Economic and Capital Market Review

Third Quarter 2015

Executive Summary

Volatility in the equity markets reached multi-year highs during the third quarter as global growth continued to struggle. Decelerating growth in China, the world's second-largest economy, had a negative impact on commodity prices, global equity markets, and many emerging-market economies. Interestingly, as dreary as capital market performance has been year-to-date, economic growth in the Eurozone, while modest, continued to strengthen.

Economic growth in the United States continued to be mixed as strength in household spending and the housing market were partially offset by weak growth in exports and business fixed investment. The Federal Reserve opted to delay the timing of interest-rate normalization at the September Federal Open Market Committee (FOMC) meeting, citing concerns about downward pressure on inflation rates, as well as recent global economic and financial market developments. The probability of rate hikes later this year diminished following the September decision, but we believe the initial rate increase is likely to take place at the December meeting.

During the period, global equity markets underwent the steepest price declines since late 2011. Most of the damage during the quarter occurred in the emerging markets, which returned -18% in U.S. dollar (USD) terms and -12% in local currency terms. Developed international equity indices returned -10% and -9% in USD terms and local currency terms, respectively. Domestic equities were not immune to the correction, as the Russell 2000 Index, which tracks small caps, fell approximately -12%, while the S&P 500, which tracks large caps, dropped -6.4%.

Fixed-income markets during the quarter produced positive returns across most Treasuries and investment-grade sectors, however widening credit spreads negatively impacted returns across the high-yield sector. The U.S. Treasury yield curve flattened as shorter-term rates moved modestly higher in anticipation of possible Fed tightening, while longer-term maturities fell approximately 20 to 30 basis points (bps) and produced respective returns of approximately 3% and 5% for 10-year and 30-year U.S. Treasury issues.

Outside of traditional asset classes, the diversified REIT index produced modest returns, although the range of returns from property types was quite wide. Commodities remained under pressure, driven primarily by the 24% drop in crude oil during the quarter.

In the following pages, we will look deeper at China and its impact on the global economy. We will also review the varied successes that accommodative monetary policies had on economic recoveries in the Eurozone and Japan. In addition, we will

Total Returns Asset Allocation/ Balanced	YTD	Trailing 3 Months	Trailing 1 Year	Trailing 3 Year*	Trailing 5 Year*	Trailing 10 Year*	Trailing 15 Year*
S&P 500	-5.29%	-6.44%	-0.61%	12.40%	13.34%	6.80%	3.96%
Russell 2000	-7.73%	-11.92%	1.25%	11.02%	11.73%	6.55%	6.51%
MSCI EAFE (USD)	-4.91%	-10.19%	-8.27%	6.08%	4.45%	3.44%	3.48%
MSCI Emerging Market (USD)	-15.22%	-17.78%	-18.98%	-4.93%	-3.25%	4.60%	7.79%
Barclays Aggregate	1.13%	1.23%	2.94%	1.71%	3.10%	4.64%	5.29%
Barclays Corporate	-0.10%	0.83%	1.66%	2.23%	4.32%	5.39%	6.14%
Barclays High Yield	-2.45%	-4.86%	-3.43%	3.51%	6.15%	7.25%	7.35%
Barclays U.S. TIPS	-0.80%	-1.15%	-0.83%	-1.83%	2.55%	4.01%	5.82%
Barclays 3M Treasury Bill	0.04%	0.03%	0.05%	0.07%	0.09%	1.38%	1.75%
S&P GSCommodity Index	-19.46%	-19.30%	-41.74%	-19.84%	-9.79%	-10.01%	-2.61%
FTSE NAREIT Index	-4.52%	0.76%	7.35%	8.59%	11.70%	6.28%	10.50%
S&P Municipal Bond Short	0.88%	0.63%	0.91%	1.00%	1.35%	n/a	n/a
S&P Municipal Bond Short Int.	1.44%	1.09%	1.69%	1.73%	2.49%	n/a	n/a
S&P Municipal Bond Intermediate	1.88%	1.74%	2.83%	2.71%	3.97%	n/a	n/a

Source: S&P, Russell, MSCI, Barclays Capital, FTSE **Annualized* *As of: 9/30/2015*

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evaluate the U.S. economy and the prospect for interest rate normalization in December. Finally, we will review performance drivers in the fixed-income and equity markets.

Economic Review – China and Emerging Markets

Global growth projections for 2015 continue to moderate. The International Monetary Fund revised its 2015 projections for world output lower in October to 3.1% due to softer U.S. growth during the first half of the year and continued weakness in the emerging markets. The weakness in the emerging markets has primarily been impacted by the slowdown in China. However it is also due to the softness in local currencies relative to advanced economies, which has led to a deterioration in the capital flows necessary to support growth.

It should not be surprising that a slowdown in China is having such a dramatic impact on global growth. Emerging markets represented less than 20% of global output 25 years ago. Today, that representation has roughly doubled to 40%. During the same period, China grew from about 2% of global GDP to 15% today.

