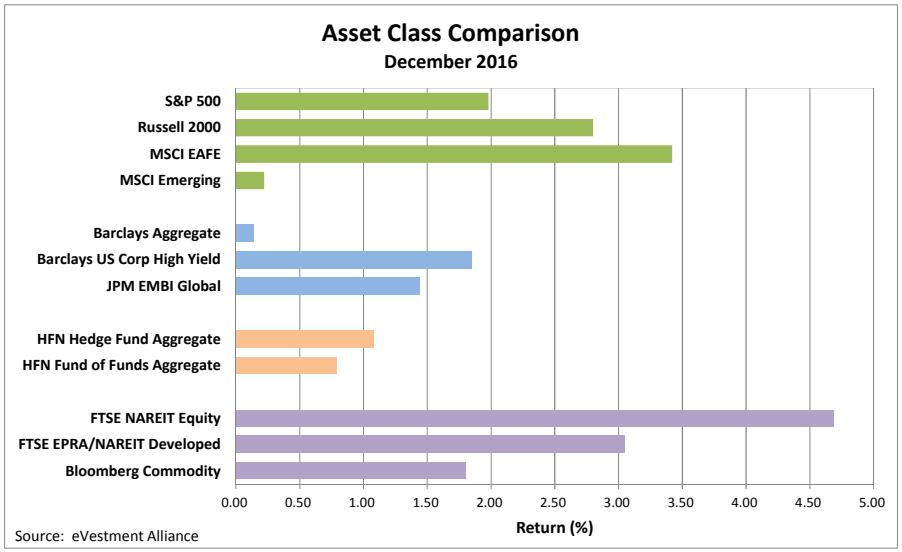
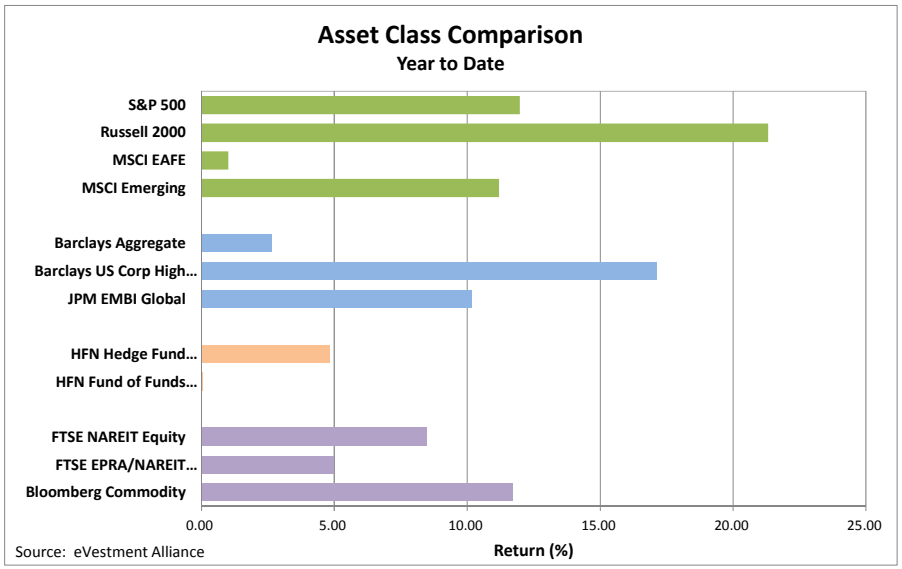
MESA: Monthly Market Flash

December 2016





Market Overview

- U.S. equity markets rallied on strong economic data releases, optimism over the pro-business policies of the incoming administration and encouraging comments made by the Fed on the state of the economy. European markets advanced on continued accommodation by the central bank. The ECB extended its asset purchase program, which was set to expire in March 2017, through year-end and possibly into 2018. In addition, although it did reduce the size of monthly purchases from €80 billion to €60 billion beginning in April 2017, it eliminated restrictions on which bonds could be purchased. Emerging market equities lagged developed markets as the potential for protectionist trade policies out of the U.S. weighed on sentiment. The U.S. dollar was stronger versus most major market currencies as the U.S. Federal Reserve raised the Federal Funds target rate by 25 bps to a range of 0.50%-0.75% on December 14th. This represents only the second such increase in ten years.

