sonen capital

Social & Environmental impact investment management

Market Commentary

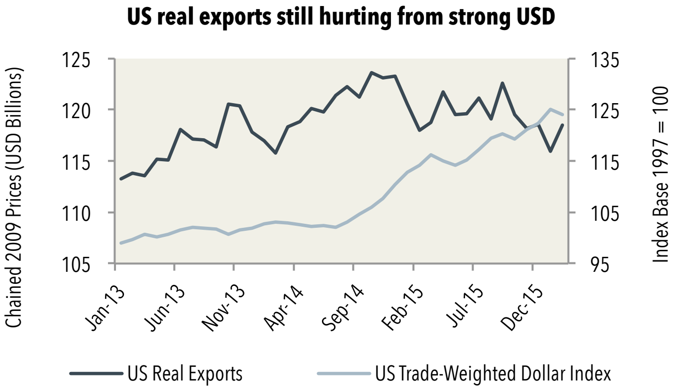
FIRST QUARTER 2016 REPORT

GLOBAL ECONOMIC REVIEW

» Q1 2016 included one of the worst starts to the year on record for equity markets. The MSCI ACWI had fallen 11.5% by the middle of February as investors fretted anew over the worries that have driven markets for the past couple of quarters: China, oil and interest rates. Global equities recovered during the rest of the quarter, however, and the index finished roughly flat.

» The US economy is generally robust, but the data are mixed and the Fed is moving cautiously as it seeks to normalize monetary policy. Unemployment is down to 5%, but as indicated by the two charts below, the headline unemployment rate does not tell a complete economic story. The strong dollar and falling real incomes represent headwinds. Importantly, the labor force participation rate in the US has begun to tick upward and is now at 63%.

» The strong USD has hurt real exports in the US, which peaked in late 2014 and have been trending down since then. Median household income in the US has also been on a downward trend, roughly since the Dot Com crash in 2000.



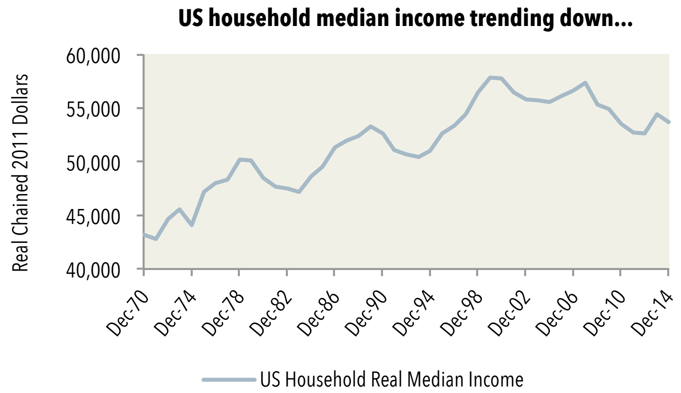
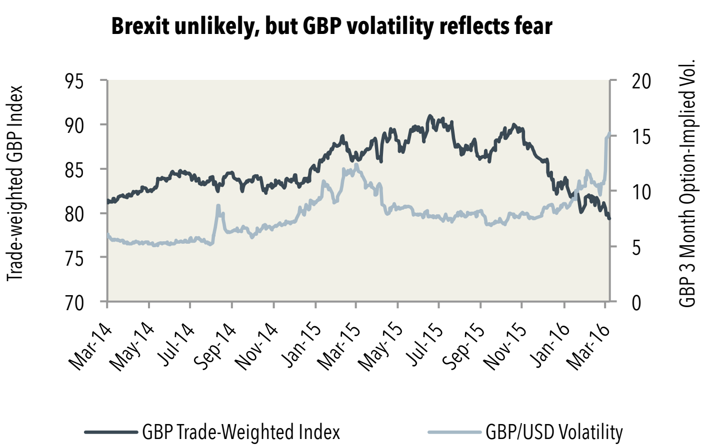


Chart Data Source: Bloomberg.

» Until recently, many investors dismissed "Brexit" (Britain exiting the European Union) as a remote possibility and a fringe idea propagated by nationalist Britons. Now, polls suggest that those for and against Brexit have roughly equal numbers in Britain. While we still see Brexit as unlikely, it is difficult to ignore the spike in Sterling volatility over recent months. The possibility that Britain might leave the EU has created another risk factor adding to investor uncertainty.

» While Brexit may not be a sensible solution to Britain's economic problems, Britons are understandably frustrated over the lack of growth in Europe. Neither European, US, nor Japanese central bankers have been able to generate the inflation they've been seeking.

» Finally, global growth remains sluggish, and the engines of recent growth – developing economies – are not providing sufficient support to lackluster developed market growth. Despite a weakening USD in Q1 2016 (and a rise in the price of oil), we believe developing economies are not likely to provide a significant boost to global growth and inflation in the near-term.



