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2017 Outlook

Commodities Positive, Four Strategies for Higher Interest Rates

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Summary

Actionable Thoughts

- Supply cutbacks and resilient demand started a commodities bull market a year ago; we expect the “grind trade” to continue. We provide data on commodities and commodity equities for this type of market.
- Central banks are reversing their embrace of negative interest rates, so we are likely in a new era for fixed income. We review four strategies for this new environment.

Issues to Track in 2017

- *Trade policy and its impact on emerging markets*
  Exports of “Old China” goods have been upsetting trade partners. Will China be willing to cut a deal on State-Owned Enterprise (SOE) reform?
- *Interest rates in U.S.*
  Rates can’t go too high unless Congress bends the curve on entitlement spending and manages the debt overhang.

Please see important disclosures at the beginning of this presentation and index descriptions and definitions at the end.

2017 Outlook

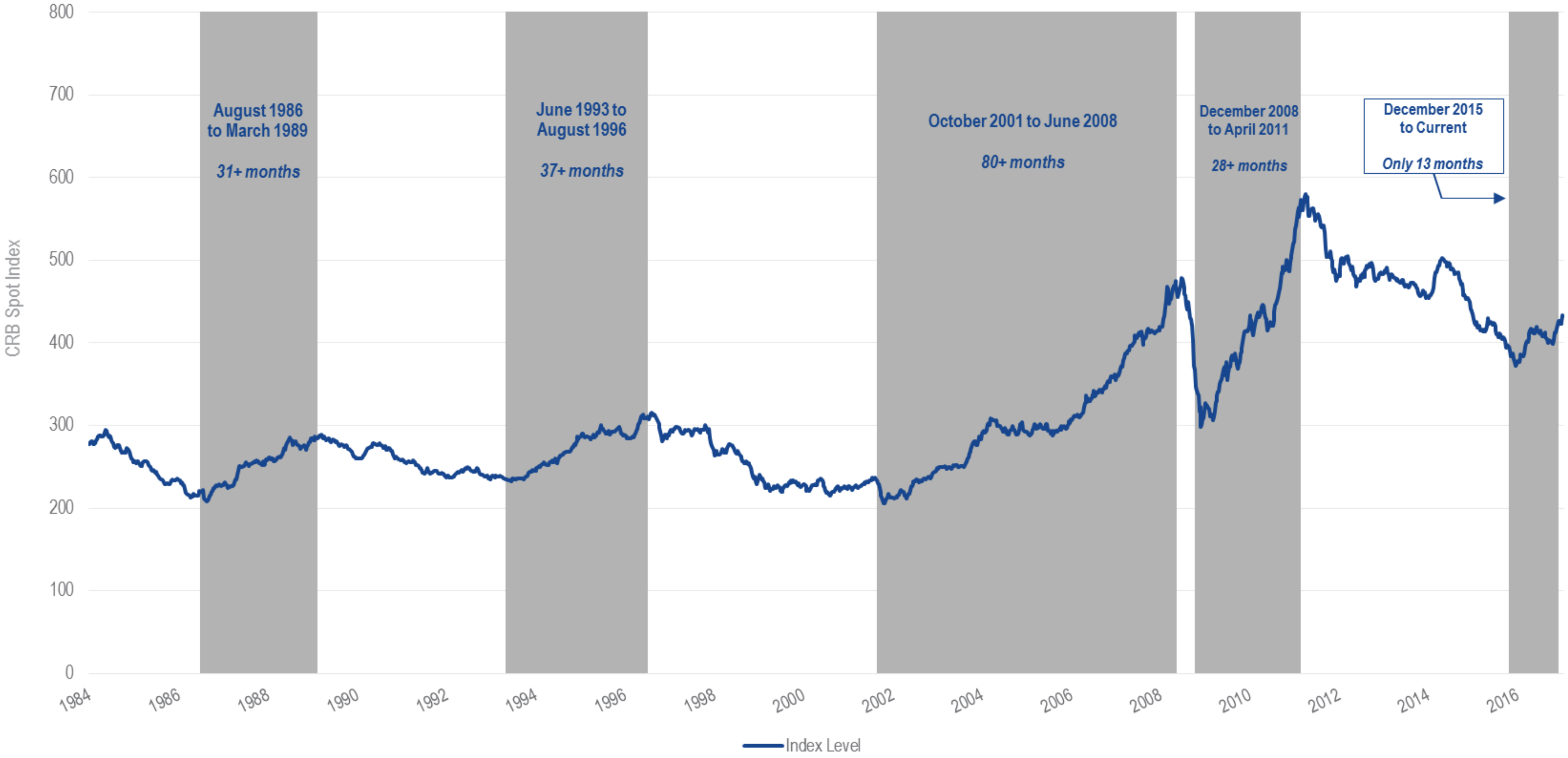
Macro Views

- The macro outlook has changed; global growth is ticking up
- Inflation highest in a while, but a major trend is not yet in place
- For the U.S. economy, the markets expect stimulative fiscal and tighter monetary policies
- Recovery of commodity markets and lower contagion effects suggest global hard landing risks are low

Market Views

- The opportunity in selected commodities and gold is still available
- Debt super-cycle still a major force: cracks continue to appear
- Negative real interest rates should be good for gold
- Multi-year trends continue to play out in China with little systemic risk, but weaker RMB

Most commodity recoveries last much longer than six months



Source: VanEck; Bloomberg. Data as of January 18, 2017.

Please see important disclosures at the beginning of this presentation and index descriptions and definitions at the end.

Energy weighting in the U.S. stock market is at multi-year lows

- The energy sector within the S&P 500 Index remains well below its long-term average
- Market conditions still indicate early stages of a new cycle with a return to normal levels
- But this can be a slow development which is why we call it the “grind trade”

Energy Sector Weightings in the S&P 500 Index

Source: VanEck; Bloomberg. Data as of December 31, 2016.

