Commentary

October 15, 2015

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A Mixed Global Market Presents Challenges

Principals Nicholas Chermayeff, Robert Greenhill Jr. and David Bechtel provide their current perspective on the economy and market.

Q3 2015 Macro Overview

The third quarter, historically a volatile period for financial markets, did not disappoint as global equity markets were buffeted by macro headwinds from China and global central bank policy. At the beginning of Q3, China's Shanghai A Share Index was up an incredible 113% year-over-year before growth fears and questions surrounding the stainability of the rally began to settle in. In the midst of a large pullback in global equity markets, growth fears were only heightened as the People's Bank of China intervened on August 10th to devalue the Yuan.

Once it became clear that fixed investment growth in China was slowing, market participants anticipated the secondary effects on its trading partners, especially in emerging markets. The headwinds from China added more stress to emerging markets, which had already been feeling pressure from a strengthening U.S. dollar and a looming rate rise in the U.S. These forces combined to result in a global sell off of risk assets, sending certain markets into "correction" territory before recovering a bit on the last day of the quarter and handing the S&P 500 its worst quarter since 2011.

Index (Local Currency)	Q1 2015	Q2 2015	Q3 2015 (Sorted)	YTD
Swiss Market Index	1.62%	-3.81%	-3.05%	-5.23%
Bolsa - Mexico	1.34%	3.04%	-5.37%	-1.19%
S&P 500 - U.S.	0.44%	-0.23%	-6.94%	-6.74%
CAC 40- France	17.81%	-4.84%	-6.99%	4.27%
FTSE 100 - U.K.	3.15%	-3.72%	-7.04%	-7.68%
S&P/TSX - Canada	1.85%	-2.34%	-8.56%	-9.06%
IBEX - Spain	12.08%	-6.52%	-11.23%	-7.00%
DAX - Germany	22.03%	-8.53%	-11.74%	-1.48%
Nikkei 225 - Japan	10.06%	5.36%	-14.07%	-0.36%
Bovespa - Brazil	2.29%	3.77%	-15.11%	-9.89%
Hang Sang - Hong Kong	5.49%	5.42%	-20.59%	-11.69%
Shanghai A Shares - China	15.90%	14.04%	-28.63%	-5.67%

Source: Strategas Research, Bloomberg

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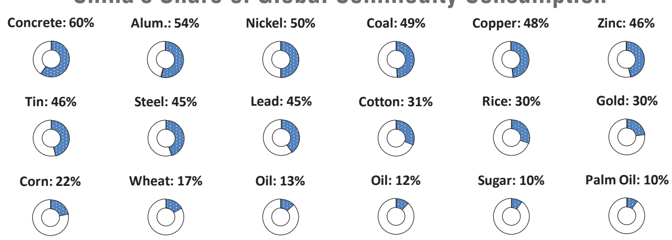
China Worries

Many conversations have taken place regarding the impacts a slow down in China would have on the global economy and, more specifically here in the States, how it might affect U.S. firms. While we believe small and mid-cap companies with minimal international exposure should be less affected, large, international companies that generate revenue overseas could face pressure moving forward. We believe firms with direct exposure to commodity markets especially could experience further stress as China, the largest consumer of commodities over the past 15 years, begins to slow down industrial expansion and rebalance toward consumer-led growth.

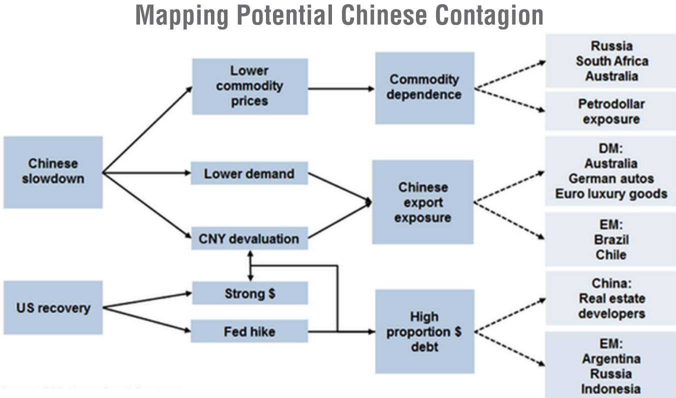
China's Share of Global Commodity Consumption



Source: VisualCapitalist.com, World Economic Forum, WSJ, WEMS, BP, Morgan Stanley, USDA

We are of the opinion that while many U.S. firms should be insulated from a slow down in China, emerging markets, which have been feeling the pressure of a strengthening dollar over the past year and rely heavily on Chinese demand for their exports, and Europe, could face further issues.

