2017 SECOND QUARTER MARKET REVIEW & OUTLOOK

JUNE 30, 2017

DISCLAIMER

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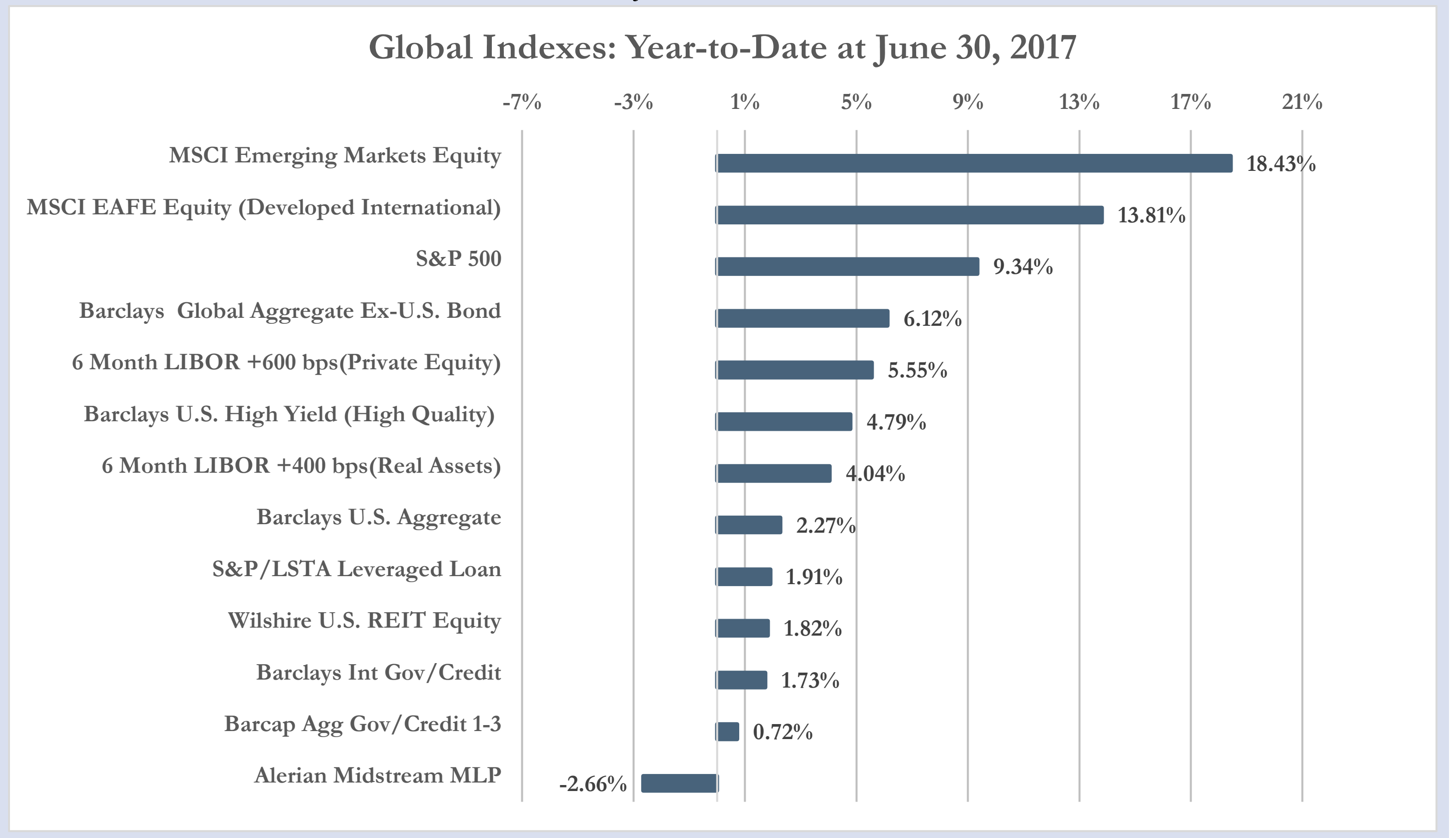
I. GLOBAL MARKETS "AT A GLANCE" – YEAR TO DATE AT JUNE 30, 2017

