Some point to continued jitters around China’s economy, while others blame those ever-sinking oil prices. Still others spy chinks in the six-plus-year-old-long armor that is the U.S. economic recovery.

The challenge comes from sifting the mixed signals from financial markets, several of which are pointing to a bear market, and the economic data, which have been upbeat. We have already seen nearly all major international developed markets head into bear territory, including Japan, Germany, Italy, and Spain. Only France at –18% and the U.K. at –14%, are not down more than 20% from their 2015 peak; by comparison, consider that the U.S. is down 9% from its high last May (Figure 1).

Perhaps the most daunting signals for the U.S. are coming from the fixed income arena, especially risk spreads on corporate debt (Figure 2). Those spreads rose quickly for high-yield energy sector firms starting in mid-2014 when the price of crude fell, and now exceed 15%, surpassing the 2008 peak. While weakness in the energy sector is quite reasonable, the real concern is a general spillover into other sectors. Here we have seen spreads for the high-yield debt (ex energy) sector rise from 400 basis points, or bps (4.00%), in mid-2015 to just over 700bps (7.00%) last

---

Tony Roth, Chief Investment Officer

Riddle me this. When 2015 drew to a close, you would have been hard-pressed to find someone ready to predict that the word “recession” would be bandied about a scant two months into 2016. After some rough months, markets had mostly calmed by year-end and our data-dependent (some might say overly trepidatious) Federal Reserve finally felt the economy was sufficiently solid that it made its long-awaited interest rate hike for the first time in nearly 10 years. And then came January, with its vigorously bucking broncos in the form of markets and economies, to which many understandably responded, “What gives?”

Some point to continued jitters around China’s economy, while others blame those ever-sinking oil prices. Still others spy chinks in the six-plus-year-old-long armor that is the U.S. economic recovery.

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CONTINUED
month. The increase in risk has even hit investment-grade firms, where spreads have doubled from 95bps (0.95%) to 190bps (1.90%) since mid-2014. Much of that widening has been limited to the energy and basic industry sectors, but the trend is unnerving nonetheless. Last, the yield curve has greatly flattened, which some believe is a precursor to recessions.

With the fragility in financial markets one may be tempted to think that a U.S. recession, and a bear market, must be imminent. But those markets are of course volatile and tend to overpredict. Paul Samuelson once famously quipped that the stock market had correctly predicted nine out of the last five recessions. Unfortunately Samuelson was an economist, a discipline that has a long history of underpredicting recessions.

What is the economic data telling us?

The recession–bear market connection

Even in the current financial market conditions the economic data are holding up quite well and showed renewed strength in the fourth quarter of 2015, when we witnessed a sharp acceleration in job growth, and open positions for jobs near all-time highs. Over the past four months, 1.5 million people have joined the labor force; it’s the strongest growth thus far since the recovery began in March of 2009. The labor force strength is partly in response to wage gains that finally broke away from weakness in late 2015. The manufacturing sector is showing signs of bottoming out after being pummeled by weak energy markets and weak exports last year. Manufacturers reported strong activity last month in terms of orders for new durable goods as well as cranking up production activity. Worth noting is that the U.S. consumer is still alive and well, with spending on goods and services showing strong gains in January (Figure 3). That strong spending, along with low unemployment and accelerating wages, is pushing inflation back up to more normal levels.
Our proactive positioning shifts

In the expectation that volatility would be front and center for the long haul, we began last fall to pull back risk levels in our portfolios. This included an initial step of cutting our stock overweight to roughly half of where it was last summer, and was followed by moves last month to bring our stock weights closer into alignment with our strategic benchmarks. At that time, we retained pro-cyclical risk exposures (more sensitive to economic fluctuations) and a modest overweight to international stock markets. Now, given the uncertainty around which direction markets may break, we are pulling back these exposures as well.

As noted in our investment themes on page 5, we maintain our long-term commitment to the bright outlook for technology and healthcare. That said, we have reason to believe that these sectors will not fulfill their potential in the short term and we expect to curb our still-overweight positions in those sectors. In our view, the healthcare industry will remain the beneficiary of the aging baby boomer population but moves forward will likely be curtailed by the political posturing expected to intensify in the months leading up to the presidential election (see Luke Tilley’s “In Focus” on page 9). Financials are also likely to benefit from the prospect of a stronger economy and possible rate hikes but their loans to the energy sector have become an issue. Time is needed before we can fully discount this problem.

Outside of these sectors, we are reducing our active weights to reflect positioning closer to the Russell 1000, a step that reflects concerns about how these areas are likely to perform in a market that may be tempest-tossed.

In another effort to de-risk, we are eliminating our currency-hedged exposure to Japanese stocks. This position has behaved far more erratically than expected and reflects the difficulty markets are having in coming to grips with the Bank of Japan’s first-ever foray into using negative interest rates. We are uncertain this central bank will be able to reinvigorate the Japanese economy’s stalled growth and will be moving the proceeds from this sale to our actively managed large-cap stocks in the U.S., an area in which we have greater confidence. In light of the big drop in U.S. stocks thus far in 2016, we see an opportunity for managers to find attractive values.