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Commodity equities are an attractive way to play a rebound

Average Annual Total Returns/Volatility (%)

	1970s[1]		1980s		1990s		2000s		2010s	
	Return	Volatility	Return	Volatility	Return	Volatility	Return	Volatility	Return	Volatility
Commodities[2]	21.3	25.7	10.7	16.0	3.9	23.2	5.1	29.3	-8.6	17.2
Natural Resource Equities[3]	14.2	20.1	**14.5**	18.1	**9.7**	12.9	9.2	26.1	2.9	18.5
Precious Metals Equities[4]	19.5	38.5	4.1	37.0	-5.5	31.4	9.5	24.7	-10.3	39.7
U.S. Equities[5]	5.8	18.3	**17.6**	12.0	**18.2**	13.4	-0.9	20.0	12.8	9.6
Fixed Income[6]	5.6	5.9	12.2	8.4	7.7	6.8	6.3	3.0	3.8	3.6

Source: Bloomberg; FactSet; CRSP; Siblis Research. Data as of December 31, 2016.

[1]Representative **Fixed Income** index data only available beginning in 1972; all other representative index data available beginning in 1970. [2]**Commodities**: S&P Goldman Sachs Commodity Total Return Index (SPGSCITR). [3]**Natural Resource Equities**: for calendar-year periods from 1997 to 2016, performance is represented by the S&P North American Natural Resources Sector Index (SPGINRTR, index data availability date 8/30/1996); from 1971 to 1996, by a 50%/50% blend of the S&P 500 Total Return Index's (SPXTR, annual sector return availability date 12/31/1971) Energy and Materials sector returns; for 1970 by a 60%/15%/10%/10%/5% blend of Oil, Coal, Steel, Mines and Gold average value weighted returns from CRSP's 49 Industry Portfolios dataset (http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html#Research). [4]**Precious Metals Equities**: for calendar-year periods from 1984 to 2016, represented by the Philadelphia Gold and Silver Mining Index (XAU, index launch date 12/19/1983); from 1970 to 1983, by the Barron's Gold Mining Index (BGMI). Note: 1970s volatility calculated using annualized weekly returns. [5]**U.S. Equities**: S&P 500 Total Return Index (SPXTR). [6]**Fixed Income**: Bloomberg Barclays U.S. Aggregate Government/Credit Total Return Index (LUGCTRUU, annual return data availability date 12/31/1972). All indices are unmanaged and include the reinvestment of all dividends but do not reflect the payment of transactions costs, advisory fees or expenses that are typically associated with managed accounts or investment funds. Indices were selected for illustrative purposes only and are not securities in which investments can be made.

