management. For instance, different individuals may be responsible for the separate accounts and mutual funds within a specific strategy. These individuals may have different views on portfolio construction, leading to a divergence in performance. A rolling style analysis may uncover inconsistencies with a manager's strategy and help investors understand any drift or variance compared to expectations.

3 Pragmatism

The investable manager universe is robust and understanding a manager's competitive edge is a salient factor in distinguishing top tier managers. Having a sustainable competitive advantage helps to create a niche position for the manager. For example, private equity managers need to have a high quality source of deal flow in order to access attractive investment opportunities. This is difficult to replicate because the source of deal flow largely depends on a manager's professional network, which heavily relies on relationships and less on public information. After identifying a competitive edge, we need to understand the manager's plan to sustain it and invest in it so that it does not erode over time.

Often, an element of a manager's edge is the experience of the investment team in combination with the processes they have put in place to manage assets. Therefore, understanding how the team is incentivized and ensuring the team has access to the appropriate systems and tools to effectively execute on a repeatable basis are critical. Knowledge about the investment professional backgrounds provides valuable insight about their alignment with a particular investment strategy. In addition to experience, we favor managers who conduct a majority of proprietary research and use proprietary models, as we think this assists them in forming investment theses that differ from consensus. Managers who have the flexibility to take appropriate risks and act on intuition that comes from experience, likely have the aptitude to create and sustain a competitive investment strategy.

4 Investment Culture

As highlighted in the discussion above, investment culture is an invaluable element of a successful investment firm. Culture is the most difficult principle to fully evaluate because people largely influence the traditions and customs of the firm. As a result, part of our process is to visit the investment manager

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on-site and meet with key professionals in order to obtain a sense of the environment and cultural tone. On paper, fully grasping how team members interact and which team members dominate conversation is difficult. On-site visits can clarify these relationships and help us understand the conversation focus, intensity, and passion of the team. While formal meetings are one example of the research process, this level of transparency is indicative of the manager's confidence in the team and structure to their investment approach. Often, when we interview analysts and portfolio managers separately, we will hear common phrases, techniques, approaches, and viewpoints that help illustrate the cohesion of the team. Regardless of whether a manager trains and promotes from within, or hires external experienced analysts, individuals should share the same philosophy and goals for success.

Culture helps to attract and retain professionals, as people generally will gravitate towards a positive environment that provides opportunities for career growth and development. Firms that understand their assets walk in and out of the company each night are competitive because they recognize employee value and typically create an environment that motivates and enriches the group. Compensation is a factor in successful employee retention. High performing individuals should be incentivized and rewarded appropriately with a partnering mentality. In some instances, this may mean firm ownership, profit sharing arrangements, or reasonable payout of carried interest among team members. As firms endeavor to create good cultural environments for employees, creation of ethical relationships with investors is especially necessary. For example, if an advisory board exists for a limited partnership, one may ask what are the voting rights and how is the board utilized? Additionally, what types of investor reporting and communication policies are in place for these strategies, and are there equitable terms and conditions for investors? The goal of asking these questions is to build confidence that the firm will manage investor capital with prudence and integrity.

5 Risk Control

While conviction is important, appropriate risk controls must be in place to help ensure investment risks are intended and understood. Risk measurement is not the same thing as risk control. We consider risk from many different angles, including, but not limited to business risk, strategy risk, operational risk, and liquidity risk. From the manager's perspective, risk can be monitored and controlled at various levels, such as the individual security level, the strategy level, and firm level. Risk control does not merely consist of security diversification and credit quality constraints, it is much more involved. A strong risk management program is ingrained into the firm's culture and can be observed throughout the investment process. For instance, managers who are concerned about risk management understand appropriate liquidity constraints, and do not take on excessive levels of leverage. Further, a manager willing to close their strategy based on capacity constraints, versus engaging in excess asset gathering to generate additional income, shows the manager is concerned about effective portfolio management and generating appropriate alpha as assets build, not diminishing excess returns because the asset size becomes too large.

In addition to understanding the manager's internal risk controls, we evaluate the strength of the business to determine if appropriate institutional processes are in place. Operational risk is also important. Knowledge of key professional's experience, as well as back office systems, compliance procedures, disaster recovery capabilities, and counterparty risks is essential. Additionally, a review of litigation, audits, financial statements, and reference checks can help provide confirmation of risk management oversight. Moreover, experienced and quality service providers ranging from legal and audit to system vendors, are a sign of institutional strength and a commitment to investing in the business.

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6 Active Return

While a solid track record is necessary, we consider a manager's performance versus expectations, peer groups, and other investment opportunities, rather than a simple comparison against a stated benchmark. We think this is an appropriate method to evaluate manager performance because benchmarks have limits and may not be a true comparison for a manager's style. If multiple team members have been responsible for a performance history, understanding the details of succession in order to appropriately evaluate performance is crucial. A long track record is less meaningful if key decision makers are no longer involved in a strategy or if the strategy has been inconsistent. Also, evaluating a manager's ability to generate excess returns relative to the risk assumed is important. If a manager uses leverage, considering how that leverage contributed to the return history is necessary. By understanding return expectations through various market cycles, analysts can gauge discipline to style and manager conviction in their process. Assessing a manager's fee structure when evaluating performance is important as well, because fees can quickly dilute a manager's ability to generate excess return. An attractive performance history does not resonate with an analyst unless the entire qualitative assessment proves that the manager's approach offers a preferred investment opportunity.

