Quarterly Review and Strategy Update

December 31, 2022

Source: NY Times, Al Drago, Bloomberg, Getty

- **Financial markets continue to be volatile as the Federal Reserve persists in raising interest rates**
- **While equity markets show signs of recovery, historical data offers divergent views about the timing of possible market troughs**
- **The FTX collapse offers pertinent lessons for all investors on the need for rigorous due diligence**

View Capital Advisors, LLC

2727 N. Harwood, Suite 225
Dallas, TX 75201
Tel: 214.855.2550
www.view-cap.com

Ken Shoji, CFA
kshoji@view-cap.com

Austin Tatum, CFA
atatum@view-cap.com

THE ECONOMIC ENVIRONMENT

Let's fight the Fed! That seems to be the mantra of some investors who have hungrily seized upon every release of economic data hinting at peaking inflation, weaker job growth or signals of an imminent recession to induce the markets to move higher, hoping to propel it beyond escape velocity once and for all, away from the misery of the bear market. Surely the Federal Reserve must realize that it is as misguided about the threat of rising inflation as they had been about its transitory nature, and pivot post-haste into a more accommodative policy?

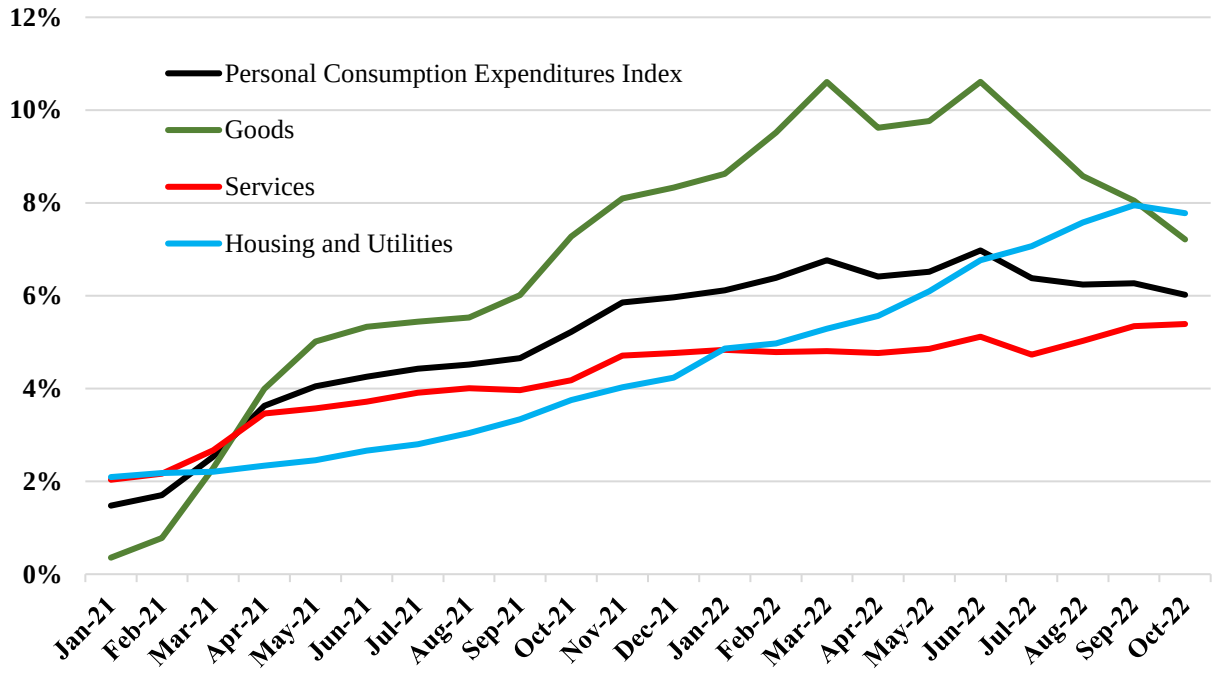
To the chagrin of these bulls, every market rally has been crushed by Fed Chair Jay Powell, who has insisted the central bank is not close to ending its anti-inflation campaign. "We still have some ways to go," he told a press conference on December 14th after the Federal Open Market Committee raised its benchmark rate by 50 basis points to a 4.25% to 4.5% target range. He signaled that the Fed would deliver further interest rate increases next year. The Fed's "dot plot" – the Fed governors' and regional presidents' forecast – showed that their median consensus had in fact risen to 5.1% by the end of 2023, up from their 4.6% projection in September. While their expectations for the Fed funds rate eventually falls to 4% in 2024 and to 3% in 2025, Powell made it abundantly clear that he would not be rushed into a looser money stance. "I wouldn't see us considering rate cuts until the committee is confident that inflation is moving down to 2% in a sustained way," he said. "Restoring price stability will likely require maintaining a restrictive policy stance for some time."

Interest rate doves counter that there is plenty of evidence, not only of falling inflation but of signs of economic malaise. The annual consumer price index declined for a six straight month to 6.5% in December, below the 7.1% level in November and down from the peak of 9.1% in June. The CPI also declined by 0.1% from November, reversing the month-over-month increases seen over the past three months. Producer prices have also eased for a fifth straight month to 7.4% in November compared to year ago, continuing a downward trend since June. The Institute for Supply Management's Manufacturing Purchasing Managers' Index fell in November compared to the previous month, reflecting a steady decline over the past year. The pace of factory output and new orders has been slowing. Structural supply constraints are also waning. The floating traffic jam of cargo ships waiting off the ports of Los Angeles and Long Beach, which had reached its peak of 109 vessels last January, has now disappeared entirely. The post-pandemic consumer spending boom appears to have dried up, as "excess savings" from stimulus programs have vanished, and the personal savings rate has declined to just 2.4% from the pandemic peak of 34% in the spring of 2020. As for sentiment, investors' focus has now clearly shifted from irritation at inflation to fear of recession.

