

**June 30, 2016**

Shown below is the quarterly report on the status of the Montgomery County Consolidated Retiree Health Benefits Trust ("CRHBT") for the quarter ending June 30, 2016. This quarterly report is designed to assist you in understanding the current status of the CRHBT.

***History***

The Consolidated Retiree Health Benefits Trust was established in 2008 as a Section 115 Trust to provide funding for retiree health benefits for retirees and their dependents of Montgomery County and other agencies or political subdivisions who elect to participate.

***Participating Agencies and Other Trust Participants***

Participating agencies include Montgomery County Government, Revenue Authority, Credit Union, Department of Assessment & Tax, Strathmore Hall Foundation, Housing and Opportunity Commission, Washington Suburban Transit Commission, and Village of Friendship Heights. Beginning in June 2012, funding for retiree health benefits for Montgomery County Public Schools ("MCPS") and Montgomery College were also contributed to the CRHBT.

***Board of Trustees***

The Board of Trustees consists of 19 members: The Montgomery County Directors of Management and Budget, Finance, and Human Resources; the Council Administrator; a Police Bargaining Unit Representative; a Fire & Rescue Bargaining Unit Representative; an Office, Professional, and Technical (OPT) and Service, Labor and Trades (SLT) Bargaining Unit Representative; a Non-Bargaining Unit Representative; a Retired Employees Representative; two persons recommended by the Council who are knowledgeable in pensions, investments, or financial matters; two individuals knowledgeable in pensions, investments, or financial matters appointed by the County Executive; three members nominated by the Montgomery County Board of Education including a designee of the Superintendent, a Bargaining Unit Representative and retiree of MCPS; and 3 members nominated by the Board of Trustees of Montgomery College including a designee of the President, a Bargaining Unit Representative, and a retiree of Montgomery College.

***Performance Results***

The total net of fee return for the first quarter was a gain of 2.53%, 91 basis points (bps) behind the 3.44% gain recorded by the policy benchmark. For the one year ending June 30, 2016, the loss of 0.60% was 233 bps behind the 1.78% gain recorded by the policy benchmark. Our annualized net of fee performance for the three-year period was a gain of 5.43% and 5.38% for the five-year period ending June 30, 2016.

The total market value of trust assets at June 30, 2016 was \$675.8 million. The CRHBT's asset allocation was: Domestic Equities 23.3%, International Equities 18.1%, Global Equities 4.2%, Fixed Income 25.6%, Inflation Linked Bonds 10.0%, Public Real Assets 11.0%, Hedge Funds 2.2%, Private Real Assets 1.7%, Private Equity 3.1%, and 0.8% Cash.

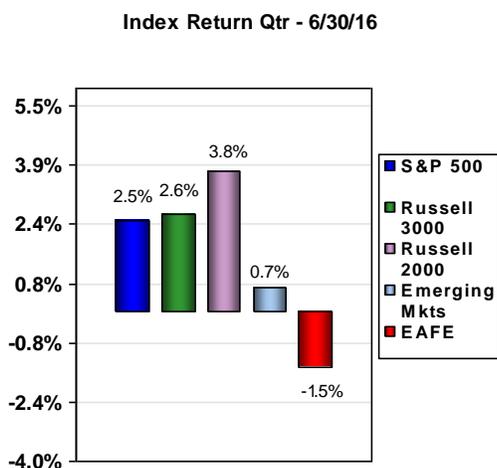
***Major Initiatives/Changes***

During the quarter, the following commitments were made: \$50 million to Nomura High Yield Fund, \$45 million to Jennison Long Duration Fund, \$45 million to Schroders Long Duration Fund, \$7 million commitment to K3 Private Investors, a private equity fund, \$3 million to Lime Rock Resources IV, a private real asset fund, \$3 million to Franklin Park 2016 Venture Series, and \$3 million to Franklin Park 2016 International Fund.

# QUARTERLY REPORT

## Capital Markets and Economic Conditions

Economic data reflected that GDP increased at a 1.2% annual rate in the second quarter of 2016, an increase of approximately 70bps from the economy's first quarter expansion of 0.5%. This GDP reading was well below the 2.6% consensus estimate of economists. Consumer spending was strong in Q2, expanding 4.2%, which represents the largest increase since Q4 of 2014. Nonresidential fixed investment declined by a 2.2% rate, which outweighed the robust gain in consumer spending. The economy grew at a rate of 1.0% through the first half of 2016, which represents the lowest level of economic growth since 2011. Despite weak economic growth, household finances remain in solid shape with the household debt service ratio hovering near an all-time low level of 10% and household net worth increasing to a record level of \$89.5 trillion. The residential real estate sector of the economy continues its long recovery as housing starts and median home prices both experienced quarterly increases. Despite these gains, both housing measures are still below peak levels seen before the global financial crisis. The economy added 460,000 jobs during the second quarter and saw the unemployment rate decrease to 4.9%. Additionally, the labor force participation rate decreased from 63.0% to 62.7% and the employment-to-population ratio decreased from 59.9% to 59.6%. Inflation continues to be muted as the CPI posted a modest 1.1% growth rate year-over-year due to declining food prices. Core CPI, which excludes food and energy, has seen a modest uptick to 2.2% due to increases in housing and medical related costs.



