Market Summary

As of June 30, 2013

Market Review

Although most global markets saw negative returns for the quarter amid uncertainty surrounding economic growth and central bank policy, the US equity markets were a standout with a positive quarterly return on the S&P 500 Index of 2.91%[1]. For first half of 2013, this index was up 13.82%, beating its international counterparts by over 700 basis points. For the quarter, small caps beat large caps on investor risk-taking as the Russell 2000 returned 3.08%.The MSCI EAFE Index of international equities returned -0.73%. Emerging markets fared worse than all developed markets, with the MSCI Emerging Markets Index returning -7.95% for the quarter and -9.40% for the first half of 2013. During June, the World Bank cut its 2013 global economic growth forecast from 2.4% to 2.2%, below last year's 2.3% growth rate.[2] Notably, euro region growth is expected to contract 0.6% during 2013. At the same time, earnings forecasts for many emerging market stocks have been reduced. China continued to be faced with uncertain growth prospects as their central bank undertook efforts to reduce rapid credit growth. News in Japan was more positive as the equity market gained 4.42% for the quarter, aided by stimulus from Japan's central bank. Additionally, real estate trailed broad equity indices with the domestic-oriented FTSE NAREIT All Equity Index returning -1.57%. REITs, along with many income-oriented asset classes, were hurt by the sudden rise in bond yields. Commodities continued their correction and were broadly lower, impacted by higher supplies in agricultural commodities, and the decline in the price of gold, which was down 23% over the quarter.[3]

The Barclays Aggregate Bond Index returned -2.32% for the quarter, as most sectors felt the impact of a broad sell-off in bond assets. While government securities were the best performing sector, longer-term Treasuries were impacted with their higher sensitivity to interest rate changes. Some Investment grade corporate bonds also struggled. In addition, high yield and emerging market bonds were hurt by the increases in market volatility,& declines in equity-sensitive assets, given uncertain growth prospects and central bank moves.

Economic Highlights

Much attention & subsequent reaction occurred post Federal Reserve Chairman Ben Bernanke's comments regarding a potential change in quantitative easing policy, which would reduce stimulus through a tapering of bond purchases. Bernanke indicated that monthly bond purchases might first be reduced and then would end around the middle of 2014.[4] Despite the fact that Bernanke's comments implied that economic conditions may improve, the market reacted as if this

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[1] Index returns from Morningstar Direct
[2] Source: World Bank
[3] Source: Bloomberg
[4] Source: Federal Reserve

Note: An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged, with no associated expenses, and investors cannot invest directly in an index. Past performance is no guarantee of future results. All index returns shown in the table represent total return figures with dividends reinvested, which means the return includes not only the change in price for the securities in the index, but any income generated by those securities. Sources: Bloomberg, Barclays, Dow Jones, MSCI Barra, Russell, Zephyr Associates.

were an increase in rates and the 10-year Treasury yield rose from 1.87% to 2.52%. Good news was considered bad by the market due to reliance on the Federal Reserve to prop up markets. The Federal Open Market Committee (FOMC) released updated economic projections following their June meeting. Real GDP was projected to range 2.3% – 2.6% in 2013 and then improve to 3.0% – 3.5% in 2014. The unemployment rate was expected to decline to 6.5% – 6.8% by the end of 2014. This is notable because the Fed has stated it will likely keep short-term rates low until a 6.5% unemployment rate is reached. Actually, many Fed officials do not expect an actual increase in short-term rates until 2015. While much has been made of recent statements from the Federal Reserve, current inflation readings are supportive of gradual changes in Fed policy. The Consumer Price Index (CPI) was up 1.4% on a year-over-year basis during May.[5] The core reading was somewhat higher at 1.7%, but both of these inflation figures are below the Fed's longer-term inflation target of 2.0%, and below the historical average of 2.5%. This suggests that inflation is not an immediate threat, with the potential for the Fed to maintain an overall accommodative stance in the medium term as the US economy continues to improve.

Market Statistics

At the end of the second quarter of 2013, the Dow Jones Industrial Average had advanced 2.92% for the quarter and 15.20% on a year-to-date basis.[6] The S&P 500 Index finished with gains of 2.91% for the quarter and 13.82% year-to-date.[7] Within US equity markets, value led growth in large caps, but growth outperformed value in small-to-mid caps. In the international arena, returns were negative for the quarter with the MSCI EAFE Index (a proxy for developed international markets) recorded a loss of 0.73% for the quarter but held a 4.47% gain on a year-to-date basis.[8] The MSCI Emerging Markets Index lost 7.95% during the quarter and 9.40% year-to-date. The FTSE NAREIT decreased 1.57% for the quarter but held a 6.49% gain year-to-date. In the bond markets, the Barclays US Aggregate Bond Index declined 2.32% for the quarter and 2.44% year-to-date. The US economy grew 1.80% during the first quarter of 2013, improving relative to the 0.40% expansion experienced during the fourth quarter of 2012. The Federal Reserve (the Fed) continued to keep the Fed Funds target rate within the 0.00% - 0.25% range. Measured by the Consumer Price Index, inflation for the month of May was 1.40% on a year-over-year basis.[9] Unemployment, as measured by the jobless rate released by the Bureau of Labor Statistics in May, was 7.60%. Oil futures closed at $96.56 per barrel in June, a price decrease of 0.69% from their close in March.[10] The US dollar weakened 1.91% against the euro and appreciated 5.27% versus the Japanese yen for the quarter.[11]