China's leaders continue to focus on structural reforms with the overall goal of transitioning the country from a capital-intensive, export-oriented economy to one that resembles the consumption and service aspects of a more developed market. Currently, household consumption in China represents approximately 38% of the economy, while capital formation (investment) is 44%, one of the highest shares of fixed-asset investment in the world. Chinese authorities are attempting to balance their economy and avoid a hard-landing scenario as they further develop the non-public sector. However, simultaneous anti-corruption reforms have led to more fiscal restraint by state-owned enterprises (SOEs) and provincial governments.

Prior to the global financial crisis, capital formation in China was growing around 20%. But it has since dropped sharply to single-digit growth. China is not in a recession in the traditional definition. However, the deceleration of the country's annual growth rate has been significant, falling from around 12% in 2010 to 7% in recent quarters. This deceleration has pushed some countries dependent on Chinese investment into recession, particularly countries with commodity-exporting economies.

Prices of base metals such as iron, copper, aluminum, and nickel have all significantly declined as Chinese demand has moderated and new capacity has come on stream. In 2014, the International Monetary Fund (IMF) estimated that China represented nearly one half of total global consumption of major base metals. Oil prices have also been under additional pressure. Oil prices ended the quarter around $45 a barrel, nearly 60% below the 2014 high mark of near $110. Prices made a comeback during the second quarter, rising to the $60 level, but have since declined to as low as $40 in August as market volatility dramatically increased. Major commodity producers of oil and base metals include Australia, Brazil, Canada, and Russia, which continue to see weakness in their currencies and economies.

Country	% of Global GDP	Commodity Exports % of GDP *Total*	Commodity Exports % of GDP *To China*
United States	22.5%	9.3%	0.7%
Germany	5.0%	39.2%	2.6%
France	3.7%	19.9%	0.8%
United Kingdom	3.8%	17.4%	0.9%
Canada	2.3%	26.4%	1.0%
Australia	1.9%	16.6%	5.6%
Korea	1.8%	40.4%	10.3%
New Zealand	0.3%	21.0%	4.2%
China	13.4%	22.6%	n/a
Brazil	3.0%	9.6%	1.7%
India	2.7%	15.5%	0.7%
Russia	2.4%	26.8%	1.2%
Colombia	0.5%	14.2%	1.5%
Thailand	0.5%	60.9%	6.7%
South Africa	0.5%	25.9%	2.5%
Malaysia	0.4%	71.6%	8.6%
Philippines	0.4%	21.7%	2.8%
Chile	0.3%	29.7%	7.3%
Peru	0.3%	19.0%	3.5%

Source: International Monetary Funds, UN Comtrade, Bloomberg

Overview of World Economic Outlook Projection				
GDP Growth	2013	2014	2015E	2016E
World Output	**3.4%**	**3.4%**	**3.1%**	**3.6%**
Advanced Economies	**1.4%**	**1.8%**	**2.0%**	**2.2%**
United States	**2.2%**	**2.4%**	**2.6%**	**2.8%**
Euro Area	-0.4%	0.9%	1.5%	1.6%
United Kingdom	1.7%	3.0%	2.5%	2.2%
Japan	1.6%	-0.1%	0.6%	1.0%
Emerging Markets	**5.0%**	**4.6%**	**4.0%**	**4.5%**
China	7.7%	7.3%	6.8%	6.3%
Brazil	2.7%	0.1%	-3.0%	-1.0%
India	6.9%	7.3%	7.3%	7.5%
Russia	1.3%	0.6%	-3.8%	-0.6%
Inflation	2013	2014	2015E	2016E
Advanced Economies	1.4%	1.4%	0.3%	1.2%
Emerging Markets	5.9%	5.1%	5.6%	5.1%

Source: International Monetary Fund - WEO October 2015

Local currency depreciation in emerging-market countries compared to advanced economies has also led to a slowdown in capital flows. Capital flows are crucial for emerging economies to bridge the gap between domestic investment and domestic savings. Surges in capital flows have historically led to boom-bust conditions when asset price bubbles pop, which in turn lead to currency devaluations similar to what occurred during the Asian currency crisis in the late 1990s.

Capital flows are driven by a combination of push and pull factors. Pull factors are generally favorable economic developments that attract foreign capital. Push factors usually originate from the sources of capital. The strong investment growth in China that existed during the past decade was a pull factor that attracted foreign capital with the hopes of earning attractive investment returns. The low-interest rate environment that has existed in several advanced economies is an example of a push factor that encourages the carry trade — borrowing cheaply in one currency, and lending or investing in a foreign currency with a higher interest rate. As long as the exchange rates between the two currencies remain unchanged, there is an arbitrage profit to be earned.

China's currency was pegged to the dollar in 1994. That peg was dropped in 2005, and the yuan was allowed to trade in a band subsequently depreciating relative to the dollar and making the country's exports cheaper, which helped drive China's economic growth. During the financial crisis, the peg was briefly restored to insulate the country. But China's long-term objective is for the yuan to be fully convertible and compete with other major global currencies. The next major step is for the yuan to be added to the IMF's Special Drawing Rights (SDRs) foreign exchange reserves held by central banks. This designation would not only lift the yuan's global profile, but also raise China's influence in setting prices of commodities of which it is the major international buyer.

