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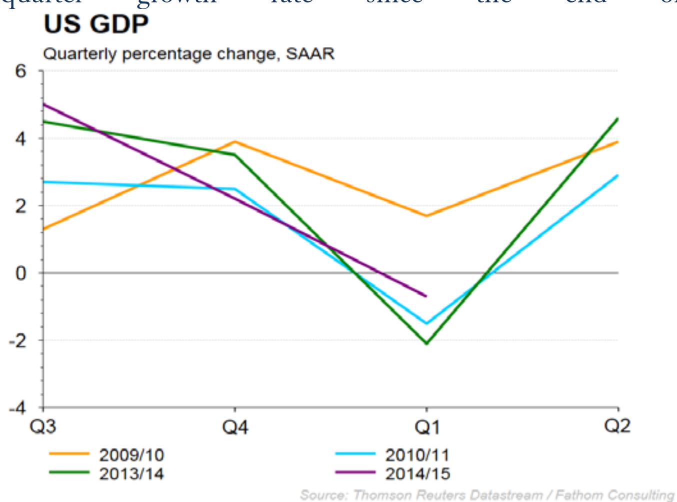
Market Review

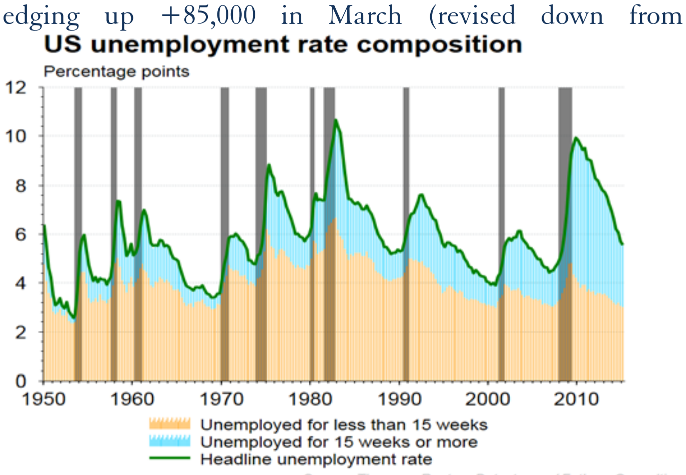
May 2015

Economic Review

US first quarter real GDP was weaker than initially thought, contracting by 0.7% annualized rate (a.r.), according to the second estimate released by the Bureau of Economic Analysis (BEA). In the advance estimate, real GDP increased 0.2%. The downward revision was primarily driven by higher trade deficit and lower private inventory investment than previously estimated. The average first quarter growth rate since the end of recession has been 0.4%, while the average growth rate over that period was 2.2%. The BEA is currently working to improve its GDP seasonality estimates and the San Francisco Fed has recently published a method they believe will better adjust for residual seasonality. The Federal Reserve attributed the weak GDP figures to transitory factors. The American economy has been unable to generate much growth momentum since the recession ended. This is the third quarterly GDP contraction during this recovery.

