Quarterly Review and Strategy Update

December 31, 2019

The Best and Worst Perfoming Industry Sectors in 2019

Source: Visual Capitalist

- **Strong job growth and consumer spending continue to drive U.S. economic growth. The Federal Reserve cut interest rates for a third time and injected liquidity into the banking system**
- **Announcement of trade deal with China propelled financial markets upward, with both the Dow Jones and S&P 500 indices reaching new highs**
- **Investors need to rebalance portfolios and reduce risk**

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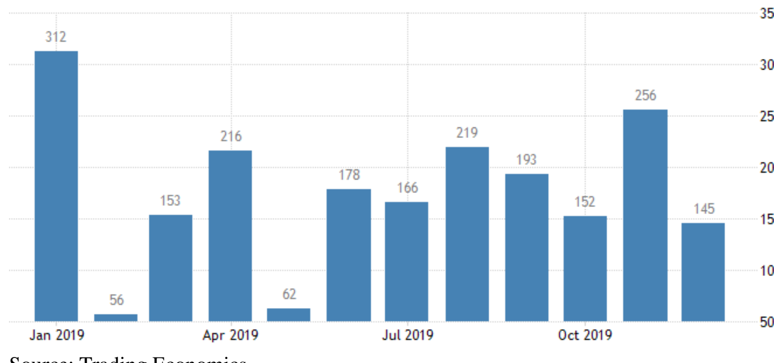
THE ECONOMIC ENVIRONMENT

Non-Farm Payrolls



Source: Trading Economics

- **U.S. economy grew at 3.1% in the final quarter, better than forecast**
- **Federal Reserve cut interest rates for the third time this year - further action on hold**
- **Europe may have reached limits of negative interest rate policy**

"Don't fight the Fed" might be conventional wisdom on Wall Street, but its power was clear this year as almost all financial assets surged following the three interest rate cuts implemented by the central bank, the last at the end of October. The S&P 500 index returned 31% in 2019, the highest annual gain since 2013. Bond markets also generated strong returns, with both investment grade corporate and high-yield bonds generating 14% total returns. The Federal Reserve's policy turnaround, which reversed nearly all the rate hikes in 2018, convinced the financial markets that it would manage monetary policy to counter the negative impact of trade wars, high valuations, impeachment and a stagnant global economy. The bar to any change in an accommodative monetary policy, either up or down, will now be very high. "The appropriate path of policy is to stay where we are," Dallas Fed President Robert Kaplan said, adding he had "penciled in" no changes in 2020. Boston Fed President Eric Rosengren added the Fed is unlikely to need to cut rates in the near term, barring a "material change" in the outlook for the economy. He opined there was little chance of an economic downturn next year.

The third quarter did produce some worrying economic news – slowing GDP, manufacturing weakness and deteriorating business confidence. However, other data pointed to unexpected resilience in the U.S. economy. Third quarter GDP growth was confirmed at 2.1%, with the full year expected to come in at over 2%. The Institute for Supply Management's October and November reports showed that manufacturing activity, while continuing to contract, had at least stabilized. The biggest positive surprise came in employment, where non-farm payrolls increased by 266,000 in November, together with an upward revision of 156,000 in October, representing the largest advance in payrolls since January, and reducing the employment rate to 3.5%. The rate matched the September level, which was the lowest since 1969. Holiday retail sales increased by 3.4% over last year, according to Mastercard's post-Christmas spending report. Higher household savings rates (currently at 8% compared to 3% in 2007) and moderate indebtedness (consumer debt-to-GDP stands at 65%, the lowest level since the Global Financial Crisis, when it hit 85%) are providing the American consumer with more confidence to continue spending.

The financial markets were also buoyed by signs of easing trade tensions. On December 13th the White House announced that the U.S. and China had tentatively reached a "Phase One" trade deal. While the exact details of the agreement are still murky, it is reputed to contain a commitment from China to buy over $30 billion of U.S. agriculture products, in exchange for the U.S. halving its 15% tariff on $120 billion of Chinese imports and postponing the next round of scheduled tariffs. Not surprisingly, there were vague platitudes regarding the more contentious issues of forced technology transfer, intellectual property protection and currency manipulation. Moreover, 25% tariffs are expected to remain in over $250 billion in Chinese goods. Also, in December, House Democrats and the Trump Administration agreed to adjustments to the US-Mexico-Canada Agreement, which tightens Mexico's environmental and labor commitments and increases the North American content of vehicles sold in the U.S.. While these are certainly positive developments, they simply mitigate the supply chain disruption and damage created by the imposition of tariffs in the first place. Moreover, many trade disputes remain. In October the U.S. imposed $7.5 billion tariffs on European goods, including cheese, wine and olives over a row on European subsidies to Airbus, and has complained about digital taxes imposed by France and Italy that it believes are unfairly targeting American technology companies. These disagreements will no doubt emerge over the coming year to jolt the markets.

As the prospects of a recession recede and the longer the business and market cycles march on, excesses will continue to build. The cumulative federal budget deficit reached $984 billion at the end of September, the end of the 2019 fiscal year, and is projected to exceed $1 trillion by the end of 2020. Although Congressional support is highly unlikely, President Trump has expressed a desire to see additional tax cuts this year, and if a Democrat wins the White House, spending on healthcare and social programs will add to the budget deficit. The Federal Reserve is already struggling with the flood of Treasury issuance needed to keep the government in business. Its balance sheet has exploded from $3.8 trillion to $4.2 trillion in just the final quarter of the year as it adds liquidity to the banking sector to finance new Treasury issuance. "The federal budget is on an unsustainable path, with high and rising debt," Fed chair Powell told the Congressional Joint Economic Committee. "Over time, this outlook could restrain fiscal policymakers' willingness or ability to support economic activity during a downturn."