FEG's approach to manager research is a detailed and methodical evaluation that assists in uncovering high-quality managers who could provide excess returns over a long investment horizon. The qualitative framework creates an unbiased tactic, allowing analysts to uniformly source, select, and monitor investment managers from the extensive universe of investable opportunities. This six tenet approach is central to our manager selection process. Due diligence is a top priority because, as a fiduciary, we strive to create a relationship of confidence and trust with our clients. The stability, experience, and expertise of our research group enables us to effectively gain access to premier investment managers, and our process provides the discipline and consistency necessary to enjoy success.

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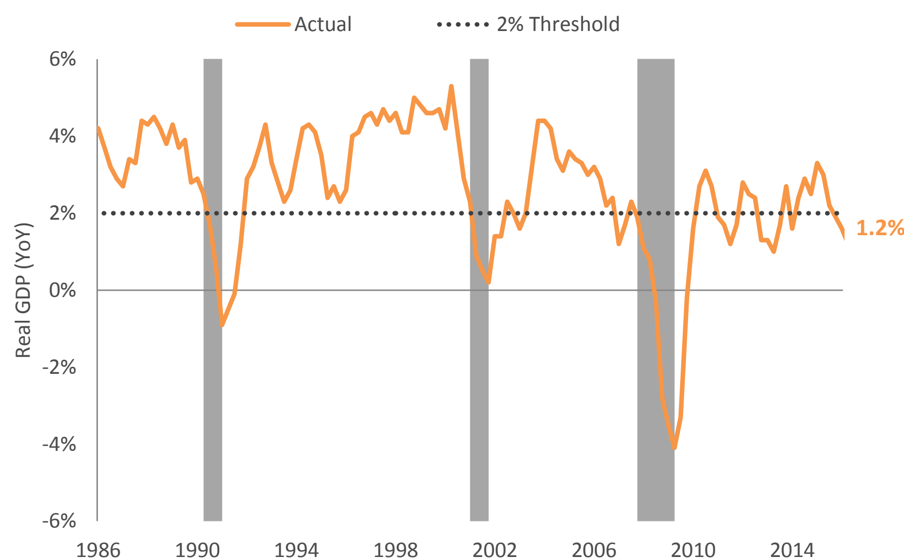
Economic Update

GDP Growth Disappoints in Second Quarter

The advance estimate of second quarter gross domestic product (GDP) released by the Bureau of Economic Analysis (BEA) on Friday, July 29, showed that real GDP printed at 1.2% for the second quarter, versus the downwardly-revised rate of 0.8% in the first quarter. The 1.2% second quarter reading was less than half of the Bloomberg consensus estimate, which called for a quarterly growth rate of 2.6%. Year-over-year (YoY), real GDP cooled to 1.2% from a downwardly-revised rate of 1.6% at the end of the first quarter, and represented the weakest YoY growth rate since the second quarter of 2013 (1.0%). On a nominal basis, GDP declined to 2.4% (YoY), the weakest reading of the post-Global Financial Crisis period. Analyzing U.S. business cycles since the Great Moderation (circa mid-1980s) shows that sub-2% prints of real GDP have historically coincided with recessions.



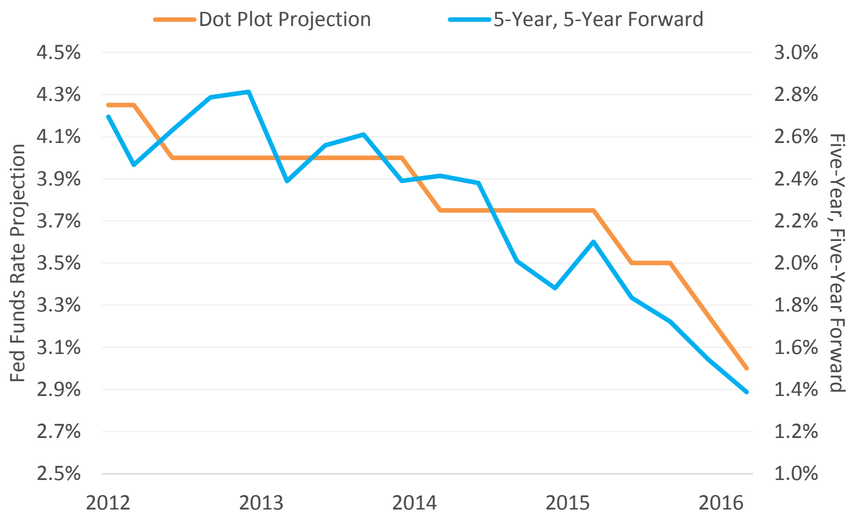
Data sources: BEA, NBER, Bloomberg, L.P.; Data as of 2Q 2016 (first estimate)
Note: Gray bars represent recessionary periods

Personal consumption growth contributed 2.8 percentage points (ppt) to the overall 1.2% quarterly reading, followed by a 0.2 ppt contribution from the net export component. Components that detracted from aggregate GDP growth during the quarter included government spending (-0.2 ppts), fixed investment (-0.5 ppts), and inventories (-1.2 ppts). Although a number of indicators point to a relatively low likelihood of a near-term recession, such as an upward-sloping yield curve, and positive growth in the Conference Board's Leading Economic Indicators index and Employment Trends Index, the slowdown in aggregate economic activity since mid-2015 may further complicate the Federal Reserve's goal of tightening monetary policy.

Further obfuscating the Fed's anticipated path of policy tightening have been ongoing declines in market-implied measures of long-run expected inflation. For example, the Fed's 5-year, 5-year forward rate—the average 5-year inflation commencing 5 years from today—has collapsed to just 1.37% as of August 2, 2016.

