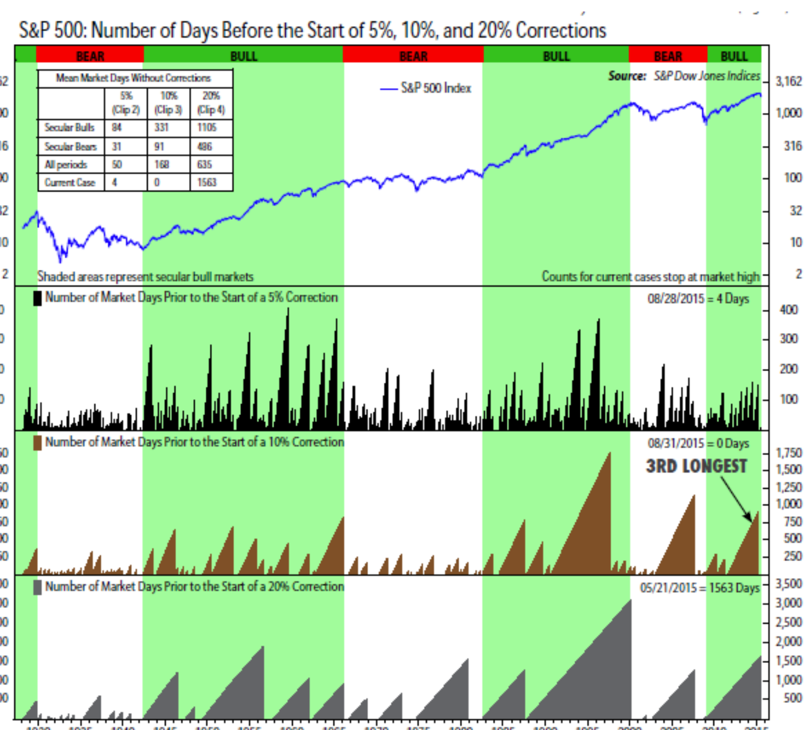
Investment Commentary: 9/2015

Volatility increased sharply around the world as investors became increasingly worried about weak economic growth in China, the steep drop in the price of oil, lackluster corporate earnings and the potential of a coming hike in interest rates. Stock market volatility in the U.S., as measured by the VIX index, spiked to more than 50—the highest reading since the 2008 financial crisis. Given this backdrop, global stock markets finished the month in sharply negative territory. The S&P 500 declined more than 10% over a six-day period—the first 10% correction since 2011—and finished the month down 6%. Developed international stocks also had a rough month, finishing down more than 7%, while emerging-markets stocks were the biggest losers as large declines in Chinese stocks dragged the broad emerging market indices down over 9%.

Core bonds as reflected by the Barclay's Aggregate Bond Index were down a slight 0.14% and helped to offset the volatility of stocks during the month. Riskier segments of the bond market, such as high-yield and emerging market bonds provided less protection to investors down 1.7% and 5.4% respectively**. In our view, this was a good reminder about the importance of maintaining some exposure to core bonds in balanced portfolios as way to counterbalance the risk of growth-oriented assets like stocks.**

Economic news showed some improvements, as second quarter GDP came in at 3.7% compared to 0.6% in the first quarter. The improvement in GDP was driven mainly by increased consumer spending, strong residential investment and an uptick in exports. **The housing market remained a consistent performer with sales of new homes up 5.4% and existing home sales up 2.0%.** These and other factors contributed to an increase in the Consumer Confidence Index, up to 101.5 from 90.9 in July, a sign that consumers were feeling better about the economy.

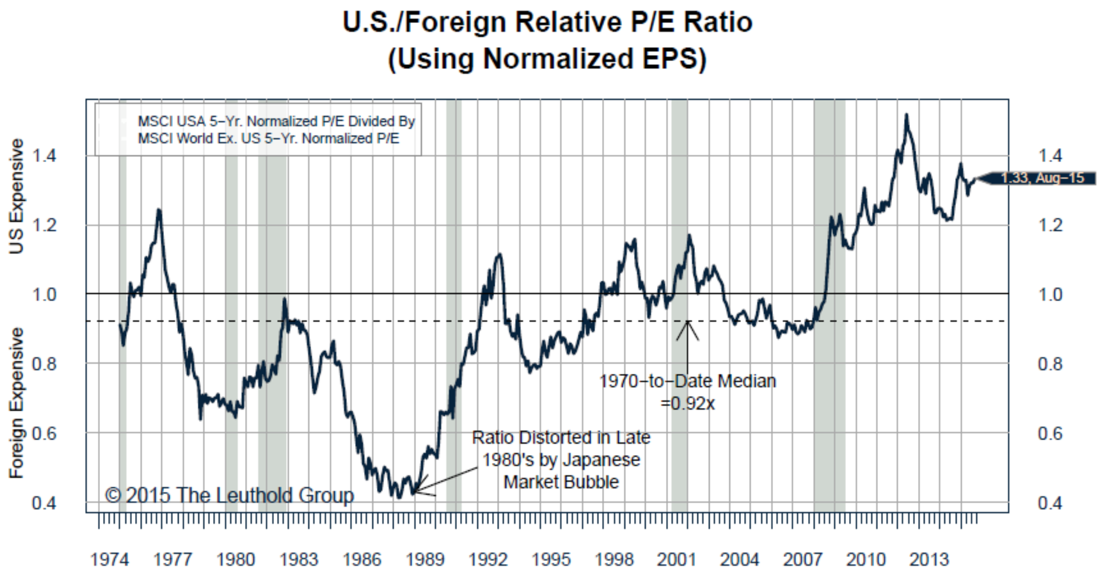
Although the U.S. economy has shown some signs of improvement, investors are likely to remain worried about the slowdown in China and the impact it may have on the global economy. China is a massive consumer of natural resources such as copper, oil and other commodities, and the collapse in commodity prices the past year creates worry that the economic slowdown may be greater than Chinese officials are admitting. The performance of China and other emerging economies in the coming months will provide insightful clues on the direction of global growth and should be watched closely.



