Fund Evaluation Group®
investment advisors

PRIVATE CAPITAL QUARTERLY

RESEARCH REVIEW

THIRD QUARTER 2016

INSIDE THIS ISSUE

Introduction	**1**
Focus Topic	**3**
Private Equity	**8**
Venture Capital	8
Buyouts	10
Private Debt	**12**
Private Real Estate	**14**
Natural Resources	**16**
Disclosures	**18**
Investments Team	**19**

Here We Go Again

SUSAN MAHAN FASIG, CFA / **Managing Principal / Director of Private Capital**

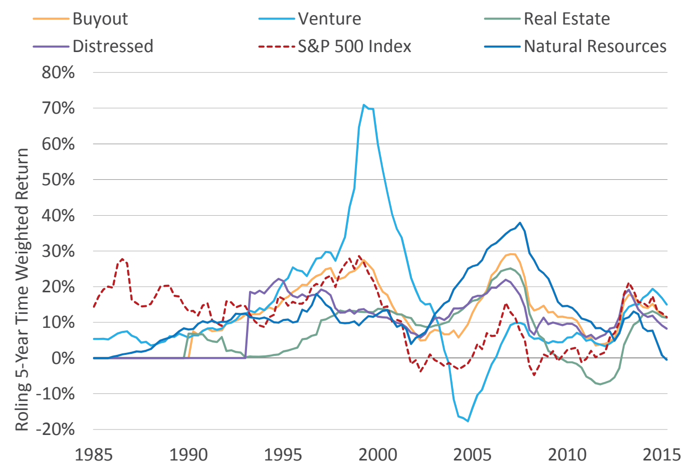
Writing this on November 8, Election Day, the cartoon seems to appropriately describe this U.S. election year, no matter your voting preference. Performance from various sectors of the capital markets exhibits a remarkable similar pattern of peaks and valleys. The private equity, real estate, and natural resources sectors have all demonstrated severe volatility over the last two decades. (Although, to be clear, we are not forecasting a steep decline into a barrier gate!)

ROLLER COASTER OF LIFE

As Frank rode the roller coaster of life, he let out a sudden shriek as he caught a glimpse of what lay ahead.

Source: www.justoutsidethebox.com

PRIVATE CAPITAL PERFORMANCE

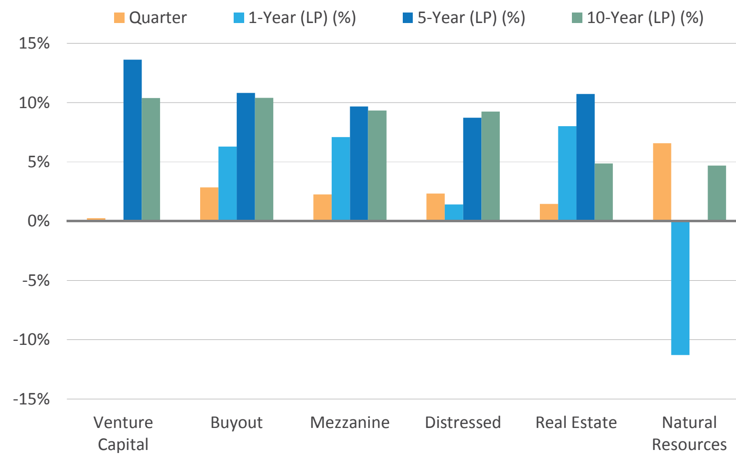


Data source: Thomson One; data as of 06/30/2016

© 2016 Fund Evaluation Group, LLC

With much post-election uncertainty ahead, we should remember that we have been here before—from political and regulatory changes to the fall of the Berlin wall—with some events more volatile than others. This quarter we highlight the least volatile segment of private markets: private lending. Private lending encompasses an array of strategies. Over the past five years, policies implemented to comply with Dodd-Frank legislation have dramatically altered the lending landscape. Restrictions placed on banks limited their capacity and flexibility, and experienced lending professionals have set up shop to fill the gap. In our Focus Topic this quarter, Keith Berlin, FEG Director of Fixed Income and Credit, highlights the evolution of the private lending and touches on recent opportunities.

The remainder of this report reviews activity and performance by sector—and what the ride has recently looked like from the front seat of the roller coaster. It is generally unwise to focus too much on short-term returns in a long-term asset class. However, it is interesting to see the flat-lining of venture returns for the past quarter and year (versus the strong recent five-year period) and, at the other end of the chart, the sharp rise in returns for the resource sector relative to a still very negative one-year period. Volatility also brings opportunity. And private capital, if deployed wisely, has its advantages.



Data source: Thomson One; data as of 06/30/2016

© 2016 Fund Evaluation Group, LLC

Altered States:
The Private Lending Landscape

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

With a new President-elect, the landscape in the U.S. may shift, but in recent years, the low return potential provided by traditional fixed income markets globally has led investors to consider private lending strategies as a meaningful component of their fixed income portfolio. While the concepts of "disintermediation of banks" and "private lending" are not likely to come up at the family dinner table, the theme has been trending since the global financial crisis ended. The disintermediation of banks is a consequence of regulatory measures stemming from the 2008–2009 credit crisis. Specifically, regulatory measures such as Dodd-Frank, Basel III, and the Volcker Rule were designed to shift "risky" lending permanently off the balance sheets of U.S. commercial banks. One visible result of this shift has been an increase in new entrants into the private lending market.

FEG has recommended private lending strategies for nearly a decade. Our effort has focused on lending to the financially underserved U.S. middle market, with an emphasis on the lower end of this market. The U.S. middle market encompasses nearly 200,000 companies that generate annual revenue of between $10 million and $1 billion. Collectively, these companies employ nearly 48 million Americans, representing one third of all U.S. jobs—the equivalent of the third largest global economy.[1]

Due primarily to size (or lack thereof), these companies are unable to access the public debt markets. For example, the typical high yield bond new issue is at least $200 million. Companies in the middle market may have a financing need of only a small fraction of that, typically $15 million to $50 million. A private mezzanine loan can fill the junior debt role in a company's capital structure in the same manner a high yield bond would for a larger entity. The mezzanine loan is not a tradable security, however, and the inherent illiquidity commands a higher yield.

FEG believes private lending strategies represent an attractive opportunity for fixed income investors relative to what is available in the public credit markets. We believe the implicitly higher credit risk profile inherent in these companies can be mitigated through careful manager due diligence. When properly structured, and taking the risks into consideration, the inclusion of these strategies can result in a more diversified, higher-return potential, fixed income portfolio.