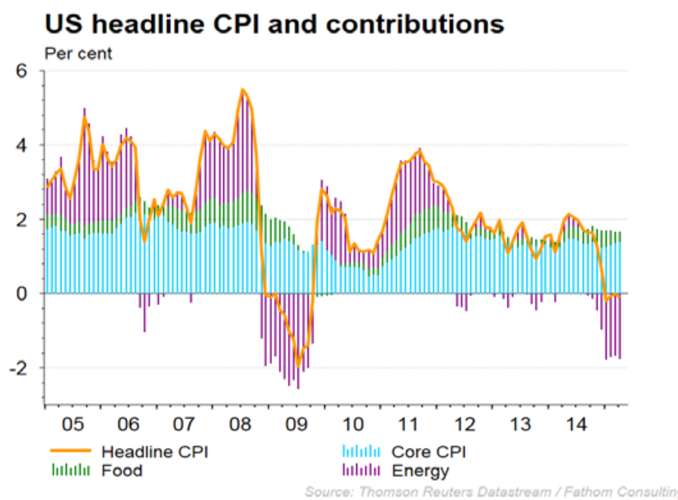


Total nonfarm payrolls increased by 223,000 in April, after edging up +85,000 in March (revised down from +126,000). Employment growth has averaged 191,000 jobs per month over the past three months. The unemployment rate was at 5.4% in April and the number of unemployed persons was 8.5 million. The unemployment rate and the number of unemployed people have declined 0.8% and 1.1 million, respectively, over the past twelve months. The civilian labor-force-participation-rate was little changed at 62.8%. The employment-population ratio also held at 59.3%. Average hourly earnings for all employees on private nonfarm payrolls rose by 3 cents to $24.87. Over the past 12 months, average hourly earnings have increased 2.2 percent.



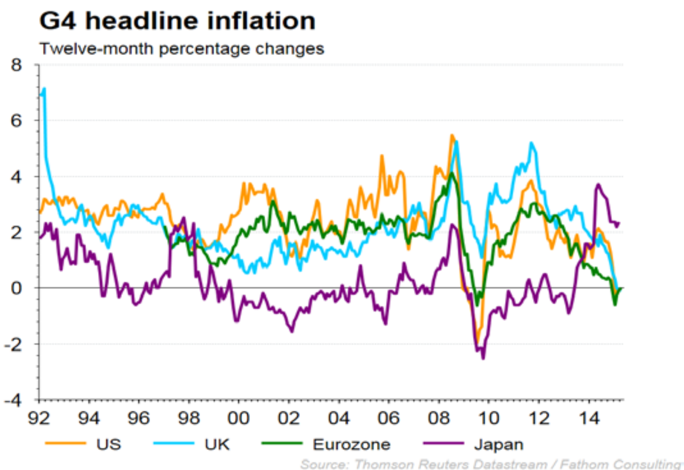
Home prices, as measured by the S&P/Case-Shiller 20-city Home Price Index, gained 5% year-over-year (YoY) in March, the same growth as in February. Existing home sales declined 3.3% month-over-month (MoM) to 5.04 million units in April. New home sales increased by 6.8% to an a.r. of 517,000. Housing starts increased 20.2% MoM, the strongest pace in nearly seven years. Building permits, a leading indicator for housing starts, increased 10.1% MoM during April.

Headline and Core inflation numbers came in as expected during April. The Consumer Price Index increased 0.1% MoM and declined 0.2% YoY. Core CPI (which excludes food and energy costs) rose 0.3% MoM and is up 1.8% YoY. The 5 year/5 year forward breakeven inflation rate narrowed 10 bps in May, closing at 1.83%.



Federal Reserve Chair Yellen stated that it would be appropriate to raise overnight rates at some point this year if the economy continued to improve. With weak first quarter growth, investors now expect the Fed to hike the rate in September or December. The next FOMC meeting is scheduled for June 16 and 17.

Eurostat's estimate of April inflation in the Eurozone was 0% on a year-over-year basis, as the region slowly recovers from recent deflationary pressures. The European commission's updated forecast reflects an increase to the Eurozone's GDP growth rate and inflation to 1.5% and 0.1%, respectively, in 2015, up from 1.3% and down 0.1% in its previous forecast. Unemployment remains high at 11.3%, according to Eurostat. Greece and Spain continue to lag the rest of the Eurozone from an unemployment perspective, as the countries registered unemployment rates of 25.7% and 23%, respectively.



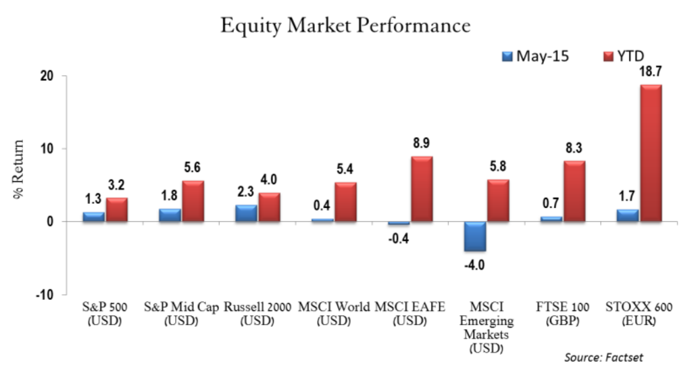
In the UK, the Office of National Statistics' (ONS) estimate of first quarter unemployment was 5.5%, down from the previous 5.6% estimate. Wages rose 2.2% for the quarter while inflation turned negative at -0.1%. Still, the Bank of England (BOE) cut its 2015 growth forecast to 2.5% from 2.9% and its 2016 growth forecast to 2.6% from 2.9%. In addition, BOE Governor Mark Carney stated that inflation would approach the 2% target by the end of the year.

