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Market Observations – 1Q 2018 Recap

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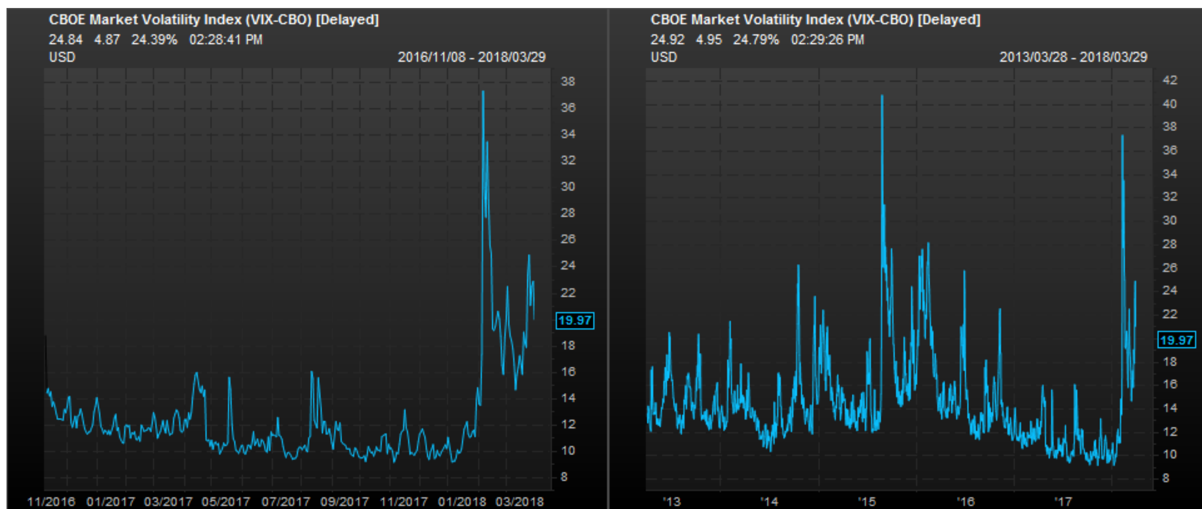
After a period of calm over the past couple of years, volatility came back with a vengeance this quarter. For a prolonged period of time, we as investors have become largely complacent with volatility at unusually low levels. However, the return of volatility, while nerve-racking, is a return to normalcy. To help illustrate this anomaly, the chart below on the left shows equity market volatility depicted by the CBOE VIX index since the presidential election. The chart on the right is the CBOE VIX index over the past five years. Comparing VIX levels in the two charts shows that our current level of volatility, 20.0 at the end of the quarter, is by most considerations a *normal* level.



What is most ironic about the return to normal volatility levels is that we have become unaccustomed to experiencing it. We believe what caused the resumption of volatility is what the market has been waiting for: the return of inflation. The Fed's intention of keeping rates exceptionally low and purchasing bonds (quantitative easing) was to reignite the economy and spur inflation. However, when inflation finally appeared via wage growth in February, the market freaked out (technical term) about the Fed potentially being more aggressive with future rate increases. This uncertainty has brought the return of volatility.

While corporate fundamentals remain strong and the economy is on sound footing, markets tend to not like uncertainty. The mix of uncertainty surrounding future Fed rate hikes, as well as the potential for tightening trade policies in the US, has thrown the markets from a momentous run. In the first quarter the S&P 500 returned -0.8% while the Bloomberg Barclays US Aggregate Bond index was down 1.5%. The correlation among equity and bond markets has risen, creating a potentially dangerous environment for investors where neither 'risk' nor 'risk-free' assets may offer attractive returns going forward.

Commentary on the various market segments for the first quarter of 2018 is on the pages that follow.