Correction Finally Arrives

In our June commentary, we provided a chart (right) from Ned Davis Research that showed the number of days since we had a correction of 5, 10 or 20% and wrote the following: "the chart does not suggest that a correction is imminent, but it does suggest a correction is probably overdue and likely to occur in the next year." The chart clearly shows that we were approaching 1,000 days without a 10% correction, which is the 3rd longest period since 1928. Based on this, we really shouldn't be surprised that the S&P 500 corrected 12.4% from 5/21 to 8/25. **In fact, corrections of this nature should be welcomed by long-term investors that are still accumulating assets as they help restore balance in the markets and create opportunities to buy at better values.**

Whether or not the correction has run its course is difficult to say. In our June commentary we also reviewed some of the indicators we monitor to gauge the "health" of the stock market. The indicators mentioned included several measures of breadth such as- advance/declines, new highs, percentage of stocks in a bear market as well as market leadership. **As we write this commentary many of those indicators (and others) suggest that a patient approach to investing will be rewarded, and the temptation to chase the most aggressive parts of the market should be resisted.** We believe now is a time to develop your watch lists and selectively identify parts of the global financial markets that represent good value and attractive risk/reward. There are many individual securities that are approaching attractive valuations that we have not seen in a while. In addition we believe foreign developed stocks are at attractive relative valuations compared to the U.S., the chart on the right from Leuthold highlights the relative valuation of foreign stocks to U.S. stocks. Note- higher points on the chart indicate foreign stocks are relatively inexpensive compared to U.S. stocks.



Update on the Active vs. Passive Debate

We have written many times over the years on the performance of active managers vs. passive benchmarks, using Standard & Poor's SPIVA data as a resource, with the general conclusion being that most active managers have performed poorly relative to their passive benchmarks. **There are likely several factors that contribute to the poor performance of active managers, however our suspicion has been that high costs were one of the most significant factors.** A recent study by Morningstar helps to confirm our suspicions. Their study (updated semi-annually) compares active managers' actual returns against a composite of relevant passive index funds (including exchange-traded funds). We believe this approach makes more sense since it reflects the actual, net-of-fee performance of passive funds rather than an index, which is not investable. The table on the next page shows the 'success' rate of active funds by category. Success is measured as the percentage of funds from the beginning of the sample period that went on to generate a return in excess of the equal-weighted average passive fund. The last two columns in the table show the success rate for the cheapest and most expensive quartile of funds for each category.

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The table shows that investors substantially improved their odds of success by selecting the lowest cost funds, and that selecting a high-cost fund significantly reduces your odds of success. The large-value and mid-value categories showed the strongest relationship of low costs contributing to success, although the relationship can be seen in all categories with the exception of small-blend (which showed similar success rates for low and high costs). The take-away for us is clear and reinforces our belief that **keeping costs low are a crucial part of long-term investing success**. Our manager research and selection process is based on the 5P's, which incudes looking at a managers philosophy, process, performance, people and **price**. We find that using a disciplined approach to evaluating the 5P's and putting an emphasis on price greatly increases our odds of identifying managers that outperfrom long-term. It is also important to recognize that the performance cycle of active vs. passive tends to run in cycles and that passive has outperformed the past seven years. **Going forward we believe the odds are high that the performance of active managers will improve**, we of course will work hard to identify the best low-cost institutional managers that will add value to portfolios.

Active Funds' Success Rate by Category (%)

Category	1-Year	3-Year	5-Year	10-Year	10-Year (Lowest Cost)	10-Year (Highest Cost)
U.S. Large Blend	32.7	35.6	25.1	21.6	29.7	9.9
U.S. Large Value	21.3	49.0	25.4	38.2	66.3	18.6
U.S. Large Growth	42.3	26.0	12.2	16.9	28.9	14.2
U.S. Mid Blend	36.5	34.5	23.8	13.7	21.7	4.6
U.S. Mid Value	20.9	34.8	13.5	54.4	68.2	27.3
U.S. Mid Growth	48.0	37.0	31.1	26.8	47.1	13.4
U.S. Small Blend	40.7	35.5	37.1	38.9	35.7	34.2
U.S. Small Value	25.2	22.0	47.7	48.4	52.2	34.8
U.S. Small Growth	51.4	40.8	30.2	24.4	33.8	17.9
Foreign Large Blend	47.0	44.8	52.8	40.2	58.5	34.2
Diversified Emerging Markets	58.2	70.4	65.8	36.6	47.4	22.2
Intermediate-Term Bond	47.9	73.0	69.7	42.4	54.9	30.5

Source: Morningstar. Data and calculations as of 12/31/14.

We appreciate your confidence, please contact us if you have any questions regarding this commentary or your portfolio strategy.