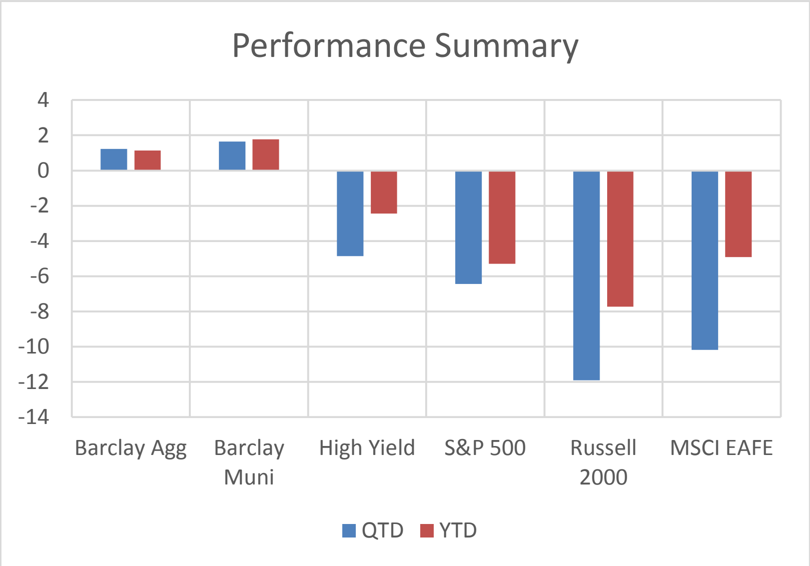
Q3 Investment Commentary

Volatility returned to equities in the third quarter, impacted by economic stress in China, weak corporate earnings and rapidly declining energy prices. The S&P 500 fell 7% for the quarter, and experienced its first correction since 2011. The biggest decline was in small-cap stocks, down 12%. Foreign stocks were also hit hard during the quarter with developed markets down 10%, and emerging market stocks down close to 18%. Core bonds were up 1.23% and served their role as portfolio diversifiers and helped to reduce risk in investment strategies. More aggressive parts of the bond market were down sharply as evidenced by high-yield bonds down 4.86% and emerging market bonds down 10.54%.

The S&P 500 dropped 12% from its high a month earlier, marking the first correction since 2011. An unusually long stretch given historically, a correction occurs roughly once a year. **For perspective, the S&P 500 has had a 10% plus correction 52 times since the end of WW II, they are not unusual**.



As of early October stock markets are attempting to rally from the third quarter's sell-off. A weak jobs report gave investors' confidence that the Fed would hold-off raising rates and stock markets successfully bounced off the August lows. **The recent show of technical strength has increased expectations that a yearend rally is in the works.** Although stocks may rally near-term, we are not convinced the correction is over yet, and would not be surprised if stocks were to retest the earlier lows. In our opinion, a quick recovery back to previous highs would leave the stock market with many of the same vulnerabilities that started the correction. The chief vulnerability being valuation. Valuations can stay high for an extended period, especially when interest rates are at zero, economic growth is moderate and inflation is low and stable with no wage pressure. **However, whether it's this year or next, the U.S. is headed towards an interest rate reset that will make high valuations less sustainable**. In addition, after six years of earnings recovery we are starting to see earnings growth slow and even decline in some sectors. Lastly, although investors seemed nervous during the correction we didn't see much evidence of capitulation.

In spite of this, investors should not overreact to these periods of volatility, they are the norm, and need to be tolerated if we expect to reap the long-term rewards of owning stocks. **As long-term investors, we view corrections as opportunities**, and often remind ourselves of famed investor Shelby Davis' famous quote "most of your money is made in a bear market, you just don't know it at the time." **These periods of increased volatility allow us to purchase quality assets at discounted prices that will reward us in the next rally.** And we have been finding select opportunities to purchase quality stocks, with strong economic moats and good valuations that were previously too expensive.

We also believe foreign developed markets are attractively valued relative to the U.S. and expect to move portfolios in this direction as appropriate. In addition, if areas such as emerging markets and commodities continue to be pressured we will likely view this as an opportunity to add positions for accounts with a longer time horizon.

