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September | 2020

Institutional Perspectives

Monthly investment analysis and insights from Wilmington Trust Investment Advisors

ON THE RECORD

Rallies, Risks, and Recovery
Is the glass half-full or half-empty?

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Tony Roth
Chief Investment Officer

Notwithstanding the correction in the first week of September, the stock market's impressive rise this year has continued with seeming disregard for the immediate woes of the economy. The S&P 500 returned 35% from April through August of this year—the best five-month run for U.S. large-cap equities since 1938. Even more impressive has been the performance of tech stocks, which have returned 55% over that period for a year-to-date return of 39%, despite (or perhaps because of) the global pandemic. The S&P 500 returned 7% in August alone, a month that typically suffers from weak seasonality and low liquidity. The stock market is rightly focused on the early bounce in the economic data and rapid progress of COVID-19 vaccine development, but there are risks. Now, as underlying risks associated with both the pandemic and the election persist, this is a time to adhere to the key investment principle of discipline. Our focus on three key pillars—economics, a long-term investment horizon, and risk mitigation—continue to guide us toward a somewhat cautious but by no means overly defensive portfolio positioning.

Reasons for optimism

Recent months have witnessed continued progress on the COVID-19 vaccine front, with surprisingly few hiccups or disappointments to date. Our work and discussions with medical experts leave us optimistic that we will see more than one vaccine approved by the Federal Drug Administration for distribution by the end of 2020. Prospects for a "medical miracle" by year end have powered stocks higher.

We also observe that investors are operating under the assumption that fiscal relief from Congress will be both forthcoming and adequate to continue the economy's

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Figure 1

ISM manufacturing rises at fastest rate since 2018

U.S. ISM Manufacturing New Orders Index

Data as of August 31, 2020.

Sources: Institute for Supply Management, Macrobond.

The longer Congress waits to pass another relief bill or a vaccine takes to inoculate the population, the more lasting we would expect the economic damage to be in the form of small business bankruptcies and permanent job losses.

recovery. We, too, believe that a fiscal aid package in the ballpark of $1.5 trillion will come to fruition in the next month. Where we express caution is in recognizing how dependent on additional aid the economy remains, particularly small businesses and lower-income households.

Vaccines and stimulus are important supports for the market, but timing is key. I would draw the analogy to a flooded basement. The higher the waters rise and the longer they sit, the more permanent the potential damage to the structural integrity of the building. Similarly, the longer Congress waits to pass another relief bill or a vaccine takes to inoculate the population, the more lasting we would expect the economic damage to be in the form of small business bankruptcies and permanent job losses.

The Fed also continues to support the economic recovery, and their most recent policy announcement has potential implications that are both long and short term in nature. Chairman Powell announced the formal decision to target average inflation over a longer timeframe, which we take to mean the Fed will allow inflation to run hot to make up for periods of undershooting its inflation target (so inflation averages 2% over the long term). It is possible that this could result in a longer and more robust economic cycle. (For more on this, see our latest Wilmington Wire blog post.) Regardless, we believe the Fed's commitment to keep rates low for a longer period also sends a positive message to risk markets in context of the immediate economic crisis.

Underpriced risks

There are certainly some bright spots in the economic data. The August ISM manufacturing index shows a continuing recovery, with the new orders sub-index climbing to a 16-year high (Figure 1). Housing activity has been surprisingly robust,

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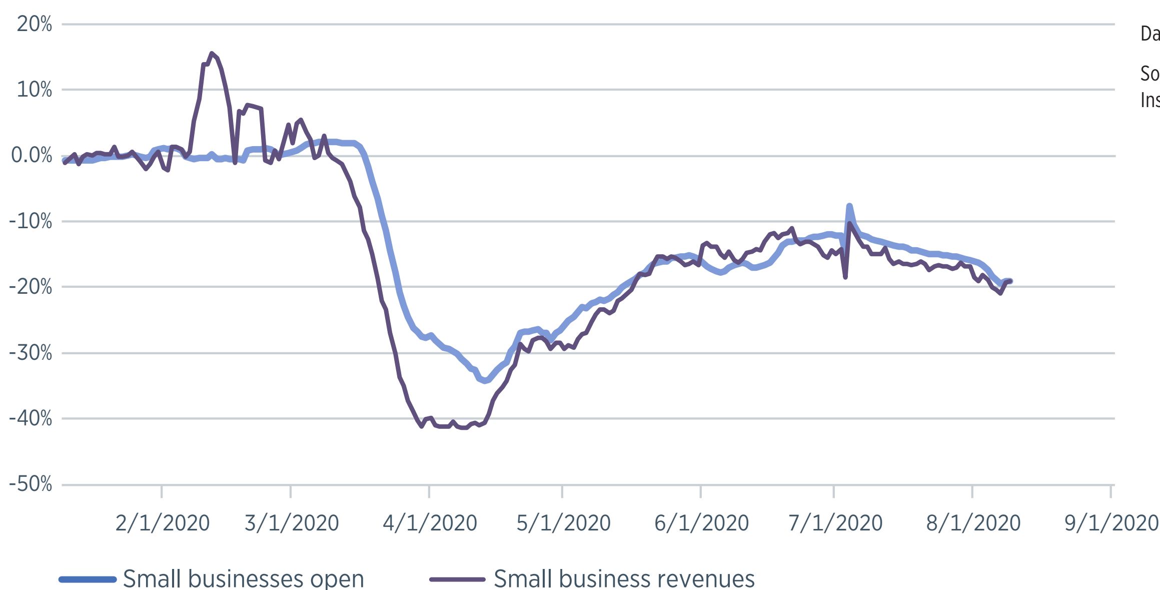
Figure 2