**Public Equity Markets:** U.S. stocks advanced during the quarter despite the negative sentiment developing around the Brexit event. However, the shock and uncertainty of the event lasted only a few days. The rally in commodity prices boosted gains in the Energy and Materials sectors. Stocks with bond-like characteristics, such as Utilities and REITs, rallied during the quarter. Small cap stocks outperformed larger cap stocks, while growth continued to lag value. Eight of the ten sectors of the S&P 500 Index advanced with Energy, Telecom, and Utilities performing the best. IT and Consumer Discretionary were the only sectors that posted negative returns during the quarter. Our combined domestic equity performance was a

gain of 1.60%, underperforming the 2.63% gain recorded by the Russell 3000 benchmark.

International developed markets were down due to the Brexit vote which unleashed substantial additional uncertainty into the European and global economies. While the majority of investor focus was on Europe, the Asian region had a relatively quiet second quarter and posted strong results. Emerging markets benefited from improving commodity prices due to the modest rebound in Chinese economic activity. Markets such as Brazil and Russia benefited from the increase in crude oil prices. Most of the developed markets were down with Italy and Austria declining the most while New Zealand and Canada posting strong returns. During the quarter, developed markets, as measured by the MSCI EAFE Index, were down 1.46%, while Emerging Markets were up 0.66%. Our combined international equity performance was a loss of 1.60% for the quarter, underperforming the 0.66% loss recorded by the custom MCHBT International Equity Index. Our global equity manager recorded a gain of 3.52%, outperforming the 0.99% gain of the MSCI ACWI benchmark.

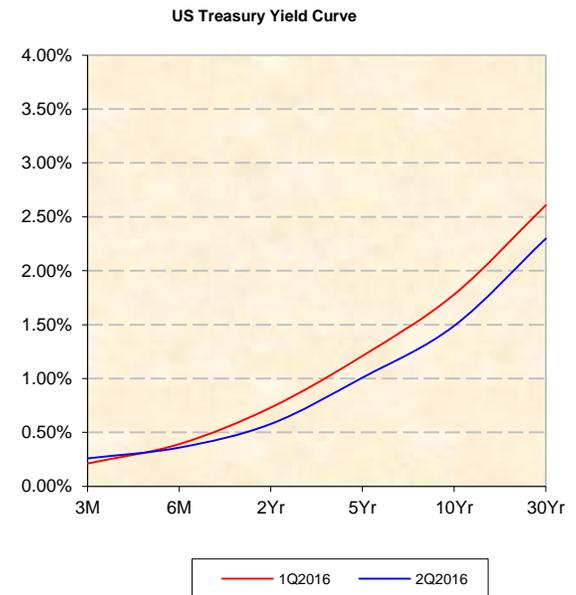
**Private Equity:** Buyout funds raised \$64 billion during the second quarter, up from the \$14 billion raised in the previous quarter. There were a total of 650 private equity-backed buyout deals in the second quarter, slightly up from the previous quarter. U.S. pricing multiples declined from 9.9x to 9.7x versus the previous quarter while leverage multiples continued their downward slope, ending the quarter at 5.3x. Within venture capital, investment activity was in line while invested capital saw a 15% decline versus the previous quarter. Exit activity (primarily through IPOs and M&A transactions) in U.S. buyout and venture markets were slightly up versus the previous quarter. During the quarter, our private equity managers called a combined \$5.2 million and paid distributions of \$1.2 million. Our current allocation to private equity is 3.08%, with a market value of \$20.8 million. Due to the young age of the portfolio, performance data is not relevant.

**Hedge Funds:** Hedge funds, as measured by the HFRI Fund Weighted Composite Index, gained 2.3% in the second quarter, reversing the declines from Q1 2016. On a sub-strategy basis, the HFRI Event-Driven

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Index rose 2.7%, the HFRI Relative Value Index gained 2.8%, and the HFRI Macro Index was up 2.0%. The hedge fund portfolio lost 5.19% in the second quarter.