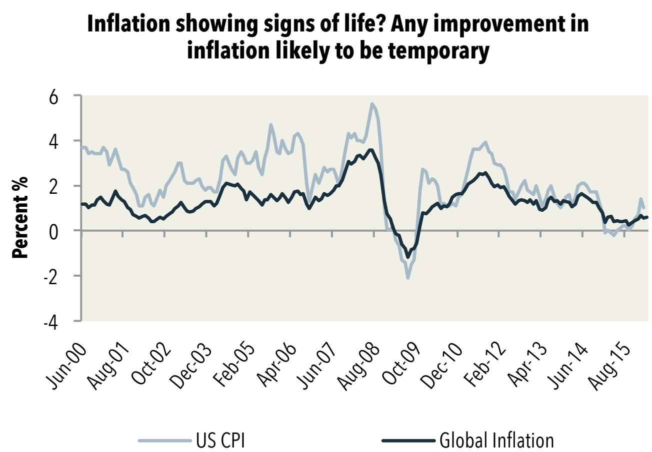


Chart Data Source: Bloomberg, Barclays.

GLOBAL FIXED INCOME REVIEW

- The Barclays Global Aggregate bond index returned 5.90% in the first quarter as risk appetite wavered. The beginning of the quarter saw sharp selloffs in the riskier components of the index, while the latter half of the quarter saw the lower end of investment grade rally.
- While long duration sovereign bonds generally outperformed shorter duration, and drove returns in the Barclays Global Aggregate, a significant portion of the benchmark's Q1 return was driven by appreciation in the Japanese yen (see chart below). The yen appreciated almost 7% vs. the USD despite the Bank of Japan's continued efforts to weaken it.
- Investment grade corporate bonds generally underperformed the Barclays Global Aggregate, although long duration corporate bonds outperformed. US High Yield underperformed the Global Aggregate as well, despite strong performance in March from lower-rated bonds.

Fixed income sector performance: Q1 2016

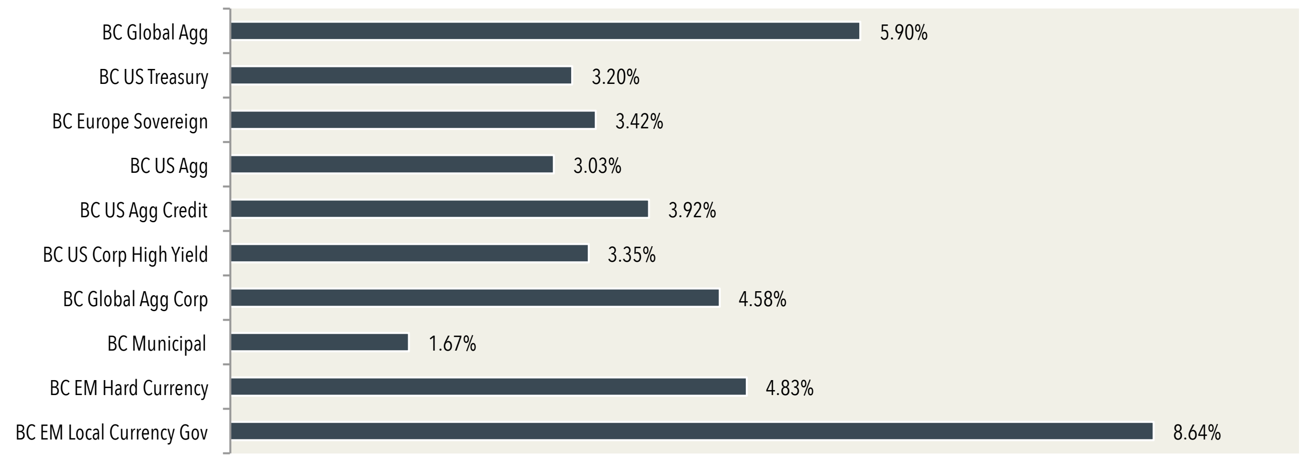
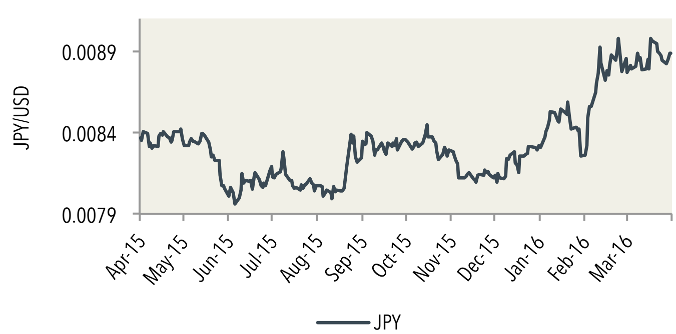


Chart Data Source: Barclays, Bloomberg.
Past performance is no indication of future results. Index returns and sector returns are for illustrative purposes only and do not represent the return of any particular investment. Indices are unmanaged. Index performance returns include the reinvestment of dividends or interest and do not reflect management fees, transaction costs or expenses. You cannot invest directly in an index.

