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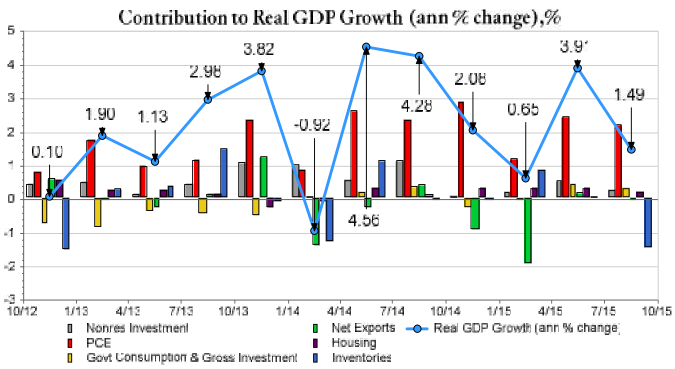
Market Review

October 2015

Economic Review

The US economy grew at an annualized rate (a.r.) of 1.5% during the third quarter according to the advance estimate. The increase in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditures, state and local government spending, non-residential fixed investment, and residential fixed investment that were partly offset by negative contributions from private inventory investment. Net exports subtracted just -0.03% from economic growth despite the strong dollar and weakness abroad.

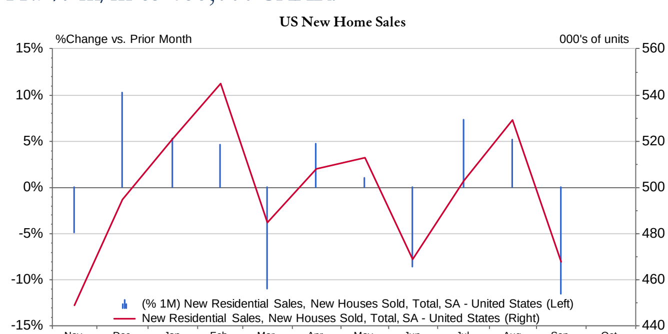


The September employment report was disappointing and followed a weak August report. Nonfarm payrolls increased by 142,000, much weaker than the expected 203,000 jobs. Payrolls for the prior two months were revised downward by 59,000 jobs. Job growth has averaged 198,000 per month in 2015 compared to an average monthly gain of 260,000 in 2014. The unemployment rate remained at 5.1% in September. The labor force fell by 350,000, driving the participation rate to a forty-year low of 62.4%. The employment-population ratio declined to 59.2%. Average weekly hours of all private employees fell by 0.1 hours to 34.5 while average hourly earnings showed little improvement at $25.09.

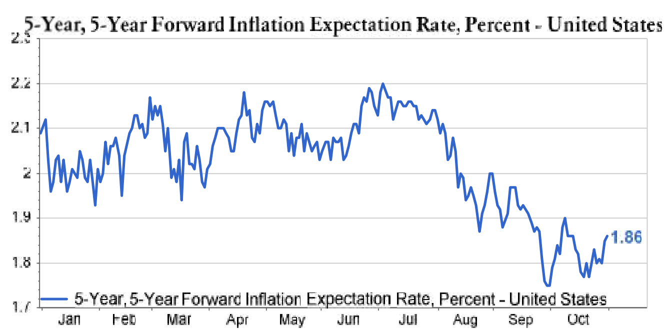
The ISM Manufacturing Index came in at 50.2, less than the estimate of 50.5. The index is at its lowest level since May 2013. Backlog orders and export orders, at 41.5 and 46.5 respectively, are in the fourth straight month of contraction. Production, at 51.8, is currently better than the orders components but expected to decrease due to weakness in orders. The September ISM Non-manufacturing index was 56.9, down from 59 in August. Value above 50 indicates expansion, below 50 indicates contraction.

The IMF cut global growth forecasts for a second time in 2015, citing weak commodity prices and a slowdown in China. The IMF is now forecasting that the world economy will grow at 3.1% this year and by 3.6% in 2016. Both new forecasts are 0.2% below the July forecast. The US is expected to grow 2.6% in 2015 and by 2.8% in 2016. The Eurozone economy is forecast to grow 1.5% and 1.6% in 2015 and 2016 respectively.

Housing data released in October were mixed. The S&P Case-Shiller Home Price Index rose +0.11% month-over-month (m/m) and is up +5.1% year-over-year (y/y). Existing home sales were strong in September, coming in ahead of consensus at 5.55M, +4.7% m/m and +8.8% y/y. Housing starts increased 6.5% m/m to a 1.21 million SAAR (seasonally adjusted annual rate), above the consensus estimate of 1.15 million. The increase was primarily due to strength in the volatile multi-family category. New Home Sales declined 11.5% m/m to 468,000 SAAR.