During August, in an effort to join the IMF's SDR program, Chinese policy makers devalued the yuan relative to the U.S. dollar. The move however, which was the first major devaluation of the yuan since 1994, was poorly communicated to the financial markets and poorly timed as Chinese authorities were attempting to stabilize their country's quickly deflating stock market bubble. The intention of the yuan devaluation was to combat China's economic slowdown and support the local equity market. However, the yuan devaluation actually escalated concerns that Chinese authorities were having trouble controlling the weakness in their economy and financial markets. (The Shanghai Composite Index rose 60% through June and has since erased most of its gains).

Unlike many developed markets, Chinese policy makers have a myriad of monetary and fiscal tools still available to them. With inflation hovering around 2%, there is some flexibility to lower interest rates, unlike the situation in the many major developed economies around the world where rates are near all-time lows. The policy rate in China has eased from 6% at the beginning of the year down to 4.6%.

On the fiscal policy front, the authorities also have plenty of room for fiscal policy expansion. The Chinese budget deficit was less than 2% in 2014, and government debt relative to GDP is only 15%. Chinese authorities may simultaneously desire to keep their currency relatively weak in order to further stimulate demand for exports.

We continue to believe that China will avoid a hard-landing scenario, but the structural rebalancing efforts will affect growth. The consensus growth rate of 6% to 7% (or we believe possibly lower) is likely to persist as the country continues to rebalance its economy to become more market oriented. Our International Equity team believes there are significant growth-investing opportunities in the region. While the state is likely to remain the main driver of China's economy for now, the perception is that the market will play an increasingly larger role in the country's economic future.

Economic Review – Developed Markets

There are few advanced economies that have not been impacted by the slowdown in China. Canada, Australia, Korea, New Zealand, and even Germany are countries that export a large share of commodities and also have high commodity export exposure to China. Relative to the U.S. dollar, the currencies in those respective countries have all depreciated substantially (between 10% and 25%) since the second quarter of 2014. Real GDP growth has also decelerated in those countries, with the exception of Germany. But there too, Germany is under increasing pressure from the slowdown in the emerging markets.

Economic progress in the Eurozone has been fairly encouraging especially as countries on the periphery show marginal acceleration in growth. Spain, for example, is growing at over 3.3%. As a whole, real GDP growth in the Eurozone continues to be modest at 1.5% as the region remains challenged by sluggish productivity and demographic conditions, the recent migration influx notwithstanding. But there continue to be encouraging signs. Unemployment rates are moving lower across the region, even as the harmonized rate for the region has only come down by about 1 percentage point to 11% since the peak in the middle of 2013. Unemployment still remains high in both Greece and Spain, especially for those under the age of 25, where nearly one out of every two people is unemployed.

Core inflation has moved closer to 1% during the back half of the year, but headline inflation is below zero due in part to energy prices. Interest rates on 10-year German government debt are off the deflationary low of 0.075% reached in April and now are at 0.60%. The European Central Bank's (ECB) asset-purchasing program, which has increased the size of the central bank's balance sheet by €60 billion a month, is set to continue at least through September 2016.

In light of the increased market volatility and rising risks to the euro-area economy, ECB President Mario Draghi indicated that the central bank was ready to adjust the size, duration, and composition of the quantitative easing (QE) program to ensure that the recovery in the Eurozone continues. The ECB's balance sheet has increased from 20% of Eurozone GDP to 27%. During 2012, the balance sheet had been at levels around 32%. With little inflation pressure, the ECB can continue to keep its QE program in place in order to keep the economic recovery on track.

Japan continues to pursue structural reforms as well. The Trans Pacific Partnership is a cornerstone of Prime Minister Abe's third arrow and bolsters reform efforts. On the monetary front, the size of the Bank of Japan's balance sheet has skyrocketed since late 2012 and is nearing 75% of Japan's GDP. In Japan, the yields on 10-year government bonds remain the lowest among major developed economies near 0.35%. Consequently, the yen is currently the most undervalued of the major global currencies and is making Japanese corporations much more competitive.

Despite the massive amounts of monetary stimulus, however, the Japanese economy is still struggling to produce meaningful growth primarily due to its trade relations and proximity to China. Annual growth rates of real GDP, industrial production, retail sales, and core inflation are all below 1%. Recent data has shown modest increases, but Abe's three-pronged plan for monetary easing, fiscal stimulus, and structural reforms have thus far only succeeded in maintaining the status quo of extremely low growth, while significantly increasing the size of the Bank of Japan's balance sheet and devaluing the local currency relative to other major developed nations. Time will tell if the policy prescriptions will work.

