Selectivity Drives Opportunity in 2016

Manning & Napier's
Semi-Annual Outlook

A Look Ahead

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Ebrahim Busheri is the Director of Investments at Manning & Napier. In his more than 25-year career in investment management, he has served in past roles as Director of Research for Manning & Napier in addition to serving as the head of various sector groups within the firm, and as Director of Investments and a Consultant at other investment firms.

A selective approach to making investment decisions is important in any environment, and it's especially critical today.

Weak GDP growth, as we have seen across the globe of late, tends to translate into weak revenue and earnings growth for companies. Investors must be selective in order to correctly identify the smaller subset of companies that can grow revenue and earnings – even in the face of a slow growth economic environment.

As we head into 2016, we provide our view of what to expect in global financial markets, and review how we expect the selective approach offered by active management to reward long-term investors.

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Volatility Hasn't Woken the Bear

Generally subdued market volatility between 2012 and mid-2014 led to a prolonged period of elevated investor complacency. This translated to increased speculation as evidenced by record-high levels of outstanding margin debt. In late 2014 and throughout 2015, these dynamics gave rise to bouts of volatility in global financial markets as concerns emerged surrounding overseas growth prospects, the conclusion of the Fed's third round of quantitative easing, and political developments in Greece.

Volatility ultimately spiked to a near four-year high in August 2015. Global equity markets experienced a correction with a broad sell-off arising from renewed emerging market growth concerns. In particular, there was uncertainty surrounding China's weakening economy and how this would affect global growth. The timing and trajectory of U.S. monetary policy normalization also was a factor.

The volatility in August and September served to rein in investor complacency that had built up during an extended period of equity market tranquility. However, the percentage of investors with a bearish market outlook is not at a level we would consider extreme. Therefore, as unexpected events continue to materialize, further bouts of volatility are likely, which makes active management more important than ever.

WHAT TO EXPECT

We believe investors should expect further gyrations in equity markets heading into 2016, due to catalysts including:

- geopolitical risks
- diverging monetary policies of major central banks
- commodity price pressures
- potential that global growth deviates from expectations

Dealing with volatility can be difficult; however, we encourage investors to maintain a long-term perspective.

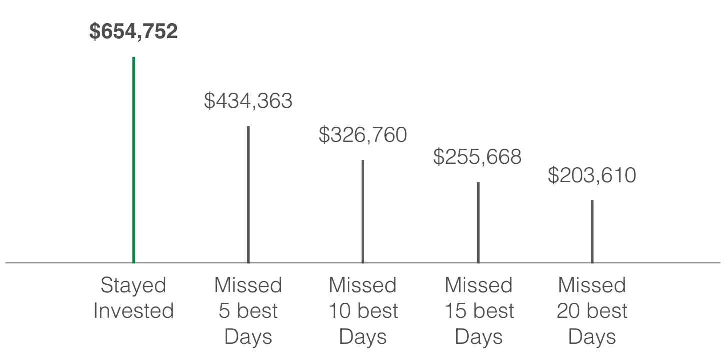
The indicators we monitor do not currently suggest the risk of a sustained bear market in equities.

OPPORTUNITY COST OF TRYING TO TIME THE MARKET

Growth of $100,000 Equity Investment in the S&P 500[1] (1995 - 2014)

