



QUARTERLY OUTLOOK – Q3 2015



Edge Capital Research

Q3 2015 Outlook

Confidential

July 2015

Investors want certainty when it is hard to find

Market sentiment turned very sour as we exited the second quarter and this sentiment persisted through early July. Time and time again, the Greek debt crisis reached a point journalists called the end of the road, only to see no resolution of any kind. In fact, debtors and creditors seemed to move farther apart post an impromptu referendum in which the population was asked to vote on a complicated and technical issue that they were given no time to understand. At the same time, the meteoric rise of the Chinese market opened primarily to locals came crashing down. Daily intervention by central policy makers failed to stem the flood of selling by over-leveraged, under-experienced investors. Again, journalists found fodder to call the end of days for the second-largest economy in the world based on the wild gyrations of the underdeveloped financial market. And if that were not enough, the United States also showed that trading halts are not something only for emerging markets. A technology glitch from a software upgrade caused the venerable New York Stock Exchange to stop trading for several hours, demonstrating just how vulnerable exchanges can be on any given day.

With so many uncertainties peaking at the same time, it is little wonder we saw global growth-related assets fall off. Equity markets sold down to varying degrees, with the U.S. preserving capital well relative to non-U.S. counterparts. Oil prices fell 15% in less than a week and copper prices followed suit. Financial contagion was on the lips of investors, once again fighting the last war they did not anticipate - the impact of subprime debt on the global banking system in 2007 and 2008. It seems only appropriate to say the financial markets are in a mood of wait and see. "Show me the money!" they say. Will Europe succumb to the moral hazard of Greece desiring to vote itself a better negotiating position? Will the Chinese equity market decline cause political unrest in China or disrupt the fragile transformation of growth drivers toward consumption? Will the fall of oil prices cause mass defaults in the energy industry and jeopardize the volume growth we have seen? Will the Fed act too quickly to raise rates in these tenuous conditions and create a down-leg into the next economic cycle? Will earnings growth be sufficient to justify valuations?

On the following pages, we will detail our outlook to these and other questions. We will also explain why, in our opinion, the depression of sentiment weighed upon by uncertainty will lift. It will take time for the facts to reveal themselves, but as they do we expect our core investment themes to perform well. If history is any guide, by then the market attention will have moved on to the next wall of worry to climb.



In his depiction of sports agent Jerry Maguire, Tom Cruise placates his superstar client, Rod Tidwell (played by Cuba Gooding), who requests that Jerry "show me the money" in his attempt to secure a new sports contract.

Jerry Maguire was one of the top-grossing films in 1996, pulling in \$275 million. Tom Cruise was nominated for an Oscar for Best Actor while Cuba Gooding won the Oscar for Best Supporting Actor. Source: Wikipedia

Expect stronger economic growth in quarters ahead

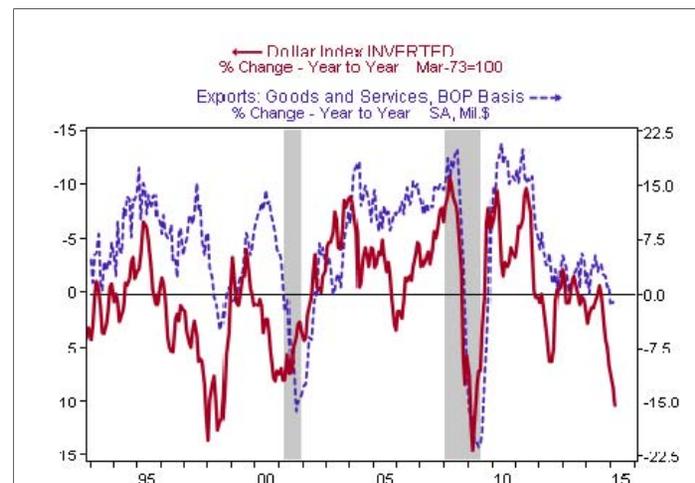
Several headwinds impacted economic growth in Q1, and we believe these will subside as we move into the second half of the year. For starters, energy capital expenditures declined at nearly a 50% rate. This has happened only five other times in the past, and in aggregate, the energy impact detracted a half point from headline growth in Q1. In addition, the dollar soared 20% year over year in Q1, which has happened only three other times since the gold standard ended in 1971. The dollar's rise negatively impacted U.S. exports. In turn, net export data shaved nearly two percentage points from GDP growth in Q1. If you net the oil and dollar impact, the U.S. economy was estimated to expand by 1.7%.

With recent revisions included, real Q1 GDP now stands at -0.2% quarter over quarter. More recent data suggests an acceleration in economic activity. Continued strength in the housing sector suggest upward revisions in GDP estimates for Q2. While the dollar will be an ongoing headwind for American exports, the resumption of activity at the West Coast ports should provide a boost to economic growth in Q2. Excluding the effect of the West Coast port strike and the unusually harsh winter, we see a trend of real GDP growth getting back to 2.5% to 3%.

The June jobs report could be described as a mixed bag, coming in at 223,000, slightly under expectations of 233,000. Given the seasonal factors that are typical in June as a result of the school year, we incorporate the moving average into our analysis and see a rate of job growth that portends a further decline in the unemployment rate. The three-month moving average for job growth is 221,000, consistent with the Fed's June economic outlook. Wage growth showed no change in June, leaving the year-over-year rate at 2%. This should keep inflation concerns at bay for the near term, although we would watch this figure closely. The Fed places a high degree of importance on this measure as a harbinger of inflation pressure and will most likely use it to justify the pace of interest rate increases.

We believe a weak Q1 will prove to be a head fake, and that economic growth will accelerate for the remainder of the year. Improving consumer trends will be a primary driver of this growth acceleration. Consumers' expectations of future economic growth improved in June; consumers expect more jobs over the coming months, and they have begun to recognize the potential for higher interest rates. The Conference Board's measure of consumer confidence rose to 101.4 and is the highest reading since March. Consumer spending also increased 0.9% month over month in May. It looks poised to accelerate in the second half of the year as consumer credit conditions continue to improve. Given that it is still 70% of the U.S. economy, we believe this bodes well for the second half.