Asset Class Views

Asset Class	View*	Comments
Equities		
U.S. Large Cap	↔	Markets have corrected, however, valuations are still relatively high and we expect long-term returns to be below the long-term average. Volatility will likely remain high, which will selectively create opportunities to purchase high quality companies with strong economic moats and good valuations.
U.S. Small/Mid Cap	↓	Despite the recent sell-off we believe this segment of the market is still overvalued and should be underweighted, expected returns over the next five years look sub-par.
International Developed	↑	Valuations are more attractive than U.S. stocks. Volatility is likely to remain high near-term, however we expect foreign developed stocks to outperform U.S. stocks over the next five years due to better valuations.
Emerging Markets	↔	Markets have pulled back sharply and valuations look attractive for long-term returns; near-term we expect volatility to remain high due to concerns about currency and liquidity risks, which may create better values.
Fixed Income		
Investment Grade	↔	Yields have come down as the global economy has slowed; however we recommend keeping exposure for risk management and diversification.
High-Yield Bonds	↓	Valuations have improved but do not justify the risks. If the economy continues to slow or enters recession, we expect substantial downside risk.
Municipal Bonds	↔	Valuations are fair, however they look attractive for high tax-bracket investors.
TIPS	↔	Valuations are improved; TIPs make sense in tax-deferred accounts as a hedge against inflation.
Floating-Rate Loans	↔	We view FRLs as a reasonably attractive, however rates are well below the “floor’ level and it may take several rate increases for any rate adjustments to kick-in.
Emerging Markets	↔	Valuations have improved, however we are concerned about currency, debt levels and liquidity risks. We remain cautious and will wait for potential “wash-outs” before looking to pick-up bargains.
Alternatives		
Absolute-Return/Alternatives	↑	We like this asset class and believe it can improve the risk/reward profile of portfolios that hold traditional asset classes; investors need to maintain a long-term perspective. Performance in the recent correction has been disappointing.
REITs	↔	Valuations for the general asset class look full; selectively we see opportunities in individual health-care REITs
Commodities/Gold	↔	We view gold as an “insurance” asset and recommend holding small positions, precious metals have been in a tight trading range and we will watch closely to see if they break support or resistance. Commodities have sold off dramatically and may be nearing a buying opportunity for long-term investors.

*** ↔ Neutral weight ↓ Underweight ↑ Overweight**

U.S. Stocks

Market Performance, Third Quarter 2015

Index	Q3 2015	YTD
S&P 500	(6.44%)	(5.29%)
Russell 1000	(6.83%)	(5.24%)
Russell 1000 Value	(8.39%)	(8.96%)
Russell 1000 Growth	(5.29%)	(1.54%)
Russell Midcap	(8.01%)	(5.84%)
Russell 2000	(11.92%)	(7.73%)

Source: Morningstar

- Stocks dropped as investors worried about slow growth in China and other emerging markets, weak earnings growth and a drop in energy/commodity prices.
- The S&P 500 was down 7%, and experienced its first correction since 2011, as prices dropped 12.5% from its high in the quarter. Small-cap stocks were hit the hardest, down 12% for the quarter.
- Growth stocks outperformed value stocks by 3% in the quarter. We continue to have a slight bias towards growth as we believe they will be favored in a low economic growth environment.

International Stocks

Market Performance, Third Quarter 2015

Index	Q3 2015	YTD
MSCI EAFE	(10.19%)	(4.91%)
MCSI EME	(17.78%)	(15.22%)
MSCI BRIC	(21.04%)	(14.39%)

Source: Morningstar

- International developed and emerging market stocks were both down sharply in the quarter. Emerging markets as a whole were down 18% and several countries are in bear market territory.
- We believe foreign markets are attractively valued relatively to the U.S., and expect them to outperform over the next five years.

