Fund Evaluation Group®
investment advisors

RESEARCH REVIEW

SECOND QUARTER 2016

INSIDE THIS ISSUE

Market Commentary: Britain's Vote for Independence

MICHAEL J. OYSTER, CFA **Managing Principal / Portfolio Strategist**

For several previous quarters, we have described the omnipresent influence of central bankers around the world. Their words and actions have overwhelmed market fundamentals through the depression of interest rates, which has, in turn, pushed investors to take more risk in pursuit of return.

Although central bank influence remains prominent and is expected to continue for the foreseeable future, the attention of markets was briefly and violently ripped away from monetary policy in late June when the new market focus became the unexpected decision by the people of the United Kingdom (U.K.) to leave the European Union (EU) in the so-called “Brexit” event.

Polls leading up to the vote showed that the race was tight, but the “stay” camp was confident in evidence suggesting that—based upon two prior U.K. referenda—the status quo was understated by approximately 3 percentage points.[1] The unexpected decision to leave immediately roiled markets, as the world was forced to accept the forthcoming unchartered territory.

The primary source of post-Brexit volatility reflects expectations that the country’s choice to leave the EU will slow economic growth in the U.K. and beyond. Expectations are that trade will lessen now that it hinges on the negotiation of new deals or investment; corporate activity also seems likely to dampen until the implications of the vote are more clearly realized.

Confirming the fears touted by those who promoted a "stay" vote, major ratings agencies downgraded the U.K. with a negative outlook based on increased uncertainty. On June 27, S&P Global Ratings lowered its unsolicited long-term foreign and local currency sovereign credit ratings on the United Kingdom to 'AA' from 'AAA.' Some of the rationale for this change provided by S&P summarizes the basis for the market volatility immediately following the vote.

> *"The downgrade reflects our view that the "leave" result in the U.K.'s referendum on the country's EU membership ("Brexit") will weaken the predictability, stability, and effectiveness of policymaking in the U.K. and affect its economy, GDP growth, and fiscal and external balances… The Brexit result could lead to a deterioration of the U.K.'s economic performance, including its large financial services sector, which is a major contributor to employment and public receipts."* [2]

And then shockingly, S&P continued with,

> *"Brexit could also, over time, diminish sterling's role as a global reserve currency."*

S&P added that it is a possibility that the rating could be lowered further if the identified inhibitors to growth actually come to pass or continue to deteriorate.

The 5.3% loss in the S&P 500 over the two days following Brexit was more negative than 99.8% of all two-day periods since the end of World War II.[3] The British pound fell approximately 10% almost immediately after the vote. The reality of diminished purchasing power on the world stage due to a weaker currency, the potential that business could leave the U.K., the unknowable outcomes in travel and immigration, the potentially higher costs of doing business, the possibility that Scotland or Northern Ireland could leave the U.K. in order to remain part of the EU, and prime minister David Cameron's immediate resignation shocked the British citizenry. In fact, it is possible that many people may not have even known what exactly they were voting for; Google Trends reported that "what is the EU?" was the second-most asked question in the U.K. in the waning hours after the results of the vote were announced.[4]

After the initial two-trading-day reaction, markets stabilized. Stock prices around the world found some footing, albeit at levels below those at pre-vote, and the pound stemmed its slide. Reasons for this likely included an appreciation that the future may not be as dire as feared and, in a particularly odd turn of events, the growing possibility that the U.K. might not leave the EU after all.

Although members of the U.K. parliament and outgoing prime minister Cameron have indicated that the will of the people will be carried out, the actual vote was an "advisory," non-binding referendum. By the strict letter of the law, the prime minister is under no legal obligation to carry out the referendum. If in the process of finding Cameron's replacement, a group emerges that is supportive of the idea of staying in the EU, the new prime minister may feel empowered reverse the departure, or at the very least, offer the public a second referendum that could have a different outcome.

Furthermore, Scotland's Prime Minister, Nicola Sturgeon, recently indicated that a second independence vote is possible and has requested talks with the EU about separate membership.[5] Some have postulated that Scotland could retain the spot within the EU vacated by the broader U.K. When faced with the idea of a weaker U.K. upon Scotland's departure, British citizens—already stinging from the prospects of constrained growth and potential flight of business and capital—may feel enough "Regrexit" to prompt a reversal of the decision to depart.

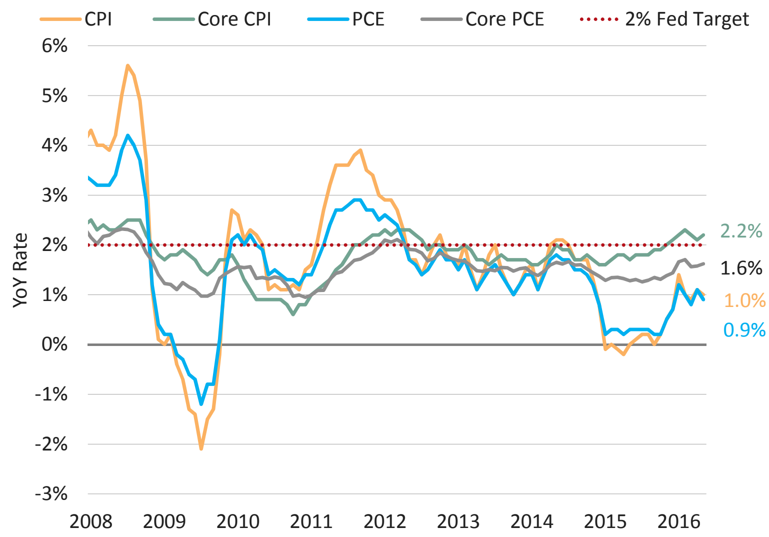
One final point is a bit of perspective from London-based investment firm Toscafund Asset Management, who, in a recent letter, cited similarities between Brexit and the U.K.'s exit from the European Exchange Rate Mechanism (ERM) in 1992. Toscafund indicated that in similar fashion to the post-Brexit decline, the pound initially declined after the U.K. left the ERM; however, subsequent GDP growth and stock market performance was strong. They suggested that the economy in the U.K. today is stronger and more capable of handling adversity than in the past, and that despite a somewhat cloudy road ahead, the Brexit vote will almost certainly not bring international trade to a halt. Businesses will adapt and the financial markets will remain open and functioning. After the initial shock of the unexpected result passes—and in many respects the shock had waned by the end of the second quarter—markets should simply absorb the new information and move forward.

Investors concerned about the primary and secondary implications of an impending departure of the U.K. from the EU have been keeping an eye on the impact on currencies and interest rates. When markets are faced with the type of uncertainty that followed the Brexit vote, they tend to seek perceived storehouses of safety. Primary beneficiaries of the British pound's decline thus far are the U.S. dollar and the Japanese yen.

Expectations for further rate hikes from the U.S. Federal Reserve (Fed) were reduced after the Brexit vote. Bolstering the idea that the environment for interest rates in the U.S. is "lower for longer, and still longer" was the May jobs report, which was far weaker than expected. Only 38,000 new non-farm payroll jobs were added in May, versus the Bloomberg consensus estimate of 160,000. The 38,000 payrolls print was the weakest reading since September 2010.[6]

Until signs of inflation appear, no meaningful increase in interest rates in the U.S. is expected, and inflation today can be described as tepid at best. Despite a current unemployment rate below the Fed's target of 5%, most inflation measures remain stubbornly under the Fed's stated target of 2%.

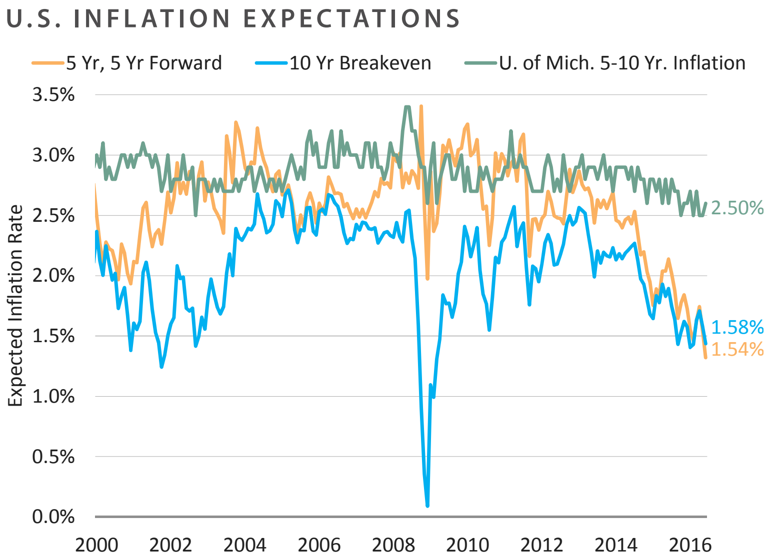
KEY U.S. REALIZED INFLATION GUAGES



Data sources: BLS, BEA, Bloomberg, L.P.; data as of May 2016

In contrast to Fed-stated goals, the market's expectations for the future trajectory of inflation is actually one of continued decline.

Both the probability of a reduction in the Fed funds rate and an additional round of stimulus seem low; however, neither does FEG believe that interest rates will move substantially higher from current levels. In the absence of a surprising jump in economic growth—a possibility that has become even less likely post Brexit—or an unexpected upward trend in wage pressures or the employment picture in general, the currently low interest rate environment appears to be in place for the foreseeable future.