Dollar strength led to a decline in exports



Real personal consumption expenditures



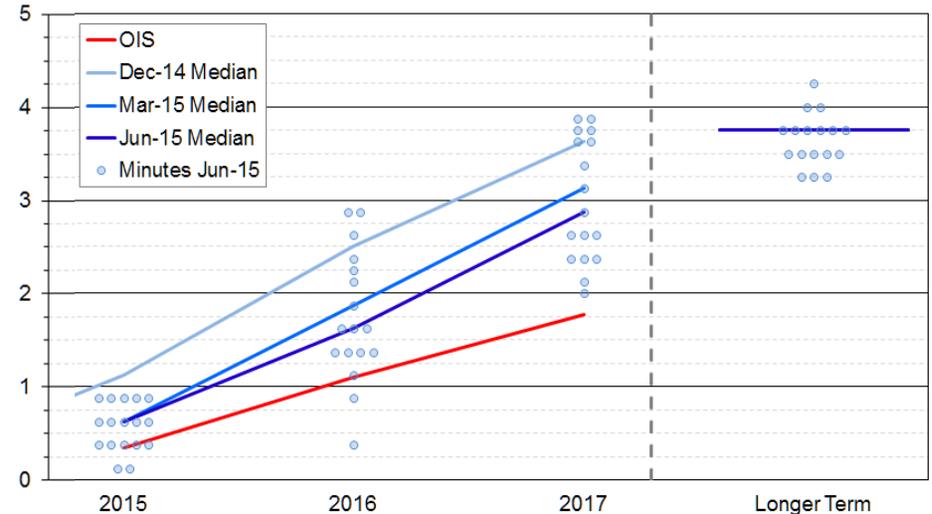
Follow the dotted line

It has been almost 7 years in the making, but it looks like the Federal Reserve is planning on raising the fed funds rate from above zero for the first time later this year. The exact date is still open to market interpretation, but currently fed funds rate probabilities are split evenly between September and December. Reading into the "dots" from the June FOMC meeting indicates a dovish narrative going forward, economic projections were little changed, but the dots moved noticeably lower, with 2016 and 2017 year-end average rate projections decreasing 25 basis points. Seven of the 17 members (only 12 vote on policy and dots are anonymous) expect only one rate increase by year-end, a change from the previously predicated two increases. While the Fed's median year-end rate estimates have been decreasing through the year, as the graph on the upper right shows, the market still expects a lower rate trajectory of rate increases than the Fed at this point. Absent a deterioration in economic data, the Fed has painted itself into a corner and will almost need to raise rates by year-end not to lose creditability with the market.

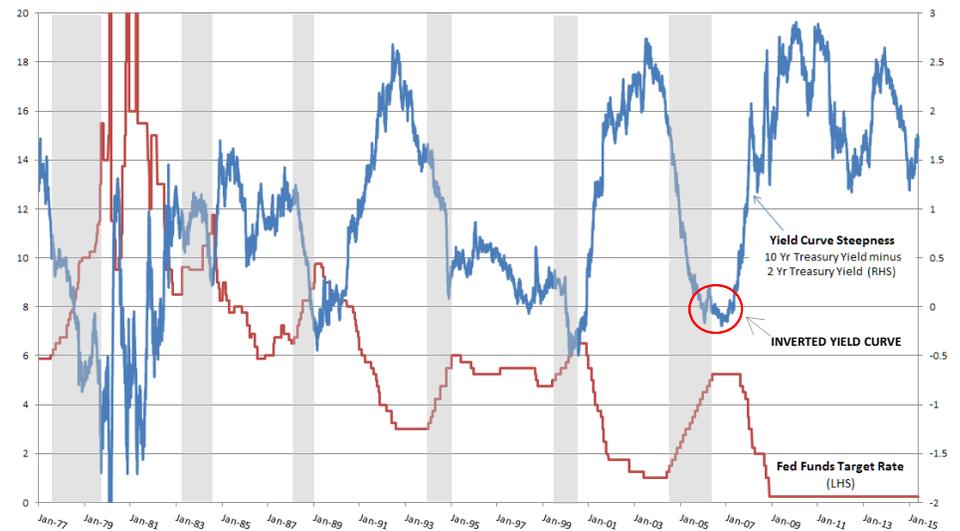
The hangover from this party is likely going to be long lasting. The market almost expects there to be a "pause and wait" mentality where the FOMC might raise rates and then hold steady for a meeting or two before raising again. And do not forget the Fed still owns \$1.96 trillion in Treasury bonds and another \$1.75 trillion in agency mortgage-backed securities and is reinvesting proceeds as they pay down. The Fed will drain those reserves back into the marketplace at the appropriate time, but look for it to be well after the FOMC raises the benchmark rate.

So where does this leave us as global asset allocators? For most investors, bonds of one nature or another play a crucial role in a diversified portfolio, either offensively or defensively. Here is where the rubber meets the road: if the Fed is raising rates because of improving economic fundamentals (which we believe to be the case), then owning credit-sensitive securities (High Yield) should not be entirely scary, and owning securities that adjust upward with interest rates (Floating Rate Loans) should be doubly blessed with rate increases and improving credit fundamentals. If economic fundamentals deteriorate, the Fed will maintain its current policy stance and we will continue to muddle through. The Fed is in a tough spot; it risks raising rates too early and potentially having to reverse course, or it can hold off for longer and potentially stimulate bubbles in the economy and potentially have no bullets for the next crisis. Being in a reactionary mode always puts the Fed behind the 8-ball. Should rates rise too quickly, we could see another inversion of the yield curve similar to what was experienced in 2006.

Fed median estimate continues to move lower



Historically the yield curve flattens as the Fed raises



Sources: Bloomberg

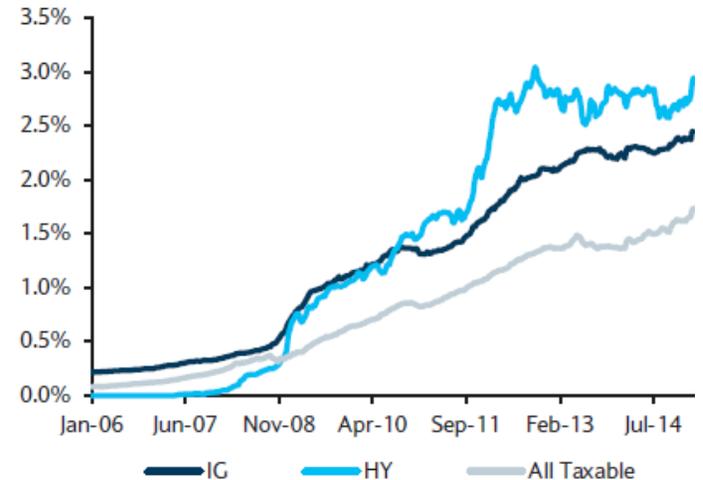
Keep an eye on bond liquidity

The top five corporate bond ETFs have more bonds under management than the current inventory available at all sell-side firms. The recent rise in bond ETFs creates a potential liquidity mismatch between institutional investors that are willing to buy those bonds and retail investors that may want to reduce holdings quickly in the event of a rapid rise in interest rates. Markets had a glimpse of this during the Fed Taper Tantrum in 2013, where the price of certain bond ETFs fell below the net asset value of the bonds they held because of the lack of intraday trading volume. Given the continued growth of ETF bond assets since that time, future volatility episodes may be exacerbated further. This will also create opportunities for those with some dry powder on hand. Several bank CEOs have noted that the recent volatility in bonds is the result of regulations imposed after the last crisis. They point to Treasury bonds, which suffered a so called “flash crash” in October last year, with the yield on the 10-year issue falling by a third of a percentage point within minutes. They also note the recent sharp moves in German bonds. Banks are now required to hold more capital to underpin their bond-trading business, making it less profitable to make a market in bonds. Dealer inventories of corporate bonds have plunged more than 76% since the financial crisis.

