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INVESTMENT COMMITTEE MARKET COMMENTARY

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U.S. EQUITIES

U.S. stocks were down for the second straight week as markets boosted by better than expected earnings from financials, were dampened by comments from Federal Reserve Chairwoman Janet Yellen when she suggested the Fed could overshoot its 2% inflation target, and a strengthening dollar.

a) ***Dow Jones -0.58% MTD -0.90% YTD +6.28%*** b) ***S&P 500 -0.95% MTD -1.55% YTD +6.17%***
c) ***Russell 2000 -1.94% MTD -3.13% YTD +8.01%***

Drivers: I) It may be wise to run a "high pressure" economy with a tight labor market to reverse some of the negative effects of the Great Recession, ***Fed Chairwoman Janet Yellen said last week. In a speech at a Boston Fed conference*** on the "not-so-great recovery," Yellen said a disappointing economy may force economists to think about the economy in new ways. Her comments show ***she is willing to let inflation run a little bit higher than (2%) target for a time and that the Fed is going to err on the side of raising rates too slow rather than too fast.***

II) ***The S&P 500's financial sector rose 0.5% and was the biggest gainer among its 11 sectors last Friday as strong quarterly earnings were reported by the sectors largest companies.*** JPMorgan reported revenues and earnings that topped analyst expectations and similar results came from Citigroup and Wells Fargo.

III) ***Consumer sentiment took a hit as concerns about the presidential election began to weigh, the University of Michigan reported***. ***Its index for early October fell to 87.9 from 91.2, below expectations of a 92.0 reading among economists.*** The sub-index of consumer expectations fell to 76.6, its lowest level in two years, mostly from households with incomes lower than $75,000. The index of current economic conditions was up to 105.5 from 104.2 last month.

IV***) Sales at U.S. retail stores rebounded in September, with auto dealers and gas stations seeing the largest gains***, in a sign consumers are still spending enough to keep the economy on a slow but steady growth path. ***Retail sales rose 0.6% last month to bounce back from a small decline in August that was the first in five months.*** Economists had forecast a 0.7% increase.

V) ***Equity prices in October are mostly lower with Large-Cap, Value and Financials leading equity price performance. The laggards for the month are Small-Cap and Growth Stocks, Healthcare and Materials.***

Capitalization: ***Large Caps -1.65%*** (YTD +6.14%), Mid-Caps -2.66% (YTD +7.33%) and ***Small Caps -3.10%*** (YTD +8.01%). Style: ***Value -2.19%*** (YTD +13.10%) and ***Growth -2.27%*** (YTD +7.68%). Industry Groups (Leaders): ***Energy -1.12%*** (YTD +18.05%), Telecommunication -2.12% (YTD +15.09%), Utilities -2.52% (YTD +13.02%), Consumer Staples -0.65% (YTD +12.20%), Technology -0.83% (YTD +12.13%), Information Technology -0.84% (YTD +11.85%), Consumer Discretionary -1.50% (YTD +8.57%), ***Materials -2.98%*** (YTD +8.06%) and ***Financial Services +0.58%*** (YTD +1.86%). (Laggards): ***Healthcare -3.41%*** (YTD -1.66).

EUROPEAN EQUITIES

The MSCI Europe index was lower last week falling -1.44%. European equities were lower last week despite the fact that bank shares rose and mining stocks got a lift from upbeat inflation news out of China.

Drivers: I) ***European bank shares rose, with Banca Popolare dell'Emilia Romagna*** up 5.2% last Friday. ***The Italian lender has sold a 618 million-euro portfolio of bad loans***, Reuters reported, and it will hold a shareholder vote this weekend on a ***proposed merger with Banca Popolare di Milano PM*** whose shares rose 6.1%.

II) ***U.K. sales rose 1.3% in September from the year-earlier period***, according to data from the British Retail Consortium and KPMG on Tuesday. ***September saw the consumer confidence index restored to levels seen before the EU referendum in June*** which did translate into a willingness to spend on bigger ticket items. But there is ongoing volatility in retail spending, it said, "reflecting "longer- term economic headwinds as retailers begin to seek to mitigate the impact of higher import costs due to the fall in the value of the pound."

III) ***Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index fell -1.44% for the week (MTD -2.78% YTD -2.78%).***

ASIAN EQUITIES

Asian equity markets were lower for the week as China's prolonged industrial deflation finally came to an end in September, pointing to improved operating conditions for factory owners. The Dow Jones Asia Pacific Index was down -1.80% for the week, (MTD -1.24), (YTD +4.77%).

Drivers: I) ***China's long battle with industrial deflation turned a corner last month as a gauge of prices for factory output turned positive for the first time in more than four years. China's producer price index edged up 0.1% in September*** from a year ago, the government reported Friday, marking the first time the index was positive in 54 months. The uptick into positive territory will likely give a boost to profits and operating conditions for hard-pressed manufacturers, whose struggles have weighed on the overall economy.

II) ***Japan posted its largest current account surplus for the month of August since 2007***, the finance ministry said Tuesday, as an improvement in the trade balance on lower import prices inflated the overall figure. ***The surplus in the current account, the broadest measure of Japan's trade with the rest of the world, stood at Y2.001 trillion in August*** before seasonal adjustment, the data showed, up 23% from a year earlier.