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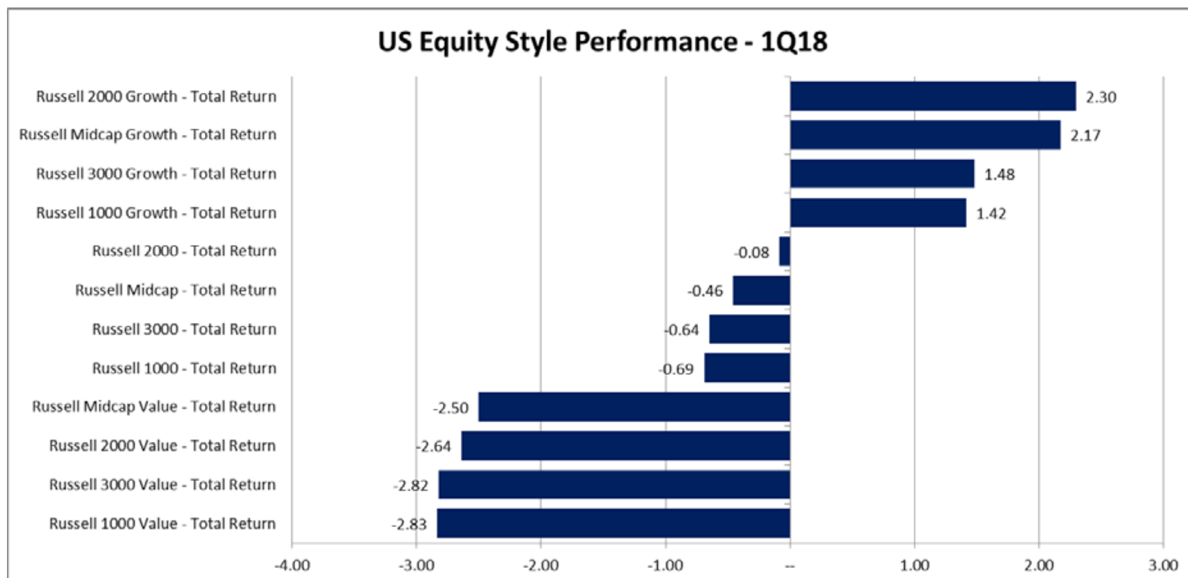
US Equity Style: The US equity advance hit a road block in the first quarter brought about by inflationary concerns and a potential trade war despite a great showing of fourth quarter earnings and revenue growth. At current valuations, investors are likely to be more focused on earnings growth as a market driver rather than multiple expansion.

- The Growth style outperformed the Value style across all market cap segments during the quarter. In fact, only the Russell 2000 Growth, Russell Mid Cap Growth, and Russell 1000 Growth indices posted positive returns for the quarter.
- Large Cap Value stocks were the worst performing in the first quarter as the Russell 1000 Value index posted a -2.8% return as the Energy, Materials and Industrials sectors, which represent 1/3 of the S&P 500, were down for the quarter.
- Strong performance by the Information Technology and Consumer Discretionary sectors in the Large Cap segment, and Information Technology and Health Care sectors within the Small and Mid-Cap segments drove their respective growth indices.
- From a market cap standpoint, Small Cap stocks outperformed Mid and Large Cap Stocks for the quarter.
- The Momentum and Growth factors dominated for the quarter which is consistent with what we saw in 2017. Value and Quality factors were the weakest performing during the quarter.
- The dispersion between the best performing style (Small Cap Growth) and the worst performing style (Large Cap Value) in the first quarter was 5.1%, indicating that manager had a meaningful impact on active manager performance.



Source: FactSet

US Sectors: Information Technology and Consumer Discretionary were the only S&P 500 sectors to post positive performance for the first quarter. All other sectors underperformed the 0.8% return posted by the S&P 500.