Historical fund flow data confirms that it is important for loan funds to have a mechanism to deal with potential mismatches in cash flows. Across the entire loan mutual fund universe, the largest 20-day streak of aggregate outflows in the past four years was 5% of assets under management. This may indicate that cash balances alone are insufficient to cope with outflows in extreme scenarios. Large loan funds have set up revolving credit facilities to prepare for potential periods of mass outflows. Banks are unlikely to reduce revolving credit lines made to large fund management clients, but they may have to charge more for them as a result of new rules that require them to hold more capital against all of their assets. The effort to make banks safer in the wake of financial crisis is now causing mutual fund companies to feel like they are holding the short end of the stick – funds that want to prepare for a bear market in bonds may find it difficult to do so.

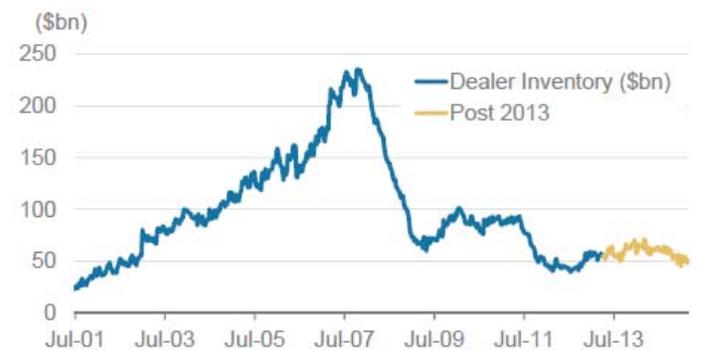
Fortunately, investors in bond funds typically expect bond prices to fluctuate when interest rates rise. Additionally, mutual funds and exchange-traded funds are not the dominant investors in the bond market - around \$1.83 trillion is invested in American corporate-bond mutual funds and another \$160 billion in corporate bond ETFs. Globally, the total amount of corporate bonds outstanding is \$20.5 trillion, according to Thomson Reuters. Corporate debt issuance was \$3.2 trillion last year alone. We would be cognizant of the potential increase in bond market volatility as rates increase, especially in non-investment grade funds. We believe investors should match asset and liability time horizons appropriately and avoid ETFs that target the least liquid areas of the bond market. This would include high-yield, bank loan, and emerging market bond ETFs.

ETF share of corporate fixed income



(1) Source: Bloomberg, Barclays

Dealer balance sheets have shrunk



(2) Source: The Economist, Morgan Stanley, Federal Reserve, Bloomberg

Trough revisions is usually good for equities

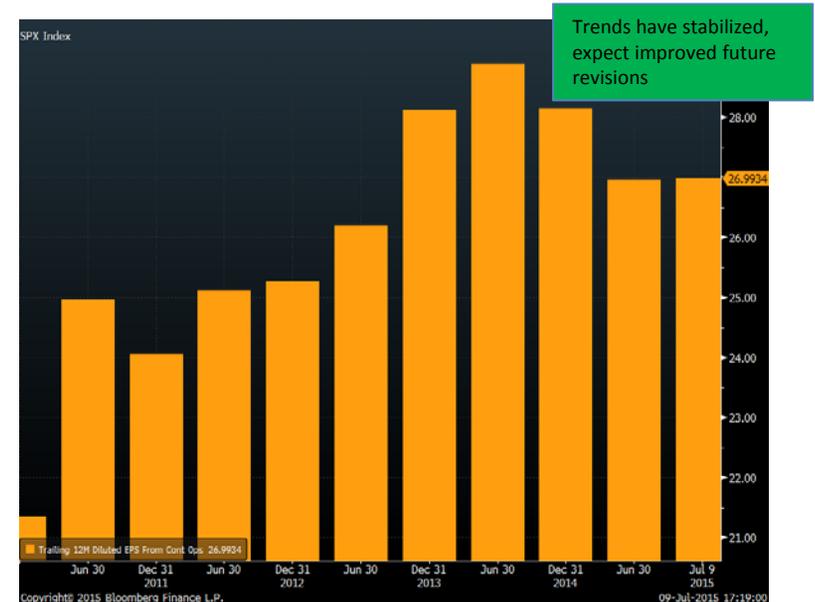
According to Running USA, the official number of finishers in U.S. running events has nearly quadrupled since 1990. While the 5K (3.1-mile race) holds the No. 1 spot in popularity, the marathon (26.2 miles) is also a widespread choice. Even though both challenges fall under the road-racing umbrella, the training and execution strategy is very different for each and presents their own sets of challenges and guidelines. As long-term value investors, we focus on our discipline, which is to buy quality assets at attractive prices. In other words, we train to run marathons but recognize that unlike racing, there is no predefined finish line and we must remain alert to the fact that markets often present short-term obstacles that can impact the run. There were many of these obstacles during the quarter; however, we recommend investors not change their approach and remain focused on the longer goal.

Growth expectations clearly disappointed in Q1, but our view is that factors such as the West Coast port strike, the fall in oil prices, and poor weather artificially dampened the results. In our opinion, during the first half of 2015, downward revisions of earning expectations by the street were overshot. The data suggest that U.S. earnings revisions have toughed and are now trending upward. We find this encouraging because over the past 15 years, when U.S. earnings revisions troughed the equity markets tend to rise over the next few months. The median forward 12-month return has averaged 15.7%.

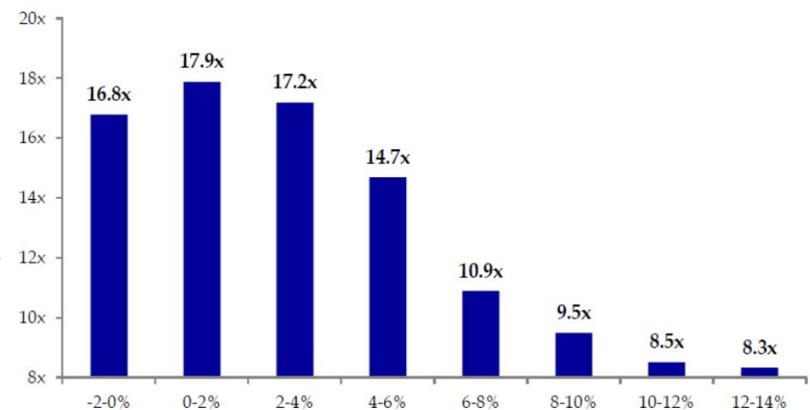
In the context of the inflation outlook in the U.S. and the developed world, there appears to be very little risk for earnings multiples in the short term, barring an unforeseeable event. The trailing 12-month PE multiple for the S&P 500 is around 18x, and while equities are no longer outright cheap on a multiple basis, they have historically served as a good inflation hedge for investors. Looking back 65 years, when year-over-year CPI has been in the -2% to +4% range, S&P average multiples have ranged between 17x and 18x. Our position is that the Fed will be very slow and cautious while raising rates, which is ultimately supportive of current multiples. Growth in average hourly earnings of 4% often precedes recession. Today we stand at 2.04%. With the decline in energy prices and the strength of the dollar, the chances for a lengthened cycle have increased.