That is nearly half of the historical average of 2.56% and more than 60 basis points below the Fed's 2.0% targeted inflation level. In an effort to help combat growing pessimism regarding the U.S. economy's wherewithal to generate healthy levels of realized inflation—in the Fed's eyes, at least—the Federal Open Market Committee (FOMC) has made a number of downward revisions to the committee's long-run estimate of the appropriate level of the federal funds rate, including downward revisions at the FOMC's March 16th and June 15th meetings. In summation, declining economic growth rates and falling inflation expectations have the potential to drive the Federal Reserve further away from the rate tightening path, serving as a headwind to U.S. dollar appreciation, but a likely tailwind to risky asset prices over the near-term horizon.

FOMC MEDIAN LONG-TERM DOT PLOT PLAN PROJECTION & MARKET-IMPLIED INFLATION EXPECTATIONS



Data sources: Federal Reserve, Bloomberg, L.P.; Data as of 6/15/2016

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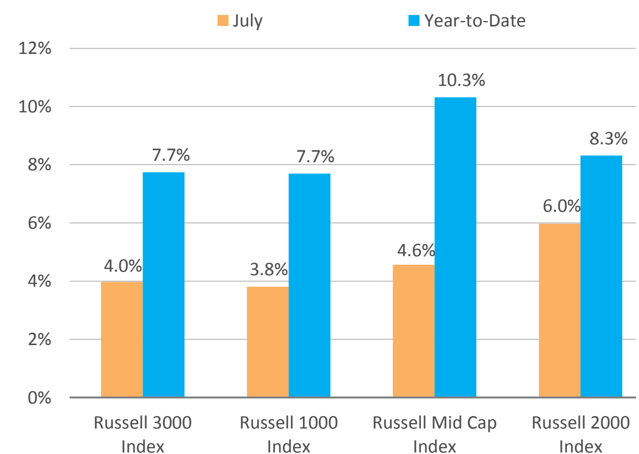
Global Equity

U.S. Equity

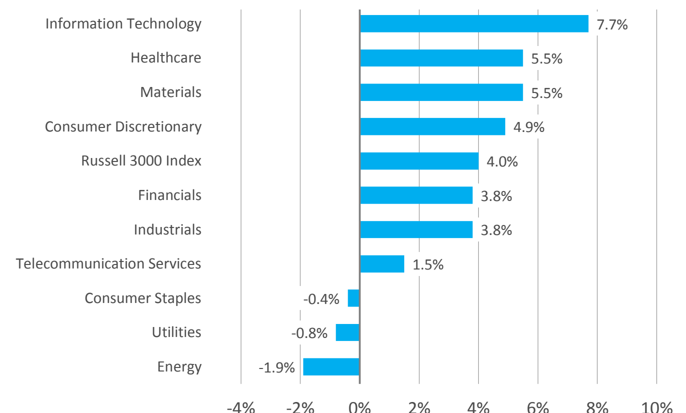
- The U.S. stock market, represented by the Russell 3000 Index, gained 4.0% in July. U.S. stocks ascended on a commitment to accommodative monetary policies by global central banks and lowered concern over the impact of the United Kingdom's vote to exit the European Union. Many U.S. companies also exhibited better-than-expected second quarter earnings.
- Small cap stocks (+6.0%) continued to rally, followed by mid (+4.6%) and large (+3.8%) cap. Mid cap stocks lead year-to-date (YTD) at +10.3%, and a strong July propelled small cap (+8.3%) above large cap (+7.7%).
- Seven of the ten sectors posted gains in the second quarter. Information technology stocks led at 7.7%, based on strong second quarter earnings. Earnings were also the basis for the rise in healthcare (+5.5%) and financials (+3.8%). Improving economic data and positive sales developments from automotive companies pushed consumer discretionary stocks rally of 4.9%.
- Energy (-1.9%), utilities (-0.8%), and consumer staples (-0.4%) were the three sectors with negative returns for the month, offsetting some of their second quarter gains.
- Telecommunication services and utilities, which are historically more defensive and interest rate-sensitive sectors, continued to be the best performers YTD, up 25.3% and 22.7%, respectively. All sectors exhibited positive YTD performance.
- There was a stylistic shift for the month of July, with growth leading value stocks across market capitalizations. The outperformance of information technology, healthcare, and consumer discretionary boosted growth, while utilities and telecommunications services weighed on value performance.
- The gains in growth were not enough to eclipse value's stronger YTD performance. Value has outperformed growth across all market capitalizations YTD, with the widest spread in the small cap universe (+11.8% vs. +4.8%).