Data sources: Bloomberg, L.P., University of Michigan; data as of May 2016

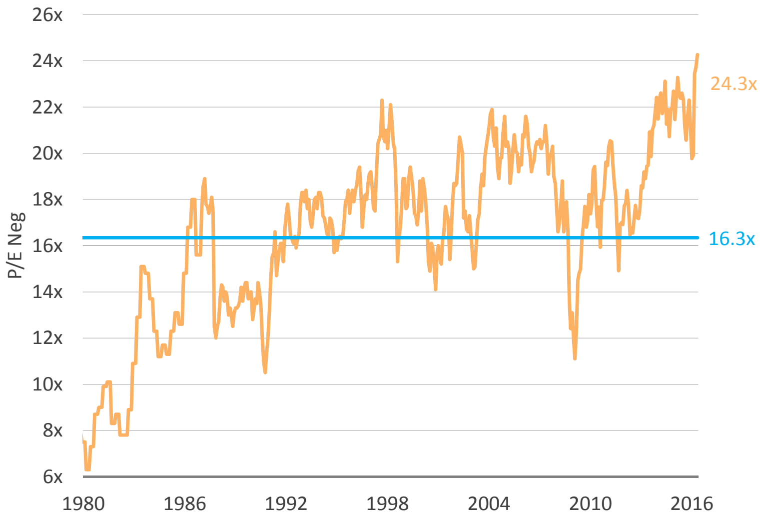
Equities

After trailing their growth counterparts in many recent quarters, U.S. value equities generally outperformed in the second quarter. Although it has not been the case of late, historically, value stocks have outperformed growth stocks over time. Given the magnitude and duration of value's underperformance in recent years, an eventual turn in the cycle was inevitable. We continue to believe in the long-term merits of value equity investing and we expect additional periods of outperformance in the future.

Another important story of the second quarter was emerging markets stocks, which after two positive quarters in a row have posted a mid-single-digit return so far this year outpacing stocks in the developed world. Given the attractive valuations on an absolute and relative basis, and having recently posted some favorable near-term price momentum, the outlook has become that much more encouraging.

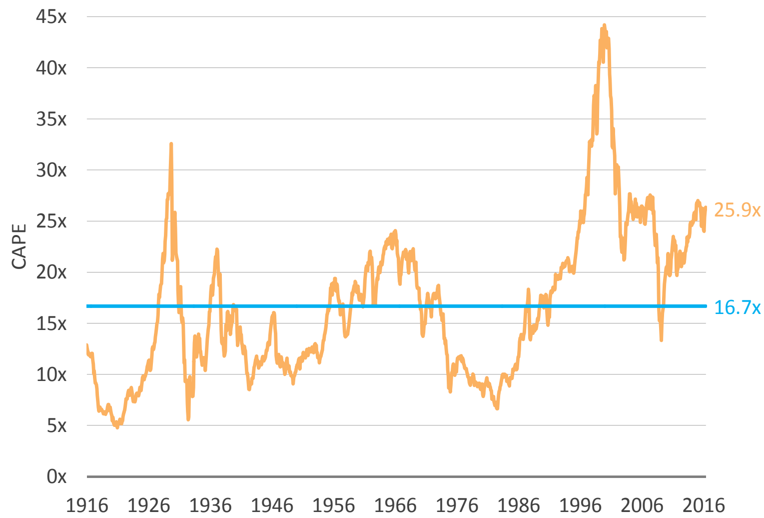
Importantly, recent returns from both domestic and international equities have not matched the strong returns observed since bottoming in early 2009. The torrid pace of global equity market ascension in the years following the depths of the financial crisis has waned in the absence of the Fed's bond-buying quantitative easing (QE) program.

RUSSELL 2000 P/E (EX-NEG EARNINGS)



Data sources: Russell, Bloomberg, L.P.; data as of May 2016

U.S. SHILLER P/E 10 (CAPE, REAL)



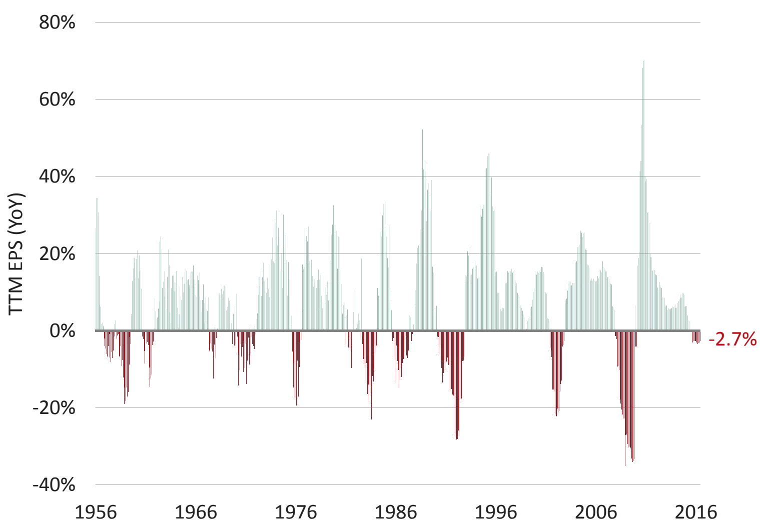
Data sources: Robert Shiller and S&P; data as of June 2016

When considering the prospects for future returns from equities, one obvious factor is that valuation metrics have become stretched to heights seen only rarely in history. The price/earnings multiple on U.S. small cap equities (as measured by the Russell 2000), for example, are at the highest levels in history, exceeding even those posted in the late 1990s.

Although below only the stratospheric levels of the late-1990s technology bubble, large cap stocks in the U.S. are also trading at elevated multiples and are in the highest 10% in history.

Valuation metrics provide great insight into long-term return potential. When considering how expensive U.S. equities are today in an environment that is devoid of QE combined with a downward trend in earnings, an objective projection for future returns should be below historical averages. FEG's capital market expectation for large cap U.S. equities, in fact, is 5% annualized over the course of the next decade.

S&P 500 INDEX EARNINGS PER SHARE GROWTH



Data source: Bloomberg, L.P.; data as of June 2016

If, as expected, long-only equity markets in the U.S. post below-average in the years to come, investors will require that their return goals be met by alternate means. For those with the requisite level of sophistication and capacity to give up liquidity, private equity may serve as one potential solution.

Although historical returns from private equity have outpaced their public market equivalents,[7] the current state of private equity can be described as "becoming mature." A heightened amount of competition combined with elevated fundraising levels suggests that the return enhancement one might expect from private equity relative to public equity should fall at the lower end of the historical range. A variety of potential pitfalls threaten the naive investor who blindly enters new private equity commitments today.

That being said, opportunities to achieve outsized returns in private equity do exist. Manager selection in private equity is critical in all periods, but in an environment with increased competition and high purchase price multiples, selection becomes even more essential. Sector specialists with demonstrated expertise in a narrow part of the investment universe such as technology or biopharma may still find opportunities despite the maturity of the private equity universe in general. Such an environment may also favor managers raising smaller funds earlier in their tenure as opposed to managers with massive amounts of capital to deploy in a saturated part of the market.

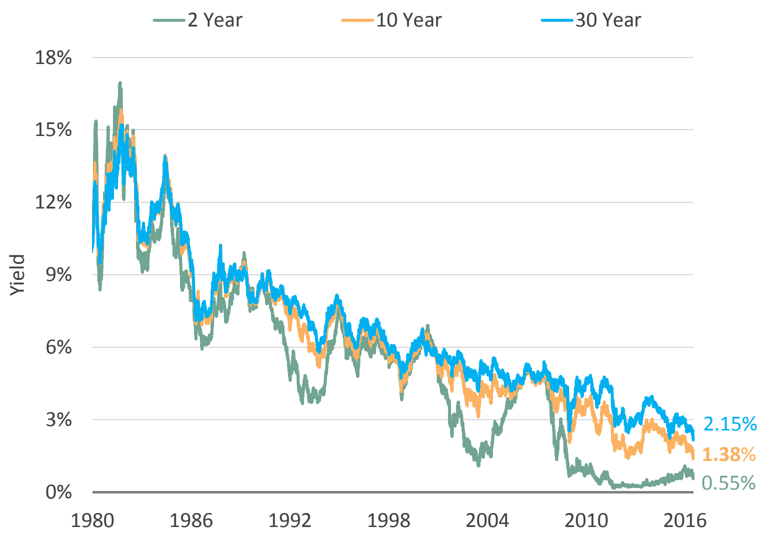
The state of both public and private equity is one that is largely devoid of simple buy-the-market "beta" opportunities as central bank intervention has driven multiples to historically high levels. As such, FEG believes that an investor's risk budget would be more fruitfully deployed by allocating it to manager risk rather than blindly allocating to market risk.

Fixed Income

Interest rates have been declining since then-chairman of the Federal Reserve, Paul Volker, pushed them to unprecedented heights as a means of stamping out inflation in the late 1970s and early 1980s. Since then, a gradual decline in rates has supported financial assets (stocks and bonds) with a duration tailwind the likes of which we may never see again.

Recently, central banks around the world have placed acute downward pressure on rates. At the end of the second quarter, central bank intervention had astoundingly moved rates in 13 countries into negative territory and the flight to safety following the Brexit announcement resulted in a decline in the yield on the 10-year U.S. Treasury bond to less than 1.5%.

U.S. NOMINAL TREASURY RATES

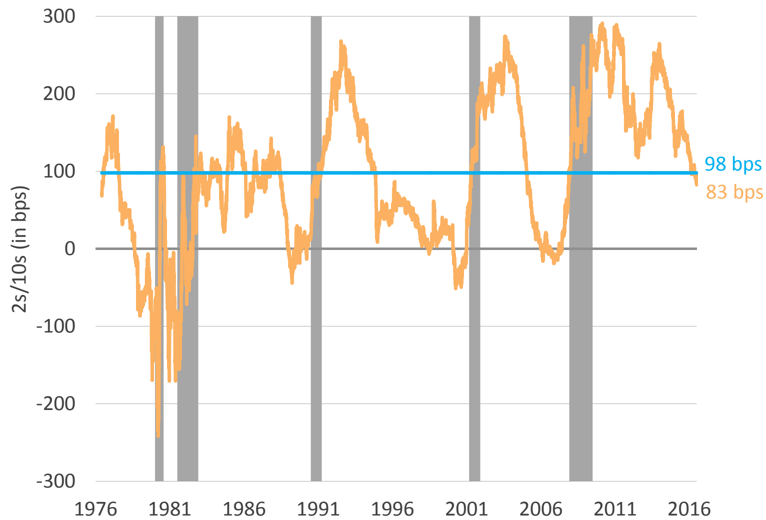


Data sources: Bloomberg, L.P., NBER; data as of June 5, 2016

In a normal environment, longer-dated Treasuries generally exhibit higher rates, offering investors compensation for duration risk relative to their shorter-term counterparts. However, there have been periods when short-term rates have exceeded the long-term, creating a so-called "inverted" yield curve. Such periods have often been harbingers of coming recessions—although not exclusively.