Internationally too, there is growing pressure on governments to spend more to stimulate growth. Fresh from a landslide election victory, Boris Johnson has pledged to boost spending on Britain's National Health Service and reward the industrial heartlands that had switched their historic support from the Labor Party to the Conservatives. He has promised to implement "colossal new investments in infrastructure and science, using our technological advantages to make this country the cleanest, greenest on earth, with the most far-reaching environmental programme." In Japan, the Abe government has launched a larger-than-expected $121 billion stimulus package to be spent over the next 15 months, and trade union and business leaders in Germany have demanded a €450 billion "public investment offensive". "Borrow and spend" might indeed appear to be the smart policy when interest rates are low or negative, and inflation seems to have gone into hibernation. History has however shown that such complacency will inevitably be punished.

CARLOTA PEREZ AND THE 5TH TECHNOLOGICAL REVOLUION

Technological Revolution	Innovation initiating the revolution	New industries and infrastructure	Business practices, structures and social developments
The Industrial Revolution	**Arkwright's water-powered cotton mill in Derbyshire, 1771**	• Mechanized cotton looms • Wrought iron • Canals and turnpike roads	• Factory production • Mechanization • Time management
The Age of Steam, Coal, Iron and Railways	**The Liverpool Manchester steam railroad, 1829**	• Steam engines • Iron and coal mining • Railways • Universal Postal Service Telegraph	• Urbanization • Standardizing of parts • Energy on demand
The Age of Steel, Electricity and Heavy Engineering	**The Carnegie Bessemer steel plant in Pittsburgh, 1875**	• Cheap steel • Heavy chemical and civil engineering • Global shipping lines • Telephone • Electrical grid	• Vertical integration • Distributed power • Science as productive force • Mass production
The Age of Oil, the Automobile and Mass Production	**Ford Model-T, 1908**	• Mass-produced cars • Internal combustion engine • Home electrical appliances • Universal analog telecommunications	• Hierarchical management • Functional business specialization • Growth of suburbs • Global standards and coordination • Synthetic materials
The Age of Information and Telecommunications Source: Adapted from Carlota Perez, "*Technological Revolutions and Financial Capital*", 2002	**The Intel microprocessor, 1971**	• Cheap electronics • Computers software • Global digital telecommunications • The Internet • Biotechnology	• Knowledge as capital • Instant contact and communications • Decentralized business structures • Network business models • Hyper segmentation of markets • Global branding

Wall Street's obsession with quarterly corporate performance is often blamed for the paucity of visionary strategic thinking amongst corporate executives, and even investment professionals allocating to a longer horizon can often see only a few years ahead into the future. So, it is inspiring to encounter an economist whose analysis of technological, economic and social developments spans decades and centuries. Carlota Perez is not a household name, but the 80-year old Venezuelan economic historian has a growing cadre of fans among an unlikely coalition of environmentalists, technology geeks and macro hedge fund managers, and her ideas are worth contemplation.

Perez is a historian of technological paradigm shifts and their impact on economic growth. In her 2002 book "*Technological Revolutions and Financial Capital*", she describes the five major technological revolutions that have emerged since the 18th century. Perez points out that technological change is constant but does not occur in a smooth, continuous manner; rather major innovations in technology erupt in successive waves of disruption, adoption and decline. Each major technological revolution has led to rapid economic growth driven by the development of new industries and a facilitating infrastructure necessary for the transportation of physical goods and information. The development of technology and associated infrastructure is symbiotic – the growth and application of steam power to many industries in mid-19th century Britain could not have occurred without the contemporaneous development of the railroad network and the ability of steam-powered trains to transport coal and iron ore from mining regions to the manufacturing centers of the Midlands. In a similar way, network-based business models like Uber, Airbnb and eBay are inconceivable without universal and instant internet connectivity.

Perez argues that technological change also leads to innovations in business practices and social organization. In order to fully exploit the combination of water power, cutting-edge textile machinery and the new raw material of cotton, Richard Arkwright imported labor into the town of Cromford, where he set up his first mill, and built "corporate housing" for his employees, introduced systematic training and instituted a shift system of work hours - effectively inventing the modern industrial factory system. Indeed, what differentiates Perez from other analysts of technological change is her assessment that technological innovation leads to broader social, political and institutional disruption. She believes that what we are experiencing today - stagnant growth, income inequality, "casino venture finance", workers angry at their skill obsolescence, xenophobia, messianic populist leaders, mass economic migration – are direct consequences of the computer and technology information revolution. Such phenomena were all prevalent during a similar turning point of the last technological revolution in the 1930s.

