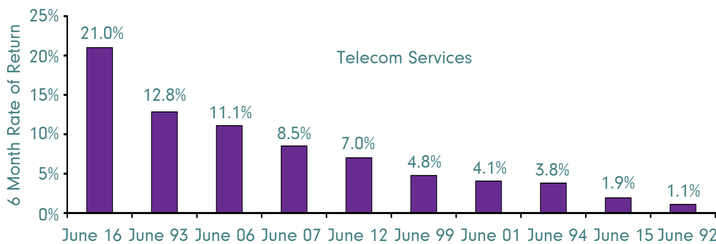
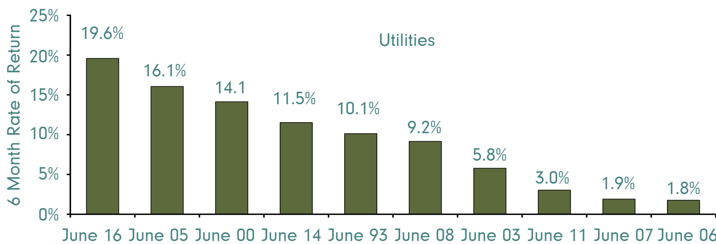
Market Review
Second Quarter 2016

Financial market volatility continued during the second quarter primarily driven by the surprising outcome to the U.K. Brexit vote. For the quarter the S&P 500 Index gained 2.46%, bringing the year-to-date return to 3.84%. Smaller stocks, as measured by the Russell 2000 Index, managed to break into positive territory for the year-to-date with a return of 2.22%. The NASDAQ Composite Index continued to struggle with a decline of 2.66% year to date. Higher yielding stocks continued to perform well with the S&P utilities and telecom sectors up approximately 20% year to date, their best start since at least 1990 (See chart: *Performance of Telecom Services and Utilities*). Emerging market stocks, as measured by the MSCI Emerging Markets Index, increased only slightly in the quarter (+ 0.81%), but they are up 6.67% for the year to date.

Performance of Telecom Services and Utilities
Best Start to a Year* Since at Least 1990



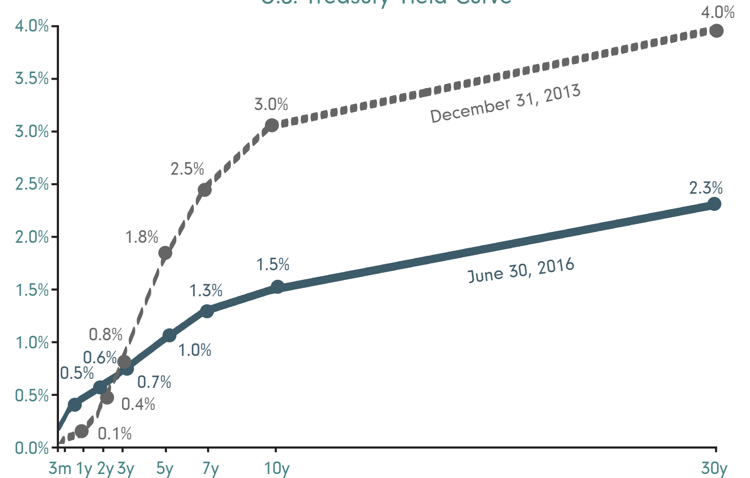


Source: Bloomberg
**Based on first six months of a year.*
Data is assumed to be reliable.
Past performance is no guarantee of future results.

Bonds, as measured by the Barclays U.S. Aggregate Bond Index, had another strong quarter returning 2.21%, bringing the year-to-date return to 5.31%. Credit-sensitive areas continued to perform well with emerging-market debt, as measured by the JPMorgan Emerging Markets Bond Index Global, returning 11.55% and high-yield bonds, as measured by the Bank of America Merrill Lynch U.S. High Yield Index, returning 9.74% for the year to date. California municipal bonds, as measured by Barclays California Municipal Bond Index, performed well and are up 4.33% for the year to date. At the risk of sounding repetitive, the 10-year U.S. Treasury yield fell once again during the quarter from 1.77% down to 1.47%.

Many of the trends we witnessed in the first quarter continued into the second quarter. Investors lowered their expectations for global growth rates slightly, at least in the short term, driven by the Brexit vote causing global bond yields to continue to decline. (For more details on our thoughts and implications for Brexit, please listen to our podcast released on June 27 available on kayne.com or iTunes).The yield curve has continued to flatten which essentially throws into question how much flexibility the Fed has to "normalize" interest rates at the short end of the curve (See chart: *Yield Curve*).