In Japan, the estimate of first quarter GDP growth was 2.4% annualized, the highest growth in over a year, which was driven by recoveries in household spending and private investment. The 2.4% figure was much stronger than the 1.5% forecast and the 1.1% revised rate in the fourth quarter. In China, the manufacturing sector, as measured by the HSBC Purchasing Managers' Index, contracted for the third straight month. Driven lower by weakening exports and new orders, the PMI registered 49.2, which was above the previous month's 49.1 reading, but below the 50 mark that separates expansion from contraction. A sub-index for new exports hit 46.7, the lowest since June 2013, and significantly lower than April's 50.3 reading.

Equity Markets

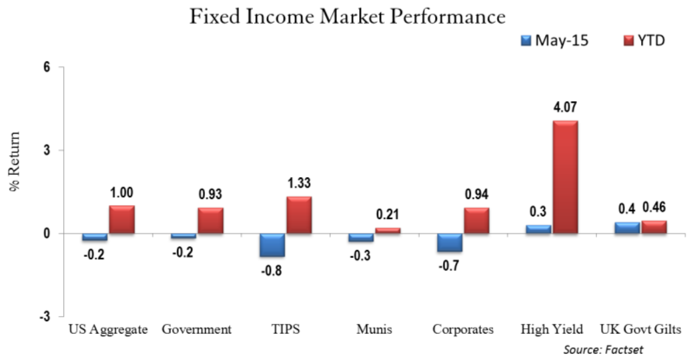
Global equities rose in May, with the MSCI World Index gaining 0.4%. Domestic large cap stocks, as measured by the S&P 500, gained 1.3% in May, and are now up 3.2% in 2015. Domestic mid-cap stocks, as measured by the S&P 400 returned 1.8% and the Russell 2000 small-cap index finished the month up 2.3%. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) gained 1.7% and 0.7%, respectively. Emerging Markets lagged in May, as the MSCI Emerging Markets index lost 4.0%. At the sector level, Health Care and Technology led the US markets higher, with gains of 4.5% and 2.3%, respectively. On a rolling 12 months basis, Health Care has been the strongest U.S. sector by a wide margin, gaining 27.2% compared to 18.8% for Technology, the second strongest sector. Energy was the worst performing sector in May, losing 4.8%; the Energy sector is down 15.4% over the last 12 months.

Market volatility, as measured by the CBOE Market Volatility Index (VIX), fell slightly to end the month at 13.84, down from 14.55 at the end of April, but above the intra-month low of 12.11. The 13.84 reading is well below the long-run average of 20. The volatility of European stocks, as measured by the Euro Stoxx 50 VIX Index, spiked to 25.22 on the first trading day of May, but settled at 23.54, lower than April's 24.21 close.

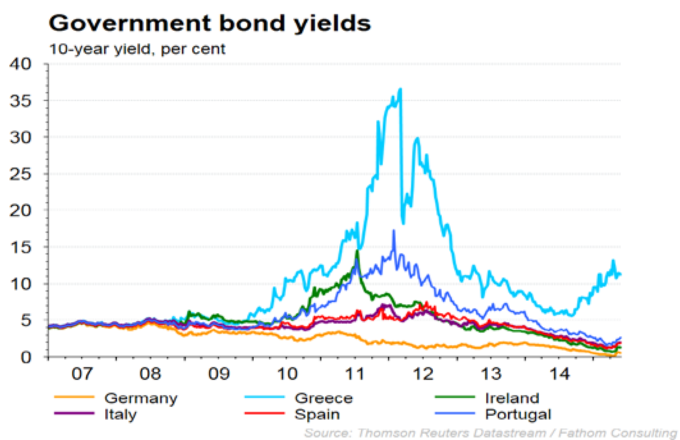


Bond Markets

Record investment grade bond issuance put pressure on rates and credit spreads in May. Rates declined towards the end of May on news about Greece. A record $150 billion of corporate bonds were issued in May. The additional supply may have helped account for credit spreads widening five basis points as measured by Barclays Credit Index option adjusted spread.