- Information Technology and Consumer Discretionary were the top performing sectors for the quarter thanks to a month of January that saw the sectors return 7.6% and 9.3%, respectively. Amid the volatility in February and March these sectors were able to hold onto those gains generated in January. Apple, Microsoft, and Netflix were the top contributors to the S&P 500 for the quarter.
- The Information Technology sector has grown to become a 24.6% weighting of the S&P 500. This is up from 17.8% at the market bottom during the financial crisis (3/9/09). At the same time, we saw a crack in the armor in some leading tech stocks in the month of March with Amazon and Facebook being the primary culprits. Amazon is under scrutiny from the Trump administration and Facebook's stock has corrected as a result of privacy leaks.
- The Consumer Staples and Telecom sectors were the weakest performing sectors for the quarter with returns of -7.5% and -7.1%, respectively. These sectors were followed by the Energy, Real Estate, Materials and Utilities sectors. The higher yielding sectors continue to be hurt by rising rates which make their yields look less attractive than bonds.
- There was a fairly wide level of dispersion between the best and worst performing sectors for the quarter. The level of dispersion was 11.0% with the Information Technology sector being the best performer and the Telecom sector being the worst performer indicating that sector positioning had a meaningful impact on active management.
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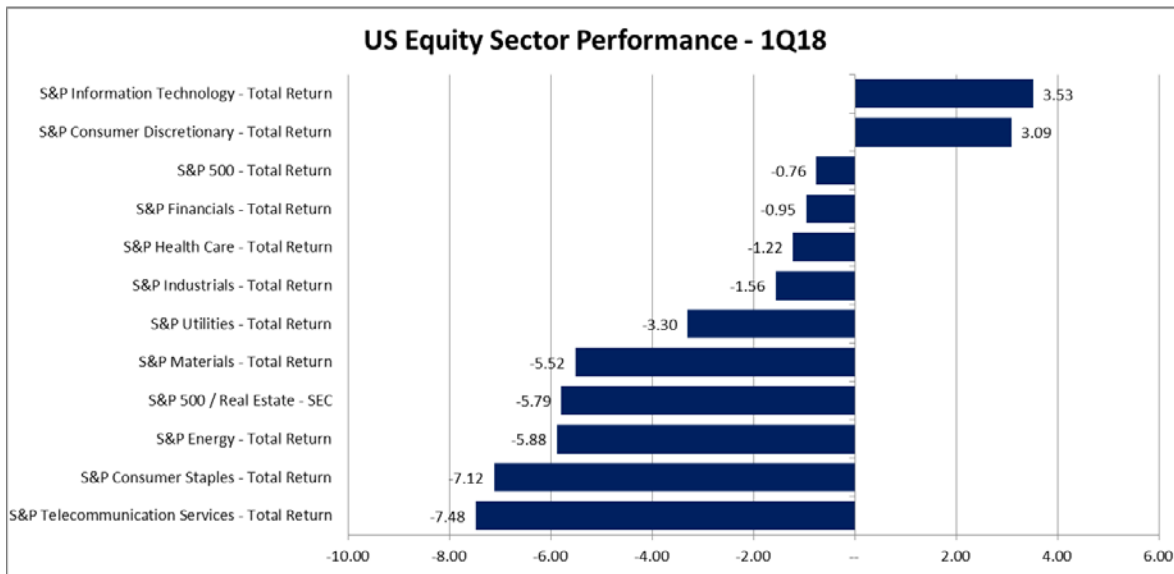

Source: FactSet

Non-US Markets: Emerging markets slightly outperformed the US, posting a positive return for the quarter. Non-US developed markets underperformed the US. A continuation of the declining US Dollar positively impacted non-US equity returns during the quarter.

- The MSCI EAFE index returned -1.5% in the first quarter. The MSCI EAFE index underperformed the S&P 500's -0.8% total return. As in the US, the Growth style outperformed the Value style but not by a convincing amount like in the US. Utilities, Information Technology and Consumer Discretionary were the top performing sectors for the quarter. Telecom, Materials and Consumer Staples were the weakest performing sectors. Like in the US, Small Cap stocks outperformed Large Cap Stocks within non-US developed markets.
- The Far East region, which includes Japan, returned 0.6% for the quarter. Japan, which has been seeing signs of economic improvement, returned 0.8%, benefiting primarily by a 5.9% appreciation of the Yen. The MSCI Europe index, which includes the Eurozone, returned -2.0% for the quarter. Despite the Euro appreciating by 3.5%, the Eurozone experienced some disappointing news in a declining PMI and reduced earnings expectations.
- The MSCI EM index returned 1.4% for the quarter. Despite the Fed being in tightening mode as well as reform to US trade policy, emerging markets held up well for the quarter due to a strong January when the index was up 8.3%. Within emerging markets Large Cap outperformed Small Cap. The Latin American region was the best performing region driven by a 12.4% return from MSCI Brazil. The Eastern European region was up 4.1% for the quarter driven by a 9.4% return for MSCI Russia.
- The US Dollar depreciated relative to most major currencies in the first quarter. The US Dollar index, a trade weighted basket of currencies, declined 2.1%. Only the Australian Dollar, South Korean Won, and Indian Rupee were the only currencies to depreciate against the US Dollar. The Mexican Peso, Japanese Yen and Euro made the greatest advances relative to the US Dollar.
- In emerging markets, Energy was the leading sector with a strong return of 7.5%. This sector was driven by strong returns from a select few global energy giants; namely Petrobras & Lukoil. This was followed by Health Care and Financials sectors. The weakest performing sectors were Consumer Discretionary, Telecom, and Real Estate.
- Frontier markets outperformed emerging markets for the quarter. The MSCI Frontier Markets index returned 5.1% while the MSCI Frontier Emerging Market index returned 1.6%. Argentina and Vietnam were the main drivers of the MSC Frontier Market index for the year. The former was driven by strong returns from Vietnam, Kuwait and Nigeria. The later index, which has a 22% weighting to the Philippines was dragged down by a -11.6% return in that market.