While the Federal Reserve acknowledges that growth is slowing – it is forecasting just 0.5% GDP growth next year – it evidently needs to see the job market cool considerably before it is willing to pause its rate hiking program. Employers added 223,000 jobs in December; over the past twelve months the economy has added an average 375,250 new jobs, double the pre-pandemic average pace. Although many prominent companies, such as Amazon, Meta, Pepsi, and Goldman Sachs have announced layoffs, initial

jobless claims remain low and job vacancies remain above 10 million. The robust job market also explains why even as the goods component of the Personal Consumption Expenditures Index (the Fed's preferred measure of inflation) has come down from its summer peak, the services component – reflecting the costs of housing, healthcare, transportation, recreation, hospitality, and financial services – has remained stubbornly high. The cost of services is more sensitive to labor costs and tends to be more "sticky". Average hourly earnings grew 5.1% in November from a year earlier, well above the pre-pandemic pace of 3%... Many workers have won higher compensation over the past year. In November, Congress forced the end of a long-running railroad labor dispute, which, despite the unions' failure to secure paid sick leave, offered railroad workers a 24% increase in wages from 2020 through 2024. Even in workforces that are not fully unionized, pay raises have been generous. For example, Delta Air Lines pilots negotiated a 30% increase in compensation over four years.

Personal Consumer Price Index (annual change)



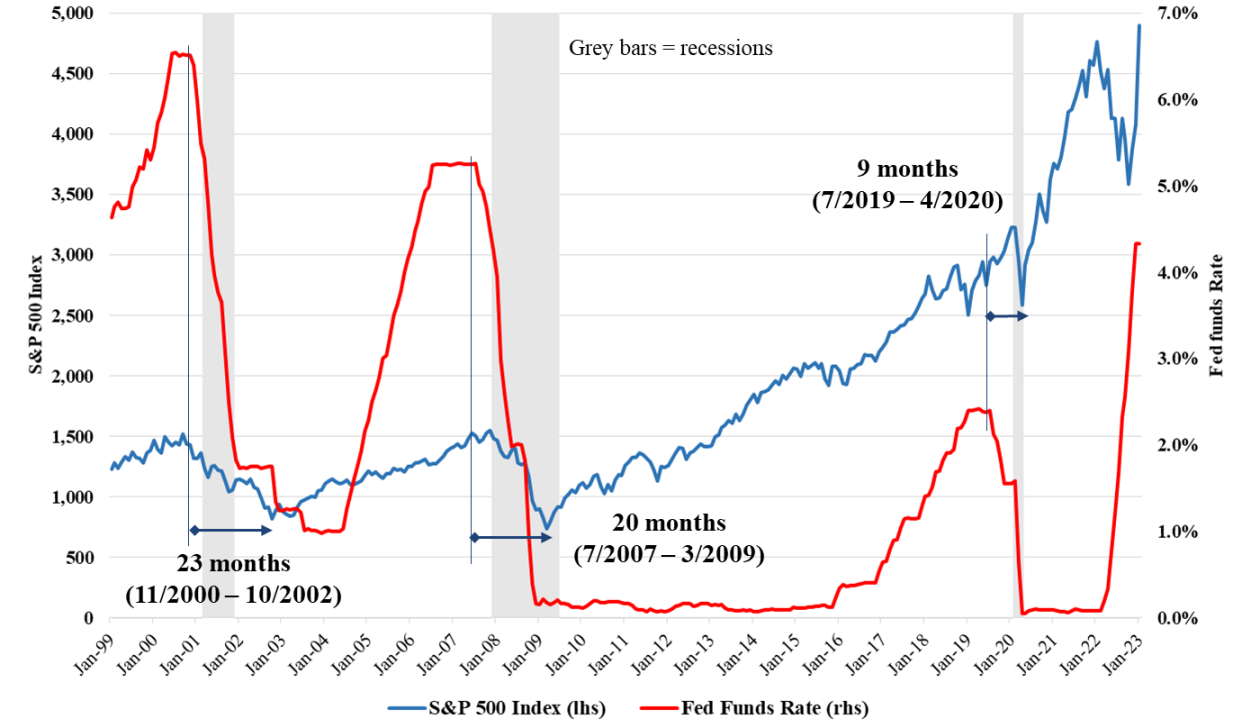
Source: Bureau of Economic Analysis

Another significant contributor to service inflation has been housing, which, as the chart above shows, has risen sharply over the past two years. While shelter costs are expected to peak in the first half of this year as a result of falling mortgage rates (the average 30-year mortgage rate has dropped from a peak of 7.3% in October to 6.6% in December) and slowing multifamily rent growth (expected to fall to mid-single digits from the 13.5% increase in 2021 as new supply comes to market), they are still consuming an increasing share of household income.

So, what does the current economic picture mean for the financial markets? As we discuss in the Equity section of this newsletter, some historical patterns suggest that the time has come to get back into the market. On the other hand, economist David Rosenberg has pointed out that equity markets do not reach

their troughs until well after the Fed *begins to cut interest rates* in response to a recession. For example, in the aftermath of the bursting of the internet bubble and the Global Financial Crisis, it took 23 and 20 months respectively *after* the Fed pivoted before the equity market bottomed out.

The Fed Interest Rate Cycle and Equity Market Troughs



Source: Federal Reserve Bank of St. Louis

Although market and economic conditions may deteriorate sufficiently for the Federal Reserve to pause its hiking program, the market acknowledges that Powell does not want to be remembered as another Arthur Burns, the Fed president from 1970 to 1978 who failed to stamp out inflation due to several half-hearted interest rate hiking campaigns, but rather as another Paul Volker, whose resolute fortitude in dispensing bitter monetary medicine in spite of 11% unemployment brought inflation to heel. If this historical pattern were to repeat in the current cycle, then we may be waiting some time before the equity market finally capitulates.

