ECONOMIC AND MARKET SNAPSHOT
(MONTH ENDING JULY 31ST, 2015)

Uncertainty over the near-term path of Federal Reserve policy will likely build as we approach the September 17th meeting. This uncertainty will likely trigger greater volatility across the capital markets in the coming weeks and months. While the start of rate hikes will likely cause some temporary turbulence in financial markets, the fundamental backdrop should still be reflationary. The start of the next rate cycle is not about preventing a surge in consumer price inflation in the next year or two, but about unwinding an unprecedented monetary experiment. In other words, the Fed is not going to be raising rates to combat inflation, but rather as a reflection that the economy is strong enough that it no longer needs an emergency, zero-rate policy.

GROWTH

The U.S. economy expanded at a 2.3% year-over-year pace in 2Q 2015, below consensus estimates for growth of 2.9%. The report sent mixed signals about growth in the U.S. On one hand, data showing an economic contraction in 1Q 2015 was revised up to 0.6%, painting a better picture of growth in 2015. On the other hand, the BEA's annual revision process, in which it restates GDP for the past three years, caused average GDP growth since the financial crisis to drop from 2.2% to 2.1%. Additionally, some growth in 2015 to date was fueled by higher-than-average inventory accumulation which can be a drag to future growth. However, overall we see the U.S. economy continuing to expand in the second half of 2015.

JOBS

The July jobs report came in very close to expectations, with payrolls increasing by 215,000, and shows a labor market that continues to see, in the words of the FOMC, "some further improvement". However wage gains remain subdued, rising only 0.1% m/m for production and nonsupervisory workers. While this report likely leaves the Fed on track to raise rates for the first time in September, it increases the focus on the August jobs report, due out on September 4, as a final deciding factor on the timing of an interest rate liftoff.

PROFITS

Second quarter earnings season is in full gear with approximately 70% of companies reporting earnings through July 31st. According to FactSet, 73% of companies have exceeded earnings expectations and 51% have exceeded revenue expectations. As a result of these upside earnings surprises, S&P 500 earnings for the second quarter are now expected to increase 0.9% and avoid the first decrease in year over year quarterly earnings since the third quarter of 2009. Excluding the energy sector, earnings growth is estimated at an impressive 8.8%.

RATES

The FOMC left rates unchanged in July, but indicated in its policy statement that it needs to see only "some" improvement in labor markets before moving to raise rates. References to the labor market were more positive throughout the statement indicating that another robust employment report along with signs of wage growth should be enough for to warrant a rate increase in September.

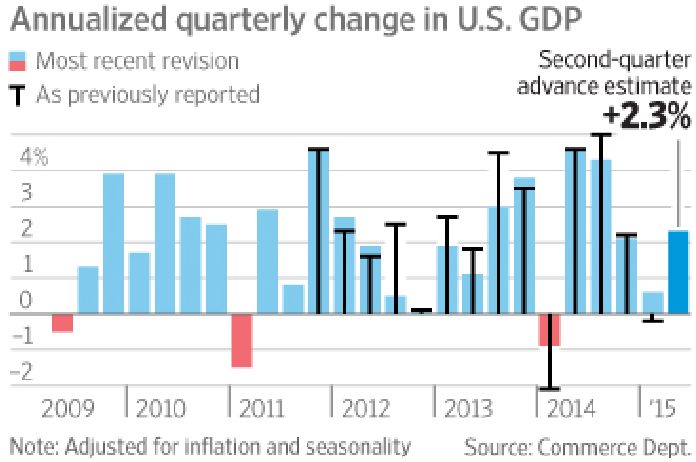
INVESTMENT THEMES

- As we progress through the economic and market cycles, increased volatility in both equity and fixed income investments is to be expected.
- Equities continue to benefit from a slowly improving economy and represent a better proposition than fixed income and cash.
- Interest rate volatility is likely to remain elevated as markets wrestle with the timing of a rate hike by the Federal Reserve. Maintaining a balanced and diversified approach within fixed income remains prudent.