Economic Review – United States

The United States has not been immune to the global slowdown or to lower commodity prices, and continues to be the strongest of the developed economies. There remains a divergence between the strength of the service sector and the weakness in the manufacturing sector that began during the fourth quarter of 2014. Annual rates of industrial production have moved lower throughout the year and inventories have increased, resulting in declines in future order growth. Exports have contracted due to slowing demand across the globe, but also because of the stronger U.S. dollar, which makes domestically produced goods and services more expensive.

Markit® Purchasing Managers Index

	Sep 2015	Aug 2015	Jul 2015	Jun 2015	May 2015	Apr 2015	Mar 2015	Feb 2015	Jan 2015	Dec 2014	Nov 2014	Oct 2014
Global	50.6	50.7	51.1	51.0	51.3	51.0	51.7	51.9	51.7	51.5	51.8	52.2
U.S.	53.1	53.0	53.8	53.6	54.0	54.1	55.7	55.1	53.9	53.9	54.8	55.9
U.K.	51.5	51.6	51.9	51.4	51.9	51.8	53.6	53.9	53.0	52.7	53.5	53.4
Japan	51.0	51.7	51.2	50.1	50.9	49.9	50.3	51.6	52.2	52.0	52.0	52.4
Eurozone	52.0	52.3	52.4	52.5	52.2	52.0	52.2	51.0	51.0	50.6	50.1	50.6
Germany	52.3	53.3	51.8	51.9	51.1	52.1	52.8	51.1	50.9	51.2	49.5	51.4
France	50.6	48.3	49.6	50.7	49.4	48.0	48.8	47.6	49.2	47.5	48.4	48.5
Italy	52.7	53.8	55.3	54.1	54.8	53.8	53.3	51.9	49.9	48.4	49.0	49.0
Spain	51.7	53.2	53.6	54.5	55.8	54.2	54.3	54.2	54.7	53.8	54.7	52.6
Netherlands	53.0	53.9	56.0	56.2	55.5	54.0	52.5	52.2	54.1	53.5	54.6	53.0
Austria	52.5	50.5	52.4	51.2	50.3	50.1	47.7	48.7	48.5	49.2	47.4	46.9
Ireland	53.8	53.6	56.7	54.6	57.1	55.8	56.8	57.5	55.1	56.9	56.2	56.6
Czech Republic	55.5	56.6	57.5	56.9	55.5	54.7	56.1	55.6	56.1	53.3	55.6	54.4
Emerging Markets	48.5	48.6	49.0	49.5	49.7	49.6	50.1	51.1	50.9	50.6	50.9	50.8
Russia	49.1	47.9	48.3	48.7	47.6	48.9	48.1	49.7	47.6	48.9	51.7	50.3
China	47.2	47.3	47.8	49.4	49.2	48.9	49.6	50.7	49.7	49.6	50.0	50.4

Source: Bloomberg, Markit PMI

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The bright side of the U.S. economy continues to be consumer spending and the housing market. During the last recession, 8.7 million jobs were lost, unemployment rose to about 10%, and job openings dropped to 2 million. As of September, there were more than 5.7 million job openings and the U.S. has added more than 12.7 million jobs since the depths of the recession. Furthermore, the unemployment rate has been nearly cut in half to 5.1%, which is very close to the Fed's projections of where long-run unemployment should be.

The housing market also remains in decent shape. Housing affordability remains elevated compared to longer-run averages as mortgage rates remain low and home price increases have stabilized at a 5% annual rate. New- and existing-home inventory levels also remain stable with annual rates of about 200,000 and 2 million, respectively. New housing construction, which drives residential investment in GDP, remains above an annual rate of one million units. Residential investment remains a fairly small percentage of overall GDP, but maintaining stability in home prices is important to keeping both household net worth and consumer confidence stable. This stability contributes to consumer spending and to the health of the overall U.S. economy.

The Federal Reserve opted to delay the timing of interest-rate normalization at the September FOMC meeting citing concerns about downward pressure on inflation rates and recent global economic and financial developments. Despite the Fed's optimism about improvements in the labor market, its policy statement noted concerns about decreases in the labor participation rate, as well as weak wage growth. It also contained new language which highlighted concerns about economic and financial developments abroad.

In addition to new language in the policy statement, the economic projections released by the Fed showed one participant believed the economic situation called for a zero-interest-rate policy (ZIRP) and that rate normalization should not begin until 2017. Three other participants pushed their projections for normalization into 2016. The forecast for U.S. real GDP growth for the longer run also dropped from a range of 2.0% to 2.3% down to 1.8% to 2.2%. Finally, the longer-run projection for the fed funds rate was reduced to 3.5% from 3.8%.

The probability of rate hikes this year diminished after the September meeting, but we believe rate the initial rate increase will take place at the Fed's December meeting. The timing and the path of future rate increases will ultimately be data dependent, but currently we see the fed funds rate at 1% by the end of 2016, which implies three additional rate hikes next year. Our projection lies between the FOMC median projection from the dot-plot survey of 1.4%, and the 0.75% level implied by current fed fund futures rates.