- Emerging market bonds rallied strongly in Q1 after dismal performance in 2015. Investors bought these riskier assets after determining that they were generally oversold.
- EM currencies, particularly those of commodity exporters, rallied in Q1 as the price of oil rose and investors waded back into developing market assets. Strong beneficiaries included the Brazilian real and Russian ruble, however, neither country appears poised for an economic recovery and currency appreciation may be short-lived.

JPY appreciation in Q1 reflected concerns over viability of Japanese reflation efforts



BRL and RUB led Q1, but neither is likely to solve economic problems quickly

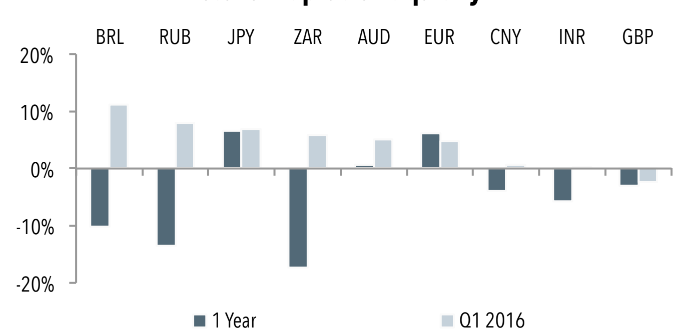


Chart Data Source: Barclays, Bloomberg.

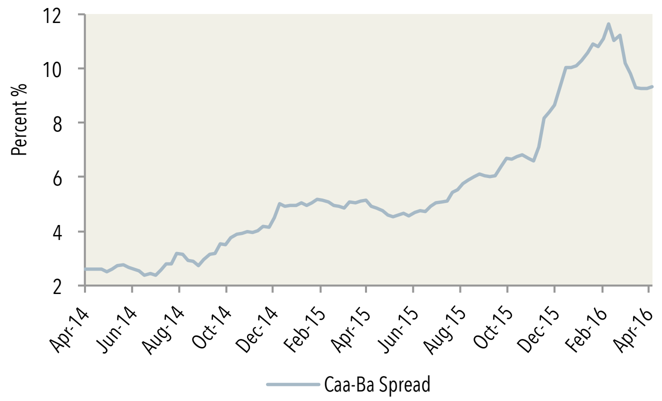
GLOBAL FIXED INCOME REVIEW

» After rising dramatically between the summer of 2014 and the winter of 2016, the spread between the lowest-rated and the highest-rated US High Yield bonds swiftly declined in the second half of Q1. Investors saw some stabilization in oil prices (which we believe to be temporary given continued oversupply), as well as improving Chinese economic data, and responded by buying lower-rated securities.

» Additionally, zero- and negative-interest rate regimes across developed markets continue to force investors to seek yield-generating assets in riskier segments, such as high yield and EM.

» Investors reacted similarly in Europe. After reaching 2012 levels (the height of the European debt crisis), the spread between High Yield and Investment Grade corporate bonds narrowed sharply in the second half of Q1.

Spread between lower and higher quality US HY bonds has fallen since mid-Q1



Likewise, spreads between riskier and less risky debt have narrowed in Europe

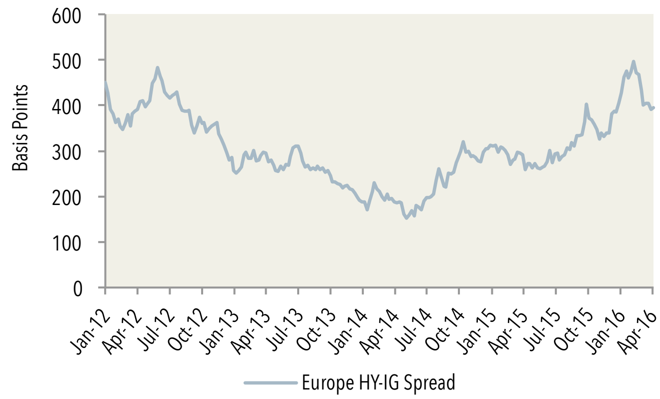


Chart Data Source: Bloomberg.

» China currently faces one of the greatest economic challenges in history, and even its excellent monetary and fiscal policymakers must accept reality: it is not possible to simultaneously maintain free capital flows, independent monetary policy, and a fixed exchange rate (i.e. the RMB pegged to the USD).

