COLONY FAMILY OFFICES

Market Review and Investment Outlook
May 2017

Executive Summary
In sharp contrast to how 2016 began, financial market volatility was historically low to start 2017. US stocks[1] continued their post-election climb in the first quarter, yet developed international[2] and emerging markets[3] stocks outperformed as the US dollar weakened. The environment also proved favorable for most fixed income asset categories as US interest rates were largely unchanged in the first quarter.

A quick survey of the economic landscape suggests the macro backdrop should remain supportive of stocks and other risk assets over the intermediate term. For the first time in a while, global economic growth is in sync and improving, albeit modestly. However, we do expect volatility to increase from its current low levels. We also continue to describe the financial market backdrop as one that generally lacks undervalued asset classes. Put simply, bond yields are low, credit spreads are tight, and corporate profit margins remain near record highs. That's not to say there are no compelling investment opportunities, but that forward-looking expected returns for most traditional asset classes are likely below their historical averages.

Based on our assessment of the macro backdrop and relative asset class valuations and risks, our current portfolio positioning themes include the following:
- Don't tilt too far away from an appropriate strategic asset mix, but maintain an elevated cash position and slight underweight to core fixed income.
- Target a slight underweight position in equities while emphasizing large cap, high quality stocks.
- Continue to reduce US equites on recent strength while increasing exposure to more reasonably priced international and emerging markets stocks.
- Target an overweight position to certain flexible/alternative strategies that potentially benefit from elevated market volatility and increased dispersion.

Asset Category Performance (As of March 31, 2017)	1Q 2017	Full Year 2016	Last 5 Years*	Last 10 Years*
Fixed Income				
US Municipal Bonds (Barclays 1-10 Year Municipal)	+1.6%	-0.1%	+2.2%	+3.8%
US Taxable Bonds (Barclays US Aggregate)	+0.8%	+2.7%	+2.3%	+4.3%
Bank Loans (S&P/LSTA US Leveraged Loan)	+1.0%	+10.2%	+4.5%	+4.5%
High Yield Corporate Bonds (Barclays US High Yield)	+2.7%	+17.1%	+6.8%	+7.5%
Equities				
Global (MSCI All Country World)	+6.9%	+7.9%	+8.4%	+4.0%
US Large Cap (S&P 500)	+6.1%	+12.0%	+13.3%	+7.5%
US Small Cap (Russell 2000)	+2.5%	+21.3%	+12.4%	+7.1%
Non-US Developed Markets (MSCI EAFE)	+7.3%	+1.0%	+5.8%	+1.1%
Emerging Markets (MSCI Emerging Markets)	+11.5%	+11.2%	+0.8%	+2.7%
Real Assets				
Commodities (Bloomberg Commodity)	-2.3%	+11.8%	-9.5%	-6.2%
Energy MLPs (Alerian MLP)	+4.0%	+18.3%	+2.6%	+7.2%
Global REITs (MSCI ACWI REIT)	+3.1%	+5.1%	+8.9%	+2.3%
Flexible/Alternative Strategies				
Directional Hedge (HFRI FOF Strategic)	+3.5%	-0.1%	+3.5%	+1.2%
Less-Directional Hedge (HFRI FOF Conservative)	+1.4%	+1.9%	+3.2%	+1.1%

*Note: Data provided by Zephyr Associates. *Indicates annualized return. Past performance is not indicative of future results.*

Market Review

The buoyant mood that pushed stocks higher through year-end 2016 carried into the first quarter as signs of an improving global economy continued to mount. However, in sharp contrast to how 2016 began, financial market volatility was historically low to start 2017. In its April 1st issue, Barron's claimed that the first quarter was the least volatile on record since the 1960s as the daily absolute price moves of the S&P 500 were materially below historical averages.[4]

Large cap US stocks continued their post-election climb in the first quarter with a gain of +6.1%. Yet, the opening quarter has produced positive returns for eight straight years—the last time large cap US stocks lost ground in a first quarter was in 2009. At the sector level, markets experienced a partial reversal of last year's rotation into financials and cyclicals—the so-called "Trump trade"—with technology and healthcare stocks resuming their prior market leadership by the end of the quarter.[5]

Developed international stocks outpaced domestic stocks in the first quarter, led by Europe where a combination of bullish investor sentiment and positive economic data helped drive gains. A weaker US dollar also benefited results. Emerging markets stocks were the best-performing region, surging more than +11% and outperforming both US and international developed markets stocks.