RUSSELL INDICES PERFORMANCE



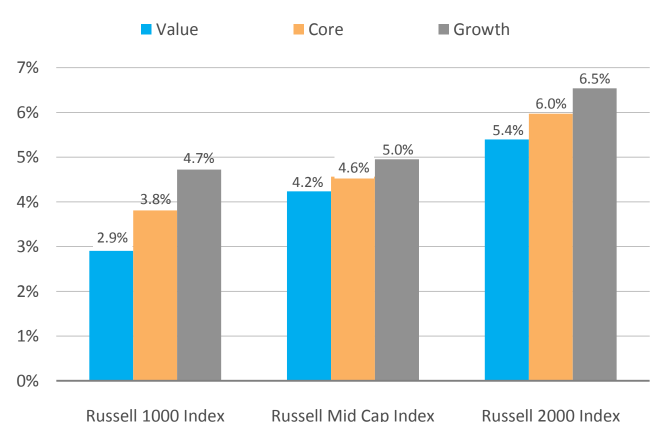
Data source: Russell

JULY RUSSELL 3000 SECTOR PERFORMANCE



Data source: Russell

JULY RUSSELL INDICES PERFORMANCE



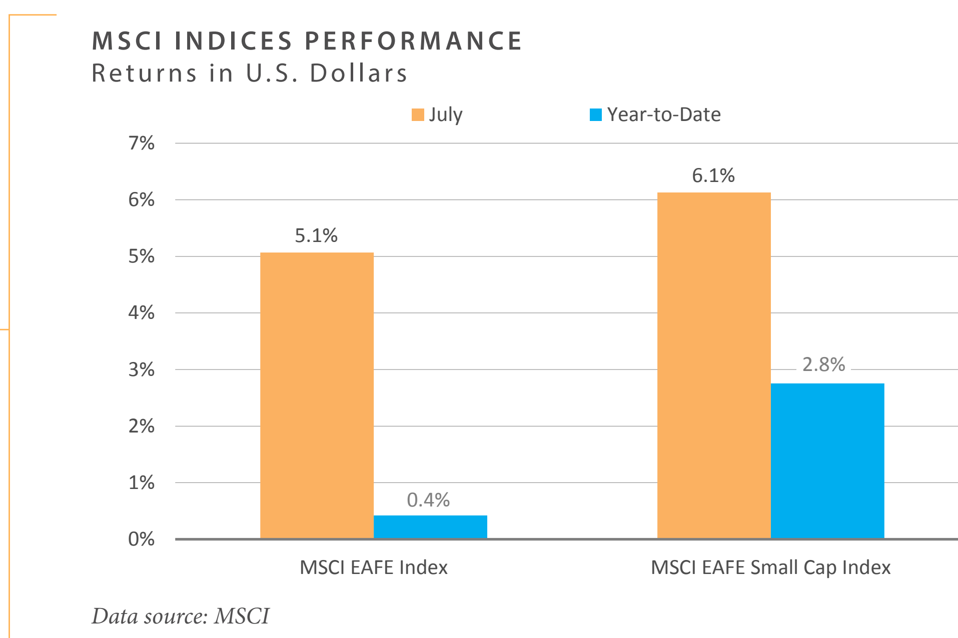
Data source: Russell

International Equity

All returns in local currency unless otherwise indicated.

INTERNATIONAL DEVELOPED MARKETS

- International developed equity markets rose 4.8% in July. In contrast to the second quarter, currency fluctuations were a positive contributor to U.S. investors results for the month, as returns in U.S. dollars (USD) were 5.1% after adjusting for currency changes.
- International developed markets had mixed results YTD, returning -2.8% (+0.4% USD), trailing U.S., emerging, and frontier market indices. Currency movements have had a positive impact on U.S. investors YTD.
- Pacific markets rose 6.1% (+6.6% USD) on strength from New Zealand (+9.1%) and most other countries in the region. Japanese equities rose 6.4% amid hopes of additional central bank stimulus and increased political stability.
- European stocks experienced a bounce-back rally in July, gaining 4.0% (+4.2% USD) and recouping some of the losses suffered in June after the Brexit vote. Austria and Germany were especially strong, gaining 7.5% and 6.7%, respectively. Most sectors had positive returns, with the largest gains in information technology and consumer discretionary stocks.
- Small cap stocks, as measured by the MSCI EAFE Small Cap Index, gained 5.9% (+6.1% USD) in July, outperforming large cap stocks and taking the lead in performance YTD.



Data source: MSCI

EMERGING MARKETS

- Emerging markets, as measured by the MSCI Emerging Markets Index, slightly underperformed developed international markets, gaining 4.2% in July (+5.0% USD). Emerging markets gained 7.8% YTD (+11.8% USD), outperforming international developed markets and U.S. stocks.
- Brazilian stocks continued to surge, increasing their YTD gain to 31.5% as anticipation that the temporary government would secure passage of economic reform to lift the country from recession grew. Peru also gained significantly during the month (+5.6%), helping to bolster returns for the Latin American region for the month (+6.6%) and YTD (+21.7%).

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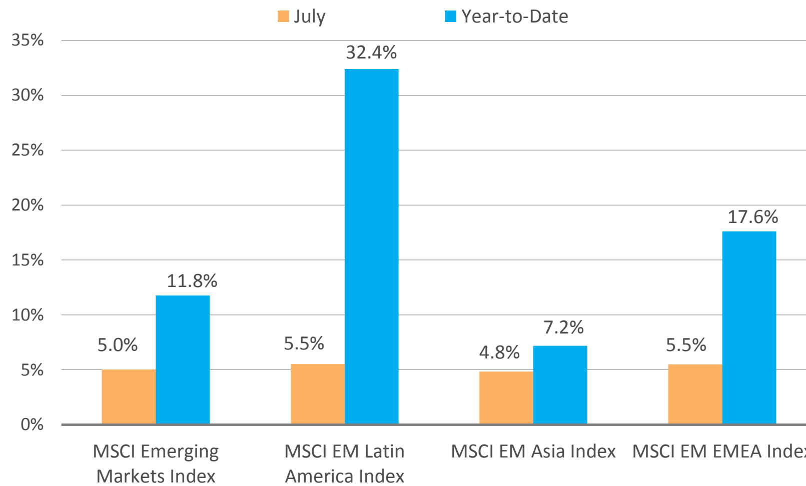
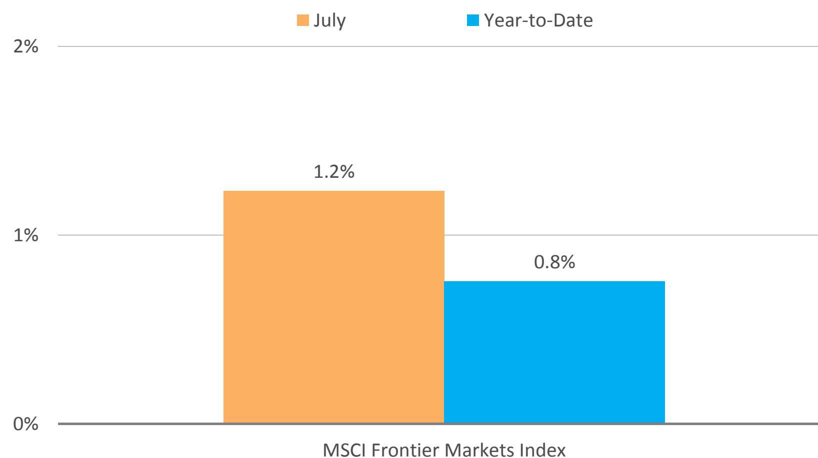
- Asian emerging market stocks had solid gains of 3.9%, with Thailand and Taiwan performing strongest at 6.3% and 5.5%, respectively. Chinese stocks had their best monthly gain since March (+3.5%) amid signs of economic stabilization. China remains down YTD at -1.3%.
- European emerging market counties bounced back in July, led by the Czech Republic (+7.4%), Hungary (+5.9%), and Greece (+7.4%). Turkish stocks stumbled in July (-2.0%) as military officials made a shocking attempt to overthrow the government, but remain positive YTD (+8.1%).