The CPI Index fell 0.2% m/m and was unchanged y/y while core CPI rose 0.2% m/m and 1.9% y/y. Core PCE, the Fed's preferred measure of inflation, increased 1.3% y/y. The 10-year breakeven inflation rate increased 10 bps to 1.53% while the 5-year breakeven inflation rate increased 11 bps to 1.86%. Market inflation expectations have been falling over the past four months.



The Federal Open Market Committee (FOMC) maintained its overnight target rate at the 0-0.25% range citing concerns about global economic growth and overall financial market turbulence. The Fed left the door open for a potential rate hike when they meet next in December.

Economic data released in the Eurozone in October were slightly better than expected. Eurostat's flash estimate of October inflation was flat on a year-over-year basis, slightly higher than September's -0.1% reading, as falling energy prices continue to weigh on headline inflation. Eurostat's core inflation reading, which strips out food and energy prices, rose to 1% in October from 0.9% in the previous month. The unemployment rate fell to 10.8% from 10.9% in the previous month and 11.5% in the same period last year; the 10.8% unemployment reading was the lowest rate recorded in the Eurozone since January 2012. Unemployment at the individual country level continues to show wide dispersion, with Germany's 4.5% and Spain's 21.6%, as the region's low and high rates. Despite the economy showing some signs of progress, weak price inflation data has the European Central Bank (ECB) discussing additional stimulus measures. The ECB's is expected to announce a decision on further stimulus at its next governing council meeting, which takes place in December.

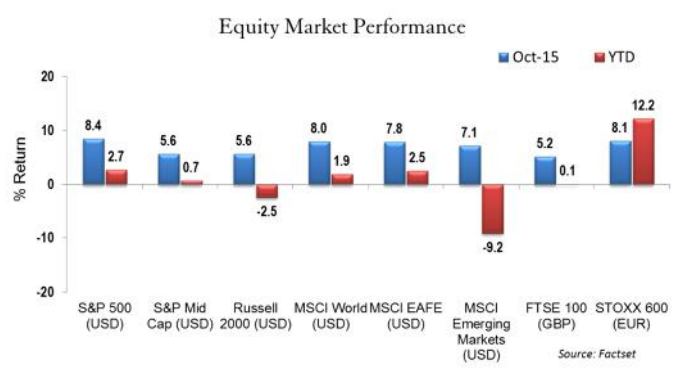
In the UK, the Office of National Statistics' (ONS) estimated that the unemployment rate was 5.4%, the lowest level since the second quarter of 2008. Earnings have continued to show strength, rising 3% year-over-year in August while consumer price inflation remains weak. The headline CPI rate for the UK fell to -0.1% in September, driven primarily by falling energy prices, and core inflation came in at 1.0%. Inflation remains well below the 2% target set by the Bank of England (BOE). Despite the improving unemployment rate and steadily growing worker earnings, the BOE kept interest rates unchanged at its most recent Monetary Policy Committee meeting. The committee cited persistently low inflation, a downward revision of the Bank's UK growth forecast for next quarter, and economic weakness in China as reasons to keep the headline rate steady at 0.5%.

In Japan, the Bank of Japan (BOJ) cut its outlook on growth and inflation, as slowing growth in China and soft domestic demand weigh on the Japanese economy. Japan's export growth fell to 0.6%, substantially lower than the 3.4% rate expected by economists. The 0.6% growth figure was the lowest since August 2014, and much weaker than the previous month's 3.1% annual growth rate. Japan's CPI fell 0.1% in September while the core inflation rate rose 0.9%. Household spending in Japan fell 0.4% in September, as weakening prices have not increased consumer demand. In China, the People's Bank of China (PBOC) cut interest rates for the sixth time in 2015 in an attempt to simulate the Chinese economy, which continues to face disinflationary pressure and slowing growth. The one-year lending rate was cut 25 bps to 4.35%, and the one-year deposit rate fell from 1.75% to 1.5%.

Equity Markets

Global equity markets rebounded sharply in October, with the MSCI World Index returning 8.0%. US large cap stocks, as measured by the S&P 500, gained 8.4% in September, returning to positive territory for 2015. US mid-cap stocks, as measured by the S&P 400 returned 5.6% and the Russell 2000 small-cap index finished the month up 5.6%. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) returned 8.1% and 5.2%, respectively. The MSCI Emerging Markets index gained 7.0% in October, and is now down 9.2% in 2015. At the sector level, previous laggards Materials and Energy led the market higher with gains of 13.5% and 11.4%, respectively. Utilities lagged the market in October, gaining only 1.1% for the month, as bond yields rose. Healthcare stocks rebounded strongly, posting a 7.8% return for the month, though Biotechnology stocks remain under pressure and accusations of improprieties at Valeant Pharmaceuticals (VRX) weighed on the sector.