Commodities can rise in interest rate hiking cycles

Commodities historically best asset in hiking cycles

Total Asset Return During Hiking Cycle

Rate-Hike Cycle	Days	Start	End	Hike	US Equities	World Equities	U.S. Treasuries	U.S. Credits	Gold	Commodities	U.S. Dollar Index
Jan '73-May '75	484	5.50	13.00	7.50	-24.00	-19.8	3.1	-4.0	169.5	71.3	-10.6
Dec '76-Mar '80	1189	4.75	20.00	15.25	3.0	32.4	4.6	-7.7	386.6	117.4	-17.3
Aug '80-Dec '80	121	10.00	20.00	10.00	9.6	7.7	-4.7	-7.3	0.6	2.6	6.3
May '83-Aug '84	478	8.50	11.75	3.25	1.0	4.1	5.8	1.9	-19.4	10.7	14.6
Dec '86-Feb '89	802	5.88	9.75	3.88	12.8	44.7	10.7	13.6	-1.5	64.7	-12.0
Feb '94-Feb '95	363	3.00	6.00	3.00	-1.5	-4.5	-3.1	-3.4	-2.9	-5.7	-8.4
Jun '99-May '00	322	4.75	6.50	1.75	8.1	11.0	3.2	0.1	5.7	51.2	8.0
Jun '04-Jun '06	730	1.00	5.25	4.25	12.9	22.4	5.4	5.8	52.8	39.6	-3.9
Average	561	5.42	11.53	6.11	2.7	12.2	3.1	-0.1	73.9	44.0	-2.9
Median	481	5.13	10.75	4.06	5.5	9.3	3.9	-1.6	3.2	45.4	-6.2

Annualized Asset Return during Hiking Cycle

Rate-Hike Cycle	Days	Start	End	Hike	US Equities	World Equities	U.S. Treasuries	U.S. Credits	Gold	Commodities	U.S. Dollar Index
Jan '73-May '75	484	5.50	13.00	7.50	-18.7	-15.3	2.3	-3.0	111.2	50.0	-8.1
Dec '76-Mar '80	1189	4.75	20.00	15.25	0.9	9.0	1.4	-2.4	62.5	26.9	-5.7
Aug '80-Dec '80	121	10.00	20.00	10.00	31.9	24.9	-13.4	-20.4	1.8	8.1	20.3
May '83-Aug '84	478	8.50	11.75	3.25	0.8	3.1	4.4	1.5	-15.2	8.1	10.9
Dec '86-Feb '89	802	5.88	9.75	3.88	5.6	18.3	4.7	6.0	-0.7	25.5	-5.7
Feb '94-Feb '95	363	3.00	6.00	3.00	-1.5	-4.6	-3.1	-3.4	-2.9	-5.7	-8.5
Jun '99-May '00	322	4.75	6.50	1.75	9.2	12.5	3.6	0.1	6.5	59.8	9.1
Jun '04-Jun '06	730	1.00	5.25	4.25	6.2	10.7	2.7	2.9	23.6	18.2	-2.0
Average	561	5.42	11.53	6.11	4.3	7.3	0.3	-2.4	23.4	23.9	-1.3
Median	481	5.13	10.75	4.06	3.3	9.8	2.5	-1.2	4.2	21.8	-3.8

Source: Bloomberg; Deutsche Bank; New York Federal Reserve; Robeco; Morgan Creek.

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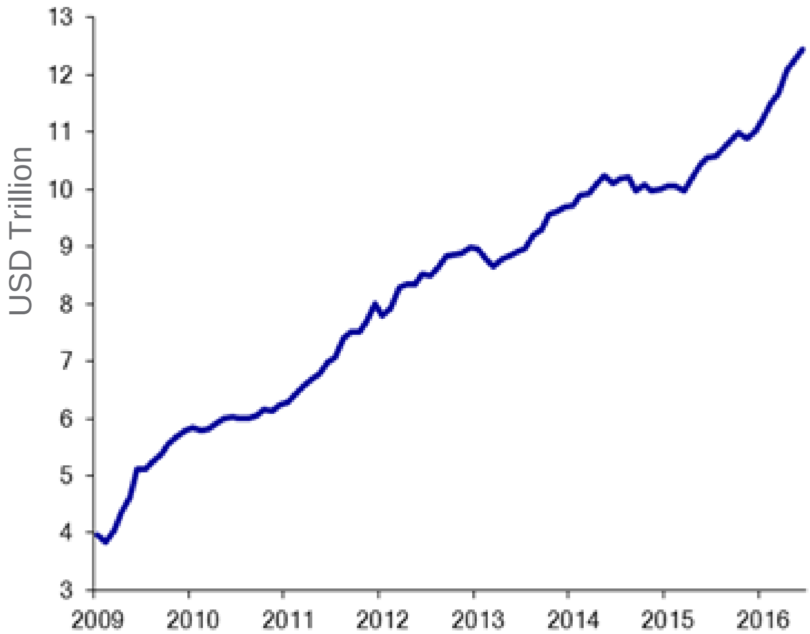
A new era for interest rates: Central bank buying has likely peaked