Total Returns Equity Indices	YTD	Trailing 3 Months	Trailing 1 Year	Trailing 3 Year*	Trailing 5 Year*	Trailing 10 Year*	Trailing 15 Year*
S&P 500	-5.29%	-6.44%	-0.61%	12.40%	13.34%	6.80%	3.96%
Russell 1000	-5.24%	-6.83%	-0.61%	12.66%	13.42%	6.95%	4.14%
Russell 1000 Value	-8.96%	-8.39%	-4.42%	11.59%	12.29%	5.71%	5.73%
Russell 1000 Growth	-1.54%	-5.29%	3.17%	13.61%	14.47%	8.09%	2.20%
Russell Mid-Cap	-5.84%	-8.01%	-0.25%	13.91%	13.40%	7.87%	7.63%
Russell 2000	-7.73%	-11.92%	1.25%	11.02%	11.73%	6.55%	6.51%
Russell 2000 Value	-10.06%	-10.73%	-1.60%	9.18%	10.17%	5.35%	8.53%
Russell 2000 Growth	-5.47%	-13.06%	4.04%	12.85%	13.26%	7.67%	4.15%
Russell 3000	-5.45%	-7.25%	-0.49%	12.53%	13.28%	6.92%	4.31%
MSCI ACWI (USD)	-6.65%	-9.34%	-6.16%	7.52%	7.39%	5.14%	3.86%
MSCI EAFE (USD)	-4.91%	-10.19%	-8.27%	6.08%	4.45%	3.44%	3.48%
MSCI Emerging Market (USD)	-15.22%	-17.78%	-18.98%	-4.93%	-3.25%	4.60%	7.79%

Source: S&P, Russell, MSCI **Annualized* *As of: 9/30/2015*

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Capital Market Review – Equity Markets

During the third quarter of 2015, global equities were under significant pressure, led by declines in emerging markets. The MSCI Emerging Markets Index fell -12% in local currency terms during the quarter and -18.8% in USD terms as the dollar strengthened versus emerging-market currencies. Both Asian and Latin American equities were hit the hardest during the quarter in local currency terms, falling -13.4% and -10.7%, respectively. Year-to-date, emerging-market equities have fallen -6.9% in local currency terms and -15.2% in USD terms.

Developed international equities faired modestly better than emerging-market equities and decreased -8.9% during the quarter in local currency terms, and -10.1% in USD terms. During the quarter Eurozone equities fell approximately -7% in local currency terms, while equity indices of developed economies situated in the Pacific fell -12.7%. Year-to-date, the MSCI EAFE Index has decreased -0.6% in local currency terms and -4.9% in USD terms.

During the quarter, the Russell 2000 Index fell -11.9%. The index's small-cap growth stocks outperformed small-cap value as both styles fell -13% and -10.7%, respectively. Meanwhile, the Russell Midcap Index outperformed small caps and dropping -8.0%, during the quarter. Year-to-date, the Russell 2000 Index has decreased -7.7% and growth has outperformed value.

The S&P 500, which tracks large-cap stocks, fell -6.4% during the quarter and has given up 5.3% over the course of the year. Like small caps, among large caps value underperformed growth both in the third quarter and year-to-date. The Russell 1000 Value Index has returned -9% year-to-date, while the Russell 1000 Growth Index has returned -1.5%.

Total Returns S&P 500 Sectors	YTD	Trailing 3 Months	Trailing 1 Year
Utilities	-5.85%	5.40%	6.57%
Consumer St.	-0.97%	-0.20%	7.10%
Consumer Disc.	4.08%	-2.56%	13.18%
Info. Tech.	-2.97%	-3.70%	2.12%
S&P 500	-5.29%	-6.44%	-0.61%
Financials	-7.06%	-6.72%	-0.33%
Telecom.	-3.91%	-6.85%	-7.91%
Industrials	-9.75%	-6.90%	-3.65%
Health Care	-2.13%	-10.67%	5.19%
Materials	-16.48%	-16.90%	-17.98%
Energy	-21.28%	-17.41%	-29.68%

Source: Standard & Poors *As of: 9/30/2015*

During the quarter, only the Utility sector produced positive returns, while the Materials, Energy, and Health Care sectors logged double-digit losses. For the year, the Consumer Discretionary sector saw the only positive return with a gain of 4.1%, which reflects the strength of the U.S. consumer. Not surprisingly, the Energy and Materials sectors were the hardest hit, falling -21.3% and -16.5% respectively.

As global equity prices decreased, valuations became more attractive. The S&P 500's 2015 price-earnings (P/E) ratio ended the quarter at 16.3x, nearly 2 multiple points cheaper than at the end of the previous quarter. Relative to the S&P 500, the Russell 2000 Index P/E ratio is 24.2x, nearly 4 multiple points cheaper than at the end of the second quarter. The 2015-2016 earnings growth estimate for the S&P 500 is 10.4% and 19.6% for the Russell 2000.

