ABBOT DOWNING

ABBOT DOWNING STRATEGY REPORT

The Great Moderation

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In this issue:

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The Great Moderation

> *"Excess on occasion is exhilarating. It prevents moderation from acquiring the deadening effect of a habit."*
>
> W. Somerset Maugham

After plenty of "excess" to mark the end of 2018 and beginning of 2019, investors are working to discern what comes next—and, we suspect, hoping for a bit less "exhilaration". Trouble is, while markets may well benefit technically from a period of sideways movement to consolidate the rapid gains made in January, investors like action (preferably to the upside, of course). Our natural wiring leads us to prefer doing *something* versus standing still, perhaps to stave off the "deadening effects" of learning a sloth-some habit.

Behavioral scientists tell us that human psyches abhor uncertainty and seek to bring order and predictability to their affairs. Unfortunately, markets are by their nature unpredictable and the traditional guide posts we often use to help outline the range of possible outcomes are themselves rather opaque at the moment. This is likely to remain true until the next earnings season kicks off in early April. Despite this, our sense is that the domestic economy is in reasonable shape with a more sustainable growth trajectory than the torrid, tax-cut-fueled pace of last year. While Developed Market (DM) growth is slowing (and turning negative in some countries such as Italy and for a quarter even Germany)[1], European Central Bankers remain accommodative, pulling many different levers in an attempt to stabilize activity. Emerging Market (EM) economies are growing more rapidly than much of the rest of the world[2], partially influenced by demographics and growing middle classes.

We recently reduced our long-standing global equity overweight to neutral by trimming DM equity holdings. Portfolios remain underweight fixed income, with proceeds held in cash and Master Limited Partnerships. Our highest probability scenario is that global economies are entering a moderation—not a deceleration phase and that the next recession is still a ways off. Nonetheless, we believe it prudent, especially after the markets, represented by the S&P 500 Index, near 20% advance off the December 24, 2018 lows[3], to err on the side of more predictable yields until data and market direction sort themselves out. Some of the strengths and concerns we are watching are outlined below.

OF CONCERN

U.S. Data is Muddy – and likely won't clarify anytime soon. The government shutdown, unusually harsh weather in much of the country, and the knock on impact of tariffs to supply chains and consumers produce winners and losers, though it's tough to read at this point which direction aggregating those impacts moves the needle. As if that weren't enough Q1 GDP data is notoriously confusing/messy to begin with. While this murkiness is tough for investors, we suspect it is less impactful for a patient, "data dependent" Federal Reserve where each of the local banks have broad and deep qualitative ties into all aspects of activity in their regions. The Beige Book will make for interesting reading these next few months!

Trade War – while the next round of potential increases on Chinese goods is pushed off for some unknown length of time, the tariffs already in place are having a direct impact on U.S. consumers and domestic businesses engaged in any part of the global supply chain. A recent report by the Centre for Economic Policy Research, notes that the impact of the current round of tariffs levied against China and others are falling entirely on the shoulders of U.S. consumers and import businesses—to the tune of an estimated $4.4 billion per month in added tax costs and "efficiency losses".[4]

It also noted evidence that this protection of domestic suppliers was leading to price increases in effected industries. Interestingly, the paper also asserts that these impacts are similar in countries that levied retaliatory levies (i.e., their consumers and importers are bearing the brunt). Keep in mind, this is the direct cost, and does not factor in all the ancillary turmoil caused by disrupted supply chains, delayed capital expenditures, nervous business owners, and concerned citizens. We suspect resolution not only to stave off new tariffs, but to cancel old ones would be a big boost to consumer, business, and market psychology.

Geopolitics – many things are in hand, if not entirely settled for now. Or perhaps investors are just tired of hearing about all of them and trying to parse potential market impact. Brexit, of course remains an open wound with unknown outcome as of this writing. Markets are behaving as if an extension will be asked for and granted (then again they were relatively peaceful in front of the 2016 vote in the first place too—subsequently reacting badly to the outcome). Relations with North Korea are in stalemate—but at least the rhetoric is not as vehement as it was early in the current presidency. Chaos in Venezuela and orderly production cuts from OPEC have pushed energy prices higher which helps some and hurts others. Relations with Iran are testy. While we rarely, if ever, would recommend shifting allocations based on global geopolitics, there are enough moving parts to impact investor and business confidence until more concrete resolutions are at hand.

The Global Economy – has slowed some, particularly in many DM countries as businesses in the EU in particular try to reposition supply chains, staff, and infrastructure to adapt to a post Brexit world. All eyes are on China and its attempts to reflate a slowing economy—which can be a tough act given both the country's large debt load (especially among shadow banks) and it's rapidly aging work force. In just the past five to 10 years, China's population has gone from global growth miracle to an aging problem more akin to many DM countries.

Behavior of Growth Versus Value Stocks – a hallmark of the two spikes in volatility in 2018 was that the so-called "risk on" trade (high P/E stocks, growth industries, high yield bonds, and emerging market assets) did not get hit as hard on the downside, and rallied upwards on the subsequent upswing. Indeed EM stocks and debt held up exceedingly well during November to December of 2018, only dropping low single digits versus double digit declines for domestic assets.[5]

Another hallmark of the past year or two was the wide divergence—sometimes as much as approximately 30 points between the performance of growth and value indexes as illustrated by MSCI Growth and Value indexes. Year to date in 2019, however, this disparity has closed, and we have seen groups like utilities and other traditionally defensive names hold steady/rise in the most volatile days.

POSITIVES TO BEAR IN MIND

Valuations are Lower – despite the fact that markets have regained nearly all of their losses since the late 2018 swoon. Thank solid earnings growth and rolling to 2019 numbers.

Central Banks are Accommodative and the Fed is On Hold – creating an environment where credit is more easily available than it seemed a quarter or two ago.[6]

Earnings Season – is right around the corner. We suspect the media will start talking about the potential for an "earnings recession" in the first half of the year. But given the tax cut fueled near 30% increase in last year's first couple of quarters,[7] flattish overall numbers would still represent solid progress. By the back half of the year, 2018 numbers will be lapped and we suspect full year numbers will show a low-to-mid single digits earnings increase for the aggregate S&P 500 companies.

Signs of Market Excess – are largely absent. Bull market endings are often accompanied by certain indicators of excess such as accelerating Initial Public Offerings (IPO's); mergers and acquisitions (M&A) constructed at record valuations; substantially easier credit terms; and ebullient investor sentiment. Further, there is often a generalized feeling of complacency amidst the notion that "the really good times could roll forever". While some of this activity is starting to appear, it is nowhere near the frothy state witnessed in prior bull market blow offs (think dot.com stocks in 1999).

Recent Economic Stats – have shown some signs of strength, including wage growth, the employment rate, and new home sales. The next few months should bring clarity to a number of factors and cleaner numbers to boot, allowing the "moderation" we suspect we are currently in to extend for longer than many now suspect probable.

If Goldilocks Managed Assets

> *"They refused to receive her; and at this rebuff, the angry old woman went home in a huff."*
>
> Eleanor Mure,
> *The Story of the Three Bears*

Eleanor Mure was not a famous writer, in fact very little is known about who exactly she was. What is known is that she was an artistic aunt who in 1831 captured what is considered to be the first written version of The Three Bears fairy tale in a book of poems she authored and illustrated for her favorite nephew. In this early version, the human intruder was represented by a "meddlesome old woman". The woman didn't transform into a young fair-haired girl until later versions, and didn't get her name Goldilocks until almost a century later. There are a number of different industry professionals that owe a debt of gratitude to Flora Annie Steel for her eponymous change to the story in her book *English Fairy Tales*. The story provides us with a clearly defined distinction between what is commonly viewed as two polar extremes and the 'just right' choice made by Goldilocks. Without her how else would we describe things that inhabit the perfect zone between two extremes? Federal Reserve Chairman Jerome Powell detailing the circumstances of a 'meddlesome old woman economy' just doesn't have the same ring to it as the common reference to a 'Goldilocks economy.'