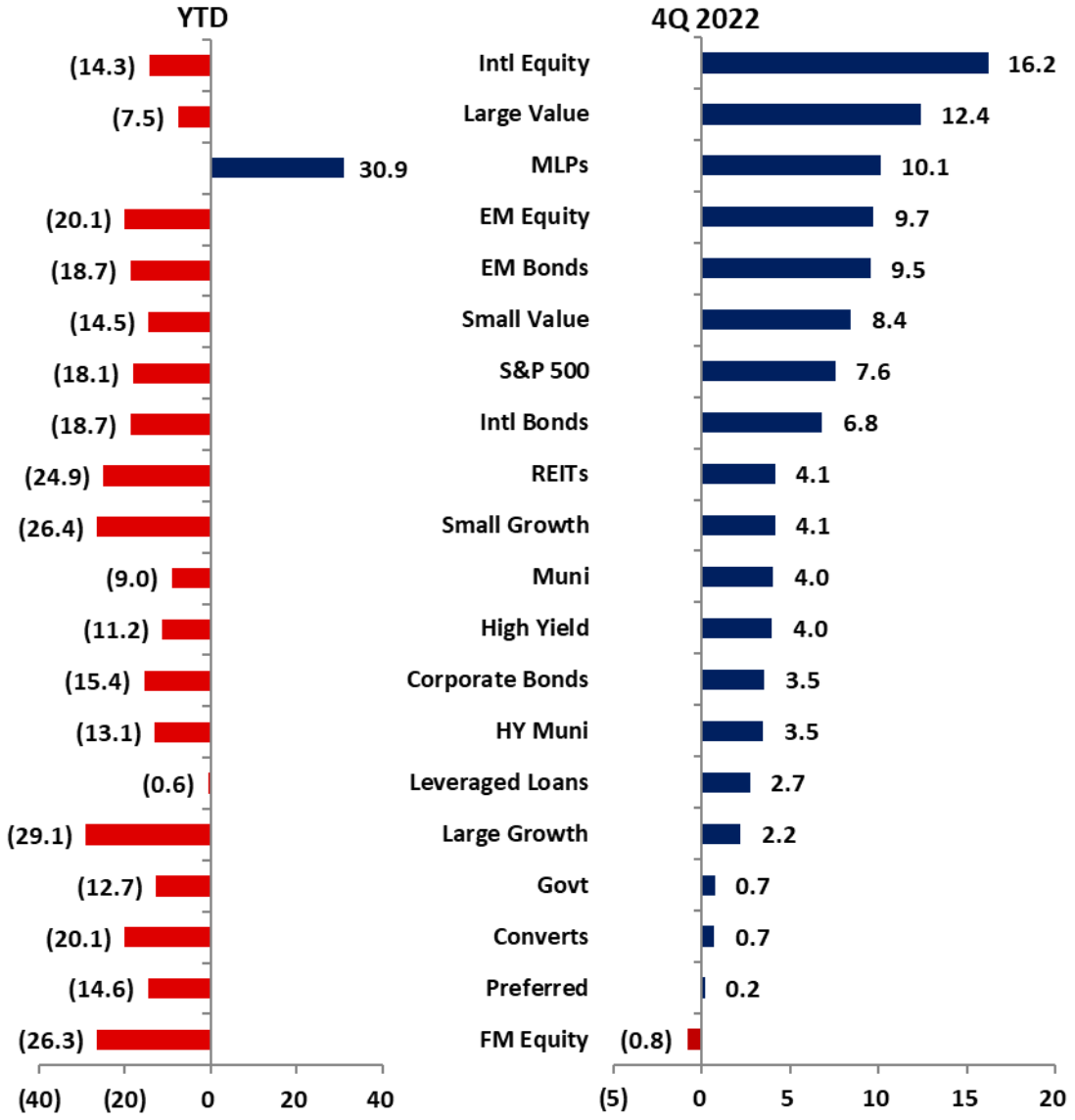
Two related macro-economic factors may significantly impact global economies and the financial markets this year. Last year, the Dollar Index (the U.S. Dollar against a basket of major developed country currencies) appreciated 20%, primarily due to the interest rate differentials between the Dollar and other currencies. The Dollar rose 15% against the Euro, 20% against the Yen and 15% against the Chinese Yuan. This has created a challenge for many countries who have faced higher funding costs, as well as for many American companies who have seen the value of foreign earnings decline. Many central banks around the world have been catching up with the Federal Reserve, most notably the European Central Bank (which raised its base rate to 2.5%), the Bank of England (to 3.5%) and the Bank of Japan, which permitted the yield on 10-year government bonds to rise to 0.50%. This last action caused U.S. Treasury

rates to rise due to concerns that higher rates in Japan would lead to capital flowing out of Treasuries into Japanese bonds. A reversal of Dollar strength this year could boost foreign earnings of U.S. multinationals, induce slightly higher inflation at home, but support commodities, gold and emerging market equities.

Finally, China's re-opening is the wild card that could have an unpredictable impact on the global economy. If the country can resume the 4% to 5% pre-pandemic growth rate that many economists expect this year, it will provide a powerful tailwind to global growth. If, however, the sudden reversal of the draconian "zero-Covid" policy, which has exposed an under-vaccinated population to a surge of infections, leads to the spread of new Covid variants resistant to existing vaccines, a nightmare scenario could unfold that could have dire consequences for the global economy.