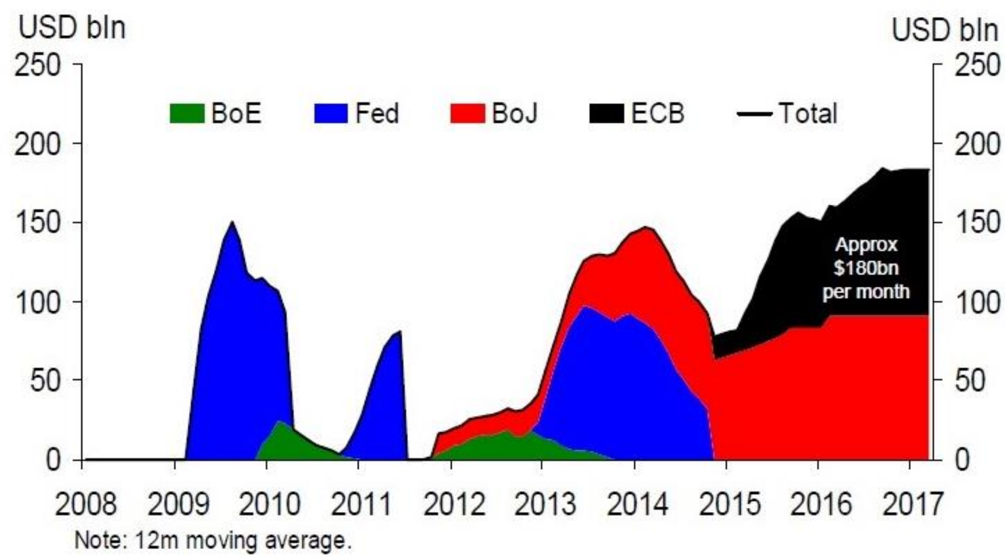
- Pursuit of negative interest rates and pace of central bank asset purchases has likely peaked
- So we are entering a different era with likely more interest rate volatility

Total Balance Sheets of Central Banks Buying Bonds
(Federal Reserve, European Central Bank, Bank of England, Bank of Japan, Swiss National Bank)



Still plenty of liquidity being added to markets: ECB and BoJ buying approx. $180B every month

Monthly Fed, ECB and BoJ asset purchases



Source: Evercore ISI (left chart); DB Global Markets Research (right chart). Data as of June 30, 2016.

