Alternatives Update
2nd Quarter 2017

The capital markets continually offer up uncertainty and confusion. A "Chekov's gun" mindset to market analysis will likely result in terabytes of data mining, great mental anguish, but perhaps little else. Rarely do any markets follow the careful sequencing of a well-crafted spy novel or a tightly written screenplay. In fact, it might be said that the incoherent jumbled mess of a Michael Bay directed movie is logical and cohesive by comparison. As a tangent, the current administration and both political parties seem to be giving Michael Bay a serious run for his money. Fortunately for investors, the markets appear to be ignoring both domestic and global political dysfunction. Despite all the noise, a couple of clear themes emerged in the second quarter: For risk assets, any news was good news, and there has been a shift in messaging from the Federal Open Market Committee (FOMC).

Second quarter returns for traditional assets were strong across the board with global equity markets continuing to dominate (see Figure 1). Carrying on the theme that has been in place since the start of quantitative easing, equity or credit of most varieties proved to be rewarding. Despite the FOMC raising rates and signaling more to come, long dated treasuries rallied strongly, outpacing the S&P 500. Two of the more popular explanations for the flattening are: The bond market is telling the FOMC that they should not be raising rates at this juncture and the talk of several more rate moves and balance sheet unwinding is just that, talk.

Alternative Investment ("Alternatives") returns were modest by comparison to traditional long only risk assets. For the quarter, 7 of the 11 alternative categories had positive returns. Real estate was the best performing category and Commodities the worst (see Figure 2). As in the recent past, exposure to equity beta seems to have been a major driver of returns. As was the case for most of 2016 and the first quarter of 2017, returns mostly aligned with the rank order correlation to the S&P 500 (see Figure 3). Real assets (commodities, real estate, gold), struggled in the second quarter realizing an average return of -0.34%, with only real estate ending in the black. Given that first quarter returns for real estate and gold were nearly equal to or greater than their total returns for all of 2016, it is not clear if this is a manifestation of lower inflation expectations or simply a pause following outsized returns. Commodities, after a strong 2016, posted another negative return quarter, -3.0% (see Figure 4).

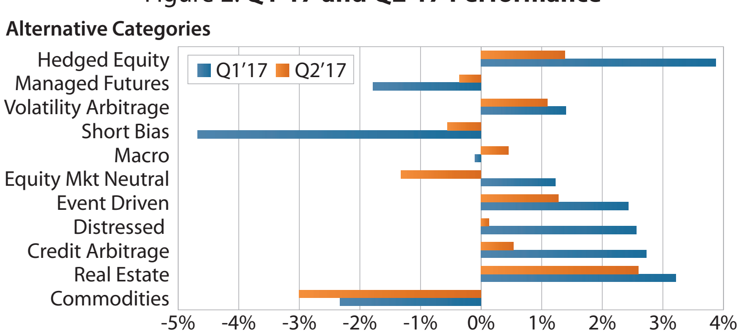
Managed Futures, commodities, and macro strategies have historically shown low correlations and beta to stocks and bonds, thus they serve as potentially strong portfolio diversifiers. Strategies such as credit, event driven, hedge equity, et al., which have higher correlations with equities and bonds, provide attractive risk/return profiles through lower volatility. These characteristics may allow investors to broaden their investment choices and create more efficient portfolios.

Figure 1: **Asset Class Returns**

	2Q17
S&P 500	3.09%
MSCI EAFE	6.12%
MSCI Emerging	6.27%
U.S. Treasury	4.18%
Real Estate	2.59%
Commodities	-3.00%
Bloomberg Barclays High Yield	2.20%
Bloomberg Barclays Aggregate	1.45%

Source: Bloomberg, 6/30/17. Past performance is no guarantee of future results. An investor cannot invest directly in an index.

Figure 2: **Q1'17 and Q2'17 Performance**



Source: Bloomberg, 6/30/17. Past performance is no guarantee of future results. An investor cannot invest directly in an index.

Figure 3: **Correlations (2-Year) & Returns**

	S&P 500	2Q17
Hedged Equity	0.88	1.39%
Event Driven	0.78	1.27%
Real Estate	0.74	2.59%
Distressed	0.61	0.13%
Credit Arbitrage	0.58	0.53%
Equity Market Neutral	0.56	1.10%
Volatility Arbitrage	0.5	-1.32%
Macro	0.18	0.45%
Commodities	0.09	-3.00%
Managed Futures	-0.06	-0.36%
Short Bias	-0.7	-0.56%

Source: Bloomberg, 6/30/17. Past performance is no guarantee of future results. An investor cannot invest directly in an index.

