Gateway Index/RA Composite Commentary

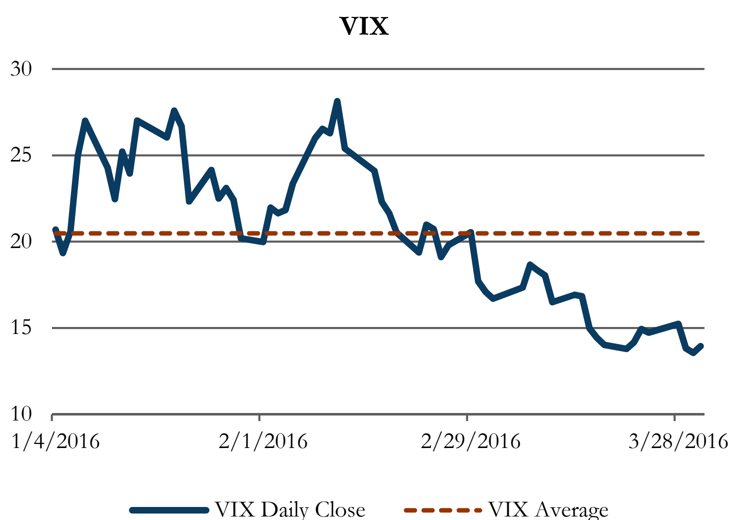
Q1 2016

EQUITY MARKETS

The S&P 500® Index gained 1.35% for the first quarter. Losses of 4.96% and 0.13% in January and February, respectively, were followed by a 6.78% advance in March. The market gyrations over the course of the quarter were more extreme than the monthly returns suggest. The quarter began with a 10.27% loss through February 11th and ended with a 12.95% rally through March 31st. It was the first time since 1933 that the S&P 500® Index experienced a loss of greater than 10% to start a quarter and recovered to post a positive return by quarter-end. Macroeconomic concerns such as falling oil prices, slowing economic growth in China and Federal Reserve (the Fed) monetary policy were the primary drivers of the decline. Drivers of the recovery included firming oil prices and a series of monetary policy developments which included: the Bank of Japan announcing a policy of negative short-term interest rates, additional monetary stimulus from the European Central Bank and indications from the Fed that the likelihood of more than two rate increases this year had lessened.

Though nearly 70% of the 497 S&P 500® Index companies which reported earnings during the quarter exceeded analysts' estimates, aggregate earnings were estimated to decline by 8.5% year-over-year once all companies have reported. A decline in year-over-year aggregate earnings for the first quarter would be the fourth consecutive quarter of declines, something that has not happened since 2008-2009. The final estimate of fourth quarter 2015 GDP growth was revised from 0.7% to 1.0%, which exceeded analysts' consensus estimates.

Implied volatility, as measured by the CBOE Volatility Index (the VIX), averaged 20.49 for the quarter, exceeding S&P 500® Index realized volatility (as measured by its annualized standard deviation of daily returns) which was 18.82%. It was the first time since the second quarter of 2012 that the VIX averaged over 20 for a quarter. The VIX rose to a closing high of 28.14 as the market bottomed on February 11th and then declined as the market recovered to end the quarter at 13.95.



Datasource: Bloomberg, L.P.

FIXED INCOME MARKET

The Barclays U.S. Aggregate Bond Index returned 3.03% for the first quarter. The yield on the 10-year U.S. Treasury Note declined from 2.27% on December 31st to a low for the quarter of 1.66% on February 11th, its lowest level in more than a year and less than 30 bps from its all-time low registered in July of 2012. The yield rose as the equity market rallied, reaching nearly 2% before declining again after the Fed held rates steady in March. It ended the quarter at 1.77%.

GATEWAY INDEX/RA COMPOSITE PERFORMANCE

The Gateway Index/RA Composite (net of fees) (the Composite) lost 0.63% for the first quarter, underperforming the S&P 500® Index by 198 bps. Despite outperforming the S&P 500® Index in January and February by 186 and 68 bps, respectively, the Composite's lower rate of return as compared to the S&P 500® Index for the quarter was mostly due to March's strong equity market rally.

GATEWAY INDEX/RA COMPOSITE PERFORMANCE (Continued)

In March, the Composite lagged the S&P 500® Index by 479 bps, a return that was consistent with an environment of implied volatility declining from above-average levels while the equity market advanced at a rate well above historical averages.