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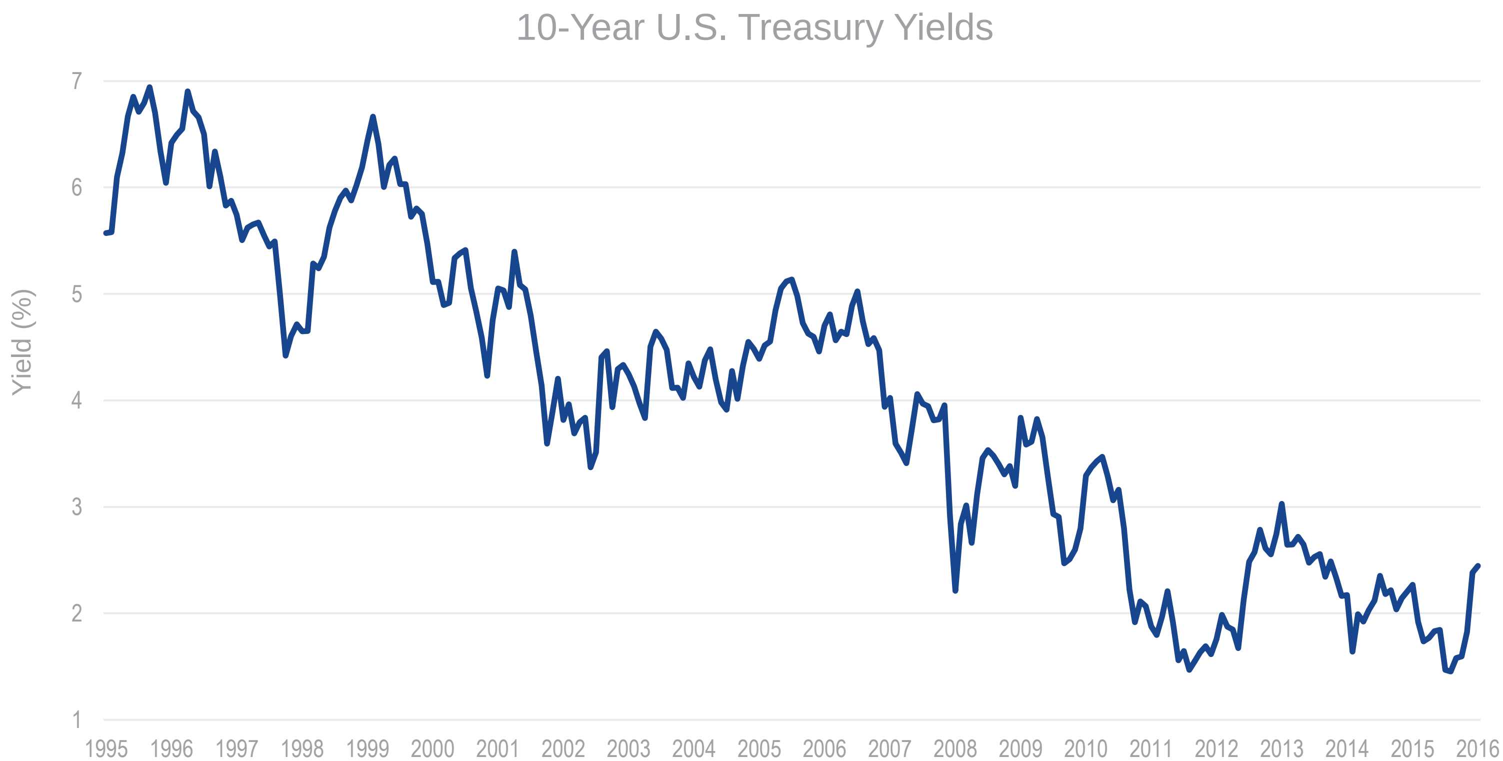
A new era for bonds: We are facing the end of long bull market

- Bonds retested the 2012 low of 1.5%
- China's Producer Price Index (PPI) turned positive for the first time