2016 Second Quarter Review of the Markets

Index	2nd Qtr Return	YTD Return
S&P 500	2.46%	3.84%
MSCI ACWI Ex USA	-0.64%	-1.02%
Barclay's Bond Index	2.21%	5.31%
Consumer Price Index	0.84%	0.79%

Investment Commentary

After a tumultuous start to the year, most of the second quarter was quite calm within global markets. Great Britain's referendum in late June to exit the European Union (known as "Brexit") was unexpected and brought about significant volatility, sending the S&P 500 down 5% and non-U.S. stocks down 8%. Markets did rebound before the end of the quarter as domestic stocks finished up 2.5% while non-U.S. stocks were only down 0.6%. With the benefit of hindsight, we see that the very close results of the United Kingdom's vote may have been driven by social rather than economic issues.

As global investors were caught off guard by the Brexit vote, there was a flight to safety which drove down bond yields as investment grade bonds rallied late in the quarter. The Barclays Aggregate Bond index increased 2.2% in the second quarter. The yield on the 10 year US Treasury bond dipped below 1.50% during the last week of the quarter before eventually setting a historic record low of 1.366% in early July. With interest rates falling globally, it is of no surprise that higher dividend paying stocks have generally been amongst the best performers so far this year.

Oil, which was a dominating theme in the first quarter of the year as prices touched below $27 per barrel, had a strong quarter. Prices increased over 30% on West Texas Intermediate crude. Oil-related stocks and high yield bonds responded positively to this price improvement.

Economic Outlook

The Brexit vote may present economic growth issues within the European Union. Specific to the United Kingdom, the European Union ("E.U.") is somewhat incentivized to take a hard line in economic treaty negotiations, which could lead to less favorable trade terms than the U.K. enjoyed previously. The E.U. would take such a stance to demonstrate to other member nations that leaving the Union would not be in their best interests economically. However, despite tougher trade policies, some nations may choose to place their autonomy over their own economies and hold referendums similar to that which Great Britain held. Nationalistic sentiments continue to grow across Europe in stark opposition to decades of globalization and integration. We believe this to be partially the result of concerns brought about by immigration in a region in which terrorist attacks have grown in frequency and severity, as well as concerns regarding economic growth in a region that is still battling against deflationary forces.

The above concerns about European economic expansion contribute to our thesis that slow global growth will hold long term interest rates to low levels for the foreseeable future. Populist movements show us that decisions are not always made to maximize economic potential. This could be challenging to the capitalist system that has underpinned

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growth in the developed world. Given the negative demographic forces at play across developed (and in many cases emerging) markets, and elevated current levels of debt (as a percentage of GDP), the case for stronger growth is tenuous at best. Viewing the world from this prism, we think that it is likely that global yields will continue to be challenged for the foreseeable future.

The case for global stock markets continues to be the lack of viable alternatives that are capable of generating sufficient portfolio growth for investors to reach their goals. As such, given the above economic back drop and reasonably strong performance year-to-date, our expectations of future returns remain well below historical averages! Bloomberg recently reported that there is now nearly $10 Trillion of negative-yielding global bonds, and, in real terms (meaning adjusting for expected inflation), there are trillions of dollars of additional debt that have negative real yields. Of course, cash also currently bears a negative real yield. We believe that this lack of viable alternatives continues to be supportive of average valuations (meaning the prices that investors are willing to pay for a share of company's earnings) for stocks, even in an environment in which earnings growth could remain challenged.

In this environment, one may wonder if stocks that pay significant dividends are particularly attractive. This is not lost on other investors, and, in many cases, traditionally high-dividend paying stock sectors have been bid up to the point that return in the form of dividends could very well be offset by negative return in terms of the stock price. It is also worth bearing in mind that every dollar that a company pays out in the form of a dividend is one less dollar that the company has to reinvest within the business. We are certainly not averse to dividends, but view a dividend as just one factor that plays into a portfolio's total return.

Investment Strategy

As has been the case throughout 2016, we remain at a "neutral" allocation to risk assets throughout our risk profiles; this is a result of finding stocks neither cheap nor expensive. The more meaningful drawdowns we have seen this year have prompted some clients to ask whether it is wise to "buy the dips" in equity indices. To the extent clients contribute cash to their portfolios and that cash needs to be deployed into stocks, we do think it makes sense. However, it would take a meaningful decrease in valuations, coupled with a sustainable thesis on why those valuations should revert to their averages, for us to make the decision to overweight risk assets in client portfolios.

Insofar as there is cash accumulated in client accounts, these dollars are generally earmarked for an allocation to fixed income. With the 10 year U.S. Treasury yielding less than 1.5% at the end of the quarter, there were many periods throughout the quarter when we did not feel clients were being reasonably compensated for purchasing long term bonds. We view Treasury bonds as insurance, and at those yields we believe the insurance costs more than it would eventually pay out in the absence of a recession. We do expect these dollars to be put to work in the near future.

With all of the distinctive events that have had a short-term price impact on markets, it is worth reminding clients that we build asset allocations to accomplish long term goals and objectives. Short term market moves rarely warrant a change in strategy. We are constantly evaluating markets in search for opportunities to purchase undervalued assets, and have taken advantage of such opportunities throughout the year. While low economic growth may be persistent, periods of low absolute returns in equity markets are generally brief and we will eventually see a better environment. We continue to allocate assets thoughtfully with our clients' financial independence at the forefront of our decision making.