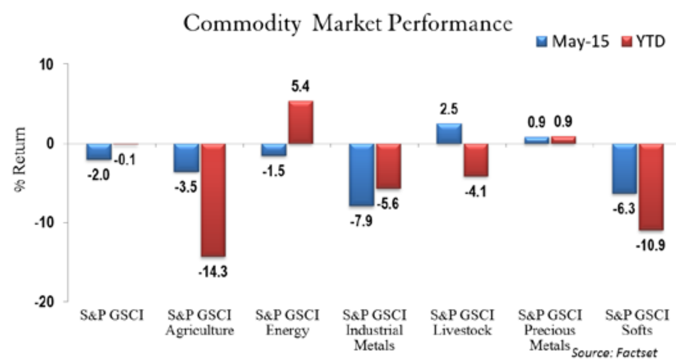
The yield on the 10-year US Treasury bond increased 5 bps to close May at 2.1%. The yield on the 30-year US Treasury bond rose 10 bps to close at 2.85%. The US 2/10 Treasury curve steepened 5 bps. The UK 10-year benchmark gilt yield edged down 2.5 bps, to close at 1.825%. The yield on German 10-year benchmark bonds rose nearly 13 bps to close at 0.487% at the end of May.



Commodities

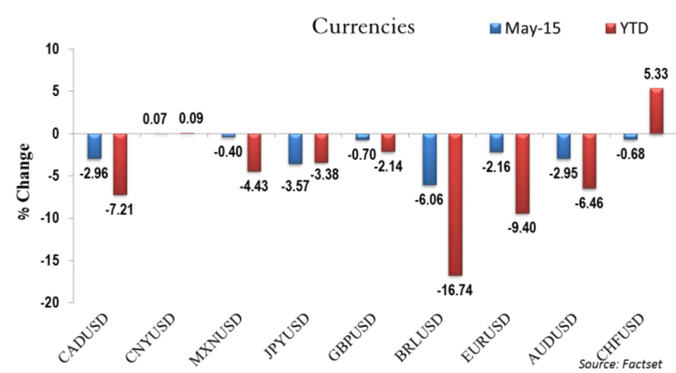
The S&P GSCI Total Return Index, a headline index of 24 commodities, returned -2.0% in May, erasing the small year-to-date gains and moving into negative territory for 2015. The index is down -0.1% through the first 5 months of 2015, as vacillations in energy, industrial metals, and softs have kept the index nearly flat, albeit with increased volatility. The Industrial Metals sub-index lost 7.9% in May, as Aluminum (-11.0%), Nickel (-9.7%), Lead (-8.5%), and Zinc (-7.4%) declined amid global deflation concerns. Nickel prices were further impacted by the abatement of labor related unrest at Colombian ore mines.

The Agricultural and Softs sub-indices fell sharply in May, losing 3.5% and 6.3%, respectively. Softs, which consists of agricultural commodities that are grown (i.e. corn) and not raised (i.e. livestock), were significantly impacted by supply gluts in the Sugar and Coffee markets. Sugar prices fell to their lowest level since 2009 during May, as the International sugar Organization forecasted that production of Sugar would outstrip demand for the fifth year in a row. Coffee was similarly impacted by a change in supply forecast, as Volcafe (a part of ED&F Man's commodities group), forecasted a production surplus for 2015-2016.



Currencies

The US Dollar rose against a basket of peers in May as investors anticipated diverging monetary policies between the US and other developed countries. The US Dollar Index appreciated 2.2% in May and is up +7.32% for the year.



The Euro weakened 2.2% against the US Dollar to close at 1.096 USD/EUR in May while the British Pound lost 0.7% to close at 1.523 USD/GBP.