

Asset Allocation 2016

Public Fixed Income

October 15, 2015

Summary of Asset Class Valuation Models

	U.S. Large Cap	U.S. Small Cap	Developed International	Emerging Markets	Interest Rate	Credit
9/30/2015	-1.62	-1.05	-1.19	-0.48	0.81	-0.17
9/30/2014	-0.65	-0.66	-0.84	0.68	0.36	-0.41
YoY Change	-0.97	-0.39	-0.35	-1.16	0.45	0.24

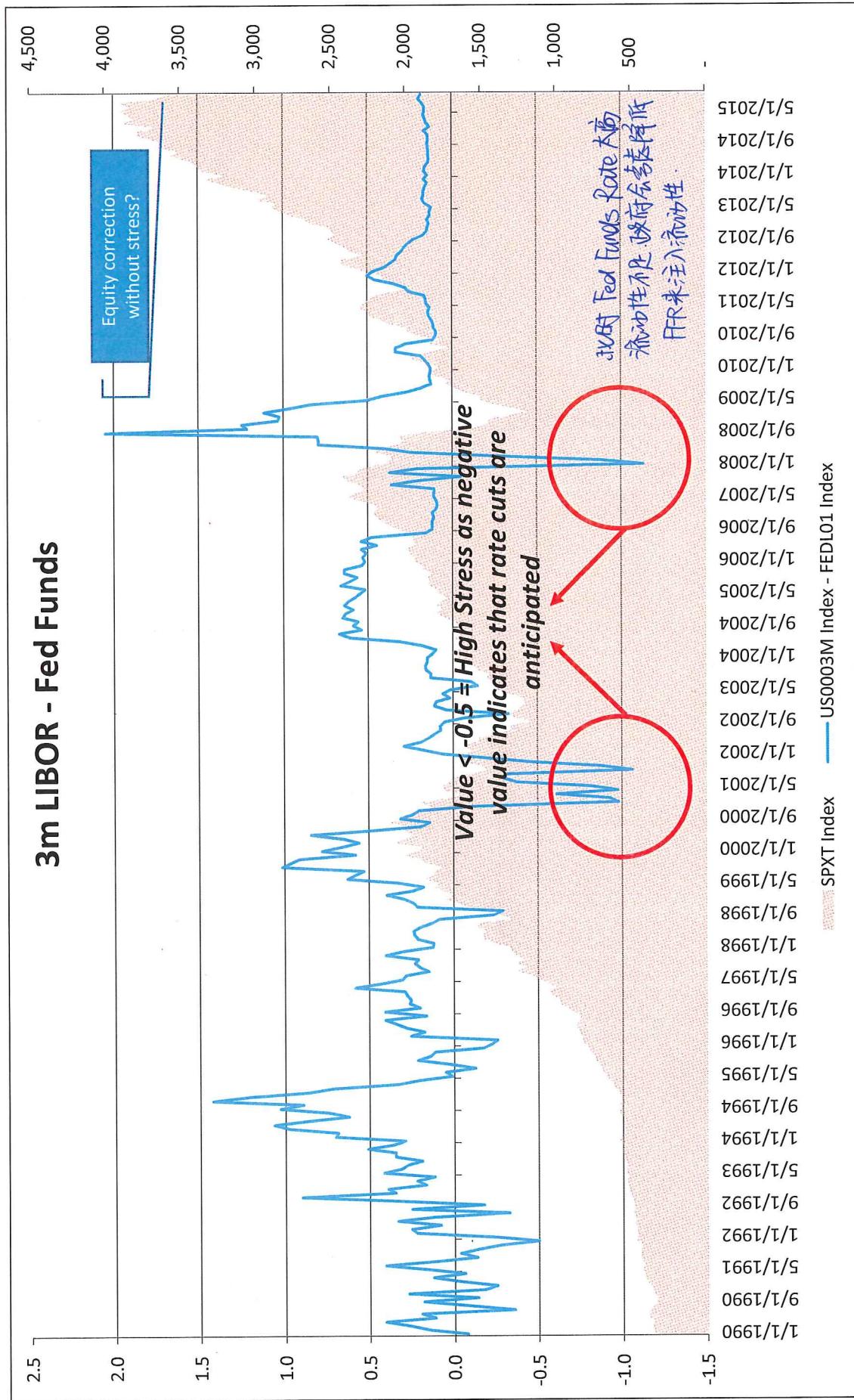
Key Points

- Liquidity model shows modest positive slope, but no signs of stress.
- Feel positive about EAFE due to CB easing, but model is negative, so we're taking both into account.
- Less excited about US LC, but valuations look less expensive, so hold the course.
- When we get a sell signal (likely to happen in 2016), we recommend reducing equities across the board (int'l less). We would assess relative valuations at that time to determine how to allocate capital.
- Rates: Rates have consistently been below market expectations. Short end rates continue to rise, but less than implied by market. Long rates likely to be contained absent inflation.
- Credit: Spreads have room to retrace to mid-cycle highs of fall 2011.