The investment environment also proved favorable for most fixed income asset categories. After a strong move up in the fourth quarter of 2016, US interest rates were largely unchanged in the first quarter. For example, the 10-year US Treasury yield started the year at 2.45% and ended March at 2.40%. Investors took in stride the Federal Reserve's widely anticipated 0.25% rate hike on March 15th as the central bank reaffirmed its intent to maintain a gradual pace of tightening. Core investment grade bonds generated modest gains in the quarter, while riskier credit-sensitive sectors such as bank loans and high yield corporate bonds outperformed. Given recent strong performance, high yield credit spreads are approaching the cyclical lows reached in 2014.

Performance within the commodities complex was mixed in the first quarter. Precious and industrial metals exhibited gains while energy and agricultural commodities experienced declines. In aggregate, the broad-based Bloomberg Commodity Index fell -2.3%. Crude oil prices fell below $50 a barrel to their lowest levels since mid-December after the Energy Information Administration (EIA) reported a significant rise in US stockpiles in March.

Macro Backdrop

For the first time in a while, the global economy is experiencing a broad-based upturn. Economic growth in most countries and industries is in sync and has been accelerating, albeit modestly. Leading economic indicators suggest this trend can continue, and many of the respected economic research firms we follow agree. For example, Capital Economics recently increased its growth forecasts for several economies and now expects world GDP growth to be 3.3% this year, up from 2.5% in 2016.[6] While the US economy remains healthy evidenced by continued labor market strength, activity in the Eurozone has picked up strongly despite political uncertainties. For instance, the Eurozone Manufacturing Purchasing Managers Index (PMI) is at its highest level since April 2011. Meanwhile, many emerging economies are benefitting from higher commodity prices. And after years of stagnation, there are signs that world trade volumes have begun to pick up.[7]

According to Capital Economics, household expenditure should continue to be the main driver of the recovery in advanced economies. Employment is rising throughout the developed world, household debt burdens have fallen to more sustainable levels, and both property and equity prices have risen.[8] In addition, the recent strength in consumer confidence indices points to continued consumption growth.

While the current macroeconomic backdrop offers reason for optimism, we remain concerned about the unresolved risks stemming from the post-financial crisis global debt build-up and unprecedented central bank policies. Yet, political upheaval and geopolitical tensions seem to be the more significant sources of potential shorter-term risk. In the US, there is still uncertainty around the new administration's policies and priorities. The setback on healthcare reform also makes it less clear how well the administration will work with Congress and the bureaucracy[9]. Outside of the US, the outcome of upcoming European elections and related developments in France (May) and Germany (September) may have an unexpected impact. At the same time, negotiations are set to begin for the United Kingdom's exit from the EU. And half a world away, North Korea has raised significant concerns with recent missile launches. Against this backdrop, we are reminded that successful investing requires not only patience and discipline, but also an ability to live with uncertainty.

Monetary Policy

As we've previously communicated, global monetary policy continues to have a significant influence on financial markets and remains a key source of longer-term uncertainty. Over the last several years, the size of central bank balance sheets has risen dramatically as policymakers experimented with a range of unconventional measures (zero interest rate policy, quantitative easing, forward guidance, etc.) in order to combat the deflationary pressures of the 2008 global recession. Critics of these unconventional policies have long worried about the potential unintended consequences. While central banks' actions have boosted sentiment and helped markets heal, historically low interest rates have also been detrimental to banks, pensioners, and savers.[10] As such, policy makers are under pressure to begin the normalization process as soon as conditions allow.

