Q2 2019
Economic Outlook

By the LNWM Investment Strategy & Research Group

SUMMARY

The incredibly strong first quarter of 2019, particularly for US stocks, can certainly tempt investors to increase exposure to the market. While we've benefitted from the market rebound in the 1st quarter, we remain cautious as we look forward. We are not convinced that the repricing of risky assets in the first quarter is justified by fundamental data. It seems the bond market agrees with us, as the Treasury bond yield curve flirts with inversion (short-term bonds yielding more than long-term) and bond yields in general stay stubbornly low.

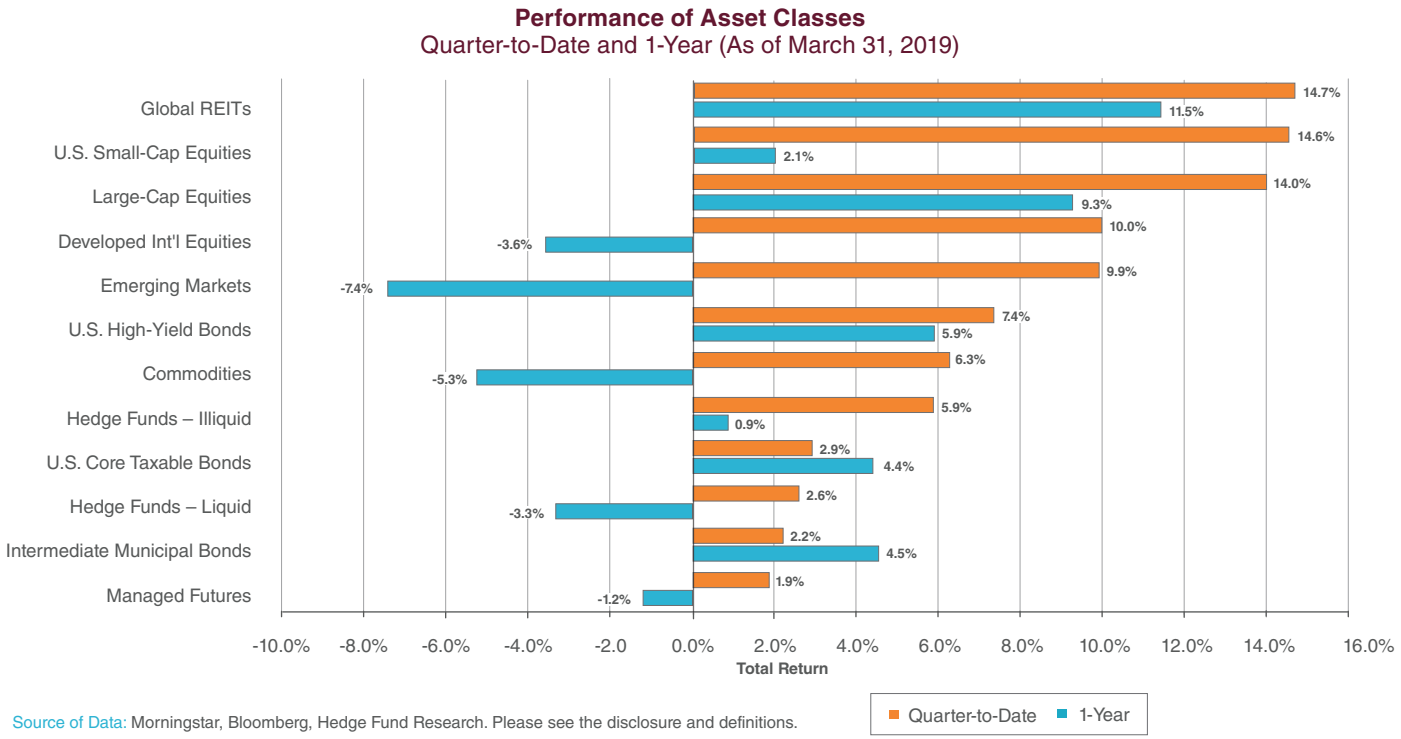
Very little has changed fundamentally, other than the Federal Reserve indicating a propensity to be patient about making further changes in the target interest rate, which provided the catalyst for the market turnaround. We remain mindful of the fact that the Federal Reserve changed its stance because they are concerned about global growth going forward. An inverted yield curve (to be clear, the curve is now relatively flat, not inverted) tells us that investors are willing to accept lower yields on longer-dated investments out of lack of belief in future economic growth and the rate of inflation.

With the stock market upbeat but bonds flashing caution, which signal is right? We would argue neither – stock pricing could well be too optimistic while bond yields reflect too much pessimism. However, we do think — given current data — that the potential downside is greater than the upside. Hence, we are generally more conservative in our portfolio allocations, comfortably waiting for an improved opportunity set.

> "The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails."
>
> **– William Arthur Ward**

Resisting FOMO

A quick Google search reveals the definition of FOMO as "state of mental or emotional strain caused by the Fear Of Missing Out." When markets drift higher, as they have been so far this year, investors can be tempted to keep buying risk assets (such as stocks and high-yield bonds) out of FOMO. My response can be summed up by a saying I heard early in my career while managing bond portfolios: "Yield hogs get slaughtered." In other words, stretching to achieve a desired outcome can often result in very poor outcomes. Here at LNWM, we are are continuing to take actions to make our portfolios more conservative and resisting FOMO.

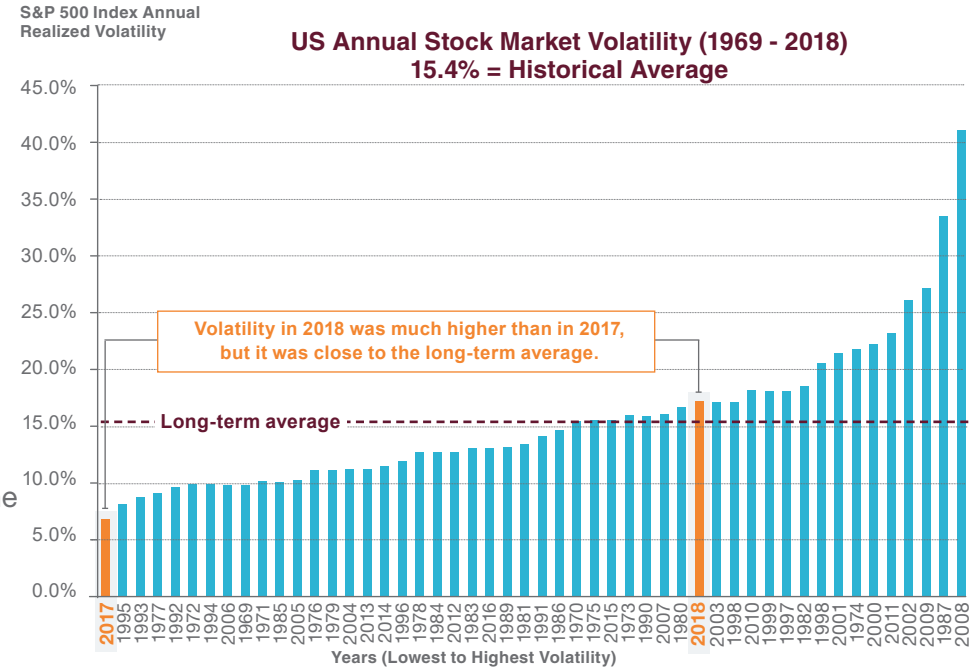


Source of Data: Morningstar, Bloomberg, Hedge Fund Research. Please see the disclosure and definitions.