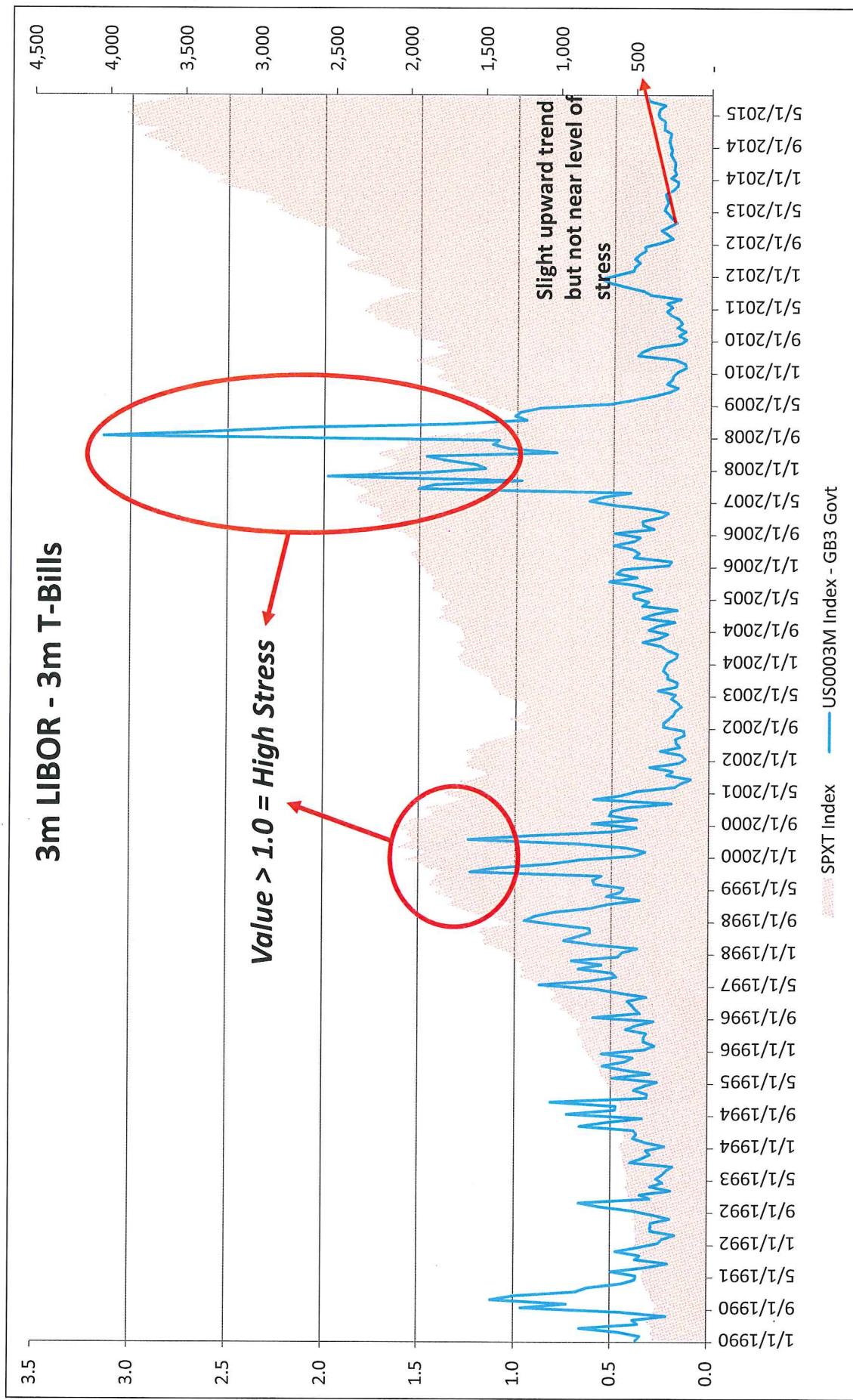
Views

- Expect above-average 5-7 year returns: Developed Non-US Equities and Interest Rates.
- Expect average 5-7 year returns: TIPS, ILBs, Barclays Agg, Bank Loans, US Large Cap, US Small Cap, EME
- Expect below-average 5-7 year returns: High Yield, EMD \$, EMD Local