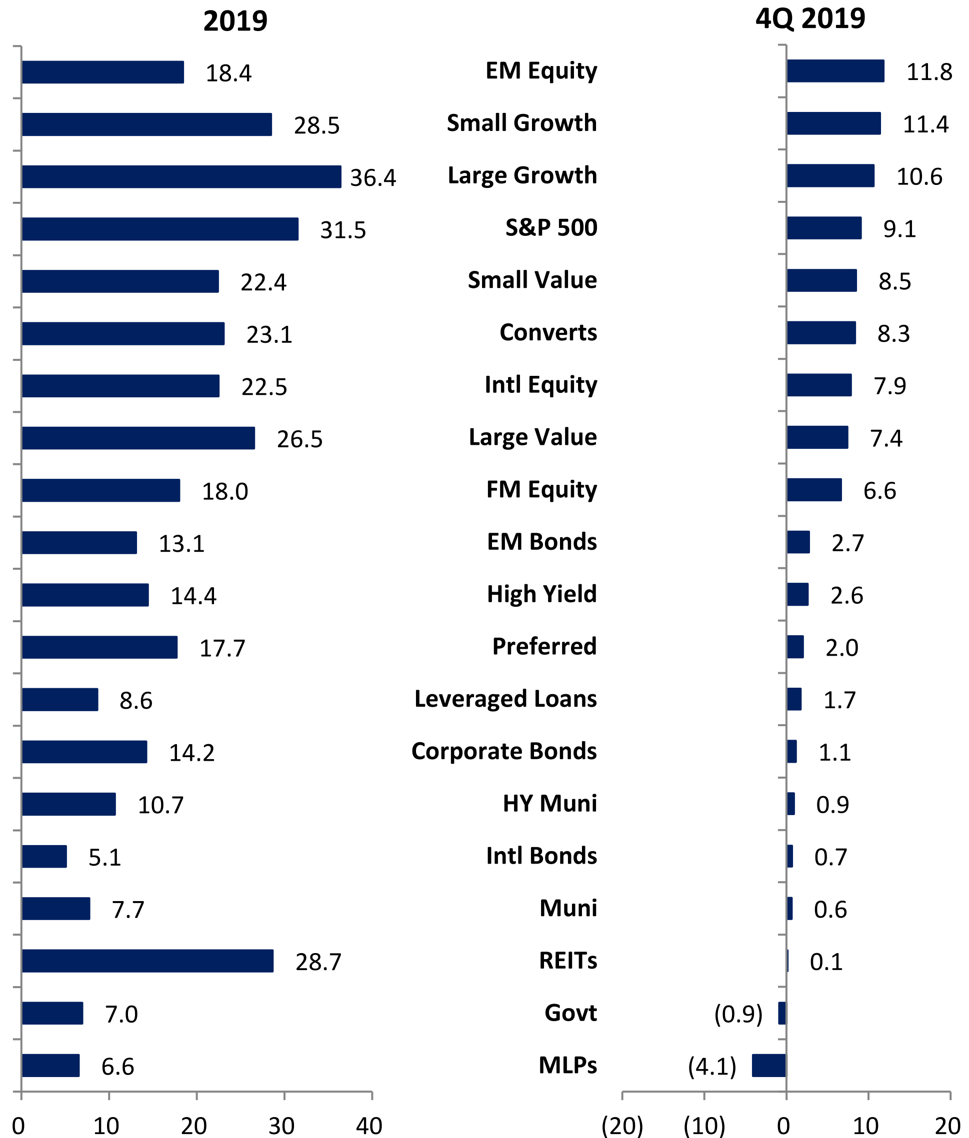
While these parallels are disturbing, Perez' analysis is ultimately optimistic. She argues that once society has absorbed the implications of each revolution, and overcome the resulting disruption, it enters a "golden age", where the benefits of the technology and associated new infrastructure can result in a period of significant growth and prosperity. Indeed, she believes that even the challenge of climate change can be converted into economic opportunity. She suggests that business leaders who claim that environmental regulations present an obstacle to growth, and environmentalists who argue that economic development is incompatible with environmental sustainability, are both wrong. She believes that emerging technologies can attack climate change and environmental degradation while giving birth to new, profitable businesses. For example, renewable energy is expected to produce a quarter of U.S. power needs by 2050, not because of government subsidies, but because of competitive costs due to advances in solar panel and storage technology. Seaweed is being used to create packaging as a substitute

for plastic. Impossible Foods and Beyond Meat cannot keep up with demand for their meatless hamburgers.

Perez warns that the golden age of innovation-led growth can only flourish with changes in regulation and social organization that tackle the disruptions it creates. Some of the ideas she advocates include a globally coordinated tax regime, laws governing the ownership of personal data, lifelong education and skill training and a new Marshal Plan for lagging economies. If such changes can be combined with the innovations of the 5th technological revolution - 5G communications, quantum computing, big data processing, nanotechnology and genome sequencing - farsighted investors can potentially reap the benefits of the coming golden age.

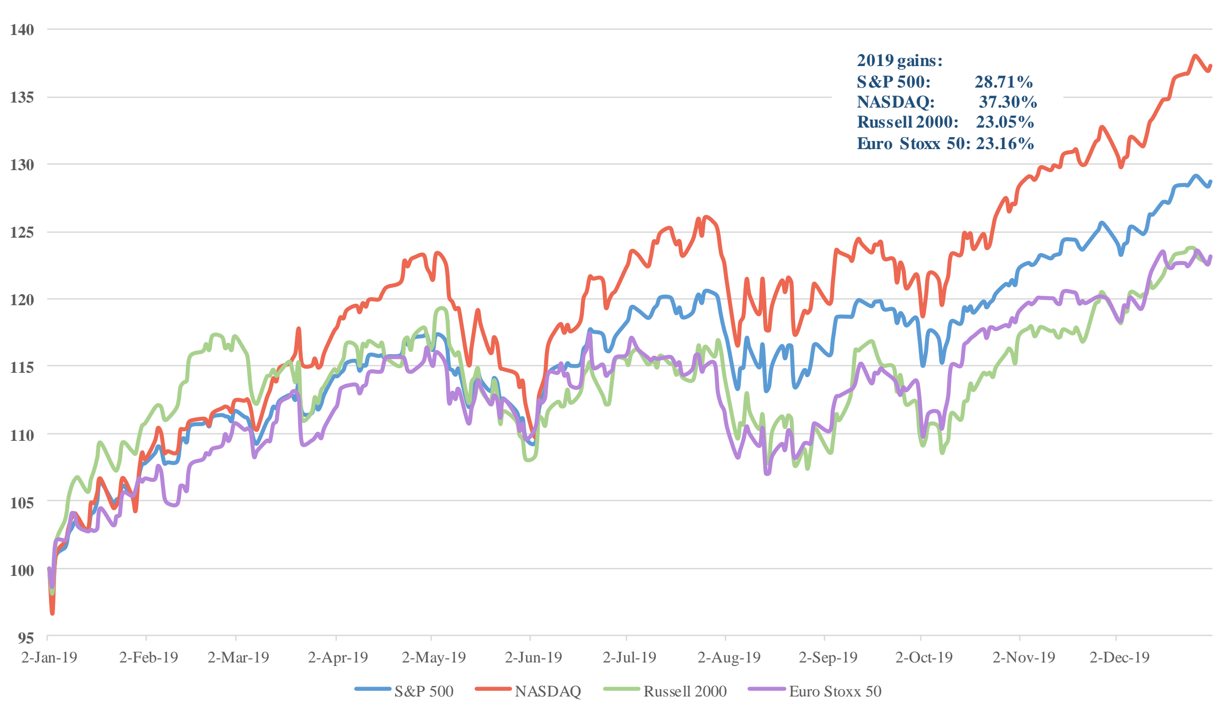
4th QUARTER 2019 PERFORMANCE OF MAJOR ASSET CLASSES