- Global equities performed well in the second quarter, supported by encouraging corporate earnings and generally positive economic data.
- U.S. equities gained in the second quarter despite heightened political uncertainty and volatile oil prices with the S&P up 3.1%.
- Domestic equity markets reacted favorably to FED's decision to raise base rates by 0.25% in June, and its plan to reduce its balance sheet.
- Midstream MLPs lost the positive momentum from 2016 as oil prices declined, but midstream remains attractively valued with high yields.
- International developed equities gained amid reduced political risk in the Eurozone and robust corporate earnings in the UK.
- Emerging market equities rallied in the second quarter, supported by a weaker U.S. dollar and a favorable global economic backdrop.
- U.S. Treasury yields declined, quarter-over-quarter, alongside the weakening of the U.S. dollar; the 10-year was down 5.6% over 12-mos.
- U.S. investment grade bonds rewarded investors with consistency of return and stable interest income during the second quarter.
- U.S. high yield bonds gained 2.2% in the second quarter, with the broad index offering yields in excess of 5.5% with minimal default risk.
- U.S. floating rate loans declined 0.04% in June, marking the first loss in 15-months, but yields are expected to drift higher as rates rise.
- Global bonds performed particularly well during the second quarter, supported by accommodative monetary policy, positive economic data, a weaker U.S. dollar and subdued inflation.

SELECT BENCHMARKS – YEAR-TO-DATE AT JUNE 30, 2017



Source: eVestment Analytics

II.GLOBAL ECONOMY – SECOND QUARTER 2017

Subdued Growth Forecast & Geopolitical Concerns

The global economy is forecast to grow over the next 18-months, but at a subdued pace. Real GDP is forecast to rise 2.3% in North America, 1.7% in the Eurozone and 4.6% in Asia Pacific. The global inflation forecast is also subdued, with analysts suggesting rates for 2018 of 2.2%, 1.7% and 2.2% in North America, the Eurozone and Asia Pacific, respectively.

The subdued global growth and inflation forecasts is disappointing considering the significant amount of monetary accommodation that has occurred over the last eight years. Interest rates remain close to zero in many countries, or negative in a few cases. The European Central Bank and Bank of Japan continue implementing quantitative easing programs, but despite the subdued growth forecast and below-target inflationary pressures, it seems likely that these countries will begin to discuss reducing monetary stimulus.

The U.S. Federal Reserve has taken the lead and begun actively tightening monetary policy. Since December 2015, the Fed has raised short-term rates three times, and is poised to announce a plan later in 2017 to reduce the Fed's balance sheet from $4.2 trillion to $2.2 trillion by 2022. Europe is considered to be in the early stage of its economic recovery, yet upbeat comments from European Central Bank head Mario Draghi have resulted in speculation that the ECB could scale back monetary accommodation sooner than expected.

As the U.S. Federal Reserve continues to tighten we see a significant flattening of the yield curve. It is likely to flatten further as the Fed continues to raise rates while growth and inflation forecasts remain subdued. Monetary tightening is intended to cool off an overheating economy, but previous tightening cycles have in some cases resulted in recession. The market expects one more rate hike in 2017 (December), and though a recession is not forecast, the monetary tightening could impact asset markets that are currently inflated due to investor demand for yield and capital appreciation. It is important that Central Banks act cautiously.

While monetary policy has the potential to impact the performance of the economy, geopolitical tensions have proven to be equally influential. Fortunately the European election results have been well received by the market, especially the victory of Macron in France. The UK general elections were less well received, with the Conservative Party losing its majority. Germany's general election is scheduled for September.