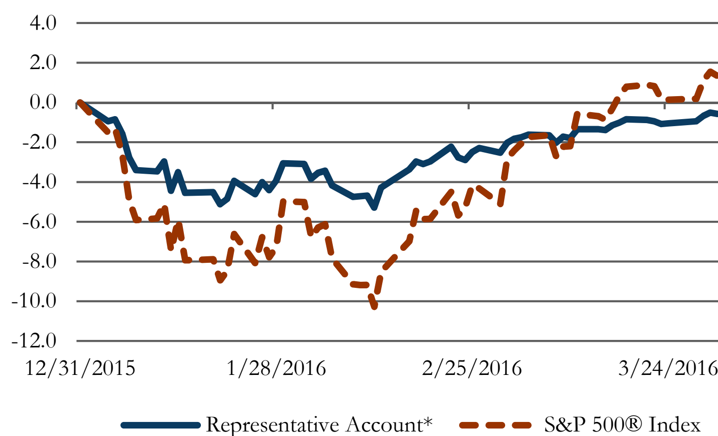
The partial period returns, portfolio performance contributions, annualized standard deviation and portfolio statistics quoted for the Composite in the following paragraphs are those measured by a representative account.*

The Composite provided significant downside protection over the first six weeks of the year as its 5.28% loss through February 11th was 499 bps better than the 10.27% decline in the S&P 500® Index. During this period, elevated implied volatility was a beneficial factor in regards to the downside protection delivered by the Composite, and both index call premiums collected and gains from index put options contributed positively to performance. From February 11th through quarter-end, the Composite returned 4.98%, a strong return for the Composite relative to its history but not quite sufficient enough to fully recover from the loss sustained during the market's decline.

For the first quarter, the Composite's underlying equity portfolio contributed a total return of 2.05%, resulting in a positive performance differential of 70 bps relative to the S&P 500® Index. The Composite's index call option portfolio contributed positively to returns in January and February, but detracted from return in March. Similarly, index put options contributed positively to returns in January and February, but detracted from return in March. The Composite's annualized standard deviation of daily returns for the quarter was 8.87% as compared to 18.82% for the S&P 500® Index. The Composite exhibited a beta to the S&P 500® Index of 0.45 for the quarter.

As the market declined over the first half of the quarter, Gateway's index call option management focused on rolling strike prices down while taking advantage of elevated levels of implied volatility to increase cashflow to the strategy and, in some cases, trading call options well in advance of expiration. The investment management team was also active in managing the cost of protection provided by the Composite's index put options, taking advantage of opportunities to close out certain index put option positions at a profit.

*Represents supplemental information to the GIPS-compliant presentation. This representative account was selected as it is the largest account in the Composite.



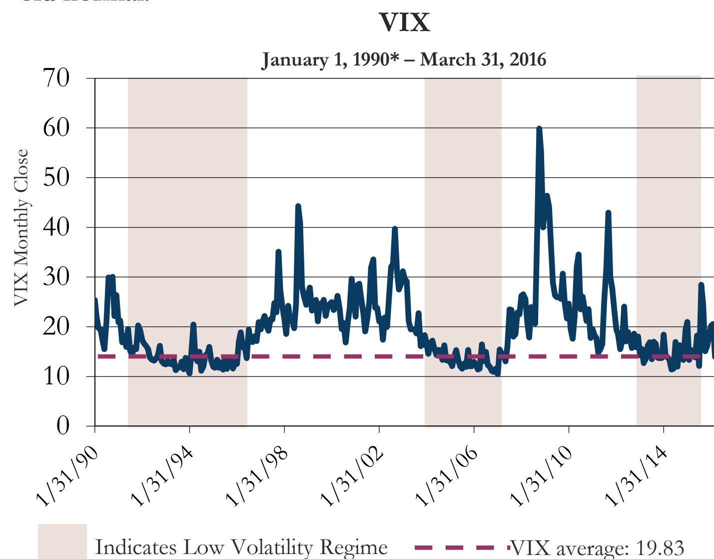
On February 11th, a put position was sold at a profit and not immediately replaced – resulting in less than full put coverage on the Composite's underlying equity portfolio. Index call option positions were adjusted to maintain the Composite's risk profile. Over the remainder of the month, several index put options were traded well ahead of their expirations and replaced with contracts that had later expiration dates to help manage the overall cost of downside protection. On February 26th, the Composite was returned to full put coverage.

As the market swiftly advanced late February and throughout March, the focus of index call option management decisions was to replace expiring contracts with higher strike price contracts while being patient enough to protect the portfolio from the potentially adverse effects of a market pullback. Gateway's investment management team took advantage of declining implied volatility by executing several index put option trades well in advance of their expiration dates in an effort to manage the cost of downside protection while maintaining the strategy's typical relative risk profile.

As of March 31st, the Composite's diversified equity portfolio was over 95% hedged with index call options with average strike prices between 1.5% and 2.5% in-the-money, average time to expiration of 36 days and annualized premium to earn of 7.5% to 10%. The Composite ended the quarter hedged with index put options on over 95% of the notional value of its portfolio with average strike prices between 12.5% and 15% out-of-the-money, average time to expiration of 50 days and annualized cost of less than 2.5%. Relative to the beginning of the quarter, this positioning represented less market exposure and lower net cashflow potential.