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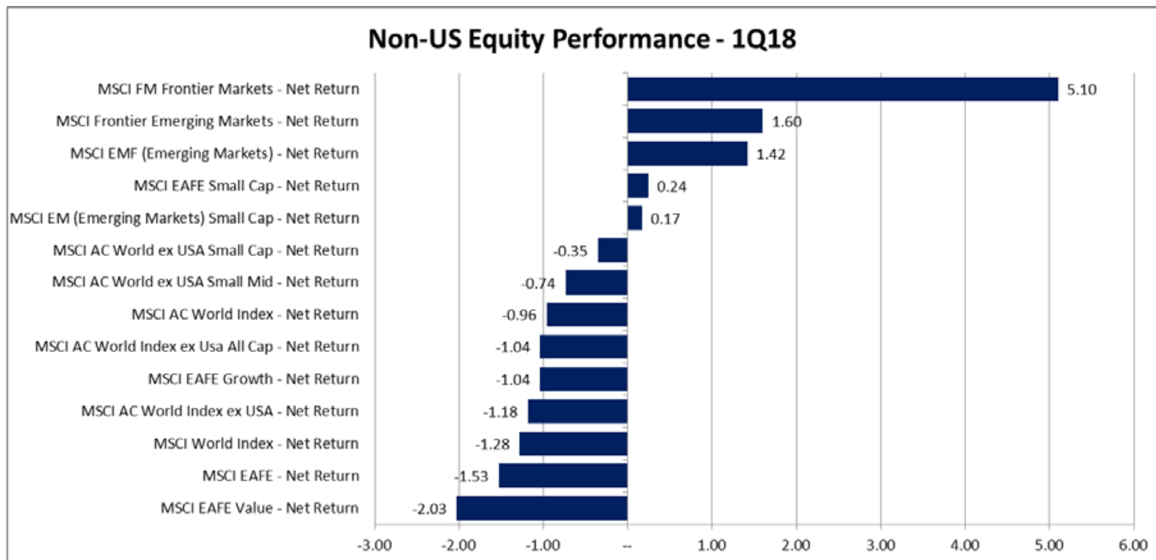

Source: FactSet

Fixed Income: Most US fixed income segments posted negative returns in the first quarter. High quality bonds didn't provide the protection they usually do during market drawdown. High yield and low quality led the fixed income markets in the first quarter as their yield buffer was able to overcome spread widening.

- The lower the credit quality the better the performance as below CCC rated corporate credit was the best performing bond segment as the BofA ML US High Yield (CCC & Lower) index returned 1.4% for the quarter. Broad high yield via the BofA ML US High Yield index returned -0.9%, its first negative quarter since the fourth quarter of 2015. Credit spreads widened during the quarter continue to tighten and are now 410 basis points above Treasuries. This is still below the long term average of 580 basis points.
- Leveraged loans/floating rate also performed well during the quarter and benefited from their short duration which protected them from the rising yields that hurt longer duration investments.
- Investment grade credit performed poorly during the quarter, posting a -2.3% return as per the Bloomberg Barclays Aggregate Investment Grade Credit index.
- The yield curve steepened over the course of the quarter. The 2-year Treasury rose from 1.89% at the beginning of the quarter to 2.27% at the end of the quarter. The 10-year Treasury rose from 2.4% at the beginning of the quarter to 2.74% at the end of the quarter. The rise in the short-end of the curve was induced by the expectations of at least three Fed rate hikes in 2018. The steepening at the long-end was due to a combination of a pickup in inflation concerns as well as an increasing US deficit resulting from recently enacted tax cuts and an increased federal budget.
- Both investment grade and high yield municipal bonds posted negative returns for the quarter. The 10-year Muni/Treasury yield ratio ended the quarter at 0.97, which is slightly above its long term average of 0.93. This is an indication that municipal bonds are now fairly valued relative to their taxable counterpart.
- Despite a challenging February, global bonds posted strong returns for the first quarter. Local currency EM debt was the best performing segment amid strong returns in Mexican Peso and Chinese RMB, with the JPMorgan GBI-EM Global Diversified returning 4.7% for the period. Contrastingly, US dollar-denominated EM debt declined -1.7% in the quarter. Strength in Europe and Japan also supported Developed Market bonds, as the Citigroup Non-USD WGBI returned 4.4%.