4th QUARTER AND YEAR-TO-DATE PERFORMANCE OF MAJOR ASSET CLASSES

Numbers represent percentage change



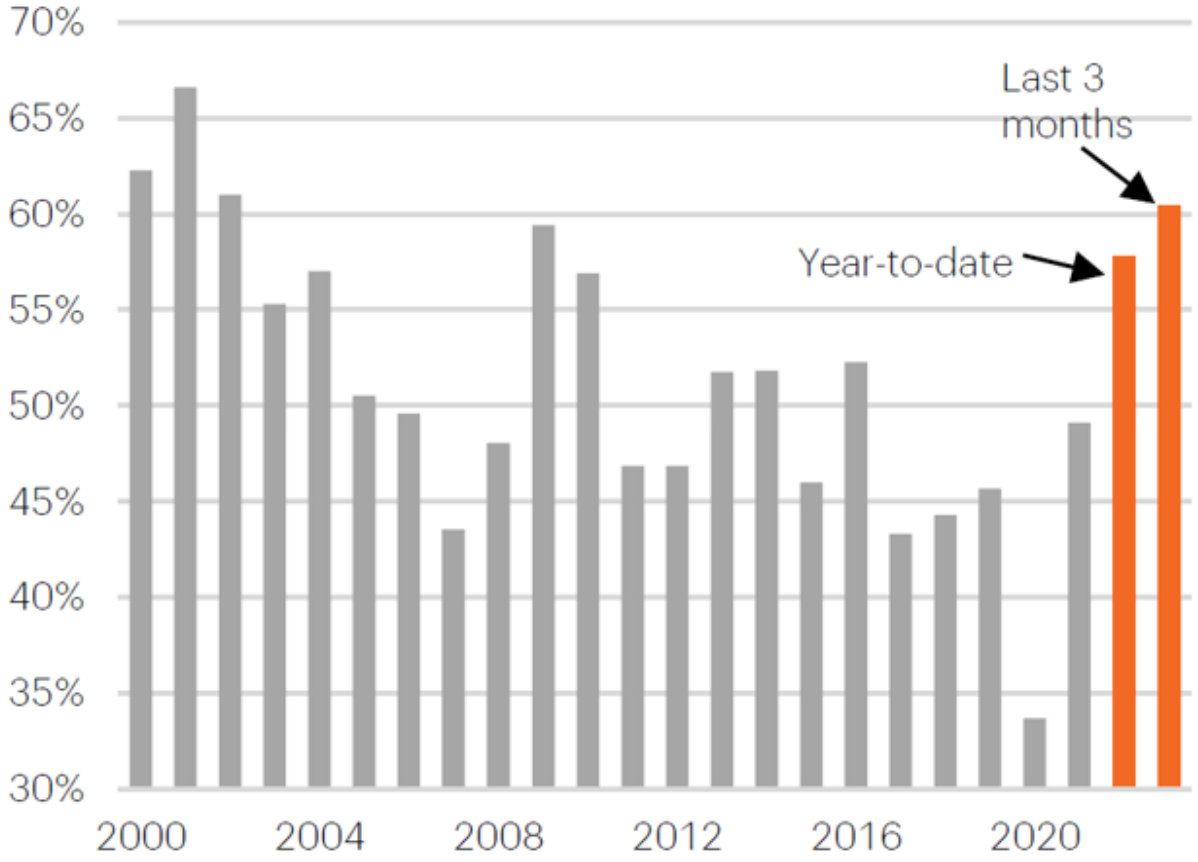
Source: Morningstar

EQUITIES

Equity markets were volatile in the fourth quarter, with the S&P 500 fluctuating due to the varying qualities of economic data releases, earnings reports, and resulting implications for interest rate hike expectations. In Europe, the STOXX 600 and FTSE 100 also saw ups and downs related to the UK's fiscal tax cuts and the resignation of Prime Minister Liz Truss, and markets in Asia were mixed around China's Covid policy and weakness in the Japanese yen.