Given the recent improvement in the global economic backdrop, there is an increasingly common view that we are on the cusp of a global policy tightening cycle. However, while we don't expect many central banks to loosen policy further, it's likely that interest rates in many advanced economies will remain near historically low levels for the foreseeable future.[11] Indeed, the US Fed has begun its gradual pace of tightening—two more rate hikes are likely in 2017 and policy focus is expected to shift in 2018 towards reducing its $4.5 trillion balance sheet. Yet, central banks elsewhere need not follow suit. As Capital Economics points out, in the past, global monetary policy cycles have been synchronized when the underlying business cycles have been aligned. Today, conditions in the US are different from those elsewhere. In particular, core inflation and wage pressures in Europe and Japan are still exceptionally weak.[12] As a result, both the European Central Bank (ECB) and Bank of Japan (BOJ) are likely to maintain their stimulative policies.

Market Outlook

The global economic backdrop and accommodative central bank policies should remain supportive of equities and other risk assets over the intermediate term. While unexpected macro shocks can occur at any time, causing at least a short-term flight from risk assets, the likelihood of an imminent US or global economic recession appears low. Without a recession, history suggests an equity bear market (commonly defined by a peak-to-trough decline in stock prices of at least 20%) is unlikely. However, we do expect market volatility (both stock and bond) to increase from its current low levels. It's hard to predict what will cause volatility to increase, but such a reversion to the mean is likely—particularly given the many geopolitical events currently in play, a new US administration, and the likelihood of additional US Fed rate hikes this year.[13]

Multiple expansion, or a rising price/earnings (P/E) ratio, has accounted for a large part of the strong equity market performance over the last several years. For example, the current forward P/E multiple for the S&P 500 is now roughly 17.6x versus a longer-term historical average of approximately 14x.[14] As a result, we continue to believe that current valuations will be a headwind to equity market returns looking out longer-term. In our view, prospective returns will largely be driven by a combination of dividends and modest earnings per share growth. The recovery in corporate profits that began in mid-2016 is likely to continue as the negative effects of a strong US dollar and low oil prices are fading, yet profit margins should eventually be pressured by rising wages.

On a comparison of earnings yields to bond yields, stocks continue to look *relatively* undervalued, suggesting that, despite increased volatility, equity market returns are likely to outpace fixed income returns in the long run. The return potential for most investment grade fixed income categories is limited given the very low yield environment. Aging demographics and a global debt overhang should continue to keep both longer-term nominal interest rates and inflation in check.[15] However, we expect that rates will rise modestly in the coming years as the economy continues to improve and the US Fed continues to gradually normalize its monetary policy.

Portfolio Strategy & Tactical Asset Allocation Views

Although a strategic asset allocation plan provides a sound, long-term framework, we also believe that an active, flexible approach can enhance returns by shifting capital to attractive risk/reward opportunities. As we've communicated in the past, and as evidenced by the table below, we believe that there is currently a lack of undervalued asset classes. In general, bond yields remain new historical lows, credit spreads are tight, and corporate profit margins remain near record highs. That's not to say there are no compelling investment opportunities, but that forward-looking expected returns for most traditional asset classes are likely below their historical averages.

Asset Category Tactical Views	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight
Cash					
Cash & Ultra Short-Term Bonds				✓	
Fixed Income					
US Investment Grade Bonds		✓			
Non-US Investment Grade Bonds		✓			
Tax-Free Municipal Bonds			✓		
Bank Loans/High Yield			✓		
Equities					
US Large Cap		✓			
US Small Cap		✓			
Non-US Developed Markets			✓		
Emerging Markets			✓		
Private Equity (Large Buyout)	✓				
Private Equity (Mid-Market Buyout)		✓			
Private Equity (Venture Capital)		✓			
Real Assets					
Commodities			✓		
Public Real Estate (Core)	✓				
Private Real Estate (Opportunistic)		✓			
Flexible/Alternative Strategies					
Directional Hedge			✓		
Less Directional Hedge				✓	

Note: Based on research and opinion provided by Greycourt & Co. as of March 31, 2017. Tactical views reflect a three-year investment horizon. Suggested asset class weights are influenced by Greycourt's detailed quarterly tactical analysis and are used as a starting point in assessing client portfolio weights against strategic targets which typically reflect a ten-year investing horizon. The tactical views expressed for private/illiquid asset classes are intended to inform planned commitments in the context of a longer-term investment program.