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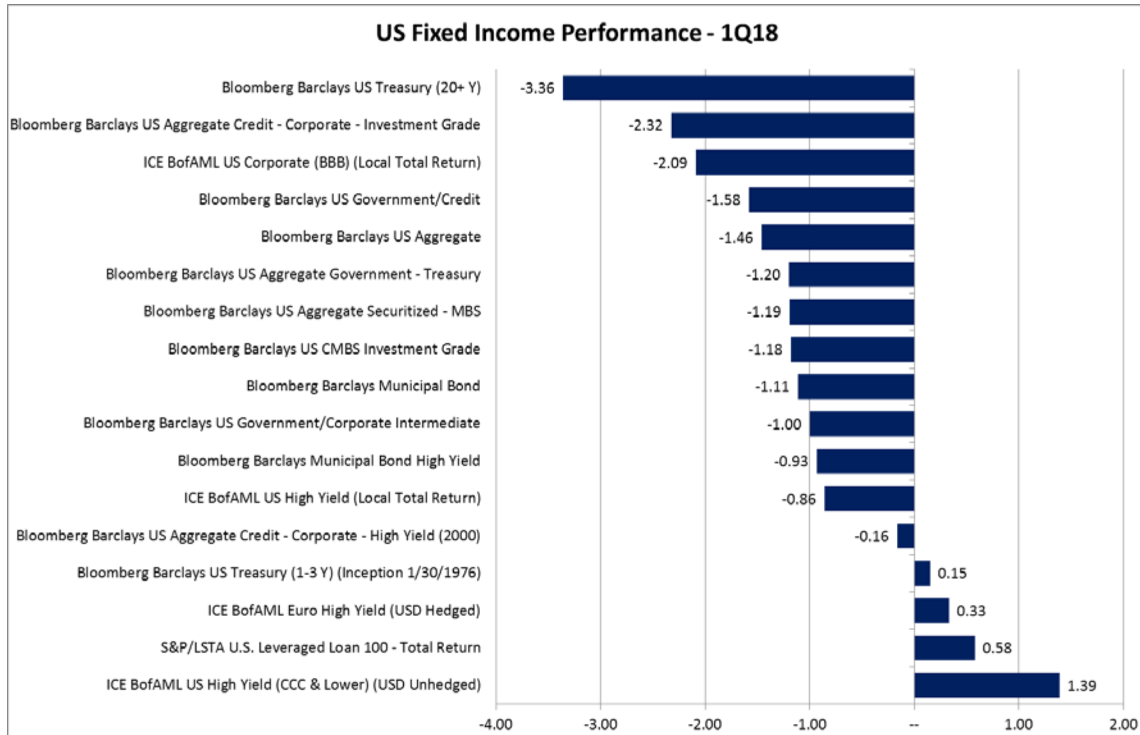

Source: FactSet

Manager Review:

In a period of low rates and low volatility, active management tends to have a difficult time outperforming within their specific segments of the market. Today we feel active management is poised to benefit from a number of factors that are present in the markets.

1) **Rising rates:** Loose monetary policy and a period of low interest rates tend to encourage risk-taking. In such an environment active management typically struggles, as risk assets tend to be highly correlated. Now that we are in a rising rate environment the correlations amongst stocks have been, and should continue, to decline. This should be advantageous for active management.
2) **Rising volatility:** The recent rise in market volatility is beneficial to active management. The catalyst for the recent rise in volatility is rising rates. As mentioned above, rising rates, which increases volatility, decreases the correlation amongst risk assets which is beneficial to active management.
3) **Market drawdowns:** Rising rates, which increases volatility and causes risk assets to become less correlated, typically results in drawdowns. Drawdowns are fairly typical with the average drawdown for the S&P 500 being 14% over the past 30 years. Many active managers tend to prove their worth in difficult market environments, which we haven't experienced much of since the financial crisis. More frequent drawdowns should be beneficial for many active managers.
4) **Top-heavy indexes:** The S&P 500 is a market cap weighted index. Despite having 500 stocks in the index the top ten stocks represent a 21.6% weighting as of the end of the first quarter. First of all, this is not as diversified an index as many think. Secondly, the top ten stocks are heavily skewed by highflying media and tech stocks such as Apple, Amazon, Facebook, and Alphabet. Throw in Microsoft and these stocks represent 64% of the top ten. These stocks represent the momentum currently driving the market**.** When this momentum falters, index tracking products will catch 100% (if not more) of the downside. This is beneficial to active managers who look vastly different than these index tracking products via high active share.