This does not mean we have not been benefited from the Q1 rally. Across our portfolios, performance was very strong and into the double digits for the LNWM Moderate and Growth portfolios, while our Conservative portfolios achieved high single-digit returns. The key factor driving the rally: The Federal Reserve indicating it will hold off on interest rate increases. “We’re listening with sensitivity to the message that markets are sending,” said Fed Chair Jerome Powell, meaning that no further rate increases unless economic data improves. An accommodative Fed is more likely to engineer a soft landing for the US economy, a perception reflected in the relatively low levels of market volatility.

In fact, annualized volatility in the markets has been quite low, even if you include the year-end plunge in 2018. Take a look at the chart at right. Volatility in 2018, while significantly higher than 2017, was actually in line with historical averages. After the record-low volatility of 2017, the volatility spike in 2018 may have felt alarming, although in reality it was in line with what one would expect late in an economic cycle.

However, the US is not immune to slowing global



Source of Data: PIMCO, Bloomberg.

growth, and we think market volatility could bounce back despite the first quarter's performance. That is why we are maintaining well-diversified portfolios for now – and resisting FOMO.

Beginning in the 3rd quarter of last year and until now, we've reduced risk in our portfolios by gradually lowering equity exposure globally in favor of short-term fixed income. The December sell-off followed by the strongest quarter since Q3 of 2009 has led to client conversations around the questions of "Can this continue?" and "Should we increase risk so as not to miss out on the continued rally in risky assets?"

Can This Continue?

The short answer is yes, but the pillars of support are less strong. In our Q1 2019 outlook, we highlighted the Fed's change in policy (no more interest rate increases in the near term), which triggered the prompt turnaround in market sentiment and sent both stocks and bonds on a rising trajectory. The Fed's "dovish" stance on interest rates was matched by the European Central Bank (ECB), causing German government bond yields to once again turn negative and to fall markedly lower across the Eurozone during the 1st quarter.

While central bank policy has become more supportive, there has been little to no improvement in fundamental economic data and weakening can be seen in Europe and arguably parts of Asia. In fact, the pervasive theme from many strategists, economists and business leaders alike seems to be slower growth. No wonder that the markets were spooked by a near-inversion of the US Treasury yield curve in March, as the yield on 2-year Treasuries came close to topping the yield on 10-year Treasuries. An inversion is often viewed as a precursor to recession, although we think that argument is not as strong given an unprecedented decade of very loose monetary policy.

While we do not see a recession in the offing, we would agree that growth will continue to slow. Further, the strong first quarter run in equities has generally caused asset prices to return to fair value. As I am writing this, the valuations of US equities are about where they were at the outset of 2018, despite prices being up more than 13% so far in 2019.

Looking Out

Monetary policy in the US is set to remain on hold for the remainder of 2019, which should glide the US economy toward a soft landing if need be. Outside the US, growth remains more elusive and recession is an increasing risk for Europe. Last week, the IMF cut its expectations for 2019 world growth to the lowest level since 2009 – 3.2% — which is the 3rd such downgrade. US-China trade tensions remain unresolved and Brexit, whose deadline has been moved to October 2019, is as unclear as ever. The combination of these factors leaves us questioning the recent equity market rally. We acknowledge that as we head into earnings season equities could continue to rally if earnings come in better than expected or there's a meaningful trade agreement with China. However, we think anything other than perfection will be met with some selling.

In Sum: We think the asymmetry of return potential is now skewed to the downside — i.e. what we may miss on the upside is small relative to what we think the potential downside is, given current conditions.

What We Did/Are Doing

Early in 4th quarter 2018, we recognized the potential for a market downturn and prudently began reducing risk across LNWM portfolios. During our annual asset allocation review, we made a strategic allocation to short-term fixed income to benefit from higher short-term rates, a more accommodative Federal Reserve, and to maintain flexibility for future opportunities that arise. We funded this shift by trimming exposure to multistrategy fixed-income funds and hedge funds.

Throughout the first quarter of 2019, we took further steps to reduce risk by reducing our small-cap stock exposure in foreign developed markets, which we think face both geopolitical and economic headwinds given the relatively high allocation to Europe. We then increased our exposure to infrastructure (first added in early 2018) at the expense of international small-cap equities, which has proved beneficial for client portfolios. While infrastructure represents an equity investment, it has been shown to be less sensitive to general market volatility.

Finally, at quarter end, we made a change to our US small-cap manager lineup to include a growth manager that we believe offers a highly differentiated, well-defined approach to stock selection. Further, we maintained our emerging market exposure, given more favorable valuations and stronger expected GDP growth, particularly in Asia, and the prospect that emerging markets should benefit from a stabilizing US dollar and any progress toward a trade agreement between the US and China.

Q2 2019 Key Economic Drivers

Credit-Driven Concerns – Concerns about the creditworthiness of bond issuers have been somewhat allayed, as interest rates and bond yields have moved lower in 2019. Yields may be restrained; however, the absolute level of debt worldwide, particularly corporate and government, is garnering much deserved attention. Debt crises — sovereign, corporate or personal — have been the cause of economic chaos more than once in history. As debt levels have risen, demand for fixed-income securities has risen at a faster rate. Hence, for now, lower yields and market demand have been able to satisfy the continued issuance, particularly investment-grade. We've seen this reverse quickly in history and continue to believe that the best strategy for credit at this time is to focus on short duration, high-quality obligations.