The Details of Private Lending

Private lending strategies focus on providing private senior loans (direct lending), junior (mezzanine debt), or in some cases for smaller companies, providing a blend of private senior loans and mezzanine debt into one structure known as "unitranche" lending. Some of these strategies include equity-like components such as warrants.

Key elements of a private senior loan resemble those of public senior loans, with some important nuances. Both incorporate floating rate features and trade based on a spread to a risk-free benchmark, typically three-month London Interbank Offered Rate (LIBOR). LIBOR-based pricing provides inflation mitigation in environments where central bankers raise short-term funding costs for banks (through LIBOR floors) to fight inflationary pressures. The spread is typically around 200+ basis points for public bank loans and 400+ basis points or higher for private senior loans.

© 2016 Fund Evaluation Group, LLC

The areas in which private senior loans and public bank loans differ tend to favor private lenders, primarily by offering origination fees and stronger covenant protection. Origination fees of 0.5% to 2.0% are typically shared in part or fully with limited partners (which is additive to investor returns). Covenant protection—both financial and negative covenants—is materially stronger than what is available in the public market. Per Credit Suisse, more than 65% of public bank loans are considered “covenant lite.” FEG believes private lenders benefit from a “margin of safety” in the form of the spread differential versus the public bank loan market, as well as through origination fees. The improvement in covenant protection is also critical in reducing the overall credit risk in private lending strategies. Private lenders benefit from direct access to data and management, allowing them to be proactive in defending their investments in a challenging situation. Public bank loan managers are often one of a broad syndicate (i.e., public) of lenders.

Origination fees and better covenants and yields are also available in the junior debt offerings of private versus public markets. Like private senior loans, mezzanine debt providers can charge origination fees that range from 1.5% to 2.0%. These fees are typically shared with the investor and boost overall fund returns. Coupons for mezzanine loans are different than high yield bonds in that there is often a cash coupon component that can be supplemented with a “pay-in-kind” (PIK) component, which increases the overall coupon potential of the loan. The yield premium is typically around 300 basis points including the PIK coupon. Covenant packages used in mezzanine debt financings focus on financial maintenance covenants, akin to those for high yield bonds.

CAPITAL STRUCTURE

SENIOR SECURED	
Public Bank Loans	Direct Loans + 200 - 250 bps illiquidity premium
JUNIOR	
Public High Yield	Private Mezzanine + 300 bps illiquidity premium
EQUITY	
Public Equity	Private Equity + 300 bps illiquidity premium

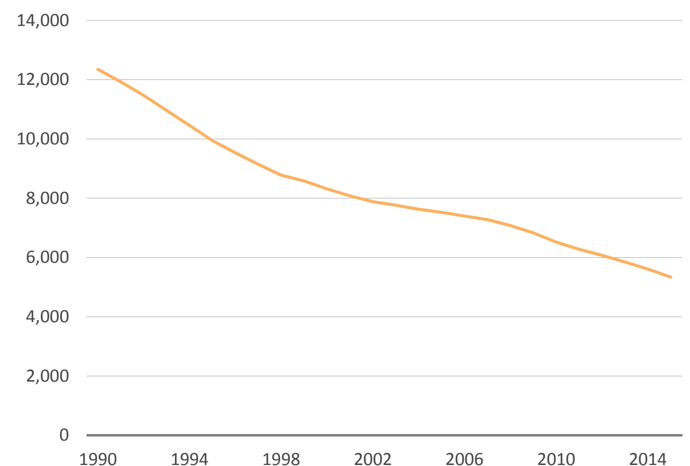
Sources: FEG, S&P Capital IQ

Defining the Private Lending Opportunity Set

There is a persistent need for private lending regardless of the credit or economic cycle. The lower U.S. middle market segment is target-rich, yet, the number of the historical providers of financing to the middle market (commercial banks) continue to decline due to acquisitions or a change in focus. The decline has been taking place since the early 1990s, exacerbated by the increase in regulatory restrictions and capital constraints on banking institutions since the credit crisis. The implications of a new administration may impact this trend, but it is too early to tell.

The U.S. middle market has benefitted from fundamental improvement in 2016 versus the pre-crisis period. In 2007, investors paid “too much” for over-levered companies that exhibited weak earnings, and private companies were not well supported by equity sponsors.

FDIC-INSURED COMMERCIAL BANKS



Data source: Federal Deposit Insurance Corporation

© 2016 Fund Evaluation Group, LLC

Fast forward to 2016: Investors are paying more reasonable prices for more modestly levered companies with stronger earnings that are well supported by equity sponsors. The difference is meaningful and is due in part (on the leverage side) to regulatory pressures intended to keep Debt/EBITDA multiples below 6.0x.

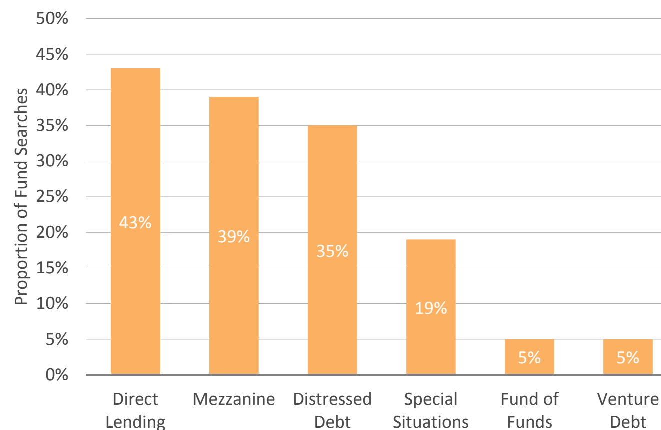
The table below highlights U.S. middle market buyout transactions'—a sub-component of all middle market transactions—current period metrics versus the pre-crisis (2007) and year-end 2015 periods.