COVID-19 shuttered more than one million small businesses

Small business revenues and businesses open (% change from January)



Data as of August 9, 2020.

Source: Opportunity Insights.

The median consensus estimate for third-quarter GDP is currently 21.2%, a number that would normally appear to be a typo.

with new and existing home sales soaring in July +36% y/y and +9% y/y, respectively. Even auto demand has recovered better than many expected. The median consensus estimate for third-quarter GDP is currently 21.2%,[1] a number that would normally appear to be a typo.

Our core concern, however, is that economic improvement is starting to plateau at levels that are still sadly dismal. That same ISM Manufacturing report shows respondents continue to cut jobs despite the resurgent activity. Data from the Opportunity Insights Economic Tracker indicate that small business revenues and the number of businesses open are both down roughly 19% since January (Figure 2). The unemployment rate still remains high, and near the global financial crisis peak, with the risk of more temporary layoffs becoming permanent. An increase in COVID-19 cases in Europe has taken some wind out of its recovery in recent weeks, and Japan's composite PMI remains in contraction for the seventh consecutive month. In addition to the economy, we believe risks around the election remain somewhat underpriced. The political landscape has been made more complex by the state of the economy, but there are risks coming from both sides of the aisle about which investors appear a bit complacent. Neither an increase in corporate taxes from the left nor a resumption of the China trade war from the right would be particularly helpful for stocks. (See "In Focus" on page 5 for more on the election and the economy.)

Investing amid uncertainty

We are closely monitoring the economic trajectory for signs of an inflection one way or the other. We also are maintaining a long-term investment approach whereby we minimize market timing and look through short-term bouts of volatility that are likely

[1] According to analysts surveyed by Bloomberg.

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Mitigating risk is not just about positioning defensively in the event of a sell-off. It is also about allocating in a prudent way that gives our clients' portfolios the best opportunity to succeed in a variety of scenarios.

to manifest in coming months. Our desire to mitigate risk in a time of heightened uncertainty takes shape in our asset allocation and portfolio construction.

- **Asset allocation.** We maintain a slight underweight to equities versus our long-term strategic benchmark. Valuations are elevated and risks appear skewed to the downside after a record run in the markets. However, we advise against positioning too defensively or holding high levels of cash. Instead, we are hedging the portfolio against both upside risks to inflation and downside risks to equities with a modest allocation to gold.

- **Portfolio construction.** In recent months, our client portfolios have been positioned with a bias toward growth stocks—those companies that generate high levels of organic growth and free cash flow irrespective of the economic environment. Many technology and internet companies fall into this category and have benefited disproportionately from the disruption caused by COVID-19. In this environment, growth stocks have acted more defensively than is typical, as any risks of virus resurgence have driven investors further into the "stay at home" stocks.

  While risks are skewed to the downside, in our view, they are not strictly one way, and we feel it necessary to also allocate some of our equity holdings toward value-oriented strategies. These types of stocks tend to be more cyclical in nature and are cheaper for a number of reasons. (I recommend listening to, "Are Value Stocks Dead?" a recent *Wilmington WealthWise* podcast episode on the subject.) Many of these stocks have not yet participated in the equity market rally, and in fact over 50% of the S&P 500 is still negative for the year. Should promises of a vaccine materialize later this year and allow the economy to more swiftly return to normal, we would expect a rotation into those stocks most beaten down and dependent on macroeconomic growth to outperform. We want our client portfolios to be hedged against these upside risks as well.

Mitigating risk is not just about positioning defensively in the event of a sell-off. It is also about allocating in a prudent way that gives our clients' portfolios the best opportunity to succeed in a variety of scenarios. Indeed, even as we have maintained a slight underweight to risk assets throughout the recovery, we have managed to deliver a degree of outperformance due to our overall diversification and the success of our chosen investment strategies. We aim to continue delivering over the remainder of 2020, a year that will likely continue to unfold in ways we never could have imagined.