When it is Better to be Small

Where we are different is that we can 'think big and act small'. Because of the unique client base that we serve, some investments are only available to Abbot Downing clients. This provides us with several distinct advantages—two in particular are speed and differentiation. We explore "unloved" sectors early, before they've become front page news. We don't have to wait until the firm has $1 billion in capital available for the opportunity. Our private capital due diligence efforts can focus on smaller fund sizes in these sectors that require a highly experienced team to be able to vet successfully. By moving quickly into these niche areas, without sacrificing any of the due diligence rigor, we can provide clients with exposure to a highly differentiated set of investment opportunities that are far too small for many of our competitors. In 2018 alone we added exposure to a $200 million opportunistic credit strategy, a $250 million highly diversified venture capital strategy, and a $250 million fund that is a very creatively structured way to access socially-responsible timber investing.

When it Helps to be Big

The ability to properly assess the potential future success of an investment style, product, or manager often comes down to hard work; performing deep, thorough due diligence to fully vet both the opportunity and the risks. As a part of the bank, our due diligence team often leverages the knowledge of our partners in other areas—something we only benefit from because we are part of a much larger organization. This network provides real-time market intelligence that is used to help source the best investment opportunities for our clients and allows access to unique niches not readily available to the public.

For example, we have worked with our partners in Middle Market Banking (MMB has 130 offices nationwide) to analyze the existing credit market conditions facing small to medium sized companies. Much has been made over the last several years about how lending terms have become much more favorable for borrowers. These so-called 'covenant lite' deals are important to understand as they can meaningfully impact the amount lenders get back in the event that a company defaults. Our MMB partners have given us a much clearer view of the landscape, allowing us to avoid some industries where this practice is particularly prevalent, while locating other industries where investment opportunities are still favorably tilted towards the lender. Similarly, we have worked with colleagues in the Energy Banking Group (2nd largest equity capital markets bank in energy and utilities) to help gauge where the value might be in both traditional and alternative energy investments. Our Commercial Real Estate Group (#1 commercial real estate lender in the U.S. since 2009) has been an invaluable partner helping us perform due diligence on senior management at funds we may be looking to invest capital with. These and several other partnerships throughout the bank have allowed us to locate unique investment opportunities and/or avoid under-appreciated risks within an industry or geography.

In addition to being part of a large bank, we also consider the amount of managed assets within Abbot Downing (currently $45 billion) to be of a significant enough size to gain access to managers that are often not available to individual investors. Managers with successful track records—particularly those in the alternative investments space—can often pick and choose their investors. We stack up very well because we have a large asset base but a small imprint on their resources. The advantage lies in the 'commingled, but not commingled' aspect of how we put client assets to work. From the manager's perspective, we are often seen as a commingled account—a single client. This means, for example, that the Portfolio Manager and investment team can speak to our Abbot Downing due diligence team as a single point of contact requiring much less bandwidth than if they had to meet with each individual investor. But behind the scenes we have the operational expertise (leveraging the tools within the larger Wells Fargo) to put our clients into investments as individual Limited Partners; as opposed to using feeder funds which can add a layer of fees. To the manager we feel like a large single client. For our clients we get them access to these best-in-class managers at very low minimums.

Conclusion

Ultimately the benefits of being both large and small as an organization flow through to being able to build an investment platform recognized in the industry as being best-in-class, which ultimately helps our clients reach their financial goals. We're happy with the modern version of the Goldilocks story and feel the analogy works pretty well. Her story was not originally designed to relate a tale of seeking out what you want until you find something that is 'just right'. Along the way authors changed the intruder from an old woman to a young girl to act as a cautionary tale to children about the dangers of wandering far from home. Mure's original version was designed to warn her nephew about the dangers of being 'meddlesome'; she drove her point home by having the bears catch the woman, burn her, drown her and then impale her on the steeple of St. Paul's Cathedral ('thanks for the bedtime story, aunt Eleanor...'). In many respects we consider Abbot Downing to be a 'Goldilocks' business model; a boutique business within the Wealth and Investment Management division providing personalized service enhanced by the strength and vast resources of Wells Fargo.[8]

Key Market Events

Listed below are key upcoming events and/or accelerating trends we're watching especially closely, as well as a few comments related to how they may impact short-term markets.

The Return of Volatility

Global equity markets have rebounded from the sharp losses experienced in Q4. The S&P 500 has rebounded 20% from the recent low on December 24, 2018. A more cautious tone in comments from the Fed chairman Jerome Powell on future rate hikes and balance sheet reduction, combined with increased optimism that a U.S.-China trade deal will be completed are key factors for the stock-market turnaround. Although the February employment report was weaker than expected, weather was probably a factor and other jobs data for the month were positive; the risk of a U.S. recession seems remote in 2019. Nevertheless, market gyrations will most likely continue throughout the year, as two potential headwinds will be continuously scrutinized—the extent to which S&P 500 EPS growth decelerates from the unsustainable pace of 20% plus in 2018, and the magnitude of China's economic slowdown.

Behind the broad, swift equity-market slide of 2018 and rebound in early 2019 is an underlying new reality: Roughly 85% of all trading is on autopilot—controlled by machines, models, or passive investing formulas.[9] While fundamentals ultimately drive capital markets in the long run, the aforementioned program-trading environment combined with an extended business cycle will likely result in continued volatility in 2019.

Global Trade

President Trump and China's leader Xi Jinping met in Buenos Aires during the G-20 summit, and announced a temporary trade deal with the U.S. agreeing to hold off on raising tariffs to 25% from 10% on $200 billion of Chinese goods until March 1. And there have been significant concessions from China since November: Beijing has agreed to reduce tariffs on auto imports, increased purchases of U.S. agricultural products, promised to ease foreign joint venture regulations (including allowing foreign institutions majority ownership of financial institutions), and publicly acknowledged that more needs to be done with foreign intellectual property. The most difficult issue to resolve is how to enforce any agreement; the U.S. wants a binding, written agreement that will finally hold China accountable to their promises. Chief U.S. trade negotiator Robert Lighthizer recently spoke before the Senate finance committee and suggested negotiations with Beijing were reaching the final stages, but that a deal could not be taken for granted. Pressure is growing on the U.S. and China to forge a trade deal. Investors have been heartened by signs that President Trump is looking to sign a deal with Chinese leader Xi Jinping, although this is more likely to occur in April at the earliest according to sources from both sides.

Global trade negotiations have evolved into a political chess match that is highly unpredictable and we feel they thus carry a greater than average risk of "surprising" investors and markets.

Domestic Geopolitical Concerns

Historically, equity markets have corrected in the run-up to midterm elections, but once this uncertainty has been removed following the election, stocks have performed well over the following 12 months—regardless of which party was in charge before or after the election. Looking forward however, the new Democrat Party-controlled House of Representatives could add to market volatility in this rather hostile political environment. Although the new U.S. tax bill with permanently lower corporate tax rates and immediate write off of capital expenditures for the next five years is currently not in danger of being overturned, issues relating to deficits, regulation, the environment, and fiscal spending will likely produce added friction. Case and point, President Trump initiated a controversial national emergency in order to transfer military funds to secure the U.S. border—a decree that will likely face challenges in the judicial system.