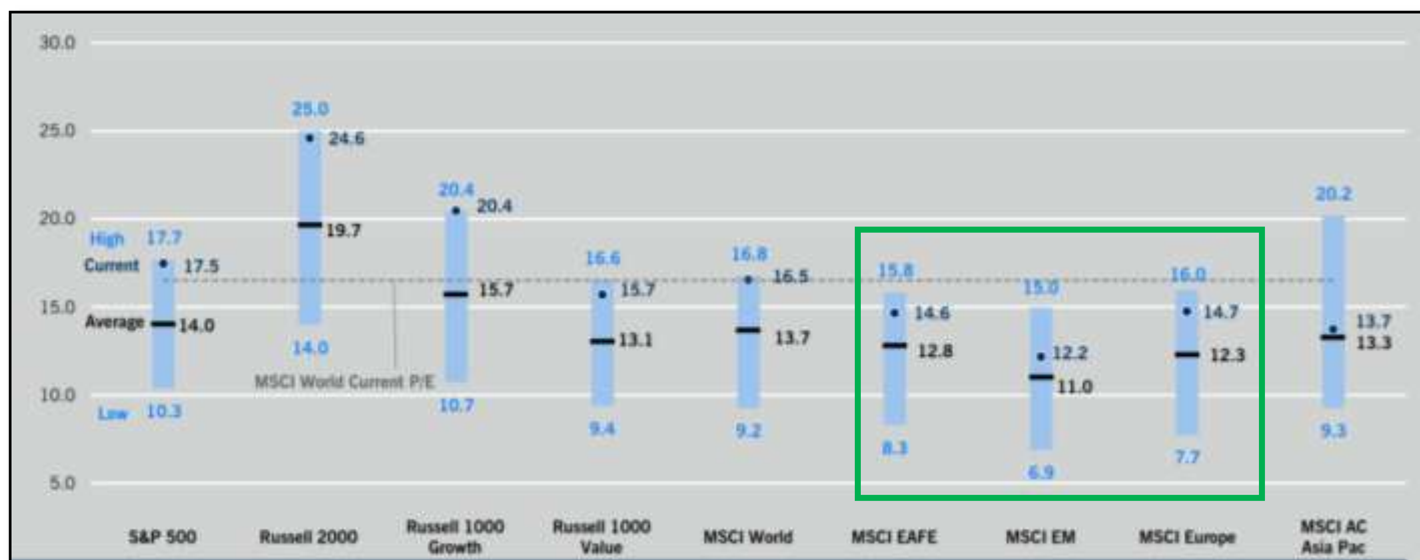
The U.S. is taking a more aggressive approach to renegotiating trade treaties with key allies and trading partners, including Canada, Mexico, and South Korea; recent discussions with China have failed. Although there is no doubt that the NAFT agreement could be improved with updating, the risk of a mis-step to the U.S. and North American economy cannot be discounted. Likewise, legal immigration reform could be either a significant positive or negative factor for U.S. growth and jobs.

Tensions have risen within the oil-producing countries of the Middle East. Saudi Arabia, the United Arab Emirates, Egypt and Bahrain broke relations and isolated Qatar with demands that it satisfy 13 specific demands before they will consider reestablishing relations. Qatar, which is backed by Iran and Turkey, has shown little intention of satisfying any of these demands. In addition to the stand-off between Qatar and OPEC, diplomatic relations between the U.S. and North Korea were further strained after Kim Jong-un's regime successfully tested its first intercontinental ballistic missile.

VALUATIONS

Every major global stock and fixed income market has performed well in 2017, with the lone exception of commodities. However, the reflation trade from 2016 has given way to the existing low-growth, low-rate and low-volatility environment, one in which asset prices have appreciated but growth and inflation forecasts are subdued and monetary support is withdrawn. While valuations appear full, as evidenced by the global equity chart below, we do see opportunities across equity and fixed income markets. The green box in the P/E chart below identifies the most attractively valued global equity regions, and the "X" marks in the chart under "Areas of Opportunity & Future Market Return" provide an insight into our best thinking on both equity and fixed income markets.

P/E (Next 12-Months) vs. 10-Year High, Low and Average



AREAS OF OPPORTUNITY & FUTURE MARKET RETURN

Asset Class	View	Tailwinds	Headwinds
U.S. Equity	----------X------	Healthy growth, moderating inflation, full employment.	Suspicion over certainty of proposed stimulus and reform.
Europe ex.-UK Equity	-------------X---	Improving fundamentals, attractive valuations, ECB support.	Brexit risk remains elevated, reduced monetary stimulus?
EM Equity	------------X----	Weaker U.S. dollar has driven return and fund flows.	China's growth outlook is uncertain, U.S. trade is critical.
REIT Equity	-------X---------	Full employment and higher wages should drive growth.	Rising interest rates and recent retail bankruptcies.
Midstream MLP	-----------X-----	High income, better coverage ratios, room to run.	Oil price volatility, infrastructure regulation, headline risk.
U.S. Treasuries	--X--------------	Low Inflation, higher yields expected.	Appear overvalued, Fed policy dependent.
IG U.S. Bonds	-------X---------	Low default rates, low volatility, ample new issuance.	Underwhelming yields, bonds trading at premium to par.
HY U.S. Bonds	-----------X-----	Low default risk, improving fundamentals, spread pickup.	Repricing, bonds trading at a premium to par.
Floating Rate Bonds	-----------X-----	Trading at discount to par, high relative yields, and buffer against rising rates.	Susceptible to secondary price retreats, oil price volatility and supply surpluses.
Global ex.-U.S. Bonds	---------X-------	Mature USD bull market, accommodative monetary policy.	Uncertain interest rate environment, sensitivity to currency/sector rotation.

