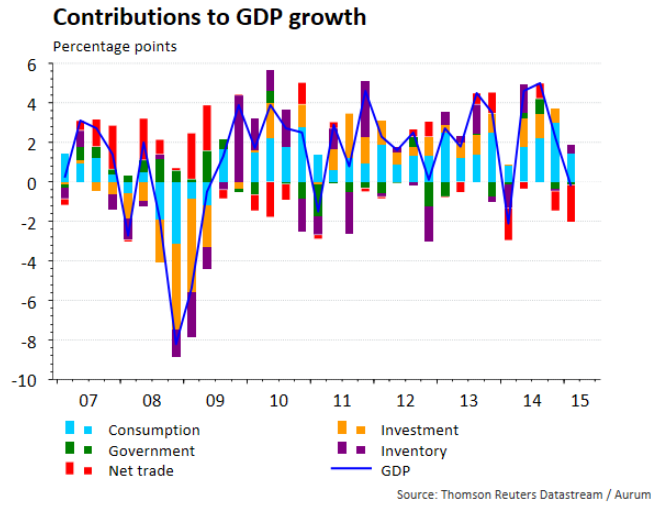
AURUM

Strategy Newsletter
3rd Quarter 2015

- Parsing through the U.S. economic data shows strength, though less so abroad.
- Japan quietly leads global equity market performance.
- Bond yields rose during the quarter while managers see value in CMBS.
- Are the winds changing for alternative managers?

Economy

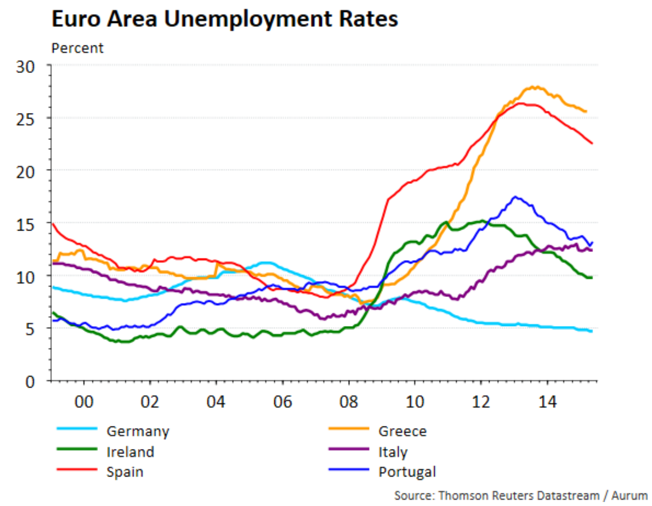
Yes, the U.S. economy contracted slightly in the first quarter. The second straight extremely harsh winter hurt growth along with a drop in exports due to the strong U.S. dollar.



The coincident data we follow shows strong retail sales, employment gains, with slightly lower production. Add this all up and the data today indicates a slim chance of the U.S. economy being in a recession (since two consecutive quarters of negative GDP technically is a recession).

Abroad is a different story. After Greece voted "No" to accepting harsh austerity measures from the European Central Bank, the chances of the country leaving the Euro currency system increases. Many feel Greece never should have been allowed into the Euro since it fudged the numbers of its national accounts upon its inception. Yet the Euro is not about fundamental data, it is about politics, and whether Greece stays or goes will depend on how much responsbility the creditors who loaned Greece the money want to take and the pain the Greek people can withstand.

The unemployment rate in Greece is comparable to the U.S. Great Depression of the 1930s at 25%. Though the silver lining is that unemployment is trending downwards.



Turning to China, the parabolic rise of the stock market and subsequent 30% fall still leaves it 100% higher than one year ago. The authorities followed a classic playbook of blaming short sellers and stepping in with their own capital, which usually results in more downward price pressure.

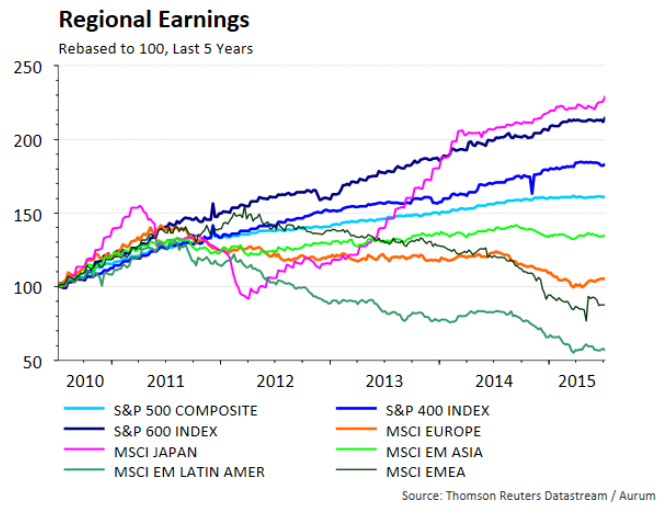
The issue is that many Chinese citizens were brought into the frenzy of playing the stock market, with margin loans no less. The steep decline will affect consumption growth going forward. This is not a great time for a slowdown since the authorities are trying to bring Chinese consumption up from 45% of GDP (for comparison in the U.S., consumption makes up 70% of GDP).