Numbers represent percentage change



EQUITIES

4th Quarter Equity Market Performance

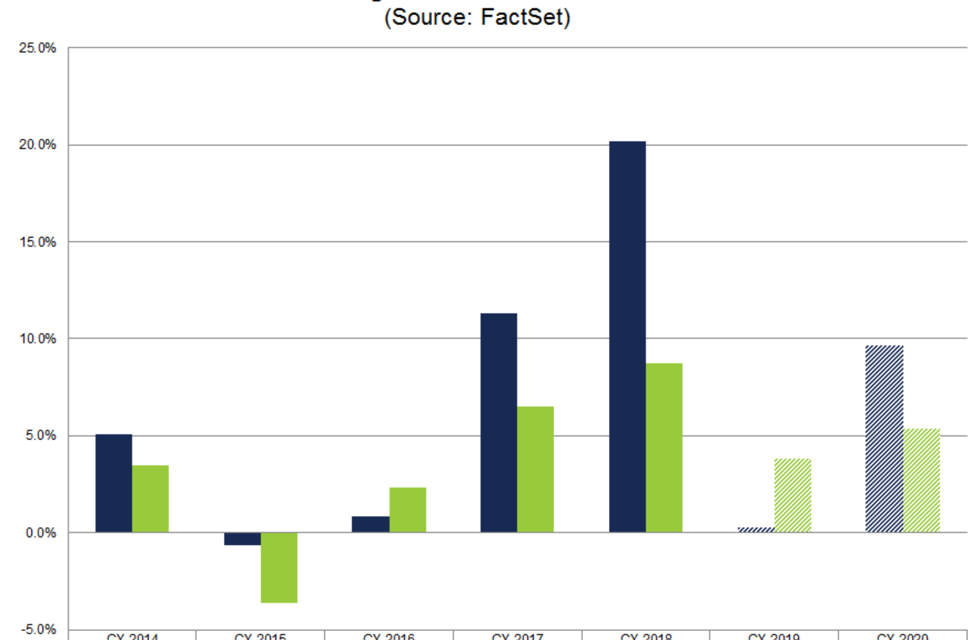


Source: Bloomberg

U.S. Equities

The U.S. equity market climbed steadily during the fourth quarter, fed by the Federal Reserve's rate cut, positive economic data and progress on the trade war with China. The S&P 500 index returned 9% for the quarter, the NASDAQ was up 12% and the Russell 2000 up 9.5%. The S&P 500 index's 31% gain for the full year represented the best performance of the index since 2013.

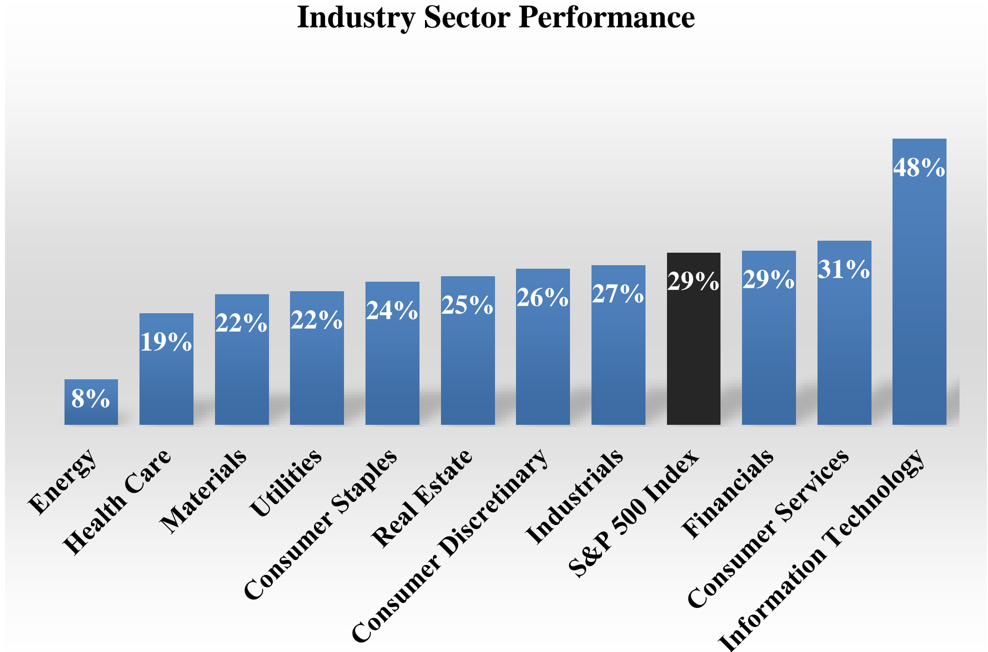
The appreciation of the stock market this year has been due entirely to multiple expansion. While revenues for companies in the S&P 500 Index rose 3.8% last year, earnings were up only 1%, with declines in every quarter except for the first. This reflected margin compression due to higher wage costs and in some instances higher import prices because of tariffs. Companies are retaining about a third of their net profits to reinvest in their businesses, as return on equity has been measly.



Source: FactSet

Consequently, many companies have only succeeded in keeping their earnings per share flat or rising by reducing their share count. Share repurchases this year were only slightly lower than the tax-incentive inspired record of $806 billion spent in 2018. Apple alone bought back over $70 billion of its own shares. According to Yardeni Research, the S&P 500 companies are now spending the equivalent of 63% of their operating earnings on buybacks. Issuers have also borrowed heavily to buy back stock. One must wonder if corporate managements would be more prudent to pay down the record levels of debt than buy shares at today's inflated valuations.