	2007	2015	3Q2016
Debt / EBITDA multiples	5.6x	5.3x	4.9x
Equity Contribution	32%	45%	45%
Purchase Price Multiple	9.3x	10.7x	9.9x
Pro forma EBITDA	$29.0M	$36.2M	$37.8M

Source: S&P Middle Market Quarterly Review 3Q16

While the fundamental story has improved from the pre-credit crisis period, the perceived stability of the U.S. middle market, combined with a lack of yield available in the public credit markets, has led to an increase in private lending funds in recent years. According to Preqin, there are over 247 private debt funds in the market as of September 30, 2016, and demand is highest for direct (or senior) lending funds. Together, direct lending and mezzanine debt strategies represent a meaningful proportion of the $141 billion in targeted private debt commitments in North America and Europe.[2]

FUND TYPES TARGETED BY PRIVATE DEBT INVESTORS IN THE NEXT 12 MONTHS



Data source: Preqin

The amount of capital being raised for private lending strategies initially gives us a contrarian pause. Too much money chasing too few opportunities often leads to poor performance. With the caveat that much may change under Trump's presidency, three key factors give us confidence that increased activity has not created "credit bubble" in private lending to date. First, and most important, is a recognition that new capital and new entrants into the private lending space are merely replacing a portion of the capital that was previously provided by U.S. commercial banks and public financial institutions, although it remains difficult to quantify. Second, "rational" credit underwriting metrics, in terms of leverage and coverage ratios, remain in place in the U.S. middle market. Third is the recognition that the private equity industry has grown dramatically in the last decade[3], and sustained growth is likely to increase the demand for private lending.

© 2016 Fund Evaluation Group, LLC

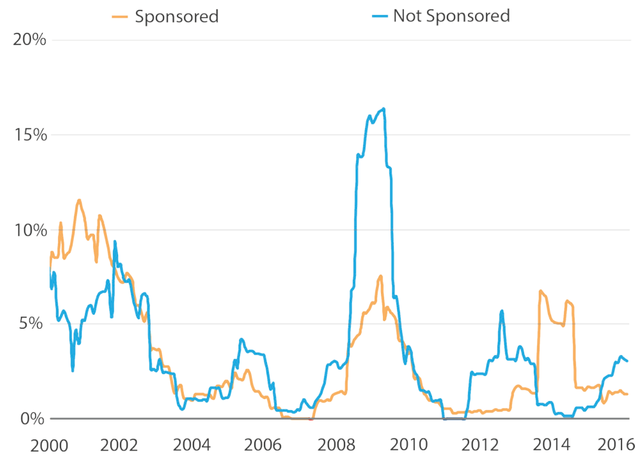
Key Risks

The key risk to any lending strategy—public or private—is credit risk. Credit risk is primarily mitigated by a strong credit underwriting process and by diversification. As such, manager (i.e., lender) selection and portfolio construction is the primary risk mitigation tools for investors considering allocating to private lending strategies.

Developing a multiple manager program that invests in a range of strategies over multiple vintage years can reduce the credit risk of any one transaction or market segment. This portfolio construction approach will also allow for a more measured allocation of capital, which can help reduce the potential of too much capital being allocated in a recessionary period.

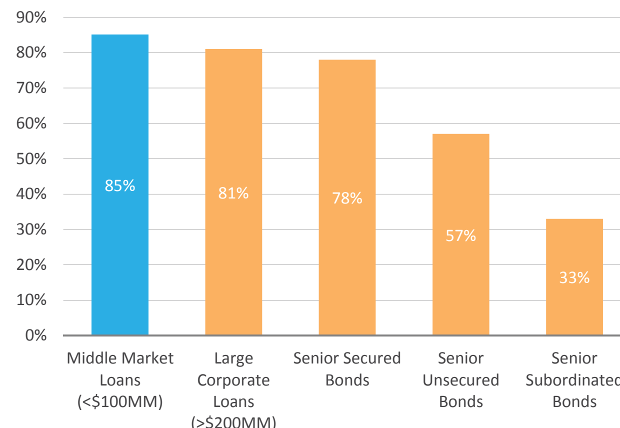
Historical default rates for both sponsored—private equity owned—and non-sponsored loans have averaged in the low to mid single digits since 2000, while recovery rates for U.S. middle market loans have been higher than syndicated (i.e., public) bank loans due primarily to better covenant protection, as previously mentioned.

LAGGING 12 MONTH DEFAULT RATES
BY PRINCIPAL AMOUNT



Data source: S&P LCD

AVERAGE RECOVERY RATES
1995–2015



Data source: S&P LCD

© 2016 Fund Evaluation Group, LLC

What FEG Looks for—and Seeks to Avoid—in a Private Lending Manager

All FEG asset manager recommendations reflect our six-tenet investment philosophy: conviction, consistency, pragmatism, investment culture, risk control, and active return. Within this framework, we seek our managers steadfastly focused on the lower middle market and who have successfully navigated multiple credit cycles.

Managers focused on the lower middle market tend to raise funds with less than $1 billion. We believe at this size a manager can run a successful business while maintaining focus and economic interest that are well aligned with investors. We prefer to avoid upper-middle market private lenders who tend to raise larger funds, compete on price, and compete with public credit markets. We also like to avoid the “micro” area of the lower U.S. middle market, where returns that exhibit more of a “growth equity” investing experience than a lending experience.

Conclusion

FEG has long advocated private lending strategies with a preference for the lower U.S. middle market. Despite recent new entrants, particularly in direct lending, this is not a new area. The lower U.S. middle market has a well-established group of private lenders across both direct (senior) and mezzanine (junior) debt. Within and outside of the lower U.S. middle market, new entrants are likely to continue to bring new capital as well as replacement capital to the market. As long as there remains a lack of attractive opportunities in the traditional fixed income and public credit markets, these new entrants will be welcomed. The challenge for investors considering private lending strategies as a part of their long-term strategic fixed income portfolios is to find and hire the most skillful asset managers to minimize the risks. FEG is ready to help.

ALTERED STATES FOOTNOTES

[1] National Center for the Middle Market, 2Q16 Middle Market Indicator
[2] Preqin
[3] Angelo Gordon, Middle Market Direct Lending, October 2016