» The government must let go of one of these three objectives. The most likely candidate is the currency, which leads us to expect further devaluation of the Chinese renminbi.

» We have compared capital flows into India and Brazil before. For a couple of years capital has fled Brazil, and the economy is still fighting economic, political and environmental disasters. Brazil is being forced to raise interest rates to fight inflation, despite the extremely weak position of the economy. India, on the other hand, is on a stimulative path and is reducing interest rates. While this is negative for the INR, it may boost the economy overall.

China cannot have free capital flows, independent monetary policy, and a fixed RMB exchange rate...

Brazil fighting recession and inflation...India moving to stimulate

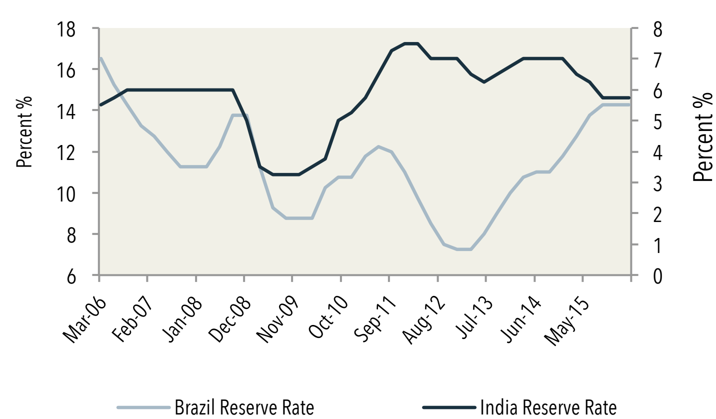


Chart Data Source: Bloomberg.

GLOBAL EQUITY REVIEW

» Global equities were roughly flat for the quarter, with the MSCI ACWI returning -0.28%. What this return masks, however, is the -11.52% drawdown through mid-February, and the subsequent 12.71% rally through the end of March.

» Across Europe, the MSCI Europe index returned -7.71% in Q1 after a -16.89% drop during the first part of the quarter. European financials sold off sharply during the quarter as negative interest rates continued to pressure bank earnings.

» Japanese markets fell sharply, with the MSCI Japan losing 11.24% over the quarter.

» The MSCI EM index, however, rallied over the quarter, returning 21.54% since its bottom in January. The index returned 5.36% overall for the quarter as investor appetite for EM risk increased.

Global Equity: Valuation Measures (as of 3/31/16)								
Period	Latest				10-yr average			
Valuation Measure	P/E	Dividend Yield	P/B	P/CF	P/E	Dividend Yield	P/B	P/CF
MSCI ACWI	18.14	2.70	2.02	8.91	16.66	2.63	1.98	9.31
MSCI Europe	23.46	3.77	1.65	7.17	18.34	3.64	1.76	8.63
Nikkei 225	21.37	1.81	1.49	8.89	21.66	1.66	1.53	9.42
Shanghai Composite	15.76	2.03	1.71	6.49	19.25	1.84	2.44	49.78
MSCI Emerging Markets	13.86	2.92	1.43	6.26	13.37	2.64	1.79	8.10