III. FIXED INCOME MARKETS

Lower Yields Support Positive Returns

Major fixed income groups posted low single-digit total returns in the second quarter. Longer-term bonds were the strongest performers as they benefitted from a drop in long-term yields. Most credit-sensitive categories advanced following the continued narrowing of credit spreads. Despite a fourth policy rate-hike from the Federal Reserve in Q2 (2015-2017), bond yields moved even lower across categories during the quarter. Yields remained extremely low overall, and most sectors are considered expensive as credit spreads compressed further.

SELECT BENCHMARKS – GLOBAL FIXED INCOME MARKETS – **UPDATED JUNE 30, 2017**

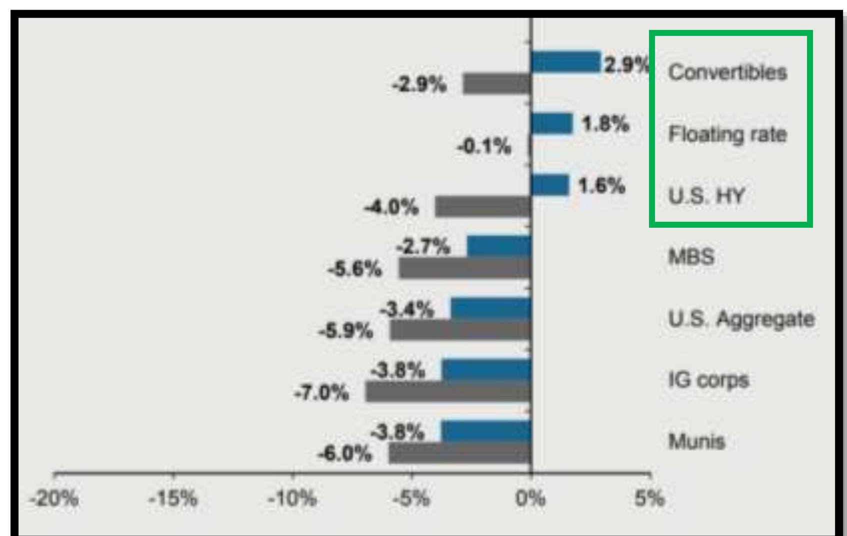
	2Q17	One Yr	Three Yr	Five Yr	Ten Yr
US Aggregate Bond	1.45	-0.31	2.48	2.21	4.48
US Municipal Bond	1.96	-0.49	3.33	3.26	4.60
US Corporate High Yield	2.17	12.70	4.48	6.89	7.67
US High Quality High Yield	2.68	9.83	5.21	6.80	8.20
S&P/LSTA Leveraged Loans	0.76	7.42	3.35	4.58	4.48
Global Agg. Ex-U.S.	3.55	-3.80	-2.42	-0.36	3.05

Source: eVestment Analytics

TAXABLE BONDS

U.S. Investment Grade Taxable Bonds [YTD +2.3%]

U.S. investment grade bonds posted a 1.5% total return in the second quarter, supported by a strong 2.5% return for U.S. corporate investment grade bonds. Asset backed bonds detracted the most from return, posting a gain of only 0.6%. Investment grade returns varied during the quarter, with AAA-rated bonds returning 3.6% compared to 2.7% for BBB-rated bonds. Investment grade bonds traded at a $5.60 premium to par at quarter-end while offering a yield of 3.2%. High yield bonds, in comparison, traded at a $1.30 premium to par while offering a yield of 5.7%. With default rates at or near historic lows, and considering investment grade bonds are the most sensitive to rises in interest rates (see chart), an argument can be made that investment grade bonds are less attractive than high yield bonds at this time. The following chart shows the impact of a 1% rise in interest rates on the major bond market asset classes.