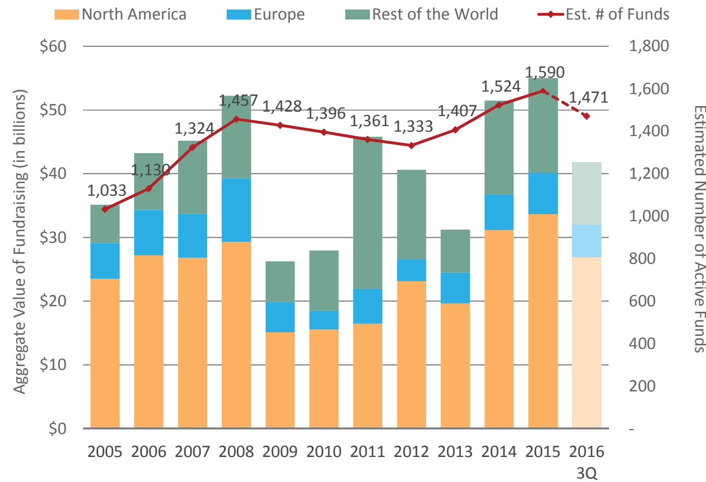
© 2016 Fund Evaluation Group, LLC

PRIVATE EQUITY

Venture Capital

FUNDRAISING AND INVESTING

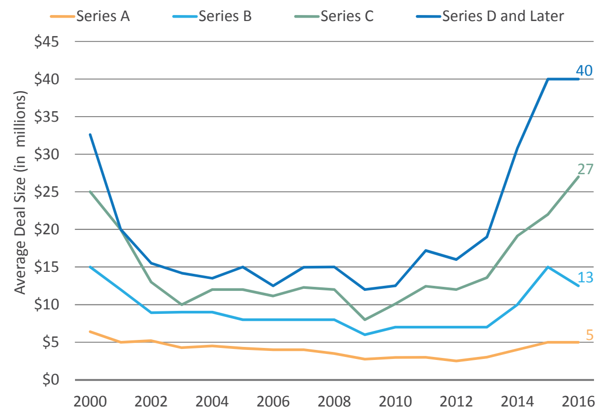
VENTURE FUNDRAISING & ESTIMATED NUMBER OF ACTIVE FUNDS



Data source: Preqin; data as of September 30, 2016

- Globally, venture funds raised over $40 billion in commitments through September 2016.[1] On an annualized basis, fundraising in 2016 is on pace with last year's elevated level in both the U.S. and globally.
- In a similar vein, the number of active venture funds in 2016 remains at lofty levels.
- Trends in median deal size that began earlier in the year continued into the third quarter. Very early (Series A) and very late-stage (Series D and Later) investments were flat compared to prior years. Series B round sizes declined while Series C investments continued a sharp increase.[2] Feedback from venture capital managers is that the public equity investors who fueled the late-stage boom over the last several years have withdrawn from the market. This is expected to push down deal sizes in the coming quarters.
- U.S. venture capital firms invested $10.6 billion in 891 companies during the third quarter, a 32% decline from the prior quarter and a 19% decline compared to year-ago levels.[3]

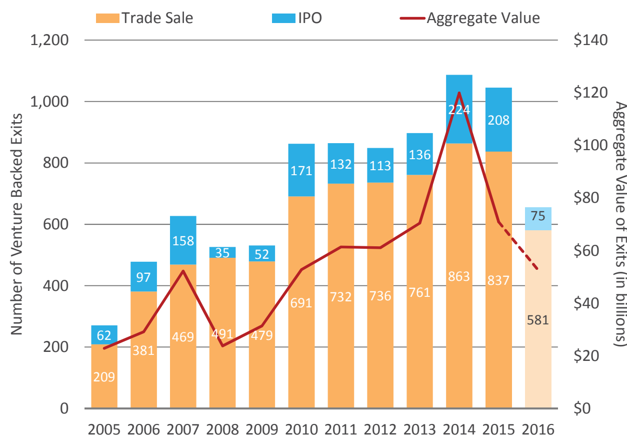
MEDIAN DEAL SIZE BY FINANCING ROUND



Data source: Preqin; data as of September 30, 2016

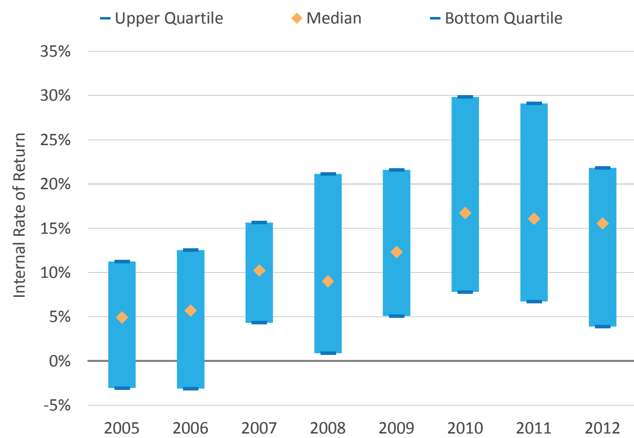
© 2016 Fund Evaluation Group, LLC

VENTURE CAPITAL EXIT ACTIVITY



Data source: Preqin; data as of September 30, 2016

VENTURE CAPITAL PERFORMANCE



Data source: Thomson One; data as of June 30, 2016

EXIT ENVIRONMENT

- Exit activity continued to slow in 2016 following several years of peak exit volumes from 2013–2015.[4] The volatile public equity markets slowed the initial public offering (IPO) market for venture-backed companies, while corporate acquisition activity also retreated off prior year levels.

VENTURE CAPITAL PERFORMANCE

- Venture fund performance came down slightly in the first half of the year. The pull-back in the exit market, combined with slower investment pace, put downward pressure on valuations. Longer-term performance remained strong for funds with vintage years of 2008–2012. Given the strong IPO and acquisition activity over the last three years, venture funds have posted double-digit median net internal rate of returns and top quartile returns consistently above 20%. If volatility in the public market and weakness in late-stage financing continue, venture capital performance could trend lower.

CONCLUSION

- Venture capital metrics are mixed. Fundraising and performance have been strong while exit opportunities have weakened. Softness in the IPO market and late-stage financings will likely lead to lower valuations and near-term performance.

VENTURE CAPITAL FOOTNOTES

1 Preqin
2 Preqin
3 PricewaterhouseCoopers MoneyTree Report, Third Quarter 2016
4 Preqin

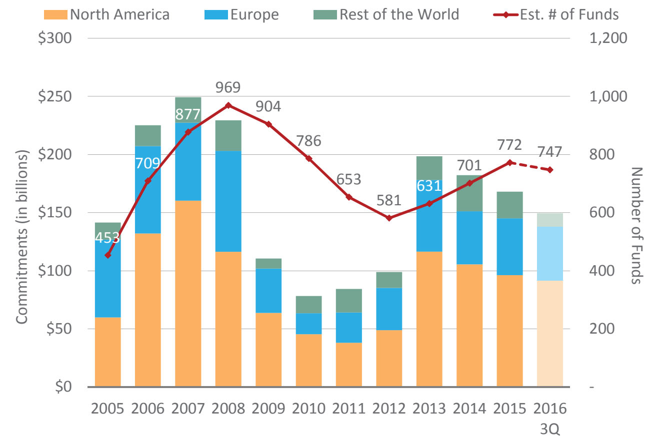
© 2016 Fund Evaluation Group, LLC

Buyouts

GLOBAL BUYOUT INVESTMENT AND FUNDRAISING

- Global buyout fundraising slowed during the third quarter, with roughly $30 billion of new capital raised for the strategy. Year-to-date fundraising remained strong, however; should the current pace continue, 2016 will be the biggest fundraising year post the global financial crisis.
- Commitments for both European and U.S.-based funds are well ahead of last year's pace, while fundraising for emerging markets and other countries declined compared to 2015.[1]