Equity

For the second quarter in a row, international markets broadly outperformed the U.S., though sector leadership across regions was quite similar. Healthcare and technology tend to be leaving others in the dust, especially the 'old economy' areas of industrials, energy, and materials.

US Equity	2Q 2015
Large Cap Stock	
Dow Jones Industrial Average	-0.29%
S&P 500	0.28%
Small & Mid Cap Stock	
Russell Mid Cap	-1.54%
Russell 2000	0.42%
Style Indices	
Russell 3000 Value	0.00%
Russell 3000 Growth	0.27%
International Equity	**2Q 2015**
MSCI EAFE	0.84%
MSCI EAFE Value	0.48%
MSCI EAFE Growth	1.19%
MSCI Europe	0.68%
MSCI Japan	3.12%
MSCI Emerging Markets	0.82%

This quarter we examine the earnings growth across regions over the last five years. It is arranged with U.S. large, mid, and small caps represented in shades of *blue* and reported steady growth across market capitilzations.



The *pink futia* line jumps out for its rough ride down and then up the last few years for Japan, while Europe's *orange* line is relatively flat to down. Shades of *green* represent different emerging markets regions. Latin American emerging markets watched earnings fall by over 40% the past few years, as slower demand from China for natural resources and more recently lower oil prices detracted from the bottom line. Emerging markets in Asia grew relatively steadily over the past few years thanks to strong results out of China, Indonesia, and India.

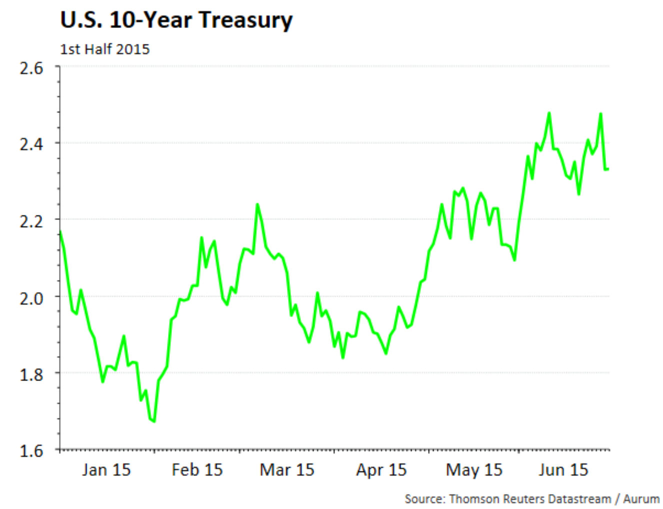
Portfolios maintain the target weight to equities while tactically holding an overweight to emerging market countries and underweighting U.S. small cap stocks on the basis of cheaper valuations.

Fixed Income

Bonds gave back the first quarter gains and then some during the second quarter.

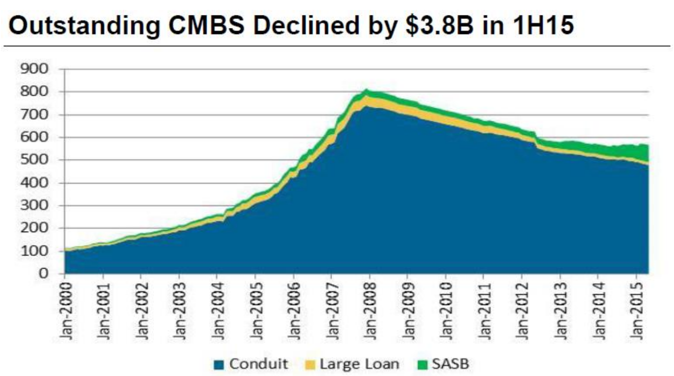
Fixed Income	2Q 2015
Barclays U.S. Aggregate Bond	-1.68%
Barclays Corporate Inv. Grade	-3.16%
Barclays High Yield Bond	0.00%
Barclays Global ex. U.S. Tres.	-1.46%
Barclays Municipal Bond	-0.89%

The benchmark 10-year yield began the year at 2.17%, fell to 1.67% in the first week of February, then marched higher for the last five months, closing the quarter at 2.33%.



One area we see our fixed income managers increasing allocations is to Commercial Mortgage Backed Securities [CMBS]. CMBS are loans of all different types of commercial properties (from office, multi-family, industrial, and even mobile home parks), packaged into one security that pays back interest and principal.

The last real estate cycle watched CMBS climb to over $800 billion in total assets. It declined steadily ever since as many loans were not able to find refinancing.



Source: Morgan Stanley Research

With few opportunities in traditional bonds and yields in the mid-single digits, our managers see value with greater sector exposure to CMBS in portfolios.