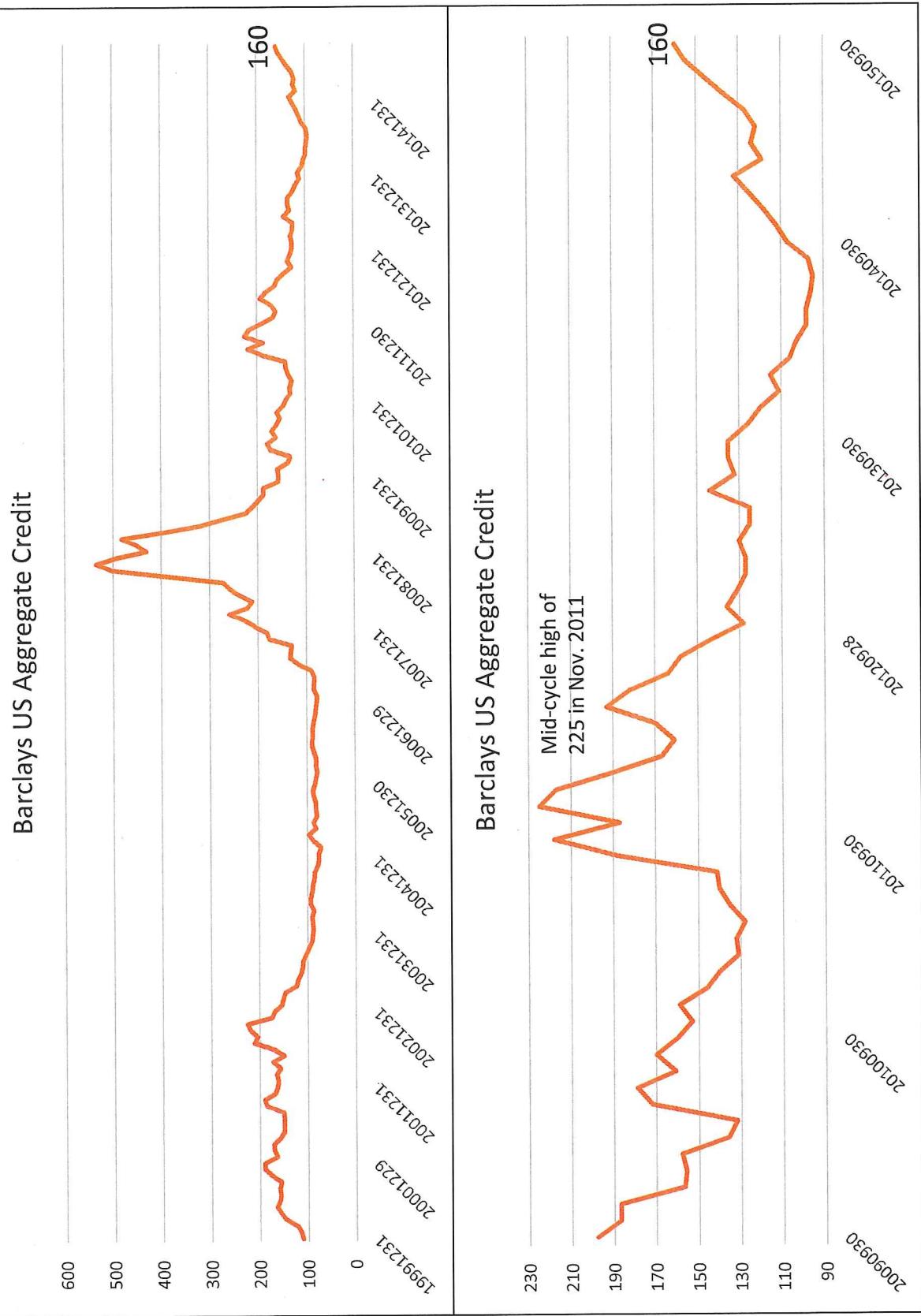
Liquidity Model: Measure of Financial Stress