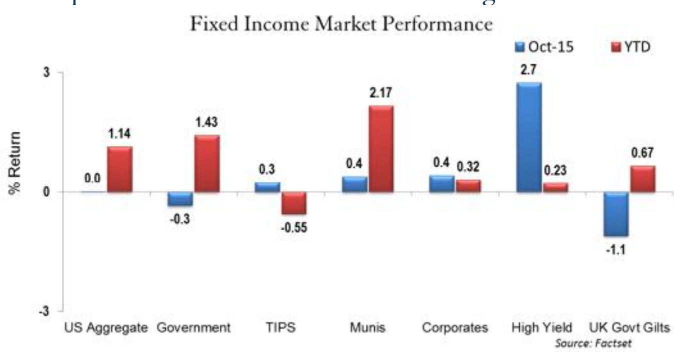
The S&P 500 traded straight up throughout the month, and was up as much as 9% before slightly falling into the month end. Market volatility, as measured by the CBOE Market Volatility Index (VIX), fell steadily in October, closing at 15.07, down from September's close of 24.50. The VIX collapsed from 24.50 to 16.17 in the month's first eight trading sessions. The volatility of European stocks, as measured by the Euro Stoxx 50 VIX Index, finished October significantly lower, closing the month at 20.36 after closing September at 32.05.



Bond Markets

A rate cut by PBOC and expectations of additional QE from the European Central Bank helped risk assets to rally in October. Credit spreads narrowed with the Option Adjusted

Spread on the Barclays Credit Index tightening after widening for six consecutive months. Corporate credit issuance remained high. Long-term treasury yields traded in a narrow band for most of the month, with yields rising subsequent to the Oct 28th FOMC meeting.

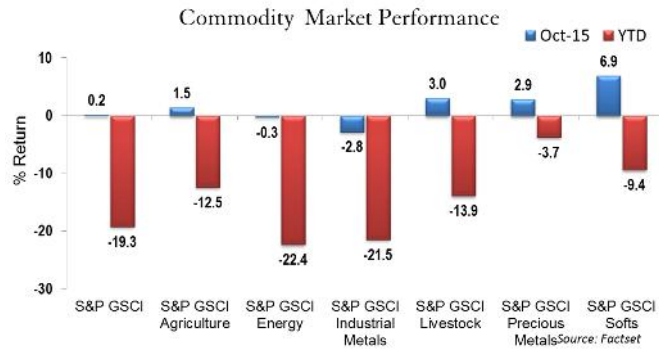


The U.S. Treasury 10-year benchmark bond closed the month at 2.15%, 9 bps higher than September's closing yield of 2.06%. The 30-year benchmark bond closed at 2.93%. The yield of the U.K. 10-year benchmark bond increased 26 bps, closing the month at 1.92%. German 10-year benchmark bond yields fell 7 bps to close at 1.25%.

Commodities

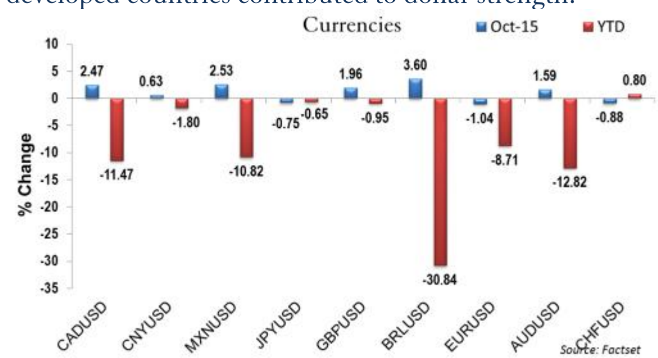
The S&P GSCI Total Return Index, a headline index of 24 commodities, returned 0.2% in October. The index has fallen 19.3% in 2015, with each of the major sub-indices in negative territory for the year. The Softs sub-index was the strongest performer in October, gaining 6.9% for the month. The sub-index was led higher by Sugar [+12.7%], as greater than expected rainfall in Brazil, the world's largest sugar producer, threatened to disrupt the harvest season and impact supply.

The Energy sub-index fell 0.3% in October, after September's sharp decline. The energy sub-index was dragged lower by Natural Gas [-15.3%], which fell on record supply levels and warmer than normal weather in the United States. West-Texas Crude Oil opened the month at $45.09/bbl. and traded choppily throughout the month, closing October slightly higher at $46.59/bbl. Refining margins contracted slightly in October, as Crude Oil outperformed Gasoline [+0.7%], Gasoil [-2.6%], and Heating Oil [-3.3%].



Currencies

The US Dollar continued to strengthen versus a basket of major currencies in October. The Dollar Index climbed 0.63% during the month and is up +7.35% for the year. Monetary policy divergence between the US and most other developed countries contributed to dollar strength.



The Euro weakened for the second consecutive month against the US Dollar. The Euro lost 1.4% against the greenback to close at 1.1047 USD/EUR in September. The Euro has weakened 8.7% YTD. The British Pound strengthened 1.96% to close at 1.544 USD/GBP.