The spread between the long and short parts of the yield curve has narrowed and is closing in on inversion. Although not a perfect predictor, previous inversions have preceded recessions and the current environment is certainly not one of bounding economic growth. With few, if any, signs of inflation, growth remaining stubbornly slow both here and abroad, and the Fed leery of pushing the U.S. economy back into recession, the likelihood of near-term rate hikes seems miniscule at best.

U.S. YIELD CURVE AND BUSINESS CYCLES



Data sources: Bloomberg, L.P., NBER; data as of June 5, 2016
Note: Shaded areas represent recessionary periods

That said, FEG also does not expect yields to fall substantially further from current levels barring any Fed action to stave off the prospects of a deflationary spiral—the consequences of which would be disastrous. The U.S. economy is not as vigorous as some would prefer, but it is showing signs of growth. Thus, the risk of deflation is relatively low.

Where does this leave investors? In similar fashion to the equity markets that are offering few, if any, highly compelling broad-market-based opportunities—emerging markets equities being one exception—investors should seek active managers with a unique skill set that have the ability to add value in virtually any market environment. Truly differentiated private debt mandates, for example, can offer investors outsized returns and stable cash flow for those with the ability to access them and the willingness to sacrifice some measure of near-term liquidity.

FEG has helped clients access private debt managers with a focus on emerging markets. In similar fashion to our favorable view of emerging market equities, we believe a wealth of opportunities exist in emerging markets debt for managers with the demonstrated skill and expertise to extract them.

We also believe that specialized managers can find value in distressed opportunities in Europe. It was speculated that the required divestiture of European bank assets in an effort to shore up their balance sheets would result in a massive fire sale opportunity for distressed investing. Although the magnitude of that event has been lessened by the European Central Bank's bond-buying intervention designed to support the European economy, managers with the proper experience who are region insiders may still find access to attractive deal flow.

The past can serve as a helpful guide for investors, but given the current level of interest rates, the future of fixed income is likely to play out quite differently. A rising-rate environment makes fixed income investing more difficult; and more importantly, the absence of future rate declines may uncover risks that had been masked by the decades-long tailwind. Given the unpredictable, yet influential nature of central banks, FEG believes that current duration risk would be borne without adequate compensation. Although not without substantial shortcomings, a focus on manager risk rather than market risk is the prudent course of action in the current fixed income environment.

Real Assets

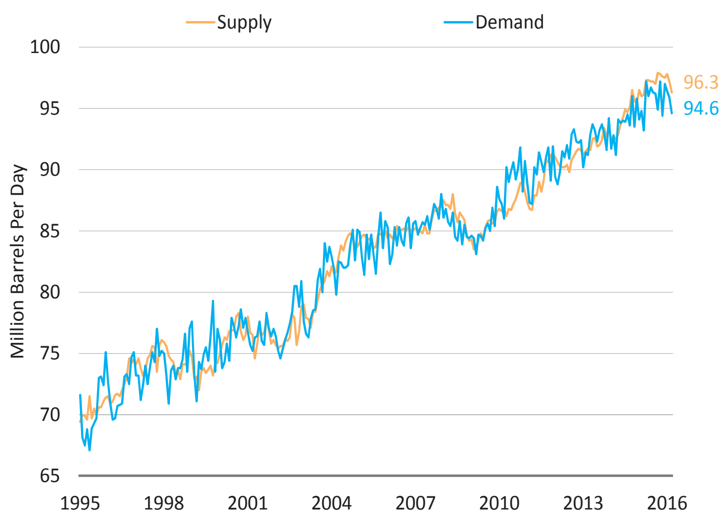
In February of this year, the nearly two-year collapse in oil finally came to an end with prices in the mid-$20s. At the time, dire predictions of $10 oil were not terribly uncommon, but production cuts, a lower rig count, and continually growing demand chipped away at the oversupplied market.

U.S. crude production peaked at 9.6 million barrels per day on June 5, 2015 and has since declined to 8.6 million barrels per day as of June 24, 2016. Also as of June 24, the oil rig count dropped to 330, potentially bottoming out at levels just above those reached in the depths of the financial crisis.

Since the early days of 2016, oil prices have recovered and are now actually exhibiting a modicum of positive momentum. This is not to say that FEG has a bullish outlook on commodities in general and oil in particular, as the possibility exists that production that has been reigned in could be resumed likely resulting in few, if any, sustained price rallies. In the absence of global economic demand—the problem central bankers are battling so fiercely with unconventional monetary policy—protracted advances in commodity prices seem unlikely.

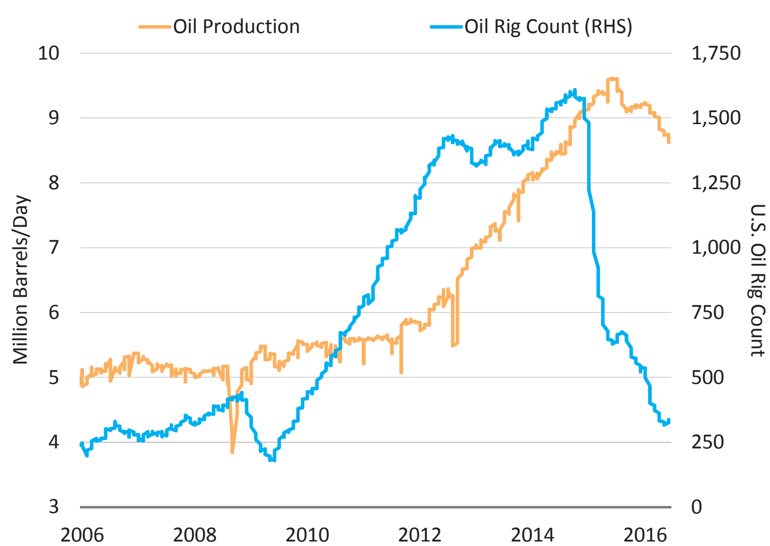
FEG also does not believe that there is a renewed plunge back below $30 in oil's future. The glut of supply has been stemmed; and demand, although not growing at the previous pace, remains upward trending. This dynamic is important for MLPs, which we believe do not necessarily need oil prices to move higher to benefit their own returns, just simply avoid another crashing decline.

TOTAL WORLD OIL SUPPLY AND DEMAND



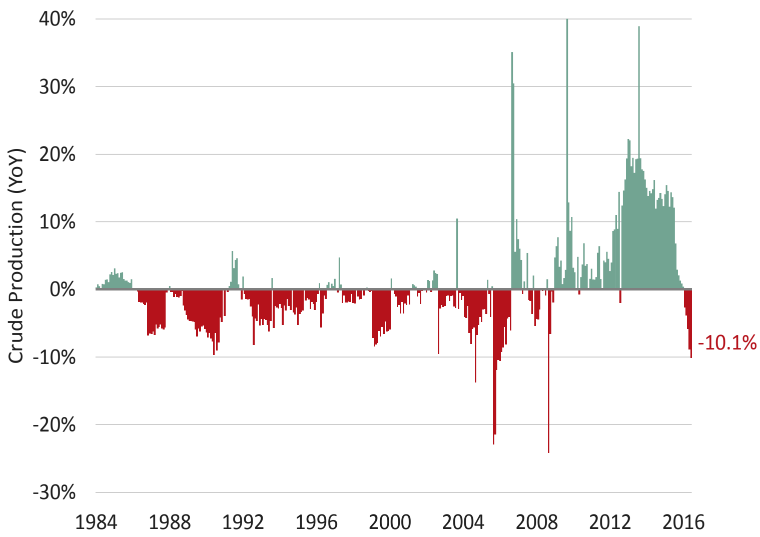
Data sources: Energy Intelligence Group, Bloomberg, L.P.; data as of May 2016

U.S. OIL RIG COUNT & U.S. OIL PRODUCTION



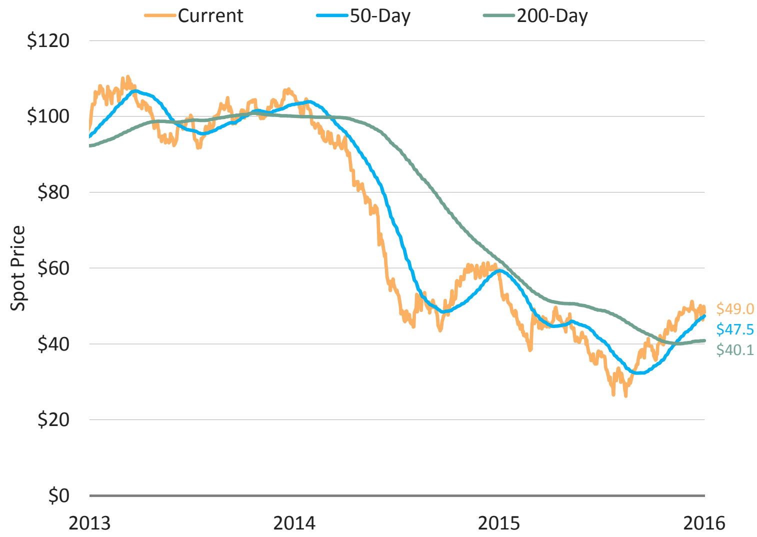
Data sources: U.S. DOE, EIA, Baker Huges, Bloomberg, L.P.; data as of May 24, 2016

U.S. CRUDE OIL PRODUCTION GROWTH (YoY)



Data sources: EIA, Bloomberg, L.P.; data as of June 2016

CRUDE OIL (WTI) WITH MOVING AVERAGES



Data source: Bloomberg, L.P.; data as of July 1, 2016

MLPs offer one of the few opportunities where we believe risk is justified by expected return. After declining in lockstep with oil since mid-to-late 2014, MLP valuations began appearing particularly attractive in late 2015 and remain so today. Yield spreads relative to U.S. Treasuries are nearly as wide as they have ever been; and following oil's price bottoming earlier this year, MLP momentum has started to exhibit a more favorable profile. As such, FEG believes that MLPs are among the more attractive investment opportunities available today.