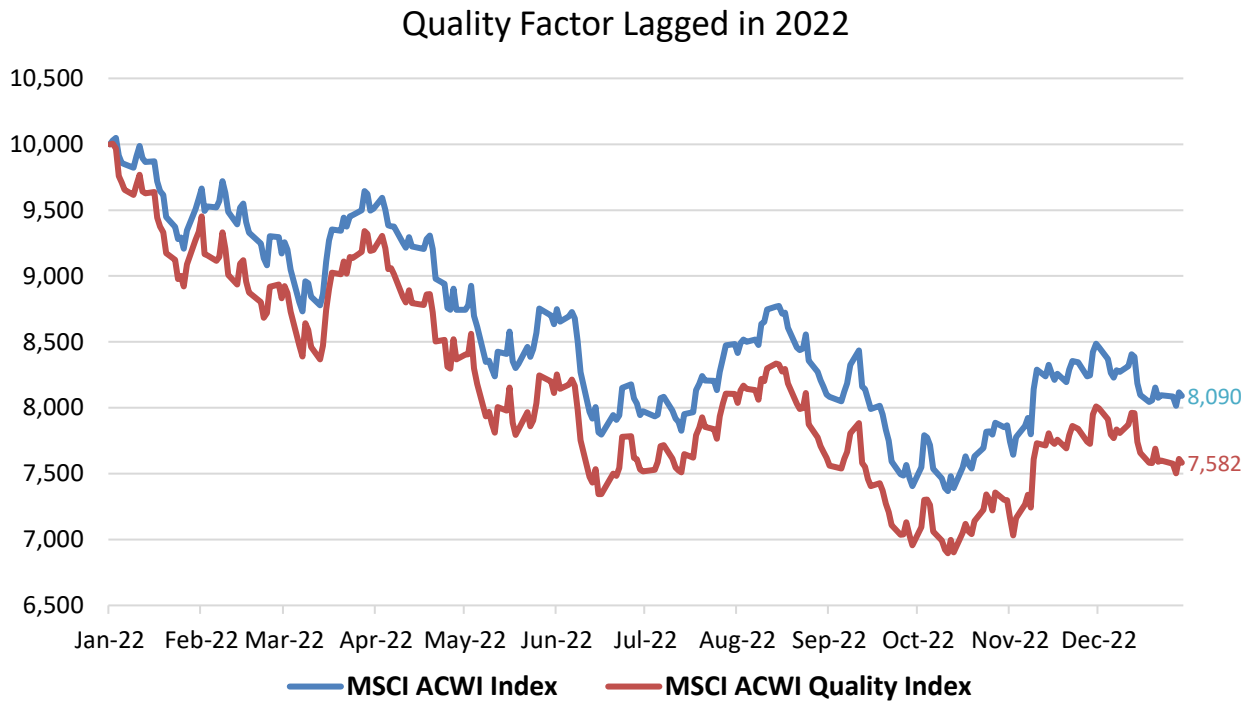
Despite the volatility, stocks ended the quarter in positive territory. Even with a sharply negative December, the S&P 500 returned over +7.5%, led again by the outperformance of value stocks (+12.4%). The technology heavy NASDAQ index continued to struggle, and was down -1.2%. International stocks saw their fortunes reverse from the previous quarter with a +16.2% return, propelled by U.S. dollar weakness. With these market fluctuations, we expect to see greater opportunities for active managers who selectively buy and sell stocks on fundamental and technical cues. This is supported by evidence that a growing percentage of stocks are outperforming their index. Skilled stock-pickers could be looking at their most attractive markets in more than 10 years.

Percentage of the S&P 500 Stocks Beating the Index



Source: FS Investments, Bloomberg

It should come as no surprise that stock valuations fall as interest rates rise, all else equal. What has been unusual this year is the underperformance of the quality factor. During typical downturns, you would expect companies with stronger balance sheets and more stable earnings profiles to outperform the broader market. That hasn't been the case this year as exhibited by the lagging performance of the MSCI ACWI Quality Index versus the broader MSCI ACWI Index, which measures the performance of large- and mid-capitalization companies worldwide.



Source: GQG Partners, Morningstar

The cause of this underperformance is somewhat unclear, but much of it is a result of the outperformance of energy equities, which are rarely included in quality indices due to their highly variable income streams. Energy was the only industry sector that generated positive returns in 2022, with a 42% gain. Another contributing factor is the nature of the market decline: one largely determined by the path of interest rates and without an imminent recessionary backdrop. We still expect the quality factor to outperform in a scenario of weakening demand, margin compression, and lower profits.

After such a dour year, it would be easy to capitulate and give up on equities for a while, waiting for clearer skies and rosier outlooks, but it has historically paid off over the long-term when buying into weakness and maintaining asset allocation discipline. While not necessarily indicative of future returns and no one will be able to consistently time market bottoms, the subsequent 1-, 3-, 5-, and 10-year returns after an S&P 500 market trough of 25% or lower since 1950 are compelling. It has bottomed-so-far at -24.95% on October 12th, but given the gloomy economic outlook and unlikelihood of a "soft-landing", markets could continue their correction into the New Year.

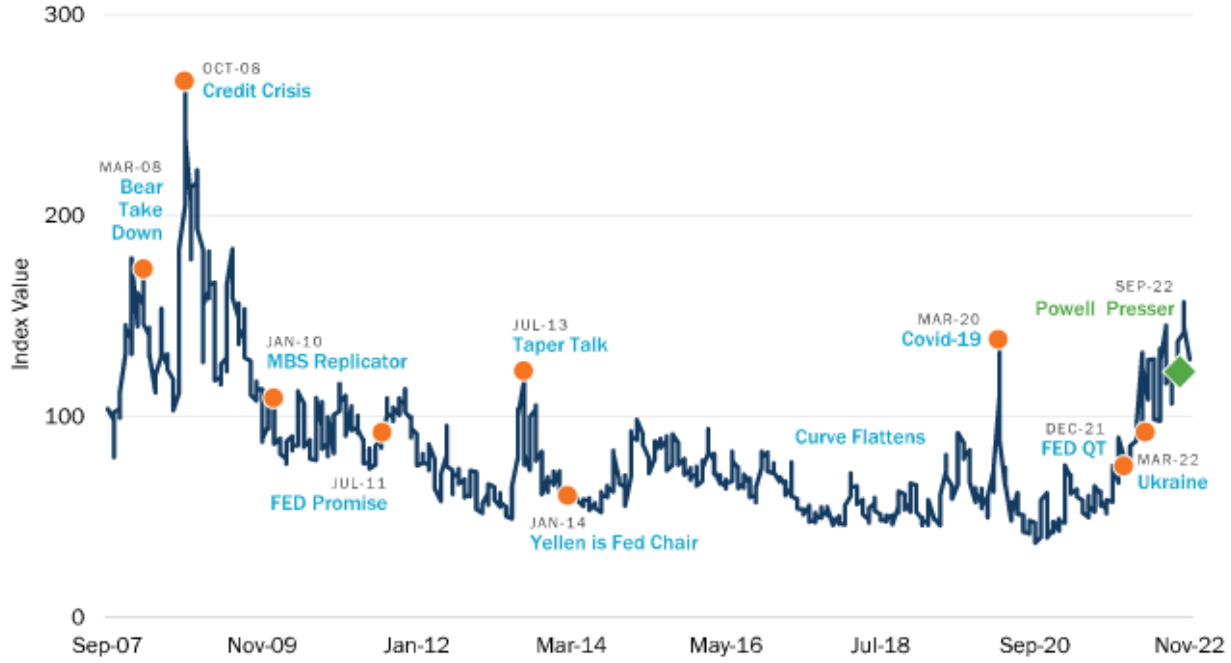
S&P 500 Performance after Declining -25% or Worse Since 1960