Our final de-risking effort deals with a response to signals of modestly higher inflation by adding to our U.S. position of Treasury inflation-protected securities. With so-called breakeven inflation rates (the amount of the Treasury market’s yield attributable to protecting against inflation) still below long-term inflation expectations, we see potential value here. Looking ahead, we expect portfolios to hold nearly 4% of this asset class, compared to virtually nothing last summer.

Until next month,

Tony
## Investment positioning

**Portfolio targets effective 3/1/16 for high-net-worth clients with nontraditional assets**

<table>
<thead>
<tr>
<th>Stocks</th>
<th>Aggressive</th>
<th>Growth &amp; Income</th>
<th>Conservative</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>WT strategic benchmark</td>
<td>Current</td>
<td>Change this month</td>
</tr>
<tr>
<td>U.S. large-cap non-sector*</td>
<td>23.3%</td>
<td>30.0%</td>
<td>1.8%</td>
</tr>
<tr>
<td>U.S. large-cap sector ETFs*</td>
<td>23.3%</td>
<td>19.6%</td>
<td>0.0%</td>
</tr>
<tr>
<td>U.S. small-cap stocks</td>
<td>13.4%</td>
<td>12.3%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Developed international stocks</td>
<td>16.2%</td>
<td>21.9%</td>
<td>−1.8%</td>
</tr>
<tr>
<td>Emerging markets stocks</td>
<td>10.8%</td>
<td>3.3%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Total stocks</td>
<td>87.0%</td>
<td>87.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nominal bonds/cash</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>2.0%</td>
<td>1.0%</td>
<td>−1.0%</td>
<td>2.0%</td>
<td>7.4%</td>
<td>−1.0%</td>
<td>2.0%</td>
<td>2.4%</td>
<td>−1.0%</td>
</tr>
<tr>
<td>Core muni</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>26.4%</td>
<td>18.0%</td>
<td>0.0%</td>
<td>59.0%</td>
<td>48.8%</td>
<td>0.0%</td>
</tr>
<tr>
<td>High-yield munis &amp; corporates</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>7.0%</td>
<td>5.0%</td>
<td>0.0%</td>
<td>6.0%</td>
<td>6.3%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Non-core interest rate-sensitive</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>4.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>4.7%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Total nominal bonds/cash</td>
<td>2.0%</td>
<td>1.0%</td>
<td>−1.0%</td>
<td>35.4%</td>
<td>34.4%</td>
<td>−1.0%</td>
<td>67.0%</td>
<td>62.2%</td>
<td>−1.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Real assets</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nontraditional</td>
<td>5.0%</td>
<td>5.0%</td>
<td>0.0%</td>
<td>5.0%</td>
<td>5.0%</td>
<td>0.0%</td>
<td>5.0%</td>
<td>10.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Totals</td>
<td>100.0%</td>
<td>100.0%</td>
<td>0.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>0.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Forecasted performance</th>
<th>Aggressive</th>
<th>Growth &amp; Income</th>
<th>Conservative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected return</td>
<td>11.9%</td>
<td>12.0%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Expected standard deviation</td>
<td>15.5%</td>
<td>15.2%</td>
<td>10.2%</td>
</tr>
<tr>
<td>Strategy yield</td>
<td>1.9%</td>
<td>1.8%</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

* Large-cap allocations are broken down into the portion designated for use with active or passive managers (U.S. large-cap non-sector) and the portion using our Sector Allocation Strategy (U.S. large-cap sector ETFs). Current positions are shown on page 6 in the graph "Our sector inputs and allocations."

Source: Wilmington Trust Investment Advisors, Inc. (WTIA)

Our reference portfolios are developed from our long-term economic outlook, reflecting our highlighted themes as well as the insights of our investment and economic professionals, reference portfolios serve as a baseline strategic allocation for long-term investors.

Note: Rounding errors may cause the allocation subtotals of some asset classes to differ slightly from the building blocks of their allocations.

The expected returns presented constitute the informed judgments and opinions of Wilmington Trust about likely future capital market performance. No assurance can be given as to actual future market results or the results of Wilmington Trust’s investment products and strategies. Strategy forecasts are derived from the expected return and volatility assumptions in Wilmington Trust’s Capital Markets Forecast 2016–2026, which is available upon request. A summary of the calculations used to develop these numbers can be found in the disclosures section under forecasted performance. Return projections are pre-tax and pre-fees. Volatility (standard deviation of return) estimates are based on pre-tax return projections.

There is no assurance that forecast results will be realized or that any investment strategy will be successful.