**Fixed Income:** U.S. Treasury yields declined across the curve during the quarter as the unexpected outcome of Brexit vote caused equity markets to sell off and drove investors into safe haven Treasury assets in the face of ongoing uncertainty. Negative interest rates in pockets of developed Europe's largest bond markets are also driving more foreign capital into U.S. Treasuries, causing a further decline in yields. The yield on the 30-year bond decreased 31 bps during the quarter, and ended the period at 2.30%. The yield curve flattened (shown in the chart to the right) as the spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, tightened by 14 bps to 91 bps. For the quarter, the 2-year Treasury yield ended at 0.58%, down by 15 bps from the prior period, while the 10-year Treasury yield moved down by 29 bps to 1.49%. For the quarter, the Merrill High Yield II Constrained Index rose by 5.88%, the Barclays Aggregate was up 2.21%, and the Barclays Long Govt/Credit Index increased by 6.55%, as the long end of the yield curve continued to fall. The fixed income performance for the quarter was a gain of 5.83%, underperforming the custom benchmark's return of 6.31%. The Treasury Inflation-linked bonds (TIPS) advanced 1.83% for the quarter, slightly above the 1.71% gain reported by the benchmark.



**Private Real Assets:** U.S. real estate values rose 2.0% during the second quarter with 1.2% coming from income and 0.8% from capital appreciation, according to the NCREIF Property Index (NPI). Industrial and retail sectors were the leading performers with 2.9% and 2.2% gains respectively. Property fundamentals remain healthy with occupancy edging up to 93.2%, a 15-year high. For the upstream oil and gas sector, stabilizing commodity prices and cautious optimism narrowed bid-ask spreads and increased deal volumes. During the quarter, 51 oil and gas deals were announced, totaling \$26.1 billion. Deal volumes were driven by smaller deals primarily focused in low cost basins such as the Permian and Marcellus. During the quarter, our private real assets managers called a combined negative \$12,000 (due to negative capital calls as funds had subsequent closes) and paid distributions of \$134,000. Our current allocation to private real assets is 1.7%, with a market value of \$11.6 million. Due to the young age of the portfolio, performance data is not relevant.

**Public Real Assets:** The Bloomberg Commodity Index was up 12.78% as the commodity market rally, which began in the latter half of the first quarter, extended into the second quarter. Crude oil spot prices advanced 25% due to declining US oil production and numerous international supply disruptions. Due to the negative roll yield future prices underperformed spot prices, returning 18.7%. The negative roll yield was even more pronounced in natural gas where the spot prices rose 49% versus a 31% rise in the near dated futures. Following an unseasonably warm winter,

Quarterly Commodity Performance



natural gas prices rebounded due to declining production and strong seasonal demand in the power sector. Precious metals rallied sharply led by a 19.9% gain in silver futures. Silver benefitted from industrial metal cutbacks as the majority of silver mined annually is a by-product from mining other metals. Within industrial metals, zinc and nickel rose as both commodities moved into deficit from surplus due to strong supply declines. In contrast, copper was flat due to a stronger US dollar and rising production. Agriculture gains were led by soybean futures advancing 27.8%. Major flooding in Argentina and dryness in Brazil raised concerns about soybean supplies from these two key global suppliers.

Global listed real estate securities as measured by the FTSE EPRA/NAREIT Developed Index advanced 3.46% for the quarter. Returns were mostly positive across countries, led by Canada, U.S., Australia, and Hong Kong. Canadian shares continued to perform well due to higher oil prices and declining interest rates. Within the U.S., most property sectors posted positive returns in the quarter, led by Data Centers, which are benefitting from tremendous growth in cloud computing and e-commerce. Healthcare also performed well as the lower interest rates favored these longer lease duration assets. UK listed property markets was a notable exception to the positive performance posted by most countries as the results of the UK's Brexit referendum led to double digit declines.

Master Limited Partnerships (MLPs), as measured by the Alerian MLP Total Return Index, surged 19.7% for the quarter as energy prices continued to recover and sentiment around the sector improved. Concerns related to counterparty risks with US exploration and production (E&P) customers eased considerably. Fears about access to capital markets at reasonable costs also dissipated as several companies announced consolidations of their general partner/limited partner to eliminate their incentive distribution rights (IDRs).

For the quarter, the public real asset portfolio advanced 7.72%, underperforming the custom benchmark by 146 bps.