- In fixed income markets interest rates were on the rise while corporate yield spreads tightened. Lower quality issues outperformed higher quality as investors continued to embrace risk. The high yield market experienced gains as energy issues rallied on the back of increases in oil prices. Oil prices increased on OPEC's deal to reduce output. WTI Crude was up more than 6.5% on the month. Dollar denominated emerging markets debt was up 1.4% in December after a tough couple of months, on a rise in market rates, ending the quarter with a return of -4.2% but capping the year with a very healthy return of 10.2% as investors sought out good relative value and the outlook for emerging economies improved. Local currency emerging market debt was up 1.9% for the month, fell -6.1% for the quarter but gained 9.9% for the year. The emerging market debt market, as measured by the JPM EMBI Global Index, ended the year with a yield-to-worst of 6.05% and a spread of 365 bps. High yield ended 2016 with a yield-to-worst of 6.12% and a spread of 409 bps.

- REITS put in a very strong performance for December after struggling for several months on concern over rising interest rates. Fundamentals in the commercial real estate market continue to be good compelling investors to be somewhat less focused on rates and more focused on earnings growth. In commodity markets, a rise in oil prices drove returns for the broader commodity index for the month (+1.8%), quarter (+2.6%) and year (+11.8%).

Equity Markets

- U.S. equities registered solid returns in December, as the post-election rally continued during the first half of the month. By mid-month, there was a pause in the market's advance given the Federal Reserve's decision to raise the Federal Funds target rate, change in its forecast for the number of target rate increases for 2017, end-of-year portfolio repositioning and the typical slowdown ahead of the holidays. All told, the S&P 500 was up nearly 2% for December and 3.8% for the quarter. Small cap stocks beat large caps returning a solid 2.8% for the month and 8.8% for the quarter. Value stocks beat growth across the capitalization spectrum. Within industry sectors, energy and financials were the best relative performers in the month on a rise in oil prices and interest rates, in addition to the expectation of financial market deregulation in the future under the Trump administration. In overseas markets, Europe outperformed the U.S. and other developed markets on central bank accommodation. Emerging markets lagged with Russia being the notable performance standout on a rise in oil prices and the currency.

Fixed Income Markets

- Interest rates increased and the yield curve flattened with the biggest increases impacting the short end of the curve. The 2- and 5-year Treasuries increased by 8-9 bps ending the year at 1.19% and 1.93%, respectively. The 10-year maturity increased 6 bps to end the year at 2.45% while the 30-year Treasury was up 3 bps to 3.07%. Despite the increase in interest rates, the BC Aggregate Index was up fractionally (+0.14%) as corporate spreads tightened and credit outperformed. Corporates outperformed like-duration Treasuries by 82 bps while mortgage-backed securities outperformed by a more modest 6 bps. Speculative grade credit, both high yield and leverage loans, outperformed the investment grade market ending the year with equity-like returns.

Alternative Strategies

- Across hedge fund strategies, equity and credit strategies were performance leaders while CTA/managed futures strategies also put in respectable performance. For the year, event-driven, and in particular distressed credit were standouts, a reflection of a rebound in energy and strength in the speculative grade credit market.

Developed Market Returns (%)

	Month	Year to Date
S&P 500	1.98	11.98
Russell 2000	2.80	21.32
MSCI EAFE ($)	3.42	1.01
MSCI Europe ($)	5.24	(0.41)
MSCI UK ($)	4.14	(0.11)
MSCI Japan ($)	0.97	2.37
MSCI Pacific ex Japan ($)	(0.55)	7.85

Source: eVestment Alliance, MSCI

Emerging Market Returns (%)

	Month	Year to Date
MSCI EM ($)	0.22	11.20
MSCI EM Asia ($)	(1.34)	6.52
MSCI EM EMEA ($)	7.21	19.95
MSCI EM Latin America ($)	0.87	31.05

Source: eVestment Alliance, MSCI

U.S. Fixed Income Returns (%)

	Month	Year to Date
Barclays Aggregate	0.14	2.66
Barclays Government	(0.11)	1.04
Barclays U.S. TIPS	(0.10)	4.69
Barclays U.S. Inv. Grade Corp.	0.67	6.11
Barclays U.S. Mortgaged Backed	0.00	1.69
Barclays U.S. High Yield	1.85	17.14
Credit Suisse Leveraged Loan	1.15	9.87

Source: eVestment Alliance, Barclays, Credit Suisse

Non-U.S. Fixed Income Returns (%)

	Month	Year to Date
Citigroup Non-U.S. WGBI Hedged	0.37	5.13
Citigroup Non-U.S. WGBI Unhedged	(0.97)	1.80
JP Morgan EMBI Global	1.44	10.20

Source: eVestment Alliance, Citigroup, JP Morgan