Sources: J.P. Morgan, LPL Financial Research, CentralBankNews.info, ADP Employment Report, Thomson Reuters, FactSet, Goldman Sachs

ECONOMIC OVERVIEW – DOMESTIC GROWTH IS MOVING ALONG

Economic headlines in July were dominated by global risk hotspots (Greece, China) and falling commodity prices, but behind the headlines U.S. economic data told a story of slow but steady economic improvement. The headline economic report for July was the first estimate of second quarter's gross domestic product (GDP), which came in at 2.3% annualized growth. While below the consensus expectation of +2.9%, first quarter's growth was also revised substantially higher (from -0.2% to +0.6%), offsetting the miss. Consumer spending, especially on goods, and export activity made large positive contributions to GDP growth compared with first quarter, while spending on inventories detracted. As is the case every July, the Bureau of Economic Analysis released revised GDP data going back to the start of 2012. Average GDP growth was revised lower from +2.2% to +2.0% for the period, indicating more slack in the economy than previously thought.



Labor market data in July were mixed but the overall trend points to continued improvement. On the positive side, the economy added a solid 215,000 jobs in June, the unemployment rate held steady at 5.3%, and new claims for unemployment fell to a 42-year low. To blur the overall picture of a strengthening labor market, the Bureau of Labor Statistics' Employment Cost Index (ECI), a measure of total employee compensation, rose only 0.2% in the second quarter; the lowest rate of quarterly growth in the 33-year history of the report. Year-over-year growth for the ECI was still near 2.0%, in-line with where it has been for most of the current expansion. Should the August employment report a month from now show improvement, odds of a rate hike at September's Federal Open Market Committee meeting (with the current market implied probability at approximately 53%) will likely increase.

After two years of stagnant growth, the housing market is finally showing signs of strength. Existing home sales are rising steadily, with single-family and multifamily sales up 9.8 percent and 8.3 percent year over year, respectively. Building permits for new homes a leading indicator for the housing market were up 7.4% year over year, suggesting further strength to come in the housing market for the second half of the year. Another reassuring trend in the housing market comes from data that reflects who is buying these homes. Investors are playing a smaller role in the housing market as fewer distressed homes are available for sale. In June, investors accounted for just 12% of existing home sales, down from 17% as recently as January. In addition, first time homebuyers are increasing their presence, accounting for 30% of sales, up from 28% at the start of the year.

The manufacturing segment of the economy showed signs of life in June as the Institute for Supply Management's Manufacturing index showed the sector expanding at the fastest pace in five months. Between the sharp decline in oil prices, a stronger U.S. Dollar and slow foreign demand, the factory sector has been under pressure since the start of the year. The manufacturing sector looks poised to continue at a modest growth rate through the second half of the year as the headwinds facing the sector gradually subside. That said, a slow global growth environment and volatility in oil prices do provide some downside risks to the sector as the year progresses.

Other broad measures of economic activity released in July were generally upbeat. The Chicago Federal Reserve's (Fed) National Activity Index, a coincident indicator that helps capture the current state of the economy, signaled economic activity climbed above the long-term trend for the first time this year in June.

Looking forward, the Conference Board's Leading Economic Index (LEI) continued to advance at a healthy clip of 5.5% year over year. Large contributors to the advancement of the Leading Economic Index include gains in housing permits and consumer confidence. A strong 7.4% year-over-year jump in building permits, a leading indicator for the housing market, suggests further strength to come in the housing market for the second half of the year. The Conference Board's Consumer Confidence index came in strong in June, bouncing back from weak readings in April and May. Confidence jumped 6.8 points to 101.4, matching the second best number of the expansion. With the consumer accounting for approximately 2/3rds of U.S. economic growth, confidence amongst the consumer bodes well for future spending and conseqeuntly growth.

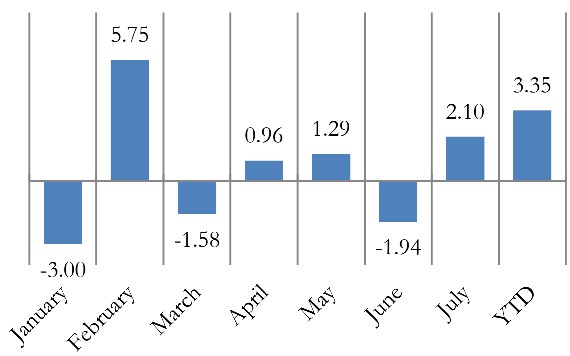
In agreggate, economic indicators suggest the trend of modest economic growth will continue into the third quarter with with pockets of strength in autos, consumer durables and housing. This is balanced by weaker performance in the factory sector, particularly for non-defense capital goods. Government spending should be a steady, modest contributor to growth in the coming quarters. The trade deficit stabilized during the second quarter, but it is likely to resume the widening trend over the balance of the year given the slowing growth indicators in Asia and continued dollar strength.