The above comments do not only pertain to US equity strategies. These comments also pertain to international equity strategies, emerging market equity strategies, fixed income strategies, etc. We believe active management is worth the price when utilizing managers that are "truly active" and have a highly disciplined approach to investing.

Disclosures

Indices are unmanaged and presented for comparison purposes only. Please note that the returns displayed for indices do not take into account any of the costs associated with buying and selling individual securities. Individuals cannot invest directly in an index.

Bloomberg Barclays Capital U.S. Aggregate Bond Index: *The U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The Index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM pass throughs), ABS, and CMBS sectors. The U.S. Aggregate Index is a component of the U.S. Universal Index in its entirety. The index was created in 1986 with index history backfilled to January 1, 1976. All issues in the Aggregate Index are rated Baaa3/BBB-/BBB- or higher (using the middle rating of Moody's, S&P, and Fitch, respectively) and have at least one year to maturity and have an outstanding par value of at least $250 million.*

Bloomberg Barclays CMBS IG TR USD: *The index measures the performance of investment-grade commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974, which will deem ERISA eligible the certificates with the first priority of principal repayment, as long as certain conditions are met, including the requirement that the certificates be rated in one of the three highest rating categories by Fitch, Inc., Moody's Investors Services or Standard & Poor's.*

Bloomberg Barclays Municipal TR USD: *The Bloomberg Barclays Municipal Bond Index is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year.*

Bloomberg Barclays US Corp IG TR USD: *The index measures the performance of investment grade corporate bonds.*

Bloomberg Barclays US Corporate High Yield TR USD: *Bloomberg Barclays US Corporate High Yield TR USD*

Bloomberg Barclays US Govt/Credit Interm TR USD: *A subgroup of the Bloomberg Barclays Government/Credit Bond Index that is based on maturity with greater than 1 to 10 years.*

Bloomberg Barclays US Govt/Credit TR USD: *The U.S. Government/Credit Bond Index is the non-securitized component of the U.S. Aggregate Index. Specifically, the Government/Credit Index includes treasuries (i.e., public obligations of the US Treasury that have remaining maturities of more than 1 year), Government-Related issues (i.e. agency, sovereign, supranational, and local authority debt) and Corporates (publicly issued US corporate and Yankee debentures and secured notes that meet specified maturity, liquidity, and quality requirements). All issues in the Government/Credit Index are rated Baaa3/BBB-/BBB- or higher (using the middle rating of Moody's, S&P, and Fitch, respectively) and have at least one year to maturity and have an outstanding par value of at least $250 million.*

Bloomberg Barclays US MBS TR USD: *The Bloomberg Barclays Mortgage-backed Securities Index is a market value-weighted index which covers the mortgage-backed securities component of the Bloomberg Barclays U.S. Aggregate Bond Index. The index is composed of agency mortgage-backed pass through securities of the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) with a minimum $150 million par amount outstanding and a weighted-average maturity of at least 1 year. The index includes reinvestment of income*

Bloomberg Barclays US Treasury 1-3 Yr TR USD: *The Bloomberg Barclays Capital US Treasury Bond 1-3yr term index measures the performance of short-term government bonds issued by the US Treasury.*

Bloomberg Barclays US Treasury 20+ Yr TR USD: *The Index is market capitalization weighted and includes all of the securities that meet the Index criteria. The index includes all publicly issued, U.S. Treasury securities that have a remaining maturity greater than 20 years, are non-convertible, are denominated in U.S. dollars, are rated investment grade (Baa3 or better) by Moody's Investors Service, are fixed rate, and have more than $150 million par outstanding. Excluded from the*

Index are certain special issues, such as flower bonds, targeted investor notes (TINs) and state and local government series bonds (SLGs), and coupon issues that have been stripped from assets already included.

Bloomberg Barclays US Treasury TR USD: *The U.S. Treasury Index includes public obligations of the U.S. Treasury. Treasury bills are excluded by the maturity constraint but are part of a separate Short Treasury Index. In addition, certain special issues, such as state and local government series bonds (SLGs), as well as U.S. Treasury TIPS, are excluded. STRIPS are excluded from the index because their inclusion would result in double-counting. Securities in the index roll up to the U.S. Aggregate, U.S. Universal, and Global Aggregate Indices. The U.S. Treasury Index was launched on January 1, 1973.*

Bloomberg Barclays US Treasury US TIPS TR USD: *The Index includes all publicly issued, U.SS Treasury inflation-protected securities that have at least 1 year remaining to maturity, 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. The Index is market capitalization weighted and the securities in the Index are updated on the last calendar day of each month.*

