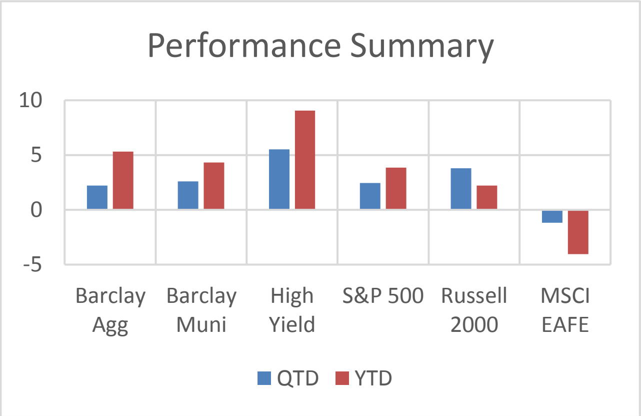
Q2 Investment Commentary

Large cap stocks in the U.S. dropped sharply in the wake of Brexit before rebounding to finish the quarter with a 2.5% gain. Small-cap stocks followed a similar pattern, finishing the quarter up 3.8%. As we write this commentary, the S&P 500 is close to making new highs. However it's important to note that stock market leadership is being led by a flight to quality into defensive sectors with high dividend yields, such as utilities and telecom. Defensive stock leadership is not typical market action in a sustained bull market, rather it reflects the sentiment of TINA (there is no alternative to stocks) that has become prevalent in today's low interest rate environment. **In our opinion, a transition in stock market leadership from defensive sectors into more economically sensitive sectors would be a positive sign that any breakout to new highs is sustainable.** Bonds have also benefited from economic uncertainty and the ongoing chase for yield; core bonds finished the quarter up 2.2% and high-yield bonds were up 5.5%. Both categories are outperforming stocks on a YTD basis.

As we move into July, we expect investors to start focusing on the upcoming earnings season. As of early July, the current estimate for the second quarter S&P 500 earnings is for a year-over-year decline of 4.9%. According to Goldman Sach's the growth for operating earnings per share, S&P's preferred metric, will also be negative. If so, that would mark the seventh consecutive quarter with negative operating earnings growth, something that has never happened outside of an economic recession based on data going back to 1967. The decline in earnings is projected to be wide spread across six sectors, led by energy (-79%), financials (-7%), materials (-6.7%), tech (-5.2%), staples (-3.8%) and Telecom (-2.4%). The top performers are expected to be discretion (+9.4%), industrials (+7.9%) and healthcare up (+3.0%). **The end result is the current U.S. earnings recessions will continue in the upcoming quarter and possibly beyond. Suggesting that if markets continue to head higher in the near-term, interest rates, and not earnings, are likely to be the driver.** We believe security selection, not beta, will be a key determinant of performance in the coming year(s). Therefore we will remain disciplined in our investment decisions, resisting the temptation to follow the herd into overvalued securities based on the pursuit of yield or overzealous growth assumptions.



Considering the current market climate there are several themes we plan to emphasize in portfolios in the coming year(s) to improve returns: 1. Continue to favor stocks with growing dividends, but watch valuations closely. 2. We expect volatility and periodic sell-offs to increase in frequency, and will actively trade them to capitalize on good buying opportunities. 3. Tactically allocate to global asset classes that have higher expected returns as opportunities arise. 4. Utilize alternative asset classes that have a low correlation to traditional asset classes (stocks and bonds) and can improve absolute and risk-adjusted returns. 5. Stay disciplined to our quality-at-a-reasonable-price (QARP) investment style and not chase overvalued securities. 6. Keep investment and trading costs as low as possible. The next page provides a more detailed view of our outlook for the major asset classes.