Mapping Potential Chinese Contagion



Source: RBS Macro Credit Research

Fed Rate Hike

While China received most of the attention in the third quarter, the Federal Reserve's rate hike decision was also monitored very closely but ultimately resulted in a continuation of zero interest policy for the time being. As we've highlighted before, historically, the first step in tightening has had little effect on the total return of the S&P 500.

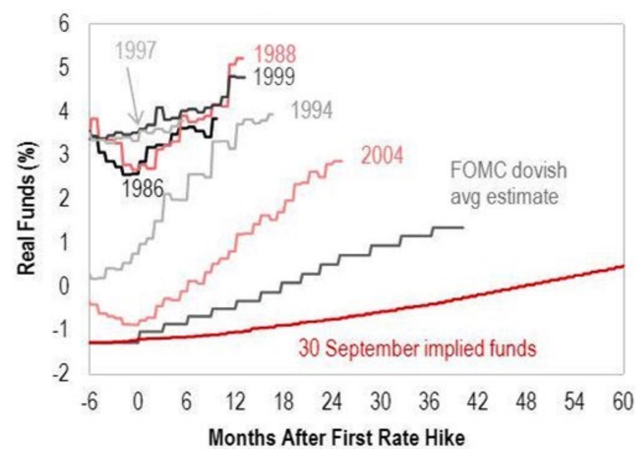
S&P 500 Performance Before and After First Fed Rate Hike

Date of First Raise	6 Months Prior	3 Months Prior	3 Months After	6 Months After	12 Months After
March 1983	27.0%	8.8%	9.9%	8.6%	4.1%
January 1987	0.2%	7.9%	19.1%	21.1%	2.6%
March 1988	-19.8%	4.1%	6.0%	5.4%	13.3%
February 1994	4.7%	2.7%	-3.9%	-2.4%	1.9%
June 1999	11.7%	6.7%	-6.6%	7.0%	6.0%
June 2004	2.6%	1.3%	-2.3%	6.2%	4.4%
Average	**4.4%**	**5.2%**	**3.7%**	**7.7%**	**5.4%**

Source: Strategas Research

The Fed's tightening is likely to be very measured if it comes at all, allowing global markets to digest the changes and adjust. Currently the market and the Federal Open Market Committee (FOMC) are projecting one of the slowest tightening cycles in history.

FOMC and Market Project Slow Increase in Fed Funds Rate



Source: The Daily Shot, HSBC, FOMC, Bloomberg, CBOT

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U.S. Markets

The macro turmoil in the third quarter was also apparent in performance results as investors fled to safety, favoring large-cap equities over small- and mid-caps. Although the underlying fundamentals of small-and mid-cap names were hardly affected by the macro noise, market volatility caused investors to "throw the baby out with the bath water."

Index	Q1 2015	Q2 2015	Q3 2015 (Sorted)	YTD
S&P 500 TR (Large-Cap)	0.95%	0.28%	-6.44%	-5.29%
S&P 400 TR (Mid-Cap)	5.31%	-1.06%	-8.50%	-4.66%
S&P 600 TR (Small-Cap)	3.96%	0.19%	-9.27%	-5.49%
Russell 2000 TR (Small-Cap)	4.32%	0.42%	-11.92%	-7.73%

Source: Bloomberg

Looking Ahead

We believe that looming interest rate increases and uncertainties in China bode well for buying and creates a "stock picker's" environment, especially in the mid- and small-cap segments. At Barrow Street Advisors, we are methodical and dispassionate about finding opportunities. By investing at the intersection of quality and value, we strive to build portfolios that exhibit exceptional total return potential. Our focus on spotting attractive entry levels during these volatile market periods can result in outstanding performance. ■

Important Information

Performance data quoted represents past performance; past performance does not guarantee future results.

The **S&P 500 Index** is an unmanaged index of equity prices and is representative of a broader market and range of securities than is found in the Fund's portfolio. The **S&P 400 Index** is an unmanaged index commonly used to measure the performance of 400 medium-capitalization U.S. stocks. The **S&P 600 Index** is an unmanaged index commonly used to measure the performance of 600 small-capitalization U.S. stocks. The **Russell 2000 Index** is an unmanaged index commonly used to measure the performance of 2000 U.S. small-capitalization stocks. The **Shanghai A Share Index** is a capitalization-weighted index that tracks the daily price performance of all A shares listed on the Shanghai Stock Exchange. These A shares are typically restricted to local investors and qualified institutional foreign investors. It is not possible to invest directly in indexes which are unmanaged and do not incur fees and charges.

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