Market Commentary
September 30, 2016

Quarterly Market Review

U.S. equities traded in a narrow range for much of the summer as investors recovered from the volatile sessions triggered by the U.K. decision to leave the European Union on June 27th. Indeed, for the first 45 trading days of the quarter, the S&P 500 index recorded only one day with a move of 1% or more. However, after the Labor Day holiday weekend, investors returned to a market focused on Global Central Bank policy, specifically the Federal Reserve.

In the weeks leading up to the Federal Reserve September meeting, several FOMC voting members publicly voiced their case for an increase in short term interest rates while Chair Yellen and other members countered these arguments citing the recent disappointing economic data and a need to be patient. While the dissention inside the Fed pushed Treasury yields higher and risk assets lower, investors evaluated the preset conditions needed for the Federal Reserve to change policy and concluded the Fed will remain on hold. As a result, bond yields declined and stock prices finished flat for the month but higher for the quarter. Particular strong results were witnessed among small cap stocks with the Russell 2000 index posting an 8.7% gain for the quarter and leading out the year with a 10.2% gain.

U.S. Treasury Bonds finished the quarter relatively flat with the ten-year Treasury yield rising from 1.49% to 1.60%, however yields remain well below the January 2.25% level lifting the total return on the intermediate term Treasury to 7.0% year to date. For investors holding longer dated Treasury Bonds (20 years or longer), they recorded an impressive 15.5% total return year to date.

Turning to global markets, European equities recovered from their "Brexit" lows put in on June 27th, however markets remain mixed on a year to date basis with the U.K. FTSE 100 Index posting a 10.5% gain year to date. In Asia, the Japanese Nikkei 225 Index continues to struggle and remains firmly in negative territory for the year recording a -13.6% decline. Emerging markets recorded similar disappointing results with China's Shenzhen CSI 300 Index declining -12.8% year to date.

Global Economic Outlook

United States: The world's largest economy continues operating at two speeds. On the one hand, a strong U.S. dollar and lackluster global demand are weighing on exports, while low oil prices and rising election uncertainty continue adding pressure on business investment. On the other hand, a solid labor market, rising real wages and buoyant consumer confidence are boosting household spending. Economic data for August showed that the ISM manufacturing index fell into contractionary territory for the first time in six months and nominal retail sales decreased over the previous month. The drop in retail sales mainly reflected a price effect from the fall in gasoline prices that month rather than a slowdown in consumption. In fact, consumer fundamentals remain rock solid: employers created 151,000 new jobs in August and consumer confidence rose to an 11-month high.

The U.S. economy is expected to strengthen in the second half, buoyed by solid private consumption and a bounce-back in inventories. Yet a strong U.S. dollar, weak global demand and low oil prices will continue to weigh on the country's exports and fixed investment. Analysts expect GDP to increase 1.6% in 2016. For 2017, the consensus sees GDP growth at 2.1%.

Eurozone: The Eurozone economy slowed in the second quarter as weakness in domestic demand outweighed a brighter external sector. Despite the downturn, many of the conditions that have driven the recovery remain intact and high frequency data for Q3 has been resilient, suggesting that a large Brexit-induced shock to growth has yet to materialize. The composite PMI remained in expansionary territory in September and economic sentiment recorded only a mild decline in August. However, post-Brexit vote optimism is still premature as the brunt of the impact will be felt over a longer horizon. The vote also has profound political complications for the European Union and leaders from the member countries—except for the UK—met in September to discuss a

roadmap for the future. The talks focused on promoting growth and bolstering security within the Union but kicked more controversial topics such as migrant quotas down the road.

Risks to the Eurozone's outlook remain fairly balanced. While slower global growth and the uncertain political environment could weigh on growth prospects, supportive monetary policy and resilient domestic dynamics are supporting the economy. Economists see the Eurozone economy expanding 1.5% in 2016 before decelerating slightly to 1.4% growth in 2017.

Japan: The Central Bank in Japan's ultra-loose monetary policy, the government's proactive fiscal stimulus and a low unemployment rate are expected to support growth this year. However, a strong yen remains the main downside risk to growth. Overall, the lack of profound economic reforms is clouding Japan's long-term growth prospects. Analysts see the economy growing 0.6% this year and 0.8% in 2017.

China: Although the economy in China is expected to decelerate in the coming months, Chinese authorities showed their willingness to avert any sharp downturn by shoring up the economy through cheap credit and policy support. Nevertheless, if sustained, credit-fueled growth and government intervention have the potential to slow China's reforms and exacerbate macroeconomic imbalances. Economists see GDP rising 6.6% this year and GDP growth slowing to 6.3% for 2017.

Investment Strategy

Never before have investors been so focused on Central Bank policy with every word being carefully scrutinized in a desperate hope for clues as to how the Central Bank will modify monetary policy to combat a low growth, disinflationary world. In terms of investment strategy, the frustration for income oriented investors continues as bond yields fail to generate the current income required to meet their financial obligations; Pension funds, endowments and insurance companies all suffering as interest rates remain at or near the zero bound. Negative bond yields, stagnate economic growth and disinflation describes the new normal these investors must continue to navigate while the efficacy of nearly a decade of central bank accommodation is questioned and the unintended consequences of such polices begin to emerge.

We believe the U.S. economy remains in a mid-cycle expansion, however late cycle pressures appear to be rising. In addition, divergent global central bank policy, while accommodative, will likely create periods of volatility and uncertainty over the short run. Furthermore, we see U.S. equity valuations approaching the top end of their historical range and earnings growth moderating with limited multiple expansion. We believe an inflection point for equities may be on the horizon with fundamental securities analysis or "stock picking" becoming more important than in recent years.

Our strategic asset allocation continues to favor equities over bonds as equities will likely produce superior risk adjusted returns over the near term given our cyclical outlook for the global economy and Central Bank accommodation. In addition, while our global allocation emphasizes U.S. equities, we see relative value in select quality dividend growth stocks in Europe.

We continue to avoid long duration, fixed income securities which offer poor relative risk adjusted returns/yields when compared to other income producing securities such as dividend growth stocks and MLP's. However, while the outlook for bonds is muted in our view, the asset class remains an important hedge or counter weight to equities as part of a prudent risk management strategy for client portfolios.

Performance Scorecard

Benchmark Description	Q3	YTD
Barclays Aggregate Bond Index	0.5%	5.8%
S&P 500 Total Return Index	3.9%	7.8%
NASDAQ Dividend Achievers Select TR Index	1.3%	9.6%
S&P Small Cap 600 Index	7.2%	13.9%
Alerian MLP Index	-0.8%	8.9%
MSCI ACWI Ex USA Index (Net)	7.1%	6.1%

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