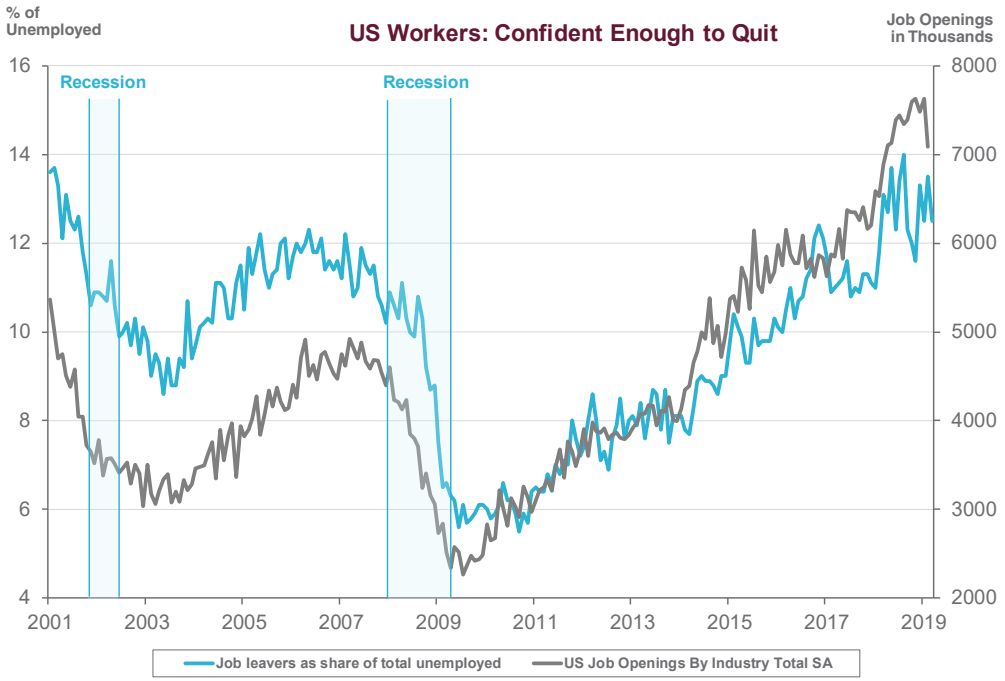
Asset Class Correlations – In the Q1 2019 Outlook, we wrote about the disconcertingly high correlation among asset classes; in other words, everything moved together in Q4 2018. We also felt confident that this trend would be a short-lived. While we've certainly seen price correlations diminish in the first quarter of 2019, and expect that trend to continue into the 2nd quarter, we are also aware that the divergence in pricing between the equity and bond markets is signaling different things. Stocks are telling us that all is OK as they continue to trend higher, indicative of investor optimism about economic growth. On the other hand, the Treasury bond yield curve, which has flattened in the past quarter, would portend a weakening economy. We would argue that stocks are a little ahead of themselves while the bond market is too pessimistic.

Q2 2019 Key Economic Drivers (continued)

US-China Trade – After signs of weakness, China for the first quarter of 2019 reported annualized GDP growth of about 6%, which many would call a "rebound." We have long held that it is in the interest of both China and the US to get a trade deal done. In addition, China has indicated willingness to provide some sort of stimulus to offset the effects of trade tensions. To us, all of this indicates that a trade deal is near; however, what is difficult to assess is how much of this has already been priced into stock prices.

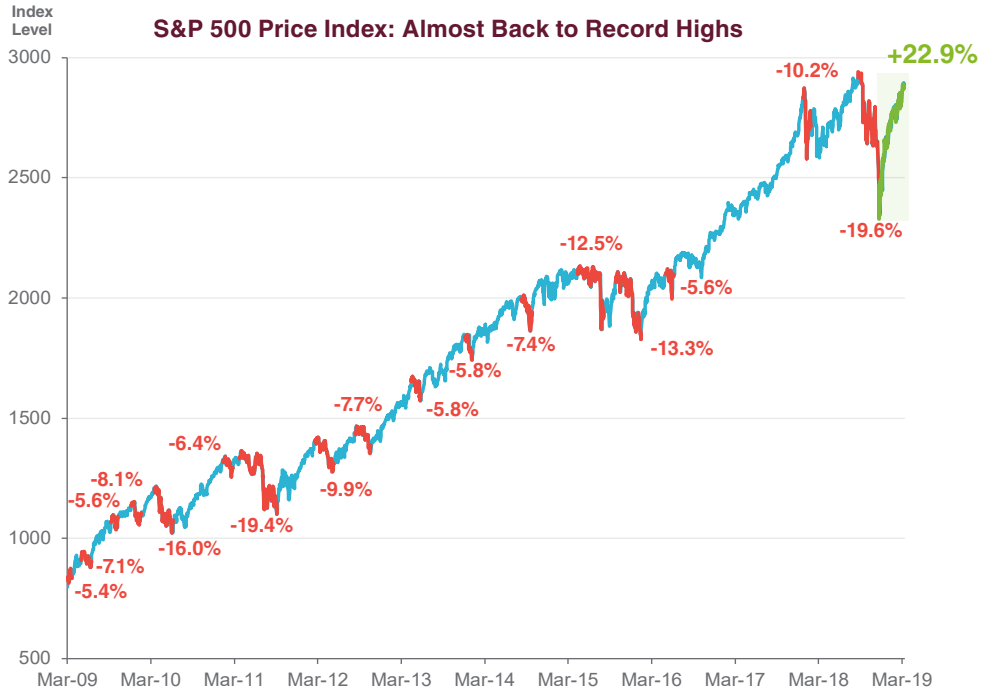
Central Bank Policy – We've already emphasized the "dovish" turn of global central banks, as they refrain from raising interest rates. In the US, limited wage and price pressures (i.e. inflation) seem to have the Federal Reserve comfortable taking a pause from any further changes in interest rate policy. According to Dallas Fed President Robert Kaplan, "An elevated level of corporate debt, along with the high level of US government debt, is likely to mean that the US economy is much more interest rate sensitive than it has been historically." Given this, the market's reaction to any Fed policy change stands to reason. We would agree, although we remain concerned about the potential for market influence on Fed policy. That said, we are confident that Chairman Powell and other current members of the Federal Reserve board will remain apolitical in their handling of further rate moves.

Europe – Brexit, France and Italy – Very little, if any, progress has been made toward a smooth Brexit and the economies of continental Europe are showing continued signs of slowing. Most recently, after expressing concerns regarding the impact of negative interest rates, Mario Draghi, European Central Bank President, also indicated willingness to implement further easing measures out of concern for growth in Europe. The significant fall in global trade volumes as a result of new tariffs and trade tensions will be particularly difficult for the Eurozone given that 20% of its GDP is derived from exports.