Please see disclosures for information about our asset allocation strategies, risk assumptions, performance forecasts, fee assumptions, and other important information.
## Major themes

<table>
<thead>
<tr>
<th>Investment themes</th>
<th>Current positioning</th>
<th>Potential tipping points</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Prefer healthcare &amp; technology</strong></td>
<td>Through our sector approach, our underlying sector allocations favor both technology and healthcare. However we are reducing our overweights due to the upcoming elections, political uncertainty, and credit concerns.</td>
<td>Signs: Regulations restricting growth, profitability, or the ability to innovate new products; too-rich valuations.</td>
</tr>
<tr>
<td><strong>Minimal inflation pickup in sight</strong></td>
<td>Real assets are positioned to benefit from market opportunities in U.S. TIPS but the limited inflation threats are supported by no allocation to commodities.</td>
<td>Signs: Further wage growth acceleration, which would portend higher inflation. Evidence that slack in the labor market is disappearing. A pickup in global investment that reverses commodity price declines. A dramatic drop in the U.S. dollar.</td>
</tr>
<tr>
<td><strong>Income a main component of returns</strong></td>
<td>Current exposures include high-yield bonds and REITS which have the potential to provide high income levels. Active managers aim to reduce high-yield credit concerns and manage around riskier sectors such as materials and energy.</td>
<td>Signs: Dividend growth does not keep pace with GDP growth. Dramatic, longer-term collapse in credit conditions. Yields remain at current levels.</td>
</tr>
<tr>
<td><strong>Emerging markets to reemerge</strong></td>
<td>Within international stocks, we favor developed markets and, in particular, Europe. Underweighting emerging market stocks with no exposure to emerging market debt.</td>
<td>Signs: Indications that the commodity markets are taking a greater toll making a recovery very difficult. Signs that economies are not shifting from old to new.</td>
</tr>
</tbody>
</table>

## Have a question for our Chief Investment Officer or Chief Economist?

You are cordially invited to our quarterly Capital Perspectives Client Call on April 6 at 1:00 pm ET

Please join Tony Roth and Luke Tilley on an invitation-only client call, where they will offer market and economic insights and explore what they could mean for your portfolio.

Special guest speaker will be Stephen M. Goddard, CFA, Managing Director and Founder of investment firm The London Company. The speakers will take questions from listeners after their discussion.

**Callers in the U.S. and Canada** – 877.256.3246

**Call reservation number** – 21806694

**Note:** Please dial in 10 minutes early so you’ll have time to register before the call begins.
Stocks

**Asset Class Overview**

**Stocks**

<table>
<thead>
<tr>
<th></th>
<th>Month to date</th>
<th>Year to date</th>
<th>Trailing 12-month return</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>-0.1%</td>
<td>-5.1%</td>
<td>-6.2%</td>
</tr>
<tr>
<td>Russell 2000</td>
<td>0.0%</td>
<td>-8.8%</td>
<td>-15.0%</td>
</tr>
<tr>
<td>MSCI EAFE</td>
<td>-1.8%</td>
<td>-8.9%</td>
<td>-15.2%</td>
</tr>
<tr>
<td>MSCI Emerging Markets</td>
<td>-0.2%</td>
<td>-6.6%</td>
<td>-23.4%</td>
</tr>
</tbody>
</table>

Sources: FactSet, Bloomberg. Investing involves risks and you may incur a profit or a loss. Past performance is no guarantee of future results.

**U.S. stocks**

Stock market performance reflects a few factors that call into question the path of corporate earnings growth. Investors have been unnerved by continued weakness in oil prices and China’s currency and stock markets, along with short-term U.S. interest rate rise and a stronger U.S. dollar (USD). To reflect continued pressure from oil prices on stock returns, we cut our index earnings forecast for 2017 to $140 from $142. Our year-end 2016 target is 2170, down from 2201 ($140 times 15.5x forward P/E).

To develop a 9- to 12-month outlook on Russell 1000 sector rankings (chart below), we use three inputs: [macroeconomic](#), from our chief economist, based on sensitivity to factors such as credit spreads; [quantitative](#), which incorporates statistical analysis based on relative valuation and momentum; and [fundamental](#), from our portfolio managers and analysts.

The macro view has a slight pro-cyclical tilt reflecting a higher oil price forecast than currently discounted in the market. The quant model ranks healthcare and consumer discretionary lower, picking up on the reversal of these sectors’ relative momentum in this market pullback. The quant view is positive on telecom, and the fundamental view is more positive relative to last month, as our team detects foundational improvements at index heavyweights AT&T and Verizon, attractive yields, and reasonable valuation.

We prefer large-cap stocks to small, but believe a stronger case can now be made for small-caps as their relative underperformance has made their valuations more attractive. Also, small-caps are more exposed to the stronger U.S. economy and less subject to stresses from global weakness and the stronger U.S. dollar (USD).

**International**

Rising market concerns over global recession in 2016 so far negatively impacted international stock returns, both in foreign currency and USD terms. Such market fears led to an appreciation of traditional safe haven assets, such as gold and U.S. Treasuries and, to a lesser degree, the euro. As a result, the last month has not been a good time to be invested in currency-hedged eurozone and Japanese stocks, but we expect a stabilization of global financial markets and feel it should lead to recoveries for these areas. We see the June 23 “Brexit” referendum (on the withdrawal of the U.K. from the European Union) as a major risk to U.K. stocks, particularly in USD terms. Emerging markets, including those in the Asia ex Japan region, continue to present poor near-term prospects, in our view.