Until next month,

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Election Roundup: Special Q&A

Meghan Shue
Head of Investment Strategy

The overall level of the economy is still quite weak whether you are evaluating based on the unemployment rate, the number of small businesses that have shuttered their doors temporarily or permanently, or overall consumer spending.

The U.S. presidential election is just two months away—with the race close and the stakes high—and policy is an important consideration for the economy and markets. Here, we address some of the most pressing questions on our clients' minds as they relate to politics, policy, and portfolios.

Q: How does Wilmington Trust expect the economy to impact the presidential election?

A: The economy is always a critical factor in a presidential election, but we expect the economy to play an outsized role in determining the election outcome as well as the policy priorities on the other side.

Generally, the economy and markets have been good predictors of the presidential election outcome. A strong economy bodes well for the incumbent, while a struggling economy favors a change in leadership. Over time, the two most telling metrics have generally been the labor market and overall economic growth. Consider the following:

- **Unemployment**—Historically, the change in unemployment in the year before the election exhibited a negative relationship with the popular vote margin for the incumbent party's candidate. In other words, falling unemployment has been a tailwind for the incumbent, and rising unemployment has been a headwind. The relationship is weaker for different lead times (e.g., changes in unemployment rate three and six months ahead of the election).

- **Recessions**—Going back to 1912, five out of the six presidents to experience a recession within two years of their second-term election failed to win reelection. The only incumbent president to win reelection with a recession in the rear-view mirror was Calvin Coolidge (his first election for a full term; Warren G. Harding's death made him president).

Clearly the economy is important, but it is also important to recognize that this recession is unlike any we have experienced historically in its nature, speed, and depth. In particular, the overall level of the economy is still quite weak whether you are evaluating based on the unemployment rate, the number of small businesses that have shuttered their doors temporarily or permanently, or overall consumer spending. However, the rate of improvement is also off the charts, and 2020 was likely the shortest recession ever on record. It is unclear whether the level or rate of change will be more influential in this election cycle.

Also, please note that the sample size for the examples we gave is relatively small, and there are always other issues that combine with the economy to form a complex web of considerations.

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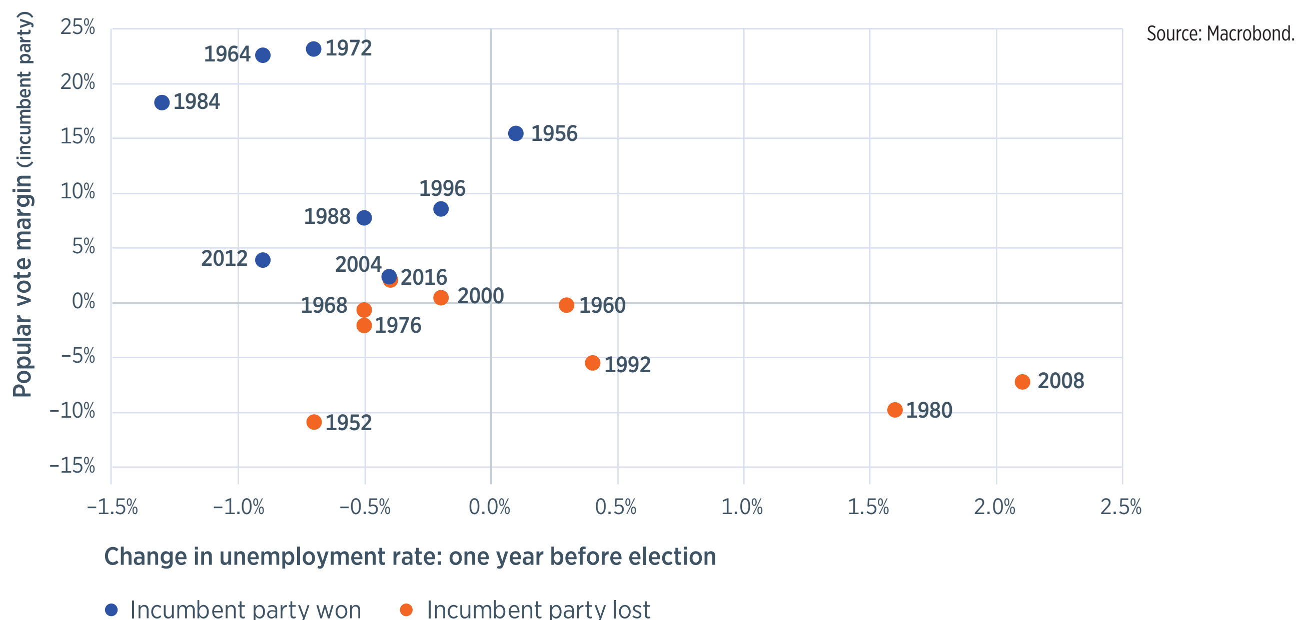
Figure 1

Popular vote margin for incumbent party vs. change in unemployment rate one year before election



Source: Macrobond.