MARKET PERSPECTIVE

Did the nearly 13% rally staged by the S&P 500® Index since February 11th bring an end to the higher volatility experienced by the equity market since August? Despite recent implied volatility readings in the low teens, history suggests we may have just experienced the first several months of an elevated volatility phase. As the chart below shows, the high and low phases of a volatility cycle can last for years, rather than for months or quarters. The extreme spike in implied volatility experienced by the market in August of 2015 may have ended a three-year phase of generally below-average volatility. That phase was preceded by a high volatility period which lasted about five years. This cycle of multi-year phases tends to repeat itself over the full history of the VIX. The cycle appears repetitive enough such that the return of increased market volatility could be described as a return to the "old normal."



*January 1, 1990 is first date of available VIX data.
Datasource: Bloomberg, L.P.

Looking beyond historical patterns, current drivers of market volatility also make the case for its likely persistence. The August volatility spike was driven by a range of factors, including investor concerns about the impact of slowing economic growth in China, plummeting oil prices and monetary policy uncertainty. These same issues remain in the headlines today and none seem likely to be resolved in the near term.

It's not just that China's economy is cooling or that oil prices are well off the highs that weigh on investors – it's the follow-on effects of those trends. In China's case, the country's reduced demand hurts commodities exporters.

Furthermore, low oil prices signal headwinds and not just for traditional oil-producing countries. The U.S., as well as an increased portion of its economy, is tied to oil production to a much greater level than was the case the last time an oil boom went bust.

The Fed's normalization of monetary policy, and its broad plan to increase benchmark interest rates as it sees U.S. economic indicators improve, also has the potential to continue to rile markets. The effect of monetary policy on market volatility is further magnified because of uncertainty about the scale and direction of future rate changes and the potential second-order effects they might have on the economy. As of now, the timeline of the Fed's normalization of monetary policy extends to 2018, so investors should not expect the market's obsession with Fed policy to dissipate anytime soon.

Though the term "normalization" doesn't suggest it, the U.S. may have entered an experimental phase in monetary policy. December marked the first rate increase in a decade and also the first time in many years that the Fed has been out of sync with global counterparts, including the European Central Bank and Bank of Japan which have driven key interest rates into negative territory.

There is no certainty that the Fed will be able to proceed with raising rates in accordance with its estimations. As of mid-February, the Fed futures market had priced in a higher likelihood of a rate *decrease* by mid-2016 than a rate hike. With Congress questioning Chairman Yellen at that time about the effect of a potential negative interest rate policy in the U.S., a high degree of uncertainty may exist. Regardless of what the Fed does next, the U.S. economy appears to be in uncharted territory with potentially volatile market conditions a possibility in the near-term. Investors may benefit from seeking risk management tools that allow them to participate in equity market advances while offering reliable downside protection should volatility surge during significant equity market declines. Given the relationship between implied volatility and option premiums, strategies that incorporate index option selling tend to favorably fit this profile in a normal to above-normal implied volatility environment than they do in low implied volatility environments. In short, an "old normal" volatility trend potentially creates a favorable environment for strong risk-adjusted returns for the low volatility equity strategies that have an index-option selling component.

Standard Performance

Average Annual Performance As of March 31, 2016							
	1 Year	**3 Years**	**5 Years**	**10 Years**	**20 Years**	**Return Since Inception***	**Risk** Since Inception***
Index/RA (Net)	0.74%	3.41%	3.87%	3.27%	5.15%	7.18%	**6.40%**
S&P 500® Index	1.78%	11.82%	11.58%	7.01%	7.98%	10.23%	**14.41%**
Barclays U.S. Aggregate Bond Index	1.96%	2.50%	3.78%	4.90%	5.59%	6.65%	3.77%

*Inception of Gateway Index/RA Composite is January 1, 1988
** Standard deviation is based on monthly performance

Periods over one year are annualized.
Datasource: Morningstar Direct℠ and Gateway Investment Advisers, LLC
Past performance is no guarantee of future results.