BUYOUT FUNDRAISING & EST. NUMBER OF ACTIVE FUNDS

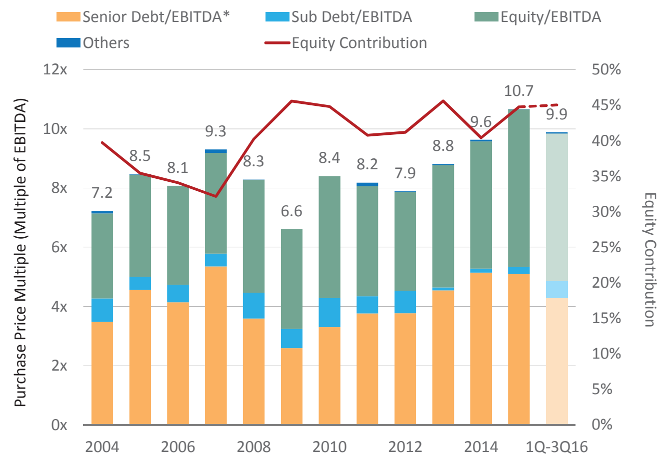


Data source: Preqin; Data reflects the number of global buyout funds with a final closing in the current vintage year plus the prior three vintage years. As of September 30, 2016

GLOBAL BUYOUT INVESTMENT ACTIVITY

- Through the third quarter, the average purchase price multiple for middle-market buyout transactions was 9.9x EBITDA. Leverage ratios rose modestly during the quarter. According to S&P Capital IQ, the average debt multiple for middle market LBOs was roughly 5.6x EBITDA, in line with the 2015 annual average.[2]
- Equity contributions in large buyout transactions rose to 44%, well within a reasonable range. The peak was 47% in 2009, when financing was scarce. The low point was in 2007, when the ratio dipped below 35%. Equity contributions in middle market transactions were little changed at 45%.[3] (Note: The S&P Capital IQ data represent only a sample set of leverage buyout transactions executed during a given time period.)

AVERAGE PURCHASE PRICE MULTIPLES & EQUITY CONTRIBUTION

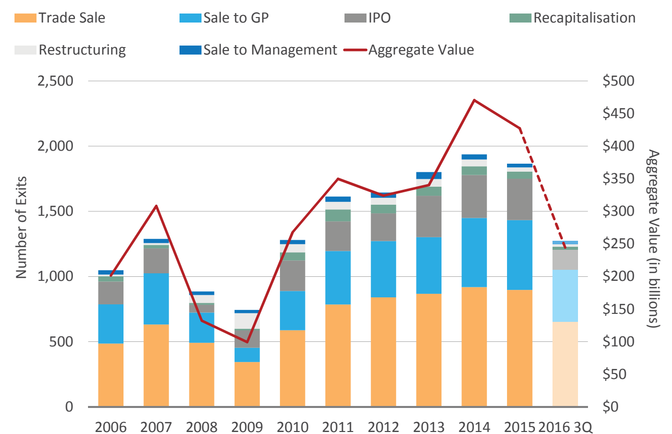


Data source: S&P Leverage Buyout Review; as of September 30, 2016

GLOBAL BUYOUT EXIT ACTIVITY

- Exit activity during the third quarter slowed modestly, due in part to continued public market volatility and concerns regarding the U.S. election. Year-to-date exit volume and value were down nearly 10% and 30%, respectively, over the same time period in 2015.[4]
- Trade sales continued to represent more than half of all buyout-related exit volume and values.

BUYOUT EXIT ACTIVITY

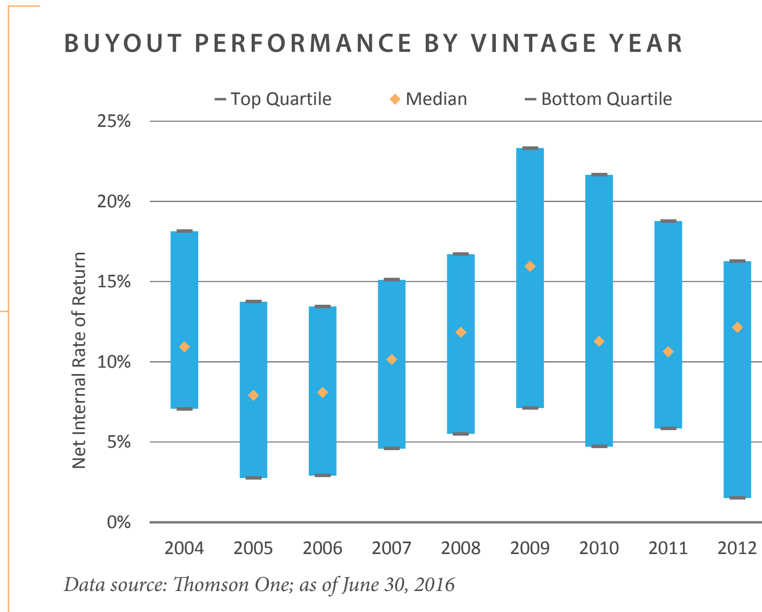


Data source: Preqin; as of September 30, 2016

© 2016 Fund Evaluation Group, LLC

GLOBAL BUYOUT PERFORMANCE

- Performance has been strong on a 1-, 3-, 5-, and 10-year basis with time-weighted returns of 8.5%, 13.3%, 12.3%, and 11.2%, respectively. [5]
- The dispersion of returns between top- and lower-quartile funds has consistently been over 950 basis points, demonstrating the importance of manager selection.



Data source: Thomson One; as of June 30, 2016

CONCLUSION

- Elevated fundraising levels and purchase price multiples give reason for concern. Manager discipline is critical to making successful investments when the market is flush with capital. FEG continues to look for managers with clear competitive advantages and investment philosophies built on fundamental value.