Figure 4: **Real Assets**

	2Q17	1Q17	2016
Real Estate	2.59%	7.56%	5.89%
Commodities	-3.00%	-2.33%	11.77%
Gold	-0.62%	8.43%	8.56%
Average	***-0.34%***	***4.55%***	***8.74%***

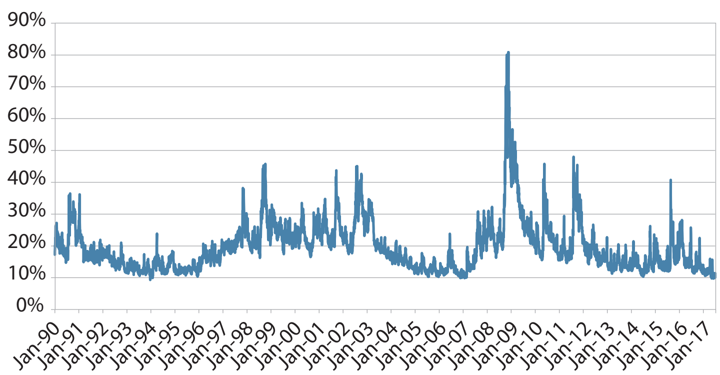
Source: Bloomberg, 6/30/17. Past performance is no guarantee of future results. An investor cannot invest directly in an index.

The U.S. political dynamics continue to provide fodder for late night talk shows, but for the average American, the waning prospect of meaningful healthcare reform, tax reform, and regulatory curtailment is no laughing matter. While those central tenets of the Trump platform gave hope to the markets after last year's election, their dimming prospects do not appear to be impacting capital markets in a symmetric fashion to the downside. Second quarter earnings growth for U.S. stocks and U.S. employment data were bright spots, while global growth and inflation/deflation concerns remain sizable question marks. Most markets seemed willing to ignore the negatives and seize firmly on the positives.

U.S. equity volatility (as measured by the VIX Index) remained suppressed, touching a low of 9.75 before ending the quarter at 11.18 (see Figure 5). In our 2017 first quarter commentary, we noted that "The average daily VIX level in the first quarter (11.69) was the second lowest reading since the creation of the VIX Index." That is no longer true, as the average daily VIX level in the most recent quarter is now the second lowest reading since the creation of the VIX index (see Figure 6). To further gain perspective on just how low equity volatility was in the second quarter, it is instructive to look at the extreme percentiles. Sorting all daily VIX closing levels since inception and then examining the lowest 1%, one will find the greatest number (27) occurred in 2017 (and the year is only half over). All 27 instances were in the second quarter. The next largest cluster of readings in the lowest 1% tallied 17. Of some concern is that all 17 of those instances occurred in the first two months of 2007, right before the collapse in the Shanghai composite and the onset of the subprime crisis (see Figure 7). Credit spreads tightened slightly 16 basis points (bps) as money continued to seek out yield, though with rates at extremely low absolute levels, further tightening may be limited (see Figure 8).

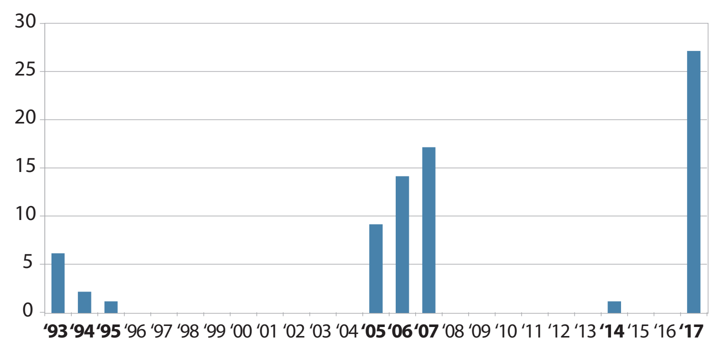
The ratio of New Highs to New Lows for the NYSE and for the NASDAQ ticked down in the quarter continuing a medium-term trend begun in late 2016, possibly reflecting the narrowing of leadership (see Figure 9). Comparing absolute levels across a lengthier history does not indicate sentiment being a concern at the moment (see Figure 10).