**Our sector inputs and allocations, as of 2/29/2016**

<table>
<thead>
<tr>
<th>GICS sector</th>
<th>Sector rank</th>
<th>Macroeconomic</th>
<th>Quantitative</th>
<th>Fundamental</th>
<th>U.S. large-cap sector allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financials</td>
<td>1</td>
<td>10</td>
<td>1</td>
<td>2</td>
<td><img src="#" alt="Macroeconomic" /></td>
</tr>
<tr>
<td>Telecom</td>
<td>2</td>
<td>8</td>
<td>3</td>
<td>7</td>
<td><img src="#" alt="Quantitative" /></td>
</tr>
<tr>
<td>Industrials</td>
<td>3</td>
<td>7</td>
<td>4</td>
<td>5</td>
<td><img src="#" alt="Fundamental" /></td>
</tr>
<tr>
<td>Technology</td>
<td>4</td>
<td>9</td>
<td>2</td>
<td>3</td>
<td><img src="#" alt="U.S. large-cap sector allocations" /></td>
</tr>
<tr>
<td>Materials</td>
<td>5</td>
<td>1</td>
<td>8</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td>6</td>
<td>5</td>
<td>5</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Healthcare</td>
<td>7</td>
<td>6</td>
<td>6</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>8</td>
<td>2</td>
<td>7</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Discretionary</td>
<td>9</td>
<td>3</td>
<td>10</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Staples</td>
<td>10</td>
<td>4</td>
<td>9</td>
<td>10</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Bloomberg, WTIA

Continued...
U.S. Treasuries

U.S. Treasury rates declined over the month as commodity prices continued to fall and the scope of lackluster global economic growth prospects grew. The 10-year note hit an intra-month yield of 1.65%, its lowest in 12 months. The yield curve continued to flatten over the month, as we expected. Treasury inflation-protected securities (TIPS) outperformed nominal Treasuries (not tied to inflation), as January’s Consumer Price Index (the inflation barometer) was slightly higher than expected. Nonetheless, given the low level of inflation and inflationary expectations, TIPS continue to trade well below their long-run breakeven levels.

Investment-grade corporates

Risk premiums for investment-grade (IG) credit increased in February, following a significant widening of the risk premium in January. The option-adjusted spread of the Barclays U.S. Credit Index widened 3 basis points (bps) to 184bps, as of February 29. The energy sector underperformed both Treasuries and the overall IG market. Lower oil prices for a longer period of time should lead to a number of credit rating downgrades for the sector. Banks also underperformed during February, due to concern about bank net interest margins and energy exposure. The new issue market remains active and the pipeline of new deals strong.

High-yield corporates

The selloff in high yield (HY) gathered momentum in February amid accumulating signs of global distress. Concerns include: increasing balance sheet stress in the U.S. energy sector amid fresh headlines surrounding possible bankruptcies; heightening stress on select European financials, with credit spreads widening to a high not seen since 2011; and questions on the part of investors around the efficacy of extreme global central bank measures. The rout on the energy complex has only deepened with oil prices settling in the mid-$30s. As a result, the HY market is likely to post an unprecedented (nearly consecutive) loss record, down in 8 of the last 9 months.

Municipals

Volatility in stocks, commodities (particularly oil), and global uncertainties have driven the “risk-off” trade early in 2016. Municipals have benefited, as demonstrated by the 1.0% total return YTD from the S&P Municipal Bond Index. Mix in the often crazy presidential primary season and one can see continued volatility ahead. Individuals seeking yield have reached down the credit spectrum in municipals, driving spreads narrower and narrower. Fund flows are strong and, until that changes, we expect HY municipal spreads to continue to be tight.

International

Japanese yen-denominated bonds have recently appreciated in value, not only due to their perceived safe haven status during a period of global volatility, but also because the Bank of Japan adopted a negative interest rate for a key short-term policy rate. We foresee the European Central Bank further reducing its already negative policy rate, which may lead to some appreciation of euro-denominated bonds. We expect considerable volatility in sterling bonds as we approach the June 23 Brexit referendum (on the withdrawal of the U.K. from the European Union). As for USD-denominated emerging markets bonds, which are of relatively long duration, we expect continued whipsawing, since U.S. long-term yields and oil prices remain highly volatile.

Sources: FactSet, Bloomberg.