We believe U.S. equity markets remain healthy and despite valuation multiples hovering near recent highs, economic data and corporate fundamentals support current levels. In this example, it is clear that investors have been running a marathon with many short-term obstacles, but none to date have been capable of shortening the race. We would also like to remind investors that similar to a second-half runner's pace, we expect forward returns to be more modest when compared with the prior five-year run.

S&P 500 - Trailing 5 quarterly EPS



Avg S&P 500 LTM P/E by CPI tranche (1950 – 2015)



Source: Strategas

Wide dispersion in sector trends, focus on growth

To start the year, operating earnings for the S&P 500 actually *declined* 5.5% on a year-over-year basis. This decline was driven by several factors (previously mentioned), all of which have proved to be temporary (or “transitory” in the Fed’s language).

Despite the poor results, there is plenty to be optimistic about for the back half of the year. Much of the weakness in earnings can be attributed to energy, materials, and consumer staples. The energy and materials sector earnings declined year-over-year, while the consumer staples sector reported flat earnings growth as U.S. dollar strength offset a rebound in European growth. The other seven S&P sectors had positive growth with healthcare, technology, and industrials showing strong results. It is not a coincidence that sectors with the strongest earnings growth posted the best sector equity returns during the first half.

All four of the trends that hurt Q1 earnings have neutralized or even reversed. Oil, which remains choppy at the time of this release, closed the second quarter up 36% from its low, and the dollar fell 6% vs. the euro. Weather has been more seasonal, and the West Coast port situation has been resolved. Earnings estimates may have been cut too far and could be revised upward.

Looking ahead, earnings are expected to increase a modest 2.3% for 2015 – a key reason why we would like to remind investors that equity market returns are likely to be positive this year but modest. When earnings growth is combined with dividend yield, we are estimating a mid-single-digit return for U.S. equities in 2015. As we have just discussed, however, specific sectors, such as technology and healthcare are capable of generating higher returns for equity investors. As always, selectivity is key, both at the sector level and across various geographies – many of which offer stronger earnings growth and lower valuations than their U.S. counterparts.



Sector returns follow EPS- eventually

S&P 500 Sector	Year/Year Est. EPS Change	1H 2015 Performance
Health Care	26.3%	9.6%
Consumer Discretionary	8.8%	6.8%
Telecommunication	58.5%	3.2%
S&P 500	2.3%	1.2%
Information Technology	12.4%	0.8%
Materials	-0.1%	0.5%
Financials	5.8%	-0.4%
Consumer Staples	2.4%	-0.8%
Industrials	7.1%	-3.1%
Energy	-67.2%	-4.7%
Utilities	3.7%	-10.7%

Q2 reversal= tailwind for earnings



Source: Bloomberg

The last shall be first...

One of the few relative certainties in investing is that performance tends to be mean-reverting over time. We are currently seeing this phenomena in global markets, where the U.S. has become a laggard for the first time in several years.

Over the past 3 years, the S&P 500 has returned 8% per year more than the MSCI ACWI ex-U.S. Index. Over this period, S&P 500 earnings have grown but have not kept pace with share price gains, resulting in valuations that are higher in the U.S. than in most international markets. The Edge valuation process is grounded in identifying future return opportunities by purchasing fundamentally attractive assets at lower current valuations. This discipline led us to increase our international equity weightings, mainly our exposure to Europe and Asia in late 2013 and throughout 2014. The benefits of international diversification were muted in 2014; however, our investors are now reaping the rewards of that decision as improving fundamentals in non-U.S. markets are generating higher equity market returns in 2015.

The good news is that we expect this trend to persist. In late June/early July, Greece headlines and China volatility caused a reversal in flows back to the U.S. but we urge investors to stay the course internationally. Neither of these events will erode the growth story. We continue to recommend investors look outside the U.S. (specifically Europe and Asia ex-Japan) for a portion of their growth investments.

Most recent investor inquiries are centered on Greece and the risks of a eurozone Grexit; however, we remind them that the biggest risk to equity portfolios is not Greece but rather current growth expectations. For foreign markets to maintain investor capital, companies must deliver on results. The "show-me" story is strong and investors want to see earnings growth from their companies in order to justify both the shift in capital away from U.S. markets and current market valuations.



Asset class comparison: first half 2014 versus 2015

Asset Class/Category	1H 2014	1H 2015	Difference
European Equity (Bloomberg 500- EUR)	6.5%	12.6%	6.1%
Crude Oil (WTI)	7.1%	11.6%	4.6%
US Small Cap Equity (Russell 2000)	3.2%	4.8%	1.6%
Long-Short Equity (HFRX Equity Hedge)	1.3%	2.2%	0.9%
Developed International Equity (MSCI EAFE)	5.2%	5.9%	0.8%
Asia ex-Japan (MSCI)	6.3%	5.5%	-0.8%
International Equity (MSCI ACWI ex-US)	5.9%	4.4%	-1.5%
European Equity (Bloomberg 500- USD)	5.7%	3.8%	-1.9%
Dow Jones Indus. Avg.	2.7%	0.0%	-2.6%
US High Yield Bonds (Barclays High Yield)	5.5%	2.5%	-2.9%
Emerging Markets (MSCI)	6.1%	3.1%	-3.1%
US Bonds (Barclays Aggregate)	3.9%	-0.1%	-4.0%
S&P 500	7.1%	1.2%	-5.9%
Gold	10.1%	-1.1%	-11.1%
Commodities (Thompson Reuters CRB)	10.0%	-1.2%	-11.2%
Latin American Equity (MSCI)	7.4%	-6.2%	-13.6%
MLPs (Alerian)	16.3%	-11.0%	-27.3%



We highlight MLPs as an asset class which has struggled due to fears over a slowdown in growth related to lower oil & gas production. On a Price/Discounted Cash Flow basis, the Alerian Index trades below its 5-year average, offering a valuation opportunity for investors that have been under-invested in the sector.