Figure 5: **U. S. Volatility Benchmark**



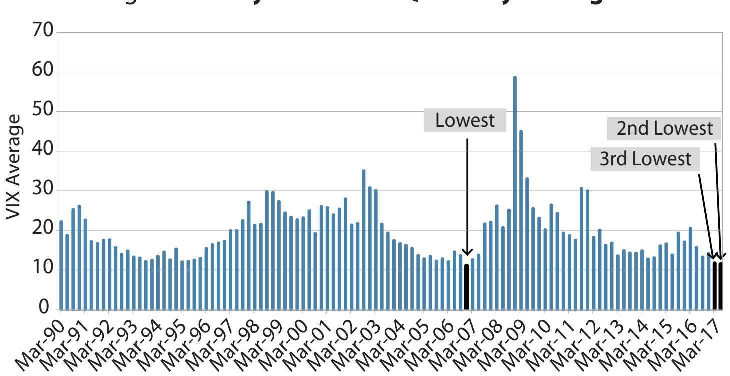
Source: Bloomberg, 6/30/17.

Figure 7: **# of Daily VIX Closings in Lowest 1%**



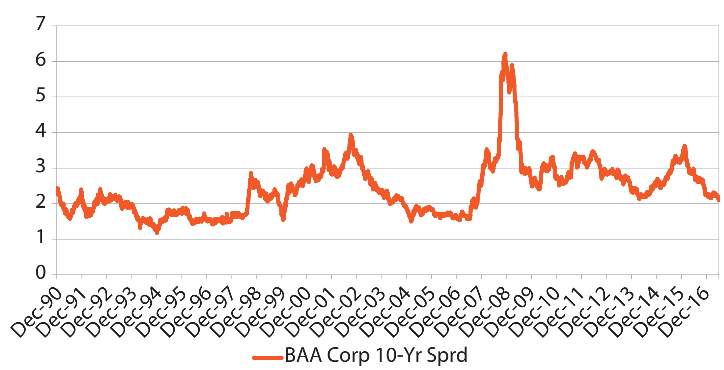
Source: Bloomberg, 6/30/17.

Figure 6: **Daily VIX Level - Quarterly Average**



Source: Bloomberg, 6/30/17

Figure 8: **Credit Spread vs. 10-Year U.S. Treasury**



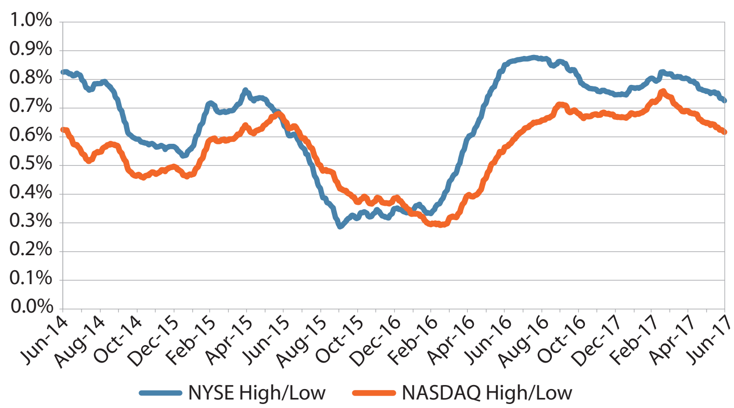
Source: Bloomberg, 6/30/17.

The FOMC raised rates 25bps at the June 14, 2017 meeting citing positive labor markets, recent inflation readings near the target level of 2% but potentially climbing, and monetary policy as continuing to be accommodative. Previously, language from the FOMC had implied that balance sheet reduction was far in the future. The June meeting initiated a departure from this narrative. A plan to start shrinking the balance sheet was not only mentioned, but the FOMC issued a reasonably detailed map in its "Addendum to Policy Normalization Principles and Plans." While the Addendum made it clear that balance sheet downsizing would be measured and possibly modified at the first sign of disturbance to the economy, the change in tone from "dovish at all costs" was clear.