Investing involves risks and you may incur a profit or a loss. Past performance is no guarantee of future results.
Nontraditional

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>AS OF FEBRUARY 29, 2016</th>
<th>Month to date</th>
<th>Year to date</th>
<th>Trailing 12-month return</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P Developed Property Index</td>
<td>0.7%</td>
<td>-3.7%</td>
<td>-7.1%</td>
<td></td>
</tr>
<tr>
<td>Barclays Inflation-Linked Bond Index</td>
<td>0.4%</td>
<td>2.6%</td>
<td>0.1%</td>
<td></td>
</tr>
<tr>
<td>UBS Bloomberg CMCI (commodity) Index</td>
<td>-1.6%</td>
<td>-3.3%</td>
<td>-26.5%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hedge Fund Research Institute Indexes</th>
<th>AS OF JANUARY 31, 2016</th>
<th>Month to date</th>
<th>Year to date</th>
<th>Trailing 12-month return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund Weighted</td>
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<td>-2.4%</td>
<td>-3.5%</td>
<td></td>
</tr>
<tr>
<td>Equity Hedge</td>
<td>-4.4%</td>
<td>-4.4%</td>
<td>-4.3%</td>
<td></td>
</tr>
<tr>
<td>Event Driven</td>
<td>-3.2%</td>
<td>-3.2%</td>
<td>-5.8%</td>
<td></td>
</tr>
<tr>
<td>Macro</td>
<td>1.2%</td>
<td>1.2%</td>
<td>-2.5%</td>
<td></td>
</tr>
<tr>
<td>Relative Value</td>
<td>-1.6%</td>
<td>-1.6%</td>
<td>-1.8%</td>
<td></td>
</tr>
</tbody>
</table>

Sources: FactSet, Bloomberg.
Investing involves risks and you may incur a profit or a loss. Past performance is no guarantee of future results.

REAL ASSETS

Listed real estate
Global listed real estate fell hard in January, in line with stock markets. U.S. real estate performed better than international markets, as market turmoil has meant decreased probability of interest rate increases. February price movements were volatile.

Inflation-linked bonds
Inflation-linked bonds (ILBs) gained over 2% in January as flight to quality drove down real yields to levels not seen since the 2Q 2015. Inflation expectations fell sharply in January, and continued to drift down in February despite a U.S. Core CPI release that came in above consensus forecasts.

Commodities
Energy has continued to see remarkably volatile trading; from the beginning of the year through February 29 Brent Crude has experienced 10 days of price moves greater than 5% and has moved more than 3% on 20 trading days. Commodities outside the energy patch have begun to see divergent performance—precious metals are up strongly and certain agricultural commodities have seen price gains.

HEDGE FUND STRATEGIES

Equity hedge funds
January was the worst month for equity hedge funds since May of 2012. Losses were most pronounced in technology and healthcare specialists as well as managers with significant positions in Asia. Among managers with significant net exposure, European managers fared best.

Event-driven hedge funds
Event driven finished down with losses concentrated in activist and special situations managers who are often long biased. Merger arbitrage was the top-performing sub-strategy and though down, distressed funds were able to limit losses, in part due to increased cash positions.

Macro hedge funds
Macro managers had a positive month, with systematic trend-following strategies leading the way. Widely held profitable trades included short positions in commodities and stocks. Discretionary macro managers saw more muted performance as gains were offset by losses in short fixed income trades and volatile currency positions.

Relative-value hedge funds
Relative-value (RV) strategies were negative but managers were generally able to limit losses. Volatility trading and sovereign fixed income RV were down less than 0.5% and yield alternatives was the only sub-strategy that lost more than 2%.

OTHER

Private markets
Despite market volatility, private markets fundraising activity was strong in the second half of the year. While the total number of funds closed declined year over year, aggregate capital raised is poised to meet or exceed 2014 levels. Equity fundraising declined slightly on valuation fears while debt saw a significant increase as investors sought new sources of yield.

CONTINUED
Fiscal year 2015 records show we are in hock for a whopping $18.1 trillion—with $13.1 trillion held by the public.¹ The debt tally represents 74% of gross domestic product (GDP), according to the Congressional Budget Office (CBO)—more than double the 35% recorded in 2007 before the Great Recession (Figure 1). That the measure has increased is understandably worrisome, yet interest rates remain low, an indication that investors still see little risk of non-repayment.

Are we at risk?

Whether the U.S. will continue to be viewed as able to repay its debt remains uncertain. In our Capital Markets Forecast, we argue these fiscal issues are a key risk to the long-term health of the U.S. economy. There has been much improvement in annual deficits following the explosion of borrowing (e.g., the $800 billion stimulus plan and rising unemployment insurance) that coincided with the Great Recession. After surging more than three-fold from 3.1% of GDP in 2008² to 9.8% in 2009, thanks to a correcting economy and higher revenues, the annual deficit came down in subsequent years, reaching 2.5% in 2015.

The CBO projects that 2016 will mark an about-face in that deficits will begin climbing once again due to rising debt obligations and the unsustainability of the federal health and pension programs of Medicare, Medicaid, and Social Security (Figure 2). Net interest payments on the debt are projected to more than double from $223 billion in 2015 to $498 billion by 2020. Spending on all mandatory programs is projected to increase by $682 billion over that time and the 10-year outlook is even worse.

What’s the answer?

The math of fixing the budget deficit is simple. Making real-life changes to effect a solution is another matter entirely. Simply taxing more would be damaging to long-term economic health. And there is not enough room to cut discretionary spending enough to solve the problem. So where does that leave us? Any viable long-

¹ Budget and Economic Outlook, January 2016. Economists typically focus on debt held by the public, which excludes debt held internally within government accounts such as the Social Security Trust Fund.