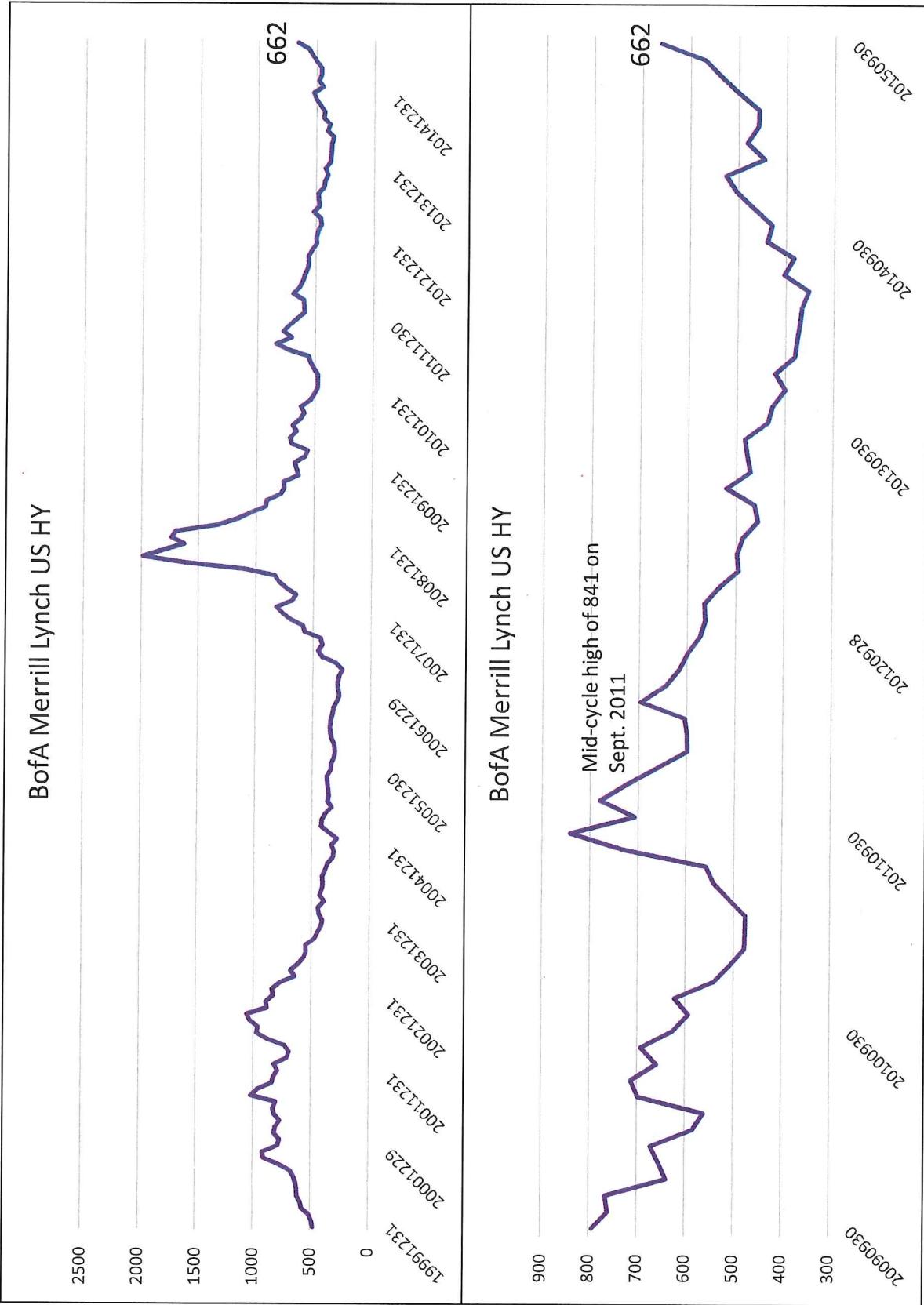
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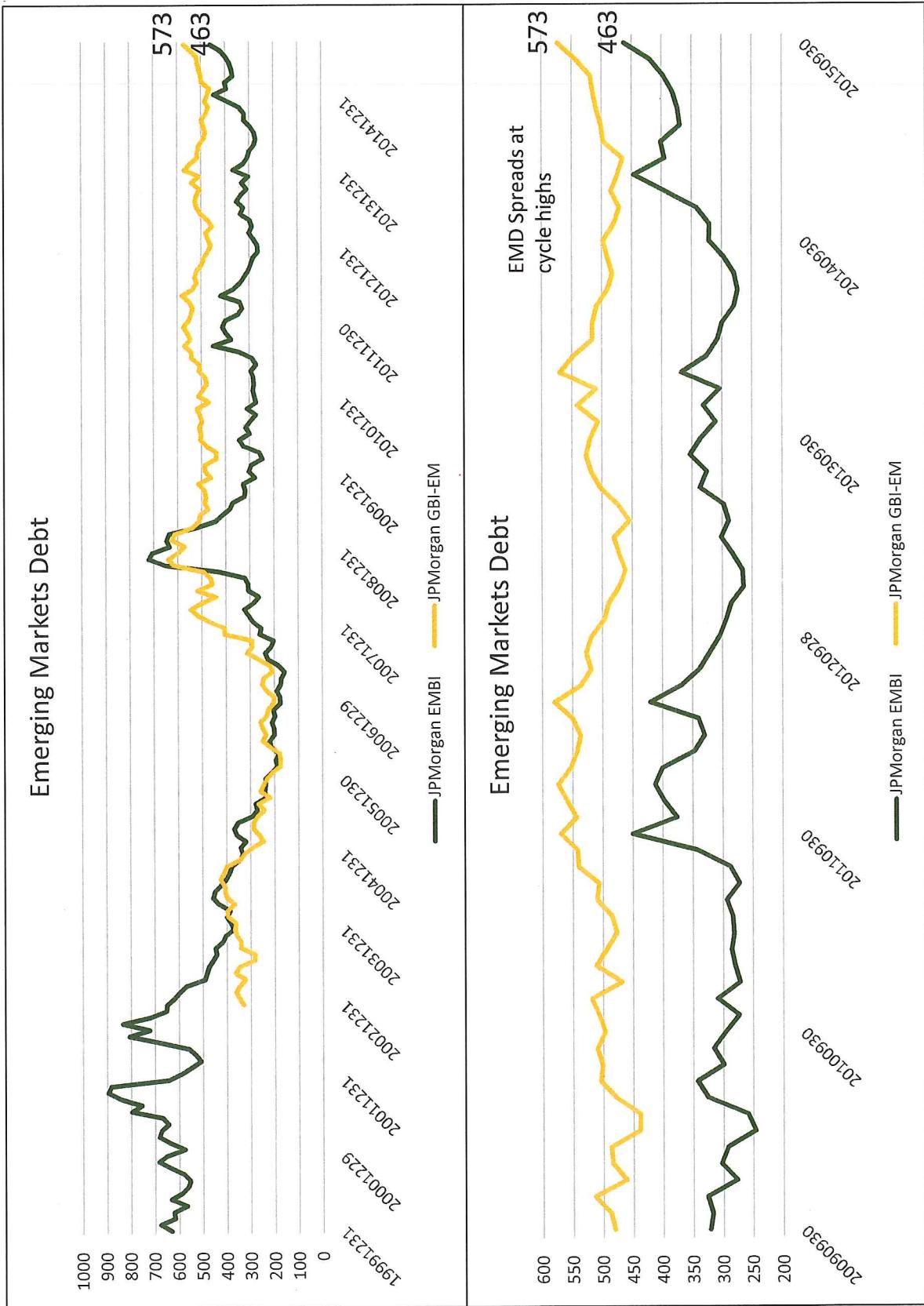
Investment Grade Credit Spreads