Source: FactSet

Analysis: Manning & Napier

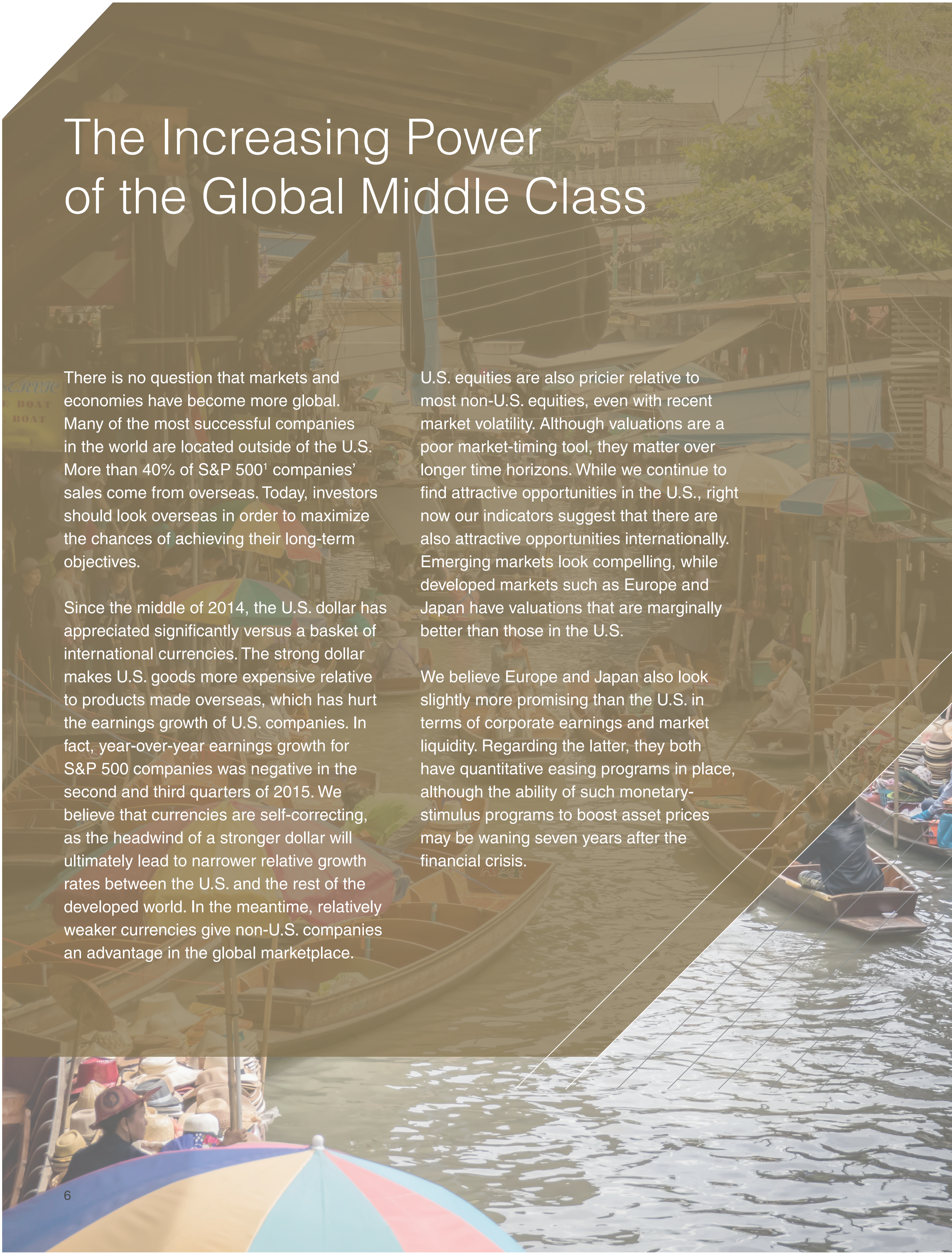


LOOKING AHEAD

Given the lack of extremes in our indicators today, investors can expect us to seek opportunities in short-term market dislocations.

Our analysis shows that over the last 20 years, the top-performing days for equities occurred during periods of heightened volatility.

Missing top-performing days can significantly erode portfolio value over time; therefore, investors should remain focused on their long-term investment objectives and resist the urge to time the market.



The Increasing Power of the Global Middle Class

There is no question that markets and economies have become more global. Many of the most successful companies in the world are located outside of the U.S. More than 40% of S&P 500[1] companies' sales come from overseas. Today, investors should look overseas in order to maximize the chances of achieving their long-term objectives.

Since the middle of 2014, the U.S. dollar has appreciated significantly versus a basket of international currencies. The strong dollar makes U.S. goods more expensive relative to products made overseas, which has hurt the earnings growth of U.S. companies. In fact, year-over-year earnings growth for S&P 500 companies was negative in the second and third quarters of 2015. We believe that currencies are self-correcting, as the headwind of a stronger dollar will ultimately lead to narrower relative growth rates between the U.S. and the rest of the developed world. In the meantime, relatively weaker currencies give non-U.S. companies an advantage in the global marketplace.