Data source: MSCI

FRONTIER MARKETS

- Frontier markets gained 2.1% in the quarter (+1.2% USD) bringing the YTD performance to 5.1%. Currency fluctuations have impacted U.S. investors negatively in 2016, lessening the YTD gain in local currency to 0.8% USD.
- Central and Eastern Europe led performance with (+5.6%. The Ukraine, Slovenia, and Kazakhstan were also strong performers, at 11.1%, 8.0%, and 5.6%, respectively. Asian returns of 4.0% were boosted primarily by Pakistan (+5.7%). YTD, Estonia (+18.4%) and Argentina (+16.1%) were strong, adding to other YTD leaders, Ukraine (+21.6%) and Pakistan (+20.0%).



Data source: MSCI

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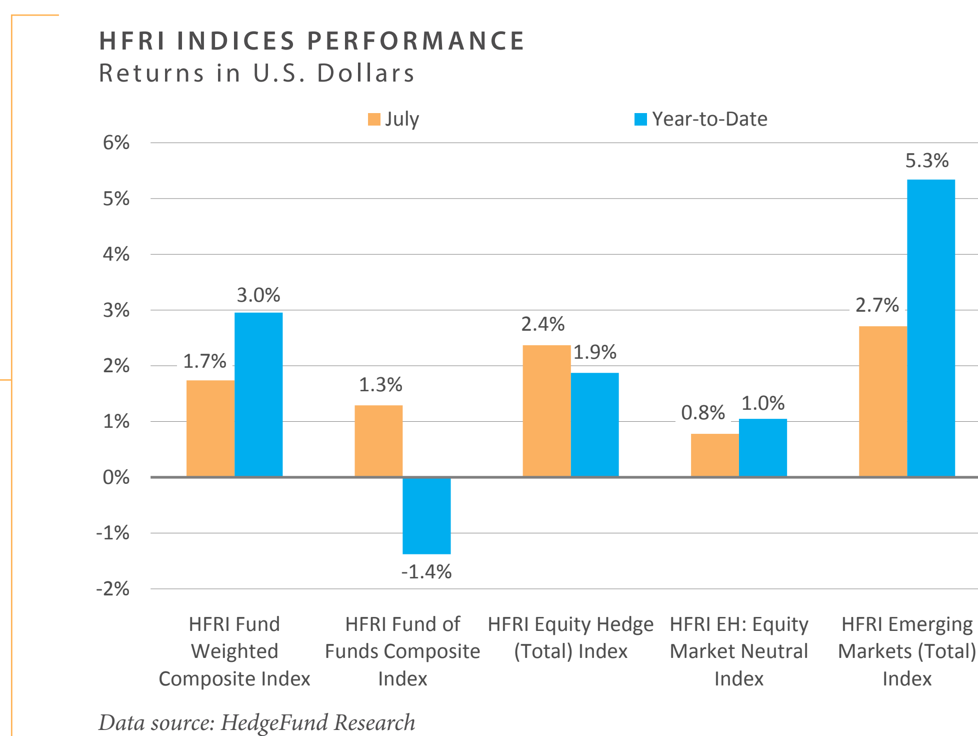
Hedged Equity

- Equities continued rally throughout July and the HFRI Equity Hedge (Total) Index moved well into positive return territory for the year. The index's 2.4% July return brought YTD performance to 1.9%. The long-only S&P 500 Index and the MSCI ACWI Index returned 3.7% and 4.3%, bringing YTD performance to 7.7% and 5.6%, respectively.
- Hedged equity sub-index returns were broadly positive with the exception of the HFRI EH: Short Bias Index, which returned -0.5%. Conversely, equity market neutral managers generated positive performance, illustrated by the 0.8% return of the HFRI EH: Equity Market Neutral Index.
- Both fundamental-oriented managers and quantitatively-driven strategies generated strong performance. The HFRI EH: Fundamental Value Index and the HFRI EH: Fundamental Growth Index returned 2.7% and 2.6%, respectively, and the HFRI EH: Quantitative Directional Index returned 2.5%.
- Sector specialists generated mixed performance relative to long-only indices. The technology and healthcare index was the top performing equity hedge sub-index. Energy and materials managers endured headwinds as the energy sector, particularly crude oil and Brent, sharply declined. The HFRI EH: Sector – Technology/Healthcare Index and the HFRI EH: Sector – Energy/Basic Materials Index returned 2.9% and 0.2%, respectively.
- The broad HFRI Emerging Markets (Total) Index returned 2.7%. With the exception of the HFRI Emerging Markets: MENA Index, -2.0%, performance was generally positive by region. Certain Middle Eastern countries suffered from energy market declines, largely contributing to the index's poor performance. The top performing regional sub-indices tended to be in Asia and Latin America. The HFRI Emerging Markets: Latin America Index, the HFRI Emerging Markets: India Index, and the HFRI Emerging Markets: Asia ex-Japan Index returned 4.0%, 3.6%, and 3.2%, respectively.