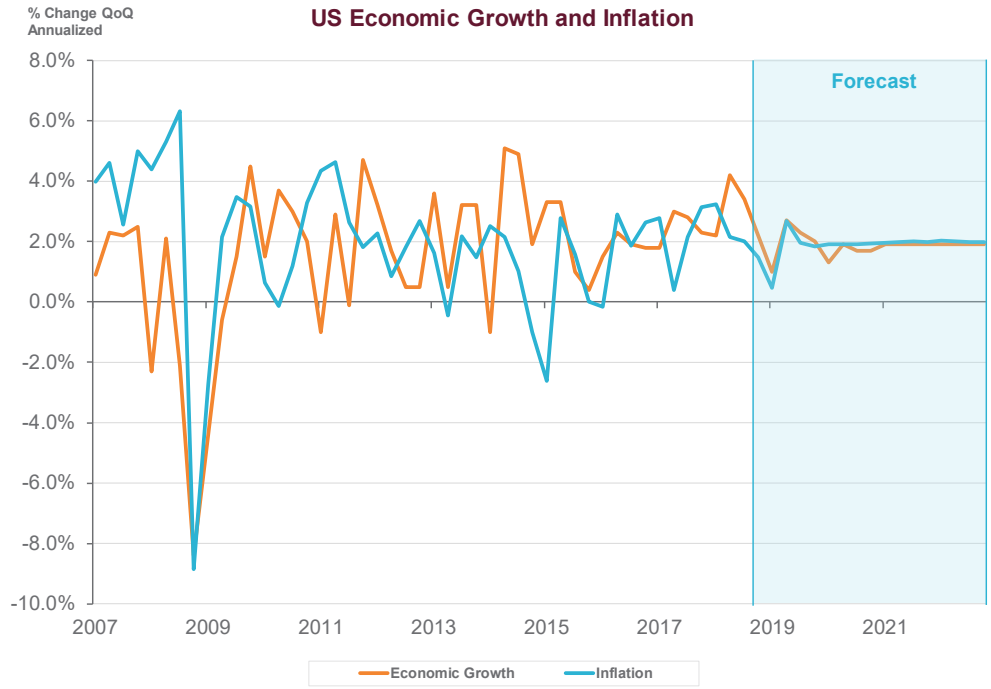
Source of Data: Bloomberg.

A sign of strength in the labor market is a jump in the number of people quitting their jobs and risking unemployment in the hope of finding a better position. People who have quit jobs are making up a greater percentage of the unemployed (blue line on chart), a trend that has been in place since 2011 but which accelerated recently. The quit rate typically declines before a recession as workers see clouds on the horizon. Currently, a record number of job openings mean there isn't a shortage of opportunities.



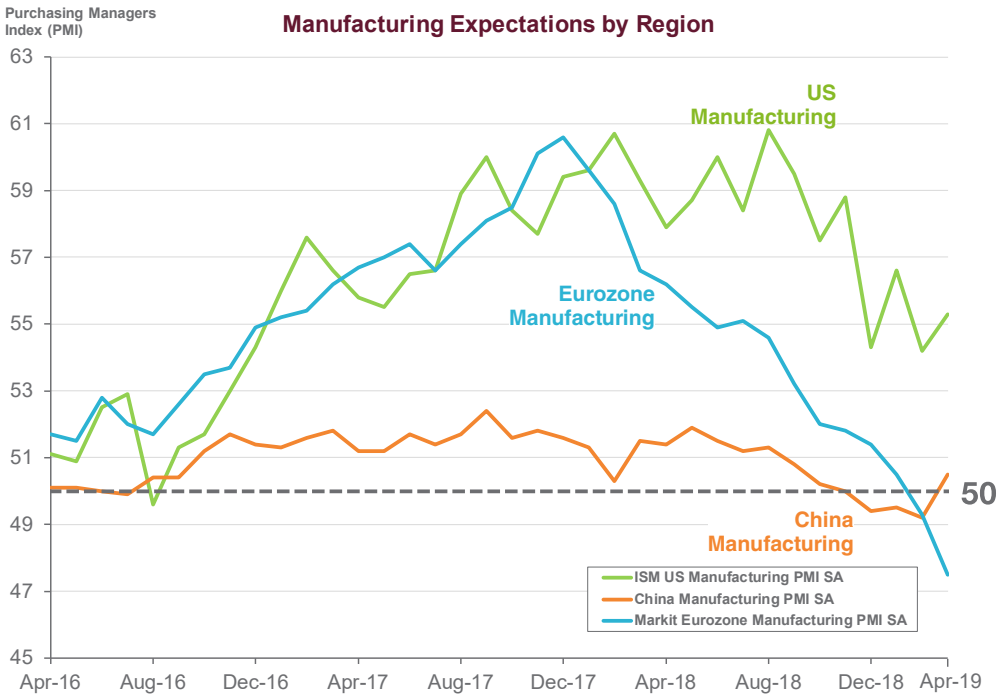
Source of Data: Wall Street Journal, Bloomberg.

The US stock market rally in the first quarter of 2019 mirrored the major sell-off in the fourth quarter of 2018. However, despite rallying more than 22% from its December 2018 bottom, the S&P 500 Index is still not back to the record high hit in October 2018.



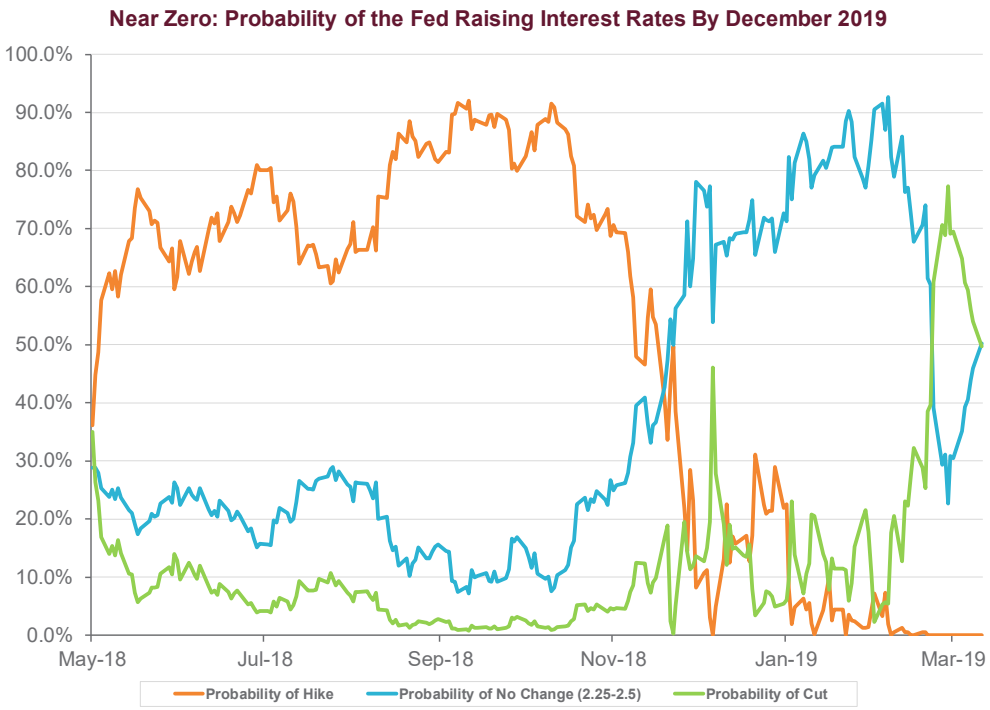
Source of Data: Bloomberg, Oxford Economics.