Data Source: Bloomberg.
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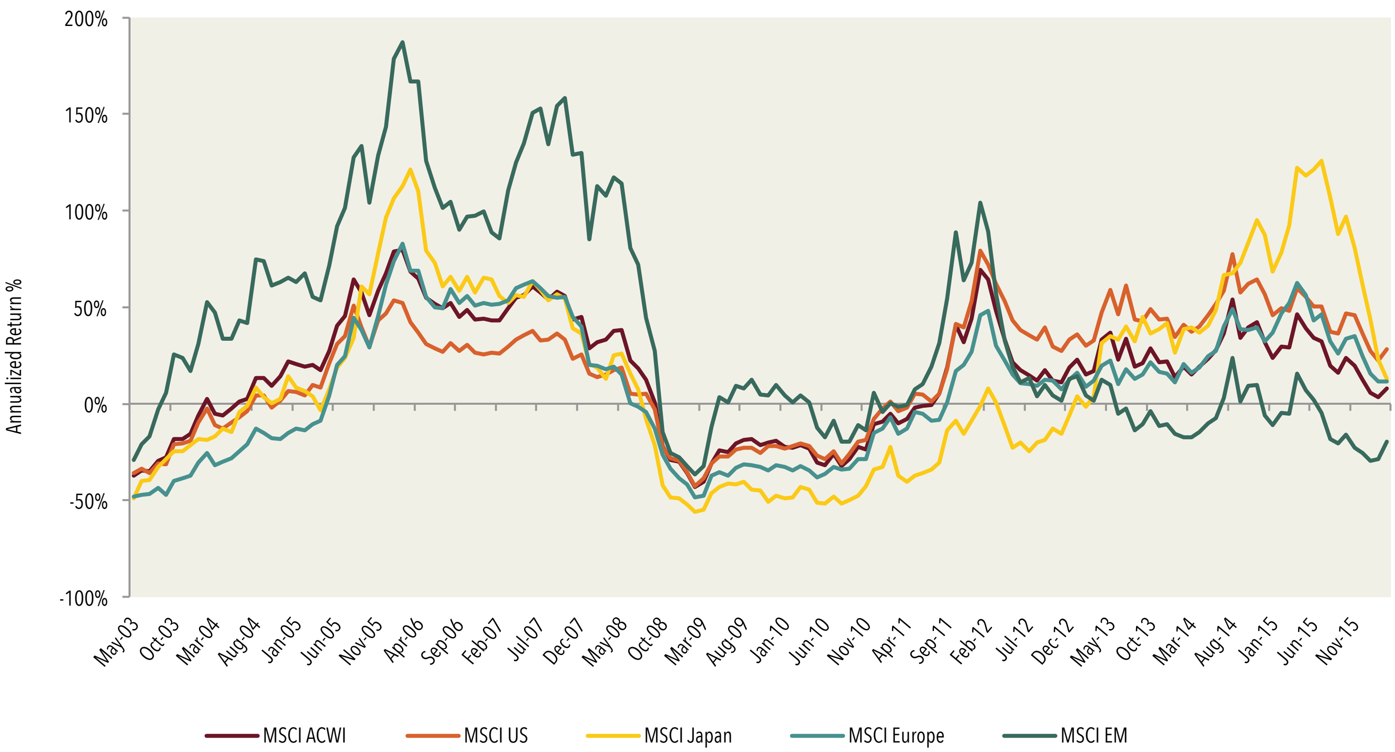
Global Equity Indices - 36 Month Rolling Annualized Return, %



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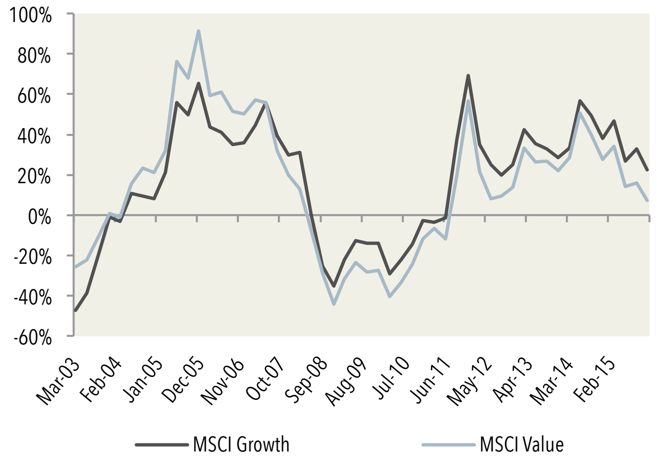
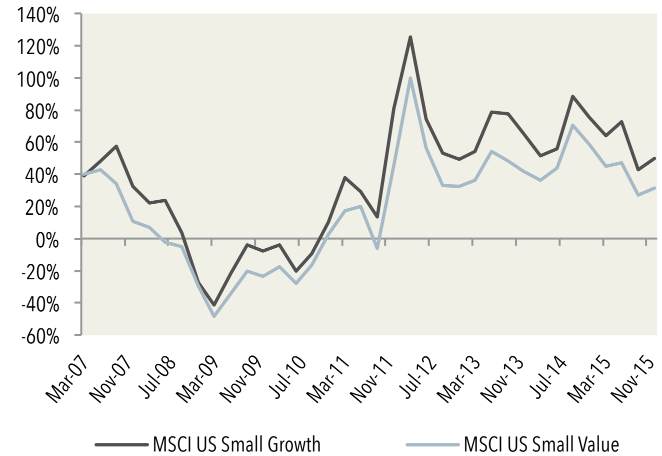
GLOBAL EQUITY REVIEW

- The MSCI US index outperformed global equities, returning 1.94%, with a slightly lower drawdown over the first 5 weeks of the quarter and a stronger rally during the remainder of the quarter.
- For several years growth stocks have outperformed value stocks, and the trend appears to be continuing across equity markets. Historically, investors have found that value can outperform growth for lengthy periods – leading to the so-called "value premium." Lately, however, the markets have not rewarded value investors as growth stock multiples have expanded.
- The S&P 500 Energy sector began to reverse course in Q1, gaining 4.02% as oil prices staged a partial recovery. However, a sustained recovery in the energy sector seems unlikely given that the market remains substantially oversupplied.
- The Healthcare sector, which is up almost 108% in the last five years, has retreated over the past several quarters. Still, the sector is only down about 8% from its peak in 2015. Biotech, on the other hand, saw particularly poor performance in the beginning of the year and has lost about -37% since its peak.
- The strongest performance in the S&P 500 in Q1 came from Utilities and the relatively small Telecom sector, which returned 15.96% and 18.74%, respectively. Over the past year, Utilities returned 15.56% and Telecoms returned 16.61%.