All industry sectors generated positive performance, with healthcare and energy being the only two sectors that rose less than 20%. Healthcare was impacted by the opioid crisis, executive action on drug prices and policies espoused by the Democratic presidential candidates. In August, Johnson & Johnson was ordered to pay $572 million in a landmark opioid case in Oklahoma. Although the amount fell far short of the $17 billion judgment that the state had sought to recover to pay for addiction treatment, the judgement cast a dark shadow over the industry. In December President Trump proposed rules allowing the importation of certain prescription drugs from Canada as part of a policy aimed at reducing drug prices.

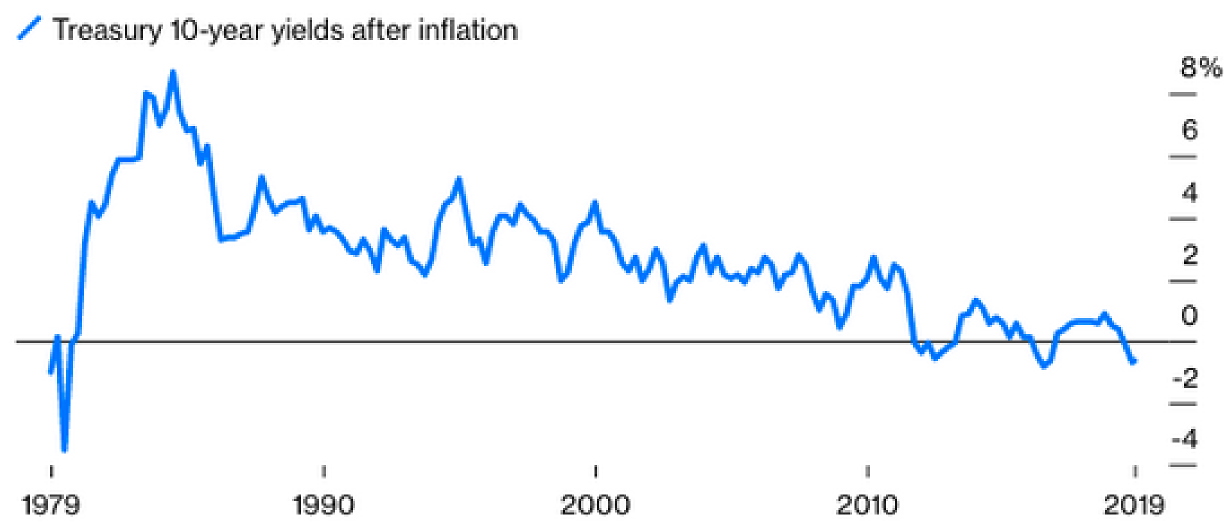


Source: Fidelity

The energy sector reported the largest year-over-year earnings decline of all industry sectors at -28%, driven by lower oil prices that averaged $57 a barrel, 12% lower than the average price in 2018. At the start of 1980, energy was the largest sector in the S&P 500, representing 25% of the index; today it has fallen to just over 5%. Investors have fled the sector following the 2014-2015 collapse in oil prices, a glut of crude supply and the threat of climate-based regulation. The industry has however responded by becoming much more disciplined in its capital spending, and with expectations so depressed, even a slight upside surprise in crude prices could spur a rally in the sector.

The overall earnings picture for 2020 looks promising, with revenues expected to be up 5.4% and earnings up 9.6%. As a result most market strategists expect modest, single-digit returns for the year, with greater market dispersion and volatility. Some developments that emerged in the latter half of 2019 – such as small-caps outpacing large-caps, cyclicals outperforming defensives, small-cap value beating small-cap growth – often occur when the economy is growing, and may continue into 2020.