While core inflation (blue line on chart) has been trending gently upward over the last three years, neither US inflation nor GDP growth (orange line) have shown prolonged acceleration or deceleration. It is difficult to imagine the Federal Reserve seeing a need for more restrictive monetary policy given this rather tepid economic backdrop. However, the Fed has indicated willingness to be nimble with monetary policy should anything change.



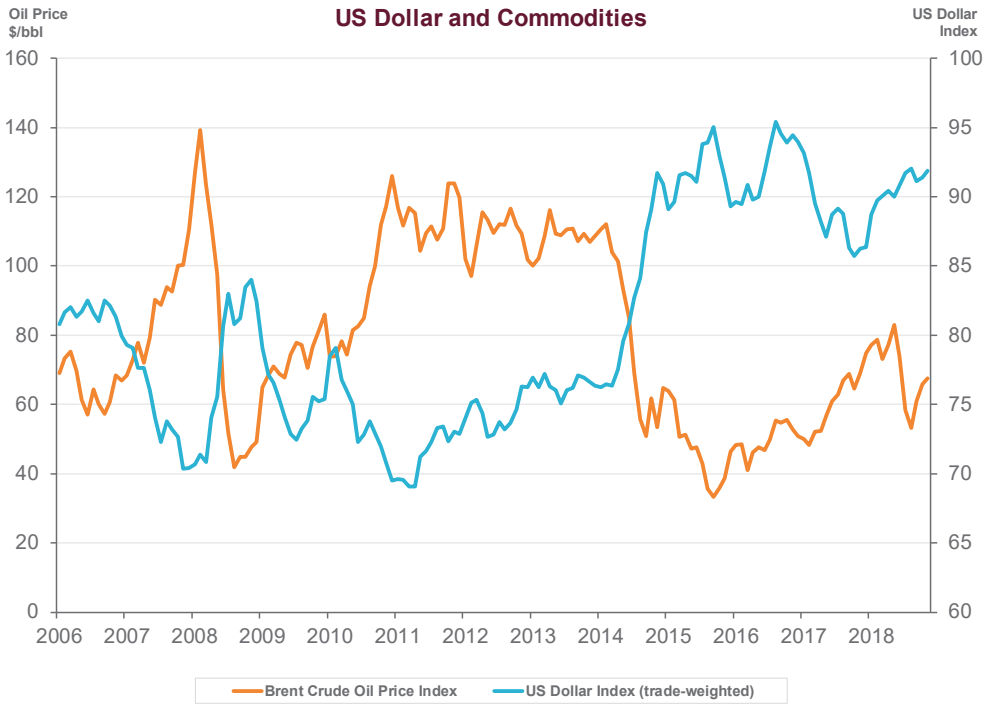
Source of Data: Bloomberg.

Manufacturing expectations (based on the Purchasing Managers Index or PMI) remain fairly high in the US (above 50 on the Index indicates expansion), whereas the manufacturing outlook has weakened substanially for our major trading partners. We continue to believe that the Eurozone faces geopolitical and economic obstacles, whereas Asia could be a top-performing region given support from valuations, relatively strong growth and a potential US-China trade deal.



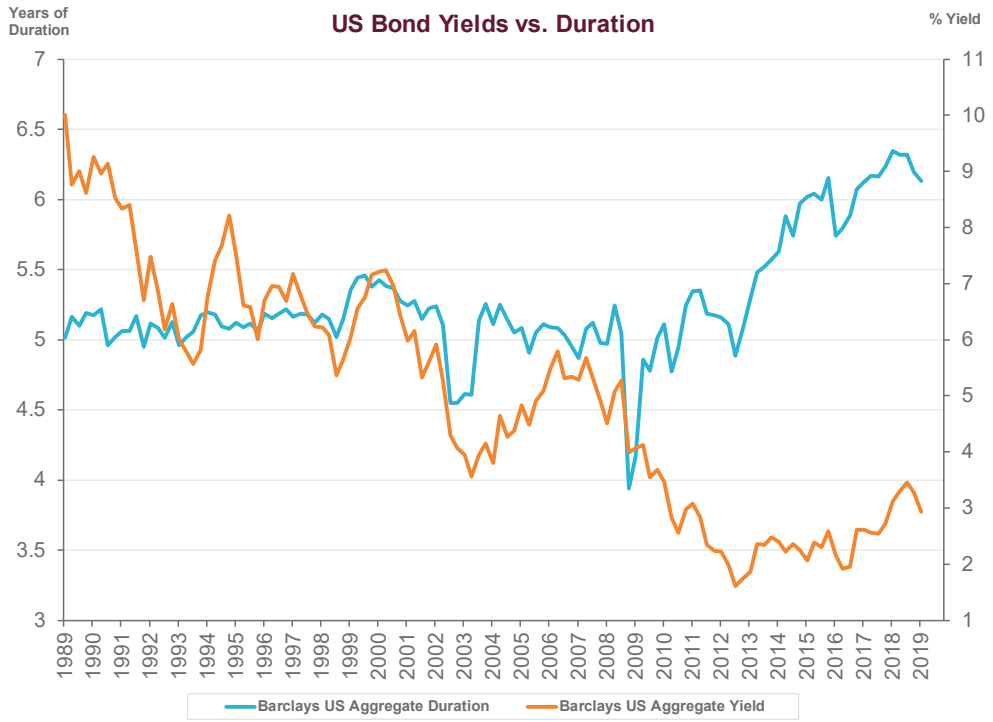
Source of Data: Bloomberg.

The consensus market outlook for interest rates has changed dramatically in a few short months. In the fall of 2018, investors were pricing in the near certainty of higher interest rates. In April 2019, expectations are that interest rates will remain steady or even decline. Should this prove the case, we think core fixed income will perform well.