Based on our assessment of the macro backdrop and relative asset class valuations and risks, our current portfolio positioning themes include the following:

- **Don't tilt too far away from an appropriate strategic asset mix, but maintain an elevated cash position**. We continue to recommend staying broadly diversified across a range of risk factors while maintaining allocations at-or-near longer-term target weights. Yet, we also advocate holding some cash as dry powder in order to potentially take advantage of significant volatility.

- **Continue to target a slight underweight position and/or shorter-than benchmark duration in the core fixed income space.** The risk from rising rates continues to outweigh the higher yields on long duration bonds. However, we recommend continuing to own protective assets such as high quality, intermediate duration bonds to provide a source of liquidity and stability. Municipal bonds remain attractively valued on an after-tax basis relative to treasuries and corporates, though the potential for lower federal tax rates may diminish this relative attractiveness.

- **Maintain exposure to certain riskier/credit-oriented fixed income investments that we believe remain attractive in the current environment.** For example, fundamentals remain healthy for floating-rate bank loans and the asset class potentially benefits from rising short-term interest rates.

- **Target a slight underweight position in equities while emphasizing large cap, high quality stocks.** Although we believe the backdrop of modest economic growth and accommodative monetary policies should continue to support stocks, based on broad equity market valuations we recommend a slight underweight position. We also continue to prefer a tilt towards higher quality companies (those with strong balance sheets, stable earnings, and high margins) that typically provide defensive characteristics in more challenging market environments.

- **Continue to reduce US equities on recent strength while increasing the allocation to more reasonably priced international and emerging markets stocks**. In our view, both international developed and emerging markets stocks offer attractive value relative to their US counterparts. Better economic data and inflation outlooks combined with an expected drop in uncertainty following the French election should make European equities more appealing. We also remain optimistic about emerging markets' long-term fundamentals and believe they are likely to outperform, though risks exist. Ultimately, we think they are better positioned today to weather the potential for higher US interest rates and a strong dollar than they were a few years ago. Many countries are implementing reforms and undergoing political change that could be positive longer term.

- **Target an overweight position to certain flexible/alternative strategies that potentially benefit from elevated market volatility and increased dispersion**. We continue to believe that certain types of hedge fund strategies are valuable for their diversifying active returns. In our view, the potential attractiveness of these alternative strategies is increased given the current valuations of traditional asset classes. In general, the market backdrop over the last several years has been a challenging one for hedge funds, yet we anticipate that the opportunity set will improve as volatility across asset classes and sectors increases to more normal levels.

- **Where appropriate, continue to develop private equity and private real estate investment programs as a means to potentially enhance long-term returns.** Because of the associated illiquidity premium and inherent inefficiencies, we believe these asset classes provide an opportunity to generate higher absolute returns while also potentially improving portfolio diversification. However, it is especially important for investors to approach illiquid asset classes with a clear strategy for implementation and portfolio construction—in our view, a successful program will be long-term in nature and diversified across geography, stages and vintage years.

Benchmark Definitions

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs). The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated real-time on a price-return basis.

The Barclays Capital Aggregate Index represents securities that are US domestic, taxable, and dollar denominated. The index covers the US investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

The Barclays Capital 1-10 Year Municipal Blend Index is a market value-weighted index which covers the short and intermediate components of the Barclays Municipal Bond Index—an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market. The 1-10 Year Municipal Blend index tracks tax-exempt municipal General Obligation, Revenue, Insured, and Prerefunded bonds with a minimum $5 million par amount outstanding, issued as part of a transaction of at least $50 million, and with a remaining maturity from 1 up to (but not including) 12 years.

The Barclays Capital US Corporate High-Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt.

The Bloomberg Commodity Index is composed of futures contracts on physical commodities. Included in the index family are subindexes representing the major commodity sectors within the broad index: Energy, Petroleum, Precious Metals, Industrial Metals, Grains, Livestock, Softs, and Agriculture.