² All dates refer to federal government fiscal years.
term solution must include changes to the health and pension programs as well as some higher revenue. Solving the long-term budget outlook is the most important economic issue of the 2016 election cycle, and there are currently no signs of a positive outcome. Let’s take a look at where the presidential candidates stand on this serious issue.

On the right…

The leading Republican candidates’ proposals differ in the details but can generally be characterized as simplifying the tax code and reducing tax rates, which in turn would cut revenue and add to the debt. Donald Trump’s proposal would greatly lower marginal tax rates on individuals and businesses, increasing standard deduction amounts to nearly four times current levels, and decreasing many tax expenditures. The nonpartisan Tax Policy Center (TPC) estimates his proposal would cut federal revenue by $9.5 trillion over its first decade and add an additional $11.2 trillion to the national debt.

Ted Cruz’s plan would enact a 10% flat tax on individual income and replace the corporate income tax with a 16% value-added tax, or VAT. The TPC estimates reduced revenue of $8.6 trillion and increased debt of $10.2 trillion over 10 years. Marco Rubio’s plan would reduce today’s seven income tax rates to just three: 15%, 25%, and 35%, and set the corporate rate at 25%. The TPC estimates a $6.8 trillion hit to revenue which would hike the debt by $8.2 trillion over 10 years. The TPC does not figure in the dynamic impacts of possible stronger economic growth that these candidates argue would result from a lower tax environment. We feel these policies would almost certainly have a positive impact on growth, but not enough to make them debt-neutral.

“Even with the potentially stronger growth from lower taxes, we feel these policies would not be positive enough to be debt-neutral.”

Even with the potentially stronger growth from lower taxes, we feel these policies would not be positive enough to be debt-neutral.
…and the left

Hillary Clinton has proposed keeping the current tax rate structure but also adding a 4% surtax on incomes over $5 million. She also supports a 30% effective rate for anyone with income over $1 million. On capital income, she proposes raising the holding period for long-term capital gains to two years with a declining rate on gains the longer they are held, down to 20% for assets held over six years, and then tax the carried interest as ordinary income.

Most of her policies raise tax revenue as designed, except for her capital gains policy, which would actually end up losing revenue due to the incentives it creates to hold assets longer. She would also repeal fossil fuel tax incentives and increase estate and gift taxes. The TPC estimates her plan would increase revenue by $1.1 trillion over the next 10 years and reduce the debt by $1.3 trillion. And the converse of its Republican proposals calculations holds true here as well, i.e., it doesn’t factor in any drag on economic growth that may come from higher taxes. Bernie Sanders has proposed increases across the tax spectrum and says he’d use the additional estimated $13.6 trillion in revenue over the next decade to pay for sweeping new government programs.

It’s déjà vu all over again

We find ourselves in familiar territory. Republicans are proposing weighty tax cuts they promise will bolster the economy so much that they’ll pay for themselves, while Democrats are proposing some higher taxes, especially on the wealthy, and some new spending programs. We believe a realistic solution lies in a blend of the two extremes to achieve broad reform of the tax code, to include gingerly raising taxes so as to not negatively impact economic activity, while also reducing the long-term costs of the major entitlement programs. Any progress of course would require more political unity than we have today, or that we have had in quite some time. Will anyone be able to achieve a sensible, long-term plan that will put the debt-to-GDP ratio on a downward path? That remains to be seen.
Barclays Ba U.S. High Yield Index
Measures the performance of a subset of Barclays U.S. Corporate High Yield Index with issues rated Ba, the highest speculative-grade quality rating.

Barclays Inflation-Linked Bond Index
Measures the performance of publicly issued U.S. Treasury inflation-protected securities (where par value is adjusted semi-annually based on measures of broad inflation) that have at least one year to maturity on index rebalancing date.

Barclays U.S. Aggregate Bond Index
Measures the performance of the U.S. market of taxable, fixed-rate, investment-grade bonds with at least one year to maturity.

Barclays U.S. Corporate High Yield Index
Measures the performance of taxable, fixed-rate bonds issued by U.S. companies rated below investment-grade quality rating (i.e., speculative grade or high yield) with at least one year to maturity.

Barclays U.S. Credit Index
Measures the performance of U.S. investment-grade corporate and government agency bonds with at least one year to maturity.

Cambridge Associates U.S. Private Equity Index
Measures the performance of a broad range of private equity funds (e.g., buyout, growth equity, sector focus, and mezzanine funds) based on end-to-end calculation of data compiled from over 1,100 U.S. private equity funds formed since 1986, including fully liquidated funds.

Commodities
A basic, physical good used in commerce—such as corn, gold, beef, oil, and natural gas—that is interchangeable with similar types of goods. Investment exposure in commodities may be obtained directly, through futures or other derivatives, or by investment in companies with business exposure to one or more commodities.

(CBOE) Volatility Index® (VIX®)
A key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Since its introduction in 1993, VIX has been considered by many to be the world’s premier barometer of investor sentiment and market volatility. Several investors expressed interest in trading instruments related to the market’s expectation of future volatility, and so VIX futures were introduced in 2004, and VIX options were introduced in 2006.