Source: Bloomberg

European recovery fragile but stay the course

European equity investors rode through the first half of 2015 largely unscathed until the final days of the quarter when the Greece tragedy once again erupted. We thought surely this time investors would look through their well-documented fiscal inabilities – as a reminder from two economists well versed in Greek history, the country has defaulted on its repayments during 50% of the years since 1800. Despite the checkered history, the recent IMF loan default was enough to cause a short-lived global meltdown during the final week of the quarter. Through early July, the crisis continues to be fluid with most economists estimating a 50/50 probability of Greece retaining its euozone membership. Regardless of the headlines, we believe Greece's fiscal challenges do not pose a meaningful threat to the broader eurozone and therefore assess the risk of contagion to other members as low.

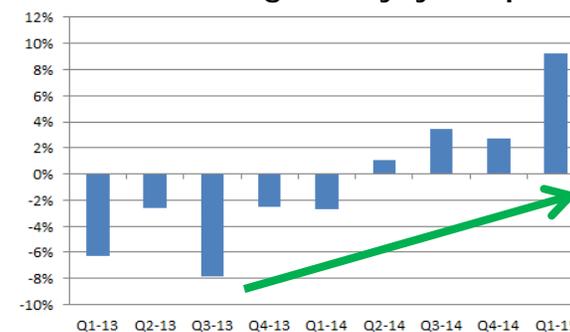
Between Greek defaults, investors should focus on the broader eurozone and the continuation of an economic recovery, albeit fragile, that started in 2014. We concede that the "recovery" remains tepid and elusive at times (Q1 for example) with not all actors participating at the same time. For example, Spain's Q1 GDP growth (0.9%) was stronger than Germany's (0.3%). We find the economic data compelling enough to encourage investors to stay the course. In our view, the eurozone needs more time - more time for the benefits of a weaker euro to work through the economic engine. Whether the engine is driven by exports (Germany) or services (Italy/Spain), we believe a weaker euro is broadly beneficial to the region.

In addition to economic improvement, we continue to look for fundamental improvements in the larger eurozone companies. As a result of the positive shift in sentiment, European equity markets have performed well during the first half of the year, despite the recent Greek tragedy. In euro terms, the MSCI Europe has returned +13% YTD (+4.4% in USD) and has outperformed the S&P 500 over this short period. The rally will not persist if eurozone companies don't participate. We examined the revenue and margin trends of the 50 largest eurozone companies that report quarterly financials (including Q1) to determine whether the business recovery is following the economic recovery. Revenue trends (as indicated middle right) have improved dramatically, largely driven by euro depreciation and translation benefits, but as we have seen, revenue ex currency impacts has also turned positive for most companies. Because of the FX impact to revenue, we would argue that margins are the more important metric to consider. Because many companies have offsetting local expenses, margins generally negate the impact of FX. As we highlight (bottom right) margin trends have steadily improved since 2013, supporting the equity advancement. Better news for investors: margins are still below 2006 levels and have room for upside. Despite the trends, Europe is by no means in the clear. More work needs to be done; however, as long as the ECB continues to stimulate via bond purchases, the euro remains weak, and economic progress continues, we believe equity markets perform.

Eurozone unemployment rate (%)



Revenue growth y/y – Top 50



Operating margin – Top 50



Source: Bloomberg

China's great market "meltup" and meltdown

Recent China headlines have also dented market sentiment, but similar to Greece, it is important to put news headlines in context. Local investors have piled into China's Shanghai Index (A-Share market) again this year, which has returned nearly 10% through 7/8/2015 net of a 32% pullback in equity prices since the middle of June. Even after this drawdown, the index is still up over 73% in the trailing 12 months. As you recall from our prior Outlooks, this market is not generally accessible to people off the mainland. It is estimated that foreign investors own approximately 1.5% of A-share market capitalization. In March and April, some of the momentum rode the Stock Connect "train" into Hong Kong, causing a swift increase in price that has now subsequently flowed out. However, the valuation gap between the related markets is clear. Where the rising A-share market has led to a P/E multiple at 17.4x, the Hang Seng China Enterprises index (the subset of the Hang Seng that are China-based businesses and referred to as H-shares) is only 8x.

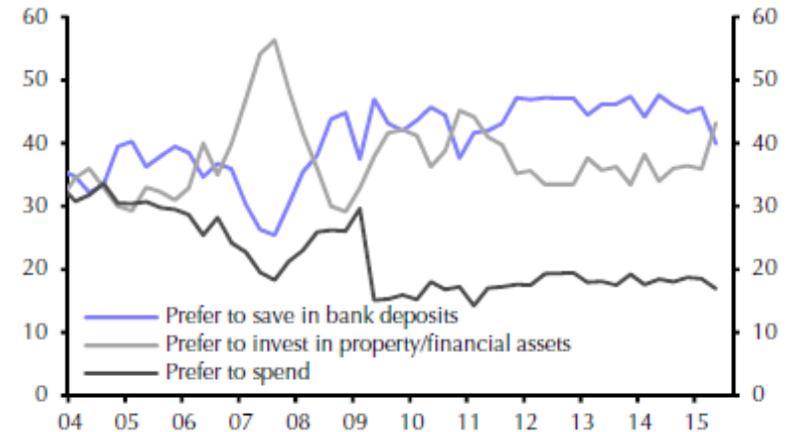
Adding to the momentum and volatility, local investors, most of which lack any previous market experience, have relied on leverage (margin) to increase exposure. Margin works great on the way up but not so much on the way down. Why did local investors become so focused on Chinese equities, an asset class that has been largely ignored since 2007? From August 2009 until the end of 2013, stock prices fell 33% cumulatively, while earnings doubled from the end of 2008 to the end of 2013. Instead, investors with few options focused on real estate and wealth management products until the government cooled these options. As a result, local investors turned their attention to equities, creating a volatility surge. Even with recent attempts, volatility and drawdowns in the A-share market will continue as they tinker with the "rules" until stronger and experienced investors become a larger part of the market. The recent attempts at stabilization will only be temporary until the quick money is flushed out. The question until then is how much volatility (and drawdown risk) will Hong Kong investors absorb before throwing in the towel?

One of our daily liquid active managers focusing on the Chinese consumer illustrates why we continue to like the exposure over the long term. The P/E multiple on the portfolio is approximately 11.3x, well below the 16.3x of the S&P 500. Despite the slowing economic growth in China, the portfolio companies were able to grow sales almost 9% last year in aggregate compared with the U.S. index blend at a little over 2%. As the economy shifts toward a consumption-driven growth model (and away from an export and fixed investment model), the slower but sustainable growth will continue. On the technical side, the government's further support and liberalization of the financial markets will likely create inflows over the medium term, especially as markets deepen, mature, and add transparency.

In summary, as long-term investors, we continue to remain optimistic about Chinese equity markets in the coming year but recommend that investors maintain focus on the H-shares and emotionally prepare for volatility as it comes. Investors with less risk appetite should continue to favor the broader Asia ex-Japan region as a compliment to their existing dividend equity exposure.