since 2012 – signals less global deflationary pressure through exports



Source: Bloomberg. Data as of December 30, 2016.

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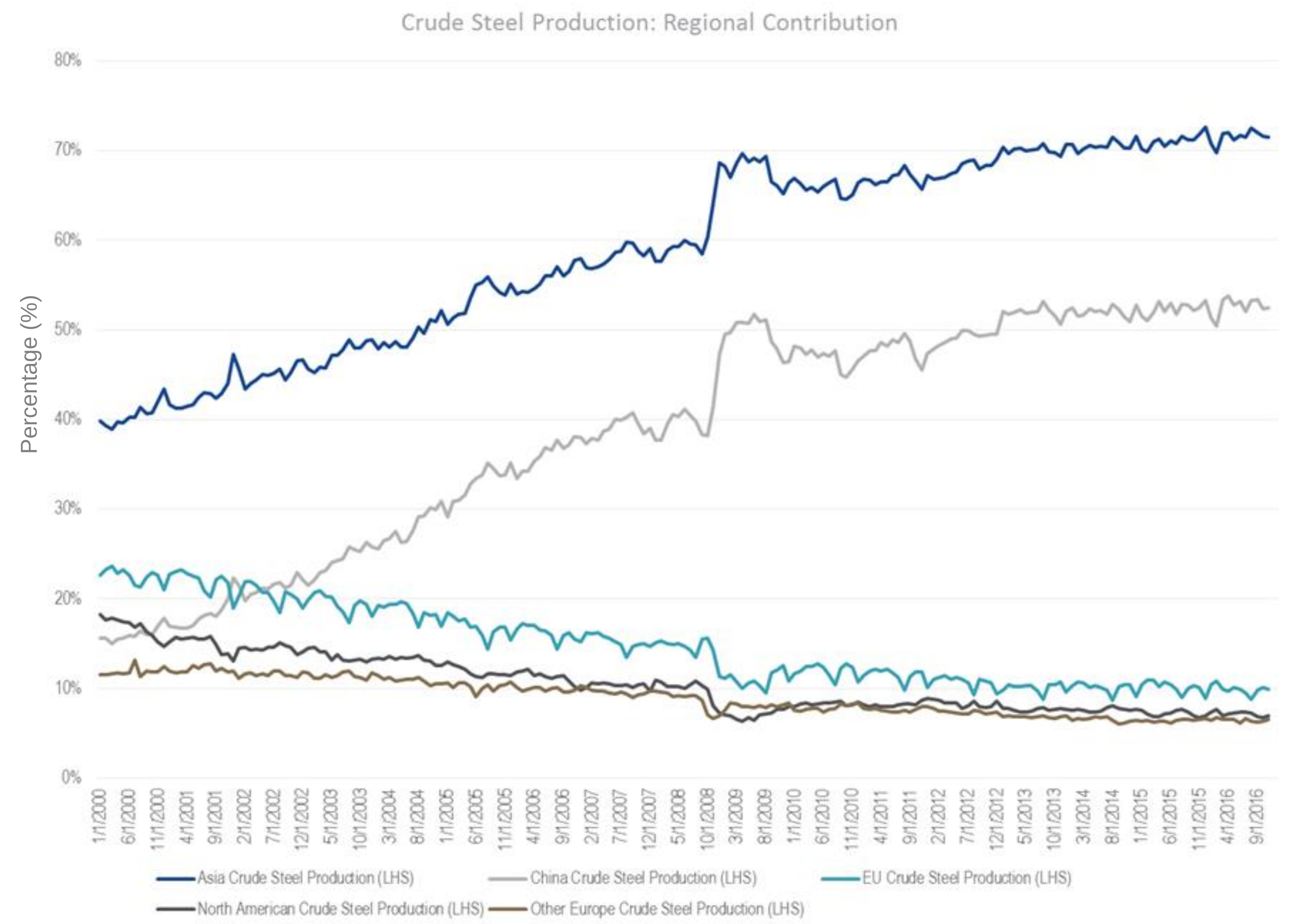
Four strategies for a new fixed income environment