The three months ending June 2016 were highly favorable for investors holding real assets. In addition to MLPs (Alerian MLP Index +19.7%) and commodities (Bloomberg Commodity Index +12.8%), domestic REITs (FTSE NAREIT All Equity Index +7.4%) posted one of the strongest returns of any investment category during the second quarter of 2016. The outlook for REITs contrasts positive recent price momentum and a yield component that may prove attractive if rates remain as low against valuations that have become stretched.

Although FEG's outlook on REITs is neutral, we continue to believe opportunities in private real estate can be found that may help investors achieve the returns they seek.

Over the past six years, FEG has helped clients access private real estate managers across different property types, geographies, and cap structures—a combination of debt and equity. In addition to the traditional real estate sectors (apartments, retail, office, etc.), FEG has advocated increasing exposure to niche areas like data centers, senior living, student housing, and even Native American gaming.

We recognize that in this environment, many investors have begun to view subsets of real estate (core for example) as a "fixed income substitute." Importantly (and obviously), the risks associated with real estate and fixed income should not be viewed synonymously. While considering the risks, FEG believes that a variety of opportunities in private real estate exist for investors with the capability and willingness to enter into the long-dated private capital structure with limited liquidity. However, the ability to do so does not guarantee success. The differences between the successful and ineffective private real estate investment opportunities have been and are expected to be vast, making manager selection critical to investor success.

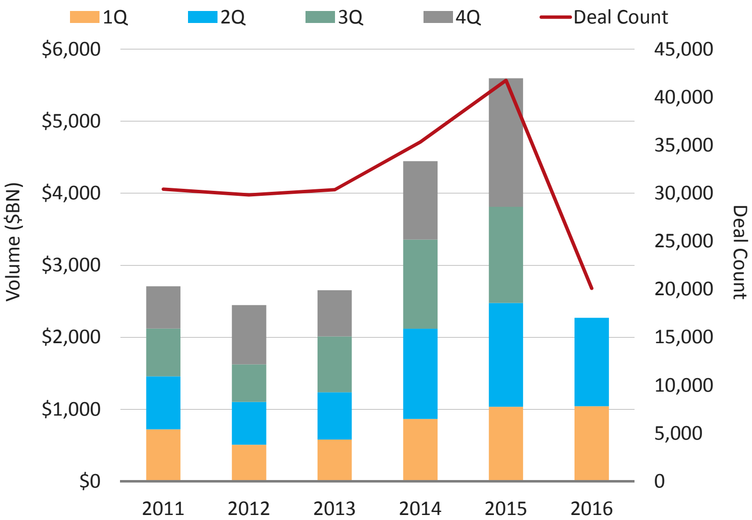
Diversifying Strategies

Few truly attractive investment opportunities exist in traditional areas of the marketplace, but there are currently two particularly interesting strategies within diversifying strategies.

MERGER ARBITRAGE

Merger and acquisition (M&A) activity has ballooned in recent years, which opens a wealth of opportunities for managers who have a demonstrated ability to assess risks and capitalize on them. In an active M&A environment, managers have the luxury of deploying capital more selectively than they might during slower times. Additionally, the risk that excessive amounts of capital will overwhelm opportunities, dilute returns, and ultimately crowd out even the most accomplished experts is lower when M&A activity is high.

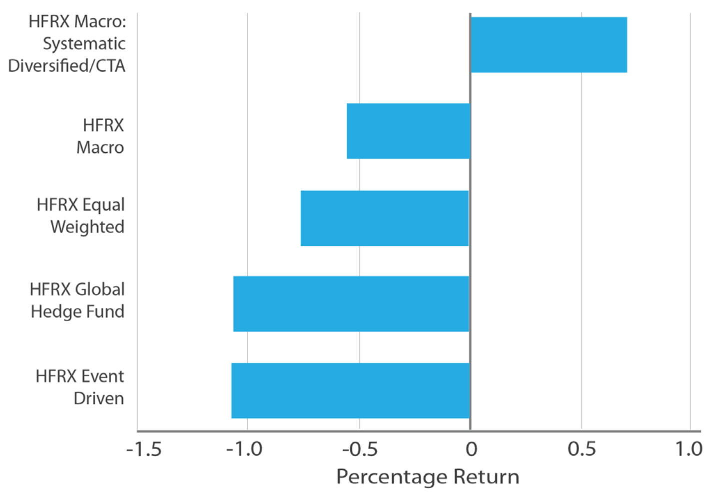
GLOBAL M&A VOLUME



Data source: Bloomberg, L.P.; data as of May 2016

MANAGING THE BREXIT TURMOIL

Percentage returns on June 24



Data source: Bloomberg, L.P. HFR hedge fund indexes

GLOBAL MACRO

One of the more appealing aspects of global macro strategies is the uniqueness of their risk profile, making them generally uncorrelated to traditional equity and fixed income mandates—a particularly useful characteristic during periods of market stress. In 2008, for example, macro strategies represented one of the few non-U.S. Treasury bond investments that posted positive returns.[8]

More recently, as the initial shock following the Brexit vote staggered equity markets around the world, many diversifying strategies mandates held up well by comparison—some even posted positive returns. The graph from Bloomberg illustrates the performance of various types of diversifying strategies on June 24, the day after the Brexit vote result was announced. Note: the S&P 500 lost 3.5% that day.

Diversifying strategies serve a critical role in broad-based investment portfolios during volatile periods marked by uncertainty. With the ability to provide mitigation of loss when other asset categories fall under duress, diversifying strategies should remain a key component within investment portfolios for the foreseeable future. FEG believes that a focus on managers with a demonstrated ability in the merger arbitrage and global macro areas are particularly opportune at present.

Conclusion

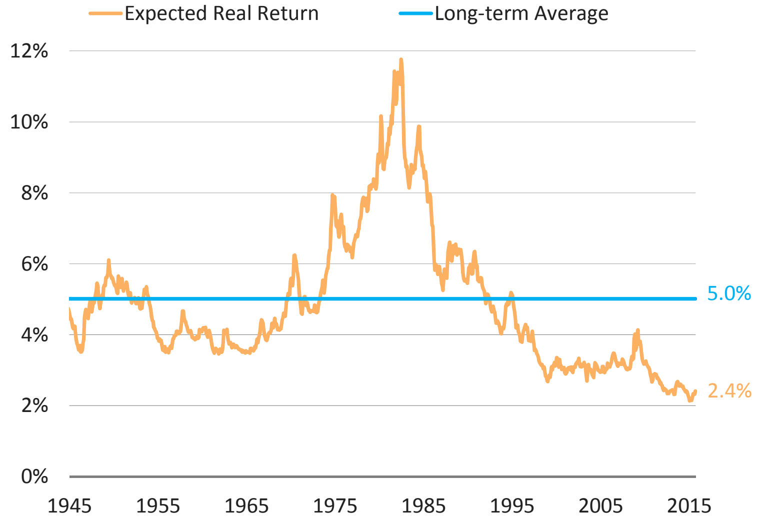
Central bankers around the world are engaged in a battle against stubbornly slow growth, tepid demand, and limited capital investment. Conventional monetary policy has been largely exhausted with interest rates at or below the zero bound in most of the developed world, which have been exacerbated by fears of what will follow Brexit.

Renowned author and researcher Peter Bernstein once said that the market is not a very accommodating machine; it will not provide high returns just because you need them. That is certainly true, but it must also be recognized that investor performance needs do not disappear just because expected market returns are low.

With a realistic perspective, however, we must recognize that the expected return of a traditional mix of long-only U.S. equities and core bonds over the subsequent decade is lower today than it has ever been.

In the years to come, investors who achieve their performance goals are likely to be those who maximize their illiquidity premium, access unique strategies with limited-capacity managers, allocate to assets with attractive valuations, deploy capital into the teeth of volatility, reach globally, diversify by sources of risk, and avoid behavioral errors by making decisions based upon fundamental principles rather than burning emotions. In a world that is almost exclusively manipulated by unconventional monetary policies, current investors must apply a thoughtful and strategic approach that defies convention and expands beyond the traditional.

EXPECTED REAL RETURN OF A HYPOTHETICAL U.S. 60/40 STOCK/BOND PORTFOLIO



*Data source: Robert Shiller and Standard & Poor's, adapted from AQR. U.S. stocks expected real return calculated from 50% of the earnings yield*1.0107 plus 50% dividend yield + 1.5% to account for real earnings growth. U.S. bond yield is the government rate - FEG's 10-year inflation forecast. Investments cannot be made directly in an index. Past performance is not indicative of future results. Please see appendix for full disclosure. Data as of December 31, 2015*

FOOTNOTES

1. BCA Research, *European Investment Strategy*, "Brexit: The final days, part 1," June 16, 2016.
2. S&P Global Ratings, ZeroHedge.com, June 27, 2016.
3. Bloomberg, L.P.
4. Alina Selyukh, NPR.com, "After Brexit vote, Britain asks Google: 'What is the EU?'" June 24, 2016.
5. Severin Carrell, Scotland Editor and Libby Brooks, *The Guardian*, "Nicola Sturgeon: second Scottish independence poll highly likely," June 24, 2016.
6. Bureau of labor statistics. BLS.gov
7. Robert S. Harris, Tim Jenkinson, and Steven N. Kaplan, "How Do Private Equity Investments Perform Compared to Public Equity?", April 8, 2015.
8. HedgeFund Research. The HFRI Macro Total Index advanced 11.1% in 2008.