III) Performance of Asian Indexes for the week, month-to-date and year-to-date. ***The Nikkei was lower by -0.02% (MTD +2.47% YTD -11.44%), the Hang Seng Index fell by -2.59% (MTD +0.21% YTD +6.02%) and the Shanghai Composite advanced by +1.97% (MTD +1.01% YTD -13.43%).***

FIXED INCOME

Treasury yields for long-term bonds rose last Friday pushing them to their highest levels in four months, after Federal Reserve Chairwoman Janet Yellen suggested there may be benefits in letting inflation run higher than the current target of 2% in order to stimulate the economy.

Performance: I) ***The 10-year Treasury was higher last week ending at 1.801% up from 1.722%. The 30-year yield rose last week advancing from 2.456% to 2.561%.***

II) ***Performance for the week, month-to-date and year-to-date. Barclays US Aggregate Bond was up +0.09% last week, MTD -0.42% and YTD +5.33%. The Barclays US MBS TR was flat at +0.00% last week, MTD -0.21% and YTD +3.52%. The Barclay's US Corporate HY Index rose by +0.08%, MTD +0.64% and YTD+15.92%.***

COMMODITIES

The DJ Commodity Index was higher last week by +0.65% rising from 265.57 to and is up month to date +1.29% (YTD +10.58%) propelled by a recovery in agriculture and the continued rise in energy prices.

Performance: I) ***The price of oil was higher last week by +1.55%*** climbing from $49.55 to $50.32 and is up month to date +4.72% (YTD +23.61%). ***Oil rose for a fourth consecutive week, as traders fixated on a decline in U.S. crude production for the lower 48 states*** to a level not seen in more than two years.

II) ***The ICE USD Index***, a gauge of the U.S dollar's movement against six other major currencies, ***was positive rising +1.67%*** from 96.48 to 98.09 for the week (MTD +2.80% YTD -0.61%). ***The USD was higher for the week, posting its sharpest weekly advance in almost a year as expectations for an interest-rate hike by year's end continued to increase.***

III) ***Gold was lower last week as the U.S. dollar rose on upbeat retail sales data, which put some pressure on dollar-denominated precious metals prices.*** For the week gold was lower by -0.55% declining from $1258.6 to $1251.7 (MTD -5.09% YTD 17.92%).

HEDGE FUNDS

Hedge funds returns in October are primarily lower with the core strategies Distressed and Relative Value positive while Equity Hedge, Event Driven and Macro are in negative territory

<u>Performance</u>:

I) The HFRX Global Hedge Fund Index is lower at -0.34% MTD and +0.99% YTD.

II) ***Equity Hedge has fallen -0.30% MTD and has fallen -0.98% YTD.***

III) ***Event Driven is down MTD -0.43% and is up YTD +6.70%.***

IV) ***Distressed Debt is higher at +0.28% MTD and is positive YTD +13.87%***

V) ***Macro/CTA has fallen by -0.81% MTD and is down -1.95% YTD.***

VI) ***Relative Value Arbitrage is higher at +0.03% and is down -0.22% YTD.***

ECONOMIC DATA WATCH AND MARKET OUTLOOK

As we head into next week, investors will be keeping a close watch on the S&P 500's operating profit margins which hit record levels in 2014 and have declined slightly since. Profit margin measures how much of every dollar in sales a company gets to keep in earnings. In other words, the more companies are able to control their costs, the higher their bottom line.

If large U.S. corporations manage to beat earnings estimates by a few percentage points this time around, instead of the -2% projected decline we will see the first positive earnings growth in five quarters, and the first revenue growth since the end of 2014. The earnings outlook for the S&P 500 for the next year is fairly optimistic. According to FactSet, consensus expectations are for 13% earnings growth year over year.

But, importantly, how 2017 earnings perform assumes that profit margins will resume their climb. According to Yardeni Research Inc., ***trailing fourth-quarter average operating profit margin at the end of the second quarter were 10.3% and net margins were at 7.7%. However, there are on-going concerns as record-high profit margins have been facilitated by low interest rates and stable labor costs***. This enabled companies to spend higher and higher proportions of cash flows on [share] buybacks and dividends instead of growing their businesses. Ultimately this is not sustainable.

On the economic data front, the latest US CPI report will be released on Tuesday October 18th at 08.30 EST. The most likely outcome is that the Federal Reserve will raise interest rates in December and will look to maintain a very slow pace of tightening. There is, however, an increasing risk that the bond markets will react negatively if there is evidence of a significant increase in inflation. 10-yields are already at four-month highs and the sentiment surrounding bonds remains much more cautious. ***The latest inflation data will, therefore, be very important in assessing underlying trends within the economy and the bond-market reaction will be crucial.***

Headline consumer prices fell 0.2% in the October 2015 release and there is, therefore, a strong probability that there will be a significant upward move in the headline annual inflation rate for this month.

The ECB will announce its latest policy decision on Thursday October 20th at 07.45 EST. Bank President Draghi will hold his regular press conference 45 minutes later. ***This will be an important meeting for the ECB, especially as there is only one further meeting in 2016***. There will be an ***important focus on the bond-purchase program, which is currently due to come to an end in March 2017, although the ECB has stated that it will be extended if necessary.***

Since the previous meeting, there have been reports that the ECB is close to a consensus on the need to taper bond purchases before the program comes to an end. There have also been reports that the bank could consider a temporary relaxation of rules, allowing some bonds to be bought with yields below the -0.40% deposit rate, and potentially amending the capital key.