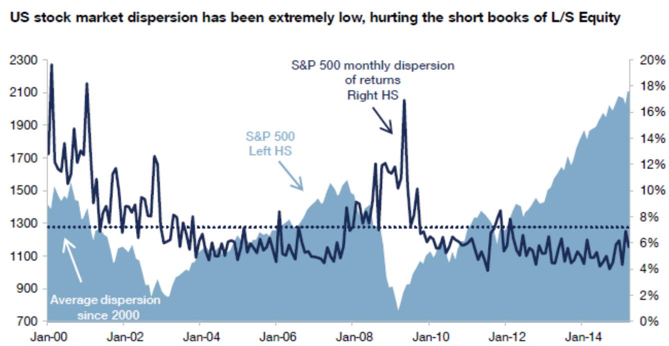
The Aurum Asset Allocation Frameworks maintain fixed income allocations near strategic targets after we added to current managers during the quarter.

Alternative Investments

Hedge fund strategies outperformed for the second consecutive quarter while the interest rate sensitivity of REITs [Real Estate Investment Trusts] and TIPS [Treasury Inflaiton Protected Securiteis] led to a fall in prices for both asset classes around the globe.

Alternative Assets	2Q 2015
HFRI Hedge Fund of Funds	0.10%
Dow Global Select REIT	-7.67%
Barclays TIPS	-1.06%

Lyxor, a large hedge fund of funds, recently published a whitepaper discussing the struggles of hedge fund strategies the last few years after prior decades of outstanding performance. Reasons cited included low interest rates, low volatility, and low stock dispersion (chart below).

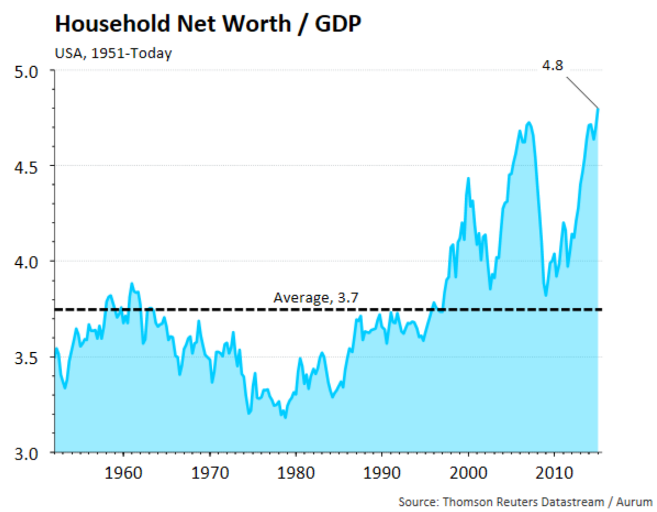


Source: Lyxor Research

Diversified alternative strategies drew an increasing share of portfolio assets as we added a new strategy which we categorize as a combitnation of relative value and macro. It seeks to exploit four factors (value, momentum, carry, and defensive) across all asset classes on a long/short basis.

Conclusion

There are major issues with the European monetary system along with China's transitioning economy and volatile stock market that grabbed headlines. However, the datapoint that is concerning for portfolios in the long-term is below.



This is the U.S. Household Net Worth divided by GDP ratio, which averaged 3.7 since 1951, 4.2 over the last 20 years, and sits at an all-time high of 4.8 today. In the early 2000's we had the tech bubble, in the mid-2000's we had a real estate bubble, and today we have stocks, real estate, and bonds at all–time highs driven by extremely accommodative Fed policy. There is no reason this ratio cannot go higher, as the argrument for this expansion lasting longer than normal is intriguing with little inflation and merely okay economic data precluding a true tightening cycle. Yet all that asset classes seem to be doing is borrowing from future returns and at some point the direct line higher will be challenged.

Aurum Asset Allocation Frameworks

	Conservative Income		Conservative Balanced		Moderate Balanced		Aggressive Balanced		Aggressive Growth	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Equity	0%	0%	20%	20%	35%	35%	50%	50%	70%	72%
U.S. Equity	0%	0%	12%	8%	20%	14%	30%	22%	42%	35%
Int'l - Develop. Markets	0%	0%	6%	6%	12%	12%	16%	16%	21%	21%
Int'l - Emerg. Markets	0%	0%	2%	6%	3%	9%	4%	12%	7%	16%
Fixed Income	65%	60%	45%	42%	30%	30%	17%	18%	10%	10%
U.S. Fixed Income	56%	57%	39%	39%	26%	27%	15%	15%	7%	8%
Global Fixed Income	9%	1%	6%	1%	4%	1%	2%	1%	3%	1%
Alternative Invest.	25%	28%	28%	28%	30%	28%	30%	28%	19%	18%
Diversified Strategies	19%	28%	22%	28%	24%	28%	24%	28%	15%	18%
Real Estate & REITs	2%	0%	2%	0%	3%	0%	3%	0%	4%	0%
Inflation-Indexed Sec.	4%	0%	4%	0%	3%	0%	3%	0%	0%	0%
Cash/Equivalents	10%	12%	7%	10%	5%	7%	3%	4%	1%	1%
U.S. Dollar	10%	12%	7%	10%	5%	7%	3%	4%	1%	1%

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.

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