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[5] Source: Bureau of Labor Statistics
[6] Bloomberg
[7] Ibid
[8] Ibid
[9] Bureau of Labor Statistics
[10] Bloomberg
[11] Ibid

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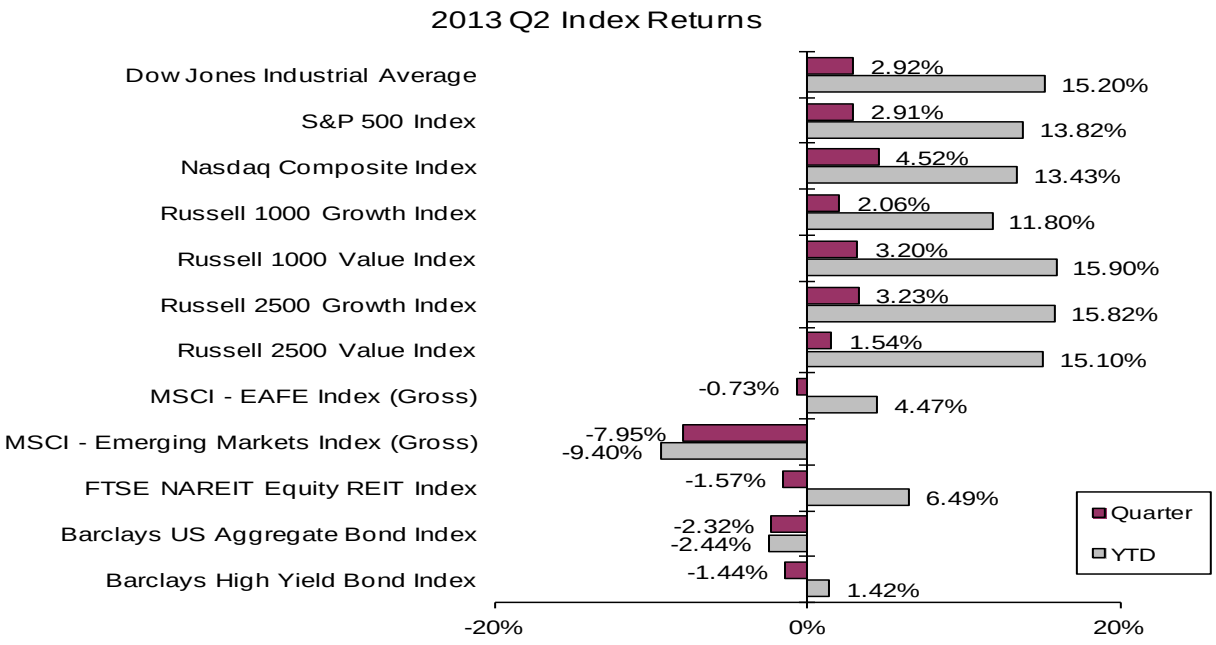

Looking ahead, the outlook for equities is mixed, depending on the valuation measure and region. In the US, the cyclically-adjusted Shiller P/E ratio at 23.6 suggests that US stocks are overvalued relative to their longer-term average of 19.0.[12] and especially in comparison to more conservative 14 or 15 P/E measure. Nonetheless, as compared to the fixed income market, many investors consider stocks to appear more attractive. The forward earnings yield (inverse of P/E) on the S&P 500 at 7.2% is currently above the 5.4% yield on Baa-rated corporate bonds. The recent volatility across financial markets and the rise in bond yields has only heightened investor concern over fixed income portfolio allocations. This is a time to again remind ourselves of the purpose of each part of our portfolios & the need to diversify across asset classes exposures without taking on unintended risks. Fixed income allocations are typically used to help provide diversification from equities, especially in times of flight to quality, to provide income and to help reduce overall volatility. We continue to be vigilant over embedded risk and to consider portfolio diversification with additional asset classes and investment strategies that can complement traditional bond exposures. Please contact us with any changes in your financial situation, objectives or should you have any questions, whatsoever.

[12] Source: Standard & Poor's, Factset, Robert Shiller Data, J.P. Morgan Asset Management

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