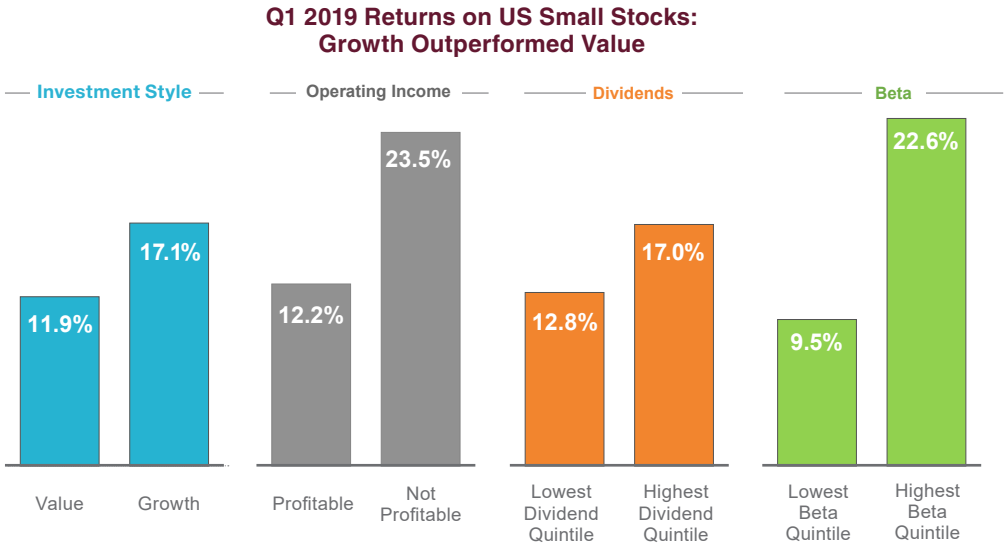
Source of Data: Bloomberg.

Many commodities are priced in US dollars, so when the dollar appreciates relative to other currencies, it is a headwind for commodities, making them more expensive and lowering demand. The chart shows the long-term relationship between the US dollar and Brent Crude oil prices. Year-to-date, the dollar has stabilized allowing for strong returns on commodities, with oil the greatest beneficiary.



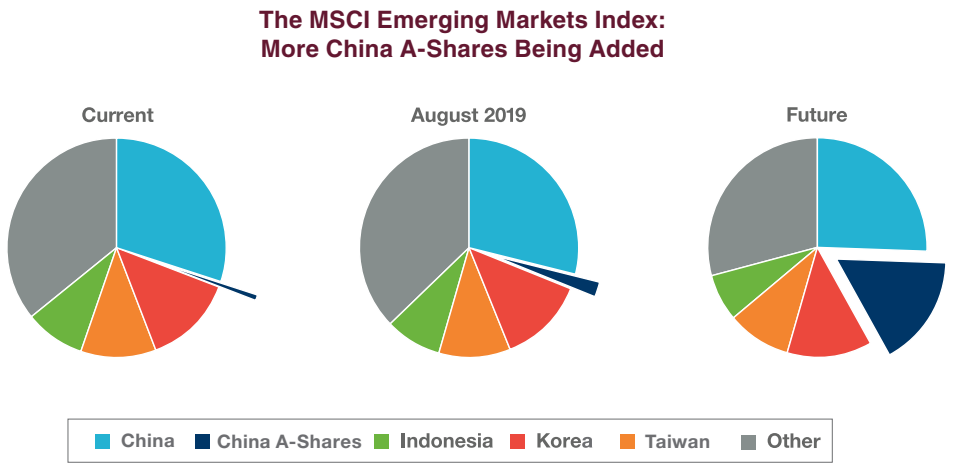
Source of Data: Bloomberg.

During the past decade, yields on intermediate-term bonds have been in persistent decline. Meanwhile, the average duration of bonds has increased, climbing to a multi-decade high. The greater a bond's duration, the higher its sensitivity to interest rates and the more it will drop in value should rates rise. While the probability of rapidly rising US interest rates seems low, we recommend reduced interest rate risk in a portfolio since there are now decent yields on shorter-term bonds.



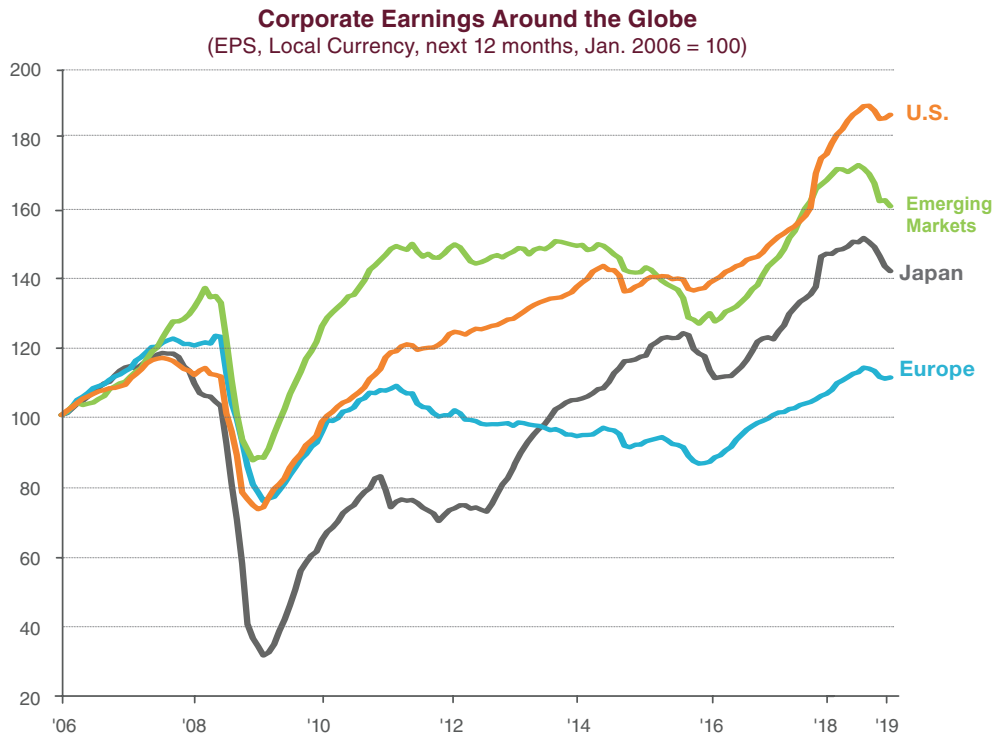
Source of Data: Royce & Associates.

US small cap stocks bounced back strongly in Q1 2019, after a very tough Q4 2018. However, the appreciation was most pronounced in high-growth companies, many of which are not yet profitable, and whose shares tend to move much more than the market, in both directions (they are in the “highest beta quintile”). The small cap front-runners were very different from our positioning, which was in high quality smaller companies with strong cash flow and less sensitivity to the overall market. We are optimistic that the current focus on high-octane growth will reverse, and our holdings will be rewarded given their stronger business models and better valuations.