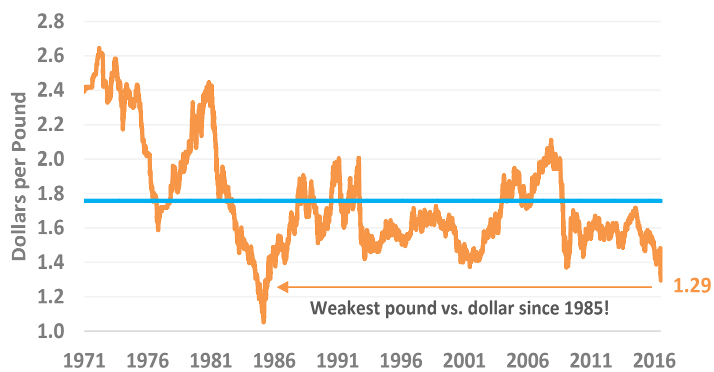
Economic Update

Great Britain Votes to Leave the European Union

The recent Brexit vote has certainly created some choppy political and financial waves. On June 23, 2016, 52% of U.K. voters chose to leave the European Union (EU), setting the stage for an ugly, messy, and uncertain divorce. In the weeks leading up to the referendum, polls were largely in the "remain" camp's favor, which gave a transitory tailwind to risky asset prices. After the historic vote, following a victory for the "leavers," risky asset prices—particularly international equities—witnessed an increase in downside volatility. On the other end of the risk spectrum, high-quality sovereign bonds, for one, benefited directly from the flight-to-quality ethos that gripped the market in the referendum's aftermath.

And of course, the British pound (GBP) slumped. In fact, after mainly weakening versus the U.S. dollar (USD) from late 2014 until June 23, 2016, the GBP declined even further post-Brexit by order of more than 10% on a spot price basis. As of early July, it was at its weakest versus the USD since 1985.

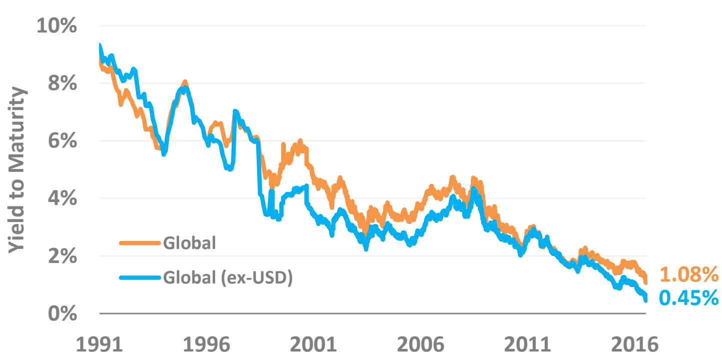
BRITISH POUND SPOT PRICE



Data source: Bloomberg, L.P.; data as of July 7, 2016

The full effects of Great Britain's desire to leave the EU will likely take multiple years to materialize, as the country must now invoke Article 50 of the Lisbon Treaty before formally exiting. Brexit may not pose an immediate risk to investment markets. However, there is talk that Scotland and Northern Ireland may follow with exit referendums of their own. The political turmoil and potential dissolution of the EU is a risk that investors should respect. The global fixed income market seems to be appreciating this possible destabilizing factor, as high-quality bond yields continue to move lower (see chart), while global equity markets do not seem overly concerned at the present time.

BARCLAYS GLOBAL AGGREGATE BOND YIELDS



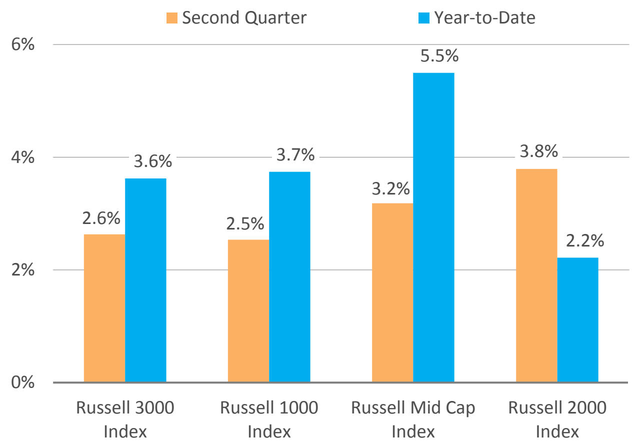
Data sources: Barclays, Bloomberg, L.P.; data as of July 7, 2016

Global Equity

U.S. Equity

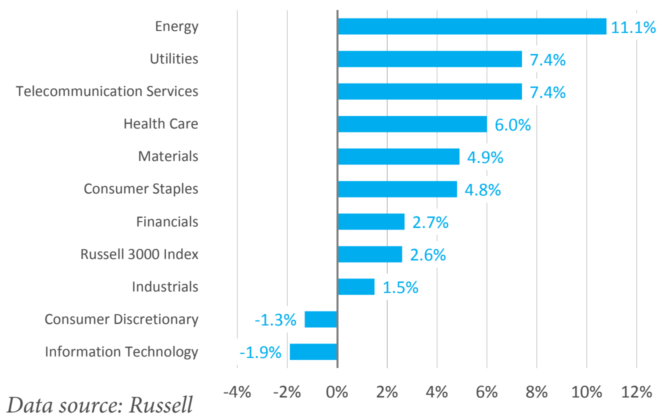
- The U.S. stock market, represented by the Russell 3000 Index, gained 2.6% in the second quarter. Stocks initially dropped sharply after the Brexit vote, but a strong bounce-back erased most of those losses.
- Small cap stocks (+3.8%) continued to rally, followed by mid (+3.2%) and large (+2.5%) stocks. Returns on small cap stocks are positive year-to-date (YTD) at 2.2%, but trail their larger cap peers. Mid cap stocks have been the best performing market capitalization YTD (+5.5%).
- Eight of the ten sectors posted gains in the second quarter. Rising oil prices fueled gains in the energy sector (+11.1%) as they continued to recover from last year's slide, while information technology (-1.9%) and consumer discretionary (-1.3%) stocks declined. The quarter was characterized by a flight-to-safety, as investor demand shifted into defensive sectors and safe-haven investments.
- Utilities and telecommunication services, historically the more defensive and interest rate-sensitive sectors, continue to be the best performers YTD, up 23.7% and 23.4%, respectively. Health care, financials, and information technology are the sectors that have posted negative returns YTD, down 1.4%, 1.1%, and 0.4%, respectively.
- Value stocks led growth stocks across market capitalizations in the second quarter. The outperformance of REITs, energy, utilities, and telecommunication services boosted value, while pharmaceuticals, biotechnology, software, and technology equipment were a drag on growth performance.
- Value has outperformed growth across all market capitalizations YTD, with the spread widest in the large cap universe (+4.6% vs. +0.6%).

RUSSELL INDICES PERFORMANCE



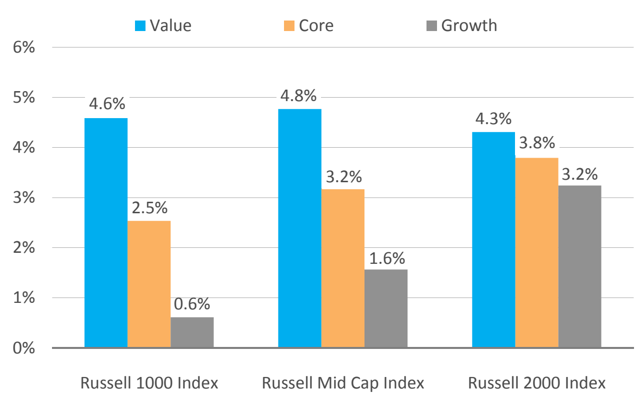
Data source: Russell

SECOND QUARTER RUSSELL 3000 SECTOR PERFORMANCE



Data source: Russell

SECOND QUARTER RUSSELL INDICES PERFORMANCE



Data source: Russell

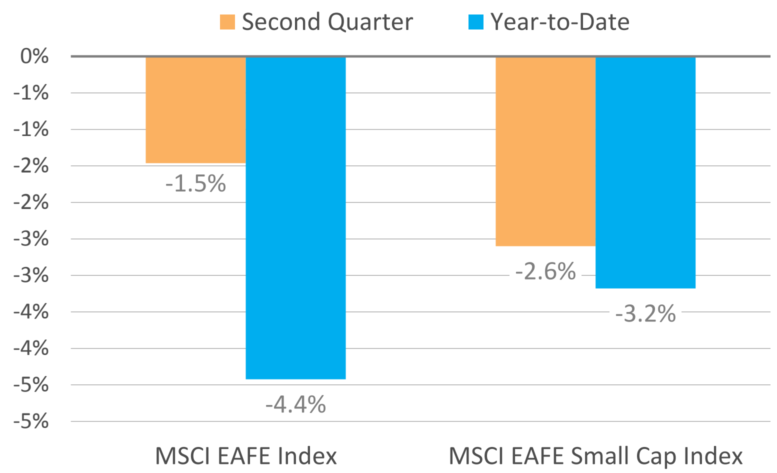
International Equity

All returns in local currency unless otherwise indicated.