BUYOUTS FOOTNOTES

[1,2] Preqin, "Funds in the Market," www.preqin.com, September 30, 2016
[3] S&P Leveraged Buyout Review, Third Quarter 2016
[4] Preqin, "Buyout Deals Analyst," www.preqin.com, September 30, 2016
[5] Thomson One, Horizon Summary Report, March 31, 2016

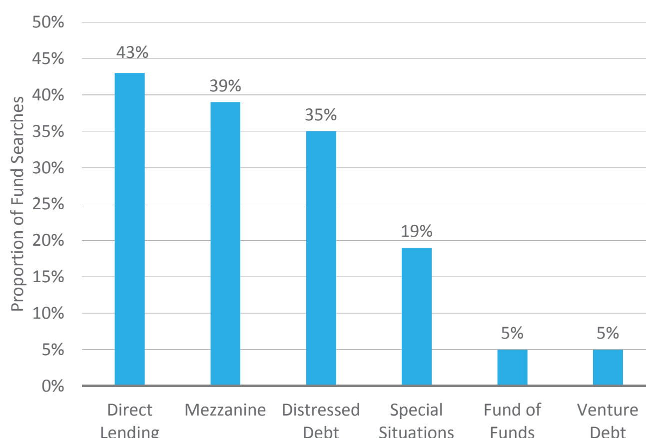
© 2016 Fund Evaluation Group, LLC

PRIVATE DEBT

PRIVATE DEBT FUNDRAISING

- According to Preqin, 24 private debt funds reached a final close in the third quarter of 2016, representing $11 billion in commitments, lower (although subject to upward revision) than the $20 billion closed in the second quarter.
- Investor interest in private debt remains strong, with mezzanine and direct lending accounting for most of the funds and aggregate capital raised during the third quarter. Demand for these strategies is widely anticipated to continue, particularly in light of the low returns available in the traditional credit markets.

PRIVATE DEBT FUNDRAISING IN THIRD QUARTER 2016 BY FUND TYPE



Data source: Preqin Data Online

PRIVATE DEBT FUNDAMENTAL BACKDROP

- According to S&P LCD Quarterly 3Q16 data, fundamentals in the lower middle market remain favorable, particularly relative to the prior peak of 2007 and the end of 2015. This table suggests fundamental improvement in 2016 versus the pre-crisis period. In 2007, investors paid “too much” for over-levered companies. In 2016, investors are paying high but more reasonable prices for modestly levered companies with stronger earnings and solid equity support.

	2007	2015	3Q2016
Debt / EBITDA multiples	5.6x	5.3x	4.9x
Equity Contribution	32%	45%	45%
Purchase Price Multiple	9.3x	10.7x	9.9x
Pro forma EBITDA	$29.0M	$36.2M	$37.8M

Source: S&P Middle Market Quarterly Review 3Q16

- Overall transaction volume in the U.S. middle market softened on a year-over-year basis as of September 2016, as year-to-date transaction volume was $16.1 billion versus $29.1 billion at the end of the third quarter of 2015.[1] Continued strength in capital raising in direct lending strategies (as shown in the chart) has not had a material impact on pricing of deals to this point, but the trend remains worth watching.

© 2016 Fund Evaluation Group, LLC

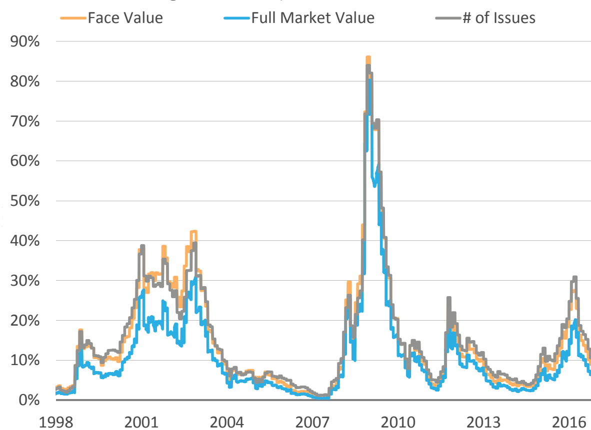
DISTRESSED UPDATE

- The European distressed opportunity set remains attractive. FEG was recently in London interviewing asset managers for an update on their perspectives. Our findings suggested continued opportunity in the non-performing loan market, as investors note an uptick in sales from Spanish and Italian banks in recent quarters. Basel III requirements are set to trigger additional improvement in the balance sheets of European banks in the next few years. New leverage ratios must be met in 2018, and new capital and liquidity requirements are expected to be met in 2019. Additional pressure could force the hand of weaker sellers, but goal posts have a history of being pushed back in Europe.

- The U.S. distressed opportunity set has softened for the near term similar to the strength in the high yield and bank loan markets in 2016. The resultant search for yield following January and February weakness has pushed distressed ratios considerably lower from the beginning of the year. The higher correlation to oil prices and the rally in oil prices off the lows this year are noteworthy.

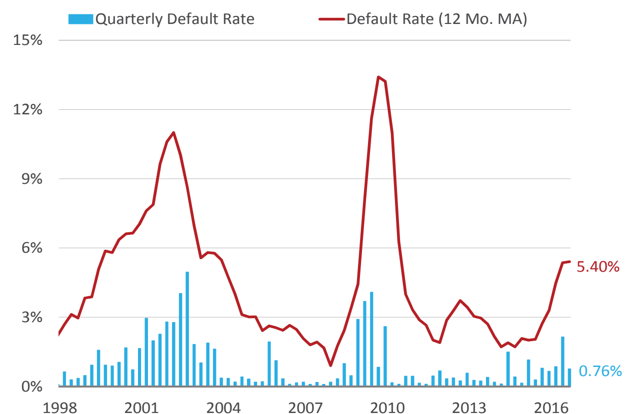
U.S HIGH YIELD DISTRESSED RATIOS

Bonds Trading 1000 bps Above Treasuries



Data sources: Bank of America/ Merrill Lynch, Bloomberg L.P; data as of 11/01/2016

U.S HIGH YIELD DEFAULT RATE



Data sources: BofA/ML, Moody's, Edward Altman; data as of 3Q2016

CONCLUSION

- Private lending strategies continue to garner the most interest from investors looking to lock up capital in the private debt space, with distressed and special situations also in the mix.

- Middle market fundamentals remain reasonably healthy, reflecting a mixed bag of late credit cycle characteristics. Middle market issuance volume has softened, however, which gives some pause.

- European distressed opportunities remain prevalent and predicated continued pressure from Basel III deadlines. U.S. defaults have increased but remain energy-centric. Absent a U.S. recession, a broad-based U.S. distressed opportunity remains further down the horizon.