BofAML US Corps BBB TR USD: *This data represents the BofA Merrill Lynch US Corporate BBB Index, a subset of the BofA Merrill Lynch US Corporate Master Index tracking the performance of US dollar denominated investment grade rated corporate debt publically issued in the US domestic market. This subset includes all securities with a given investment grade rating BBB.*

BofAML US HY CCC- Constrained TR USD: *The BofA Merrill Lynch CCC and Lower US High Yield Constrained Index contains all securities in The BofA Merrill Lynch US High Yield Index that are rated CCC1 and lower, based on an average of Moody's, S&P and Fitch, but caps issuer exposure at 2%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro-rata basis. Similarly, the face values of bonds of all other issuers that fall below the 2% cap are increased on a pro-rata basis. In the event there are fewer than 50 issuers in the Index, each is equally weighted and the face values of their respective bonds are increased or decreased on a pro-rata basis.*

BofAML US HY Master II Constnd TR USD: *The BofA Merrill Lynch US High Yield Constrained Index contains all securities in The BofA Merrill Lynch US High*

BofAML US HY Master II TR USD: *Tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic markets.*

Europe Stoxx 600: *The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.*

Russell 1000 Growth Index (R1000 Growth*): Measures the performance of the Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.*

Russell 1000 Index (Russell 1000): *Measures the performance of the 1,000 largest companies in the Russell 3000 Index. Frank Russell Co. ranks the US common stocks from largest to smallest market capitalization at each annual reconstitution period. The*
Russell 1000 Index represents the vast majority of the total market capitalization of the Russell 3000 Index. It is considered to be generally representative of US Equity Large Cap performance.

Russell 1000 Value Index (R1000 Value): *Measures the performance of the Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.*

Russell 2000 Growth Index (R2000 Growth*): Measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.*

Russell 2000 Index (Russell 2000): *Measures the performance of the 2,000 smallest companies in the Russell 3000 Index. Frank Russell Co. ranks the US common stocks from largest to smallest market capitalization at each annual reconstitution period. The*
Russell 2000 Index represents a very small percentage of the total market capitalization of the Russell 3000 Index. It is considered to be generally representative of US Equity Small and Mid Cap performance.

Russell 2000 Value Index (R2000 Value): *Measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values*

Russell 3000 Growth: *The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values.*

Russell 3000 Index (Russell 3000): *Measures the performance of the 3,000 largest US companies based on total market capitalization, which represents nearly the entire market capitalization of the investable US equity market. Frank Russell Co. ranks the US common stocks from largest to smallest market capitalization at each annual reconstitution period.*

Russell 3000 Value: *The Russell 3000 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values.*

Russell Midcap Growth Index (Russell Midcap Growth): *Contains those Russell Midcap (800) securities with a greater than-average growth orientation. Companies in this index tend to exhibit higher price-to-book and price-earnings ratios, lower dividend yields and higher forecasted growth values than the Value universe.*

Russell Midcap Index (Russell Midcap): *Measures the performance of the mid-cap segment of the US equity universe. The Russell Midcap Index includes the smallest 800 securities in the Russell 1000.*

Russell Midcap Value Index (Russell Midcap Value): *Contains those Russell Midcap (800) securities with a less-than average growth orientation. Securities in this index generally have lower price-to-book and price-earnings ratios, higher dividend yields and lower forecasted growth values than the Growth universe.*

S&P 500 Index: *The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The Index is one of the most widely used benchmarks of US Equity Large Cap performance.*

S&P 500 Sector/Consumer Discretionary Index: *The S&P 500 Sector/Consumer Discretionary Index consists of stocks chosen for their representation in the Consumer Discretionary industry. The companies in the index tend to be the most sensitive to economic cycles. Manufacturing companies include automotive, household durable goods, textiles and apparel, and leisure equipment. Service companies include hotels, restaurants/leisure facilities, media production and services, consumer retailing and services and education services. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Consumer Staples Index: *The S&P 500 Sector/Consumer Staples Index consists of stocks chosen for their representation in the Consumer Staples industry. The companies in the index tend to be the less sensitive to economic cycles. They include manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products; also food and drug retailing companies. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Energy Index: *The S&P 500 Sector/Energy Index consists of stocks chosen for their representation in the Energy industry. The companies in the index are dominated by either the construction for provision of oil rigs, drilling equipment and other energy-related service and equipment or the exploration, production, marketing, refining and/or*

transportation of oil and gas products, coal and consumable fuels. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