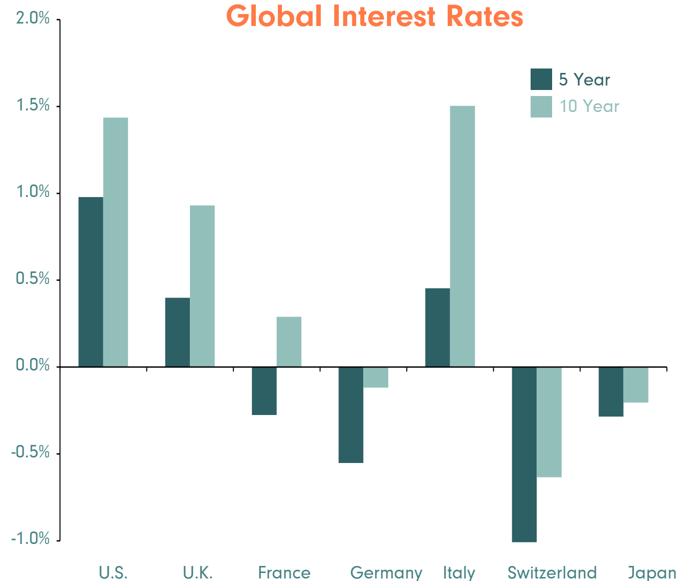
Yield Curve
U.S. Treasury Yield Curve



Source: FactSet, J.P. Morgan Asset Management
Data as of June 30, 2016.Data is assumed to be reliable.
Past performance is no guarantee of future results.

In response to the potential economic uncertainty created by the Brexit vote, any further interest-rate increases will be very modest at best. It has become increasingly clear that we are in a steady, but slow, global growth environment and this is causing the Fed to reassess what "normal" really means for monetary policy today. Many countries (Switzerland, Germany, France, and Japan) already have negative interest rates which continue to make our paltry yields look attractive to foreign investors (See chart: *Global Interest Rates*). Central banks need help from fiscal policies around the globe in the way of pro-growth initiatives and structural labor and corporate tax reforms in order to stimulate better growth globally.

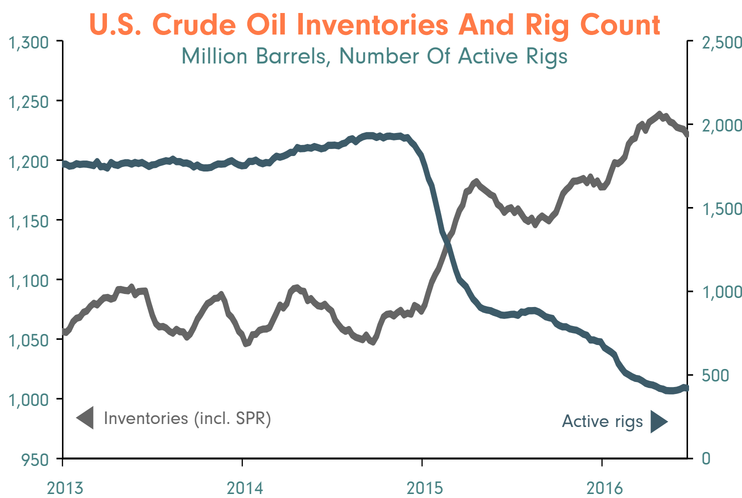
Global Interest Rates



Source: Bloomberg
Data as of June 27, 2016. Data is assumed to be reliable.
Past performance is no guarantee of future results.

Continued on Page 2

Our forecast for 2016 remains unchanged. We believe the domestic economy will grow at a modest rate in the range of 1.5% to 2.5% and corporate earnings will grow in the mid-single digit range. Our confidence is growing that oil has finally bottomed because domestic shale producers and major international oil companies have announced dramatic reductions in capital spending on the order of 40% to 70%. These supply reductions combined with natural depletion rates will ultimately reduce excess supply (See chart: *U.S. Crude Oil Inventories and Rig Count*). Importantly, stability in the price of oil and the U.S. dollar will help stabilize reported profits for companies in the S&P 500, which have been sliding downward over the last two years due to the impact of weak oil and a strong U.S. dollar. This stability is needed in order for equity markets to generate returns in line with earnings growth. We continue to believe equity returns for the S&P 500 will be in the 5% to 7% range for the year as long as energy prices remain fairly stable.