U.S. Treasury Yield Curve

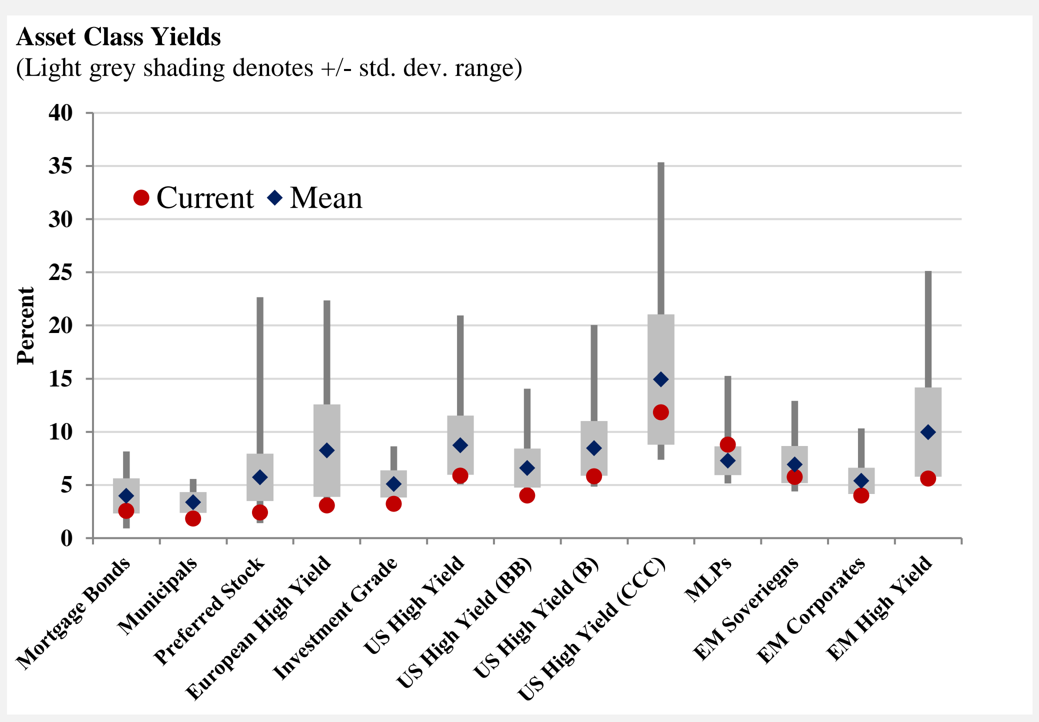


Source: Bloomberg

Treasury Bonds	At the end of October, the Federal Reserve cut its benchmark interest rates for the third time in the year, lowering its target range to 1.75% to 1.5%. While the overall yield curve continues to drop lower, the shape of the curve has steepened, with the yield on the 2-year Treasury note falling from 1.62% at the end of the 3rd quarter to 1.58% at the end of the year, while that of the 10-year Treasury bond has risen from 1.67% at the end of the 3rd quarter to 1.92%. Consequently, the spread between the 10-year and 2-year yields expanded to the widest level in more than a year. The rise in longer term rates reflects growing belief that an economic downturn has been postponed. Far more important than the short-term moves in interest rates has been the continuing trend of lower real yields over the past 40 years. Real, as opposed to nominal yields, represent the return on capital after adjusting for the impact of inflation. While inflation has been subdued at under 2% since the Global Financial Crisis, interest rates have collapsed, so we now have the highest negative real yields since 1975 when inflation stood at 10%. Investors allocating to Treasury bonds are essentially sacrificing purchasing power for their "safe haven" properties, in the hope that they will provide capital preservation in the event of a market drawdown, As real yields on bonds have collapsed it is not surprising that investors who have positive after-inflation return objectives such as endowments, or liabilities linked to inflation such as pension funds, have been forced to take on much greater risk to achieve their objectives. The 7% or even 8% actuarial return targets that some pension funds use are clearly unrealistic.

Investors in Europe and Japan have suffered negative nominal as well as real interest rates for some time. Those conditions reflect persistent weaknesses in their underlying economies and their unwillingness or inability to address fundamental structural and political problems. The U.S. economy, in contrast, is growing at a much faster rate, and has historically shown much faster adaptability. The irony is that the longer negative rates persist abroad, the greater the amount of capital that will flow into the U.S. bond markets, compressing yields further. When weakness does ultimately appear in the U.S. economy, interest rates may already have been pulled closer to the zero, less by Federal Reserve action than by the tsunami of foreign money desperately seeking positive returns.

Corporate Credit

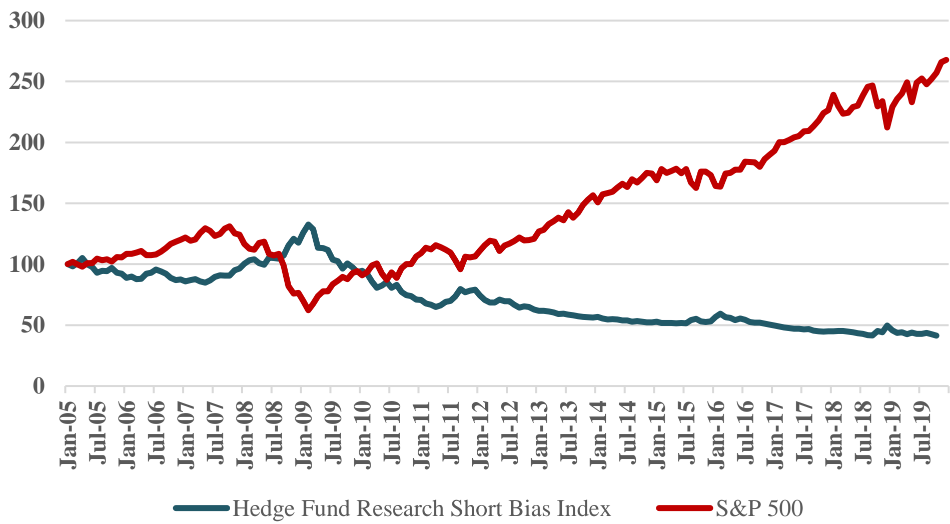


For the corporate bond markets, 2019 mirrored the strong performance of the equity markets. "It would be hard to imagine we could do better than we did in 2019. It was kind of perfect from a total return standpoint. It was a combination of yield levels moving lower and credit spreads narrowing," noted Jon Duensing, director of investment grade corporates at Amundi Pioneer. 2019 was a record year for corporate bond issuance, with over $1.2 trillion of new issues beating the previous record set in 2017 by a sizable margin. American companies have borrowed over $1 trillion in each year of the decade since 2010, resulting in total debt outstanding exceeding $10 trillion, compared to about $6 trillion at the start of the decade.

The year ended with corporate spreads at their tightest levels since last year, with BBB investment-grade corporate spreads at just 1.3% over Treasuries and B high yield spreads at 5.3% over. When the market is bullish the spreads of even the highest risk bonds normally tighten as investors become comfortable with risk. However the yields of CCC-rated bonds – those that, according to the rating agencies, "in the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitments on the obligation" - have stayed high, and have risen from their spring lows. Pater Tenenbrarum, a market analyst, believes that this bifurcation in credit rating spreads is a subtle indication that the credit cycle may finally be coming to its end. He argues that it is "subtle" in the sense that defaults are not perceived as being imminent, but that bond buyers have become slightly more selective and cautious.

SHOULD SHORT SELLING BE BANNED?

Hedge Fund Research Short Bias Hedge Fund Index vs. S&P 500 Index



Source: HFR, Bloomberg

In November Tesla Chief Executive Officer Elon Musk strutted on to the stage in Hawthorne, California to unveil Tesla's futuristic, stainless-steel, electrical pickup "Cybertruck". He handed a sledgehammer to Franz von Holzhausen, Tesla's chief designer, and invited him to smash the truck's steel exterior with it, to show that it would not dent. The hammer made no dent, so after the admiring gasps from the audience, von Holzhausen threw a metallic ball at the windows. Instead of bouncing off the alleged "Tesla armor glass" without a scratch, as was the plan, the ball shattered the glass, prompting Musk to blurt out "Oh my f---ing god" in shock. Tesla shares fell 6% the following day, its sharpest decline in almost two months.