GLOBAL EQUITIES: DOMESTIC EQUITIES GRIND HIGHER

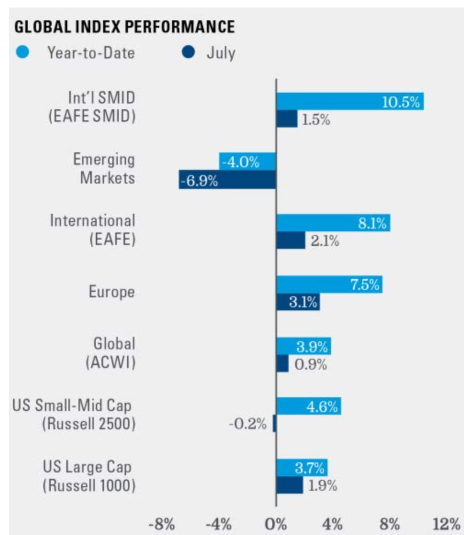
U.S. equity markets had a solid July, with the S&P 500 returning 2.1%. Markets spent the month vacillating between concerns about headline risk from China, Greece, and commodities, on the one hand, and improved confidence in fundamentals as the bulk of Q2 2015 earnings rolled in.

As it has been the case for most of 2015, the ride to a 2.1% return was a choppy one with two days of losses of more than 1%. After hitting an all time high on May 21st, the S&P 500 bottomed out from a 4% pullback on July 8th. Well-received early earnings results and a relief rally following forward progress on Greece, as well as Chinese intervention in its sharply falling markets, helped the S&P 500 rally to near all-time highs on July 20, but commodity weakness and some disappointing headline earnings results then drove a five-session losing streak. Markets rallied again heading into month end as earnings continued to surprise to the upside and concerns about the impact of China's losses on U.S. markets subsided.

S&P 500 Index Monthly Returns



Rallies were supported by a strong earnings season compared with initial expectations. As of the end of July, over 70% of the S&P 500 constituents reported Q2 2015 earnings, and expected earnings growth for the quarter stood at +0.9% year over year, a substantial improvement from the -3.0% expected as of the end of the second quarter. The strongest earnings surprises came in the consumer discretionary, utilities, and healthcare sectors.



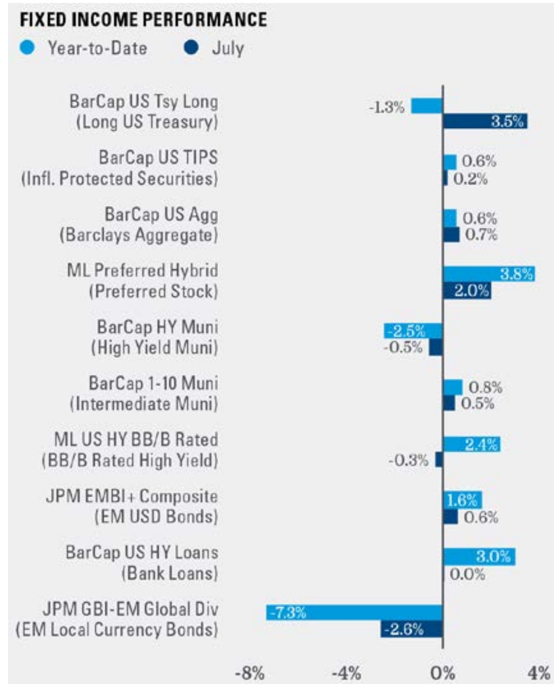
Our portfolios continue to benefit from their large cap growth tilt as growth soundly outperformed value across all major market cap categories, as measured by the Russell 1000 (large cap), Russell 2000 (small cap), Russell Midcap Indexes, and their growth and value subindexes, as investors continued to seek growth opportunities in a low-growth world. Large cap also outperformed small across styles as measured by the same indexes, helped by relative valuations, the ability to maintain or improve margins, and some credit concerns among small caps as commodity prices fell.