The long end of the Treasury yield curve, which had been mostly unchanged starting the second quarter, rose slightly in the first week of May before turning sharply lower. A yield of 2.70% was reached on June 26, before drifting higher and ending at 2.835% as of June 30, 2017, 17.5bps below yields at the start of the quarter (see Figure 11). Since December of 2015, the Treasury curve has flattened just over 105bps, with the bulk of the movement coming on the short end.

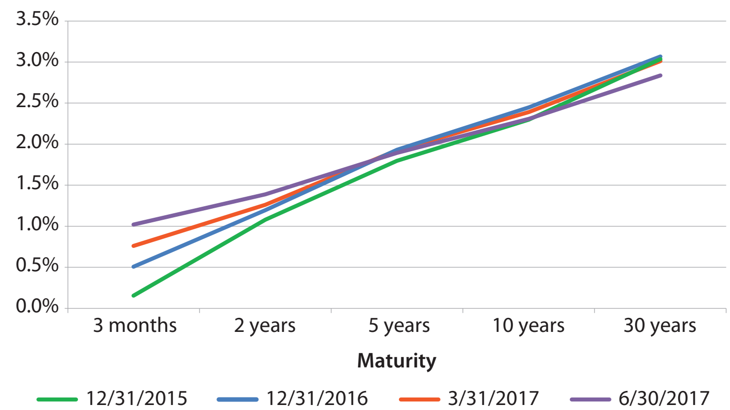
It was a good quarter for "Risk On" (+2.35%) and passable for "Risk Off" assets (+1.78%), with Gold and the Japanese Yen being exceptions, (see Figure 12). There was no clear rotation to one side or the other but more a reshuffling of allocations. We continue to emphasize that Alternatives have historically provided significant diversification benefits when paired with a portfolio of traditional assets, in addition to both competitive absolute returns and attractive risk-adjusted returns.

Figure 9: **New Highs/New Lows** *(90-Day Rolling Average)*



Source: Bloomberg, 6/30/17.

Figure 11: **U.S. Treasury Yield Curve**

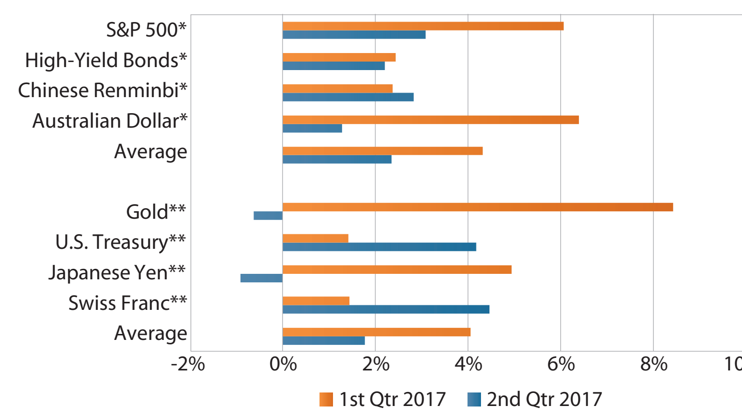


Source: Bloomberg, 6/30/17.

Figure 10: **U.S. 30-Yr. Treasury Yield**

Source: Bloomberg, 6/30/17.

Figure 12: **Risk Off vs. Risk On Asset Returns**



Source: Bloomberg, 6/30/17.
** Considered to be "Risk On" asset class. ** Considered to be "Risk Off" asset class.*

All charts shown herein are for illustrative purposes only and not indicative of any investment. The performance illustrations exclude the effects of taxes and brokerage commissions or other expenses incurred when investing. Past performance is not indicative of future results and there can be no assurance past trends will continue in the future. An investor cannot invest directly in an index.

Alternative investments may employ complex strategies, have unique investment and risk characteristics that may not be suitable for all investors.

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Definitions

Correlation: Pearson Product Moment Correlation is a linear statistical measure that quantifies the extent to which two or more data series fluctuate together. Values run from -1.0 to +1.0.

Bloomberg Barclays US Agg: The Bloomberg Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Hedged Equity: Hedge Fund Research HFRI Equity Hedge Total Index. Investment Managers who maintain positions both long (positions that are owned) and short (positions that are owed) in primarily equity and equity derivative securities. Hedged Equity managers would typically maintain at least 50%, and may in some cases be substantially entirely invested in equities, both long and short.