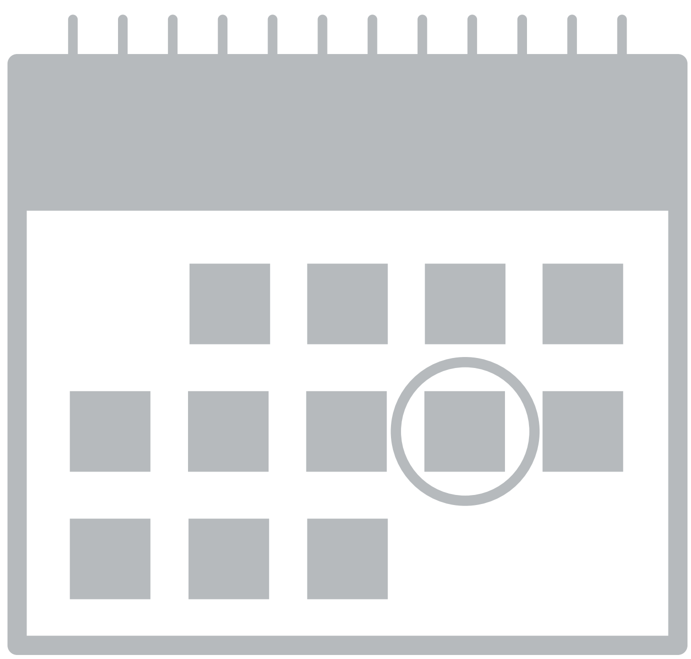
Although still early in the cycle, investors are beginning to focus more attention on the 2020 presidential election. New proposals focusing on higher taxes and regulations from recently-announced contenders will likely rattle equity markets heading into the primary season.

Finally, the Mueller investigation surrounding the 2016 election will undoubtedly result in partisan attacks from both political parties when a final report from the independent counsel is ultimately submitted—probably fairly soon. House Democrats have also promised hearings on President Trump's tax returns and prior financial dealings.

Commodity Prices

WTI crude prices have recently plunged from $76 per barrel to $42 per barrel in Q4—before rebounding back to $58 early this year, as the Trump Administration eased sanctions on Iran by allowing key trading partners to continue buying its oil, along with a massive unwinding of hedge-fund long positions in futures markets. Oil prices are expected to increase and trade between $60 to $70 over the next year due to OPEC and Russian production cuts along with a re-emergence of political risks (Iran, Venezuela). The falling prices have been beneficial in headline inflation numbers such as CPI and PPI, perhaps giving the Fed wiggle room in moderating the pace of rate hikes in 2019.

Commodities price volatility, especially to the upside, could further stoke investor nerves regarding inflationary pressures.



Central Bank Meetings—The Fed and The ECB

The U.S. Federal Reserve voted to maintain the target range for the federal funds rate at 2.25% to 2.50% at the January meeting, and is expected to leave rates steady at the March meeting. The future path of interest rates (as projected by the FOMC "dot plots") was also unchanged with two rate increases expected in 2019. In the meantime, futures markets indicate a low probability of further hikes in 2019. The Fed is clearly in a pause mode; officials have stopped talking about the need to lift interest rates, a stark change from three months ago.

QE tapering will remain a focus in 2019, as the Fed reduces the bond purchasing program initiated in the wake of the financial crisis. At the January FOMC meeting, the Fed announced it will continue reducing Treasury security purchases by up to $30 billion per month and mortgage-backed purchases by up to $20 billion monthly. The Fed also left open the possibility of adjusting its balance sheet reduction plan in the future if it needs to respond to economic and financial developments. Adding to the demand/supply issue is the fact that the U.S. Treasury has begun increasing its issuance of T-bills, notes, and bonds to pay for an expanding deficit, and increased government spending. Investors will be watching closely to see if yields are forced upward given the extra supply, reduced demand and pending what happens with the U.S. Budget appropriations in coming weeks.

Employment cost index releases should continue to spawn market volatility; recent monthly unemployment reports have reached the lowest levels since year 2000 and year-over-year wage gains exceeding 3.0% have been the best since 2009. These are likely to be much-watched statistics for the remainder of the year along with their inferred implication for Fed monetary policy decisions.

Acting less than three months after it phased out a 2.6 trillion euro bond-buying program, the ECB introduced surprise plans to stimulate the European economy: (1) Pushing an interest-rate increase into 2020 at the earliest, after previously suggesting one might come this year, (2) Issue more targeted long-term refinancing operations—TLTROs—to provide cheap funding to European banks until 2023, and (3) Roll over in full maturing bonds acquired under its QE program.

We feel that markets will remain focused on the progress of inflation and the Fed's comments surrounding economic health. Fed Chair Powell held a press conference following the January meeting, and he noted that the Fed will discuss balance sheet plans and reserve levels at future meetings, while continuing to follow a data-dependent approach to any rate changes. To help increase transparency, Chair Powell has initiated the practice of holding a press conference after every FOMC meeting, while press conferences generally were held at every other meeting in the past.

We believe markets will also continue to scrutinize ECB President Mario Draghi's comments. After unveiling the aforementioned new stimulus plan, Mr. Draghi blamed the Eurozone's weakness on external factors—protectionism, geopolitical uncertainty, and fragility in some emerging economies.

Techlash

Despite rebounding sharply in early 2019 and outperforming the S&P 500 year to date, the tech sector will likely continue to experience greater volatility relative to other equity sectors. High profile (and continued) hacks, data misuse announcements, and potential meddling/manipulation of data feeds by a variety of bad actors continue to plague many players. Key leaders from companies like Google and Facebook are making repeat visits to testify in front of congressional panels, and moves against key global players by the U.S. and China keep the industry in the headline news flow. Most recently, two influential Senators (including a Presidential contender) recommended breaking up big tech companies like Facebook and Amazon. Scrutiny of the all-important technology sector is likely to continue and bears watching as any unexpectedly negative announcement—even if preliminary—could impact the stocks.

In addition to regulatory issues, tech stocks have come under pressure due to fundamentals; concerns of peak earnings, slowing revenue, and high valuations have led to additional volatility for this sector. Indeed, shares of Apple, Inc. initially plunged after management slashed its quarterly revenue forecast for the first time in 15 years, prompted by a slowdown in sales of iPhones in China.

The European Union is far ahead of the U.S. on this front and has already lodged fines on affected companies from Facebook to Apple. Given the high profile, and growth-valuations that many individual names bear, we expect news flow and market sentiment to continue to buffet the industry on a day-to-day basis.

U.S. Economic Data Heading into 2019

According to the U.S. Bureau of Economic Analysis (BEA), the latest GDP report showed the U.S. economy accelerating 2.6% on an annualized basis in Q4, down from 3.5% in Q3. Overall, U.S. GDP growth advanced 3.0% in 2019, and is forecast to increase 2.5% in 2019. We believe the latest data inputs support continued growth through 2019: leading economic indicators (LEI), quality corporate bond spreads, and manufacturing surveys are all forecasting solid expansion.

Although output has clearly accelerated throughout 2018, we believe monitoring incoming data late in a business cycle for signs of acceleration and deceleration is prudent as year 2019 progresses.

Non-U.S. Geopolitical Concerns

Corporate fundamentals in Europe and Japan have improved, but investors should still be aware of political risks. For example, uncertainties surrounding the Brexit endgame continue to heighten levels of market volatility. Last week, members of U.K. parliament (MPs) in the House of Commons resoundingly rejected for a second time Theresa May's Brexit deal that she negotiated with the EU. A day later, lawmakers ruled out a no-deal exit from the European Union. As of this writing, Parliament voted to extend the Brexit deadline from March 29 to June 30, if a deal can be reached on how to approach the EU with the extension; an extension would require the unanimous approval of the other 27 EU governments. The closer Brexit negotiations reach the deadline for the U.K. to quit the EU without an agreement (Hard Brexit), the more uncertainty it creates for European businesses and capital markets.