INTERNATIONAL DEVELOPED MARKETS

- International developed equity markets declined in the second quarter (-0.7%). Currency fluctuations, however, had a negative impact on U.S. investors due to the dollar's rally against most other major currencies. Returns for U.S. investors dropped to -1.5% after adjusting for currency changes.
- The U.S. dollar appreciated most significantly against the British pound (+8.5%), Chinese renminbi (+3.1%), Australian dollar (+3.0%), and euro (+2.8%).
- International developed markets declined 7.2% YTD (-4.4% in U.S. dollar terms), trailing U.S., emerging, and frontier markets indices. Due to first quarter U.S. dollar depreciation, currency movements have had a positive impact on U.S. investors YTD.
- European stocks declined after British voters approved a ballot measure to leave the European Union, which raised questions about EU stability and the potential for an economic downturn. Markets, however, staged a strong rally in the final few days of the quarter, erasing some of the losses. Europe gained 1.2% in the quarter, but fell 2.7% for U.S. investors.
- Pacific markets also declined in local terms (-4.3%) but gained for U.S. investors (+0.9%). Japan was among the worst returning developed countries (-7.8%), declining amid a strengthening yen and a sluggish economy.
- Small cap stocks, as measured by the MSCI EAFE Small Cap Index, declined 1.6% (-2.6% in U.S. dollars) in the second quarter, underperforming large cap stocks and narrowing their outperformance lead YTD.

MSCI INDICES PERFORMANCE
Returns in U.S. Dollars



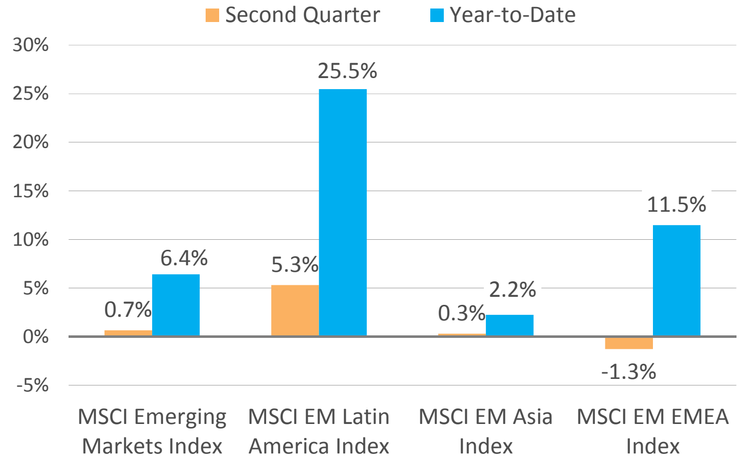
Data source: MSCI

EMERGING MARKETS

- Emerging markets, as measured by the MSCI Emerging Markets Index, outperformed developed international markets and gained 0.7% (also 0.7% in U.S. dollars). Emerging markets have gained 3.5% YTD (+6.4% in dollar terms), outperforming international developed markets and U.S. stocks.

- Brazilian equities were strong in the second quarter, increasing their YTD gain (+18.5%) as President Dilma Rousseff was suspended from office due to allegations she disguised a budget deficit. Peru also gained significantly (+18.2%), helping to bolster returns for the Latin American region (+14.2%).
- Asian emerging market stocks had a slight gain (+1.0% in local currency), but currency impact flattened that gain for U.S. investors (+0.3% in U.S. dollars). India (+5.7%) propped up the broader region returns, helped by favorable quarterly earnings at a number of companies.
- European emerging market countries were down in the quarter except for Russia, which gained +0.3%.
- The impact of currency fluctuations was neutral for U.S.-based investors for the quarter. The most notable moves were U.S. dollar depreciation against the Brazilian real (-10.6%) and the Russian ruble (-4.9%), which were offset by dollar gains against other currencies.

MSCI INDICES PERFORMANCE
Returns in U.S. Dollars

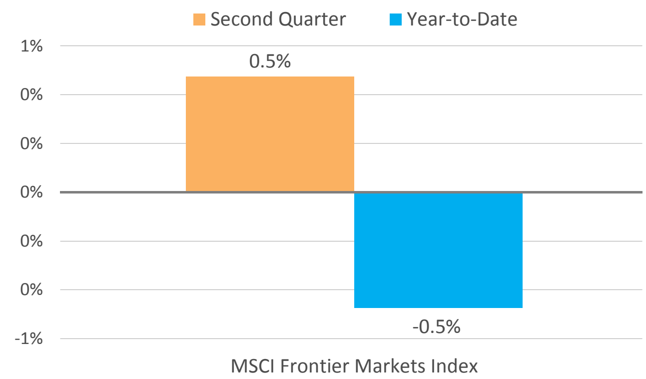


Data source: MSCI

FRONTIER MARKETS

- Frontier markets gained 4.8% in the quarter (+0.5% in U.S. dollars), bringing the YTD performance to 2.9%. Currency fluctuations impacted U.S. investors negatively, flipping the YTD gain in local currency to a loss of 0.5% in U.S. dollar terms.
- Asia (+11.9%), Africa (+10.4%), and Latin America (+7.4%) were the strongest performing regions. Nigerian markets gained 25.4%, followed by gains in Pakistan (+14.4%) and Vietnam (+11.0%). Performance in Argentina has been notable YTD, up 16.4%, driven by continued political reform.

MSCI INDICES PERFORMANCE
Returns in U.S. Dollars

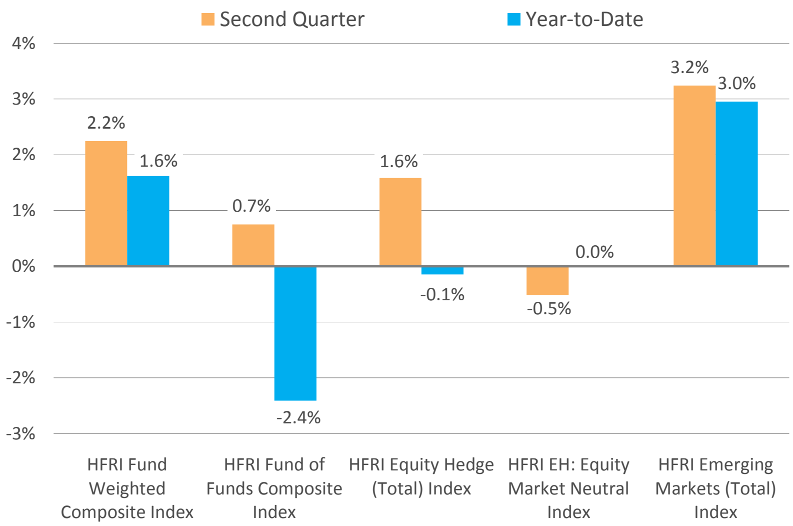


Data source: MSCI

Hedged Equity

- Following a challenging first quarter, YTD performance turned positive for the HFRI Equity Hedge (Total) Index in May before giving back gains in June. The index's 1.6% second quarter return brought YTD performance to -0.1%. The long-only S&P 500 Index and the MSCI ACWI Index returned 2.5% and 1.0%, bringing YTD performance to 3.8% and 1.2%, respectively. Hedged equity managers continue to recover from a challenging start of the year. Gross and net exposures generally remained below average across managers, particularly in Europe, helping insulate performance from the volatility that followed the U.K.'s decision to leave the EU.
- Hedged equity sub-index returns were generally positive, with the exception of the HFRI EH: Equity Market Neutral Index (-0.5%). Conversely, short biased managers generated positive alpha, illustrated by the 2.3% return of the HFRI EH: Short Bias Index.
- Fundamental-oriented managers outperformed quantitatively driven strategies. The HFRI EH: Fundamental Growth Index and the HFRI EH: Fundamental Value Index returned 1.8% and 1.0%, respectively, while the HFRI EH: Quantitative Directional Index returned only 0.2%.
- Sector specialists generated strong performance, continuing to benefit from the recovery in energy, materials, health care, and technology. The HFRI EH: Sector – Energy/Basic Materials Index returned 6.6% and the HFRI EH: Sector – Technology/Healthcare Index returned 4.2%.
- The broad HFRI Emerging Markets (Total) Index returned 3.2% with generally positive regional performance. The top-performing regional indices were the HFRI Emerging Markets: Latin America Index and the HFRI Emerging Markets: India Index, which gained 9.9% and 6.2%, respectively. The largest regional detractor was the HFRI Emerging Markets: MENA Index (-4.7%).

HFRI INDICES PERFORMANCE
Returns in U.S. Dollars

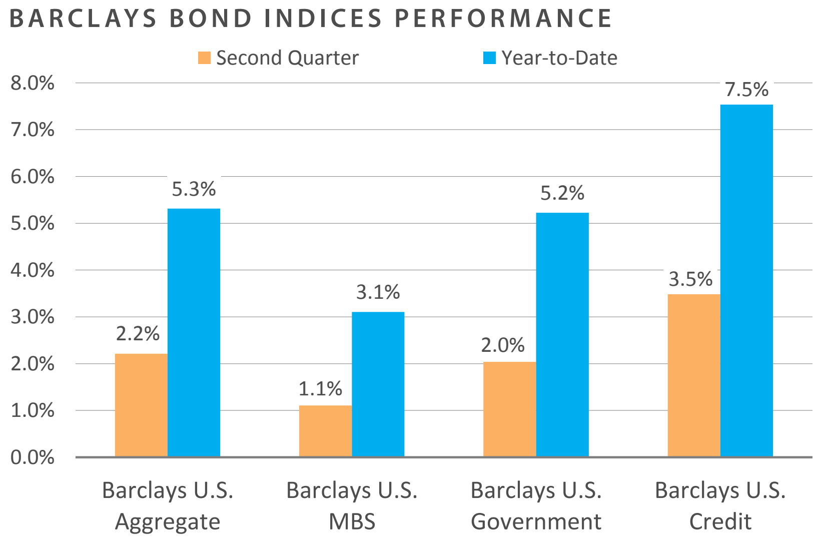


Data source: HedgeFund Research

Fixed Income

OVERVIEW

- The Barclays U.S. Aggregate Bond Index (BAGG) increased 2.2% during the second quarter. Agency mortgage-backed securities (MBS) returned 1.1%. U.S. government securities returned 2.0%, and investment-grade credit returned 3.5%.
- Investment-grade commercial mortgage-backed securities (CMBS), a smaller component of the BAGG, increased 2.2% during the quarter.
- Emerging market debt (EMD) local currency posted a gain of 0.3%, and dollar-denominated EMD increased 6.0%.