Global growth continues to outperform value
36-month rolling performance (cumulative)



US small cap growth still outperforming value
36-month rolling performance (cumulative)



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US Equity: Valuation Measures (as of 3/31/16)			Historical Averages			
Valuation Measure	Description	Latest	1 yr ago	5-yr avg.	10-yr avg.	25-yr avg.
P/E	Price to Earnings	18.80	18.41	16.30	16.57	19.64
CAPE	Shiller P/E	26.24	26.99	23.75	22.92	25.76
Div. Yield	Dividend Yield	2.19	2.00	2.06	2.12	2.04
P/B	Price to Book	2.81	2.67	2.34	2.41	2.84
P/CF	Price to Cash Flow	11.29	10.55	8.90	10.39	10.88
EY Spread	EY-Baa Yield	1.47	1.93	2.35	1.11	-0.96

Index: S&P 500

Data Source: Bloomberg, Robert Shiller's website. Please see Appendix for definitions.
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THEMATIC IMPACT REVIEW

- The green bond market continues to grow. Bank of America has led the charge so far in 2016, underwriting more than the next three largest underwriters combined.
- These underwritings constitute the "labeled" issuance for Q1, 2016, however the unlabeled green bond market continues to grow as well.

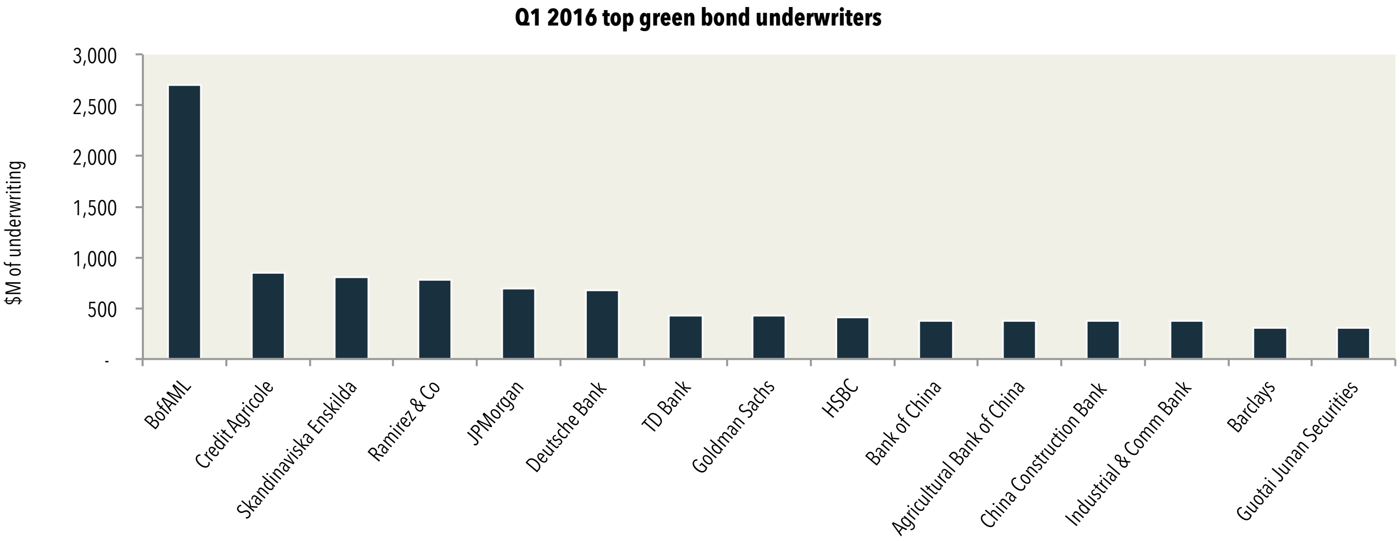
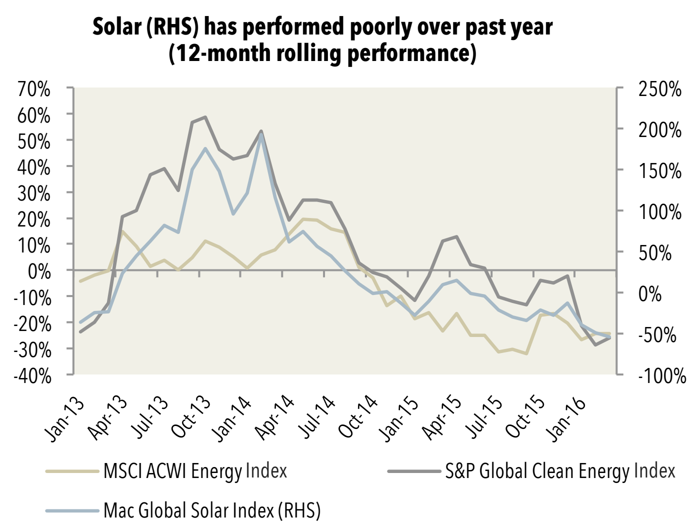
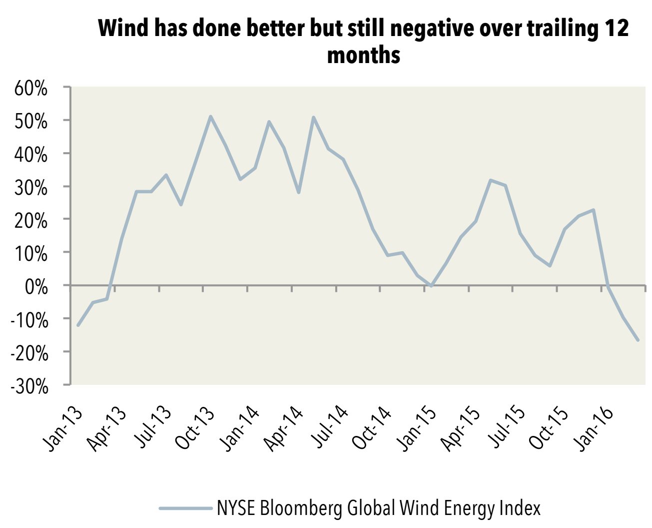