TAX-EXEMPT BONDS

U.S. Investment Grade Municipal Bonds [YTD +3.6%]

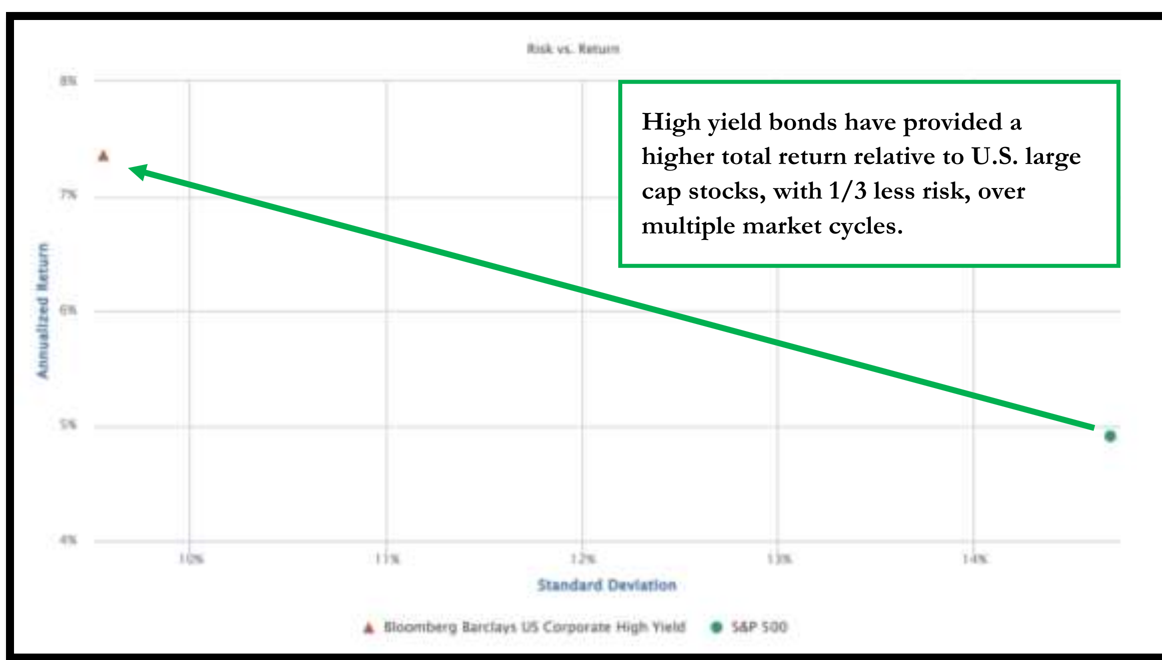
During the second quarter the average yield of the broad U.S. municipal bond market fell by 0.25% to 2.20%, producing a total return of 2.0%. Bonds with lower credit ratings generally outperformed bonds of higher quality during the quarter. Among investment grade bonds, the returns were 2.1% for bonds rated BBB vs 1.9% for AA rated bonds. The outperformance of the lower-rated bonds was in part because of their longer average durations, but also because of higher starting yields and some narrowing of credit spreads.

HIGH YIELD & FLOATING RATE

High Yield [YTD +4.9%]

Despite negative headlines, the high yield market experienced a clean sweep of positive monthly returns in the second quarter. High yield prices have remained relatively unchanged since the start of the year, and have changed little over the past two years, which belies the notion that the asset class is in a bubble. High yield bonds have performed well even through the 2014-2016 oil crash, the 2013 'Taper Tantrum" and the recent increases in the Federal Funds rate. In fact, the Barclays U.S. Corporate High Yield index has outperformed the S&P 500 index since 2000 with about 1/3 less risk (see chart below). That said, valuations for high yield bonds are high. This means that owning these lower-rated bonds is more about earning the yield and less about capital appreciation.

High Yield Bonds vs. U.S. Large Cap Stocks: 2000-2017



Floating Rate [YTD +1.9%]

The S&P/LSTA Leveraged Loan Index posted a decline of 0.04% in June, ending a 15-month winning streak. The loss is underscored by a large, sudden supply surplus in June, the first occurrence since February 2016. The weighted average bid of the LSTA/Leverage Loan index retreated 31 basis points in June, to $98.02 (discount to par), and is now slightly lower than the closing level for 2016. Despite the small negative monthly return, the asset class remains attractive when viewed in terms of valuation, high yield (+5%) and consistently low annual default rate (less than 2%).