Operating margins have moderated from recent cyclical peaks, so there is some room for operating leverage. However, we remain concerned about the overall macro backdrop and how sales growth may be impacted. For the third quarter, it is expected that the blended growth rate[1] for the S&P 500 will decrease 3.3% year-over-year and earnings per share (EPS) will fall 5.1%. The Energy and Materials sectors represent the majority of the drop, while most other sectors are expected to see single-digit sales growth and EPS growth in the low-teens. In the Industrial sector, sales are predicted to fall 5.2%, while EPS is seen dropping -6.0% year-over-year.

Valuations of the MSCI EAFE and the MSCI Emerging Market indices are attractive at 14.4x and 11.5x, respectively. Those indices also offer attractive dividend yields of 3.5% and 3.1%, respectively. However, the indices' earnings expectations of 8.1% and 12.1% remain a little high given the economic backdrop. We believe developed international equities offer relative value compared to domestic equities, but selectivity in specific countries is preferred versus investing in an index.

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Capital Market Review – Fixed-Income Markets

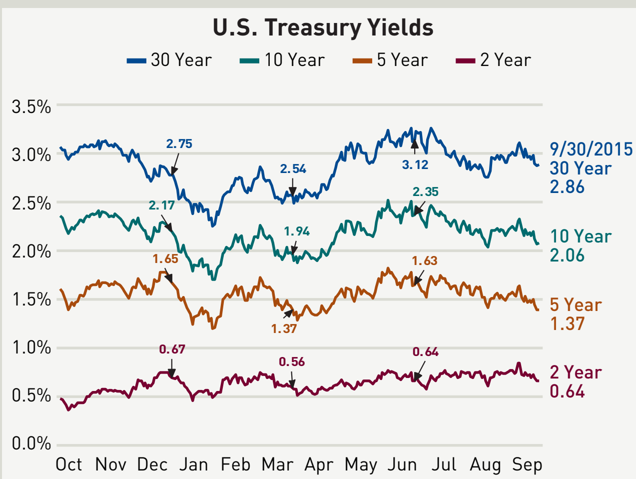
During the third quarter, fixed-income markets produced positive returns across most Treasury and investment-grade sectors, however widening credit spreads negatively impacted returns in the High-Yield sector. The Barclays U.S. Aggregate Index returned 1.2% during the quarter, as yields fell 11 bps and spreads widened 2 bps. The Barclays Intermediate U.S. Aggregate Index performed roughly in-line with the Barclays U.S. Aggregate, despite a slightly shorter duration. Year-to-date, the Barclays U.S. Aggregate and the Barclays Intermediate U.S. Aggregate indices returned 1.1% and 1.7%, respectively.

