CanterburyConsulting

Quarterly Asset Class Report

Hedge Funds

September 30, 2016

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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):

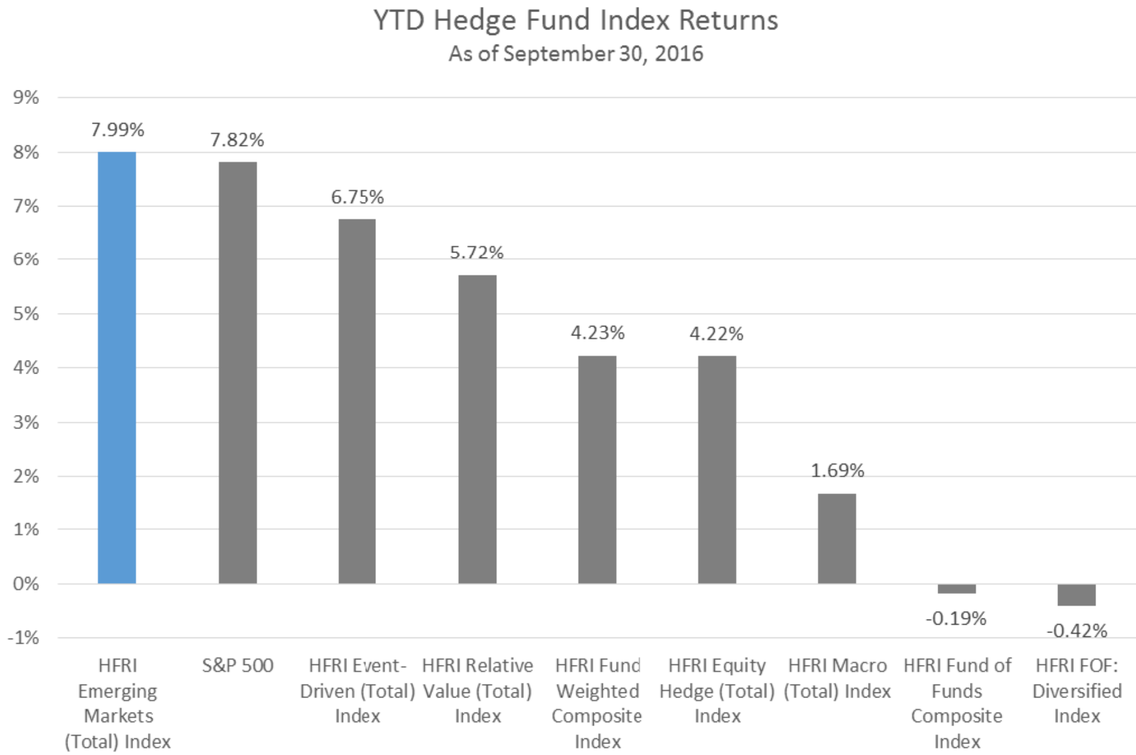
(i) Preserve capital and mitigate volatility

(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



Source: HFRI

- During the third quarter, we saw a rebound in hedge fund performance, driven by alpha generation by Emerging Markets, Long/Short Equity, and Event-Driven; other major HFRI indices, including the Relative Value and Fund of Funds Composite, were up more than 2%
- The only detractor was the HFRI Macro Index (-1.1%)
- The Emerging Markets Index generated 5.1% in the quarter, and our global managers with emerging-markets tilt benefited from strong performance
- Event-driven, distressed debt funds experienced major catalysts in their core holdings in the form of large distributions and capital appreciation
- Long/Short Equity funds experienced strong performance on the long side, primarily driven by the post-Brexit rebound in the information technology and consumer discretionary sector

Drivers of Performance

- Reversion to fundamentally-driven markets from technically-driven markets
  - Quantitative Easing policies are in full effect in European and Japanese markets taking yields in many countries into negative territory
  - This caused low-volatility, high-dividend stocks that are underfollowed by hedge funds to outperform growth-oriented, high-quality stocks during the first half of 2016
  - The reversal occurred in the third quarter after Brexit and many of fundamental investment theses have played out, especially on the long side
- More uncertainty amid presidential election
  - We expect the markets to experience volatility depending on the outcome of the presidential election
  - We may experience an elevated level of volatility in currency-sensitive names
- Credit and Multi-Strategy lead
  - After a period of trailing other strategies, credit and multi-strategy funds have performed well this year, generating uncorrelated returns despite volatility in the markets
  - Energy bonds recovered from a challenging year in 2015 as oil prices rebounded from historically low levels
  - Although this year's credit performance is strong, many credit managers are cautious of allocating capital to new situations due to the late-stage credit cycle

Canterbury Consulting 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 Consulting expect markets to experience volatility with greater frequency in 2016 that will create long and short opportunities across equity and credit securities
- Long/short equity returns could outperform multi-strategy managers as well as long/short credit managers for an extended period. This is a reversal from the longer term trend and the year to date trend, but we believe that this could persist for some time going forward due to the lack of distressed credit and special situation opportunities
- Historically, rising rate environments have favored actively managed investment strategies. Falling rates has supported positive market returns, but with interest rate hikes in our 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
- A market environment with a heightened level of volatility and a higher dispersion of return would provide more opportunities for managers to outperform through active security selection and management of overall exposures.
- 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