2015 Third Quarter ReView of the Markets

Index	3rd Qtr Return	YTD Return
S&P 500	-6.4%	-5.3%
MSCI ACWI Ex USA	-11.9%	-7.8%
Barclay's Bond Index	1.2%	1.1%
Consumer Price Index	-0.1%	0.5%

Investment Commentary

The period between July 1 and September 30 was the worst quarter for equity markets since the debt ceiling debate in 2011 and the first negative quarterly return for the index since 2012. The S&P 500 dropped 6.4%, hurt most by energy stocks as oil prices fell over 20%. Stock prices declined as a result of worries over global growth and concern created by the Federal Reserve's inaction during their September meeting.

Internationally, China was a focus as international stocks dropped over 11% as measured by broad-based international indices, with emerging market stocks falling more than that. China is in the midst of a massive economic reform as they attempt to transition from investment-based economic growth (think investing in building new cities, roads, bridges, etc.), to a more consumer-driven economy. As a result, growth in the world's second largest economy is slowing, although it is still quite high relative to developed markets. While the transition has been painful in recent years, we still view the transition as both necessary and positive over the long term for China's economy. Since China accounts for a large percentage of commodity consumption, its slowdown has a meaningful impact on the aggregate amount of global commodity demand, and thus pushes prices lower. Naturally, economies that are heavily reliant on commodity exports, such as Russia and Brazil, experienced a disproportionate amount of pain.

Bond rates continue to remain range-bound as the Federal Reserve (the Fed) kept its benchmark interest rate near 0%. Many expected that the Fed would increase interest rates during their September meeting; however Chairwoman Yellen cited global financial market volatility brought about by concerns over global economic growth, among other things, as a reason for holding rates unchanged. The Barclays Aggregate Bond Index, an index composed primarily of high quality government-related bonds, was the best performing major stock or bond index for the quarter, up a whopping 1.2%. As investors fled riskier asset classes such as equities, they purchased high quality investment grade bonds, driving their prices up. Lower quality, higher yielding bonds performed more like equities than their investment grade counterparts, as they lost 5% for the quarter. From our perspective, this is to be expected as historically low quality bonds have exhibited sensitivity to movements in equity markets.

Economic Outlook

During the quarter we learned that U.S. economic growth accelerated at an annualized rate of 3.9% through June 30. While this seems impressive on its face, rising inventories and the strong U.S. dollar will likely lower that growth back down to the 2% to 2.5% growth we have experienced over the past several years.

The economic slowdown in China is frequently cited as a challenge for U.S. economic growth. However, a decelerating Chinese economy isn't likely to have a meaningful impact in the U.S. Exports from the U.S. to China represent less than 1% of total GDP. In other developed economies including the Eurozone and Japan, exports to China represent less than 5% of total GDP. Certain emerging market economies, such as Korea, rely much more on Chinese consumption.

Financial markets will likely remain susceptible to volatility and concerns regarding the lack of strong growth in the global economy. Investors more closely watch every economic indicator because, with economic growth low by historical standards, slight changes have a larger impact on a percentage basis. This impacts prices of financial assets as market participants tend to overreact on both the downside and the upside to individual indicators, like employment and retail sales, as opposed to the economy as a whole. Additionally, the slow growth economic landscape has a somewhat circular impact on the real economy as companies are less willing to spend money on capital expenditures out of anxiety that the economy may stall and their return on investment could be lower than their forecasts. Against this backdrop, we do not expect that global growth will meaningfully surprise on the upside, and we believe this makes it likely that long term interest rates will remain low for the foreseeable future.

The idea that the Fed and other central banks around the world have nearly exhausted monetary policy as a tool to deal with economic weakness is of some concern. Moreover, as the Fed prepares to increase interest rates, prices of risk assets such as stocks will be far more exposed to their underlying fundamentals and, as already noted, these fundamentals are reasonable albeit not particularly strong. We remain hopeful that at some stage, the baton will be passed from monetary policy, which is implemented by central banks, to fiscal policy, which is implemented by legislatures.

Investment Strategy

Recent declines in U.S. and international equity prices have made broad equity valuations slightly more attractive than they were earlier in the year. While U.S. corporate earnings have decreased this year, the majority of the decline is attributable to the strong dollar and declines in commodity prices. We do not expect either of these factors to reverse in the short term, but they do not diminish our overall outlook for the U.S. economy.

As mentioned, we expect global economic growth to remain low and thus, we believe that long term interest rates (i.e. 10 years and longer) will not quickly increase. However, in the event we are wrong, we do not think there is adequate compensation from the yield on long duration bonds to justify the risk. We will maintain a shorter average duration on our fixed income allocation, perhaps extending into intermediate term bonds where there is some value.

Although this quarter's drop in equity markets was difficult for investors, equity market volatility actually remains near its historical average. We have continued to remind clients in recent years that volatility has been abnormally low and that a 10% intra-year drop in equity markets was overdue from a historical context. Despite this, we know the negative price action can make some clients uneasy and we welcome the opportunity to discuss your long term asset allocation.