Fixed Income Indices

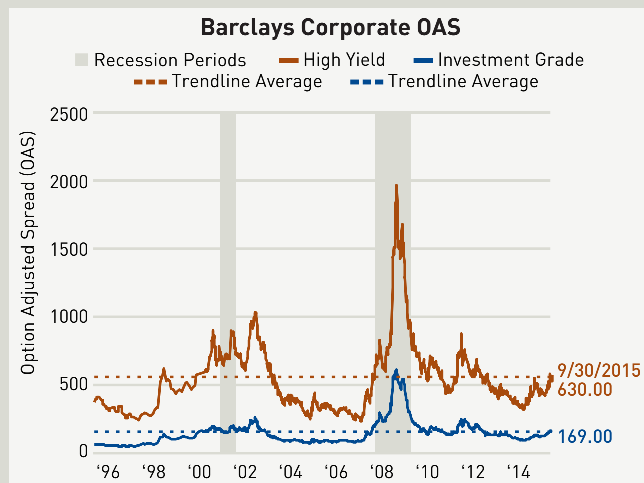
As of: 9/30/15	Current			Year to Date			Trailing Three Months			Trailing One Year			Total Return (Annualized)			
	Yield to Worst	OAS (BPS)	Duration	Total Return	BPS Change in: YTW	BPS Change in: OAS	Total Return	BPS Change in: YTW	BPS Change in: OAS	Total Return	BPS Change in: YTW	BPS Change in: OAS	Trailing 3 Year	Trailing 5 Year	Trailing 10 Year	Trailing 15 Year
US Aggregate	2.31%	59	5.6	1.13%	6	11	1.23%	-8	8	2.94%	-5	16	1.71%	3.10%	4.64%	5.29%
Intermediate	2.01%	45	4.1	1.73%	1	9	1.08%	-9	6	2.95%	-8	12	1.64%	2.69%	4.37%	4.97%
US Govt/Credit	2.19%	69	6.2	0.90%	8	15	1.20%	-5	9	2.73%	5	22	1.59%	3.09%	4.61%	5.36%
1 to 3 Year	0.96%	28	1.9	1.02%	7	8	0.29%	5	3	1.19%	19	12	0.86%	1.04%	2.85%	3.41%
Intermediate	1.69%	50	4.0	1.77%	2	12	0.95%	-5	7	2.68%	1	18	1.45%	2.42%	4.17%	4.83%
US Treasury	1.36%	0	5.8	1.80%	-7	0	1.76%	-12	0	3.76%	-14	0	1.29%	2.55%	4.35%	4.98%
Intermediate	1.13%	0	3.9	2.06%	-11	0	1.24%	-11	0	3.05%	-14	0	1.09%	1.92%	3.91%	4.34%
Long	2.75%	0	17.5	0.17%	11	0	5.08%	-25	0	8.80%	-33	0	2.78%	6.22%	6.99%	7.56%
US TIPS	1.86%	0	5.5	-0.80%	-12	0	-1.15%	-19	0	-0.83%	-40	0	-1.83%	2.55%	4.01%	5.82%
US Agency	1.30%	17	3.5	1.66%	-8	1	1.06%	-7	-1	2.84%	-11	1	1.31%	1.95%	3.84%	4.68%
Intermediate	1.08%	10	2.5	1.71%	-11	-1	0.80%	-8	-3	2.42%	-13	-2	1.12%	1.60%	3.61%	4.39%
Long	3.07%	68	11.5	1.06%	11	10	3.32%	-18	7	6.43%	-24	16	2.71%	5.54%	6.44%	7.68%
US Credit	3.29%	160	7.0	-0.26%	28	35	0.53%	4	23	1.50%	27	53	2.02%	4.09%	5.28%	6.09%
US Corporate Invest. Grade	3.42%	169	7.1	-0.10%	31	38	0.83%	6	24	1.66%	32	57	2.23%	4.32%	5.39%	6.14%
Industrials	3.64%	184	7.6	-0.80%	37	44	0.32%	11	31	0.73%	40	69	1.53%	3.86%	5.58%	6.31%
Utilities	3.63%	152	9.5	-0.82%	34	33	1.97%	-3	15	2.57%	23	46	2.48%	4.91%	6.30%	6.11%
Financial Institutions	2.95%	145	5.7	1.37%	19	28	1.51%	-2	12	3.18%	15	38	3.44%	5.02%	5.18%	6.13%
US Corporate High Yield	8.04%	630	4.4	-2.45%	143	147	-4.86%	147	154	-3.43%	191	206	3.51%	6.15%	7.25%	7.35%
Non-Corporates	2.78%	122	6.3	-0.89%	13	19	-0.63%	-2	15	0.83%	10	34	1.22%	3.24%	4.99%	6.77%
Supranationals	1.22%	17	3.6	1.74%	0	4	1.15%	-9	0	2.58%	-3	5	1.34%	2.00%	4.08%	4.88%
Yankee	2.86%	139	5.7	-0.54%	20	29	-0.64%	6	22	0.58%	23	48	1.26%	2.94%	4.90%	5.89%
US Securitized	2.58%	37	4.2	1.66%	2	4	1.31%	-15	5	3.43%	-24	2	1.99%	3.11%	4.65%	5.17%
Fixed Rate MBS	2.62%	31	4.2	1.61%	1	3	1.31%	-17	5	3.45%	-28	1	1.98%	3.06%	4.74%	5.20%
ABS	1.47%	69	2.4	1.83%	0	11	0.74%	2	7	2.38%	8	13	1.21%	2.12%	3.41%	4.31%
CMBS	2.45%	108	4.8	2.24%	12	10	1.54%	-4	7	3.72%	8	9	2.52%	4.54%	5.39%	6.25%
Short Municipal	0.90%	n/a	2.0	0.88%	11	n/a	0.63%	-11	n/a	0.91%	21	n/a	1.00%	1.35%	n/a	n/a
Short-Intermidate Muni.	1.39%	n/a	3.3	1.44%	6	n/a	1.09%	-11	n/a	1.69%	14	n/a	1.73%	2.49%	n/a	n/a
Intermediate Municipal	2.10%	n/a	4.9	1.88%	10	n/a	1.74%	-14	n/a	2.83%	7	n/a	2.71%	3.97%	n/a	n/a

Source: Factset Datasystems, Barclays Capital for Taxable Fixed Income Indices

The U.S. Treasury yield curve flattened as shorter-term rates moved modestly higher in anticipation of possible Fed tightening, while longer-term maturities decreased approximately 20 to 30 bps and produced respective returns near 3% and 5% for 10-year and 30-year U.S. Treasury issues.



Source: Federal Reserve ©FactSet Research Systems



Source: Barclays Capital ©FactSet Research Systems

PNC CAPITAL ADVISORS

Economic and Capital Market Review

Third Quarter 2015

The Intermediate component of Barclays U.S. Treasury index returned 1.2% during the quarter as yields fell 11 bps. The Long component of the U.S. Treasury index returned 5.1% as yields fell 25 bps during the quarter. Year-to-date, the Long Treasury component returned 0.2% as yields are 11 bps higher than at the beginning of the year. The Intermediate component returned 2.1% year-to-date as yields are 11 bps lower than at the beginning of the year.

