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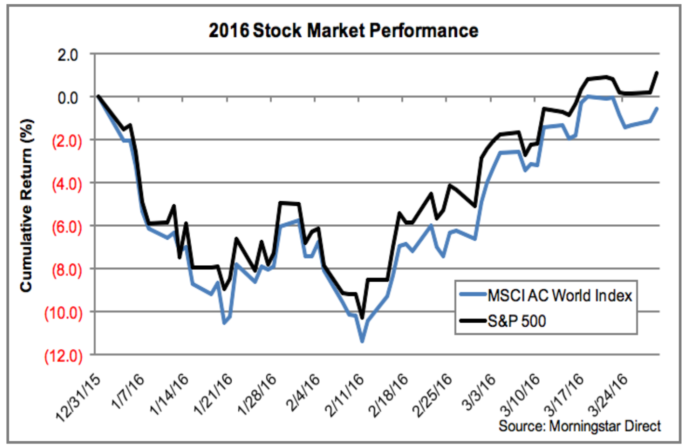
First Quarter 2016 Investment Review & Outlook

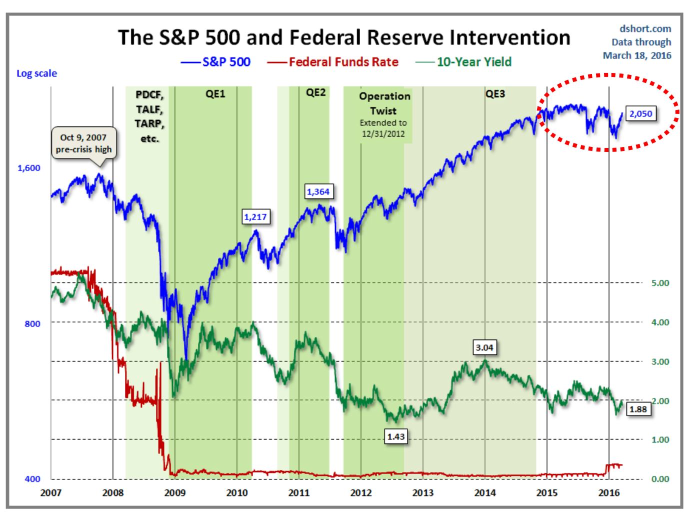
To Our Clients and Friends,



Market volatility picked up substantially in Q1 as equities suffered double digit losses in the first six weeks of 2016. It was a forceful move that left many wondering whether we were destined for a major bear market. Within weeks, however, those fears abated as stocks rebounded just as quickly as they had declined. Large cap US stocks ultimately finished the quarter slightly positive after their biggest intra-quarter recovery since 1933[1].

Markets were clearly influenced by wild swings in crude oil prices and the Federal Reserve's rhetoric during the quarter. Earnings weakness also contributed to volatility as corporate results disappointed. Fourth quarter earnings were impacted by a fall in energy profits and the impact of a much stronger US dollar on exports, particularly in the industrial and manufacturing sectors. As year-over-year comparisons slide forward and as the commodity and the greenback stabilize, however, much of this impact is expected to dissipate. Analysts project earnings growth to resume in the back half of 2016.

Despite the market action, our view remains largely unchanged: fundamentals are not spectacular, but they're strong enough to support stocks and other risk assets. While some investors obsess over the short term vagaries of economic data, a big picture perspective suggests the fundamental backdrop is slowly getting healthier – as evidenced by improving data for housing, consumption, and employment. What is clear, however, is that we have entered a new regime of market volatility. After not experiencing a stock market correction – defined as a loss of 10% or more – in more than four years, we have now seen two within the past six months.

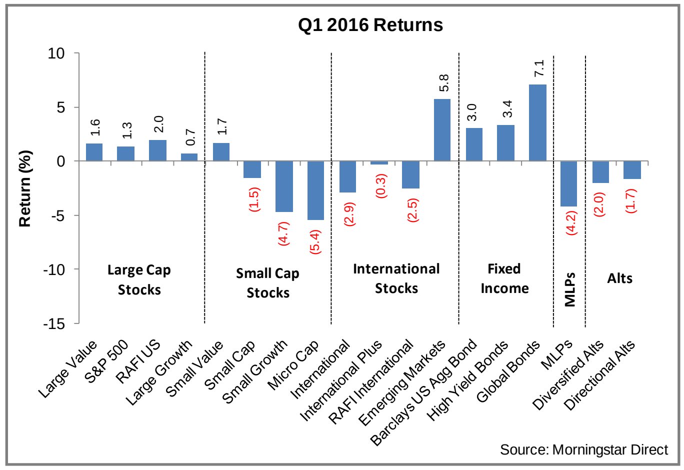


We don't believe it's a coincidence that market volatility has increased since the end of the Federal Reserve's quantitative easing program in late 2014. The market is clearly grasping for evidence that the economy can stand on its own, trading in a range-bound fashion in the interim. While the economy appears to be slowly healing, we may be stuck in a transitional period until markets focus more on fundamental data again and less on the latest machinations of policymakers. Whether this is a short or

[1] Source: TheStreet.com, in reference to the Dow Jones Industrial Average

protracted process is, unfortunately, unclear at this juncture.