Asset Class Views

Asset Class		* ↔ Neutral weight ↓ Underweight ↑ Overweight
Equities	***View****	***Comments***
U.S. Large Cap	↔	Despite Brexit and valuation concerns, large-cap stocks finished the quarter with a modest gain of 2.5%. Globally interest rates are declining which has driven investors to rotate into high-yielding defensive stocks. The SHUT sectors (staples, healthcare, utilities and telecom) are leading the way, but look pricey.
U.S. Small/Mid Cap	↓	Small-cap stocks have lagged for several years and the valuation premium has narrowed relative to large-cap stocks. However, given the late stage of the market cycle our preference is to stay underweight.
International Developed	↔	Valuations are more attractive than U.S. stocks. However volatility is likely to remain high given concerns about Brexit, weak economic growth and whether foreign central banks can continue to drive markets.
Emerging Markets	↔	Market performance has improved in 2016. Given reasonable valuations in many emerging markets we are comfortable with small positions in lower volatility and higher quality strategies.
Fixed Income		
Investment Grade	↔	Yields are drifting down around the world, with roughly 14 trillion in foreign government bonds now having negative yields; we expect future returns to be low but are keeping some exposure for risk management and diversification purposes.
High-Yield Bonds	↓	High-yield bonds have rallied from the February lows; Since high-yield bonds have similar risk profiles to stocks and our preference is to seek growth from our stock market exposure and not from low quality bonds.
Municipal Bonds	↔	Valuations are fair, however they look attractive for high tax-bracket investors.
TIPS	↑	TIPs make sense in tax-deferred accounts as a hedge against inflation; our preference is short-duration exposure to avoid interest rate risk.
Floating-Rate Loans	↔	We view FRLs as 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 remain cautious about currency/liquidity risks. Our preference is to wait for potential “wash-outs” before seeking direct exposure; we are comfortable if our managers add select exposure.
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 this year has improved significantly.
REITs	↔	Valuations for the general asset class look full however REITs will benefit from addition to the S&P this year; selectively we see opportunities in specific REITs and expect good risk adjusted returns if rates stay contained.
Commodities/Gold	↔	We view gold as an “insurance” asset and recommend holding small positions, precious metals have broken out of their trading range and have performed very well this year.

U.S. Stocks
Market Performance, Second Quarter 2016

Index	Q2 2016	YTD
S&P 500	2.46%	3.84%
Russell 1000	2.54%	3.74%
Russell 1000 Value	4.58%	6.30%
Russell 1000 Growth	0.61%	1.36%
Russell Midcap	3.18%	5.50%
Russell 2000	3.79%	2.22%

Source: Morningstar

- Stocks shook off the negatives of Brexit and slow economic growth to finish the quarter with a modest gain.
- The S&P 500 was up 2.46%, including dividends. Small-cap stocks outperformed with a gain of 3.79%, however continue to lag YTD.
- Value stocks continued to show leadership and the performance gap relative to growth has widened YTD. If interest rates continue to drift lower we expect the outperformance of value and dividend paying stocks to continue as well.

International Stocks
Market Performance, Second Quarter 2016

Index	Q2 2016	YTD
MSCI EAFE	(1.19%)	(4.04%)
MCSI EME	0.80%	6.60%
MSCI BRIC	3.21%	4.61%

Source: Morningstar

- Emerging markets continued their outperformance during the quarter, and now have a wide lead over developed markets YTD. Foreign developed markets lagged as investors became cautious on global macro risks from terrorism, Brexit, and slow economic growth.
- We believe foreign developed markets are attractively valued relatively to the U.S. We are also comfortable starting positions in emerging market stocks in lower volatility and higher quality strategies.

Fixed Income

Market Performance, Second Quarter 2016

Index	Q2 2016	YTD
Vanguard Total Bond Index	2.34%	5.47%
Barclays Muni Bond	2.61%	4.33%
Barclays US Corp High-Yield	5.52%	9.06%
JPM GBI- EM Global Diversified	2.96%	14.30%
iShares TIPS Bond	1.66%	6.16%
BofA Merrill Lynch 3 month Treasury Note	0.06%	0.12%

Source: Morningstar

- Core bonds continue to surprise investors and finished the quarter with a gain of 2.2%, and are outperforming stocks on a YTD basis.
- More aggressive parts of the bond market continued after a weak showing in 2015. High-yield bonds were up 5.52% and emerging market bonds were up 2.96%. TIPs had a decent quarter as investors are becoming concerned that extraordinary global monetary policies may lead to higher inflation.
- Core bonds yields remain in a low trading range and we have modest expectations for returns in the coming years. We own core bonds mainly for diversification and risk management.

Alternative Assets

Market Performance, Second Quarter 2016

Index	Q2 2016	YTD
PIMCO All Asset All Authority	4.55%	10.36%
AQR Diversified Arbitrage	0.99%	0.11%
Gateway	1.98%	1.40%

Source: Morningstar

- In general, liquid alternative had a strong quarter depending on the strategy being used. Strategies focused on real return, gold and commodities also had strong performance.
- We continue to recommend moderate allocations for the long-term and believe they will improve the risk-adjusted return 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.