While not necessarily helpful for political or social progress, a divided government makes it less likely that major political initiatives will be passed, something investors appreciate as it lowers the risk premium on equities.

Lastly, it bears mention that the stock market has historically been a surprisingly consistent predictor of the election outcome. The S&P 500 has correctly predicted the victor 87% of the time since 1928 (20 of the last 23 elections). That is, when the S&P 500 return in the three months before an election has been positive, the incumbent party won; when the return has been negative three months before, the incumbent party lost. This could be the result of the following influences: the stock market is trending with the economy; the incumbent party benefits from a rising market into the election; or the market begins to discount the odds of a change in policy from a new administration (in other words, greater uncertainty). Some combination of these three factors is likely at play.

Q: How might the markets react to a Trump victory? Biden victory?

A: Predicting the election is challenging, and predicting the market impact is even harder.

It is important to recognize how humbling a task it is to predict the market reaction to any singular event, particularly an election. If political events of the last cycle in 2016 (U.S. presidential election and Brexit) taught us anything, it is to maintain humility in predicting not only the outcome of the election but also the market's subsequent reaction.

If there is one thing markets dislike, it is uncertainty. Lack of clarity regarding policy makes it incredibly difficult for businesses to plan (and for investors to factor in any potential changes to a company's future profitability). As a result, equities historically have often treaded water in the months ahead of close political votes but

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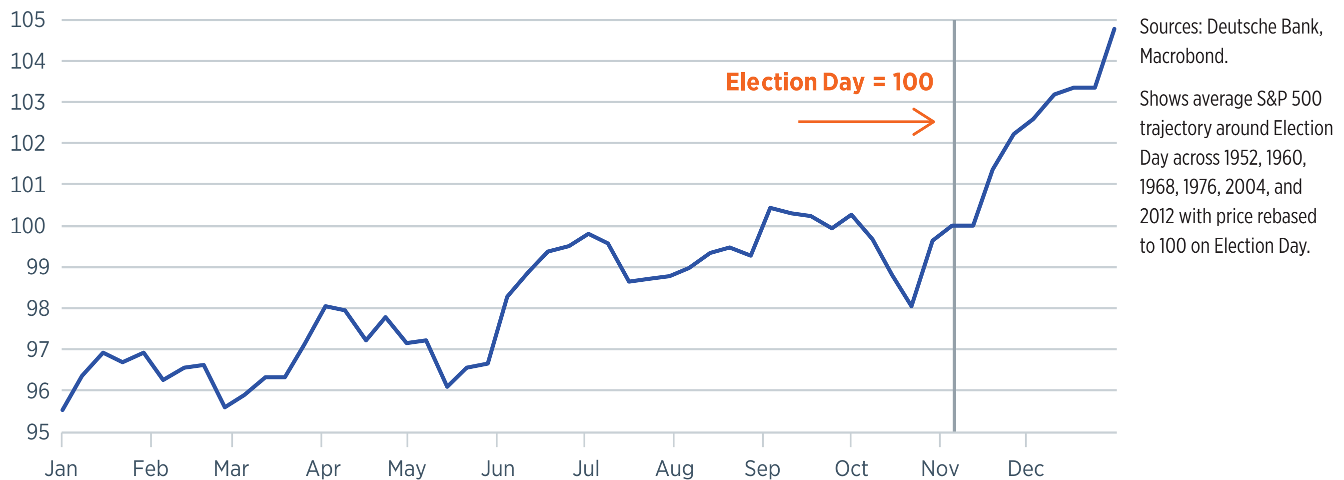
Figure 2

S&P 500 around close elections



Sources: Deutsche Bank, Macrobond.

Shows average S&P 500 trajectory around Election Day across 1952, 1960, 1968, 1976, 2004, and 2012 with price rebased to 100 on Election Day.

Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses such as management fees and transaction costs which will reduce returns.

The S&P 500 has correctly predicted the victor 87% of the time since 1928 (20 of the last 23 elections).

then rallied after the vote regardless of the outcome, in part because the market had certainty and could move forward to price in the likely policy actions.

In a similar vein, the best performance from the stock market has historically coincided with a divided government. While not necessarily helpful for political or social progress, a divided government makes it less likely that major political initiatives will be passed, something investors appreciate as it lowers the risk premium on equities. While unlikely in the upcoming election based on current polling and the likelihood of "down-ballot voting" (political contests not at the top of the ballot), if the Senate were to go a different way than the general election (for example, if Biden wins the presidency and the Senate retains its Republican majority), the market may react favorably given the reduced likelihood of material changes to policy.

