CanterburyConsulting

Quarterly Asset Class Report

Hedge Funds

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March 31, 2016

Role in the Portfolio

Canterbury Consulting recommends and communicates asset-class strategy with the objective of constructing a diversified portfolio of long/short strategies designed to (in aggregate):

(i) Preserve capital and mitigate volatility

(ii) Maintain exposure to a diversified set of securities in global markets

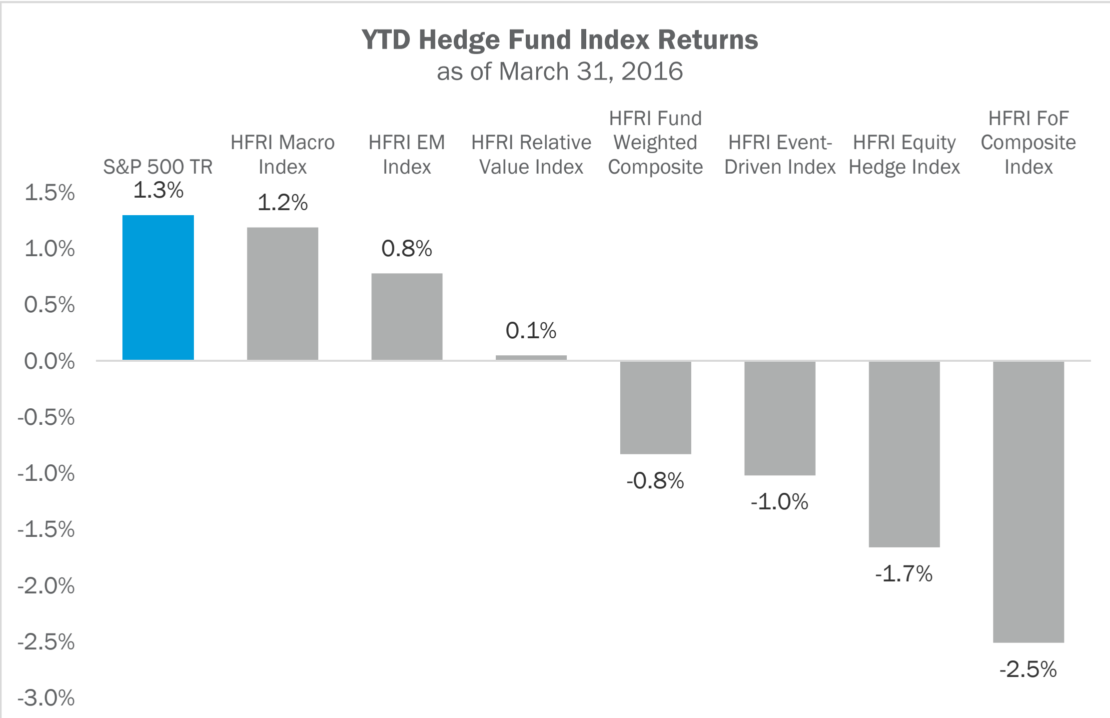
(iii) Exhibit uncorrelated investment returns

Role	Asset Categories	Risks
Growth	Public and Private Equity	Market Decline
Capital Preservation	**Fixed Income, Hedge Funds**	**Rising Interest Rates, Highly Correlated Markets**
Inflation Protection	Real Assets: Real Estate, Commodities	Deflation

- Canterbury Consulting recommends a diversified mix of long/short equity, long/short credit and multi-strategy managers for client portfolios. We depend on managers with strategies that rely upon superior security selection and portfolio management, not leverage or quantitative models, to generate performance
- Short term returns from Canterbury hedge funds may act differently than broad market indices, but they should generally protect from losses in negative markets and participate with the gains of positive markets
- Over a full market cycle, Canterbury hedge fund portfolios are expected to produce market-like returns with a significantly lower volatility profile

First Quarter 2016

Hedge Fund Review



Source: HFRI

- Q1 performance was mixed across the board primarily a function of macro and technical risk factors driving asset class performance
- Global equity and credit markets were very volatile in Q1 due to Fed policy uncertainty and global growth concerns
- Credit markets ended Q1 flat as they reversed first half weakness in mid-February after evidence of central bank policy coordination on currencies and monetary easing
- Macro hedge funds were best positioned to take advantage of the opportunity set at the expense of fundamental equity strategies
- In Q1, large-cap and value-oriented businesses modestly outperformed smaller cap and growth-oriented peers
- Among S&P 500 sectors, Utilities, Telecom, and Consumer Staples outperformed hedge fund heavy counterparts including Healthcare, Consumer Discretionary

- Slower global growth and a low return environment continues
  - GDP forecasts continue to be revised downwards with the Atlanta Fed Q1 GDP forecast at 0.1% as of April 8th, well below trend and reinforcing the vulnerability of the U.S. economy
  - Meanwhile, Quantitative Easing policies are in full effect in Europe and Japan, creating an environment where liquidity is abundant but fundamentals are not on strong footing
  - Convergence in monetary policy – Fed lowered its forecast of interest rate hikes to 2 from 4. The path continues to be biased towards dovishness as opposed to hawkishness
- Higher volatility has been a negative this quarter
  - Dispersion among business sectors and outperformance of lower quality businesses has led to an underperformance in the near term and negative alpha generation, much of it a reversal from last year
  - Utilities and Consumer Staples were the best performing sectors and were under-owned by most managers, adding to performance woes
  - If the macro environment were to change dramatically, managers remain nimble to adjust exposures and protect capital
- Late cycle positioning
  - As the business cycle extends into the later innings, managers are positioning portfolios accordingly, especially on the credit side, waiting for dislocations before adding risk
  - Market returns in credit and equities have shown a deceleration over the past three years which provides good opportunities to take calculated superior risk adjusted bets with a focus on the long term

Canterbury recommends a diversified mix of long/short equity, long/short credit, and multi-strategy managers. We expect positive absolute and relative returns from hedge fund strategies as the market headwinds that have accompanied this prolonged rally dissipate

- Hedge fund managers and Canterbury expect markets to experience volatility with greater frequency during the remainder of 2016 which should create long and short opportunities across equity and credit securities
- Long/short equity managers are well positioned, due to higher volatility in equity markets, to better take advantage of the opportunity set despite a setback in the first quarter
- Canterbury expects the opportunity set for distressed managers to pick up later in 2016 or towards the start of 2017, especially within the energy sector
- Historically, rising rate environments have favored actively managed investment strategies. Falling rates have supported positive market returns, but with interest rate hikes in the not so distant future, Canterbury is focused on recommending exposure to a diversified line-up of managers that can generate alpha through portfolio management and superior security selection
- Canterbury expects managers who excel at exposure management, security selection and position sizing to outperform benchmarks in a market with increased volatility and dispersion of investment returns
- Canterbury recommends that clients keep their hedge fund allocations at target weights with an even split between long/short equity and multi-strategy/credit hedge funds