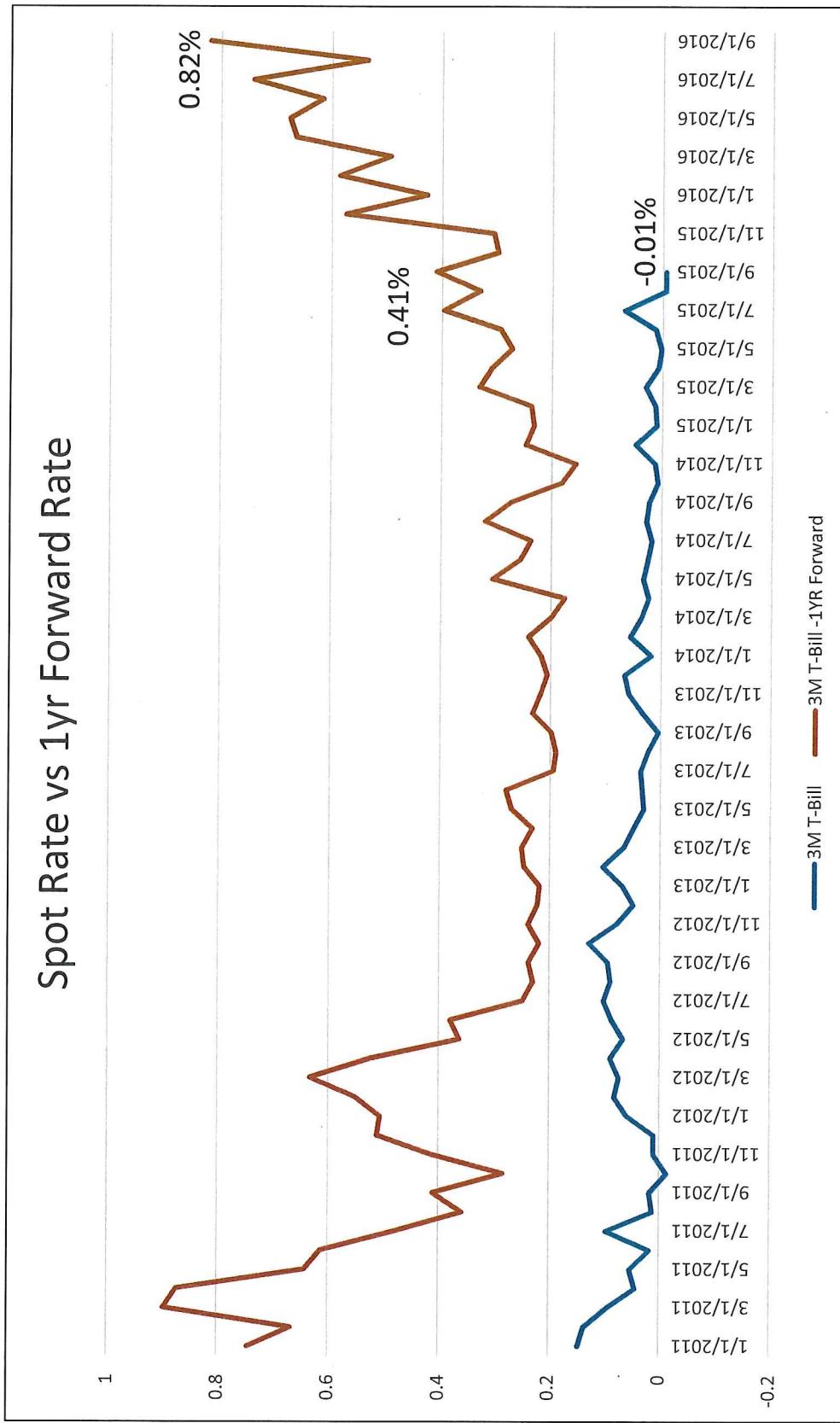
High Yield Credit Spreads



Emerging Market Debt Spreads



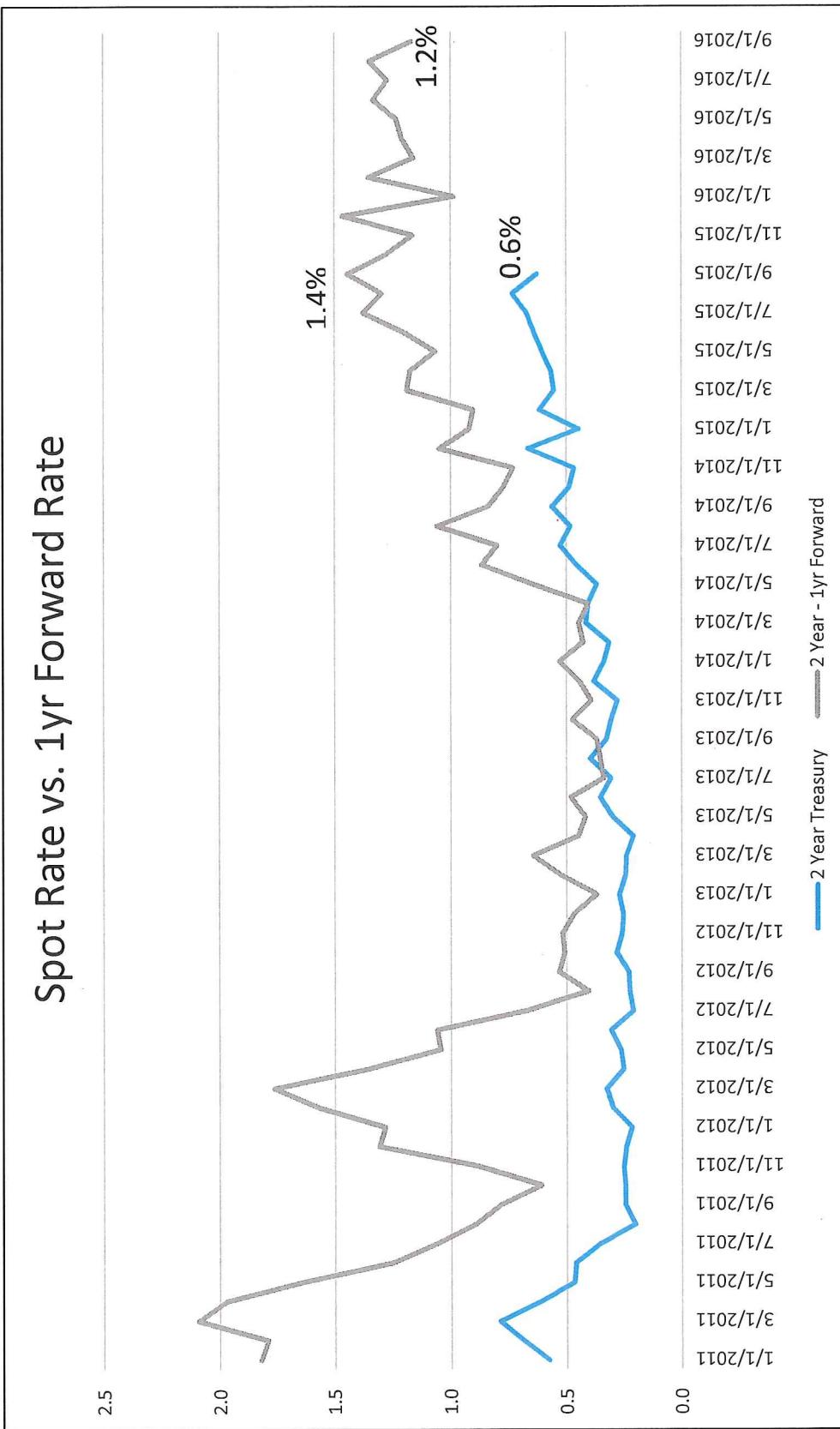
Market has consistently over estimated Fed tightening
3 Month T-Bills near zero but predicted to be 0.8% in 12 months