Chart Data Source: Bloomberg

- We believe that a confluence of factors have driven clean energy markets into a period of very difficult performance over the last eighteen months. Our view is that these markets have been most adversely affected by the fall in oil prices, but concerns over government policies, the health of the Chinese economy, and general wariness of the sector have dragged stocks down.
- Solar has performed particularly poorly over the last year, falling over 50% as measured by the Mac Global Solar Index, or more than twice as far as other renewable energy sectors and the traditional energy sector.
- Wind energy stocks have outperformed both traditional energy and other clean energy equities on a relative basis, having fallen about 17% over the last year as measured by the NYSE Bloomberg Global Wind Energy Index.





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ASSET CLASS RETURNS

2007	2008	2009	2010	2011	2012	2013	2014	2015	YTD	1Q16
S&P Gbl Clean Energy 78.36	BC Agg 5.24	MSCI EME 79.02	MSCI EME 19.20	BC US Corp IG 8.15	MSCI EME 18.63	S&P Gbl Clean Energy 48.42	S&P 500 13.69	S&P Gbl Clean Energy 1.85	EM Debt 11.02	EM Debt 11.02
MSCI EME 39.78	BC Global Agg 4.79	MSCI EAFE 32.46	DJ UBS Cmdty 16.83	BC Agg 7.84	MSCI ACWI ex Fsl Fuels 18.00	S&P 500 32.39	BC US Corp IG 7.46	S&P 500 1.38	BC Global Agg 5.90	BC Global Agg 5.90
EM Debt 18.11	BC US Corp IG -4.94	S&P 500 26.46	EM Debt 15.68	BC Global Agg 5.64	MSCI EAFE 17.90	MSCI ACWI ex Fsl Fuels 24.36	MSCI ACWI ex Fsl Fuels 6.05	BC Agg 0.55	MSCI EME 5.75	MSCI EME 5.75
DJ UBS Cmdty 16.23	EM Debt -5.22	EM Debt 21.98	S&P 500 15.06	S&P 500 2.11	EM Debt 16.76	MSCI EAFE 23.29	BC Agg 5.97	MSCI EAFE -0.39	BC US Corp IG 3.97	BC US Corp IG 3.97
MSCI EAFE 11.63	DJ UBS Cmdty -35.65	DJ UBS Cmdty 18.91	BC US Corp IG 9.00	EM Debt -1.75	S&P 500 16.00	BC US Corp IG -1.53	BC Global Agg 0.59	MSCI ACWI ex Fsl Fuels -0.49	BC Agg 3.03	BC Agg 3.03
BC Global Agg 9.48	S&P 500 -37.00	BC US Corp IG 18.68	MSCI EAFE 8.21	MSCI ACWI ex Fsl Fuels -7.50	BC US Corp IG 9.82	BC Agg -2.02	MSCI EME -1.82	BC US Corp IG -0.68	S&P 500 1.35	S&P 500 1.35
BC Agg 6.97	MSCI EAFE -43.06	S&P Gbl Clean Energy 7.35	BC Agg 6.54	MSCI EAFE -11.73	BC Global Agg 4.32	MSCI EME -2.27	MSCI EAFE -4.48	BC Global Agg -3.15	DJ UBS Cmdty 0.42	DJ UBS Cmdty 0.42
S&P 500 5.49	MSCI EME -53.18	BC Global Agg 6.93	BC Global Agg 5.54	DJ UBS Cmdty -13.32	BC Agg 4.22	BC Global Agg -2.60	S&P Gbl Clean Energy -4.63	MSCI EME -14.60	MSCI ACWI ex Fsl Fuels -0.17	MSCI ACWI ex Fsl Fuels -0.17
BC US Corp IG 4.56	S&P Gbl Clean Energy -65.28	BC Agg 5.93	S&P Gbl Clean Energy -27.63	MSCI EME -18.17	DJ UBS Cmdty -1.06	EM Debt -8.98	EM Debt -5.72	EM Debt -14.92	MSCI EAFE -2.88	MSCI EAFE -2.88
MSCI ACWI ex Fsl Fuels NA	MSCI ACWI ex Fsl Fuels NA	MSCI ACWI ex Fsl Fuels NA	MSCI ACWI ex Fsl Fuels NA	S&P Gbl Clean Energy -44.47	S&P Gbl Clean Energy -16.15	DJ UBS Cmdty -9.52	DJ UBS Cmdty -17.01	DJ UBS Cmdty -24.66	S&P Gbl Clean Energy -5.41	S&P Gbl Clean Energy -5.41