**Outlook**

Fed president Janet Yellen remains dovish as her June 2016 comments hinted that the Federal Reserve will likely hold off on raising interest rates in the near future. She noted that U.S. long-term prospects remain favorable but slower employment gains, weak productivity growth, and continued inflation readings well below target levels. Following Japan's historic adoption of a negative interest rate policy in Q1, the Bank of Japan held its policy rate steady at negative 0.1% at its June meeting, while cutting the inflation outlook. The European Central Bank also held their policy rate steady at negative 0.4%, remaining at record low levels.

The United Kingdom's shocking decision to leave the European Union at the end of June briefly spooked markets with fears that this decision could lead to a domino effect of other countries electing to exit, leading to a global recession. Recessionary fears in the U.S. were briefly revived post-Brexit as the U.S. Dollar sharply appreciated, although the gains were lost in the subsequent two months. Given that consumption and housing remain steady, it is unlikely that the U.S. will fall into a recession in the near term given that these sectors comprise about 75% of GDP.

The domestic economy is likely to continue to grow at a slow pace throughout the remainder of 2016 as the headwinds of decelerating employment gains and business investment weighs down the tailwinds of an improving wage picture, low commodity prices, low interest rates, housing market strength, and a healthy consumer. Despite the uncertainty generated by the Brexit vote, the Eurozone should continue to moderately grow due to low energy prices and slight gains in the employment and wage pictures.

*Sources: Bloomberg, Northern Trust, MSCI, S&P, T. Rowe Price, FRM, Wilshire Associates, Bridgewater, JP Morgan, BlackRock, PE Hub, Private Equity Analyst, Pitchbook, Real Capital Analytics, RE Alert, Schroder, Oil & Gas Investor, U.S. Bureau of Labor Statistics, PwC Deals, NCREIF.*

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### Risk Profile

The risk/return statistics for the CRHBT for the 1, 3 and 5 year periods ending June 30, 2016 are shown below:

	<u>1 Year</u>				
	Total Return	Risk	Sharpe Ratio	Sortino Ratio	Return/Risk
CRHBT - Net of Fees	-0.60	8.20	-0.12	-0.14	-0.07
CRHBT Benchmark	1.73	8.56	0.16	0.19	0.20

	<u>3 Year</u>				
	Total Return	Risk	Sharpe Ratio	Sortino Ratio	Return/Risk
CRHBT - Net of Fees	5.43	6.32	5.44	0.81	0.86
CRHBT Benchmark	5.83	6.23	5.92	0.90	0.94

	<u>5 Year</u>				
	Total Return	Risk	Sharpe Ratio	Sortino Ratio	Return/Risk
CRHBT - Net of Fees	5.38	9.61	0.52	0.64	0.56
CRHBT Benchmark	5.60	9.58	0.56	0.68	0.58

### Participating Agency Allocation

Agency	3/31/2016		3/31/2016 - 6/30/2016			6/30/2016	
	Balance \$	Balance %	Contributions	Expenses	Investment Gain/Loss	Balance \$	Balance %
Montgomery County Govt	\$282,699,090	46.60%	\$29,013,373	(\$365,423)	\$8,947,692	\$320,294,733	47.20%
MontCo Revenue Authority	\$2,008,889	0.33%	\$44,925	(\$2,525)	\$63,714	\$2,115,002	0.31%
Strathmore Hall Foundation	\$917,415	0.15%	\$24,825	(\$1,155)	\$29,106	\$970,191	0.14%
Credit Union	\$833,564	0.14%	\$20,525	(\$1,048)	\$26,441	\$879,482	0.13%
Dept of Assessments & Tax	\$10,550	0.00%	\$0	(\$13)	\$334	\$10,871	0.00%
District Court of Maryland	\$0	0.00%	\$0	\$0	\$0	\$0	0.00%
HOC	\$10,537,262	1.74%	\$285,100	(\$13,263)	\$334,310	\$11,143,409	1.64%
WSTC	\$73,195	0.01%	\$1,975	(\$92)	\$2,322	\$77,400	0.01%
Village of Friendship Heights	\$251,773	0.04%	\$6,275	(\$317)	\$7,987	\$265,718	0.04%
Montg. Cty. Public Schools *	\$268,923,891	44.33%	\$23,022,000	(\$195,221)	\$8,512,157	\$300,262,827	44.25%
Montgomery College	\$40,410,145	6.66%	\$952,000	(\$28,721)	\$1,279,457	\$42,612,881	6.28%
<b>Total</b>	<b>\$606,665,773</b>	<b>100.00%</b>	<b>\$53,370,998</b>	<b>(\$607,778)</b>	<b>\$19,203,521</b>	<b>\$678,632,514</b>	<b>100.00%</b>