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

RATES

- The 2-year note yield decreased 14 basis points to 0.58%, the 10-year note yield decreased 30 basis points to 1.47%, and the 30-year bond yield decreased 33 basis points to 2.28%.
- Inflation expectations decreased during the quarter. The 10-year break-even rate of inflation decreased 19 basis points to 1.44% and concluded the month 56 basis points below the Fed's 2.0% target. The yield on the benchmark 10-year Treasury Inflation-Protected Securities (TIPS) moved 9 basis point lower to 0.05%, and the Barclays U.S. TIPS Index posted a gain of 2.1% during the quarter.

CREDIT

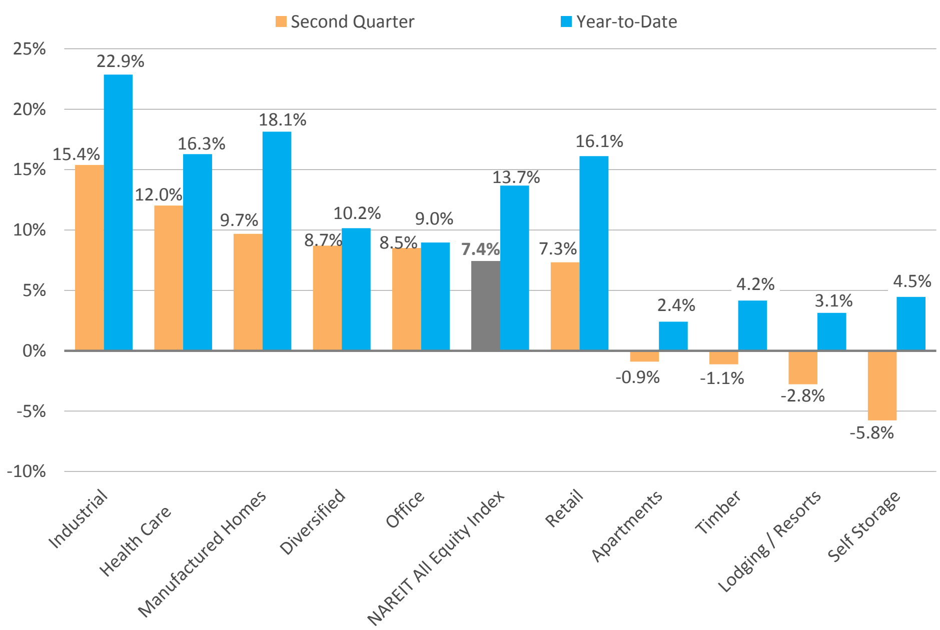
- Investment-grade corporate bonds increased 3.5%, with utilities being the best sector, up 4.5%. Industrials were up 4.0%, and financials gained 2.5%.
- Both fixed income risk sectors were up, with a 5.5% gain for the Barclays U.S. Corporate High Yield Index and 1.7% gain for bank loans.

Real Assets

DOMESTIC REITs

- Real estate investment trusts (REITs), as measured by the FTSE NAREIT All Equity Index, gained 7.4% in the second quarter. After the Brexit vote shook financial markets worldwide, the U.S.—and REITs specifically—were viewed as a safe haven for investors. Additionally, global financial uncertainty has drastically lowered the probability the Fed will hike rates in July or September, further benefiting the asset class.
- At the end of the second quarter, REITs' dividend yield stood at 3.6%, versus a yield of 1.5% for the 10-year Treasury.[1]
- Industrial REITs exhibited the strongest returns, up 15.4%, and have gained 22.9% YTD. High occupancy levels and relatively low amounts of new supply have positively impacted the sector's fundamentals. Additionally, consumer confidence remained at elevated levels, helping drive retail demand and, therefore, demand for industrial warehousing.
- Conversely, the self-storage sector declined 5.8%, but the sector is up 4.5% YTD. Sovran Self Storage was primarily responsible for the weakness in the quarter, declining -11.1%. Self-storage fundamentals remain strong, but investors could be concerned with Sovran's exposure to Texas (25% of NOI) and, more specifically, to Houston (11% of NOI), which may be impacted by lower oil prices.
- In terms of implied REIT capitalization rates, compression appears to have found a bottom. Implied REIT cap rates for all property types are either at or below their pre-financial crisis levels, and some have begun to expand in recent months. A significant reversal is not widely expected, but a bottoming of cap rates could be a sign of a peak in the real estate cycle.

FTSE NAREIT ALL EQUITY INDEX
Sector Returns – Second Quarter 2016

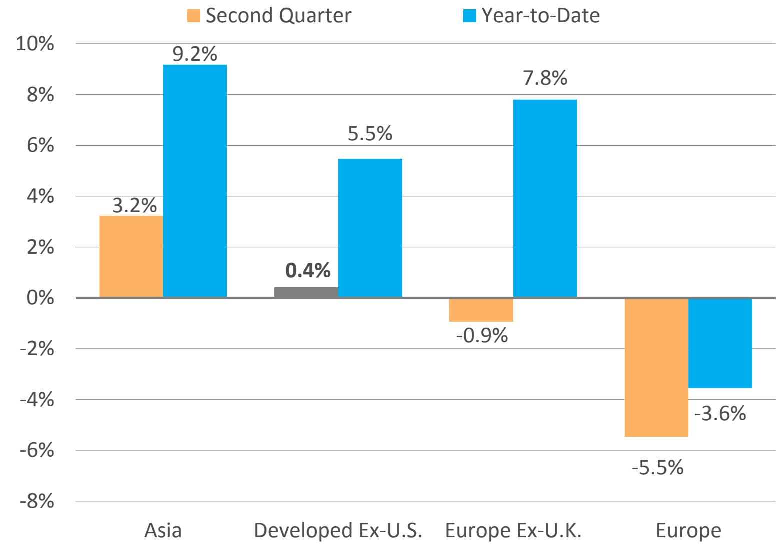


Data source: NAREIT

INTERNATIONAL REAL ESTATE SECURITIES

- International real estate securities, as measured by the FTSE EPRA/NAREIT Developed Ex-U.S. Total Return Index, gained 0.4% in U.S. dollar terms in the second quarter.[2]
- Uncertainty leading up to the Brexit vote had already increased volatility throughout the region during the second quarter. This was exacerbated following the vote to leave, sending European equities, the British pound, and bond yields sharply negative, all while spiking volatility across the region. The implications are witnessed in both the year-to-date and quarterly outperformance of the Europe Ex-U.K. index (-0.9% in Q2; +7.8% YTD) versus the broader European index (-5.5% in Q2; -3.6% YTD), which includes the U.K. While real estate valuations in the U.K. remained largely unchanged to end the quarter, transaction volume and pricing during the second half of 2016 could falter if sellers have trouble completing deals.
- Conversely, Asian property markets gained 3.2% and are up 9.2% YTD. Low or even negative interest rates throughout the region (and the world) have benefited Asian property markets this year. Investors chasing yield have driven a wealth of Asian domestic capital flow into the real estate market, positively impacting asset values.

FTSE EPRA / NAREIT DEVELOPED MARKET INDICES
Regional Returns (U.S. dollars) – Second Quarter 2016



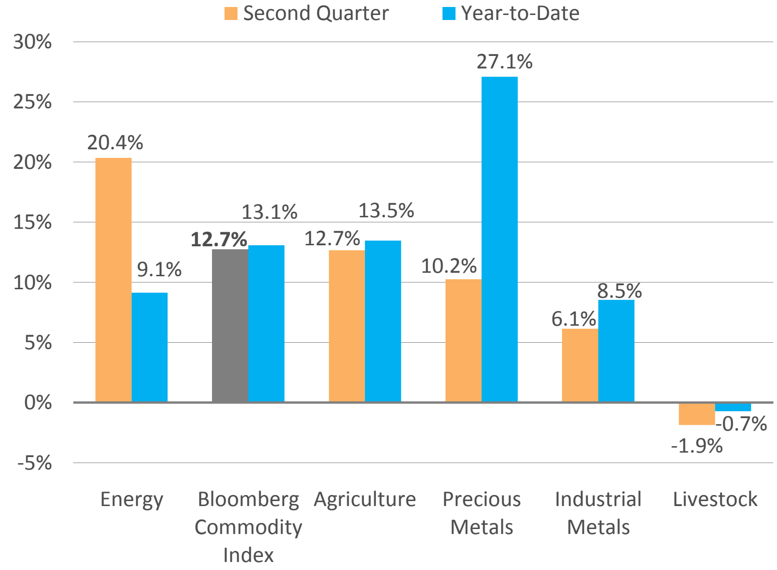
Data source: Bloomberg, L.P.

COMMODITIES

- Commodities, as measured by the Bloomberg Commodity Index (BCOM), increased 12.7% during the second quarter and gained 13.1% YTD. Rebalancing within commodities markets, most notably energy, and a slight retracement of the U.S. dollar positively impacted commodity futures prices.[3]
- The energy sector posted the strongest return, gaining 20.4%. Despite the turbulent global market, this sector posted its strongest quarterly gain in eight years, as natural gas (+30.1%) and WTI crude (+18.7%) futures moved sharply higher. Helping to balance the market are supply disruptions in Canada and Nigeria, resilient demand growth boosted by the start of summer driving season, and declining U.S. production.

- Precious metals gained 10.2% and were up 27.1% YTD. Gold, specifically, has benefited from Brexit, global economic uncertainty, and a weakening U.S. dollar, rallying 16.5% and 6.8% in the first and second quarters, respectively.
- Conversely, the livestock sector declined 1.9%. Beef production in the U.S. is on pace for the first annual production increase since 2010, and the glut of supply is negatively impacting futures prices for live cattle.[4]

BLOOMBERG COMMODITY INDEX
Sector Returns



Data source: Bloomberg, L.P.