OUTLOOK

It is likely that the Fed will continue its normalization initiative through the end of 2017 and into 2018. This could result in a further flattening of the yield curve, which could lead to more gains but at a cost of lower yields. Investment grade bonds are susceptible to higher interest rates, but corporate bonds are supported by improved labor markets and strong earnings and should remain a component of a properly diversified fixed income allocation. That said, lower quality bonds, especially high quality high yield bonds and floating rate loans, offer lower cost, higher yield and a cushion against rising rates. It is worth noting that these fixed income categories maintain default rates below 2%. Looking ahead, we believe a slight underweight to investment grade bonds, and a slight overweight to higher quality high yield bonds and loans is appropriate.

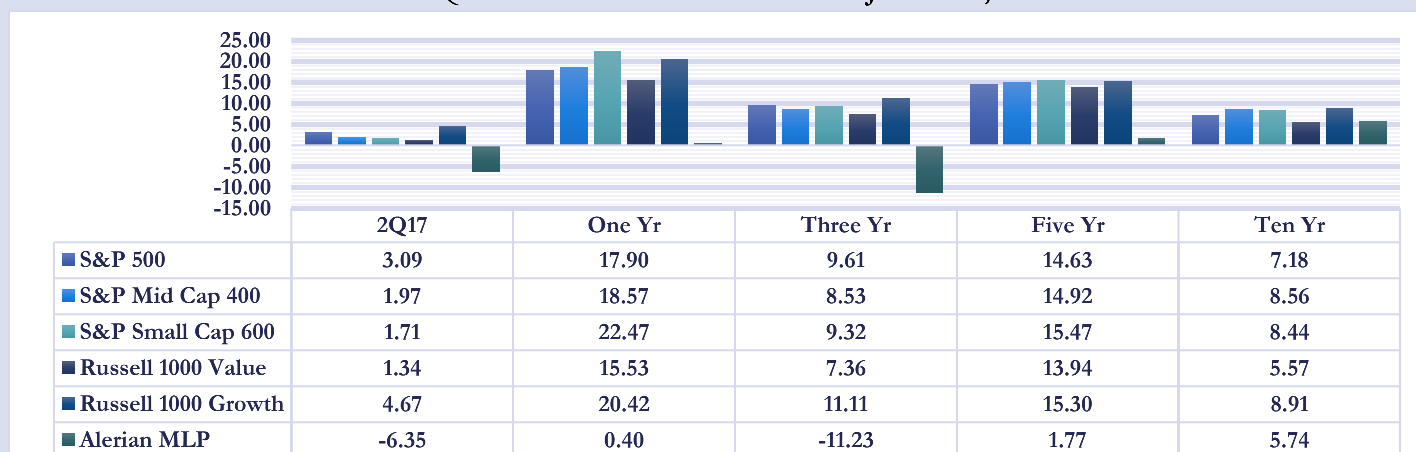
IV. U.S. EQUITY MARKET

U.S. Large Cap [YTD +9.3%]

U.S. equities advanced despite mixed economic data and political uncertainty. The S&P 500 experienced new record highs and posted a total return of 3.1% over the quarter. Some forward-looking indicators were unfavorable, including those used to measure the health of the manufacturing and consumer sectors, yet others, such as consumer spending and employment, were above consensus.

Growth and large-cap stocks continued to outpace other U.S. equity categories in Q2 due to their exposure to the improving international economic backdrop. Sector performance was varied, but generally positive, with only energy and telecommunication services experiencing outright declines. This was largely attributable to falling crude oil prices and price competition, respectively. Large cap equities outperformed small and mid-cap stocks over the quarter, with the S&P Mid Cap 400 and S&P Small Cap 600 recording respective total returns of 2.0% and 1.7%.