Although Tesla claimed to have received over 250,000 orders for the truck, expected to be available in 2021 for $39,900 and $49,900, the embarrassing launch was yet another proof for the critics of the company who are convinced that Tesla's aggressive public relations hype conceals a pile of operational and financial woes. Almost since its IPO in 2010 Tesla's stock has been a target of short sellers. David Einhorn of Greenlight Capital, perhaps the most prominent of them, has accused Musk of "erratic and desperate" behavior, implying that the company's electric cars are unreliable and even dangerous, its accounting possibly fraudulent, and that investors will never see profits given "over $6 billion of accumulated losses, despite billions of dollars of taxpayer subsidies".

Time will tell whether Musk or Einhorn will emerge victorious; so far both have been bloodied. Last year Musk was sanctioned by the SEC after settling fraud charges relating to a botched attempt to take the company private and forced to step aside as the company's chairman. Einhorn has reputedly lost a bundle on his Tesla short position as the stock has surged almost 26-fold since its IPO, from $19.20 to $492 as of this newsletters' publication. Greenlight Capital was down 34% in 2018, the largest loss since Einhorn founded his firm in 1996.

The decade-long bull market has not been kind to short sellers. The exploits of hedge fund managers like Einhorn, John Paulson, Steve Eisman and Michael Burry (the latter of "The Big Short" fame) who made fortunes by shorting Lehman Brothers, mortgages and Collateralized Debt Obligations during the Global Financial Crisis have faded from memory. A generation of traders have abandoned short selling, or have never been inspired to learn the craft. Long/short equity hedge funds, whose raison d'etre resides in their supposed ability to make money by identifying both winners and losers, have returned just 5% annualized over the past decade, and have collectively demonstrated a failure to generate meaningful alpha from shorting.

Yet short sellers persist. Indeed Fahmi Quadir, who runs Safkhet Capital, a dedicated-short hedge fund, argues that the confluence of a bull market, cheap debt and pervasive accounting manipulation have created a glut of opportunities. She has categorized companies exhibiting bad behavior into several "fraudulent archetypes":

FINANCIAL

Accounting, tax inversions, earnings manipulation, financial engineering, roll-ups, excessive leverage, JOBS Act, IPO, reverse

GOVERNANCE

Questionable management, nepotism, related-party transactions, friendly board, aggressive compensation

OBSOLESCENCE

Outdated business models, waning fads, competitive entry, commodification, asset deterioration, stagnant technology, patent loss

STOCK PROMOTION

Pump-and-dump, news leaks, reverse mergers, pyramids, headquarters in cities like Las Vegas, unscientific product claims

PREDATORY LENDING

Subprime lending, payday loans, retail credit, mortgage origination, for-profit education, student loans, excessive lending fees

GOVERNMENT FRAUD

False claims, qui tam, tax evasion, procurement fraud, anti-competitive, contractor fraud, misrepresentation, RICO offenses

ELDER FRAUD

Medicare fraud, assisted living, anti-aging products, telemarketing schemes, Ponzi schemes, suspect real estate

HEALTHCARE FRAUD

Medicaid abuse, insurance fraud, corruption, over-prescription, data falsification, faulty science, price gouging

While she has identified plenty of candidates engaged in unethical behavior – such as Wirecard for accounting fraud, Health Insurance Innovations for selling predatory health insurance plans and Valeant for jacking up prices of acquired drugs to astronomical levels – there are many others whose stock market valuations may be vulnerable because of obsolete business models (retailers who are victims of Amazon's online market dominance), cyclical companies over-earning at the peak of a cycle or fads coming to an end (e.g., Crocs).

Short sellers like Quadir are courageous, not only in sticking with an inherently challenging investment model, but because they have to be willing to stand up to the abuse and harassment dispensed by their target managements. In November the Justice Department indicted Parker Petit and William Taylor, two former senior executives of MiMedx Group, a maker of tissue grafts, for accounting fraud. The Securities and Exchange Commission separately filed a civil suit against MiMedx and its executives, for conducting a "pervasive" accounting fraud. Executives involved in corporate fraud are often serial offenders, so it is not surprising that Parker Petit had previously started two healthcare companies, Healthdyne and Matria, both of whom had been charged by the SEC for accounting irregularities and Medicare fraud. MiMedix had been investigated by the Wall Street Journal who had exposed the relationship between Petit and Tom

Price, the former health and human services secretary, and Georgia Senator Johnny Isakson. Both politicians were recipients of significant donations from Petit and had intervened with the FDA and the Department of Veteran Affairs on behalf of the company. It appears that Isakson even directed the FBI to harass Marc Cohodes, a prominent short seller, to demand that he desist in making further revelations about MiMedx. In May, however, the company acknowledged that its injectable wound-care products hadn't met regulatory standards, including for purity and sterility, more than two years after it had assured the Food and Drug Administration that it had complied with such requirements. MiMedx stock fell as low as $1.15 in December last year, a 93% decline from its high of $17.21.

Short sellers need to be defended, and indeed encouraged. Short selling is vital to the integrity of the capital markets. It promotes more efficient price discovery, bursts price bubbles, increases market liquidity and facilitates hedging and risk management. Short sellers have often been the "canary in the coalmine", being the first to broadcast potential problems at companies. Jonathan M. Karpoff and Xiaoxia Lou, two finance professors, published a study in 2008 that concluded that short sellers anticipated the eventual discovery and severity of financial misconduct, and benefited investors by revealing facts obscured by false corporate announcements and inaccurate financial statements.