During the third quarter, the Barclays U.S. Corporate Investment Grade Index returned 0.8%, driven by the Utility and Financial sectors which returned 2% and 1.5%, respectively. The Industrials sector returned 0.3%, while the Basic Materials subsector fell -2.9% and the Energy subsector dropped 2.5%. All of the other sectors generally produced returns of about 1.3%. In terms of credit quality, higher-quality issues outperformed lower-quality issues. The AAA-rated portion of the index returned 2.4%, while the BAA-rated components produced a negligible loss. Year-to-date, Corporate Investment Grade has produced a small loss of 0.10%, as yields have increased 31 bps and spreads have widened 38 bps.

High-yield U.S. corporate bonds saw yields rise and spreads widen during the quarter. The Barclays U.S. Corporate High Yield Index returned -4.9% during the quarter, as yields rose 147 bps and spreads widened 154 bps. Similar to investment grade, the Industrial sector underperformed the Utility and Financial sectors. The Basic Materials and Energy high-yield subsectors produced losses of -11.3% and -15.9% during the quarter, while yields and spreads climbed more than 3%. Year-to-date, the Corporate High-Yield Index components have returned -2.5% as yields and spreads rose 150 bps.

In terms of valuations, yields on the corporate investment-grade index components have increased to 3.4%, but remain nearly 100 bps below their 10-year averages. The index's spreads, however have widened to 169 bps and are just slightly below the 180 bps 10-year average. The yields on the Corporate High-Yield Index components have widened above 8% and are just below the 10-year average of 8.5%. Spreads on the index are now 630 bps and above the ten-year average of 600 bps.

Asset-backed indices performed in-line with the U.S. Aggregate Index during the quarter and returned 1.3% on mortgage-backed securities (MBS), 1.5% on commercial mortgage-backed securities (CMBS) generally lower, with the exception of the asset-backed securities (ABS) index components, which returned 0.7% as yields rose slightly. Year-to-date, CMBS has outperformed returning 2.2%, while MBS and ABS have returned 1.6% and 1.8%, respectively.

Outlook for the Remainder of 2015 and into 2016

Our outlook for 2015 remains largely in place from the end of the 2014. U.S. economic growth is expected to continue to outpace other developed countries, with U.S. real GDP buoyed by further employment increases, modest wage gains, and the potential for stimulus from lower energy prices. Real consumption is expected to grow in the 2.5% to 3.0% range. Business investment is expected to be additive, although there are real concerns about energy sector cutbacks. Government is expected to grow modestly after years of slight retrenchment. The export sector could face headwinds due to the stronger U.S. currency and weaker growth abroad.

Valuations for domestic large-cap indices have trended higher, and are above long-term averages. Annual revenue growth has been in the low single digits for the past few years, consistent with nominal GDP growth. EPS growth year-over-year has been modest with low single-digit growth reflecting weak top-line growth and building margin pressures. Our belief is that continued operating margin expansion is limited and that year-over-year EPS growth expectations for 2015 will be revised downward as company management keeps analysts' expectations tempered.

For 2015, we expect increased capital market volatility to continue as the market anticipates the Federal Reserve's rate normalization process. In such an environment, we expect more subdued low- to mid-single-digit large-cap equity gains (assuming 3% real GDP, a benign 1.5% inflation rate, a modest dividend yield, stable valuations, and slight profit margin compression).

In an upside scenario — albeit less likely in our view — large-cap equities could produce low double-digit returns, resulting from positive surprises in the economy coupled with expanding price-earnings ratios. The clear risk to our base case comes from continued global deflation concerns. In our downside case, large-cap equities could see price retrenchment if economic growth falters, global deflation fears persist, margins continue to fall, and price-earnings ratios compress.

In summary, more modest equity returns are likely the prudent call for 2015, given the previous strong run-up in equities against the weaker economic backdrop earlier in the decade. Additionally, companies face increasing challenges if they try to drive further earnings gains by expanding their profit margins. Indeed, some companies are starting to respond to tighter labor markets with much publicized wage increases – often for their lowest-earning employees.

In other areas of the equity market, small-cap index valuations continue to trade at a premium compared to large caps and are also trading above longer-term averages. Outside the U.S., international equity indices are relatively less expensive compared to domestic equities. And earnings may not have yet bottomed. However, foreign-developed markets have begun to anticipate some recovery and started the year with strong gains in local currency terms. We favor active management in both areas, which can help ferret out opportunities in less efficient economies and markets.

Market-based indicators suggest short-term U.S. interest rates will increase during the second half of the year. Over the next few years, investment-grade fixed-income returns may look similar to the 1950s when interest rates increased from the low single digits. Total returns during that time period were low to negative as rates rose. Investors should understand both credit and duration exposures within their fixed-income portfolios, as risks in both metrics have increased due to the low absolute level of interest rates and the generally modest credit spreads. Again, actively managed strategies may help investors mitigate some of these risks, as the anticipated monetary policy change moves to raise interest rates for the first time in nearly nine years.

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1 The blended growth rate combines actual earnings results for firms that have reported with estimated earnings for companies that have not yet reported.