Turning back to the first quarter, we saw significant performance dispersion across asset classes. While large cap stocks and high quality fixed income generated positive returns, many other areas of the market were materially negative. Domestic small cap and developed international stocks experienced losses, as did MLPs and most alternatives. Interestingly, however, some traditional pockets of risk such as emerging market stocks and high yield bonds bucked the trend and finished higher. With correlations elevated in today's "risk-on, risk-off" market, we are encouraged by such cross currents – it is evidence of a more discerning investor, often a sign of a healthier market environment.



We were less content with the performance of alternative investments. After a lackluster 2015, our expectations were raised for a rebound in 2016. That obviously did not occur, as many funds were caught flat-footed by the renewed selloff in equity markets in January and February. We invest in alternatives not only to produce attractive returns over full market cycles, but also to mitigate volatility and to protect from capital losses. The latter premise was tested in the first two months of the year. While we understand the individual reasons for managers' underperformance, we are disappointed that such a heterogeneous group of strategies appeared to fall victim to the same factors.

Despite recent results, we continue to believe alternatives are an important component of diversified portfolios. As such, we felt it was important to review the reasons for investing in the asset class and to provide some perspective on performance. We make the following observations:

- **Previous underperformance has preceded strong gains –** underperformance amid a choppy market is not unprecedented. The most recent example of this was five years ago during the European Sovereign Debt Crisis. Like today's environment, that period was marked by rapid risk-on, risk-off trading as market sentiment oscillated quickly between panic and euphoria. Before that, many hedge funds struggled in 1998 amid the Asian Financial Crisis and the fall of Long Term Capital Management. The common thread between those periods and today is that market fundamentals were ignored in favor of negative sentiment and quick capital flows. In each period, however, a normalization of this market behavior set up hedge fund managers for strong double digit gains in subsequent years.
- **Alternatives are best poised to benefit from market dislocations** - flexibility in mandate, the ability to analyze complex situations, and the ability to quickly reallocate capital affords alternative strategies the best chance to take advantage of significant opportunities in the market. We have been free of true market dislocations for several years, but that is starting to change – creating more opportunities for managers. We are particularly attracted to this capability after several years of strong market gains.
- **Alternatives capitalize on unique opportunities** - not all investment opportunities are available to plain vanilla, long-only money managers – especially those that are less liquid, require hands-on restructurings/legal action, or require unique trade structures. The inability of traditional investors to access these opportunities creates mispricings that can be exploited by managers with more flexible

portfolio approaches. This has historically been a significant contributor to return for many alternative strategies.

- **Diversification benefits are difficult to obtain elsewhere –** despite a disappointing stretch, alternatives continue to provide significant risk reduction characteristics not present in other asset classes. The inherent flexibility afforded to these strategies allows them to hedge and dynamically allocate capital to mitigate volatility and limit capital losses. We have historically advocated alternatives because they have the tools to generate a comparable return to a stock-bond portfolio with significantly less risk. Short-term performance notwithstanding, we don't believe this fundamental premise has been compromised.

Alternatives are often viewed as a panacea, but ultimately they are a complement to traditional portfolio allocations – not a replacement. Like all asset classes, alternatives will suffer periodic stretches of underperformance. We understand that some have less tolerance for such struggles because of higher fees in this space. Over time, however, these solutions have shown they deserve a role in portfolios, even after those fees. In our opinion, eliminating their presence from portfolios would create a much less durable, and less dynamic, asset allocation for clients.

The most recent quarter reminds us that the road ahead is, as always, uncertain. But we remain confident in the ability of thoughtfully diversified portfolios to grow capital over time. It can be difficult in the moment to keep this in focus, but a vast history of evidence supports a disciplined asset allocation approach. We encourage you to stay the course as we navigate a more turbulent market environment.

As always, please call us or visit our offices should you have questions. If you are concerned by the recent market volatility and would like to review your current asset allocation or risk profile, we encourage you to speak with us at your convenience.

Kindest regards,
Your Investment Team
4/20/2016