U.S. equities are also pricier relative to most non-U.S. equities, even with recent market volatility. Although valuations are a poor market-timing tool, they matter over longer time horizons. While we continue to find attractive opportunities in the U.S., right now our indicators suggest that there are also attractive opportunities internationally. Emerging markets look compelling, while developed markets such as Europe and Japan have valuations that are marginally better than those in the U.S.

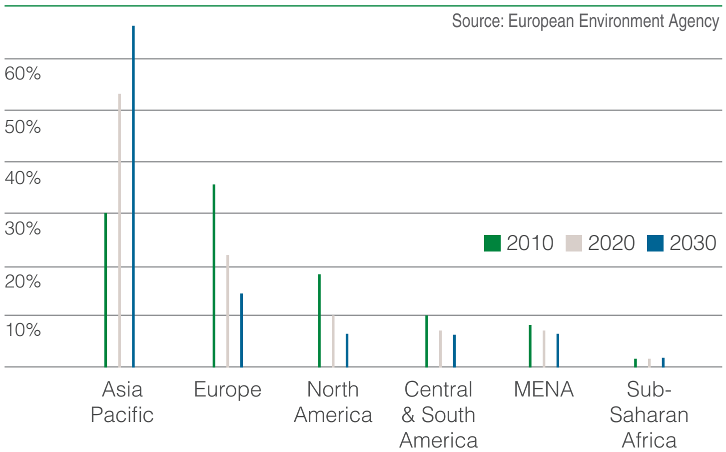
We believe Europe and Japan also look slightly more promising than the U.S. in terms of corporate earnings and market liquidity. Regarding the latter, they both have quantitative easing programs in place, although the ability of such monetary-stimulus programs to boost asset prices may be waning seven years after the financial crisis.

WHAT TO EXPECT

Despite recent difficulties such as declining economic growth and capital outflows, we believe the long-term story for emerging markets remains a compelling opportunity in overseas investing. Volatility may still be an issue in the short-term, but the changing profile of the global middle class favors developing markets in the long run. Consumers in emerging markets currently spend only a fraction of what their developed world counterparts spend, due in large part to income disparities.

As the emerging markets' middle class grows, consumer spending on goods and services should become larger contributors to GDP growth.

PROJECTED DISTRIBUTION OF THE GLOBAL MIDDLE CLASS



LOOKING AHEAD

Notwithstanding all that overseas investing has to offer, it remains important to be selective in both developed and emerging markets, as opportunities are far from uniform across all countries and sectors.

Is the Commodity Supercycle Winding Down?

From precious metals to fossil fuels, global commodities enjoyed a long-term period of rising prices over the past 20+ years. Many pundits have come to call this trend the commodity ‘supercycle.’ It was fueled by a mixture of solid growth in developed economies and rapid expansion in emerging markets, China in particular. To gain a sense of the seemingly insatiable appetite for raw materials China developed as it rose to become the world’s second largest economy, consider that from 2011 through 2013 China used almost 50% more cement than the U.S. did during the entire 20th century.

Recently, China’s economy has been slowing. Real GDP growth decelerated from a 10% annual growth pace in 2010 to just under 7% growth in late 2015. While Chinese policymakers are providing ample support through fiscal, monetary, and other channels, the economy may continue to slow as consumption evolves to become the primary engine of growth. Previously, investment spending was the driving force in China’s economy as the country spent heavily to build out industry and infrastructure. These efforts required all manner of commodities, but now the tide is shifting. We believe falling commodity prices in 2015 are reflective of China’s slowdown and weakness across the global economy in general. Weaker demand and excess supply drives prices lower. Perhaps the high point of the commodity supercycle, with China at the helm, is behind us.

In the midst of these commodity headwinds, there is evidence of a supply response developing:

- Announcements of merger activity and deal-making, bankruptcies, and significant cuts to commodity producers’ spending budgets are all taking place.
- Over time, businesses that can survive the cycle trough should emerge stronger when conditions begin to improve.

WHAT TO EXPECT

Manning & Napier pursues investments in cyclical industries through our proprietary Hurdle Rate strategy, which seeks to identify the strongest industry competitors and build positions in those companies as the cycle bottoms. These businesses tend to reap the benefits when the cycle begins anew.

Cyclical troughs can be ugly. If the supercycle of the past few decades is truly drawing to a close, lower commodity prices and the associated pain in commodity industries could linger for some time.

