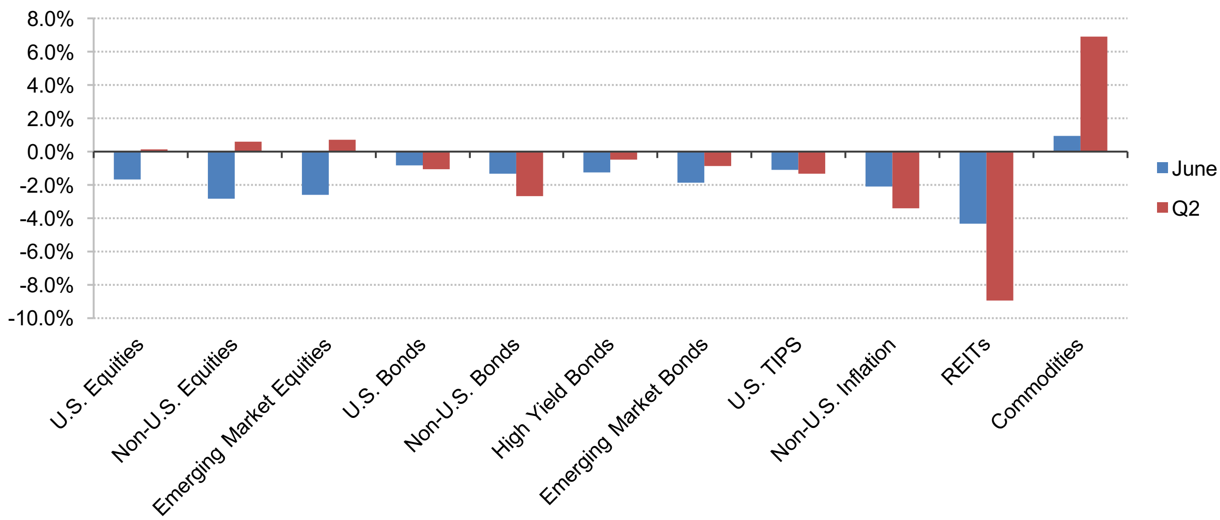
Today's Investment Environment

August 18, 2015

The second quarter and first half of 2015 comprised periods of extended market calm interrupted sporadically by turbulence related among other things to China, Greece/Europe, and energy prices. Today's macro conditions represent in many ways a continuation of what we experienced in the latter half of 2014. Over the quarter, as shown in Exhibit 1, U.S. equities were flat while developed and emerging market equities gained marginally. All fixed income categories were down. The big movers were REITS and commodities which continued their recent pattern of counterbalancing one another: this time, it was commodities that registered significant gains while REITs did the opposite.

Exhibit 1: A Mixed Pattern of Asset Class Returns in Q2, 2015*



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We are in an environment where the broad equity and fixed income markets have been resilient despite uncertainty surrounding global economic growth and the future path of interest rates. Within some sectors—technology and biotechnology, for example—there have been some huge gains registered (although also some notable losses), while other areas have been especially volatile, such as China equities and energy prices. In other words, the whole has been doing OK even as individual parts have had quite divergent fortunes. This environment contrasts strongly with the financial crisis period of 2008-

09 when almost all risk assets moved strongly together. Today, short of correctly guessing which sectors will next be hot or cold, portfolio diversification is especially important.

China is important from an investment perspective given the sheer size of its economy and its share of world trade. Yet China's equity market, valued today at some $8 trillion (vs. $5 trillion for Japan and $25 trillion for the U.S.) has shown surprisingly little correlation with other capital markets. Its primary equity market—the A Share market—is predominantly held by local retail investors and it is not that closely tied to the broad Chinese economy. It is particularly subject to fads, frauds and crashes. At this writing, the A share market is still up for the year, but down 30% from its June 12 high with losses of $3.3 trillion over that time, and it is currently being supported through an explicit government directive. It is astonishing to us that so much market value can be created and lost in a short period of time with little impact on global equities. To date it has been a very noteworthy sideshow.

Overall, we consider China to be a fertile hunting ground for skilled active investors but would cautiously size overall exposures to the area. Irrespective of the specific investments we may have, we are vigilant about spillover risks to global markets should an economy the size of China experience a significant contraction in growth and/or take actions that, in aiding its own cause, negatively impact other regions or sectors. Our view for now remains that the resources and tools at the government's disposal should not be underestimated but the situation is fluid and bears close attention.

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Definitions for Exhibit 1 are as follows:

Asset Class	Index
U.S. Equities	Russell 3000 Index
Non-U.S. Equities	MSCI EAFE Index*
Emerging Market Equities	MSCI Emerging Markets Index*
U.S. Bonds	Merrill Lynch 7-10yr U.S. Treasury Index
Non-U.S. Bonds	JP Morgan Global Government Bond Ex-US Hedged USD Index
High-Yield Bonds	Merrill Lynch High Yield Bond Master II Index*
Emerging Market Bonds	JP Morgan EMBI+ Emerging Market Bond Index
U.S. TIPS	Barclays U.S. Inflation Protected Securities Index
Non-U.S. Inflation	Barclays World Govt. Ex US Inflation-Linked Bonds Hedged USD Index
REITs	NAREIT Real Estate Investment Trust Index
Commodities	S&P GSCI Reduced Energy Total Return Index