DJ UBS Cmdty = Dow Jones-UBS Commodity Index
MSCI EAFE = MSCI EAFE Index
MSCI EME = MSCI EM Equity Index
S&P 500 = S&P 500 Index
S&P Gbl Clean Energy = S&P Global Clean Energy Index

EM Debt = JP Morgan GBI EM Global Diversified Unhdged
BC Agg = Barclays Capital US Aggregate Bond Index
MSCI ACWI ex Fsl Fuels = MSCI ACWI ex Fossil Fuels Index
BC Global Agg = Barclays Capital Global Aggregate Bond Index
BC US Corp IG = Barclays Capital US Corporate Bond Index

Chart Data Source: Morningstar, MPI.
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APPENDIX

- Ba: Moody's Bond Rating
- BC EM Hard Currency: Barclays Capital Emerging Markets Hard Currency Aggregate Index
- BC EM Local Currency Gov: Barclays Capital Emerging Markets Local Currency Diversified Total Return Index
- BC Europe Sovereign: Barclays Capital Europe Sovereign Index
- BC Global Agg Corp: Barclays Capital Global Aggregate Corporate Bond Index
- BC Global Agg: Barclays Capital Global Aggregate Bond Index
- BC Municipal: Barclays Capital US Municipal Bond Index
- BC US Agg Credit: Barclays Capital United States Aggregate Credit Total Return Index
- BC US Agg: Barclays Capital US Aggregate Bond Index
- BC US Corporate High Yield: Barclays Capital United States Corporate High Yield Total Return Index
- BC US Treasury: Barclays Capital United States Treasury Total Return Index
- Caa: Moody's Bond Rating
- CAPE: Shiller P/E (Cyclically Adjusted PE) from Robert Shiller's website http://www.multpl.com/shiller-pe/
- CPI: US Consumer Price Index
- Div. Yield: Dividend Yield
- Europe HY: Barclays Capital Europe High Yield Bond index
- Europe IG: Barclays Capital Europe Investment Grade Corporate Bond index
- EY Spread: EY-Baa Yield derived by subtracting the Barclays Capital Baa US Credit YTW from the S&P 500 (SPX) Earnings Yield (the inverse of the P/E ratio)
- Labeled Green Bonds: Bonds self-labelled or third-party verified as green bonds
- MSCI ACWI: MSCI All Country World Index
- MSCI Emerging Markets (EM): MSCI Emerging Markets Index
- MSCI Europe: MSCI All Country Europe Index
- MSCI Growth: MSCI World Growth Index

APPENDIX CONTINUED

- MSCI Value: MSCI World Value Index
- MSCI Japan: MSCI Japan Index
- MSCI US: MSCI United States Index
- MSCI US Small Growth: MSCI US Small Cap Growth Index
- MSCI US Small Value: MSCI US Small Cap Growth Index
- Nikkei 225: Nikkei 225 Stock Average
- P/B: Trailing 12 months price to book ratio
- P/CF: Trailing 12 months price to cash flow ratio
- P/E: Trailing 12 months price to earning ratio
- Shanghai Composite: Shanghai Stock Exchange Composite Index
- Unlabeled Green Bonds: Bonds determined to be green bonds by Sonen or other data source
- US HY: Barclays Capital US High Yield Bond index

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