				Cumulative Forward Returns After Market Bottom			
Peak	Trough	Decline	Days Peak-to-Trough	1-year	3-year	5-year	10-year
12/12/61	6/26/62	-28%	196	34%	59%	76%	107%
11/29/68	5/26/70	-36%	543	44%	56%	31%	60%
1/11/73	10/3/74	-48%	630	35%	55%	76%	163%
11/28/80	8/12/82	-27%	622	58%	84%	225%	309%
8/25/87	12/4/87	-33%	101	21%	45%	92%	336%
3/24/00	10/9/02	-49%	929	33%	54%	100%	87%
10/9/07	3/9/09	-56%	517	68%	102%	178%	305%
2/19/20	3/23/20	-34%	33	76%	?	?	?
1/3/22	10/12/22	-25%	282	?	?	?	?
	Average	**-37%**	**428**	**46%**	**65%**	**111%**	**195%**

Source: AMG Funds, Morningstar

BONDS

Bond Market Volatility

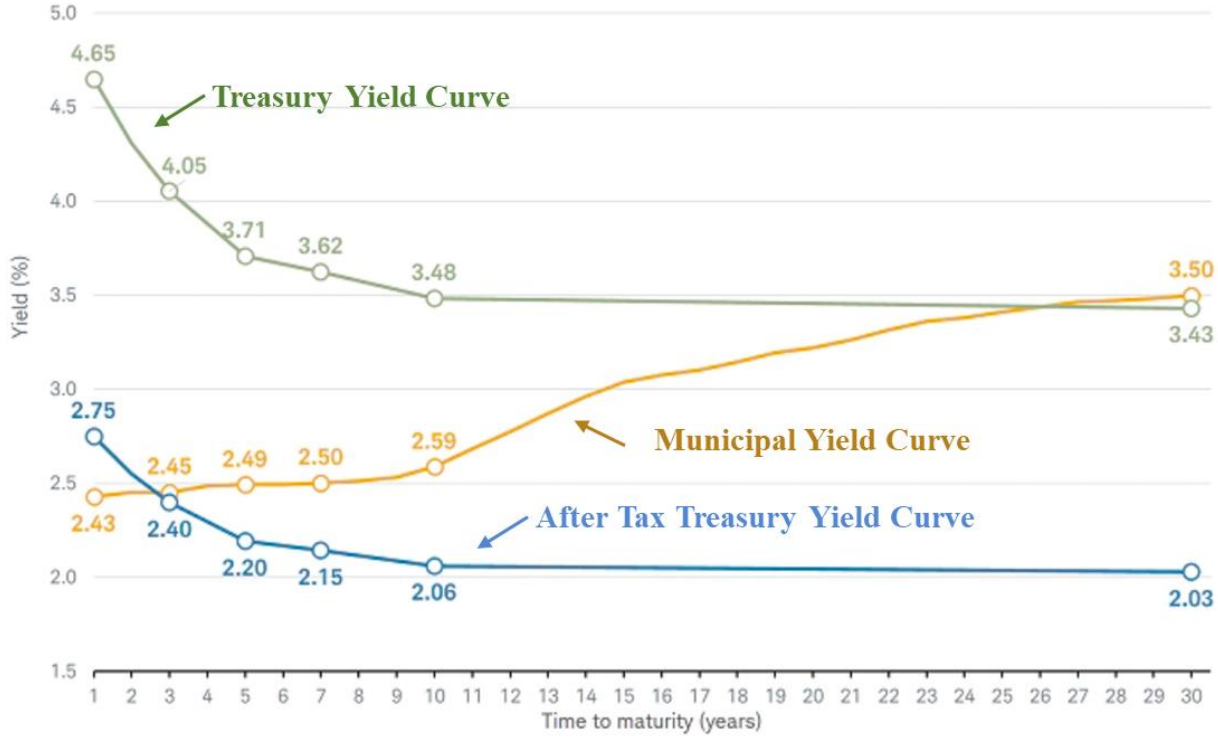


Source: MacKay Shields

The fixed income markets continued their roller-coaster rides in the final quarter of the year with the 10-year Treasury yield moving up from 3.8% at the end of September to a peak of 4.25% in October before ending the year back at 3.8%. Interest rates have been driven by a battle of views between traders who continue to be concerned about inflation and those who are pricing in an impending recession. During the course of the year, the yield curve has inverted, with the spread between the 10-year and 2-year Treasuries flipping from positive 70 basis points (1.45% minus 0.75%) at the start of the year to negative 55 basis points (3.7% minus 4.25%) at the end. As the chart above shows, the volatility of interest rates has hit its highest level since the Global Financial Crisis, suggesting an elevated level of uncertainty about market direction.

The speed at which yields on all fixed income assets have risen this year has been unprecedented. While this move has led to losses in existing bond portfolios, investors are now able to put new money to work at some of the most attractive yields we have seen over the past decade. However, investors should first examine how much duration they have in their portfolios. While Treasuries traditionally provide downside protection in times of market crises, the losses incurred this year may have persuaded many to divest this component of their asset allocation. Near-zero Treasury yields had not provided any compensation for holding such portfolio insurance, but rising yields have changed this equation. Investors may also want to consider intermediate term municipal bonds as a complement to Treasury duration. As Schwab has pointed out, municipals beyond 3-year maturities now offer higher after-tax returns than Treasuries.