Managed Futures: BarclayHedge US Managed Futures Industry Top 50 (BTop 50) Index. The Index seeks to replicate the overall composition of the managed futures industry with regard to trading style and overall market exposure.

Volatility Arbitrage: Hedge Fund Research HFRI Relative Value Volatility Index. Volatility strategies trade volatility as an asset class, employing arbitrage, directional, market neutral or a mix of types of strategies, and include exposures which can be long, short, neutral or variable to the direction of implied volatility, and can include both listed and unlisted instruments. Directional volatility strategies maintain exposure to the direction of implied volatility of a particular asset or, more generally, to the trend of implied volatility in broader asset classes. Arbitrage strategies employ an investment process designed to isolate opportunities between the price of multiple options or instruments. Volatility arbitrage positions typically maintain characteristic sensitivities to levels of implied and realized volatility, levels of interest rates and the valuation of the issuer's equity, among other more general market and idiosyncratic sensitivities.

Short Bias: Hedge Fund Research HFRI EH Short Bias Index. Short-Biased strategies employ analytical techniques in which the investment thesis is predicated on assessment of the valuation characteristics on the underlying companies with the goal of identifying overvalued companies.

Macro: Hedge Fund Research HFRI Macro Total Index. Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed-income, hard currency and commodity markets.

Equity Market Neutral: Hedge Fund Research HFRI EH Equity Market Neutral Index. Equity Market Neutral strategies employ sophisticated quantitative techniques of analyzing price data to ascertain information about future price movement and relationships between securities, select securities for purchase and sale. Equity Market Neutral Strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

Event Driven: Hedge Fund Research HFRI Event-Driven Total Index. Investment Managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments.

Distressed: Hedge Fund Research HFRI ED Distressed/Restructuring Total Index. Distressed/ Restructuring strategies employ an investment process focused on corporate fixed-income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance or obliged (par value) at maturity as a result of either formal bankruptcy proceeding or financial market perception of near term proceedings.

Credit Arbitrage: Hedge Fund Research HFRI ED Credit Arbitrage Index. Credit Arbitrage strategies employ an investment process designed to isolate attractive opportunities in corporate fixed-income securities; these include both senior and subordinated claims as well as bank debt and other outstanding obligations, structuring positions with little of no broad credit market exposure. These may also contain a limited exposure to government, sovereign, equity, convertible or other obligations but the focus of the strategy is primarily on fixed corporate obligations and other securities are held as component of positions within these structures.

Real Estate: Dow Jones US Real Estate Total Return Index. The DJ US Real Estate Index represents REITs & other companies that invest directly or indirectly in real estate through development, management or ownership, including property agencies.

Commodities: Bloomberg Commodity Total Return Index. The Bloomberg Commodity Total Return index is composed of futures contracts and reflects the returns on a fully collateralized investment in the Bloomberg Commodity Index. This combines the returns of the Bloomberg Commodity Index with the returns on cash collateral invested in 13 week (3 Month) U.S. Treasury Bills.

Investment Grade CDX Spread: Markit CDX North America Investment Grade Index. The Markit CDX North America Investment Grade Index is composed of 125 equally weighted credit default swaps on investment grade entities. A credit default swap is an agreement in which the buyer makes payments to the swap seller until maturity of the contract. In return the seller agrees that, in the event that the debt issuer has a credit event (missed payment or a default) the seller will pay the security's premium as well as interest.

Credit Spread: The difference in yield between two fixed-income instruments with differing credit profiles.

VIX: Chicago Board Options Exchange SPX Volatility Index. The Chicago Board Options Exchange Volatility Index reflects a market estimate of future volatility, based on the weighted average of the implied volatilities for a wide range of strike prices.

VStoxx 50: Euro Stoxx 50 Volatility Index VSTOXX. VSTOXX Index is based on a methodology jointly developed by Deutsche Borse and Goldman Sachs to measure volatility in the Eurozone. VSTOXX is based on the EURO STOXX 50 Index options traded on Eurex. It measures implied volatility on options with a rolling 30 day expiry.

BAA Corp: Moody's Bond Indices Corporate BAA. Moody's Long-Term Corporate Bond Yield Averages are derived from pricing data on a regularly replenished population of corporate bonds in the U.S. market, each with current outstandings over $100 million. The bonds have maturities as close as possible to 30 years; they are dropped from the list if their remaining life falls below 20 years, if they are susceptible to redemption, or if their ratings change. All yields are yield-to- maturity calculated on a semi-annual basis.