DXY Index
Measures the value of the U.S. dollar relative to the currencies of several significant trading partners.

Global Industry Classification Standard (GICS)
Developed in 1999 by Standard & Poor’s and MSCI Barra in response to the global financial community’s need for a complete, consistent set of global sector and industry definitions.

Gross domestic product (GDP)
Often cited as an indication of the economy’s overall health, GDP measures the value of all finished goods and services produced over a certain period, expressed on an annualized basis.

Hedge funds
A nontraditional investment, these funds afford their managers more latitude to pursue their insights than traditional, long-only investing. Hedge fund strategies include trading across financial markets, employing leverage and taking concentrated or short positions. Some common examples of types of hedge fund strategies include:

Event-driven
Strategies that seek to take advantage of pricing inefficiencies that may occur before or after a corporate event, such as a bankruptcy, merger, acquisition, or spinoff.

Macro
Strategies that seek to take advantage of movements in broad economic variables and the impact these can have on capital flow across equity, bond, currency, and commodity markets.

Relative-value arbitrage
Describes a basket of strategies using an array of related securities; purchasing the side that is expected to appreciate while shorting the related security that is expected to depreciate, e.g., stocks of the acquiring versus the acquired companies in an acquisition, convertible bonds versus stocks of the same issuer, etc.

High-yield (speculative-grade) credit
Bonds of issuers deemed to be at risk of (or in) default on interest and/or principal payments, as reflected in their quality ratings. Such issuers typically offer higher yields to compensate investors for higher credit risk.

Hedge Fund Research Institute (HFRI)
Fund of Funds Composite
Benchmark designed to reflect the results of over 800 domestic and offshore fund of funds using a broad range of hedge strategies. The index is equal-weighted among reporting funds, which must have at least $50 million in assets or have been active for 12 months. Funds report returns net of fees. The broad index is used to illustrate the results of hedge funds of funds generally, with sub-indexes focusing on specific strategies.

HFRI Fund Weighted Composite Index
Encompasses over 2000 funds, to the increasingly specific-level of the sub-strategy classifications. The funds are weighted based on the asset size of the underlying indices.

HFRI Equity Hedge Index
Index of hedge funds that mainly manage their portfolios through both long and short positions in equity securities and derivatives.

Investment-grade credit
Bonds of issuers deemed to have at least adequate protection of their capacity to meet financial commitments, as reflected in their quality ratings. Such issuers tend to offer lower interest rates than more speculative issuers as a result of the higher credit quality implied by such ratings.

CONTINUED
J.P. Morgan Global High Yield Index
Consists of fixed income securities of domestic and foreign issuers with a maximum credit rating of BB+ or Ba1. This index seeks a high level of current income by investing primarily in a diversified portfolio of debt securities that are unrated or rated below investment grade. Capital appreciation is a secondary objective.

J.P. Morgan Leveraged Loan Index
Designed to mirror the investable universe of U.S. dollar institutional leveraged loans, including U.S. and international borrowers.

J.P. Morgan U.S. Liquid Index
Market-weighted index that measures the performance of the most liquid issues in the investment-grade, U.S. dollar-denominated corporate bond market.

MSCI ACWI ex USA Investable Market Index
Captures large-, mid-, and small-cap representation across 22 developed market countries outside the U.S. and 23 emerging markets countries. With over 6,000 constituents, the index covers approximately 99% of the equity opportunity set outside the U.S.

MSCI EAFE Index
Measures the performance of global developed equity markets in Europe, Australasia, and the Far East, excluding U.S. and Canada.

MSCI Emerging Markets Index
Measures stock market performance in the global emerging markets, covering over 800 securities across 23 markets and representing roughly 13% of world market capitalization.

Nontraditional assets
(also referred to as alternative investments)
Seek risk exposures and return drivers that are different from traditional, long-only financial market investments. Exposure may be sought by targeting particular assets, such as real estate or commodities, or through strategies with more latitude to pursue manager insights, such as trading across financial markets and/or taking short positions (i.e., hedge strategies).

Private equity
Nontraditional asset that pursues investment in equity or debt securities of operating companies, typically with the intent to exert control over the management of company and often targeting a particular industry, financial condition, and/or stage of development.

Quality ratings
Used to evaluate the likelihood of default by a bond issuer. Independent rating agencies analyze the financial strength of each rated issuer. Moody’s ratings range from Aaa (highest quality) to C (lowest quality). Bonds rated Baa and better are considered “investment grade.” Bonds rated Ba and below are “speculative grade” or “high yield.” Similarly, Standard & Poor’s ratings range from AAA to D. Bonds rated BBB– and better are considered “investment grade” and bonds rated BB+ and below are “speculative grade.”

Speculative grade (also “high yield”)
Bonds of issuers deemed to be at risk of or in default of interest and/or principal payments, as reflected in their quality ratings. Such issuers tend to offer higher interest rates than investment-grade bond issuers as a result of the lower credit quality implied by such ratings.