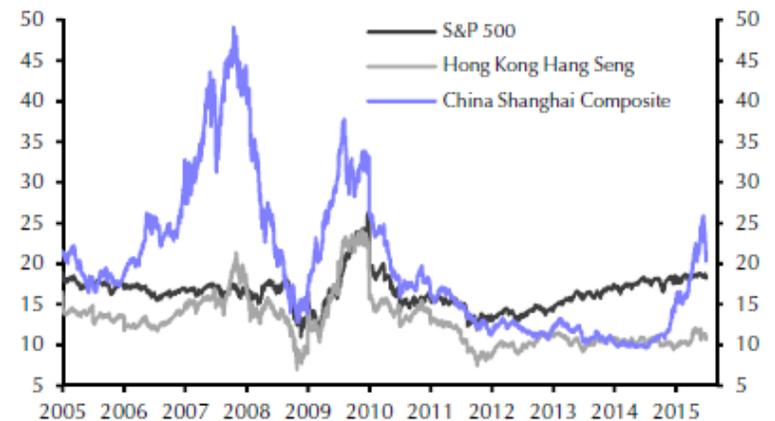


Consumer households prefer to increase spending, saving or investment (% of total)



Source: Capital Economics

Valuation reasonable, especially in the H-shares price/12 month trailing earnings ratios



Source: Capital Economics

Real asset sensitivity to rising rates

REITs, MLPs, and Utilities own physical, long-lived assets with inflation escalators. Revenue for REITs is the most cyclical of the three due to market rental rate adjustments, whereas revenue for MLPs and Utilities is tied to inelastic energy demand. As capital-intensive businesses, they all require significant debt where interest expense impacts their profitability and, therefore, their ability to increase distributions to investors.

June was a vicious month for real assets as the 10-year Treasury jumped 17 bps, following its 50 bps spike since February. The three sectors were down 6.2% on average in June and are now down 9.2% for the year. While valuations were full at the beginning of the year, we argue the decline is due more to investors voting with their feet over rising rates in the future, which could negatively impact their profitability for attractive distribution growth. We have been steadfast in our thesis to be underweight REITs and Utilities due to valuation, but these two sectors are now starting to look interesting on this pullback. Sentiment is starting to override fundamentals, which are sound. We believe the Fed will raise rates but at a very gradual level. Historically speaking, REITs, Utilities, and MLPs produce attractive returns and income in gradual rate increases over time.

The MLP price index has corrected more than 20% since last September, suffering more downside than other energy equity-related indices. This too is a result of valuations that were full but also include reductions in growth expectations and sentiment over rising rates. Fundamentals are mixed because the decline in all energy prices impacts upstream, midstream, and downstream differently, which is why active management is so critical in the universe. Not all MLPs are midstream and not all midstream MLPs operate pipelines. Each segment carries its own set of business fundamentals and risks. Furthermore, several MLPs offer different investment options for investors through the GP and LP.

Our active management has significantly outperformed the MLP index during this downturn, thanks to overweighting midstream pipeline GPs that continue to experience double-digit distribution growth. We caution that MLPs will continue to be choppy in the short term due to concerns over upcoming earnings/distributions announcements and potential interest rate increases. Broadly speaking, MLPs are trading at their most attractive valuation over the past five years. One example is their current 400 bps yield spread over the 10-year Treasury, something we have not seen since 2012 and 100 bps greater than its average normalized spread since 1995. We are comfortable being paid distributions over the short term to wait for energy prices and interest rates to stabilize. Over the long run, monopolistic footprints with mandated tariff increases combined with much-needed energy infrastructure demand from increased production will lead to an attractive income and growth investment.

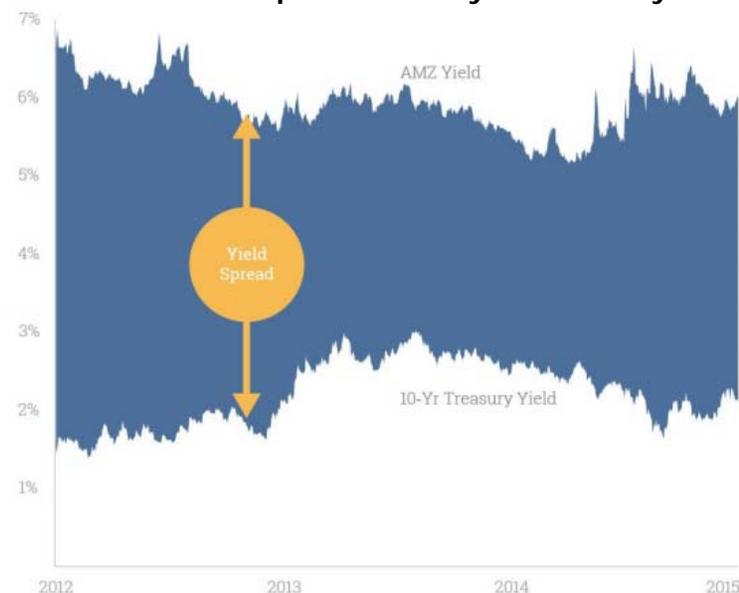
June massacre for real assets

		12/31/2014	5/31/2015	6/30/2015
10 Year Treasury Yield		2.17%	2.18%	2.35%

	Index	YTD	QTD	June
MLPs	Alerian MLP	-11.0%	-6.1%	-8.3%
Utilities	S&P 500 Utilities	-10.7%	-5.8%	-6.0%
REITs	DJ US Select REIT	-5.8%	-10.0%	-4.4%

Source: Bloomberg

Alerian MLP spread vs. 10 year treasury



Source: Alerian

Hedge funds make a comeback

A pickup in equity market volatility is likely in front of the upcoming Fed rate increase. Less confidence in the direction of short- and long-term bond yields should push stock dispersion back to the long-term average; this should benefit alternative investment strategies. More specifically, long/short equity strategies provide investors the ability to profit from market declines, while maintaining a long biased exposure to equities. A short portfolio can hedge against any market correction or act as a stand-alone return generator. In our Q2 2015 Outlook, we noted that investors would become more selective with their capital as interest rates began to increase. We believe this should further benefit alternative managers who are able to short companies with deteriorating balance sheet fundamentals. We also believe event-driven strategies should do well given the record high levels of cash on corporate balance sheets, the latest rise in activist investing, and the increase in deal flows. Hedge fund managers who predict acquisition targets are benefitting from the greatest deal flow since 2007. Given supportive financing conditions in the U.S. and Europe, expectations are for at least a continuation in merger activity for the rest of this year.