10-Yr Treasury: Yield of U.S. Treasury securities maturing in approximately 10 years.

S&P 500 Implied Volatility: 30 day implied volatility of S&P 500 options at 100.0% moneyness from Bloomberg volatility model. Moneyness is the relationship between the strike price of an option and the current price of its underlying security. 100% moneyness means the strike price and underlying security price are equal.

S&P 500 Realized Volatility: A measure of the risk of price moves for a security calculated from the standard deviation of day to day logarithmic historical price changes. The 30-day price volatility equals the annualized standard deviation of the relative price change for the 30 most recent trading days closing price, expressed as a percentage.

NYSE High/Low: Bloomberg New Highs and New Lows Sentiment Index NYSE. The New Highs and New Lows indices represent the 52-week highs/lows for the securities on a specific exchange (NYSE) on a given day. New Highs divided by the sum of the new highs plus the new lows.

NASDAQ High/Low: Bloomberg New Highs and New Lows Sentiment Index NASDAQ Composite. The New Highs and New Lows indices represent the 52-week highs/lows for the securities on a specific exchange (NASDAQ Composite) on a given day. New Highs divided by the sum of the new highs plus the new lows.

CBOE Skew Index: CBOE SKEW Index is a global, strike independent measure of the slope of the implied volatility curve that increases as this curve tends to steepen. The index is calculated from the price of a tradable portfolio of out-of-the money S&P 500 options. Out-of-the money call options are those in which the strike price of the option exceeds the price of the underlying security. Out-of-the-money put options are those in which the strike price of the option is below the price of the underlying security.

U.S. 30-Yr Treasury Yield: Yield of U.S. Treasury securities maturing in approximately 30 years.

S&P 500: An unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance.

Bloomberg Barclays High Yield Bonds: A component of the Bloomberg Barclays US Corp High Yield Index that is designed to track a more liquid component of the USD-denominated, high yield, fixed-rate corporate bond market. The US High Yield VLI uses the same eligibility criteria as the US Corp High Yield Index, but includes only the three largest bonds from each issuer that have a min amount outstanding of USD500mn and less than five years from issue date.

High-Yield Bonds: A component of the US Corp High Yield Index that is designed to track a more liquid component of the USD-denominated, high yield, fixed-rate corporate bond market. The US High Yield VLI uses the same eligibility criteria as the US Corp High Yield Index, but includes only the three largest bonds from each issuer that have a min amount outstanding of USD500mn and less than five years from issue date.

Chinese Renminbi: The S&P Chinese Renminbi Index is designed as a tradable index that replicates the performance of the Chinese Renminbi versus the U.S. Dollar.

Australian Dollar: The return from selling the short currency (USD) to buy the long currency (AUD) and earning interest. The return is calculated by adding the spot return to the interest earned from the long currency position. It is designed to measure the performance of the Australian dollar vs. the U.S. dollar.

Gold: The return of the gold spot price as quoted as U.S. dollars per Troy Ounce.

U.S. Treasury: The ICE U.S. Treasury 20+ Years Bond Index is part of a series of indices intended to assess U.S. Treasury issued debt. Only U.S. dollar denominated, fixed-rate securities with minimum term to maturity greater than twenty years are included.

Japanese Yen: The return from selling the short currency (USD) to buy the long currency (JPY) and earning interest. The return is calculated by adding the spot return to the interest earned from the long currency position. It is designed to measure the performance of the Japanese yen vs. the U.S. dollar.

Swiss Franc: The return from selling the short currency (USD) to buy the long currency (CHF) and earning interest. The return is calculated by adding the spot return to the interest earned from the long currency position. It is designed to measure the performance of the Swiss franc vs. the U.S. dollar.

MSCI EAFE: The MSCI EAFE Index covers Developed Market countries in Europe, Australasia, Israel, and the Far East. The index is a free-float weighted equity index.

MSCI Emerging: The MSCI Emerging Markets Index captures large and mid cap representation across Emerging Markets (EM) countries. The index is a free-float weighted equity index and captures 85% of the free float-adjusted market capitalization in each country.

Beta: A measure of the risk arising from exposure to general market movements as opposed to idiosyncratic factors.