France has endured 13 straight weekends of "Yellow-Vest" demonstrations with no signs of letting up, sparked by new fuel taxes that disproportionately hurt workers who commute from the suburbs and rural areas. In response, President Emmaneual Macron rolled back the fuel tax and some pension taxes, while also increasing the minimum wage. Although Mr. Macron promised to continue his broader pro-business agenda (the wealth tax was not reinstated), the riots are still likely to negatively impact future reforms.

Italy currently has a coalition government formed by two populist parties: The left-wing 5 Star movement and the right-wing Lega party, which presents a complicated situation. Indeed, the Italian parliament initially produced a budget that was rejected by the EU based on spending rules and debt levels. Brussels has demanded that Italy revise and resubmit its budget. Moody's subsequently downgraded Italy's debt, while Standard and Poors has "lowered its outlook" on Italy. Italy countered with a revised deficit target proposal in line with demands by the EU (from 2.4% to 2.0% of GDP). The yield on the country's 10-year government bonds dropped to 2.5% for the first time since July and stocks climbed on the news. Nevertheless, the Italian economy fell into a technical recession in the last half of 2018 after a sharp increase in borrowing costs and political uncertainty regarding the stand-off with Brussels over its budget plans.

Investors are keenly aware of intense political divisions within the European bloc that could be disruptive. In its latest assessment of "imbalances" in its member state economies, the EU highlighted Italy as one of three countries—along with Greece and Spain—that is suffering from excessive economic imbalances.

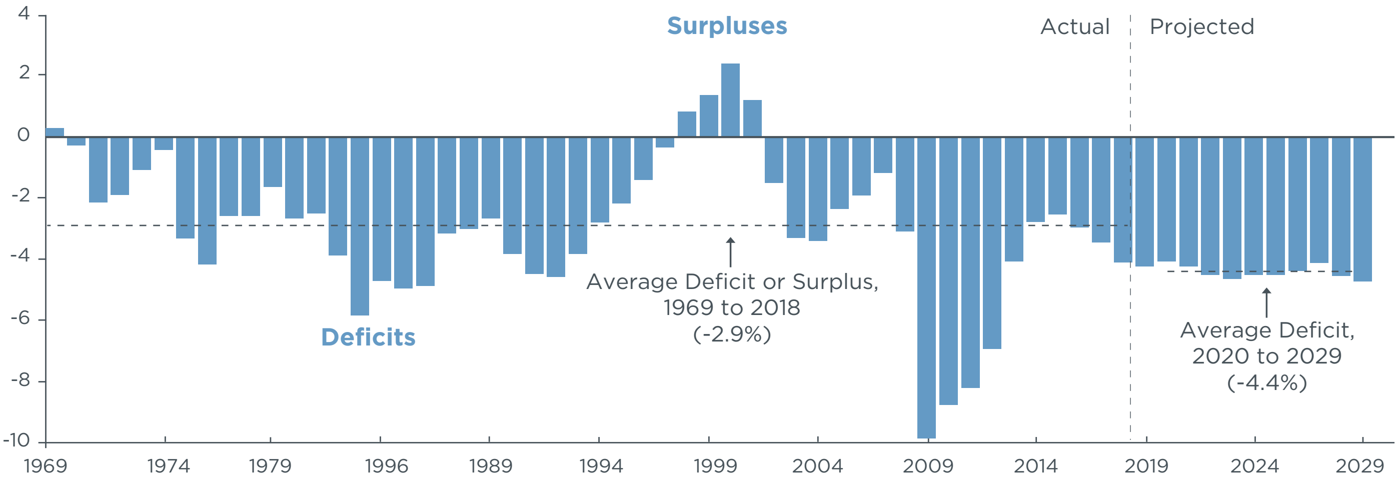
Notable Observations

Growing Indebtedness

The Congressional Budget Office (the non-partisan research arm for Congress) recently released its 2019 and beyond outlook for the U.S. Economy. A companion piece, "The Budget Outlook for 2019 to 2029 in 16 slides" had some especially intriguing charts related to past, current and more importantly, projected deficits and debt levels. While the popular lore is that "citizens don't vote their deficit concerns" (giving politicians an understandable pass to largely ignore them) if even part of the CBO's projections come to fruition, perhaps this will change in years ahead?

Chart A: Historical and Projected Federal Budget Deficits

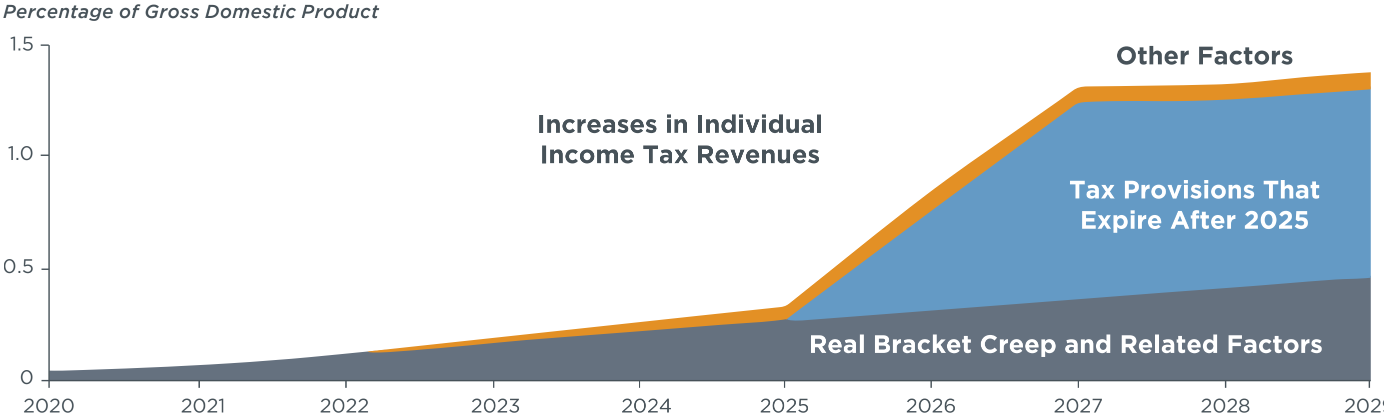
Percentage of Gross Domestic Product



Source: Congressional Budget Office, The Budget Outlook for 2019 to 2029 in 16 slides, March 2019

Chart B: Historical and Projected Federal Debt Held by the Public

Percentage of Gross Domestic Product



Source: Congressional Budget Office, The Budget Outlook for 2019 to 2029 in 16 slides, March 2019

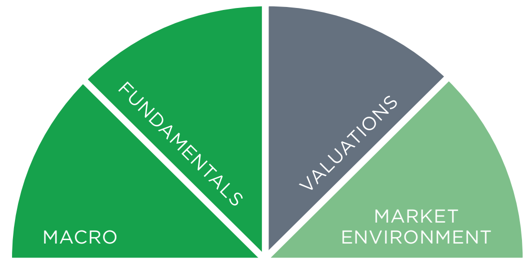
Dynamic Allocation Summary

Global Equities Outlook Overview

U.S. Large Cap Equities

Outlook: Mixed Positive

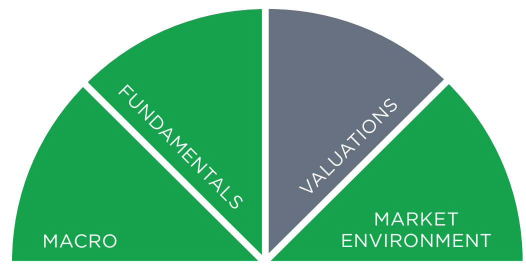
Macro and fundamental inputs continue to favor U.S. large-cap equities. Valuations have returned to average after the strong rebound in early 2019, and in instances where clients are in need of capital we would consider taking profits in this asset class, if the client is above target weights. At the same time, if U.S. large-cap stocks were to experience additional volatility, we would consider this a potential opportunity to invest at more attractive prices.