- Downshift duration
- Access alternative sources of income; seek income with lower correlation to U.S. Treasuries
- Increase credit risk to offset duration losses: buy high yield bonds
- Allocate to an unconstrained bond manager

Tariff war with China in context

- In China's industrialization, huge capacity was built in "Old China" industries (see next slides)
- "Old China" is dominated by SOEs that are heavily owned and managed by the government and receive access to credit from large banks that are also SOEs
- Private Chinese companies still struggle to access credit and, if they can borrow, interest rates are higher for them than what SOEs get from the big Chinese banks
- "Old China" companies are largest source of growth in Chinese debt recently, but not much has been structurally addressed; bad debt from this sector is estimated at over $2 trillion
- Chinese overcapacity in "Old China" industries has dominated the global steel market
- The U.S. and Europe have been addressing this problem for years – not just starting in 2017
- A structural solution could create a better tone for emerging market currencies and equity markets

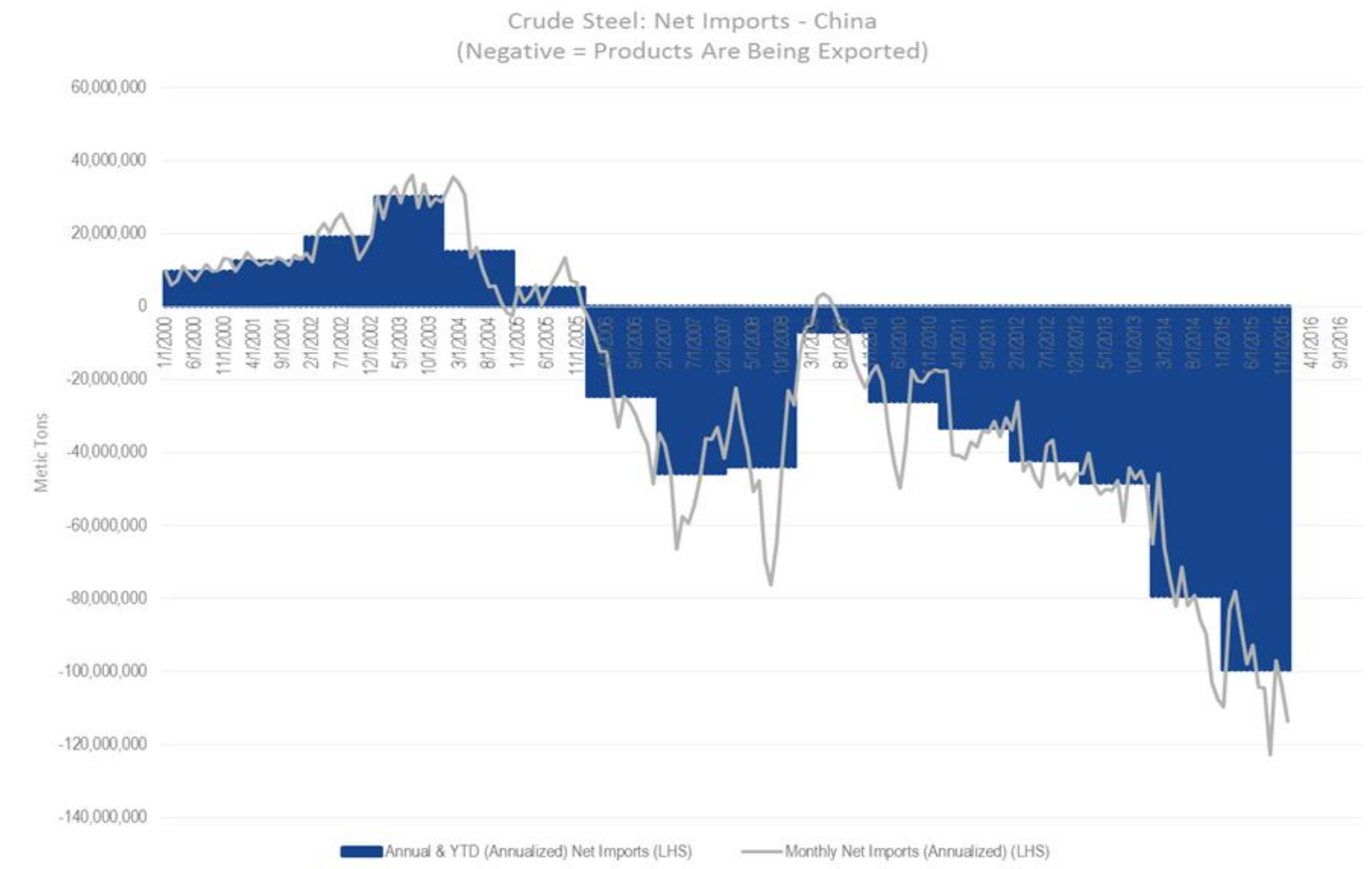
Backdrop to China trade: China dominates steel



Source: Deutsche Bank, CEIC, PBOC, NBS. Data as of June 2016.

Please see important disclosures at the beginning of this presentation and index descriptions and definitions at the end.

Trade: China goes from importer of steel to large exporter



Source: Deutsche Bank, CEIC, PBOC, NBS. Data as of June 2016.