Policy priorities are also important determinants of post-election market performance. Furthermore, this is where the economy comes back into play, as it could shift candidate policy priorities based on the trajectory of the recovery in 2021. Each party presents a mixed bag of both goodies and more bitter pills for investors to swallow.

The Democrats

Vice President Biden's tax proposals are more moderate than those of some of his former Democratic challengers, but still pose a stark contrast to those of the Trump administration. Biden's tax plan includes the following:

- Increasing the corporate tax rate from 21% to 28% (it was at 35% before the 2017 Tax Cuts and Jobs Act)
- Imposing a 15% minimum book tax (similar to a corporate alternative minimum tax)

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Some political analysts have posited that Biden's ties to Delaware, where many businesses are incorporated, could lead to a less dramatic increase in financial regulation.

While some argue Trump may be emboldened by a second term without reelection motivations to temper his actions, others make the case that China's President Xi would be more inclined to both negotiate and follow through on promises with the reality of another four years of a Trump presidency.

- Restoring the top income tax rate to 39.6% and increasing the capital gains tax rate to the ordinary income level for those earnings more than $1 million
- Eliminating the estate tax step-up in basis (i.e., taxing unrealized capital gains at death)

The corporate tax rate increase is probably the biggest tax-related risk to markets, as such a move would increase the effective tax rate for the S&P 500 by 4%–5% and could reduce EPS by a similar amount (~$8–$10/share off 2021 earnings depending on estimates). Sectors that saw the biggest benefit from the original tax cuts would similarly be hurt the most by a tax increase, including utilities, staples, communications, and consumer discretionary. It is possible that a slower economic recovery would lead a Democratic administration to punt or reduce the corporate tax increase, though the stock market's robust recovery could make big business a target.

On the other hand, the Democratic party has indicated a higher proclivity to spend, and that is an incredibly important factor given the broad-based economic weakness resulting from COVID-19. Economic data indicate that the economy remains hugely reliant on fiscal transfers in the form of expanded unemployment insurance and direct checks to consumers. A Democratic sweep could lead to more spending should the economy languish, which could help support equities.

The Republicans

President Trump's most market-friendly policies relate to taxes and business regulation. Prior to the COVID-19 health crisis and extraordinary fiscal response, the Trump administration discussed a "Tax Cuts 2.0" plan, though no specifics have been officially released. Some of the proposals (discussed with or leaked to the press) include reference to a lower tax rate for the 22% bracket to 15%, indexing capital gains for inflation, extending individual and estate tax provisions beyond the expiration date, and possibly a modest cut in the corporate tax rate from 21% to 20%.

The reduced regulatory burden enjoyed by companies under the Trump administration is a bit more difficult to quantify (since many regulatory changes were more about personnel choices and enforcement rather than changes to law). A continuation of lighter regulatory policy would be helpful for financials, energy, tech, and communications companies. Some political analysts have posited that Biden's ties to Delaware, where many businesses are incorporated, could lead to a less dramatic increase in financial regulation.

The Trump administration's tough stance on China is a complex issue for investors to digest. The attention brought to China's unfair trade and business practices has been broadly welcomed by the business community. In fact, there are fewer issues that receive more bipartisan support than a "tough on China" stance. But this policy is also one that has created a great deal of uncertainty for businesses and investors alike, particularly as it relates to technology companies and other multinationals reliant on China for supply chains and revenues—many of which have powered the stock market higher since March.