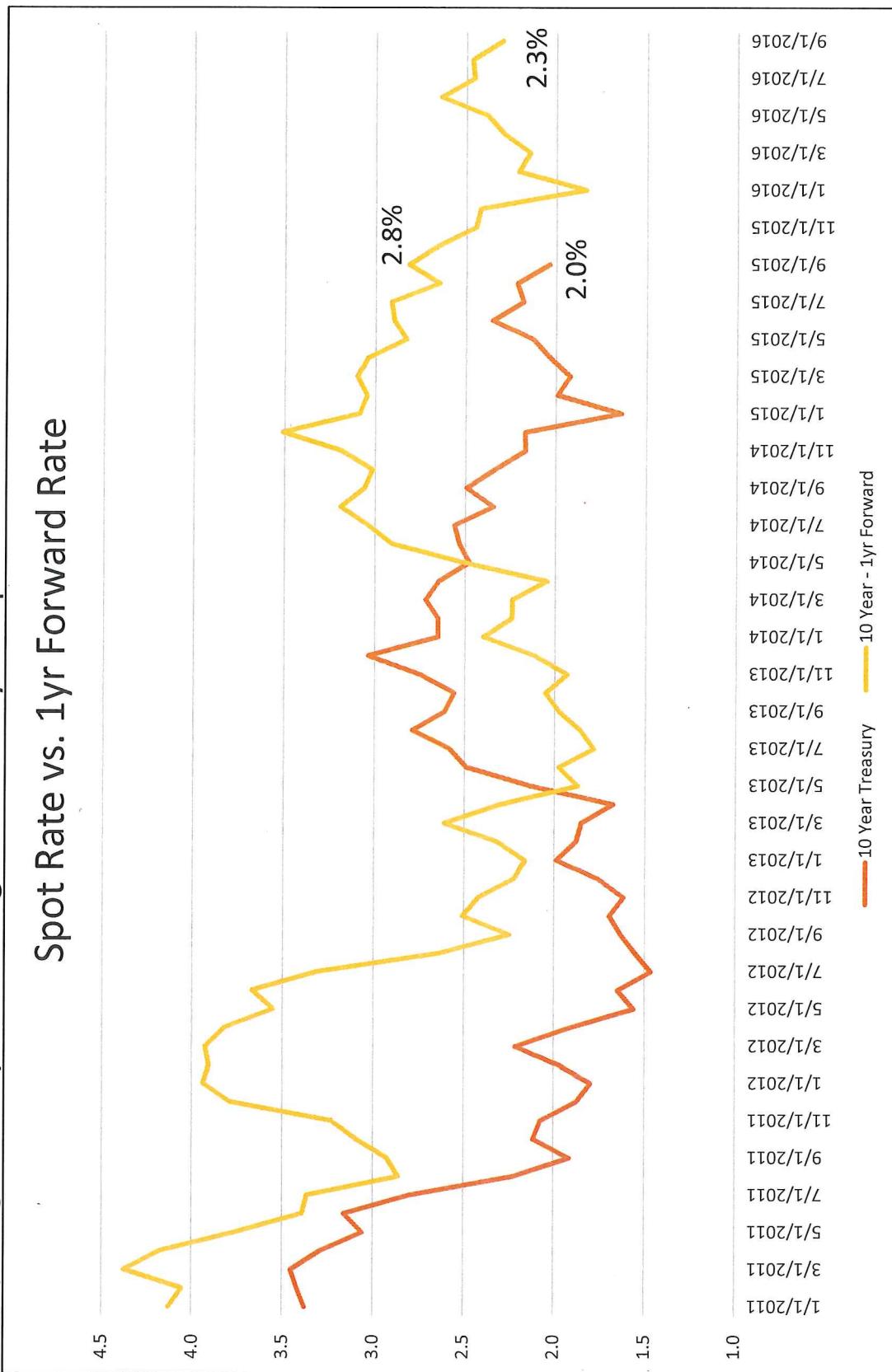
~~2 year TSY~~

2 year TSY at 0.6% is predicted to be 1.2% in 12 months
12 months ago the market predicted 2yr TSY yield to be 1.4%