Fixed Income
Market Performance, Third Quarter 2015

Index	Q3 2015	YTD
Vanguard Total Bond Index	1.16%	0.94%
Barclays Muni Bond	1.65%	1.77%
Barclays US Corp High-Yield	(4.86%)	(2.45%)
JPM GBI- EM Global Diversified	(10.54%)	(14.91%)
iShares TIPS Bond	(1.21%)	(0.93%)
BofA Merrill Lynch 3 month Treasury Note	0.02%	0.03%

Source: Morningstar

- Core bonds were up 1.23% and were one of the few asset classes to generate positive returns in the quarter. Serving their role as diversifiers and reducing risk in portfolios.
- More aggressive parts of the bond market were down sharply, with high yield bonds down 4.86% and emerging market bonds down 10.54%
- We own bonds mostly for diversification and we have low expectations for returns in the coming years. We are selectively using absolute return and flexible bond managers to add value.

Alternative Assets
Market Performance, Third Quarter 2015

Index	Q3 2015	YTD
PIMCO All Asset All Authority	(10.03%)	(14.51%)
AQR Diversified Arbitrage	(2.17%)	(2.27%)
Gateway	(2.32%)	0.28%

Source: Morningstar

- Alternative asset performance was mixed for the quarter. The All Asset All Authority fund posted poor performance in a down market, while the other funds performed in-line with expectations.
- We continue to recommend moderate allocations for the long-term and believe they will improve the risk-adjusted returns of portfolios.

Appendix:

Benchmark Definitions

U.S. Equity		Description
S&P 500	Index	The index includes 500 leading US companies and captures approximately 80% coverage of available market capitalization.
Russell 1000	Index	The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe and includes approximately 1000 of the largest securities. The Russell 1000 represents approximately 92% of the U.S. market.
Russell 1000 Value	Index	The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.
Russell 1000 Growth	Index	The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
Russell Midcap	Index	The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership.
Russell 2000	Index	The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

International Equity		Description
MSCI EAFE	Index	The EAFE (Europe, Australasia, Far East) index consists of 21 developed market country indexes, excluding the US & Canada. It is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets.
MCSI EME	Index	The index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets and includes 23 emerging market countries in the index.
MSCI BRIC	Index	The index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the following four emerging market country indexes: Brazil, Russia, India and China.

Fixed Income		Description
Vanguard Total Bond Index	Index Fund	This index measures a wide spectrum of public, investment-grade, taxable, fixed income securities in the United States—including government, corporate, and international dollar-denominated bonds, as well as mortgage-backed and asset-backed securities, all with maturities of more than 1 year.
Barclays Aggregate Bond	Index	The U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM pass-through bonds), ABS, and CMBS sectors.
Barclays Muni Bond	Index	The U.S. Municipal Indices cover the USD-denominated long term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.
Barclays US Corp High-Yield	Index	The index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market and excludes Emerging Markets debt.
JPM GBI- EM Global Divers	Index	The index tracks returns for actively traded external debt instruments in emerging markets. Included in the index are US-dollar denominated Brady bonds, Eurobonds, and traded loans issued by sovereign entities.
iShares TIPS Bond	ETF	The iShares TIPS Bond ETF seeks to track the investment results of an index composed of inflation-protected U.S. Treasury bonds.
BofA Merrill Lynch 3 month Treasury Note	Index	The 3-month US Treasury Note Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month, that issue is sold and rolled into a newly selected issue.
Alternative Assets		**Description**
PIMCO All Asset All Authority	Mutual Fund	The investment seeks maximum real return, consistent with preservation of real capital and prudent investment management. The primary benchmark for the fund is the S&P 500, with a secondary objective of Consumer Price Index +650 basis points.
AQR Diversified Arbitrage	Mutual Fund	The investment seeks long-term absolute (positive) returns. It invests in a diversified portfolio of instruments, including equities, convertible securities, debt securities, loans, warrants, options, other types of derivative instruments.
Gateway	Mutual Fund	The investment seeks to capture the majority of the returns associated with equity market investments, while exposing investors to less risk than other equity investments. The fund invests in a broadly diversified portfolio of common stocks, while also selling index call options and purchasing index put options.