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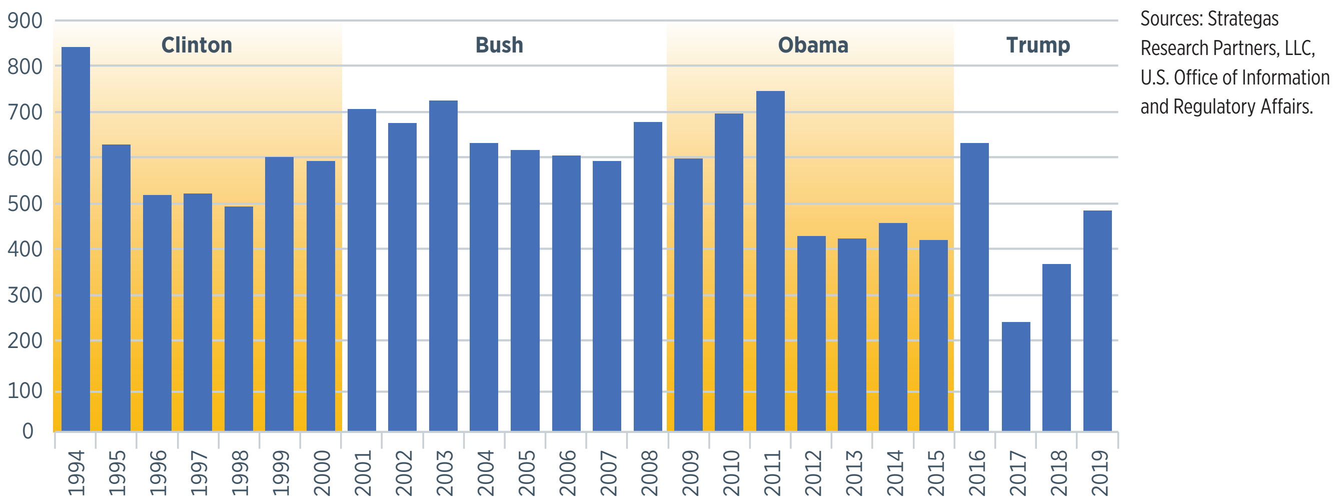
Figure 3

Major regulations passed across all government agencies by year



Sources: Strategas Research Partners, LLC, U.S. Office of Information and Regulatory Affairs.

To stay in the know, be sure to listen to our *Wilmington WealthWise* podcasts and read our *Wilmington Wire* blog posts for real-time updates.

The U.S. and China may be on a path toward structurally decoupling, but Biden would likely slow this trend relative to a Trump administration and provide some relief to those companies most affected by the tariffs imposed under the Trump administration. A second term for President Trump could see a reacceleration of tensions with China. While some argue Trump may be emboldened by a second term without reelection motivations to temper his actions, others make the case that China's President Xi would be more inclined to both negotiate and follow through on promises with the reality of another four years of a Trump presidency. In any event, U.S.-China relations could act as a headwind on the markets in the short term under a Trump administration.

Q: It seems neither party is particularly concerned about the debt situation. How does the Wilmington Trust investment team view the risk of an ever-increasing federal deficit?

A: We think the debt is manageable in the short run and problematic in the long run.

The U.S. debt situation has been an area of concern for us even before the COVID-19 health crisis, as described in our 2020 and 2019 Capital Markets Forecasts. We also discussed the debt in a recent podcast.

The rolling 12-month federal government deficit had been on a slowly worsening path since austerity measures were relaxed in 2015, but the deficit has dramatically worsened this year. As a percent of GDP, the federal budget deficit fell from –4.7% in December 2019 to –15.1% as of July 31, 2020. Federal debt held by the public stood at 80% of GDP as of January 31, 2020; the Congressional Budget Office in an April update projected that figure will reach 101% of GDP by the end of the fiscal year and 108% of GDP by the end of 2021, as a result of updated growth projections and pandemic-related legislation.

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Longer term, it will be necessary to reverse the trend of the deficits in order to avoid an unsustainable situation resulting in higher interest rates, higher inflation, a weaker U.S. dollar, and crowding out of private investment.

In the short term, legislative spending will provide support for consumers and businesses that could help avoid a worst-case scenario decline of personal consumption and increase in corporate defaults. Longer term, it will be necessary to reverse the trend of the deficits in order to avoid an unsustainable situation resulting in higher interest rates, higher inflation, a weaker U.S. dollar, and crowding out of private investment.

Q: How is the election influencing the way you are positioning portfolios?

A: We are increasing our focus on managing overall market and sector-related risk ahead of the election. We do this by monitoring tracking error and active share "budgets"—the fraction of a fund's portfolio holdings that deviate from the benchmark index—in the context of cycle-high valuations.

In this environment of elevated policy uncertainty and two-way risk (both upside and downside), it is critical that investors remain invested but with a modest underweight to equities. We also continue to allocate to managers in a way that offers a diversified exposure to different investment sectors and factors such as growth, value, volatility, and quality.

We expect the market to focus more on the election as we approach October and November, and that could increase volatility as investors price in uncertainty. COVID-19 is creating challenges that could result in an unclear outcome on election night. There are very few historical examples of controversial or contested elections. The only election in the twentieth or twenty-first centuries where a victor was not named on election night was the 2000 election, which involved candidates George W. Bush and Al Gore and a court battle over "hanging chads." In the month-long process of determining a winner after that election, the S&P 500 declined approximately 4%. With little else in the way of historical precedent to point to, all we can say with reasonable certainty is that we would expect heightened volatility during any potential period of contention. In our experience, it is best to ride *through* short-term bouts of policy-induced volatility rather than attempt to trade *around* them.