U.S. Small Cap Equities

Outlook: Neutral

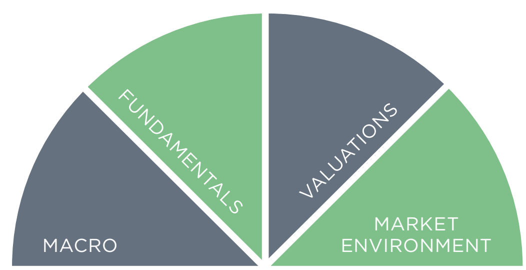
We have a neutral weighting on domestic small cap equities. Valuations are deemed expensive relative to larger companies, but the new tax plan should benefit small-cap stocks by comparatively more than the large-cap indices; smaller domestic companies tend to pay higher tax rates than large, multinational companies, and generally have lower profit margins. Active management is favored to generate alpha in this space.



Developed Market Equities

Outlook: Neutral

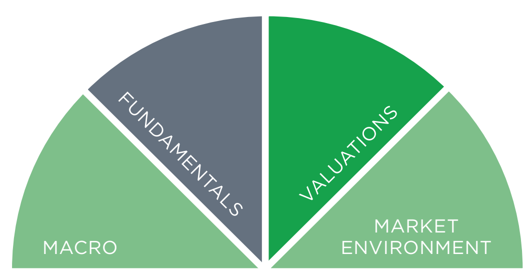
Developed market equities have been downgraded to neutral. Although we are not forecasting a recession, economic growth in Europe is expected to decelerate further in 2019. Rising corporate profits and reasonable valuations warrant a target weight in developed equities.



Emerging Market Equities

Outlook: Neutral

We have become more optimistic on emerging market equities due to strengthening currencies and stabilizing commodity prices, along with attractive valuations. A potential slowdown in China and future stability of the Yuan are potential risks.



Outlook Ratings POSITIVE | MIXED POSITIVE | NEUTRAL | NEGATIVE

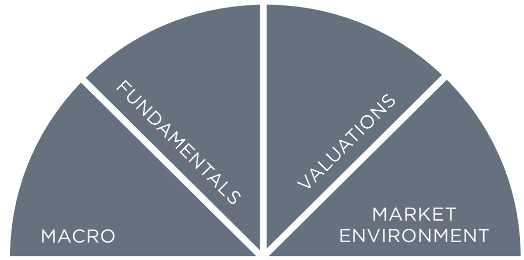
The color-coded rating system applies to specific inputs only (Macro, Fundamentals, Valuations, and Market Environment) and represents the current and shorter-term (three to six months) outlook for the specific inputs based on qualitative data and recommendations from the Abbot Downing Asset Allocation Committee. It is intended to provide guidance to the Abbot Downing Portfolio Construction Team. The content does not represent a buy, hold, or sell recommendation for specific asset classes.

Dynamic Allocation Summary (Continued)

U.S. Investment Grade Fixed Income

Outlook: Neutral

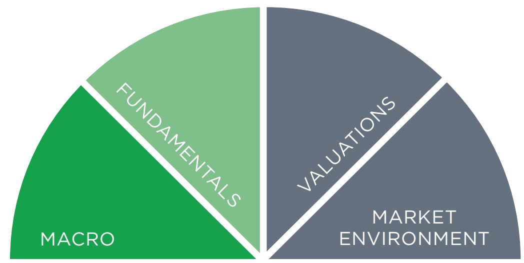
We feel that yields of investment-grade bonds (Treasuries, municipals, and corporates) have moved into fair value range, and are supported by expectations that the Fed will continue to raise rates at a gradual pace; markets currently appear to anticipate a low probability of additional rate hikes in 2019.



Non-Investment Grade Fixed Income

Outlook: Neutral

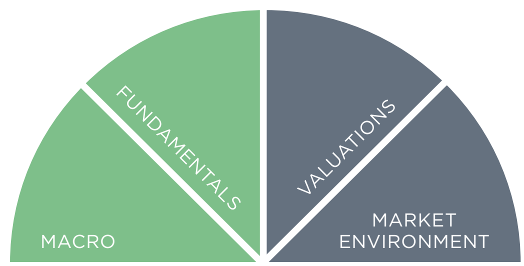
We remain constructive on preferred stock securities based on healthy yield premiums versus investment-grade bonds. Valuations have become expensive in the high-yield asset class.



International Fixed Income

Outlook: Negative

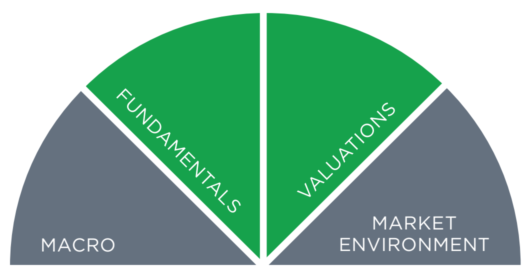
We believe near zero yields on many developed country sovereign debt issues warrant caution for this sector. Emerging market bond spreads are now above their long-term historical averages.



Real Estate Investment Trusts (REITs)

Outlook: Neutral

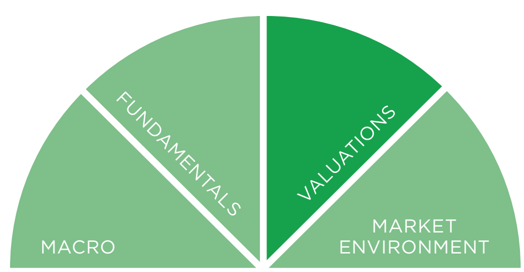
We have downgraded REITs to neutral, as they have become more sensitive to interest rate moves. REIT fundamentals remain solid and exhibit attractive valuations. REITs currently sell at a 1.5% discount to underlying real estate holdings.



Master Limited Partnerships (MLPs)

Outlook: Positive

Although MLPs came under pressure in Q4 as investors adjusted to lower oil prices and tax-loss selling, performance has rebounded strongly based on stronger fundamentals. Current MLP yields of near 9% are also attractive on both an absolute and relative basis. Finally, active management is favored in this space due to the recent FERC ruling and risk of C-corp conversion.



Outlook Ratings POSITIVE | MIXED POSITIVE | NEUTRAL | NEGATIVE

Disclosures

Risk Considerations

Past performance does not indicate future results. The value or income associated with a security or an investment may fluctuate. There is always the potential for loss as well as gain. Investments discussed in this report may be unsuitable for some investors depending on their specific investment objectives and financial position.

Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses. Your individual allocation may be different than the strategic long-term allocation above due to your unique individual circumstances but is targeted to be in the allocation ranges detailed. The asset allocation reflected above may fluctuate based on asset values, portfolio decisions, and account needs.

Investing in **commodities** is not suitable for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Investments in commodities may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Convertible securities are subject to the same interest rate, price and credit risks as regular debt securities. Prices tend to be inversely affected by changes in interest rates. In addition, a convertible security is also subject to the risks associated with common stocks. The return and principal value of stocks fluctuate with changes in market conditions.