SELECT BENCHMARKS – U.S. EQUITY MARKETS – **UPDATED JUNE 30, 2017**



	2Q17	One Yr	Three Yr	Five Yr	Ten Yr
S&P 500	3.09	17.90	9.61	14.63	7.18
S&P Mid Cap 400	1.97	18.57	8.53	14.92	8.56
S&P Small Cap 600	1.71	22.47	9.32	15.47	8.44
Russell 1000 Value	1.34	15.53	7.36	13.94	5.57
Russell 1000 Growth	4.67	20.42	11.11	15.30	8.91
Alerian MLP	-6.35	0.40	-11.23	1.77	5.74

MASTER LIMITED PARTNERSHIPS (MIDSTREAM MLPS)

Master Limited Partnerships [YTD -2.6%]

The Alerian MLP Index fell 6.4% in the second quarter after gaining 4.0% in Q1. The sharp decline was precipitated by a $4.56 drop in oil prices, which ended the quarter 8.6% lower at $46.04 per barrel. Oil price

volatility was particularly high throughout the quarter, with a barrel of crude fluctuating between a high of $53.76 and a low of $42.05 (a difference of $11.71). The volatility was primarily attributable to OPEC's ousting of Qatar, and to a lesser extent the announcement that France would ban the sale of petrol engine powered pedestrian vehicles by 2040. The latter is an example of headline risk, as this announcement clearly rattled the commodity market despite the 20 plus years before the proposed implementation would impact consumers.

It is important to remember that the primary advantages of investing in MLPs is ultimately their underlying assets and the source of their cash flows. While MLPs are often described in a way that implies that the entire asset class generates predictable, fee-based cash flows, the reality is that of the approximately 130 publicly traded MLPs that exist today, only around 100 are classified as "energy MLP." Furthermore, it is important to understand that the risk spectrum shifts depending on the underlying assets of MLPs, the nature of the pipelines themselves, the commodities they carry, leverage, partnership structures and many other factors. Some MLPs generate seemingly high current income, while carrying correspondingly higher risk.

For example, during the most recent market downturn in 2015-2016, more than 67% of Exploration & Production, coal shipping and other Up/Down MLPs cut their distributions, while less than 10% of long-haul pipeline (Midstream) MLPs did. Not all investments labeled "MLP" are the same, so it is important to work with specialized managers that have the experience and resources necessary to construct and manage a concentrated portfolio (yet diversified) of MLPs and Mid-stream energy C-Corporations that offer; 1) stability of the dividend distribution, 2) positive 3-5 year estimated growth rates of the dividend distributions, 3) attractive current valuations relative to proprietary assessment of the stocks intrinsic value, 4) cash flow stability, 5) minimal commodity price sensitivity, 6) strong distribution coverage, and 7) a healthy balance sheet health and leverage profile.

V. INTERNATIONAL DEVELOPED & EMERGING MARKETS

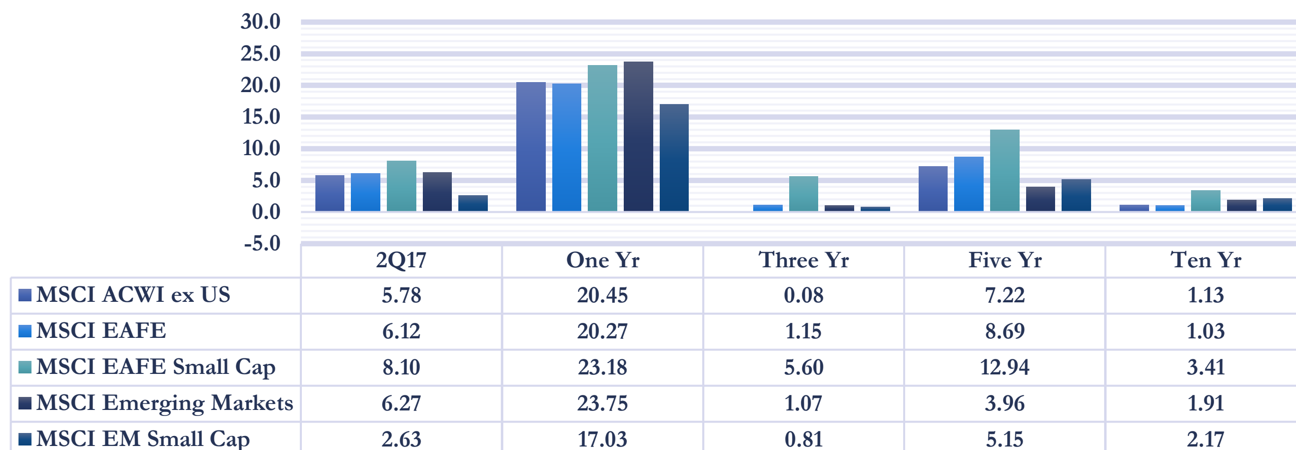
International Developed [YTD +13.8%]