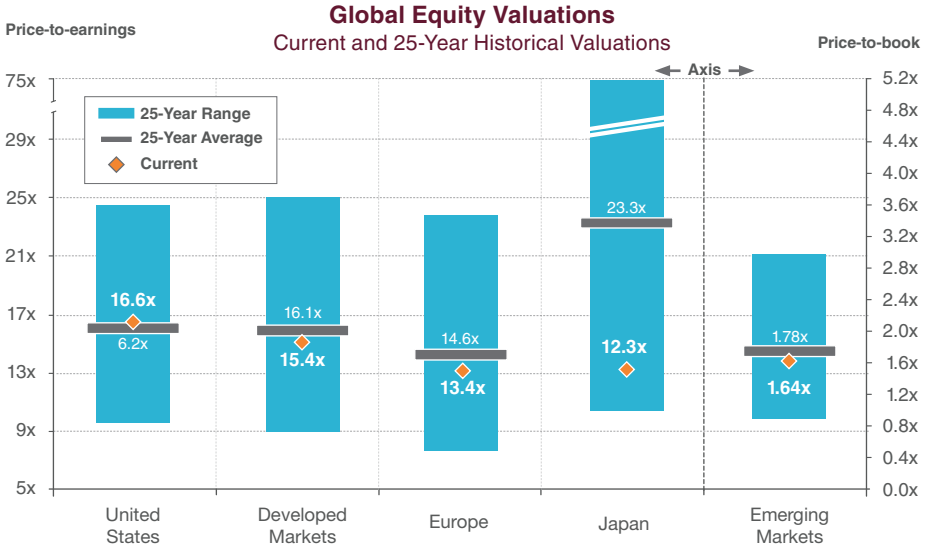
Source of Data: MSCI.

Stocks listed on exchanges in mainland China (so-called A-Shares) had not previously been available to investors outside China. Now that they are, the MSCI stock indexes have started to include a higher weighting to A-Shares. Eventually, the addition of A-Shares will result in China's allocation within the MSCI Emerging Markets Index rising to 40%. In light of this, we have been reviewing our allocation to China and other Asian emerging markets to determine if any changes are needed to improve our overall portfolio risk/return.



Source of Data: J.P. Morgan.

Corporate earnings are starting to decline around the globe (see chart). In the US, earnings for the S&P 500 for Q1 2019 are expected to be 2.3% lower vs. Q1 2018. While this level of decrease is widely anticipated, a larger than expected drop could cause additional volatility in the equity markets. As such, we have become more cautious and defensive in our equity allocations.



SOURCE OF DATA: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.

Globally, equity valuations have moved significantly higher since the end of 2018, with US valuations surpassing their 25-year average. Since valuation is a key component of our investment analysis, we are more optimistic about valuations outside the US and believe Asian emerging markets present the best value currently.

THE BENEFITS OF DIVERSIFICATION

Total return by asset category relative to a diversified* allocation.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 YTD	15-Year Annualized Return	15-Year Annualized Volatility#
Best Performance	Global REITs 37.96%	MSCI EM 34.00%	Global REITs 42.35%	MSCI EM 39.42%	10yr Treas 20.06%	MSCI EM 78.51%	US Small Cap 26.85%	10yr Treas 17.15%	Global REITs 28.65%	US Small Cap 38.82%	Global REITs 15.89%	Muni Bonds 2.45%	US Small Cap 21.31%	MSCI EM 37.28%	Muni Bonds 1.64%	Global REITs 14.86%	US Large Cap 8.74%	MSCI EM 21.43%
	MSCI EM 25.55%	COMM. 21.36%	MSCI EM 32.14%	COMM. 16.23%	US Bonds 5.24%	Global REITs 38.26%	Global REITs 20.40%	US Bonds 7.84%	MSCI EM 18.22%	US Large Cap 33.11%	US Large Cap 13.24%	US Large Cap 0.92%	US Large Cap 12.05%	MSCI EAFE 25.03%	US Bonds 0.01%	US Small Cap 14.58%	US Small Cap 8.04%	Global REITs 19.00%
	MSCI EAFE 20.25%	Global REITs 15.35%	MSCI EAFE 26.34%	MSCI EAFE 11.17%	Muni Bonds 4.23%	MSCI EAFE 31.78%	MSCI EM 18.88%	Muni Bonds 7.62%	MSCI EAFE 17.32%	MSCI EAFE 22.78%	10yr Treas 10.72%	10yr Treas 0.91%	COMM. 11.77%	US Large Cap 21.69%	10yr Treas -0.03%	US Large Cap 14.00%	MSCI EM 7.92%	US Small Cap 18.58%
	US Small Cap 18.33%	MSCI EAFE 13.54%	US Small Cap 18.37%	Diversified 10.91%	Illiquid HF -19.03%	US Large Cap 28.43%	COMM. 16.83%	US Large Cap 1.50%	US Large Cap 16.42%	Diversified 15.60%	US Bonds 5.97%	US Bonds 0.55%	MSCI EM 11.19%	Diversified 17.29%	Global REITs -4.74%	MSCI EAFE 9.98%	Global REITs 7.68%	MSCI EAFE 16.38%
	Diversified 13.73	Diversified 10.39%	Diversified 17.36%	Illiquid HF 9.95%	Liquid HF -23.25%	Diversified 27.48%	US Large Cap 16.10%	Diversified -3.56%	US Small Cap 16.35%	Illiquid HF 9.14%	US Small Cap 4.89%	Global REITs 0.05%	Diversified 7.11%	US Small Cap 14.65%	Illiquid HF -4.75%	MSCI EM 9.91%	Diversified 6.37%	COMM. 16.27%
	US Large Cap 11.40%	Illiquid HF 9.27%	US Large Cap 15.46%	10yr Treas 9.76%	Diversified -30.77%	US Small Cap 27.17%	Diversified 12.00%	US Small Cap -4.18%	Diversified 12.54%	Liquid HF 6.73%	Muni Bonds 4.66%	MSCI EAFE -0.81%	Illiquid HF 5.46%	Global REITs 11.42%	US Large Cap -4.78%	Diversified 9.25%	MSCI EAFE 5.11%	US Large Cap 13.86%
	COMM. 9.15%	US Large Cap 6.27%	Illiquid HF 12.89%	US Bonds 6.97%	US Small Cap -33.79%	Illiquid HF 20.01%	Illiquid HF 10.24%	Illiquid HF -5.25%	Illiquid HF 6.37%	Global REITs 4.39%	Diversified 3.79%	Illiquid HF -1.11%	Global REITs 4.99%	Illiquid HF 8.58%	Liquid HF -6.74%	COMM. 6.32%	Illiquid HF 4.65%	Diversified 10.78%
	Illiquid HF 9.05%	US Small Cap 4.55%	Liquid HF 9.25%	US Large Cap 5.77%	COMM. -35.65%	COMM. 18.91%	10yr Treas 7.90%	Global REITs -5.82%	US Bonds 4.21%	Muni Bonds -0.32%	Illiquid HF 2.98%	Diversified -2.23%	US Bonds 2.65%	Liquid HF 5.98%	Diversified -7.07%	Illiquid HF 5.88%	US Bonds 3.89%	10yr Treas 6.95%
	10yr Treas 4.83%	Liquid HF 2.72%	US Bonds 4.33%	Muni Bonds 4.79%	US Large Cap -37.60%	Liquid HF 13.40%	MSCI EAFE 7.75%	Liquid HF -8.88%	10yr Treas 4.18%	US Bonds -2.02%	Liquid HF -0.57%	Liquid HF -3.64%	Liquid HF 2.51%	US Bonds 3.54%	US Small Cap -11.01%	10yr Treas 3.10%	10yr Treas 3.82%	Illiquid HF 5.77%
	US Bonds 4.34%	US Bonds 2.43%	Muni Bonds 3.74%	Liquid HF 4.24%	MSCI EAFE -43.38%	Muni Bonds 7.18%	US Bonds 6.54%	MSCI EAFE -12.14%	Muni Bonds 3.56%	MSCI EM -2.60%	MSCI EM -2.19%	US Small Cap -4.41%	MSCI EAFE 1.00%	Muni Bonds 3.49%	COMM. -11.25%	US Bonds 2.94%	Muni Bonds 3.42%	Liquid HF 5.40%
	Muni Bonds 2.92%	10yr Treas 1.99%	COMM. 2.07%	US Small Cap -1.57%	Global REITs -47.72%	US Bonds 5.93%	Liquid HF 5.19%	COMM. -13.32%	Liquid HF 3.51%	10yr Treas -7.83%	MSCI EAFE -4.90%	MSCI EM -14.92%	Muni Bonds -0.10%	10yr Treas 2.07%	MSCI EAFE -13.79%	Liquid HF 2.60%	Liquid HF 0.53%	US Bonds 3.22%
Worst Performance	Liquid HF 2.68%	Muni Bonds 1.67%	10yr Treas 1.36%	Global REITs -6.96%	MSCI EM -53.33%	10yr Treas -9.71%	Muni Bonds 3.13%	MSCI EM -18.42%	COMM. -1.06%	COMM. -9.52%	COMM. -17.01%	COMM. -24.66%	10yr Treas -0.16%	COMM. 1.70%	MSCI EM -14.57%	Muni Bonds 2.21%	COMM. -2.79%	Muni Bonds 2.79%

