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First Quarter 2016 Performance Review

Global Balanced Strategy

Our global balanced strategy, which allocates among bonds, stocks, and commodities around the world, rose 2.9% last quarter, reducing the past 12-month loss to 1.8%.

Global asset markets, despite a rocky start, ended the first quarter on a positive note. Market sentiment tumbled in January due to the Chinese yuan devaluation, rising energy company bond defaults, and a possible U.S. recession. In mid-February, the gloomy mood was swept away by the Federal Reserve, which announced that it would take a much slower pace than previously indicated in raising interest rates. The policy shift relieved built-up stress on risk assets, followed by a drastic turn of equity markets, short-sale squeezes, and a V-shaped reversal of equity recovery amid swift trading. However, the Fed's delay in making the announcement upset the dollar bulls, stalling the 18-month dollar rally. Global bond yields, at the same time, fell further into the abyss. Record-low rates and a weak dollar set up a springboard for gold, which jumped $200 in one month to post the best quarterly return since its November 2011 peak.

At the quarter's end, global equities closed flat from a quarter ago with the help of stronger markets in the U.S. and commodity-producing countries. The S&P 500 Index managed to gain 1.3%, and the MSCI Emerging Markets Index, benefiting from a weak dollar and a sharp bounce of crude prices, surged 5.8%. Developed market equities, however, were dampened by poor performances in Europe and Japan. Both markets succumbed to weak exports, falling bank shares, and stronger currencies. The MSCI EAFE Index declined 3.0% in U.S. dollars in the first quarter.

Unlike the mixed picture in equity markets, global bond markets had a broader rally, gaining 3.3% for the quarter. Plunging global yields, which boosted a variety of bond prices across all segments, caused this outstanding performance. The U.S. Broad Bond Index rose 3% for the quarter as 10-year Treasury yields sank below 1.8%, a 12-month low. Similarly, Germany's 10-year Bund yields moved closer to zero, and Japan's 10-year yields were negative. Sliding bond yields around the world not only reacted to rate cuts by central banks in Europe and Japan but could also be a bad sign for global growth.

The International Monetary Fund, or IMF, in its recent report, warned of global stagnation; after five years of tepid growth, the world economy had the worst period since the 1980s. The IMF said that it could soon downgrade its growth forecast again, predicting that global growth will be only 3.2% this year, below the previous estimate of 3.4% in January. The revisions, this time, will be broad-based, forecasting weak growth for America, Europe, and the emerging world. In the past five years, America was insulated from the worldwide slowdown. Now, according to Atlantic Fed's forecast, U.S. real GDP would rise 0.3% in the first quarter, half the rate of a year ago, assuming no cold weather slows things further.

At the quarter's end, our strategy's equity portion returned 0.6% for the quarter, reducing the 12-month loss to 4.1%, and the bond portion gained 4.9%, bringing the return to 2.3% for the last 12 months. Our bond results, in particular, were better than the global bond benchmark due to the weak dollar.

The equity and commodities portion accounted for 50% of the strategy's assets, and bonds accounted for the remaining 50%. Specifically, 23.5% of strategy assets were invested in U.S. equities, 21.5% in foreign equities, 27% in U.S. bonds, 23% in foreign bonds, and 5% in commodities.

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Emerging Markets Strategy

Emerging markets made an unexpectedly strong start during the first quarter after being an underdog throughout 2015. Our emerging markets strategy, which invests in less-developed companies and economies, soared 7.4% in the past three months, lowering the last 12-month loss to 6.4%.

In early January, emerging markets were still ravaged by two major worries—a decelerating Chinese economy and a poor profit outlook around the world. The gloom suddenly deepened when the Chinese yuan dropped sharply as if last midsummer's turmoil had returned. After a month's sell-off, policy makers stepped in to calm investor fears. In the U.S., the Fed altered its tightening cycle, and in China, the government acted to vitalize growth with more fiscal and monetary stimuli. Market sentiment immediately brightened, adding new fuel to power global equities, which rallied all the way to the end of March. Emerging markets also joined the rally. A weak dollar and falling sovereign yields around the world, resulting from the Fed's policy shift, further energized buyers. As trading days went on, a stable yuan, new lending, rising housing activities, and more positive Chinese economic data also helped push the financial disturbances into the background.

Emerging markets ended in a celebration, reporting strong gains in bonds, stocks, and currencies. Emerging market debt outperformed their global peers by a large percentage as EM debt worries dissipated. Emerging market local debt surged 9% from a quarter ago on falling bond yields and a cheaper dollar. A favorable market environment also gave a lift to EM U.S.D.-denominated bonds, which rose 4.5% during the quarter.

Emerging market equities performed even better, advancing 5.8% according to the MSCI Emerging Market Index, and outshining U.S. stocks by 4.5%. A spectacular surge of equity prices in resource-rich countries bolstered EM equities: Brazil skyrocketed almost 30% and Russia and South Africa also had double-digit gains. However, Indian and Chinese stocks slipped for the quarter. China, in particular, still struggled with rising debt and industrial overcapacity despite its first quarter 2016 growth target that met expectations. The loss in Chinese stocks implied that China's economy is not out of the danger zone, although a hard landing so far has been averted. As the government pursued growth over reform, its debt pile has ballooned. Last March, Moody's rating agency cut China's debt outlook from stable to negative.

At the quarter's end, our strategy's equity portion returned 8.0% for the quarter, reducing the 12-month loss to 12.7%, and the bond portion gained 7.2%, bringing the return to 2.9% for the last 12 months. A weak dollar, yield spread contractions, and higher commodity prices created these better results.

At the quarter's end, equities constituted 58% of the strategy, of which 29% was invested in Asia, 19% in Latin America, 5% in Eastern Europe, and 5% in the Middle East and South Africa. The balance of the strategy was invested in fixed income securities.