Alternative investments, such as hedge funds, carry specific investor qualifications which can include high income and net worth requirements as well as relatively high investment minimums. They are complex investment vehicles which generally have high costs and substantial risks. The high expenses often associated with these investments must be offset by trading profits and other income. They tend to be more volatile than other types of investments and present an increased risk of investment loss. There may also be a lack of transparency as to the underlying assets. Alternative investments are subject to fewer regulatory requirements than mutual funds and other registered investment company products and thus may offer investors fewer legal protections than they would have with more traditional investments. Additionally, there may be no secondary market for alternative investment interests and transferability may be limited or even prohibited. Other risks may apply as well, depending on the specific investment product. Please carefully review the prospectus, private placement memorandum or other offering documents for complete information regarding terms, including all applicable fees, as well as risks and other factors you should consider before investing.

Investments in **fixed-income securities** are subject to interest rate and credit risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and principal. High yield fixed income securities are considered speculative, involve greater risk of default, and tend to be more volatile than investment grade fixed income securities. Municipal bonds offer interest payments exempt from federal taxes, and potentially state and local income taxes. They are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Mortgage-related and asset-backed securities are subject to prepayment risks. Changes in prepayments may significantly affect yield, average life and expected maturity.

Currency hedging is a technique used to seek to reduce the risk arising from the change in price of one currency against another. The use of hedging to manage currency exchange rate movements may not be successful and could produce disproportionate gains or losses in a portfolio and may increase volatility and costs.

Investing in **foreign securities** presents certain risks that may not be present in domestic securities. For example, investments in foreign, emerging and frontier markets present special risks, including currency fluctuation, the potential for diplomatic and potential instability, regulatory and liquidity risks, foreign taxation and differences in auditing and other financial standards.

Master Limited Partnerships (MLPs) involves certain risks which differ from an investment in the securities of a corporation. MLPs may be sensitive to price changes in oil, natural gas, etc., regulatory risk, and rising interest rates. A change in the current tax law regarding MLPs could result in the MLP being treated as a corporation for federal income tax purposes which would reduce the amount of cash flows distributed by the MLP. Other risks include the volatility associated with the use of leverage; volatility of the commodities markets; market risks; supply and demand; natural and man-made catastrophes; competition; liquidity; market price discount from Net Asset Value and other material risks.

There are special risks associated with investing in **preferred securities**. Preferred securities are subject to interest rate and credit risks and are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.

Private debt has speculative characteristics that include potential default, limited liquidity and the infrequent availability of independent credit ratings for private companies.

There are risks associated with investments in **private companies**. Such companies are not subject to SEC reporting requirements and are not required to maintain effective internal controls over financial reporting. These companies may have limited financial resources; shorter operating histories; more asset concentration risk; narrower product lines and smaller market shares that larger companies. In addition, securities issued by private companies are typically illiquid and there may be no readily available trading market for such securities.

Investing in **real estate** involves special risks, including the possible illiquidity of the underlying property, credit risk, interest rate fluctuations and the impact of varied economic conditions.

The prices of **small cap and mid cap company stocks** are generally more volatile than large cap company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Treasury Inflation-Protected Securities (TIPS) are subject to interest rate risk, especially when real interest rates rise. This may cause the underlying value of the bond to fluctuate more than other fixed income securities. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

There is no assurance that any of the target prices or other forward-looking statements mentioned will be attained.

Index and Other Definitions

An index is unmanaged and not available for direct investment

Inflation is the change in the **Consumer Price Index (CPI)**. The CPI measures the price of a fixed basket of goods and services purchased by an average consumer.

Core inflation is the change in the core **Consumer Price Index (CPI)**. The core CPI measures the price of a fixed basket of goods and services—excluding the volatile food and energy components—purchased by an average consumer.

Alpha is a coefficient measuring the risk-adjusted performance, considering the risk due to the specific security, rather than the overall market. A large alpha indicates that the stock or mutual fund has performed better than would be predicted given its beta (volatility).

Beta measures a security's or group of securities' (portfolio's) volatility relative to a benchmark. A result greater than 1.0 implies that the security or portfolio is more volatile than the benchmark; a result less than 1.0 suggests that the security or portfolio is less volatile than the benchmark. Betas may change over time.

Conference Board's Leading Economic Index (LEI) is a composite economic index designed to signal peaks and troughs in the business cycle. The leading economic index is essentially a composite average of several individual leading indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component—primarily because they smooth out some of the volatility of individual components.

Consumer Confidence Index® (CCI) is a barometer of the health of the U.S. economy from the perspective of the consumer. The index is based on consumers' perceptions of current business and employment conditions, as well as their expectations for six months hence regarding business conditions, employment, and income.

Markit Manufacturing Purchasing Managers Index (PMI) tracks manufacturing and service sector activity in the Eurozone. An Index value over 50 indicates expansion; below 50 indicates contraction. The values for the index can be between 0 and 100.

PMI Surveys, such as the **Eurozone Manufacturing PMI**, track sentiment among purchasing managers at manufacturing, construction and/or services firms. An overall sentiment index is generally calculated from the results of queries on production, orders, inventories, employment, prices, etc.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output.

The Market Volatility Index (VIX) is an index designed to track market volatility as an independent entity. The index is calculated based on option activity and is used as an indicator of investor sentiment, with high values implying pessimism and low values implying optimism.

The Institute of Supply Management (ISM) **Manufacturing Index®** is a composite index based on the diffusion indexes of five of the indexes with equal weights: New Orders (seasonally adjusted), Production (seasonally adjusted), Employment (seasonally adjusted), Supplier Deliveries (seasonally adjusted), and Inventories. An Index values over 50 indicate expansion; below 50 indicates contraction. The values for the index can be between 0 and 100.

The U.S. Dollar Index (USDX, DXY) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies.

Real economic growth is the change in the gross domestic product (GDP) adjusted for inflation—that is, the volume of services and goods produced in the United States.

Disclosures (Continued)

West Texas Intermediate Crude Oil is a light, sweet (i.e., low sulfur) crude oil which is the main type of U.S. crude oil traded in U.S. futures markets.

Brent Crude Oil is a light, sweet crude oil extracted from the North Sea. It serves as a major benchmark price for purchases of oil worldwide.

Bond credit rating. A grade given to bonds that indicates their credit quality. Private independent rating services such as Standard & Poor's, Moody's and Fitch provide these evaluations of a bond issuer's financial strength, or its the ability to pay a bond's principal and interest in a timely fashion. The general meaning of these credit rating opinions are as follows:

AAA—Extremely strong capacity to meet financial commitments. Highest Rating.

AA—Very strong capacity to meet financial commitments.

A—Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.

BBB—Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.

Global Fixed Income Representative Indices

Global Multiverse Fixed Income: Bloomberg Barclays Multiverse Index provides a broad-based measure of the global fixed-income bond market. The index represents the union of the Global Aggregate Index and the Global High-Yield Index and captures investment grade and high yield securities in all eligible currencies. Standalone indices such as the Euro Floating-Rate ABS Index and the Chinese Aggregate Index are excluded. The Multiverse Index family includes a wide range of standard and customized sub-indices by sector, quality, maturity, and country. JP Morgan Global Ex United States Bond Index is a total return, market capitalization weighted index, rebalanced monthly consisting of the following countries: Australia, Germany, Spain, Belgium, Italy, Sweden, Canada, Japan, United Kingdom, Denmark, Netherlands, and France.