***Diversified asset allocation:** 20% U.S. Large Cap Equities; 20% U.S. Municipal Bonds; 20% Hedge Funds (10% Absolute Return, 10% Market Directional); 15% Int'l Developed Equities; 5% U.S. Small Cap Equities; 5% Emerging Markets Equities; 5% Global REITs; 5%, Commodities; 5% Managed Futures.

#Annualized Volatility as measured by standard deviation (the dispersion of outcomes around "the mean," or average result). When the standard deviation is lower, realized results tend to be closer to expected results (and vice versa). Standard deviation is not intended to reflect the entire range of gains or losses possible from an investment.

Past performance is no guarantee of future results. Data as of 3/31/2019. Returns are for period and index indicated (see Disclosures page for index definitions). "Diversified Allocation" returns assume quarterly rebalancing.

Source of Data: Morningstar.

The chart above shows annual returns on a diversified portfolio (consisting of the asset classes noted in the footnote) for each year from 2004 to 2019 (as of March 31, 2019), relative to returns on all other major classes. The last two columns show 15-year annualized returns and price volatility for the diversified portfolio (relative to other asset classes). Non-US equities were detractors in 2018 (both developed and emerging markets) but they have added value so far in 2019. Generally, when performance is evaluated over the long term (15 years in this case), global diversification has added value in terms of risk reduction and return enhancement.

ABOUT THE AUTHOR

Gino Perrina, Ph.D., CFA is the Chief Investment Officer at Laird Norton Wealth Management and has more than 15 years of experience in investment analysis, strategy and risk management. Prior to joining LNWM in November 2015, Gino was a Managing Director at BlackRock Inc. in New York City, responsible for managing risk in the firm's alternative asset portfolios (+$100 billion in total investment). He was also Managing Director of Research and Risk Management at BlackRock Alternative Advisors (2006 to 2010), Head of Fixed Income Research at Russell Investments (2010 to 2012) and a fixed income analyst and portfolio manager at Microsoft and IAC/InterActive Corp.

ABOUT LAIRD NORTON WEALTH MANAGEMENT

With nearly $5 billion in assets under advisement, Laird Norton Wealth Management is the Northwest's premier wealth management company. Founded in 1967 to serve the financial management needs of the Laird and Norton families, the firm now provides integrated wealth management solutions to more than 600 individuals, families, business leaders, private foundations and nonprofit organizations.

LNWM ASSET CLASS RETURNS CHART INDEX DEFINITIONS

Intermediate Municipal Bonds: Barclays Municipal Bond 1-10 Year Blend Index that measures the performance of municipal bonds with maturities between one and 10 years.

U.S. High-Yield Bonds: ICE BofAML US High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.

U.S. Core Taxable Bonds: The Barclays Capital U.S. Aggregate Bond 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, ABS, and CMBS sectors.

U.S. Large-Cap Equities: The Russell 1000 Index is an index of approximately 1,000 of the largest companies in the U.S. equity market.

U.S. Small-Cap Equities: Russell 2000 Index, a measure of the performance of the 2,000 smallest companies in the Russell 3000 Index, representative of the U.S. small capitalization securities market.

Developed International Equities: MSCI EAFE Index, a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada. As of June 2014, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

Emerging Markets: MSCI Emerging Markets Index, a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of June 2014, MSCI Emerging Markets Index consisted of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

Commodities: The Bloomberg Commodity Index is made up of 22 exchange-traded futures on physical commodities. The commodities are weighted to account for economic significance and market liquidity and weighting restrictions on individual commodities and commodity groups promote diversification.

Global REITs: FTSE EPRA/NAREIT Global Equity REIT Index, a measure that tracks the performance of listed real estate companies and REITs worldwide.

Managed Futures: The SG CTA Index provides the market with a reliable daily performance benchmark of major commodity trading advisors (CTAs). The SG CTA Index calculates the daily rate of return for a pool of CTAs selected from the larger managers that are open to new investment.

Hedge Funds – Liquid: HFRX Global Hedge Fund Index – A daily-valued index designed to be representative of the overall liquid hedge fund universe. It is comprised of all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted based on the distribution of assets in the hedge fund industry.

Hedge Funds – Illiquid: HFRI Fund Weighted Composite Index – A global, monthly-valued, equal-weighted index of over 2,000 single-manager funds that is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies. Constituent funds report monthly net of all fees performance in U.S. dollar and have a minimum of $50 Million under management or a twelve (12) month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

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