Treasury and Municipal Yields



Source: Schwab

Credit spreads tightened during the quarter, with investment grade spreads falling from 1.7% to 1.4%, and high yield spreads falling from 5.4% to 4.7%, although for the year they have risen 40 and 160 basis points, respectively.

A consideration in allocating to credit spread products is the relationship between interest rates and credit spreads as they evolve during the market cycle. Research from Amundi, summarized in the table below, shows how credit spreads widen and peak at the end of recessionary periods, and tighten as the economy picks up. In past recessionary periods since 1969, spreads have tightened 184 basis points from their peaks to their troughs, over a period of 21 months on average. However, during the same periods, Treasury yields have risen as confidence in economic recovery increases, so the net effect is that on average *total yields* did not change very much.

Both high yield and bank loan markets continued to show signs of stress in the second half of 2022. Banks that had financed large transactions such as Vista's purchase of Citrix, Broadcom's acquisition of VMware, Microsoft's acquisition of Activation Blizzard, and Elon Musk's takeover of Twitter are still digesting their resulting loans, slowing syndication of new deals. Leveraged loan issuance has dropped 69% to the end of the third quarter of 2022 compared to the previous year, and issuance in high yield bonds has also plummeted 78%. If these supply/demand factors lead to market dislocations this year, there could be very attractive entry points for many spread products, ranging from residential and commercial mortgages, bank loans, CLOs, and high yield debt.

Credit Spreads, Treasury Yield and Total BBB Yields Changes in Recessions

Recession Start	Recession End	Spread Peak	BBB Peak Spreads	Spread Trough	BBB Trough Spreads	Change	Treasury Peak Yields	Treasury Trough Yields	Change	BBB Peak Yields	BBB Trough Yields	Change
Dec-69	Nov-70	Dec-70	284	Aug-73	92	-192	6.4	7.4	1.01	9.2	8.3	-0.91
Nov-73	Mar-75	Feb-75	294	Mar-78	101	-193	7.4	8.0	0.65	10.3	9.1	-1.28
Jan-80	Jul-80	Jun-80	282	Sep-81	185	-97	9.8	15.3	5.54	12.6	17.2	4.57
Jul-81	Nov-82	Oct-82	376	May-84	131	-245	10.9	13.4	2.5	14.7	14.7	0.05
Jul-90	Mar-91	Jan-91	227	Jul-91	163	-64	8.1	8.5	0.38	10.4	10.1	-0.26
Mar-01	Nov-02	Oct-02	273	Apr-04	130	-143	4.3	4.4	0.06	7.0	5.7	-1.37
Dec-07	Jun-09	Dec-08	525	Apr-10	172	-353	2.2	3.7	1.46	7.5	5.4	-2.07
		Average =	**323**		**139**	**-184**	**7.0**	**8.7**	**1.7**	**10.2**	**10.1**	**(0)**

Source: Amundi

SHOULD INVESTORS – AND NOT REGUATORS – TAKE THE BLAME FOR FTX's COLLAPSE?

"Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here. From compromised systems integrity and faulty regulatory oversight abroad, to the concentration of control in the hands of a very small group of inexperienced, unsophisticated and potentially compromised individuals, this situation is unprecedented." *John J. Ray, appointed as the CEO of FTX following its bankruptcy filing.*

What can the failure of FTX teach the investment community about the right way to evaluate and diligence investments? The cryptocurrency exchange filed for bankruptcy on November 11th, and its CEO, Sam Bankman-Fried, was arrested and charged with fraud, money laundering and campaign finance offenses. Much of the criticism around the collapse of FTX has been aimed at the regulators, who appear to be almost paralyzed in their response to the rapid evolution of cryptocurrencies and blockchain technology. Laws and regulations always lag technological revolutions, often by decades – after all, we are just now debating the complex ethical issues and the appropriate regulatory framework that should govern social media platforms, 18 years after the launch of Facebook in 2004. Moreover, the U.S. is behind the European Union, which approved in October the Digital Services Act, which will regulate starting in 2024 how social media platforms referee online speech.

While regulators cannot be expected to be on the cutting edge of innovation, what about the investors who financed FTX? Given the long history of hacks, thefts, and fraud afflicting crypto exchanges going back to the collapse of Mt. Gox in 2014, one would have thought that any institutional investor contemplating an investment in FTX would have subjected it to the most intense level of scrutiny. Yet, sophisticated

institutions, such as Sequoia Capital, SoftBank, BlackRock, and the Ontario Teachers' Pension Plan, either seem to have been blind to some glaring deficiencies in FTX or so hungry to ingratiate themselves with Bankman-Fried that they simply acquiesced to his demand to just "support him and observe."

Despite being very familiar with the infrastructure of traditional securities trading, many investors failed to see the red flags raised by FTX's business model. In traditional financial markets, functions along the chain of a security transaction are segregated in order to ensure that cash is exchanged simultaneously with securities, conflicts of interest are avoided and all market participants are treated reasonably fairly. Custodian banks who hold assets in safekeeping on behalf of investors are typically unaffiliated with brokers who execute trades, who are in turn distinct from the exchanges that facilitate price discovery and match buyers and sellers. Exchanges are governed by detailed rules covering order management and transaction settlement. Each institution in this ecosystem operates under regulations to assure the safety, impartiality and integrity of the financial markets. For example, under the Commodities Exchange Act of 1936, a broker's customer assets are required to be kept segregated from the firm's assets, so customers can always access their money, regardless of what happens to the broker. Custodians are generally not permitted to invest or move a customer's cash or assets without their authorization. The industry is extremely vigilant of violations and abuses of these regulations, since they can put assets at risk. When MF Global invested customer margin deposits in speculative bonds without permission, it led to the broker's bankruptcy in 2011 and $1.2 billion of customer losses.