HFRI INDICES PERFORMANCE
Returns in U.S. Dollars



Data source: HedgeFund Research

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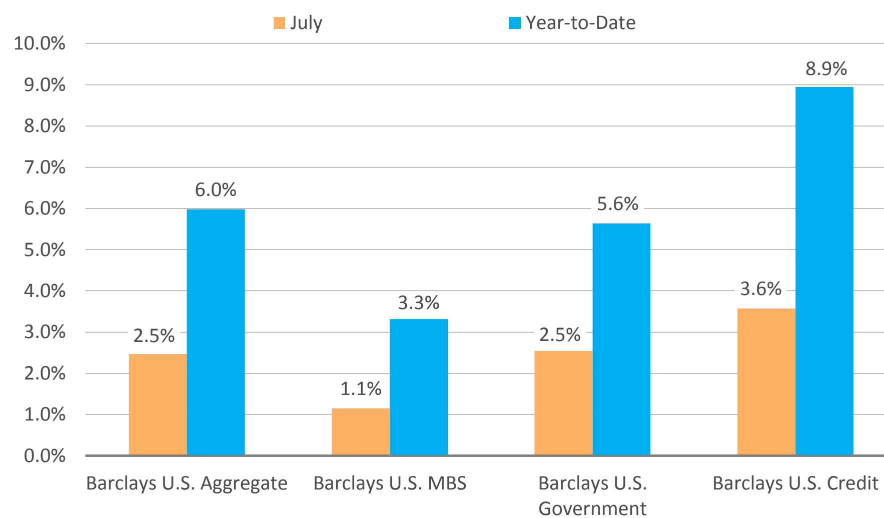
Fixed Income

OVERVIEW

- The Barclays U.S. Aggregate Bond Index (BAGG) increased 2.5% during the second quarter. Agency mortgage-backed securities returned 1.1%. Investment-grade credit returned 3.6% and U.S. government securities returned 2.5%.
- Investment-grade commercial mortgage-backed securities (CMBS), a smaller component of the BAGG, increased 1.0% during the quarter.
- Emerging market debt (EMD) local currency posted a gain of 0.4% and dollar-denominated EMD increased 6.0%.



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

RATES

- The 2-year note yield increased 8 basis points (bps) to 0.66%, the 10-year note yield decreased 2 bps to 1.45%, and the 30-year bond yield decreased 10 bps to 2.18%.
- Inflation expectations slightly increased during the quarter. The 10-year break-even rate of inflation increased 5 bps to 1.49% and concluded the month 51 bps below the Fed's 2.0% target. The yield on the benchmark 10-year Treasury Inflation- Protected Securities (TIPS) moved 9 bps lower to -0.04%, and the Barclays U.S. TIPS Index posted a gain of 0.9% during the quarter.

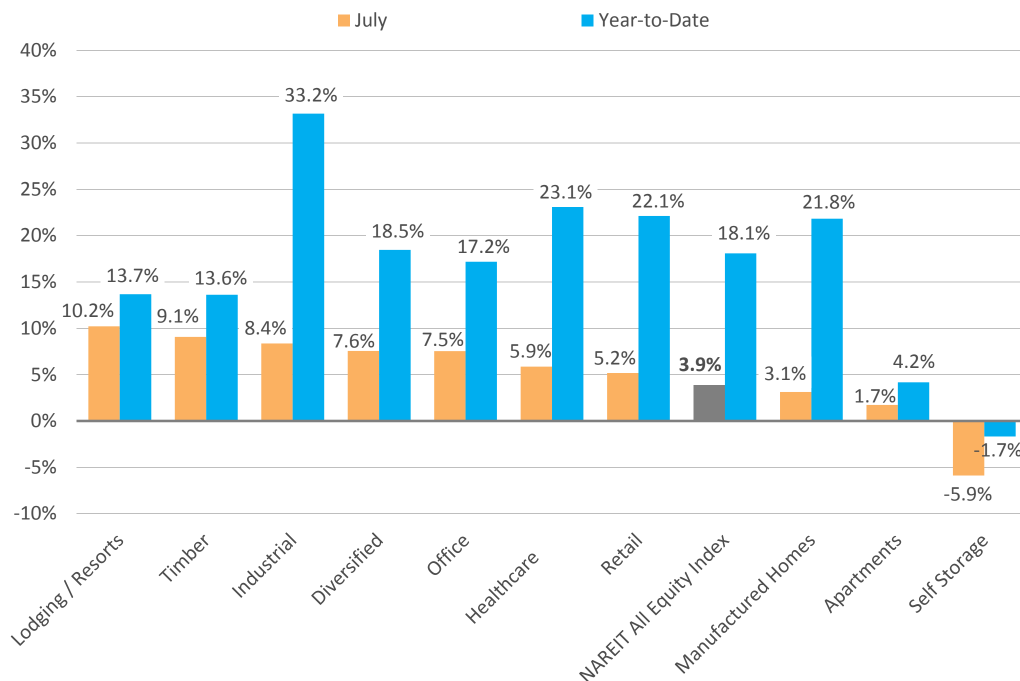
CREDIT

- Investment-grade corporate bonds increased 1.3%, with utilities being the best sector, up 1.7%. Industrials gained 1.6% and financials returned 1.2%.
- Both fixed income risk sectors were up with a 2.7% gain for the Barclays U.S. Corporate High Yield Index and 1.2% gain for leveraged loans.