Given the importance of short sellers in identifying corporate misbehavior it is disturbing when regulators and investors place obstacles in their way. In an extraordinary and unprecedented move, BaFin, the German Federal Financial Supervisory Authority, imposed a ban in February this year on short selling shares of Wirecard, a payment processor and a subject of Quadir's investigations that is suspected of fraud, corruption and money laundering. Rather than investigate the company, BaFin bizarrely filed a criminal complaint against two Financial Times journalists for disseminating reports about the company's accounting fraud with the intent of "manipulating the market". Short selling bans, which were imposed in many markets during the Global financial Crisis, are ineffective. "Like many such prohibitions", argues Liam Ward-Proud, a Reuters columnist, "the ban treats the symptoms rather than the cause of the payment group's misery. It needs to address its fundamental problem…how its opaque Asian business is performing". Wirecard's offices in Singapore were recently raided by the local police, and the company has now admitted that criminal activity may indeed have taken place. The German regulator appeared to be more concerned about protecting the reputation of a constituent of the DAX Stock Market Index than protecting the rights of investors.

Since institutional investors are becoming more active in promoting their agendas, for example in the area of environmental, social and governance polices, it is also distressing to see some investors hinder the work of short sellers. In December, Japan's Government Pension Investment Fund, the world's largest pension fund, announced that it had suspended stock lending for short selling, calling the practice inconsistent with its responsibilities as a long-term investor. Elon Musk immediately tweeted, "Bravo, right thing to do! Short selling should be illegal". A fiduciary for Japanese pensioners, who are still paying for the consequences of the 1980s real estate and stock market bubbles, should on the contrary be supporting the efforts of short sellers to root out corporate incompetence, mendacity and fraud. Regardless of whether companies like Tesla are ultimately successful as a business, those who question their strategies, valuations and management behavior have a legitimate an important place in the market.

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Glossary and Index Definition

•Alerian MLP Index (MLP) - The Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships calculated by Standard & Poor's using a float-adjusted market capitalization methodology. The index is disseminated by the New York Stock Exchange real-time on a price return basis (NYSE: AMZ). The corresponding total return index is calculated and disseminated daily through ticker AMZX.

•Barclays Capital U.S. Municipal Index – The U.S. Municipal Index covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligations, revenue bonds, insured bonds, and prerefunded bonds. Many of the subindices of the Municipal Index have historical data to January 1980. In addition, several subindices based on maturity and revenue source have been created, some with inception dates after January 1980 but no later than July 1, 1993. In January 1996, Barclays Capital also began publishing a non-investment grade municipal bond index and "enhanced" state specific indices for Arizona, Connecticut, Maryland, Massachusetts, Minnesota, and Ohio. These indices are published separately from the Barclays Capital Municipal Bond Index.

•BofA Merrill Lynch Convertible Bond Index (Convertibles) - The BofA Merrill Lynch Convertible Bond Index tracks the performance of US dollar denominated convertible bonds issued in the US domestic market. In addition, qualifying securities must have at least one-year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of $100 million.

•BofA Merrill Lynch Perpetual Preferred Securities Index (Preferred) - The BofA Merrill Lynch Fixed Rate Preferred Securities Index tracks the performance of US dollar denominated preferred securities issued in the US domestic market. Qualifying securities must be rated investment grade (based on an average of Moody's, S&P and Fitch) and must have an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

•BofA Merrill Lynch US High Yield Master II Index – This index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

•BofA Merrill Lynch EM External Debt Sovereign Index – This index tracks the performance of US dollar-denominated debt issued by sovereign issuers in countries belonging to emerging markets.

•BofA Merrill Lynch Mortgage Master Index – This index tracks the performance of US dollar-denominated mortgage securities.

•BofA Merrill Lynch Municipal Bond Index – This index tracks the performance of US dollar-denominated investment grade tax-exempt bonds.

•Credit Suisse Leveraged Loan Index – This index tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

•JP Morgan Emerging Market Bond Index (EMBI+) - The Emerging Markets Bond Index Plus tracks total returns for traded external debt instruments in the emerging markets. The instruments include external-currency-denominated Brady bonds, loans and Eurobonds, as well as U.S. dollar local markets instruments. The EMBI+ is concentrated in instruments from the three major Latin American countries (Argentina, Brazil, and Mexico), reflecting the size and liquidity of these external debt markets. The non-Latin countries are represented in the index by Bulgaria, Morocco, Nigeria, the Philippines, Poland, Russia, and South Africa.

•MSCI Emerging Market Index (Emerging Market Equities) - The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of March 2015, the 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.

•MSCI Frontier Market Index – The MSCI Frontier Market Index is a free float-adjusted market capitalization index designed to measure equity market performance of the frontier markets. As of March 2015, the MSCI Frontier Markets Index consists of the following 24 frontier market country indices: Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kenya, Kuwait, Lebanon, Lithuania, Kazakhstan, Mauritius, Morocco, Nigeria, Oman, Pakistan, Romania, Serbia, Slovenia, Sri Lanka, Tunisia, Ukraine, and Vietnam.

•Russell 2000 Index (TR) - The best-known of a series of market-value weighted indices published by the Frank Russell Company. The index measures the performance of the smallest 2,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization.

•Russell 1000 Index (TR) –A market-value weighted indices published by the Frank Russell Company. The index measures the performance of the largest 1,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization.

•S&P 500 Index (TR) -Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes 500 leading companies in leading industries of the U.S. economy. S&P 500 is a core component of the U.S. indices that could be used as building blocks for portfolio construction. It is also the U.S. component of S&P Global 1200. Total return (TR) provides investors with a price-plus-gross cash dividend return. Gross cash dividends are applied on the ex-date of the dividend.

•FTSE NAREIT US Real Estate Index Series – The FTSE NAREIT US Real Estate Index Series is designed to present investors with a comprehensive family of REIT performance indexes that span the commercial real estate space across the US economy, offering exposure to all investment and property sectors. In addition, the more narrowly focused property sector and sub-sector indexes provide the facility to concentrate commercial real estate exposure in more selected markets.

Data Sources: Bloomberg, L.P., JPMorgan, BofA Merrill Lynch, Standard and Poors, Barclays Capital, Alerian, Morningstar Direct, MSCI, HFR, Goldman Sachs, Trading Economics, HIS Markit, Eurostat, Eaton Vance.