U.S. Inv Grade Taxable Fixed Income: Bloomberg Barclays U.S. Aggregate Bond Index is composed of the Bloomberg Barclays Capital U.S. Government/Credit Index and the Bloomberg Barclays Capital U.S. Mortgage-Backed Securities Index, and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities.

U.S. Treasury Bills Fixed Income: Bloomberg Barclays U.S. Treasury Bills includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than three months and more than one month, are rated investment grade, and have $250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars and must be fixed rate and non-convertible.

Short, Intermediate and Long Term Fixed Income: Bloomberg Barclays U.S. Aggregate Bond Index is made up of the Bloomberg Barclays U.S. Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.

U.S. Treasury Fixed Income: Bloomberg Barclays U.S. Treasury Index includes public obligations of the U.S. Treasury with a remaining maturity of one year or more.

U.S. Corporate Fixed Income: Bloomberg Barclays U.S. Corporate Bond Index includes publicly issued U.S. corporate and Yankee debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

U.S. Municipal Fixed Income: Bloomberg Barclays U.S. Municipal Bond Index represents municipal bonds with a minimum credit rating of at least Baa, an outstanding par value of at least $3 million, and a remaining maturity of at least one year. The Index excludes taxable municipal bonds, bonds with floating rates, derivatives, and certificates of participation.

U.S. TIPS Fixed Income: Bloomberg Barclays Treasury Inflation Protected Securities (TIPS) Index includes all publicly issued, investment-grade U.S. TIPS with an outstanding face value of more than $250 million and that have at least one year to maturity.

U.S. High Yield Fixed Income: Bloomberg Barclays U.S. High Yield Bond Index is an unmanaged index that tracks the performance of below investment grade U.S.-dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

Developed ex. U.S. Fixed Income: JPMorgan GBI Global ex-U.S. (Unhedged) in USD is an unmanaged index market representative of the total return performance in U.S. dollars on an unhedged basis of major non-U.S. bond markets.

Emerging Market Spread: Bloomberg Barclays EM USD Aggregate Index is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. The index is broad-based in its coverage by sector and by country, and reflects the evolution of EM benchmarking from traditional sovereign bond indices to Aggregate-style benchmarks that are more representative of the EM investment choice set. Country eligibility and classification as an Emerging Market is rules-based and reviewed on an annual basis using World Bank income group and International Monetary Fund (IMF) country classifications. This index was previously called the Bloomberg Barclays U.S. EM Index and history is available back to 1993.

Emerging Market Bond (U.S. Dollar): JP Morgan Emerging Markets Bond Index (EMBI Global) currently covers 27 emerging market countries. Included in the EMBI Global are U.S.-dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities.

Preferred Stock: S&P Preferred Stock is an unmanaged index consisting of U.S.-listed preferred stocks.

U.S. Dollar Index (USDX) measures the value of the U.S. dollar relative to majority of its most significant trading partners. This index is similar to other trade-weighted indexes, which also use the exchange rates from the same major currencies.

Global Equity Representative Indices

Global Market Equity: MSCI AC World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The Index consists of 46 country indices comprising 23 developed and 23 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and the United States. The emerging market country indices included are: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

Dow Jones Industrial Average is a price-weighted index of 30 “blue-chip” industrial U.S. stocks.

NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.

Large Cap Equity: S&P 500 Index is a capitalization-weighted index calculated on a total return basis with dividends reinvested. The index includes 500 widely held U.S. market industrial, utility, transportation, and financial companies.

Large Cap Equity (Growth): Russell 1000® Growth Index measures the performance of those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values.

Large Cap Equity (Value): Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values.

Mid Cap Equity: Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000® Index, which represent approximately 25% of the total market capitalization of the Russell 1000® Index.

Small Cap Equity: Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000® Index.

Developed Market ex. U.S. Equity: MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. The Index consists of the following 21 developed market country indexes: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

Emerging Markets: MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 23 emerging market country indexes: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and United Arab Emirates.

Frontier Market Equity: MSCI Frontier Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of frontier markets. The MSCI Frontier Markets Index consists of the following 24 frontier market country indexes: Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kenya, Kuwait, Lebanon, Lithuania, Morocco, Kazakhstan, Mauritius, Nigeria, Oman, Pakistan, Romania, Serbia, Slovenia, Sri Lanka, Tunisia, Ukraine, and Vietnam. The MSCI Saudi Arabia Index is currently not included in the MSCI Frontier Markets Index but is part of the MSCI Gulf Cooperation Council (GCC) Countries Index. The MSCI Bosnia Herzegovina Index, the MSCI Botswana Index, the MSCI Ghana Index, the MSCI Jamaica Index, the MSCI Palestine IMI, the MSCI Trinidad & Tobago Index, and the MSCI Zimbabwe Index are currently stand-alone country indexes and are not included in the MSCI Frontier Markets Index. The addition of these country indexes to the MSCI Frontier Markets Index is under consideration.

Disclosures (Continued)

Global Real Assets Representative Indices

Global REITs: FTSE EPRA/NAREIT Developed Index is designed to track the performance of listed real-estate companies and REITs in developed countries worldwide.

Domestic REITs: FTSE NAREIT U.S. All Equity REITs Index is designed to track the performance of REITs representing equity interests in (as opposed to mortgages on) properties. It represents all tax-qualified REITs with more than 50% of total assets in qualifying real estate assets, other than mortgages secured by real property that also meet minimum size and liquidity criteria.

International REITs: FTSE EPRA/NAREIT Developed ex-U.S. Index is designed to track the performance of listed real estate companies in developed countries worldwide other than the United States.

MLPs: Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class. The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated real-time on a price-return basis and on a total-return basis.

Commodities (S&P GSCI): S&P Goldman Sachs Commodity Index is a trade-weighted index of commodity sector returns representing unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The index includes futures contracts on 24 physical commodities, of which Energy represents nearly 70%.

Commodities (BCOM): Bloomberg Commodity Index represents futures contracts on 19 physical commodities. No related group of commodities (e.g., energy, precious metals, livestock and grains) may constitute more than 33% of the index as of the annual reweighing of the components. No single commodity may constitute less than 2% of the index.

Commodities (RICI): The Rogers International Commodity Index is a U.S. dollar based index representing the value of a basket of commodities consumed in the global economy. Representing futures contracts on 37 physical commodities, it is designed to track prices of raw materials not just in the U.S. but around the world.

Global Alternative Investments Representative Indices

Global Hedge Funds: HFRI Fund Weighted Composite Index. A global, equal-weighted index of over 2,000 single-manager funds that report to HFR Database. Constituent funds report monthly net-of-all-fees performance in U.S. Dollars and have a minimum of $50 million under management or a 12-month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

Relative Value Arbitrage: HFRI Relative Value (Total) Index. Strategy is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative, or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager. RV position may be involved in corporate transactions also, but as opposed to ED exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction.

Arbitrage: HFRI RV: Fixed Income Sovereign Index. Includes strategies predicated on realization of a spread between related instruments in which one or multiple components of the spread is a sovereign fixed income instrument. Strategies employ an investment process designed to isolate attractive opportunities between a variety of fixed income instruments, typically realizing an attractive spread between multiple sovereign bonds or between a corporate and risk-free government bond. Fixed Income Sovereign typically employ multiple investment processes including both quantitative and fundamental discretionary approaches and relative to other Relative Value Arbitrage sub-strategies, these have the most significant top-down macro influences, relative to the more idiosyncratic fundamental approaches employed.