OUR PROPRIETARY HURDLE RATE STRATEGY

When to Buy	When to Sell
Demand low Industry returns low Capacity leaving Stocks depressed	Demand strengthening Industry returns increasing Attracting new capacity Stocks rising

LOOKING AHEAD

Global economic growth is likely to remain slow in 2016, and imbalances between supply and demand for certain commodities could persist. Against this backdrop a cautious approach to commodity-oriented market sectors such as Industrials and Materials is warranted over the next several quarters.

Positioning for Change in Fixed Income

Janet Yellen and the U.S. Federal Reserve are likely to remain the centerpiece of economic and market conversations as we enter the first half of 2016. Hiking policy interest rates would reflect the reality that the U.S. economy is much stronger today than during the financial crisis. However, the economy has not yet achieved the velocity necessary to escape a path of slow growth, which continues to weigh on the minds of Yellen and her colleagues as they evaluate incoming economic data.

Given its dual mandate, the Federal Open Market Committee (FOMC) pays particular attention to inflation and employment data. While the unemployment rate has fallen to its lowest point since the financial crisis in 2008, the pace of rising prices continues to fall short of policymakers' 2% annual target. Tighter labor markets should manifest in quicker wage growth in the future, which could feed inflation and inflation expectations. Additionally, the strong U.S. dollar and weak commodity prices represent transitory factors that are keeping headline inflation low in the near-term, but are expected to abate with time.

In the ongoing rate debate, policymakers are also sensitive to the potential presence of asset bubbles. Multiple rounds of quantitative easing added ample liquidity to the financial system, and the FOMC members want to prevent any unintended influence this could have on asset prices and markets.

WHAT TO EXPECT

Investors will need to be selective in fixed income markets going forward. We continue to see attractive opportunities in investment grade bonds, and believe a cautious approach can identify compelling options in high yield securities as well. Our fixed income approach leads us to take on risk when we believe investors are adequately compensated for that risk, and this is our rationale for continuing to have a very limited exposure to long-term Treasury bonds. In our view, long-term Treasury yields remain too low to justify investment.

Bonds are often viewed as a source of safety and stability, but if Treasury yields rise and a bond is sold prior to maturity, negative returns are likely.

THE IMPACT OF RISING TREASURY YIELDS
Yield as of 09/30/2015*

Source: FactSet | Analysis: Manning & Napier

If the 10-year Treasury Yield in one year is	→	The total return will be approximately
1.47%	(50-year low - 2012)	6.83%
2.04%*	(Yield at 09/30/15)	2.04%
3.13%	(10-year average)	-6.45%
6.08%	(50-year average)	-25.65%

For illustrative purposes only. Past performance does not guartanee future results.

LOOKING AHEAD

The Fed is at least a little bit anxious to normalize policy, which we expect should involve slightly higher policy interest rates in the not-too-distant future. As the process takes shape, we believe the Fed will seek to remain flexible and proceed slowly with small increases in the Fed funds rate that do not follow a well-defined schedule.

The near-zero policy interest rate regime the U.S. has been in since late 2008 represents emergency levels of accommodation. At this point in time, we believe the domestic economy is far from a crisis situation that would require such intense support. Labor markets are clearly tightening, underscored by strong job growth in recent years and the unemployment rate descending to 5%.

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Sources: FactSet, Pensions & Investments, European Environment Agency, Washington Post, Reuters.

[1]The S&P 500 Total Return Index is an unmanaged, capitalization-weighted measure of 500 widely held common stocks listed on the New York Stock Exchange, American Stock Exchange, and the Over-the-Counter market. The Index returns assume daily reinvestment of dividends and do not reflect any fees or expenses. S&P Dow Jones Indices LLC, a subsidiary of the McGraw Hill Financial, Inc., is the publisher of various index based data products and services and has licensed certain of its products and services for use by Manning & Napier. All such content Copyright © 2015 by S&P Dow Jones Indices LLC and/or its affiliates. All rights reserved. Neither S&P Dow Jones Indices LLC, Dow Jones Trademark Holdings LLC, their affiliates nor their third party licensors make any representation or warranty, express or implied, as to the ability of any index to accurately represent the asset class or market sector that it purports to represent and none of these parties shall have any liability for any errors, omissions, or interruptions of any index or the data included therein.

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