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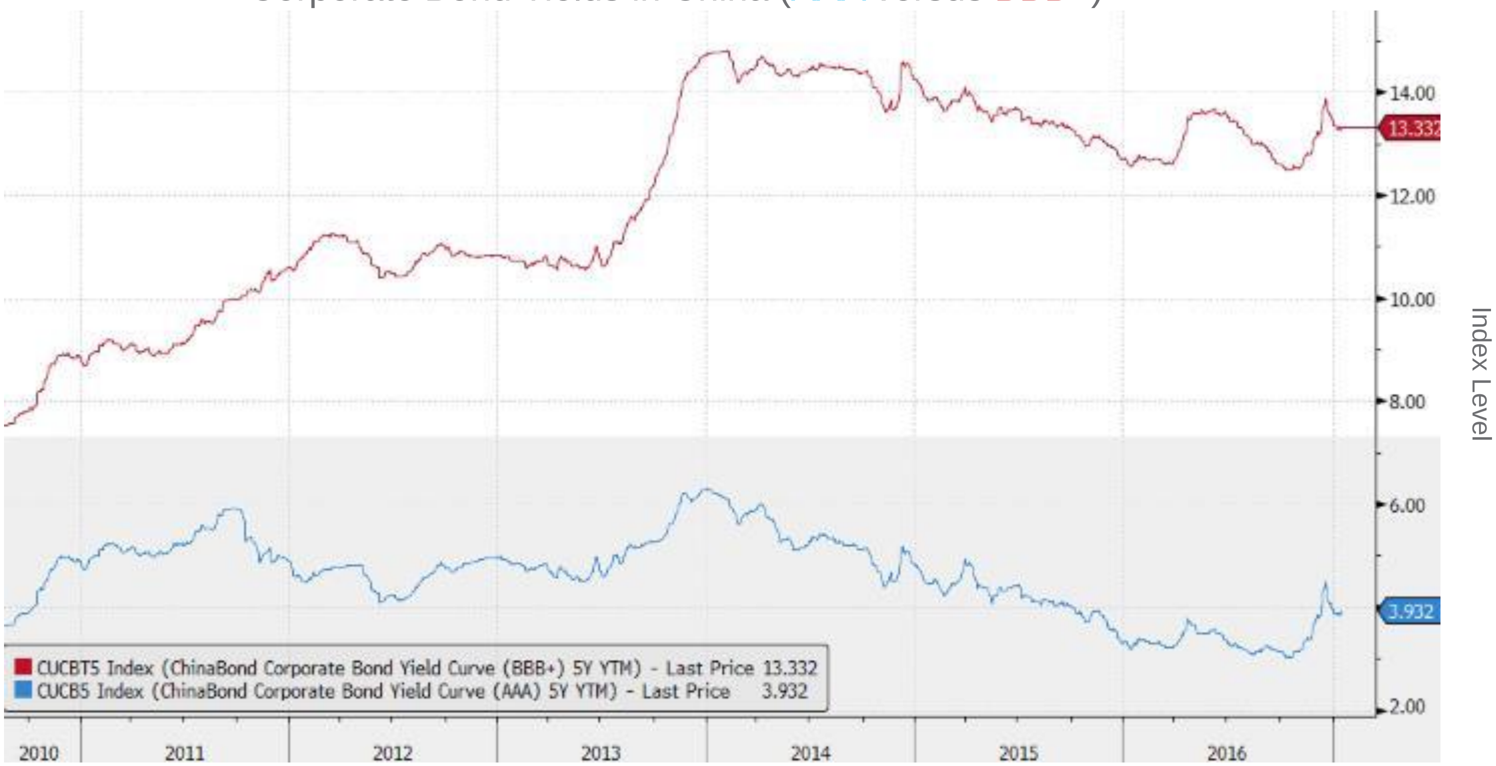
Money is still expensive for non-SOE companies in China

Corporate Bond Yields in China (AAA versus BBB+)



Note: Data for above-scale industrial companies.

Source: Deutsche Bank, CEIC, PBOC, NBS. Data as of June 2016.

Tariff war with China started a while ago

- **Rare Earths**. In 2012, the Obama administration filed a case with the Dispute Settlement Body of the WTO. In 2014, the World Trade Organization (WTO) ruled against China, which led China to drop the export quotas in 2015

- **Steel**. The U.S. Commerce Department has slapped duties of up to 450 percent on the steel products from China and duties ranging from 3 percent to 92 percent on corrosion-resistant steel from Italy, India, South Korea, and Taiwan

- **DDG/Distillers Dried Grain/Corn.** 33.8% first imposed; added 10% in September 2016; 5% Ethanol tax to 30% in 2017

- **Aluminum.** January 12, 2017: U.S. announces that it may start a WTO grievance against China for aluminum dumping

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The **Producer Price Index (PPI)** is a family of indexes that measures the average change in selling prices received by domestic producers of goods and services over time. PPIs measure price change from the perspective of the seller and differs from other indexes, such as the Consumer Price Index, that measure price change from the purchaser's perspective.

S&P 500® Index (SPX) consists of 500 widely held common stocks, covering four broad sectors (industrials, utilities, financial and transportation).

Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

Bloomberg Barclays Capital US Aggregate Bond Index (LBUSTRUU) is a market capitalization-weighted index representing most U.S. traded investment grade bonds. The index comprises government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the market. The maturity of the bonds in the index is over one year.

U.S. Dollar Index (DXY) indicates the general international value of the U.S. Dollar. The DXY does this by averaging the exchange rates between the U.S. Dollar and six major world currencies: Euro, Japanese yen, Pound sterling, Canadian dollar, Swedish kroner, and Swiss franc.

Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It includes approximately 1,000 of the largest U.S. securities based on market capitalization. **The Russell 1000 Value Index** measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and forecasted growth values. The **Russell 1000 Growth Index** measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and forecasted growth values.

Federal Funds Rate is the "interest rate" in the U.S. at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis. Institutions with surplus balances in their accounts lend those balances to institutions in need of larger balances.

Price-Earnings Ratio (P/E Ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings.

Price-Book Ratio (P/B Ratio) is a ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share.