The HFRI FOF (Fund of Funds) Composite Index. Fund of Funds invest with multiple managers through funds or managed accounts. The strategy designs a diversified portfolio of managers with the objective of significantly lowering the risk (volatility) of investing with an individual manager. The Fund of Funds manager has discretion in choosing which strategies to invest in for the portfolio. A manager may allocate funds to numerous managers within a single strategy, or with numerous managers in multiple strategies. The minimum investment in a Fund of Funds may be lower than an investment in an individual hedge fund or managed account. The investor has the advantage of diversification among managers and styles with significantly less capital than investing with separate managers.

The HFRI FOF (Fund of Funds) Conservative Index. FOFs classified as 'Conservative' exhibit one or more of the following characteristics: seeks consistent returns by primarily investing in funds that generally engage in more 'conservative' strategies such as Equity Market Neutral, Fixed Income Arbitrage, and Convertible Arbitrage; exhibits a lower historical annual standard deviation than the HFRI Fund of Funds Composite Index. A fund in the HFRI FOF Conservative Index shows generally consistent performance regardless of market conditions.

The HFRI FOF (Fund of Funds) Strategic Index. FOFs classified as 'Strategic' exhibit one or more of the following characteristics: seeks superior returns by primarily investing in funds that generally engage in more opportunistic strategies such as Emerging Markets, Sector specific, and Equity Hedge; exhibits a greater dispersion of returns and higher volatility compared to the HFRI Fund of Funds Composite Index. A fund in the HFRI FOF Strategic Index tends to outperform the HFRI Fund of Fund Composite Index in up markets and underperform the index in down markets.

The MSCI All Country World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. As of May 27, 2010 the MSCI ACWI consisted of 45 country indices comprising 24 developed and 21 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indices included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

The MSCI ACWI REIT Index is a free float-adjusted market capitalization index that captures large and mid cap representation across 23 Developed and 23 Emerging Markets countries, which generate a majority of their revenue and income from real estate rental and leasing operations. With 71 constituents, it represents about 85% of the global equity REIT universe and all securities are classified in the REIT sector according to the Global Industry Classification Standard (GICS®).

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. As of May 27, 2010 the MSCI EAFE Index consisted of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of May 27, 2010 the MSCI Emerging Markets Index consisted of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The S&P/LSTA Leveraged Loan Index is an unmanaged index of the institutional leveraged loan market. S&P Leveraged Loan Indexes are capitalization-weighted syndicated loan indexes based upon market weightings, spreads and interest payments. The S&P/LSTA Leveraged Loan Index covers the U.S. market back to 1997 and currently calculates on a daily basis.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index (stock price times number of share outstanding), with each stock's weight in the Index proportionate to its market value. The S&P 500 is one of the most widely used benchmarks of US equity performance.

The US Dollar Index is a measure of the value of the United States dollar relative to a basket of foreign currencies. It is a weighted geometric mean of the dollar's value relative to other select currencies, including the Euro, Japanese yen, Pound Sterling, Canadian dollar, Swedish krona, and Swiss franc.

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Colony Family Offices is a registered investment advisor. More information about the firm, including its investment strategies and objectives, can be found in our ADV Part 2, which is available, without charge, upon request. Our Form ADV contains information regarding our Firm's business practices and the backgrounds of our key personnel.

As always, past performance is not necessarily indicative of future results, and the value of investments and the income they might generate can fluctuate. CFO-17-26

[1] Defined by the S&P 500 Index.
[2] Defined by the MSCI EAFE Index.
[3] Defined by the MSCI Emerging Markets Index.
[4] Lighthouse Partners 1Q17 Quarterly Review, April 19, 2017.
[5] Ibid.
[6] Andrew Kenningham, Capital Economics, Global Economics Update, April 7, 2017.
[7] Capital Economics, The Capital Markets Analyst, April 26, 2017.
[8] Ibid.
[9] Lazard Asset Management, Outlook on the United States, April 7, 2017.
[10] Lazard Asset Management, Outlook on Europe, April 7, 2017.
[11] Andrew Kenningham, Capital Economics, Global Economics Update, March 16, 2017.
[12] Ibid.
[13] Lighthouse Partners, 1Q17 Quarterly Review, April 19, 2017.
[14] John Butters, FactSet, Earnings Insight, April 28, 2017.
[15] Lazard Asset Management, Outlook on US Fixed Income, April 7, 2017.

