3Q 2014

Global Market Overview

DIVERGENT GLOBAL ECONOMIC PROSPECTS

At first glance, world equity markets seemed calm during Q3. However, under the surface, results were much more disperse. Along with continued turmoil in Ukraine and the resultant depressing impact on European trade with Russia, investors' confidence was rattled by U.S. led military action in Syria and Iraq and the impact that pro-democracy protests in Hong Kong (with their Tiananmen-square associations) might have on stability of a Chinese-centered Asia. The euro grabbed most of the summer's headlines as it weakened -8% against the U.S. dollar.

European markets fell broadly during September on weaker-than-expected regional economic data and concern about the potential onset of deflation. Within the MSCI EAFE Index, Germany declined 3.7% in local terms for the quarter while France, Italy and the U.K. declined by about 1% and Spain was flat for the period. Global sector returns within the MSCI were mixed; the defensive healthcare sector was strongest, up 8.0% in local currencies, while information technology was second with a 7.3% gain. Energy was the weakest sector, off 5.2% in local currencies given the quarter's sharp fall in oil prices. The economically sensitive materials sector was the benchmark's second weakest, down 2.6% on concern over global growth.

While U.S. and Japanese authorities have pursued aggressive monetary stimulus to spark lethargic economies, the European Central Bank is politically restrained from stronger measures by opposition from Germany and other opponents of monetary ease as the preferred solution for the continent's unemployment and growth woes. However, so-called "structural reforms" to incentive employment and investment are often difficult to implement given national political opposition and cultural legacies. Authorities continue to hope that ECB stimulus measures to date will slowly take

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effect and they continue to view stagnant pricing data as a consequence of soft energy and food prices rather than a core deflationary threat. As a result, the European economic arena continues to present investors with an anxious waiting game.

SLOW, BUT STEADY U.S. GROWTH

While the US economy has been showing greater signs of strength than the rest of the world, growth there is by no means strong. Employment has continued to improve, yet job gains seem dominated by lower-paid service positions and real wage growth remains stagnant. Housing sales have improved, yet consumer confidence has weakened recently in the face of geo-political concerns. The Federal Reserve provided guidance that it expects to begin raising short-term rates sometime in 2015, inflation continues to come in below target and the Fed has clearly stated that policy will ultimately be data-dependent and not driven by adherence to a pre-set calendar. As in Europe, the outlook in the U.S. remains a mixed-bag of hopeful signs and concerns.

In the U.S., the broad market as measured by the Russell 3000 was flat for the quarter. The U.S. Federal Reserve is setting the stage for a retreat from accommodative monetary policies with the likely conclusion of its third round of quantitative easing (i.e. monthly Treasury and mortgage bond purchases) in October. U.S. return patterns echoed broad global trends.

The largest 200 companies, as measured by the Russell Top 200 Index, returned 1.7% for the quarter, while the smallest, as measured by the Russell Microcap Index, returned -8.21%. Within the S&P 500, the defensive healthcare (+5.4%) and telecom services (+3.1%) led returns, along with information technology (+4.8%) which remains near its lowest relative valuation in 20 years. Energy (-8.6%) was the weakest sector as oil prices declined sharply.

The divergence of economic prospects around the world — with reasonably slow but steady U.S. growth contrasting with weak conditions in Europe and Japan — continues to dominate the global investment landscape. Two immediate results of this divergence have been a significant rise in the value of the U.S. dollar versus other currencies and a widening dispersion in returns across both the capitalization and sectors. The tide of global monetary ease is no longer raising all ships.

Such economic cross-currents have fostered a dichotomy in market returns as the largest global companies continued to perform well, masking significant declines among many small-cap names. Given that benchmarks are capitalization weighted, the relative outperformance of the large companies helps maintain an appearance of strong performance across the market.