S&P 500 Sector/Financials TR Index: *The S&P 500 Sector/Financials Index consists of stocks chosen for their representation in the Financials industry. The companies in the index are involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investments, and real estate, including REITs. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

*S**&P 500 Sector/Healthcare TR Index:*** *The S&P 500 Sector/Healthcare Index consists of stocks chosen for their representation in the Healthcare industry. The companies in the index are involved in health care equipment and supplies, health care-related services, or in the research, development, production and marketing of pharmaceuticals and biotechnology products. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Industrials TR Index: *The S&P 500 Sector/Industrials Index consists of stocks chosen for their representation in the Industrials industry. Companies include those that manufacture and distribute capital goods (i.e. aerospace/defense, construction, engineering and building products, electrical equipment and industrial machinery); provide commercial services and supplies (i.e. printing, employment, environmental/office services); or provide transportation services (i.e. airlines, couriers, marine, road/rail and transportation infrastructure). It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Information Technology TR Index: *The S&P 500 Sector/Information Technology Index consists of stocks chosen for their representation in the Info Tech industry. Companies considered are involved in technology software and services and technology hardware and equipment. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Materials TR Index: *The S&P 500 Sector/Materials Index consists of stocks chosen for their representation in the Materials industry. These include companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including steel producers. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Telecommunication Services TR Index: *The S&P 500 Sector/Telecom Services Index consists of stocks chosen for their representation in the Telecom industry. The companies in the index are involved in health care equipment and supplies, health care-related services, or in the research, development, production and marketing of pharmaceuticals and biotechnology products. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P 500 Sector/Utilities TR Index: *The S&P 500 Sector/Utilities Index consists of stocks chosen for their representation in the Utilities industry. Companies considered include electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.*

S&P/LSTA Leveraged Loan TR: *The S&P/LSTA U.S. Leveraged Loan 100 Index is designed to reflect the performance of the largest facilities in the leveraged loan market. Yield Index but caps issuer exposure at 2%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro-rata basis. Similarly, the face values of bonds of all other issuers that fall below the 2% cap are increased on a pro-rata basis. In the event there are fewer than 50 issuers in the Index, each is equally weighted and the face values of their respective bonds are increased or decreased on a pro rata basis.*

The success of an investment program may be affected by general economic and market conditions, such as interest rates, availability of credit, inflation rates, economic uncertainty, changes in laws and national and international political circumstances. These factors may

affect the level and volatility of securities prices and the liquidity of a portfolio's investments. Unexpected volatility or illiquidity could result in losses.

Investing in securities is speculative and entails risk. There can be no assurance that one's investment objectives will be achieved or that an investment strategy will be successful. Significant losses could result if a strategy involves the use leverage, short sales and derivative transactions, investment in foreign or illiquid securities, and potentially limited diversification.

Special Risks of Fixed Income Securities

For fixed income securities, there is a risk that the price of these securities will go down as interest rates rise. Another risk of fixed income securities is credit risk, which is the risk that an issuer of a bond will not be able to make principal and interest payments on time.

Special Risks of Foreign Securities

Investments in foreign securities are affected by risk factors generally not thought to be present in the US. The factors include, but are not limited to, the following: less public information about issuers of foreign securities and less governmental regulation and supervision over the issuance and trading of securities.

Special Risks of Small Market Capitalization Securities

Investments in companies with smaller market capitalization are generally riskier than investments in larger, well-established companies. Smaller companies often are more recently formed than larger companies and may have limited product lines, distribution channels and financial and managerial resources. These companies may not be well known to the investing public, may not have significant institutional ownership and may have cyclical, static or moderate growth prospects. There is often less publicly available information about these companies than there is for larger, more established issuers, making it more difficult for the Investment Manager to analyze that value of the company. The equity securities of small and mid-capitalization companies are often traded over-the-counter or on regional exchanges and may not be traded in the volume typical for securities that are traded on a national securities exchange. Consequently, the Investment Manager may be required to sell these securities over a longer period of time (and potentially at less favorable prices) than would be the case for securities of larger companies. In addition, the prices of the securities of small and mid-capitalization companies may be more volatile that those of larger companies.

Special Risks of Master Limited Partnerships

Master limited partnerships (MLPs) are publicly listed securities that trade much like a stock, but they are taxed as partnerships. MLPS are typically concentrated investments in assets such as oil, timber, gold and real estate. The risks of MLPS include concentration risk, illiquidity, exposure to potential volatility, tax reporting complexity, fiscal policy and market risk. MLPS are not suitable for all investors.

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