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ASSET CLASS OVERVIEW

Hedge Funds

Jordan Strauss, CFA, Senior Portfolio Manager
Jessica Blitz, Research Analyst

AS OF AUGUST 31, 2020

	Month	YTD	Trailing 12-month return
Global	1.5%	1.8%	4.9%
Equity Hedge	2.7%	-3.0%	0.5%
Event Driven	1.6%	4.2%	11.0%
Macro	0.4%	1.4%	0.1%
Relative Value	1.1%	4.3%	6.3%

Sources: FactSet, Bloomberg, HedgeFundResearch Indices. Investing involves risks and you may incur a profit or a loss. Past performance cannot guarantee future results. Indices are not available for direct investment.

What we are seeing now

Hedge funds as an asset class rebounded in 2019 from a challenging 2018, seeing strong annual returns throughout the year. After starting 2020 on a high, the coronavirus-driven market sell-off pushed returns into negative territory, though both fundamental and systematic funds outperformed the broader market as measured by the MSCI ACWI Index. Hedge fund returns lagged the market slightly on the upswing but benefited from strong capital protection and outperformed year-to-date (YTD) at the end of the second quarter. Broadly speaking, funds that performed the worst in 1Q 2020 recovered the strongest in 2Q.

The second quarter of 2020 was the ninth consecutive quarter of net outflows for the hedge fund industry. In fact, the first half of the year outpaced all of 2019 for total outflows, reaching $45.6 billion by the end of June. Despite this, and largely due to strong returns, total hedge fund assets under management (AUM) remain well above historical average levels, and just slightly below the 2019 peak of $3.25 trillion. Outflows remain concentrated in equity long/short and discretionary macro funds, the two strategies that have generated negative alpha (on average) over the last decade. Quant equity funds, which were favored over other equity strategies previously, saw their highest net outflows in the last decade in the second quarter of 2020. The strong interest seen in credit long/short and distressed funds in late 2018, the last downturn, has since picked back up, largely due to increasing market volatility.

Investors entered 2020 with a generally positive view of hedge funds given high market valuations. These sentiments reversed course during the March sell-off, but quickly bounced back to prior levels. Market surveys indicate that investors plan to increase allocation to nearly all hedge fund strategies moving forward, with equity long/short and credit funds seeing the most attention.

What's changing

Hedge fund manager dispersion (the ability to reap out-performance through active management, relative to the indices tracked), which peaked in March, fell dramatically after the sell-off, but remains higher than the historical average based on 2Q 2020 returns. Dispersion based on year-to-date returns, which includes both the first and second quarters, reached a 49% spread between the top and bottom 5% of managers, the widest level since 2009.

As ESG/SRI (environmental, social and governance/socially responsible investing) strategies gain traction across asset classes, more hedge fund investors are indicating a willingness or an ongoing effort to allocate to ESG/SRI strategies in their portfolios. This is especially prominent in larger allocators with over $5 billion in assets. While in previous periods, investors dedicated resources to ESG/SRI because clients requested it, an increasing number of investors believe this is an area of future structural growth.

Crowding, an ongoing issue among hedge funds, reached new highs in June. Nearly 40% of hedge funds' long exposure is to stocks in the top 50 hedge fund names—which outperformed the S&P 500 by almost 20%, but are increasingly concentrated in information technology and communication services.

What we expect

We believe that major industry trends—fee compression, hedge fund market concentration, and manager dispersion—will continue in the foreseeable future. We think that with strong due diligence, investing in the right hedge fund can provide a diversified return stream for investors, as well as downside mitigation as witnessed in March and April of this year. Despite a surging market, we expect a high level of uncertainty to remain in the coming months, providing potential for hedge funds to yet again prove whether they can protect capital during challenging market environments.

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Investment Positioning

Portfolio targets effective September 1, 2020, for institutional clients with Private Hedge Funds

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large-Cap	27.5%	**Underweight**
U.S. Small-Cap	5.5%	**Neutral**
International Developed	15.8%	**Neutral**
Emerging Markets	5.5%	**Underweight**
Fixed Income		
U.S. Investment Grade–Taxable	24.2%	**Overweight**
High-Yield–Taxable	3.0%	**Underweight**
Real Assets		
U.S. Inflation-Linked Bonds	1.0%	**Underweight**
Global REITs	1.5%	**Neutral**
Other	1.5%	**Overweight**
Private Hedge Funds	12.5%	**Overweight**
Cash & Equivalents	2.0%	**Neutral**
Total	100.0%	

Note: Totals may differ slightly from the allocation building blocks due to rounding.

TAA, or Tactical Asset Allocation, represents our *current recommendation* for each model strategy.

SAA, or Strategic Asset Allocation, represents our *current benchmark* allocation for each model strategy.

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For an overview of our asset allocation strategies, please see the disclosures.

Source: WTIA.