Long/Short Credit: HFRI RV: Fixed Income—Corporate Index. Includes strategies predicated on realization of a spread between related instruments in which one or multiple components of the spread is a corporate fixed-income instrument. Strategies are designed to isolate attractive opportunities between a variety of fixed income instruments, typically realizing an attractive spread between multiple corporate bonds or between a corporate and risk-free government bond. They typically involve arbitrage positions with little or no net credit market exposure, but are predicated on specific, anticipated idiosyncratic developments.

Disclosures (Continued)

Structured Credit/Asset Backed: HFRI RV: Fixed Income—Asset Backed Index. Includes strategies predicated on realization of a spread between related instruments in which one or multiple components of the spread is a fixed-income instrument backed by physical collateral or other financial obligations (loans, credit cards) other than those of a specific corporation. Strategies are designed to isolate attractive opportunities between a variety of fixed income instruments specifically securitized by collateral commitments, which frequently include loans, pools and portfolios of loans, receivables, real estate, machinery, or other tangible financial commitments. Investment thesis may be predicated on an attractive spread given the nature and quality of the collateral, the liquidity characteristics of the underlying instruments and on issuance and trends in collateralized fixed-income instruments, broadly speaking. In many cases, investment managers hedge, limit, or offset interest-rate exposure in the interest of isolating the risk of the position to strictly the disparity between the yield of the instrument and that of the lower-risk instruments.

Macro: HFRI Macro (Total) Index. Encompass a broad range of strategies predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard-currency, and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top-down and bottom-up theses, quantitative and fundamental approaches and long- and short-term holding periods. Although some strategies employ RV techniques, Macro strategies are distinct from RV strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments rather than on realization of a valuation discrepancy between securities. In a similar way, while both Macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposed to EH, in which the fundamental characteristics on the company are the most significant are integral to investment thesis.

Systematic Macro: HFRI Macro: Systematic Diversified Index. Diversified strategies employing mathematical, algorithmic and technical models, with little or no influence of individuals over the portfolio positioning. Strategies are designed to identify opportunities in markets exhibiting trending or momentum characteristics across individual instruments or asset classes. Strategies typically employ quantitative processes which focus on statistically robust or technical patterns in the return series of the asset, and they typically focus on highly liquid instruments and maintain shorter holding periods than either discretionary or mean-reverting strategies. Although some strategies seek to employ counter-trend models, strategies benefit most from an environment characterized by persistent, discernible trending behavior. Typically have no greater than 35% of portfolio in either dedicated currency or commodity exposures over a given market cycle.

Discretionary Macro: HFRI Macro: Discretionary Thematic Index. Strategies primarily rely on the evaluation of market data, relationships and influences, as interpreted by individuals who make decisions on portfolio positions; strategies employ an investment process most heavily influenced by top-down analysis of macroeconomic variables. Investment Managers may trade actively in developed and emerging markets, focusing on both absolute and relative levels on equity markets, interest rates/fixed income markets, currency and commodity markets; they frequently employ spread trades to isolate a differential between instrument identified by the Investment Manager as being inconsistent with expected value. Portfolio positions typically are predicated on the evolution of investment themes the Manager expects to develop over a relevant time frame, which in many cases contain contrarian or volatility-focused components.

Event Driven: HFRI Event Driven (Total) Index. Maintains positions in companies currently or prospectively involved in corporate transactions of a wide variety including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated and frequently involve additional derivative securities. Exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments. Investment theses are typically predicated on fundamental (as opposed to quantitative) characteristics, with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

Activist: HFRI ED: Activist Index. Strategies may obtain or attempt to obtain representation on the company's board of directors in an effort to impact the firm's policies or strategic direction and in some cases, may advocate activities such as division or asset sales, partial or complete corporate divestiture, dividends or share buybacks, and changes in management. Strategies employ an investment process primarily focused on opportunities in equity and equity-related instruments of companies that are currently or prospectively engaged in a corporate transaction, security issuance/repurchase, asset sales, division spin-off, or another catalyst-oriented situation. These involve both announced transactions and situations in which no formal announcement is expected to occur. Activist strategies would expect to have greater than 50% of the portfolio in activist positions, as described.

Disclosures (Continued)

Distressed Credit: HFRI ED: Distressed/Restructuring Index. Strategies focus on corporate fixed-income instruments, primarily 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 proceedings or financial-market perception of near-term proceedings. Managers are typically actively involved with the management of these companies; they are frequently involved on creditors' committees in negotiating the exchange of securities for alternative obligations, either swaps of debt, equity or hybrid securities. Managers employ fundamental credit processes focused on valuation and asset coverage of securities of distressed firms; in most cases portfolio exposures are concentrated in instruments that are publicly traded, in some cases actively and in others under reduced liquidity but in general for which a reasonable public market exists. Strategies employ primarily debt (greater than 60%) but also may maintain related equity exposure.

Merger Arbitrage: HFRI ED: Merger Arbitrage Index. Strategies primarily focus on opportunities in equity and equity-related instruments of companies that are currently engaged in a corporate transaction. Merger Arbitrage involves primarily announced transactions, typically with limited or no exposure to situations in which no formal announcement is expected to occur. Opportunities are frequently presented in cross-border, collared, and international transactions that incorporate multiple geographic regulatory institutions, typically with minimal exposure to corporate credits. Strategies typically have over 75% of positions in announced transactions over a given market cycle.

Equity Hedge: HFRI Equity Hedge (Total) Index. Equity Hedge Investment Managers who maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. EH managers would typically maintain at least 50% exposure to, and may in some cases be entirely invested in, equities, both long and short.

Directional Equity: HFRX EH: Multi-Strategy Index. Managers maintain positions both long and short in primarily equity and equity-derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage, holding period, concentrations of market capitalizations, and valuation ranges of typical portfolios. Managers typically do not maintain more than 50% exposure to any one Equity Hedge sub-strategy.

Equity Market Neutral: HFRI EH: Equity Market Neutral Index. Strategies employ sophisticated quantitative techniques to analyze price data to ascertain information about future price movement and relationships between securities. These can include both Factor-based and Statistical Arbitrage/Trading strategies. Factor-based investment strategies include strategies predicated on the systematic analysis of common relationships between securities. In many cases, portfolios are constructed to be neutral to one or multiple variables, such as broader equity markets in dollar or beta terms, and leverage is frequently employed to enhance the return profile of the positions identified. Statistical Arbitrage/Trading strategies consist of strategies predicated on exploiting pricing anomalies which may occur as a function of expected mean reversion inherent in security prices; high-frequency techniques may be employed; trading strategies may also be based on technical analysis or designed opportunistically to exploit new information that the investment manager believes has not been fully, completely, or accurately discounted into current security prices. Strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

Cambridge Associates LLC U.S. Private Equity Index® is an end-to-end calculation based on data compiled from 1,152 U.S. private equity funds (buyout, growth equity, private equity energy and mezzanine funds), including fully liquidated partnerships, formed between 1986 and 2014. Pooled end-to-end return, net of fees, expenses, and carried interest. The latest published returns data are as of September 30, 2014.

Note: While the HFRI Indices are frequently used, they have limitations (some of which are typical of other widely used indices). These limitations include survivorship bias (the returns of the indices may not be representative of all the hedge funds in the universe because of the tendency of lower performing funds to leave the index); heterogeneity (not all hedge funds are alike or comparable to one another, and the index may not accurately reflect the performance of a described style); and limited data (many hedge funds do not report to indices, and, therefore, the index may omit funds, the inclusion of which might significantly affect the performance shown. The HFRI Indices are based on information hedge fund managers decide on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, L.L.C. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indices may not be complete or accurate representations of the hedge fund universe, and may be biased in several ways. Returns of the underlying hedge funds are net of fees and are denominated in USD.

Citations

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