The HFRI Equity Hedge Index, a proxy for equity hedge fund manager performance, is up 4.1% this year through June, compared with a 1.2% rise for the S&P 500. This is its widest lead over the S&P 500 since 2009 for the comparable YTD period. Total global hedge fund assets grew by 1.37% in May, bringing total hedge fund assets under management to \$3.17 trillion. The industry has had five consecutive months of inflows, bringing the amount of new capital added by investors to \$65 billion year-to-date, well ahead of the average amount of \$45.9 billion usually seen during this time frame.

The recent performance gains continue the momentum established last autumn amid volatility in currency and commodity markets. Markets around the world have been nervous about the mixed signals coming out of Europe and China, creating a bit of a challenge for passive investors clinging to broad market indices. Lower correlations among individual stocks and higher dispersion among sectors are improving the relative performance of active managers who are able to profit from both an increase and decrease in prices.

Not all hedge funds are having a good year. Macro funds that try to predict global trends have suffered recently as a result of erratic moves in currencies, continued political uncertainty in Greece, and wide price swings in commodities markets. We believe that an allocation to long/short, event driven, and merger arbitrage strategies makes sense in an environment with greater interest rate volatility, strengthening deal flow, and higher dispersion among stocks. An expected increase in the Fed Funds rate should provide an additional rebate to alternative investments that hold cash as part of their investment strategy.

Increase in stock dispersion is tailwind for managers



Hedge funds flexing their muscle (and capital)



Source: Strategas, Wall Street Journal

M&A remains robust and signals more growth to come

Corporate earnings have been running at or close to peak margins for the last several quarters. Many investors wonder whether these levels of profitability can be sustained into the future in the face of likely wage inflation and increases in the cost of financing over the next few years. One indicator that the recent margin expansion run may face internal pressure is the surge in merger and acquisitions over the past year.

Companies are merging at a pace unseen since pre-financial crisis. At midyear, about \$2.4 trillion in M&A transactions had been announced globally, putting 2015 on pace with 2007's record year. This past quarter's \$1.54 trillion deal volume stood out for the number of mega deals announced and fell just short of eclipsing the second quarter of 2007, which saw a record \$1.62 trillion in announcement activity. In the U.S., last quarter's approximate \$800 billion of announced volume exceeded the 2007 mark for the same quarter by nearly \$200 billion.

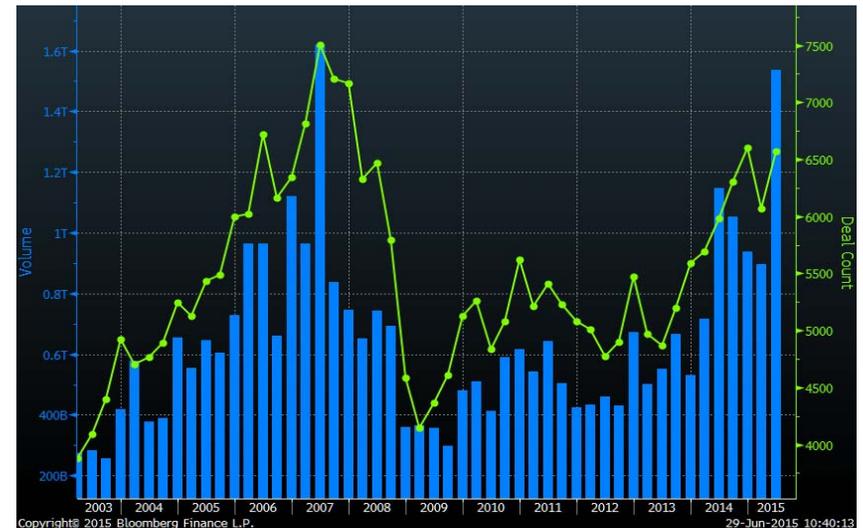
The major difference between the M&A surge leading up to the financial crisis and the current boom is that the former was largely fueled by private equity-sponsored leveraged buyouts while the present activity has been and continues to be driven by strategic corporate deals and industry consolidation. Year to date, global private equity as a percentage of M&A volume represents less than half its proportion of deals in the first half of 2007. Given the common buyer type has shifted from financial to strategic, one might expect higher acquisition multiples and premiums, however recent such metrics are fairly close to (if not below) the levels paid in the last "bubble".

The flood of deal interest began last year, driven by cheap debt, ample cash on corporate balance sheets, and rising stock prices. This is in contrast to the period eight years ago. Today, companies are seeking to take advantage of lower relative financing costs, higher stock values that can be used as part of the takeover payment exchange, and in the case of U.S. companies, a stronger relative currency. Additionally, tax inversion deals whereby companies pursue overseas mergers that move their legal addresses abroad to produce tax benefits, have been another major incentive for transactions, despite the U.S. Treasury's guidance last fall that seeks to crack down on such transactions.

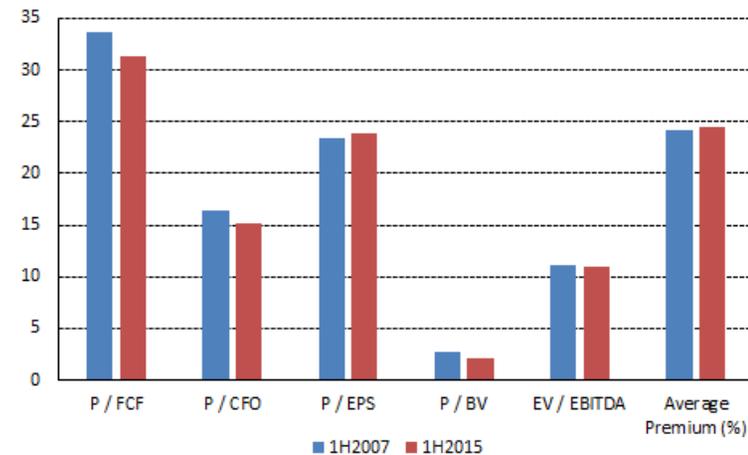
While it is possible that corporate executives and boards feel they must look to outside sources to maintain pace with the strong earnings growth of the last three years, the prevailing sentiment driving recent activity seems to be more of a fear of losing ground to competitors more eager to strike deals.