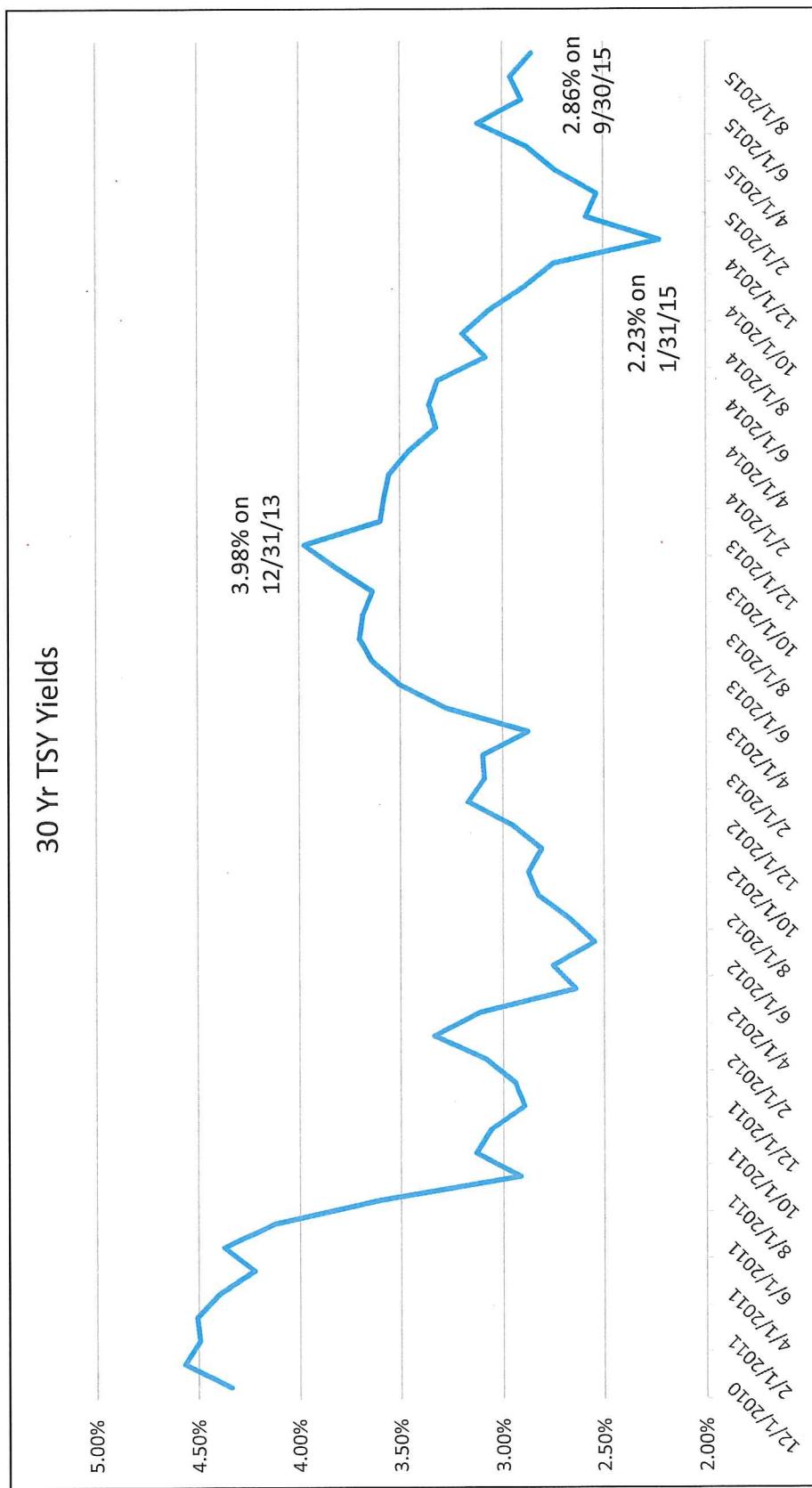
Spot Rate vs. 1yr Forward Rate



Forecast for long term yields is less compelling
30 bps higher despite missing the mark by 80 bps.



Long term yields have room to move...in either direction.



Appendix

PRIM Asset Class Valuation Model		As of 9/30/2015		9/30/2015																																																	
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Data selected immediate, following most recent, with the exception of 1st(12th), GDP Growth (2 months after quarter), Consumer Confidence Index (24th). All data is from FactSet (24th). In data series with 1st, the model looks at the latest available data.

1. Z-scores based on 5-year historical average. Z-score = measure of standard deviations from mean ((Value today - mean)/σ), 2/3 of time, z-score will be between -1/1.

2. Current value reflects actual data point as of the most recent period, which may differ from the data calculation used for the z-score. For example, the current 2x 10's spread may differ from the 12-month average.