Gateway Investment Advisers, LLC
Gateway Index/RA Composite
Annual Disclosure Presentation

Year End	Annual Performance Results				Composite 3-Year Std. Dev	S&P 500® 3-Year Std. Dev	Barclays 3-Year Std. Dev	Number of Composite Accounts	Composite Dispersion	Composite Assets (millions)	Firm Assets (millions)
	Composite Gross	Composite Net	S&P 500®	Barclays Aggregate							
1993	8.44%	7.75%	10.08%	9.75%	N/A	N/A	N/A	15	0.7	$ 348	$ 408
1994	6.27	5.62	1.32	-2.92	N/A	N/A	N/A	14	0.5	303	660
1995	12.52	11.75	37.58	18.47	4.07%	8.34%	4.30%	12	1.6	283	473
1996	11.83	11.11	22.96	3.63	4.44	9.72	4.65	27	0.9	329	360
1997	13.34	12.58	33.36	9.65	3.83	11.30	4.06	27	1.1	399	476
1998	13.21	12.49	28.58	8.69	5.53	16.24	3.58	44	1.2	686	805
1999	12.94	12.27	21.04	-0.82	5.39	16.76	3.25	76	1.4	1,348	1,470
2000	6.55	6.08	-9.10	11.63	5.30	17.67	3.06	107	1.2	2,052	2,206
2001	-2.69	-3.28	-11.89	8.44	6.29	16.94	3.40	85	0.5	1,853	1,944
2002	-3.87	-4.45	-22.10	10.25	9.41	18.81	3.40	67	0.4	1,651	1,744
2003	12.53	11.84	28.68	4.10	9.70	18.32	4.26	59	0.4	2,029	2,160
2004	7.84	7.22	10.88	4.34	8.35	15.07	4.34	53	0.5	3,350	3,636
2005	5.86	5.17	4.91	2.43	4.09	9.17	4.12	35	0.5	3,879	6,134
2006	11.06	10.35	15.79	4.33	2.64	6.92	3.25	29	0.5	4,569	6,946
2007	8.67	7.99	5.49	6.97	3.10	7.79	2.80	25	0.5	4,780	7,892
2008	-13.39	-13.95	-37.00	5.24	8.41	15.29	4.03	22	1.0	5,073	7,071
2009	7.37	6.70	26.46	5.93	10.36	19.91	4.17	15	0.4	5,054	7,188
2010	5.76	5.11	15.06	6.54	11.01	22.16	4.22	12	0.1	5,552	7,699
2011	3.82	3.16	2.11	7.84	8.27	18.97	2.82	11	0.3	5,729	8,081
2012	5.41	4.74	16.00	4.22	5.84	15.30	2.42	10	0.2	7,424	10,517
2013	9.35	8.64	32.39	-2.02	4.23	12.11	2.75	11	0.2	8,899	12,475
2014	4.23	3.59	13.69	5.97	3.45	9.10	2.67	10	0.3	8,997	12,239
2015	3.20	2.54	1.38	0.55	3.97	10.62	2.92	11	0.2	8,783	12,210

N/A: The three year annualized ex-post standard deviation of the Composite and benchmarks is not presented as 36-month returns are not available.

Gateway Index/RA Composite contains fully discretionary hedged equity accounts which hold common stock and sell index call options on at least 95% of the underlying stock value. This call activity reduces volatility and provides cash flow. The accounts typically buy index put options that can protect the Composite from a significant market decline that may occur over a short period of time. Indexes utilized for call and put option activity are U. S. domestic equity indexes that include all sectors of the economy. The Gateway Index/RA Composite was created January 1, 1993. As of June 1, 2009, the Composite definition was refined to more accurately reflect the criteria used to determine membership. No membership changes resulted from the revision.

For comparison purposes the Gateway Index/RA Composite is measured against two indexes, the S&P 500® Index (a popular indicator of the performance of the large capitalization sector of the U. S. stock market) and the Barclays U. S. Aggregate Bond Index (an unmanaged index of investment-grade bonds with one- to ten-year maturities issued by the U. S. government, its agencies and U. S. corporations). Prior to April 2008, the Lehman Brothers U. S. Intermediate Government/ Credit Bond Index was utilized for comparison. The bond index change was made as the Barclays U. S. Aggregate Bond Index is widely viewed as more broadly representative of the fixed income markets and was considered to be more in line with the historical volatility associated with the Composite's investment strategy.

Performance results are based on fully discretionary accounts under management, including accounts that may no longer be with the firm, and are expressed in U. S. dollars. Performance returns are presented gross and net of management fees and include the reinvestment of all income. Past performance is not indicative of future results. The annual Composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the Composite the entire year.

Net of fee performance was calculated using actual management fees. The current investment management fee schedule is as follows: 0.85% on the first $5 million; 0.65% on the next $5 million; 0.50% on the next $40 million; and 0.45% on assets in excess of $50 million. Actual investment management fees incurred by composite accounts may vary.

Gateway Investment Advisers, LLC (Gateway) is an independent registered investment adviser and a successor in interest to Gateway Investment Advisers, L.P. as of February 15, 2008. Gateway claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Gateway has been independently verified for the periods January 1, 1993 through December 31, 2015.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. The Gateway Index/RA Composite has been examined for the periods January 1, 1993 through December 31, 2015. The verification and performance examination reports are available upon request.

Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request. A list of composite descriptions is also available upon request.