Global mergers & acquisitions



Valuations then and now



Market Performance

DOMESTIC EQUITY												
Index	April	May	June	Total Return						Trailing (annualized)		
				Q2-15	2015	2014	2013	2012	2011	3yr	5yr	10yr
S&P 500	1.0%	1.3%	-1.9%	0.3%	1.2%	13.7%	32.4%	16.0%	2.1%	17.3%	17.3%	7.9%
DOW JONES INDUSTRIAL	0.4%	1.4%	-2.1%	-0.3%	0.0%	10.0%	29.7%	10.2%	8.4%	13.8%	15.4%	8.3%
NASDAQ	0.9%	2.8%	-1.6%	2.1%	6.0%	14.8%	40.2%	17.7%	-0.8%	21.0%	20.3%	10.5%
S&P 400 Midcap	-1.5%	1.8%	-1.3%	-1.1%	4.2%	9.7%	33.5%	17.8%	-1.7%	18.6%	17.8%	9.7%
RUSSELL 2000 INDEX	-2.6%	2.3%	0.7%	0.4%	4.8%	4.9%	38.8%	16.4%	-4.2%	17.8%	17.1%	8.4%
RUSSELL 3000 INDEX	0.5%	1.4%	-1.7%	0.1%	1.9%	12.6%	33.6%	16.4%	1.0%	17.7%	17.5%	8.1%
ALERIAN INDEX	6.2%	-3.6%	-8.3%	-6.1%	-11.0%	4.8%	27.6%	4.8%	13.9%	7.8%	11.5%	11.4%
INTERNATIONAL EQUITY												
MSCI AC World (ACWI)	2.9%	-0.1%	-2.3%	0.5%	3.0%	4.8%	23.5%	16.9%	-6.8%	13.7%	12.6%	7.1%
MSCI EAFE	4.1%	-0.4%	-2.8%	0.8%	5.9%	-4.3%	23.5%	18.1%	-11.6%	12.7%	10.2%	5.8%
MSCI EM	7.7%	-4.0%	-2.5%	0.8%	3.1%	-2.0%	-2.3%	18.6%	-18.2%	4.0%	4.0%	8.4%
MSCI EMEA	8.5%	-6.4%	0.4%	2.0%	4.1%	-14.5%	-4.7%	22.5%	-20.2%	-0.8%	2.2%	5.4%
DJ Stoxx 50	2.7%	-1.9%	-2.2%	-1.5%	3.0%	-7.9%	28.2%	21.8%	-15.7%	14.2%	8.3%	4.1%
FTSE 100 INDEX	6.5%	0.3%	-3.6%	3.1%	2.4%	-5.0%	21.4%	15.6%	-2.3%	9.7%	11.1%	5.3%
NIKKEI 225	1.9%	1.6%	0.1%	3.6%	14.4%	-4.2%	30.6%	12.4%	-10.4%	15.7%	11.4%	6.5%
HANG SENG INDEX	13.1%	-2.2%	-3.0%	7.2%	13.7%	5.3%	6.5%	27.7%	-17.3%	14.6%	9.3%	10.0%
SHANGHAI SE COMPOSITE	18.6%	4.1%	-7.0%	14.8%	33.1%	54.0%	-1.0%	6.9%	-16.5%	28.6%	17.0%	20.4%
BRAZIL BOVESPA INDEX	17.1%	-11.2%	3.0%	7.0%	-9.5%	-13.4%	-26.8%	-2.0%	-27.1%	-14.2%	-12.8%	4.9%
MSCI BRAZIL SMALLCAP	12.2%	-8.0%	0.9%	4.1%	-21.8%	-25.2%	-26.1%	29.5%	-24.0%	-19.2%	-8.9%	NA
S&P SECTOR BREAKDOWN												
S&P 500 ENERGY INDEX	6.7%	-4.8%	-3.4%	-1.9%	-4.7%	-7.8%	25.0%	4.6%	4.7%	5.6%	10.5%	7.1%
S&P 500 MATERIALS INDEX	3.1%	0.5%	-3.9%	-0.5%	0.5%	6.9%	25.6%	15.0%	-9.8%	13.4%	14.4%	8.5%
S&P 500 INDUSTRIALS IDX	0.0%	0.3%	-2.5%	-2.2%	-3.1%	9.8%	40.6%	15.3%	-0.6%	17.2%	17.0%	8.0%
S&P 500 CONS DISCRET IDX	0.0%	1.3%	0.6%	1.9%	6.8%	9.7%	43.1%	23.9%	6.1%	22.5%	23.4%	10.6%
S&P 500 CONS STAPLES IDX	-0.8%	0.8%	-1.8%	-1.7%	-0.8%	16.0%	26.1%	10.8%	14.0%	14.0%	16.5%	10.6%
S&P 500 FINANCIALS INDEX	0.2%	1.8%	-0.3%	1.7%	-0.4%	15.2%	35.6%	28.7%	-17.1%	20.8%	14.1%	0.3%
S&P 500 HEALTH CARE IDX	-1.3%	4.5%	-0.3%	2.8%	9.6%	25.3%	41.5%	17.9%	12.7%	27.3%	23.8%	11.3%
S&P 500 INFO TECH INDEX	2.3%	2.3%	-4.3%	0.2%	0.8%	20.1%	28.4%	14.8%	2.4%	16.3%	17.6%	9.6%
S&P 500 TELECOMM SVCS IX	5.9%	-1.8%	-2.3%	1.6%	3.2%	3.0%	11.5%	18.3%	6.3%	6.3%	14.1%	7.3%
S&P 500 UTILITIES INDEX	-0.4%	0.7%	-6.0%	-5.8%	-10.7%	29.0%	13.2%	1.3%	19.9%	8.0%	12.5%	6.9%
FIXED INCOME												
US TREASURY BILLS	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%			
US TREASURY MASTER	-0.6%	-0.2%	-1.0%	-1.8%	-0.1%	6.0%	-3.4%	2.2%	9.8%			
US MUNICIPAL 3-5 YEAR	-0.1%	-0.3%	0.3%	0.0%	0.4%	2.0%	1.4%	2.4%	5.4%			
US BROAD CORPORATE	-0.5%	-0.5%	-1.6%	-2.7%	-0.5%	7.5%	-1.5%	10.4%	7.5%			
GLOBAL BROAD MKT CORP	-0.6%	-0.4%	-1.6%	-2.6%	-0.5%	7.8%	0.1%	10.8%	5.2%			
US HIGH YIELD	1.2%	0.3%	-1.5%	0.0%	2.5%	2.5%	7.4%	15.6%	4.4%			

All performance data quoted in USD and includes dividends



The opinions expressed herein are those of Edge Capital Partners (“Edge”) and the report is not meant as legal, tax or financial advice. You should consult your own professional advisors as to the legal, tax, or other matters relevant to the suitability of potential investments. The external data presented in this report have been obtained from independent sources (as noted) and are believed to be accurate, but no independent verification has been made and accuracy is not guaranteed. The information contained in this report is not intended to address the needs of any particular investor. This presentation is solely for the recipient. By accepting this report, the recipient acknowledges that distribution to any other person is unauthorized, and any reproduction of this report, in whole or in part, without the prior consent of Edge Capital Partners is strictly prohibited. This communication is not to be construed as an offer to sell or the solicitation of an offer to buy any security. Such as an offer can only be made through receipt of an offering memorandum which will explain all risks. All figures are estimated and unaudited. The case studies shown are meant to demonstrate Edge’s investment process and are not meant as an indication of investment performance. Past performance is not necessarily indicative of future results.