In contrast, FTX, like many other cryptocurrency exchanges, performed many functions – custodian, exchange, market maker, lender and broker – and may have fragrantly disregarded its responsibilities in each capacity. FTX's terms of service specifically prohibited the exchange from hypothecating or investing customer assets without their explicit authorization, yet it seemed to have done so routinely. FTX was closely intertwined with Alameda Research, a trading firm also owned by Sam Bankman-Fried. Alameda reputedly front-ran other traders on the FTX platform, manipulated the prices of cryptocurrencies, and used the exchange's customer funds to pay for its debts, expenses and speculative investments, including real estate in Bermuda. Bankman-Fried allegedly instructed his coders to alter the exchange's execution protocols so that Alameda was exempt from rules such as stop-losses that were imposed on other participants, allowing it, according to the SEC, to "maintain a negative balance in its account, untethered from any collateral requirements. No other customer account at FTX was permitted to maintain such a negative balance." Astonishingly, FTX even directed customers to deposit dollars not into their accounts at the exchange, but into bank accounts controlled by Alameda, allowing the trading firm to draw down from a "virtually limitless" line of credit funded by FTX customer assets. In the civil charges filed by the Commodity Futures Trading Commission, it claimed that Bankman-Fried also fraudulently borrowed money by artificially boosting the price of FTT, a digital token issued by the exchange itself, in order to increase their collateral value. FTX apparently used a third of its revenues to buy FTT in order to remove it from the marketplace and inflate its value.

What is deplorable – beyond the brazen nature of these alleged crimes – is the failure of FTX's institutional sponsors to conduct appropriate diligence before ploughing $1.8 billion into the company and their negligence in allowing such behavior. Tiger Global, a $10 billion hedge fund, delegated their due diligence to Bain Capital, a private equity conglomerate with over 1,200 professionals, who found no

reason to back away. Temasek, Singapore's state-owned sovereign wealth fund, revealed that after eight months of intensive due diligence "it did not find any red flags before deciding to invest $275 million." Once the investments were made, these investors failed to exercise adequate oversight. Private equity firms universally claim that they add value to their investee companies by establishing robust corporate controls and governance, by bringing in competent executives, and by implementing operational improvements. Did Sequoia Capital, perhaps the pre-eminent venture capital firm in Silicon Valley, not feel that a board of directors comprised of seasoned professionals with expertise in trading, market structure, or regulatory compliance would be helpful in guiding the frat house of twenty-something's running FTX? Did BlackRock, the largest money manager in the world, not think that it might be a good idea for FTX to have basic cash management controls, such as authorized signatory lists, rather than have cash wires approved via social media chat platforms? Did the Ontario Teachers' Pension Plan, one of the most sophisticated investors in the world, not feel that a multi-billion-dollar company needed a Chief Financial Officer? Apparently not.

Did any of the investors evaluate the roles of the 139 subsidiaries that FTX set up, to check whether they were legitimate and necessary? Was no one at these investment firms old enough to remember Friehling and Horowitz, the 3-person accounting firm housed in a New Jersey strip mall that allegedly audited Bernie Madoff? Given the complex and specialized nature of cryptocurrency transactions, did these investors not feel that a well-resourced accounting firm with the technical expertise in cryptocurrencies might be engaged to audit their investment? Clearly not, since they accepted instead the assurances of Prager Metis International, "the first CPA firm to officially open its Metaverse headquarters in the metaverse platform Decentraland." According to Francine McKenna, a lecturer at Wharton who has reviewed the platform's audited statements, the appointed accountants never issued letters stating the companies' internal controls were adequate, as is customary. Moreover, these auditors took on their assignments under terms that prevented them from seeing the full picture of either FTX or Alameda. So, how could the investors have been satisfied that adequate financial controls were in place?

Start-up ventures are not expected to have a fully built out C-suite of seasoned executives, state of the art operational, financial or CRM systems, or top-tier service providers and advisors. But while FTX was only founded in 2019, it was processing up to $16 billion of transactions a day for over a million customers by the end of 2021, so it was clearly beyond being a fledgling business. The institutional investors who funded FTX had the responsibility to insist on implementing the systems, hiring staff and establishing the processes necessary for the platform to operate safely. Perhaps some investors relied too much on the reputations of early round seeders to make their decisions rather than conduct diligence themselves. Some of the individuals making the allocation decisions may have lacked the industry knowledge, expertise and historical perspective to understand what they were dealing with. The director of crypto and blockchain investments at Temasek was "a Top 100 influencer in FinTech" with no investment training before he assumed his role at the sovereign wealth fund. At Sequoia, one of the professionals responsible for the FTX relationship was a "partner" after only 3 years of investing experience. Perhaps their bosses should have sent them to investment boot camp, so they could learn the basics of investment research and due diligence.

The Securities and Exchange Commission is now investigating some FTX investors to determine whether their failures were so egregious that they violated their fiduciary responsibilities to their own investors. Several years ago, an aspiring hedge fund manager made the rounds of institutional investors proclaiming that her goal was to "disrupt the hedge fund industry." Given the revolutionary nature of her strategy, she claimed, it could not be evaluated or diligenced by traditional methods. Not surprisingly, it emerged that there was not much substance beyond her grandiose rhetoric. Fourteen years after the discovery of Bernie Madoff's $65 billion Ponzi scheme, investors need to be reminded that they should not be blinded by the charisma of a persuasive showman. Checking personal backgrounds, verifying espoused claims, understanding organizational charts, and conducting comprehensive financial audits may be unfashionable in the age of crypto, but they can still help investors avoid humiliating losses.

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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 prefunded bonds. Many of the sub-indices 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.