MASTER LIMITED PARTNERSHIPS

- Master Limited Partnerships (MLPs), as measured by the Alerian MLP Index (AMZ), gained 17.4% during the second quarter. As of the end of June, MLPs' distribution yield stood at 7.1% versus a yield of 1.5% for the 10-year Treasury.[5]
- MLPs continued their strong performance off the lows of February, gaining 10%, 1.2%, and 5.3% in April, May, and June, respectively. Stabilizing commodity prices drove performance. In particular, there was significant strength in natural gas, which has led to improved investor sentiment and a modest positive reversal to fund flows.
- The biggest news in the MLP sector during the quarter was the events tied to the Energy Transfer Equity (ETE)/Williams (WMB) transaction. The Delaware Chancery Court effectively ruled on June 24 that ETE could terminate the merger under the terms of the agreement. While WMB has appealed, ETE officially announced a termination of the merger on June 29.

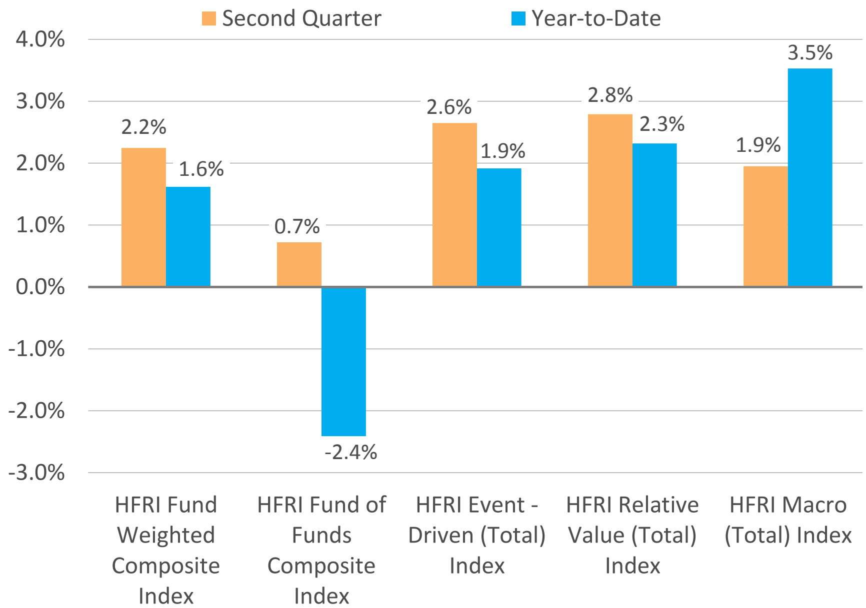
REAL ASSETS FOOTNOTES

1 All performance data from www.nareit.com. Accessed on 7 July 2016
2 All performance data from FTSE EPRA/NAREIT Indexes, Bloomberg L.P. Accessed on 8 July 2016
3 All performance data from Bloomberg L.P. Accessed on 6 July 2016
4 Bloomberg Commodity Index (BCOM) Tables & Charts – June 2016
5 All performance data from www.alerian.com. Accessed on 8 July 2016

Diversifying Strategies

- The HFRI Fund Weighted Composite Index returned 2.2%. Performance was broadly positive amongst strategy sub-indices, with gains from relative value, event-driven, and global macro managers.
- The HFRI Event-Driven (Total) Index returned 2.6%. Event-driven sub-strategy returns were mixed, with four of six generating positive performance. Distressed managers were the top performers, illustrated by the 5.6% return of the HFRI ED: Distressed/Restructuring Index. Fears of systemic risk somewhat subsided, largely due to the expectation for continued accommodation of global central banks. The HFRI ED: Credit Arbitrage Index and the HFRI ED: Special Situations Index also benefitted from these tailwinds, returning 3.5% and 3.0%, respectively.
- The HFRI Relative Value (Total) Index returned 2.8%. Each relative value sub-strategy generated positive performance. The strongest performing hedge fund sub-index was the HFRI RV: Yield Alternatives Index (+12.0%). Fixed income strategies also generated attractive returns, including the HFRI RV: Fixed Income – Corporate Index (+3.3%), the HFRI RV: Fixed Income – Sovereign Index (+2.8%), and the HFRI RV: Fixed Income – Convertible Index (+2.7%).
- The HFRI Macro (Total) Index returned 1.9%, and performance was positive across macro sub-indices. Systematic macro managers slightly outperformed discretionary managers, with the HFRI Macro: Systematic Diversified Index and the HFRI Macro: Discretionary Thematic Index returning 1.4% and 1.0%, respectively. Commodity traders, represented by the HFRI Macro: Commodity Index (+4.1%), benefitted from significant rallies in energy and certain metals.

HFRI INDICES PERFORMANCE
Returns in U.S. Dollars



Data source: HedgeFund Research

This page is intentionally left blank.

DISCLOSURES

This report was prepared by Fund Evaluation Group, LLC (FEG), a federally registered investment adviser under the Investment Advisers Act of 1940, as amended, providing non-discretionary and discretionary investment advice to its clients on an individual basis. Registration as an investment adviser does not imply a certain level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. Fund Evaluation Group, LLC, Form ADV Part 2A & 2B can be obtained by written request directly to: Fund Evaluation Group, LLC, 201 East Fifth Street, Suite 1600, Cincinnati, OH 45202, Attention: Compliance Department.

The information herein was obtained from various sources. FEG does not guarantee the accuracy or completeness of such information provided by third parties. The information in this report is given as of the date indicated and believed to be reliable. FEG assumes no obligation to update this information, or to advise on further developments relating to it. FEG, its affiliates, directors, officers, employees, employee benefit programs and client accounts may have a long position in any securities of issuers discussed in this report.

Index performance results do not represent any managed portfolio returns. An investor cannot invest directly in a presented index, as an investment vehicle replicating an index would be required. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

Neither the information nor any opinion expressed in this report constitutes an offer, or an invitation to make an offer, to buy or sell any securities.

Any return expectations provided are not intended as, and must not be regarded as, a representation, warranty or predication that the investment will achieve any particular rate of return over any particular time period or that investors will not incur losses.

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.

This report is prepared for informational purposes only. It does not address specific investment objectives, or the financial situation and the particular needs of any person who may receive this report. The 60/40 portfolios shown on page 11 is represented by the index within each asset class. As such, the returns shown in the chart are those of the indices. The results do not necessarily represent the actual asset allocation of any client or investor portfolio and may not reflect the impact that material economic and market factors might have had on investment decisions. Investment results achieved by actual client accounts may differ from the results portrayed. Diversification or asset allocation does not assure or guarantee better performance and cannot eliminate risk of investment loss. Investments cannot be made directly in an index. No representation is being made that any fund or account will or is likely to achieve profits or losses similar to those shown herein. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently realized by any particular trading program. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. Hypothetical performance results are presented for illustrative purposes only. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented.

All data is as of June 30, 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.

RES-2056 7-22-2016 EXP. 01-31-2017

Research and Investments Team

JEREMY M. ALBERS, CFA, CAIA / Research Analyst / Global Fixed Income and Credit

CHERYL A. BARKER / Senior Research Analyst / Global Equities

SKYE BARRY / Research Analyst / Private Capital

NOLAN M. BEAN, CFA, CAIA / Managing Principal / Head of Institutional Investments

KEITH M. BERLIN / Senior Vice President / Director of Global Fixed Income and Credit

CHRISTIAN S. BUSKEN / Senior Vice President / Director of Real Assets

KEVIN J. CONROY, CFA, CAIA / Vice President / Hedged Strategies

KEVIN C. DEE / Research Analyst / Global Fixed Income and Credit

BRAD J. DERFLINGER, CFA / Vice President / Assistant Portfolio Manager, Risk Management

GREGORY M. DOWLING, CFA, CAIA / Managing Principal / Chief Investment Officer, Head of Research

SUSAN MAHAN FASIG, CFA / Managing Principal / Portfolio Manager, Private Investments

ANTHONY L. FESTA, CFA / Managing Principal / Head of Portfolio Strategy

MICHAEL B. FRANKE / Research Analyst / Hedged Strategies

JEFFREY D. FURST, CFA, CAIA / Vice President / Hedged Strategies

BRIAN A. HOOPER / Vice President / Global Equities

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

ZACHARY R. JANSEN / Research Analyst / Real Assets

JAY R. JOHNSTON / Senior Research Analyst / Real Assets

MARK A. KOENIG, CFA / Senior Vice President / Director of Quantitative Analysis

J. ALAN LENAHAN, CFA, CAIA / Managing Principal / Chief Investment Officer, Head of Portfolio Management

DAVID L. MASON, CAIA / Vice President / Investment Strategies

MICHAEL J. OYSTER, CFA / Managing Principal / Chief Investment Strategist

MICHAEL J. O'CONNOR, CFA, CAIA / Vice President / Assistant Portfolio Manager, Public Investments

WILLIAM B. PHELPS, CAIA / Senior Analyst / Investment Strategies

SAMUEL A. RAGAN / Research Analyst / Global Equities

G. SCOTT TABOR, CAIA / Vice President / Private Capital

NATHAN C. WERNER, CFA, CAIA / Senior Vice President / Director of Private Equity

The CFA designation is a professional certification issued by the CFA Institute to qualified financial analysts who: (i) have a bachelor's degree and four years of professional experience involving investment decision making or four years of qualified work experience[full time, but not necessarily investment related]; (ii) complete a self-study program (250 hours of study for each of the three levels); (iii) successfully complete a series of three six-hour exams; and (iv) pledge to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct.

The Chartered Alternative Investment Analyst Association® is an independent, not-for-profit global organization committed to education and professionalism in the field of alternative investments. Founded in 2002, the CAIA Association is the sponsoring body for the CAIA designation. Recognized globally, the designation certifies one's mastery of the concepts, tools and practices essential for understanding alternative investments and promotes adherence to high standards of professional conduct.

Research and Investments Team as of date of publication.