International equity markets continued to record gains during the second quarter, led by large cap technology stocks that rallied against a generally positive global economic backdrop and robust earnings growth. The MSCI EAFE index posted a total return of 6.1% in Q2, and offered a yield of 3.1%. Eurozone equities gained as political risks abated, but gains were capped due to concerns that the central bank could start to tighten monetary policy. UK equities were positive due to strong corporate earnings, but volatility remained high through the quarter. The UK volatility was a result of political unrest and monetary policy uncertainty. Japan registered positive returns amid an encouraging corporate earnings season and upbeat assessment from the Bank of Japan on the health of the economy.

Emerging Markets [YTD +18.4%]

Emerging market equities gained 6.3% in the second quarter. The strong return was attributable to a supportive global backdrop and a weaker U.S. dollar. Emerging markets equities remain the most attractively priced global equity category, and the index currently yields 2.4%.

SELECT BENCHMARKS – NON-U.S. EQUITY MARKETS – **UPDATED JUNE 30, 2017**



	2Q17	One Yr	Three Yr	Five Yr	Ten Yr
MSCI ACWI ex US	5.78	20.45	0.08	7.22	1.13
MSCI EAFE	6.12	20.27	1.15	8.69	1.03
MSCI EAFE Small Cap	8.10	23.18	5.60	12.94	3.41
MSCI Emerging Markets	6.27	23.75	1.07	3.96	1.91
MSCI EM Small Cap	2.63	17.03	0.81	5.15	2.17

OUTLOOK

U.S. equity markets continue to advance, but for how long? The reflation trade appears to be nearing an end, yet corporate profits remain strong and the global economic backdrop should support growth. The Fed has maintained its confidence in the economy, evidenced by the succession of rate hikes and a determination to trim the balance sheet, but additional tightening could curb future growth.

In addition, valuations appear close to full and yields on domestic equities fall short of those offered overseas. Considering these points, it is reasonable to expect U.S. common equities to continue their upward growth trend. The most attractive domestic equity category remains MLPs, however, which are attractively priced, have ample room to run, and offer current yields in excess of 7%.

Developed international and emerging markets equities are more attractively priced relative to U.S. common stocks, and should be considered as suitable categories for new or rebalanced capital. Offering higher yields than traditional U.S. common equity, these asset classes are currently enjoying accelerating earnings growth. The early discussions about reducing monetary accommodation should be monitored, but the reduced European unrest, strong corporate profits and generally improving labor market data supports a continuation of the growth trend witnessed in 2016 and the first half of 2017.

VI. TAILWINDS & HEADWINDS – SECOND HALF 2017

Region	Tailwinds	Headwinds
United States	Oil Price Stabilization	Foreign Trade Policy
	Tax, Infrastructure & Regulatory Reform	Ability to Deliver on Objectives
	Declining Unemployment	Weakening U.S. Dollar
	Low Credit Defaults	Fed Tightening
Developed International	Accommodative Central Banks (Japan and Europe)	Political Diversion
	Improving Employment	Unemployment Still High
	Improving Bank Lending	Tight Lending Conditions
Emerging Markets	Weakening U.S. Dollar	U.S. Trade Policy
	6.5% China GDP - Attainable	Rising U.S. Rates
	Low Corporate & Government Debt	Slowing Global Growth

VII. GLOBAL ASSET ALLOCATION VIEWS – SECOND HALF 2017

Asset Class	Sub-Class	Outlook	Underweight	Neutral	Overweight
Main Asset Classes	Equities	↑			✓
	Credit	↑		✓	
	Cash	↓	✓		
Equities	U.S. Large	↑			✓
	U.S. Mid/Small	↑	✓		
	Europe ex-UK	↑		✓	
	UK	↓	✓		
	Emerging Markets	↓		✓	
	U.S. REITs	↑		✓	
	Midstream MLPs	↑			✓
Credit	U.S. Investment Grade	↓		✓	
	U.S. Treasuries	↓	✓		
	U.S. High Yield	-			✓
	Floating Rate	-			✓
	Bank Loans	↓		✓	
	EM Debt	↑	✓		
	Credit L.P.	↑		✓	