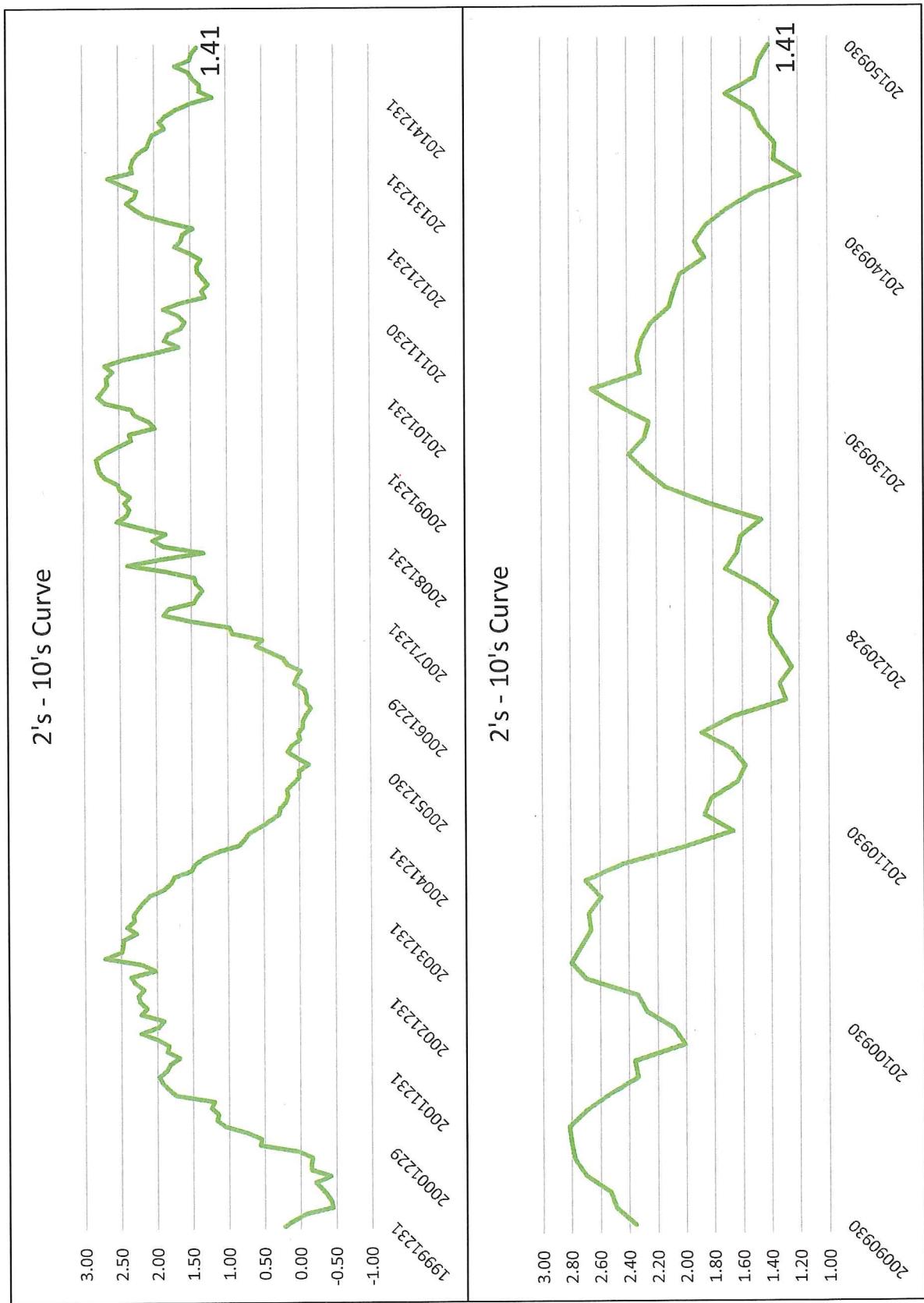
PRIM Asset Class Valuation Model					
Credit Model		As of 9/30/2015		9/30/2015	
Legend					
■ Negative					
■ Neutral					
■ Positive					
Credit Model		Signal		Signs	
OVERALL CREDIT MODEL SIGNAL		-0.12		-0.17	
Weight		Z-score ¹		5-yr average	
25% Macro Signal		Current Value ²		5-yr average value	
Inflation Expectations (5yr/5yr Fwd Break-even)		-1.2		-1.8	
2's 10's spread (level), 12-mo avg		-1.3		1.4%	
Corporate profitability, S&P 500 Index, Net Margin (12-mo Change)		-1.2		10.6	
Debt/EBITDA (12M Change)		1.3		3.5	
GDP Growth (12-mo Change)		-0.3		3.9	
50% Valuation Signal		Current Value ²		5-yr average value	
BBB Spreads (Current Level)		1.1		229.0	
IG-HY spreads (Current Level)		1.5		502.0	
12m forward Earnings Growth, Russell 2000 Index (level, 12-mo avg)		-0.9		25.5	
Earnings Yield Russell 2000 Index - US T10y yield (level, 12-mo avg)		-0.5		2.4%	
1.0% Sentiment Signal		Current Value ²		5-yr average value	
VIX (level, 12-mo avg)		-0.3		24.5	
Consumer Confidence Index (level, 12-mo avg)		2.0		103.0	
CCC Ratio (12m Average)		-1.8		14.4%	
Distressed Ratio (12m Average)		0.0		67.7%	
HY Spread Vol (12m Std Dev)		0.0		227.5	
Distressed Trading Activity (12m Average)		3.1		269.4	
C&I Loan Demand (senior loan officer survey, 4q average)		-0.1		10.0	
1.5% Momentum Signal		Current Value ²		5-yr average value	
200 DMA: IG Credit spread (Change from Prior Month: rising = negative, falling = positive)		-0.3		17.9	
50 DMA: IG Credit spread (Change from Prior Month: rising = negative, falling = positive)		0.03		-2.0	
50 DMA - 200 DMA (if 50 DMA>200 DMA, negative)		0.06		-2.0	
		0.03		-2.0	

Data released immediate following month-end, with the exception of LEI (19th), GDP Growth (2 months after quarter), Consumer Confidence Index (24th), All Bull-Bear Spread (24th). In data series with a lag the model looks to the latest available data.

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$2'5 - 10's$ Curve



10's – 30's Curve