PRIVATE DEBT FOOTNOTES

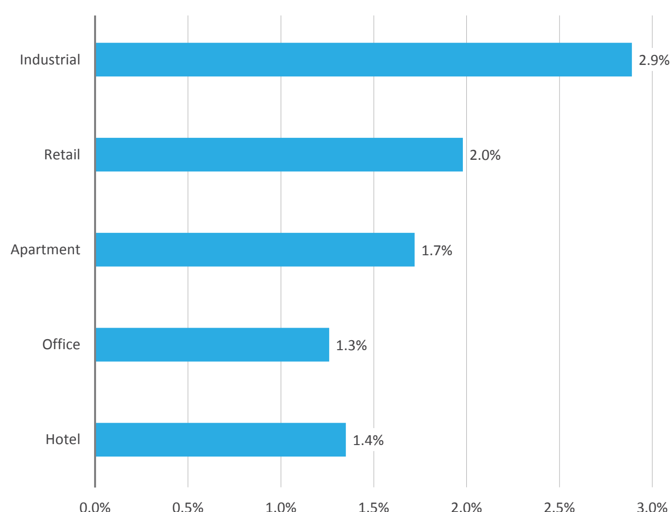
[1] S&P LCD Middle Market Review, 3Q 2016

© 2016 Fund Evaluation Group, LLC

Private Real Estate

- Real estate values, as measured by the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index, increased 1.8% during the third quarter following a 2.0% gain during the second quarter. On a trailing one-year basis, the index gained 9.2%, and the annualized 5-year return was 11.2% as of September 30, 2016.[1] For the third quarter, the industrial and retail sectors were the top performers, gaining 2.9% and 2.0%, respectively.
- Property fundamentals were stable in the third quarter, with occupancy for the NCREIF at a 15-year high of 93.2% and trailing year net operating income (NOI) growth of 5.4%.[2] The implied valuation cap rate edged down to 4.5% in the third quarter, a new low. Cap rate compression occurred across all property types in the quarter, led by the apartment and office sectors.[3]
- Global commercial real estate transaction volume totaled $260 billion in the third quarter, a 15% year-over-year decline compared to the same period in 2015.[4] Year-to-date through third quarter 2016, global transaction volume was $816.2 billion, an 11% drop versus the same period in 2015. In the U.S., transaction volume has fallen or been flat for three consecutive quarters, yet certain types of investors have been more active than others, most notably overseas investors seeking yield through buying properties in major metropolitan markets.[5] In contrast, deal volume in secondary markets strengthened, reflecting a move by investors into markets with more attractive pricing compared to core-major metropolitan markets.

NCREIF NATIONAL PROPERTY INDEX
SECTOR RETURNS—THIRD QUARTER 2016

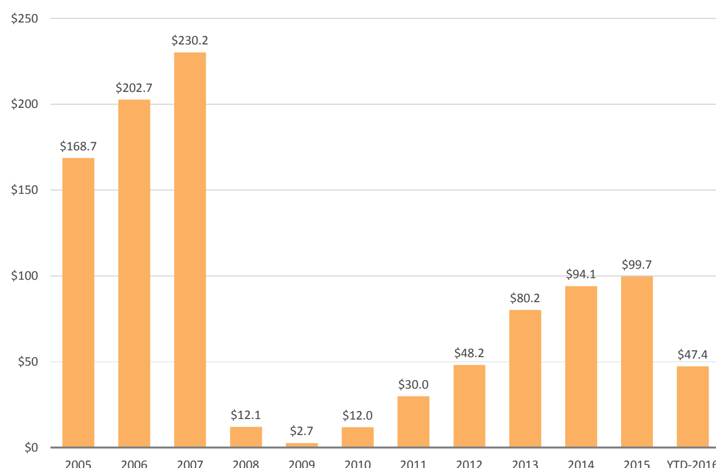


Data source: NCREIF

REAL ESTATE CAPITAL MARKETS

- The commercial mortgage-backed securities (CMBS) market, which saw new issuance plunge to a four-year low during the second quarter, rebounded in the third quarter with $18 billion of issuance.[6] This compares with $22.1 billion of deal volume during the same period a year ago. While some 15 deals are in the forward pipeline, issuance for the full-year 2016 will fall well below last year's $95.1 billion of volume.[7] Issuance during the latest quarter picked up when spreads began to tighten following an extremely volatile first half.
- CMBS fills a key segment of the financing market for middle-market properties. If the CMBS market continues to contract, it's unclear whether other groups (i.e. banks and insurance companies) will provide permanent financing for these types of properties.

© 2016 Fund Evaluation Group, LLC



Data source: Bloomberg, L.P.; as of September 30, 2016

PROPERTY SECTORS

Apartments

- While the apartment sector has been one of the strongest of the major real estate property types in recent years, there were signs of slowing during the third quarter. The U.S. apartment vacancy rate was unchanged at 4.4% during the quarter, and rent growth decelerated in a period that generally sees increases.[8] Asking and effective rents both expanded 0.9% during the quarter, compared with a 1.1% growth rate in the second quarter.[9] This was the third consecutive quarter of decelerating year-over-year rent growth. New construction fell to 37,744 units delivered in the third quarter, down from 53,587 units in the second quarter, suggesting that developers were not rushing to complete construction.[10] New York remained the most expensive market, with effective rents averaging $3,441 per unit per month, followed by San Francisco at $2,481 per unit per month.[11] Overall, fundamentals point to a moderating market driven by a rebalancing of supply and demand after years of strong growth.

Office

- U.S. national vacancy rate for the office sector was unchanged from the second quarter, at 16%. The year-over-year decline in office vacancy was 40 basis points.[12] Asking rents grew by 0.3% while effective rent rose by 0.4% in the third quarter. Office market fundamentals are expected to improve in the coming quarters, and recent employment growth should reduce vacancy rate below 15.8%.[13]

Retail

- U.S. retail mall vacancies fell to 7.8% in the third quarter, down 10 basis points from the second quarter. High-end regional malls helped offset slower growth in smaller retail spaces, like community centers, and effective rents for shopping centers rose for a third straight quarter.[14] Vacancy rates for neighborhood and community centers are expected to move lower, and rent growth should increase at a slightly faster rate. The national vacancy rate for neighborhood and community shopping centers rose to 10 percent, up 10 basis points from the second quarter.[15] Construction activity accelerated with 2.53 million square feet of new neighborhood and community center space completed during the third quarter, the highest level of completions in the past four quarters.[16]