Real Assets

DOMESTIC REITs

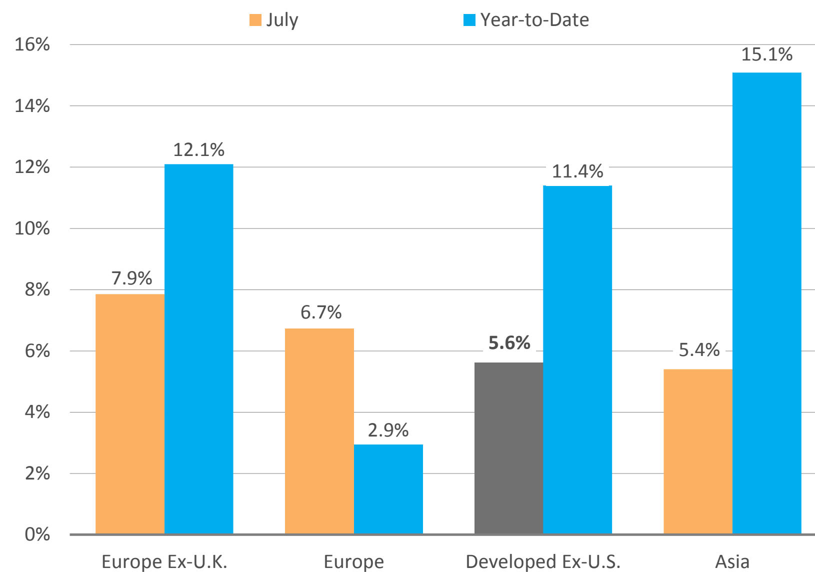
- Real estate investment trusts (REITs), as measured by the FTSE NAREIT All Equity Index, gained 3.9% in July. Global financial uncertainty has drastically lowered the probability of a Fed rate hike in 2016, positively impacting real estate.
- At the end of the July, REITs' dividend yield stood at 3.5%, versus a yield of 1.5% for the 10-year Treasury.[1]
- The lodging and resorts sector exhibited the strongest returns, gaining 10.2%. According to Smith Travel Research, lodging performance improved during the second quarter, with revenue per-available-room gaining 3.5% versus 2.6% from the prior quarter. Additionally, domestic travel has seen a boost as lower gas prices, global terrorism incidents, and concerns over the Zika virus kept travelers from going abroad.
- Elsewhere, the self-storage sector declined 5.8%, and has fallen 1.7% YTD. While new construction is still low by historical standards, Public Storage (PSA), the largest self-storage REIT by market cap, stated during its earnings call that an influx of new supply is creating challenges in some of its markets. PSA's stock price subsequently fell 4.8% after the call, and declined 6.5% over the full month.
- Cap rates in the U.S.—already at or below historic lows—were largely unchanged, driven by continued investor demand for yield in a low interest rate environment. Property prices, as measured by the Moody's/Real Capital Analytics Commercial Property Price Indices (RCA CPPI) national aggregate, were mixed, with major markets declining and secondary markets rising, further indication of risk aversion by investors in areas where asset values have stretched to all-time highs.



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 5.6% USD in July.[2]
- European property markets rallied on the heels of the Brexit shock, with the European Ex-U.K. property market and the broad European market gaining 7.9% and 6.7%, respectively. Since the vote, the market is pricing in a cut to U.K. policy rates and an expansion of the Bank of England's Quantitative Easing program, buoying property markets.
- Additionally, Asian property markets gained 5.4% and are up 15.1% in 2016. Low or negative interest rates throughout the region have benefited Asian property markets this year. Investor thirst for yield drove a wealth of Asian domestic capital flow into the real estate market, positively impacting asset values across the Asia-Pacific.



Data source: Bloomberg, L.P.

COMMODITIES

- Commodities, as measured by the Bloomberg Commodity Index (BCOM), declined 5.1% during July, but have gained 7.3% YTD. During the month, the index declined, giving up nearly half of its 2016 gains. The decline was led in large part by continuing supply concerns across the energy and grains complexes.[3]
- Precious metals posted the strongest return amongst the sectors at 4.3%, and are up 32.5% YTD. With a significant amount of global sovereign debt having negative yields, precious metals have experienced strong demand as a store of value.
- Conversely, the Energy sector declined 10.7%. Oversupply concerns resurfaced during the month, as U.S. production increased for the third straight week, driven by growth in Alaskan production. Lower 48 production continued to decline; however, near record high U.S. inventories counteracted a drop in production volumes.