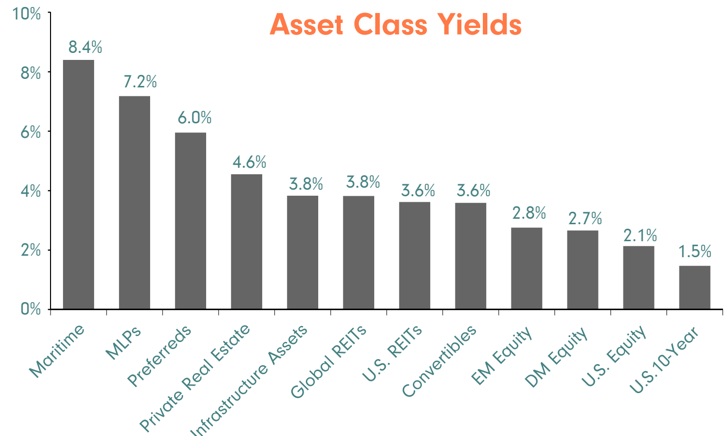


Source: J.P. Morgan Asset Management, EIA, Baker Hughes
U.S. crude oil inventories include the Strategic Petroleum Reserve (SPR). Active rig count includes both natural gas and oil rigs.
Data as of June 30, 2016.Data is assumed to be reliable.
Past performance is no guarantee of future results.

Despite fairly modest overall equity returns, there continues to be significant dispersion among sectors. Sectors close to or in a recession over the last two years (such as oil and gas, manufacturers who export, industrial companies, and many railroads) continued to show some stability this quarter, but have yet to materially improve. Given this environment over the last two years, stock selection has become paramount and, subsequently, many of our investment strategies are performing very well on a relative basis. As always, we will attempt to use this sector volatility to our clients' advantage.

Investors are finding it increasingly difficult to capture yield and continue to bid up higher yielding sectors as fixed-income yields shrink (See chart: *Asset Class Yields*). Additionally, two-thirds of the S&P 500 now yields more than a 10-year bond. Lower rates have continued to pressure banks' net interest margins, particularly in Europe.

As we have experienced thus far this year, it is likely to continue to be a volatile year for financial markets. Repercussions from the Brexit vote and our own presidential elections are likely to cause continued market volatility. However, we remain steadfast in our high-quality orientation as we have done through good and bad times over the last three decades. We thank you for your continued trust and confidence and welcome any questions you may have.



Source: FactSet, J.P. Morgan Asset Management
Alerian, BAML, Barclays, Clarkson, Drewry Maritime Consultants, Federal Reserve, FTSE, MSCI, NCREIF, Standard & Poor's. Dividend vs. capital appreciation returns are through 12/31/15. Yields are as of 6/30/16, except Maritime (12/31/2015) and Private Real Estate and Infrastructure Assets (3/31/16). Maritime: Unlevered Yields for maritime assets are calculated as the difference between charter rates (rental income) and operating expenses as a percentage of current asset value. Yields for each of the sub-vessel types above are calculated and the respective weightings are applied to calculate sub-sector specific yields, and then weighted to arrive at the current indicative yield for the World Maritime Fleet; MLPs: Alerian MLP; Preferreds: BAML Hybrid Preferred Securities; Private Real Estate: NCREIF ODCE; Global/U.S. REITs: FTSE NAREIT Global/USA REITs; Infrastructure Assets: MSCI Global Infrastructure Asset Index;
Convertibles: Barclays U.S. Convertibles Composite; EM Equity: MSCI Emerging Markets; DM Equity: MSCI The World Index; U.S. Equity: MSCI USA.
Data as of June 30, 2016. Data is assumed to be reliable.
Past performance is no guarantee of future results.

Douglas S. Foreman, CFA
Chief Investment Officer
Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 30 years of investment experience.

The S&P 500® Index is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The NASDAQ Composite Index is the market capitalization-weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange. The MSCI® Emerging Markets (EM) Index is a free-float adjusted market capitalization index tracking the equity performance of global emerging markets. The Barclays U.S. Aggregate Bond Index is a market value weighted index that tracks the daily price, coupon, pay downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. Performance is calculated on a total return basis with dividends reinvested. The JP Morgan Emerging Markets Bond Index Global is a benchmark index for measuring the total return performance of international government bonds issued by emerging market countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements. The Bank of America Merrill Lynch U.S. High Yield Index tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. The Barclays California Municipal Bond Index is a market capitalization-weighted index of California investment-grade municipal bonds with maturities of one year or more.

This report is based on the assumptions and analysis made and believed to be reasonable by Advisor. However, no assurance can be given that Advisor's opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities. Past performance is no guarantee of future results.