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Alternative assets, such as strategies that invest in hedge funds, can present greater risk and are not suitable for all investors.

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Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that will reduce returns.

An overview of our asset allocation strategies:
Wilmington Trust offers seven asset allocation models for taxable (high-net-worth) and tax-exempt (institutional) investors across five strategies reflecting a range of investment objectives and risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. The seven models are High-Net-Worth (HNW), HNW with Liquid Alternatives, HNW with Private Markets, HNW Tax Advantaged, Institutional, Institutional with Hedge LP, and Institutional with Private Markets. As the names imply, the strategies vary with the type and degree of exposure to hedge strategies and private market exposure, as well as with the focus on taxable or tax-exempt income.

Model Strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international stocks, emerging market stocks, U.S. and international real asset securities (including inflation-linked bonds and commodity-related and real estate-related securities), U.S. and international investment-grade bonds (corporate for Institutional or Tax Advantaged, municipal for other HNW), U.S. and international speculative grade (high-yield) corporate bonds and floating-rate notes, emerging markets debt, and cash equivalents. Model Strategies employing nontraditional hedge and private market investments will, naturally, carry those exposures as well. **Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.**

Allocations:
Each strategy is constructed with target weights for each asset class. Wilmington Trust periodically adjusts the target allocations and may shift away from the target allocations within certain ranges. Such tactical adjustments to allocations typically are considered on a monthly basis in response to market conditions. The asset classes and their current proxies are: large–cap U.S. stocks: Russell 1000® Index; small–cap U.S. stocks: Russell 2000® Index; developed international stocks: MSCI EAFE® (Net) Index; emerging market stocks: MSCI Emerging Markets Index; U.S. inflation-linked bonds: Bloomberg/Barclays US Government ILB Index; international inflation-linked bonds: Bloomberg/Barclays World exUS ILB (Hedged) Index; commodity-related securities: Bloomberg Commodity Index; U.S. REITs: S&P US REIT Index; international REITs: Dow Jones Global exUS Select RESI Index; private markets: S&P Listed Private Equity Index; hedge funds: HFRI Fund of Funds Composite Index; U.S. taxable, investment-grade bonds: Bloomberg/Barclays U.S. Aggregate Index; U.S. high-yield corporate bonds: Bloomberg/Barclays U.S. Corporate High Yield Index; U.S. municipal, investment-grade bonds: S&P Municipal Bond Index; U.S. municipal high-yield bonds: Bloomberg/Barclays 60% High Yield Municipal Bond Index / 40% Municipal Bond Index; international taxable, investment-grade bonds: Bloomberg/Barclays Global Aggregate exUS; emerging bond markets: Bloomberg/Barclays EM USD Aggregate; and cash equivalents: 30-day U.S. Treasury bill rate.

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Disclosures Continued

All investments carry some degree of risk. Return volatility, as measured by standard deviation, of asset classes is often used as a proxy for illustrating risk. Volatility serves as a collective, quantitative estimate of risks present to varying degrees in the respective asset classes (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. **Investors should develop a thorough understanding of the risks of any investment prior to committing funds.**

Quality ratings are used to evaluate the likelihood of default by a bond issuer. Independent rating agencies, such as Moody's Investors Service and Standard & Poors, analyze the financial strength of each bond's issuer. Ratings range from Aaa or AAA (highest quality) to C or D (lowest quality). Bonds rated Baa3 or BBB and better are considered **Investment Grade.** Bonds rated Ba1 or BB and below are **Speculative Grade** (also **High Yield**.)

Definitions:

Alpha is a measure of performance on a risk-adjusted basis. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

Equity risk premium is the extra return that's available to equity investors above the return they could get by investing in a riskless investment like T-Bills or T-Bonds or cash.

Event-driven hedge fund strategies attempt to take advantage of temporary stock mispricing before or after a corporate event takes place. An event-driven strategy exploits the tendency of a company's stock price to suffer during a period of change.

HFR® (HedgeFundResearch) Indices are the established global leader in the indexation, analysis and research of the hedge fund industry.

LIBOR is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another.

Macro hedge fund strategies generally focus on financial instruments that are broad in scope and move based on systemic or market risk (not security specific). In general, portfolio managers who trade within the context of macro strategies focus on currency strategies, interest rates strategies, and stock index strategies.

Relative value hedge fund strategies cover a variety of low-volatility trading strategies with the consistent theme of attempting to reduce market risk, i.e., the manager seeks to generate a profit regardless of which direction the markets are moving. All relative value strategies minimize market risk by taking offsetting long and short positions in related stocks, bonds, and other types of securities.

S&P 500 index measures the stock performance of 500 large companies listed on stock exchanges in the U.S. and is one of the most commonly followed equity indices.

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