Russell 1000 Index
Measures the performance of the 1,000 largest companies in the Russell 3000 Index, representing approximately 90% of U.S. equity market cap.

Russell 2000 Index
Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, representing approximately 8% of U.S. equity market cap.

Russell 3000 Index
Measures the performance of the 3,000 largest U.S. companies based on total market capitalization, representing approximately 98% of the investable U.S. equity market.

Russell Midcap Index
Measures the performance of the 800 smallest companies in the Russell 1000 Index, representing approximately 25% of U.S. equity market cap.

S&P 500 index
Measures the performance of approximately 500 widely held, typically large-cap, common stocks listed on U.S. exchanges, as selected by S&P.

S&P Developed Property Index
Measures an investable universe of publicly traded companies in developed markets that are engaged in real estate-related activities such as property rental, development, or management.

S&P Municipal Bond Index
Measures the performance of U.S., fixed-rate bonds exempt from federal income tax, though they may be subject to the alternative minimum tax, with par outstanding of at least $2 million. The index includes bonds of all quality ratings, including non-rated and defaulted bonds, and from all sectors of the municipal bond market.

Treasury inflation-protected securities (TIPS)
A security issued by the U.S. Treasury that has both a fixed interest rate component and a par value that rises with inflation, as measured by the Consumer Price Index. Interest on TIPS is paid semiannually.

UBS Bloomberg CMCI (Constant Maturity Commodity Index)
Diversifies across both a broad range of commodities (27 futures contracts across a number of sectors, such as precious metals, agricultural and livestock) and investment maturities for each individual commodity. It is the first commodity index to include a time dimension.
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Indexes are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that would reduce returns.

An overview of our asset allocation strategies:

Wilmington Trust offers five model asset allocation strategies each for taxable and tax-exempt investors with particular sets of risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. Each strategy can be implemented with or without allocations to hedge funds. Reference portfolios are maintained for each strategy and, on a quarterly basis, we publish the results of all of these strategy models versus benchmarks representing static investments without tactical tilts.

Model strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international large-cap, developed international small-cap and emerging market stocks, inflation hedges (including global inflation-linked bonds and commodity-related and global real estate-related securities), investment-grade bonds (corporate or municipal), high-yield corporate bonds and floating-rate notes, and cash equivalents. Directional and absolute return hedge funds are distinct to the strategies with hedge funds. Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.

Forecasted performance:

Expected results are hypothetical and do not represent the performance of client accounts or actual investment products. “Expected returns” for each strategy are derived from our forecast returns for the underlying assets as described in the Capital Markets Forecast 2016–2026 and weighted based on their current allocation percentage. Forecasts are subject to a number of assumptions regarding future returns, volatility, and the interrelationship (correlation) of asset classes. Actual events may differ from underlying assumptions, which are subject to various uncertainties. No assurance can be given as to actual future market results. Expected returns for the individual asset classes are based on factors including, for equity-based securities, dividend growth rates and dividend yield changes. For fixed income securities, expected returns are calculated based on principal impacts from changes in the underlying U.S. Treasury curve, yield spread changes vs. the U.S. Treasury curve, and the interest income that could be earned. Estimates of default rates are also taken into consideration. “Expected standard deviations” are forecast from the trailing 10-year rolling standard deviation of the asset class and “Expected yield” is based on the current expected dividend or interest income and is expressed as a percentage of the underlying principal value.
Fee assumptions:
No adjustments are made for advisory fees, transaction costs, or any other expenses. In the course of implementing a given asset allocation, clients could select among a number of investment vehicles or strategies, each of which will have such fees and expenses. These expenses have the effect of reducing returns at a compound rate over time, and would reduce the results shown. In cases where Wilmington Trust, or an affiliate, provides advisory, brokerage, or other services to such an investment vehicle, Wilmington Trust may benefit directly or indirectly from those advisory, brokerage, or other fees. Investors should develop a thorough understanding of the fees, expenses, and other costs of any investment prior to committing funds.

Impact of fees:
The following is a hypothetical example of the impact over time of fees charged to a client’s account. It is not meant to suggest actual fees, which may vary, and does not reflect actual returns. Assuming an initial investment of $1,000,000 account value and an average annual return of 10%, an annual fee of 100 basis points (i.e., 1.00%) would result in account level fees of $10,641 the first year, $35,351 over three years, and $65,458 over five years. A schedule of Wilmington Trust's fees is available upon request.

Actual results will vary from forecast results:
In the course of implementing a given asset allocation, clients could select among a number of investment vehicles or strategies, each of which would contribute differently to overall results. The returns for individual clients will vary depending upon the performance of each actual investment vehicle or activity, any restrictions, inception date, timing of rebalancing, actual expenses and fees, and other factors.

Risk assumptions:
All investments carry some degree of risk. This publication uses the return volatility, as measured by standard deviation, of asset classes as a proxy for illustrating risk. Volatility serves as a collective, quantitative estimate of risks present to varying degrees in the respective asset classes (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. Investors should develop a thorough understanding of the risks of any investment prior to committing funds.

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