REAL ESTATE FOOTNOTES

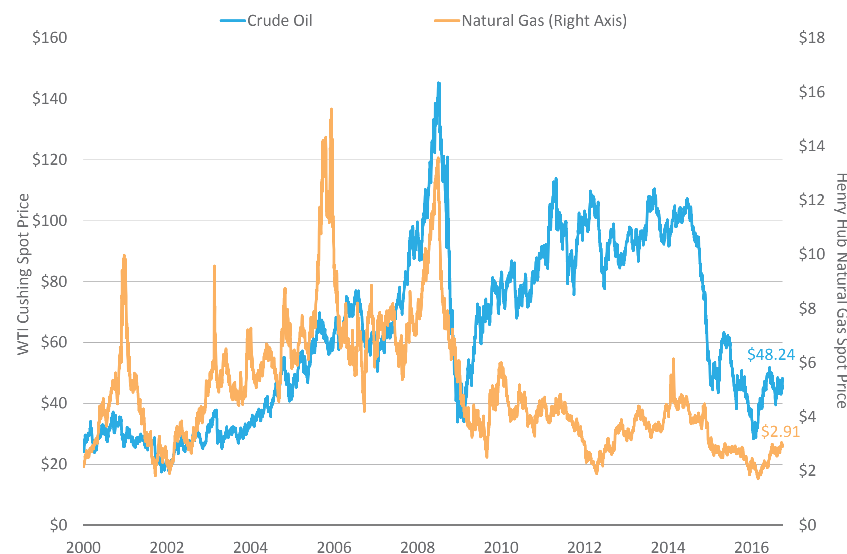
[1-3] www.ncreif.com October 25, 2016
[4,5] Real Capital Analytics–Global Capital Trends–Third Quarter 2016
[6,7] www.trepp.com October 6, 2016
[8-11] Business Insider October 3, 2016
[12,13] Reuters October 2, 2016
[14 - 16] www.reis.com October 7, 2016

© 2016 Fund Evaluation Group, LLC

Natural Resources

- After falling to multi-year lows early in the year, crude oil prices stabilized in the third quarter and were largely unchanged from the end of the second quarter. Oil prices closed at $48.24/barrel compared to $48.33/barrel at the end of the second quarter.[1] Concerns about oversupply continue to dominate oil markets. During the quarter, attention shifted to OPEC and a potential production freeze or cut. In late September, OPEC announced that it would look to curb production and accelerate the unwinding of the global supply glut. Target cuts would imply a reduction of between 0.5–1.0 million barrels/day from current levels. Oil prices surged on the news, as the potential move would be the first for OPEC in eight years.[2] Despite the announcement, most analysts remain skeptical that the members of OPEC can reach an agreement on a freeze/cut in late November.

CRUDE OIL AND NATURAL GAS PRICES
As of September 30, 2016



Data source: Bloomberg L.P.

- During the quarter, the global oil demand picture also continued to weaken, as the International Energy Agency (IEA) published a report showing that year-over-year demand growth has been easing throughout this year.[3] Having peaked at 2.3 MMBbl/d in the third quarter of 2015, growth is expected to slow to an estimated 0.8 MMBbl/d in 2016 due to decelerating crude demand growth in China, India, and Europe. Despite the recent run up, most analysts believe oil prices will be relatively range bound for the remainder of the year.[4] Longer-term, the massive cuts in capital expenditure across the energy sector could set the stage for higher prices.

- Natural gas prices were also flat for the third quarter, closing at $2.91/MMBtu compared to $2.92/MMBtu at the end of the second quarter.[5] Most analysts believe prices will begin strengthening again in November, moving into winter, which is historically the largest drawdown season.

© 2016 Fund Evaluation Group, LLC

- As of the end of the third quarter, the total U.S. rig count (as measured by Baker Hughes) stood at 522, down approximately 1,400 rigs from the September 2014 peak.[6] However, the rig count was up 24.0% from the prior quarter, as operators began to put rigs back to work due to stabilizing oil prices. Year-over-year, the U.S. total onshore and offshore rig count decreased 37.7%, or roughly 316 rigs.[7] A key concern is that higher prices will cause operators to quickly bring more production online, capping future price increases.

- U.S. oil and gas deal activity continued to strengthen during the quarter, with 64 onshore transactions totaling $15.3 billion.[8] The Permian Basin remained the center of activity, accounting for 35% of the transactions and 68% of the total value.[9] Valuations in the Permian also remained rich, with core acreage in the Midland and Delaware Basins selling for $30,000–$40,000/acre. Notable deals during the quarter included EOG's corporate buyout of Yates Petroleum for $2.5 billion; Silver Run's corporate buyout of Centennial, a Delaware Basin operator, for $1.7 billion; Concho's purchase of Reliance's Midland Basin assets for $1.6 billion; and PDC's purchase of Kimmeridge's Delaware Basin assets for $1.5 billion.[10]

NATURAL RESOURCES FOOTNOTES

[1] CoreCommodity Quarterly Letter – September 2016
[2-10] EnCap Investments – Third Quarter 2016 Letter

© 2016 Fund Evaluation Group, LLC

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.

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.

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

All data is as of September 30, 2016 unless otherwise noted.

INDICES

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 FTSE NAREIT Composite Index (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 REIT securities in the U.S. Relevant real estate activities are defined as the ownership, disposer, and development of income-producing real estate. See www.ftse.com/Indices 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.

The Moody's/RCA Commercial Property Price Indices measure price changes in US commercial real estate based on completed sales of the same commercial properties over time, or the "repeat-sales" methodology.

The NCREIF Property Index is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only.

The NCREIF Timberland Index is a quarterly time series composite return measure of investment performance of a large pool of individual timber properties acquired in the private market for investment purposes only. All properties in the Timberland Index have been acquired, at least in part, on behalf of tax-exempt institutional investors - the great majority being pension funds. As such, all properties are held in a fiduciary environment.

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

RES-3122 11-30-2016 Exp. 3-31-2017

 © 2016 Fund Evaluation Group, LLC

Research and Portfolio Management 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 Equity

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 / CIO and Head of Research

SUSAN MAHAN FASIG, CFA / Managing Principal / Director of Private Capital

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

MICHAEL B. FRANKE, CFA / Research Analyst / Hedged Strategies

BRIAN A. HOOPER / Senior Research Analyst / Global Equities

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

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

SEAN P. McCHESNEY / Vice President / Hedged Strategies

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

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

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

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

SAMUEL A. RAGAN / Research Analyst / Global Equities

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

STEVEN G. THIEME, CFA / Senior Research Analyst / Hedged Strategies

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.

© 2016 Fund Evaluation Group, LLC

Fund Evaluation Group®
investment advisors

www.feg.com

201 EAST FIFTH STREET, SUITE 1600, CINCINNATI, OH 45202

PH 513 977 4400 • FX 513 977 4430 • INFORMATION@FEG.COM

SATELLITE OFFICES Detroit / Indianapolis