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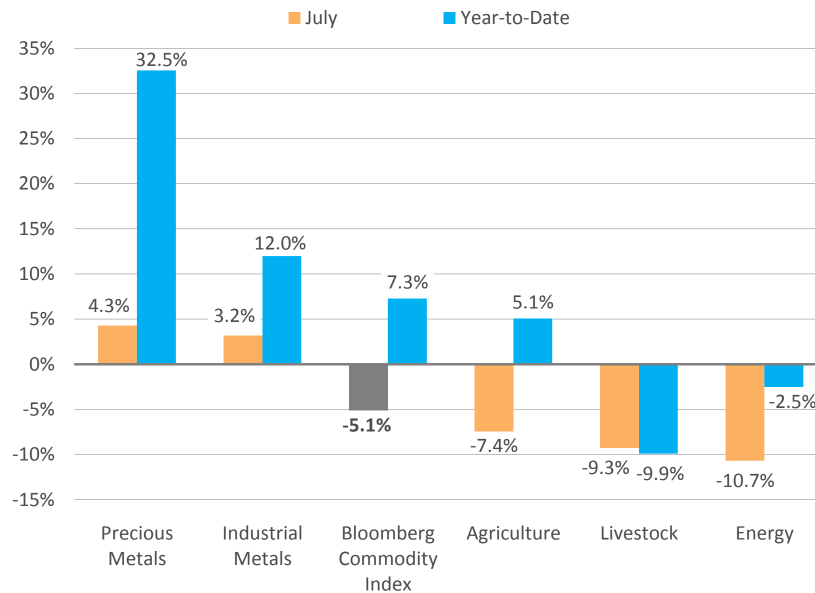
- Additionally, the livestock sector declined 9.3%. Live Cattle and Lean Hogs have both declined nearly 10% in 2016, reflecting their well-supplied markets. Lean Hogs futures declined 17.5% in July alone, marking its worst month in 14 years. Greater than expected existing supplies coupled with a diminishing demand picture negatively affected pork prices.[4]



Data source: Bloomberg, L.P.

REAL ASSETS FOOTNOTES

[1] All performance data from www.nareit.com. Accessed on 8 August 2016

[2] All performance data from FTSE EPRA/NAREIT Indexes, Bloomberg L.P. Accessed on 8 August 2016

[3] All performance data from Bloomberg L.P. Accessed on 8 August 2016

[4] Bloomberg Commodity Index (BCOM) Tables & Charts – July 2016

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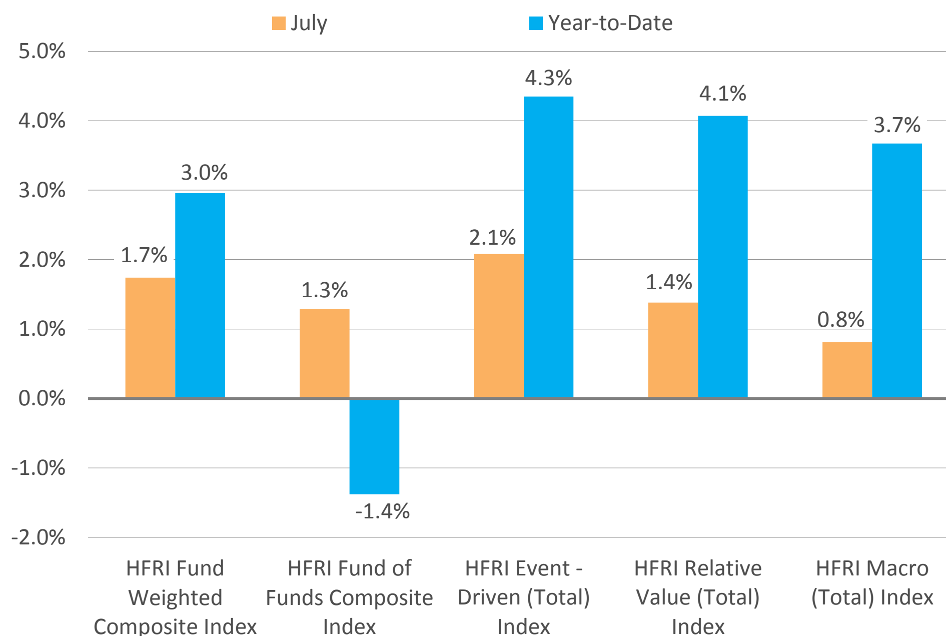
Diversifying Strategies

- The HFRI Fund Weighted Composite Index returned 1.7%. Performance was broadly positive among strategy sub-indices, with gains from relative value, event-driven, and global macro managers.
- The HFRI Event-Driven (Total) Index returned 2.1%. Event-driven sub-strategy returns were positive as each index generated gains for the month. Activist, distressed debt, and special situations managers were the top performers, benefitting from the broad rally in risk assets. The HFRI ED: Activist Index was the top performing event-driven sub-index, returning 3.4%, followed by the HFRI ED: Distressed/ Restructuring Index and the HFRI ED: Special Situations Index, which returned 2.6% and 2.3%, respectively.
- The HFRI Relative Value (Total) Index returned 1.4%. Each relative value sub-strategy was also positive for the month, with returns generally in the 1-2% range. The strongest performing sub-index was the HFRI RV: Fixed Income – Corporate Index, which returned 1.9%. The HFRI RV: Volatility Index returned 1.6%, and the HFRI RV: Yield Alternatives Index and the HFRI RV: Multi-Strategy Index each returned 1.5%.
- The HFRI Macro (Total) Index returned 0.8% and performance was positive across macro sub-indices, with the exception of commodity traders. Certain commodity markets, such as crude oil, endured sharp declines creating headwinds for the HFRI Macro: Commodity Index, which returned 1.7%. Systematic traders outperformed discretionary managers. The HFRI Macro: Systematic Diversified Index returned 1.2%, while the HFRI Macro: Discretionary Thematic Index ended the month flat.



Data source: HedgeFund Research

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Past performance is not indicative of future results.

Investments in private funds are speculative, involve a high degree of risk, and are designed for sophisticated investors.

All data is as of July 31, 2016 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.

J.P. Morgan's Global Index Research group produces proprietary index products that track emerging markets, government debt, and corporate debt asset classes. Some of these indices include the JPMorgan Emerging Market Bond Plus Index, JPMorgan Emerging Market Local Plus Index, JPMorgan Global Bond Non-US Index and JPMorgan Global Bond Non-US Index. See www.jpmorgan.com for more information.

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.