As was the case in June, Greece and China dominated the headline risk for international markets in July. China's large cap "A-shares," fell over 30% in under a month between June 12 and July 8, 2015, as measured by the Shanghai Composite. (A-shares are locally listed stocks that international investors have very limited access to.) Despite rallying mid-month as the government deployed a wide range of, at times, radical measures to try to stabilize markets, the Shanghai finished the month near its closing lows. While China's stock market volatility provided little new information about its overall economy, it did reignite some concerns about China's future growth path, creating some market contagion for commodity-producing emerging markets on demand worries. Overall, the MSCI Emerging Markets Index had a dismal month with a nearly 7% loss.

Performance in international developed markets mirrored the U.S. with a nearly identical 2.1% return, as measured by the MSCI EAFE Index. Europe's gains were stronger than Japan's, with a more robust bounce back on progress in Greece and less close trading ties to China.

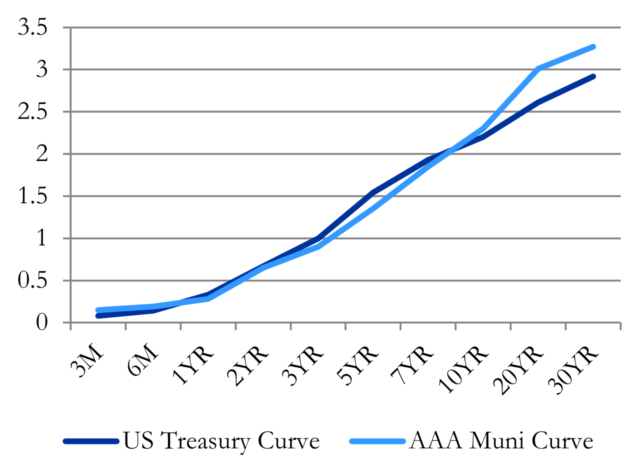
FIXED INCOME: INTEREST RATES FALL AMID GROWTH CONCERNS

Interest rates fell modestly during July, with the 10-year Treasury yield falling from 2.4% at the end of June to 2.2% at the end of July. The backdrop of falling interest rates was a tailwind for fixed income, and July was a broadly positive month as a result. The overall bond market, represented by the Barclays Aggregate, gained 0.7% during the month, while Treasuries returned 0.8%. Falling interest rates favored longer-term bonds over shorter-term bonds.



Higher credit quality also outperformed lower quality — high-yield was the only major bond sector that was negative for the month, returning -0.6%. After months of relative stability, renewed weakness in the price of oil led to pressures in high-yield energy, which weighed on high-yield overall.

The broader municipal bond market took the news of a default in Puerto Rico in stride during July with a return of 0.8%. Most investors realize that Puerto Rico, like other troubled municipal bond issuers, remains an isolated case and is not symptomatic of the broad municipal bond market. Municipal bonds continue to represent a source of value relative to their taxable counterparts, with 10-year municipals yielding 2.3% relative to the 2.2% yield offered by their taxable counterparts.



The yield curve flattened over the month, with long-term rates falling and shorter-term rates rising. Domestic economic data were moderate over the month, which slightly tempered the market's optimism about economic growth. The July Fed meeting reiterated the Fed's intention to raise interest rates in late 2015, which helped raise short-term interest rates. Mild concerns over the impact of the rate hike on the pace of domestic economic growth added to growth worries and helped pressure long-term rates downward.

FIVE HIGHLIGHTS

- In aggregate, economic indicators suggest the trend of modest economic growth will continue into the third quarter with pockets of strength in autos, consumer durables and housing.
- Second quarter earnings seasons has been particularly impressive when removing the energy sector's nearly 60% year-over-year decline. Excluding energy, S&P 500 earnings growth is tracking 8-9%.
- Interest rate volatility is likely to remain elevated as markets wrestle with the timing of a rate hike by the Federal Reserve. The probability of a September rate hike implied by the futures market is just over 53% highlighting the uncertainty held by investors. We continue to believe the Fed is likely to raise rates in the late part of 2015 and therefore maintain a defensive, well diversified, posture within our fixed income portfolios
- Europe and Japan should also continue to benefit from market-friendly central bank easing. We have long been proponents of increasing international equity exposure, but even more so these days.
- Volatility, a factor that has been subdued to unusually low levels in recent years, will likely increase throughout the remainder of the year to more normalized levels.

Sources: MSCI, Barclays Capital, Bloomberg LP, WSJ, The Economist, FactSet, Russell, Thomson-Reuters, J.P. Morgan, Barclays Capital, Goldman Sachs, LPL Financial Research, Fidelity Investments.